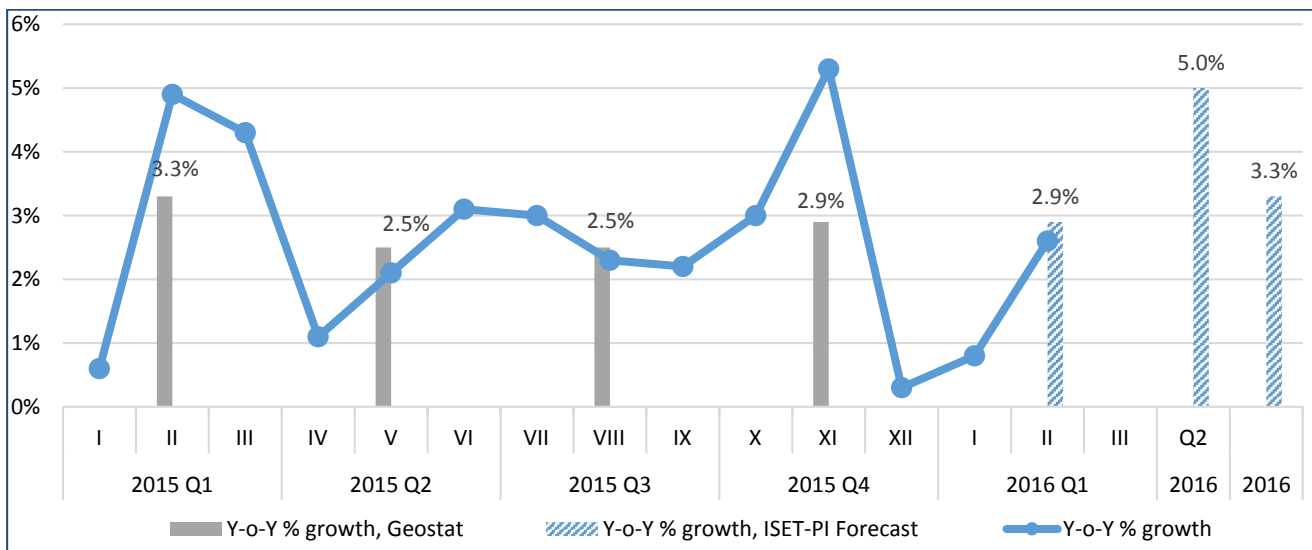




*Resilience to Macroeconomic Shocks – a Good Foundation for Georgia’s Long-Term Development Plans*

Figure 1: GDP Growth, ISET-PI Forecast, %

Source: GeoStat, ISET-PI

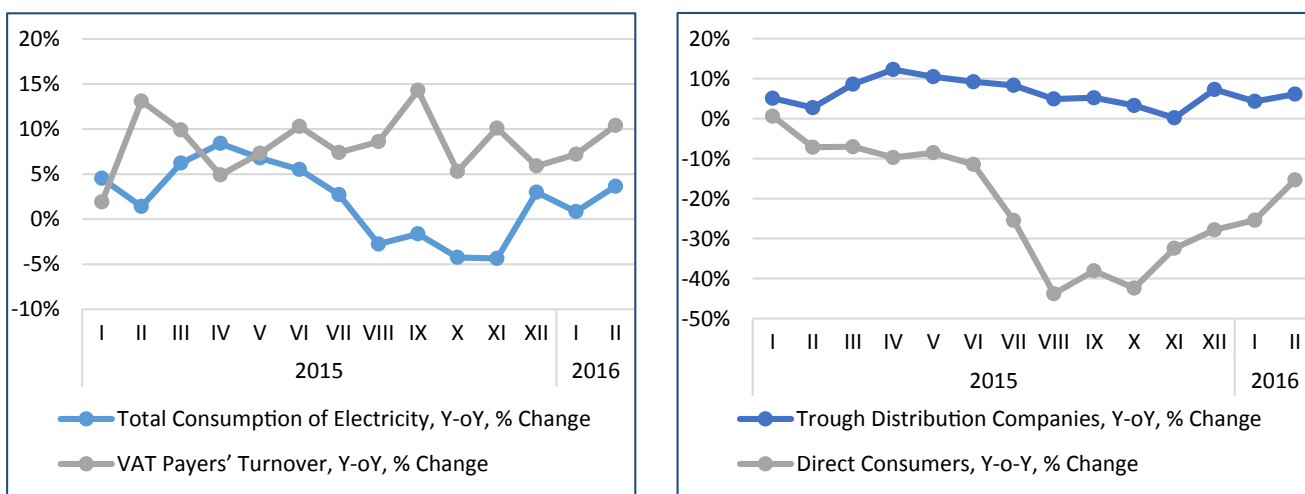


According to Geostat estimates, **real GDP grew by 2.6% year over year in February 2016**. This growth rate is an improvement over the 0.8% growth observed in the previous months. Still, in order to reach the predicted quarterly 2.9% growth (the ISET-PI forecast for Q1 real growth), the economy would have to have expanded by at least 5.4% in March. While the actual growth for March is likely to be lower than that figure, the increases in the consumer and business confidence indices ([CCI](#), [BCI](#)) in the last month can be interpreted as good signs for the economy going forward. The resilience to macroeconomic shocks which the Georgian economy exhibited in 2015-2016 provides a good foundation for the country’s long-term development plans.

**Demand indicators on the mend since the beginning of the year**

The aggregate demand indicators, **consumption of electricity and VAT payers’ turnover**, grew in February by **3.6% and 10.4% year over year respectively**. The growth in electricity consumption can, in particular, be considered a good indicator for tracking the real increase in the country’s economic activity. Last year, for example, the total electricity consumption in Georgia was significantly affected by the decline in the production of

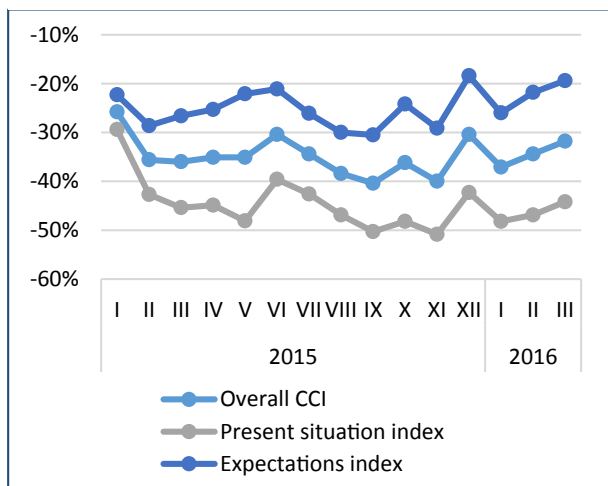
Figure 2: VAT Turnover and Electricity Consumption, Y-o-Y Change, % Source: Ministry of Energy of Georgia, GeoStat



the “Georgian Manganese” company. This was due to the collapse of world commodity prices and the price of manganese in particular. As one can see from Figure 2, the growth in the electricity consumption indicator (direct consumers) seems to be on the path to recovery since the beginning of the year. Furthermore, global manganese prices increased by 34% in February, reaching April 2015 levels.



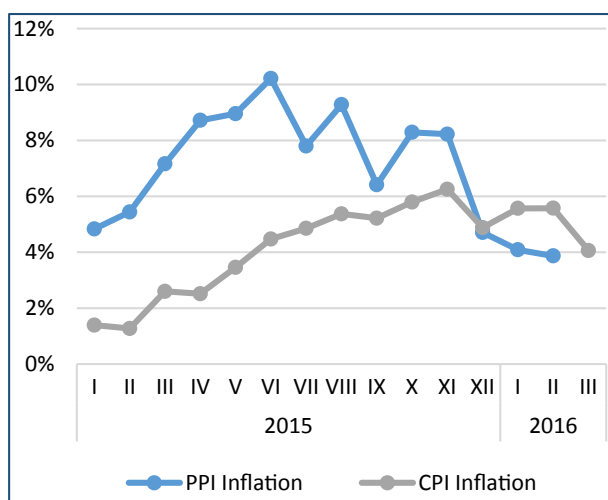
Figure 3: Consumer Confidence Index Source: ISET-PI



In February, the **consumer confidence index reached -34.4 points, which was a 2.7-point increase** from January 2016. The present situation component of the index slightly increased by 1.2 points, reaching the -46.9-point mark. In contrast, the **expectations index increased more significantly by 4.2 points**, reaching the -21.8-point mark. The government's more active involvement in the regions, primarily through agricultural programs, seem to have borne fruit. The two most notable agricultural support programs are "Plant the Future", which provides subsidies for farmers willing to invest in orchards, and the subsidies offered to farmers for plowing. Although the CCI for Tbilisi continued to decrease in February, Georgia's regions drove the overall improvement in the country-wide index.

**Inflation rate not as bad as feared - staying within the NBG's target**

Figure 4: Inflation Rates, Y-o-Y, % Source: GeoStat



Inflation, as measured by the consumer price index, increased by 0.1% month over month and by 5.6% year over year in February. The NBG did not change its monetary policy rate in February or March and, according to **their forecast, annual inflation in 2016 will be 3.5-4%**. It seems that the pressure on the lari is over and no further depreciation is expected. The consumer price index reached its maximum in February and stabilized on the current level.

The products whose prices increased most in the reported months were **alcoholic beverages and tobacco, which saw a 14.3% year-over-year increase** that contributed 0.86 percentage points to overall inflation. This hike in prices was mainly caused by the increase in excise tax in the beginning of the year. The other important drivers of inflation were the **health and furnishings & household equipment categories**. Prices in both categories increased by 10.5% and contributed 1.03 and 0.67 percentage points respectively.

Prices in both categories increased by 10.5% and contributed 1.03 and 0.67 percentage points respectively. The only factors driving the inflation rate down were the **transport and clothing & footwear categories, which saw a 0.4% and 1.5% price decrease year over year respectively**. However, when taken together, these categories contributed only -0.19 percentage points to total inflation.

Figure 5: Inflation Rates by Category, Y-o-Y, %

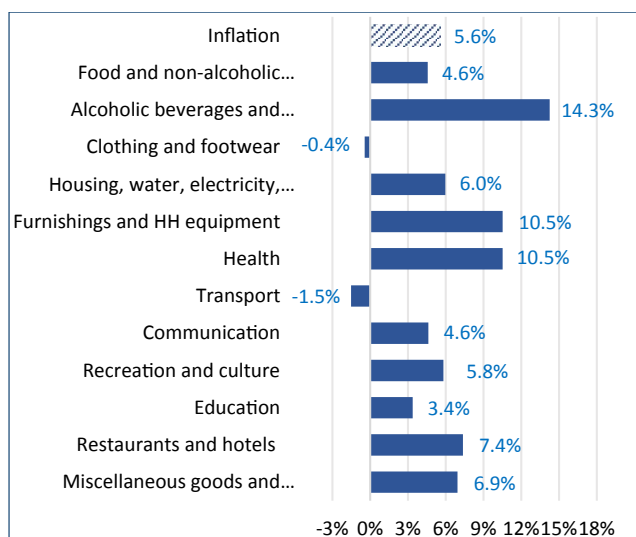
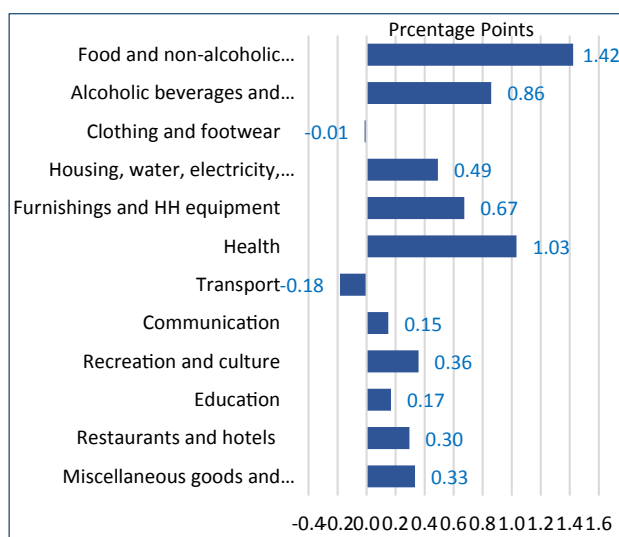


Figure 6: Contribution to Inflation Rate by Category



Source: GeoStat

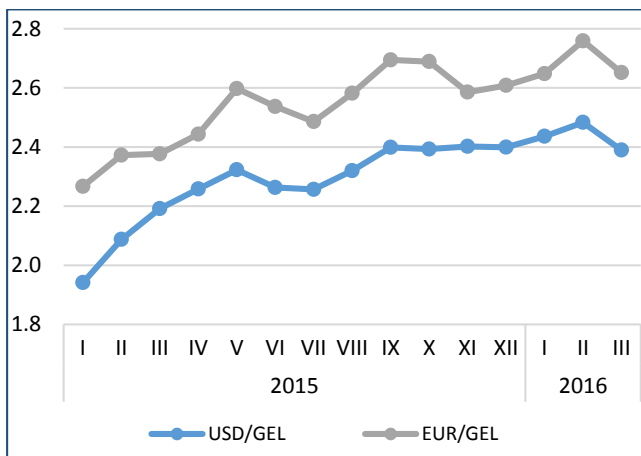
Source: GeoStat



**Lari Depreciation in February Seen as a Temporary Phenomenon**

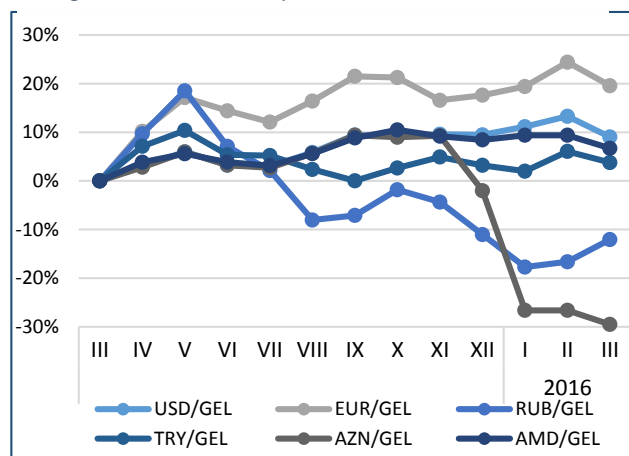
The Georgian currency depreciated in February, reaching a historical average monthly minimum of 2.48 lari per US dollar, a 13% depreciation year over year. **This bout of depreciation was seen as non-structural**, driven by temporary/speculative fluctuations in the currency value. The lari also depreciated against other currencies (the euro, ruble, and lira) in February (see Figure 8). Yet, the **February spike was reversed for almost all currencies in March**. The external pressures that drove the lari depreciation a year earlier have largely worn off, and an analysis of macroeconomic trends suggests that a further depreciation of the lari is not expected.

Figure 7: Nominal Exchange Rates



Source: NBG

Figure 8: Lari Fluctuation against Other Currencies (% change from March 2015)

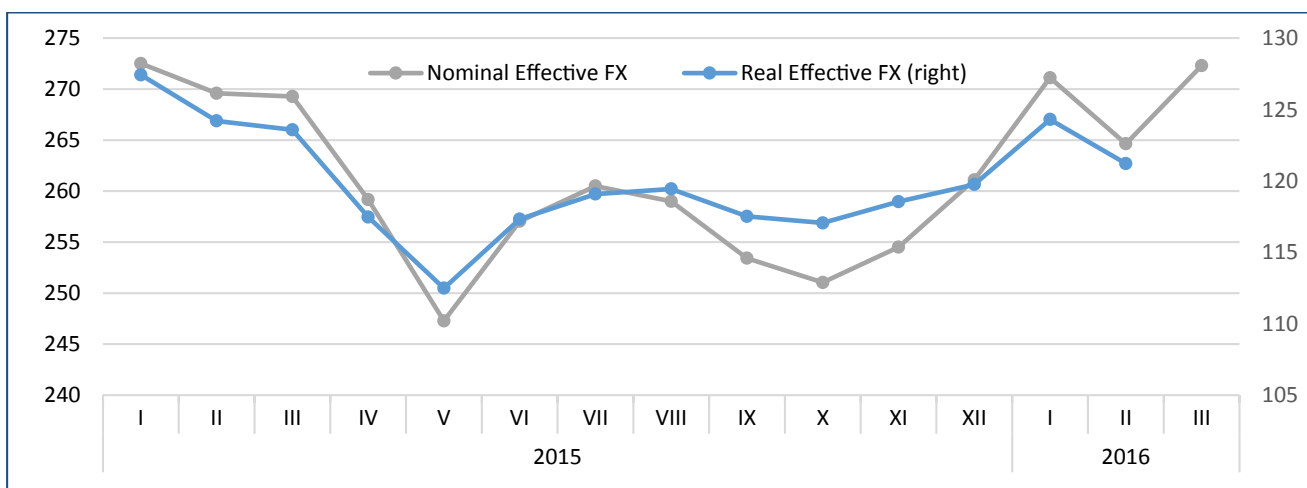


Source: NBG

This dynamic was also reflected in the effective exchange rates: both the nominal and real effective exchange rates declined (the lari depreciated) by 2.4% and 2.5% month over month respectively in February 2016 (a -1.8% and -2.4% change year over year).

Figure 9: Change of Effective Exchange Rates

Source: NBG, ISET-PI



**External Sector Conundrums Continue**

In February, according to GeoStat official statistics, **trade continued to worsen**. The 13.5% year-over-year shrinking of the trade deficit in February was caused by a **9.7% decline in the total trade turnover**. **Exports** amounted to 159 million US dollars, a **5.1% year-over-year decrease**.

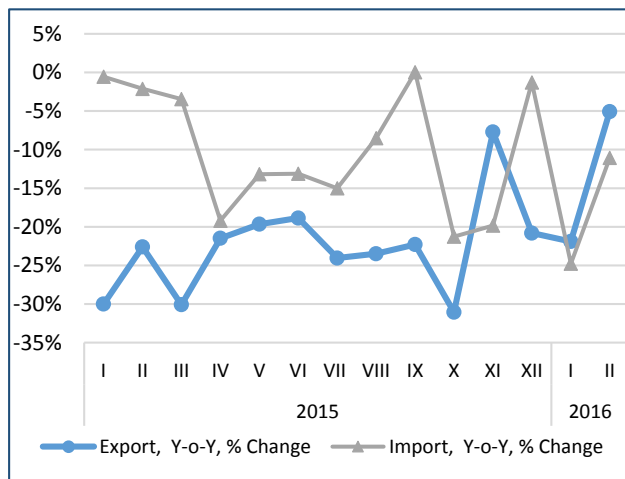
Exports to EU countries decreased by 4.1% and those to CIS countries by 6.1%, while exports to other countries actually increased by 5.2%. Of these other countries, the main contributors to export growth were China and Turkey, which saw a 145% and 67% year-over-year increase.



Imports amounted to 515 million US dollars (excluding a 208 million US dollar donation of medicine), an 11.1% year-over-year decrease. Imports from EU countries declined by 6.6%, those from CIS countries by 14.9%, and from other countries by 10.9%.

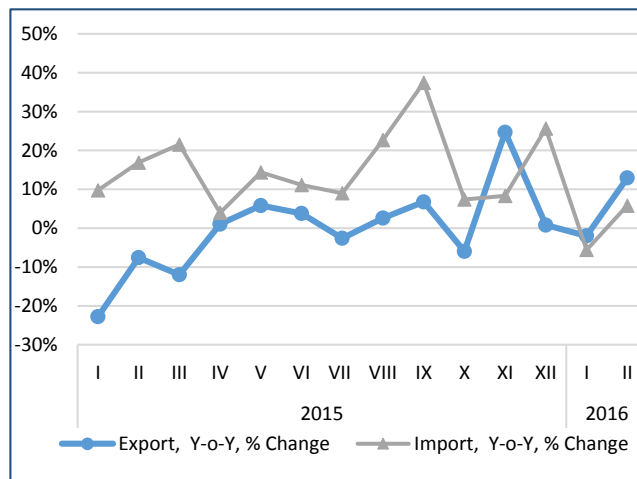
Considering exchange rate fluctuations, the official statistics, which are quoted in US dollar terms, may distort the real changes in trade. As we discussed in previous publications, this is because Georgia's trading partners experienced massive currency devaluations against the USD, thus lowering the amount of US dollars circulating between countries. Indeed, the statistics adjusted by exchange rate show a somewhat different picture: **real exports** (using 2012 as a base year for the exchange rate) **increased by 12.9%**, and **imports increased by 5.8%**, while the **trade deficit increased by 2.9%**.

Figure 10: Trade, Y-o-Y, % Change



Source: GeoStat

Figure 11: Adjusted Trade, Y-o-Y, % Change



Source: GeoStat

**Financial Sector Is Largely Stable, but Deposits Are Still Highly Dollarized**

The **total stock of loans** granted by commercial banks amounted to 14.9 billion lari in February 2016, a **14.3% year-over-year increase**. Nearly half of the loans (45.8%), were granted to legal entities, while 54.2% went to households.

The biggest sectors by stock of outstanding loans were trade, industry, and operations with real estate, which comprised 26%, 22% and 9% of the total loan stock respectively.

Of the loans granted by commercial banks to households, 28% were consumer loans, while 72% were loans secured by real estate.

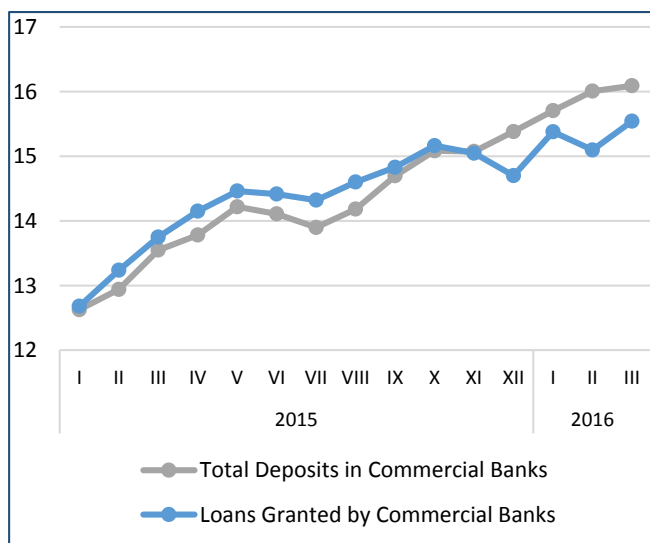
Total stock of deposits amounted to 15.8 billion lari in February 2016, a 24.1% year-over-year increase. A total of 68% of deposits were dollarized, while the dollarization of loans stood at 66%. As we mentioned in previous publications, the dollarization rates were affected by the exchange rate depreciation. Calculating dollarization rates using adjusted exchange rates shows that deposits and loans are in fact somewhat less dollarized than the official statistics suggest. The adjusted dollarization rate was 59% for deposits and 56% for loans.

In the beginning of the year, the financial sector also saw a nearly 4 percentage points increase in the market interest rates on the national currency loans. The Lari loans interest rates increased from 20.4% in December to 24.1% in February (it is likely that the market reacted with a lag to the increases in the NBG refinancing rate in November and December). In the same time, the corresponding interest rates on foreign currency loans declined from 10.3% to 10.1%.

The widening gap in the cost of borrowing between national and foreign currencies, coupled with more stability in the currency market, may encourage more foreign currency borrowing and increase loan dollarization rates.

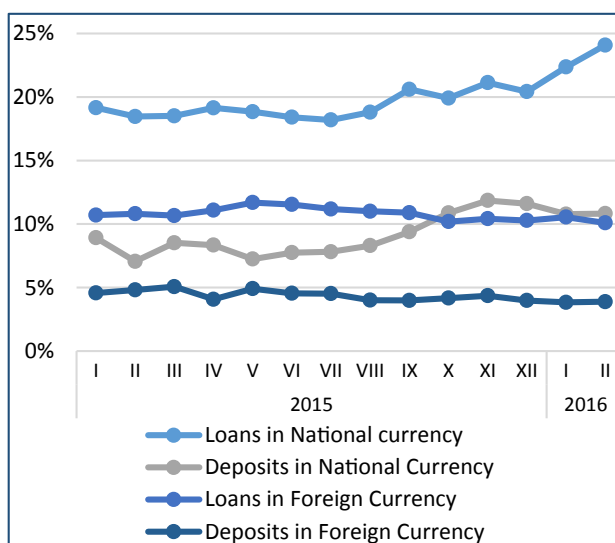


Figure 12: Total Deposits and Loans, Stocks, Billion Lari



Source: NBG

Figure 13: Market Interest Rates



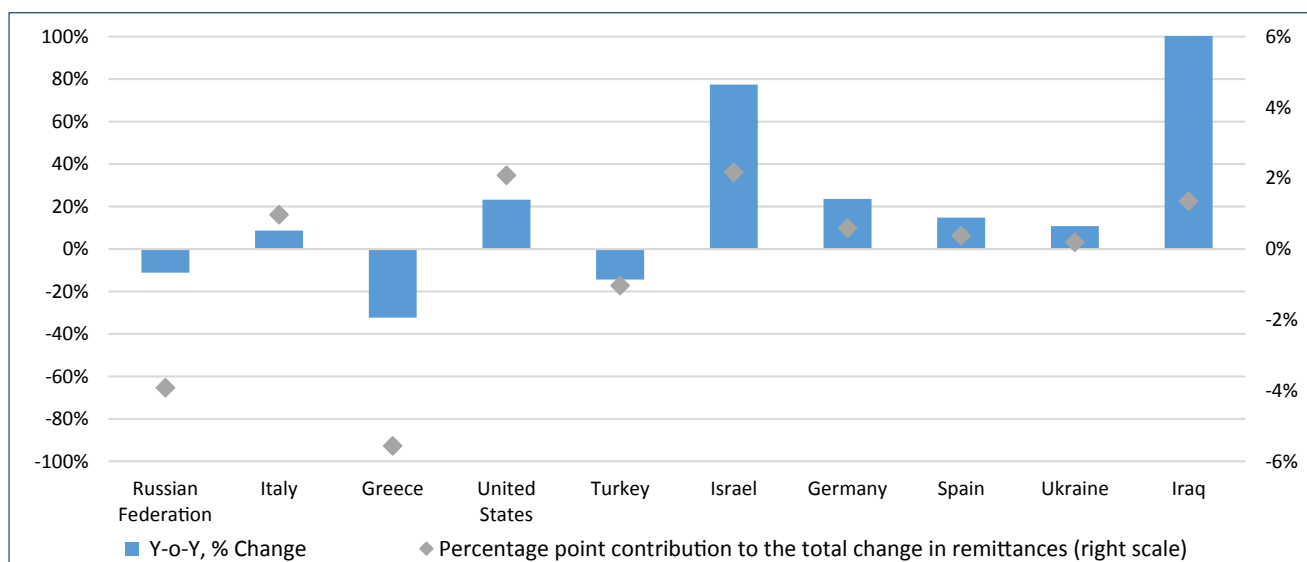
Source: NBG

**Transfers Are Down from Greece and Russia, but Other Countries Help Compensate for the Loss**

Remittances to Georgia equaled 79.9 million US dollars in February 2016, a mere **2.6% decrease year over year**. The key countries behind the decline were Greece (-32% year over year) and Russia (-11.1% year over year). Taken together, these two countries contributed 9.5 percentage points to the overall remittances decline. However, these **losses were almost compensated by increased money inflows from Israel, the USA and Iraq**. Together, these countries increased inflows by 5.7 percentage points.

Figure 14: Remittances by Country, 2015 Compared to 2014, % Change

Source: NBG



**Tourism Sector Sees an Increase in International Arrivals**

In the first three months of 2016, there were 1.13 million international visitors to Georgia, a 14.7% year-over-year increase; 85.7% arrived by land, 12.8% by air, 0.8% by sea and 0.7% by rail.

Visitors who stayed in Georgia for 24 hours and more constituted 35.9% of the total arrivals or 407,000 people, a 15.7% year-over-year increase. This statistic bodes well for the expectations of a massive inflow of international tourists to Georgia that were expressed back in 2015. At that time policy makers had expected that **visa liberalization with Iran and the strained Turkey-Russia relationship would increase tourist inflows from both Iran and Russia**. Indeed, the number of international arrivals from Russia and Iran increased by **16.7% and 446% respectively**.



Figure 15: International Arrivals

	Country	2015: 3 Months	2016: 3 Months	Change	Change %	Share %
1	Azerbaijan	283 603	353 186	69 583	24,5%	31,1%
2	Turkey	261 992	273 532	11 540	4,4%	24,1%
3	Armenia	229 653	229 114	-539	-0,2%	20,2%
4	Russia	124 048	144 764	20 716	16,7%	12,8%
5	Ukraine	23 666	28 383	4 717	19,9%	2,5%
6	Iran	3 020	16 498	13 478	446,3%	1,5%
7	Kazakhstan	4 965	6 290	1 325	26,7%	0,6%
8	USA	4 733	5 228	495	10,5%	0,5%
9	India	1 170	4 652	3 482	297,6%	0,4%
10	Germany	6 105	4 590	-1 515	-24,8%	0,4%
11	Israel	2 524	4 563	2 039	80,8%	0,4%
12	Philippines	886	4 019	3 133	353,6%	0,4%
13	Belarus	2 668	3 647	979	36,7%	0,3%
14	UAE	802	3 589	2 787	347,5%	0,3%
15	Poland	3 193	3 368	175	5,5%	0,3%

**Government Budget Overview for February**

The general budget deficit amounted to 132 million lari in February this year, which was 2.9% higher than in the previous year. **Budget income increased by 15% year over year and equaled 601 million lari.** This increase was driven by a **14.1% year-over-year increase of income from taxes.** General government **spending on operating activities increased by 13.1%** and equaled 666 million lari. **The main contributor to this growth was a 16.4% year over year increase of social benefits.**

Figure 16: General Budget, million GEL

Source: MoF

