Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2003	2004	2005	2006
Real GDP growth				
US	3.0	4.4	3.1	2.9
Russia	7.3	7.1	6.0	5.0
Turkey	5.8	7.8	5.3	3.9
EU	0.8	2.1	1.8	2.0
Exchange rates (av)				
¥:US$	115.9	108.1	95.5	94.0
US$:€	1.132	1.244	1.380	1.400
US$:SDR	1.40	1.48	1.58	1.60
Financial indicators				
€ 3-month interbank rate	2.33	2.13	2.10	2.25
US$ 3-month commercial paper rate	1.10	1.48	3.19	4.38
Commodity prices				
Oil (Brent; US$/b)	28.8	39.0	36.8	29.0
Gold (US$/troy oz)	363.3	412.3	435.0	396.3
Food, feedstuffs & beverages (% change in US$ terms)	6.6	9.3	-5.1	-2.7
Industrial raw materials (% change in US$ terms)	13.0	20.5	-2.1	-4.7

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Global economic growth in 2004, at an estimated 5%, was the fastest for more than 20 years. Not only did the large economies of the US, China and Japan grow rapidly, but the performance of the west European economies also improved, and many emerging markets, including Russia, surged ahead. However, there are already signs that growth is decelerating in some major economies, in part owing to a tightening of monetary policy, and the outlook for 2005-06 is for a more modest pace of expansion, at an annual average of about 4%.

The performance of the Russian economy has implications for Georgia 's growth prospects, given Russia 's importance as an investor and export market. With oil prices expected to remain high throughout 2005, Russia is likely to continue to lift regional economic performance during the coming year. However, should oil prices drop back more rapidly than expected in 2005—for example, if the expansion of oil demand in China or the US were to slow—even non-oil-exporting states in the region would be affected because of their links to the Russian economy. This effect would be compounded by our forecast for a slight weakening of Turkish import demand in 2005— Turkey is Georgia 's second-largest export market. Slightly offsetting this is the fact that prices of metals will remain high—even though they are expected to rise by only 1% year on year in 2005, this follows a 36% year-on-year increase in 2004.

Economic growth

The construction of two major pipelines—the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the South Caucasus Gas Pipeline Project (SCP)—will fuel economic growth over the forecast period. The construction of the pipelines will have important spillover effects on related sectors such as transport and communications, and hotels and catering. Employees in these sectors of the economy will benefit from an increase in wages, which will translate into further strong domestic demand. A resurgence of international interest in Georgia will pull in external financial assistance, which will also have a beneficial impact on growth. External financing will be used to implement economic reforms, build up Georgia 's deteriorating infrastructure and cover budgetary spending. We therefore expect average annual real GDP growth of about 10% in 2005-06. However, t here is a risk of a slippage in the development schedule for the two pipelines, with the result that our figures for forecast growth would have to be pushed back by about a year in each case, although this risk pertains more to SCP development.

Inflation

Inflation over the forecast period will primarily be driven by solid economic growth, which will boost employment and domestic demand. The poor agricultural harvest in 2004 will result in higher food prices in 2005, which will lead to faster inflation than we would have otherwise expected. However, inflation will be tempered by a nominal strengthening of the lari in 2005-06, which will reduce imported inflation, and by the NBG's tight monetary stance. Consumer price inflation will decline slightly over the course of 2006, assuming a good agricultural harvest and a downward trend in energy prices. We therefore anticipate annual average consumer price inflation of 6% in 2005 and 5.6% in 2006. There is a risk that higher oil prices than we currently expect, or a surge in hard-currency inflows from multilateral and bilateral donors, will push inflation above our current forecasts.

Exchange rates

As foreign-currency inflows, in the form of workers' remittances and inflows of foreign direct investment (FDI), are likely to remain high in 2005-06, the lari will continue to strengthen against the US dollar. The NBG will attempt to sterilise these foreign-currency inflows, but, given the limited tools at its disposal, it will struggle to achieve this. The official debt market is poorly developed, making it difficult for the authorities to sterilise excess hard-currency inflows by selling short-term lari-denominated assets. In addition, because of the weakness of local banks, most savings are in hard currency. There is a risk that h igher import expenditure than we currently expect, and which is not related to infrastructure development, will put pressure on international reserves. This will hamper the ability of the NBG to cushion the lari against external shocks.

External sector

Pipeline construction has brought a temporary deterioration in the trade balance, although this will be offset by an increased surplus on the services and transfers balances in 2005-06. Georgia has an insufficiently developed industrial base and the domestic economy is ill equipped to service the pipeline projects. Therefore, capital imports and services related to construction, transport and consulting will increase sharply over the forecast period. The government's infrastructure development will also push up import costs. Export revenue growth will temper compared with 2004, as prices of metals stagnate and Turkish demand slows. However, the services balance will benefit from a surge in crude oil transiting Georgia from the second half of 2005, when the BTC oil pipeline becomes operational. Services credits will rise further in 2006, when the SCP pipeline begins to send gas to external markets. Rising transit revenue and workers remittances will help to keep the current-account deficit from rising above 9% of GDP in 2005-06. Pipeline construction will not result in a build-up of foreign debt, since these projects will be funded with inflows of FDI.

Forecast summary

(US$ m unless otherwise indicated)

	2003	a2004	b2005	c2006 c
Real GDP growth	11.1	8.5	10.0	10.0
Consumer price inflation (av)	4.8	5.6	a6.0	5.6
Exports of goods fob (US$ bn)	831	987	1,089	1,154
Imports of goods fob (US$ bn)	-1,467	-1,849	-2,214	-2,407
Current-account balance (US$ bn)	-379	-432	-613	-638
Current-account balance (% of GDP)	-9.1	-7.6	-8.4	-6.9
Exchange rate Lari:US$	2.15	1.92	a1.85	1.83
Exchange rate Lari:€	2.43	2.38	a2.55	2.56
Exchange rate Lari:Rb	0.070	0.067	a0.066	0.064

a Actual. b Economist Intelligence Unit estimates. c Economist Intelligence Unit forecasts.