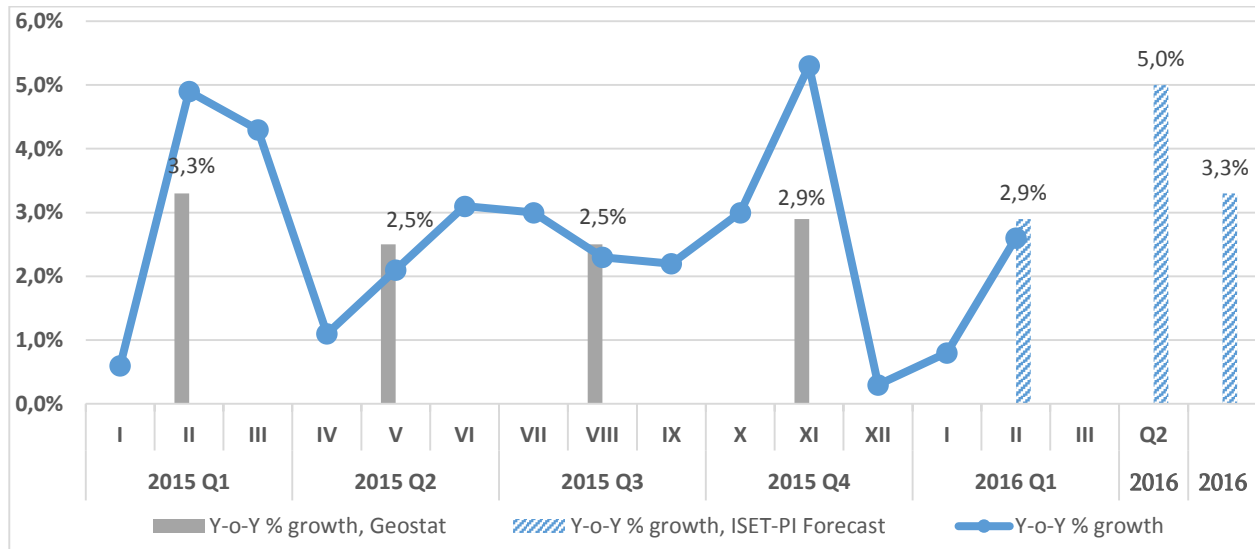


The Georgian economy at the start of 2016: doing better than the neighbors might be good enough (for now)

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

Source: GeoStat, ISET-PI



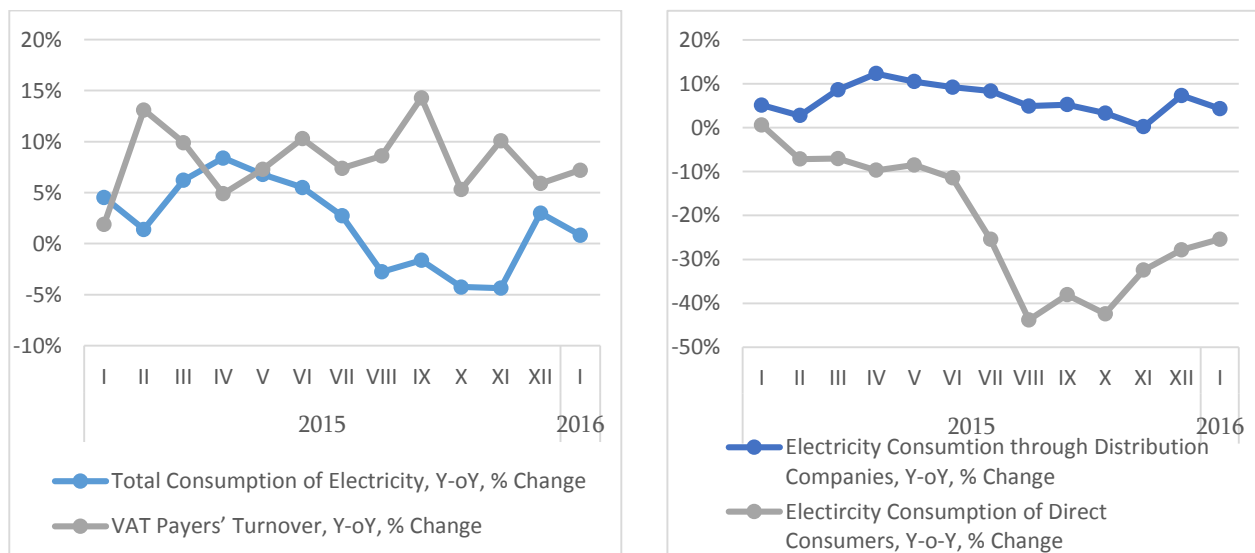
Low growth in Georgia is still higher than in neighboring countries

According to GeoStat data, real GDP growth was 0.8% in January and 2.8% in February 2016. While these figures are by no means high, growth rates in the rest of the region are expected to be quite low this year. In this respect, in contrast to its neighbors, **Georgia is performing reasonably well**.

According to the World Bank GDP forecast made in January 2016, the Georgian economy will grow by 3.0% this year, which is above the expected growth of Eastern Europe (0.5%), Azerbaijan (0.8%), Armenia (2.2%), and Russia (-0.7%). The ISET-PI forecast for the first and second quarters of 2016 is 2.9% and 5.0% respectively. The recently-updated [forecast](#) predicts 3.3% year-over-year real growth in 2016.

Figure 2: VAT Turnover and Electricity Consumption, Y-o-Y Change, %

Source: Ministry of Energy of Georgia, GeoStat



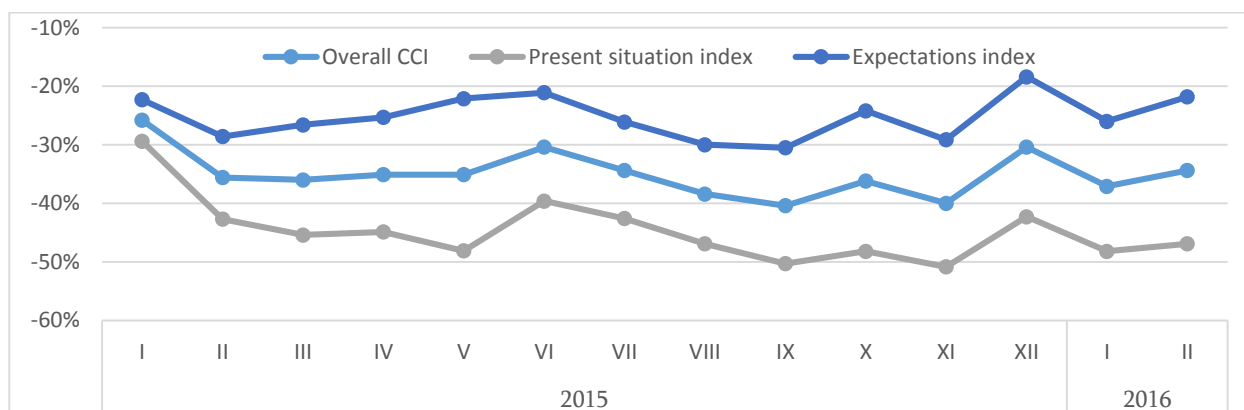
Aggregate demand – main indicators

Total consumption of electricity increased by a mere 0.8% year over year in January. Electricity consumption through distribution companies increased by 4.3%, while direct consumers decreased their electricity consumption by 25.4% year over year in the reported month. According to GeoStat's recent estimates, VAT payers' turnover increased by 7.2% year over year in January 2016. Although VAT turnover is typically a good predictor of aggregate demand changes, data shows that the growth rate of **VAT payers' turnover may be a better proxy for nominal rather than real GDP growth in Georgia.**

The consumer confidence index ([CCI](#)) appears to have suffered from a bout of “winter blues”. In January 2016, the index declined after the large monthly increase of the previous month. Since then, however, the index has recovered and is on track to continue the increasing trend that began in October 2015.

Figure 3: Consumer Confidence Index

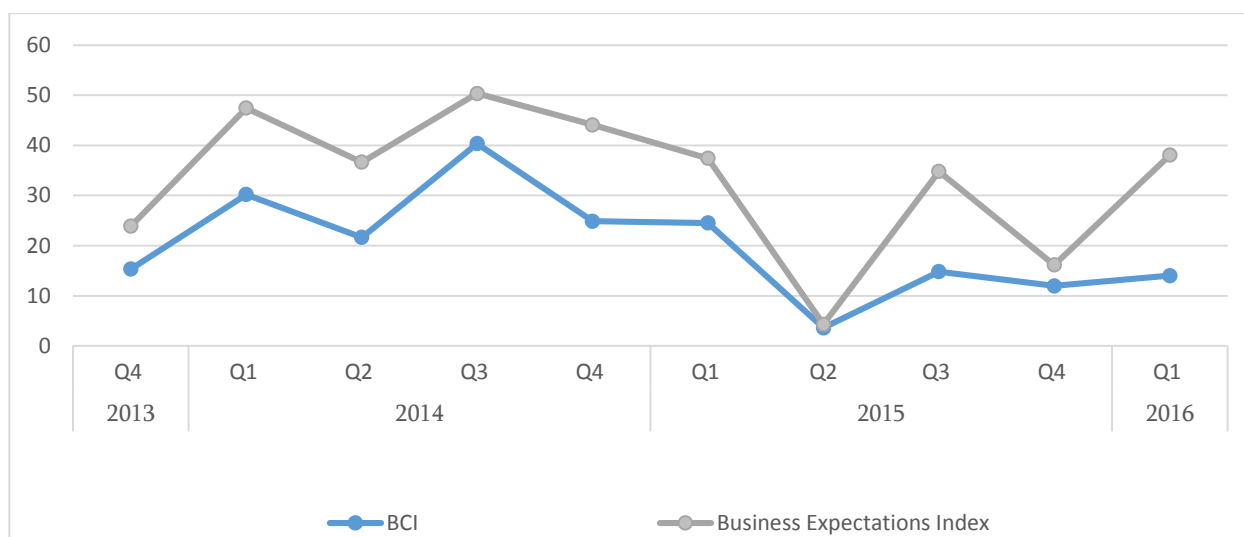
Source: ISET-PI



The Georgian Business Confidence Index ([BCI](#)) gained 3 points (on a [-100/100 scale]) due to a dramatic **strengthening of business expectations**. These increased from 16 points in the fourth quarter of 2015 to 38 index points in the first quarter of 2016. As Georgia did not experience any major changes in the macroeconomic context during this time, such a sharp advance in expectations can be best understood as a vote of confidence from the Georgian business community in Giorgi Kvirikashvili's leadership.

Figure 4: Business Confidence Index

Source: ISET-PI



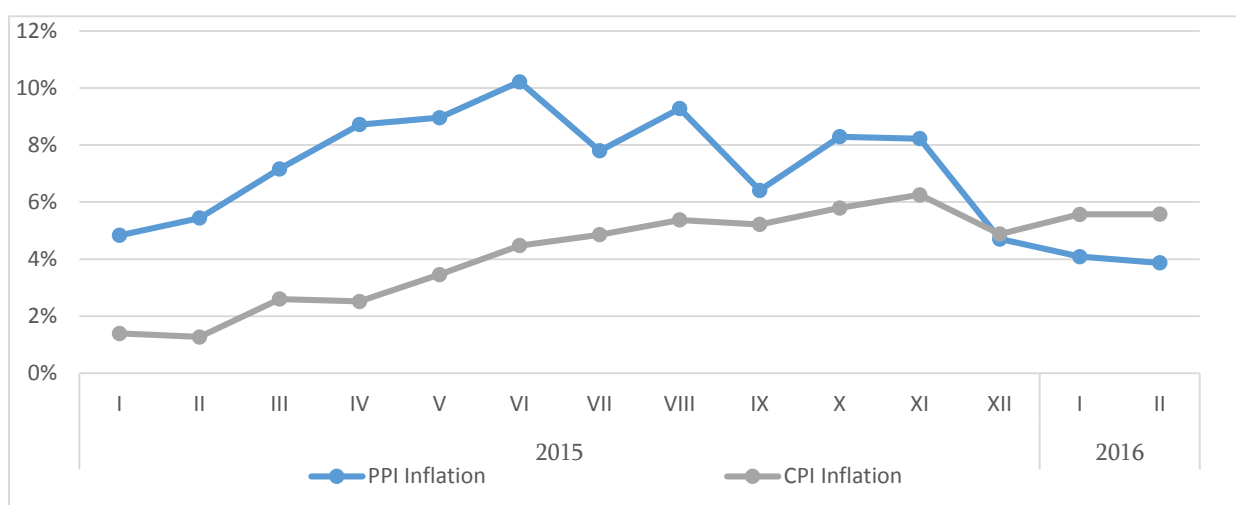
Indeed, the first months of Kvirikashvili's term as Georgia's Prime Minister were marked by a large number of pro-business initiatives targeting the Georgian tax code and tax administration. The Georgian government is developing proposals that will make significant changes in corporate taxation and will see an abolition of VAT on imported capital goods, improvements in tax administration and insolvency regulation.

Inflation stabilizes in early 2016

Consumer Price Index (CPI)-based inflation was 5.6% year over year in both January and February 2016. **Monthly inflation**, however, was just **0.1% in February, pointing to the stabilization of price growth**. The contractionary monetary policy adopted by the NBG in 2015 had an effect on money aggregates in the beginning of the year, with M2 decreasing by 6.2% month over month and 2.0% year over year in January 2016.

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

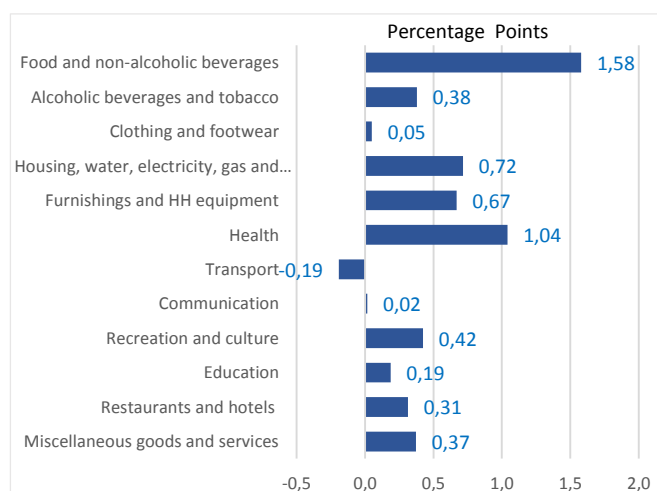
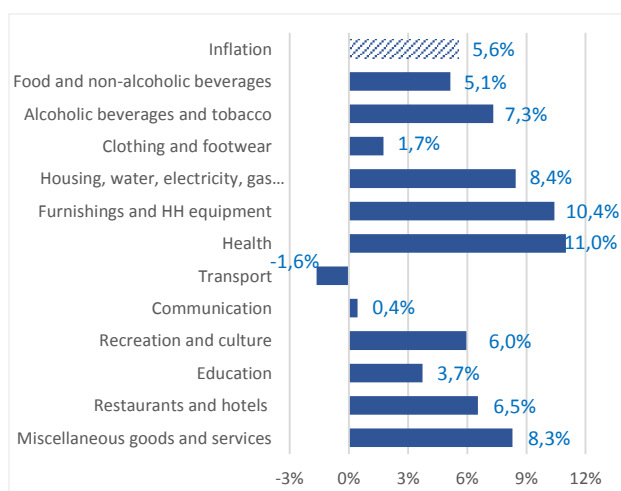
Source: GeoStat



In January, the main contributors to the 5.6% annual inflation were a **5.1% increase in the prices of food and non-alcoholic beverages** and an **11.0% increase in average healthcare prices** – these categories contributed 1.58 and 1.04 percentage points respectively. Transport prices was the only category for which a year-over-year decline was observed in January 2016 (-1.6%).

Figure 6: Inflation Rates by Category, Y-o-Y, %

Figure 7: Contribution to Inflation Rate by Category, Percentage Points



Source: GeoStat

Source: GeoStat

January's nominal depreciation is likely driven by seasonal factors

After four months of stability at the level of 2.4 GEL per USD, the Georgian lari lost some value against the US dollar in January and February 2016. **This devaluation likely a reflection of seasonal factors, as the demand for GEL decreased somewhat after the winter holidays.** The GEL depreciated against the USD by 1.5% month over month and by 25.5% year over year in January. The GEL also depreciated against the euro by 1.5% month over month and by 16.8% year over year in the same period.

These changes were not reflected in the effective exchange rates – both the nominal and real effective exchange rates actually appreciated by 3.8% month over month. The reason for this was the 49% devaluation of the Azerbaijani manat against the USD on 21 December 2015 and the 14% year-over-year depreciation of the Russian ruble in January 2016. In annual terms, both the nominal and real effective exchange rates depreciated by only 0.5% and 2.5% respectively. The appreciation of the effective exchange rates, which began in October 2015, **could potentially jeopardize Georgian export growth in 2016.**

Figure 8: Nominal Exchange Rates

Source: NBG

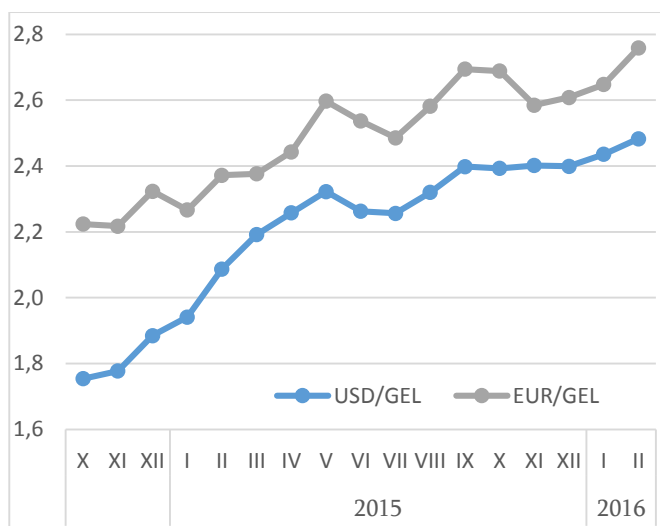
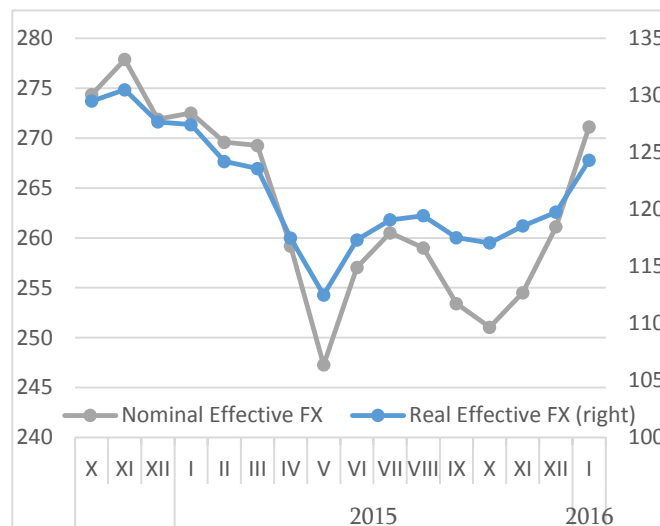


Figure9: Effective Exchange Rates

Source: NBG



Trade sector performance

Georgian exports amounted to 187.2 million USD in January 2016, which represents a 21.9% year-over-year decline. Exports to CIS countries contributed -16.5 percentage points to the total, while exports to EU countries contributed -14.8 percentage points. Exports to other countries increased and contributed 9.4 percentage points.

Imports to Georgia totaled 405.5 million USD in January 2016, a 24.8% year-over-year decline. EU countries contributed -4.1 percentage points to this total, the CIS -2.7 percentage points, and other countries -18.0 percentage points.

Because of the significant drop in imports, the trade deficit in January amounted to 283.3 million USD, which was 25.9% lower than the same month in 2015.

Figure 10: Trade Balance, million USD

Source: GeoStat

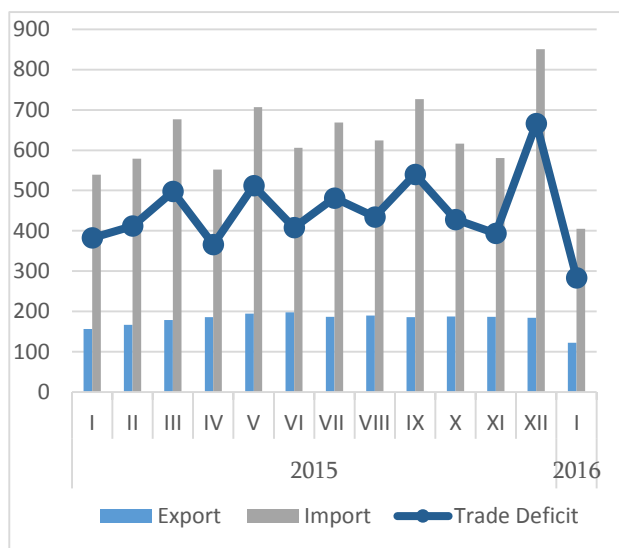
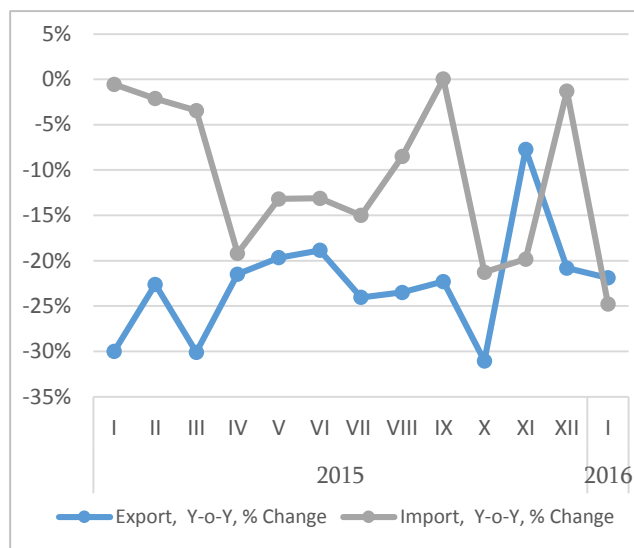


Figure 11: Trade, Y-o-Y, % Change

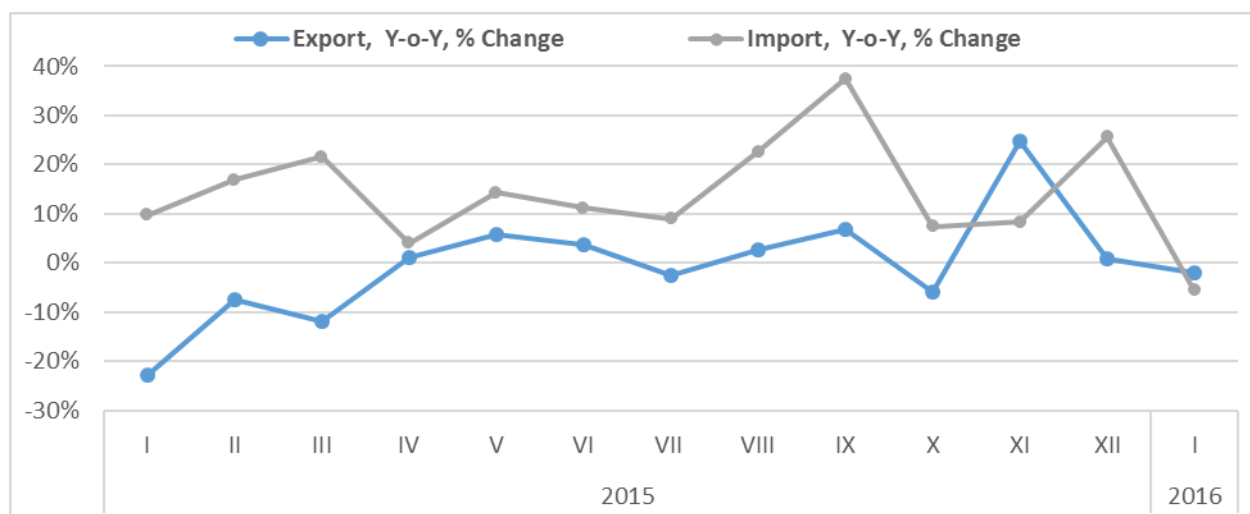
Source: GeoStat



Adjusting the trade data using the average exchange rate from 2012 as a reference gives somewhat different results. According to our adjusted calculations, imports decreased by 5.6%, while exports decreased by only 2.0% and the trade deficit decreased by 7.1% year-over-year.

Figure 12: Trade, Y-o-Y, % Change (2012 as a base year)

Source: GeoStat, ISET-PI



FDI strong in 2015 from Azerbaijani and UK investments

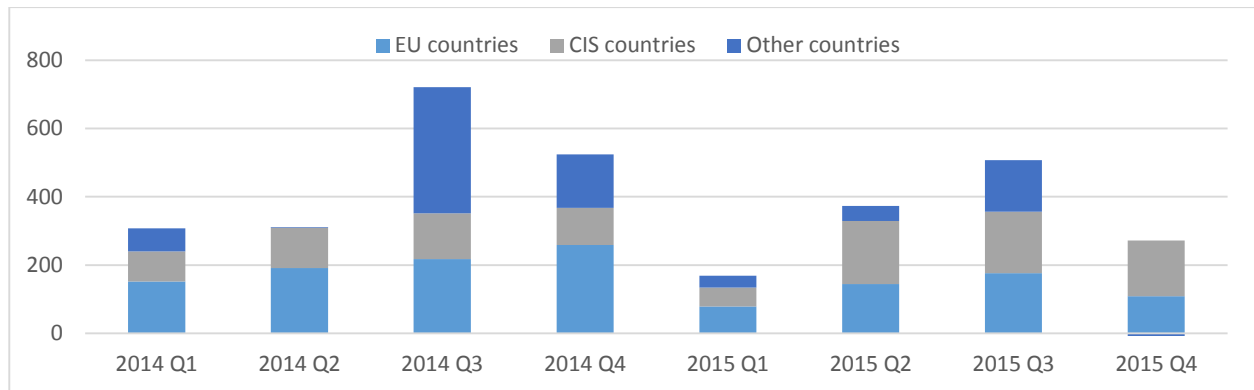
According to the most recent GeoStat preliminary statistics, total foreign direct investment in Georgia amounted to 1,351 million USD in 2015, which was a 6.0% year-over-year increase compared to the preliminary data of 2014. It should be noted that the figures for 2015 will be adjusted later this year, so we are likely to see a revision of the existing numbers. Currently, the preliminary FDI statistics for 2015 represent a 23.2% year-over-year decrease compared to the *adjusted* FDI statistics of 2014.

The top three countries investing in Georgia in 2015 were Azerbaijan (542 million USD), the United Kingdom (198 million USD), and the Netherlands (111 million USD). Taken together, these three

countries comprised 63.0% of the total FDI in 2015. The top three economic sectors for FDI were transport and communication (594 million USD), the financial sector (191 million USD) and the construction sector (129 million USD).

Figure 13: Foreign Direct Investment by Country Group

Source: GeoStat



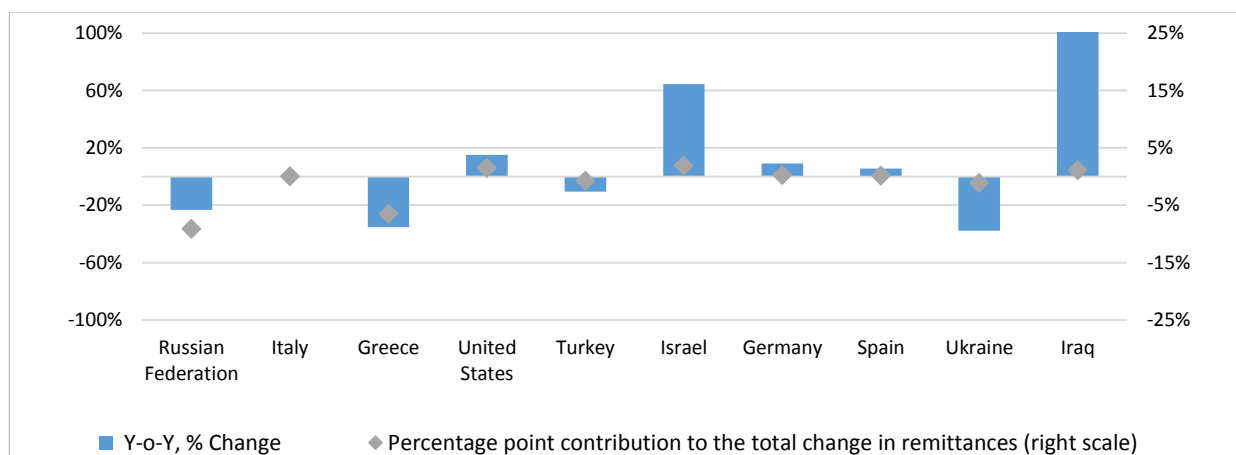
Remittances decline in USD terms, but increase in GEL. The purchasing power of transfers rises

Remittances amounted to 66.6 million USD in January 2016, a 11.8% year-over-year decrease. Figure 14 below shows the top 10 countries from which Georgia received remittances in the reported month. Declining money inflows from Russia and Greece contributed the most to the overall decrease, -9.1 and -6.5 percentage points respectively. The United States, Israel and Iraq were the only countries that had positive dynamics in January, contributing 1.5, 1.9 and 1.1 percentage points respectively.

In terms of GEL, total remittances amounted to 162.1 million GEL, which represents a **10.7% year-over-year increase in January 2016**. Since annual consumer price inflation was 5.6% in the same month, the purchasing power of total remittance transfers increased overall.

Figure 14: Remittances by Country, January 2016 Compared to January 2015, % Change

Source: NBG

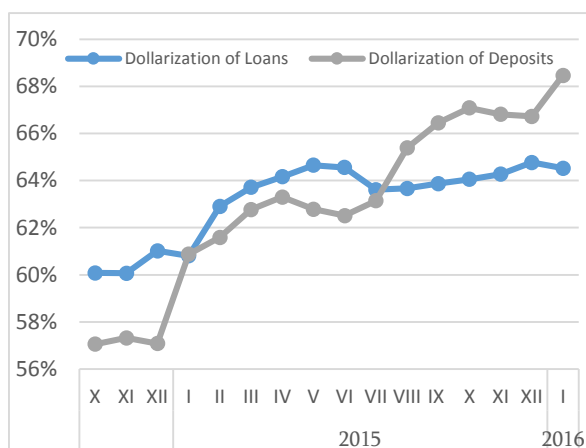


Deposit and loan dollarization rates diverge further at the beginning of the year

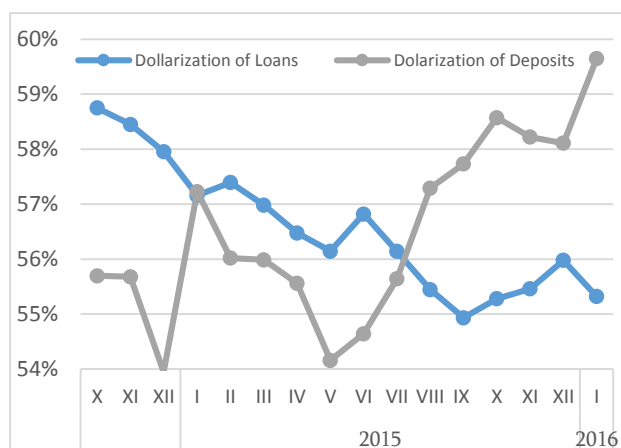
The deposit dollarization rate was 68.5% in January 2016, while loans granted by commercial banks were 64.5% dollarized. The dollarization dynamics reflected **expectations about a continued depreciation of the national currency**. The dollarization statistics calculated using 2012 as a base year for the USD/GEL exchange rate (right panel) emphasizes this point.

Figure 15: Dollarization Rates

Source: NBG



Dollarization Rates (2012 as a base year) Source: ISET-PI



The Government budget deficit worsens in January. Tax reforms initiated

In January 2016, the common budget was in deficit by 21.1 million USD, which is 77.7 million USD higher than in the same month in the previous year. Income from taxes decreased by 1.1% year over year and amounted to 602.7 million USD in the reporting month, while expenditures increased by 18.6% to 623.7 million USD.

As was mentioned earlier, the Ministry of Finance and the Prime Minister's office are planning a number of significant initiatives targeting the Georgian tax code and tax administration in 2016-2019. The changes will affect corporate taxation, VAT on imported capital goods, tax administration and insolvency regulation.

According to Minister of Finance, the planned changes in the tax code will be implemented in three stages:

1. Elimination of value added tax on imports of capital goods (approximately April 2016),
2. Replacing corporate tax with tax on dividends (1 January 2017),
3. Replacing corporate tax with tax on dividends for the financial sector (1 January 2019).

Figure 15: Common Budget, million GEL

Source: Ministry of Finance of Georgia

