



Development of Inflation Targeting in Georgia - Role of Fiscal Policy

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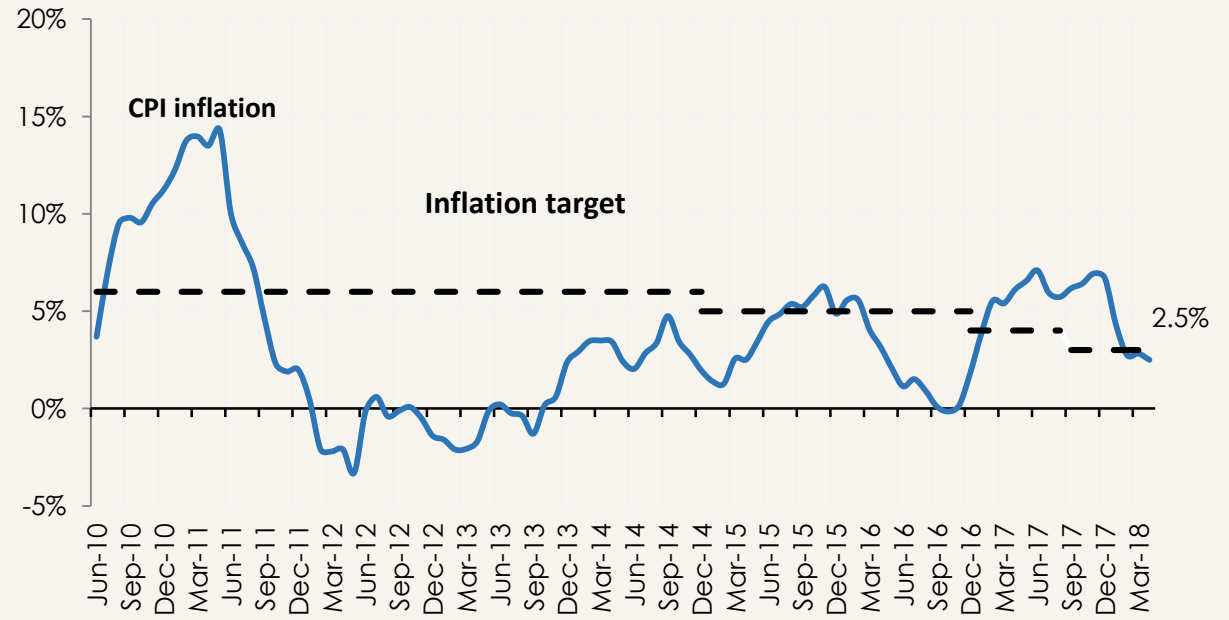
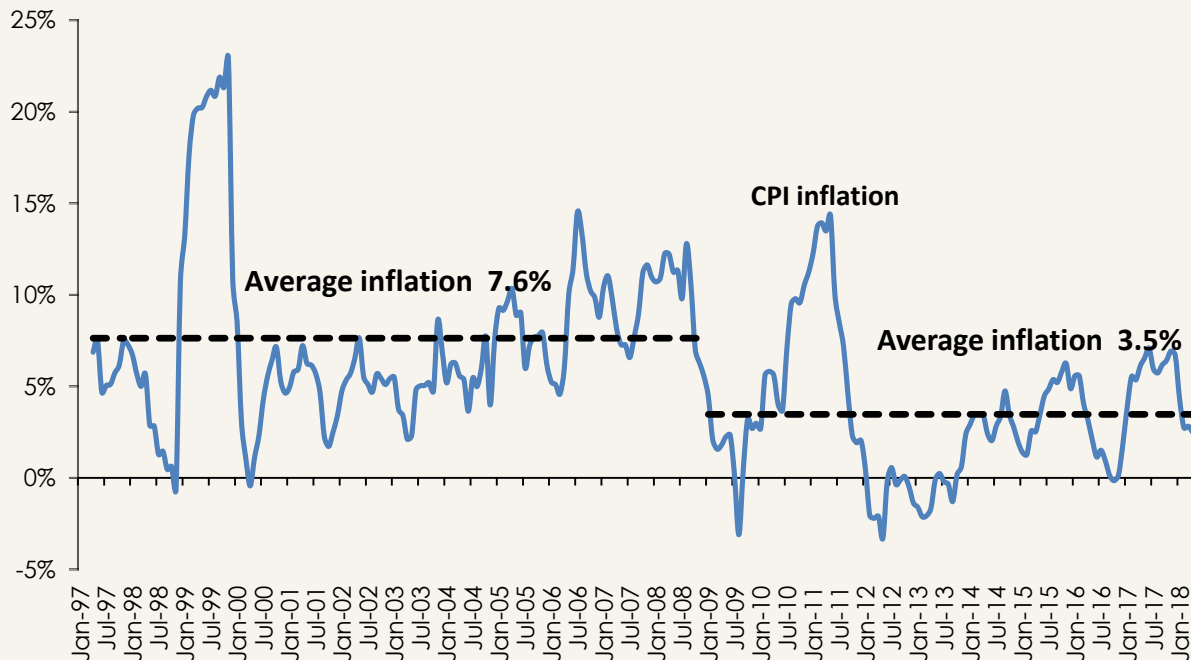
Role of Fiscal Policy under Inflation Targeting

Interaction Between Monetary & Fiscal Policies

- ❖ Legal and institutional infrastructure:
 - ❖ Independent Central Bank;
 - ❖ No fiscal dominance;
- ❖ Coordination and communication between the government and the central bank
 - ❖ Improve liquidity forecasting and management;
 - ❖ Develop financial markets.

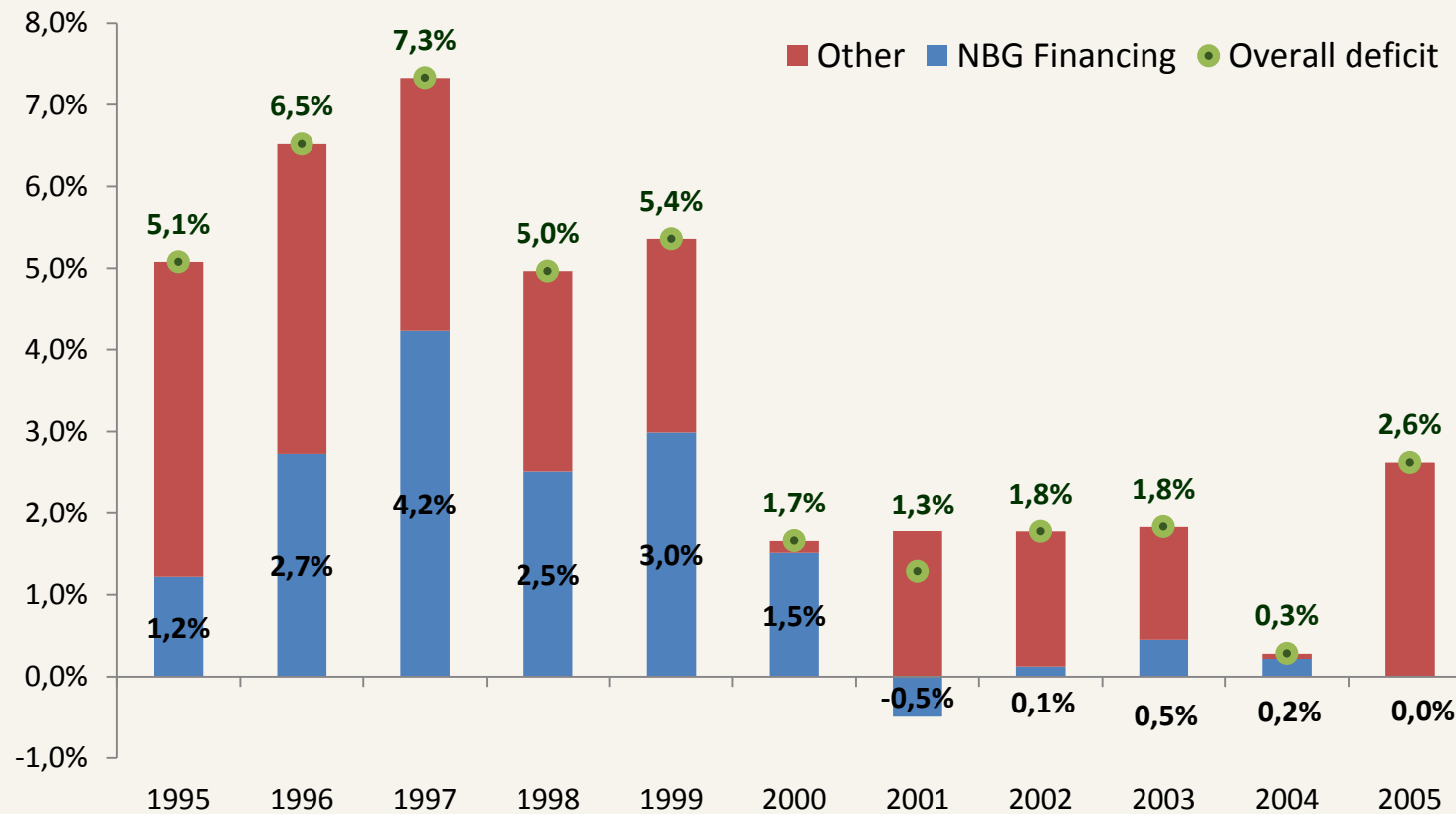
Introduction of Inflation Targeting

- ❖ The NBG switched to inflation targeting in 2009;
- ❖ The main objective of the monetary policy is to **ensure price stability**;
 - ❖ Financial stability;
 - ❖ Promote sustainable economic growth.



Fiscal Policy in 90s

- ❖ Turbulence in 90s;
 - ❖ Relatively higher level of deficit in mid 90s;
 - ❖ Difficulties in financing budget deficit.
- ❖ High share of the NBG in budget deficit financing.

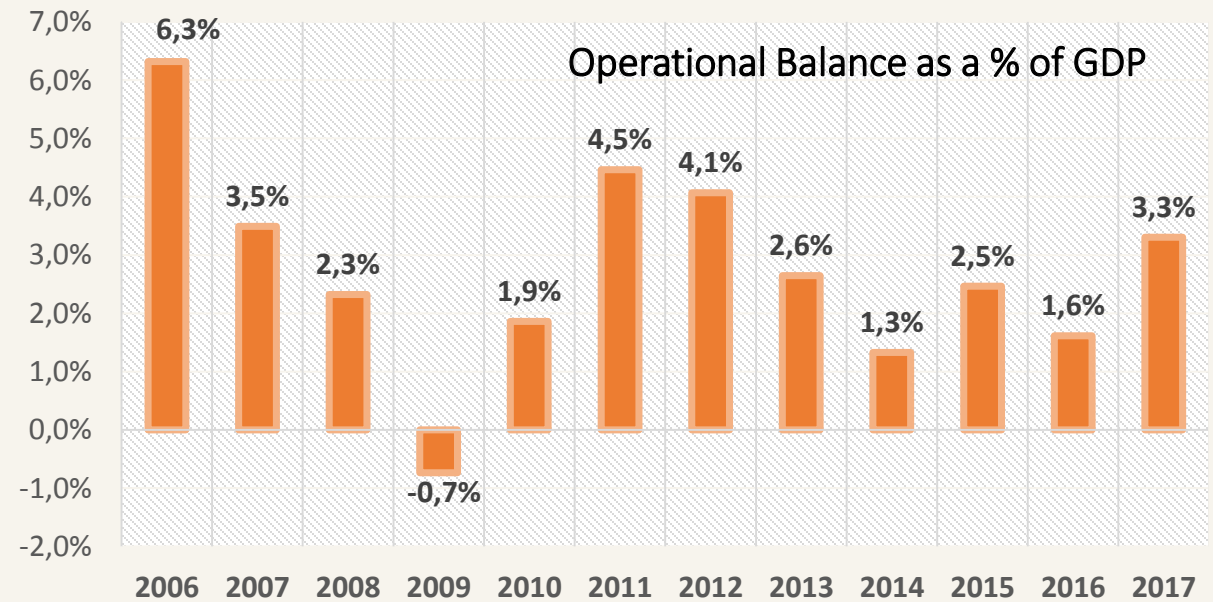
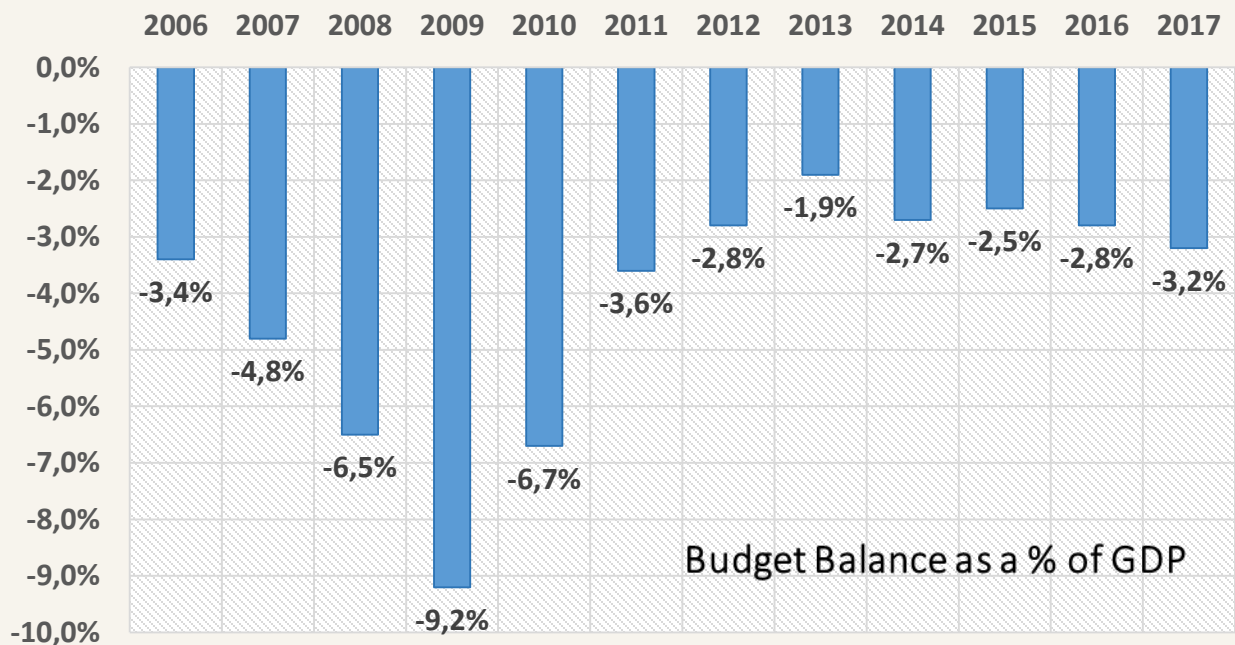


Independence of the NBG

- ❖ For inflation targeting, an **Independent Central Bank** is a pre-requisite;
- ❖ The organic law on the National Bank of Georgia (2009):
 - ❖ The NBG is independent in defining its objectives and main directions of monetary and exchange rate policies;
 - ❖ MPC determines monetary policy and instruments used to achieve its goals;
 - ❖ 7 year tenor for the board.
- ❖ The NBG **suspended the direct lending** to the government (2005);

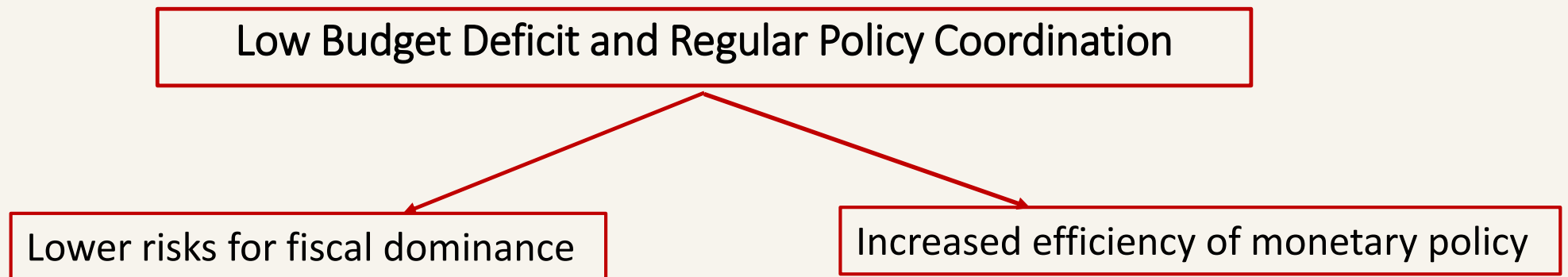
No Fiscal Dominance

- ❖ Budget deficit for the last decade stood at a moderate level;
- ❖ The operational balance for the last ten years is positive → budget deficit was used to finance capital spending.



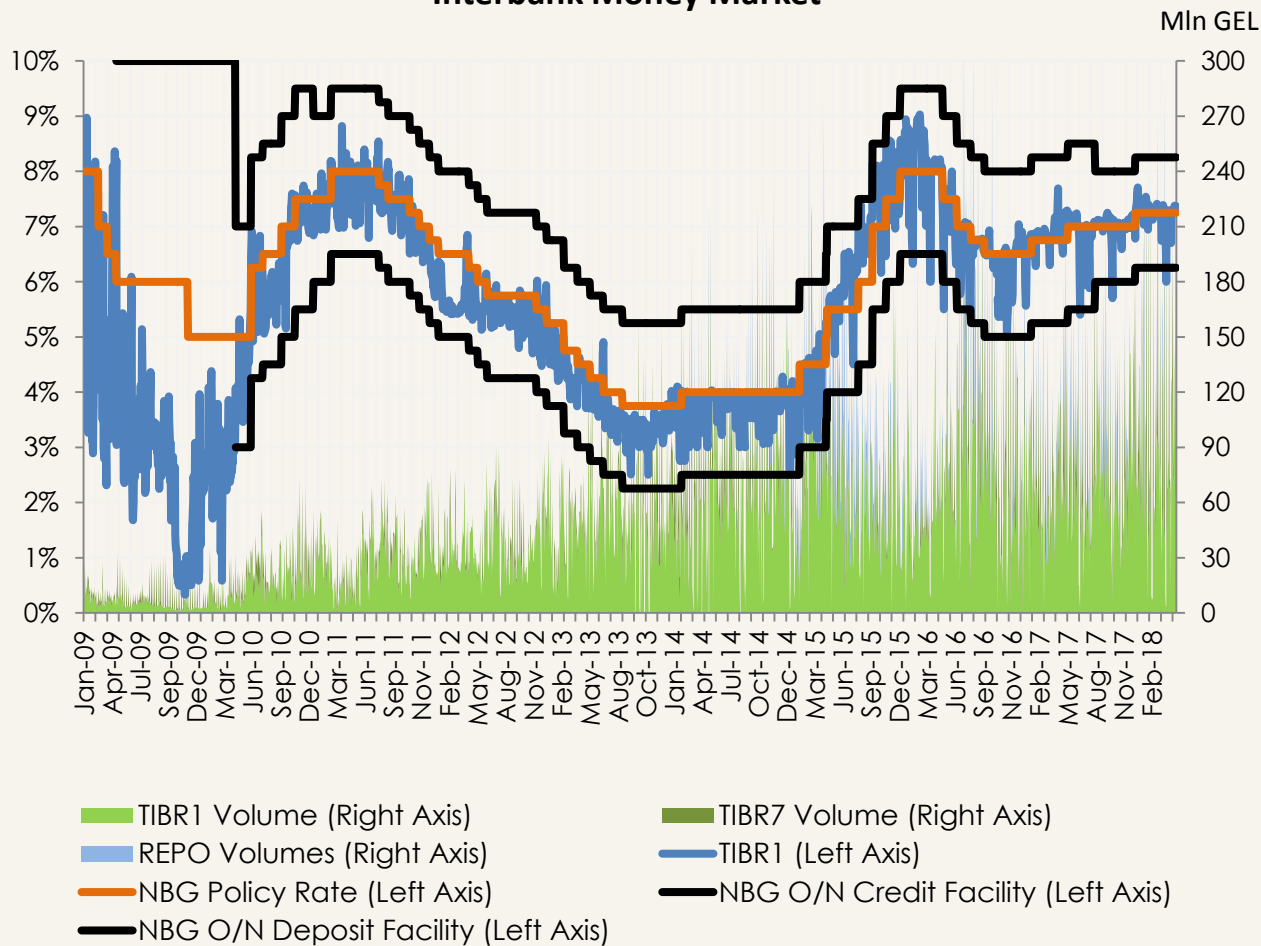
Coordination of Policies

- ❖ Coordination of fiscal and monetary policies → **efficient liquidity management;**
- ❖ The NBG and government coordinate:
 - ❖ Usage of different tools to absorb excess liquidity;
 - ❖ Guidance on the long-term reference interest rates for the market;
- ❖ The exchange of information is key for accuracy of **liquidity forecasts;**
- ❖ The NBG & government cooperate on **debt management issues;**

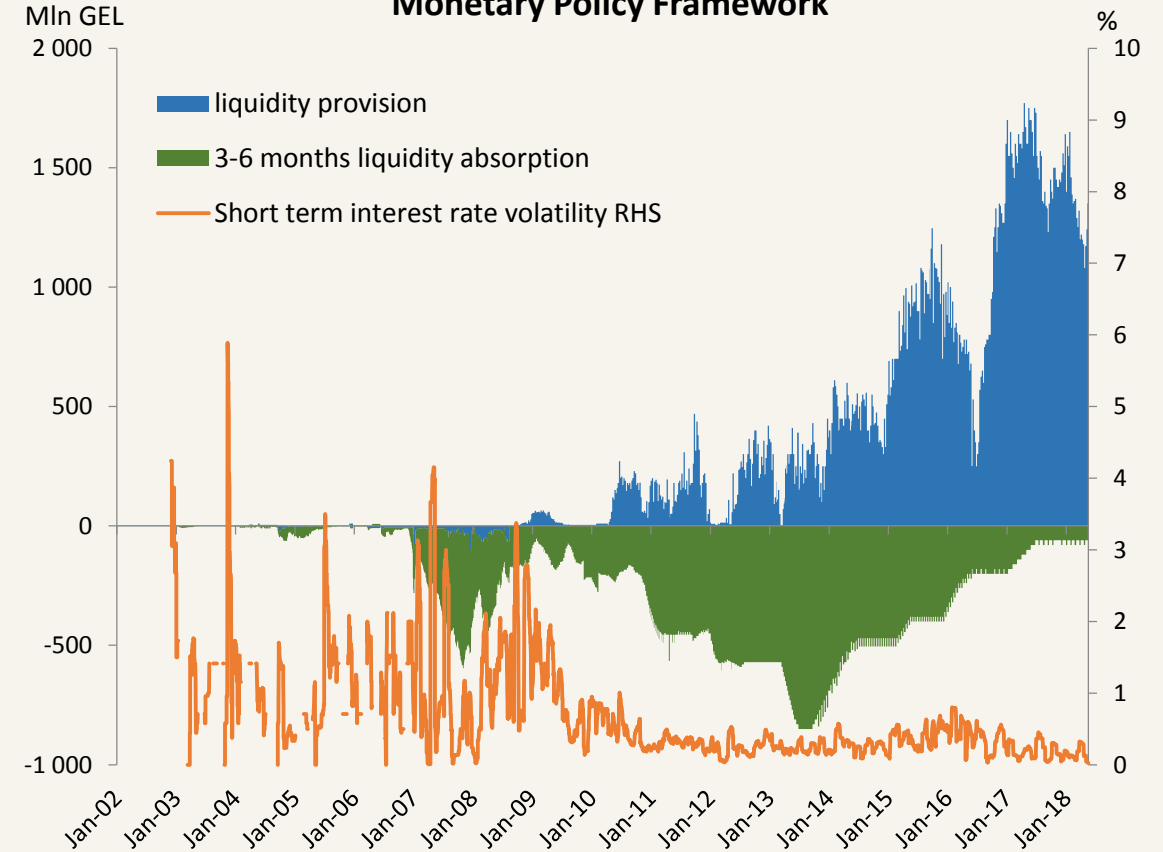


Efficiency of the Monetary Policy

Interbank Money Market



Monetary Policy Framework

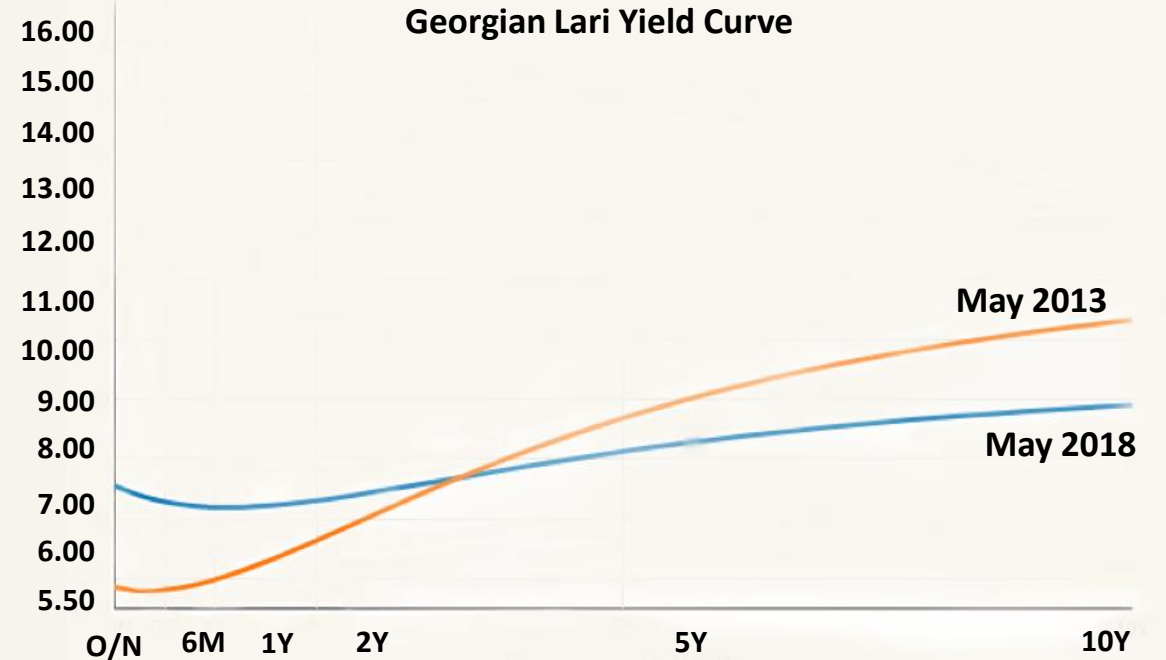
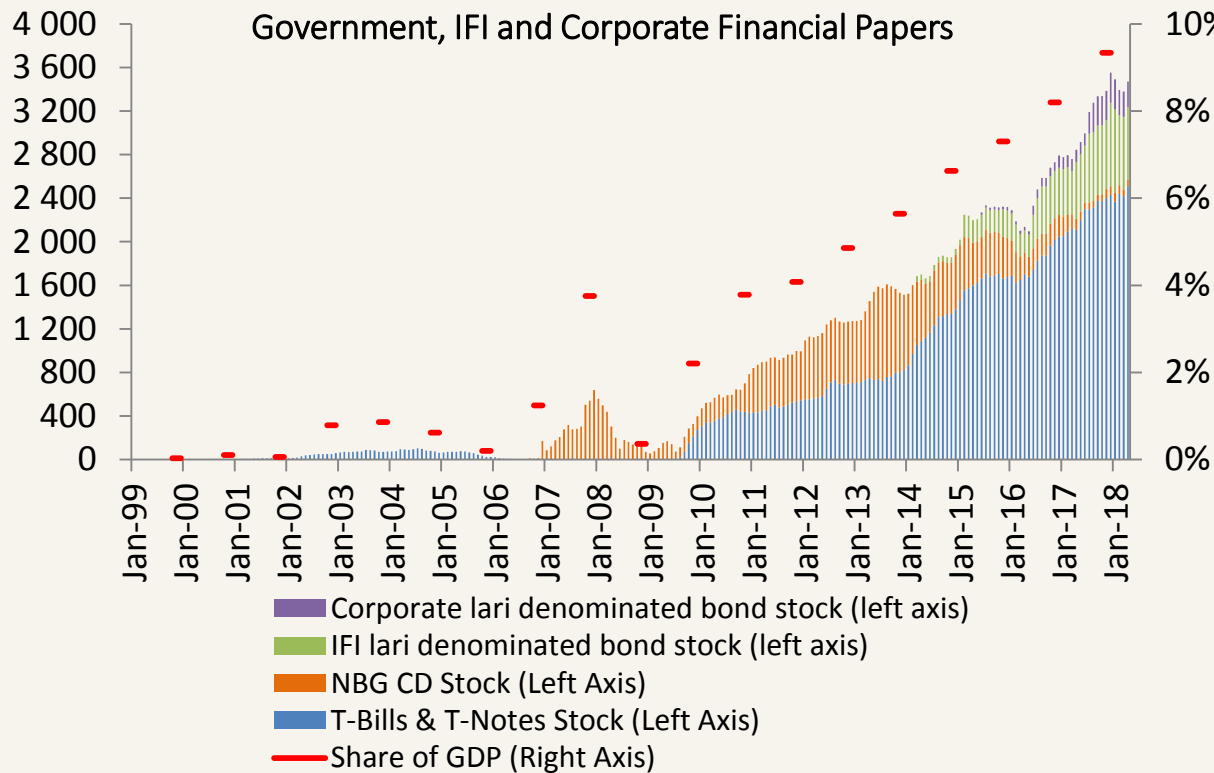


Development of Financial Markets

- ❖ Development of liquid financial markets is keystone to the **efficiency of monetary policy transmission**;
- ❖ Financial markets mainly consist of:
 - ❖ NBG's Certificates of Deposits;
 - ❖ Treasury securities;
 - ❖ IFI bonds issued in local currency.
- ❖ The government and the NBG cooperate on increasing the volume and maturity of securities;
 - ❖ Used as a collateral for refinancing loans.
- ❖ Currently, the portfolio of traded securities stands at **9.3%** of GDP;
- ❖ Transactions are concentrated on **primary market**.

Development of Financial Markets

- ❖ The deepening of a secondary market is important to develop and increase the availability of non-bank funding;
- ❖ The NBG provides modern high tech infrastructure for the market;
- ❖ Regulatory and legislative reforms.



Benefits of Inflation Targeting

- ❖ The inflation targeting framework, combined with the floating exchange rate regime, has served Georgia well;
 - ❖ Low inflationary environment – 3.5% annual rate of inflation on average;
 - ❖ Low long term interest rates including on the government Bills and Notes – 10 year notes are traded with 9 percent interest rates;
 - ❖ Stable exchange rate in the long term;
 - ❖ Favorable macro environment for long term economic growth.

Thank you!