Appendix I. Letter of Intent

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

Tbilisi, April 24, 2020

Dear Ms. Georgieva:

1. Like many other countries, Georgia has been negatively affected by the COVID-19 pandemic. The outlook for the Georgian economy has worsened. We prioritized containment and implemented a robust public health response, which has helped limit the number of cases. The Extended Fund Facility (EFF) arrangement with the IMF, expiring in April 2021, has provided economic resilience and safeguarded macroeconomic stability. Nonetheless, we need additional assistance to deal with the impact of the shock and support a robust recovery. We remain committed to the policies detailed in our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of March 27, 2017, updated most recently on December 2, 2019.

2. The COVID-19 pandemic has interrupted our positive economic trajectory. The economy grew strongly, and the current account deficit reached a historic low in 2019. Real GDP increased by 5.1 percent y/y notwithstanding the ban on direct flights from Russia since July 2019. The current account deficit was 5.1 percent of GDP largely due to strong export performance and subdued imports growth. Inflation accelerated to 7 percent (e.o.p.) reflecting nominal effective depreciation of the lari and excise tax increases. To anchor inflation expectations and limit exchange rate volatility, the NBG increased the policy rate by 250 basis points from September to December 2019 and sold reserves, which still stood at $3.5 billion (99 percent of the ARA metric) at end-2019.

3. We have taken far-reaching measures to control the spread of the COVID-19 virus and limit its economic impact. We declared the state of emergency on March 20th, restricted internal mobility and closed non-essential activity. We scaled up health spending to care for the sick. The economic impact has been significant. The standstill in global travel has halted tourism inflows, a significant income source, and containment measures should slow economic activity significantly.

4. We expect a recession in 2020 and have identified an additional balance of payments financing gap of $1,790 million over 2020-21, to be covered with IMF and other donor assistance. The sharp decline in the oil price is expected to lower growth in our key trading partners and hurt exports and remittances. Combined with containment measures affecting domestic demand, this is expected to bring growth down to -4 percent this year. Deteriorating trade balance should widen our current account deficit to 11.3 percent of GDP. At the same time, net financial inflows from private sources are expected to decline substantially due to rising global risk aversion. With IMF and other donor assistance, we expect to keep gross international reserves stable at around $3.5 billion (104 percent of the ARA metric) in 2020. Reserves accumulation will be temporarily supported by the swaps lines we introduced to manage lari liquidity. The pandemic and containment measures will also entail revenue losses and substantial fiscal costs, to be financed by reprioritizing spending and increasing donor financing, including IMF budget support.

5. Most of the conditionality for the Sixth Review was met. All but one of the end-December 20219 quantitative performance criteria (QPCs) were met. We request a waiver of nonobservance for the ceiling on the augmented general government deficit, which was missed by a small margin (0.02 percent of GDP). We have also met most structural benchmarks for the Sixth Review under the EFF arrangement, although some were met with delays. We plan to submit to Parliament the rules-based mechanism for indexing basic public pensions by end-April 2020. We have consulted with the IMF staff on the reasons inflation exceeded the inner band of the Inflation Consultation Clause (ICC) in December 2019 and agreed on the policies to bring inflation to target. Two indicative targets (ITs) on primary current expenditure and the stock of VAT refunds were missed by small amounts.

6. Given the positive performance under the program, and the policies in the enclosed MEFP, we request the completion of this review, an augmentation of access under the EFF arrangement of SDR 274 million, and the release of the related disbursement. We intend to purchase SDR147 million, which will bring total drawings under the arrangement to SDR327 million. Our program will continue to be monitored through an Inflation Consultation Clause (ICC), QPCs, ITs with end-June and end-December test dates, and continuous performance criteria. Consistent with our reform agenda, our program also envisages Structural Benchmarks (SBs). These are set out in Tables 1–3 of the MEFP (Attachment I) and defined in the attached Technical Memorandum of Understanding (TMU, Attachment II). Reviews will continue to be conducted semi-annually. The Seventh Review will be based on end-June 2020 performance criteria and would take place on or after October 25, 2020.

7. The attached MEFP, updating the previous ones, will enable us to achieve the objectives of our economic program. We will monitor progress continuously, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this LOI in accordance with the IMF's policies on such consultations. We will also provide the IMF with the information for monitoring program implementation. We authorize the IMF to publish this LOI and its attachments, and the related Staff Report. These documents will also be posted on the official websites of the Georgian government after the approval by the IMF Board.

Very truly yours,

/s/
Koba Gvenetadze
Governor of the National Bank of Georgia

/s/
Natia Turnava
Minister of Economy and Sustainable Development

/s/
Ivane Matchavariani
Minister of Finance

Attachments: 1. Memorandum of Economic and Financial Policies (MEFP); 2. Technical Memorandum of Understanding (TMU)

Attachment I: Memorandum of Economic and Financial Policies

1. This memorandum reports on recent economic developments and updates the economic and financial policy agenda of the National Bank of Georgia (NBG) and the Government of Georgia to address economic challenges arising from the COVID-19 pandemic and over the medium-term.

Macroeconomic Framework

2. The economy is expected to contract in 2020 due to the impact of the COVID-19 pandemic. We expect a sharp contraction in economic activity in 2020Q2-Q3, followed by a gradual recovery. Growth is projected at -4 percent, 8.3 percentage points lower compared to the Fifth review projection. Inflation, expected at 3½ percent at end-2020, will remain somewhat above our three-percent target reflecting nominal depreciation (the lari has depreciated by 10 percent in nominal effective terms since December 2019).

3. We project a balance-of-payment (BOP) financing need of $ 1.8 billion in 2020-21, to be financed with an EFF augmentation and donor assistance. We have used reserves to smooth exchange rate volatility. The current account deficit is expected to widen to 11.3 percent of GDP due to lower tourism receipts and lower growth in our trading partners hurting exports and remittances. The 2020 financial account is projected to deteriorate significantly (by 5.1 percent of GDP y/y, to 0.4 percent of GDP) due to portfolio and deposits outflows and lower FDI inflows. As a result, the shock has generated significant BOP financing needs in 2020-21, considering further needs to use reserves to tame excessive exchange rate volatility. Our foreign exchange (FX) reserves will remain stable at about 104 percent of the ARA metric in 2020, but will fall to around 98 percent in 2021 as we unwind currency swaps initiated to provide GEL liquidity to the economy (see below). To maintain our external buffers, we expect to secure financing from the IMF and other donors (expected at $1.4 billion in 2020 and $0.4 billion in 2021).

4. The pandemic has imposed substantial fiscal costs, which we expect to finance mainly by drawing down our deposits and increasing donor borrowing. We expect the augmented general government deficit (program definition) to be 8.5 percent of GDP in 2020, compared to the Fifth Review projection of 2.5 percent of GDP. Lower economic activity would reduce revenues excluding grants (by 3.3 percent of 2020 GDP compared to the Fifth Review projection). Our fiscal relief package includes temporary, targeted and timely fiscal measures to address the pandemic and support the economy, including increased health-related expenditure to deal with the pandemic, higher social transfers, and support to businesses.

5. We expect growth to rebound in 2021 and medium-term growth projections remain unchanged. We expect growth of 4 percent in 2021, 0.8 percentage points lower than the Fifth Review projection as tourism and external demand gradually recover after the COVID-19 pandemic. Medium-term growth projections remain unchanged owing to the steadfast implementation of our structural reforms and infrastructure investment. Inflation should decline to target by end-2021 as the impact of exchange rate depreciation fades and monetary policy adjusts as needed. We remain committed to medium-term fiscal sustainability. We plan to continue investing in core infrastructure and education, and addressing pressing social needs. The current account deficit is projected to gradually decline to 5.3 percent of GDP and will remain predominantly financed by net FDI inflows, which is expected to reach 5.6 percent of GDP by 2025.

6. Risks to the outlook remain on the downside. The duration and full impact of the pandemic are difficult to quantify, and the path to recovery in Georgia and our key trading partners remains uncertain. Our first line of defense against these considerable risks is our continued commitment to exchange rate flexibility and sound macroeconomic and financial policies. Additional resources from the IMF and other donors should help anchor confidence in the face of negative shocks, including from regional instability, financial market volatility, and possible recurrence of the pandemic.

Economic Policies

A. Fiscal Policy

7. The end-December 2019 ceiling on the augmented deficit (QPC) and the indicative ceilings on primary current spending and VAT refunds (ITs) were missed by small margins. Strong revenue performance in 2019 (0.2 percent of GDP above the Fifth Review projections) allowed for record-high capital spending (7.9 percent of GDP). An earlier-than-expected donor disbursement made us exceed the end-December 2019 augmented deficit ceiling by 0.02 percent of GDP. Additionally, the primary current spending on goods and services was marginally higher than expected (0.2 percent of GDP), because of overruns in goods and services and health spending. Despite reaching a record high of 1.2 percent of GDP in VAT refunds in 2019, the mid-December stock of outstanding VAT credits still exceeded the indicative ceiling of GEL1,570 million by GEL28 million.

8. Additional fiscal measures during the COVID-19 pandemic accommodates higher health-related spending and helps lay the foundations for the economic recovery. The fiscal measures include the following targeted, temporary and timely measures to help deal with the consequences of pandemic:

- Social assistance in the form of direct transfers to the following groups
    - Transfers for those who lost or are at risk of losing their employment (up to GEL700 million, 1.4 percent of GDP), which is expected to benefit around 720,000 individuals in formal employment before the COVID-19 pandemic. The transfer would be targeted as follows:

i. Direct transfers, up to GEL150 per month—equal to the income tax on the first GEL750 of the salary, to companies supporting employment retention. The transfers would be effective for up to 6 months.

ii. Direct monthly transfers of up to GEL200 for laid-off employees and self-employed individuals who can verify income loss for up to 6 months.

- Direct transfer of GEL100 (on average, dependent on the number of members in the family) to families registered in the social ranking system with a score of 65,000-100,000, for up to 6 months. The measure is expected to benefit around 70,000 families, for a total cost of GEL42 million (0.1 percent of GDP).

- Direct transfer of GEL100 to families with 3 and more children of 0-16 age, registered in the social ranking system with a score below 100,000, for up to 6 months. The measure is expected to benefit around 21,000 families, for a total cost of GEL13 million (0.03 percent of GDP).

- Direct Transfer of GEL100 to people with severe disabilities (including children with disabilities), for up to 6 months. The measure is expected to benefit around 40,000 children, for a total cost of GEL24 million (0.05 percent of GDP).

- One-time transfer to those part of the informal economy and that face vulnerable economic conditions, who are not eligible for the benefits above and can prove loss of income as a result of the COVID-19 shock. This measure is budgeted for up to GEL75 million (0.14 percent of GDP).

- A subsidy for electricity, natural gas, and utility bills of approximately GEL65 per month targeted to households that consume less than KV200 and less than 200 m^3 per month, for 3 months. This measure is expected to benefit 1,100,000 electricity- and 651,000 gas-subscribers, including vulnerable beneficiaries who do not receive targeted support from other social programs.

- Increased healthcare expenditure to deal with the COVID-19 pandemic (GEL350 million, (0.7 percent of 2019 GDP). This includes lab testing and quarantine expenditures and increased healthcare costs associated with hospitalization and medical treatment and supplies. This also includes GEL50 million in healthcare-related infrastructure and specialized equipment.

- Building a stock of basic food products (e.g. flour, bread, pasta, rice, sugar), including by providing a price subsidy, all for a total cost of GEL50 million (0.1 percent of GDP).

- Because of the unprecedented nature of the COVID-19 shock, we will provide temporary support to businesses (up to GEL500 million in 2020), in coordination with the IMF and other donors. These temporary arrangements will be designed guaranteeing equal and transparent access to all eligible beneficiaries, preserving competition, and will refrain from implementing any scheme designed to cover for foreign-exchange risks or compensate for the depreciation, or directed support to an specific company. We will revamp the credit guarantee scheme to sustain access to finance with loans co-financed with and administered by commercial banks. In addition, subject to a condition to retain workforce, we plan to develop other temporary schemes targeted to specific sectors particularly hit by the outbreak. Such support would aim at companies which were in good financial standing and did not face financial difficulties before January 1st, 2020.

9. Consistent with the supplementary budget, we propose revisiting some of our end-June fiscal QPCs and ITs and set new ones for end-December 2020.

- We propose revising the end-June 2020 augmented deficit ceiling to GEL2,300 million and propose an end-December-2020 augmented deficit ceiling at GEL4,300 million (8.5 percent of GDP). The primary current spending would not exceed GEL6,000 million by end-June (IT), and GEL12,450 million by end-December.

- The healthcare costs associated with containing the COVID-19 pandemic are inherently uncertain. Therefore, we propose adjusting the augmented fiscal balance and the primary current spending ceilings for any additional healthcare spending directly related to the COVID-19 pandemic, as defined in the attached Technical Memorandum of Understanding (TMU).

- We are committed to use any over-performance in revenues (excluding grants) or under-execution in current or investment spending towards a lower augmented fiscal deficit (program definition). In turn, available financing would help build fiscal buffers that we would use, in consultation with the IMF, if downside risks materialize.

- We will maintain our efforts to reduce the stock of VAT credits. For mid-December 2020, we will target a stock of credits of GEL1,470 million (IT). We aim to refund at least GEL600 million in 2020, which will provide liquidity to the private sector. Additional refunds will be accommodated through an adjustor to the deficit ceiling (see TMU, ¶14).

10. Our medium-term fiscal policy will continue to balance increasing social and infrastructure spending with fiscal consolidation to bring the public debt (net of government deposits) below 45 percent of GDP. We stand ready to adopt additional measures, if needed, in consultation with the IMF.

- In 2021, we expect to unwind most of temporary measures to address the COVID-19 pandemic. The augmented fiscal deficit is projected at GEL2,600 million (4.8 percent of GDP). We commit to adopt the 2021 budget consistent with the policies agreed at the time of the Seventh Review under the EFF arrangement (**new end-December 2020 structural benchmark**).

- We will continue to enhance the annual Fiscal Risk Statement expanding the estimates associated with potential fiscal costs arising from our Public-Private Partnerships (PPPs) and Purchasing Power Arrangements (PPAs). We are committed to reassess and implement, if needed, additional fiscal measures based on our fiscal risk profile to build buffers to guard against those risks. Under the current domestic electricity pricing regulated mechanism, the potential fiscal costs of PPAs would normally be avoided, since guaranteed prices would be fully passed on to end-users. Our baseline scenario forecasting electricity prices suggests that PPAs would imply marginal tariff increases in the foreseeable future. However, we recognize that public finances are exposed to regulatory risks, which could materialize if electricity tariffs are not adjusted to fully reflect guaranteed prices under PPAs. Moreover, losses would arise from exporting surplus electricity if export prices are below the guaranteed prices. These risks are analyzed in our FRS.

11. We have submitted legislation for a rule-based mechanism to index basic pensions (end-December 2019 structural benchmark). Given the risk of old-age poverty in Georgia, the authorities envisage indexing monthly pensions to the average inflation for the last 12 months for pensioners below age 70 and to inflation (for the last 12 months) plus 80 percent of real GDP growth (for the last 6 quarters) for those above, subject to a GEL20/25 minimum increase, respectively. The indexation rule supports expanding the social safety net gradually. It also provides fiscal predictability, as discretionary increases in the public pensions would not occur in the future, and maintains budget flexibility over time, even under adverse demographic projections. In the long term, replacement rates should gradually increase as the new contributory pension pillar would complement the basic pension.

12. We remain committed to medium-term fiscal sustainability. Nominal depreciation and the response to the COVID-19 pandemic will increase public debt (net of government deposits) to XX percent of GDP, above the level anchoring the EFF arrangement (45 percent of GDP). We are committed to a declining debt path over the medium term with sustained fiscal discipline. We will improve public administration efficiency by (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) developing a comprehensive strategy to address financial vulnerabilities and improve corporate governance in SOEs; and (iv) broadening the scope of performance-based budgeting. Additionally, in reducing our reliance on electricity imports, we are committed to expanding Georgia’s power generation capacity in a fiscally sustainable manner. This will require continued investment by the public and private sector. Before taking on any major energy investment project, we will conduct, in consultation with the IMF, an in-depth analysis of implications on public finances and medium-term fiscal sustainability.

13. Our financing strategy aims to support domestic market development and reduce external vulnerabilities. We would gradually increase the size of domestic benchmark bonds, to encourage foreign participation once global finance conditions ease. We are discussing with 6 domestic banks interested in participating in a pilot primary dealer program for government securities, but the signature of memoranda of understanding has been delayed due to other pressing developments. In parallel, we will ensure that foreign banks participating as primary dealers would be under the same reporting and transparency requirements as domestic banks. Our issuance had previously exceeded our domestic financing needs, which allowed us to build a buffer of deposits.

14. We aim to contain fiscal risks and remain committed to avoid domestic/external debt payment arrears.

- We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion); (ii) accumulate net domestic expenditure arrears of the general government (indicative target); or (iii) issue new public guarantees (performance criterion), or comfort letters.

- In mid-April, we made our PPP framework fully operational by approving the Value-for-Money (VfM) methodology following the recommendations of IMF TA, and incorporating it in the PPP Value-for-Money guidelines (**end-March 2020 structural benchmark**).

- We will refrain from taking over any SOE debt or providing equity injections to SOEs without a comprehensive strategy that, among other things, fully supports commercial viability and improves corporate governance; we will consult with the IMF on the strategy and on specific measures. Our public corporations will refrain from engaging in any new quasi-fiscal measures. Our public corporations will refrain from engaging in any new quasi-fiscal activities. We are committed to limit quasi-fiscal operations and to systematically report them in the Fiscal Risk Statement.

- We are also committed to formulate the SOE strategy outlining the authorities' SOEs policy principles by end-March 2021, including (i) defining the rationale for ownership of public corporations; (ii) strengthening the framework to identify and report quasi-fiscal activities; and (iii) enhancing SOE corporate governance.

15. We will continue to limit the Partnership Fund (PF) operations. Given that the PF does not follow commercial objectives, we are limiting the PF's gross acquisition of financial and non-financial assets, other than cash and bank deposits, to zero except for existing commitments in ongoing projects (**continuous performance criterion**). Accordingly, the PF will not undertake any new projects nor engage in any net borrowing (**continuous performance criterion**).

B. Structural Fiscal Policies

16. We are strengthening our revenue administration to improve taxpayer services and strengthen compliance. Following the 2016 Tax Administration Diagnostic Assessment and IMF TA, we are close to finishing a 3-year plan, supported by the Revenue Mobilization Trust Fund, that focuses on improving:

- *Organizational structure.* We have restructured the Georgia's Revenue Service's (GRS) and hired additional personnel (see previous MEFPs). In light of the fraud cases prosecuted in

2019, we have reviewed our structure and procedures to avoid similar cases in the future. In the last 6 months, we created specialized units to deal with large taxpayers within the Audit Department and the Taxpayer Services Department.

- *IT resources and capacity*. We will launch IT strategy for GRS and an IT investment plan in line with IMF TA recommendations by end-September 2020, including (i) an infrastructure sustainability assessment, (ii) an application sustainability assessment, (iii) an inventory of business functionality improvement and data analytics needs. We aim to approve the strategy and the roadmap for implementation by end-May 2020. We commit to bolster our IT capacity by hiring additional staff or seeking a partnership of GRS with a private sector IT provider. We will also replace software that is no longer supported in a timely manner.

- *VAT tax administration*.

    - Stock of unrefunded VAT credits. We are committed to eliminate unrefunded VAT credits. We aim to reduce by at least 50 percent the outstanding stock of those VAT credits that are within the limitation period for audit (from GEL1.4 billion at end-2017 to GEL700 million by end-2021). For the stock of existing credits, we are committed to audit or risk-assess 100 percent of declarations (within the statute of limitations for audit) by mid-2020.

    - Automatic risk assessment and risk-based auditing. Since June 2019, more than 90 percent of new credit declarations have been immediately eligible for a refund, if requested by taxpayers and there are no outstanding tax liabilities (**end-June 2019 structural benchmark**). The remaining declarations with the highest risk score are reviewed by the specialized VAT unit to determine compliance actions.

    - Automatic refunding of new VAT credits. Starting May 1st, 2020, all risk-assessed and approved new credits will be either offset against existing liabilities or refunded to the taxpayer without the need to request a refund. The electronic VAT declaration form will be changed accordingly and will require taxpayers to submit their bank account details. The option to offset the stock of existing credits against new liabilities will remain unchanged, and taxpayers will retain the option to request a cash refund through a separate form for those stocks within the three-year statute of limitations.

- Compliance and audit yields. With IMF TA, we plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We have developed audit plans to give a balanced coverage of tax categories and will better manage the audit scope. Our work on the pilot audit case management system is making good progress. After some delays in the procurement process, we expect the system to start working in pilot mode by June 2020}, becoming fully operational by end-August 2020. Once implemented, this will enhance audit timeliness and productivity. We will ensure an IT strategy and resources for achieving these objectives.

- Filing compliance. We established key performance indicators to improve filing compliance, but tax deferrals in the aftermath of the COVID-19 pandemic may delay the process. The program, initially developed for VAT, has been expanded to all tax categories. Parliament approved legal amendments so that an unfiled declaration is no longer deemed to be a nil declaration, where the MoF requires a declaration. The MoF has issued an order defining cases needing a declaration.

- Taxpayer register. We have adopted a ministerial decree to clarify tax registration requirements and give the GRS the mandate to enforce compliance and control of the registration process for all tax types, including issuing tax identification numbers. In addition, the GRS will create and maintains a register of employees for tax administration purposes.

- October 2019, GRS has received regular and comprehensive access to information from other ministries, as well as National Agency of Public Registry on real estate transactions, rentals and leases. We are working to expand the system of information sharing with other government agencies and the Financial Monitoring Service (FMS) from monitoring entities on suspicious transactions, as defined in the law on Automatic access to third-party information. Since facilitating the prevention of illicit income by October 2020. In addition, GRS signed an agreement with the Tbilisi municipality to receive access to monthly information on construction permits starting in February 2020. Providing information on Joint Stock Companies (JSC) partners and changes in company equity will require improvements in data collection, but we plan to receive available information from the NBG on a regular basis by end-2020.

17. We are committed to contain fiscal risks to safeguard fiscal sustainability. In particular, we have reformed our SOE monitoring and PPP frameworks to reap the benefits of PPPs, while controlling the risks. We have undertaken the following steps:

- *Adopted a new PPP law and associated regulations.* Parliament approved a PPP law in May 2018, and a government decree implementing the PPP law was issued in August 2018 (see previous MEFPs for details).

- *We have assessed the stock of the PPP liabilities.* This assessment has been based on the relevant International Public Sector Accounting Standards. It will be updated regularly and included in the annual Fiscal Risk Statement.

- *Continued strengthening the Fiscal Risk Statement (FRS) accompanying the budget.* The FRS in the 2020 budget documentation has included a more comprehensive coverage of general government financial asset operations and provide information on the rates of return on general government equity holdings and loans (**structural benchmark, end-December 2019**). We commit to further expand the FRS in line with the FAD TA recommendations by including (i) a sub-section on the sectorization exercise, (ii) a risk analysis of the top 10 SOEs, (iii) an assessment of the gross financing requirements of major SOEs, and (iv) updated estimates of the quasi-fiscal activities (**new end-December 2020 structural benchmark**).

- *Strengthened the monitoring of SOEs.* The MoF and the Ministry of Economy and Sustainable Development (MOESD) collect data on SOEs, including performance information, transfers between the state and SOEs and among SOEs, borrowing, guarantees and any litigation, at least, on an annual basis. We finalized a complete inventory of SOEs, classifying them into public corporations and general government entities under GFSM2014, in line with IMF TA recommendations (**end-March 2020 structural benchmark**).

- *Improved the Public Investment Management Framework (PIMF).* Our PIMF covers PPP-type projects to support priorities and assess alongside traditionally procured projects. In coordination with the IMF, we have (i) further strengthened the public investment management methodology that guides project appraisal, selection and management; and (ii) improved reporting and oversight requirements for public investment projects at the MoF by updating the Government Decree on PIM methodology (**end-December 2019 structural benchmark**). These measures should help us identify project implementation delays earlier. We have designed a system for regular intra-year reporting of project implementation progress.

18. We believe that accurate and transparent budgeting and accounting is a cornerstone of fiscal stability. Accordingly, we commit to:

- *Make the coverage of General Government consistent with the classification of SOEs into General Government units and Public Corporations.* This will require changes to the PFM legislation. From January 2021, all our fiscal reports will incorporate these changes.

- *Strengthening the Medium-Term Budget Framework (MTBF).* Since the 2020 budget, we regularly discuss compliance with the fiscal rule and revised expenditure plans, and any projected deviation from previous years' MTBF.

- *Improving the quality of fiscal reports and complying with international accounting standards.* In our efforts to improve fiscal transparency, starting in 2021, we will produce an annual consolidated central government sector financial report based on International Public-Sector Accounting Standards (IPSAS) basis.

C. Monetary Policy

19. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. The clause entails dual consultation bands set symmetrically around the forecast for headline CPI (Table 1). Should actual inflation be higher or lower than the inner consultation band of ± 2 percent, the NBG will consult with IMF staff on the reasons for the deviation and the policies to return to target. Should actual inflation be higher or lower than the outer consultation band of ± 3 percent, a consultation with the IMF Board will be triggered.

20. The end-December inflation triggered a consultation with IMF staff; no further actions are needed at this point. The higher-than-projected inflation was due to one-off increases in excises in 2019H1 and rapid passthrough from nominal depreciation in 2019H2. As the NBG appropriately tightened policy rates by a cumulative 250 bps since September 2019, our monetary policy stance is considered to be moderately tight.

21. We are committed to our inflation targeting (IT) framework to maintain price stability. With the output gap widening, we will closely monitor inflationary expectations and developments as we would need to balance the need to stabilize inflation expectations prompted by significant nominal depreciation with the need to support demand in the aftermath of the COVID-19 pandemic.

22. We will maintain a flexible exchange rate regime to protect the economy against external shocks, while preventing excessive lari volatility. The floating exchange rate regime continues to work well as a shock absorber, but excessive lari volatility could become disruptive to financial stability as Georgia remains a dollarized economy. Our commitment to exchange rate flexibility is signaled by a floor on net international reserves (NIR, performance criterion). In the aftermath of the COVID-19 shock, we suspended accumulation of reserves and our FX interventions have been limited to smoothing excessive exchange rate volatility and supporting FX availability in a thin market. Our FX sales will continue to be mostly driven by ad-hoc discretionary interventions to address relatively large one-off imbalances. This will be complemented by smaller sized FX sales triggered by the volatility of the exchange rate and the need to support FX market liquidity.

23. Given exceptionally challenging market conditions, we expect to draw on our reserves to sustain macroeconomic stability in the near-term. We have identified additional BOP needs of $1,790 million in 2020-21 due to the COVID-19 shock. Donor assistance would help finance the balance-of-payments needs without resulting in a drawdown of gross international reserves. GIR is projected at 104 percent of the ARA metric by end-December 2020. However, because of the need to intervene to smooth exchange rate volatility, we project lower net international reserves. We therefore propose to change the end-June NIR floor QPC to $1120 million and set the end-December 2020 QPC to $1,100 million.

24. Over the medium term, we remain committed to build adequate reserves, upgrade our FX intervention policy, and strengthen NBG's communication. Our FX policy will remain guided by reserve adequacy and price stability goals; with reserve accumulation suspended at times when markets become disorderly. To improve the transparency of our FX policy, we will design a clear FX intervention strategy, explaining the FX policy goals and underlying principles of the mechanisms used to achieve those goals. Over the medium term, we project GIR to reach 105 percent of the ARA metric by 2025.

25. Starting April 2020, we established FX swap lines with financial institutions to provide lari liquidity on a temporary basis. We communicated to financial institutions that temporary FX swap lines are available up to a maximum amount of $400 million. The swap lines are temporary instruments to support market liquidity during the COVID-19 crisis and their use follows from the NBG's mandate to promote financial stability. All banks and microfinance institutions can participate; pricing and allocation of amount of swap lines among institutions will be based on uniform and transparent principles. We will also establish another standing swap line facility that will enable commercial banks to have access to lari liquidity at a penalty rate. We will monitor closely FX and money markets and banks' open currency positions to smoothly operate the swap lines. In addition, we will establish a swap line of up to $200 million with the EBRD to provide lari liquidity targeted to support companies.

D. Financial Sector Policy

26. We improved the capacity of the banking sector to withstand the shocks. We increased capital requirements in line with Basel III capital regulations including Pillar 2 and systemic buffers; improved the quality of capital by gradually increasing CET-1 and Tier-1 requirements; enhanced liquidity framework with LCR and NSFR requirements; and introduced responsible consumer lending regulation to moderate consumer credit growth, reduce borrower over-indebtedness and incentivize larization. We are also refining our resolution framework, approved in parliament in December 2020, in line with the best international practice.

27. We have taken decisive steps to safeguard financial stability in the aftermath of the COVID-19 shock. The NBG has announced that (i) banks could utilize capital conservation buffers (with an automatic prohibition on dividends and other payouts); (ii) postpone previously planned increases in capital buffers; and (iii) communicated to banks' ability to go below 100 percent LCR in case of liquidity pressures. Banks have been asked to evaluate the quality of their loan portfolios; on-site inspections have been suspended; and a moratorium on fines was introduced where a breach emerged due to the crisis. These policy measures will ensure that inevitable losses are promptly recognized, but viable enterprises are not denied financing due to temporary liquidity difficulties.

28. We have postponed the full implementation of the regulation on the large exposure limits until June 2021. In line with Basel III principles, we tightened the large exposure limit to 25 percent of Tier 1 capital for both related and non-related parties. The regulation was issued in November 2019 to be effective from January 2020 for new loans (the banks were given until June 2020 to comply with tighter limits for all loans). However, because of GEL depreciation, and additional expected credit losses in a challenging economic environment when borrowers have limited ability to reduce their exposures, it is becoming particularly difficult to comply with the June 2020 deadline. Therefore, we have granted banks until June 2021 to comply with the new requirement, and from January 2021, banks should refrain from creating any new exposures that breach this limit. We will regularly collect additional information from banks about the financial situation of large borrowers and monitor portfolio concentration risk.

29. We will take proactive measures to restore lending to the non-financial private sector. We are revising our emergency liquidity assistance framework, will accept broader collateral for temporary liquidity assistance to solvent financial institutions. More proactive measures to provide liquidity support and restore lending to the real sector may be needed in the future. Those measures may include credit guarantees provided by government to the sectors affected by the current crisis, liquidity support for banks. The NBG and the MoF will coordinate measures to help borrowers (e.g. interest rate subsidies, loan guarantees) and measures considered by supervisors (releasing capital and liquidity buffers, liquidity support for banks).

30. The Ministry of Finance will issue debt securities (up to GEL600 million, 1.2 percent of GDP) to inject GEL liquidity into the banking system. The MoF will place the proceeds as long-term deposits in banks, proportionally to the amounts each bank purchased. Banks can then use these securities as collateral for secured funding with the NBG.

31. We will further mobilize funding for contingency and backstop measures if downside risks to the financial sector were to materialize. We will consider increasing the limit for insured deposits and obtaining additional funding for the deposit insurance and the banking resolution funds. These measures will allow us to increase confidence in financial system and create an effective backstop mechanism to be used when needed.

32. We have adjusted our plans to strengthen the financial stability policy framework, regulation and supervision.

- Banks will be requested to fully transfer their financial and regulatory reporting to IFRS framework by the end of 2021, rather than end-December 2020 as originally planned, although they can do so on a voluntary basis starting at end-December 2020. Once fully transitioned to IFRS, we will request capital adequacy information both on stand-alone and consolidated basis under IFRS accounting framework using relevant prudential filters.

- We have revised the regulation on consumer lending by reinforcing its principle-based nature, allowing banks greater flexibility in managing risks associated with consumer lending, including by reducing the number of income brackets for PTI and extending local currency mortgage maturities. We are also introducing more robust risk governance requirements specifically for consumer lending.

- The draft law on supplementary supervision for financial conglomerates will now be submitted to Parliament by December 2020.

- In March 2020, we approved standards for interest rate risk in the banking book—in line with Basel and EBA guidelines. The regulation will be effective from September 2020.

- Following a successful publication of the Financial Stability Report in 2019, we commit to publishing these reports annually.

33. We are strengthening our banking resolution framework. With IMF TA support, the Parliament enacted legislation to enhance banking crisis management, including by clarifying the authorities' role and the decision-making process and granting the NBG a clearer resolution mandate. The legislation prohibits unsecured lending by the NBG, mandates a penalty rate for emergency liquidity assistance (ELA), and clarifies the role of the MoF in an effective ELA framework for systemic cases. In implementing this reform in consultation with the IMF, we are preparing secondary legislation on: (i) the NBG's Resolution Committee and the inter-agency Financial Stability Committee; (ii) identification of critical functions; (iii) recovery plans; (iv) valuation; and (v) accelerated supervisory approvals during resolution (e.g. share acquisitions) (**end-June 2020 structural benchmark**). Thereafter, we intend to issue secondary legislation on: (i) resolution plans; (ii) temporary administrator and special manager; (iii) recapitalization tools; including the bail-in; (iv) the bridge bank tool; (v) temporary public support and ex-post resolution fund; and (vi) ELA against government guarantees (**end-December 2020 structural benchmark**).

34. Despite delays due to the COVID-19 shock, we will continue capital market development to support larization and reduce external vulnerabilities. Our steps to develop local capital markets are:

- We have submitted to Parliament (ii) legislation establishing investment funds; and (ii) related changes to the tax code.
- We have submitted to Parliament amendments to the securities market legislation to improve investor rights protection and corporate transparency. The legislation also targets approximation to the EU directives/regulations, as specified under the DCFTA agreement.
- During 2020, we will strengthen the regulatory framework for investment funds, funded-pension operations, market abuse and transparency, business conduct and custody.
- The law on derivatives and financial collateral was enacted at the end of 2019 to help develop the money markets. We will submit legislation to Parliament for securities holding, aligned with the international best practices by June 2020. The framework will strengthen investors' protection and incorporate an indirect holding regime, where only banks and brokers would be authorized to hold securities on behalf of their clients.
- In 2020, we plan to submit to Parliament legislation for (i) securities holding, creating the basis for dematerialized securities holding; and (ii) covered bonds, to improve access to long-term lari funding for commercial banks and help develop the fixed-income market.
- In 2020, we plan to finalize diagnostics/feasibility study for financial instruments such as securitization and inflation-linked debt securities, to promote developing the domestic securities markets,
- In consultation with the IMF, we aim to transition gradually to a primary-dealer (PD) system. This would entail the following steps:

    a. We will update our regulation to allow for the introduction of a PD system by end-September 2020 including: (i) a primary market regulation issued jointly by the MoF and NBG, (ii) a core PD arrangement (in the form of an agreement or Memorandum of Understanding), (iii) contractual agreements (e.g., repurchase and securities lending agreements) for financial transactions in public debt securities between the primary dealers on the one hand and the MoF and NBG on the other hand; and (iv) market conduct regulation to ensure segregation between PDs own-trading activities and the clients' order collection.

b. The implementation of the PD system will start with a pilot intermediate market making arrangement (IMMA), subject to the participation of a minimum number of financial institutions, with a focus on a key benchmark tenor only and a streamlined set of rights and obligations. We requested financial institutions' expressions of interest in becoming PDs in the pilot IMMA, and plan to launch the IMMA by September 2020.

c. We will assess the IMMA within 12 months of its launch to adjust the system to maximize its effectiveness and gradually extend it.

E. Structural Reforms

35. To support that recovery brings more robust and inclusive growth, we will continue with a steadfast implementation of our comprehensive structural reform agenda. Our reforms aim at strengthening Georgia's connectivity through infrastructure spending and trade initiatives, improving education and vocational training, mobilizing savings, the business environment, and land and energy reforms. These steps should boost long-term growth, diversify the economy, strengthen our external position, create jobs and reduce poverty. At the same time, targeted social assistance and healthcare will continue to protect the most vulnerable.

36. Enhancing connectivity is key to Georgia's development. Despite some delays, we continue advancing our investment in core infrastructure, which will transform Georgia into a transport and logistics hub connecting Europe with Asia and support regional development. To this end, we have signed all the remaining contracts required for the construction of the East-West highway and began construction on the critical section of the North-South corridor.

37. We have started implementing our comprehensive education reform to improve job creation, productivity and wages. We will revise the government decree on teachers regulatory documents to clarify teachers' roles and responsibilities at all four categories (Practitioner, Senior, Lead and Mentor); and to establish a non-discretionary approach to teacher's career advancement based on: (i) abolishing credit-point (incl. partial) accumulation system; (ii) introducing special exams for teacher 's promotion at each level of teacher status (currently exams are only for practitioners).

38. We are working to make our funded pension pillar fully operational. The pension agency appointed a chief investment officer and is designing the investment strategy. In the interim, pension contributions are placed in bank deposits and certificates of deposit. In March, Parliament adopted amendments to the Law on Pension Savings clarifying the requirements for custodian institutions. A fully functioning pension agency, with adequate safeguards in place, will promote savings and create an institutional investor for long-term lari assets.

39. We will continue to improve the business environment. To improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. In March 2020, we submitted to Parliament a draft insolvency law providing adequate protection of creditor rights, timely and efficient insolvency processes and effective rehabilitation framework in line with best international standards. This law will be critical to deal with the aftermath of the COVID-19 shock. To advance the reform, we will finalize the framework for insolvency professionals and begin licensing professionals by end-December 2020. (end-December 2020 structural benchmark). Starting January 2020, we started applying regulatory impact assessments to policy decisions to protect the economy from undue costs.

40. Land registration continues to be pivotal for rural and agricultural development. Land cadasters are important for protecting property rights, simplifying land transactions, and providing collateral for borrowing. We have been assisting citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Currently, registered land plots amount to 2.1 million compared to 0.6 million that were registered within the land reform launched on August 1, 2016.

41. Deepening trade relations with the rest of the world is one of Georgia's key priority. We have signed a free trade agreement with the UK to continue our trade relations after its departure from the EU. We have finalized a feasibility study for a free trade agreement (FTA) with India and are continuing to negotiate with Turkey an expansion of the current FTA. We remain committed to pursue other FTAs with priority countries, including the United States, Israel, and the Gulf Cooperation Council countries.

42. Our energy reform strategy will increase market competition, promote renewable energy, and enhance energy efficiency.

- We will develop competitive electricity and gas markets based on the EU energy market principles. For the largest electricity consumers (accounting for around 30 percent of electricity consumption) we have already implemented a third-party access model, separating transmission and distribution from suppliers, traders and generators. This is expected to foster wholesale competition, promote cross-border trading capacity, and open the sector to private investment in renewable energy. In parallel, we will gradually deregulate the natural gas sector.

- The government will adopt a new Electricity Market Concept Design, designing new market rules. The same procedure will be carried out for the natural gas sector as defined by the law on Energy and Water Supply.

- We will continue promoting energy savings and independence, security in energy supply, and energy efficiency in the energy market. We are developing a national energy efficiency target and an energy efficiency obligation scheme and/or alternative policy measures for energy savings. The Parliament of Georgia is expected to adopt the new laws on energy efficiency and on energy performance in buildings in May 2020.

43. We are modernizing our national accounts statistics to support strong economic policymaking. We plan to further improve our national accounts series in 2020 by computing GDP based on supply and use tables and quarterly GDP by expenditure at constant prices. This will provide a more detailed picture of the structural transformation in our economy.

F. Program Monitoring and Safeguards

44. The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause and structural benchmarks. Semi-annual program reviews will be based on June and December test dates. All quantitative performance criteria and indicative targets are listed in Table 2, and structural benchmarks are set out in Table 3. The Technical Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the inflation consultation clause as well as data provision requirements.

45. The NBG continues to maintain a strong safeguard framework and internal controls environment. As required by the safeguard policy, we continue to engage independent external audit firms to conduct the audit of the NBG in accordance with international standards.

46. Given that part of the Fund financing will be used to provide direct budget support, the NBG and the Ministry of Finance will sign and provide the IMF with a Memorandum of Understanding that clarifies the responsibilities for timely servicing of the related financial obligations to the IMF. As part of these arrangements, Fund disbursements to be used for budget financing will be deposited into the government's account at the NBG.

Table 1. Georgia: Inflation Consultation Targets and Bands for 2019-20

	2019				2020		
	End June	Outturn	End Dec.	Outturn	End June	End June 1/	End Dec. 2/
Inflation Consultation Bands for CPI (in percent)							
Central point	3.0	4.3	4.5	7.0	4.9	6.0	3.5
Inner band, upper limit/lower limit	5 / 1		6.5 / 2.5		6.9/2.9	8.0 / 4.0	5.5 / 1.5
Outer band, upper limit/lower limit	6 / 0		7.5 / 1.5		7.9/1.9	9.0 / 3.0	6.5 / 0.5

Source: Geostat, IMF staff estimates

1/ Proposed revised target and bands.

2/ Newly proposed target and bands.

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for end-December 2019 through end-December 2020

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

	2019				2020		2020
	End-December				End-June		Proposed End-December
	Target	Adjusted Target	Outturn	Status	5th Review	Proposed Target	Proposed Target
Performance Criteria							
Ceiling on augmented general government deficit (program definition)	1,170	1,009	1,022	Not met	550	2,300	4,300
Ceiling on general government net budget lending	335	171	111	Met	90	40	150
Floor on NIR of NBG[1] (end-period stock, million of U.S. dollars)	1,490	1,507	1,552	Met	1,450	1,120	1,100
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0		0		0	0	0
Ceiling on new public guarantees (continuous criterion)	0		0		0	0	0
Ceiling on the cash deficit of the Partnership Fund (million of U.S. dollars)	0		0		0	0	0
Ceiling on new investments by the Partnership Fund (continuous criterion)	0		0		0	0	0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the EFF program)	0		0		0	0	0
Indicative Targets							
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0		0	Met	0	0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	9,810		9,908	Not met	5,200	6,000	12,450
Stock of VAT credits[2]	1,570		1,598	Not met	1,470	1,470	1,470

[1] The NIR target is set at a program rate defined as the exchange rate on December 31, 2016, which for the GEL/US$ was 2.6468.

[2] The stock of VAT credits is evaluated in mid-June/mid-December respectively.

Table 3a. Georgia: Completed Structural Benchmarks - First through Fifth Review

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks	End-December 2017	Met
Submit to Parliament legislation giving NBG oversight power over credit information bureaus	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019	End-June 2017	Met
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards	End-June 2018	Met
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation	End-September 2018	Met
Introduce regulation on banks corporate governance in line with Basel Principles	End-September 2018	Met
NBG to publish a renewed financial stability report	End-November 2019	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds	End-December 2017	Met
Monetary policy operations and communication		
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018	End-June 2017	Met
Bank Resolution Framework		
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations	End-September 2017	Met
Fiscal		
Submission to Parliament of a 2018 budget consistent with the fiscal deficit in the Fund-supported program	End-December 2017	Met
Adopt a remuneration law for public civil service	End-December 2017	Met
Submit to Parliament a new fiscal rule framework consistent with IMF TA recommendations	End-December 2018	Met
Tax Administration		
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs)	End-September 2017	Met
Restructure the GRS headquarters into a function-based organization	End-February 2018	Met
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims	End-March 2018	Not Met 1/
Create a new specialized VAT unit focusing on validating VAT claims	End-June 2018	Met
Submit to Parliament a revised penalty regime with gradual tax-geared penalties based on materiality and approve changes to the tax code granting the GRS powers to pay out refunds without the need for a refund request	End-December 2018	Met
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities	End-June 2019	Met
Public-Private Partnership and Fiscal Risks		
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	End-December 2017	Met
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement	End-December 2017	Met
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as described in the MEFP	End-December 2018	Not Met 2/
Adopt the government decree implementing the PPP law following the recommendations of the FAD TA report	End-December 2018	Met
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns	End-December 2017	Met
Adopt a government decree clarifying the mandate of SOEs that are public interest entities, their governance and reporting requirements, in line with recent FAD recommendations	End-November 2019	Met
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system	End-December 2017	Met
Establishing an independent pension agency.	End-July 2018	Not Met 3/
Structural Reform		
Submit to parliament the new insolvency law ensuring adequate protection of creditors rights, timely insolvency processes and effective rehabilitation framework (in line with best international practice)	End-July 2019	Not Met 4/

1/ Implemented with two months delay
2/ Implemented with one month delay
3/ Implemented with a two week delay
4/ Implemented with seven months delay

Table 3b. Georgia: Remaining and Proposed Structural Benchmarks, by Completion Date 2019 -20

Sixth Review	Date	Status
Strengthen the public investment management methodology that guides project appraisal, selection and management; and adopt a government decree implementing reporting and oversight requirements for public investment projects at the MoF	End-December 2019	Met
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions	End-December 2019	Not Met
Submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from the monitoring entities on suspicious transactions, and put in place safeguards that protect the information from improper use	End-December 2019	Met
Adopt a budget for 2020 with an augmented deficit of GEL1,320 million in line with policies agreed at the Fifth Review	End-December 2019	Met
Publish a fiscal risk statement with a more comprehensive coverage of general government financial asset operations and provide information on the rates of return on general government equity holdings and loans	End-December 2019	Met
Enact legislative changes to implement effective ELA and resolution framework in line with international best practices	End-December 2019	Met
Provide a complete list of the SOEs qualifying as public corporation and SOEs qualifying as general government under the GFSM2014, done in consultation with FAD's regional resident advisor	End-March 2020	Met
Issues guidelines establishing valuation methodology for PPPs	End-March 2020	Not Met 1/
Upcoming		
Adopt the first phase of secondary legislation implementing bank resolution framework	End-June 2020	
Introduce the regulatory framework for insolvency professionals and begin licensing	End-December 2020	
Adopt the second phase of secondary legislation implementing bank resolution framework	End-December 2020	
Proposed New Structural Benchmarks		
Expand the 2020 Fiscal Risk Statement in line with recent FAD TA recommendations	End-December 2020	
Adopting a 2021 budget consistent with the policies agreed at the Seventh Review	End-December 2020	

1/ Completed in April 2020.

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria, inflation consultation mechanism and indicative targets) and describes the reporting requirements used to monitor developments under the Extended Fund Facility and methods to be used in assessing the program performance with respect to these targets. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available.

A. Program Assumptions

2. For the purposes of the program monitoring, all foreign currency denominated assets will be valued in lari at program exchange rates as specified below. Amounts denominated in currencies other than the U.S. dollar will be converted for program purposes into U.S. dollar amounts using the cross-rates as of December 31, 2016, published on the IMF web site http://www.imf.org/.

Table 1. Georgia: Program Exchange Rates

	Currency Name	**Currency/US$**
SDR	Special Drawing Rights	0.7439
GEL	Georgian lari	2.6468
AUD	Australian dollar	0.7227
CAD	Canadian dollar	0.7419
EUR	Euro	1.0556

B. Institutional Definition

3. The **general government** is defined as comprising the central government and local governments, excluding Legal Entities of Public Law. The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001 (GFSM 2001). The authorities will inform IMF staff on the creation of any such entities without delay. The general government coverage excludes state-owned companies and the Partnership Fund. The **public sector** consists of the general government, Legal Entities of Public Law and public financial and non-financial corporations, including the National Bank of Georgia and the Partnership Fund.

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

C. Quantitative Program Targets

5. The program will be assessed through performance criteria and indicative targets. Performance criteria are set with respect to:

- a performance criterion (ceiling) on the augmented cash deficit of the general government;
- a performance criterion (ceiling) on net budget lending operations;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (ceiling) on the accumulation of external debt arrears by the general government;
- a performance criterion (ceiling) on the new guarantees issued by the public sector;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund;
- a performance criterion (ceiling) on new net borrowing by the Partnership Fund.
- an indicative target (ceiling) on the primary current spending of the general government;
- an indicative target (ceiling) on outstanding VAT credits;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government;

In addition, the program will include a consultation clause on the 12-month rate of inflation (Tables 1, 2 attached to the Letter of Intent).

6. In addition to the performance criteria listed above and in Table 2 of Attachment I, the arrangement includes the performance criteria standard to all Fund arrangements, namely: (i) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions; (ii) no introduction or modification of multiple currency practices; (iii) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement; and (iv) no imposition or intensification of import restrictions for balance of payments reasons. These four performance criteria will be monitored continuously.

7. Performance criteria and indicative targets have been set for end-June 2020 and end-December 2020 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (except for (i) the NIR target, which is monitored in terms of stock levels and (ii) the new net borrowing by the Partnership Fund, which is monitored since program approval), while continuous performance criteria are monitored on a continuous basis.

D. Inflation Consultation Mechanism

8. Inflation consultation bands around the projected path for inflation are set for each test date under the program. Test date inflation is defined as the year-on-year percentage change of the monthly consumer price index (CPI) in the month of the test date as measured and published by the National Statistics Office of Georgia (GEOSTAT).

9. If test date inflation falls outside the outer bands specified in Table 1 of the MEFP, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) the proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the test date inflation falls outside the inner bands specified in Table 1 for the test dates, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

E. Program Definitions, Adjustors, and Reporting Requirements

General Government

Ceilings on (i) the augmented cash deficit of the general government and (ii) net budget lending

10. Definition: The **augmented cash balance of the general government** is defined as: revenues minus expense, minus net acquisition of non-financial assets (as defined by GFSM 2001) minus net budget lending (as defined below). A negative augmented cash balance is a deficit.

11. The **augmented cash balance of the general government** will be measured from the financing side at current exchange rates established by the NBG at the date of the transaction. Accordingly, augmented cash deficit of the general government will be measured by: i) net acquisition of financial assets (including changes in balances of the revenue reserve account), excluding net budget lending as defined by GFSM 2001; minus ii) net incurrence in domestic and foreign liabilities as defined in GFSM 2001.

12. Adjustor: The ceiling on augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of foreign-financed project loan disbursements above/below the program amounts (Table 2) .

13. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted downward (lower deficit) by the cumulative amount of receipts from sale of non-financial assets above the program amounts (Table 2).

14. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative amount of VAT credits refunded in cash above/below the program amounts (Table 2).

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

16. Adjustor: The ceilings on the augmented cash deficit and the primary current spending (indicative target) will be adjusted upward (higher deficit and higher primary current spending) for healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases in excess of the originally planned amount of GEL351 million (Table 2). Activities included for the adjustor are the ones defined by:

- Government Decree #164 28.01.2020 “On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus”:
    - Article 4.1 – Activities under the competencies of NCDC and Center for coordinating Emergency situation;
    - Article 4.8[2] – Tourism Agency providing quarantine services, including renting hotels and providing catering for the people in quarantine
    - Annex #20 “Managing Novel COVID-19” of the Government Decree #674 31.12.2019 “On Approving 2020 Healthcare Programs”, added to the decree by the Government decree #176 17.03.2020;
- Government Decree #653 25.12.2019 “On approving 2020 State Program of Rehabilitating and equipping Medical Facilities”.

Table 2. Georgia: Projected Financing for Cash Deficit of the General Government (in millions of GEL, cumulative from the beginning of the calendar year)		
	June 30, 2020	**December 31, 2020**
Healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases	N/A	351
Disbursements of foreign-financed project loans[1]	627	2,040
Receipts from sale of non-financial assets	83	150
VAT refunds	300	600
On-lent amounts from project loan disbursements	80	250

[1] Adjustments will not be made on project loans that are used to support the budget and/or the healthcare sector, namely, the World Bank's Fast Track COVID-19 Facility and EIB's healthcare project.

Supporting Material:

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

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

- Healthcare spending specified under (i)the Government Decree #164 28.01.2020, "On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus" under the categories of Articles 4 and 4.8[2], and Annex #20; and (ii) Government Decree #653 25.12.2019 "On approving 2020 State Program of Rehabilitating and equipping Medical Facilities".

- Data will be provided at actual exchange rates.

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

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

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

- Number and GEL value of claims for cash refunds submitted by taxpayers, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid automatically (i.e., without manual check or audit), separately for VAT and other taxes.

17. Definition: Consistent with GFSM 2001, **net budget lending** is defined as the net acquisition of financial assets for policy purposes by the general government.

Ceiling on the Current Primary Expenditures of the General Government

18. Definition: primary current expenditures is defined as expense (as defined by GFSM 2001) on a cash basis, minus interest payments.

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

Ceiling on the Outstanding stock of VAT credit refunds

20. Supporting material: Data for the period from the 16th day of the previous month to the 15th day of the current month will be provided by the Georgia Revenue Service by the end of each month on:

- Opening balance in taxpayer accounts (stock)
- New tax credits declared by taxpayers,
- Tax credit balance adjustments made by GRS after desk check / audit and by taxpayers,
- Tax payments to the budget
- Tax credits offset against tax liabilities,
- Tax credit refunds paid in cash,
- Other flows (residual),
- Closing balance in taxpayer accounts (stock),
- Closing balance amounts not eligible for a cash refund (stock).

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

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

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

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

Continuous Indicative Target on Accumulation of General Government Domestic Expenditure Arrears

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

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

Continuous Ceiling on the New Guarantees Issued by the Public Sector

26. Definition: For the purposes of the program, a **guarantee** of a debt arises from any explicit legal obligation of the public sector to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind).

[1] Arrears to Turkmenistan.

27. Supporting Material: The Ministry of Finance will provide to the IMF information on any new guarantees issued by the public sector within 4 weeks after the end of each quarter.

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

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

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

Ceiling on New Net Borrowing by the Partnership Fund

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

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

Continuous ceiling on New Investments by the Partnership Fund

33. Definition: New investments by the Partnership Fund are defined as gross acquisition of non-financial and financial assets, excluding (i) currency and deposits and (ii) other accounts receivables. Further excluded are transactions which are unambiguously required by contractual obligations established before November 1, 2019.

34. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly acquisition of financial and non-financial assets within four weeks of the end of each quarter. The Ministry of Finance will notify the IMF about transactions required by preexisting contractual obligations within 10 days of their occurrence and provide the necessary documentation establishing such obligation.

Net International Reserves

Floor on the Net International Reserves of the NBG

35. Definition: Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. **Foreign assets of the NBG** include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. **Foreign liabilities of the NBG** shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to $1,552 million as of December 31, 2019 (at program exchange rates).

36. For the purpose of the program, **budget support grants to the general government** are defined as grants received by the general government for direct budget support from external donors and not related to project financing. **Budget support loans to the general government** are defined as disbursements of commercial loans and loans from bilateral and multilateral donors for budget support.

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

- Upward (downward) by any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.
- Upward (downward) by any excess (shortfall) of budget support grants compared to program amounts (Table 3).
- Downward by any shortfall of budget support loans compared to program amounts (Table 3).
- Upward by the sum of the total excess of budget support loans compared to program amounts (Table 3) and any negative net Eurobond issuance by the government, if this sum is positive.
- Upward by any positive net Eurobond issuance by the government.

- Upward/downward by 100 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Georgia: Projected Balance of Payment Support Financing[3]
(millions of U.S. dollars)

	June 30, 2020[1]	December 31, 2020[2]
Projected privatization revenue	0.0	0.0
Budget support grants from external donors and not related to project financing	0.0	91.2
Budget support loans, including bilateral and multilateral donors for budget support	297.8	1,278.1
Disbursements of project loans and grants	75.9	225.2

[1] Cumulative from January 2020 to end-June 2020.
[2] Cumulative from January 2020 to end-December 2020.
[3] Flows are valued at program exchange rates for the June and December targets.

38. Supporting material: Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payment support loans, cash grants to the general government, amortization (excluding repayments to the IMF), interest payments on external debt by the Ministry of Finance and the NBG; and conversions for government imports will be provided to the IMF in a foreign exchange cash flow table (which includes details of inflows, outflows and net international reserves) on a weekly basis within three working days following the end of the week.