
National Bank of Georgia
Annual Report
1999

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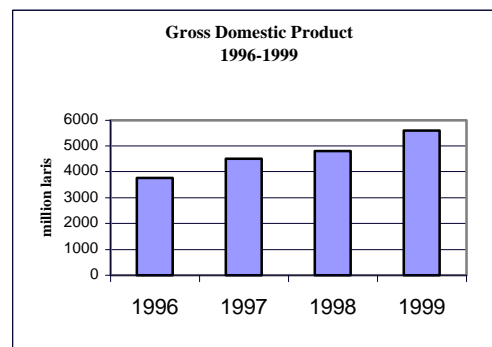
Chapter 1. Financial Position of Georgia and Major Results of Economic Developments in 1999

1.1. Macroeconomic Trends

Notwithstanding the budgetary crisis, which emerged in 1998 and became more serious a year after, certain positive economic developments have been witnessed in Georgia during the reporting year.

The National Bank of Georgia has combated, in a rather short time, the foreign exchange difficulties which developed in Georgia by the end of 1998. Achievement of overall stability of the Lari exchange rate, fluctuations of which have been reduced to a narrow band, should be viewed as the major macroeconomic accomplishment of 1999.

In the freely floating exchange rate regime that existed in 1999, it became feasible to contain price fluctuations. Relatively low inflation and only slight movements in the exchange rate created a favourable environment for overall economic development of the country.



Real GDP grew by 3 per cent in 1999. Value added in the real sectors of economy, except for construction, somewhat exceeded the overall rate of Georgian economic growth. Compared to the previous year, value added increased by 5.7 per cent in industrial sector; 5.6 per cent in agriculture and fishing; 5.4 per cent in transportation; and 5.8 per cent in telecommunications. The value added indicator in the services sector was also higher than the average. For instance, over the year it grew by 14.8 per cent in the trade area; 18.1 per cent in the hotels and restaurants business; and 29.5 per cent in financial intermediation.

No significant changes have been observed in the sectoral breakdown of GDP. Nominal GDP amounted to

5,543 million lari, of which 1,564 million lari, i.e. 28.2 per cent of total was the value added created in agriculture and fishing; 1,019 million lari (18.4 per cent) in manufacturing (including household production); 510 million lari (9.2 per cent) in transport; 183 million lari (2.5 per cent) in telecommunications; and 653 million lari (11.8 per cent) in trade.

Manufacturing

Certain positive trends in industrial sector developments were still observed, notwithstanding economic difficulties prevailing in the country in 1999.

Almost all industrial enterprises have been incorporated or transformed to other organisational forms relevant to the market economy in line with the existing legislation. The vast majority of these enterprises have been privatised. The ability to operate independently has improved within the new macroeconomic and legal environment, and a new class of business entrepreneurs, with a totally different mentality and initiative, has emerged. It can be said that an essential stage of adaptation to market economy conditions is now passed and

the production sector is beginning to realise substantial economic potential.

Georgian manufacturing increased by 7.4 per cent in 1999. Produced output (goods and services) in current wholesale prices totalled 963.1 million lari. Out of 2,978 industrial enterprises, more than half of which were created after 1995 as small and medium size enterprises (SME), some 887 entities or 29.8 per cent of total were not operational in 1999.

Output growth has led to increased collection of the budget revenues. According to the Ministry of Industry, nearly 20 million lari was contributed to the state budget by enterprises overseen by the Ministry itself. The corresponding figure for 1998 was only 13 million lari. In 1999 48 per cent (more than 100 million lari) of the output produced by these enterprises was exported, and substantially exceeded the previous year. Exported merchandise included mineral fertilizers with azoth, ferrous manganese, copper concentrate, metal forms, steel pipes, airplanes, pumps, small operational capacity electric machines, apparel and footwear.

In 1999 the number of employees in the manufacturing sector increased by 4-5 thousand people and exceeded 45 thousand. At the same time, the average number of employees on the payroll in this sector was 115.7 thousand suggesting that many enterprises still operated below full capacity.

61 per cent of the industrial output was produced by the public sector, and the remaining 39 per cent by the private sector. Of 101.2 thousand employees, 57.2 per cent worked in the public sector, and 42.8 per cent were employed in private enterprises.

Among major types of production, growth in 1999 was observed in extraction of manganese ore and zeolite, production of carbonated electric ferrous manganese, diesel fuel, mazut, synthetic ammonium, mineral fertilizers, chemical thread and fiber, television sets, footwear, cement, fat cheese, sparkling wines, spirits, liqueurs, beer, school notebooks, electric household irons, porcelain platters, and filter and non-filter cigarettes.

Reduction in output occurred in exploitation of coal and oil, production

of steel pipes, metal cutting machines, trucks, construction blocks and other construction materials, fabrics, stockings and cotton, meat, vegetable oil, mineral waters, soft drinks, tea, wall paper, paints and other products.

Despite the progress, many unresolved problems still remain in the industrial sector. Productive capacities of enterprises are still not fully utilised, and restructuring and privatisation of a number of large companies are delayed. Shortage of investment capital results in hold-ups of many potentially viable enterprises. The majority of industrial enterprises are unable to produce competitive output, and consequently suffer from poor financial and economic performance. The share of the shadow economy remains large, substantially limiting budget revenues and seriously obstructing formation of healthy market-based relationships in a number of industrial sectors.

Agriculture

Technical and financial assistance from various international financial organisations, and agricultural reforms implemented in the recent years, have provided favourable grounds for

reviving economic activities in the agricultural sector.

Significant progress has been achieved in upgrading the agricultural technical base and improving productivity in the areas of crop production and cattle breeding. In 1999 the country imported a substantial amount of high productivity grain and potato seeds, quality eggs and other breeding goods, and chemical substances for protecting plants from various diseases. A number of steps have been taken for rehabilitation of irrigation systems.

Total agricultural produce in 1999 totalled 2,650 million lari, 8 per cent higher than in 1998.

Plant production has notably increased over the reporting year. There were 786 thousand tons of crops produced in 1999, some 188.2 thousand tons, or 31.5 per cent more than in the previous year. Compared to 1998, there were increases in production of sunflowers (by 17.2 thousand tons, i.e. 75.4 per cent), potatoes (by 32.2 thousand tons, i.e. 9.2 per cent), vegetables (by 80 thousand tons, i.e. 27 per cent), quality tea leaves (by 12.8 thousand tons, i.e. 27 per cent), and milk (by 26 thousand

tons, i.e. 4 per cent), and in other products.

Trends observed in cattle breeding in recent years have continued in 1999 as well. The number of cattle increased by 1 per cent compared to 1998, and the numbers of pigs and sheep increased by 4.7 per cent and 2.8 per cent respectively.

In 1999 there has been a growth in the market share of family farming, which produced 96 per cent of crops, 90 per cent of vegetables and potatoes, 99 per cent of citrus products, 97 per cent of grapes, and 99 per cent of cattle.

Parallel to the positive trends in agriculture, a number of problems still persist, which impede overall development of the sector. These include:

- Obsolete agricultural tools and technical equipment in the sector;
- An old and out of date tractor fleet;
- A shortage of spare parts and repair materials;
- Inefficient land utilisation;
- Partitioning of the land into small plots makes irrigation activities almost impossible; it restricts

planting of highly productive species, introduction of new technologies, and efficient seed circulation.

Positive developments have been witnessed in some areas of the food-processing sector. Compared to the previous year, output volumes have increased for 18 out of 31 most important types of officially registered products. The growth was particularly notable for black tea leaves, sparkling wines, brandy, filter and non-filter cigarettes, sugar, beer, canned fruit and vegetables, fish, and other products.

In total 242.6 million lari worth of goods were produced in the food and processing sector in 1999, some 5.9 per cent, or 15.1 million lari less than the year before. The shortfall was due to reduced production of bread and bakery products, which amounted to only 98.9 million lari or 69 per cent of the 1998 volume. Apart from the bakery products, the amount of food and processing sector output increased by 25.5 per cent.

Increased production of quality tea leaves led to higher output of Black Baikhi tea, which increased by 10.3 per cent to 10,896.8 tons. At the same

time production of Green Agura, and granule and packaged tea fell by 4 tons and 933.6 tons respectively. The main reasons for the reduction were problems in marketing and distribution.

Wine production in 1999 amounted to 1,800 thousand decilitres, some 474.6 thousand decilitres less than in the previous year. Inability to penetrate international markets and imports of similar but cheaper wines, which were more attractive for low-income consumers, were the primary causes for the reduction in sales of Georgian wines. In 1999 production of sparkling wines, and of vodka and liqueurs at wineries, increased by 39.7 per cent and by 3.3 times respectively. Export of these goods has also increased.

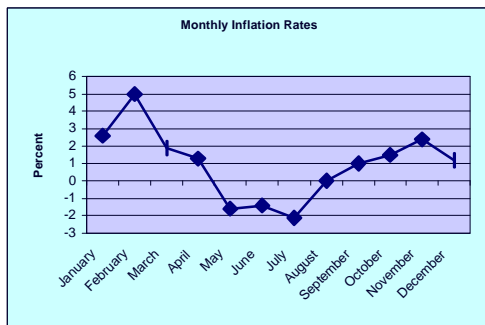
Production and sales of mineral waters has substantially decreased over the reporting year. In 1999 it amounted to 49 million bottles, which is 19.3 per cent less than in 1998. The decline was due to marketing problems of Georgian mineral waters beyond the traditional markets outside Georgia.

The majority of food processing enterprises producing meat, milk and canned products, operate well below

full productive capacity or do not function at all. Consequently, most agricultural goods appear on the consumer markets without being properly processed in factories. As a result not only consumers suffer, but also enterprises producing and processing raw materials, and the state budget.

Inflation

Over 1999, the consumer price index increased by 10.8 per cent with average monthly inflation of 0.85 per cent.



Throughout 1999, on a month-to-month basis prices increased in January (by 2.6 per cent), February (by 5 per cent), March (by 1.9 per cent), and April (by 1.3 per cent). Inflation in January and February was mainly due to seasonal price increases for fruits and vegetables, and also increases in tobacco prices due to the expected introduction of excise stamps.

In May, for the first time since the beginning of the year, consumer prices fell by 1.6 per cent. Deflation continued in June (1.4 per cent) and July (2.1 per cent), mainly due to seasonal factors and appreciation of the lari against the US dollar. The same trend continued in August as well, when a seasonal reduction in consumer prices was offset by increased fuel prices. Consequently the overall consumer price level remained unchanged.

Following the summer deflation, the CPI increased by 1 per cent in September due to a gradual increase of fruit and vegetable prices. Prices continued to rise in October by 0.5 per cent, and in November by 2.4 per cent. The latter increase was mainly due to a sharp jump in prices for energy substitutes. Prices for gasoline in Georgia increased by 17 per cent, and on diesel fuel by 50 per cent, which in turn, led to higher fares for transportation services. Intercity coach fares increased by 24.4 per cent, city bus fares by 2.3 per cent, and taxi fares by 7.5 per cent.

Compared to the previous month, prices for liquid gas and kerosene, which still remain the primary products

used by households for heating purposes, also increased in November by 9.3 per cent and by 41.8 per cent respectively. In December prices for both goods increased by 0.5 per cent.

Prices for goods and services in the sectors regulated by the state have also changed in 1999. In particular, by the Decree no. 1 “On Realignment of Electricity Tariffs” issued on May 31, 1999 by the National Energy Regulation Commission of Georgia, from June 1, 1999, electricity tariffs for all consumer groups including households were raised from 6 to 9 tetris per kW/h in Tbilisi (a 50 per cent increase), and to 8.3 tetris in other parts of the country (a 38.3 per cent increase).

According to the Commission, electricity prices were raised due to exchange rate fluctuations and changes in the taxation regime covering energy and fuel imports. This increase in the tariffs was facilitated by conditions under the investment program stipulated in the privatisation contract of the energy distribution company “Telasi”.

Exchange rate fluctuations at end-1998 and the beginning of 1999 led to higher

wholesale and retail prices for natural gas. From May 1, 1999 gas prices in Tbilisi increased from 214 to 288 laris per 1000 cubic meters (by 34.6 per cent). Later on, however, under the Decree of the National Energy Regulation Commission, effective August 1, 1999 the natural gas tariffs were set at 250 laris per 1000 cubic meters (a 13.2 per cent reduction).

During 1999, prices most notably increased for corn flour (by 37.3 per cent), imported filter cigarettes (by 30.2 per cent), smoked fish (by 29.8 per cent), dry beans (by 26.3 per cent), walnuts (by 22.7 per cent), buckwheat (by 21.3 per cent), kerosene (2.2 times), diesel fuel (2.1 times), telephone service fees (by 89.8 per cent), natural gas (by 75.9 per cent), gasoline (by 69.9 per cent), air fares (by 37.1 per cent), suburban coach fares (by 32.5 per cent), and intercity coach fares (by 28.2 per cent).

Employment

The potential labour force of Georgia totalled 2,402.6 thousand in 1999. Of these, the number employed in the national economy amounted to 2,079 thousand people, and the number of registered unemployed was 103.9

thousand. The unemployment rate was officially registered at 4.8 per cent.

The largest part of the working population - 56.5 per cent - were employed in agriculture, forestry and fishing; 10.4 per cent - in trade and communal services; 8.5 per cent - in education, culture and arts; 6.1 per cent - in manufacturing; 4.6 per cent - in healthcare and social services; and 4.8 per cent in warehouses and telecommunications.

More than 60 per cent of the 370,000 people working for various enterprises were employed in the private sector, which accounts for 51 per cent of the output produced by all enterprises.

According to the State Employment Fund of Georgia, the number of registered job seekers in 1999 increased by 4.3 per cent to 106.3 thousand people, majority of which (96.5 per cent, i.e. 102.6 thousand people) were unemployed. 55.2 per cent of these were women among whom 33.4 per cent were below the age of 30, and 20.9 per cent above the age of 50. 16 per cent of job seekers were unemployed for up to 1 year; 36.6 per cent for 1 to 3 years; and 47.4 per cent for more than 3 years.

As of December 1999 there were 18,553 vacancies registered at the Employment Fund, 2.4 times higher in the previous year. Of these, 43 per cent were positions for workers; 29.1 per cent for specialists; and 27.9 per cent for junior service personnel.

Recruitment of the unemployed has exhibited a positive trend. 12.3 per cent of registered job seekers have found a job during 1999; this figure exceeds by 1.7 times the corresponding number in 1998. Of those recruited over the year, 4.61 thousand people were employed in material production, and 7.97 thousand people in the services' sector. 5.76 thousand people got jobs in state owned enterprises, and 5.44 thousand in the private sector. 53.8 per cent of those recruited were workers, 32.9 per cent - specialists, and 13.3 per cent - junior service staff.

To facilitate recruitment of the registered unemployed, the State Employment Fund has designed a special program for its Business Training Centre. This program is aimed at identifying entrepreneurial skills of individuals and assisting them in personal business development through intensive consultation. An

agreement to provide long-term preferential credits to the unemployed for start-up businesses has been reached with several Georgian banks. In addition, the Fund cooperates with foreign companies and joint ventures, which undertake various projects in Georgia. During the first stages of project implementation, more than 5,000 highly qualified unemployed personnel have been recruited through the employment service.

There is also special importance given to strengthening relationships with entrepreneurs and their unions to aid recruitment of the unemployed and creation of new work places. To this end the Fund organises fairs and conducts other joint activities.

Due to reduction in the number of jobs in the government sector in the first half of the year, the share of self-employed remained relatively high at 55 per cent.

More than 8 thousand people were recruited by enterprises and organisations to newly created positions in 1999; this represents 23.2 per cent of the total number of workers hired by enterprises in this period.

In accordance with labour market demand, the necessity to establish a strong institute for professional training emerged. The training centre was created with the purpose to provide unemployed people with prospective professions. 1,289 people have gone through the centre and its branches in 1999, and more than 60 per cent of them have already found employment.

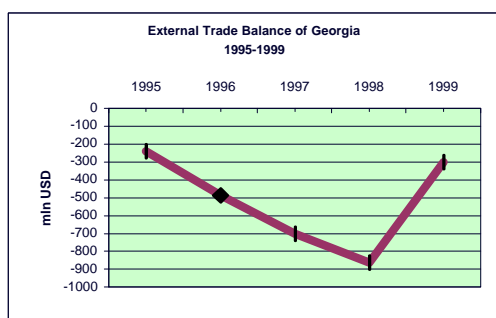
Serious measures have been undertaken to improve the registration system for unemployed job seekers, and for developing a proper benefit payments mechanism to ensure efficient utilisation of labour force.

1.2. Foreign Economic Position of Georgia

Balance of Payments

Georgian foreign trade turnover in 1999 (excluding non-organised trade) totalled USD 863.3 million - 80.5 per cent of the 1998 level. The volume of exports reached USD 240.7 million (126.8 per cent of 1998 level), and imports amounted to USD 622.6 million (70.5 per cent of the 1998 level). The import coverage ratio increased to 38.7 per cent – the largest for the last five years (in 1998 the

corresponding figure was 21.5 per cent).



The trade deficit in 1999 amounted to USD 381.8 million, 1.8 times lower than the corresponding figure for last year.

A negative trade balance was recorded for 89 partner countries with a total trade deficit of USD 398.6 million, compared with 107 countries and USD 778.9 million in 1998. In 1999, Georgia had a negative trade balance in excess of USD 1 million with 39 countries, including Russia, USA, Turkey, Germany, Azerbaijan, Ukraine, and the UK.

At the same time, the trade balance was in surplus with 22 countries, and amounted to USD 16.8 million, compared with a USD 9.4 million surplus with 14 countries in 1998. A positive trade balance in excess of USD 1 million was recorded with only

four countries: Congo, Syria, Armenia and Tajikistan.

34.5 per cent of the trade deficit resulted from the trade with CIS countries (as opposed to 23.1 per cent in 1998). Trade turnover with these countries amounted to USD 347.9 million (5.8 per cent less than in 1998), and to USD 515.4 million (or 26.8 per cent less) with other countries. The CIS states accounted for 40.2 per cent of total Georgian foreign trade turnover, and for 44.9 per cent and 38.5 per cent of exports and imports respectively (in 1998 corresponding figures were 34.4%, 55.1% and 30%).

In 1999, the share of Georgia's ten major trading partners (Russia, Turkey, USA, Germany, Azerbaijan, Ukraine, Turkmenistan, Armenia, UK, Italy) in total trade turnover increased by 2.5 percentage points to 75.5 per cent. Five of them were CIS countries accounting for 38.9 per cent of total trade. In 1998 only three CIS countries were in the top-ten list with a 29.5 per cent share in the aggregate trade volume.

The major export commodity groups in 1999 were black scrap metal (9.8 per cent of total exports), ferrous alloys

(8.4 per cent), and aircrafts (7.9 per cent).

Imports were again dominated by oil and oil products, though its share in total imports declined by 5.1 per cent compared to 1998; natural gas imports declined by 3.9 per cent, and pharmaceuticals increased by 2.7 per cent.

Analysis of the geographic structure indicates that, if in earlier years CIS countries were the primary markets for Georgian exports, prospects of penetrating into other markets are now gradually appearing. In 1999 the volume of exports to CIS countries increased by only 2 per cent and amounted to USD 100.9 million. This substantially (by USD 29.2 million) lagged behind exports to other foreign countries.

There have also been changes with Georgia's major trading partners – Russia, Turkey and Azerbaijan. Russia's share in total foreign trade increased from 15.3 per cent in 1998 to 19.8 per cent in 1999. Turkey's share also increased to 13.1 per cent (by 1.9 per cent), while Azerbaijan's share fell by 1.1 percentage points.

An important accomplishment of foreign economic relations in 1999 was the USD 311.3 million reduction in Georgia's trade deficit. No less importantly, the share of exports in total trade turnover increased from 18.6 per cent in 1998 to 29.8 per cent in 1999.

Attracting foreign investments to finance various important state investment programs is the major priority of the Georgian foreign economic policy. This funding is mainly obtained through loans and grants from international financial institutions and governments of various donor countries, and from investment resources attracted via sovereign guarantees. These are usually not reflected in the state budget.

External Debt

By end 1999 Georgia had signed foreign debt contracts totalling USD 2 billion, of which USD 1.7 billion has been disbursed since 1995. Loans extended to Georgia are usually preferential, with a maturity of 30 to 40 years at very low interest rates (up to 1 per cent), and 8-10 year grace periods. All foreign credits received from international financial institutions

are intended for rehabilitation and development of specific sectors of the economy. For example, loans from the International Monetary Fund (IMF) are used to promote macroeconomic stability, implement structural reforms, or correct balance of payments imbalances. A part of the World Bank credits is used to cover the budget deficit, while the major portion is aimed at rehabilitation of healthcare, agriculture, energy, social security, culture and other sectors of the economy.

Preferential credits issued by the German government through KfW and loans of the European Bank for Reconstruction and Development (EBRD) are also very important. Intensive cooperation has been initiated with the Japanese government. Substantial funds have been allocated through the Japanese Bank for International Cooperation (JBIC) for rehabilitation of the energy sector.

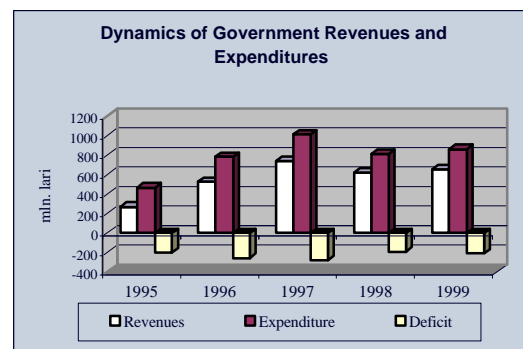
With the assistance of IMF, restructuring of Georgian foreign debt, and resolution of debt servicing and repayment problems have continued in 1999. At the beginning of the year the

sovereign debt of Georgia totalled USD 1,864.9 million.

Over the past year, new credits of USD 128.1 million have been disbursed. A substantial portion of these loans was used for institutional and legal reforms, and for rehabilitation of the energy sector.

1.3. State Budget

The State Budget of Georgia comprises the central budget and special government funds. The law on the State Budget for 1999 estimated total budget revenues, including capital items, at 922.5 million lari. According to preliminary estimates actual revenues amounted to 653.9 million lari (70.9 per cent of the budgeted figure) resulting in a shortfall of 268.6 million lari.



Actual expenditures are estimated at 862.4 million lari resulting in a deficit

of 208.5 million lari, or 3.7 per cent of GDP.

Domestic financing of the budget deficit equalled 137.5 million lari; 97.5 million were credits from the National Bank of Georgia. The remaining 63.3 million lari were obtained from external sources.

The Law on the Budget for 1999 projected central budget revenues (including capital revenues) of 684.9 million lari. Of this, total tax revenues were set at 561.7 million lari (the plan for the tax inspectorate was 216.2 million lari, and for the customs department – 345.5 million lari), capital revenues at 60 million lari, and non-tax revenues at 63.2 million lari.

Grant receipts were projected at 86.4 million lari. Consequently, planned total revenues and grants for 1999 were set at 771.3 million lari.

From preliminary estimates actual revenue collections amounted to 455.2 million lari (66.5 per cent of expected figure), some 229.7 million lari less than projected in the budget. The contribution of the tax inspectorate was 202.9 million lari (93.8 per cent of the budgeted figure), 13.6 million lari less

than projected, and that of customs department 210.4 million lari (60.9 per cent of the budgeted figure), or 135.2 million lari less than projected. Non-tax revenues amounted to 20.9 million lari (33 per cent of the budgeted figure) with a shortfall of 42.3 million lari; and capital revenues totalled 21 million lari (35 per cent of the budgeted figure) with a shortfall of 39 million lari.

Grant receipts equalled 48.3 million lari (55.8 per cent of the budgeted figure), 38.1 million lari less than projected.

Total revenues and grants received during 1999 totalled 503.4 million lari (65.3 per cent of the forecast) falling short of the budgeted figure by 267.9 million lari.

The collection of tax revenues fell below budget due primarily to shortfalls in import revenues. The main causes were a substantially lower than projected volume of imports, and a weak customs administration.

Total revenues and grants of the central budget in 1999 exceeded the level of the previous year. Total taxes increased by 82.3 million lari: excise collections increased by 83.1 million

lari, VAT – by 26.2 million lari, and income taxes – by 5.7 million lari. At the same time profit taxes fell by 0.2 million lari, and customs duties – by 32.4 million lari. Non-tax revenues also decreased by 49.7 million lari.

Of the special funds only the Road Fund failed to meet the revenue projections. Actual collections equalled 33.6 million lari – 95.7 per cent of the projected 35.1 million lari. Revenues of the Social Security and the Employment Funds totalled 112.8 million and 4 million laris. These were 100.4 per cent and 105.3 per cent of the budgeted figures of 112.3 million and 3.8 million lari respectively.

Privatisation of state property is considered one of the most important sources of financing the budget deficit. Revenues were projected at 60 million lari from state property privatisation, and 8 million lari from land privatisation. In fact, the budget received only 20.9 million lari and 0.9 million lari respectively from these sources during 1999. The shortfalls were primarily due to the very troublesome process of privatisation in the energy sector. While working on contracts with investors, a number of problems, including issue of debt, have

emerged. Negotiation of these aspects took considerable time. Nevertheless, an agreement was reached, and an American company AES received rights to manage the power generating plants “Khrami 1” and “Khrami 2” for 25 years.

Repayment of credits is considered another important source of budget revenues. While 15.1 million lari was expected from this source, actual proceeds amounted to only 2.5 million lari. Such a large shortfall resulted primarily from non-repayment of credits by the energy sector. The existence of large outstanding overdue obligations to the government substantially impeded the privatisation process of energy sector enterprises. Under the circumstances, when customers avoid paying their electricity bills, it becomes very difficult to attract investors willing to assume massive debts.

Substantial shortfalls in financing the budget deficit have resulted in accumulation of considerable arrears. The most severe problem of the central budget remained rising arrears in protected items: wage and pension arrears carried forward from 1998 increased further in 1999. Out of 100

million lari envisaged by the budget for wages and salaries, only 72,6 million was actually paid. Benefits and other types of assistance to refugees amounted to 54.4 million lari, compared to the budgeted 57.7 million lari. Instead of the planned 43.2 million, territorial transfers only amounted to 36.2 million lari.

Due to financial difficulties, the share of investment expenditures in the budget for 1999 was insignificant. Actual amounts spent were also very low.

The 1999 fiscal year turned out to be rather difficult and full of controversies. Developments in the economic and financial sectors of the country further intensified the budgetary crisis that had emerged in 1998. Continued fiscal problems have substantially hampered successful implementation of government reforms aimed at social and overall macroeconomic stability.

Chapter 2. Monetary Policy Conducted by the National Bank of Georgia

2.1. Main Trends and Results of Monetary Policy

Throughout 1999, the National Bank of Georgia has been implementing monetary policy in accordance with the decree of the Parliament of Georgia “On Main Directions of Monetary and Exchange Rate Policy”, and the financial program agreed upon by the country’s government and international financial institutions.

The main strategy behind the monetary and exchange rate policy in the reporting year was to ameliorate macroeconomic imbalances, and to achieve economic growth with minimal inflation and an optimal level of the exchange rate. As in previous years the monetary policy stance of the National Bank of Georgia remained very strict.

In accordance with the quantitative targets set by the government and the financial program agreed upon with the international financial institutions, money supply grew with a

simultaneous reduction in net international assets, and growth in net domestic assets and net credits to the government.

To maintain purchasing power of lari, and at the same time to ensure an appropriate amount of money stock in the economy, monthly limits were set on the growth of money supply. The targets were fully met in the first half of the year.

The fiscal crisis, further aggravated by shortfalls in privatisation revenues and proceeds from external sources of budget deficit financing, substantially reduced funding of protected items of the budget. Consequently, payment arrears of wages, pensions, benefits to refugees, and external debt servicing increased tremendously from the second half of 1999. This had negative repercussions domestically as well as from foreign creditor countries. Taking into consideration deflationary processes in May-July and the stability of the lari exchange rate, the National Bank of Georgia (acting in accordance

with the Article 22 of the “Law on State Budget of Georgia for 1999”) decided to issue additional short-term loans to the government. These credits were to be repaid by the end of the year through expected privatisation revenues and expected receipts from external sources of financing the budget deficit.

By the end of 1999, these expectations did not materialise. As a result, since no alternative sources for repayment of short-term credits were available, the Georgian Parliament agreed to revise upward the limit on change in NBG’s net claims on government. The limit was raised by 101.4 million from 15.5 million lari. Over the year the level of net claims on the government increased by 116.8 million lari and amounted to 695 million lari (This includes 70.3 million lari of debt securities issued by the Ministry of Finance to cover the 1998 net losses of the National Bank. Following final determination of IAS net profits of the NBG in late March 2000, this amount was reduced to 28.1 million lari by applying all of the 1999 net profits to the repayment of these securities). The stock of net claims on the government and its growth exceeded corresponding targets defined by the program of the

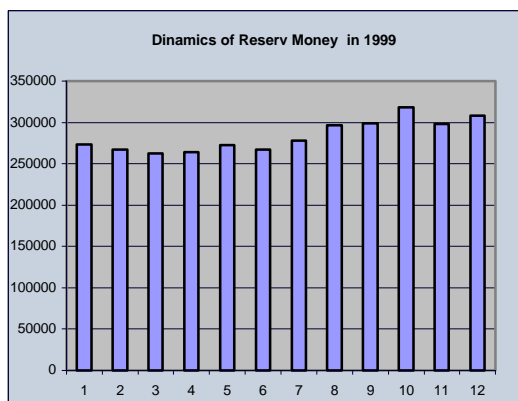
International Monetary Fund by 101.4 million lari and 101.3 million lari respectively. In addition, other assets (net) exceeded the program indicator by 7.5 million lari, while net claims on banks fell short of the program by 8.1 million lari. Consequently, net domestic assets surpassed the program target by 100 million lari and amounted to 677.9 million lari.

By end 1999, net international assets of the National Bank of Georgia were negative due to excess of liabilities over assets of USD 191.4 million (equivalent to 369.4 million lari). They were USD 44.7 million greater than envisaged by the program. This was because foreign liabilities fell short of the program by USD 40.1 million, while international reserves were only USD 16.3 million less than the program target. Gross foreign assets and liabilities equalled USD 128.5 million and USD 319.9 million respectively.

The above USD 16.3 million discrepancy in international reserves resulted from non-disbursement of an Enhanced Structural Adjustment Facility (ESAF) tranche of USD 45 million. This was partially offset by foreign currency purchases by the

NBG from Tbilisi Interbank Currency Exchange (TICEX) amounting to USD 14 million; by foreign currency revaluation gains of USD 6 million; and by USD 8 million less than projected conversions for the government.

The divergence of net foreign and domestic assets from the program was 60.5 million lari and 100.8 million lari respectively. This gave rise to a difference in reserve money as well. The actual stock of reserve money at the end of 1999 amounted to 308.5 million lari, 161.3 million lari higher than set by the program.



The breakdown of reserve money by components indicates that currency in circulation and correspondent accounts of commercial banks exceeded the program by 152.3 million lari and 12.4 million lari respectively. Required reserves, on the other hand, fell short

of the program by 3.4 million lari. Over the reporting, year with a 3 per cent GDP growth and 10.9 per cent consumer price inflation, currency in circulation increased by 17 per cent and amounted to 259.8 million lari. Rapid growth first occurred in January 1999, due to intensive spending of the revenues from privatisation of Telasi (energy distribution company of Tbilisi) in December 1998. The following three months showed a falling trend and by the end of March currency in circulation reached 221.9 million lari - the level as at the beginning of the year. Insignificant growth in the next two months was followed by a decrease of a similar magnitude in June. Another wave of significant expansion occurred in the second half of 1999 due to the rapid increase in short-term credits to the government.

Lending to Government and Commercial Banks

The main policy instrument used by the National Bank of Georgia in 1999 was direct lending to the government. Of 147.2 million lari total credit, 146.7 million lari, or 99.7 per cent was issued to the government, and only 0.5

million lari, i.e. 0.3 per cent of the total, to commercial banks.

Credits to the government were issued to finance the budget deficit within the limits set by the Parliament in accordance with the financial program agreed with the IMF. These limits envisaged additional intra-year (short-term) credits to the government to restructure a debt to Turkmenistan, and in case of non-receipt of external financing within a pre-scheduled time frame.

Over 1999 the Ministry of Finance received 146.7 million lari in loans from the National Bank (1.9 times less than in 1998) at an annual interest rate of 12 per cent. Of these 97.5 million lari were long-term loans to finance the budget deficit, and 49.2 million lari – short-term credits. The issuance of the latter was due to insufficient and irregular tax collections, and the 39 million lari shortfall in privatisation revenues. The latter had been projected at 60 million lari in the law on State Budget for 1999.

As of December 31, 1999 total outstanding loans to the government equalled 638.9 million lari (excluding accrued interest of 7.1 million lari).

This includes credits issued from 1994. Of these, 18.3 million lari (1994 credits) falling due in 1999, were restructured for a 6-year period, at annual interest rates of 1 per cent for the first two years, and inflation rate plus 1 percent for the remaining years.

Due to inadequate fiscal policy, the National Bank of Georgia did not act as a lender of last resort to commercial banks.

Over the year there was only one instance, when 0.5 million lari was allocated to a commercial bank through a Lombard facility at an annual interest rate of 17.5 per cent.

At end 1999 claims of the National Bank on commercial banks totalled 1.8 million lari, 4.7 million lari less than at the beginning of the year. 72 per cent of these claims were overdue loans issued prior to 1998 to four commercial banks; licenses have already been revoked from these banks.

Minimum Reserve Requirements

Required reserves were again used over 1999 for monetary regulation with

the minimum reserve requirement set at 16 per cent.

As of December 31, 1999 required reserves of commercial banks amounted to 29.7 million lari. This constituted 92.8 per cent compliance with the minimum requirement. The deficiency was caused by liquidity problems of several banks. In order to protect commercial banks from losses due to inflation and exchange rate fluctuations, and to stimulate attraction of deposits, interest was paid on required reserves at an annualised 10 per cent rate. Only those banks fully complying with the minimum reserve requirements were eligible for such remuneration.

Interest payments on required reserves totalled 5.1 million lari during 1999.

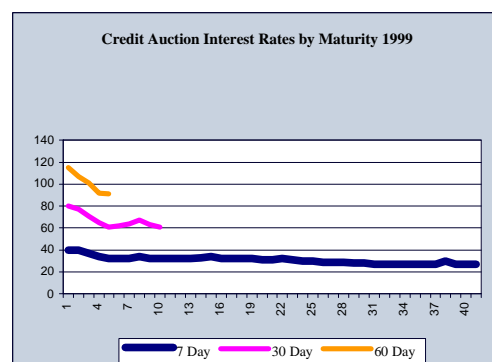
2.2. Local Financial Markets

Money Market

Interbank credit auctions serve as the main facility for liquidity management in the banking system. In addition, the direct interbank credit market also operates parallel to the auctions. As opposed to the latter, where trade takes place only in national currency, the direct credit markets allow foreign

exchange liquidity to be traded as well. Nevertheless, in 1999 the annual turnover at credit auctions was somewhat higher than in the direct interbank market. The main reason for this was that auction rules fully protect the supplier bank from non-repayment risks.

The total volume of transactions at interbank credit auctions in 1999 equalled 31.8 million lari, 17 million lari less than in 1998. The turnover of 7-day credits increased by 15.9 million to 29.4 million lari. The trade volume of credits up to 90 days maturity fell by 32.9 million to 2.4 million lari.



The shift in the term structure of interbank loans was caused mainly by reallocation of assets by banks from national to foreign currency due to the devaluation of lari at the end of 1998.

Of 50 auctions for 7-day credits held in 1999, only 41 were successful. A total

of 29.4 million lari was sold of which 23.8 million, or 81 percent, was purchased by the National Bank of Georgia.

For 7 to 90-day credits, only 15 out of 44 auctions were successful. The volume of transactions totalled 2.4 million lari, and 33.3 percent was purchased by the National Bank of Georgia.

Interest rates observed at the auctions trended downwards throughout the year and for the last three months averaged 27-29 per cent.

Securities Market

The fiscal crisis in Georgia and dramatic downturns in the securities markets of various countries have seriously undermined investors' confidence in Treasury Bills of the Georgian Government. Resumption of T-Bill auctions, which had ceased in October 1998, proved to be very difficult.

Joint efforts of the Ministry of Finance and the National Bank of Georgia attempted to stimulate interest of commercial banks in government

securities. Certain amendments were made to the decree on issuance, placement, circulation, registration and repayment of T-Bills, as well as to some other regulations. T-Bill auctions resumed from August 1999. Treasury bills of 28-day and 91-day maturities with a total value of 4.8 million lari were offered in 7 auctions held throughout the year, and only 3.9 million lari (81.2 per cent of total) were allocated. Of this amount, 2.2 million lari was used to retire maturing treasury bills, and 1.7 million lari to finance the budget deficit.

The weighted average annual interest rate on treasury bills was 14.11 per cent (with minimum and maximum rates of 12.98 per cent and 15.95 per cent respectively). This was somewhat lower than interest rates in other segments of the financial market.

Even though all necessary preconditions (trading floor and system at TICEX, and well-defined securities trading rules) have already been developed, the secondary market for treasury bills does not function yet due to the very thin primary market.

Foreign Exchange Market

The foreign exchange market is the most active and liquid financial market in the country. It consists of Tbilisi Interbank Currency Exchange (TICEX), off-TICEX interbank market, and non-bank exchange bureaus.

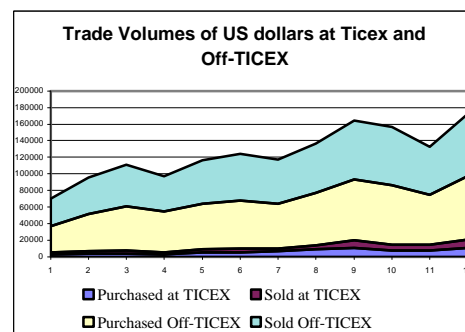
Despite the efforts to legalise operations of non-bank exchange bureaus, full monitoring and accurate accounting of their transactions is still impossible. Therefore statistics on foreign exchange trade in domestic markets do not reflect transactions of these bureaus.

Exchange rate setting in each segment of the market is entirely based on market mechanisms, especially after the National Bank stopped interventions on December 7, 1998.

The role of TICEX in determining the market exchange rates still remains crucial. In 1999 TICEX accounted for 10 per cent of total sales in the official foreign exchange market.

Market participants are using the exchange rate set daily at TICEX as a main reference rate for determining market exchange rates in other

segments. The trade volume at TICEX in 1999 amounted to USD 76.1 million. Throughout the year the National Bank of Georgia intervened only on the buy-side of foreign currency transactions at TICEX, and purchased a total of USD 14.5 million, which contributed to growth of international reserves. In 1999, the foreign exchange market developed a self-regulating mechanism, which ensured exchange rate stability in the absence of direct interventions of the National Bank. In addition, about 10 large commercial banks were identified as market makers; they account for the largest share of transactions at TICEX.



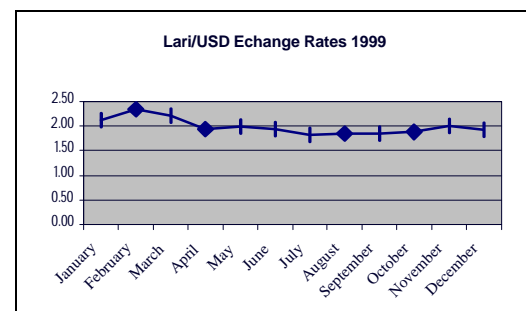
Turnover in the direct interbank market was almost the same as at TICEX with an 8-10 per cent share of total sales in the official foreign exchange market. The rest of the transactions were carried out among banks and their clients.

To facilitate direct interbank foreign exchange trading, the National Bank of Georgia and TICEX jointly designed an electronic trading system in the second half of 1999. The system connects the National Bank and 15 largest commercial banks, the major players in the foreign exchange market, and allows participants to place bids and conduct foreign exchange transactions over-the-counter. At the same time, it enables the National Bank of Georgia to keep track of off-TICEX trading and exchange rate dynamics in real time.

2.3. Exchange Rate Policy of the National Bank of Georgia

The exchange rate policy in 1999 was primarily targeted at maintaining exchange rate stability in the absence of foreign currency interventions by the National Bank of Georgia at TICEX. At times of excess supply of US dollars, to avoid unjustified appreciation of the lari and worsening of the country's current account, the National Bank purchased foreign exchange. The build-up of international reserves, which were depleted during the crisis of 1998, was also of immense importance. Because of shortfalls in receipts from external

sources of financing the budget deficit, accumulation of reserves could have been accomplished by purchases of foreign currency in the market. This was done with caution to avoid excessive growth of currency in circulation, which might have led to an acceleration in inflation.



Under a flexible exchange regime and tight monetary policy, exchange rate fluctuations were minimised by the end of the first quarter of 1999 and stability was maintained throughout the year.

The Dealing Room of the Foreign Exchange Department of the National Bank of Georgia successfully managed international reserves within the limits set by the Monetary Policy Commission of the National Bank. Dealers used bank deposits of up to 3 months' maturity as primary money market instruments to allocate official reserves. The counter parties in these transactions were banking institutions

such as Tokyo Mitsubishi Bank (Japan), Bank for International Settlements (Basel, Switzerland), Deutsche Bank (Germany), Commerzbank (Germany), Creditte Suisse (Switzerland), Banque National de Paris (France), Union Bank of Switzerland (Switzerland), ABN AMRO (Netherlands), and Citibank (USA). The National Bank of Georgia earned an equivalent of USD 3 million in interest revenues.

In accordance with the decree issued on April 16, 1999 by the Council of the National Bank “On Diversification of International Reserves of the National Bank of Georgia” the reserve portfolio was diversified to reflect currencies included in the Special Drawing Rights (SDR) basket; these are the US dollar, euro, Japanese yen and pound sterling. The permissible deviations of actual weights for each currency were set at 5 per cent from the weights defined by the International Monetary Fund.

Diversification of international reserves in SDR currencies is an optimal reserve management strategy, since it safeguards the reserve portfolio from unfavourable fluctuations of exchange rates in the international markets. At the same time it facilitates

better management of SDR denominated foreign liabilities.

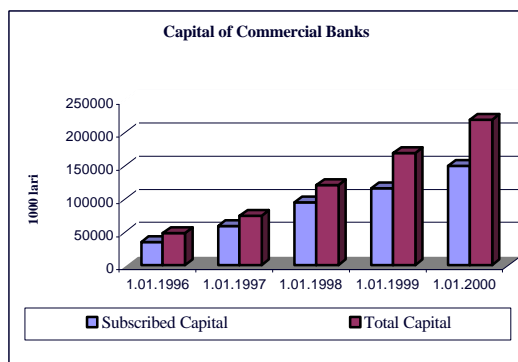
As of December 31, 1999 international reserves of the National Bank of Georgia amounted to USD 128.5 million, and were distributed in the following way: 40.99 per cent – US dollars, 27 per cent – euros, 19.86 per cent - Japanese yen, and 12.60 per cent – pounds sterling.

3. Bank Prudential Supervision and Regulation

3.1. Condition of the Banking System

In 1999 the National Bank of Georgia continued its efforts towards establishment of a stable banking system. This broadly involved management of commercial bank consolidation processes and improved banking supervision via refinements to prudential regulations.

Despite the fiscal and foreign exchange crisis in Georgia at the end of 1998, the banking system managed to regain strength and achieve positive results over the reporting year. Subscribed and total capital increased by 34.4 million and 46.5 million to 150.8 million lari and 179.8 million lari respectively. Importantly, the latter grew faster than the former.

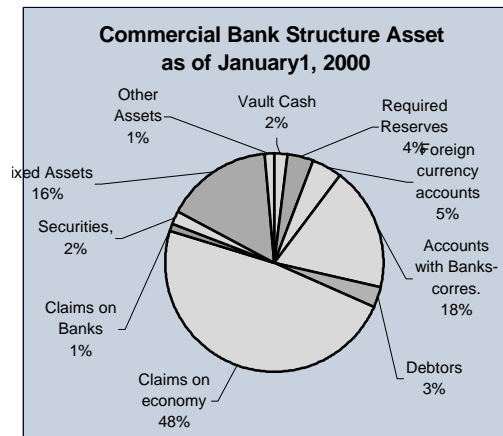


From the beginning of the year the number of banks CAMEL-rated as 1 and 2 increased noticeably. At the same time, by revoking licenses or improving the quality of poorly performing banks, the number of banks CAMEL-rated as 4 and 5 fell considerably.

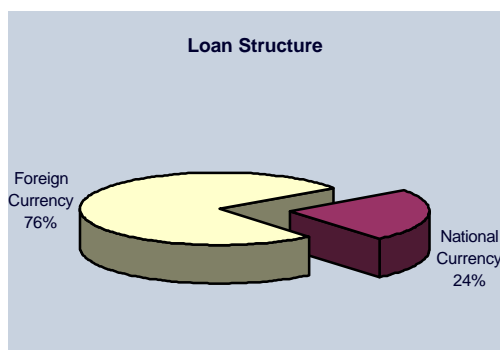
During the course of the year the share of banks CAMEL-rated 1 and 2 in total assets of the whole banking system increased to 67.3 per cent, i.e. by 31.8 percentage points.

Total assets grew by 140 million lari, of which more than half (77 million lari) was due to increase in domestic loans. Portfolio investments and other assets also increased significantly. The majority of commercial bank credit was denominated in foreign currency. As a result, overdue loans were somewhat higher in foreign than in the national currency, and amounted to 12.9 million lari and 4.7 million lari respectively. The term structure of the loan portfolios shows that 74 per cent of total credits were short-term, 18 per

cent – long-term, and the remaining 8 per cent overdue loans.



Interest rates on both domestic and foreign currency loans have been predominantly falling, but rates on the latter were persistently higher than on the former.



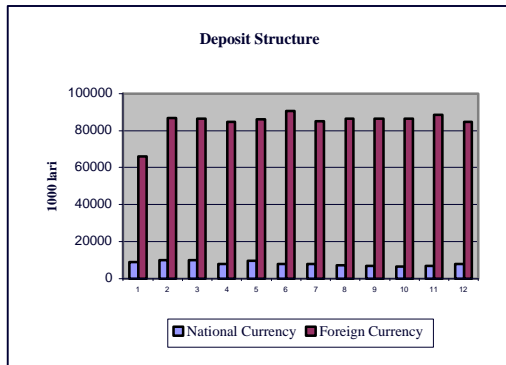
Despite the downtrend, interest rates remained quite high at 26-27 per cent per annum. This reduced demand for credit, slowing down entrepreneurial

activities and hampering development of banks.

Financial intermediation of the banking system remained limited in 1999. The main causes were:

- Existence of alternative opportunities for economic agents to allocate their savings;
- The large share of undercapitalised banks (with capital less than 4 million lari);
- The low level of public confidence in the domestic currency, which is well reflected in the structure of broad money and deposits. Broad money (M2), excluding foreign currency deposits, increased by 25 million lari, while M3 – broad money including foreign currency deposits – rose by 76 million lari.

The growth in M2 was solely due to a 32 million lari increase in currency outside banks, and a simultaneous reduction in domestic currency deposits by 7 million lari.



Domestic currency deposits decreased from January to May 1999, and increased thereafter until November. In the last two months of the year deposits fell by 2 million lari and 3 million lari respectively. This was due to increased exchange rate risk associated with depreciation and frequent fluctuations of the lari. Foreign currency deposits exhibited the opposite tendency. From the beginning of the year until October they grew by USD 3.5 million per month on average.

Even though the lari depreciated notably in October-November relative to July-September, foreign exchange deposits decreased from the end of September, and then started to grow again in the last month of the year. By end-December 1999 they reached the level of August – USD 82.4 million.

As a consequence of the high dollarisation ratio, which increased by 10.3 percentage points from the beginning of the year, the money multiplier fell by 0.1 points for M2, and increased by 0.02 points for M3.

Development of the existing deposit structure was assisted by the interest rate policies of commercial banks.

By the end of the year, interest rates on short-term deposits (of upto-3-month of maturity) were somewhat lower for national than for foreign currency deposits. For longer-term (3-12 months) deposits the situation was the opposite.

Even though interest rates on loans were falling persistently, the spread between lending and deposit rates remained quite high at about 20 percent.

3.2. Registration and Licensing of Banking Activities

As a result of the structural reorganisation at the National Bank of Georgia in 1999, the Banking Supervision Department and the Licensing Department were merged to form the Banking Supervision and

Regulation Department. The aim of the merger was to improve licensing and supervision efficiency through closer relations between the two.

Following the reorganisation, compliance with licensing requirements by commercial banks and exchange bureaus was examined. This was preceded by enactment of the rules on “Licensing and Regulation of Exchange Bureaus Owned by Physical and Non-Bank Juridical Entities” approved by the order no. 4 of the National Bank of Georgia issued on January 29, 1999, and slightly amended by the order no. 171 of July 15, 1999.

In line with these regulations, 134 exchange bureaus were licensed in 1999. Of these, 93 licenses were issued to physical and 41 to non-banking juridical entities. Applications were refused in 10 cases on the grounds of non-compliance with the regulations.

In accordance with the order no. 262 of the National Bank of Georgia issued on October 26, 1999, to ensure consistency with the law on licensing entrepreneurial activities, changes were made to the licensing forms of banks and exchange bureaus.

In 1999 banking licenses were issued to the following banks with a foreign equity share: Microfinance Bank of Georgia; Agrobusiness Bank of Georgia; and Tbilisi branch of the Azeri Bank for Caucasian Development.

Approvals to open 16 new branches of commercial banks were also granted in 1999.

Throughout 1999 the National Bank of Georgia was closely monitoring compliance of legal documentation, as well as the timely submission of changes to them with the Regulations on Banking Licensing approved by the order no. 84 of the National bank issued on September 10, 1998.

Special reporting forms were designed for commercial banks from which licenses have been revoked in order to better analyse and control their liquidation processes.

At the end of the reporting year, there were 23 license-withdrawn banks in the process of liquidation.

Licenses were withdrawn from 9 commercial banks and 1 branch of a foreign bank in 1999:

1. Investment Trade Bank Ltd.
2. Eldorado Ltd.
3. Georgian-Italian “Industry Bank” Ltd.
4. Monolith Ltd.
5. Tbilinvestbank Ltd.
6. Olymp JSC
7. Magistral Bank JSC
8. Georgian Invest Bank Ltd.
9. Transcaucassus JSC
10. Tbilisi branch of Azeri joint commercial “Caucassus Development Bank”

Of these banks, Magistral Bank JSC and Georgian Invest Bank Ltd were self-liquidated.

In 1999 three banks were liquidated and removed from the banking registry.

By orders of the Courts, liquidators were appointed in: Investment Trade Bank Ltd, Georgian-Italian Industrial Bank Ltd, Monolith Ltd, Tbilinvestbank Ltd, Olymp JSC, and Magistralbank. As for Eldorado Ltd, appointment of a liquidator was delayed as the bank filed a court

petition questioning the legality of the license withdrawal.

Under decrees no. 64 and 63 issued by the National Bank of Georgia on October 25, the commercial banks Kolkhida and Pyramid were declared insolvent. Their licenses were revoked by a decision of the Krtsanisi-Mtatsminda District Court, issued on November 5.

3.3. Banking Supervision

Efforts to improve banking supervision have continued in 1999. In order to align banking regulation with international standards of supervision, conditions limiting banking risks were introduced in the reporting year.

Due attention was paid to on-site inspection of banks as well as to the CAMEL analysis of financial statements presented by commercial banks to the National Bank of Georgia.

Inspections were conducted in accordance with the schedule approved by the order no. 110 of the National Bank of Georgia issued on May 14, 1999. Overall, 32 banks were examined throughout the year. In total 46 inspections were completed, of

which one was specified, and in one case no composite rating was determined.

To refine and improve banking supervision, CAMEL based quarterly analysis of bank performances (based on financial reportings of banks) were carried out throughout 1999. Refinements to the forms used for CAMEL rating resulted in a deeper and more comprehensive analysis of the financial position of banks.

Examinations of off-balance sheet activities have been performed four times during the year for each commercial bank operating in Georgia. Based on outcomes, appropriate measures have been applied.

Depending on violations identified in the banking system, relevant course of actions were taken against banks, such as written warnings and instructions requiring compliance with the regulations. In certain cases banks were penalised.

Banks were fined a total amount of 364,603 lari for non-compliance with minimum reserve requirements, and 179,347 lari for violating the limit for open foreign exchange positions.

To strengthen the banking system and deepen related reforms, the National Bank of Georgia continued to further improve the regulatory base. In particular, regulations governing bank mergers were developed. Legal problems concerning minimum capital requirements were resolved.

By the order no. 189 issued on July 30, 1999, the National Bank of Georgia approved a new manual for off-site examination of banks and CAMEL-rating tables. This played a crucial role in considerably improving the quality of off-site inspections, and of the whole supervision process.

Rules on “Supervision and Regulation of Commercial Banking Activities” were enacted from January 1, 1999, and serious efforts were made to introduce these rules at the Supervision Department of the National Bank of Georgia and at commercial banks. These regulations refined the definition of “capital” for supervision purposes in line with international standards.

To assess credit risk sensitivity of commercial bank assets, these rules also introduced a new concept of “risk weighted assets”. In combination,

these two economic parameters fully characterise one of the most important indicators – capital adequacy. Supervision requirements became stricter with this document, in order to ensure soundness and stability of the whole banking system as well as of particular commercial banks.

New reporting forms consistent with International Accounting Standards were designed and introduced from January 1, 1999. These forms more accurately reflect performance and financial results of banking activities, and allow for deeper and more thorough analysis of the current financial position of banks.

In order to strengthen and refine banking supervision, a “System of Measures for Banking Supervision” was enacted from January 1, 1999; and intensive work was carried out during the year to make it functional. The System defines a set of measures to be taken by the National Bank of Georgia against commercial banks with deficiencies and problems in their financial positions.

At present, certain amendments are being made to the loan loss provisioning rules. Liquidation rules

for license-withdrawn banks will also change markedly from the earlier version. These amendments will allow the National Bank of Georgia to better assess quality of bank assets and to control liquidation processes in a more comprehensive manner.

Chapter 4. Organisational Structure and Personnel of the National Bank of Georgia

Developments in human resources management at the National Bank of Georgia in 1999 were in line with ongoing reforms of the governance structure. Personnel practices and methods for resolving current problems were based on the “Program for Selecting Government Employees and Improving the State System of Working with Personnel”, approved by the order no. 101 of the President of Georgia issued on March 13, 1998.

In accordance with the requirements of the Law of Georgia “On Public service”, and taking into account recommendations of the Civil Service Bureau of the State Chancellery, considerable work was done to refine mechanisms for selecting personnel and evaluating performance. By the order of the President of the National Bank of Georgia, a special workgroup of senior specialists of main areas was formed to work with the specialists of the Tbilisi Banking Training and Consulting Centre. The project is expected to end in the first half of 2000.

Over the year 121 employees of the National Bank of Georgia took part in various forms of professional training. Of these, 73 employees were trained abroad. The most important partners of the National Bank of Georgia in the training field were: Joint Vienna Institute (JVI), Bank of England, Bank of France, Central Bank of Netherlands, Deutsche Bank and Russian Central Bank.

In contrast with the previous year, local training of employees improved and expanded substantially. A practice of presenting seminars was introduced at the head office of the National Bank of Georgia.

Specialists invited from foreign banks conducted a series of seminars, attended by more than 50 employees of the National Bank of Georgia. Computer training and English language courses were also organised for employees.

Full computerisation of the Personnel Department was completed during 1999.

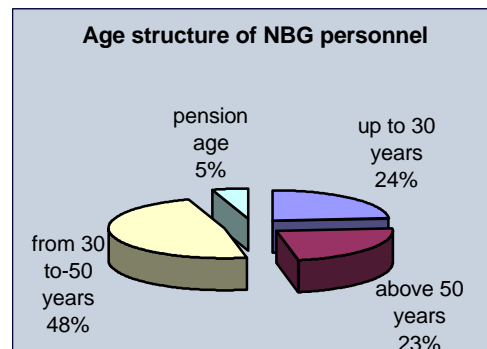
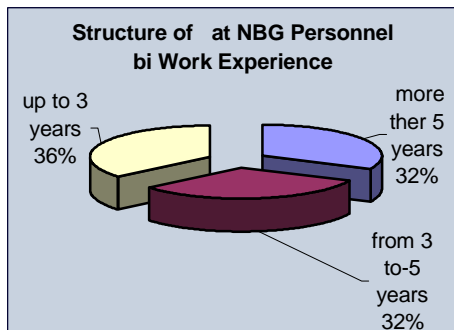
Following World Bank recommendations, close cooperation was established between the Personnel Departments of the National Bank of Georgia and the Central Bank of Latvia.

Reorganisation of the National Bank of Georgia was largely completed in 1999, and branch structural reforms were also initiated. The Council of the National Bank approved charters for the new structure.

Job descriptions with responsibilities for each employee played a positive role in refining recruitment mechanisms and defining job requirements for the various areas of the bank. The descriptions were prepared in accordance with recommendations of the Civil Service Bureau of the State Chancellery.

Georgia and its branches, some 24 less than last year. Of these, 363 people i.e. 64.8 per cent are civil servants. Some 77 per cent of employees are specialists with university education, 8 per cent more than in 1998. Of the civil servants employed at the Bank, 95 per cent have a university education. Over the year 74 employees left the Bank, of which 68 were discharged following reorganisation.

Over the year the National Bank recruited 59 new employees, of which 42 were civil servants. Of newly recruited personnel, 48 per cent were below the age of 30. By the end of the reporting year 24 per cent of total employees were under the age of 30, and 28 people, or 5 per cent of total, above the age of 60. The average age of employees was 39 years. There were 40 employees promoted in 1999 with an average age of 33 years.



As of December 31, 1999 there were 560 positions at the National Bank of

Chapter 5. Development of Regulatory and Legal Base for the Banking System

The National Bank of Georgia continued to issue and revise regulations and normative acts in the areas of monetary and foreign exchange regulations, accounting and bank supervision.

Over the reporting year, 77 legal acts were prepared, 15 of which were registered at the Ministry of Justice. These were:

1. Order no. 3 of the National Bank of Georgia issued on January 15, 1999 “On Cash Operations at Credit Institutions”, amending Order no. 66a issued by the President of the National Bank on July 24, 1998;
2. Order no. 1 of the President of the National Bank of Georgia issued on January 15, 1999 “On Rules for Determining Exchange Rate of Lari Against Foreign Currencies”;
3. Order no. 4 of the President of the NBG issued on January 29, 1999 “On Adoption of Rules on Licensing and Regulation of Exchange Bureaus Owned by Physical and Non-Bank Juridical Entities”;
4. Joint Order no. 55/28 of the National Bank of Georgia and the Ministry of Finance issued on February 26, 1999 “On Amendments to the Rules of Issuance, Placement, Circulation, Accounting and Repayment of Treasury Bills of the Ministry of Finance”;
5. Order no. 115 of the National Bank of Georgia issued on May 18, 1999 “On Opening Accounts Without a Seal by Entrepreneurs at Banking Institutions”;
6. Order no. 124 of the National Bank of Georgia issued on May 25, 1999 “On Definition of Minimum Paid-in Capital for Commercial Banks Operating in Georgia”;
7. Order no. 71 of the National Bank of Georgia issued on July 15, 1999 “On Amendments to the Rules of Licensing and Regulation of Exchange Bureaus Owned by Physical

- and Non-Bank Juridical Entities”;
8. Order no. 220 of the National Bank of Georgia issued on September 2, 1999 “On Adoption of Non-Cash Settlement Rules in Georgia”;
 9. “On Adoption of Temporary Instructions on Opening Settlement, Correspondent, Foreign Exchange, Budget, Current and Other (Temporary, Cash Service) Accounts at Banking Institutions of Georgia”;
 10. Order no. 242 of the NBG issued on September 27, 1999 “On Amendments to Rules for Regulations and Supervision of Commercial Banks” adopted by the Order no. 118 of the National Bank of Georgia issued on December 3, 1999;
 11. Order no. 262 of the National Bank for Georgia issued on October 26, 1999 “On Adoption of Licensing Forms of Banks and Exchange Bureaus”;
 12. Decree no. 27 of the Council of the National Bank of Georgia issued on October 22, 1999 “On Amendments to Ten-day Rules of Calculation and Compliance with Minimum Reserve Requirements” adopted by the Decree no. 15 of the Council of the National Bank issued on November 27, 1998;
 13. Decree no. 28 of the Council of the National Bank of Georgia issued on December 10, 1999 “On Issuing Modified National Currency Bills of 1, 2, 5, 10, 20, 50 and 100 Lari Denomination”;
 14. Order no. 314 of the National Bank of Georgia issued on December 17, 1999 “On Adoption of Rules on Allocation and Repayment of Lombard Credits to Commercial Banks as by the National Bank of Georgia”;
 15. Order no. 328 of the National Bank of Georgia issued on December 31, 1999 “On Adoption of Cash Desk Operation Rules”.

In 1999 there were further improvements and refinements to the banking legislation. Draft laws were prepared “About Amendments and Additions to the Law of the National Bank of Georgia and to the Law on Commercial Banking Activities”. The

drafts will be submitted to the Parliament of Georgia in the nearest future.

A draft law “About Amendments to the Law of State Control, Analysis and Stamping Precious Metals and Stones” was also prepared and submitted to the Parliament on May 13, 1999.

A draft law “On Factoring and Leasing Operations” was prepared and submitted to the State Chancellery. After receiving comments from the Chancellery, the draft will be presented to the Parliament.

Several versions of the draft law on Deposit Insurance were also prepared. They will be discussed with experts of international organisations and specialists of the Banking Association to consider the most suitable variant.

Chapter 6. Internal Audit of the National Bank of Georgia

In 1999 the internal audit developments of the National Bank of Georgia followed a pre-approved plan of activities, which mainly focused on inspection of financial activities of the National Bank and its branches. Special attention was paid to compliance with laws and various regulations of the National Bank.

14 audits were carried out over the year at departments and branches of the National Bank of Georgia. The audits revealed full compliance with responsibilities and regulations.

The audits identified certain problems as well. A number of orders on relevant organisational and technical refinements were issued to deal with these problems.

Throughout the reporting year attention was paid to improving the professionalism of the Internal Audit staff. Various forms of training were utilised. Participation of Internal Audit staff in meetings related to any activities of the National Bank of

Georgia was introduced into general practice. Special technical training was organised to familiarise auditors with National Bank regulations. For cross-country experience sharing, contacts were established with a number of central banks. Information received from them was used to develop various procedural documents.

Staff of the Internal Audit took part in various seminars organised in Georgia and abroad. Five employees participated in training courses at the Joint Vienna Institute (International Monetary Fund), the Bank of England, and the Deutsche Bank. In addition, after taking into account recommendations of external auditors, the quality of internal audit improved markedly.

Chapter 7. Payment System of Georgia

7.1. Development and Refinement of Payment System

Certain refinements were made in 1999 to improve efficiency and reliability of the transactions settlement system. The system comprises the National Bank of Georgia and commercial banks.

The policy of the National Bank of Georgia in this area envisaged further modernisation of the settlement system, chart of accounts, and banking technologies. It aimed to create necessary conditions for better liquidity management and for improved quality of bank services.

In preparation for introduction of the Montran settlements system in 2000, certain methodological and organisational changes have been implemented. A modern automated system for real time transactions was also installed during the year.

Due to development problems at Montran Corporation, implementation of the system was deferred from 1999 to 2000. At the same time fundamental changes occurred in the current

systems of settlement and operational day processing. Some new functional modules were also added to meet current requirements.

These new functions include the ability to return extra payments to payers, to make transfers from one account to another, and to transfer bonuses from inspections to special accounts. The new technology allows the processing of virtually unlimited information within a day.

On the one hand, these methodologies facilitated acceleration of payments to the budget, and on the other hand they brought information processing closer to a real time regime.

To avoid the Y2K computer problems, assessment and testing of major operation systems of the National Bank of Georgia were conducted with the assistance of foreign experts. Deficiencies identified during the testing were corrected.

From February 1999 a project commenced to introduce International Accounting Standards in the Georgian

banking sector. This project was funded by the European Union, and implemented by the British company Development Partnerships - the winner of the tender. A Project Council and six-member implementation workgroup was created. This workgroup includes three employees of the National Bank.

Complementing the IAS project implementation, the National Bank of Georgia continued to refine the new IAS compatible draft chart of accounts originally developed by Dutch company Deloitte & Touche, Amsterdam. A revised draft chart of accounts was sent to commercial banks in June 1999 together with the relevant matrix of old and new accounts. In November the banks were sent the necessary procedures for the new chart of accounts.

A pilot group of ten participating commercial banks was selected at the beginning of 1999. In October, seminars were held for the remaining banks where the IAS project was explained and relevant IAS materials were distributed.

During the implementation period, four seminars have been presented to

commercial banks. Thirteen meetings were held by the Project Council, which coordinates and supervises the IAS project implementation.

In order to improve accounting, analysis and projections of revenues of the state and territorial budgets, accounting by types of economic activities was developed and introduced in 1999. These refinements were jointly developed with the Ministry of Finance.

7.2 Organisation of Note Issue and Cash-Desk Operations

Organisation of note issue and cash desk activities in 1999 was aimed at problem free circulation and regulation of cash, consistent with the Main Directions of Monetary and Foreign Exchange Policies.

Throughout the year special attention was paid to the following:

- Development and refinement of the regulatory base of the cash desk activities;
- Control of compliance with the rules on cash desk operations;
- Improvement of currency exchange operations;

- Refinement of note issue activities.

A number of regulations on cash-related activities were adopted in 1999.

These were:

1. Statutes "On Interim Special Commission of Control Recounting and Destruction of Banknotes Unfit for Circulation" approved by order no. 16 of the President of Georgia issued on January 17, 1999;
2. Circular "On Licensing and Regulation of Exchange Bureaus Owned by Physical and Non-Bank Juridical Entities" approved by order no. 4 of the National Bank of Georgia issued on January 29, 1999;
3. Statutes "On Cash Desk Operation at the National Bank of Georgia" approved by order no. 37 of the National Bank of Georgia issued on March 10, 1999;
4. Statutes "On Special Commission Established for Organised Conduct of Review, Selection and Related Activities on Sketches of Jubilee Coins" approved with

order no. 59 issued by the National Bank of Georgia on March 31, 1999.

5. Statutes "On Cash Desk Operation" approved by order no. 328 of the National Bank of Georgia issued on December 31, 1999;

To control compliance with the rules of cash desk operations, inspections were conducted in 32 commercial banks, 81 branches and 39 cash desks of commercial banks. The branches of the National Bank of Georgia were inspected two to three times during the year. Relevant measures were taken in response to the violations identified during these inspections.

There was a large fraud case identified at Zugdidi branch of the National Bank of Georgia. After investigation of the causes of the fraud, Zugdidi branch was suspended from cash operations. The branch manager, chief accountant and cashier were dismissed and have been charged with criminal offences.

Throughout the year the National Bank of Georgia has exerted efforts to legalise activities of non-bank exchange bureaus and to establish public order in this area.

Licensing and registration of exchange bureaus was carried out, and regular reporting of their exchange operations was introduced. The existence of some 800 unlicensed bureaus inhibits establishment of order. Elimination of these bureaus is the responsibility of law enforcement bodies.

A number of measures were implemented during the reporting year against money counterfeiting. Namely:

- draft amendments to the Civil Code prepared at the National Bank of Georgia were adopted by the Parliament;
- to improve qualifications of cashiers at exchange bureaus and banking institutions, 458 cashiers were trained and were issued relevant certificates.

There were 2,238 counterfeit 50-tetri coins with a value of 1,119 lari detected in 1999. Also detected were 2 forged 20 tetri coins; 258 forged lari banknotes with a total value of 2,208 lari; 21 forged USD banknotes with a total value of USD 2,000, and 2 forged pound sterling notes with a face value of 100 pounds.

A substantial amount of work was also carried out for issuance, handling and storage of modified lari banknotes.

The National Bank of Georgia continued to work towards introduction of new technologies for cash processing, and for identification and elimination of worn-out notes.

Rules and procedures were developed for destruction of “soiled” banknotes and securities. Lari bills unfit for circulation with the face value of 254,773,000 lari (80 per cent of the total amount of worn-out cash) were counted.

Special attention was paid to security for transporting valuables between the NBG and its branches.

Various cash processing machinery was upgraded during the reporting year. In particular, new equipment was purchased and installed for counting and sorting cash, identifying banknote authenticity, and storing and transporting valuables.

Substantial work was done at the National Bank of Georgia in preparation for the anniversaries of

2000 years from the Birth of Christ and
3000 years of Georgian State. Namely:

- To establish a numismatic museum, copies of nearly 300 historic coins were recreated, and specimens of almost all banknotes and coins that have ever circulated in Georgia were collected. In addition, samples of currencies have been received from 66 countries, and efforts to receive samples from about 50 other countries are still continuing;
- A catalogue “Money in Georgia” was prepared for publishing;
- Preparatory work was done to produce 3 jubilee coins – Kolkha Tetri, King David “Aghmashenebeli” and Tbilisian Orabaziani (Georgian Tetri) coins, and associated gift boxes;
- Publication of a numismatic calendar for the year 2000 is also being considered.

9. Statistical Data

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