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GEORGIA

December 2022

FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND STRUCTURAL BENCHMARKS —PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GEORGIA

In the context of the First Review Under the Stand-By Arrangement and Request for Modifications of Performance Criteria and Structural Benchmarks, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 21, 2022 consideration of the staff report on issues related to the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 21, 2022, following discussions that ended on November 8, 2022 with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 6, 2022.
- A **Staff Statement**
- 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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PRESS RELEASE

PR22/443

IMF Executive Board Completes First Review under the Stand-By Arrangement with Georgia

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed the first review under the Stand-By Arrangement (SBA) with Georgia, providing the country with access to about US$40 million.
- Strong growth of 10 percent is projected for 2022. Inflation has been slowing but remains elevated due to high commodity prices and strong domestic demand. Both growth and inflation are expected to moderate in 2023.
- Georgia's program continues to focus on reinforcing macroeconomic stability and maintaining reform momentum through prudent macroeconomic policies to reduce inflation and rebuild fiscal and external buffers, and structural reforms to foster more inclusive and job-rich growth.

Washington, DC – **December 21, 2022:** The Executive Board of the International Monetary Fund (IMF) completed the first review of the three-year Stand-By Arrangement (SBA) for Georgia. The completion of the review enables access of SDR 30 million (about US$40 million). The Georgian authorities continue to treat the arrangement as precautionary.

Strong growth of 10 percent is projected for 2022. This reflects limited adverse spillovers from Russia's war in Ukraine, buoyant tourism revenues, a surge in war-related inbound migration and financial inflows, and a rise in transit trade through Georgia. These developments have lifted fiscal revenues and supported reserve accumulation. Inflation has been slowing but remains elevated at around 10½ percent due to high commodity prices and strong domestic demand.

Both growth and inflation are expected to moderate in 2023. A slowdown in global trade and tighter financial conditions should weigh on growth, which along with falling commodity prices, recent lari appreciation, and sufficiently tight monetary policy should help reduce inflation. Uncertainty and risks to the outlook remain high.

Following the Executive Board's discussion, Ms. Antoinette M. Sayeh, Deputy Managing Director and Acting Chair, issued the following statement:

The Georgian economy has performed strongly in 2022 and thus far adverse spillovers from Russia's war in Ukraine have had less impact than expected. The authorities have appropriately used recent positive outturns to rebuild fiscal and external buffers, and their performance under the program has been satisfactory. In the context of high uncertainty and risks to the global outlook, continued prudent policies are important to further entrench macroeconomic stability.

The authorities have used the revenue overperformance to achieve faster deficit reduction this year and committed to further deficit reduction to comply with their fiscal rule in 2023. Further progress on reducing tax expenditures, improving revenue administration, and strengthening public investment management will be important to increase fiscal space for priority spending and improve the quality of capital spending. The authorities have taken important actions on state-owned enterprise governance reform and renewable energy development, areas in which implementation of the strategies remains important, including to guard against fiscal risks.

The National Bank of Georgia has appropriately taken advantage of favorable conditions this year to rebuild international reserves more quickly than programmed. Monetary policy will need to remain sufficiently tight to bring down inflation and policymakers will need to be ready to tighten monetary policy further if high inflation persists. Continued exchange rate flexibility and prudent accumulation of reserves will provide Georgia further resilience against external shocks.

Advancing the structural reform agenda will support stronger and more inclusive growth. It will be important to improve competitiveness by strengthening the business environment and enhancing governance. The authorities' plans for education reform and training programs will also help reduce unemployment and enhance inclusion. Finally, it will be important to prioritize among key infrastructure projects.

Table 1. Georgia: Selected Economic and Financial Indicators, 2020–24

	2020	2021	2022	2023	2024
	Actual		Projections		
National accounts and prices	(annual percentage change; unless otherwise indicated)				
Real GDP	-6.8	10.5	10.0	4.0	5.2
Nominal GDP (in billion of laris)	49.3	60.0	72.5	80.1	86.9
Nominal GDP (in billion of U.S. dollars)	15.8	18.6	24.7	27.1	29.7
GDP per capita (in thousand of U.S. dollars)	4.3	5.0	6.7	7.3	8.0
GDP deflator, period average	7.2	10.3	10.0	6.5	3.0
CPI, Period average	5.2	9.6	12.0	6.0	3.0
CPI, End-of-period	2.4	13.9	10.5	3.8	3.0
Consolidated government operations	(in percent of GDP)				
Revenue and grants	25.2	25.5	26.5	25.9	25.8
o.w. Tax revenue	22.3	22.6	23.9	23.6	23.6
Total Expenditure	34.5	31.6	29.3	28.9	28.0
Current expenditures	26.3	24.6	21.7	21.9	22.1
Net acquisition of nonfinancial assets	8.2	6.9	7.6	7.0	5.9
Net Lending/Borrowing (GFSM 2001)	-9.3	-6.0	-2.8	-2.9	-2.2
Augmented Net lending / borrowing (Program definition) 1/	-9.4	-6.1	-3.1	-2.8	-2.3
Public debt	60.2	49.7	41.2	42.0	41.4
o.w. Foreign-currency denominated	47.6	39.9	31.4	31.5	29.7
Money and credit	(in percent; unless otherwise indicated)				
Credit to the private sector (annual percentage change)	22.4	12.4	5.2	10.5	8.5
In constant exchange rate	9.0	18.2	10.9	7.6	8.8
Broad money (annual percentage change)	24.6	11.4	7.4	12.6	11.1
Broad money (excl. fx deposits, annual percentage change)	18.8	17.9	12.8	13.7	12.2
External sector	(in percent of GDP; unless otherwise indicated)				
Current account balance	-12.5	-10.4	-5.6	-6.6	-5.7
Trade balance	-20.0	-20.3	-22.0	-22.2	-18.4
Terms of trade (percent change)	5.7	-13.6	2.5	3.5	1.5
Gross international reserves (in billions of US$)	3.9	4.3	4.3	3.8	3.9
In percent of IMF Composite measure (floating)	107.4	106.9	98.6	83.3	81.4
Gross external debt	110.5	99.8	77.7	73.1	68.4

Sources: Georgian authorities; and Fund staff estimates.

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

INTERNATIONAL MONETARY FUND

GEORGIA

December 6, 2022

STAFF REPORT FOR THE FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND STRUCTURAL BENCHMARKS

EXECUTIVE SUMMARY

Context. The Georgian economy has performed strongly in 2022 as adverse spillovers expected from the war in Ukraine have not materialized thus far. Buoyant tourism revenues, a surge in war-related immigration and financial inflows, and a rise in transit trade through Georgia have lifted growth and fiscal revenues, strengthened the current account balance and the lari, and supported reserve accumulation. Inflation remains elevated, reflecting still high commodity prices and strong domestic demand. Growth and inflation are expected to moderate in 2023 with subsiding external inflows, less favorable global economic and financial conditions, smaller fiscal deficits, and a sufficiently tight monetary policy stance. In 2024, growth is projected to converge to its potential rate and inflation is forecast to fall to the NBG's target.

Program status. All quantitative performance criteria (QPCs) for the first review were met. Fiscal and reserve balance targets were met with substantial margins and June inflation was within the inner bands of the consultation target. Steady progress was made on structural benchmarks (SBs) with four met (reporting tax expenditures, processing VAT credits, improving financial risk supervision, and subjecting large investments to the public investment management framework), and four being implemented as prior actions (three on SOE reform and one on a renewable energy support scheme) given their importance in limiting fiscal risks.

Program priorities. Policies should focus firmly on reinforcing macroeconomic stability and maintaining reform momentum through: a sufficiently tight monetary policy stance to bring down high inflation, continued exchange rate flexibility and a build-up of international reserves, and further strengthening of financial sector resilience; further fiscal consolidation to comply with the fiscal rule in 2023, strengthening public investment management, and limiting fiscal risks including from state-owned enterprises and the energy sector; and fostering more inclusive growth to reduce high unemployment.

Staff views. Given the authorities' strong program performance, ownership, and reform commitments, staff supports completion of the first review and modifications to quantitative and structural targets. The authorities continue to treat the program as precautionary and will only consider making purchases if the balance of payments deteriorates materially.

Approved By
Subir Lall (MCD)
Natalia Tamirisa (SPR)

Discussions were held during October 26 - November 8, 2022, in Tbilisi. The mission team comprised J. John (head), E. Ture, M. Al Taj, W. Abel, N. Reyes (MCD), J. Yoo (FAD), M. Leika (MCM), Y. Zhao (SPR), S. Cakir (Resident Representative), and N. Sharashidze (Local Economist). The mission was assisted by S. Zolotareva (MCD) and K. Danelia (IMF Tbilisi Office). S. Tsur (OED) attended some meetings.

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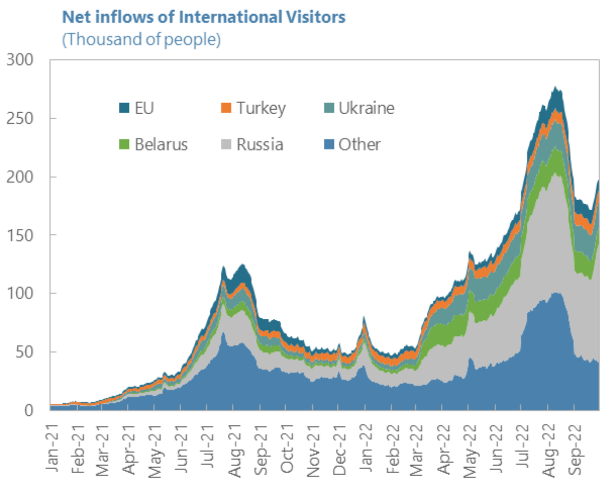
CONTEXT AND RECENT ECONOMIC DEVELOPMENTS

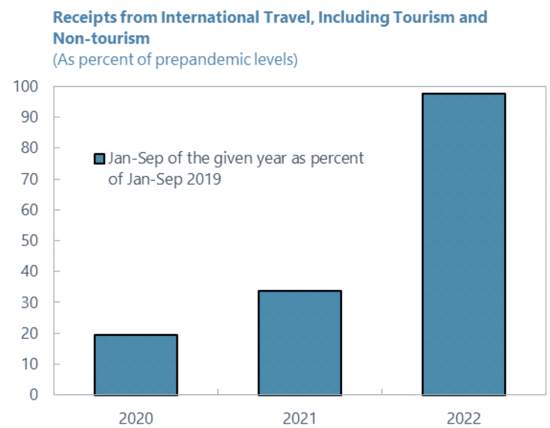
1. The expected negative impact of Russia's war in Ukraine has not materialized thus far. The war in Ukraine was expected to dampen growth and widen the current account deficit through lower exports, remittances, and tourism revenues. Since the start of the war, however, Georgia has seen a fast recovery in tourism, a surge in war-related immigration and financial inflows, and a rise in transit trade. The war's impact on global commodity prices has contributed to high inflation.

Text Figure 1. Georgia: Visitor and FX Inflows

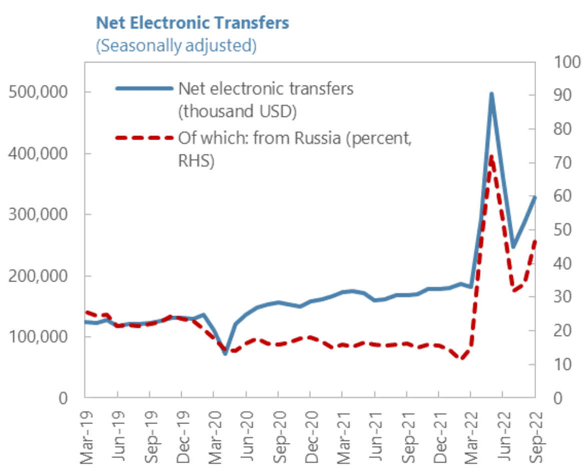
The number of international visitors has surged amid a recovery in tourism and war-related migration…



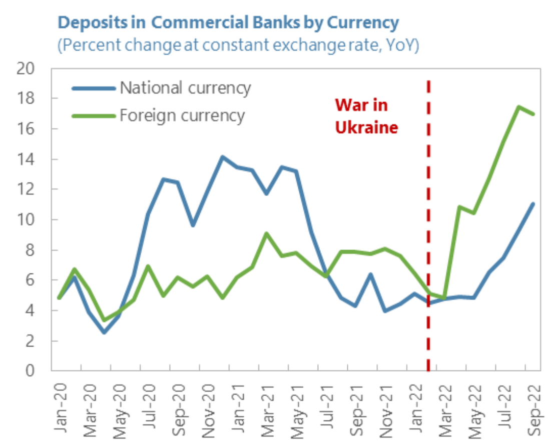
…with an increase in spending by both tourists and migrants.



Electronic money transfers, notably from Russia, have also increased…



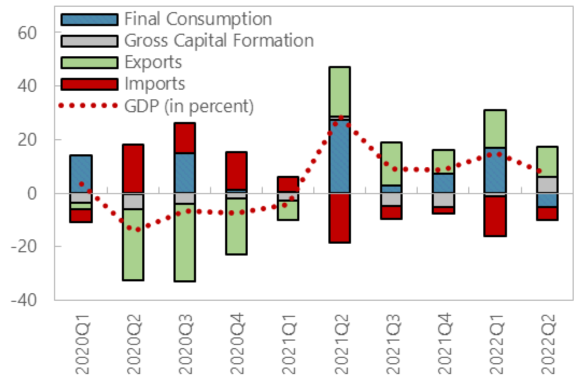
…together with bank deposits in foreign currency.



Sources: Haver, NBG and IMF staff calculations.

2. Reflecting strong domestic demand supported by visitor and FX inflows, growth in 2022 has significantly exceeded expectations (Table 1, Figure 1). According to flash estimates, real GDP grew by 10 percent y/y during January-October 2022, supported by robust activity in transportation and storage, construction, and other services. Higher imports that mirror strong domestic demand, tourism recovery, and lari appreciation contributed to a wider goods trade deficit, but were more than offset by tourism revenues (including spending by migrants) and remittances, improving the current account balance (Table 2, Figure 2).

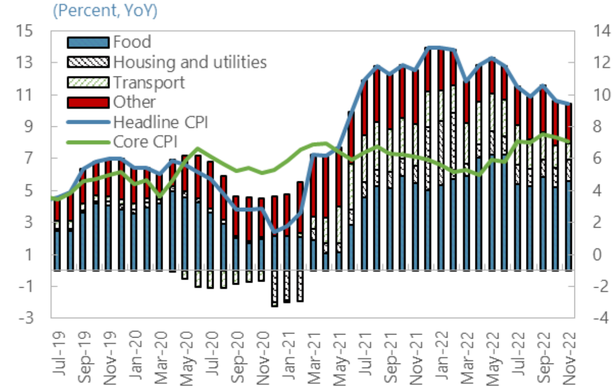
Contribution to Real GDP Growth by Expenditure
(In percentage points except as noted)



Source: National authorities

3. Inflation has come off its peaks but remains well above the NBG's 3 percent target. Falling commodity prices, lari appreciation, and slowing credit growth have contributed to a decline in inflation since SBA approval, from 12.8 percent y/y in June to 10.4 percent y/y in November. Core inflation remains elevated at 7.1 percent y/y in November, due to strong demand and rising housing rents, with the latter in part driven by migrant inflows. Wage growth has also risen sharply to 16.1 percent y/y in 2022Q2. The NBG has kept the policy rate on hold at 11 percent since March and complemented the monetary policy stance with macroprudential measures.

Decomposition of Georgian Inflation
(Percent, YoY)



Sources: GeoStat, and IMF staff calculations.

4. The lari has strengthened since the outbreak of the war in Ukraine and the NBG has increased its foreign exchange reserves. Following a sharp initial depreciation vis-à-vis the US dollar, the lari has appreciated by 17 percent in nominal effective terms from its pre-war levels through end-October, reflecting strong tourism as well as migrant-related FX inflows and remittances. Favorable market conditions have allowed the NBG to make net FX purchases of $350 million between March and October,[1] raising gross international reserves (GIR) to about $4.4 billion.

Lari Exchange Rate
(Index, Feb 23, 2022=100)

Sources: Haver, Financial Times and NBG
Note: Feb 23, 2022 as the start of the war in Ukraine.

[1] This excludes FX sales to the government and SOEs (conducted at market exchange rates).

5. The fiscal deficit has been much smaller than expected, reflecting strong revenues (Table 3, Figure 3). The deficit through October was just 0.9 percent of GDP (text table 1). Revenues grew rapidly, led by income taxes and VAT receipts reflecting strong economic activity and inflation, as well as unusually high corporate income tax (CIT) collection.[2] Spending execution grew modestly with capital expenditures expected to accelerate toward year-end.

Text Table 1. Budget Execution, January-October 2021/22

	Jan - Oct 2021		Jan - Oct 2022		SBA, June 2022	
	GEL mn	%GDP	GEL mn	%GDP	GEL mn	%GDP
Revenues and grants	11,992	20.0	15,611	21.5	17,354	25.2
Taxes	10,672	17.8	13,935	19.2	15,707	22.8
Grants	294	0.5	235	0.3	288	0.4
Other revenues	1,026	1.7	1,441	2.0	1,359	2.0
Primary current spending	11,082	18.5	11,836	16.3	14,206	20.6
Interest expense	676	1.1	633	0.9	761	1.1
Net acquisition of non-financial assets	2,962	4.9	3,751	5.2	5,099	7.4
Capital spending	3,291	5.5	4,079	5.6	5,549	8.0
Privatization	329	0.5	328	0.5	-450	-0.7
Net lending/borrowing	-2,729	-4.5	-608	-0.8	-2,711	-3.9
Net budget lending	72	0.1	73	0.1	76	0.1
Augmented balance	-2,799	-4.7	-680	-0.9	-2,786	-4.0
Nominal GDP	60,003		72,458		68,971	

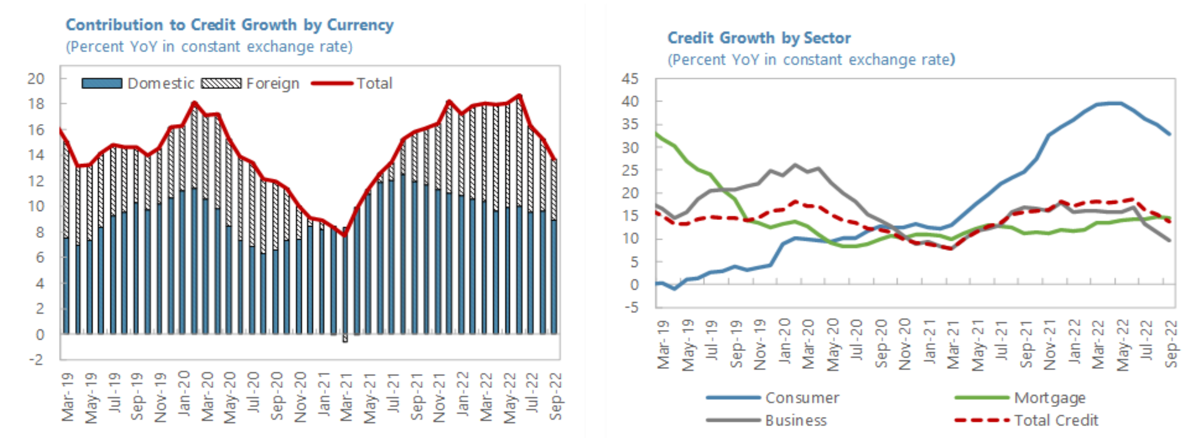
Source: National authorities and IMF staff estimates

6. Credit growth has slowed, reflecting macroprudential measures and a decline in foreign currency lending (Table 4, Figure 4). Against the backdrop of continued strong GDP growth, total credit growth (y/y in constant exchange rates) has slowed since July to 13.8 percent in October as corporate credit growth decelerated due to rising FX borrowing costs and a large one-off FX repayment. Consumer credit growth has also declined, supported by recent NBG measures (¶27).

7. The banking sector remains healthy (Table 5). As of September, the banking system's capital adequacy ratio stood at 20.6 percent and most lenders remain very profitable (29 percent return on equity), with the two largest banks having undertaken dividend payments and share buybacks. The liquidity ratio (23 percent) exceeded pre-pandemic levels and the loan-to-deposit ratio declined, reflecting a surge in nonresident deposits and a slowdown in credit growth. Asset quality continued to improve with NPLs down to 4.5 percent (1.9 percent by the IMF's measure) although the construction, hotel, restaurant, and tourism sectors are still lagging. Restructured loans remain steady (16 percent). Due to a declining interest rate differential between GEL and FX loans, loan dollarization continued to decline and reached the lowest level in a decade (45 percent) while deposit dollarization (57 percent) declined marginally, notwithstanding migrant-related FX inflows.

[2] CIT collection in 2022 included adjustments for companies' actual 2021 profits relative to their proxied profits based on 2020, which were exceptionally low during the peak of the pandemic.

Text Figure 2. Georgia: Credit Growth



Source: NBG.

8. Sanctions on Russia so far have not impeded economic activity. The NBG instructed financial institutions to adhere to the requirements of respective financial sanctions imposed by the US, the EU, and the UK. SWIFT links with unsanctioned banks in Russia remain operational and the largest Georgian banks have retained western correspondent banking relationships and are providing services to customers of affected banks. While most assets and liabilities of sanctioned VTB Georgia were quickly moved to other banks, transfer of its license to a new owner is still pending. A large mineral water company has resumed operations after the government acquired some shares, reducing its sanctioned owners' stake to a minority one. If concerns about sanctions were to arise, this could affect correspondent banking activities.

9. The recent decision on Georgia's EU bid is a political focal point. In response to the EU decision to offer a "European perspective" for Georgia rather than candidate status and a roadmap of 12 reform priorities (including reducing political polarization, strengthening the judicial system, and "de-oligarchization"), the government has produced an action plan and created working groups, but cooperation between the government and opposition parties is limited.

OUTLOOK AND RISKS

10. Growth is set to exceed expectations in 2022 and moderate in 2023, before returning to potential. Growth of 10 percent and a positive output gap are projected for 2022. This reflects strong domestic demand supported by migrant and FX inflows and buoyant exports (especially tourism) with some moderation in the second half of 2022. Growth is expected to slow to 4 percent in 2023 due to subsiding migrant and FX inflows, a weaker external environment including a slowdown in trading partners, and tightening global financial conditions. It would converge to its potential of around 5 percent in 2024, supported by continued strong private consumption, robust investments including infrastructure, as well as a more favorable external environment.

11. Inflation is expected to slow and the current account balance to improve gradually.

- Inflation is projected to average 12 percent in 2022 before easing to 6 percent in 2023,[3] and converging to the NBG's 3 percent target in 2024. This path reflects: falling global commodity prices; a stronger lari; slowing credit growth including due to recent macroprudential measures and tightening global financial conditions; dampened demand from slowing migration, FX inflows, and trading partner growth; smaller fiscal deficits; sizeable base effects; and the NBG's commitment to tighten monetary policy if necessary to bring down high inflation.
- The current account deficit is expected to narrow significantly to 5.6 percent of GDP in 2022 due to buoyant tourism revenues (including spending by migrants) and remittances outweighing strong imports. It is then projected to widen again to 6.6 percent of GDP in 2023, as the goods trade balance deteriorates amid a gloomy global economic outlook and still elevated import prices, while tourism continues to recover.[4] The current account deficit would then gradually decrease to 5.3 percent of GDP by 2027 as goods exports and tourism continue to improve with stronger external conditions. Higher-than-expected private external inflows and a lower current account deficit are facilitating NBG reserve purchases and would contribute to significantly higher GIR in 2022 relative to program approval, by around $1 billion (or 19 percentage points of the ARA metric, taking coverage to 99 percent), despite a decline in borrowing from development partners.

12. Risks to the outlook are balanced although uncertainty is high (Annex I). Considerable downside risks include weaker trading partner growth, tighter global financial conditions, lower external inflows including from tourism or a reversal of recent inflows, and sustained high global food and energy prices, resulting for instance from a further deterioration of the war in Ukraine or sanctions on Russia, which could dampen growth and lead to depreciation and higher inflation (Annex II). While public debt remains sustainable and is expected to decline, depreciation would increase debt burdens given the high FX share.[5] Upside risks for growth include a faster tourism recovery, higher capital inflows, further war-related migration of workers and companies, and increased transit trade, although these could add to inflation pressures.

PROGRAM PERFORMANCE

13. All end-June and continuous quantitative performance criteria (QPCs) were met (MEFP ¶6, MEFP Tables 1-2). Fiscal and international reserve QPCs for end-June were met with substantial margins and June inflation was within the inner bands of the inflation consultation clause.

14. The authorities have made steady progress on structural benchmarks (SBs) (MEFP ¶6, MEFP Table 3). They met the end-June SB on enhancing governance of internal processes for financial risk supervision, end-July SB on automatic processing of VAT credits, and end-September SBs on establishing a schedule for tax expenditure reporting and submitting a budget code

[3] If m/m inflation in 2023 continued at the average of the last six months (June – November 2022) average inflation would fall to 6 percent in 2023.

[4] Travel revenue during January-September in 2022 recovered to 98 percent of the comparable 2019 period, but with only 68 percent of the number of travelers. Staff expects the number of travelers to increase further in 2023 amid dissipating COVID concerns and tourism revenue to exceed the 2019 level.

[5] See Debt Sustainability Assessment (DSA), IMF Country Report No. 22/188.

amendment to subject all investments above a threshold to the public investment management (PIM) framework. They also met the end-December SB on publishing a climate-related financial risk assessment and end-March 2023 SB on the public investment management assessment (PIMA) update well ahead of schedule. The end-July SBs on finalizing and adopting an SOE reform strategy and determining the ownership of Georgian State Electrosystem, and the end-August SB on issuing a timebound plan for the implementation and piloting of the SOE reform strategy are being implemented as prior actions and expected to be met by mid-December (¶19). The end-July SB on developing a support scheme for renewable energy has been implemented as a prior action in November (¶20). These prior actions are critical to limit fiscal risks.

POLICY DISCUSSIONS

Policy discussions focused on: (i) fiscal consolidation to comply with the fiscal rule and build buffers, improving public investment management, strengthening revenue generation, and managing fiscal risks including related to SOEs and the energy sector; (ii) bringing inflation toward target, maintaining exchange rate flexibility, and building reserves; (iii) staying vigilant to financial sector risks; and (iv) strengthening competitiveness and inclusiveness.

A. Rebuilding Fiscal Buffers and Managing Risks

15. The authorities have saved part of the revenue overperformance to achieve a much lower 2022 deficit than projected at SBA approval (MEFP ¶7). Revenue overperformance is expected to be significant, about GEL 1.9 billion for the full year. This is projected to deliver a 2022 deficit of around 3.1 percent of GDP compared to the program target of 4 percent, even with additional current spending to avoid too large a drop in real outlays given high inflation, additional capital expenditures including to frontload payments of around GEL 230 million to smooth spending pressures next year, and additional budget lending of about GEL 200 million to enable gas purchases by an SOE (text table 2).[6,7] Accordingly, the authorities requested raising the *December 2022 indicative ceiling* on primary current expenditure from GEL 14.2 billion to GEL 15 billion and the *December 2022 QPC* ceiling on net budget lending from GEL 75 million to GEL 275 million.

[6] The supplementary budget includes support for vulnerable households and subsistence farmers and a newly launched public employment program to help address entrenched unemployment.

[7] The budget lending will help the Georgian Oil and Gas Corporation (GOGC) purchase gas early next year. To reduce the possibility for such support in the future, quasi-fiscal activities by the GOGC will be significantly curtailed by mid-2023, which will facilitate repayment of the budget lending in 2023-24.

Text Table 2. Additional Revenue and Expenditure, 2022

	Revised budget (Nov) 1/ vs. SBA approval (Jun)	
	GEL mn	% GDP 2/
Revenues and grants	1,863	2.6
Tax	1,643	2.3
Grants	9	0.0
Other revenues	211	0.3
Current spending	775	1.1
of which:		
Additional support to municipalities 3/	170	0.2
Agricultural programs 4/	105	0.1
Water supply rehabilitation programs	80	0.1
Healthcare programs	75	0.1
Tourism-related events	70	0.1
COVID-19 related expenses	45	0.1
Vineyards support 5/	40	0.1
Public works program	40	0.1
Logistic expenses in defence	30	0.0
Sports awards	25	0.0
Net acquisition of non-financial assets	386	0.5
Capital spending	386	0.5
Privatization	0	0.0
Net lending/borrowing	702	1.0
Net budget lending	166	0.2
Augmented balance 6/	535.6	0.7

Source: National authorities and IMF staff estimates.
1/ projections as of December 5, 2022;
2/ in percent of the latest GDP projection for 2022;
3/ including to accommodate higher costs due to inflation;
4/ increased demand for existing programs, including agrocredits and land-owners support;
5/ to support grape production amid lower demand related to the war in Ukraine;
6/ the augmented balance improved 0.9 percentage points of GDP from SBA approval until end-November, from a deficit of 4 percent of GDP to a deficit of 3.1 percent of GDP, taking into account revised GDP projections.

16. The authorities are committed to a 2023 fiscal deficit that complies with the fiscal rule and rebuilds buffers (MEFP ¶7)**.** The deficit target of 2.8 percent of GDP envisaged in the budget and the program would achieve compliance with the fiscal rule's 3 percent of GDP ceiling as required in 2023. The implied negative fiscal impulse (a 1.2 percent of GDP decline in the cyclically adjusted primary balance (CAPB)) is appropriate given still-high inflation partly driven by domestic demand. The fiscal deficit would be reduced to 2.3 percent of GDP in 2024-25 (implying a manageable 0.7 percent of GDP CAPB adjustment in 2024) to further build fiscal buffers and keep public debt around 40 percent of GDP in the medium term, comfortably below the fiscal rule ceiling of 60 percent of GDP (MEFP ¶8).

17. A balanced approach is appropriate on the composition of fiscal consolidation in 2023. A modest reduction in capital expenditure as major infrastructure projects approach completion will allow reasonable levels of current spending. The budget also reflects the phasing out of COVID-related healthcare costs and an increase in public sector salaries to narrow the growing gap with private sector wages. The authorities emphasized the need for continued investments in a range of road, rail, port, energy, logistics, and undersea cable projects to enhance transit trade potential, energy independence, and connectivity with Europe (¶MEFP 33). The application of improved public investment management practices (¶21) will help ensure high-quality capital spending, while additional revenue (¶18) would help accommodate priorities.

18. Further efforts will support increased revenue collection (MEFP ¶9) and improved spending. The authorities have established a schedule for annual tax expenditure reporting and have published a first tax expenditure report *(December 2022 SB)*. They will complete a tax expenditure review for VAT and income taxes next year, including cost-benefit analysis for key tax expenditure items *(June 2023 SB)*. Staff advocated early action on reviewing and streamlining tax expenditures and improving tax administration to create room for priority outlays, modernizing the property tax system, and developing a medium-term revenue strategy (MTRS) *(March 2024 SB)*. The authorities will continue to automatically process VAT refunds *(January 2023 SB)* and are committed to further reducing the stock of audited VAT payments *(December 2022 SB)*. Nonetheless, the target stock would be raised to GEL 70 million from GEL 50 million since some VAT payers prefer to keep their credits with the government rather than receive refunds (MEFP ¶10). Conducting expenditure reviews in select priority areas with the help of IMF TA will also improve spending effectiveness and efficiency (MEFP ¶11).

19. The authorities have made good progress on SOE governance reforms (MEFP ¶6) **and are committed to advancing this agenda** (MEFP ¶13)**.**

- The SOE reform strategy, to be finalized and adopted as a *prior action*, incorporates a dual model for SOE ownership (50 percent each for the Ministries of Finance and Economy), which will ensure a strong Ministry of Finance role and veto over key decisions to help limit fiscal risks. The ownership model along with other elements of the strategy—for example, ensuring that SOEs operate on the basis of commercial principles, have independent supervisory boards, and avoid quasi-fiscal activities unless explicitly mandated and compensated—reflect FAD TA advice. The authorities will issue a timebound plan for the strategy's implementation, including to pilot it in three major SOEs starting in the first quarter of 2023,[8] also as a *prior action*. Development of the draft SOE framework law will be delayed *(September 2023 SB)* given the later finalization of the SOE strategy and to adequately address the new ownership model and consult stakeholders.

- Unbundling of power generation and transmission to meet European Energy Community (EEC) commitments requires establishing an entity independent from ministries and the Prime Minister to own and oversee power generation SOEs.[9] The authorities will establish a council

[8] The three pilot SOEs are Georgian Railway, Georgian Gas Transportation Company, and United Airports of Georgia.

[9] Splitting ownership of power generation and transmission companies between the Ministries of Finance and Economy as proposed in the previous MEFP would not satisfy EEC requirements.

with a board appointed by Parliament and will incorporate staff recommendations to establish a strong governance framework for its operations. These include ensuring that SOEs overseen by the council will operate with commercial objectives and that the legal foundation of the council will be made consistent with the approved SOE strategy and coming SOE framework law to minimize fiscal and political risks. The ownership of Georgian State Electrosystem has been determined; in line with the SOE strategy, it will be shared equally between the Ministries of Finance and Economy *(prior action)*.

20. The authorities have developed a renewable energy support scheme that guards against fiscal risks, fulfilling a prior action (MEFP ¶6)**.** All projects under the scheme will be awarded through competitive auctions and potential fiscal risks will be mitigated by ensuring that the costs of the scheme are passed on to final consumers. In the first phase (2022-2023), total capacity of 300 MW will be auctioned, and the capacities for subsequent years will be determined based on updated demand and supply projections including to reflect progress on other energy projects. For example, if outstanding power purchase agreements (PPAs) are shown to be advancing during a 3-month assessment period, they will move forward with existing terms and will be netted out of the amounts to be supported under the new scheme. If such projects are not advancing, the authorities will seek to terminate them to limit fiscal risks.

21. Continued public investment management progress will support high-quality capital expenditure (MEFP ¶14). Following the budget code amendment in September subjecting all investments above a certain threshold to the PIM framework, the authorities identified an appropriate threshold with IMF TA in November and will adopt the threshold through a government decree in December. The authorities confirmed that all new 2023 investment projects over the specified threshold are being selected according to PIM guidelines *(December 2022 SB)*. The authorities are updating their PIM methodology, also reflecting some of the PIMA recommendations, and are developing a digital PIM module to track major projects over their lifecycle, which will help integrate the PIM framework into the budget process. The first Climate PIMA was conducted in 2022. It found good practices in some areas especially risk management, while indicating that more can be done to enhance climate awareness and climate resilience in PIM.

22. Steps are being taken to address other fiscal risks and improve transparency. Efforts include reducing the share of FX denominated public debt to below 70 percent by 2025 to mitigate currency risk (MEFP ¶8); improving the quality of fiscal accounting and reporting in line with international standards *(June 2023 SB)* and undertaking a fiscal transparency evaluation in 2023 (MEFP ¶12); including in the 2022 Fiscal Risk Statement (FRS) quantification of risks related to climate change and legal claims, as well as a long-term sustainability assessment for health and aging-related spending *(December 2022 SB)* (MEFP ¶17); continuing to curtail Partnership Fund operations *(QPCs)* (MEFP ¶16); and limiting government support for SMEs (MEFP ¶19).

23. The authorities will consult further on potential changes to the pension system (MEFP ¶18). The authorities have submitted to Parliament amendments to create a third pension pillar and to modify the second pillar including by broadening the investment mandate of the Pension Fund (e.g., co-financing private projects along with IFIs), raising concentration limits on its investment portfolio, and modifying its governance arrangements. The authorities will consult further with staff and other development partners and stakeholders, including to consider potential fiscal costs related to a third pension pillar.

B. Achieving The Inflation Target and Building Reserves

24. Further tightening of the monetary policy stance may be necessary to ensure inflation returns to target (MEFP ¶20)**.** While headline inflation is slowing, core inflation remains elevated, and one-year-ahead inflation expectations remain around 5½ percent. Inflation is expected to fall in 2023 and further in 2024 due to the factors outlined in ¶11, but uncertainty and risks remain high, and additional tightening may be warranted to bring inflation down. In this context, the NBG intends to maintain its policy rate at 11 percent until a clear trend of decreasing inflation is seen. If inflation expectations rise or there are additional pressures from the demand side, the NBG would maintain its current stance for longer or undertake additional policy rate tightening, complemented by macroprudential measures, including to limit FX lending. Further policy rate hikes would help lower inflation by slowing credit growth, reducing demand given many floating rate loans, and affecting expectations (they would also increase incentives to hold lari assets, potentially reducing deposit dollarization). Macroprudential measures (¶27) and tightening global financial conditions will continue to limit switching to FX loans, the share of which is the lowest in a decade.

25. The NBG remains committed to exchange rate flexibility and strengthening foreign exchange reserve coverage to enhance resilience against shocks (MEFP ¶21-¶22)**.** Georgia's external position in 2021 was broadly in line with the level implied by fundamentals and desirable policies.[10] With stronger than expected external inflows in 2022 and reserve coverage still lower than desired, the NBG has undertaken substantial reserve purchases this year, and to lock in those gains the *December 2022 NIR target* would be raised from $840 million to $1.6 billion. This would help build buffers against future shocks while allowing for some flexibility to avoid disorderly market conditions if needed. GIR coverage in terms of the ARA metric would be significantly higher than expected at the time of program approval in 2022, and moderately higher at the end of the program period. To facilitate reserve build-up, the authorities will phase out direct FX sales to SOEs during 2023.

26. Effective NBG communication will further strengthen monetary policy traction (MEFP ¶22). The NBG is committed to updating its communication strategy *(December 2022 SB)*, including on FX reserve management and interventions, and will conduct regular impact assessments. The authorities also continue to consider the potential benefits of modifications to the organizational and decision-making structure of the NBG with the support of IMF TA experts (MEFP ¶23).

C. Keeping The Financial Sector Resilient

27. The NBG and other authorities are undertaking a range of actions to further enhance financial sector resilience. As detailed in ¶7, the banking system has weathered the shocks from the pandemic and war in Ukraine well, reflecting among other factors the robust regulatory and

[10] See External Sector Assessment, IMF Country Report No. 22/188.

supervisory framework put in place in recent years, but uncertainty and risks including related to external developments and FX inflows are high. In addition to maintaining adequate loan loss reserves and capital buffers as financial conditions tighten globally and regularly assessing delinquent and restructured loans, particularly in the hotel, restaurant, and tourism sectors where loan quality should be improving, the authorities are taking a number of specific steps. These include:

- Strengthening the macroprudential framework in place before program approval with further measures affecting consumer lending and FX reserve requirements.[11] These have reduced risks to the financial system and borrowers including from dollarization. They have also contributed to slower credit growth (especially consumer credit) while limiting the potential for a shift to FX loans or macroprudential leakages. The authorities are considering further strengthening capital buffer requirements and limiting risks from FX lending for unhedged borrowers (MEFP ¶25).

- Implementing financial sector conditionality under the program (MEFP ¶24)**.** The NBG has updated the General Risk Assessment Program procedures (*June 2022 SB* on enhancing governance of key internal processes for supervisory actions), strengthened large exposure regulations,[12] and published an assessment of climate-related financial sector risks *(December 2022 SB)*. Progress is being made on enhancing the corrective action framework for banks *(December 2022 SB)*, and on strengthening bank resolution by developing a bridge bank playbook *(March 2023 SB)*, deciding on bridge bank funding arrangements, and ensuring sufficient bail-in-able liabilities.

- Further strengthening the AML/CFT framework and its implementation through increased measures on financial institutions' sanctions risk management and compliance as well as automated sanction screening by the NBG (MEFP ¶28) and more rigorous supervision in light of increased bank and virtual asset service provider risks (MEFP ¶29).[13]

- Continue developing local capital markets through greater use of benchmark bonds; legislation on covered bonds, securitization, and dematerialized securities holdings; and corporate governance standards (MEFP ¶27).

[11] In 2022, the NBG: i) recalibrated the Currency Induced Credit Risk (CICR) buffer to assign higher risk weights to more dollarized loan portfolios (effective January 1st); ii) lowered the maximum maturity of mortgage loans from 15 to 10 years (effective January 1st); iii) increased the income threshold (from GEL 1000 to GEL 1500) below which a stricter (25 percent) PTI ratio applies (effective April 1st); iv) introduced a 3 ppt interest rate shock in calculating PTI on floating interest rate loans (effective May 1st); v) reduced the maximum term of consumer loans from 4 to 3 years (effective August 15th), and vi) set remuneration on banks' required reserves to zero for USD (effective May 13th) and euro (effective September 15th) liabilities.

[12] The NBG published in August draft instructions on connected borrowers to limit risks from concentration of large exposures at banks.

[13] The NBG recently gained supervisory and regulatory authority for VASPs.

D. Enhancing Growth and Inclusion

28. Addressing skills mismatches and improving the quality of education and training will reduce unemployment and enhance inclusiveness. The Ministry of Health and Labor is conducting a survey of demand for labor and skills *(June 2023 SB)*, which along with efforts to strengthen vocational training and the testing and training of teachers will improve workforce skills and help address structural unemployment (MEFP ¶30). Parliamentary and government reports on legislative gaps and potential active labor market policies to support the further integration of women into the labor market are due by the end of the year (MEFP ¶31).

29. Continuing efforts to strengthen social safety nets will be key to protect the vulnerable. The authorities are continuing to improve Targeted Social Assistance—the primary mechanism for supporting vulnerable families—by updating the proxy-means-testing formula and digitalizing the system to make it more efficient (MEFP ¶31).

30. Governance reforms seek to improve a generally positive business environment. The recently passed insolvency law is now in operation (MEFP ¶32) and a bill has been introduced to establish a National Anti-Corruption Bureau. The bill is part of efforts to meet EU conditions for obtaining candidate status. Implementing these reforms, such as strengthening the independence of the judicial system, would further improve the business environment and make Georgia more attractive for foreign investment.

31. Prioritizing infrastructure plans to enhance regional connectivity will be important. A large range of potentially useful infrastructure projects exist within Georgia—e.g., roads, rail, ports, logistics, energy, and an undersea cable (MEFP ¶33). However, given limited fiscal space it would be beneficial for the authorities to identify their key priorities, in part to allow for co-ordination amongst international donors and investors and to evaluate feasibility and fiscal risks.

PROGRAM MODALITIES

32. The authorities request and staff supports the following modifications to program conditionality: (i) the end-December QPC on the floor on net international reserves be raised from $840 million to $1.61 billion to lock in recent gains; (ii) the end-December QPC on the ceiling on net budget lending be raised from GEL 75 million to GEL 275 million for gas purchases by the Georgian Oil and Gas Corporation (GOGC); (iii) the end-December indicative target on the ceiling on primary current expenditure be raised from GEL 14.2 billion to GEL 15 billion to accommodate supplementary budget spending and avoid too large a drop in real outlays due to high inflation; (iv) the end-December SB on reducing the audited stock of VAT declarations cleared for payments to no more than GEL 50 million be modified to GEL 70 million; (v) the end-December SB on submitting to Parliament a draft framework law for public corporations consistent with the adopted strategy be reset to end-September 2023 given the delay in adopting the SOE strategy; (vi) the end-September 2023 SB on developing a medium-term revenue strategy (MTRS) be reset to end-March 2024 to allow sufficient time to develop a strategy; and (vii) QPCs be set for end-June 2023 and end-December 2023.

33. Financing assurances remain adequate and the improved macroeconomic outlook has strengthened capacity to repay. The program is fully financed, with firm commitments for the next 12 months, and good prospects for the full period of the arrangement (Table 2). Debt service to the IMF is manageable. Although the program is being treated as precautionary, if all drawings are made and assuming an adverse scenario materializes (Annex II), capacity to repay would remain adequate, with obligations reaching 0.7 percent of GDP in 2027 (1.3 and 5.4 percent of exports and GIR) (Table 7).

34. An updated Safeguards Assessment of the NBG was finalized in July. The assessment found the safeguards framework of the NBG to be generally strong and well aligned with leading practices, including on financial reporting, audit mechanisms, and controls over key operations. Nonetheless, independent oversight by the Board has been constrained by an executive majority owing to vacancies in non-executive positions that have not been filled. Legal amendments are necessary to address this gap. The NBG is committed to addressing the Safeguards recommendations and has requested IMF TA (MEFP ¶35).

35. Risks to the program are manageable and mitigated by the authorities' track record of policy implementation. The improved macroeconomic outlook has reduced risks relative to program approval. Political tensions and/or reform fatigue could undermine efforts to implement reforms. Strong program ownership by the authorities provides safeguards and mitigates these risks.

STAFF APPRAISAL

36. The Georgian economy has performed strongly in 2022 as adverse spillovers expected from the war in Ukraine have not materialized thus far. Buoyant tourism revenues, a surge in war-related immigration and financial inflows, and a rise in transit trade through Georgia have lifted growth and fiscal revenues, strengthened the current account balance and the lari, and supported reserve accumulation. Inflation remains elevated reflecting still high commodity prices and strong domestic demand.

37. The authorities have made good use of favorable economic developments this year to enhance resilience, consistent with program goals and in a context of high uncertainty and risks. By saving a portion of revenue windfalls, the authorities will achieve a much lower fiscal deficit for 2022 than expected at the time of program approval. The NBG is taking advantage of strong FX inflows to boost international reserve coverage and resilience. The authorities' policy actions signal their adherence to the program's goals of further entrenching macroeconomic stability, rebuilding fiscal buffers, and reducing external vulnerabilities, and they are committed to continue strengthening resilience amid high uncertainty and downside risks related to global economic and financial conditions, global food and energy prices, and external flows.

38. The authorities are strongly committed to the program's fiscal objectives. The draft 2023 budget would achieve a deficit of 2.8 percent of GDP, complying with the fiscal rule's 3 percent of GDP deficit ceiling, and medium-term plans seek to create further fiscal space.

39. Further action on revenue measures could help create space for spending priorities. Building on recent steps to strengthen reporting of tax expenditures, action to streamline tax expenditures, improved tax administration, and development of an MTRS could create fiscal space for priorities such as education reform and infrastructure investment, which will benefit from PIM reforms to prioritize high-return projects.

40. Important progress is being made on SOE reform and energy sector development. Adoption of an SOE governance reform strategy will promote operation on the basis of commercial principles, benefiting economic efficiency and limiting fiscal risks. The renewable energy support scheme will help Georgia meet its energy demand needs in a climate-friendly way, again while guarding against fiscal risks.

41. Further tightening of monetary policy may be necessary to help bring inflation back to target. The inflation targeting framework and floating exchange rate regime have served Georgia well. While inflation is expected to begin declining early in 2023, uncertainty and risks are high, and additional policy rate tightening may be needed. The NBG's commitment to further tighten the monetary policy stance if necessary to reduce inflation and to exchange rate flexibility is welcome and would be supplemented by recent macroprudential measures.

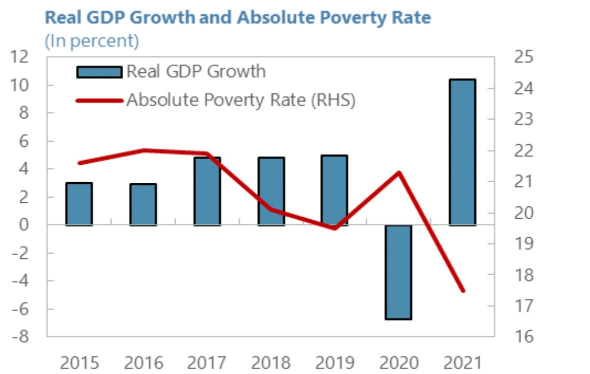
42. Continued reforms will further strengthen the already resilient financial sector. Substantial efforts in past years have supported the health of the financial sector and its ability to weather shocks. Further steps such as enhancing the corrective action framework, strengthening bank resolution preparedness, and bolstering AML/CFT regulation and supervision will build further safeguards into the financial system, as would raising capital requirements and limiting risks from FX lending for unhedged borrowers.

43. Advancing the structural reform agenda will support stronger and more inclusive growth. A survey of labor demand and skills as well as efforts to strengthen education and active labor market policies should help reduce structurally high unemployment and gender disparities. Further strengthening the business environment, prioritizing key infrastructure projects, and continuing to promote capital market development could help catalyze additional private investment.

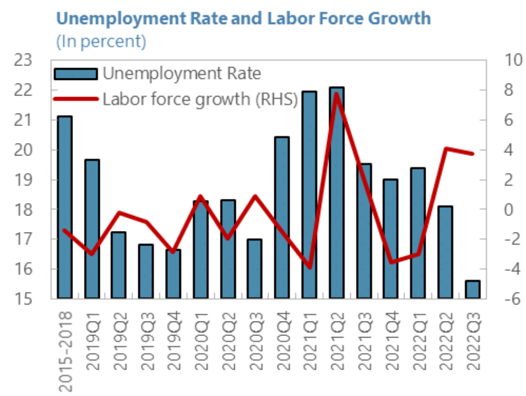
44. Given the authorities' strong program performance and ownership, and renewed reform commitments, staff supports the request for modification of performance criteria and structural benchmarks and completion of the first review. The authorities continue to treat the program as precautionary and will only consider making purchases if the balance of payments deteriorates materially

Figure 1. Georgia: Real Sector Developments

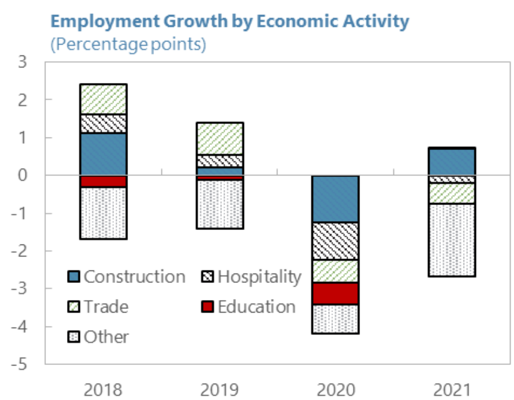
The economic recovery from the COVID-19 shock helped reduce absolute poverty in 2021 below its pre-pandemic level…



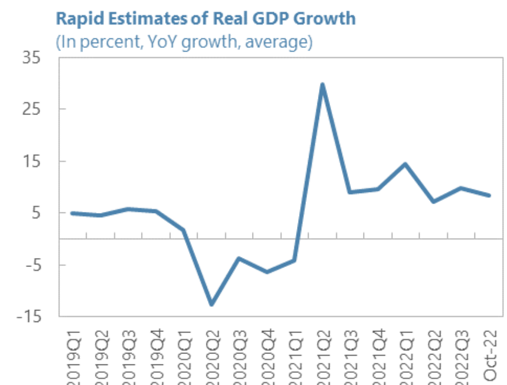
… and reversed the rising unemployment trend, while contributing to labor force growth.



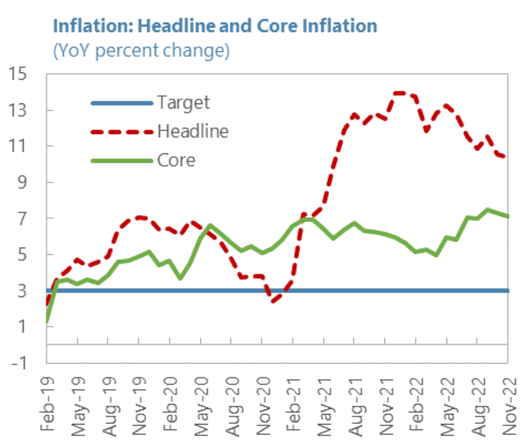
The employment gains were largely witnessed in construction, while other sectors are yet to catch up.



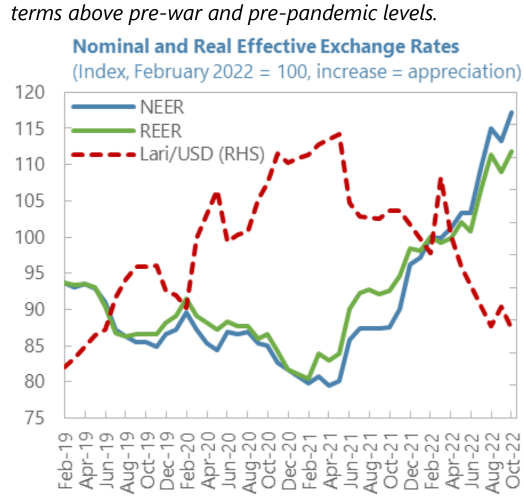
Despite a challenging external environment, growth continued to impress during January-October 2022.



Headline inflation has slowed recently, but both headline and core inflation remain well above the NBG target.



The lari has appreciated in both nominal and real effective terms above pre-war and pre-pandemic levels.



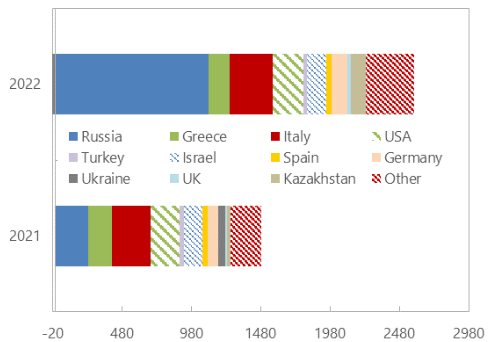
Source: National authorities, Haver, GeoStat, and IMF staff calculations.

Figure 2. Georgia: External Sector Developments

Net money transfers have risen dramatically, partially driven by outflows from Russia…

Net Money Tranfers

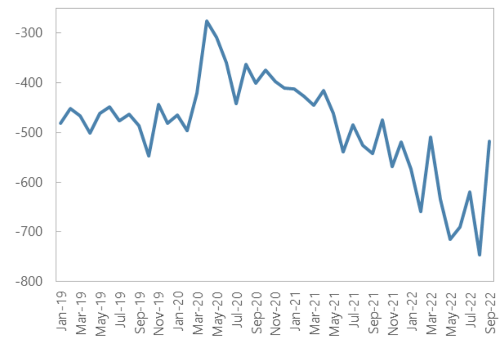
(US$ million; Jan-Sep, 2022 relative to Jan-Sep 2021)



…but the goods trade balance has deteriorated, reflecting higher imports.

Goods Trade Balance

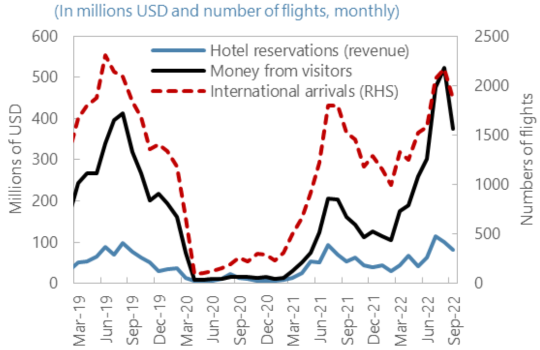
(US$ million, SA)



Hotel reservations and the number of flights continued to rise despite the challenging external environment…

Major Sources of Tourism

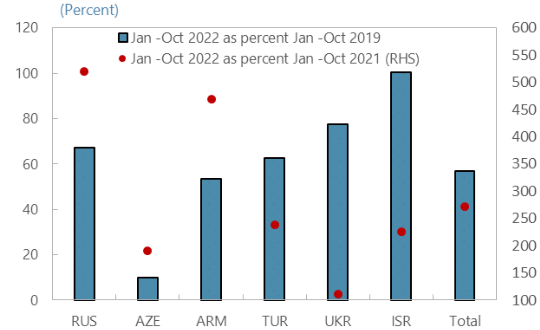
(In millions USD and number of flights, monthly)



…and major sources of tourism have continued the robust (but incomplete) recovery towards pre-pandemic levels.

International Visitors Trips

(Percent)

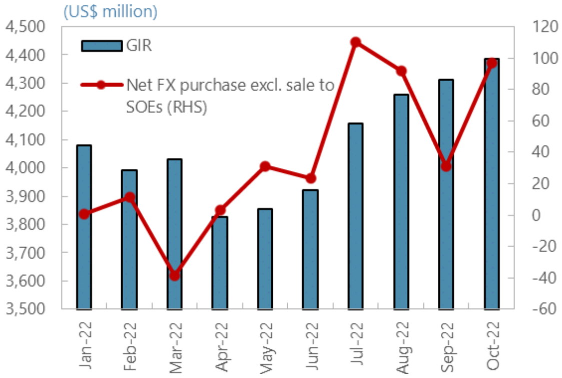


Note: International visitors trips include overnight trips and same-day trips. Data on country breakdowns of overnight trips are unavailable.

GIR remained close to record highs, as expected FX sales did not materialize, and the NBG was able to make purchases…

Gross International Reserves and Net FX Purchases

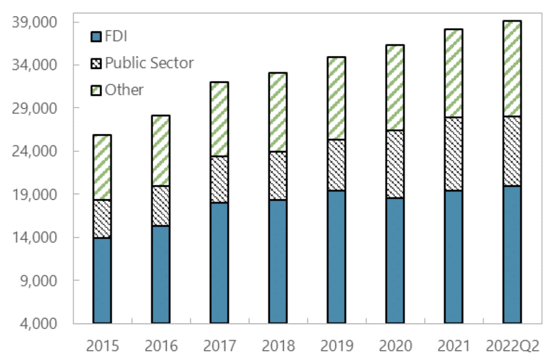
(US$ million)



…and as the FDI and migration-related inflows more than offset a decline in disbursements by donors.

Financial Inflows

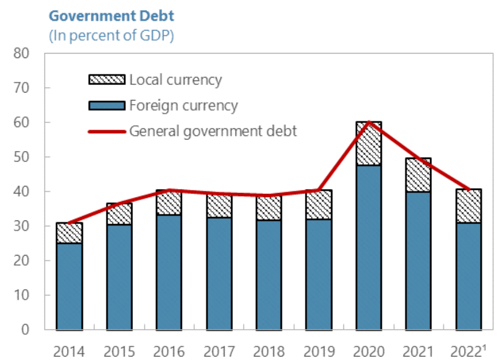
(US$ million)



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

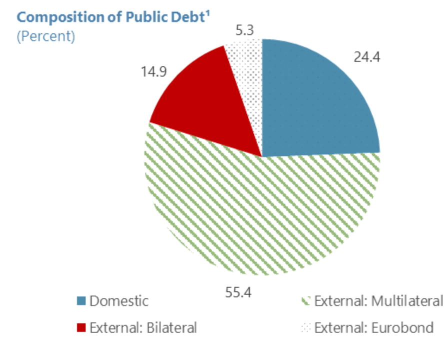
Figure 3. Georgia: Fiscal Sector Developments

General government debt declined by about 10 percent of GDP in 2021 after a sharp increase during the pandemic.



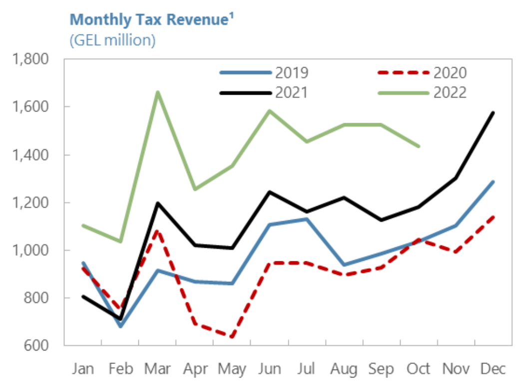
1/Projections

The share of external debt remains high at about 76 percent of the total, while most is to official creditors.



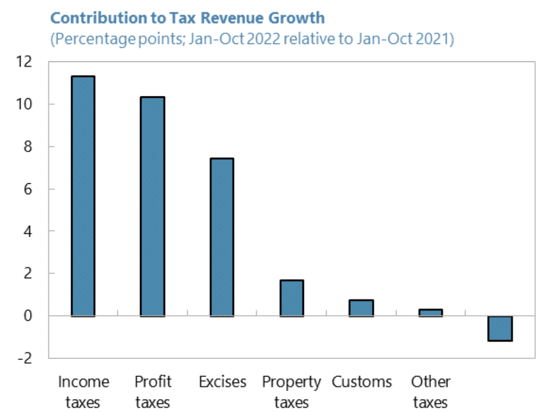
1/Data up to September 2022.

Revenue performance in 2022 has been strong through October, increasing by 30 percent, y/y, …

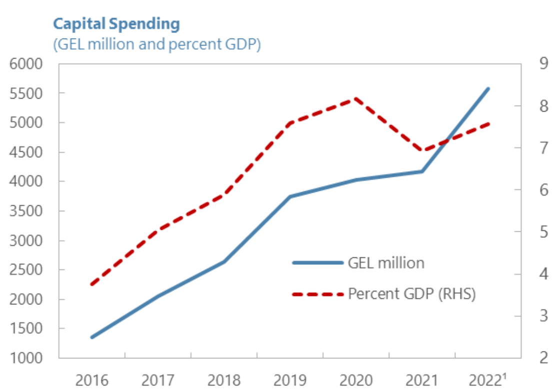


1/Includes tax outflows due to tax credit refunds.

… driven by income taxes and VAT.

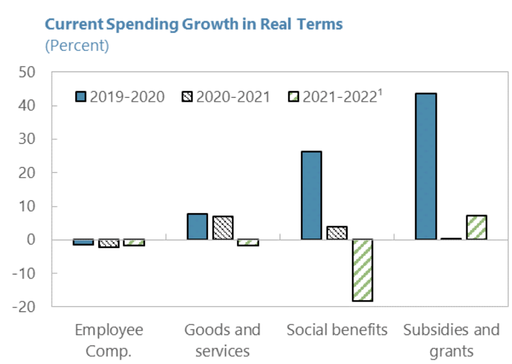


Capital spending as a share of GDP remains high after reaching a historical peak in 2020.



1/Projections.

Current spending declined in real terms in 2022, as pandemic-related spending continued to be wound down.



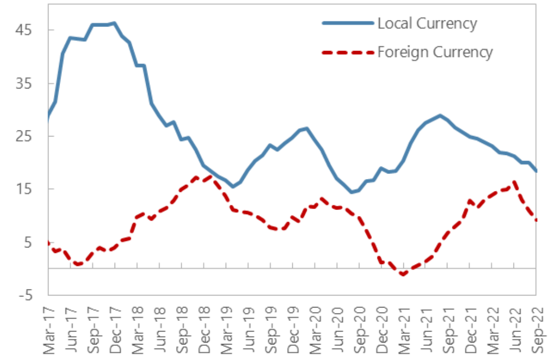
1/Spending through October (Jan.- Oct. 2022 vs. Jan.- Oct. 2021).

Source: National authorities, and IMF staff estimates.

Figure 4. Georgia: Financial Sector Developments

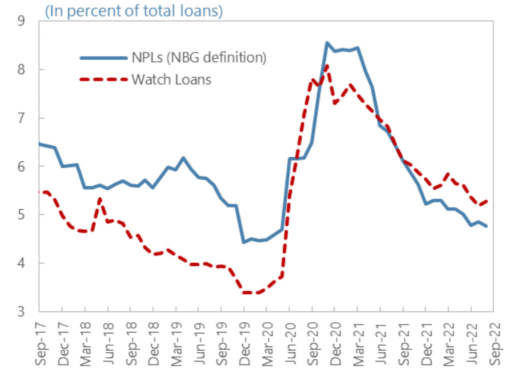
Private sector credit growth has slowed recently, reflecting monetary policy tightening and macroprudential measures.

Private Sector Credit
(YoY growth; constant exchange rate)



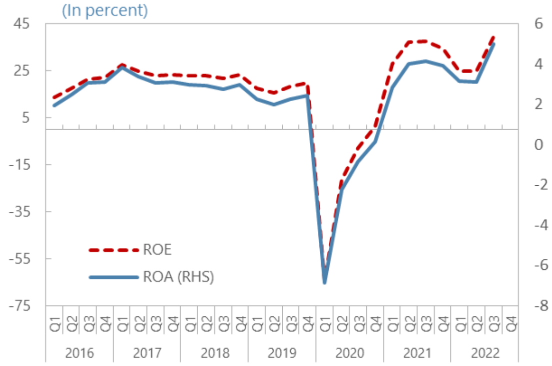
NPLs and watch loans have continued to decline, reaching their pre-pandemic levels.

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



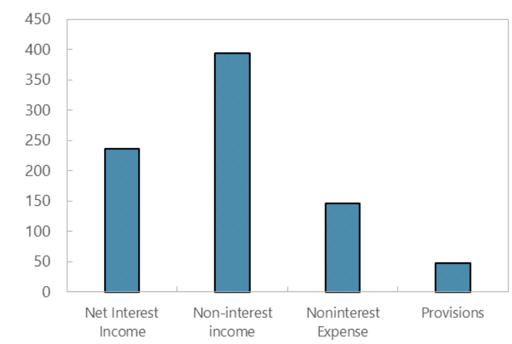
Bank profitability has remained robust...

Return on Assets and Equity Ratios
(In percent)



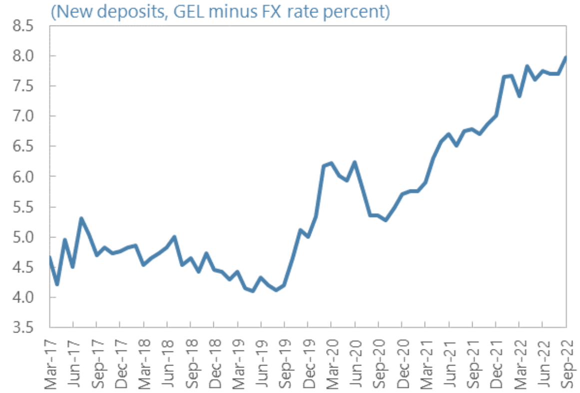
...owing to higher net interest and non-interest income compared to pre-pandemic levels.

Key Drivers of Bank Profitability
(GEL million, 2022Q3 minus 2019Q4)



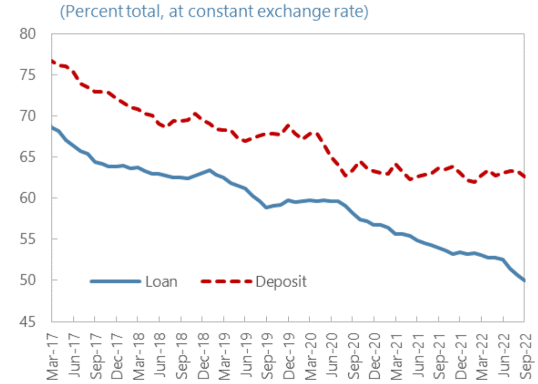
The interest rate differential between lari and FX deposits continued to widen, reaching its highest level.

Interest Rates Differential
(New deposits, GEL minus FX rate percent)



Loan dollarization resumed its post-pandemic decline, while deposit dollarization remained largely stable.

Loan and Deposit Dollarization
(Percent total, at constant exchange rate)



Source: NBG, and IMF staff calculations.

Table 1. Georgia: Selected Economic and Financial Indicators, 2019–27

	2019	2020	2021	2022	2022	2023	2024	2025	2026	2027
		Actual		SBA Request			Projections			
National accounts and prices	(annual percentage change; unless otherwise indicated)									
Real GDP	5.0	-6.8	10.5	3.2	10.0	4.0	5.2	5.2	5.2	5.2
Output Gap	-0.6	-5.2	-1.9	-0.2	2.1	0.5	0.2	0.0	0.0	0.0
Nominal GDP (in billion of laris)	49.3	49.3	60.0	69.0	72.5	80.1	86.9	94.1	102.0	110.5
Nominal GDP (in billion of U.S. dollars)	17.5	15.8	18.6	22.3	24.7	27.1	29.7	32.3	35.2	38.2
GDP per capita (in thousand of U.S. dollars)	4.7	4.3	5.0	6.0	6.7	7.3	8.0	8.8	9.6	10.5
GDP deflator, period average	5.2	7.2	10.3	11.3	10.0	6.5	3.0	3.0	3.0	3.0
CPI, Period average	4.9	5.2	9.6	10.9	12.0	6.0	3.0	3.0	3.0	3.0
CPI, End-of-period	7.0	2.4	13.9	8.1	10.5	3.8	3.0	3.0	3.0	3.0
Core CPI, End-of-period	5.2	5.3	5.9	...	...	...	...	...	...	...
Investment and saving	(in percent of GDP)									
Gross national saving	19.4	11.4	11.6	9.6	15.9	14.5	14.9	15.9	16.8	18.0
Investment	25.3	23.9	22.0	20.6	21.5	21.1	20.6	21.4	22.3	23.3
Public	8.0	8.6	7.7	8.0	8.2	7.5	6.2	6.1	6.0	6.0
Private	17.3	15.3	14.4	12.5	13.3	13.6	14.4	15.3	16.3	17.3
Consolidated government operations	(in percent of GDP)									
Revenue and grants	27.1	25.2	25.5	25.2	26.5	25.9	25.8	25.8	25.7	25.7
o.w. Tax revenue	23.7	22.3	22.6	22.8	23.9	23.6	23.6	23.7	23.7	23.7
Expenditures	28.9	34.5	31.6	29.1	29.3	28.9	28.0	28.0	27.9	27.9
Expense	21.4	26.3	24.6	21.7	21.7	21.9	22.1	22.2	22.2	22.2
Net acquisition of non-financial assets	7.6	8.2	6.9	7.4	7.6	7.0	5.9	5.8	5.7	5.7
Capital spending	8.0	8.6	7.7	8.0	8.2	7.5	6.2	6.1	6.0	6.0
Privatization proceeds	-0.4	-0.4	-0.7	-0.7	-0.6	-0.4	-0.3	-0.3	-0.3	-0.3
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.3
Net lending / borrowing after adjustment	-1.8	-9.3	-6.0	-3.9	-2.8	-2.9	-2.2	-2.2	-2.1	-2.0
Net budget lending	0.2	0.1	0.1	0.1	0.3	-0.1	0.1	0.1	0.1	0.1
Augmented Net lending / borrowing (program definition) 1/	-2.1	-9.4	-6.1	-4.0	-3.1	-2.8	-2.3	-2.3	-2.2	-2.1
General government debt 2/	40.4	60.2	49.7	47.1	41.2	42.0	41.4	40.4	40.2	39.2
o.w. Foreign-currency denominated	32.0	47.6	39.9	37.5	31.4	31.5	29.7	28.1	26.4	25.0
Money and credit	(annual percentage change; unless otherwise indicated)									
Credit to the private sector	20.7	22.4	12.4	20.9	5.2	10.5	8.5	8.2	8.4	8.3
In constant exchange rate	16.1	9.0	18.2	21.2	10.9	7.6	8.8	8.4	8.5	8.3
Broad money	17.6	24.6	11.4	19.9	7.4	12.6	11.1	10.9	11.1	10.9
In constant exchange rate (estimate)	14.3	14.4	15.6	20.4	14.3	9.4	11.5	11.2	11.2	11.1
Broad money (excl. fx deposits)	18.8	18.8	17.9	16.8	12.8	13.7	12.2	12.0	12.2	12.0
Deposit dollarization (percent of total) 3/	64.0	61.4	59.9	60.0	55.8	55.3	54.7	54.2	53.6	53.1
Credit dollarization (percent of total)	55.4	55.7	50.9	50.9	45.4	44.4	43.4	42.4	41.4	40.4
Credit to the private sector (percent of GDP)	62.8	76.8	70.9	74.6	61.7	61.7	61.7	61.7	61.7	61.7
External sector	(in percent of GDP; unless otherwise indicated)									
Current account balance (in billions of US$)	-1.0	-2.0	-1.9	-2.4	-1.4	-1.8	-1.7	-1.8	-1.9	-2.0
Current account balance	-5.9	-12.5	-10.4	-10.9	-5.6	-6.6	-5.7	-5.6	-5.4	-5.3
Trade balance	-21.7	-20.0	-20.3	-20.3	-22.0	-22.2	-18.4	-18.5	-18.4	-18.4
Terms of trade, goods (percent change)	-1.2	5.7	-13.6	-8.9	2.5	3.5	1.5	1.5	1.3	1.2
Gross international reserves (in billions of US$) 4/	3.5	3.9	4.3	3.3	4.3	3.8	3.9	4.6	5.5	6.4
In percent of ARA metric	100.5	107.4	106.9	79.4	98.6	83.3	81.4	91.8	102.6	112.7
Gross external debt	88.4	110.5	99.8	85.8	77.7	73.1	68.4	63.9	59.7	56.1
Laris per U.S. dollar (period average)	2.82	3.11	3.22	...	...	...	...	...	...	...
Laris per euro (period average)	3.15	3.55	3.82	...	...	...	...	...	...	...
REER (period average; CPI based, Jan 2010=100)	100.5	97.5	99.2	...	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

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

2/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

3/ Includes nonresident deposits.

4/ Using current exchange rates; includes SDR allocations (SDR 144 million before 2021 and SDR 346 million since 2021).

Table 2. Georgia: Balance of Payments, 2019–27

	2019	2020	2021	2022	2022	2023	2024	2025	2026	2027
		Actual		SBA Request			Projections 1/			
				(in millions of U.S. dollars)						
Current account balance	-1,025	-1,981	-1,937	-2,435	-1,396	-1,782	-1,703	-1,799	-1,915	-2,039
Trade balance (goods)	-3,792	-3,165	-3,790	-4,509	-5,444	-6,009	-5,469	-5,979	-6,467	-7,032
Exports	4,946	4,347	5,539	5,567	7,201	7,444	8,547	9,550	10,567	11,789
Imports	8,737	7,512	9,329	10,076	12,645	13,454	14,016	15,528	17,034	18,821
Services	2,176	124	725	1,084	2,512	2,564	2,504	2,963	3,370	3,749
Services: credit	4,600	1,580	2,547	3,365	4,835	5,145	5,336	6,033	6,693	7,342
Of which: travel revenue 2/	3,269	542	1,245	2,016	3,468	3,726	3,743	4,130	4,498	4,754
Services: debit	2,425	1,456	1,822	2,281	2,324	2,582	2,832	3,070	3,323	3,593
Primary income	-784	-749	-1,176	-1,011	-1,141	-855	-1,203	-1,268	-1,370	-1,403
Secondary income	1,375	1,810	2,304	2,001	2,677	2,519	2,464	2,485	2,552	2,648
Of which : remittances	916	1,168	1,609	1,401	1,980	1,781	1,736	1,771	1,806	1,891
Capital account	47	41	38	40	43	43	43	43	43	43
Financial account (- is inflow)	-1,187	-2,024	-2,266	-1,459	-1,434	-1,242	-1,814	-2,586	-2,838	-2,965
Direct investment (net)	-1,071	-567	-920	-916	-1,177	-1,227	-1,534	-1,629	-1,737	-1,938
Net acquisition of financial assets	312	-15	348	23	322	322	402	452	557	622
Net incurrence of liabilities	1,382	552	1,267	939	1,499	1,549	1,936	2,081	2,294	2,560
Portfolio investment (net)	-829	-75	311	59	228	63	-41	42	19	-7
Net acquisition of financial assets	29	47	37	258	274	244	109	123	143	148
Net incurrence of liabilities	858	122	-274	199	45	181	150	81	123	155
Financial derivatives (net)	-4	-27	-1	-6	-16	-10	-12	-12	-11	-11
Other investment (net)	717	-1,355	-1,656	-595	-469	-68	-227	-987	-1,110	-1,009
Net acquisition of financial assets	511	-95	-39	155	470	708	488	-302	-104	-299
Of which: currency and deposits (+ is outflow) 3/	433	-44	-128	108	390	648	436	-357	-179	-365
Net incurrence of liabilities 4/	-206	1,260	1,617	750	939	776	715	686	1,006	710
Of which: general government loans 5/	262	1,128	940	566	400	380	337	324	243	352
SDR (allocations)	0	0	286	0	0	0	0	0	0	0
Errors and omissions	-90	-94	-112	0	0	0	0	0	0	0
Overall balance (+ is surplus)	120	-10	254	-936	81	-497	153	830	967	969
Financing	-120	10	-254	936	-81	497	-153	-830	-967	-969
Change in gross international reserves (- is increase)	-202	-305	-362	954	-64	525	-99	-735	-863	-869
Use of Fund Resources (- is net repayment)	83	315	108	-18	-17	-29	-54	-95	-103	-100
Disbursement	83	315	111	0	0	0	0	0	0	0
Repayment (Principal)	0	0	3	18	17	29	54	95	103	100
Memorandum items:				(in percent of GDP)						
Current account balance	-5.9	-12.5	-10.4	-10.9	-5.6	-6.6	-5.7	-5.6	-5.4	-5.3
Trade balance (goods)	-21.7	-20.0	-20.3	-20.3	-22.0	-22.2	-18.4	-18.5	-18.4	-18.4
Financial account (- is inflow)	-6.8	-12.8	-12.2	-6.6	-5.8	-4.6	-6.1	-8.0	-8.1	-7.8
Foreign direct investment (net)	-6.1	-3.6	-4.9	-4.1	-4.8	-4.5	-5.2	-5.0	-4.9	-5.1
Gross international reserves (in million of USD) 6/	3,506	3,911	4,273	3,318	4,336	3,811	3,910	4,645	5,509	6,378
in percent of ARA metric	100.5	107.4	106.9	79.4	98.6	83.3	81.4	91.8	102.6	112.7
in months of next year GNFS imports	4.7	4.2	3.4	3.2	3.2	2.7	2.5	2.7	2.9	3.0

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

1/ Balance of payments numbers are now presented according the BPM6 manual, so comparisons with Article IV, which used BPM5, are not presented.

2/ The majority of the travel revenue is tourism revenue.

3/ By deposit-taking corporations (except central bank) and other private sectors. This indicator partially reflects capital outflow.

4/ Excluding IMF loan disbursements (to both Ministry of Finance and NBG) and principal repayments.

5/ Excluding IMF loan disbursements to Ministry of Finance and the principal repayments.

6/ Using current exchange rates; includes SDR allocations (SDR 144 million before 2021 and SDR 346 million since 2021).

Table 3a. Georgia: General Government Operations, GFSM2001 2019–27
(In millions of GEL)

	2019	2020	2021	2022	2022	2023	2024	2025	2026	2027
	Actual			SBA Request	Projections					
Revenue	13,350	12,422	15,313	17,354	19,217	20,782	22,443	24,268	26,204	28,381
Taxes	11,860	10,979	13,550	15,707	17,350	18,867	20,545	22,320	24,205	26,209
Taxes on Income, profits and capital gains	4,349	4,246	4,791	6,042	6,989	7,521	8,162	8,835	9,581	10,374
Payable by individuals	3,483	3,327	3,776	4,676	5,056	5,703	6,188	6,699	7,264	7,866
Payable by corporations	866	919	1,015	1,367	1,933	1,818	1,973	2,136	2,316	2,508
Taxes on property	474	434	511	556	561	621	648	675	732	792
Taxes on goods and services	6,746	6,457	7,898	8,833	9,489	10,368	11,340	12,275	13,311	14,413
General taxes on goods and services (VAT)	5,239	4,837	6,030	6,904	7,381	8,176	8,961	9,700	10,519	11,390
Excises	1,507	1,619	1,869	1,929	2,108	2,192	2,379	2,575	2,792	3,023
Taxes on international trade	79	74	86	90	107	115	125	135	147	159
Other taxes 1/	212	-232	263	186	204	242	271	401	435	471
of which VAT Refunds	-1	-1	-2	-2,100	-2	-2	-3	-3	-3	-3
Grants	422	405	344	288	297	315	250	250	250	271
Other revenue	1,067	1,038	1,419	1,359	1,570	1,600	1,648	1,698	1,749	1,901
Total Expenditure	14,257	16,981	18,939	20,066	21,227	23,147	24,327	26,311	28,442	30,863
Expense	10,518	12,960	14,770	14,967	15,742	17,503	19,238	20,871	22,620	24,534
Compensation of employees	1,785	1,851	1,984	2,284	2,280	2,759	3,035	3,338	3,620	3,920
Use of goods and services	1,659	1,881	2,203	2,207	2,400	2,597	2,818	3,051	3,308	3,582
Interest	611	769	800	761	775	1,245	1,454	1,537	1,752	1,936
External	324	337	284	219	240	456	490	517	534	544
Domestic	287	433	516	542	535	789	963	1,020	1,218	1,393
Subsidies	990	1,452	1,660	1,582	2,110	2,182	2,268	2,375	2,475	2,680
Grants	126	237	196	267	322	222	241	248	255	263
Social benefits	4,198	5,575	6,342	6,251	6,215	6,752	7,535	8,289	9,011	9,780
Other expense 2/	1,150	1,196	1,586	1,615	1,640	1,747	1,887	2,034	2,198	2,372
Net acquisition of nonfinancial assets	3,739	4,022	4,169	5,099	5,485	5,644	5,090	5,440	5,823	6,330
Increase (capital spending)	3,945	4,229	4,591	5,549	5,935	5,994	5,390	5,740	6,123	6,630
Decrease (privatization proceeds)	-206	-208	-422	-450	-450	-350	-300	-300	-300	-300
Net lending / borrowing before adjustment	-907	-4,559	-3,627	-2,711	-2,010	-2,365	-1,884	-2,043	-2,238	-2,482
Unidentified measures	0	-2	0	0	0	2	5	0	113	282
Net lending / borrowing	-908	-4,562	-3,627	-2,711	-2,010	-2,363	-1,879	-2,043	-2,125	-2,200
Change in net financial worth, transactions	-908	-4,562	-3,627	-2,711	-2,010	-2,363	-1,879	-2,043	-2,125	-2,200
Net acquisition of financial assets ("+": increase in assets)	456	1,770	-1,103	-28	459	84	670	128	952	197
Domestic	456	1,770	-1,103	-28	459	84	670	128	952	197
Budget lending (net)	111	55	41	75	241	-120	120	120	120	120
Deposits (NBG and commercial banks)	346	1,736	-1,141	-103	219	204	550	8	832	77
Financial privatization	0	-21	-3	0	-1	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,364	6,332	2,524	2,683	2,469	2,447	2,549	2,171	3,077	2,397
Domestic	898	1,970	-377	801	1,235	1,308	1,720	1,387	2,536	1,559
Securities other than shares	898	1,970	-377	801	1,235	1,308	1,720	1,387	2,536	1,559
Loans	0	0	0	0	0	0	0	0	0	0
Foreign	467	4,362	2,901	1,882	1,234	1,139	829	784	541	838
Loans	467	4,362	2,901	1,882	1,234	1,139	829	784	541	838
Memorandum items:										
Nominal GDP	49,253	49,267	60,003	68,971	72,485	80,107	86,933	94,099	102,046	110,494
Government debt 3/	19,915	29,654	29,812	32,511	29,847	33,669	36,010	38,017	40,995	43,292
End-year government deposits	1,454	3,190	2,049	1,946	2,268	2,472	3,022	3,030	3,862	3,939
Operating balance	2,831	-538	543	2,388	3,475	3,278	3,206	3,397	3,584	3,847
Net lending / borrowing (excluding privatization)	-1,114	-4,767	-4,048	-3,161	-2,460	-2,715	-2,184	-2,343	-2,538	-2,782
Augmented Net lending / borrowing (program definition) 4/	-1,019	-4,617	-3,667	-2,786	-2,250	-2,243	-1,999	-2,163	-2,245	-2,320
Cyclically-adjusted primary balance (program definition)	-827	-2,948	-2,553	-1,990	-1,874	-1,104	-592	-626	-493	-384

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/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.
4/ Augmented Net lending / borrowing (program definition) = Net lending / borrowing - Budget lending (net).

Table 3b. Georgia: General Government Operations, GFSM2001 2019–27

(In percent GDP)

	2019	2020	2021	2022	2022	2023	2024	2025	2026	2027
	Actual			SBA Request	Projections					
Revenue	27.1	25.2	25.5	25.2	26.5	25.9	25.8	25.8	25.7	25.7
Taxes	24.1	22.3	22.6	22.8	23.9	23.6	23.6	23.7	23.7	23.7
Taxes on Income, profits and capital gains	8.8	8.6	8.0	8.8	9.6	9.4	9.4	9.4	9.4	9.4
Payable by individuals	7.1	6.8	6.3	6.8	7.0	7.1	7.1	7.1	7.1	7.1
Payable by corporations	1.8	1.9	1.7	2.0	2.7	2.3	2.3	2.3	2.3	2.3
Taxes on property	1.0	0.9	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Taxes on goods and services	13.7	13.1	13.2	12.8	13.1	12.9	13.0	13.0	13.0	13.0
General taxes on goods and services (VAT)	10.6	9.8	10.0	10.0	10.2	10.2	10.3	10.3	10.3	10.3
Excises	3.1	3.3	3.1	2.8	2.9	2.7	2.7	2.7	2.7	2.7
Taxes on international trade	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other taxes 1/	0.4	-0.5	0.4	0.3	0.3	0.3	0.3	0.4	0.4	0.4
of which VAT Refunds	0.0	0.0	0.0	-3.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.9	0.8	0.6	0.4	0.4	0.4	0.3	0.3	0.2	0.2
Other revenue	2.2	2.1	2.4	2.0	2.2	2.0	1.9	1.8	1.7	1.7
Total Expenditure	28.9	34.5	31.6	29.1	29.3	28.9	28.0	28.0	27.9	27.9
Expense	21.4	26.3	24.6	21.7	21.7	21.9	22.1	22.2	22.2	22.2
Compensation of employees	3.6	3.8	3.3	3.3	3.1	3.4	3.5	3.5	3.5	3.5
Use of goods and services	3.4	3.8	3.7	3.2	3.3	3.2	3.2	3.2	3.2	3.2
Interest	1.2	1.6	1.3	1.1	1.1	1.6	1.7	1.6	1.7	1.8
External	0.7	0.7	0.5	0.3	0.3	0.6	0.6	0.5	0.5	0.5
Domestic	0.6	0.9	0.9	0.8	0.7	1.0	1.1	1.1	1.2	1.3
Subsidies	2.0	2.9	2.8	2.3	2.9	2.7	2.6	2.5	2.4	2.4
Grants	0.3	0.5	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.2
Social benefits	8.5	11.3	10.6	9.1	8.6	8.4	8.7	8.8	8.8	8.9
Other expense 2/	2.3	2.4	2.6	2.3	2.3	2.2	2.2	2.2	2.2	2.1
Net acquisition of nonfinancial assets	7.6	8.2	6.9	7.4	7.6	7.0	5.9	5.8	5.7	5.7
Increase (capital spending)	8.0	8.6	7.7	8.0	8.2	7.5	6.2	6.1	6.0	6.0
Decrease (privatization proceeds)	-0.4	-0.4	-0.7	-0.7	-0.6	-0.4	-0.3	-0.3	-0.3	-0.3
Net lending / borrowing before adjustment	-1.8	-9.3	-6.0	-3.9	-2.8	-3.0	-2.2	-2.2	-2.2	-2.2
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.3
Net lending / borrowing	-1.8	-9.3	-6.0	-3.9	-2.8	-2.9	-2.2	-2.2	-2.1	-2.0
Change in net financial worth, transactions	-1.8	-9.3	-6.0	-3.9	-2.8	-2.9	-2.2	-2.2	-2.1	-2.0
Net acquisition of financial assets ("+": increase in assets)	0.9	3.6	-1.8	0.0	0.6	0.1	0.8	0.1	0.9	0.2
Domestic	0.9	3.6	-1.8	0.0	0.6	0.1	0.8	0.1	0.9	0.2
Budget lending (net)	0.2	0.1	0.1	0.1	0.3	-0.1	0.1	0.1	0.1	0.1
Deposits (NBG and commercial banks)	0.7	3.5	-1.9	-0.1	0.3	0.3	0.6	0.0	0.8	0.1
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)	2.8	12.9	4.2	3.9	3.4	3.1	2.9	2.3	3.0	2.2
Domestic	1.8	4.0	-0.6	1.2	1.7	1.6	2.0	1.5	2.5	1.4
Securities other than shares	1.8	4.0	-0.6	1.2	1.7	1.6	2.0	1.5	2.5	1.4
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.9	8.9	4.8	2.7	1.7	1.4	1.0	0.8	0.5	0.8
Loans	0.9	8.9	4.8	2.7	1.7	1.4	1.0	0.8	0.5	0.8
Memorandum items:										
Nominal GDP (in millions of GEL)	49,253	49,267	60,003	68,971	72,485	80,107	86,933	94,099	102,046	110,494
General government debt 3/	40.4	60.2	49.7	47.1	41.2	42.0	41.4	40.4	40.2	39.2
End-year government deposits	3.0	6.5	3.4	2.8	3.1	3.1	3.5	3.2	3.8	3.6
Operating balance (before adjustment)	5.7	-1.1	0.9	3.5	4.8	4.1	3.7	3.6	3.5	3.5
Net lending / borrowing (excluding privatization)	-2.3	-9.7	-6.7	-4.6	-3.4	-3.4	-2.5	-2.5	-2.5	-2.5
Augmented Net lending / borrowing (program definition) 4/	-2.1	-9.4	-6.1	-4.0	-3.1	-2.8	-2.3	-2.3	-2.2	-2.1
Cyclically-adjusted primary balance (program definition)	-1.7	-6.0	-4.3	-2.9	-2.6	-1.4	-0.7	-0.7	-0.5	-0.3

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/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

4/ Augmented Net lending / borrowing (program definition) = Net lending / borrowing - Budget lending (net).

Table 4. Georgia: Monetary Survey, 2019–22

	2019	2020	2021		2022	
					Act.	Proj.
			June	Dec	June	Dec
Central Bank			(in billions of lari)			
Net foreign assets	8.8	10.9	10.2	10.3	8.9	9.7
Gross international reserves	10.1	12.8	12.4	13.2	11.5	12.1
Foreign liabilities	1.3	1.9	2.2	2.9	2.6	2.4
Of which: use of Fund resources	0.7	1.2	1.5	1.4	1.3	1.2
Net domestic assets	0.2	-0.1	0.3	0.1	1.5	0.9
Net claims on central government	-0.4	-0.1	0.7	0.1	0.5	1.0
Claims on general government (incl. T-bills)	1.0	1.4	1.7	1.8	1.8	2.1
Nontradable govt. debt	0.2	0.2	0.2	0.2	0.1	0.1
Debt securities (tradable)	0.8	1.2	1.5	1.6	1.7	2.0
Deposits	1.5	1.5	1.0	1.7	1.3	1.1
Net claims on banks (excl. reserves)	3.1	3.2	2.5	3.1	3.7	3.0
Bank refinancing (incl. swap lines)	3.1	3.2	2.6	3.1	3.8	3.1
Certificates of deposits and bonds	0.1	0.1	0.1	0.1	0.1	0.1
Other items, net	-2.5	-3.2	-3.0	-3.1	-2.8	-3.1
Reserve Money	8.9	10.8	10.5	10.4	10.3	10.6
Banking System			(in billions of lari)			
Net foreign assets	-0.4	0.9	0.1	0.0	0.2	-0.3
NBG	8.8	10.9	10.2	10.3	8.9	9.7
Commercial banks	-9.1	-10.0	-10.1	-10.3	-8.7	-10.0
Net domestic assets	24.7	29.4	30.3	33.9	33.5	36.6
Domestic credit	33.3	40.2	41.4	45.4	46.1	48.6
Net claims on central government	1.6	1.5	1.6	1.9	2.2	3.0
Of which: government deposits at NBG	-1.5	-1.5	-1.0	-1.7	-1.3	-1.1
Of which: T-bills at commercial banks	2.8	4.4	3.4	3.4	3.8	4.3
Claims on Other Sectors	31.7	38.7	39.7	43.4	43.9	45.6
Other items, net	-8.6	-10.7	-11.1	-11.5	-12.6	-12.0
Broad money (M3)	24.4	30.4	30.4	33.8	33.7	36.3
Lari Broad money (M2)	11.5	13.7	14.1	16.1	16.5	18.2
Currency held by the public	3.2	3.7	3.7	3.5	3.6	3.8
Lari resident deposits	8.3	9.9	10.4	12.6	12.9	14.4
Resident foreign exchange deposits	12.9	16.7	16.3	17.7	17.2	18.2
Sources of funds of commercial banks	39.8	49.7	48.1	51.8	53.9	54.8
Resident deposits	22.0	29.7	29.7	32.3	32.8	35.3
Non-resident deposits	5.0	5.6	5.6	5.9	6.8	5.9
Other resident liabilities	3.7	3.9	3.3	3.7	4.3	3.7
Other foreign liabilities	9.1	10.4	9.6	9.9	9.9	9.9
Uses of funds of commercial banks	39.8	49.7	48.1	51.8	53.9	54.8
Claims on Central Bank	5.7	7.1	6.9	7.0	6.8	6.9
Credit to the Private Sector	31.7	38.7	39.7	43.4	43.9	45.6
National currency	14.1	17.1	18.8	21.3	21.6	24.9
Foreign currency	17.6	21.5	21.0	22.1	22.4	20.7
Other foreign assets	5.0	6.1	5.0	5.5	8.1	5.9
Other items, net	-2.6	-2.2	-3.6	-4.2	-4.9	-3.6
			(in percent of GDP)			
Broad money (M3)	49.5	61.7	50.6	56.4	46.5	50.1
Lari Broad money (M2)	23.3	27.7	23.5	26.8	22.8	25.1
Currency held by the public	6.6	7.6	6.1	5.9	5.0	5.2
Non-resident deposits (percent of total deposits)	18.5	16.0	15.8	15.5	17.2	14.4
Credit to the Economy	64.4	78.5	66.2	72.4	60.6	63.0
Nominal GDP (billions of lari)	49.3	49.3		60.0		72.5
			(year-on-year growth)			
Reserve Money	30.6	20.8	10.4	-3.6	-1.7	2.3
Broad money (M3)	24.6	24.6	18.8	11.4	10.8	7.4
NBG Claims on Banks	315.3	2.3	-7.4	-2.1	44.4	-1.2
Credit to the Economy	30.5	22.0	16.3	12.3	10.6	5.1

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

Table 5. Georgia: Financial Soundness Indicators, 2019–22Q3
(In percent, unless otherwise indicated)

	2019	2020	2021				2022		
	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep
Capital Adequacy									
Capital to risk-weighted assets 1/	19.5	17.6	18.2	19.2	19.1	19.6	20.1	20.3	20.6
Nonperforming loans net of provisions to capital	5.2	7.3	7.3	6.5	6.3	5.1	4.8	5.0	4.8
Leverage ratio 2/	19.0	16.3	17.1	18.6	18.5	19.2	19.6	19.1	18.7
Asset Quality									
Nonperforming to total gross loans (IMF) 3/	1.9	2.3	2.4	2.2	2.2	1.9	1.8	1.9	1.9
Nonperforming to total gross loans (NBG) 4/	4.4	8.2	8.3	6.7	6.0	5.2	5.0	4.7	4.5
Restructured loans to total gross loans	5.1	19.0	20.0	19.0	19.2	18.3	15.3	16.4	16.1
Specific provisions to total loans	1.9	3.2	3.2	2.7	2.5	2.2	2.1	2.0	1.9
Sectoral distribution of loans to total loans									
Residents	97.4	96.4	96.5	96.3	96.3	96.4	96.6	96.5	96.5
Deposit-takers	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	0.0	0.0	0.8	0.8	0.8	0.0	0.0	0.0	0.0
Nonfinancial corporations	49.8	47.1	46.2	45.6	45.7	45.7	44.7	44.8	42.9
Other domestic sectors 5/	47.5	49.1	49.3	49.9	49.8	49.9	51.2	51.8	53.5
Non-residents	2.6	3.6	3.5	3.7	3.7	3.6	3.4	3.5	3.5
Earnings and Profitability									
Return on assets (ROA)	2.4	0.1	2.8	4.0	4.1	3.9	3.1	3.1	3.6
Return on equity (ROE)	20.3	1.4	29.4	37.3	37.3	34.4	24.8	24.9	29.0
Interest margin to gross income	58.1	58.4	59.9	57.1	57.0	57.9	60.4	58.2	54.4
Non-interest expenses to gross income	52.9	54.3	49.1	46.8	46.5	48.1	53.8	51.8	47.5
Liquidity									
Liquid assets to total assets ratio	19.6	21.1	22.5	20.9	19.4	20.2	20.7	20.3	23.1
Liquid assets to total short-term liabilities 6/	24.2	25.2	27.3	26.8	25.2	26.3	26.9	26.3	29.1
Loan-to-deposit ratio (in percent) 7/	121.7	110.6	108.0	113.6	114.4	115.9	116.9	114.1	102.8
Liquidity coverage ratio (GEL, percent)	100.8	120.3	117.8	108.9	103.1	115.1	104.8	102.9	109.9
Liquidity coverage ratio (FX, percent)	154.0	154.6	161.0	146.2	136.5	132.9	129.3	131.6	144.4
Foreign Currency Position and Dollarization									
Deposit dollarization (total non-bank deposits)	64.0	61.4	63.5	60.0	60.7	59.9	59.4	57.9	57.0
Loans in foreign exchange to total loans	55.2	55.7	55.6	52.8	51.7	50.9	50.6	48.6	45.4
Net foreign assets to total assets	-18.9	-17.6	-16.7	-18.0	-16.1	-17.0	-16.6	-13.5	-10.0
Net open foreign exchange position to regulatory capital	0.2	0.2	-0.9	2.0	1.4	2.6	3.1	4.7	3.5
Borrowed funds from abroad-to-GDP ratio 8/	19.1	18.0	18.5	16.5	15.9	17.0	14.3	14.5	14.5
Other									
Loans collateralized by real estate to total loans	64.9	53.5	64.8	65.4	64.1	64.0	61.0	62.1	61.7
Memorandum items									
Georgia EMBIG Sovereign Spread	157	407	232	181	210	206	294	379	398
Georgia EMBIG Sovereign Yield	3.2	4.2	2.4	2.3	3.0	3.3	4.8	6.7	7.2

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 households and individual entrepreneurs.

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

7/ Loans and deposits from the banking sector.

8/ Borrowed funds include subordinated debt.

Table 6. Georgia: Schedule of Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase (SDR millions)	Amount of Purchase (Percent of quota)
15-Jun-22	Approve the 36-month SBA	30.0	14.3
3-Oct-22	Complete the first review based on end-June 2022 performance criteria and other relevant performance criteria	30.0	14.3
3-Apr-23	Complete the second review based on end-December 2022 performance criteria and other relevant performance criteria	30.0	14.3
2-Oct-23	Complete the third review based on end-June 2023 performance criteria and other relevant performance criteria	30.0	14.3
1-Apr-24	Complete the fourth review based on end-December 2023 performance criteria and other relevant performance criteria	30.0	14.3
7-Oct-24	Complete the fifth review based on end-June 2024 performance criteria and other relevant performance criteria	30.0	14.3
7-Apr-25	Complete the sixth review based on end-December 2024 performance criteria and other relevant performance criteria	30.4	14.4
Total available		210.4	100.0

Source: Fund staff estimates and projections.

Table 7. Georgia: Indicators of Fund Credit, 2019–27

(In millions of SDR)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Actual	Projections					
Existing Fund credit									
Purchases (EFF)	60.0	226.0	78.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	180.0	406.0	481.5	469.0	446.5	404.3	330.1	249.4	171.3
SBA and EFF	180.0	406.0	481.5	469.0	446.5	404.3	330.1	249.4	171.3
Obligations	38.1	4.2	4.2	12.5	41.0	59.4	88.7	92.2	86.8
SBA and EFF	38.1	4.2	4.2	12.5	41.0	59.4	88.7	92.2	86.8
Principal (repurchases)	35.0	0.0	2.5	12.5	22.5	42.3	74.2	80.7	78.2
Interest charges	3.1	4.2	1.7	0.0	18.5	17.2	14.5	11.5	8.6
Prospective purchases 2/									
Purchases	0.0	0.0	0.0	60.0	60.0	60.0	30.4	0.0	0.0
Stock 1/	0.0	0.0	0.0	60.0	120.0	180.0	210.4	172.9	97.9
Obligations 3/	0.0	0.0	0.0	0.3	4.4	8.6	12.6	48.5	80.9
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	37.5	75.0
Interest charges	0.0	0.0	0.0	0.3	4.4	8.6	12.6	11.0	5.9
Stock of existing and prospective Fund credit 2/	180.0	406.0	481.5	529.0	566.5	584.3	540.5	422.3	269.2
In percent of quota	85.6	193.0	228.8	251.4	269.2	277.7	256.9	200.7	127.9
In percent of GDP	1.4	3.6	3.7	3.1	3.4	3.2	2.5	1.8	1.1
In percent of exports of goods and nonfactor services	2.6	9.5	8.5	6.4	7.1	6.5	5.3	3.7	2.1
In percent of gross reserves	7.1	14.5	16.1	17.7	29.0	27.9	22.9	15.6	8.6
In percent of public external debt	4.1	7.2	9.0	9.8	10.3	10.6	9.8	7.8	5.1
in percent of total government revenues and grants	5.9	16.2	17.2	12.2	13.4	12.9	10.1	7.4	4.3
Obligations to the Fund from existing and prospective	38.1	4.2	4.2	12.8	45.4	68.0	101.2	140.7	167.7
In percent of quota	18.1	2.0	2.0	6.1	21.6	32.3	48.1	66.9	79.7
In percent of GDP	0.3	0.0	0.0	0.1	0.3	0.4	0.5	0.6	0.7
In percent of exports of goods and nonfactor services	0.6	0.1	0.1	0.2	0.6	0.8	1.0	1.2	1.3
In percent of gross reserves	1.5	0.2	0.1	0.4	2.3	3.2	4.3	5.2	5.4
In percent of public external debt service	11.5	1.4	1.4	3.9	13.5	19.1	28.5	41.3	59.7
in percent of total government revenues and grants	1.2	0.2	0.2	0.3	1.1	1.5	1.9	2.5	2.7

Source: Fund staff estimates and projections.

1/ End of period.

2/ Although the authorities intend to treat the arrangement as precautionary, indicators are computed assuming the adverse scenario outlined in Annex II and purchases phased equally over the duration of the program (in line with IMF Finance Department's assumption and as a close proxy for the expected disbursement path in the adverse scenario, a disbursement of SDR 60 million is assumed to take place in end-2022 rather than in 2023).

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

Annex I. Risk Assessment Matrix[1]

Risk Assessment Matrix			
Source of Risks	**Likelihood**	**Expected Impact on the Economy if Risks Materialize**	**Policy Response**
Conjunctural Risks			
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility with Europe, LICs, and commodity-importing EMs among the worst hit.	High	Medium Although spillovers from the war in Ukraine have been contained so far, intensified war and sanctions could lower tourism, trade, remittances, and investments, while increasing depreciation pressures and inflation. Sanctions may lead to AML/CFT and sanctions-related regulatory risks for financial institutions. On the upside, war-related capital and migrant inflows (workers and companies), as well as trade rerouted through Georgia could also increase under intensified war and sanctions, boosting demand and the external balance.	Allow flexible exchange rate to act as a shock absorber. Utilize foreign exchange reserves to prevent disorderly market conditions that could jeopardize financial stability, drawing on SBA financing as needed. Maintain tight monetary policy to keep inflation expectations anchored and avoid capital outflows. Accelerate diversification of trade markets and routes. Monitor financial institutions' sanctions risk management and compliance.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	High Rising global commodity prices would further increase inflationary pressures and diminish	Maintain tight monetary policy to keep inflation expectations anchored. Reprioritize spending to provide targeted

[1] Prepared by Elif Ture (MCD). The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
		households' purchasing power.	fiscal support to the most vulnerable. Draw on SBA financing should a larger fiscal response be necessary and to bolster foreign exchange reserves.
Systemic social unrest. Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).	**High**	**High** Political polarization and social tensions could result in a disorderly lari depreciation. Social tensions would undermine the ability of policymakers to implement structural reforms. They could also threaten external financing flows from international financial institutions (IFIs) on which Georgia relies.	Improve communication about economic policy – especially in terms of setting a medium-term reform agenda. Maintain commitment and ownership of reforms. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	**Medium**	**High** Persistently high inflation, including from rising global commodity prices and de-anchoring expectations would further diminish households' purchasing power.	Allow flexible exchange rate to act as a shock absorber. Further tighten monetary policy, communicating and signaling strong commitment to inflation targeting. Reprioritize spending to provide targeted fiscal support to the most vulnerable.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. **EMDEs:** Sharp tightening of global financial conditions combined with volatile commodity prices leads to spiking risk premia, widening of	**High**	**High** A global recession scenario would lower tourism, trade, remittances, and investments, while increasing depreciation, inflation (stagflation), and fiscal and external pressures.	Allow flexible exchange rate to act as a shock absorber. Use existing policy space to support the economy and protect the most vulnerable, consistent with the inflation targeting framework and fiscal sustainability. Utilize foreign exchange reserves to prevent a disorderly depreciation that

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
external imbalances and fiscal pressures, capital outflows, sudden stops, and debt and financial crises across EMDEs.			would jeopardize financial stability. Draw on SBA financing should a larger fiscal response be necessary and to bolster foreign exchange reserves.
Local Covid-19 outbreaks. Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	**Medium**	**Medium** Further lockdowns would negatively affect growth, including through lower tourism and investment. Capital outflows in the context of a high current account deficit and external financing requirements would lead to lari depreciation and accelerating inflation. Poverty among the vulnerable would rise.	Allow exchange rate to adjust to new fundamentals. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Further tighten monetary policy to keep inflation expectations anchored. Reprioritize spending to meet health needs and provide targeted support to affected populations and businesses.
Structural Risks			
Deepening geo-economic fragmentation and geopolitical tensions. Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower 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 source of future growth that is less reliant on the external environment.	Allow the exchange rate to adjust to reflect the new fundamentals. If inflation has fallen, utilize monetary policy space to ensure that the output gap does not stay negative for too long. Extend targeted measures to support individuals and businesses by reprioritizing spending.

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
Georgia-Specific Structural Risks			
Financial risks. As a result of one of the global shocks above, the exchange rate could depreciate rapidly, undermining confidence in the currency and increasing inflation expectations.	**Medium**	**Medium** Depreciation in a highly dollarized economy could hurt growth and threaten financial stability as households and firms struggle to repay loans. 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. Allow the exchange rate to adjust to new fundamentals. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Strengthen the resolution framework to ensure that financial stability challenges can be addressed. Allow use of capital and liquidity buffers to cope with shocks. Adjust macroprudential measures to avoid an undue tightening of financial conditions. Enforce provisioning rules in line with international best practices.
Fiscal risks. Materialization of contingent liabilities/fiscal risks could put pressure on the deficit.	**Medium**	**High** The need to cover contingent liabilities could complicate efforts to comply with the fiscal rule or result in lower capital or	Continue improving SOE governance and fiscal risk management practices. Strengthen revenue raising capacity.

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
		current spending, the latter of which has already been significantly compressed.	Strengthen reform agenda and seek IFI support.
Political risks. Political instability and/or 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 segments of the population and ensure that growth is sufficiently inclusive.

Annex II. Downside Scenario[1]

The adverse scenario considers the combined impact of several plausible downside shocks to Georgia's economy: (i) negative spillovers from the war in Ukraine, (ii) lower growth in major trading partners, and (iii) further increases in commodity prices. The impact would be felt through (i) deteriorating terms of trade, (ii) lower tourism revenues, remittances, and goods exports, and (iii) capital outflows owing to greater global financial risk aversion.

1. The scenario assumes that the combined negative shocks will have the following impacts on the economy:

- **Commodity prices**. Due to continuing supply disruptions, food and oil prices are assumed to be 10 percent higher in 2023 compared to the baseline, before gradually declining to baseline levels in 2025.
- **Remittances.** Due to negative spillovers from the war in Ukraine and the larger global slowdown, net remittances are assumed to be 5 percent lower than the baseline in 2023, and 2.5 percent lower in 2024.[2]
- **Services exports/tourism.** Tourism revenue is assumed to be 15 percent lower than the baseline in 2023, and 7.5 percent lower in 2024. This would imply a fall in tourism revenue to 3 percent below the 2019 level in 2023, before recovering back to the baseline by 2025.
- **Goods exports.** Lower growth in key trading partners results in lower merchandise exports by 5 percent compared to the baseline in 2023, and 2.5 percent in 2024.
- **Capital outflows.** Global risk aversion results in nonresidents selling all their holdings of local government bonds ($130 million) in 2023. In addition, a faster-than-expected net outflow of migrants leads to a reduction of nonresident deposits by 15 percent compared to the baseline in 2023, and 7.5 percent in 2024.

2. The downside shock would lower growth, increase inflation, and weaken the lari. Lower exports, tourism, and remittances would hurt growth in addition to an already conservative scenario in 2023, and deteriorate the growth outlook for 2024 (Annex Table 1). The lari would depreciate by 10 percent compared to the baseline in 2023 reflecting weaker fundamentals. This along with higher commodity prices would add to inflation in 2023 and 2024 and delay inflation returning to target until end-2024. Lari depreciation and lower growth would also worsen the outlook for external and public debt.

3. The current account would deteriorate significantly, resulting in much lower reserves. While lower external demand would dampen exports of goods and services, imports would also

[1] Prepared by the Georgia team. The scenario assumes shocks that are similar in nature but larger in size than those assumed under the downside scenario at program approval.

[2] Net remittances are already projected to decline by 10 percent relative to 2022 in the baseline, reversing a trend of very strong growth in recent years (by 28 percent, 38 percent, and 23 percent y/y in 2020, 2021, and 2022, respectively).

decline reflecting lower GDP growth and tourism activity, as well as lari depreciation, reducing the impact of the shocks on the goods trade balance somewhat. The current account balance would still deteriorate compared to the baseline by 3.7 percentage points of GDP in 2023 and 0.2 percentage points in 2024, reflecting lower services receipts and remittances. In the absence of additional external financing, the deterioration would be covered by reserves, which would fall to 66 percent of the ARA metric by 2024 (16 percentage points lower than the baseline in 2024).

4. **The authorities would be expected to respond to the shocks with a tight monetary policy stance to contain inflationary pressures, while providing fiscal support to the vulnerable.** The NBG would focus on keeping interest rates high, while allowing the exchange rate to act as a shock absorber and utilizing reserves to prevent disorderly exchange rate adjustment. The government is expected to prioritize targeted support to the vulnerable within the deficit limit of 3 percent of GDP, still complying with the fiscal rule.

5. **Drawing on the SBA would allow the authorities to reach 75 percent of the ARA metric by the end of the program in 2025.** While this level is somewhat lower than reserve adequacy in the aftermath of the last regional shock in 2015–16 (86–89 percent of the ARA metric), the authorities could consider an augmentation and additional financing from other IFIs and development partners as they did during the COVID-19 shock to further boost reserves.

Table AII.1. Georgia: Key Macroeconomic Indicators in Baseline and Downside Scenarios

(Percent of GDP, unless otherwise noted)

	2022	2023		2024		2025	
	Baseline	Baseline	Downside	Baseline	Downside	Baseline	Downside
Real GDP growth (percent change)	10.0	4.0	2.0	5.2	3.5	5.2	5.2
GDP deflator (percent change)	10.0	6.5	7.5	3.0	4.0	3.0	3.0
Net lending/borrowing (percent of GDP)	-2.8	-3.0	-3.0	-2.3	-2.3	-2.3	-2.3
Augmented net lending/borrowing (program definition) 1/	-3.1	-2.8	-2.8	-2.3	-2.4	-2.3	-2.4
Current account	-5.6	-6.6	-10.3	-5.7	-5.9	-5.6	-6.6
General government debt	41.2	45.6	42.5	45.1	42.1	41.1	41.1
External debt	77.7	73.1	81.2	68.4	76.4	63.9	65.0
GIR (in percent of ARA metric)	98.6	83.3	64.2	81.4	65.8	91.8	70.0
GIR after drawing (in percent of ARA metric)			67.7		70.7		75.4

1/ Net lending/borrowing - Budget lending (net)

Appendix I. Letter of Intent

Tbilisi, December 6, 2022

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

Dear Ms. Georgieva:

1. **The near-term macroeconomic outlook for Georgia has significantly improved since program approval.** Georgia had been enjoying a strong recovery from the pandemic supported by sound macroeconomic policies. Russia's invasion of Ukraine created significant challenges for Georgia and the region. Nevertheless, further recovery in tourism revenues, increased transit trade through Georgia, as well as migration and financial inflows triggered by the war in Ukraine have buoyed growth and fiscal revenues, improved our current account balance, and strengthened the lari, allowing us to replenish our reserve buffers. We have maintained exchange rate flexibility, saved much of the revenue gain to achieve a lower fiscal deficit than targeted under the program, and implemented macroprudential measures to enhance financial resilience, protect consumers, and reduce credit growth. Inflation remains higher than our target, partly reflecting still elevated global commodity prices. While we have kept the policy rate on hold since March, we remain committed to tighten monetary policy further if necessary.

2. **All end-June and continuous quantitative performance criteria (QPCs) were met and steady progress has been made in meeting structural benchmarks (SBs)** (MEFP ¶6). June inflation was within the inner bands of the inflation consultation target. The end-June ceiling for the fiscal deficit and the floor on net international reserves (NIR) were met by substantial margins. The SB for the public investment management assessment update was met in September as was the SB on publishing an assessment of climate related financial sector risks in July, well-ahead of schedule. We also met the SBs on the authorization and scheduling of tax expenditure reporting; automatic processing of VAT credits; submitting a budget code amendment to make all investments above a certain threshold subject to the public investment management (PIM) framework; and improving the governance of key internal processes for the NBG's supervisory operations and decisions. As prior actions for this review, we are: (i) developing a complementary support scheme for renewable energy that limits fiscal risks, and (ii) finalizing and adopting our SOE strategy, issuing a timebound plan for its implementation including to pilot it in three major SOEs starting in the first quarter of 2023, and determining the ownership of the Georgian State Electrosystem (GSE).

3. **Against this background we request modifications to our program.** We request that: (i) the end-December QPC on the floor on net international reserves be raised to lock in recent gains; (ii) the end December QPC on the ceiling on net budget lending be raised given needed support to the Georgian Oil and Gas Corporation (GOGC); (iii) the end-December indicative target on the ceiling on primary current expenditure be raised to accommodate supplementary budget spending and avoid too large a drop in real outlays due to high inflation; (iv) the SB on reducing the audited stock of VAT

declarations cleared for payments be modified given some VAT payers' preferences (v) the SB on submitting to Parliament a draft framework law for public corporations consistent with our adopted strategy be reset to end-September 2023 given the delay in adopting the SOE strategy; (vi) the SB on developing a medium-term revenue strategy (MTRS) be reset to end-March 2024; and (vii) QPCs be set for end-June 2023 and end-December 2023.

4. Given the overall strong performance under the program and policies enclosed in the Memorandum of Economic and Financial Policies (MEFP), we request the completion of this review. We continue to treat the arrangement as precautionary and will only consider making purchases if our balance of payments deteriorates materially. We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of our program. We will monitor progress continuously and stand ready to take further measures if needed to reach our objectives outlined in the MEFP. We will continue to consult in advance with IMF staff on the adoption of such measures and any revisions to policies included in the MEFP in accordance with the IMF's policies on such consultations. We will also provide IMF staff with the information for monitoring program implementation.

5. The attached MEFP updates the one from May 27, 2022 and documents our achievements and priorities. We reaffirm our commitment to the policies and objectives of the economic program supported by the IMF's Stand-by Arrangement (SBA) and outline in the updated MEFP progress and further policy steps toward meeting these objectives. We authorize the IMF to publish this letter and its attachments, and the accompanying staff report.

Very truly yours,

/s/

Koba Gvenetadze
Governor of the National Bank of Georgia

/s/
Levan Davitashvili
Vice Prime Minister, Minister of Economy and Sustainable Development

/s/
Lasha Khutsishvili
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

1. This memorandum reports on the economic developments since the approval of the 36-month Stand-By-Arrangement (SBA) in June 2022 and the outlook, and reviews the implemented and planned economic and financial policies by the National Bank of Georgia (NBG) and the Government of Georgia to achieve program objectives.

Recent Developments and the Outlook

2. The Georgian economy is set to achieve strong growth this year as adverse spillovers expected from the war in Ukraine have not materialized thus far. Real GDP growth was 10 percent during January-October, reflecting strong recovery of tourism, a rise in transit trade through Georgia, and a surge in migration and financial inflows triggered by the war. Growth is expected to moderate in 2023, reflecting subsiding external inflows, a slowdown in Georgia's major trading partners, and tightening global financial conditions, before converging to its potential rate of about 5 percent in the medium term, driven by a more stable external environment with higher exports and tourism, and greater public and private investments in digital and physical infrastructure. Achieving the growth potential will require advancing structural reforms including those related to strengthening SOE governance, reducing unemployment, promoting inclusion in the workforce, strengthening social safety nets, diversifying trade markets, and improving regional trade connectivity.

3. Despite easing since May, inflation has remained elevated in 2022. Inflation was 10.4 percent y/y in November and is projected to close the year at 10.5 percent—slightly higher than at program approval, driven by persistently high food and energy prices, spikes in rents and transportation costs, and increased demand including due to the influx of war-related migrants and double-digit wage growth. Nevertheless, inflation is expected to ease in 2023 to an average of 6 percent and converge to the NBG's target level of 3 percent in 2024. The reduction in inflation reflects expectations of falling global commodity prices, dampened demand from slowing immigration and foreign exchange (FX) inflows, smaller fiscal deficits, and our continued tight monetary policy stance. The NBG is strongly committed to its inflation target and stands ready to increase the policy rate further if inflation pressures persist.

4. Robust tourism, inward migration, and FX inflows have strengthened external indicators, growth, and fiscal revenues. The lari has appreciated by over 13 percent in nominal effective terms since program approval and the current account deficit is projected to narrow from 10.4 percent in 2021 to 5.6 percent in 2022, reflecting buoyant tourism revenue (including spending by migrants) and remittances outweighing strong imports. Higher than expected financial inflows helped raise gross international reserves (GIR) to US$4.4 billion (100 percent of the ARA metric) in October compared to the year-end GIR projection at the time of program approval of US$3.3 billion (79 percent of the ARA metric). The fiscal deficit through October has been lower than expected at 0.9 percent of GDP due to strong revenue, compared to 4 percent of GDP projected for 2022 at program approval. Over the medium-term, the current account and fiscal balances are expected to narrow further.

5. Risks to the outlook stem from an intensification of the war in Ukraine and sanctions on Russia, as well as deteriorating global economic and financial conditions. Georgia has so far benefitted from migrant and financial inflows from Russia, which could reverse or moderate. A further intensification of sanctions could affect Georgia through commodity price, trade, and financial channels, although increased transit trade through Georgia could be a mitigating factor. Slowing global growth and tightening global financial conditions pose additional downside risks. Our first line of defense against these risks is our continued commitment to exchange rate flexibility, sound macroeconomic and financial policies, and implementation of structural reforms.

Program Performance

6. We met the end-June inflation consultation target and all end-June and continuous quantitative performance criteria (QPCs), and made steady progress in meeting structural benchmarks (SBs). (Tables 1-3).

- **Inflation consultation clause.**
  - *Inflation target.* At 12.8 percent y/y in June, headline inflation was within the inner bands of the inflation consultation target.
- **Quantitative performance criteria.**
  - *Fiscal targets.* The general government cash deficit and net budget lending through June were GEL 172 million and GEL 18 million, significantly under the respective program ceilings (GEL 1,370 million and GEL 30 million). We have not issued any new public guarantees and met all continuous QPCs on Partnership Fund operations (a US$8 million surplus against a zero cash deficit QPC, and no new investment or new net borrowing). Primary current expenditure through June was GEL 7,052 million, slightly above the indicative target ceiling of GEL 7,030 million.
  - *External targets.* Net international reserves (NIR) reached US$1,602 million as of end-June, exceeding the program target by a comfortable margin (US$398 million).
- **Structural benchmarks.**
  - *SOE governance*. We are finalizing and adopting a public corporation reform strategy in agreement with IMF staff and in line with OECD principles, EU directives, and the Energy Community acquis, including by ensuring clear separation between the state's shareholder and policymaking functions (**prior action**). The strategy envisages equal ownership of public corporations by the Ministry of Finance (MOF) and the Ministry of Economy and

Sustainable Development (MOESD).[1] The shared ownership will strengthen the financial oversight functions, decision-making role, and effective enforcement mechanisms of the MOF. Accordingly, the strategy will state that the two ministries will equally share the ownership of Georgia State Electrosystem (GSE) (**prior action**). Power generation SOEs will be overseen by a new independent council with board members approved by Parliament to comply with the EU directive on unbundling. In consultation with IMF staff, we will take steps to establish a strong governance framework for the new council including to ensure that SOEs under its ownership will operate on the basis of commercial objectives, indicate that the legal foundation of the council will be made consistent with the approved SOE strategy and coming new framework law on public corporations (¶13), clarify and limit the council's mandate, and strengthen the qualifications for council board members. To limit potential fiscal risks, the law will also ensure a strong role for the MOF including to safeguard key financial governance decisions such as investment, borrowing, and dividend policy, and require regular financial reporting to the MOF. We are issuing a timebound plan to implement the SOE reform strategy, including to pilot it in three major SOEs[2] starting in the first quarter of 2023 (**prior action**).

- *Renewable Energy Generation*. To meet growing domestic energy demand, we have developed a complementary support scheme for renewable power generation that limits fiscal risks (**prior action**) in consultation with IMF staff and also benefitting from World Bank staff input. The scheme currently envisages support for a maximum total power generation capacity of 1,500 MW to be awarded through auctions over the next three years. The total capacity will be adjusted as needed based on updated demand and supply projections including to reflect progress on other energy projects. In the first phase (2022-2023), we will auction 300 MW. The capacities for the following years (2023-2024 and 2024-2025) will be subsequently determined in agreement with IMF staff. We will award all projects under the scheme through competitive auctions. We will mitigate potential fiscal risks by ensuring that the costs of the scheme will be passed on to final consumers. For previously approved renewable energy projects supported by power purchase agreements (PPAs) that are not advancing materially, we will allow a three-month assessment period to determine whether projects can move forward with the existing terms. Projects that are not deemed viable under the existing terms will be terminated and can be considered under the new scheme's auction mechanism.
- *Public investment management*. We undertook an updated Public Investment Management Assessment (PIMA) in 2022 (**end-March 2023 SB**), as well as a Climate PIMA. The PIMA update noted significant improvement in public investment management (PIM) compared to the assessment in 2018, while identifying areas for further progress including the strengthening of project preparation, appraisal and selection processes, and

[1] As part of the SOE reform, ownership of Georgian Railways and the GOGC will be transferred from the Partnership Fund to the government.

[2] The three pilot SOEs are Georgian Railway, Georgian Gas Transportation Company, and United Airports of Georgia.

the development of a credible pipeline of appraised projects that can be considered when preparing medium-term and annual budgets. The Climate PIMA found good practices in risk management but indicated that more can be done to enhance climate awareness and climate resilience in PIM. We also submitted a budget code amendment to make all investments above a certain threshold subject to the public investment management (PIM) framework (**end-September SB**).

- *Tax policy and administration*. We submitted to Parliament an amendment to the budget code to authorize the requirement for tax expenditure reporting including the nature of tax expenditures and their costs, and established a schedule for annual tax expenditure reporting (**end-September 2022 SB**). We automatically processed more than 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produced statistics for June 2022 to monitor compliance with this measure (**end-July 2022 SB**).
- *Financial stability*. In line with FSAP recommendations to formalize and improve the governance of key internal processes for supervisory operations and decisions, we developed and published updated internal procedures for the General Risk Assessment Program (GRAPE) (**end June 2022 SB**). The revised document details the categories of risks to be assessed for GRAPE purposes, risk mitigators, definitions and criteria for assigning scores to each risk, and procedural aspects. We published in July a report on Climate-related Risk Radar for Georgian Economic Sectors to assess climate-related financial sector risks (**end-December 2022 SB)**.

Economic Policy Agenda

A. Fiscal Policy

7. We are committed to further consolidating public finances in compliance with our fiscal rule and rebuilding fiscal buffers.

- We are committed to the end-December 2022 augmented cash deficit of the general government of below GEL 2,740 million (**performance criterion**) and expect to achieve a much lower deficit. We will strive to keep primary current spending below GEL 15 billion (**indicative target**—revised up from GEL 14.2 billion to accommodate supplementary budget spending and avoid too large a drop in real outlays given high inflation) and net budget lending below GEL 275 million (**performance criterion**—revised up from GEL 75 million to support GOGC operations; to reduce the possibility of such support in the future, quasi-fiscal activities by the GOGC will be eliminated with a significant reduction by mid-2023, which will facilitate repayment of the budget lending).
- We have submitted a 2023 budget with a spending envelope consistent with our fiscal rule and the policies agreed for this program. The submitted budget envisages total spending excluding interest payment of GEL 22 billion. With revenues around GEL 21 billion, this level of spending is consistent with an augmented deficit of 2.8 percent of GDP—below the

3 percent of GDP ceiling in the fiscal rule—and implies a contractionary stance in line with still-high inflation. In the event of revenue overperformance relative to our adopted budget, we intend to save any windfalls to rebuild buffers with the possible exception of limited and targeted support for the vulnerable if needed to cushion the impact of high global food and energy prices. We stand ready to adopt additional measures in consultation with IMF staff, including reductions in expenditures, if needed to meet an augmented deficit target of 2.8 percent of GDP.

- We will reduce the augmented general government deficit from 2.8 percent of GDP in 2023 to 2.3 percent of GDP in 2024-2025, while at the same time expanding the general government perimeter to include state-owned enterprises classified as general government units. Meeting the deficit targets in 2024-2025 may require additional revenue measures (see ¶9), which we will adopt in consultation with IMF staff. In the medium term, we believe further saving can be achieved by strengthening SOE performance through the successful implementation of the SOE reform (¶13). Infrastructure projects in the pipeline could also be delayed if needed to meet deficit targets.

8. We are committed to keeping general government debt sustainable and increasing the share of local currency-denominated debt. We have successfully reduced the debt-to-GDP ratio to below 40 percent as of September 2022, reflecting fiscal adjustment and helped by lari appreciation and strong nominal growth. We are committed to keeping debt comfortably below the fiscal rule ceiling of 60 percent of GDP, while reducing debt vulnerabilities and risks. We project the debt-to-GDP ratio to be stable in 2023-25. In line with our public debt management strategy published last year, we will continue efforts to deepen the local capital market (¶27) and increase the share of local currency debt from 25 percent in 2022 to 32 percent in 2025, thereby mitigating exchange rate risks.

9. We are committed to mobilizing additional revenue to support deficit reduction while making space for priority spending, including on infrastructure and education.

- **We are strengthening our revenue administration to improve revenue collection.** We will continue to develop our compliance risk management including by enhancing the use of risk-based audits to address high tax compliance risks and reduce compliance gaps. We have made progress in establishing a large taxpayer office (LTO) and will expand LTO operations on subsidiaries and entities associated with large taxpayers. We will continue to build our analytical capacity and technical tools to improve risk management and reduce identified compliance risks in a cost-effective way, while also improving the organizational structure. We created a register of employees for tax administration purposes, which provides a strong basis for improving reporting and filing compliance. We are expanding the system of information-sharing with government agencies and the Financial Monitoring Service for monitoring high-risk, suspicious transactions. Legislation to implement Common Reporting Standards for the collection, reporting, and exchange of financial account information on foreign tax residents in line with the International Standard for Automatic Exchange of Financial Account Information for tax purposes has been submitted to Parliament and is expected to be approved by the end of the year. We signed the international agreement in November. We will also seek to improve information sharing with third parties to support domestic revenue mobilization.

- **We will continue efforts to expand the tax base.** We have published a first tax expenditure report, including the nature of existing tax expenditures and their costs (**end-December 2022 SB**). We will draw on analysis from the report to achieve greater efficiency in tax expenditures in future budgets. We will complete a tax expenditure review for VAT and income taxes including cost-benefit analysis for key tax expenditure items (**end-June 2023 SB**).

- **We will develop a medium-term revenue strategy (MTRS).** With the help of IMF TA, we will identify options for revenue mobilization, while promoting tax efficiency and progressivity (**end-March 2024 SB**—delayed from end-September 2023 to allow more time to develop the strategy).

- **We will modernize the property tax system,** by introducing a more centralized and comprehensive valuation process, and consider changing the property tax so that only properties with a value above a certain threshold are taxed to protect the poor.

10. We will continue to reduce the stock of unrefunded VAT credits. We are committed to reducing the audited stock of VAT declarations cleared for payments to no more than GEL 70 million (end-December 2022 SB—revised up from GEL 50 million, due to some companies' preference to keep positive VAT account balances). We will continue to automatically process (refund or offset) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produce statistics on a monthly basis (for July through December 2022) to monitor compliance with this measure (end-January 2023 SB).

11. We are committed to improving the effectiveness and efficiency of spending. We are considering conducting spending reviews with the help of IMF TA on select priority areas such as health, education, and agriculture to enhance the quality of spending and fiscal outcomes in the medium term.

12. We will continue to improve the quality of fiscal reports and accounting. We will publish the 2022 consolidated financial statements for the central government based on International Public Sector Accounting Standards (IPSAS) and consistent with FAD advice (**end-June 2023 SB**). To ensure that the general government statistics adequately cover the SOEs that are categorized as general government units (GG SOEs) and to allow timely access to information in GFS reporting format, we will begin the process of transferring bank accounts of major GG SOEs to the Treasury account in 2023. We will also undertake a Fiscal Transparency Evaluation in the first half of 2023.

13. We are committed to advancing SOE reform. We will submit a draft framework law for public corporations to Parliament in accordance with the strategy approved by the Government (**end-September 2023 SB**—delayed from end-December 2022), consistent with

IMF TA, and in line with best international practices, EU directives, and the Energy Community acquis. The September 2023 deadline would allow time to ensure that the framework law adequately addresses the complexities that arise from the new ownership model and to consult relevant stakeholders. The law will establish the governance framework for all public corporations, including those that are subject to the special unbundling requirements of the EU Energy Community and those that are subject to the shared ownership between the MOF and MOESD. In particular, the law will establish that the primary objective of public corporations will be to operate commercially. The law will also set out the criteria for establishing or retaining a public corporation, and provide for SOEs to: (i) face the same regulatory and market conditions as their private sector competitors; (ii) comply with a corporate governance code in line with international best practice standards; (iii) publish ownership policy statements that define how the SOEs' ownership rights will be exercised; and (iv) define and implement a comprehensive performance management framework. The law will include measures to separate the ownership role of the MOESD from its policy role in order to address potential conflicts of interest. Under the law, the government will refrain from asking SOEs to engage in new quasi-fiscal activities (QFAs). For any QFAs, the law will require that they be explicitly mandated by the government. SOEs will be prohibited from engaging in implicit QFAs. Starting in 2023, we will introduce a transparent mechanism to identify and compensate public corporations for public service obligations in line with the SOE law.

14. We are committed to further strengthening public investment management (PIM). To ensure selected projects are of high quality, we will not include any new investment projects over GEL 20 million in the 2023 state budget law unless they are selected according to the PIM guidelines (**end-December 2022 SB**). To provide a durable legal foundation in this area, we submitted to Parliament an amendment to the budget code to make all investments above a threshold subject to the PIM framework. The threshold will be identified with IMF TA in November and set through a government decree.

15. We will continue to avoid domestic/external debt payment arrears. We will not (i) accumulate any general government external debt payment arrears **(continuous performance criterion)**; (ii) accumulate net domestic expenditure arrears of the general government (**indicative target**); or (iii) issue new public guarantees **(continuous performance criterion)**.

16. We will continue to curtail Partnership Fund operations. The Partnership Fund will not undertake any new investments or borrowing **(continuous performance criteria)** and will not run a deficit **(performance criterion)**.

17. We will continue to monitor and address fiscal risks. We will include in the 2022 Fiscal Risks Statement quantification of risks related to climate change and legal claims, as well as a long-term sustainability assessment for health and aging-related spending (**end-December 2022 SB**).

18. We will consult IMF staff regarding changes to the pension system. With support from the ADB, we have submitted to Parliament amendments to the funded pension law (second pillar), and proposed a new framework for voluntary private pensions (third pillar). Amendments to the funded pension law include improvements to the institutional arrangements underlying the pension system and diversification of the Pension Fund's investment portfolio. Before amendments are adopted, we will consult with IMF staff on draft changes to the pension system.

19. We will take steps to limit governance risks if any additional mechanisms to support SMEs are considered. In consultation with IMF staff, we will explore the scope for minority government participation in private equity or venture capital investment funds focused on small and medium-sized enterprises, ideally alongside international financial institution co-investors. Any support for equity investment would be based on OECD corporate governance principles, with an exit strategy and a specific time horizon for investment. We will ensure including via legislative amendments that the government is a minority shareholder and would not be involved in selecting investment recipients. Apart from possible minority participation in a private fund as described above, the government will refrain from taking new equity stakes in private Georgian businesses or from establishing any institution that would seek to take such equity stakes. The Partnership Fund will not be involved in any way in government participation in private equity or venture capital investment funds.

B. Monetary Policy

20. We are committed to our inflation targeting framework to maintain price stability. Our monetary policy decisions will continue to depend on the inflation outlook. Inflation is projected to decline to an average of 6 percent in 2023 and 3 percent in 2024, aided by falling global commodity prices, smaller fiscal deficits, and continued tight monetary policy. However, we recognize the risk that transient inflation developments may become entrenched or that external shocks could trigger lari depreciation and inflation pressures, increasing inflation expectations persistently. We stand ready to tighten policy rates further, complemented by other measures as needed, to counter these risks.

21. We are committed to exchange rate flexibility to guard against external shocks, while preventing disorderly market conditions. The floating exchange rate regime continues to work well as a shock absorber, but disorderly exchange rate adjustments could become disruptive to financial stability as Georgia still remains a highly dollarized economy, even after progress in recent years. We will continue to meet our targets on net international reserves (NIR), and use reserves only to avoid disorderly market conditions. As the pandemic has receded and its effects on FX market volatility have subsided, we will phase out in 2023 FX sales to public corporations through the Treasury.

22. We are committed to maintaining adequate reserves, and strengthening the NBG's communications especially regarding foreign exchange reserve management. We have taken advantage of more favorable than expected foreign exchange market conditions so far in 2022 to strengthen international reserve coverage. We project that the ratio of GIR to the IMF reserve adequacy metric (ARA), which is expected to reach about 99 percent by end-2022, will decrease by about 17 percentage points from end-2022 to end-2024 as the external environment remains challenging and international borrowing by the government continues to fall in the context of efforts to develop domestic capital markets (¶27). Over the medium term, we expect our reserve coverage to improve gradually and reach about 113 percent of the ARA metric by 2027, reflecting improved prospects for exports and tourism. We are committed to rebuilding our external buffers faster, consistent with exchange rate flexibility, and if market conditions allow. We are working on updating the NBG communication strategy including by specifying objectives and introducing regular impact assessments for NBG communications **(end-December 2022 SB)**, including to strengthen our communications about FX reserve management and intervention.

23. We are reviewing the framework for decision-making, oversight, transparency, internal controls, and accountability for key monetary and financial sector policies. This includes, inter alia, assessing the advantages of collegial versus presidential decision-making practices for monetary and financial sector policies against increased responsibilities of the NBG and the dynamic development of the financial system. We are benefitting from the Fund's TA in this area, including benchmarking against international best practices. We will continue to consult with Fund staff before suggesting possible changes to the Organic Law on the NBG.

C. Financial Sector Policy

24. We will continue to monitor and strengthen banking system health. Banking sector performance has improved since program approval thanks to strong economic growth. Liquidity is substantial, capital buffers are adequate, profitability is high, and NPLs have declined although restructured loans remain steadier, especially in the construction, hotel, and restaurant sectors. A portion of the restructured loans are being repaid, and will be reclassified as performing over time.

- **We will continue to monitor developments in NPLs and restructured loans**. In case of any significant deterioration, we will ensure that banks promptly account for expected losses through provisioning and timely write-downs of NPLs.

- **We will further strengthen the corrective action framework for banks**. We will develop policy guidance (**end-December 2022 SB**) to ensure that timely action, including the initiation of license revocation or alternative failure resolution action, is taken promptly in response to financial deterioration in any bank.

- **We will continue to improve our bank recovery and resolution framework.** In line with the recommendations of IMF TA, we will continue establishing an effective recovery planning framework and infrastructure that are consistent with relevant international standards and governance principles. Namely, we will build capacity at the NBG's Resolution Authority by developing a playbook to make the bridge bank tool operational **(end-March 2023 SB)** and finalizing decisions regarding resolution funding arrangements. This playbook will address matters such as establishment, governance, capitalization and financing, operation, and eventual sale of the bridge bank. We will also strengthen inter-agency resolution coordination and communication domestically and cross-border as necessary.

25. **We will continue to strengthen our assessment and mitigation of systemic financial sector risks.** Credit growth and FX exposures including dollarized loans have declined, reflecting the NBG's macroprudential measures and tightening global financial conditions. Since program approval, we have temporarily reduced the maximum maturity for unsecured consumer loans from 4 to 3 years, and published draft instructions on connected borrowers to limit risks from concentration of large exposures at banks. Going forward, we intend to implement the following policy measures:

- **To strengthen the resilience of the financial system**, and considering current strong economic growth coupled with high bank profitability, we intend to require banks to build up additional capital buffers. We will also further refine climate-related data collection and analysis for both physical and transition risks.
- **To protect unhedged borrowers,** we will implement additional measures to reduce the risks related to FX loans.
- **To improve the responsible lending regulation,** we will gradually restrict the use of informal income to calculate the payment-to-income ratio for retail borrowers.
- **To protect consumers and strengthen monetary transmission channels,** we will seek to increase competition among financial institutions by enhancing transparency in product pricing. Namely, we will enhance disclosure of effective rates on financial products and promote product comparison websites.

26. **We are committed to enhancing governance and internal procedures for supervisory activities.** We will clarify the roles and responsibilities of NBG structural units and committees regarding supervisory activities by: (i) developing clear delegations of authority to department heads from the Vice-Governor responsible for financial supervision in line with IMF TA recommendations and (ii) reviewing the charter and operations of the Financial Sector Supervision Committee to clarify its role in the supervisory process in line with FSAP recommendations. We will formalize the supervisory policy development process, including by ensuring a more structured process for public consultations regarding new legislations.

27. **We will continue to develop our capital markets**. The government has adopted the capital market development strategy for 2022-2028. The strategy focuses on two main goals: development of capital market instruments and deepening of the investor base. In 2022, we have submitted to Parliament draft laws on covered bonds and securitization to broaden available instruments on the market. With the assistance of the World Bank, we developed and adopted corporate governance standards for public companies. With the help of IMF legal department, we have drafted the law on dematerialized securities holdings, which will strengthen the foundation for the securities market, allow for centralized issuance of public

securities with a central securities depository (CSD), and improve investor protection. We have expanded the primary dealers program with new benchmarks and enhanced compliance monitoring tools.

28. We will continue to strengthen our AML/CFT framework. In February 2022 we instructed financial institutions to adhere to the requirements of respective financial sanctions imposed by the US, the EU, and the UK. Considering risks due to sanctions on Russia and visitor arrivals from Russia, in June 2022 we created a specialized sanctions unit under the AML Supervision Department of the NBG and are seeking technical assistance from foreign authorities. In addition, we have requested and now receive additional monthly reports from commercial banks and payment service providers about customers connected to Russia, Belarus, and other risk-bearing countries with the aim of analyzing trends and risks associated with these customers and transactions to deploy further supervisory measures. To reduce sanctions evasion risks, the NBG has restricted banks' ability to send cash to jurisdictions other than the US, the EU and the UK; increased the USD cash withdrawal fee for banks; and imposed transaction limits on remittances. We will work to further automate sanctions screening and develop a comprehensive AML/CFT risk prevention framework.

29. We will start supervising Virtual Asset Service Providers (VASPs) from January 2023 and subject VASPs to rigorous AML/CFT standards. The framework includes licensing/registration and revocation, applying fit and proper requirements on owners and management of VASPs, conducting AML/CFT supervision, determination of the information accompanying the transfer of virtual assets, issuance of written instructions, setting additional requirements and restrictions, and imposing sanctions.

D. Structural Reforms

30. We will continue our efforts to reduce high unemployment by addressing skills mismatches in the labor market and improving the quality of education and training. To foster evidence-based labor market policies, we have established a periodic labor demand and skills survey, the latest of which is being conducted with the results expected by June 2023 (**end-June 2023 SB**). The findings from this survey will inform various policy efforts, including the strengthening of vocational, education, and training (VET) programs in line with the 2019-2023 National Strategy for Labor and Employment Policy. We introduced the Public Employment Works Program in March 2022, which will also support the transition of those receiving targeted social assistance (TSA) into formal employment. We aim to address job market inefficiencies by utilizing digital means to facilitate job seekers in matching potential opportunities. We are committed to improving the quality and cost-effectiveness of education including by strengthening testing and training of teachers.

31. Protecting the most vulnerable continues to be a key priority. We aim to strengthen the targeting of the TSA by improving the means testing methodology. We are currently running a pilot program trialing an improved methodology for calculating need, supported by the World Bank. We are working on digitalizing the TSA to accelerate the application process, selection of beneficiaries, and disbursement of benefits. We are aiming to reduce the time from application for TSA to disbursement from four months to one month. Gender equality committees in both Parliament and the government will report on legislative gaps and active labor market policies (ALMPs) to support the economic empowerment of women.

32. We will continue to improve the business environment and corporate governance to boost competitiveness and attract foreign direct investment (FDI). We have introduced a bill to establish a National Anti-Corruption Bureau, which should strengthen Georgia's business environment and send a positive signal to potential investors. Operationalization of the new insolvency law to improve the efficiency of insolvency procedures continues with the training and licensing of insolvency practitioners gaining pace. As of end-October 2022, 18 insolvency practitioners have been authorized by the National Bureau of Enforcement. Since the operationalization of the insolvency law, 25 insolvency cases have been opened, out of which 12 were bankruptcy proceedings and 13 were rehabilitation motions.

33. We remain committed to deepening trade relations and strengthening regional connectivity to support economic diversification. Negotiations are ongoing with the UAE to sign the Comprehensive Economic Partnership Agreement. In September, Georgia and Turkey deepened their existing free trade agreement (FTA), agreeing to further liberalize tariffs on agricultural products and expanding the scope of the agreement on trade in services. We have ongoing discussions with several countries (Republic of Korea, Israel, India and, some of the GCC countries) to launch FTA negotiations. We continue to make advances on core infrastructure investments, including major highway corridors, which will better integrate regions within the country, facilitate exports, and support the establishment of Georgia as a transport and logistics hub connecting Europe with Asia. Railway modernization is ongoing, and will increase capacity and safety, and reduce travel time and costs. We will soon announce a new selection process for developing the Anaklia Sea Port and start conducting a feasibility study on the development of ferry and feeder services between Georgia, Romania, Bulgaria, Ukraine, and Turkey, supported by the EU. We are also considering further infrastructure projects including a submarine Black Sea cable to enhance digital and power connectivity, for which a feasibility study is being conducted.

E. Program Monitoring and Safeguards

34. The program will continue to be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause, and structural benchmarks. The inflation consultation clause targets and bands are shown in Table 1; quantitative performance criteria and indicative targets for end-December 2022, end-June 2023, and end-December 2023 are listed in Table 2; and a list of structural benchmarks under the program is set out in Table 3. The Technical Memorandum of Understanding is also attached to describe the definitions of the inflation consultation clause and QPCs as well as data provision requirements.

35. The NBG continues to maintain a strong safeguard framework and internal control environment. We have completed an update of the IMF Safeguards Assessment in July. The assessment found the safeguards framework of the NBG generally strong and well aligned with leading practice, including on financial reporting, audit mechanisms, and controls over key operations. With the help of IMF TA, we will introduce legal amendments to the NBG governance framework to ensure a non-executive majority and independent oversight by the board. We will also coordinate with relevant parties to expedite the appointment of a non-executive board member. As required by the safeguard policy, we continue to engage independent external audit firms to conduct audits of the NBG in accordance with international standards.

Table 1. Georgia: Inflation Consultation Clause Targets and Bands for 2022-23

	Target End June 2022	Actual End June 2022	Target End Dec. 2022	Target End June 2023	Target End Dec. 2023
Inflation Consultation Bands for CPI (in percent)					
Central point	11.8		8.1	6.2	3.8
Inner band, upper limit/lower limit	13.8 / 9.8	12.8	10.1 / 6.1	8.2 / 4.2	5.8 / 1.8
Outer band, upper limit/lower limit	14.8 / 8.8		11.1 / 5.1	9.2 / 3.2	6.8 / 0.8

Source: IMF staff estimates

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for end-June and end-December 2022-23

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

	Target at SBA Approval	Actual	Status	Target at SBA Approval	Proposed New Target	Proposed New Target	Proposed New Target
	End-June 2022	End-June 2022		End-December 2022	End-December 2022	End-June 2023	End-December 2023
Performance Criteria							
Ceiling on the augmented cash deficit of the general government (program definition)	1,370	172	Met.	2,740	2,740	1,175	2,350
Ceiling on general government net budget lending	30	18	Met.	75	275	100	0
Floor on NIR of NBG 1/ (end-period stock, million of U.S. dollars)	1,204	1,602	Met.	840	1,610	1,410	1,310
Ceiling on the accumulation of external debt arrears of the general government (continuous criterion) (million of U.S. dollars)	0	0	Met.	0	0	0	0
Ceiling on new public guarantees (continuous criterion)	0	0	Met.	0	0	0	0
Ceiling on the cash deficit of the Partnership Fund (million of U.S. dollars)	0	-8	Met.	0	0	0	0
Ceiling on new investments by the Partnership Fund (continuous criterion)	0	0	Met.	0	0	0	0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the program, continuous criterion)	0	0	Met.	0	0	0	0
Indicative Targets							
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0	0	Met.	0	0	0	0
Ceiling on primary current expenditures of the general government	7,030	7,052	Not met.	14,210	15,000	8,250	16,500

1/ The NIR target is proposed using a constant USD/EUR exchange rate on March 15, 2022 (1.09875).

Table 3. Georgia: Prior Actions and Structural Benchmarks

Action	Proposed Date	Status as of End-November 2022
Prior Action		
Fiscal		
Fiscal Risks		
Finalize and adopt public corporation reform strategy in consultation with the IMF staff and in line with OECD principles, including by ensuring a clear separation between state shareholding and policymaking functions	Prior Action	Not met.
Determine the ultimate ownership of Georgian State Electrosystem	Prior Action	Not met.
Issue a timebound plan for the implementation of the SOE reform strategy, including to pilot it in three major SOEs starting in the first quarter of 2023, to be selected in consultation with the IMF staff	Prior Action	Not met.
Public Financial Management		
Develop a complementary support scheme for renewable power generation that limits fiscal risks in consultation with the IMF staff	Prior action	Met.
Structural Benchmarks		
Fiscal		
Fiscal and Tax Policy		
Submit budget code amendments to authorize the requirement for tax expenditure reporting including the nature of tax expenditures and their costs and establish a schedule for annual tax expenditure reporting	End-September 2022	Met.
Publish first tax expenditure report including the nature of existing tax expenditures and their costs	End-December 2022	
Complete a tax expenditure review for VAT and income taxes including cost-benefit analysis for key tax expenditure items	End-June 2023	
Develop a medium-term revenue strategy supported by IMF TA	End-March 2024	
Public Financial Management		
Submit to Parliament an amendment to the budget code to make all investments above a threshold (to be identified with IMF TA) subject to the PIM framework	End-September 2022	Met.
Require all investment project over GEL 20 million in the 2023 state budget law to be selected according to the PIM guidelines	End-December 2022	
Undertake an updated Public Investment Management Assessment (supported by IMF TA)	End-March 2023	Met.
Fiscal Risks		
Submit to Parliament a draft framework law for public corporations developed in consultation with IMF staff that is consistent with the strategy approved by the Government of Georgia	End-September 2023	
Include in the 2022 Fiscal Risk Statement a quantification of fiscal risks from climate change and legal claims, and a long-term sustainability assessment for health and aging-related spending	End-December 2022	
Publish the consolidated central government financial statements for 2022 based on IPSAS standard and consistent with IMF staff advice	End-June 2023	
Tax Administration		
Automatically process (refund, offset, or permanently disallow) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produce statistics on a monthly basis to monitor compliance	End-July 2022	Met.
Reduce the audited stock of VAT declarations cleared for payments to no more than GEL 70 million	End-December 2022	
Automatically process (refund or offset) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produce statistics on a monthly basis (for July through December 2022) to monitor compliance	End-January 2023	
Monetary Policy and Financial Sector		
Communication		
Update NBG communication strategy including by specifying objectives and introducing regular impact assessments of NBG communications	End-December 2022	
Financial Stability		
Develop policy guidance on corrective action framework for banks (see MEFP ¶24)	End-December 2022	
Enhance governance of key internal processes for supervisory operations and decisions in line with FSAP recommendations (see MEFP ¶22)	End-June 2022	Met.
Develop a playbook to make the bridge bank tool operational.	End-March 2023	
Publish an assessment of climate-related financial sector risks	End-December 2022	Met.
Structural Reform		
Conduct a labor market survey to monitor labor demand and skills needs	End-June 2023	

Attachment II. Technical Memorandum of Understanding

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 Stand-By Arrangement (SBA) 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 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 March 15, 2022, published on the IMF web site https://www.imf.org/external/np/fin/data/rms_sdrv.aspx.

Table 1. Georgia: Program Exchange Rates

	Currency Name	**US$ per Currency**
SDR	Special Drawing Rights	1.37933
GEL	Georgian lari[1]	0.30939
EUR	Euro	1.09875
AUD	Australian dollar[2]	0.72440
CAD	Canadian dollar[2]	0.78371

1 Equivalently, 1 US$ = 3.23220 GEL.
2 Cross-calculations based on the NBG's daily official exchange rates are available at https://nbg.gov.ge/en/monetary-policy/currency.

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 continuous 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 continuous performance criterion (ceiling) on new investments by the Partnership Fund;
- a continuous performance criterion (ceiling) on new net borrowing by the Partnership Fund;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government; and
- an indicative target (ceiling) on the primary current spending of the general government.

In addition, the program will include a consultation clause on the 12-month rate of inflation (Table 1, 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-December 2022 and end-June 2023 (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 expenses, 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, the 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 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).

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

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

	Dec. 31, 2022	Jun. 30, 2023	Dec. 31, 2023
Receipts from sale of non-financial assets	450	150	350
On-lent amounts from project loan disbursements	200	120	335

Supporting Material:

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

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

c. Data will be provided at actual exchange rates.

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

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

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

- Number and GEL value of claims for VAT credits submitted by taxpayers within 30 calendar days,
- Number and GEL value of VAT refunds paid under the Automatic VAT System (AVS) within 30 calendar days,

- Number and GEL value of VAT cash refunds paid automatically within 30 calendar days,
- Number and GEL value of VAT credits offset automatically within 30 calendar days,
- Number and GEL value of VAT credits permanently disallowed within 30 calendar days,
- Number and GEL value of VAT credits manually reviewed in less than 30 calendar days, and
- GEL value of the old stock of VAT credits.

14. 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

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

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

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

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

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

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

Continuous Indicative Target on Accumulation of General Government Domestic Expenditure Arrears

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

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

Continuous Ceiling on the New Guarantees Issued by the Public Sector

22. 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).

23. 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

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

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

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[1] Arrears to Turkmenistan.

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

Continuous Ceiling on New Net Borrowing by the Partnership Fund

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

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

Continuous ceiling on New Investments by the Partnership Fund

29. 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.

30. 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

31. 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 (excluding the SDR allocations). **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) 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 and SDR allocations. 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 $1,602 million as of June 30, 2022 (at program exchange rates).

32. For program purposes, 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.

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

- Upward (downward) by any excess (shortfall) of privatization revenue in foreign exchange above (below) the programmed amounts (Table 3). 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[1]
(Millions of U.S. dollars)

	Dec. 31, 2022[2]	Jun. 30, 2023[3]	Dec. 31, 2023[3]
Projected privatization revenue	0.0	0.0	0.0
Budget support grants from external donors and not related to project financing	19.7	0.0	35.8
Budget support loans, including bilateral and multilateral donors for budget support	238.4	0.0	109.0
Project loans and grants	241.8	96.6	285.4

[1] Flows are valued at program exchange rates for all targets.
[2] Cumulative from January 1, 2022.
[3] Cumulative from January 1, 2023.

34. 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 the Staff Representative on Georgia
December 21, 2022

This statement provides an update on developments since the staff report (EBS/22/112) was issued on December 7, 2022, specifically on remaining prior actions, which staff now assess as met, and on passage of the 2023 budget. This information does not alter the thrust of the staff appraisal.

1. The prior actions on state-owned enterprise (SOE) governance reform have been met (MEFP ¶6). Specifically, the prior actions on finalizing and adopting a public corporation (SOE) reform strategy, issuing a timebound plan for implementation of the SOE reform strategy including to pilot it in three major SOEs starting in the first quarter of 2023, and determining the ownership of the Georgian State Electrosystem (GSE) have been completed. This was achieved through the adoption on December 14, 2022 of government decree number 573, which includes the overall SOE reform strategy, a timebound implementation plan, and an action plan to pilot the strategy in three major SOEs in 2023. These documents were developed in consultation with IMF staff. The strategy and the timebound implementation plan stipulate that the ownership of GSE will be shared equally between the Ministry of Finance and the Ministry of Economy and Sustainable Development.

2. The final SOE reform strategy reflects IMF policy advice. The strategy calls for the introduction of corporate governance standards for SOEs such as each SOE having a qualified, independent board to supervise its executives; the operation of SOEs under commercial principles and competitive neutrality; the clarification of state ownership goals and rationales under the dual ownership model (equal ownership of the Ministry of Finance and the Ministry of Economy and Sustainable Development with an exception for power generation companies);[1] and the strategic management of SOEs in line with statements of corporate intent to be submitted to shareholders annually. The implementation plans will advance the strategy's principles, which will also be reflected in a framework law on SOEs (end-September 2023 SB).

3. The Georgian Parliament approved the 2023 budget on December 15, 2022 (MEFP ¶7). The approved budget is in line with program commitments with an augmented deficit target of 2.8 percent of GDP, below the 3 percent of GDP fiscal rule ceiling.

[1] To comply with European Energy Community unbundling requirements, power generation companies will be overseen by a new independent council with board members approved by Parliament, but will be subject to the other key elements of the strategy.

Statement by Mr. Rashkovan and Mr. Tsur on Georgia
December 21, 2022

The Georgian authorities thank staff for their dedicated and constructive engagement during the discussions on the first review of the SBA program, and a well-written report. Georgia's strong economic performance is built on prudent macroeconomic decisions and years of well-founded structural reforms. The dialogue between staff and the authorities supported the continuation of strong policies, including key structural reforms, to guarantee sustainable growth. The proven benefits of the implemented policies, the continued engagement with the IMF — currently in a precautionary setup — and the authorities' strong ownership of the program provide a strong anchor during this difficult period for the world and the global economy.

Sound short- and long-term policies contributed to the strong economic performance of Georgia

Growth in 2022 is stronger than expected, and the negative impacts of Russia's war in Ukraine do not dominate the economic development thus far. The estimated real GDP growth rate amounted to 10 percent YoY during January-October 2022, driven by a broad-based increase of activity in most sectors. This broad-based growth occurred alongside a prominent employment increase of 6.7 percent in the business sector, mainly wholesale and retail trade and the information and communication industry, since the beginning of the year. As a result, unemployment continued to decrease during 2022, with a sharp reduction from 18.1 percent in Q2 to 15.6 percent in Q3. As staff indicates in the report, while the strong demand in the economy induced larger imports, these were offset by tourism revenues and remittances, resulting in an improved current account.

The positive developments in 2022 are built on strong fundamentals owing to years of sound macroeconomic policies and a comprehensive reform agenda. Strong growth and the improved external sector position during 2022 continue the positive trend set by the prudent policies to address the COVID-19 crisis. More broadly, the government's efforts in recent years to increase the quality of education, improve the business environment, and invest in core infrastructure and information technology (IT), have contributed to growth and increased the attractiveness of Georgia for investors.

Tight fiscal and monetary policies contribute to reducing inflation and rebuilding buffers

The National Bank of Georgia (NBG) is committed to maintaining the tightening stance until inflation approaches its target. The average annual level of economic activity in 2022 is expected to exceed its potential level, and demand-driven inflationary risks are high. To keep inflation expectations firmly anchored, the NBG increased the policy rate by a cumulative 250 basis points in 2021 and 50 basis points in 2022 to 11%, keeping the real policy rate positive. As a result of the tight monetary policy and the recently implemented macroprudential instruments, credit growth has begun to slow down.

The NBG expects credit growth to slow further, especially with monetary policy tightening from the European Central Bank and the Federal Reserve. Furthermore, inflationary pressures are offset by the strengthening of the GEL exchange rate as a result of foreign exchange inflows. The above factors have moderated inflation from 11.5 percent in September, to 10.6 in October and 10.4 in November, and the NBG expects inflation to approach the target level in the second half of 2023.

Despite a declining trend, credit dollarization remains one of the main challenges for the Georgian economy. In response to related risks and to promote borrowers' creditworthiness, the NBG recalibrated certain requirements in the responsible lending regulation. This includes stricter regulation on the maximum maturity of consumer and FX mortgage loans, the payment-to-income ratio and borrower's creditworthiness for floating interest rate loans.

The fiscal deficit is shrinking, helping to restrain demand-side inflationary pressure. The fiscal rule requires bringing the deficit below 3 percent of GDP by end-2023, but thanks to the better-than-expected economic activity, the government might achieve this target already this year. In line with the authorities' commitment to the SBA, the government has been saving part of the rapidly growing revenues, leading to a projected deficit of 3.1%, after a 4% projection six months ago.

The government and the NBG took advantage of the boost in activity and inflows to rebuild buffers and bring them close to their pre-pandemic levels. Saving part of the additional revenues contributed to a faster-than-expected reduction of the debt-to-GDP ratio. After peaking at 60 percent in 2020, amid the COVID-19 crisis, debt-to-GDP reduced to 49.7 percent in 2021 and is now expected to get very close to the pre-pandemic level of 40% by the end of this year. Similarly, the NBG used the stronger-than-expected external inflows in 2022 to purchase international reserves to bring their ARA metric level very close to their pre-pandemic level (staff now projects 98.6 percent, much higher than the 79.4 percent projected at SBA approval).

Buffers have also increased in the financial sector which remains resilient. The banking sector continues to provide smooth lending to the economy. During 2022, the quality of banking sector assets, profitability, and capital and liquidity ratios improved, allowing banks to restore capital buffers before the date set by the NBG. Furthermore, last month the Financial Stability Committee of the NBG decided to revise the framework for setting a countercyclical capital buffer, following the Basel Committee recommendation.

The NBG mandates that all supervised entities comply with the sanctions of the US, EU, and UK since they were imposed in February 2022. The NBG enhanced sanctions monitoring since then and created a specialized sanctions unit under the AML Supervision Department in June 2022, in line with international standards. They require monthly reports from commercial banks and other financial institutions about customers connected to Russia, Belarus, and other risk-bearing countries.

SOE reform and energy sector development are promoted as part of the SBA commitments

The authorities continued promoting the SOE reform to minimize fiscal risks and increase the efficiency of their activity. To reach the agreement of the first review, the authorities and staff discussed the SOE reform intensively, based on IMF TA recommendations and OECD principles. The authorities met the respective structural benchmarks (prior actions for the first review) through a government decree on public corporation reform strategy that ensures a clear separation between state shareholding and policymaking functions. The decree includes plans for the implementation of the SOE reform strategy and a pilot for reforms in three major SOEs starting in the first quarter of 2023. The SOE reform is a key element of the SBA program and the government's long-term agenda.

The government sees the development of renewable energy sources as vital to ensure continuous energy security for Georgia. To avoid a gap between the growing electricity demand and local generation, the government decided to gradually increase local generation capacities. This decision is included in a government decree, which also formulates a complementary support scheme for renewable power generation. To limit fiscal risks, the government included two key principles: first, basing the renewable energy support scheme on competition and market principles, and second, passing the costs of the scheme on to the final consumers.

The authorities acknowledge the need for more reforms and are determined to promote them

The authorities agree with staff that achieving the growth potential will require further advancing structural reforms, and they reiterate their ownership of the reform agenda laid out in the precautionary SBA. The authorities will continue strengthening SOE governance, promote inclusion in the workforce, strengthen social safety nets, and more, as detailed in the staff report. The authorities emphasize their ambition to develop Georgia as a regional data exchange hub and as a reliable connectivity corridor, given its favorable geographical location, to attract large investments. To promote Georgia as a reliable connectivity corridor, the government carefully considers many infrastructure projects including improving roads. This includes cultivating the East-West Corridor with a modern highway, set to be completed in 2023. As for the potential to develop Georgia as a regional data exchange hub, the authorities are considering, among others, a submarine Black Sea cable to enhance digital and power connectivity.

Georgia's strong track record and its commitment to the precautionary SBA program is driven by the authorities' motivation to implement beneficial structural reforms. The authorities maintain close cooperation also with other partners, including the World Bank, the EBRD, the ADB, the US, and the EU. They are confident that these engagements will catalyze resources to finance some of the reforms and infrastructure projects needed for Georgia's green, digital, and inclusive future. In particular, the authorities look forward to continuing the close engagement with the Fund, which they consider the anchor for the reform momentum and confidence of the markets in Georgia's economy.