INTERNATIONAL MONETARY FUND

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GEORGIA

December 2020

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

In the context of the Staff Report for the Seventh Review Under the Extended Fund Facility Arrangement and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 16, 2020, following discussions that ended on November 9, 2020 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 December 1, 2020.
- A **Statement by the Executive Director** for Georgia.

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Completes the Seventh Review under the Extended Fund Facility for Georgia

FOR IMMEDIATE RELEASE

- The IMF Executive Board approved a disbursement of $113.9 million to help Georgia meet balance of payments needs stemming from the COVID-19 shock.
- The authorities have taken appropriate steps to alleviate the adverse economic and social impact of the shock given the pronounced economic slowdown.
- Macroeconomic policy discipline and decisive implementation of structural reforms will be critical to support the recovery and limit scarring from the COVID-19 shock.

Washington, DC – December 16, 2020: The Executive Board of the International Monetary Fund (IMF) completed today the Seventh Review of Georgia's economic reform program supported by a four-year extended arrangement under the Extended Fund Facility (EFF).

The completion of the review will release SDR79 million (about $113.9 million) to help Georgia meet balance of payments needs stemming from the COVID-19 shock. Total disbursements so far under the arrangement amount to SDR406 million (about $585.4 million).

Following the Executive Board discussion, Mr. Tao Zhang, IMF Deputy Managing Director and Chair, made the following statement:

"Georgia faces a pronounced economic slowdown due to the COVID-19 pandemic. Despite the successful containment of the first wave of the pandemic, the recent rise in cases has required new measures that could weaken the recovery. Risks are large and mostly to the downside.

"The National Bank of Georgia has appropriately maintained a moderately tight monetary stance to anchor inflation expectations, while safeguarding exchange rate flexibility. Inflation pressures have abated as the output gap widened and the nominal effective exchange rate stabilized. The tight monetary policy stance and continued foreign-exchange intervention may need to be sustained to prevent disorderly market conditions and bring inflation towards the 3-percent target. Macroeconomic policy discipline and donor support is expected to keep foreign exchange reserves at an adequate level. The proactive monitoring of financial risks and actions to preserve banks' capital until the economy rebounds would support the recovery.

"The fiscal response to the pandemic has helped alleviate its adverse economic and social impact, with higher healthcare spending, targeted and temporary support to households and businesses, and sustained public investment. The 2021 Budget will further support the economic recovery while starting fiscal consolidation consistent with Georgia's fiscal rule. The authorities' proactive monitoring of fiscal risks stemming from power purchase agreements and state-owned enterprises are expected to help safeguard debt sustainability. Plans to reform state-owned enterprises will help to improve the efficiency of the public sector.

"Decisive implementation of structural reforms is critical to support the recovery and limit scarring from the COVID-19 shock. Mobilizing investment, advancing education reform, implementing the new insolvency framework, developing the local capital market, and judiciary reforms would further improve the business environment and support private sector–led growth.

“Performance under the IMF-supported program remains satisfactory. The EFF arrangement has helped support the authorities’ policies to limit the economic impact of the pandemic.”

Table 1. Georgia: Selected Economic and Financial Indicators, 2018–21

	2018	2019	2020	2020	2021
	Actual		CR 20/149 1/	Projections	
National accounts and prices	*(annual percentage change; unless otherwise indicated)*				
Real GDP	4.8	5.1	-4.0	-5.1	4.3
Nominal GDP (in billion of laris)	44.6	50.0	50.3	49.9	53.9
Nominal GDP (in billion of U.S. dollars)	17.6	17.7	15.1	16.2	17.0
GDP per capita (in thousand of U.S. dollars)	4.7	4.8	4.1	4.4	4.6
GDP deflator, period average	4.3	6.4	5.1	5.2	3.8
CPI, Period average	2.6	4.9	4.7	5.2	2.5
CPI, End-of-period	1.5	7.0	3.5	3.5	3.0
Investment and saving	*(in percent of GDP)*				
Gross national saving	21.4	23.2	20.3	16.6	15.1
Investment	28.1	28.6	31.6	26.4	23.6
Public	6.4	7.9	6.4	8.1	7.9
Private	21.7	20.7	25.2	18.3	15.7
Consolidated government operations	*(in percent of GDP)*				
Revenue and grants	26.4	26.7	24.1	24.9	24.9
o.w. Tax revenue	23.4	23.7	21.4	21.8	22.3
Expenditures	29.2	29.1	32.9	34.2	32.9
Current expenditures	21.3	21.0	26.2	25.9	24.9
Capital spending and budget lending	7.9	8.1	6.7	8.3	8.0
Net Lending/Borrowing (GFSM 2001)	-0.8	-1.8	-8.2	-8.8	-7.4
Augmented Net lending / borrowing (Program definition) 2/	-2.3	-2.0	-8.5	-9.0	-7.5
Public debt	38.4	41.2	62.8	56.3	59.1
Money and credit	*(in percent; unless otherwise indicated)*				
Credit to the private sector (annual percentage change)	19.9	20.7	5.9	17.1	6.5
In constant exchange rate	17.7	16.1	-2.3	10.0	6.0
Broad money (annual percentage change)	13.9	17.6	3.6	14.3	16.5
Broad money (incl. fx deposits, annual percentage change)	15.9	18.8	-4.6	14.3	17.7
In constant exchange rate	15.1	14.3	3.1	8.8	14.9
Deposit dollarization (in percent of total)	63.1	64.0	62.4	64.1	63.4
Credit dollarization (in percent of total)	57.1	55.4	51.6	56.9	56.7
Credit to GDP	57.4	61.8	66.2	72.6	71.5
External sector	*(in percent of GDP; unless otherwise indicated)*				
Current account balance	-6.8	-5.4	-1.7	-9.8	-8.5
Trade balance	-23.4	-21.0	-11.3	-17.1	-16.8
Terms of trade (percent change)	-5.2	2.5	-20.4	4.8	-0.5
Gross international reserves (in billions of US$)	3.3	3.5	3.5	3.6	3.4
In percent of IMF Composite measure (floating)	95.0	99.0	103.9	105.4	95.4
Gross external debt	100.3	103.4	136.3	127.0	129.0
Gross external debt, excl. intercompany loans	82.2	85.0	111.4	103.8	106.5
Laris per U.S. dollar (period average)	2.53	...	...	...	...
Laris per euro (period average)	2.99	...	...	...	...
REER (period average; CPI based, 2010=100)	106.2	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Please refer to this link for details https://www.imf.org/en/Publications/CR/Issues/2020/05/05/Georgia-Sixth-Review-Under-the-Extended-Arrangement-and-Requests-for-a-Waiver-of-49394

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

INTERNATIONAL MONETARY FUND

GEORGIA

December 1, 2020

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

EXECUTIVE SUMMARY

Context. Georgia's performance under the Extended Arrangement has been positive, but the country is now facing a pronounced economic slowdown. Domestic and external demand remain weak, and service sector activity remains sluggish. Staff projects the economy to shrink by 5.1 percent this year followed by a gradual recovery.

Program status. The EFF arrangement is broadly on track. All end-June 2020 quantitative performance criteria and the structural benchmark for the Seventh Review have been met. Completion of this review will make SDR79 million (about $112.1 million) available to Georgia, bringing total disbursements under the EFF arrangement to SDR406 million (about $576.4 million). The remaining period of this EFF arrangement provides the room for existing commitments to be implemented in the context of continued policy discipline.

Program policies. The 2021 Budget will imply a mild contractionary fiscal stance. Importantly, fiscal support to households and businesses will remain in place to limit the impact of the crisis on the population and support a gradual recovery. Medium-term fiscal plans are anchored by the fiscal rule which calls for the fiscal deficit to reach 3 percent of GDP by 2023 and public debt to remain below 60 percent of GDP. Monetary policy should maintain its moderately tight bias to keep inflation expectations firmly anchored in the context of a depreciating lari. Exchange rate flexibility allows the lari to work as a shock absorber, but excessive volatility would prove disruptive to financial stability. The proactive monitoring of financial risks and actions to preserve banks' capital resources until the economy is clearly on the rebound would allow the banking system to support the recovery. Decisive implementation of structural reforms is critical to support the recovery and limit the scarring from the COVID-19 shock. Mobilizing investment, advancing education reform, implementing the new insolvency framework, developing the local capital market, and judiciary reforms would further improve the business environment and support private sector–led growth.

Approved By
Subir Lall (MCD) and Rupa Duttagupta (SPR)

An IMF team consisting of M. Vera Martin (head), R. Al Farah, M. Debbich and S. Saksonovs (all MCD), M. Leika (MCM), A. Lagerborg (FAD), Y. Zhao (SPR), S. Cakir (Resident Representative) and N. Sharashidze (local economist) held discussions with the Georgian authorities by videoconference during October 5 – November 9, 2020. R. Al Farah and T. Pecherkina assisted in the preparation of this report. Discussions were led on the authorities' side by Governor K. Gvenetadze, Finance Minister I. Matchavariani, and other senior officials. Mr. Zedginidze (OED) participated in the discussions.

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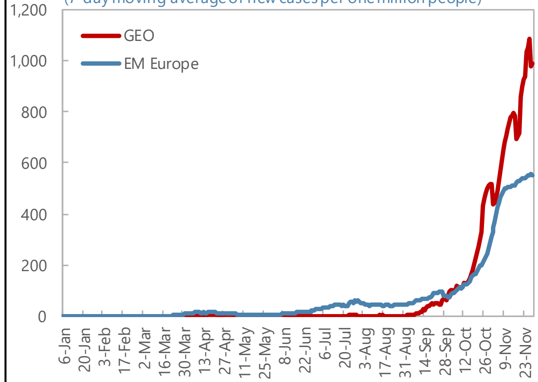
RECENT ECONOMIC DEVELOPMENTS

1. Against a surge in COVID-19 cases, the authorities announced new containment measures, and reaffirmed their commitment to combat the pandemic and support the economy. Stringent measures (including curfews and a two-week ban on private vehicle travel) in the second quarter initially kept COVID-19 cases subdued (Box 1). By mid-June, businesses reopened, and international flights resumed to a limited number of countries. More recently, a surge in COVID-19 cases (Text Figure) has forced the government to announce a new lockdown in the retail and hospitality sectors for December 2020 and January 2021. The authorities have reaffirmed the commitment to curb the pandemic while continuing to support the economy and resuming structural reforms to limit economic scarring.

Daily COVID-19 Cases
(7-day moving average of new cases per one million people)

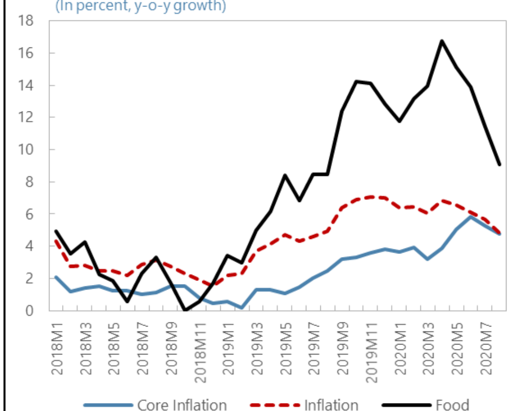


Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

2. Economic activity contracted significantly in the wake of the COVID-19 pandemic (Tables 1–4).

- Preliminary estimates suggest that real GDP contracted by 5.6 percent (y-o-y) in 2020H1 because of the lockdown and the standstill in tourism. Economic activity rebounded in Q3 as businesses reopened but remained below its 2019Q3 level (–3.8 percent, y-o-y) according to flash estimates.

Inflation
(In percent, y-o-y growth)



Source: National authorities, and IMF staff cailculations.

- Inflation declined to 3.8 percent (y-o-y) in October after peaking at 6.9 percent (y-o-y) in April, primarily due to increased food prices during the lockdown that reflected precautionary stockpiling and domestic supply disruptions. Inflation has been on a declining path since the reopening as the output gap widened and the nominal effective exchange rate stabilized.

- The current account deficit widened to 10.5 percent of GDP in the first half of 2020. The trade deficit narrowed by 12 percent y-o-y as imports decreased more than exports. Tourism receipts have dried up since the pandemic hit. By contrast, net remittances increased by 6.3 percent (y-o-y) in the first nine months of 2020, as transfers from Turkey and Europe rebounded since May.

- The financial account balance deteriorated to 3.1 percent of GDP in the first half of the year. FDI declined to 3.9 percent of GDP over the same period (-38 percent y-o-y) while portfolio flows have been stronger than envisaged. Donor project loan disbursements increased in 2020H1.

- From February to October, the lari depreciated by 5.1 (5.4) percent in nominal (real) effective terms. This overall trend reflects an initial phase through May when it depreciated by 5.7 (4.7) percent in nominal (real) effective terms, followed by a rebound of 2.9 (0.6) percent in nominal (real) effective terms between May and end-August, before a resumption in depreciation since then in part due to the rapid increase in COVID-19 cases.

3. **Fiscal performance has been adversely affected by the pandemic, both through the slowdown in economic activity and due to the need for additional fiscal support.** The authorities approved adequate measures to support the economy in response to the COVID-19 shock (Box 2). The cumulated augmented fiscal deficit reached GEL1,492 million (3 percent of GDP) by end-June, below the program ceiling of GEL2,300 million. The end-September deficit widened to 6 percent of GDP, as revenues dropped (by 1.5 percent of GDP) and current spending increased (by 3.1 percent of GDP) year-on-year. Meanwhile, capital spending was sustained (Text Table 1) and VAT refunds were accelerated to support the private sector. End-September government deposits amounted to 5.3 percent of GDP.

Budget Execution, January-September 2020
(GEL millions)

	Execution (Jan-Sep)		Difference	
	2019	2020	GEL mls	% of GDP
Revenues and grants	9,460	8,702	-758	-1.5
Taxes	8,432	7,805	-626	-1.2
of which: Excises	993	1,074	80	0.2
of which: VAT refunds	-424	-629	-205	-0.4
Other revenues	753	813	61	0.1
Grants	276	83	-193	-0.4
Primary current spending	7,089	8,614	1,525	3.1
of which: Covid-19 fiscal measures	0	1,092	1,092	2.2
Interest expense	460	542	82	0.2
Net acquisition of non-financial assets	2,292	2,554	262	0.5
Capital spending	2,428	2,692	264	0.5
Privatization	137	138	2	0.0
Net budget lending	93	36	-57	-0.1
Augmented deficit	476	3,024	2,548	5.1

Source: National authorities and IMF staff estimates.

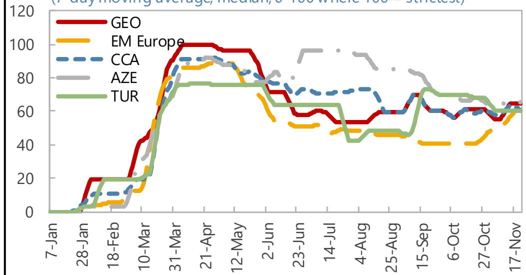
4. **The National Bank of Georgia (NBG) started loosening monetary policy as inflation began declining since April.** Subdued demand and the post-lockdown recovery in supply helped ease inflation pressures. Accordingly, the NBG lowered the policy rate three times by a cumulative 100 bps since the reopening and signaled a cautious easing bias reflecting weak aggregate demand. Since September, however, the NBG has kept rates on hold given continued exchange rate depreciation which could if sustained feed into inflation expectations.

5. **Credit growth has decelerated but remains robust.** Credit growth (at constant exchange rates) slowed to 12 percent in September (y/y) compared to 18 percent in February. Credit growth was driven by loans for large enterprises, partly reflecting increased demand for lari funding in light of depreciation pressures, and mortgages, which have been supported by

Box 1. The COVID-19 Pandemic in Georgia

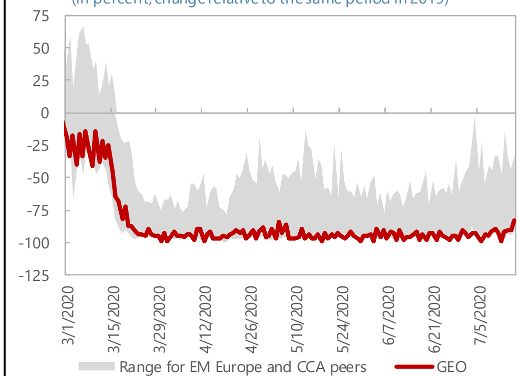
The Georgian authorities responded promptly to the COVID-19 pandemic. Georgia was among the first countries to adopt containment measures compared with its peers (Emerging Europe and the Caucasus and Central Asia). Measures included border closures, mass contact tracing and quarantines, school and non-essential business closures, and wide-spread public awareness campaigns. Average mobility of residents in Georgia was down by 85 percent on April 20th by the Google Mobility Report. The authorities also decided to suspend international flights. By end-June, arriving international flights were down by 95 percent.

Oxford Government Response Stringency Index
(7-day moving average, median, 0-100 where 100 = strictest)



Sources: Oxford COVID-19 Response Tracker; and IMF staff calculations.
Note: The Government Response Stringency Index is a composite measure based on 9 indicators including school closures, workplace closures, and travel bans. This index simply records the number and strictness of policies, and should not be interpreted as 'scoring' the appropriateness or effectiveness of a country's response.

Number of International Arrivals Flights
(In percent, change relative to the same period in 2019)

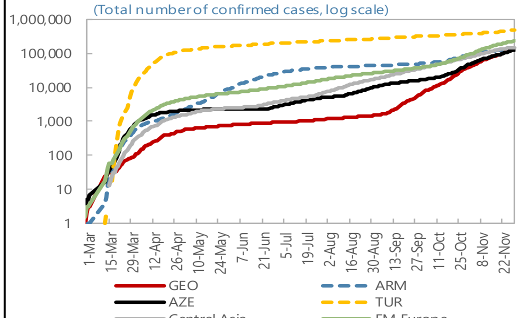


Source: FlightRadar24, and IMF staff calculations.

The swift response helped curb the spread of COVID-19 in the first half of 2020, but the surge in infection rates called for a second lockdown in December. Quarantine measures and contact tracing allowed Georgia to effectively contain the first wave, with cases well those in neighboring countries. In the second quarter of 2020, Georgia had only 810 new cases and recorded 15 deaths. A phased reopening kept infection rates low. Since September, however, daily infections surged likely due to increased mobility. As of November 29, cases in Georgia reached around 33,200 per one million people, surpassing the average of its counterparts in the CCA and in Emerging Europe. Given pressures in the healthcare system, the government announced containment measures to be implemented at varying degrees through January 2021 – including a shutdown of non-essential businesses, a countrywide curfew, restrictions on public transportation, and restaurant closures for dine in services. The measures are only applicable over the weekend in January.

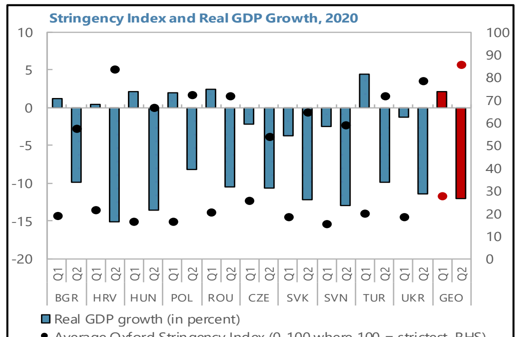
Despite strict measures to reduce mobility, economic growth has not been as negative as observed in other countries. Growth in the first quarter of 2020, at 2.2 percent, represented a significant deceleration in economic activity, but remained positive. The full impact of the lockdown and the COVID-19 shock materialized in the second quarter when output declined by 12 percent year-on-year. Although economic activity sharply decelerated, Georgia performed on par with peers.

Confirmed COVID-19 Cases
(Total number of confirmed cases, log scale)



Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

Stringency Index and Real GDP Growth, 2020

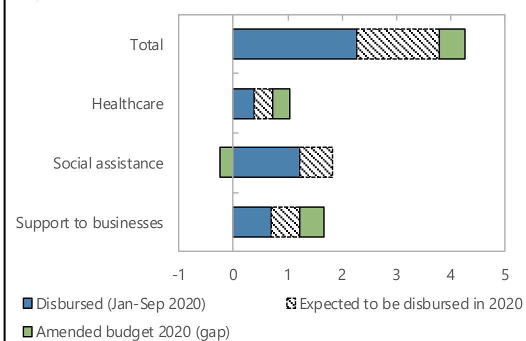


Source: Oxford COVID-19 Response Tracker, Haver; and IMF staff calculations.

Box 2. Georgia's Fiscal Response to COVID-19 in 2020

The end-June supplementary budget envisaged 4.3 percent of GDP in temporary and targeted measures to support households and businesses. This comprised of additional health-related spending (1.0 percent of GDP), transfers targeting vulnerable households (1.6 percent of GDP), and support to SMEs and businesses in hard-hit sectors (1.7 percent of GDP). Direct transfers were provided to workers who lost income, vulnerable families, severely disabled people, and to families with low electricity consumption. Businesses were supported by income tax relief for retaining workers, a property tax waiver for the tourism sector, a redesigned credit guarantee scheme for SMEs and micro enterprises, interest rate subsidies to small hotels for loan repayments, an interest-rate subsidy and partial loan guarantee for new lari-denominated mortgages below GEL200,000, support to the agriculture sector (e.g., co-financing working capital), and microgrants.

Covid-19 Fiscal Measures in 2020
(In percent of GDP)



Source: National authorities, and IMF staff calculations and estimates.
Note: When the amended budget gap is positive it means that less is to be disbursed than was planned in the amended budget. When the amended budget gap is negative more is to be disbursed in 2020 than was planned.

The authorities redirected social support in August as the social spending envelope was being underutilized. Challenges in channeling social support to vulnerable households, especially in identifying recipients in the informal sector, and under-utilization for some social support measures (e.g. cash transfers to workers who lost jobs) created space for the authorities to introduce new measures. In August, the government redirected social transfers of GEL410 million (0.8 percent of GDP) to be spent on: (i) a one-time cash transfer per child (GEL200), (ii) university tuition assistance to students from vulnerable families, (iii) extending utility subsidies for four months, and (iv) additional social transfers to the self-employed. As of end-September, about 54 percent of the fiscal support package had been utilized. By end-2020, the authorities project disbursements close to 90 percent of the package, with higher-than-originally-budgeted social assistance (16 percent) and lower-than-projected support to businesses (26 percent) and healthcare spending (30 percent). The low demand for the credit guarantee scheme and highly successful containment of the first wave of the virus largely account for the respective underutilization of business and health-related support.

Covid-19 Fiscal Support Measures in 2020

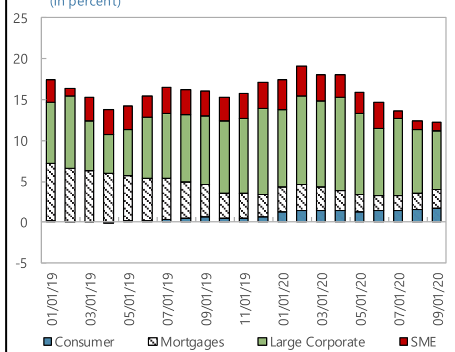
	Actual (Jan-Sep)		Proj. 2020	
	GEL mls	% of total	GEL mls	% of GDP
TOTAL COVID-SUPPORT MEASURES	**1,138**	**58**	**1,961**	**3.9**
REVENUE MEASURES	**261**	**77**	**340**	**0.7**
Income tax relief on businesses who retain workers.	216	73	295	0.6
Property tax exemption for tourism sector	45	100	45	0.1
EXPENDITURE MEASURES	**877**	**54**	**1,621**	**3.2**
Current expenditure	**829**	**54**	**1,542**	**3.1**
Goods and services	**130**	**64**	**203**	**0.4**
Healthcare (medical supplies, quarantine costs)	130	64	203	0.4
Subsidies	**22**	**25**	**90**	**0.2**
For basic food commodities.	6	100	6	0.0
For small hotels (interest rate subsidy)	16	26	60	0.1
Microgrants	0	0	20	0.0
For the real estate sector (interest rate subsidy on eligible mortgages)	1	13	4	0.0
Social benefits	**630**	**61**	**1,033**	**2.1**
Healthcare (testing and treatment costs)	25	28	89	0.2
Direct transfers for employees in the private sector before Covid-19.	181	78	231	0.5
Formal sector employees who lost their salary income	106	84	126	0.3
Other vulnerable households who lost jobs (e.g. self-employed, informa	75	99	75	0.2
Workers in closed sectors during second lockdown (e.g. retail)	0	0	30	0.1
Direct transfers	251	93	270	0.5
To families (social ranking system score of 65,000-100,000)	42	87	48	0.1
To families with 3+ children (social ranking system score below 100,00	11	88	13	0.0
To people with disabilities	22	90	24	0.0
To families with children aged below 18	177	95	185	0.4
Subsidies for utility bills (April 2020-February 2021)	173	43	403	0.8
University tuition assistance (families with social ranking score below 150,	0	0	40	0.1
Grants	**7**	**4**	**166**	**0.3**
o/w credit guarantee scheme for SMEs and micro enterprises	6	4	150	0.3
Other expense	**40**	**80**	**50**	**0.1**
Support to agriculture sector (co-financing working capital for small-scale f	40	80	50	0.1
Capital expenditure	**48**	**61**	**79**	**0.2**
Health infrastructure	34	52	65	0.1
Supplies of basic food	14	100	14	0.0

Source: Ministry of Finance of Georgia; and IMF staff estimates.

With the new lockdown starting in December, the authorities announced a one-time transfer of GEL300 for those losing their jobs as a result of the closures in the retail sector, restaurants and winter resorts. Those working formally, informally or self-employed, around 100,000 people, are eligible, with an estimated cost of GEL30 million. The authorities also project revenues to lower by GEL90 million as a result of the lockdown.

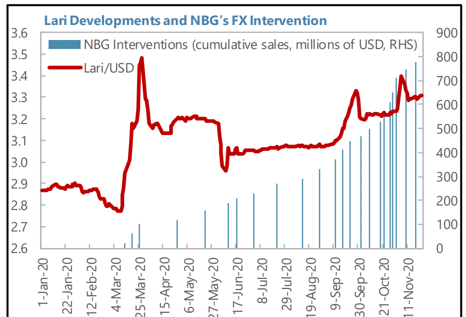
government subsidies.[1] Non-performing loans increased to 2.3 percent in 2020Q3 as the partial moratorium on loan repayments remains in effect (Table 5). System-wide regulatory capital ratios declined marginally below end-2019 levels; and retained earnings helped banks to sustain capital levels despite proactive loan provisions. As of end-September, loan dollarization was 57.5 percent (up 2.2 percentage points compared to end-September 2019), while deposit dollarization was 61.6 percent (down 2.1 percentage points compared to end-September 2019).

Decomposition of Credit Growth
(In percent)



Source: NBG, and IMF staff calculations.

Lari Developments and NBG's FX Intervention



Source: NBG, Haver, and IMF staff calculations.
Note: NBG sales in 2020 amounted to USD 777 million; total interventions by the NBG however is around USD 820 million including USD 42.9 million that the NBG sold via the Bloomberg-match system.

6. **The NBG resorted to FX sales to dampen FX pressures and anchor inflation expectations.** After the announcement of the augmentation of the EFF arrangement and additional donor support, the lari stabilized. Lower-than-projected FX sales sustained net international reserves at $1,335 million (at program rates) as of end-June, $370 million above the adjusted target ($966 million). After peaking at $3.9 billion at end-August 2020, gross international reserves (GIR) declined to $3.7 billion at end-October as the NBG increased its FX sales to prevent disorderly market conditions since September and anchor inflation expectations given the strong exchange rate pass-through. As of November 30, the NBG has cumulatively sold about $866.5 million this year.

7. **Program implementation is satisfactory.** All end-June quantitative performance criteria (QPCs) and the structural benchmark on the first wave of regulatory reforms for the banking resolution framework were met (MEFP, Tables 1–3). Inflation remained within the inner band of the inflation consultation clause (ICC). Parliament approved the legislation to index basic public pensions (**end-December 2019 SB**) in July, and towards a new insolvency framework in September.

OUTLOOK AND RISKS

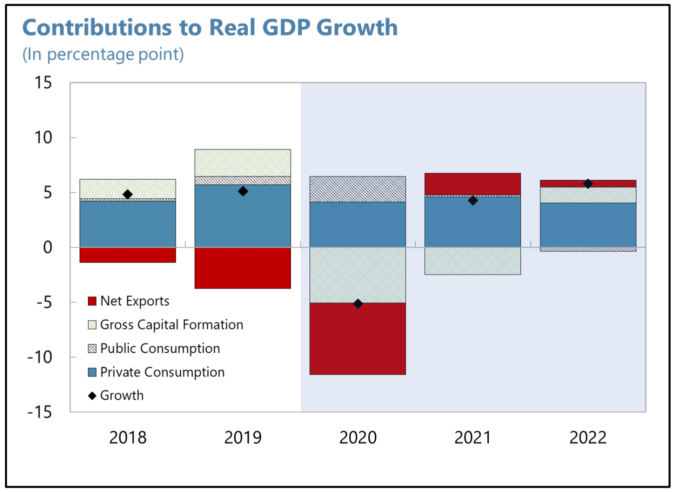
8. **The outlook remains subject to significant uncertainty.** The path of the pandemic, the availability of effective treatments, and the associated impact on economic activity, are inherently difficult to predict. Consistent with the October 2020 WEO, staff assumes that social distancing will persist into 2021, but will then fade as vaccine coverage expands and therapies improve, with the acute phase of the pandemic over by end-2022. Consequently, economic activity in contact-intensive sectors, such as in services, will continue to suffer in the near term. On the other hand,

[1] The government subsidizes 4 percentage points of the interest rate of new mortgage loans for five years. The scheme only applies to lari-denominated mortgages below GEL200,000 to purchase newly built residential apartments that are signed from June 1, 2020 to January 1, 2021.

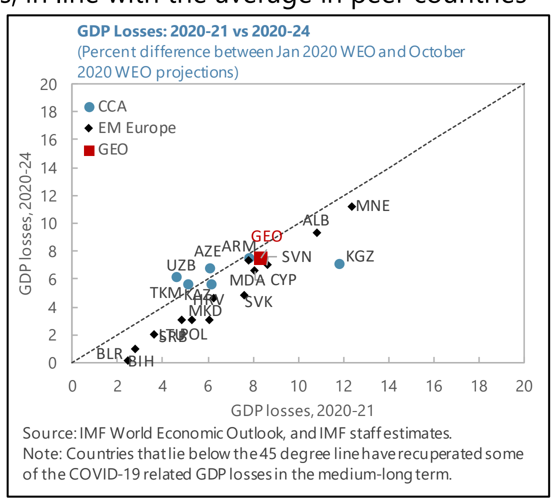
manufacturing and agriculture should rebound faster, in line with trading partners re-opening. Exacerbating the overall recovery are potential scarring effects from dislocations in the labor market, which may suppress potential output and demand over the medium term.

9. Growth prospects remain uncertain, with risks to the downside.

- Growth in 2020 is projected to contract by 5.1 percent driven by falling external demand, notably for tourism-related activities, and private investment, mainly during the lockdown but also due to rising geopolitical tensions after the reopening–although recent developments suggest tensions could fade. Inflation is projected at 3.5 percent at end-2020 as the increase in food prices during the lockdown has been fully compensated by the decline in inflation after the reopening. The output gap is projected to widen slightly to –2.7 percent as potential GDP is expected to decline.



- Assuming the pandemic fades gradually, staff projects growth to rebound to 4.3 percent in 2021, supported by strengthening external demand and an assumed gradual re-opening of activity that slowly leads to improving domestic demand. Medium-term growth is expected to reach 5¼ percent by 2025, supported by infrastructure spending and structural reforms (see below). While output is projected to exceed pre-crisis levels by 2022, staff estimates real GDP by 2025 to be about 8 percent below pre-pandemic projections, in line with the average in peer countries (Text Figure). The widening of the output gap and limited depreciation pressures (in nominal effective terms) are projected to pull inflation below 3 percent in 2021H1 before inflation starts increasing and reaches the target by end-2021 as demand recovers. Gross external debt is projected to decline steadily and reach 90 percent of GDP by 2025, although it would remain vulnerable to external shocks, especially to lari depreciation (Tables 6–7).



10. Staff projects balance-of-payments gaps of $1.3 billion in 2020 and $0.8 billion in 2021. The current account deficit is expected to widen from 5.4 percent of GDP in 2019 to 9.8 percent of GDP in 2020, mostly driven by the sudden stop in tourism. Imports are expected to decline, driven by lower commodity prices and weaker domestic demand. The financial account is projected to deteriorate by 3.2 percent of GDP to 2.6 percent of GDP in 2020, as lower FDI and portfolio investment are expected to be partially mitigated by additional IFI loans. The BOP gap in 2021 is partially driven by a more protracted recovery in tourism, with tourism revenues projected at only 25 percent of the 2019 level and the current account deficit projected to be 8.5 percent of GDP. BOP gaps are expected to be closed with IMF and donor financing.

11. Risks are large and mostly to the downside (Annex I). A prolonged COVID-19 spread, protectionism, and a protracted slowdown in major trading partners, along with intensified regional conflicts and security risks could harm investment, dampen external demand for longer—especially tourism—and weaken financial stability. Restructured loans are a concern and could lead to a further deterioration in credit quality as would exchange rate depreciation. Financial volatility in neighboring countries could also exacerbate lari volatility, reverse the declining trend on inflation, and reduce demand in the short term, hindering the recovery. Delays in structural reforms may deepen the scarring effects from the crisis. Delays in establishing the new Parliament may exacerbate uncertainty and deteriorate the recovery. The newly announced containment measures also pose additional risks to growth. On the upside, a faster-than-expected development and distribution of an effective vaccine could boost confidence, support a rebound in tourism and investment, and accelerate the recovery.

12. Authorities' views. The authorities highlighted the very significant uncertainty owing to the pandemic and the regional conflict. They noted that the most recent economic data point to potential upsides to staff's projections, while broadly agreeing with the characterization of risks. They considered that the gradual re-opening of sectors and regions underway would facilitate the recovery.

POLICY DISCUSSIONS

A. Fiscal Policy: Providing Support in the Recovery

13. The 2020 fiscal deficit is projected at 9 percent of GDP, consistent with the adjusted program ceiling. VAT refunds are projected to be GEL400 million (0.8 percent of GDP) higher than initially planned at the time of the Sixth Review (as part of the program deficit adjustor), providing some further relief to the private sector. Compared to the projections at the Sixth Review, higher-than-expected revenues (1.4 percent of GDP excluding VAT refunds), largely due to sustained tax performance, and lower-than-expected current spending (0.6 percent of GDP) have helped sustain capital spending, where execution has been better than anticipated (by 1.6 percent of GDP), which will help limit the scarring in the economy.[2] Georgia did not experience severe physical constraints to the execution of infrastructure projects, supported by a mild first wave of COVID-19 and continued implementation (infrastructure projects were classified as an essential work sector during the lockdown). Fiscal measures enacted in response

[2] During the Sixth Review, however, the authorities committed to save any over-performance in revenues (excluding grants) or under-execution in current spending towards a lower deficit.

to the COVID-19 shock are projected at 3.9 percent of GDP, below the budget allocation (4.3 percent of GDP), with higher-than-projected social assistance and lower-than-projected healthcare spending and support to businesses. Government debt issuance (both domestic and external) helped finance the deficit and allowed the authorities to accumulate buffers, with deposits projected to reach 7 percent of GDP by end-2020 (MEFP ¶10). Gross public debt is projected at 56.3 percent of GDP.[3]

14. The authorities envision gradual fiscal consolidation and the lifting of measures as the economy recovers and COVID-19 risks abate, but plan to extend targeted fiscal support to households and businesses in 2021 (MEFP, ¶11). Fiscal projections for 2021 contain temporary targeted measures amounting to 2.0 percent of GDP in response to COVID-19. Social assistance will include temporary transfers to workers in the formal and informal sectors and self-employed who lost income, additional direct transfers to vulnerable families with children, and utility subsidies to low energy consumers in January and February 2021; this last measure is expected to reach the informal sector. Temporary support to businesses will continue through income tax relief on businesses who retain low-wage workers (with monthly salaries below GEL750), the credit guarantee scheme for SMEs, microgrants to support small businesses to invest, and targeted support to the tourism sector (property tax relief) and real estate sector (interest rate subsidies on new mortgages).[4] In addition to current spending measures, the recovery will be supported by elevated capital spending.

15. The authorities and staff agreed on an augmented deficit of 7.5 percent of GDP in the 2021 budget (MEFP, ¶11). Given the protracted COVID-19 shock and a widening output gap, staff is supportive of a mildly contractionary fiscal stance that would not impede the recovery. Staff and the authorities concurred that the augmented fiscal deficit (higher than the one projected at the Sixth Review due to the continued targeted support measures and sustained capital spending) should be helpful in preempting downside risks to growth. The 2021 budget

COVID-19 Temporary Fiscal Support Measures in 2021

	GEL million	% of GDP
Revenue Measures	**265**	**0.5**
Income tax relief on businesses who retain workers	220	0.4
Property tax exemption for tourism sector	45	0.1
Expenditure Measures	**877**	**1.6**
Goods and services	225	0.4
Healthcare (medical supplies, quarantine costs)	225	0.4
Subsidies	35	0.1
Microgrants	35	0.1
Social benefits	532	1.0
Healthcare-related for COVID-19 (e.g. testing and treatment costs)	225	0.4
Compensation for private sector employees who lose jobs	150	0.3
Direct transfers to vulnerable families (scoring of 65,000-100,000)	55	0.1
Direct transfers to families with 3+ children, registered in the social ranking system with a score < 100,	15	0.0
Direct transfers to people with severe disabilities	27	0.1
Subsidies for utility bills (electricity, natural gas) to households that consume < KV200 and 200m³ per r	60	0.1
Grants	85	0.2
Credit guarantee scheme for SMEs and micro enterprises.	50	0.1
Interest rate subsidies for mortgages issued in 2020 worth below GEL 200,000	35	0.1
Total COVID-19 Fiscal Measures	**1,142**	**2.1**

Source: Ministry of Finance of Georgia; and IMF staff estimates.

[3] The 2020 public debt is now projected 6½ p.p.t. lower than at the Sixth Review, partly due to lower net debt issuance (1.7 percent of GDP), a downward revision in nominal GDP (0.5 percent of GDP), and the exclusion of legacy domestic debt (1.3 percent of GDP).

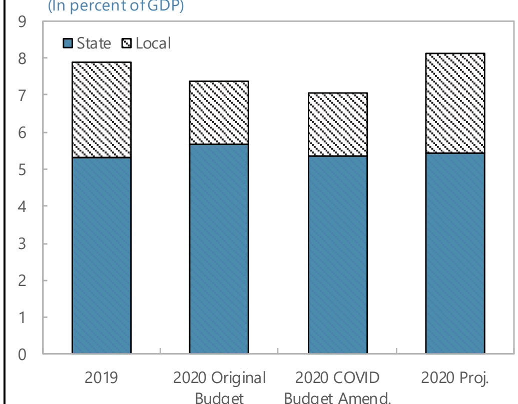
[4] Only applicable to mortgages issued up to end-2020, with subsidies provided for a 5-year period.

projects revenues to remain sustained (with VAT refunds projected at GEL0.9 billion) and includes temporary support measures totaling 2.1 percent of GDP and sustains capital expenditure at 7.9 percent of GDP. Given heightened uncertainty, staff cautioned against a significant drawdown in government deposits and supported the authorities' plan to refinance the 2021 Eurobond. Public debt (net of government deposits) is projected at 59.1 percent of GDP in 2021 due to higher borrowing and lari depreciation.

16. The authorities are committed to a gradual fiscal consolidation over the medium term, as prescribed by Georgia's fiscal rule (MEFP, ¶12). A gradual fiscal consolidation will balance providing support to the economy to limit scarring while adhering to the fiscal rule. By 2023, the fiscal deficit will reach 3 percent of GDP and gross public debt is expected to remain below 60 percent of GDP.[5] The more gradual path for fiscal adjustment will put public debt on a higher trajectory and postpone the resumption of its declining trend to 2022, with public debt (net of government deposits) now projected above 45 percent of GDP (program anchor) in the medium term. As the adverse effects due to the pandemic wane, tax revenues would recover and support measures would elapse, while the wage bill and spending on goods and services are projected to remain contained. Improving tax administration and mobilizing additional revenues, including by reducing tax expenditures, would generate space for higher infrastructure and education spending. If fiscal risks materialize, the authorities are committed to reassess and implement, if needed, additional fiscal consolidation efforts to comply with the fiscal rule.

17. Staff called for strengthening public investment management (MEFP, ¶12). Capital spending has been increasing in recent years, with execution capacity improving, including at the municipal level. In 2020, capital spending is expected to amount to almost GEL4.1 billion, above levels approved in the amended budget (GEL3.5 billion), driven primarily by local government spending. Going forward, the government plans to continue with its ambitious public investment agenda. In this context, staff called for the need to enhance public investment management including by strengthening project planning (e.g., appraisal and national/sectoral planning), allocation (e.g. project selection procedures and tracking maintenance funding), and implementation (e.g. plans and audits).[6]

Capital Spending
(In percent of GDP)



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

[5] The fiscal rule escape clause (Article 2.7 of the Liberty Act) envisages a plan on returning to the limits established by the fiscal rule over a period of 3 years, allowing for a gradual fiscal consolidation.

[6] For further details, see IMF's Public Investment Management Assessment (May 2018).

18. Staff welcomed progress on fiscal structural reforms in the areas of tax administration and fiscal risks analysis and mitigation:

- Georgia's Revenue Service (GRS) is advancing with its IT strategy and IT investment plan, following IMF CD recommendations (MEFP, ¶17). A risk-based approach is being further developed to better identify non-compliant cases. With an audit case management system being implemented in early 2021, this should help improve audit productivity and timeliness. A recent Tax Administration Diagnostic Assessment, completed with IMF TA support in October 2020, shows notable progress has been made since the previous assessment conducted in 2016, but also identifies weaknesses to be addressed going forward.

- The authorities remain committed to reducing the outstanding stock of unrefunded VAT credits (MEFP, ¶17). Automatic VAT refunds without taxpayers' request for a refund started effectively by end-November 2020, to help prevent an increasing stock of outstanding VAT credits.

- The authorities are markedly improving the disclosure of fiscal risks, including those associated with SOEs and PPAs (Annex II):

  - Consistent with IMF CD recommendations, the 2020 Fiscal Risk Statement (FRS) will summarize the SOE reclassification, analyze risks associated with the top 10 SOEs, assess the gross financing requirements of major SOEs, and estimate the quasi-fiscal activities (**end-December 2020 SB**) and is expected to expand coverage to 90 percent of SOEs and estimate the impact of COVID-19 on major SOEs (MEFP ¶13).
  - The authorities have adopted a feed-in premium to promote hydropower energy generation, which reduces fiscal risks over past PPA schemes as volumes would not be guaranteed (MEFP ¶12). To support a level-playing field in energy generation, a similar support scheme is being considered for other renewable energy projects to promote technology neutrality, and the authorities have committed to specify the criteria for cases when it may be necessary to deviate from the feed-in premium scheme (MEFP ¶12).

19. The authorities are preparing a comprehensive SOE reform to enhance their efficiency and limit fiscal risks. Despite a relatively healthy and comparatively lean public sector balance sheet, the SOE sector is large, generates risk exposure, and is a net draw on the budget. Significant financing requirements in coming years pose risks for several large SOEs, some with significant foreign exchange mismatches. The authorities will refrain from taking over any SOE debt or providing SOE equity injections without a comprehensive SOE governance strategy (MEFP ¶13).The authorities are preparing a strategy to enhance the governance in public corporations; improve fiscal reporting of SOEs in line with international statistical standards; and establish auditing requirements for consolidated government financial statements (MEFP ¶15). As the sectorization exercise was completed, many SOEs including ESCO, United Water Supply, and the Partnership Fund (PF) are to be included within the general government. In this process, staff called for the joint-stock company structure of the PF to be dismantled and its SOEs to be separated consistent with best international practices.

B. Monetary and Exchange Rate Policies: Inflation Dynamics in a Complex Environment

20. The gradual pace of monetary easing has been appropriate, but exchange rate pressures may require a tightening of the monetary stance to anchor inflation expectations (MEFP ¶20). Although inflation has declined as demand has weakened, the scope for relaxing monetary policy is limited. The authorities should balance the need to support economic activity against the risk of renewed exchange rate pressures in the context of strong exchange rate pass-through and high financial dollarization. While exchange rate flexibility should remain the first line of defense to external shocks, a sharp depreciation of the lari would require a combination of policy rate tightening and limited foreign exchange (FX) interventions to anchor inflation expectations and preserve financial stability. Under the baseline scenario, inflation is expected to decline below the 3-percent target in 2021 and then gradually converge to it by end-2021. However, high exchange rate pass-through may keep inflation expectations elevated (Annex III). The NBG noted their readiness to tighten monetary policy if exchange rate pressures intensify due to, for example, a faster-than-expected recovery in private sector demand and a slower pace of fiscal consolidation.

21. The end-December 2020 NIR target would help build buffers against a protracted period of challenging market conditions (MEFP ¶22). The relative stability of the lari in the summer limited the need of FX interventions. Given renewed pressures on the lari and considerable uncertainty about the outlook, the end-December 2020 NIR floor ($1.1 billion) reflects the possibility that FX sales may be needed to prevent disorderly market conditions. GIR are now expected to reach 105 percent of the ARA metric in end-2020, higher than projected in the Sixth Review, largely due to a better financial account balance.

22. Maintaining reserves remains critical to sustain macroeconomic and financial stability in 2021 (MEFP ¶23). Higher reserves in 2020 and continued donor support help sustain a GIR of 95 percent of the ARA metric in 2021, even as balance of payments pressures are expected to intensify. The authorities and staff agreed that since COVID-19 related uncertainty is likely to persist well into 2021, it is important to sustain external buffers to provide confidence, which is crucial to safeguard macro and financial stability, If external pressures intensify, these buffers could be used further.

C. Financial Sector Policies: Proactively Monitoring Risks

23. The NBG is actively monitoring risks in the banking sector (Box 3, MEFP ¶25). The banking system entered the COVID-19 crisis with significant capital and liquidity buffers, which helped banks cope with liquidity outflows during the early weeks of COVID-19 shock.[7] Banks' voluntary loan moratorium and proactive restructuring helped borrowers postpone payments and limit the impact on NPLs.[8] Preemptive provisioning allowed banks to build buffers in anticipation for credit deterioration, which is expected due to of the share of loans with delayed payments (10 percent of total loans); especially in construction, real estate, and hotels sectors where up to 1/3 of loans are overdue. The authorities should monitor the implications of the temporary capital relief measures on banks' resilience and ensure that banks' capital is only restored gradually to preserve financial stability while supporting the recovery. The authorities' stress tests (Box 3) revealed that most banks remain above regulatory capital requirements, and upside risks could rise by the support measures to the private sector. The authorities highlighted the strength and stability of the financial sector, the implementation of the Basel III framework, and their monitoring of potential risks, including restructured loans; and await the assessment from the ongoing Financial Sector Assessment Program (FSAP) to further improve their ability to assess risks to financial stability, and policy responses, and institutional arrangements.[9]

24. Concentration risks and unhedged borrowers' FX liabilities remain key sources of potential credit losses (MEFP ¶25). FX-denominated loans constitute 56 percent of loans with only 10 percent of the borrowers in FX having a natural hedge.[10] In terms of funding, 63 percent of deposits are denominated in foreign currency; although this is an aggregate figure which masks significant variation in the hedging of individual borrowers, FX deposits may help some borrowers to hedge their FX debt exposure. Customers, especially large corporates, shift to FX deposits once the GEL/USD rate volatility increases. Lari depreciation may lead to further decline in lari deposits and require the NBG fill the lari funding gap. Implementing concentration limits might reduce access to finance for key corporates. With limits on bank financing, these corporates would need to seek financing from capital markets, with domestic markets being relatively under-developed and international markets requiring sizable scale of issuance.

[7] Before the pandemic outbreak, banks' aggregate CET1 capital ratio was 13.4 percent and total capital ratio was close to 20 percent; the liquidity coverage ratio (LCR) reached 120 percent. In the past, the NBG imposed additional Pillar-2 capital requirements, such as the unhedged Currency-Induced Credit Risk (CICR) buffer, the credit portfolio concentration buffer (CPCB), and the General Risk Assessment Program (GRAPE) buffer. Since end-September 2017, the NBG introduced Liquidity Coverage Ratio (LCR) and since 2019—the Net Stable Funding Ratio (NSFR)—requirements, which are both macroprudential measures and capital flow management measures (MPM/CFMs) as they distinguish between residents and non-residents. Additional macroprudential instruments were enacted as well, such as the payment-to-income ratio (PTI) and the loan-to-value ratio (LTV) requirements, to tame credit growth.

[8] Up to half of loans benefited from grace periods at the outset of the COVID-19, but only 8 percent were in moratoria by October. Restructured loans (at 13 percent) reached an all-time high since statistics started in 2012.

[9] A joint Financial Sector Assessment Program (FSAP) with the World Bank is expected to be completed in mid-2021. The IMF team will assess financial vulnerabilities, including stress tests of the banking system, the macroprudential framework and tools to address dollarization, financial oversight, and financial safety nets. The World Bank team will focus on financial market infrastructures, access to finance for SMEs, capital markets development and banking sector competition.

[10] Some of the customers with natural FX hedge (such as hotels, with FX income from tourists) may face FX liquidity shortages and thus loan portfolio quality is expected to deteriorate further.

25. Considerable uncertainty related to the recovery calls for preserving banks' capital resources. Given the prevailing uncertainty, the authorities should consider actions to preserve banks' capital resources until the economy is clearly recovering, which could also allow banks to support the recovery. A premature re-introduction of higher capital requirements may hinder credit to the private sector; the withdrawal of support measures to the private sector could lead to further credit losses and higher cost of loans (especially for those loans benefiting from the credit guarantee). Finally, the effects from further depreciation of GEL are still uncertain on risk–weighted assets or additional provisions. The NBG is looking at additional initiatives to preserve capital resources, if needed.

26. Normalizing financial policies would require advanced planning and communication. The implementation of several regulatory measures (e.g., the stress test buffer and the limits on large exposures) has appropriately been delayed until financial and economic conditions improve. Before fully restoring capital buffers, banks are restricted from distributing dividends, which seems prudent. To balance tradeoffs and cement the recovery, it would be important for the NBG to clearly communicate the timeline for decisions, and the period over which banks would be expected to rebuild capital buffers.

27. The implementation of the resolution framework is advancing in a timely manner (MEFP ¶28). At end-June 2020, the NBG adopted the secondary legislation on recovery plans, critical functions, valuation of assets and liabilities for resolution purposes, simplified procedures regarding acquisition of significant shares of a commercial bank during resolution, and licensing, managing and market exit of a bridge bank (**end-June 2020 SB**). Also, the NBG, Ministry of Finance, the Deposit Guarantee Fund and Insurance State Supervision Service signed the charters on the resolution committee and of the interagency financial stability committee in June. The NBG is expected to finalize the regulatory changes to the framework (**end-December 2020 SB**).

D. Structural Reforms to Boost Potential Growth

28. Structural reforms are needed to limit economic scarring from the COVID-19 pandemic, foster diversification and jobs, and boost potential growth.

- **Infrastructure (MEFP ¶31).** Despite the pandemic, the authorities have advanced their infrastructure development plans to strengthen Georgia's position as a regional trade and logistics hub connecting Asia with Europe. Two of four sections of the East-West Highway are about to be completed while the construction on the remaining sections is underway. Infrastructure spending during the onset of the pandemic has contributed to mitigate the impact of the shock on economic activity and will support the recovery while improving growth potential in the medium-term.

Box 3. Assessing COVID-19 Shock Impact on Loan Portfolio Quality

The NBG, in coordination with the banks, has been assessing the impact of the shock on loan portfolio quality. The detailed assessment of the quality of the loan portfolio aims at checking the adequacy of the provisioning for the cycle of the shock. The exercise assumes a turnover shock for each industry and a three-year recovery for corporate and SME sectors. All the corporate and most of the retail sector borrowers are assessed individually by banks, followed by NBG's assessment of provisioning adequacy via portfolio sampling. Corporate and SMEs ability to service debt is assessed using the Debt Service Coverage Ratio and Debt-to-EBITDA ratios, in line with international practice. The quality of the retail portfolio considers updated payment-to-income ratios, days past due, and restructuring status. The methodology for assessing retail sector provisioning aims at avoiding distortion from loan moratoria, while encouraging restructurings for creditworthy borrowers.

The assessment assumed multiple simultaneous shocks, with tighter provisioning requirements for retail loans. The scenario included a 5 percent contraction in economic activity and sectoral-specific contractions, followed by a 3-year recovery. The contraction in GDP incorporates assumptions about sectoral contractions. To address risks of under-provisioning for the retail portfolio, the NBG required banks not only to consider days past due but also loan PTI ratios and restructuring status in determining provisioning after the moratorium expires.

The analysis shows that the banking system is adequately capitalized, although most banks tapped into capital buffers. The assessment resulted in GEL1.1 billion in provisions (booked as a general provision in March), part of these will be financed by net income before loan losses. Overall, provisioning almost doubles and reaches 7 percent of the loan portfolio. System-wide CET depletion rate is 320 basis points and all banks would remain above the minimum requirements, though most banks would have to use capital buffers. Restructured loans and NPLs are expected to increase, but the analysis suggests that the impact on net income and capital would be limited as the general provisioning for the full cycle of the crisis has already been reflected. A further delay in the recovery of the tourism sector may require additional provisioning. The quality of consumer loans may further deteriorate due to (i) the reduced capacity of unhedged borrowers to repay FX loans in the case of further lari depreciation; or (ii) a further increase in unemployment and reduced income due to scarring effects from the COVID-19 shock.

Additional simulations could help assess the resilience of the banking system, including to a prolonged impact from COVID-19. The recovery from the COVID-19 is highly uncertain both in terms of timing and in terms of changes in consumer (especially tourist) and investor behavior. The NBG may need to simulate further sensitivity analysis involving a delayed recovery or a second wave of infections coupled with further potential restrictions on economic activity. Risks that government support schemes may expire and will not be renewed could be considered when designing updated stress test scenarios.

Reverse stress testing may help estimate for how long the crisis would need to last for banks to fall below the minimum capital requirements. Reverse stress testing can be adopted to deal with scenario uncertainty during times of stress. It answers the question of how much worse things would need to be to put banks in a position where they need to stop lending or start to deleverage. Reverse stress test would help the authorities to prepare for any potential capital support measures of the banking system.

- **Education (MEFP ¶32).** Improving education and vocational training remains key to increase the skills of the labor force and raise potential output in the medium-term. The authorities have committed to resume efforts in this area as the education reform has stalled amid the pandemic. In particular, the authorities plan to revise the government decree on teachers' regulatory documents to clarify teachers' roles and responsibilities in all four categories (Practitioner, Senior, Lead and Mentor) and establish a non-discretionary approach to teachers' career advancement. A merit-based system for career advancement will reinforce the capacity of the education sector to attract and retain talented staff. The pandemic has accelerated progress on remote teaching with the help of the World Bank. Efforts in this direction should be sustained and leveraged to improve the quality of education, particularly in the regions.

- **Business environment (MEFP ¶33-35).** The authorities have modernized the labor code, abiding by their Association Agreement with the EU. The revamped legislation which was adopted in September will provide better working conditions for employees while giving employers a sounder and predictable legal environment. Parliament also adopted the insolvency legislation in September, but the licensing of professionals will start only in 2021Q1 as the closure of Parliament during the lockdown delayed the approval of the reform. The authorities and staff propose to postpone the **end-December 2020** SB to end-March 2021 (**reset to end-March 2021 SB**). The authorities should further pursue efforts to improve the business climate and mobilize investment, notably by enhancing efficiency and transparency of the judiciary system.

- **Energy (MEFP ¶38).** Parliament adopted legislation on energy efficiency and performance in buildings in May 2020 and the Electricity Market Concept Design will become applicable for the natural gas sector by end-2021. The energy reform strategy will contribute to foster a green recovery from the COVID-19 pandemic by promoting energy savings and efficiency while supporting the business environment by promoting more competitive pricing.

- **National accounts (MEFP ¶39).** The authorities have started compiling and publishing quarterly GDP at constant prices by expenditure and plan to publish the balanced supply and use tables (SUT) for 2019 by end-2020. This will improve the quality of national accounts, enhance transparency and provide a better picture of economic activity to support policymaking.

PROGRAM ISSUES AND FINANCING

29. The authorities and staff reached an understanding to propose updated program conditionality as follows (MEFP, Tables 1–3). The authorities request (i) modifications of the performance criteria as the adjustors on program/project financing were updated to the latest projections; these are applicable to the fiscal deficit (program definition) and the NIR quantitative performance criteria with no changes to the end-December targets; and (ii) postponing the end-December 2020 SB on the insolvency framework to be postponed to end-March 2021 as they have been delays with the Parliamentary approval due to COVID-19.

30. Financing assurances are in place for the Seventh Review (Table 8). The program, concluding in April 2021, is fully financed and financing assurances are in place for the next 12 months, with the remaining BOP needs to be filled by support from other multilateral and bilateral creditors.

31. Capacity to repay the Fund remains adequate. Georgia's debt is sustainable but, given the recent increase in public debt, warrants high scrutiny under the Emerging Market Debt Sustainability Analysis. Total external debt service remains elevated over the medium term, but debt service to the IMF appears to be manageable, even under downside scenarios. The full drawing under the program would imply repayments to the IMF at 0.5 percent of GDP or 2.4 percent of GIR in 2025 (Table 9).

32. Risks to the program remain manageable, assuming continued sound policies reflecting the authorities' good record under the EFF arrangement and cautious policies proposed under this review. Risks to program implementation could increase in case of a worsened external environment or a weaker-than-projected recovery, for which the authorities have built additional buffers in 2020. Keeping the program on track may require, in consultation with IMF staff, reformulating the policy mix if downside risks were to materialize. The augmentation of the program and donor financing have served as bulwark against heightened uncertainty, supporting macroeconomic prudence.

STAFF APPRAISAL

33. Georgia has weathered the initial COVID-19 shock well, but severe challenges remain. The authorities' prompt policy response helped limit the initial toll of the pandemic. However, as in other countries, the number of cases has been rising recently. The crisis is now expected to last longer than at the Sixth Review and further restrictions on mobility cannot be ruled out. Policies must strike a difficult balancing act between supporting the economy and ensuring that the health system is fully able to cope with the second wave of the pandemic, while preserving buffers against considerable downside risks.

34. The economic impact of the shock has been stronger than initially projected. Growth in 2020 is now projected to contract 5.1 percent, 1.1 percentage points lower than at the Sixth Review, on account of the impact of the lockdown and a more protracted shock, notably to tourism. The recovery is also expected to be slower with the output gap closing only by 2023. Estimated balance of payments needs remain broadly unchanged as robust remittances and better financial account balance offset the deterioration in tourism revenues.

35. The 2021 budget balances continued support to the economy with the need to safeguard debt sustainability. Staff supports extending social transfers, which helped protect the vulnerable, and providing additional financing to the healthcare sector. Reducing capital spending, which outperformed expectations in 2021, should leave the government a fiscal buffer to deploy if downside risks materialize. Strict adherence to the fiscal rule will be critical over the medium term to preserve fiscal credibility, given increased public debt and sizeable contingent liabilities. The latter should be controlled by prompt implementation of the SOE reform.

36. The NBG should continue its efforts to achieve the 3-percent inflation target, in the context of a flexible exchange rate regime. Staff supports recent gradual policy rate cuts in line with declining inflation as demand weakened. However, the scope for further cuts may be limited, given the resumption of depreciation pressures on the lari and the risks to the inflation target and financial stability that a disorderly depreciation would present. The NBG should continue to use interventions to prevent disorderly market conditions.

37. Robust financial supervision helped ensure that the financial system has withstood the COVID-19 shock. Staff welcomes efforts to assess the quality of loan portfolios after the expiration of loan repayment moratoria and ensure that losses are recognized promptly. Viable, solvent enterprises and households should be supported. The timeline for rebuilding capital buffers should be adopted in consultation with the financial sector and based on specific indicators such as the outlook for profitability, while ensuring resilience of the financial sector. Staff welcomes continued progress on implementing the bank resolution framework, which will further strengthen financial resilience.

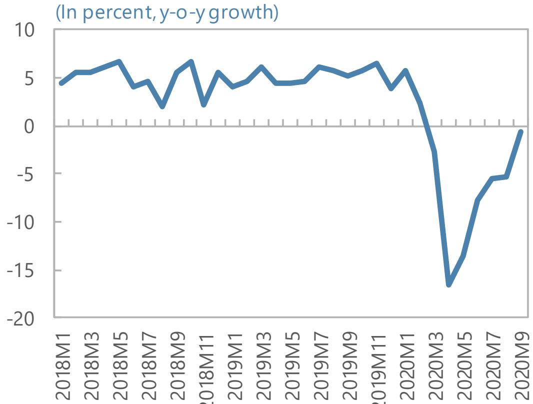
38. Although dealing with the fallout of the COVID-19 shock is the focus of near-term policies, structural reforms should ultimately sustain a durable and inclusive recovery. Implementing the insolvency framework will be important to support the recovery. The authorities should persevere with a comprehensive education reform to increase job creation, productivity and wages in the aftermath of the pandemic.

39. Staff supports the authorities' requests for the completion of the Seventh Review, and modification of performance criteria. The authorities are committed to deal with the fallout of the pandemic in a way that enhances Georgia's resilience to future shocks. Implementation of the authorities' policy commitments under the objectives under the EFF program should help lay the foundations for a durable and inclusive recovery.

Figure 1. Georgia: Real Sector and Inflation Developments

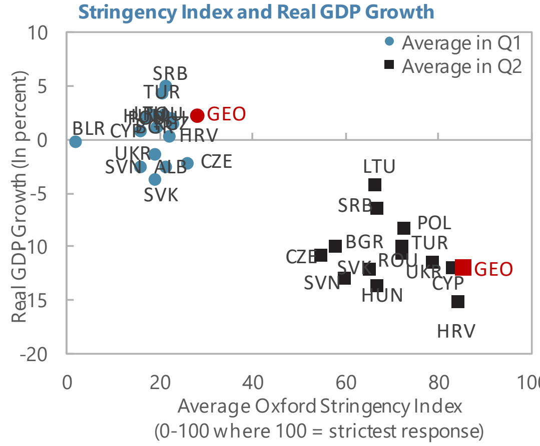
Growth contracted sharply in 2020Q2…

Rapid Estimates of Real GDP Growth
(In percent, y-o-y growth)



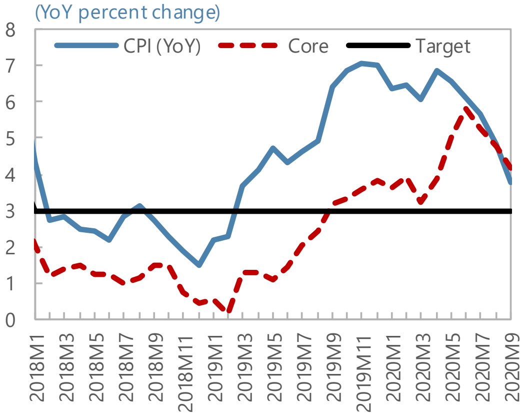
…on the back of stringent containment measures.

Stringency Index and Real GDP Growth



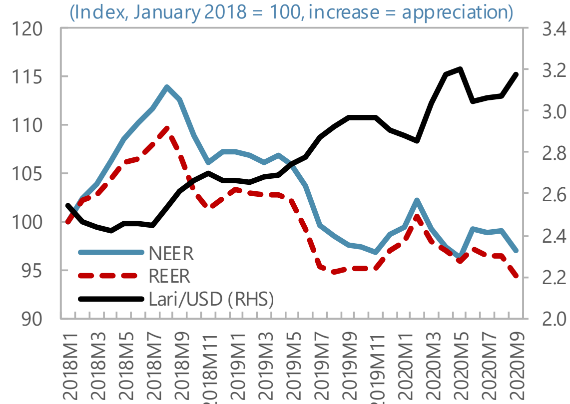
Headline and core inflation picked up during the lockdown before starting to decline…

Inflation: Headline and Core Inflation
(YoY percent change)



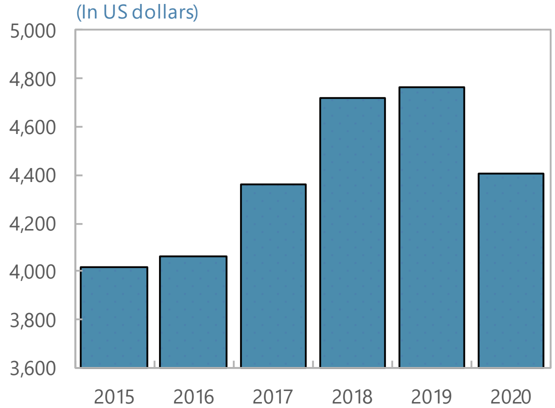
…and the lari continued to depreciate against the dollar and in nominal and real effective terms.

Nominal and Real Effective Exchange Rates
(Index, January 2018 = 100, increase = appreciation)



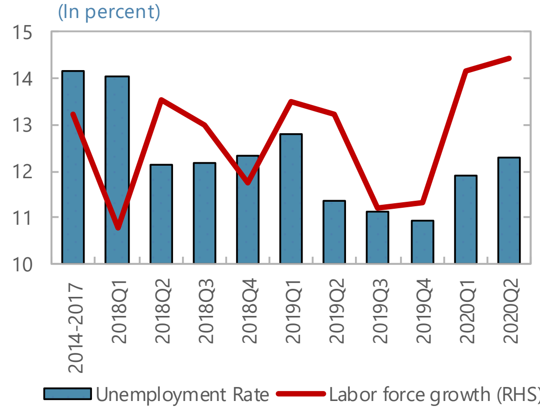
Nominal GDP per capita is expected to decrease…

Nominal GDP per capita
(In US dollars)



…and unemployment picked up in 2020H1.

Unemployment Rate and Labor Force Growth
(In percent)

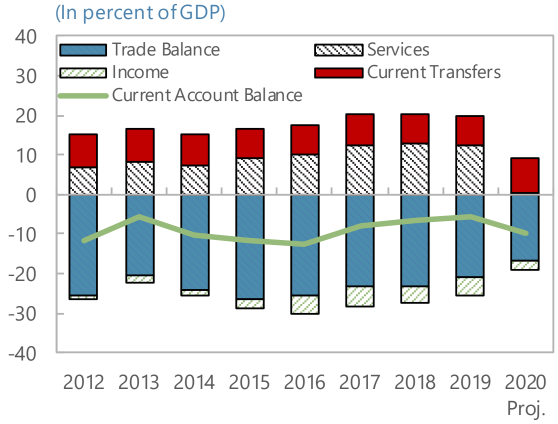


Source: National authorities, Oxford COVID-19 Response Tracker, Haver, GEOStat, and IMF staff calculations.

Figure 2. Georgia: External Sector Developments

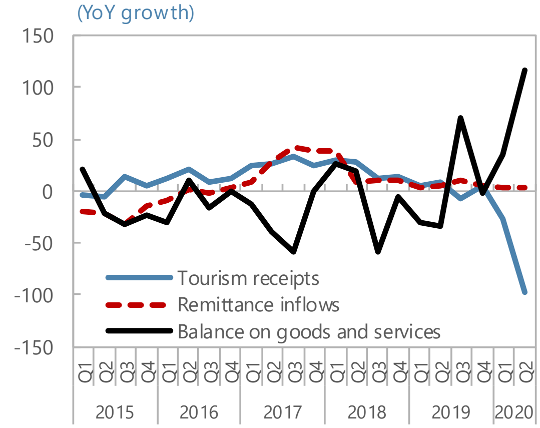
The current account is expected to widen in 2020…

Current Account Balance
(In percent of GDP)



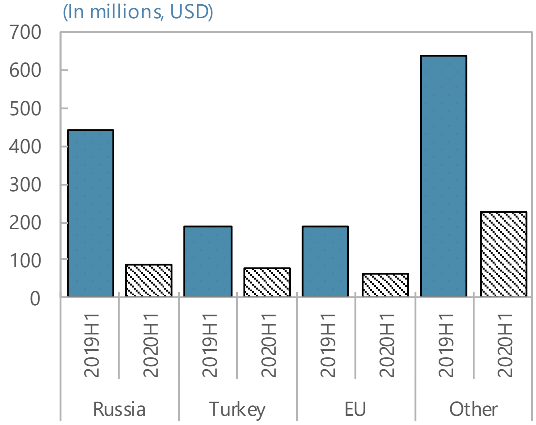
…with tourism almost completely at a standstill.

Net Exports, Tourist Receipts, and Remittances
(YoY growth)



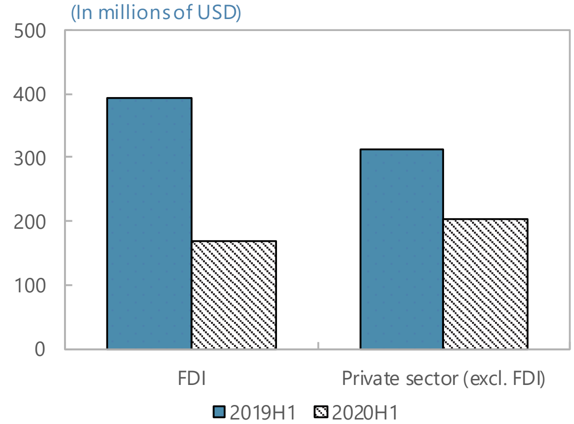
The sharp decline in tourism occurred across the board.

Travel Receipts by Country
(In millions, USD)



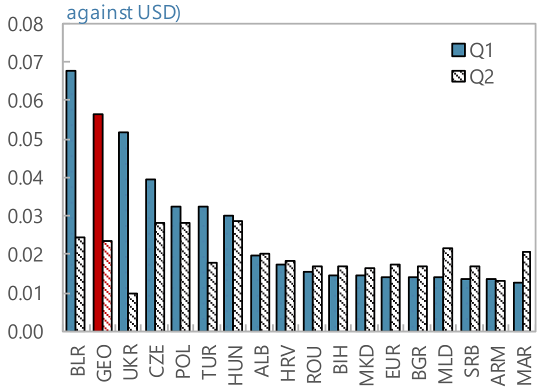
The financial account was stable, largely driven by private sector net inflows that decreased by less than FDI.

Composition of Financial Account
(In millions of USD)



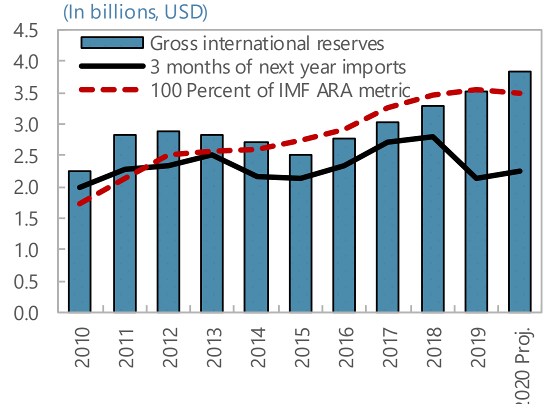
The exchange rate in 2020Q2 was more stable than expected, thanks to donor financing and central bank intervention.

Exchange Rate Volatility
(Standard deviation divided by the daily FX rate against USD)



Reserve coverage is projected to be at adequate levels, supported by IMF and donor financing and FX swap lines.

Reserve Adequacy
(In billions, USD)

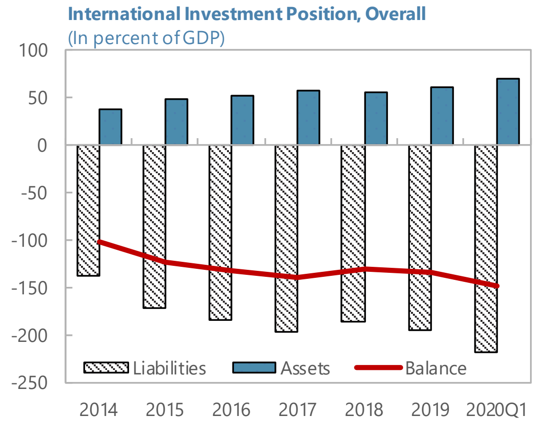


Source: National authorities, Haver, GeoStat, and IMF staff calculations.

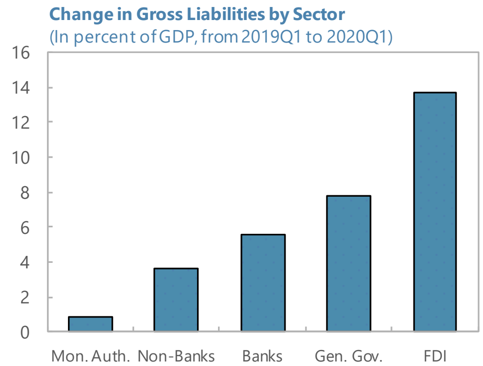
Figure 3. Georgia: International Investment Position (IIP)

(In percent of GDP)

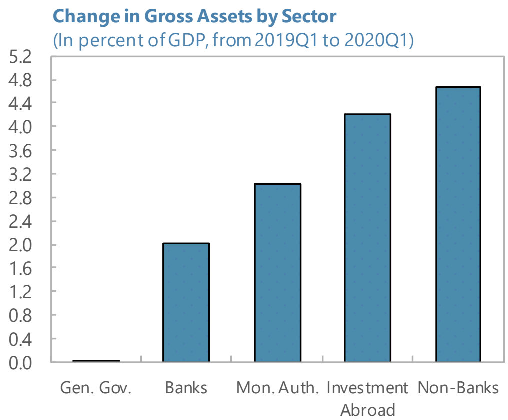
The net IIP remained broadly unchanged in 2019.



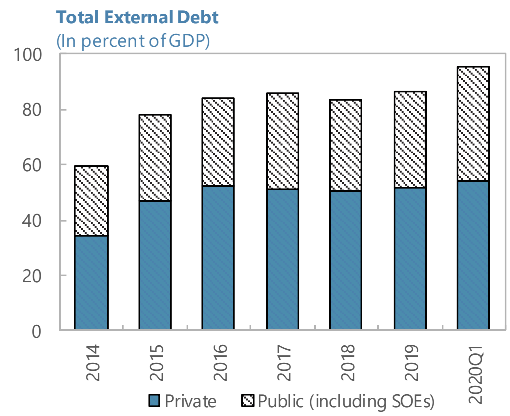
Increases in private sector external debt…



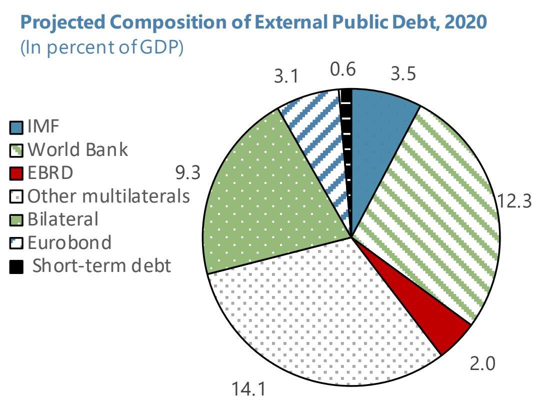
…were offset by NBG's foreign asset accumulation.



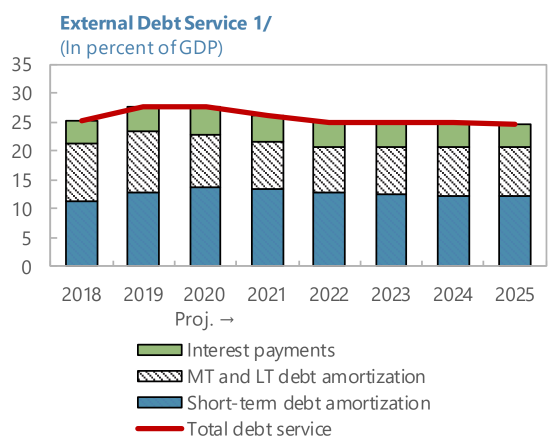
Total external debt remains elevated, driven by the private sector,



…and dominated by official creditors.



Debt service is expected to remain elevated over the medium term.



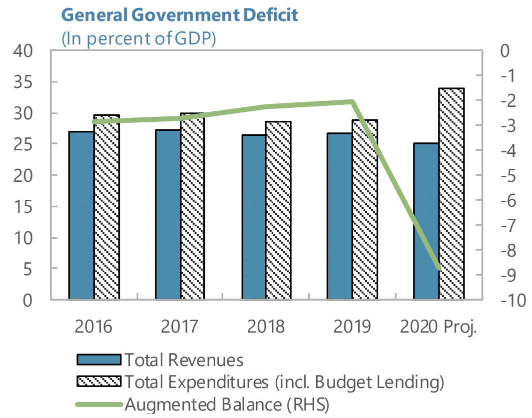
1/ Includes non-resident deposits.

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

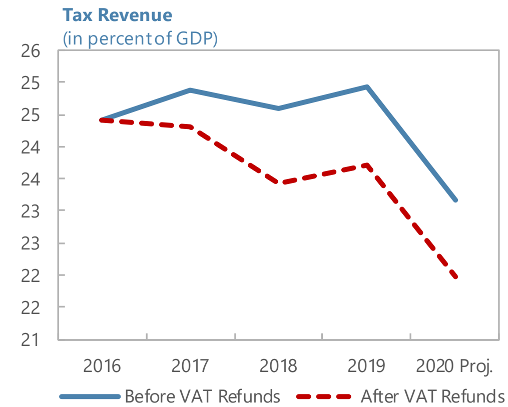
Figure 4. Georgia: Fiscal Sector Developments

(in percent of GDP, unless specified)

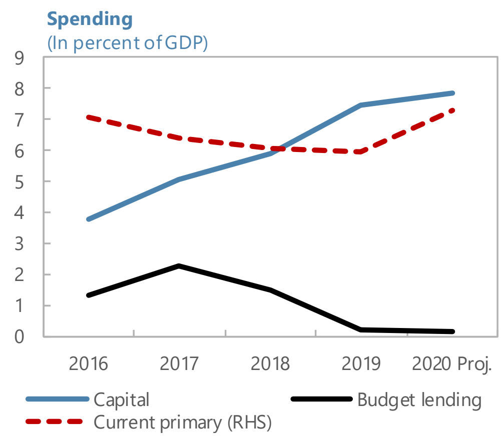
The augmented fiscal deficit is projected to deteriorate this year…



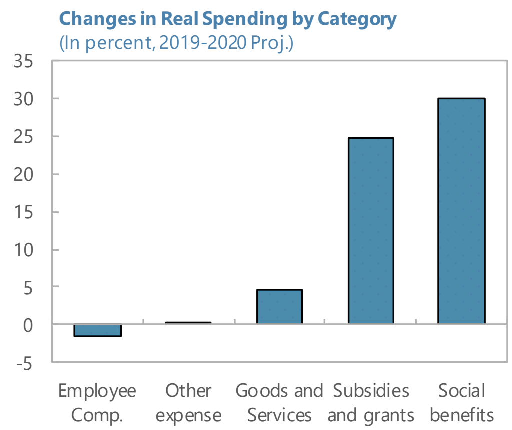
… as the COVID-19 shock is expected to hurt revenues…



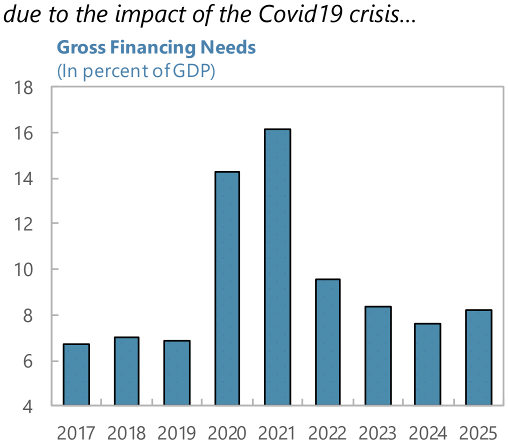
…and increase current spending due to support measures to households and businesses.



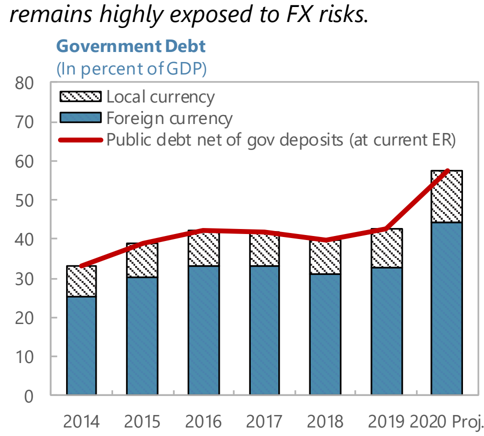
Spending cuts have been concentrated on goods and services, while social benefits have been preserved.



Gross financing needs are expected to peak in 2020-21 due to the impact of the Covid19 crisis…



…triggering an increase in public debt which remains highly exposed to FX risks.

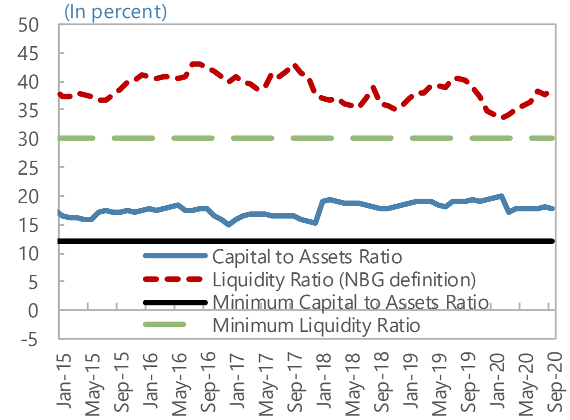


Source: National authorities, and IMF staff estimates.

Figure 5. Georgia: Financial Sector Developments

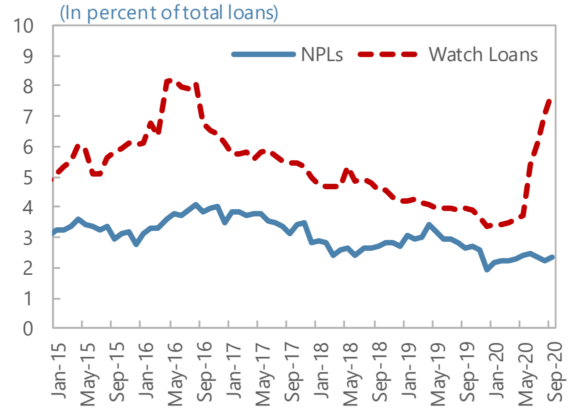
Banks remain liquid and well capitalized.

Capital and Liquidity Ratios
(In percent)



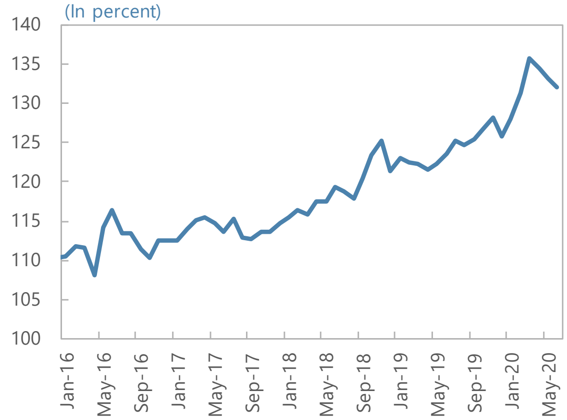
Watch loans have increased, but NPLs are likely to remain subdued partly because of the repayment moratoria.

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



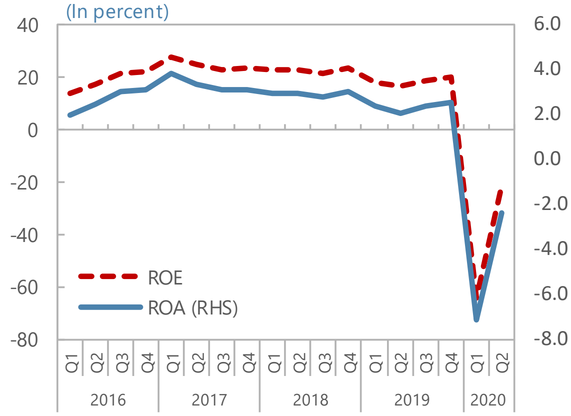
Loan-to-deposit ratio (at constant exchange rates) started to decline as lari deposits recovered.

Loan-To-Deposit Ratio
(In percent)



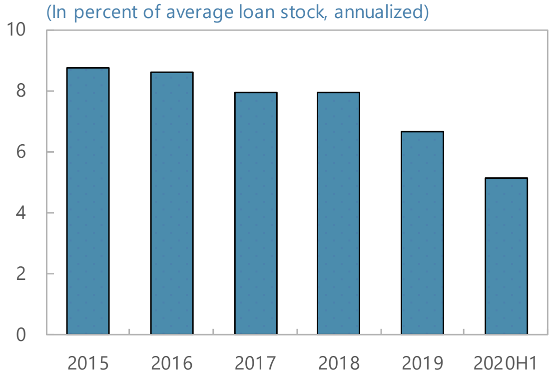
Profitability sharply deteriorated due to loan loss provisions, though it has begun to recover.

Return on Assets and Equity Ratios
(In percent)



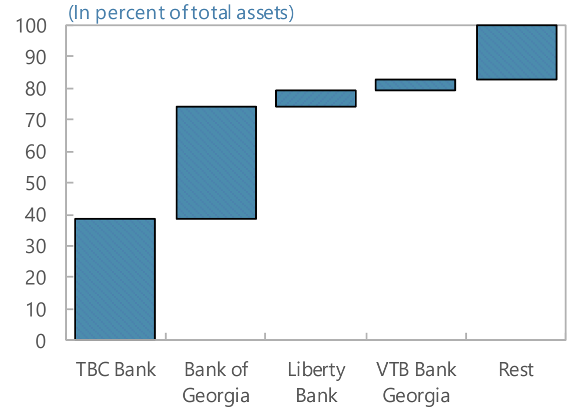
Net interest income declined significantly.

Net Interest Income
(In percent of average loan stock, annualized)



The banking sector remains highly concentrated.

Market Concentration of Assets, Sept 2020
(In percent of total assets)

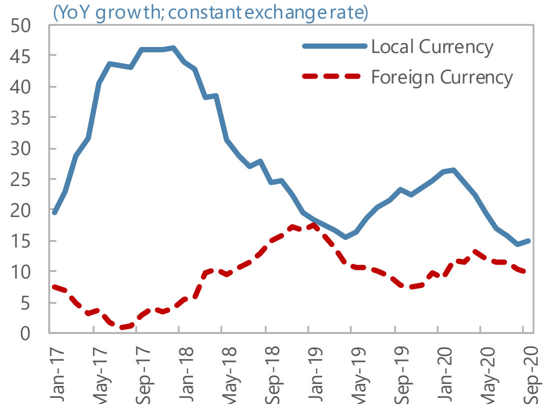


Source: National Bank of Georgia, and IMF staff calculations.

Figure 5. Georgia: Financial Sector Developments
(Concluded)

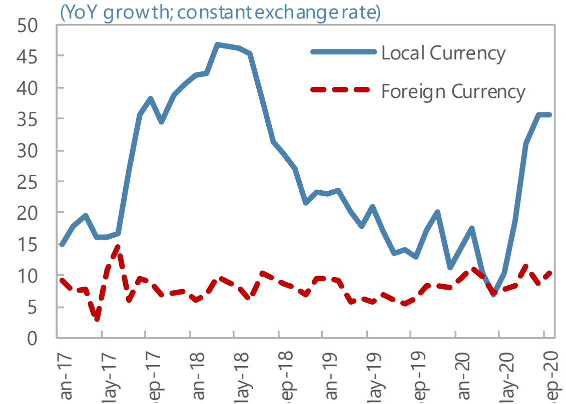
Growth in lari-dominated credit has been slowing down, but remains robust…

Private Sector Credit
(YoY growth; constant exchange rate)



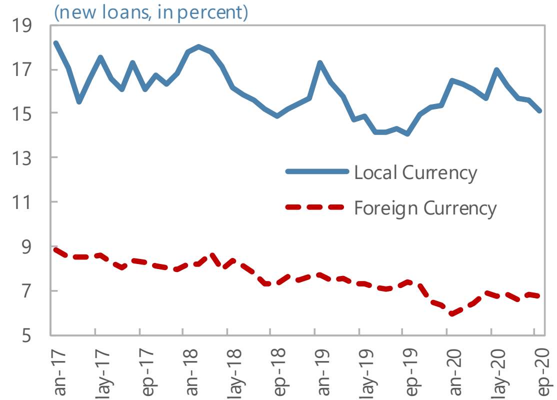
…as lari deposit growth accelerated significantly driven by government operations.

Deposits
(YoY growth; constant exchange rate)



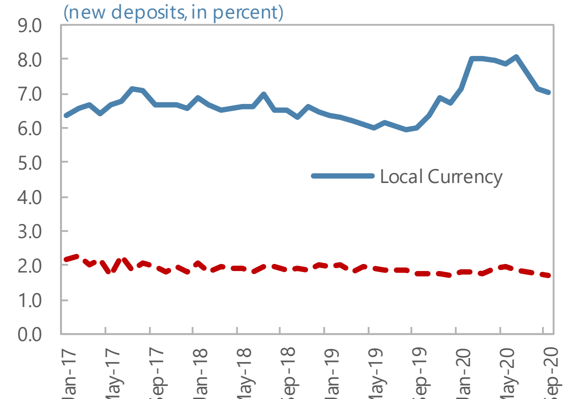
Interest rates on lari loans remain elevated, while those on foreign currency loans declined.

Interest Rates For Loans
(new loans, in percent)



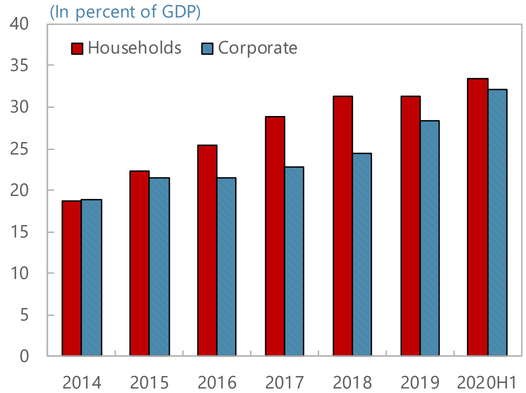
Lari deposit rates spiked during the lari liquidity shortage following the COVID-19 shock.

Interest Rates For Deposits
(new deposits, in percent)



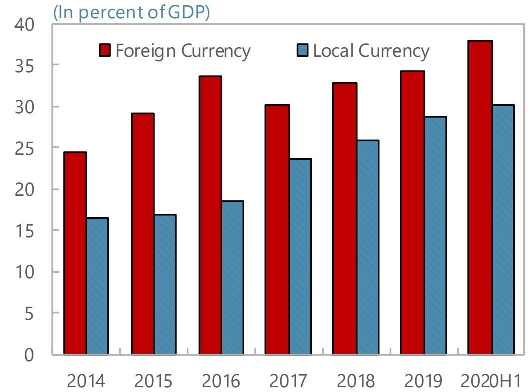
Growth in credit to GDP ratio has been driven by corporate credit.

Credit to the Private Sector
(In percent of GDP)



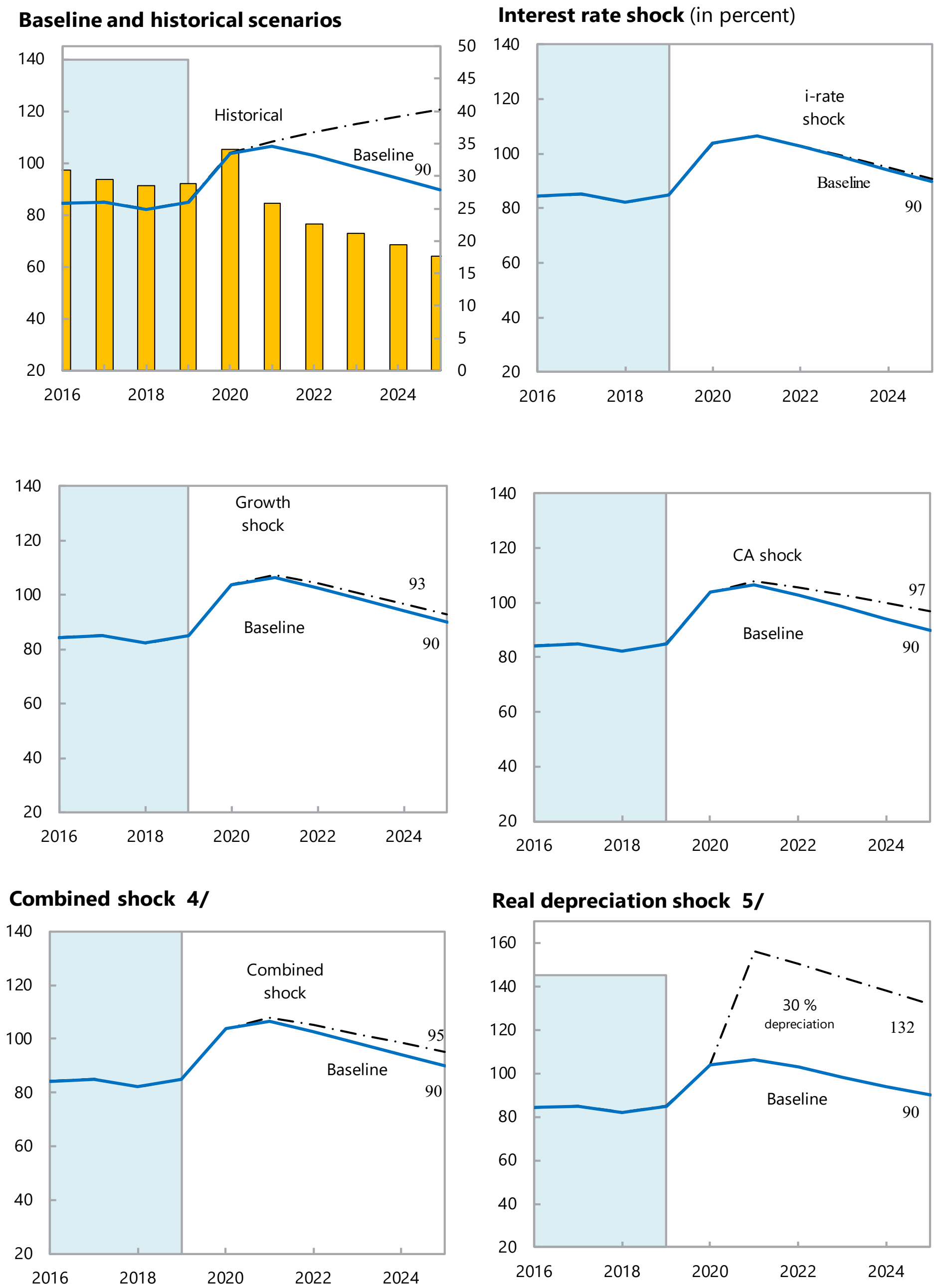
Credit to GDP ratio is also increased due to depreciation increasing the value of FX denominated loans.

Credit-to the Private Sector
(In percent of GDP)



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

Figure 6. Georgia: External Debt Sustainability: Bound Tests
(External debt in percent of GDP)



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

1/The analysis excludes inter-company loans, which are part of FDI and accounted for 18 percent of GDP in 2019.

2/ 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.

3/ 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.

4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

5/ One-time real depreciation of 30 percent occurs in 2019.

Figure 7. Georgia: Public Sector Debt Sustainability Analysis - Baseline Scenario
(In percent of GDP unless otherwise indicated)

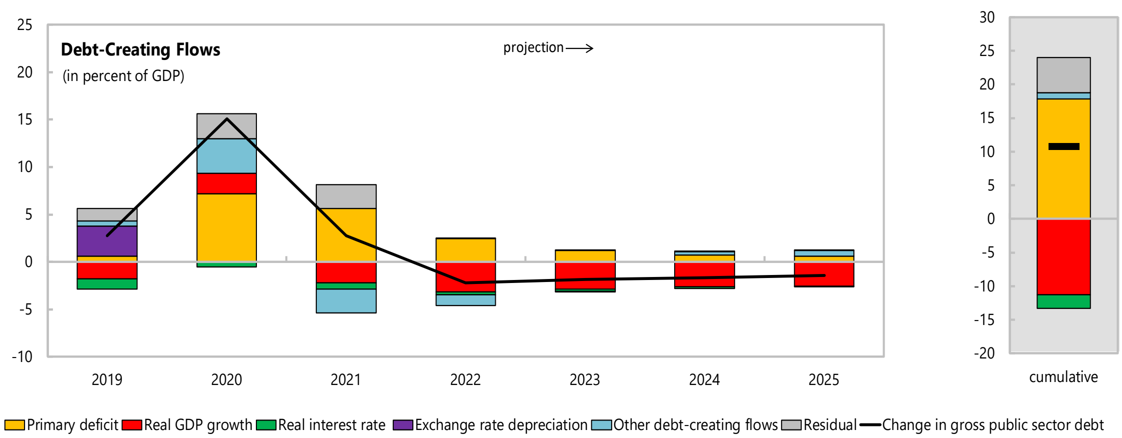
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2009-2017 [2]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	35.3	38.4	41.2	56.3	59.1	56.9	55.0	53.3	51.9
Public gross financing needs	4.5	5.2	6.3	13.5	15.8	10.4	9.4	10.1	11.1
Real GDP growth (in percent)	3.9	4.8	5.1	-5.1	4.3	5.8	5.5	5.2	5.2
Inflation (GDP deflator, in percent)	4.4	4.3	6.4	5.2	3.8	3.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	8.7	9.4	12.1	-0.2	8.1	9.0	8.7	8.4	8.4
Effective interest rate (in percent) [4]	3.1	3.3	3.6	3.6	2.7	2.6	2.7	2.9	3.0

As of November 18, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		434
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba2	Ba2
S&Ps	BB	BB
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	1.0	-0.7	2.8	15.1	2.8	-2.2	-1.9	-1.7	-1.4	10.7	
Identified debt-creating flows	0.3	-1.1	1.4	12.4	0.3	-2.2	-1.9	-1.7	-1.4	5.5	
Primary deficit	0.7	-0.4	0.6	7.2	5.6	2.4	1.2	0.7	0.6	17.8	-2.0
Primary (noninterest) revenue and grants	27.3	26.4	26.7	24.9	24.9	25.5	25.7	25.9	25.9	152.9	
Primary (noninterest) expenditure	28.0	26.0	27.3	32.1	30.5	28.0	27.0	26.7	26.5	170.7	
Automatic debt dynamics [5]	-0.5	-1.9	0.3	1.6	-2.9	-3.5	-3.1	-2.8	-2.6	-13.3	
Interest rate/growth differential [6]	-1.8	-2.2	-2.8	1.6	-2.9	-3.5	-3.1	-2.8	-2.6	-13.3	
Of which: real interest rate	-0.5	-0.5	-1.1	-0.5	-0.6	-0.3	-0.2	-0.1	-0.1	-2.0	
Of which: real GDP growth	-1.2	-1.7	-1.8	2.1	-2.2	-3.1	-2.9	-2.6	-2.6	-11.3	
Exchange rate depreciation [7]	1.3	0.3	3.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.1	1.2	0.5	3.7	-2.5	-1.2	0.0	0.4	0.6	1.0	
GG: Privatization and Drawdown of deposits (negative)	-0.9	-0.3	0.3	3.5	-2.7	-1.5	-0.2	0.1	0.3	-0.5	
GG: Net acquisition of financial assets: Budget lending [8]	1.1	1.5	0.2	0.2	0.2	0.3	0.3	0.3	0.3	1.5	
Residual, including asset changes [9]	0.6	0.4	1.3	2.7	2.5	0.0	0.0	0.0	0.0	5.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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

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

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

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

8/ Includes net budget lending.

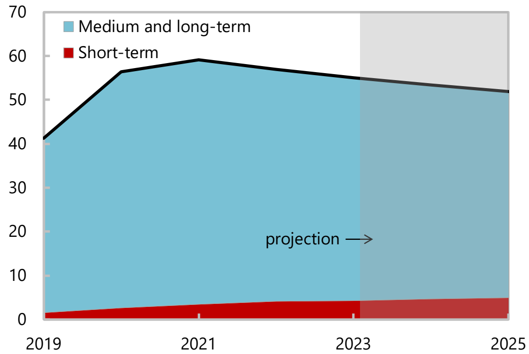
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

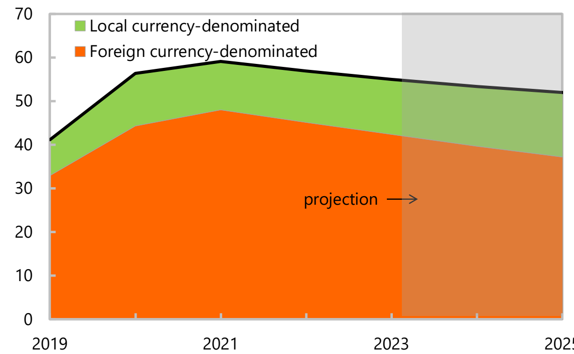
Figure 8. Georgia: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



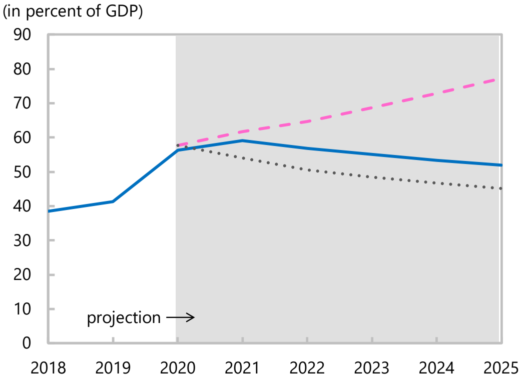
By Currency
(in percent of GDP)



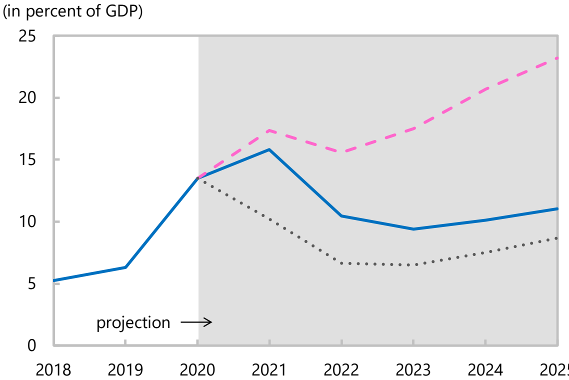
Alternative Scenarios

Baseline | Historical | Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-5.1	4.3	5.8	5.5	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-7.2	-5.6	-2.4	-1.2	-0.7	-0.6
Effective interest rate	3.6	2.7	2.6	2.7	2.9	3.0
Constant Primary Balance Scenario						
Real GDP growth	-5.1	4.3	5.8	5.5	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-7.2	-7.2	-7.2	-7.2	-7.2	-7.2
Effective interest rate	3.6	2.6	2.5	2.7	2.8	3.0

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-5.1	4.9	4.9	4.9	4.9	4.9
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-7.2	-0.1	-0.1	-0.1	-0.1	-0.1
Effective interest rate	3.6	2.6	2.3	2.3	2.3	2.3

Source: IMF staff.

Table 1. Georgia: Selected Economic and Financial Indicators, 2018–25

	2018	2019	2020	2020	2021	2021	2022	2023	2024	2025
	Actual	Actual	EFF 6th Review	Proj.	EFF 6th Review			Projections		
National accounts and prices 1/			(annual percentage change; unless otherwise indicated)							
Real GDP	4.8	5.1	-4.0	-5.1	4.0	4.3	5.8	5.5	5.2	5.2
Output Gap	-1.5	-0.5	-1.5	-2.7	-1.7	-2.5	-1.0	0.0	0.0	0.0
Nominal GDP (in billion of laris)	44.6	50.0	50.3	49.9	54.5	53.9	58.8	63.9	69.2	75.0
Nominal GDP (in billion of U.S. dollars)	17.6	17.7	15.1	16.2	17.7	17.0	18.5	20.1	21.8	23.6
GDP per capita (in thousand of U.S. dollars)	4.7	4.8	4.1	4.4	4.8	4.6	5.0	5.4	5.9	6.4
GDP deflator, period average	4.3	6.4	5.1	5.2	4.0	3.8	3.0	3.0	3.0	3.0
CPI, Period average	2.6	4.9	4.7	5.2	3.6	2.5	3.0	3.0	3.0	3.0
CPI, End-of-period	1.5	7.0	3.5	3.5	3.0	3.0	3.0	3.0	3.0	3.0
Core CPI, End-of-period	0.5	3.8	…	…	…	…	…	…	…	…
Investment and saving					(in percent of GDP)					
Gross national saving	21.4	23.2	20.3	16.6	25.5	15.1	18.0	17.7	18.5	19.0
Investment	28.1	28.6	31.6	26.4	33.0	23.6	24.4	23.9	24.2	24.5
Public	6.4	7.9	6.4	8.1	6.4	7.9	7.0	5.9	5.5	5.2
Private	21.7	20.7	25.2	18.3	26.6	15.7	17.4	18.0	18.7	19.3
Consolidated government operations					(in percent of GDP)					
Revenue and grants	26.4	26.7	24.1	24.9	24.7	24.9	25.5	25.7	25.9	25.9
o.w. Tax revenue	23.4	23.7	21.4	21.8	22.2	22.3	22.9	23.2	23.4	23.4
Expenditures	29.2	29.1	32.9	34.2	29.9	32.9	29.9	28.9	28.6	28.4
Current expenditures	21.3	21.0	26.2	25.9	23.2	24.9	22.6	22.7	22.8	22.9
Capital spending and budget lending	7.9	8.1	6.7	8.3	6.8	8.0	7.3	6.2	5.8	5.5
Net Lending/Borrowing (GFSM 2001)	-0.8	-1.8	-8.2	-8.8	-4.4	-7.4	-3.6	-2.5	-2.0	-1.9
Augmented Net lending / borrowing (Program definition) 2/	-2.3	-2.0	-8.5	-9.0	-4.8	-7.5	-4.0	-2.7	-2.3	-2.2
Public debt 3/	38.4	41.2	62.8	56.3	59.6	59.1	56.9	55.0	53.3	51.9
o.w. Foreign-currency denominated	31.2	32.9	50.6	44.3	45.6	48.0	45.1	42.4	39.7	37.1
Public debt net of government deposits 3/	36.0	38.3	54.0	49.6	51.2	55.1	54.3	52.5	50.5	48.7
Money and credit				(in percent; unless otherwise indicated)						
Credit to the private sector (annual percentage change)	19.9	20.7	5.9	17.1	3.6	6.5	7.6	8.0	8.4	8.4
In constant exchange rate	17.7	16.1	-2.3	10.0	8.2	6.0	7.5	8.0	8.4	8.4
Broad money (annual percentage change)	13.9	17.6	3.6	14.3	11.5	16.5	14.5	10.2	9.8	9.8
In constant exchange rate (estimate)	15.1	14.3	-4.6	8.8	16.7	14.9	14.5	10.1	9.8	9.8
Broad money (excl. fx deposits, annual percentage change)	15.9	18.8	3.1	14.3	8.3	17.7	15.7	11.3	10.9	10.9
Deposit dollarization (in percent of total)	63.1	64.0	62.4	64.1	58.4	63.4	62.7	62.0	61.4	60.8
Credit dollarization (in percent of total)	57.1	55.4	51.6	56.9	49.2	56.7	56.7	55.7	54.7	53.7
Credit to the private sector (percent GDP)	57.4	61.8	66.2	72.6	63.3	71.5	70.6	70.2	70.2	70.2
External sector				(in percent; unless otherwise indicated)						
Current account balance (in billions of US$)	-1.2	-1.0	-1.7	-1.6	-1.3	-1.4	-1.2	-1.2	-1.2	-1.3
Current account balance	-6.8	-5.4	-11.3	-9.8	-7.5	-8.5	-6.4	-6.2	-5.7	-5.5
Trade balance	-23.4	-21.0	-20.4	-17.1	-19.8	-16.8	-16.7	-16.6	-16.5	-16.3
Terms of trade (percent change)	-5.2	2.5	1.8	4.8	3.9	-0.5	0.6	1.0	1.8	1.4
Gross international reserves (in billions of US$)	3.3	3.5	3.5	3.6	3.6	3.4	3.7	3.9	4.2	4.4
In percent of IMF Composite measure (floating)	95.0	99.0	103.9	105.4	98.5	95.4	95.5	95.9	98.7	101.3
Gross external debt	100.3	103.4	136.3	127.0	124.1	129.0	124.4	120.9	116.2	111.6
Gross external debt, excl. intercompany loans	82.2	85.0	111.4	103.8	102.2	106.5	102.7	98.4	94.2	89.9
Laris per U.S. dollar (period average)	2.53	2.82	…	…	…	…	…	…	…	…
Laris per euro (period average)	2.99	3.15	…	…	…	…	…	…	…	…
REER (period average; CPI based, 2010=100)	106.2	100.5	…	…	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.

1/ National accounts numbers include the impact of GDP rebasing, which increased GDP levels while leaving growth rates unchanged.

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

3/ Public debt includes central government and NBG and excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 2. Georgia: Balance of Payments, 2018-25

	2018	2019	2020	2020	2021	2021	2022	2023	2024	2025
	Actual	Actual	EFF 6th Review	Proj.	EFF 6th Review			Projections		
				(in millions of U.S. dollars)						
Current account balance	-1,191	-957	-1,714	-1,588	-1,326	-1,444	-1,182	-1,239	-1,244	-1,305
Trade balance	-4,112	-3,726	-3,091	-2,759	-3,502	-2,853	-3,098	-3,338	-3,593	-3,860
Exports	4,448	4,990	3,784	4,225	4,101	4,593	4,870	5,372	5,922	6,286
Imports	-8,560	-8,716	-6,875	-6,985	-7,603	-7,446	-7,968	-8,710	-9,515	-10,146
Services	2,241	2,169	1,059	79	1,709	430	980	1,329	1,670	1,933
Services: credit	4,482	4,586	2,032	1,634	3,300	1,993	2,908	3,858	4,810	5,382
Services: debit	-2,241	-2,418	-973	-1,555	-1,591	-1,563	-1,928	-2,528	-3,140	-3,449
Income	-685	-775	-920	-310	-886	-489	-621	-817	-979	-1,094
Of which : interest payments	-552	-608	-586	-597	-580	-582	-620	-658	-698	-741
Transfers	1,364	1,375	1,238	1,402	1,353	1,469	1,558	1,587	1,659	1,716
Of which : remittances (net)	864	915	779	951	857	1,018	1,048	1,080	1,112	1,145
Capital account	77	48	71	40	73	40	39	38	38	37
General government	72	42	71	40	73	40	39	38	38	37
Financial account	1,058	1,016	57	415	730	372	1,361	1,408	1,506	1,499
Direct investment (net)	925	1,029	736	611	928	575	862	1,099	1,294	1,396
Portfolio investment (net)	-44	707	-225	176	-50	-87	300	206	240	271
Equity	-59	-50	0	-10	0	0	0	0	0	0
Debt securities	15	758	-225	186	-50	-87	300	206	240	271
Loans (net)	154	-136	298	276	350	507	406	403	302	244
Short-term loans (net)	-85	40	-75	53	-19	-23	4	5	7	7
Public	4	-1	0	-4	0	-4	-4	-2	-2	-2
Private	-90	41	-75	57	-19	-20	8	7	9	9
Medium and long-term loans (net)	239	-176	373	222	370	530	402	398	295	237
Public 1/	141	91	340	247	186	219	207	216	184	173
Private	98	-266	33	-25	183	311	195	182	112	64
Bank	332	-73	241	161	296	422	336	324	271	241
Non-bank	-234	-193	-208	-186	-113	-112	-141	-142	-160	-177
Others (net) 2/	23	-585	-752	-648	-498	-623	-206	-300	-330	-412
Errors and omissions	-31	-29	0	-36	0	0	0	0	0	0
Overall balance	-88	77	-1,586	-1,169	-523	-1,032	219	208	300	231
Financing	-114	-324	-27	-136	-45	202	-219	-208	-300	-231
Gross International Reserves (-increase)	-278	-202	-27	-136	-45	202	-219	-208	-300	-231
Rescheduled debts and arrears clearance	165	-122	0	0	0	0	0	0	0	0
Financing gap	201	247	1,613	1,305	568	830	0	0	0	0
Use of Fund Resources	27	35	313	310	96	106	0	0	0	0
Proposed IMF EFF	84	83	313	310	99	109	0	0	0	0
Repayment 3/	-57	-48	0	0	-3	-4	0	0	0	0
Official creditors	174	212	1,301	992	473	722	30	0	0	0
Memorandum items:				(in percent of GDP)						
Current account balance	-6.8	-5.4	-11.3	-9.8	-7.5	-8.5	-6.4	-6.2	-5.7	-5.5
Trade balance	-23.4	-21.0	-20.4	-17.1	-19.8	-16.8	-16.7	-16.6	-16.5	-16.3
Financial account	6.0	5.7	0.4	2.6	4.1	2.2	7.3	7.0	6.9	6.3
Foreign direct investment (net)	5.3	5.8	4.9	3.8	5.3	3.4	4.7	5.5	5.9	5.9
External financing requirement	28.1	28.9	36.5	33.3	25.6	26.5	22.5	21.3	19.2	17.5
Gross international reserves (in million of USD)	3,289	3,506	3,533	3,642	3,578	3,440	3,659	3,866	4,166	4,396
in months of next year GNFS imports	3.5	4.9	4.6	4.9	3.9	4.2	3.9	3.7	3.7	3.9
in percent of short-term debt at remaining maturity	79	95	99	99	91	90	88	85	86	88
in percent of broad money and non-resident deposits	33	34	39	38	34	33	33	31	31	30
in percent of IMF Composite measure (floating)	95	99	104	105	99	95	96	96	99	101
in percent of short-term external debt (remaining matur	79	95	99	99	91	90	88	85	86	88
Reserve cover (percent) 4/	50.4	53.7	49.5	50.9	51.1	48.0	50.8	50.4	51.3	50.8

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

1/ Including general government and monetary authorities

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

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

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

Table 3a. Georgia: General Government Operations, 2018–25

(In millions of GEL)

	2018	2019	2020	2020	2021	2021	2022	2023	2024	2025
			EFF 6th		EFF 6th					
	Actual	Actual	Review	Proj.	Review			Projections		
Revenue	11,761	13,350	12,143	12,448	13,467	13,421	15,005	16,440	17,943	19,386
Taxes	10,445	11,860	10,761	10,872	12,106	12,045	13,467	14,798	16,193	17,517
Taxes on income, profits, and capital gains	3,984	4,349	4,060	4,148	4,470	4,580	5,195	5,705	6,302	6,827
Payable by individuals	3,247	3,483	3,162	3,222	3,549	3,649	4,196	4,620	5,057	5,477
Payable by corporations	737	866	899	926	921	931	999	1,086	1,245	1,350
Taxes on property	441	474	477	400	517	415	502	545	591	640
Taxes on goods and services	5,893	6,746	6,242	6,379	7,076	6,930	7,670	8,430	9,206	9,975
General taxes on goods and services (VAT)	4,427	5,239	4,836	4,884	5,483	5,356	5,954	6,566	7,186	7,786
Excises	1,466	1,507	1,406	1,495	1,592	1,574	1,716	1,864	2,020	2,189
Taxes on international trade	73	79	81	74	83	78	84	91	99	107
Other taxes 1/	54	212	-100	-129	-40	42	17	26	-5	-32
Grants	341	422	432	496	331	276	339	339	339	339
Other revenue	975	1,067	950	1,080	1,029	1,100	1,199	1,303	1,411	1,529
Total Expenditure	12,125	14,257	16,261	16,837	15,875	17,393	17,144	18,005	19,340	20,824
Expense	9,496	10,518	13,179	12,932	12,625	13,407	13,294	14,505	15,794	17,177
Compensation of employees	1,685	1,785	1,838	1,850	2,023	1,955	2,092	2,238	2,425	2,628
Use of goods and services	1,584	1,659	1,712	1,825	1,828	2,070	1,954	2,067	2,239	2,426
Interest	520	611	779	801	864	933	707	792	882	984
External	269	324	383	386	347	388	359	344	325	306
Domestic	252	287	396	415	517	545	348	448	557	678
Subsidies	849	990	1,550	1,190	1,109	1,285	1,163	1,230	1,333	1,445
Grants	66	126	135	275	146	170	93	101	109	118
Social benefits	3,732	4,198	5,957	5,776	5,281	5,573	5,547	6,088	6,649	7,240
Other expense 2/	1,060	1,150	1,208	1,215	1,374	1,422	1,739	1,989	2,156	2,336
Net acquisition of nonfinancial assets	2,629	3,739	3,082	3,905	3,250	3,986	3,850	3,500	3,546	3,647
Increase (capital spending)	2,860	3,945	3,232	4,055	3,500	4,236	4,100	3,750	3,800	3,900
Decrease (privatization proceeds)	-231	-206	-150	-150	-250	-250	-250	-250	-254	-253
Net lending / borrowing before adjustment	-364	-907	-4,118	-4,389	-2,408	-3,972	-2,139	-1,565	-1,397	-1,438
Unidentified measures	0	0	0	0	0	0	0	0	0	0
Net lending / borrowing	-364	-908	-4,118	-4,389	-2,408	-3,972	-2,139	-1,565	-1,397	-1,438
Change in net financial worth, transactions	-364	-908	-4,118	-4,389	-2,408	-3,972	-2,139	-1,565	-1,397	-1,438
Net acquisition of financial assets ("+": increase in assets)	753	456	3,102	1,976	343	-1,105	-428	280	504	687
Domestic	753	456	3,102	1,976	343	-1,105	-428	280	504	687
Budget lending	657	111	150	80	185	91	185	185	185	221
Deposits (NBG and commercial banks)	96	346	2,952	1,896	158	-1,196	-613	95	319	466
Financial privatization	0	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,117	1,364	7,219	6,365	2,751	2,867	1,711	1,845	1,901	2,125
Domestic	377	898	1,142	1,809	760	-75	960	1,160	1,360	1,660
Securities other than shares	377	898	1,142	1,215	760	-75	960	1,160	1,360	1,660
Loans	0	0	0	594	0	0	0	0	0	0
Foreign	740	467	6,078	4,556	1,991	2,942	751	685	541	465
Loans	740	467	6,078	4,556	1,991	2,942	751	685	541	465
Memorandum items:										
Nominal GDP	44,599	50,002	50,303	49,897	54,505	53,924	58,772	63,858	69,194	74,974
Public debt 4/	17,146	20,615	31,466	28,106	31,645	31,862	33,435	35,132	36,907	38,928
End-year government deposits	1,108	1,454	4,405	3,350	4,563	2,154	1,540	1,636	1,954	2,420
Operating balance	2,265	2,831	-1,036	-485	842	14	1,711	1,935	2,149	2,209
Net lending / borrowing (excluding privatization)	-595	-1,114	-4,268	-4,539	-2,658	-4,222	-2,389	-1,815	-1,651	-1,691
Augmented Net lending / borrowing (Program definition) 3/	-1,021	-1,019	-4,268	-4,469	-2,593	-4,063	-2,324	-1,750	-1,582	-1,659
Cyclically-adjusted primary balance (Program definition)	-335	-349	-3,317	-3,345	-1,512	-2,800	-1,472	-958	-700	-675

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.
2/ Includes wages and salaries in the education sector.
3/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.
4/ Public debt includes central government and NBG and excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 3b. Georgia: General Government Operations, 2018–25
(In percent of GDP)

	2018	2019	2020	2020	2021	2021	2022	2023	2024	2025
			EFF 6th		EFF 6th					
	Actual	Actual	Review	Proj.	Review			Projections		
Revenue	26.4	26.7	24.1	24.9	24.7	24.9	25.5	25.7	25.9	25.9
Taxes	23.4	23.7	21.4	21.8	22.2	22.3	22.9	23.2	23.4	23.4
Taxes on income, profits, and capital gains	8.9	8.7	8.1	8.3	8.2	8.5	8.8	8.9	9.1	9.1
Payable by individuals	7.3	7.0	6.3	6.5	6.5	6.8	7.1	7.2	7.3	7.3
Payable by corporations	1.7	1.7	1.8	1.9	1.7	1.7	1.7	1.7	1.8	1.8
Taxes on property	1.0	0.9	0.9	0.8	0.9	0.8	0.9	0.9	0.9	0.9
Taxes on goods and services	13.2	13.5	12.4	12.8	13.0	12.9	13.0	13.2	13.3	13.3
General taxes on goods and services (VAT)	9.9	10.5	9.6	9.8	10.1	9.9	10.1	10.3	10.4	10.4
Excises	3.3	3.0	2.8	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Taxes on international trade	0.2	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Other taxes 1/	0.1	0.4	-0.2	-0.3	-0.1	0.1	0.0	0.0	0.0	0.0
Grants	0.8	0.8	0.9	1.0	0.6	0.5	0.6	0.5	0.5	0.5
Other revenue	2.2	2.1	1.9	2.2	1.9	2.0	2.0	2.0	2.0	2.0
Total Expenditure	27.2	28.5	32.3	33.7	29.1	32.3	29.2	28.2	28.0	27.8
Expense	21.3	21.0	26.2	25.9	23.2	24.9	22.6	22.7	22.8	22.9
Compensation of employees	3.8	3.6	3.7	3.7	3.7	3.6	3.6	3.5	3.5	3.5
Use of goods and services	3.6	3.3	3.4	3.7	3.4	3.8	3.3	3.2	3.2	3.2
Interest	1.2	1.2	1.5	1.6	1.6	1.7	1.2	1.2	1.3	1.3
External	0.6	0.6	0.8	0.8	0.6	0.7	0.6	0.5	0.5	0.4
Domestic	0.6	0.6	0.8	0.8	0.9	1.0	0.6	0.7	0.8	0.9
Subsidies	1.9	2.0	3.1	2.4	2.0	2.4	2.0	1.9	1.9	1.9
Grants	0.1	0.3	0.3	0.6	0.3	0.3	0.2	0.2	0.2	0.2
Social benefits	8.4	8.4	11.8	11.6	9.7	10.3	9.4	9.5	9.6	9.7
Other expense 2/	2.4	2.3	2.4	2.4	2.5	2.6	3.0	3.1	3.1	3.1
Net acquisition of nonfinancial assets	5.9	7.5	6.1	7.8	6.0	7.4	6.6	5.5	5.1	4.9
Increase (capital spending)	6.4	7.9	6.4	8.1	6.4	7.9	7.0	5.9	5.5	5.2
Decrease (privatization proceeds)	-0.5	-0.4	-0.3	-0.3	-0.5	-0.5	-0.4	-0.4	-0.4	-0.3
Net lending / borrowing before adjustment	-0.8	-1.8	-8.2	-8.8	-4.4	-7.4	-3.6	-2.5	-2.0	-1.9
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / borrowing	-0.8	-1.8	-8.2	-8.8	-4.4	-7.4	-3.6	-2.5	-2.0	-1.9
Change in net financial worth, transactions	-0.8	-1.8	-8.2	-8.8	-4.4	-7.4	-3.6	-2.5	-2.0	-1.9
Net acquisition of financial assets ("+": increase in assets)	1.7	0.9	6.2	4.0	0.6	-2.0	-0.7	0.4	0.7	0.9
Domestic	1.7	0.9	6.2	4.0	0.6	-2.0	-0.7	0.4	0.7	0.9
Budget lending	1.5	0.2	0.3	0.2	0.3	0.2	0.3	0.3	0.3	0.3
Deposits (NBG and commercial banks)	0.2	0.7	5.9	3.8	0.3	-2.2	-1.0	0.1	0.5	0.6
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)	2.5	2.7	14.4	12.8	5.0	5.3	2.9	2.9	2.7	2.8
Domestic	0.8	1.8	2.3	3.6	1.4	-0.1	1.6	1.8	2.0	2.2
Securities other than shares	0.8	1.8	2.3	2.4	1.4	-0.1	1.6	1.8	2.0	2.2
Loans	0.0	0.0	0.0	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.7	0.9	12.1	9.1	3.7	5.5	1.3	1.1	0.8	0.6
Loans	1.7	0.9	12.1	9.1	3.7	5.5	1.3	1.1	0.8	0.6
Memorandum items:										
Nominal GDP (in millions of GEL)	44,599	50,002	50,303	49,897	54,505	53,924	58,772	63,858	69,194	74,974
Public debt 4/	38.4	41.2	62.6	56.3	58.1	59.1	56.9	55.0	53.3	51.9
End-year government deposits	2.5	2.9	8.8	6.7	8.4	4.0	2.6	2.6	2.8	3.2
Operating balance (before adjustment)	5.1	5.7	-2.1	-1.0	1.5	0.0	2.9	3.0	3.1	2.9
Net lending / borrowing (excluding privatization)	-1.3	-2.2	-8.5	-9.1	-4.9	-7.8	-4.1	-2.8	-2.4	-2.3
Augmented Net lending / borrowing (Program definition) 3/	-2.3	-2.0	-8.5	-9.0	-4.8	-7.5	-4.0	-2.7	-2.3	-2.2
Cyclically-adjusted primary balance (Program definition)	-0.8	-0.7	-6.6	-6.7	-2.8	-5.2	-2.5	-1.5	-1.0	-0.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.
2/ Includes wages and salaries in the education sector.
3/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.
4/ Public debt includes central government and NBG and excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 4. Georgia: Monetary Survey, 2018-21

	2018	2019		2020		2021	
						Projections	
		June	Dec	June	Dec	June	Dec
Central Bank				(In billions of lari)			
Net foreign assets	7.8	9.5	8.8	9.7	9.4	8.8	8.6
Gross international reserves	8.8	10.7	10.1	11.0	11.2	11.0	10.8
Foreign liabilities	1.0	1.2	1.3	1.4	1.8	2.2	2.2
Of which : use of Fund resources	0.4	0.6	0.7	0.8	1.1	1.5	1.5
Net domestic assets	0.0	-0.5	0.2	-0.2	1.0	2.2	3.4
Net claims on central government	-0.1	0.4	-0.4	-0.3	-0.6	0.0	0.6
Claims on general government (incl. T-bills)	0.6	0.8	1.0	1.2	1.1	1.1	1.1
Nontradable govt. debt	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Debt securities (tradable)	0.4	0.6	0.8	1.0	0.9	1.0	0.9
Deposits	0.8	0.5	1.5	1.5	1.7	1.1	0.5
Net claims on banks (excl. reserves)	1.8	1.3	3.1	2.8	4.7	5.3	6.0
Bank refinancing (incl. swap lines)	1.9	1.4	3.1	2.8	4.8	5.4	6.0
Certificates of deposits and bonds	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other items, net	-1.7	-2.2	-2.5	-2.7	-3.1	-3.1	-3.1
Reserve Money	7.9	9.0	8.9	9.5	10.4	11.0	12.1
Banking System				(In billions of lari)			
Net foreign assets	-0.2	0.0	-0.4	-1.0	-1.3	-3.5	-3.7
NBG	7.8	9.5	8.8	9.7	9.4	8.8	8.6
Commercial banks	-8.0	-9.6	-9.1	-10.7	-10.7	-12.3	-12.3
Net domestic assets	20.9	22.4	24.7	26.6	29.2	31.6	36.1
Domestic credit	28.1	30.7	33.3	36.2	37.9	39.6	41.4
Net claims on central government	1.6	2.0	1.6	2.0	0.9	1.5	2.0
Of which : government deposits at NBG	0.8	0.5	1.5	1.5	1.7	1.1	0.5
Of which : T-bills at commercial banks	1.1	1.1	0.8	1.6	2.5	2.5	2.5
Claims on Other Sectors	26.5	28.7	31.7	34.2	37.0	38.2	39.4
Other items, net	-7.2	-8.3	-8.6	-9.6	-8.7	-8.0	-5.3
Broad money (M3)	20.7	22.3	24.4	25.6	27.9	28.2	32.5
Lari Broad money (M2)	9.7	10.6	11.5	12.1	13.1	12.3	15.5
Currency held by the public	2.8	3.1	3.2	3.5	2.8	2.8	3.2
Lari resident deposits	6.8	7.6	8.3	8.6	10.4	9.5	12.2
Resident foreign exchange deposits	11.1	11.7	12.9	13.5	14.7	15.9	17.0
Sources of funds of commercial banks	33.4	36.1	39.8	42.9	48.5	49.8	55.4
Resident deposits	19.1	20.6	22.0	24.2	27.9	28.7	32.0
Non-resident deposits	4.4	4.8	5.0	5.3	5.4	5.8	6.0
Other resident liabilities	2.3	2.0	3.7	3.4	5.4	4.2	6.6
Other foreign liabilities	7.5	8.8	9.1	10.1	9.9	11.1	10.9
Uses of funds of commercial banks	33.4	36.1	39.8	42.9	48.5	49.8	55.4
Claims on Central Bank	5.1	6.0	5.7	6.1	7.7	8.7	8.9
Credit to the Private Sector	26.5	28.7	31.7	34.2	37.0	38.2	39.4
National currency	11.4	12.4	14.1	14.7	15.9	16.4	17.1
Foreign currency	15.1	16.3	17.6	19.5	21.0	21.8	22.3
Other foreign assets	4.0	4.0	5.0	4.6	4.5	4.6	4.5
Other items, net	-2.1	-2.5	-2.6	-2.0	-0.7	-1.7	2.6
				(In percent of GDP)			
Broad money (M3)	46.5	44.7	48.8	51.2	55.9	52.2	60.2
Lari Broad money (M2)	21.7	21.3	23.0	24.2	26.3	22.8	28.7
Currency held by the public	6.3	6.1	6.5	6.9	5.5	5.2	6.0
Non-resident deposits (percent of total deposits)	18.8	18.7	18.5	18.0	16.3	16.9	15.7
Credit to the Economy	59.4	57.4	63.4	68.5	74.1	70.8	73.0
Nominal GDP (billions of lari)	44.6		50.0		49.9		53.9
				(year-on-year growth)			
Reserve Money	14.8	35.3	13.4	5.1	17.1	16.2	15.8
Broad money (M3)	13.9	25.0	17.6	14.4	14.3	10.1	16.5
NBG Claims on Banks	7.5	-7.1	61.3	102.5	52.1	90.8	25.9
Credit to the Economy (Percent change, year on year	20.4	24.4	19.7	19.0	16.5	11.7	6.5

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

Table 5. Georgia: Financial Soundness Indicators, 2018–20

(In percent, unless otherwise indicated)

	2018	2019				2020	
		Mar	Jun	Sep	Dec	Mar	Jun
Capital Adequacy							
Capital to risk-weighted assets 1/	18.4	19.1	18.2	19.0	19.5	17.0	17.7
Nonperforming loans net of provisions to capital	6.4	7.3	8.0	6.8	5.2	7.8	7.6
Leverage ratio 2/	18.5	19.2	17.9	18.6	19.0	16.2	16.6
Asset Quality							
Nonperforming to total gross loans 3/	2.7	3.0	2.9	2.6	1.9	2.2	2.3
Nonperforming to total gross loans 4/	5.5	5.9	5.7	5.3	4.4	4.5	6.2
Substandard and restructured loans to total gross loans 5/	15.3	15.9	15.5	15.1	12.9	27.0	20.5
Specific provisions to total loans	2.5	2.7	2.6	2.4	1.9	2.1	2.6
Sectoral distribution of loans to total loans							
Residents	97.4	97.5	97.4	97.5	97.4	95.4	96.1
Deposit-takers	0.0	0.3	0.6	0.1	0.1	0.1	0.1
Other financial corporations	0.7	0.6	0.0	0.5	0.0	0.6	0.0
Nonfinancial corporations	46.3	46.7	47.5	48.4	49.8	46.3	46.2
Other domestic sectors 6/	50.5	49.8	49.3	48.4	47.5	48.4	49.7
Non-residents	2.6	2.5	2.6	2.5	2.6	4.6	3.9
Earnings and Profitability							
Return on assets (ROA)	3.0	2.4	2.1	2.4	2.5	-7.1	-2.4
Return on equity (ROE)	23.3	18.0	16.2	18.9	20.3	-64.4	-21.7
Interest margin to gross income	61.0	61.4	60.3	58.7	58.1	56.5	58.1
Non-interest expenses to gross income	49.6	51.0	53.7	52.5	52.9	55.0	56.5
Liquidity							
Liquid assets to total liabilities ratio	21.6	22.9	23.2	22.9	19.6	20.0	21.4
Liquid assets to total short-term liabilities 7/	27.1	29.1	28.5	28.3	24.2	24.0	25.6
Loan-to-deposit ratio (in percent) 8/	115.6	115.9	116.6	117.7	121.7	121.5	113.2
Foreign Currency Position and Dollarization							
Deposit dollarization (residents)	62.1	61.7	61.2	61.6	61.9	66.0	64.6
Loans in foreign exchange to total loans	57.1	56.5	56.5	55.2	55.2	58.9	57.3
Net foreign assets to total assets	-18.3	-19.8	-21.3	-20.1	-18.9	-19.3	-22.1
Net open foreign exchange position to regulatory capital	5.2	0.1	-1.7	-0.3	0.2	2.2	0.6
Borrowed funds from abroad-to-GDP ratio 9/	16.2	14.4	16.7	16.5	19.1	17.2	17.7
Other							
Loans collateralized by real estate to total loans	62.0	63.2	64.0	65.5	64.9	65.5	65.7
Memorandum items							
Georgia EMBIG Sovereign Spread	252	246	214	187	157	239	679
Georgia EMBIG Sovereign Yield	5.4	4.9	4.3	3.5	3.2	3.5	7.0

Source: National authorities and IMF staff calculations.

1/ Basel III definition.

2/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.

3/ IMF definition for NPLs: includes loans in doubtful and loss categories (categories overdue 90 days or more).

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

5/ Includes watch, non-standard, doubtful, bad, and restructured loans.

6/ Includes households and individual entrepreneurs.

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

8/ Loans and deposits from the banking sector.

9/ Borrowed funds include subordinated debt.

Table 6. Georgia: External Debt Sustainability Framework, 2016-25
(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 7/
Baseline: External debt 1/	85.4	91.3	89.1	85.7			**103.8**	**106.5**	**102.7**	**98.4**	**94.2**	**89.9**	**-1.9**
Change in external debt	6.9	5.9	-2.2	-3.4			18.1	2.8	-3.8	-4.3	-4.3	-4.3	
Identified external debt-creating flows (4+8+9)	3.3	-8.2	-5.0	-0.4			10.7	-1.7	-5.0	-5.1	-4.7	-4.8	
Current account deficit, excluding interest payments	8.5	4.7	3.1	0.7			6.0	3.5	2.2	1.8	1.9	1.6	
Deficit in balance of goods and services	15.4	11.8	11.5	8.9			12.6	10.5	9.2	9.4	8.7	7.8	
Exports	41.6	50.3	55.0	54.4			36.3	42.6	47.9	50.9	51.9	52.3	
Imports	57.1	62.1	66.5	63.3			48.9	53.1	57.1	60.3	60.5	60.1	
Net non-debt creating capital inflows (negative)	-8.2	-10.8	-5.3	-5.4			-4.7	-5.2	-5.8	-5.9	-5.9	-5.9	
Automatic debt dynamics 2/	3.1	-2.0	-2.8	4.2			9.4	0.1	-1.4	-1.0	-0.6	-0.5	
Contribution from nominal interest rate	4.1	3.7	4.2	4.7			4.6	4.3	4.2	4.2	4.1	4.0	
Contribution from real GDP growth	-2.3	-3.9	-4.1	-4.6			4.8	-4.2	-5.7	-5.2	-4.7	-4.5	
Contribution from price and exchange rate changes 3/	1.3	-1.9	-2.9	4.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	3.5	14.0	2.8	-3.0			8.1	4.4	1.2	0.8	0.4	0.5	
External debt-to-exports ratio (in percent)	205.1	181.6	162.0	157.5			285.6	250.1	214.6	193.3	181.5	171.9	
Gross external financing need (in billions of US dollars) 5/	4.7	4.8	5.0	5.1			5.5	4.4	4.2	4.3	4.2	4.2	
in percent of GDP	31.4	31.6	30.8	29.1	10-Year	10-Year	34.1	25.8	22.6	21.2	19.4	17.6	
Scenario with key variables at their historical averages 6/							**103.8**	**108.3**	**111.9**	**115.1**	**117.9**	**120.8**	**-6.8**
Key Macroeconomic Assumptions Underlying Baseline					Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.9	4.8	4.8	5.1	4.9	1.5	-5.1	4.3	5.8	5.5	5.2	5.2	
GDP deflator in US dollars (change in percent)	-1.6	2.2	3.3	-4.4	0.2	8.2	-3.9	0.9	3.0	3.0	3.0	3.0	
Nominal external interest rate (in percent)	5.3	4.7	5.0	5.3	5.1	0.4	5.0	4.4	4.3	4.4	4.5	4.6	
Growth of exports (US dollar terms, in percent)	1.0	22.2	17.4	7.2	12.3	13.6	-38.6	23.2	22.5	15.6	10.4	9.2	
Growth of imports (US dollar terms, in percent)	-2.0	10.1	15.0	3.2	8.4	12.0	-29.0	14.1	17.3	14.8	8.7	7.6	
Current account balance, excluding interest payments	-8.5	-4.7	-3.1	-0.7	-5.9	3.0	-6.0	-3.5	-2.2	-1.8	-1.9	-1.6	
Net non-debt creating capital inflows	8.2	10.8	5.3	5.4	6.8	2.0	4.7	5.2	5.8	5.9	5.9	5.9	

1/ Excludes intercompany loans.

2/ 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.

3/ 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).

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

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

6/ 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.

7/ 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.

Table 7. Georgia: External Vulnerability Indicators, 2018–25

	2018	2019	2020	2021	2022	2023	2024	2025
	Actual	Prel.			Projections			
Value of exports of goods and services, percent change	17.4	7.2	-38.8	12.4	18.1	18.7	16.3	8.7
Value of imports of goods and services, percent change	15.0	3.1	-23.5	5.7	9.8	13.5	12.6	7.4
Terms of trade (deterioration -)	-5.2	2.5	4.8	-0.5	0.6	1.0	1.8	1.4
Current account balance (percent of GDP)	-6.8	-5.4	-9.7	-8.5	-6.3	-6.1	-5.6	-5.4
Capital and financial account (percent of GDP)	7.4	7.2	8.8	6.7	7.7	7.2	7.1	6.5
External public debt (percent of GDP)	31.7	33.4	46.1	49.8	46.8	43.9	41.1	38.4
(in percent of exports of goods and services)	62.5	61.9	127.3	128.6	111.4	95.7	83.5	77.8
Debt service on external public debt								
(in percent of exports of goods and services)	4.5	4.8	7.7	6.4	6.1	5.5	5.3	5.1
External debt (percent of GDP) 1/	82.2	85.0	103.8	106.5	102.7	98.4	94.2	89.9
(in percent of exports of goods and services)	162.0	157.5	286.5	275.0	244.8	214.7	191.4	182.0
Debt service on MLT external debt								
(in percent of exports of goods and services)	19.3	19.3	25.4	21.1	18.9	17.9	17.0	17.1

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

Table 8. Georgia: Gross External Requirement, 2018-25
(In millions of U.S. dollars)

	2018	2019	2020	2021	2022	2023	2024	2025
						Projections		
Total financing requirement	2,444	2,125	3,020	3,033	2,031	2,390	2,525	2,754
Current account deficit	1,191	957	1,565	1,439	1,174	1,225	1,224	1,283
Medium and long-term debt	1,231	1,290	959	880	951	1,071	1,211	1,330
Private	1,004	1,005	641	579	592	670	752	832
Banks	603	713	415	183	175	232	291	349
Corporates	401	292	226	397	417	438	461	483
Public	227	285	318	300	359	401	459	498
Others (net)	21	-122	495	715	-94	94	90	141
Total financing sources	2,387	2,230	1,886	2,001	2,258	2,611	2,845	3,007
Capital transfers	77	48	40	40	39	38	38	37
Direct investment, net	925	1,029	611	575	862	1,099	1,294	1,396
Medium and long-term debt	1,470	1,114	1,182	1,409	1,353	1,469	1,506	1,567
Private	1,102	738	616	890	787	852	863	896
Banks	935	639	576	605	511	556	562	590
Corporates	167	99	40	285	276	297	301	306
Public (only project loans)	368	376	566	520	566	617	643	671
Short-term debt (net)	-85	40	53	-23	4	5	7	7
Increase in gross reserves	278	202	136	-202	227	221	320	253
Rescheduled debt and arrears clearance	-165	122	0	0	0	0	0	0
Errors and omissions	-31	-29	-36	0	0	0	0	0
Total financing needs	202	247	1,305	830	0	0	0	0
Official financing	201	247	1,303	828	30	0	0	0
IMF	27	35	310	106	0	0	0	0
Prospective purchases	84	83	310	109	0	0	0	0
Repurchases	-57	-48	0	-4	0	0	0	0
Official creditors	174	212	992	722	30	0	0	0
Memorandum items:								
Gross international reserves	3,289	3,506	3,642	3,440	3,667	3,888	4,207	4,460
in months of next year GNFS imports	4	5	5	4	4	4	4	4
in percent of short-term debt at remaining maturity	79	95	99	90	88	86	86	89
in percent of IMF Composite measure (floating)	95	99	106	95	96	97	100	103
EFF in percent of total official financing	14	14	24	13	…	…	…	…

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

Table 9. Georgia: Indicators of Fund Credit, 2019-25
(In millions of SDR)

	2019	2020	2021	2022	2023	2024	2025
	Actual	Projections					
Existing Fund credit							
Disbursements (EFF)	60.0	147.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	180.0	327.0	324.5	312.0	289.5	247.3	192.8
SBA and EFF	180.0	327.0	324.5	312.0	289.5	247.3	192.8
Obligations	38.1	2.2	6.1	16.1	25.9	45.4	57.1
SBA and EFF	38.1	2.2	6.1	16.1	25.9	45.4	57.1
Principal (repurchases)	35.0	0.0	2.5	12.5	22.5	42.3	54.5
Interest charges	3.1	2.2	3.6	3.6	3.4	3.1	2.6
Prospective purchases							
Disbursements	0.0	79.0	78.0	0.0	0.0	0.0	0.0
Stock 1/	0.0	406.0	481.5	469.0	446.5	404.3	330.1
Obligations 2/	0.0	0.9	3.0	3.4	3.2	2.7	21.5
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	19.7
Interest charges	0.0	0.9	3.0	3.4	3.2	2.7	1.8
Stock of existing and prospective Fund credit 1/	180.0	733.0	806.0	781.0	736.0	651.5	522.8
In percent of quota 3/	85.6	348.4	383.1	371.2	349.8	309.6	248.5
In percent of GDP	1.4	6.3	6.8	6.1	5.3	4.3	3.2
In percent of exports of goods and nonfactor services	2.6	17.4	17.5	14.4	11.5	8.8	6.5
In percent of gross reserves	7.1	28.0	33.5	30.6	27.4	22.5	17.0
In percent of public external debt	4.2	13.7	13.6	13.0	12.0	10.5	8.4
in percent of total government revenues and grants	5.9	28.7	33.6	29.5	25.6	20.9	15.6
Obligations to the Fund from existing and prospective	38.1	3.1	9.1	19.5	29.1	48.1	78.6
In percent of quota	18.1	1.5	4.3	9.3	13.8	22.9	37.4
In percent of GDP	0.3	0.0	0.1	0.2	0.2	0.3	0.5
In percent of exports of goods and nonfactor services	0.5	0.1	0.2	0.4	0.5	0.6	1.0
In percent of gross reserves	1.5	0.1	0.4	0.8	1.1	1.7	2.6
In percent of public external debt service	11.5	1.0	3.1	5.9	8.2	12.4	19.2
in percent of total government revenues and grants	1.2	0.1	0.4	0.7	1.0	1.5	2.3

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 10. 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
12-Apr-20	Complete the sixth review based on end-December 2019 performance criteria and other relevant performance criteria	147	70.0
25-Oct-20	Complete the seventh review based on end-June 2020 performance criteria and other relevant performance criteria	79	37.3
20-Mar-21	Complete the eigth review based on end-December 2020 performance criteria and other relevant performance criteria	78	37.2
Total available		484	230.0

Source: Fund staff estimates and projections.

Annex I. Risk Assessment Matrix

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
Conjunctural Shocks and Scenarios			
Unexpected shift in the Covid-19 pandemic. ▪ **Downside.** The disease proves harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources). Monetary and fiscal policy response is insufficient amid dwindling policy space and concerns about debt sustainability. Financial markets reassess real economy risks leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening financial intermediaries–forcing them to reduce credit (further weighing on growth). Financing difficulties extend to vulnerable sovereigns, leading to cascading debt defaults, capital outflows, depreciation pressures, and in some cases inflation. Pandemic-prompted protectionist actions reemerge, disrupting trade and global value chains.	**High**	**High** The need to renew lockdown measures in Georgia or its trading partners would reduce growth and put pressure on government revenues. Lack of recovery in the tourism sector would eventually increase non-performing loans and unemployment. An increase in external imbalances would put pressure on the lari.	Utilize fiscal space to soften the negative impact on growth, extending the measures to support individuals and providing additional support to businesses. To the extent that inflation expectations remain anchored utilize available monetary policy space to support demand. Maintain commitment to exchange rate flexibility but utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability.
▪ **Upside.** Recovery from the pandemic is faster than expected due to the discovery of an effective and widely available vaccine and/or a faster-than-expected adjustment to the virus that boosts confidence and economic activity.	**Low**	**High** Higher growth in trading partners would enable a faster recovery in Georgia, especially in the tourism sector. .	Maintain prudent macroeconomic policies to build up buffers.
Widespread social discontent and political instability. Social tensions erupt as the pandemic cause economic hardship (unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities. Economic activity is disrupted. Growing political polarization and instability (e.g., contested elections) weaken policymaking and confidence.	**High**	**High** Disruptions in economic activity in Georgia's trading partners would reduce growth. They could also threaten external financing flows from international financial institutions (IFIs) on which Georgia relies.	Utilize fiscal space to soften the negative impact on growth, extending the measures to support individuals and providing additional support to businesses. To the extent that inflation expectations remain anchored, utilize available monetary

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
			policy space to support demand. Maintain exchange rate flexibility but use foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability.
		Structural Risks	
Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	**High**	**Medium** Accelerating de-globalization would put the merits of Georgia's efforts to become a logistics hub in doubt. The country would need to find a new growth model that relies less on the external environment.	Allow the exchange rate to adjust to reflect the new fundamentals. Utilize monetary and fiscal policy space to ensure that the output gap does not stay negative for too long.
		Georgia-Specific Structural Risks	
Financial risks. As a result of one of the global shocks above, exchange rate could depreciate rapidly undermining confidence in the currency and increasing inflation expectations.	**Medium**	**High** Depreciation in a highly dollarized economy threaten financial stability as households and firms struggle to repay loans, and could hurt growth. Higher inflation and depreciation expectations could result in a vicious cycle of loan conversions putting further pressure on the currency.	Maintain tight monetary policy to ensure confidence in the currency and keep inflation expectations anchored. Strengthen the resolution framework to ensure that financial stability challenges can be addressed. Adjust macroprudential measures to avoid an undue tightening of financial conditions.
Fiscal risks. Materialization of contingent liabilities/fiscal risks could put pressure on the deficit.	**Medium**	**High** The need to cover contingent liabilities could result in lower capital spending or lower current spending, which has already been significantly compressed.	Continue improving SOE governance and fiscal risk management practices. Enhance PFM monitoring in view of risks relating to COVID-19 spending. Utilize fiscal buffers accumulated due to

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
			capital markets development strategy.
Political risks. Political backlash or/and reform fatigue could undermine efforts to undertake structural reforms.	**Medium**	**Medium** Policy uncertainty could undermine confidence and hurt growth.	Maintain macroeconomic policy discipline. Strengthen social safety nets to protect the most vulnerable and support inclusive growth.

Annex II. Reform on State-Owned Enterprises and Fiscal Risks Analysis[1]

Enhancing Monitoring and Transparency of Fiscal Risks

1. In recent years, the Georgian authorities have made substantial progress on improving the oversight and reporting of fiscal risks, including from SOEs. High-quality analysis of fiscal risks has been disclosed in the annually released Fiscal Risk Statement (FRS), which has been improving since its first release in 2014. The 2019 FRS included an assessment of: (i) the impact of macroeconomic risks on the fiscal sector, (ii) Georgia's public sector balance sheet, including rates of return on its assets, (iii) a preliminary impact assessment of SOE sectorization on fiscal aggregates, (iv) SOE performance, quasi-fiscal activities, and transfers received from the government, (v) financial risk analysis of six major SOEs, and (vi) fiscal risks associated with PPAs and the stock of PPP liabilities. In parallel, the MOF has increased monitoring capacity by establishing a Fiscal Risk Management Unit in charge of centralizing information on fiscal risks and contingent liabilities, collecting information on PPAs and PPPs, and rationalizing SOEs and their operations.

2. The latest analysis of Georgia's public sector balance sheet (PSBS) indicates it is in a relatively sound position (see IMF Technical Report 2020). In 2018, public sector net worth was estimated at 68 percent of GDP, with assets and liabilities respectively worth 149 and 81 percent of GDP, making it a comparatively lean balance sheet. Georgia's general government liquidity exposure (comparing liquid assets to short-term liabilities) and near-term gross financing needs are also relatively comfortable.

Main fiscal risks are identified relating to:

- **High public sector net foreign exchange exposure**, which—estimated at 50 percent of GDP (mostly in U.S. dollars) —is relatively large among measured countries, making the public sector vulnerable to exchange rate depreciation.

- **Demographic shifts and existing guarantees under PPAs, which are set to increase fiscal pressures and could deteriorate public sector net worth.** Georgia's intertemporal net worth, measured under existing policies in 2019 (before the Covid-19 shock), was estimated to be negative (-35 percent of GDP) due to future fiscal deficits exceeding net worth. Existing guarantees from PPAs are set to peak in 2024, with projected government costs estimated to average 0.5 percent of GDP (annually) over 40 years, a figure that could double under adverse scenarios (related to exchange rate depreciation or regulatory risks associated with the capacity to pass on prices to the end-consumer). In addition, with one of the highest population ageing rates, Georgia's health and pension spending is expected to increase substantially in the medium-to-long term (albeit from currently low levels). The recent increase in basic pensions and newly instated pension indexation rule, much needed to protect elderly people's real incomes and safeguard against ad-hoc discretionary increases, also adds to the pension bill. In order to maintain current net worth, fiscal

[1] Prepared by A. Lagerborg. This annex draws on the following IMF TA Report: IMF (2020) "Georgia: The Public Sector Balance Sheet and State-Owned Enterprises". Country Report No. 2020/223

adjustments will be needed through reducing spending and/or increasing revenues. The authorities' medium-term fiscal strategy proposes reforms to address these issues.

- **The SOE sector is large, risky, and a net draw on the budget, with substantial and imminent financing needs.** SOEs constitute a major part of Georgia's PSBS, with non-financial public corporation assets estimated at around 40 percent of GDP (and liabilities of an equivalent size), of which the six largest SOEs account for two-thirds.[2] Overall, the sector has drawn around 6 percent of GDP from the government budget over the past five years.[3] Moreover, government on-lending has resulted in some heavily indebted public corporations.[4] Deeper analysis of the big six SOEs, included in the FRS, finds that their financial performance has been deteriorating and, while most are generating positive operating earnings, only one is generating sufficient profits to cover its capital costs and others are making substantial losses.[5] Moreover, gross financing requirements are substantial, estimated at 18 percent of GDP over 2020-22, and leverage and exposures to foreign exchange mismatches are significant. With leverage estimated at 88 percent, most of the SOEs are severely undercapitalized and have limited capacity to absorb downside risks; the level of recapitalization needed to restore adequate levels of equity is estimated at around 7 percent of GDP. Due to their high FX exposure, a 30-percent depreciation would increase losses of the SOE sector by an estimated 4 percent of GDP.

3. To improve the disclosure and monitoring of SOEs, the authorities conducted a sectorization exercise of all SOEs, which was finalized in March 2020. Among Central Asia and Eastern Europe countries, Georgia is the first country to carry out such a comprehensive sectorization exercise. The sectorization assessed all SOEs based on whether they can be considered commercial entities on economic grounds, in line with IMF TA recommendations under the Government Finance Statistics Manual (GFSM) 2014. The analysis concludes that 183 SOEs qualify as general government entities and 52 entities as public corporations.[6] In September 2020, 116 additional SOEs were identified as a result of expanding coverage of municipalities to 100 percent; newly identified SOEs will be part of the general government sector until assessed otherwise. In addition to improving fiscal transparency and oversight by appropriately reflecting general government entities in public finance reporting, this

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[2] Engurhesi, Georgian Oil and Gas Corporation (GOGC), Georgia Railway (GR), Georgian State Electrosystem (GSE), Marabda Katsakhi Rail (MKR), and United Water Supply Company (UWS) account for around two-thirds of the SOE sector.

[3] For example, in 2018, SOE losses were estimated at 1.8 percent of GDP, SOE quasi-fiscal activities amounted to 1.1 percent of GDP, and funds transferred from the state budget to various SOEs totaled 0.4 percent of GDP.

[4] Four public companies concentrate 80 percent of the loan book and about 15 percent has been subject to some loan rescheduling, raising concerns about the ability of some public corporations to service debt.

[5] Their average return on assets decreased from 3.8 percent in 2016 to negative 4.8 percent in 2018, reflecting a materialization of downside risks and asset write-downs.

[6] The sectorization concluded that ESCO, UWS, Melioration of Georgia, and the Partnership Fund (among others) are to be classified as general government entities with reporting starting in 2021.

exercise represents a cornerstone to reform the SOE sector and sets the stage for a comprehensive strategy to improve management and monitoring of SOEs and their corporate governance.[7,8]

Reform Initiatives to Reduce Fiscal Risks

4. The authorities are planning a comprehensive SOE reform aiming to transition from identification and reporting of fiscal risks to their management and mitigation. The reform envisages the introduction of OECD principles for corporate governance of SOEs and other best international practices, with support from the IMF and other international organizations. As part of this reform, the authorities are committed to: (i) defining the rationale for ownership and long-term strategy of public corporations (by end-March 2021); (ii) piloting the strategy in a few selected companies (GSE and UWS), and (iii) drafting legislation that incorporates a framework for public corporations in line with OECD principles. The authorities have also committed to refrain from taking over any SOE debt or providing equity injections to SOEs without a strategy that fully supports commercial viability and improves corporate governance. This reform expects to increase SOEs' profitability, return on equity, and reduce fiscal risks.

5. The authorities also remain committed to further improving monitoring and transparency of fiscal risks, including by expanding the FRS's coverage of PPAs and SOEs. To mitigate fiscal risks, the authorities are also committed to refrain from undertaking new PPAs until an independent technical evaluation supports their commercial viability and medium-term fiscal sustainability, in consultation with IMF staff. The 2020 FRS will assess PPAs; summarize the impact of SOE reclassification; analyze risks associated with the top 10 SOEs; assess the gross financing requirements of major SOEs; estimate the quasi-fiscal activities; and assess the impact of COVID-19 on major SOEs. The 2020 FRS will also highlight the SOE reform framework.

6. The authorities are also improving the quality of data and accounting systems, which is key to increasing the reliability of the PSBS analysis. The government's financial statements are currently based on national standards,[9] are aggregated rather than consolidated, and remain unaudited at a consolidated level. As a result, there are gaps, particularly regarding state land and non-financial assets. The accounting system reform, including transitioning to the International Public Sector Accounting Standards (IPSAS) in 2020 (with adequate training and IT system preparation) and instating auditing requirements of consolidated financial statements, will help reduce data gaps.

[7] The sectorization exercise is expected to increase the general government's deficit by 1.4 percent of GDP and government debt by 0.7 percent of GDP.

[8] For example, while in the past decisions regarding liquidations and mergers of SOEs had largely been done by applying a rationale for state ownership (whether an SOE serves a public policy objective) and a financial rationale (whether an SOE is financially viable), these criteria are weaker than the rationale set out in the OECD corporate governance guidelines and FAD advice.

[9] By contrast, the NBG and SOE accounts are based on International Financial Reporting Standards.

Annex III. Inflation Determinants[1]

Inflation in Georgia is primarily driven by domestic factors and changes in the nominal effective exchange rate (NEER). Forward expectations drive long-term inflation dynamics while changes in the NEER and the monetary stance impact inflation in the short term. This highlights the role of monetary policy to control inflation in the short run while anchoring forward expectations in the long run.

1. Inflation has been reflecting increases in food and services prices. Over 2012-120, headline inflation in Georgia has evolved from negative territories–in May 2012 deflation reached 3⅓ percent–to peaking above 7 percent in June 2017. Inflation averaged 2⅔ percent over that period, alternating cycles of acceleration (2015, 2017 and 2019) and deceleration (2016 and 2018). Inflation dynamics has been mainly reflecting increases in food and services prices while housing and other consumption items contributed moderately.

2. One-off effects also played a role in inflation dynamics. The authorities raised excise taxes on tobacco several times between 2013 and 2019 while internet and communication and energy prices (electricity and gas) were lowered in 2013 and 2014. Electricity and gas prices were then raised in between 2015 and 2018. The reform of the health care system also entailed one-off increases in the prices of medicines and medical services (2014 and 2016H1). Yet, one-offs only account for part of inflation dynamics in Georgia–about 2 percentage points of average inflation in 2019–and a more structural approach is warranted to capture domestic and external factors.

3. A variant of the hybrid Neo-Keynesian Phillips curve (NKPC) captures the contributions of domestic and external factors. The inflation equation is based on the standard variables of the NKPC (lagged inflation, forward expectations and output gap) to which a vector of external variables — including the NEER, oil and other imports prices — and a variable reflecting monetary stance[2] are added. Formally, the augmented hybrid NKPC is as follows:

$$\pi_t = \alpha_1 + \alpha_2 \pi_{t-1} + \alpha_3 \pi_t^e + \alpha_4 ygap_t + \alpha_5 mst_t + \alpha_6 neer_t + \alpha_7 oil_t + \alpha_8 imp_t + u_t$$

Where π is inflation (y-o-y); π^e represents one-year-ahead inflation expectations[3]; $ygap$ is the output gap; mst stands for the monetary stance; $neer$ is the change in nominal effective exchange rate; oil is oil price inflation; imp is other imports price inflation and t is a time index.

4. Domestic factors and the NEER are significantly related to inflation dynamics (Table A1). The first column reports the results of the ordinary least squares regressions. The variables exhibit the expected signs except forward expectations. The output gap is not significant. Additional analysis shows

[1] Prepared by M. Debbich.

[2] Monetary stance is calculated as the log difference between the seasonally adjusted currency in circulation and its trend estimated with the Hodrick-Prescott filter.

[3] Inflation expectations data are survey-based and derived from the Consensus Economics database.

a significantly positive coefficient on the output gap (column 2).[4] The last column reports the estimates of a constrained SUR in which the sum of the weights on backward- and forward-looking expectations is equal to one. Oil and other imports price inflation do not appear to be significantly related to inflation in either regressions.[5]

Table A1. Georgia: Augmented Hybrid Phillips Curve Estimation

	(1)	(2)	(3)
	OLS	SUR	CSUR
Lag of inflation	0.866***	0.851***	0.895***
	(0.036)	(0.035)	(0.033)
1-year inflation expectations	-0.246*	-0.266**	0.105***
	(0.126)	(0.114)	(0.034)
Output gap	0.096	0.163***	0.137**
	(0.062)	(0.059)	(0.060)
Monetary stance	0.059**	0.075***	0.075***
	(0.026)	(0.024)	(0.025)
NEER change	-0.055***	-0.066***	-0.075***
	(0.017)	(0.016)	(0.016)
Oil price inflation	-0.001	-0.002	0.002
	(0.003)	(0.003)	(0.003)
Other imports price inflation	-0.053	-0.050	-0.008
	(0.039)	(0.035)	(0.034)
Constant	1.503***	1.647***	-0.033
	(0.562)	(0.512)	(0.111)
Observations	96	96	96
Adjusted R-squared	0.908	0.905	0.898

Dependent variable is contemporaneous inflation. Estimation sample: January 2012 – December 2019.
Standard errors in parentheses.
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

5. Forward expectations and changes in the NEER are the main determinants of headline inflation in Georgia. The historical decomposition shows that forward expectations have a consistently positive impact on inflation since 2012 (Text Figure).[6] NEER appreciation contributed to lower inflation from 2012 to early-2019 while more recent depreciation pushed inflation upward. The model suggests that monetary policy was tight enough to decrease inflation in 2012-13, 2016 and 2018H2-2019H1

[4] Since domestic variables in the augmented hybrid NKPC are simultaneously determined, a seemingly unrelated regressions (SUR) system is also estimated following Impavido (2018) to control for endogeneity. For details, see Impavido, G. (2018) Short Term Inflation Determinants in Barbados. IMF Working Paper No. 18/134.

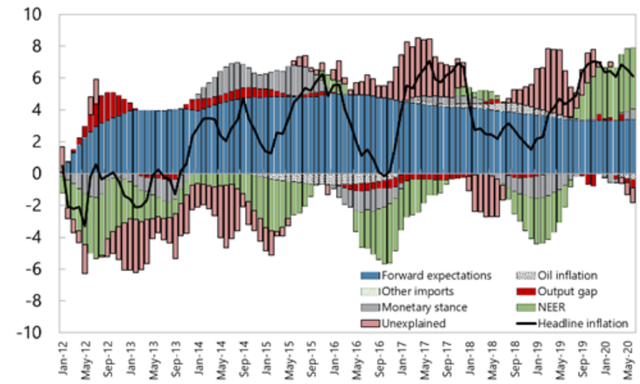
[5] While this could stem from a collinearity issue with the NEER index, both variables remain not significant when estimating the system without the NEER variable.

[6] Estimates in Table A1 provide only the effects of domestic and external factors in excess of past inflation. Historical decomposition is calculated using backward iteration by expressing inflation as a function of its initial value and domestic and external factors

while it was loose enough to contribute to raise inflation in 2014-15. The effect of the output gap appears marginal. Inflation driven by oil and other import prices seems not significant. The unexplained contribution to inflation appears sizeable at some periods and could be traced back to one-off changes in prices following administrative decisions. Overall, forward expectations seem to be the long-term driver of headline inflation while short-term dynamics is driven by changes in the NEER and the monetary stance. This conclusion highlights the importance of monetary policy to control inflation in the short run while anchoring forward expectations for the long run.

Contributions to Inflation Dynamics

(YoY, in percent)



Sources: GeoStat, NBG and IMF staff calculations.

Appendix I. Letter of Intent

Tbilisi, December 1, 2020

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Georgieva:

1. **A recovery is underway as Georgia continues to battle the COVID-19 pandemic.** The recovery is sustained by a gradual unwinding of our far-reaching measures to control the spread of the COVID-19 virus. We prioritized containment and implemented a robust public health response. By mid-June, most businesses started reopening. Although below those in neighboring countries, COVID19 cases has been rising. We are expanding testing and tracing capacity, maintaining our health response and considering, where necessary, localized lockdowns. We are closely monitoring COVID-19 cases in Georgia and globally, and stand ready to implement additional measures to limit the pandemic.

2. **The pandemic has impacted our economy significantly.** The standstill in global travel and domestic mobility restrictions reduced growth in the second quarter of 2020, contracting 12.3 percent y/y. Inflation has been on a declining path since the reopening of the economy and decelerated to 3.8 percent (y/y) in October. We now expect real GDP to contract by 5.1 percent in 2020. The current account deficit is projected to widened to 9.8 percent of GDP, as the deteriorating service account is partially compensated by a better-than-projected trade balance and remittances. Accordingly, the NBG reduced the policy rate by a cumulative 100 basis points from March to October 2020 and intervened in the foreign exchange market to prevent disorderly market conditions.

3. **Our fiscal response has supported economic activity and jobs.** To deal with the economic fallout of the pandemic, a supplementary budget, approved in June, contained fiscal measures amounting to 4 percent of GDP to address higher health spending and support households and businesses that have been most impacted by the shock. Despite the lockdown, we were able to increase public investment in 2020, especially in the regions, which helped support jobs.

4. **The IMF's Extended Fund Facility (EFF) arrangement has helped safeguard macroeconomic stability and catalyze significant donor assistance.** 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 April 24, 2020. These policies should help us support the recovery and limit the economic scarring of the pandemic.

5. **Conditionality for the Seventh Review was met.** All of the end-June 2020 quantitative performance criteria (QPCs) and structural benchmarks (SBs) were met. The NBG adopted secondary legislation toward the implementation of the new bank resolution framework.

6. Given the positive performance under the program and the policies in the enclosed MEFP, we request the completion of this review, the release of the related disbursement, and request modifications of the performance criteria for the last review. We intend to purchase SDR79 million, which will bring total drawings under the arrangement to SDR406 million. For the remaining review, our program will be monitored through an Inflation Consultation Clause (ICC), QPCs, ITs with 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). The Eighth Review will be based on end-December 2020 performance criteria and would take place on or after March 20th, 2021. The request for modifications of performance criteria is related to updated figures on the adjustors for program/project loan disbursements with no changes to the end-December 2020 NIR and augmented fiscal deficit targets.

7. The attached MEFP, updating the previous ones, will enable us to achieve the objectives of our economic program under these unprecedented times. We will monitor progress continuously, 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 for monitoring program implementation. We authorize the IMF to publish this LOI and its attachments, and the related Staff Report. These documents will also be posted on the official websites of the Georgian government after the IMF's Executive Board approval.

Very truly yours,

/s/

Koba Gvenetadze
Governor of the National Bank of Georgia

/s/

Natia Turnava
Minister of Economy and Sustainable Development

/s/

Ivane Matchavariani
Minister of Finance

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 economic challenges arising from the COVID-19 pandemic and over the medium-term.

Macroeconomic Framework

2. The economy is expected to contract in 2020 due to the COVID-19 pandemic. Real GDP declined by 5.6 percent in the first half of 2020. Since then, a gradual recovery has taken hold with growth for the year projected to contract 5.1 percent, 1.1 percentage point lower to the projection at the time of the Sixth Review. Inflation is expected to continue decelerating to 3½ percent at end-2020—as the nominal effective exchange rate has remained broadly stable and as the output gap widens—and to decline below the 3-percent target in the first half of 2021, before converging by end-2021, as demand recovers.

3. The medium-term outlook envisages a gradual recovery. The baseline projection assumes that social distancing will continue into 2021 but will then fade over time as vaccine coverage expands and therapies improve, with local transmission brought to low levels by the end-2021. Growth in 2021 is expected to rebound to 4.3 percent, supported by a recovery in domestic and external demand. Medium-term growth remains unchanged at 5¼ percent supported by infrastructure spending and hinges strongly on advancing structural reforms to increase productivity and enhance private-sector led growth.

4. Macroeconomic policy discipline and donor support should ensure that reserves remain adequate over the medium term. The current account deficit is expected to widen to 9.8 percent of GDP primarily due to lower tourism. The shock to tourism is expected to be protracted with a recovery of tourism receipts to the 2019 level envisaged only by 2024 and the current account deficit reaching 5.5 percent of GDP by 2025, financed predominantly by FDI. The financial account is also expected to weaken—from 5.7 percent of GDP in 2019 to 2.6 percent of GDP in 2020 due to portfolio outflows and lower FDI. We have secured financing from the IMF and donors to maintain our reserves adequate, at around 105 percent of the ARA metric by end-2020, despite the unprecedented shock.

5. Downside risks to the outlook remain significant. Uncertainty regarding the evolution of the pandemic makes it difficult to predict the path to recovery in Georgia and our key trading partners. A protracted slowdown in major trading partners, along with intensified geopolitical tensions, could harm investment, dampen external demand —especially tourism— for longer. Delays in structural reforms may deepen the scarring effects from the crisis. Our first line of defense against these considerable risks is our continued commitment to exchange rate flexibility, sound macroeconomic and financial policies, and continued commitment to implement comprehensive structural reforms.

Economic Policies

A. Fiscal Policy

6. We met all end-June 2020 fiscal QPCs. The augmented fiscal deficit reached GEL1,492 million, against an adjusted ceiling of GEL2,380 million, mainly due to higher-than-projected revenues and lower-than-projected current spending (mainly because of lower healthcare spending as the pandemic was contained). Accordingly, the IT on primary current expenditure was also met by a large margin. To support the private sector, we refunded 0.9 percent of GDP of VAT claims in the first half of 2020, with the stock of unrefunded VAT claims estimated at GEL1,303 million, compared to the end-June indicative target of GEL1,470 million.

7. In August, we reallocated some of the social transfers to better support those in need. Within the existing spending envelope envisaged in the amended budget, we shifted social spending to better deal with the consequences of pandemic:

- A one-time cash transfer to cash families with children (GEL200), which benefited 855,000 families with a total cost of 0.4 percent of GDP.
- Tuition assistance to university students from vulnerable families, benefitting 33,000 individuals at a cost of 0.1 percent of GDP.
- Extension of the electricity and gas subsidies from November 2020 until February 2021. So far, over one million households have benefitted from the subsidies, with the extension expected to cost 0.5 percent of GDP.
- Additional social transfers to the self-employed who lost income, by relaxing eligibility criteria for a one-time cash transfer of GEL300, benefiting 80,000 individuals at a cost of 0.1 percent of GDP.

8. Despite the COVID-19 pandemic, we sustained capital spending in 2020. Capital spending is projected at GEL4,055 million at end-2020, GEL534 million above the envelope envisaged in the amended budget and marginally above the 2019 level. Against the initial belief that the COVID19 pandemic would slowdown investment execution, investment remained apace during the lockdown and local governments used the opportunity to reallocate jobs, primarily toward road infrastructure projects.

9. The pandemic prompted a swift fiscal response, which resulted in increasing public debt. The nominal depreciation and the response to the COVID-19 pandemic would increase public debt (net of government deposits) to 49.4 percent of GDP by end-2020, from 38.3 percent of GDP in 2019. The increase in public debt was financed mostly by donor and IMF financing. Public debt average maturity remains long-term and low interest costs, and is mostly vulnerable to FX risks given—about ¾ of the public debt is FX-denominated. Public debt (net of government deposits) is projected to peak at 54.6 percent of GDP in 2021 once all donor financing gets disbursed, and above the level anchoring the EFF arrangement in the past (45 percent of GDP).

10. We remain committed to our end-2020 fiscal QPCs and ITs. Specifically:

- Given lower growth and significant uncertainty about the recovery, we decided to use the generated fiscal space in 2020 for additional capital spending and VAT refunds to support the recovery and limit the economic scarring. We believe that this approach was adequate despite our initial commitment under the program to use any over-performance in revenues (excluding grants) or under-execution in current or investment spending towards a lower augmented fiscal deficit. After mobilizing significant donor financing, we built significant fiscal buffers and government deposits are projected at 7 percent of GDP by end-2020.

- We will maintain our efforts to reduce the stock of VAT credits. For end-December 2020, we will target a stock of credits of GEL1,300 million (IT), with refunds reaching GEL1,000 million in 2020. This amount is well-above the original projected amount (GEL600 million), with the difference be accommodated through the adjustor to the deficit ceiling (see TMU, ¶14).

11. The 2021 budget will continue to balance a gradual unwinding of the COVID-19 support measures with the need to increase social and infrastructure spending. We stand ready to adopt additional measures, if needed, in consultation with IMF staff.

- In 2021, we will continue the temporary support to address the COVID-19 pandemic. The augmented fiscal deficit is projected at GEL4,063 million (7.5 percent of GDP). The 2021 budget envisages temporary and targeted fiscal measures amounting to 2.1 percent of GDP (outlined below) that provides additional space for healthcare spending to deal with the pandemic, social benefits to the most vulnerable families, and support to hard-hit businesses, including SMEs and hard-hit sectors. We plan on sustaining capital spending at 7.9 percent of GDP in 2021 to support the economic recovery. We commit to adopt the 2021 budget consistent with the policies agreed at this time, during the Seventh Review under the EFF arrangement (**end-December 2020 structural benchmark**).

- With the newly formulated containment measures, we will implement renewed fiscal support measures starting in December 2020 and mostly deployed in 2021, amounting to 2.1 percent of GDP, as follows:

    - Transfers for those who lost or are at risk of losing their employment (up to GEL400 million, 0.8 percent of GDP), which is expected to benefit approximately 500,000 individuals in formal employment before the COVID-19 pandemic hit, targeted as:

        - Income tax relief of up to GEL150 per employee per month – equal to the income tax on the first GEL750 of the salary, to companies supporting employment retention. The transfers would be effective for up to 6 months.

        - Direct monthly transfers of up to GEL200 for laid-off employees and self-employed individuals who can verify their income loss, for up to 6 months.

- A one-time transfer to those affected by the lockdown of retail sector in December and January 2021. The measure expected to affect around 100 thousand employees in the sector, with an estimated total cost of GEL30 million.

- A direct transfer to GEL100 (on average, dependent on the number of members in the family) to families registered in the social ranking system with a score of 65,000-100,000 for up to 6 months. The measure is expected to benefit around 70,000 families, for a total cost of GEL55 million (0.1 percent of GDP).

- A direct monthly transfer of GEL100 to families with 3 and more children aged up to 16 years old, registered in the social ranking system with a score below 100,000, for up to 6 months. The measure is expected to benefit around 24,000 families, for a total cost of GEL15 million.

- A direct monthly transfer of GEL100 to people with severe disabilities (including children with disabilities), for up to 6 months. The measure expected to benefit around 43,000 people, for an estimated total cost of GEL27 million.

- Subsidies for electricity, natural gas, and utility bills to low-energy-consuming households in 2021, for a total cost of GEL60 million (0.1 percent of GDP)

- Healthcare expenditure in response to the COVID-19 pandemic (GEL350 million, 0.6 percent of GDP).

- Extension of the revamped credit guarantee scheme to support SMEs (GEL50 million, 0.1 percent of GDP).

- Additional support to businesses in hard-hit sectors in the form of:

  - Property tax exemption for the tourism sector for 2021 (GEL45 million, 0.1 percent of GDP).

  - Interest-rate subsidies for mortgages issued in 2020 to support the real estate sector (GEL25 million).

  - Grants (GEL20 million) to micro and small businesses (part of the Micro and Small Businesses Support Program), to help expand their funded projects and start new ones.

- We are committed to save any revenue overperformance or spending under-execution towards VAT refunds, and/or lowering the deficit.

- We stand ready to reformulate our fiscal stance if downside risks materialize, including by considering fiscal measures.

12. We are committed to medium-term fiscal sustainability as directed by our fiscal rule. Under our fiscal rule, we will bring the fiscal deficit under 3 percent of GDP and public debt under 60 percent of GDP by 2023. The recovery in revenues, as economic growth resumes, and the unwinding of temporary support measures would help reduce the budget deficit, while commitments toward higher education and infrastructure spending would require creating additional fiscal space within the current spending envelop and/or mobilize revenues.

- We will improve public administration efficiency by (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) developing a comprehensive strategy to address financial vulnerabilities and (iv) improve corporate governance in SOEs; and (v) broadening the scope of performance-based budgeting.

- We will improve public investment management by (i) fully monitoring the full cycle of all public investment projects according to recently updated standards starting 2022; and (ii) launching the E-system for public investment projects within the system of E-PFMs incorporating all stages of PIM cycle.

- We are committed to expanding Georgia's power generation capacity in a fiscally sustainable manner. Reducing our reliance on electricity imports will require continued investment, with any public-sector involvement requiring safeguarding medium-term debt sustainability. We have therefore issued Government Decree 403 setting to promote hydropower energy generation through a feed-in premium. Such scheme is a step in the right direction to limit fiscal risks, as quantities would not be guaranteed. To support a level-playing field in energy generation, we will issue a similar support scheme for other renewable energy projects to promote technology neutrality. We will also specify the criteria for cases when it may be necessary to deviate from the feed-in premium scheme and amend the Government Decree 403 accordingly. We will refrain from initiating additional PPAs that deviate from a feed-in premium until such criteria are clarified by end-February 2021.

- Taking into account the rising public debt and the need for fiscal consolidation, we will refrain from (i) signing additional PPAs except for cases described in the previous paragraph until the liberalized energy market for electricity is fully operational and we clarify the potential realization of contingency liabilities to the budget; and (ii) engaging the public sector in any energy investment without an independent technical evaluation that supports commercial viability and a consultation with the IMF on fiscal sustainability.

- We are committed to reassess and implement, if needed, additional fiscal measures based on our fiscal risk profile. Under the current domestic electricity pricing regulated mechanism, the potential fiscal costs of PPAs would normally be avoided, since guaranteed prices would be fully passed on to end-users. Our baseline scenario forecasting electricity prices suggests that PPAs would imply marginal tariff increases in the foreseeable future. Risks stemming from PPAs will materialize if PPA prices are higher than price of electricity on the local market or export prices. These risks are analyzed in our FRS.

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

- 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.

- We will refrain from taking over any SOE debt or providing equity injections to SOEs without a comprehensive strategy that, among other things, fully supports commercial viability and improves corporate governance; we will consult with the IMF on the strategy and on specific measures. Our public corporations will refrain from engaging in any new quasi-fiscal activities. The government will refrain from asking SOEs to engage in any new quasi-fiscal operations and to systematically report them in the Fiscal Risk Statement.

- We have reformed our SOE monitoring and PPP frameworks to reap the benefits of PPPs, while improving risk management. We commit to further expand the FRS in line with the FAD TA recommendations by including (i) a sub-section on the sectorization exercise, (ii) a risk analysis of the top 10 SOEs, (iii) an assessment of the gross financing requirements of major SOEs, and (iv) updated estimates of quasi-fiscal activities (**end-December 2020 structural benchmark**). The 2020 FRS expands on the fiscal risk analysis associated with SOEs (with coverage of over 90 percent of SOEs) and includes a sub-section on the impact of COVID-19 on SOEs and a section SOE governance reform plans.

- We will continue to enhance the annual Fiscal Risk Statement by updating the estimates associated with potential fiscal costs arising from our Public-Private Partnerships (PPPs) including Purchasing Power Arrangements (PPAs) and those associated with SOEs.

14. We will continue to limit the operations of the Partnership Fund (PF). We are limiting the PF's gross acquisition of financial and non-financial assets, other than cash and bank deposits, to zero except for existing commitments in ongoing projects (**continuous performance criterion**). Accordingly, the PF will not undertake any new projects nor engage in any net borrowing (**continuous performance criterion**).

15. We are formulating a reform strategy for SOEs that would bring SOE governance consistent with best international practices. Locking in benefits from fiscal transparency in PCs requires to move from risk disclosure to risk management and mitigation. Hence, we are committed to develop a new governance framework that (i) defines the general objectives, competitive neutrality, and rationale for ownership of public corporations; (ii) strengthens the framework to identify, report and treat quasi-fiscal activities; and (iii) enhances SOE corporate governance in line with OECD guidelines. We plan to prepare a comprehensive draft strategy by end-March 2021, in consultation with IMF staff, and pilot the strategy in a few selected companies in preparation for a new legal framework for SOEs.

16. Our financing strategy to develop the domestic capital market and reduce external vulnerabilities would be delayed. To avoid a decline in external reserves, we plan to issue an Eurobond in 2021, if market conditions allow. As a result, we will delay our plans to expand the domestic issuance. In the future, we plan to gradually increase the size of domestic benchmark bonds, to encourage foreign investor participation. Such approach would help scale up our efforts to reduce FX risks over the medium term.

B. Structural Fiscal Policies

17. We are strengthening our revenue administration to improve taxpayer services and strengthen compliance. Following the 2016 Tax Administration Diagnostic Assessment and IMF TA, we have been implementing a reform program supported by the Revenue Mobilization Trust Fund.[1] Reforms have focused on:

- *IT resources and capacity*. A new IT strategy has been approved by the head of the GRS and an IT investment plan has been devised in line with IMF TA recommendations. In turn, the Ministry of Finance has committed resources for the implementation of the IT strategy, including an adequate upgrade of the IT system software. We expect the IT strategy to be fully implemented by end-2022.

- *VAT tax administration.*

    - Stock of unrefunded VAT credits. We remain committed to reduce by at least 50 percent the outstanding stock of those VAT credits that are within the limitation period for audit (from GEL1.4 billion at end-2017 to GEL700 million) by end-2021. By July 2021, we aim to reduce the outstanding stock of VAT claims to GEL1.0 billion. For the stock of existing credits, our commitment to audit or risk-assess 100 percent of declarations (within the statute of limitations for audit) by mid-2020 has been delayed due to interruptions in audit process during the global pandemic; we plan to finalize this by July 2021. As of September 2020, approximately 50 percent of the value of VAT claims have been audited. As of September 2020, approximately GEL300 millions of audited taxpayer declarations are assessed as valid to be refunded, which we plan to do by March 2021.

    - Automatic refunding of new VAT credits. Our earlier plan to have all risk-assessed and approved new credits to be either offset against existing liabilities or automatically refunded to the taxpayer starting May 1st, 2020 has been delayed. This was due to an uncertain outlook on budget resources due to the Covid-19 shock, and the need to assess risks stemming from the new automatic system. Given that our revenue mobilization efforts have been effective, we are now implementing the automatic VAT refunds effective November 20th, 2020.

[1] See previous MEFP for details.

- Compliance and audit yields. We plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. The system itself is functional and staff are being trained. A pilot audit case management system will be launched by end-2020. Once fully operational in early 2021, the audit case management system should enhance audit timeliness and productivity.

- Taxpayer register. The GRS will create a register of employees for tax administration purposes by end–2021.

- We have been working to expand the system of information sharing with government agencies and the Financial Monitoring Service (FMS) from monitoring suspicious transactions. Automatic reporting from financial institutions will be considered in the context of the international reporting requirements under the automatic exchange of financial information for tax purposes, which Georgia has committed to have implemented by September 2023.

18. We believe that accurate and transparent budgeting and accounting is a cornerstone of fiscal stability. Accordingly, we commit to:

- Make the coverage of General Government consistent with the classification of SOEs into General Government units and Public Corporations. A sectorization exercise of all SOEs was finalized in March 2020, resulting in 52 SOEs qualifying as public corporations and 183 as general government entities, which should be reflected accordingly in public sector financial reporting. Any newly identified SOEs are considered to be general government entities until there is prudent evidence to classify them to the public corporation sector. From January 2021, all of our fiscal reports will incorporate these changes. This will require changes to the PFM legislation.

- Improving the quality of fiscal reports and complying with international accounting standards. In our efforts to improve fiscal transparency, starting in 2021, we will produce an annual consolidated central government sector financial report based on International Public-Sector Accounting Standards (IPSAS) basis.

- We will further improve fiscal transparency by disclosing tax expenditures. The 2021 Budget documentation includes a statement on selected Value Added Tax (VAT) expenditures and will work towards a comprehensive tax expenditure review by end-2021, with IMF and USAID support.

C. Monetary Policy

19. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. The clause entails 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.

20. We are committed to our inflation targeting (IT) framework to maintain price stability. While inflation has been on a declining path, our monetary policy decisions will depend on the inflation outlook. We will closely monitor inflationary expectations and developments as we would need to balance inflation expectations, which remain elevated following exchange rate depreciation (the NEER depreciated by 5.1 percent during February-October 2020), with the need to support demand in the aftermath of the COVID-19 pandemic. Further exchange rate passthrough to inflation expectations may warrant future tightening of the monetary stance to preserve price stability.

21. **We will maintain a flexible exchange rate regime to protect the economy against external shocks, while preventing excessive lari volatility.** The floating exchange rate regime continues to work well as a shock absorber, but excessive lari volatility could become disruptive to financial stability as Georgia remains a dollarized economy. Our commitment to exchange rate flexibility is signaled by a floor on net international reserves (NIR, performance criterion). In the aftermath of the COVID-19 shock, we suspended accumulating reserves and focused on providing foreign exchange (FX) liquidity. Our FX sales remain mostly driven by ad-hoc interventions to support the supply of FX. This has been complemented by smaller sized FX sales triggered by the volatility of the exchange rate and the need for FX market liquidity.

22. **Despite challenging market conditions, we did not draw on our reserves as much as originally expected.** The end-June NIR reached $1,335 million, significantly above the target, which had to be adjusted downwards to $966 million due to lower external disbursements. However, the situation remains volatile and we remain committed to intervene to sustain stable market conditions. Without jeopardizing such strategy, we remain committed to the end-December 2020 QPC to $1,100 million providing some buffer in the context of the deteriorated outlook and continued uncertainty about the recovery. GIR are projected at $3.6 billion (105 percent of the ARA metric) at end-2020.

23. **Over the medium term, we remain committed to maintain adequate reserves, upgrade our FX intervention policy, and strengthen NBG's communication.** As the economy recovers from the shock and market conditions allow, we will start rebuilding external buffers. Our FX policy will remain guided by reserve adequacy and price stability goals; with reserve accumulation objectives suspended at times when markets become disorderly. To improve the transparency of our FX policy, we will design a clear FX intervention strategy by May 2021, explaining the FX policy goals and principles used to achieve those goals.

D. Financial Sector Policy

24. **We have taken decisive steps to safeguard financial stability in the aftermath of the COVID-19 shock.** Banks have been asked to evaluate the quality of their loan portfolios; on-site inspections have been suspended; encouraged the use of moratoria on loan repayments; and a moratorium on fines was introduced where a breach emerged due to the crisis. We provided banks with standardized scenarios and methodology to assess credit loss expected from the current shock. These guidelines also aim at avoiding delays in recognizing potential losses due to the loan moratoria. Provisioning for business loans is based on forecasted 2022 debt-service-coverage and debt-to-ebitda ratios, which incorporate standardized sectoral forecasts. Provisioning for retail loans is assessed based on overdue days, restructuring status, previous use of moratorium, and payment-to-income ratios.

Banks have conducted a granular assessment of COVID-19 impact on banks' loan portfolios to determine adequate general and specific provisions. These measures will support that inevitable losses are promptly recognized, but viable enterprises are not denied financing due to temporary liquidity difficulties.

25. We have postponed implementing large exposure limits until June 2022. In line with Basel III principles, we tightened the large exposure limit to 25 percent of Tier–1 capital for both related and non-related parties (interconnected borrowers). Because of the lari depreciation, and additional expected credit losses in a challenging economic environment when borrowers have limited ability to reduce their exposures, we have granted banks until June 2022 to comply with the new requirement, and from January 2022, banks should refrain from creating any new exposures that breach this limit. We will regularly collect additional information from banks about the financial situation of large borrowers and monitor portfolio concentration risk.

26. We will support lending to the non-financial private sector. We revised our emergency liquidity assistance framework and now accept broader collateral for temporary liquidity assistance to solvent financial institutions. To restore lending to the real sector, measures include credit guarantees provided by government to the sectors affected by the current crisis, liquidity support for banks and interest rate subsidies for lari-denominated mortgages to households. To support bank lending, we released capital requirements in March 2020 by more than 3 percentage points for CET–1. We may further release up to one percentage point of existing capital buffers, which makes current actual level of capital 4 percentage points above the minimum CET–1 requirement. We plan to give banks a two-year period to re-build capital buffers, subject to the path of economic recovery. The timing to rebuild capital buffers will depend on factors such as the banks' capital position and prospects for profitability. Dividend distribution will be restricted for banks until capital buffers are fully re-built.

27. We have adjusted our plans to strengthen the financial stability policy framework, regulation and supervision.

- We have initiated the transition to supervisory reporting from local GAAP to IFRS. Banks will be required to fully transfer their financial and regulatory reporting to IFRS framework by January 2023. In order to align full framework to IFRS without material impact on prudential requirements, we intend to develop IFRS-based supervisory reporting standards and forms, including new principles on asset provisioning and guidelines on models used for provisioning by June 2021. Reporting forms and core principles will be adopted by end-2020 and starting from 2021, banks can move voluntarily to new IFRS based reporting; however, they have to meet the regulations under local accounting standards. Starting in 2022, the banks will start transitioning to IFRS-based rules. Once fully transitioned, we will request capital adequacy information both on stand-alone and consolidated basis under IFRS accounting framework using relevant prudential filters.

- The draft law on supplementary supervision for financial conglomerates will now be submitted to Parliament by June 2021.

- Standards for interest rate risk in the banking book—in line with Basel and EBA guidelines—became effective in September 2020.

- In line with our commitment to an annual publication, we have published the 2020 Financial Stability Report in September 2020, highlighting vulnerabilities and risks in the financial and non-financial sectors and assessing the resilience of the financial system to the COVID-19 shock.

- We will develop regulation on the fit-and-proper requirements for shareholders and beneficial owners of holding companies in line with EU legislation and Basel standards by April 2021.

- By April 2021, in line with the newly revised legislation on competition and in consultation with IMF staff, we will develop secondary legislation on notifying and approving concentration in the banking sector (e.g. mergers, acquisition of controlling holding), and procedures to investigate complaints on cases that may violate competition in the banking sector.

- We have scaled up our efforts to develop fintech and banking digitalization. The NBG has created the financial innovation office, a regulatory laboratory, a new digital bank licensing framework, and a new risk management framework that employs data-driven statistical, artificial intelligence, and machine learning models. NBG has developed private public partnerships with banks to develop common Open API standards, to become effective by April 2021.

- To strengthen the standards of non-financial risk management, the NBG intends to publish, by June 2021, a taxonomy on sustainable finance that aims at setting a common language to support investors to assess whether investments and/or economic activity are meeting robust environmental standards.

28. We are strengthening our banking resolution framework. We approved the secondary legislation on: (i) the NBG's Resolution Committee and the inter-agency Financial Stability Committee; (ii) identification of critical functions; (iii) recovery plans; (iv) valuation; and(v) accelerated supervisory approvals during resolution (e.g. share acquisitions) (**end-June 2020 structural benchmark**). We intend to issue secondary legislation on: (i) resolution plans; (ii) temporary administrator and special manager; (iii) recapitalization tools; including the bail-in; (iv) temporary public support and ex-post resolution fund; and (v) ELA against government guarantees (**end-December 2020 structural benchmark**). The end-June regulation already establishes the bridge bank tool.

29. We continued developing the domestic capital market to support larization and reduce external vulnerabilities.

- We implemented "first-generation reforms" of the capital market legal and regulatory framework:

- Given the relatively small scale of our economy, the investment fund market (private equity/venture capital) could create alternative funding for domestic corporates. In 2020, the Parliament adopted the "Investment Funds Law of Georgia" and introduced the tax regime for investment fund operations.[2] The NBG also introduced new regulations for investment fund operations (asset manager, specialized depositary, investment funds authorization/registration/regulation rules), and updated the capital market regulations, aligning it with the IOSCO principles and improving investors protection and transparency; both are fundamental prerequisites for capital market development.

- In 2020, the Parliament adopted amendments to the "Law of Georgia on Securities Market", which will improve transparency among issuers of public securities and incorporate provisions related to insider trading and market manipulation. The new framework is in full compliance with the EU directives and the IOSCO principles.

- We have launched a market platform and a new code for foreign exchange transactions consistent with international best practices. The platform increases the number of market participants, supports better price discovery and narrows spreads, and improves liquidity in the FX market. The new FX code puts in place important client protections – e.g. prohibition of front-running, restrictions on cross selling, mandates greater transparency of FX conversion services and fees.

- The legislation for securities holding (creating the basis for dematerialized securities holding) and covered bonds (to improve access to long-term lari funding for commercial banks and help develop the fixed-income market) is expected to be approved in the first half of 2021. The new framework for securities holding should strengthen investors' protection and incorporate an indirect holding regime, where only banks and brokers would be authorized to hold securities on behalf of their clients. The legislation on covered bonds should improve the availability of funding for banks.

- In consultation with IMF staff, we are gradually transitioning to a primary-dealer (PD) system:

    a. We have updated our regulations to allow for the introduction of a PD system: (i) a primary market regulation issued jointly by the MoF and NBG, (ii) a core PD arrangement (in the form of an agreement or Memorandum of Understanding), and (iii) market conduct regulation to ensure separation between PDs own-trading activities and the clients' orders.

    b. We launched the pilot intermediate market making arrangement (MMA) for the PD system in October, and a first auction took place end-November. The system will include a single issuance of a two-year bond that will be reopened periodically. We will continuously assess the IMMA to maximize its effectiveness and gradually extend it.

    c. We will update contractual agreements (e.g., repurchase and securities lending agreements) for financial transactions in public debt securities between the primary dealers and the MoF.

[2] The legislation is based on the EU principles derived from Alternative Investment Fund. Managers Directive (AIFMD) and UCITS (Directive 2009/65/EC of the European Parliament and of the Council, July 13, 2009).

E. Structural Reforms

30. We are committed to resume implementation of our comprehensive structural reform agenda to support the recovery and limit economic scarring from the pandemic. Our reforms aim at strengthening Georgia's connectivity through infrastructure spending and trade initiatives, improving education and vocational training, mobilizing savings, the business environment, and land and energy reforms. These steps should boost productivity and raise long-term potential growth while limiting economic scarring. At the same time, targeted social assistance and healthcare will continue to protect the most vulnerable.

31. Enhancing regional connectivity remains a key priority for Georgia's development. Despite the constraints imposed by the pandemic, we are continuing to advance investment in core infrastructure, which will transform Georgia into a transport and logistics hub connecting Europe with Asia and support regional development. To this end, two out of four subsections of the East-West Highway (F1 and F2) are well underway and construction work on the remaining subsections (F3 and F4) are at an early stage.

32. We will revisit our comprehensive education reform to improve job creation, productivity and wages in the aftermath of the pandemic. We will revise the government decree on teachers regulatory documents to clarify teachers' roles and responsibilities at all four categories (Practitioner, Senior, Lead and Mentor); and to establish a non-discretionary approach to teacher's career advancement based on: (i) abolishing credit-point (incl. partial) accumulation system; (ii) introducing special exams for teacher 's promotion at each level of teacher status.

33. We have modernized our labor code to provide better protection to workers and a sound and predictable legal environment to employers. As part of our Association Agreement with the EU, our revamped labor legislation will enhance workers' conditions in Georgia by clarifying requirements for terms and conditions of employment, regulating working time and establishing an official labor inspection body. This new legislation will also support legal protection of employers by improving predictability in employment agreements.

34. The pension agency has approved its investment strategy and is finalizing measures to access a more comprehensive set of investment instruments. More than GEL1 billion of contributions has been accumulated and the agency is preparing to deploy these into (initially) a low-risk investment portfolio, as required by the law. Over the medium-term, the agency will gradually access a broader set of instruments that would facilitate more diversified portfolios. With adequate safeguards in place, the Pension Agency should promote savings and create an institutional investor for long-term lari assets.

35. We will continue to improve the business environment. To improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. In September 2020, the Parliament approved the new insolvency law providing adequate protection of creditor rights, timely and efficient insolvency processes, and effective rehabilitation framework in line with best international standards. This law will promote more efficient insolvency procedures, which would be critical if corporate insolvencies increase in the aftermath of the COVID-19 shock. Because the approval of the law took longer than expected, the final implementation of the framework for licensing professionals will be re-set to end-March 2021 (**reset end-December 2020 structural benchmark**).

36. Land registration continues to 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 been assisting citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Currently, registered land plots amount to 2.2 million compared to 0.9 million at the launch of the land reform on August 1, 2016.

37. Deepening trade relations would support economic diversification. We have signed a free trade agreement with the U.K. to continue our trade relations after its departure from the EU. We continue to negotiate with Turkey an expansion of the current FTA. We remain committed to pursue other FTAs with priority countries, including South Korea, the United States, Israel, and the GCC countries.

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

- The government has adopted a new Electricity Market Concept Design, promoting market rules; to become applicable for the natural gas sector by the end of 2021.
- We will continue promoting energy savings and independence, security in energy supply, and energy efficiency. We are developing national action plans on energy and climate, on energy efficiency, and on renewable energy. The Parliament of Georgia adopted legislation on energy efficiency and performance in buildings in May 2020.

39. We are modernizing our national accounts statistics to support strong economic policymaking. We have further improved our national accounts series in 2020 by compiling and publishing quarterly GDP at constant prices by expenditure. We have computed GDP based on supply and use tables (SUT) for 2019 and we plan to publish the balanced SUT by end-2020. This will provide a more detailed picture of the structural transformation in our economy.

F. Program Monitoring and Safeguards

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

41. The NBG continues to maintain a strong safeguard framework and internal control environment. As required by the safeguard policy, we 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 2019-20

	2020		
	End June	Outturn	End Dec.
Inflation Consultation Bands for CPI (in percent)			
Central point	6.0	6.4	3.5
Inner band, upper limit/lower limit	8.0 / 4.0		5.5 / 1.5
Outer band, upper limit/lower limit	9.0 / 3.0		6.5 / 0.5

Source: Geostat, IMF staff estimates

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for end-June Through end-December 2020

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

	2020				2020
	End-June				End-December
	Target	Adjusted Target	Outturn	Status	Target
Performance Criteria					
Ceiling on augmented general government deficit (program definition)	2,300	2,507	1,492	Met	4,300
Ceiling on general government net budget lending	40	51.5	20.1	Met	150
Floor on NIR of NBG[1] (end-period stock, million of U.S. dollars)	1,120	966	1,335	Met	1,100
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0	0	0	Met	0
Ceiling on new public guarantees (continuous criterion)	0	0			0
Ceiling on the cash deficit of the Partnership Fund (million of U.S. dollars)	0	0	-4	Met	0
Ceiling on new investments by the Partnership Fund (continuous criterion)	0	0	0	Met	0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the EFF program)	0	0	0	Met	0
Indicative Targets					
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0	0			0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	6,000	6,000	5,482	Met	12,450
Stock of VAT credits[2]	1,470	1,470	1,303	Met	1,470

[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.

[2] The stock of VAT credits is evaluated in mid-June/mid-December respectively.

Table 3a. Georgia: Completed Structural Benchmarks—First Through Fifth Review

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks	End-December 2017	Met
Submit to Parliament legislation giving NBG oversight power over credit information bureaus	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019	End-June 2017	Met
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards	End-June 2018	Met
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation	End-September 2018	Met
Introduce regulation on banks corporate governance in line with Basel Principles	End-September 2018	Met
NBG to publish a renewed financial stability report	End-November 2019	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds	End-December 2017	Met
Monetary policy operations and communication		
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018	End-June 2017	Met
Bank Resolution Framework		
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations	End-September 2017	Met
Fiscal		
Submission to Parliament of a 2018 budget consistent with the fiscal deficit in the Fund-supported program	End-December 2017	Met
Adopt a remuneration law for public civil service	End-December 2017	Met
Submit to Parliament a new fiscal rule framework consistent with IMF TA recommendations	End-December 2018	Met
Tax Administration		
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs)	End-September 2017	Met
Restructure the GRS headquarters into a function-based organization	End-February 2018	Met
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims	End-March 2018	Not Met 1/
Create a new specialized VAT unit focusing on validating VAT claims	End-June 2018	Met
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	End-December 2018	Met
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities	End-June 2019	Met
Public-Private Partnership and Fiscal Risks		
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	End-December 2017	Met
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement	End-December 2017	Met
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as described in the MEFP	End-December 2018	Not Met 2/
Adopt the government decree implementing the PPP law following the recommendations of the FAD TA report	End-December 2018	Met
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns	End-December 2017	Met
Adopt a government decree clarifying the mandate of SOEs that are public interest entities, their governance and reporting requirements, in line with recent FAD recommendations	End-November 2019	Met
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system	End-December 2017	Met
Establishing an independent pension agency.	End-July 2018	Not Met 3/
Structural Reform		
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)	End-July 2019	Not Met 4/

1/ Implemented with two months delay
2/ Implemented with one month delay
3/ Implemented with a two week delay
4/ Implemented with seven months delay

Table 3b. Georgia: Remaining and Proposed Structural Benchmarks, by Completion Date, 2019–2020

Sixth Review	Date	Status
Strengthen the public investment management methodology that guides project appraisal, selection and management; and adopt a government decree implementing reporting and oversight requirements for public investment projects at the MoF	End-December 2019	Met
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions	End-December 2019	Not Met
Submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from the monitoring entities on suspicious transactions, and put in place safeguards that protect the information from improper use	End-December 2019	Met
Adopt a budget for 2020 with an augmented deficit of GEL1,320 million in line with policies agreed at the Fifth Review	End-December 2019	Met
Publish a fiscal risk statement with a more comprehensive coverage of general government financial asset operations and provide information on the rates of return on general government equity holdings and loans	End-December 2019	Met
Enact legislative changes to implement effective ELA and resolution framework in line with international best practices	End-December 2019	Met
Provide a complete list of the SOEs qualifying as public corporation and SOEs qualifying as general government under the GFSM2014, done in consultation with FAD's regional resident advisor	End-March 2020	Met
Issues guidelines establishing valuation methodology for PPPs	End-March 2020	Not Met 1/
Seventh Review		
Adopt the first phase of secondary legislation implementing bank resolution framework	End-June 2020	Met
Upcoming		
Introduce the regulatory framework for insolvency professionals and begin licensing	End-December 2020	Re-set to March 2021
Adopt the second phase of secondary legislation implementing bank resolution framework	End-December 2020	
Expand the 2020 Fiscal Risk Statement in line with recent FAD TA recommendations	End-December 2020	
Adopting a 2021 budget consistent with the policies agreed at the Seventh Review	End-December 2020	

Attachment II. Technical Memorandum of Understanding (TMU)

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

A. Program Assumptions

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

Table 1. Georgia: Program Exchange Rates

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

B. Institutional Definition

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

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

Treasury will provide, daily, 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;
- a performance criterion (ceiling) on net budget lending operations;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (ceiling) on the accumulation of external debt arrears by the general government;
- 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.
- an indicative target (ceiling) on the primary current spending of the general government;
- an indicative target (ceiling) on outstanding VAT credits;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government;

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. In addition to the performance criteria listed above and in Table 2 of Attachment I, the arrangement includes the performance criteria standard to all Fund arrangements, namely: (i) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions; (ii) no introduction or modification of multiple currency practices; (iii) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement; and (iv) no imposition or intensification of import restrictions for balance of payments reasons. These four performance criteria will be monitored continuously.

7. Performance criteria and indicative targets have been set for end-June 2020 and end-December 2020 (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

8. 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).

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

E. Program Definitions, Adjustors, and Reporting Requirements

General Government

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

10. 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.

11. 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.

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).

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

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

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

16. Adjustor: The ceilings on the augmented cash deficit and the primary current spending (indicative target) will be adjusted upward (higher deficit and higher primary current spending) for healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases in excess of the originally planned amount of GEL[351] million (Table 2). Activities included for the adjustor are the ones defined by:

- Government Decree #164 28.01.2020 "On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus":
  - Article 4.1 – Activities under the competencies of NCDC and Center for coordinating Emergency situation;
  - Article 4.8[2] – Tourism Agency providing quarantine services, including renting hotels and providing catering for the people in quarantine
  - Annex #20 "Managing Novel COVID-19" of the Government Decree #674 31.12.2019 "On Approving 2020 Healthcare Programs", added to the decree by the Government decree #176 17.03.2020;
- Government Decree #653 25.12.2019 "On approving 2020 State Program of Rehabilitating and equipping Medical Facilities".

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

	June 30, 2020	December 31, 2020
Healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases	N/A	351
Disbursements of foreign-financed project loans[1]	627	1,170
Receipts from sale of non-financial assets	83	150
VAT refunds	300	600
On-lent amounts from project loan disbursements	80	250

[1]This value excludes project loans that are used to support the budget and/or the healthcare sector, namely, the World Bank's Fast Track COVID-19 Facility and EIB's healthcare project. Adjustments will not be made on these loans.

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. Healthcare spending specified under (i)the Government Decree #164 28.01.2020, "On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus" under the categories of Articles 4 and 4.8[2], and Annex #20; and (ii) Government Decree #653 25.12.2019 "On approving 2020 State Program of Rehabilitating and equipping Medical Facilities".

d. Data will be provided at actual exchange rates.

e. 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.

f. 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.

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.

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

Ceiling on the Current Primary Expenditures of the General Government

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

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

Ceiling on the Outstanding stock of VAT credit refunds

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

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

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

21. 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.

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

[1] Arrears to Turkmenistan.

23. 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

24. 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.

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

Continuous Ceiling on the New Guarantees Issued by the Public Sector

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

27. Supporting Material: The Ministry of Finance will provide to the IMF information on any new guarantees issued by the public sector within 4 weeks after the end of each quarter.

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

29. 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.

30. 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

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

32. 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.

Continuous ceiling on New Investments by the Partnership Fund

33. Definition: New investments by the Partnership Fund are defined as gross acquisition of non-financial and financial assets, excluding (i) currency and deposits and (ii) other accounts receivables. Further excluded are transactions which are unambiguously required by contractual obligations established before November 1, 2019.

34. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly acquisition of financial and non-financial assets within four weeks of the end of each quarter. The Ministry of Finance will notify the IMF about transactions required by preexisting contractual obligations within 10 days of their occurrence and provide the necessary documentation establishing such obligation.

Net International Reserves

Floor on the Net International Reserves of the NBG

35. 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 $1,335 million as of June 30, 2020 (at program exchange rates).

36. 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.

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

- Upward (downward) by any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.
- Upward (downward) by any excess (shortfall) of budget support grants compared to program amounts (Table 3).
- Downward by any shortfall of budget support loans compared to program amounts (Table 3).
- Upward by the sum of the total excess of budget support loans compared to program amounts (Table 3) and any negative net Eurobond issuance by the government, if this sum is positive.
- Upward by any positive net Eurobond issuance by the government.
- Upward/downward by 100 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Georgia: Projected Balance of Payment Support Financing[3]
(Million of U.S. dollars)

	June 30, 2020[1]	December 31, 2020[2]
Projected privatization revenue	0.0	0.0
Budget support grants from external donors and not related to project financing	0.0	118.6
Budget support loans, including bilateral and multilateral donors for budget support	297.8	908.1
Disbursements of project loans and grants	75.9	335.1

[1] Cumulative from January 2020 to end-June 2020.
[2] Cumulative from January 2020 to end-December 2020.
[3] Flows are valued at program exchange rates for the June and December targets.

38. 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.

Statement by Mr. Hilbers, Mr. Rashkovan, and Mr. Zedginidze on Georgia
December 16, 2020

On behalf of the Georgian authorities, we thank Mission Chief Ms. Vera Martin and her team for the constructive policy dialogue during the mission and insightful report. The authorities broadly agree with the policy advice and staff's assessment of the economy.

Economic performance and outlook

The Georgian economy is battling the protracted impact of the pandemic. While the economy showed signs of recovery in Q3, as businesses reopened after stringent measures, the recent surge in Covid-19 cases necessitated a tightening of social restrictions. The authorities, in line with staff estimates, expect GDP to contract by 5.1 percent in 2020, before rebounding back to 4.3 percent in 2021. This estimate assumes that tourism revenues in 2021 will reach only 25 percent of their 2019 level. The authorities believe that, although subject to significant uncertainty, the recovery can be stronger on the back of vaccine developments.

Despite the challenging environment, the authorities performed well under the EFF program. They implemented all structural benchmarks, including the adoption of a rule- based pension system, to contain long term fiscal risks and support inclusive growth. The authorities also showed progress in the implementation of the banking resolution and insolvency frameworks. All the quantitative performance criteria (QPC) were met. Notably, the QPC on the augmented fiscal deficit and Net International Reserves (NIR) were met by decent margins; and inflation remained within the inner band of the inflation consultation clause.

Fiscal performance has been on track and consistent with program objectives. The 2020 deficit widened to 9 percent of GDP driven by pandemic related spending and slowdown in the economy. Increased healthcare and social spending have been instrumental to save lives and sustain livelihoods. Revenue performance was better than expected, which enabled the authorities to continue infrastructure spending to strengthen the medium-term growth potential and limit economic scarring.

As acknowledged in the report, Georgia's medium-term growth potential remains strong, with a growth rate above 5 percent. The growth potential is supported by the authorities' sound macroeconomic policies, infrastructure spending, and structural reforms.

Policy response to Covid-19

To mitigate the social and economic impact of the pandemic, the authorities maintain fiscal measures in consultation with the IMF. On November 26, in response to the recent surge in Covid-19 cases, the government adopted a resolution to restrict movement and activity in the retail and hospitality sectors for two months. Contact-intensive sectors and vulnerable people are hit particularly hard by these measures. Therefore, the 2021 budget includes additional measures to support affected households and businesses. The new fiscal package includes increased healthcare spending to deal with the pandemic, a tax credit to support wages, as well as income transfers targeted to low-income households. In total, additional fiscal costs to counter the direct and indirect impact of the pandemic in 2021 accounts for 2.1 percent of GDP. The authorities emphasized that these measures are targeted and temporary.

The National Bank of Georgia's prompt actions on the monetary and financial sector policy front helped ease liquidity and credit constraints. According to the authorities' and staff's recent assessment banks maintain sound financial positions.

Medium-term policies

Fiscal policy and reforms

The authorities reiterate their commitment to fiscal consolidation in the medium-term. The 2021 fiscal deficit is projected at 7.5 percent of GDP, implicating a 5.2 percent of GDP in cyclically-adjusted terms. While the 2021 budget enables increased healthcare and infrastructure spending to address the impact of the shock, it also signals resuming the fiscal consolidation path compared to a 9 percent deficit (6.7 in cyclically-adjusted terms) in 2020. Moreover, the fiscal budget includes significant spending measures for Covid-19 related healthcare and social assistance. Thus, some part of fiscal consolidation will automatically occur post-pandemic.

As the report notes, Georgia's debt is sustainable and the capacity to repay the Fund is adequate. Adopted by the parliament as the Organic Law, Georgia's fiscal rule prescribes a fiscal deficit under 3 percent of GDP and public debt under 60 percent of GDP by 2023. Nevertheless, the authorities stand ready to adopt additional measures in consultation with the IMF to strengthen fiscal sustainability if needed.

The authorities' fiscal reforms further support their consolidation efforts. Progress has been made on both revenue administration and fiscal risk analysis. Advancing revenue administration enables space for growth-enhancing public spending, while their progress on fiscal risk analysis guards against risks. The authorities continue improving SOE governance which, among other goals, will also reduce fiscal risks. Until SOE reform is finalized the fiscal risks are in part mitigated by the authorities' commitment to refrain from either taking over any SOE debt or providing equity injections.

Staff's view on the importance of solid public financial management is shared by the authorities. The IMF's Public Investment Management (PIM) Assessment (May 2018) finds that while Georgia shows weaknesses in some areas it also performs better than average compared to EMEs in other PIM areas. Moreover, several efforts to improve PIM have been underway since 2018 and the end-2019 benchmark on strengthening PIM methodology was also met. Yet, given the authorities' plan to scale up public infrastructure and increase the share of municipal capital expenditure, they will continue their efforts to bring PIM to best international standards.

Monetary and Financial sector policies

The authorities view a flexible exchange rate and macroeconomic adjustment as the first line of defense against shocks; however, a high level of dollarization and the temporary drop in tourism revenue called for FX interventions. Prior to the pandemic, the NBG intervened mostly to build up reserves. Since the pandemic started, the exchange rate absorbed significant shocks but the NBG considers that the benefits of additional exchange rate depreciation might be limited, not least because of its significant negative impact on unhedged FX borrowers. The authorities will continue to intervene to smoothen volatility while remaining committed to maintaining adequate reserves.

The NBG's monetary policy continues its balanced focus on supporting demand and curbing inflation expectations driven by FX pressures. The NBG maintains its policy rate at 8 percent and stands ready to tighten monetary policy if exchange rate pressures intensify. They however note that in the dollarized economy excessive tightening of monetary policy may incentivize borrowers to move away from local currency loans toward FX loans, contributing to a further increase in the FX mismatches. A higher policy rate may also adversely affect already sluggish growth. The NBG believes that further increases of FX pressures may warrant a coordinated response of monetary and fiscal policies.

The authorities continue their efforts to strengthen financial stability and reduce dollarization. The financial sector policies – as outlined in the MEFP - aim at containing the pandemic impact and building resilience. Despite the NBG's progress to reduce dollarization, it remains elevated and constitutes a concern that the authorities want to address. In this context, they have expressed interest in a successor program, among other objectives, to support their de-dollarization efforts.

Structural reforms

The authorities reiterate their commitment to resume implementing reforms at full speed once the pandemic subsides. To address growth restraints, the authorities will scale-up investment in physical and human capital, as well as continue their efforts to initiate free trade agreements that should help attract foreign investment and improve competitiveness. Staff's emphasis on judicial reform and the insolvency framework is welcome, and the importance of these reforms cannot be overstated. There are ongoing efforts to address challenges on these fronts. Even so, according to various international ratings, Georgia's business environment overall fares relatively well compared to other EMEs.

Conclusion

Prompt augmentation of the EFF arrangement has helped the authorities counter the social and economic impact of the pandemic, as well as catalyze donor financing. On the back of positive performance under the EFF program, the authorities request the completion of the 7th review and modification of performance criteria. They also express interest in a successor program to support their reform agenda going forward. The authorities are grateful for the Fund's continued support.