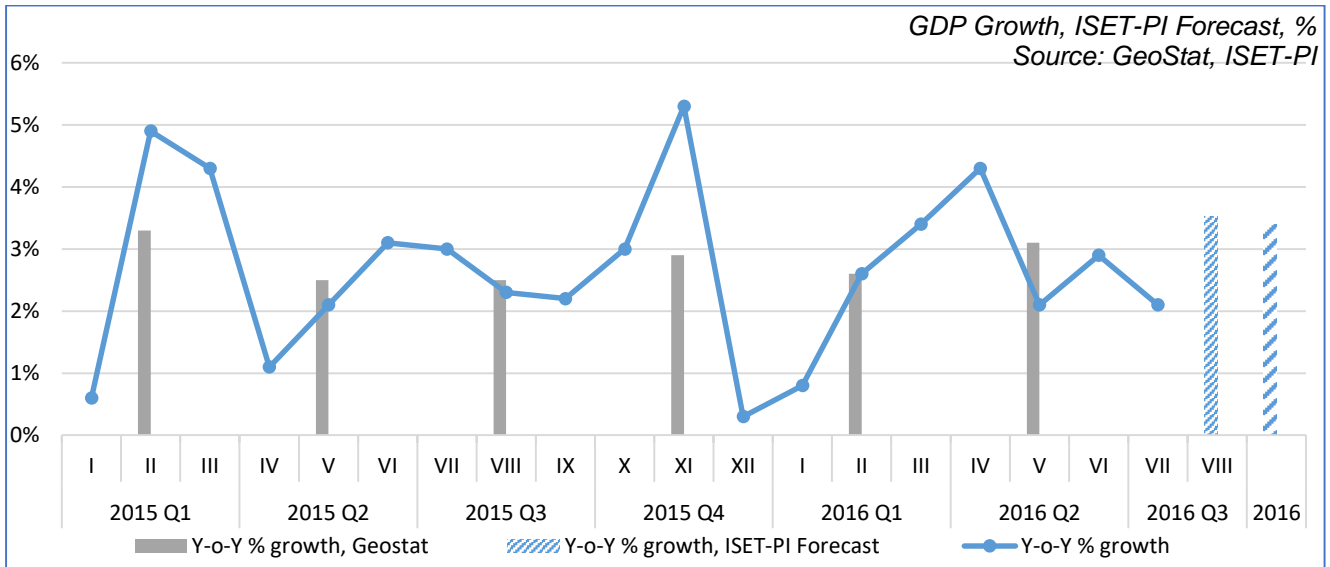




Georgia in the First Seven Months of 2016: Crisis Recovery Underscored by Low Inflation, Appreciating Currency and Falling Merchandize Trade Turnover

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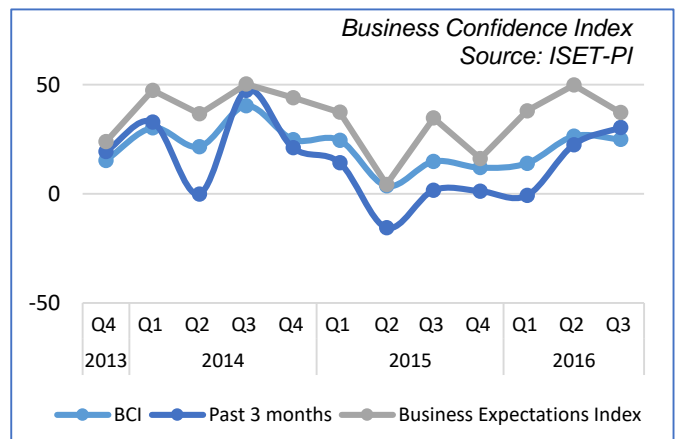
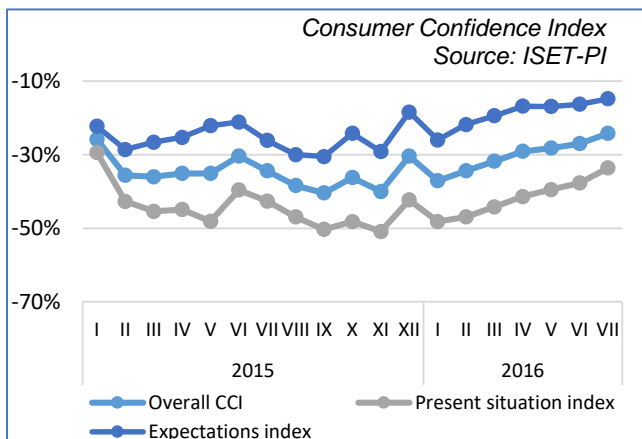
GDP growth trends and forecasts

According to Geostat’s rapid estimates, real GDP grew by 2.1% in July 2016, while the growth rate for Q2 stood at 2.3% year over year (YoY). The estimated second quarter growth was thus 1.6 percentage points lower than ISET-PI’s GDP forecast for the quarter.

Based on new information, the ISET-PI forecast for Q3 has been lowered from 4.8% to 3.5%. The Q4 forecast remains largely the same at 4.2%. The estimated real GDP growth for the first seven months of 2016 was 2.7% YoY. This is 0.7 percentage points less than ISET-PI’s annual GDP forecast.

Low regional demand and other negative spillovers from neighboring countries’ weak economies have contributed to relatively low growth rates in Georgia.

Consumer and business confidence has been edging up compared to last year. ISET-PI’s Consumer Confidence Index (CCI) gives reason for optimism, showing a clear positive trend in the reporting year. In July 2016, the CCI continued the upward trend and showed a monthly increase of 2.8 points in the overall index.





However, in absolute terms consumer confidence remains deeply negative, currently standing at -24.2 points. This means that the number of people who answer the questions about their current situation and their expectations pessimistically continue to outnumber those who give positive answers. Still, -24.2 is a much better indicator than the CCI's all-time low of -40.4 points that occurred in September 2015. In July, the overall index reached its highest point since January 2015 ([see the full CCI report here](#)).

The Georgian Business Confidence Index (BCI) decreased only marginally in Q3, but at 25.0 points it remains stable and significantly more positive than compared to the same quarter last year (when it registered 14.8 points).

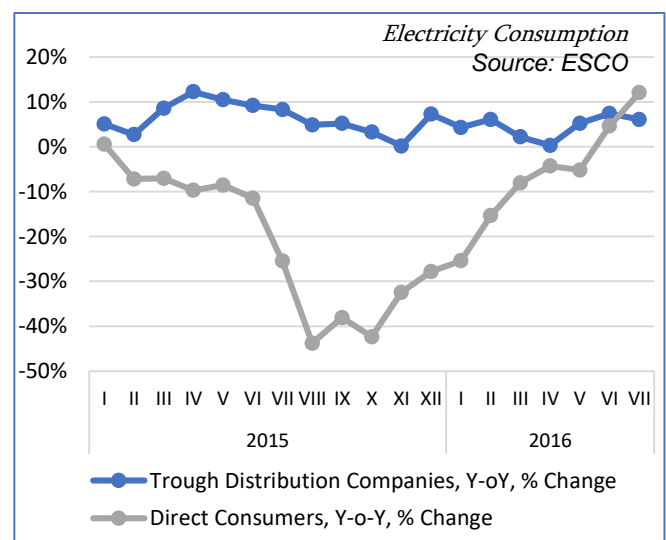
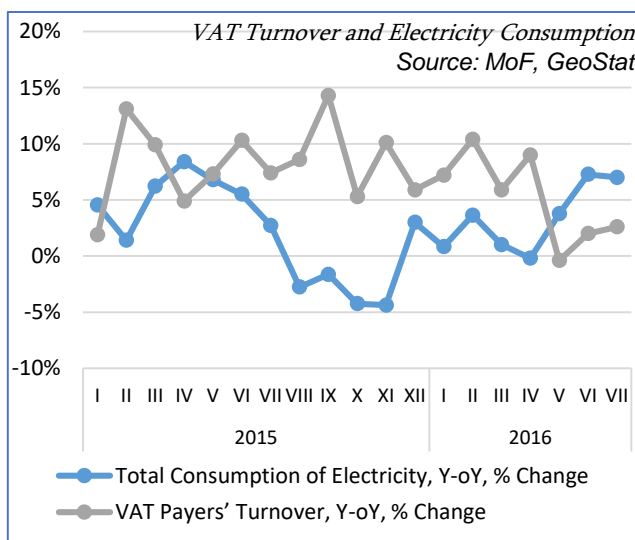
At the end of the summer, about 80% of surveyed firms reported that their business conditions either remained unchanged (43%) or had improved (38%) in the past 3 months. At the same time, expectations about business conditions in the next 3 months decreased somewhat compared to the previous quarter. About 50% of firms expected improvement in the next 3 months, while in Q2 this number was higher at 55%. Expectations about the economy at the end of the summer season were weaker in all business sectors ([see the full BCI report here](#)).

Monitoring the BCI and CCI trends is a bit like measuring the vital signs of a patient in hospital. The indicators show that our patient (the Georgian economy) is getting better following the 2015 regional crisis, but that it has not yet fully recovered.

Aggregate demand indicators: VAT and Electricity Consumption

VAT payers' turnover was reflected in the slowdown of the real GDP growth rate over the last months – it grew by only 2% and 2.6% YoY in June and July respectively.

In contrast, total electricity consumption increased by 7.3% and 7% YoY in June and July respectively. Direct consumption increased by 4.6% and 12% YoY in the same months. The main driver of the increase was the company Georgian Manganese – the biggest direct consumer of electricity in Georgia, which resumed mining operations in May. However, the very slow recovery of manganese prices does not guarantee a bright future for one of the country's major employers. Despite the recent YoY increase of direct consumption, this year's figures are far below 2014 levels. Electricity consumption through distribution companies increased by 6.3% and 5.1% YoY in June and July, respectively.

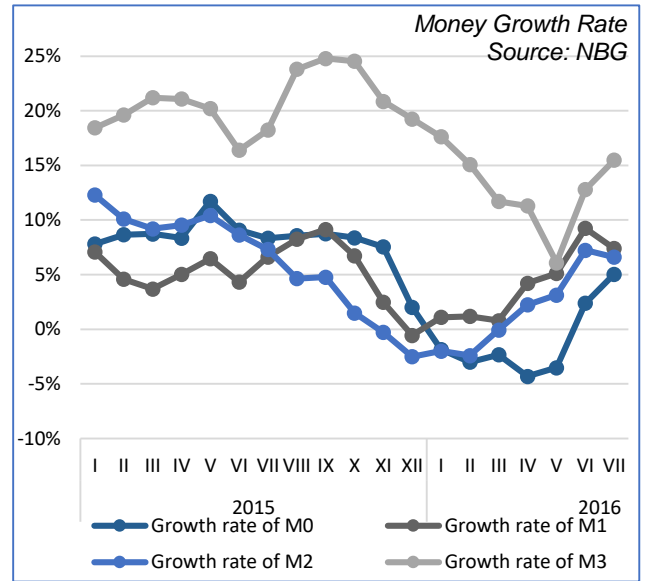
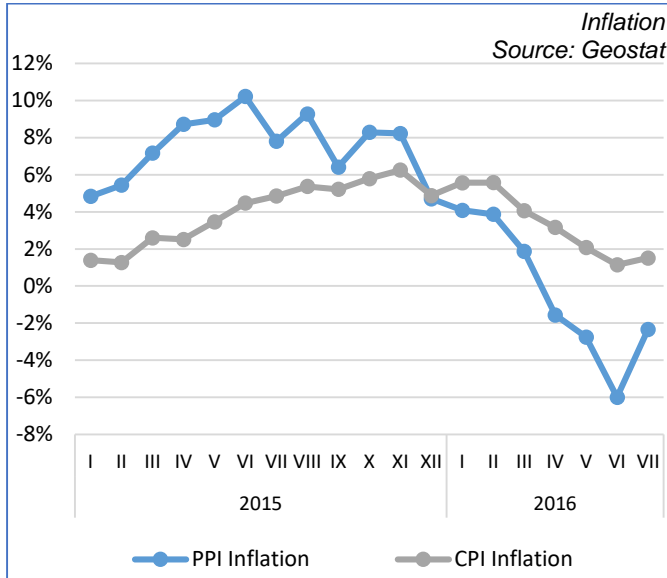


Monetary Indicators: Inflation and Money Growth

The annual inflation rate was well below its target level in the first seven months of 2016, reaching 3.3% on average. In June and July, CPI based inflation was even lower at 1.1% and 1.5%, respectively. Based on these figures and its macroeconomic forecast, the National Bank of Georgia



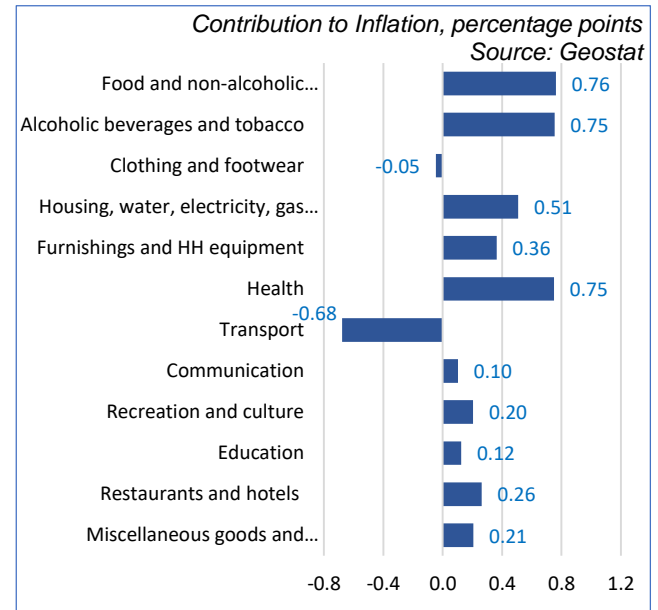
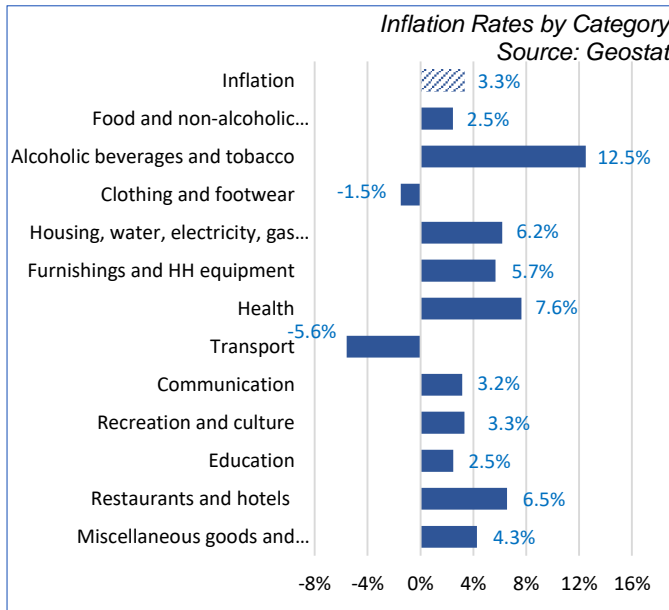
continued to gradually weaken the previously tight monetary policy. The monetary policy rate was reduced from 8% (in February) to 6.5% (in September). The NBG announced that the expansionary monetary policy would be continued until the monetary policy rate reaches the “neutral level” of 6%. These steps caused the increase of money aggregates and positive YoY growth in June and July. Theoretically, this move should positively affect future economic growth and increase inflation closer to its target level.



The decomposition of the consumer price index shows that the 3.3% YoY inflation in the first seven months of the year was mainly driven by higher prices of three product categories: food and non-alcoholic beverages, alcoholic beverages and tobacco, and healthcare. Together, these categories contributed about 2.3 percentage points to total inflation in 2016. Alcoholic beverages and tobacco, saw a 12.5% YoY increase in prices, which was mainly due to the higher excise tax introduced in January this year. Transport prices were down by -5.6% in in the first seven months of 2016 and drove inflation down by 0.68 percentage points.

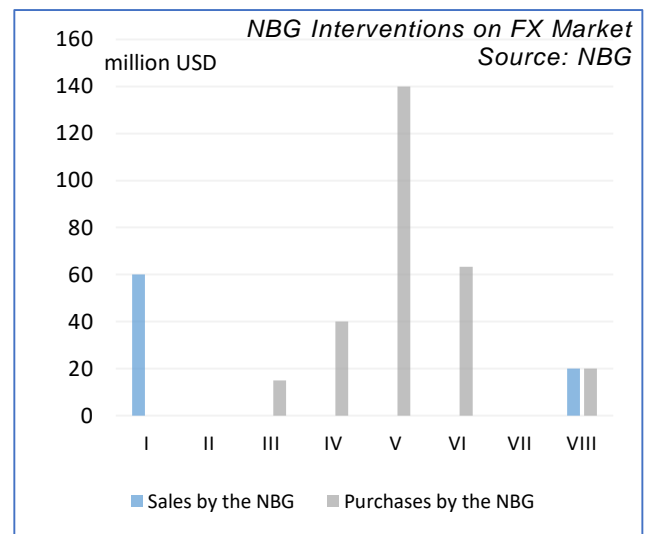
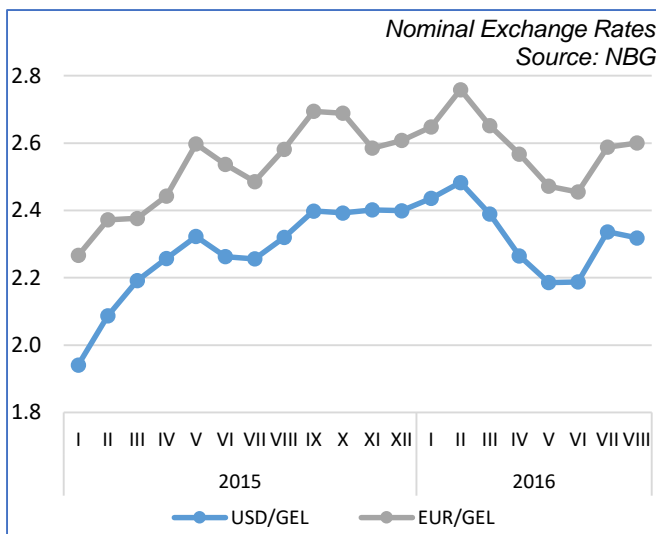
According to the NBG’s forecast, which is explained by low internal and external demand and low commodity prices on the world market, CPI based inflation will hit its target level only at the end of 2017.

PPI prices, which were trending upwards throughout 2015, fell quite sharply in the second quarter of 2016. Thus, in July 2016 producer prices were 2.3 percentage points below those in July 2015. The main contributors to the producer price drop were manufacturing products, in particular food, beverages and tobacco; textiles; and chemical products.



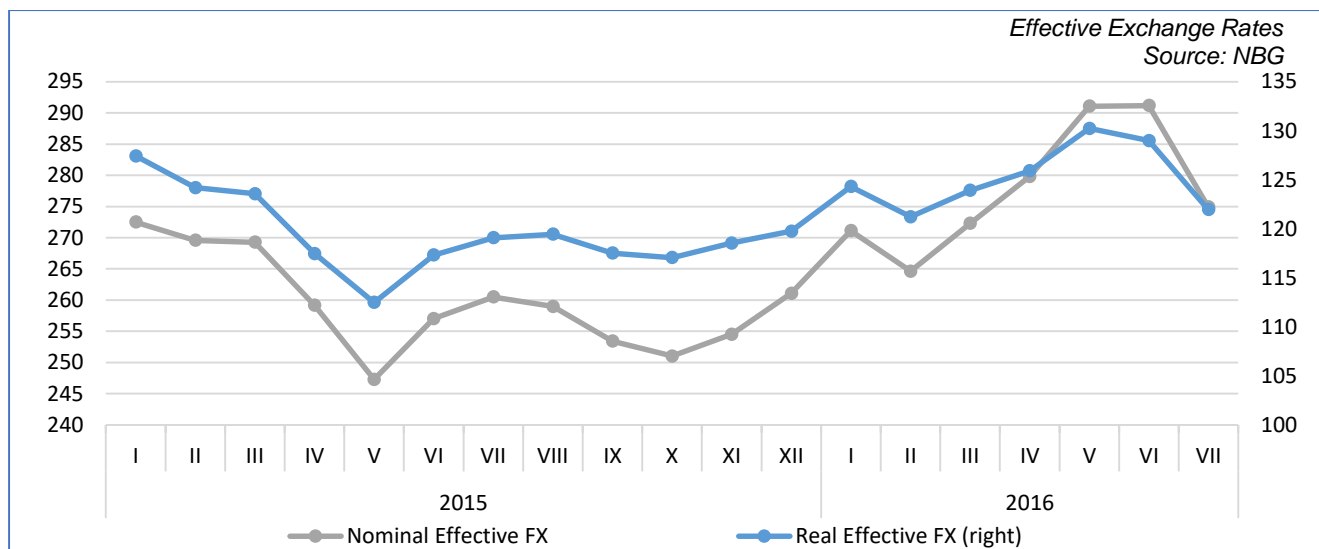
Lari appreciates against partner currencies in annual terms

After four consecutive months of appreciation, the lari depreciated at the end of June and the beginning of July. In the reported month, the lari month-on-month depreciation was 6.8% against the US dollar and 5.4% against the euro.



The recent depreciation was likely the market response to the sharp appreciation (overshooting) of the national currency caused by expectation pressures. The NBG tried to prevent the lari appreciation by making interventions on the foreign exchange market. The National Bank purchased 258.35 million USD in 13 auctions during February-July 2016. As a result, the NBG managed to smooth the lari fluctuation. In August, the NBG performed both the sale and purchase of reserves of the same amount. This type of intervention (known as sterilized intervention) is done in order to influence the exchange rate value of the domestic currency without changing the monetary base.

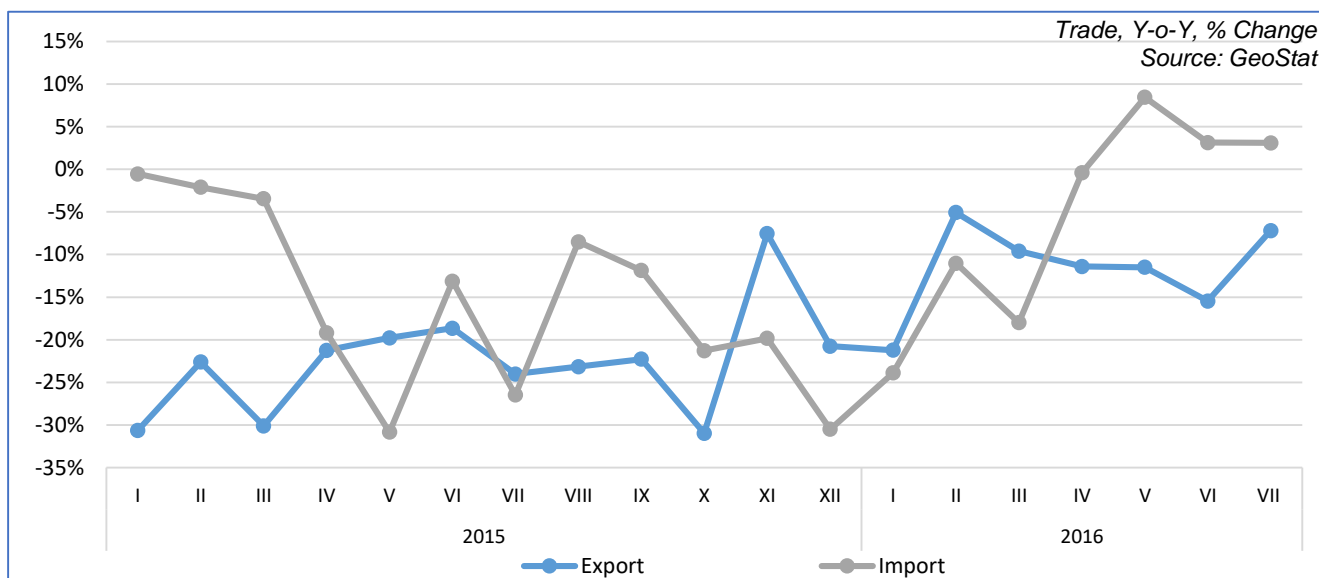
Both nominal and real effective exchange rates showed a month-over-month depreciation in July, at 5.6% and 5.5% respectively. However, in annual terms, the lari effective exchange rates appreciated by 5.5% (nominal) and 2.4% (real). This means that the country's trading partners experienced higher inflation in July than the 1.5% recorded in Georgia: Azerbaijan (11.3% YoY), Turkey (8.8% YoY), Ukraine (7.8% YoY) and Russia (7.2% YoY).



External Trade

Georgian exports amounted to 173.6 million USD in July – a 7.2% YoY decline. Most of this decline came from EU countries (-45.4% YoY) and CIS countries (-19.7% YoY), while exports to other countries increased by 21% YoY. The main drivers of the fall of exports were exports of medicaments (-51.9%), fertilizers (-57.3%), spirituous beverages (-13.8%) and mineral waters (-9%). At the same time, exports of copper, ferro alloys, hazelnuts, wine, and gold experienced a significant YoY increase in July.

Imports to Georgia amounted to 596.2 million USD in the reported month – a 3.1% YoY decline (excluding the donation of hepatitis c medicines). Imports of cars (+9.1% YoY), copper (+182.7% YoY) and telephones (+51.7% YoY) were the main drivers of import increases, while the import of petroleum and gases declined by 5.1% and 25.1% YoY respectively in July.



As a result, in **July 2016 the trade deficit increased by 8% YoY**, and amounted to 422.6 million USD. In the first seven months of 2016, **exports decreased by 11.5% YoY and amounted 1.12 billion USD**, while **imports decreased by 5.7% YoY and amounted to 3.86 billion USD**. The main losers of 2016 in terms of the YoY decrease in exports values, were ferro alloys (-22.9%), motorcar re-exports (-21.5%), medicaments (-28.5%), mineral waters (-10.4%) and fertilizers (-24.4%). Meanwhile, copper



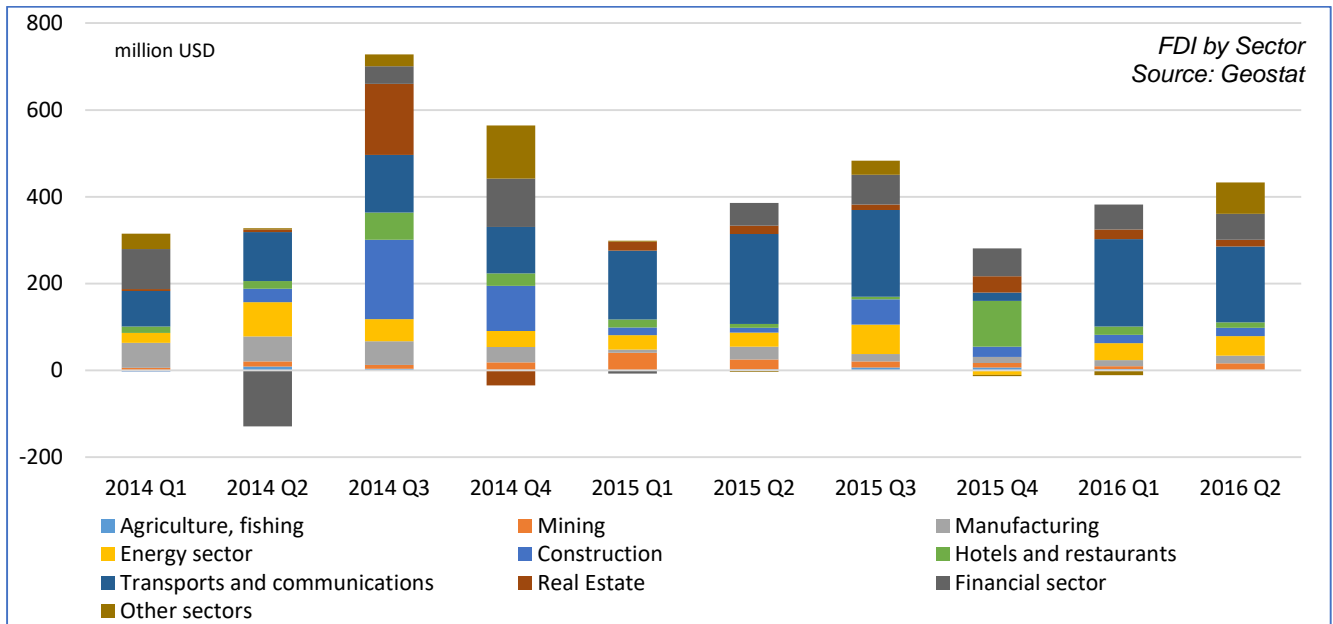
(+14.7%), hazelnuts (+4.8%), wine (+16.2%), gold (+38.4%) and spirituous beverages (+37.9%) were the top export products to show a YoY increase.

In the first seven months of 2016, the overall trade deficit shrank by 3.0% YoY, while the external merchandise trade turnover decreased by 7.1%.

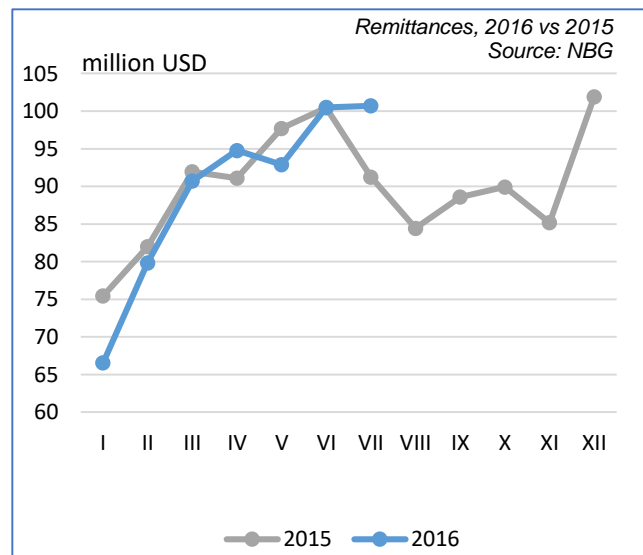
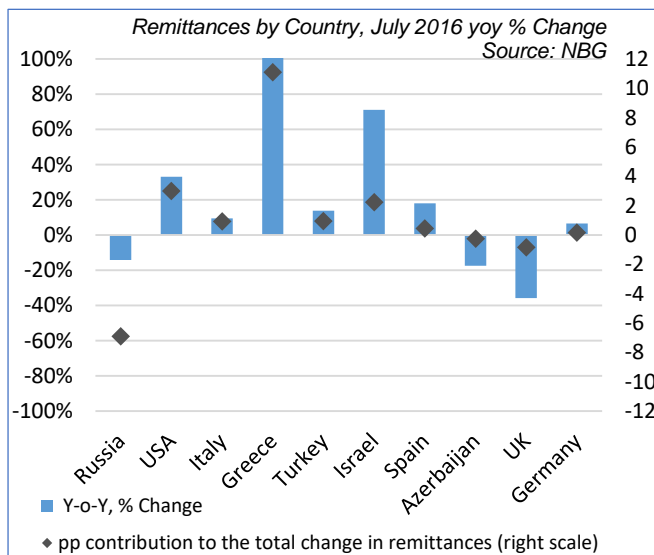
FDI trends

According to Geostat’s preliminary estimates, FDI in Georgia amounted to 445.3 million USD in Q2 2016, a 3.8% YoY increase. The top five source countries by share of total FDI were Azerbaijan (33%), the UK (14%), the Czech Republic (8%), Turkey (6%), and Panama (6%).

In Q2 2016, transport and communications was the largest FDI recipient sector with 174.7 million USD (39.2% of total FDI), the financial and energy sectors followed with 59.8 million USD (13.4%) and 45.7 million USD (10.3%), respectively.



Remittances inflows to Georgia amounted to 100.7 million USD in July 2016, which is a 10.4% YoY increase. This was mainly caused by an approximately 12 times increase of money inflows from Greece, where restrictions on money transfers were applied in July 2015. The contribution of Greece to the July YoY change in remittances was 11.1 percentage points (pp). Money inflows from the USA (33.1%) and Israel (71%) contributed 3.0 pp and 2.2 pp to the YoY remittances change. The decline in transfers from





Russia (-14.3% YoY) was once again the main factor weighing down money inflows. It contributed -6.9 pp to the overall remittances change in July.

Overall, in the first seven months of 2016, total remittances amounted to 626 million USD - a 0.9% YoY decrease. However, if we look at remittances incomes in CPI-adjusted lari terms, the **inflows from abroad showed a 2.1% YoY real (purchasing power adjusted) increase.**

Tourism trends

In July, 764,000 international visitors were in Georgia - a 3.5% YoY increase. Of these, 78.1% arrived by land, 19.7% by air, 0.6% by sea and 1.5% by rail. Visitors who stayed in Georgia for 24 hours or more constituted 51.1% of total arrivals, or 390,000 people – a **15.8% YoY increase.**

The extreme YoY increase of arrivals from Iran (575%), Saudi Arabia (112%), and the UAE (50.5%) have made Asia a priority in terms of tourism development.

Surprisingly, international arrivals from Russia decreased by 2.7% YoY. However, looking at **the number of international visitors arriving by air showed a 41.8% YoY increase.**

International Arrivals (July 2016)

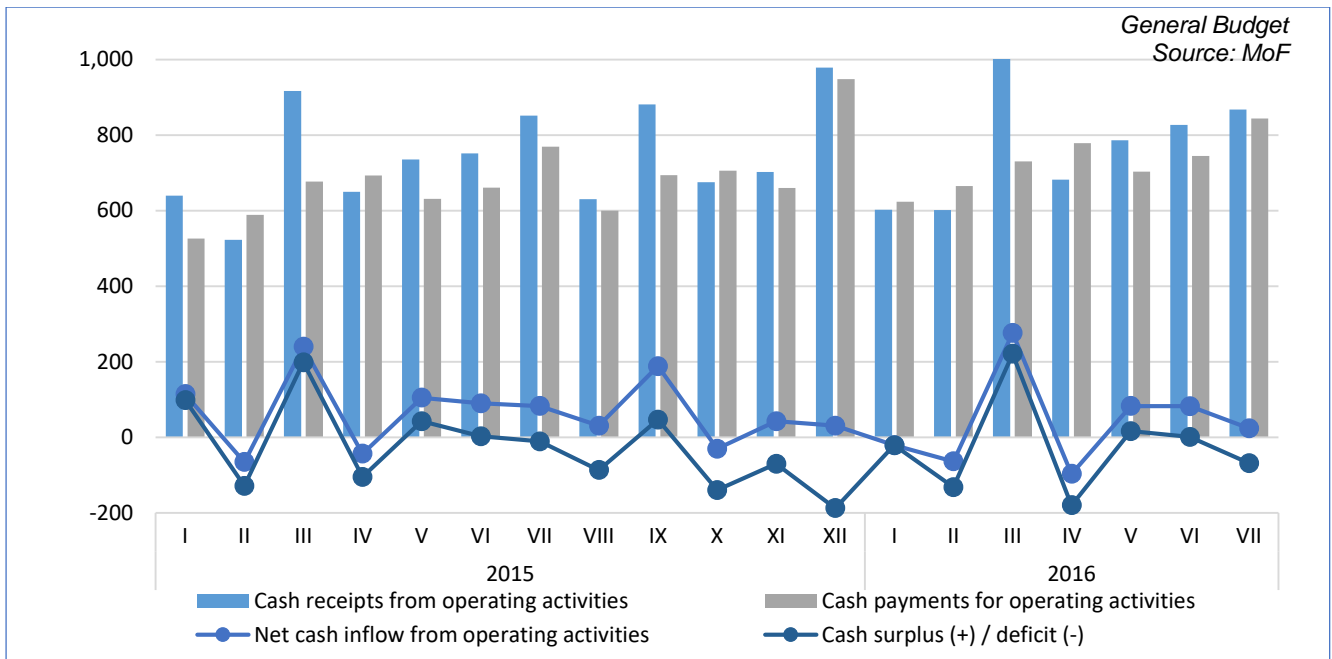
Source: GNTA

	Country	2015: July	2016: July	Change	Change %	Share %
1	Azerbaijan	160 407	167 507	7 100	4.4%	21.9%
2	Armenia	180 119	166 769	-13 350	-7.4%	21.8%
3	Turkey	152 203	140 234	-11 969	-7.9%	18.4%
4	Russia	140 413	136 559	-3 854	-2.7%	17.9%
5	Iran	3 567	24 089	20 522	575.3%	3.2%
6	Ukraine	18 850	22 319	3 469	18.4%	2.9%
7	Israel	10 504	13 187	2 683	25.5%	1.7%
8	Kazakhstan	6 526	9 847	3 321	50.9%	1.3%
9	Poland	7 318	7 277	-41	-0.6%	1.0%
10	Belarus	5 792	6 762	970	16.7%	0.9%
11	Germany	4 562	5 384	822	18.0%	0.7%
12	Saudi Arabia	2 252	4 780	2 528	112.3%	0.6%
13	United Arab Emirates	3 040	4 574	1 534	50.5%	0.6%
14	USA	4 334	4 475	141	3.3%	0.6%
15	Oman	1 339	3 845	2 506	187.2%	0.5%

Overall, in the first seven months of 2016 the total number of **international arrivals stood at 3.4 million people, a 10.6% YoY increase.** Of these, 82.3% arrived by land, 16.1% by air, 0.9% by sea and 0.7% by rail. While the total number of international arrivals reflects both transit and tourist statistics, the international visitors who arrived to Georgia by air are more likely high-end tourists. **The number of high-end tourists increased by 35.7% YoY in the first seven months of 2016.** This means that the regional economic slowdown mainly affected trade and transit through Georgia, but had a much lesser effect on the tourism sector.

Government budget trends

In the first seven months of 2016, government expenditure increased by 12% compared to the same period in the previous year and constituted 5.091 billion USD.



Total expenditure increased mainly as a result of a 11.9% increase in social benefits and a 14.6% increase in the purchase of goods and services. Government revenues increased by only 6% (taxes rose by 8.4% YoY) in the same period. The biggest contributors to this change were revenues from excise tax, which increased by 23.1%, and property tax, which increased by 56.3%.

Overall, the government budget was 164.5 million USD in deficit in the first seven months of 2016, while in the same period of the previous year it showed a 97 million USD surplus. Total government debt amounted to 13.3 billion GEL in July, which was a 5.6% YoY increase.