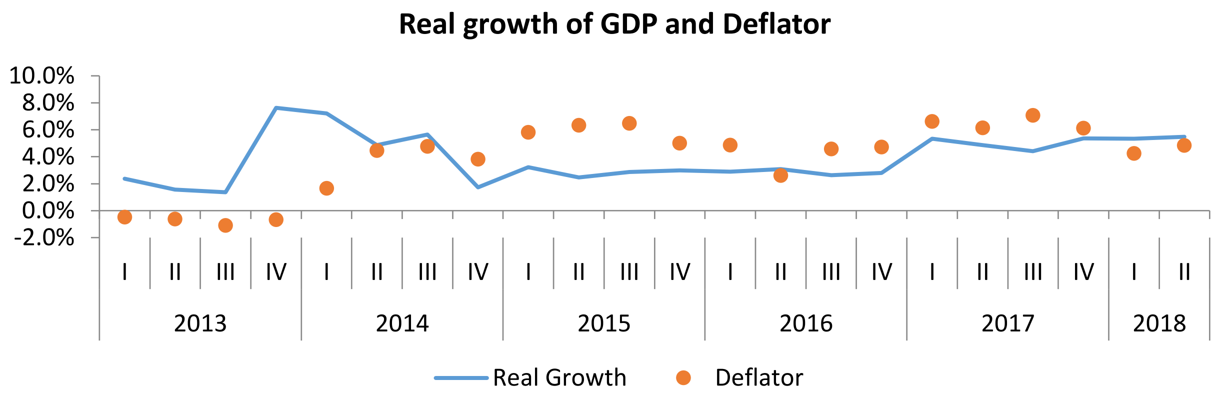
Macro Outlook

September, 2018

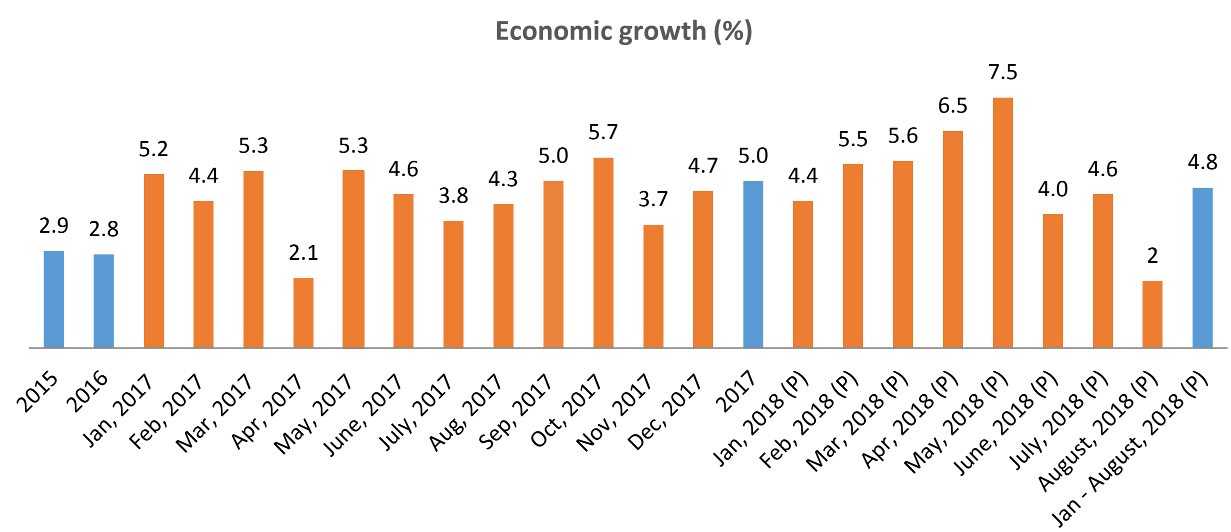
Content

Gross Domestic Product (GDP)

From the beginning of 2017 year Georgian economy started rapid recovering after the economic slowdown in 2014-2016. For the IV quarter real growth was amounted to 5.4 percent, while in 2017 growth rate of real GDP was 5.0 percent.



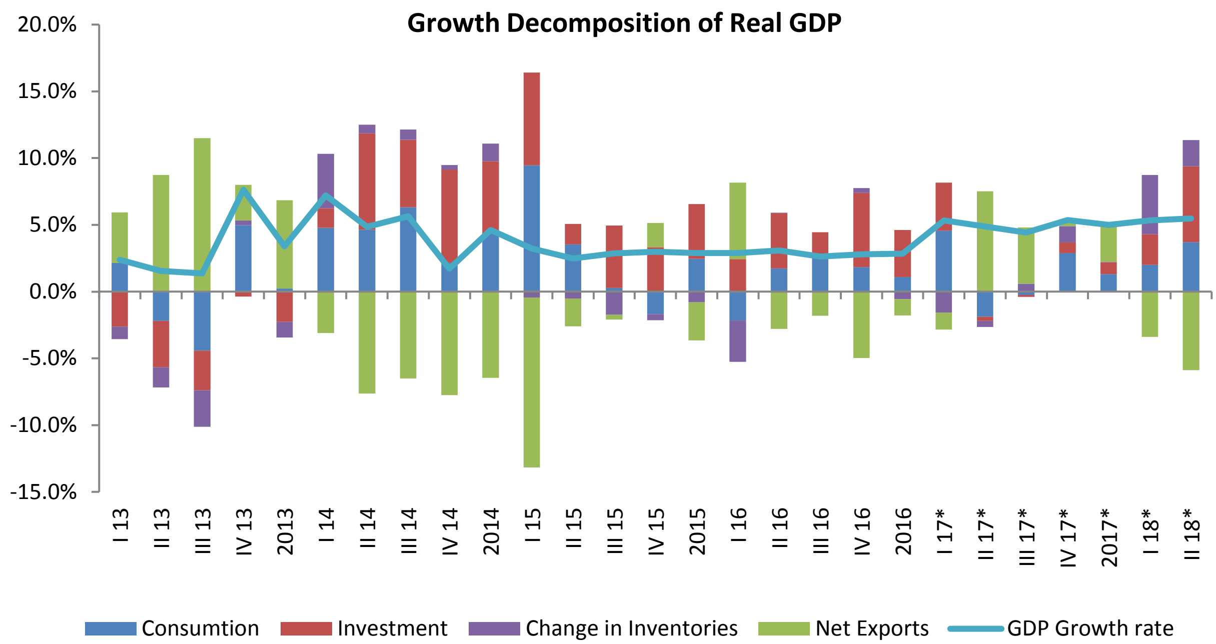
Economic activity has started with growing trend in 2018. According to the preliminary estimations, for the first quarter of 2018 economic growth amounted to 5.3 percent, for the second quarter of 2018 – 5.5 percent. As for July and August, economic growth was 4.6 percent and 2.0 percent, respectively. For the first eight months growth was 4.8 percent.



For 2017, the main growth was in the following sectors: Trade (growth 6.6, contribution 0.9%), construction (growth 11.2, contribution 0.7%), transport (growth 7.2, contribution 0.5%), manufacturing (growth 5.0, contribution 0.4%), financial intermediation (growth 9.2, contribution 0.3%), hotels and restaurants (growth 11.2, contribution 0.3%).

Structure of Economic Growth

Economic growth in 2017 was 5.0 percent. This acceleration of economic growth was mainly export driven. Global economic recovery and positive development in our trade partners positively affected export, consumption and economic growth overall.



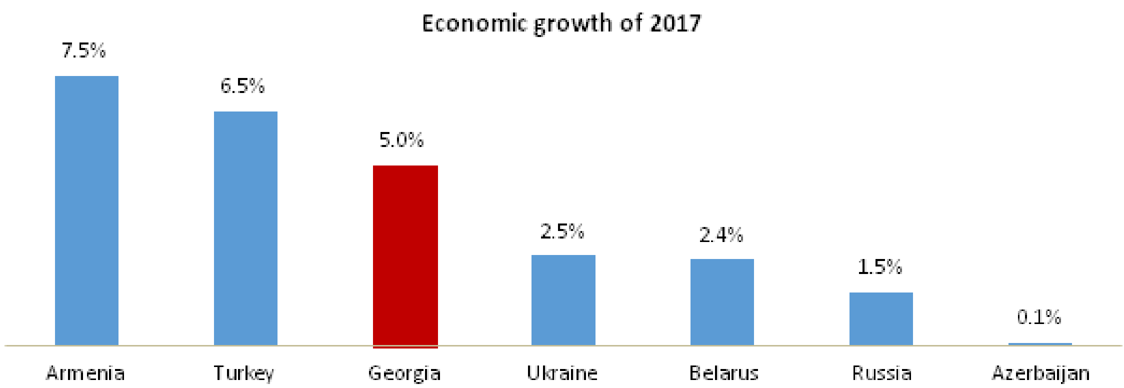
For the first quarter of 2018 the main contributor of economic growth was investments and change in inventories, while share of net export was negative unlike 2017. Deterioration of net export was caused by high growth of import compared to export growth. Investment contributed the biggest share of the economic growth in the last several years. We expect that in the medium term net export will remain a growth driver since global economic recovery is expected to be trade driven. Investments will be another important growth factor. The reforms implemented and in the ones in the pipeline focus on growth of savings and investments in the country.

Economic Growth in Georgia and Neighboring Countries

During last several years, despite economic growth slowdown, economic growth in Georgia was higher than in trading partners.

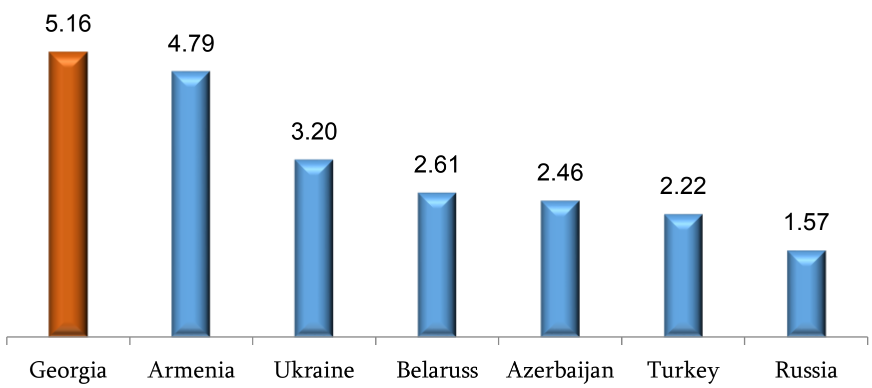
Georgia has also showed impressive resilience in the period of economic slowdown in region during 2014-2016. Georgian economy was growing about 3.4 percent in average (4.6 in 2014, 2.9 in 2015 and 2.8 in 2016), while all of our neighbor's experienced negative growth. Consistent reaction of the macroeconomic policy on the external shock made Georgian economy one of the leading country in 2016 too.

Economic activity has strengthened even more in 2017 and is 5.0 percent, which is the result of the existing economic policy and current reforms.



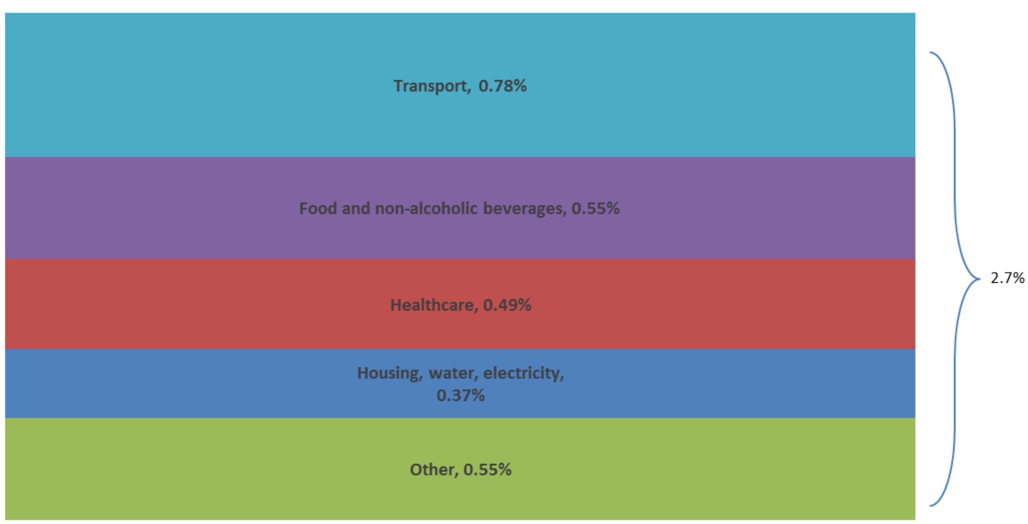
According to IMF estimates, Georgia will stay to be a leading country in region in terms of economic growth in medium-term. As for 2018, IMF has revised growth projection upward to 5.5 percent as a result of stronger than expected economic activity.

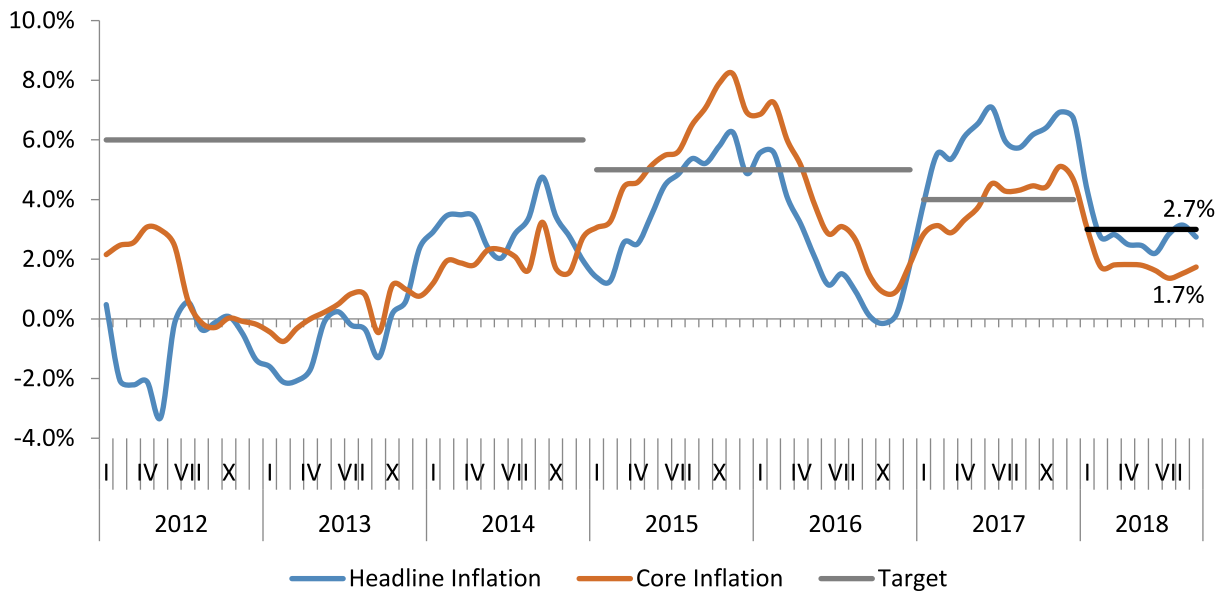
Average growth rate of real GDP 2018-2023



Prices

National Bank of Georgia (NBG) has a policy of inflation targeting. As for 2018, after the impact of excise has faded out, inflation has started to stabilize. Annual inflation rate in January amounted to 4.3 percent, while in the next months, inflation was lower and around targeted 3 percent. In September – 2.7 percent compared to the same period of 2017. Core inflation was at 1.7 percent.





Annual rate of inflation in 2017 was 6.0 percent, a bit higher than the target of 4 percent. However, this deviation from the target is attributed by the one-off factors related to the changes in the excise taxes (on tobaccos, fuels, motor cars etc.) under the new fiscal reform implemented in 2017.

Annual inflation rate in December 2017 amounted 6.7 percent, while core inflation was at 4.7 percent. Core[1] inflation was fluctuating around the target level during the whole year.

Price changes on the following groups of products contributed to formation of yearly inflation in September[2]:

- Transport: the prices in the group increased by 6.2 percent, with a relevant contribution of 0.83 percentage points to the overall index growth. The prices within the group increased for operation of personal transport equipment (10.8 percent);

- Food and non-alcoholic beverages: the prices went up by 1.8 percent, contributing 0.55 percentage points to the annual inflation. There was an increase in the prices for the following subgroups: vegetables (8.7 percent), fish (5.1 percent), oils and fats (3.8 percent), meat (3.3 percent), bread and cereals (2.1 percent), coffee, tea and cocoa (2.0 percent). Meanwhile, the prices decreased for the group of fruit and grapes (-9.9 percent), sugar, jam, honey, chocolate and confectionary (-3.5 percent), also for milk, cheese and

[1] Non-food, non-energy inflation

[2] Source: National Statistics Office of Georgia

eggs (-1.4 percent);

- Health: the prices increased by 5.7 percent, which resulted in a 0.48 percentage point contribution to the overall annual inflation. The prices were up for the following subgroups: medical products, appliances and equipment (11.1 percent), out-patient services (3.6 percent) and hospital services (2.2 percent);

- Housing, water, electricity, gas and other fuels: the prices were higher by 4.4 percent, contributing 0.38 percentage points to the annual inflation. The prices increased for the subgroup of water supply and miscellaneous services relating to the dwelling (7.7 percent), also for electricity, gas and other fuels (4.4 percent) and maintenance and repair of the dwelling (2.5 percent);

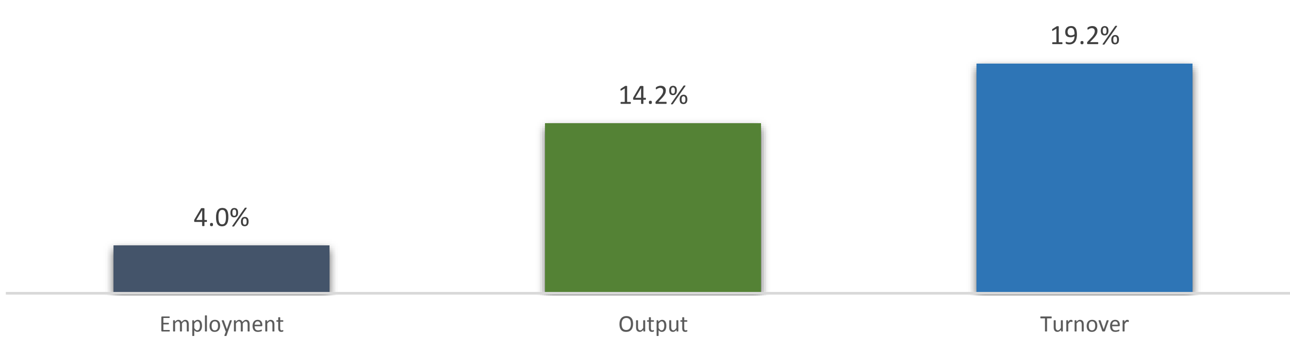
- Alcoholic beverages and tobacco: the prices in the group increased by 4.9 percent, with a relevant contribution of 0.34 percentage points to the annual inflation. The prices went up for the subgroup of tobacco (8.0 percent) and alcoholic beverages (1.8 percent).

The Role of Private Sector in Economic Growth

Private sector historically had a leading role in economic growth of the country and the trend continued in 2017 as well.

Turnover of the business sector increased by 18.6 percent in the first quarter of 2018 compared to the same period of 2017, output was 16.0 percent higher than in 2017 and employment grew by 5.3 percent, which is 32,063 new job. Total number of employees was 637,047. As for 6 months, output has increased by 14.2 percent, while total turnover has increased by 19.2 percent.

Business Sector, 6 months 2018



External Trade

Economic recovery in region strongly affected on the Georgian export and merchandise export has increased by 27.1 percent in January-August of 2018. In August export has increased by 16.6 percent. This is continuation of the trend started in January 2017 due to global recovery.

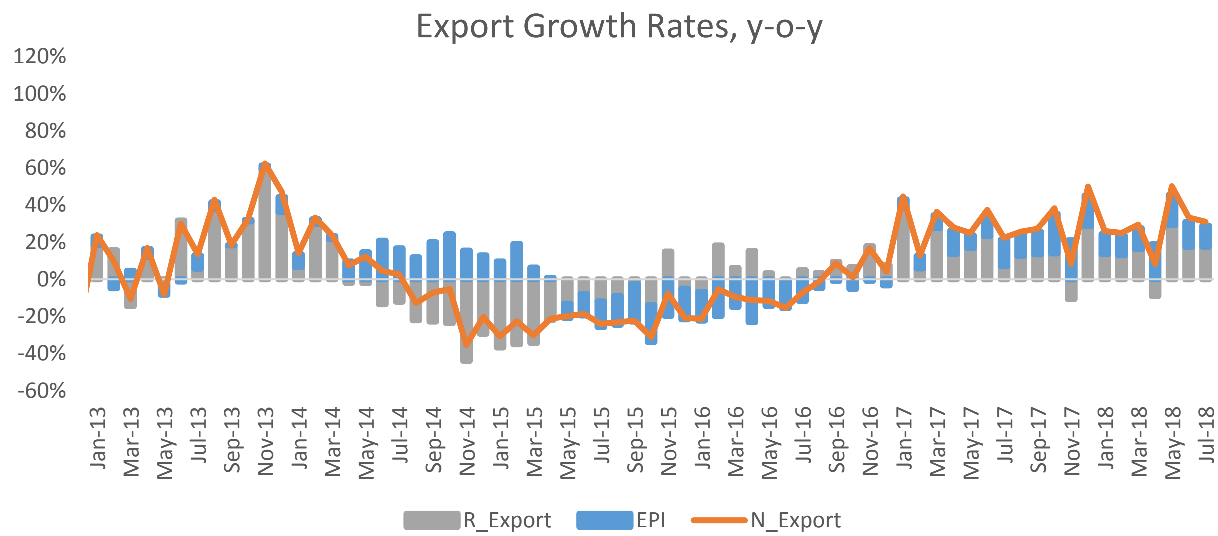
In the first quarter of 2018, export has increased by 26.5 percent which constitutes 154 million USD, while in the second quarter export growth was 29.7 percent which is 198 million USD. Import growth was 22.1 percent in the first quarter which is 382 million USD in nominal terms, while it was 23.8 percent and 446 million USD in the second quarter. As a result, trade balance worsened by 228 and 248 million USD compared to the same period of previous year, in the first and second quarter, respectively.

As for April, export has increased by 8.3 percent and import – by 24.2 percent, while trade balance worsened by 125 million USD. Should be mentioned, that 4.0 percentage growth of import in March and 1.2 percentage growth of import in April was coming from the import of turbo-jets, turbo-propellers and gas turbines from Netherlands. In addition, in April there was significant growth of copper ores from Chile and motor cars from Belgium. Growth of import of these three products amounted to 4.3 percentage growth in total import growth. There is significant improvement in export in May and growth amounted to 50.2 percent.

As for August, export has increased by 16.6 percent which is 39 million USD, while import has increased by 8.3 percent which constitutes 58 million USD. As a result, trade balance has worsened by USD 19 million compared to August of the previous year.

The main contributors of import in August were Motor cars (contribution in growth 8.3%), Cigars (contribution in growth 5.1%), Copper ores (contribution in growth 3.9%), ethyl alcohol, Spirits (contribution in growth 1.7%), Hazelnuts (contribution in growth 1.1%).

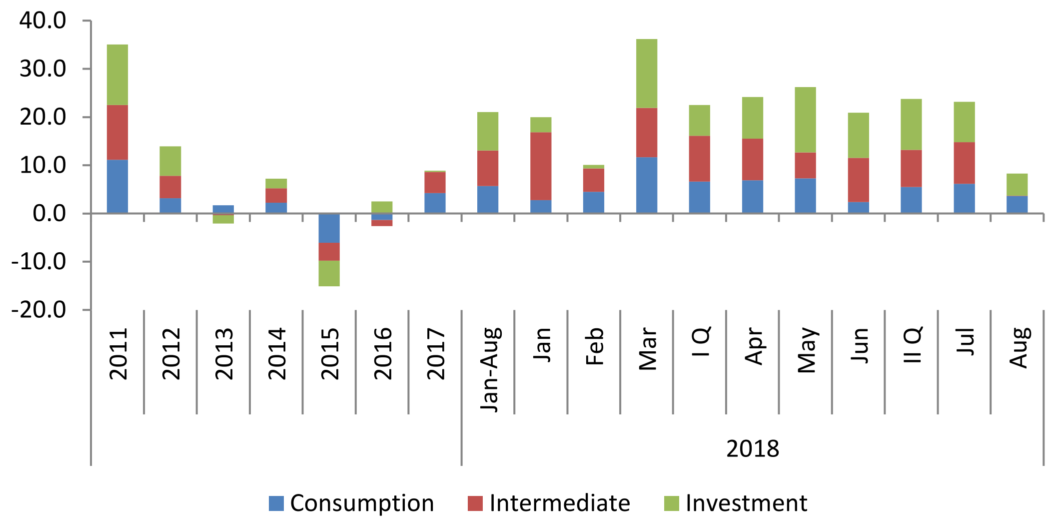
Overall, during January-August export has increased by 27.1 percent, while import growth was 21.0 percent, of which 15.4 percent was contributed by capital and intermediate goods.

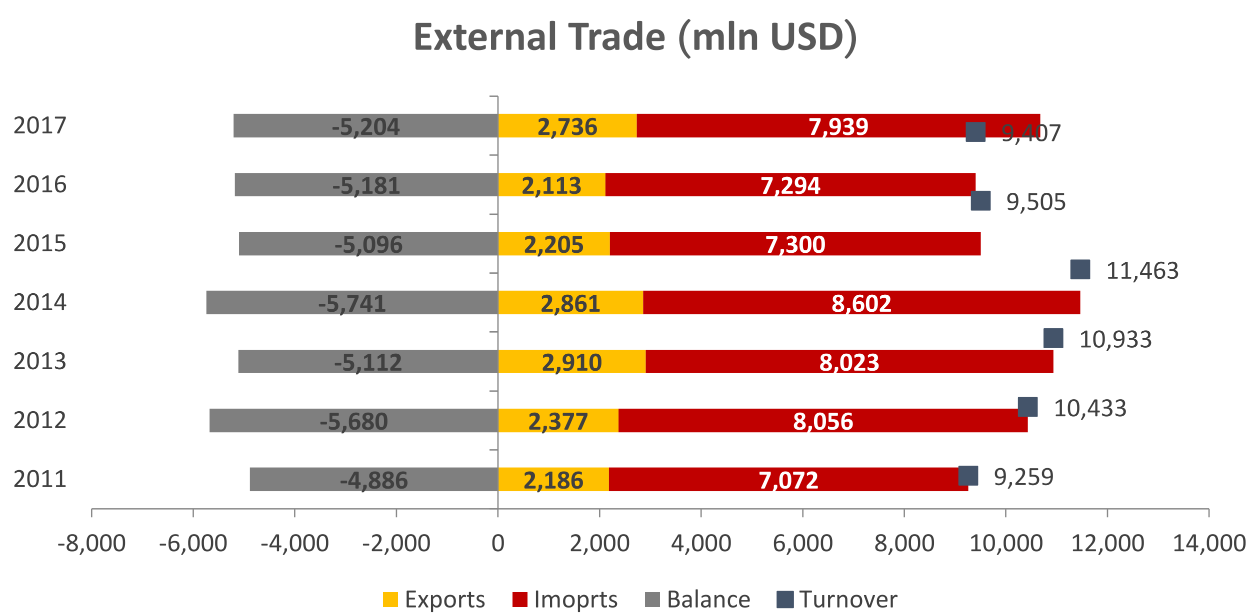


As for the last period, export has started to decline from August 2014. The tendency reversed in the third quarter of 2015 when price effect was dominating in export reduction and export stopped to decline in real terms.

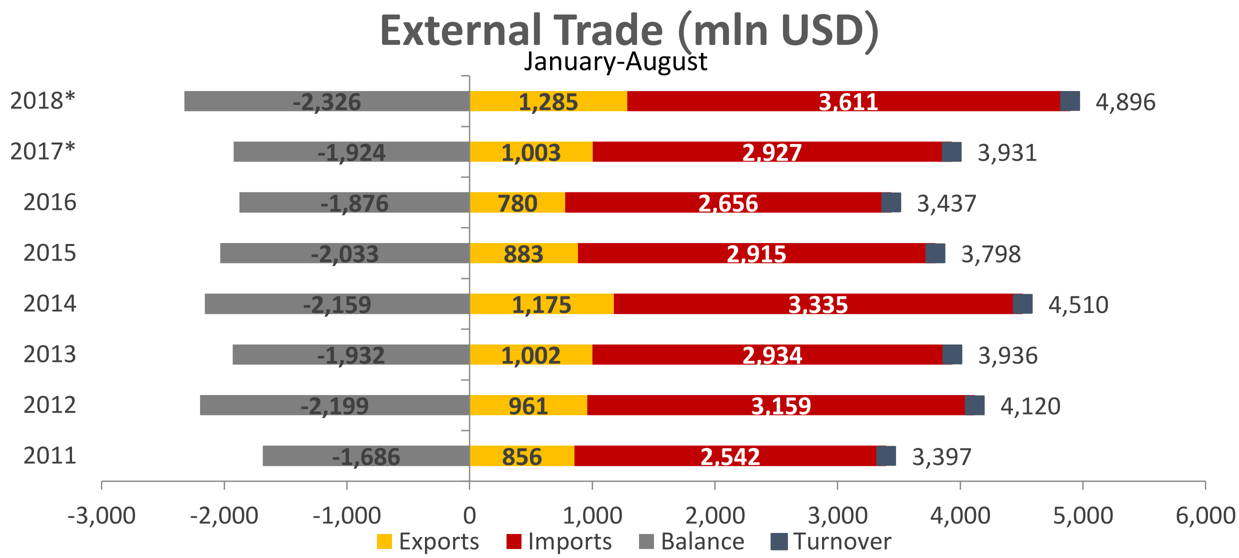
Import adjustments resulting from currency depreciation started in the second quarter of 2015 and import declining dynamics continued to May 2016. Since May, significant growth of import of investment goods, which was mainly caused by growth of machinery import (including generators, medical equipment, calculating machines, industrial equipment, etc.), contributed to growth of total import. In addition, growth of intermediary goods import (including machinery parts, fuel and lubricants) was high periodically. During the last three months of 2017, consumption goods import had a significant share in total import growth, which was linked to petroleum import. During the year, only investment goods import had a positive share in total import growth.

In 2017 there was observed 9.4 percent growth in imports. High growth was in import of consumption and intermediate products.





To sum up dynamics in trade with goods, in 2017 exports have increased by 29.5 percent. This constitutes 622 million USD in nominal terms. At the same time growth in imports amounted to 8.8 percent or 645 million USD. As a result, trade balance worsened by around 23 million USD as compared to the same period of 2016.



Tourism

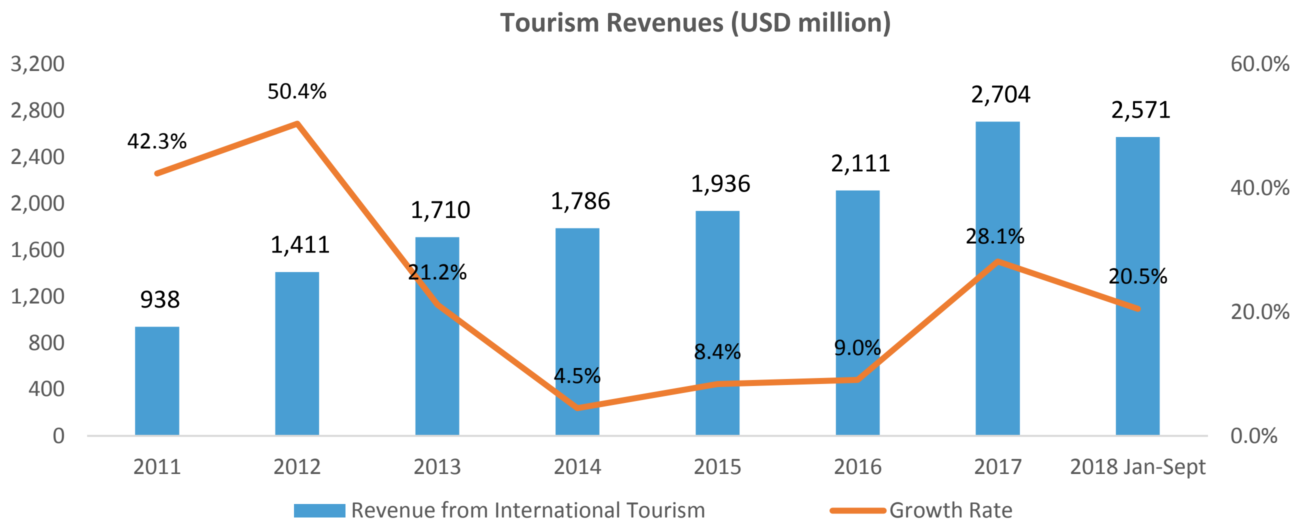
During the last years tourism has formed as one of the most important sectors of the economy.

With increasing trend of visitors has started 2018. In the first quarter there were 15.6 percent higher visitors in Georgia, which is 197.4 thousand higher than in the previous period of the last year. In the second quarter it was 12.8 percent higher, while in the third quarter growth rate was 9.1 percent. In September number of visitors have increased by 6.7 percent compared to September 2017 and amounted 814.9 thousand.

Overall, there were 6 498 thousand visitors in Georgia during January-September of 2018, which is 11.6 percent higher than the same period of 2017, while tourism revenues amounted to USD 2 571 million and exceeds the numbers of January-September of the previous year by 20.5 percent.

According the preliminary estimates, in 2017 revenues from international tourism increased by 28.1 percent and generated USD 593.6 million more foreign exchange inflows compared to the previous year. Tourism sector is increased by about nine times during last decade. In 2016, international tourism revenues exceeded USD 2 billion for the first time.

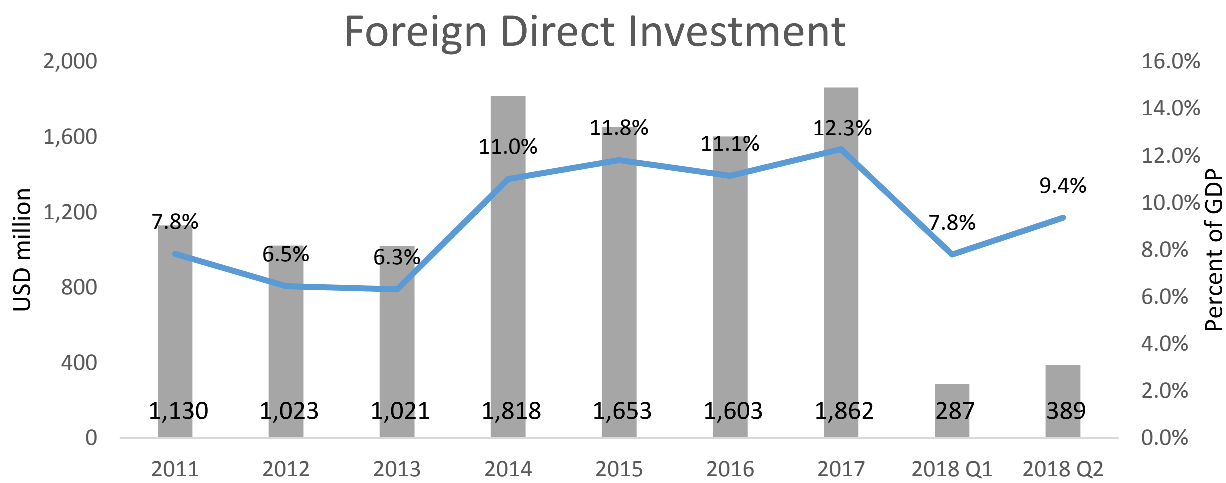
During the whole 2017, there were 7 555 thousand visitors in Georgia, which was 18.8 percent higher than in the previous year. Tourism revenues amounted to around USD 2 704 million and is increased by 28.1 percent compared to the previous year.



Foreign Direct Investments (FDI)

For the first half of 2018, FDI has amounted to 8.6 percent of GDP. In the first quarter of 2018, FDI was 7.8 percent of GDP, while for the second quarter it amounted to 9.4 percent of GDP. The main share foreign direct investment implemented in the following sectors for the second quarter: energy sector – 28.0 percent, transport and communication – 19.8 percent and financial sector - 16.5 percent.

During the last four years, Foreign Direct Investments has improved significantly in Georgia and steadily amounts 10 percent of GDP. For the first quarter of 2018 FDI amounted to USD 287 million, while for the second quarter FDI was 389 USD million. In 2016 FDI was USD 1 603 million, while in 2017 it was USD 1 862 million and is increased by 16.2 percent compared to 2016. In percent of GDP, FDI amounted 12.3 percent in 2017.



The main share of foreign direct investment in 2017 was implemented in transport and communication sector and was 25.8 percent, while in financial intermediation sector it amounted 16.0 percent, in construction – 14.9 percent, in the energy sector – 11.8 percent, in real estate – 9.4 percent, in manufacturing – 5.2 percent, in hotels and restaurants – 4.0 percent, and in mining – 2.7 percent.

There is improvement in FDI diversification by investing in new sectors. For instance, in 2015, there was rapid growth of investments in healthcare compared to the previous years. In 2016, FDI has increased in communication sector, where investments share of total FDI amounted 3.8 percent. In 2017, significant increase was observed in financial and construction sectors. In financial sector investments amounted 16.0 percent of total FDI, while in construction sector investments were 14.9 percent of total FDI. The same trend has identified at the beginning of 2018. However, for the second quarter of 2018, investment has increased in the energy sector, which amounted to 28.0 percent of total investments, while for the first quarter it was financial sector where FDI amounted to 25.9 percent of total FDI, transport – 18.8 percent and energy sector – 17.4 percent.

The biggest investors by FDI in Georgia for 2017 were Azerbaijan with 25.9 percent, Turkey with 15.0 percent and the UK with 13.4 percent shares. As for the second quarter of 2018, the biggest investor is Azerbaijan with 20.7 percent, and then are Czech Republic (20.0 percent) and Netherlands (16.8 percent).

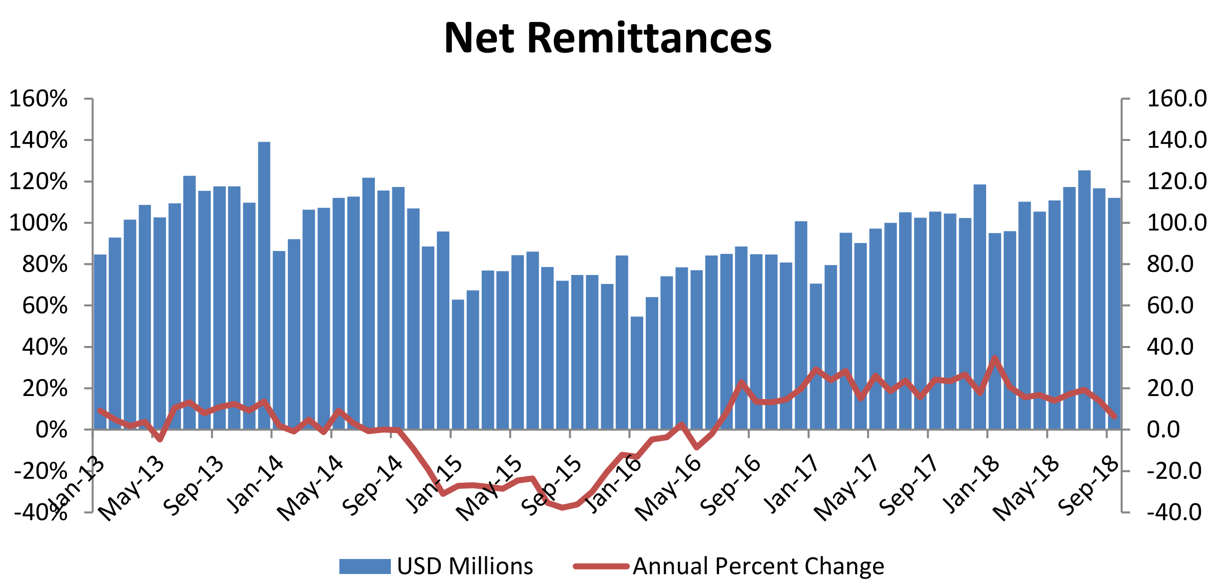
It is important that in 2016 the highest indicator was recorded in case of reinvestments amounting to 32 percent of total FDI, and in 2017 reinvestment was 43.9%, which demonstrates that the government's economic policy and improved business environment is positively perceived by investors and more investors decided to extend their business plans in Georgia. The current economic policies and the reforms are prerequisites for maintaining of the high levels of reinvestment in subsequent periods and for increasing it in the medium and long term.

Money Transfers

In 2017, net money transfers were 22.3 percent higher compared to the same period of 2016. Increase of money transfers is important from starting of 2018. In January there was 34.7 percent annual increase, which is the maximum level of recent years. Growth of the following months of money transfers was between 14-20 percent. In September growth of net money transfers amounted to 6.3 percent.

Dramatically increase in the money transfer started from the second half of 2016. Despite the declining trend in the first five month of the year, money transfers increased by 8 percent in July, by 23.0 percent in August (the highest in 2016), by 14.6 in November and by 19.7 percent in December. In total, net money transfers increased by 5.3 percent in 2016 compared to 2015.

Starting from January 2017, there was higher increase in net money transfers. In January the number amounted to 29.1 percent, while the whole year remittances increased by 22.3 percent compared to the previous year.



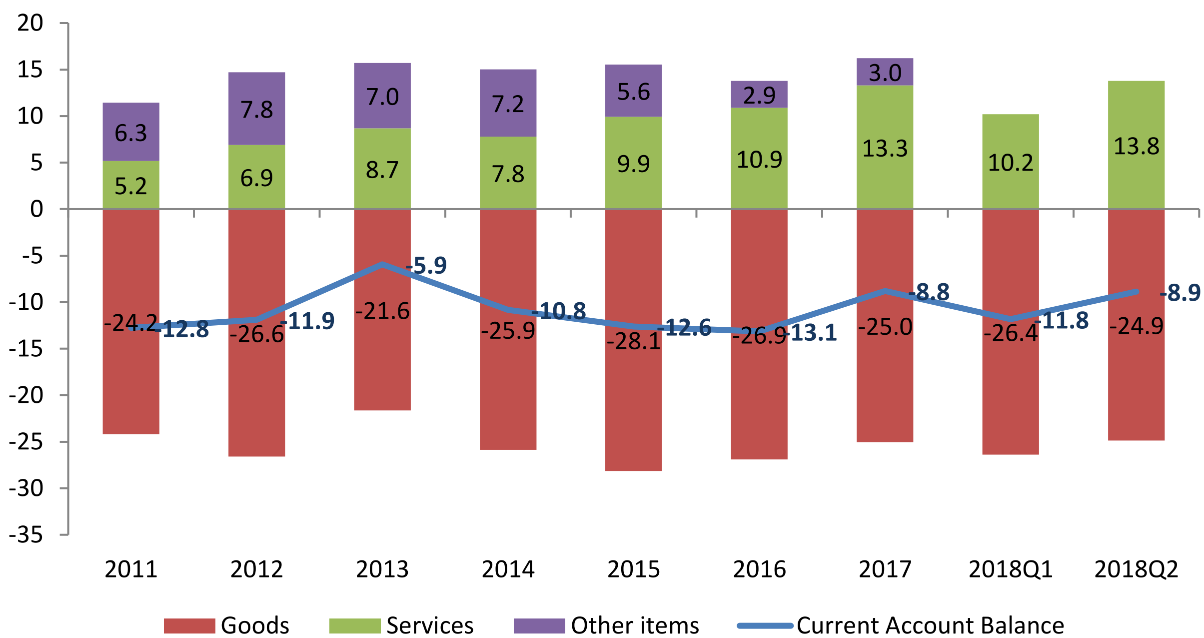
To sum up, during the whole 2017, foreign inflows from the merchandise exports, tourism and remittances increased by 1 413 million USD. At the same time, increase in outflow on imports totaled 684.8 million of USD. Accordingly, positive pressure on CA was observed in the whole 2017. In January-August 2018 foreign inflows from the international exports, tourism and remittances increased by 1 000 million USD, while outflow on imports increased by 1 032 million USD. As a result, in the first eight months there was negative pressure on CA by 32 million USD, mainly due to the increasing import.

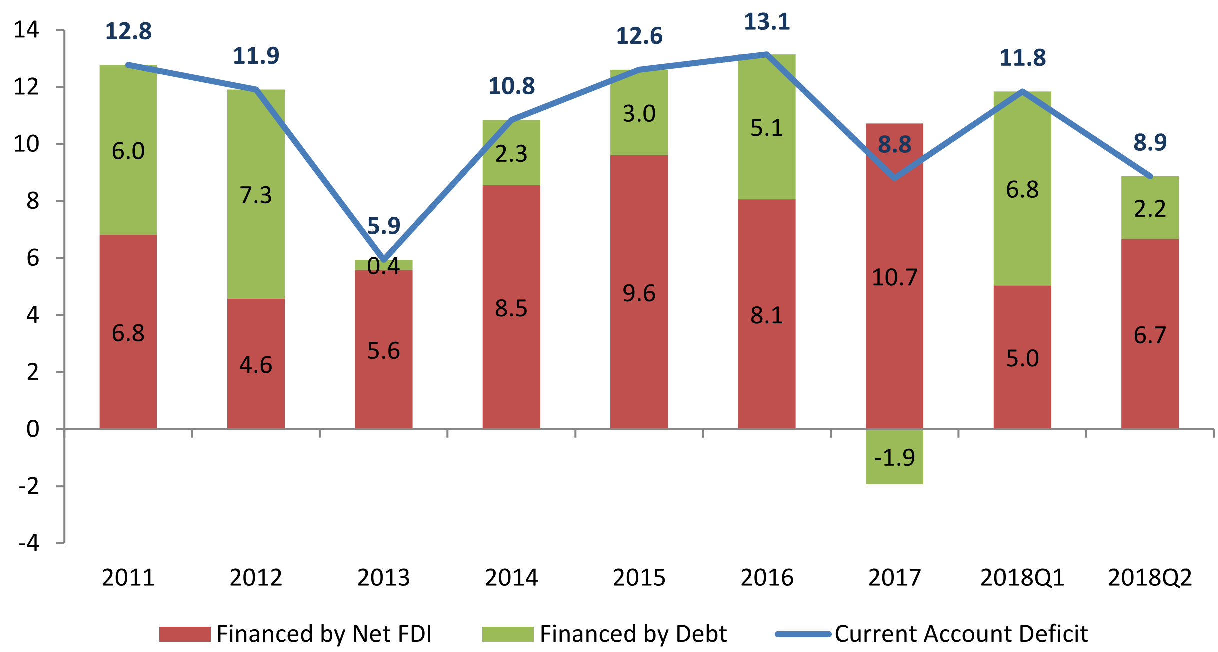
Current Account (CA) Balance

High current account deficit is one of the main vulnerabilities of the Georgian economy. Because that, Government of Georgia initiated set of reforms to promote saving, increase productivity and export and gradually close saving-investment gap which effectively means balanced current account.

Fir the first quarter of 2018, current account deficit amounted to 11.8 percent, while for the second quarter it was – 8.9 percent. Deficit in this period was mainly due to the worsen trade balance.

The first results are quite impressive: according to the preliminary data, current account deficit for 2017 amounted to 8.8 percent which is significant improvement of the current account in recent period. In the third quarter of 2017, current account deficit to GDP amounted 3.0 percent, which is a lowest level historically. Declining tendency started in 2017. CA deficit in 2016 was 13.1 percent of GDP, in the first quarter it reduced to 11.0 percent, to 8.3 percent in the second quarter, to 3.0 percent in the third quarter and 13.3 percent in the fourth quarter of 2017.





Credit Ratings

Georgia continues to cooperate with the international rating companies Standard & Poor's, Fitch and Moody's. The country maintains stable ratings. Currently, Georgia has stable "BB-" rating according to Standard & Poor's, "BB-" positive rating according to Fitch and "Ba2" stable rating according to Moody's. On the other hand, there was a deterioration of the ratings in the countries of the region, credit ratings have started to improve in our neighbor countries from the end of 2017, however, in 2018 there was significant deterioration of Turkey's credit rating.

S&P and Fitch worsened ratings of Azerbaijan and affirmed to „BB+" negative, which was changed from „BBB+" in 2016, however outlook has improved from negative to stable at the beginning of 2018, according to both companies. Moody's decreased it from Baa3 to Ba1 in 2016 and from Ba1 to Ba2 in the previous year. Moody's also decreased rating of Armenia from Ba3 to B1. According to Fitch, rating of Armenia is „B+" positive now.

According to S&P and Moody's, Russia's credit rating deteriorated as well. Compared to December 2014, Russia's credit rating deteriorated from Baa3 to Ba1 according to Moody's and from "BBB-" to "BB+" according to S&P. As for the beginning of 2018, rating of Russia is still "BBB-" stable according to S&P, while it is "BBB-" positive according to Fitch.

Moody's decreased rating of Turkey from Baa3 to Ba1 in September 2016 and from stable to negative in March 2017, in 2018 rating has deteriorated to Ba2 and then to Ba3. S&P decreased its rating from "BB+" to BB in 2016, to "BB-" in 2018 and then to "B+" stable, while Fitch decreased from "BBB-" to "BB+" and then to BB negative.

Rating company Moody's upgraded rating of Georgia to Ba2 from Ba3 in September 2017, while outlook remain stable. Fitch revises Georgia's outlook to positive from stable "BB-" in March 2018.

International Rating Agencys Statement

The rating upgrade and stable outlook are supported by rating agencies' view that the Georgian economy's resilience in the wake of the regional economic shock which began in 2014 demonstrates the increasing strength of the economy and institutions. Looking forward, ongoing economic reforms, supported by the International Monetary Fund, will mitigate some of Georgia's underlying credit weaknesses, further boosting credit strength over time. However, material banking sector and external vulnerability risks continue to constrain the rating.

Ongoing economic reforms are positively perceived by rating agency - "Credible new reforms will further support credit strength". The 3-year program with IMF has improved credibility of the reforms:

The program emphasizes structural reforms to generate higher and more inclusive growth. The focus will be on improved education, road infrastructure investment, more efficient public administration, and further improvements in the business climate to boost the private sector's role as a growth driver.

Moody's mentioned following positive factors: strong institutions and agreement with EU, diversified export countries and trade agreements, which will help the FDI to maintain average 10% of GDP, will increase the export in the medium-term and will accelerate economic growth.

Rating agency S&P mentioned the following factors as the main positive movements in Georgia: structural reforms, strong institutional framework, economic growth, improvement of international trade conditions and current IMF program.

According to Fitch report about the rating of Georgia, positive contributors of rating were: high economic growth, strengthening of fiscal sustainability and significant progress towards Larization. In the report, existing cooperation with the International Monetary Fund is positively assessed and successful ongoing process of the program is mentioned. According them, continued progress is meeting benchmarks aimed at strengthening of its financial sector, will help contribute towards further improvement of structural indicators, stimulating investment and savings.

The main weaknesses of Georgian economy are high levels of current account deficit and external debt, which still remain as the main vulnerabilities. Dollarization and external vulnerabilities remain as main weaknesses of the economy, although Larization process is positively assessed by agencies. Saving promoting reforms are encouraged by rating agency and reduction of saving-investment gap is considered as potential upward pressure on the rating. Should be mentioned also significantly improvement of current account.

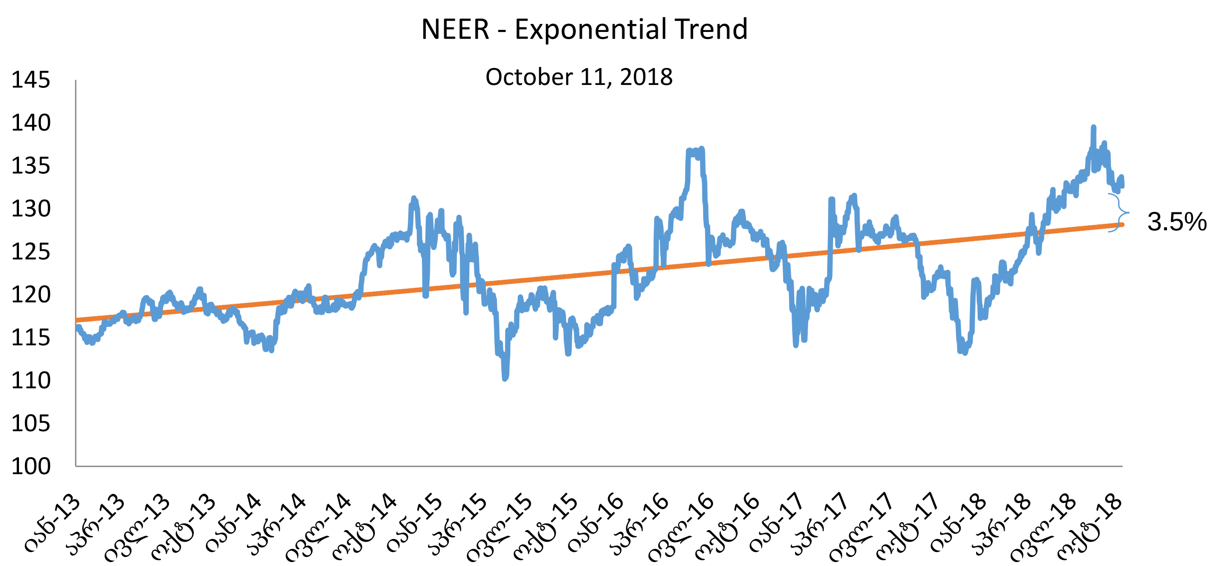
Overall, despite the deterioration economic environment in the region, Georgia has maintained stable outlook and improved credit rating (outlook is positive by Fitch rating), which is the result of the correct policy (flexible exchange rate, inflation targeting, counter-cyclical fiscal policy, removal of trade barriers and export diversification, agreement with EU), low risks and medium-term perspectives.

Exchange Rate

As for 11th October of 2018, NEER appreciated 12.3 percent compared to January 1st of 2018 and 10.6 percent compared to January 1st of 2017. In real terms, annual appreciation rate of Lari is 8.2 percent while 8.3 percent appreciation is compared to January of the last year.

NEER is appreciated by 3.5 percent related to its medium term trend.

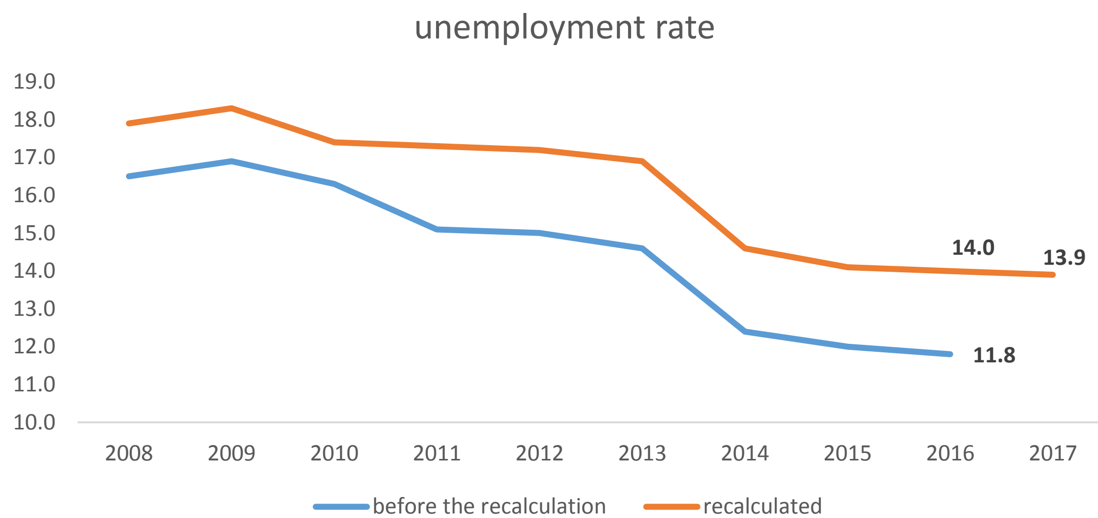
	11 October, 2018	11 Oct 2018 - 1 Jan 2018	11 Oct 2018 - 1 Jan 2017
Euro	3.0199	-7.5%	-13.5%
US Dollar	2.6262	0.8%	-8.7%
Turkish Lira	0.4322	73.6%	89.5%
Russian Ruble	0.0398	8.2%	-18.2%
NEER	132.62	12.3%	10.6%
REER (September 2018)	125.10	8.2%	8.3%



Unemployment Rate

Unemployment rate maintained diminishing tendency last few years even during the regional economic slowdown. In 2016, unemployment rate in Georgia decreased by 0.2 percent and stood at 11.8 percent, at the lowest level historically, guaranteeing inclusive growth.

As a result of population census conducted in 2014, there was an absolute decrease in the country's population. The labor force data has recalculated, which reflected to the different rate of unemployment. Recalculated unemployment rate is higher than before the recalculation, but the trend is similar and unemployment rate in 2017 was at the minimum level historically - at 13.9 percent.



Tax Revenues

In 2016, generated tax revenues were by GEL 775.2 million higher compared to the same period of 2015, which accounts to 9.7 percent of tax revenues. Tax revenues of 2016 are 100.5 percent of planed target exceeding it by GEL 46.1 million.

In 2017, generated tax revenues were by GEL 992.9 million higher compared to the same period of 2016, which accounts to 11.3 percent of tax revenues. Tax revenues of 2017 are 100.4 percent of planed target exceeding it by GEL 38.9 million.

In January-September 2018, generated tax revenues amounted to GEL 7 697.2 million which is 6.8 percent higher (GEL 491.8 million) compared to the same indicator of 2017. Forecast of taxes in the January-September was GEL 7 472.8 million. Hence, during the 9 months of 2018 there was recorded 3.0 percent over performance compared to the projections, which amounted to GEL 224.4 million.

- Income taxes mobilized GEL 2 440.4 million which is 102.9 percent of forecast (GEL 2 372.0 million).

- Profit taxes mobilized GEL 576.4 million that is 114.8 percent of forecast (GEL 502.0 million).

- VAT mobilized GEL 3 295.7 million which is 102.4 percent of forecast (GEL 3 218.0 million).

- Excise mobilized GEL 1 091.0 million which is 102.9 percent of forecast (GEL 1 060.0 million).

- Import taxes mobilized GEL 55.7 million that is 128.2 percent of forecast (GEL 43.5 million).

- Property taxes mobilized GEL 333.3 million.

Other taxes mobilized GEL -95.3 million.

General Government Debt and Financing of the Budget

General Government Debt

- The stock of general government debt at the end of 2017 amounted 44.0% of the estimated GDP (of which external debt – 34.7%), while it was 44.4% at the end of 2016 (external debt – 35.1%) and 41.3% at the end of 2015 (external debt – 32.4%)
- The growth of general government debt both in 2015 and in 2016 were mainly caused by the change of exchange rate.
- In the medium term, it projected to maintain the general government debt to GDP ratio below 45% level.
- The market value of general government debt as of December 2016 was 32% (excluding legacy debt, 1% of GDP as of end 2016), because significant part of our debt is under concessional terms.

At the same time, with development of capital market, treasury securities issues will increase, which will support to decrease external financing and increase share of domestic debt in the total debt.

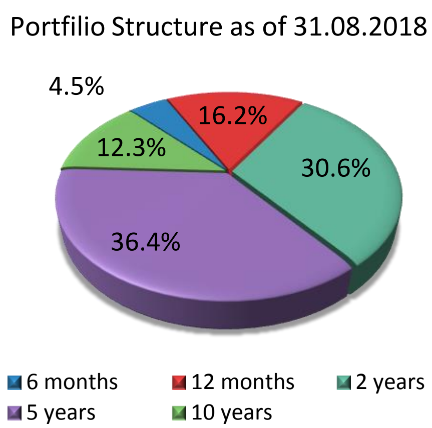
Government Securities Market

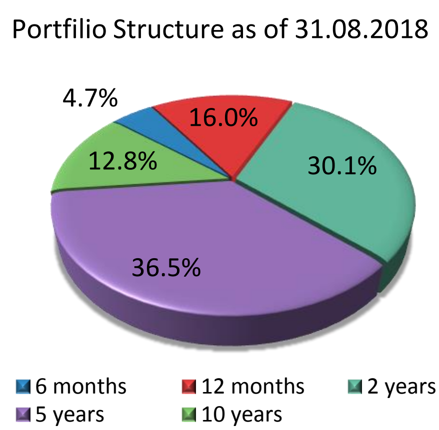
In September 2018, 4 auctions were held with total issuance volume of 130 million GEL. The weighted average interest rate was 7.228%.

There were issued treasury bills with maturity of 6 months and 12 months; Treasury bonds with maturity of 2 years and 5 years. Treasury securities with total amount of 40 million GEL were redeemed.

	6M	1Y	2Y	5Y	Total
Issue size	20	40	40	30	**130**
Weighted average interest rate	7.139	7.115	7.232	7.431	**7.228**
Redemption	20	20	0	0	**40**
Difference	0	20	40	30	**90**

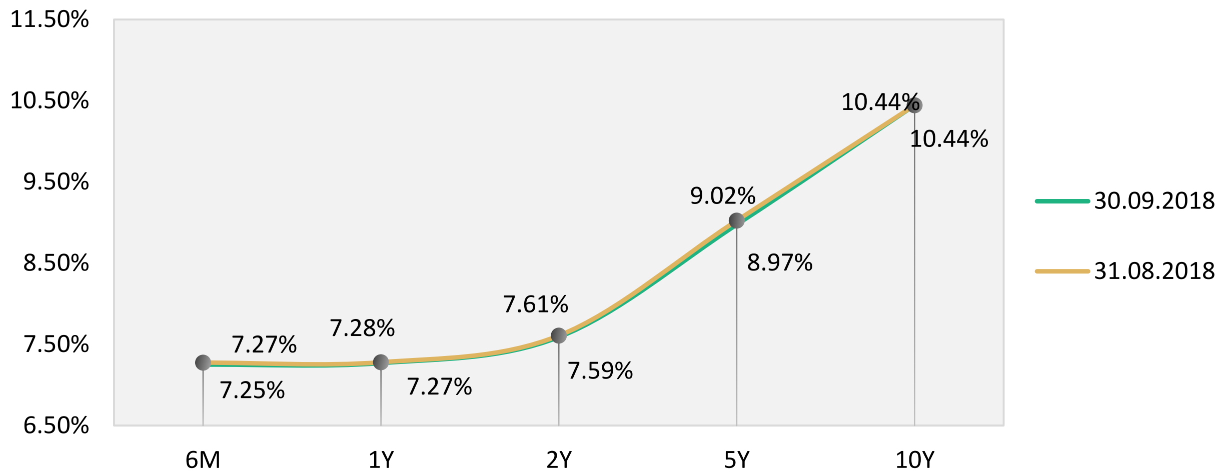
The structure of treasury securities portfolio has changed slightly:





The portfolio yield almost has not changed.

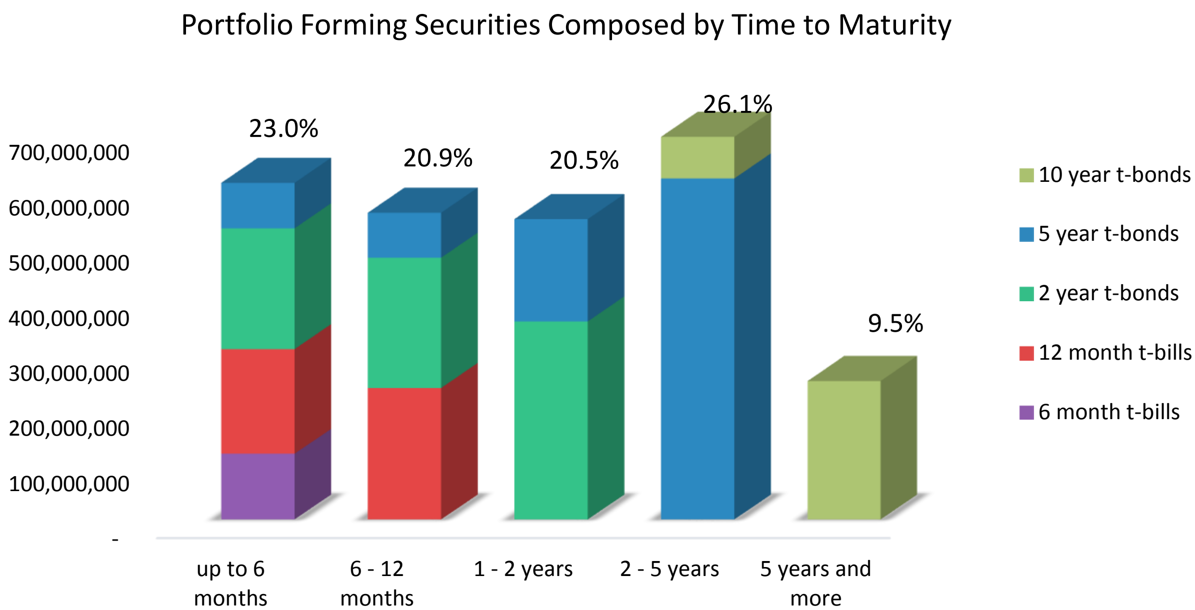
Portfolio Yield Curve for the Last Two Months



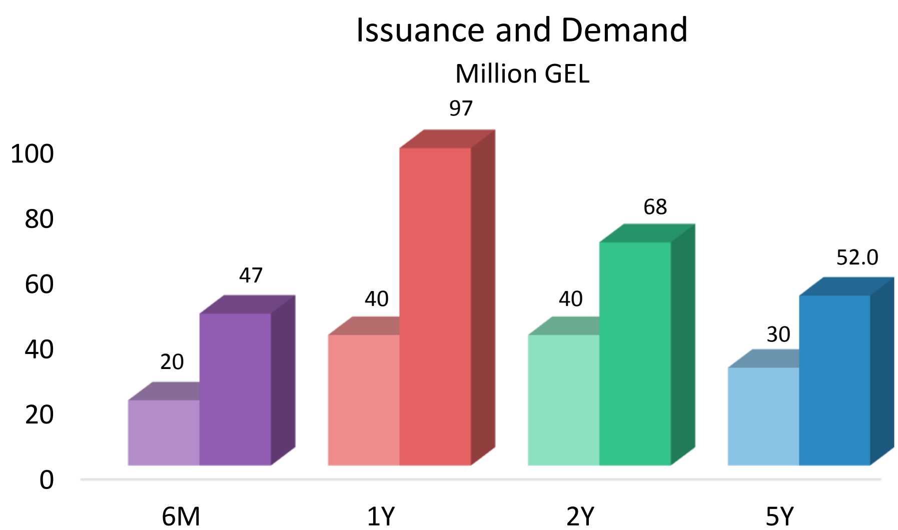
Average Time to Maturity (ATM) for all securities forming the portfolio has decreased slightly compared to the previous month's value.

Average Time To Maturity (Years)			
	31.07.2018	31.08.2018	30.09.2018
6 month t-bills	0.24	0.24	0.24
12 month t-bills	0.51	0.52	0.51
2 year t-bonds	0.94	0.91	0.88
5 year t-bonds	2.86	2.83	2.82
10 year t-bonds	7.51	6.78	6.70
Total	**2.55**	**2.27**	**2.21**

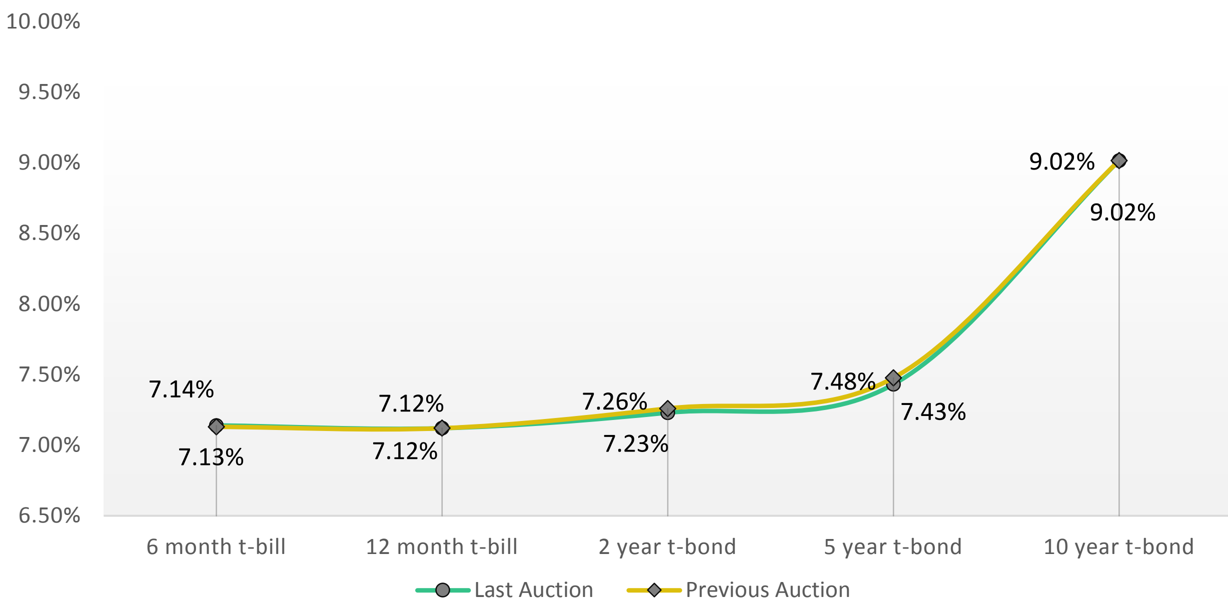
As of September 30, 2018, 23% of treasury securities portfolio is composed of securities whose maturity date is due for the next 6 months. Securities' distribution by time to maturity is shown below:



Bid-to-cover ratio has decreased compared to the previous month's value (August 2.02) and is 2.03. Weighted average interest rates resulted on the auctions have decreased slightly, but yields for the whole portfolio almost have not changed.



Weighted average interest rates from the last month's auctions: *



*- If there was not issued any of the given maturity securities in the last month, previous results will be shown on the chart instead.

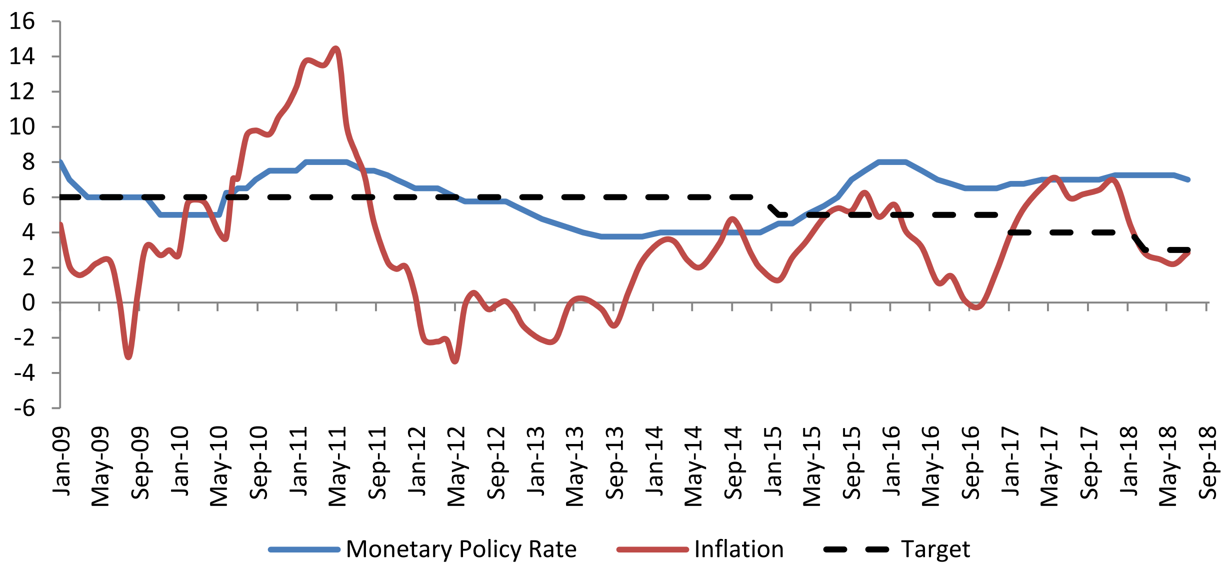
Monetary Policy

On December 13th monetary policy committee increased the policy rate by 25 basis points to 7.25 percent, which was explained by worsen of nominal effective exchange rate and inflation pressure. According to NBG, together with the increase in global oil prices, inflation expectations have also risen and larger than expected improvement in economic activity decreased the downside pressure on inflation coming from demand-side, so the committee decided to increase the policy rate. Once the impact of those factors has faded out, the inflation is expected to decrease from the beginning of 2018.

Starting from January 2018, the monetary policy committee keep the refinancing rate unchanged at 7.25 percent, which was mainly derived by the starting of nominal effective exchange rate appreciation and the fact that aggregate demand remain below its potential level that has a downward pressure on inflation.

On July 25th monetary policy committee has cut the refinancing rate by 25 basis points, to 7.0 percent. The main reasons were: declining of annual inflation, which is close to the target level;

higher than expected appreciation of nominal exchange rate, which reduced inflationary pressure. Monetary policy easing will continue at a slower pace than expected due to the recent improvement in aggregate demand and faster closing of output gap than expected, which declined downward pressure on inflation.



2017 Budget

Government 4 point plan and strategy is directed to support growth friendly policies and accelerate infrastructural projects. At the same time government is in for fiscal consolidation, cutting administrative costs and maintaining it low in mid-term.

As part of the growth friendly policy CIT reform was conducted, which implies improved tax environment favoring business sector.

In order to compensated loss of revenues on initial stages of CIT reform and mobilized resources for accelerating capital spending Government undertook measures both on revenue as well as expenditure side.

- Revenue-enhancing measures: Fuel excise increase (GEL 270 million, 0.7 percent of GDP); tobacco excise increase (GEL 215 million, 0.6 percent of GDP); gambling fee and e-gambling tax increase (GEL50 million, 0.2 percent of GDP); and a vehicle excise increase (GEL 45 million, 0.1 percent of GDP).

- Expenditure-reducing measures: reduction of the wage bill at the central and local government levels (GEL190 million, 0.5 percent of GDP); cuts in goods and services (GEL [50] million, 0.2 percent of GDP); improved efficiency of public healthcare provision and targeting of social programs in municipalities (GEL 90 million, 0.3 percent of GDP); and end of the agro-land program (cumulative GEL [50] million, 0.1 percent of GDP).

2017 budget deficit is anticipated to be about 4.1%. Infrastructural projects financed though Capital Spending and lending is projected about 3 billion GEL (8.3%).

Relationship with the IMF

On 12th of April 2017, the IMF Executive Board Approved US$285.3 million Extended Arrangement under the Extended Fund Facility for Georgia.

IMF shares and welcomes the economic policies of the Government of Georgia, which ensures sustainable economic growth for the country. It is important that the new program is homemade, based on the Government's new four-point reform plan. Within the program, IMF will be our country's partner in carrying out Government's economic policies.

The economic and structural reforms were approved by IMF, which aims to support macroeconomic stability and economic growth.

2017 budget, as well as the government's medium-term budgetary plans, qualitatively represent transformed fiscal policy, which includes:

- Reducing administrative costs;
- Creating tax-system adapted to the economic growth;
- Increasing the effectiveness of the budget programs;
- Increasing investments in infrastructure projects.

In 2017-2020 country's road infrastructure backbone will be finished, that will allow us to fully use our logistical and touristic potential. Development of infrastructure will improve communication between the regions, which will increase their involvement in country's economic development.

During 2017-2020, capital expenditures foreseen under the budget will increase from 5.6% of GDP to 9%. Meanwhile, administrative costs will be reduced from 26.5% to 21.7%.

Within the program, Government of Georgia plans to carry out the most important structural reforms, which will support economic growth. Such as:

- Pension Reform;
- Capital Market Reform;
- Establishment of Deposit Insurance System;
- Establishment of Public-Private Partnership (PPP) System;
- Establishment of insolvency legislative framework;
- Land Reform;
- Insurance System Reform;
- Measures for improving the Public Finance Management;
- etc.

The decision of the Government of Georgia is to return the Financial Sector Supervision function to the National Bank of Georgia.