# Table of Contents

Table of Contents ........................................................................................................... iii

Acronyms ......................................................................................................................... iii

List of Figures .................................................................................................................. iv

List of Tables .................................................................................................................... v

Executive Summary ......................................................................................................... 1

1. Introduction .................................................................................................................. 2

2. Objectives and Scope of the Debt Management Strategy ............................................. 4

3. Macroeconomic Outlook .............................................................................................. 5

4. General Government Debt Portfolio Description ....................................................... 8

5. General Government Debt Portfolio Analysis ............................................................ 10
   5.1 Exchange Rate Risk .................................................................................................. 10
   5.2 Refinancing Risk ..................................................................................................... 13
   5.3 Interest Rate Risk ................................................................................................... 14

6. Borrowing Sources ....................................................................................................... 16
   6.1. Loans from Multilateral and Bilateral Creditors (MBCs) ...................................... 16
   6.2. Issuance of Government Securities on International Market .............................. 17
   6.3. Issuance of Government Securities on Domestic Market .................................. 18
   6.4. Comparison of Borrowing Sources ..................................................................... 19

7. Strategy Targets (Guidelines) ..................................................................................... 21

8. Annex ........................................................................................................................... 23
Acronyms

ADB – Asian Development Bank

AFD – French Development Agency

ATM – Average Time to Maturity

ATR – Average Time to Re-fixing

DMS – Debt Management Strategy

EBRD – European Bank for Reconstruction and Development

EIB – European Investment Bank

EU – European Union

FDI – Foreign Direct Investments

IBRD – International Bank for Reconstruction and Development

IDA – International Development Association

IMF – International Monetary Fund

IFAD – International Bank for Agriculture Development

KfW – Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute)

NBG – National Bank of Georgia

SDR – Special Drawing Rights

WB – World Bank
List of Figures

Figure 1: Real GDP Growth y-o-y (%)

Figure 2: Current Account Balance (% of Nominal GDP)

Figure 3: Evolution of General Government Debt (% of GDP)

Figure 4: General Government External and Domestic Debt Portfolio by Instrument Type by the End of 2018

Figure 5: Georgian Eurobond Yield Curve

Figure 6: General Government External Debt by Currency by the End of 2018

Figure 7: Optimal Composition of GEL Portfolio (borrowed in USD and EUR) by Risk Minimization

Figure 8: Correlation of Economic Growth in Eurozone and Various Countries’ Economies before and after Joining the EU

Figure 9: Fluctuations of Normalized Standard Deviation of nominal exchange rate percentage change of EUR and USD (against GEL) by Periods

Figure 10: General Government Debt Redemption

Figure 11: General Government External Debt by Interest Rate Type by the End of 2018

Figure 12: Domestic Securities Yield Curves
List of Tables

Table 1: Projected Data of Gross Financing Needs, General Government Debt, and Macroeconomic Indicators for 2018-2021

Table 2: Average Weighted Interest Rates on General Government Domestic and External Debt by the End of 2018

Table 3: Refinancing Indicators by the End of 2018

Table 4: Interest Rate Indicators by the End of 2018

Table 5: Borrowing Types and Sources

Table 6: External Disbursements under Committed Loan Agreements

Table 7: Relative Advantages of Financing Sources

Table 8: Strategic Targets for 2021 (Guidelines)
Executive Summary

The aim of General Government Debt Management is on the one hand to obtain financial resources while minimizing medium term and long term costs, consistent with a prudent degree of risk and on the other hand to develop government securities’ market. The General Government Debt Management Strategy represents the Government debt management policy and introduces guidelines, which needs to be implemented by the government in order to achieve desired composition of general government debt portfolio.

General Government Debt Management Strategy document summarizes government’s debt management targets and guidelines through 2019-2021. The document is prepared according to the MTDS methodology\(^1\) developed by International Monetary Fund (IMF) and World Bank (WB) and reflects the recommendations received from the consultations with them, alongside with international practices. Considering current domestic and external macroeconomic environments, the guideline presented in this document suggests the steps that have to be taken gradually by the government of Georgia in order to achieve stated targets.

The General Government debt management strategy document consists of eight parts. The first and second parts briefly describe the main principles, goals and institutional schemes of borrowing, alongside with the main objectives and targets of the document.

The third part presents macroeconomic overview that describes current macroeconomic conditions in the country and region. Moreover, this part summaries the expected macroeconomic indicators for 2019-2021, which is the basis of the strategy document.

The fourth and fifth parts analyze current state of the general government debt in respect of refinancing, interest rate and exchange rate risks, correspondingly.

The sixth part describes the funding sources by which Government of Georgia can raise resources for financial needs. Additionally, this part represents respective advantages and disadvantages of funding sources.

The seventh part presents strategic guidelines to which the forthcoming general government debt management policy should be consistent with, in order to achieve the strategy objectives. Finally, in the eighth part, General Government Debt Management Strategy action plan is presented.

\(^1\) http://www.worldbank.org/en/topic/debt/brief/mtds
1. Introduction

The General Government Debt Management Strategy document reflects the actions that should be taken by the Government of Georgia to achieve debt management objectives and to ensure effective debt management policy.

Government borrowing is based on fair intergenerational resource redistribution principle, which means the following: generations who are benefiting from investment projects outcomes should undertake the debt service costs needed for these projects implementation.

The DMS is a public document in order to ensure the transparency of general government debt management policy and to increase the awareness of society, creditors, investors and credit rating agencies.

According to the Law on Public Debt of Georgia, borrowing on behalf of Georgia and issuance of government guarantees under other loan agreements, are undertaken by the Ministry of Finance with the consent of the Government of Georgia and consultation with the National Bank of Georgia.

Government of Georgia obtains funds from multilateral and bilateral creditors, also from the issuance of government securities on domestic and international financial markets. The government of Georgia borrows to finance investment projects and to promote government reforms, which supports defined guidelines of the government reform agenda.

With borrowed resources, the Government of Georgia finances only capital expenditures and covers existing financial liabilities. Budget operating balance is permanently positive. For 2019-2021 years average operating balance is about 2.7 billion GEL (5.6% of GDP), which means that current revenues fully finance current expenses. Out of 2.7 billion GEL, 1.3 billion GEL will be spent on repayments of the debt principal and the remaining portion (1.4 Billion GEL) finances capital expenditures. However, further investments are needed in order to continue development of the country and to achieve governments’ economic development objectives. For this purpose, the government of Georgia obtains additional financial resources from domestic and external creditors.

Currently Georgia is classified as lower-middle income country. However, for the medium term it is expected that Georgia will be promoted up to the upper-middle level.

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2 International Financial Institutions and partner countries.
3 Operating Balance is difference between current revenues and current expenditures.
5 [https://data.worldbank.org/country/georgia](https://data.worldbank.org/country/georgia)
Presumably, Georgia will have access to concessional funding\textsuperscript{6} in the medium term, but in the long run, along with the country's economic growth, the volumes of concessional loans will gradually decrease.

Alongside with decreasing access to financial resources from bilateral and multilateral creditors, government should replace them with funds raised by market instruments. Mostly, this will be domestic market instruments with low costs and prudent degree of risk. In the medium term, for diversification purposes, government of Georgia is planning to preserve its presence on international capital markets.

\textsuperscript{6} Concessional Loans have lower interest rates compared to the market rates.
2. Objectives and Scope of the Debt Management Strategy

The Debt Management Strategy document covers general government debt, which is defined by “Law on Public Debt of Georgia” excluding NBG loan owed by IMF.

The main objectives of the debt management strategy are:

1. **Covering the government financial needs**, while minimizing medium and long term costs, consistent with a prudent degree of risk. This objective implies maintaining the general government debt on a sustainable level with minimal costs, considering refinancing risk, interest rate risk and exchange rate risk.

2. **Development of domestic market of government securities**, which implies increasing liquidity, transparency and predictability of the market. Under the development of government securities market one of the main issue is the growth of existing securities volume, in order to increase investors’ interest towards domestic government securities, and correspondingly expand the investor base. Based on the best practices, a more developed domestic market should decrease the budget expenses on debt service and reduce risks in the medium and long-term. Developed government securities market will support the development of domestic capital market, which in turn will create additional GEL denominated financial resources available for the market participants.

---

7 The sum of budget deficit and government debt amortization
3. Macroeconomic Outlook

After slowdown of economic growth in 2014-2016 years Georgian economy quickly recovered in 2017 and economic growth was 4.8 percent. Economic activity continued and preliminary real GDP growth retained at 4.8 percent in 2018. In the medium term, similar to previous period, net export will be the main driver of economic growth, also, it is expected that trade will be vital for recovery of the world economy. Another important driver of the economic growth will be an investment. Herewith, implemented reforms and pipeline project intent to increase savings and investment level in the country.

**Figure 1: Real GDP Growth y-o-y (%)**

As for price level, National Bank of Georgia operates under the inflation targeting framework. In 2018, inflation level started to stabilize after eliminating excise tax effect and varies around targeted level 3%.

Economic recovery in the region had positive impact on Georgia’s export and export growth rate amounted to 22.9 percent in 2018.

In recent years tourism became as one of the most significant sector for the economy. In Georgia 8,326 thousand visitors arrived in 2018 that is 10.2 percent increase compared to 2017. Income received from tourism amounted to 3,202 million USD, which is 18.4 percent higher than previous year’s indicator.

Throughout the last four years significant growth of foreign direct investment has been observed, which persistently varies around 10 percent of gross domestic product. In 2018, compared to last year, there was decline of investment level, which was mainly caused by
the completion of main pipeline construction project, besides, residents of Georgia became owners of several enterprises and liabilities toward nonresident investors were reduced.

Although, it is noteworthy that the diversification of FDI is increasing through investing in new sectors. For instance, in 2015 relative to last years, investment level significantly increased in healthcare sector. In 2016 compared to 2015 investment level enlarged in communication sector where investment level amounted to 3.8 percent of total FDI. As for 2017, there was substantial increase of FDI in financial and construction sector. Throughout three quarter of 2018 the share of investments in financial sector amounted to 19.7 percent, 17.3 percent in transport and 15.4 percent in the energy sector.

Starting from second half of 2016 there was significant increase of remittances. In 2017, remittances were 22.3 percent higher compared to same period of last year. The increase of remittances was significant in 2018.

High level of current account deficit is the main source of vulnerability of Georgian economy. Thus, the Government of Georgia has developed the reforms to encourage savings, increase productivity and export, gradually close savings-investment gap, which means balanced current account. By the end of 2017, the current account deficit amounted to 8.8% of GDP, while the expected value for the 2018 is 7.5% (Figure 2).

**Figure 2: Current Account Balance (% of Nominal GDP)**

![Current Account Balance Graph]

Source: NBG

For the medium and long term, the structural reforms are planned to foster the savings, which in turn is crucial for improving the current account balance.

As of credit ratings of Georgia, in September 2017, the rating company Moody’s upgraded the country’s rating from “Ba3” to “Ba2” and the outlook remained as “stable”. According to S&P, the rating position of Georgia is on “BB-” Stable and in February 2019 “Fitch” upgraded the rating from “BB-” Positive to “BB” Stable.
According to rating agencies, the improvement of Georgia’s rating is due to the fact that the country’s economy was sustainable towards the economic shock started in the region in 2014, thus showed the strength of Georgia’s economy and institutions. The current economic reforms that are implemented with the assistance of IMF will reduce Georgia’s main credit weaknesses and will gradually increase the credit strengths. However, improving the rating is impeded by the risks of external vulnerability.

The ongoing economic reforms are positively perceived by the rating agencies. Moody’s and S&P emphasize the factors that support improvement of Georgia’s rating. These factors include strong institutions, EU-Georgia Association Agreement, diversified export markets, trade agreements, significant improvement of current account, improvement of fiscal sustainability and significant progress in Larization.

Furthermore, the following are positively considered by the rating agencies: 3-year program with IMF, improving the quality of education, financing the road infrastructure, efficient public administration, expanding the international trade, improved business climate, which will strengthen the private sector role as the main economic driver.

Realizing the Government’s medium and long term plans depends on the following fiscal and macroeconomic assumptions.

**Table 1: Projected Data of Gross Financing Needs, General Government Debt, and Macroeconomic Indicators for 2018-2021**

<table>
<thead>
<tr>
<th>Indicators (mln GEL)</th>
<th>2018P</th>
<th>2019P</th>
<th>2020P</th>
<th>2021P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget Revenues</td>
<td>11,705</td>
<td>12,578</td>
<td>13,402</td>
<td>14,250</td>
</tr>
<tr>
<td>Budget Expenses</td>
<td>9,561</td>
<td>10,326</td>
<td>10,710</td>
<td>10,979</td>
</tr>
<tr>
<td>Total Balance</td>
<td>-336</td>
<td>-970</td>
<td>-1,018</td>
<td>-1,029</td>
</tr>
<tr>
<td>Net Growth of Financial Assets</td>
<td>584</td>
<td>213</td>
<td>200</td>
<td>310</td>
</tr>
<tr>
<td>Gross Financing Needs⁸</td>
<td>2,885</td>
<td>3,317</td>
<td>3,323</td>
<td>4,759</td>
</tr>
<tr>
<td>Nominal GDP (mln GEL)</td>
<td>41,237</td>
<td>44,601</td>
<td>48,236</td>
<td>52,415</td>
</tr>
<tr>
<td>General Government Debt (% of GDP)</td>
<td>42.1</td>
<td>41.4</td>
<td>41.5</td>
<td>40.6</td>
</tr>
<tr>
<td>GDP Growth Rate (%)</td>
<td>4.8</td>
<td>4.5</td>
<td>5.0</td>
<td>5.5</td>
</tr>
<tr>
<td>GDP Deflator (% Change)</td>
<td>4.0</td>
<td>3.5</td>
<td>3.0</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Source: MoF

⁸ Budget Deficit as it is defined and agreed in IMF program (difference between total balance and net growth of financial assets) plus general government debt amortization.
4. General Government Debt Portfolio Description

By the end of 2018, Georgia’s general government debt to GDP ratio is estimated to be 42.1% of which 34.2% is general government external debt.\(^9\)

**Figure 3: Evolution of General Government Debt (% of GDP)\(^ {10}\)**

General government external debt has a significant share (81.3%) in total general government debt portfolio. The largest part - 88.1% of external debt comes from foreign creditors, mostly under concessional terms. The second largest share of external debt is Eurobond with 9.5% and the rest 2.4% is the Legacy Debt.\(^ {11}\) General government domestic debt is composed of T-Bonds (69.3%), T-Bills (17.3%) and government bonds\(^ {12}\) (13.3%).

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\(^9\) General Government Debt denominated in foreign currency.

\(^{10}\) This figure as well as whole strategy document does not consider domestic “Legacy Debt”.

\(^{11}\) Restructured Loans.

\(^{12}\) Government Bonds – loan from NBG, which was converted to securities.
By the end of 2018, weighted average interest rate for the external and domestic debt on different types of funds was the following: Creditor financing – 1.4%, legacy debt – 3.5%, Eurobond – 6.9% and domestic debt – 8.3% (Table 2)

**Table 2: Weighted Average Interest Rates on General Government Domestic and External Debt by the End of 2018**

<table>
<thead>
<tr>
<th></th>
<th>Weighted Average Interest Rate of the Portfolio</th>
<th>Weighted Average Interest Rate for Last Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Domestic Debt</strong></td>
<td>8.3%</td>
<td>7.5%</td>
</tr>
<tr>
<td>6 month T-Bills</td>
<td>7.1%</td>
<td>7.2%</td>
</tr>
<tr>
<td>12 month T-Bills</td>
<td>7.3%</td>
<td>7.3%</td>
</tr>
<tr>
<td>2 year T-Bonds</td>
<td>7.6%</td>
<td>7.4%</td>
</tr>
<tr>
<td>2 year T-Bonds</td>
<td>8.8%</td>
<td>7.7%</td>
</tr>
<tr>
<td>2 year T-Bonds</td>
<td>10.3%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Government Bonds</td>
<td>8.4%</td>
<td>7.8%</td>
</tr>
<tr>
<td><strong>External Debt</strong></td>
<td>1.5%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Creditor Financing</td>
<td>1.4%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Legacy Debt</td>
<td>3.5%</td>
<td>-</td>
</tr>
<tr>
<td><strong>Eurobond</strong></td>
<td>6.9%</td>
<td>-</td>
</tr>
</tbody>
</table>

By the end of 2018, Georgian Eurobond yield is 4.46%, which amounted to 6.875% in 2011. During recent years, Eurobond yield curve is on a declining trend (Figure 5).

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13 Weighted average interest rate for last 6 month
5. General Government Debt Portfolio Analysis

In order to develop an effective general government debt management policy, it is crucial to evaluate risks related to the size of the portfolio and expected volatility of its service costs. In this regards, exchange rate, refinancing and interest rate risks are assessed and managed.

5.1 Exchange Rate Risk

By the end of 2018, 35% of general government external debt was dominated in SDR, 34% in USD, 27% in EUR and the remaining 4% in other currencies. Despite considerable diversification of general government external debt portfolio, it is still vulnerable to exchange rate shocks. 81.3% of total general government debt is denominated in foreign currency, which means that depreciation of GEL against foreign currency would negatively affect significant part of general government debt. Therefore, in order to mitigate exchange rate risk, it is important to balance general government debt portfolio by increasing the share of general government domestic debt.
In 2017, 77% of loans were denominated in euro, 20% in US dollars and 3% in KWD. In 2018, all signed loans were in euros. Increasing the share of EUR denominated loans follows a policy developed for reducing the portfolio’s exposure toward exchange rate risk in the medium and long run (Figure 7).

**Figure 7: Optimal Composition of GEL Portfolio (borrowed in USD and EUR) by Risk Minimization**

Increasing the share of EUR denominated loans is based on various important factors:

1. Georgia’s economic relations with EU countries has been strengthening over time, implying that loans denominated in EUR represent a more natural hedge for exchange rate risk. It is worth to note, that after joining the EU, correlations of economic cycles between EU and different countries’ increased significantly (compared to pre-joining correlation) (Figure 8).
2. The economic relations between Georgia’s main trade partners and EU are remarkably strong, which means that economic cycles of EU countries are also indirectly related to Georgia’s economy. This is another argument in favor of borrowing in euro.

3. While observing the fluctuations of exchange rate of USD-GEL and EUR-GEL over time, it is clear that the EUR-GEL exchange rate is more stable than the USD-GEL exchange rate in the medium and long run. This fact emphasizes the attractiveness of borrowing in EUR compared to USD (Figure 9).

Figure 9: Fluctuations of Normalized Standard Deviation of nominal exchange rate percentage change of EUR and USD (against GEL) by Periods

Source: MoF
5.2 Refinancing Risk

The Average Time to Maturity (ATM) is one of the indicator for estimation of the refinancing risk. By the end of 2018, ATM amounted to 7.3 years for general government debt portfolio, and debt maturing within 1 year as a percent of total was 11.5%. These indicators for different types of the debt are the following:

a) External Creditor Financing: ATM for external creditor financing is 9.1 years, which shows good position. The share of the loans maturing within a year as a percent of total general government external debt is 6.3%.

b) External Legacy Debt: the ATM for restructured loans is 3.1 years. Aforementioned indicator is less than ATM for general government external debt, which negatively impacts on ATM of general government external debt portfolio. The share of the loans maturing within a year as a percent of total external legacy debt is 17.1%.

c) Eurobond: ATM is 2.5 years.

d) General Government Domestic Debt: the ATM is 2.6 years, and domestic debt maturing within a year as a percent of total is 35.8%.

Currently, the major buyers of government domestic securities are quite small group of investors (mostly commercial banks). The share of international investors is small and amounts to only 1.9 percent. These conditions increase refinancing risk. In order to mitigate aforementioned risk, it is important to expand investor base.

The redemption profile of general government external debt (except 2021) it is distributed more or less evenly, which makes government less exposed to refinancing risk.

In 2021, Government of Georgia covers 500 million USD Eurobond, which makes refinancing risk higher for 2021. During 2019, Government of Georgia will elaborate a particular plan for the Eurobond redemption.

**Figure 10: General Government Debt Redemption**
Table 3: Refinancing Indicators by the End of 2018

<table>
<thead>
<tr>
<th>Refinancing Indicators</th>
<th>Creditor Financing</th>
<th>External Legacy Debt</th>
<th>Eurobond</th>
<th>Domestic Debt</th>
<th>Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Time to Maturity (ATM)</td>
<td>9.1</td>
<td>3.1</td>
<td>2.5</td>
<td>2.6</td>
<td>7.3</td>
</tr>
<tr>
<td>Debt Maturing within 1 Year (% of Total)</td>
<td>6.3</td>
<td>17.1</td>
<td>-</td>
<td>35.8</td>
<td>11.5</td>
</tr>
</tbody>
</table>

Source: MoF

5.3 Interest Rate Risk

Evaluation of interest rate risk is based on the share of variable general government debt into total and share of fixed debt maturing within 1 year. As variable rates potentially are lower than fixed rates, and are characterized by counter-cyclicality, it creates a volatility of interest rate expenditure. Aforementioned risk does not exist for fixed interest rate loans. Therefore, fixed rate loans are characterized by higher interest rates compared to variable rate loans (includes additional interest rate risk premium).

Development of shares of fixed and variable interest rate loans for recent years are the following: (Figure 11).

Figure 11: General Government External Debt by Interest Rate Type by the End of 2018

The dynamic of general government external debt portfolio indicates that the share of variable interest rate loans is increasing over time. The increase of EUR denominated loans with variable interest rate is preferable in order to provide counter-cycles of budget expenditure. Presumably, Georgia’s economic activities are getting closer to economic
activities of EU countries that is expected to cause gradual convergence of interest rate dynamics.

Increasing trend of interest rates on EUR denominated loans is associated to the higher economic activity in Georgia and Europe. Therefore, increase in service cost caused by increasing interest rates on EUR denominated loans will be compensated by increased budget revenues, under the assumption that Georgian economic growth will be positively affected by economic growth of the EU and will stabilize increased interest rate expenditures. Counter-cyclical trend of interest rate expenditure is an important argument supporting the preference of loans denominated in EUR with variable interest rate.

Average Time to Re-fixing (ATR) for external creditor financing is 4.2 years, 3.1 for external legacy debt, 2.5 for Eurobond, 2.6 years for general government domestic debt and 3.7 years for total general government debt.

42.3% of total general government debt needs interest rate re-fixing in 1 year. For external creditor financing, the indicator is 49.2%, which is mainly caused by existence of variable interest rate loans in the general government external debt portfolio. The same indicator for general government domestic debt is 35.8%, even though general government domestic debt is fully fixed, significant share is covered within a year that requires re-fixing in 1 year. For external legacy debt, the same indicator is 17.1%. (Table 4).

**Table 4: Interest Rate Indicators by the End of 2018**

<table>
<thead>
<tr>
<th>Refinancing Indicators</th>
<th>Creditor Financing</th>
<th>External Legacy Debt</th>
<th>Eurobond</th>
<th>Domestic Debt</th>
<th>Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Time to Re-fixing (ATR)</td>
<td>4.2</td>
<td>3.1</td>
<td>2.5</td>
<td>2.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Debt Re-fixing in 1 year (% of Total)</td>
<td>49.2</td>
<td>17.1</td>
<td>-</td>
<td>35.8</td>
<td>42.3</td>
</tr>
</tbody>
</table>

Source: MoF
6. Borrowing Sources

Gross financing need consists of budget deficit and funds required to finance particular year's debt principal payments. In order to finance this needs, Government can use several sources (Table 5).

Table 5: Borrowing Types and Sources

<table>
<thead>
<tr>
<th>Type</th>
<th>Borrowing Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>External</td>
<td>Loans from Multilateral and Bilateral Creditors</td>
</tr>
<tr>
<td></td>
<td>Issuance of Government Securities on International Market</td>
</tr>
<tr>
<td>Domestic</td>
<td>Issuance of Government Securities on Domestic Market</td>
</tr>
</tbody>
</table>

Source: MoF

6.1. Loans from Multilateral and Bilateral Creditors (MBCs)

Loans from MBCs are the major part in Georgia’s total borrowing. These types of loans played significant role for development and forming the country, which has democracy, supremacy of law, and European priorities. Government of Georgia takes two types of loans from creditors: Project Loans, which are directly connected to a certain projects and Government Reforms’ Supporting Loans. As it was mentioned earlier, both types of loans are used to cover capital expenditures and to pay off existing loans. The loans from foreign sources are assigned to finance vital programs necessary for country development and for infrastructure rehabilitation. By creditor financing, it is possible to implement important projects, such as: transit highway modernization, which is important for development of road chain and reaching modern standards, also, implementation of key programs in energy industry in order to achieve energy system independence, safety and stability; implementation of various projects to support agriculture sector that makes drinking water and wastewater system available for big and small size towns and villages, which have big potential of developing agro business, tourism, and regional trade; also, implementation of various urgent arrangements and programs. At the same time, financing from creditors is important for reform implementation, expressing with expertise assistance and knowledge sharing while implementing.

During 2018, 1,379.8 mln GEL were borrowed from MBCs. Out of that, 924.8 mln GEL were Project Loans and 455.0 mln GEL Government Reforms Supporting Loans. In 2019, it is intended to borrow 1,686.1 million GEL from MBCs: around 1301.1 million for Project Loans and 385.0 mln GEL for Government Reforms Supporting Loans.
Table 6: External Disbursement under Committed Loan Agreements

<table>
<thead>
<tr>
<th>Mln GEL</th>
<th>2018 Actual</th>
<th>2019 Projection</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Project Loans</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IDA</td>
<td>17.3</td>
<td>13.1</td>
</tr>
<tr>
<td>IBRD</td>
<td>149.1</td>
<td>177.7</td>
</tr>
<tr>
<td>IFAD</td>
<td>9.7</td>
<td>6.7</td>
</tr>
<tr>
<td>EBRD</td>
<td>15.4</td>
<td>132.7</td>
</tr>
<tr>
<td>ADB</td>
<td>281.5</td>
<td>420.6</td>
</tr>
<tr>
<td>EIB</td>
<td>356.5</td>
<td>327.3</td>
</tr>
<tr>
<td>AIIB</td>
<td>11.3</td>
<td>28.0</td>
</tr>
<tr>
<td>CEB</td>
<td>0.0</td>
<td>1.5</td>
</tr>
<tr>
<td>NEFCO</td>
<td>0.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Japan</td>
<td>1.6</td>
<td>50.5</td>
</tr>
<tr>
<td>Kuwait</td>
<td>7.3</td>
<td>9.2</td>
</tr>
<tr>
<td>Germany</td>
<td>32.0</td>
<td>75.8</td>
</tr>
<tr>
<td>France/SG</td>
<td>23.0</td>
<td>55.0</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>924.8</strong></td>
<td><strong>1,301.1</strong></td>
</tr>
</tbody>
</table>

| **Government Reforms’ Supporting Loans** | | |
| AFD | 262.5 | 180.0 |
| KfW | 147.5 | 145.0 |
| EU | 45.0 | 60.0 |
| **Total:** | **455.0** | **385.0** |
| **Grand Total:** | **1,379.8** | **1,686.1** |

Source: MoF

Currently, Georgia benefits from various favorable borrowing terms offered by official creditors: low interest rates, long maturities and long grace periods.

In many cases, projects that are implemented by financing from creditors are equipped with expertise, project implementation experience, knowledge sharing, and high standards of job performance. In some cases, offered loans are accompanied with investment grants.

**6.2. Issuance of Government Securities on International Market**

Raising funds on International Market is another option for obtaining financial resources. This option is especially important, when domestic market is not developed enough, inflation expectations are overestimated and domestic borrowings are costly. That is the time, when international capital market gives opportunity to the government to attract financial resources. In order to use these opportunities, it is essential to increase Georgia’s awareness on the international capital market. Currently, Georgia has 500 mln USD Eurobond maturing in 2021. It is important to mention, that future conditions on domestic and international markets will have significant influence for another Eurobond issuance decision.
6.3. Issuance of Government Securities on Domestic Market

Issuance of government securities is the third source for obtaining financial resources. In order to attract financing in the medium and long run with lower costs, consistent with prudent degree of risks, domestic market of government securities should be developed further. As it was mentioned earlier, it is expected that Georgia will have limited access to concessional loans from MBCs in the long run.

Currently, the major buyers of government securities are a relatively small group of local commercial banks, but in order to develop domestic market of government securities, pension funds, mutual funds and other private domestic and foreign investors should be attracted. Main constraint for the foreign investor is small market size and underdeveloped secondary market. If investor wishes to sell significant amount of government securities he/she can’t do it easily, because of low liquidity on the market. Existing volume of domestic market securities is not sufficient to attract large investment funds. Therefore, increase in total issuance of all securities as well as each issue size will result in increased demand from foreign investors, which in turn will decrease interest rates and will reduce risks associated with repayment of debt.

In response to the above-mentioned hindrances, Government of Georgia started to issue benchmark Bonds\textsuperscript{14} from 2018. Larger issue size with systematic issuances will increase investors’ interest towards Georgian government securities, which will support overall development of domestic market.

In order to meet the objectives, set in the strategy it is planned to gradually increase the issuance of government securities. Furthermore, in order to support benchmark bonds issuance strategy and to better manage refinancing risk, it is planned to implement liability management operations’ instrument – buy-back.

Primary Dealers System implementation is planned for further development of the domestic government securities market; it will potentially promote activity on the primary and secondary markets, also demand from foreign investors will increase.

In 2014-2015, regional developments had negative impact on the domestic market of treasury securities in Georgia. GEL, like all the currencies in the region, significantly depreciated against USD, which with other negative factors, shifted yield curve of government securities.

\textsuperscript{14} Information regarding Benchmark Bond issuance calendar - \url{https://mof.ge/5147}
securities upwards. However, this was a temporary shock in the economy and interest rates have been gradually declining. (Figure 12).

**Figure 12: Domestic Securities Yield Curves**  

![Figure 12: Domestic Securities Yield Curves](image)

Source: MoF

### 6.4. Comparison of Borrowing Sources

Government of Georgia decides what type of instrument to use before raising funds. In order to make optimal decision it is important to compare the financial conditions of all existing sources with each other.

While comparing conditions of external borrowing from MBCs to domestic borrowing at first glance it may appear that borrowing for MBCs is cheaper than borrowing on the domestic market, but to have a clear picture, apart from interest rates, other factors has to be considered like an exchange rate risk and sterilization cost.

Borrowing in local currency distinct from external borrowing does not have an exchange rate risk. Recent developments indicate that there is a need to mitigate negative consequences of exchange rate depreciation through the reduction of external borrowing share in the total borrowing, while substituting it by borrowing in local currency.

A more developed domestic government debt markets will facilitate the development of domestic capital market as well. Government bonds will play a role of benchmark for private sector bonds. Hence, it will facilitate the issuance of debt for private sector entities with lower cost, consistent with prudent degree of risk.

Financing from local market is non-inflationary, which means that the amount of money taken out from the circulation equals public expenditure by government.

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15 Interest Rates are calculated as weighted average yields on primary market
It is important to mention, that increased government borrowing on domestic market will not shift interest rates upward for private sector loans and will not cause crowding-out effect and slow down of the economic growth. The development of government securities market will increase liquidity of domestic debt instrument that improves efficiency of financial intermediaries. As a result, maturity of GEL denominated loans will increase, interest rates will decrease that cause increment in demand on loans.

As for borrowing from international capital market, currently it is even more expensive than borrowing from MBCs. However, for the medium and long term perspectives it is important to increase the country’s awareness on international capital markets.

In Table 7, there are qualitative comparison of borrowing sources. There are pros and cons for each sources, but overall picture shows the advantages of domestic borrowing over others.

**Table 7: Relative Advantages of Financing Sources**

<table>
<thead>
<tr>
<th></th>
<th>Loans from Multilateral and Bilateral Creditors</th>
<th>Issuance of Government Securities on International Market</th>
<th>Issuance of Government Securities on Domestic Market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Refinancing Risk</strong></td>
<td>Low</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Interest Rate Risk</strong></td>
<td>Medium</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Absence of Exchange Rate Risk</strong></td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Absence of Crowding-out Effect</strong></td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td><strong>Concessional Terms</strong></td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Impact on Increase of Official Reserves of Country</strong></td>
<td>✔</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td><strong>Absence of Restrictions Due to Regulations</strong></td>
<td>✔</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td><strong>Facilitate the Development of Capital Market</strong></td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Risk-free Investing Opportunities in GEL for Institutional Investors</strong></td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Increase of Awareness on International Markets</strong></td>
<td>✔</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: MoF
In order to evaluate the future costs and risks of general government debt portfolio the following four alternative scenarios were analyzed for the projected time period (2019-2021):

- **Financing the total needs by loans received from multilateral and bilateral creditor organizations (S.1);**
- **Financing the total needs by issuance of Eurobonds (S.2);**
- **Financing the total needs by domestic sources (S.3);**
- **Financing total needs by loans received from multilateral and bilateral creditor organizations and form domestic sources (S.4).**

Alternative funding strategies were simulated under different types of FX and interest rate shocks. The simulation showed that there are no significant differences between strategies’ results in terms of cost and risk, but still the best option is scenario 3 (Financing the total needs by domestic sources).

Currently, domestic market development level is not sufficient, thus it is not possible to finance the total needs on the domestic market. Moreover, in medium term International Financial Institutions and partner countries will finance large capital investment projects, which require expertise and experience of creditors. Therefore, Gross Financing Needs for 2019-2021 will be financed from both external and domestic sources.

In order to meet strategic objectives the following strategic guidelines are set for the year of 2021:

**Refinancing Risk:**

1. The government is planning to increase the shares of medium and long-term securities’ in the composition of all securities that are in the domestic market.
2. Borrowing from external sources has long maturity and significant grace period. It is planned to keep the same track while making the future borrowing decisions and giving priority to loans with longer maturities.
3. Government of Georgia is going to elaborate the plan for existing maturing Eurobond during 2019.
4. For the better management of refinancing risk, it is planned debt maturing in 1 year (% of total) should not exceed 20%.
5. Another guideline for refinancing risk is to control ATM (years). In this regard, it is intended to keep ATM for general government domestic debt at minimum of 5.5 years.
**Interest Rate Risk**

1. By the end of 2018, 60.7% out of total general government debt was bearing fixed interest rate. In order not to increase vulnerability of general government debt with respect to interest rate risk and at the same time reduce borrowing costs, it is important to maintain share of the loans with fixed interest rate minimum at 40% level.

2. The second indicator of interest rate risk is Average Time to Re-fixing (ATR). In order to manage interest rate risk, it is important to keep ATR above 2.0 years.

3. Another indicator of interest rate risk is debt re-fixing in 1 year. Regarding this indicator, it should not be higher than 70%.

**Exchange Rate Risk:**

1. Currently, share of general government external debt out of the total is 81.3%, the remaining part 18.7% is general government domestic debt. In order not to increase vulnerability of general government debt against exchange rate risk, the share of general government domestic debt in total is planned to be maintained at least 20% for 2021, for the long run this share is planned to increase gradually up to 35%.

**Table 8: Strategic Targets for 2021 (Guidelines)**

<table>
<thead>
<tr>
<th>Types of Risk</th>
<th>Indicators</th>
<th>2018</th>
<th>2021 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Refinancing Ring</td>
<td>Debt maturing within 1 year (% of total) for total government debt</td>
<td>11.5%</td>
<td>Max. 20.0%</td>
</tr>
<tr>
<td></td>
<td>ATM for total government debt</td>
<td>7.3</td>
<td>Min. 5.5</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>Share of fixed debt in total government debt</td>
<td>60.7%</td>
<td>Min. 40.0%</td>
</tr>
<tr>
<td></td>
<td>ATR for total government debt</td>
<td>3.7</td>
<td>Min. 2.0</td>
</tr>
<tr>
<td></td>
<td>Debt re-fixing in 1 year (% of total)</td>
<td>42.3%</td>
<td>Max. 70.0%</td>
</tr>
<tr>
<td>Exchange rate risk</td>
<td>Share of government domestic debt into total government debt</td>
<td>18.7%</td>
<td>Min. 20.0%</td>
</tr>
</tbody>
</table>

The final borrowing decision is based on combination of the simulation results and judgment based analysis.

The monitoring of implementation and assessment of the strategy will be conducted at least once a year by the Public Debt Management Department in the Ministry of Finance of Georgia.

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16 Based on the assumption that no significant internal or external shock would happen during 2019-2021.
8. Annex

**General Government Debt Management Strategy Action Plan**

In order to achieve objectives set in the Strategy, following targets and activities were defined:

1. **Increasing the liquidity of government securities market**
   1.1. Gradual increase of benchmark bonds issuances and overall market size
   1.2. Implementation of new market instruments considering international experience
       (using scientific literature, WB and IMF technical assistance missions)

2. **Implementation of Primary Dealers (PD) System in order to develop government securities market**
   2.1. Establishing PD working group with clear duties separation. Defining primary dealers' rights and liabilities
   2.2. Initiation and implementation of required legal changes
   2.3. Preparation and implementation of Pilot PD System, with defined scope
   2.4. Full-fledged PD System implementation initiation after assessment of Pilot System

3. **Liabilities Management Operations implementation in order to increase the efficiency of the general government debt management**
   3.1. Implementation of Buy-back operation considering international experience (using scientific literature, WB and IMF technical assistance missions)
   3.2. Initiation and implementation of legal changes considering recommendations from international organizations
   3.3. Update of existing debt management system in order to implement buy-back operations
   3.4. Implementation of buy-back operations
   3.5. Evaluation of switch operations implementation possibility (using scientific literature, WB and IMF technical assistance missions)

4. **Improvement of communication with investors in order to diversify the investor base of the government securities market.**
   4.1. Establishment of continuous dialogue with market participants and potential investors
   4.2. Preparation of investor relation strategy
   4.3. Organization of informational meetings and “road-shows”
   4.4. Preparation of regular statistical and analytical information for investors
   4.5. Having regular webinars with investors
5. Eurobond refinancing strategy preparation in order to improve the effectiveness of government debt risk management
   5.1. Meetings with local and foreign investors
   5.2. Consultations with National Bank of Georgia in order to assess the effect of different refinancing options on country’s official international reserves
   5.3. Consultations with IMF and WB
   5.4. Cost and risk analysis of different refinancing options in order to make final decision

6. Simplifying the access to the government securities for individuals
   6.1. Sharing international experience with partner countries and organizations
   6.2. Preparation of electronic trading system concept in order to make decision on implementation of this system.