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Georgia: First Review Under the Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia

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

- The staff report for the First Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on November 5, 2008, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 1, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its December 15, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Georgia.

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

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INTERNATIONAL MONETARY FUND

GEORGIA

First Review Under the Stand-By Arrangement

Prepared by the Middle East and Central Asia Department
(In consultation with other Departments)

Approved by David Owen (MCD) and Dominique Desruelle (SPR)

December 1, 2008

- **Arrangement:** An 18-month Stand-By Arrangement (SBA) for SDR 477.1 million (317 percent of quota) was approved on September 15, 2008, to help restore investor confidence in the wake of the August armed conflict with Russia. A first purchase of SDR 161.7 million ($250 million) was disbursed upon approval. All end-September performance criteria have been observed.
- **Policy Discussions:** Discussions centered on economic management in the face of the adverse impact of the conflict on confidence—further compounded by the unfolding global financial crisis. Increased pressures in the foreign exchange market due to recent and expected losses in foreign inflows led the authorities to allow a sharp depreciation in November. They reaffirmed their commitment to greater exchange rate flexibility.
- **Review under the Emergency Financing Mechanism:** The SBA first review also satisfies the review prescribed under the emergency financing mechanism in relation to the initial policy response and the reaction of markets to these policies.
- **Team:** A.L. Coronel (Head), C. Dieterich, J. Koeda (all MCD), P. Lohmus (MCM), A. Sadikov (SPR), and E. Gardner (Senior Resident Representative in Lebanon).
- **Exchange Rate Regime:** The regime was reclassified as a de facto conventional peg from managed float based on the exchange rate policy introduced during and after the conflict.
- **Statistics:** Economic data are broadly adequate for surveillance and program monitoring. Georgia participates in the GDDS.

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Attachments

EXECUTIVE SUMMARY

The authorities' actions to stabilize the markets in the wake of the armed conflict with Russia proved effective. The temporary exchange rate peg helped stabilize expectations, and the central bank liquidity injections helped protect the integrity of the payments and the financial systems. Financial indicators showed some improvement through end September, allowing for the observance of all performance criteria for the first review of the Stand By Arrangement (SBA).

However, a resumption of market uneasiness—probably linked to the global financial crisis—added to the post-conflict-related investment uncertainties. Increased demand for foreign exchange, reflecting the recent and expected decline in private capital inflows and the perception of exchange rate overvaluation, led to a deposit decline and significant losses in international reserves since late September. Faced with these pressures, the authorities acted decisively by allowing a large depreciation of the lari in the second week of November. Since then, the markets seem to have stabilized, but developments in the next few weeks will determine whether the exchange rate has found its new equilibrium.

The international financial turmoil and the economic slowdown in neighboring countries pose new challenges to the outlook. The recovery of private inflows will likely take longer to materialize and is subject to greater uncertainty. This delay, along with a possible reduction in remittances and a slowdown in trade activity, would reinforce downward risks to economic growth and create further pressures to the balance of payments. Moreover, curtailed access to international capital markets, the recent lari depreciation, and the spillover effects on confidence will likely generate new vulnerabilities for the banking sector. On the positive side, the expected substantial donor support will help counteract these adverse shocks by bolstering international reserves and supporting economic growth.

The authorities' Fund supported program will continue to address these challenges to restore access to international markets. Sustaining economic growth and maintaining confidence in the currency and the financial system within the constraints of available external financing are the main program priorities. To this end, fiscal policy is set to support economic activity while addressing key social and reconstruction needs, and monetary policy will focus on achieving the inflation objective by assigning a more active role to interest rate adjustments in the context of exchange rate flexibility.

Continued monitoring of the financial sector is crucial at this time of stress. Financial assistance from IFIs is expected to help banks meet their maturing external obligations, but liquidity could suffer from market nervousness. Moreover, the exchange rate depreciation and a reversal of the real estate boom could hurt bank asset quality. Enhanced supervisory efforts are therefore needed to ensure the soundness of the financial system.

I. Recent Political and Economic Developments

A. Political Developments

1. **Geopolitical tensions remain high in the aftermath of the August armed conflict with Russia.** While Russian troops have pulled back from undisputed Georgian territory following the deployment of international observers, the prospects of a withdrawal from the disputed areas seem remote, and conditions in the two breakaway regions remain tense. Georgia's prospects for NATO membership are still uncertain.

2. **President Saakashvili maintains political and popular support.** Solidarity with the President has strengthened his party, which has a two-thirds majority in parliament. A new Prime Minister, Mr. Mgaloblishvili, was appointed on November 1, 2008. The opposition has been rallying support for challenging the decisions leading up to the conflict and calling for early elections in the spring, but recent demonstrations did not gather much momentum.

B. Economic Developments

3. **The stabilization actions following the conflict proved effective, but financial conditions began deteriorating in late September, leading to market uneasiness.** The temporary peg of the lari to the U.S. dollar served as an effective anchor to preserve confidence in the short term. At the same time, the easing of liquidity conditions helped protect the integrity of the payments and financial systems. However, financial indicators, which showed some improvement in September, have again come under pressure partly as Georgia began to feel the effects of the global financial crisis (see Box).

Box. Georgia—Recent Evolution of Key Financial Indicators

- **Gross international reserves** increased to $1.37 billion by end-September, aided by the SBA purchase ($250 million) and a first transfer of $50 million from the foreign assets of the sovereign wealth funds (SWFs) to the government's accounts.[1] In October, however, reserves declined to $1.27 billion mainly due to interventions, notwithstanding additional transfers of about $150 million from the SWFs.

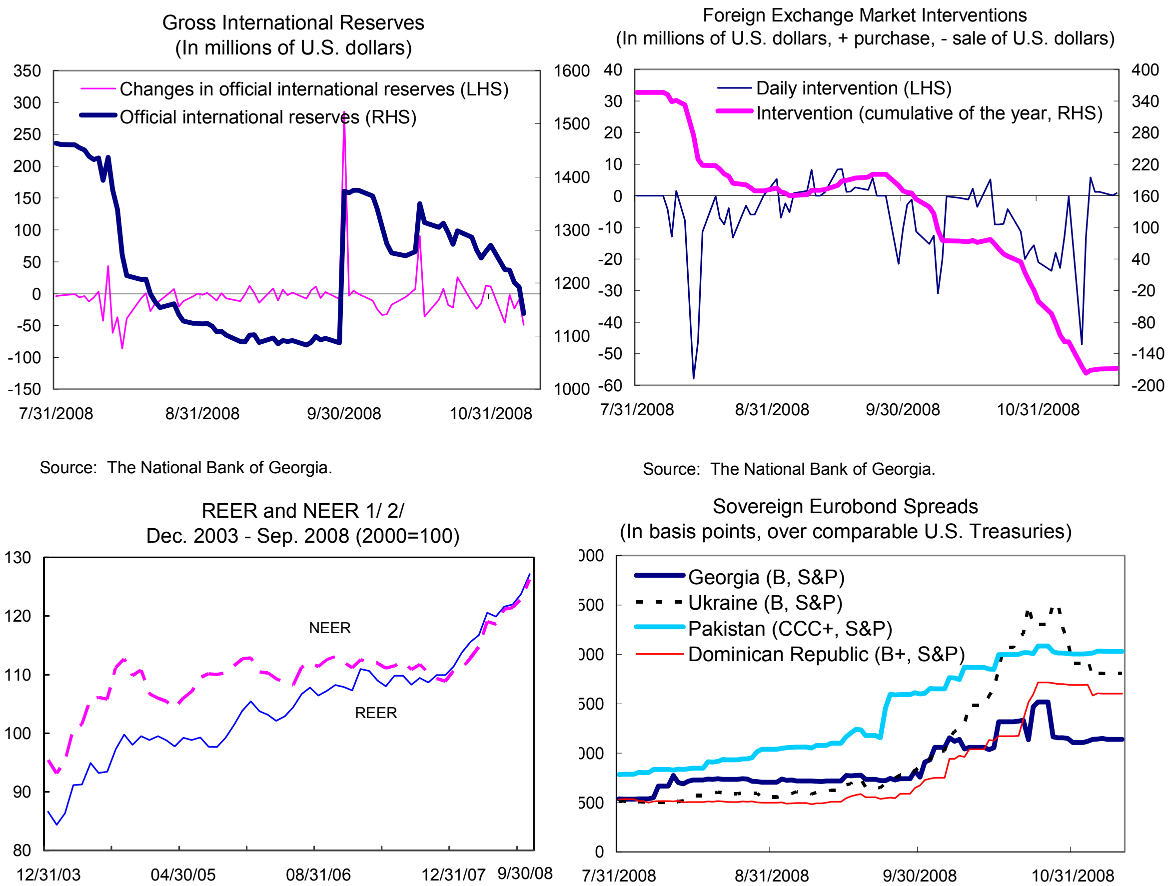
- **Interventions in the foreign exchange market** by the National Bank of Georgia (NBG) to defend the temporary peg amounted to one-third of gross reserves during August 7–November 7. In August only, sales amounted to $190 million. During most of September the situation stabilized faster than expected under the program, with the NBG purchasing foreign exchange. However, pressures resumed, and the NBG sold $320 million from September 28 to November 7, when the lari began to depreciate.

- **Bank deposits** dropped by 13 percent in August, creating strong pressures on bank liquidity. During September they recovered by 5 percent, but in October and early November they declined again. The share of foreign currency deposits increased somewhat, and the decline in currency in circulation is likely to reflect an increase in dollar cash holdings.

- **The spread on Georgia's sovereign bonds** over comparable U.S. Treasury bills increased from 550 to nearly 800 basis points during the conflict, declined to 700 basis points after the cease-fire, but rose to over 1100 basis points in the wake of the global financial crisis.

1/ The government decided to repatriate most of the SWFs resources ($370 million) in September-December 2008, even though it still intends to use them in 2009.

Figure 1. Georgia: Key Financial Indicators



Source: The National Bank of Georgia.

Source: The National Bank of Georgia.

Sources: National Bank of Georgia, Ministry of Economic Development; and Fund staff estimates.

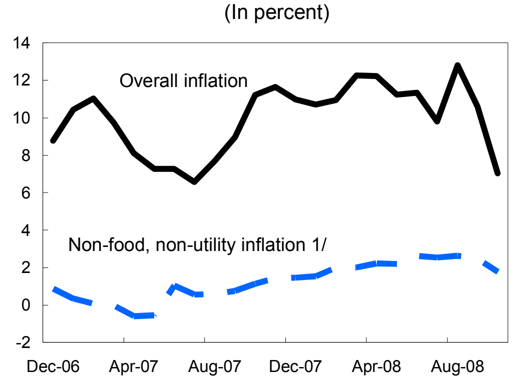
Source: Bloomberg.

1/ Real exchange rate appreciation during the first 8 months of 2008 was driven by nominal appreciation and inflation pressures. Recent events (particularly, nominal depreciation in early November) have not been reflected in the actual data.
2/ Based on INS exchange rates and CPI. An increase indicates an appreciation.

4. **The conflict had only a temporary impact on domestic prices but, in combination with the global slowdown, it impaired economic activity.**

- **Annual inflation** rose sharply to 12¾ percent in August due to major transportation and supply disruptions, but fell to 7 percent in October. Taking into account the expected economic slowdown and the recent lari depreciation, end-year inflation is projected to be about 10 percent.

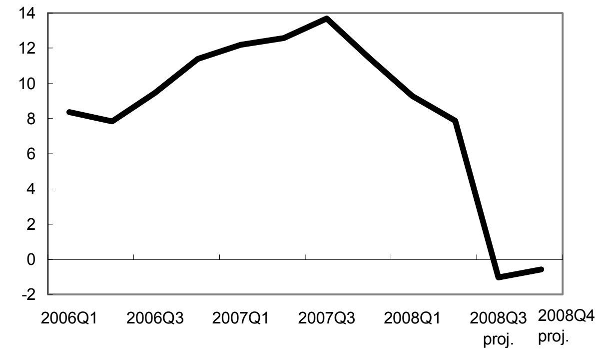
Figure 2. Georgia: 12-Month CPI Inflation
(In percent)



Source: Department of Statistics of Georgia.
1/ Utility includes transportation, housing, and electricity.

- **Real GDP growth**, which had been impressive and broad based until June 2008, is projected to become negative in the second half of 2008, following a sharp decline in private demand driven by lower inflows and the shock to confidence. Growth in 2008 is projected at 3½ percent.

Figure 3. Georgia: Real GDP Growth
(In percent, relative to same quarter of previous year)



Source: Department of Statistics of Georgia.

5. **The central bank provided ample bank liquidity during and after the conflict.** It waived the 13 percent reserve requirement for seven weeks and reintroduced it at a 5 percent rate. It also granted to banks uncollateralized 180-day loans for 140 million lari (5 percent of deposits) at lower-than-market interest rates. Liquidity concerns, which dominated the immediate post-conflict situation, have been mitigated and the payments system is functioning well. Banks' demand for liquid assets now appears to be essentially precautionary and motivated by heightened uncertainties about stability of the depositor base and the availability of funding to meet external obligations.

6. **Reflecting the ongoing uncertainty, growth in monetary aggregates and in credit to the private sector has continued to shrink.** Banks' cautious approach to lending does not appear to be related to liquidity conditions or interest rates, but rather to their concern about underlying economic conditions, the future evolution of the cost of funding, the need for provisioning, and the health of the real estate loan portfolio. Deposit and lending rates have not fluctuated much and have not reacted to central bank signaling.

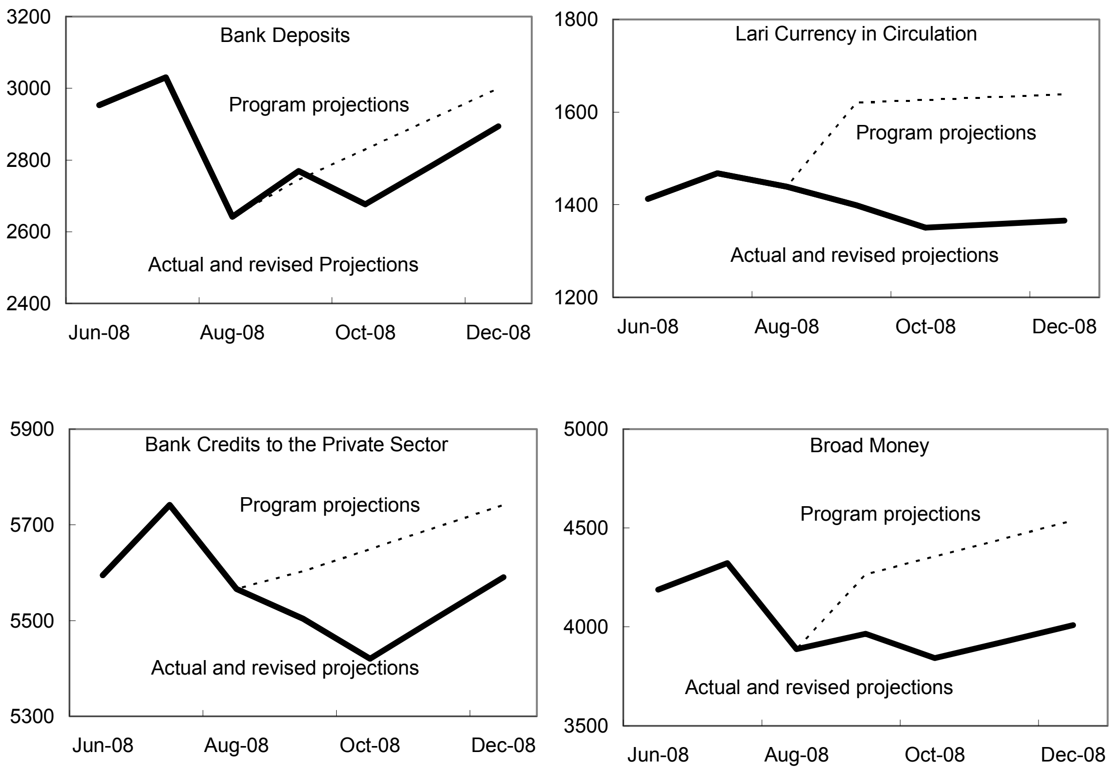
Text Table 1. Georgia: Bank Deposit and Lending Rates 1/
(In percent)

	1-Dec-07	1-Aug-08	1-Oct-08
Lending rate (lari)	23.0	23.0	23.0
Lending rate (foreign currency)	19.0	20.0	21.0
Deposit rate (lari)	12.0	13.0	14.0
Deposit rate (foreign currency)	10.0	10.0	11.0
90-day CD rate	13.0	19.0	6.4

Source: National Bank of Georgia.

1/ Weighted average rate offered by commercial banks on 6-12 months deposits.

Figure 4. Georgia: Financial Sector Indicators
(In millions of lari)



Sources: Georgian authorities; and Fund staff estimates.

7. **Fiscal performance in the third quarter was broadly in line with the program.** August tax revenues were significantly lower than the monthly average so far in 2008, but they recovered by September and October. Spending increased reflecting the repair of conflict-related damage and rising social needs. The 2008 deficit contained in the budget supplement approved by parliament in October slightly exceeds the program deficit, but the authorities are confident the target will be met.

Text Table 2: Georgia: Fiscal Developments, 2008 (In millions of lari)

	Q3		Annual	
	Prog.	Act.	Prog.	Proj.
Revenues	1,159	1,318	5,356	5,790
Current spending	1,339	1,235	5,157	5,245
Capital spending and net lending	356	468	1,410	1,703
Total deficit	-537	-385	-1,211	-1,158
Statistical discrepancy	0	-59	60	0
Domestic financing	425	268	242	-454
External financing	68	114	283	982
o/w Sovereign Wealth Fund	0	70	-541	-37
Privatization	44	61	624	630

Source: Ministry of Finance.

8. **With total pledges of $4.5 billion over three years, the October donor conference in Brussels was a success.** Although the disbursement schedule is uncertain, some $1.3 billion are expected in 2008–09 to support budgetary needs and capital projects, and about $500 million for lending and equity injections in commercial banks—to help them meet the external obligations coming due in 2009. The package to the public sector is highly concessional, and while adding to the debt stock, is not expected to compromise Georgia's debt outlook as illustrated in the September 2008 DSA (Country Report No. 08/328).

Text Table 3. Georgia: External Financing Assumptions, 2008–10 1/

Recipient	2008		2009	2010
	Q4	Full year		
Public sector (budget) 2/	451	614	1,133	1,368
Grants	313	385	572	303
Loans	138	229	561	1,065
Grants through nonpublic entities	119	232	117	136
Commercial banks 3/	284	284	270	0

Sources: Ministry of Finance; and Fund staff estimates.

1/ Authorities' and Fund staff projections based on the pledges made during the donor conference.
2/ Including pre-conflict commitments and roughly $1.3 billion of new commitments for the last quarter of 2008 and 2009.
3/ Lending and equity injections.

II. Performance Under the Program

9. **All conditionality for the first review was observed.** The end-September quantitative targets were met with ample margins and the end-October structural benchmark on signing and implementing a Memorandum of Understanding (MoU) between the NBG and the Financial Supervisory Agency (FSA) was also observed (see Tables 1 and 2 of the LOI). The quantitative targets for end-2008 and for 2009 were adjusted to reflect the earlier-than-anticipated transfer from the sovereign wealth funds to reserves and the impact of donor financing.

10. **The initial market reaction to the program was favorable.** The timely announcement of the SBA boosted reserves and contributed to easing pressures in the market. It also helped mobilize significant donor support. If all SBA purchases were drawn, Fund support would amount to 30 percent of total incremental donor support in 2008–09. The potential catalytic impact of the Fund program on private sector inflows was hindered by the additional shock to confidence stemming from the global financial crisis.

III. Outlook and Risks Linked to the Global Financial Crisis

11. **The global financial crisis has created new risks for the outlook.** The uncertainty about the post-conflict security situation has dampened the business environment. Moreover, the unfolding international financial crisis and the economic downturn in neighboring countries has further buffeted the Georgian economy. If these uncertainties do not recede, the

economy would be subject to (i) balance of payments pressures; (ii) higher risk of financial stress from a weakening bank loan portfolio; and (iii) downward risks to economic growth.

Balance of payments pressures

12. **There are indications that foreign inflows, trade activity, and remittances could be affected by the global economic slowdown.** Most investors remain in a wait-and-see mode, with only ongoing projects being brought to completion. Revisions to the balance of payments outlook point to lower-than-anticipated private direct investment and other capital flows in 2009, even though the highly diversified sourcing of FDI should help limit the risks of an outright freeze. Moreover, the economic slowdown in Russia could weaken remittances, and trade activity would be hurt by weaker global demand and disruption to trade credits. The envisaged donor support—if not imperiled by the global financial difficulties—is expected to help counteract this impact. Overall, the shift in the composition of financial inflow providers (from international investors to multilateral and bilateral creditors and donors) and inflow recipients (from private companies, banks, and individuals to the government) creates a new challenge for the authorities, placing the government in the key role of intermediating foreign inflows.

Text Table 4. Georgia: Summary Balance of Payments, 2008–09
(In millions of U.S. dollars)

	2008 H1 Prog.	2008H1 Act.	2008H2 Prog.	2008H2 Proj.	2009H1 Prog.	2009H1 Proj.	2009H2 Proj.
Current account balance	-1,549	-1,685	-1,208	-1,091	-1,253	-1,024	-1,405
Trade balance	-1,819	-1,865	-1,672	-1,836	-1,694	-1,518	-1,874
Exports	1,294	1,289	1,191	1,432	1,371	1,167	1,253
Imports	-3,113	-3,154	-2,863	-3,268	3,065	-2,685	-3,127
Financial account	1,694	1,876	319	631	1,041	766	1,291
Direct investment (net)	857	938	380	322	593	471	663
General government	164	179	6	453	212	175	367
Private Sector, excl. FDI	673	757	-67	-144	236	120	261
Banks		681		-61		102	213
Other sectors		75		-83		17	48
Gross International Reserves (-increase)	-125	-137	256	148	-241	6	-101
Use of Fund Resources	-18	-18	332	234	162	-13	-15
Memorandum items:							
Current account balance (percent of GDP)		-27.3		-15.7		-16.9	-19.8
Net capital inflows to private sector	1,530	1,694	313	178	829	590	709
Gross international reserves (end of period)	1,526	1,526	1,270	1,378	1,511	1,372	1,473

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

Banking sector vulnerabilities

13. **While official inflows should help cover banks' repayment obligations, and the confidence shock on depositors has so far been contained, banks remain vulnerable.** The banking sector is relatively small, and direct links with international financial markets are weak. Nonetheless, the system is still vulnerable to spillover confidence effects on depositors and a deterioration in the quality of the loan portfolio, in particular if global financial

pressures continue, investor interest in infrastructure and real estate projects diminish, and funding costs rise further. Although bank soundness indicators are broadly adequate, the recent sharp increase in nonperforming loans and the decline in profitability are matters of concern.

Text Table 5. Georgia: Prudential Indicators of Commercial Banks, 2004–08

	2004	2005	2006	2007	2008	
					Jun.	Sep.
Capital adequacy ratio (in percent)	18.8	17.5	20.6	16.0	15.7	17.0
Nonperforming loans (in percent of total loans)	6.2	3.8	2.5	2.6	3.4	9.9
Loans in foreign exchange (in percent of total loans)	86.7	76.2	73.8	68.6	64.9	67.5
Net open foreign exchange position 1/	7.4	7.5	3.7	5.0	1.5	1.5
Liquidity ratio (in percent)	45.0	33.3	41.5	37.2	33.3	30.4
Return on equity	10.0	14.9	15.3	9.6	8.8	-2.8

Source: National Bank of Georgia.

1/ Percent of total regulatory capital.

Economic growth

14. **The authorities expect a real GDP growth of 4 percent in 2009 with higher public spending offsetting lower private investment.** Such a growth projection represents a sharp improvement relative to the second half of 2008, but is only one-third of last year's growth. GDP growth is subject to downward risks as it would largely rely on the absorptive and implementation capacity of public spending and the timeliness of donor funding. With subdued private investment, public investment would be the main contributor to growth in 2009. Exports will benefit from the recent exchange rate depreciation, but its contribution to growth will be hurt by the expected decline in metal prices (a key export item). Nonetheless, lower imports reflecting the slowdown in capital inflows and growth, as well as the depreciation, should help narrow the external current account deficit to 18½ percent of GDP from 21¼ percent in 2008.

Text Table 6. Georgia: Savings and Investment Balance, 2006–09
(In percent of GDP)

	2006 Act.	2007 Prel.	2008 Proj.	2009 Proj.
Investment	25.6	28.1	25.5	22.0
Public	9.0	9.0	8.8	12.6
Private	16.6	19.1	16.7	9.4
Gross national saving	10.4	8.5	4.3	3.5
Public	5.9	4.2	2.8	5.9
Private	4.5	4.2	1.5	-2.3
Saving-investment balance	-15.1	-19.6	-21.2	-18.5

Sources: Georgian authorities; and Fund staff estimates.

15. **If downside risks materialize, policy adjustments would be needed**. Should pressures in the balance of payments be stronger than envisaged (e.g. lower-than-projected private inflows), the exchange rate should be allowed to find its new equilibrium. On the fiscal front, the government would need to limit its use of the SWFs resources to help protect international reserves, and should carefully scrutinize donor-financed spending to avoid additional pressures in the current account. Financial sector policies should aim at safeguarding bank soundness in the face of a likely further deterioration in bank asset quality.

IV. Policy Discussions

A. Exchange Rate and Monetary Management

16. **Following the pressures in the foreign exchange market and the fragile balance of payments outlook, the authorities allowed the lari to depreciate.** Aware of the disruptive effects of a delayed forced exit, the NBG took corrective action coordinated at the political and technical level. It allowed the exchange rate to depreciate by 16 percent in the first ten days of November (culminating in a one-off adjustment of 11 percent on November 10). Following this adjustment, the NBG intervened in the market for two days to stabilize the rate at its new level and restore confidence. Thereafter, the NBG started to purchase/sell smaller daily amounts of foreign exchange at the new rate as it considers that the exchange rate will find its equilibrium at about that level. NBG has reconfirmed its commitment to allow for exchange rate flexibility. The end-December NIR target provides a small margin for intervention, but the target is relatively tight. While the recent depreciation will imply an upward adjustment in consumer prices and will raise costs for economic agents with foreign exchange exposures, it will help address the balance of payments pressures, preserve international reserves, improve competitiveness, and support economic growth.

17. **Exchange rate flexibility should be accompanied by supportive monetary policies.** Staff recommended a more active role for monetary policy in encouraging market interest rate adjustments, and stressed that lowering liquidity surpluses once confidence returns—including by increasing policy rates, which were significantly reduced after the conflict—would be a necessary step. The effectiveness of monetary operations in signaling interest rates to the market could be enhanced by improving liquidity forecasting—in particular regarding fiscal liquidity needs, further securitizing government debt, and developing government bond markets.

18. **Improving the NBG's lender of last resort facility (LoLR) is of crucial importance**. Staff and the authorities agreed that this facility (structural performance criterion for end-December 2008) should not encourage excessive risk-taking by banks. The framework should place limits on lending to individual banks in relation to their capital and clarify the role of the FSA in certifying that participating institutions are solvent and in monitoring the use of resources. A Fund MCM technical assistance mission will discuss the details with the authorities.

B. Addressing Bank Vulnerabilities

19. **Strong supervisory vigilance over the banking system remains crucial.** Over the past years the FSA has tightened prudential regulations significantly, but following the conflict it lowered the liquidity ratio from 30 to 20 percent, and brought down from 200 to 175 percent the risk weights for foreign currency loans. Staff pointed out that while the strong standards have enhanced banks' ability to weather the more difficult environment, the recent relaxation should be temporary and needs to be accompanied by efforts to ensure banks' compliance and by measures to strengthen the FSA's institutional capacity. The authorities explained that they are working with banks on the implementation of action plans based on individual vulnerabilities.

20. **On liquidity, the main concerns are banks' maturing external liabilities and the impact of market uneasiness on deposits.** The authorities explained that the expected lending and equity injections of about $500 million by IFIs (notably the EBRD and the IFC) and some credit from parents of foreign owned banks should help meet maturing large external obligations in 2009, which amount to around $700 million (14 percent of liabilities). The recovery of domestic deposits will depend critically on the resurgence of confidence.

21. **The general economic slowdown and the currency depreciation could weaken the quality of bank assets.** The expected decline in asset prices (mainly in real estate) could weaken banks' balance sheets. While their foreign exchange position is roughly balanced, banks will have to absorb any deterioration in the loan portfolio from lending in foreign currency to unhedged borrowers. Estimates by the FSA suggest that the banking sector would be able to absorb such deterioration, but close monitoring to detect the emergence of any solvency issues will become critical.

22. **With global markets in distress, the authorities should work on contingency planning to keep the financial sector strong.** The authorities believe they are prepared to manage potential bank difficulties—in case they arise—in an effective and coordinated manner. Staff emphasized however the need to complete as soon as possible a contingency plan to deal with depositors, borrowers, and bank recapitalization.

C. Calibrating the Fiscal Stimulus

23. **The expected donor support should help finance a deficit of about 6¾ percent of GDP in 2009**.[1] The decline in the tax-to-GDP ratio reflects the ongoing reduction of the income and dividend tax rate to 15 percent (a reduction of 5 percentage points in January 2009). Staff expressed concern about this decision given that the recent revenue

[1] This target assumes full use of the 3 percent of GDP adjustor envisaged in the program to accommodate concessional donor financing. It would be adjusted upward in the event that the 2008 fiscal target is overperformed.

overperformance may prove temporary, but the government felt it was critical to stimulate private sector activity. On the expenditure front, capital spending is projected to increase significantly (by about 4 percent of GDP), while current spending (mainly on defense) is anticipated to fall sharply despite the expected pick up of social outlays. As a result, the fiscal stimulus (measured as the change in primary balance excluding grants) will be about 2 percent of GDP in 2009, and the operational surplus of the government is projected to improve significantly.

24. **The envisaged countercyclical fiscal stance is not expected to add pressures to the balance of payments.** The authorities are aware that given the high import component of spending, the magnitude and pacing of expenditure—particularly of the domestically financed outlays—should be consistent with the balance of payments objectives. Given the uncertainty of the timing of donor disbursements, the government plans to manage the budget carefully through supplements that gradually incorporate financing that actually materializes, which is a reasonable approach although not optimal in terms of medium-term planning. Staff stressed the need to prioritize spending in favor of the most pressing reconstruction and social needs.

25. **Progress has been made in structural fiscal reforms.** Coverage of the budget has been improved by reporting legal entities' operations in the draft 2009 budget. A pilot program was initiated to allow ministries to incorporate their budgets into the medium-term expenditure framework, and a dispute resolution office at the ministry of finance was established.

V. Other Issues

26. **Safeguards Assessment of the NBG.** The update assessment of the NBG's governance framework confirmed relatively strong safeguards, but also found that it faces emerging risks as it modernizes its audit, accounting, and control systems, and responds to the impact of the conflict and the global financial crisis. To address these risks, the NBG needs to reconstitute its audit committee with only non-executive members, and appoint external auditors for a multi-year term to improve audit efficiency and effectiveness.

27. **Statistical Issues.** While data quality has strengthened, economic analysis would benefit from an improvement in real sector information (early indicators of economic activity) and BOP data (timely data on capital and portfolio inflows).

28. **Drawing of the Second Purchase.** The authorities have indicated that, given expected donor financing and the availability of resources transferred from the SWFs, they do not currently intend to draw the SBA tranche (SDR 63.1 million) that will be available following completion of the first review.

VI. Staff Appraisal

29. **The authorities dealt effectively with the immediate consequences of the conflict and took commendable action to allow the exchange rate to depreciate.** While the exchange rate adjustment could involve costs for the banking and corporate sectors, it avoided the risks of a disorderly exit later on, and should help preserve international reserves, improve competitiveness, and support economic growth. The NBG's decision to intervene temporarily in the market to avoid excessive fluctuations in the exchange rate following the step depreciation was appropriate, but it is important that this is short-lived so as to avoid the reestablishment of a de-facto peg. The authorities' commitment to exchange rate flexibility will help protect international reserves, which are essential given the uncertain outlook for private capital inflows.

30. **The replacement of large private inflows with sizable, but temporary, official inflows creates new macroeconomic management challenges.** Until access to international markets is restored and consumers and investors regain confidence, the main challenges are to sustain growth and maintain confidence in the currency and the financial system within the constraints of available external financing. This creates difficult policy tensions for exchange rate management (between calming the markets and facilitating the needed adjustment) and fiscal policy (between sustaining demand and containing balance of payments pressures). The authorities' decision to allow an orderly depreciation, while expanding fiscal policy in line with available financing, strikes the right balance between these competing demands.

31. **The anticipated financial support from development partners is expected to create space for the needed countercyclical fiscal policy.** The generous support by donors, which will not compromise the debt sustainability outlook, is expected to fill the 2009 balance of payments gap while financing important government outlays. The envisaged fiscal stimulus will focus on addressing reconstruction and social needs, while minimizing unproductive spending. Timely disbursements by donors will be critical to the success of the program.

32. **There is room for a more vigorous role for interest rate adjustments now that the post-conflict liquidity concerns have been addressed.** Although uncertainty may limit the response of deposits to higher returns, better interest rate signaling by the NBG and enhanced use of the policy instruments should help avoid liquidity surpluses in the market and ease any further pressures in the foreign exchange market. The improved LoLR facility will also help the NBG deal with this crucial central bank function both in normal and in extraordinary times.

33. **Strong supervisory vigilance over the banking system remains crucial.** Liquidity could suffer from market nervousness and a further decline in asset quality, notably from a reversal of real estate prices, would lower capital adequacy ratios. Strong efforts are therefore needed to ensure that banks comply with loan classification and provisioning requirements,

supported by continued on-site inspections to detect the emergence of any solvency issues. The recently signed MoU between the NBG and the FSA provides a critical instrument for enhancing policy coordination. Nonetheless, there is a need to prepare a plan to reinforce the framework for managing potential banking sector difficulties.

34. **Risks to the program have increased as the Georgian economy has begun to feel the effects of the global financial crisis.** The main challenges are the balance of payments imbalances that could be created by a larger-than-anticipated decline in private inflows, slower-than-envisaged donor disbursements, financial sector vulnerabilities stemming from a possible weakening of bank asset quality, a weakening of trade activity, and a sharper slowdown in economic growth. Given its good debt servicing record and strong commitment to macroeconomic discipline, Georgia is not expected to experience difficulties in repaying the Fund despite the challenging environment.

35. **Over the medium term, adjustment policies could be needed to address a very large external current account deficit.** The sudden decline in private capital inflows has exposed this key vulnerability, and the future evolution of these inflows will determine the need for adjustment. In this regard, renewed exchange rate flexibility will provide the authorities with a key policy tool.

36. **The authorities do not currently intend to draw the SBA purchase that will be available at the completion of the first review.**

Table 1. Georgia: Selected Macroeconomic Indicators, 2006–09

	2006 Act.	2007 Prel.	2008 Proj.	2009 Proj.
(Annual percentage change, unless otherwise indicated)				
National accounts				
Real GDP growth	9.4	12.4	3.5	4.0
Population (million)	4.3	4.4	4.4	4.4
Consumer price index, period average	9.2	9.2	10.9	7.9
Consumer price index, end-of-period	8.8	11.0	10.0	8.0
GDP per capita (US$)	1,800	2,324	2,977	2,990
Unemployment rate (in percent)	13.6	13.3	...	...
Investment and saving		(In percent of GDP)		
Investment	25.6	28.1	25.5	22.0
Public	9.0	9.0	8.8	12.6
Private	16.6	19.1	16.7	9.4
Gross national saving	10.4	8.5	4.3	3.5
Public	5.9	4.2	2.8	5.9
Private	4.5	4.2	1.5	-2.3
Saving-investment balance	-15.1	-19.6	-21.2	-18.5
Consolidated Government Operations		(In percent of GDP)		
Revenue	26.7	29.2	29.9	28.9
Current expenditure	20.8	25.0	27.1	23.0
Operational balance	5.9	4.2	2.8	5.9
Capital spending and net lending	9.0	9.0	8.8	12.6
Total balance	-3.0	-4.7	-6.0	-6.8
Statistical discrepancy	...	0.2	0.0	0.0
Total financing	3.0	4.5	6.0	6.8
Domestic	-1.7	-0.9	-2.3	2.1
External	-0.4	0.2	5.1	3.7
Privatization receipts	5.2	5.2	3.3	0.9
Monetary sector		(Annual growth rates)		
Reserve money	19.2	25.6	-2.0	12.0
Broad money (including foreign exch. deposits)	39.3	49.6	0.7	14.9
Private credit	53.4	68.9	18.0	8.1
External sector				
Exports of goods and services (percent of GDP)	32.9	31.1	30.3	28.3
Annual percentage change	16.9	24.7	24.8	-6.1
Annual percentage change (volume)	-8.4	4.7	5.1	11.4
Imports of goods and services (percent of GDP)	56.8	57.9	58.4	53.3
Annual percentage change	33.0	34.1	29.2	-8.1
Annual percentage change (volume)	11.5	11.9	4.1	5.4
Imports of oil and oil products (in millions of US$)	443	556	772	560
Current account balance (in millions of US$)	-1174	-2006	-2776	-2429
In percent of GDP	-15.1	-19.6	-21.2	-18.5
Gross International reserves (in millions of US$)	881	1361	1378	1473
In months of next year's imports of goods and services	1.8	2.1	2.4	2.2
Private capital flows, net (in millions of US$)	1593	2292	1873	1514
In percent of GDP	20.5	22.4	14.3	11.5
Foreign direct investment (in millions of US$)	1170	1750	1266	1134
In percent of GDP	15.1	17.1	9.7	8.6
External debt (in millions of US$)	2328	3136	4407	4617

Sources: Georgian authorities; and Fund staff estimates.

Table 2. Georgia: Annual Consolidated Government Operations 1/

	2006	2007	2008		2009		2006	2007	2008		2009	
			Prog. 2/	Proj.	Prog.	Proj.			Prog.	Proj.	Prog.	Proj.
	(In millions of lari)						(In percent of GDP)					
Revenues	3,678	4,972	5,356	5,790	5,644	6,287	26.7	29.2	27.7	29.9	26.0	28.9
Taxes	3,152	4,390	4,778	4,803	5,169	5,002	22.9	25.8	24.7	24.8	23.8	23.0
Direct	1,351	1,936	2,083	2,108	2,195	2,086	9.8	11.4	10.8	10.9	10.1	9.6
Indirect	1,801	2,454	2,695	2,695	2,974	2,916	13.1	14.4	13.9	13.9	13.7	13.4
Other revenues	358	480	402	461	297	341	2.6	2.8	2.1	2.4	1.4	1.6
Grants	168	102	176	526	178	944	1.2	0.6	0.9	2.7	0.8	4.3
Current expenditure	2,861	4,254	5,157	5,245	5,013	5,010	20.8	25.0	26.6	27.1	23.1	23.0
Compensation for employees	565	676	1,022	1,023	1,079	1,119	4.1	4.0	5.3	5.3	5.0	5.1
Use of goods and services	774	1,580	1,754	1,766	1,527	1,070	5.6	9.3	9.1	9.1	7.0	4.9
Subsidies	387	399	391	421	341	416	2.8	2.3	2.0	2.2	1.6	1.9
Grants	7	14	12	12	10	10	0.0	0.1	0.1	0.1	0.0	0.0
Social expenses	709	851	1,238	1,264	1,368	1,525	5.1	5.0	6.4	6.5	6.3	7.0
Other expenses	317	636	602	631	521	657	2.3	3.7	3.1	3.3	2.4	3.0
Interest	104	98	137	128	168	213	0.8	0.6	0.7	0.7	0.8	1.0
To nonresidents	36	39	79	69	110	155	0.3	0.2	0.4	0.4	0.5	0.7
To residents	68	59	59	59	58	58	0.5	0.3	0.3	0.3	0.3	0.3
Operational balance	817	718	198	545	631	1,277	5.9	4.2	1.0	2.8	2.9	5.9
Capital spending and net lending	1,237	1,524	1,410	1,703	1,446	2,747	9.0	9.0	7.3	8.8	6.7	12.6
Capital	1,070	1,465	1,325	1,612	1,421	2,630	7.8	8.6	6.8	8.3	6.5	12.1
Net lending	167	59	85	91	25	117	1.2	0.3	0.4	0.5	0.1	0.5
Total balance	-420	-806	-1,211	-1,158	-815	-1,470	-3.0	-4.7	-6.3	-6.0	-3.8	-6.8
Statistical discrepancy	...	33	60	0	0	0	...	0.2	0.3	0.0	0.0	0.0
Total financing	420	773	1,151	1,158	815	1,470	3.0	4.5	5.9	6.0	3.8	6.8
Domestic	-237	-149	242	-454	-67	464	-1.7	-0.9	1.3	-2.3	-0.3	2.1
Amortization	-64	-30	-61	-63	-67	-77	-0.5	-0.2	-0.3	-0.3	-0.3	-0.4
Use of deposits at the NBG and banks	-173	-119	303	-391	0	541	-1.3	-0.7	1.6	-2.0	0.0	2.5
External	-62	34	283	982	681	810	-0.4	0.2	1.5	5.1	3.1	3.7
Borrowing	173	166	920	1,072	232	931	1.3	1.0	4.8	5.5	1.1	4.3
Repayment	-234	-132	-96	-53	-92	-157	-1.7	-0.8	-0.5	-0.3	-0.4	-0.7
Use of Sovereign Wealth Fund resources	0	0	-541	-37	541	37	0.0	0.0	-2.8	-0.2	2.5	0.2
Privatization receipts	719	889	624	630	200	196	5.2	5.2	3.2	3.3	0.9	0.9
Memorandum items:												
Nominal GDP	13,784	16,999	19,353	19,353	21,737	21,737						
Total financing including adjustors												
Adjustor	...	...	387	387	...	...	...	...	2.0	2.0	...	...
Amount of the adjustor to be used 3/	...	...	...	152	...	...	...	...	...	0.8	...	...
Fiscal deficit excluding grants	588	875	1,327	1,684	993	2,414			6.9	8.7	4.6	11.1
Combined financing from SWF and deposits			-238	-428	541	578						

Sources: Ministry of Finance; and Fund staff estimates.

1/ Consolidated government includes central and local governments and the Sovereign Wealth Funds.
2/ The 2008 deficit PC remains unchanged except for Lari 24 million which was added to reflect the fact that a grant financed pre-payment of debt to the EU was postponed.

3/ The adjustor is derived from additional $40 million financing from the World Bank which was partly offset by lower than programmed spending for capital projects. In addition, the borrowing projections include $70 million from the AsDB which are not assumed to be spent in the 2008 budget.

Table 3. Georgia: Quarterly Consolidated Government Operations 1/
(In millions of lari)

	2008						2009				
	Q1 Actual	Q2 Actual	Q3 Proj.	Q3 Act.	Q4 Proj.	Annual Proj.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.
Revenues	1,310	1,402	1,159	1,318	1,760	5,790	1,300	1,574	1,617	1,796	6,287
Taxes	1,120	1,265	1,090	1,183	1,235	4,803	1,027	1,229	1,318	1,428	5,002
Direct	517	565	485	517	509	2,108	418	523	561	585	2,086
Indirect	603	700	606	666	726	2,695	609	707	756	844	2,916
Other revenues	157	119	65	91	94	461	63	64	92	123	341
Grants	33	18	3	45	431	526	211	281	207	245	944
Current expenditure	1,290	1,397	1,339	1,235	1,322	5,245	1,012	1,226	1,259	1,512	5,010
Compensation for employees	235	257	261	250	282	1,023	241	270	270	338	1,119
Use of goods and services	525	572	472	390	279	1,766	209	277	285	299	1,070
Subsidies	97	69	102	77	178	421	86	97	97	135	416
Grants	6	3	2	2	2	12	2	2	2	3	10
Social expenses	287	329	313	316	332	1,264	346	387	386	405	1,525
Other expenses	116	146	161	175	194	631	75	140	164	277	657
Interest	25	22	28	24	56	128	53	52	54	54	213
To nonresidents	10	8	13	15	36	69	19	60	22	54	155
To residents	15	14	15	10	20	59	14	13	16	16	58
Operational balance	19	5	-181	83	437	545	288	348	358	284	1,277
Capital spending and net lending	201	431	356	468	603	1,703	516	636	704	891	2,747
Capital	183	405	313	417	606	1,612	487	682	822	639	2,630
Net lending	18	26	43	51	-3	91	29	-46	-118	252	117
Total balance	-182	-426	-537	-385	-166	-1,158	-229	-288	-346	-607	-1,470
Statistical discrepancy	23	9	0	-59	27	0	0	0	0	0	0
Total financing	159	416	537	444	139	1,158	229	288	346	607	1,470
Domestic	-25	-190	425	268	-507	-454	152	151	83	78	464
Amortization	-15	-19	-9	-8	-21	-63	-18	-24	-10	-25	-77
Use of deposits at the NBG and banks	-10	-171	434	277	-486	-391	170	175	93	103	541
External	16	228	68	114	624	982	67	132	253	358	810
Borrowing	27	780	93	59	207	1,072	68	184	267	412	931
Amortization	-10	-13	-26	-14	-16	-53	-38	-51	-14	-54	-157
Use of Sovereign Wealth Fund resources	0	-540	0	70	433	-37	37	0	0	0	37
Privatization receipts	168	379	44	61	22	630	10	5	10	171	196
Memorandum items:											
Nominal GDP	4183	4995	4,993	4895	5280	19,353	4,577	5,379	5,658	6,124	21,737
Combined financing from SWF and deposits	-10	-711	434	346	-53	-428	207	175	93	103	578

Sources: Ministry of Finance; and Fund staff estimates.

1/ Consolidated government includes central and local governments and the Sovereign Wealth Funds.

Table 4. Georgia: Summary Balance of Payments, 2006–12
(In millions of U.S. dollars)

	2006	2007	2008 Prog.	2008 Proj.	2009 Prog.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Current account balance	-1,174	-2,006	-2,757	-2,776	-2,618	-2,429	-2,934	-2,347	-2,441
Trade balance	-2,019	-2,896	-3,491	-3,701	-3,520	-3,391	-3,969	-3,605	-3,830
Exports	1,667	2,088	2,485	2,722	2,750	2,420	2,623	2,957	3,267
Imports	-3,686	-4,984	-5,976	-6,423	-6,270	-5,812	-6,592	-6,563	-7,096
Services	158	161	57	27	217	98	151	296	379
Income (net)	164	39	-178	-256	-236	-135	-110	-103	-99
Of which : interest payments	-63	-118		-221		-275	-253	-271	-284
Transfers (net)	524	689	855	1,154	921	999	995	1,066	1,109
Of which : public sector	140	139	30	460	8	179	114	119	95
Capital account	171	128	138	110	234	495	311	162	105
Financial account	1,584	2,307	2013	2,507	2248	2,057	2,833	2,372	2,605
Direct investment (net)	1,186	1,676	1,237	1,260	1,198	1,134	1,412	1,697	1,928
Monetary authorities, net	-2	-101		2		0	0	0	0
General government	-7	116	170	632	422	543	1,011	172	139
Portfolio investment (net)	0	0		456		52	0	0	0
Long-term loans received	-15	111		200		466	1,011	172	139
Drawing	109	156		237		561	1,065	250	242
Repayment	-124	-45		-37		-95	-54	-78	-102
Other, net	8	5		-23		25	0	0	0
Private Sector, excl. FDI		616	606	613	628	380	410	503	538
Banks	354	569		621		315	334	375	413
Portfolio investment, net	140	21		164		188	187	199	267
Of which : equity liabilities	142	34		157		116	147	154	202
Loans received (net)	221	653		711		-214	62	96	46
Other, net (currency and deposits, loans extended)	-7	-105		-255		341	85	80	100
Other sectors	53	47		-8		65	76	128	125
Portfolio investment, net	0	0		70		70	74	78	81
Long-term loans received (net)	35	78		-41		66	-12	12	15
Other, net	18	-31		-36		-71	14	39	28
Errors and omissions	-59	-21	-43	-52	0	0	0	0	0
Overall balance	523	408	-649	-211	-137	123	211	187	268
Financing	-523	-408	449	211	-188	-123	-211	-187	-268
Gross International Reserves (-increase)	-439	-377	131	10	-485	-95	-189	-128	-113
Use of Fund Resources	-8	3	315	216	297	-27	-22	-59	-155
Exceptional financing	-77	-34	3	-16	0	0	0	0	0
Memorandum items:									
Nominal GDP	7,764	10,227	13,281	13,099	13,973	13,163	14,195	15,339	16,733
Current account balance (percent of GDP)	-15.1	-19.6	-20.8	-21.2	-18.7	-18.5	-20.7	-15.3	-14.6
Excluding official transfers (percent of GDP)	-16.9	-21.0	-21.0	-24.7	-18.8	-19.8	-21.5	-16.1	-15.2
Trade balance (in percent of GDP)	-26.0	-28.3	-26.6	-28.3	-26.6	-25.8	-28.0	-23.5	-22.9
GNFS exports growth (percent)	16.9	24.7	18.2	24.8	10.6	-6.1	10.4	12.7	11.0
GNFS exports volume growth (percent)	-8.4	4.7	3.6	5.1	6.7	11.4	9.4	10.2	10.0
GNFS imports growth (percent)	33.0	34.1	20.3	29.2	7.4	-8.1	13.0	0.2	8.2
GNFS imports volume growth (percent)	11.5	11.9	4.4	4.1	6.8	5.4	9.0	-1.1	7.4
Net capital inflows to private sector	20.5	2,292	1,843	1,873	1,826	1,514	1,822	2,200	2,466
(in percent of GDP)	20.5	22.4	15.2	14.3	14.2	11.5	12.8	14.3	14.7
Gross international reserves (end of period)	881	1,361	1,270	1,378	1,755	1,473	1,662	1,790	1,903
(in months of next year GNFS imports)	1.8	2.1	2.1	2.4	2.6	2.2	2.5	2.5	2.5
External debt (nominal) /1	2,328	3,136	4,600	4,407	5,745	4,617	5,490	5,792	5,877
(in percent of GDP)	30	30.7	34.6	33.6	41.1	35.1	38.7	37.8	35.1
External debt service /1	269	265	512	793	626	993	794	985	1,406
(in percent of exports)	10.50	8.20	14.0	20.0	15.3	26.6	19.3	21.2	27.3
External public sector debt (nominal)	1,697	1,790	2,790	2,676	3,618	3,057	3,848	3,987	4,022
(in percent of GDP)	22	17.5	21.0	20.4	24.1	23.2	27.1	26.0	24.0
External public debt service	198	143	181	158	181	169	182	242	365
(in percent of exports)	7.7	4.4	4.9	4.0	4.4	4.5	4.4	5.2	7.1

1/ For private debt starting 2008, estimates are based on the survey conducted by the National Bank of Georgia and Fund staff assumptions.

Table 5. Georgia: Accounts of the National Bank of Georgia, 2006–09

	2006	2007	2008							2009			
	Dec.	Dec.	Mar.	Jun. Act.	Sep. Prog.	Sep. Act.	Oct Act.	Dec. Prog.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)												
Net foreign assets 1/	1,006	1,460	1,500	1,594	959	1,266	1,102	846	1,475	1,373	1,421	1,588	1,630
Net domestic assets	187	38	-87	6	765	468	471	938	-7	81	102	10	15
Net claims on general government	407	329	315	149	554	400	382	618	-62	108	283	376	479
Claims on general government (incl. t-bills)	785	776	776	776	778	778	778	778	778	778	778	778	778
Nontradable govt. debt	785	737	689	689	689	689	689	689	689	641	641	641	641
Securitized debt (marketable)	0	39	87	87	89	89	89	89	89	137	137	137	137
Deposits	-378	-447	-461	-627	-223	-377	-396	-159	-839	-669	-494	-401	-298
Claims on rest of economy	99	103	3	3	3	3	4	3	3	3	3	3	3
Claims on banks	-255	-304	-392	-180	139	-18	-18	249	-28	-129	-304	-511	-625
Other items, net	-65	-90	-13	34	68	82	103	67	80	98	119	142	157
Reserve money	1,193	1,499	1,414	1,600	1,723	1,734	1,572	1,784	1,469	1,454	1,523	1,599	1,645
Currency in circulation	930	1,310	1,287	1,413	1,620	1,399	1,351	1,639	1,366	1,309	1,370	1,447	1,489
Required reserves 2/	225	1	0	0	0	0	0	0	0	0	0	0	0
Balances on banks' correspondent accounts 3/	39	187	126	187	103	335	222	144	103	145	152	152	156
	(Percent contribution, compared to reserve money at the end of previous year)												
Net foreign assets	66.3	38.0	2.7	8.9	-33.5	-13.0	-23.9	-41.0	1.0	-6.9	-3.7	7.7	10.6
Net domestic assets	-47.2	-12.5	-8.3	-2.2	48.5	28.7	28.9	60.0	-3.0	5.9	7.4	1.2	1.4
Net claims on general government	-23.9	-6.5	-0.9	-12.0	15.0	4.8	3.5	19.3	-26.1	11.6	23.5	29.8	36.8
Claims on rest of economy	0.7	0.3	-6.6	-6.6	-6.6	-6.6	-6.6	-6.6	-6.6	0.0	0.0	0.0	0.0
Claims on banks	-25.4	-4.1	-5.9	8.2	29.5	19.1	19.1	36.9	18.4	-6.9	-18.8	-32.9	-40.7
Other items, net	1.4	-2.1	5.1	8.2	10.5	11.5	12.9	10.5	11.3	1.3	2.7	4.2	5.3
	(Percentage change, relative to end of previous year)												
Reserve money	19.2	25.6	-5.7	6.8	15.0	15.7	4.9	19.0	-2.0	-1.0	3.7	8.9	12.0
Currency in circulation	14.6	41.0	-1.8	7.8	23.6	6.8	3.1	25.1	4.2	-4.2	0.3	5.9	9.0
Required reserves 2/	73.0	-99.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Balances on banks' correspondent accounts 3/	-35.0	377.7	-32.4	0.0	-44.7	79.3	18.6	-22.7	-45.0	41.4	48.1	47.7	52.0
Memorandum items:													
Net international reserves (in millions of US$, at prog. exchange rates) 4/	…	…	…	1,055	602	848	779	537	851	836	861	958	971
Net domestic assets (in millions of lari, at prog. exchange rate)	…	…	…	42	765	452	424	989	214	295	329	267	294
Reserve money (in percent, 12-month growth)	19.2	25.6	22.6	22.4	24.9	25.7	15.4	19.0	-2.0	2.9	-4.8	-7.8	12.0

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

1/ New classification of gross international reserves reported since the beginning of 2007.
2/ The required reserve regime was modified in May 2007. Under the new regime, tha lari reserves are deposited at banks' corresponding accounts, the foreign-currency reserves have been gradually converted into the required currency (US$) and included in the NFA as both asset and liability.
3/ Including the lari required reserves and overnight deposits from banks.
4/ Projections are based on projected exchange rates.

Table 6. Georgia: Monetary Survey, 2006–09

	2006	2007				2008						2009			
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun. Act.	Sep. Prog.	Sep. Act.	Dec. Prog.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)														
Net foreign assets 1/	621	584	772	799	274	199	-40	-561	-394	-554	-185	-320	-305	-285	-402
NBG	1,006	1,211	1,515	1,811	1,460	1,500	1,594	959	1,266	846	1,475	1,373	1,421	1,588	1,630
Commercial banks	-385	-627	-743	-1,012	-1,186	-1,301	-1,634	-1,520	-1,660	-1,400	-1,660	-1,693	-1,726	-1,874	-2,032
Net domestic assets	2,040	2,091	2,476	2,910	3,706	3,828	4,228	4,826	4,360	5,092	4,195	4,304	4,492	4,714	5,008
Domestic credit	3,219	3,228	3,705	4,251	5,032	5,336	5,682	6,126	5,846	6,342	5,495	5,664	5,872	6,114	6,488
Net claims on general government	413	107	67	-40	293	265	85	520	339	598	-99	71	246	339	442
Credit to the rest of the economy	2,806	3,122	3,638	4,291	4,739	5,071	5,598	5,606	5,507	5,744	5,594	5,593	5,627	5,775	6,046
Other items, net	-1,178	-1,138	-1,229	-1,341	-1,326	-1,508	-1,454	-1,300	-1,486	-1,250	-1,300	-1,360	-1,380	-1,400	-1,480
Broad money (M3)	2,662	2,674	3,248	3,709	3,981	4,027	4,188	4,265	3,966	4,538	4,009	3,984	4,187	4,429	4,606
Broad money, excl. forex deposits (M2)	1,389	1,365	1,646	1,928	2,132	2,259	2,417	2,568	2,257	2,658	2,165	2,137	2,269	2,422	2,536
Currency held by the public	827	762	851	952	1,152	1,123	1,235	1,520	1,196	1,539	1,116	1,059	1,120	1,197	1,239
Total deposit liabilities	1,834	1,912	2,397	2,756	2,829	2,904	2,952	2,745	2,769	2,999	2,894	2,925	3,067	3,232	3,367
	(Percent contribution, compared to broad money at the end of previous year)														
Net foreign assets	26.7	-1.4	5.7	6.7	-13.0	-1.9	-7.9	-21.0	-16.8	-20.8	-11.5	-3.4	-3.0	-2.5	-5.4
Net domestic assets	12.5	1.9	16.4	32.7	62.6	3.1	13.1	28.1	16.4	34.8	12.3	2.7	7.4	13.0	20.3
Domestic credit	39.6	0.4	18.3	38.8	68.1	7.6	16.3	27.5	20.4	32.9	11.6	4.2	9.4	15.4	24.8
Net claims on general government	-11.5	-11.5	-13.0	-17.0	-4.5	-0.7	-5.2	5.7	1.1	7.7	-9.9	4.2	8.6	10.9	13.5
Credit to the rest of the economy	51.1	11.9	31.3	55.8	72.6	8.3	21.6	21.8	19.3	25.3	21.5	0.0	0.8	4.5	11.3
Other items, net	-27.0	1.5	-1.9	-6.1	-5.5	-4.6	-3.2	0.6	-4.0	1.9	0.6	-1.5	-2.0	-2.5	-4.5
	(Percentage change, relative to end of previous year)														
Broad money (M3)	39.3	0.5	22.0	39.3	49.6	1.2	5.2	7.2	-0.4	14.0	0.7	-0.6	4.4	10.5	14.9
Broad money, excl. forex deposits (M2)	29.8	-1.7	18.5	38.8	53.5	6.0	13.4	20.4	5.9	24.7	1.5	-1.3	4.8	11.9	17.2
Currency held by the public	12.4	-7.9	2.9	15.1	39.2	-2.5	7.2	31.9	3.9	33.6	-3.1	-5.1	0.4	7.3	11.0
Total deposit liabilities	56.1	4.3	30.7	50.3	54.2	2.7	4.4	-2.9	-2.1	6.0	2.3	1.1	6.0	11.7	16.4
Memorandum items:															
Growth of M3 (in percent, 12-month growth)	39.3	33.5	42.2	53.2	49.6	50.6	28.9	15.0	6.9	14.0	0.7	-1.1	0.0	11.7	14.9
Growth of M2 (in percent, 12-month growth)	29.8	25.6	31.5	51.4	53.5	65.4	46.8	33.2	17.1	24.7	1.5	-5.4	-6.1	7.3	17.2
Growth of credit to the rest of the economy (in percent, relative to end of previous year)	53.4	11.3	29.7	52.9	68.9	7.0	18.1	18.3	16.2	21.2	18.0	0.0	0.6	3.2	8.1
Growth of credit to the rest of the economy (in percent, 12-month growth)	53.4	52.6	55.8	62.8	68.9	62.4	53.9	30.7	28.3	21.2	18.0	10.3	0.5	4.9	8.1
M2 multiplier 2/	1.16	1.18	1.26	1.40	1.42	1.60	1.51	1.49	1.30	1.49	1.47	1.47	1.49	1.52	1.54
M3 multiplier 3/	2.23	2.32	2.48	2.69	2.66	2.85	2.62	2.48	2.29	2.54	2.73	2.74	2.75	2.77	2.80
Foreign exchange deposits in percent of total deposits	69.4	68.4	66.8	64.6	65.4	60.9	60.0	61.8	61.7	62.7	63.7	63.1	62.6	62.1	61.5

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

1/ New classification of gross international reserve reported since the beginning of 2007.
2/ M2 divided by reserve money.
3/ M3 divided by reserve money.

Table 7. Georgia: External Vulnerability Indicators, 2006–12

	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Value of exports of goods and services, percent change	16.9	24.7	24.8	-6.1	10.4	12.7	11.0
Value of imports of goods and services, percent change	33.0	34.1	29.2	-8.1	13.0	0.2	8.2
Terms of trade (deterioration -)	6.9	-0.5	-4.4	-3.3	-2.7	1.0	0.2
Current account balance (percent of GDP)	-15.1	-19.6	-21.2	-18.5	-20.7	-15.3	-14.6
Capital and financial account (percent of GDP)	22.6	23.8	20.0	19.4	22.1	16.5	16.2
External public debt (percent of GDP)	21.9	17.5	20.4	23.2	27.1	26.0	24.0
(in percent of exports of goods and services)	66.5	56.2	67.4	82.0	93.5	85.9	78.1
Debt service on external public debt							
(in percent of exports of goods and services)	7.7	4.4	4.0	4.5	4.4	5.2	7.1
External debt (percent of GDP)	30.0	30.7	33.6	35.1	38.7	37.8	35.1
(in percent of exports of goods and services)	91.2	98.5	111.0	123.8	133.3	124.8	114.1
Debt service on external debt							
(in percent of exports of goods and services)	10.5	8.2	20.0	26.6	19.3	21.2	27.3
Gross international reserves							
In millions of US$	881	1,361	1,378	1,473	1,662	1,790	1,903
In months of next year's imports of goods and servces	1.8	2.1	2.4	2.2	2.5	2.5	2.5
In percent of external debt	37.9	43.4	31.3	31.9	30.3	30.9	32.4
In percent of short-term external debt	277	283	...	...	...	...	...
In percent of short-term external debt 1/	491	549	598	8186	908	666	588

Sources: IMF Finance Department; and Fund staff estimates and projections.

1/ Excluding currency and deposit liabilities of banks.

Table 8. Georgia: Indicators of Fund Credit, 2006–17
(In millions of SDR)

	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Existing Fund credit												
Stock 1/	157.1	159.2	298.8	280.8	266.7	228.6	127.8	47.6	29.4	14.0	4.2	0.0
PRGF	157.1	159.2	137.1	119.1	105.0	87.1	67.2	47.6	29.4	14.0	4.2	0.0
SBA			161.7	161.7	161.7	141.5	60.6	0.0	0.0	0.0	0.0	0.0
Obligations	34.2	26.7	23.4	24.5	20.6	44.5	105.7	82.1	18.4	15.5	9.8	4.2
PRGF	34.2	26.7	22.8	18.6	14.7	18.4	20.3	19.9	18.4	15.5	9.8	4.2
SBA 2/			0.5	4.8	4.8	25.0	84.6	61.9	0.0	0.0	0.0	0.0
Prospective drawing under the SBA												
Disbursements	...	...	63.1	205.0	47.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	...	...	63.1	268.1	315.4	315.4	242.5	90.7	5.9	0.0	0.0	0.0
Obligations 2/	...	...	0.3	5.3	11.0	11.5	83.2	157.7	86.4	6.0	0.0	0.0
Principal (repurchases)	...	...	0.0	0.0	0.0	0.0	73.0	151.8	84.8	5.9	0.0	0.0
GRA and other charges	...	...	0.3	5.3	11.0	11.5	10.3	5.9	1.7	0.1	0.0	0.0
Stock of existing and prospective Fund credit 1/	157.1	159.2	361.9	548.9	582.1	544.0	370.3	138.3	35.3	14.0	4.2	0.0
In percent of quota	104.5	105.9	240.8	365.2	387.3	361.9	246.4	92.0	23.5	9.3	2.8	0.0
In percent of GDP	3.0	2.4	4.4	6.4	6.3	5.5	3.4	1.2	0.3	0.1	0.0	0.0
In percent of exports of goods and nonfactor services	9.1	7.7	14.5	22.5	21.7	18.0	11.1	3.8	0.9	0.3	0.1	0.0
In percent of gross reserves	26.2	17.9	41.7	57.1	53.8	46.7	30.0	10.2	2.0	0.7	0.2	0.0
Obligations to the Fund from existing and prospective Fund credit 2/	34.2	26.7	23.7	29.7	31.6	55.9	188.9	239.8	104.8	21.5	9.8	4.2
In percent of quota	22.8	17.8	15.8	19.8	21.0	37.2	125.7	159.5	69.7	14.3	6.5	2.8
In percent of GDP	0.6	0.4	0.3	0.3	0.3	0.6	1.7	2.0	0.8	0.2	0.1	0.0
In percent of exports of goods and nonfactor services	2.0	1.3	0.9	1.2	1.2	1.9	5.7	6.6	2.7	0.5	0.2	0.1
In percent of gross reserves	5.7	3.0	2.7	3.1	2.9	4.8	15.3	17.6	6.0	1.1	0.5	0.2

Sources: IMF Finance Department; and Fund staff estimates and projections.

1/ End of period.
2/ Repayment schedule based on repurchase obligations.

Table 9. Georgia: External Financing Requirements and Sources, 2006–12
(In millions of U.S. dollars)

	2006	2007	2008	2009	2010	2011	2012
Total requirements	-1,410	-2,270	-3,030	-2,966	-3,457	-2,877	-3,217
Current account deficit	-1,174	-2,006	-2,776	-2,429	-2,934	-2,347	-2,441
Capital outflows: Repayments of long-term loans	-236	-264	-255	-537	-523	-531	-776
Total sources	1,410	2,270	3,030	2,966	3,457	2,877	3,217
Capital flows	1,884	2,638	2,784	3,061	3,646	3,005	3,330
Public sector	261	128	753	1,084	1,326	358	291
Project grants	145	68	82	447	260	109	49
Long-term loan disbursements to public sector	109	156	237	561	1,065	250	242
Other 1/	6	-96	434	77	0	0	0
Private sector	1,624	2,510	2,031	1,977	2,320	2,647	3,039
Foreign direct investment in Georgia	1,170	1,750	1,266	1,134	1,412	1,697	1,928
Long-term loan disbursements to private sector	285	828	622	421	330	435	543
Other net inflows 2/	168	-68	143	422	577	515	569
Financing	-36	9	236	0	0	0	0
IMF 3/	41	43	252	0	0	0	0
Change in arrears, net (- decrease)	-69	-29	4	0	0	0	0
Debt rescheduling, pre-payment (net) 4/	41	9	0	0	0	0	0
Advance Repayments	-48	-14	-20	0	0	0	0
Change in reserves (- increase)	-439	-377	10	-95	-189	-128	-113
Memorandum items (in percent of GDP):							
Total financing requirements	-18.2	-22.2	-23.1	-22.5	-24.3	-18.8	-19.2
Total sources	18.2	22.2	23.1	22.5	24.3	18.8	19.2
Capital inflows	24.3	25.8	21.3	23.3	25.7	19.6	19.9
Exceptional financing	-0.5	0.1	1.8	0.0	0.0	0.0	0.0
Change in reserves (- increase)	-5.6	-3.7	0.1	-0.7	-1.3	-0.8	-0.7

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

1/ Including the receipts from bond issuance.

2/ Including errors and omissions.

3/ PRGF disbursements in 2006 and 2007, SBA purchases from 2008.

4/ Assumes rescheduling of 2003 arrears in 2004 and of principal maturities falling due during 2004-06. Includes comparable treatment by non-Paris Club bilateral creditors.

ATTACHMENT I. GEORGIA: LETTER OF INTENT

November 28, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Strauss-Kahn:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement for Georgia to assist with recovering from the economic dislocation caused by the conflict with Russia. This support proved invaluable in the months immediately following the conflict and we are grateful to the IMF for the support and especially the expeditious manner in which the program was approved.

2. This letter of intent describes our economic strategy and the range of economic policies that we plan to implement during the remainder of 2008 and in 2009. We are, of course, committed to fulfilling the commitments made in the Letter of Intent dated September 9, 2008. Further, we affirm our commitment to implementing policies that will ensure macroeconomic stability characterized by private sector led growth in an environment of low inflation. This will facilitate restoration of investor confidence and renewed access to capital markets. We believe that achieving sustainable economic growth is the best means of improving the living standards of Georgians and reducing poverty in a united country.

Recent Economic Developments

3. Economic performance during the first half of 2008 was robust. Real GDP grew by 8.5 percent in the 12 months to end-June 2008. As in past years, this strong performance was due mainly to large private capital inflows. In the first six months of 2008, private capital inflows totaled USD 1.6 billion, which is the largest amount recorded in any six-month period. Despite strong growth, disciplined monetary and fiscal policies kept inflation at 9.8 percent for the 12 months ending in July.

4. During the first half of 2008, the NBG tightened monetary policy in response to inflationary pressures. Reserve money growth was 19 percent in the 12 months to mid-August 2008, while broad money growth was 28 percent over the same period. Greater flexibility in exchange rates was allowed with the result that the lari appreciated by 12 percent in nominal terms against the dollar in the first seven months of this year.

5. Tax performance was also strong during the first half of 2008 with revenue collection increasing by 31.3 percent compared with the same period last year. At the same time, expenditures were higher.

6. The conflict with Russia in early August had serious economic, social and political consequences. The immediate economic consequence was the disruption of our transport infrastructure, which severely hindered economic activity, and a slowdown in foreign inflows. As a result, we estimate that growth in the third quarter was barely positive. Because of these dislocations, 12-month inflation spiked in August—12.8 percent—but has since subsided to 7 percent for the 12 months ending in October.

7. The current account deficit was about USD 1.7 billion in the first half of 2008. This reflects mainly the financing requirements associated with FDI-related imports. With the slowing of FDI in the second half of this year, we expect that FDI-related imports will also decline in the coming months, but there will be higher imports related to urgent humanitarian and reconstruction needs. Overall, the current account deficit is set to narrow considerably in the second half of the year.

8. The financial sector expansion was slowing prior to August as part of a policy to slow the growth of monetary aggregates and inflationary pressures. The immediate consequence of the conflict was an outflow of deposits and increased dollarization. Reflecting the underlying strength of the sector and public confidence, by the end-October the banking system recovered a considerable share of the lost deposits.

9. On balance, our record of growth and stability performance was indeed impressive before the conflict with Russia, and we believe that it will resume in the near future. In order to overcome the dire consequences of the conflict with Russia and the global economic crisis, we plan to redouble our efforts to improve macroeconomic conditions and reassure investors that Georgia will continue to be an attractive place for business.

Macroeconomic Policies for 2009

10. Without question, the major macroeconomic challenge facing Georgia is restoring investor and consumer confidence and, in turn, private capital inflows. We recognize this will be a daunting task especially in the context of the global economic crisis. Nonetheless, we are committed to maintaining macroeconomic stability and to intensifying our economic reform process as the main vehicle of resuming strong growth. We anticipate—on the basis of the generous pledges made at the recent donor meeting in Brussels—that significant financial support will be available to Georgia very soon, notably budget support from the U.S. These resources will support a wide range of mainly capital expenditures necessitated by the conflict and needed for establishing a foundation for sustained economic growth. They will also help close the balance of payments gap stemming from the expected decline in

private inflows. The expansionary fiscal effects will also allow us to offset the contractionary consequences of the conflict and the global economic environment, establishing a foundation for sustained economic growth.

11. For 2008, we project an overall fiscal deficit of GEL 1,158 million (performance criterion for end-December) or about 6.0 percent of GDP. The main emphasis of budget expenditures in the remainder of 2008 and next year will be increased and improved social spending and reconstruction of damaged infrastructure. For 2009, we expect a fiscal deficit of GEL 1,470 or about 6.8 percent of GDP which can be accommodated within the SBA's indicative target. This ceiling would be reviewed in the context of subsequent program reviews. The Government of Georgia is fully committed to manage the financial assistance from the donor community in an efficient and transparent manner.

12. The combination of a tight monetary stance in the first half of 2008 and the current economic slowdown have significantly eased inflationary pressures. For 2009 we project growth in reserve money of 12 percent and we are targeting growth of the broader monetary aggregates of 17 percent for M2 and 15 percent for M3.

13. In order to maintain macroeconomic stability and confidence, we decided to defend the domestic currency in the midst and aftermath of the conflict with Russia. The exchange rate stabilized without intervention by the central bank during most of September, but due to the global erosion of confidence we again had to intervene to maintain stability in the foreign exchange market. Nonetheless, the exchange rate depreciated by 16 percent in early November and we remain committed to a more flexible exchange rate regime. Priority will be given to maintaining the targeted level of net international reserves under the program. Our monetary policy will be managed accordingly to meet our inflation target.

14. The financial sector once again demonstrated its robustness and resilience to the two shocks that developed from the beginning of August. That has been possible due to the health of the banking sector, i.e. high liquidity position and capitalization of banks. Since the conflict erupted, banks responded by shrinking their balance sheets and taking a more cautious approach to lending due to changed perception of risks. At the same time the liquidity situation of banks strengthened because of the conservative lending policies and the liquidity injections of the central bank. Thus, we believe that as banks ultimately secure long-term funding from the international financial institutions they will resume private sector lending.

15. Under the terms of the memorandum of understanding between the NBG and the FSA that was signed in October (structural benchmark for end-October), we have established a Joint Financial Sector Committee (JFSC). It is envisioned that the JFSC will be the main vehicle for discussing and analyzing issues related to the financial sector.

16. We commit to implementing the recommendations of the recent update safeguards assessment report within the agreed deadlines. In particular, we will reconstitute the NBG's Audit Committee with only non-executive members, and require the internal audit department to audit the monetary data reported to the Fund at each test date and at the financial year-end.

Program Monitoring

17. All performance criteria for the First Review under the Stand-By Arrangement were met. We request the completion of the First Review and express our intention not to draw the SBA purchase that will be available at the completion of the first review. We will maintain the usual close policy dialogue with the Fund and stand ready to take additional measures as appropriate to ensure the achievement of the program objectives. The third and fourth reviews are scheduled for end-May 2009 and end-August 2009. We request the modification of the performance criteria for end-December 2008, on which the next quarterly review will be based (attached Tables 1 and 2).

18. We authorize the IMF to publish the Letter of Intent and its attachments as well as the related staff report.

Sincerely yours,

/s/	/s/	/s/
Grigol Mgaloblishvili	Nika Gilauri	David Amaglobeli
Prime Minister of Georgia	Minister of Finance	Acting President of the NBG

Table 1. Georgia: Quantitative Performance Criteria and Indicative Targets, 2008–09

	Cumulative Change from End-June 2008					Cumulative Change from End-December 2008			
	Sep-08			Dec-08		Mar-09		Jun-09	
	PC	Actual	Diff.	Orig. PC	Rev. PC	Orig. targets	PC	Orig. targets	PC
					(In millions of lari)				
Ceiling on cash deficit of the consolidated government	537	444	93	603	627 3/	141	229	469	517
					(In millions of U.S. dollars)				
Ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector	0	0	0	250	250	250	250	250	250
					Stocks at the end of the period				
					(In millions of lari)				
Ceiling on net domestic assets (NDA) of the NBG 1/	765	452	313	989	214	878	295	904	329
					(In millions of U.S. dollars)				
Floor on net international reserves (NIR) of the NBG 1/	602	848	-246	537	851	572	836	639	861
Ceiling on accumulation of external arrears 2/	0	0	0	0	0	0	0	0	0

Source: Georgian authorities; and Fund staff estimates.

1/ Actual figures for September 2008 and quantitative targets are based on program exchange rates.
2/ The continuous performance criterion for external arrears is defined in paragraph 14 of the TMU.
3/ The 2008 deficit PC remains unchanged except for Lari 24 million which was added to reflect the fact that a grant financed pre-payment of debt to the EU was postponed.

Table 2. Georgia: Structural Benchmarks and Performance Criteria

Action	Timing
FSA and NBG to sign and implement a memorandum of understanding to strengthen cooperation.	End-October 2008 Done
NBG to introduce revised LOLR facility (structural performance criterion).	End-December 2008
Submission to parliament of a state budget for 2009 with an overall fiscal deficit of no more than 3¾ percent of projected GDP (subject to an adjustor of at most 3 percent of GDP as set out in the TMU).	End-December 2008
NBG to develop and publish a liquidity management framework, including the introduction of a refinancing mechanism as the main instrument to provide liquidity.	End-March 2009
Appointment of the remaining members to the FSA board.	End-June 2009
Submission to parliament of a law to upgrade the Budget System Law to an organic law (structural performance criterion).	End-June 2009

ATTACHMENT II. GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

November 28, 2008

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative and structural performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement (SBA). These performance criteria and indicative targets are reported in Tables 1 and 2 of the Memorandum of Economic and Financial Policies (MEFP), attached to the letter dated September 9, 2008 and Table 1 attached to the letter of intent dated November 28, 2008.

2. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL 1.41 = $1. The corresponding cross exchange rates are provided in Table 1.

Consolidated Government and the Public Sector

3. **Definition:** The consolidated government is defined as the central government, local governments, extrabudgetary funds, public services providing general government system LEPLs, and the Sovereign Wealth Funds (Future Generations and Stable Development Funds). In case the government establishes extrabudgetary funds, they will be consolidated within the consolidated government. The public sector consists of the consolidated government and the National Bank of Georgia (NBG).

4. **Supporting material:** The Treasury Department of the Ministry of Finance (MOF) will provide to the IMF detailed information on monthly revenues, expenditures, and arrears of the consolidated government. In addition, data will be provided on the cash balances in the accounts of the Ministry of Finance.

Quantitative Performance Criteria, Indicative Targets, and Continuous Performance Criteria: Definitions and Reporting Standards

A. Ceiling on the Cash Deficit of the Consolidated Government

5. **Definition:** The cash deficit of the consolidated government will be measured from the financing side at current exchange rates, and will be defined as equal to the total financing. Total financing will be defined as the sum of (i) net domestic financing from banks and nonbanks, (ii) net external financing, and (iii) privatization receipts.

- Net domestic financing consists of bank and nonbank financing to the consolidated government which will be defined as follows:

  (i) Loans provided by commercial banks to the consolidated government minus accounts held by the consolidated government at commercial banks. These accounts and loans will be monitored based on the NBG's monetary survey. Any other

securities issued by the consolidated government (for example, promissory notes) are also included in domestic financing.

(ii) Loans provided by the NBG to the consolidated government minus accounts of the consolidated government held at the NBG in lari and foreign currency. Accounts that are outside of the MOF's control are excluded from domestic financing. These accounts include VAT refund account; earmarked grants account; account for state agencies deposits; account for local government revenues for the day to be transferred to their account; national disaster fund account; and investment grant and credit account. As of June 30, 2008, cash balances in these accounts were lari 160.5 million. These accounts will be monitored based on the changes in cash balances as recorded by the Treasury Department.

(iii) Treasury bills that have been securitized and sold by the NBG, including the bills that have been purchased by nonbanks.

- Net external financing is defined as the total of loans disbursed to the consolidated government for balance-of-payments support and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the consolidated government abroad, including the accounts of the Sovereign Wealth Fund, minus amortization. Amortization includes all external debt-related payments of principal by the consolidated government. Amortization to external creditors via third parties is accounted for at the time and in the amount of payment by the budget to the third party, rather than at the time of recognition of amortization by the external creditor.

- Privatization receipts consist of all transfers of monies received by the central and local governments in connection with the sale of central or local government assets, including privatization proceeds which were transferred to the Sovereign Wealth Funds. This includes receipts from the sales of shares, the sale of assets as well as leases and the sale of licenses with duration of 10 years and longer.

6. **Adjustor:**

    - For 2008, the fiscal deficit target will be adjusted upward for any excess in foreign borrowing by the consolidated government relative to the projected amounts presented in Table 2. The upward adjustor shall not exceed 387 million Georgian lari.

    - For 2009, the fiscal deficit target will be adjusted downward for any shortfall in foreign borrowing by the consolidated government relative to the projected amounts (Table 2). In addition, the fiscal targets for each quarter of 2009 will be adjusted upward by the overperformance of the fiscal deficit relative to the target for end-December 2008, up to a ceiling of lari 479 million.

7. **Supporting material:**

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

- Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Debt Unit at the MOF (specifying projects by creditor) within two weeks of the end of each month.

- Data will be provided at the actual exchange rates.

- Data on the accounts of the Sovereign Wealth Funds will be provided by the NBG.

- Data on privatization receipts will be provided by the Treasury Department of the MOF to the IMF on a monthly basis within two weeks of the end of each month. The data will be consistent with the revenue account(s) in the NBG.

- Data on treasury bills that have been securitized and sold by the NBG, including the bills that have been purchased by nonbanks, will be reported by the NBG on a monthly basis within two weeks of the end of each month.

B. Floor on the Net International Reserves of the NBG

8. **Definition:** Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets minus foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, 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 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 shall be defined as outstanding liabilities to the IMF and any other liabilities of the NBG. This defined, the definition of NIR excludes foreign assets stemming from foreign currency deposits of financial institutions at 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 on paragraph 2 above. The stock of NIR amounted to $1,060 million as of end-June 2008 (at the program exchange rate).

9. **Supporting material:** Data on net international reserves (both at actual and program exchange rates) and on net foreign financing (balance of payments support loans; cash grants to the consolidated government; amortization (excluding repayments to the IMF); interest payments on external debt by the MOF and the NBG) will be provided to the IMF in a table on the NBG's foreign exchange flows (which include details of inflows, outflows, and net international reserves) on a monthly basis within two weeks following the end of the month.

C. Ceiling on Net Domestic Assets of the NBG

10. **Definition:** Net domestic assets of the NBG are defined as the difference between its net foreign assets and reserve money. Thus defined, the net domestic assets are the sum of net claims on the government (the sum of loans and treasury bills purchased by the NBG, less deposits of the government with the NBG), claims on banks, claims on the rest of the economy, and other items net (comprising the NBG capital accounts, net unclassified assets, counterpart funds and exchange rate revaluation). Performance against the NDA target will be measured at program exchange rates.

11. **Supporting material**: The NBG will provide to the IMF its balance sheet, which includes data on its net domestic assets, on a monthly basis within two weeks of the end of each month. Data will be provided using both actual and program exchange rates.

D. Ceiling on Contracting or Guaranteeing of New Nonconcessional External Debt by the Public Sector

12. **Definition:** Nonconcessional external loans are defined as loans from lenders other than the IMF with a grant element of less than 35 percent of the value of the loan. The grant element is to be calculated by using currency-specific discount rates reported by the OECD (CIRRs).[2] For maturities of less than 15 years, the grant element will be calculated based on six-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This performance criterion applies not only to debt as defined in point No. 9 of the IMF's Guidelines on Performance Criteria with Respect to External Debt (Decision No. 12274-(00/85) August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.[3]

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[2] An electronic spreadsheet file that shows the relevant discount rates reported by the OECD (CIRRs) will be provided on a periodic basis by IMF staff. A web-based grant element calculator is available at http://www.imf.org/concessionality.

[3] 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 arrangement 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. Debts 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 some time 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

(continued)

Previously contracted nonconcessional external debt that has been rescheduled will be excluded from the definition of "new debt" for the purposes of this performance criterion.

13. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the MOF to the IMF on a monthly basis within two weeks of the end of each month. Data will be provided using actual exchange rates.

E. Continuous Performance Criteria on Nonaccumulation of External Arrears

14. **Definition:** During the period of the arrangement, the consolidated government and the NBG will not accumulate any new external payment arrears on debt service obligations to official creditors. Official external payment arrears are defined as unpaid debt service by the consolidated government and the NBG beyond 30 days after the due date. The performance criterion on nonaccumulation of external debt is continuous.

15. **Supporting material:** Details of official 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.

Table 1. Program Exchange Rates

	Currency Name	Currency/US$
SDR	Special Drawing Rights	1.58
GEL	Georgian lari	1.41
EUR	Euro	1.48

Table 2. Projected Foreign Borrowing of the Consolidated Government 1/
(In millions of U.S. Dollars)

December 31, 2008 2/	50.4
March 31, 2009	41.3
June 30, 2009	153.1
September 30, 2009	314.4
December 31, 2009	561.3

1/ For 2008, cumulative starting from June 30, 2008.
For 2009, cumulative from the beginning of the calendar year.
2/ In line with the borrowing assumption in the original program.

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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 payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

INTERNATIONAL MONETARY FUND

GEORGIA

First Review Under the Stand-By Arrangement

Informational Annex

Prepared by the Middle East and Central Asia Department

December 1, 2008

Contents Page

ANNEX I. GEORGIA: RELATIONS WITH THE FUND

(As of October 31, 2008)

I. **Membership Status:** Georgia joined the Fund on May 5, 1992.

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	150.30	100.00
Fund holdings of currency	312.00	207.58
Reserve position in Fund	0.01	0.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	0.53	N/A

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	161.70	107.58
PRGF Arrangements	137.06	91.19

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn SDR Million)
Stand-By	9/15/08	3/14/10	477.10	161.70
PRGF	6/4/04	9/30/07	98.00	98.00
PRGF	1/12/01	1/11/04	108.00	49.50

VI. **Projected Payments to Fund (Expectation Basis):**
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	**2009**	**2010**	**2011**	**2012**
Principal		17.96	34.31	98.75	80.54
Charges/interest	0.8	5.47	5.39	4.19	1.67
Total	0.8	23.43	39.71	102.94	82.21

VII. **Safeguard Assessments:**

An update safeguards assessment of the National Bank of Georgia (NBG) required in conjunction with the Stand-By Arrangement approved on September 15, 2008 is substantially completed. This assessment found that the NBG has developed its safeguards in many

respects, namely: (i) its financial statements comply with a recognized accounting and financial reporting framework (i.e., International Financial Reporting Standards); (ii) the financial statements are audited by international firms in compliance with International Standards on Auditing, and receive a "clean" opinion (latest opinion is for the year ended December 31, 2007); and (iii) the audited financial statements are published in the NBG's Annual Report and on its website. However, the NBG faces emerging risks as it modernizes its reserve management practices and accounting systems, and responds to the impact of the August conflict and the global financial crisis. To address such risks, the NBG needs to modernize its audit oversight functions by reconstituting its audit committee with only non-executive members, commission a quality assurance review of its internal audit function, move to longer-term appointments of its external auditor to improve audit efficiency and effectiveness, and require its internal audit department to audit the monetary data reported to the Fund at each test date and at the financial year-end. The update assessment report is expected to be finalized before the first review under the SBA.

VIII. **Implementation of Multilateral Debt Relief Initiative (MDRI):**

Not Applicable.

IX. **Implementation of HIPC Initiative:**

Not Applicable.

X. **Exchange Arrangements:**

(a) Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the domestic currency vis-à-vis the U.S. dollar. These auctions are conducted daily. Foreign exchange bureaus are allowed to buy and sell foreign currency bank notes. A temporary de facto exchange rate peg to the U.S. dollar was introduced in the wake of the early August armed conflict. During the second week of November, the authorities allowed a 16 percent depreciation of the lari.

(b) Georgia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

XI. **Article IV Consultation:**

The 2006 Article IV consultation was concluded on March 31, 2006.

XII. **FSAP Participation:**

Two FSAP missions visited Tbilisi during May 1–15, and July 24–August 7, 2001. An FSAP update mission visited Tbilisi during February 15–28, 2006.

XIII. **Technical Assistance:**

See Table 1 of this Annex.

XIV. **Resident Representative:**

The Fund has currently no permanent resident representative in Georgia, but Mr. Edward Gardner, Senior Resident Representative in Lebanon, visits Georgia between missions for discussions with the authorities.

XV. **National Bank of Georgia Resident Advisors:**

Ms. Vance, MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi in September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG in May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 1999. Mr. Fish was resident advisor on banking supervision from August 10, 1999 to January 31, 2002. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000. Mr. Wellwood Mason provided technical assistance on payment system issues on a peripatetic basis in 2002 and 2003. Mr. Howard C. Edmonds served from September 2004 to October 2007 as a resident advisor on banking supervision issues.

XIV. **Ministry of Finance Resident Advisors:**

Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury beginning in May 1997. Mr. Sainsbury, an FAD advisor, assisted the ministry of finance from June 1998 to November 1999. Mr. Chaturvedi was FAD resident advisor in 2001 and 2002 to assist the authorities in continuing the development of the Treasury and the Treasury Single Account, in revising the legislative framework, expenditure control systems, and budgeting issues. Between 2001 and 2003, Mr. Welling was an FAD peripatetic advisor to assist the State Customs Department in preparing and introducing measures for the custom reform and modernization program. In March 2005, Mr. Zohrab started advising the authorities on treasury-related reforms, and his term ended in November 2006.

Table 1. Georgia: Fund Technical Assistance Missions, 2004–07

Subject	Type of Mission	Timing	Counterpart
	Fiscal Affairs Department (FAD)		
Tax Policy	Review of tax policy	June 8–21, 2004	Ministry of Finance
Public Expenditure Management	Assessment of Treasury system.	Nov. 8–23, 2004	Ministry of Finance
Public Financial Management	Resident advisor (Zohrab)	Mar. 2005–Nov. 2006	Ministry of Finance
Tax Administration	Mission—review of modernization program	Nov. 8-21, 2005	Ministry of Finance
Tax Administration	Expert assistance	July 9–14, 2006	Ministry of Finance
Tax Administration	Expert assistance (Bosch)	Oct. 9–25, 2006	Ministry of Finance
Tax Administration	Follow-up mission	Jan. 17–30, 2007	Ministry of Finance
Tax Administration	Expert assistance (Woodley)	Jan/Feb and Apr/May 2008	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	June 11-22, 2007	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Oct. 8-19, 2007	Ministry of Finance
	Monetary and Capital Markets Department (MCM)		
Government Securities Market, Deposit Insurance, Anti-Money Laundering	Advisory	April 20–30, 2004	National Bank of Georgia
Monetary Operations, Banking Sector Competition	Advisory	Oct. 24–Nov. 5, 2004	National Bank of Georgia
Liquidity Management; Trends in Securities and Insurance Sectors	Advisory	April 18–29, 2005	National Bank of Georgia
FSAP Update	Assessment	Feb. 15–28, 2006	National Bank of Georgia
Monetary Operations/Monetary Policy/Foreign Exchange	Advisory	Feb. 16–Mar. 2, 2007	National Bank of Georgia
Consolidated Supervision	Advisory	Dec. 4–14, 2007	National Bank of Georgia

Table 1. Georgia: Fund Technical Assistance Missions, 2004–07

Subject	Type of Mission	Timing	Counterpart
Statistics Department (STA)			
National Accounts	Follow-up assistance	April 26–May 7, 2004	State Department of Statistics
National Accounts	Follow-up assistance	April 18–29, 2005	State Department of Statistics
Price Statistics	Follow-up assistance	May 23–June 3, 2005	State Department of Statistics
Balance of Payments Statistics/International Investment Position	Follow-up assistance	June 15–28, 2005	State Department of Statistics and National Bank of Georgia
Price Statistics	Follow-up assistance	June 20–July 13, 2006	State Department of Statistics
Balance of Payments	Follow-up assistance	Sept. 6–19, 2006	National Bank of Georgia
GDDS/Government Finance Statistics	Follow-up assistance	Nov. 8–22, 2006	State Department of Statistics, National Bank of Georgia, Ministry of Finance
Balance of Payments	Follow-up assistance	July 9-20, 2007	National Bank of Georgia
Legal Department (LEG)			
Tax Code	Follow-up assistance	Jan. 28–Feb. 9, 2001	Ministry of Finance, Tax Inspectorate of Georgia
Tax Code	Follow-up assistance	Jul. 13–24, 2001	Ministry of Finance, Tax Inspectorate of Georgia

ANNEX II. GEORGIA: IMF-WORLD BANK RELATIONS

Partnership in Georgia's Development Strategy

1. Georgia had a strong economic performance until August of 2008 when the conflict with Russia broke out resulting in severe shocks to macroeconomic stability and a sharp deterioration in investor and consumer confidence. GDP growth which had averaged above 12 percent in 2007 and 8.6 percent in the first half of 2008 is projected to decline sharply in the second half of 2008 and remain below 4 percent through 2009; largely affected by the sharp decline in the private capital inflows which have been the main driver of growth in the last few years.

2. The international community through an October 2008 Donors' conference led by the World Bank and the European Commission responded positively by providing pledges of financial support totaling 4.5 billion dollars over the period of 2008–2010 to provide financial assistance in light of the sudden decline in capital inflows; to help Georgia with its external financing needs to maintain its macro stability; to assist with rebuilding of its damaged infrastructure; and to help Georgia cope with the downturn of the economy and the substantial social needs of its new and past displaced population.

3. Georgia has been a member of the World Bank since 1992 and the International Development Association (IDA) since 1993. With borrowings of US$1062.5 million for 48 operations, Georgia is one of the largest IDA borrowers in the CIS. There are currently sixteen IDA operations under implementation. The last World Bank Country Partnership Strategy (CSP) of Georgia for FY06-09 was presented to the World Bank Board of Executive Directors in September 2005. The CPS, built on the Economic Development and Poverty Reduction Program (EDPRP) of the Government (its PRSP), was designed to assist Georgia in implementation of its reform program. A CPS Progress Report to assess the mid-term progress in the implementation of the CPS was presented to the Board in June 2008.

4. The Poverty Reduction Support Operation series, four annual operations of the last four years have been the cornerstone of the Georgia CPS Strategy and have supported further elaboration and implementation of the key elements of the Government's poverty reduction strategy as described in the PRSP (EDPRP) Progress Report. The Fourth PRSO, the last in the series was approved on May 27, 2008.

5. In response to the August conflict and to help Georgia sustain its overall reform program in the face of unanticipated strains to the 2008 budget, a Supplemental Financing to Georgia's PRSO IV in the amount of US$40 million was processed on an expedited basis and presented and approved by the IDA Board on October 2, 2008, along with a Municipal Infrastructure Development Project in the amount of US$40 million which included an

additional component to provide funding for the housing needs of the newly displaced population. In parallel, IDA responded to a request from the Government for the extension of the East-West Highway to improve transport access in light of the infrastructure damage caused by the conflict, by providing US$20 million additional funding to the existing Second East-West Highway which was approved by the Board on October 30, 2008.

6. A Joint Staff Advisory Note was prepared which together with the second PRSP Progress Report were presented to the Boards of IDA and IMF in September 2006. The IMF presented the Staff Report of the Sixth and final Review under the PRGF arrangement to the IMF Board in August 2007. In the wake of the August events, an 18-month Stand-By Arrangement (SBA) in the amount of US$750 million was approved by the IMF Board on September 15, 2008 to restore investor confidence, with its first purchase of US$250 million disbursed upon approval. The IMF conducted a first review mission of the SBA in early November.

7. The Fund has taken the lead in assisting Georgia in improving macroeconomic stability and pursuing fiscal reforms. The World Bank has taken the lead in the policy dialogue on structural issues, focusing on: (i) strengthening public expenditure management; (ii) improving performance of the public sector; (iii) reducing corruption; (iv) deepening and diversifying sources of growth; (v) protecting the environment; and (vi) reducing poverty.

8. The PRSO program and Supplemental Financing to PRSOIV have focused on four central reform areas: (i) strengthening public sector accountability, efficiency, and transparency; (ii) improving electricity and gas sector services; (iii) improving the environment for private sector development; and (iv) improving social protection, education and health care services.

9. Other support has come in the form of project support and Analytic and Advisory Activities across a broad spectrum of areas including education, health care, social protection, energy, roads, water and sanitation, agriculture, agricultural research and extension, irrigation and drainage, forestry, environment, biodiversity, enterprise development, municipal development, judicial reform, and cultural heritage. A Public Expenditure Review (PER) was prepared in 2002, and a Trade Study in 2003. A Country Procurement Assessment Report (CPAR) was prepared in 2002 and a Country Financial Accountability Assessment (CFAA) in 2003. A Country Fiduciary Assessment (CFA) was prepared in 2007. A series of annual programmatic Poverty Assessments are being implemented with a report to be issued in 2008. A Programmatic Public Finance Policy Review (PPFPR) and a Country Economic Memorandum (CEM) are planned for FY09.

10. Georgia became a shareholder and a member of IFC in 1995, and IFC has financed projects in the finance projects in the financial, infrastructure, oil and gas, and manufacturing

sectors. IFC's portfolio in Georgia as of January 2008 stands at about $93 million with seven clients. In the financial sector, IFC has focused on supporting the development of the housing finance market, providing investment and technical assistance to three leading banks—TBC Bank, the Bank of Georgia, and Bank Republic. To reach small and medium enterprises, IFC helped to establish ProCredit Bank of Georgia, the country's first bank specializing in lending to micro and small enterprises. IFC has also provided a credit line to TBC Leasing to support the rapid growth of their portfolio of SME clients. In FY08, IFC also supported GRDC in their financing of the development of office and retail space.

11. IFC has also mobilized its investment assistance to provide stability to the Georgian banking system which is facing significant challenges following the August conflict as well as funding constraints exacerbated by the current situation in international financial markets. In partnership with EBRD and OPIC, a new investment project will provide Bank of Georgia, the largest bank in Georgia, with the required capital to continue lending to Georgian individuals and SMEs, which is critical for the further development of the Georgian economy. Support to the banking sector would remain IFC's first priority in the World Bank Group's post-conflict strategy in Georgia. IFC would continue to look for opportunities to provide systemically important banks with a mix of equity, subordinated loans, trade lines and senior debt funding. In addition, IFC would continue to support SME and microfinance borrowers through the banks, as well as other emerging financial market leaders to deepen the financial sector and increase the range of financial products available.

12. In the real sector, IFC's most recent transaction is a loan to TAV to support their construction of new airport terminals in Tbilisi and Batumi. In oil transit, IFC has provided equity and credit to local and international companies, including investments by British Petroleum and other sponsors in the construction of the Baku- Supsa Early Oil Pipeline and the Baku-Tbilisi-Ceyhan Pipeline. Other investment projects have been in electricity distribution (AES-Telasi), mineral water (GGMW), and glass bottle production (Ksani Glass Factory). In the real sector, IFC continues to look for opportunities to support the growth of the private sector, particularly in export-oriented companies or those that support overall private sector development. Sectors of interest include agribusiness, infrastructure, manufacturing, and the development of natural resources.

13. IFC has also provided donor-supported technical assistance to strengthen its client banks and introduce new financial products (including leasing and housing finance). IFC is currently providing technical assistance in Georgia to improve the business climate and corporate governance practices. The World Bank-IFC Doing Business report has ranked Georgia as a top reformer in its Doing Business 2008 report, and the Government is actively engaged with IFC to make further progress on reforms for the business enabling environment.

14. The division of responsibilities between the World Bank and the IMF is described in the next section. In a number of areas—for example, the social sectors, rural development, environment, and infrastructure—the World Bank takes the lead in the dialogue and there is no related conditionality in the IMF-supported program. The World Bank is also leading the dialogue on private sector development and energy, and the World Bank analysis serves as inputs into the Fund program. In other areas—the financial sector, public expenditure management, and civil service reform—both institutions are working together. Finally, in areas like monetary policy and domestic customs revenue, the IMF takes the lead.

IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads and there is no direct IMF involvement

15. In the **social sectors**, IDA updates Georgia's Poverty Assessment based on quarterly household survey data. IDA's focus has been to improve execution of budgetary expenditures for health, education and poverty benefits and to raise the efficiency in the use of scarce public resources. Through the Social Investment Fund credits, IDA is focusing in particular on areas with high poverty levels to provide basic infrastructure to the poorest communities. Through the PRSO program, IDA is strengthening the dialogue with the Government on social protection reform (safety nets, pensions, poverty benefits, labor market institutions and policies). Under the PRSO program, a poverty benefit targeted for the extreme poor is being implemented.

16. In **education,** the Adaptable Program Credit of Education System Realignment & Strengthening Program (APL #1 and APL #2) addresses a broad spectrum of educational reform issues, aimed at improving learning outcomes of primary and secondary students through curriculum reform, development of a national assessment and examination system, training of teachers, provision of learning materials, and development of capacity to make better use of physical, financial, and human resources. It also tackles key financing issues through the introduction of a per capita based formula for financing basic education. The second phase of the program provides continued assistance to the implementation of the institutional and policy framework adopted under phase one of the program and includes support to schools in emergency conditions. The PRSO program is supporting the Government's efforts in institutionalizing systemic changes initiated with its education reform strategy.

17. In **health**, IDA credits support the government in improving provision of primary health care services by providing training, equipment and supporting the health information system as well as capacity building in management. IDA is supporting the provision of health insurance coverage for the poor and has conducted the initial impact evaluation of this program. IDA is engaged in policy dialogue with the government on health sector reform

through the PROS program as well as Health Technical Assistance by providing policy advice on regulatory framework for health insurance market, provider payment issues and benefit package.

18. In **infrastructure,** support is being provided through the Secondary and Local Roads Project, the First East-West Highway Improvement Project, and the Second East-West Highway Improvement Project and its additional funding to finance improvement of country's main, secondary and local road infrastructure, as well as through the Municipal Development and Decentralization Project II and the Social Investment Fund Project to finance critical infrastructure needs at the municipal and community level. Under the latter primarily school and health facility heating and repair, small hydropower schemes rehabilitation, drinking water and sanitation rehabilitation, street lightning improvements, as well as local transportation infrastructure rehabilitation has been targeted. The ongoing Infrastructure Pre-Investment Facility project is to facilitate infrastructure investments of strategic importance and/or special complexity by providing technical assistance to assess the feasibility and effectiveness of investments, focusing on energy and transport sectors. Specifically, it targets preparation of First and Second East-West Highway Improvement projects, preparation of Khudoni Hydro Power Plant project (if feasible).

19. In **rural development**, IDA credits have supported development of private sector farming and agro-processing improvements, agricultural credit, irrigation and drainage, and agricultural research. IDA credits have also been supporting creation of local institutions, such as rural credit unions and water users associations. A recently approved Rural Development Project is to develop the productivity and profitability of the private agriculture sector with the aim to increase incomes and employment and reduce poverty in rural areas.

20. A recently closed **Judicial Reform** Project provided funds for development of new court administration and case management procedures, rehabilitation and construction of courthouses, a computerized network system, assistance for judicial training, and an extensive public information and education outreach effort to inform citizens of their rights and communicate the Government's reform efforts.

Areas in which the World Bank leads and its analysis serves as input into the IMF program

21. The World Bank leads the dialogue on structural reforms through the PRSO program. Institution building and technical assistance have been supported through the Structural Reform Support Project. The World Bank also leads in the areas of:

a) **Private Sector Development.** The PRSO program and IFC's advisory work focus on improving investment climate and reducing constraints to private sector development in

Georgia. IDA has also been supporting private sector participation in other areas, such as energy, urban services and agriculture. The IMF has worked with the authorities to initiate audits of the accounts of three major state-owned enterprises.

b) **Energy.** The energy system was in poor condition, with unreliable supply and unsustainable debts. However, under the PRSO program, the Georgian authorities have made progress and payment collections and service levels have improved substantially in the power sector. The Government of Georgia has been working with IDA and other donors, including the Fund, to implement a series of short-term action plans and longer term steps to improve the overall functioning of the sector. At the beginning of the PRGF program, the Fund has been focusing on reducing quasi-fiscal losses in the sector. The World Bank through the PRSO program focused on improved bill collections, the handling of sector legacy debt, some sector restructuring, and the pursuit of tariff policies at cost-recovery levels was facilitated by a World Bank-assisted review of the tariff policy methodology. The Georgian authorities have prepared and implemented Energy Sector Strategic Action Plans and updates thereof under the PRSO program since 2005. In an ongoing operation, the World Bank finances a feasibility study for a major, new hydropower plant that could add about 20 percent to the country's hydropower capacity.

c) **Public Sector Management.** The PRSO program supports through its first pillar, inter alia, improving public expenditure policies and management; implementing procurement reform; strengthening public financial management accountability; implementing intergovernmental fiscal reform; developing a strategy for administrative and civil service reform; and implementing the National Anti-corruption Strategy. The Public Sector Financial Management Reform Support Project (IDA grant pooled together with resources from other donors) is to provide technical assistance and capacity building in support of the first pillar of the PRSO program. The Fund is providing technical assistance in support of tax and customs administration reform.

d) **Municipal Finance:** The Municipal Development and Decentralization Project II has been assisting the Government to review the current intergovernmental fiscal relation, and to suggest an equalization transfer system to compensate for horizontal fiscal disparities across local governments.

e) **Health Sector:** The Structural Reform Support Project supported the GoG in the improving of the secondary health care services by reducing the surplus of hospitals and personnel, providing the various types of the technical assistance in health care financing, HR development, service provision, quality of services. Number of medical facilities has been renovated, equipped and staff trained, so they can offer the decent quality of services to the population of Georgia.

Areas of shared responsibility

22. The World Bank and the Fund have been working jointly in the following main areas:

a) **Poverty Reduction Strategy.** Both institutions have been working closely with the Government to support the implementation of the PRSP (or EDPRP as it is known in Georgia), through seminars and workshops, direct staff input, and donor coordination. A JSAN on the progress with implementation of the Government's EDPRP was issued in September 2006.

b) **Budget Planning and Execution.** The PRSO program is supporting reforms to improve public expenditure policies and management including development of an MTEF, and strengthening public financial accountability. The Public Sector Financial Management Reform Support Project is financing technical assistance and necessary investment to support budget planning and management processes within the MoF and line ministries. The Fund is focusing on treasury reform within the Ministry of Finance.

c) **Financial Sector Reforms.** The joint Financial Sector Assessment Program has supported: (i) strengthened banking and non-banking supervision; (ii) introduction of international accounting standards; (iii) consolidation of banks through higher capital requirement ratios; (iv) anti money-laundering legislation; (v) strengthening the regulatory environment and removing impediments for development of viable non-bank financial institutions; and (vi) strengthening the payment system. IFC has worked to strengthen the banking sector through investment and technical assistance, and has supported the development of the financial leasing market through technical assistance. The Fund has focused on banking supervision, anti-money laundering legislation, and improvements in monetary control instruments with extensive technical assistance from its Monetary and Capital Markets Department.

Areas in which the IMF leads and its analysis serves as input into the World Bank program

a) **Fiscal Framework and reforms in tax policy and tax and customs administration**. The Fund's focus on prudent fiscal policy has served as an important framework for IDA's work on public expenditure management. The Fund's Fiscal Affairs Department has the lead in the areas of tax policy and tax and customs administration reform.

b) **Economic Statistics.** IMF technical assistance has been conducive to improvements in national accounts, price, monetary and government financial statistics. The World Bank's grant on Statistical Capacity Building will build on the recommendations of Fund TA to strengthen the quality of national accounts statistics.

Areas in which the IMF leads and there is no direct World Bank involvement

a) **Monetary Framework**. The IMF collaborates closely with the NBG in the design and implementation of a monetary program that aims at rebuilding international reserves while keeping inflation low and monetizing the economy.

World Bank Group Strategy

On September 15, 2005, the World Bank Executive Board endorsed the new Country Partnership Strategy (CPS) for FY06-09 designed to assist Georgia with deeper institutional reform as well as more fundamental infrastructure improvements. A CPS Progress Report assessing mid-term progress in the implementation of the CPS was presented to the Board in June 2008. In general, the first two and a half years of the CPS period have been characterized by rapid reform with most of the CPS goals achieved on schedule or earlier than anticipated. The First PRSO, of a series of single tranche annual Poverty Reduction Support Operations was approved in September 2005 (US$13.5 million is a regular IDA credit and US$6.5 million is an IDA grant). The Second PRSO for US$ 20 million of IDA credit was approved by the World Bank's Board in October 2006. The Third PRSO for US$20 million of IDA was approved by the World Bank's Board in June 2007, and the Fourth PRSO, the last in the series of PRSO was approved in May 2008.

A Supplemental Financing to Georgia's PRSO IV in the amount of US$40 million was processed on an expedited basis and presented and approved by the IDA Board on October 2, 2008. Other recent operations include a US$40 million Municipal Infrastructure Development Project was approved on October 2, 2008, and aUS$20 million additional financing for the Second East-West Highway Project approved on October 30, 2008.

The US$19 million First East-West Highway Improvement Project and a $35 million Second East-West Highway Improvement Project were approved in November 2006 and November 2007 respectively. A US$15 million Education System Realignment & Strengthening Program supported by the Japanese government co-financing grant in the amount of US$4. 9 million,, a US$5 million Infrastructure Pre-Investment Facility, a US$3 million grant Public Sector Financial Management Reform Support Project, a US$24 million Reform Support Credit, a US$20 million Secondary and Local Roads Project, a US$3.6 million Electricity Market Support Project, a US$10 million Rural Development Project, US $ 20 million PHC Development Project, US $ 10 million Avian Influenza Control and Human Pandemic Preparedness and Response Project and a US$5 million Irrigation and Drainage Community Development Project Additional Funding for flood control.

The World Bank continues its discussion with the Government on a more comprehensive medium-term reform strategy that would be supported by possible future programmatic Development Policy Credit series and technical assistance operations.

Questions may be referred to Ms. R. Quintanilla (202-473-7673), Ms. Afsaneh Sedghi (202-473-7518), or Mr. A. Cholst (202-458-0324).

ANNEX III. GEORGIA: RELATIONS WITH THE EBRD

(As of October 31, 2008)

1. As of October 31, 2008, the European Bank for Reconstruction and Development (EBRD) had signed 75 investments in Georgia with cumulative commitments totaling USD 755.29 million.[1] Current Portfolio Stock equals to USD 504.97 million. The EBRD's first operation, a power rehabilitation project, was signed in December 1994. Since then, the pace and composition of portfolio growth has varied significantly from year to year.

2. During 2007 the Bank had signed 23 transactions in Georgia totaling USD 162.00 million. The Bank provided syndicated loan to ProCreditBank Georgia (USD 8 m); increased its equity participation in the Republic Bank, introduced Medium size co financing facility (MCFF) in Republic Bank and signed three sub operations under the facility in agriculture and health sectors (total USD 9.35m). MCFF has been successfully working for several years in one of the country's largest Bank TBC, with which the Bank signed six additional projects under the MCFF in agriculture (USD 26m), general industry (USD 1 m) and natural resources (USD 3 m) sectors. The Bank financed mortgage lines to TBC Bank (USD 12 m) and Republic Bank (USD 4 m) and provided loans to the Republic Bank (USD 10 m), Cartu Bank (USD 7 m) and Basis Bank (USD 6m) for on-lending purposes to medium, small and micro enterprises. The Bank introduced Energy Efficiency facility in two Georgian Banks: TBC Bank (USD 10 m) and Cartu Bank (USD 5 million).

3. As at 31 October 2008 the Bank's annual business volume reached USD 110.2 million through its 14 transactions. The project examples include: USD 7.5m loan to TBC Bank for development of SMEs, additional mortgage loan (USD 20m) to Republic Bank, the equity investment in Basis Bank, equity increase and subordinated debt (USD 5 m) to the Republic Bank. In 2008 the Bank signed two operations in municipal and environmental infrastructure development sector, namely: Batumi Public transport (USD 3.2m) and Kobuleti water improvement projects (USD 1.9 m). In October 2008 the Bank provided USD 14 m loan to the company Geo Steel to finance construction and operation of 175 k ton capacity steel mini-mill.

4. The ratio of private sector projects in the portfolio now stands at 83.5 percent. The Bank plans to focus primarily on private sector financing, but may also consider selected public sector projects. The Bank will give preference to non-sovereign operations although, where sovereign guarantees will be required, donor co-funding on a grant basis will be sought.

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[1] Evaluated at an exchange rate of US$1.2819 per euro.

5. Georgia is part of the ‘Early Transition Countries’ (ETC) initiative. Launched in April 2004, the initiative aims to increase investments in the Bank’s seven poorest countries. The initiative builds on international efforts to address poverty in these countries. Through this initiative, the EBRD focuses its efforts on private sector business development and selected public sector interventions. It aims to stimulate market activity by using a streamlined approach to financing, focusing on smaller projects, mobilizing more investment, and encouraging ongoing economic reform. The Bank will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking. Since launch of the ETC initiative the Bank’s annual business volume in Georgia has been increased five times.

Table 1. Georgia: EBRD Portfolio for Georgia
As of October 31, 2008 (US$, million)

Project Name	Date of Agreement	Outstanding Amount
Bank Republic - MSE Loan	27-Apr 2006	2.59
Bank Republic Equity	15-Sep 2006	7.59
Bank Republic Equity (Capital Increase)	23-Apr 2008	1.26
Bank Republic Mortgage Loan	20-Dec 2006	8.06
Bank Republic Mortgage Loan II	22-Aug 2008	14.11
Bank Republic Subordinated Debt	07-Jul 2008	5.04
Basis Bank Equity Investment - Georgian Financial Sector F/W	19-May 2008	3.60
Batumi Public Transport Project	02-Sep 2008	3.20
CEEP - Cartu Bank	20-Dec 2007	5.04
CEEP - TBC	30-Nov 2007	5.04
DIF - Alfapet	08-Dec 2007	0.10
DIF - Delidor	17-Jun 2005	1.41
DIF - Georgian Hazelnut Production Ltd.	26-Oct 2006	0.80
DIF - Iberia Refreshments	25-Sep 2003	2.67
DIF - Imedi L	30-Dec 2006	1.48
DLF - BTM TEKSTIL	21-Dec 2006	2.23
DLF - Georgian Hazelnut Production Ltd	26-Oct 2006	2.80
ETC Non-Bank MFI Framework II - Constanta	28-Nov 2006	3.02
ETC Non-Bank MFI Framework II - WV Credo	07-Mar 2008	1.51
Enguri Hydro power Plant Rehabilitation project	22-Dec 1998	28.33
Geo Steel	20-Oct 2008	14.11
Georgia: Trans-Caucasian Rail Link Project	22-Dec 1998	4.48
Georgian Financial Sector F/W - Basis Bank (MSME Loan)	21-Sep 2007	6.05
Georgian Financial Sector F/W-Bank Republic MSE Loan	21-Dec 2007	12.10
Georgian Financial Sector F/W-Cartu Bank SME Loan	20-Dec 2007	7.06
Georgian Financial Sector FW-TBC Bank Mortgage Line II	21-Dec 2007	12.10
Georgian Property Debt FW - Tbilisi Central Train Station	28-Dec 2007	8.57
Georgian Property Debt Facility - Green Building	19-Mar 2007	2.94
Georgian Property Equity Investment	29-Aug 2007	13.87
Georgian Wines & Spirits Ltd.	10-Mar 2005	6.17
JSC Channel Energy Poti Port	19-Mar 2002	3.75
Kobuleti Water	27-Jun 2008	1.92
Kutaisi Water Project	15-Sep 2006	3.85
MCFF - Bank Republic - Begi Co. II	28-Dec 2007	5.95
MCFF - Bank Republic - Begi Company	28-Dec 2007	0.96
MCFF - Bank of Georgia Full Recourse Portion	14-Jun 2005	4.25
MCFF - BoG Iberia Refreshments Sub-Loan (NRP)	27-Sep 2006	2.88
MCFF - TBC - Tsiskvilkombinati II	21-Nov 2007	4.39
MCFF - TBC Bank - Jaokeni Company JSC	04-Aug 2008	3.22
MCFF - TBC Bank EMBAWOOD Sub Loan	13-Jun 2007	0.88
MCFF - TBC Bank JSC Full Recourse Portion	13-Jun 2005	2.47

MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP)	03-Aug 2005	1.45
MCFF - TBC Bank Tegeta Motors	01-Apr 2008	6.80
MCFF - TBC Bank Wissol Sub-Loan (NRP)	10-Oct 2007	6.05
MCFF - TBC Coca Cola Ltd. sub-loan	02-Feb 2007	5.46
MCFF - TBC Tsiskvilkombinati	21-Nov 2007	2.20
MCFF BOG - Renewable Energy Programme - Okami SHPP NRP	21-Dec 2006	0.10
MCFF BOG - Renewable Energy Programme Lopota SHPP NRP	21-Dec 2006	0.17
MCFF Bank Republic - Mediclub Georgia	30-Oct 2007	2.52
MCFF TBC Bank - Goodwill	31-Oct 2007	7.56
Poti Water Supply Project	15-Sep 2006	3.20
Power Rehabilitation Project	20-Dec 1994	2.37
ProCredit Georgia - Syndicated Loan	21-Jun 2007	8.06
Regional TFP Basisbank (Guarantee & Pre-export)	06-Nov 2007	0.35
Regional TFP: Bank Republic (Guarantee & Pre-export)	15-Feb 2006	0.00
Regional TFP: Bank of Georgia (Guarantee & Pre-export)	29-Jul 1999	25.63
Regional TFP: Cartu Bank	28-Apr 2006	4.09
Regional TFP: TBC Bank (guarantee & pre-export)	17-Aug 1999	38.84
Regional TFP: VTB Bank Georgia	24-Dec 2000	0.00
TBC Bank - SME Credit Line	19-Dec 2003	1.51
TBC Bank - Syndicated Loan	20-Dec 2005	1.76
TBC Bank Mortgage Loan	29-Jun 2006	13.44
TBC Bank SME Credit Line III	26-Sep 2005	3.15
TBC Bank SME Line	29-Jul 2008	7.56
TBC Leasing - Equity Investment	01-Mar 2006	0.12
TBC Leasing, Senior Debt	21-Dec 2005	2.16
Tbilisi International Airport	17-May 2006	25.06
Tbilisi Public Transport Project	29-Jul 2005	2.24
VTB Bank Georgia	09-Oct 2006	10.08
VTB Bank Georgia (debt, equity)	20-Nov 1997	2.30
VTB Bank Georgia Capital Increase	09-Oct 2006	2.25
		408.37
Regional Projects		
BIH	18-Dec 2006	0.80
BSR Europe Co-Investment Facility	14-Aug 2006	8.97
Baku-Tbilisi-Ceyhan (BTC) Pipeline	03-Feb 2004	57.08
Baring Vostok Private Equity Fund	13-Dec 2000	0.07
First NIS Regional Fund	21-Nov 1994	0.00
Lukoil Overseas : South Caucasus Gas Pipeline	28-Jul 2005	29.64
NIS Restructuring Facility	16-Mar 2000	0.04
		96.61
GRAND TOTAL		**504.97**

ANNEX IV. GEORGIA: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring. The Fund has provided technical assistance (TA) in the compilation of macroeconomic statistics (Annex I, Table 1). Despite improvements in the areas of national accounts, price, monetary, and government finance statistics, the quality of macroeconomic statistics remains poor, reflecting insufficient resources and deficiencies in statistical methodologies and coverage. Problems are particularly acute in the compilation of national accounts, balance of payments, foreign trade, and fiscal statistics.

2. The data module of the Report on the Observance of Standards and Codes (ROSC), prepared in July 2002 was published on the Fund's external website on May 27, 2003. A General Data Dissemination System (GDDS) mission in November helped finalize metadata and on December 15, 2006 Georgia began participation in the GDDS. Since then the country is working to meet the requirements of the Special Data Dissemination Standard.

Real sector statistics

3. National accounts statistics follow the concepts and definitions of the *System of National Accounts 1993.* Annual and quarterly GDP estimates are compiled by both the production and expenditure approaches. Preliminary national accounts estimates are available after 85 days, and final estimates after 13 months. The 2002 data ROSC mission found several weaknesses regarding data sources, including poor coverage of units in terms of value added for agriculture, retail trade, construction, catering, and services; limited administrative sources to estimate the nonobserved economy; and inadequate data for imports and exports of services (taken from the balance of payments). Follow-up missions in 2004 and 2005 found that although the authorities have made good progress in addressing some of these issues, there was scope for improving the constant price estimates and advancing the development of the system of supply and use tables. On price statistics STA missions in May/June 2006 and August/September 2007 both reported important progress regarding the development of agricultural price indices, although inadequate funding was causing delays in implementation. The authorities' plans for improvements include the compilation of supply and use tables in current and constant prices, as well as launching a PPI for agriculture.

Monetary and financial statistics

4. A March 2002 STA mission found that the authorities had implemented many of the recommendations of the December 2000 mission. The July 2002 data ROSC mission found that most elements in the data quality assessment framework for monetary statistics were fully or largely observed and recommended improvements in the statistical coverage of nonbank depository corporations and the provision of documentation on metadata. It also recommended increased transparency regarding access by governmental agencies to monetary statistics prior to their release to the public.

5. In accordance with the *Monetary and Financial Statistics Manual*, the NBG has begun compiling monetary data using the framework of the STA's Standardized Report Forms (SRF) and has been providing data regularly. These data have been published in the *IFS Supplement* since September 2006. Beginning from December 2001, data published in *IFS* have been revised in accordance with the SRF.

6. A TA mission is scheduled for March 2009 to assist the NBG in developing a data reporting and compilation framework for Other Financial Corporations.

Government finance statistics

7. Annual and monthly Government finance statistics (GFS) compiled on a cash basis in accordance with the methodology of the *GFSM 2001* are reported to STA for publication in the *GFS Yearbook* and *International Financial Statistics*, respectively. The country is well advanced on a program of reform to their central and local government budget and accounting systems to fully adopt the *GFSM 2001* methodology and the International Public Sector Accounting Standards (IPSASs), including the staged introduction of accrual recording into transactions data, and an expansion in the range of items recorded in the balance sheet. These reforms are documented in the paper *Accounting Reform Strategy, 2007–17.* The authorities' commitment to the accounting reform strategy is set out in Decree 101 issued by the Minister of Finance on February 10, 2006. This decree approves the general strategy, but implementation of some of the individual steps in the transition plan will require amendments to the law of Georgia on the budget system (Budget System Law).

External sector statistics

8. A September 2006 TA mission in assisted the authorities to prepare an action plan for the transfer of responsibility for the compilation of balance of payments statistics from the DS to NBG; advised on the structure of the NBG's new balance of payments division; and developed a framework for the collection of source data. The mission also helped to further develop the framework for compilation of an international investment position statement. The balance of payments compilation function was transferred to NBG in January 2007, although DS will remain the main provider of data for exports of goods and services and direct investment. The transfer led to improvements in data quality.

9. The STA Resident Statistics Advisor (RSA) stationed in Baku undertook six peripatetic TA missions to Georgia during April 2007–October 2008. The work of the RSA was focused on further improving Georgia's data collection and compilation programs for external sector statistics. The major remaining weaknesses in external sector statistics are: (i) data sharing between the public institutions involved in producing external sector statistics is not yet implemented, and (ii) the data collection system for private sector liabilities should be improved.

GEORGIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE (AS OF NOVEMBER 14, 2008)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality—Methodological soundness[8]	Data Quality—Accuracy and reliability[9]
Exchange Rates	11/13/08	11/14/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/13/08	11/14/08	D	D	M		
Reserve/Base Money	11/13/08	11/14/08	D	D	M	O, LO, LO, O	O,O,O,O,LO
Broad Money	11/12/08	11/14/08	M	M	M		
Central Bank Balance Sheet	11/13/08	11/14/08	D	D	M		
Consolidated Balance Sheet of the Banking System	10/08	11/01/08	M	M	M		
Interest Rates[2]	11/13/08	11/14/08	D	D	D		
Consumer Price Index	10/08	11/10/08	M	M	M	O,LO,O,O	LO,LO,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	9/08	10/4/08	M	M	M	LNO,LO,LNO, O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	10/08	11/12/08	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/07	8/23/08	Q	Q	Q		
External Current Account Balance	6/08	7/17/08	Q	Q	Q	O,LO,LO,LO	LNO, LNO, LNO ,LNO, LNO
Exports and Imports of Goods and Services	6/08	7/17/08	Q	Q	Q		
GDP/GNP	Q2/08	10/02/08	Q	Q	Q	O,LO,O,LO	LNO, LNO, LNO, LO, LO
Gross External Debt	12/07	8/23/08	Q	Q	Q		
International Investment Position[6]	Q4 /07	10/21/08	A	A	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC (published on May 27, 2003, and based on the findings of the mission that took place during July 15 – 31, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] 8 Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Press Release No. 08/328
FOR IMMEDIATE RELEASE
December 16, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under the Stand-By Arrangement for Georgia

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Georgia's performance under an 18-month SDR 477.1 million (about US$726 million) Stand-By Arrangement, which was approved on September 15, 2008 (see Press Release No. 08/208) to support the Georgian authorities' macroeconomic policies, rebuild gross international reserves, and bolster investor confidence.

The Georgian authorities expressed their intention not to draw the amount available at the completion of this review. The first review also satisfies the review prescribed under the Emergency Financing Mechanism in relation to the initial policy response and the reaction of markets to these policies.

After the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Georgia's Stand-By Arrangement (SBA) in support of the authorities' strong actions to stabilize financial markets has produced positive initial results. It has helped to boost international reserves, ease pressures in financial markets, and mobilize significant donor assistance in support of reconstruction and infrastructure spending.

"Looking ahead, the authorities' program will focus on addressing the challenges posed by the international financial turmoil and the global economic slowdown. Sustaining economic growth and maintaining confidence in the currency and the financial system, within the constraints of available external financing, are the program's main priorities until access to international markets is restored and confidence regained.

"Market uneasiness resumed in late September as the global financial crisis spread, adding to the post-conflict uncertainties. In response, the lari depreciated against the U.S. dollar in November. Since then, the National Bank of Georgia has intervened moderately in the

market to stabilize the exchange rate. The authorities remain committed to a flexible exchange rate regime and to maintaining an adequate level of international reserves.

"Fiscal policy is aimed at supporting economic activity while addressing key social and reconstruction needs. Aided by generous support from development partners in the form of grants and concessional financing, the authorities intend to boost capital spending while minimizing unproductive outlays. Monetary policy will focus on achieving the inflation objective by assigning a more active role to interest rate adjustments in the context of exchange rate flexibility.

"Financial assistance from international financial institutions is expected to help banks meet their maturing external obligations. The authorities are planning to enhance bank regulation and supervision capacity, and to work with banks to mitigate liquidity risks and avoid a deterioration of bank asset quality. The recently signed memorandum of understanding between the National Bank of Georgia and the Financial Supervisory Agency provides an important instrument for enhancing policy coordination between both institutions.

"The authorities' readiness to act quickly to strengthen policies if needed will be key to ensure continued successful economic performance in the face of the difficult and uncertain external environment," Mr. Kato said.

Statement by Age Bakker, Executive Director for Georgia
December 15, 2008

Developments since the SBA approval

1. After years of strong growth, supported by a wide range of reforms, economic activity slumped as a result of the armed conflict in early August. Infrastructure was damaged, private capital inflows slowed sharply and domestic confidence dropped. The immediate consequence of this pervasive uncertainty was an outflow of deposits and a flight into dollar-denominated assets.

2. In the aftermath of the conflict, the authorities managed to stabilize the situation by temporarily pegging the currency against the dollar, helping to anchor short-term expectations. By easing liquidity conditions significantly, the central bank ensured a smooth functioning of the payments system. Financial market turbulence was further eased thanks to the timely announcement of IMF support. The IMF program supported the government in its stabilization policies and helped to catalyze other financial support. The donor conference that took place in Brussels in October 2008 proved to be a huge success, resulting in pledges of about USD 4.5 bln over the years 2008-10. Georgia's authorities are grateful to the IMF for its support and for the speedy manner the program was approved by the Board.

3. Reflecting the authorities' strong commitment to the IMF program, all conditions for the first review were fulfilled. Quantitative targets were met by a wide margin. The structural benchmark was also observed on signing and implementing the Memorandum of Understanding between the National Bank of Georgia and the Financial Sector Authority (FSA) in order to improve cooperation between these institutions. In the meantime, a new prime minister has been appointed, who recently nominated 4 new ministers, including one for economic development. The authorities would like to reassure that these government appointments will have no impact on the cooperative relation between the government and the IMF. The authorities remain fully committed to achieving the program's objectives.

4. Despite the swift response by the authorities and the Fund, financial conditions began to deteriorate again since late September. A rapidly deteriorating external environment, associated with the ongoing crisis in global financial markets, confronted Georgia with a second shock in less than two months time. The spread on Georgia's sovereign bond spreads rose, bank deposits declined again and credit growth dropped. In order to stabilize the foreign exchange market, the authorities initially intervened, but as pressures on the exchange rate persisted they allowed the lari to depreciate by 16 percent in the first ten days of November. After this bold step, volatility in the foreign exchange market returned to more normal levels.

The outlook

5. While the challenges were already large in the wake of the conflict, the global financial crisis is making the authorities' tasks even more daunting. Restoring private capital inflows and business and consumer confidence may take more time, potentially producing a more protracted slowdown in economic activity and adding to the existing pressures in the balance of payments and in the banking sector. In these circumstances, the expected support from donors will be essential in restoring stability. For 2008 and 2009, the authorities anticipate donor support of USD 1.8 bln flowing into the country, with frontloaded disbursement of grants.

6. In view of this bleak environment, economic activity is set to contract in the second half of 2008. Owing to a strong first half, annual growth is still expected to reach 3.5 percent. For 2009, the authorities project GDP growth to reach 4 percent, mirroring a strong acceleration in public investment, which will compensate for the expected slump in private investment and consumption. Although exports are benefiting from the lari depreciation, the contribution of exports to GDP growth is hampered by a fall in metal prices. As imports are dropping too, the current account deficit is set to narrow from more than 21 percent of GDP in 2008 to slightly more than 18 percent of GDP in 2009. While this deficit remains substantial, it is expected to be fully funded by foreign direct investment and donor inflows.

7. Following the two large shocks, the banking sector is also facing pressures at the liability and asset side of the balance sheet. Deposit outflows increased banks' liquidity needs; whereas the economic downturn coupled with lari depreciation is leading to a rise in non-performing loans. Thanks to strong capital and liquidity buffers, the banking sector has managed to accommodate these shocks without major problems. As a sign of confidence in its resilience, the banking sector recovered a considerable share of lost deposits by the end of October. Deposits have remained relatively firm since then.

The policies

8. With donor money flowing into the country, the authorities have the room to expand fiscal policies further to counteract the adverse impact from the shocks on economic activity. In line with the program, the 2009 fiscal deficit is expected to increase to 6.8 percent of GDP, up from 6 percent of GDP in 2008. Taxes on income and dividends will be further lowered by 5 percentage points to stimulate private sector activity. At the same time, expenditures will be increased and targeted at social outlays and the reconstruction of damaged infrastructure. In order to avoid any unproductive spending, the authorities have also committed to allocate donor assistance in a fully transparent and efficient manner.

9. The authorities have moved towards a more accommodative monetary policy stance following the conflict. Despite the recent depreciation of the lari, inflationary

pressures are expected to ease to 7-8 percent by the end of next year on the back of the economic downturn. The authorities are firmly committed to monetary policy consistent with the inflation target. They also reaffirmed their commitment to a more flexible exchange rate and to maintaining the targeted level of net international reserves.

10. Given banks' strong capital and liquidity standards due to years of tight prudential regulations, the FSA relaxed its prudential regulations to cope with the uncertain financial environment. The required liquidity ratio was cut and the risk weight for foreign currency loans was lowered. These measures are expected to be reversed in case credit growth accelerates quickly. Banks' liquidity has recently strengthened due to more cautious lending practices and liquidity injections by the central bank. As a result, the actual liquidity ratio of the banking system is several percentage points above the required level. Stronger liquidity, combined with the prospect of USD 500 mln lending and equity injections by IFIs, will help banks to largely cover their external debt obligations for 2009.

11. The authorities noted the deterioration in banks' loan quality, but are confident that banks could withstand losses arising from the recent depreciation of the lari, and even possible stagnation of GDP growth and a decline in real estate prices in 2009. The system as a whole would be able to absorb more severe shocks thanks to very conservative capital adequacy requirements. To further strengthen the banking sector, the authorities are currently working on improving the central bank's lender of last resort facility. In order to review recent developments in the financial system and the new regulatory framework, the authorities requested a streamlined Financial Sector Assessment Program for the second half of 2009.

12. The authorities recognized the downward risks to the outlook and stressed they remain vigilant. In case the risk of a stronger drop in private capital materializes, the authorities are confident this risk can be addressed effectively with the support of their strong macroeconomic framework, including a more flexible exchange rate regime, and the robustness of their financial system. Additional policy adjustments will be taken, if these were to be required.

13. Against this background, the authorities request the completion of the first review. They intend not to draw the SBA purchase that will be available at the completion of the first review given the expected donor financing and the availability of resources transferred from the sovereign wealth funds.