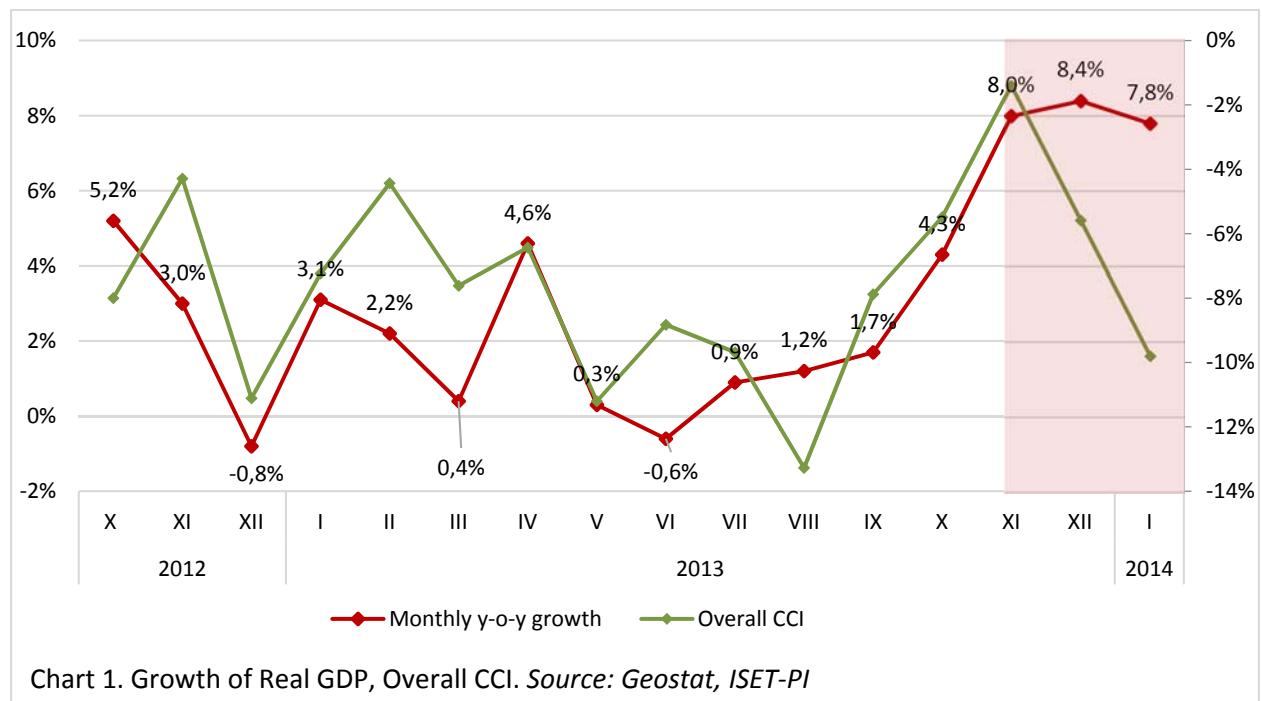


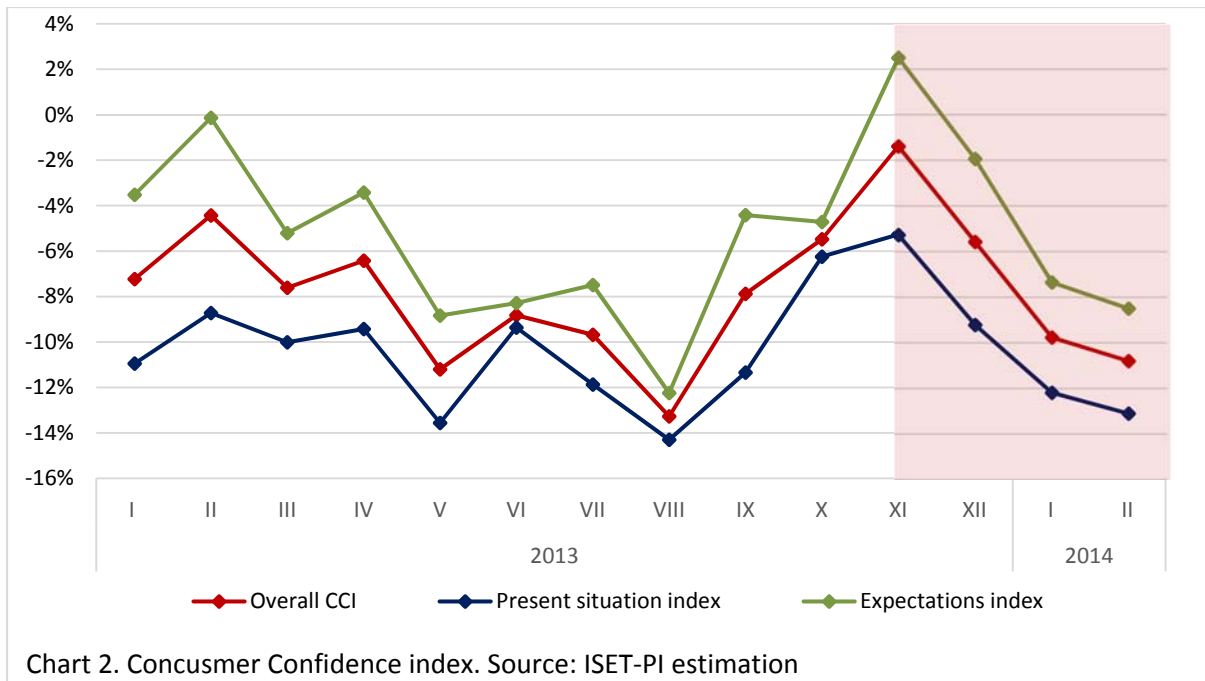
Macro Trends in January 2014

After the reaching negative growth in June 2013 the y-o-y growth of real GDP started to improve slowly and already in November, 2013 the growth rate catch up its previous 2011-2012 higher numbers. According to the GeoStat primary estimations, average growth rate of previous three month (November, December 2013 and January 2014) is approximately 8.1% (see Chart 1).

Does the high numbers of growth translate into stable growth in the future?



One of the corner point of the higher growth is how fast it will trickle down to society. According to the Consumer Confidence Index (CCI), worked out by ISET-PI, despite the higher growth started from the November, 2013 the overall CCI started deteriorating significantly (see Chart 2).

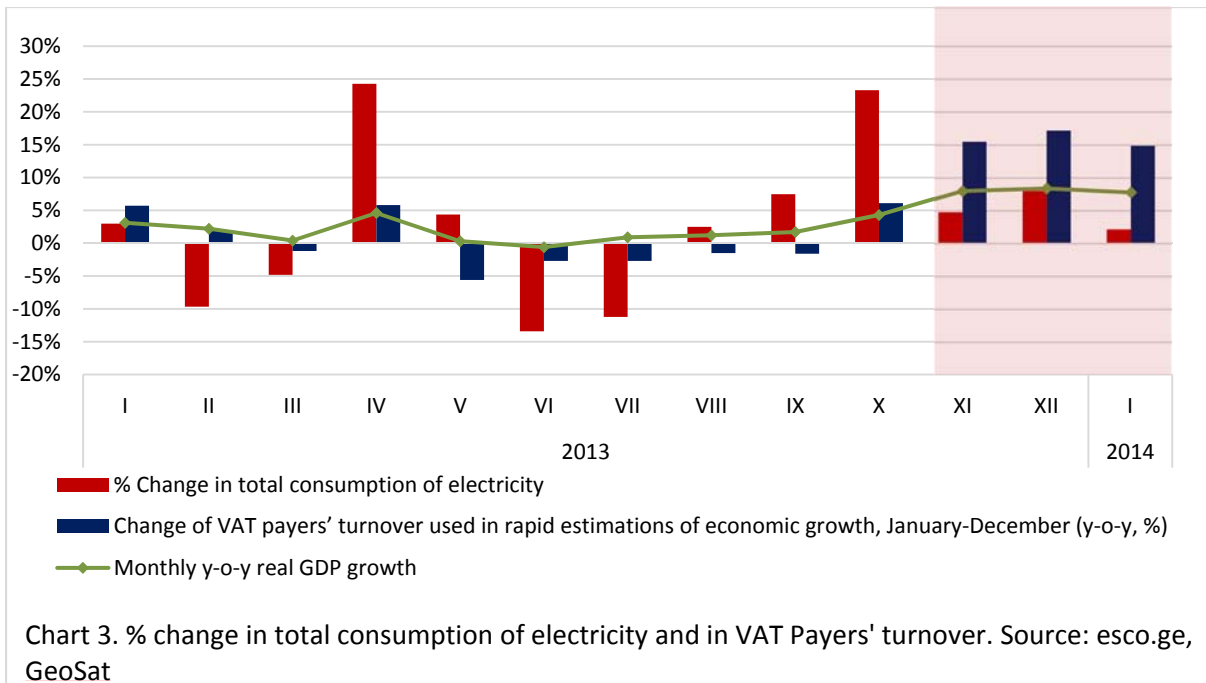


From the Chart 2 it's obvious that Georgian consumers are not feeling the "gain" despite high growth indicators. There are a couple of possible explanations:

At first glance, observing the opposite evolution of real GDP growth and CCI, the layperson "conspiracy theorists" would claim that GDP numbers are "cooked" to make the economy look good.

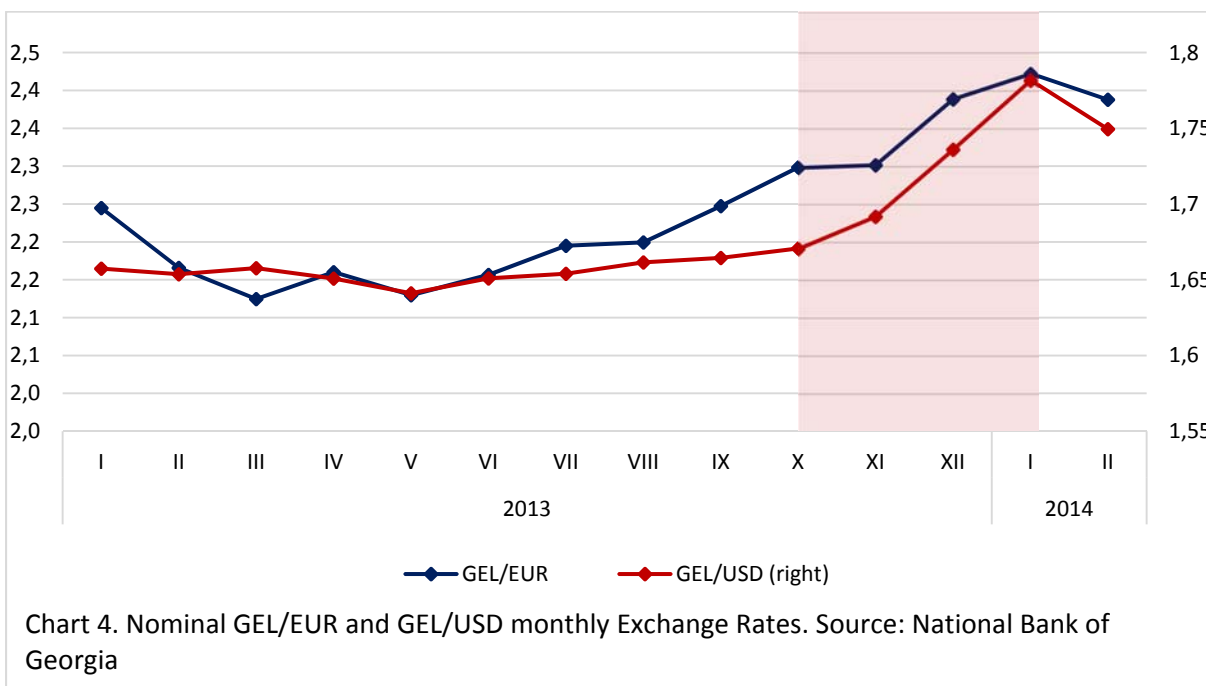
However, if one remembers significant dip in output last year which started in the fourth quarter of 2012, than it will be clear that the growth rate numbers reported by GeoStat are high in relative terms. As ordinary people may be reacting to the lack of significant progress in absolute terms the CCI data does not correspond to the relative change of real GDP. This creates perception that numbers are somehow wrong, which they are not.

The reliability of the growth data could be also checked by the VAT turnover and electricity consumption data, which have always been considered as estimation of economic growth direction. In Georgia the high growth rates in (November 2013 – January 2014) are corroborated by the evidence of higher electricity consumption and higher VAT turnover data (see Chart 3).

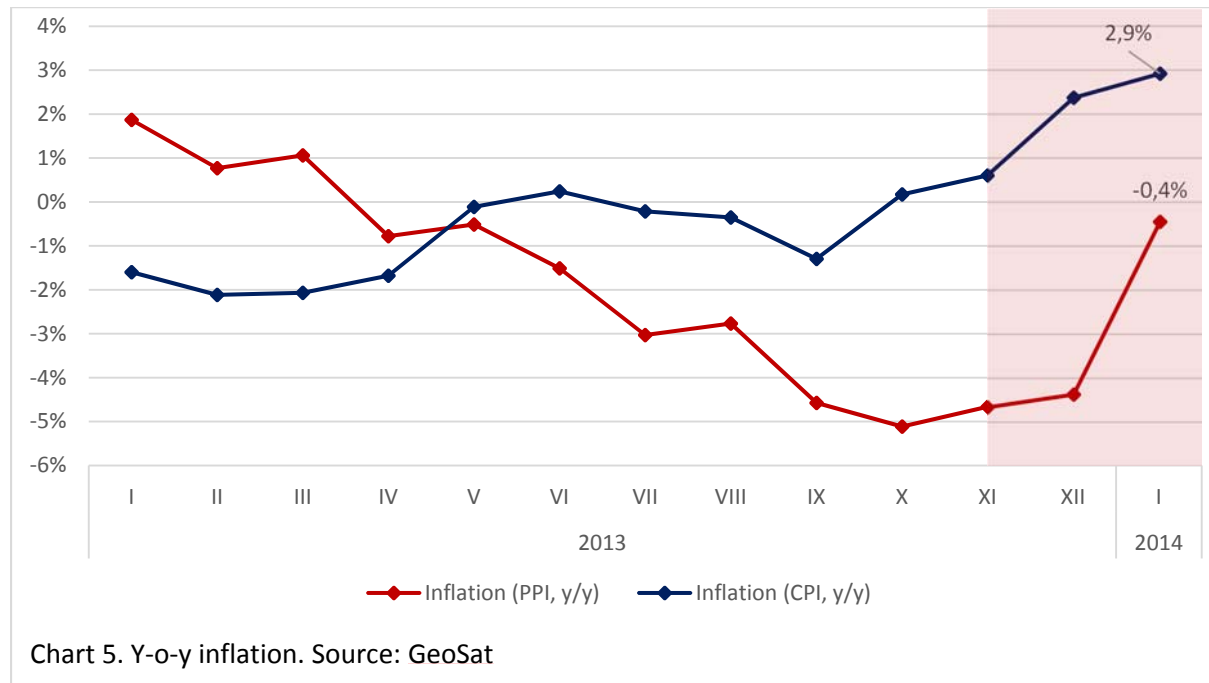


Another reason why people’s perception of present situation and expectations does not follow the upward trend of real economic growth is that these indicators (VAT turnover, electricity consumption) do not directly relate to people every day experience and the perception of well-being. The average person does not observe changes in aggregate electricity consumption, and movement of goods across the border does not directly enter their daily life.

However, what the average person could see in the recent months was a significant GEL depreciation and consequent price increase. The stability of national currency is one of the main indicator that directly affects people's daily lives (see Chart 4).



In particular, significant currency depreciation hit the prices of imported products, which constitutes large part of a typical Georgian's consumer basket. Y-o-y inflation calculated by CPI reached 2.9% in January and Producer prices deflation reduced from 4.4% to 0.4% (see Chart 5).



Beside consumers, the devaluation of GEL would have helped exporters, but hurt importers. Since Georgia is a net importer from the rest of the world, it is understandable that depreciation generated more "pain" than "gain" in the short run.

In this respect there is interesting connection with Business Confidence Index issued in December: last report indicated that Trade sector firms were among the least "optimistic" in the sample. On the question "How has (have) your business activity (sales) developed over the past 3 months?" From the surveyed firms 38% answered that their business activities decreased, while for 46% of companies sales did not change. Contrary to the manufacturing and service sector firms, the retail sector's expectation are also less optimistic. On the question about future expectations: How do you expect your business activity (sales) to change over the next 3 months? 46% of respondent firms do not expect any changes in sales and only 38% of respondent companies believe their sales will increase over the next 3 months. This makes sense, since most traders are importing stuff from abroad, and devaluation would have negative consequences for them.

We can observe the same story using the GeoStat data. After picking up y-o-y growth rate of import in November and December 2013, y-o-y growth rate of import dropped by 6.6 percentage point in January 2014. On the other hand, this depreciation did not result significant increase in export. In January y-o-y export increased only by 13.9%, while for example in December y-o-y growth rate of export was 47.4%. As a result external trade balance deteriorated by 15.4% (see Chart 6).

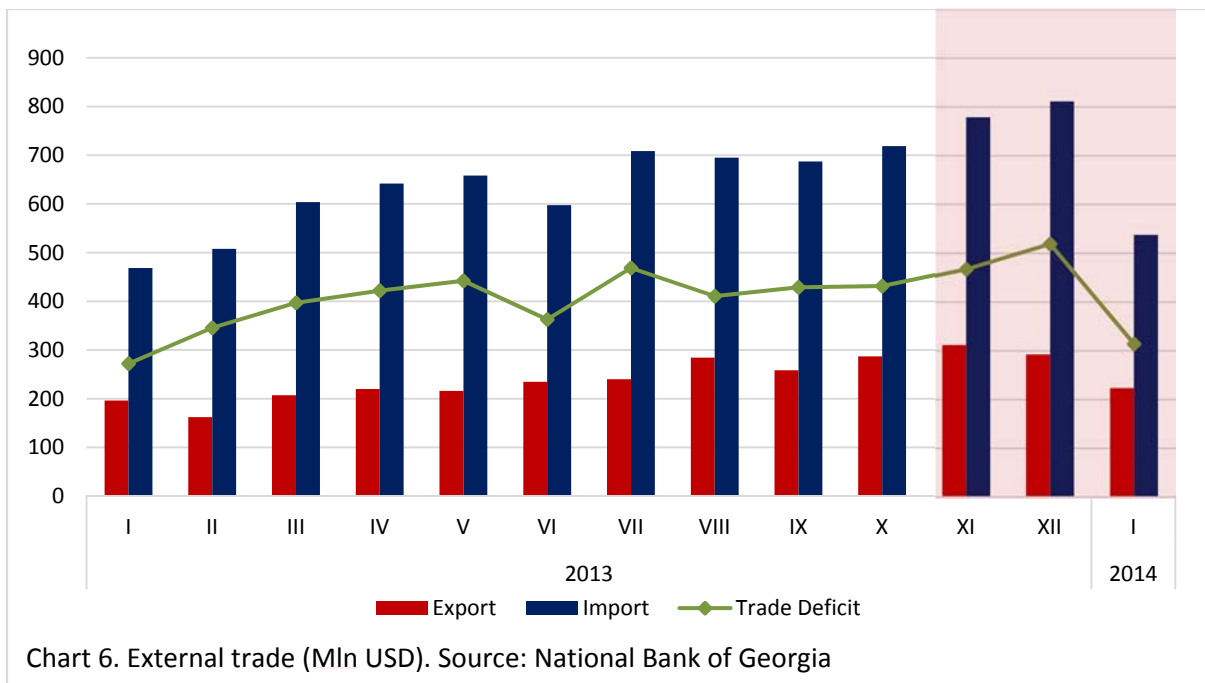


Chart 6. External trade (Mln USD). Source: National Bank of Georgia

Inflation, which is still lower than target inflation of NBS may not be such a big problem for consumers and even it could help recover of the economy. However, Lari depreciation could have higher negative (?) effect on the monetary sector.

In particular, those who have bank loans in USD but receive their incomes in GEL would have felt the pinch. Not surprisingly, in the recent month the dollarization of bank deposits has increased by 3.1 percentage point and reached 58.8%, while the opposite happened to liabilities and the dollarization of loans decreased by 0.5 percentage point and reached 61.8%.

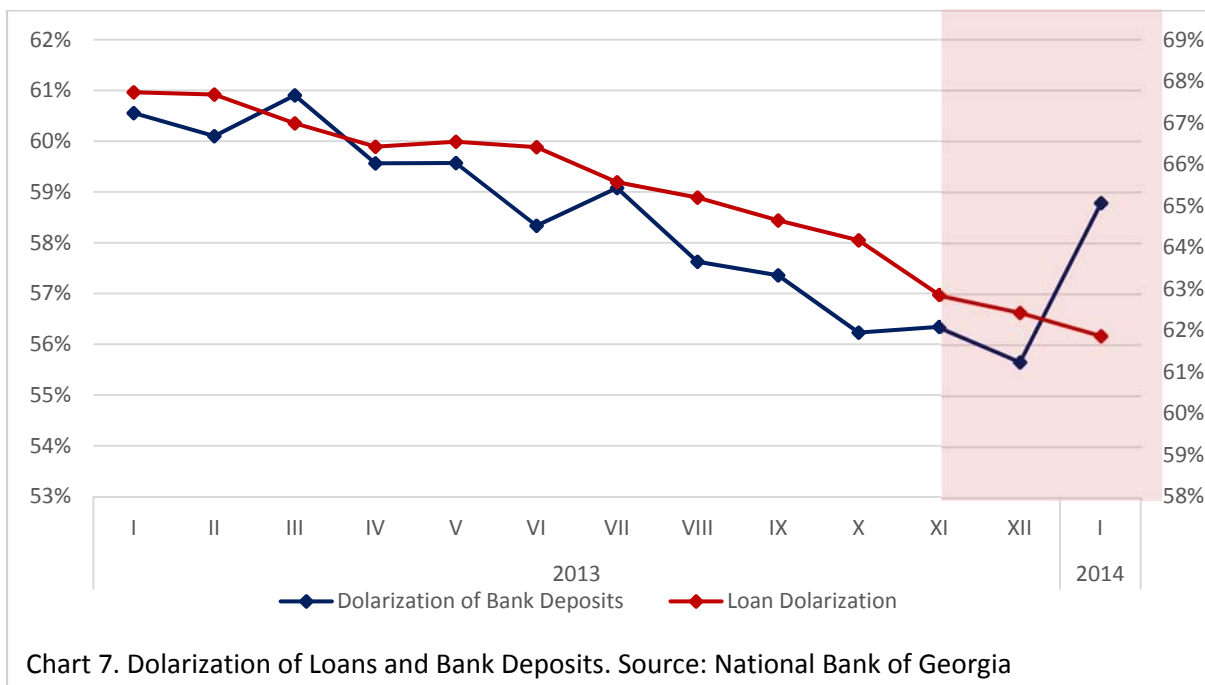
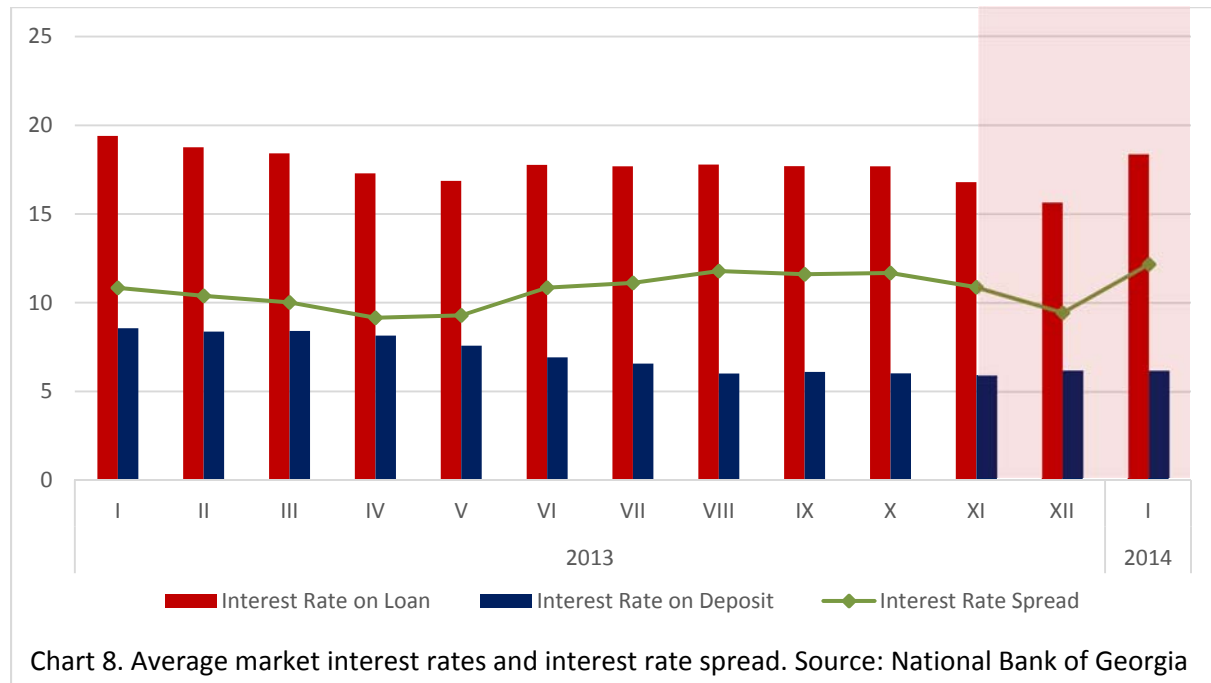


Chart 7. Dollarization of Loans and Bank Deposits. Source: National Bank of Georgia

Besides, in January 2014 interest rates on Loans increased, average market interest rate increased by 2.7 percentage point (see Chart 8). (I am not sure whether we should use or not that two weeks ago National Bank of Georgia raised it refinance rate again by 0.25 percentage point)



Finally, all these abovementioned changes in January 2014 could explain the differences between the upward economic trend and deteriorating consumer confidence. The fact is that in February 2014 CCI continued to decline, which means that the effect of Lari depreciation still are on people's mind. Will this low perceptions about future be reflected into real economic growth it will be known in late March when Geostat will publish its primary estimation of real economic growth of February. Before we should take into account that based on ISET-PI GDP Forecast average growth of first quarter is 5.7, which is much lower than January 2014 real growth.