INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/373

GEORGIA

December 2018

THIRD REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STAFF SUPPLEMENT

In the context of the Staff Report for the Third Review under the Extended Arrangement, the following documents have been released and are included in this package:

- A **Press Release.**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on October 29, 2018 with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on November 27.
- A **Staff Supplement** of December 12, 2018 updating information on recent budget developments.

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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December 19, 2018

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

- The authorities' reform program supported by the Extended Fund Facility arrangement remains on track, reflecting prudent macro-financial policies and sound reform implementation.
- Georgia's economic performance remains strong, but downside risks to the outlook have increased.
- Persevering with structural reforms is key to achieving higher and more inclusive growth.

On December 19, the Executive Board of the International Monetary Fund (IMF) completed the Third Review of Georgia's performance under the three-year extended arrangement under the Extended Fund Facility (EFF) on a lapse of time basis.[1] The completion of the review will release SDR 30 million (about $41.6 million), bringing total disbursements under the arrangement to SDR 120 million (about $166.3 million).The extended arrangement for SDR 210.4 million (about $291.5 million or 100 percent of quota) was approved by the Executive Board on April 12, 2017 (see Press Release No. 17/130).

Program implementation through end-June 2018 was satisfactory. All end-June 2018 performance criteria were met—some with significant margin. All structural benchmark but one were observed, and the missed one was completed with a two-week delay.

Georgia's economic performance remains strong, but downside risks to the outlook have increased. Inflation has stayed below the 3-percent inflation target in 2018, and the external position has strengthened. Higher revenues and lower investment resulted in a fiscal surplus through September 2018. Against the background of high credit growth, the authorities introduced regulations to limit household over-indebtedness. The banking sector remains

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

well capitalized, liquid, and profitable, but dollarization remains high. Despite the positive outturns, the authorities need to remain vigilant to a deteriorating external outlook and to sustain reform efforts to promote more inclusive growth.

The agreed 2019 deficit appropriately targets a broadly neutral fiscal stance, while allowing for accelerating capital and social spending. Medium-term fiscal commitments, including those related to a comprehensive education reform, should be consistent with fiscal sustainability and supported by institutional fiscal reforms.

The inflation-targeting framework, combined with the floating exchange rate regime, continues to serve Georgia well. The current monetary policy stance remains appropriate. Efforts to build international reserves need to be stepped up given heightened external uncertainty and Georgia's vulnerability to external shocks. Regulations to increase financial resilience are welcome but its impact on credit growth needs to be closely monitored.

Persevering with structural reforms is key to achieving higher and more inclusive growth. Priorities include adopting a new corporate insolvency law and a well-designed and comprehensive education reform.

Georgia: Selected Economic and Financial Indicators, 2015-2019

	2015	2016	2017	2018	2018	2019
	Actual		Preliminary	Country Report 18/198 1/	Projections	
National accounts and prices	(annual percentage change; unless otherwise indicated)					
Real GDP	2.9	2.8	5.0	4.8	5.0	4.6
Nominal GDP (in billion of laris)	31.8	34.0	38.0	41.4	41.6	45.0
Nominal GDP (in billion of U.S. dollars)	14.0	14.4	15.2	16.9	16.5	17.2
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	4.1	4.5	4.4	4.6
GDP deflator, period average	5.9	4.2	6.5	3.8	4.2	3.4
CPI, Period average	4.0	2.1	6.0	2.8	2.8	3.1
CPI, End-of-period	4.9	1.8	6.7	2.7	2.3	3.0
Investment and saving	(in percent of GDP)					
Gross national saving	18.9	19.6	23.1	25.5	25.5	25.4
Investment	31.5	32.7	31.9	34.7	34.5	34.9
Public	5.6	5.0	6.1	6.8	6.6	7.1
Private	25.9	27.7	25.8	27.9	27.9	27.9
Consolidated government operations	(in percent of GDP)					
Revenue and grants	28.1	28.3	29.0	27.9	27.9	28.0
o.w. Tax revenue	25.1	25.7	26.0	25.0	25.0	25.1
Expenditures	32.0	32.5	32.7	31.1	30.8	30.9
Current expenditures	25.0	26.0	24.2	23.1	23.0	23.1
Capital spending and budget lending	7.0	6.5	8.5	7.9	7.8	7.8
Net Lending/Borrowing (GFSM 2001)	-1.2	-1.5	-0.5	-1.6	-1.2	-1.9
Augmented Net lending / borrowing (Program definition)2/	-2.6	-2.9	-2.9	-2.8	-2.3	-2.6
Public debt	41.4	44.4	44.9	42.8	43.4	43.5
o.w. NBG debt to the IMF	...	...	0.6	0.5	0.5	1.0
o.w. Foreign-currency denominated	32.5	35.1	35.6	33.2	34.1	33.8
Money and credit	(in percent; unless otherwise indicated)					
Credit to the private sector (annual percentage change)	22.1	19.6	17.6	14.1	17.6	12.6
In constant exchange rate	4.1	11.9	19.4	18.0	16.3	13.1
Broad money (annual percentage change)	19.2	20.4	14.8	12.6	13.6	12.2
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	13.7	10.5	12.6	10.8
In constant exchange rate	5.3	13.4	16.5	16.2	12.5	12.8
Deposit dollarization (in percent of total)	66.8	69.9	63.7	59.7	62.2	59.6
Credit dollarization (in percent of total)	63.1	64.6	56.1	50.7	53.7	51.3
Credit to GDP	49.2	54.9	57.8	60.6	62.1	64.6
External sector	(in percent of GDP; unless otherwise indicated)					
Current account balance	-12.6	-13.1	-8.8	-9.2	-9.0	-9.5
Trade balance	-28.1	-26.9	-25.0	-27.2	-26.2	-27.4
Terms of trade (percent change)	30.6	-1.2	-2.7	-1.9	-4.9	-0.9
Gross international reserves (in billions of US$)	2.5	2.8	3.0	3.3	3.2	3.5
In percent of IMF Composite measure (floating)	90.0	90.6	89.9	93.3	92.3	95.6
Gross external debt	107.6	109.3	113.2	107.9	108.9	113.3
Gross external debt, excl. intercompany loans	86.1	91.8	95.9	90.9	91.5	95.0
Laris per U.S. dollar (period average)	2.27	2.37	2.51	...	...	...
Laris per euro (period average)	2.52	2.62	2.83	...	...	...
REER (period average; CPI based, 2010=100)	104.0	107.5	105.2	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Please refer to this link for details https://www.imf.org/en/Publications/CR/Issues/2018/06/28/Georgia-2018-Article-IV-Consultation-Second-Review-under-the-Extended-Fund-Facility-46036

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

INTERNATIONAL MONETARY FUND

GEORGIA

December 4, 2018

THIRD REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT

KEY ISSUES

Recent economic developments. Economic activity remained strong in 2018H1 but decelerated since due to subdued private construction activity and delays in public infrastructure. Inflation has remained below the 3-percent inflation target in 2018. Higher revenues and lower investment resulted in a fiscal surplus through September 2018. Against the background of high credit growth, the authorities introduced regulations to limit household over-indebtedness. The banking sector remains well capitalized, liquid, and profitable, but dollarization remains high.

Program status. The 36-month Extended Fund Facility (EFF) approved on April 12, 2017 with access of SDR 210.4 million (100 percent of quota), is on track. All end-June 2018 performance criteria (PCs) were met, some with significant margins. All structural benchmark (SB) but one were observed, and the missed one was completed with a two-week delay. Completion of the review will make available SDR30 million.

Program policies. The envisaged 2019 deficit appropriately targets a broadly neutral fiscal stance that provides space for higher capital and social spending. Medium-term fiscal plans, including those to reform education, need to preserve fiscal sustainability, while improving public investment oversight and fiscal risk monitoring. Accelerating VAT refunds to reduce the stock of claims would help support economic activity next year and provide for additional fiscal space over the medium term. The stance of monetary policy is adequate given downward pressures on inflation from slowing aggregate demand and muted pressures from salaries and the budget, and the National Bank of Georgia (NBG) remains committed to the floating exchange rate regime while continuing efforts to build up reserves. Perseverance with structural reforms is needed to increase potential growth and make it more inclusive. Education reform is critical to generate opportunities and jobs. Establishing a new insolvency framework for nonfinancial corporations will improve further the business environment. The funded pension pillar, coupled with capital market reforms, should help mobilize domestic savings for investment, which would also be supported by the new PPP framework.

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

Discussions were held in Tbilisi during October 17–30, 2018 with Prime Minister Bakhtadze, Minister of Finance Matchavariani, Minister of Economy and Sustainable Development Kobulia, NBG Governor Gvenetadze, 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). Ms. Stetsenko (LEG) joined the mission to discuss progress toward the new insolvency framework. Mr. Hanson (OED) joined the discussions. Ms. Al Farah provided research assistance. Ms. Toshmuhamedova and Mr. Laumann helped with document preparation.

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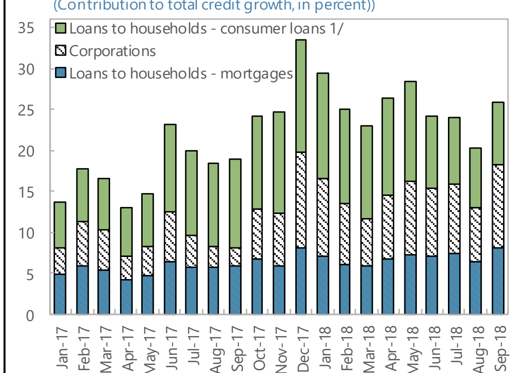
CONTEXT

1. **The new government reaffirmed the commitment to the reform agenda.** In June, a new government within the governing party—headed by Prime Minister Bakhtadze—confirmed Georgia's commitment to the reform agenda, and renewed efforts to improve social policies and achieve more inclusive growth, consistent with program commitments. In the Presidential elections, Ms. Zurabishvili, endorsed by the ruling party, was elected in the runoff on November 28.

2. **The economy continues to perform well, but growth has recently slowed (Figures 1–6, Tables 1–5).** Flash estimates suggest that real GDP growth was 4.9 percent (y/y) in the first three quarters of 2018, down from 5.4 percent in 2018H1. A slowdown in private construction and delays in public infrastructure projects contributed to a contraction in the third quarter (-1.0 q/q, s. a.). Headline inflation stood at 2.3 percent (y/y) in October, fueled by healthcare and transportation prices. Core inflation, at 1.7 percent, remained subdued. External demand supported economic activity.[1] In 2018H1, the current account deficit reached 10.2 percent of GDP, 0.8 percentage points larger than the previous year, due to higher oil prices, while the financial account weakened by 1 percent of GDP with lower net FDI partially being compensated by higher portfolio and banking inflows. The end-September 2018 gross international reserves (GIR) stood at \$3.15 billion, as foreign exchange (FX) interventions (\$112.5 million) and higher FX reserve requirements (\$292 million) supported accumulation.[2] Through end-September, the lari appreciated by 2.5 percent in nominal effective terms and remained stable in real effective terms (y/y) despite some weakening against the dollar.

3. **Against the background of high credit growth, the authorities introduced regulations to limit household over-indebtedness.** The maximum effective lending rate was reduced to 50 percent (from 100 percent) to limit predatory lending. Since May, a limit to banks' lending to households without verifiable income (25 percent of banks' regulatory capital) slowed growth in consumer lending. In turn, mortgage lending, mostly in FX, picked up as interest rates declined. As of September, private credit growth (at constant exchange rates) remained at 20 percent y/y). Credit by micro-financial institutions (MFIs) increased by 20 percent (y/y) in 2018Q2. Above-trend growth in the credit-to-GDP ratio has increased the loan-to-deposit ratio. On November 19, the private Cartu Foundation offered to purchase all loans below GEL2,000 that have been in distress for at least one year, to forgive debt to about 600,000 households.[3] The authorities indicated that the impact on financial institutions would be negligible.

Credit to the Private Sector
(Contribution to total credit growth, in percent))



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

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[1] Exports of goods and remittances increased by 26 percent and 16 percent (y/y), respectively, through September while tourism receipts increased by 29 percent in 2018H1 (y/y).

[2] As of September 2018, FX reserve requirements accounted for 44 percent of GIR.

[3] Financial institutions participate on a voluntary basis. The operation covers approximately one million loans made by banks, MFIs, and other lending institutions.

4. The banking sector remains well capitalized, liquid, and profitable, but dollarization remains high. As of September, the capital adequacy and liquidity ratios reached 18 and 31 percent, respectively, well above regulatory limits; nonperforming loans (NPLs) stood at 2.7 percent; and return on assets and equity stood at 2.7 and 21 percent, respectively. Dollarization has marginally declined, driven by corporate dollarization, and household loan dollarization remained stable at 45 percent in September 2018.

5. The authorities and staff agreed that while growth has exceeded expectations it has not been sufficiently inclusive. The absolute poverty rate has remained stagnant since 2015.[4] Food price inflation has surpassed CPI inflation, hurting poorer households. A UNICEF survey suggests that average out-of-pocket expenditure on health has increased, a key poverty risk, raising concerns that efficiency gains in healthcare could undermine coverage for vulnerable households; and more families resort to borrowing to cope with economic hardships.

PROGRAM PERFORMANCE

6. Quantitative program targets and all the structural benchmarks (SBs) except one for the third review were met (MEFP, Tables 1-3). The authorities reiterated their commitment to program objectives and targets.

- All quantitative PCs and indicative targets were observed. The end-June PCs on Net International Reserves (NIR), the augmented deficit, the cash deficit, and new borrowing by the Partnership Fund (PF, a public financial institution) were met. The government did not incur any external or domestic arrears, nor did it issue any guarantees. Inflation remained within the inner consultation band.
- All the SBs but one were also met. The authorities met the end-June SBs on: (i) introducing a regulation on bank's real estate appraisal in line with international valuation standards; and (ii) creating a new specialized VAT unit focusing on validating VAT claims. They also met the end-September SBs on introducing regulations on (i) the leverage ratio and (ii) banks' corporate governance. The SB on establishing an independent pension agency was not met but the action was completed with a brief delay. The authorities are advancing towards end-year SBs.

OUTLOOK

7. The outlook remains broadly unchanged since the second review. Given higher-than-expected domestic demand in 2018H1, real GDP growth for 2018 was revised to 5 percent (0.2 percentage points higher than at the second review). The current account deficit in 2018 is expected to be 9.0 percent of GDP, compared to 9.2 percent at the second review, while net financial flows are projected to be 0.8 percent of GDP lower, primarily due to lower net FDI. Lower growth in trading partners and tighter domestic financial conditions would slow growth to 4.6 percent in 2019. Over the medium term, GDP growth is projected to gradually increase to 5.2 percent, provided that

[4] Relative poverty, defined as consumption below 60 percent of the median, increased from 20 to 22 percent in 2015–17.

structural reforms are implemented. Inflation is expected to stabilize at the NBG's target of 3 percent by end-2019. The current account deficit would narrow to below 8 percent by 2023 and remain financed mostly by FDI. External debt is expected to decline gradually, reducing external financing requirements.

8. **Downside risks to the outlook have increased.** Georgia is vulnerable to trade shocks, mainly related to regional developments, global trade tensions, and weaker global growth (Annex I). Although the impact of Turkey's crisis has been limited so far (Annex II), a protracted slowdown could hurt growth. A greater-than-expected slowdown in credit growth, due to new financial regulations and delays in investment projects could temporarily weigh on growth. The current account deficit and external debt (96 percent of GDP, excluding intercompany loans) generate large external financing needs. Lower external financing and spillovers from emerging markets volatility could lead to a lari depreciation, which might undermine financial stability and growth, given high dollarization and external debt. And the reform momentum could slow ahead of the 2020 parliamentary elections. On the upside, a recovery in oil exporters could benefit Georgia through stronger external demand and remittances.

9. **The authorities shared staff's views on the outlook and risks, and reiterated their plans to maintain prudent macroeconomic policies and advance structural reforms.** The authorities expressed concerns about possible adverse spillovers from regional market volatility, which could undermine growth and the pace of reforms. Staff and the authorities agreed that, as a small open economy, Georgia remains vulnerable to external shocks despite its improved resilience.

POLICY DISCUSSIONS

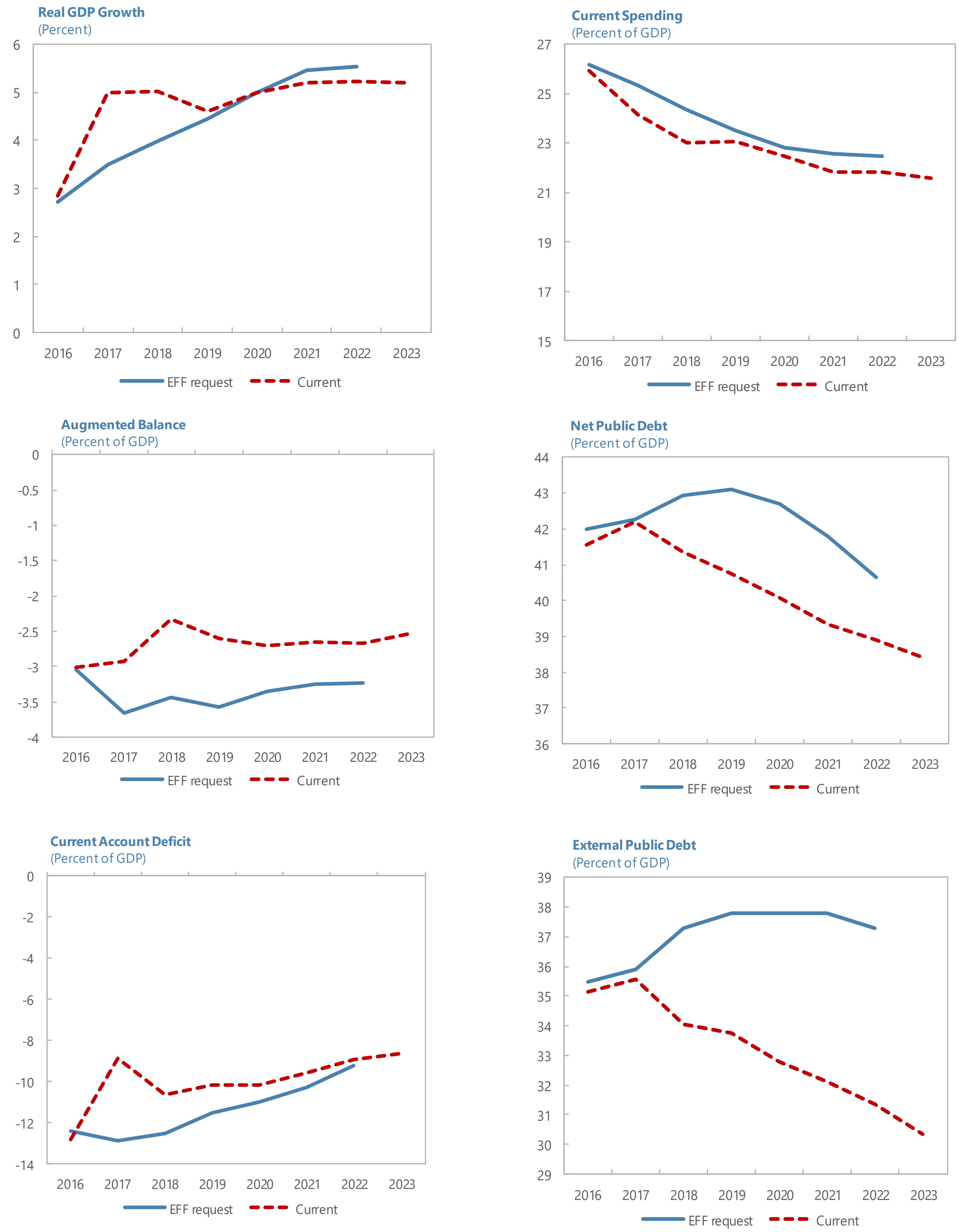
The authorities remain committed to a prudent fiscal policy. Better-than-expected fiscal and external outturns have created space to increase targeted social spending. The monetary policy stance remains appropriate, but efforts to build reserves need to be stepped up. Financial regulations to contain rapid credit growth will help promote financial resilience but need to be monitored to prevent a disruptive credit deceleration. Ongoing structural reforms will help promote higher and more inclusive growth.

A. Fiscal Policy

10. **Strong revenue performance and policy implementation have generated some fiscal space (MEFP, ¶3).** While the program calls for gradual fiscal consolidation, the current account and fiscal outturns have been stronger than expected (text figure), providing room for additional spending beyond the baseline envisaged at the time of the second review. Gross debt is projected to remain below the program anchor of 45 percent of GDP over the medium term, due to favorable growth dynamics, contained current spending, and higher-than-expected revenues. Slack in the economy suggests that the revenue performance is not merely cyclical, providing room to address social needs.[5]

[5] Moreover, the cash deficit outturns understate the amount of consolidation as refunds of accrued VAT credits (0.5 percent of GDP annually) reduce revenues. These refunds are temporary; cash revenues will return to higher levels once the stock of credits is amortized.

Figure 1. Georgia: Fiscal Performance under the Extended Fund Facility, 2016–23



Source: Georgian authorities and IMF staff calculations.

11. Tax buoyancy and subdued public investment led to a substantial fiscal surplus through September 2018 (Text Table 1, MEFP, ¶6). The augmented fiscal surplus reached 0.9 percent of GDP through September, exceeding program projections by 2.7 percent of GDP.[6] Revenue overperformance relative to the budget was driven by PIT (0.4 percent of GDP) and VAT (0.2 percent) due to stronger growth, CIT (0.2 percent) due to lower-than-expected losses from the tax reform, and non-tax revenue (0.2 percent) in part due to higher interest revenue. Delays in executing externally-financed projects reduced capital spending and budget lending. Consistent with program commitments, current primary expenditure remains contained in real terms. Accelerated VAT refunds reduced the stock of outstanding credits by 0.5 percent of GDP, to 3.6 percent of GDP (end-September). Due to low external disbursements and a stronger lari, gross public debt fell to 40 percent of GDP at end-September, while the fiscal surplus and domestic debt issuance led government deposits to exceed 5 percent of GDP.[7]

Text Table 1: Budget Execution, January-September 2018
(In Million GEL)

	Prog. Proj.	Actual	Diff.	Diff. (In percent of GDP)
Revenue and grants	**8,359**	**8,670**	**311**	**0.7**
of which VAT credit refunds	-150	-307	-157	-0.4
of which grants (including LEPL receipts)	230	288	58	0.1
Primary current expenditure	**6,614**	**6,419**	**-195**	**-0.5**
Interest	**415**	**390**	**-25**	**-0.1**
Net acquisiton of nonfinancial assets	**1,648**	**1,265**	**-383**	**-0.9**
Capital Expenditure	1,752	1,453	-299	-0.7
Privatization	104	188	84	0.2
Net budget lending	**424**	**204**	**-220**	**-0.5**
Augmented balance	**-742**	**392**	**1,134**	**2.7**
Memorandum item:				
External project loan disbursements	1,025	378	-647	-1.6

Source: Georgian authorities and IMF staff calculations.

12. The end-2018 fiscal target is expected to be met with a comfortable margin (MEFP, ¶7). The 2018 augmented deficit is projected at GEL 972 million, 2.3 percent of GDP, 0.5 percentage points lower than envisaged at the Second EFF Review. The budget deficit in the fourth quarter alone is projected to be 3.2 percent of GDP.[8] The authorities and staff agreed that the major backloading of spending to the fourth quarter could put undue pressure on the balance of payments; and that any shortfalls in spending related to further delays in external disbursements would not be replaced with domestically financed spending. To improve project appraisal, selection, and management, the authorities will revise the Public Investment Management methodology in line with FAD TA recommendations and with technical donor support (**new SB, end-December 2019**).

13. With an augmented deficit of 2.6 percent of GDP, the agreed 2019 deficit aims at a broadly neutral fiscal stance while expanding social spending and public investment (MEFP ¶7). Revenue projections incorporate 1.2 percent of GDP in VAT refunds and 0.3 percent of GDP from revenue measures. Social spending will increase by 0.4 percent of GDP relative to 2018. In addition to

[6] The augmented balance combines the overall fiscal balance and net budget lending.

[7] Debt issuance has increased to support market development. About 4 percent of GDP in deposits are held in term deposits auctioned to commercial banks, currently at interest rates above those for treasury bills, suggesting that the treasury is contributing to an improved allocation of liquidity in the financial system.

[8] About 1 percent of GDP will be in the form of advance payments for infrastructure projects, in line with initial plans.

increases in the basic pension, the monthly targeted child benefits will increase five-fold (by 0.2 percent of GDP) from GEL10 per child to GEL20 in cash plus GEL30 in vouchers for food and medicine, a measure endorsed by donors, including UNICEF.[9, 10] Incentives will also be introduced for beneficiaries of the Targeted Social Assistance program to participate in the labor market. Social spending also includes a one-off allocation (0.2 percent of GDP) related to the education reform. The authorities are preparing legislation on a rule-based mechanism to index basic pensions **(SB, end-February 2019)**. Staff welcomed the increase in social benefits, whose impact on the deficit is to be more than offset by revenue measures and by further containing other current spending.

Text Table 2: Impact of 2019 Budget Measures on the Augmented Fiscal Balance
(In percent of GDP)

Revenue	**0.2**
Revenue measures	0.3
o/w permanent	0.1
Pillar II pension reform	-0.2
Primary current spending	**0.0**
Pillar I pensions	-0.4
Targeted transfers	-0.2
Education (one-off)	-0.2
Contain other primary current spending	0.8
Capital spending an budget lending	**-0.1**
Capital spending	-0.5
Net budget lending	0.4
Combined impact	**0.1**

Source: IMF staff estimates

14. The design of education reform is advancing, but the reform needs to be comprehensive and fully costed (see ¶26). The authorities' initial plan is to increase the quality of teachers by dismissing teachers with low qualifications, training the remaining teachers, and hiring qualified new ones. These actions would be coupled with salary increases for teachers, school directors, and administrative staff. Staff agreed with the authorities on the need for education reform and called for formulating a fully-costed comprehensive strategy before implementation. This strategy should include identification of financing to ensure that the reform fits within the targeted fiscal deficit path.

15. Efforts are ongoing to modernize the Revenue Service (GRS) and address the large stock of outstanding VAT credits (MEFP ¶12). Staff highlighted that sustaining momentum in revenue administration reform is macro critical, particularly given the need for additional resources to support education reform. The VAT unit in the audit department is operational (**SB, end-June 2018**). A legal amendment allowing Georgia Revenue Service (GRS) to refund tax credits without an explicit request by the taxpayer, currently under government consideration, would remove a bottleneck to refunds. The GRS will obtain access to information received by the Financial Monitoring Service (FMS) from the Monitoring Entities (FMS, **new SB, end-May 2019**) as well as relevant information from various government agencies to strengthen risk-based auditing. In line with international best practice, the GRS will control the taxpayer register, which will help reduce and better manage compliance risks.

16. The coverage and reporting of fiscal risks, including those arising from SOEs, continues to improve (MEFP ¶13). The upcoming fiscal risk statement will expand on contingent liabilities

[9] Monthly basic pensions, only marginally above subsistence minimum, will increase by GEL20 to GEL200 in 2019, and to GEL 220 in 2020, as announced in late 2017.

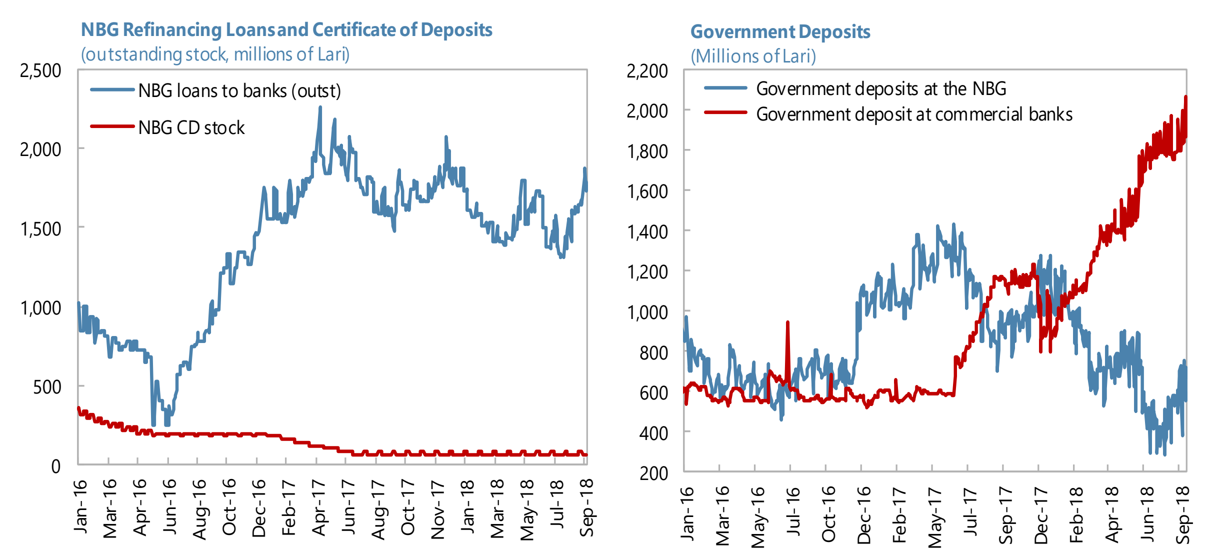
[10] Child benefits are well-targeted and a valuable tool for addressing the age-specific vulnerabilities of children and the needs of the families with children.

arising from purchasing power agreements and from selected SOEs. To improve further SOE monitoring and reporting, the authorities will analyze which SOEs should be included in the general government accounts according to GFSM2014 (**new SB, end-September 2019**) and clarify the mandate, governance structure, and reporting requirements of all SOEs (**new SB, end-November 2019**). Finally, the authorities are committed to containing fiscal risks arising from a prospective credit guarantee fund, to be designed in consultation with staff, that would help promote access to finance for small and medium enterprises.

17. The draft fiscal rule has been strengthened to support fiscal sustainability (MEFP ¶14). In line with IMF TA recommendations, the proposed fiscal rule submitted to Parliament **(SB, end-December 2018)** eliminates the expenditure ceiling, clarifies scope of the deficit and the public debt under the rule, applies to fiscal outturns, and defines escape clauses. The proposed fiscal rule will allow for a more comprehensive coverage of the general government according to GFSM2014 standards and improve parliamentary oversight. Staff also welcomed including contingent liabilities from PPPs under the debt ceiling. However, staff opposed excluding specific spending categories, such as education, from the fiscal rule, as such an approach would undermine the rule. Staff and the authorities agreed that the medium-term budget framework could be strengthened to become a more binding declaration of fiscal plans that better reflects fiscal priorities, including education.

B. Monetary and Exchange Rate Policies

18. The National Bank of Georgia (NBG) has continued to deliver on its policy mandate by adjusting the policy rate, providing domestic liquidity, and supporting larization. With receding inflationary pressures, the NBG reduced the policy rate by 25 bps (to 7 percent) in July and has kept it unchanged since. With limited inter-bank activity, the NBG continues to provide short-term liquidity to banks (outstanding stock at 5 percent of GDP)—mainly via one-week refinancing loans and one-month open market operations. Further, government deposits at commercial banks have provided longer-



Source: National authorities.

maturity lari liquidity.[11] To provide further long-maturity liquidity, the NBG has extended open market operations to outright purchases of treasury securities since May 2018. To reduce dollarization, the NBG increased reserve requirements on short-term FX deposits from 20 to 25 percent in July, while reducing the reserve requirement on short-term lari deposits from 7 to 5 percent.

19. The monetary policy stance remains appropriate (MEFP ¶15). The authorities and staff agreed that the current monetary policy stance is appropriate given downward pressures on inflation from slowing aggregate demand and muted pressures from salaries and the budget, with space to gradually reduce the policy rate (50 basis points) by end-2019 provided that inflationary pressures remain subdued. The authorities anticipate reaching the three-percent target by end-2019 —rather than in mid-2019. Once the target is reached, the NBG plans to reduce gradually the policy rate to its neutral level over the medium term.

20. Efforts to build FX reserves need to be scaled up to protect against external vulnerabilities (MEFP ¶16). The floating exchange rate regime continues to work well as a shock absorber; in 2018 FX interventions have been limited to building up reserves. However, reserve accumulation has been lower than envisaged under the program. Adjusted for lower financial flows, the end-December NIR target was expected to decline to $1,403 million from the $1,550 million set at the First Review. Given the heightened global uncertainty, staff called for increased efforts to build up reserves towards 100 percent of the ARA metric. Hence, the NIR target was set at $1,456 million for end-June 2019, which keeps NIR on a path to reach 96 percent of the ARA metric by end-2019. The NBG noted that reaching the end-2018 target may require purchases in a challenging environment of accelerating public spending, and especially if externally-financed project disbursements were to be delayed. The NBG also cautioned against a rapid buildup in reserves that could weaken the lari unduly and undermine NBG's credibility and de-dollarization. Staff argued that smoothing intervention would help reduce the impact on the lari, and agreed to revisit the pace of NIR accumulation should market conditions become disruptive and result in excessive lari volatility. The NBG proposed, and staff supported, pre-announced rule-based FX put options to accumulate reserves without targeting an exchange rate level, starting in 2019.[12]

C. Financial Sector Policies

21. The NBG continues to strengthen regulations to enhance financial sector resilience (MEFP ¶19-26).

- For banks, regulations have been issued on (i) real estate appraisals in line with international valuation standards (**SB, end-June 2018**); (ii) a 5-percent leverage ratio requirement starting September 2018, above the 3-percent Basel recommendation (**SB, end-September 2018**); and (iii) corporate governance (**SB, end-September 2018**), with provisions on supervisory board

[11] Government deposit auctions are well coordinated with the NBG.

[12] The NBG will announce monthly auctions, and banks will get to exercise the put option when the exchange rate appreciates vis-a-vis the average exchange rate of the previous 20 business days. FX put options have worked well for reserve accumulation at times of domestic currency appreciation in emerging market economies (e.g. Mexico, Colombia).

composition and a cap on remuneration for directors. The NBG plans to introduce regulations on a net stable funding ratio (NSFR) in line with Basel III principles by September 2019.[13]

- For non-banks, legislation made registration of micro-finance institutions (MFI) with the NBG more transparent; introduced capital adequacy and liquidity ratios (effective December 2018); and clarified rules for their liquidation. The NBG also regulates credit information bureaus since September 2018; and all lending institutions (under prudential regulation and non-prudential oversight by January 2019) will be required to provide data on loans daily, strengthening the credit registry.

22. The authorities are strengthening prudential policies to contain household indebtedness (MEFP, ¶20-23). The NBG is preparing a regulation incorporating limits on payment-to-income (PTI) and loan-to-value (LTV) ratios for retail loans.[14] The limits vary according to household income and currency denomination, with more stringent limits for unhedged exposures. The regulation aims to (i) reduce household over-indebtedness, particularly at low-income levels (consumer protection); and (ii) limit balance-sheet mismatches from unhedged exposures (financial stability). Tighter lending standards are expected to reduce credit growth to 13 percent (y/y) by end-2019. Staff and the authorities agreed that the long-term impact would be positive, but a greater-than-expected slowdown in credit could impact growth in the short term. The government has also proposed to Parliament an increase in the floor for new foreign exchange (FX) loans (from GEL100,000 to GEL200,000) to promote de-dollarization. The mission reiterated that well-targeted prudential measures that account for higher risk associated with FX borrowing, as in the policies described above, would be preferable to broad-based administrative measures. This measure, on top of limits on PTIs and LTVs, could further reduce credit growth and economic activity.

23. Efforts are underway to bring the resolution framework in line with best international practice (SB, end-May 2019, MEFP ¶23). The current framework lacks escalation and sequencing of corrective actions, and recovery and resolution planning requirements; its temporary administration mechanism lacks adequate resolution powers to manage a systemic bank failure and does not provide for explicit funding provisions. The Emergency Liquidity Assistance (ELA) framework also needs to be strengthened, including by discontinuing unsecured lending by the NBG, introducing penalty rates for ELA, and clarifying the role of the MoF in providing public guarantees during financial stress.

24. The NBG will resume publishing a financial stability report (FSR, MEFP ¶21). The NBG stopped issuing the FSR as a stand-alone publication in 2011, while moving to discuss financial stability issues in its annual reports. The FSR mainly focused on backward-looking analysis of credit and financial sector developments, short of best international practice. Following IMF TA

[13] The NSFR, together with the liquidity coverage ratio introduced in 2017, would mitigate liquidity risk, including from non-resident deposits. Hence, staff supports the NBG's plan, consistent with the IMF's Institutional View on capital flows (IV), to remove the additional liquid asset requirement against non-resident deposits, once the NSFR is introduced. This measure (introduced in 2013) is assessed as a residency-based capital flow management measure and a macroprudential measure (CFM/MPM) under the Article IV, because it is differentiated based on residency and aimed at mitigating a buildup of systemic liquidity risks stemming from large non-resident deposits.

[14] About 60 percent of borrowers in the loan portfolio owe less than GEL2,500, concentrating also in terms of overdue loans. While the small loan size may limit financial stability risks, it raised concerns about consumer protection and financial inclusion.

recommendations, the NBG established a financial stability department to assess systemic risks and interactions between monetary and macroprudential policies. Staff welcomed the authorities' intention to enhance communication about financial stability by starting to publish a new financial stability report (**new SB, end-November 2019**) which will provide a forward-looking assessment of risks and vulnerabilities in the financial system and in private non-financial sector balance sheets, and details on financial policy actions taken to mitigate those risks.

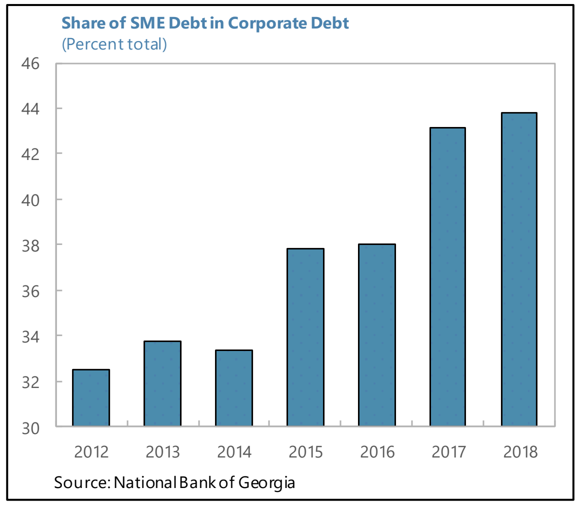
D. Structural Policies

25. The authorities remain committed to their comprehensive structural reform agenda (MEFP ¶27–34). Achieving higher and more inclusive growth, particularly given increased downside risks to the outlook, requires persevering with structural reforms. The authorities and staff agreed on the next steps to increase medium-term growth potential: (i) continue strengthening Georgia's connectivity with the world economy by improving infrastructure (including by better management of public projects) and trade integration; (ii) comprehensively reform the education system; (iii) mobilize domestic savings for investment; and (iv) reform the corporate insolvency framework.

26. A comprehensive education reform should help enhance the quality of the labor force, which is key to supporting higher growth (MEFP ¶29). Although education spending has been growing steadily, the share of pupils in private schools has been rising, suggesting that parents prefer to opt out of public school if they can. Surveys suggest that Georgia lags its neighbors and the EU average in the perception of high school and university graduates about their preparedness to respond to labor market needs. The authorities therefore plan to strengthen curriculum standards, improve school infrastructure, increase the number of teachers with higher qualifications, and strengthening pre-school, vocational and tertiary education, details are to be specified and discussed with the donors and educations experts.

27. The funded pension pillar, coupled with capital market reforms, should help mobilize domestic savings for investment (MEFP ¶30). The authorities have established a funded pension pillar (Pillar 2) and created a pension agency in August 2018. The agency is expected to start collecting contributions (paid equally by employers, employees, and the state) starting January 2019. The authorities are planning to formulate a private pension savings system (Pillar 3) in 2019. The upcoming legislation on investment funds, improving trading infrastructure, and the new PPP framework would also help mobilize savings for investment.

28. The planned corporate insolvency reform is critical to further improve the business environment (MEFP ¶31). The authorities have made remarkable progress over the years, with Georgia now ranking 6th in the 2018 World Bank Doing Business report thanks to improved business registration procedures and contract enforcement. However, this report continues to highlight insolvency reform as the area where the distance to best practice is the largest. Given the steadily rising share of SME debt in overall corporate debt, it is important to build a resilient framework that would maximize recovery values and allow for rehabilitation. The authorities plan to submit to Parliament a new insolvency law ensuring adequate protection of creditors rights, timely and efficient insolvency processes, and an effective rehabilitation framework in line with best international practice (**new SB, end-July 2019**). The draft insolvency law should exclude individuals, as it lacks provisions for verifying consumer assets, living expenses, and repayment capacity. The authorities also plan to introduce international financial reporting standards for corporations in 2019, and consolidate public services provided to enterprises in a one-stop shop by 2020. The planned Court of Arbitration with the International Chamber of Commerce should help mobilize foreign direct investment, by improving the speed and clarity of the dispute resolution mechanism.



PROGRAM ISSUES AND FINANCING

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

- Performance criteria are proposed for end-June 2019, in line with semiannual projections.
- The SB on submitting to Parliament a more gradual penalty regime based on culpability (set in the First Review for end-December 2018) will be reformulated (MEFP ¶12). The authorities need more time to reflect the degree of culpability in the penalty regime. To avoid delays in reducing the stock of VAT credits, the authorities request reformulating the SB to (i) revise the penalty regime by incorporating materiality (i.e., the penalty will depend on the difference between the tax paid and the GRS assessment of what should have been paid), and (ii) grant the GRS powers to pay out refunds without the need for a refund request (**new SB, end-December 2018**). These actions should help accelerate VAT refunds in 2019.
- **New SBs** are proposed for **end-February 2019**, on amending a regulation to designate the GRS as a supervisory authority entitled to access information received by the FMS from the monitoring entities, and put in place safeguards that protect the information from any improper use; for **end-July 2019**, on submitting to Parliament a new insolvency law in line with best international practice; for **end-September 2019**, on establishing a complete inventory of SOEs clearly identifying those qualifying as public corporations or as general government entities according to GFSM2014; for **end-November 2019**, on adopting a government decree clarifying the mandate, governance, and reporting requirements of public corporations, and on publishing a financial stability report; and for **end-December 2019**, on strengthening the public investment management methodology that guides project appraisal, selection, and management, and implement reporting and oversight requirements for public investment projects at the MoF.

30. Financing assurances are in place for the third review. The program is fully financed for the next twelve months, with good prospects for adequate financing for the remainder of the program.

31. Georgia's capacity to repay remains adequate. Georgia's debt profile continues to warrant low scrutiny under the Emerging Market Debt Sustainability Analysis. Debt service to the IMF will remain manageable, even if more adverse circumstances materialize. In case of full drawing under the EFF, repayments to the IMF would peak at 0.2 percent of GDP or 0.7 percent of gross reserves in 2023 (Table 8).

32. Risks to the program are manageable. Progress under the program in the runup to the 2020 Parliamentary elections could lead to complacency in implementing the reform agenda. The authorities stand ready to adopt measures to fulfill their commitments. Their continued program ownership provides safeguards and mitigate these risks.

STAFF APPRAISAL

33. Georgia's economic performance remains strong, but downside risks to the outlook have increased. Growth remains strong, inflation is converging towards the target, and the external position has strengthened. Revenue overperformance and delays in capital spending provide room for additional VAT credit repayments in 2018. The banking sector remains liquid, profitable, and well capitalized. Despite the positive outturns, the authorities need to remain vigilant to a deterioration in the external outlook and sustain reform efforts to promote more inclusive growth.

34. The agreed 2019 deficit appropriately targets a broadly neutral fiscal stance. With an augmented deficit of 2.6 percent of GDP, the 2019 deficit allows for accelerating capital spending and increasing social spending. The increase in social benefits, including higher child benefits, will be more than offset by revenue measures and by the continued containment of other current spending. The increase in capital spending should be accompanied by improving public investment management, to avoid delays and improve efficiency in the use of public resources.

35. Medium-term fiscal commitments should be consistent with fiscal sustainability, supported by advancing institutional fiscal reforms. Plans toward a comprehensive and fully-costed education reform should be formulated within the new fiscal framework which establishes deficit and public debt rules as anchors for medium-term fiscal sustainability. Efforts to strengthen revenue administration should continue; advancing repaying the stock of VAT credits would help generate fiscal space for education reform while maintaining capital spending plans. Continued progress with assessing and monitoring fiscal risks is commendable and should advance toward improving the mandate, governance, and reporting requirements of SOEs. Transitioning toward GFSM2014 in the 2020 budget will help improve fiscal transparency and accountability.

36. Monetary policy remains focused on price stability, supported by the floating exchange rate regime. The inflation-targeting framework, combined with the floating exchange rate regime, continues to serve Georgia well. The current monetary policy stance remains appropriate, with space to gradually reduce the policy rate (50 basis points) by end-2019 as planned. As inflation converges to the 3-percent target and expectations remains well anchored, the monetary policy rate is expected to decline to its neutral level. Strengthening liquidity management and the transmission mechanism would enhance the effectiveness of monetary policy.

37. Efforts to build reserves need to be stepped up. Reserves remain below the norm for flexible exchange rate regimes. Given heightened external uncertainty and Georgia's vulnerability to external shocks, building up external buffers will require scaling up FX intervention while avoiding excessive exchange rate volatility. Pre-announced FX put options will help provide predictability to reserve accumulation without targeting a specific exchange rate level.

38. Regulations to increase financial resilience are welcome but need to be monitored to prevent disruptive credit deceleration. Regulations on banks' real estate appraisal, the leverage ratio, and banks' corporate governance, and efforts to enhance nonbanking prudential regulation and supervision should help strengthen financial resilience. Upcoming regulations on healthy lending should help limit household over-indebtedness, promoting financial stability over the medium term. In the short term, the NBG should closely monitor the tightening of lending standards as this may negatively impact economic activity.

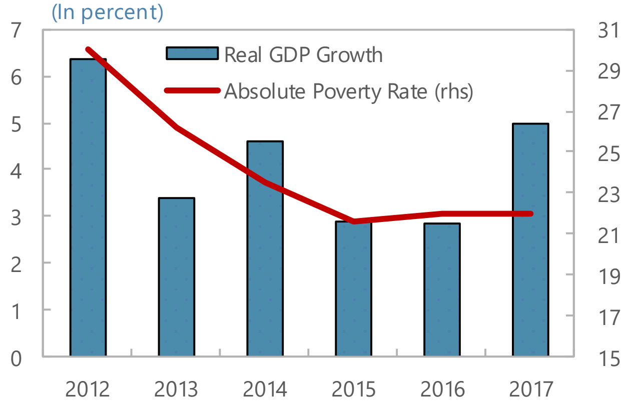
39. Persevering with structural reforms is key to achieving higher and more inclusive growth. Georgia's high ranking in the 2019 World Bank Doing Business report confirms considerable progress in improving the business environment. The authorities are taking commendable steps by preparing a new insolvency law, creating a one-stop shop for public services to businesses, and reforming financial reporting standards. Further, a well-designed and comprehensive education reform would enhance the quality of the labor force and increase growth, also making it more inclusive. The funded pension pillar will help mobilize domestic savings for investment, gradually reducing dependency on external financing.

40. Staff supports the authorities' request for completion of the Third Review under the Extended Fund Facility. Staff also supports the authorities' request to reformulate the end-December 2018 structural benchmark on the tax penalty regime. Strong program implementation in both macroeconomic policies and structural reforms provides confidence that the program will continue meeting its objectives.

Figure 2. Georgia: Real Sector and Inflation Developments

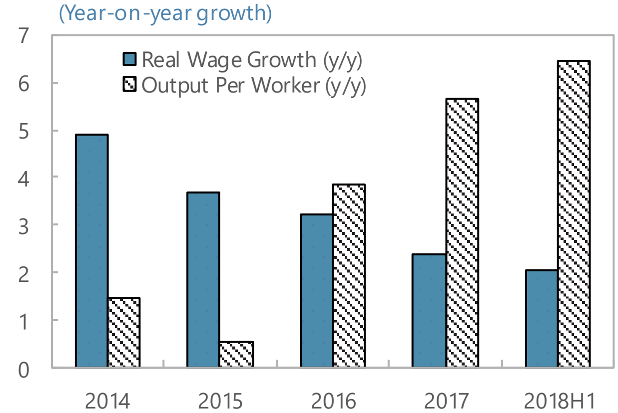
Poverty reduction stalled in spite of higher growth…

Real GDP Growth and Absolute Poverty Rate
(In percent)



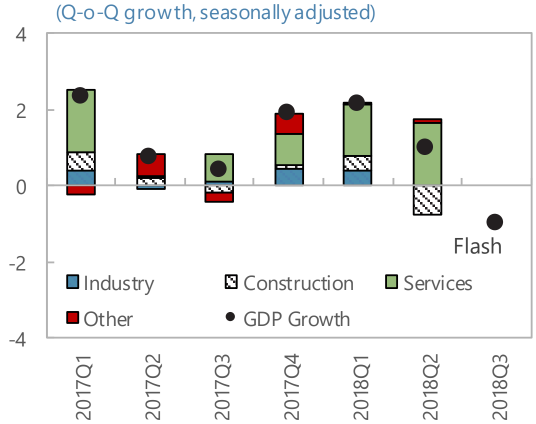
… as real wage growth fell below labor productivity growth.

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



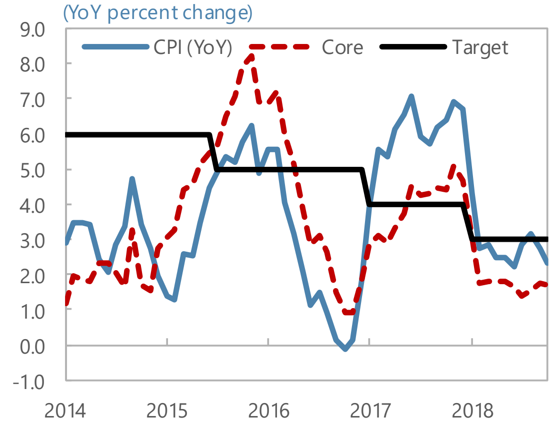
Growth has slowed due to lower construction activity.

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



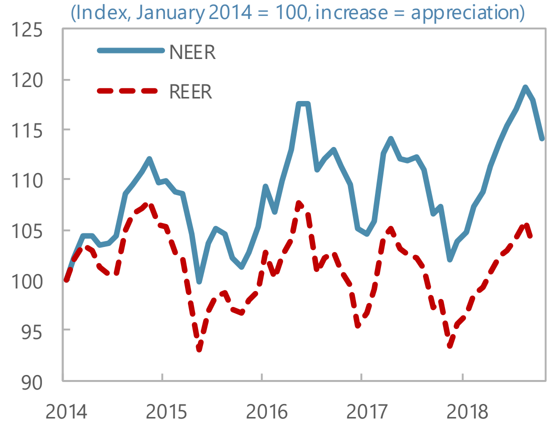
Inflation remained below target with core inflation subdued.

Inflation: Headline and Core Inflation
(YoY percent change)



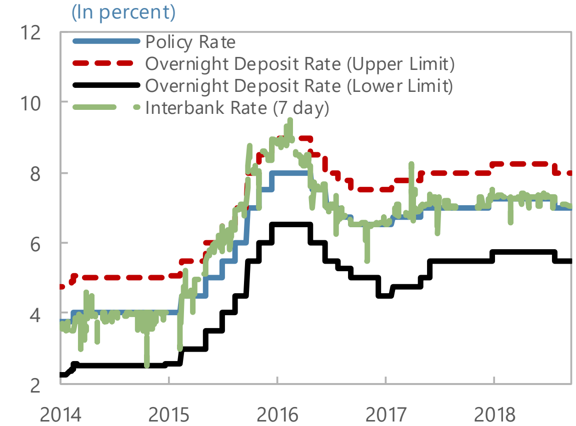
Nominal appreciation in 2018H1 has begun to reverse.

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



NBG has kept policy rate constant since July at 7 percent.

Interest Rates
(In percent)

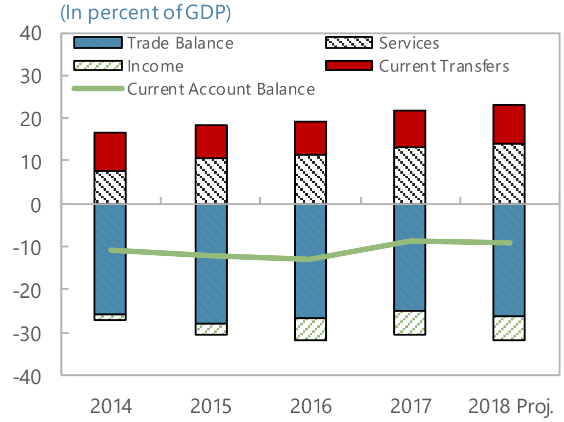


Sources: National authorities; and IMF staff calculations.

Figure 3. Georgia: External Sector Developments

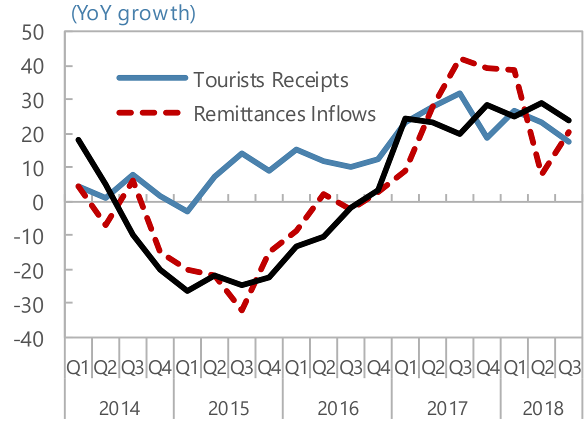
The current account deficit increased modestly, …

Current Account Balance
(In percent of GDP)



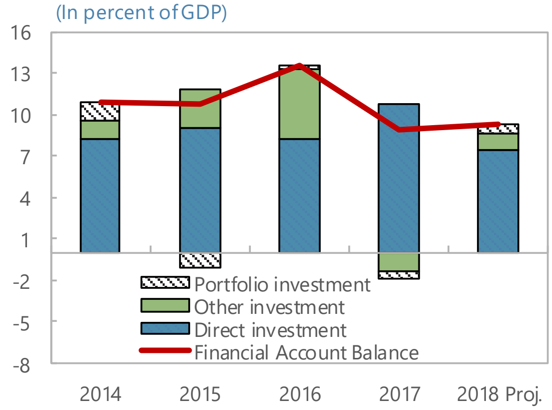
… despite strong growth in exports, tourism, and remittances.

Exports, Tourist Receipts, and Remittances
(YoY growth)



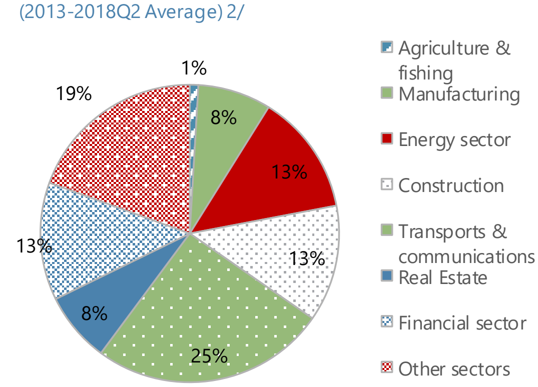
Direct investment dominates financial inflows in 2017, …

Financial Account Components
(In percent of GDP)



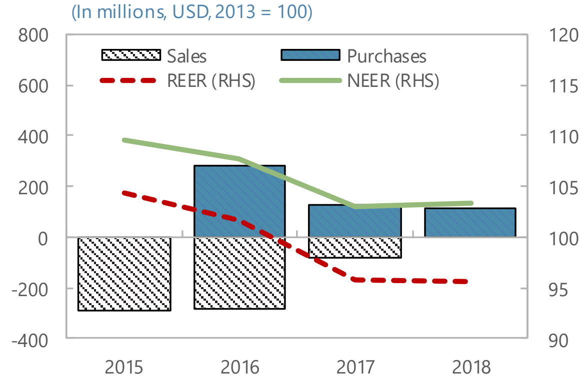
… and was concentrated in transport and energy sectors.

Net FDI Inflows by Industry
(2013-2018Q2 Average) 2/



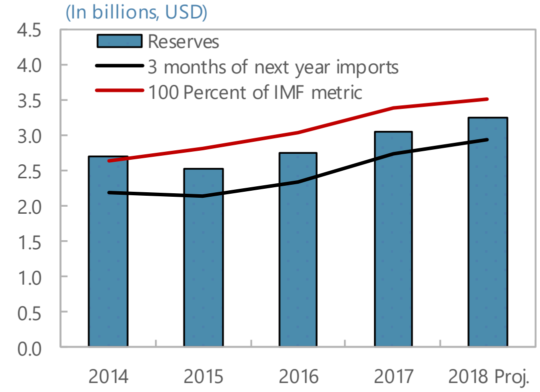
NBG's FX intervention has been mostly two-sided.

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



While gross reserves have increased, reserve coverage remains low.

Reserve Adequacy
(In billions, USD)

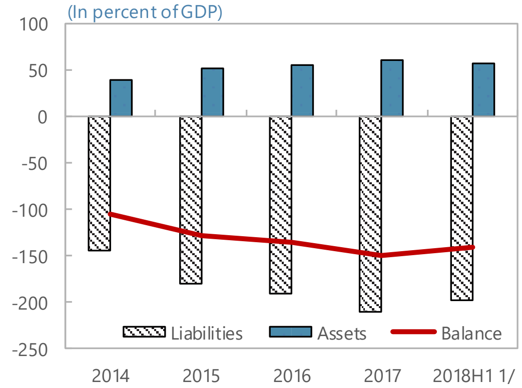


Sources: National authorities; GEOSTAT; and IMF staff estimates.
1/ Interventions for 2018 are as of October, and 2017 interventions include sales from loan conversion scheme.
2/ 2018 data is preliminary.

Figure 4. Georgia: International Investment Position (IIP)

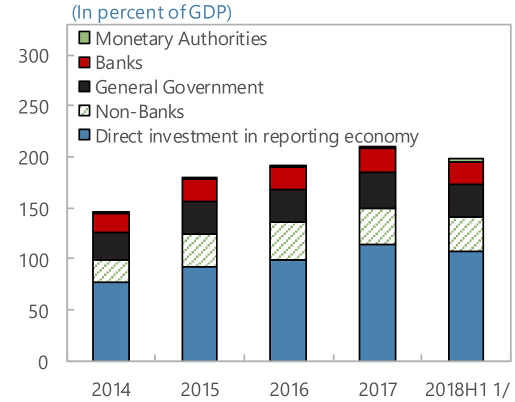
Net IIP has narrowed in the first part of 2018, ...

International Investment Position, Overall
(In percent of GDP)



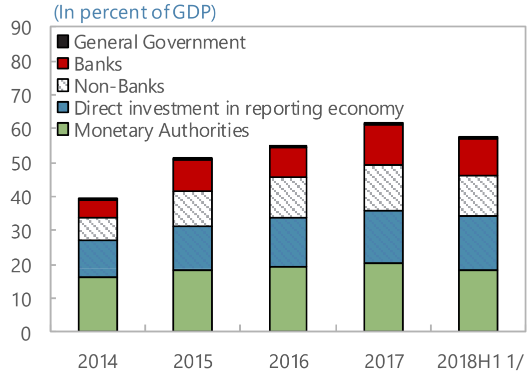
... mostly due to declining FDI liabilities, ...

Gross Liabilities by Borrower
(In percent of GDP)



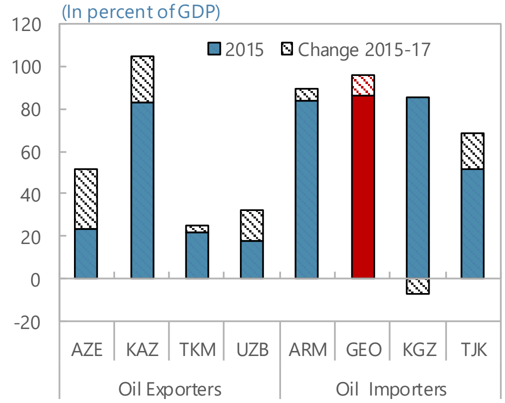
...supported by increasing foreign assets in the banking and non-banking sectors.

Gross Assets by Borrower
(In percent of GDP)



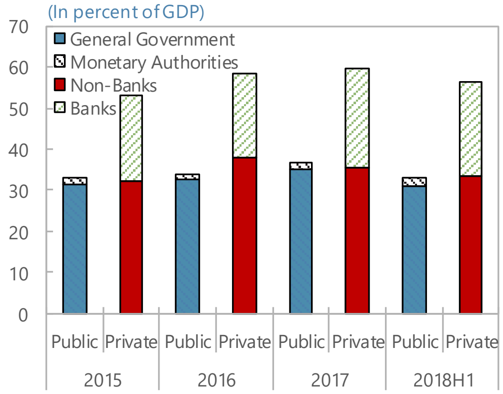
Georgia's external debt has slightly increased, in line with other oil importers in the Caucasus.

External Debt
(In percent of GDP)



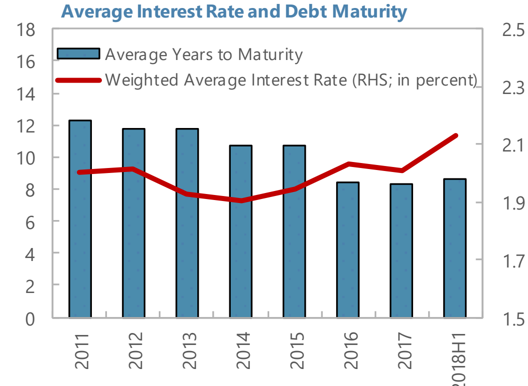
External debt dynamics remain driven by the private sector.

Total External Debt 2/
(In percent of GDP)



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

Average Interest Rate and Debt Maturity

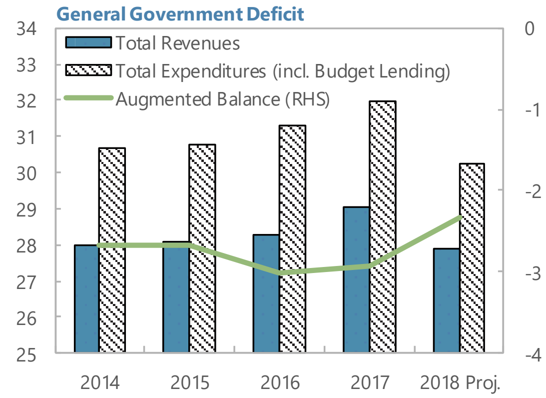


Sources: National authorities; World Economic Outlook; and IMF staff estimates.
1/ 2018H1 based on projected GDP for 2018.
2/ Excludes intercompany lending. Private includes financial institutions and corporations.

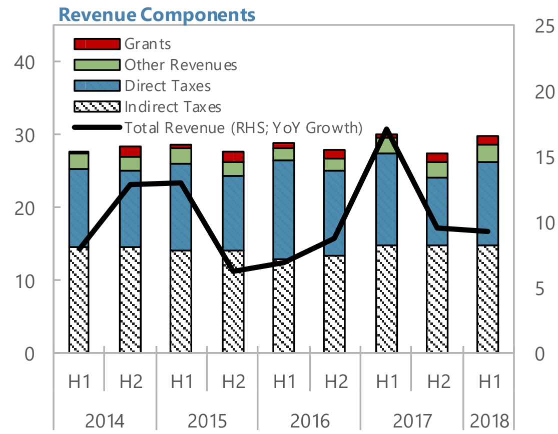
Figure 5. Georgia: Fiscal Sector Developments

(In percent of GDP)

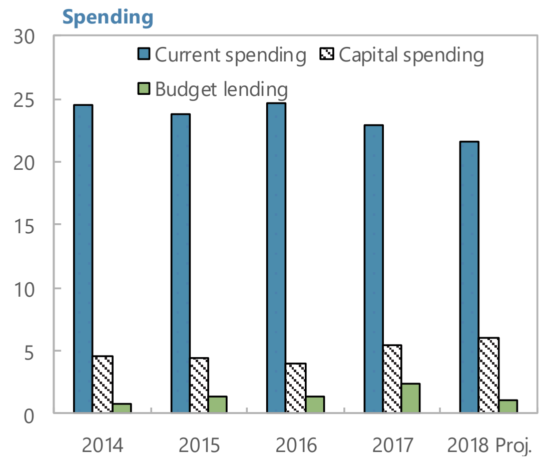
The augmented fiscal balance has improved since 2016, …



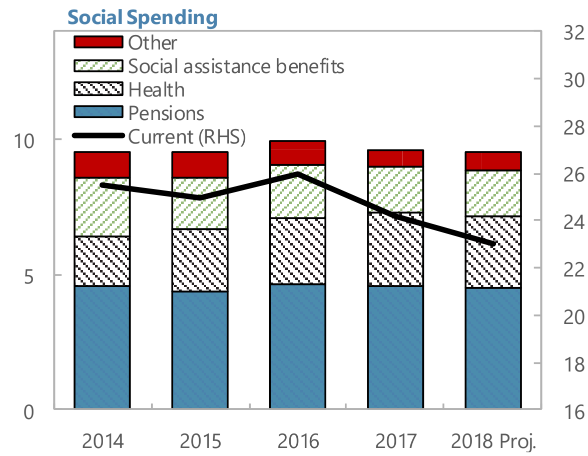
… driven by strong revenue performance …



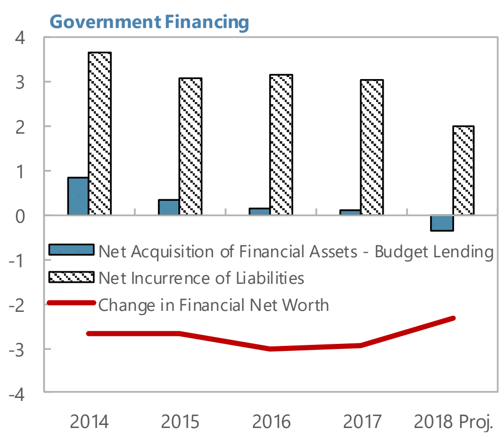
… and contained current spending, creating space to expand public investment.



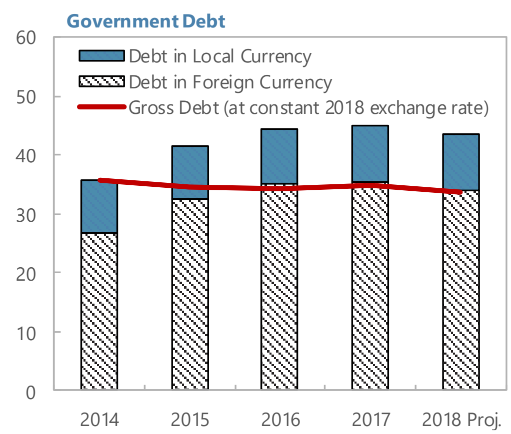
Social spending remains a key component of current spending.



Financing needs remain relatively stable.



Public debt is exposed to FX risks.

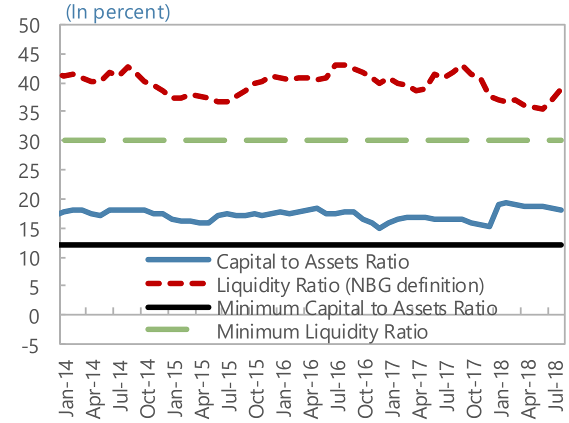


Sources: National authorities; and IMF staff estimates.

Figure 6. Georgia: Financial Sector Developments

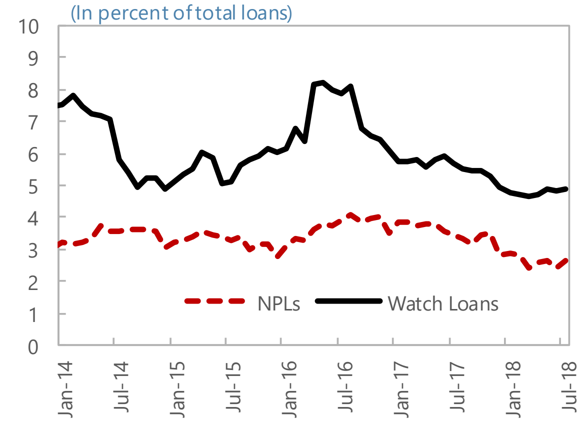
Banks are liquid and well capitalized, …

Capital and Liquidity Ratios
(In percent)



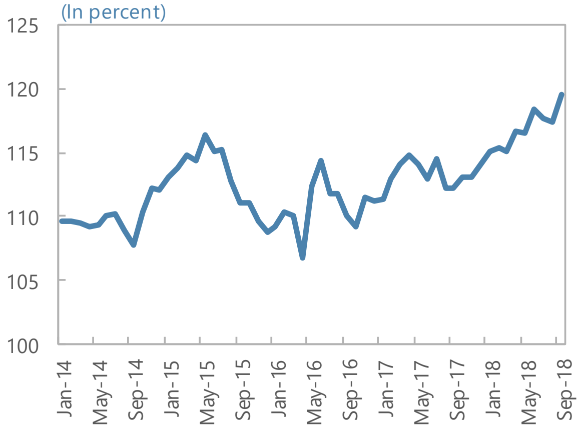
… while NPLs and watch loans have stabilized in recent months.

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



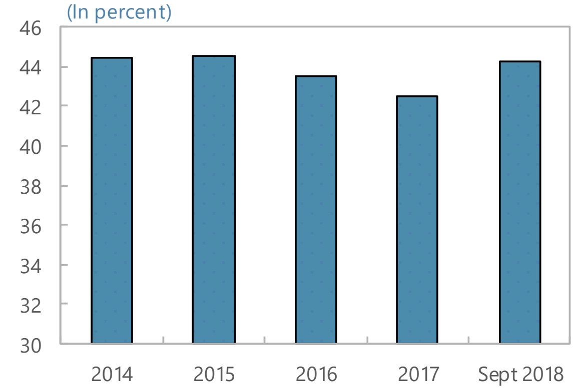
The loan-to-deposit ratio (at constant exchange rates) have increased in the last year.

Loan-To-Deposit Ratio
(In percent)



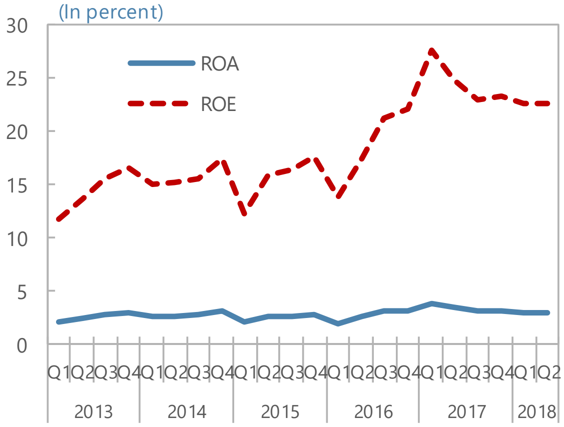
Financial performance continues to be strong, …

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



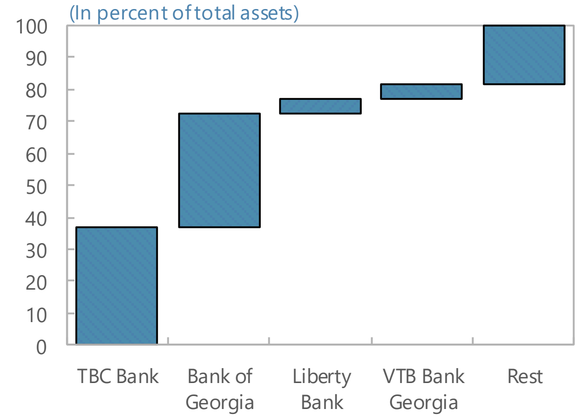
… supporting high profitability, …

Return on Assets and Equity Ratios
(In percent)



… in the context of a highly concentrated market.

Market Concentration of Assets, Aug 2018
(In percent of total assets)



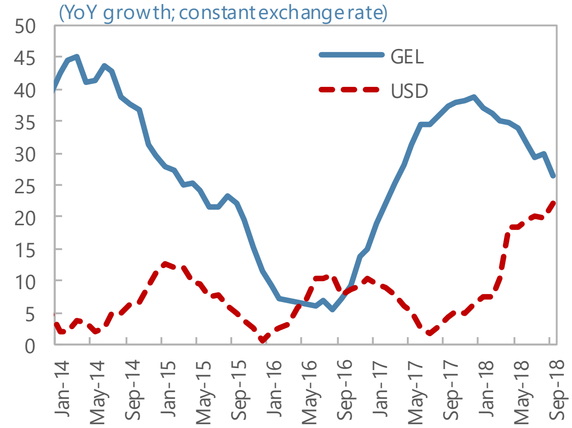
Sources: National Bank of Georgia; and IMF staff calculations.

Figure 6. Georgia: Financial Sector Developments (concluded)

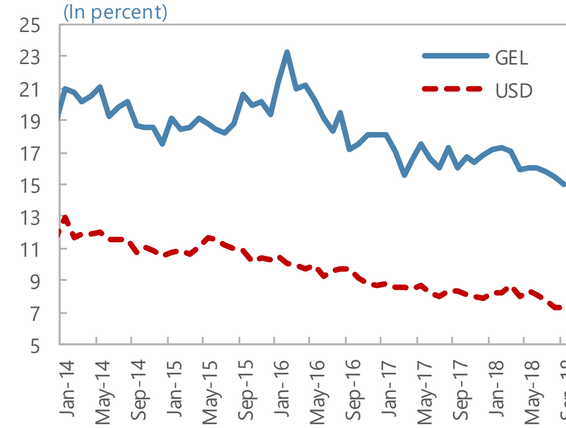
Credit to the private sector has accelerated since mid-2016, …

… and lending rates have remained broadly stable.

Private Sector Credit
(YoY growth; constant exchange rate)



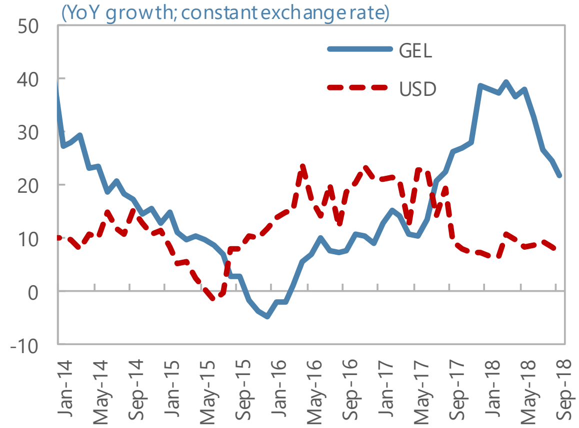
Interest Rates For Loans
(In percent)



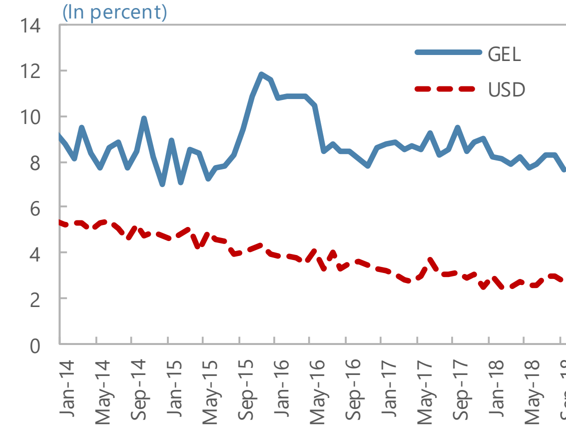
Deposit growth has fallen recently, …

… while interest rates on deposits have remained stable.

Resident Deposits
(YoY growth; constant exchange rate)



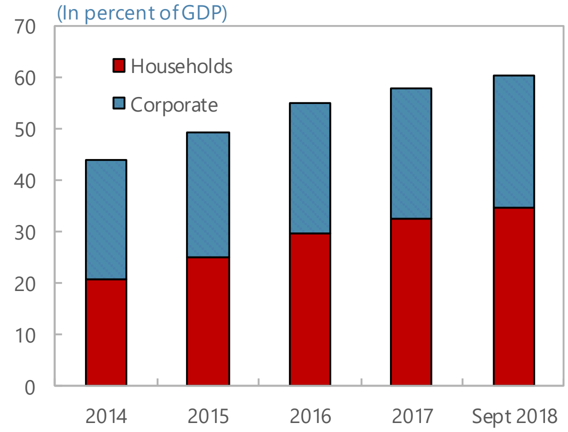
Interest Rates For Deposits
(In percent)



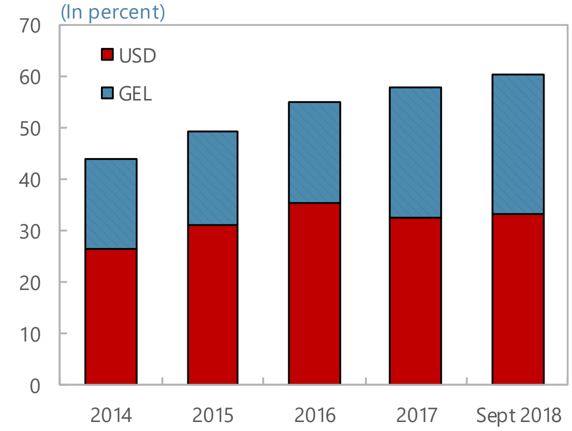
Credit developments are driven by credit to households,

… with an increasing share of loans in local currency.

Credit Developments
(In percent of GDP)



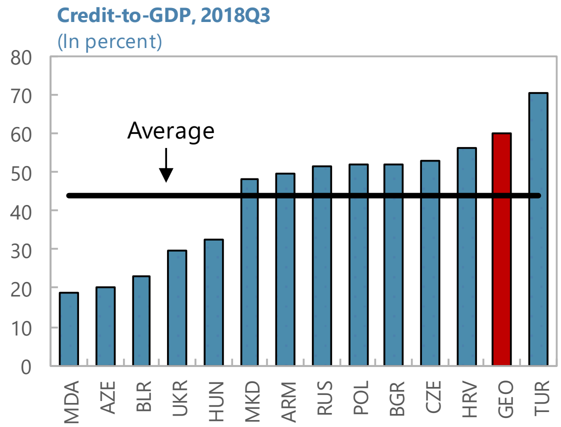
Private Sector Credit-To-GDP Ratio
(In percent)



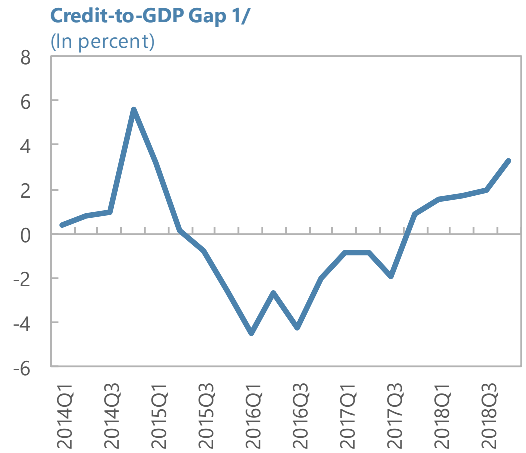
Sources: National Bank of Georgia; and IMF staff calculations.

Figure 7. Georgia: Macro-Financial Developments

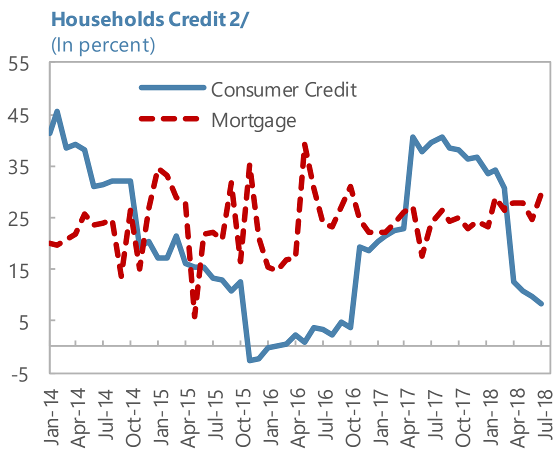
Georgia's credit to GDP is higher than peers…



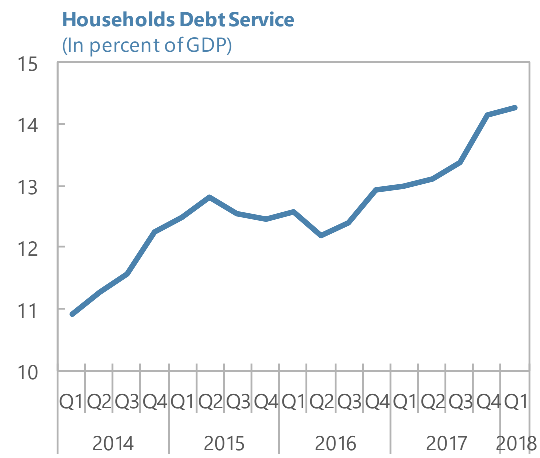
… with a positive credit gap.



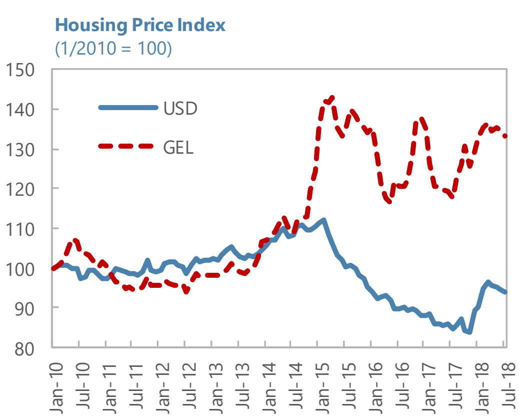
Household debt has been driven by consumer and mortgage loans.



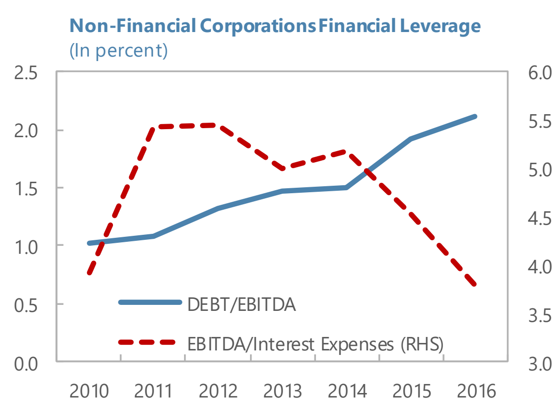
While household debt is increasing, debt service remains manageable.



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

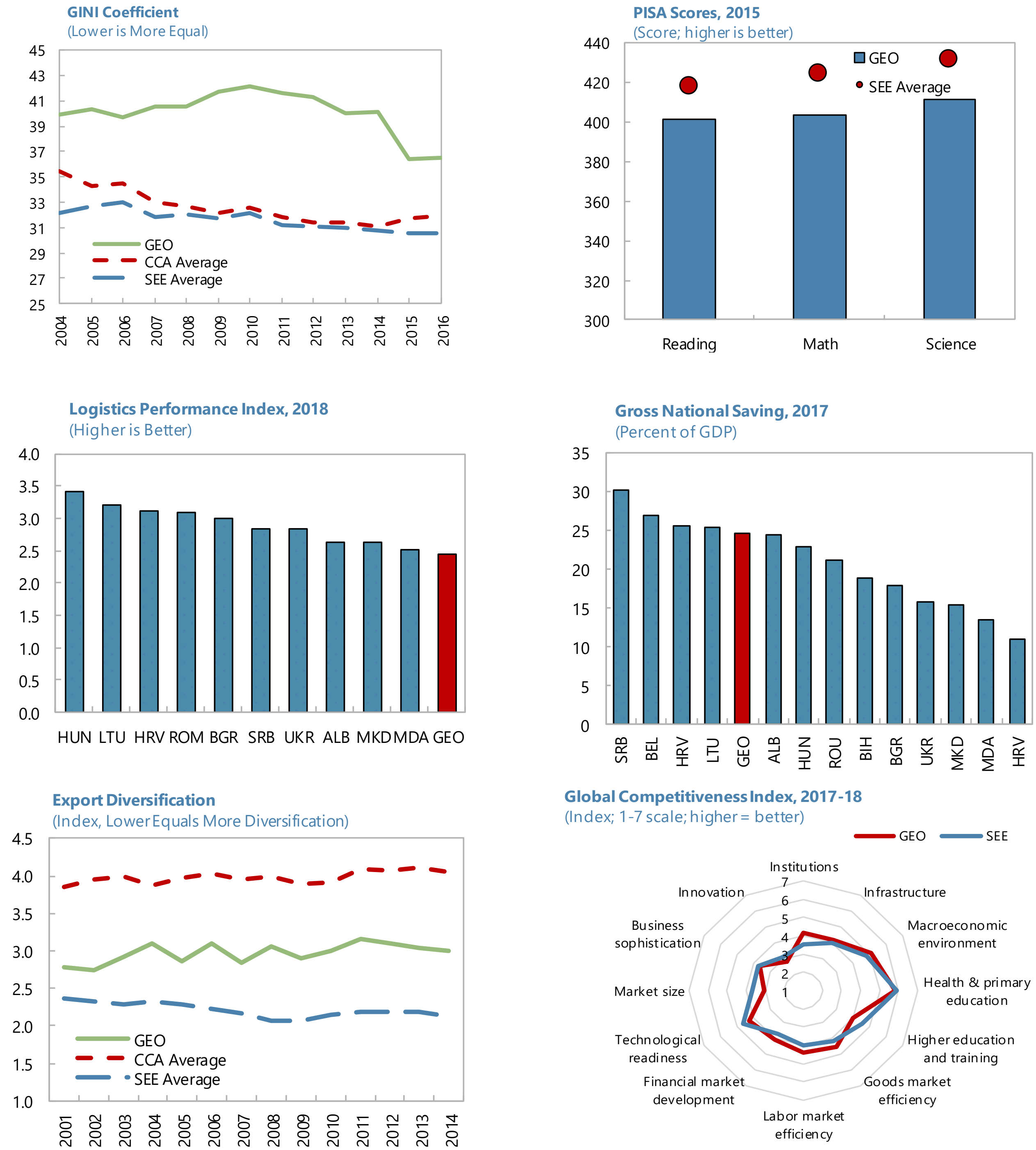


… neither of debt service pressures in the non-financial corporate sector.



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

Figure 8. 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.

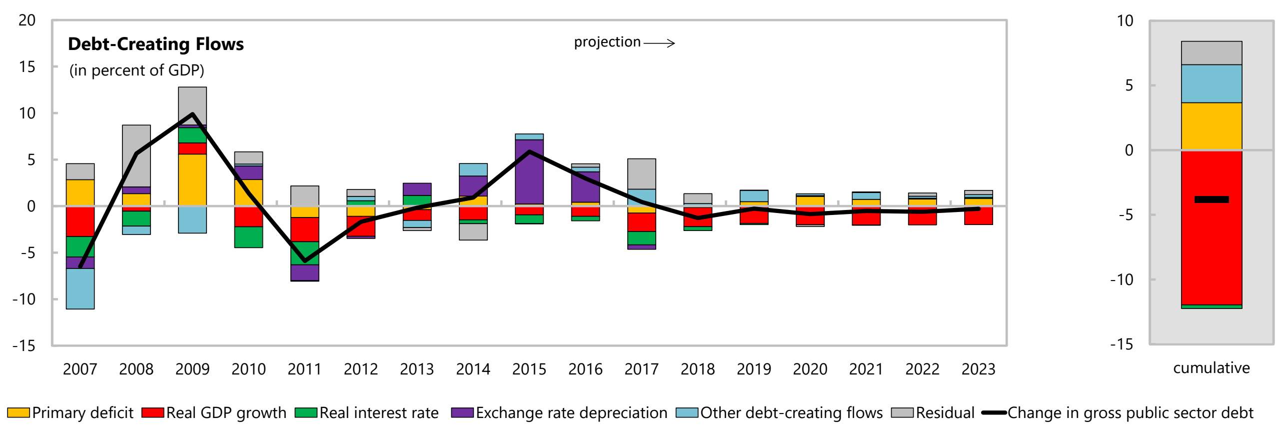
Figure 9. Georgia: Public Sector Debt Sustainability Analysis (DSA)
(In percent of GDP; unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of November 06, 2018		
	2007-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	35.9	44.4	44.9	43.6	43.3	42.5	41.9	41.3	41.0	EMBIG (bp) 3/	227	
Public gross financing needs	4.4	4.9	4.3	5.7	5.8	5.7	7.5	5.3	5.5	5Y CDS (bp)	384	
Real GDP growth (in percent)	4.7	2.8	5.0	5.0	4.6	5.0	5.2	5.2	5.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.0	4.2	6.5	4.2	3.4	3.0	3.0	3.0	3.0	Moody's	Ba2	Ba2
Nominal GDP growth (in percent)	10.0	7.2	11.8	9.4	8.2	8.1	8.4	8.4	8.4	S&Ps	BB-	BB-
Effective interest rate (in percent) [4]	2.8	3.1	3.2	3.4	3.2	3.3	3.1	3.4	3.5	Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	1.0	3.0	0.4	-1.3	-0.3	-0.9	-0.5	-0.6	-0.3	-3.8	
Identified debt-creating flows	-0.6	2.6	-2.8	-2.3	-0.3	-0.7	-0.6	-1.0	-0.7	-5.6	
Primary deficit	1.2	0.4	-0.7	-0.2	0.5	1.0	0.7	0.7	0.8	3.7	-1.6
Primary (noninterest) revenue and grants	28.6	28.3	29.0	27.9	28.0	27.5	27.2	27.2	27.2	165.1	
Primary (noninterest) expenditure	29.9	28.7	28.3	27.8	28.5	28.6	27.9	28.0	28.0	168.8	
Automatic debt dynamics [5]	-1.1	1.7	-3.9	-2.5	-2.0	-1.9	-2.1	-1.9	-1.9	-12.2	
Interest rate/growth differential [6]	-2.2	-1.6	-3.4	-2.5	-2.0	-1.9	-2.1	-1.9	-1.9	-12.2	
Of which: real interest rate	-0.7	-0.5	-1.4	-0.4	-0.1	0.1	0.0	0.1	0.1	-0.3	
Of which: real GDP growth	-1.5	-1.1	-2.0	-2.1	-1.9	-2.0	-2.0	-2.0	-2.0	-12.0	
Exchange rate depreciation [7]	1.1	3.3	-0.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.7	0.5	1.8	0.3	1.2	0.2	0.7	0.2	0.3	2.9	
GG: Privatization and Drawdown of deposits (negative)	-1.5	-0.9	-0.6	-0.9	0.5	-0.2	0.1	-0.3	-0.2	-0.9	
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]	0.8	1.4	2.4	1.2	0.7	0.4	0.6	0.5	0.5	3.8	
Residual, including asset changes [9]	1.6	0.4	3.3	1.1	0.0	-0.2	0.1	0.4	0.5	1.8	



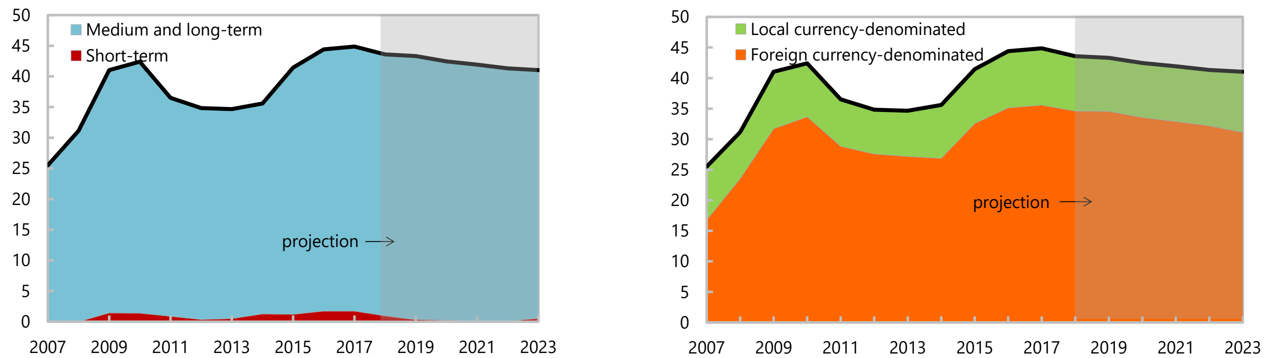
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt 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 $r - \pi (1+g)$ 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 10. Georgia: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)

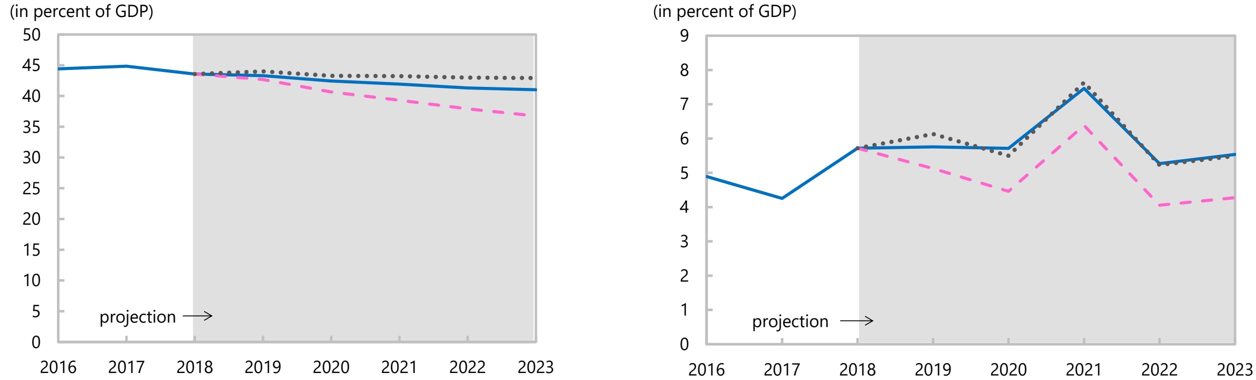
By Currency
(in percent of GDP)



Alternative Scenarios

Gross Nominal Public Debt
(in percent of GDP)

Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

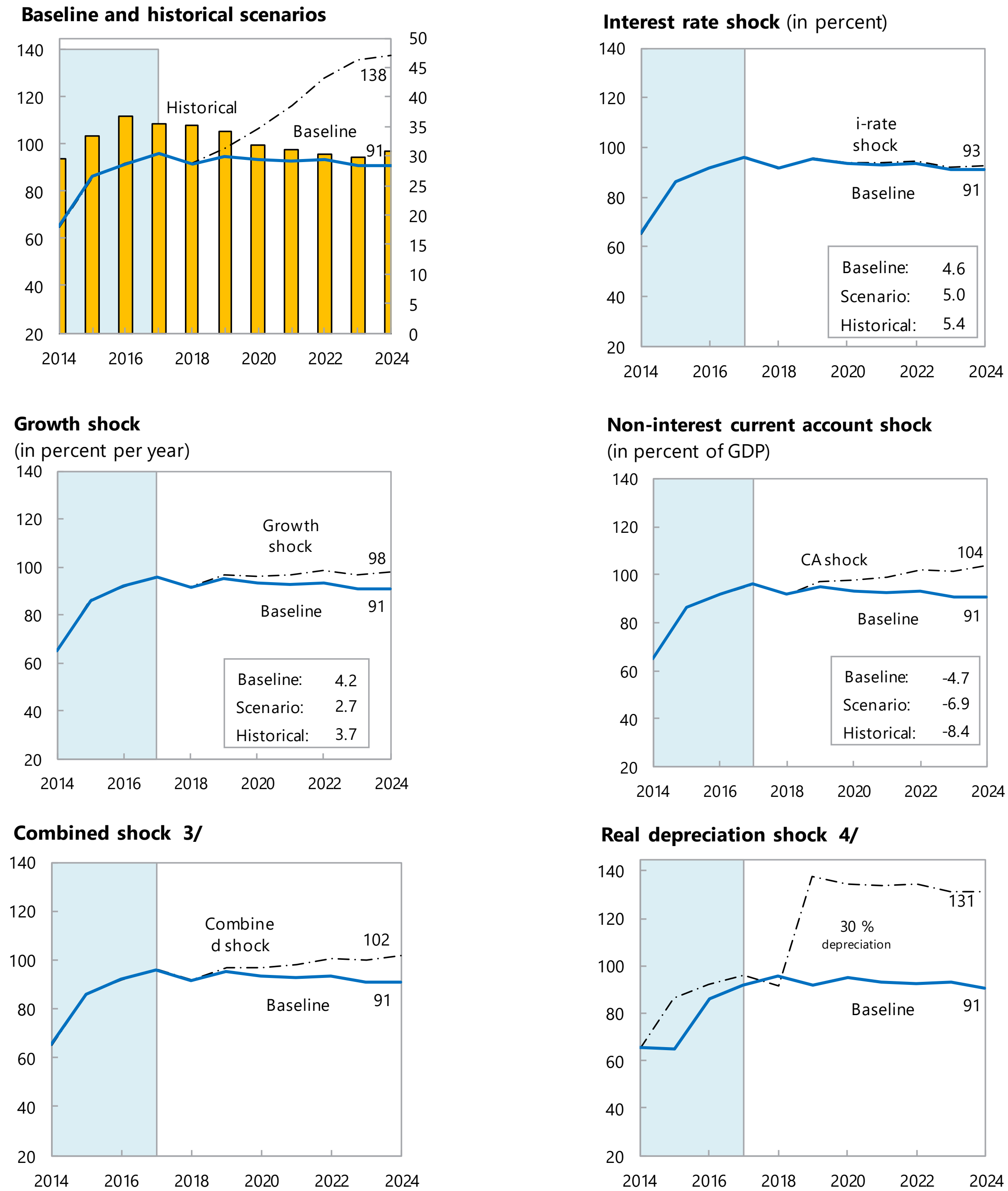
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	4.6	5.0	5.2	5.2	5.2
Inflation	4.2	3.4	3.0	3.0	3.0	3.0
Primary Balance	0.2	-0.5	-1.0	-0.7	-0.7	-0.8
Effective interest rate	3.4	3.2	3.3	3.1	3.4	3.5
Constant Primary Balance Scenario						
Real GDP growth	5.0	4.6	5.0	5.2	5.2	5.2
Inflation	4.2	3.4	3.0	3.0	3.0	3.0
Primary Balance	0.2	0.2	0.2	0.2	0.2	0.2
Effective interest rate	3.4	3.2	3.3	3.1	3.4	3.5

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	3.7	3.7	3.7	3.7	3.7
Inflation	4.2	3.4	3.0	3.0	3.0	3.0
Primary Balance	0.2	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	3.4	3.2	3.0	2.7	2.8	2.7

Source: IMF staff.

Figure 11. 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 2018.

Table 1. Georgia: Selected Economic and Financial Indicators, 2015–23

	2015	2016	2017	2018	2018	2019	2020	2021	2022	2023
	Actual		Prel.	EFF 2nd Review	Projections					
National accounts and prices	(annual percentage change; unless otherwise indicated)									
Real GDP	2.9	2.8	5.0	4.8	5.0	4.6	5.0	5.2	5.2	5.2
Nominal GDP (in billion of laris)	31.8	34.0	38.0	41.4	41.6	45.0	48.7	52.8	57.2	62.0
Nominal GDP (in billion of U.S. dollars)	14.0	14.4	15.2	16.9	16.5	17.2	18.9	20.7	22.4	24.2
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	4.1	4.5	4.4	4.6	5.1	5.6	6.1	6.6
GDP deflator, period average	5.9	4.2	6.5	3.8	4.2	3.4	3.0	3.0	3.0	3.0
CPI, Period average	4.0	2.1	6.0	2.8	2.8	3.1	3.0	3.0	3.0	3.0
CPI, End-of-period	4.9	1.8	6.7	2.7	2.3	3.0	3.0	3.0	3.0	3.0
Investment and saving	(in percent of GDP)									
Gross national saving	18.9	19.6	23.1	25.5	25.5	25.4	25.4	25.6	25.8	26.2
Investment	31.5	32.7	31.9	34.7	34.5	34.9	34.8	34.3	34.3	34.1
Public	5.6	5.0	6.1	6.8	6.6	7.1	7.9	7.9	8.0	8.0
Private	25.9	27.7	25.8	27.9	27.9	27.9	26.9	26.4	26.3	26.1
Consolidated government operations	(in percent of GDP)									
Revenue and grants	28.1	28.3	29.0	27.9	27.9	28.0	27.5	27.2	27.2	27.2
o.w. Tax revenue	25.1	25.7	26.0	25.0	25.0	25.1	24.9	24.7	24.7	24.7
Expenditures	32.0	32.5	32.7	31.1	30.8	30.9	30.8	30.3	30.3	30.0
Current expenditures	25.0	26.0	24.2	23.1	23.0	23.1	22.5	21.8	21.8	21.6
Capital spending and budget lending	7.0	6.5	8.5	7.9	7.8	7.8	8.3	8.5	8.4	8.4
Net Lending/Borrowing (GFSM 2001)	-1.2	-1.5	-0.5	-1.6	-1.2	-1.9	-2.3	-2.1	-2.2	-2.1
Augmented Net lending / borrowing (Program definition) 1/	-2.6	-2.9	-2.9	-2.8	-2.3	-2.6	-2.7	-2.7	-2.7	-2.5
Public debt	41.4	44.4	44.9	42.8	43.4	43.5	42.8	42.3	41.7	41.2
o.w. NBG debt to the IMF	…	…	0.6	0.5	0.5	1.0	1.1	0.9	0.7	0.7
o.w. Foreign-currency denominated	32.5	35.1	35.6	33.2	34.1	33.8	32.8	32.1	31.4	30.3
Money and credit	(in percent; unless otherwise indicated)									
Credit to the private sector (annual percentage change)	22.1	19.6	17.6	14.1	17.6	12.6	9.8	8.4	8.4	8.6
In constant exchange rate	4.1	11.9	19.4	18.0	16.3	13.1	10.7	9.0	8.4	8.4
Broad money (annual percentage change)	19.2	20.4	14.8	12.6	13.6	12.2	10.8	10.2	9.1	9.0
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	13.7	10.5	12.6	10.8	9.8	9.4	9.0	9.1
In constant exchange rate	5.3	13.4	16.5	16.2	12.5	12.8	11.8	10.7	9.1	8.8
Deposit dollarization (in percent of total)	66.8	69.9	63.7	59.7	62.2	59.6	55.8	53.8	52.5	51.0
Credit dollarization (in percent of total)	63.1	64.6	56.1	50.7	53.7	51.3	50.4	49.5	48.6	47.7
Credit to GDP	49.2	54.9	57.8	60.6	62.1	64.6	65.6	65.6	65.6	65.7
External sector	(in percent of GDP; unless otherwise indicated)									
Current account balance	-12.6	-13.1	-8.8	-9.2	-9.0	-9.5	-9.3	-8.7	-8.4	-7.9
Trade balance	-28.1	-26.9	-25.0	-27.2	-26.2	-27.4	-26.9	-26.0	-25.7	-25.4
Terms of trade (percent change)	30.6	-1.2	-2.7	-1.9	-4.9	-0.9	0.6	0.7	1.1	1.1
Gross international reserves (in billions of US$)	2.5	2.8	3.0	3.3	3.2	3.5	3.8	4.2	4.6	4.9
In percent of IMF Composite measure (floating)	90.0	90.6	89.9	93.3	92.3	95.6	99.7	104.6	109.7	113.9
Gross external debt	107.6	109.3	113.2	107.9	108.9	113.3	111.5	111.0	111.8	110.9
Gross external debt, excl. intercompany loans	86.1	91.8	95.9	90.9	91.5	95.0	93.2	92.7	93.2	90.8
Laris per U.S. dollar (period average)	2.27	2.37	2.51	…	…	…	…	…	…	…
Laris per euro (period average)	2.52	2.62	2.83	…	…	…	…	…	…	…
REER (period average; CPI based, 2010=100)	104.0	107.5	105.2	…	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.

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

Table 2. Georgia: Summary Balance of Payments, 2015–23

	2015	2016	2017	2018 EFF 2nd Review	2018	2019	2020	2021	2022	2023
	Actual		Prel.		Projections					
	(in millions of U.S. dollars)									
Current account balance	-1,763	-1,889	-1,334	-1,555	-1,488	-1,636	-1,763	-1,794	-1,892	-1,918
Trade balance	-3,935	-3,869	-3,796	-4,582	-4,314	-4,703	-5,083	-5,388	-5,773	-6,157
Exports	3,099	2,931	3,634	4,205	4,416	4,709	5,071	5,506	5,956	6,148
Imports	-7,034	-6,800	-7,430	-8,786	-8,731	-9,412	-10,155	-10,894	-11,729	-12,305
Services	1,390	1,564	2,014	2,494	2,350	2,626	2,895	3,171	3,409	3,664
Services: credit	3,066	3,295	3,976	4,709	4,544	4,973	5,397	5,825	6,260	6,669
Services: debit	-1,675	-1,731	-1,962	-2,216	-2,194	-2,347	-2,502	-2,654	-2,851	-3,005
Income	-338	-706	-826	-880	-942	-1,073	-1,194	-1,305	-1,372	-1,367
Of which : interest payments	-505	-519	-521	-546	-553	-591	-642	-676	-740	-616
Transfers	1,120	1,121	1,274	1,413	1,418	1,515	1,619	1,728	1,844	1,942
Of which : remittances credit	588	579	750	903	903	966	1,034	1,106	1,189	1,261
Capital account	60	58	109	82	82	80	78	77	75	74
General government	56	54	83	82	82	80	78	77	75	74
Financial account	1,560	1,944	1,233	1,531	1,393	1,627	1,928	2,097	2,208	2,228
Direct investment (net)	1,343	1,159	1,625	1,480	1,222	1,359	1,634	1,792	1,997	2,097
Portfolio investment (net)	-154	41	-71	50	106	0	50	50	50	50
Equity	5	-15	-53	0	-24	0	0	0	0	0
Debt securities	-158	56	-18	50	130	0	50	50	50	50
Loans (net)	727	1,013	268	458	334	501	512	586	578	541
Short-term loans (net)	-3	269	27	18	-60	15	17	18	19	21
Public	1	2	3	3	3	3	3	3	3	3
Private	-4	267	24	15	-63	13	15	15	16	19
Medium and long-term loans (net)	730	744	241	440	394	486	495	568	558	520
Public 1/	344	281	238	276	96	309	307	453	430	370
Private	386	463	3	164	298	177	188	115	129	150
Bank	103	239	194	138	307	138	144	112	102	123
Non-bank	283	224	-191	26	-9	40	44	3	27	26
Others (net) 2/	-357	-270	-589	-457	-269	-233	-269	-331	-417	-460
Errors and omissions	-58	81	-76	0	0	0	0	0	0	0
Overall balance	-201	193	-68	58	-13	72	243	380	391	384
Financing	201	-193	-118	-253	-161	-249	-334	-376	-374	-352
Gross International Reserves (-increase)	99	-245	-242	-248	-199	-249	-334	-376	-374	-352
Use of Fund Resources 3/	-73	-14	...	...	...	...	...	...	...	...
Rescheduled debts and arrears clearance	175	65	124	-5	38	0	0	0	0	0
Financing gap	...	...	192	195	174	177	91	-4	-18	-32
Proposed use of Fund Resources	...	...	71	29	28	35	43	-4	-18	-32
Proposed IMF EFF	...	...	84	87	85	84	43	0	0	0
Repayment 3/	...	...	-13	-58	-57	-49	0	-4	-18	-32
Official creditors	...	...	121	166	146	142	48	0	0	0
World Bank	...	...	106	0	0	0	0	0	0	0
EU	...	...	15	44	17	23	0	0	0	0
AFD	...	...	0	122	129	119	48	0	0	0
Memorandum items:					(In percent of GDP)					
Current account balance	-12.6	-13.1	-8.8	-9.2	-9.0	-9.5	-9.3	-8.7	-8.4	-7.9
Trade balance	-28.1	-26.9	-25.0	-27.2	-26.2	-27.4	-26.9	-26.0	-25.7	-25.4
Financial account	11.1	13.5	8.1	9.1	8.5	9.5	10.2	10.1	9.8	9.2
Foreign direct investment (net)	9.6	8.1	10.7	8.8	7.4	7.9	8.6	8.7	8.9	8.7
External financing requirement	37.0	38.8	37.1	34.3	34.1	34.2	33.3	32.2	31.6	30.6
Gross international reserves (in million of USD)	2,521	2,756	3,039	3,288	3,238	3,487	3,821	4,198	4,571	4,923
in months of next year GNFS imports	3.5	3.5	3.3	3.3	3.3	3.3	3.4	3.5	3.6	3.7
in percent of short-term debt at remaining maturity	75	69	73	78	79	83	84	86	88	88
in percent of broad money and non-resident deposits	37	37	36	32	34	33	32	32	32	32
in percent of IMF Composite measure (floating)	90	91	90	93	92	96	100	105	110	114
Reserve cover (percent) 4/	39.9	38.3	42.5	43.6	43.3	45.6	46.9	48.4	49.2	50.1

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

1/ Including general government and monetary authorities

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

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

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

Table 3a. Georgia: General Government Operations, GFSM 2001, 2015–23
(In millions of GEL)

	2015	2016	2017	2018	2018	2019	2020	2021	2022	2023
				EFF 2nd						
	Actual		Prel.	Review	Projections					
Revenue	8,923	9,623	11,051	11,572	11,617	12,607	13,408	14,363	15,589	16,853
Taxes	7,971	8,750	9,909	10,360	10,420	11,304	12,132	13,020	14,154	15,323
Taxes on income, profits, and capital gains	3,207	3,535	3,675	3,869	3,964	4,196	4,518	4,877	5,271	5,698
Payable by individuals	2,182	2,479	2,919	3,157	3,224	3,396	3,671	3,979	4,314	4,676
Payable by corporations	1,025	1,056	757	712	740	801	847	898	957	1,022
Taxes on property	264	363	394	430	433	468	506	548	595	645
Taxes on goods and services	4,404	4,756	5,573	5,935	5,990	6,560	6,983	7,569	8,207	8,895
General taxes on goods and services (VAT)	3,533	3,686	4,123	4,532	4,543	5,014	5,312	5,758	6,243	6,767
Excises	871	1,070	1,451	1,403	1,447	1,545	1,671	1,811	1,963	2,128
Taxes on international trade	69	70	72	70	75	84	89	95	102	108
Other taxes 1/	26	25	195	56	-42	-4	36	-69	-20	-23
Grants	319	282	304	411	307	393	330	317	322	324
Other revenue	634	592	838	800	890	910	947	1,026	1,113	1,206
Total Expenditure	9,304	10,136	11,248	12,231	12,109	13,441	14,602	15,458	16,842	18,144
Expense	7,883	8,786	9,194	9,585	9,579	10,392	10,942	11,508	12,492	13,394
Compensation of employees	1,602	1,753	1,649	1,710	1,693	1,765	1,818	1,872	2,030	2,200
Use of goods and services	1,203	1,394	1,536	1,505	1,540	1,548	1,594	1,642	1,781	1,931
Interest	330	403	482	554	557	620	683	710	824	784
External	174	195	238	284	287	321	355	342	415	332
Domestic	156	208	244	270	270	299	328	368	410	453
Subsidies	671	701	871	857	857	936	964	993	1,077	1,167
Grants	84	82	64	80	80	128	132	136	147	159
Social benefits	3,037	3,394	3,544	3,730	3,723	4,186	4,527	4,894	5,304	5,751
Other expense	957	1,059	1,050	1,150	1,130	1,210	1,224	1,261	1,329	1,401
Net acquisition of nonfinancial assets	1,421	1,351	2,054	2,646	2,530	3,049	3,660	3,950	4,350	4,750
Increase (capital spending)	1,776	1,718	2,314	2,796	2,750	3,189	3,840	4,150	4,550	4,950
Decrease (privatization proceeds)	-355	-367	-260	-150	-220	-140	-180	-200	-200	-200
Net lending / borrowing before adjustment	-402	-545	-197	-660	-492	-834	-1,193	-1,095	-1,253	-1,291
Unidentified measures	20	31	0	0	0	0	79	0	0	0
Net lending / borrowing	-382	-513	-198	-660	-492	-834	-1,114	-1,095	-1,253	-1,291
Change in net financial worth, transactions	-382	-513	-198	-660	-492	-834	-1,114	-1,095	-1,253	-1,291
Net acquisition of financial assets ("+": increase in assets)	552	533	954	651	334	685	284	584	326	380
Domestic	552	533	954	651	334	685	284	584	326	380
Budget lending	447	481	915	480	480	335	200	310	280	280
Deposits (NBG and commercial banks)	105	54	39	171	-146	350	84	274	46	100
Financial privatization	0	-2	0	0	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	934	1,046	1,152	1,311	827	1,520	1,398	1,679	1,579	1,671
Domestic	268	300	354	368	359	467	484	532	528	806
Securities other than shares	277	314	354	368	359	467	484	532	528	806
Loans	-9	-14	0	0	0	0	0	0	0	0
Foreign	666	747	798	943	467	1,053	914	1,147	1,051	865
Loans	666	747	798	943	467	1,053	914	1,147	1,051	865
Memorandum items:										
Nominal GDP	31,756	34,028	38,042	41,410	41,629	45,032	48,681	52,766	57,211	62,012
Public debt	13,161	15,113	17,066	17,508	18,083	19,572	20,816	22,330	23,865	25,538
End-year government deposits	919	973	1,012	1,183	866	1,216	1,300	1,574	1,620	1,720
Operating balance	1,040	837	1,857	1,986	2,038	2,215	2,467	2,855	3,097	3,459
Net lending / borrowing (excluding privatization)	-757	-912	-457	-810	-712	-974	-1,373	-1,295	-1,453	-1,491
Augmented Net lending / borrowing (Program definition) 2/	-849	-1,025	-1,113	-1,140	-972	-1,169	-1,314	-1,405	-1,533	-1,571
Cyclically-adjusted primary balance (Program definition)	-531	-536	-546	-580	-344	-424	-482	-534	-537	-599

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, GFSM 2001, 2015–23
(In percent of GDP)

	2015	2016	2017	2018	2018	2019	2020	2021	2022	2023
				EFF 2nd						
	Actual		Prel.	Review	Projections					
Revenue	28.1	28.3	29.0	27.9	27.9	28.0	27.5	27.2	27.2	27.2
Taxes	25.1	25.7	26.0	25.0	25.0	25.1	24.9	24.7	24.7	24.7
Taxes on income, profits, and capital gains	10.1	10.4	9.7	9.3	9.5	9.3	9.3	9.2	9.2	9.2
Payable by individuals	6.9	7.3	7.7	7.6	7.7	7.5	7.5	7.5	7.5	7.5
Payable by corporations	3.2	3.1	2.0	1.7	1.8	1.8	1.7	1.7	1.7	1.6
Taxes on property	0.8	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Taxes on goods and services	13.9	14.0	14.7	14.3	14.4	14.6	14.3	14.3	14.3	14.3
General taxes on goods and services (VAT)	11.1	10.8	10.8	10.9	10.9	11.1	10.9	10.9	10.9	10.9
Excises	2.7	3.1	3.8	3.4	3.5	3.4	3.4	3.4	3.4	3.4
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/	0.1	0.1	0.5	0.1	-0.1	0.0	0.1	-0.1	0.0	0.0
Grants	1.0	0.8	0.8	1.0	0.7	0.9	0.7	0.6	0.6	0.5
Other revenue	2.0	1.7	2.2	1.9	2.1	2.0	1.9	1.9	1.9	1.9
Total Expenditure	29.3	29.8	29.6	29.5	29.1	29.8	30.0	29.3	29.4	29.3
Expense	24.8	25.8	24.2	23.1	23.0	23.1	22.5	21.8	21.8	21.6
Compensation of employees	5.0	5.2	4.3	4.1	4.1	3.9	3.7	3.5	3.5	3.5
Use of goods and services	3.8	4.1	4.0	3.6	3.7	3.4	3.3	3.1	3.1	3.1
Interest	1.0	1.2	1.3	1.3	1.3	1.4	1.4	1.3	1.4	1.3
External	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.6	0.7	0.5
Domestic	0.5	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.7
Subsidies	2.1	2.1	2.3	2.1	2.1	2.1	2.0	1.9	1.9	1.9
Grants	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Social benefits	9.6	10.0	9.3	9.0	8.9	9.3	9.3	9.3	9.3	9.3
Other expense	3.0	3.1	2.8	2.8	2.7	2.7	2.5	2.4	2.3	2.3
Net acquisition of nonfinancial assets	4.5	4.0	5.4	6.4	6.1	6.8	7.5	7.5	7.6	7.7
Increase (capital spending)	5.6	5.0	6.1	6.8	6.6	7.1	7.9	7.9	8.0	8.0
Decrease (privatization proceeds)	-1.1	-1.1	-0.7	-0.4	-0.5	-0.3	-0.4	-0.4	-0.3	-0.3
Net lending / borrowing before adjustment	-1.3	-1.6	-0.5	-1.6	-1.2	-1.9	-2.5	-2.1	-2.2	-2.1
Unidentified measures	0.1	0.1	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0
Net lending / borrowing	-1.2	-1.5	-0.5	-1.6	-1.2	-1.9	-2.3	-2.1	-2.2	-2.1
Change in net financial worth, transactions	-1.2	-1.5	-0.5	-1.6	-1.2	-1.9	-2.3	-2.1	-2.2	-2.1
Net acquisition of financial assets ("+": increase in assets)	1.7	1.6	2.5	1.6	0.8	1.5	0.6	1.1	0.6	0.6
Domestic	1.7	1.6	2.5	1.6	0.8	1.5	0.6	1.1	0.6	0.6
Budget lending	1.4	1.4	2.4	1.2	1.2	0.7	0.4	0.6	0.5	0.5
Deposits (NBG and commercial banks)	0.3	0.2	0.1	0.4	-0.3	0.8	0.2	0.5	0.1	0.2
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)	2.9	3.1	3.0	3.2	2.0	3.4	2.9	3.2	2.8	2.7
Domestic	0.8	0.9	0.9	0.9	0.9	1.0	1.0	1.0	0.9	1.3
Securities other than shares	0.9	0.9	0.9	0.9	0.9	1.0	1.0	1.0	0.9	1.3
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	2.1	2.2	2.1	2.3	1.1	2.3	1.9	2.2	1.8	1.4
Loans	2.1	2.2	2.1	2.3	1.1	2.3	1.9	2.2	1.8	1.4
Memorandum items:										
Nominal GDP	31,756	34,028	38,042	41,410	41,629	45,032	48,681	52,766	57,211	62,012
Public debt	41.4	44.4	44.9	42.3	43.4	43.5	42.8	42.3	41.7	41.2
End-year government deposits	2.9	2.9	2.7	2.9	2.1	2.7	2.7	3.0	2.8	2.8
Operating balance (before adjustment)	3.3	2.5	4.9	4.8	4.9	4.9	5.1	5.4	5.4	5.6
Net lending / borrowing (excluding privatization)	-2.4	-2.7	-1.2	-2.0	-1.7	-2.2	-2.8	-2.5	-2.5	-2.4
Augmented Net lending / borrowing (Program definition) 2/	-2.7	-3.0	-2.9	-2.8	-2.3	-2.6	-2.7	-2.7	-2.7	-2.5
Cyclically-adjusted primary balance (Program definition)	-1.7	-1.6	-1.4	-1.4	-0.8	-0.9	-1.0	-1.0	-0.9	-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, 2015–19

	2015	2016		2017		2018		2019	
						Projections			
		June	Dec	June	Dec	June	Dec	June	Dec
Central Bank	(In billions of lari)								
Net foreign assets	3.5	3.7	3.8	3.6	4.0	3.6	3.0	1.7	3.4
Gross international reserves	6.0	6.7	7.3	7.1	7.9	7.4	8.5	7.0	9.1
Other foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency liabilities	-2.5	-3.0	-3.5	-3.5	-3.9	-3.8	-5.6	-5.3	-5.7
Of which : use of Fund resources	0.0	0.0	0.0	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4
Of which : compulsory reserves in USD	-1.7	-2.3	-2.8	-2.6	-2.8	-2.7	-4.2	-4.0	-4.4
Net domestic assets	-0.6	-0.9	-0.4	-0.3	-0.3	0.1	1.0	2.1	1.0
Net claims on general government	-0.4	0.0	-0.5	-0.9	-0.5	0.0	0.4	0.4	0.5
Claims on general government (incl. T-bills)	0.5	0.5	0.5	0.5	0.5	0.5	0.7	0.7	0.8
Nontradable govt. debt	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Securitized debt (marketable)	0.1	0.2	0.1	0.2	0.2	0.2	0.4	0.4	0.5
Deposits	-0.9	-0.5	-1.0	-1.4	-1.0	-0.5	-0.3	-0.3	-0.3
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	0.7	0.2	1.6	1.8	1.7	1.4	2.2	3.2	2.1
Bank refinancing	1.1	0.4	1.8	1.8	1.8	1.5	2.3	3.3	2.1
Certificates of deposits and bonds	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other items, net	-0.9	-1.0	-1.4	-1.2	-1.5	-1.3	-1.6	-1.6	-1.6
Banking System	(In billions of lari)								
Net foreign assets	1.0	0.8	1.9	1.8	1.0	-1.3	-2.1	-3.8	-2.0
NBG	5.2	6.1	6.6	6.1	6.8	6.3	7.2	5.7	7.8
Commercial banks	-4.3	-5.2	-4.7	-4.3	-5.8	-7.6	-9.3	-9.5	-9.7
Net domestic assets	12.4	12.5	14.2	13.8	17.4	19.4	23.0	24.4	25.5
Domestic credit	16.4	17.2	19.6	19.7	22.9	23.8	27.2	28.3	30.9
Net claims on general government	0.7	1.0	0.9	0.6	0.9	0.9	1.3	1.7	1.8
Of which : government deposits at NBG	-0.9	-0.5	-1.0	-1.4	-1.0	-0.5	-0.3	-0.3	-0.3
Of which : T-bills at commercial banks	1.6	1.7	2.0	2.3	2.4	2.5	2.8	3.2	3.3
Private credit	15.6	16.2	18.7	19.1	22.0	22.9	25.8	26.7	29.1
Other items, net	-4.0	-4.6	-5.4	-6.0	-5.5	-4.4	-4.1	-4.0	-5.4
Broad money (M3)	13.3	13.3	16.1	15.6	18.4	18.1	20.9	20.6	23.5
(Broad money, percent change year on year)	19.2	13.3	20.4	16.6	14.8	16.4	13.6	13.8	12.2
Lari Broad money (M2)	5.7	6.0	6.5	6.9	8.4	8.6	9.8	10.2	11.5
Currency held by the public	2.0	2.0	2.4	2.3	2.7	2.5	3.1	2.9	3.4
Lari resident deposits	3.8	4.0	4.1	4.6	5.7	6.1	6.7	7.3	8.1
Resident foreign exchange deposits	7.6	7.3	9.6	8.6	10.0	9.5	11.1	10.4	12.0
Sources of funds of commercial banks	18.7	19.0	21.7	21.3	25.9	27.3	31.0	31.1	33.7
Resident deposits	11.4	11.3	13.7	13.2	15.7	15.6	17.8	17.7	20.1
Non-resident deposits	3.1	3.1	3.5	3.6	3.8	3.8	4.1	4.2	4.2
Other foreign liabilities	4.2	4.6	4.5	4.5	6.3	8.0	9.1	9.2	9.4
Uses of funds of commercial banks	18.7	19.0	21.7	21.3	25.9	27.3	31.0	31.1	33.7
Reserves	4.9	4.8	6.3	6.2	6.9	6.6	7.3	7.1	7.5
Domestic credit	16.7	17.2	20.1	20.6	23.4	23.9	26.7	27.9	30.4
Lari domestic credit	6.9	6.8	8.0	9.7	11.0	11.5	12.9	13.9	15.5
Fx domestic credit	9.9	10.4	12.1	11.0	12.3	12.3	13.9	14.0	14.9
Other foreign assets	0.6	0.5	0.4	0.4	0.5	0.5	0.6	0.6	0.6
Other items, net	-3.0	-3.1	-4.7	-5.5	-4.4	-3.1	-3.1	-3.9	-4.2
Memorandum items:	(Percent of GDP, unless otherwise indicated)								
Broad money (M3)	42.0	40.6	47.2	43.2	48.4	45.5	50.3	47.6	52.2
Lari Broad money (M2)	18.1	18.4	19.1	19.2	22.1	21.6	23.7	23.5	25.6
Currency held by the public	6.2	6.1	7.0	6.5	7.1	6.3	7.5	6.6	7.6
Non-resident deposits (percent of total deposits)	17.1	16.2	16.6	17.7	16.6	16.5	15.4	15.6	14.4
Private credit (Percent change, year on year)	22.1	11.5	19.6	18.5	17.6	19.8	17.6	16.2	12.6
Private credit	49.2	49.1	54.9	53.1	57.8	57.6	62.1	61.5	64.6
Nominal GDP (billions of lari)	31.8	32.9	34.0	36.0	38.0	39.8	41.6	43.3	45.0

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

Table 5. Georgia: Selected Monetary and Financial Soundness Indicators, 2015–August 2018

	2015	2016	2017	Aug 2018
Deposit dollarization (residents, in percent)	66.8	69.9	63.7	63.3
Loan-to-deposit ratio (in percent) 1/	103.9	103.6	107.0	107.6
Credit-to-GDP ratio (in percent)	49.2	54.9	57.8	59.3
Capital adequacy ratio (in percent) 2/	17.5	15.0	15.2	18.1
Capital adequacy ratio (in percent) 3/	26.0	23.2	22.5	…
Liquidity ratio (in percent) 4/	41.2	39.7	37.8	38.9
Nonperforming loans (in percent of total loans) 5/	7.5	7.3	6.0	5.7
Nonperforming loans (in percent of total loans) 6/	2.7	3.5	2.8	2.7
Loans collateralized by real estate (in percent of total loans)	54.8	59.2	59.0	61.0
Loans in foreign exchange (in percent of total loans)	64.3	65.4	57.1	55.7
Specific provisions (in percent of total loans)	3.7	3.6	2.8	2.8
Net foreign assets (in percent of total assets)	-13.1	-15.0	-14.9	-16.3
Net open foreign exchange position (in percent of regulatory capital)	-0.6	4.4	4.2	3.9
Return on equity (cumulative through the year, annualized) 7/	15.4	19.2	20.7	18.4
Borrowed funds from abroad-to-GDP ratio 8/	14.1	15.3	16.5	15.9

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 2011.
3/ Basel I definition. This ratio has discontinued end of 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, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Actual		Prel.	Projections					
Value of exports of goods and services, percent change	-13.1	1.0	22.2	17.8	8.1	8.1	8.2	7.8	4.9
Value of imports of goods and services, percent change	-13.6	-2.0	10.1	16.3	7.6	7.6	7.0	7.6	5.0
Terms of trade (deterioration -)	30.6	-1.2	-2.7	-4.9	-0.9	0.6	0.7	1.1	1.1
Current account balance (percent of GDP)	-12.6	-13.1	-8.8	-9.0	-9.5	-9.3	-8.7	-8.4	-7.9
Capital and financial account (percent of GDP)	11.6	13.9	9.6	9.8	10.8	10.9	10.5	10.2	9.5
External public debt (percent of GDP)	32.8	33.4	36.1	35.2	36.9	36.0	35.3	34.6	33.5
(in percent of exports of goods and services)	74.4	77.0	71.8	64.7	65.5	65.0	64.4	63.6	63.3
Debt service on external public debt									
(in percent of exports of goods and services)	4.4	3.9	3.7	4.4	4.6	4.3	4.2	4.4	3.9
External debt (percent of GDP)[1]	86.1	91.8	95.9	91.5	95.0	93.2	92.7	93.2	90.8
(in percent of exports of goods and services)	195.4	212.0	191.1	168.4	168.6	168.3	169.2	171.1	171.4
Debt service on MLT external debt									
(in percent of exports of goods and services)	21.9	20.9	21.7	18.3	17.2	16.3	16.0	16.1	14.7
Gross international reserves									
in millions of USD	2,521	2,756	3,039	3,238	3,487	3,821	4,198	4,571	4,923
in months of next year's imports of goods and services	3.5	3.5	3.3	3.3	3.3	3.4	3.5	3.6	3.8
in percent of external debt	20.9	20.9	20.9	21.5	21.4	21.7	21.9	21.9	22.4
in percent of short-term external debt (remaining maturity)	75	69	73	79	83	84	86	88	88

Source: Fund staff estimates and projections.

[1] Excluding intercompany loans.

Table 7. Georgia: Gross External Requirement, 2017–23
(Millions of U.S. Dollars)

	2017	2018	2019	2020	2021	2022	2023
	Actual	Projections					
Total financing requirement	3,216	2,734	2,980	3,145	3,305	3,564	3,634
Current account deficit	1,334	1,488	1,636	1,763	1,794	1,892	1,918
Medium and long-term debt	1,222	1,083	1,111	1,163	1,230	1,305	1,307
Private	1,057	865	840	850	890	953	975
Banks	341	453	297	284	306	352	366
Corporates	716	412	543	566	584	602	609
Public	165	218	271	313	340	352	332
Others (net)	660	163	233	219	281	367	410
Total financing sources	3,224	2,721	3,051	3,388	3,685	3,955	4,018
Capital transfers	109	82	80	78	77	75	74
Direct investment, net	1,625	1,222	1,359	1,634	1,792	1,997	2,097
Medium and long-term debt	1,463	1,477	1,597	1,658	1,798	1,864	1,826
Private	1,060	1,163	1,017	1,038	1,005	1,082	1,124
Banks	536	760	434	428	418	453	489
Corporates	524	403	583	610	586	629	635
Public (only project loans)	404	314	580	620	793	781	701
Short-term debt (net)	27	-60	15	17	18	19	21
Increase in gross reserves	242	199	249	334	376	374	352
Rescheduled debt and arrears clearance	-124	-38	0	0	0	0	1
Errors and omissions	-76	0	0	0	0	0	0
Total financing needs	186	174	177	91	-3	-17	-32
Official financing	192	174	177	91	-4	-18	-32
IMF	71	28	35	43	-4	-18	-32
Prospective purchases	84	85	84	43	0	0	0
Repurchases	-13	-57	-49	0	-4	-18	-32
Official creditors	121	146	142	48	0	0	0
World Bank	106	0	0	0	0	0	0
EU	15	17	23	0	0	0	0
Others	0	129	119	48	0	0	0
Memorandum items:							
Gross international reserves	3,039	3,238	3,487	3,821	4,198	4,571	4,923
in months of next year GNFS imports	3	3	3	3	3	4	4
in percent of short-term debt at remaining maturity	73	79	83	84	86	88	88
in percent of IMF Composite measure (floating)	90	92	96	100	105	110	114
EFF in percent of total official financing	37	16	20	47	…	…	…

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

Table 8. Georgia: Indicators of Fund Credit, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Actual			Projections					
Existing Fund credit									
Disbursements (EFF)	0.0	0.0	60.0	30.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	94.0	84.2	135.0	125.0	90.0	90.0	87.5	75.0	60.0
SBA and EFF	80.0	80.0	135.0	125.0	90.0	90.0	87.5	75.0	60.0
Obligations	53.2	10.7	10.9	41.8	37.4	1.9	4.3	14.2	16.5
SBA and EFF	37.8	0.8	6.7	41.8	37.4	1.9	4.3	14.2	16.5
Principal (repurchases)	36.8	0.0	5.0	40.0	35.0	0.0	2.5	12.5	15.0
Interest charges	1.0	0.8	1.7	1.8	2.4	1.9	1.8	1.7	1.5
Prospective purchases									
Disbursements	0.0	0.0	0.0	30.0	60.0	30.4	0.0	0.0	0.0
Stock 1/	0.0	0.0	0.0	30.0	90.0	120.4	120.4	120.4	112.9
Obligations 2/	0.0	0.0	0.2	0.2	1.2	2.3	2.4	2.4	9.9
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.5
Interest charges	0.0	0.0	0.2	0.2	1.2	2.3	2.4	2.4	2.4
Stock of existing and prospective Fund credit 1/	94.0	84.2	135.0	155.0	180.0	210.4	207.9	195.4	172.9
In percent of quota 3/	62.5	40.0	64.2	73.7	85.6	100.0	98.8	92.9	82.2
In percent of GDP	0.9	0.8	1.2	1.3	1.5	1.6	1.4	1.2	1.0
In percent of exports of goods and nonfactor services	2.1	1.9	2.5	2.5	2.6	2.8	2.6	2.3	1.9
In percent of gross reserves	5.2	4.2	6.2	6.8	7.3	7.8	7.0	6.0	5.0
In percent of public external debt	2.9	2.4	3.4	3.8	4.0	4.4	4.0	3.5	3.0
Obligations to the Fund from existing and prospective Fund credit	53.2	10.7	11.0	41.9	38.6	4.2	6.7	16.6	26.4
In percent of quota	35.4	5.1	5.2	19.9	18.3	2.0	3.2	7.9	12.5
In percent of GDP	0.5	0.1	0.1	0.4	0.3	0.0	0.0	0.1	0.2
In percent of exports of goods and nonfactor services	1.2	0.2	0.2	0.7	0.6	0.1	0.1	0.2	0.3
In percent of gross reserves	3.0	0.5	0.5	1.8	1.6	0.2	0.2	0.5	0.8
In percent of public external debt service	27.5	6.1	5.4	15.2	12.2	1.3	2.0	4.4	7.5

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, 2014–23

(In percent of GDP; unless otherwise indicated)

	Actual						Projections						
	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	65.1	86.1	91.8	95.9			**91.5**	**95.0**	**93.2**	**92.7**	**93.2**	**90.8**	**-5.2**
Change in external debt	-0.6	21.0	5.8	4.1			-4.4	3.5	-1.8	-0.6	0.6	-2.4	
Identified external debt-creating flows (4+8+9)	1.0	14.7	2.5	-6.4			-2.3	-2.2	-3.8	-4.4	-5.2	-5.1	
Current account deficit, excluding interest payments	7.5	7.5	8.1	4.2			5.0	5.3	4.9	4.5	3.9	4.6	
Deficit in balance of goods and services	18.1	17.7	16.0	11.8			11.9	12.1	11.6	10.7	10.5	10.3	
Exports	42.9	44.5	43.3	50.2			54.4	56.4	55.4	54.8	54.5	53.0	
Imports	61.0	62.2	59.3	62.0			66.3	68.5	67.0	65.5	65.0	63.3	
Net non-debt creating capital inflows (negative)	-8.3	-9.0	-8.0	-10.4			-7.3	-7.9	-8.6	-8.7	-8.9	-8.7	
Automatic debt dynamics 1/	1.8	16.3	2.4	-0.3			0.0	0.4	0.0	-0.2	-0.2	-1.0	
Contribution from nominal interest rate	3.2	4.5	4.7	4.5			4.4	4.4	4.3	4.2	4.2	3.5	
Contribution from real GDP growth	-3.0	-2.2	-2.4	-4.3			-4.4	-4.0	-4.3	-4.4	-4.5	-4.5	
Contribution from price and exchange rate changes 2/	1.5	13.9	0.1	-0.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-1.5	6.3	3.2	10.6			-2.1	5.7	2.0	3.9	5.8	2.6	
External debt-to-exports ratio (in percent)	151.6	193.3	212.0	191.1			168.4	168.6	168.3	169.2	171.1	171.4	
Gross external financing need (in billions of US dollars) 4/	4.9	4.7	5.3	5.4			5.8	5.9	6.0	6.4	6.8	7.2	
in percent of GDP	29.4	33.5	36.7	35.5	10-Year	10-Year	35.3	34.1	31.9	31.0	30.3	29.8	
Scenario with key variables at their historical averages 5/							**91.5**	**98.4**	**106.6**	**116.5**	**127.8**	**135.3**	**-6.5**
Key Macroeconomic Assumptions Underlying Baseline					Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.6	2.9	2.8	5.0	3.7	3.1	5.0	4.6	5.0	5.2	5.2	5.2	
GDP deflator in US dollars (change in percent)	-2.2	-17.6	-0.1	0.4	1.0	11.8	3.5	-0.4	4.8	4.0	3.0	2.6	
Nominal external interest rate (in percent)	5.1	5.9	5.6	5.1	5.4	0.7	5.0	5.0	5.0	4.9	4.9	4.0	
Growth of exports (US dollar terms, in percent)	-1.6	-12.1	-0.1	22.2	10.2	15.7	17.8	8.1	8.1	8.2	7.8	4.9	
Growth of imports (US dollar terms, in percent)	8.4	-13.5	-2.0	10.1	6.3	18.2	16.3	7.6	7.6	7.0	7.6	5.0	
Current account balance, excluding interest payments	-7.5	-7.5	-8.1	-4.2	-8.4	4.5	-5.0	-5.3	-4.9	-4.5	-3.9	-4.6	
Net non-debt creating capital inflows	8.3	9.0	8.0	10.4	7.4	2.4	7.3	7.9	8.6	8.7	8.9	8.7	

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 Global imbalances and fraying consensus about the benefits of globalization lead to escalating and sustained trade actions and spreading isolationism. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. In the short term, increased uncertainty about growth triggered by escalating trade tensions leads to increased financial market volatility. Negative consequences for growth are, in turn, exacerbated by adverse changes in market sentiment and investment.	**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 fiscal sustainability and financial stability to weather external shocks from a stronger position.
Sharp tightening of global financial conditions causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. Tighter financial conditions could be triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks.	**High** **Short Term**	**Medium** Higher lari volatility and depreciating pressures could generate negative balance-sheet effects and negatively affect 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 against a background of large external financing requirements.	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.
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.

[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.

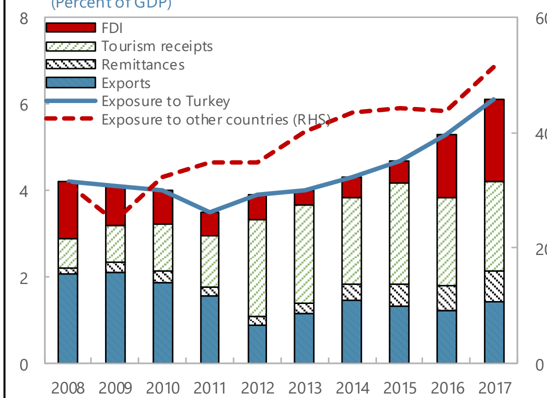
Source of Risks	Relative Likelihood/Time Horizon	Expected Impact on the Economy if Risks Materialize	Policy Response
Weaker-than-expected global growth • **Euro Area:** Progress on fiscal adjustment, on addressing legacy banking-sector problems, and on other structural reforms slows or reverses, raising debt sustainability concerns, steadily pushing up borrowing costs, and undermining medium-term growth prospects. • **U.S.:** As capacity constraints become more binding and the economy pushes further through full employment, the risks of a sharper-than-expected slowdown increase. • **China:** Disorderly deleveraging adversely affects near-term growth (low likelihood). In the medium term, insufficient progress in deleveraging and rebalancing reduces growth, with additional credit stimulus postponing the slowdown, but making it sharper (medium likelihood).	**Medium** **Medium Term** **Medium** **Medium Term** **Low/Medium** **Short to Medium Term**	**Medium** Weaker global demand, including in other emerging economies, and potential slowdown to Georgia's main trading partners' growth would risk the envisaged economic recovery. Lower economic growth could reduce the buying-in on much-needed structural reforms for economic diversification and more inclusive e growth.	A flexible exchange rate should serve as a first line of defense. Accelerate structural reforms, including on education, to enhance confidence and improve competitiveness. Strengthen fiscal sustainability and financial stability to weather external shocks from a stronger policy position. Strengthen social safety nets to protect the most vulnerable segments of the population.
Georgia-Specific Risks			
Risks from tighter macroprudential regulation. The introduction of new income-based limits on PTIs and LTVs may have a higher than expected impact on credit and GDP growth.	**High**	**Medium**	The impact of macroprudential regulations should be closely monitored and NBG should be ready to adjust PTIs and LTVs to strike the right balance between managing household balance sheet risks and preventing over-indebtedness, while avoiding excessive tightening of financial conditions.
Financial risks. Reduced financial buffers, especially for unhedged borrowers, will limit the capacity to absorb further shocks. Risks could stem from the non-banking sector.	**Medium**	**Medium**	
Fiscal risks • Materialization of contingent liabilities/fiscal risks could deteriorate public debt dynamics. • Delays in loan disbursements and/or associated delays in the implementation of infrastructure projects could weigh on growth.	**Medium**	**High**	Use the flexible exchange rate as a first line of defense. Accelerate implementation of structural reforms to improve confidence and competitiveness. Strengthen fiscal sustainability and institutions and enhance financial stability to weather shocks from a stronger position.
Political risks. Political backlash or/and reform fatigue could undermine efforts to undertake structural reforms.	**Low**	**Medium**	

Annex II. Spillovers from the Deterioration in the Turkish Economy

Although Georgia's exposure to Turkey through trade, remittances, tourism and FDI flows is sizable, the negative spillovers from the deterioration in Turkey's economy have been moderate so far and are expected to be limited in the near term. The lari has depreciated against the dollar, in line with previous years and other emerging market currencies but remained broadly stable in nominal and real effective terms. Furthermore, Turkey's turbulence is expected to have a limited effect on Georgia's current account inflows.

1. **Georgia has a sizable exposure to Turkey through trade, tourism, and FDI inflows, whereas financial linkages remain limited. In 2017,** Turkey was the largest trading partner of Georgia in terms on imports (9 percent of GDP), and the 3rd largest destination of Georgian exports (1.4 percent of GDP). Georgia's trade deficit with Turkey averaged 7.8 percent of GDP over 2015–17. In 2017, imports from Turkey represented 9 percent of GDP, while Georgia's exports of goods to Turkey represented 1.4 percent of GDP. In the same year, tourism receipts from Turkey reached 2.1 percent of GDP (16.5 percent of total arrivals), and FDI from Turkey accounted for 1.8 percent of GDP. At the same time, remittances from Turkey represented only 0.7 percent of GDP. Financial linkages are limited; two Turkish banks subsidiaries operate in Georgia, representing only 1.07 percent of Georgia banking sector assets as of June 2018.[1]

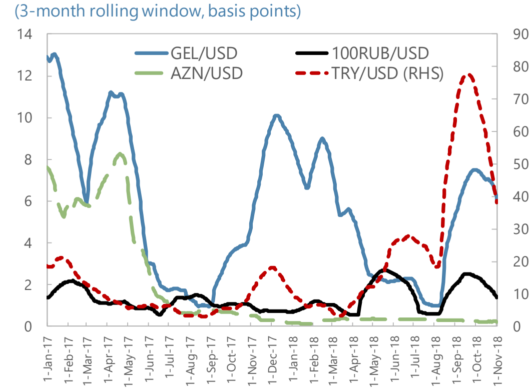
Georgia: Exposure to Turkey via exports, remittance, FDI and tourism
(Percent of GDP)



Source: NBG, GeoStat, GNTA, and IMF staff calculations.

2. **Volatility in the Turkish lira (TYR) has not significantly affected the lari.** The lari tends to appreciate during the spring/summer—supported by booming tourism—and depreciates in the last quarter of the year, as seasonal imports (including energy imports) increase and budget execution accelerates. Accordingly, in 2018, the lari appreciated in the first half of the year, and started depreciating by August, with an increase in volatility in line with previous years, and comparable to developments observed with the ruble. In September 2018, the lira has depreciated by 43 and 31 percent in nominal and real effective terms, respectively, although high inflation in Turkey is expected to contain the real depreciation of the Lira against the

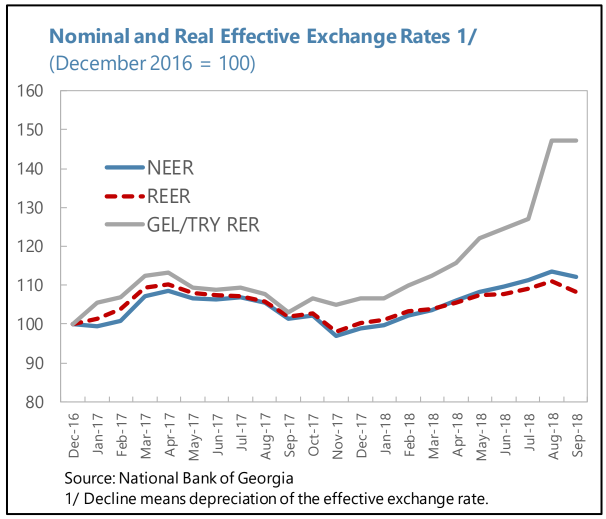
Georgia: Nominal Bilateral Exchange Rate Volality
(3-month rolling window, basis points)



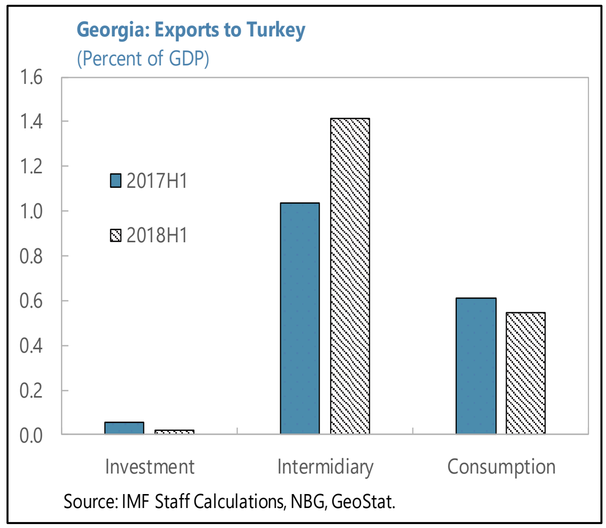
Source: IMF Staff Calculations, NBG, GeoStat.

[1] Isbank and Ziraat Bank are the two Turkish banks providing corporate and retail banking services in Georgia.

real depreciation of the Lira against the Lari.[2] The lari has cumulatively against the Lari. The lari has cumulatively appreciated in real effective terms against the TYR by about 38 percent over January-September 2018, while at the same time, Georgia's REER increased 8 percent, cumulative over January-September 2018).



3. Turkey's turbulence is projected to have a limited effect on Georgia's current account in 2018. The exchange rate elasticity of trade flows has declined due to the increasing importance of intermediary goods in good trade. Accordingly, Georgian exports to Turkey–which consists of textile products from Turkish companies (31 percent) unlikely to relocate and metal products and Ferro alloys (39 percent)—is expected to be little affected in the near term. The weaker TRY is likely to trigger Turkish imports (now less expensive) to substitute imports from other countries, somewhat compensating the income effect. Furthermore, given the large share of capital and intermediate goods in total imports from Turkey (61 percent of imports from Turkey in 2018H1), the depreciation of the Turkish Lira could act as a positive supply side shock, somehow mitigated by the negative effect of lower competitiveness on domestic production (especially of consumption goods). Reduced tourism to Georgia—driven by TYR depreciation and slower economic activity in Turkey—is expected to be compensated by sustained growth in tourism receipts from other countries.



4. A protracted depreciation of the lira would have a moderate effect on Georgia, which could be offset by positive developments Azerbaijan and Russia. A prolonged lira depreciation could lead to the relocation of Turkish companies operating in Georgia, notably in the textile sector. However, in the near term, the demand for Georgian inputs (raw and intermediate material) by Turkish domestic producers is expected to remain high, given the global value-chain effect. Prolonged lira depreciation and high inflation in Turkey would limit remittances from Turkey. In the near and medium term, the lira depreciation would curb the financial capacity and risk appetite of Turkish investors in Georgia, affecting new FDI investments inflows. The continued recovery in Russia and Azerbaijan from higher oil price would help balance those risks.

[2] The inflation differential between Turkey and Georgia stood at 15 percent and 22 percent in August and September 2018, compared with 6 percent in January 2018.

Appendix I. Letter of Intent

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

Tbilisi, December 4, 2018

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 May 30, 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 (including at the municipality level), strengthening governance, supporting SMEs, facilitating entrepreneurship, and integrating further Georgia into the global economy. We remain committed to scaling-up our public investment to address structural bottlenecks in the economy and support inclusive growth. 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. **Strong and sustained economic performance will allow us to resolutely implement our reform program.** Preliminary estimates indicate that through September, economic growth averaged 4.9 percent (y/y) while inflation has remained close to our 3-percent inflation target. Robust growth of exports, remittances and tourism, have helped contain the current account deficit to 8.9 percent of GDP in 2018Q2, despite strong import growth fueled by domestic demand and higher commodity prices. A relatively supportive external environment has helped us purchase USD132.5 million in foreign exchange (FX) reserves so far in 2018. Higher-than-expected revenues, contained current spending, and delays in large capital infrastructure projects have resulted in a fiscal surplus through September. We are committed to address the delays in public investment encountered this year.

3. **We have hitherto met most of the conditionality under our IMF-supported program**. We have met all end-June quantitative performance criteria (QPCs), and inflation has remained within the inflation consultation clause (ICC). Most structural benchmarks (SBs) have been met for the third review; the creation of the pension agency, however, was implemented with a 2-week delay.

4. **We request the completion of the Third 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 a further SDR 30 million from the IMF, bringing

our drawings under this program to SDR 120 million. Our program will continue to be monitored through Quantitative Performance Criteria (QPCs), indicative targets, and an Inflation Consultation Clause (ICC), 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 Fourth Review will be based on end-December 2018 performance criteria and is expected to be completed on or after April 12, 2019. The Fifth Review will be based on end-June 2019 performance criteria and is expected to take place on or after October 25, 2019.

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/
Giorgi Kobulia
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. Georgia's economic growth has benefitted from our prudent policies and robust growth in our main trading partners. Through September, our economy has shown momentum, with growth averaging 4.9 percent, slightly higher than assumed in the 2018 Budget. Our current account balance has strengthened considerably in 2017-18 due to vigorous growth in exports, tourism receipts and remittances. Inflation has remained close to the central bank's inflation target in 2018. We surpassed the end-June NIR program target with some margin. The improved confidence in the Georgian economy and our larization measures have put dollarization on a downward trend. Continued reform implementation also resulted in Georgia ranking 6th in the 2019 World Bank's Doing Business Report and 5th in the 2017 International Budget Partnership's Open Budget Survey. Our credit rating has also improved, and we will strive to reach investment grade status by continuing to implement prudent macroeconomic policies.

3. We are maintaining prudent macroeconomic assumptions for our 2019 Budget and IMF-supported program.

a) We expect robust growth to continue in 2018 supported by domestic demand. For 2019, we forecast GDP growth of 4.6 percent and will remain vigilant about regional developments which could negatively impact our economy. Over the medium term, growth is expected to gradually increase due to the steadfast implementation of our structural reforms and continued growth in our main trading partners.

b) Strong revenue performance and robust growth will generate additional fiscal space. This will allow us to accelerate infrastructure spending, undertake education reform, and address pressing social needs while maintaining medium-term fiscal sustainability (see below).

c) The current account is expected to marginally deteriorate in 2018-19 owing to rising global fuel prices and strong domestic demand. The current account deficit is projected at 9.0 percent of GDP in 2018 and 9.5 percent in 2019, and is expected to gradually decline to 8 percent of GDP over the medium term. External financing requirements are projected to gradually decline over the medium term. While external financing will continue to rely mostly on FDI, its share is expected to decline slightly over time, to be replaced by debt. A strong external position and FX interventions will help us reach an adequate level of the reserves by 2020.

4. Our reform agenda will help bolster inclusive growth and external competitiveness. We will create new business opportunities and support economic diversification by: (i) reforming our education system; (ii) improving the business environment (establishing commercial chambers, improving revenue administration, updating our insolvency laws and commercial arbitration); and (iii) strengthening Georgia's connectivity, by scaling-up public infrastructure to facilitate uninterrupted passenger and cargo transportation, and deepening our trade relations with the rest of the world. These are a few of the ambitious structural reforms to be implemented by Georgia to help mobilize FDI in tradable sectors, improve competitiveness, and reduce external vulnerabilities.

5. While robust economic growth is expected to continue, downside risks to the outlook have increased. Downside risks are mainly related to regional developments, emerging market volatility, retreat from cross-border integration, and weaker global growth. Our structural reform agenda will mitigate medium-term risks associated with Georgia's high external debt, current account deficit and financial dollarization. In the meantime, our first line of defense against external risks is our commitment to exchange rate flexibility, sound macroeconomic policies to rebuild buffers and financial policies. Delays in infrastructure projects could lead to an unduly contractionary fiscal impulse. Georgia's IMF-supported program provides an additional anchor to help us cope with negative shocks. Upside risks stem from stronger domestic and external demand. Materialization of these risks leading to an overheating of the economy may require tightening macro policies.

Economic Policies

A. Fiscal Policy

6. Significant fiscal overperformance was recorded during January-September 2018. Through June, the augmented fiscal balance (TMU definition) recorded a surplus of GEL278 million, compared to an adjusted deficit ceiling of GEL269 million under the program. This mostly reflected strong revenue collection (due to robust economic growth) and delays in public investment projects. Continued fiscal overperformance through September led to a surplus of GEL392 million. We are working with the International Financial Institutions (IFIs) to reduce the risk of further project delays in the future.

7. We will maintain fiscal prudence.

a) We remain committed to keep the end-December 2018 augmented deficit below the program ceiling of GEL1,150 million (2.8 percent of GDP). Given delays in project implementation and to avoid an excessive contraction, we have accelerated spending on investment projects.

b) For 2019, we are committed to an augmented deficit of GEL1,170 million (2.6 percent of GDP), with measures to be announced by mid-December 2018. We commit to achieving an augmented deficit of no more than GEL250 million by end-June 2019 (performance criterion). We will continue containing current primary spending (indicative target), although spending pressures are arising from pension reform and additional social spending. In particular, we will provide financial incentives to improve the quality of teachers, increase wages for well-qualified teachers and our targeted social assistance to address child poverty, and include incentives for a more gradual withdrawal of assistance that encourages beneficiaries to participate in the labor market. Stronger-than-programmed adjustment to current spending has created room for these permanent spending increases. Even so, to make some additional fiscal space, we are committed to take revenue measures yielding GEL150 million in 2019, of which about a third would be in permanent revenues. Moreover, we will continue to accelerate capital spending in 2019-20, but at a more moderate rate than envisaged at the time of the Second Review under the EFF.

c) Our basic public pension, which amounts to GEL180 per month, is marginally higher than the subsistence minimum. Hence, we will increase the basic monthly pension to GEL200 and GEL220 per month in 2019 and 2020, respectively. In consultation with the IMF, we will submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (structural benchmark, end-February 2019).

d) We aim to refund GEL400 million in value-added tax (VAT) credits in 2018, and GEL250 million in the first half of 2019. We will put additional efforts to increase VAT refunds above these levels; those additional refunds, should they materialize, will be accommodated under the program through an adjustor (see Technical Memorandum of Understanding (TMU), ¶14).

e) 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.

8. 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 medium-term fiscal consolidation and remain proactive in addressing fiscal pressures that could emerge. In coordination with donors, we are finalizing the design of a comprehensive education reform (see ¶29). While the budgetary effect of Public-Private Partnerships (PPPs) and Purchasing Power Agreements (PPAs) is intrinsically uncertain, some contingent liabilities stemming from PPPs/PPAs have a greater likelihood of materializing. The immediate effect of such risk events would mostly be felt by public enterprises, but any cost would eventually be passed on to the budget through lower dividends, delayed debt service payments, or a need for capital injections. 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 in the medium to long term, will prudently consider the need for additional fiscal measures to build precautionary buffers.

9. We remain committed to medium-term fiscal sustainability while undertaking our reforms. We will continue to create additional fiscal room for investment in both infrastructure and education. To achieve this, we will improve the efficiency of the public administration including through (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and (iv) improving performance-based budgeting. To support the vulnerable population, the existing social safety net will be strengthened, and the basic public pension will be increased (see below). In addition, we do not plan to extend the dividend distribution model of corporate income taxation to financial institutions until 2023, to avoid the resulting revenue loss (up to 0.5 percent of GDP) in the near term. However, in consultation with the IMF, we will 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, including on the revenue side.

10. We aim to reduce 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 continue to pursue only commercial objectives (providing minority equity or loan co-financing), 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-December 2018 and end-June 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-December 2018 and end-June 2019 (performance criterion).

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 the operationalization of 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) Consistent with our program commitments, we conducted a fiscal risks analysis for the Namakhvani HPP Cascade Project and the Koromkheti HPP PPAs, which are outside of the terms mentioned above (since then, we decided not to pursue the Koromkheti project). The risk assessment updated the analysis of gross exposure of all signed PPA projects and these two large projects; and analyzed the net risk exposure with different demand, price and exchange rate assumptions. The risk assessment also described and quantified other risk-sharing contractual obligations (including, for instance, termination risk or construction risk). Negotiations of the memorandum of understanding (MoU) associated with the Namakhvani HPP Cascade Project (planned capacity of MW433) are ongoing.

f) We are proposing to create a credit guarantee scheme (CGS) to support SMEs' access to finance. The CGS will be based on best international practices to limit fiscal risks. In particular, the CGS would be limited in size, targeted, easy to dismantle, transparently incorporated in the budget, and use market-based principles for its operations. The specific characteristic of the CGS, including its size, will be determined in consultation with the IMF and other international partners. Plans for establishing an 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 will undertake fiscal decentralization to achieve greater government efficiency. Starting with the 2019 budget, local governments will keep 19 percent of all VAT proceeds. Concomitantly, the claw back clause requiring local governments to surrender additional revenues will be abolished, as it discouraged local governments to collect their own revenues. Efforts to build capacity at the local governments will be necessary to support adequate spending.

12. 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 Services (GRS) headquarter was restructured into a function-based organization to modernize tax administration, with logical groupings of core functions – such as taxpayer service, returns filing and payment, audit, appeals, arrears management, policy and interpretations, and compliance management. We will continue building capacity of the GRS by adequately staffing the new HQ departments in line with international best practices and by empowering HQ to direct field operations. To this effect, we assigned deputy directors general their responsibilities in December 2018.

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 of those VAT credits that are within the limitation period for audit. To achieve this, we established a steering committee with representatives from the MoF, Georgia Revenue Service (GRS), and GTS that proposed in May 2018 the necessary legal amendments or ministerial decrees to facilitate implementing the 2017 action plan. 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. A new specialized VAT unit in the GRS audit department was created (structural benchmark, end-June 2018) to review VAT declarations and to audit or take other compliance action where necessary.

ii. Automatic risk assessment and risk-based auditing. All new VAT declarations will be risk-assessed under the automated system starting January 2019. We improved our automatic risk-assessment system to check all VAT declarations and will have a fully automated system by end-2018. Under this system, those 90 percent of new declarations with the lowest risk score will not be subject to further manual review by GRS 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 the appropriate compliance action.

iii. Automatic refunding of new VAT credits. From January 2020, to further automate the refund system, 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.** We received IMF TA on enhancing compliance risk analysis and improving data management for new risk models. We are committed to increase audit capacity, efficiency, and impact on compliance. 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 July 2019. Once implemented, this will enhance audit timeliness and productivity, and 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. By end-2018,we will submit to Parliament legal amendments so that an unfiled declaration is no longer deemed to be a nil declaration where the MoF requires a declaration. We have set up and staffed a unit that deals with filing default and late filing for all revenue types.

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 prevent 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 by better utilizing the information already received from taxpayers.

f) **Penalty regime**. The requirement for taxpayers to request a refund and their reluctance to do so has been a major bottleneck to reducing the outstanding stock of tax credits. To create a more effective and fair system and to remove a main deterrent preventing tax payers from requesting a tax credit refund, we committed to submitting to Parliament a more gradual penalty regime based on culpability (structural benchmark, end-December 2018). However, following FAD TA, we are of the view that additional work is needed to carefully calibrate the degree of discretion given to auditors in assessing culpability. We will continue working towards a penalty regime that reflects the degree of culpability and develop guidelines for assessing culpability. In the meantime, to avoid delays in the program objective of reducing the stock of outstanding VAT credits, we request reformulating the structural benchmark to (i) revising the penalty regime by incorporating materiality (i.e., the penalty will depend on the difference between the tax paid and the GRS assessment of what should have been paid) and (ii) approve changes to the tax code granting the GRS powers to pay out refunds without the need for a refund request (new structural benchmark, end-December 2018). These actions will help accelerate VAT refunds in 2019 and prevent a build-up of new VAT credits.

g) Automatic access to third-party information. Risk analysis relies on data to improve the effectiveness of a tax administration, allowing the targeting of resources towards areas of greater non-compliance. GRS has little direct access to risk-relevant databases held in other government agencies despite no legal impediment to gaining access to such data. Recently, MoF has requested from other ministries and agencies access to their databases for tax administration purposes. The GRS will be provided with 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, and on the Joint Stock Companies (JSC) partners and changes in company equity (tentatively by end-2018); (ii) municipalities, information on construction permits; and (iii) the Financial Monitoring Service (FMS) on suspicious transactions as defined in the law on facilitating the prevention of illicit income legislation. To this end, we will 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 (new structural benchmark, end-May 2019).

13. We are committed to contain fiscal risks to safeguard fiscal sustainability. We understand the importance of properly managing fiscal risks as an intrinsic part of prudent fiscal policy. 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 and PPAs can play a pivotal role in Georgia's development by attracting investment, including FDI. In this vein, improvements in the relevant legislation are required to reap the benefits of further PPPs and PPAs. Hence, we are committed to:

a) Adopt a new PPP law and associated regulations. Parliament approved a PPP law that includes sound elements following best international practices, 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 (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 within the first half of 2019.

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

i. Building on the progress made in the 2018 FRS, the 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs (structural benchmark, end-December 2018). For PPPs and PPAs, the 2019 FRS will disclose: (i) in addition to the NPV, the expected nominal cost per year for the lifespan of these projects, (ii) the expected nominal cost of the riskiest top 3/5/10 projects, by year, for the period of the agreements, and their NPVs; and (iii) the total nominal net payments for the base case and alternative scenarios, and their NPVs. In consultation with the IMF, the 2019 FRS will also include financial baseline projections and sensitivity analysis for major SOEs (largest 7 SOEs), covering the year of the FRS and the year after, which will be used as the basis for prospective sensitivity analysis.

ii. For the MoF fiscal risks management unit, we commit to recruit additional staff by mid-2019 with practical corporate finance experience and to intensify the training of its existing staff in corporate finance.

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 comprehensive 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 GFSM 2014 (new 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 (new structural benchmark, end-November 2019).

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 developed a comprehensive action plan to address these weaknesses. We will strengthen 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 to strengthen further our PIMF by strengthening the public investment management methodology that guides project appraisal, selection and management and implement reporting and oversight requirements for public investment projects at the MoF (new structural benchmark, end-December 2019). By enhancing the monitoring of the project cycle, these measures would also help identify project implementation delays early in the process.

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

a) **Improve our fiscal rule to safeguard fiscal sustainability.** With IMF support, we reviewed our fiscal framework to support our medium-term fiscal sustainability while also granting flexibility in formulating fiscal policy over the economic cycle. We submitted to parliament a revised fiscal framework following IMF recommendations included in the TA report of November 2017 (structural benchmark, end-December 2018). 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 contingent liabilities from PPPs under the debt ceiling.

b) **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, revisions of expenditure plans and will explain any projected breach of expenditure ceilings under the 2019 MTBF.

c) **Follow the guidelines for new budget lending operations.** We adopted new guidelines governing budget lending operations (Dec. 2017) and prepared the 2019 State Budget applying the Government Fiscal Statistics (GFS) classification of equity injections and on-lending following the "reasonable commercial return test" -If the test is not met equity injections are treated as subsidies or capital transfers.

d) **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 GFSM 2014 standards. We will upgrade our public finances presentation from GFSM 2001 to GFSM 2014 classification in the context of the 2020 budget.

e) **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

15. 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.

16. 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 to external shocks. 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 interventions of $50 million in 2018H1 enabled us to accumulate more reserves than envisaged under the end-June program floor. We will step up efforts to accumulate international reserves given that GIR are still below an adequate level according to the IMF ARA metric. Starting in 2019, we will support reserve accumulation through a preannounced rule-based and transparent FX options, which would facilitate FX purchases without interfering with the floating exchange rate regime. We are committed to our end-December 2018 adjusted NIR performance criterion currently estimated at$1,403 million (down from $1,550 million at the time of the second review due to lower external disbursements), and $1,456 million by end-June 2019.

17. We will continue strengthening the monetary policy transmission mechanism. We strengthened lari liquidity management and have extended open market operations to outright purchases of treasury securities since May 2018. Strengthened NBG's liquidity management helps promote maturity transformation in the banking sector. The interbank interest rates remain close to the policy rate. We will submit legal amendments to Parliament by end-2018 to support derivatives and repo transactions in line with best international practices.

18. Monetary policy will be enhanced by improving our communication toolkit. We have requested IMF TA to strengthen our communication. We will continue publishing our quarterly monetary policy reports on a pre-announced schedule in par with associated meeting with experts. Every second monetary-policy meeting will also continue to be followed by a press conference. We will further strengthen our communication by issuing a manual for monetary policy operations in line with the IMF TA recommendations by March 2019.

D. Financial Sector Policy

19. Our policies will strengthen financial sector stability. As noted in previous MEFPs, we took significant steps to enhance our financial stability policy framework, regulation and supervision, including: (i) operationalizing macroprudential policy; (ii) strengthening capital requirements, including a countercyclical buffer and additional capital requirements for systematically important banks; (iii) allowing the NBG to supervise banking groups ; (iv) empowering the NBG to supervise and regulate micro-financial institutions, (v) improving consumer protection in financial operations; (vi) empowering the NBG to oversee credit bureaus; (vii) strengthening the operational framework of the Financial Stability Committee; (viii) introducing impairment guidelines and publishing macroeconomic forecasts and risk scenarios for IFRS 9 implementation; and (iv) establishing a deposit guarantee agency. This will support the banking sector's ability to cope with shocks and improve financial intermediation. We will further strengthen: (i) the supervisory and regulatory framework; (ii) the financial stability policy framework; and (iii) the safety nets and the bank resolution framework for crisis preparedness. 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) A roadmap to transition to IFRS regulatory reporting was approved in June 2018. Ultimately, NBG aims to transfer banks' regulatory reporting to IFRS framework through EU standards (FINREP/COREP forms).

b) In May 2018, we introduced a 25-percent limit of banks' regulatory capital for loans to households with no verifiable income to limit households' over-indebtedness. To support sustainable household 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 will enter into effect in January 2019.

c) The NBG and the State Insurance Supervision Agency are working together on developing a supervision framework for financial conglomerates. We drafted the law on supplementary supervision of financial conglomerates in accordance with the relevant EU directives. We plan to submit the law to Parliament by December 2018.

d) We introduced regulations on: (i) leverage ratios based on Basel principles and relevant EU regulations (structural benchmark, end-September 2018); (ii) credit information bureaus (with the support of WB TA) to set requirements and limits, issue guidelines and apply fines, protect consumers and limit business-continuity risks; (iii) bank's real estate appraisal of collateral in line with International Valuation Standards (structural benchmark, end-June 2018); and (iv) corporate governance in line with Basel principles (structural benchmark, end-September 2018). We will introduce regulations on net stable funding ratio in line with Basel III principles by September 2019.

e) With the help of 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 will become operational in January 2019.

f) With the support of IMF TA, we developed a macro-financial model tailored to our economy. The model incorporates interlinkages between the real economy and the financial system, analyzes financial and macroeconomic risks scenarios and main policy trade-offs, and allows conducting macro stress tests. Improved tools for macro-financial analysis will help strengthen financial stability by operationalizing macroprudential policy.

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. We will develop a macroprudential strategy document that anchors the financial stability function within the NBG. The publication of the new FSR (new 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, as well as the macro-prudential policy actions taken to mitigate risks.

22. We have made progress toward developing a sustainable finance framework. In September 2018, we held the Sustainable Finance Workshop in cooperation with the IFC and the Sustainable Banking Network (SBN), during which we agreed on NBG's next steps, including the publication of a sustainable finance roadmap in 2019. We are also working with the OECD on Environmental, Social and Governance (ESG) Reporting and Disclosure Principles for financial institutions.

23. We are strengthening financial safety nets.

a) We continue to cooperate with banks to strengthen their recovery plans.

b) Following international best practices, we will strengthen our capacity to act as lender of last resort by identifying 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 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).

24. We have taken steps to further enhance financial larization to reduce FX risks and improve monetary policy transmission mechanisms. We adopted a comprehensive plan in December 2016 (detailed in previous MEFP), which supported a decline in loan dollarization. Stronger confidence in the local currency has also led to a trend decline in deposit dollarization. We recently further increased FX reserve requirements on short-term FX deposits from 20 to 25 percent, while reducing the reserve requirements on short-term local currency deposits from 7 to 5 percent. To further reduce FX risks for unhedged borrowers, we proposed to Parliament to increase from GEL100,000 to GEL200,000 the threshold under which only loans in local currency can be issued. 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 promote consumer protection (¶20, b).

25. We are committed to strengthening consumer protection, financial inclusion and literacy. Expanding financial education will help households have a better understanding of the risks associated to FX borrowing. The NBG i was awarded the 2018 Child and Youth Financial Inclusion Award. We are also actively promoting financial literacy and have recently partnered with the European Fund for Southeast Europe and the Export Development Association to develop and implement a financial education program for micro and small enterprises. We are also actively working with the Ministry of Education, Science, Culture and Sports to scale-up our SchoolBank project and help develop educational materials. In September 2018, to limit predatory lending, we reduced the maximum lending rate to 50 percent (from 100 percent) and the maximum penalty rate to 0.27 percent daily (from 0.41 percent daily) and introduced a cap on the accrued penalty (150 percent of outstanding overdue amount).

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

a) A law establishing investment funds is expected to be submitted to Parliament by December 2018. In parallel, we are working on the legal and regulatory frameworks for other financial instruments, such as derivatives and securitization.

b) We will upgrade 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 will allow for delivery-versus-payments settlements in central bank money for all securities and full integration with the Georgian Stock Exchange and OTC trading platforms. We expect the system to be fully operational by end-2018.

c) We are committed to continue publishing a multi-year plan of government bond issuance to develop benchmarks along the yield curve to facilitate price discovery for private-sector bonds.

d) We will align our legal framework in the securities market with EU directives and strengthen the legal underpinnings of insolvency and securities holding frameworks.

e) 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.

E. Structural Reforms

27. Achieving more robust and inclusive growth will require steadfastly advancing 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 scaling-up infrastructure spending and trade initiatives, improving education and vocational training, the business environment, and land reform. 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.

28. Scaling-up infrastructure and spatial planning is key to Georgia's development. Despite some delays, we aim to finalize the East-West highway by 2022, and the South-North corridor by 2023, with the help of our international partners. Additional infrastructure projects, including ports, and railways, will transform Georgia into a transport and logistics hub connecting Europe with Asia. We are also developing radial roads to better connect regions and urban and rural areas. To improve public investment efficiency and transparency, we have brought our public procurement process closer to international standards. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season tourist destination.

29. We are working on a comprehensive education reform to improve job creation, productivity and wages. The lack of qualified 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 are designing a comprehensive education reform that will cover 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 will entail, among other things, setting curriculum standards, a new teacher policy framework, and more effective vocational training and adult learning. We will encourage the participation of employers in the design of curriculum to better prepare the young for labor market demands. Finally, we will support job seekers with guidance on job selection, preparation and retraining.

30. Our funded pension pillar will become operational in 2019. This will improve the standards of living of our future retirees, promote savings and create an institutional investor for long-term lari assets. With the assistance of the WB and the ADB, we submitted to Parliament a law establishing a Pilar II pension system followed by the creation of an independent pension agency in August (structural benchmark, end-July 2018). In parallel, we are committed to formulate a private pension savings system (Pillar 3) in 2019.

31. We will continue to improve the business environment. We will establish a Business House by 2020 to provide public services to enterprises under a one-stop shop. We also plan to introduce IFRS for corporations and to submit to Parliament a new insolvency law ensuring adequate protection of creditors rights, timely and efficient insolvency processes and effective rehabilitation framework in line with best international practices (new 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 are actively negotiating with the International Chamber of Commerce to establish a Court of Arbitration.

32. 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 1.8 million, where 30.5 percent (0.55 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.

33. 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 some 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.

34. We are strengthening our statistics to support strong economic policy-making. We started publishing quarterly unemployment figures (August 2018) and hours worked (October 2018). We reconciled the differences between the 2014 and the 2002 census results (June 2018), and published poverty figures (May 2018) and quarterly statistics on tourism. In October 2018, we published a survey on the structure of earnings by occupations and labor costs. 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 release in 2020.

F. Program Monitoring and Safeguards

35. The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause and structural benchmarks. Semi-annual program reviews will be based on December and June test dates. All quantitative performance criteria and indicative targets are listed in Table 2, and structural benchmarks are set out in Table 3. The Technical

Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the inflation consultation clause as well as data provision requirements.

36. 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 2017–19

	2017				2018			2019
	End June	Outturn	End Dec.	Outturn	End June	Outturn	End Dec.	End June
Inflation Consultation Bands for CPI (in percent)								
Central point	6	7.1	5	6.7	3	2.2	3	3
Inner band, upper limit/lower limit	8/4	...	7/3	...	5/1	...	5/1	5/1
Outer band, upper limit/lower limit	9/3	...	8/2	...	6/0	...	6/0	6/0

Source: IMF staff estimates

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

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

	2017					2018							2019
	End-December					End-June					End-December		Proposed End-June
	Target	Revised Target	Adjusted Target	Outturn	Status	Target	Revised Target	Adjusted Target	Outturn	Status	Target	Adjusted Target[1]	Target
Performance Criteria													
Ceiling on augmented general government deficit (program definition)	1,335	1,335	1,350	1,113	Met	430	430	169	-278	Met	1,150		250
Floor on NIR of NBG[1] (end-period stock, million of U.S. dollars)	1,350	1,390	1,314	1,416	Met	1,450	1,490	1,363	1,387	Met	1,550	1,403	1,456
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0	0	...	0	Met	0	0	...	0	Met	0	...	0
Ceiling on new public guarantees (continuous criterion)	0	0	...	0	Met	0	0	...	0	Met	0	...	0
Ceiling on the cash deficit of the Partnership Fund	0	0	...	-22	Met	0	0	...	-2	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	...	0	Met	20	20	...	0	Met	20	...	20
Indicative Targets													
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0	0	...	0	Met	0	0	...	0	Met	0	...	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	8,685	8,685	...	8,713	Not Met	4,675	4,675	...	4,322	Met	9,035	...	4,600

[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
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 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/
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

1/ Amendments and decrees were proposed in May 2018.

Table 3b. Georgia: Structural Benchmarks, by Completion Date

Third Review	Date	Status
Create a new specialized VAT unit focusing on validating VAT claims (MEFP ¶12).	End-June 2018	Met
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards (MEFP ¶20).	End-June 2018	Met
Establishing an independent pension agency (MEFP ¶30).	End-July 2018	Implemented with a 2-week delay
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation (MEFP ¶20).	End-September 2018	Met
Introduce regulation on banks corporate governance in line with Basel Principles (MEFP ¶20).	End-September 2018	Met
Upcoming		
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as described in the MEFP (MEFP ¶13)	End-December 2018	
Adopt the government decree implementing the PPP law following the recommendations of the FAD TA report (MEFP ¶13)	End-December 2018	
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 request (MEFP ¶12)	End-December 2018	
Submit to Parliament a new fiscal rule framework consistent with IMF TA recommendations (MEFP ¶14)	End-December 2018	
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (MEFP ¶30)	End-February 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 ¶12)	End-May 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 ¶23)	End-May 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 ¶31)	End-July 2019	
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities (MEFP ¶12)	End-June-2019	
Provide a complete list of the SOEs qualifying as public corporation according to GFSM2014. The assessment should be done in consultation with FAD's regional resident advisor (MEFP ¶14)	End-June-2019	
Adopt a government decree clarifying public corporations' mandate, government and reporting requirements, in line with recent FAD recommendations (MEFP ¶13)	End-November-2019	
NBG to publish a renewed financial stability report (MEFP ¶21)	End-November-2019	
Adopt the government decree implementing reporting and oversight requirements for public investment projects at the MoF (MEFP ¶13)	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-related assets will be valued in lari at program exchange rates as specified below. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of December 31, 2016, published on the IMF web site http://www.imf.org/.

Table 1. 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.

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;
- 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-December 2018 and end-June 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

Ceiling on the Augmented Cash Deficit of the General Government

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

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

11. **Definition:** Consistent with GFSM 2001, **net budget lending** is defined 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 amount of VAT credits refunded in cash 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)

	December 31, 2018	June 30, 2019
Disbursements of foreign-financed project loans	1214	760
Receipts from sale of non-financial assets	150	70
VAT refunds	400	250

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 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)

g. 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

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

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

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

17. 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.

18. 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]

19. 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

20. 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.

21. 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

[1] Arrears to Turkmenistan.

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

23. 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.

24. 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

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

26. 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

27. 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).

28. 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.

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

- Upward (downward) by the cumulative amount of any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.
- Upward (downward) by the cumulative amount of any excess (shortfall) of budget support grants and loans compared to program amounts (Table 3).
- Upward/downward for any excess/shortfall related to net issuance of the Eurobond from the general government relative to program amounts (Table 3).
- Upward/downward by 75 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

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

	December 31, 2018	June 30, 2019 [1]
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	45.7	40.6
Budget support loans, including bilateral and multilateral donors for budget support	166.4	165.6
Net issuance of the Eurobond from the general government	0	0
Disbursements of project loans and grants	306.8	179.4

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

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

Appendix to the TMU: The Partnership Fund

A. Organization and Operational Structure

Legal Structure and Corporate Governance

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

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

- An investment board, currently composed of internal members (CEO, CIO, portfolio officers) and can add external members (like experts and private sector representatives), which approves business cases and initiates projects;
- A risk management committee, composed of internal members (CFO, Chief Legal Officer, and Chief Accountant), which advises on project risks to be reflected in project implementation agreements;
- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes members of the government and is chaired by the Prime Minister; and
- In cases of equity participation in projects, the PF needs government approval.

B. Corporate Mandate and Portfolio Management

Corporate Mandate

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

Portfolio Management Strategy

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

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

Project Development Methodology

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

Reporting and Auditing

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

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

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

Fiscal risks associated with the PF will be limited since:

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

INTERNATIONAL MONETARY FUND

GEORGIA

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THIRD REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT—SUPPLEMENTARY INFORMATION

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

This supplement updates the staff report on budget discussion in Georgia.

1. **Parliament is set to approve the 2019 budget on December 13.** Parliamentary discussions on the budget were finalized on December 12, and the vote is set for December 13. The budget deficit is expected to be marginally lower than the one envisaged in the staff report. As revenue measures, the government announced the elimination of tax payment benefits and an increase in excise taxes for unfiltered cigarettes (to align prices with filtered cigarettes). The authorities plan to announce a one-off social spending allocation (0.2 percent of GDP) shortly; this allocation is planned for 2019H2 and will require a budget amendment. No program conditionality for this review is associated with this measure.

2. **This information does not change the thrust of the staff appraisal or the basis for the proposal for LOT consideration.** Staff continues to support the conclusion of the Third Review.