

Monitoring Report of the Fiscal Rules Established by the Organic Law of Georgia on Economic Freedom

Parliamentary Budget Office

2022



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Note: Given the mandate of the Parliamentary Budget Office of Georgia, the report cannot be considered as any kind of recommendation on the relevant issue. The report aims to comprise the results of independent financial assessments in specific direction, to make sure that stakeholders and decision-makers are informed properly.

The Parliamentary Budget Office of Georgia is an independent fiscal institution, with the main goal to provide independent and impartial analysis, research and assessment of fiscal policy, which consequently strengthens parliamentary oversight over the public finance management and promotes fiscal sustainability for medium/long-term period.

The Parliamentary Budget Office of Georgia provides financial, budgetary, economic and other type of analytical information to the Parliament of Georgia, its committees, fractions, independent Members of the Parliament and Parliamentary Secretariat.

The report is based on the final version of the Draft Law of Georgia “On the 2023 State Budget of Georgia”, statistical data and budget documentation presented to the Parliament of Georgia and published no later than on December 10, 2022.

Acronyms

ARDL - Autoregressive Distributed Lag

CPI – Consumer Price Index

GDP – Gross Domestic Product

GEL – Georgian Lari

GFSM – Government Finance Statistics Manual

IMF – International Monetary Fund

LEPL – Legal Entity under Public Law

NNLE – Non-entrepreneurial (Non-commercial) Legal Entity

OLS- Ordinary Least Square

PBO – Parliamentary Budget Office of Georgia

PPP – Public-Private Partnership

SDR - Special Drawing Rights

VAR- Vector Auto Regression

VECM - Vector Error Correction Model

WEO - World Economic Outlook

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Executive summary

One of the main functions of fiscal policy is to ensure macroeconomic stabilization, which itself requires adoption of policy based on fiscal responsibility. Fiscal responsibility includes fiscal discipline: fulfillment of fiscal indicators, planned by the government, is one of the prerequisites for budget sustainability and economic development in the short and long term.

One of the most important components of effective management of public finances are fiscal rules and their monitoring. These tools support and contribute significantly in ensuring fiscal discipline.

The main purpose of this document is to assess the compliance of the budget parameters for 2023 with the fiscal rules established by the Organic Law of Georgia on Economic Freedom. The report also provides an analysis of the compliance of fiscal rules in the medium-term (2023-2026).

According to the Georgian legislation, the basic fiscal rules are: **the revenue rule**, according to which it is not allowed to increase the general state tax other than excise without a referendum and to introduce a new tax or change the tax rate, which will lead to an increase in the tax burden. Also two macroeconomic parameters: the unified budget deficit should not exceed 3% of GDP (**so-called balance/deficit rule**) and government debt should not exceed 60% of GDP (**so-called debt rule**).

Regarding the so-called the **deficit rule**, it should be noted that according to Article 14 of the draft Law of Georgia on the State Budget for 2023 (final version), **the deficit of the state's unified budget defined by 2,261.0 million GEL, which is 2.8% of the projected GDP (defined limit - 3% of GDP)**. However, according to the PBO, the ratio of the unified budget deficit (2,121 million GEL) to GDP will be 2.7% in 2023, which is mainly driven by the post Covid-19 high economic growth rates, including high growth rates in international trade, remittances, foreign direct investments, financial sector, tourism sector and other economic fields.

In addition, it should be noted that, in 2015-2018, the defined macroeconomic parameter limit was complied, according to the deficit rule threshold existed by that time. Accordingly, the ratio of the consolidated budget deficit to GDP ranged from 0.7% to 1.4%. The limit mentioned above was also complied in 2019, the ratio of the unified budget deficit to GDP amounted to 2.6%. Violation of the macroeconomic parameter limit is observed in 2020 and 2021, in particular, unified budget deficit to GDP ratio was observed at 9.0% in 2020, whereas, in 2021 this figure was 6.2%. As a result of the amendment of the State Budget 2022 implemented in December 2022, the ratio of the unified budget deficit to GDP returned to the macroeconomic parameter limit defined by the organic law and amounted to 2.7%.

As for the so-called **debt rule**, according to the draft Law of Georgia on the State Budget for 2023 (final version), **the government debt to GDP ratio will be defined at 38.3% by the end of 2023, and the current value of PPP commitments (as of January 1, 2022) is 0.5% of GDP. In total, 38.8% of GDP**. It should be noted that according to the PBO forecast, the ratio of the government debt to GDP will be 39.2% in 2023 (without PPP commitments), while with PPP commitments, the ratio will reach 39.7% of GDP.

At the same time, it should be noted that, in 2012-2019 the ratios of state debt and government debt did not exceed the limit set by the Organic Law of Georgia on Economic Freedom. In 2020, the macroeconomic parameter - so-called debt rule was violated. However, in 2021, the amount of government debt returned to the limit determined by the debt rule, and it is expected that the mentioned limit will be respected in 2022-2023 as well.

As for **the medium-term period (2023-2026)**, according to the baseline forecasts of both the PBO and the government (forecasts related to the third submission of the 2023 budget law), **debt rule is not expected to violate and exceed 60% limit**. As for the deficit rule, according to the government's estimates, it is expected that the deficit rule will not be violated in 2023 and **the unified deficit-to-GDP ratio will be remained below 3% in the medium-term**. Given the macroeconomic and fiscal forecasts of the PBO and the existing policy of the government, it is expected that **the unified budget deficit-to-GDP ratio will be below 3% in 2023 and in the medium-term as well**.

The report discusses fiscal rules in the medium-term according to different macroeconomic scenarios (positive and negative). It also analyzes the sensitivity of the fiscal limits to various macroeconomic shocks.

It should be noted that, as the sensitivity analysis showed, despite to the increased debt in the medium term along with the high economic growth, **even in case of significant depreciation of the exchange rate, debt to GDP ratio will be retained below 60%**.

1. Introduction

Independent fiscal institutions have an important role in the process of establishing a sustainable public finance system. Analysis performed by an independent fiscal institution is characterized by a high level of impartiality and objectivity. It is a well-known worldwide practice for such institutions to perform monitoring of a county's fiscal rules compliance¹. This practice is reflected in many European legal acts that require the assessment of fiscal rules compliance to be performed by an "independent agency", be that a Fiscal Council, a Budget Office or any other fiscal institution. Among these acts, is the Council of Europe Directive 2011/85/EU of November 8, 2011, on "Requirements for Budgetary Frameworks of the Member States"², according to which the independent agencies must perform "the effective and timely monitoring of compliance with the rules". This commitment was strengthened by the Treaty on Stability, Coordination and Governance³ (TSCG), which was adopted by the EU Member States and entered into force in November 2011.

Independent fiscal institutions can address the tendency in some finance ministries to produce overoptimistic macro forecasts either by providing unbiased forecasts themselves or by exposing the bias to the public.

This document represents a report on the monitoring of the fiscal rules carried out by the Parliamentary Budget Office of Georgia (hereinafter – the PBO) in accordance with the Organic Law of Georgia on Economic Freedom.

1.1 Grounds for Report Preparation

Assessment of the compliance with fiscal rules is a well-established practice not only in the countries of the European Union but throughout the world. Monitoring of fiscal rules compliance is one of the most important components of achieving effective fiscal rules in a country. Such fiscal rules are respected and they significantly influence fiscal policy.

Strong fiscal rules have certain characteristics from which one of the most important is creating effective mechanisms for their implementation and carrying out monitoring by an independent body, which have to identify eventual non-compliance.

Thus, establishing the practice of monitoring fiscal rules compliance in Georgia is crucial and should not be underestimated.

In the context of monitoring fiscal rules compliance, it is important to mention a document prepared by the International Monetary Fund in 2017 – "**Georgia - Enhancing the Fiscal Rules Framework**"⁴. According to this document, the Government of Georgia provides an abundance of fiscal information but does not report on compliance with the fiscal rules, ex ante or ex post. Moreover, the effective implementation and monitoring of fiscal rules often requires the increase of the role of budget institutions. Particularly, this implies a strong institution, which performs macroeconomic and fiscal forecasting, medium-term budget planning, and fiscal risk management and disclosure.

¹ For additional information, please see the publication of the PBO on "Monitoring of Fiscal Rules Compliance: Theoretical Aspects and International Experience". Policy Paper N 03/20. Available at: http://pbo.parliament.ge/publications/Monitoring%20of%20Fiscal%20Rules%20Compliance_%20Theoretical%20Aspects%20and%20International%20Experience.html

² Available at: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0041:0047:EN:PDF>

³ Available at: https://www.consilium.europa.eu/media/20399/st00tscg26_en12.pdf

⁴ Available at: <https://mof.ge/images/File/public%20finances%20in%20Geo/georgia-fiscal%20rules%20report%202018.pdf>

Another noteworthy document prepared by the International Monetary Fund is “**Georgia – Fiscal Transparency Evaluation**”⁵, according to which fiscal transparency of the country has to be strengthened. As it is recommended, it is necessary to publish regular statements on performance against the fiscal rules that provide an explanation of whether budget plans and budget outcomes are consistent with the fiscal rules.

The activities of the PBO in relation to the assessment of macroeconomic and fiscal forecasts of the Government are assessed positively by the document. “Georgia – Fiscal Transparency Evaluation” document recommends expanding the legal mandate of the PBO, so that it evaluates performance against the Government’s stated fiscal rules and publishes an independent assessment in its fiscal reports.

1.2 The Structure of the Report

The second chapter of the present report addresses macroeconomic overview and medium-term economic growth of Georgia. In this context, macroeconomic environment and change in indicators presented in 2022 Monitoring Report of Fiscal Rules⁶ are reviewed.

The third chapter – “The fiscal rules established by the Organic Law of Georgia on Economic Freedom”, includes the review of the balance/deficit, debt and revenue rules and the compliance of the indicators of the final version of 2023 State Budget draft law of Georgia with these fiscal rules.

The fourth chapter – “Compliance of Georgian budget indicators with the fiscal rules in the medium-term” consists of sub-chapters on issues affecting the fiscal rules, unified budget deficit in the medium-term, Government debt in the medium-term and sensitivity analysis and scenarios.

⁵ Available at: <https://mof.ge/images/File/public%20finances%20in%20Geo/Fiscal-Transparency-Evaluation-IMF.pdf>

⁶ Available at: http://pbo.parliament.ge/media/k2/attachments/Monitoring_Report_of_Fiscal_Rules_2022_ENG-Final_version.pdf

2. Macroeconomic overview and medium-term economic growth of Georgia

This Chapter analyses the macroeconomic environment and the medium-term economic growth of Georgia. It also provides key macroeconomic indicators and discusses changes⁷ compared to the previous Fiscal Rules Assessment document⁸. The review of the macroeconomic environment in 2022 and 2023 and the analysis of key indicators are based on the estimates and forecasts of the PBO and the Government of Georgia (hereinafter government).

2.1 Macroeconomic environment and key indicators

In 2021, Georgia's economic growth was set at 10.5%, which is mainly driven by the base effect of a high reduction in 2020 caused by the COVID-19 pandemic and by easing/canceling the pandemic-related restrictions, which stimulate growth of both demand and supply, that also affects the 2022 forecast. High economic growth, observed in the first, second and third quarters of 2022 and beyond, as well as external trade, financial sector growth and other economic figures indicate a gradual recovery of the economic activity. According to this, both PBO and the government forecast (Hereinafter - the current forecast) high economic growth rates (9.8% and 10.0%, respectively), which is in accordance to current tendencies and January-October average economic growth rate (10.2%) published by Geostat. According to the final version of the draft law "On the 2023 State Budget of Georgia" (hereinafter - the draft state budget for 2023), both the PBO and the government forecast that the economic recovery process will continue and positive economic growth will be recorded (5.1% and 5.0% respectively) by 2023.

Should be mentioned, that high growth rate of inflation observed in the second half of 2021 was maintained in 2022. Namely, high inflation rates were observed due to the supply shock in the first and second quarters of 2022 as a result of the Russia-Ukraine war, significantly increased prices on energy and food products in the world market as well as increased freight transportation costs, the more revitalized aggregate demand and higher economic growth than expected. In January-November, 2022 the average inflation was set at 12.1%. As for 2023, the PBO and the government forecast inflation to fall to 5.5% and 5.3%, respectively. According to the PBO forecasts, inflation will decline in the first half of 2023 and approach the target (3%) during the year.

Nominal gross domestic product (GDP) was also characterized by a positive trend in 2015-2019 (average annual growth rate 9.6%). In 2020, due to a COVID-19, an insignificant growth (0.03%) was observed. In 2021, due to a high economic recovery rate, the nominal gross domestic product increased by 21.8%. According to the current forecast of the PBO, the increasing trend of the nominal GDP will be maintained in 2022 at 19.8%. The government similarly forecasts a high growth rate of the nominal GDP (by 20.5%) in accordance to the current economic growth. As for 2023, the PBO expects the nominal GDP to increase by 10.8%, while the government - by 10.3%.

The sectoral analysis of GDP in 2021 shows that all sectors, except public administration and construction have had a positive impact on economic growth. Should be noticed, that in post Covid period high growth rates were observed mainly in manufacturing, trade and service

⁷ http://pbo.parliament.ge/media/k2/attachments/Monitoring_Report_of_Fiscal_Rules_2022_ENG-Final_version.pdf

⁸ The previous document incorporates forecasts made in December 2021

setors. The share of the following sectors should be noted, such as: manufacturing (1.9 pp), trade (1.6 pp), transport (1.6 pp), arts, entertainment and recreation (1.3 pp), healthcare (1.1 pp), financial activities (0.9 pp), real estate (0.9 pp) and accommodation and food service activities (hotels and restaurants) (0.8 pp). The analysis of the dynamics of the sectoral structure of GDP shows that, industry, financial activities, construction, real estate transactions and construction were the main driving sectors of economic growth in 2011-2020..

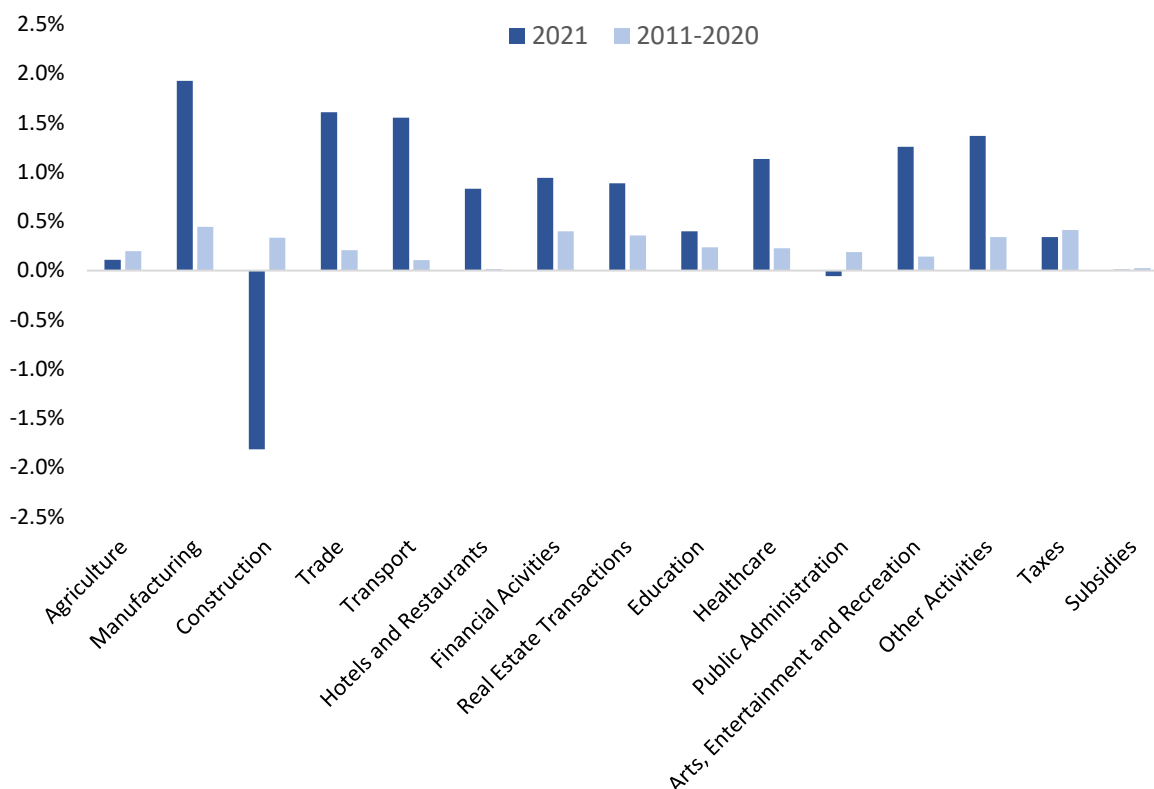


Figure 1: Contribution of various sectors in GDP growth. Source: Geostat

The PBO estimates, that the unified budget tax revenues are expected to increase by 30.0% in 2022, while the government forecasts the growth rates of the unified budget tax revenues at 29.7%. The PBO as well as the government forecast tax revenues to increase by 10.0% and 8.9%, respectively in 2023. Meanwhile, according to the government’s medium-term plan, 13.5% and 9.0% increase in expenditure and non-financial assets is expected respectively in 2022 and 2023⁹.

According to the PBO, the ratio of the net lending/net borrowing to GDP will be -3.0% in 2022, while the government forecasts the ratio to be -2.7%. As for 2023, PBO forecast an improvement in this figure, while government forecasts deterioration (-2.7% and -2.8%, respectively).

⁹ PBO does not forecast current and capital expenditures

Indicator	2019	2020	2021	Trend	2022		2023	
					PBO	Government	PBO	Government
Nominal GDP (GEL Million)	49,253	49,267	60,003		71,911	72,276	79,691	79,685
Real GDP Growth	5.0%	-6.8%	10.5%		9.8%	10.0%	5.1%	5.0%
DDP Gap	-0.4%	-4.9%	-0.8%		1.1%	-	0.6%	-
Consumer Price Index	4.9%	5.2%	9.6%		12.0%	11.9%	5.5%	5.3%
Operating Balance*	5.1%	-0.7%	1.0%		5.4%	5.4%	4.9%	4.8%
Net Lending / Net Borrowing*	-2.6%	-9.0%	-6.2%		-3.0%	-2.7%	-2.7%	-2.8%
Current Account Balance*	-5.8%	-12.4%	-10.4%		-6.3%	-5.7%	-6.5%	-6.4%
Government Debt*	40.4%	60.2%	49.7%		41.1%	39.6%	39.2%	38.3%

Table 1¹⁰: Key macroeconomic indicators for 2019-2023. Sources: National Bank of Georgia, Geostat, PBO and Government.

Exports as well as imports are expected to increase in 2022. According to the PBO assessment, the indicators will be defined at 42.3% and 27.8%, respectively, while the government forecasts the following indicators to be 44.5% and 30.5%. As for 2023, both the PBO and the government are forecasting a revival of foreign trade, albeit on a different scale. In particular, the PBO expects an increase of export by 16.8% and import by 15.2% respectively, while the government figures are 21.8% and 20.9%.

After a significant reduction of international trade caused by COVID-19 in 2020, foreign activity has started to significantly revive since 2021. It is expected that, economic growth trend will remain and the volume of international trade will increase significantly. Both the PBO and the government forecast that the current account balance will improve in 2022. The PBO and the government forecast the current account-to-GDP ratio at -6.3% and -5.7% respectively in 2022. As for 2023, PBO forecasts the rate at -6.5%, while the government forecasts at -6.4%.

Government debt is also expected to decrease in 2022. The PBO estimates that the government debt-to-GDP ratio will reach 39.8%, while the government forecast is 39.6%. As for 2023, the PBO expects this figure to improve and reach to 39.2%, while the government forecast is defined at 38.3%.

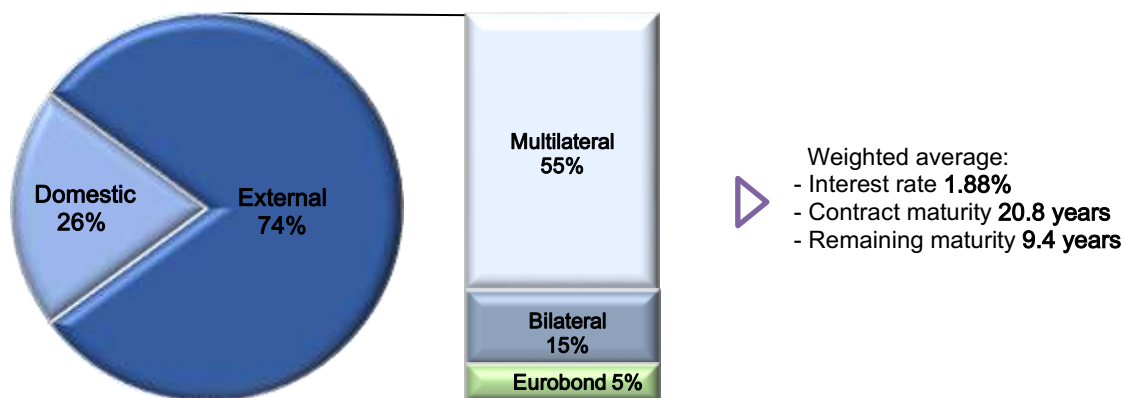


Figure 2: The structure of government debt as of October 31, 2022. Source: Government of Georgia

¹⁰ % Change, unless noted otherwise

Operating balance and net lending/net borrowing of unified budget.

* % of GDP

According to the “Government Debt” annex of the draft state budget law for 2023, as of October 31, 2022 the government debt balance amounts to 27,455.1 million GEL. Among with the state debt - provided by the Law of Georgia on State Debt, except the liabilities of the National Bank of Georgia, amounts to 27,028.1 million GEL, the balance of loans of Budget Organizations – 42.4 million GEL and the current value of PPP commitments – 384.6 million GEL. The balance of the external debt of the government, 20,149.6 million GEL, accounts for 74% of government’s total debt. Most of these credit resources are received from multilateral and bilateral donors / partners.

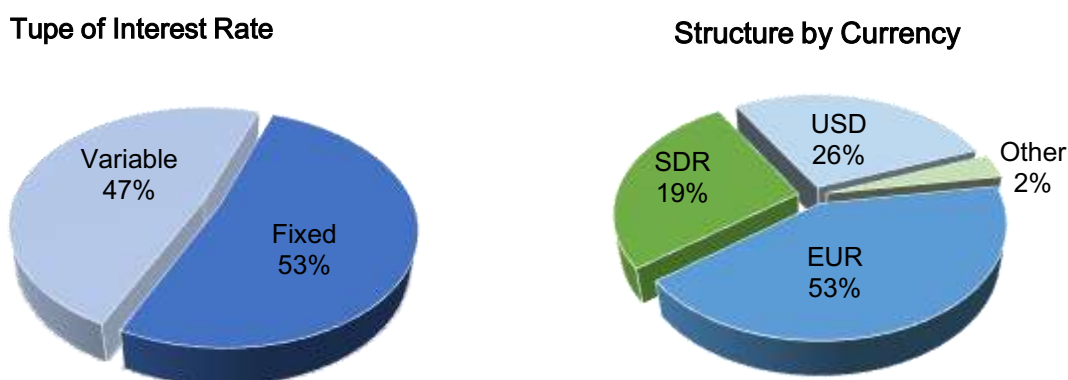


Figure 3 and 4: Type of interest rate and the structure by currency as of October 31, 2022. Source: Government of Georgia

According to the estimates of the PBO and the government, in 2022 and 2023, external debt is almost three times more than internal debt (see Table 2). This has advantages, as well as disadvantages. The most important positive factor of the external debt is that it is cheaper than the sources of domestic financing, that is, generally, external debt has lower interest rate. Among the negative factors two most significant can be pointed out: first of all, external debt, that is frequently foreign currency denominated debt, is vulnerable to the exchange rate fluctuation: if the exchange rate of a country depreciates, the amount of external debt, all else being equal, increases. Moreover, bigger external debt means that country is more dependent on external sources of financing rather than on domestic sources, that are generally more stable. In addition, as shown in Figure 3, the share of variable and fixed interest rates are correspondingly defined at 47% and 53%. It should be noted, that the variable interest rate is riskier than the fixed one, as the variable rate may increase over time. However, variable interest rates are typically relatively lower than fixed rates which is naturally in line with their high risk.

In addition, it should be noted, that the net increase in domestic liabilities is planned for 2023, in particular, according to the draft consolidated budget of 2023, the net increase in domestic liabilities is defined at 1,300 million GEL in 2023.

Detailed information on the projected debt (by the end of 2023) presented in the draft state budget for 2023 can be found in Annex 6.

	PBO		Government	
	2022	2023	2022	2023
Government Debt	28,609	31,272	28,609	30,539
External Debt	21,508	22,818	21,508	22,085
Domestic Debt	7,100	8,454	7,100	8,454
Government Debt*	39.8%	39.2%	39.6%	38.3%
External Debt*	29.9%	28.6%	29.8%	27.7%
Domestic Debt*	9.9%	10.6%	9.8%	10.6%

Table 2: Forecast balance of Government Debt 2022 and 2023, (million GEL, * % of GDP)

To discuss the GDP based on expenditure, in recent years, consumption has accounted for the largest share of GDP, especially private consumption, whose contribution to GDP in 2017-2019 averaged 75%. The share of investments in GDP was relatively small, averaging 27% in 2017-2019. As for the contribution of foreign trade, the negative share of imports in 2017-2019 averaged 10% higher than the corresponding rate of exports. In 2020, the structure and dynamics of economy has changed due to Covid-19 pandemic. As a result of restrictions imposed against pandemic, the negative effect was observed to foreign trade. The most vulnerable sector was service export, disrupted by deterioration of tourism flows. By 2020, the share of consumption in GDP was the highest 95.4% (private consumption was 88%) compared to previous years, while the share of investments declined even more and equaled to 23.9%. The foreign trade indicators (export and import) declined as well and reached 37.3% and -56.6%. As for 2021, the share of consumption increased slightly compared to previous years and reached 97.5%, while the share of investments declined and equaled to 19.0%. The foreign trade indicators improved more than expected in 2021 and the share of net export amounted to -16.4%. By 2022, PBO estimates a decrease in the share of consumption and a slight increase the share of investment. According to government forecasts, the share of consumption will decrease, while the share of investment compared to previous years will increase. According to the PBO, these figures are defined at 91.5% and 19.8%, while the government estimates are 86.4% and 25.2%. Compared to 2021, in 2022 the PBO as well as the government expects the share of export to GDP to increase, while the share of import to decrease. Accordingly, in 2022 the PBO forecasts the share of net export to GDP to be -11.3%, while the government forecasts the ratio at -11.6% (See Appendix 2 for more details). As for the foreign trade estimates for 2023, both the PBO and the government forecast that the share of exports and imports to GDP will increase compared to 2022, albeit slightly in both cases. Consequently, the figures for 2023 are as follows: According to the budget office forecast, the share of net exports to GDP in 2023 will be -10.8%, while the government estimates the ratio at -11.4%. It should be noted, that in the medium term, the budget office estimates that domestic consumption and investment will still play a leading role in economic growth. In addition, due to a fiscal consolidation, capital expenditures of the government will decrease and private investment will increase in the following years.

2.2 Changes compared to the previous Fiscal Rules Assessment document¹¹

The 2023 fiscal rules monitoring report is based on the PBO estimates published in the Annual Macroeconomic Forecast document¹² in December 2022, which differs from the 2022 fiscal rules monitoring report based on the PBO's similar estimates document¹³ of December of 2021. The differences are largely due to the unpredictable dynamics of the Covid-19 pandemic and higher than expected economic activity in 2022.

In particular, in December 2021 the forecasted economic growth for 2022-2023 was 5.6% and 5.3%, respectively, while in December 2022 the expected figures are 9.8% and 5.1%, respectively.

According to the forecasts published by the PBO in December 2021, consumer price inflation rates were expected to be 5.4% and 3.1% as well in 2022-2023, while in December 2022 the PBO forecasted these figures to be 12.0% and 5.5%, respectively.

In addition, compared to the December 2021 forecast, the tax revenues of the unified budget for 2022 and 2023 increased by 14.0% and 15.3%, respectively. At the same time, the net lending/net borrowing of the unified budget for 2022 has increased by 1,207 million GEL, while the similar figure for 2023 has deteriorated by 30 million GEL.

The ratio of the current account balance to GDP for 2022-2023 has also improved, namely from -8.2% to -6.3% in 2022 and from -6.8% to -6.5% in 2023.

According to the December 2021 estimates, both exports and imports were expected to increase by 24.4% and 17.1% in 2022, respectively, while 17.5% and 10.2% growth rates were expected in 2023. Based on current year estimates published in December 2022, exports and imports are expected to increase by 42.3% and 27.8% in 2022, while both indicators are expected to increase by 16.8% and 15.2% respectively in 2023. In addition, the forecast of the international reserves for 2022-2023 increased by 8.3% and 13.5% respectively, compared to the December 2021 forecast. According to the December 2022 estimate of the sum of investments and consumption the PBO forecasts increased by 4.9% in 2022 and by 8.3% in 2023 compared to the December 2021 forecast.

Considering above mentioned, according to the PBO forecasts published in December 2022 the nominal GDP in the medium term is consistently higher than the figures forecasted in December 2021. The situation is similar in the case of the government's medium-term forecasts. In case of the real GDP growth rate in the medium term, the PBO's forecast of the real GDP growth rate in 2022 published in December 2022 is higher than the December 2021 forecast, while in 2023-2025 the expected growth rate is slightly lower. As for the current forecast of the government, 2022 real GDP growth rate is higher compared to the December 2021 forecast, 2023 real GDP growth rate is lower, while in 2024-2025 it is actually similar. Besides that, both the PBO and the government estimate that consumer price inflation will return to the target (3%) in the medium term (See Appendices 3, 4 and 5 for more details).

¹¹ The previous document incorporates forecasts made in December 2021:

http://pbo.parliament.ge/media/k2/attachments/Monitoring_Report_of_Fiscal_Rules_2022_ENG-Final_version.pdf

¹² English version not available

¹³ http://pbo.parliament.ge/media/k2/attachments/Macroeconomic_Forecasts_December_2021_ENG.pdf

Forecast	Indicators	2022	2023	2024	2025
PBO					
December 2021	Real GDP Growth	5.6%	5.3%	5.1%	5.2%
	Nominal GDP (mln GEL)	66,997	73,742	80,815	88,437
	Net Borrowing* (mln GEL)	-3,144	-2,110	-2,097	-1,980
	Government Debt+PPP Comm. (mln GEL)	33,933	35,758	37,712	39,668
Current	Real GDP Growth	9.8%	5.1%	5.0%	5.2%
	Nominal GDP (mln GEL)	71,911	79,691	87,247	95,680
	Net Borrowing* (mln GEL)	-2,112	-2,213	-1,706	-1,907
	Government Debt+PPP Comm. (mln GEL)	28,993	31,657	33,821	35,961
Government					
December 2021	Real GDP Growth	6.0%	5.5%	5.2%	5.2%
	Nominal GDP (mln GEL)	64,832	70,450	76,337	82,716
	Net Borrowing* (mln GEL)	-2,750	-1,940	-1,923	-1,959
	Government Debt+PPP Comm. (mln GEL)	33,519	35,744	37,809	39,813
Current	Real GDP Growth	10.0%	5.0%	5.2%	5.2%
	Nominal GDP (mln GEL)	72,276	79,685	86,343	93,558
	Net Borrowing* (mln GEL)	-1,963	-2,261	-1,868	-2,083
	Government Debt+PPP Comm. (mln GEL)	28,993	30,923	33,063	35,183

Table 3¹⁴: Comparison of the medium-term Forecasts of the PBO and the Government. Source: PBO and Government of Georgia

According to the estimates published by the PBO in December 2022, the medium-term forecasts of the unified budget tax revenues are steadily higher than the forecasts of those figures made in December, 2021 (see Figure 5).

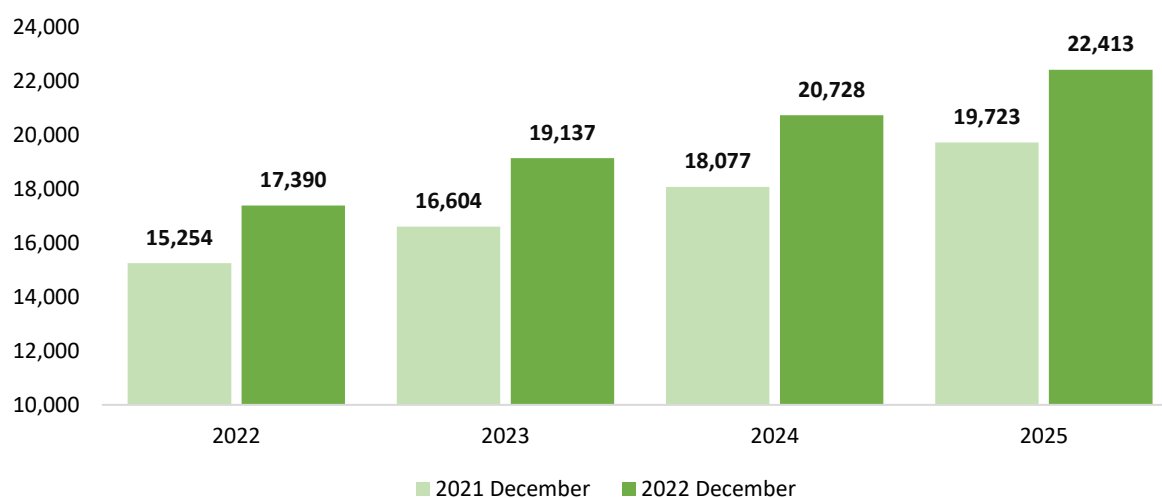


Figure 5: Tax revenues of the unified budget, December 2022 and December 2021 forecasts. Source: PBO.

In addition, according to the December 2022 forecast of the PBO, in the medium-term the net borrowing of the unified budget has improved compared to the December 2021 forecast. It should be noted, that the deterioration of the net borrowing in the medium-term is due to an increase in the non-financial assets (capital expenditures) as well as current expenditures.

¹⁴ In million GEL

* Net borrowing of the unified budget.

Despite that, in the medium-term the ratio of net borrowing of the unified budget to GDP shows an improving trend.

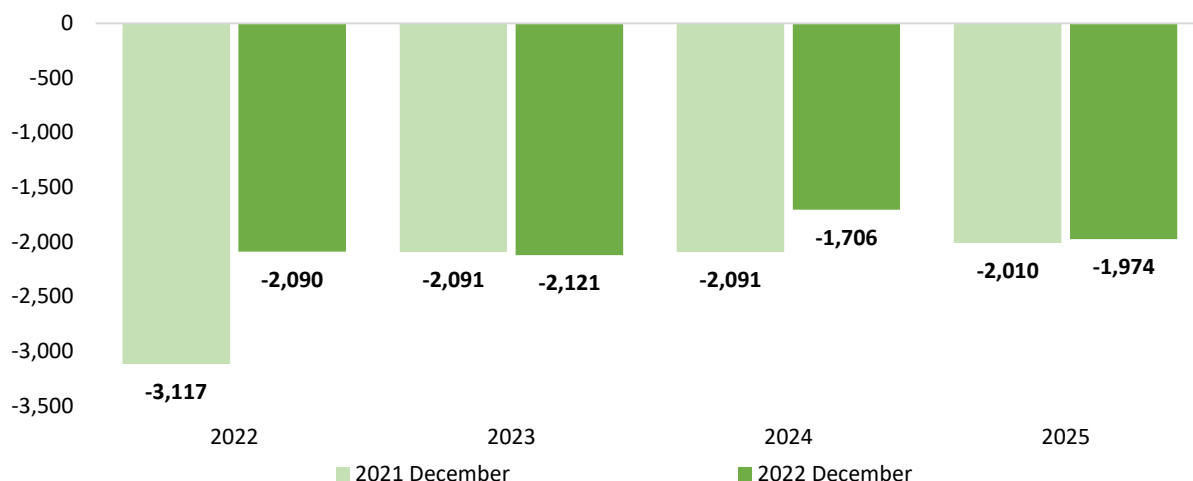


Figure 6: Net borrowing of the unified budget (absolute value). December 2022 and December 2021 forecasts. Source: PBO

As for the government debt plus public and private-partnership commitments, there is a difference between the December 2022 and December 2021 estimates of the PBO. According to the December 2022 estimates for the medium-term the figures are lower compared to the December 2021 forecast (see Figure 7). Since the amount of the public-private partnership project commitments is unknown in the medium-term, it is assumed that the figure given in the appendix to the draft state budget for 2023 - "Fiscal Risk Analysis Document" - will remain the same in the medium-term (384.6 million GEL as of January 1, 2022, while the current value of commitments was 395.4 million GEL as of January 1, 2021).

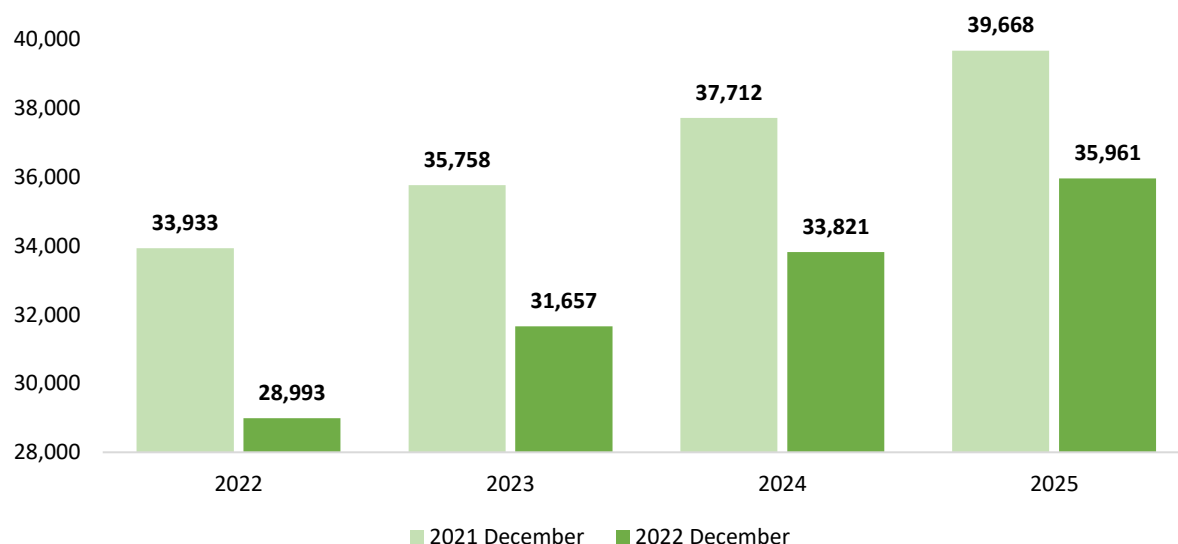


Figure 7: Government debt + PPP commitments. December 2022 and December 2021 forecasts. Source: PBO

According to the forecasts published by the PBO in December, 2022, the ratio of the net borrowing to GDP by 2025 is set at -2.1%, while in December 2021 the ratio was forecasted to be -2.3% in 2025. In 2026, this figure will improve to -2.0%.

According to the PBO forecasts made in December, 2022, the ratio of the government debt + PPP commitments to GDP is expected to be 37.6% (the December 2021 estimate was set at 44.9%).

3. Fiscal Rules Established by the Organic Law of Georgia on Economic Freedom

The following Chapter addresses the Organic Law of Georgia on Economic Freedom (hereinafter – Organic Law), the fiscal rules established by this law and compliance of the 2023 State Budget draft law indicators with the fiscal rules.

3.1 Review of the Organic Law¹⁵

According to the paragraph 2 of Article 67¹⁶ of the Constitution of Georgia, “The fundamental principles of economic policy for ensuring long-term and stable economic growth shall be defined by the organic law. In cases of special necessity, the breaching of and deviation from the limits set by macroeconomic parameters, as well as measures to be taken to return to those parameters, shall be determined by the organic law”.

In July 2011 the parliament adopted the Organic Law, which came into force on December 31, 2013. Georgian citizens, under the Constitution of Georgia and the above-mentioned Organic Law, establish guarantees of economic rights and freedoms for the present and future generations. Economic rights and freedom are human rights and freedom that can only be limited according to the rules and within the limits established by the Constitution and laws of Georgia.

The state guarantees economic rights and freedom that are to become the basis of the development of society, the welfare of people and the long-term, stable growth of the economy.

Freedom is a basic principle of economic policy that is expressed in small size of government, responsible macroeconomic policy and law taxes.

For the purposes of the above-mentioned, under the initial version¹⁷ of the Organic Law, the following fiscal rules were defined:

- The ratio of total volume of consolidated budget expenses and acquisitions of nonfinancial assets to GDP shall not be more than 30% (so-called expenditure rule);
- The ratio of the consolidated budget deficit to GDP shall not be more than 3% (so-called balance/deficit rule, hereinafter – deficit rule);
- The ratio of state debt to GDP shall not be more than 60% (so-called debt rule);
- From the date of entry into force of the above-mentioned Law, the introduction of a new type of national tax, except for excise tax, or the introduction of an increase in the upper margin of the rate according to the type of national tax, except for excise tax, shall be permissible only through a referendum (so-called revenue rule).

In December 2018, as a result of the amendments made to this Law, the expenditure rule was abolished and the deficit and debt rules were changed. In particular, for the deficit rule, instead of using the ratio of the consolidated budget deficit to the GDP – the maximum margin of the ratio of state’s unified budget deficit to GDP; and for the debt rule, instead of using the ratio of

¹⁵ English version not available

¹⁶ Article 67 – Taxes and fees, economic policy

¹⁷ Available at: <https://matsne.gov.ge/en/document/view/1405264?publication=0>

the state debt to GDP – the maximum margin of the ratio of government debt to GDP was defined. These amendments entered into force on January 1, 2019.

In view of the above-mentioned information, as of 2022, three following fiscal rules are operating in Georgia:

- The ratio of the deficit of the state's unified budget, defined by the Budget Code of Georgia, to GDP - not more than 3% (so-called deficit rule);
- The ratio of Government debt to GDP shall not be more than 60% (so-called debt Rule);
- From the date of entry into force of the mentioned Law, the introduction of a new type of national tax, except for excise tax, or the introduction of an increase in the upper margin of the rate according to the type of national tax, except for excise tax, shall be permissible only through a referendum (so-called revenue rule).

According to the Organic Law, under the rules established by the Georgian legislation, the preparation of draft Law of Georgia on State Budget, its adoption and implementation of state budget shall be performed in such a way that state's unified budget performance parameters are in accordance with the deficit and debt rules, both for the planned and performed indicators.

The government, under the Georgian legislation, while presenting the draft Law of Georgia on State Budget and its Annual Report on Execution, shall report to the parliament on the observance of the fiscal limits stipulated by this law and on the compliance of fiscal parameters with defined margins (the deficit and debt rules).

According to the Budget Code of Georgia, the government submits Annual Report of State Budget Execution to the parliament, no later than within 5 months from the end of the fiscal year. Resolution of the parliament on the adoption or non-adoption of the Annual Report on State Budget Execution is issued prior to the end of the Spring Session. The preliminary data of the LEPL National Statistics Office of Georgia on GDP of the previous year is published in March, whereas revised data – in November. Thus, after the revised indicator is published, it is possible for the ratio of the Government debt and unified budget deficit in relation to the GDP to be changed, when the parliament has adopted the Resolution on the adoption or non-adoption of the Annual Report on State Budget Execution.

It must be noted that according to the article 155¹ of the Organic Law of Georgia - Local Self-Government Code, the parliament may, for adhering to the maximum limits of macroeconomic indicators determined under the Organic Law, set limits by the Law of Georgia on State Budget with respect to the major indicators of budgets of local self-governing units.

According to the Organic Law, it is possible to plan the annual budget outside the limits set by this law only in the following cases (escape clause):

- a) In case of the extraordinary or military state of affairs, proclaimed according to the rule stipulated by the legislation of Georgia or in the case of the need to liquidate the effects of such extraordinary developments.
- b) In case of retarded economic growth or recession, if the annual real growth quarterly figures announced by the GEOSTAT for two consequent quarters show real growth (growth over same quarters of the previous year) that is 2% lower than the average real growth of the past 10 years.

It should be mentioned that if at least one of the two above-mentioned conditions is not met, in such a case the Organic Law does not envisage additional procedures on the possibility to plan beyond marginal values. Namely, in following years of planning macroeconomic parameters determined by escape clauses, the above-mentioned organic law does not foresee determination procedures of the same macroeconomic parameters that are beyond the limit, in terms of escape clauses absence.

After the end of a budget year, while reporting, in case of violation of the deficit and debt rules (expect the above-mentioned cases), the government, alongside with the Annual Report on Execution of the Law of Georgia on State Budget, presents to the parliament the following:

- a) Information on the reasons of violation of the deficit and debt rules;
- b) Information on the performance of the state budget of current year and consequently, its impact on the parameters of the unified state budget, their compliance with the margins defined by the Organic Law. The government also presents to the parliament a plan to return to the limits determined by the mentioned Organic Law. The plan of returning to the limits shall not exceed 3 years.

At the same time, it must be mentioned that the Organic Law does not envisage the monitoring procedures for the fiscal rules defined by this law, and authority, which has to perform monitoring. Organic Law also does not envisage possible sanctioning mechanism in case of fiscal rules violation, expect of the mechanism of corrective actions.

3.1.1 The Deficit rule

The ratio of the deficit of the state’s unified budget, defined by the Budget Code of Georgia, to GDP - not more than 3%;

According to the Order N99 of the Minister of Finance of Georgia on Approval of Georgia’s Budget Classification, issued on April 5, 2019, net lending/net borrowing balance shows the volume of budget surplus (positive value) or deficit (negative value). And for the net lending/net borrowing balance, it is calculated by the formula: the difference between budget revenues¹⁸ and expenses¹⁹ minus gross investment in nonfinancial assets²⁰.

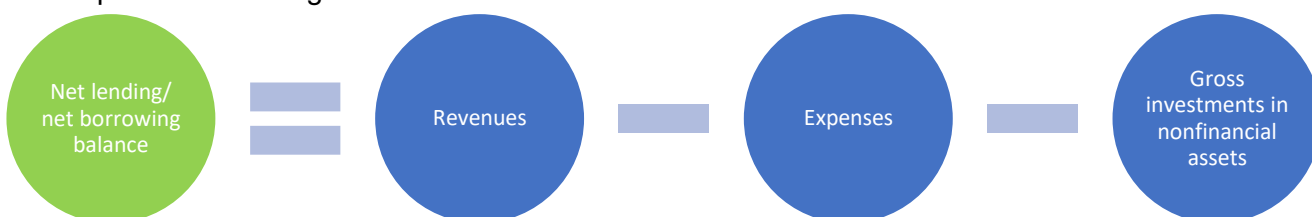


Figure 8: calculation of net lending/net borrowing balance

As it was mentioned above, the current version of the deficit rule is in force from January 1, 2019; while in the initial version, the deficit rule defined a maximum limit of the ratio of the consolidated budget deficit to GDP.

¹⁸ Revenues include taxes, grants and other revenues.

¹⁹ Expenses include compensation of employees, use of good and services, interest, subsidies, grants, social benefits and other expenses.

²⁰ The gross investment in nonfinancial assets equals acquisitions minus disposals.

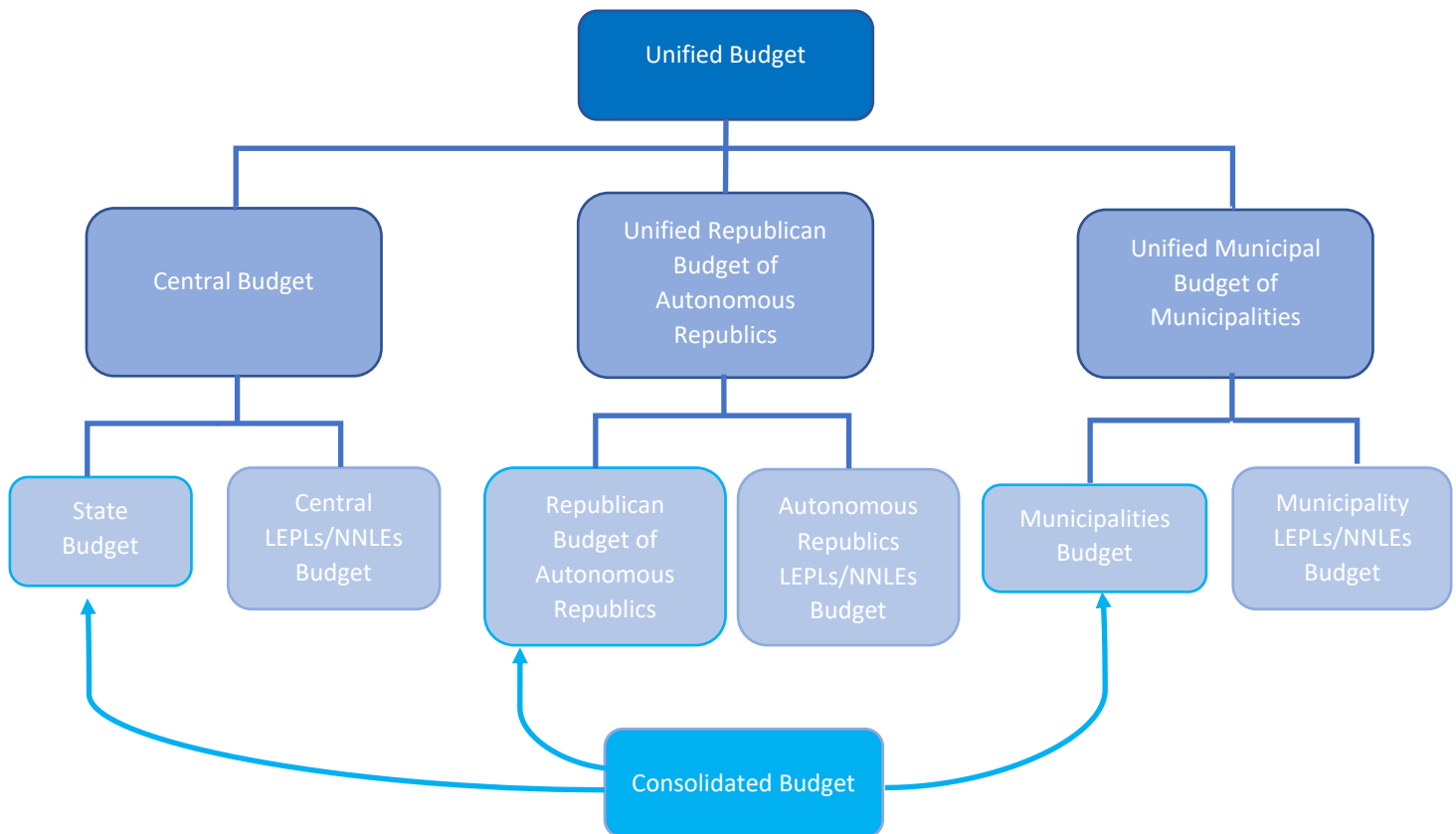


Figure 9: The Structure of Consolidated and Unified Budgets, according to the Budget Code of Georgia

Consolidated budget is the consolidated budget of Georgia’s State, Autonomous Republics and Municipalities of Georgia. The unified budget is consolidated budget of the Central, Autonomous Republics unified republican and Municipalities unified municipal budgets. Thus, as a result of the amendment made to the Organic Law, in December 2018, from January 1, 2019, the deficit rule includes deficits of the LEPLs and NNLEs of the Central, Autonomous Republics and Municipalities budgets’.

3.1.2 The Debt Rule

The ratio of government debt to GDP shall not be more than 60%.

As it was mentioned above, the current version of the debt rule is in force from January 1, 2019, whereas in the initial version, the debt Rule defined the maximum limit of the ratio of State debt to GDP.

Furthermore, in December 2018, as a result of the amendment made to the Organic Law, a record was added to the Organic Law, according to which, for the purposes of this Law, the Government Debt includes:

- a) The State Debt defined by the Law of Georgia on “State Debt”, excluding the NBG commitments.
- b) The Debt contracted by the budget organizations, excluding their borrowing from other budget organizations.

Moreover, the debt rule also envisages the current value of the commitments made within the basic principles of public-private partnership and corresponding projects of the criteria of

public-private partnership, which is envisaged in the Law of Georgia on Public-Private Partnership.



Figure 10: Debt rule defined by the Organic Law

3.1.3 The Revenue rule

The introduction of a new type of national tax, except for excise tax, or the introduction of an increase in the upper margin of the rate according to the type of national tax, except for excise tax, shall be permissible only through a referendum.

Only government has the right to initiate a referendum and on this topic a referendum is held in accordance with the Organic Law of Georgia on Referendums. The issues of tax progressivity, tax regime/methodology may not be questioned by a referendum. The government is authorized to request a temporary increase in taxes, up to 3 years. In such a case a referendum is not required.

National taxes are defined by the Tax Code of Georgia and are following:

- a) Income tax;
- b) Profit tax;
- c) Value added tax (VAT);
- d) Import tax;
- e) Excise tax.

According to the Organic Law, the introduction or modification of a tax that is an alternative to an existing tax or replaces it without increasing the tax burden shall not be considered as the introduction of a new type of national tax or as an increase in the upper margin of the rate. The modification of the rate of tax according to the tax type within the existing marginal rate shall not be considered as the introduction of a new type of national tax or as an increase in the upper margin of the rate either.

Taking into account the above-mentioned, the limitation on the increase of tax burden is connected only with the case when there is an introduction or a modification of a tax, when it is an alternative of an existing one or replaces it; whereas if there is such a change, when only the condition of taxation is altered so that tax burden increases, in such a case the above-mentioned Organic Law does not establish limiting procedures.

Compared to the initial version, unlike for the deficit and debt rules, there were not made any significant amendments to the revenue rule. Namely, in September 2018, as a result of the amendment made to the Organic Law, a record was added: "Contributions to the pension and insurance schemes are regulated by the separate laws and do not constitute taxes or fees". Moreover, the validity period of the revenue rule and above-mentioned added record was defined – they are effective from the date of the Amendment #1324 RS introduced to the Constitution of Georgia on October 13, 2017 and for the following 12 years.

The date of entry into force of the above-mentioned amendment made to the Organic Law is the date of an oath²¹ of the elected President of Georgia in the next elections.

As for the amendments made to the Organic Law in December 2018, the amendments were not in frames of the revenue rule.

3.2 The Compliance of the 2022 State Budget Draft Law Indicators with the Fiscal Rules

This sub-chapter aims to assess the compliance of the 2023 State Budget draft law indicators with the fiscal rules.

A forecast of the marginal parameters (the deficit and debt rules) defined by the Organic Law is made by the Article 14 of 2023 Georgian State Budget draft law.

3.2.1 Compliance with the Deficit rule

According to the Article 14 of the 2023 State Budget draft law, in 2023, the deficit of the state's unified budget defined by 2,261.0 million GEL, which is 2.8% of the projected GDP (defined margin – 3% of the GDP).

2023 state's unified budget deficit, compared to the 2022 state's unified budget deficit – 1,963.0 million GEL (2.7% of GDP), defined by the Article 14 of 2021 State Budget Law, is more by 298.0 million GEL.

In the table given below, the structure of net lending/net borrowing balance of Georgia's unified budget for 2022-2023 is presented according to the attached annex of the 2023 State Budget draft law - Basic Economic and Financial Indicators (Baseline Scenario).

	2022 Expected	2023 Forecast	Difference
Revenues	20,739.0	22,475.0	1,736.0
Taxes	17,350.0	18,890.0	1,540.0
Indirect Taxes	9,600.0	10,465.0	865.0
Direct Taxes	7,750.0	8,425.0	675.0
Grants	279.0	310.0	31.0
Other Revenues	3,110.0	3,275.0	165.0
Expenses	16,872.0	18,681.0	1,809.0
Compensation of Employees	2,820.0	3,325.0	505.0
Use of Goods and Services	2,980.0	3,255.0	275.0
Interest	780.0	1,226.0	446.0
Subsidies	2,220.0	2,240.0	20.0
Grants	122.0	25.0	-97.0
Social Benefits	6,230.0	6,755.0	525.0
Other Expenses	1,720.0	1,855.0	135.0
Gross Operating Balance	3,867.0	3,794.0	-73.0
Gross Investment in Nonfinancial assets	5,830.0	6,055.0	225.0
Acquisitions	6,285.0	6,410.0	125.0
Disposals	-455.0	-355.0	100.0
Net lending/net borrowing Balance	-1,963.0	-2,261.0	-298.0

Table 4: Net lending/net borrowing balance of Georgia's unified Budget for 2022-2023 (million GEL).

²¹ The oath of the 5th President of Georgia took place on December 16, 2018.

As shown in the table, it is expected that the state's unified budget deficit will increase by 298.0 million GEL for 2023, compared to the 2022, caused by the increase of the state's unified budget revenues by 1,736.0 million GEL (including increase in tax revenues by 1,540.0 million GEL), increase in expenses by 1,809.0 million GEL (including increase in social benefits by 525.0 million GEL, compensation of employees - by 505.0 million GEL and interest – by 446.0 million GEL) and increase of gross investment in nonfinancial assets by 225.0 million GEL.

As for the structure of unified budget's deficit in relation to the levels of relevant budgets, it should be noted that, in the attached documentation of the 2023 State Budget draft law, there was only presented information on the Central budget, the deficit of which amounted to 2,611.3 million GEL. There was not provided any information on these topics in the documentation of the Budget draft law about components of unified budget, Autonomous Republics Unified Republican and Municipalities Unified Municipal budgets. Thus, it is impossible to discuss the structure of the unified budget deficit in relation to relevant levels of budgets.

As for the deficit of the state's unified budget in recent years, both in nominal expression and in relation to the GDP, for the years of 2015-2023, it reaches its highest negative point in 2020. The diagram below shows Georgia's unified and consolidated budget deficits and their ratio to GDP in the years of 2015-2023.

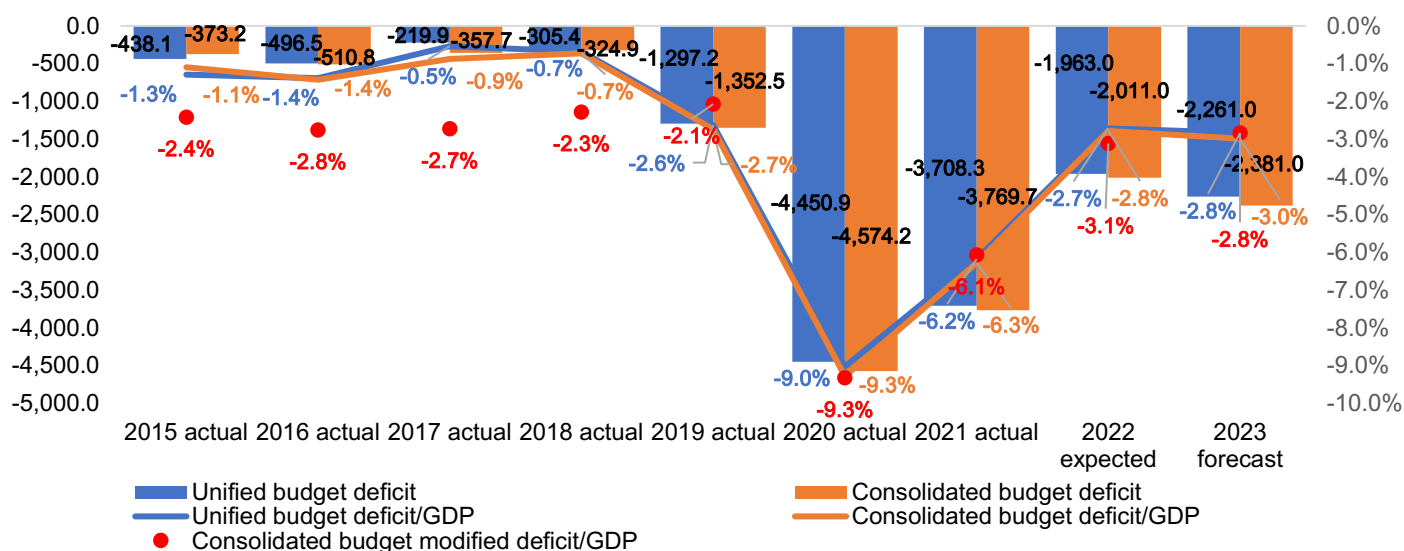


Figure 11: Georgia's unified and consolidated budget deficits and their ratio to GDP in the years of 2015-2023 (million GEL, %).

As shown in the diagram, in 2015-2018, defined macroeconomic parameter limit, according to the deficit rule's version of that time, was complied. The ratio of the consolidated budget deficit to GDP ranged from 0.7% to 1.4%. Mentioned limit was also complied as for the actual figure of 2019, the ratio of the state's unified budget deficit to GDP amounted to - 2.6%. Breach in macroeconomic parameter limit will take place in 2020-2021, precisely, in 2020, the state's unified budget deficit to GDP ratio was 9.0%, whereas, in 2021 – 6.2%. According to the law of Georgia "on State Budget of Georgia 2022", adopted by the parliament in December 2021, the ratio of the state's unified budget deficit to GDP exceeds the macroeconomic parameter limit set by the Organic Law, with the amount of 4.2%. In addition, as a result of the amendment of the State Budget 2022 implemented in October 2022, the ratio of the unified budget deficit to GDP was defined beyond the mentioned limit, with the amount of 3.1%. Whereas, as a result of the amendment of the State Budget 2022 implemented in December 2022, the ratio of the unified budget deficit to GDP returned to the macroeconomic parameter limit defined by the organic law and amounted to 2.7%.

3.2.2 Compliance with the Debt Rule

According to the Article 14 of the 2023 State Budget draft law, by the end of 2023, Government debt-to-GDP ratio is 38.3%. The present value of commitments under public-private partnership projects (as of January 1, 2022) is 0.5% of GDP. So in total: **38.8% of GDP** (defined limit - 60% of GDP).

According to the attached annex of the 2023 State Budget draft law – “Government Debt” - the balance of external debt of the government for December 31, 2023 was estimated at 22,084.8 million GEL (27.7% of GDP). Government domestic debt balance amounts to 8,453.8 million GEL (10.6% of GDP), in total - 30,538.6 million GEL (38.3% of GDP). Besides, according to the annex of the 2023 State Budget draft law - “Document of Fiscal Risks’ Analysis”, the commitments under public-private partnership projects (as of January 1, 2022) amount to 384.6 million GEL (0.5% of GDP).

It should be noted, As of December 31, 2022, the defined amount of the Government Debt does not include the commitments determined by the Article 48 of the Law of Georgia on Public Debt (so-called historical debt). According to the Law of Georgia on State Budget 2019 adopted by the Parliament in December 2018, the value of above-mentioned commitments amounted to 672.3 million GEL, which, due to the amendment of October 2019, made to the 2019 Budget Law, was not included in the value of the State Debt. This practice continued for 2020-2023 as well. **The ratio of the above-mentioned, so-called historic debt to 2023 projected GDP is 0.8%.**

Taking into consideration the above-mentioned, if we add to 2023 debt rule purposes calculated (in the 2023 State Budget draft law of Georgia) figure (38.8%) the historical debt amount (0.8% of GDP), **the figure for the purposes of debt rule will increase to 39.7%.**

In the diagram presented below, the Government Debt and State Debt are presented, as well as their ratio to GDP for the years of 2012-2023.²²

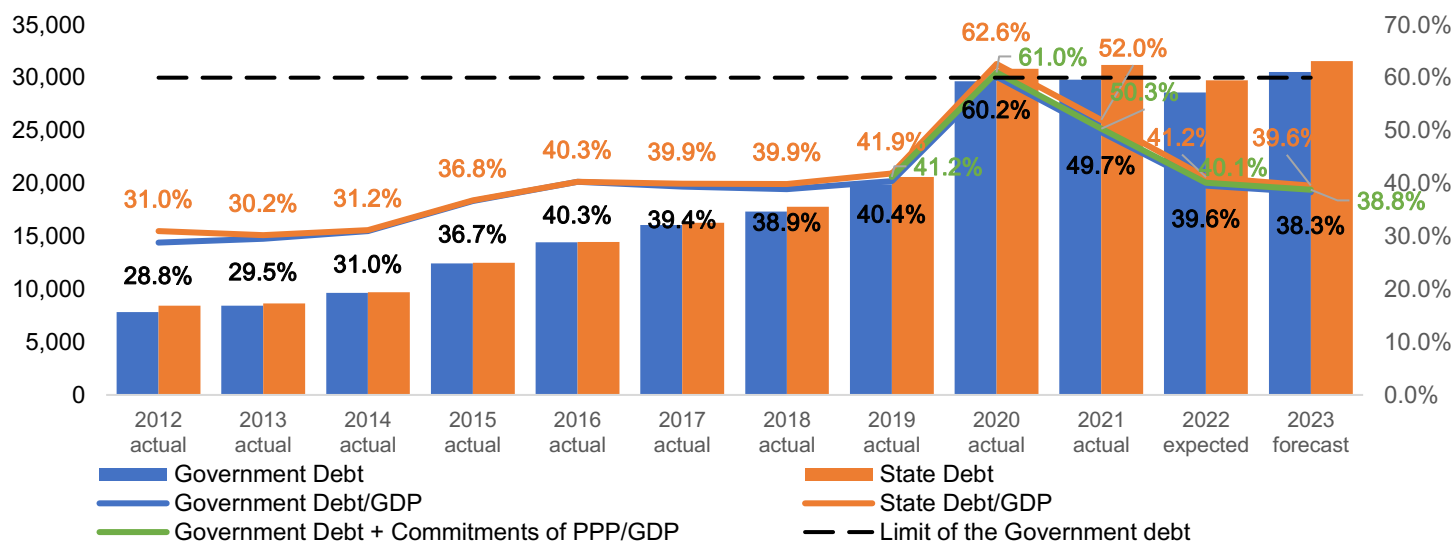


Figure 12: Government Debt, State Debt and their ratio to GDP for the years of 2012-2023 (million GEL, %).

²² The presented information does not include the conditional amount of historical debt - 672 million GEL.

As shown on the diagram, for the years of 2012-2019, the amount of State Debt and Government Debt does not exceed the limit set by the Organic Law. Breach in macroeconomic parameter foreseen by the organic law limit, which took place in 2020. However, in 2021, the amount of government debt returned to the limit determined by the debt rule, and it is expected that the mentioned limit will be respected in 2022-2023 as well.

3.2.3 Compliance with the Revenue Rule

According to the paragraph 5 of Article 2 of the Organic Law, the Government, under the rule established by the legislation of Georgia, while presenting to the Parliament the draft law on State Budget and its Annual Report on Execution, presents information on the compliance of fiscal parameters with established limits by this law. Established by the above-mentioned Organic law, the limit is defined by Article 2 of this law, which includes the deficit and debt rules. Thus, the government does not have an obligation to present to the parliament information on the compliance of the revenue rule, at the stage of presenting a draft Law on State Budget and its Annual Report on Execution.

Taking all the above into consideration, 2023 State Budget draft law indicators do not include information on compliance with the revenue rule.

4. Compliance of Georgian budget indicators with fiscal rules in the medium-term

This chapter analyses the Georgian government's ability to comply with fiscal rules in the medium-term, it also discusses the factors that affect them, possible scenarios and sensitivity analysis.

4.1 Factors affecting fiscal rules

The compliance of fiscal rules in the medium-term may be affected by various types of macroeconomic shocks, as well as by the government's discretionary policies, which may include: tax reforms, that will have a significant impact on tax revenues and changes in government spending priorities, that may lead to an increase of expenditures of the unified budget. All of this may lead to a change in the unified budget balance over the medium-term or affect the medium-term debt trajectory.

The macroeconomic shocks caused by the current Russia-Ukraine war are the largest and most important among the factors affecting fiscal rules in 2023-2026. The negative effect of the war was not significant for Georgia in 2022, although it might have an impact on the economic growth in the medium-term.

The negative effects caused by Covid-19 were reflected on the economic growth in 2020, which was followed by an increase in the budget expenditures to carry out relevant preventive actions and expansionary policy. Amid the decreased economic growth it was followed by an increase in the budget deficit. However, along with the economic recovery and the high economic growth rates observed in 2021, budget revenues increased and the unified budget deficit started to decline. According to the PBO estimates, the unified budget deficit is expected to decrease in the medium term and remain under 3% limit. As a result, the ratio of the government debt to GDP will decrease, as well.

All else being equal, the debt growth may also be influenced by two important factors:

- Depreciation of the exchange rate;
- The increase in interest rates;

With the onset of difficulties caused by the coronavirus in March 2020, GEL exchange rate began to depreciate. As a result, at the end of the year compared to December 2019, GEL depreciated against the USD by 14.3%, which directly affected the amount of debt, although it shows a strengthening trend in 2021-2022.

It should be noted, that the share of foreign debt (20,149.6 GEL million) in total government debt as of October 31, 2022 is 74%.

One of the negative consequences of the macroeconomic instability and deteriorating economic situation might be the increase in interest rates on both domestic and foreign government debt. This will directly increase the cost of debt service and consequently, the unified budget deficit and the government debt.

All else being equal, excluding the effects of above-mentioned shocks, a decrease in the debt-to-GDP ratio is expected, due to an increase of the economic activity and the nominal GDP.

4.2 Unified budget deficit in the medium-term

According to the Organic Law, the threshold of the unified budget deficit-to-GDP ratio is 3%. Due to the events mentioned above, it is a significant challenge for the government to comply with this rule.

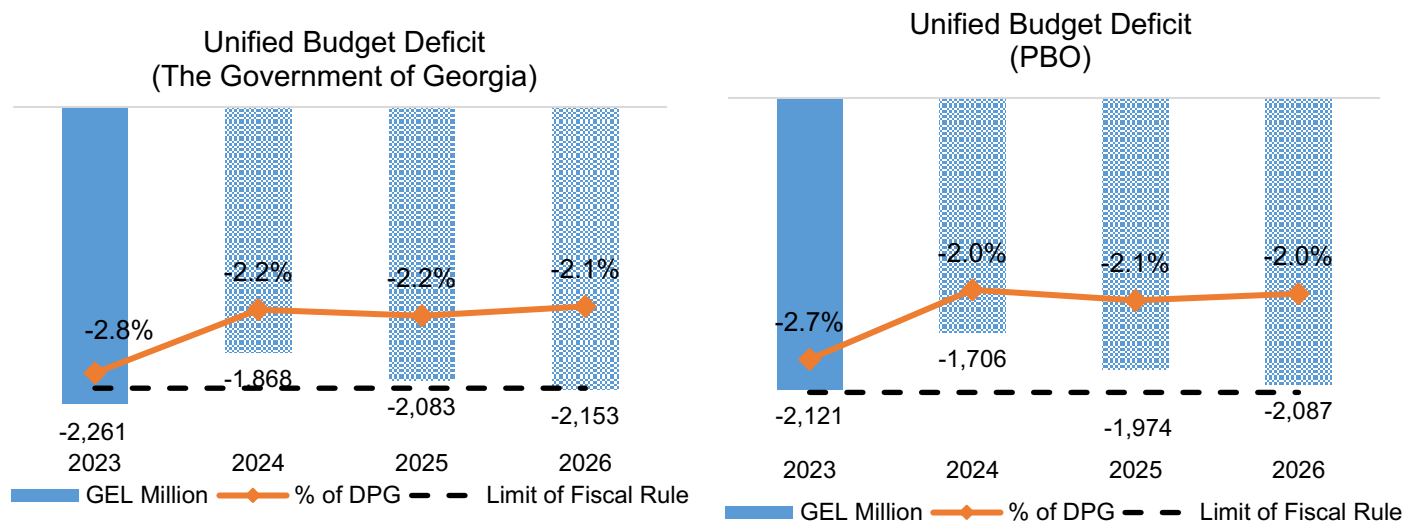


Figure 13: Unified budget deficit in 2023-2026

According to the medium-term baseline scenario annexed to the draft state budget for 2023, from 2023, consistent reduction of the unified budget deficit is planned. Although, according to the estimate, its volume will reach 2.2 billion GEL by 2026. The same indicator in 2023 is expected to amount 2.3 billion GEL.

According to the government's estimates, it is expected that the deficit rule will not be violated in 2023 as well as in the medium-term and the deficit-to-GDP ratio will be 3% or less.

However, given the macroeconomic and fiscal forecasts of the PBO and the existing policy of the government, it is possible that the unified budget deficit-to-GDP ratio will be less than 3% by 2023. As for the previous estimate of December 2021, the PBO expected that the unified budget deficit in 2021-2023 would be more than 3% of GDP, and a reduction below the limit was only expected for 2024.

In order to calculate the unified budget deficit²³ PBO used following:

- Independent forecast of tax revenues of the consolidated budget;
- Independent forecast of other revenues of the consolidated budget;
- Government's forecast of grants of the unified budget;
- Government's forecast of revenues of Legal Entities of Public Law and Non-entrepreneurial (Non-commercial) legal entities reflected in other revenues of the unified budget;
- Government's forecast of expenditures and non-financial assets.

The difference between the forecasted volumes of the unified budget deficit is due to the tax revenues of the unified budget, where the PBO's and the government's predictions differ. In turn, the forecast of the tax revenues is based on the medium-term macroeconomic scenario of the PBO, that differs from the same scenario simulated by the government.

²³ More about PBO forecast see in annex 5

4.3. Government Debt²⁴ in the medium-term

The government debt-to-GDP ratio in the medium-term is effected by the expected volume of the debt, the volume of the GDP and the exchange rate trajectory.

According to the government forecast, the exchange rate in the medium-term is fixed as the equivalent to the exchange rate existing at the time of budget planning. Whereas, according to the PBO estimate, the exchange rate is expected to appreciate along with the improved economic parameters.

According to the PBO, the government debt-to-GDP ratio in the medium-term is based on the following:

- Government forecast of the nominal debt;
- Independent forecast of the exchange rate;
- Independent forecast of the nominal GDP.

With this in mind, it should be noted, that according to both the PBO and the government medium-term forecasts, the government debt-to-GDP ratio remains under the statutory 60% limit in 2022-2026.

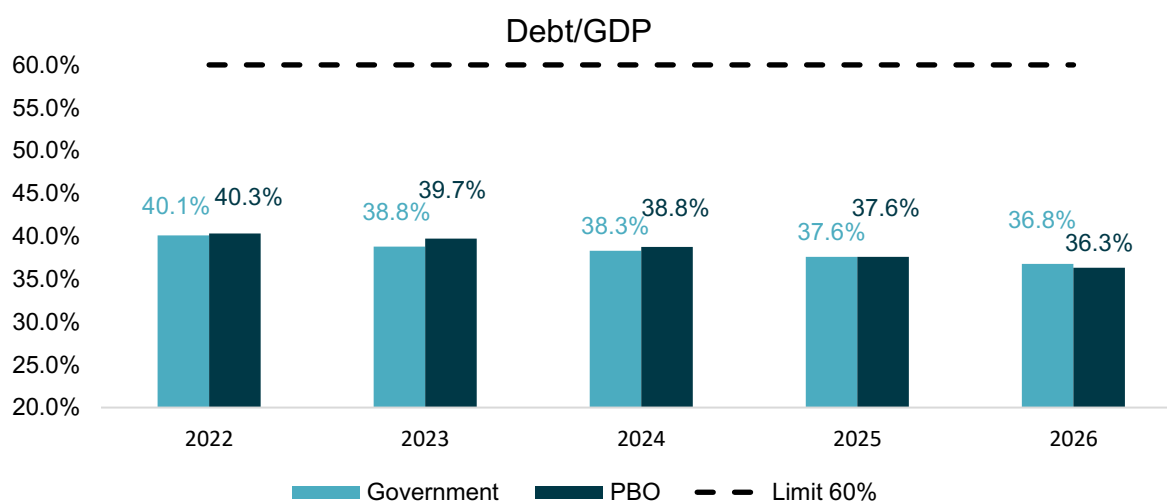


Figure 14: Government debt-to-GDP ratio in 2022-2026, including PPP (%)

According to the estimates of the PBO, the government debt-to-GDP ratio will be constantly decreasing and will reach 36.3% by 2026. According to government forecasts, despite the decline of the ratio, it will be consistently higher than that of the PBO, and will be defined at 36.8% by 2026. As for the previous estimates of December 2021, the PBO estimated that the government debt-to-GDP ratio would decrease to 50.6% by 2022, while in 2023-2025 its gradual decline was expected to reach 44.9% of GDP²⁵. At the same time, according to the government estimates, the government debt-to-GDP ratio was planned to be defined at – 48.1% by 2025.

²⁴ In the annexed document of the budget, government debt in the medium term does not include PPP commitments. In purpose for monitoring fiscal rules, in this document, both the government and PBO debt indicators in the medium term include PPP commitments, which as of October 31, 2022 amounted to GEL 384.6 million.

²⁵ It should be noted that since the 1990's the government owns the so-called historical domestic debt (approximately 672 million GEL), which is not accounted in total debt. If we take historical debt into account, it increases government debt rate on average by 1% of GDP in the medium term.

4.4 Sensitivity analysis and scenarios

During the budget planning process, both the government²⁶ and the PBO²⁷ simulate positive and negative scenarios on the development of the economy based on the various macroeconomic risks and assumptions, which also includes relevant fiscal scenarios.

The positive scenario of the PBO forecasts implies permanent positive shocks in the country during the medium-term, while during the negative scenario, each year, compared to the base scenario, negative trends in economic development are expected.

	2023		2024		2025		2026	
	Government	PBO	Government	PBO	Government	PBO	Government	PBO
Real GDP Growth								
Baseline	5.0%	5.1%	5.2%	5.0%	5.2%	5.2%	5.0%	5.0%
Positive	6.3%	6.1%	6.5%	6.6%	6.5%	6.5%	6.3%	6.7%
Negative	2.5%	3.0%	2.7%	3.1%	2.7%	3.3%	2.5%	3.0%
Consumer Price Inflation								
Baseline	5.3%	5.5%	3.0%	3.0%	3.0%	3.1%	3.0%	3.0%
Positive	6.3%	6.1%	4.0%	4.3%	4.0%	4.1%	4.0%	4.2%
Negative	4.3%	2.7%	2.0%	2.2%	2.0%	2.0%	2.0%	2.1%

Table 5: The Medium-term macroeconomic scenarios of the PBO and the government.

Based on these parameters, if the baseline, the positive or the negative macroeconomic scenario takes place, according to the estimates of the government, the unified budget deficit-to-GDP ratio will return to 3% by 2022. However, according to the PBO, if the baseline or the positive macroeconomic scenario takes place, the unified budget deficit-to-GDP ratio will return to 3% by 2022, while in case of the negative scenario, PBO expects the ratio to decrease below the statutory limit by 2023.

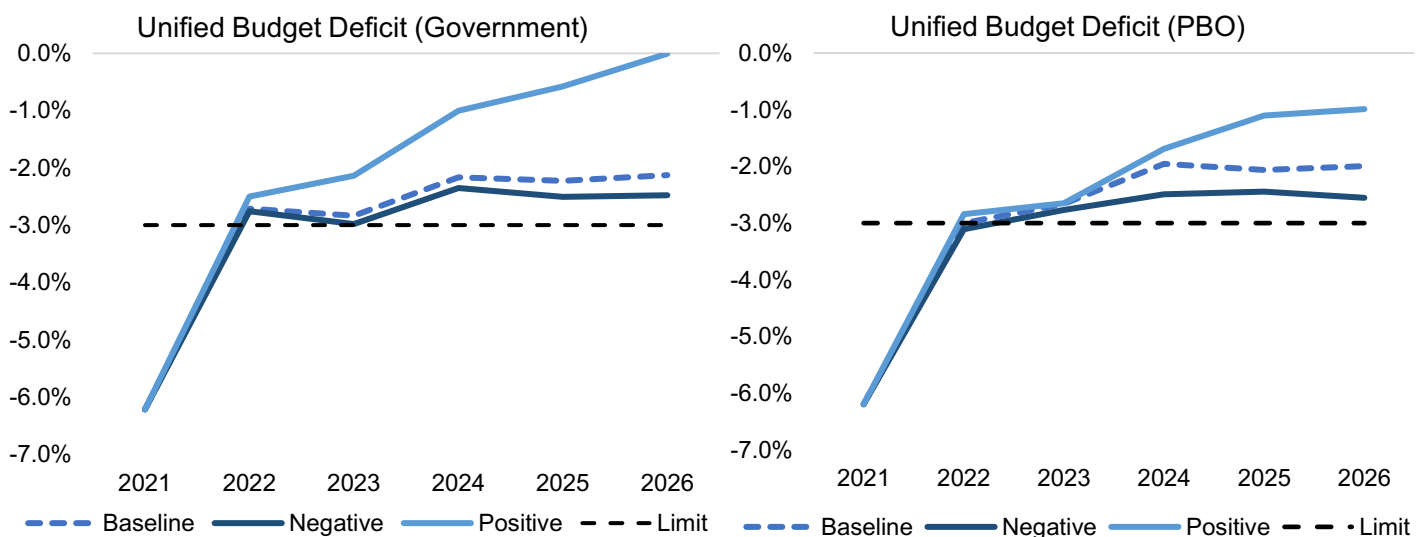


Figure 15: The unified budget deficit-to-GDP ratio in the medium-term (%). Positive and negative scenarios.

²⁶ <https://parliament.ge/legislation/22864>

²⁷ English version not available

As for the debt in the medium term, both the government and the PBO estimate that in case of the positive or the negative scenario, it will not exceed the fiscal limit. According to the government's negative scenario, the debt-to-GDP ratio will reach 42.8% by 2026, while according to the PBO forecast, the ratio will be 40.4%.

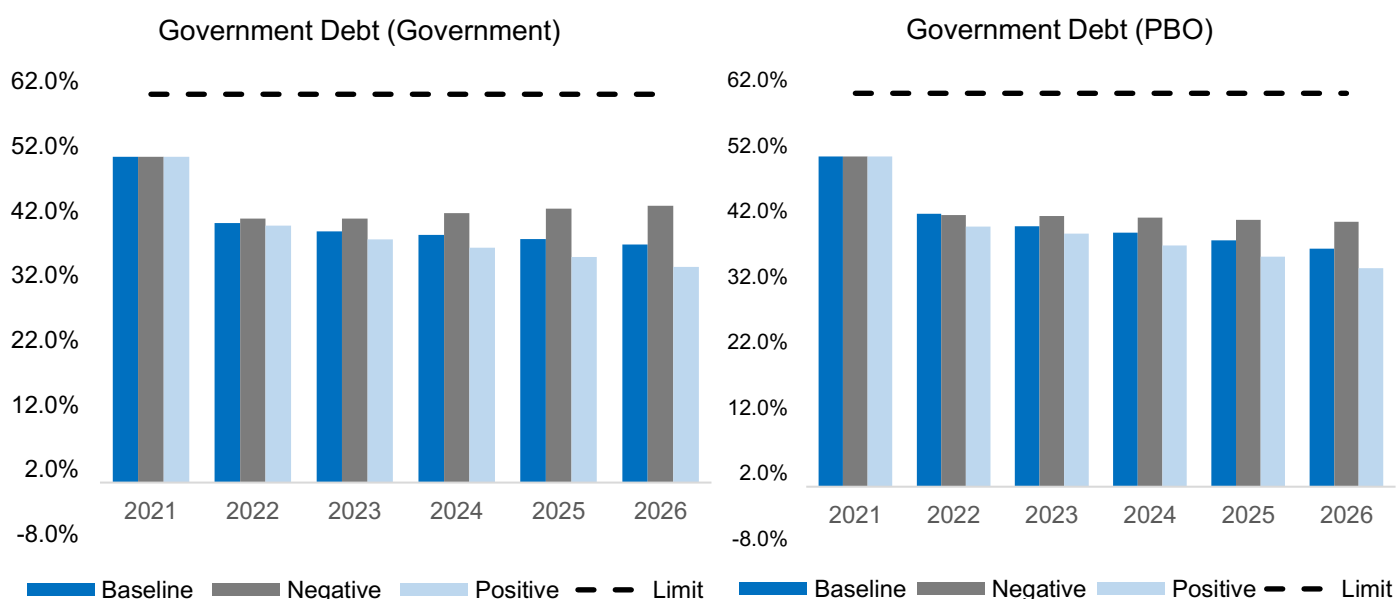


Figure 16: The Government Debt-to-GDP ratio in the Medium-term (%). Positive and negative scenarios.

According to the debt sustainability analysis of the government²⁸ and the PBO²⁹, the government debt is mostly sensitive to the exchange rate shocks. The estimated debt level is based on different medium-term forecasts of exchange rate simulated by the government and the PBO:

- According to the medium-term forecast of the government, the exchange rate is always fixed.
- According to the medium-term forecast of the PBO, appreciation of the exchange rate is expected.

In contrast to 2022, during which an average appreciation of 12.5% is expected, in the recent period there has been a depreciation of the exchange rate (by an average of 6% in 2017-2019 and by 14.3% in 2020). Based on the past experience, it would be interesting to consider the exchange rate depreciation next years, in particular, 14.3% depreciation of the exchange rate in the baseline scenarios of the government and the PBO (similar to the 2020 figure) in 2023 and annual depreciation of 2% in the following years. This, in turn, will have an increasing impact on the interest rate of the debt and the deficit, as well as on other indicators of the external sector and economic activity. Nevertheless, in this scenario, we examine the effect of the exchange rate on the debt level, all else being equal.

²⁸ English version not available

²⁹ English version not available

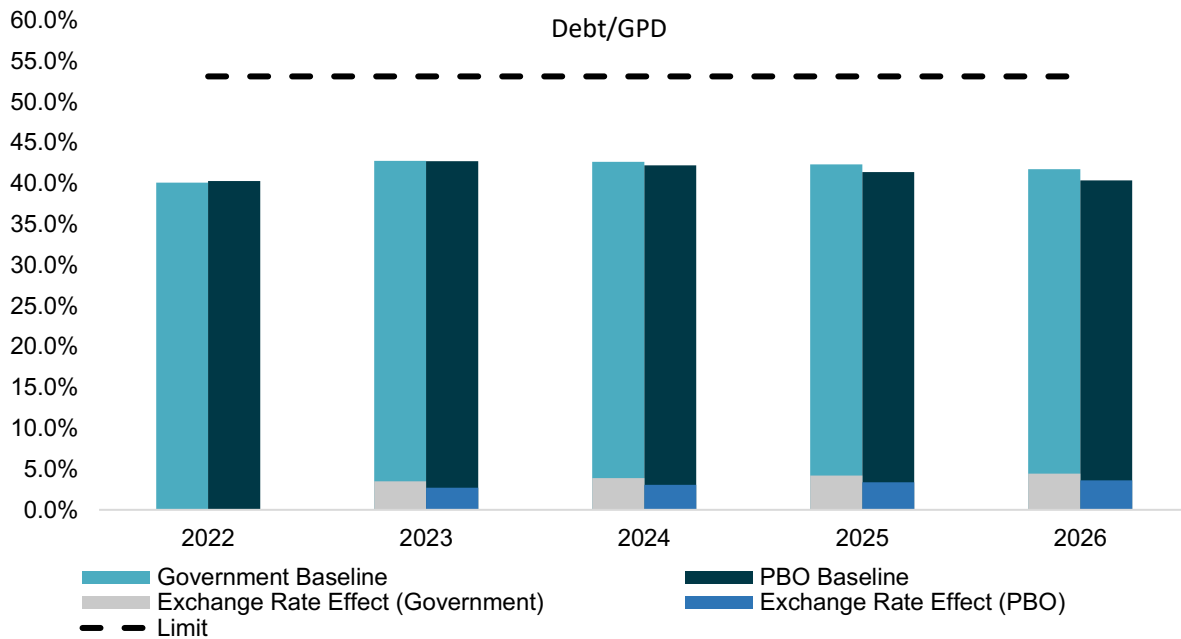


Figure 17: The Government Debt-to-GDP ratio in the medium-term (The scenario of annual depreciation of the exchange rate).

As represented on figure 17, the one-time significant depreciation of the exchange rate will not increase debt-to-GDP ratio that much to **be above the 60% limit in the medium term**, as well as a negligible depreciation of the exchange rate in the following years will not either.

On the other hand, it is also possible to analyze how sensitive the government debt is to changes in interest rates on the debt. According to the historical data, the average interest rate on foreign debt in 2000-2021 was 2.1%, while it was 9% on domestic debt. If in 2022-2026 we increase the projected interest rates by 2 standard deviation of the historical data, the external debt interest rate will increase on average from 1.0% to 2.1%, and for the domestic debt it will increase from 9.2% to 12.5%. This shock will affect both the unified budget deficit, as well as the government debt.

The PBO estimates that the interest rate shock has no significant effect on the debt rule, but on the other hand it affects the deficit rule and keeps it constantly below the fiscal limit in the medium term.

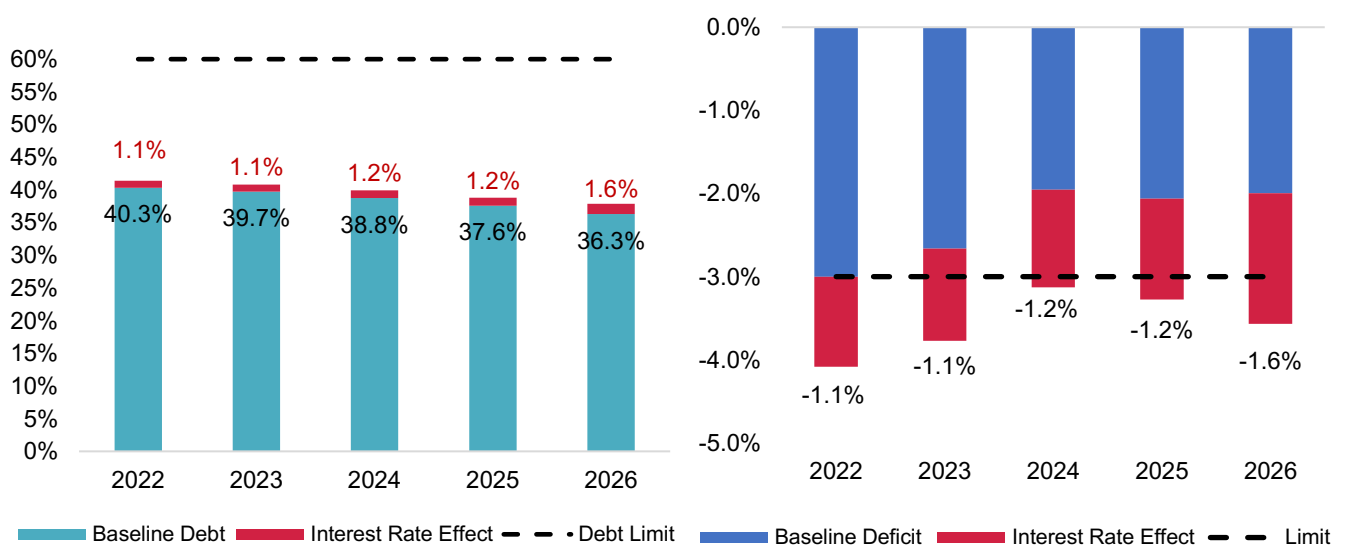


Figure 18: The Government Debt and the unified budget deficit in the medium-term (2 standard deviation interest rate shock).

It is also possible to combine the above two shocks and all else being equal, estimate the combined impact of the exchange rate and the interest rate on fiscal parameters. In this scenario, the combined shock affects the medium-term dynamics of the debt. Despite that, the indicator will not exceed the debt rule limit (60%) in the medium-term.

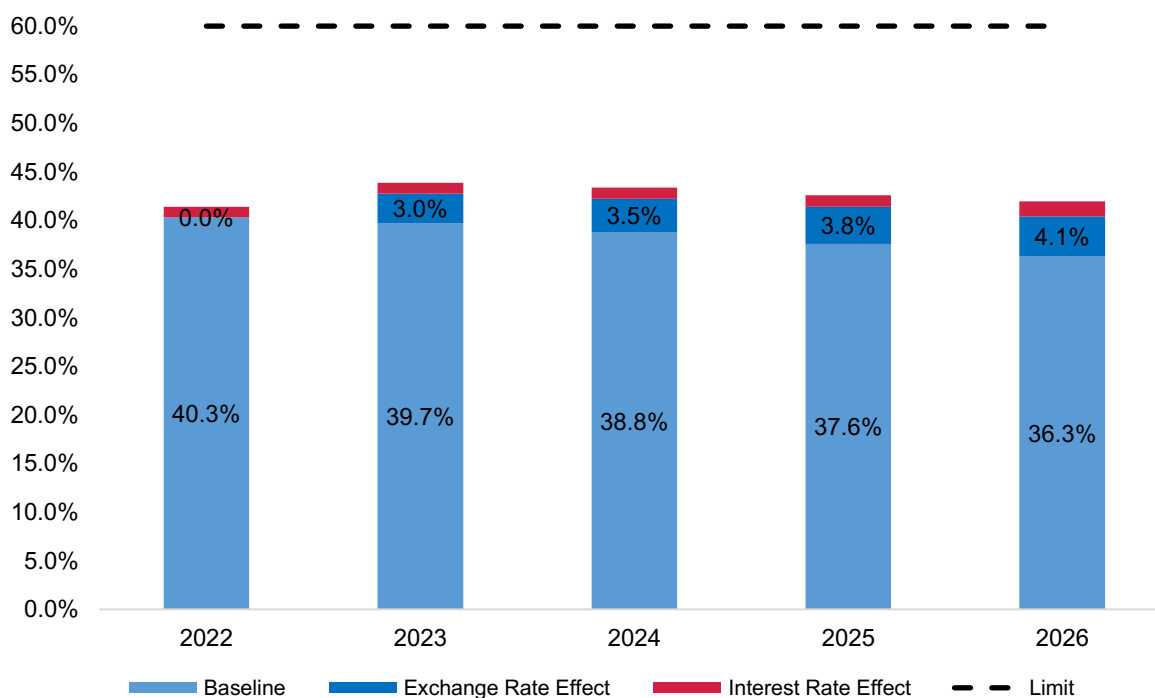


Figure 19: The Government Debt in the medium-term (The scenario of a two standard deviation interest rate shock and an annual depreciation of the exchange rate).

4.5 Potential Fiscal Risks

It is possible to identify the risks, which might be potentially increased during the medium term due to the exogenous shocks or the domestic economic policy changes.

Contingent liability risk. The draft law of Georgia "On the 2023 State Budget of Georgia" is accompanied by a fiscal risk analysis document, which provides possible volumes and sources of contingent liabilities and attempts to quantify them and analyze several different scenarios. Despite that, in the environment where uncertainty is increased dramatically and the world is facing one of the deepest recession, the probability of contingent liabilities realization increases.

Fiscal risk document discloses all possible explicit contingent liabilities, but in current situation the risk of implicit contingent liabilities can be raised.

Excessive exchange rate depreciation. According to the PBO calculations, the government debt-to-GDP ratio will be defined at 39.2% at the end of 2023. The fact that almost 74% of the debt is FX denominated, implies that a sharp depreciation of the GEL/USD will have a negative effect for both the debt and the deficit rule in 2023, as well as in the medium-term. Such sharp annual depreciation already happened several times (1998, 2015, 2016 and 2020) over the last 25 years, among which GEL depreciated by 14.3% in 2020.

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Glossary

Consolidated Budget – consolidated budget of Georgia's State, Autonomous Republics and Municipalities. Consolidated budget is not subject to the approval by the representative bodies of any authority.

Contingent explicit liabilities - are legal obligations for governments to make payments only if particular events occur.

Contingent implicit liabilities - are contingent liabilities, which are not officially recognized until after a failure occurs.

Contingent liability - Contingent liability is a liability that may occur depending on the outcome of an uncertain future event.

Fiscal Risk – fiscal aggregates deviation opportunity from expected indicators, which were defined during budget planning phase or formation of fiscal forecasts.

GDP gap – GDP gap is the difference between potential GDP and real GDP. When the economy falls into recession, the GDP gap is positive. When the economy experiences an inflationary boom, the GDP gap is negative.

National Taxes – National taxes shall be the taxes provided for under the Tax Code of Georgia, the payment of which is mandatory across the whole territory of Georgia.

Net Lending/Net Borrowing Balance – net lending/net borrowing balance shows the volume of budget surplus (positive value) or deficit (negative value). net lending/net borrowing balance is calculated by the formula: the difference between budget revenues and expenses minus gross investment in nonfinancial assets.

Special Drawing Rights - SDRs are supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund.

Public-private partnership/public-private partnership project - a long-term partnership between a public partner and a private partner that meets the criteria provided for by Article 4 of Law of Georgia on Public-private Partnerships, and is carried out for the purpose of the performance of works and/or the provision of public services in the form of a concession, or a non-concessional public-private partnership.

State Budget - set of revenues, expenditures and adjusted balance approved by the Parliament of Georgia for the execution of functions and duties assigned to the Central Authorities of Georgia.

State Debt of Georgia – the total amount of domestic and external debts, expressed in the national currency, taken through agreements entered into by the Ministry of Finance of Georgia on behalf of Georgia and, with guarantees provided by the Ministry of Finance, by other bodies/institutions, also in amounts received from the placement of government securities denominated in the national and foreign convertible currency by the Ministry of Finance of Georgia on behalf of Georgia and received from the financial resources approved by the International Monetary Fund for Georgia.

Unified Budget - consolidated budget of the Central, Autonomous Republics unified republican and Municipalities unified municipal budgets. Unified budget is not subject to the approval by the representative bodies of any authority.

Annex 1A: Detailed Forecasts ³⁰ of Key Macroeconomic Indicators for 2022-2026 (Baseline Scenario)³¹

	2019 Actual	2020 Actual	2021 Actual	2022 PBO Expected	2023 PBO Forecast	2024 PBO Forecast	2025 PBO Forecast	2026 PBO Forecast
REAL SECTOR	% change							
Real GDP	5.0%	-6.8%	10.5%	9.8%	5.1%	5.0%	5.2%	5.0%
Consumer Price Inflation	4.9%	5.2%	9.6%	12.0%	5.5%	3.0%	3.1%	3.0%
GDP Deflator	5.2%	7.3%	10.3%	9.1%	5.8%	4.2%	4.3%	4.1%
Nominal GDP								
GEL Million	49,253	49,267	60,003	71,911	79,691	87,247	95,680	104,605
USD Million	17 471	15 843	18 629	24,701	27,551	29,486	32,312	35,207
GDP Per Capita								
GEL	13,239	13,234	16,179	19,390	21,488	23,525	25,799	28,206
USD	4 696	4 256	5 023	6,660	7,429	7,951	8,713	9,493
	GEL million							
Absorption	109.0	119.3	116.4	111.3	110.8	109.9	108.8	108.1
Consumption	83.7	95.4	97.5	91.5	90.4	90.4	87.9	86.1
Private	76.7	87.9	90.5	85.1	84.2	84.4	82.0	80.4
Government	7.0	7.6	7.0	6.4	6.1	6.0	5.9	5.7
Investment	25.3	23.9	19.0	19.8	20.5	19.4	21.0	22.0
Private	17.3	15.3	11.3	11.8	13.7	13.4	15.0	16.2
Government	8.0	8.6	7.7	8.0	6.8	6.0	6.0	5.9
Gross National Saving	19.7	11.3	8.6	13.4	13.9	13.3	15.7	17.5
Private	4.9	-1.1	0.7	4.7	4.5	4.5	4.3	4.3
Government	14.9	12.4	7.9	8.7	9.5	8.8	11.4	13.2

³⁰ PBO forecast of December 2022

³¹ Nominal expenditures, non-financial assets and debt are taken from the forecasted macroeconomic indicators for 2023-2026 presented in the final draft law "On the State Budget of Georgia for 2023".

Annex 1B: Detailed Forecasts of Key Macroeconomic Indicators for 2022-2026 (Baseline Scenario)³²

	2019 Actual	2020 Actual	2021 Actual	2022 PBO Expected	2023 PBO Forecast	2024 PBO Forecast	2025 PBO Forecast	2026 PBO Forecast
MONETARY SECTOR	GEL Million							
Net Foreign Assets	-355	931	-11	-249	124	206	302	381
Net Domestic Assets	24,736	29,449	33,857	39,849	46,558	53,619	61,655	70,578
Broad Money M3	24,380	30,380	33,846	39,600	46,682	53,825	61,957	70,959
Broad Money M2	11,495	13,660	16,107	19,168	22,944	26,789	30,944	35,614
EXTERNAL SECTOR	% of GDP, unless noted otherwise							
Current Account Balance	-5.8%	-12.5%	-10.4%	-6.3%	-6.5%	-6.1%	-5.3%	-4.5%
Trade Balance	-9.2%	-19.2%	-16.4%	-11.1%	-10.8%	-9.9%	-8.9%	-8.1%
Official International Reserves (USD Million)	3,506	3,911	4,272	4,963	5,469	5,887	6,365	6,789
Months of Import	3.8	5.2	4.6	4.2	4.0	3.9	3.9	3.8
Net Private Capital and Financial Flows (USD Million)	796.7	983.9	843.8	945	1,126	1,321	1,370	1,387

³² PBO forecast of December 2022

Annex 1C: Detailed Forecasts of Key Macroeconomic Indicators for 2022-2026 (Baseline Scenario)³³

	2019 Actual	2020 Actual	2021 Actual	2022 PBO Expected	2023 PBO Forecast	2024 PBO Forecast	2025 PBO Forecast	2026 PBO Forecast
FISCAL SECTOR³⁴	GEL Million							
Revenues and Grants	12,907	12,405	15,143	19,090	20,945	22,238	23,903	25,770
Tax Revenues	11,418	10,964	13,380	17,390	19,137	20,728	22,413	24,297
Direct Taxes	4,593	4,433	5,395	7,727	8,266	9,071	9,973	11,008
Indirect Taxes	6,825	6,531	7,985	9,663	10,871	11,657	12,440	13,289
Expenditures and Acquisition of Nonfinancial Assets	14,464	17,187	19,334	21,652	23,508	24,245	26,110	28,013
Recurrent expenditures	10,519	12,958	14,742	15,717	17,388	18,335	19,800	21,323
Capital expenditures	3,945	4,229	4,592	5,935	6,120	5,910	6,310	6,690
Operating Balance	2,389	-553	400	3,373	3,557	3,904	4,103	4,448
Overall Balance	-1,350	-4,574	-3,770	-2,112	-2,213	-1,706	-1,907	-1,992
State Debt	19,916	29,654	29,812	28,609	31,272	33,436	35,576	37,609
External	15,750	23,467	23,967	21,508	22,818	23,562	24,182	24,595
Domestic	4,166	6,186	5,845	7,100	8,454	9,874	11,394	13,014
Modified Net Lending\Net Borrowing	-1,019	-4,608	-3,812	-2,352	-2,093	-1,826	-2,027	-2,112
Unified Budget Net Lending\Net Borrowing	-1,297	-4,451	-3,732	-2,090	-2,121	-1,706	-1,974	-2,087
	% of GDP							
Revenues and Grants	26.2%	25.2%	25.2%	27.4%	26.3%	25.5%	25.0%	24.6%
Tax Revenues	23.2%	22.3%	22.3%	25.0%	24.0%	23.8%	23.4%	23.2%
Direct Taxes	9.3%	9.0%	9.0%	11.1%	10.4%	10.4%	10.4%	10.5%
Indirect Taxes	13.9%	13.3%	13.3%	13.9%	13.6%	13.4%	13.0%	12.7%
Expenditures and Acquisition of Nonfinancial Assets	29.4%	34.9%	32.2%	31.1%	29.5%	27.8%	27.3%	26.8%
Recurrent expenditures	21.4%	26.3%	24.6%	22.6%	21.8%	21.0%	20.7%	20.4%
Capital expenditures	8.0%	8.6%	7.7%	8.5%	7.7%	6.8%	6.6%	6.4%
Operating Balance	4.9%	-1.1%	0.7%	4.8%	4.5%	4.5%	4.3%	4.3%
Overall Balance	-2.7%	-9.3%	-6.3%	-3.0%	-2.8%	-2.0%	-2.0%	-1.9%
State Debt ³⁵	40.4%	60.2%	49.7%	39.8%	39.2%	38.3%	37.2%	36.0%
External	32.0%	47.6%	39.9%	29.9%	28.6%	27.0%	25.3%	23.5%
Domestic	8.5%	12.6%	9.7%	9.9%	10.6%	11.3%	11.9%	12.4%
Modified Net Lending\Net Borrowing	-2.1%	-9.4%	-6.4%	-3.4%	-2.6%	-2.1%	-2.1%	-2.0%
Unified Budget Net Lending\Net Borrowing	-2.6%	-9.0%	-6.2%	-3.0%	-2.7%	-2.0%	-2.1%	-2.0%

³³ PBO forecast of December 2022

³⁴ Except for the net borrowing of the unified budget, all indicators are indicators of the consolidated budget

³⁵ The ratio of government debt to GDP without PPP commitments

Annex 2: Components of GDP in 2019-2023 (GEL Million).³⁶ Source: PBO and Government of Georgia

GDP Components	2019	2020	2021	2022		2023	
				PBO	Government	PBO	Government
Consumption	41,346	46,967	56,659	65,799	62,423	72,005	68,573
Government	3,444	3,732	4,187	4,572	4,680	4,884	5,370
Private	37,902	43,236	52,472	61,227	57,743	67,121	63,203
Investment	12,460	11,753	13,218	14,254	18,210	16,308	20,184
Government	3,947	4,229	4,591	5,737	5,935	5,384	6,120
Private	8,514	7,524	8,627	8,517	12,275	10,924	14,064
Export	26,902	18,426	26,050	33,675	34,123	38,984	38,584
Import	31,456	27,880	35,924	41,817	42,479	47,605	47,657

³⁶ PBO forecast of December 2022

Annex 3: Change in Forecasts of Key Macroeconomic Indicators, 2022 (Baseline Scenario)³⁷

	2021			
	December 2022		December 2021	
	Government	PBO	Government	PBO
Real GDP (% Growth)	10.0%	9.8%	6.0%	5.6%
Consumer Price Inflation	11.9%	12.0%	4.5%	5.4%
GDP Deflator	9.5%	9.1%	4.5%	6.2%
Nominal GDP (GEL Million)	72,276	71,911	64,832	66,997
Tax Revenues (GEL Million)	17,350	17,390	15,558	15,254
Direct Taxes (GEL Million)	7,750	7,727	6,753	6,174
Indirect Taxes (GEL Million)	9,600	9,663	8,805	9,080
Consolidated Budget Overall Balance (GEL Million)	-2,011	-2,112	-2,777	-3,144
Current Account Balance (% of GDP)	-5.7%	-6.3%	-7.6%	-8.2%
Trade Balance (% of GDP)	-11.6%	-11.1%	-12.7%	-13.8%
Exports (% change YoY, USD)	44.5%	42.3%	20.1%	24.4%
Imports (% change YoY, USD)	30.5%	27.8%	13.4%	17.5%
International Reserves (USD Million)	4,699	4,963	5,168	4,582
Money Aggregate M3 (GEL Million)	38,284	36,600	41,333	40,258
Money Aggregate M2 (GEL Million)	19,045	19,168	19,166	19,945

³⁷ PBO forecast of December 2022

Annex 4: Change in Forecasts of Key Macroeconomic Indicators, 2023-2024 (Baseline Scenario)³⁸

	2022				2023			
	December 2022		December 2021		December 2022		December 2021	
	Government	PBO	Government	PBO	Government	PBO	Government	PBO
Real GDP (% Growth)	5.0%	5.1%	5.5%	5.3%	5.2%	5.0%	5.2%	5.1%
Consumer Price Inflation	5.3%	5.5%	3.0%	3.1%	3.0%	3.0%	3.0%	2.9%
GDP Deflator	5.0%	5.8%	3.0%	4.5%	3.0%	4.2%	3.0%	4.3%
Nominal GDP (GEL Million)	79,685	79,691	70,450	73,742	86,343	87,247	76,337	80,815
Tax Revenues (GEL Million)	18,890	19,137	16,738	16,604	20,216	20,728	18,162	18,077
Direct Taxes (GEL Million)	8,425	8,266	7,272	6,602	9,061	9,071	7,914	7,345
Indirect Taxes (GEL Million)	10,465	10,871	9,466	10,002	11,155	11,657	10,248	10,732
Consolidated Budget Overall Balance (GEL Million)	-2,381	-2,213	-1,959	-2,110	-1,898	-1,706	-1,929	-2,097
Current Account Balance (% of GDP)	-6.4%	-6.5%	-6.6%	-6.8%	-5.6%	-6.1%	-6.2%	-6.4%
Trade Balance (% of GDP)	-11.4%	-10.8%	-9.4%	-10.5%	-10.6%	-9.9%	-8.4%	-9.5%
Exports (% change YoY, USD)	21.8%	16.8%	18.1%	17.5%	10.1%	12.5%	11.2%	16.0%
Imports (% change YoY, USD)	20.9%	15.2%	9.6%	10.2%	8.3%	9.9%	8.9%	12.9%
International Reserves (USD Million)	5,122	5,469	5,685	4,818	5,583	5,887	6,197	5,180
Money Aggregate M3 (GEL Million)	44,925	46,682	48,118	46,943	51,889	53,825	55,610	54,476
Money Aggregate M2 (GEL Million)	22,506	22,944	22,471	23,721	26,208	26,789	26,169	27,465

³⁸ PBO forecast of December 2022

Annex 4: Change in Forecasts of Key Macroeconomic Indicators, 2025 (Baseline Scenario)³⁹

	2025			
	December 2022		December 2022	
	Government	PBO	Government	PBO
Real GDP (% Growth)	5.2%	5.2%	5.2%	5.2%
Consumer Price Inflation	3.0%	3.1%	3.0%	3.0%
GDP Deflator	3.0%	4.3%	3.0%	4.0%
Nominal GDP (GEL Million)	93,558	95,680	82,716	88,437
Tax Revenues (GEL Million)	21,884	22,413	19,666	19,723
Direct Taxes (GEL Million)	9,834	9,973	8,588	8,243
Indirect Taxes (GEL Million)	12,050	12,440	11,078	11,480
Consolidated Budget Overall Balance (GEL Million)	-2,048	-1,907	-1,929	-1,980
Current Account Balance (% of GDP)	-4.9%	-5.3%	-5.1%	-6.1%
Trade Balance (% of GDP)	-10.0%	-8.9%	-6.9%	-9.2%
Exports (% change YoY, USD)	9.8%	10.0%	11.4%	16.5%
Imports (% change YoY, USD)	8.5%	8.1%	8.2%	14.6%
International Reserves (USD Million)	6,030	6,365	6,692	5,635
Money Aggregate M3 (GEL Million)	59,933	61,957	64,268	63,253
Money Aggregate M2 (GEL Million)	30,519	30,944	30,476	31,693

³⁹ PBO forecast of December 2022

Annex 6: Government debt forecast by the end of 2023 (GEL thousand)⁴⁰

Lender		Projected Balance (31.12.2023)
External Government Debt, Total		22,084,808
Multilateral Lenders		16,382,318
1	Asian Development Bank (ADB)	5,886,135
2	Asian Infrastructure Investment Bank (AIIB)	552,044
3	European Bank for Reconstruction and Development (EBRD)	651,913
4	European Investment Bank (EIB)	2,703,078
5	European Union (EU)	375,326
6	World Bank (WB) European Investment Bank (EIB)	5,540,162
7	International Fund for Agricultural Development (IFAD)	106,081
8	International Monetary Fund (IMF)	521,179
9	Council of Europe Development Bank (CEB)	40,429
10	Nordic Environment Finance Corporation (NEFCO)	5,970
Bilateral Lenders		4,345,183
1	Armenia	5,328
2	Azerbaijan	6,040
3	Austria	32,845
4	France	2,110,310
5	Germany	1,660,402
6	Iran	4,406
7	Japan	382,245
8	Kazakhstan	6,570
9	Kuwait	60,066
10	Netherlands	129
11	Russia	41,286
12	Turkey	11,761
13	Turkmenistan	572
14	USA	23,222
Other External Debt		1,354,400
	Eurobond	1,354,400
State guaranteed loans		2,907
	Germany	2,907
Domestic Government Debt		8,453,800
1	One-year, annually renewable government bonds for the National Bank of Georgia	80,846
2	Government bonds of different maturities for open market operations	152,000.0
3	Treasury Liabilities of the Ministry of Finance of Georgia	481,642.0
4	Treasury bonds of the Ministry of Finance of Georgia	7,704,311.9
5	Debt in the form of loans to Budget Organizations	35,000.0
Total Government Debt		30,538,608

Note: Exchange rates for November 27, 2022 are used: 1 EUR = 2.8220 GEL; 1 SDR = 3.5454 GEL; 100 JPY = 1.9457 GEL; 1 KWD = 8.8091 GEL; 1 USD = 2.7088 GEL.

⁴⁰ Source: Government of Georgia

Annex 7: Characteristics of PBO's Forecast

For evaluating fiscal rules in the medium term PBO use its own independent Forecasts of different macroeconomic items;

For deficit rule, it uses:

- Independent forecast of consolidated budget tax revenues;
- Independent forecast of other revenues;

However, all other fiscal items which are included in the calculation of the unified budget net/lending borrowing are taken from the governments medium term forecasts. This is mainly determined by the fact, that main part of rest of the items are under discretion of fiscal policy and only small part are so called macro sensitive items. As, year by year information about the government expenditure is getting much detailed, increasing their time horizon and some part of them is getting more and more macro sensitive, PBO plans to cover expenditure items forecasts in future.

Consolidated tax revenue forecast is done by so-called “bottom up” approach. PBO forecasts each tax items separately using different econometric equations and sum them for getting tax revenue.

Methodology used for budget revenue forecasting:

Items	Forecasting Bases	Forecasting Methods
VAT	Ral consumption, CPI	Breakpoints OLS
PIT	Ral GDP, CPI	Breakpoints OLS
CIP	Ral GDP, CPI	Breakpoints OLS
EXC	Ral GDP, CPI	Breakpoints OLS
IMPD	Import in Usd, GEL/usd Exchange rate	ARDL
REST	Ral GDP, CPI	Error Corection OLS
OTHT	Ral GDP, CPI	Breakpoints OLS
OTHREV	Ral GDP, CPI	BVAR

Each items are forecasted by these methodologies given in the table but, time-to-time the specification and the structure of the equations change due to new available data and new structural breaks in the macroeconomic indicators.

For the Debt rule, it uses:

- Independent forecast of exchange rate;
- Independent forecast of nominal GDP.

GEL/USD exchange rate forecast is done by monthly Bayesian VAR model with help of 2 principal components, that are obtained from 35 countries NC/USD monthly data. VAR model also includes:

- Real GDP growth of Georgia
- CPI inflation of Georgia
- Trade Balance of Georgia
- Oil prices (Brent)
- M3 aggregate of Georgia

Nominal GDP includes Real GDP and GDP deflator forecast. *Real GDP* forecast represents average estimation 3 Different models.

- First is VAR model which includes GDP and its components by expenditure side;
- Second is VAR model which includes GDP and its components by revenue side;
- Third model represents excel spreadsheet estimation, which measures impact of main exporter countries GDP growths on Georgian economy. Trade partners GDP forecasts are obtained from IMF WEO data.

GDP deflator forecast is done by VECM, which includes real GDP gap, GEL/USD real exchange rate, and NBG monetary policy rate.