

Macro review, March 2014

The frenzied seasonal agricultural activities – purchases of plants, seeds, fertilizers, investment in food processing, as well as the upcoming elections, invigorated real economic activity in March 2014. According to the GeoStat primary estimates, in this month the y-o-y real economic growth reached 8.3%. As a result, primary growth rate for the first quarter of 2014 increased to 7.4 %.

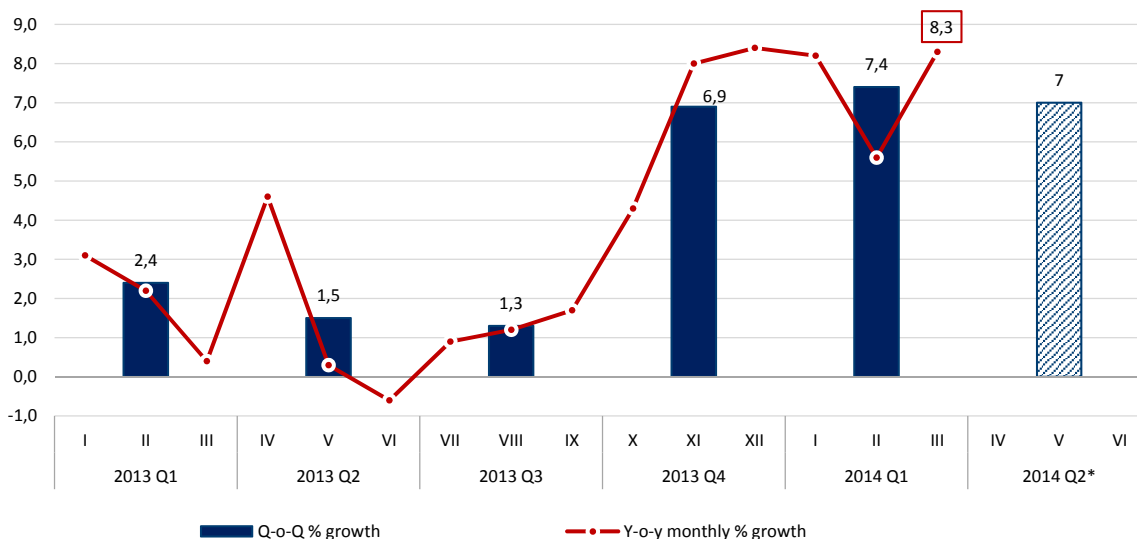


Chart 1. Y-o-y monthly (red line) and q-o-q (blue bars) % growth rate of real GDP. Growth rate for Q2 for 2014 represents ISET-PI Forecast (* dashed blue bars). Source: GeoStat, ISET-PI

As encouraging as the figures look, the important question is whether growth is driven by the increased business activity or an increase in private household consumption? Unfortunately, at this point there is no solid evidence on which one could base an answer to this question. The data on the breakdown of GDP by categories on a monthly basis is simply not available. We have reasons to believe, however, that March growth is driven at least in part by higher consumer spending, and in that sense may be short-lived. The business activity has picked up as well, but the relative importance of these two growth components in GDP is yet to be ascertained.

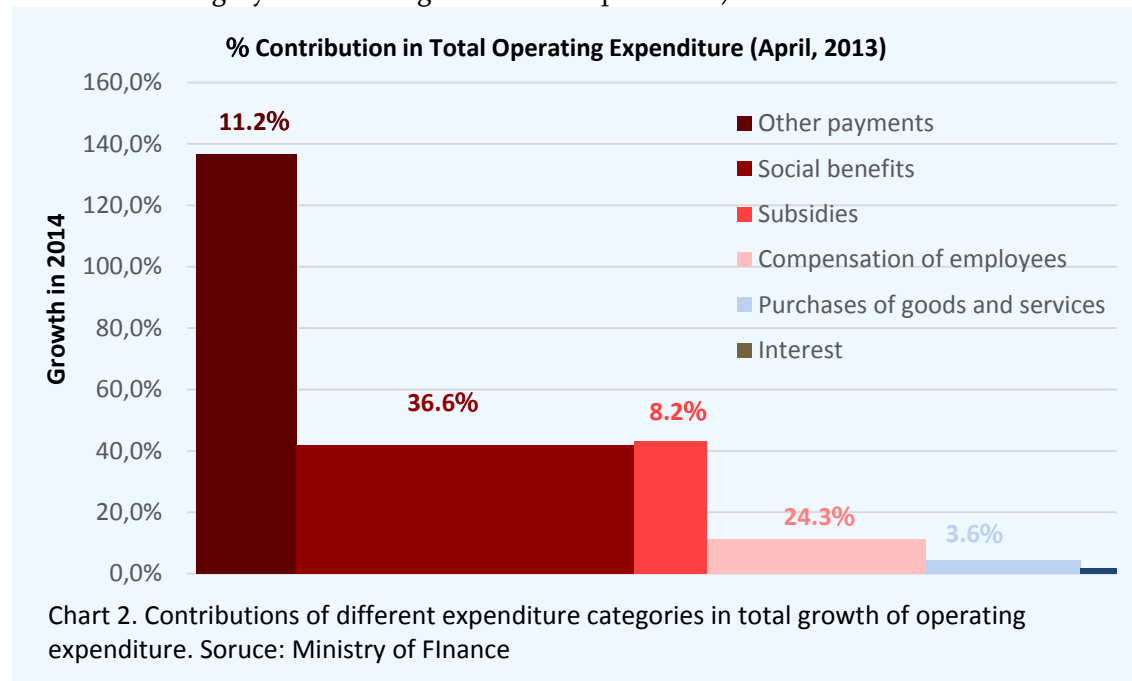
In addition, the high growth in March 2014 can be driven by the “base effects”: as we know, the economy grew by very little (0.4% y-o-y) in March 2013, and in that respect the GDP this year is increasing from a lower base level.

Minimal Tax Refund

The policy to refund taxes based on the non-taxable income minimum started in April, 2014. Since this is a lump sum transfer to relatively low-income families, it is quite reasonable to suppose that these families will use the money largely to finance every-day consumption. Even though the largest effect on consumption spending is expected in April, in March the anticipation of the refund may have already caused some increase in spending against the future income.

Elections effect

Increased economic growth could also be attributed to the approaching June 2014 election. The elections spending provides a temporary boost to disposable income. One can see some of this effect reflected in the Government Operating Expenditure, which increased by 37.6% y-o-y bases. The contribution of the *Other Payments* and *Social Benefits* to this growth are respectively 15.32 and 15.28 percentage points. On Chart 2, the area of each rectangle represents contribution of each expenditure category to the total increase in government operating expenditure (y-o-y growth multiplied by the share of the category in the total government expenditure)



Low hopes of consumers:

Despite the increases in the current or expected future disposable income, the **Consumer Confidence Index** continued to decline and reached its historical minimum in March 2014. Partially this could be the result of a decline in the overall consumer incomes in March. For example, the general budget analysis shows that in March **income tax revenues** decreased by 8.1% y-o-y, contributing 2.3 percentage points to the total 3.7% decline of general budget revenues. In the same time, the expected tax refund program and election spending may have been correctly perceived by consumers as only a temporary boost to their incomes, and therefore were not reflected in the March consumer confidence index.

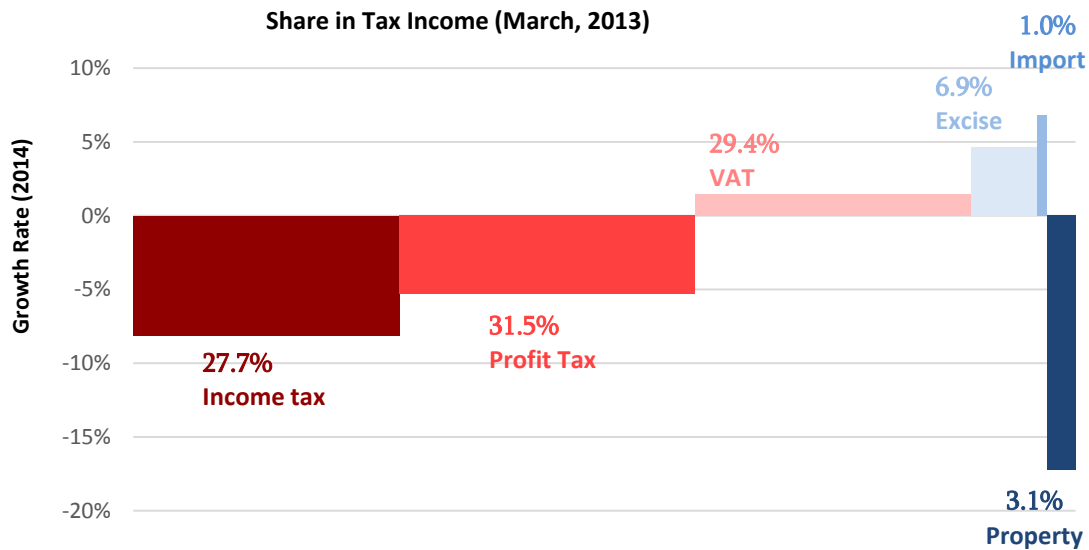


Chart 3. Contributions of different income categories in total decrease of operating income.
Source: Ministry of Finance

Increased real economic activity

Another reason behind March growth is an increase in the real economic activity due primarily to the **seasonal agricultural work**. At this time of the year nearly 54% percent of the population (those who are employed mostly in agricultural sector), invest in food processing and land cultivation. In addition, in 2014 the “Smallholder farmers support program” proposed by Ministry of Agriculture provides almost all small farmers with monetary support to cultivate their land. As a result, even those people who were not able to cultivate land before are involved in the food processing activities. This of course increases real output growth.

Besides, one of the indicators of real economic activity, the **VAT turnover**, has increased in March. According to the GeoStat primary estimates VAT payers’ turnover increased substantially by 19.6% in y-o-y terms.

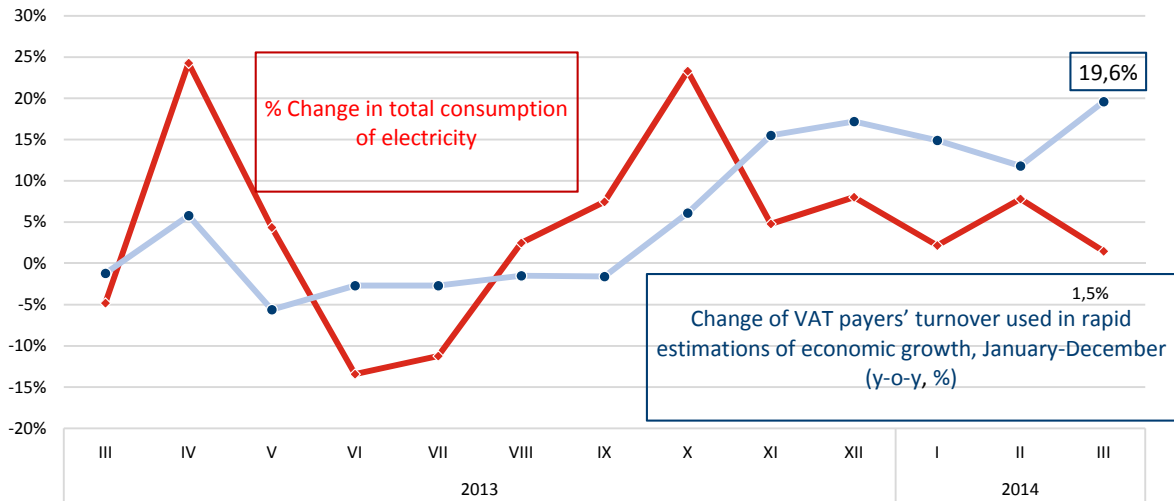


Chart 4. Source: GeoStat, ISET-PI

The appreciation of **real effective exchange rate** in January 2014 – March 2014 period would imply that exports from Georgia were becoming more expensive for foreigners, while imports were getting cheaper. And yet, the **external demand** continued to be strong during this time. In particular, the share of export in total turnover increased in 2014.

On the graph below we can see that real appreciation also occurred last year during the same time period. This can be explained by seasonal patterns. Planting season increases the demand for agricultural inputs and may increase the demand for Lari vis a vis the foreign currencies. Besides, upcoming tourism season could also have effect on Lari appreciation.

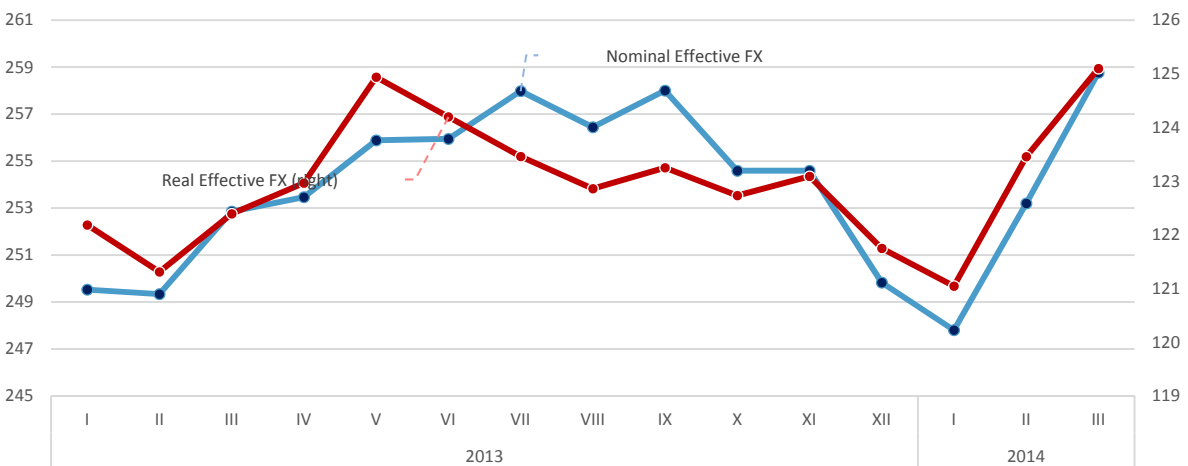


Chart 5.

However, despite real appreciation, the y-o-y **exports** in March 2014 increased by 23.8%. It is worth noting that export of wine, natural juice and mineral waters increased significantly in March as well. Y-o-y **imports** increased by 15.9%. Typically an increase in import is a sign of strong aggregate demand for goods and services.

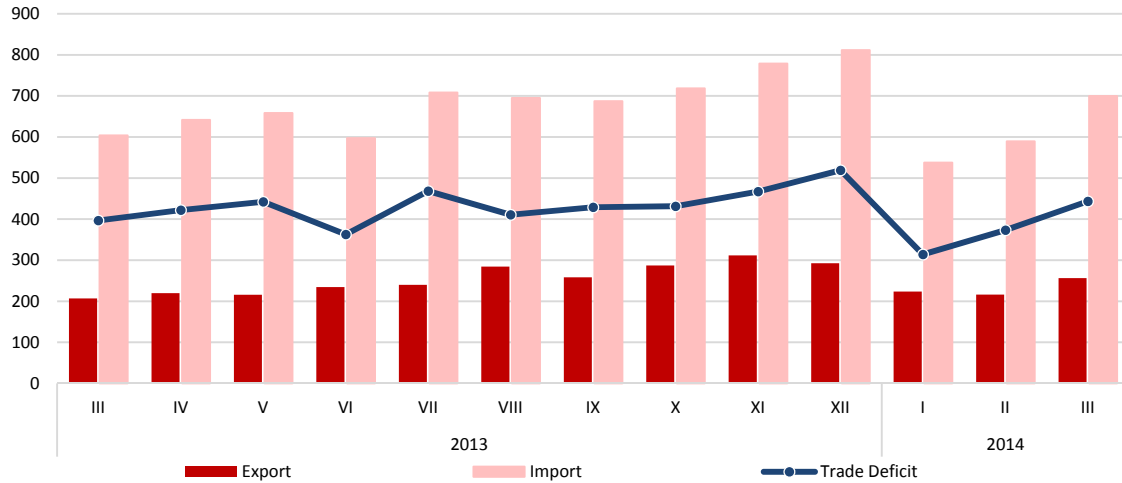


Chart 6.

What to expect for April:

Given that the *Minimal Tax Refund* policy kicked in on the 1st of April and nearly 865 million GEL have already been refunded by May 8th, we would expect a strong increase of consumption expenditure in April. Of course, people typically save some fraction of their disposable incomes. However, given that the people receiving the refund are mostly low-income families, it is likely that the entire amount will be spent on consumption goods, or possibly will go towards paying the existing debts.

Based on the Consumer Confidence Index data for April, the present situation and the expectations about the future started improving relative to the March minimum.

Based on these data, one would expect growth patterns in April to be at least as strong as in March 2014.

