

# Innovations in the Monetary and Credit System of Georgia

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**To cite this article:**

Mzevinar Nozadze, Maia Kapanadze. Innovations in the Monetary and Credit System of Georgia. *Science Innovation*. Vol. 10, No. 6, 2022, pp. 221-224. doi: 10.11648/j.si.20221006.17

**Received:** November 10, 2022; **Accepted:** December 8, 2022; **Published:** December 28, 2022

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**Abstract:** A monetary credit system is an essential part of financial and economic system of any country. An effective monetary credit system is a precondition of development and stability of economic system of any country. The monetary credit system consists of two components: 1. The monetary system is a form of money circulation that has gone through a long path of origin and development, and its mechanisms and tools are different depending on the different levels of economic development of countries. The monetary systems of various countries are regulated by the international legislation; 2. The credit system is the aggregate of the credit and financial institutes that facilitate the monetary capital and then issues it to physical and legal entities via credit loans. This system includes the forms and methods of credit usage. Central and commercial banks belong to the basic link of the monetary-credit system. It is important to note that the monetary credit system - in its centralized and administrative form - functioned in post-socialist countries, including Georgia. After the collapse of the post-socialist system, these countries declared their independence and sovereignty, so the integration process of their monetary and credit system into the international monetary and credit systems became an inevitable process. On the current stage of the development of the monetary and credit relationships, these countries as well as other developing countries are the participants of the global finance and credit relationships. It is very interesting to analyze and review the international aspects of their monetary and credit systems.

**Keywords:** Georgian Monetary Credit System, International Monetary Credit System, International Legislation, Monetary Policy, Financial-Credit Institutions

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## 1. Introduction

The monetary credit system of various countries has three levels: 1. the central bank of the country; 2. the system of commercial banks; 3. non-banking (credit) institutions (micro financing organizations, credit unions, pension funds, and mutual help funds, leasing companies, factoring firms, trust companies).

A national bank is a main link of the monetary credit system. It manages the monetary credit system of a country. Commercial banks are credit institutions, which manage the attraction of monetary capital and then loan it (interest rate) based on return, terms and security conditions. Non-banking (credit) institutions implement small volume credit (loan) operations. On the current stage of the globalization, the monetary credit system of any country is integrated with the international monetary credit system.

## 2. Georgian Monetary System and International Aspects of Its Functioning

### 2.1. Preconditions of the Emergence of Georgian Monetary and Credit System

As a result of reforms and institutional development, the monetary and credit system of independent Georgia has been established as one of the most successful sectors in the country, which plays an important role in the economic system of Georgia (as well as any other country). In the 1990s, after the recognition of political and economic independence by the post-socialist countries, the issue came up on the agenda: on one hand, changing the rules and mechanisms of the functioning of their financial and credit system, and on the other hand, the integration and

globalization of the said system with the international financial and credit system.

"The introduction of an independent financial and credit system put the issue of the introduction of the national currency on the agenda (it is known that in Georgia and the post-socialist countries before that there was a common currency - the Ruble). The national Georgian currency - Lari - has been in circulation since 1995". [1]

It is a well-known fact that post-socialist countries, including Georgia, did not have independent experience in managing the monetary and credit system, and therefore, initially, the management of the mentioned system was not effective. Significant progress has been made in this direction since 1992, when Georgia became a member country of the World Bank and the International Monetary Fund. In order to develop the exchange market, the National Bank implemented the exchange rate reform and replaced the Tbilisi Interbank Exchange with foreign exchange auctions, which currently represents the only instrument of intervention in the foreign exchange market. [2]

As a result of the aforementioned reform, the need for the National Bank's interventions in the foreign exchange market and its share in foreign exchange transactions have significantly decreased. The new policy significantly increased the short-term volatility of the exchange rate, which is an important factor characteristic of the foreign exchange market". [3]

Effective functioning of the banking-credit system is a general catalyst for the development of the national economy. As for the different features of their development in different countries, they are determined by historical, political, ethnic and religious factors.

## ***2.2. Georgian Monetary and Credit System, Its Structure and the International Aspects of Functioning***

A central bank plays a significant role in regulation of the monetary credit system. The National Bank of Georgia, which is the central bank of the country, is responsible for the formulation and implementation of the monetary policy in Georgia. It represents an independent body from the government and guides in the mentioned process within the scope of powers defined by the organic law "On the National Bank of Georgia" and the resolution of the Parliament of Georgia "On the main directions of monetary and credit and currency policy". The central bank of the country - The National Bank of Georgia - has been functioning since 1991. The National Bank of Georgia is responsible for ensuring the fulfillment of the main functions and goals assigned to it by the legislation with the regulatory and monetary instruments at its disposal. The National Bank of Georgia is authorized to provide banking services to the governments of other countries, monetary and credit authorities and central banks, as well as to international organizations. "The National Bank of Georgia participates in the work of those international organizations whose goal is to promote economic stability in the monetary and credit field through international cooperation." [4]

Modern Georgian monetary and credit system consists of commercial banks and non-banking organizations registered in Georgia, including 14 licensed commercial banks, 37 microfinance organizations, 333 loan issuing subjects and credit unions as well as currency exchange points.

The interbank deposit and credit market in Georgia is a money market where banks trade with short-term excess liquidity. This market is of great interest to the National Bank of Georgia, as this market has a decisive role in the functioning of the monetary transmission mechanism. "Money market instruments are monetary policy instruments: refinancing loan and permanent refinancing loan (7-day maturity); overnight deposits and overnight loans; certificates of deposit (3-6 month maturity) and treasury bills, repo operations and others". [5]

The official exchange rate of the national currency of Georgia - Lari - is calculated according to the transactions made on the Bloomberg electronic trading system - Bmatch - platform and is published daily on the website of the National Bank.

On the Bmatch platform of Bloomberg's electronic trading system, foreign currency purchase and sale transactions are concluded between its participants. Local commercial banks using the Bloomberg system, microfinance organizations, as well as other local and foreign companies with the approval of the National Bank have the right to participate in the Bmatch platform. Every working day, the participants of the platform publish their own buying and selling rates (quotes) in the Bloomberg trading system, which is available without limitation to all participants of this system. [6]

The official exchange rate of GEL against the currencies of other countries is determined on the basis of cross-exchange rate conversion of the rates available on the international markets or on the domestic currency market of the issuing country. "The source of information about the exchange rates required for recalculation is the information systems of "Reuters", "Bloomberg" and the central banks of the respective countries. Information is received, processed and distributed from these systems in automatic mode". [7]

It is important to note that one of the functions of the National Bank is the management of international currency reserves, which is the largest asset on its balance sheet. The organic law determines the permissible composition of international reserve assets. International reserve assets are calculated according to the methodology established by the International Monetary Fund and published on the website of the National Bank on the 7th day after the end of the month. The total international reserves of Georgia are characterized by growth dynamics. By the end of 2020, its value is a maximum of 3.9 billion US dollars. "For 2010-2020, the share of foreign currency reserves in total international reserves is increasing and the specific share of SDR is decreasing. Together with these data, the country's reserve position in the International Monetary Fund improves". [8] The National

Bank of Georgia is trying to increase the efficiency of the country's monetary and credit market, taking into account international monetary practice.

The Georgian money market is regulated by the National Bank. An integral part of the Georgian money market is the interbank foreign exchange market, organized in the Bloomberg International Electronic Trading System, through which foreign exchange transactions are concluded [9].

As to the credit market of Georgia, the main participants here are the commercial banks. "A commercial bank is a legal entity licensed by The National Bank of Georgia (hereinafter - The National Bank). A commercial bank accepts deposits and, using them, carries out banking activities defined by the legislation of Georgia on its own behalf". [10]

"Since 1992, the World Bank allocated more than 2,7 billion USD cheap credits and loans for funding 69 projects in different economic sectors of Georgia. The current portfolio includes 12 active investment projects and development policy measures, equaling 789 million USD in total" [11].

Georgia has been a member-country of The Bank for Reconstruction and Development since 1992. From that period to the present, together with other international financial and credit organizations, its share in the development of the financial and credit system of Georgia is important.

The rating given by the international rating agencies indicates the reliability and stability of the banking system of Georgia. In particular, the international rating company "Standard & Poor" (S&P) raised Georgia's sovereign rating to the "BB" level with a stable outlook. Also, the second big rating company "Fitch Ratings" increased the sovereign credit rating of Georgia from "BB\_" to "BB". The increase in the international credit rating has a positive impact on the rating of the banking sector of Georgia and its reliability, which increases the confidence of international institutions in the country's banking system.

The high reliability and high rating of Georgian commercial banks is confirmed by the fact that two commercial banks operating in Georgia trade their shares on the London Stock Exchange. "TBC Bank shares has been traded on London Stock Exchange since 2014. During the last two years, the bank has demonstrated the best results of corporate trading and confirmed it is a company of the highest standards, which deserved moving to the highest segment of London Stock Exchange" [12].

Bank of Georgia is listed on the main market of the London Stock Exchange and is a constituent of the FTSE 250 Index. Bank of Georgia has credit ratings from global rating agencies: 'Moody's': 'Ba3/Ba 2 (foreign and local currency), Fitch Ratings: 'BB-' (long and short term issuer default ratings); outlooks are 'Stable'. [13]

The National Bank of Georgia takes into account the recommendations issued by the International Monetary Fund and the Basel Committee on Banking Supervision. According to the principle of the Basel Committee on Banking

Supervision, the main task of banking supervision should be the sound and safe operation of the system. International banking regulation is considered a very relevant issue in Georgia, especially after the introduction of Basel III. On 2017, the National Bank of Georgia finished the process of formalization of Pillar-2 elements of the capital adequacy framework, which is based on Basel III. Within the capital adequacy framework, the changes were made in order to rise the supervisory capital and improve the conformity with Basel III.

In order to develop the banking sector and refine the supervising standards, the National Bank of Georgia cooperates with various international organizations, supervisory institutions of various countries and international supervisory groups. The National Bank of Georgia is a member of the following bank supervising groups: Basel Consultative Group – BCG and Group of Banking Supervisors from Central and Eastern Europe – BSCEE. The international cooperation, membership of the supervising groups and memorandums signed with various supervising bodies significantly facilitates the data exchange and reaching the best international practices.

In Georgia, the monetary and credit system functions according to the local and foreign practices and the related norms. The country seeks to develop such a legislative regime that will rise the trust to it on the international scale. Considering the practice of the international banking sphere, a deposit insurance system is an approved method of securing deposits worldwide. It secures the compensation for deposits in case of an insurance case of a certain amount. The deposit insurance system works functions in Georgia according to the best international practice and standards. It was launched in Georgia in 2008. It regulated by the law On the Deposit Insurance System. The World Bank and the International Monetary Fund assisted Georgia in establishing this system. According to the mentioned law, all the commercial banks in Georgia ensure the deposits of the current resident and non-resident entities. According to the law of Georgia On Commercial Banks Activities, in case a liquidation process of any commercial bank was launched, the Deposit Insurance Agency provides the compensation of depositors' amounts within the set limit, within 20 calendar days. All types of deposits of resident and non-resident entities, including current and card accounts, term deposits and demand deposit are subject to the insurance.

The National Bank of Georgia, along with standard refinancing loans, manages liquidity with swap operations for both commercial banks and microfinance organizations. In April 2019, the National Bank signed a 200 million USD limit swap agreement with the European Bank for Reconstruction and Development (EBRD), within the framework of which it will provide the corresponding amount of GEL liquidity. As is known, EBRD finances many important projects in Georgia. Financing is carried out both in foreign currency and, in some cases, in national currency. [14]

The work done by the National Bank of Georgia won international recognition in 2021, as in previous years. Many authoritative international organizations have confirmed it: the International Monetary Fund, The World Bank, The European Investment Bank, Asian Development Bank, and The European Bank for Reconstruction and Development, rating companies etc. [15]

The National Bank of Georgia constantly takes care of improving the pace of innovations in the financial sector. The National Bank of Georgia develops various supervisory approaches and promotes the creation of basic infrastructure for fintech activities, which consists of two vectors, namely: development of financial infrastructure and supervisory framework.

Examples of infrastructure are open banking, API standardization, fast payments system and digital lari project. During infrastructural projects, the National Bank of Georgia tries to manage the project with the maximum involvement of the private sector and to act according to the public-private-partnership scheme.

### 3. Conclusion

The monetary credit system of Georgia is undergoing changes and it is being refined. The National Bank of Georgia, as the main monetary and credit institution of Georgia shares and establishes the European and international monetary credit standards into this system. The financial and banking system of Georgia is a part of the global financial and credit system. It is facilitated by their cooperation with the following international financial credit institutions: The World Bank, International Monetary Fund.

In order to promote new technologies and develop the fintech ecosystem, the National Bank of Georgia has taken a number of successful steps: along with fintech infrastructure projects, such as standardization of open banking, instant payments, digital lari, and in order to reduce fixed costs for fintech companies - digital bank. It should be noted that the National Bank of Georgia uses an open regulatory framework that allows fintech innovators to participate in the development of the supervisory framework.

As for development in the direction of regulation, the National Bank is focused on finding the optimal balance between innovation and risk. It should be noted that the risk-oriented approach can only be used by a developed supervisor. This approach was developed over the years and is a signature of the National Bank of Georgia. The risk-oriented approach has international recognition and contributes to the high stability of the Georgian banking sector.

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