GOLD, RESERVES, AND TURMOIL: THE POLITICS BEHIND GEORGIA'S CURRENCY STABILITY

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CONTEXT: HEIGHTENED POLITICAL UNCERTAINTIES

For the past two years, Georgia has faced persistent political instability, driven by various legislative and electoral actions of the ruling party, ultimately resulting in a profound political crisis that has undermined the domestic and international legitimacy of the ruling party (Chart 1.). Political turbulences have aggravated with the first attempted introduction of the law on transparency of foreign influence in 2023 which was followed by protests, resulting in its withdrawal, and a promise by the ruling party of its non-introduction in the future. Tensions scaled up significantly in a spring 2024, when the ruling party broke its promise, re-initiated, and approved the highly controversial and widely protested **Law on Transparency of Foreign Influence.**

While the pre-Parliamentary election period in autumn 2024 remained relatively calm, demonstrations erupted once none of President and the opposition political parties recognized the election results. The OSCE Office for Democratic Institutions and Human Rights **(ODIHR)** later reported that Georgia's elections were characterized by an uneven playing field, marked by instances of pressure and tension. Protest actions peaked in November 2024 when Georgian Dream announced its decision not to place the issue of opening accession negotiations with the EU on the agenda until the end of **2028**. Massive demonstrations were violently dispersed by the ruling party followed by arrests and repressive legislative actions.[1] Presently, demonstrations continue, reflecting the public's sustained dissatisfaction with the government's stance and actions.

The international legitimacy of the ruling party is also under scrutiny and its isolation is growing. Key strategic partners of Georgia have announced their financial disengagement plans and introduced sanctions against the ruling party. The **USA has halted its strategic partnership with Georgia,** while some EU countries have stopped cooperation with the Georgian government, redirecting their funds to support civil society in Georgia. In addition, the Office of Foreign Assets Control (OFAC) of the U.S. Department of the Treasury recently **imposed sanctions on Bidzina Ivanishvili**. These measures, which include asset freezes and travel bans, aim to address democratic backsliding in Georgia and Ivanishvili's personal role in the country's perceived drift toward Russian influence. The United States has imposed **Global Magnitsky sanctions** on Georgia's Minister of Internal Affairs and Deputy Head of the Special Tasks Department, citing their roles in violent crackdowns on media, opposition, and protesters.[2]

[1] **MEDIA POLARIZATION INDEX** reached its historical maximum in November 2024 and remained at a high level in December 2024, reflecting the intensification of societal divisions and heightened tensions during this period.

[2] Also see ISET Policy Institute's policy brief on sanctions https://iset-pi.ge/en/publications/policy-briefs/3540-recent-targeted-sanctions-immediate-economic-impacts-and-long-term-economic-risks-for-georgia

Chart 1. Key Dates: Calendar of Actions Contributing to Political Uncertainties

GROSS INTERNATIONAL RESERVES: TRENDS, INTERVENTIONS, AND REGULATORY ACTIONS

Amid heightened uncertainties Gross International Reserves (GIR) declined in 2023-2024. In face of depreciation pressures, the NBG has heavily intervened to stabilize the currency in H2 2024. As reserves got depleted, the NBG increased reserve requirements for commercial banks and suspended foreign exchange market auction, as a signaling mechanism while maintaining other direct sales to commercial banks.

Trends

Since the onset of Russia's war in Ukraine in 2022, Georgia has witnessed a substantial influx of Russian migrants[3], accompanied by a significant inflow of foreign currency. These developments, coupled with improved re-export and transit opportunities, have notably bolstered the country's

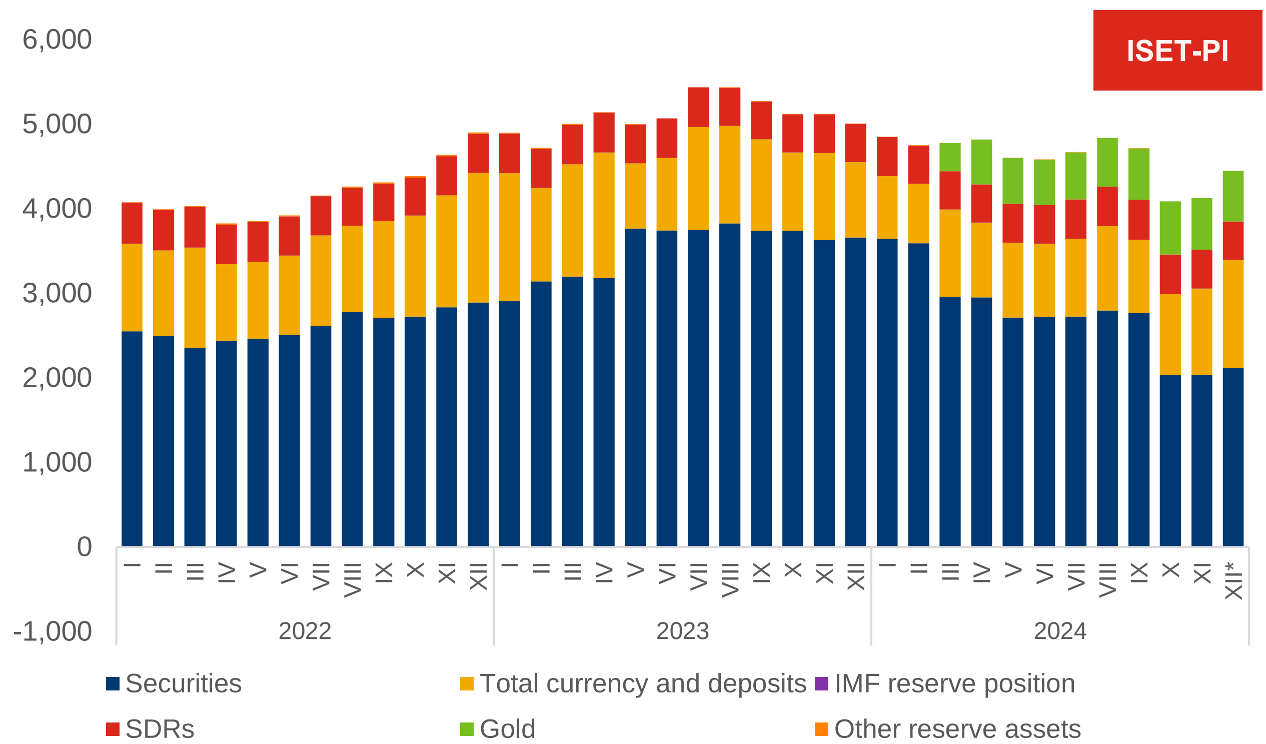
[3] In 2022, money inflows to Georgia rose by 86.1% compared to 2021, driven primarily by a 402.7% and 716.5% surge in transfers from Russia and Belarus respectively, largely attributed to Russian and Belarusian migrants transferring funds for current or future consumption. However, inflows declined by 5.2% in 2023 and 18.9% in 2024, with transfers from Russia decreasing sharply by 26.1% in 2023 and 64.6% in 2024.

external position. The resulting increase in foreign currency inflows contributed to a marked reduction in Georgia's current account deficit, which reached its lowest level in recent history.

In response to this external shock, the National Bank of Georgia (NBG) actively accumulated foreign currency reserves as a buffer to safeguard against potential future crises and to also prevent excessive currency appreciation in face of temporary inflows. At the beginning of 2022, Georgia's Gross International Reserves (GIR) amounted to just over USD 4 billion. Over the course of the year, the NBG achieved a net purchase of USD 824 million, reinforcing the country's capacity to weather external shocks.

Gross International Reserves (GIR)[4] peaked at USD 5.44 billion in August 2023 before declining to USD 4.45 billion by December 2024, representing a net decrease of USD 989 million. The decline became particularly stark after September 2023, with reserves shrinking by USD 856 million by June 2024. The situation deteriorated further amid the deepening political crisis in October 2024 (after the parliamentary election), when reserves dropped by a dramatic USD 628 million in just one month.

Figure 1. Gross International Reserves (GIR) (Million USD)



Source: National Bank of Georgia

*Note: * Preliminary Data*

The decline in GIR over the past two years has been largely driven by a substantial reduction in foreign currency reserves, which dropped from USD 4.98 billion in August 2023 to USD 3.40

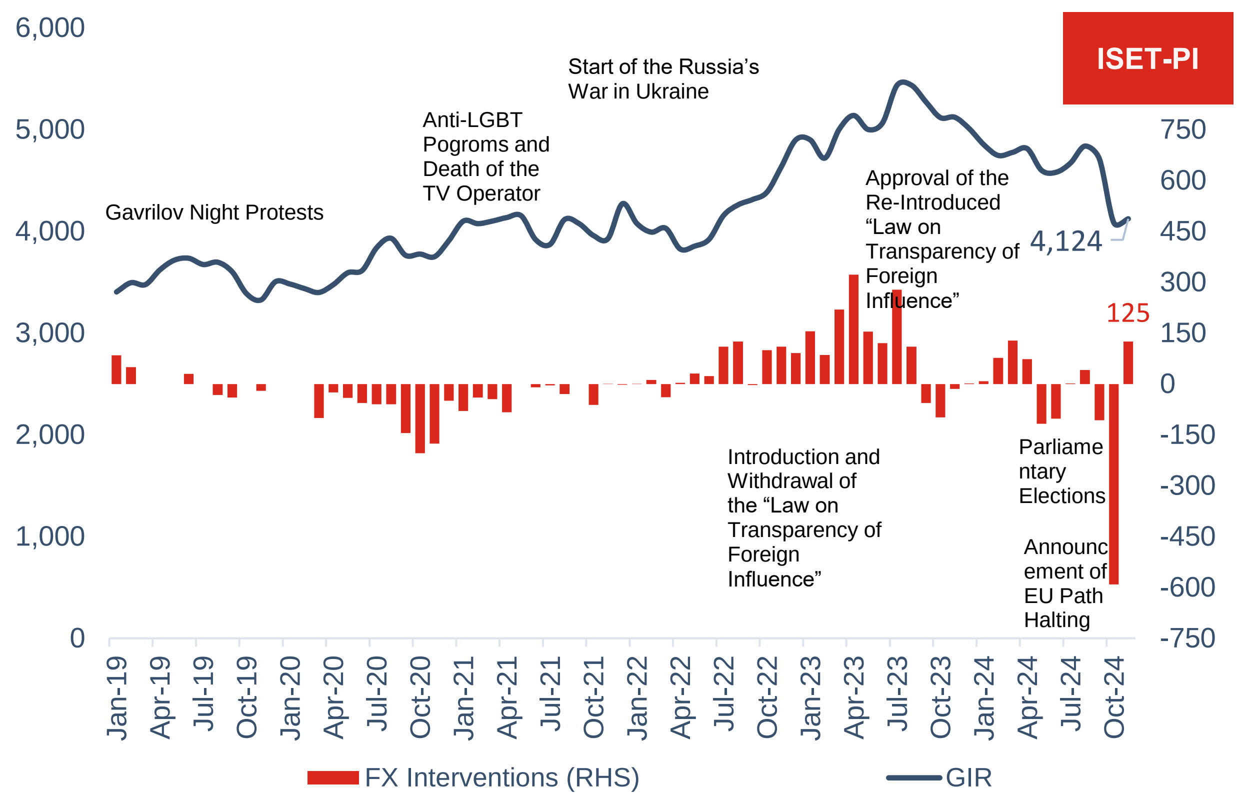
[4] GIR includes foreign currency reserves, the IMF reserve position, Special Drawing Rights (SDRs), gold, and other assets

billion by December 2024, a total decrease of USD 1.58 billion. Among the components, securities, which form the largest share of foreign currency reserves, saw a sharp decline from USD 3.83 billion in August 2023 to USD 2.12 billion by December 2024. At the same time, total currency and deposits recorded a small increase, moving from USD 1.15 billion in August 2023 to USD 1.28 billion by the end of 2024.

Interventions and Regulatory Actions

The decline in reserves can be attributed to the NBG's interventions, which included selling USD 167 million in 2023 and USD 382 million in 2024 during **Foreign Exchange Auctions** (Figure 2.). The most notable decline in foreign currency reserves occurred in October 2024, coinciding with the severe escalation of the political crisis, as reserves dropped by an alarming USD 640.5 million in just one month. In the last two months of 2024, reserves have rebounded by USD 401.4 million reaching USD 4.40 billion at end-December 2024. However, this recent recovery in reserves was largely driven by the NBG's regulatory action which increased minimum reserve requirements for commercial banks by 5 percent - the higher portion of commercial banks' reserves must be held in foreign currency with the NBG[5]. Since October 2024, the NBG also suspended foreign exchange market auctions, as a signaling mechanism, while maintaining other direct sales (via **BMATCH Platform**) to commercial banks.

Figure 2. Foreign Currency Interventions and Gross International Reserves (GIR) (Million USD)



Source: National Bank of Georgia
Note: FX interventions include purchase/sale in the BMatch Platform

[5] **Financial Stability and Monetary Policy Committees' Decision,** November 27, 2024.

GOLD: THE NBG'S BUY AND THE NBG'S SELL

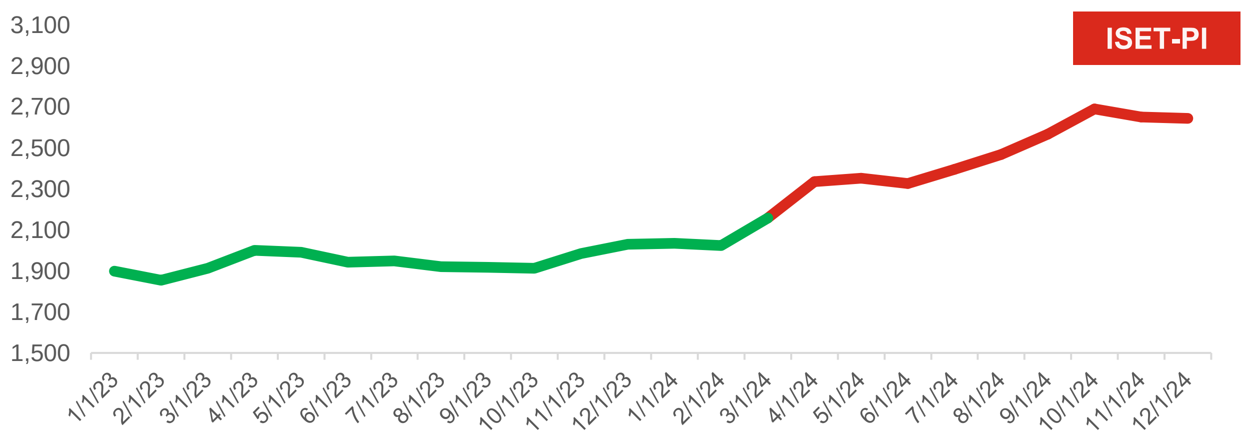
The NBG's gold acquisition may align with economic motives; however, recent political turmoil, including the US sanctions on political figures and concerns over the NBG's governance, sharpen questions about whether this gold purchase is also a strategic response to international sanctions and financial instability, rather than purely economic considerations.[6]

Buy: Monetary Gold

In March 2024 just before the ruling party's re-introduction of the controversial Law on Transparency of Foreign Influence to the Parliament, the NBG has acquired 7 tons of high-quality Monetary Gold valued at USD 529.4 million (April 2024)[7], which represents about 11 percent of its GIR, marking the first such acquisition since Georgia regained independence. This move aims to enhance diversification in light of increasing global geopolitical risks. Central banks, especially in emerging economies, typically pursue gold reserves for economic reasons, such as portfolio diversification and protection against inflation, or political motives, like reducing dependence on the US dollar and mitigating sanction risks.

Valuation of Monetary **Gold Reserves** increased to USD 598.7 million in December 2024 from USD 529.4 million in April 2024 due to the significant rise in **Global Gold Prices** during this period (Figure 4.).[8] This sharp rise in market gold prices likely reflects global economic uncertainties, as investors sought gold as a safe-haven asset amidst financial market volatility and geopolitical tensions. For Georgia, the increase in gold prices translated into a significant valuation gains of its **Monetary Gold Reserve** holdings without increasing the physical quantity of Monetary Gold held at the NBG.

Figure 3. Gold Price Per Troy Ounce – USD



Source: Bloomberg, Datastream, ICE Benchmark Administration, World Gold Council

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[6] ISET Policy Institute, **Why the National Bank of Georgia is Ditching Dollars for Gold**, May 2024.

[7] In March 2024, gold accounted for USD 332.1 million, representing 7% of Georgia's Gross International Reserves.

[8] An analysis of gold price trends reveals that prices steadily climbed from USD 2,158 per ounce at the end of March 2024 to USD 2,644 per ounce by December 2024.

Sell: Investment Gold

In face of valuation gains on **Monetary Gold,** in November 2024, the NBG sold USD 43 million worth of gold[9] which was classified as **Investment Gold,** not Monetary Gold which is part of the country's GIR discussed above. According to the NBG, Investment Gold was stored separately under the category of "other assets", further details regarding the specifics of this sale have not been disclosed. The NBG started to sell investment gold since December 2023 to capitalize on higher global demand for gold amid rising inflation and geopolitical tensions.

IMF RESERVE POSITION AND SPECIAL DRAWING RIGHTS (SDRS)

In addition, the **IMF Reserve Position** remained relatively stable, hovering around USD 0.029 million, while **Special Drawing Rights (SDRs)** experienced minor fluctuations, decreasing from USD 462.3 million in January 2023 to USD 453.8 million by December 2024. Meanwhile, other reserve assets constitute only a minor portion of the Gross International Reserves and, as such, do not have a notable impact on the overall level of reserves.

IS THE PRESSURE ON THE CURRENCY DRIVEN BY FUNDAMENTAL FACTORS?
(ANSWER: PROBABLY NO)

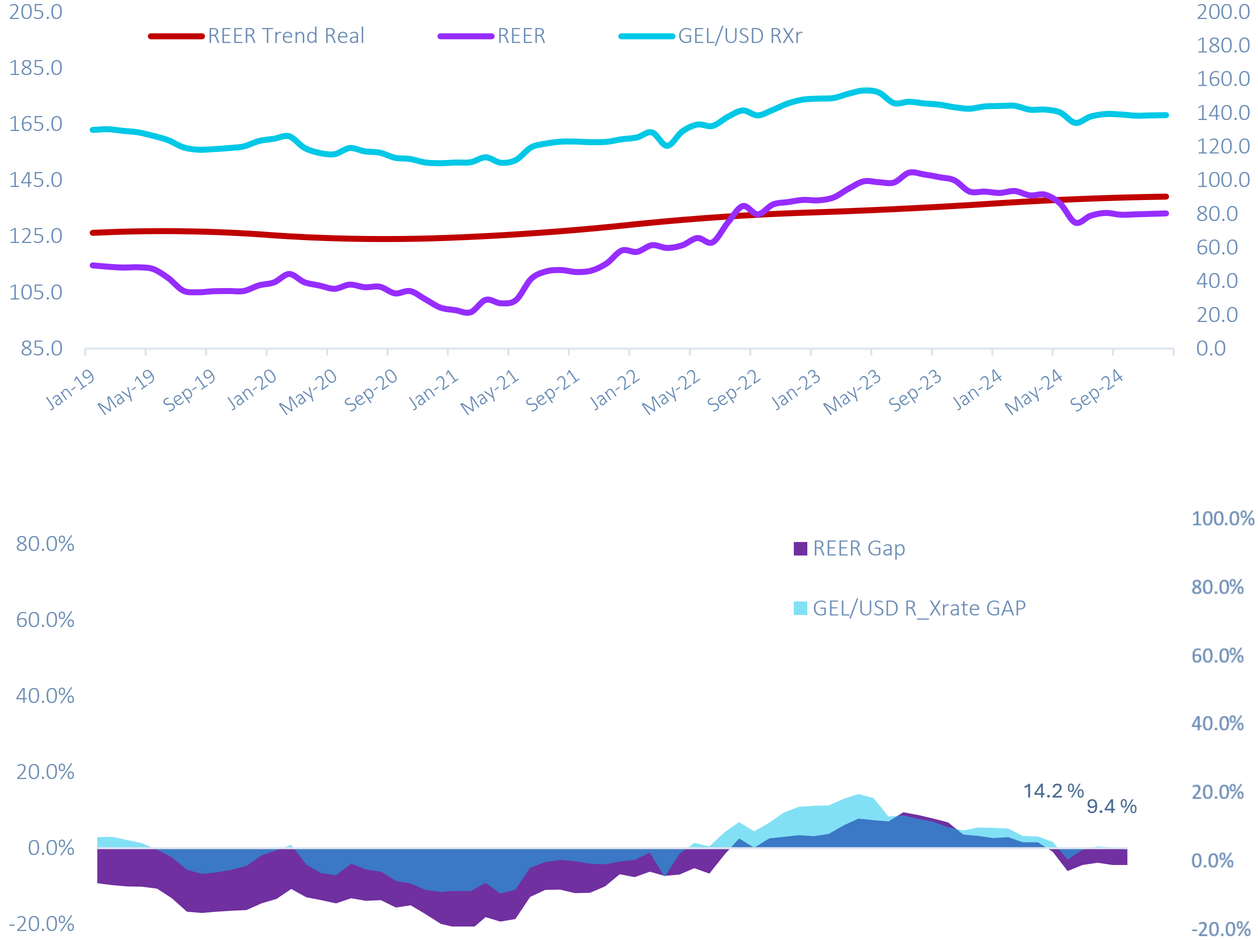
Understanding the notable decline in foreign currency reserves requires examining the factors driving pressure on the exchange rate. In general, three major factors determine the short-, medium-, and long-term equilibria of the foreign exchange rate. **The Long-Term Equilibrium** is primarily influenced by the **Differences In Productivity** between Georgia and its partner countries. **The Balassa-Samuelson Effect** explains how differential productivity growth between a country's tradable and non-tradable sectors influences currency valuation. When productivity rises in tradable sectors, such as manufacturing, wages increase in both tradable and non-tradable sectors due to labor mobility. This drives up overall price levels and leads to an appreciation of the real exchange rate.

During periods of **Undervaluation,** REER falls below its long-term trend, indicating that the currency is weaker than it should be. Conversely, **Overvaluation** occurs when the REER is higher than its long-term trend, suggesting that the currency is stronger than justified by productivity differences. This logic can also be applied to the GEL/USD exchange rate (Figure 4.). From August 2022 to May 2024, the GEL was overvalued, but since May 2024, it has been undervalued. The deviation of the exchange rate from its trend might be driven by Balance of Payments (BOP) trends or short-term sentiments.

[9] BMG, According to SEB, **They Sold Gold in the Form of Bars and Certificates**. December 2024.

Figure 4. REER, GEL/USD and Gaps

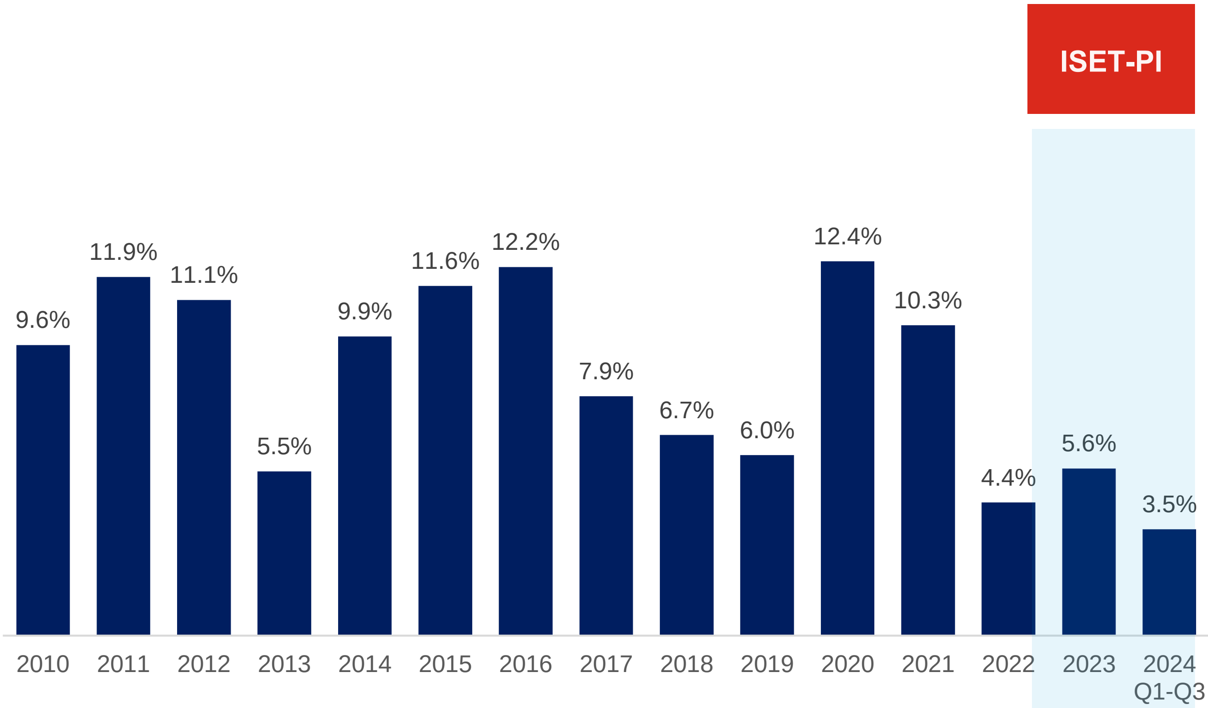
ISET-PI



Source: NBG, Authors' Calculations

Since 2022, Georgia has demonstrated strong performance in terms of net foreign currency inflows. In 2022, the **Current Account Deficit** dropped to 4.4% of GDP, the lowest rate in at least 12 years and more than 2.3 times lower than the deficit recorded in 2021 (10.3%) (see Figure 5). Although the deficit increased slightly in 2023, it remained relatively low at 5.6% of GDP. In the first three quarters of 2024, the deficit further declined to 3.5% of GDP, reflecting continued improvement in Georgia's external balance.

Figure 5. Current Account Deficit as a Share of GDP



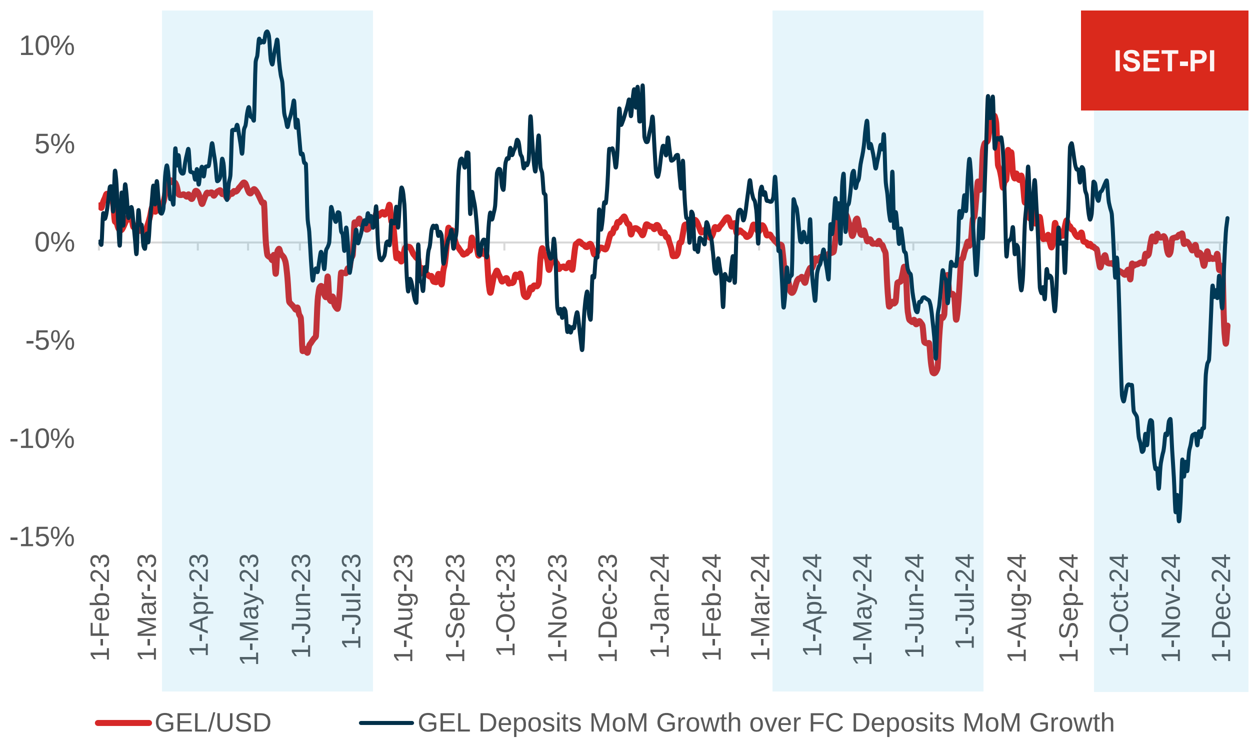
Source: NBG, Geostat, Authors' Calculations

According to the BOP for 2023, Georgia's **Trade Deficit in Goods** increased by 19.2%, driven by a 7.7% rise in exports and a 12.4% rise in imports. In contrast, the **Net Export of Services** posted a significant surplus, increasing by 28.4% as a result of a 23.7% growth in service exports and a 19.5% rise in service imports, largely attributed to improved **Tourism** activity. The **Balance of Secondary Income**, which includes **Remittances**, grew by 9% compared to the previous year. Notably, remittances, which had surged following the arrival of Russian and Belarusian migrants in Georgia who sent funds for immediate and future consumption, began to normalize in 2023. Due to this level effect, Russia's contribution to remittances turned negative, while nearly all other remittance sources saw increases. On the downside, **Foreign Direct Investment (FDI)** declined sharply by 15.7% in 2023. It is worth mentioning that in 2022, the **Current Account Deficit** had already narrowed significantly compared to 2021, and despite a moderate increase in the deficit in 2023, it remained well below the 2021 level.

Similar trends persisted during the first three quarters of 2024. The **Trade Deficit of Goods** rose by 8.2%, while the **Surplus in Net Exports of Services** grew by 12.1%. The **Net Surplus of Secondary Income** increased by 3.5%, whereas **FDI** plummeted further, declining by a substantial 40%. Overall, the **Current Account Deficit** contracted by 19% during this period, reflecting an improvement in Georgia's external balance despite ongoing challenges. These findings are particularly surprising, given the significant amount of foreign currency reserves sold during 2023-2024, suggesting that factors beyond the current account are contributing to the pressures on the exchange rate and reserve dynamics.

Since the components of the BOP alone cannot fully account for the pressure on the domestic currency, it becomes essential to examine short-term factors, which are predominantly influenced by **negative market expectations.** Figure 6 illustrates the month-to-month growth of GEL deposits compared to the month-to-month growth of USD deposits. A negative value on the graph signifies that economic agents favored USD deposits over GEL deposits, leading to an increase in deposit dollarization. Since the beginning of 2023, there have been numerous instances where the two lines have exhibited a tendency to move in the same direction. This pattern was particularly evident in the spring of 2023 and 2024, coinciding with the introduction of the Law on Transparency of Foreign Influence. However, during October and November, amidst the parliamentary elections and the recent political crisis, the growth in USD deposits significantly outpaced that of GEL deposits. Despite this, the exchange rate remained stable, albeit at the cost of depleting foreign currency reserves. A sharp depreciation of the GEL was observed only in December.

Figure 6. Foreign Currency Reserves and GEL/USD Exchange Rate



Source: Authors Calculations, National Bank of Georgia

Notably, although the **Monetary Policy Rate (MPR)** declined from 11% at the beginning of 2023 to 8% in 2024, it remains above the standard level of 7%. Amid high uncertainty, the National Bank of Georgia (NBG) has kept the MPR at 8% since May 2024. This policy limits the supply of GEL, reduces GEL liquidity, and supports the stability of the exchange rate in the face of ongoing economic and political challenges.

However, it is essential to conduct a thorough analysis using economic models to gain a clearer understanding of the factors exerting pressure on GEL during periods of political crisis.

DOES THE NATIONAL BANK OF GEORGIA EXHIBIT A FEAR OF FLOATING?

(Answer: Probably Yes)

Despite the theoretical benefits of a **Free-Floating Exchange Rate**, an increasing number of emerging market economies exhibit what Calvo and Reinhart (2000) described as a "Fear Of Floating (FoF)." These countries, while officially classified as free floaters, tend to adopt tight monetary policies and frequently intervene in currency markets to prevent sharp depreciation of their currencies. According to Calvo and Reinhart's findings, as many as 76.4% of emerging economies classified as free floaters demonstrate such tendencies.

The Calvo-Reinhart (C-R) Fear Of Floating (FoF) Index is calculated as the ratio of the Coefficient of Variation (CV) of the USD/GEL exchange rate (measured as the average for the period) to the sum of the Coefficients of Variation (CV) for the monetary policy rate and the change in Gross International Reserves. The lower the index value, the greater the "fear of floating", with a value of zero representing a fixed exchange rate regime. Analyzing the dynamics of the index for Georgia highlights notable shifts in the National Bank of Georgia's (NBG) approach to managing the exchange rate.

Between 2008 and 2013, the National Bank of Georgia (NBG) demonstrated a pronounced fear of floating, characterized by frequent interventions in the foreign exchange market and extensive reliance on monetary policy instruments. During this period, the C-R FoF index remained near zero, even when inflation was close to its target, indicating a highly controlled exchange rate regime (see Figure 7).

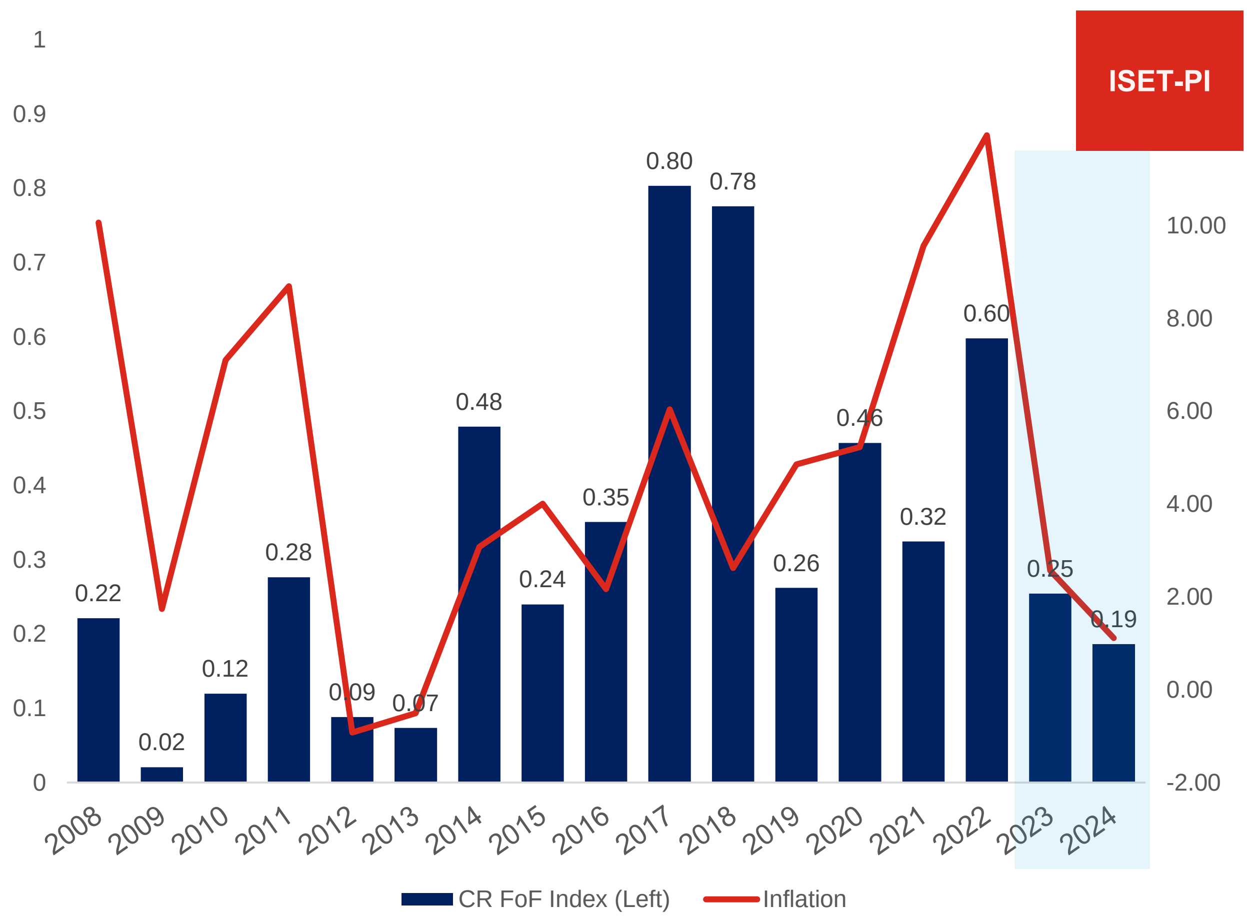
In subsequent years, the National Bank of Georgia (NBG) underwent a significant policy shift, gradually increasing the role of market mechanisms in determining the exchange rate while scaling back direct interventions. This transition was particularly pronounced during 2017-2018, a period of recovery following the regional economic turmoil caused by Russia's war with Ukraine in 2014, the imposition of international sanctions on Russia, and the sharp decline in global oil prices. During this phase, the C-R FoF index reflected a diminished fear of floating, underscoring the NBG's adoption of a more flexible and market-oriented approach to exchange rate management.

During the period from 2022 to 2024, the C-R index displayed varied trends. In 2022, the index recorded relatively high values, indicating a diminished fear of floating, as the National Bank of Georgia (NBG) reduced its reliance on direct foreign exchange interventions despite strong inflows of foreign currency. However, in 2023-2024, the index reflected a significant shift, pointing to a heightened fear of floating. This change occurred even amid continued robust foreign currency inflows, highlighting the NBG's increased caution in response to political instability, negative market sentiment, and concerns over potential exchange rate volatility.

Notably, the Calvo-Reinhart Fear of Floating (C-R FoF) Index reached its lowest average level, 0.14, during the tenure of the current acting president of the National Bank of Georgia (NBG), reflecting a period of intensified intervention and stricter exchange rate management. By contrast, the index averaged 0.32 and 0.31 during the governorships of the two preceding presidents, respectively, indicating a greater degree of exchange rate flexibility under their leadership. This suggests that their policies aligned more closely with market-driven dynamics, allowing for less direct intervention in the foreign exchange market.

In its **2024 Central Banker Report Cards, Global Finance Magazine** assigned a "D" grade to the Acting President of the National Bank of Georgia (NBG), marking the lowest rating among central bank governors globally. This assessment highlights significant concerns regarding her management of inflation control, economic growth, currency stability, and interest rate policies. Criticism has also been directed at her failure to implement international sanctions against individuals linked to Russia, a shortcoming that has triggered high-profile resignations within the NBG and public disapproval from Georgia's President. Her controversial interventions to stabilize the Georgian Lari amidst ongoing political instability have further intensified scrutiny. Fitch Ratings has cautioned that perceived threats to the NBG's independence could undermine its policy credibility, exacerbating uncertainty in an already volatile economic landscape.

Figure 7. Calvo-Reinhart Fear of Floating Index



Source: Authors Calculations, National Bank of Georgia

WHY DO COUNTRIES FEAR FLOATING?

The decision to intervene in exchange rate fluctuations is shaped by a range of factors critical to maintaining economic stability and addressing policy priorities, particularly in transition economies like Georgia. Key determinants include historical experiences with inflation, the extent of exchange rate pass-through to domestic prices, the prevalence of dollarization, and external borrowing constraints. These factors collectively influence the approach to exchange rate management:

1. **Historical Inflation Experience**. Countries that have experienced high inflation or hyperinflation during economic transitions often adopt fixed or de facto floating exchange rate regimes as a means of stabilizing their economies. Georgia's early transition years, marked by hyperinflation, have had a lasting impact on its exchange rate policy.
2. **Pass-Through Effect to Prices**. The central bank's emphasis on controlling inflation often drives intervention when exchange rate fluctuations significantly affect domestic prices. In Georgia, the strong exchange rate pass-through effect amplifies this concern, with a 1% change in the nominal exchange rate resulting in an approximate 0.42 percentage point change in long-run price levels, typically with a lag of 4-5 months (Mdivnishvili, 2014). As a net importer, Georgia is particularly susceptible to exchange rate volatility, which can destabilize prices and erode the credibility of inflation-targeting policies, further complicating monetary policy objectives.
3. **High Dollarization**. Georgia demonstrates high levels of dollarization, with loan dollarization ratios exceeding 30% and deposit dollarization ratios surpassing 50% in recent years. These ratios have declined following the introduction of the National Bank of Georgia's (NBG) de-dollarization policy, which implemented strict administrative measures. Among these measures was the prohibition of foreign currency lending to individuals whose loans exceeded a specified threshold. Currency mismatches, where borrowers earn income in local currency but hold debts in foreign currency, exacerbate the costs of currency depreciation. This often results in reduced aggregate demand and output, a phenomenon referred to as contractionary depreciation.
4. **Original Sin and Borrowing Constraints**. Many developing countries, including Georgia, experience the "original sin" phenomenon, where they are unable to borrow in their domestic currency. In such cases, currency depreciation exacerbates the debt burden by increasing the value of foreign-denominated liabilities. This dynamic often compels policymakers to prioritize exchange rate stabilization to alleviate financial strain and reduce the associated economic vulnerabilities.

While traditional factors such as economic stability and inflation targeting often explain the fear of floating, recent geopolitical developments have revealed a non-economic dimension to this phenomenon. In authoritarian regimes confronting sanctions or political crises, the exchange rate frequently serves as a symbol of economic stability, becoming central to government efforts to project resilience.

As one of the most sensitive economic indicators, the exchange rate is typically among the first variables to signal economic distress. Aware of its symbolic importance, such regimes often prioritize maintaining a strong and stable domestic currency, even amid severe economic challenges. This strategy transcends economic considerations, functioning as a **propaganda tool** to bolster public confidence and shape perceptions of economic well-being, regardless of underlying economic realities.

ARE FOREIGN RESERVES ADEQUATE TO WITHSTAND PROLONGED UNCERTAINTIES?

(ANSWER: PROBABLY NO)

For nearly all economies—whether developed, emerging, or developing—holding prudent reserves, along with sound policies and fundamentals, can yield significant benefits. These reserves reduce the likelihood of balance-of-payments crises, help preserve economic and financial stability against pressures on exchange rates and disorderly market conditions and create room for policy autonomy. Assessing the appropriate level of reserves is challenging due to the complexity of quantifying external risks and vulnerabilities, as well as the opportunity costs that each country faces. Thus, this assessment should consider specific characteristics, such as economic flexibility, financial integration, and maturity, along with vulnerabilities. International Monetary Fund (IMF) has utilized several traditional approaches, including import and short-term debt coverage, typically capturing individual risks.[10]

Drawing from the most recent IMF article IV consultation report's reserve adequacy assessment and adding ISET PI estimates using the latest gross international reserves data (all else equal), possibly indicate worrisome decline of official reserve coverage metric to inadequate levels. Over the past six months, the international reserve position has significantly deteriorated, falling below reserve adequacy thresholds, which has been further impaired by substantial interventions during the election period. **Gross International Reserves (GIR)** have fallen below the IMF's adequacy threshold, after previously standing at 102.2% of the **Assessing Reserve Adequacy** (**ARA) Metric**[11] in 2022. GIR dropping to 95.5% and further declined to estimated 84.4% of the ARA metric in 2023 and 2024, respectively. Similarly, GIR as a percentage of the **Adjusted ARA Metric** stood at 123.7% in 2022 but declined sharply to 115.2% in 2023 and further declined to estimated 95.2% in 2024. **Gross International Reserves** were sufficient to cover 3.4 **Months of Imports** in 2023; however, this indicator could have dropped to estimated 3.2 months of import cover in 2024 (Table 1.). Considering the risks associated with a potential further deterioration of the external balance amid a severe political crisis, the adequacy of reserves could decline even further, raising serious concerns about Georgia's ability to withstand future economic shocks.

[10] IMF, **Assessing Reserve Adequacy – ARA,** October 2024.

[11] P48, 2024 Georgia IMF Article IV Consultation Report

Table 1. Georgia: Reserve Adequacy Assessment 2022-2024

	2022 IMF Article IV	2023 IMF Article IV	2024 IMF Article IV	2024 ISET Est.
Exports (goods and services)	13 240	15 161	14 587	14 587
Broad Money (M2)	7 324	9 349	10 459	10 459
Short-term debt residual maturity	4 811	5 282	4 610	4 610
ST debt by original maturity	3 678	4 017	3 438	3 438
Ammortization on MLT debt	1 133	1 265	1 345	1 345
Other liabilities	15 504	16 242	17 563	17 563
ARA Metric	4 797	5 246	5 270	5 270
ARA Metric-Adjusted	3 960	4 347	4 670	4 670
Bank ST assets (deposits)	1 889	2 122	2 172	2 172
Bank ST liabilities (deposits)	2 778	3 141	3 488	3 488
Adjusted banks ST deposit liabilities	889	1 019	1 266	1 266
Gross International Reserves (GIR)				
GIR	4 901	5 010	4 996	4 447
GIR (Percent of ARA Metric)	**102,2**	**95,5**	**94,8**	**84,4**
GIR (Percent of Adjusted ARA metric)	**123,7**	**115,2**	**107**	**95,2**
GIR (Month of Import)	3,3	3,4	3,3	3,2

Source: 2024 Georgia IMF Article IV Consultation Report and ISET PI estimates

ARE CENTRAL BANK'S SAFEGUARDS ADEQUATE TO NAVIGATE PROLONGED UNCERTAINTIES?

(ANSWER: NO)

The governance-related safeguards of the NBG are currently inadequate. For the National Bank of Georgia, strengthening these safeguards is vital to maintain credibility and address challenges posed by declining reserves and political instability. According to the latest IMF Article IV assessment report on Georgia, the proposed amendments to strengthen governance and financial autonomy in the NBG Law and to fill vacancies at the NBG Board remain outstanding. The NBG Law should be amended to: (i) ensure a non-executive majority on the NBG's oversight board and limit discretionary transfers to the government, and (ii) clarify and strengthen the NBG succession framework and board member qualification criteria; iii) ensure a non-executive majority on the NBG's oversight board and limit discretionary transfers to the government. Shifting from a presidential to a collegial decision-making model is also desirable.[12] See box 1 for key indicators of central banks safeguards assessments, in general.

Also, 2024 Central Banker Report Cards, Global Finance Magazine assigned a "D" grade to the Acting President of the NBG, the lowest rating among central bank governors. The rating reflects widespread concerns about her management of inflation control, economic growth, currency stability, and interest rate policies. Critics have also pointed to her failure to enforce international sanctions against individuals linked to Russia, which has led to high-profile resignations within the NBG and public criticism from Georgia's President. Her interventions to stabilize the Georgian Lari amid ongoing political turmoil have further fueled controversy. Fitch Ratings has warned that perceived threats to the independence of the NBG could erode its policy credibility, exacerbating uncertainty in an already volatile economic environment. This combination of factors has cast a shadow over her tenure, amplifying concerns about the institution's ability to navigate the current challenges effectively.

CONCLUSION

In assessing Georgia's ability to withstand ongoing political uncertainties, it appears that the nation's foreign official reserves are likely inadequate. Over the past two years, a series of political crises have destabilized the country's governance, resulting in a significant erosion of public and international trust in the ruling party. This instability has been exacerbated by controversial legislative actions and the subsequent civil unrest, which have raised serious concerns about the government's legitimacy and its capacity to maintain economic stability. As a result, the NBG has faced considerable pressures to intervene in foreign exchange markets, leading to a substantial decline in GIR.

The data presented indicates a worrying trend of dwindling reserves, falling below the IMF adequacy thresholds. The GIR has seen a decline from 102.2% of the ARA metric in 2022 to a mere estimated 84.4% in 2024. This deterioration is alarming, particularly in light of the potential for further economic shocks arising from a protracted political crisis. With reserves dropping to levels that could only cover approximately 3.2 months of imports in 2024, the situation raises serious questions about Georgia's capacity to navigate forthcoming external pressures effectively.

Furthermore, the NBG's governance and regulatory frameworks are not presently equipped to respond to these challenges. The need for reforms to enhance financial autonomy and strengthen institutional credibility cannot be overstated. Without decisive action to bolster these safeguards, the risks associated with depletion of the Georgia's foreign official reserves will likely increase, leaving the country vulnerable to both economic and geopolitical instability. In summary, while the challenges are significant, the pathway to recovery hinges on effective governance, strategic reserve management, and the restoration of international confidence in Georgia's political landscape.

[12] P13, 2024 Georgia IMF Article IV Consultation Report

BOX 1. IMF: SAFEGUARDS ASSESSMENTS OF CENTRAL BANKS[13]

When the IMF lends to a country, it seeks assurances that the country's central bank can manage the funds it receives and provide reliable information. IMF safeguards assessments are a due diligence exercise to fulfill this objective. The IMF's Articles of Agreement require "adequate safeguards" for the use of its resources. This is to ensure that loans to member countries are repaid as they fall due, making those funds available to other members in need. Safeguards include limits on how much can be borrowed, conditions on the loans, measures to deal with misreporting and arrears, and safeguards assessments of central banks.

What do safeguards assessments of central banks entail?

A safeguards assessment is a diagnostic review of a central bank's governance and control framework. Six key areas denoted by the acronym **GELRIC** are assessed to help safeguard IMF disbursements and minimize the risk of inaccurate reporting of key data to the IMF (misreporting).

Governance arrangements: Are governance bodies established to provide appropriate structures and systems for close independent oversight of the central bank' operations? Do key decision-making bodies, such as the board, audit committee, governor and his/her deputies, exercise strong professional diligence in the execution of their fiduciary duties to the central bank? What is the composition of the key governance bodies and how are they appointed? Do they have the requisite capacity to discharge their mandate?

External audit mechanism: Does the central bank publish its annual financial statements that are independently audited in accordance with international standards? What is the process for selecting and rotating external auditors? Are audits subject to robust internal processes to ensure audit quality? Do external auditor's communicate with those charged with oversight (for example, the central bank board and audit committee)?

Legal structure and autonomy: Does the legal framework provide the central bank with an appropriate level of autonomy and does it support the other five GELRIC areas? Does the central bank law provide for strong governance arrangements, including autonomy and transparency? Are internal and external checks and balances in place? Is the central bank safeguarded from government interference or override?

Financial Reporting: Does the central bank adhere to international good practices for transparent accounting and financial reporting? Are financial statements published in a timely manner? Is monetary data reported under IMF programs consistent with the published financial information and the underlying accounting data?

Internal audit mechanism: Does the central bank's internal audit function comply with international standards? Does the function have sufficient capacity and organizational independence to evaluate the effectiveness of the bank's risk management, control, and governance processes? Are the monitoring and reporting mechanisms well established?

Internal Controls: Is the central bank committed to building and maintaining a robust control environment? Are operational and financial risks well managed? Are controls in place for foreign reserves management, lending, currency and banking operations, and cybersecurity and business continuity arrangements? Do internal processes support accurate and timely reporting of monetary program data to the Fund?

[13] See: https://www.imf.org/en/About/Factsheets/Sheets/2023/Protecting-IMF-resources-safeguards-assessments-of-central-banks