12.2024

Ministry of Finance of Georgia

Public Debt Management Department

Government Debt Management Annual Report

2023

Table of Contents

Figures

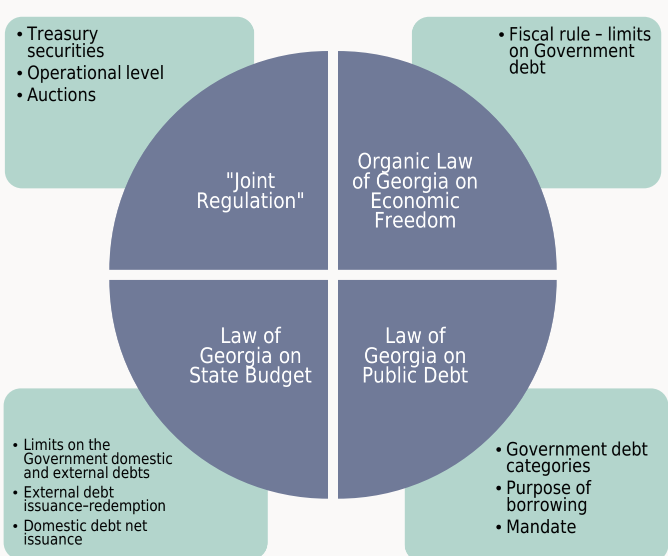
Boxes

Regulatory and Guiding Framework for Government Debt Management

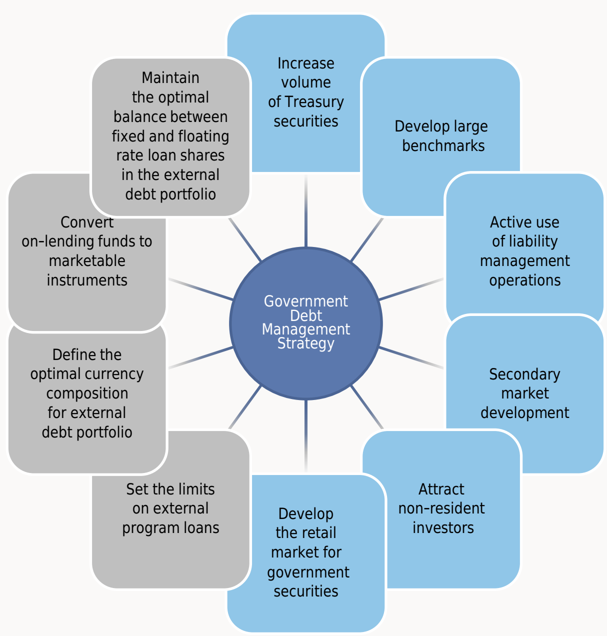
A fundamental level of regulatory framework for the Government debt is formed within the Organic Law of Georgia on Economic Freedom, which sets the fiscal rules – the limits for macroeconomic indicators – including those related to the Government debt. On the next level, the Law of Georgia on Public Debt defines the categories of domestic and external debt, their forms, the purpose of the borrowing. The law establishes the mandate for debt management, as well as for annual limits on both categories.

The operations related to the Treasury securities are regulated by the 2010 joint regulation signed by the Minister of Finance of Georgia and the Governor of the National Bank of Georgia on "Approval of the Regulation on the Issue, Circulation, Registration and Redemption of Treasury Bills and Treasury Bonds Issued by the Ministry of Finance of Georgia". The regulatory and guiding frameworks for the Government debt are present below.

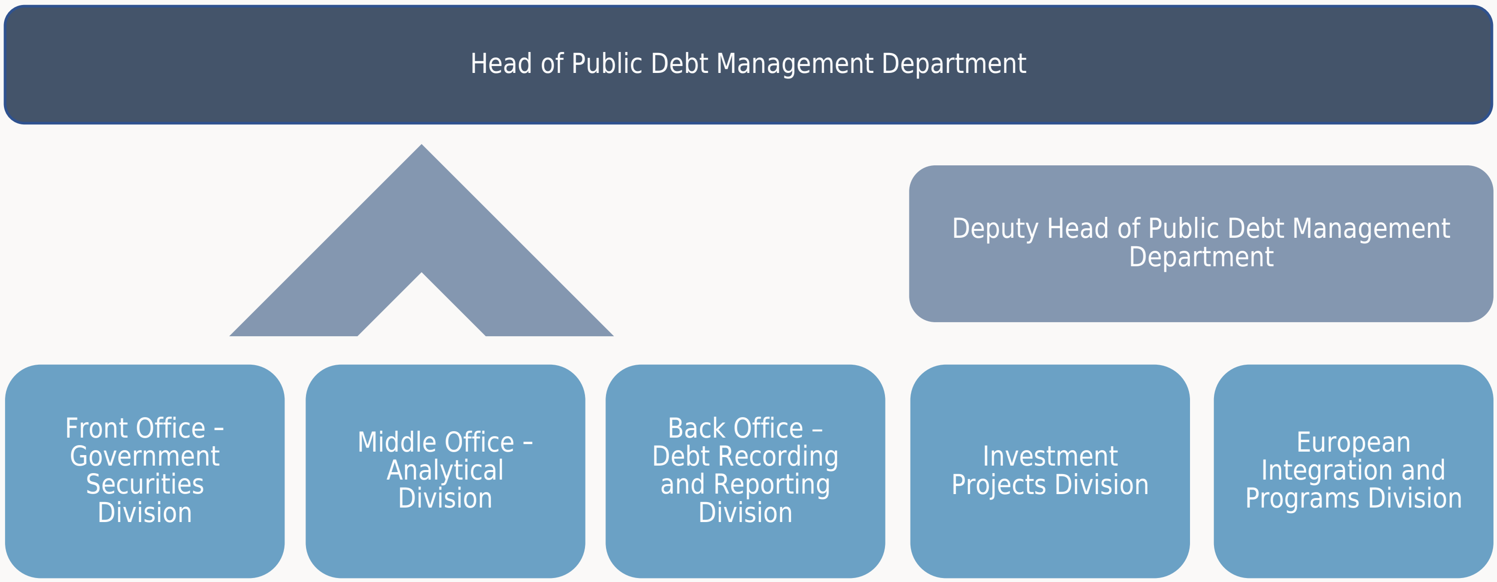
Regulatory Framework



Guiding Framework



Public Debt Management Department Structure

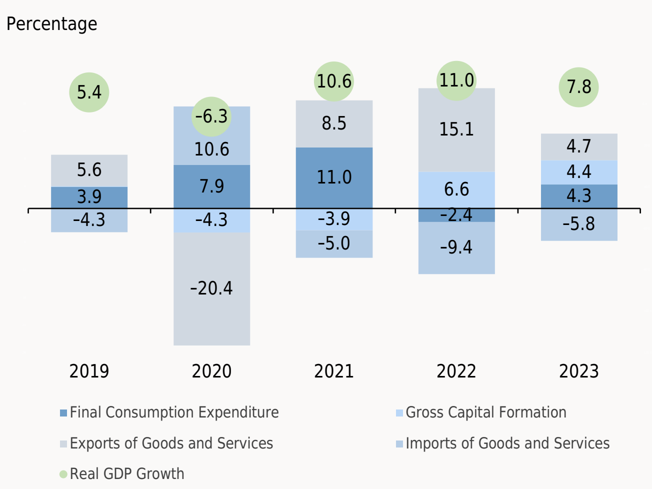


Macroeconomic Overview

The Georgian economy has been experiencing significant growth over the past few years. Despite the shocks from the COVID-19 pandemic, the country's fundamentals have quickly returned to pre-pandemic levels and have significantly exceeded them in some areas.

Since 2021, the country's economic recovery has begun at a high pace, because of which GDP growth in 2021 amounted to 10.6 percent. In 2022, this figure increased to 11.0 percent. According to data for 2023, real GDP growth amounted to 7.8 percent, which confirms the process of sustainable and continuous recovery of the country's economy. Investment and consumption were the main contributors to this progress.

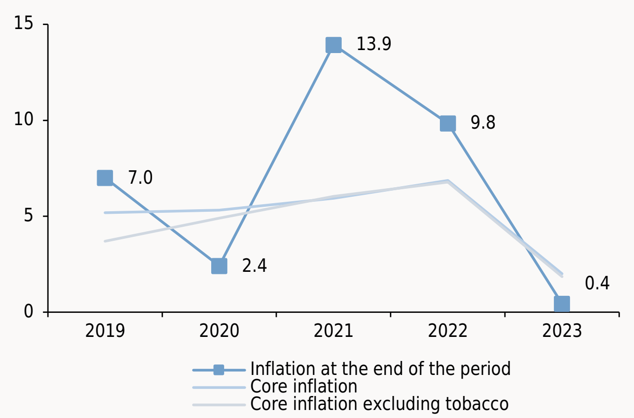
Figure 1.1 Contributors to Real GDP Growth



Source: Geostat

Inflation in Georgia, like other macroeconomic indicators, has been subject to significant fluctuations over the past few years, driven by both global and domestic economic factors. At the end of 2021, as a result of disruptions in global supply chains, inflation increased to 13.9 percent. However, it began to decline in 2022 and by the end of 2023 (December 2023 – compared to December of the previous year) it fell significantly below the target level of 3 percent, consequently amounted to 0.4 percent. The decrease in prices for food and non-alcoholic beverages had a significant impact on the reduction of inflation in 2023.

Figure 1.2 Annual Inflation at the End of the Period

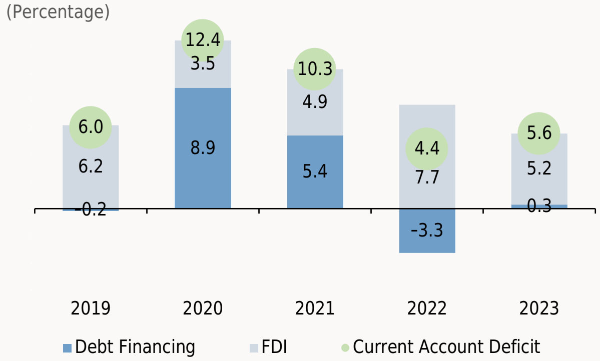


Source: Geostat

Along with the high growth rate of the economy, unemployment, according to the data published by the National Statistics Office of Georgia (Geostat), decreased from 20.6 percent in 2021 to 17.3 percent in 2022, and in 2023 reached historical minimum of 16.4 percent. By 2023, the labor market had expanded in terms of labor force compared to 2019.

An important indicator of the economic development process is the current account deficit, which amounted to 6.0 percent of GDP in 2019, although in 2020 the deficit increased to 12.4 percent as a result of the negative effects of the pandemic. In subsequent years, the current account deficit was characterized by a decreasing trend: in 2021 it was 10.3 percent, in 2022 it was 4.4 percent, and in 2023 it reached 5.6 percent. Debt financing played an important role in covering the current account deficit during the pandemic, and in 2023 foreign direct investment became the main source of financing.

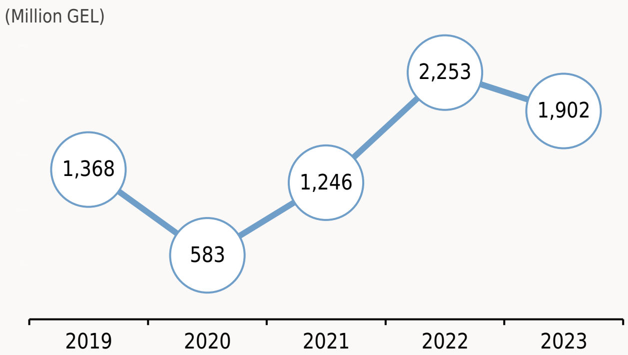
Figure 1.3 Current Account Financing



Source: NBG, Geostat

The dynamics of foreign direct investment have been characterized by heterogeneity over the past years. During the pandemic, investments decreased by 57.4 percent in 2020 compared to 2019, however, in 2022, foreign direct investment exceeded the 2019 figure by 64.7 percent. This once again demonstrates the rapid improvement in fundamental indicators after the pandemic.

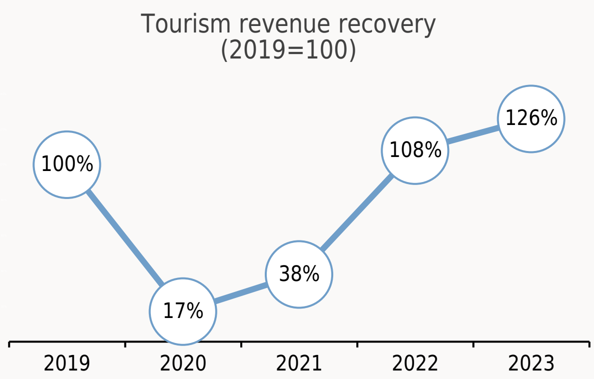
Figure 1.4 Foreign Direct Investment



Source: Geostat

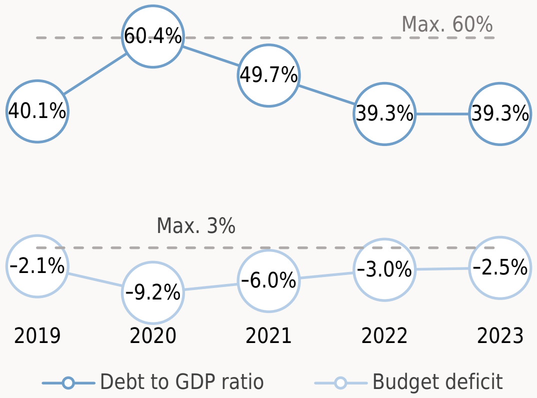
After the COVID–19 pandemic, significant progress was similarly noted in the field of tourism. While tourism revenues decreased by 83 percent in 2020 compared to 2019, in 2023 this figure exceeded the corresponding figure in 2019 by 26 percent. Furthermore, the tourism sector is characterized by significant diversification in terms of geographical areas.

Figure 1.5 Tourism Recovery



Source: Geostat

Figure 1.6 Fiscal Indicators



Source: Geostat

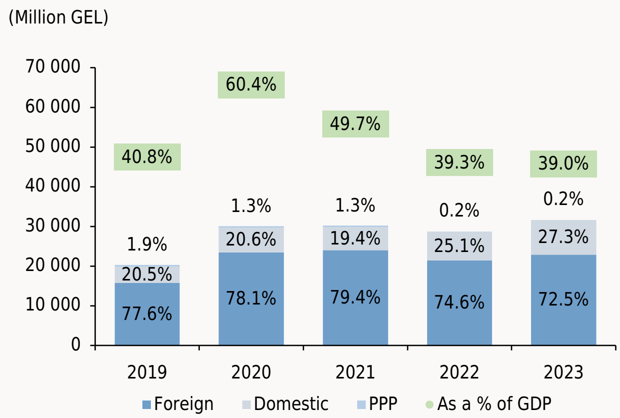
Analysis of Georgia's fiscal performance shows that Georgia is distinguished by significant fiscal discipline. Although the negative effects of the COVID-19 pandemic impacted fiscal performance and the fiscal rule was breached in 2020 for both the budget deficit and government debt levels, two years later both indicators returned to pre-pandemic figures. This demonstrates the effectiveness of the reforms and fiscal consolidation implemented in the country.

General Government Debt

Government Debt Dynamics

As of the end of 2023, Georgia's government debt amounted to 31.5 billion GEL, of which the foreign currency-denominated debt was 22.9 billion GEL, and the debt denominated in local currency amounted to 8.6 billion GEL. The volume of PPP liabilities as of December 31, 2023, was 57.5 million GEL. Georgia, like majority of other developing countries, has a high external debt ratio. Since the local securities market is in the early stages of development, it does not have capacity to provide financial resources at interest costs as low as those available from foreign sources. As of the end of 2023, 72.5 percent of the portfolio was represented by external debt, 27.3 percent by domestic debt, and 0.2 percent by PPP liabilities. The high level of dollarization in the government's debt portfolio makes it exposed to exchange rate fluctuations.

Figure 2.1 Government Debt Dynamics



Source: Ministry of Finance of Georgia

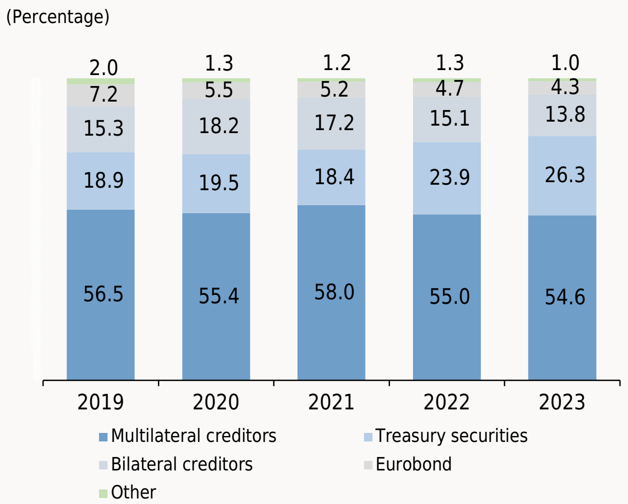
Hence, this represents one of the key challenges in the government's debt management. It is important to gradually replace external financing, while focusing more on the domestic sources, considering the local market's readiness. To facilitate this, a number of measures have been implemented in recent years, and new financial instruments for debt management have been introduced. These efforts also aim to strengthen the local capital market and promote economic resilience.

As of the end of 2023, the government's debt-to-GDP ratio was 39.0 percent (38.9 percent excluding PPP liabilities). Due to the impact of the pandemic and the deterioration of the country's macroeconomic parameters, the debt-to-GDP ratio slightly exceeded the critical 60 percent threshold defined by Georgian legislation at the end of 2020. However, in the following years, with the recovery of the economy and positive exchange rate dynamics, this indicator stabilized. By the end of 2021, it was 49.7 percent, and by the end of 2022, it decreased below the safe level defined by the general government's debt management strategy (40.0 percent of GDP), reaching 39.3 percent.

Government Debt Dynamics by Loan Type

Government of Georgia raises funding through loans from bilateral and multilateral creditors, as well as by issuing securities on international (Appendix I – Eurobonds) and domestic markets. As of the end of 2023, the volume of financial resources raised from international financial institutions accounted for 54.6 percent of the government's total debt portfolio. Furthermore, this indicator, as well as the share of funds raised from partner countries, has been characterized by stable trend in recent years.

Figure 2.2 Government Debt Dynamics by Loan Type



Source: Ministry of Finance of Georgia

One of the key objectives of the general government's debt management strategy is to increase the share of domestic currency-denominated debt in the total portfolio. Therefore, with the development of the domestic market, the share of treasury securities in the portfolio has significantly increased. While treasury securities represented 18.9 percent of the portfolio in 2019, by the end of 2023, same indicator had risen to 26.3 percent. In nominal terms, the capitalization of the treasury securities market in 2023 increased approximately 2.2 times compared to 2019. Additionally, a minor share comprises of the debt of budgetary organizations and guaranteed loans.

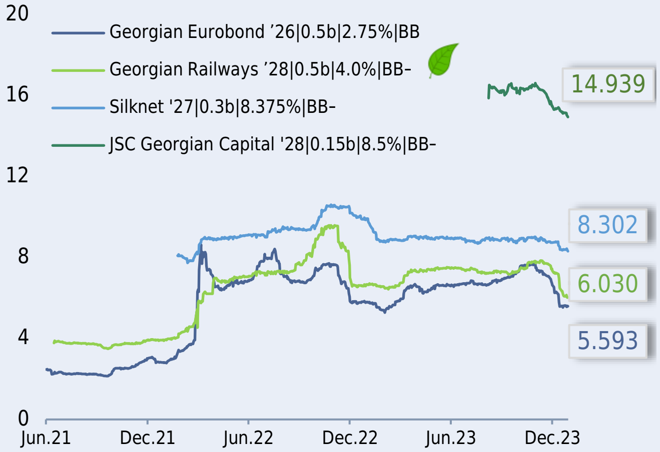
Box I - Eurobond

In April 2008, Georgia entered the international capital market for the first time by issuing Eurobonds worth $500 million with a five-year maturity. This issuance was particularly significant for positioning Georgia on the global financial map and diversifying the investor base.

In April 2011, Georgia entered the international capital market for the second time by issuing $500 million in 10-year Eurobonds. This transaction allowed existing investors to swap their current positions, leading to an exceptionally high 83% participation rate in the buyback tender for the redemption of the 2008 Eurobonds. Moreover, in terms of issuance parameters, Georgia's second Eurobond featured more favorable terms compared to the predecessor and was competitive with those of higher-rated countries. This issuance served as an important tool for extending debt maturities and provided a new liquid benchmark for potential local private and quasi-sovereign borrowers. Additionally, the issuance attracted new investors, primarily from the United States.

In April 2021, Georgia's Ministry of Finance successfully completed the country's third Eurobond issuance in the international capital market. Despite being issued during the COVID-19 pandemic, the $500 million, 5-year bond offered significant advantages both historically and compared to regional issuances. Key highlights included a 2.5-fold reduction in interest costs compared to the previous issuance, with a coupon rate set at 2.75% (compared to 6.875% in 2011), a decreased benchmark spread from 356.5 bps to 207.4 bps, a diverse base of international investors, and demand that was four times the issuance volume.

To ensure a successful placement, the issuance was arranged in collaboration with international investment banks—Goldman Sachs, JP Morgan, and ICBC—alongside local investment banks, Galt & Taggart and TBC Capital. Notably, successfully issuing the Eurobond during the pandemic allowed the country to preserve its international foreign exchange reserves, which were otherwise needed for repaying the previous Eurobond.



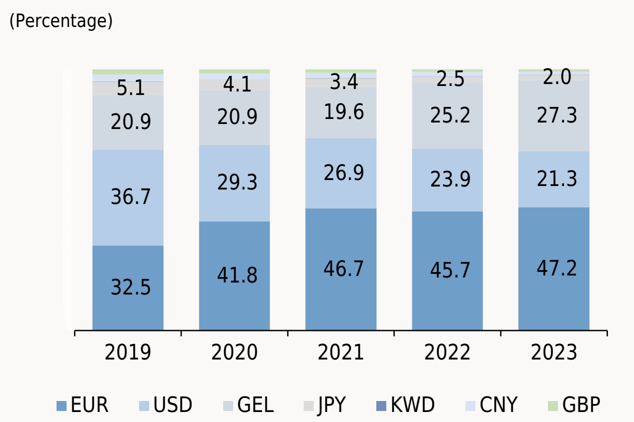
Source: Bloomberg

Government Debt Dynamics – Currency Composition

Figure 2.3 reflects the currency composition of the government debt portfolio, considering decomposition of the SDR. It is noteworthy that the share of euro-denominated debt has significantly increased in recent years. While in 2019, euro-denominated debt accounted for 32.5 percent of the total portfolio, by 2023, the same indicator grew to 47.2 percent. Over the past five years, the increase in the euro's share has primarily been driven by the strategy for utilizing existing financial resources and the ongoing economic and political alignment with the Eurozone. It should be noted that loans are not taken in British pounds (GBP) or Chinese yuan (CNY). Therefore, the shares of these currencies shown in the diagram result from the decomposition of the SDR.

In 2022, the Ministry of Finance of Georgia and the Currency Exchange Fund (TCX) signed a Memorandum of Understanding, which aims to share expertise in currency risk hedging. In regards to that, the Public Debt Management Department of the Ministry of Finance hosted a technical assistance mission organized by the TCX, during which, various models were developed for portfolio analysis.

Figure 2.3 Government Debt Dynamics - Currency Composition



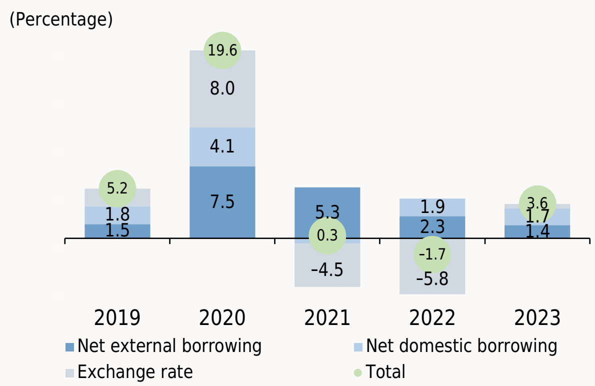
Source: Ministry of Finance of Georgia

Throughout 2023, consultations were held with international donors, including the International Bank for Reconstruction and Development (IBRD), the European Bank for Reconstruction and Development (EBRD), the French Development Agency (AFD), and the Asian Development Bank (ADB), to explore the possibility of raising loans in local currency. This initiative aims to strengthen the management of the currency risks related to the foreign debt.

Contributors to Changes in the Government Debt Portfolio

During the COVID-19 pandemic, due to the deteriorated economic environment and high financing needs, a large volume of financial resources was mobilized, resulting in a 19.6 percent increase in the debt portfolio in 2020. Of this, 11.6 percent was due to the government's net borrowing, while 8.0 percent was due to the depreciation of the Georgian Lari. This emphasizes the importance of developing the domestic market to strengthen the debt portfolio and reduce the exposure to currency risks.

Figure 2.4 Contributors to Changes in the Government Debt Portfolio

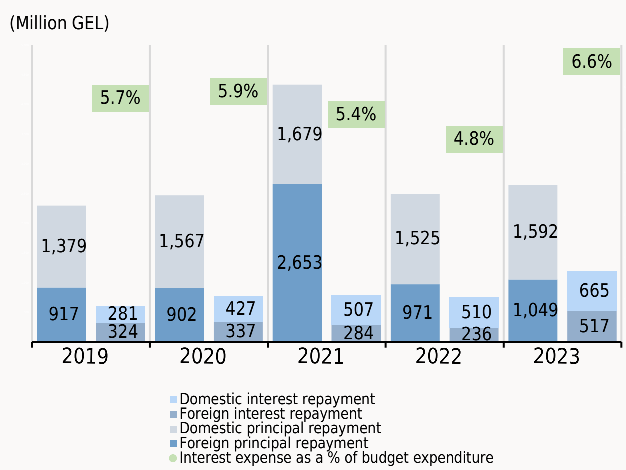


Source: Ministry of Finance of Georgia

Government Debt Service

Government debt servicing (including interest and principal payments) has mostly followed a relatively stable trend. An exception was in 2021, when a $500 million Eurobond was repaid. Between 2019 and 2022, due to budget growth, the government's interest expenses as a share of total budget expenditures decreased from 5.4 percent to 4.8 percent. However, in 2023, due to the sharp rise in global interest rates, the same indicator increased to 6.6 percent.

Figure 2.5 Government Debt Service



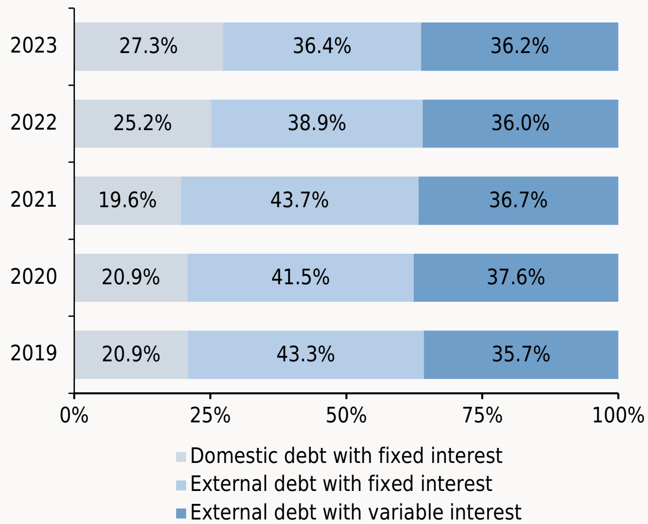
Source: Ministry of Finance of Georgia

Government Debt Portfolio Indicators

Government Debt by Interest Rate Type

A significant portion of the government debt portfolio has a fixed interest rate. By the end of 2023, the share of fixed-rate debt in the total portfolio was 63.8 percent. This indicator has remained relatively stable over the past five years. During the same period, the share of fixed-rate loans within the external debt has shown a declining trend. In 2019, 43.3 percent of the total external debt portfolio had a fixed rate, whereas by the end of 2023, this share had decreased to 36.4 percent. This decline is attributed to the repayment of older concessional external loans with fixed interest rate and the acquisition of new external loans, mostly at a variable interest rate. Meanwhile, domestic debt solely bears fixed interest rates.

Figure 2.6 Government Debt by Interest Rate Type

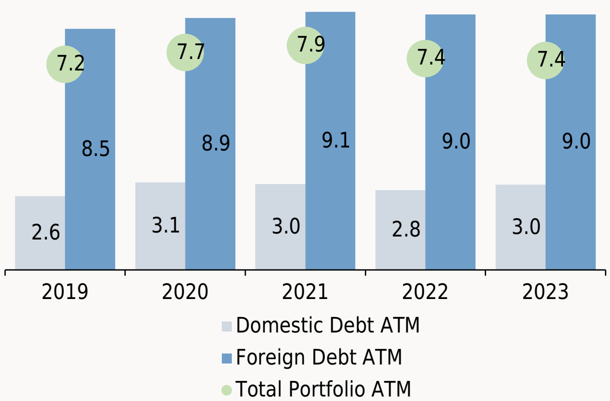


Source: Ministry of Finance of Georgia

Average Time to Maturity and Weighted Interest Rate of Government Debt

The government debt portfolio is characterized by a high average time to maturity. Over the past five years, this indicator has remained stable, standing at 7.4 years as of the end of 2023. Loans mobilized from external sources generally have a longer maturity period compared to domestic debt. However, with the development of the local securities market, it will be possible to issue treasury bonds with relatively longer maturities in GEL. To manage the refinancing risks of the portfolio, it is crucial to control the average time to maturity and the share of debt maturing within one year relative to the total portfolio. In this regard, the general government's debt management strategy defines target indicators for the average time to maturity. Additionally, the domestic debt portfolio maturity profile extension is facilitated by the active use of liability management operations, such as Buybacks and Swaps.

Figure 2.7 Weighted Average Time to Maturity of the Government Debt Portfolio

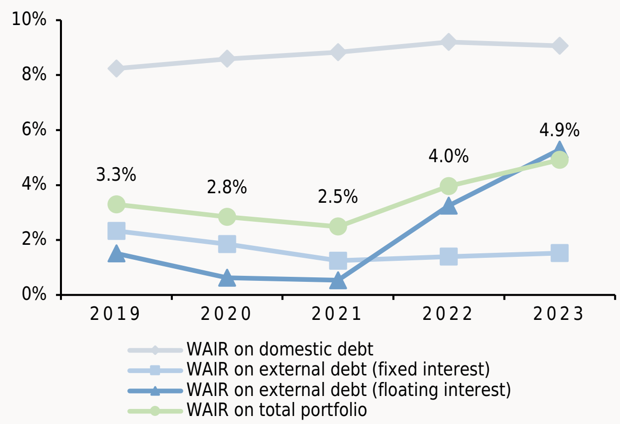


Source: Ministry of Finance of Georgia

Until 2023, the weighted average interest rate of the government debt portfolio fluctuated around 3.0 percent. However, amid global challenges, the sharp increase in interest rates on international markets significantly raised the cost of external financing in 2023. For the meantime, increased interest rates are expected to persist in the medium term.

Considering the domestic market, monetary policy tightening—implemented to manage inflation driven by supply chain disruptions caused by the pandemic and other internal and external shocks—increased the cost of borrowing in local currency too. As a result, by the end of 2023, the weighted average interest rate of the total government debt portfolio reached a historical high of 4.9 percent.

Figure 2.8 Weighted Average Interest Rate on Government Debt

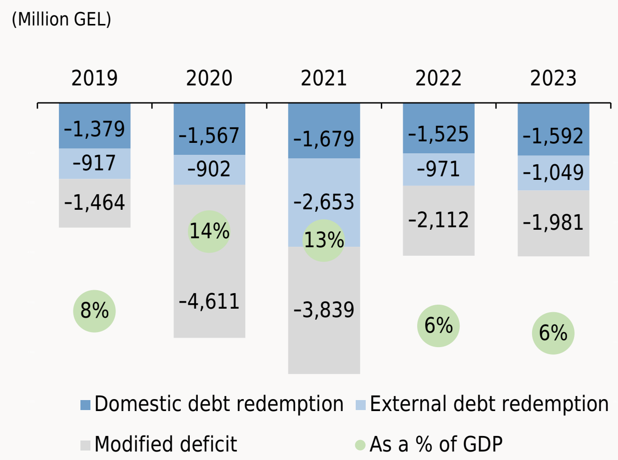


Source: Ministry of Finance of Georgia

Total Funding Need

One of the main objectives of government debt management is to determine the total financing need and meet this need through domestic and external resources. As shown in Figure 2.9, the largest component of total financing need is the budget deficit. During 2020-2021, the share of the deficit in total financing needs increased significantly due to higher expenditures amid the pandemic. However, in the post-pandemic period, this indicator began to decline and gradually reached pre-pandemic levels.

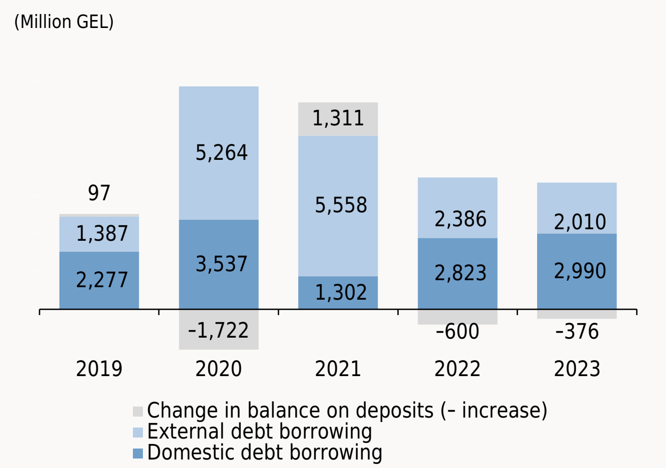
Figure 2.9 Total Funding Requirement



Source: Ministry of Finance of Georgia

In the context of resource mobilization for financing need, it should be noted that until 2022, most mobilized funds came from external creditor sources. However, since 2022, domestic financing exceeded external borrowing. Additionally, in 2020, due to the risks of a continuation of the pandemic, the volume of mobilized resources exceeded total financing need. Fiscal buffer was created, in order to mitigate potential risks (by depositing the excess funds in local commercial banks). By 2021, a significant portion of these deposits was used to meet overall financing need.

Figure 2.10 Total Funding Resources



Source: Ministry of Finance of Georgia

Domestic Debt

The government domestic debt is represented as sum of the funds in domestic currency borrowed by the Ministry of Finance of Georgia on behalf of Georgia and the loans of the budgetary organizations. At the end of 2023, the domestic debt is comprised of the following three components:

- Treasury securities;
- Government bonds (Box II – Debt Owed to the National Bank of Georgia);
- Loans of budgetary organizations.

Treasury securities as marketable instruments take the largest portion of the domestic debt portfolio. Incurring the domestic debt in the form of Treasuries serves for the following purposes:

- Financing the budget deficit;
- Covering short-term cash imbalances;
- Supporting the development of local capital market;
- Other purposes specified within the annual budget law.

In the long-term perspective, against the backdrop of strong economic growth, Georgia will surpass the threshold levels of economic indicators that are the main criteria for access to concessional donor financing, and the focus of financing will shift to the local capital market. Therefore, the primary objective of issuing domestic debt in the form of Treasury securities is to gradually develop the local capital market as a fundamental medium to meet the financing needs.

Domestic debt, alongside external debt, is one of the components for financing the budget deficit. For domestic debt, determining next year's financing need places a focus on two main areas: redemption of the maturing securities; and maintaining the gradual increase of net issuance, which aims at enhancing liquidity in the treasury securities market and, thereby, creating a reliable benchmark for the local capital market. Next year's target net issuance is defined by the annual Law on the State Budget and the Public Debt Management Department takes the accountability of reaching this target amount by designing and executing the annual and quarterly plans for issuances and liability management operations (buybacks, switches).

The Ministry of Finance of Georgia started issuing Treasury securities in August 2009, initially by issuing only the 6-month T-bills. Longer maturities have been introduced over two years and by 2012 the Treasury securities portfolio was already comprised of T-bills with maturities of 6 and 12 months, and T-bonds with original maturities of 2, 5 and 10 years.

Treasury securities are issued via auctions, multiple-price technique, and only the commercial banks are allowed to participate in the bidding process, while any other stakeholder can access the primary market via commercial banks.

In 2018, by designing and implementing the benchmark building policy, the Treasury securities market emerged into a new stage of development. The major goal of issuing the benchmark bonds is to attract all sorts of investors with wide range of preferred investing horizons – implying deepening the liquidity, dedicating to regularity and foreseeability of re-openings. The MOF started issuing the non-standard maturities of benchmark bonds in 2020. During 2023, T-bills with maturities of 6 months and 12 months and T-bonds with original maturities of 5, 10, and 11 years were issued.

All kinds of information related to domestic debt is published on the Ministry website, i.e., annual and quarterly issuance calendars, Treasury securities portfolio, debt statistics, regulatory framework, information about primary dealers, Treasury securities market dynamic, etc.

The strategic goals and directions related to domestic debt are outlined in the government's Debt Management Strategy. The strategy is updated annually and describes the progress made towards achieving the objectives set within. Additionally, new strategic directions are incorporated in it. The development of the Treasury securities market declared in the 2024-2027 Strategy document consists of six key directions, which are designed to achieve the medium-term targets of the indicators defined within the strategy. Table 1 describes the relationship between these directions and target indicators.

Table 1. Strategic Directions and Target Indicators of Domestic Debt

The Pillars of Treasury Securities Market Development	Indicators	2023	2027
Increase the volume of Treasury securities	Share of domestic debt in the Government debt portfolio	27.9%	Min. 35.0%
Secondary market development			
Develop the retail market for government bonds			
Active use of liability management operations	ATM for domestic debt (year)	3.0	Min. 3.0
Attract non-resident investors	Non-resident investor participation in Treasury securities market (share in portfolio)	2.9%	20%-25%
Develop large benchmarks	Meeting the requirements for international index inclusion	52.3%	100%

Box II – Debt Owed to the National Bank of Georgia

As of March 15, 2006, the government's debt to the National Bank amounted to 832,846,323.5 GEL. Based on the monetary and fiscal policy objectives, an agreement was signed between the Government of Georgia and the National Bank on March 20, 2006, according to which, the debt conversion is conducted annually in the following way: one part of the debt is converted into various-maturity government bonds for open market operations, while the other part is converted into a one-year bond held until maturity. According to the agreement, the final conversion will take place in 2025, and the full repayment of the debt will occur in 2030. In 2023, government bonds with different maturities (3.5, 3.8, 4.3, 5 years) were issued in the amount of 40 million GEL, while the remaining part, 80.85 million GEL, was converted into one-year bond. On the other hand, the government bonds in volume of 40 million GEL were redeemed in 2023. By the end of 2023, the sum of both types of government bonds to NBG amounted to 232.9 million GEL.

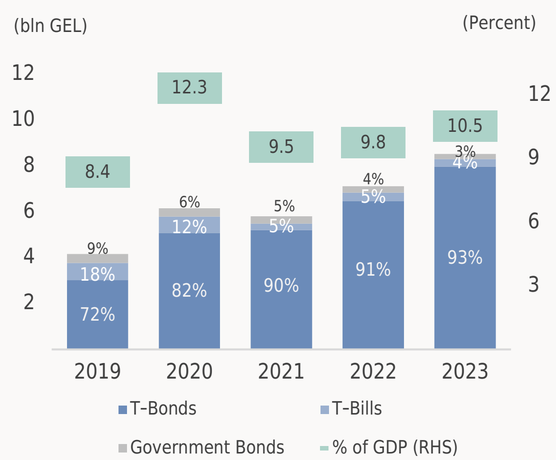
Dynamics of Domestic Debt

Treasury Securities Portfolio

The government domestic debt increased by 19.6 percent in 2023 and amounted to 8,606.3 million GEL, of which 99.1 percent is represented by securities, and 0.9 percent by loans of budgetary organizations. Over the past 5 years, as well as in the prior period, domestic debt has been characterized by an upward trend, mainly driven by actions taken to develop the Treasury securities market. In 2021, due to the impact of the COVID-19 pandemic, the acceleration of net issuance of Treasury securities slowed to some degree, which was primarily driven by the decline of T-bill issuances, while the liquidity of T-bonds slightly increased. Over the five year period, the government securities market has almost tripled compared to its size at the beginning of 2019. This growth aligns with the objectives outlined in the government's debt management strategy, which involves gradually shifting the focus of borrowing from external sources to the domestic market. At the end of 2023, the volume of the securities portfolio amounted to 8,524.6 million GEL and 10.5 percent of GDP. 93.4 percent of the portfolio is represented by T-bonds comprising of 2, 5, 10, and 11-year original maturities.

The share of T-bills is 3.9 percent, represented by 6 and 12-month maturities. 2.7 percent of the portfolio consists of Government Bonds (representing the government's debt to the central bank).

Figure 3.1 Portfolio Structure of Government Securities

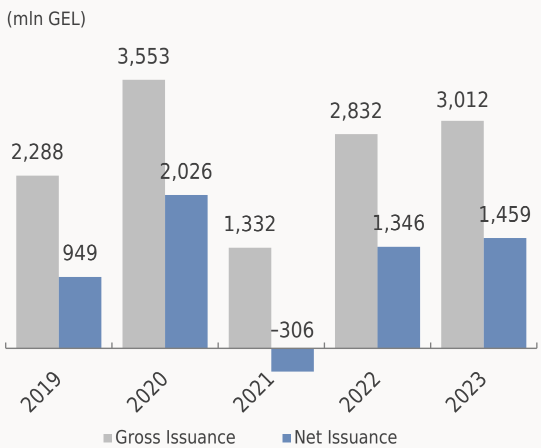


Source: Ministry of Finance of Georgia; Geostat.

Issuance of Treasury Securities

In 2023, 66 auctions were held, 6-month and 12-month T-bills and T-bonds with residual maturities of 3, 5, 7, and 10 years were issued. The funds raised through these issuances during the year amounted to 2,884.9 million GEL in nominal terms and 3,011.8 million GEL in cash terms. Therefore, the size of the portfolio increased by 1,459.4 million GEL compared to the previous year.

Figure 3.2 Gross and Net Issuances of Treasury Securities



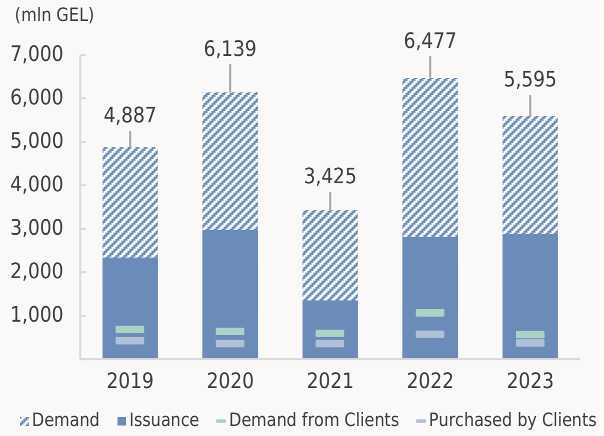
Source: Ministry of Finance of Georgia.

As mentioned above, the negative number of net issuance in 2021 can be explained by the adverse shock caused by the COVID-19 pandemic – a significant volume of concessional external resources was mobilized to cope with the pandemic, which, in the context of staying adhered to fiscal rules, required a slowdown in domestic borrowing, although only in 2021. For this year, the issuance plan was mostly focused on the seamless refinancing of T-bonds. Under normal conditions, the net issuances (the difference between issuances and redemptions) tend to increase. 2023 was also planned with similar goal – a target net issuance of 1,400 million GEL – set by the 2023 Law on State Budget . However, due to lower actual interest rates compared to the projections the size of total budgetary inflows from the placement of securities slightly exceeded the target, even though still remaining within the acceptable range. The government debt management strategy stipulates a goal of an annual growth of net issuance to 100 million GEL.

Demand for Treasury Securities

Demand for the Treasury securities typically significantly exceeds supply, which is one of the indicators of market health. Over the past five years, the annual demand has exceeded supply by an average of 2.2 times. As for 2023, the demand/supply ratio for treasury securities was 1.9. In 2023, the main impetus of demand, accounting for 89.9 percent, was shaped by local commercial banks. However, in the same period, the demand from non-banking clients, despite its small volume, played a significant role in terms of competition and market dynamics. In 2023, demand from non-bank clients amounted to 565.4 million GEL, out of which the securities in amount of 375.4 million GEL were successfully purchased. To develop this segment, resident and non-resident investors are actively provided with information about the Treasury securities market through “roadshows” and “Monthly Debt Report”.

Figure 3.3 Treasury Securities Issuance and Demand



Source: Ministry of Finance of Georgia.

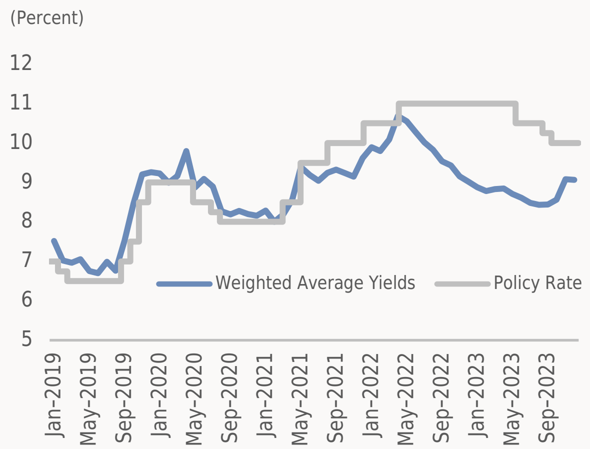
Yield and Duration

The yields on Treasury securities followed the dynamic of the monetary policy rate and remained above it until mid-2021. Since then, until the end of 2023, the yields were recorded below the monetary policy rate. This crossover effect can be explained by the slowdown in the supply of Treasury securities, which on the backdrop of demand for replenishment of liquid assets led to a decrease in the required yields.

This effect deepened even further in 2022, which can be explained by the combined impact of several factors: the surge in inflationary pressure, resulting from the slowdown in the global supply chain, induced the tighter monetary policy stance, which was initially reflected in the rising of yields on short-term instruments (Treasury bills). Subsequently, due to the deceleration in inflation combined with the market expectations for easier monetary policy, long-term instruments tended to exhibit significantly lower interest rates.

Finally, as the issuance volume of T-bonds during a month is much higher than T-bills, the gap widened further as shown on Figure 3.4. In the same period, the central bank made large-scale purchases of Treasury securities in the secondary market as part of its monetary operations, which, as reflected in the figure below, may have indirectly impacted the yield dynamics of Treasury bonds to some degree. Additionally, significant foreign currency inflows have taken place during this period, which must have led to the sharp increase in liquidity in commercial banks and consequently, higher demand for Treasury bonds. In 2023, and particularly in the fourth quarter, the Treasury yields and the monetary policy rate began to converge, which was happening in the light of gradual easing of the monetary policy. During the year, the policy rate decreased from 11.0 percent to 9.5 percent.

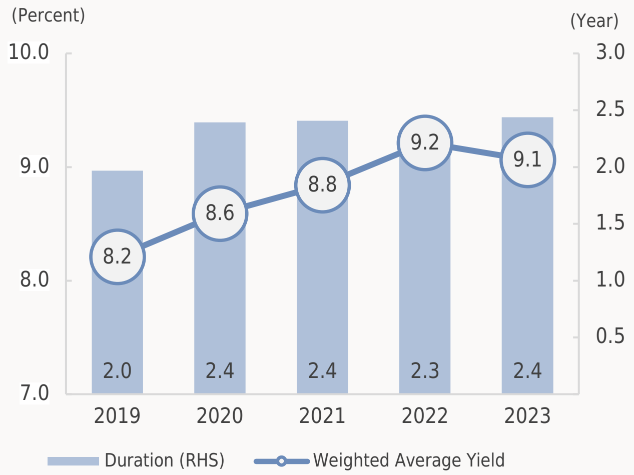
Figure 3.4 Weighted Average Monthly Yields and Monetary Policy Rate



Source: Ministry of Finance of Georgia.

The weighted average interest rate of the treasury securities portfolio declined from 9.2 percent at the beginning of the year to 9.1 percent by the end of 2023. Due to the concentration on large-volume and long-term benchmarks, the duration of the Treasury securities portfolio increased significantly, exceeding 2.4 years by the end of the year.

Figure 3.5 Portfolio Yield and Duration

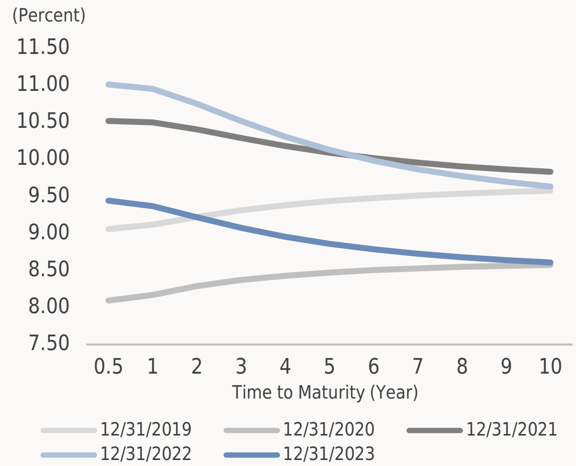


Source: Ministry of Finance of Georgia.

Yield Curves

The yield curves observed at the end of each year throughout the 2019–2023 period effectively reflect the overall impact of the factors discussed above on the dynamics of yields. Over the past three years, the Treasury securities yield curve remained inverted, indicating higher interest rates on the short-term securities compared to medium and long-term securities. In 2023, the yields on Treasury securities decreased compared to 2022 and 2021. It is expected that following the easing of monetary policy, the yield curves will gradually return to a "normal" upward slope.

Figure 3.6 Yield Curves of Treasury Securities

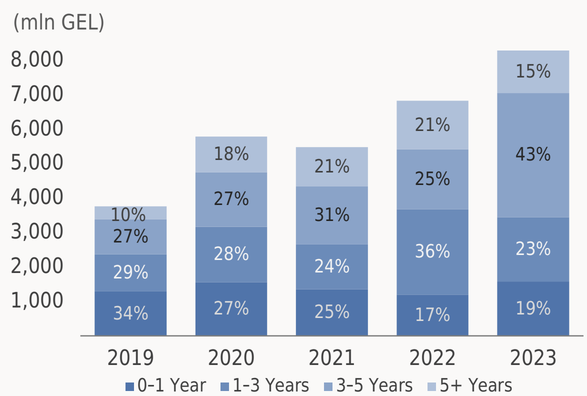


Srouce: Ministry of Finance of Georgia.

Treasury Securities Portfolio by Residual Maturity

Over the past five years, a positive dynamic of portfolio concentration from a relatively short-term to a medium-term segment, could have been observed, which in turn enables the DMO to manage the refinancing risk with greater efficiency. The share of securities with residual maturities of 3-5 years increased from 26.9 percent in 2019 to 43.5 percent in 2023, while the share of securities maturing within one year decreased from 34.2 percent to 19.0 percent in the same period. As a result, the weighted average maturity of the Treasuries' portfolio increased from 2.4 years in 2019 and reached 3.0 years by the end of 2023. The further increase in weighted average maturity and maintaining it above three years is one of the key target indicators of the government debt management strategy.

Figure 3.7 Treasury Securities Portfolio by Residual Maturity

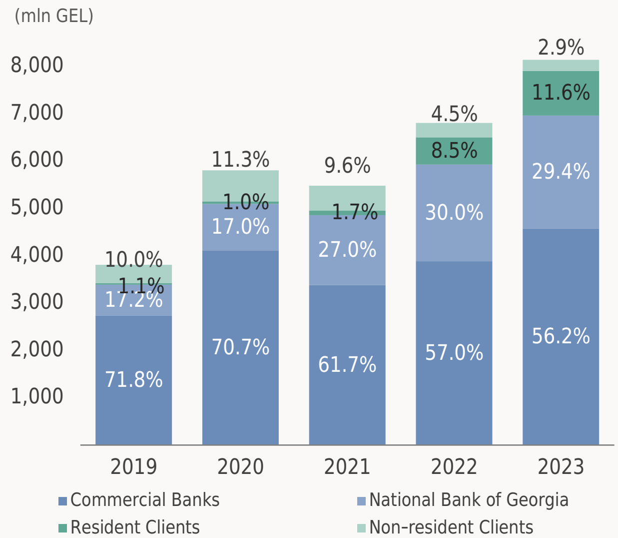


Source: Ministry of Finance of Georgia.

Holding of Treasury Securities

At the end of 2023, as in previous years, the majority of the portfolio—56.2 percent—is owned by local commercial banks. This share has been on a declining trend over the past five years. However, the holdings by commercial banks in nominal terms has been increasing over the last three years. Along with the decrease in the percentage share of commercial banks, the shares of both the National Bank and non-bank investors increased. By the end of 2023, 29.4 percent of Treasury securities were held by the National Bank, 11.6 percent by resident investors, and 2.9 percent by non-resident investors. The share of resident investors has increased significantly over the past two years, largely due to the Pension Agency's activity in the Treasury securities market. On the other hand, the share of non-resident investors has been declining, influenced by factors such as exchange rate and Georgian yield dynamics amidst rising interest rates on international capital markets. At the end of 2023, the difference between the GEL interest rates and the rates on major currencies on international markets reached a historic low, making investments in GEL instruments less attractive. However, as a result of monetary policy easing in international markets and taking into account the strength of GEL supported by fundamental factors, non-resident investor participation is expected to improve gradually.

Figure 3.8 Treasury Securities Portfolio by Holders

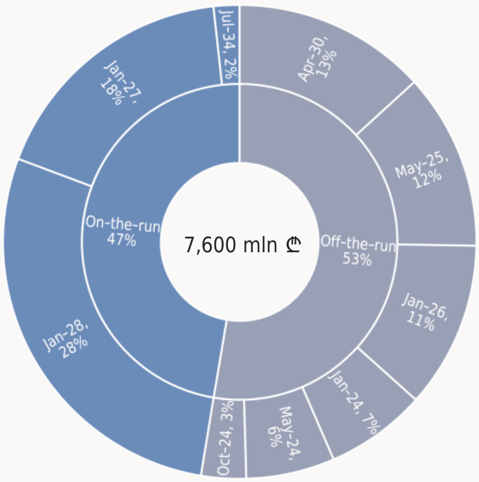


Source: Ministry of Finance of Georgia.

Benchmark bonds

In 2018, to enhance the liquidity of the government securities market, the Ministry of Finance of Georgia introduced the benchmark bonds.

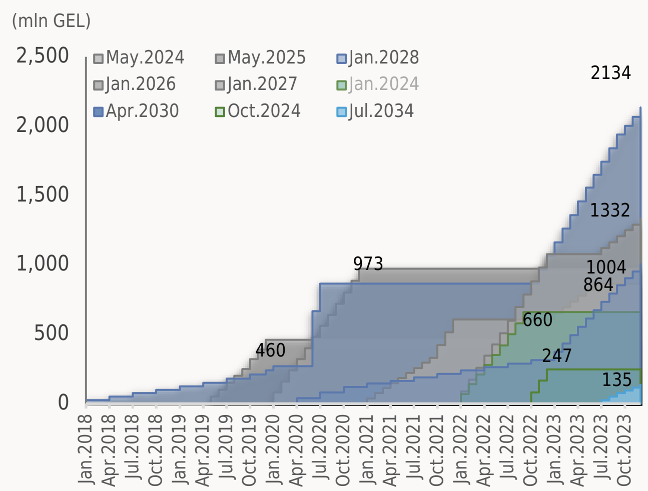
Figure 3.9 Benchmark Bonds as of the End of 2023



Source: Ministry of Finance of Georgia.

International Monetary Fund and the World Bank. Accordingly, by the end of 2023, only 2 out of the 9 benchmark bonds in the portfolio had an original maturity of 2 years, while 4 had 5-year, 2 had 10-year and 1 had

Figure 3.10 Evolution of Benchmark Bonds



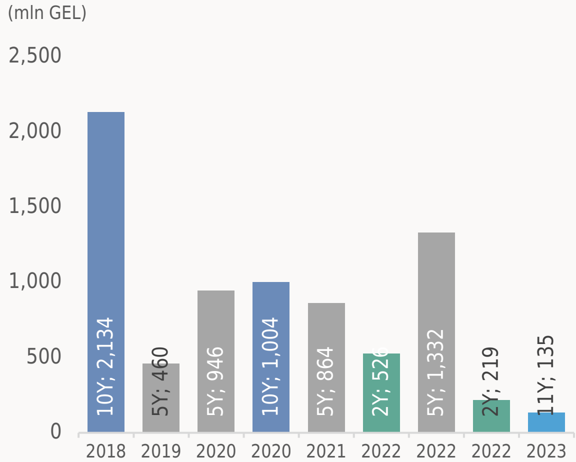
Source: Ministry of Finance of Georgia.

The initial target volume of benchmark bonds was 240 million GEL, which gradually increased over time. From 2018 to 2023, a total of 18 benchmark bonds were issued, including 9 with two-year maturity, 6 with five-year maturity, and 2 with ten-year maturity. In 2023, for the first time, an 11-year benchmark bond was issued. To extend the average maturity of the domestic debt portfolio, in the Fall of 2022, the decision to issue (re-open) the bonds with residual maturity of 3 years, instead of issuing 2-year original maturity bonds, has been made. The decision was based on the recommendations from the technical assistance mission of

11-year maturities. The reduction in the number of benchmark bonds allowed for greater portfolio concentration on 10-year and 5-year benchmarks, which helped increase the weighted average maturity from 2.4 years in 2019 to 3.0 years by the end of 2023. At the end of 2023, the portfolio consisted of 3 active and 6 inactive benchmarks, with a total nominal value of 7,600 million GEL. The largest benchmark bond in the portfolio reached a size of 2,133.6 million GEL.

The issuance of benchmark bonds enhances market liquidity, however on the other hand, increases refinancing risk, as it creates repayment peaks in the maturity schedule. To manage this risk, liability management operations were resumed in 2023.

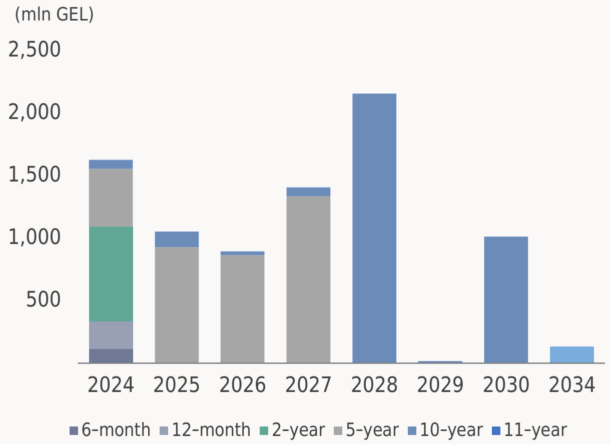
Figure 3.11 Benchmark Bonds at the End of 2023



Source: Ministry of Finance of Georgia.

As of the end of 2023, the peaks formed on the maturity profile, and especially the volume of the 2028 benchmark, poses a significant refinancing risk, however by using the buyback and switch operations the peaks and the maturity profile will gradually smooth out.

Figure 3.12 Maturity Profile of Treasury Securities



Source: Ministry of Finance of Georgia.

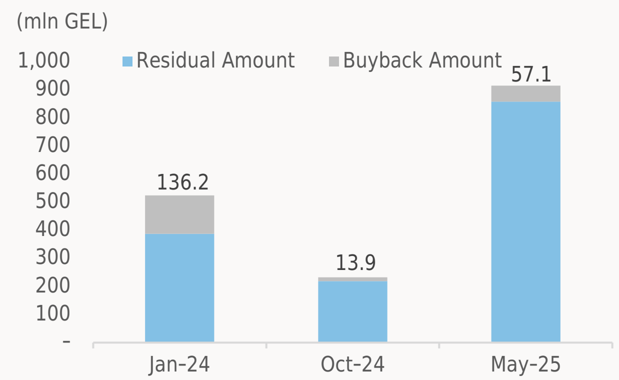
Liability Management Operations

In order to reduce the peaks in the domestic debt maturity profile and strengthen the benchmark building policy, a new instrument for liability management operations – a buyback – was introduced in 2019. In addition to benefiting from favorable market conditions in terms of yields, this instrument supports improving the liquidity of government securities and forming the yield curve. Furthermore, the use of liability management operations contributes to greater flexibility in the treasury securities issuance plan and represents a tool for achieving the target net issuance of domestic debt defined by the annual budget law.

In July 2023, buyback operations were resumed, conducted on regular monthly basis. In 2023, a total of 207.2 million GEL of 2-year and 5-year (original maturity) government bonds were repurchased, out of which 65.7 percent represents a 5-year Treasury bond issued in 2019. These buyback operations enabled the MOF to significantly reduce the outflow burden on January 2024.

As for the second instrument of liability management operations — a switch — due to its technical flexibilities and advantages in efficiently extending the average maturity of the portfolio, the DMO planned to introduce it in 2024. Prior to its implementation, consultations were held with the National Bank of Georgia and domestic market participants. Additionally, necessary amendments were made to the regulation on treasury securities, defining the procedures for conducting switch auctions.

Figure 3.13 Buyback Operations

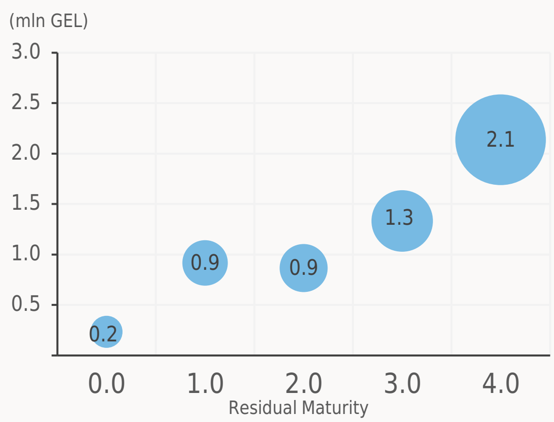


Source: Ministry of Finance of Georgia.

Primary Dealers Pilot Program

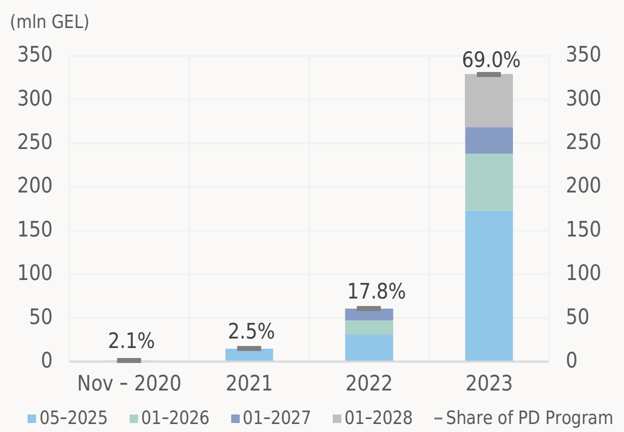
The Primary Dealers Pilot Program (Box III – Primary Dealers Pilot Program) was introduced in 2020, and since then until the end of 2023, five treasury securities have been gradually included. As of the end of 2023, the largest benchmark included in the program amounts to 2.13 billion GEL, which represents 26.2 percent of the whole treasury securities portfolio. By the end of 2023 the program size amounted to 5.48 billion GEL, accounting for 67.3 percent of the treasury securities portfolio.

Figure 3.14 Designated Benchmark Bonds for Primary Dealers Pilot Program



Source: Ministry of Finance of Georgia.

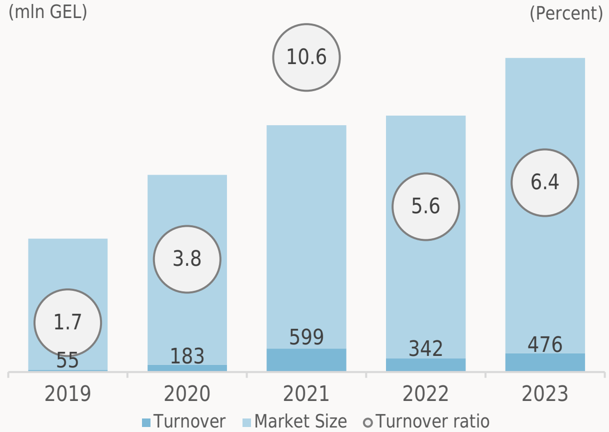
By the end of 2023, out of the five benchmarks included in the program, two had an “on-the-run” status. A new benchmark is planned to be added to the program in 2024. The Primary Dealers Program, with the securities it consists of, contributes significantly to secondary market activity. In less than 2.5 years, trading of securities included in the program accounted for 17.8 percent of total secondary market trading, and by the end of 2023, it amounted to 69.0 percent. This configuration aligns with the dynamics of the program’s volume, and it is expected that with the transition to a full-fledged system, secondary market turnover will increase substantially. Despite the program's healthy structure and stable gradual development, the secondary market is still characterized by low activity and the turnover ratio at the end of 2023 amounted to 6.4 percent, while the average ratio for the past 5 years lands at 7.3 percent. The highest activity in terms of secondary market turnover was recorded in 2021 and reached 598.6 million GEL, while over the last two years, activity has decreased relatively and amounted to 476.5 million GEL in 2023. Nevertheless, the trend still has a healthy development trajectory.



Source: Ministry of Finance of Georgia; National Bank of Georgia.

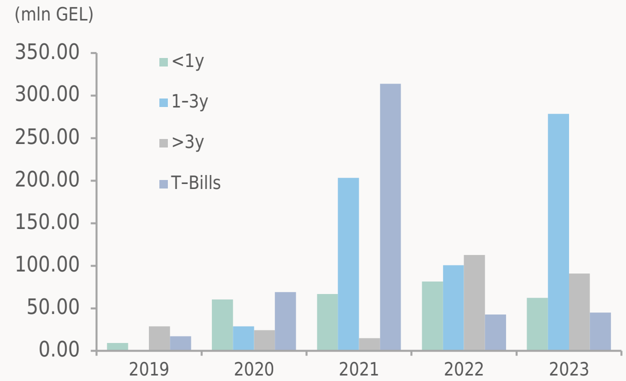
Figure 3.15 Trading with Securities Included in the Primary Dealership Pilot Program

Figure 3.16 Secondary Market Turnover



Source: Ministry of Finance of Georgia; National Bank of Georgia.

Figure 3.17 Secondary Market Turnover by Residual Maturity



Source: Ministry of Finance of Georgia; National Bank of Georgia.

As noted above, secondary market activity for designated Treasury bonds is growing rapidly, and as of 2023, it is significantly higher than for Treasury securities outside of the program.

Over the past five years, the secondary market activity for Treasury securities with a residual maturity of up to one year has demonstrated significantly greater stability in comparison to other maturity segments. Over the past 3 years, turnover of securities with residual maturities of 1 to 3 years has increased significantly. Particular significance can be put on the revived activity in the relatively long-term segment during 2022-2023, which constituted, on average, one-fourth of the total turnover. In 2023, the largest activity was recorded in the 1-3 year segment, amounting to 278.5 million GEL, which accounts for 58.4 percent of the total turnover. The 1-3 year segment not only leads in volume but also in the number of transactions, totaling 13.

The concentration on shorter residual maturities in Treasury bonds is due to two factors: firstly, by holding the securities with lower duration investor minimizes portfolio price sensitivity and secondly, investor reduces the risks of holding debt securities for long-term perspective, thus, effectively receives the principal earlier, that allows for earlier reinvestment opportunities. If this configuration is maintained, it is expected that secondary market activity will gradually increase alongside the expansion of the Primary Dealers Pilot Program. Initially, this may be characterized by some lag, but as the Program transitions to a full-fledged system, it is anticipated that due to the reduction in liquidity risks and hence elimination of entry and exit barriers, the turnover of these residual maturity segments will grow and equalize.

Box IIII – Primary Dealers Pilot Program

In November 2020, the Ministry of Finance of Georgia, in close collaboration with the National Bank of Georgia and with active involvement of the International Monetary Fund and the World Bank, launched the Primary Dealers Pilot Program. The program is of significant importance, both for the stability and predictability of the primary market, as well as for activating the secondary market, which is the main focus of the program. Additionally, the primary dealers pilot program aims to expand the investor base, diversify it, and enhance institutional investors' involvement. The program was launched with the inclusion of one designated Treasury bond and, gradually 4 additional securities were included up to the end of 2023. At this stage, the program is consisted of 4 primary dealers, all of which are the local commercial banks. The "Primary Dealer" status implies that dealers are responsible for the daily quoting of prices on designated benchmark bonds on the secondary market (Bloomberg trading platform), maintaining reasonable and narrow bid-ask spread, classifying the minimum allowed volume of designated securities as "available for sale", meeting a minimum allowed share in secondary market turnover, and other duties. In return, dealers receive significant privileges such as the exclusive rights to participate in: primary market issuance auctions for designated bonds; buyback and switch operations; and open market operations of the National Bank. In addition, the establishment of the program was preceded by the creation of the working group consisting of the Ministry of Finance of Georgia, the National Bank of Georgia, and the primary dealers, which serves as a medium for information exchange, consultations, and decision-making regarding the program. The Pilot Program is planned to be transformed to a full-fledged system, covering the full range of Treasury securities. This will be carried out gradually, based on regular assessments of the program's effectiveness, which includes criteria for evaluating the efforts and performance of the primary dealers.

Investor Relations

In recent years, special attention has been drawn to investor relations, and important steps have been taken in this regard:

- In 2022, the "Monthly Debt Report" was developed and published on the Ministry’s website, which includes detailed monthly updates on the dynamics of government debt, its structure, currency composition, and other indicators. The focus of the report is placed on describing the dynamics of the Treasury securities market, includes the issuance calendar for Treasury securities and other relevant information. Simultaneously to its publication, the report is delivered to both local and foreign investors.
- An "Investor Relations Strategy" was developed, which outlines the key principles and areas to be improved in the context of investor relations.
- Informational meetings (Roadshows) are held abroad with international investors in London and the United States, where they are provided with information on the current stance and future prospects on the Treasury securities market. In some cases, the private sector is also involved, which further enhances the opportunities to raise awareness about the country’s capital market.

Ongoing Activities

For the next stage of government securities market development, the following activities are being pursued: the development of the retail investor segment and the inclusion of Georgia in international bond indices. The development of the retail market, in addition to diversifying the investor base, provides a significant stimulus for financial education and, in the long term, supports the accumulation of domestic savings. Currently, the experience of countries with best practices is being studied, and the development of the program structure is planned for 2024. As for international bond indices, this aims to draw international investors interest to Georgia's Government securities market, which serves as a fundamental gateway to the whole country's capital market. Two indices are being considered: FTSE Frontier Emerging Markets Government Bond Index and J.P. Morgan Government Bond Index. Both of them imply meeting certain quantitative and qualitative criteria. Among the quantitative criteria, the size of the overall market, and in case of JP Morgan index the size of the individual benchmark, represents a significant challenge.

Accordingly, the above-mentioned benchmark building policy is closely related to achieving this goal, as it involves the concentration of the Treasury bonds' portfolio on a few large benchmarks and their consequent gradual increase. As of the end of 2023, the total volume of the Treasury securities market reaches 8.14 billion GEL, while the volumes of the two largest benchmarks are 2.13 and 1.33 billion GEL. These goals support the formation of the yield curve, since in an optimal scheme a small number of benchmarks should cover evenly spaced points of the yield curve, which in turn implies the establishment of a wide range of investment time horizons.

General Government External Debt

According to the Law of Georgia on Public Debt, external debt is a constituent part of the public debt of Georgia expressed in foreign convertible currency. Since the local market is still in the development process, the government attracts financial resources from external sources to finance various large-scale projects and programs.

Over the past years, numerous significant projects aimed at improving the country's economic and social conditions have been implemented through loans raised from external sources. The Ministry of Finance of Georgia selects the terms of loans to be taken from foreign creditors. It should be mentioned, that the initiation of taking out an investment loan is carried out primarily for projects that have undergone a preliminary assessment stage according to the Investment/Capital Projects Management methodology (PIM) and have received an approval from the Economic Council.

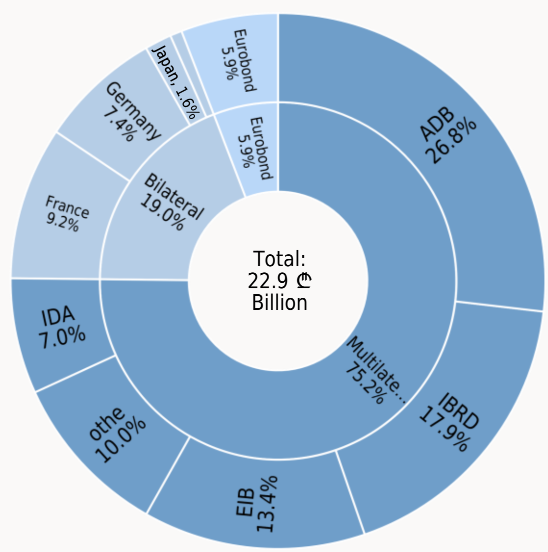
External Debt Portfolio

Structure of the External Debt Portfolio

As of the end of 2023, external debt portfolio amounted to 22.9 billion GEL. The largest portion of the portfolio, 75.2 percent, consists of loans from multilateral creditors, while 19.0 percent comes from bilateral creditors, and the remaining 5.9 percent is a bond issued on the international market.

It should be noted that the largest donors among multilateral creditors are the Asian Development Bank (ADB), the World Bank (WB), and the European Investment Bank (EIB), while a significant portion of bilateral creditors comes from development agencies of the governments of Germany and France.

Figure 4.1 External Debt Portfolio

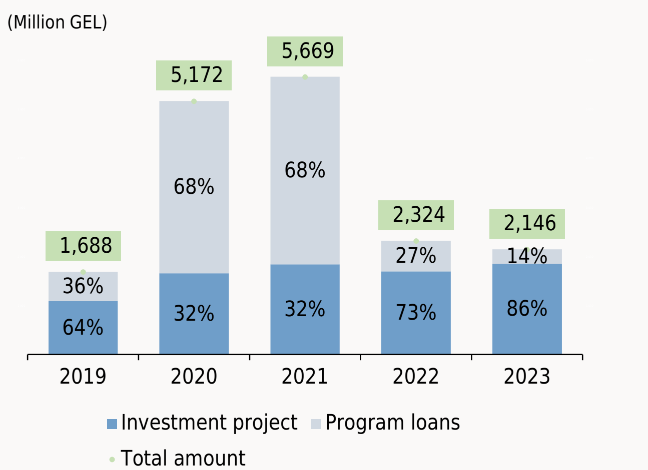


Source: Ministry of Finance of Georgia

Disbursed Financial Resources

Financial resources raised from external sources are divided into two categories based on their purpose: budget-supporting program loans and investment loans intended for financing of the capital projects. Historically, the amount of investment loans over the years significantly exceeded the amount of program loans. The exception was in 2020 and 2021, when, due to the increased financing need caused by the COVID-19 pandemic, the amount of program loans considerably increased.

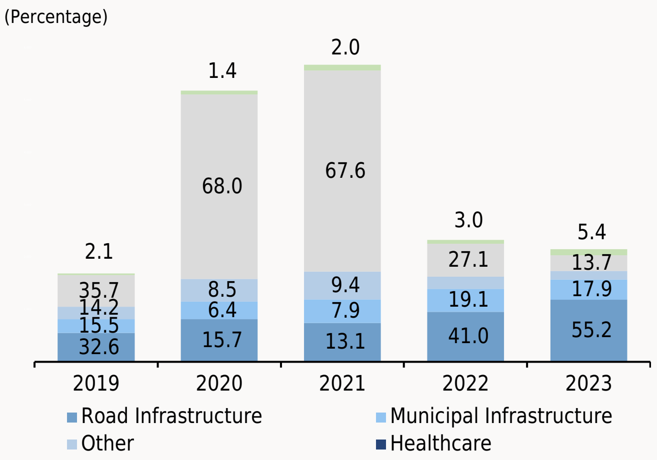
Figure 4.2 New Loans Disbursed During the Year



Source: Ministry of Finance of Georgia

The purpose of the investment loans in the external debt portfolio is determined based on the needs of capital projects. In 2023, 55.2 percent of the total drawings was allocated to road infrastructure, the largest portion of which was used for the construction of the East-West Highway.

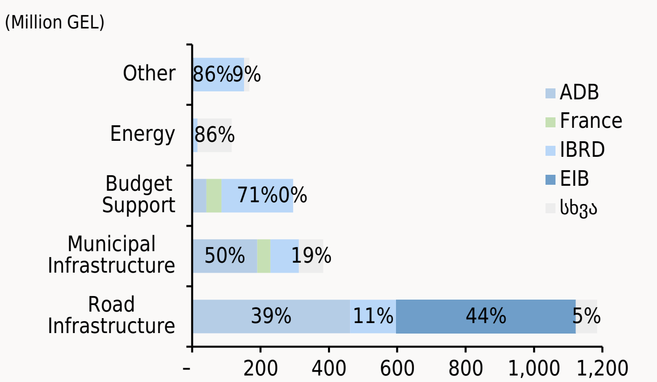
Figure 4.3 Disbursed Loans by Sectors



Source: Ministry of Finance of Georgia

Also, a significant portion was also allocated to municipal infrastructure, specifically the renovation of water systems, solid waste systems, and other rehabilitation works. It should be noted that all of these loans were obtained under concessional conditions from international donors.

Figure 4.4 The Main Sectors of Donor Funding During 2023.



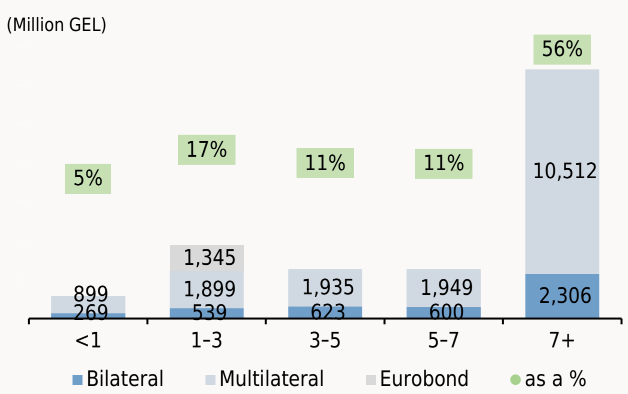
Source: Ministry of Finance of Georgia

External Debt Portfolio Maturity and Interest Rate

As of the end of 2023, the average time to maturity (ATM) of the external debt portfolio was 9.0 years. As shown in Figure 4.5, the repayment of a significant portion of the portfolio – 56.0 percent begins after seven years, while the amount to be paid in 2024 accounts for only 5.1 percent of the total portfolio. This aligns with the strategic objectives of the debt management. Concluding that the external debt portfolio is characterized by relatively low refinancing risk.

However, it should be noted that a 500 million USD Eurobond, accounting for 5.9 percent of the external debt portfolio, is due for repayment in 2026. This increases the refinancing risk for that year and requires a development of an effective refinancing risk management plan.

Figure 4.5 External Debt Redemption Schedule as of the End of 2023

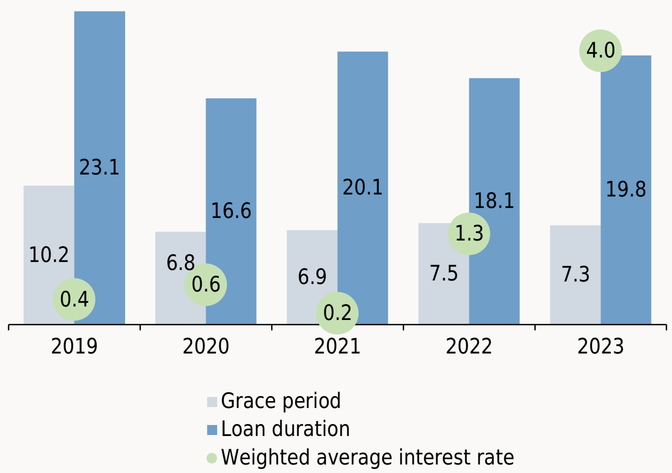


Source: Ministry of Finance of Georgia

Figure 4.6 presents the average time to maturity, grace period, and average weighted interest rate of all loans signed each year over the past five years. When selecting the terms of external loans, priority is generally given to options with the longest maturity and grace period to optimize refinancing risk.

At first glance, the external debt portfolio is characterized by a high average time to maturity and a significant grace period. This is due to the fact that the portfolio is primarily composed of investment project loans, which generally have both larger volumes and longer maturities compared to program loans.

Figure 4.6 Maturity and Interest Rate of Loans Signed During the Year

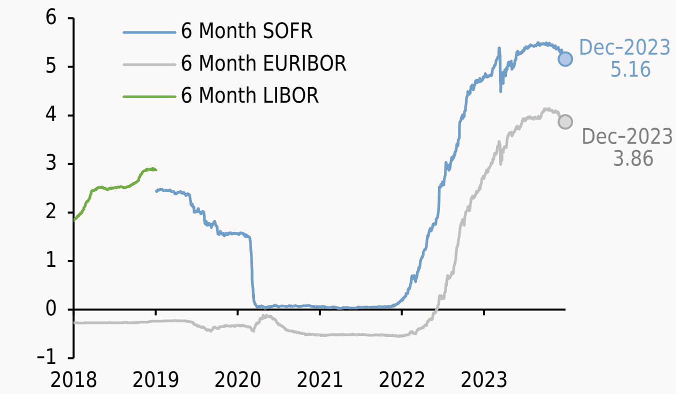


Source: Ministry of Finance of Georgia

Over the past two years, the average weighted interest rate of newly signed loans has fluctuated heavily due to volatility in the global market. During the pandemic, as reference interest rates (EURIBOR, SOFR, LIBOR) in euros and us dollars were close to zero, interest rates on loans moved close to zero. However, since 2022, high inflation in Europe and the U.S. has led to tighter monetary policies, resulting in increased borrowing costs for external loans. The trend of the average weighted interest rate of newly signed external loans, as presented in Figure 4.6, aligns with the five-year dynamics of the six-month SOFR and EURIBOR shown in Figure 4.7. Notably, after a sharp increase, interest rates began to stabilize from the end of 2023. The potential negative effects caused by global shocks highlight the importance of developing hedging instruments in government debt management.

Figure 4.7 Dynamics of 6-month SOFR, LIBOR, EURIBOR

(Percentage)

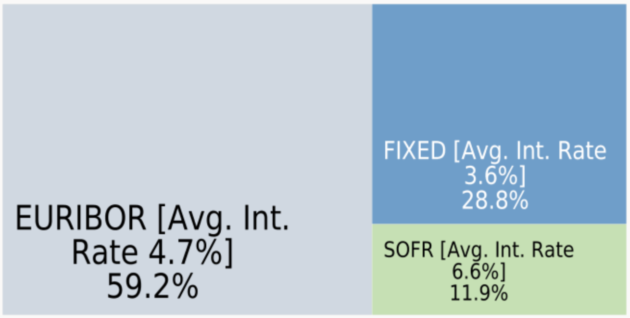


Source: Bloomberg

Composition of Loans Disbursed and Repaid in 2023 by Interest Rate Type

The rise in global market interest rates has led to a preference for variable interest rate options when taking long-term capital loans. Figure 4.8 shows that in 2023, a significant portion—71.2 percent—of disbursed loans had variable interest rates, with 59.2 percent linked to EURIBOR and 11.9 percent to SOFR. The remaining 28.8 percent were fixed-rate loans.

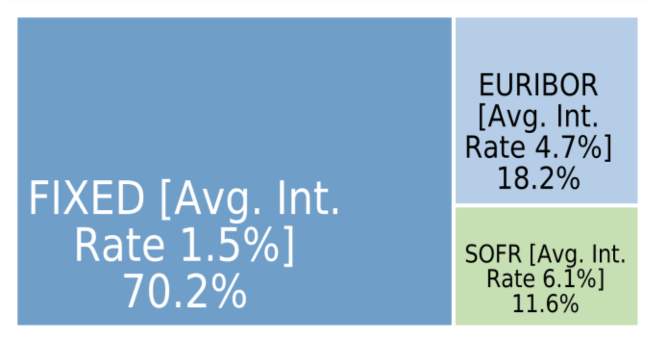
Figure 4.8 Composition of Loans Disbursed in 2023 by Interest Rate Type



Source: Ministry of Finance of Georgia

Figure 4.9 shows that in 2023, the majority of paid loans (70.2 percent) had a fixed interest rate, with an average weighted interest rate of 1.5 percent.

Figure 4.9 Composition of Loans Repaid in 2023 by Interest Rate Type



Source: Ministry of Finance of Georgia

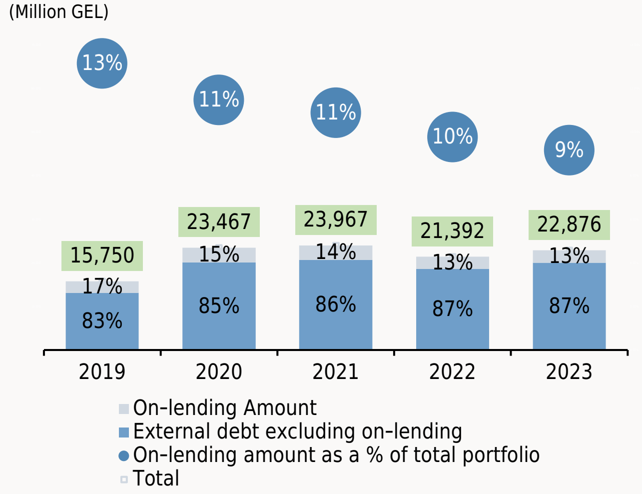
However, the imbalance between the structures of loans disbursed and repaid has further accelerated the increase in the share of loans with variable interest rates in the government's external debt portfolio.

It is possible to modify the financial terms of existing loans with major donors such as the Asian Development Bank and the World Bank. Both the type of interest rate and the currency can be converted. However, it is important to choose the optimal time for this process to avoid fixing high interest rates on loans.

On-lending Debt Portfolio

According to the Law of Georgia on Public Debt, the Ministry of Finance has been given the mandate for on-lending financial resources raised from external sources.

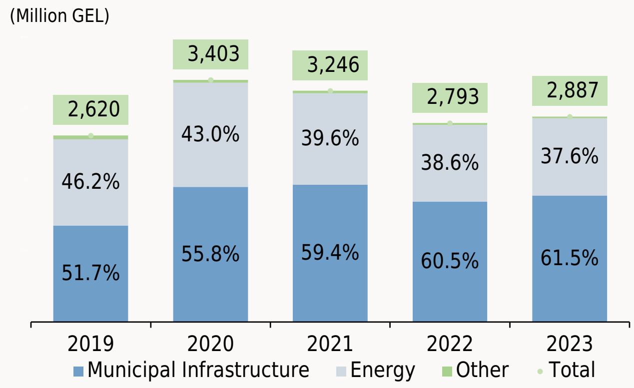
Figure 4.10 Dynamics of On-lending



Source: Ministry of Finance of Georgia

Since Georgia benefits from concessional credit resources from international donor organizations, the transfer of raised funds allows the country to achieve economic benefits in line with its priorities, under conditions of low interest costs. In recent years, the on-lending of financial resources obtained from donors to state-owned enterprises and municipalities has been carried out continuously. It is noteworthy that the on-lending is done under the same financial conditions as the credit was obtained by the government itself.

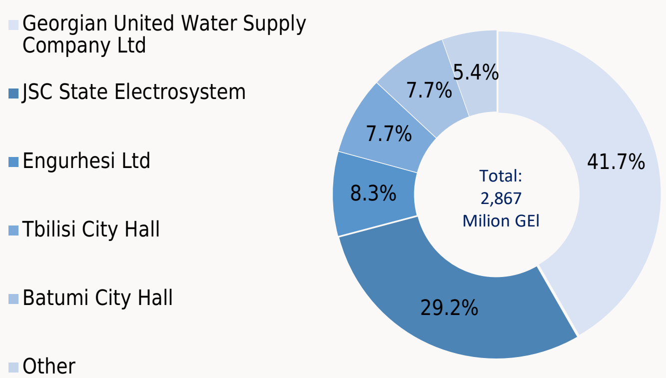
Figure 4.11 On-lending by Sectors



Source: Ministry of Finance of Georgia

The majority of the on-lending debt portfolio is allocated to municipal infrastructure and energy sectors, with the largest beneficiary being the LLC "United Water Supply Company of Georgia" (41.7 percent of the total on-lending debt portfolio). It is noteworthy that the energy sector has two main beneficiaries, collectively accounting for 37.5 percent.

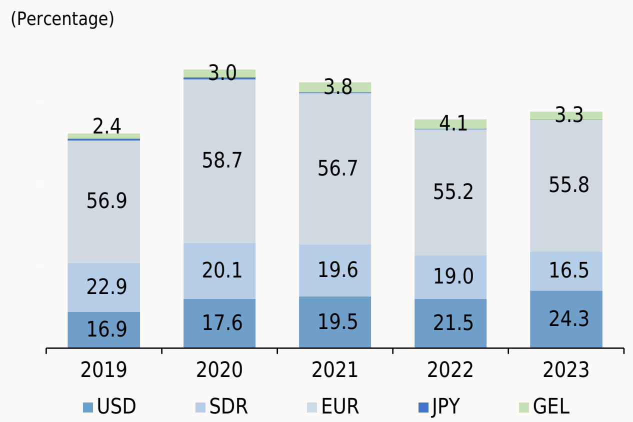
Figure 4.12 On-lending by Beneficiary in 2023



Source: Ministry of Finance of Georgia

As mentioned earlier, the on-lending is carried out without changes to the financial terms. Accordingly, the composition of the on-lending debt portfolio by currency and interest rate is similar to the government's external debt portfolio.

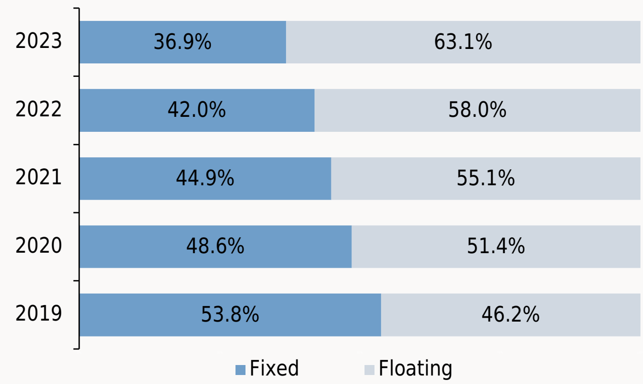
Figure 4.13 Dynamics of On-lending Debt - Currency Composition



Source: Ministry of Finance of Georgia

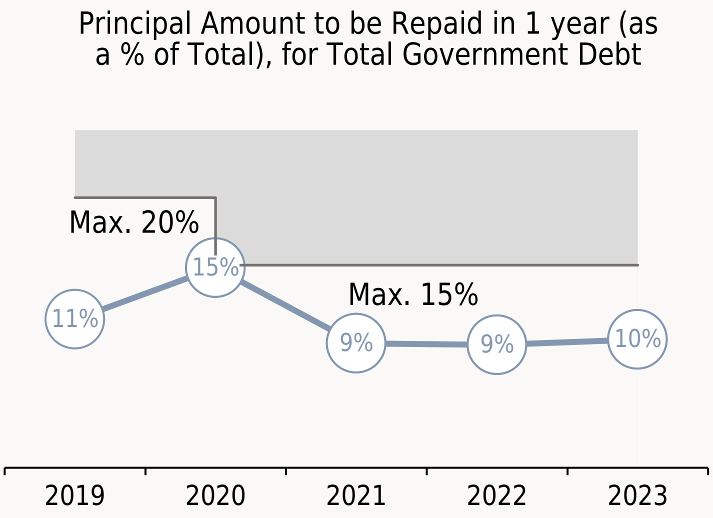
On one hand, the share of euro-denominated loans is increasing, which aligns with the objectives outlined in the general government's debt management strategy. On the other hand, the share of loans with fixed interest rates in the portfolio is decreasing, which is due to the structural changes in the portfolio.

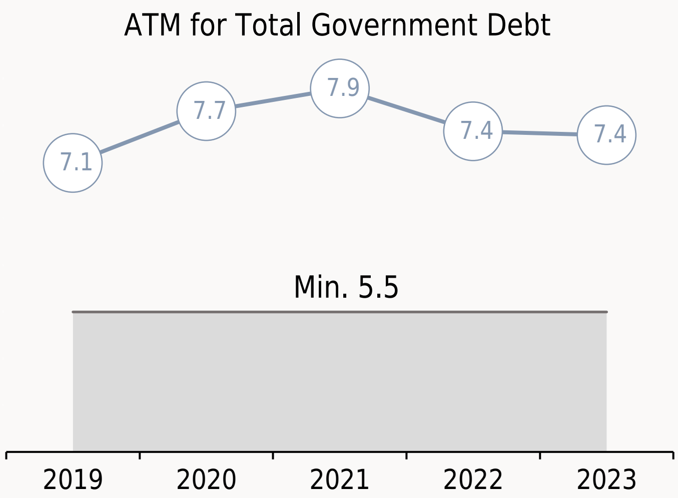
Figure 4.14 On-lending by Interest Rate Type

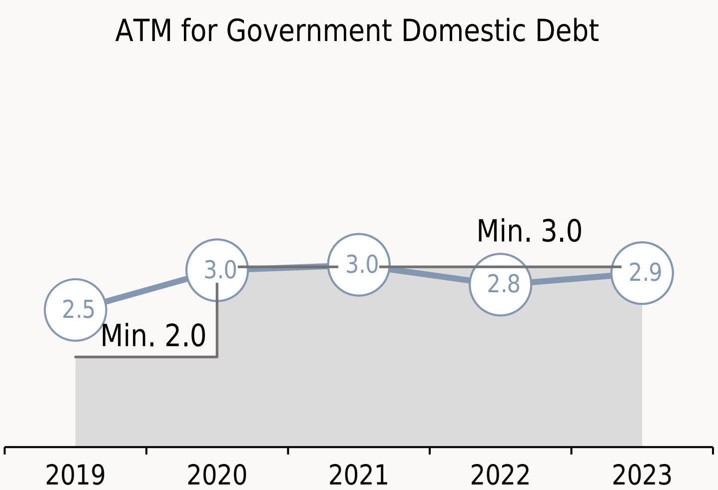


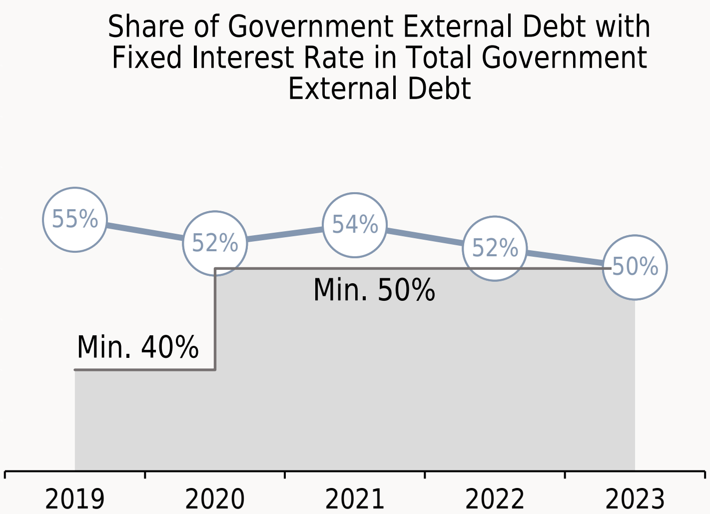
Source: Ministry of Finance of Georgia

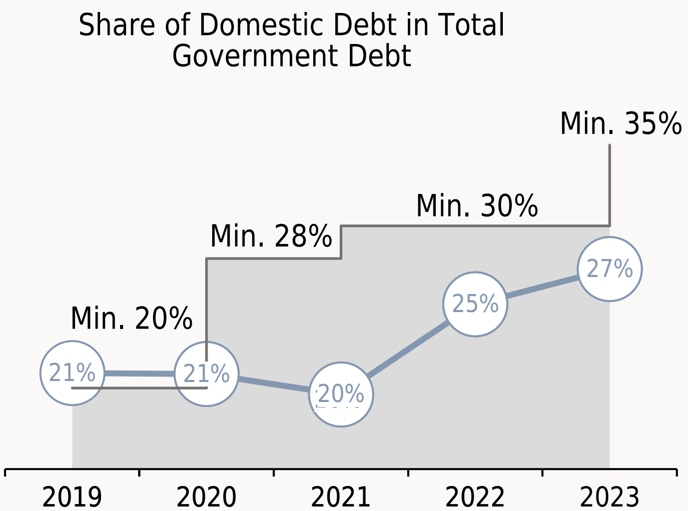
Monitoring of the General Government Debt Management Strategy Indicators

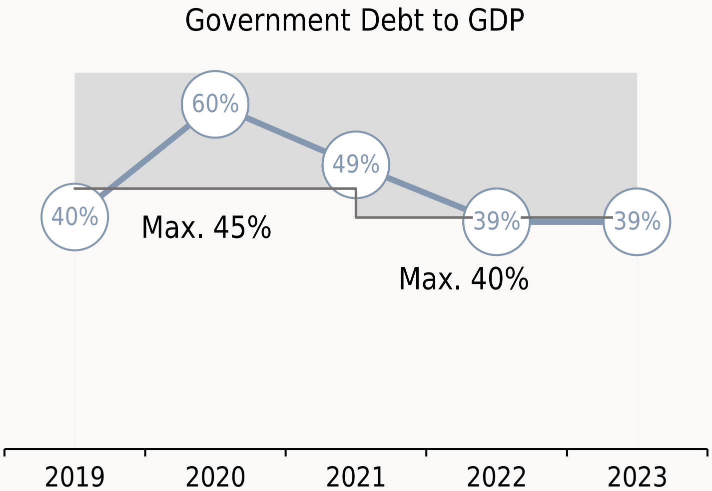












Source: Ministry of Finance of Georgia

Ministry of Finance of Georgia
Public Debt Management Department
https://mof.ge/
https://mof.ge/saxelmwifo_valis_martva