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Taking Stock of Georgia's Larization Policy Since 2016: What Worked, What Didn't, and What Needs to Change

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INTRODUCTION

In the past several months the world has been rocked by profound economic and social turbulence. The COVID-19 epidemic has forced many countries around the world into widespread emergency lockdowns. Economic activity plunged dramatically in February-March 2020, with rapid indicators showing strong contractions in retail, restaurant business, and passenger transport. The scale of the imminent economic fallout is not yet known, but early expert opinions suggest that the economic shock may be even more dramatic than during the 2008 global financial crisis. Under these circumstances, it seems impossible to think of any kind of economic policies except those related to the epidemic and the means of combatting its fallout. Yet, some policies, particularly those that have long-term economic consequences for the country, deserve our attention even in these turbulent times. Among them are the larization policy measures initiated by the National Bank of Georgia in June 2016.

One of the reasons for paying attention to the larization policyis that it has a direct bearing on the health of the financial system, the sustainability of the private sector, and the stability of key economic variables such as inflation, interest rates, exchange rates,and growth. In this policy note we examine the larization policy in Georgia in the context of international experience with de-dollarization. We discuss how the larization measures have impacted the economy so far, which market distortions may have been corrected, and which may have been created inadvertently**.** Finally, we suggest the direction of policy actions that may be taken in the future.

TAKING STOCK OF INTERNATIONAL EXPERIENCE

It is a truth universally acknowledged that persistent high levels of financial dollarization can inflict considerable economic damage. Among the unpleasant consequences highlighted in the economic literature are: creating foreign currency risks for unhedged borrowers; reducing the efficiency of monetary policy since the central bank can only influence national currency interest rates; creating liquidity risks, since the central bank cannot act as a lender of last resort of foreign currency; limited ability of the central bank to collect "seigniorage revenues" from lending in domestic currency; and finally, with high dollarization, the exchange rate cannot act as an absorber of external shocks. Given these risks, many countries seek to reduce or revert dollarization.

Potential de-dollarization measures

There is, however, a consensus in the economic literature that financial dollarization is difficult to revert, and the de-dollarization process needs three main ingredients: time, consistent stabilization efforts, and policy-maker credibility[1].

Drawing on international experience, one can distinguish three broad groups of policy activities that can lead to de-dollarization:

a) ***Macroeconomic Stabilization***–these activities require considerable time and consistency from policy makers. The literature suggests that achieving macroeconomic stability is a necessary, but (on many occasions) not a sufficient condition to reach sustainable de-dollarization. Macroeconomic stabilization involves:
   - ***achievingfiscal consolidation***by cutting the fiscal deficit. This reduces the government's need to borrow in foreign currency;
   - ***reducing inflation***under an inflation-targeting regime to build confidence in the national currency and reduce the volatility of local currency interest rates;
   - ***maintaining atwo-sided flexible exchange rate***to avoid speculation on the exchange rate, reduce pass-through from exchange rate to inflation, and overcome the "fear of floating"[2];

[1] *Alvarez-Plata and Garcia-Herrero, 2007; Kokenyne, Ley, and Veyrune, 2010; Catao and Terrones, 2016; Ergun, Gouveia, and Ortiz, 2017; Sophromadze, 2019*

- ***strengthening the macroeconomic environment***addressing macroeconomic imbalances, especially external ones (e.g. a persistent current account deficit, growing negative net foreign asset position, etc.);
- ***improving the credibility of the central bank*** (having independent monetary policy). This helps control inflationary expectations and builds confidence in the local currency.

b) **Market-Driven Activities and Prudential Measures**– these activities also take time and effort to establish. Moreover, they need to be used with caution in order to minimize potential market distortions. These measures include:

- ***deepening the capital market*** i.e. supporting the issuance of local currency and/or inflation-indexed securities. This contributes to the de-dollarization process bycreating long-term debt instruments in national currency, improving the local currency liquidity management process. If capital markets are underdeveloped (as is still the case in Georgia) there will be few opportunities for domestic firms to borrow long-term in national currency. This will necessitate foreign currency borrowing. Moreover, the existing domestic debt instruments will not be liquid enough, which would further incentivize dollarization.
- ***developing hedging instruments***includingforward exchange contracts for currencies, derivative products;
- ***introducingasymmetric reserve requirements*** (higher minimum reserve requirements for foreign currency than for domestic currency), which makes foreign currency lending relatively more expensive. This and similar measures need to be used with caution, as we will discuss later on in the text.
- ***limiting open foreign currency positions***to reduce possible risks resulting from foreign exchange transactions, in the case of possible exchange rate movements;
- ***demanding higher liquidity requirements on foreign currency deposits***;
- ***raising capital requirements on foreign currency loans***;
- ***introducing strict credit coefficients on foreign currency loans.***The latter three prudential measures aim to internalize the negative externality for commercial banks of giving foreign currency loans to unhedged borrowers*;*
- ***announcing deposit insurance only on domestic currency deposits***, which makes domestic currency deposits more attractive for risk-averse retail bank clients.

c) **Administrative Forces (Forced De-dollarization)** – These are “quick fix” measures designed to achieve some of the de-dollarization goals in the shortest possible time. Among them:

- ***Forcible conversion of foreign currency deposits to local currency***;
- ***Mandatory conversion of foreign currency loans to local currency***;
- ***Limiting (banning in extreme cases) foreign currency deposits***;
- ***Limiting (or even banning) foreign currency lending***.

The forced de-dollarization measures are, however, mostly supplementary tools in the wider de-dollarization plan. One would be hard pressed to find empirical evidence of the effectiveness of these measures. On the contrary, according to the empirical literature, these measures (especially mandatory conversion of deposits) fail to achieve a de-dollarization plan and even create problems of financial disintermediation and macroeconomic instability.

Many try but few succeed

The causes and consequences of financial dollarization have beenstudied widely in both the theoretical and the empirical literature. In general, while many countries try to de-dollarize their economies, **only a few of them have managed to succeed in this effort**.*Mecagni et al. (2015)* studied 42 cases of initially dollarized countries[3] (including Georgia) between 2002 and 2012. Out of these, only 11 countries managed to successfully de-dollarize, while the other 31 countries failed to meetthe criteria for

[2] Calvo and Reinhart (2002) introduced the notion of “fear of floating”, which refers to situations where a country prefers a fixed exchange rate to a floating one (at least de facto, if not de jure).
[3]The authors covered 194 countries.

success. The authors have identified several key factors that distinguished the successful cases of de-dollarization from the unsuccessful ones.

One of the first lessons is: sound macroeconomic policies matter. While on the de-dollarization path, successful countries managed to reach higher real GDP growth (on average 2.5 ppts higher), improve the current account balance (on average, from a deficit of 5.0% to a surplus of 0.3%[4]), and reduce fiscal balance (on average, from a deficit of 2.8% to a small surplus of 1.4%), while unsuccessful countries have not made significant progress in these areas. In addition, the successful countries have had a prolonged appreciation of their national currencies during the de-dollarization period. There is, however, not much evidence that these variables caused the success in de-dollarization. It is more likely that sound macroeconomic policies influence both de-dollarization and also result in higher economic growth, improved current account position and lowerbudget deficit.

The second important lesson: initial conditions matter. Successful countries usually started out with a higher average initial level of dollarization (67.4% for successful and 48.4% for unsuccessful countries). The higher the initial dollarization, the more likely that a country will achieve the de-dollarization target. Similarly, successful countries had higher initial inflation rates and managed to reduce inflation considerably during the process of de-dollarization. This may be due to the fact that the de-dollarization process requires **significant patience and commitment on the part of the authorities**, and countries with higher dollarization and higher inflation levels may have been more committed to achieving results.

Yet, as the body of research on de-dollarization makes clear, there is no universal recipe for a successful de-dollarization policy. Some conclusions, however, can be drawn on the basis of country case studies. For example, the cases of **Israel and Poland**tell a story of successful de-dollarization coupled with prudential regulations. Both countries started reducing dollarization by achieving macroeconomic stability.

Poland

Poland's dollarization problem in the 1980s was nearly as severe as Georgia's. Deposit dollarization was about 80%. By 1993, Poland's dollarization level reached 35%, and 4.5% by 1999. Improved macroeconomic stability seems to be one of the most important components in the country's fight against dollarization. Poland managed to strengthen its macroeconomic environment, stabilize the inflation rate, deepen the local bond market (e.g. in 1991, the Polish government started to issue local currency treasury bills, which were considered an alternative form of savings, reducing demand for foreign currency deposits. T-bills were seen as a safe investment). The supervision of foreign currency loans was strengthened.Poland also used some administrative measures on the deposit side (requiring special permission for depositing money in foreign currency, which made foreign currency deposits less convenient/attractive). The efficacy of this regulation wasquestioned, however, and it lasted only 3 years before being abolished in 1999.

Israel

Israel started out with 39% dollar-denominated deposits in 1984, and reached 17% in 2002.

From 1985 through the 1990s, Israel cut its fiscal deficit from 19% of GDP to 10%; reduced inflation under an inflation-targeting regime; gradually increased exchange rate flexibility; and managed to restore confidence in the national currency. On the prudential side, the country introduced higher remuneration of reserve requirements in foreign currency and introduced stronger requirements for collateral on foreign currency loans to borrowers with income in domestic currency. Furthermore, Israel developed hedging instruments, managed to deepen the local bonds market (issuing bonds indexed to inflation), and started to finance government debt in local currency. In addition, the country employed some administrative measures. For example, they banned short-term (less than 1 year) dollar deposits and prohibited local transactions in foreign currency (notably, however, these administrative measures were not the main drivers of the de-dollarization process, according to studies).

[4]The current account deficit has even deepened for unsuccessful countries.

Among the unsuccessful cases one may single out the experience of **Bolivia and Peru in the 1980s**. These countries attempted to de-dollarize by following strict administrative measures,

among them: mandatory conversion of foreign currency deposits into domestic currency; and imposing capital controls, price controls, and interest rate caps (in Bolivia's case). These strict administrative measures led to financial disintermediation, capital flight, and macroeconomic instability in both countries. Ultimately these measures had to be abandoned.

The international experience with de-dollarizationoffers**valuable lessons for Georgia on its own path**. These lessons are summarized here and will be discussed in more detail in Part 2 of this policy note.

- Administrative measures such as prohibiting or restricting deposits in USD, or imposing capital controls generally do not work. Luckily, Georgia did not embrace capital controls and does not regulate USD deposits. However, the country does have a blanket restriction on lending to individuals in foreign currency. At first the cap was 100,000 GEL, later raised further to 200,000 GEL. The potential consequences of such restrictions, pros and cons, are discussed in more detail in the next sections.
- Macroeconomic stability is the crucial factor, but it does not guarantee successful de-dollarization. Thus, even achieving stable growth, low inflation, and a low budget deficit, which was a case in Israel and Poland, and as Georgia has done in the past, may not automatically solve the dollarization problem.
- De-dollarization takes a long time and may sometimes be derailed by external events. Thus, consistency, patience, and commitment are key to success in this process.
- A well-functioning domestic capital market is an important component in successful de-dollarization. This process takes time and patience as well. Georgia's newly established pension fund may help contribute to the creation of a viable domestic capital market. Now, however, there is no clear mechanism howthe pension fund will contribute to capital market development.
- Two-way exchange rate flexibility is important (i.e. the national currency sometimes depreciates, and sometimes appreciates, making returns on savings in foreign currency more risky). Trust in the national currency is the key, and if the public perceives that the domestic currency is much more likely to depreciate than appreciate, then deposit dollarization will live on.
- Finally, the adopted de-dollarization policies, should be market-sensitive, i.e. there should not be a large gap between the regulations and the market-driven incentives. Otherwise, there is a risk of derailing the de-dollarization process and pushing it into the shadows.

Early larization efforts in Georgia

Georgia started out with a very high initial dollarization level—over 80% in 2009. The National Bank of Georgia (NBG) embarked on the road to larization with a high level of commitment, following a meticulous 'by the book' approach. The priority was to achieve macroeconomic stability and establish a proper liquidity management system. Thus, the NBG introduced an inflation targeting regime in 2009. In addition, NBG improved the liquidity management system by introducing one-week refinance loans in 2008, and refinancing loan standing facility and overnight loans in 2010. These measures reduced the volatility of interest rates and made the national currency more attractive.

Price levels and general macroeconomic indicators have indeed stabilized. If the annual inflation rate from 2004-2008 was 8.5%, the same measure from 2009 until February of 2020 averaged just 3.6%[5]. Yet, despite a steady decline in both deposit and loan real dollarization rates (for deposits from 80% in 2009 to 71% in 2014 and from 84% to 71% for loans during the same period), the progress towards financial dollarization was slow. For example, during tranquil times deposit dollarization showed a declining trend, but the gains were reversed in times of crisis (in particular during the global financial crisis of 2008 and the regional economic crisis of 2014-16). Loan dollarization rates for both businesses and households

[5]The annual inflation rate exceeded the targeted level in only a few cases. Inflation was significantly higher than the targeted value in 2011, 2017, and 2019. While Georgia experienced deflation in 2012-13.

were also on the decline between 2009-2014, but still hovered above 60%. This could be explained by the fact that lending rates in domestic currency and the interest rate spread between domestic and foreign currency loans were very high and increasing (the gap was on average 6 percentage points between January 2009 and November 2014 and reached 7.8 percentage points by the time the Georgian lari started depreciating rapidly at the end of 2014). In the same time, the Georgian lari did not suffer from a major depreciation episode until 2014. The combination of these factors created incentives for Georgians to borrow in foreign currency.

Regional currency crisis and the "second wave" of larization

The regional currency crisis of 2014-2016 affected nearly all of Georgia's trading partners and caused a significant lari depreciation, the largest since 2009. For many households who had loans in foreign currency this was a major shock. These events prompted NBG to step up de-dollarization efforts, including introducing administrative measures. The following measures were adopted:

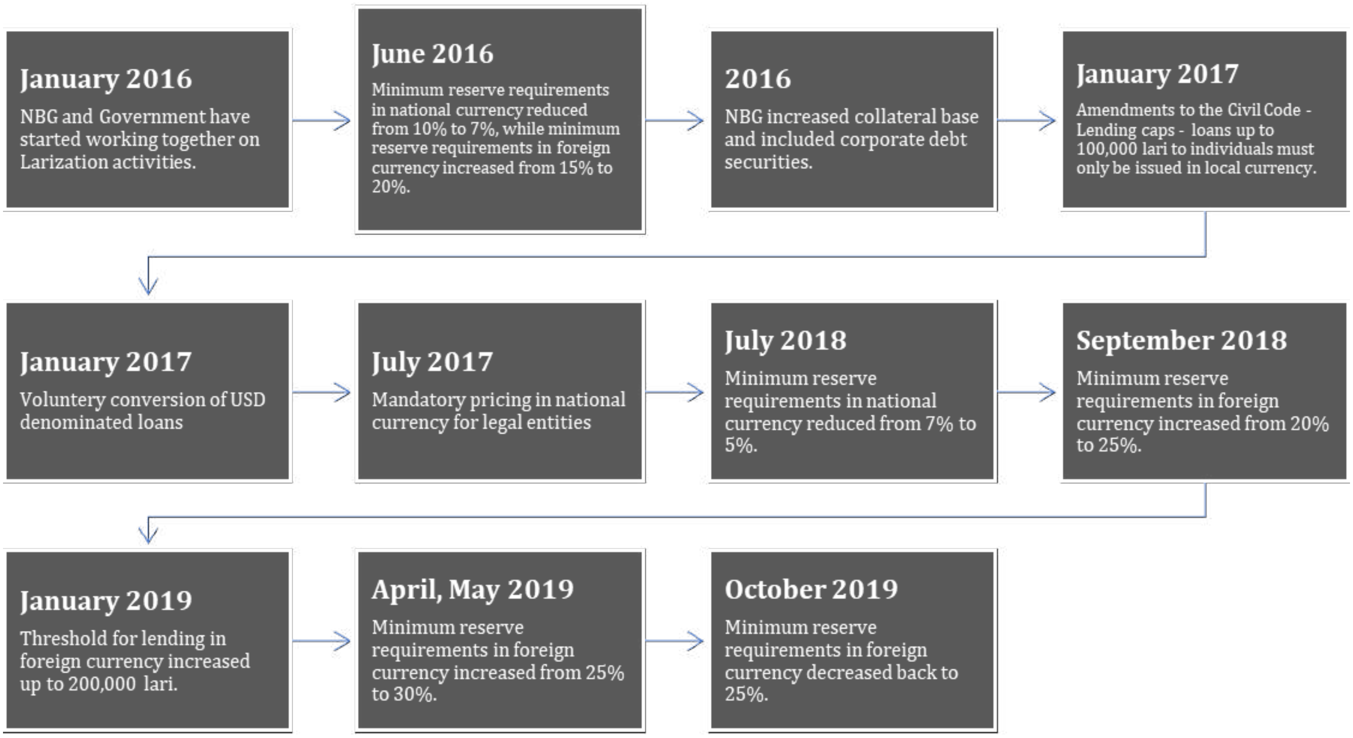
- In June of 2016, NBG **lowered minimum reserve requirements (MRRs)**on national currency from 10% to 7%, and at the same time **increased MRRs on foreign currency**from 15% to 20%. The main goal of this policy was to make the acquisition of foreign currency resources more expensive for banks, which was expected to lead to a relative increase of interest rates on foreign currency loans, further stimulating the de-dollarization process. Since then, NBG further reduced MRRs on national currency from 7% to 5% in 2018, and increased MRRs on foreign currency twice from 20% to 30% in 2018-19. The asymmetry between foreign currency and national currency MRRs reached its peak in the middle of 2019.

In addition, NBG together with the Georgian government introduced a few other administrative de-dollarization measures:

- **A voluntary conversion** of USD bank loans into lari (with government subsidy);
- **A lending cap,** i.e. banning the issue of loans in foreign currency below a certain threshold (at first the lending cap threshold was 100,000 lari, but it increased to 200,000 lari in 2019) for the majority of lending institutions from the 1st of January, 2017. This regulation affected household loans, but not legal entities.
- A regulation **obliging legal entities to price any goods and services in a national currency**was introduced in July of 2017. This regulation was mainly focused on real estate markets, which were highly dollarized.

How effective were the larization/de-dollarization measures?

Figure 1: Timeline of the De-dollarization Program



Between January 2017 and September 2019, when most of the larization program measures took place, Georgia's dollarization index went down, with both deposit and loan dollarization decreasing from around 70% to 60% (more precisely: 72% to 64% for deposit dollarization and 65% to 55% for loan dollarization). Both households and businesses saw a decline in deposit and loan dollarization rates (the decline was especially notable for businesses, since legal entities were not directly affected by the new lending caps).

Real loan dollarization of businesses declined from 82% to 70% between June 2016 and December 2019. Deposit dollarization for businesses declined from 79% to 75% during the same period. Deposit dollarization rates for households went down as well, although by much less, from 82% to 75% in the corresponding period[6], and the overall dollarization gap (the difference between deposit and loan dollarization rates) increased from 1.5% to 8.6% during the same period.

Part of the story behind the steady, albeit slow de-dollarization process during this period was the country's improved macroeconomic conditions: annual inflation was stable and close to the target value (the relatively higher inflation rate in 2017 was a result of a one-time increase of excise tax on tobacco and oil), and annual real GDP growth went up to an average of 4.9% during the 2016-19 period. Long-term interest rates have also started to decline in the reference years. However, the USD to GEL exchange rate was relatively volatile during this period. Notably, NBG actively pursued other policy measures, like improved strategic communication with economic agents, sharing and explaining the results of the monetary policy committee meetings, as well as proactive communication with the general public.

The systemic weaknessesthreatening this good progress at the time were:

- Underdeveloped domestic capital markets in the country left domestic businesses very sensitive to exchange rate swings, as they would still rely on borrowing in foreign currency or on FDI.

[6]Loan dollarization rates for households predictably went down by much more due to the lending cap: from 57 to 47 percent between June 2017 and December 2018; then, after the tightening of the lending cap, loan dollarization decreased further to 41.5 percent in December 2019.

- The declining, but still high, deposit dollarization generated additional pressure on exchange rates (as discussed in the section below).

The economic effects and side-effects of the larization policy

The combination of**improved macroeconomic conditions in the country, NBG's policy-measures and effectivecommunication strategies** helped drive the larization process in the right direction from 2017 to 2019. To some degree, even the administrative measures contributed to removing certain distortions on the lending market, namely shifting the currency mismatch risk from small-time borrowers (who were ill-equipped to recognize and handle such risks) to financial institutions (arguably more prepared to handle the risk of currency mismatch).

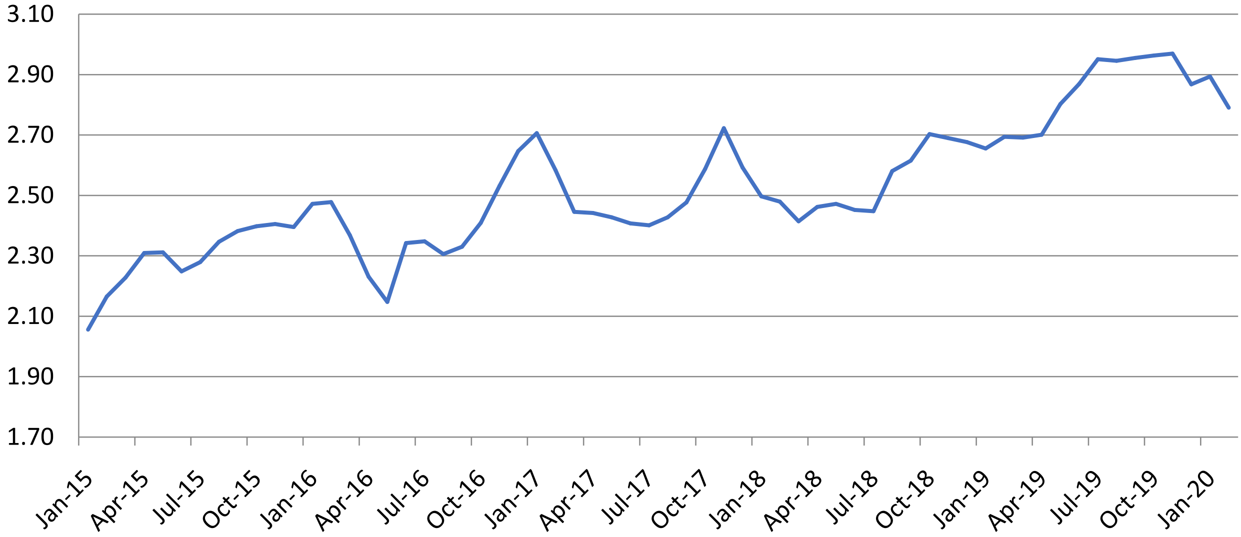
Despite all the positive measures from NBG, progress was relatively slow, and it was evident that financial de-dollarization would take considerably more time than one could hope for. Moreover, **certain aspects of the de-dollarization process created a number of side-effects**which need to be considered more closely.

Challenges in the liquidity management system. Theasymmetric minimum reserve requirements in national and foreign currencies and banning foreign currency lending up to 100,000 lari (and then to 200,000 lari) made the liquidity management process more difficult due to the gap between loan and deposit dollarization. On the one hand, the commercial banks had relatively more abundant foreign currency resources (due to high deposit dollarization), but now faced an additional need for national currency to issue new loans.

This, in turn, put additional pressure on the foreign exchange rate. The combination of the above-mentioned asymmetry in minimum reserve requirements, limited lending in foreign currency, and stricter prudential regulation for foreign currency loans can certainly create an additional pressure on the exchange rate. In order for the exchange rate not to be affected, the *decreased supply of the foreign currency resulting from these measures should be matched by declining demand for the foreign currency*, in particular due to the deposit de-dollarization process. In general, the slower the switching process and the larger the asymmetry in loan and deposit dollarization rates, the higher the pressure on the domestic currency.

In the case of Georgia, the gap between deposit and loan dollarization increased during the reference period. This could have generated further pressure on the exchange rate.

Figure 2: USD/GEL Exchange Rate



Source: National Bank of Georgia

The Georgian lari depreciated several times during the 2017-19 period. The last round of notable depreciation during the reference period started in May 2019 and affected the inflation rate through the end of the year.

One may notice that this round of depreciation started before the June 2019 events which further strained relations with Russia (and included the banning of direct flights from Russia to Georgia). There may have been various factors affecting exchange rate depreciation during that time. Yet, one may observe that the economic fundamentals were generally favorable for the lari exchange rate just before June 2019[7]. Nevertheless, the very fact that depreciation translated into domestic price inflation around this time raised questions on NBG's policy among businesses, especially those who rely on FDI inflows, as well as among ordinary households who depend on price stability.

De-dollarization policy and the evolution of interest rates

According to the literature, the de-dollarization measures mentioned above tend to increase the spread between domestic and foreign currency deposit rates by increasing domestic and reducing foreign currency deposit rates. This, in turn, incentivizes the switch from foreign to national currency deposits. At the same time, the spread on lending interest rates in national and foreign currency should be getting smaller as a result of de-dollarization measures, making national currency loans more affordable and foreign currency loans more expensive.

In the case of Georgia, **the spread between deposit rates in national and foreign currencies notably increased and then remained relatively stable until the end of 2019.** Annual weighted average interest rates in national currency deposits increased dramatically by the end of 2015 before starting to decline in line with foreign currency interest rates.

However, contrary to what was expected, **the spread between national and foreign currency loan rates did not decline. The spread increased in the beginning of 2016 and then remained unchanged.** At the end of 2019, national currency loan rates started to climb again, while the foreign currency lending rate continued its declining trend (hence, the spread increased again). At this point one cannot say with certainty whether these trends were driven by de-dollarization measures *per se* or by other external factors, but these trends have challenged the market-driven de-dollarization forces in the ways discussed below.

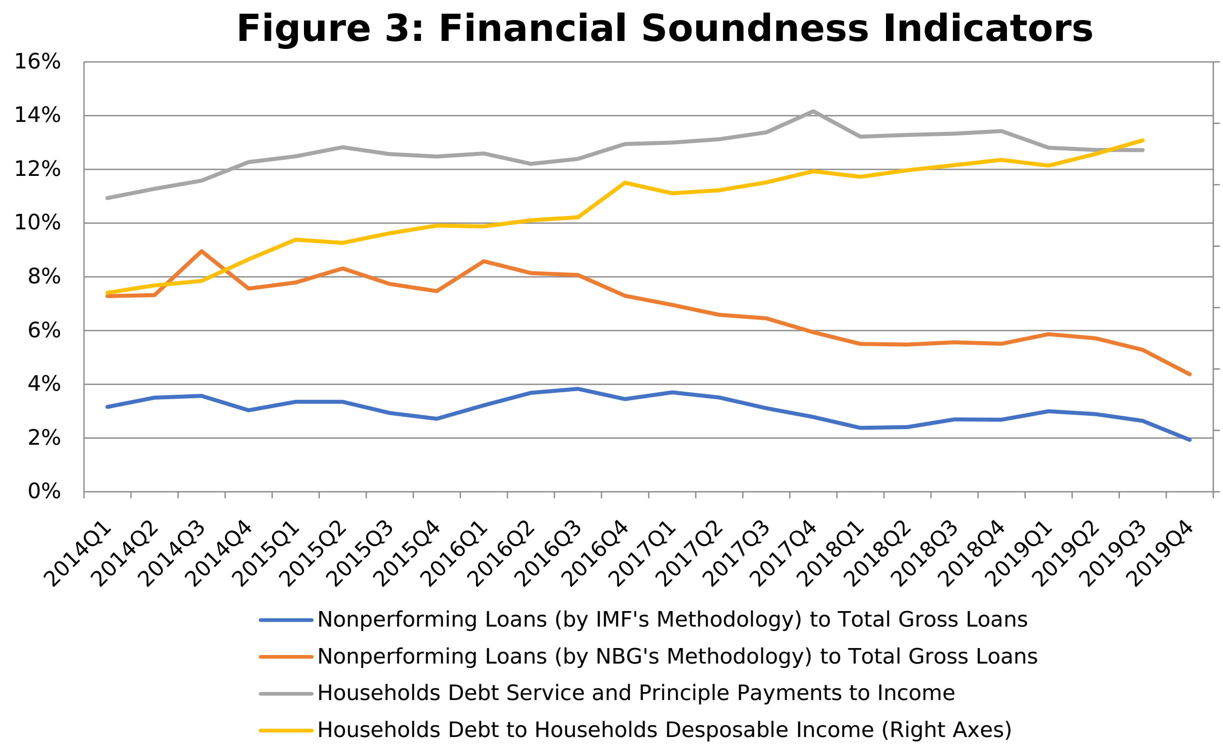
Risks of emergence of shadow banking. The strict administrative measures, such as the lending cap applied to all retail loans, and strict macro-prudential measures could cause the risk of financial disintermediation and the emergence of shadow banking. The risk is high in an environment where capital markets are not sufficiently developed and where interest rate gaps make dollarized loans not less but more attractive to retail borrowers. In Georgia's case, the potential shadow banking transactions in the retail sector are related to the practice of providing internal installment loans by real estate development companies, as well as electronics and furniture shops. These lending practices are neither efficient (these companies have limited resources) nor based on lending experience (in contrast with financial institutions which specialize in lending). In addition, they are beyond the regulatory framework and, as such, can potentially create instabilities in the financial system.

The effect of limiting foreign currency lending on individuals with income in foreign currency.'Blanket' lending cap measures caused the inability of hedged borrowers to take advantage of

[7]There have been no significant changes to the fundamental factors in the reference period. The export of goods and services increased by 8.9% and 7.0% annually in the first and second quarters of 2019. As a result, the trade deficit shrunk during the reference period. In addition, Georgia experienced only a minor annual decline in secondary income (which includes remittances) in Q1 and Q2 of 2019. Hence, the current account balance improved in the first two quarters of 2019 in yearly terms. As for the financial account, the big drop in foreign direct investment (FDI) was fully compensated by inflows of the portfolio investment in the corresponding period (due to high inflows in the second quarter [portfolio investment slightly declined in the first quarter]). Thus, the fundamental factors are not expected to have put pressure on the exchange rate before June 2019. The situation has changed after the ban on Russian flights and a period of political instability in the country.

lower interest rates in foreign currency, thus creating a market inefficiency. One argument in favor of a blanket lending cap was that the number of such hedged borrowers is relatively small in Georgia, so efficiency costs are not very high. This, however, depends on who we consider a hedged borrower. For example, families that typically receive remittances from the United States or EU countries may be considered hedged (while those who receive remittances from Russia or other countries are not). For instance, in February 2020 around 52% of all remittances came from either the EU or the US. The currency mismatch vulnerability works in the opposite direction for recipients of euro and dollar remittances (e.g. they are vulnerable to lari appreciation episodes).

The effect of the de-dollarization measures on financial stability. In general, de-dollarization programs have a positive impact on the stability of the financial system. The low level of loan dollarization reduces currency mismatch, making individuals less vulnerable to exchange rate shocks (making them more hedged—having income and liabilities in the same currency). On a highly positive note, in Georgia**, non-performing loans by commercial banks show a declining trend**since the beginning of 2016. However, **household debt burden**(measured by household debt to household disposable income) and **debt service payments to income**(measured by household debt and principal payments to income) **had an increasing trend in the last couple of years.** (see Figure 3). The increase in household indebtedness makes people vulnerable to domestic interest rate fluctuations, rather than exchange rate fluctuations.



Source: National Bank of Georgia, Authors' Calculations

CONCLUSIONS

Taking stock of the larization policy measures, analyzing the progress and the evidence of its effectiveness, with caveats of risks, it is possible to arrive at the following set of conclusions:

- The larization policy of NBG showed solid progress, as it was accompanied by stabilized macroeconomic environment, stable inflation rate within the target, and the policy measures which included considerably improved and effective communication policy and practices of NBG.
- Larization measures (such as the initially introduced lending cap of 100,000 GEL and stricter macroprudential requirements) managed to remove some of the market distortions which were related to the currency risk exposure of households with relatively small loans.

- On the other hand, the policies such as further increasing asymmetry in minimum reserve requirements between domestic and foreign currencies and the increase of lending cap to 200,000 GEL, were marginally less productive and may have created certain market inefficiencies, including:
    - Making it more difficult for banks to manage liquidity as their deposits were denominated mostly in foreign currency.
    - Putting additional pressure on the exchange rate, as the decrease in the supply of foreign currency was not matched by the decrease in the demand for foreign currency due to still-high rates of deposit dollarization.
    - The high 'blanket' lending cap limited borrowing options for hedged households with income in foreign currency (such as receivers of remittances from US and EU).
- The strict administrative measures may give rise to shadow banking practices, including the practice of providing internal installment loans by real estate developer companies, as well as technology and furniture shops.

POLICY RECOMMENDATIONS

- The COVID-19 epidemic will most certainly change the economic landscape of the country for the worse in the coming year. It will also exacerbate the exchange rate pressure on the Georgian lari. It would be important in this environment for NBG to keep a long-term goal of financial de-dollarization in mind, be consistent and patient in its policies, but in the same time avoid or consider relaxing the practices that could further exacerbate the pressure on the GEL exchange rate.
- In the environment where reducing the policy rate may lead to additional inflation rate and exchange rate pressures, NBG may wish to consider **decreasing the minimum reserve requirements for deposits in a foreign currency. This will stimulate FX lending and economic activity, without creating depreciation or inflationary expectations**. This measure may be appropriate during the time when there is an unusual pressure on GEL exchange rate.
- **Reducing the lending cap of 200,000 GEL back to the original level of 100,000 GEL** will help stimulating economy in the environment of relatively high and potentially unstable domestic interest rates, allowing hedged borrowers to take advantage of lower foreign currency rates. It will alleviate the currency mismatch and improve liquidity management within the banking sector.

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