

UNDER PRESSURE

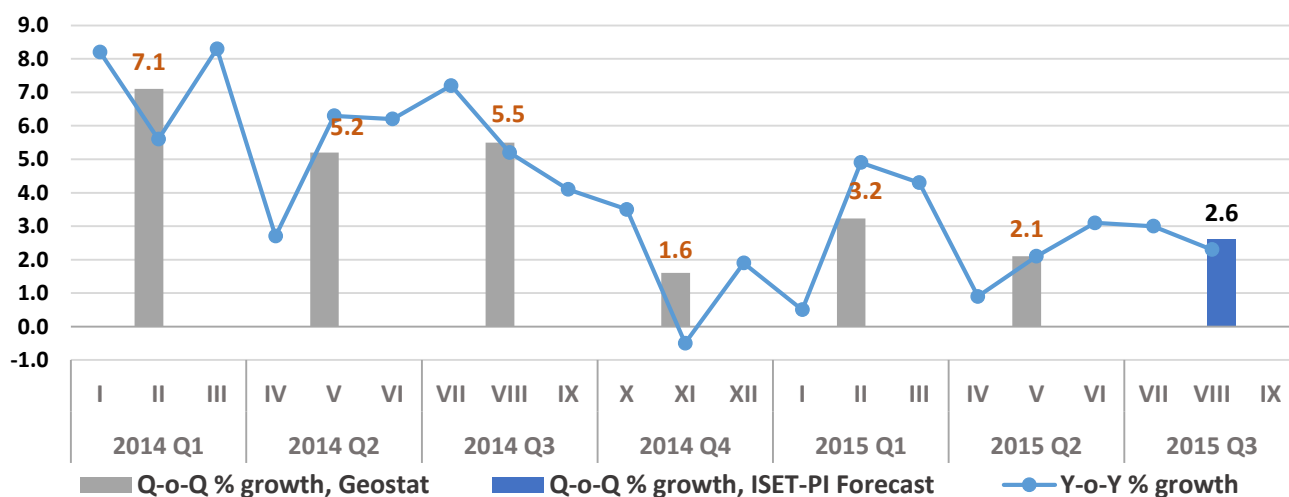
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TRENDS SUMMARY

- In August 2015, domestic production in Georgia increased by 2.3% annually – a figure that is expected to retain stability around this year’s overall trend.
- Consumer price inflation reached its highest value in two years (5.4%). The August 2015 increase in electricity tariffs and the growing number of tourist arrivals put additional upward pressure on consumer price inflation.
- Georgia’s main economic indicators show remarkable resilience, especially in light of the economic pressures from neighboring countries.
- Between July and August, the value of the Georgian lari against the dollar fell once more. In spite of this, the national currency remains relatively stable against the basket of Georgia’s trading partner currencies.
- Export growth continued to decline in annual terms, but there are signs that export patterns have recently been shifting. Georgian companies are looking for new trading partners in Europe and beyond.
- Bulgaria became Georgia’s fastest growing export destination for the second consecutive month.

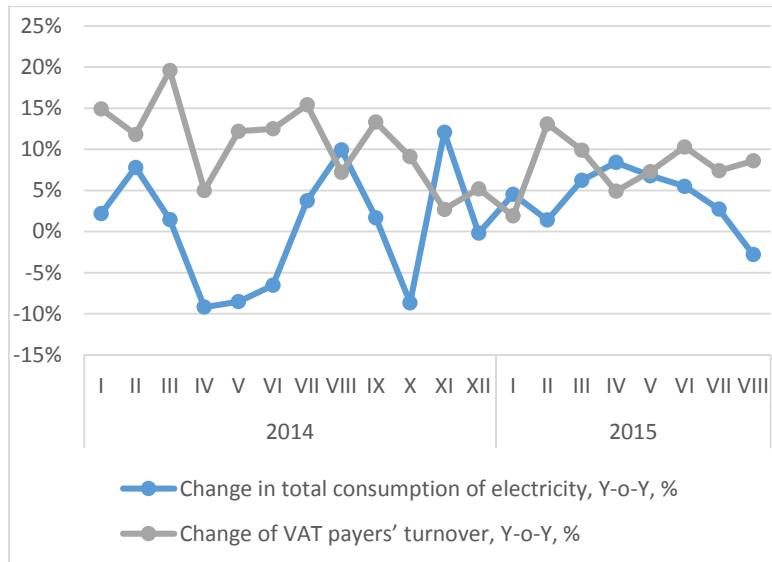
According to Geostat’s rapid estimates for August, Georgia’s real GDP increased by 2.3% annually. The average real GDP growth rate in the first eight months of 2015 was 2.8%. In the context of the slowdown of both regional and global growth, such low rates are to be expected. On the positive side, both the August estimate and the average annual growth in 2015 remain above the official IMF forecasts (of 2%), and August saw the fifth highest growth rate value since the beginning of the year.

Figure 1: GDP Growth



Source: Geostat, ISET-PI

Figure 2: VAT Turnover and Electricity Consumption

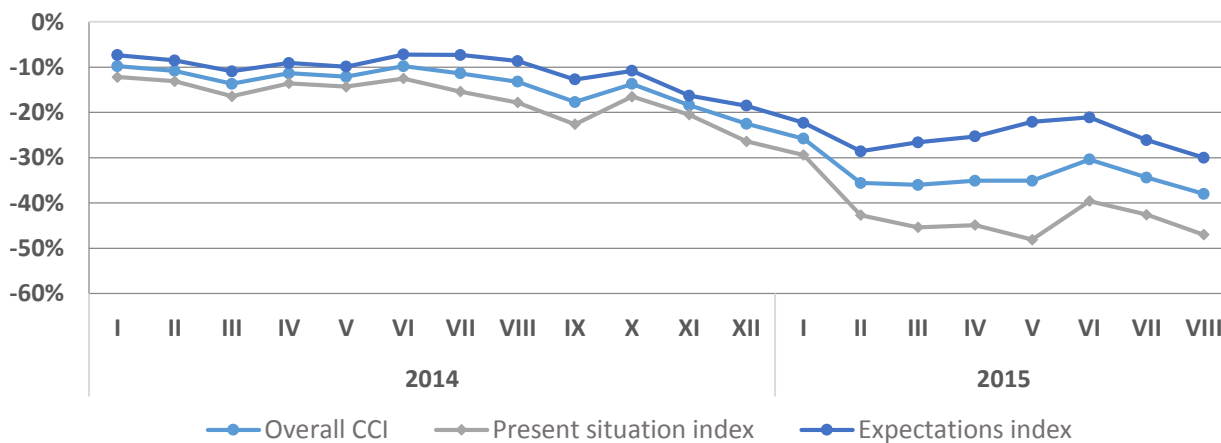


Source: Ministry of Energy of Georgia, GeoStat

Among the related indicators closely tracking monthly production changes, VAT payer’s turnover increased by 7.4% in August, while electricity consumption decreased by 2.7%. The fall in the total consumption of electricity was due to the roll out of new tariffs instituted on 1 August in the regions of Georgia. The tariffs increased the average price of electricity for consumers by 25-35% per kWh. In the coming months, total electricity consumption is expected to decline even further as on 5 September the new tariffs reach Tbilisi, which is home to more than a third of the country’s total population.

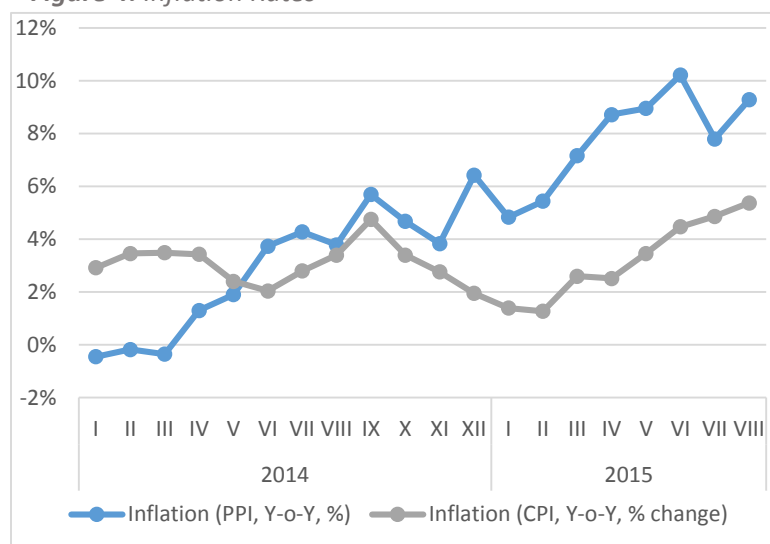
The ISET-PI indicator of consumer sentiment, the **Consumer Confidence Index (CCI)**, took a new hit in **August**. After several months of incremental improvements, the CCI dropped 4.1 points in August, reaching a new historical minimum of -38.4 points. Interestingly, this entire drop was driven by older respondents (aged over 35). Both components of the CCI moved in tandem: the present situation index reached -46.9 points (losing 4.2 points), while the expectations index reached a record low of -30 points (a drop of 3.9 points). The gap between the two indices thus remained more or less intact.

Figure 3: Consumer Confidence Index



Source: ISET-PI

Figure 4: Inflation Rates



Source: Geostat

Annual CPI inflation reached 5.4% in August, beating the previous month’s two-year record. Despite decreasing world food prices (a 22% decrease compared to August 2014) the increase in consumer prices in Georgia was largely driven by food and non-alcoholic beverages (6.3%), and alcoholic beverages and tobacco (13.1%). This apparent contradiction can be explained by a 10% increase in the number of tourist arrivals compared to August 2014. Healthcare (an increase of 9.1% annually) was another main accelerator of inflation in August. Taken together, these three

categories contributed over 3.47 percentage points to the CPI inflation rate.

Producer price index (PPI) inflation reached 9.4% annually. The PPI, which is based on the prices Georgian producers receive for their products, has been increasing more rapidly than the CPI since November 2014. This is expected of both export-oriented and import-dependent producers. For firms that import inputs from abroad, contracts with foreign suppliers are mostly denominated in dollars - which drives up the lari prices of produced goods. In addition, lari payments on dollar denominated loans rise, increasing production costs.

Despite regional pressures, growth and inflation indicators outperform annual projections.

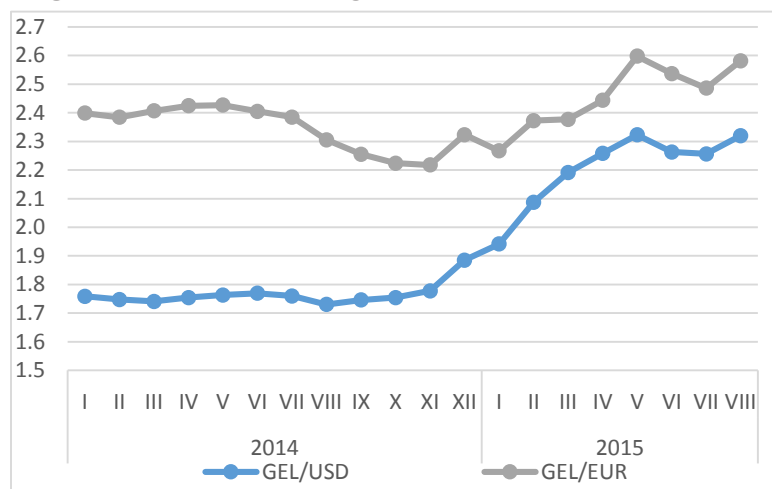
Table 1: IMF projections from October 2015

	Real GDP annual growth rate			CPI Inflation Rate			
	2014	Projections		2014	Projections		2015 (August)
		2015	2016		2015	2016	
Armenia	3.4%	2.5%	2.2%	3.0%	4.3%	3.4%	3.6%
Azerbaijan	2.8%	4.0%	2.5%	1.4%	5.0%	4.2%	3.8%
Georgia	4.8%	2.0%	3.0%	3.1%	3.7%	5.0%	5.4%
Russia	0.6%	-3.8%	-0.6%	7.8%	15.8%	8.6%	15.7%
Turkey	2.9%	3.0%	2.9%	8.9%	7.4%	7.0%	7.1%

Source: IMF

According to the IMF forecast from October 2015, Georgia has one of the lowest expected growth rates in the South Caucasus region in 2015 (see Table 1, above), but this is expected to rebound more strongly in 2016. Thus far, this year Georgia has been *outperforming the growth forecast*. In addition, Georgia's average inflation rate in September 2015 stood at 3.3% (average 12 months inflation over the previous 12 months), which is lower than the expected 3.7% average annual inflation for 2015.

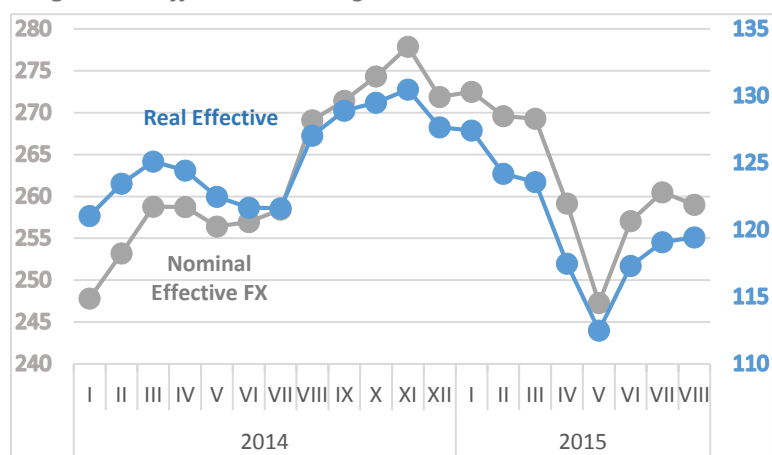
Figure 5a: Nominal Exchange Rates



Source: National Bank of Georgia

In August, the lari continued to depreciate against both the dollar (34%, year on year) and the euro (12%, year on year). Monthly depreciation against these currencies stood at 3% and 4% respectively. The lari appreciated against the Russian ruble by 26% and went head to head with the Turkish lira. Overall, the lari lost value against partner currencies in both nominal and real terms. The real depreciation of the lari was due to the fact that *Georgia's trading partners have experienced relatively high annual inflation rates in August.*

Figure 5b: Effective Exchange Rates



Source: National Bank of Georgia

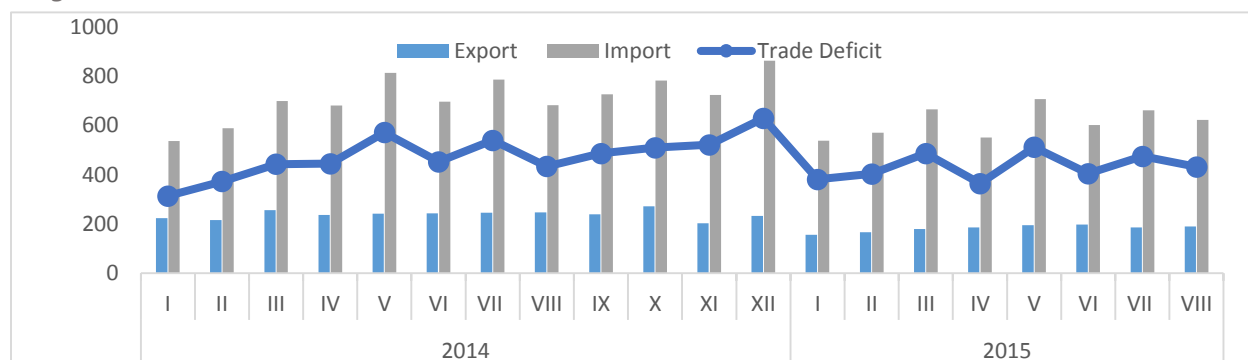
Georgia's external trade situation remains challenging. In the first eight months of 2015, Georgia's external trade volume shrank by 13.8% year on year. Exports fell by 23.8%, while imports were 10.4% lower than in the same period last year.

Georgian exports are seeking new markets

Georgia's exports to its largest trading partners declined significantly in January-August 2015 – Azerbaijan

(-54%), Armenia (-36%), Russia (-47%), USA (-44%) and Ukraine (-65%). At the same time, exports increased significantly to Bulgaria (28%) and China (49%).

Figure 6: Trade Balance

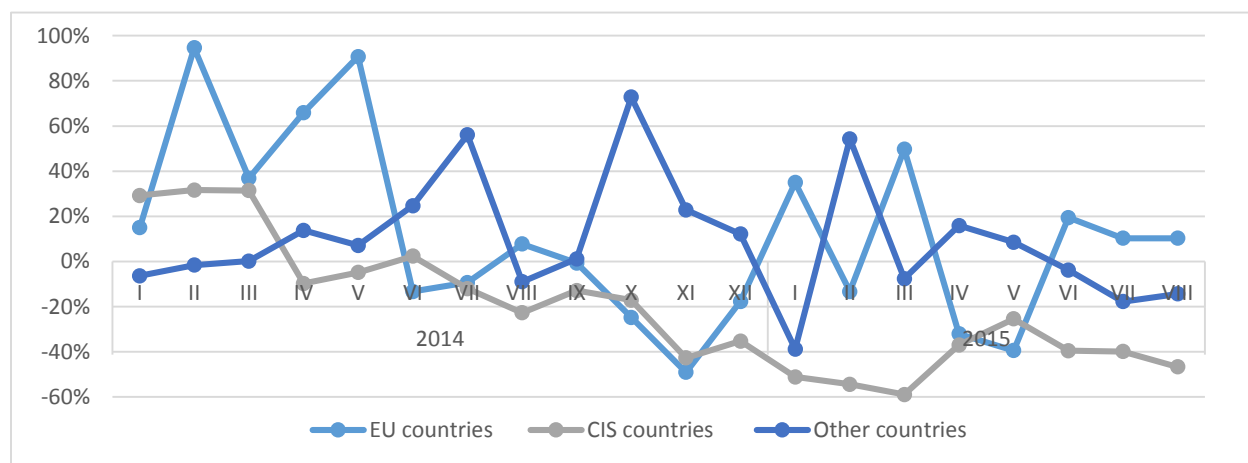


Source: Geostat

Bulgaria became the second largest importer from Georgia (after Azerbaijan). In July and August 2015, Bulgaria even displaced Azerbaijan as the number one importer country. The main categories of export to Bulgaria are copper ores and concentrates, crude petroleum and petroleum oils, and mineral and chemical fertilizers.

In August, Georgia also started embracing Poland as a new export market. During the month, total exports to Poland exceeded 10 million USD – such figures were much lower for the whole of 2014 (and in other years). The discovery of new markets, particularly in the EU, is happening at a time when Georgia is losing its traditional CIS trading partners as a consequence of regional economic troubles.

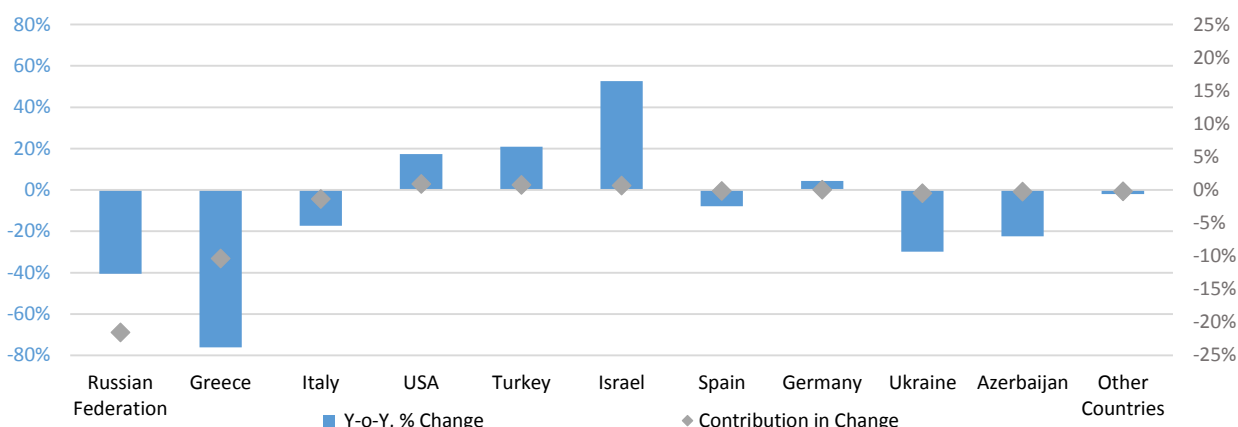
Figure 7: Georgian Exports by Region



Source: Geostat

Annual remittances decreased by 32% in August and amounted to 84 million USD. This drop was once again driven by Russia and Greece. In August, annual remittances from these countries decreased by 44% and 93% respectively. Russia and Greece together account for nearly 65% of all remittance transfers to Georgia. Remittances increased from Turkey, Israel and the USA, but their share in total remittances in August was only 12%.

Figure 8: Remittances by Country



Source: National Bank of Georgia

Monetary and banking sector indicators remained stable in August, but the high degree of loan and deposit dollarization (66% and 63.7% respectively) persists.

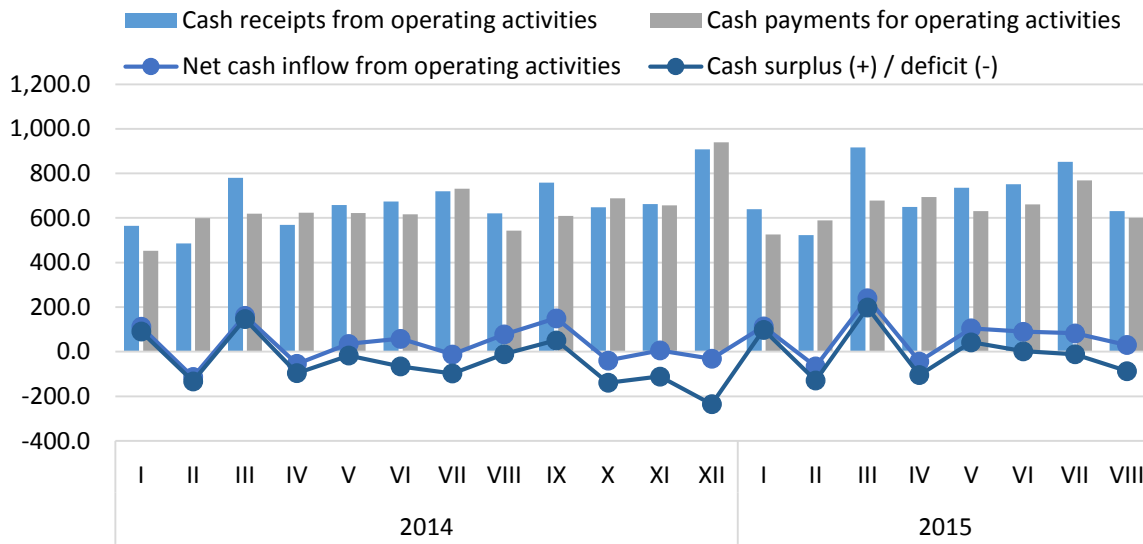
In Georgia, loan dollarization is driven by the high dollarization rate of **mortgage loans (83% dollarized)**, which account for more than half (52%) of total loans. The dollarization of mortgage loans can be explained by the fact that housing market is traditionally almost entirely dollarized. In turn, this contributes to dollarization in the financial sector.

In August, average bank interest rates on loans increased by 1 percentage point compared to July and equaled 15.8%. The spread between lari and dollar lending rates widened between July and August from 7% to 7.8%.

The government’s budget was in deficit by about 86.9 million GEL in August.

This was mainly due to the 26% (221 million GEL) decline in total government income compared to July. Total government spending declined at a slower rate, by 22% (169 million GEL). In the next few months, however, government spending should be set to decline further (in annual terms) and work in tandem with CB to fight expected inflation.

Figure 9: Common Budget, in million GEL



Source: Ministry of Finance of Georgia