Ministry of Finance of Georgia

General Government Debt Management Strategy 2022-2025

Tbilisi, December 2021

Contents

1. Introduction

The General Government Debt Management Strategy document covers the main areas and objectives of government debt management for 2022-2025. The strategy reflects the plan of the Government of Georgia, which should ensure the implementation of efficient debt management policies and achieve the objectives of debt management. The document also outlines the measures taken by the Government of Georgia to achieve the goals of the 2019-2021 strategy (Annex 1).

According to the "Law on Public Debt" of Georgia, borrowing on behalf of Georgia and issuing state guarantees under other loan agreements, are undertaken by the Ministry of Finance, with the consent of the Government of Georgia and in consultation with the National Bank of Georgia. The government of Georgia obtains funds from bilateral and multilateral creditors[1] as well as from the issuance of government securities on international and domestic financial markets.

The government of Georgia borrows to finance investment projects and to promote government-planned reforms.

It should be noted that according to the World Bank classification, Georgia is currently included in the group of upper middle-income countries[2]. Georgia is expected to have access to concessional funding[3] in the medium term, but in the long run, as the country's economy grows, access to concessional funding will gradually decline. Alongside with decreasing access to financial resources from bilateral and multilateral creditors, they will be replaced by local market instruments. At the same time, it is important to increase country awareness in the international capital market for the diversification of access to financial resources.

The Government Debt Management Strategy is a public document that ensures the transparency of the government debt management policy and increases the awareness to creditors, investors, credit rating agencies and the society on this issue.

[1] International Financial Institutions and Partner Countries.

[2] https://data.worldbank.org/country/georgia

[3] Concessional loans have lower interest rates compared to the market rates.

2. Strategy Scope and Objectives

The Government Debt Management Strategy Document covers the debt indicator, which includes:

1. Debt of the Government of Georgia, as defined by the Organic Law of Georgia on Economic Freedom. In particular, it covers a) Public Debt, as defined by the Law of Georgia on Public Debt, except for liabilities undertaken by the National Bank of Georgia, and b) debt undertaken by budgetary organizations, except the debt undertaken from budgetary organizations.
2. Public-private partnership (PPP) liabilities, which is the fair value[4] of the liabilities made within the framework of the basic principles of public-private partnership and the relevant projects of the criteria of PPP provided by "Law of Georgia on Public-Private Partnership".

The global pandemic that started at the end of 2019 had a significant negative impact on all countries of the world, including Georgia. As a result, the economy shrank by 6.8 percent in 2020, the ratio of the common budget deficit to GDP increased to 9.3 percent, and GEL depreciated against major borrowing currencies composing the government debt portfolio. Consequently, the government debt-to-GDP ratio, which was 40.4 percent at the end of 2019, exceeded the 60% threshold, defined by Georgian legislation[5].

Given the above, government debt management has faced with new challenges. As a result, the following strategic directions of government debt management were identified:

1. Reducing the government net debt to GDP ratio;
2. Increasing GEL-denominated debt share in the government debt portfolio;
3. Increasing the focus on the development-oriented external loans;
4. Cost and risk optimization of the government total debt portfolio;
5. Government securities' market development.

The strategy focuses on the five directions listed above, defines the target indicators for each direction and sets the plan to achieve them.

[4] This component is taken into consideration only in the calculation of the Debt-to-GDP ratio.
[5] Organic Law of Georgia on Economic Freedom.

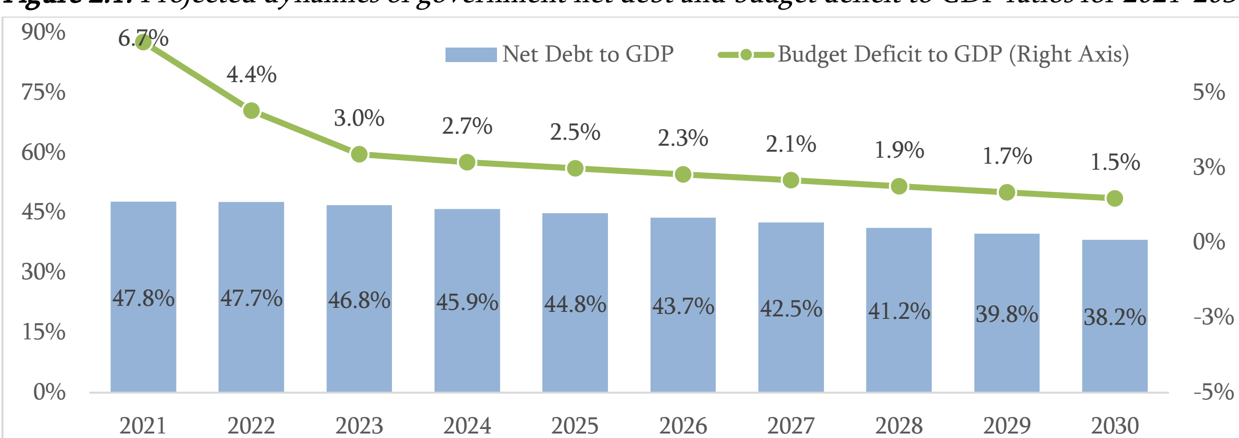
Direction 1. Reducing the Government Net Debt[6] to GDP Ratio

Georgia was always characterized by low debt indicators. However, since the pandemic resulted in the economic shock, increased spending in the areas of health, social and business support, the government debt-to-GDP ratio exceeded 60.0 percent by the end of 2020. Therefore, the main objective of the government debt management has become to bring the indicator back to the pre-crisis level. The ministry of finance of Georgia has estimated the safe level of 40 percent for government net debt to GDP ratio that was 52.8% at the end of 2020. Therefore, bringing the government net debt to GDP ratio to the safe level is the objective of the debt management strategy. This level of government net debt would enable the country to respond to shocks, in a period of severe economic crisis, such that the government debt to GDP ratio does not exceed the 60 percent threshold, set by the law. Therefore, it is important to determine the time required to reach the target.

Budget deficit to GDP ratio is the main tool for reducing the government debt level. Also, the foreign exchange rate is an important factor influencing the level of government debt. However, the government policy is not aimed to strengthen or depreciate the exchange rate and it is assumed to remain unchanged for the projection period. Thus, reducing the fiscal deficit is the only way to reduce the government net debt to GDP ratio to the targeted 40.0%.

The economic shock caused by the pandemic, in its content and scope, is an event that takes place once in a century. Therefore, after this kind of shock, it is not reasonable to reduce the net debt to 40.0 percent of GDP within the timeframe of this strategy, as this would require a drastic reduction in the budget deficit to an irrationally low level. The target can be achieved by 2030 with an ambitious reduction in the budget deficit (Figure 2.1).

Figure 2.1. *Projected dynamics of government net debt and budget deficit to GDP ratios for 2021-2030*



Source: *Ministry of Finance of Georgia*

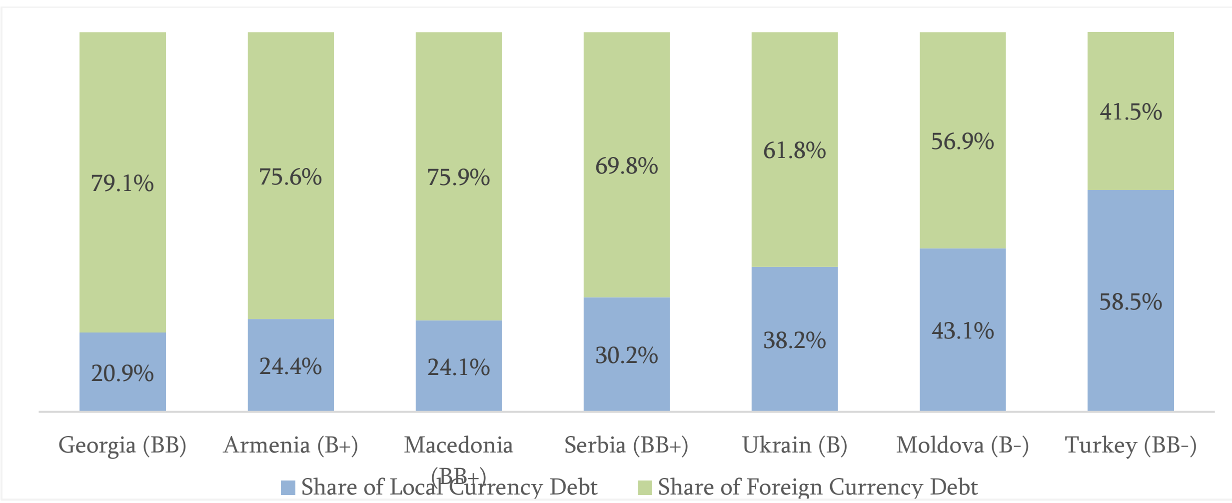
[6] Defined as the difference between total government debt and the balance of deposits

As far as achieving the debt target within the time horizon of this strategy is not realistic, the strategy sets 45 percent of net debt to GDP ratio, as an intermediate target, to be achieved by the end of 2025.

Direction 2. Increasing GEL-denominated debt share in the government debt portfolio

The main problem of the Government Debt portfolio is historically large share of foreign currency denominated debt. At the end of 2020, foreign currency denominated debt accounted for 79.1 percent of the total debt portfolio, which is the highest level compared to the regional and other comparable countries (Figure 2.2).

Figure 2.2. The share of local and foreign currency denominated government debt in the total debt portfolio, for different countries, as of the end of 2020



***Source**: Ministries of Finance of the respective countries*

Government debt to GDP ratio is one of the main indicators affecting country's credit rating. However, in this regard, the share of foreign currency denominated debt in the total portfolio is a much more important factor. Most of the developed countries have a high debt to GDP ratio, but due to the local currency denomination of a significant portion of the debt portfolios, the issue of their creditworthiness is not questionable. It should be noted that at the end of 2020 government external debt to GDP ratio for Georgia amounted 47.6 percent.

According to the methodology applied by credit rating agencies, the share of debt denominated in foreign currency in the government debt portfolio negatively affects the sovereign rating of the country. Thus, the high level of external debt (79.1%) in Georgia's government debt portfolio significantly hinders the ability of Georgia to improve its credit rating.

In recent years, foreign currency denominated loans have lower interest rates. However, it should be noted that this difference is only of an optical nature and, in fact, a direct comparison of interest rates in different currencies is not valid. There is also a difference between interest rates in global currencies. For example, interest rates on EUR-denominated loans in 2014-2019 were, on average, about 1.5 percentage points lower compared to the interest rates on USD-denominated loans. However, the explicit conclusion that borrowing in EUR is cheaper than borrowing in USD would not be fair, given the difference between the USD/EUR spot and forward exchange rates in the financial markets.

The high share of external debt in the government debt portfolio, also, hinders the effectiveness of debt management policy. To achieve the long-term target for Direction 1, debt needs to become more manageable, which primarily means increasing the share of GEL-denominated debt in the portfolio.

In this direction, the target indicators of the debt management strategy are: a) reduction of the external debt to GDP ratio to 35 percent, and b) reduction of the external debt share in total debt below 72 percent. Achieving these targets is planned by 2025.

The following net increases in the domestic and external debt are planned to achieve the targets set above:

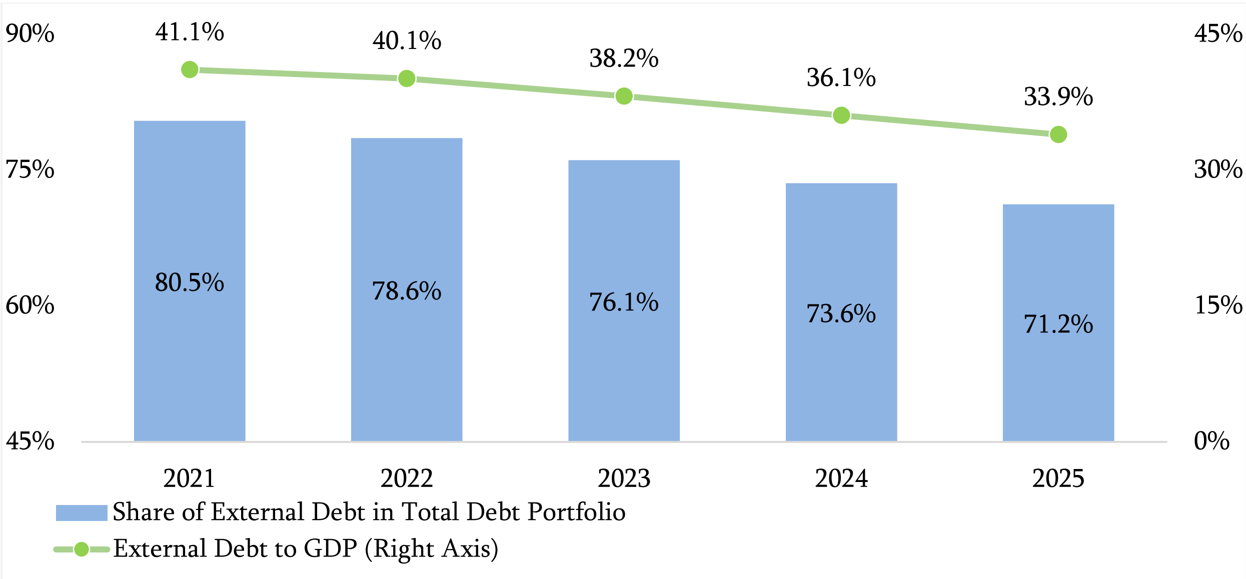
Table 2.1. *Projected annual changes in the domestic and external debt and deposit balance for 2021-2025 (Million GEL)*

	2021	2022	2023	2024	2025
Net increase of domestic debt	-375	1,245	1,345	1,445	1,445
Net increase of external debt	2,611	1,858	880	620	559
Change of the balance of deposits	-1,677	251	146	16	-45

Source: *Ministry of Finance of Georgia*

Given the above and the macroeconomic assumptions of the strategy (Table 3.2), the projected dynamics of the share of external debt in the portfolio and the external debt to GDP ratio are presented in the diagram below.

Figure 2.3. Projected dynamics of external debt share in the total debt portfolio and external debt to GDP ratio for 2021-2025



Source: *Ministry of Finance of Georgia*

Both targets mentioned above are quite ambitious. Moreover, by 2026, Georgia's $500 million Eurobond will mature. Refinancing it with GEL-denominated debt will allow the country to reduce the external debt share in the government debt portfolio to 65 percent. This implies to bring the foreign currency denominated debt to GDP ratio to pre-pandemic level.

Direction 3. Increasing the Focus on the Development-oriented External Loans

The government of Georgia takes two types of loans from Multilateral and Bilateral creditors: Investment Loans, which are directly connected to certain projects, and reform-supporting loans such as Program Loans.

Due to the domination of foreign currency-denominated loans and debt Larization goal, the strategy's objective in this direction represents to be focused on the loans having a high transformational effect. However, in the medium-term foreign currency loans will remain as a major source of funding gross financing needs.

To achieve this strategic objective, a loan will be taken under the following principles:

For investment loans:

- **Investment loans will be taken only for large and complex projects.** These are projects that require the support of development partners in the project implementation process to achieve a high standard of performance, and which are accompanied by expertise and knowledge sharing. The main benefit of taking an investment loan is not only the attraction of financial resources but also the support that should facilitate the project implementation with the relevant standards. Consequently, the government will not take (submit a new application) investment loans for projects that can be implemented with the same success and efficiency using budget resources;
- **There must be a positive evaluation[7] of project's efficiency under each investment loan**. Investment loans can be initiated only for projects that have passed the pre-selection stage according to the Public Investment Management Methodology[8] (PIM) and have received a positive decision from the Interagency Commission[9]. Therefore, it is a necessary precondition for the beneficiary ministry or municipality to have a public investment management system in place to initiate an investment loan. In addition, investment projects that are not subject to review by the rules defined by the state investment methodology will be selected by the Fiscal Board of the Ministry of Finance of Georgia.
- **On-lending to the state-owned enterprises will take place only if the enterprise expresses its readiness to make reforms**. To meet the minimum standard of reform, a state-owned enterprise must: a) implement corporate governance practices according to the corporate governance code compatible to the OECD standard approved by the government; and b) undergoes the reform according to the standard agreed with the International Monetary Fund and approved by the Minister of Finance of Georgia;
- **For fully corporatized enterprises, the government will stop on-lending practices**. By doing so, the government will encourage companies to enter the private equity market and attract financial resources independently. It is important that the investments required for the company is not part of the budget process and is independent of budgetary constraints, which in turn will increase investments in the country's economy; At the same time, the government will convert the loans already lent to companies into

[7] The evaluation according to the PIM methodology will start from 2022 and by 2025 each new project will be funded with a positive evaluation precondition.

[8] Resolution # 191 of the Government of Georgia of April 22, 2016 "On the Approval of the Investment Project Management Guide".

[9] The Commission established by the Government of Georgia for the selection of investment projects, which makes decisions at various stages of an investment project according to the Resolution # 191 of the Government of Georgia of April 22, 2016 “On the Approval of the Investment Project Management Guide”.

marketable instruments. By 2025, loans of up to GEL 900 million will be converted into marketable instruments.

For program loans:

- **From 2022, external borrowing will be available only for significant transformational reforms.** Under such programs a significant technical assistance is provided to support the implementation of reforms in line with international best practices. It is important to focus on and implement reforms with a highly transformative nature. Program loans will be taken only for significant government reforms, for which the outcome will be assessed in advance and approved by the government. The degree of transformability of the reform will be assessed by the Fiscal Board of the Ministry of Finance of Georgia. For the program loans, an annual limit of $ 250 million will be set for 2022-2025.

Direction 4. Cost and Risk Optimization of the Government Total Debt Portfolio

This direction includes refinancing risk management issues for the total debt portfolio and important factors to consider when taking foreign loans.

Refinancing risk. To manage refinancing risk, it is important to maximize the average time to maturity of the portfolio and control the amount of debt maturing within 1 year relative to total debt in order to avoid peaks in the government debt repayment schedule. Therefore, to manage this risk, it is important that

- **The average time to maturity (ATM) of the government total debt portfolio** should not fall below 5.5 years, while this indicator for the domestic debt portfolio should be maintained above 3 years;
- **The share of the debt maturing within 1 year** should not exceed 15.0% of the total debt portfolio.

This direction in regard with foreign loans means to achieve the optimal level of costs and risks associated with a loan when selecting the terms of the loan. To achieve the optimal level, the following key parameters considered are:

- **Grant Element.** The grant element is the difference between the present value of servicing the loan from development partners and the cost of servicing an alternative loan with market terms. The higher the grant element the more preferable the loan. When selecting the loan terms, priority is given to the option with a higher grant element, which in most cases is achieved by selecting the maximum maturity and grace period;

- **Loan currency**. The long-term analysis of the dynamics of the GEL exchange rate against the main currencies of the government debt portfolio shows that the GEL is less volatile against the EUR. At the same time, due to the ongoing economic and political convergence with the Euro area, an increase in the share of EUR-denominated loans in the external debt portfolio reduces the currency risk. Accordingly, EUR-denominated loans are preferred when choosing a loan currency;
- **Type of interest rate**. Choosing between fixed and variable interest rates implies to solve the dilemma of minimizing cost and refinancing risk. For interest rate risk management purposes, it is important the share of fixed interest rate debt in the external debt portfolio not to fall below 50%. Accordingly, in the current period, when taking a new loan, the focus is on loans with fixed interest rates, which is mainly due to the historically low interest rates.

Direction 5. Treasury Securities Market Development

According to international best practices, the developed local securities market reduces the budget servicing cost on loans and the risks for the medium and long term.

A developed market allows the government to respond quickly to financial needs and to manage cash efficiently.

The developed securities market is a critical factor in achieving the goal of debt portfolio Larization.

The developed treasury securities market is fundamental for the country's capital market. It also plays an important role in shaping and enlarging the investor base. Government securities create a benchmark for other corporate securities, overall allowing corporate issuers to attract investors more effectively.

In this regard, the objectives of government debt management strategy are: a) increase of the market liquidity, b) diversification of the investor base, and c) increase of the supply, transparency, and predictability of securities.

To achieve the stated objectives, it is important to take the following steps:

To increase the market liquidity:

- **Increase the securities volume**. The increased volume of securities in circulation increases the investors' interest. Large volume market reduces the risks for investors to enter in and exit from the market;
- **Secondary market development.** A developed secondary market is an important factor for investors. To develop the secondary market, in November 2020, the Ministry of Finance of Georgia, in consultation with the International Monetary Fund and the World Bank, launched a Market Making Pilot Program. It is important to make the transition from this pilot program to the fully-fledged system, according to market readiness;
- **Strong benchmark**. The strength of a benchmark is measured by its volume. In 2018, the Ministry of Finance of Georgia started issuing benchmark bonds with a volume of GEL 240 million. Currently, the volume of the largest benchmark is GEL 972 million, which is quite a significant achievement. Benchmark size is one of the main criteria for Georgia to be included in JP Morgan's GBI-EM index[10], which will significantly increase the liquidity of government securities. <u>By 2025, it is planned to meet the inclusion requirements of JP Morgan's GBI-EM Index.</u>

To diversify the investor base:

- **Increase the share of non-resident investors**. Increasing the share of non-resident investors will diversify the investor base, which will reduce the cost of GEL-denominated debt and increase the currency inflows into the country. For this, an Investor Relations strategy[11] is being developed that will help attract non-resident investors to the country through regular and effective communication, moreover, inclusion in JP Morgan's the GBI-EM Index will significantly increase the activity of non-resident investors in the local market. <u>By 2025, the target for the share of non-resident investors in treasury securities holders is set at 25 percent;</u>
- **Introduction of EuroClear to the local securities market**. The introduction of EuroClear in the local market is one of the contributing factors to the growth of credibility by foreign investors. This step will significantly simplify international transactions and reduce transaction costs for investors;
- **Create a market for retail investors**. Creating a market for retail investors will help to increase public awareness of financial markets and to improve the level of financial

[10] Index for local currency denominated Government securities.
[11] The strategy will be published by 2022.

education. The implementation of this is appropriate in the medium term and requires the creation, implementation, and maintenance of an appropriate platform before the creation of the retail investor market.

To increase the supply, transparency, and predictability of securities:

- Early publishment of treasury securities annual issuance plan in the local market, and determination and presentation of gross annual borrowing in the local market to the investors. The periodicity and the format of the abovementioned measures (information) will be defined in the Investor Relations strategy. Achieving this goal will increase investor confidence to the issuer and make it easier for investors to manage their finances accordingly.

Considering all the above-mentioned strategic directions, the following tables provide risk indicators and relevant targets:

Table 2.2. *Strategic Targets for 2025*[12]

Types of Risk	Indicators	2020 (Actual)	2025 (Target)
Refinancing Risk	Debt maturing within 1 year (% of total) for total government debt	14.8%	Max. 15.0%
	ATM for total government debt	7.5	Min. 5.5
	ATMfor government domestic debt	3.1	Min. 3.0
Interest Rate Risk	Share of fixed-interest external debt in government external debt	52.5%	Min. 50.0%
Exchange Rate Risk	Share of government domestic debt into total government debt	20.9%	Min. 28.0%
Default Risk	Government net debt to GDP ratio	52.8%	Max. 45.0%

[12] These strategic directions assume that there will be no internal or external shocks during the strategy period, which will significantly change the macroeconomic environment and will not apply in the cases provided in Article 2, Paragraph 7 of the Organic Law of Georgia on Economic Freedom.

Table 2.3. *Operational Targets by 2025*[13]

Indicators	2020 (Actual)	2025 (Target)
Limit on External Program Loans*	-	250 mln USD
Conversion of on-lent resources into market instruments	-	900 mln GEL
PIM-based investment loans*	-	100%
Program loans approved by the Fiscal Board of the Ministry of Finance	-	100%
Non-resident investors participation in the local market	11.3%	25%
Compliance with JP Morgan GBI-EM index inclusion requirements	18.6%	100%

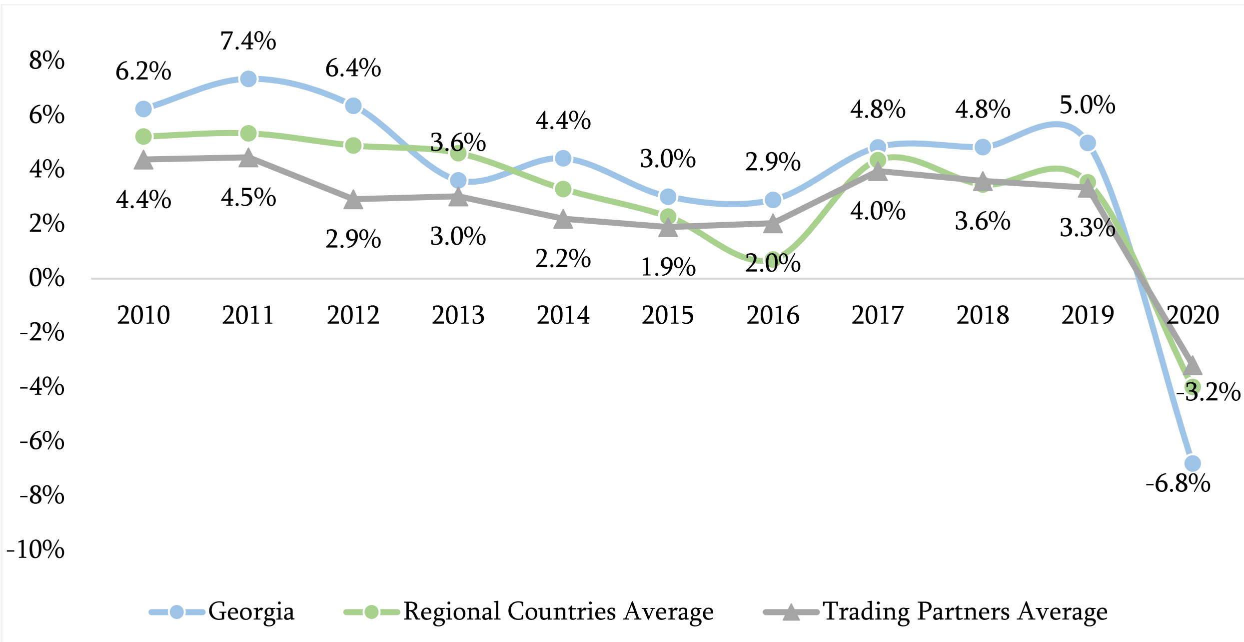
**-Indicators are based on the operations carried out within a year*

[13] These strategic directions assume that there will be no internal or external shocks during the strategy period, which will significantly change the macroeconomic environment and will not apply in the cases provided for in Article 2, Paragraph 7 of the Organic Law of Georgia on Economic Freedom.

3. Macroeconomic Outlook

In 2017-2019, economic growth in Georgia was more stable compared to the regional and other trading partner countries (the smallest standard deviation). At the same time, economic growth in Georgia was higher than the average economic growth of the regional and other trading partner countries. However, Covid-19 pandemic started from the end of 2019, has had significant negative impact on the macroeconomic indicators of Georgia and the world. There were shocks coming from both demand and supply sides. As a result, in 2020, the economic growth rate of Georgia was -6.8 percent.

Figure 3.1: *Real Economic growth of Georgia, regional and trading partner countries[14] for 2010-2020*

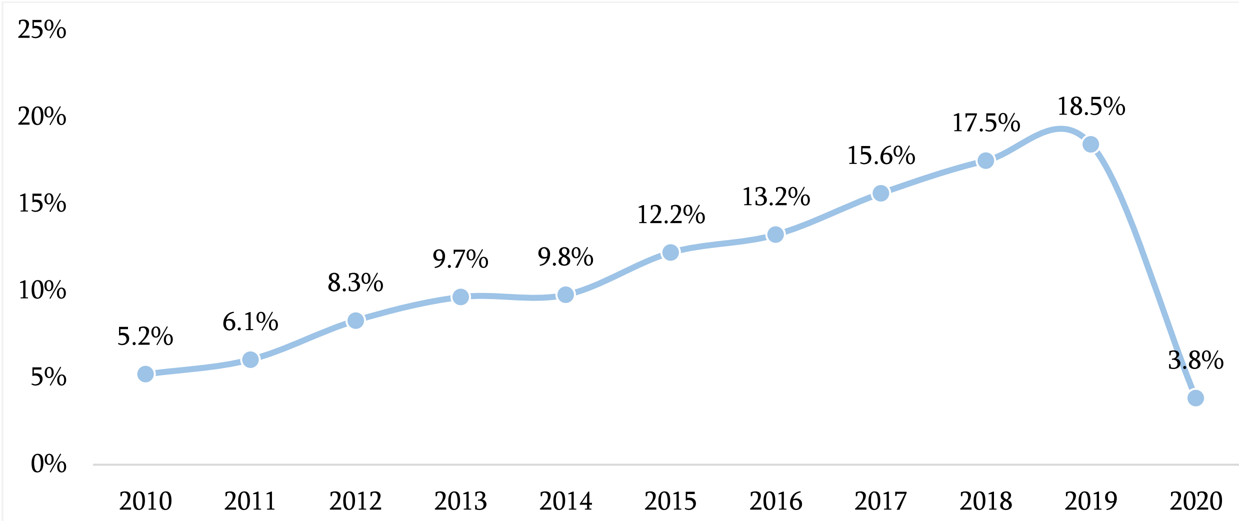


Source: *National Statistics Office of Georgia, International Monetary Fund*

Negative economic growth rate in 2020 was mainly due to the tourism and related sectors' vulnerabilities to external shocks. During the last decade tourism sector's contribution to Georgian economy was growing at a significantly high rate, but in 2020, due to the pandemic this sector reduced almost by 100 percent.

[14] Regional Countries: Azerbaijan, Turkey, Russia, Georgia, Armenia.
Trading Partners: : Azerbaijan, USA, Bulgaria, Eurozone, Turkey, Poland, Russia, Armenia, Ukraine, China.

Figure 3.2:*Tourism Revenues to GDP ratio for 2010-2020, Seasonally Adjusted*



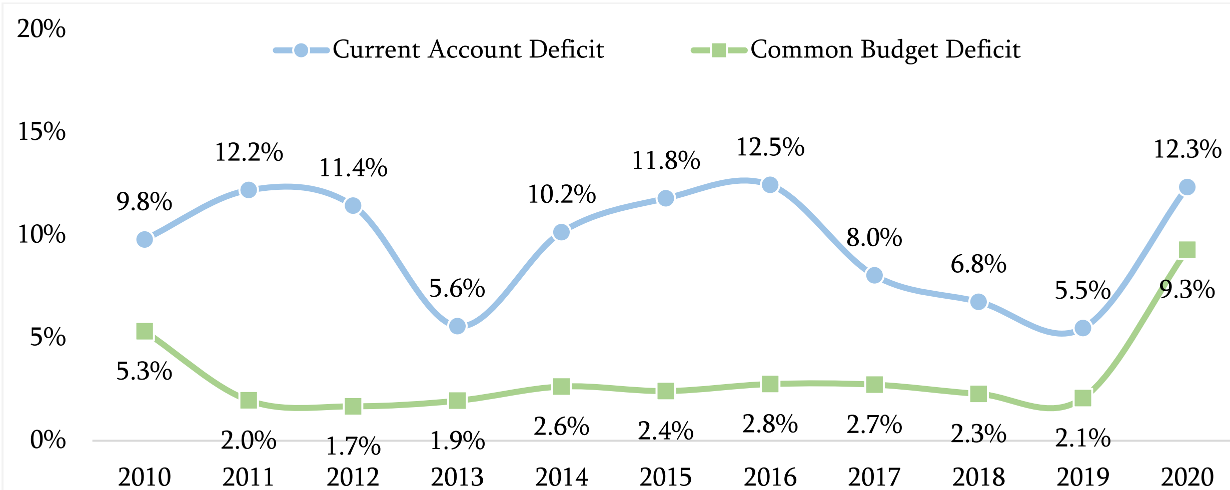
Source: *National Statistics Office of Georgia, National Bank of Georgia, Ministry of Finance of Georgia*

2017-2019 was special period regarding fiscal sustainability recovery. As the result of successfully implemented fiscal consolidation in this period, in 2019 deficit amounted to historically the lowest of 2.1 percent. Along with fiscal consolidation the government savings and capital expenditures were significantly increased. In 2019 capital expenditures amounted to 8.5 percent of GDP. In the same period current expenditures to GDP equaled to 21.4 percent. In response of covid-19 pandemic, Georgian government introduced 4-stage anti-crisis plan, aiding citizens and businesses. Caring for citizens includes: subsidies on utility bills, compensations for unemployed and self-employed people, assistance for social groups, assistance for children under 17, and subsidies on student's tuition fees. Regarding the assistance to businesses the following decisions were made by the government: rescheduling of income tax, exemption from property tax in tourism sector, subsidies on interest rates, assistance for construction and agricultural sectors, provision of GEL liquidity to the banks.

It should be noted that besides the above-mentioned measures that increased expenditure and decreased revenue from the taxes, budget revenue declined further due to reduced economic activity that finally increased budget deficit to 9.3 percent.

The pandemic has significantly deteriorated trade balance. Due to reduced export and import and deteriorated economic situation internally and externally, current account deficit turned to two-digit number for the first time after 2016 and amounted to 12.3 percent in 2020.

Figure 3.3:*Common budget deficit and current account deficit to GDP ratios for 2010-2020*



Source: *National Statistics Office of Georgia, National Bank of Georgia*

The pandemic on the one hand caused the reduction of tourism service export and on the other hand, due to reduced mobility, hindered supply channels of consumer products that led to inflation on the initial stage. The same tendency was in almost every country. From the second half of 2020 the demand reduction effect exceeded the supply reduction effect and, as a result, inflation rate started to decrease. Despite of this, according to the National Bank projection inflation rate in the short-term will be higher than the target and from 2022 it will start to decrease and through tight monetary policy will get closer to the target[15].

In 2017-2019, international credit rating agencies were noting the reduced vulnerabilities and implemented reforms which had a positive impact on country's sovereign credit ratings. In that period, the rating agency Fitch upgraded the country's credit rating from "BB-" stable to "BB" stable. The improvement of Georgia's credit rating was due to higher quality macroeconomic management compared to "BB" group countries, higher economic growth, and lower government debt level; the significant improvement of current account deficit and fiscal sustainability also contributed. In 2019, Standard & Poor's also upgraded country's sovereign rating to "BB" stable. According to S&P, improvement in credit rating resulted from a relatively high growth of Georgian economy despite the worsen external factors. In 2018-2020 Sovereign ratings of Georgia assessed by the credit rating agencies are presented in the following table.

[15] Monetary Policy Report, August, 2021

Table 3.1: Sovereign credit ratings of Georgia assessed by rating agencies y-o-y

Credit Rating Agencies	2018	2019	2020
Fitch	BB- Positive	BB Stable	BB Negative
Standard & Poor's	BB- Stable	BB Stable	BB Stable
Moody's	Ba2 Stable	Ba2 Stable	Ba2 Stable

Source: *Ministry of Finance of Georgia*

Target indicators of Government Debt Management Strategy for the medium and long term are based on the following fiscal and macroeconomic assumptions:

Table 3.2:*Projected data of macroeconomic indicators for 2021-2025*

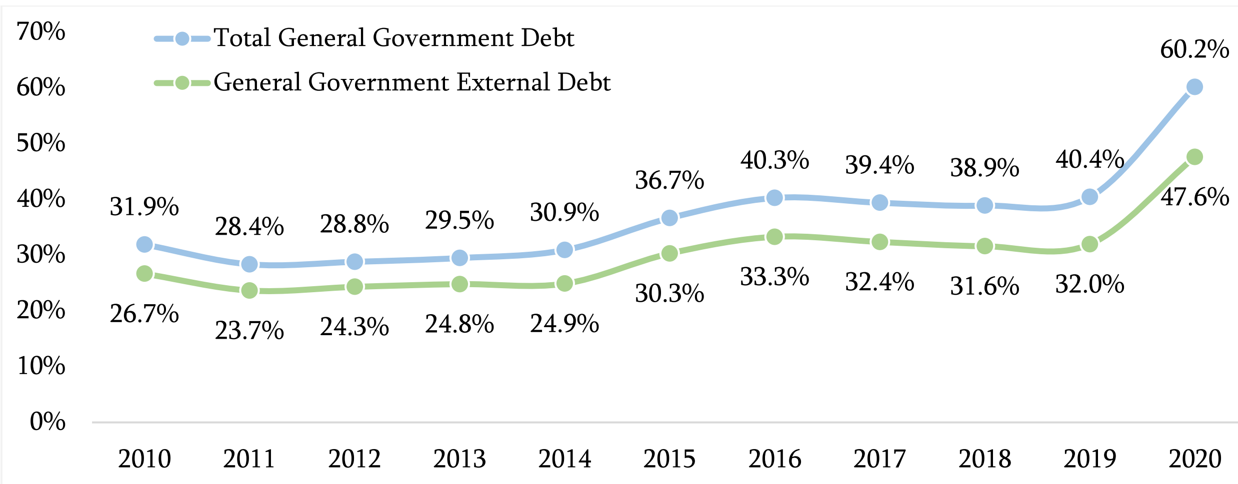
Indicators (mln GEL)	2021	2022	2023	2024	2025
Common Budget Revenues	14,928	17,205	18,228	19,732	21,266
Common Budget Expenses	14,688	14,753	15,768	16,887	18,071
Net growth of Non-Financial Assets	4,208	5,229	4,419	4,774	5,124
Net growth of Financial Assets	- 55	75	120	120	120
Modified Budget	-3,913	-2,852	-2,079	-2,049	-2,049
Gross Financing Needs	-8,272	-5,576	-4,609	-4,889	-5,585
Domestic	- 375	1,245	1,345	1,445	1,445
Borrowing	1,305	2,775	2,655	2,905	3,540
Redemption	-1,680	-1,530	-1,310	-1,460	-2,095
External	2,611	1,858	880	620	559
Borrowing	5,290	3,052	2,100	2,000	2,000
Redemption	-2,679	-1,194	-1,220	-1,380	-1,441
Change of the Balance of Deposits	-1,677	251	146	16	- 45
Balance of Deposits[16]	1,957	2,208	2,354	2,370	2,325
Government Gross Debt	29,905	33,123	35,348	37,413	39,417
Government Net Debt	27,949	30,916	32,995	35,044	37,093
Nominal GDP	58,529	64,832	70,450	76,337	82,716
Real GDP Growth	10.0%	6.0%	5.5%	5.2%	5.2%
Change in GDP Deflator	8.0%	4.5%	3.0%	3.0%	3.0%
Percent to GDP					
Modified Deficit	-6.7%	-4.4%	-3.0%	-2.7%	-2.5%
Gross Financing Needs	-14.1%	-8.6%	-6.5%	-6.4%	-6.8%
Balance of Deposits	3.3%	3.4%	3.3%	3.1%	2.8%
Government Gross Debt	51.1%	51.1%	50.2%	49.0%	47.7%
Government Net Debt	47.8%	47.7%	46.8%	45.9%	44.8%

[16] The balance for the forecast years is adjusted for the change in the balance on the consolidated budget deposits.

4. General Government Debt Portfolio Description

By the end of 2020, Georgia's general government debt amounted to 29,653[17] mln GEL, of which foreign currency denominated debt amounted to 23,467 mln GEL, and local currency denominated debt amounted to 6,186[18] mln GEL. To overcome the pandemic crisis, government debt increased more than planned throughout 2020, and as a result, by the end of 2020, general government debt to GDP ratio amounted to 60.2 percent, of which foreign currency denominated debt to GDP ratio constituted 47.6 percent.

Figure 4.1. *General Government Debt Dynamics (% of GDP)[19] for 2010-2020*



Source: *Ministry of Finance of Georgia*

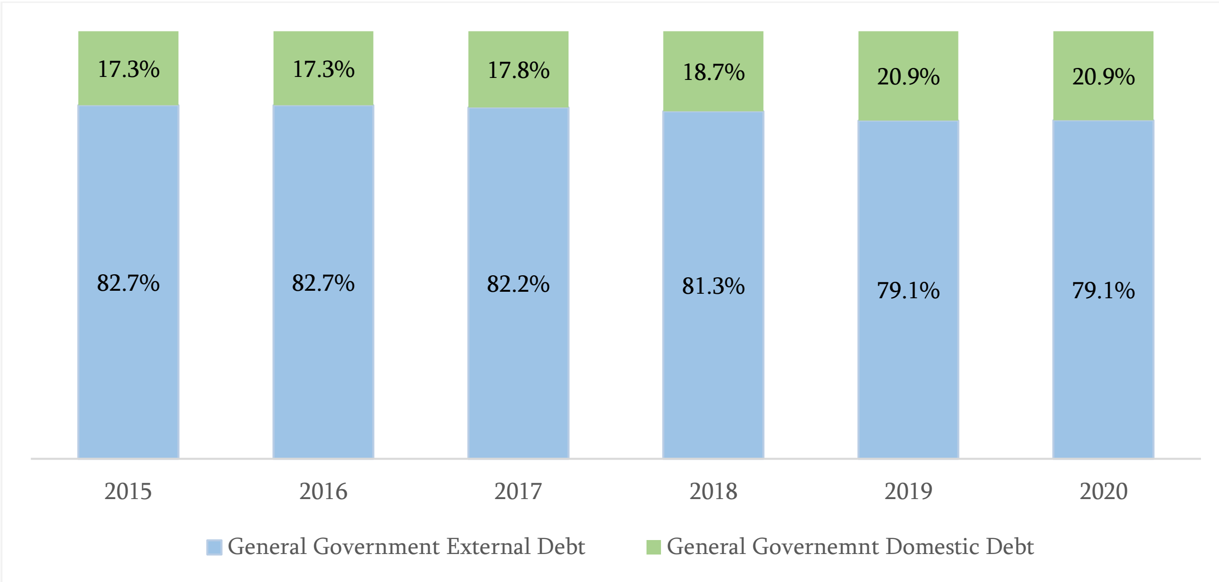
79.1% of general government debt portfolio is denominated in foreign currency. Although this indicator has historically been declining, it still remains quite high.

[17] The strategy document does not include the so called Domestic "Legacy Debt"; includes debt of budgetary organizations, except the debt taken from budgetary organizations.

[18] Includes debt of budgetary organizations, except the debt taken from budgetary organizations.

[19] The general government debt to GDP ratio, including the PPP liabilities, amounted to 61.0% by the end of 2020 (Amount of the PPP liabilities was 395.4 mln GEL by the end of 2020).

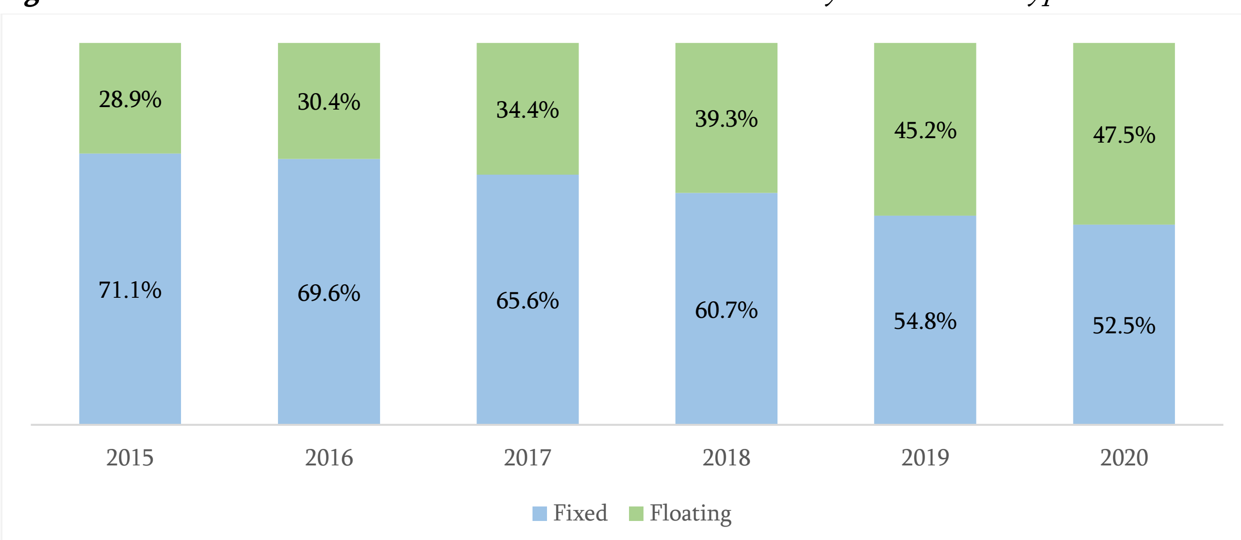
Figure 4.2.*General Government Debt Portfolio Structure for 2015-2020*



Source*: Ministry of Finance of Georgia*

A significant portion (62%) of the general government debt portfolio is debt with a fixed interest rate. This indicator for the external debt portfolio amounted to 52.5% by the end of 2020.

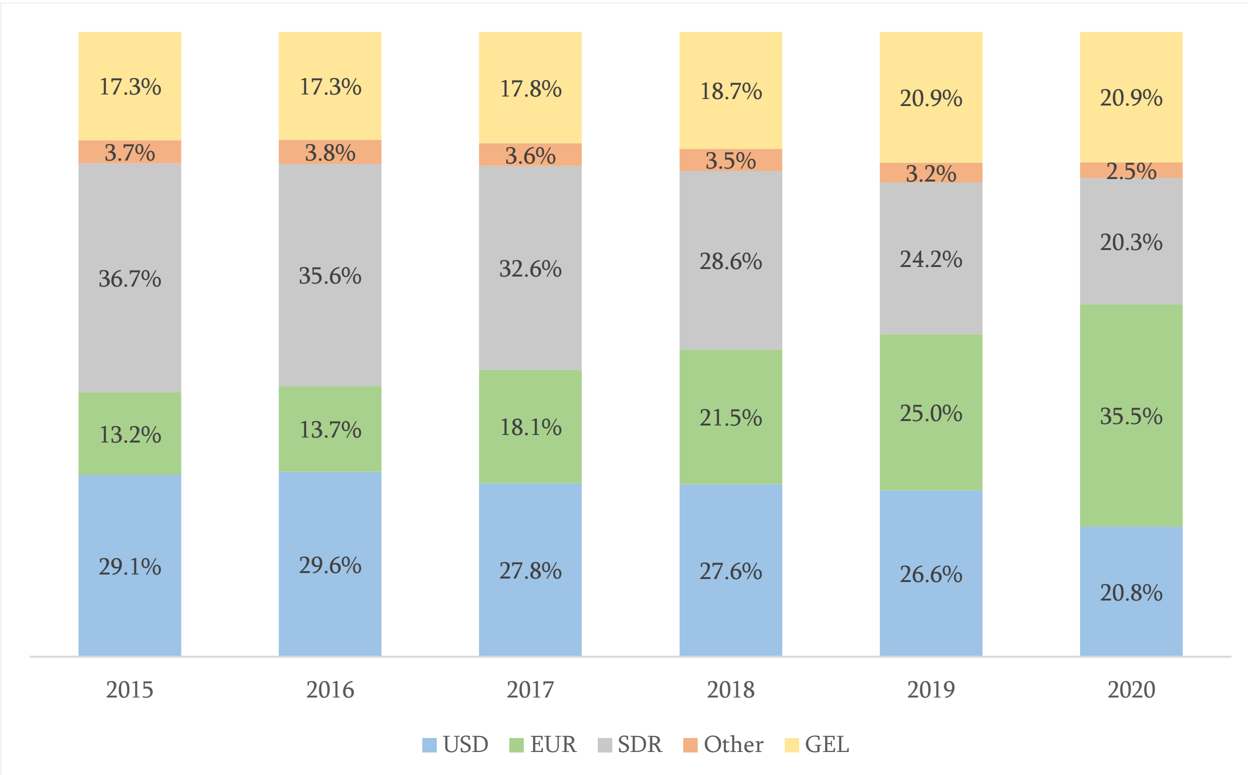
Figure 4.3.*General Government External Debt Portfolio Structure by Interest Rate Type for 2015-2020*



Source*: Ministry of Finance of Georgia*

By the end of 2020, 20.8% of the general government debt portfolio was denominated in USD. It is notable, that recently the share of the USD denominated debt has been declining due to the increase in the shares of debt denominated in Euro (35.5%) and local currency (20.9%). 20.3% of the general government debt is denominated in SDR. Recently, similar to the share in USD, debt denominated in SDR has been declining, mainly due to the limited access to loans denominated in this particular currency. 2.5% of the portfolio is denominated in other currencies[20].

Figure 4.4. *Currency Composition of the General Government Debt Portfolio for 2015-2020*

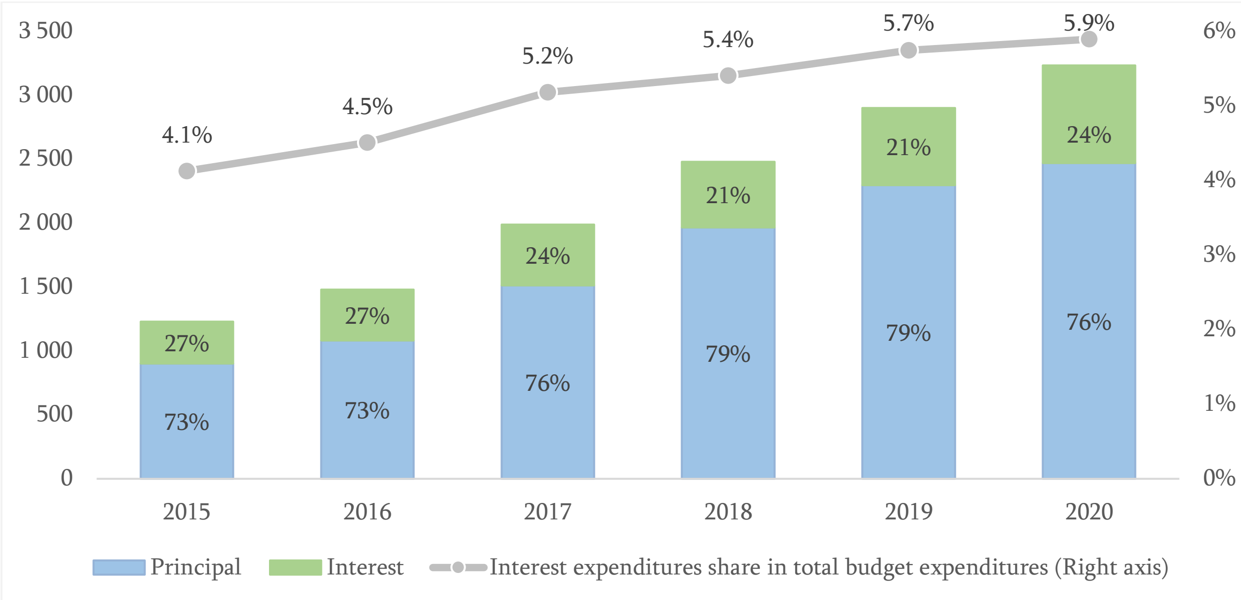


Source: *Ministry of Finance of Georgia*

Debt portfolio service schedule based on stock is taken into account when taking new loans. The loans comprising the debt portfolio usually have long-term repayment schedule and long concessional period, which ensures the equal distribution of debt service, and therefore, does not impose the significant pressure on budgetary expenditures, neither the expenses are concentrated on short-term time horizons. The interest rate expenditures of the general government debt portfolio amounted to 5.9% of the total budget expenditures by the end of 2020.

[20] Includes: Japanese Yen (JPY), Chinese Yuan (CNY), Kuwaiti Dinar (KWD).

Figure 4.5. *General Government Debt Service for 2015-2020 (mln GEL)*



Source*: Ministry of Finance of Georgia, National Statistics Office of Georgia*

In 2020, the weighted average interest rate on the general government domestic debt portfolio increased compared to the previous year's value and amounted to 8.65%; while the weighted average interest rate on the general government external debt decreased to 0.91%[21], mostly due to the concessional conditions on external loans. The weighted average interest rate on the new loans, attracted throughout the last year from the donor organizations, amounted to 0.88%.

[21] Does not include the Eurobond.

Table 4.1. Weighted Average Interest Rates on the General Government Domestic and External Debt Portfolios

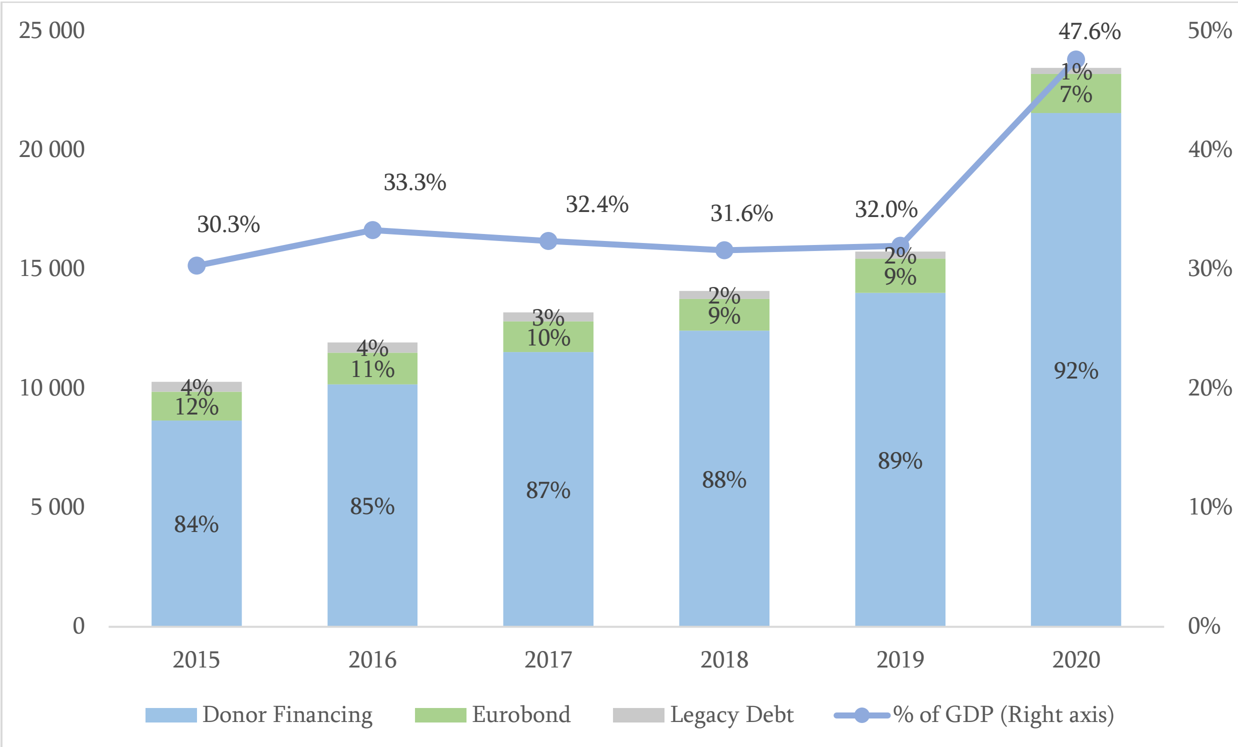
	Weighted Average Interest Rate of the Portfolio		Weighted Average Interest Rate of Last Year	
	2019	2020	2019	2020
Domestic Debt	**8.21%**	**8.59%**	**7.62%**	**8.73%**
6m T-Bills	8.18%	8.16%	7.72%	8.66%
12m T-Bills	7.42%	8.57%	7.42%	8.57%
2y T-Bonds	7.47%	8.17%	7.53%	8.70%
5y T-Bonds	8.42%	8.34%	8.02%	8.76%
10y T-Bonds	9.97%	9.62%	9.06%	9.38%
Government Bonds	8.50%	8.60%	7.38%	9.03%
External Debt (excludes the Eurobond)	**1.49%**	**0.91%**	**0.67%**	**0.75%**
Donor Financing	1.44%	0.88%	0.67%	0.75%
Legacy Debt	3.59%	3.57%	-	-
Eurobond	**6.88%**	**6.88%**	-	-

***Source**: Ministry of Finance of Georgia*

By the end of 2020, 91.9% of the general government external debt is composed of the funds attracted from the bilateral and multilateral creditors. A large portion of this loan portfolio has concessional conditions. The Eurobond takes the 7.0% share in the external debt portfolio, while the rest is the share of the "Legacy Debt"[22], whose significant portion is due to be repaid in 2021, and will be fully covered in 2025.

[22] Existing and other restructured loans to the former republics of the USSR.

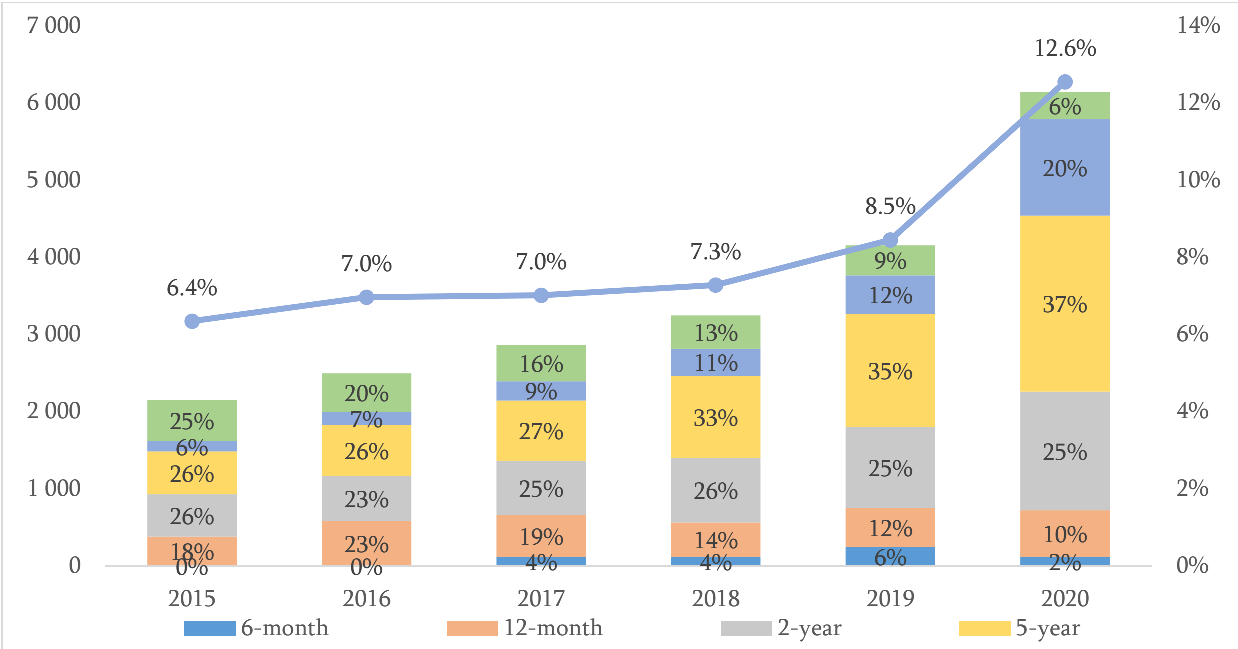
Figure 4.6. General Government External Debt Structure for 2015-2020 (mln GEL)



***Source:** Ministry of Finance of Georgia*

The general government domestic debt has been increasing in recent years. By the end of 2020, domestic debt to GDP ratio amounted to 12.6%. Huge portion of domestic debt constitutes of treasury bonds: 2-year, 5-year and 10-year treasury securities issued on behalf of the government. By the end of 2020, volume of on-the-run treasury bonds amounted to 81.9% of the domestic debt. Treasury bills, comprising of 6-month and 12-month treasury securities, amounted to 11.7% of the domestic debt. 5.7% of the domestic debt is government bonds – liabilities to National Bank of Georgia, while 0.7% represents the debt of the budgetary organizations.

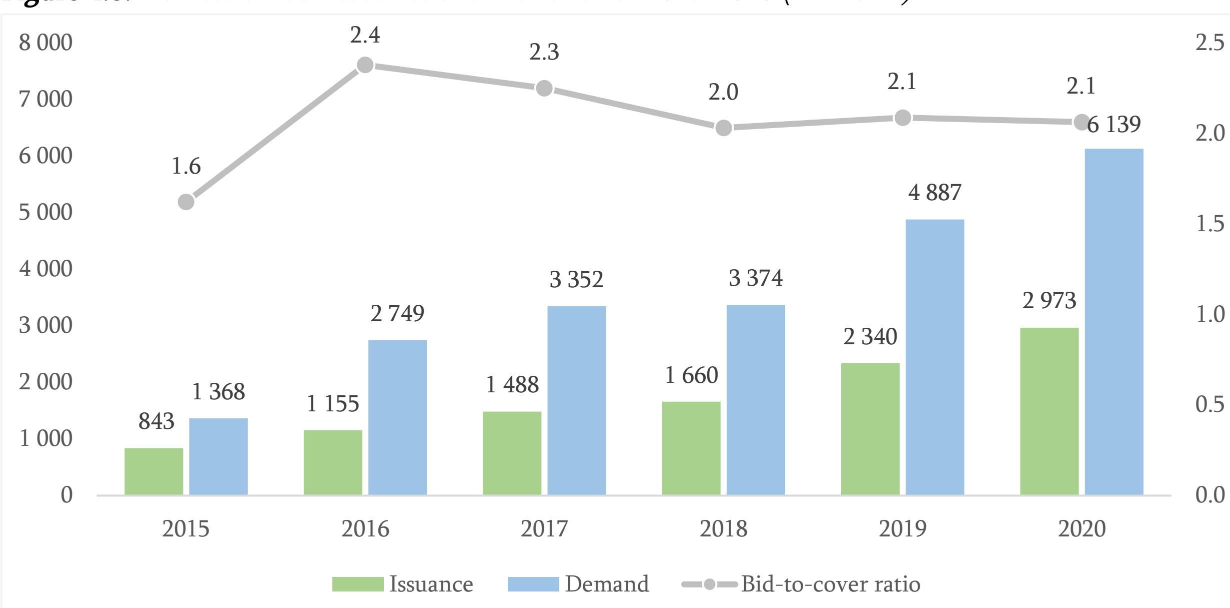
Figure 4.7. *General Government Domestic Debt Portfolio Structure for 2015-2020*



Source: *Ministry of Finance of Georgia, National Statistics Office of Georgia*

Despite the increasing issuance of government securities, demand significantly exceeds issue sizes. Bid-to-cover ratio amounted to 2.1 for 2020.

Figure 4.8. *Domestic Debt Issuance and Demand for 2015-2020 (mln GEL)*



Source: *Ministry of Finance of Georgia*

Annex

The following key actions have been taken to achieve the objectives defined under General Government Debt Management Strategy 2019-2021:

- **Promoting the liquidity of government securities by the gradual increase of benchmark bonds.** Government of Georgia started issuing the benchmark bonds from 2018, and the benchmark sizes increased in 2019. Benchmark bond is one of the crucial instruments for increasing investor interest towards Georgia's government securities and for developing the government securities' market.
- **Introduction of Buy-back operations.** In order to efficiently manage the refinancing risk, new liability management instrument – Buy-back operations – have been introduced from 2019.
- **Introduction of Primary Dealers' Pilot Program.** In 2019, working group for the program was established, and under the scope of the working group the memorandum of understanding and the appropriate legal framework were developed. As a result, Primary Dealers' Pilot Program was launched in November 2020.
- **Increase of the share of the Euro denominated external loans in the external debt portfolio.** Throughout the recent years, when taking the new external loans, Euro denominated options have been prioritized, since they are characterized by lower costs.

Table 1. *Strategic Targets of Risk Indicators of General Government Debt Management Strategy for 2019-2021 and Figures of 2020*

Types of Risk	Indicators	2019	2020	2021 Target Thresholds
Refinancing Risk	Debt maturing within 1 year (% of total) for total government debt	11.3%	14.8%	Max. 20.0%
	ATM for total government debt	7.2	7.5	Min. 5.5
Interest Rate Risk	Share of fixed debt in total government debt	54.8%	52.5%	Min. 40.0%
	ATR for total government debt	3.1	3.7	Min. 2.0
	Debt re-fixing in 1 year (% of total)	46.1%	51.5%	Max. 70.0%
Exchange Rate Risk	Share of government domestic debt into total government debt	20.9%	20.9%	Min. 20.0%

Source: *Ministry of Finance of Georgia*