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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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