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FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATION OF A PERFORMANCE CRITERION—STAFF REPORT; AND PRESS RELEASE

In the context of the first review under the Stand-By Arrangement and request for modification of a performance criterion, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on October 28, 2014, 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 5, 2014.
- A **Press Release**

The following documents have been or will be separately released.

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

*Also included in Staff Report

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

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GEORGIA

December 5, 2014

FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATION OF A PERFORMANCE CRITERION

KEY ISSUES

Context. Macroeconomic developments have been in line with the program. Growth has recovered, led by domestic demand, with the Russia-Ukraine crisis having limited economic impact so far. Growth should reach 5 percent in 2014. Georgia and the EU started applying their Deep and Comprehensive Free Trade Area (DCFTA) agreement provisionally in September. Although some ministers left the cabinet in November, the ruling Georgian Dream government has kept its majority and has reaffirmed its commitment to Georgia's goal of increased European integration.

Outlook and Risks. Growth should remain at 5 percent in 2015. Downside risks stem from possible escalation of regional tensions and weaker recovery in the Euro area. On the upside, lower oil prices could boost growth and reduce the current account deficit.

Policies. Although this year's fiscal deficit should come in below target, the composition of spending has again shifted from capital to current and the substantial increase in government spending planned for the fourth quarter could lead to balance of payments pressures. The 3 percent of GDP deficit in the 2015 draft budget is consistent with the program objectives of preserving fiscal sustainability and supporting external adjustment. The draft budget envisages increases in pensions, teacher salaries, drug benefit coverage, and capital spending paid for by higher excises on tobacco, alcohol, and incoming international phone calls. Annual inflation rose to 3½ percent in October but remains below the National Bank of Georgia's (NBG) inflation target of 6 percent for 2014. The stability of the lari against the U.S. dollar has resulted in appreciation against key trading partners. The current account deficit has widened in 2014 as expected with the economic recovery but should decline in the medium term supported by fiscal consolidation, exchange rate flexibility, reforms to improve competitiveness, and greater trade opportunities. Reserve accumulation under the program will strengthen resilience to shocks. The NBG is committed to implementing the FSAP recommendations.

Program. The program is on track, with all September conditionality met except for the structural benchmark on preparing an access to finance study which has now been reset. SDR40 million will become available upon the completion of the review.

Approved By
Juha Kähkönen (MCD) and Athanasios Arvanitis (SPR)

A staff team comprising Mark Griffiths (head), Gösta Ljungman, Sergio Sola (all MCD), Ruo Chen (SPR), and Samah Mazraani (FAD) visited Tbilisi October 15–28, 2014. Azim Sadikov (Resident Representative) and Nia Sharashidze (IMF office) assisted the mission. The mission met with Deputy Prime Minister and Economy Minister Kvirikashvili, Finance Minister Khaduri, Education Minister Sanikidze, Regional Development and Infrastructure Minister Shavliashvili, NBG Governor Kadagidze, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. Willy Kiekens (OED) joined the discussions.

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PROGRAM PERFORMANCE

1. **Macroeconomic developments are broadly in line with the Fund-supported program (Figure 1).** Growth this year should reach the program's 5 percent, helped by the base effect from the rapid growth in end-2013 and the usual fourth quarter increase in government spending. Activity moderated in the first half of 2014 (seasonally-adjusted, GDP grew by 1 percent from January to June), but growth momentum has strengthened since then. Annual growth through June was broad based, supported by buoyant consumption, a rebound in private investment as business confidence continues to improve, and exports. Among sectors, construction, retail trade, and manufacturing contributed most to growth.

2. **Inflation has increased though remains below the central bank's 6 percent target.** With inflation still only 2–3 percent through summer, the National Bank of Georgia (NBG) has held its policy rate at 4 percent. Food prices have risen, in part due to strong Russian import demand. However, core inflation remains below 2 percent. Inflation should end the year just below 4 percent (3.5 percent year average), within the program's inner consultation band.

3. **Credit growth, especially for retail and SME loans, has strengthened domestic demand (Figure 2).** Lower lending rates and the introduction of variable-rate lari loans last year increased credit growth to 21 percent year-on-year (17 percent exchange rate adjusted), 29 percent to the retail and 16 percent to the SME sector. Corporate loans increased less, by 16 percent year-on-year. Increasing macroeconomic stability and measures promoting the use of the lari have reduced loan dollarization, though at around 60 percent this is still high. Household deposit dollarization has increased slightly but remains just below 60 percent.

4. **The current account deficit has widened as expected with the economic recovery (Figure 3).** Exports grew by 7 percent year-on-year in January-September, as lower used car exports to Azerbaijan (which has restricted imports of older cars) was offset by higher exports to the EU (metals) and Russia (wine and mineral water). However, the domestic recovery has resulted in imports (which also are much larger than exports) increasing by even more (12 percent). This has worsened the trade balance by US$400 million (around 2½ percent of GDP). The services balance continues to improve, with more high-spending tourists from Russia, Ukraine, and Eastern Europe. A small decline in remittances from Russia, which accounts for half of all transfers, has been more than offset by receipts from Greece, Italy, and Turkey.

5. **Foreign capital inflows continue to finance the current account deficit.** FDI (almost 6 percent of GDP) and official loans (2½ percent of GDP) remain the main sources of external financing. June's successful US$240 million initial public offering and listing of Georgia's second largest commercial bank (TBC) on the London Stock Exchange resulted in net inflows of around

US$100 million.[1] Following program approval in July, Moody's and Fitch upgraded the outlook on Georgia's sovereign rating to positive, citing improved economic prospects with the provisional application of the Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU from September.

6. **The Georgian lari's stability against the U.S. dollar has resulted in appreciation against trading partners (Figure 1).** Seasonal inflows (tourism) allowed the NBG to purchase US$120 million in August, offsetting sales at the start of the year. These purchases helped stem the appreciation of the lari, which stabilized at around GEL1.75 GEL/US$. However, given the strength of the dollar, the result has been an appreciation in nominal effective terms since the start of the year of close to 10 percent (much of this since July). This will likely dampen future inflation, and the appreciation of the real effective exchange rate raises concerns over competitiveness.

7. **The budget deficit in the first nine months of 2014 reached 1.1 percent of GDP, ½ percent of GDP lower than planned in the program (Figure 4).** Lower-than-anticipated personal income tax refunds, stronger than expected impact of last year's tobacco excise increases, tax administration gains, and higher VAT (due to import growth and the one-off impact of the abolition of the grace period for importers to pay import VAT) boosted revenues. Aggregate spending was slightly above plan, with a shift in composition from capital to current. Local governments spent more than anticipated on wages, good and services, and subsidies, in part because of the summer local elections.

8. **Program performance has been on track, with all applicable performance criteria (PC) and the indicative target (IT) met.** The fiscal deficit target was met by a large margin. The NIR target was met after the NBG purchased foreign exchange in August, while the NDA target was met comfortably as the reserve money impact of these foreign exchange purchases was offset by lower central bank refinancing. The government did not accumulate any external arrears, and the Partnership Fund did not run a cash deficit. Inflation was well within the program's end-September inner consultation band. However, to include input from the World Bank and KfW, and the FSAP findings, preparation of the study of possible obstacles to access to finance will need more time. The end-September benchmark has been reset to December 2015.

OUTLOOK AND RISKS

9. **Growth in 2015 is projected to remain at 5 percent.** The authorities believe growth could reach 6 percent (which they view as potential), because of improved political stability (the first election-free year since 2011) and application of the DCFTA. With a domestic component of roughly 20 percent, expansion of the South Caucasus gas pipeline should also boost demand by

[1] The transaction caused a US$110 million drop in the FDI statistics, as some of the main foreign shareholders sold to portfolio (mainly institutional) investors.

around US$400 million (2.5 percent of GDP), spread over four years. However, because growth has been marked down in the EU and the CIS and downside risks are high, the authorities agreed with staff to base the program and the 2015 budget on 5 percent growth.

10. After increasing this year, from 2015 the current account deficit is projected to decline. Temporary factors (the cyclical drop in imports) that resulted in a sharp narrowing of the current account deficit in 2013 have reversed, and the current account deficit should widen this year to 8½ percent of GDP. The deficit is then projected to decline gradually under the program baseline (to 8 percent of GDP in 2015 and 5 percent of GDP by 2019) due to fiscal consolidation, gradual depreciation of the lari, reforms to improve competitiveness, and opportunities provided by the DCFTA. If FDI were to take off (for example in response to DCFTA), then current account adjustment might be delayed. Conversely, the recent drop in projected oil prices from US$100 to US$85 per barrel, if sustained, should reduce the current account deficit by around 0.7 percent of GDP (first-round effect) relative to the baseline.

11. Potential external shocks and regional tensions create downside risks (Annex I: Risk Assessment Matrix). Georgia's high current account deficit and external debt create large gross external financing needs. While funding has been stable, regional tensions or monetary policy normalization in advanced countries could put this at risk. Exports and remittances could suffer if the Russia-Ukraine crisis leads to a protracted slowdown of their economies and further currency weakening, or if Euro area growth remains low. External financing shortfalls could lead to lari depreciation, which might undermine stability given high loan dollarization and foreign currency denominated external debt. On the domestic side, there are risks that the 2016 parliamentary elections, though seemingly far away, could make politicians less ambitious in implementing economic reform.

12. Despite these downside risks, there are also opportunities for stronger economic performance. Georgia's business environment is attractive, by both world and regional standards, and the EU DCFTA creates new investment opportunities. The free trade agreement with Russia remains in place despite earlier signs that Russia might review this. Success in making the democratic transition might also prove attractive to foreign investors. Lower oil prices should help reduce the current account deficit and inflation, and boost growth.

POLICY DISCUSSIONS

A. Fiscal Policy

13. This year's budget deficit should fall slightly below the program's 3.7 percent of GDP target. Performance this year suggests that revenue could exceed program projections by GEL 70 million (0.2 percent of GDP). In contrast, overall spending levels should remain broadly as planned, but the composition will likely change. Local government spending will be around GEL 120 million higher. The authorities argued that this reflects one-off factors (June local elections), but there are also permanent factors such as increased pre-school spending. In addition, net lending will be around GEL 40 million above projection. Offsetting this, current spending by central governments will be around GEL 45 million lower, reflecting more stringent regulations on bonuses, a later-than-expected shift to universal healthcare for all beneficiaries, and lower interest payments. In addition, although having increased in recent months, capital spending will likely fall short of budget by about GEL 110 million (7 percent of the capital budget, 0.3 percent of GDP), mostly in donor-financed projects. The combined effect of higher revenues and unchanged overall spending should be to keep the deficit to around 3.5 percent of GDP, below the program target.

14. Increased government spending in the fourth quarter might, like last year, put pressure on the lari. Although following a smoother path than in 2013, the budget deficit in the fourth quarter alone is still projected to be 2½ percent of GDP. This stimulus could lead to balance of payments pressures similar to those experienced in late 2013. Against this, the government believed that since the fourth quarter deficit would be less than last year and financed largely by donor disbursements, the balance of payments impact should be less. However, staff cautioned that the program's end-December reserve target left little room for intervention to defend the lari. Consistent with the floating exchange rate, there had also been fewer foreign exchange purchases this summer than last, and the lari had appreciated instead.

15. Staff encouraged the authorities to develop contingency plans in case the resulting balance of payments pressures were to prove excessive. Aside from the program commitment to make sure the deficit path does not destabilize the economy, these could include improved communications both within the authorities and with the public. However, to the extent that markets are forward looking and had already factored in the likely impact of a higher deficit in the fourth quarter (during the summer, deposit dollarization had increased, perhaps in anticipation of this), there was also the possibility that exchange rate pressures might be less or might not even materialize at all in the fourth quarter.

16. For 2015, the government's budget targets a 3 percent of GDP deficit, consistent with the program (LOI ¶14). The draft budget submitted to Parliament on November 5 provides for: (i) a small increase in old-age pensions (from GEL 150 to GEL 160 per month), from October 2015; (ii) a modest expansion of drug coverage for some of the socially vulnerable under universal healthcare; (iii) an increase in the base salary for all teachers from GEL 350 to GEL 400 per month and a higher increase of up to GEL 200 per month for qualified teachers (both from September 2015); and (iv) increased public investment. Spending on wages and subsidies will either remain flat or see a minor increase, and decline as a share of GDP. To pay for these spending initiatives while keeping the deficit to 3 percent of GDP, the budget raises cigarette and alcohol excises, and introduces an excise on incoming international phone calls.[2] These revenue measures should yield GEL 140 million (0.5 percent of GDP).

[2] Staff cautioned the authorities that the phone excise might lead to lower than expected revenues, to the extent that international calls were price elastic. Staff instead recommended increasing excises on diesel and other fuels to raise revenues. These would also correct for negative externalities.

17. The mission encouraged the authorities to use their spending increases to encourage economic reform and to reduce poverty:

- **The mission argued against ad hoc and discretionary pensions increases (which might be sensitive to the political calendar), and recommended some form of indexation instead.** Staff acknowledged that even after the proposed increase, pensions would be very low: less than US$100 per month though in line with the minimum subsistence level. They are really a form of social assistance. Better targeting of the most vulnerable pensioners would have allowed for a larger increase and more effective poverty reduction. The authorities recognize that pension reform and higher domestic saving (including higher contributions) will be needed to pay for higher future pensions. But this would not help existing pensioners.

- **The mission encouraged the authorities to use education spending increases to raise educational quality**. Georgia scores poorly in international comparisons of educational attainment, and this is an impediment to growth. In part, the low scores are explained by low levels of public spending on education (2.9 percent of GDP compared to 4.7 percent of GDP in Central and Eastern Europe, and 4.1 percent in the CIS), and very low base teacher salaries (only GEL 350 per month (US$200)). So education spending needs to increase, but in a way which rewards the best qualified teachers and which addresses the problem of low student-teacher ratios.

18. The authorities are considering ways to improve targeting of social assistance. Under the current system, anyone scoring (even marginally) above the eligibility cutoff loses all benefits. Staff expressed concern that this cutoff creates substantial work disincentives and encourages evasion. The government plans to remedy this by introducing a cascading benefit system (working with the World Bank), where benefits would be more gradually phased out. It hoped that this would be introduced in 2015.

19. The authorities are abolishing the tax-free threshold for personal income tax which they introduced in 2013. No refunds will be paid in 2016 on income earned in 2015. Abolition will generate annual savings of about 0.5 percent of GDP from 2016, which would pay for the full year effect of pension and teacher salary increases to be introduced in late 2015. The authorities accept that this is a regressive measure, but pointed to potential problems of evasion and the disincentives caused by those earning above GEL 500 per month not being eligible for this allowance. They noted that substantial increases in targeted social assistance and introduction of universal health care would help the poor.

20. The authorities intend to improve budget execution:

- **Control of local government spending needs to be improved**. Although local governments cannot borrow without Finance Ministry approval, they can spend more if revenues are higher, and by drawing down deposits (about GEL 240 million (0.8 percent of GDP) at end-2013).

For 2014, local governments are projected to run a 0.2 percent of GDP deficit, compared to balance assumed in the program. Stressing the benefits from decentralization, the authorities argued that monitoring of local governments' liquidity and expenditure classification would improve starting in 2015 as budgets of all central and local units would be administered by the Treasury.

- **Capital budget execution has faced project design and procurement delays**. However, discussions with the new Minister of Infrastructure and Regional Development and his team revealed a strong commitment to ensure this is not repeated in 2015.

21. Debt sustainability analysis remains materially the same as when the program was launched. Macroeconomic shocks do not jeopardize the sustainability of either public debt or external debt (Annex I). However, both public and external debt are vulnerable to exchange rate depreciation due to large shares of foreign currency denominated debt. A hypothetical 30 percent depreciation would increase the stock of public debt by 5 percent of GDP (peaking at 38 percent of GDP) and the stock of external debt by 30 percent of GDP (to peak at 94 percent of GDP).

B. Monetary and Exchange Rate Policy

22. With inflation below the target, policy rates have been kept relatively low. However, the NBG's technical staff was concerned that stronger domestic demand, higher food prices, and higher partner country inflation might cause the 5 percent target to be exceeded, and that higher policy rates might be needed soon. In contrast, staff noted the recent appreciation of the nominal effective exchange rate, which should lower inflation. Although higher food prices might pose a risk, the recent drop in commodity prices should lower inflation, and it was not clear that monetary policy should respond to supply shocks. In response, the NBG stressed that the model results formed only one input in its decision-making process. Given the uncertain environment, including the risks to demand in partner countries, the NBG agreed it would be premature to raise rates unless there was convincing evidence of a threat to the inflation target.

23. The authorities stressed their commitment to central bank independence, and the NBG continues to enhance its monetary policy framework (LOI ¶15). Policies to encourage lari floating-rate loans as well as the government's scheme to place treasury bills in banks and to hold long-term bank deposits have promoted dedollarization. This should help strengthen the transmission mechanism. In light of its success in reducing inflation, the NBG has lowered its inflation target for 2017 to 4 percent, from 5 percent in 2015 and 2016 and 6 percent in 2014.

24. To support its inflation targeting regime, staff encouraged the NBG to enhance its communication strategy (LOI ¶17). This could help influence inflation expectations and, by being required to explain monetary policy and inflation outturns, can form part of the "constrained discretion" needed for successful inflation targeting. Steps include issuing the existing quarterly inflation report without delay on a fixed pre-announced publication schedule. In addition to existing regular meetings with market participants following its Monetary Policy Committee (MPC) meetings, the NBG agreed to start holding regular press conferences after every other MPC meeting, starting from early 2015.

25. The NBG will continue to accumulate foreign reserves to protect against external vulnerabilities (LOI ¶10). Consistent with this goal, it is proposed that the end-December 2014 NIR performance criterion be modified for a modest increase of US$35 million (and the NDA indicative target lowered). Gross international reserves would then increase to US$3.1 billion (about 3.3 months of projected 2016 imports) by end-2015. This would require about US$320 million foreign exchange purchases through the year. Staff again encouraged the NBG to accumulate these through a system of pre-announced auctions. This avoids the dilemma of whether and how much foreign exchange to buy. Citing uncertainty around the timing of inflows, the NBG thought this step was premature, but agreed to discuss the issue during the next review. Instead it plans to conduct purchases around the time of strong inflows.

26. The authorities reiterated their commitment to floating exchange rates. Although the lari has again become relatively stable against the dollar, this reflects market forces since the NBG has not intervened. The authorities questioned the efficacy of the exchange rate channel in securing external adjustment. They argued that exports were largely supply driven: Georgia's export prices were determined (in dollars) in world markets; for key export items investments were already made and Georgia was able to sell all of its export output. They stressed that sustained reduction in the current account deficit could be achieved only through structural reforms that generate growth and improve competitiveness. Staff agreed on the importance of structural reforms but argued that a more competitive lari would help producers compete with imports, and the resulting higher domestic profitability might also encourage production of new export goods.

C. Financial Sector

27. Stress tests in the FSAP show the banking sector is relatively resilient, though needs to strengthen capital and liquidity buffers. Banks maintain sufficient capital to withstand shocks, although there are some weaknesses among small banks. The reported asset-to-equity ratio is strong at around 6 and the capital adequacy ratio is 18 percent (26 percent according to Basel definition). At 40 percent on average for the system, liquidity remains well above the minimum 30 percent requirement. NPLs are low at 3.6 percent (standard 90-day measure), although the NBG's more conservative approach puts them at 8.6 percent.

28. However, the recent FSAP identified vulnerabilities facing the banking sector (LOI ¶18). With almost 60 percent of loans in foreign currency, including to unhedged borrowers, banks are exposed to significant currency-induced credit risk. More than one third of their balance sheet is funded externally, making them susceptible to volatility in international markets. About half of all loans are collateralized by real estate (although prices remain below their pre-2008 crisis peaks and so there are no signs of overheating). The loan-deposit ratio has declined but remains above 100 percent.

29. The banking sector's resilience should help mitigate against recent risks. Credit growth has accelerated, in response to lower interest rates and the NBG's efforts to promote domestic currency lending, raising the estimated credit-to-GDP gap 2 percent above its long-term trend. This rapid credit growth has limited the increase in the NPL ratio (standard definition), even though NPLs themselves are growing. Recent retail loan growth includes riskier products such as consumer loans, credit cards, and installment credits.

30. The authorities are incorporating FSAP recommendations to strengthen financial stability and supervision (LOI ¶19). Although the NBG has put in place a forward-looking comprehensive supervisory and regulatory approach, weaknesses remain, especially in crisis preparedness and management and safety nets. To address these risks, the NBG and MOF have signed a memorandum of understanding to improve financial sector management and information sharing, which should help with crisis management. They are also submitting legal amendments to improve regulation and supervision; developing guidelines for concentration risk (as part of Basel III); and taking steps to improve training and retention of staff.

D. Structural Reform

31. The authorities have agreed to conduct a thorough study of access to finance before taking any decision on establishing a development finance institution. Despite rapid SME loan growth, the government believes that SMEs continue to face difficulties accessing finance and has thus initiated a study of the credit market. Recognizing the problem's complexity and after consulting development partners, the government decided to undertake a deeper and more extensive analysis, seeking inputs from the World Bank and KfW (revised structural benchmark, December 2015). The study will assess the extent of the access to finance constraint, analyze market imperfections behind it, and propose solutions, including whether a development finance institution is the best means and if its benefits outweigh potential costs. The study will also consider the question of what to do with the many government funds that already exist, and scope for consolidating them. The government's decision on a development finance institution will be based on the findings of this study, and after consultations with the Fund and other partners.

32. The authorities continue to advance a wide range of structural reforms:

- **Tax administration reform, supported by Fund technical assistance (LOI ¶26).** Measures include: abolition of the so-called Alternative Audit program by end-April 2015; legal amendments making clear when revenue service auditors can access third party information; establishing a new unit to manage the stock of arrears; legal amendments facilitating the write-off of arrears; and introducing single taxpayer accounts (which should avoid a build-up of excess tax credits).

- **Inclusion of a fiscal risk statement in the 2015 budget (LOI ¶25).**

- **Creation of working groups on capital market reform** (in line with FSAP recommendations) and pension reform (with the help of the World Bank and ADB).

- **The authorities will develop an action plan with timetable for introducing deposit insurance (structural benchmark, December 2015) (LOI ¶18).** Under the EU Association Agreement the authorities have committed to introducing deposit insurance by 2020. In light of the FSAP recommendations, the mission encouraged the authorities to bring forward the introduction, and hoped that the action plan would facilitate this.

- **Improved quality and coverage of national statistics.** November 2014 sees the first census conducted since 2002. Draft amendments to the Law on Statistics which—among other things—make reporting to GEOSTAT compulsory will be submitted shortly. Quarterly unemployment data should be published starting in 2017 (LOI ¶24).

PROGRAM MODALITIES

33. The program has helped catalyze official financing and is fully financed. The World Bank recently approved a policy loan of US$92 million, a new US$75 million ADB policy loan is under preparation, and the EU is expected to disburse the first tranche (€26 million) of its Macro-Financial Assistance program this year. The program is fully financed through the next 12 months, with good prospects for adequate financing thereafter.

34. Georgia's capacity to repay the Fund remains strong. Despite the purchases under the program, Georgia is making net repayments to the Fund in 2014, with outstanding credit expected to fall to about 97 percent of quota by end-2014.

Box 1. Risk Assessment Matrix

Nature/source of risk	Likelihood of realization in the next three years[1]	Expected impact on the economy if risk is realized
Global Shocks		
Side-effects from global financial conditions: • **An abrupt surge in global financial market volatility**, as investors reassess underlying risk. • **Financial imbalances from protracted period of low interest rates continue to build:** excess leverage, especially for corporates; asset price bubbles; delays in fiscal and structural reforms	**Staff assessment:** **High** **Medium**	**Staff assessment: Medium** Market volatility and increases in long-term rates could lead to a reversal in bank flows as a result of advanced countries exiting from UMP. As the current account deficit continues to be high, such a reversal would put pressure on the external account.
Geopolitical fragmentation that erodes the globalization process and fosters inefficiency: • **Russia/Ukraine**: sustained tensions depress business confidence and heighten risk aversion, amid disturbances in global financial, trade and commodity markets. • **Heightened risk of fragmentation/state failure in the Middle East,** leading to a sharp rise in oil prices, with negative spillovers to the global economy.	**Staff assessment:** **Medium** **Medium**	**Staff assessment: Medium** So far the reaction of markets has been subdued. However, an increase of political tensions could have adverse effects on international trade and capital flows. The main economic channels of contagion for Georgia would come from trade linkages with Russia and Ukraine and remittances from Russia. Uncertainty over relations with Russia could hurt business confidence and deter investment.
Protracted period of slower growth in advanced and emerging economies: • **Advanced economies:** Lower-than-anticipated potential growth and persistently low inflation due to a failure to fully address legacies of the financial crisis, leading to secular stagnation. • **Emerging markets:** Maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth.	**Staff assessment:** **High** **High**	**Staff assessment: High** A long period of slow growth in the world economy (and particularly in Georgia's main trading partners) would hurt exports and GDP growth.
Country Specific Risks		
Depreciation pressures: External financing shortfalls and fiscal expansion in 2014Q4 could put pressure on the Lari.	**Staff assessment:** **Medium**	**Staff assessment: Medium** Sharp depreciation – fuelled by speculative pressures – could generate balance sheet effects for un-hedged borrowers. Effective communication from the Government and the NBG would be crucial to avoid deposits' withdraws.
Policy response will depend on the type and the strength of the shock but most likely would involve exchange rate flexibility, acceleration of structural reforms. Scope for additional fiscal stimulus is limited given the 2014 deficit; the government needs to demonstrate its ability to build sufficient fiscal buffers during tranquil times.		

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed 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.

STAFF APPRAISAL

35. Georgia's Fund-supported program remains on track. Its strategy of fiscal consolidation, inflation targeting with central bank independence, reserve accumulation, external adjustment supported by exchange rate flexibility, and improved competitiveness remains appropriate.

36. Macroeconomic performance has been broadly in line with the program. The economy has recovered from the 2013 slowdown due to improved investor sentiment and accommodative policies. The Russia-Ukraine crisis' economic impact has so far been contained given Georgia's limited (but growing) trade links with Russia and increasing remittances from Southern Europe. Growth momentum should strengthen going into 2015, supported by the usual fourth quarter increase in government spending. However, to sustain this growth, the authorities need to implement ambitious structural reforms.

37. Risks remain tilted to the downside. Escalation of regional tensions or further disappointment over the Euro area recovery could weigh on foreign investment and trade. While policy making continues to improve, and there are opportunities for reform, implementation could falter as political parties start positioning for the 2016 general elections. On the upside, the recent decline in oil prices, if sustained, should translate into higher growth and a lower current account deficit. The EU DCFTA also provides export and investment opportunities.

38. Fiscal policy implementation improved in 2014 but weaknesses remain. The path of aggregate spending has been smoother this year than in 2013, but mainly due to higher-than-planned current spending by local governments. The Ministry of Finance should strengthen the monitoring of local government spending to preserve budget discipline. The projected increase in spending in the fourth quarter could lead to balance of payments pressures. To avoid a repeat of last year's volatility, the government should be ready to undershoot the deficit, by holding spending back. The underexecution of the capital budget for a second year in succession points to the need to strengthen project prioritization, preparation, and procurement.

39. The 3 percent of GDP deficit in the 2015 draft budget confirms the government's commitment to the program's fiscal strategy. The deficit target is consistent with preserving fiscal sustainability and supporting external adjustment. However, changes in the composition of measures might have been considered. An increase in fuel excises or introduction of a recurring vehicle circulation tax would have corrected negative externalities and would seem more desirable on economic grounds to the excise on incoming international phone calls, which adds to the cost of doing business. Staff supports higher education spending, but it should be accompanied by reforms to improve the quality of education. The reforms should be carefully costed and reflected in the medium-term fiscal framework. The government should consider introducing rule-based regular pension increases to prevent large ad-hoc increases in pre-election years.

40. Medium-term fiscal consolidation needs to protect the socially vulnerable. Abolishing the tax-free threshold for personal income tax will disproportionately affect low-income households. It will be important that the targeted social assistance scheme and universal health care provide sufficient compensation. The Economic Liberty Act restricts increases in general state taxes, but the government should consider more equitable revenue measures that are allowed, such as increasing and widening the base of property taxes, including moveable assets and streamlining tax benefits to free industrial zones.

41. The monetary stance is appropriate and tightening would be premature. Although inflation has increased recently, the lari's appreciation and the fall in commodity prices are likely to keep inflation low. The NBG should continue to monitor developments and inflation expectations carefully and adjust monetary policy as needed. Staff welcomes the NBG's commitment to publish quarterly inflation reports according to a fixed schedule and to hold regular press conferences from 2015. To achieve these objectives, it will be important to further enhance cooperation between the NBG and the government and to continue to respect the independence of the NBG.

42. The program helps strengthen the economy's resilience to external shocks. Given Georgia's vulnerabilities and heightened external risks, the NBG should continue to accumulate foreign reserves in line with the program targets. The NBG should limit intervention if the lari comes under pressure in the fourth quarter, allowing it to float in line with market forces and reverse some of its appreciation earlier this year. Staff encourages the NBG to pre-announce part of its programmed foreign currency purchases in 2015 and to conduct smaller interventions in-between to prevent excess exchange rate volatility.

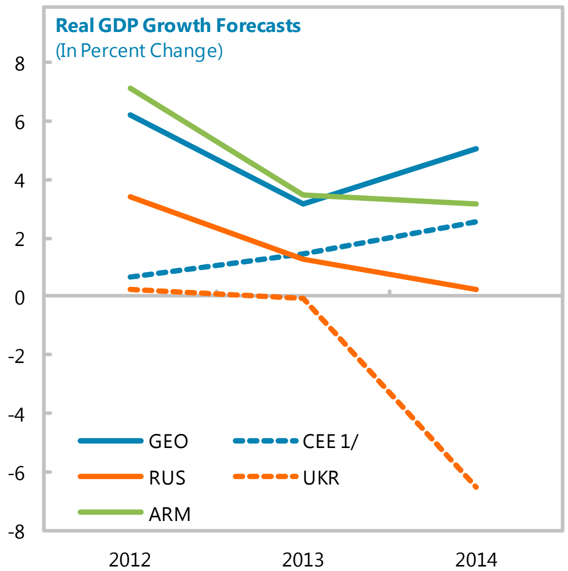
43. Staff welcomes the NBG's intention to implement the FSAP recommendations. The NBG should continue strengthening its forward-looking risk-based supervision, and to monitor carefully the recent increase in credit growth.

44. Staff supports the government's decision to wait for the findings of the access to finance study before taking any decision on creating a development finance institution. This will ensure a comprehensive approach to overcoming constraints to finance, especially among SMEs. The authorities should address credit market imperfections by easing collateral constraints, facilitating enterprise restructuring, strengthening the exit regime, improving disclosure and reporting, and deepening capital markets. If the authorities determine—based on the study and consultations with development partners—that a development finance institution could improve access to finance, it will be important that this institution does not distort the markets, operates in a fiscally responsible and sustainable manner, and practices good transparency and governance.

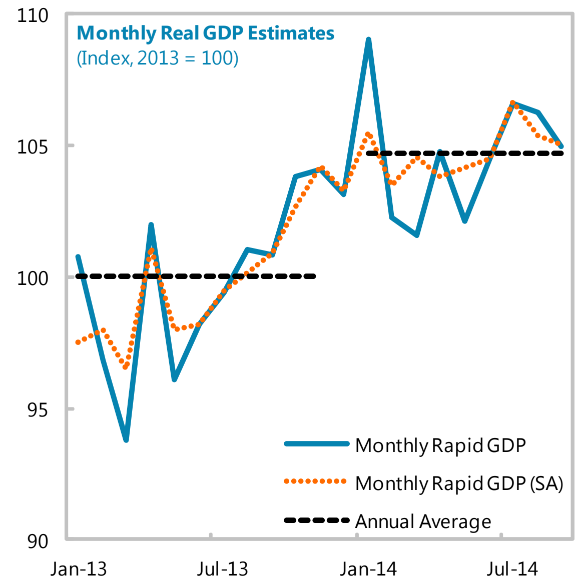
45. Staff recommends the completion of the First Review under the program. The authorities have met the performance criteria and demonstrated a strong commitment to program implementation, as seen in the draft 2015 budget which targets a 3 percent of GDP deficit, the decision to take a more considered approach to problems of access to finance, and openness to new structural reforms, which is worthy of continued international support. Staff supports the modification of the end-December 2014 performance criterion on NIR, and recommends the establishment of new end-June 2015 and end-December 2015 performance criteria, and the ceilings and floors of the inflation outer bands for 2015, as set out in the Letter of Intent.

Figure 1. Georgia: Macroeconomic Developments

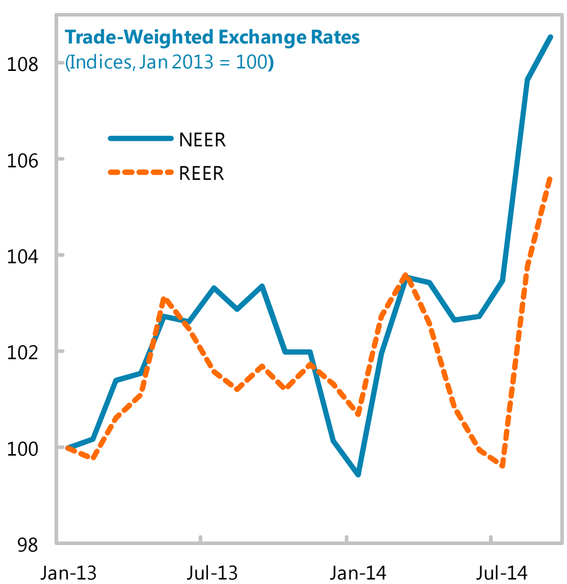
Despite slow growth in the region …



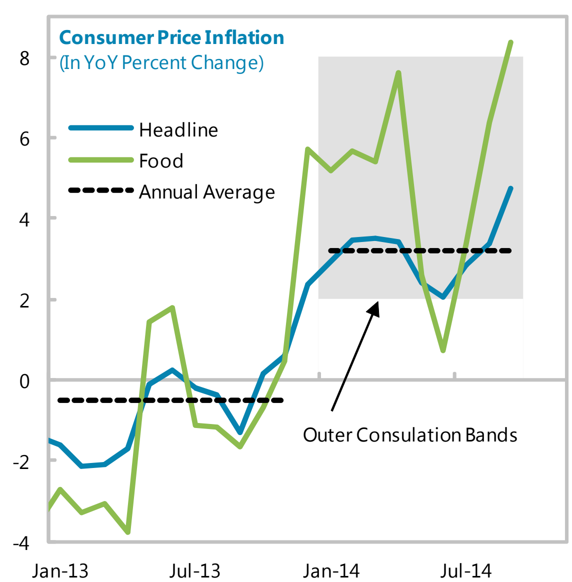
… Georgia's target growth rate of 5 percent is well within reach.



While imported inflation will remain low due to appreciation relative to trading partners …



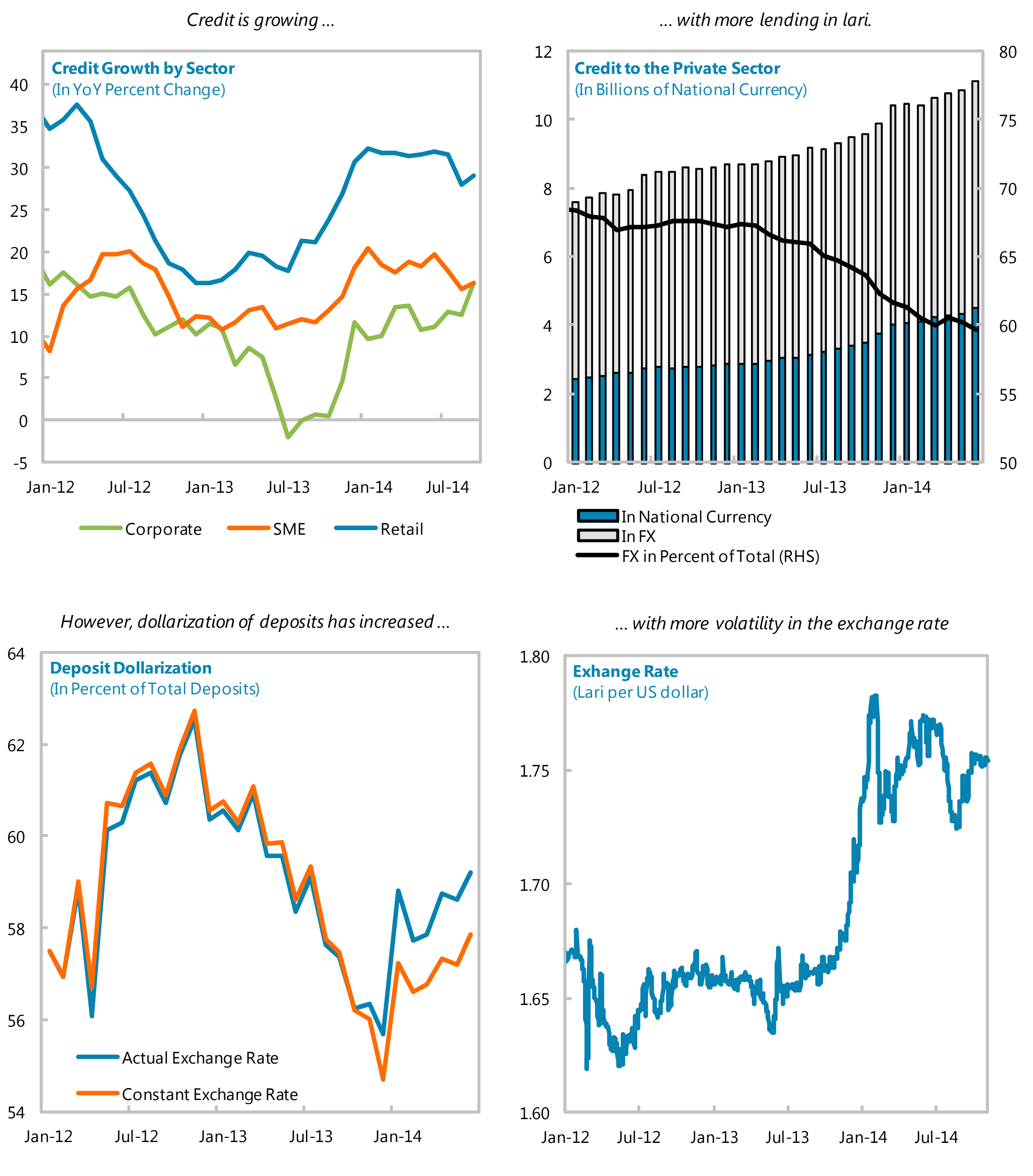
… inflation, driven by food prices, will remain within the program's consulation bands.



Source: National authorities; and IMF staff estimates.

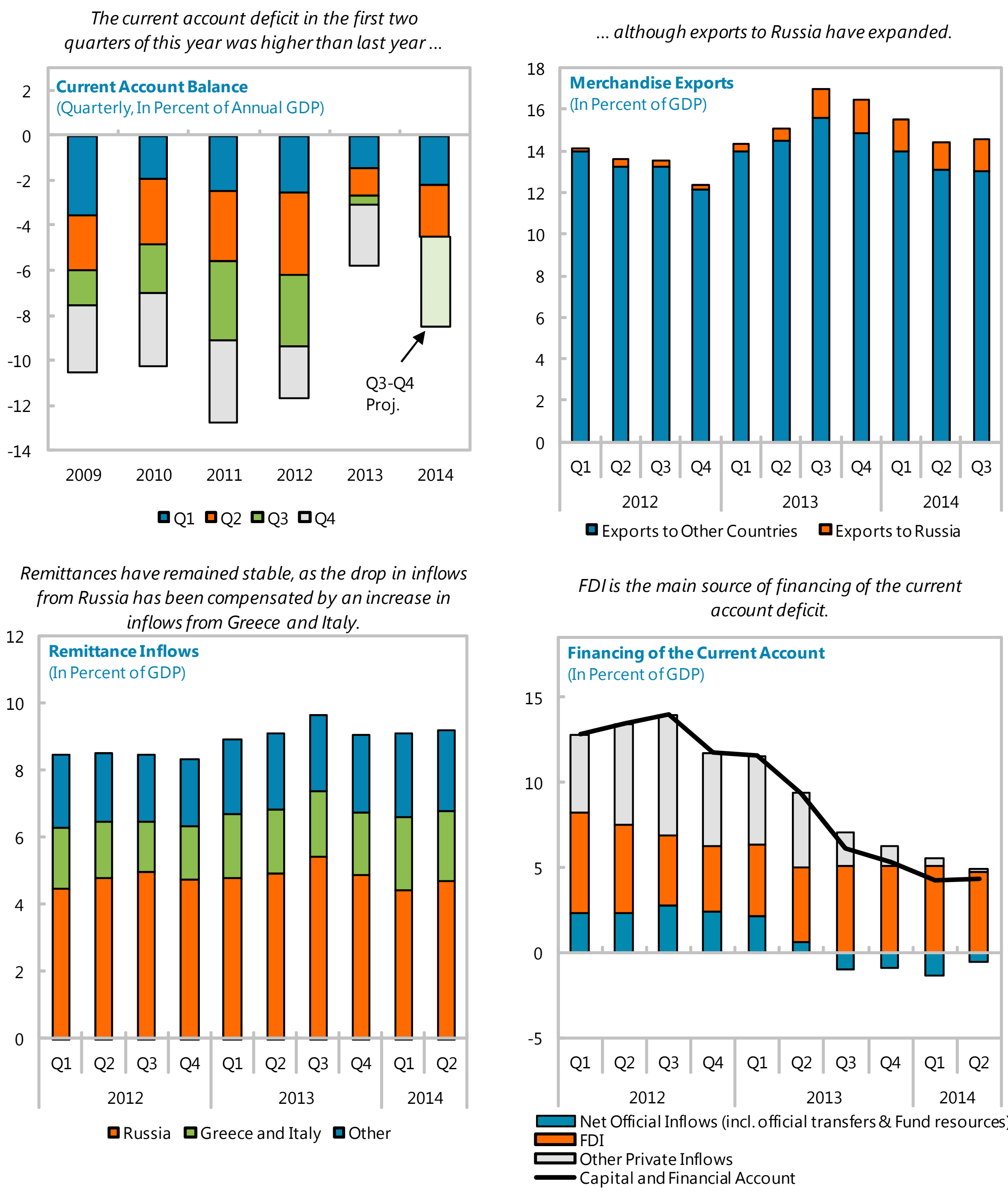
1/ Includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovak Republic, and Slovenia.

Figure 2. Georgia: Monetary Developments



Source: National authorities; and IMF staff calculations.

Figure 3. Georgia: External Sector



Source: National authorities; and IMF staff estimates.

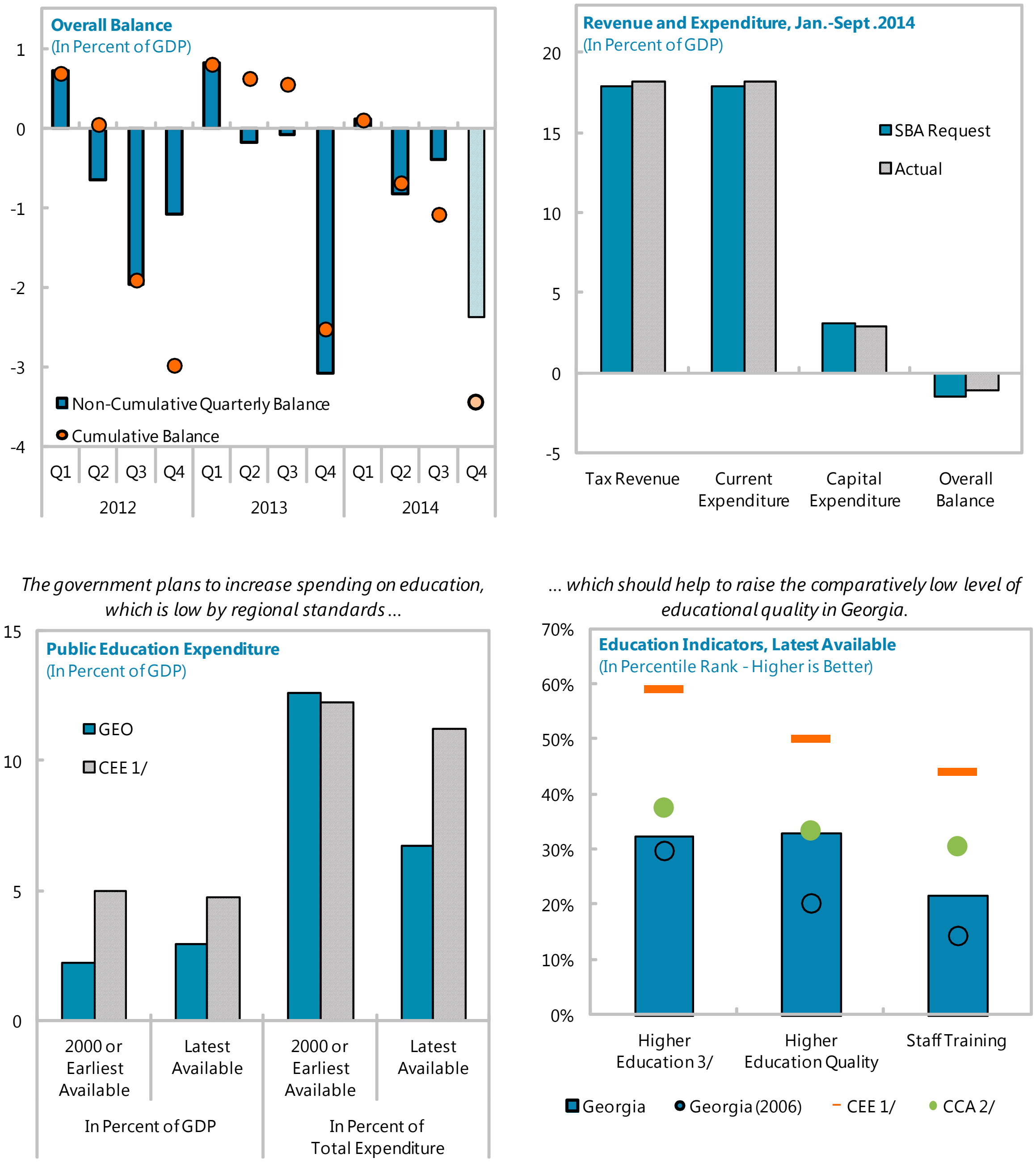
Figure 4. Georgia: Public Finance Developments

The spending pattern has been smoother this year and the deficit is on track to reach 3.5 percent of GDP.

Revenues were higher and the deficit was lower than anticipated in the first 9 months of 2014.

The government plans to increase spending on education, which is low by regional standards…

… which should help to raise the comparatively low level of educational quality in Georgia.



Source: National authorities; World Bank World Development Indicators; World Economic Forum Global Competitiveness Report; and IMF staff estimates.

1/ Includes available data for Albania, Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Serbia, Slovak Republic, and Slovenia.
2/ Includes Armenia, Azerbaijan, Georgia, Kazakhstan, and Kyrgyz Republic.
3/ Higher Education is an index measuring both the quality and quantity of higher education in each country.

Table 1. Georgia: Macroeconomic Framework, 2013–19

	Actual	SBA	Projections					
	2013	2014	2014	2015	2016	2017	2018	2019
National accounts	(annual percentage change; unless otherwise indicated)							
Real GDP	3.3	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Nominal GDP (in billion of laris)	26.8	29.2	29.2	31.9	35.2	38.4	42.0	45.8
Nominal GDP (in billion of U.S. dollars)	16.1	16.1	16.7	17.9	19.4	21.3	23.3	25.5
GDP per capita (in thousand of U.S. dollars)	3.7	3.6	3.9	4.2	4.5	5.0	5.5	6.0
GDP deflator, period average	-0.7	3.5	3.8	4.0	5.0	4.0	4.0	4.0
Investment and saving								
Gross national saving	19.0	17.2	16.7	17.7	18.0	18.0	17.8	18.2
Investment	24.8	25.5	25.2	25.6	25.0	24.4	23.8	23.2
Public	5.1	5.7	5.3	5.8	6.1	6.2	6.3	6.5
Private	19.7	19.8	19.9	19.7	18.9	18.2	17.5	16.8
Inflation	(in percent)							
Period average	-0.5	4.6	3.5	4.0	5.0	4.5	4.0	4.0
End-of-period	2.4	5.0	3.8	5.0	5.0	4.0	4.0	4.0
Consolidated government operations	(in percent of GDP)							
Revenue 1/	27.5	27.1	27.3	27.5	27.8	27.6	27.5	27.3
o.w. Tax revenue	24.7	24.7	25.0	25.2	25.7	25.6	25.5	25.5
Expenditures	30.1	30.8	30.8	30.5	30.5	30.1	30.0	29.8
Current expenditures	24.3	24.8	25.0	24.2	24.0	23.6	23.3	23.0
Capital spending and net lending	5.9	6.0	5.7	6.3	6.5	6.6	6.7	6.8
Overall balance	-2.6	-3.7	-3.5	-3.0	-2.7	-2.5	-2.5	-2.5
Government debt 2/	32.2	33.9	32.7	33.0	32.7	32.0	31.2	30.3
Of which: foreign-currency denominated	28.2	27.6	28.5	28.6	28.5	27.7	26.7	25.4
Money and credit	(annual percentage change; unless otherwise indicated)							
Credit to the private sector	19.5	21.6	16.2	21.4	16.9	14.7	15.2	14.3
Credit to the private sector (constant exchange rate from 12 month prior)	16.1	18.7	15.3	19.8	14.9	13.0	13.8	13.3
Broad money, incl. fx deposits	24.4	21.5	15.9	24.6	19.4	17.9	14.5	15.4
Broad money, incl. fx deposits (constant exchange rate from 12 month prior)	21.8	19.2	15.3	23.2	19.2	18.1	14.6	15.5
Deposit dollarization (in percent)	62.1	63.6	62.9	61.4	58.4	57.0	55.8	54.6
External sector	(in percent of GDP; unless otherwise indicated)							
Gross international reserves (in billions of US$)	2.8	2.7	2.8	3.1	3.7	4.6	5.3	6.0
In months of next year's imports of goods and services	3.4	3.0	3.1	3.3	3.7	4.3	4.6	4.9
In percent of broad money and non-resident deposits	42.5	35.5	36.5	33.8	35.0	37.1	37.3	37.1
Current account balance (in billions of US$)	-0.9	-1.3	-1.4	-1.4	-1.4	-1.4	-1.4	-1.3
In percent of GDP	-5.7	-8.4	-8.5	-7.9	-7.0	-6.4	-6.0	-5.0
Trade balance	-21.6	-25.1	-23.9	-23.5	-22.5	-21.7	-21.0	-20.2
Foreign direct investment (inflows)	5.8	6.4	5.8	6.9	6.7	6.5	6.2	6.0
Gross external debt	81.8	84.2	82.3	81.0	79.8	77.6	75.6	73.3
Gross external debt, excl. intercompany loans	65.4	64.0	65.0	63.3	62.0	59.8	57.9	55.7
Exchange rates								
Laris per U.S. dollar (period average) 3/	1.66	1.75	1.75	…	…	…	…	…
Laris per euro (period average) 3/	2.21	2.40	2.22	…	…	…	…	…
REER (period average; CPI based, 2005=100)	107.7	…	…	…	…	…	…	…

Sources: Georgian authorities; and IMF staff estimates.

1/ Includes grants.

2/ Includes Government's debt and obligations to the Fund

3/ The 2014 value of the Lari/Dollar and the Lari/Euro exchange rate for 2014 is based on the value as of October 24th 2014.

Table 2. Georgia: General Government Operations, 2013–19

	Act.	SBA Request	Proj.					
	2013	2014	2014	2015	2016	2017	2018	2019
Revenues	7,386	7,909	7,982	8,770	9,771	10,622	11,521	12,499
Taxes	6,642	7,224	7,299	8,030	9,030	9,852	10,722	11,669
Direct taxes	3,000	3,046	3,097	3,400	3,900	4,244	4,614	5,016
Taxes on income	1,934	1,994	2,050	2,242	2,622	2,863	3,125	3,411
Taxes on profits	807	795	790	900	1,012	1,110	1,212	1,323
Other Taxes (incl. property)	259	257	257	258	266	271	276	282
Indirect taxes	3,642	4,178	4,202	4,630	5,130	5,608	6,108	6,653
VAT	2,831	3,308	3,310	3,567	3,986	4,376	4,777	5,214
Excises	722	767	789	948	1,017	1,096	1,184	1,282
Custom duties	89	103	103	115	128	136	146	157
Other revenues	536	510	517	530	560	590	620	650
Grants	208	175	166	210	181	180	180	179
Expenditures	8,087	8,989	8,994	9,740	10,722	11,585	12,572	13,645
Current expenditures	6,515	7,237	7,314	7,725	8,442	9,064	9,775	10,540
Compensation of employees	1,395	1,498	1,523	1,610	1,736	1,858	2,006	2,167
Use of goods and services	1,011	1,079	1,109	1,200	1,313	1,415	1,521	1,635
Subsidies and grants	562	558	617	597	648	694	740	789
Social expenses	2,295	2,811	2,793	2,923	3,222	3,463	3,740	4,040
Other expenses	1,014	981	979	1,055	1,143	1,219	1,308	1,397
Interest	238	310	293	340	380	415	459	513
Capital spending and net lending	1,572	1,753	1,681	2,015	2,280	2,520	2,797	3,105
Capital	1,361	1,657	1,547	1,865	2,130	2,370	2,647	2,955
Net lending	211	96	134	150	150	150	150	150
Overall balance	-700	-1,080	-1,012	-970	-951	-962	-1,050	-1,146
Financing	700	1,080	1,012	970	951	962	1,050	1,146
Domestic	419	455	439	248	112	241	519	716
Net T-bill issuance	150	600	574	400	400	400	600	700
Amortization 1/	-50	-48	-52	-60	-55	-57	-59	-61
Use of deposits	320	-97	-83	-92	-233	-102	-22	78
External	155	525	462	612	769	651	481	380
Borrowing	586	1,078	965	959	978	921	924	893
Amortization	-430	-554	-504	-346	-209	-270	-443	-513
Privatization receipts	126	100	111	110	70	70	50	50
Memorandum items:								
Government debt 2/	9,249	9,953	10,228	11,440	12,573	13,531	14,637	15,727
End-year government deposits 3/	526	623	609	701	934	1,036	1,057	980
Cyclically adjusted primary balance	-447	-774	-720	-638	-590	-569	-616	-658
Structural primary balance 4/	-380	-817	-781	-752	-680	-659	-705	-748
Fiscal deficit excluding grants	909	1,256	1,178	1,180	1,132	1,142	1,230	1,325

Sources: Ministry of Finance; and IMF staff estimates.

1/ Excluding arrears clearance, provisions and T-bill repayment.
2/ Includes Government's debt and obligations to the Fund.
3/ Includes Treasury single account, Revenue reserve account, Local government deposit, and long-term deposits at commercial banks.
4/ Excludes grants and one-offs.

Table 2. Georgia: General Government Operations, 2013–19, concluded

	Act.	SBA Request	Proj.					
	2013	2014	2014	2015	2016	2017	2018	2019
Revenues	27.5	27.1	27.3	27.5	27.8	27.6	27.5	27.3
Taxes	24.7	24.7	25.0	25.2	25.7	25.6	25.5	25.5
Direct taxes	11.2	10.4	10.6	10.7	11.1	11.0	11.0	10.9
Taxes on income	7.2	6.8	7.0	7.0	7.5	7.4	7.4	7.4
Taxes on profits	3.0	2.7	2.7	2.8	2.9	2.9	2.9	2.9
Other Taxes (incl. property)	1.0	0.9	0.9	0.8	0.8	0.7	0.7	0.6
Indirect taxes	13.6	14.3	14.4	14.5	14.6	14.6	14.6	14.5
VAT	10.5	11.3	11.3	11.2	11.3	11.4	11.4	11.4
Excises	2.7	2.6	2.7	3.0	2.9	2.9	2.8	2.8
Custom duties	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Other revenues	2.0	1.7	1.8	1.7	1.6	1.5	1.5	1.4
Grants	0.8	0.6	0.6	0.7	0.5	0.5	0.4	0.4
Expenditures	30.1	30.8	30.8	30.5	30.5	30.1	30.0	29.8
Current expenditures	24.3	24.8	25.0	24.2	24.0	23.6	23.3	23.0
Compensation of employees	5.2	5.1	5.2	5.0	4.9	4.8	4.8	4.7
Use of goods and services	3.8	3.7	3.8	3.8	3.7	3.7	3.6	3.6
Subsidies and grants	2.1	1.9	2.1	1.9	1.8	1.8	1.8	1.7
Social expenses	8.5	9.6	9.6	9.2	9.2	9.0	8.9	8.8
Other expenses	3.8	3.4	3.3	3.3	3.2	3.2	3.1	3.0
Interest	0.9	1.1	1.0	1.1	1.1	1.1	1.1	1.1
Capital spending and net lending	5.9	6.0	5.7	6.3	6.5	6.6	6.7	6.8
Capital	5.1	5.7	5.3	5.8	6.1	6.2	6.3	6.5
Net lending	0.8	0.3	0.5	0.5	0.4	0.4	0.4	0.3
Overall balance	-2.6	-3.7	-3.5	-3.0	-2.7	-2.5	-2.5	-2.5
Financing	2.6	3.7	3.5	3.0	2.7	2.5	2.5	2.5
Domestic	1.6	1.6	1.5	0.8	0.3	0.6	1.2	1.6
Net T-bill issuance	0.6	2.1	2.0	1.3	1.1	1.0	1.4	1.5
Amortization 1/	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Use of deposits at the NBG and banks	1.2	-0.3	-0.3	-0.3	-0.7	-0.3	-0.1	0.2
External	0.6	1.8	1.6	1.9	2.2	1.7	1.1	0.8
Borrowing	2.2	3.7	3.3	3.0	2.8	2.4	2.2	1.9
Amortization	-1.6	-1.9	-1.7	-1.1	-0.6	-0.7	-1.1	-1.1
Privatization receipts	0.5	0.3	0.4	0.3	0.2	0.2	0.1	0.1
Memorandum items:								
End-year government deposits 2/	2.0	2.1	2.1	2.2	2.7	2.7	2.5	2.1
Cyclically adjusted primary balance 3/	-1.7	-2.7	-2.5	-2.0	-1.7	-1.5	-1.5	-1.4
Structural primary balance 4/	-1.4	-2.8	-2.7	-2.4	-1.9	-1.7	-1.7	-1.6

Sources: Ministry of Finance; and IMF staff estimates.

1/ Excluding arrears clearance, provisions and T-bill re|

2/ Includes Treasury single account, revenue reserve account, Local government deposits, and long-term deposits at commercial banks.

3/ In percent of potential GDP.

4/ In percent of potential GDP, excludes grants and one-offs.

Table 3. Georgia: Summary Balance of Payments 2013–19
(In millions of U.S. dollars)

	Act.	SBA	Proj.	Proj.				
	2013	2014		2015	2016	2017	2018	2019
Current account balance	-926	-1,347	-1,418	-1,413	-1,356	-1,360	-1,412	-1,288
Trade balance	-3,493	-4,041	-3,993	-4,203	-4,379	-4,631	-4,901	-5,150
Exports	4,246	4,456	4,306	4,549	4,967	5,362	5,801	6,292
Imports	-7,738	-8,497	-8,299	-8,752	-9,346	-9,993	-10,701	-11,443
Services	1,406	1,466	1,390	1,533	1,726	1,938	2,163	2,409
Services: credit	2,964	3,163	3,100	3,331	3,617	3,957	4,322	4,717
Services: debit	-1,558	-1,697	-1,710	-1,799	-1,891	-2,019	-2,158	-2,307
Income (net)	-305	-300	-310	-325	-344	-378	-428	-404
Of which: interest payments	-374	-394	-380	-386	-409	-416	-462	-493
Transfers (net)	1,466	1,528	1,495	1,582	1,641	1,712	1,754	1,857
Capital account	134	109	113	100	98	96	94	92
General government	129	106	109	97	95	93	92	90
Financial account	1,107	1,249	1,350	1,683	1,924	2,164	2,061	2,001
Direct investment (net) 1/	829	916	846	1,112	1,169	1,249	1,307	1,390
Monetary authorities, net	0	0	1	1	0	0	0	0
General government	108	343	329	399	425	369	329	266
Portfolio investment (net)	-172	-12	1	-1	0	0	0	0
Long-term loans received	280	354	325	400	425	369	329	266
Other, net	0	1	3	0	0	0	0	0
Private Sector, excl. FDI	170	-10	174	171	330	546	424	345
Banks	-43	118	247	144	224	380	206	92
Portfolio investment, net	133	6	199	-25	1	203	13	14
Of which: equity liabilities	0	6	201	2	7	12	13	14
Loans received (net)	-131	110	3	97	98	97	87	-29
Long-term loans	-48	109	66	65	64	59	46	-73
Short-term loans	-83	1	-63	31	34	37	41	45
Other, net (currency and deposits)	-45	3	46	72	125	80	106	107
Assets	-182	-30	13	22	25	5	6	7
Liabilities (including NRDs)	137	33	33	50	100	75	100	100
of which: NRDs	206	33	81	100	100	75	100	100
Other sectors	213	-128	-73	27	106	167	218	253
Portfolio investment, net	2	3	1	-28	1	-2	0	0
Long-term loans received (net)	87	13	73	34	95	163	215	252
Other, net	123	-144	-147	21	10	5	3	1
Errors and omissions	-12	0	4	0	0	0	0	0
Overall balance	303	11	49	370	666	900	743	806
Financing	-303	-11	-49	-370	-666	-900	-743	-806
Gross International Reserves (-increase)	45	122	67	-303	-663	-892	-678	-742
Use of Fund Resources	-382	-134	-135	-68	-3	-8	-65	-64
Purchases (SBA)	0	123	121	12	12	6	0	0
Repayments (SBA/SCF)	-382	-257	-256	-80	-15	-14	-65	-64
Exceptional financing	33	0	19	0	0	0	0	0

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

1/ About US$110 million FDI was reclassified as bank's portfolio investment in 2014.

Table 3. Georgia: Summary Balance of Payments 2013–19, (concluded)

	Est. 2013 Proj.	SBA 2014	Proj. 2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
				(in percent of GDP)				
Current account balance	-5.7	-8.4	-8.5	-7.9	-7.0	-6.4	-6.0	-5.0
excluding official transfers	-6.3	-8.7	-8.9	-8.2	-7.2	-6.5	-5.9	-4.9
Trade balance	-21.6	-25.1	-23.9	-23.5	-22.5	-21.7	-21.0	-20.2
Net capital inflows to private sector	6.2	5.6	6.1	7.2	7.7	8.4	7.4	6.8
				(growth rates, in percent)				
Exports of GNFS								
value growth	19.2	5.6	2.7	6.4	8.9	8.6	8.6	8.8
volume growth	24.8	8.6	3.0	8.5	7.9	7.0	7.1	7.1
price change	-4.5	-2.8	-0.2	-1.9	1.0	1.4	1.4	1.5
Imports of GNFS								
value growth	1.5	9.6	7.7	5.4	6.5	6.9	7.1	6.9
volume growth	3.5	11.1	7.8	8.8	6.6	7.1	7.1	6.9
price change	-1.9	-1.3	-0.1	-3.1	-0.1	-0.2	0.0	0.0
				(in billions of U.S. dollars, unless otherwise indicated)				
Gross international reserves (end of period)	2.8	2.7	2.8	3.1	3.7	4.6	5.3	6.0
in months of next year GNFS imports	3.4	3.0	3.1	3.3	3.7	4.3	4.6	4.9
in percent of short-term debt at remaining maturity	98	102	102	109	121	134	134	143
in percent of broad money and non-resident deposits	43	36	36	34	35	37	37	37
Reserve cover 1/	60	52	52	55	64	74	78	84
External debt	13.2	13.6	13.7	14.5	15.5	16.6	17.6	18.7
External debt, excluding intercompany loans	10.6	10.3	10.9	11.3	12.0	12.8	13.5	14.2
Public 2/	4.6	4.5	4.8	5.1	5.5	5.9	6.2	6.5
Private	6.0	5.9	6.1	6.2	6.5	6.9	7.3	7.7
Long-term	4.1	4.0	4.1	4.1	4.2	4.3	4.5	4.6
Short-term	1.9	1.9	2.0	2.1	2.3	2.6	2.8	3.1
Intercompany loans	2.6	3.3	2.9	3.2	3.5	3.8	4.1	4.5
				(in percent of GDP)				
External debt	81.8	84.2	82.3	81.0	79.8	77.6	75.6	73.3
External debt, excluding intercompany loans	65.4	64.0	65.0	63.3	62.0	59.8	57.9	55.7
Public 2/	28.2	27.6	28.5	28.6	28.5	27.7	26.7	25.4
Private	37.2	36.4	36.6	34.7	33.5	32.1	31.2	30.3
Long-term	25.2	24.7	24.8	22.9	21.6	20.1	19.1	18.2
Short-term	12.1	11.8	11.8	11.9	11.9	12.0	12.0	12.1
Intercompany loans	16.4	20.2	17.2	17.7	17.9	17.8	17.7	17.6
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	16.1	16.1	16.7	17.9	19.4	21.3	23.3	25.5

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

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

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

Table 4. Georgia: Monetary Survey 2013–15

	2013	2014			2015	
		Jun.	Dec.	SBA	Jun.	Dec.
	Act.	Act.	Proj.	Annual	Proj.	Proj.
	(In billions of lari)					
Broad money (M3)	9.8	10.1	11.4	11.9	11.9	14.2
Lari Broad money (M2)	5.4	5.2	6.1	6.3	6.2	7.5
Currency held by the public	1.9	1.8	2.0	2.2	1.9	2.3
Lari resident deposits	3.5	3.4	4.0	4.1	4.4	5.2
Resident foreign exchange deposits	4.4	4.9	5.3	5.6	5.7	6.6
Net foreign assets	1.0	0.7	0.9	0.7	0.7	1.1
NBG	4.2	3.7	4.2	4.2	4.2	4.8
Commercial banks	-3.2	-3.0	-3.3	-3.6	-3.5	-3.8
Of which: liabilities	-4.8	-4.7	-5.0	-5.1	-5.3	-5.6
Net domestic assets	8.8	9.4	10.5	11.3	11.3	13.1
Domestic credit	11.0	11.9	13.0	13.7	13.9	15.9
Net claims on general government	0.6	0.8	1.0	1.1	0.9	1.3
Of which: government deposits at NBG	-0.5	-0.4	-0.5	-0.3	-0.7	-0.6
Of which: T-bills at commercial banks	0.7	1.1	1.3	1.4	1.5	1.7
Private credit	10.4	11.1	12.1	12.6	13.0	14.6
Other items, net	-2.1	-2.5	-2.5	-2.5	-2.7	-2.8
Sources of funds of commercial banks	12.7	13.1	14.4	14.8	15.4	17.4
Resident deposits	7.9	8.3	9.4	9.7	10.1	11.9
Non-resident deposits	1.7	1.8	1.9	1.8	2.0	2.1
Other foreign liabilities	3.1	3.0	3.2	3.3	3.4	3.5
Uses of funds of commercial banks	12.7	13.1	14.4	14.8	15.4	17.4
Reserves	3.4	3.4	3.6	3.2	3.8	4.1
Lari domestic credit	4.5	5.2	6.0	6.1	6.6	7.6
Fx domestic credit	6.4	6.6	7.0	7.4	7.3	8.1
Other items, net	-1.5	-2.1	-2.2	-1.9	-2.4	-2.3
	(Percentage change, year on year)					
Broad money (M3)	24.4	21.3	15.9	21.5	17.9	24.6
Broad money (M3): Constant exchange rate	21.8	17.3	15.3	19.2	17.5	23.2
Private credit	19.5	21.4	16.2	21.6	17.1	21.4
Private credit: Constant exchange rate	16.1	16.6	15.3	18.7	16.7	19.8
	(Percent of GDP, unless otherwise indicated)					
Memorandum items:						
Broad money (M3)	36.6	36.1	38.9	40.9	39.3	44.4
Lari Broad money (M2)	20.2	18.6	20.7	21.6	20.6	23.6
Currency held by the public	7.1	6.4	7.0	7.7	6.2	7.3
Non-resident deposits (percent of total deposits)	15.5	14.9	14.3	14.0	14.1	12.8
Private credit	38.7	39.7	41.2	43.3	42.9	45.8
Nominal GDP (billions of lari)	26.8	28.0	29.3	29.2	30.3	31.9

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

Table 5. Georgia: Accounts of the National Bank of Georgia, 2013–15

	2013	2014		2015		
	Act.	Jun. Act.	Dec. Proj.	SBA Annual	Jun. Proj.	Dec. Proj.
	(In millions of lari)					
Net foreign exchange position	3,183	2,725	3,015	3,068	2,990	3,479
Gross International Reserves	4,902	4,419	4,836	4,890	4,860	5,498
Other foreign assets	1	1	2	1	2	2
Foreign currency liabilities	-1,720	-1,696	-1,823	1,823	-1,872	-2,021
Of which: use of Fund resources	-199	-112	-79	82	-68	-61
Of which: compulsory reserves in USD	-993	-1,017	-1,138	1,181	-1,209	-1,369
Net domestic assets	-329	-67	59	188	-26	42
Net claims on general government	35	105	58	191	-18	259
Claims on general government (incl. T-bills)	523	519	520	519	720	812
Nontradable govt. debt	481	441	441	441	441	433
Securitized debt (marketable)	43	78	80	78	280	380
Deposits	-488	-414	-462	328	-739	-554
Claims on banks	-285	-16	82	209	110	-58
Bank refinancing	400	450	500	500	500	500
Certificates of deposits and bonds	-685	-466	-418	-291	-390	-558
Other items, net	-81	-157	-83	-213	-119	-159
Reserve money	2,854	2,657	3,074	3,256	2,963	3,521
Currency in circulation	2,352	2,209	2,490	2,657	2,326	2,774
Bank lari reserves	206	371	402	406	437	522
Banks overnight deposits	297	77	181	192	200	225
	(Percentage change, year on year)					
Reserve money	23.6	24.4	7.7	14.1	11.5	14.6
Currency in circulation	22.6	21.2	5.9	13.0	5.3	11.4
Bank lari reserves	3.1	148.4	95.2	97.2	18.0	29.8
Memorandum items:	(In millions of lari)					
Net international reserves						
(in millions of USD, at prog. exchange rates) 1/	1,555	1,372	1,555	1,520	1,568	1,830
Net domestic assets (in millions of lari) 1/	154	259	353	600	219	320

Sources: National Bank of Georgia; and IMF staff estimates.
1/ Program definition.

Table 6. Georgia: External Vulnerability Indicators, 2013–19

	Act.	Proj.					
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Value of exports of goods and services, percent change	19.2	2.7	6.4	8.9	8.6	8.6	8.8
Value of imports of goods and services, percent change	1.5	7.7	5.4	6.5	6.9	7.1	6.9
Terms of trade (deterioration -)	-2.6	-0.1	1.2	1.1	1.7	1.4	1.5
Current account balance (percent of GDP)	-5.7	-8.5	-7.9	-7.0	-6.4	-6.0	-5.0
Capital and financial account (percent of GDP)	7.7	8.8	10.0	10.4	10.6	9.2	8.2
External public debt (percent of GDP)	28.2	28.5	28.6	28.5	27.7	26.7	25.4
(in percent of exports of goods and services)	63.1	64.2	65.1	64.5	63.3	61.6	59.0
Debt service on external public debt							
(in percent of exports of goods and services)	7.3	6.0	3.8	2.5	2.7	3.7	3.9
External debt (percent of GDP) 1/	65.4	65.0	63.3	62.0	59.8	57.9	55.7
(in percent of exports of goods and services)	146.5	146.6	144.0	140.4	136.8	133.5	129.3
Debt service on MLT external debt							
(in percent of exports of goods and services)	18.9	17.4	14.0	12.5	12.3	13.0	14.4
Gross international reserves							
in millions of USD	2,823	2,750	3,053	3,716	4,608	5,286	6,028
in months of next year's imports of goods and services	3.4	3.1	3.3	3.7	4.3	4.6	4.9
in percent of external debt	26.7	25.3	26.9	30.8	36.1	39.1	42.4
in percent of short-term external debt (remaining maturity)	98	102	109	121	134	134	143

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

Table 7. Georgia: Indicators of Fund Credit, 2013–19
(In millions SDR)

	Act.	Proj.					
	2013	2014	2015	2016	2017	2018	2019
Existing Fund credit							
Stock 1/	233.0	106.2	54.0	44.2	35.0	15.0	0.0
ECF 2/	47.6	29.4	14.0	4.2	0.0	0.0	0.0
SBA	185.4	76.8	40.0	40.0	35.0	15.0	0.0
Obligations 3/	255.1	168.3	52.9	10.2	9.6	20.3	15.1
ECF 2/	19.6	18.2	15.5	9.8	4.2	0.0	0.0
SBA	235.5	150.1	37.4	0.4	5.4	20.3	15.1
Prospective purchases under the SBA							
Disbursements	...	40.0	8.0	8.0	4.0	0.0	0.0
Stock 1/	...	40.0	48.0	56.0	60.0	38.0	12.0
Obligations 3/	...	0.2	0.5	0.6	0.6	22.6	26.3
Principal (repurchases)	...	0.0	0.0	0.0	0.0	22.0	26.0
Interest charges	...	0.2	0.5	0.6	0.6	0.6	0.3
Stock of existing and prospective Fund credit 1/	233.0	146.2	102.0	100.2	95.0	53.0	12.0
In percent of quota	155.0	97.3	67.9	66.7	63.2	35.3	8.0
In percent of GDP	2.2	1.3	0.9	0.8	0.7	0.4	0.1
In percent of exports of goods and nonfactor services	4.9	3.0	2.0	1.8	1.6	0.8	0.2
In percent of gross reserves	12.5	8.2	5.1	4.1	3.1	1.5	0.3
In percent of public external debt	7.8	4.7	3.1	2.8	2.5	1.3	0.3
Obligations to the Fund from existing and prospective Fund credit	255.1	168.5	53.3	10.8	10.3	42.9	41.4
In percent of quota	169.7	112.1	35.5	7.2	6.8	28.5	27.6
In percent of GDP	2.4	1.6	0.5	0.1	0.1	0.3	0.3
In percent of exports of goods and nonfactor services	5.4	3.5	1.0	0.2	0.2	0.7	0.6
In percent of gross reserves	13.7	9.4	2.7	0.4	0.3	1.2	1.1
In percent of public external debt service	74.0	58.6	27.0	7.6	6.3	17.9	15.2

Source: Fund staff estimates and projections.

1/ End of period.

2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) Arrangements.ECF interest is based on 0 percent through end December 2014 and 0.25 percent thereafter.

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

Table 8. Georgia: External Financing Requirements and Sources, 2013–19

	2013	2014	2015	2016	2017	2018	2019
Total requirements	-1,941	-2,350	-2,148	-2,041	-2,116	-2,295	-2,412
Current account deficit	-926	-1,418	-1,413	-1,356	-1,360	-1,412	-1,288
Capital outflows: Repayments of MLT loans	-1,015	-932	-735	-685	-756	-883	-1,124
Total sources	1,941	2,350	2,148	2,041	2,116	2,295	2,412
Capital flows	1,863	2,143	2,438	2,692	3,002	2,973	3,153
Public sector	290	543	635	636	604	606	588
Project grants	129	109	97	95	93	92	90
Long-term loan disbursements to public sector	333	429	538	541	511	514	498
Other	-172	5	0	0	0	0	0
Private sector	1,573	1,600	1,803	2,056	2,398	2,367	2,566
Foreign direct investment in Georgia	942	977	1,245	1,304	1,387	1,448	1,534
Long-term loan disbursements to private secto	620	689	612	714	822	895	1,007
Other net inflows 1/	11	-66	-54	38	188	24	25
Financing	33	140	12	12	6	0	0
IMF	0	121	12	12	6	0	0
Change in arrears, net (- decrease)	2	14	0	0	0	0	0
Debt rescheduling, pre-payment (net)	34	5	0	0	0	0	0
Advance Repayments	-2	0	0	0	0	0	0
Change in reserves (- increase)	45	67	-303	-663	-892	-678	-742
Financing gap	0	0	0	0	0	0	0
Memorandum items				(In percent of GDP)			
Total financing requirements	-12.0	-14.1	-12.0	-10.5	-9.9	-9.8	-9.4
Total sources	12.0	14.1	12.0	10.5	9.9	9.8	9.4
Capital inflows	11.5	12.8	13.6	13.8	14.1	12.7	12.3
Exceptional financing	0.2	0.8	0.1	0.1	0.0	0.0	0.0
Change in reserves (- increase)	0.3	0.4	-1.7	-3.4	-4.2	-2.9	-2.9

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

1/ Including errors and omissions. The 2014 value includes a projected outflow of non-resident deposits due to the additional liquidity measures introduced by the authorities.

Table 9. Georgia: Schedule of Prospective Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase (SDR millions)	Amount of Purchase (Percent of quota)
30-Jul-14	Approve the 36-month SBA	40	26.7
15-Nov-14	Complete the first review based on end-September 2014 performance criteria and other relevant performance criteria	40	26.7
15-Feb-15	Complete the second review based on end-Dec 2014 performance criteria and other relevant performance criteria	4	2.7
15-Aug-15	Complete the third review based on end-June 2015 performance criteria and other relevant performance criteria	4	2.7
15-Feb-16	Complete the fourth review based on end-December 2015 performance criteria and other relevant performance criteria	4	2.7
15-Aug-16	Complete the fifth review based on end-June 2016 performance criteria and other relevant performance criteria	4	2.7
15-Feb-17	Complete the sixth review based on end-December 2016 performance criteria and other relevant performance criteria	4	2.7
Total available		100	67

Annex I. Debt Sustainability Analysis

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

(in percent of GDP unless otherwise indicated)

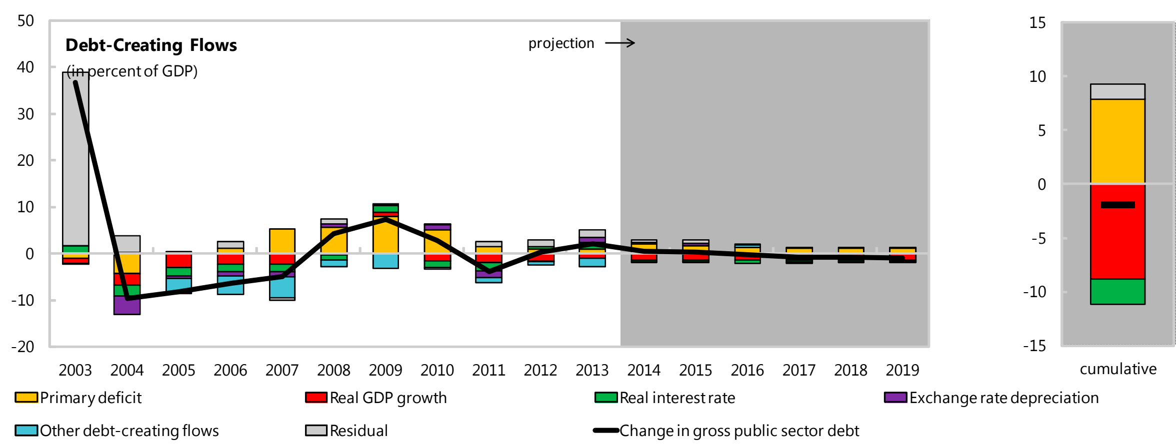
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	31.0	30.0	32.2	32.7	33.0	32.7	32.0	31.2	30.3
Public gross financing needs	5.1	2.4	3.8	6.1	5.5	5.2	5.5	5.9	6.7
Real GDP growth (in percent)	6.7	6.2	4.1	5.0	5.0	5.0	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	7.1	1.2	-1.4	3.8	4.0	5.0	4.0	4.0	4.0
Nominal GDP growth (in percent)	14.3	7.5	2.6	8.9	9.2	10.3	9.2	9.2	9.1
Effective interest rate (in percent) [4/]	5.3	3.5	3.0	2.8	3.0	3.0	3.0	3.0	3.2

As of March 21, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		403
5Y CDS (bp)		566
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	BB-	BB-
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing
Change in gross public sector debt	2.0	0.2	2.2	0.6	0.3	-0.3	-0.8	-0.8	-0.9	-1.9	primary
Identified debt-creating flows	-2.9	-1.1	0.6	0.1	-0.4	-0.5	-0.8	-0.8	-0.9	-3.3	balance [9/]
Primary deficit	2.3	0.9	0.9	2.0	1.5	1.2	1.0	1.1	1.1	7.8	-2.0
Primary (noninterest) revenue and grants	26.2	28.8	27.5	27.3	27.5	27.8	27.6	27.5	27.3	164.9	
Primary (noninterest) expenditure	28.5	29.7	28.4	29.3	29.0	29.0	28.7	28.5	28.3	172.8	
Automatic debt dynamics [5/]	-3.2	-1.3	1.3	-1.8	-1.8	-2.2	-1.9	-1.8	-1.7	-11.2	
Interest rate/growth differential [6/]	-2.6	-1.1	0.1	-1.8	-1.8	-2.2	-1.9	-1.8	-1.7	-11.2	
Of which: real interest rate	-0.9	0.6	1.3	-0.3	-0.3	-0.7	-0.4	-0.3	-0.3	-2.4	
Of which: real GDP growth	-1.6	-1.7	-1.2	-1.5	-1.5	-1.5	-1.5	-1.5	-1.4	-8.8	
Exchange rate depreciation [7/]	-0.7	-0.2	1.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	-2.0	-0.7	-1.7	-0.1	-0.1	0.5	0.1	-0.1	-0.3	0.0	
GG: Privatization and Drawdown of deposits (negative)	-2.0	-0.7	-1.7	-0.1	-0.1	0.5	0.1	-0.1	-0.3	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	4.9	1.3	1.6	0.5	0.7	0.2	0.0	0.0	0.0	1.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

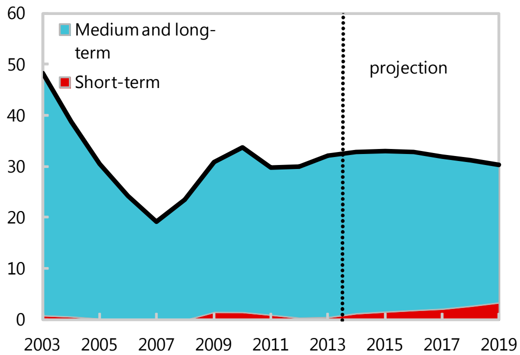
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

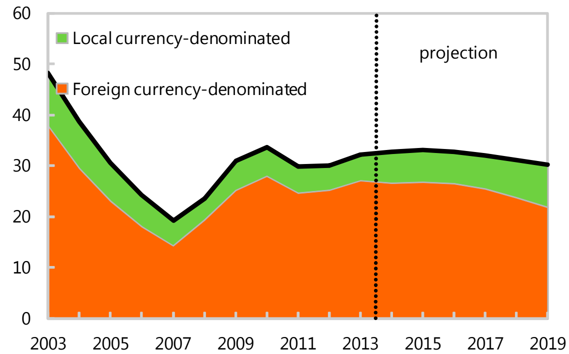
Georgia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



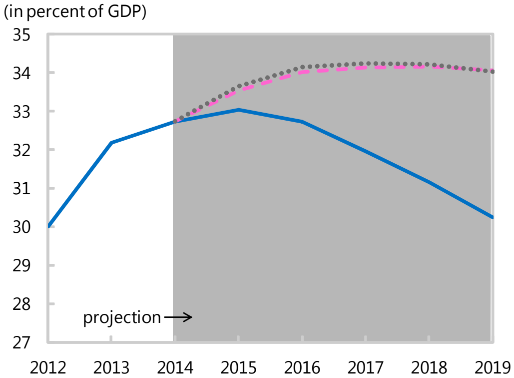
By Currency
(in percent of GDP)



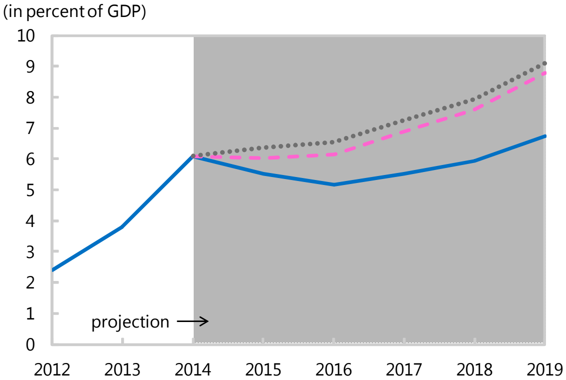
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.0	5.0	5.0	5.0	5.0	5.0
Inflation	3.8	4.0	5.0	4.0	4.0	4.0
Primary Balance	-2.0	-1.5	-1.2	-1.0	-1.1	-1.1
Effective interest rate	2.8	3.0	3.0	3.0	3.0	3.2
Constant Primary Balance Scenario						
Real GDP growth	5.0	5.0	5.0	5.0	5.0	5.0
Inflation	3.8	4.0	5.0	4.0	4.0	4.0
Primary Balance	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	2.8	3.0	3.1	3.0	3.0	3.2

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.0	5.9	5.9	5.9	5.9	5.9
Inflation	3.8	4.0	5.0	4.0	4.0	4.0
Primary Balance	-2.0	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	2.8	3.0	2.8	2.6	2.6	2.7

Source: IMF staff.

Georgia: External Debt Sustainability Framework, 2009-2019
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013	10-Year Historical Average	10-Year Standard Deviation	2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	61.7	65.8	61.5	66.9	65.4			**65.0**	**63.3**	**62.0**	**59.8**	**57.9**	**55.7**	**-7.7**
Change in external debt	16.5	4.1	-4.4	5.4	-1.5			-0.4	-1.7	-1.4	-2.2	-1.9	-2.1	
Identified external debt-creating flows (4+8+9)	12.8	-0.2	-6.3	2.5	-0.7			0.3	-1.3	-2.0	-2.3	-2.3	-3.0	
Current account deficit, excluding interest payments	7.6	7.5	10.2	8.7	2.7			5.5	5.0	4.1	3.7	3.3	2.4	
Deficit in balance of goods and services	19.1	17.8	19.0	19.7	12.9			15.6	14.9	13.6	12.6	11.7	10.7	
Exports	29.8	34.9	36.5	38.2	44.7			44.4	44.0	44.1	43.7	43.4	43.1	
Imports	48.9	52.7	55.5	57.8	57.6			59.9	58.9	57.8	56.3	55.1	53.8	
Net non-debt creating capital inflows (negative)	-6.3	-5.8	-6.2	-3.7	-5.2			-5.1	-6.2	-6.0	-5.9	-5.6	-5.4	
Automatic debt dynamics 1/	11.4	-1.9	-10.2	-2.4	1.8			-0.1	-0.1	-0.1	-0.2	0.0	0.0	
Contribution from nominal interest rate	2.9	2.7	2.6	3.0	3.0			3.0	2.9	2.8	2.7	2.7	2.7	
Contribution from real GDP growth	2.0	-3.6	-3.8	-3.5	-2.7			-3.1	-3.0	-2.9	-2.8	-2.7	-2.6	
Contribution from price and exchange rate changes 2/	6.5	-1.1	-8.9	-2.0	1.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.8	4.3	1.9	2.9	-0.8			-0.7	-0.4	0.6	0.1	0.3	0.9	
External debt-to-exports ratio (in percent)	207.1	188.7	168.6	175.3	146.5			146.6	144.0	140.4	136.8	133.5	129.3	
Gross external financing need (in billions of US dollars) 4/	2.6	2.5	3.5	4.3	3.8			4.3	4.1	4.2	4.4	4.9	5.2	
in percent of GDP	24.2	21.6	24.0	26.9	23.5			25.7	23.0	21.4	20.8	20.8	20.4	
Scenario with key variables at their historical averages 5/								**65.0**	**61.5**	**59.6**	**57.9**	**56.2**	**54.9**	**-14.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	-3.8	6.3	7.2	6.2	4.1	5.9	4.5	5.0	5.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	-12.5	1.7	15.7	3.4	-2.1	9.2	11.3	-1.4	2.2	3.4	4.4	4.3	4.3	
Nominal external interest rate (in percent)	5.4	4.8	4.9	5.4	4.6	4.6	1.3	4.8	4.8	4.9	4.7	4.9	5.0	
Growth of exports (US dollar terms, in percent)	-13.0	26.6	29.6	14.9	19.2	19.5	13.0	2.7	6.4	8.9	8.6	8.6	8.8	
Growth of imports (US dollar terms, in percent)	-29.8	16.5	30.5	14.4	1.5	19.4	20.4	7.7	5.4	6.5	6.9	7.1	6.9	
Current account balance, excluding interest payments	-7.6	-7.5	-10.2	-8.7	-2.7	-10.5	5.4	-5.5	-5.0	-4.1	-3.7	-3.3	-2.4	
Net non-debt creating capital inflows	6.3	5.8	6.2	3.7	5.2	8.8	4.3	5.1	6.2	6.0	5.9	5.6	5.4	

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

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

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

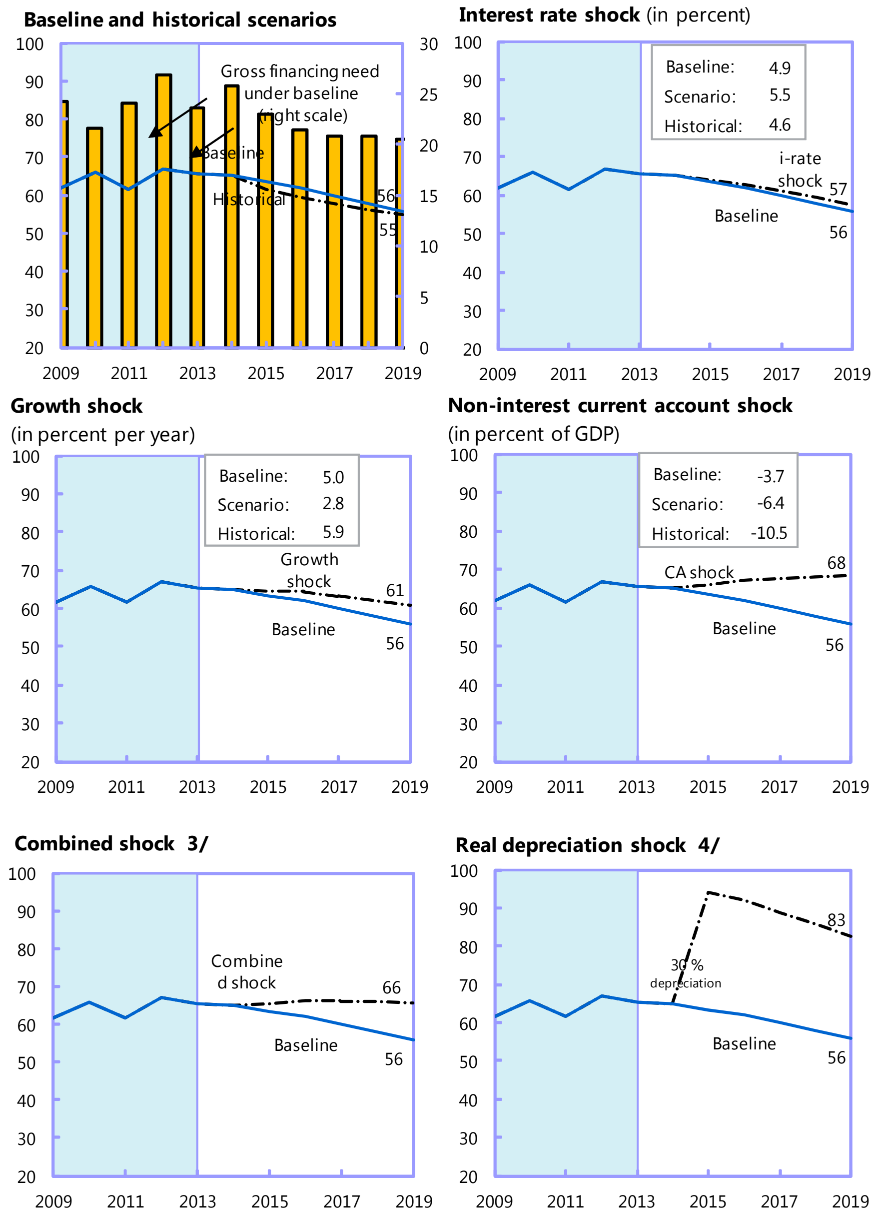
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Georgia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

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

Appendix I. Letter of Intent

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

Tbilisi, December 5 2014

Dear Madam Lagarde:

1. **Our economic program remains focused on reducing external and fiscal vulnerabilities, and promoting inclusive growth**. Uncertainties persist because of the slow recovery of the Euro area, the prospect of monetary policy tightening in the US, and turbulence in neighboring countries. However, our policies of fiscal deficit reduction, inflation targeting, continued exchange rate flexibility, and structural reforms remain appropriate. With well balanced and coordinated macroeconomic policies we will generate prosperity that can be widely shared among the population.

2. **Despite this challenging external environment, Georgia's economic performance is improving.** The EU-Georgia Deep and Comprehensive Free Trade Area (DCFTA) agreement, which is an integral part of the Association Agreement signed in June 2014, has been in force since September 1, 2014. The DCFTA has opened new economic opportunities for integration into the European market. It will support export growth and a modernization of our economy. In addition, the DCFTA increases Georgia's investment attractiveness and opens up new investment opportunities. Soon after the signing of our Association Agreement with the EU, the ratings agencies Moody's and Fitch upgraded the outlook on our sovereign debt. The gradual narrowing of sovereign spreads compared to US Treasury bonds is also an indication of the strengthened economic outlook. Recently, the Black Sea Transmission Line project became operational, which will improve domestic electricity distribution and increase the capacity to export electricity to Turkey. Two hydro power plants—Paravani (87 MW) and Kazbegi (6 MW)—became operational in October, enhancing supply. We have also announced a call for expression of interest for investments and operation of the Anaklia deep sea port, which will increase carrying capacity of the south Caucasus transport corridor.

3. **We have met all of the conditionality for end-September in our IMF-supported program, except for the structural benchmark on completing a study on access to finance**. We have met all end-September performance criteria and indicative targets, and inflation has remained within the inflation bands. Concerning the access to finance study (structural benchmark for end-September), after careful consideration and discussion with our development partners, and drawing on the recent Financial Sector Stability Assessment prepared by the Fund and the World Bank, we recognize that more time will be needed to make a full assessment of the obstacles and the appropriate remedies. We now expect that this study will be ready by end-December 2015. We are

on track to meet all end-December performance criteria, indicative targets and structural benchmarks. Inflation should remain within the consultation bands.

4. **Given our economic performance and the policies described in this letter we request the completion of the First Review under the Stand-By Arrangement**. Following completion of this review, we intend to purchase a further SDR40 million from the Fund, bringing our drawings under this program to SDR80 million out of the SDR100 million that is potentially available. Our program will continue to be monitored through quantitative performance criteria for end-June and end-December test dates, a continuous performance criterion, indicative targets, structural benchmarks and an inflation consultation clause. These are set out in Tables 1–3, and described with definitions in the attached Technical Memorandum of Understanding. Reviews will be conducted semi-annually. The Second Review will be based on end-December 2014 performance criteria and is expected to take place on or after February 15, 2015. The Third Review will be based on end-June 2015 performance criteria and is expected to take place on or after August 15, 2015.

5. **We remain committed to the policies set forth in our original Letter of Intent of July 15, 2014, updated and extended by this Letter, and believe that they will achieve the objectives of our economic program**. We will monitor progress continuously in consultation with the IMF, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this letter of Intent in accordance with the IMF's policies on such consultation. We will also provide the IMF with the information it requests for monitoring program implementation. We authorize the IMF to publish this Letter of Intent and its attachments (including the Technical Memorandum of Understanding), as well as the related Staff Report.

A. Macroeconomic Framework

6. **Our economy has performed well this year, despite the challenging external environment**. Our economy is recovering following last year's temporary slow-down of economic growth. Helped by a good tourist season, increased exports to Russia, and our more expansionary fiscal policy, in the first six months of the year our economy has grown by 6 percent compared to the same period in 2013. We expect that growth this year will be at least 5 percent. Business confidence continues to improve, supported by our DCFTA with the EU, and we believe that this will generate growth of at least 5 percent in 2015 and even higher growth over the medium term. While we cannot be immune to economic difficulties in neighboring countries, the impact so far has been limited. We are monitoring the situation closely and will be ready to react quickly in case there are negative consequences.

7. **Inflation has risen slightly, and is approaching our inflation target.** In September inflation increased to 4.8 percent, due to higher prices for food, education, and health services. For 2015 and 2016, we have set an inflation target of 5 percent, which we expect to reach by mid-2015. For 2017 and beyond, we have set an inflation target of 4 percent. Exchange rate flexibility will be important in helping us meet our inflation target.

8. **As the economy recovers, our current account deficit has increased as anticipated**. In the first nine months of the year exports increased by 7 percent year-on-year, with exports to Russia more than doubling following the gradual opening of this market. In the first nine months of 2014, the number of international arrivals reached 4.2 million, a 2 percent increase compared to the same period in 2013. However, the proportion of higher-spending visitors has increased, so that tourism revenues have increased by 5 percent. With the economy recovering from last year's temporary slowdown of the economic growth rate, imports have increased by 12 percent. We project that the current account deficit this year will reach 8.5 percent of GDP.

9. **We remain committed to reducing the current account deficit gradually over the medium-term, and to lower our external indebtedness.** As envisaged when the program was launched, this year there was a temporary increase in the current account deficit. Fiscal consolidation, exchange rate flexibility and the expansion in exports that will result from our Association Agreement with the EU, will lower the current account deficit over the medium term. We project that the current account deficit will fall to 7.9 percent of GDP in 2015. We aim for a current account deficit of 6–7 percent of GDP during the program period, and around 5 percent of GDP in the longer term, taking into account the need to maintain rapid growth. This will lower our external debt (excluding intercompany liabilities) to less than 60 percent of GDP by 2019 and net foreign liabilities to around 85 percent of GDP. Given the importance of lowering our indebtedness and of reducing our vulnerability to external shocks, we recognize the importance of reducing the current account deficit. We stand ready to take additional policy actions—including by tightening monetary and fiscal policy, allowing the exchange rate to adjust to maintain trade competitiveness, and accelerating structural reforms—should the projected declining path not materialize.

10. **Given the uncertain external environment, we will continue to build our foreign exchange reserves**. As in recent years, we will continue buying foreign exchange in 2015 so that our international reserves will reach at least 3.2 months of the following year's imports (we estimate that reserves will need to increase to US$3.1 billion to achieve this). Consistent with this goal, we request the modification of the end-December 2014 NIR performance criterion for a modest increase by US$35 million.

B. Fiscal Policy

11. **We remain committed to the medium-term program targets of gradually reducing the fiscal deficit to no more than 2.5 percent of GDP by 2017 and keeping public debt firmly below 40 percent of GDP**. Fiscal sustainability is a condition for macroeconomic stability and growth, and the overriding objective of our budget policies. To help achieve this objective, and as set out in our July Letter of Intent, we have no plans to issue public guarantees. We will also be working to gradually lower the share of foreign currency denominated debt in our government debt.

12. **We will keep the 2014 fiscal deficit within the program ceiling of 3.7 percent of GDP and we have improved our expenditure planning to keep a more even deficit profile within**

the year. Current spending (spending on subsidies, wages, goods and services, and other expenditure categories) in the first three quarters of the year was higher than projected—mostly at the local level due to the mid-year elections. We are monitoring this spending closely and are determined to make sure that current spending does not exceed the limits set in our 2014 budget by more than GEL 80 million, or 0.3 percent of GDP. Spending on government investment was low in the first half of the year. Although it has picked up in recent months, we expect it to end the year slightly below the amount set in our 2014 budget, in part reflecting delays in donor-financed projects. We expect that revenues this year will exceed projections, in part reflecting our prudent assumptions for GDP growth in our 2014 budget. Higher-than-projected revenue, and somewhat lower-than-budgeted capital and current spending at the central level, will more than offset higher-than-budgeted current expenditure of local governments such that the fiscal deficit is expected to be kept below 3.5 percent of GDP, slightly below the program target.

13. **We have submitted to Parliament a 2015 budget with a general government deficit of GEL 970 million, equivalent to 3.0 percent of GDP (prior action for completing this First Review)**. The 2015 budget reflects the government's priorities to promote social protection, health care, education, agricultural development and a well functioning public infrastructure, which we believe will support higher economic growth. Our budget includes the following main elements:

- To meet our objective of making growth more inclusive, we are increasing social spending (pensions, health expenditure, and targeted social assistance) to no more than GEL 2,926 million. Since the size of our economy is growing, this will reduce the deficit by 0.4 percent of GDP in 2015 relative to 2014.

    - **Pensions.** We will raise the pension for all old-age pensioners and social benefits for group 1 disabled by GEL 10 from September 1, 2015. This pension increase will cost GEL 28 million, 0.1 percent of GDP in 2015, but a full year effect of GEL 85 million (0.2 percent of GDP). In 2016 we plan to raise pensions further.

    - **Health.** We have gradually moved all beneficiaries, including the socially vulnerable, from private insurance programs to the universal health care system (March-September, 2014). Health care programs, including universal health care and the extension of benefits to cover some pharmaceutical payments will cost an additional GEL 60 million (0.2 percent of GDP) in 2015 compared to 2014.

    - **Targeted social assistance.** We are maintaining targeted social assistance benefit levels constant in nominal terms but intend to refine our scoring methodology to identify different categories of socially vulnerable groups. The current social assistance system depends on an interview-based scoring system: those below the threshold are eligible for assistance, those above receive nothing. Over the medium-term we intend to replace this with a more gradated system that will increase the incentives to work. We also intend to supplement interviews with other sources of information on income and wealth.

- **Education.** We will pass a new Education Law that will introduce new categories for teachers. Following this, we will classify all teachers. Once the classification is complete, we will reward those who are the most qualified and who have the strongest teaching skills. As of September 2015 we will increase salaries of the highest categories of teachers by GEL 200 per month, and salaries of other categories by GEL 50 per month. This will cost GEL 18 million (less than 0.1 percent of GDP) in 2015 (full year effect of GEL 52 million (0.2 percent of GDP)). Georgia's scores in international comparisons of education show that there is potential to improve the quality of education. We will work with the World Bank on strategies to achieve this.

- **Capital spending.** In line with our policy of improving public infrastructure, we will increase capital expenditure in 2015 by GEL 320 million, an increase from 5.3 percent of GDP in 2014 to 5.8 percent. In 2015, our five largest investment projects are:

    - East-West Highway (various sections)—total cost for 2015 is GEL 370 million;

    - internal roads (various sections)—total cost for 2015 is GEL 215 million;

    - water and sewage systems—total cost for 2015 is GEL 150 million;

    - power transmission system—total cost for 2015 is GEL 90 million; and

    - gas supply system—total cost for 2015 is GEL 20 million.

- **Other spending.** We are keeping spending on wages and salaries, and subsidies broadly constant in real terms. With our economy growing, this will reduce the deficit by 0.4 percent of GDP. As for goods and services, we are keeping them constant as a percent of GDP, allowing us to pay for maintenance of equipment, which has fallen short in recent years.

14. **To reduce the budget deficit to 3 percent of GDP we are taking the following revenue measures:**

- **We are raising excise taxes on cigarettes, alcohol, and telecommunications**, generating GEL 138 million, 0.4 percent of GDP. Legislation to this effect has been submitted to Parliament as of November 2, 2014.

    - **Cigarette excises** (GEL 76 million). We are increasing the excise on cigarettes from 0.75 GEL/pack to 0.90 GEL/pack, with effect from January 1, 2015. We are introducing an additional ad-valorem excise rate of 5 percent that will take effect from July 1, 2015. A draft law has been submitted to Parliament.

    - **Alcohol excises** (GEL 29 million). We are increasing the excise on beer from 0.4 GEL/liter to 0.6 GEL/liter, and doubling the excise on all types of spirits (on vodka from 3 GEL/liter to 6 GEL/liter, on whisky from 5 GEL/liter to 10 GEL/liter, etc) with effect from March 1, 2015. A draft law has been submitted to Parliament.

  - **Telecom excises** (GEL 33 million). We are introducing an excise of 0.15 GEL/minute and 0.08 GEL/minute for incoming international calls, applying to mobile phones and fixed lines, respectively, with effect from January 1, 2015. These extra payments will not be eligible for VAT refunds. At the same time, we are cutting the tax rate on domestic mobile phone calls from 10 percent to 8 percent. We are ready to take additional measures should the revenue estimated here fall short. A draft law has been submitted to Parliament.

- **We will abolish the tax free threshold for personal income tax, effective for income earned from January 1st 2015 onwards**. In 2015 we will still pay out personal income tax refunds for income earned in 2014. But from 2016 onwards there will be no refund payments made; this will save 0.4–0.5 percent of GDP. The additional revenue will fund the full year impact of increases in pensions and teacher salaries that will take effect from late 2015.

C. Monetary and Financial Sector Policies

15. **Monetary policy remains guided by the goal of price stability.** We will achieve this primarily through our interest rate policy in an environment of exchange rate flexibility and central bank independence.

16. **We are on track to meet our inflation target of 5 percent by end-2015**. Reflecting the slowdown of the economic growth rate in 2013, administrative price cuts on utilities, and the relative strength of the lari, over the past three years inflation has been below our target. We have responded by pursuing accommodative monetary policies, which in 2014 have helped to stimulate the economy and to raise inflation towards our 6 percent target. We expect inflation to average 3.5 percent in 2014 (and to end the year at around 4 percent). For 2015 we expect inflation to average around 4 percent.

17. **We are continuing to take steps to enhance the communication of our monetary policy strategy and to strengthen the monetary policy transmission mechanism**.

- Each quarter we publish an inflation report, according to a set schedule (available on https://www.nbg.gov.ge). We are committed to adhering to this schedule and we plan to issue the next report by November 26. Starting in 2015, we will hold press conferences after every other MPC meeting (once per quarter) to communicate to the public our monetary policies.

- We continue to promote the use of the lari in the financial system. In the past two years, we have: (i) broadened the range of collateral to include high-quality loans for the NBG's liquidity facilities; and (ii) encouraged banks to introduce floating rate lari loans. In addition, the government has placed long-term lari deposits in commercial banks to encourage lari lending. These policies have reduced the share of dollar deposits held by residents from 70 percent in 2010 to less than 60 percent today, which has strengthened the monetary policy transmission mechanism by making domestic interest rates and inflation more sensitive to the NBG's policy rate. Our policies have also improved access to finance, by making longer-term lending in lari more attractive.

18. **We continue to strengthen the stability of our financial system**. The IMF-World Bank Financial Sector Stability Assessment (FSAP) conducted this year concluded that the NBG's regulatory and supervisory framework is robust. We appreciate the efforts of the FSAP team to analyze the major developments in the banking sector and its supervision. The FSAP noted the improvements that have been made over the past years, which—according to the assessment—have resulted in an advanced, risk-based, comprehensive and forward-looking, and in some instances even leading, supervisory approach. The recent assessment confirmed that we are on the right path, pursuing well-established international standards, including the Basel Core Principles (BCP) and other international best practice guidelines. Becoming a member of the Basel Consultative Group has allowed us to be involved in discussions of current international supervisory issues, and supports our efforts to converge our supervisory framework to the frontier of best practice. At the same time, The FSAP pointed out areas where there is scope to further strengthen our framework. Drawing on the FSAP recommendations, we will take additional steps to enhance financial stability. We will:

- continue the implementation of Basel III, including enhancement of ICAAPs by pursuing active communication with directors and members of supervisory boards in banks;

- conduct a study on the introduction of deposit insurance in Georgia, including the feasible time of introduction, underpinning the commitments we made to the EU in our Association Agreement. The study will be done in cooperation with our development partners. Based on the result of the study, we will prepare an action plan, setting out the intermediate steps we need to take, together with a timetable for implementation (structural benchmark, December 2015).

- improve communication with the public concerning the health and strength of the financial sector, and the policies that we are implementing to preserve this. We will publish Financial Stability Reports on an annual basis starting in 2015 (structural benchmark, September 2015);

- further enhance the supervisory approach for concentration credit risk in commercial banks through introduction of revised guidelines for concentration risk (structural benchmark, December 2015);

- reassess NBG salary levels in light of NBG's legal obligation to maintain effective supervision by maintaining high qualified and experienced staff, and review the training and education budget to meet prevailing needs;

- prepare for parliament legal amendments to strengthen the protection of supervisory staff and the NBG by clarifying modalities for legal protection and the rights of the NBG to provide legal representation. In particular, the NBG will gain the ability to finance legal costs associated with the protection of its staff and supervisor in the case NBG or its employees are sued for actions taken or refrained from taken in good faith and in the ordinary course of duties in accordance with Georgian legislation; and

- prepare for parliament legal amendments concerning transfers of significant ownership, which will include expanding the definition of 'significant shareholder' to include persons acting in concert. The purpose is to oblige significant shareholders to notify the NBG before the disposal of their shares and further clarify the obligation of banks to notify the NBG of any material negative information concerning shareholders.

19. **To improve our preparedness for crisis-management, and in line with the FSAP recommendation, we have signed a memorandum of understanding between the Ministry of Finance and the NBG, which establishes a Financial Stability Working Group**. The memorandum of understanding lays down the framework for meetings to discuss emerging issues requiring joint efforts. It also facilitates information exchange and cooperation between the parties for the purpose of securing financial system stability and developing and improving mechanisms for managing crisis situations. The Working Group will discuss the NBG's Financial Stability Report, which, if appropriate, will be used as input into the Ministry of Finance's Fiscal Risk Assessment document.

D. Structural Reforms

20. **To achieve our goals of sustainable and inclusive growth, we are undertaking a wide range of structural reforms (Table 3 summarizes existing and new structural reform benchmarks)**. As made clear in our July Letter of Intent, we remain committed to our Georgia 2020 social economic development strategy, our Association Agreement with the EU, and the reform agendas agreed with our development partners. We will also launch two new Development Policy Operations with the World Bank: the first is focused on private sector development, the second on inclusive growth.

21. **We remain concerned over possible problems in the area of access to finance, especially for small and medium sized enterprises, and are committed to analyzing these and to finding ways to overcome them:**

- Policies implemented in the last year have helped expand access to credit. Lower interest rates together with measures to encourage banks to make more lari-denominated loans (see Section C above) have had their desired effect. Compared to the previous year, credit has grown rapidly, at about 20 percent on average (16 percent at constant exchange rate): 28 percent to households and 15 percent to firms. This is a substantial increase from 2013, where credit grew on average by only 12 percent.

- However, the recent FSAP did point to obstacles for accessing finance. Overcoming these calls for a comprehensive set of actions, including deepening the savings market, for example through deposit insurance and pension reform; and measures to deepen capital markets. As a result of these findings and our own deliberations, we believe that the access to finance study has to be more comprehensive and deeper than initially envisioned, which has caused a delay in its preparation. We will continue to work closely with the World Bank and KfW in this area, and now expect that the study, which we will prepare drawing *inter alia* on their findings, will be completed by late 2015 (structural benchmark end-December 2015).

- As for the financial vehicle to help improve access to finance, we see the need for a deeper analysis of the current situation in Georgia with regards to access to finance. We need to better understand the causes of possible market failures and ways to overcome these, including the type and functions of institutions put in place to correct market failures. Such a study will help us understand whether and how existing institutions respond to market demand. The results of the study will clarify the needs of Georgia and provide a basis for further steps. Our approach to correcting market failures in the area of access to finance will continue to be guided by the principles of not distorting markets, not setting up public entities that compete with commercial banks, avoiding undue fiscal risks, and respecting good transparency and governance practices. We will consult with the IMF and other development partners regarding the mandate, policy instruments, structure, as well as operational and financial setting before introducing legislation changing the set-up of financial institutions aimed at improving access to finance.

22. **We continue to work on improving the efficiency of the wide range of state funds and government support programs.** As envisaged in our July Letter of Intent, we will prepare a comprehensive assessment to evaluate the existing Government funds created to promote access to finance and to promote investments. To this end, we look forward to working closely with the World Bank to review the performance of the largest funds and to prepare an action plan for their future operation, including possible consolidation. We had originally hoped that our assessment would be ready by September, but in light of the unforeseen complexity of this task, we now intend to complete this assessment by December 2015 as part of our Access to Finance study. As part of our Development Policy Operation, we will work with the World Bank to reorganize and/or close the approximately 200 state enterprises.

23. **The Partnership Fund will continue** to operate according to its mandate of using minority co-financing to catalyze commercially viable projects with developmental objectives. Partnership Fund financing (debt plus equity plus guarantees) will not be allowed to exceed 100 percent of the equity of the private partner in the project. The Partnership Fund will continue to pursue only commercial objectives, and will not run a cash deficit (performance criterion).

24. **We are improving the quality and coverage of our statistics**. As well as being important in its own right, this is essential for understanding our economy and for informing our economic policy.

- We are conducting a census in 2014, the first since 2002. We believe that this will provide valuable input into improving statistics.

- We are making progress on developing GDP by expenditure in constant prices and are on track to publishing this by December 2015 (structural benchmark, December 2015).

- As mentioned in our July Letter of Intent, we will prepare a revised Law on Statistics by the end of the year which will make it mandatory for businesses to report to GEOSTAT. We will submit this Law to Parliament in January (structural benchmark, March 2015), and expect it to be passed by March 2015.

- To improve our understanding of unemployment and the policies needed to reduce it, we will improve labor force statistics by starting to publish unemployment rates each quarter, including rural-urban unemployment rates (structural benchmark, end-March 2017).

25. **We are continuing our efforts to increase fiscal transparency:**

- With the help of the IMF, we are issuing for the first time a fiscal risk statement together with the 2015 budget comprising disclosures on macroeconomic and debt-related risks (structural benchmark, end-December 2014). By the end of next year, we will expand our risk analysis to include risks stemming from large state-owned enterprises and quasi-fiscal activities (structural benchmark end-December 2015).

- Starting from 2015, budgets of all central and local units—including Legal Entities of Public Law with the exception of schools—will be executed by the Treasury, with their cashflows integrated into the Treasury Single Account. This will help better monitor local governments' liquidity and improve their expenditure classification, allowing us to have a better consolidated understanding and forecast of general government finances.

26. **We are continuing with the reforms of tax administration set out in our July Letter of Intent.** With the help of the IMF, we are strengthening tax audit capacity, improving filing compliance, and making progress on better management of uncollectible arrears and refund arrears. We will request follow-up technical assistance from the Fiscal Affairs Department (FAD) to improve the accuracy of the taxpayer register, filing of tax returns, disputes resolution, taxpayer audit, and to reduce tax refund arrears.

- In the area of taxpayer audit, we approved the decision to abolish the alternative tax audit program by early 2015 (structural benchmark, end-April 2015). In parallel, we have reduced significantly the number of private alternative auditors and have started recruiting staff to ramp up our audit capacity by end-April 2015. We have also drafted amendments to the tax code to enable GRS auditors to access bank account and third party data to increase their effectiveness.

- In the area of arrears management, we established an organizational unit under the tax administration department to manage debt in 2014 and drafted legislative amendments that we will introduce in the current session of Parliament to facilitate the write-off of uncollectible debt.

- As for tax refund arrears, we have developed plans to introduce single taxpayers' accounts in 2015 (structural benchmark, end-June 2015) which would help avoid the build-up of overdue refunds in the future. We plan to undertake a project audit to improve the accuracy of the large credit balances owed to taxpayers and to follow a risk-based approach to verifying credit returns.

27. **We are in the process of developing a cadastre**. With the support of USAID, we have prepared a package of draft legislative changes, which will increase the quality of ownership rights registration and ensure better protection of property rights. An Irrigation and Land Market Development Project (covering 11 pilot areas throughout Georgia), financed by the World Bank, will test the policies and procedures for registration of agricultural land that will allow the majority of existing land ownership rights to be registered (regularization). The pilot will inform the design of a national land registration program. The outcome of the project will enable us to choose the right direction for developing a cadastre with a full coverage of Georgia, and a registration system that ensures high data quality and the security of property rights.

28. **We have completed an updated safeguards assessment of the NBG.** The assessment of the IMF's Finance Department found that the NBG's overall governance framework is broadly appropriate. Since 2009, the majority of the NBG's systems have been upgraded, and many key operations are now largely automated. As part of this process, controls have been strengthened in key areas relevant to safeguards, in particular foreign reserves management, government banking, and currency and vault operations. Furthermore, the Fund's safeguards policy requirements for direct budget financing are in place.

Very truly yours,

/s/
Irakli Garibashvili
Prime Minister
Georgia

/s/
Giorgi Kvirikashvili
Deputy Prime Minister
Georgia

/s/
Nodar Khaduri
Minister of Finance
Georgia

/s/
Giorgi Kadagidze
Governor of the National Bank of Georgia
Georgia

Table 1. Georgia: Inflation Consultation Targets and Bands for 2014 and 2015

	2014			2015			
	End Sep.	End Sep. Actual	End Dec.	End March	End June	End Sep.	End Dec.
Inflation Consultation Bands for CPI (in percent)							
Central point	5	4.8	5	5	5	5	5
Inner band, upper limit/lower limit	7/3		7/3	7/3	7/3	7/3	7/3
Outer band, upper limit/lower limit	8/2		8/2	8/2	8/2	8/2	8/2

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for 2014 and 2015

	2014					2015	
	End Sep.	End Sep. Adjusted	End Sep. Actual	End Dec.	End Dec. Revised	End June	End Dec.
Performance Criteria							
Ceiling on the General Government cash deficit (in mn lari)	810	810	320	1,080	1,080	290	970
In Percent of GDP	*2.8*	*2.8*	*1.1*	*3.7*	*3.7*	*0.9*	*3.0*
Ceiling on Expenditures of the General Government	…	…	…	9,012	9,012	…	9,740
Floor on NIR of NBG (End-period stock, in mn USD)	1,510	1,509	1,574	1,520	1,555	1,568	1,830
Ceiling on the accumulation of external arrears of the General Government (continuous criterion) (in mn USD)	0	0	0	0	0	0	0
Ceiling on the cash deficit of the Partnership Fund (in mn lari)	0	0	-40	0	0	0	0
Indicative Targets							
Ceiling on NDA of NBG (End-period stock, in mnl lari)	450	450	33	600	353	219	320

Table 3. Georgia: Structural Benchmarks

Measure	Date
Prior Actions for the 1st review	
Submission of final draft of the 2015 budget to Parliament with a deficit of no more than 3.0 percent of GDP and including measures from the LOI (paragraphs 13 and 14).	
Financial Sector	
With the support of the World Bank, conduct a thorough assessment of the presence, nature and remedies for credit market imperfections	End-Sep 2014 New date: End-Dec 2015
Complete an Action Plan for introducing Deposit Insurance	End-Dec 2015
Start publishing annual Financial Stability Reports	End-Sep 2015
Introduce revised guidelines for credit concentration risk	End-Dec 2015
Fiscal	
Include in the 2015 state budget a statement of fiscal risks	End-Dec 2014
Approve the budget for 2015 with 3 percent of GDP deficit	End-Dec 2014
Abolish the alternative tax audit program	End-April 2015
Introduce a single taxpayer account system in the General Revenue Service	End-June 2015
Consolidate LEPLs[1] in the 2014 government financial statements	End-June 2015
Inclusion of SOE-related risks and risks from quasi-fiscal activities in the fiscal risk statement.	End-Dec 2015
Statistics	
Publish GDP by expenditure in constant prices	End-Dec 2015
Submit the Law on Statistics to make reporting of business statistics to GEOSTAT compulsory	End March 2015
Publish quarterly labour force statistics (including rural-urban and regional unemployment rates)	End-March 2017

[1]LEPL: Legal Entities of Public Law are semi-autonomous government agencies receiving partial financing from the budget.

Attachment I. Technical Memorandum of Understanding

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria, inflation consultation mechanism and indicative targets, as well as respective reporting requirements used to monitor developments under the Stand-By Arrangement. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available.

2. Inflation consultation targets and bands, performance criteria and indicative targets are listed in Tables 1 and 2 attached to the Letter of Intent dated December 5, 2014. The Georgian Lari to U.S. Dollar exchange rate is assumed to be GEL 1.75 = $1 for the purpose of the program. Table 1 below includes the corresponding cross exchange rates. For the purpose of the program, all other exchange rates and the price of gold are assumed to be those prevailing on March 31, 2014.

Table 1. Program Exchange Rates

	Currency Name	Currency/US$
SDR	Special Drawing Rights	0.65
GEL	Georgian Lari	1.75
EUR	Euro	0.73

A. General government and the public sector

3. Definition: The general government is defined as 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. The authorities will inform IMF staff on the creation of any such entities without delay. The general government does not include State-Owned Enterprises and the Partnership Fund. The public sector consists of the general government, Legal Entities of Public Law and public financial and non-financial corporations, including the National Bank of Georgia.

4. Supporting material: The Treasury Department of the Ministry of Finance will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month and monthly expenditures and arrears of the central government within four weeks of the end of each month. The Ministry of Finance will provide the stock of general government debt, broken down by currency and original maturity within one month from the end of each quarter. The Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the end of the previous business day.

B. Quantitative performance criteria, inflation consultation mechanism indicative targets and continuous performance criteria: definitions and reporting standards

Quantitative Performance Criteria and Indicative Targets

5. The quantitative performance criteria and indicative targets specified in Tables 2 attached to the Letter of Intent are:

- a performance criterion (ceiling) on the cash deficit of the general government;
- a performance criterion (ceiling) on the expenditures of the general government;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (zero ceiling) on the accumulation of external arrears;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund; and
- an indicative target (ceiling) on the net domestic assets (NDA) of the NBG

6. Performance criteria and indicative targets have been set for end-December 2014, end-June 2015 and end-December 2015 (the next three test dates). They are monitored on a cumulative basis from the beginning of the calendar year (with the exception of the NIR and NDA targets, which are monitored in terms of stock levels), while the continuous performance criterion is monitored on a continuous basis.

Inflation Consultation Mechanism

7. Inflation consultation bands around a central target are set for each test date under the program, and for quarterly dates in between to help assess program performance, see table 1 attached to the Letter of Intent. Inflation is identified as the 12-month percentage change of the consumer price index (CPI) as measured and published by the National Statistics Office of Georgia (Geostat). Should the observed year-on-year rate of CPI inflation fall outside the outer bands specified in Table 2 below on any one of the program's test dates, the authorities will consult with the IMF's Executive Board on the reasons for the deviation and the proposed policy response before further purchases can be requested under the SBA. The NBG will discuss with IMF staff should the observed year-on-year rate of CPI inflation fall outside of the inner bands specified for each test date in Table 2.

Table 2. Inflation Consultation Target and Bands			
	Dec. 31, 2014	**June 30, 2015**	**Dec. 31, 2015**
Inflation target	5.0	5.0	5.0
Inner band	±2.0	±2.0	±2.0
Outer band	±3.0	±3.0	±3.0

Ceiling on the Cash Deficit of the General Government

8. **Definition:** The cash deficit of the general government will be measured from the financing side at current exchange rates. Accordingly, the cash deficit is defined as the sum of: i) net domestic financing from banks and nonbanks; ii) net external financing; and iii) privatization receipts.

9. Net domestic bank and nonbank financing is defined as:

a. Net lending (borrowing net of repayments) provided by commercial banks to the general government, including securities (for example T-Bills), plus the use of deposits held by the general government in commercial banks. Monitoring of net lending and the use of government deposits will be based on the NBG's monetary survey and Treasury data. The change in local governments' cash balances in commercial banks for budget financing purposes will be monitored based on the 'budget of territorial unit' account data provided by the Treasury Department.

b. Net lending (borrowing net of repayments) provided by the NBG to the general government, including securities (for example T-Bills), plus the use of deposits of the general government held at the NBG. Monitoring of net lending and use of government deposits will be based on the central bank survey and treasury data. The change in cash balances of the general government at the NBG for budget financing purposes will be monitored based on the 'State Budget's Treasury Single Account (TSA)', 'Revenue Reserve Account' data provided by the Treasury Department and 'Accounts of Territorial Units' provided by the Treasury Department. From 2015, the balance of local government accounts will be monitored using the NBG's monetary survey.

c. Any securities issued by the general government and purchased by nonbanks (for example T-Bills or securitized claims on the government sold by the NBG) are also included in domestic financing.

10. Net external financing is defined as the total of loans disbursed to the general government for budget support (including the financing from the IMF whose domestic counterpart is used to finance the budget), and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the general government abroad, minus amortization and net deposit accumulation in the state budget's foreign currency account. Amortization includes all external debt-related payments of principal by the general government.

11. Privatization receipts consist of all proceeds to the central and local governments in connection with the sale of central or local government assets. This includes receipts from the sale of shares, the sale of nonfinancial assets as well as leases and the sale of licenses with duration of 10 years or longer.

12. 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 privatization receipts 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.

Ceiling on the Expenditures of the General Government

13. Definition: Expenditures of the general government comprise all current and capital expenditures as well as net lending according to GFSM 1986: i) current expenditures comprise compensation of employees, purchase of goods and services, subsidies, grants, social expenditures, other expenditures, other accounts payables, and domestic and external interest payments; ii) capital expenditure includes projects financed by foreign loans and grants as well as domestically financed capital expenditure; and iii) net lending is defined as lending minus repayments to the general government.

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

Ceiling on the Cash Deficit of the Partnership Fund

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

16. 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.

17. 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 will comprise 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.

18. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly revenue, expenditure and financial operations within four weeks of the end of each quarter.

Floor on the Net International Reserves of the NBG

19. Definition: Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. Foreign assets of the NBG include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities of the NBG shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to US$1,452 million as of March 31, 2014 (at program exchange rates).

20. Adjustors: The floor of the NIR of the NBG will be adjusted:

- Upward/downward by 50 percent for any excess/shortfall in the balance of payments support loans and balance of payment support grants relative to the projected amounts presented in Table 3.

- Upward/downward by 50 percent for any excess/shortfall in the disbursements of the project loans and project grants to the treasury single account at the NBG relative to the projected amounts presented in Table 3.

Table 3. Projected Balance of Payment Support Financing[1]

(in millions of U.S. dollars)

	Balance of payments support loans and grants	Project loans and grants
December 31, 2014	224.7	169.1
June 30, 2015	0	108.6
December 31, 2014	202.2	197.4

[1] Cumulative from the beginning of the calendar year.

21. 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.

Ceiling on Net Domestic Assets of the NBG

22. Definition: Net domestic assets (NDA) of the NBG are defined as the difference between reserve money and NIR as defined above in paragraph 19. Therefore, the ceiling on NDA is defined as projected reserve money minus the target NIR. Thus defined, the stock of NDA amounted to GEL -21 million on March 31, 2014.

23. Adjustors: The ceiling on the NDA of the NBG will be adjusted:

- Upward/downward by 50 percent for any shortfall/excess in the balance of payments support loans and balance of payments support grants relative to the projected amounts presented in Table 3.

- Upward/downward by 50 percent for any shortfall/excess in the disbursement of the project loans and project grants to the treasury single account at the NBG relative to the projected amounts presented in Table 3.

24. Supporting material: The NBG will provide to the IMF its balance sheet, which includes data on reserve money and net domestic assets on a daily basis. Data will be provided using both actual and program exchange rates.

Continuous Performance Criterion on Accumulation of General Government External Arrears

25. Definition: External debt is defined as set forth in point No. 9 of the Executive Board Decision No. 6230-(97/140), as revised on August 31, 2009 (Decision No. 14416-(09/91).[1] External debt is defined as debt contracted by the general government with nonresidents other than the IMF.

26. Definition: External arrears are defined as unpaid external debt service by the general government to official and private creditors beyond 30 days after the due date.

27. Supporting Material. Details of external arrears accumulated on interest and principal payments to creditors will be reported to the IMF within one week from the date of the missed payment. Data will be provided using actual exchange rates.

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

Appendix to the TMU: The Partnership Fund

Organization and operational structure

C. Legal Structure

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

a. Corporate Governance

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

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

Corporate mandate and portfolio management

b. Corporate Mandate

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

c. Portfolio Management Strategy

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

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

d. Project Development Methodology

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

Reporting and Auditing

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

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

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

Fiscal risks associated with the PF will be limited since:

- The PF projects don't create any kind of contingent liability for the sovereign balance sheet, as the government as no legal obligation to bail out the PF, should it become illiquid or insolvent;
- All liabilities of the PF are limited to its own balance sheet;
- The PF has its own revenue sources, namely: the dividends from its investments, the interest earnings from the loans its provides, the fees it charges on the guarantees it provides, and the proceeds of asset sales; and

The PF may decide to borrow from credible financial institution with recourse to its balance sheet facility and without state guarantee.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review of Stand-by Arrangement with Georgia, and Approves US$58.1 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Georgia's economic performance under the three-year Stand-By Arrangement (SBA). The completion of the review enables the disbursement of SDR40 million (about US$58.1 million), bringing total disbursements under the arrangement to SDR80 million (about US$116.3 million).

The Board's decision was taken without a meeting.[1] The SBA with a total access of SDR100 million (about US$145.4 million) was approved by the Executive Board on July 30, 2014 (see Press Release No. 14/377).

Despite a challenging external environment, macroeconomic developments in 2014 continue to be in line with the program. Growth of 5 percent is expected, helped by strong domestic demand and the fiscal expansion. Inflation has gradually increased but remains below the target of 6 percent for 2014. The current account deficit has widened to 8.5 percent of GDP as expected with this year's economic recovery. Although fiscal policy remains supportive to growth, the fiscal deficit is expected to come in lower than the 3.7 percent of GDP projected in the program.

Program performance is on track with all criteria and indicative targets met as of the end-September 2014 test date. Inflation has also been well within the bands set by the program. However, the study of possible obstacles to access to finance was not completed by September as expected under the program. It will instead be completed in 2015, to allow more time to incorporate inputs from key development partners and to make a deeper assessment

The program's strategy of medium-term fiscal consolidation, inflation targeting with central bank independence, strengthening resistance to external shocks and improved competitiveness remains appropriate. Structural reforms remain essential to sustain growth.

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

The authorities continue to be committed to fiscal adjustment, as evident by a 2015 budget that reduces the deficit to 3.0 percent of GDP. External adjustment remains a priority, and the flexible exchange rate regime helps to preserve competitiveness, as exchange rates in partner countries adjust. Although there are downside risks, the recent fall in oil prices could boost growth and reduce the current account deficit.