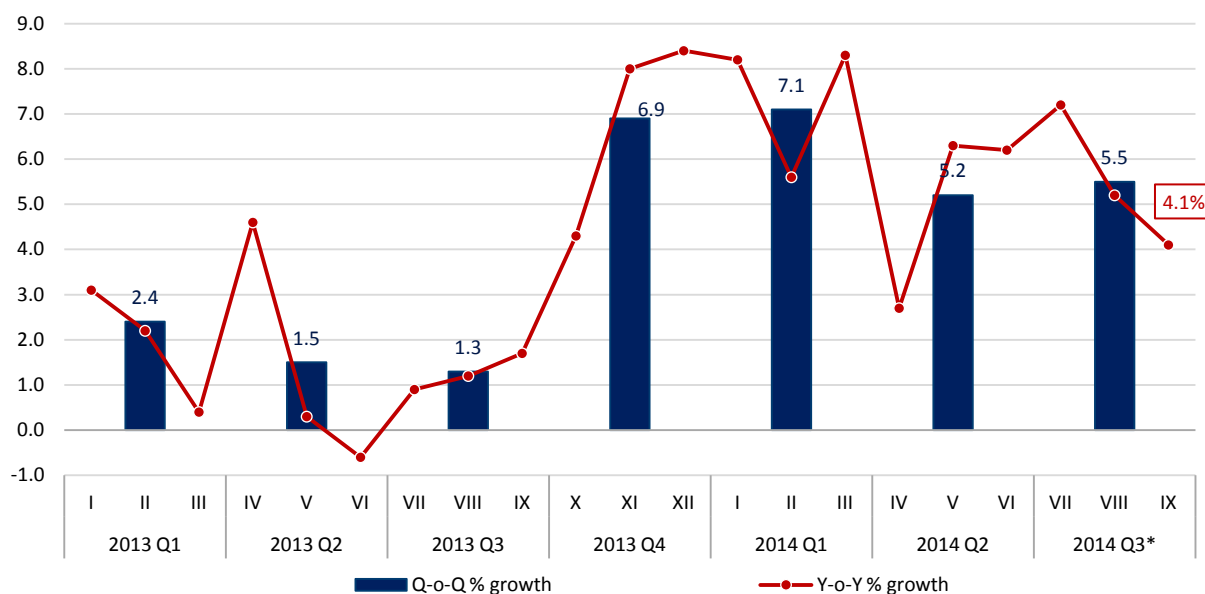


## Macroeconomic Review – November 2014 Issue

### Growth slowed in September on weak domestic, external demand conditions.

The Georgian economy's growth rate appeared to slow down in September. According to Gaostat's rapid estimates forecast, real growth of GDP decreased to 4.1%. This estimate is the lowest this year since April, when the growth rate fell to 2.7%. The ISET Leading Economic Indicators index warned about a possible slowdown of the economy in the third quarter, citing, in particular, the significant decline in exports that began in August 2014. The ISET forecast of GDP growth in the fourth quarter is 1.1%. The weaknesses of the economy seem to stem from two main sources: weak internal demand (lower consumer confidence in September affecting domestic consumption) and a slowdown in external demand (negative export growth).



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

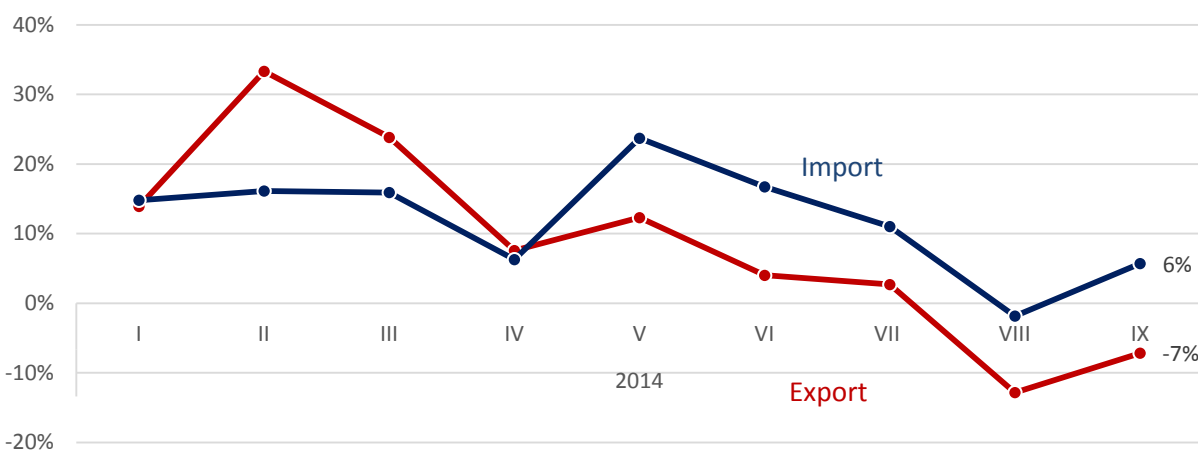
Source: GeoStat

### External demand – export declines

Starting from the second half of the year, exports have been increasing slowly, but then plunged in August and September by 13% and 7% respectively, as compared to the same months of the previous year.

Georgian exports were significantly impaired by the regulatory import restrictions undertaken in neighboring Azerbaijan. The restrictions set by Azerbaijan's government came into full effect in August, and effectively decimated the car re-export business in Georgia. Reduction in car re-exports seems to be one of the most important items driving the decline

of exports. More precisely, it contributed around 5.5 percentage points to the total 7 percent decline in September.

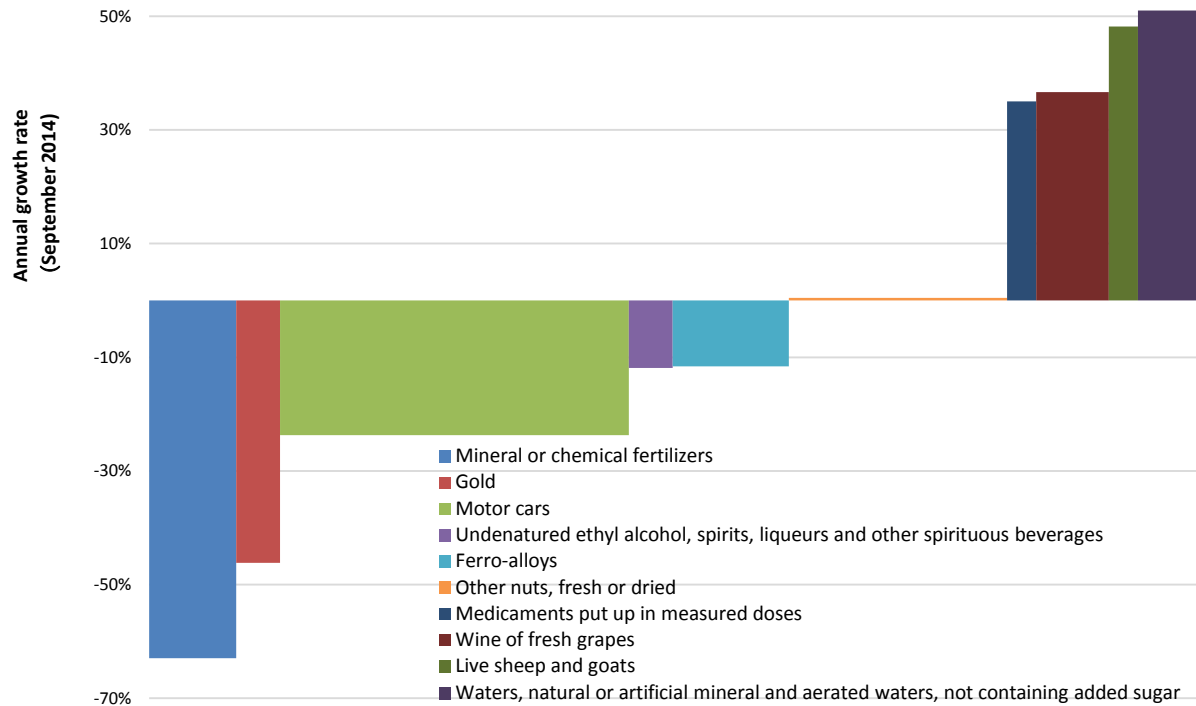


**Chart 2.** Annual growth of export and import

Is the collapse of the car re-export business bad news for Georgia? Yes and no. On the one hand, the collapse of this particular segment of the market could well have negatively affected consumer confidence. This segment provided employment and income for some of the lowest skilled and most economically vulnerable segments of the population. On the other hand, re-exporting second hand cars is about as dead-end an activity as one can be, providing no economies of scale or knowledge spillovers to benefit long-term growth.

The growth of export to CIS countries declined not only as result of the regulatory changes in Azerbaijan, but also because of the ongoing conflict in Ukraine, a traditionally large export market, and the slowdown of the Russian economy. Another worrying sign is the significant slowdown of export growth to EU countries (since June) – this market is considered the most stable for the Georgian economy, with EU countries being the destination for over 20% of Georgian exports.

If we look at the table of the top ten goods exported by Georgia (see **Chart 3**), we can see that a number of other important export sectors have recently suffered declines. Namely, a significant decline in the export of mineral and chemical fertilizers (-63%), gold (-46%), ethyl alcohol, spirits, liqueurs and other spirituous beverages (-12%) and Ferro-alloys (-12%), has been reported. However, exports of other goods, especially agricultural products, increased in September. There have been significantly increased exports of mineral waters (51%), live sheep and goats (48%) and wine (37%). The combined contribution of these exports to the overall change was 4.4 percentage points.

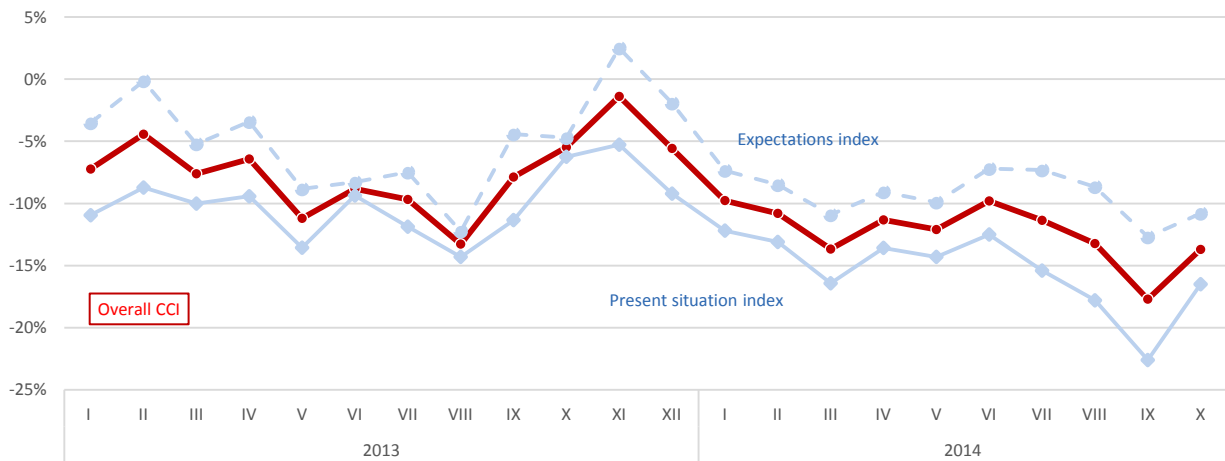


**Chart 3.** Annual growth and contribution of main export products (September 2014). Note: the width of each bar represents the share of the corresponding product group in the overall exports.

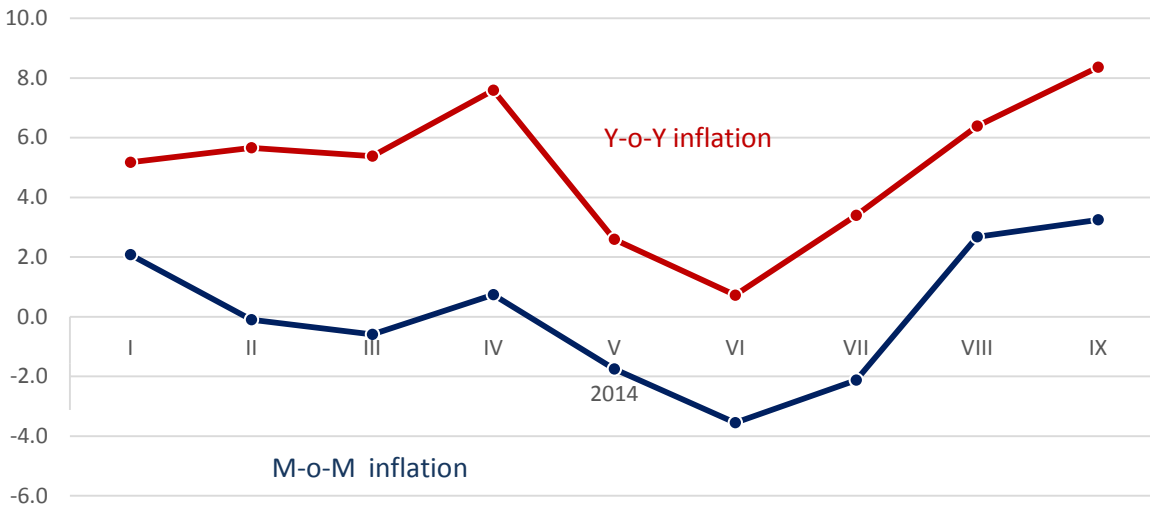
Source: GeoStat

## Internal demand

Weakened internal demand could be another explanation for the economic slowdown in September. Consumer confidence dropped to its historic minimum during the month, principally because of rising food costs (see **Chart 4**). CPI inflation reached 4.8%, in which food and non-alcoholic beverages contributed 2.56 percentage points. As **Chart 5** shows food inflation has been increasing since July in both month-on-month and year-on-year terms.



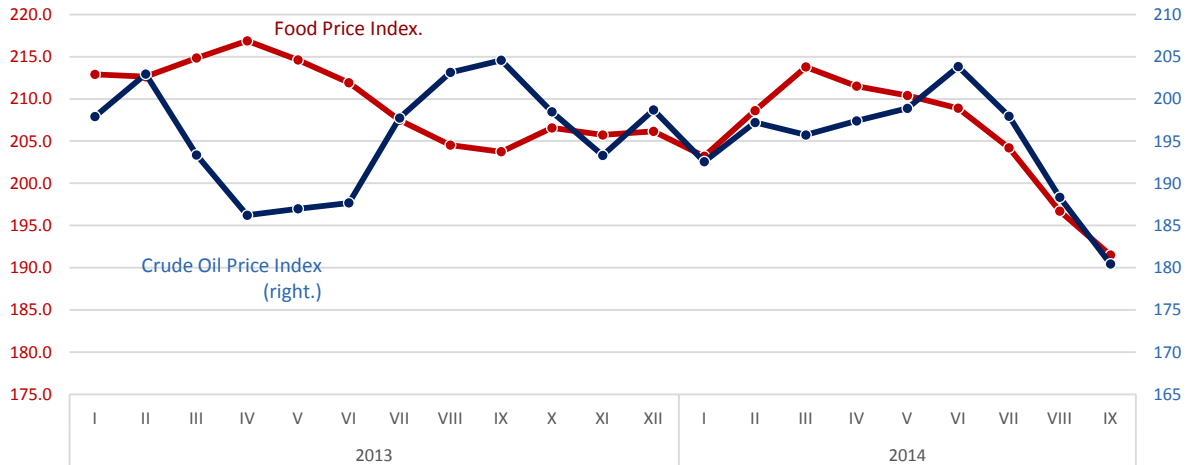
**Chart 4.** Consumer confidence index



**Chart 5.** Inflation of food and non-alcohol beverages

*Source: GeoStat*

The food price inflation is somewhat puzzling. Georgia imports a large share of its food needs. The Food Price index and Crude Oil Price indices had been on an increasing trajectory worldwide since January 2014, but declined abruptly between June and September, causing inflation rates and food prices to fall in some countries in Europe. Interestingly, this global price decline has not yet been translated into lower food prices in Georgia. The low pass-through rate of global prices (particularly downward prices) can be a sign of transmission bottlenecks. However, it is likely that a decline in global commodity prices will eventually translate into lower domestic prices that will result in improved consumer sentiment and boosted demand.

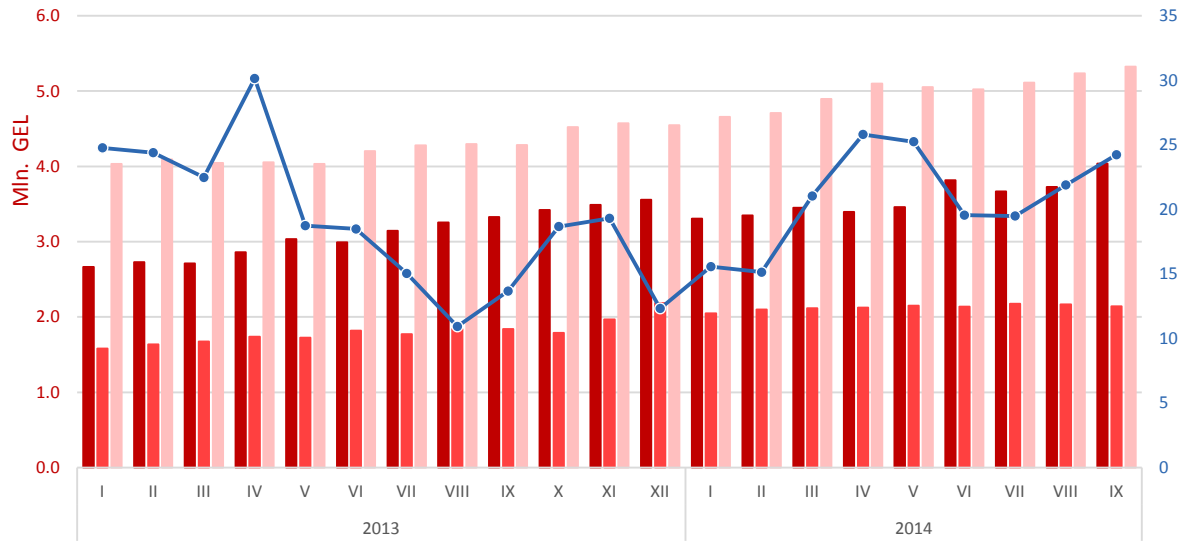


**Chart 6.** Food Price and Crude Oil Indexes

Source: [www.fao.org](http://www.fao.org), [www.indexmundi.com](http://www.indexmundi.com)

Also contributing to weak internal demand is the fact that electricity consumption by households and businesses is down – the annual growth of electricity consumption amounted to only 1.7%.

Also, the data shows that Georgians have been saving more in recent months - putting more money into longer-term time deposits. Year-on-year growth of time deposits amounted to 24.2% in September. Despite the growing amount of savings, interest rates on deposits have not declined in any significant way; moreover, they somewhat increased in September to 6.2% relative to 5.8% in August. This, perhaps, reflects the simultaneous increase of both the supply of deposits (from households and businesses) and the demand for deposits (from banks).



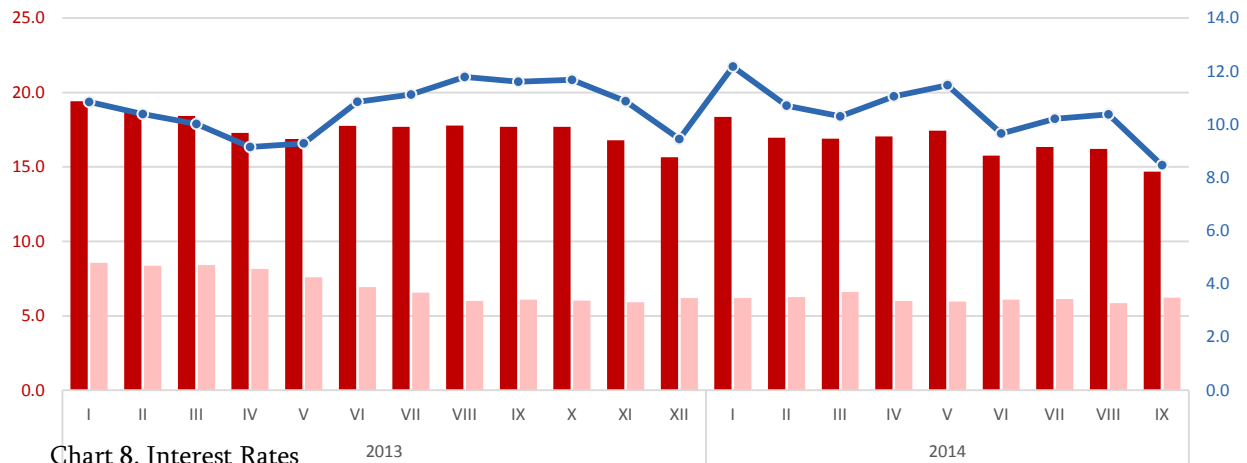
**Chart 7. Deposits**

Source: GeoStat

■ Current Accounts      ■ Demand Deposits  
■ Time Deposits      —●— y/y growth of time deposits (right)

on

On the other hand, the interest rate on loans fell in September to below the “psychological threshold” of 15% for the first time in years. More specifically, the interest rate on loans dropped to 14.7% in the reporting period, which is the lowest recorded level for the past 12 years. Borrowing has become cheaper than it has been for a long while. We can thus expect economic growth to pick up in the future.



**Chart 8. Interest Rates**

Source: GeoStat

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