



BUSINESS ASSOCIATION OF GEORGIA



ECONOMY IN BRIEF

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საქართველოს ბიზნის ასოციაცია
BUSINESS ASSOCIATION OF GEORGIA

2015 STATE BUDGET EXECUTION

According to the data on the first six months of 2015, execution of the budget is close to the plan. Total receipts exceed the planned budget by 5.7%, while total expenditures are 3.7% behind the quarterly plan.

In the section of state budget receipts, the revenues from the sales of nonfinancial assets amounted to 136.6 m GEL, constituting 525.3% of the quarterly plan. These funds are predominantly related to revenues generated by the sales of licenses of fourth generation mobile operators. The licenses were sold in December 2014, while the payment schedule was agreed in early 2015, thus the above revenues have not been reflected in the 2015 budget plan. Tax revenues exceed the quarterly plan by 2.2% and amount to 3 581 m GEL.

In the expenditures section, similar to previous years, acquisition of nonfinancial assets (so-called capital expenditures) is less than planned. Capital expenditures constitute 79.8% of the quarterly plan and its total is 61.1 m GEL less than planned. Moreover, expenses on bonds and other financial assets have exceeded the quarterly plan by 27.5% and amount to 184.4 m GEL.

There has been made one amendment to the budget over the year of 2015¹. The receipts have increased by approximately 25 m GEL. As for the expenses, they have decreased by 150 m GEL in areas such as goods and services, salaries and entitlements, and subsidies. However, total expenditures have not changed, as these funds are to be allocated to address the effects of natural disasters and to service foreign debt, which has increased because of currency depreciation.

DRAFT LAW OF 2016 STATE BUDGET

On October 1, the Government of Georgia introduced the draft law on state budget to the Parliament for the review. According to the draft law, real GDP growth for 2016 will be 3.0%, while by 2019 it is anticipated to reach 4.5%. Budget deficit is planned to be about 3.0% of GDP and it is planned to decrease to 2.0% by 2019.

2016 state budget revenues are planned to be 8 355 m GEL and exceed the similar parameter of the previous year by 404 m GEL (5.1%). This is mainly due to an increase in the tax revenues (380 m GEL). For 2016 it is planned to generate 7 780 m GEL in tax revenues. Another source of State Budget receipts is 255 m GEL grants and 320 m GEL other revenues (revenues from property, administrative fees and duties, sanctions, etc.).

As opposed to 2015 state budget, expenses in 2016 draft law of state budget are increased by 356.6 m GEL and amount to 8 373.2 m GEL. Social security expenses will be increased by 279.4 m GEL, while wage expenses will be increased by 57.3 m GEL. Increase in public sector labor force salaries is planned in parallel of decreasing the number of the above labor force. As compared to 2015, draft law of state budget for 2016 envisages staff cut in public sector by 610 persons.

Budget of the Ministry of Regional Development and Infrastructure is planned to increase by only 5 m GEL (0.48%) and constitute 950.0 m GEL. Out of the mentioned funds, 526.6 m GEL will be allocated to road infrastructure development and it is 50.5 m GEL less than it was in 2015 budget. 246.2 m GEL is allocated to regional and municipal infrastructure rehabilitation. While 170.6 m GEL is appropriated for

¹ Amendment to the 2015 budget was approved by the Parliament on July 17 of this year.

water supply system restoration - 41.0 m GEL more than it was in 2015.

As opposed to previous year's state budget, in the draft law of 2016 state budget, acquisition of non-financial assets (so-called capital expenditures) is reduced by 37.7 m GEL (4.9%). Total capital expenditures constitute 736.0 m GEL out of which 466.8 m GEL is appropriated for the Ministry of Regional Development and Infrastructure.

Draft law of 2016 state budget envisions an increase of liabilities by 1 275 m Gel. In addition, it is planned to reduce foreign debt by 360 m GEL and to decrease domestic public debt by 64.4 m GEL.

In 2016, State Budget expenses will exceed revenues, which will lead to a negative operational balance (18.2 m GEL), while, as an advance forecast suggests, the overall budget deficit will be 554.2 m GEL.

The draft law of state budget may change several times in the course of parliamentary discussions. The Parliament shall approve the final version of state budget by the end of the year.

Chart 2. Funding of Ministries (in m GEL)

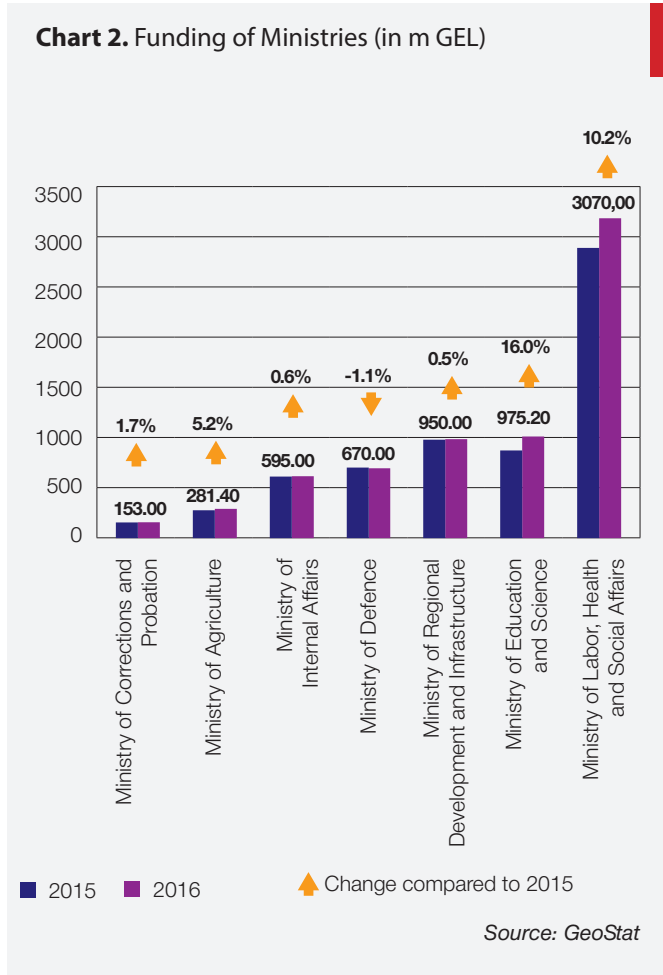
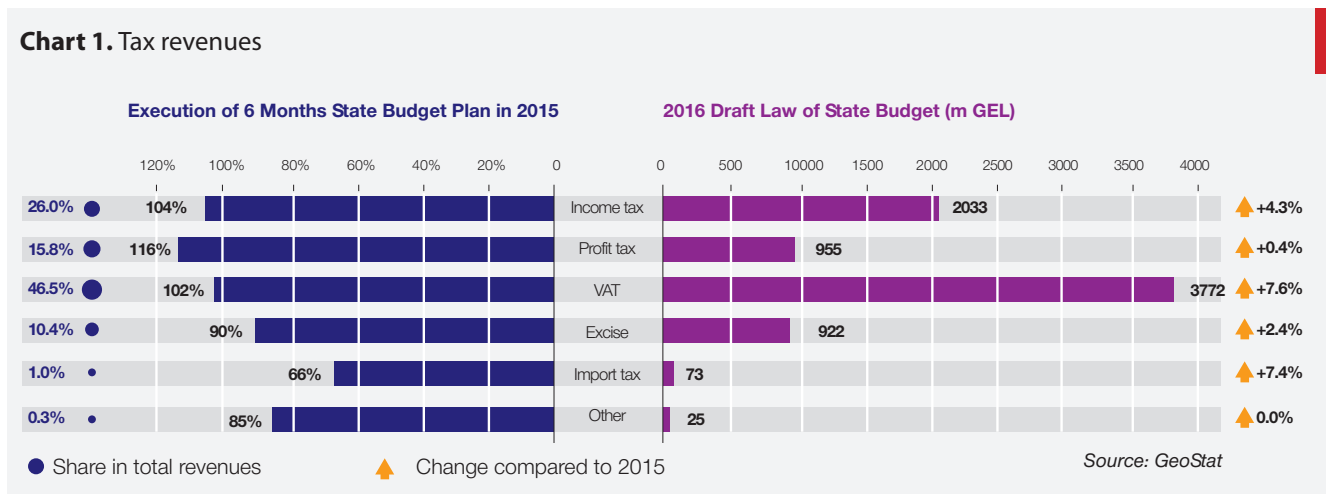


Chart 1. Tax revenues



GROWTH OF REAL GDP IS STILL SLOW

According to the preliminary data, in the second quarter of 2015, GDP was 7 772.2 m GEL. In comparison to the second quarter of the previous year, nominal GDP growth was 8.5%, while real growth² amounted to 2.5%. Moreover, depreciation of GEL against USD significantly decreased GDP denominated in USD.

In August 2015, GDP growth rate was 2.3%, while average real GDP growth for the first eight months of 2015 amounted to 2.8%. According to the estimates of the IMF, ADB and the World Bank, Georgia is estimated to have 2% GDP growth in 2015.

Slowdown in real GDP growth is pre-conditioned by various factors. Significant decrease in export level has been affected by recent negative developments in the region. Additionally, the national currency has depreciated against the US Dollar. Higher prices on imports, together with the increase in debt service expenses (as 64% of loans in Georgia are denominated in USD), and a decline in money transfers has significantly decreased the GDP growth rate.

In the second quarter of 2015, the largest real growth was acknowledged in the areas of construction (14.5%), mining industry (12.7%) and financial activities (10.6%). The structure of the gross output was not different from that of the first quarter: processing industry covers 15%, trade is on the second place with 11.3%, and the third place is held by construction with 10.6%. It should be noted that construction is the only sector with output increase of more than 1% (2.4%) in the second quarter, as compared to that of the first quarter.

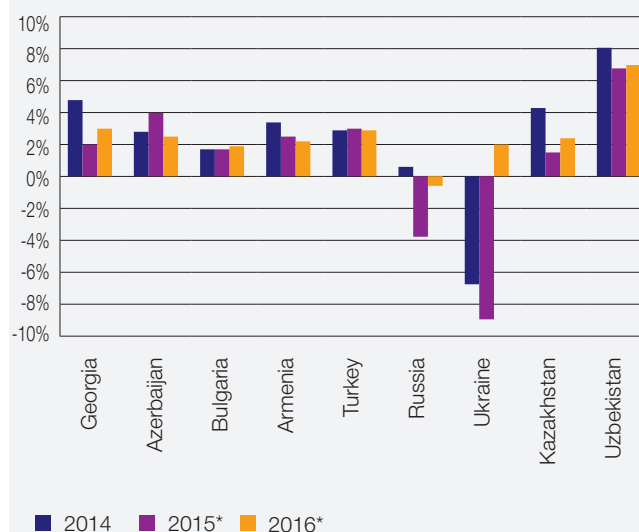
Table 1. Gross Domestic Product

	Q2 2014	Q2 2015*	DIFFERENCE
Nominal GDP (m GEL)	7 162.8	7 772.2	8.5%
Nominal GDP (m USD)	4064.1	3406.5	-16.2%
GDP per capita (GEL) ³	1 595.1	2 084.0	30.7%
GDP per capita (USD)	905.0	913.4	0.9%
real GDP growth (percent)	5.2%	2.5%	

*Preliminary Estimates

Source: GeoStat

Chart 3. Real GDP Growth



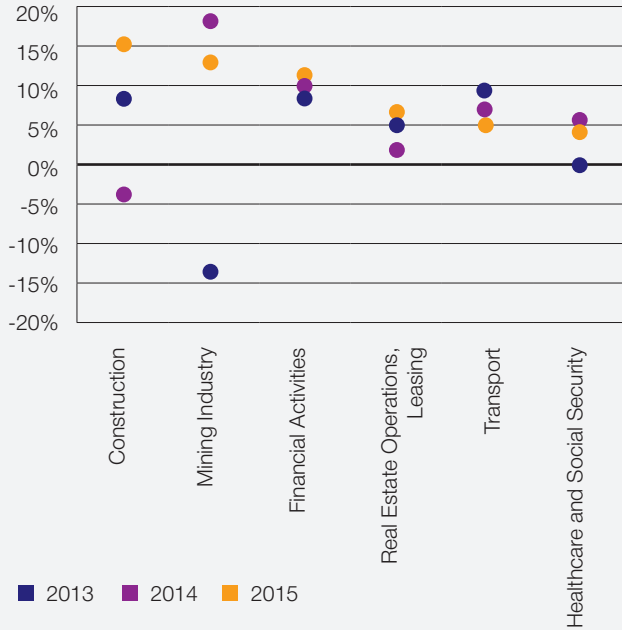
*Preliminary Estimates

Source: IMF

² Real growth is calculated based on GDP in constant prices in relation to that of previous year.

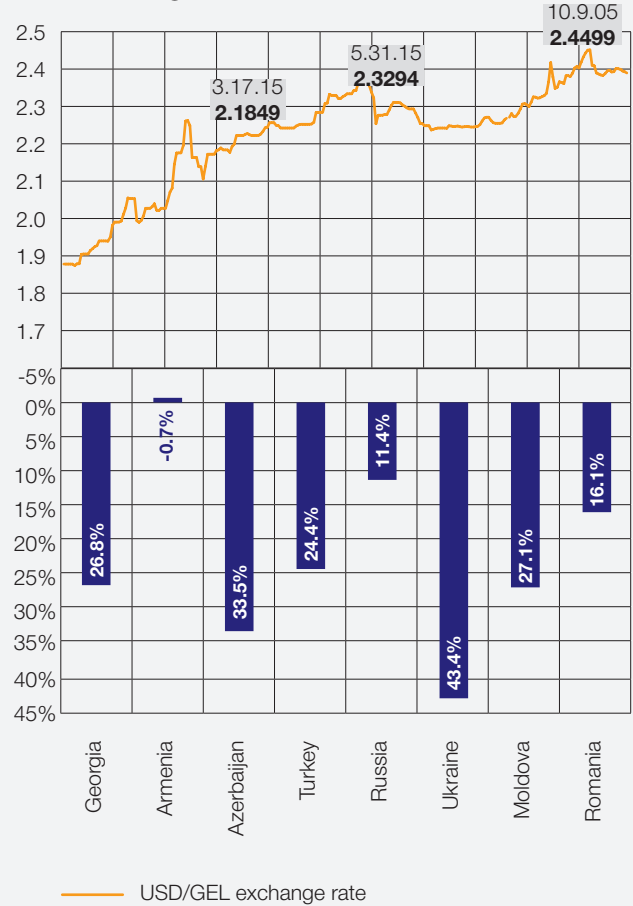
³ Per capita indicators for Q2 2015 are compiled in line with updated data from 2014 general population census. Pre-census demographic data were used for the calculation of per capita indicators of the previous years. Recalculation of 2003-2014 per capita indicators will be produced in 2016 after release of final 2014 population census data.

Chart 4. Real Growth of Different Sectors in the Second Quarter



Source: GeoStat

Chart 5. Depreciation of the National Currency against the USD, through 01.15-10.15



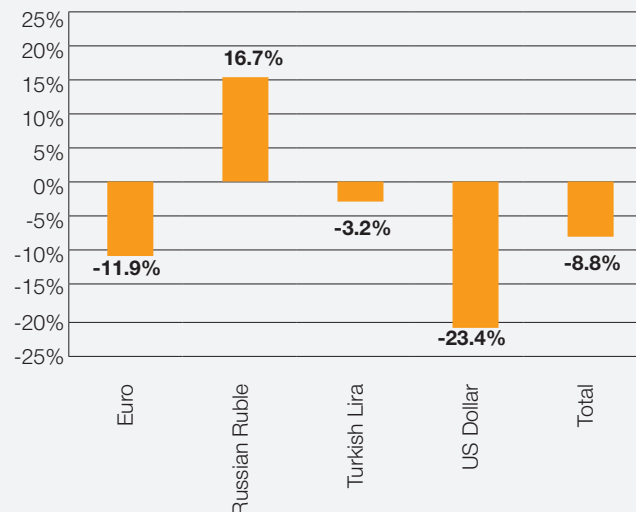
Source: National Bank of Georgia

EXCHANGE RATE OF GEL AGAINST USD MAINTAINS AN UPWARD TREND

In September, average exchange rate of GEL against USD was 2.3985. On September 22, the rate reached its maximum 2.4499, almost reaching its all-time record exchange rate - 2.4510, which was reported in February 1999. According to the assessments of the President of the National Bank of Georgia, Giorgi Kadagidze and the Minister of Finance, Nodar Khaduri, exchange rate of GEL with respect to USD has reached its highest point, and therefore, we should not expect further depreciation.

In September 2015, as opposed to September 2014, the nominal effective exchange rate⁴ of GEL depreciated by 6.6%. In comparison to August, inflation of the nominal effective exchange rate amounted to 2.2%. As for the real effective exchange rate⁵, according to August data, it has depreciated by 6.0% as opposed to that of the previous year.

Chart 6. Change of Real Exchange Rate of GEL in September 2015 compared to September 2014.



Source: National Bank of Georgia

⁴ Nominal Effective Exchange Rate (NEER) is calculated as a weighted geometric average of nominal exchange rates against main trade partner countries' currencies (Euro Zone, Turkey, Azerbaijan, Russia, Ukraine, China, Armenia, USA, Bulgaria, and Japan).

⁵ Real effective exchange rate is computed as a weighted geometric average of the exchange rates to the major trade partners' currencies considering the differences in ratio of consumer price indexes. These calculations involve the following foreign trade partners: Euro Zone, Turkey, Azerbaijan, Russia, Ukraine, China, Armenia, USA, Bulgaria, and Japan.

Since November 2014, GEL/ USD exchange rate depreciated by 35.6%.

ACCORDING TO PRELIMINARY ESTIMATES, THE CURRENT ACCOUNTS DEFICIT HAS SIGNIFICANTLY DECREASED

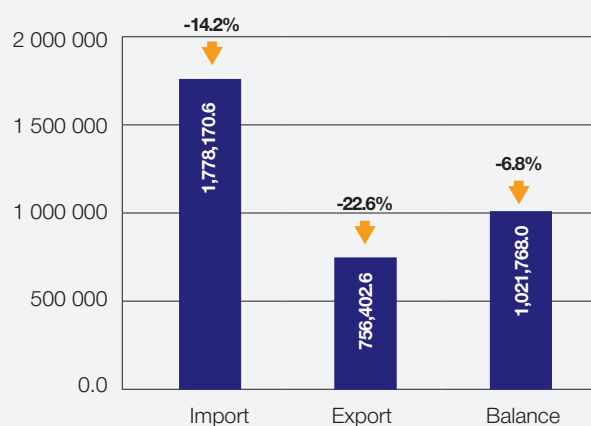
In the second quarter of 2015, the current account⁶ deficit amounted to 354.7 m USD, which constitutes 10% of GDP. According to the IMF forecast, in 2015, the current accounts deficit will amount to 10.7% of the GDP.

Compared to second quarter of 2014, current account deficit has decreased by 16.2%. This year, based on the second quarter data, the current account deficit reached the lowest point over the last 5 years, except 2013, when exports significantly increased due to the removal of the Russian embargo on Georgian exports.

In the second quarter of 2015, imports of goods exceeded exports by 991.0 m USD. Since the second quarter of 2014, imports have decreased by 295.2 m USD (14.2%), while exports have decreased by 220.9 m USD (22.6%). As a result, since the second quarter of this year, the difference between exports and imports has decreased by 74.7 m USD (6.8%). As opposed to trade in goods, volume of exports in services is larger than imports, which is mainly due to the increase in tourism.

Another factor that significantly affected the decrease of current accounts deficit was increase of one of its components - current transfers⁷ by 15.4%. This is a result of significant increase in grants received by the government and other liabilities (for example, the government of Georgia received 143.2 m USD to fund Hepatitis C Elimination Program).

Chart 7. Trade in Goods in the Second Quarter



Source: National Bank of Georgia

FOREIGN DIRECT INVESTMENTS INCREASED

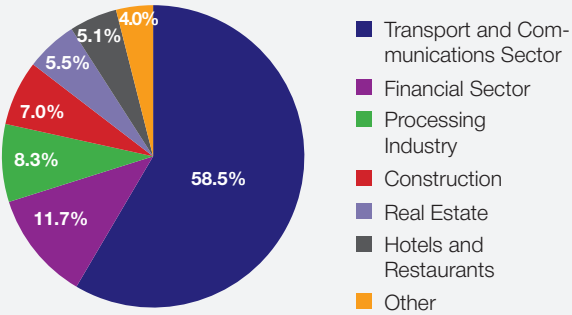
Foreign direct investments constitute one of the most important sources for financing current accounts deficit. In the second quarter, FDI have significantly increased and amounted to 354.4 m USD. As compared to the similar parameter of the last year, FDI have increased by 88.9%. Investments in equity capital amounted to 60.4%, and reinvested earnings amounted to 34.9% of FDI. Three largest foreign investors are Azerbaijan, Netherlands and Turkey. In the second quarter, investments from these countries amounted to 75.8% of total FDI.

According to second quarter data, largest portion of FDI are made in the following sectors: transport and communications (58.5%), financial sector (11.7%), processing industry (8.3%), and construction (7.0%). FDI in the energy sector has been declining since the second quarter of 2014. According to the data of the second quarter of 2015, investments in this

⁶ Current account covers trade in goods and services, employment and investment revenues, received and issued grants, etc. between residents and non-residents of a country.

⁷ Current transfers include intergovernmental and IFIs' grants, workers' remittances and other transfers.

Chart 8. Distribution of Foreign Direct Investments among Various Sectors (Q2 2015)



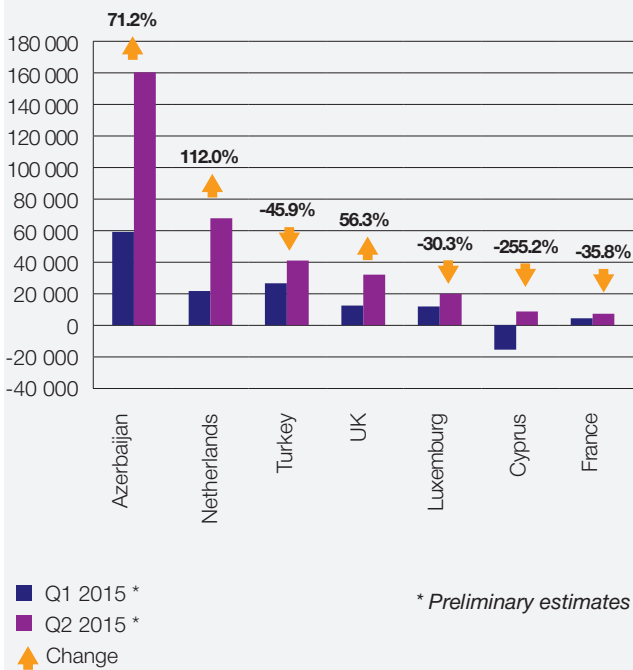
Source: National Bank of Georgia

sector have decreased by 70 m USD as opposed to the same data of the previous year and amount to 8.9 m USD.

EXTERNAL TRADE TURNOVER IS AT ITS MINIMAL LEVEL OVER THE LAST 4 YEARS

According to the preliminary estimates provided by the National Statistics Office of Georgia, through January-September 2015 external trade turnover⁸ amounted to 7 312 m GEL, which is 13% less than that of previous year. Since 2014, both export (by 24%) and import levels (9%) have declined. First 9 months figures of this year have shown the lowest levels of export and import over the last 4 years. Besides, external trade balance constitutes 55% (4 023 m GEL) of the total external trade turnover.

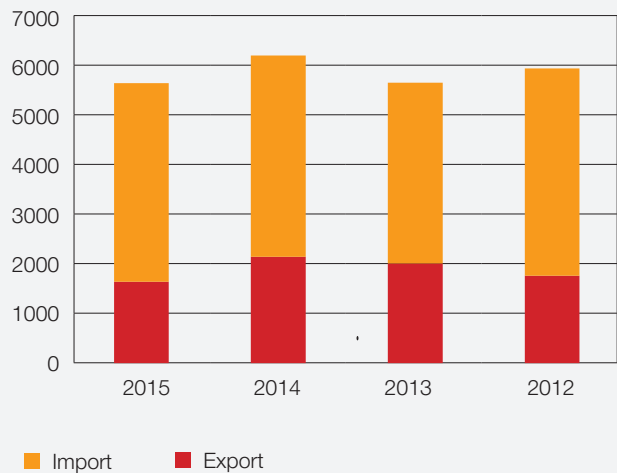
Chart 9. Foreign Direct Investments (thousand USD)



* Preliminary estimates

Source: National Bank of Georgia

Chart 10. External Trade, January-September



Source: GeoStat

8 A major criterion for recording export-imports in external trade is when certain goods cross the frontier.

Chart 11. External Trade by Countries (in thousand GEL), January-September, 2015

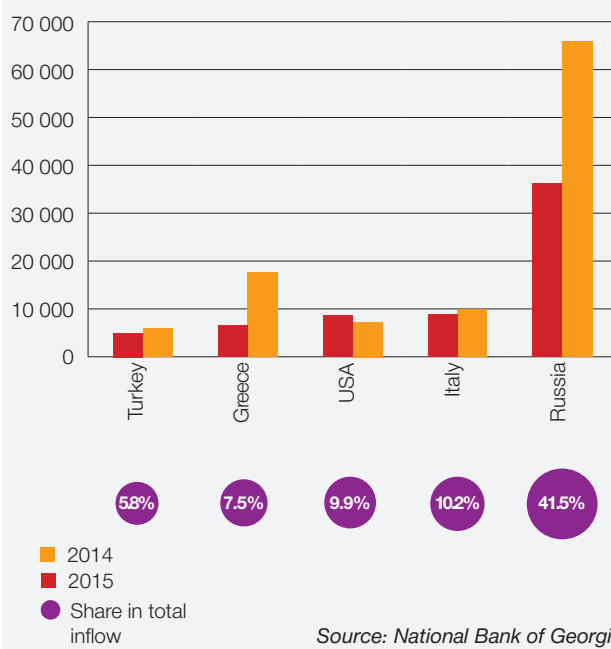


▲ ▼ Percentage change

Source: GeoStat

Table 10:

Chart 12. Money Transfers by Counties - Inflow (as of September) in thousand USD



Source: National Bank of Georgia

(5%) established by the National Bank of Georgia. As estimated by the National Bank of Georgia, inflation will approach the targeted level by the end of the year.

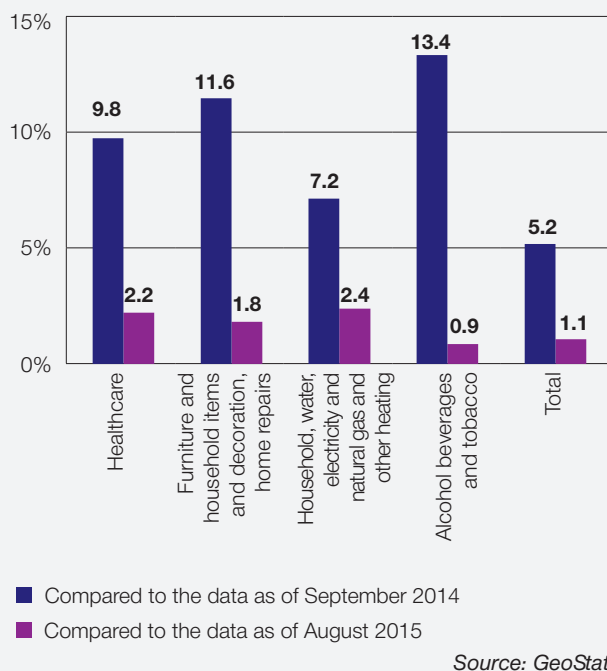
Depreciation of the national currency significantly increased prices on imports, which on its part, resulted in the increased prices of intermediate products. In addition, electrical energy tariff rate has increased. This process contributed to the increase in inflation. The largest increase has been identified in household, water, electricity and natural gas prices, which constituted 2.4% of inflation. Also should be noted inflation in other sectors, such as healthcare (2.2%), vacation, recreation, culture and education (1.7%). Prices have also increased on furniture and household products (1.8%). In the meantime, as opposed to figures from August this year, there has been a minor decrease in prices in the transportation sector (0.9%) and hotels, cafes and restaurants (0.6%). Annual inflation has mostly affected prices of alcohol and tobacco (13.4%), as well as furniture and household appliances (9.3%).

CONSUMER PRICE INDEX INCREASED

In September 2015, CPI increased by 1.1% as opposed to the previous month, while annual inflation was 5.2%, which exceeds the target inflation level

Preliminary estimates of IMF suggest that in 2015 consumer price inflation in Georgia will be 3.7%, while the ADB forecasts 4.3% annual inflation.

Chart 13. Percentage Change in Consumer Prices as of September 2015



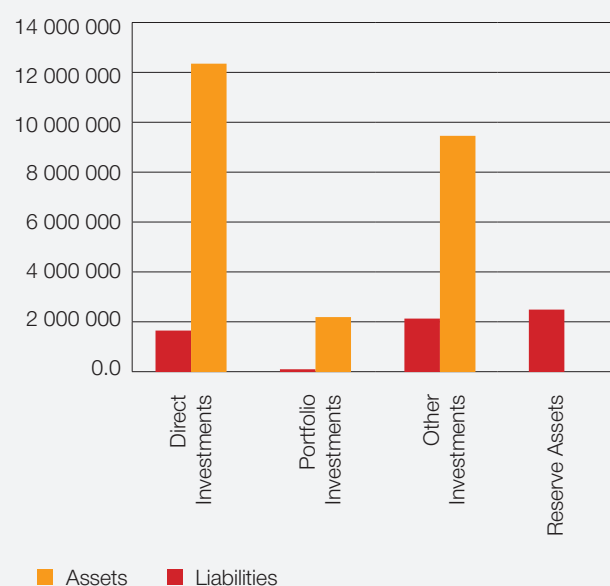
30, net international investment position constituted 112.3% of GDP.

Compared to the second quarter of 2014, this year Georgia’s assets have increased by 500.3 m USD and amount to 6.4 billion USD. Liabilities have increased by 1 107.9 m USD and in total amount to 23.8 billion USD.

NET INTERNATIONAL INVESTMENT POSITION HAS DECREASED BY 3.3%

By the end of the second quarter of 2015 net international investment position⁹ of Georgia amounted to -17,467.3 m USD, which is 607.6 m USD (3.3%) less the same figure from previous year. As for June

Chart 14. International Investment Position of Georgia



⁹ Net international investment position is a difference between claims on nonresidents and liabilities to nonresidents by the following sectors: central bank (National bank); deposit-taking corporations, except central bank; government and other sectors.

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