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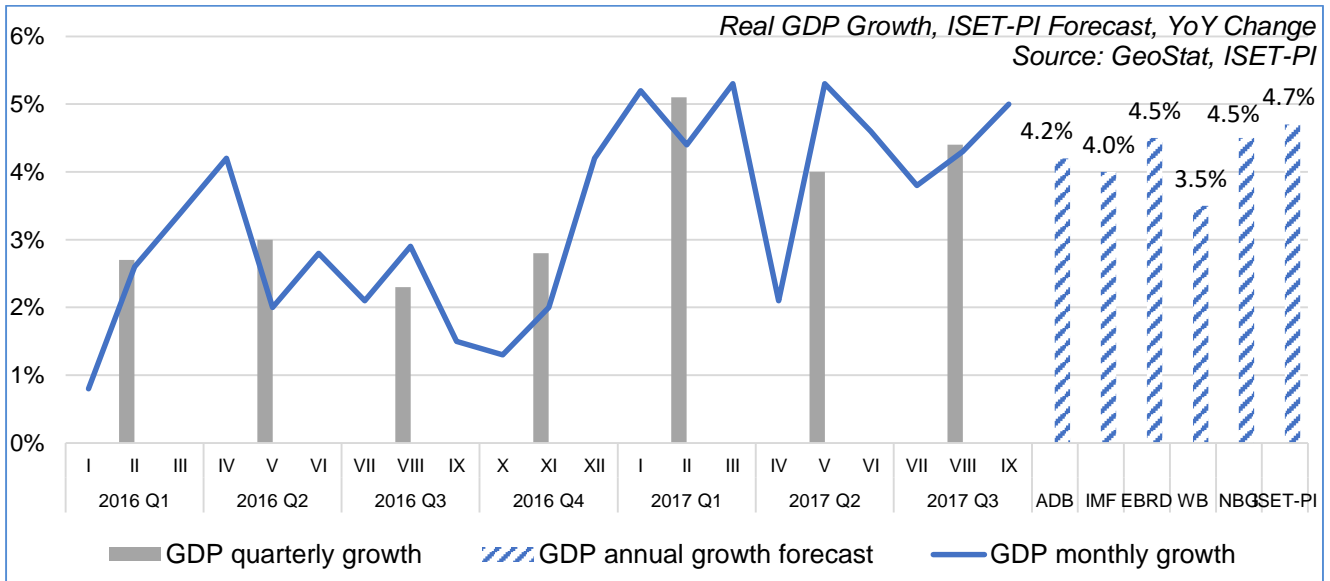
Georgia's exports on the rise, but hazelnut harvest devastation can deepen inter-regional inequalities

Highlights of this issue:

- Georgia's real GDP growth rate in Q3 reached 4.4% year-on-year, putting the country on the path to achieve 4.7% annual growth in 2017. Export, tourism and money transfer trends were behind the strong showing in Quarter 3.
- Supply side pressures will keep inflation above the 4% target in 2017.
- The Georgian lari (GEL) depreciated against the trade partner currencies both relative to the previous quarter and relative to Q3 of the last year.
- Exports rose overall by 25.5% year-on-year in Q3, which was chiefly due to an increase of external demand for traditional Georgian exports, namely ferro-alloys, car re-exports, and wine. The latter increased by 61.2% year-on-year.
- Hazelnuts, one of country's top exports, declined by nearly 56% compared to last year due to harvest damage caused by brown marmorated stink bugs in Western Georgia.
- Exports to CIS countries are becoming prominent once again, driven by the increase of exports to Russia, Azerbaijan and Armenia.
- Improvement in credit activity was one of the main drivers of economic growth in the third quarter of 2017. Retail loans increased by nearly 25% % YoY, while business loans showed a 9.5% increase.
- In Q3 2017, the volume of remittances in Georgia grew by nearly 20% compared to last year's level. All primary source countries (Russia, the U.S., Italy, Greece and Israel) showed a positive annual change. Remittances from abroad constituted 3.2% of total monthly average income in Georgia; however, for recipient families this share accounted for 42%.
- Tourism was yet another significant factor accelerating economic growth in Georgia in Q3. In the reported period, Georgia hosted 2.827 million international arrivals, a 26% year-on-year increase.

Economic Growth

Georgia's real GDP growth was 4.4% year over year (YoY) in Q3 2017, which, according to ISET-PI forecasts, puts the country on track to reach 4.7% annual growth. The forecasts from other international institutions tracking economic growth in Georgia were also inching upward. The National Bank of Georgia increased its forecast of annual growth by a 0.5 percentage point (pp) to 4.5%. The EBRD, IMF World Bank and ADB also revised their previous forecasts upward.



The Georgian economy continues to recover from its sluggish growth of previous years. The recovery is due to improvements in both the domestic and the external environment.

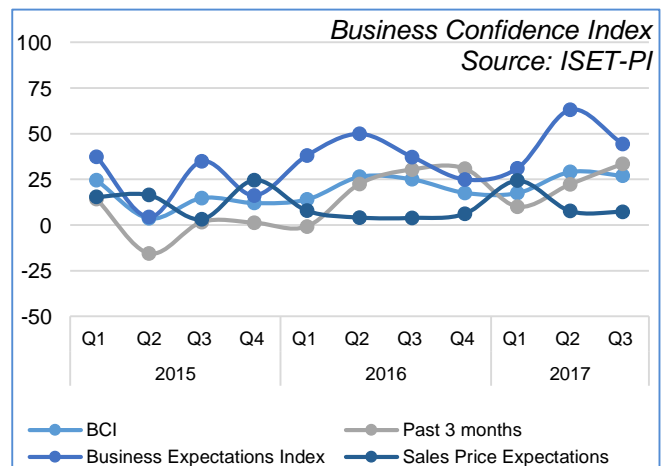
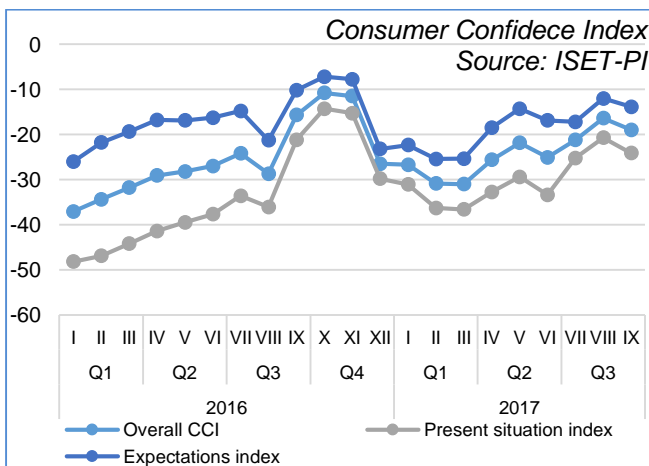
Among the domestic factors one can name stronger **consumer and business confidence**, increase in **government expenditure** and **private credit activity**, all of which boosted both domestic investment and consumption. In the same time, the **hike in exports of goods, rising tourism, and increased money transfers** were the main external drivers of economic growth in Q3 2017.

High economic growth rates in neighboring countries benefited the Georgian economy through trade and remittances flow. After two consecutive years of economic recession, Russia is expected to show 1.8% YoY growth of real GDP in 2017, while Armenia and Turkey are expected to reach 3.5% and 5.1% respectively (by IMF forecast). Only Azerbaijan is exhibiting a weaker economic performance this year, continuing to struggle with high inflation and, consequently, fiscal and monetary tightening. The country's economic growth is expected to turn positive only in 2018.

Consumer and Business Confidence

The Consumer Confidence Index (CCI), was **significantly higher in Q3** than in the same period last year – an **increase of 4 index points**. The present situation and expectation indices were up by 6.9 and 1 index points respectively.

The Georgian Business Confidence Index (BCI), a barometer of business sentiment and a guide to domestic investment and business environment also showed positive annual changes, reaching 27.0 index points (**a 2-point improvement year-on-year**). The third quarter increase in the BCI was mostly driven by strong performance in the last quarter and **a significant improvement in expectations**.





Inflation

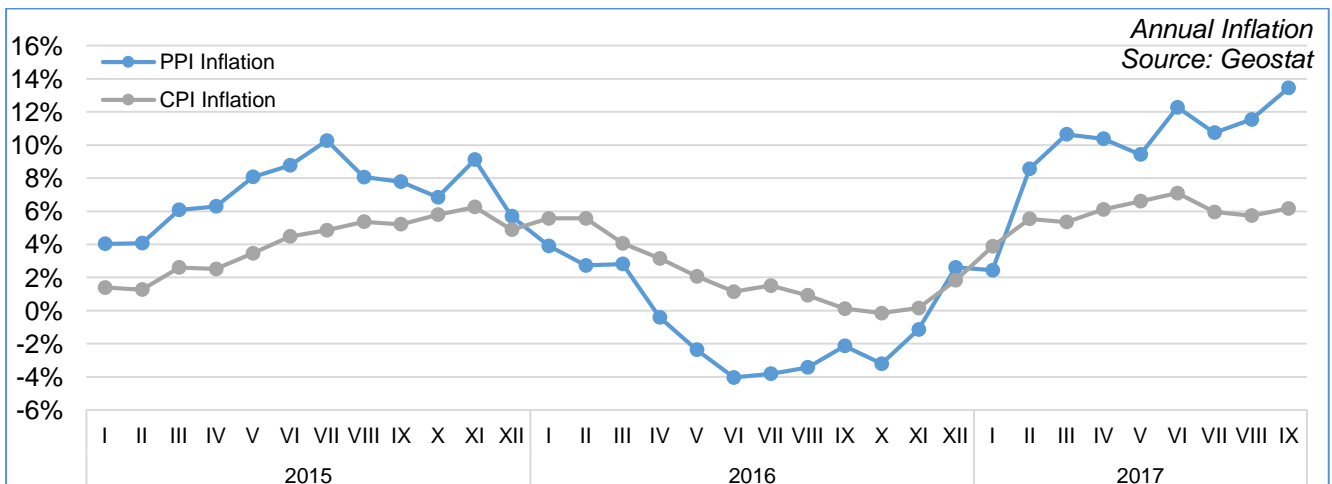
According to Geostat, producer and consumer prices increased on average by 11.9% and 5.6% respectively in Q3.

The following external and domestic factors contributed to the annual price hike:

- a. The **price increase of oil products on the world market**. On average, the fuel price index (Indexmundi) increased by 13.6% YoY.
- b. The **price increase of food commodities on the world market**. FAO Food Price Index increased by 7% YoY.
- c. **Nominal depreciation of GEL against USD**. Despite the fact that GEL stabilized against the USD in Q3 2017, on average Lari lost 4.3% of its value again the US dollar year on year.
- d. Supply side pressure due to the **hike in excise taxes on fuel, tobacco products, and car imports**.

The biggest driver of annual CPI inflation was the price change on food products, which rose by 6.6% YoY (2 pp).

Supply side pressures will keep annual inflation above its target level (of 4%) during 2017. Next year, however, inflation is expected to return to the 3% target. The NBG continues to hold monetary policy rate constant at 7% level, trying to control inflationary expectations towards the end of 2017.

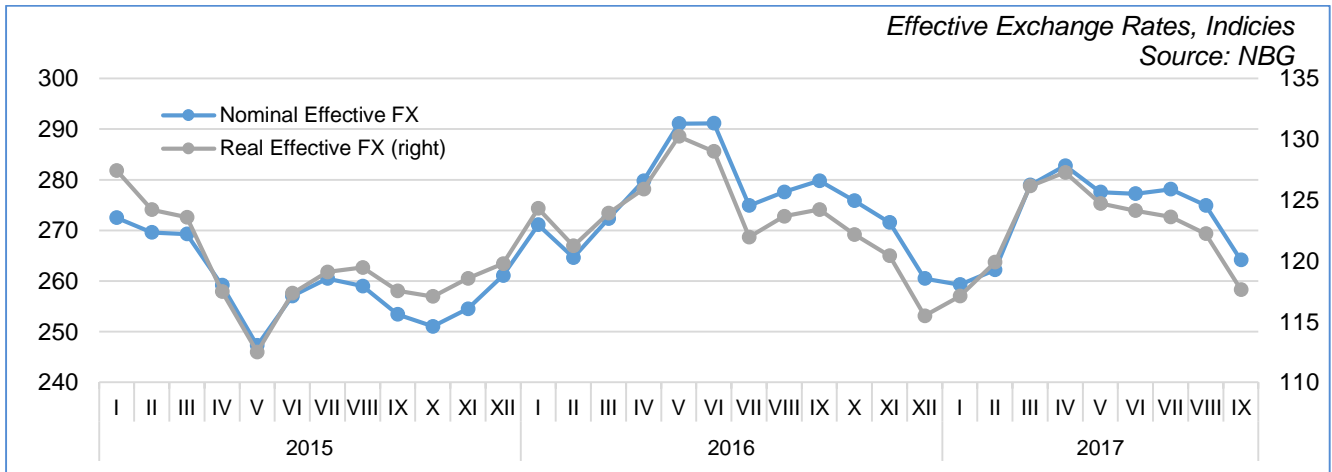


Exchange rate

The lari nominal exchange rate depreciated only slightly against both the US dollar (-0.1%) and the euro (-7%) compared to the second quarter of 2017. In annual terms the lari was down against these currencies, by 4.3% and 9.7% respectively.

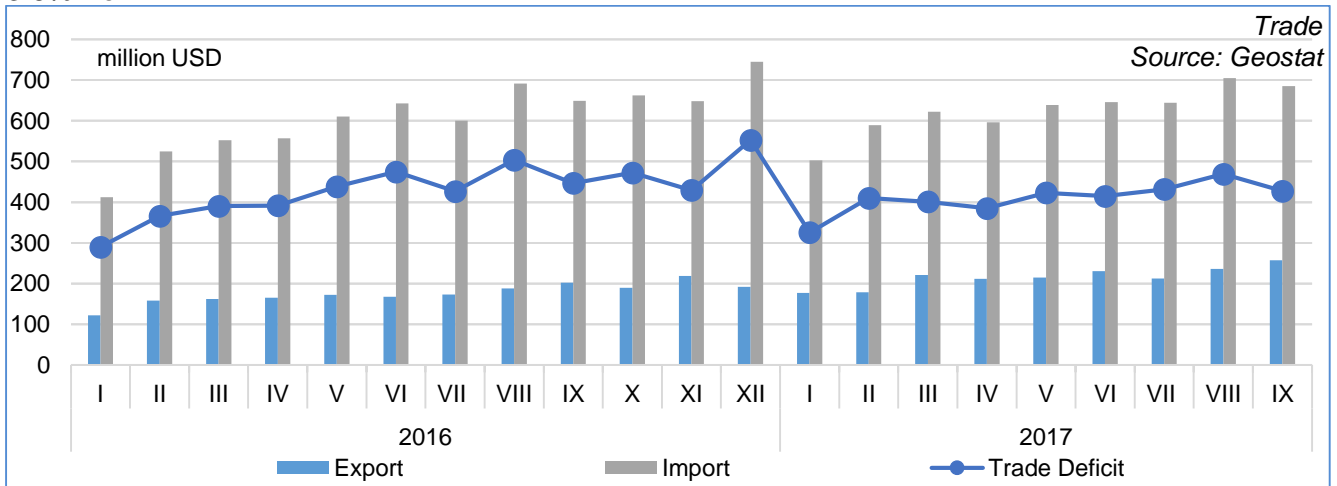
Real and nominal effective exchange rates of GEL against trading partner currencies followed the same pattern. In annual terms, both **real and nominal rates depreciated by 1.7% and 1.8% respectively, making Georgian goods cheaper for foreigners.**

The National Bank of Georgia bought 40 million US dollars in two auctions in August to smooth the temporary episode of lari depreciation. It is worth noting that NBG did not perform any selling auctions this year, while the total amount of buying auctions constituted 129.75 million USD. Compared to last year’s 280 million USD sales and 278.35 million USD purchases, the NBG foreign exchange market interventions in 2017 were relatively small.



External Trade

In Q3 trade **turnover increased significantly, by 9.4%** year over year. This rise was mostly driven by a notable increase in exports (+25.2% YoY), while imports were showed only a slight increase (a 4.8% YoY increase). As a result, the trade balance of the country has improved, with the deficit shrinking by 3.6% YoY.



The boost in export value was driven by improved external demand conditions. **Ferro-alloys** (+82.1% YoY), **petroleum** (1781.4% YoY), **cars re-exports** (+40.6% YoY), and **wine** (+61.2%) were the **main drivers of export growth** in Q3 2017, contributing 17.3 percentage points to the total.

On the other hand, **export of hazelnuts was devastated** due to the invasion of brown marmorated stink bugs in West Georgia. Hazelnut exports **went down by 55.9% YoY**. If left untreated, the infestation can cause long-term damage to the regional economy.

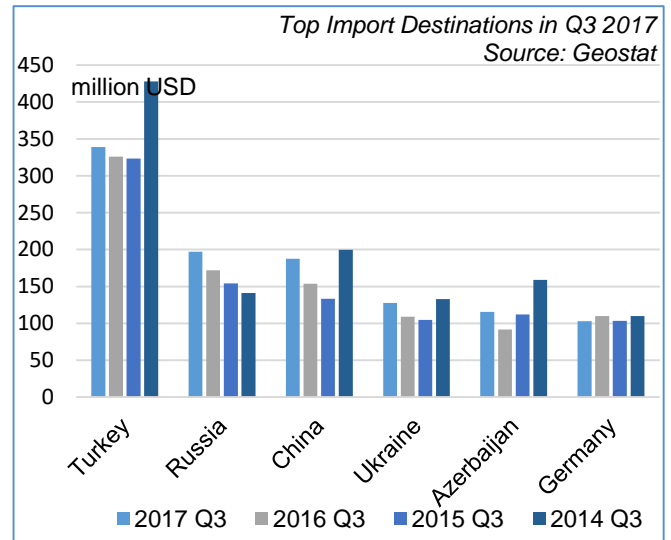
Moreover, since most wine is harvested in the east of Georgia, while hazelnuts come from the west, the change in harvest fortunes can potentially exacerbate regional income inequalities. The government should, therefore consider support programs which could help farmers battle the infestation.

In Q3 2017, Georgia witnessed the rise of two unusual exports– meat of sheep/goats and tobacco products. The export of sheep meet is mainly due to Iran opening up its market to imports of lamb and sheep from Georgia. The reasons behind an increase in tobacco exports to Kazakhstan and Singapore are not so clear. Both products showed unprecedented year-on-year growth rates – 2,245% and 607% respectively.

Exports to CIS countries are making a come-back: in Q3 they increased by 45.1% YoY. Exports to EU countries decreased by 13.5% YoY in the reporting quarter. **The main contributors** to export growth were **Russia (+81.5% YoY), Azerbaijan (+62.8% YoY) and United States (+135.4% YoY),**



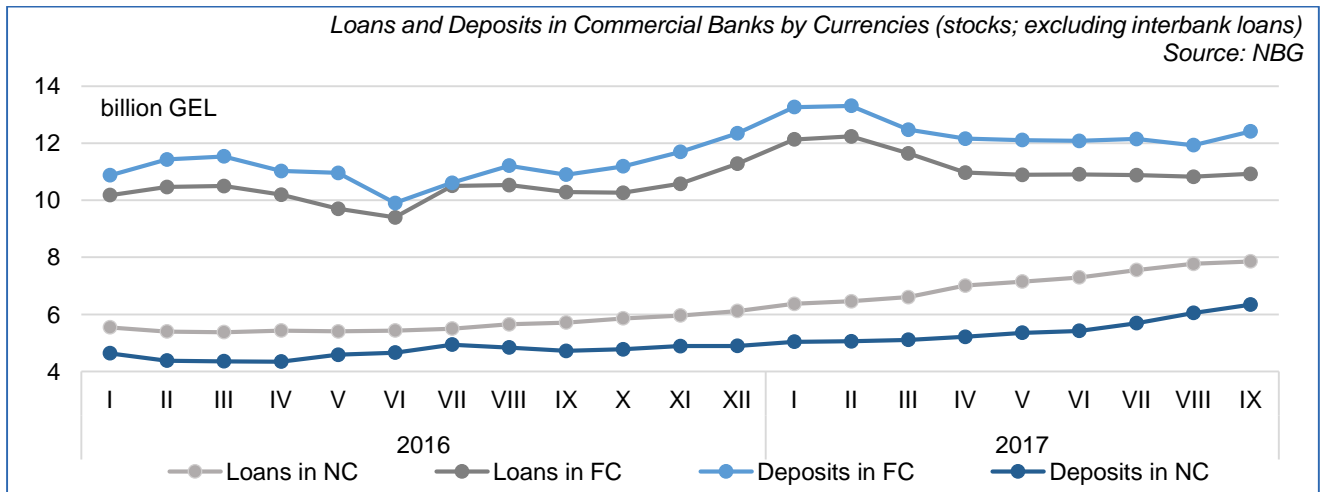
Together with **Armenia (+ 41.8% YoY)**, those countries contributed 17.7 pp to total export growth in third quarter of 2017.



Financial Sector

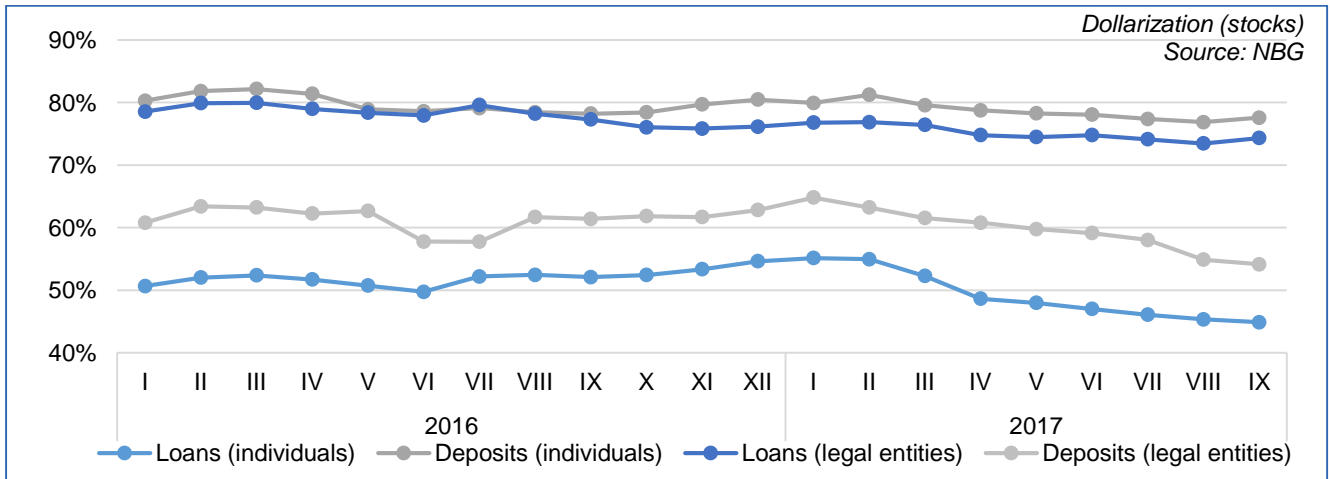
Improved credit activity was one of the main driver of economic growth in the third quarter of 2017. Total loans (stocks) granted by commercial banks amounted to 18.8 billion GEL, a 17.4% YoY increase.

Retail loans increased by 24.8% YoY, while business loans showed a 9.5% growth.



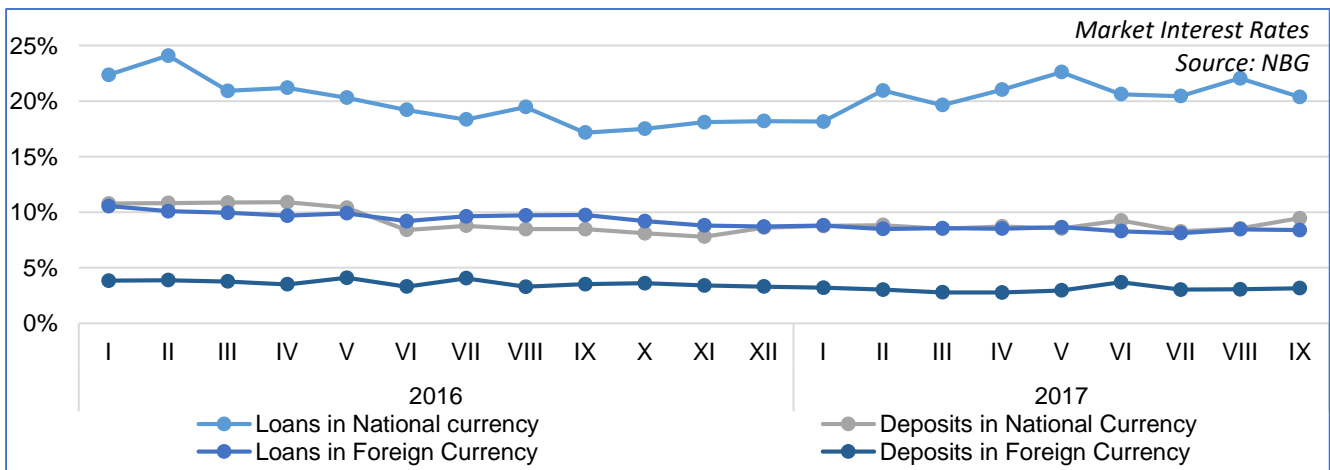
Dollarization rates of both loans and deposits fell. **Loan dollarization decreased by 6.1 pp YoY (to 58.2%).** The **dollarization rate of deposits decreased by 3.6 pp to 66.2% YoY.**

This indicates that the **de-dollarization policy implemented earlier in year has started to work.** It is, however, impossible to assess the results of this initiative over such a short period of time.



Secondly, the difference between deposit and loan dollarization rates can create **currency mismatch risks for banks**. The **difference between deposits and loans dollarization rates was 5.5 percentage points in Q3 last year. In 2017, the gap widened to 8 pp.**

The interest rates on national currency loans started to increase in the beginning of 2017, and were on average by 2.7 pp higher in Q3 2017 compared to the same period last year. The increase of monetary policy rate by 0.5 pp was partially responsible for the spike in the interest rates. Given that in October NBG also toughened certain regulatory requirements for commercial banks, making lending potentially more costly, one could expect further increase in interest rates on loans in the next quarter.

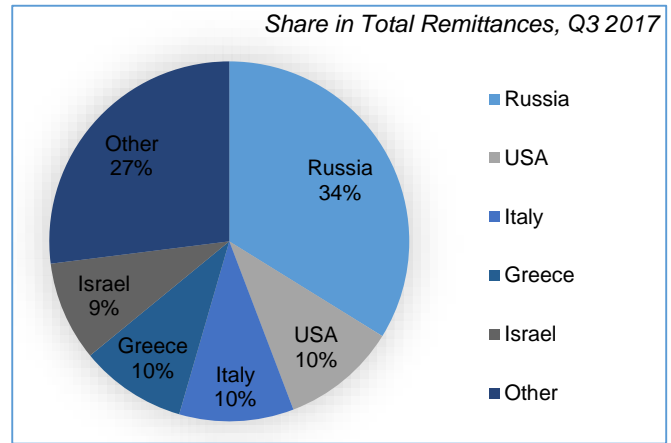
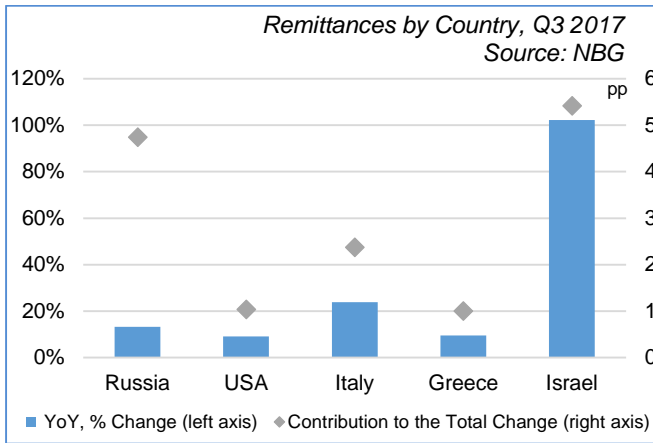


Remittances

In Q3 2017, the volume of remittances in Georgia grew by one fifth compared to last year’s level (+19.7%), reaching 367 million USD. **The recovery of remittances is a clear sign that the economy of the region continues to improve.** All primary source countries of money inflows to Georgia showed a positive annual change: Russia (+13.3% YoY), the United States (+9.1% YoY), Italy (+23.8% YoY), Greece (+9.5% YoY), and Israel (+102.2% YoY).

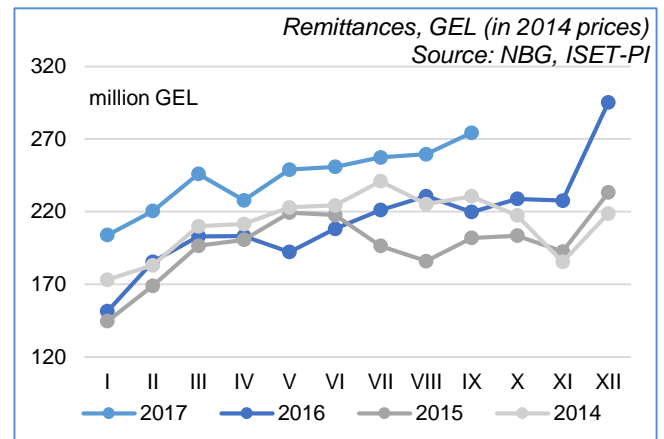
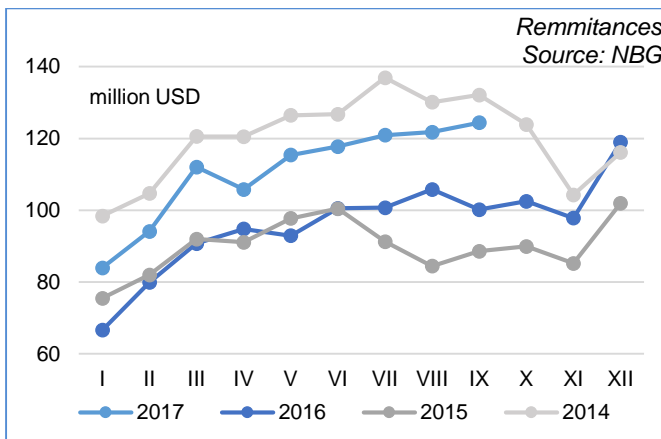
The growth of money inflows from Russia reflected the dynamics of oil prices on the world market, which positively affected economic growth and therefore the ruble exchange rate against the US dollar. Remittances from Israel have continued to show unprecedented growth, which stems from the wave of Georgian emigration that started in 2014, when the countries ratified a visa-free regime

Taken together, these two countries contributed 11.2 percentage points to the total YoY growth of remittance transfers in Q3 2017.



According to data from Geostat’s Integrated Households Survey 2016, remittances from abroad constituted 3.2% of total monthly average income in Georgia; however, for recipient families this share accounted for 42%.

While **money inflows have not yet recovered to 2014 levels**, the lari depreciation and moderate levels of inflation **boosted the purchasing power of remittances**. In Q3 2017, Georgian receivers of remittances got 17.8% more in CPI-adjusted GEL than they did in the same period last year, and 13.6% more than in Q3 2014.



Tourism

Tourism was a significant factor that accelerated economic growth in Georgia in Q3 2017. The international arrivals, were up 25.9% year on year.

Real tourists (visitors who stayed in Georgia for 24 hours or more) constituted 52.1% of total arrivals – a 28.5% YoY increase. Transit visitors showed 34.2% YoY growth, while the number of same day visits fell by 13.5% YoY.

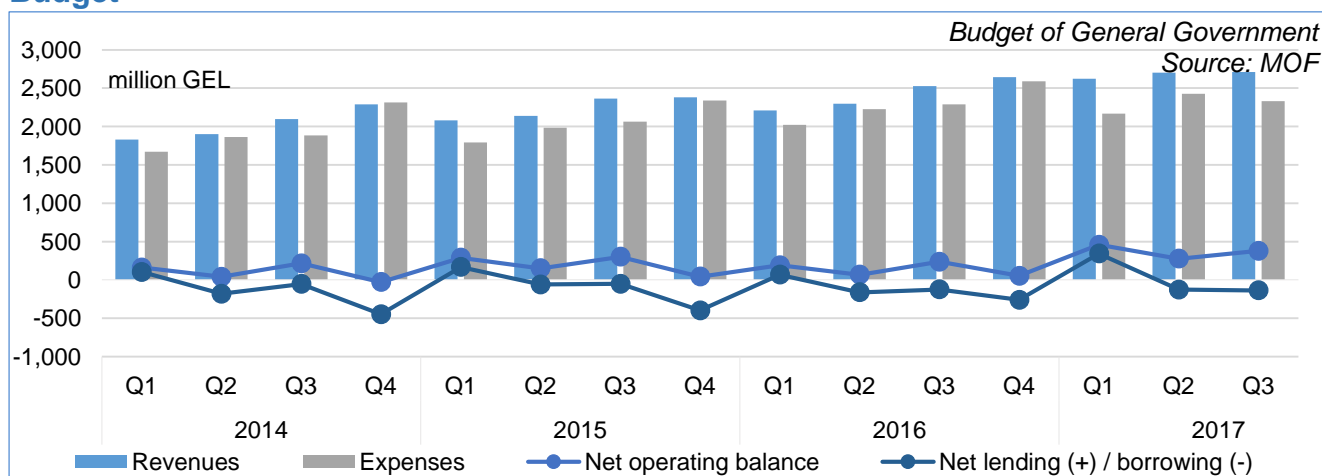
International tourism receipts surged by 31.2% YoY and reached unprecedented level of 1.072 billion USD in Q3 – **higher than for whole volume of tourist receipts in 2011.**

Georgian citizens were also actively travelling abroad. In Q3, the number of outgoing citizens showed a 20% YoY increase. It appears that visa liberalization with the EU has already boosted tourism to Europe; according to the Ministry for European and Euro-Atlantic Integration, **161,885 Georgian citizens traveled to the Schengen Zone in the period of March 28 – October 20.** Of these, only 6.1% violated the visa-free rules.



	Country	2016 Q3	2017 Q3	Change	Change %	Share %
1	Russia	435 149	605 724	170 575	39.2%	21.4%
2	Armenia	521 243	605 047	83 804	16.1%	21.4%
3	Azerbaijan	484 286	562 240	77 954	16.1%	19.9%
4	Turkey	347 783	401 813	54 030	15.5%	14.2%
5	Iran	82 845	152 040	69 195	83.5%	5.4%
6	Ukraine	67 354	72 038	4 684	7.0%	2.5%
7	Israel	40 848	50 727	9 879	24.2%	1.8%
8	Saudi Arabia	16 292	45 445	29 153	178.9%	1.6%
9	Kazakhstan	23 798	26 938	3 140	13.2%	1.0%
10	Belarus	19 276	25 673	6 397	33.2%	0.9%
11	Poland	21 537	25 373	3 836	17.8%	0.9%
12	Germany	16 868	22 245	5 377	31.9%	0.8%
13	USA	12 479	17 107	4 628	37.1%	0.6%
14	India	12 642	14 807	2 165	17.1%	0.5%
15	Greece	8 694	9 562	868	10.0%	0.3%
	Total	2 245 050	2 826 665	581 615	25.9%	100.0%

Budget



Positive economic developments of Q3 2017 were also reflected in the budget data. General government total revenues amounted to 2.709 billion GEL, a 7.2% YoY increase. Revenues from taxes increased by 6% YoY and constituted 2.457 billion GEL.

Notably, **Excise Tax and VAT tax revenues showed strong growth** (+27% YoY and +18.3% YoY respectively). The **revenues from excise tax, however, fell short of the budget plan projections** (they reached 386 million GEL out of the projected 400 million GEL for Q3).

Profit tax revenues went down by 65.9% YoY. The decline in profit tax revenues could have a silver lining: it could mean that the CIT reform is finally catching on, giving an incentive for Georgian businesses to reinvest their profits.

Expenses of the general government amounted to 2,332 million GEL, a 1.9% YoY increase. Compensation of employees (-9.7% YoY) and other expenses were the only categories of public spending that decreased in Q3; purchase of goods and services (+18.4% YoY), interest payments (+16.8% YoY), subsidies (+12.8% YoY), grants (+20.3% YoY), social benefits (+2.4% YoY) all rose.

In the reported quarter, the government performed net acquisition of nonfinancial assets of 514 million GEL. As a result, the general government budget deficit increased by 11.1% YoY to 137.3 million GEL.

To summarize, in the **first nine months of 2017, the general government budget execution was generally on track, with some deviations: total revenues were executed by 104.8%, while total expenditures by 96.4%.**