INTERNATIONAL MONETARY FUND ASSESSMENT LETTER

IMF Executive Board Approves US$154 million Stand-by Arrangement for Georgia
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The Executive Board of the International Monetary Fund (IMF) yesterday approved a 36-month SDR100 million (about US$154 million, or 67 percent of Georgia's quota) Stand-by arrangement (SBA) with Georgia to support the authorities' economic program. The Executive Board's decision enables the immediate disbursement of SDR 40 million (about US$62 million), while the remaining amount will be phased over the duration of the program, subject to reviews.

The authorities' economic reform program that will be supported by the SBA aims to reduce macroeconomic vulnerabilities, increase policy buffers and support growth, while making the economy more resilient to external shocks.

Following the Executive Board discussion on Georgia, Mr. Min Zhu, Deputy Managing Director and Acting Chair, said:

"Georgia's macroeconomic performance under the previous Fund-supported program demonstrated a strong commitment to economic and structural reforms, contributing to a recovery in growth and improved price stability. Sustained delivery of policy and structural reforms designed to rebuild policy buffers and promote higher, and more inclusive, diversified growth will help alleviate significant downside risks and reduce high poverty and unemployment rates. In this regard, Georgia's new 36-month Stand-By Arrangement will help lower the fiscal and current account deficits, strengthen inflation targeting, maintain a flexible exchange rate regime, and support more equitable growth.

"While fiscal policy is set to support economic recovery in the short run, the program aims at reducing the deficit over the medium term to create the space for fiscal policy to help stabilize the economy. The modernization of the tax system, including with support from the Fund will improve revenue collection while reducing distortions. Under the program, output and exchange rate volatility will be reduced by promoting a more even execution of the budget through the year.

"Monetary policy will continue to be anchored by inflation targeting, supported by an inflation consultation clause with the Fund and an enhanced regime of exchange rate flexibility. In addition, monetary policy effectiveness will be strengthened by ongoing efforts to reduce high levels of dollarization, while the modernization of the prudential and supervisory frameworks continues at a brisk pace.

"Structural reforms will be essential for achieving the program objectives of enhanced competitiveness and an improved business climate. In this context, the signing of the Deep and Comprehensive Free Trade Area (DCFTA) and EU Association Agreements are welcome developments that signal Georgia's deeper integration with the EU, which should enhance export competitiveness and help boost Foreign Direct Investments."

Recent Developments:

Georgia's performance under the Fund-supported program in 2012-2013 was strong. Nonetheless, the country continues to face macroeconomic challenges. The current account deficit and foreign indebtedness remain high and make the Georgian economy vulnerable. While gradually being reduced, high dollarization weakens the effectiveness of monetary policy and exposes banks to risks. Regional geopolitical tensions and potential spillovers from neighboring countries may affect the prospects for the economy, especially for trade, remittances and potentially foreign direct investment. Fiscal policy in early 2013 turned out to be procyclical: tight early in the year when the economy had slowed, but loose at the end of the year when the economy was recovering. The fiscal expansion helped growth to accelerate at the end of 2013, while causing the exchange rate to depreciate and foreign exchange reserves to decline.

Program Summary:

The program will support macroeconomic stabilization and improve confidence by providing a framework to discipline macroeconomic and fiscal policy and by providing modest balance of payments financing.

Strengthening the economy's resilience to external shocks requires reducing Georgia's net foreign liabilities to a sustainable level (about 60 percent of GDP) in the medium-term. To achieve this, the current account deficit should be brought down to about 5 percent of GDP, with 60 percent of this latter adjustment to take place by the program's conclusion.

Fiscal and monetary policies will focus on reducing the fiscal deficit, containing fiscal risks, maintaining low and stable inflation, facilitating exchange rate flexibility, and supporting growth. The program will support strengthened fiscal risk disclosure and improvements in tax administration.

To achieve a budget deficit reduction to 3 percent of GDP in 2015, the authorities will adopt measures that include increasing excises on tobacco and moderating the growth of the public wage bill, as well as other categories of current spending by keeping them constant in real terms. A key principle for deficit reduction will be to avoid measures that disproportionately affect the poor and vulnerable.

Structural reforms will focus on improving the business environment, developing education and training, creating jobs, and reducing poverty and inequality. The reform agenda includes enhancing competition, strengthening property rights, developing a commercial dispute resolution mechanism, streamlining bankruptcy procedures, improving workers' skills, and further improving the public administration.

The National Bank of Georgia (NBG) will continue to develop its monetary policy toolkit and improve its inflation modeling with technical assistance from the Fund. The NBG will also refine its communications strategy. To ensure the success of the program, the fiscal policy of the government and the monetary policy of the central bank will need to be conducted in a coherent manner while preserving the independence of the central bank.

Georgia: Macroeconomic Framework, 2012–15

	2012	2013	2014	2015
			Proj.	
	Percentage change unless otherwise indicated)			
National accounts				
• Real GDP	6.2	3.2	5.0	5.0
• Nominal GDP (in billion of laris)	26.2	26.8	29.2	32.2
• Nominal GDP (in billion of U.S. dollars)	15.8	16.1	16.1	17.5
• GDP per capita (in thousand of U.S. dollars)	3.5	3.6	3.6	3.9
• GDP deflator, period average	1.2	-0.7	3.5	5.0
Investment and saving	(in percent of GDP)			
• Gross national saving	17.3	18.9	17.2	18.3
Investment	28.9	24.8	25.5	26.2
• Public	7.5	5.1	5.7	6.4
• Private	21.4	19.7	19.8	19.8
Inflation	(in percent)			
• Period average	-0.9	-0.5	4.6	4.9
• End-of-period	-1.4	2.4	5.0	5.0
Consolidated government operations				
• Revenue [1]	28.8	27.5	27.1	27.1
• o.w. Tax revenue	25.4	24.8	24.7	24.8
• Expenditures	31.8	30.1	30.8	30.1

	2012	2013	2014	2015
			Proj.	
Current expenditures	23.1	24.3	24.8	23.3
• Capital spending and net lending	8.7	5.9	6.0	6.8
• Overall balance	-3.0	-2.6	-3.7	-3.0
• Public debt	30.0	32.2	33.9	33.6
• Of which: foreign-currency denominated	27.6	27.2	27.6	27.5
Money and Credit	(annual percentage change; unless otherwise indicated)			
Credit to the private sector	12.8	19.5	21.6	17.7
• Credit to the private sector (constant exchange rate from 12 month prior)	13.4	16.1	18.7	16.4
• Broad money, incl. fx deposits	11.4	24.4	21.5	18.5
• Broid money, incl. fx deposits (constant exchange rate from 12 months prior)	11.8	21.8	19.2	17.5
• Deposit dollarization (in percent)	66.0	62.1	63.6	61.2
External sector	(in percent of GDP; unless otherwise indicated)			
Gross international reserves (in billions of US$)	2.9	2.8	2.7	3.0
In months of next year's imports of good and services	3.7	3.3	3.0	3.1
In percent of broad money and non-resident deposits	51.9	42.5	35.5	34.0
Current account balance (in billions of US$)	-1.9	-1.0	-1.3	-1.4
In percent of GDP	-11.7	-5.9	-8.4	-7.9
Trade balance	-26.6	-21.7	-25.1	-24.7
Foreign direct investment (inflows)	5.8	6.3	6.4	6.5

	2012	2013	2014	2015
			Proj.	
Gross external debt	82.2	81.5	84.2	83.1
Gross external debt, excl. intercompany loans	63.7	62.3	64.0	63.5
Exchange rates				
Laris per U.S. dollar (period average)[2]	1.65	1.66	1.75	…
Laris per euro (period average)[2]	2.12	2.21	2.40	…
REER (period average; CPI based, 2005=100)	131.7	125.8	…	…

Sources: Georgian authorities; and IMF staff estimates.

[1] A negative value indicates a level of actual GDP that is below potential output.

[2] Fiscal projections include measures as specified in the Government Program.