International Monetary Fund

Georgia and the IMF

Press Release:
IMF Executive Board Completes Ninth and Final Review Under Stand-By Arrangement for Georgia
June 9, 2011

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Georgia: Letter of Intent

May 24, 2011

The following item is a Letter of Intent of the government of Georgia, which describes the policies that Georgia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Georgia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

GEORGIA: LETTER OF INTENT

May 24, 2011

The Acting Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Lipsky:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement (SBA) for Georgia, which was further augmented in August 2009. On January 12, 2011, the IMF's Executive Board completed the seventh and eighth reviews under the SBA. We are grateful for the assistance which the IMF has been providing to Georgia.

2. This letter of intent describes the economic policies that we plan to implement during the remainder of 2011, consistent with our commitment to maintain macroeconomic stability and facilitate the process of macroeconomic adjustment.

3. Policies beyond 2011 will be guided by the same objectives of attaining sound fiscal and balance of payments positions, and maintaining low inflation. We are presently elaborating a comprehensive economic plan to reach these objectives, and we will request Fund support for this plan through a successor arrangement in the near future.

Recent Economic Developments

4. Recent economic developments have been broadly in line with program projections:

- Positive developments for the first quarter economic indicators are consistent with an annual real GDP growth projection of 5.5 percent in 2011.

- CPI inflation peaked at 13.9 percent in March under the impetus of rising food and fuel prices, and has since begun to come down. Core inflation (defined as the CPI excluding food, beverages, tobacco, and energy) remains subdued, and has recently declined below 2 percent, pointing to the absence of second-round price effects. Based on an expected stabilization of commodity prices, we project CPI inflation to decelerate in the second half of the year to around 8.5 percent by year-end.

- Balance-of-payment developments in the first quarter of the year were more favorable than anticipated. Despite higher import prices, which resulted in a widening of the trade deficit in the first quarter by almost 50 percent year-on-year, other inflows turned out stronger than projected, notably tourism receipts, which grew by over 40 percent year-on-year. Also, net financial inflows to the private sector are estimated to have risen sharply, as banks had to meet higher reserve requirements and reflecting inflows to meet the spending needs of key corporate clients, notably the railway company.

- On April 12, Georgia successfully issued a $500-million Eurobond at very favorable terms (10-year maturity and 7.125-percent yield), reducing significantly medium-term debt rollover risks and establishing an excellent sovereign benchmark in the international capital markets. The proceeds of the issue were used to buy back most of the $500 million Eurobond maturing in 2013.

- Better-than-expected external developments contributed to an appreciation of the lari and also enabled the central bank to accumulate net international reserves in excess of program targets. Since the beginning of the year the lari has appreciated by 5.7 percent against the dollar, and by 0.1 percent against the euro. Over the same period, the central bank has purchased $20 million, on a net basis, on the foreign exchange market. As a result, net international reserves have reached their pre-crisis level.

- The growth rates of monetary and credit aggregates are currently at levels consistent with projected GDP growth and inflation. Broad money increased by 21 percent year-on year in March (down from 40 percent in mid-2010), while credit grew by 19 percent.

- Banking sector balance sheets remain sound. NPLs have declined further to 5 percent of the loan portfolio in March 2011 (by the IMF definition). Capitalization, provisioning, and liquidity ratios are within comfortable margins, bank profitability has increased, and reliance on external wholesale funding has declined significantly relative to the pre-crisis level.

Policies for 2011

5. Notwithstanding the achievements made under the program, additional efforts will be needed to ensure macroeconomic stability over the medium term. To that end, we intend to maintain the broad policy objectives to which we committed at the time of the seventh and eighth reviews.

6. The recently adopted supplementary budget for 2011 targets a larger reduction in the deficit that envisaged at the time of the seventh and eighth reviews, as higher tax revenue would largely be saved and would be only partly used to finance additional social and capital outlays. Social spending was increased by the one-off distribution of food and electricity vouchers and a 25 percent increase in basic pensions scheduled for September. The budgeted increase in capital spending reflects infrastructure upgrades across a number of sectors. Overall, we stand ready to keep spending below budgeted levels in order to achieve the desired adjustment, given the uncertainty about the recurrent component of the revenue gain. On that basis, we are committed to reducing the government fiscal deficit by 3 percentage points of GDP, from 6.6 percent in 2010 to 3.6 percent in 2011.

7. We remain committed to a flexible exchange rate. Intervention, in either direction, will be motivated by the need to dampen excess volatility in the very thin Georgian foreign exchange market. At the same time, based on the results of the first quarter, we have also revised up our annual target for net international reserves (NIR), which we now project to reach $1.1 billion by year-end.

8. We consider that the monetary policy stance is consistent with the projected deceleration of inflation. We will continue to monitor closely developments in headline and core inflation and credit growth, and stand ready to adjust our monetary policy stance in the event these indicators deviate from current projections.

Completion of the Review

9. All but one of the end-March 2011 performance criteria (PCs) were met. The end-March PC on general government expenditure was missed owing to the distribution of food and electricity vouchers (aimed at alleviating the social impact of the hike in food and fuel prices) and an accelerated pace of project implementation under the Millennium Challenge Georgia Fund. At the same time, other current spending was lower than expected. We consider that the nonobservance of this PC does not compromise the program objectives and that it is more than offset by our revised (and tighter) deficit target for the year.

10. Based on our performance under the program and the explanations provided in this letter, we request a waiver of nonobservance of the end-March PC on general government expenditures and completion of the ninth review. We will maintain our usual close policy dialogue with the Fund.

11. We authorize the IMF to publish this Letter of Intent as well as the accompanying staff report.

Sincerely yours,

/s/
Nika Gilauri
Prime Minister of Georgia

/s/
Kakha Baindurashvili
Minister of Finance

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

Table 1. Georgia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010-11

	Dec-10			Mar-11		
Performance Criteria	PC	Adjusted PC	Actual	PC	Adjusted PC	Actual
	(Cumulative change since the beginning of the year, in millions of lari)					
Ceiling on cash deficit of the general government	1,241	…	1,366	170	138	-197
Ceiling on the general government expenditures	7,106	…	7,232	1,553	1,521	1,568
	(End-period stock, in millions of lari)					
Ceiling on net domestic assets (NDA) of the NBG 1/	714	689	349	516	543	-126
	(End-period stock, in millions of U.S. dollars)					
Floor on net international reserves (NIR) of the NBG 1/	721	736	882	757	741	994
	(Cumulative change since the beginning of the year, in millions of U.S. dollars)					
Ceiling on accumulation of external arrears 2/	0	…	0	0	…	0
Indicative target	Ind. Target	Adjusted Target	Actual	Ind. Target	Adjusted Target	Proj.
	(Cumulative change since the beginning of the year, in millions of U.S. dollars)					
Ceiling on contracting or guaranteeing of new total external debt by the public sector	1,000	…	718	500	500	209

Sources: Georgian authorities; and Fund staff estimates.

1/ Actual figures and quantitative targets are based on program exchange rates.
2/ The continuous performance criterion for external arrears is defined in paragraph 21 of the TMU (EBS/10/244).