



BLACK SEA TRADE AND DEVELOPMENT BANK

GEORGIA
Country Strategy
2011-2014

THESSALONIKI
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GEORGIA COUNTRY STRATEGY TABLE OF CONTENTS

TABLES:

- Table 1: Basic Macroeconomic Indicators at a Glance**
Table 2: Active BSTDB Portfolio as at end December 2010

TEXT:

- I. Recent Economic Developments and Outlook**
 - a. Real Sector*
 - b. Public Sector and Fiscal Policy*
 - c. Monetary and Financial Sector*
 - d. External Sector*
 - e. Forecast for 2011-12*
- II. Overview of Current BSTDB Portfolio**
- III. Review of Country Strategy 2007-2010**
- IV. Priorities for 2011-2014**

ANNEXES:

- Annex I: Post Evaluation of 2007-2010 Country Strategy Georgia**

Table 1: Basic Macroeconomic Indicators at a Glance for GEORGIA

Key Long Term Foreign Currency Sovereign Risk Rating at 28 February, 2011:

Moody's: Ba3 | S&P: B+ | Fitch: B+

		2007	2008	2009	Est. 2010	Proj. 2011	Proj. 2012
1	Population (Million)	4.4	4.4	4.4	4.4	4.4	4.4
2	Avg Exch. Rate (Lari/ US\$)	1.67	1.49	1.67	1.78	1.78	1.78
3	Inflation (CPI Avg.)	9.2%	10.0%	1.7%	7.1%	6.9%	6.4%
4	Average monthly wages (US\$)	220.4	358.8	333.3	342.2		
5	GDP (Lari million)	16,993.8	19,074.9	17,986.0	20,791.3	23,441.0	26,238.0
6	GDP US\$ million	10,172.9	12,795.1	10,766.9	11,663.1	13,169.1	14,740.4
7	GDP per capita (US\$)	2,314.8	2,919.9	2,455.2	2,629.0	2,993.0	3,350.1
8	Real GDP growth, %	12.3%	2.3%	-3.8%	6.4%	5.5%	5.5%
9	Official Unemployment (end of period) %	13.3%	16.5%	16.9%	20.0%	21.0%	20.5%
10	Industrial Production Growth, %	15.5%	-2.9%				
11	Agricultural Production Growth %	1.6%	-7.3%	-6.6%			
12	Domestic Credit Growth %	62.9%	16.9%	-5.9%	17.8%	27.0%	
13	Domestic Credit/ GDP	31.6%	32.9%	32.8%	33.4%	37.7%	
14	Foreign Direct Investment - \$US million	1,750.2	1,564.0	658.4	553.0	710.0	779.0
15	FDI/ GDP	17.2%	12.2%	6.1%	4.7%	5.4%	5.3%
16	Consolidated Budget Balance/ GDP, %	-0.3%	-6.3%	-9.3%	-6.3%	-3.7%	-3.0%
17	Total External Debt- US\$ million	3,652.0	5,664.0	6,254.0	7,148.0	7,948.0	8,221.0
18	Total External Debt/ GDP	35.9%	44.3%	58.1%	61.3%	61.4%	56.2%
19	Public External Debt/GDP	17.6%	21.0%	31.4%	33.8%	33.7%	30.8%
20	Private External Debt/ GDP	18.3%	23.2%	26.7%	27.5%	27.7%	25.5%
21	Exports- \$US million (Goods)	2,088.3	2,428.0	1,893.6	2,460.0	2,807.0	2,892.0
22	Imports- \$US million (Goods)	4,984.1	6,261.2	4,292.6	5,027.0	5,686.0	5,840.0
23	Trade Balance \$US mn (Goods)	-2,895.8	-3,833.2	-2,399.0	-2,567.0	-2,879.0	-2,948.0
24	Trade Balance/ GDP	-28.5%	-30.0%	-22.3%	-22.0%	-21.9%	-20.0%
25	Current Account Balance \$US mn	-2,010.0	-2,912.4	-1,210.1	-1,116.5	-1,316.0	-1,214.0
26	Current Acct. Bal./ GDP	-19.8%	-22.8%	-11.2%	-9.6%	-10.0%	-8.2%
27	Forex Reserves (end period- exc gold) US\$ m	1,361.2	1,480.2	2,110.4	2,263.9	2,538.0	2,519.0

Sources: National Bank of Georgia, IFS –IMF February 2011, IMF Georgia: Seventh and Eighth Reviews Under the Stand-By Arrangement, and Requests for Waivers of Nonobservance of Performance Criteria and Rephasing of Purchases, Report No. 11/31 January 2011, EIU Country Report- Georgia December 2010.

I. Recent Economic Developments and Outlook

a. Real Sector

Between 2003-2007, Georgia enjoyed real GDP growth averaging 9.6% per annum. Factors driving growth during this period were broad based, and were supported by successful structural reforms, high credit growth, and strong external inflows including remittances, foreign direct investment (FDI), and to a lesser degree, official assistance. On the supply side, the services sector led the way with high growth in financial intermediation, communications, transport and also tourism, while the industrial sector performed well thanks to growth in the metals and agricultural processing sectors. Agriculture's contribution to growth was relatively stagnant.

The period of high growth came to a halt in 2008, as the economy suffered a double shock from the armed conflict in August, and from the global financial crisis. The shocks had a cascading effect throughout the economy, hurting consumption, investment, and lender confidence, also affecting foreign direct investment and other capital inflows. In response, the government moved to contain the slowdown in growth and reached agreement with the IMF on an 18-month US\$750 million Stand-By Arrangement (SBA) in September 2008 which was increased by US\$ 420 million in August 2009. An international donors conference was organized in October 2008, during which pledges of assistance to Georgia totaling US\$ 4.5 billion in grants and concessionary loans were delivered. Real GDP growth for 2008 slowed to 2.3%, down from the 12.3% achieved in 2007, and for 2009, the economy experienced a contraction of real GDP of -3.8%.

The downturn proved short-lived and has been reversed, aided by domestic institutional and structural reforms, the economic upturn in key trading partners, as well as improving global conditions. Georgia experienced an upturn in economic activity in the second half of 2009 that has continued into 2010, with annual GDP growth estimated to have reached 6.4% for the year. An analysis of GDP growth by production shows that as in the high growth years, the industrial and services sectors account for nearly all of the growth, with agriculture relatively stagnant. Best performing areas included manufacturing, construction, transport, retail trade, tourism, and in the latter half of the year, finance. On the demand side, private consumption and external demand have recovered, driving much of the growth, while public consumption slowed in 2010, as the government sought to restore fiscal balance and withdraw the SBA aided stimulus which it had injected in late 2008-2009. Public investment also rose and played a counter-cyclical role, assisted by official assistance and international financial institution (IFI) financing. The donor aid pledged at the October 2008 conference has supported job creating investment projects, with implementation of some of the larger infrastructure schemes likely to last for three to four more years, thus providing a low cost stimulus to the enhancement of the productive capacity of the Georgian economy. By way of contrast, private investment, including foreign direct investment, has been slow to recover in the aftermath of the dual shocks, and this has raised concerns that the economy may be operating near capacity in a number of sectors.

Poverty declined sharply in the middle of the previous decade, as a result of the economic growth. The national poverty rate dropped from around 52% in 2002 to 23.7% in 2007 according to a *Georgia Poverty Assessment* carried out by the World Bank¹. Extreme poverty affects 9.3% of households according to the assessment, and is particularly concentrated in rural areas. Poverty rates have likely risen since the assessment, due to the armed conflict and the financial crisis. The former resulted in over 100,000 new internally displaced persons in addition to those remaining displaced

¹ See World Bank *Georgia: Country Partnership Strategy (CPS) for FY10-13*

from conflicts in the early 1990s. Unemployment, which was high before the dual shocks, also rose during 2008-10 and remains around 20%, despite the recovery of growth. Per capita incomes grew sharply between 2003-2008, but have since fallen back a bit and as at end 2010 stood at around US\$ 2,640 in nominal terms- and US\$ 5057 in terms of purchasing power parity. Georgia is classified as a lower middle-income country by the World Bank.

b. Public Sector and Fiscal Policy

Georgia has greatly improved fiscal management over the years, and in particular has achieved success in increasing and broadening the revenue base, while it has also rationalized expenditures via tools such as medium term expenditure planning frameworks. Prior to the dual shocks, the Government's budget was basically in balance, with only a tiny deficit. Following the shocks, the decline in economic activity which reduced revenue on the one hand, and the rise in counter-cyclical spending in order to cushion the impact of the economic downturn on the other hand, resulted in an increase of the fiscal deficit to -9.2% of GDP in 2009.

In 2010, the Government pursued a policy of fiscal consolidation resulting in an improvement for the year to -6.3% of GDP, and projects further decline to -3.7% for 2011, as a result of the return of growth which boosted revenues, as well as cuts in non-essential expenditures. Nevertheless, social welfare spending was sustained due to the need to offset the negative impact of higher unemployment and poverty, despite the intention to curtail counter-cyclical spending. The SBA with the IMF projects additional fiscal consolidation in 2011 and beyond, based primarily on containment of expenditures, but also revenue side measures fostering compliance and broadening of the tax base through further improvement in tax policy and administration.

c. Monetary and Financial Sector

In the aftermath of the 1998 Russian financial crisis, the lari was heavily devalued by nearly 50% against the US dollar. Since then, it has proved remarkably stable and in the years up to 2008 had modestly but steadily appreciated against the US dollar (which has declined globally). The National Bank of Georgia (NBG) implements a 'managed floating exchange rate' policy, but intervenes in markets at times in order to avoid the risk of sharp short term movements in the exchange rate, and to maintain external competitiveness.

In late 2008, the currency was devalued by over 15% in response to the economic impact of the dual crises and in order to protect Georgia's external position. In March 2009 NBG initiated currency auctions in order to allow the exchange rate to be determined by the market, and it has become the sole mechanism of foreign exchange intervention. The lari has stabilized, although it slid by a further 6.5% on average for 2010 relative to 2009 against a stronger US dollar.

Dollarization of the economy remains high, and this hinders the effectiveness of the implementation of monetary policy and reflects a relative lack of confidence in the lari. Prior to the dual crises, deposit dollarization had fallen to around 60%, a figure which rose in the aftermath of the crises to 76% before receding to around 72% at end 2010. Achieving greater dedollarization remains a key objective of Georgia's monetary authorities, and while it depends upon successful policy implementation and continued improvement of the macroeconomic environment, NBG intends to promote the process by increasing reserve requirements on foreign exchange deposits and external borrowing.

After the period of hyperinflation in 1990s, inflation in Georgia stabilized. Between 2001-2009, average annual inflation fluctuated between 3-9%, except for 2007-08 when annual inflation broke above 10% due to rises in food and energy prices. However, the rise was temporary and not due to structural factors, a fact affirmed by the sharp drop in average inflation to 1.7% in 2009 as a result of lower international prices for food, fuel and raw materials, as well as the domestic economic slowdown which resulted in reduced demand. In 2010, inflationary pressures were higher, due to global commodity prices, a bad agricultural harvest and renewed domestic demand growth, and for the year the average inflation rate rose to 7.1%.

NBG's monetary policy seeks to control inflationary pressures by affecting interest rates, but the impact of the rate changes is diminished by the high degree of dollarization on the economy. Nevertheless, NBG lowered the refinancing rate from 12% in mid-2008 to 5% by the end of 2009 in order to stimulate the economy. As the economy has recovered, NBG has raised refinancing rates to 7.5% by end 2010, and to 8.0% in February 2011. Inflation control remains a priority, and authorities have demonstrated their willingness to tighten monetary policy and to employ a range of tools to this end beyond just interest rates, including increasing reserve requirements on foreign exchange denominated liabilities.

Banking Sector & Capital Markets

The National Bank of Georgia is responsible for supervision and regulation of the entire financial sector in Georgia, first and foremost commercial banks, but also insurance companies and the securities market in order to ensure the stability of the entire financial system. At the end of 2010, there were 19 commercial banks active in Georgia under NBG supervision, of which 16 were foreign controlled. There are no restrictions on foreign ownership of banks, and the banking sector has been entirely privately owned since 1995. As of December 2010, the total paid-in capital of commercial banks totaled GEL 723 million. There were also 18 non-bank depository institutions, 51 microfinance organizations, and 17 insurance companies active.

The role of financial intermediation in the economy remains modest but has increased steadily over the years, and at the end of 2010 domestic credit as a share of GDP was an estimated 33.5%. The dual crises of 2008 resulted in capital flight pressures as there was a temporary withdrawal of deposits and a slowdown in lending. Government intervention, with the support of IFIs and other donors, succeeded in injecting needed liquidity into the economy and restoring confidence. Thus, while lending growth was negative for 2009, it recovered in 2010 as the economy picked up and the banking sector as a whole returned to profitability, after having posted losses for 2009. The situation with non-performing loans improved markedly from mid 2009 until the end of 2010, with NPLs as a share of total loans reaching 7%. Lending interest rates remain relatively high, but dropped over the course of 2010, such that at the end of the year they stood at around 23% for lari denominated loans and 15% for foreign currency loans. A substantial portion of long term lending continues to represent on-lending operations of IFIs. Georgia's banking sector is well capitalized, with an average Basel I capital adequacy ratio of 24% (18% according to local standards).

Trade on the Georgian stock exchange began in March 2000, but to date progress has been slow and trading volumes remain low. As a result, capital markets do not play any significant role in mobilizing resources for investment.

d. External Sector

Debt

In 2007, the ratio of total public debt to GDP was 25.5%, while the ratio of external public debt to GDP was 16.8%. The low levels of public indebtedness and the favorable maturity and interest rate structure of the public debt portfolio helped to provide necessary fiscal space for the Government to enact its countercyclical fiscal stimulus measures in late 2008. The public debt stock is expected to peak at around 43% to GDP in 2011 and then to start descending to pre-crisis levels. Government external debt service features flat repayment profile, with the ratio of government external debt service to budget revenues being 2% in 2008, 4.3% in 2009, 4.4% in 2010 and a projected 4.1% in 2011. On April 12, 2011, the Government successfully issued a new US\$ 500 million 10-year EMBI-eligible Eurobond with yield to maturity of 7.125%; it used proceeds of this new issuance to buy back its 5-year US\$ 500 million Eurobond which was issued in April 2008 and was due in April 2013. This transaction has served to smooth the debt repayment profile and has contributed to the affordability of the servicing of public debt. Contributing to the sustainability of the public debt dynamics is the structure of Georgia's public debt portfolio. With fixed interest loans representing 67% of the public debt stock, the interest rate risk is very low. External public debt represents 75% of the public debt stock, with the overwhelming share of such debt owed to international financial institutions and incurred on soft and/or concessional terms.

The two SBAs agreed with the IMF in September 2008 and August 2009 represented the first non-concessional arrangement agreed with the IMF after several highly concessional- and much smaller in size- poverty reduction and growth facilities (PRGF) in previous years. This underscored the much improved debt situation of Georgia and its greatly improved creditworthiness, which resulted in the initiation of non-concessional IBRD lending by the World Bank (i.e. Georgia has become a 'blend borrower'), after graduation from highly concessional IDA financing.

Private external debt grew during the boom years as Georgian companies increased their external borrowing activities. It grew from 4.5% of GDP in 2004 to 23.2% in 2008, and while new borrowing has subsided as a result of the downturn, the level rose during 2009-2010, peaking at around 28% of GDP. This level does not represent a threat, and it is expected to decline in coming years as GDP growth is expected to outpace external lending growth, but it deserves ongoing monitoring.

In the aftermath of the dual shocks, Georgia's sovereign credit ratings were downgraded by Standard and Poor's (S&P) and Fitch. S&P upgraded Georgia during 2010, back to B+, which is the same as Fitch's. S&P and Fitch placed Georgia on positive outlook for an upgrade in March 2011, citing the economic recovery and favorable GDP growth prospects. Georgia also obtained a rating of Ba3 stable from Moody's in January 2011.

Trade and the Current Account

Starting from a low base, Georgia's international trade in goods grew by over 400%, from US\$ 1.7 billion in 2000 to US\$ 7.5 billion in 2010, peaking at US\$ 8.7 billion in 2008 but then slowing due to the economic downturn. During this period exports grew 307% and imports by 360%. Georgia has historically run structural trade deficits, which account for its current account deficits (CAD). Since 2008, the CAD has improved substantially from -22.8% of GDP in 2008 to -11.2% in 2009, and -9.6% in 2010. For 2011, estimates for the CAD are close to the 2010 level. It bears noting that in the boom years, import figures were inflated by high levels of imported equipment and intermediate goods for construction of energy lines from Azerbaijan, through Georgia and on to Turkey.

Exports for 2010 grew by 29.9% relative to 2009, driven by increases in sales of ferrous metals, as demand for Georgian iron and steel increased significantly (as did international prices for iron and steel). Other significant sources of revenues included re-export of motor cars and export of other minerals and metals. Imports rose 17.1% in 2010 relative to 2009, with oil and petroleum products representing the most important import item.

In the Black Sea region, Georgia has been and remains among the most inter-linked countries with other members of the Black Sea Economic Cooperation. Six of its top ten trading partners were from within the BSEC Region: Turkey in first place, Azerbaijan in second, Ukraine in third, Russia in seventh, Armenia in eighth and Bulgaria in ninth. These countries accounted for approximately 48% of Georgia's total foreign trade and roughly 90% of its trade with the BSEC region. Between 1999 and 2010 the proportion of BSEC trade as a share of total Georgian international trade grew from 39% to 52%. The increase in links was reciprocal as exports to BSEC countries increased 555% while imports grew 667%.

Foreign Direct Investment

Foreign direct investment (FDI) has been slow to recover following the dual shocks in 2008, falling to 6.1% of GDP in 2009, and further to 4.7% of GDP in 2010. While these levels compare favorably to other emerging markets as well as to other countries in the greater Black Sea region, they (i) are somewhat inflated by the low base against which they are measured, as Georgia remains relatively poor, and (ii) they represent a substantial decline relative to the rates of 15.3% of GDP in 2006, 17.2% of GDP in 2007, and 12.2% of GDP in 2008, attained prior to the dual crises. And while some of this investment was in the form of one off projects related to the development of the energy pipelines, Georgia had successfully managed to attract greater levels of FDI in other sectors as well.

Georgia's attractiveness as an investment destination has improved in parallel with the improvements in the country's business environment. In recent years, it has consistently been ranked as a top reforming country in the World Bank's annual *Doing Business* reports, and between 2006 and 2010 it rose from 112th to 12th position, the latter score coming out of the 183 total countries surveyed. According to the five year measure of cumulative change in *Doing Business* indicators from 2006-2011, Georgia is the top reformer globally. In the nine categories covered by the survey, Georgia is a top ten performer in the areas of starting a business (8th overall), dealing with construction permits (7th), and registering property (2nd). It is also a top quartile performer in obtaining credit (15th), protecting investors (20th), trading across borders (35th), and enforcing contracts (41st). It scores slightly lower on difficulty and cost of paying taxes, where it ranks 61st, and is in the lower half (third quartile) in only one category, that of closing a business, where it ranks 105th.

Another indicator of country risk and business environment in which Georgia is rated is *Euromoney* magazine's country risk score which has risen (improved) substantially over the years, coming in 53.6 (out of a perfect score of 100) in September 2010, which ranks above the average for the BSEC region of 52.6 but below the EU average of 75.0.

e. Forecast for 2011-12

Georgia's main policy directions are guided by a number of documents. In January 2008, "*United Georgia without Poverty*", a medium term reform program, was published. The program lays out a number of policy priorities such as macro-economic growth, lower taxes, creation of jobs, focusing

the budget on social programs, extending health insurance for the poor, rehabilitating the road network, increasing hydropower generation, increasing agricultural exports, and strengthening higher education. In addition, the Government prepares an annual strategy document *Basic Data and Directions (BDD)*, which outlines the medium term reform program for the coming three years, and provides the macro-economic framework for the period, including fiscal resources and allocations, along with descriptions of the individual sector strategies to achieve stated objectives. Key strategic directions of the Government's economic reform strategy include: economic growth, support for social needs, investments in critical infrastructure, rural productivity, education, judicial reform, and effectiveness and efficiency in provision of government services.

Following 2010's higher than expected GDP growth rate of 6.5%, conservative projections for 2011 are positive at around 5.5%, supported by continued private demand, relatively enhanced consumer, lender and investor confidence, and higher private capital inflows. This represents a lower rate than that achieved during the boom years prior to the dual shocks, but it would more gradually, and perhaps more sustainably, continue to support increases in living standards, and declines in poverty and unemployment. Recovery of investment, including FDI, will contribute to reaching these real growth rates, although they may also be exceeded under benign circumstances, and in view of the success achieved in improving the business environment in recent years. Inflationary pressures will likely decrease with rates around 6-7%, supported, inter alia, by actions taken by the NBG to tighten monetary policy and by the fiscal policy of the government. Continued fiscal consolidation targeting budget deficits below 3% of GDP from 2012 will be important both to underpin stability and growth, and also as a positive signaling mechanism of the government's ongoing commitment to reform and to maintenance of a solid macroeconomic environment.

II. Overview of Current BSTDB Portfolio

As at 31 December, 2010, the active BSTDB portfolio in Georgia amounted to five operations approved by the Board of Directors (BoD), involving an investment of € 19.6 million (US\$ 26.0m). All five operations were signed for € 19.6 million (US\$ 26.0m) and the outstanding disbursements were at € 15.1 million (US\$ 20.0m). Georgia ranks tenth across the board in the BSTDB portfolio, with 1.7% of BoD approved operations, 1.9% of signed operations, and 2.3% of amounts outstanding in the total portfolio. Relative to the Bank's active portfolio at the end of 2006, Board approvals decreased by 38.5%, signings by 26.2%, and amounts outstanding by 12.2%.

Table 2: Active BSTDB Portfolio in Georgia as at end December 2010

All Figures in Euros Million	BoD Approval Date	Approved Amount	Signed Amount	Amount Outstanding
TBC Bank	15-Nov-02/15-Apr-06	3.8	3.8	3.8
VTB Bank Georgia (former United Georgian Bank)	4-Jun-05	2.3	2.3	-
Cartu Bank	27-Jul-07	3.8	3.8	3.8
Procredit Bank Georgia SME III	1-Feb-08	7.5	7.5	7.5
TBC Leasing SME II	24-Sep-10	2.3	2.3	-
Total		19.6	19.6	15.1

III. Review of Country Strategy 2007-2010

The current evaluation was performed by the Bank's Evaluation Office as per the respective Evaluation Policy. It reveals the performance of the Bank's 2007-2010 Country Strategy for Georgia. Its goal is to provide accountability to the Board of Directors and Board of Governors as well as facilitate the decision-making by the Bank's Management and Boards on the eventual update of the country strategies.

The evaluation of the respective country strategy compares the stated targets with actual results as of end of 2010, and provides a country-oriented analytical picture. A mid-term evaluation of the Country Strategy was conducted in early 2009 and reported to the Board of Directors and Board of Governors in June 2009, as part of the Annual Evaluation Overview, issued by the Evaluation Office.

Performance of Georgia Country Strategy 2007-2010

The 2007-2010 Country Strategy was approved by the Board of Directors in early 2007, reflecting an in-depth independent evaluation of the implementation of the BSTDB's earlier strategies, conducted by the Evaluation Office in late 2006. It was aligned with the objectives of the Bank's Business Plan 2007-2010 and was therefore evaluated in that context.

Overall, the implementation of the Country Strategy was consistent with the Business Plan implementation. The performance of the strategy is rated as Partly Unsatisfactory, as the targets were implemented at about 40%, including the intended sector coverage. For a more comprehensive overview, see Annex I.

IV. BSTDB Operational Priorities for 2011 - 2014

The Bank's role and priorities are defined (i) in accordance with the priorities and targets laid out in its *Medium-term Strategy and Business Plan 2011-2014* and (ii) country needs and objectives, as well as (iii) available resources, strategies and policies of BSTDB. In this respect, BSTDB will seek viable opportunities and will continue closely monitoring the developments in the Georgian economy in order to stand prepared to support bankable projects in all sectors pertaining to the Bank's field of action. In addition the Bank shall seek co-financing opportunities with IFIs, public sector institutions and private partners.

BSTDB will focus in the next four years on providing support for the implementation of the Government program and priorities, while responding to market demand. The Bank will consider undertaking activities and providing services as may advance its purpose, paying special attention to activities promoting export of goods and services, and development of infrastructure, including energy efficiency. In addition, through selected intermediaries, the Bank would attempt to expand its financing programs in favor of SMEs.

Based on the 2011- 2014 BSTDB Business Plan, the Bank would expect on average to approve one new operation per annum during this period, for approximately € 10-15 million per year. Over the four year period, this implies around four approved operations for approximately € 51 million. With the Bank determined to raise the level of commitments (signed operations) to approved operations to over 85%, the Bank expects signings for 2011-2014 to be on the order of four operations for € 44 million (a range of € 9-13 million per annum).

These indicative targets are based on the Base Case Scenario of the MTSBP, and given appropriate circumstances and sufficient operational opportunities the Bank would make efforts to

exceed this level. In case of higher regional economic growth rates, increased demand for Bank funding, and an improved situation in financial markets, a phased increase in the average number and size of operations would allow the Bank to move towards achieving the targets envisaged under the High Case Scenario. Moreover, at the Mid-Term Review, depending upon performance and prospects, the above targets may be revised upwards².

In line with the Bank's strategy to increase operational activity in smaller shareholder countries, the Bank will insist that all operations meet criteria of sound banking principles on the one hand, and financial viability/ economic sustainability on the other hand. Within these parameters, the Bank will explore the possibility of taking on additional risk- or risks- in order to facilitate the undertaking of additional operations. The greater 'reward' that justifies the acceptance of more risk is that the Bank would participate in a larger number and volume of operations in smaller countries, and thus better fulfill its mandate to promote economic development, especially where needs are greatest.

Areas for BSTDB Financing:

BSTDB Trade Finance and Financial Sector Strategy for Georgia

Since BSTDB began its operations, the following products have been introduced through selected financial intermediaries in Georgia for the purpose of Trade Finance, Micro Finance, and small and medium enterprise (SME) development:

- Multiple Buyer Credit Facility
- Pre-export finance Facility
- Combined Trade Finance (export/import) product
- Medium –Term Micro and SME Finance product
- Leasing Facility for SMEs

The Bank already works with a number of financial intermediaries in Georgia providing trade finance products and micro-enterprise and SME medium term lending. Such activities will continue to represent a priority for the Bank, since the financial sector is rapidly developing, and the small size of most Georgian firms often renders conducting direct operations with these enterprises uneconomical (due to scale) or too difficult (due to informational difficulties and complexity of reaching out to small firms). The Bank remains committed to a pro-active strategy of working with Georgian commercial banks and leasing companies as the needs of Georgian banks and SMEs evolve. The Bank will adapt in order to meet the changing needs as effectively as possible.

For existing operations, the Bank is likely to increase the amount of existing trade finance facilities and to renew and/or increase Micro and SME loan facilities where performance is good and prospects are favorable. In addition, the Bank may make available longer term financing to fast growing micro-enterprises and SMEs, particularly in promising sectors such as construction, small manufacturing, agriculture and food processing, energy, and tourism, but also activities elsewhere which meet 'bankability' criteria.

² Under no circumstances would targets be revised downwards unless the lower case scenario of the 2011-2014 BSTDB Business Plan were to be followed.

Financial sector support may also involve extending support to non-bank financial entities as market conditions permit. This may include working with leasing companies, which are underdeveloped in Georgia but which may grow rapidly as the market matures. The Bank intends to use the leasing product not only for financing capital expenditure of SMEs but also for other companies as an effective financing tool for the promotion of regional trade. Medium-term credit lines opened to leasing companies for trade related purposes will enable them to offer their customers finance for capital expenditures on imports from other countries in the Black Sea region.

Since SME development is a priority for the Government, the Bank will also seek other ways to support SMEs, and will be open to additional forms of cooperation with intermediaries, including involvement in investment funds or innovative special purpose structures. Financial viability remains an essential precondition, but the Bank will also seek to mobilize technical assistance resources to facilitate innovation, creative structuring, and to help upgrade management practices and governance. The Bank will also consider the option to take equity participations in selected financial institutions and funds, and will also seek to develop quasi-equity products, such as subordinated loans.

The Bank will also keep in regular contact with complementary international financial institutions (IFIs) such as EBRD and IFC to seek ways to coordinate activities and share experiences, given the opportunities which exist for joint involvement.

Manufacturing and Enterprise Sector

The impact of the recent global economic crisis on Georgia was significant both in terms of FDI attracted and the overall GDP growth. Thus, it has been very challenging for BSTDB to finance bankable projects in Georgia in recent years. The situation is expected to improve in the next years so that new investment opportunities may arise. The Bank will closely follow the activities of both foreign and local investors to identify new financing opportunities. The Bank also intends to work closely with local banks as a way to support private sector development. The Bank would finance economically viable and bankable projects, mainly in the sectors outlined below. Given the relatively smaller size of the economy, and investments in general, BSTDB would concentrate on small to medium scale projects in general industries. The Bank will support enhanced co-operation and co-ordination with foreign as well as local private sector investors, while closely co-operating with other IFIs and bi-lateral institutions.

Manufacturing

Georgia has a tradition of success in areas such as manufacturing, agriculture and agribusiness. Over the past twenty years the industrial basis became outdated, but lack of investment has not permitted substantial rehabilitation. The Bank intends to take advantage of the lower thresholds for undertaking direct operations with firms in Georgia in sectors which show rapid growth potential, such as (i) agri-industry- including processed foodstuffs, wines, and mineral waters- (ii) forestry products, (iii) light industry- including textiles, consumer goods, and other manufactured products- and (iv) construction- including construction materials- which is one of the fastest growing areas of the economy. Naturally, other manufacturing areas of activity will also be considered, so long as the criteria of bankability and consistency with the Bank's mandate (supports economic development and where possible regional cooperation) are met. These other industrial areas include production of machine tools, shipbuilding, wood, glass and craft packaging, as well as agricultural products – mineral water, wine, tobacco, canning juices, and ferro-alloys and chemicals (although in low quantities).

Given the importance of ferrous metals exports, the Bank will also consider opportunities in the mining and extraction sector, particularly where post-privatization modernization of export

oriented facilities is concerned. The Bank will finance local private companies with strong cash flow potential and- preferably- an export orientation; and support them to develop their export potential, based on local raw materials by offering medium to long term instruments.

Transportation:

Georgia's geographical position makes it an important regional and inter-regional transport link, including between the Black and Caspian Seas. Given the country's location, rehabilitation and/or extension of the transport and communications network is critical for Georgia to benefit fully from its position as a transit economy. Thus, BSTDB will pay particular attention to the financing of projects that involve improvement of existing transportation networks, including roads, railways and ports. The Bank will also focus on the improvement of customs passages by supporting private companies to build warehouses, logistics facilities, service centers and access roads. Along these lines, the Bank will explore possibilities of developing regional logistics hubs and cold storage facilities. The port of Poti has a special importance as a general cargo and container terminal. The Bank will seek opportunities for financing of projects that improve and expand further the facilities of the port of Poti. The possibility to finance construction of selected toll roads on a concession basis with foreign co-investors, mainly between Georgia and Turkey will also be explored.

Energy and Infrastructure (E&I)

Given existing E&I development needs, so long as projects are 'bankable', the Bank will be keen to offer support. This applies to all key infrastructure sectors, including energy (especially renewable) and electricity, transport infrastructure, telecommunications, and municipal infrastructure. The existence of an appropriate competitive environment and regulatory framework will be an important consideration in ascertaining 'bankability' alongside development impact.

While emphasis will continue to be on bankable private sector operations, BSTDB will be willing to explore if the Georgian Government will be able to provide sovereign guarantees for E&I projects. Should a sovereign guarantee be necessary and possible, it would only be sought for an extremely high priority activity in which the guarantee would also serve as a signaling mechanism of the Government's commitment to/ ownership of the operation in order to facilitate greater resource mobilization and broader participation.

In case of the consideration of financing at the privatization stage of any E&I objects, the presence of a strategic investor would be a key factor for the Bank, and the Bank's assistance would likely come in the form of post-privatization financing to upgrade facilities and restructure. Other involvement in infrastructure operations will need to be via creative arrangements such as public-private partnerships.

The Bank will continue to ensure that all BSTDB E&I operations in Georgia meet sound banking principles and comply with the Bank's Environmental Rules and Procedures and incorporate, where appropriate, Environmental and Social Action Plans.

The Bank will also maintain its contacts with complementary international financial institutions (IFIs) and organizations such as EBRD, IFC, KfW, DEG, OeEB, etc. to seek ways to coordinate activities and share experiences.

BSTDB Energy and Infrastructure strategy in terms of banking instruments:

- Project Finance limited recourse transactions;
- Corporate recourse financing transactions;

- Exploration of financing in the form of Equity;
- Co-financing of transactions with other international financial institutions, and commercial banks;
- Participation in syndicated facilities for E&I deals in Georgia

Areas of particular focus in Energy and Infrastructure:

- Energy (including renewable),
- Electricity,
- Transport infrastructure,
- Telecommunications,
- Municipal infrastructure

ANNEX I: Post Evaluation of 2007-2010 Country Strategy Georgia (approved 04.02.2007)				
2007- 2010 TARGETS			RESULTS (end of 2010)	
General	Sectors	Target operations: Number approved/ number signed; USD approved/ USD signed (million)	Actual operations: Number approved/ number signed; USD approved/ USD signed (million)	Evaluation Summary
Work closely with local banks and other firms to support private sector development, and to assist in the promotion of improved corporate governance and management training practices.	<p>1. Financial sector</p> <ul style="list-style-type: none"> ▪ Trade finance products and SME medium term lending ▪ Longer term finance to fast growing SMEs ▪ Diversify the range of products ▪ Funding non-bank financial entities ▪ Mobilize technical assistance resources to facilitate innovation, creative structuring, managing practices and governance. <p>2. Manufacturing and Enterprise</p> <ul style="list-style-type: none"> ▪ Use the lower thresholds for direct operations in sectors with rapid growth potential, e.g. (i) agri-industry- including processed foodstuffs, wines, and mineral waters- (ii) forestry products, (iii) light industry- including textiles, consumer goods, etc. and (iv) construction/materials ▪ Mining and extraction <p>3. Energy and Infrastructure</p> <ul style="list-style-type: none"> ▪ Infrastructure improvement ▪ Energy, transport, telecommunications, municipal infrastructure ▪ Renovation of key facilities in sectors such as energy (e.g. hydropower electricity or electricity/ gas generation and distribution), ports, or telecom ▪ Cooperate with the dedicated Municipal Development Fund (MDF). ▪ Technical assistance on regional cooperation, knowledge generation, state of the art methodologies, and/or enhance the prospects for resource mobilization in the economy. 	10/9 46/40	3/3 18/18	<p>1. Volume: below target</p> <p>Approved number: 30% Approved volume: 39% Signed number: 33% Signed volume: 45%</p> <p>2. Sector coverage:</p> <ul style="list-style-type: none"> ▪ Cartu Bank (Trade finance) ▪ TBC Leasing SME II (SME) ▪ ProCredit Georgia SME III (SME) <p>3. Performance: Partly Unsatisfactory. Targets generally achieved at 40% levels, including sector coverage.</p>