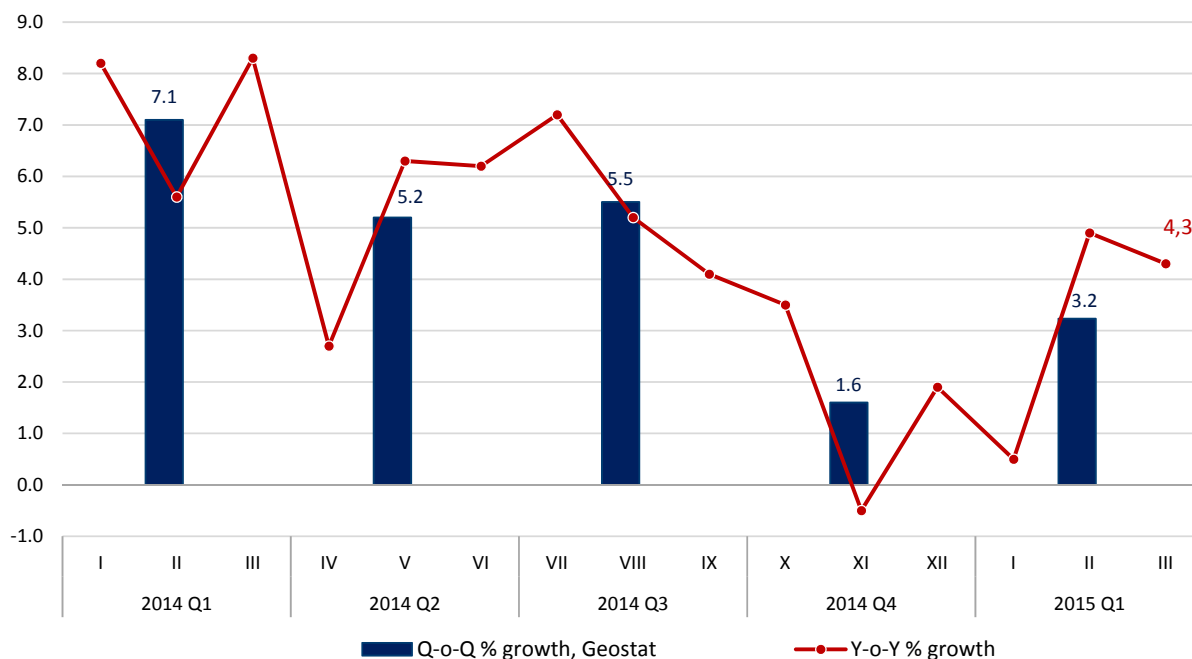


## Macro Review - May Issue

According to Geostat's rapid estimates, Georgia's economy grew by 4.3% in March 2015. After the slowdown of the last several months, the growth rate in February and March looks very promising. In the first quarter of 2015, GDP growth amounted to 3.2%. In March, VAT payers' turnover increased by 9.9% annually, and the total consumption of electricity increased by 6.2%. ISET's GDP forecast for the second quarter of 2015 is even more optimistic, at 5.1%.

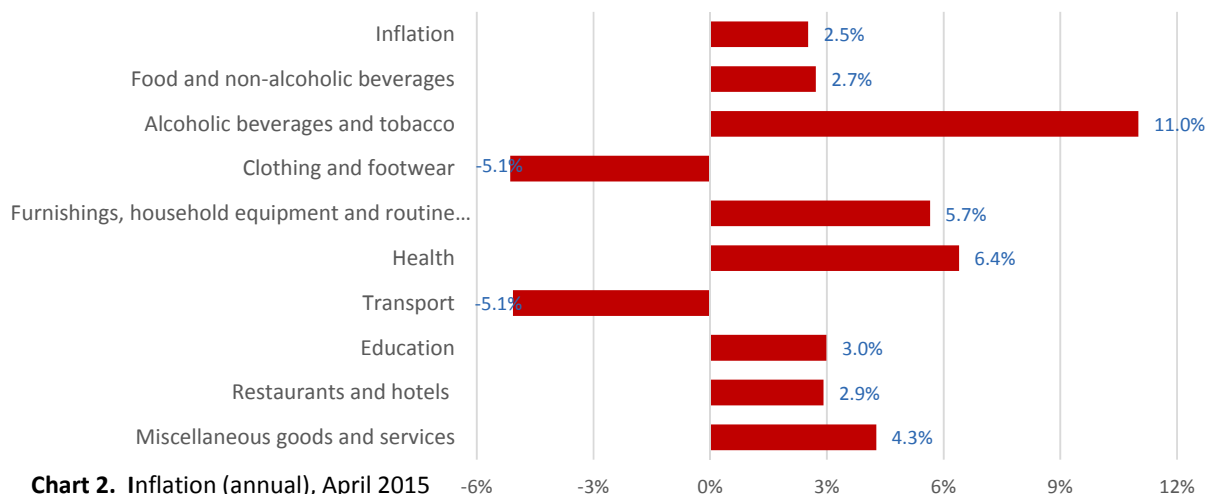


**Chart 1.** Y-o-Y (red line) and Q-o-Q (blue bars) % growth rate of real GDP.

Source: GeoStat, ISET-PI

Despite the depreciation of the lari and pressure on inflationary expectations, annual CPI inflation reached just 2.5% in April. The increase in prices was driven to a large extent by food and non-alcoholic beverages (2.7%), healthcare (6.4%), alcoholic beverages and tobacco (11%). The prices of alcoholic beverages and tobacco rose because excise tax on some of the products included in this category was increased. Taken together, these three categories contributed over 2 percentage points to the CPI inflation rate. At the same time, prices continued to fall on clothing and footwear, and transport – with both categories falling by -5.1% (see Chart 2). Producer price index (PPI) inflation was predictably much higher, at 7.2% annually.

While annual CPI inflation allows us to compare current prices with the same period last year, it may not accurately reflect the short-term price dynamics on the market. We thus need to look at monthly inflation rates. Between April and March, only a slight uptick in monthly inflation can be observed. Compared to March, overall prices increased by 0.3%. The price increases on the transport (1.8%), alcoholic beverages and tobacco (1%) categories put upward pressure on monthly CPI inflation. However, the pressure was lessened by a price decline on food and non-alcoholic beverages (-0.3%) and other categories.

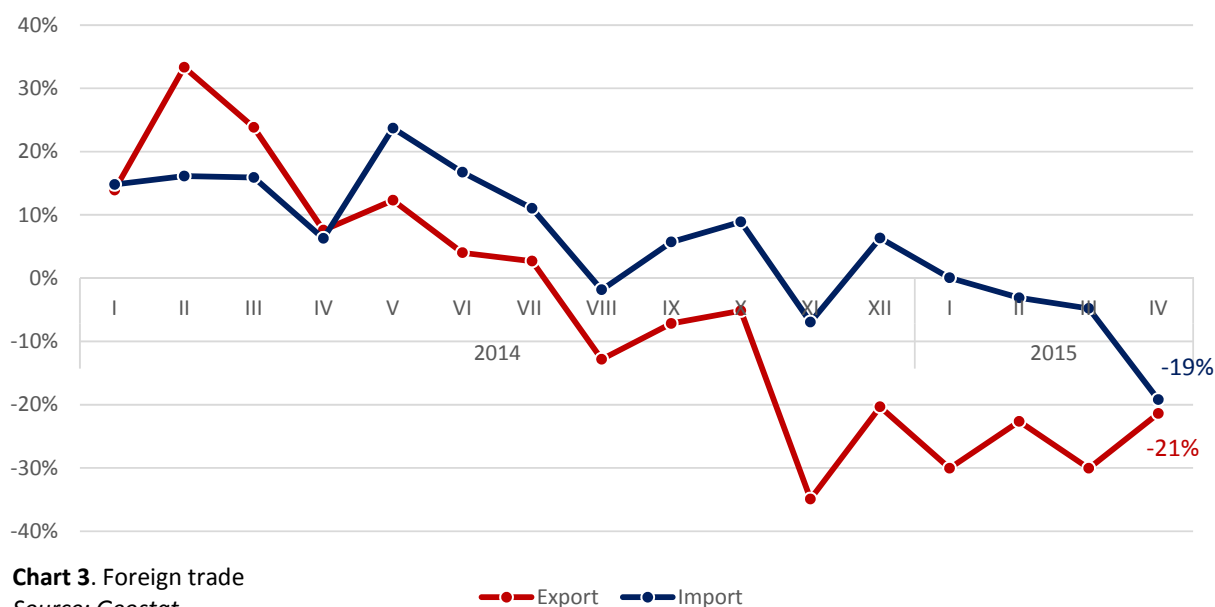


**Chart 2.** Inflation (annual), April 2015

Source: Geostat

During January-April, exports from Georgia amounted to 689 million USD. The export volume was 26% lower than in the corresponding period last year. The volume of imports to Georgia decreased as well. Over the reporting period, imports amounted to 2,326 million USD, which is 8% less than the amount reported last year. Consequently, the trade deficit deteriorated by 3% and reached 1,637 million USD.

As can be seen from the graph below, imports show a negative growth dynamic – they have been declining steadily since December 2014. At the same time, the negative annual growth rate of exports, represented by the flattening red line on the graph, point to a downward shift in the **level of exports**, rather than negative growth dynamics. Insofar as the trade deficit is concerned, this is a rare piece of good news for the country. The decrease in the level of exports at the end of 2014 implies that annual growth rates in 2015 will be negative, but the level of exports will remain stable.



**Chart 3.** Foreign trade

Source: Geostat

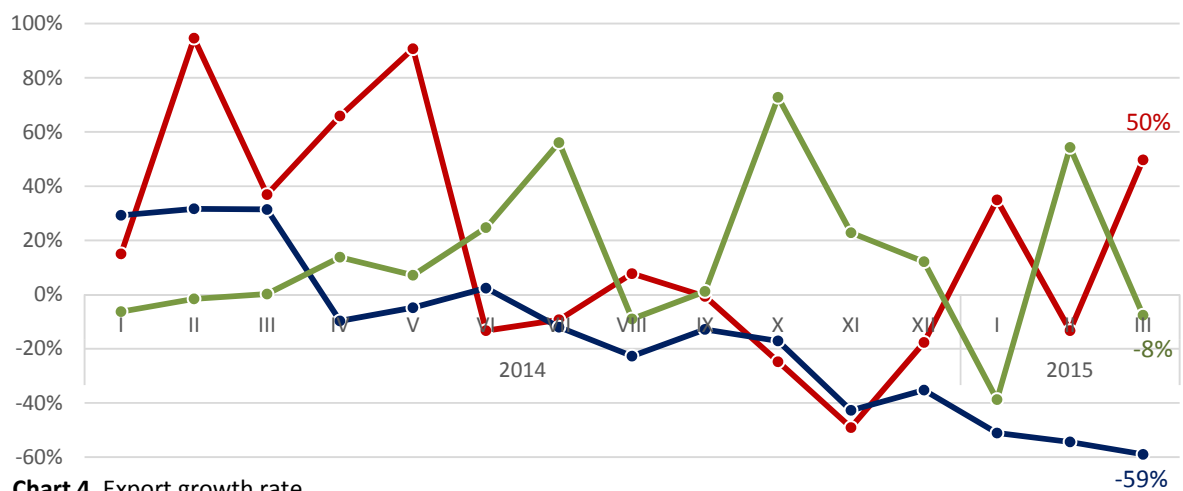
—●— Export —●— Import

The steady decrease in the level of imports coupled with the low, but stable, export level has the added benefit of easing depreciation pressure on the national currency.

If we look at the dynamics of exports by destination, we see a steady decline of exports to the CIS. This group of countries now accounts for 36% of Georgian exports, while 35% goes to the EU, and 29% to other countries, mainly Turkey, the USA and China.

Overall exports to CIS countries declined by 59%. This includes Azerbaijan (-75%), Armenia (-60%), Russia (-52%), Ukraine (-60%), and Kazakhstan (-54%). At the same time, exports to the EU countries increased by 50% annually, mostly due to increased exports to Bulgaria (143%) and the UK (246%).

Exports to countries other than the EU or CIS decreased by about 8%. This includes the USA (-72%) and Turkey (-5%). However, we still see an annual export growth to China (62%) (see Chart 5).



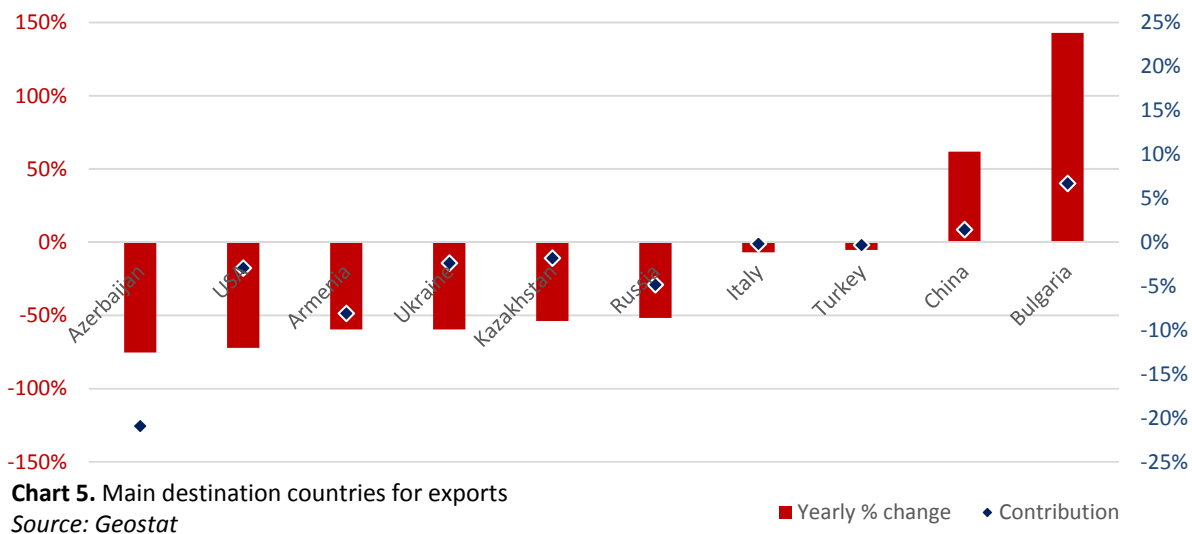
**Chart 4.** Export growth rate  
Source: Geostat

—●— EU countries    —●— CIS countries    —●— Other countries

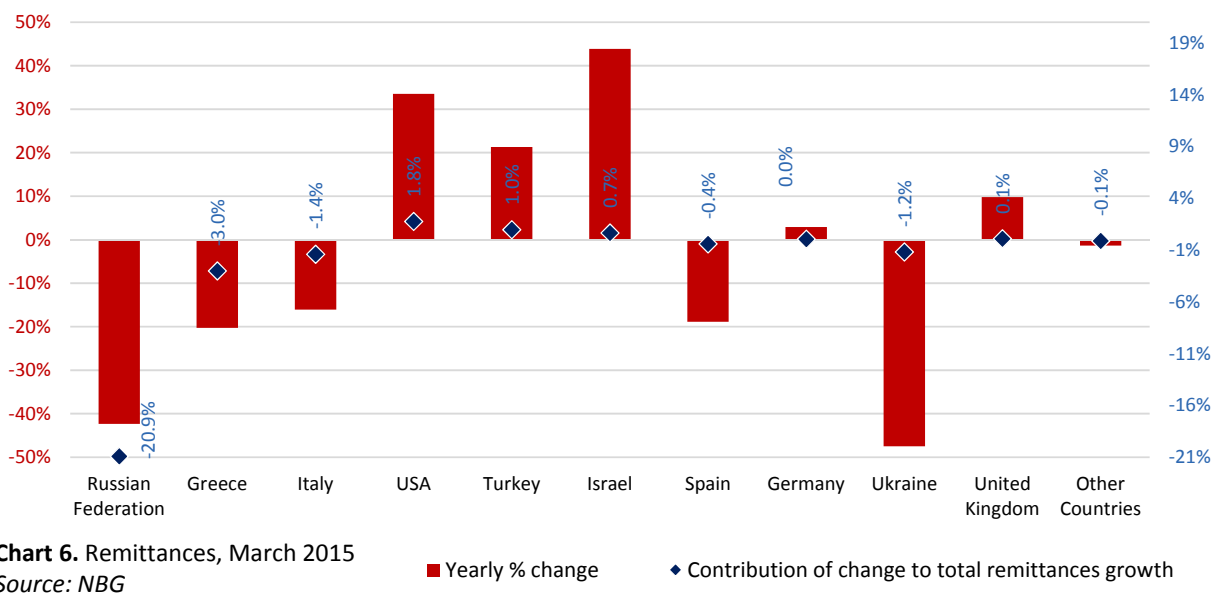
In the table below, there are presented shares, growth rates and main destination countries of main Georgian export goods in the period between January–March 2015.

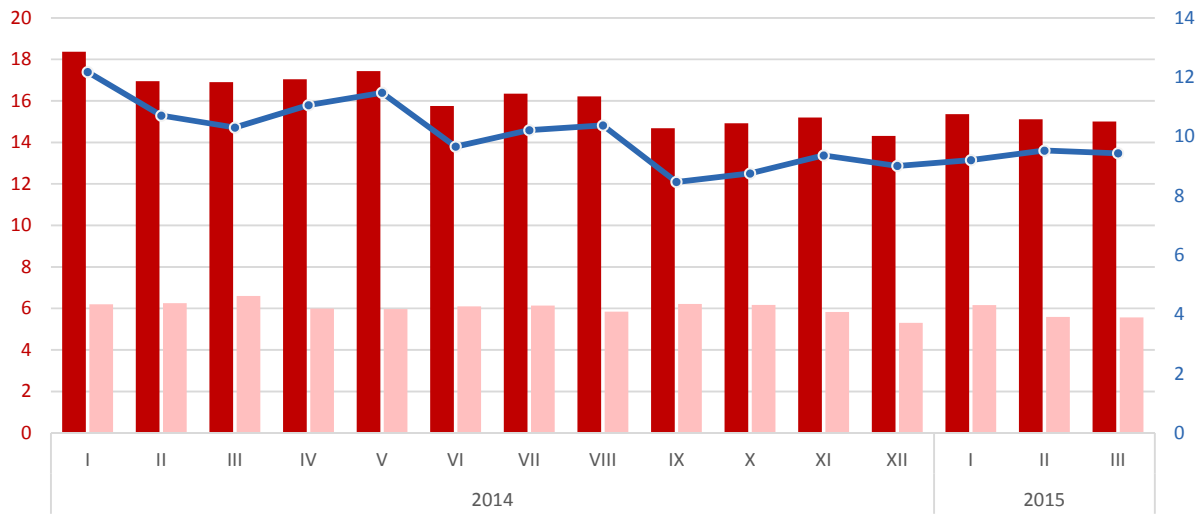
| Main Export products | Share in total export | Growth rate | Destination           |
|----------------------|-----------------------|-------------|-----------------------|
| Copper ores          | 12.2%                 | 19%         | Bulgaria, Switzerland |
| Motor cars           | 11.5%                 | -62%        | Azerbaijan            |
| Nuts                 | 10.3%                 | 138%        | Italy, Germany        |
| Ferro-alloys         | 9.6%                  | -31%        | USA, Brazil, Canada   |
| Fertilizers          | 4.8%                  | -47%        | USA, Armenia, Greece  |
| Mineral waters       | 4.5%                  | -34%        | Russia, Ukraine       |
| Wine                 | 3.1%                  | -67%        | Russia, Kazakhstan    |

Source: Geostat



In March, remittances to Georgia amounted to 92 million USD, which is down 24% from March 2014. This annual drop was mainly caused by the decline of money transfers from Russia (-42%), Greece (-20%), Italy (-16%) and Ukraine (-47%). However, remittances significantly increased from the USA (+34%), Turkey (21%) and Israel (+44%) (see Chart 6). In the first quarter of 2015, remittances to Georgia amounted to 250 million USD, which is 23% lower compared to the first quarter of 2014.





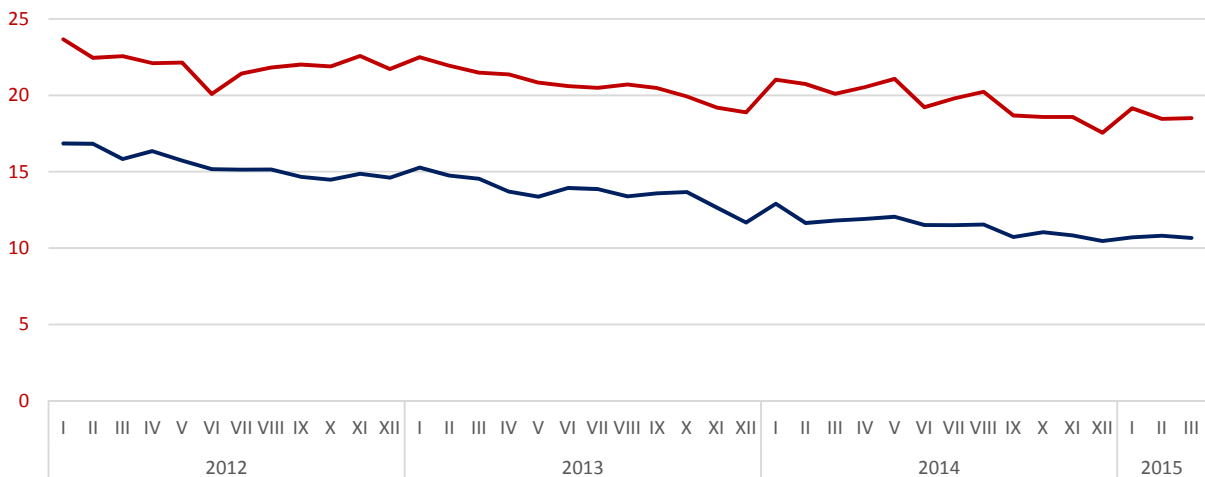
**Chart 7. Interest rates**

Source: NBG

■ Interest Rate on Loans    ■ Interest rate on deposits    ●— Interest rate spread (right)

In April, average bank interest rates on loans decreased slightly to 15%. Lari lending rates, however, have shown no change since February (and stood at an average of 18.5%). The lending rate in foreign currency decreased to 10.7%.

To put these tendencies in perspective, if we look at the evolution of interest rates in Georgia since 2012, we can see that interest rates on loans, in both lari and foreign currency, showed a declining trend. However, interest rates on foreign currency loans declined relatively more than those on lari loans, thus causing the difference between lari and foreign lending rates to widen (see Chart 8). The dynamics of lari and dollar loan rates is one of the reasons why the recent lari depreciation has been so painful for consumers, despite low inflation rates. Most borrowers, whose income is in lari, were taking out relatively cheap dollar loans, thus increasing their exposure to exchange rate fluctuations.

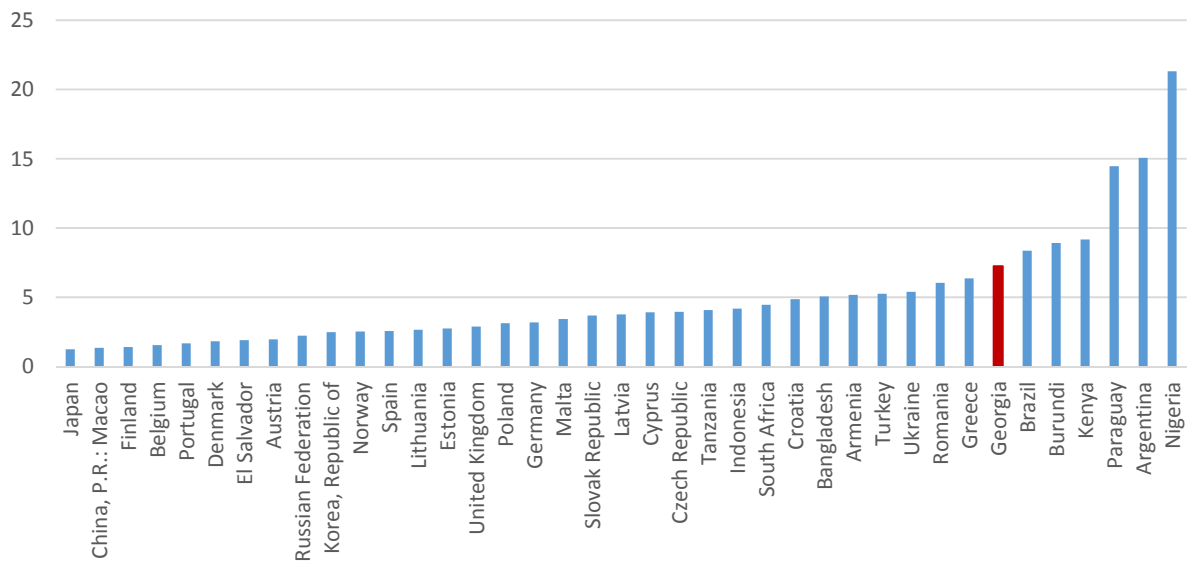


**Chart 8. Interest rates in national currency**

Source: NBG

— Interest rates on loans in National currency  
— Interest rates on deposits in National currency

As can be seen from Chart 7, the interest rate spread (the difference between lending and deposit rates) was relatively stable and stood at 9.4% as of March 2015. Interest rate spread can be interpreted as the difference between the costs of mobilizing liabilities and earnings on assets. It measures the efficiency of the financial sector – the smaller the spread, the lower the transaction cost, and consequently the more efficient the financial sector. Even though the banking sector is considered to be one of the most developed and fast growing sectors in Georgia, a cross county comparison shows that the interest rate spread in Georgia is one of the highest in the world, particularly compared to other developing countries (see Chart 9).



**Chart 9.** Spread between lending and interest rates  
*Source: IMF*