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Economic structure

Annual indicators

	2000[a]	2001[a]	2002[a]	2003[a]	2004[a]
GDP at market prices (Lari m)	5,971	6,506	7,471	8,560	9,800
GDP US$ bn	3.0	3.1	3.4	4.0	5.4
Real GDP growth (%)	1.8	4.5	5.4	11.1	8.4
Consumer price inflation (av; %)	4.0	4.7	5.6	4.8	5.7
Population (m)	4.4	4.4	4.4	4.3	4.3[b]
Exports of goods fob (US$ m)	459.0	496.1	583.4	830.4	n/a[b]
Imports of goods fob (US$ m)	-970.5	-1,045.6	-1,041.5	-1,466.6	n/a[b]
Current-account balance (US$ m)	-269.0	-211.7	-250.5	-397.1	n/a[b]
Foreign-exchange reserves excl gold (US$ m)	109.4	159.4	197.6	190.7	382.8
Exchange rate (av) Lari:US$	1.98	2.07	2.20	2.15	1.917

[a] Actual. [b] Economist Intelligence Unit estimate.

Origins of gross domestic product 2004	% of total
Agriculture	16.2
Transport & communications	14.0
Trade	13.4
Industry	13.2
Total incl others	100.0

Components of gross domestic product 2000	% of total
Public consumption	88.7
Private consumption	8.6
Gross fixed investment	17.6
Net exports of goods & services	-16.0
Total	100.0

Principal exports 2004	% of total
Ferrous waste & scrap, iron & steel	14.8
Other Aircraft	12.9
Wine & mineral water	10.5

Principal imports 2004	% of total
Oil, gas & electricity	16.2
Automotives	6.3
Iron & steel	4.3

Main destination of exports 2004	% of total
Turkey	18.3
Russia	16.1
UK	4.9
Azerbaijan	3.9
US	3.3

Main origin of imports 2004	% of total
Russia	14.0
Turkey	11.4
UK	9.3
Azerbaijan	8.5
Germany	7.2

Quarterly indicators

	2002				2003				2004			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Employment & prices												
Employed ('000)	1,659	1,742	1,768	1,713	1,679	1,805	1,897	1,809	1,746	1,809	1,819	n/a
Unemployment rate (% of the labour force)[a]	16.3	14.4	14.3	15.0	17.1	13.9	12.6	14.4	16.4	14.1	15.2	n/a
Consumer prices (Dec 2000=100)	106.5	108.3	105.5	107.5	111.1	111.6	110.9	114.9	117.4	115.6	117.3	121.5
												6.4
Consumer prices (% change, year on year)	5.3	6.7	5.3	5.4	4.3	3.0	5.1	6.8	5.9	4.8	5.5	
Financial indicators												
Exchange rate Lari:US$ (av)	2.211	2.221	2.188	2.163	2.174	2.154	2.128	2.127	2.048	1.94	1.839	1.809
Exchange rate Lari:US$ (end-period)	2.215	2.190	2.175	2.090	2.125	2.110	2.113	2.075	2.005	1.92	1.84	1.825
Deposit rate (av; %)	9.33	9.67	10.43	9.83	8.87	8.50	8.67	11.07	9.97	6.70	5.87	n/a
Deposit rate (foreign currency; av; %)	10.00	10.33	10.40	10.20	9.53	8.80	9.33	9.10	7.63	7.93	8.59	n/a
											31.27	n/a
Lending rate (av; %)	31.33	30.67	33.17	32.17	36.27	33.93	28.50	30.37	35.13	35.37		
Lending rate (foreign currency; av; %)	29.33	30.33	29.60	27.80	27.70	27.00	28.60	27.17	26.07	28.37	27.43	n/a
Money market (av; %)	30.33	24.55	30.17	26.73	19.30	15.54	14.37	18.31	17.53	15.54	8.08	n/a
M1 (end-period; Lari m)	396.79	394.16	408.47	452.84	438.44	441.45	491.88	516.92	537.1	582.4	694.71	819.5
M1 (% change, year on year)	17.4	11.4	9.2	14.9	10.5	12.0	20.4	14.2	22.6	32.0	41.2	58.5
M2 (end-period; Lari m)	763.45	773.97	805.14	870.22	893.16	933.60	1,062.13	1,068.85	1,131.5	1,196.8	1,334.85	1,521.6
M2 (% change, year on year)	27.1	20.8	16.0	17.9	17.0	20.6	31.9	22.8	26.7	28.2	21.0	42.4
Foreign trade (US$ m)												
Exports fob	57.7	89.8	92.7	84.8	58.7	99.0	149.8	136.7	165.5	298.1	n/a	n/a
CIS[b]	19.1	49.3	49.0	21.7	46.9	46.9	81.3	63.3	37.7	119.7	n/a	n/a
											n/a	n/a
Imports cif	-161.4	-188.1	-172.2	-196.2	-187.5	-246.0	-310.6	-313.8	-365.1	-436.3		
CIS[b]	71.5	66.8	-65.6	-73.1	-75.7	-80.7	-91.4	-110.6	-121.7	-141.9	n/a	n/a
Trade balance	-103.7	-98.3	-79.5	-111.4	-128.8	-147.0	-160.8	-177.1	-199.6	-138.2	n/a	n/a
Balance of payments (US$ m)												
Merchandise trade balance	-131.7	-111.7	-98.8	-116.1	-150.8	-161.3	-119.4	-185.2	-199.6	-199.8	-161.8	n/a
Services balance	7.2	8.2	11.0	9.2	6.9	13.8	16.9	10.3	14.5	14.4	-2.5	n/a
Income balance	2.0	6.9	9.9	0.0	3.8	13.0	12.2	3.1	6.3	5.5	15.4	n/a
Net transfer balance	41.5	40.9	35.2	35.7	32.9	29.0	36.2	45.7	51.9	62.7	69.7	n/a
Current-account balance	-81.0	-55.7	-42.6	-71.2	-107.2	-105.5	-54.1	-126.1	-127.0	-117.2	-80.3	n/a
Reserves excl gold (end-period)	146.57	144.37	180.53	197.55	188.37	185.44	194.03	190.72	210.8	274.1	364.2	382.2

[A] International Labour Organisation (ILO) "loose" methodology, including "discouraged" workers. [b] Commonwealth of Independent States.

Sources: TACIS, *Georgian Economic Trends*; IMF, *International Financial Statistics*. National Bank of Georgia

Outlook for 2005-06

Economic policy outlook

Policy trends

The president has stated that new government will continue the economic policy of late Prime Minister Zurab Zhvania and the appointment of Mr. Zurab Nogaidely as a new Prime Minister is an indication that at least in the near term the economic policy will remain unchanged. Former Finance Minister, Mr. Zurab Nogaideli, was a close friend and ally of Mr. Zhvania. He has a support of International Monetary Fund (IMF) and World Bank (WB) and is more conservative than State Minister in charge of economic reforms, Mr. Kakhaber Bendukidze. The two often disagreed about the scope and the pace of reforms. The differences will likely to persist, but without the political clout of his predecessor, new Prime Minister is expected to have much less influence on the course of reforms.

The government is likely to continue to make steps towards more liberalization of economy and deregulation, privatization of public enterprises, improving investment climate and increased economic integration with its immediate neighbouring countries. On the legislative side, the new tax and customs code was enacted in 2005, with significantly reduced social and income taxes. The move that is likely to reduce labour costs and increase the take home income of employees at the same time. From the second half of 2005, Value Added Tax (VAT) will be reduced from 20% to 18%. Equally important are the changes in tax administration, where many of the procedures are simplified. The implementation of these changes will be one of the keys to the success of the tax reform. In 2004 the government made big step forward towards strengthening revenue performance and in curbing smuggling, but there are still more to be done to combat corruption on low level. Improving public expenditure policy and management as well as tackling corruption should remain the main focus of government’s efforts. Reforms over the forecast period will also include energy sector, further fiscal consolidation and state property management.

The end of 2004 was marked by privatisation of several large public enterprises. The privatisation pace is likely to pick up over the forecast period. In January, the government has reached agreements on the sale of manganese plant, Chiaturmarganets and Vartsixe hydro power plant to Russian Eurasia Holding and the sale of Ocean Shipping Company to Armstrong Holding. In January government was involved in talks with several bidders for the mooring docks in Batumi, terminal of liquefied gas, 42 hectares of land and other facilities. The government intends to sell its interests in telecommunications companies Electrokavshiri, owner of the largest fixed-line network in capital Tbilisi and Georgian Telecom. The latter is likely to be acquired by US-based Metromedia International Group, which already owns 31% stake. The government has held preliminary discussions with Gazprom on the possible sale of gas pipeline. The sale though will require the legislative changes and the sale of pipeline could become a political issue, especially since the pipeline is the only leverage that the government has with Gazprom, since gas supplied to Armenia goes through it as well. Pushing this issue without late Prime Minister Mr. Zurab Zhvania could prove to be difficult. Although Mr. Bendukidze is a proponent of wholesale privatization and will likely to lobby the sale, but the move involves significant political risks, so he can be overridden on this issue.

Fiscal policy

The 2005 state budget was approved by parliament in December. The budget revenue (including grants) increased by about 2.3% year on year to Lari1,813m (US$993m; 18.5% of GDP), and budget expenditure will rise by 8%, to Lari2,106m (US$1,154m; 21.5% of GDP). The resulting deficit will amount to 3% of GDP. The government has collected Lari1,773m (US$971.5m; 18.1% GDP) in 2004, exceeding the 2004 revenue projections, which were increased second time during the year on December 28 2004, by 1.6%. The state budget revenue nearly doubled in lari terms from 2003. As a very positive sign revenues both from customs department and tax collection exceeded the targets and the total tax revenue increased more than 50% year on year. Despite the progress in revenue mobilisation, further reform in both tax and customs departments are needed to minimize low level corruption. The reforms there have so far been limited to some structural changes and to changes in upper management personnel. The modest increase in 2005 budget shows that state authorities are careful about their projections, especially after reduction of tax rates. The delay of VAT rate reduction by half a year is another indication. They may be too pessimistic however, when projecting to receive Lari94m (US$51m) in capital income, which are mainly proceeds from privatisation. The January sale of Ocean Shipping Company to Armstrong Holding should bring US$89m alone. It is likely that the budget will be revised in the coming months. Better planning is also desirable, since budget revenues showed great variability over the course of the year with government collecting Lari325m(US$178m), more than one sixth of total revenue, in December.

Monetary policy

The changes in monetary policy are very unlikely. Under the current president, Mr. Managadze, The National Bank of Georgia (NBG) has closely followed the IMF recommendations. It is expected that the current NBG president will be replaced at the end of March, when his term runs out. But new president will probably follow IFM recommendation very closely, since international financial institutions are the main creditors to Georgian economy. Monetary policy will be aimed at keeping annual inflation within a 4-6% band and ensuring that the local currency remains stable. Growth in reserves and broad money will be adjusted in order to achieve these twin goals, with the National Bank of Georgia (NBG, the central bank) relying on interventions on foreign-exchange markets and credit auctions, and keeping the refinancing rate well above inflation. These measures will suffice to keep the lari stable over the forecast period. However, Georgia’s high level of debt and its vulnerability to regional economic instability continue to be of concern, since both could have a negative impact on the exchange rate. This, in turn, could raise inflationary pressures and thereby require an increase in interest rates.

Economic policy

The budget deficit is relatively low

The state budget deficit was Lari177m (US$97m, 1.8% of GDP) in 2004, lower than targeted deficit of Lari271m. Increased tax revenues made it possible to lower the deficit while meeting the expenditure targets. Only revenues from the privatisation of state property fell short of targeted Lari81.4m and amounted to Lari67m, mostly proceeds from the sale of Tbilaviamsheni aircraft factory. The revenues from privatisation are expected to increase significantly in 2005, with government already reaching agreement in January on the sale of Chiaturmanganets and the Vartsikhe hydro power plant for US$132m and on the sale of Ocean Shipping Company for US$89m.

State budget revenue including grants was Lari1,773m (US$971.5m) in 2004, an increase of 85% year on year. It was Lari148m over the target set in August 2004, when the budget was revised upwards. Budget revenues were 18.1% of GDP, compared to 11.2% a year ago. The government managed to improve budget revenue collection dramatically from the previous year, largely due to the anticorruption campaign against the former state officials. Changes in tax and customs management personnel also resulted in better administration. Tax revenue grew 44% in real terms year on year, the first time in last 3 years that tax revenue grew faster than GDP. Such a trend may continue in 2005 as long as tax administration keeps improving.

State budget revenue, 2004
(Lari m unless otherwise indicated)

	Target	Actual	Actual/target (%)	% change, year-on-year
Total state budget revenue & grants	1,742.3	1,773.0	101.8	85.5
Tax revenue	1,293.0	1,322.1	102.3	63.3
Non-tax revenue	317.0	310.5	97.9	225.1
Grants	121.3	123.9	102.1	159.2
Revenue of special state funds	413.3	437.1	105.8	70.1

Source: Ministry of Finance; State Department of Statistics

State budget expenditure increases

State budget expenditure increased by about 72% year on year in 2004, to Lari1,950m (US$1,068.5m), a real increase of about 63%. The largest outlays continued to be on social subsidies and on current transfers and interest payments on state debt. Capital expenditures have reached Lari100m, but much more is needed to help improve Georgia’s ailing basic infrastructure.

The tax code

The government has adopted a new tax code that went into force in 2005. The social tax rate is reduced from 31% to 20% and income tax rate was lowered from 20% to 12%. VAT tax rate reduction from 20% to 18% will be effective from July 2005. Besides these rate changes, the new code has smaller number of taxes and some of the procedures are simplified. Overall it is an improvement over the old one. Still business community complained that the tax authorities retain disproportionate power and that many of the articles could be interpreted in several different ways and businesses have to wait for clarifications from tax authorities, which often times are delayed. This creates opportunities of abuse of power from tax authorities.

The monetary stance is prudent

Over the past 5 years the NBG has been ensuring macroeconomic stability by its continued tight monetary stance. Monetary policy is geared towards ensuring the stability of the currency by keeping annual inflation within a 4-6% band. The refinancing rate has been kept positive in real terms.

Successful measures for improvement of tax administration and declining shadow economy triggered demand for the local currency. Georgia received Lari44m from the World Bank as concession loan and Lari134m from other international financial organizations. As a result demand on local currency increased that forced Lari appreciation.

On the Tbilisi Inter Bank Currency Exchange there was a stable demand for the local currency. The supply of the USD exceeded demand almost three times and reached US$264.5m. The total turnover almost tripled compared to the previous year and amounted to US$276.9m. The supply of the Euro currency increased also but not substantially. To avoid appreciation of the local currency the NBG bought US$195.1 increase of almost five times compared to 2003. The large interventions of the NBG are caused by the fragility of the TICEX structure and the lack of liquidity of the commercial banks when there is high liquidity of the foreign currency on the market.

To increase currency in circulation the NBG also decreased reserve requirement for the deposits in Lari from 13% to 2% in July 2004. The cash in circulation, which increased 42.9% year-on-year bases, dominated the Lari money supply. As a result Base money increased substantially from the third quarter of 2004. Deposit liabilities of the commercial banks increased by 50.4% from the beginning of 2004. Additionally deposits in local currency increased more rapidly, by 167.9%, than in foreign exchange, by 24.9%. That is a good sign of increased confidence and continued development of financial markets.

Money supply

(Lari m unless otherwise indicated; end-period)

	2002	2003				2004			
	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Base money (M1)	452.8	438. 4	441.5	491.9	516.9	537.1	582.4	694.71	819.5
% change[a]	10.9	-3.2	0.7	11.4	5.1	3.9	8.4	19.3	17.9
Money supply (M2)	870.2	893.2	933.6	1,062.1	1,068.8	1,131.5	1,196.8	1,334.8	1,521.6
% change[a]	8.1	2.6	4.5	13.8	0.6	5.9	5.8	11.5	13.9

[a] Quarter on quarter.

Note. Monetary base is cash in circulation (M0) plus commercial banks' cash and reserves. M1 is M0, plus demand deposits of firms and households held at the NBG and in commercial banks in lari. M2 is M1 plus other household deposits and demand deposits in convertible currency of firms and households.

Source: IMF, *International Financial Statistics*; National Bank of Georgia.

The domestic economy

Economic growth decelerates

According to preliminary estimates from the state department of statistics, real GDP growth was 8.4% in 2004, decline from 11.1% rate a year ago. The number is subject to revision however.. Unlike the previous year, when the strong growth was fuelled by construction of oil and gas pipelines, the growth in 2005 was driven by the increased output in industrial sector, trade and construction. The telecommunication sector also recorded strong growth while agriculture, which remains the largest component of Georgian economy, has declined. It is interesting to note that the contribution of taxes to GDP grew from 6% in 2003 to 9% in 2004. This is indicative of the better tax administration; however it also increases inflationary pressure.

The industrial sector has recorded solid growth

Output from industrial enterprises grew by 13% year on year, owing to strong growth in manufacturing (which includes the production of key goods such as fertilisers, wine and mineral water), which grew by 20% while mining and extraction sector recorded a 15% decline. Public-sector enterprises account for 34% of total industrial output. Most extractive and manufacturing enterprises are in the private sector, and their solid performance has resulted in an increase in their share of total industrial output. The share of private sector is expected to grow significantly in 2005, with privatisation process picking up the pace. The industrial sector also began to benefit from improved energy provision in 2004. About 75% of the output came from large enterprises which comprise 2.5% of the total number of enterprises. The share slightly declined from 78.5% mark a year ago.

Gross domestic product by sector

(% change, year on year unless otherwise indicated)

	2000	2001	2002	2003	2004[a]
Share of GDP (%, current prices)					
Industry					13.2
Agriculture					16.2
Construction					6.4
Transport & communications					14.0
Trade					13.4
Sectoral growth					
Industry					13.3
Agriculture					-6.7
Construction					7.5
Transport & communications					9.0
Trade					9.5
GDP (real % change, year on year)					8.4

[a] Preliminary data for.

Sources: IMF, *Georgia: Selected issues and statistical appendix, 2003*; State Department of Statistics

The services sector has been growing rapidly

The services sector has benefited from fast growth in trade, telecommunications, and hotels and catering. The poor state of the fixed telecoms network in Georgia means that the mobile telephone industry is growing at a rapid pace, particularly as major infrastructure projects related to the hydrocarbons sector—the construction of BTC, which is to be accompanied by the construction of the South Caucasus Gas Pipeline Project (SCP)—are now coming to fruition. The number of mobile telephone subscribers increased by 43% in 2004, to 800,000. Transportation also grew despite the fact that the overall cargo turnover remained flat year over year and railway cargo volumes have actually declined by 7% according to the State Department of Statistics.

Services sector output

	% change, year-on-year		% of GDP	
Category	2003	2004	2003	2004
Trade	12.1	9.5	13.3	13.4
Hotels & restaurants	14.2	3.7	2.9	2.7
Transport	4.4	5.8	9.8	10.3
Telecommunications	36.5	25.5	3.6	4.2
Financial intermediation	18.1	8.7	1.5	1.3
State management & defence	-2.3	4.8	3.6	5.4
Education	1.6	0.9	3.2	3.5
Total incl other	13.2	7.6	51.3	52.4

Source: State Department of Statistics.

The grape harvest is the best in years

Agricultural sector declined by 6.7% in 2004, owing to bad weather conditions in the first half of the year. The output from agriculture is at the 1996 level and its contribution to GDP has declined from 33.2% in 1996 to 16.2% in 200. The output has been declining by an average of 0.1% a year since 1996. The output has declined across almost all agricultural products. This resulted in increased prices on food items, with prices increasing by 7.5% during the year.

Agricultural production
('000 tonnes)

	2000	2001	2002	2003	2004
Grain & beans	407	704	680	739	676
Maize	296	289	400	450	410
Wheat	89	307	200	225	186
Sunflowers	3	42	20	24	22
Potatoes	302	422	415	424	390
Vegetables	354	396	405	430	400
Fruits (excl grapes)	250	200	150	260	160
Grapes	210	150	80	200	180
Tea	24	23	24	26	20

Source: TACIS, *Georgian Economic Trends*; Food and Agricultural Organisation of the United Nations; State Department of Statistics

The agricultural sector continues to be hampered by a shortage of credit, which has resulted in farmers' inability to purchase high-quality seeds and fertilisers. Georgia's commercial banks are small and are also unwilling to take on the risk of lending to farmers. Moreover, land plots remain small, preventing economies of scale. The sector is therefore characterised by subsistence farming, with substantial over-employment, which has resulted in labour productivity's being four times lower than in other sectors of the economy. Nevertheless, agriculture remains the largest sector (after services), making up about 16% of GDP in 2004.

Consumer price inflation rises

Month-on-month consumer price inflation was relatively low during the most part of 2004, but started picking up in September and reached 3.5% in December. This coincides with the period when budget revenues were increasing. Year-on-year inflation reached 7.5% in December. Yearly average inflation rate reached 5.7%, increase from 4.8% in 2003. Decline in agriculture output coupled with improved tax administration and higher oil prices reflected in higher prices of food items, tobacco and alcohol products. Increased demand on Lari on the other hand made consumer durables, which are mostly imported, cheaper. With government’s increased spending at the end of the year, Lari lost some ground against USD and the prices of consumer durables also rose. Increase of excise tax rates on tobacco and alcohol product in 2005 should put upward pressure on consumer prices, but NBG is expected to keep the inflation rate with within 4-6% with its tight monetary policy.

Consumer prices
(% change)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual average
2002													
Month on month	2.0	1.2	0.4	1.8	0.0	-2.3	-1.1	-0.1	0.4	0.4	1.1	1.7	5.6
Year on year	4.8	5.4	5.8	6.6	7.7	5.7	5.2	4.8	5.9	5.6	5.2	5.5	–
2003													
Month on month	2.1	-0.5	0.0	0.5	0.2	0.1	-0.9	-0.1	0.5	0.0	4.8	0.2	4.8

Year on year	5.7	3.9	3.5	2.1	2.3	4.9	5.1	5.1	5.2	4.8	8.6	7.0	–
2004													
Month on month	0.4	0.4	0.1	-0.2	0.0	-1.6	0.8	-0.6	1.5	1.6	1.3	3.5	5.7
Year on year	5.2	6.2	6.3	5.6	5.4	3.6	5.5	4.9	6.0	7.7	4.1	7.5	–

Sources: State Department of Statistics; Economist Intelligence Unit calculations for annual rates.

The lari appreciates against the US dollar

Better tax administration has fuelled demand on Lari. At the end of the year Lari has nominally appreciated against both US dollar and Euro, on a end of the period basis. The continued slide of the US dollar against most major currencies has meant that the lari had nominally appreciated by about 18% year on year. Measures taken by NBG, such as Interventions on Tbilisi Inter Bank Foreign Exchange (TIFEX), reduction of reserve requirements and increase in money in circulation has kept Lari from further appreciation. The NBG has doubled its foreign reserves in the process, however they still remain low and with increasing trade balance deficit Lari remains susceptible to external macroeconomic shocks.

Exchange rates
(Lari:US$ unless otherwise indicated)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2002												
End-period	2.197	2.210	2.215	2.235	2.215	2.190	2.185	2.165	2.175	2.165	2.165	2.090
Average	2.189	2.215	2.228	2.231	2.214	2.217	2.204	2.182	2.180	2.165	2.180	2.144
% change, month on month[a]	-6.2	-0.6	-0.2	-0.9	0.9	1.1	0.2	0.9	-0.5	0.5	0.0	3.6
% change, year on year[b]	-7.8	-6.9	-7.4	-8.0	-6.7	-7.1	-6.2	-5.4	-4.8	-3.9	-2.4	-0.2
2003												
End-period	2.185	2.175	2.125	2.145	2.148	2.110	2.121	2.112	2.113	2.107	2.190	2.075
Average	2.189	2.185	2.149	2.160	2.154	2.148	2.134	2.122	2.127	2.099	2.164	2.118
% change, month on month[a]	-4.3	0.5	2.4	-0.9	-0.1	1.8	-0.5	0.4	0.0	0.3	-3.8	5.5
% change, year on year[b]	0.0	1.4	3.7	3.3	2.8	3.2	3.3	2.8	2.5	3.1	0.8	1.2
2004												
End-period	2.110	2.028	2.005	1.990	1.920	1.920	1.890	1.785	1.840	1.828	1.780	1.825
Average	2.121	2.064	1.993	1.991	1.941	1.920	1.909	1.832	1.804	1.832	1.797	1.799
% change, month on month[a]	-1.7	4.0	1.1	0.8	3.6	0.0	1.6	5.9	-3.0	0.7	2.7	-2.5
% change, year on year[b]	3.2	5.9	7.8	8.5	11.0	11.9	11.8	15.8	17.9	14.6	20.4	17.7

[a] Based on end-period rate. [b] Based on average rate.

Source: IMF, *International Financial Statistics*; National Bank of Georgia

Foreign trade and payments

The trade deficit widens considerably

Stronger Lari and increased prices on oil and wheat have resulted in increased trade deficit. The merchandise trade deficit rose to US$1,198.2m in 2004, from US$675.7m in 2003. Export revenue rose by about 39% year on year to US$648.8m, whereas import expenditure rose by over 60%, to reach US$1.85bn. Trade deficit reached about 22% of GDP. The number of countries the Georgia has a negative trade balance with also increased from 95 to 104. Some of the increase in imports however, could be result of better accounting from customs department. Import of cars is a good example. Balance-of-payments data tend to be more accurate, as they include an estimate of goods not captured by customs statistics. Nevertheless, customs data are useful since they are more timely than balance-of-payments data, and they also provide a more detailed breakdown of trade by product and country.

Foreign trade
(US$ m)

	2000	2001	2002	2003	2004
Exports of goods	329.9	320.0	350.4	465.3	648.8
Imports of goods	-650.7	-680.7	-744.1	-1,141.1	-1,847.0
Trade balance	-320.8	-360.7	-393.7	-675.8	-1,198.3

Sources: TACIS, *Georgian Economic Trends*; *State Department of Statistics*

Export revenue has been relatively high

Main export items remained metals, largest export item being ferrous scrap metals, primarily exported to Turkey. Aircraft was the second most important category in 2004. The aircraft industry could see some recovery with the privatisation of Tbilaviamsheni. Appreciation of Lari in real terms against all currencies during the year could have had a negative impact on export growth. Yet export grew by 39%. Over 25% of Georgia's overall exports are of metals, which are absorbed mainly by the Turkish market. Wine and mineral water form the third most important export category, with Russia remaining the main market for these items.

Composition of exports
(US$ m unless otherwise indicated; fob)

	2003	2004
Ferrous waste & scrap, iron & steel	60.1	95.9
% of total	12.9	14.8
Other Aircraft	20.3	83.7
% of total	4.4	12.9
Ferroalloys	26.1	42.5
% of total	5.6	6.6
Fertilisers	18.4	28.8
% of total	4.0	4.4
Wine, mineral water & other beverages	62.3	68.0
% of total	13.4	10.5
Sugar	34.0	34.3
% of total	7.3	5.3
Copper ore	23.4	31.8
% of total	5.0	4.9
Total incl others	465.3	648.8

Sources: *State Department of Statistics*

Manufactures for export remain restricted mainly to fertilisers and wine production, and this is indicative of Georgia's failure to develop the part of the industrial sector in which it would have a competitive advantage—a labour-intensive food-processing sector. The over-dependence on the mining sector, which is subject to substantive fluctuations in prices, leaves the country vulnerable to external shocks.

Hydrocarbons dominate imports

Oil, electricity and related products remain the largest import category, with expenditure on this category rising by about 51% year on year in 2004. Expenditure on imports of oil and electricity have risen owing to a recovery in industrial sector growth and high oil prices in 2004. Georgia has considerable potential for the generation of hydroelectric power, but only produces 10-20% of its total capacity. It thus depends heavily on imports from Russia to meet most of its energy requirements. However, the share of oil and electricity in total import spending fell to 16% in 2004, from 21.1% in 2002, owing to a surge in iron and steel (mainly pipes) imports related to BTC construction and surge in car imports in 2004. Capital imports related to pipeline construction are expected to continue in 2005, owing to the launch of the construction of the South Caucasus Gas Pipeline Project (SCP).

Composition of imports
(US$ m unless otherwise indicated; cif)

	2000	2001	2002	2003	2004
Oil, gas, oil products & electrical energy	135.6	152.4	156.9	197.3	298.8
% of total	20.8	22.4	21.1	17.3	16.2
Medicine	33.9	38.3	46.0	62.9	78.0
% of total	5.2	5.6	6.2	5.5	4.2
Iron and Steel	n/a	n/a	n/a	93.7	80.0
% of total	n/a	n/a	n/a	8.2	4.3
Automotives	15.2	12.4	21.8	47.0	116.6
% of total	2.3	1.8	2.9	4.1	6.3
Sugar	24.6	24.1	34.5	53.0	50.8
% of total	3.8	3.5	4.6	4.6	2.8
Total incl others	650.7	680.7	744.1	1,141.1	1,847.0

Sources: IMF, *Georgia: Selected Issues and Statistical Appendix, 2003*; TACIS, *Georgian Economic Trends*; State Department of Statistics

Turkey and Russia account for the bulk of trade turnover

Export opportunities are limited owing to Georgia's reliance on low value-added exports and the high cost of transport to world markets. The main factor explaining Georgia's export patterns is therefore geographical proximity, with Turkey and Russia remaining the country's leading trading partners. Exports to CIS countries constituted 50.7% of total. CIS countries also account for about 40% of Georgia’s total trade turnover. Exports to Turkey have surged by 44%. Exports to Russia also increased by 25%, however its share in total export amount declined to 16.1%. Increased trade with these two countries in 2004 is a reflection of increased import demand in Turkey, and of the fact that Russia has abandoned attempts to restrict trade with Georgia.

Russia remains the largest import supplier, primarily of gas, followed by Turkey, which provides mainly consumer goods. However, the construction of BTC has resulted in a fall in these two countries' share in import spending, since most of the products required for the pipeline can only be obtained in Western markets. The UK has emerged as a major import partner in 2003 and remained third most important trading partner in 2004 as well, accounting for 9.3% of total import expenditure. Imports Germany surged by 83% benefiting from increased demand on cars. Imports from EU will grow in importance over the next few years, owing to the necessity of importing capital goods necessary for basic infrastructure construction.

Main trading partners
(% of total)

	2000	2001	200	2003	2004
Exports to:					
Turkey	22.7	21.5	15.3	17.8	18.3

Russia	21.1	23.0	17.4	17.0	16.1
Switzerland	4.1	4.9	7.0	7.3	2.7
Ukraine	3.3	3.7	3.7	6.1	2.4
UK	n/a	7.2	9.3	5.8	4.9
Azerbaijan	6.4	3.3	8.8	3.6	3.9
US	2.2	3.0	3.9	3.3	3.3
Italy	3.8	2.7	2.2	2.1	1.8
Germany	10.4	2.5	1.6	2.3	2.5
Imports from:					
Turkey	16.0	15.4	11.8	12.4	11.0
Russia	14.1	13.7	16.3	15.0	14.0
UK	3.5	3.7	3.6	11.1	9.3
Azerbaijan	8.5	10.8	10.8	7.2	8.5
Ukraine	5.4	7.3	7.9	7.2	7.7
Germany	7.7	9.4	7.6	6.0	8.2
US	5.5	4.1	4.4	4.5	6.0
France	1.7	2.7	2.0	3.7	3.4
Italy	2.7	3.7	5.2	3.1	3.3

Sources: IMF, *Georgia: Selected Issues and Statistical Appendix, 2003*; State Department of Statistics

The current-account deficit has widened

The current-account deficit reached US$197.5m in the first half of 2004, compared with US$206.2m in the year-earlier period. The worsening of trade balance was offset by increase in current transfers, which grew by 92% over the same period last year. The reversal of a trend started in 2002, as a result of Russia's imposition of a visa regime. It is a sign of eased restrictions on Georgians working in that country. Trade deficit increased by 15% compared to the same period year ago. Although the rate of growth of export revenue exceeded that of import expenditure, the scale of import spending has continued to outweigh that of exports. Imports have been rising rapidly owing to a surge in import expenditure related to infrastructure projects. The difference in customs and balance-of-payments data for trade results from the fact that the latter measure includes an estimate for smuggling, small-scale border shopping and customs corruption.

Balance of payments, IMF estimates
(US$ m unless otherwise indicated)

	1999	2000	2001	2002	2003	Jan-Jun 2004[a]
Exports fob	329.5	459.0	496.1	583.4	830.6	480.0
Imports cif	-863.4	-970.5	-1,045.6	-1,041.6	-1,466.6	-841.7
Trade balance	-533.9	-511.5	-549.5	-458.2	-636.0	-361.6
Services: credits	216.9	206.4	314.1	391.7	442.0	231.6
Services: debits	-224.0	-216.3	-236.9	-356.1	-389.5	-220.7
Services balance	-7.1	-9.9	77.2	35.6	52.5	10.9
Income balance	146.9	117.5	32.3	18.7	34.3	20.9
Services & income balance	139.8	107.6	109.5	54.3	86.8	31.8
Current transfers (net)	195.7	134.9	228.3	153.3	152.0	132.4
Current-account balance	-198.4	-269.0	-211.7	-250.6	-397.1	-197.5
Foreign direct investment (net)	81.3	131.6	109.9	161.3	334.1	136.5
Portfolio investment (net)	6.2	2.7	-0.1	0.0	0.0	0.0
Other capital flows (net)	29.4	-41.5	99.9	-127.0	-11.1	-5.1
Capital & financial account balance	128.4	88.0	204.5	51.9	303.1	240.9
Net errors & omissions	55.7	187.4	34.9	12.3	6.6	13.4
Overall balance	-14.3	6.4	27.7	-186.4	-47.7	55.8

Changes in gross reserves (- indicates increase)	-9.6	19.8	-47.0	-37.7	1.6	-56.8
IMF credit	23.9	-26.2	19.4	-0.1	-47.4	-4.2

Note. Totals may not sum owing to rounding.

[a] Preliminary.

Sources: IMF, *International Financial Statistics*; Azerbaijan National Bank.

Foreign investment remains unchanged

Gross inflows of foreign direct investment (FDI) decrease slightly in the first half of 2004 compared to the same period a year ago. FDI inflows covered about 70% of the current-account deficit in this period. The slight decline in FDI flow in the first half 0f 2004 was caused mainly by political changed undergoing in the country. The review of old privatisation agreements caused some of the investors to halt capital expenditures in factories they thus acquired. Most of the FDI flow was related to the construction of the BTC oil pipeline. FDI over the next few years will rise rapidly, and on an annual basis will be higher than in 1998, when the Baku-Supsa oil pipeline was being constructed. This is because of the building of BTC, the imminent construction of the SCP gas pipeline and upcoming privatisation of most of public enterprises and property. BTC will become operational in 2005, and SCP will be completed in 2006-07.

Strong demand on Lari enabled NBG to add to its foreign reserves. According to the National Bank of Georgia gross foreign reserves doubled in 2004 and amounted to US$ 382.8m at the end of the year. This was equivalent to about of 2.5 months of import cover. Local currency appreciation encourages the NBG to by foreign currency on the Tbilisi Inter Bank Currency Exchange and at the same time avoid short-term fluctuations of the exchange rate. Reserves are used mainly to cover debt interest payment commitments as substantial portion of imports are related to the pipeline constructions, which are covered by FDI inflow.

Reserves
(US$ m; end-period; excl gold)

1997	199.8
1998	123.0
1999	132.4
2000	109.4
2001	160.3
2002	197.6
2003	190.7
2004	382.8

Source: IMF, *International Financial Statistics*. National Bank of Georgia

External debt stock increased slightly

The total external debt stock was US$1,857,7m (35% of GDP) in December 2004, compared with US$1,849m (47% of GDP) in 2003, 0.5% increase. Georgia's external debt was restructured by the Paris Club of official creditors in 2004, resulting in a fall in debt relative to GDP and a reduction in debt servicing. The external debt stock is likely to increase in the next few years, as government will need to run budget deficits to finance capital expenditures for countries deteriorating infrastructure. This will not be a cause of alarm as long as debt stock to GDP ratio keeps falling.