MACRO REVIEW – MAY 2014

After suffering a temporary setback in April 2014, the year-on-year growth rate in May is back to upper single digits (6.3%). However, macro indicators suggest that the economic landscape has hardly changed between April and May.

This implies that the “base effect” continues to affect the observed growth rate swings. As mentioned in our last publication, the low growth rate of April was due to a spike in output level recorded in April of last year. For the same reason, the higher growth rate in May 2014 is, in part, due to the relatively low output base in May 2013 (namely, in May 2013 there was a 0.0% annual increase of GDP).

Nevertheless, various macro indicators for May show reasonable gains for the economy on the following fronts:

VAT turnover and electricity consumption data, which are good proxies for economic growth, show an increase in y-o-y terms. Compared to May 2013, VAT turnover and electricity consumption for commercial entities are up by 12.2% and 2.9% respectively (see Chart 1).

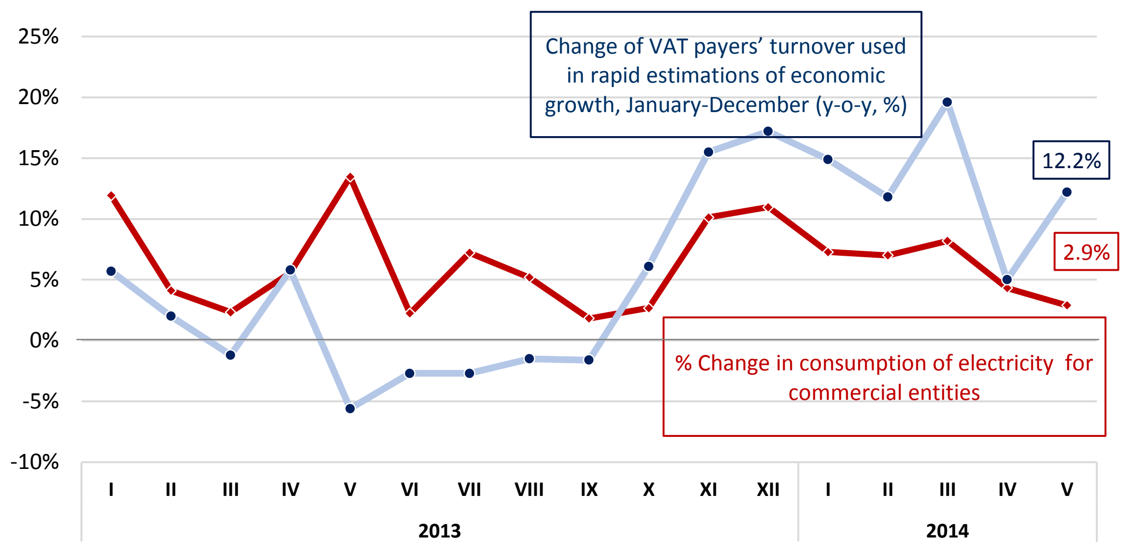

Chart 1: Annual % change in consumption of electricity and in VAT payers' turnover.
Sources: www.energy.gov.ge, www.geostat.ge

Another indicator of improved economic performance is ISET-PI’s Business Confidence Index (BCI). Chart 2 not only reflects past business conditions and business sentiment, but also business expectations for the next three months. Expectations of improved business climate may, in turn, trigger investment and hiring decisions, thus further promoting growth.

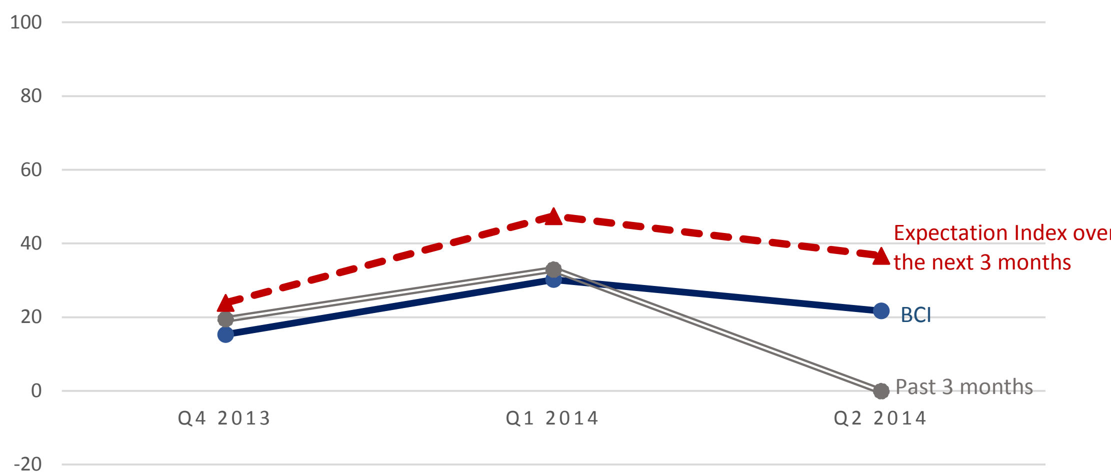

Chart 2: Business Confidence Index
Source: ww.iset-pi.ge

Borrowing/lending is increasing overall, which is good news for the economy. The volume of lending has been increasing for several months at a steady rate (around 14.0% in y-o-y terms). The growth of lending is especially pronounced for households (around 31.0% in y-o-y terms) (see Chart 3).

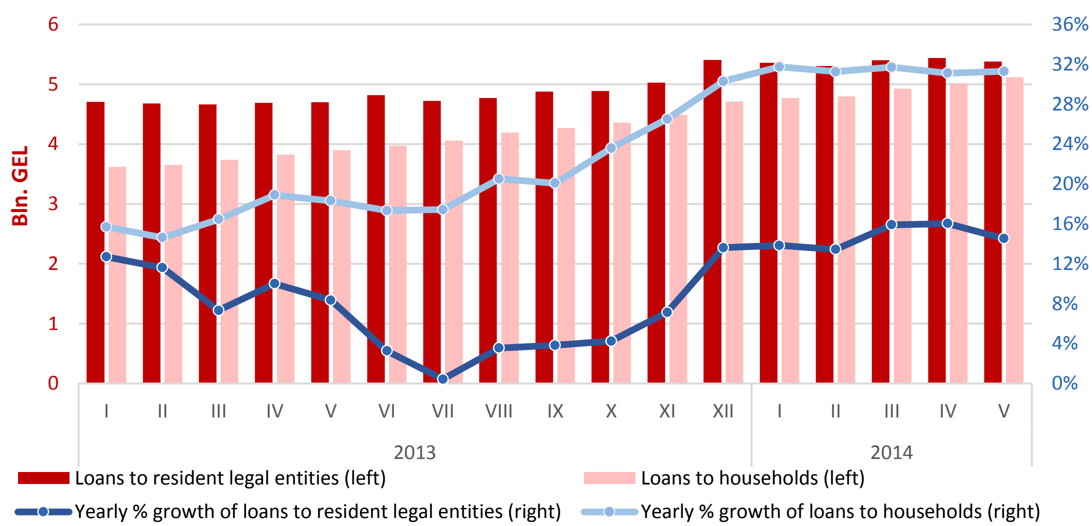

Chart 3: Loans
source: www.nbg.gov.ge

In addition, more and more lending is done in lari rather than USD (loan dollarization rates show a decreasing trend). This is likely due to the relaxed monetary policy stance of the National Bank of Georgia (NBG), seeking to provide domestic currency liquidity to banks in order to stimulate credit and support growth (see Chart 4).

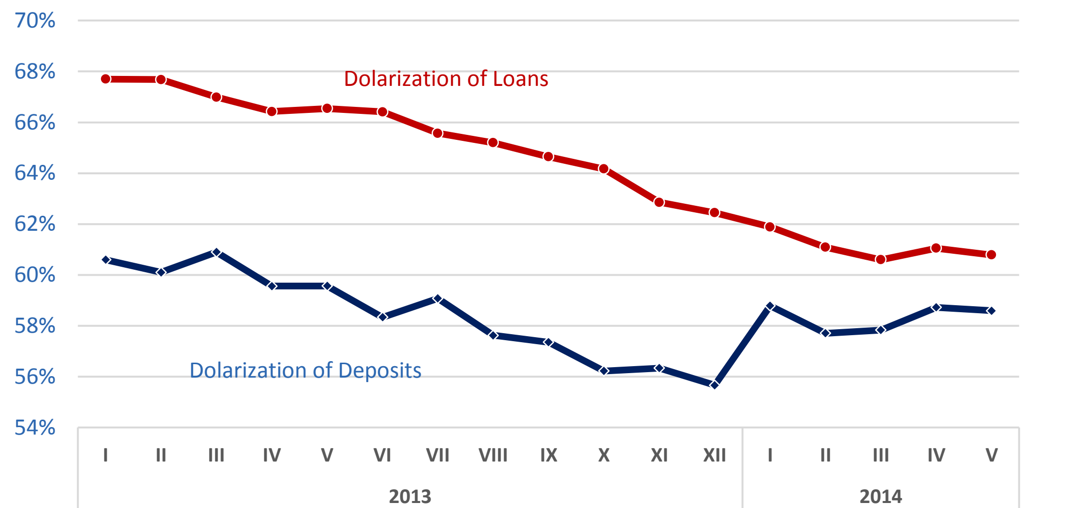

Chart 4: Dolarization
Source: www.nbg.gov.ge

Remittances are back on track after declining in April. The largest increase in remittances was from Turkey (up 52.5% in y-o-y terms, see Chart 5). This increase was likely due to the fact that some of the money flows "came out from the shadows" – moving through the banking system rather than through unofficial cash transfers. In particular, the largest bank in the country, the Bank of Georgia, has recently (January 2014) concluded a service agreement with Aktif Bank in Turkey, which made it cheaper to transfer money from Turkey to Georgia. The increase in official remittance flows from Turkey is likely to reflect these developments.

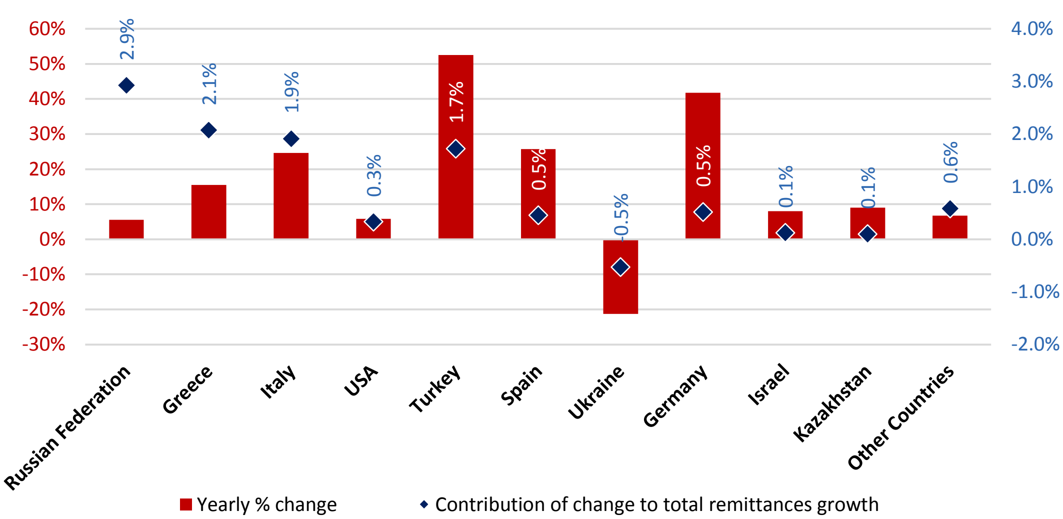

Chart 5: Remittances
Source: www.geostat.ge

In addition, the nominal lari exchange rates against the USD and EUR appear to have stabilized. However, the real effective exchange rate (the ratio of Georgian price level (CPI) to the exchange rate-adjusted price level in the main trading partner countries) dropped sharply in April. This can be explained by the relatively low CPI inflation rate in Georgia and higher inflation in Georgia's main trading partner countries. In particular, inflation in Armenia, Turkey, Ukraine and Russia stood at 3.6%, 9.7%, 10.5% and 7.6% respectively. This implies that Georgian goods became cheaper for foreigner buyers.

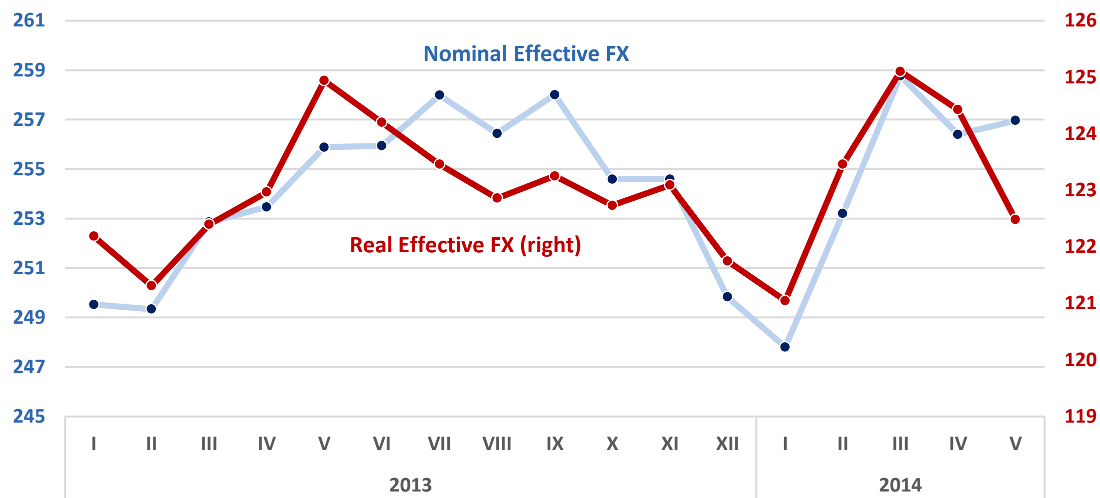

Chart 6: Nominal and Real monthly effective exchange rates (base month: December 1995=100).
Source: www.nbg.gov.ge

The Georgian annual inflation rate remained low. Consumer Price Index (CPI) added 2.4%; Producer Price Index (PPI) is up 1.9% (y-o-y). CPI inflation was low and rather stable, fluctuating in the range of 2.4-3.5% between December 2013 and May 2014.

The National Bank of Georgia's statistics decompose CPI-based inflation into domestic and import price components. Import prices were increasing throughout 2013, while domestic prices were declining, resulting in a negative inflation rate. This deflationary environment was the result of weak demand on the domestic market. In the first quarter of 2014, however, the domestic price component of CPI-based inflation increased for the first time in nearly a year. Domestic prices are also projected to increase in the second quarter of 2014, which may indicate stronger demand on the domestic market. Overall, the end of deflation and resumption of credit growth can be viewed as the most encouraging developments in the first few months of 2014.