Annual Report

2008

National Bank of Georgia

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INTRODUCTION

The present Annual Report has been prepared in accordance with Articles 62 and 621 of the Organic Law of Georgia "On the National Bank of Georgia", and incorporates the Report on Implementation of Monetary and Foreign Exchange Policies, and the Financial Statement Certified by Auditors. This paper provides a detailed review of priority directions the National Bank of Georgia (NBG) followed in the accounting period. The report also includes the NBG's assessment of domestic and external processes, determinative of the Georgian economic situation, as well as of the accomplishment of the goals set by the NBG in the accounting period. In formulating the 2008 monetary policy the NBG was governed by the main objectives and functions as laid down by Article 2e of the Organic Law of Georgia "On the National Bank of Georgia", according to which the main goal of the NBG is to maintain price stability. The NBG is also committed to ensure the stability and transparency of the financial system, as well as to promote sustainable economic growth, if possible, in such a manner as not to put the main goal in jeopardy.

The NBG conducted its activities in accordance with the Resolution #5634 of the Parliament of Georgia "On Main Directions of the 2008 Monetary and Foreign Currency Policies in Georgia" dated December 18, 2007. According to this Resolution, the 2008 monetary and exchange rate policies of the NBG were set to meet the annual inflation target near 8% level, with an allowance for a deviation in the event of exogenous shocks. At the same time, the NBG would have responded with either tightening or loosening of monetary policy as applicable, if such a deviation had a degree significant enough to have a potential impact on such a fundamental inflation factor as the inflation expectations. The year of 2008 turned out to be particularly crucial for the Georgian economy due to its large-scale negative exogenous shocks. The Russian aggression in August and the exacerbation of the global financial crisis in September essentially impacted the economy, and hence, posed a significant challenge to the NBG. The 2008 inflation was characterized by rather acute fluctuations driven mostly by exogenous factors and to a certain extent by monetary factors. As the inflation accelerated at an increasing pace in H1 2008, the NBG responded by monetary policy tightening. Starting from H2 2008 tightened monetary policy of the NBG was expected to provide a disinflation effect. However, the developments that took place in early H2 amplified disinflation pressures. The inflation slow-down was particularly favored by price decreases in world commodity markets. As a result, inflation sharply decelerated by end-2008 standing at 5.5%, while the annual inflation rate equaled 10%.

In H1 2008 the NBG conducted its exchange rate policy under the floating exchange rate regime, in any effort to increase the exchange rate flexibility. At the same time, the NBG intervened on both sides of the foreign currency market in order to avoid sharp market volatility of the lari and to maintain foreign exchange market stability.

In H1 2008 the NBG gradually reduced its market interference allowing short-term exchange rate fluctuations, which promotes exchange rate stability in the medium- and long-term perspectives. However, in order to reduce the negative impact of the Russian aggression on financial stability the NBG had to temporarily fix the lari exchange rate relative to the US dollar. As the global financial crisis escalated in the second half of October, international foreign exchange markets observed a sharp appreciation of the US dollar relative to almost all major currencies, which automatically led to the lari appreciation relative to these currencies as well. In these circumstances the most economically sound solution was to carry out a one time devaluation of the lari, which was effected in early November. As a result of such an adjustment, the lari exchange rate depreciated by 16% relative to the US dollar and the demand-supply equilibrium in the foreign exchange market was restored. Nominal effective exchange rate returned to the early August level. Apart from the fact that the adjustment facilitated restoration of stability in the foreign currency market and alleviation of current pressure on foreign exchange reserves, it was also a preventive measure aimed at avoiding sharp widening of trade deficit in the future. Georgia was brought to the necessity of such an adjustment by the Russian aggression the consequences of which were aggravated by the global financial crisis. It should be pointed out, however, that the impact of the financial crisis was so significant that some economies in the region, with the managed exchange rate regime in operation, were forced to resort to a similar measure, even without facing military intervention.

Average annual exchange rate of the lari against the US dollar appreciated in the accounting period by 11%, from 1.6703 GEL/USD to 1.4902 GEL/USD, while according to the end-year data the exchange rate depreciated by 4.7% from 1.5916 GEL/USD to 1.6670 GEL/USD.

Nominal and real effective exchange rates also manifested sharp movements throughout the accounting period. Namely, the nominal effective exchange rate appreciated by 14.4%, and the real effective exchange rate appreciated by 9.6%. Global financial and economic crisis hit virtually all world economies, the majority of which saw recessionary processes started. This represents the deepest recession by far after World War II. Having its primary roots in the financial crisis, it developed into a global recession capturing the majority of world economies. The historical experience evidences that an economic crisis originated from the financial sector is the most difficult and it takes the longest time to recover from. Some experts draw a parallel between the ongoing crisis and the Great Depression of the 1930's, the longest recession in the world history.

With due consideration of its scale, the world economic crisis did not bypass Georgia, hitting the economy via three main channels. First and foremost, the crisis undermined investors' confidence prompting them to shift their funds into safer assets. This led to the contraction of foreign capital flows in both emerging economies and corporate sectors of the advanced economies. Over the last months of 2008 the FDIs and other foreign private investment flows, such as debt capital, significantly slowed down in pace in Georgia.

In H1 2008 the FDI inflows and financial activities in Georgia preserved high growth rates. This resulted in the real GDP growth of 9.1% and 8.3% in QI and QII, respectively.

In QIII and QIV 2008 the GDP in real terms contracted by 3.9% and 2.5%, respectively, which represents an immediate consequence of the August war and the global financial crisis. Having reached the 8.7% growth rate in H1 of 2008, the GDP growth plummeted to 2.1% by end-year.

The contraction of world production and trade volumes, caused by the crisis, had a negative effect on demand for Georgian exports. Moreover, the exports also suffered from the sharp decrease in prices on ferrous metals. All this conduced to the significant decrease in the country's export revenues. It must be noted, however, that price decreases on oil and food products alleviated the pressure on the country's current account and on prices on domestically produced goods.

World economic crisis essentially impaired the Russian economy, leading to the contraction of production volumes and unemployment growth. Fortunately, the Georgian economy does not rely that much on the Russian economy as it was the case a few years ago, and hence, the economic recession in this country had a limited influence on the economic situation in Georgia. However, Russia still holds a significant share in Georgia's money remittances and, from this perspective, the weakening of the Russian economy exerts a downward pressure on money transfers to Georgia.

The 2008 fiscal policy as well as the improvements carried out in the tax and customs administration brought fruitful results in the accounting period. Actual budget revenues exceeded the official target. The tax-to-GDP ratio increased from 21.6% to 24.9%.

The growth in revenues was accompanied by a significant growth in expenditures. Government-expenditures-to-GDP ratio equaled 35% in the accounting period. Budget revenues and expenditures were moderately balanced and did not interfere with the implementation of monetary policy.

The total volume of state external and sovereign debt grew by GEL 1.265 billion amounting to GEL 3.695 billion as of December 31 2008. Despite the increase shown in absolute terms, external-debt-to-GDP ratio was rather low equaling 19%.

Current account deficit of the balance of payments totaled USD 2,850.5 million, or 22% of the GDP. Current account deficit tended to contract in H2 2009, and the tendency is expected to continue in 2009. It should be noted that that in 2008 the current account deficit was not only fully financed with foreign currency, but an accumulation of the foreign reserve assets took place as well.

Total international reserves of the NBG amounted to USD 1,480.2 million as of December 31, 2008, up 8.74% year-on-year. Sources to the international reserves growth were as follows: proceeds from privatization (USD 121 million), the IMF tranche (USD 240 million), the US budget support grant (USD 250 million), and other loans and grants received by the Ministry of Finance from donor countries. In addition to that, the reserves growth was also promoted by means of money repatriation from the sovereign funds.

A deposit leakage from commercial banks was observed against the backdrop of the war with Russia. A part of these funds flowed into to the banking system soon afterwards, but prompt and massive deposit withdrawals by physical persons created an excessive demand for foreign currency. Although it is not the NBG's main function to provide the economy with foreign currency cash banknotes, it became vital for the financial stability reasons to maintain confidence in the banking system. Therefore, within the shortest possible time the NBG managed to provide the banking system with foreign exchange cash banknotes (the US dollar and the euro), and to render unimpeded services to commercial banks and the government, thus, succeeding to avoid negative implications in that critical situation.

In the accounting period demand for money was determined by the traditional factors of the economic growth and seasonality. Based on these factors, according to the end-year data, the M3 aggregate grew by 7%, while the M2 excluding foreign currency denominated deposits contracted by 13%.

The non-bank deposit liabilities of the banking system grew by 12.1% totaling GEL 3222.6 million in 2008, which was solely due to foreign currency denominated deposits.

In the period from January through July 2008 the banking system operated in conditions of excessive liquidity with high lending growth rates. This increased the risks related to the financial system stability and inflation. Accordingly, the NBG focused on monetary policy tightening by means of open market operations, mostly using the Certificates of Deposits (CDs). However, in H2 2008 the economy faced the liquidity deficit situation as an immediate consequence of the Russian aggression in August and the global financial crisis soon afterwards. In these circumstances the NBG reversed the monetary policy towards essential loosening. In August the one-week CDs were abolished and replaced with the refinancing loans representing a newly introduced monetary policy instrument.

In order to provide commercial banks with sufficient liquidity the NBG suspended the reserve requirements of commercial banks in August, thereafter allowing them to maintain only 25% of the required reserves during the observance period. Further to these concession measures, the NBG reduced the required reserve ratio from 13% to 5% commencing October 2.

As the pressure on the financial sector increased against the backdrop of the massive exogenous shocks occurred in August-September it became particularly important to ensure smooth operation of the payment systems. The NBG maintained sufficient supply of cash banknotes in both domestic and foreign currencies.

The Georgian financial system faced a serious challenge in August 2008. In close cooperation with the Financial Supervision Agency, the NBG managed to prevent the financial system from facing serious problems. To this end, it is of a primary note that strict and conservative monetary and supervisory policies pursued prior to August had proven to help the banking system to be adequately prepared for possible shocks.

In order to maintain financial stability and to provide the banking system with short-term liquidity funds in August, the NBG used the lending of last resort facility. This facility was extended without collateral, with one-month maturity. Only three commercial banks made use of this instrument for a total amount of GEL 38.1 million. These loans were repaid before the maturity date.

As already mentioned elsewhere above, the NBG essentially loosened its monetary policy, cut interest rates, suspended reserve requirements with a subsequent reduction of the required reserve ratio from 13% to 5%, introduced the refinancing loans instrument, allowed commercial banks to repurchase securities before maturity date, and expanded the list of assets to be used as collateral. In addition, by end-September the NBG launched a special loan facility, which was extended in September in the total amount of GEL 135.9 million with six-month maturity period.

The NBG decisions, in conjunction with the similar actions of the Financial Supervision Agency, made it possible to avoid aggravation of the situation in the financial sector. During the August war commercial banks maintained smooth operation of client services, save for short-term limitations on lending and on the use of internet banking. In September, the banking sector was more or less stabilized.

In order to ensure maximum transparency of the NBG's activities and timely dissemination of information on current processes in the banking system, the NBG promptly produced press releases and regularly held press conferences, conferences, briefings, seminars, presentations, and other meetings on the relevant topics. The electronic versions of these materials are available on the official web-site of the NBG.

In 2008 the price-stability-oriented monetary policy of the NBG served to improve the investment environment, to protect households' income from devaluation, and to increase the potential long-term GDP growth.

1. MACROECONOMIC ENVIRONMENT

1.1 WORLD ECONOMY

The year of 2008 turned out to be particularly difficult for the world economy. It was the year that evidenced the unfolding of the global financial crisis and deep economic recession being more and more likened to the Great Depression of the 1930's.

The economic crisis showed its strength in H2 2008 when the economic growth rates in the majority of world economies sharply fell in the third and fourth quarters.

The implications of the global financial crisis were significant for the Georgian economy as well. This is primarily related to the country's capital inflows from the international financial markets, as the financial crisis led to liquidity famine. Another significant impact of the crisis consisted in the contraction of demand and price decreases in the world commodity markets, resulting in sharp reduction of Georgian export revenues. On the upside, the decrease of world prices on oil and food products alleviated pressure on the current account.

In the US, the world's leading economy, the annual growth rate of real GDP was at 1.1%. Meanwhile, the economic growth rates essentially differed over the year - the GDP growth rates in the first and second quarters of 2008 were at 0.9% and 2.8% (q-o-q), respectively, whereas in the next two quarters the rates plummeted to -0.5% and -6.2%, respectively. The downturn of the US economy had an adverse effect on other world economies. Economic growth of the Euro area countries in 2008 fell to an annual 1.0%, down from 2.6% in 2007. In Japan, the world's second largest economy, economic growth rate was at -0.7% in 2008. The GDP was declining over three consecutive quarters. The fourth quarter appeared to be the hardest, with the growth rate of the Japanese economy plunging to -12.7% (q-o-q). Exports, being the driving force of the country's economy, posted a record low growth in the last ten years due to the contraction of world demand as well as due to the appreciation of the yen relative to major currencies, including the US dollar, in the first place.

In China the economic growth rate slowed down in pace in 2008. After showing a 12% increase in 2007 the Chinese GDP grew by 9.0% in 2008, with the slide at its strongest in H2. For the first time in past decades the Chinese government had to shift within a several-month period from challenges related to high economic growth (economy overheating) to the recession-bound problems. Similar to Japan, the economic growth rate slowed down due to the contraction of demand for Chinese exports.

Global financial crisis turned out to be very painful for the East European and some post Soviet countries. The situation was particularly difficult in the Baltic economies. Lack of foreign capital inflows essentially harmed the economies of the three States that were enjoying high growth rates in the recent years, thanks to the attraction of low-cost resources, optimistic expectations, and accommodating fiscal policy. As a result, the GDP growth rates of these economies posted negative values in the last quarter of 2008, while in annual terms only Lithuania maintained a positive growth rate of 3.1%. The choice of the Baltic States to keep the fixed exchange rates at the existing levels resulted in substantial contraction of their reserves in September-November by circa USD 1.8 billion in Latvia (30%), and by USD 1 billion in Lithuania (20%). To weather the crisis these economies opted for measures different from introducing the flexible exchange rate, such as reduction of state expenditures, wage cuts in the public sector, etc. Hungary, Ukraine, and Armenia also faced substantial economic problems.

The second half of 2008 appeared to be particularly difficult for the Russian economy. The decrease in world prices on fuels and ferrous metals, as well as the August war with Georgia, led to a 4-time stock exchange decline, capital outflow and reserves slump. As a consequence, the annual growth of real GDP declined to 5.6% after posting a near 8% rate over the recent years, while annual inflation rate exceeded 13%. Having reached circa USD 600 billion in July 2008, total volume of the country's reserves began drastically contracting after August 8, reaching USD 430 billion by end-December.

As regards the world commodity market, prior to mid-2007 the inflationary pressure stemmed from oil products and metals, with food products (wheat, corn, and soy in the first instance) added to the list thereafter.

The above-mentioned price increases can be explained by the supply-demand interrelation. On the supply factors' side the emphasis can be put on growth of production costs and unfavorable weather conditions, while on the demand side - on world economic growth, high growth rate of money supply, and exploration of alternative sources of fuel (by means of biofuels).

However, starting from H2 2008 as the global economic crisis began unfolding, there was a downward tendency in prices on food, ferrous metals, and oil. Particularly remarkable was the decline in oil prices, which fell by end-2008 more than 3 times the July level.

1.2 ECONOMIC GROWTH

Similar to the worldwide tendencies, Georgia went through two unlike periods of economic development in 2008.

In H1 the FDIs and financial activity continued to maintain high growth rates. As a result, the real GDP growth rates in QI and QII were at 9.1% and 8.3%, respectively.

However, in H2 the country's economic development was essentially impaired by the August war and the world financial crisis. The FDIs contracted by circa 3 times a level in QI, while a two-digit growth rate of the value added produced in the banking sector turned into a 20% decline. Due to this and other factors the GDP in real terms contracted by 3.9% and 2.5% in QIII and QIV, respectively. Having reached an 8.7% rate in the first six months of 2008, real GDP contracted to 2.1% by end-year.

The development of sectors relying on budgetary financing played an important role in retaining positive economic growth in 2008. A double-digit growth was registered in the public administration and education sectors, with the effect of these sectors in the overall economic growth equaling 1.7 percentage points. In H2 2008 growth rates of Georgia's major economic sectors dramatically slowed down. In many cases negative growth was posted, with particularly low rates in the construction, transports, and manufacturing sectors at -11.0%, -10.4%, and -1.0%, respectively.

In addition to the aforesaid sectors, significant contraction of the value-added was recorded in the agriculture (-2.1%) and production and distribution of electricity, gas, and water (2.7%) sectors.

GDP BY DEMAND

The analysis of the GDP by expenditures shows that in 2008 the GDP grew largely at the expense of final consumption. Expenditures on total consump-

DIAGRAM 1.2.1
Real GDP Growth Rates

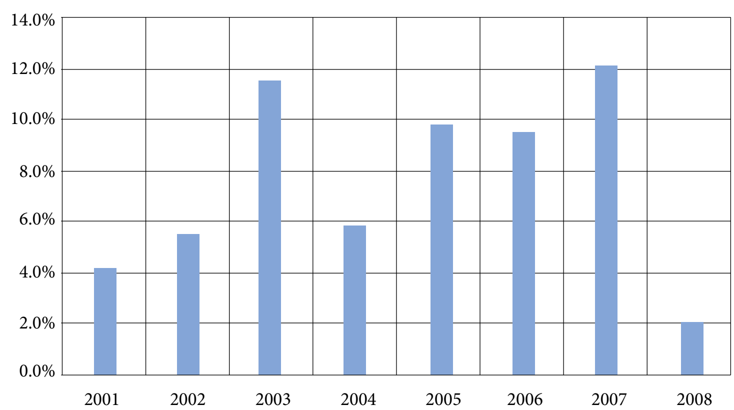


TABLE 1.2.1

	2007		2008	
	Growth Rate	Impact on GDP	Growth Rate	Impact on GDP
Agriculture, Hunting and Forestry, Fish Catching and Fishery	8.8%	1.0%	-2.1%	-0.2%
Mining and Quarrying	20.2%	0.2%	17.0%	0.2%
Manufacturing	13.7%	1.2%	-1.0%	-0.1%
Production and Distribution of Electricity, Gas and Water	5.5%	0.2%	-2.7%	-0.1%
Processing Products by Households	15.6%	0.4%	-4.6%	-0.1%
Construction	14.3%	1.0%	-11.0%	-0.7%
Trade; Repair of Cars, Home Appliances, and Goods of Personal Consumption	11.8%	1.6%	10.4%	1.4%
Hotels and Restaurants	13.5%	0.3%	5.0%	0.1%
Transports	14.4%	1.1%	-10.1%	-0.8%
Communications and Post	9.3%	0.3%	14.5%	0.5%
Financial Intermediation	14.7%	0.3%	3.3%	0.1%
Real Estate, Renting, and Business Activities	14.8%	0.5%	1.5%	0.0%
Imputed Rent of Own Occupied Dwellings	5.6%	0.1%	3.1%	0.1%
Public Administration	14.4%	1.2%	10.3%	1.3%
Education	7.6%	0.3%	13.7%	0.4%
Health Care and Social Assistance	11.1%	0.5%	5.9%	0.2%
Communal, Social, and Personal Services	5.4%	0.2%	-0.2%	0.0%
Private Households with Employed Persons	6.8%	0.0%	5.4%	0.0%
FISIM Adjustment	44.7%	-0.3%	26.3%	-0.3%
GDP at Basic Prices	11.6%	10.1%	2.3%	2.0%
Taxes on Goods	17.7%	2.3%	0.6%	0.1%
Subsidies on Goods	6.5%	0.0%	8.2%	0.0%
GDP at Market Prices	12.4%	12.4%	2.1%	2.1%

tion equaled near 100% of the GDP, while year-on-year growth rate thereof was at 20.2%. Household consumption represented the largest share of total consumption, and grew by circa 16%. Government consumption grew twice as high in the accounting period, posting a 32% year-on-year increase.

As already mentioned above, FDIs sharply contracted in 2008, having an essential effect on the total capital formation. This component amounted to GEL 5,148.8 million in 2008, down by 5.5% year-on-year. Accordingly, the share of total capital formation stood at 27%, down from 32% year-on-year.

The 2008 trade deficit substantially widened. Trade turnover began declining in H2 but the annual growth rate thereof increased by circa GEL 1 billion (21%). Exports grew slightly by GEL 166 million, amounting to GEL 5,469.1 million. Notwithstanding a GEL 212 million contraction in H2, imports posted by far a more impressive growth of GEL 1 160 million in annual terms, totaling circa GEL 11 billion. Due to the particularly wide trade deficit in H1, import's share in the GDP increased from 28.2% to 29%.

1.3 CHANGE IN CONSUMER PRICES

Similar to the previous years, in 2008 the main objective of the NBG was to maintain price stability in the country. Although inflation rates were high over H1, the annual inflation began to slow down in H2 settling at the rate of 5.5% by end-year. Average annual inflation rate was at 10% in the accounting period.

The inflation was quite volatile over 2008. It was at highest in August reaching annual 12.8% gradually decelerating over the remaining period and settling at 5.5% by end-year. Exogenous factors exerted strong influence on the price dynamics over the accounting quarter. High inflation rate in H1 was the result of a strong base effect; namely, in 2007 there was a one-time price hike on some important components of the consumer basket (natural gas, white wheat bread, sunflower oil, cold water fee, and intracity transportation), fueling acceleration of inflation over the next 12 months. After 12 months this price hike effect was no longer reflected in the inflation rate. Accordingly, after H2 2008 the annual inflation decreased. In addition to that, price decreases in international markets, being an immediate consequence of the global economic crisis, had a corresponding influence on Georgia's consumer basket, and hence, inflation continued decelerating. Prices particularly decreased for gasoline and sunflower oil. The August war also had an impact on the change in consumer prices in 2008. Inland transportation

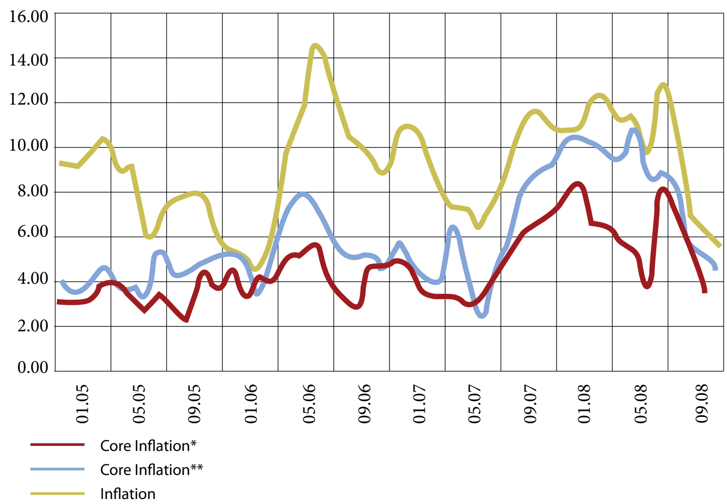
TABLE 1.3.1
Inflation (CPI) Indicators by Components (%), Their Share in the Consumer Basket (%), and Impact on the CPI (%)

	2006 December Weights	Dec-08/Dec-07		Jan08-Dec08/ Jan07-Dec07	
		Inflation	Impact	Inflation	Impact
Total	100.0%	5.5%	5.5%	10.0%	10.0%
Food and non-alcoholic beverages	44.3%	5.5%	2.5%	12.2%	5.4%
Food	43.0%	5.4%	2.4%	12.4%	5.4%
Bread and Bakery Products	12.2%	4.6%	0.7%	21.3%	2.7%
Meat and Meat Products	6.6%	11.3%	0.7%	10.3%	0.7%
Fish Products	1.1%	9.9%	0.1%	0.9%	0.0%
Milk, Cheese, Eggs	5.2%	-2.5%	-0.1%	10.0%	0.5%
Oils and Fats	3.5%	3.0%	0.1%	27.8%	1.0%
Fruits, Grapes	2.3%	38.4%	1.4%	27.4%	1.1%
Vegetables, Watermelons, Potatoes and Other Solanaceae	8.8%	-5.9%	-0.4%	-6.8%	-0.6%
Sugar, Jam, Honey, Syrups, Chocolate, Pastry	2.7%	7.5%	0.2%	-1.0%	0.0%
Other Food Products	0.6%	7.7%	0.0%	5.4%	0.0%
Non-Alcoholic Beverages	1.3%	8.5%	0.1%	4.6%	0.1%
Alcoholic Beverages, Tobacco	3.7%	-0.5%	0.0%	0.0%	0.0%
Clothing and Footwear	5.0%	-2.6%	-0.1%	-4.1%	-0.2%
Housing, Water, Electricity, Gas, and Other Fuels	10.3%	3.9%	0.4%	9.5%	1.1%
Furniture, Home Appliances and Equipment, Housing Renovation	3.7%	7.4%	0.3%	12.6%	0.5%
Healthcare	8.0%	21.5%	1.7%	14.9%	1.2%
Transport	9.0%	0.5%	0.0%	15.4%	1.4%
Communications	4.4%	4.4%	0.2%	3.9%	0.2%
Recreation, Leisure and Culture	2.7%	2.0%	0.1%	4.8%	0.1%
Education	3.5%	-0.4%	0.0%	0.7%	0.0%
Hotels, Cafes, Restaurants	2.4%	8.4%	0.2%	4.9%	0.1%
Other Goods and Services	3.2%	8.9%	0.3%	6.8%	0.2%
Non Durable Goods	68.0%	5.4%	3.7%	11.0%	7.5%
Semi-Durable Goods	6.5%	-1.6%	-0.1%	-1.4%	-0.1%
Durable Goods	1.9%	0.7%	0.0%	-0.3%	0.0%
Services	23.6%	7.7%	1.9%	10.6%	2.6%

Source: Statistics Department

of goods was hampered by military hostilities in the country, and the resulting shortage of goods supply led to sharp price increases on certain agricultural products. However, these prices gradually returned to their early levels as the situation stabilized. As a result of all the aforesaid, actual annual inflation equaled 5.5% by end-year, which is lower than the NBG's target of 8%. In 2008 comparably high inflation rates were recorded in Georgia's main trading partners. Turkey, Russia, Ukraine, and Azerbaijan accounted for more than 40% of total imports. Price dynamics in these countries were quite strongly influenced downwards by price decreases in international markets against the backdrop of global financial crisis. However, by end-year inflation in these countries

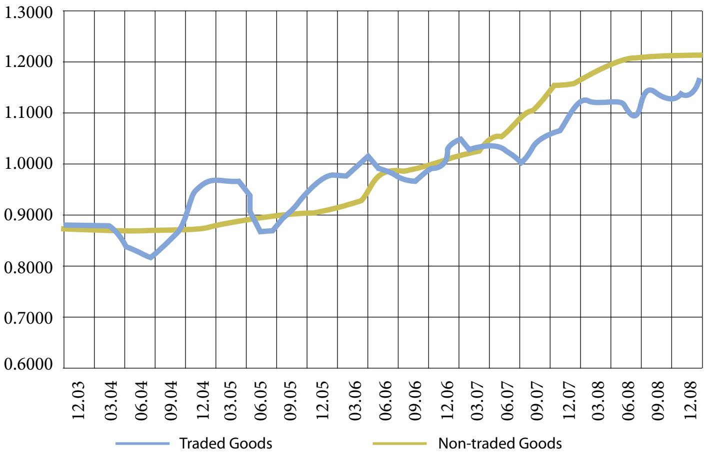
DIAGRAM 1.3.1
Annual CPI and Core Inflation (by 282 Components of the Consumer Basket as of Dec. 2006)[1]



Source: Statistics Department and the NBG Estimates

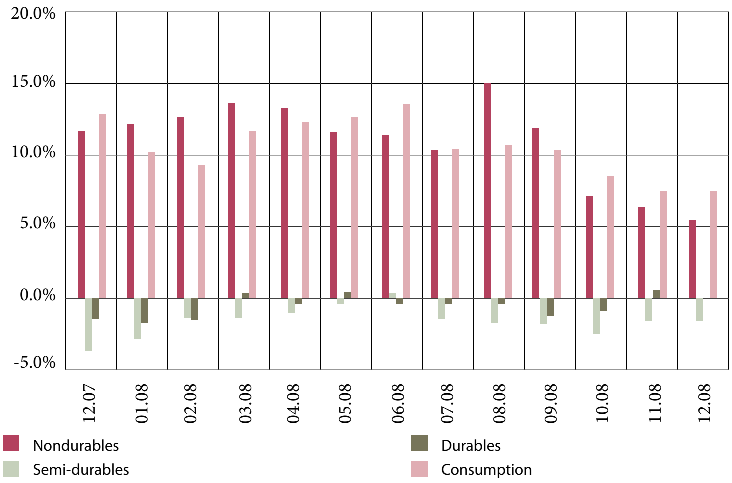
1 * For the products within the limits of one standard deviation.
** For the products within the limits of two standard deviations.

DIAGRAM 1.3.2
iInflation of Traded and Non-traded Goods [4]



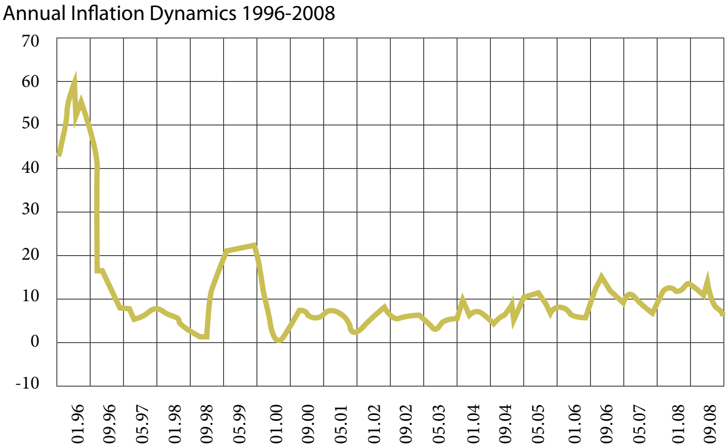
Source: Statistics Department and the NBG Estimates

DIAGRAM 1.3.3
Change in Annual Inflation for Goods by Consumption Durability and Services



Source: Statistics Department

DIAGRAM 1.3.4
Annual Inflation Dynamics 1996-2008



Source: Statistics Department

appeared to be higher than in Georgia. More specifically, the inflation was at 10.1% in Turkey, 13.3% in Russia, 22.3% in Ukraine, and 15.3% in Azerbaijan. It is remarkable that imported goods comprise quite a significant portion of Georgia's consumption basket. Subsequently, price dynamics in trading partner countries represent one of the inflation factors for Georgia.

It is noteworthy to look at the dynamics of prices on traded[2] and non-traded goods. Prices on non-tradables were rising faster than those on tradables in the recent years, which is indicative of developing countries. Intensive capital inflows that were observed over the recent years resulted in the increase of disposable income of households and hence aggregate demand. Other things being equal, this increases prices on non-tradables faster than prices on tradables since price formation of the latter is mainly influenced by world market tendencies. Demand-side pressure of such a small economy as Georgia is too weak to influence prices formed by world tendencies, but is strong enough to influence prices on non-tradables. Annual core inflation rates had a downward trend in 2008. By end-year core inflation rates for the goods within the range of one and two standard deviations were at 4.4% and 3.4%, respectively. Core inflation dynamics describe better the overall inflation tendency and partially exclude one-time and seasonal factors. Analysis of price changes by individual commodity groups showed that in 2008 prices decreased for the clothing and footwear (2.6%) and alcoholic beverages and tobacco (0.5%) commodity groups, while other groups showed price increases, including communications (4.4%), housing, water, electricity, gas and other types of energy (3.9%), household appliances (7.4%), food and non-alcoholic beverages (5.5%), and transports[3] (0.5%). Substantial price increases were registered in the healthcare commodity group (21.5%), which was large-

2 Goods and services, which can be sold at a distance from the production location.
3 In addition to intracity bus and subway transportation prices, the average change in transportation prices is included. These also comprise other means of transport such as intracity taxi, micro bus, and suburban and intercity transport, etc
4 Inflation of imported and domestically produced goods is calculated by the NBG based on the Statistics Department data on indices of each consumption basket component

ly due to the November price hike on medicaments.

Analysis of price changes by consumption durability showed that in 2008 annual inflation rate for non-durables was at 5.4%, while being at highest for services – 7.7%. Prices on durables posted a 0.7% increase, whereas semi-durables decreased in prices by 1.6%.

1.4 GOVERNMENT FINANCE

The 2008 fiscal policy as well as the improvements carried out in the tax and customs administration brought fruitful results in the accounting period. Actual budget revenues exceeded the official target. Accordingly, expenditures also increased to finance a number of priority areas.

Tax-to-GDP ratio significantly increased in 2008, equaling 24.9%, up from 21.6% a year earlier.

According to the current data, consolidated budget revenues and grants totaled GEL 6.6 billion, up GEL 0.7 billion year-on-year. State budget revenues and grants amounted to GEL 5.5 billion, up GEL 1.2 billion.

Indirect taxes accounted for 57% of total tax revenues. However, direct taxes grew at a faster rate of 70%, compared to a 10% growth rate of indirect taxes in the accounting period, which indicates that tax burden was to a certain extent shifted from consumers to producers.

Revenue growth conditioned significant increase of budget expenditures. Namely, consolidated budget expenditures grew by GEL 1.2 billion, amounting to GEL 7.2 billion, as per current data. State expenditures also grew by GEL 1.7 billion year-on-year, totaling GEL 6.7 billion, or 96% of the 2008 target. State-expenditure-to-GDP ratio equaled 35% in the accounting period. The increasing pace of this ratio, as evidenced in the recent years, has substantial influence on domestic demand, and hence, is deemed to be taken into account as an additional inflation factor.

Defense and general public services represented main priorities of the 2008 consolidated budget.

DIAGRAM 1.4.1
Ratio of Consolidated Budget Tax Revenues to GDP. 2000-2008

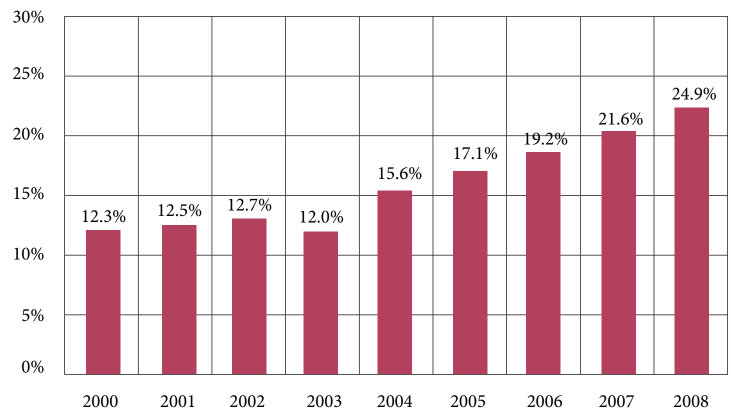


DIAGRAM 1.4.2
Tax Revenues of Consolidated Budget by Types.

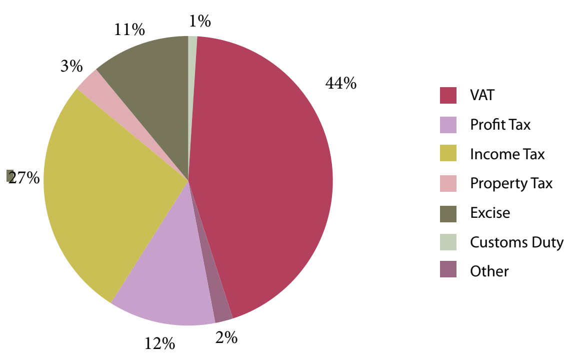


DIAGRAM 1.4.3
Budget Expenditures and Expenditure-to-GDP Ratio

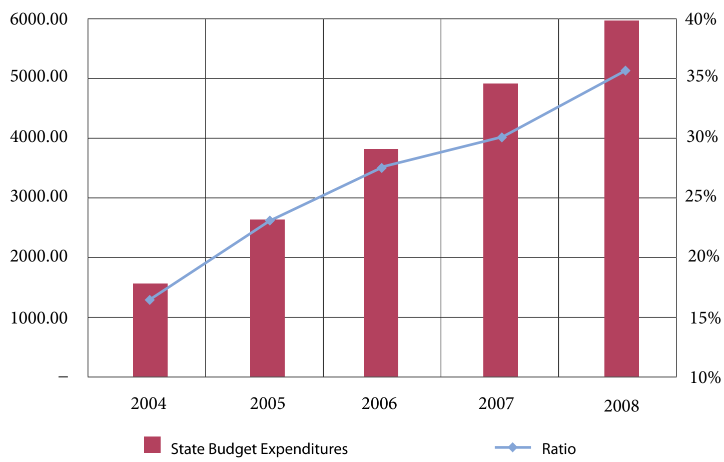


DIAGRAM 1.4.4
Consolidated Budget Disbursements by Types. 2008

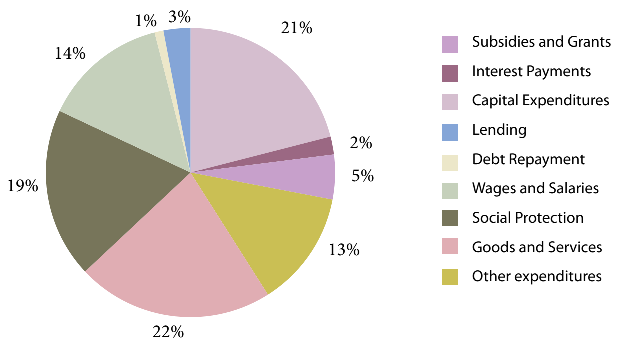


DIAGRAM 1.4.5
State Budget Deficit and Deficit-to-GDP Ratio.

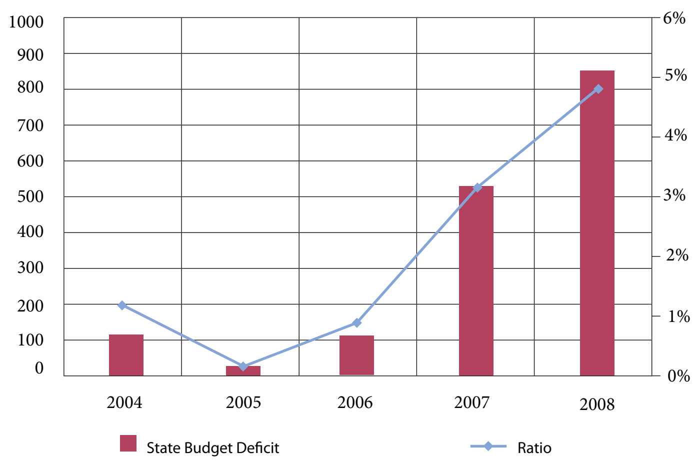
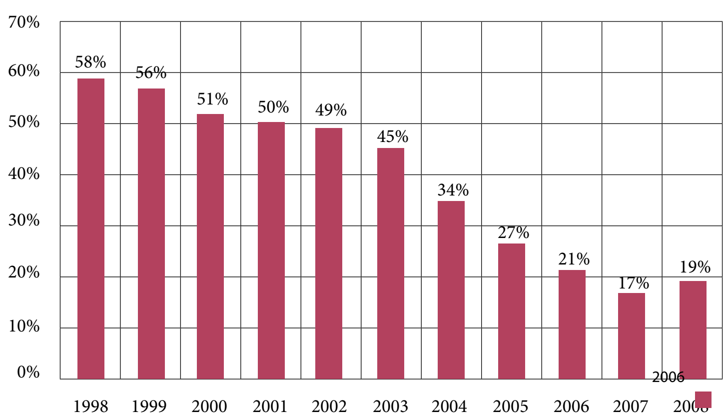


DIAGRAM 1.4.6
Share of External Debt in GDP, 1998-2008.



State budget ceiling was initially set as the GEL 16 million surplus but was thereafter revised to the GEL 506 million deficit. The actual deficit amounted to GEL 358 million, which was due to a slight growth in revenues and larger than officially planned expenditures. It should be pointed out that privatization proceeds are recorded on the revenues account and represent the source of deficit financing for the monetary policy purposes. Excluding privatization proceeds, the 2008 budget deficit amounted to GEL 927 million, or 5% of the GDP.

Balances on government deposits grew by GEL 433 million in 2008. Proceeds from external sources, more specifically, in the form of the World Bank and concessional investment loans, amounted to GEL 350 million in the accounting period, while proceeds from sales of state securities (Eurobonds) stood at GEL 720 million.

The total volume of state external and sovereign debt grew by GEL 1.265 billion amounting to GEL 3.695 billion as of December 31 2008. Debts owed to Turkmenistan, European Union, and the US significantly contracted, whereas debts owed to the IMF, World Bank, Asian Development Bank, as well as to Japan and China increased. The 2008 external-debt-to-GDP ratio, representing a more important parameter than absolute numbers, was at 19%, up from 17% in 2007. As shown in the diagram below, the share of external debt in the GDP tends to decline, save for 2008, declining by 39% over the last decade. This decline is largely due to higher GDP growth rate relative to external debt increase.

1.5 EXTERNAL SECTOR AND BALANCE OF PAYMENTS

In 2008 the current account deficit of the balance of payments amounted to USD 2,850.5 million (22% of GDP), up 42% year-on-year. It is remarkable that the current account deficit was not only fully financed in the accounting period, but even an accumulation of foreign reserve assets took place.

The 2008 current account deficit was still largely influenced by external trade. Exports of goods amounted to USD 2428.0 million, up 16.3% year-on-year, while imports totaled USD 6261.2 million, also posting a 25.6% increase year-on-year.

Imported goods included consumer goods (39%), investment goods (16%), and intermediate consumption goods (45%). This composition of imports is quite steady over the recent years. Among intermediate consumption goods the largest share falls on oil products and natural gas. Construction materials, wheat, and flour also represent important import components. 50% of the Georgian imports comprised manufacturing goods, with ferroalloys, nitrogen fertilizers, and re-exports of motor cars holding the largest share.

The first and the second halves of 2008 gave a completely different picture. External trade posted a particularly high growth rate in H1. Trade turnover figures for Q1 and Q2 increased by 37% and 49% year-on-year, whereas in QIII 2008 the same parameter decreased to 18%, while posting a 13% decline quarter-on-quarter, which was largely due to the August war. Global financial crisis had its implications on the QIV external trade, resulting in a 19% year-on-year and a 15% quarter-on-quarter decreases in trade turnover.

In QIV 2008 imports of goods contracted by 17% year-on-year, and by 7% quarter-on-quarter, which was largely due to global price decreases on oil products. At the same time, exports declined by far at a faster pace than imports, posting a 30% decline year-on-year. Such a decline was largely due to international price decreases on the country's main export item – ferrous scrap metal, the exports whereof contracted in both value and volumes.

According to annual data for 2007-2008, the composition of main export commodities did not undergo any significant changes. In 2008 main export partners of Georgia were as follows: Turkey, Azerbaijan, Ukraine, Canada, Armenia, Bulgaria, United States, Mexico, United Kingdom, and France. These countries accounted for 80% of Georgia's total exports. The Russian Federation moved to the 12th place on the Geor-

DIAGRAM 1.5.1
Current Account Deficit and Foreign Capital Inflows (% of GDP), 2004-2008

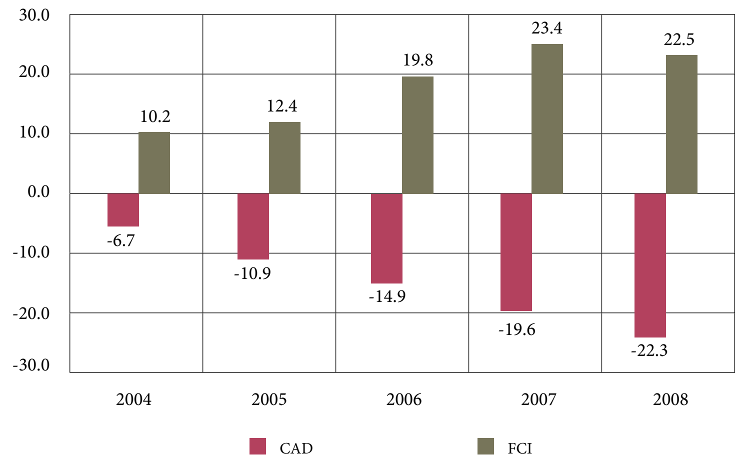


TABLE 1.5.1
Annual Growth Rates

	I 2008	II 2008	III 2008	IV 2008	2008
Exports	47.3%	45.8%	37.6%	-29.8%	21.5%
Imports	34.4%	49.5%	13.6%	-16.8%	16.2%
Trade Deficit	31%	51%	6%	-13%	14.5%

DIAGRAM 1.5.2
Dynamics of Main Export Commodity Groups, 2006-2008 (USD million)

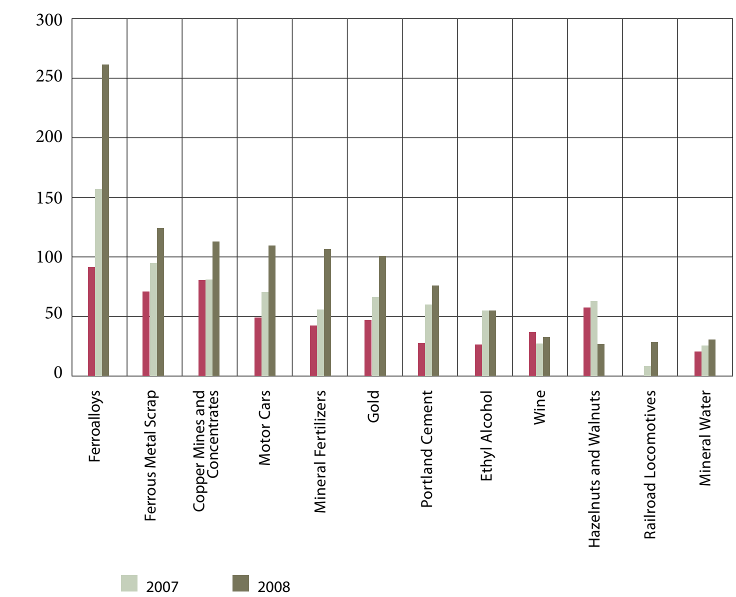
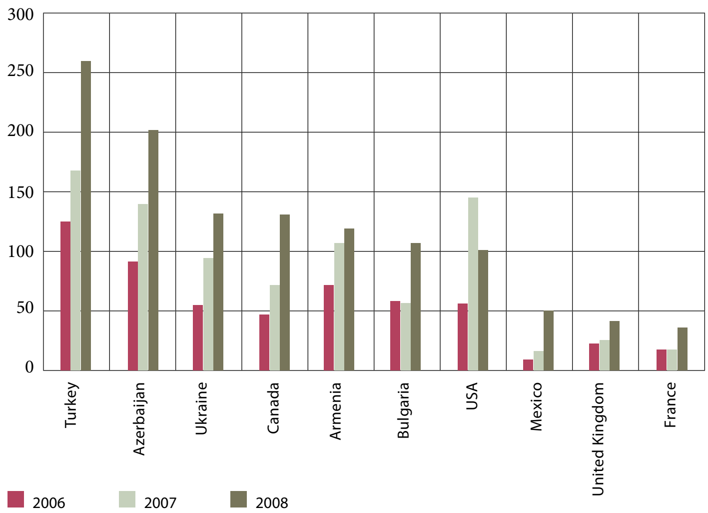


DIAGRAM 1.5.3
Main Partner Countries of Georgia by Exports (USD million)



gian exports list.

Registered imports totaled USD 6,058.1 million in 2008. Structure of imports did not undergo any significant changes, save for the contraction of natural gas imports in both value and volumes. Fuels and motor cars retained leading positions. Imports grew mainly in the first three quarters, whereas in QIV there was recorded a decline.

In 2008 the main import partners of Georgia were as follows: Turkey, Ukraine, Azerbaijan, Germany, Russian Federation, China, United Arab Emirates, United States, Italy, and Turkmenistan. These countries accounted for 78% of Georgia's total imports. Imports from the Russian Federation fell by 26% year-on-year.

Current transfers, more specifically the largest

TABLE 1.5.2
Breakdown of Main Export Commodity Groups by Partner Countries (%)

	Ferroalloys	Ferrous Metal Scrap	Copper Mines	Motor Cars	Mineral Fertilizers	Gold	Portland Cement	Ethyl Alcohol	Wine	Hazelnuts and Walnuts	Railroad Locomotives	Mineral Water
Share in total Exports	17.8	8.6	7.9	7.6	7.0	6.7	5.3	3.9	2.5	2.1	2.1	2.1
United States	26.8	0.3	-	0.0	14.4	-	-	0.0	4.0	0.0	-	3.1
Turkey	25.9	88.5	-	8.2	6.2	-	0.0	-	0.4	0.6	-	-
Mexico	19.8	-	-	-	-	-	-	-	-	-	-	-
Canada	11.7	-	-	-	-	99.9	-	-	0.3	-	-	0.3
Ukraine	9.5	-	-	3.1	-	-	-	-	51.6	8.9	70.4	48.1
France	3.1	-	-	0.0	27.9	-	-	0.0	0.4	3.0	-	0.0
United Arab Emirates	1.3	1.0	-	1.5	-	-	-	-	0.1	0.8	-	0.2
Russian Federation	0.9	-	-	0.2	-	-	-	0.7	0.4	2.3	6.7	-
Austria	0.6	-	-	-	-	-	-	-	-	0.8	-	-
Belarus	0.2	-	-	0.0	-	-	-	6.8	9.0	0.5	-	1.8
Azerbaijan	0.1	-	-	47.2	0.9	-	99.3	10.8	2.0	3.6	-	8.6
Kazakhstan	0.1	-	-	0.5	-	-	0.7	9.8	10.0	0.5	-	14.5
Spain	0.0	1.2	7.6	-	6.3	-	-	-	0.0	4.6	-	-
Armenia	0.0	-	-	30.7	5.3	0.1	-	7.5	0.4	1.6	22.9	0.5
South Africa	0.0	-	-	-	-	-	-	-	-	-	-	-
Albania	-	1.0	-	-	-	-	-	-	-	-	-	-
Belgium	-	-	-	5.1	-	-	-	0.0	0.2	1.9	-	0.0
Belize	-	0.3	-	-	-	-	-	-	-	-	-	-
Brazil	-	-	-	-	8.4	-	-	-	-	-	-	-
Bulgaria	-	-	76.2	0.2	3.8	-	-	0.4	0.0	3.3	-	0.0
Other Countries	-	7.6	16.2	3.3	26.7	-	0.0	7.8	21.3	67.6	-	22.9
Total	100	100	100	100	100	100	100	100	100	100	100	100

part thereof – money remittances, still represent the main factor influencing not only the balance of payments, but also the consumer market. Remittances received through swift money transfers grew by 16% year-on-year in 2008.

Positive balance of the 2008 capital and financial account amounted to USD 2879.0 million, up 41.5% year-on-year. The increase was due to the financial account (USD 867.4 million), while capital account posted a decrease of USD 22.8 million. The 2008 financial account grew by 45.5% amounting to USD 2,774.2 million, which was largely due to a substantial rise in foreign investment volumes with particular growth of portfolio and other investments. In addition to that, Georgia received USD 256.8 million under the IMF balance of payments support program.

In H1 2008 the FDIs grew by 35.5% year-on-year totaling USD 942.0 million. However in H2 the volumes sharply contracted by 67.9% year-on-year amounting to USD 338.3 million. Overall, in 2008 the total volume of the FDIs attracted by the country amounted to USD 1280.3 million, down 26.9% year-on-year.

Notwithstanding essential challenges in the financial sphere emerged in 2008, foreign reserves grew by USD 119.0 million in the accounting period, amounting to USD 1480.2 million. However, a contraction was recorded in QIII. Overall, the increase gained through foreign reserves operations amounted to USD 130.8 million in the accounting period.

The 2008 current account deficit turned out to widen to its largest level since 2000. During the accounting period it was at record high in H1 totaling USD 1,732.4 million, twice up year-on-year, and contracted thereafter in H2 to USD 1,118.1 million, down by 7% year-on-year. In H2 2008 balance of goods declined in both imports and exports 2008, with increased negative balance value due to a faster pace of decline in exports. Balance of services, having played an important role in financing the deficit caused by balance of goods, turned out negative in H2, which is largely due to the deteriorated balances of trans-

DIAGRAM 1.5.4
Dynamics of Main Import Commodities

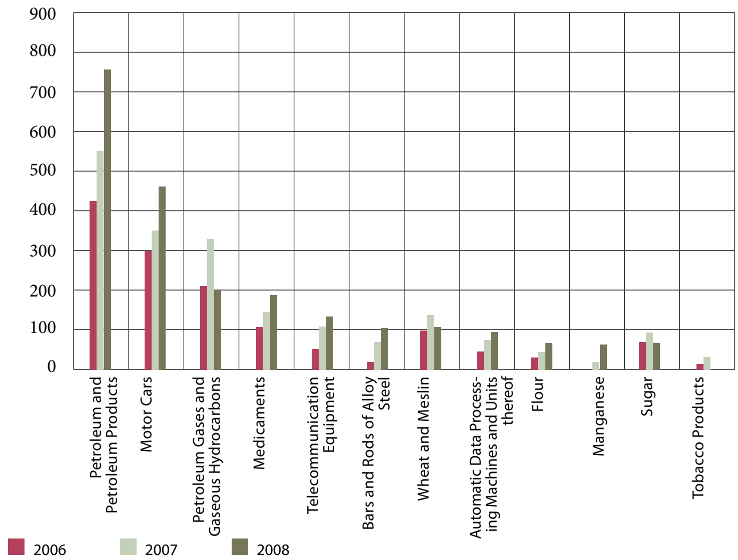


DIAGRAM 1.5.5
Main Partner Countries of Georgia by Imports

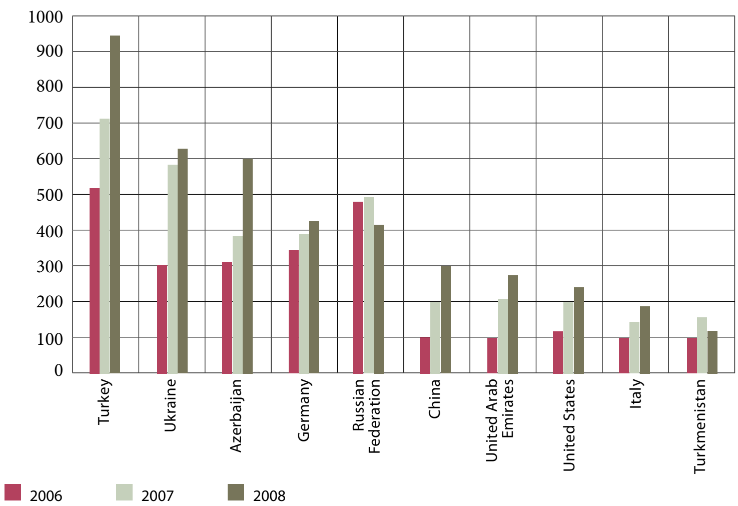


DIAGRAM 1.5.6
Dynamics of Money Remittances 2000-2008

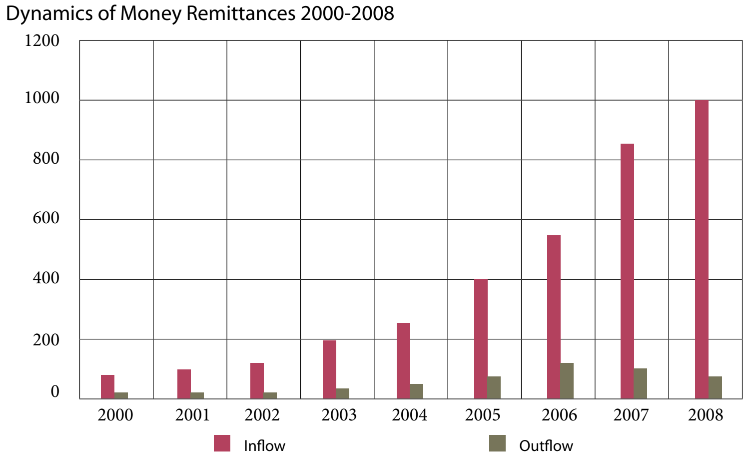
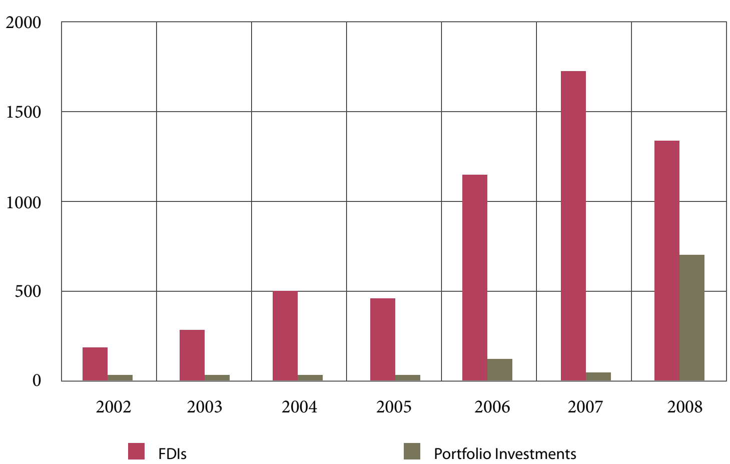


TABLE 1.5.3
Breakdown of Main Import Commodity Groups by Partner Countries (%)

	Petroleum and Petroleum Products	Motor Cars	Petroleum Gases and Gaseous Hydrocarbons	Medicaments	Telecommunication Equipment	Bars and Rods of Alloy Steel	Wheat and Meslin	Automatic data Processing Machines and Units thereof	Flour	Manganese	Sugar	Tobacco Products
Share in Total Imports	12.6	7.6	3.4	3.1	2.4	1.8	1.8	1.5	1.2	1.2	1.1	1.0
Azerbaijan	45.9	0.1	61.8	0.2	0.1	-	0.4	0.0	16.6	-	14.8	-
Turkmenistan	17.3	-	0.5	-	-	-	-	-	-	-	-	-
Romania	10.0	0.0	-	0.5	0.3	-	1.9	0.0	-	-	-	1.3
Bulgaria	9.7	0.2	-	4.7	0.1	-	-	0.0	-	-	-	4.5
Greece	5.3	0.0	-	0.5	0.0	-	-	0.0	-	-	-	0.3
Italy	4.4	1.0	-	0.6	0.2	-	-	0.3	1.1	-	0.2	-
Turkey	3.3	0.6	0.4	14.3	0.4	12.8	3.3	1.5	11.3	5.3	0.5	-
Russian Federation	1.2	1.3	37.2	2.0	0.1	0.2	51.1	0.1	24.6	-	1.4	0.0
Germany	0.6	21.9	0.0	9.8	1.8	0.3	-	12.3	0.0	-	0.1	1.9
United Kingdom	0.6	1.7	0.0	1.5	0.6	0.4	-	1.2	-	-	-	-
Switzerland	0.4	0.3	-	6.8	0.0	-	0.7	0.7	-	-	-	-
Ukraine	0.3	0.0	0.0	6.6	0.2	80.3	9.3	0.4	43.1	-	0.0	87.7
Iran	0.2	0.1	0.1	0.0	0.0	-	-	0.1	-	-	-	-
Finland	0.1	0.0	-	0.7	8.0	-	-	2.4	0.0	-	-	-
Belgium	0.1	1.5	-	3.6	2.8	-	-	0.5	-	-	0.1	0.0
United States	0.1	26.0	-	5.9	2.9	-	-	2.9	0.0	-	0.0	0.0
Lithuania	0.1	0.0	-	0.7	0.2	-	-	2.4	0.0	-	0.0	-
Oman	0.1	0.6	-	-	-	-	-	-	-	-	-	-
Uzbekistan	0.0	0.0	-	0.0	-	-	-	-	-	-	-	-
United Arab Emirates	0.0	14.1	0.0	0.0	47.7	-	-	9.8	-	-	1.5	0.0
Other Countries	0.1	30.4	-	41.5	34.6	6.0	33.3	65.3	3.2	94.7	81.3	4.3
Total	100	100	100	100	100	100	100	100	100	100	100	100

DIAGRAM 1.5.7
FDI and Portfolio Investment Volumes



ports, insurance, construction, and other services.

In 2008 negative investment income (debit), which mainly consists of labor income, exceeded the income credit. As a consequence, the 2008 income balance turned out negative. In 2008 volume of current transfers grew 1.5% year-on-year. Transfer inflows were at highest in H2 in both public and private sectors. Such a growth of current transfers was largely due to assistance from donor countries.

1.6 FINANCIAL MARKETS

CAPITAL MARKET

In 2008 the Georgian Stock Exchange conducted transactions worth GEL 256.6 million, with the fixing[5] transactions amounting to GEL 246 million. 93% of total value of transactions concluded through trading sessions fell on the stocks issued by the Bank of Georgia, the Teliani Veli, and the VTB Bank Georgia, while 90% of the fixings fell on the stocks of the Bank of Georgia, the Caucasus Energy and Infrastructure, and the VTB Bank Georgia.

5 Fixing of a transaction through the trading system, bypassing trading sessions.

TABLE 1.5.4
Balance of Payments, 2004-2008 (USD million)

	2004	2005	2006	2007	2008
Current Account	**-353.6**	**-709.5**	**-1 174.6**	**-2 008.7**	**-2 850.5**
a. Commodity	-915.5	-1 214.2	-2 019.4	-2 895.8	-3 833.2
Credit	1 092.1	1 472.4	1 666.5	2 088.3	2 428.0
Debit	-2 007.7	-2 686.6	-3 685.9	-4 984.1	-6 261.2
b. Services	69.6	83.5	158.0	161.3	27.5
Credit	554.8	715.0	885.0	1 094.1	1 263.3
Debit	-485.1	-631.5	-727.0	-932.8	-1 235.8
c. Income	78.5	62.1	162.8	37.4	-106.0
Credit	251.7	263.3	341.1	481.6	488.6
Debit	-173.3	-201.2	-178.3	-444.2	-594.5
d. Current Transfers	413.9	359.0	523.9	688.5	1 061.2
Credit	465.4	413.4	587.0	768.5	1 142.8
Debit	-51.5	-54.4	-63.0	-80.0	-81.7
Capital and Financial Accounts	**342.4**	**682.8**	**1 239.3**	**2 034.3**	**2 879.0**
Capital Account	**40.7**	**58.6**	**171.2**	**127.6**	**104.8**
Credit	44.1	61.6	172.2	127.9	104.9
Debit	-3.4	-2.9	-1.0	-0.3	-0.1
Financial Account	**301.7**	**624.2**	**1 068.1**	**1 906.8**	**2 774.2**
a. Direct Investments	482.8	542.2	1 185.9	1 674.9	1 238.7
To abroad	-9.6	89.5	15.8	-75.3	-41.6
From abroad	492.3	452.8	1 170.1	1 750.2	1 280.3
b. Portfolio Investments	-13.0	15.5	140.3	21.1	692.4
Assets	-13.1	13.1	-2.2	-12.5	-2.3
Liabilities	0.1	2.4	142.5	33.6	694.8
c. Financial Derivatives	0.0	0.0	0.0	1.1	7.8
Assets	0.0	0.0	0.0	1.2	11.1
Liabilities	0.0	0.0	0.0	-0.2	-3.3
d. Other Investments	9.8	177.1	180.5	586.7	966.1
Assets	-27.4	-16.2	-51.8	-202.3	-270.8
Liabilities	37.3	193.3	232.4	789.0	1 236.9
e. Reserve Assets	-177.9	-110.6	-438.6	-377.0	-130.8
Net Errors and Omissions	11.1	26.7	-64.7	-25.6	-28.5
Total Exceptional Financing	144.1	142.5	116.2	178.7	1015.0

As of December 31, 2008 stocks from 158 issuers were admitted to the trading system of the Stock Exchange with the capitalization[6] totaling GEL 545.6 million, or only 2.9% of GDP. In terms of this parameter, Georgia stood ahead of Armenia and Ukraine, who posted 1.5% and 0.2%, respectively, but essentially behind other developing economies with average rates[7] of 86% for the European, and 184% for the Asian developing economies.

Based on all the aforesaid, it can be said the Georgian stock market is still underdeveloped and does not represent a source of financial gains for the companies operating in the country.

TABLE 1.6.1
Capitalization at the Georgian Stock Exchange, 2000-2008

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
Share in GDP	0.8	2.8	3.1	5.1	4	5.5	4.2	13.6	2.9

DOMESTIC FOREIGN EXCHANGE MARKET

Being the most sensitive segment of the financial market, the Georgian domestic foreign exchange market echoed the political and economic processes unfolded in the country throughout 2008. Foreign exchange market turnover soared in the accounting period, including the Tbilisi Interbank Foreign Exchange, direct interbank currency market, exchange services at commercial banks, and foreign exchange bureaus.

6 Market value of stock in circulation, excluding stocks in possession of issuing company.
7 2007 data, IMF.

DIAGRAM 1.6.1
Dynamics at the TIBFEX, 2004-2008 (GEL million)

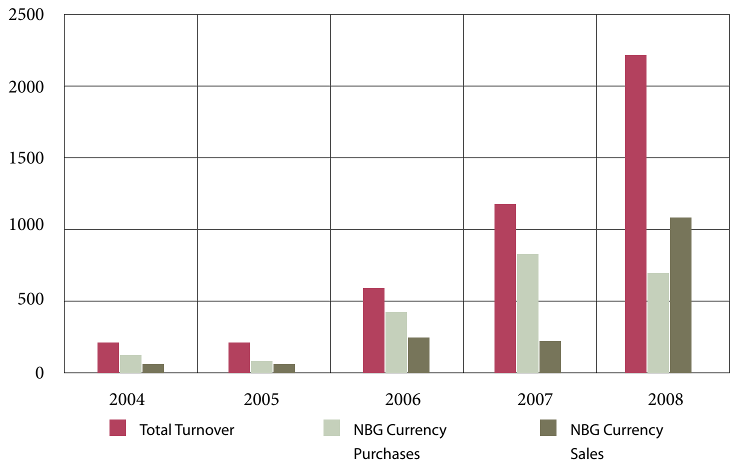


DIAGRAM 1.6.2
Dynamics of the Lari EER relative to Foreign Currencies (Dec. 2002 = 100)

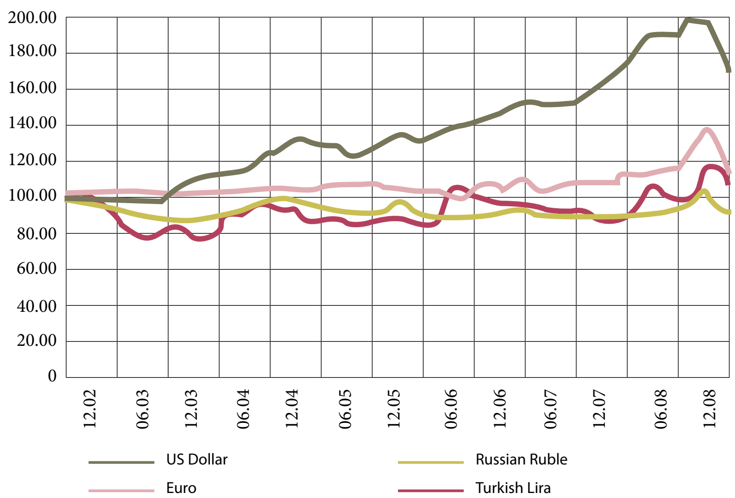
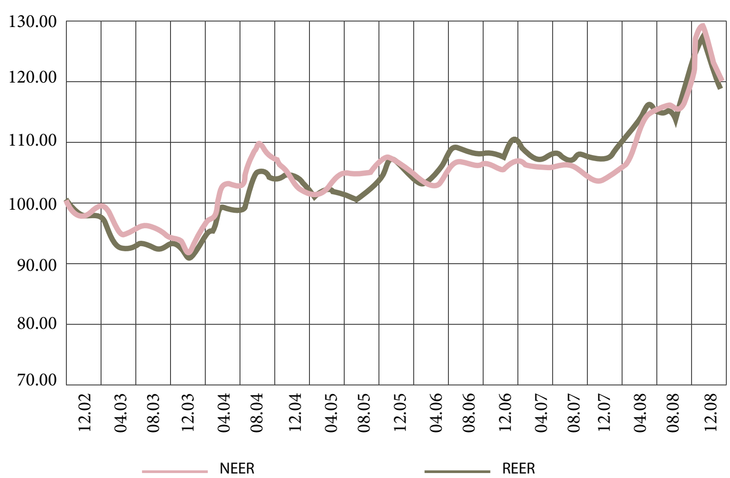


DIAGRAM 1.6.3
Monthly NEER and REER Indices (Dec. 2002 = 100)



In 2008 the TIBFEX turnover grew by 70% year-on-year totaling GEL 2,246 million. The NBG's interventions accounted for 95.5% of the TIBFEX turnover, up from 86.6% in 2007. In H1 the NBG mainly intervened on the currency withdrawal side, with the total purchases amounting to USD 356 million in the first seven months. By conducting such interventions the NBG made the process of the domestic currency appreciation comparably smooth. The lari appreciation tendency, caused by excessive foreign exchange supply in the recent years, reversed after the August war, as the foreign exchange inflows sharply contracted. From this point forward the NBG began intervening mostly to satisfy the excessive demand for foreign currency.

In the period from August 8 through early November the NBG aimed at avoiding acute movement of the lari exchange rate relative to the US dollar, as this was likely to be associated with the war and the global financial crisis, and hence, could provoke an unjustifiable and unfounded sentiment in the banking sector with detrimental consequences. Therefore, the NBG practically pegged the lari exchange rate to the U.S. dollar. In the second half of October, due to the worsening global financial crisis, the U.S. dollar sharply appreciated relative to other major currencies As a result, the dollar-pegged lari and the drastic appreciation of the U.S. dollar led to the lari appreciation above its natural level. Consequently, the NBG allowed a one-time depreciation of the lari versus the US dollar in November.

Notwithstanding the November depreciation of the domestic currency, in 2008 the lari real exchange rate appreciated relative to practically all foreign currencies, more specifically: by 5.48% relative to the euro, by 2.62% – to the Russian ruble, and by 19.59% – to the Turkish lira. As regards the US dollar, the lari real exchange rate slightly depreciated, by 0.55%.

The lari appreciation relative to other currencies had a clear impact on the lari nominal and effective exchange rates. In the accounting period both the NEER and the REER appreciated by 14.4% and 9.6%, respectively.

2. MONETARY AND FOREIGN EXCHANGE POLICY

2.1 MONETARY POLICY

In formulating the 2008 monetary policy the NBG was governed by the main objectives and functions as laid down in Article 2 of the Organic Law of Georgia "On the National Bank of Georgia", according to which "the main goal of the NBG is to maintain price stability". The priority of the price stability principle is based on the conventional idea that low and predictable inflation is a necessary prerequisite for long-term economic growth. In March 2008 amendments to the Organic Law of Georgia "On the National Bank of Georgia" were made, which clearly define the NBG's main goal and provide that the NBG is also committed to ensuring stability and transparency of the financial system, as well to promoting sustainable economic growth, if possible, in such a manner as not to put the main goal in jeopardy. Thus, in 2008 the price-stability-oriented monetary policy of the NBG served to improve the investment environment, to protect households' income from devaluation, and to increase the potential long-term GDP growth. In 2008 the NBG conducted its activities in accordance with the Resolution of the Parliament of Georgia "On Main Directions of the 2008 Monetary and Exchange Rate Policies in Georgia", according to which the projected growth rate of prices was targeted around 8% by end-year, with an allowance for a deviation in the event of exogenous shocks, which actually were in frequent presence throughout 2008. At the same time, the NBG would have responded with either tightening or loosening of monetary policy as applicable, if such a deviation had a degree significant enough to have a potential impact on such a fundamental inflation factor as the inflation expectations.

In H1 annual inflation rate was quite high, which was mainly due to the 2007 price increases on certain determinative components of the consumer basket and a one-time price hike on regulated prices. As a result, annual inflation exceeded 12% in spring. The NBG's assumption was that the above-mentioned exogenous shocks would discontinue to affecting the annual inflation in H2, and hence, the inflation would change its trend downwards. In accord with this assumption, inflation rate decelerated to a one-digit level in July. However, as inland transportation of goods was hampered by the August military hostilities, the lack of goods supply that was created in the markets led to sharp price increases on certain agricultural goods, which in turn, pushed the inflation upwards to reach the maximum rate of 12.8% by end-year. These prices gradually returned to their early levels as the situation stabilized. In addition to that, in H2 prices on fuels, wheat, and other commodities abruptly fell in international markets. By end-year annual inflation rates significantly decelerated in Georgia's main trading partners, which also had its effect on the price dynamics. As a result, inflation sharply fell by end-2008 standing at 5.5%, while the annual inflation rate was at 10%.

Likewise in previous years, the NBG's monetary policy, oriented at mid-term price stability and minimization of economic volatility, was confronted by serious challenges in the accounting period. The 2008 inflation was characterized by quite large fluctuations driven at most by exogenous factors and to a certain extent by monetary factors.

The NBG regulated the money supply in accordance with the existing demand-side pressure. Based on the expected dynamics of the economic growth, monetization, dollarization, and other factors, as well as with due consideration of the primacy of price stability, the growth rate of money mass was initially projected to be around 10%. Factoring in intensive foreign capital inflows in QI, the NBG increased its foreign exchange market interventions on the US dollar withdrawal side in order to avoid sharp fluctuations of the lari exchange rate. These operations favored the expansion of reserve money, and hence, of money supply to the economy. However, for the purposes of sterilization of currency interventions, the NBG actively used the Certificates of Deposits (CDs) to absorb the excessive liquidity. By end-March the absorption through the CDs totaled GEL 467 million. Another instrument that was extensively used by the NBG for the policy tightening purposes was the key policy rate, which was increased by three percentage points throughout H1, equaling 12%.

During the next several months the advanced western economies were confronted by the first signs of the global financial crisis. As a result, commercial banks operating in Georgia experienced difficulties in attracting foreign credit resources in the same volumes and on the same terms as earlier. However, the influence of this on the expansion rates of money aggregates was inappreciable at first, as commercial banks had quite significant funds invested in the CDs at that time and reacted to the lack of credit resources in foreign markets by recalling funds from the CDs. Subsequently, the annual growth rate of reserve money exceeded 34% as of end-July. Annual growth rates of the M2 and M3 aggregates were at 41% and 27%, respectively, as of July. Overall, in H1 the NBG conducted strict monetary policy aimed at absorption of liquidity in the banking system to contain growth rates of the money aggregates within reasonable limits.

The August military hostilities, followed by the exacerbation of the global economic crisis at a later stage, posed completely different challenges to the NBG's monetary policy. Deposit leakage from the banking system was fueled by increased uncertainty created in the country. Under these circumstances, in order to facilitate commercial banks' smooth services to deposit holders, the NBG suspended the reserve requirements of commercial banks, and by doing so, made available quite a substantial amount of resources. By that time the required reserve ratio was set at 13%. Soon thereafter the NBG reduced the ratio to 5%. This change was conditioned by the reversal of the monetary policy. More specifically, based on the assumption that that the economic growth rates were expected to decline in Georgia, its main trading partners, and overall in the world as well, that the deflation processes accelerated in international markets, that the banking system experienced the increasing liquidity shortfall, and that the credit resources were difficult to attract both within and outside the country, the NBG shifted from tight monetary policy to expansionary and stimulus-oriented policy.

The change in the monetary policy direction, as well as the swing in the banking system conditions from liquidity excess to shortfall, brought to the agenda the necessity of launching a new policy instrument –7-day refinancing loans. On the one hand, this instrument would assist commercial banks to more efficiently manage their liquidity in conditions of liquidity deficit in the system, and on the other hand, it would enable the NBG to signal the economy about policy direction by means of changing the interest rate in the interbank credit market, as well as to influence expectations of economic agents. As the economic crisis aggravated and the economic growth rate projections accordingly worsened, starting from August the NBG carried out four consecutive cuts of the key policy rate (one percentage point each time) to bring it to an 8% level by end-year, as opposed to 12% in August.

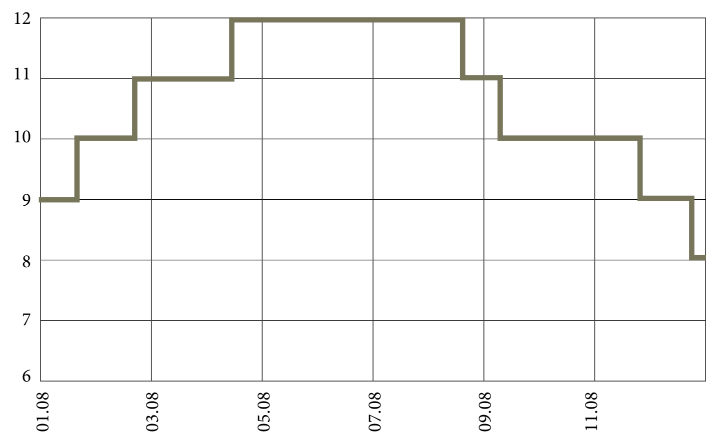
However, given the deteriorated liquidity deficit conditions, the aforesaid measures did not suffice to promote commercial banks' lending activity, and hence, recovery of economic activity. The NBG provided the banking system with an additional resource of GEL 135.9 million with a six-month maturity and the option to prolong the maturity date to one year.

Notwithstanding the above-mentioned measures, which were taken to promote economic activity through the money mass expansion, the raised expectations that the lari exchange rate will depreciate led to excessive demand for foreign currency on the part of economic agents, exerting a downside pressure on the reserve money and, as a consequence, on the money aggregates. As a result, reserve money contracted at annual rate of 7.8% by end-year. Annual decline rate of the M2 aggregate was 13%, while annual growth rate of M3 equaled 7% by end-year, down from 29% in June. The money multipliers for the M2 and M3 decreased over the year by 6% and 16%, respectively.

In the period following the August war, due to the raised expectations of the lari exchange rate depreciation, the demand for the lari plummeted. Hence, the exchange rate represented an important monetary policy implementation factor essentially determining the formation of inflation expectations. It must be noted that, proceeding from specifics of the Georgian economy, the NBG does not consider exchange rate as a mid-term target, that is, unlike the money mass growth rate, the NBG does not see the necessity to determine any exchange rate mark. However the interventions in the foreign exchange market were quite intensive in order to avoid short-term exchange rate fluctuations. With due consideration of the fact that economic agents' expectations in Georgia are quite sensitive to the lari exchange rate fluctuations, the NBG pegged the rate to the US dollar during the August developments and over the ensuing period in order to avoid undesirable market agitation. This period coincided with the sharp appreciation of the US dollar relative to other currencies, owing to the global financial crisis, which led to deviation of the lari exchange rate from the short-term equilibrium point. As a result, the lari depreciation expectations augmented bringing about additional demand for foreign currency. In response to surged speculative demand for foreign currency the NBG abandoned the peg in the beginning of November, which led to a one-time exchange rate depreciation. This action resulted in the stabilization of the market demand for foreign currency.

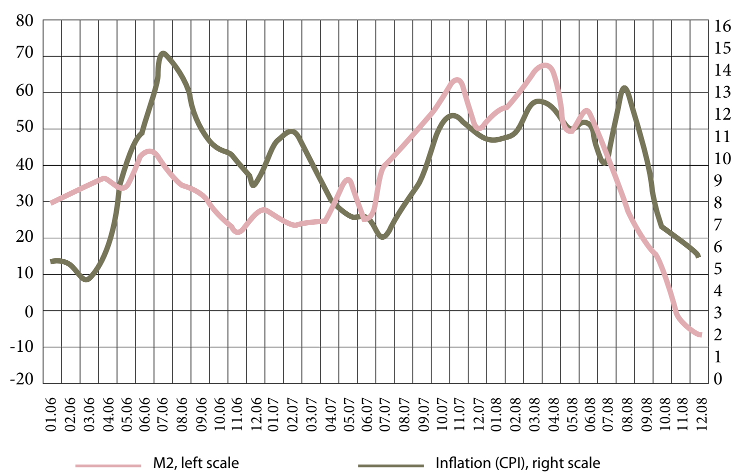
Monetization of the economy deteriorated as the demand for foreign currency slowed down in pace after the August developments and, particularly, the aggravation of the global economic crisis. In 2008 the monetization ratio relative to GDP was at 22.6% and 9.8% for the M3 and M2 aggregates, respectively. The M2 contracted at a faster pace than the M3, which is explained by the increase in demand for fo-

DIAGRAM 2.1.1
Key Policy Rate, 2008



Source: National Bank of Georgia

DIAGRAM 2.1.2
Annual Growth Rate of M2 Money Mass (Monthly Average Data)



Source: National Bank of Georgia

reign currency owing to the lari depreciation expectations raised by end-year. In 2008 demand for the lari was still driven by such factors as turnover of the state budget and population's transaction demand. One of the important sources of demand for the lari was the last years' increase in state budget turnover. In the accounting period the state budget grew by 30% year-on-year, exceeding GEL 6.5 billion. Growth of income of the part of the population dependent on state finances also contributed to the monetization of economy.

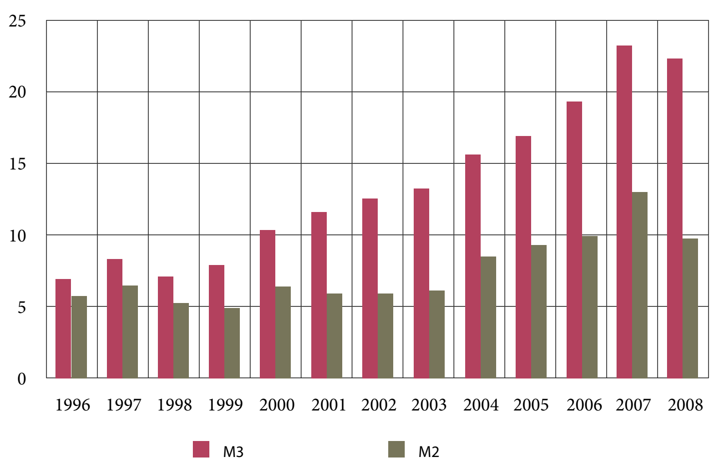
Likewise in previous year, in H1 2008 the monetary policy of the NBG was conducted under dedollarisation conditions. Bank deposits' dedollarisation ratio decreased to 60% from 65.6% at end-July. However, further developments and raised expectations of the lari depreciation conditioned the growth of dollarization. Deposits dollarization ratio started to steadily increase since August reaching 75.8% by end-year. Dollarization was also fueled by the depreciation of the lari exchange rate as the population's confidence in the lari weakened. As a result, deposits dollarization ratio grew by 15.5% over the accounting period.

As already mentioned above, the 2008 inflation dynamics were strongly influenced by exogenous factors. With due consideration of this, for the purposes of estimating core inflation the NBG used both the indices obtained by excluding different consumer basket components, and the indices obtained for the consumer basket components falling within the range of one and two standard deviations. The analysis of core inflation indices mainly suggested of stability of the general price level and temporary nature of relatively high inflation, which became evident in H2.

In such circumstances, monetary policy of the NBG in 2008 was generally aimed at achieving short- and medium-term price stability. This approach, under the conditions of rigid prices, did not imply to counteract exogenous shocks affecting price dynamics by means of weakening the demand in order to avoid the obstruction of economic growth. The focus was made rather on indirect, secondary effects of the supply shocks. Obviously, the monetary policy was oriented towards management of expected, and not actual, inflation. Transparency of the monetary policy and the NBG's public relations policy were of essential importance in order to ensure the formation of adequate inflationary expectations.

It was the NBG's belief that in order to achieve the goals sought it was crucial that financial market participants as well as wide public were clear about actual causes and expected outcomes of current economic processes, the NBG's priorities, as well as the essence and economic effects of activities conducted in line with such priorities. In this context, similar to the standard international practice followed by central banks of the leading countries, the NBG used its best endeavors to make available the information on current trends in the money and foreign exchange markets, to deliver its vision with regard to these issues, and to explain the motives underlying the decision-making process. To achieve this objective the NBG used electronic and printed publications as well as other media means publishing monthly "Monetary and Fiscal Bulletin", quarterly "Inflation

DIAGRAM 2.1.3
Monetization of Economy, 1996-2008



Source: National Bank of Georgia

Review", promptly releasing statistical data, etc.

Thus, with due consideration of the difficulties encountered it could be said that the NBG succeeded to curb the inflation growth by H2 2008. Meanwhile, these efforts were underpinned by sharp price decreases in international markets, affecting the Georgian CPI as well. As a result, the actual inflation was at 5.5% by end-period, which is below the projected level.

2.2 EXCHANGE RATE POLICY AND MANAGEMENT OF INTERNATIONAL RESERVES

In 2008 the exchange rate policy of the NBG was one of the important directions in the context of maintaining price stability. At the same time, in the accounting period the main priority of the exchange rate policy remained the mitigation of short-term volatility of the lari exchange rate, containment of appreciation of the lari real effective exchange rate, and accumulation of foreign reserves.

In the accounting period the exchange rate policy of the NBG was conducted under the managed float exchange rate regime. The NBG's foreign exchange interventions purported to avoid acute exchange rate movements rather than to affect the general trend and to establish a specific exchange rate level. At the same time, the capital account remained liberalized, allowing any economic entity to open foreign currency deposits both in Georgia and abroad, as well as to convert available amounts of money into any currency.

The NBG regulated imbalances of demand and supply of foreign exchange, in order to reduce sharp volatility of foreign exchange market. Throughout 2008 the NBG sold at the TIBFEX trading sessions USD 1211.7 million and purchased USD 821.7 million. In H1 the NBG acted mainly as a purchaser of foreign currency, supplying the lari. The inflows of foreign private capital contracted in the post-August-war period, aggravated by the global financial crisis, while the inflow of foreign exchange grew through the government channels due to international assistance. To avoid the growth of foreign reserves against the backdrop of foreign currency deficit, the NBG embarked upon selling the US dollar in H2, unlike in H1.

Throughout 2008 the official lari exchange rate relative to the US dollar averaged GEL 1.4902, appreciating by average annual 11% (from 1.6703 to 1.4902) and depreciating by 4.7% as of end-year (from 1.5916 to 1.6670).

Nominal and real effective exchange rates of the lari also experienced acute movements throughout 2008 both appreciating by 14.4% and 9.6%, respectively.

DIAGRAM 2.2.1
USD/GEL Official Exchange Rate, TIBFEX 2006-2008

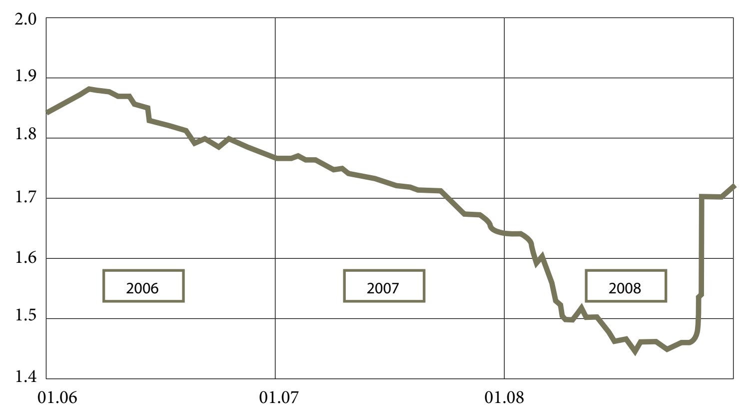


DIAGRAM 2.2.2
NBG Interventions at the TIBFEX, 2008
USD million

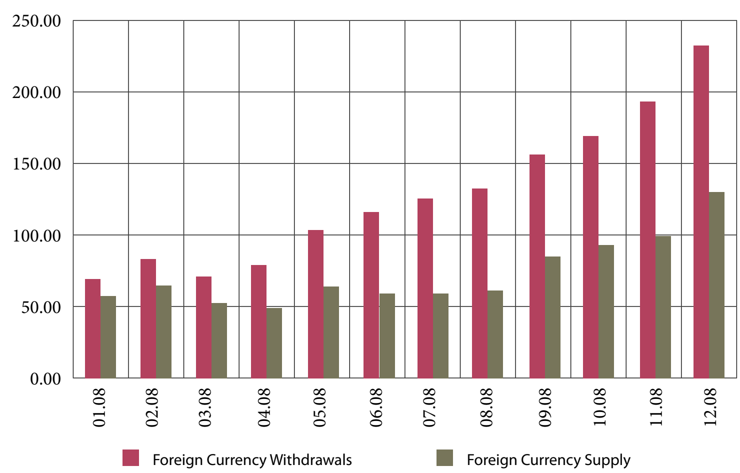


DIAGRAM 2.2.3
NEER and REER Indices (Dec 2006 = 100)

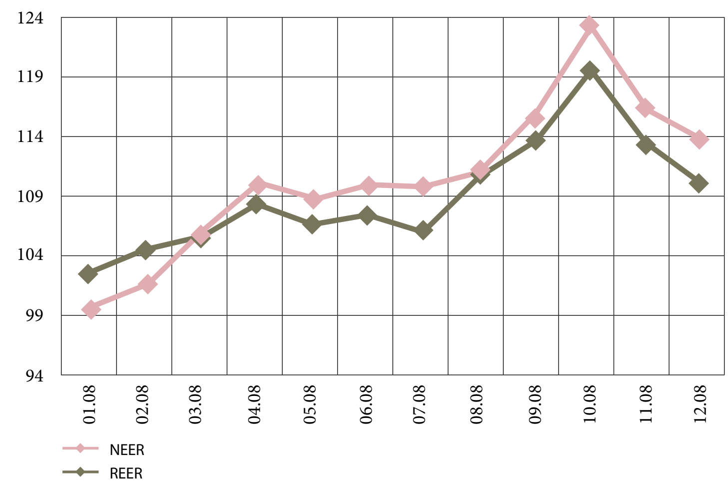
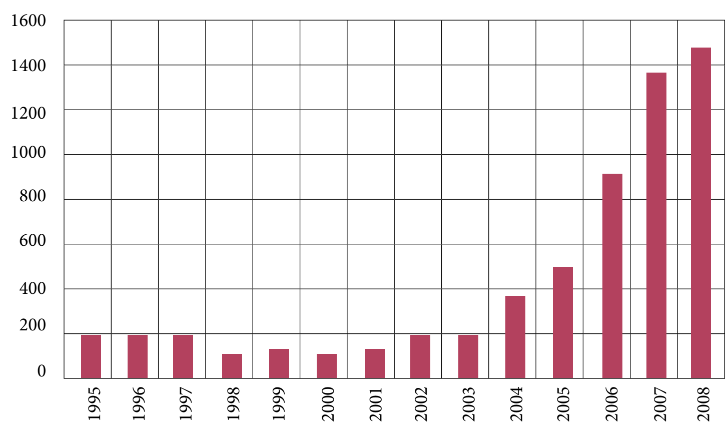


DIAGRAM 2.2.4
Official Reserve Assets, End-year Data, USD million



Dynamics of Foreign Reserves. As of December 31, 2008 the volumes of the NBG's foreign reserves amounted to USD 1 480.2 million, up 8.74% year-on-year.

It is remarkable that in 2008 the NBG net sales at the TIBFEX amounted to USD 389.49 million. Sources to the NBG foreign reserves growth were as follows: proceeds from privatization (USD 121 million), the IMF tranche (USD 240 million), the US budget support grant (USD 250 million), and other loans and grants received by the Ministry of Finance from donor countries. In addition to that, the growth of reserves was also augmented by proceeds from sales of Eurobonds and the subsequent money repatriation from the sovereign funds. Foreign reserves began to shrink in early August due to the ongoing military hostilities, and decreased by circa USD 360 million by end-September. Revenues received from the foreign reserves in 2008 amounted to GEL 70,667,926, down by GEL 26.4 million year-on-year. Such a decline represents an immediate consequence of interest rate cuts in international financial markets.

Demand of commercial banks for foreign currency banknotes drastically increased against the backdrop of tense situation developed in the country. In order to enable commercial banks to meet clients' demand, to retain stability and public confidence in the banking system, as well as to avoid sharp exchange rate movements in the country, the NBG, within the shortest possible time managed to provide the banking system with foreign exchange cash banknotes (the US dollar and the euro), and to render unimpeded services to commercial banks and the government, thus, succeeding to avoid negative implications in that critical situation.

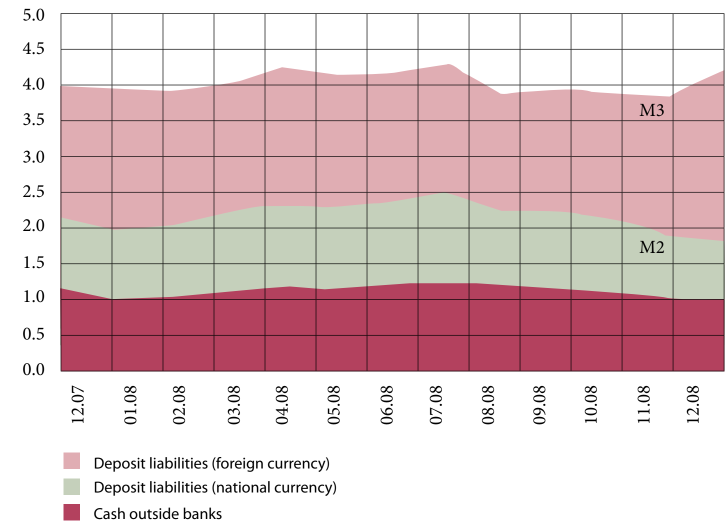
2.3 MONEY SUPPLY

In the accounting period the NBG conducted money supply taking into consideration relevant demand factors.

Money demand, in turn, was conditioned by such parameters as growth rate of the real economy, developments in the budgetary area, dynamics of inflation and exchange rate, movement of foreign exchange flows and seasonal factors.

Despite the fact that until August 2008, similar to the previous years, the monetary base tended to maintain high growth rates (for example, by end-June the annual growth rate equaled 34.1%), the consequences of the August war and the global financial crisis negatively impacted the monetary base leading to its essential contraction. In particular, in 2008 the reserve money shrank by GEL 139.7 million (7.8%) standing at GEL 1642.1 million by end-December. As it was pointed out, during January-August the monetary mass tended to grow. In this period the main determinants of money supply were foreign inflows and the state budget. One of the most important channels of money supply represented the NBG's FX interventions, against the backdrop of the foreign exchange market situation, whereas the active issuance of the CDs was used to counter those interventions. Since August, the reserve money mass shrank sharply, despite the NBG's efforts to put into operation a new monetary instrument of refinancing loans, and to provide commercial banks with the lender of last resort facility (the latter was absorbed by the banks in the amount of GEL 135.9 million). However, these measures allowed the NBG to maintain money mass expansion in September-October only, while in November and December the money mass growth plummeted (-8.6% and -7.8%, respectively).

DIAGRAM 2.3.1
Money Aggregates (GEL, billions)



In 2008 money demand was traditionally determined by economic growth and seasonal factors. The annual growth rate of the GDP equaled only 2.1%. Taking into account the above actors, by end-year data, the broad money M3 grew just by 7% (GEL 277.7 million). To make a comparison, by end-2007 the annual growth of the money mass amounted to almost 50%. Higher growth rate of the nominal GDP compared to the money demand implied the decrease of the monetization ratio. By end-year data, the monetization ratio for the M3 money aggregate decreased from 23.7% to 22.6%. The broad money M2 fell by 13% (GEL 286.8 million), leading to a decrease of the corresponding monetization ratio from 12.6% to 9.8%.

Deposit liabilities of the banking sector grew by GEL 347.2 million (12.1%) equaling GEL 3,222.6 million. Growth of deposits was solely ascribed to deposits placed in foreign currency.

TBALE 2.3.1
Reserve money, end-month data, 2008 (GEL, millions)

	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oqt-08	Nov-08	Dec-08
Reserve money	1,781.8	1,628.4	1,689.9	1,731.2	1,833.5	1,821.7	1,901.1	1,968.9	1,716.7	1,836.9	1,696.4	1,476.0	1,642.1
Cash in circulation	1,310.5	1,191.8	1,228.1	1,296.3	1,404.9	1,354.8	1,416.9	1,476.2	1,449.6	1,407.6	1,355.8	1,253.6	1,290.7
Bank deposits	471.3	436.5	461.8	434.9	428.6	466.9	484.3	492.7	267.1	429.3	340.6	222.4	351.4
Balances on the corresponding account	277.1	278.2	287.7	282.5	282.8	304.5	296.1	284.6	150.4	88.2	103.4	114.1	121.2

TBALE 2.3.2
Money aggregates, 2008 (GEL, millions)

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oqt-08	Nov-08	Dec-08
Money aggregate(M3)	4,056.9	3,993.4	4,075.9	4,333.9	4,206.6	4,234.1	4,373.5	3,941.2	4,017.8	3,936.6	3,966.1	4,305.1
Money aggregate(M2)	2,047.8	2,081.5	2,276.1	2,380.8	2,333.7	2,432.5	2,529.8	2,294.4	2,280.4	2,190.2	1,926.8	1,862.5
Cash outside banks	1,045.9	1,075.5	1,132.1	1,232.8	1,193.0	1,239.0	1,299.0	1,256.3	1,204.9	1,159.1	1,064.8	1,082.6
Deposits in the national currency	1,001.8	1,006.0	1,144.0	1,148.0	1,140.7	1,193.5	1,230.8	1,038.1	1,075.5	1,031.1	862.0	779.9
Deposits in foreign currency	2,009.2	1,911.8	1,799.8	1,953.1	1,872.9	1,801.6	1,843.8	1,646.8	1,737.4	1,746.3	2,039.3	2,442.6

Deposits placed in the national currency fell by GEL 217.3 million (21.8%). However, decrease of deposits in the national currency is mainly due to the shrinking deposits of the legal persons.

Compared to the previous years, slow growth of deposit expansion exerted an adequate influence on the crediting ability of the commercial banks, which was reflected in the levels of lending to the economy and interest rates.

In particular, interest rates on bank loans rose sharply. At end-2008, the year-on-year interest rate growth was from 19.2% to 22.7% for total loans, from 19.6% to 24.1% for loans in the national currency, and from 18.7% to 21.9% for loans in foreign currency. Meanwhile, the spread between the interest rates on bank deposits and loans denominated in the national currency grew from 7.6 percentage points to 12.7 percentage points.

Thus, money demand dynamics in 2008 was particularly unpredictable due to the processes taking place in the country. Despite the fact that the accounting year can be divided into essentially different periods with dissimilar levels of economic activity, reversal of the dedollarization trend, increased budget deficit, the NBG succeded to maintian money supply at the optimum level by means of changing the key policy rate and using appropriate monetary instruments.

2.4 MONETARY POLICY INSTRUMENTS

In January-July 2008 the Georgian banking sector operated in conditions of excessive liquidity, with high growth rate of loans creating financial stability and inflationary risks. The NBG tightened monetary policy accordingly, using such instruments as CDs and overnight loans. In H2, impacted by the August war and the financial crisis, the situation reversed as the banking system faced liquidity crunch. Accordingly, the NBG loosened monetary policy, and, in parallel to lowering interest on a few instruments, introduced a new policy instrument – refinancing loans.

OVERVIEW OF THE CD MARKET

In 2008 the primary instrument for withdrawing excess liquidity represented the Certificates of Deposits. In particular, the CDs with three-month and one-week maturity were used. It is the three-month CDs which were used for excess liquidity withdrawal. In turn, the maximum interest rate on the NBG's one-week CDs acted as the key policy rate until the abolishment of the CDs. Until September, by the decisions of the Monetary Policy Committee, the key policy rate was increased a few times reflecting the tightening monetary policy in H1.

TABLE 2.4.1
Key Policy Rate Changes by the MPC, 2008

Date of the MPC decision	Decision
23.01.08	Policy rate increase from 9% to 10%
20.02.08	Policy rate increase from 10% to 11%
16.04.08	Policy rate increase from 11% to 12%
20.08.08	Policy rate decrease from 12% to 11%
02.09.08	Introduction of refinancing loans
10.09.08	Policy rate decrease from 11% to 10%
26.11.08	Policy rate decrease from 10% to 9%
24.12.08	Policy rate decrease from 9% to 8%

Overall, in January-August 2008 GEL 1,150.2 million worth of 7-day CDs was placed at the auctions. During 2008 the value of 3-month CDs placed at the auctions stood at GEL 692.6 million.

In H1 2008 the liquidity absorption from the banking system by means of the CDs reached maximum in end-March[8] and early April. In October net absorption[9] fell to a zero mark becoming negative in December, as the NBG priority during this period

8 On March 31, 2008 liquidity withdrawal by means of CDs reached a record high GEL 467.2 million.
9 Net absorption represents liquidity withdrawal by means of CDs minus loans extended by the NBG to the commercial banks

consisted in liquidity supply instead of liquidity absorption.

REFINANCING LOANS

In conditions of increased demand for liquid funds, higher business risks, slowdown in banking and overall economic activity, the NBG loosened its monetary policy switching to liquidity supply from September. A new monetary policy instrument was introduced – refinancing loans (with 7-day maturity[10]), with the annual interest rate thereof becoming the NBG's key policy rate. Accordingly, these loans assumed an important role or forming interest rates in the economy. Supply of refinancing loans is conducted by means of auctions, with the total value of the loans to be backed by state or the NBG's securities, or foreign currency placed by commercial banks on the NBG's corresponding account.

The impact of the key policy rate on the economy is reflected through changes in interbank interest rates. However, the impact of the policy rate was limited due to the fact that the interbank market is not sufficiently developed in Georgia. Lending among banks, except for overnight loans, did not take place every day. In addition, there was a scarcity of transactions and participants observed in the interbank loan market limiting competition. Overall, the correlation rates of the key policy rate with TIBR-7[11] and TIBR-1 indices equaled 0.58[12] and 0.56, respectively.

OVERNIGHT LOANS

Overnight loans are used for providing liquidity to the banking system and maintaining stability in the sector. In case of liquidity deficit, banks may obtain overnight loans from the NBG by pledging the NBG's CDs, Treasury notes, Treasury bills of the Ministry of Finance, and their own foreign currency placed on the NBG's corresponding account. The interest rate on overnight loans is, as a rule, higher than the key

DIAGRAM 2.4.1

Refinancing Loans, Their Annual Weighted Average Interest, and Key Policy Rate

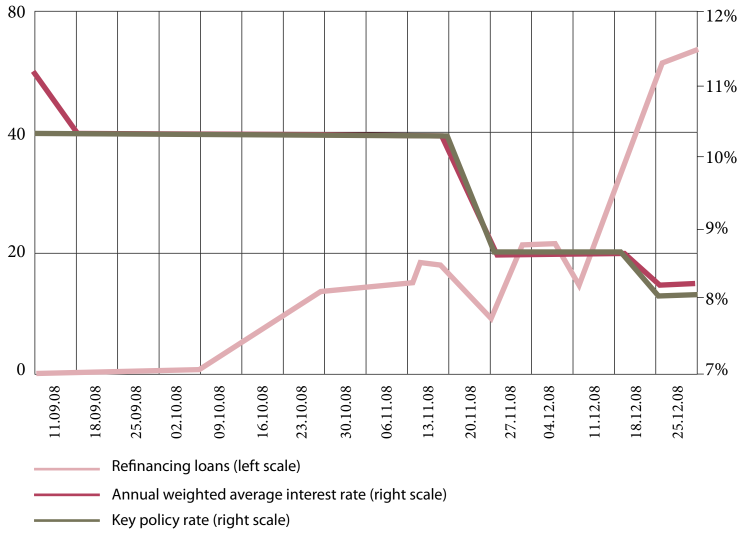


DIAGRAM 2.4.2

Impact of the NBG Policy Rate on Market Interest Rates

10 There were cases when refinancing loans were provided for 6 or 8 days.

11 TIBR–1 index includes non-secured loans with 1-day maturity. TIBR-7 index includes loans with 7-day maturity as well as all types of unsecured loans which are not comprised by TIBR-1.

12 The correlation rate is calculated for the period between February 20, 2008 and December 31, 2008

policy rate, creating incentives for commercial banks to seek necessary liquidity in the interbank market first before applying to the NBG.

In 2008 the total volume of the NBG's overnight loans to commercial banks equaled GEL 3,409.2 million, compared to only GEL 90 million in 2007 during September (launch of the facility) until the end-year.

Demand for overnight loans was high in January-February and, particularly, in April-May of 2008, stemming from aggravation of liquidity deficit. In order to meet the increased demand, the NBG expanded the overall daily limit of overnight loan indebtedness from GEL 75 million to GEL 150 million.

REQUIRED RESERVE RATIO

One of the instruments of the NBG's monetary policy is the required reserve ratio. By means of this instrument, the NBG affects the money multiplier. During January-July 2008 in parallel to the rapid development of the banking sector, banks increased attracted funds, which implied increase of required reserves as well. During this period, the required reserve ratio equaled 13% for funds attracted in the national and foreign currency, except for funds mobilized from non-residents[13].

The August military hostilities brought about essential changes in the banking system. Although lending plummeted, in the post-war period there was a leakage of bank deposits essentially jeopardizing banks' liquidity position. In order to provide commercial banks with sufficient liquidity, they were initially relieved from observing the required reserve ratio, subsequently being allowed to cover 25% of the reserve requirements. Since October 2 the required reserve ratio was reduced from 13% to 5%.

In 2008 the reserve requirement provisions for funds attracted in the national and foreign currency were made in the lari and the US dollar, respectively. Starting from QII it was made possible to keep required reserves in the euro for funds attracted in the euro, on the banks' appropriate reserve account. Commercial banks received an annual 2% interest on their required reserves covering funds attracted in foreign currency. However, since November this rule was changed, and the accrued interest on reserves placed in the US dollar and the euro has been determined as the respective key policy rate of the Fed and the ECB minus 0.5 percentage points.

13 The required reserve ratio does not comprise funds attracted from non-residents.

3. BANKING SECTOR

As of December 31, 2008 the Georgian banking system comprised 20 banking institutions, of which 18 commercial banks represented Georgian resident banks, and the remaining 2 were subsidiaries of a Turkish and an Azerbaijani bank. In the same period there were 683 units of commercial banks (125 branches and 559 service centers). For comparison, at end-2007 there were 540 structural units operating.

In the accounting period a launch of new commercial banks in Georgia should be pointed out, in particular, those are the JSC "HSBC Bank Georgia" and the JSC "Progressbank". The shareholders of the bank are the „HSBC Europe (Netherlands) BV" registered in the Netherlands (accounting for 70% of the stocks) and the „Wings Establishment" registered in Lichtenstein (30% of the stocks). The JSC „Progressbank" is fully owned by the LLC „Kala Capital".

During the last few years growth rates of the banking sector significantly exceeded growth rates in the other sectors of the economy. This tendency continued in H1 2008 when the volume of total assets, liabilities, and authorized capital soared. However, after the August war the tendency discontinued, and the quantitative indicators of the banking sector remained approximately on the same level.

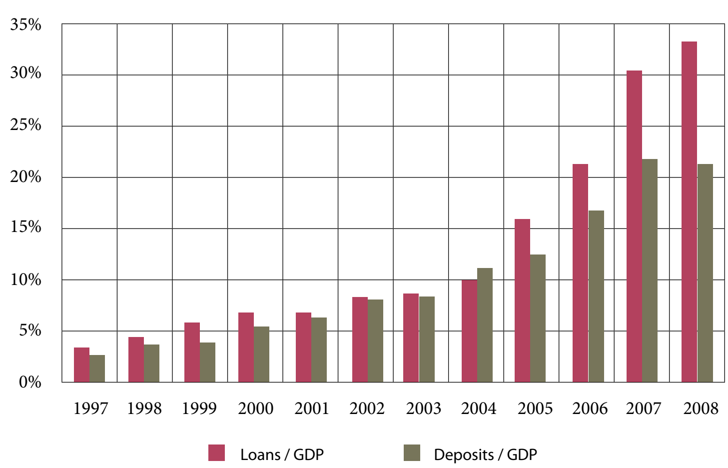
Overall, in 2008 the total assets of the banking sector grew from GEL 7,208 million to GEL 8,866 million. In the same period the volume of total liabilities increased from GEL 5,737 million to GEL 7,348 million, while the authorized capital grew from GEL 1,471 million to GEL 1,517 million. Growth of banking assets was equally conditioned by the increase of money funds and net loans as well as by the increase of fixed and intangible assets.

Total outstanding loans of commercial banks rose 31% in 2008 exceeding the GEL 6 billion mark. The loan- to-GDP ratio was at 31.8% in 2008, up from 27.5%.

Along with the growth of the credit portfolio, the volume of attracted deposits in the banking sector was also increasing. In H1 2008 the volume of deposits in the national currency grew (from GEL 997.2 million to GEL 1,193.5 million), while the volume of deposits in foreign currency fell (from GEL 1,878.2 million to GEL 1,801.6 million). However, this tendency unambiguously reversed in H2, as the volume of deposits in the national currency plummeted. Only during 5 war days in August the volume of deposits fell by 10%, although with the stabilization of the situation a large share of withdrawn deposits was recovered by the banking sector.

During 2003-2007 the return on assets (ROA) and the return on equity (ROE) in the Georgian banking sector averaged 2.7% and 12.7%, respectively. Unfortunately, as a result of economic and financial problems emerged in H2 2008, banks' profitability sharply declined. Total losses of the banking sector in 2008 amounted to GEL 215.7 million. A significant part of the banking losses was due to additional provisions made for negatively classified loans. In particular, commercial banks increased possible loan loss provisions[14], with the latter amounting to 9.0% of the total assets in 2008. The same figure stood at 3.6%

DIAGRAM 3.1.
Loan-to-GDP and Deposit-to-GDP Ratios



14 Unless there was materialization of risks, these funds will be added to banks' profit in the next year.

DIAGRAM 3.2
Profitability Dynamics in the Banking Sector (2003-2008, GEL million)

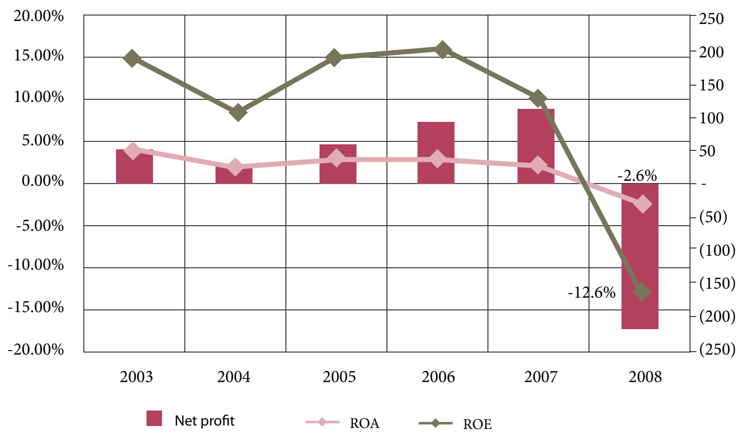
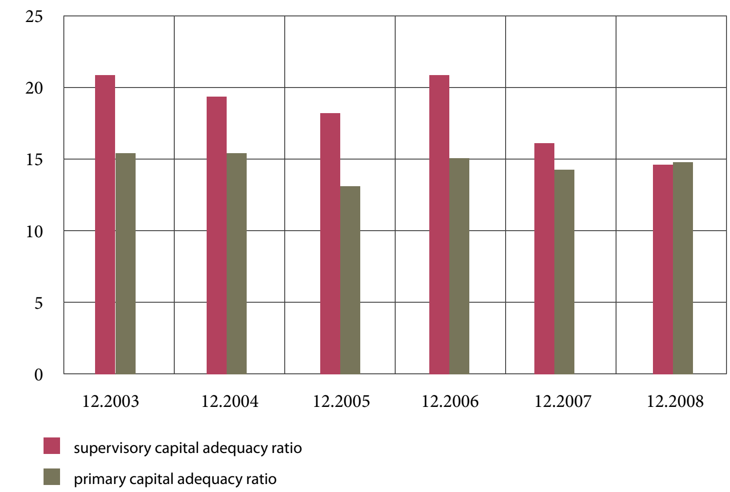


DIAGRAM 3.3
Capital Adequacy Ratios



only in 2007. As regards the operational banking indicator (profits before LLP), it stood at GEL 392 million.

In the beginning of 2009 the largest Georgian banks were facing the repayment deadlines on funds attracted from abroad. Under these circumstances, banks often managed to extend the repayment deadlines, which was favorable for both lenders and borrowers. However, against the backdrop of the global financial crisis there emerged a threat that foreign lenders will not roll over loans to the Georgian banks any more. The Georgian banks started preparations for this kind of a situation in time. In October the banks held around GEL 150-300 million of excess liquidity.

A crucial factor for stabilizing the situation represented the decision of international organizations to provide additional financing to the Georgian banks. At end-2008 the Georgian banks made an agreement with the International Finance Corporation, the European Bank for Reconstruction and Development, the US Overseas Private Investment Corporation, the German Kreditanstalt für Wiederaufbau, the Dutch Development Finance Company (FMO), the parent banks and finance groups on allocation of additional funds. As a result, the Georgian banks obtained funds in the form of loans, subordinated loans, and direct participation in equity capital. In total, these funds were sufficient for the banks' needs to meet their foreign liabilities without shrinking loan portfolio.

At end-2008 the banking sector fully satisfied the capital adequacy coefficients. The regulatory capital adequacy level is traditionally high. Despite certain decline in 2008, it still remains higher than the 12% requirement, equaling 13.9%. Primary capital adequacy ratio was even higher by end-year at 14.4%.

During 2008 the liquidity ratio of the banking sector, measured as total liquid assets divided by total liabilities, fell from 39% to 28%, which is also higher than the 20% requirement.

Overall, it should be pointed out that the Georgian banking sector had and presently has a strong ability to absorb shocks. This is due, on the one hand, to conservative supervisory requirements prompting low dependency on attracted funds, and, on the other hand, to a still low level of financial depth. All this, without the need of decreasing loans, and along with the ability to refinance foreign liabilities and to maintain confidence in the banking system, speaks of significant perspectives in the banking sector development.

4. PAYMENT SYSTEM

In the accounting period, the activities related to perfection of the payment system, improvement of the infrastructure and its servicing were under way. In this regard, a number of activities should be pointed out: in particular, exploitation and servicing the systems related to settlement activities (RTGS, MGR, ODB), the clearing system for "Visa" card transactions in the national currency (GNNSS), processing information related to the CDs and Treasury Notes auctions, services related to different types of accounts in the national and foreign currency at the NBG. In addition, the activities have been performed for the Treasury Agency of the Ministry of Finance with regard to servicing currency conversions, payment orders, and letters of credit as well as collecting payments.

In 2008 by means of the RTGS system 5,249,614 payment documents were processed in the total value of 52,246,786,589 lari. Year-on-year growth in quantitative terms equaled 3%, and in value terms – 43%.

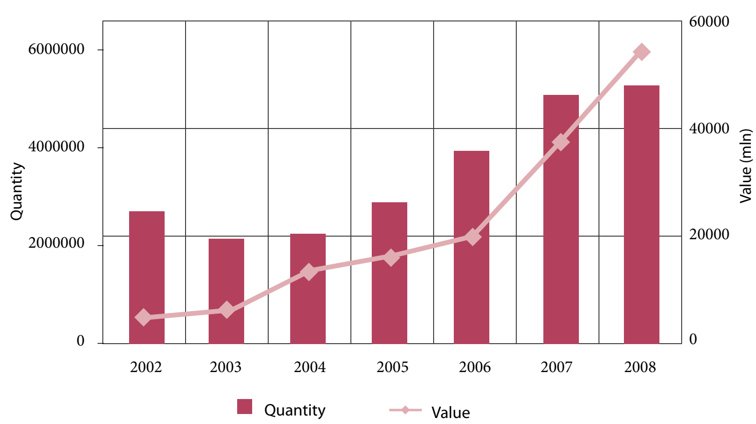
By means of the GNNSS (Visa settlement system) the total volume of processed information in value terms equaled 41,441,262 lari.

In 2008 among completed activities a special emphasis should be made on the draft reform of the National Payments System (Real Time Gross Settlement and Government Securities System). In this reform the NBG benefited from the World Bank technical assistance. Within the scope of this project, on July 10, 2008 the NBG announced an open international two-stage tender for the supply and full implementation of the System. Tender documentation was received from five companies (almost all companies dealing with these activities worldwide), which (except for one company) made presentations of the systems at the NBG.

Based on the evaluation of the proposed systems, those three companies qualified for the second stage of the tender, whose functional and technological capabilities as well as other components of the systems were fully in line with the NBG's main principles and strategic directions.

An important event of 2008 represented the establishment of the "National Payment Committee" aimed at promoting reforms in this area. The relevant normative act was the Decree #336 of the President of the NBG dated December 5, 2008. The members of the Committee are the representatives of large Georgian commercial banks, the Georgian Banking Association, the Ministry of Finance of Georgia, the Financial Supervision Agency, and the National Bank of Georgia.

DIAGRAM 4.1
Document Turnover Indicators of the RTGS System (2002–2008)



5. INTERNAL AUDIT AND ACCOUNTING

In the accounting period the Internal Audit unit of the NBG followed the "risk-based planning methodology" and conducted its activities in line with the plan approved by the NBG Board. Throughout 2008 the Internal Audit conducted 21 planned and 2 ad hoc internal audit examinations and revisions.

In the accounting period the Internal Audit systematically conducted monitoring of its recommendations made as a result of examinations in the preceding period, in line with the "Policies and Procedures for Preparing Report on Monitoring and Progress Status of Fulfilling Recommendations Made by the Internal Audit". In addition, the internal audit unit cooperated within the scope of its competences with external auditors playing an essential role in monitoring the implementation of their recommendations, in line with the "Policy and Procedures Related to Monitoring the Implementation of the External Audit Recommendations".

In the accounting period the Internal Audit elaborated methodological documents to promote further improvement of quality of services rendered. In particular, with the purpose of implementing international best practice in the important areas of internal audit activities, based on relevant standards and own experience the "Regulations on Preparation and Submission of the Report on Internal Audit Examination Conducted by the Internal Audit of the National Bank of Georgia" have been prepared. Also, the "Policies and Procedures for Documenting Internal Audit Activities" have been elaborated, whose primary goal was to provide issues and conclusions in the internal audit reports with reliable and relevant documentation, to ensure their systematization, and formalization of storage procedures.

In the accounting period, the Internal Audit cooperated with the IMF Financial Stability Assessment mission. The unit also cooperated with the internal audit units of other central banks.

In 2008 the activities aimed at improving the system of financial reporting and accounting, setting relevant priorities and raising efficiency, were under way. In this regard particular attention was paid to implementation of recommendations made by internal and external audit.

In accordance with the recommendations of the IMF Financial Stability Assessment mission, in the accounting period amendments were made to the relevant Article of the Organic Law of Georgia "On the National Bank of Georgia", recognizing international standards of financial accounting as the basis for conducting accounting activities in the NBG. Amendments were introduced to the Part of the Law "Financial Provisions".

6. ORGANIZATION OF CASH EMISSION ACTIVITIES

In order to smoothly provide the economy with the banknotes, in the accounting period the activities were under way related to perfection of money processing, improvement of the expertise of banknotes and coins, disposal of worn out cash banknotes, propaganda of the national currency, and perfection of the legal basis.

As of December 31, 2008, the volume of cash in circulation, including cash balances of commercial banks and organizations, amounted to GEL 1,290.7 million. Banknotes accounted for GEL 1,266.1 million (58.6 million notes), while the value of coins equaled was GEL 24.6 million (128.2 million pieces), including coins with 1- and 2-lari face value and 10-lari jubilee coins (See Diagram).

At the end of the accounting period, banknotes accounted for 98.1% of the total value of cash in circulation, with the coins accounting for the remaining 1.9%.

Compared to the beginning of 2008, cash in circulation as of December 31 declined by 1.51%, where the value of banknotes fell by GEL 20.1 million and the value of coins went up by GEL 311.6 thousand. In 2007 the volume of cash in circulation grew by circa 41.0%, with the value of banknotes increasing by GEL 371.4 million, and that of coins going up by GEL 9.5 million. (See Diagram for dynamics of cash in circulation in 2007-2008).

It should be noted that in early 2008 cash in circulation tended to increase, similar to the previous periods. In particular, in H1 there was a certain decrease in the demand for money due to a slowdown in economic activity, with a gradual recovery starting in June. In the beginning of August demand for money reached its peak. However, due to the following events taking place in the country, demand for the national currency fell with demand for foreign currency rising.

In the accounting period there was a slight increase in demand for high denomination banknotes. In particular, while 50-, 100-, and 200-lari banknotes accounted for 65.6% of the value of total cash in circulation in early 2008, this figure rose to 65.6% by the end of the accounting period (the share of 200-lari banknotes only grew from 8.7% to 13.0%). The share of other banknotes' value in circulation fell from 32.6% to 31.9%.

In the accounting period the process of recalculation and disposal of unusable (worn out) banknotes

DIAGRAM 6.1
Cash in Circulation

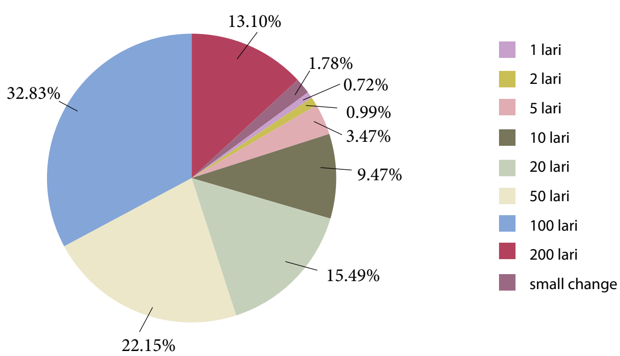


DIAGRAM 6.2
Dynamics of Cash in Circulation in 2007-2008 (GEL million)

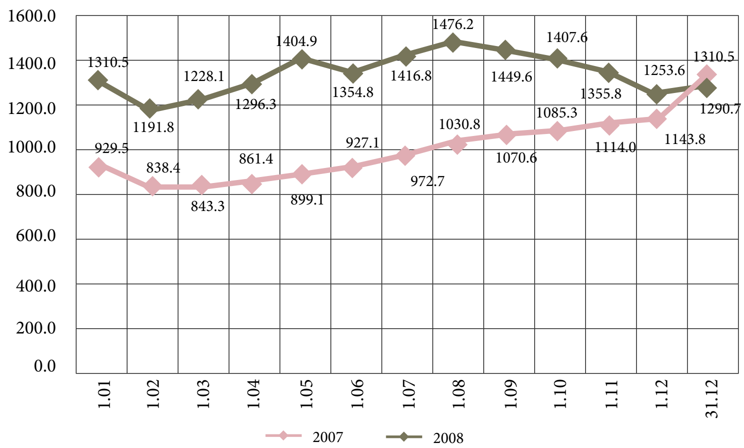


TABLE 6.1
Fake Currency by Denomination:

Banknotes	Number
1 lari	25
2 lari	104
5 lari	1 127
10 lari	560
20 lari	410
50 lari	88
100 lari	71
200 lari	213
5 dollar	3
10 dollar	2
20 dollar	4
50 dollar	97
100 dollar	435
20 pound	1
20 euro	20
50 euro	6
100 euro	22
200 euro	34
500 euro	2
500 ruble	2
1000 ruble	5

Coins	Number
10 lari	4
1 lari	2 421
2 lari	2
50 TeTri	3 802
1 pound	1
2 euro	1

DIAGRAM 6.3
Number of Fake Lari Banknotes Identified in 2007-2008

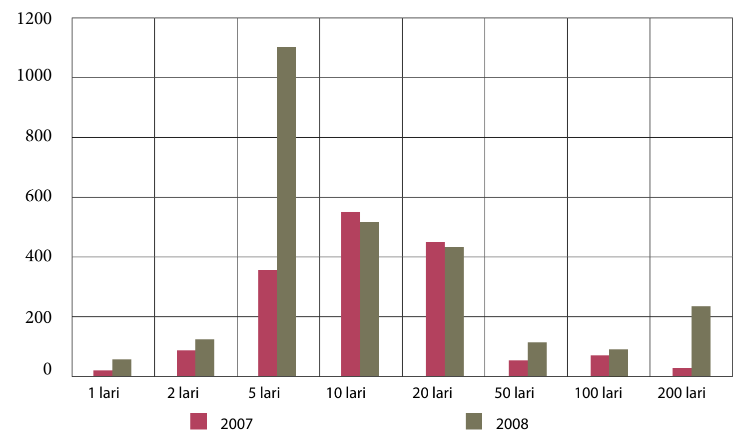
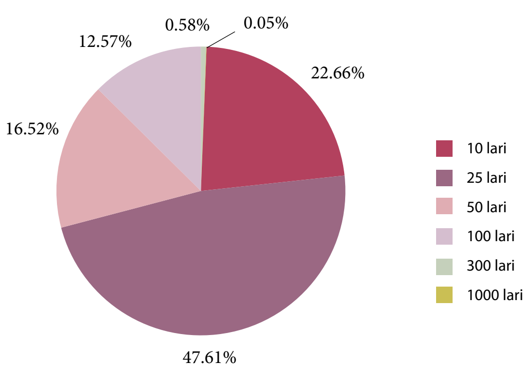


DIAGRAM 6.4
The 2008 Sales of Gold Investment Coins



accumulated in the NBG's vaults took place. In order to conduct this activity in an organized and safe way, a special Commission was established which included representatives from the NBG, the Ministries of Justice, Internal Affairs, and Economic Development. Overall, banknotes worth of GEL 1,292,401,960 (181,374,025 pieces) were disposed of, with the total weight of 128.8 tons.

As a result of expertise of currency received from the NBG's cash centre and branches, commercial banks, foreign exchange bureau, the Financial Police of the MoF, the following fake banknotes and coins were identified:

The number of fake 50-tetri coins identified in 2008 grew 63.2%, while the number of fake banknotes increased by 66.8% (See. Graph below for 2007-2008 details on fake lari banknotes in terms of face value). The number of fake US dollar banknotes grew 22.7%, and that of euro notes – 3.8 times) year-on-year. As regards fake 1-lari coins, in 2007 only 17 of those were identified, while in the accounting period this number soared to 2421 (i.e. grew 142.4 times).

In the accounting period the National Bank provided methodological guidance to commercial banks and foreign exchange bureaus, as well as to legal and physical persons in improving personnel qualification. In particular, training programs were provided for personnel dealing with cash in the banking and non-banking sectors, overall 682 cashiers have been trained. Cash collection training has been provided to 38 cash collectors.

The Museum of Money and the Kutaisi branch continued sales of investment and jubilee coins.

In 2008 total sale revenues amounted to 1,346,365 lari (of which 1,169,462 lari falls on sales of gold investment coins). The 2008 sale revenues grew by 330,035 lari against the 2007.

The 2008 sales of gold investment coins exceed the 2007 amount by 31.2% (the 2008 sales totaled 891,346 lari).

The NBG will continue to provide new and interesting coins to local and foreign numismatists.

7. PUBLIC RELATIONS AND INTERNATIONAL COOPERATION

In order to ensure maximum transparency of the NBG's activities and promptly provide information to the public on the current processes in the banking system, the NBG promptly disseminated press releases and statistica data, regularly conducted relevant press conferences, briefings, conferences, seminars, presentations, and meetings.

In order to promptly and objectively provide information about the NBG's activities, two trainings for journalists have been conducted in the accounting period.

In 2008 the NBG prepared and released the following publications: "The National Bank of Georgia, Main Directions and Functions" (in Georgian and English); "The 2007 Annual Report of the National Bank of Georgia (in Georgian and English); "Monetary and Fiscal Review" (monthly, in Georgian); "Inflation Report" (quarterly, in Georgian and English); "The 2008 Financial Stability Report" (in Georgian and English); "The 2007 Balance of Payments of Georgia" (annual, in Georgian); "Bulletin of Monetary and Banking Statistics" (quarterly, in Georgian and English. 2007 Annual and first three quarters of 2008).

Electronic versions of the NBG's publications are available on the NBG's official web site (www.nbg.gov.ge).

In the accounting period, in order to deepen international cooperation and share experience with foreign central banks in different areas, the NBG cooperated with central banks of many countries, including Finland, Sweden, Lithuania, Estonia, Czech Republic, Poland, Hungary, UK, Italy, Spain, Luxembourg, Austria, Turkey and Israel.

In 2008 a few IMF technical assistance missions visited Georgia. In line with international best practice, the missions helped the NBG and the FSA to set institutional relationships more efficiently. The IMF Financial Stability Assessment mission reviewed the NBG's control, accounting, recording, and audit systems to conclude that the NBG has developed and strong security mechanisms in place. With the help of the IMF technical assistance the International Transaction Reporting System has been successfully installed in Georgia.

Within the framework of cooperation with the World Bank, the NBG has initiated two important projects in 2008. In particular, this includes implementation of new systems related to new, modern and secure real-time interbank settlement, and improvement of international reserve management. In this spheres the NBG benefits from assistance provided by World Bank hired international experts.

8. THE NBG PERSONNEL AND CAPACITY BUILDING

In 2008, with the purpose of optimizing the NBG's organizational structure, a certain enlargement of the NBG's departments took place. In line with the changes made to the Organic Law of Georgia "On the National Bank of Georgia" and due to the fact that the supervisory functions related to commercial banks and non-bank deposit institutions were transferred to the Financial Supervision Agency (FSA) of Georgia, in May 2008 the Supervision Department of the National Bank of Georgia has been abolished.

On July 31, 2008 the Batumi, Poti, and Gurjaani branches of the NBG were abolished.

In the accounting period the number of actual NBG personnel was reduced by 307 persons. This was mainly due to personnel cuts related to reorganization, ceasing of operations of the NBG's branches, and outsourcing of certain types of technical services.

At end-2008, women accounted for 55% of the NBG's personnel. 86% of the personnel had higher education. The age structure of the personnel was as followed: under 31 – 13%, 31-51 – 66%, over 51 – 21%. The structure of personnel by length of service reveals three major groups: less than 10 years – 34%, 10-20 years – 46%, and over 20 years – 14%.

In 2008 improvement of qualifications of the NBG's personnel which involved training abroad took place mainly by means of foreign financing. In the accounting period 104 NBG stuff members participated in the seminars conducted in the Banque de France, the Deutsche Bundesbank, the National Bank of Poland, the Joint Vienna Institute and the IMF Institute, as well in the central banks of other countries.

In May and June 2008, with the support of foreign counterparts, 3 seminars were conducted in the NBG by the Luxembourg Financial Technologies Transfer Agency. These seminars were attended by the personnel of the NBG and commercial banks.

9. DEVELOPMENT OF THE LEGAL BASIS

In 2008 the number of the NBG normative acts adopted and registered in the Registry for Normative acts equaled 12. These include, in particular:

Decree N344 of the President of the NBG dated December 31, 2007 "On Approving Rule of Registering and Regulating Foreign Exchange Bureaus", which, in line with the amendments to the Organic Law "On the National Bank of Georgia, significantly simplified procedures related to regulation of foreign exchange bureaus. Namely, instead of obligatory licensing this type of activities are now subject to registration. Logistical requirements have also been simplified.

"Regulations for Implementation of Procurement by the National Bank of Georgia" approved by the NBG Board Resolution N2 dated February 15, 2008, which, in line with the NBG independence guaranteed by the Constitution of Georgia and the Organic Law of Georgia "On the National Bank of Georgia", define legal, organizational, and economic principles of procurement implementation.

The NBG Board Resolution N12 dated August 11, 2008 "On Approving the Regulation on Granting Loans to Commercial Banks by the National Bank of Georgia as a Lender of Last Resort", which defines the rules of providing credit to commercial banks by the NBG. The regulations aim at solving liquidity problems of the commercial banks, ensuring banking sector stability, avoiding systemic problems and possible crisis propagation.

Decree N234 of the President of the NBG dated September 2, 2008 "On Approving the Regulations on Granting Refinancing Loans to Commercial Banks by the National Bank of Georgia". In accordance with these regulations, with the purpose of managing liquidity and interest rates in the banking system the NBG extends refinancing loans to commercial banks –short-term funds under appropriate collateral.

The NBG Board Resolution N14 dated December 2, 2008 "On Approving the Rules of Destroying Paper Money (Banknotes) Withdrawn from Circulation", which stipulates the procedures related to destroying lari banknotes withdrawn from circulation or with production defects.

Legislative changes made on March 14, 2008 essentially changed the NBG activities, organizational and administration norms. In particular:

The main goal of monetary and exchange rate policy was defined as maintenance of the average annual growth rate of consumer prices in the medium-term period.

The notion of inflation targeting was defined, the responsibility of the NBG President was set with respect to the actual inflation rate.

The composition of the NBG Board, apart from the cases allowed by law, was defined to comprise 5 members.

The Monetary Policy Committee of the NBG was created, whose main function consists in elaborating monetary and exchange rate policy.

The financial provisions of the NBG activities related to net profit calculation and net loss distribution were adopted in the new version.

With the purpose of supervision the financial sector, a legal entity of public law – the Financial Supervision Agency of Georgia has been established.

10. STATISTICAL TABLES

1. Main Macroeconomic Aggregates

	Unit value	2000	2005	2006	2007	2008
I.Real Sector						
Nominal Gross Domestic Product	Mln GEL	6043.1	11620.9	13789.9	16993.8	19069.6
GDP per capita	GEL	1362.5	2689.1	3133.1	3866.9	4351.7
Volume of Industrial Production	Mln GEL	1793.4	3242.9	3952.7	4521.0	4993.6
Volume of Agricultural Production	Mln GEL	1857.2	2585.4	2341.7	2390.2	2623.2
Growth Rate in Real GDP	%	101.8	109.6	109.4	112.3	102.1
2. Inflation						
Consumer Prices Index	%	104.6	106.2	108.8	111.0	105.5
Food Products	%	107.5	108.4	109.3	111.4	104.8
Non-food products	%	99.2	103.3	109.2	107.9	104.8
Services	%	101.9	104.3	107.3	113.1	107.7
3. State Budget**						
Revenue	Mln GEL	640.2	2607.5	3293.3	4293.6	5517.7
of which tax revenue	%	68.4	70.4	64.7	70.1	82.3
Expenditure	Mln GEL	833.8	2618.6	2669.4	3890.0	5551.7
Deficit	Mln GEL	-193.6	-11.0	623.9	403.6	-34.0
Percentage of GDP	%	-3.2	-0.1	4.5	2.4	-0.2
4. Employment						
Employment	Thousand employees	1840.7	1744.6	1747.3	1704.3	…
Unemployment rate	%	10.3	13.8	13.6	13.3	…
5. Social Indicators						
Money Monthly Income of Households	Mln GEL	149.4	272.6	305.5	351.6	454.4
Expenditure	Mln GEL	246.7	309.1	333.7	373.0	452.7
Nominal Wages	GEL	72.3	204.2	277.9	368.1	539.6**
Growth of Nominal Wages	%	107.1	130.2	136.1	132.5	…
Growth of Real Wages	%	122.6	120.4	124.6	121.3	…
Minimum Cost of Living for:						
Adult Male	GEL	114.5	98.3	120.3	115.9	130.7
Average consumer	GEL	100.4	87.1	106.5	102.7	115.8
Average family	GEL	199.2	164.9	201.7	194.4	219.3

Source: Ministry of Economic Development, Department of Statistics; Ministry of Finance.

Notes:

a) December of the previous year is a basis for the CPI of the next year.

b) Mismatch between household income and expenditure is caused by unwillingness of households to fully reveal their income.

*) 9 months.

**) 2000–2005 – by old classification.

2. Consumer Price Indices

(Over December of the Previous Year)

	2005		2006		2007		2008	
	Price index	Monthly per-centage change	Price index	Monthly per-centage change	Price index	Monthly per-centage change	Price index	Monthly per-centage change
January	102.1	2.1	101.2	1.2	102.7	2.7	102.5	2.5
February	102.4	0.3	101.4	0.2	103.5	0.7	103.4	0.9
March	103.0	0.6	101.5	0.1	102.4	-1.1	103.5	0.1
April	103.5	0.4	103.3	1.8	102.7	0.3	103.8	0.3
May	102.1	-1.3	105.8	2.4	104.3	1.6	104.6	0.7
June	100.6	-1.4	105.6	-0.2	104.1	-0.2	104.5	-0.1
July	98.6	-1.9	106.4	0.8	104.3	0.1	103.2	-1.2
August	99.2	0.6	106.0	-0.4	104.9	0.6	106.7	3.4
September	101.1	1.9	106.0	0.0	106.2	1.2	105.8	-0.8
October	102.9	1.7	106.8	0.8	109.2	2.8	105.3	-0.5
November	104.3	1.4	107.9	1.0	110.7	1.4	106.0	0.7
December	106.2	1.8	108.8	0.9	111.0	0.3	105.5	-0.4

Source: Department of Statistics.

3. Annual Inflation

	2005		2006		2007		2008	
	12 month change	12 month average	12 month change	12 month average	12 month change	12 month average	12 month change	12 month average
January	9.3	6.1	5.2	7.9	10.4	9.6	10.7	9.3
February	9.2	6.3	5.1	7.5	11.0	10.1	10.9	9.3
March	9.7	6.6	4.6	7.1	9.7	10.5	12.3	9.5
April	10.3	7.0	6.0	6.7	8.1	10.7	12.2	9.8
May	8.9	7.3	10.0	6.9	7.3	10.4	11.2	10.2
June	9.0	7.8	11.4	7.1	7.3	10.1	11.3	10.5
July	6.0	7.8	14.5	7.8	6.6	9.4	9.8	10.8
August	7.2	8.0	13.4	8.3	7.7	9.0	12.8	11.2
September	7.7	8.1	11.2	8.6	9.0	8.8	10.6	11.3
October	7.8	7.9	10.2	8.8	11.2	8.9	7.0	10.9
November	7.9	8.3	9.8	8.9	11.6	9.1	6.3	10.5
December	6.2	8.2	8.8	9.2	11.0	9.2	5.5	10.0

Source: Department of Statistics.

4. Dynamics of Reserve Money and Its Structure
(End of period; Thous. of GEL)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Reserve Money												
2005	802537	828791	822638	852874	845680	889438	907915	931555	939546	957768	969178	1007368
2006	989149	1009984	984685	1040715	1026383	1067290	1122798	1111354	1115394	1101880	1270883	1272099
2007	1236050	1239090	1157369	1282871	1407816	1409355	1468365	1561322	1579084	1595492	1615265	1781802
2008	1628390	1689865	1731215	1833538	1821662	1901146	1968946	1716703	1836932	1696369	1475989	1642081
Currency in Circulation												
2005	634171	656852	662785	693144	683123	698215	730838	744967	750005	767996	753594	811400
2006	752834	759693	778939	795955	785653	807495	833762	841546	856959	839255	823901	929538
2007	838393	843298	861359	899127	927130	972672	1030849	1070629	1085260	1113966	1143785	1310488
2008	1191848	1228063	1296336	1404910	1354789	1416852	1476249	1449647	1407612	1355782	1253630	1290703
Balance on Banks Correspondent Accounts												
2005	57732	51950	58628	57843	50284	78568	64876	67520	67436	66100	85979	66135
2006	103132	112330	66412	101105	88771	86106	106278	71808	52954	54733	237092	118002
2007	178354	172144	64862	140216	174687	210549	191382	240580	236387	202729	208435	193061
2008	158104	173893	152157	145816	162319	188181	208115	116684	341116	237194	108216	230142
Required Reserves												
2005	90488	94344	97725	101887	108768	109141	110988	118348	122067	123171	129101	129833
2006	133183	137960	139334	143655	151959	158689	162958	177646	202331	206242	209890	224559
2007	219303	223649	231147	243528	305999	226134	246134	250113	257437	278798	263045	278253
2008	278254	287724	282537	282811	304555	296113	284582	150372	88204	103394	114144	121236

5. Dynamics of Money Aggregates
(End of period; Thous. of GEL)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Money Supply (M3)												
2005	1443563	1484314	1512412	1601587	1599309	1643988	1697075	1781527	1824447	1883967	1921281	1924919
2006	1956061	1986757	2023117	2187069	2185567	2307293	2346359	2397622	2448024	2468322	2524549	2689887
2007	2613987	2753554	2705882	2895427	2999459	3281910	3442747	3650827	3748029	3836584	3931101	4027469
2008	4056922	3993356	4075932	4333892	4206603	4234084	4373549	3941205	4017809	3936563	3966082	4305126
Money Supply (M2)												
2005	787580	809440	818036	861120	847809	894495	921353	972659	987143	1018412	1043039	1071039
2006	1055535	1057217	1092520	1147523	1158490	1258674	1255728	1260433	1279668	1247729	1242778	1392849
2007	1304141	1316010	1372487	1464488	1544770	1655771	1791198	1874078	1937606	2003664	2089028	2149311
2008	2047754	2081520	2276128	2380826	2333668	2432518	2529779	2294428	2280434	2190228	1926785	1862498
of which: Money outside Banks												
2005	577768	601686	613121	644084	628246	640135	668163	686582	689614	702863	688231	736284
2006	685795	692108	712598	717900	715217	733341	749754	756053	776625	758866	743278	827357
2007	743861	755503	765376	786906	823848	856423	913705	949535	956649	993026	1012029	1152070
2008	1045934	1075495	1132136	1232825	1192990	1239022	1299023	1256293	1204893	1159088	1064777	1082554
Deposits in National Currency												
2005	208766	206969	204225	216340	219076	253766	252823	285774	297004	315086	354117	334552
2006	369333	364778	379698	429180	442825	525086	505497	503938	502672	488260	498978	565143
2007	560281	560506	607111	677582	720923	799348	877494	924543	980956	1010638	1076998	997241
2008	1001820	1006026	1143992	1148001	1140678	1193496	1230757	1038134	1075541	1031140	862008	779944
Deposits in Foreign Currency												
2005	655302	674198	693708	739839	750959	749010	775241	808402	836850	865102	877892	853530
2006	900172	929184	930241	1039192	1026704	1048275	1087385	1133981	1165163	1217394	1278590	1293932
2007	1309845	1437544	1333396	1430939	1454688	1626139	1651548	1776749	1810423	1832919	1842074	1878158
2008	2009168	1911836	1799804	1953066	1872935	1801566	1843770	1646777	1737375	1746335	2039297	2442628

6. National Bank of Georgia Survey
(Thous. of GEL)

	01.01.08	01.04.08	01.07.08	01.10.08	01.01.09
Net Foreign Assets	1743371	1806776	1889735	1416965	1735735
Foreign Assets	2248289	2175124	2234411	2074651	2508306
Gold	0	0	0	0	0
SDR holdings	23533	3040	466	4945	20515
Foreign Exchange	2142832	2095690	2163569	1924562	2446882
Other Foreign Assets	81924	76395	70375	145144	40909
Foreign Liabilities	-504918	-368349	-344676	-657686	-772570
Use of IMF resources	-398876	-362514	-342335	-655645	-769409
Other Foreign Liabilities	-106042	-5835	-2341	-2041	-3161
Net Domestic Assets	50769	-74872	12601	421806	-92270
Net claims on general government	412084	398754	224874	346083	-99246
Net claims on central government	412084	398754	224874	346083	-99246
T-bill holdings	778467	778585	778585	779853	779664
Loans to central government	3	3	3	3	3
Deposits of central government	-366387	-379834	-553714	-433773	-878913
Loans from central government	0	0	0	0	0
Net claims on local government	0	0	0	0	0
Loans to local government	0	0	0	0	0
Deposits of local government	0	0	0	0	0
Claims on public nonfinancial corporations	98942	0	0	0	0
of which loans in foreign currency	98942	0	0	0	0
Claims on other nonfinancial corporations	0	0	0	0	0
of which loans in foreign currency	0	0	0	0	0
Claims on individuals	3575	3290	3310	3340	3951
of which loans in foreign currency	0	0	0	0	0
Net claims on banks	-303369	-392141	-180060	-17524	132100
Claims on banks	73172	75040	40	125495	209452
Liabilities to banks	-376541	-467181	-180100	-143019	-77352
Liabilities to resident financial institutions	0	0	0	0	0
Other items, net	-160463	-84775	-35523	89908	-129074
Reserve Money	1781802	1731215	1901146	1836932	1642081
Currency in circulation	1310488	1296336	1416852	1407612	1290703
Banks deposits	471314	434879	484294	429319	351378
Required reserves	278253	282537	296113	88204	121236
of which: foreign currency	277083	282479	296113	88204	121236
Correspondent account balances	193061	152157	188181	341116	230142
of which: foreign currency	6118	25798	1179	5874	88952
Other deposits	0	184	0	0	0
Deposits	12338	689	1189	1840	1385
National Currency Deposits	12338	688	1189	1837	1384
Foreign Currency Deposits	0	1	1	2	1

7. Other Depository Corporations Survey
(Thous. of GEL)

	01.01.08	01.04.08	01.07.08	01.10.08	01.01.09
Net Foreign Assets	-1276116	-1394522	-1742414	-1775897	-1738029
Foreign exchange reserves	604593	529232	580400	616067	1138783
Foreign securities	8263	7616	0	0	465
Foreign shares	3772	1367	1111	441	236
Loans to nonresidents	8754	8118	3545	3513	4168
Foreign liabilities	-1856939	-1905113	-2305291	-2374296	-2875365
Other foreign assets, net	-44559	-35743	-22178	-21622	-6316
Net Domestic Assets	4139176	4337630	4736287	4586973	4959216
Net claims on general government	-59354	-77389	-108688	-82838	-71951
Net claims on central government	30466	8083	1503	8259	-1081
T-bill & bond holdings	38185	28127	18063	18065	8019
Loans to central government	17135	14121	19876	26572	28014
Deposits of central government	-15938	-23481	-21605	-21045	-18397
Loans from the MOF to finance private business development	-8916	-10684	-14830	-15333	-18718
Net claims on local government	-49205	-44077	-46661	-44368	-23846
Loans to local government	0	0	0	0	0
Deposits of local government	-49205	-44077	-46661	-44368	-23846
Accrued tax liabilities	-40615	-41395	-63531	-46728	-47025
Claims on public nonfinancial corporations	47973	83069	77723	53278	74860
of which loans in foreign currency	23454	39554	39458	30164	21351
Claims on other nonfinancial corporations	3080225	3260257	3449776	3317819	3697428
of which loans in foreign currency	2213419	2244416	2381285	2405866	2885353
Claims on individuals	1506663	1725369	2068813	2134382	2291847
of which loans in foreign currency	939450	1048210	1199732	1268558	1495609
Other claims on private sector	224847	299895	252016	309939	348350
Bank reserves	627616	596389	660192	630377	558087
Lari holdings	158417	164200	177830	202719	208150
Required reserves	278253	282537	296113	88204	121236
Correspondent account balances	190946	149651	186249	339454	228702
Net claims on banks	25360	27555	-241811	-342622	-477382
Claims on ODCs	120534	384202	413736	322479	170915
Liabilities to ODCs	-418624	-748662	-835569	-682630	-516178
Claims on NBG	376450	467016	180022	142979	77281
Liabilities to NBG	-53000	-75000	0	-125450	-209400
Other items, net	-1314154	-1577516	-1421733	-1433362	-1462022
Other assets	788589	959047	1211868	1185067	1153771
Other liabilities	-2102743	-2536563	-2633601	-2618430	-2615793
Loans from other resident financial corporations	-220757	-196465	-195685	-195291	-231448
Money market instruments	0	-7828	0	0	0
Other liabilities	-1881987	-2332270	-2437916	-2423138	-2384345
Deposits	2863060	2943108	2993873	2811077	3221187
National Currency Deposits	984903	1143304	1192307	1073703	778560
Foreign Currency Deposits	1878157	1799803	1801565	1737373	2442627

8. Georgian Depository Corporations Survey
(Thous. of GEL)

	01.01.08	01.04.08	01.07.08	01.10.08	01.01.09
Net Foreign Assets	467255	412254	147321	-358933	-2294
Net Foreign Assets (NBG)	1743371	1806776	1889735	1416964	1735735
Net Foreign Assets (ODC)	-1276116	-1394522	-1742414	-1775897	-1738029
Net Domestic Assets	3560214	3663679	4086764	4376741	4307420
Domestic credit	5314955	5693246	5967823	6082003	6245238
Net claims on general government	352729	321366	116186	263245	-171198
Net claims on central government (NBG)	412084	398754	224874	346083	-99246
Net claims on central government (ODC)	30466	8083	1503	8259	-1081
Net claims on local government (NBG)	0	0	0	0	0
Net claims on local government (ODC)	-49205	-44077	-46661	-44368	-23846
Accrued tax liabilities (NBG)	0	0	0	0	0
Accrued tax liabilities (ODC)	-40615	-41395	-63531	-46728	-47025
Claims on public nonfinancial corporations	146916	83069	77723	53278	74860
Claims on public nonfinancial corporations(NBG)	98942	0	0	0	0
Claims on public nonfinancial corporations(DMB)	47973	83069	77723	53278	74860
Claims on other nonfinancial corporations	3080225	3260257	3449776	3317819	3697428
Claims on other nonfinancial corporations(NBG)	0	0	0	0	0
Claims on other nonfinancial corporations(DMB)	3080225	3260257	3449776	3317819	3697428
Claims on individuals	1510239	1728659	2072123	2137721	2295798
Claims on individuals(NBG)	3575	3290	3310	3340	3951
Claims on individuals(DMB)	1506663	1725369	2068813	2134382	2291847
Other claims on private sector	224847	299895	252016	309939	348350
Other claims on private sector (NBG)	224847	299895	252016	309939	348350
Other items, net	-1754742	-2029567	-1881059	-1705262	-1937818
NBG, other items	-935146	-911795	-699877	-356935	-348352
Net claims on banks (NBG)	-303369	-392141	-180060	-17554	132100
Liabilities to resident financial institutions (NBG)	0	0	0	0	0
Banks deposits (NBG)	-471314	-434879	-484294	-429319	-351378
Other items, net (NBG)	-160463	-84775	-35523	89908	-129074
ODC, other items	-819595	-1117772	-1181182	-1348327	-1589466
Required reserves (ODC)	278253	282537	296113	88204	121236
Correspondent account balances (ODC)	190946	149651	186249	339454	228702
Net claims on banks (ODC)	25360	27555	-241811	-342622	-477382
Other items, net (ODC)	-1314154	-1577516	-1421733	-1433362	-1462022
Money Supply (M3)	4027469	4075932	4234084	4017809	4305126
Money supply (M2)	2149311	2276128	2432518	2280434	1862498
Money outside Banks	1152070	1132136	1239022	1204893	1082554
Deposits in national currency	997241	1143992	1193496	1075541	779944
Deposits in foreign currency	1878158	1799804	1801566	1737375	2442628

9. Dynamics of Monetary Ratios

	Required Reserves	Com.Banks Correspondent Accounts in NBG	Cash in Com. Banks	Total Com. Banks Reserves	Dollarization Ratio,%	Money Multiplier (M2)	Money Multiplier (M3)	Velocity of Circulation (M2)	Velocity of Circulation (M3)
	procentulad komerciuli bankebis sadepozito valdebulebebTan								
2007									
January	11.75	9.56	5.06	26.37	70.04	1.06	2.11		
February	11.28	8.68	4.43	24.39	71.95	1.06	2.22		
March	11.91	3.34	4.95	20.20	68.71	1.19	2.34	12.38	6.28
April	11.55	6.65	5.32	23.52	67.86	1.14	2.26		
May	14.06	8.03	4.75	26.84	66.86	1.10	2.13		
June	9.32	8.60	4.79	22.72	67.04	1.17	2.33	10.26	5.18
July	9.73	7.57	4.63	21.93	65.30	1.22	2.34		
August	9.26	8.91	4.48	22.65	65.77	1.20	2.34		
September	9.22	8.47	4.61	22.30	64.86	1.23	2.37	8.77	4.53
October	9.80	7.13	4.25	21.19	64.46	1.26	2.40		
November	9.01	7.14	4.51	20.67	63.10	1.29	2.43		
December	9.68	6.71	5.51	21.90	65.32	1.21	2.26	7.91	4.22
2008									
January	9.24	5.25	4.85	19.34	66.73	1.26	2.49		
February	9.86	5.96	5.23	21.05	65.52	1.23	2.36		
March	9.60	5.17	5.58	20.34	61.14	1.31	2.35	8.38	4.68
April	9.12	4.70	5.55	19.37	62.98	1.30	2.36		
May	10.11	5.39	5.37	20.86	62.15	1.28	2.31		
June	9.89	6.28	5.94	22.11	60.15	1.28	2.23	7.84	4.50
July	9.26	6.77	5.76	21.79	59.97	1.28	2.22		
August	5.60	4.35	7.20	17.15	61.33	1.34	2.30		
September	3.14	12.13	7.21	22.47	61.76	1.24	2.19	8.36	4.75
October	3.72	8.54	7.08	19.34	62.87	1.29	2.32		
November	3.93	3.73	6.51	14.17	70.29	1.31	2.69		
December	3.76	7.14	6.46	17.36	75.80	1.13	2.62	10.24	4.43

10. Monetary Policy Interest Rate

Date	Interest Rates,%
23/1/08	10
20/2/08	11
19/3/08	11
16/4/08	12
14/5/08	12
25/6/08	12
23/7/08	12
20/8/08	11
10/9/08	10
17/9/08	10
15/10/08	10
26/11/08	9
24/12/08	8

Note: Until the August 20, 2008 7-day CD (Certificate of Deposit) rate was used as a Monetary Policy rate. Since then the 7-day Refinancing instrument was introduced for conducting monetary policy operations.

11. Assets and Liabilities of Commercial Banks
(Thous. of GEL)

	1.01.08	1.04.08	1.07.08	1.10.08	1.01.09
Cash	302607	346879	377025	403430	421319
Balances on Correspondent Accounts	1050605	1164671	1275520	1158611	1439111
Securities for Dealing Operations	3769	1131	884	238	719
Investment Securities	422420	502396	198160	161105	85403
Net Loans	4424689	4818142	5301132	5030920	5454833
Loans to State Sector	0	0	0	0	3
Loans to Private Sector (excluding Interbank Loans)	4580528	5003520	5527343	5428985	5982147
Interbank Loans	8811	8118	3545	9930	10730
Loan Loss Reserves (-)	164651	193496	229756	407995	538047
Accrued Interest and Dividends Receivable	63110	71611	74464	82319	98025
Equity Investments	215388	290672	244303	302198	340387
Fixed Assets	572546	616150	719957	789540	832553
Other Assets	153023	273446	414290	306593	193277
Total Assets	**7208158**	**8085099**	**8605735**	**8234954**	**8865627**
Liabilities	5737111	6332295	6813797	6509643	7348376
Deposits of Banks	296178	569676	628860	512824	277093
Non-bank Deposits	3215038	3303422	3445744	3186058	3567816
Demand Deposits	1592755	1601033	1616712	1544098	1697034
Term Deposits of Enterprises	487703	471485	500574	462246	547430
Term Deposits of Individuals	1069807	1163682	1260851	1115496	1281562
General Government Deposits	64773	67221	67607	64218	41790
Accrued Interest and Dividends Payable	85803	72201	85109	87261	106179
Borrowed Funds	1942394	2041836	2278319	2511567	3174137
Other Liabilities	197698	345161	375765	211933	223151
Equity Capital	1471046	1752804	1791939	1725311	1517250
Paid-in Capital	453991	547353	557546	591161	574293
Capital Reserves	669201	816461	833302	852776	849682
Retained Profits	347855	388989	401091	281373	93276
Total Liabilities and Equity Capital	**7208158**	**8085099**	**8605735**	**8234954**	**8865627**

12. Volume and Annual Weighted Average Interest Rates on Commercial Banks' Credits and Deposits

		1.01.08	1.04.08	1.07.08	1.10.08	1.01.09
		Thous. of GEL				
Loans in national currency to Enterprises and Households	Total	1408408	1662785	1903468	1674546	1544401
	Short-term	754340	868880	860052	645301	580656
	Long-term	654068	793904	1043416	1029244	963745
Loans in foreign currency to Enterprises and Households	Total	3096524	3239748	3534185	3597108	4278504
	Short-term	579820	663087	780715	744276	896941
	Long-term	2516704	2576660	2753470	2852832	3381563
Term deposits in national currency	Total	297732	395232	485066	372345	230270
	Short-term	246598	314453	418233	305150	186925
	Long-term	51134	80779	66833	67195	43345
Term deposits in foreign currency	Total	1259778	1239936	1276359	1205397	1598722
	Short-term	830843	807803	932422	891810	1269177
	Long-term	428935	432133	343937	313586	329546
		Interest Rates, %				
Loans in national currency to Enterprises and Households	Total	20.7	20.8	21.8	22.4	22.9
	Short-term	21.2	21.1	22.2	23.5	24.0
	Long-term	20.2	20.4	21.4	21.7	22.2
Loans in foreign currency to Enterprises and Households	Total	16.7	16.6	16.8	17.2	17.7
	Short-term	19.3	19.2	19.6	20.5	21.6
	Long-term	16.1	15.9	16.0	16.3	16.7
Term deposits in national currency	Total	9.4	8.6	9.6	9.9	10.0
	Short-term	8.6	7.3	9.0	9.0	9.2
	Long-term	13.1	13.6	13.5	13.9	13.9
Term deposits in foreign currency	Total	8.8	8.9	9.1	9.5	10.0
		7.6	7.7	8.3	8.8	9.6
	Long-term	11.1	11.2	11.1	11.4	11.7

13. Commercial Banks Loans
(Thous. of GEL)

	Total Loans	of which:	
		In National Currency	In Foreign Currency
01.01.08	4504932	1408408	3096524
01.02.08	4571093	1460056	3111037
01.03.08	4713823	1546657	3167166
01.04.08	4902532	1662785	3239748
01.05.08	5125342	1741706	3383637
01.06.08	5280359	1827351	3453008
01.07.08	5437653	1903468	3534185
01.08.08	5570972	1910375	3660597
01.09.08	5369710	1791736	3577975
01.10.08	5271653	1674546	3597108
01.11.08	5236657	1622142	3614515
01.12.08	5774682	1560744	4213939
01.01.09	5822905	1544401	4278504

14. Commercial Banks Overdue Loans
(Thous. of GEL)

	Overdue Loans, Total	of which:	
		In National Currency	In Foreign Currency
01.01.08	75597	31596	44000
01.02.08	99085	53154	45931
01.03.08	109360	43468	65892
01.04.08	100988	45599	55389
01.05.08	116605	50442	66164
01.06.08	105274	53837	51437
01.07.08	89690	39290	50401
01.08.08	99042	41987	57055
01.09.08	112406	54138	58268
01.10.08	157332	90624	66708
01.11.08	177404	98652	78751
01.12.08	208627	110074	98553
01.01.09	159245	83213	76032

15. Transactions at Tbilisi Interbank Currency Exchange
(Thous.of USD)

	Total Volume	Sold USD		Purchased USD		Net Interventions of NBG
		by commercial banks	by NBG	by commercial banks	by NBG	
2007	**1346600**	**1089175**	**257425**	**428424**	**918176**	**-660751**
January	54945	40170	14775	41795	13150	1625
February	74978	72458	2520	20394	54584	-52064
March	100625	100625	0	7405	93220	-93220
April	93115	90035	3080	14185	78930	-75850
May	98965	94485	4480	8765	90200	-85720
June	101775	98835	2940	14535	87240	-84300
July	141281	114586	26695	43320	97961	-71266
August	124111	115976	8135	19350	104761	-96626
September	115810	106960	8850	15550	100260	-91410
October	121045	121045	0	14475	106570	-106570
November	128850	19100	109750	118400	10450	99300
December	191100	114900	76200	110250	80850	-4650
2008	**2246173**	**1034937**	**1211236**	**1424426**	**821748**	**389489**
January	139111	31091	108020	115294	23817	84203
February	225360	191647	33713	44290	181070	-147357
March	262225	227375	34850	51496.5	210729	-175879
April	178535	64505	114030	134400	44135	69895
May	240450	165370	75080	111000	129450	-54370
June	145180	133430	11750	49280	95900	-84150
July	113630	89560	24070	42290	71340	-47270
August	218750	29862	188888	217150	1600	187288
September	106467	59917	46550	59960	46507	43
October	231820	15300	216520	224370	7450	209070
November	206815	19660	187155	197565	9250	177905
December	177830	7220	170610	177330	500	170110

16. Exchange Rates: GEL/USD

	End of Month	Monthly average
2007		
January	1.7199	1.7145
February	1.7130	1.7142
March	1.7000	1.7059
April	1.6900	1.6948
May	1.6780	1.6841
June	1.6695	1.6748
July	1.6680	1.6674
August	1.6625	1.6646
September	1.6580	1.6607
October	1.6225	1.6420
November	1.6210	1.6223
December	1.5916	1.6013
2008		
January	1.5870	1.5921
February	1.5540	1.5664
March	1.4760	1.5098
April	1.4620	1.4549
May	1.4440	1.4549
June	1.4180	1.4281
July	1.4080	1.4096
August	1.4100	1.4123
September	1.4050	1.4050
October	1.4210	1.4127
November	1.6500	1.5827
December	1.6670	1.6554

17. Exchange Rates: GEL/EURO

	End of Month	Monthly average
2007		
January	2.2283	2.2287
February	2.2660	2.2392
March	2.2642	2.2582
April	2.3006	2.2867
May	2.2542	2.2763
June	2.2455	2.2448
July	2.2788	2.2840
August	2.2668	2.2658
September	2.3487	2.3042
October	2.3377	2.3347
November	2.3913	2.3775
December	2.3315	2.3322
2008		
January	2.3438	2.3413
February	2.3459	2.3058
March	2.3271	2.3375
April	2.2755	2.2979
May	2.2339	2.2602
June	2.2325	2.2202
July	2.1970	2.2233
August	2.0803	2.1209
September	2.0134	2.0187
October	1.8712	1.8918
November	2.1346	2.0132
December	2.3648	2.2333

18. Public Foreign Debt of Georgia
(excluding credits, guaranteed by Government)

	2000	2005	2006	2007	2008
	Million of USD				
Foreign Debt, end of period	1556.2	1650.6	1604.5	1776.0	2681.4
of which:					
Sort-term	-	-	-	-	
Long-term	1556.2	1650.6	1604.5	1776.0	2681.4
Debt service	64.4	109.2	151.3	102.5	79.5
of which:					
Principal Repayments	24.8	88.6	130.9	79.2	35.6
Interest Payments	39.6	20.7	20.4	23.3	43.9
Export of Goods and Services	705.4	2187.5	2551.6	3182.4	3691.1
	Ratios, %				
Debt to GDP Ratio	50.9	25.7	20.7	17.5	21.0
Debt to Exports Ratio	220.6	75.5	62.9	55.8	72.6
Debt service Ratio:					
Debt Service to Total Exports Ratio	9.1	5.0	5.9	3.2	2.2
o.w. Interest Payments to Total Exports Ratio	5.6	0.9	0.8	0.7	1.2

Source: Ministry of Finance of Georgia; Department for Statistics.

19. Foreign Trade of Georgia
(excluding nonregistered trade; thous.of USD)

	Total	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exports (FOB)													
2000	322821	16078	22050.28313	26265.65329	26541	27980	29217	29006	31037	35442	23926	28587	26691
2006	936172	67665	60570	86058	87853	74352	67723	75033	76938	80894	67519	88447	103119
2007	1232371	69474	67522	86666	99579	112612	107918	114498	111157	97184	130414	110998	124349
2008	1497664	96789	101214	131397	135571	144223	187019	160814	112788	170659	110505	71258	75427
Imports (CIF)													
2000	709402	49869	51953.70926	56442.62089	51431	45186	64116	55429	76024	53049	73613	64040	68249
2006	3677745	191138	223957	267452	285379	294497	307232	309257	363567	350310	341731	333550	409676
2007	5214883	328475	334759	381864	364694	438540	376066	430090	463612	424220	522441	445563	704558
2008	6058103	402968	474143	527992	579558	611148	572569	586051	404536	507171	511768	415738	464460
Turnover													
2000	1032223	65947	74004	82708	77972	73165	93333	84436	107061	88491	97539	92627	94940
2006	4613917	258803	284527	353510	373232	368849	374954	384290	440505	431204	409250	421998	512795
2007	6447254	397949	402281	468530	464273	551152	483984	544589	574769	521404	652854	556561	828907
2008	7555767	499757	575357	659390	715130	755372	759589	746865	517324	677830	622272	486996	539887
Balance													
2000	-386581	-33791	-29903	-30177	-24891	-17206	-34899	-26423	-44987	-17607	-49687	-35452	-41558
2006	-2741573	-123473	-163387	-181394	-197525	-220145	-239509	-234224	-286629	-269415	-274212	-245103	-306557
2007	-3982512	-259001	-267238	-295198	-265115	-325927	-268147	-315592	-352455	-327036	-392027	-334566	-580209
2008	-4560439	-306179	-372928	-396595	-443987	-466925	-385550	-425237	-291748	-336513	-401263	-344480	-389034

Source: Department for Statistics.

20. Major Foreign Trade Partners of Georgia
(Thous.of USD)

	Exports (FOB)	Imports (CIF)	Balance	Turnover	
				Total	%
	2007				
Turkey	171763.9	727906.0	-556142.1	899669.9	14.0
Ukraine	94169.3	574906.0	-480736.7	669075.3	10.4
Russia	45599.0	576604.4	-531005.4	622203.4	9.7
Azerbaijan	137455.0	382367.2	-244912.2	519822.2	8.1
Germany	56155.9	387326.6	-331170.7	443482.5	6.9
USA	149036.0	203891.4	-54855.4	352927.4	5.5
Bulgaria	59357.3	184049.7	-124692.4	243407.0	3.8
United Arab Emirates	18638.3	214721.3	-196083.0	233359.6	3.6
Turkmenistan	26338.5	149901.8	-123563.3	176240.3	2.7
Armenia	110844.2	59557.5	51286.7	170401.7	2.6
Total	869357.4	3461231.9	-2591874.5	4330589.3	x
Foreign Trade, total	1232371.0	5214883.4	-3982512.4	6447254.4	100.0
Ratio,%	70.5	66.4	65.1	67.2	x
	2008				
Turkey	262912.5	939875.3	-676962.8	1202787.8	15.9
Azerbaijan	205408.0	607778.1	-402370.1	813186.1	10.8
Ukraine	134173.8	657617.8	-523444.0	791791.6	10.5
Germany	33100.6	434328.1	-401227.5	467428.7	6.2
Russia	28471.0	426023.4	-397552.4	454494.4	6.0
USA	102197.6	241390.2	-139192.6	343587.8	4.5
China	8992.7	298149.2	-289156.5	307141.9	4.1
United Arab Emirates	11228.6	272665.9	-261437.3	283894.5	3.8
Bulgaria	108216.7	122928.2	-14711.5	231144.9	3.1
Italy	17144.9	181604.4	-164459.5	198749.3	2.6
Total	911846.4	4182360.6	-3270514.2	5094207.0	x
Foreign Trade, total	1497663.6	6058103.5	-5864065.6	7555767.1	100.0
Ratio,%	60.9	69.0	55.8	67.4	x

Source: Department for Statistics.

21. Major Commodity Groups of Georgian Exports

	2007		2008	
	Thous.of USD	%	Thous.of USD	%
Exports, Total	**1232371.0**	**100.0**	**1497663.6**	**100.0**
of which:				
Ferrous Metals	159630.3	13.0	267241.6	17.8
Scrap Black Metals	96871.8	7.9	128532.3	8.6
Copper Ores and Concentrates	79212.5	6.4	118265.4	7.9
Automobiles	70176.0	5.7	113333.4	7.6
Fertilizers	57022.2	4.6	105519.4	7.0
Gold Unwrought or in Semi-Manufactured Forms	69391.7	5.6	100111.7	6.7
Cement	64002.3	5.2	80075.3	5.3
Alcohol and other Spirituous Beverages	57423.7	4.7	58993.1	3.9
Wine	29197.4	2.4	36862.8	2.5
Other Nuts, Fresh or Dried, Whether or not Shelled or Peeled	65122.0	5.3	31731.5	2.1
Other	484321.1	39.3	456997.1	30.5

22. Major Commodity Groups of Georgian Imports

	2007		2008	
	Thous.of USD	%	Thous.of USD	%
Imports, Total	**5214883.4**	**100.0**	**6058103.5**	**100.0**
of which:				
Crude Oil and Petroleum Products	556343.6	10.7	762499.2	12.6
Automobiles	369720.8	7.1	463290.0	7.6
Petroleum Gases and Other Gaseous Hydrcarbons	293867.6	5.6	204660.0	3.4
Medicines	143995.9	2.8	189864.9	3.1
Transmission Apparatus for Radio-telephony, Radio-telegraphy, Radio-broadcasting or Television	105178.2	2.0	148186.9	2.4
Other Bars and Rods of Iron or Non-alloy Steel, not Further Worked than Forged	71868.3	1.4	111133.0	1.8
Wheat	139188.9	2.7	108851.7	1.8
Automatic Data Processing Machines and Units Thereof	77988.9	1.5	92785.4	1.5
Flours	45896.7	0.9	74490.4	1.2
Manganese Ores and Concentrates	19191.1	0.4	70050.5	1.2
Other	3391643.4	65.0	3832291.5	63.3

Source: Department for Statistics.

23. Financial Institutions
(end of period)

	2005	2006	2007	2008
Number of Commercial Banks	**19**	**17**	**19**	**20**
of which:				
Foreign controlled	12*	12*	14*	17*
per 100 000 inhabitants	0.43	0.39	0.43	0.46
branches	159	122	124	124
service centers	x	298	416	559
Authorized Capital of Commercial Banks, thous.of GEL				
Equity Capital of Commercial Banks, thous.of GEL	296443	344844	524576	625616
Exchange Bureaus	479488	898373	1471046	1517250
per 100 000 inhabitants	556	655	806	1030
Non-Bank Depository Institutions	12.63	14.90	18.34	23.50
Micrifinance organizations	40	38	24	18
Stock Exchanges	x	3	15	27
Insurance Companies	1	1	1	1
Pension Schemes	16	14	15	13
sapensio sqemebi, erTeuli	3	3	4	7

* - Including 2 Branch of Non-Resident Banks.

24. List of Commercial Banks Operating in Georgia as of January 1, 2009

N	Bank	License Date	License Number	Number of Branches	Number of service centers
1	JSC Bank Republic	04.02.1992	5	8	35
2	JSC TaoPrivatBank	25.02.1992	10	-	72
3	JSC First British Bank	12.01.1993	76	-	-
4	JSC TBC Bank	20.01.1993	85	13	42
5	JSC Bank of Georgia	15.12.1994	86	1	159
6	JSC People's Bank of Georgia	10.02.1993	96	75	111
7	JSC Basisbank	04.11.1993	173	-	19
8	JSC VTB Bank Georgia	07.05.1995	226-a	14	12
9	JSC Cartu Bank	09.01.1997	229	3	4
10	JSC ProCredit Bank	13.05.1999	233	7	50
11	JSC Kor Standard Bank	25.01.2008	0110245	-	26
12	JSC BTA Bank	13.03.2001	238	1	5
13	JSC Investbank	29.09.2003	241	1	2
14	T.C. Turkish Ziraat Bank Tbilisi Branch	31.03.1998	231-1	-	-
15	OSC Transcaucasus Development Bank Tbilisi Branch	02.12.1999	234-1	-	-
16	JSC International Bank of Azerbaijan - Georgia	07.02.2007	0110242	-	-
17	JSC HSBC Bank Georgia	30.07.2007	0110243	-	-
18	JSC Progress Bank	31.12.2007	0110244	-	1
19	JSC Halyk Bank Georgia	29.01.2008	0110246	1	-
20	JSC Constanta Bank	03.07.2008	130	-	21

25. Paid-In Capital of Commercial Banks as of January 1, 2009

From 5 to 10 mln of GEL	**10 mln of GEL and above**
JSC First British Bank	JSC Cartu Bank
JSC Basisbank	JSC ProCredit Bank
T.C. Turkish Ziraat Bank Tbilisi Branch	JSC VTB Bank Georgia
OSC Transcaucasus Development Bank Tbilisi Branch	JSC Bank of Georgia
	JSC Bank Republic
	JSC Kor Standard Bank
	JSC Investbank
	JSC BTA Bank
	JSC People's Bank of Georgia
	JSC TBC Bank
	JSC TaoPrivatBank
	JSC International Bank of Azerbaijan - Georgia
	JSC HSBC Bank Georgia
	JSC Halyk Bank Georgia
	JSC Progress Bank
	JSC Constanta Bank

26. List of Microfinancial Organizations Operating in Georgia as of January 1, 2009

N	Name	License Date	License Number
1	LLC mfo "Georgian Credit "	04.10.2006	736
2	LLC mfo "Allians Group "	09.10.2006	737
3	LLC mfo "Tbilbusiness "	30.11.2006	931
4	LLC mfo "Alfa Express "	10.01.2007	7
5	LLC mfo "Alfa Credit "	12.02.2007	50
6	LLC mfo "TAM Credit "	06.03.2007	107
7	LLC mfo "Intel Express Georgia "	23.03.2007	143
8	LLC mfo "Rico Express "	11.04.2007	175
9	JSC mfo "Cristal"	18.09.2007	368
10	JSC mfo "Finagro"	30.11.2007	444
11	LLC mfo "Credo "	06.12.2007	452
12	JSC mfo "Caucasuscredit"	13.12.2007	476
13	LLC mfo "Imercredit "	18.12.2007	492
14	LLC mfo "Credit Service "	20.12.2007	504
15	JSC mfo "Finca Georgia"	28.12.2007	526
16	LLC mfo "Express Credit "	10.01.2008	6
17	JSC mfo "Lazika Capital"	21.01.2008	23
18	LLC mfo "Creditservice+ "	06.02.2008	84
19	LLC mfo "Cristal Credit "	03.04.2008	330
20	LLC mfo "Sani"	12.06.2008	73
21	LLC mfo "Moneta Express Georgia"	13.06.2008	82
22	LLC mfo "Intelnet"	01.07.2008	120
23	LLC mfo "Tbilmicrocredit"	17.10.2008	506
24	LLC mfo "Amigo+"	30.10.2008	535
25	JSC mfo "Nyke Kredit"	30.10.2008	536
26	LLC mfo "CaucasusCredit"	19.11.2008	619
27	LLC mfo "X Credit"	27.01.2009	27-01/8

The National Bank of Georgia
Financial Statements

Year ended 31 December 2008
Together with Independent Auditors' Report

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NOTES TO FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

To the Council of the National Bank of Georgia –

We have audited the accompanying financial statements of the National Bank of Georgia (the "Bank"), which comprise the balance sheet as at 31 December 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ERNST & YOUNG LLC

29 April 2009

BALANCE SHEET

As of 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Assets			
Foreign currency assets			
Cash and cash equivalents	5	1,434,590	1,145,318
Amounts due from non-resident credit institutions	6	40,947	141,537
Special Drawing Rights holdings with the International Monetary Fund	7	20,515	23,533
Available-for-sale investment securities	8	942,489	783,690
Held-to-maturity investment securities	10	66,057	154,212
Other assets	13	575	3
National currency assets			
Available-for-sale investment securities	8	94,000	39,704
Loans to resident commercial banks	9	209,412	73,132
Held-to-maturity investment securities	10	690,796	738,782
Property and equipment held for sale	11	11,260	865
Property and equipment	12	19,027	34,707
Intangible assets		221	413
Other assets	13	5,054	8,038
Total assets		**3,534,943**	**3,143,934**
Liabilities			
Foreign currency liabilities			
Amounts due to resident credit institutions	15	210,188	283,385
Amounts due to the Ministry of Finance	16	16,342	9,518
Amounts due to customers	17	-	4,232
Amounts due to the International Monetary Fund	7	763,789	400,900
Other liabilities	13	1,443	18
National currency liabilities			
Money issued in circulation	14	1,290,703	1,310,488
Amounts due to resident credit institutions	15	141,190	188,113
Amounts due to the Ministry of Finance	16	863,629	440,613
Amounts due to customers	17	4,546	15,206
Debt securities issued	18	77,352	376,541
Other liabilities	13	4,760	4,670
Total liabilities		**3,373,942**	**3,033,684**
Equity	19		
Capital		15,000	15,000
Reserve fund		119,597	60,692
Foreign currency revaluation reserve		9,824	-
Revaluation reserve arising from available-for-sale investment securities		16,580	9,558
Retained earnings		-	25,000
Total equity		**161,001**	**110,250**
Total liabilities and equity		**3,534,943**	**3,143,934**

Signed and authorized for release on behalf of the Council of the Bank:

George Kadagidze — Chairman of the Council

Demna Sakhltkhutsishvili — Head of Finance and Accounting Department

29 April 2009

The accompanying notes on pages 70 to 108 are an integral part of these financial statements

INCOME STATEMENT

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Interest income			
Investment securities		89,857	88,490
Amounts due from non-resident credit institutions		32,186	59,176
Loans to resident commercial banks		8,546	1,391
Other		856	804
		131,445	**149,861**
Interest expense			
Debt securities issued		(33,699)	(29,210)
Amounts due to resident commercial banks		(4,152)	(4,179)
Amounts due to International Financial Institutions		(358)	(2,014)
Other		(76)	(734)
		(38,285)	**(36,137)**
Net interest income		**93,160**	**113,724**
Impairment charge for other assets	13	(1,105)	(400)
Net interest income after impairment charge		**92,055**	**113,324**
Net gains (losses) from foreign currencies:			
- translation differences		9,824	(55,860)
- dealing		2,709	1,382
Net gains from realized securities		3,358	599
Other income	22	7,140	3,429
Net non-interest income (losses)		**23,031**	**(50,450)**
Personnel expenses	23	(17,309)	(17,450)
Printing money expenses		(13,264)	(4,175)
Depreciation and amortisation	12, 23	(2,669)	(3,305)
Net fee and commission expense	21	(608)	(705)
Other operating expenses	23	(12,507)	(7,628)
Non-interest expenses		**(46,357)**	**(33,263)**
Profit for the year		**68,729**	**29,611**

The accompanying notes on pages 70 to 108 are an integral part of these financial statements

EQUITY STATEMENT

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Capital	Reserve fund	Foreign currency revaluation reserve	Revaluation reserve for available-for-sale investment securities	Retained earnings	Total equity
31 December 2006	**15,000**	**56,081**	**-**	**(143)**	**40,000**	**110,938**
Net unrealized gains on available-for-sale assets (Note 19)	-	-	-	10,335	-	10,335
Net realized gain on available-for-sale assets transferred to the income statement on disposal (Note 19)	-	-	-	(634)	-	(634)
Total income for the year recognized directly in equity	-	-	-	9,558	-	9,558
Profit for the year	-	-	-	-	29,611	29,611
Total income and expense for the year	-	-	-	9,558	29,611	39,169
Transfer to the Ministry of Finance (Note 19)	-	-	-	-	(40,000)	(40,000)
Transfer to reserve fund (Note 19)	-	4,611	-	-	(4,611)	-
31 December 2007	**15,000**	**60,692**	**-**	**9,558**	**25,000**	**110,250**
Net unrealized gains on available-for-sale assets (Note 19)	-	-	-	10,380	-	10,380
Net realized gain on available-for-sale assets transferred to the income statement on disposal (Note 19)	-	-	-	(3,358)	-	(3,358)
Total income for the year recognized directly in equity	-	-	-	16,580	-	16,580
Profit for the year	-	-	-	-	68,729	68,729
Total income and expense for the year	-		-	16,580	68,729	85,309
Transfer to the Ministry of Finance (Note 19)	-	-	-	-	(25,000)	(25,000)
Transfer to foreign currency revaluation reserve (Note 19)	-	-	9,824	-	(9,824)	-
Transfer to reserve fund (Note 19)	-	58,905	-	-	(58,905)	-
31 December 2008	**15,000**	**119,597**	**9,824**	**16,580**	**-**	**161,001**

The accompanying notes on pages 70 to 108 are an integral part of these financial statements

CASH FLOW STATEMENT

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Cash flows from operating activities			
Interest received		144,145	147,697
Interest paid		(35,068)	(30,536)
Fees and commissions received		2,006	672
Fees and commissions paid		(2,614)	(1,377)
Gains less losses from investment securities		3,358	599
Net realised gains/(losses) from dealing in foreign currencies		2,708	1,382
Other income received		7,140	3,429
Personnel expenses paid		(16,513)	(17,865)
Other operating expenses paid		(22,998)	(11,161)
Cash flows from operating activities before changes in operating assets and liabilities		82,164	92,840
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		67,418	210,952
SDR holdings with the International Monetary Fund		2,576	(23,514)
Loans to banks		(136,400)	(53,132)
Other assets		1,334	1,121
Net increase(decrease) in operating liabilities			
Money issued in circulation		(19,785)	380,855
Amounts due to credit institutions		(111,844)	139,282
Amounts due to Government organizations		430,345	73,774
Amounts due to customers		(14,892)	-
Debt securities issued		1,817,280	2,942,242
Debt securities redeemed		(2,111,628)	(2,847,502)
Other liabilities		1,525	6,006
Net cash (used in)/from operating activities		**8,093**	**922,924**
Cash flows from investing activities			
Proceeds from disposal of property and equipment and intangible assets		21	276
Purchase of held-to-maturity investment securities		-	(98,972)
Proceeds from redemption of held-to-maturity investment securities		83,608	88,049
Purchase of available-for-sale investment securities		(1,471,364)	(1,214,397)
Proceeds from redemption of available-for-sale investment securities		1,291,197	689,636
Purchase of property and equipment		(808)	(406)
Purchase of intangible assets		(10)	(30)
Net cash (used in)/from investing activities		**(97,356)**	**(535,844)**
Cash flows from financing activities			
Transfer of distributable profit to the Ministry of Finance of Georgia		(25,000)	(40,000)
Increase in borrowings from International Monetary Fund		415,186	5,131
Repayment of amounts due to International Monetary Fund		(43,777)	-
Net cash from financing activities		**346,409**	**(34,869)**
Effect of exchange rates changes on cash and cash equivalents		32,126	(29,801)
Net increase in cash and cash equivalents		**289,272**	**322,410**
Cash and cash equivalents, beginning	5	1,145,318	822,908
Cash and cash equivalents, ending	5	1,434,590	1,145,318

The accompanying notes on pages 70 to 108 are an integral part of these financial statements

(Thousands of Georgian Lari)

1. Principal activities

The National Bank of Georgia (the "Bank") is the central bank of Georgia, the bank of all banks, and the banker and fiscal agent of the Georgian government. It acts in accordance with the Organic Law of Georgia "On the National Bank of Georgia" enacted effective from 23 June 1995 (the "Law") and last amended on 14 March 2008 primarily in relation to financial provisions, bank accounts and reporting.

Article 2 of the Law sets out the goals and functions of the Bank as follows:

- The primary goal of the Bank's activity is to ensure price stability;
- Ensure stability and transparency of the financial system and assess stable economic growth of the country. To the extent possible, it should be done in a way that the implementation of the Bank's major objective is not hindered;
- Develop and implement monetary and foreign exchange policies, in accordance with the main directions defined by the Parliament of Georgia;
- Hold, maintain and dispose official international reserves;
- Act as a banker and a fiscal agent of the Government of Georgia; according to the Law of Georgia on the Future Generation and Stable Development Funds, ensure implementation of functions of the general agent and the manager of the Stable Development Fund and all actions related to it;
- Ensure efficient operation of the payments system;
- Carry out emission of Georgia's monetary units;
- Carry out and disseminate information on the financial and external statistics of the country based on international standards and methodologies;
- Carry out supervision of the financial sector and support prevention of anti-money laundering and financing of terrorism, pursuant to the Law through the legal entities under public law under the Bank – Financial Supervisory Agency and Financial Monitoring Service;
- Other functions, as stipulated by the Law.

Pursuant to the legislation of Georgia and the international treaties acceded to by Georgia, the Bank represents Georgia in relations with the central banks of foreign states, as well as international financial and credit institutions in matters relating to the Bank's responsibilities and functions.

The Bank may conclude agreements on cooperation with the central banks of foreign countries concerning various areas of its activities. It may also conclude clearing and settlement agreements and other agreements with foreign public and private clearing agencies, on its own behalf and on behalf of Georgia, if appropriately empowered.

The Bank may participate in the capital and activity of international organizations for the purpose of cooperation in monetary, foreign currency and banking areas.

The Council (the "Council") of the Bank is composed of the following:

	As of 31 December 2008	**As of 31 December 2007**
Position	**Name**	**Name**
Chairman (acting president)	Mr. David Amaglobeli	Mr. David Amaglobeli
Member	Mr. Simon Gelashvili	Mr. Simon Gelashvili
Member	Mr. Mikheil Tokmazishvili	Mr. Mikheil Tokmazishvili
Member	Mr. Omar Zhizhavadze	Mr. Omar Zhizhavadze
Member		Mr. Aleksi Aleksishvili
Member	Mr. Temur Shengelia	Mr. Temur Shengelia

The Bank's main office is located on the following address: 3/5 Leonidze Street, Tbilisi, 0105, Georgia. The Bank has one regional branch in Georgia (2007: four regional branches). It has 318 personnel as of 31 December 2008 (2007: 605).

(Thousands of Georgian Lari)

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank is required to maintain its records and prepare its financial statements in Georgian Lari and in accordance with IFRS.

The Georgian Lari is the reporting and functional currency of the Bank as it is the currency of the economic environment in which the Bank operates. Transactions in other currencies are treated as transactions in foreign currencies. These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated.

The financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below. For example, available-for-sale securities have been measured at fair value.

Reclassifications

The following reclassifications have been made to 2007 balances to conform to the 2008 presentation.

	As previously reported	*Reclassification*	*Description*
Cash and cash equivalents	-	1,145,318	Reclassification of Cash and Placements with banks and other financial institutions to Cash and cash equivalents and Amounts due from credit institutions
Amounts due from non-resident credit institutions	-	141,537	Reclassification of Cash and Placements with banks and other financial institutions to Cash and cash equivalents and Amounts due from non-resident credit institutions
Cash	26,970	-	Reclassification of Cash and Placements with banks and other financial institutions to Cash and cash equivalents and Amounts due from credit institutions
Placements with banks and other financial institutions	1,259,885	-	Reclassification of Cash and Placements with banks and other financial institutions to Cash and cash equivalents and Amounts due from credit institutions
Other assets in national currency	5,083	8,038	Reclassification of Loans to government and Loans to employees to Other assets
Loans to government	3	-	Reclassification of Loans to government to Other assets
Loans to employees	2,952	-	Reclassification of Loans to employees to Other assets
Interest income	149,861	-	Reclassification of Interest income to Interest income on investment securities, amounts due from credit institutions, loans to banks and other amounts
Interest income on investment securities	-	88,490	Reclassification of Interest income to Interest income on investment securities
Interest income on amounts due from non-resident credit institutions	-	59,176	Reclassification of Interest income to Interest income on amounts due from credit institutions
Interest income on loans to banks	-	1,391	Reclassification of Interest income to Interest income on loans to banks
Interest income on other amounts	-	804	Reclassification of Interest income to Interest income on other amounts
Interest expense on debt securities issued	-	(29,210)	Reclassification of Interest expense to Interest expense on debt securities issued
Interest expense on amounts due to resident commercial banks	-	(4,179)	Reclassification of Interest expense to Interest expense on amounts due to commercial banks
Interest expense on amounts due to IMF	-	(2,014)	Reclassification of Interest expense to Interest expense on amounts due to IMF
Interest expense on other amounts	-	(734)	Reclassification of Interest expense to Interest expense on other amounts
Interest expense	(36,137)	-	Reclassification of Interest expense to Interest expense on debt securities issued, amounts due to commercial banks, amounts due to IMF and other amounts

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

Reclassifications (continued)

	As previously reported	*Reclassification*	*Description*
Net fee and commission expense	-	(705)	Presentation of gross Fee and commission income/expense as Net fee and commission income/expense
Fee and commission income	672	-	Presentation of gross Fee and commission income/expense as Net fee and commission income/expense
Fee and commission expense	(1,377)	-	Presentation of gross Fee and commission income/expense as Net fee and commission income/expense
Net gain (loss) from foreign currencies: translation differences	-	(55,860)	Presentation of Net foreign exchange loss as Net gain (loss) from foreign currencies: translation differences and Net gain (loss) from foreign currencies: dealing
Net foreign exchange loss	(54,478)	-	Presentation of Net foreign exchange loss as Net gain (loss) from foreign currencies: translation differences and Net gain (loss) from foreign currencies: dealing
Net gain (loss) from foreign currencies: dealing	-	1,382	Presentation of Net foreign exchange loss as Net gain (loss) from foreign currencies: translation differences and Net gain (loss) from foreign currencies: dealing
Personnel expenses	-	(17,450)	Reclassification of General administrative expenses to Personnel expenses
Cash and cash equivalent related expenses	-	(4,175)	Reclassification of General administrative expenses to Cash and cash equivalent related expenses
Depreciation and amortization	-	(3,305)	Reclassification of General administrative expenses to Depreciation and amortization expenses
Other operating expenses	-	(7,628)	Reclassification of General administrative expenses to Other operating expenses
General administrative expenses	(32,558)	-	Reclassification of General administrative expenses to Personnel, Cash and cash equivalent related, Depreciation and amortization and Other operating expenses

(Thousands of Georgian Lari)

3. Summary of significant accounting policies

Changes in accounting policies

The Bank applied the same accounting policies with those in prior year, except for the adoption of the following new IAS and IFRS amendments during the year:

Reclassification of Financial Assets – Amendments to IAS 39 "Financial instruments: Recognition and measurement" and IFRS 7 "Financial instruments: Disclosures"

Amendments to IAS 39 and IFRS 7 were issued on 13 October 2008 and allow reclassification of non-derivative financial assets out of the held for trading category in particular circumstances. The amendments also allow transfer of certain financial assets from the available for sale category to loans and receivables category. The effective date of those amendments is 1 July 2008. Any reclassification made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made.

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held-to-maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

There were no reclassifications made during 2008 in relation to the above.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the settlement date i.e. the date that the Bank settles the purchase or sale of the asset.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the income statement.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are impaired, as well as through the amortisation process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as available-for-sale investment securities. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement. However, interest calculated using the effective interest method is recognised in the income statement.

Determination of fair value

The fair value of financial instruments that are actively traded in organised financial markets is determined by reference to quoted market price at the close of business on the balance sheet date, without any deduction for transaction costs. For all other financial instruments where there is no active market, fair value is determined using discounted cash flow analysis and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

IFRS 7 'Financial Instruments: Disclosures'

IFRS 7 requires additional disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. In particular, it specifies minimum disclosures about credit risk, liquidity risk and market risk. IFRS 7 replaces IAS 30 'Disclosures in the Financial Statements of Companies and Similar Financial Institutions' and the disclosure requirements in IAS 32 'Financial Instruments: Disclosure and Presentation'. The disclosures are included throughout the financial statements.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, unrestricted balances on correspondent accounts including overnight deposits and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Derivative financial instruments

In the normal course of business, the Bank enters into derivative financial instruments such as forwards. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the income statement as gains less losses from trading securities or gains less losses from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair on the trading portfolio with changes in fair value recognised in the income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to Government, amounts due to credit institutions, amounts due to customers, debt securities issued and liabilities to International Monetary Fund. These are initially recognized at fair value of the consideration received less directly attributable transaction cost. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the borrowings are derecognised as well as through the amortisation process.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to banks

For amounts due from credit institutions and loans to banks carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the income statement.

Renegotiated loans

Where applicable, the Bank seeks to restructure loans. This may involve extending the payment arrangements and the agreement of new loan conditions. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

De-recognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Property and equipment

Property and equipment are carried at cost, less accumulated depreciation and any accumulated impairment. Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the estimated useful lives using the following rates:

	%
Buildings	2
Furniture and fixtures	10 - 20
Motor vehicles	20

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

Assets classified as held for sale

Property and equipment classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this, asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset and related activities to complete this plan. Farther the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of asset as held for sale.

Property and equioment held for sale are measured at the lower of its carrying amount and fair value less costs to sell. If the fair value less costs to sell of an asset held for sale is lower than its carrying amount, an impairment loss is recognized in the income statements as loss from fixed assets held for sale. Any subsequent increase in an assets fair value less costs to sell is recognized to the extent of the cumulative impairment loss that was previously recognized in relation to that specific asset.

Intangible assets

Intangible assets include computer software.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 5 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Intangible assets with indefinite useful lives are not amortised, but tested for impairment annually either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable.

Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Money issued in circulation

Money issued in circulation represents banknotes and coins issued by the Bank in accordance with the Law and its function as a central bank. Banknotes and coins in circulation are recorded on the balance sheet at their nominal value net of cash in the Bank's cash offices.

The expenses for the production of notes and coins are expensed as incurred.

When notes are returned to the Bank by the commercial banks they are removed from notes in circulation and depending on their condition or legal tender status, are either sent for destruction or held as cash by the Bank.

Certificates of deposits issued by bank

Certificates of deposits issued by bank represent discount securities and are recorded in the balance sheet at the settlement date at sale price, what represents their fair value. After initial recognition, certificates of deposits are measured at amortized cost recorded based on effective interest rate.

Taxation

Assets of the Bank, its assets, property and income, as well as its activities and operations are exempted from all taxes and other levy. The Bank performs only functions of the tax agent.

Retirement and other benefit obligations

The Bank has a pension arrangement separate from the state pension system of Georgia. The Bank's defined contribution pension plan covers substantially all full-time employees of the Bank. The Bank collects contributions from its employees. When an employee reaches the pension age, aggregated contributions are paid to the employee according to the schedule agreed with the employee.

Membership in the IMF and other international financial institutions

Based on the provision of Article 5 of the Law, the Bank acts as an intermediary of the Government of Georgia on transactions related to the membership of Georgia in international financial organizations (i.e. IMF, World Bank), including payment of membership fees to such organizations.

The International Monetary Fund (IMF) is an international organization established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription, or quota, is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. A member's quota delineates basic aspects of its financial and organizational relationship with the IMF.

Membership fee payable to IMF are denominated in Special Drawing Rights (SDR) and are revalued in GEL at the rate of exchange set by the IMF at the financial year-end of IMF. Membership quota and securities issued by the Ministry of Finance of Georgia in respect of IMF quota are not presented as on-balance sheet as they do not represent the assets and liabilities of the Bank, but are considered as off-balance sheet and are accordingly disclosed in Note 7 to the financial statements.

Contingencies

Contingent liabilities are not recognised in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the balance sheet but is disclosed when an inflow of economic benefits is probable.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income and expense

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes cash collection fees and customer services fees, which are recognized as revenue as the services are provided. Fee and commission expense consists of cash operation and settlement fees.

Foreign currency translation

The financial statements are presented in Georgian Laris, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the balance sheet date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the income statement as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the Bank's exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

The Bank used the following official exchange rates at 31 December 2008 in the preparation of these financial statements:

	2008	*2007*
1 US Dollar	1.6670 GEL	1.5916 GEL
1 Euro	2.3648 GEL	2.3315 GEL
1 Pound sterling	2.4240 GEL	3.1762 GEL
1 Special Drawing Right	2.5676 GEL	2.5123 GEL

Foreign currency exchange rates as of the report date are as follows:

	29 April 2009
1 US Dollar	1.6500 GEL
1 Euro	2.1490 GEL
1 Pound sterling	2.3996 GEL
1 Special Drawing Right	2.4554 GEL

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Up to the date of approval of the financial statements, certain new standards, interpretations and amendments to existing standards have been published that are not yet effective for the current reporting period and which the Bank has not early adopted, as follows:

Improvements to IFRS
In May 2008, the IASB issued amendments to IFRS, which resulted from the IASB's annual improvements project. They comprise amendments that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after January 1, 2009, with earlier application permitted. The Bank is currently evaluating the potential impact that the adoption of the amendments will have on its financial statements.

IAS 23 "Borrowing Costs"(Revised)
A revised IAS 23 Borrowing costs was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the Bank of loans and receivables. The Bank uses its judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

Impairment of held-to-maturity investments

The Bank holds investments in debt securities, including those that do not trade in an active market. Future adverse changes in market conditions or poor operating results could result in losses that may not be reflected in an investment's current carrying value, thereby requiring an impairment charge in the future. The Bank regularly reviews its investments to determine if there have been any indicators that the value may be impaired. These reviews require estimating the outcome of future events and determining whether factors exist that indicate impairment has occurred.

5. Cash and cash equivalents

	2008	*2007*
Cash on hand in foreign currency	248,699	26,970
Current accounts	115,320	8,708
Time deposits with credit institutions up to 90 days	1,070,571	1,109,640
Cash and cash equivalents	**1,434,590**	**1,145,318**

As of 31 December 2008 GEL 565,156 (2007: GEL 474,918) was placed in current accounts and time deposits up to 90 days with five (2007: five) internationally recognized Organization of Economic Co-operation and Development (OECD) banks and central banks.

As of 31 December 2008 annual interest rate range of time deposits with credit institutions up to 90 days was 0.10%-7.90% (2007: 4.25% - 5.36%).

6. Amounts due from non-resident credit institutions

	2008	*2007*
Restricted deposit for letters of credit	40,947	81,924
Time deposits with non-resident credit institutions more than 90 days	-	59,613
Amounts due from non-resident credit institutions	**40,947**	**141,537**

As of 31 December 2007 annual interest rate range of time deposits with credit institutions more than 90 days was 3.5% - 5.4%.

Restricted deposits as of 31 December 2008 relate to letters of credit for government related contracts and bear interest at 0.021% per annum on EUR denominated deposits and 0% on USD denominated deposits. Restricted deposits will be released by the year end 2009.

(Thousands of Georgian Lari)

7. Balances with the International Monetary Fund

	2008	2007
Assets		
Special Drawing Rights (SDR) holdings	20,515	23,533
Liabilities		
IMF current account no. 1	892	968
IMF current account no. 2	24	25
IMF current accounts	916	993
Borrowings from the IMF:		
Poverty Reduction and Growth Facility (PRGF)	350,986	399,907
Stand-by Arrangement Facility (SBA)	411,887	-
Total borrowings	762,873	399,907
Amounts due to the IMF	**763,789**	**400,900**
Off-balance sheet balances		
IMF Quota	357,188	385,915
Security held in custody in respect of IMF quota and as collateral of IMF granted facilities	(739,762)	(385,915)

SDR holdings

SDR holdings represent the current account of the Bank with IMF used for borrowings and settlements with the IMF. Interest accrued in respect of SDR holdings is calculated using the rate set by the IMF weekly on the basis of short-term market rates in major money markets. Average rate charged during 2008 was 2.56% per annum (2007: 4.07%).

IMF current accounts

The Bank is required to maintain two separate accounts: IMF current account no. 1 and IMF current account no. 2. IMF current account no. 1 is for settlement of the IMF's operational transactions, whereas IMF current account no. 2 is used for operational expenses incurred by the IMF in GEL.

IMF granted facilities

Facilities received from IMF are PRGF loan with original maturity of 10 years bearing interest of 0.5% per annum issued for the purpose of poverty reduction and macroeconomic stability, and SBA facility with original maturity of 4 years bearing floating interest rate issued to rebuild gross international reserves and strengthen investor confidence. Range of the interest rate on SBA facility in 2008 was 1.84%-3.63% per annum (2007: 4.65%-5.66%). The structure of facilities outstanding as of 31 December 2008 has changed in comparison with 2007 as Stand-by Arrangement was granted to Georgia in September 2008. The repayment of the SBA facility will commence in 2010. All facilities received from the IMF are denominated in SDR. PRGF will be fully repaid by 2017 and SBA facility will be fully repaid by 2012.

IMF Quota

The IMF Quota, in the amount of Special Drawing Rights ("SDR") 150.3 million, represents the membership subscription of Georgia with the IMF, and is non-interest bearing.

Security held in custody in respect of IMF Quota and as collateral of IMF granted facilities

Security comprises GEL 357,188 held in custody in respect of IMF Quota and GEL 382,574 held in custody as collateral of IMF granted facilities. Security was issued by the Government of Georgia in 1992 in settlement of IMF Quota. Nominal value of the security is changed annually according to the revaluation and at the time of facility receipt from the IMF General Resources Account by the facility amount. As this security is held by the Bank in custody it is accounted as off-balance sheet item and presented at nominal value.

When the Bank received SBA facility in September 2008 nominal value of the security issued by the Government of Georgia was increased by the amount of the received loan.

(Thousands of Georgian Lari)

8. Available-for-sale investment securities

	2008	2007
Government bonds:		
French Government Bonds	423,985	32,537
Belgian Treasury Bills	47,252	194,057
Dutch Treasury Bills	35,294	-
Portuguese Treasury Bills	35,000	-
US Treasury Notes	29,304	72,598
German Government Bonds	-	92,220
	570,835	**391,412**
Corporate bonds:		
Bank for International Settlements	371,654	392,278
Total available-for-sale investment securities in foreign currency	**942,489**	**783,690**
Government bonds:		
Georgian Government Bonds	93,960	39,664
Equity investments:		
Shares of Tbilisi Interbank Foreign Exchange	40	40
Total available-for-sale investment securities in local currency	**94,000**	**39,704**
Total available-for-sale investment securities	**1,036,489**	**823,394**

	2008		2007	
	Interest rate p.a.	*Maturity*	*Interest rate p.a.*	*Maturity*
French government bonds	1.77% - 4.31%	2009	3.82% - 3.90%	2008
Other foreign government bonds	2.02% - 4.12%	2009	3.88% - 4.10%	2008
US Treasury notes	3.10% - 3.60%	2009-2013	3.10% - 4.90%	2008-2013
Bank for International Settlements	3.00% - 4.00%	2009-2014	2.50% - 5.30%	2008-2013
Georgian government bonds	13.00%	2009-2012	13.00%	2009-2011

(Thousands of Georgian Lari)

9. Loans to resident commercial banks

	2008	2007
Overnight loans	-	33,000
Refinancing loans	53,512	-
Lender of last resort loans	155,900	40,132
Gross loans to resident commercial banks	**209,412**	**73,132**
Less – Allowance for impairment	-	-
Loans to resident commercial banks	**209,412**	**73,132**

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. No collateral is obtained on loans issued under loans of last resort. National Bank of Georgia has the first lien on borrowers' assets per Organic Law of Georgian "On the National Bank of Georgia".

The main types of collateral obtained are cash on correspondent balances of Bank and Government securities or debt securities issued by the Bank on refinancing loans.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Concentration of loans to resident commercial banks

As of 31 December 2008 the Bank had a concentration of loans represented by GEL 138,908 due from three largest borrowers (66% of gross loan portfolio) (2007: due from the three largest borrowers – GEL 70,134 or 96% of gross loan portfolio).

10. Held-to-maturity investment securities

	2008		2007	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
Held-to-maturity investment securities in foreign currency				
Corporate bonds				
Bank for International Settlements	66,057	66,680	154,212	154,343
Held-to-maturity investment securities in local currency				
Georgian Government Bonds	690,796	688,846	738,782	736,846
Total held-to-maturity investment securities	**756,853**	**755,526**	**892,994**	**891,189**

Nominal interest rates and maturities of these securities are as follows:

	2008		2007	
	%	*Maturity*	*%*	*Maturity*
Corporate bonds	3.3% - 3.6%	2009-2010	3.0% - 5.0%	2008
Georgian Government Bonds	6%	2009-2025	6%	2008-2025

Government bonds in local currency represent fixed interest bearing securities issued by the Ministry of Finance of Georgia according to the agreement formed between the Georgian government and the Bank in March 2006 converting the government borrowings into debt securities. Interest rate is subject to revision annually considering market rates.

(Thousands of Georgian Lari)

11. Property and equipment held for sale

	2008	2007
Beginning balance	865	728
Additions	16,175	797
Disposal	(3,466)	(660)
Effect of valuation	(2,314)	-
Ending balance	**11,260**	**865**

Additions of the property and equipment held for sale mainly comprise buildings of the Bank's branches which were closed in 2008. The Bank has classified these buildings as held for sale as they are not used for business operations and their carrying amount will be recovered through a sale transaction rather than through continuing use. Effect of valuation of GEL 2,314 originated from write-down of the Property and equipment held for sale to fair value less costs to sell.

(Thousands of Georgian Lari)

12. Property and equipment

The movements in property and equipment were as follows:

	Buildings	*Furniture and fixtures*	*Assets under construction*	*Vehicles and other*	*Total*
Cost					
31 December 2007	**34,275**	**6,400**	**128**	**13,463**	**54,266**
Additions	-	193	398	213	804
Disposals	-	(323)	-	(545)	(868)
Assets classified as held for sale	(16,003)	-	-	-	(16,003)
Transfers	398	-	(398)	-	-
31 December 2008	**18,670**	**6,270**	**128**	**13,131**	**38,199**
Accumulated depreciation					
31 December 2007	**(4,747)**	**(4,686)**	-	**(10,126)**	**(19,559)**
Depreciation charge	(537)	(681)	-	(1,247)	(2,465)
Disposals	-	301	-	362	663
Assets classified as held for sale	2,189	-	-	-	2,189
31 December 2008	**(3,095)**	**(5,066)**	**-**	**(11,011)**	**(19,172)**
Net book value:					
31 December 2007	**29,528**	**1,714**	**128**	**3,337**	**34,707**
31 December 2008	**15,575**	**1,204**	**128**	**2,120**	**19,027**

	Premises	*Furniture and fixtures*	*Assets under construction*	*Vehicles and other*	*Total*
Cost					
31 December 2006	**35,511**	**6,872**	**438**	**13,016**	**55,837**
Additions	179	31	7	843	1,060
Disposals	(643)	(503)	(51)	(438)	(1,635)
Assets classified as held for sale	(996)	-	-	-	(996)
Transfers	224	-	(266)	42	0
31 December 2007	**34,275**	**6,400**	**128**	**13,463**	**54,266**
Accumulated depreciation					
31 December 2006	**(4,370)**	**(4,299)**	**-**	**(9,084)**	**(17,753)**
Depreciation charge	(694)	(868)	-	(1,442)	(3,004)
Disposals	118	481	-	400	999
Assets classified as held for sale	199	-	-	-	199
31 December 2007	**(4,747)**	**(4,686)**	**-**	**(10,126)**	**(19,559)**
Net book value:					
31 December 2006	**31,141**	**2,573**	**438**	**3,932**	**38,084**
31 December 2007	**29,528**	**1,714**	**128**	**3,337**	**34,707**

(Thousands of Georgian Lari)

13. Other assets and liabilities

Other assets comprise:

	2008	*2007*
Other assets in foreign currency		
Prepayments	572	3
Other debtors	3	-
	575	**3**
Other assets in national currency		
Loans to employees	3,951	3,575
Commemorative gold coins	2,739	3,617
Prepayment	5	1,435
Other debtors	50	34
	6,745	**8,661**
Less - Allowance for impairment of other assets	(1,691)	(623)
	5,054	**8,038**
Total other assets	**5,629**	**8,041**

Other liabilities comprise:

	2008	*2007*
Other liabilities in foreign currency		
Amounts due to suppliers	1,244	-
Other liabilities	199	18
	1,443	**18**
Other liabilities in national currency		
Pension scheme liabilities	2,759	4,158
Bonuses payable	1,485	-
Other liabilities	516	512
	4,760	**4,670**
Total other liabilities	**6,203**	**4,688**

Pension scheme liabilities of GEL 2,759 as of 31 December 2008 (2007: GEL 4,158) represent liabilities related to the defined contribution plan. Contributions to the pension scheme are made by the Bank (13% of the employee's monthly salary) and by the employee (1% of the employee's monthly salary) on a monthly basis, and when the employee reaches the pension age aggregated contributions are returned to the employee according to the schedule agreed.

The movements in allowance for impairment of other assets were as follows:

	Other assets
31 December 2006	**(231)**
Impairment charge	(400)
Write-offs	8
31 December 2007	**(623)**
Impairment charge	(1,105)
Write-offs	37
31 December 2008	**(1,691)**

Allowance for impairment of other assets represents allowance for impairment of loans to employees and is deducted from the carrying amounts of the related assets.

(Thousands of Georgian Lari)

14. Money issued in circulation

Money issued in circulation represents the amount of national currency of Georgia issued by the Bank. Movements during the years were as follows:

	2008	*2007*
Balance as of 1 January	1,310,488	929,634
Banknotes issued in circulation	955,540	966,391
Coins issued into circulation	5,186	11,270
Less: Cash on hand in national currency	(13,282)	(16,980)
Banknotes withdrawn from circulation	(963,863)	(579,085)
Coins withdrawn from circulation	(3,366)	(742)
Balance as of 31 December	**1,290,703**	**1,310,488**

15. Amounts due to resident credit institutions

	2008	*2007*
Foreign currency liabilities		
Correspondent accounts	88,952	6,118
Minimum reserve requirement	121,236	277,267
	210,188	**283,385**
National currency liabilities		
Correspondent accounts	141,190	186,943
Minimum reserve requirement	-	1,170
	141,190	**188,113**
Amounts due to resident credit institutions	**351,378**	**471,498**

Included in current accounts and minimum reserve requirement is a balance of GEL 185,506 (2007 – GEL 320,861) with three largest local commercial banks, whose balances exceed 10% of the total amounts due to resident credit institutions.

Minimum reserve requirement represents obligatory reserves required of resident credit institutions to be maintained with the Bank and are calculated as 5% of their eligible liabilities. At the beginning of the 2008 minimum reserve requirement was calculated as 13% of the credit institution's liabilities. Annual interest rate was 0% on USD denominated minimum reserve requirement and 2.25% on EUR denominated minimum reserve requirement as of 31 December 2008.

16. Amounts due to the Ministry of Finance

	2008	*2007*
Foreign currency liabilities		
Current accounts	15,284	6,801
Restricted amount for letters of credit	1,058	2,717
	16,342	**9,518**
National currency liabilities		
Current accounts	823,764	359,585
Restricted amount for letters of credit	39,865	81,028
	863,629	**440,613**
Amounts due to the Ministry of Finance	**879,971**	**450,131**

(Thousands of Georgian Lari)

17. Amounts due to customers

	2008	2007
Foreign currency liabilities		
Amounts due to foreign financial institution	-	4,232
	-	**4,232**
National currency Liabilities		
State and budgetary organizations	1,216	313
International financial institutions	3,161	2,868
Other	169	12,025
	4,546	**15,206**
Amounts due to customers	**4,546**	**19,438**

Amounts due to international financial institutions as of 31 December 2008 comprised International Bank for Reconstruction and Development (IBRD) current accounts of GEL 3,061 (2007: GEL 2,868) and International Development Association (IDA) current accounts of GEL 100 (2007: nil).

18. Debt securities issued

	Interest rate p.a.	*Maturity*	*Nominal value*	*Carrying value*
Certificates of Deposit as of December 31, 2008	from 10.99% to 13%	Jan 8 - Mar 26, 2009	78,050	77,352
Certificates of Deposit as of December 31, 2007	from 7.98% to 13%	Jan 4 - Jun 11, 2008	382,080	376,541

(Thousands of Georgian Lari)

19. Equity

As stated in the Law, the Bank's capital is comprised of its authorized capital and reserve fund.

Authorized capital

The authorized and fully paid-up capital of the Bank is GEL 15,000.

Other reserves

Movements in other reserves were as follows:

	Reserve fund	*Foreign currenc revaluation reserve*	*Revaluation reserve for available-for-sale investment securities*	*Total*
At 1 January 2007	**56,081**	**-**	**(143)**	**55,938**
Net unrealised gains (losses) on available-for-sale investments	-	-	10,335	10,335
Realised gains (losses) on available-for-sale investment securities reclassified to the income statement	-	-	(634)	(634)
Transfer to reserve fund	4,611	-	-	4,611
At 31 December 2007	**60,692**	**-**	**9,558**	**70,250**
Net unrealised gains (losses) on available-for-sale investments	-	-	10,380	10,380
Realised gains (losses) on available-for-sale investment securities reclassified to the income statement	-	-	(3,358)	(3,358)
Transfer to foreign currency revaluation reserve	-	9,824	-	9,824
Transfer to reserve fund	58,905	-	-	58,905
At 31 December 2008	**119,597**	**9,824**	**16,580**	**146,001**

Reserve fund

According to the amended Article 23 of the Law, reserve fund should make up 15% of the reserve money, which comprises of the national currency in cash put into circulation by the Bank together with the correspondent accounts of commercial banks in national currency and are established by allocations from the realised profit for the year, which comprises profit for the year excluding net foreign currency translation gain. Reserve fund may only be used to offset losses of the Bank. Upon establishment of reserve fund, the residual balance of realised profit of the Bank shall be transferred to the State Budget. The amendments made to Articles 23 and 24 of the Organic Law of Georgia "On the National Bank of Georgia" dated 14 March 2008 (N5908) with an effective date of 1 January 2009 (the "Law") are effective for the Bank's IFRS financial statements as of and for the year ended 31 December 2008, thereby the annual profit allocation for 2008 is applied and reflected in the 2008 IFRS financial statements in accordance with the aforementioned amendments.

Prior to the amendment of Article 23 of the Law on 14 March 2008, the Bank established reserve fund by allocating no more than 50% of the realised profit for the year, until the amount of reserve fund equaled the amount of contributed capital. By authorization of the Council of the Bank, the total amount of the reserve fund could be increased beyond the contributed capital of the Bank. Upon establishment of reserve fund, the residual balance of realised profit of the Bank was transferred to the State Budget within four months after the year end.

GEL 25,000 of residual amount of the Bank's 2007 realised profit was transferred to the Ministry of Finance of Georgia in 2008 (2007: GEL 40,000 was transferred from the Bank's 2006 realized profit) based on the resolution of the Council of the Bank. As of 31 December 2008 reserve fund did not exceed 15% of the reserve money, therefore, no funds were allocated to the State Budget in 2008. In 2007 GEL 4,611 was allocated to the reserve fund based on the resolution of the Council of the Bank.

Foreign currency revaluation reserve

According to the amended Article 23 of the Law the Bank transfers net gains arising from foreign currency revaluation to the foreign currency revaluation reserve, which may only be used to offset future net revaluation losses. If there is no foreign currency revaluation reserve, net foreign currency revaluation loss is not offset and remains in the realised profit.

Revaluation reserve for available-for-sale investment securities

This reserve records fair value changes on available-for-sale investment securities.

(Thousands of Georgian Lari)

20. Commitments and contingencies

Operating environment

As an emerging market, Georgia does not possess a well-developed infrastructure that would generally exist in a more mature market economy. Operations in Georgia may involve risks that are not typically associated with those in developed markets. However over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create efficient banking, judicial, taxation and regulatory systems. This has resulted in stable macroeconomic environment with higher real growth rates and inflow of foreign investments. In management's view, these steps contribute to mitigate the risks of doing business in Georgia.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future development of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government and the Central Bank. However, the Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. During the year there have been major events that have an effect on the Bank's operations – military intervention of the Russian Federation in Georgia in August 2008 and international financial crisis which significantly affected global economies from last quarter of 2008. Though no direct damage has been sustained by the Bank during the Russian military intervention, it had caused significant damage to the Georgian economy and the Fitch and S&P country credit ratings were downgraded. The ongoing global financial crisis and the military conflict have resulted to the volatility of Georgian sovereign and corporate securities in the international markets, temporary deterioration of liquidity in the banking sector, and tighter credit conditions within Georgia. The Bank has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Georgian banks. The international community has pledged a substantial financial aid package to support the public and private sectors to withstand the negative impact of abovementioned events. This will allow the Georgian economy to continue at moderate growth rates notwithstanding the impact of external shocks.

Legal

The Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Financial commitments and contingencies

As of 31 December 2008 the Bank's financial commitments and contingencies comprised of a letter of credit issued in the amount of GEL 42,005 (2007: GEL 83,745).

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions.

(Thousands of Georgian Lari)

21. Net fee and commission expense

	2008	2007
Cash operations	1,636	362
Funds transfer	362	302
Other	8	8
Fee and commission income	**2,006**	**672**
Cash operations	(2,039)	(296)
Fees to Tbilisi Interbank Currency Exchange (TICEX)	(328)	(290)
Settlements operations	(131)	(118)
Other	(116)	(673)
Fee and commission expense	**(2,614)**	**(1,377)**
Net fee and commission expense	**(608)**	**(705)**

22. Other Income

	2008	2007
Reversal of payable	4,274	-
Revenue from fines	2,247	2,788
Gains on sale of commemorative coins	253	63
Other	366	578
Other Income	**7,140**	**3,429**

Payable of GEL 4,274 to a foreign financial institution was settled in 2008 without making payments as this was taken over by the Ministry of Finance.

(Thousands of Georgian Lari)

23. Administrative expenses

Administrative expenses comprise:

	2008	2007
Salaries and bonuses	16,096	12,931
Pension cost	722	912
Paid vacation and sick leave	491	646
Social security costs	-	2,961
Total personnel expenses	**17,309**	**17,450**
Depreciation charge (note 12)	2,465	3,004
Amortization charge	204	301
Total depreciation and amortization	**2,669**	**3,305**
Financial Monitoring Service (FMS) and Financial Supervisory Agency (FSA) related expenses	4,130	1,633
Losses on revaluation of property and equipment	2,314	-
Losses on sales of property and equipment	1,312	327
Social benefit expenses	941	416
Security	804	1,032
Subscription to information services	671	743
Utilities	569	577
Communications	318	615
Legal and consultancy	256	185
Personnel training	183	198
Repairs and maintenance of property and equipment	158	384
Business travel and related	158	262
Office supplies	131	253
Software maintenance fees	57	236
Advertising	19	55
Other	486	712
Total administrative expenses	**12,507**	**7,628**

Salaries and bonuses for the year ended 31 December 2008 includes GEL 1,920 work experience related bonus of 2005 paid in 2008 according to the court decision.

Expenses on FMS and FSA represent expenses related to financial monitoring services and financial supervisory agency which are separate entities financed by the Bank.

Losses on revaluation of property and equipment for the year ended 31 December 2008 represents loss originated from write-down of the Property and equipment held for sale to fair value less costs to sell.

(Thousands of Georgian Lari)

24. Risk management

Introduction

The activities of the Bank are exposed to various risks. Risk management therefore is a critical component of its banking activities. Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and daily monitoring, subject to risk limits and other controls. Each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The Council of the Bank is ultimately responsible for identifying and controlling risks; however, there are separate business units responsible for managing and monitoring the various risks.

Council

The Council of the Bank has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures.

Reserve Management Committee

The Reserve Management Committee (the "Committee") of the Bank is responsible for monitoring and implementation of risk mitigation measures and making sure that the Bank operates within the established risk parameters. Typical activities of the Committee are reviewing the monthly reports, approving list of eligible counterparties, approving changes to the strategy before submitting them to the Council and occasionally making important tactical decisions on asset allocation.

Risk Management and Control Division

Risk Management and Control Division (the "Division") of the Bank is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting risks. Main function of the Division is to identify, analyze and manage the risks faced by the Bank, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Also the Division works on Benchmarking and Stress Testing. The Division is responsible for monthly reports for the Reserve Management Committee.

Internal Audit

Risk management processes throughout the Bank are audited annually by the Internal Audit that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Chairman of the Council.

Risk measurement and reporting systems

Depending on the structure of operations, the risk management in the Bank is conducted by centralized and non-centralized method. Financial risk management is conducted centrally whereas operational risk management is not centralized.

Risk management is conducted directly by various departments. There are also special committees and commissions within the Bank for conducting operations and control such as the Reserve Management Committee, Credit Committee and others.

The risk related to the Bank's foreign currency assets is a significant risk. Segregation of duties, procedures and reporting for risk management are regulated by the "Guidelines on Management of International Reserves of the National Bank of Georgia".

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

(Thousands of Georgian Lari)

24. Risk management (continued)

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio.

Credit risk

The Bank exposes credit risk, which is the risk that one party will incur a loss because the other party failed to comply with its financial obligations. Credit risk is managed and controlled through proper selection of investment assets, credit quality of investment assets and setting limits on the amount of investment per investment asset. The Bank has developed policies and procedures for the management of credit exposures, including guidelines to limit portfolio concentration. Reserve Management Committee actively monitors the Bank's credit risk. The Bank's credit policy is reviewed and approved by the Council.

In order to decrease the credit risk exposure in foreign currency, the list of reliable counterparties having high long-term credit rating, established by the international rating agencies (Standard & Poor's, Moody's and Fitch) is selected by the Risk Management Division and approved by the Reserves Management Committee.

While selecting the Bank's Counterparties, the bank's credit rating, the country of its residence, the volume of the bank's assets and capital, the experience of working in international markets and with corporate clients and the spectrum of the services instruments offered to clients are taken into consideration. In case of downgrade of the long-term credit rating of the Bank's counterparty by the above-mentioned Rating Agencies, the counterparty will be withdrawn from the list of counterparties. Minimum required credit rating is higher and must be at least AA by at least two of the three Credit Rating Agencies. As to the current accounts and trading purposes, Bank sees a lower credit risk and therefore, the minimum requirement stands at A by at least two of the three credit rating agencies.

The Bank also has limits for individual counterparties and sovereign limits as well.

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before impairment allowances and the effect of mitigation through the use of master netting and collateral agreements.

	Notes	*Maximum exposure 2008*	*Maximum exposure 2007*
Cash and cash equivalents (excluding cash on hand)	5	1,185,891	1,118,348
Amounts due from non-resident credit institutions	6	40,947	141,537
Special Drawing Rights holdings with the IMF	7	20,515	23,533
Available-for-sale investment securities	8	1,036,489	823,394
Loans to resident commercial banks	9	209,412	73,132
Held-to-maturity investment securities	10	756,853	892,994
Other assets	13	3,951	3,575
		3,254,058	**3,076,513**
Financial commitments and contingencies	20	42,005	83,745
Total credit risk exposure		**3,296,063**	**3,160,258**

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values. For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

The table below represents information on credit rating of issuers of the financial instruments held by the Bank in foreign currency. The table contains ratings of S&P, Fitch and Moody's international agencies. When different credit ratings are designated by the agencies for the asset, the lowest designated rating for this asset is used.

As at 31 December 2008	*AAA*	*AA+*	*AA*	*AA-*	*A+*	*A*	*B*	*Unrated*	*Total*
Cash and cash equivalents (excluding cash on hand)	165,904	70,986	298,002	366,786	186,873	97,340	-	-	**1,185,891**
Amounts due from non-resident credit institutions	9,577	-	-	-	2,226	29,144	-	-	**40,947**
SDR holdings with the IMF	20,515	-	-	-	-	-	-	-	**20,515**
Available-for-sale investment securities	860,237	-	82,252	-	-	-	93,960	40	**1,036,489**
Loans to resident commercial banks	-	-	-	-	-	-	35,300	174,112	**209,412**
Held-to-maturity investment securities	66,057	-	-	-	-	-	690,796	-	**756,853**
Other assets	-	-	-	-	-	-	-	3,951	**3,951**

As at 31 December 2007	*AAA*	*AA+*	*AA*	*AA-*	*A+*	*A*	*B*	*Unrated*	*Total*
Cash and cash equivalents (excluding cash on hand)	112,032	87,542	598,980	263,877	55,917	-	-	-	**1,118,348**
Amounts due from non-resident credit institutions	-	540	54,961	68,663	17,373	-	-	-	**141,537**
SDR holdings with the IMF	23,533	-	-	-	-	-	-	-	**23,533**
Available-for-sale investment securities	783,690	-	-	-	-	-	39,664	40	**823,394**
Loans to resident commercial banks	-	-	-	-	-	-	50,011	23,121	**73,132**
Held-to-maturity investment securities	154,212	-	-	-	-	-	738,782	-	**892,994**
Other assets	-	-	-	-	-	-	-	3,575	**3,575**

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

As a central bank, the Bank ensures the stability of the country's financial system by granting short-term loans to banks having liquidity problems, as deemed appropriate. The table below shows the credit quality by class of asset for loan-related balance sheet lines, based on the Bank's credit rating system.

		Neither past due nor impaired 2008			*B grade*	*Total*
	Notes	*AAA grade*	*AA grade*	*A grade*	*2008*	*2008*
Loans to resident commercial banks	9	-	209,412	-	-	209,412
Held-to-maturity investment securities	10	-	690,796	-	-	690,796
Total		**-**	**900,208**	**-**	**-**	**900,208**

		Neither past due nor impaired 2007			*B grade*	*Total*
	Notes	*AAA grade*	*AA grade*	*A grade*	*2007*	*2007*
Loans to resident commercial banks	9	-	73,132	-	-	73,132
Held-to-maturity investment securities	10	-	738,782	-	-	738,782
Total		**-**	**811,914**	**-**	**-**	**811,914**

The Bank classifies its loan portfolio as follow:

AAA grade - loans issued to borrowers with excellent financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

AA grade - loans issued to borrowers with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

A grade – loans issued to borrowers with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

B grade - loans issued to borrowers with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. The attributed risk ratings are assessed and updated regularly.

Impairment assessment

The main considerations for loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of the counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to banks that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

Loans granted to employees

Employees of the Bank have right to take a loan from the Bank during the time period of his/her work. When the employee leaves the Bank, 100% allowance is made on the outstanding loan. Write-off is conducted according to the decision made by the management.

Loans granted to commercial banks

If the commercial bank fails to repay the loan within the fixed timeframe, the Bank is entitled to recover the unpaid loan from any assets of the commercial bank, in line with the requirements under Article 64 of the Organic Law. The Bank makes no allowance on the liabilities of the resident commercial banks.

The geographical concentration of the Bank's monetary assets and liabilities is set out below:

	2008			2007		
	Georgia	*OECD*	*Total*	*Georgia*	*OECD*	*Total*
Assets:						
Cash and cash equivalents	248,699	1,185,891	1,434,590	26,970	1,118,348	1,145,318
Amounts due from non-resident credit institutions	-	40,947	40,947	-	141,537	141,537
Special Drawing Rights holdings with the IMF	-	20,515	20,515	-	23,533	23,533
Available-for-sale investment securities	94,000	942,489	1,036,489	39,704	783,690	823,394
Held-to-maturity investment securities	690,796	66,057	756,853	738,782	154,212	892,994
Loans to resident commercial banks	209,412	-	209,412	73,132	-	73,132
Other assets	5,054	575	5,629	8,038	3	8,041
	1,247,961	**2,256,474**	**3,504,435**	**886,626**	**2,221,323**	**3,107,949**
Liabilities:						
Amounts due to resident credit institutions	351,378	-	351,378	471,498	-	471,498
Amounts due to the Ministry of Finance	879,971	-	879,971	450,131	-	450,131
Amounts due to customers	1,385	3,161	4,546	15,206	4,232	19,438
Amounts due to the International Monetary Fund	-	763,789	763,789	-	400,900	400,900
Debt securities issued	77,352	-	77,352	376,541	-	376,541
Other liabilities	4,959	1,244	6,203	4,670	-	4,670
	1,315,045	**768,194**	**2,083,239**	**1,318,046**	**405,132**	**1,723,178**
Net balance sheet position	**(67,084)**	**1,488,280**	**1,421,196**	**(431,420)**	**1,816,191**	**1,384,771**

(Thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Management of the liquidity risk by the Bank is based on keeping the liquidity at required level for meeting the requirements of the Bank in any condition.

In order to achieve the Bank's primary goals of maintaining price stability and control over monetary policy, the Bank maintains operational foreign currency assets which are a group of liquid assets from its foreign currency assets to ensure timely intervention when deemed necessary. Liquidity risk management consists of identifying the liquid assets and determining the minimum liquidity limits of foreign currency assets over its investment period.

The Bank's Monetary Policy and International Reserves Management Committees set limits on the minimum proportion of maturing funds available to cover cash outflows. The liquidity management policy of the Bank requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;

The Foreign Exchange and Monetary Operations Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the system as a whole.

The daily liquidity position is monitored by the stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Foreign Exchange and Monetary Operations Department. Under the normal market conditions, liquidity reports covering the liquidity position of the Bank are presented to the senior management on a weekly basis. Decisions on the Bank's liquidity management are made by the Monetary Policy Committee and International Reserves Management Committee and implemented by the Foreign Exchange and Monetary Operations Department.

(Thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2008 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many counterparties will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows.

Financial liabilities As at December 31, 2008	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
Amounts due to resident credit institutions	351,378	-	-	-	-	351,378
Amounts due to the Ministry of Finance	840,245	39,726	-	-	-	879,971
Amounts due to customers	4,546	-	-	-	-	4,546
Debt securities issued	77,352	-	-	-	-	77,352
Amounts due to the IMF	2,460	61,434	678,231	75,880	-	818,005
Other liabilities	3,444	-	-	2,759	-	6,203
Total undiscounted financial liabilities	**1,279,425**	**101,160**	**678,231**	**78,639**	**-**	**2,137,455**

Financial liabilities As at 31 December 2007	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
Amounts due to resident credit institutions	471,498	-	-	-	-	471,498
Amounts due to the Ministry of Finance	369,104	69,204	11,823	-	-	450,131
Amounts due to customers	15,217	292	-	5,970	-	21,479
Debt securities issued	376,541	-	-	-	-	376,541
Amounts due to the IMF	1,016	57,389	230,605	120,438	-	409,448
Other liabilities	157	186	4,345	-	-	4,688
Total undiscounted financial liabilities	**1,233,533**	**127,071**	**246,773**	**126,408**	**-**	**1,733,785**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
2008	2,279	39,726	-	-	-	**42,005**
2007	2,718	69,204	11,823	-	-	**83,745**

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

(Thousands of Georgian Lari)

24. Risk management (continued)

Market risk

Market risk is the risk that the value of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. Market risks comprise currency risk, interest rate risk and other price risk. Market risk arises from open positions in interest rate, currency and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices.

Interest rate risk

The objective of Market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk. The market risk is managed by preliminary index of the Neutral Duration of the Bank's international reserves. Maximum duration of instruments is stipulated for different financial instruments of portfolio.

The following table demonstrates the net effect of 1% change in interest rates to fair market value of the Bank's financial assets and liabilities. Analysis of sensitivity to interest rate risk is made on the basis of "estimated change of the risk factor" (PV01).

	2008		2007	
Currency	*Increase in interest rate*	*Sensitivity of fair market value*	*Increase in interest rate*	*Sensitivity of fair market value*
USD	1%	(1,787)	1%	(11,654)
EUR	1%	(1,679)	1%	(2,884)
GBP	1%	(95)	1%	(22)
SDR	1%	3,914	1%	(235)
Other	1%	-	1%	(7)

	2008		2007	
Currency	*Decrease in interest rate*	*Sensitivity of fair market value*	*Decrease in interest rate*	*Sensitivity of fair market value*
USD	(1%)	1,787	(1%)	11,654
EUR	(1%)	1,679	(1%)	2,884
GBP	(1%)	95	(1%)	22
SDR	(1%)	(3,914)	(1%)	235
Other	(1%)	-	(1%)	7

Limitations on sensitivity analysis: The above tables reflect the effect of changes in principal assumptions with all other assumptions remaining constant. Actually, there is an interrelation between assumptions reflected in the table and other factors. It should be noted that sensitivity exponents in the table are not calculated under line function and sensitivity to even more or less change in currency rates may not be directly interpolated and extrapolated on the basis of the table figures.

Sensitivity analysis does not account the active management of the Bank's assets and liabilities. Further, financial position of the Bank may change according to market changes. For instance, financial risk management strategy of the Bank supposes management of sensitivity to market changes. When market changes go beyond certain limit, management of the Bank may make a decision to take some measures. As a result, changes in assumptions may have no effect on liabilities, while assets are valued in balance sheet at market prices. In such cases utilization of different valuation bases for assets and liabilities may result in change of net assets.

Other limitations on the above sensitivity analysis include: usage of hypothetic market changes for demonstration of potential risk presupposed without any assurance in possible market changes for the nearest period and reflecting the Bank's position only and supposition of similar movement of all interest rates.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Subject to the currency structure of assets, the value of assets of the Bank is exposed to risk of changes in exchange rates of main foreign currencies.

(Thousands of Georgian Lari)

24. Risk management (continued)

Market risk (continued)

Currency risk (continued)

The table below indicates the currencies to which the Bank had significant exposure at 31 December 2008 and 2007 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Georgian Lari, with all other variables held constant on the income statement. A negative amount in the table reflects a potential net reduction in income statement, while a positive amount reflects a net potential increase.

	2008						*2007*					
	GEL	*USD*	*EUR*	*SDR*	*Other*	*Total*	*GEL*	*USD*	*EUR*	*SDR*	*Other*	*Total*
Assets:												
Cash and cash equivalents	-	1,001,051	357,452	-	76,087	**1,434,590**	-	832,736	312,157	-	425	**1,145,318**
Amounts due from non-resident credit institutions	-	29,642	10,760	-	545	**40,947**	-	73,499	65,836	-	2,202	**141,537**
SDR holdings with the IMF	-	-	-	20,515	-	**20,515**	-	-	-	23,533	-	**23,533**
Available-for-sale investment securities	94,000	292,931	649,558	-	-	**1,036,489**	39,704	383,443	400,247	-	-	**823,394**
Loans to resident commercial banks	209,412	-	-	-	-	**209,412**	73,132	-	-	-	-	**73,132**
Held-to-maturity investment securities	690,796	66,057	-	-	-	**756,853**	738,782	118,476	35,736	-	-	**892,994**
Other assets	5,054	-	-	572	3	**5,629**	8,038	3	-	-	-	**8,041**
Total Assets	**999,262**	**1,389,681**	**1,017,770**	**21,087**	**76,635**	**3,504,435**	**859,656**	**1,408,157**	**813,976**	**23,533**	**2,627**	**3,107,949**
Liabilities:												
Amounts due to resident credit institutions	141,190	170,749	39,429	-	10	**351,278**	188,113	282,796	577	-	12	**471,498**
Amounts due to the Ministry of Finance	863,629	15,155	580	-	607	**879,971**	440,613	6,301	1,194	-	2,023	**450,131**
Amounts due to customers	4,546	-	-	-	-	**4,546**	15,206	-	4,232	-	-	**19,438**
Debt securities issued	77,352	-	-	-	-	**77,352**	376,541	-	-	-	-	**376,541**
Liabilities to the IMF	-	-	-	763,789	-	**763,789**	-	-	-	400,900	-	**400,900**
Other liabilities	4,760	199	1,244	-	-	**6,203**	4,670	18	-	-	-	**4,688**
Total Liabilities	**1,091,477**	**186,103**	**41,253**	**763,789**	**617**	**2,083,139**	**1,025,143**	**289,115**	**6,003**	**400,900**	**2,035**	**1,723,196**
Net balance sheet position	**(92,215)**	**1,203,578**	**976,517**	**(742,702)**	**76,018**	**1,421,296**	**(165,487)**	**1,119,042**	**807,973**	**(377,367)**	**592**	**1,384,753**
Increase in currency rate in %		1%	1%	1%	1%			1%	1%	1%	1%	
Effect on profit		**12,036**	**9,765**	**(7,427)**	**760**			**11,190**	**8,080**	**(3,774)**	**6**	
Decrease in currency rate in %		-1%	-1%	-1%	-1%			-1%	-1%	-1%	-1%	
Effect on profit		**(12,036)**	**(9,765)**	**7,427**	**(760)**			**(11,190)**	**(8,080)**	**3,774**	**(6)**	

(Thousands of Georgian Lari)

24. Risk management (continued)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is expected to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

25. Fair values of financial instruments

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are carried in the financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2008	*Fair value 2008*	*Unrecognised gain/(loss) 2008*	*Carrying value 2007*	*Fair value 2007*	*Unrecognised gain/(loss) 2007*
Financial assets						
Cash and cash equivalents	1,434,590	1,434,590	-	1,145,318	1,145,318	-
Amounts due from non-resident credit institutions	40,947	40,947	-	141,537	141,537	-
SDR holdings with the IMF	20,515	20,515	-	23,533	23,533	-
Available-for-sale investment securities	1,036,489	1,036,489	-	823,394	823,394	
Loans to resident commercial banks	209,412	209,412	-	73,132	73,132	-
Held-to-maturity investment securities	756,853	620,744	(136,109)	892,994	701,986	(191,008)
Other assets	5,629	5,629	-	8,041	8,041	-
Financial liabilities						
Amounts due to resident credit institutions	351,378	351,378	-	471,498	471,498	-
Amounts due to the Ministry of Finance	879,971	879,971	-	450,131	450,131	-
Amounts due to customers	4,546	4,546	-	19,438	19,438	-
Debt securities issued	77,352	77,352	-	376,541	376,541	-
Amounts due to the IMF	763,789	743,471	20,318	400,900	299,834	101,066
Other liabilities	6,203	6,203	-	4,688	4,688	-
Total unrecognised change in unrealised fair value			**(115,791)**			**(89,942)**

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value.

Available-for-sale investment securities

Available-for–sale investment securities include government bonds in local currency issued by the Ministry of Finance of Georgia. As there have not been any transactions in 2008 providing evidence of the current fair value of the Georgian government bonds, discounted cash flow method was used for estimating fair value.

The Bank's refinancing rate of 8% as of 31 December 2008 was used for estimating fair value of the unquoted securities.

(Thousands of Georgian Lari)

25. Fair values of financial instruments (continued)

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Financial instruments recorded at fair value

The following table shows an analysis of financial instruments recorded at fair value, between those whose fair value is based on quoted market prices, those involving valuation techniques where all the model inputs are observable in the market, and those where the valuation techniques involves the use of non-market observable inputs.

Certain financial instruments are recorded at fair value using valuation techniques as current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against the prices of actual market transactions and using the Bank's best estimate of the most appropriate model inputs.

	Quoted market price 2008	**Valuation techniques – market observable inputs 2008**	**Valuation techniques – non-market observable inputs 2008**	**Total 2008**
Financial assets				
Available-for-sale investment securities	942,489	-	94,000	1,036,489
Held-to-maturity investment securities	66,057	-	690,796	756,853
	1,008,546	**-**	**784,796**	**1,793,342**
Financial liabilities				
Debt securities issued	-	-	77,352	77,352
	-	**-**	**77,352**	**77,352**

	Quoted market price 2007	**Valuation techniques – market observable inputs 2007**	**Valuation techniques – non-market observable inputs 2007**	**Total 2007**
Financial assets				
Available-for-sale investment securities	783,690	-	39,704	823,394
Held-to-maturity investment securities	154,212	-	738,782	892,994
	937,902	**-**	**778,486**	**1,716,388**
Financial liabilities				
Debt securities issued	-	-	376,541	376,541
	-	**-**	**376,541**	**376,541**

(Thousands of Georgian Lari)

26. Maturity analysis of financial assets and liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled.

	2008			2007		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	1,434,590	-	1,434,590	1,040,750	104,568	1,145,318
Amounts due from non-resident credit institutions	40,947	-	40,947	81,924	59,613	141,537
SDR holdings with the IMF	20,515	-	20,515	23,533	-	23,533
Available-for-sale investment securities	834,218	202,271	1,036,489	469,001	354,393	823,394
Loans to resident commercial banks	209,412	-	209,412	73,132	-	73,132
Held-to-maturity investment securities	66,722	690,131	756,853	92,158	800,836	892,994
Other assets	3,369	2,260	5,629	5,122	2,919	8,041
Total	**2,609,773**	**894,662**	**3,504,435**	**1,785,620**	**1,322,329**	**3,107,949**
Financial liabilities						
Amounts due to resident credit institutions	351,378	-	351,378	471,498	-	471,498
Amounts due to the Ministry of Finance	879,971	-	879,971	450,131	-	450,131
Amounts due to customers	4,546	-	4,546	19,438	-	19,438
Debt securities issued	77,352	-	77,352	376,541	-	376,541
Amounts due to the IMF	46,788	717,001	763,789	56,214	344,686	400,900
Other liabilities	3,444	2,759	6,203	530	4,158	4,688
Total	**1,363,479**	**719,760**	**2,083,239**	**1,374,352**	**348,844**	**1,723,196**
Net	**1,246,294**	**174,902**	**1,421,196**	**411,268**	**973,485**	**1,384,753**

(Thousands of Georgian Lari)

27. Related party disclosures

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. The Government of Georgia and other Georgian Government owned and controlled entities are considered as related parties.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2008				*2007*			
	Government of Georgia and Government controlled entities	*Key management personnel*	*Other employees*	*Total*	*Government of Georgia and Government controlled entities*	*Key management personnel*	*Other employees*	*Total*
Loans outstanding at 1 January, gross	3	575	2,377	2,955	3	549	2,410	2,962
Loans issued during the year	-	199	2,015	2,214	-	261	1,681	1,942
Loan repayments during the year	-	(439)	(2,467)	(2,906)	-	(235)	(1,714)	(1,949)
Loans outstanding at December 31, gross	3	335	1,925	2,263	3	575	2,377	2,955
Less: allowance for impairment at 31 December	-	-	-	-	-	-	-	-
Loans outstanding at 31 December, net	**3**	**335**	**1,925**	**2,263**	**3**	**575**	**2,377**	**2,955**
Interest income on loans	-	23	128	151	-	14	131	145
	-	**23**	**128**	**151**	**-**	**14**	**131**	**145**
Available-for-sale investment securities	39,704	-	-	39,704	-	-	-	-
Securities purchased during the year	54,296	-	-	54,296	39,704	-	-	39,704
Available-for-sale investment securities at 31 December, gross	94,000	-	-	94,000	39,704	-	-	39,704
Less: allowance for impairment at 31 December	-	-	-	-	-	-	-	-
Available-for-sale investment securities at 31 December, net	**94,000**	**-**	**-**	**94,000**	**39,704**	**-**	**-**	**39,704**
Interest income on Available-for-sale investment securities	9,880	-	-	9,880	4,259	-	-	4,259
	9,880	**-**	**-**	**9,880**	**4,259**	**-**	**-**	**4,259**
Held-to-maturity investment securities at 1 January, gross	738,782	-	-	738,782	787,251	-	-	787,251
Securities matured during the year	(47,986)	-	-	(47,986)	(48,469)	-	-	(48,469)
Held-to-maturity investment securities at 31 December, gross	690,796	-	-	690,796	738,782	-	-	738,782
Less: allowance for impairment at 31 December	-	-	-	-	-	-	-	-
Held-to-maturity investment securities at 31 December, net	**690,796**	**-**	**-**	**690,796**	**738,782**	**-**	**-**	**738,782**
Interest income on Held-to-maturity investment securities	42,065	-	-	42,065	46,424	-	-	46,424
	42,065	**-**	**-**	**42,065**	**46,424**	**-**	**-**	**46,424**

(Thousands of Georgian Lari)

27. Related party disclosures (continued)

	2008				2007			
	Government of Georgia and Government controlled entities	*Key management personnel*	*Other employees*	*Total*	*Government of Georgia and Government controlled entities*	*Key management personnel*	*Other employees*	*Total*
Amounts due to the Ministry of Finance at 31 December	**879,971**	**-**	**-**	**879,971**	**450,131**	**-**	**-**	**450,131**
Amounts due to customers at 1 January	313	-	-	313	-	-	-	-
Amounts received during the year	5,420	-	-	5,420	1,696	-	-	1,696
Amounts repaid during the year	(4,517)	-	-	(4,517)	(1,383)	-	-	(1,383)
Amounts due to customers at 31 December	1,216	-	-	1,216	313	-	-	313
Commitments and guarantees issued	42,005	-	-	42,005	83,745	-	-	83,745
Other income	4,274	-	-	4,274	-	-	-	-
Other operating expense	4,130	-	-	4,130	1,633	-	-	1,633

Compensation of key management personnel was comprised of the following:

	2008	2007
Salaries and other benefits	1,364	1,334
Post employment benefits	64	67
Social security costs	-	280
Total key management compensation	**1,428**	**1,681**

28. Events after the balance sheet date

On 26 February 2009 George Kadagidze was appointed as President and Chairman of the Council of the National Bank of Georgia.

On 18 March 2009 the Monetary Policy Committee of the National Bank of Georgia decided to lower its refinancing rate by 50 basis points to 6.5 percent.

On 28 March 2009 the Bank received the second tranche of the Stand-by Arrangement of SDR 126,200 from the IMF..

Property and equipment held for sale, except for two buildings located in Tbilisi and Batumi amounting to GEL 6,628 are in the process of transfer to the Ministry of Economy of Georgia.

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