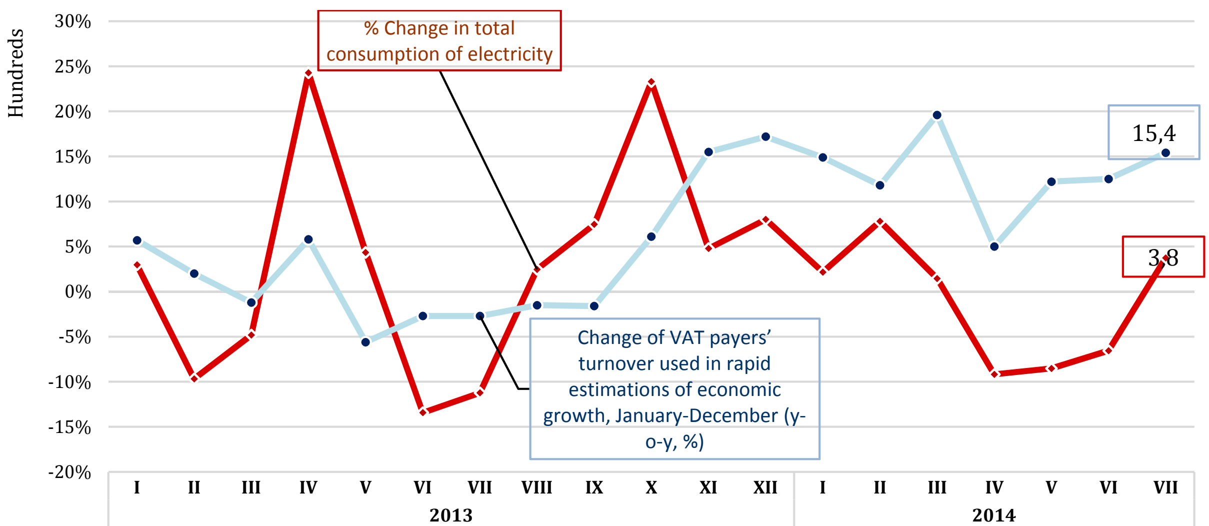
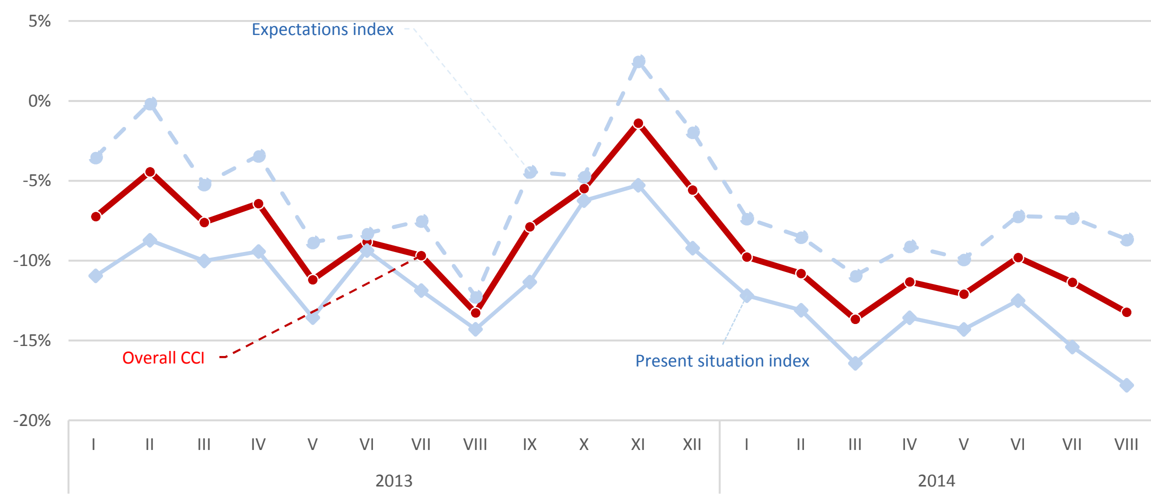
Macro Review September 2014

After a dip in April the GDP growth rate seems to be back on track, the year-on-year growth rate in July was 7.2%. Higher rates of electricity consumption and increase in the change of VAT payers' turnover corroborate this evidence. In July electricity consumption and VAT payers' turnover were 3.8 and 15.4 percent higher compared to the same month in the previous year.

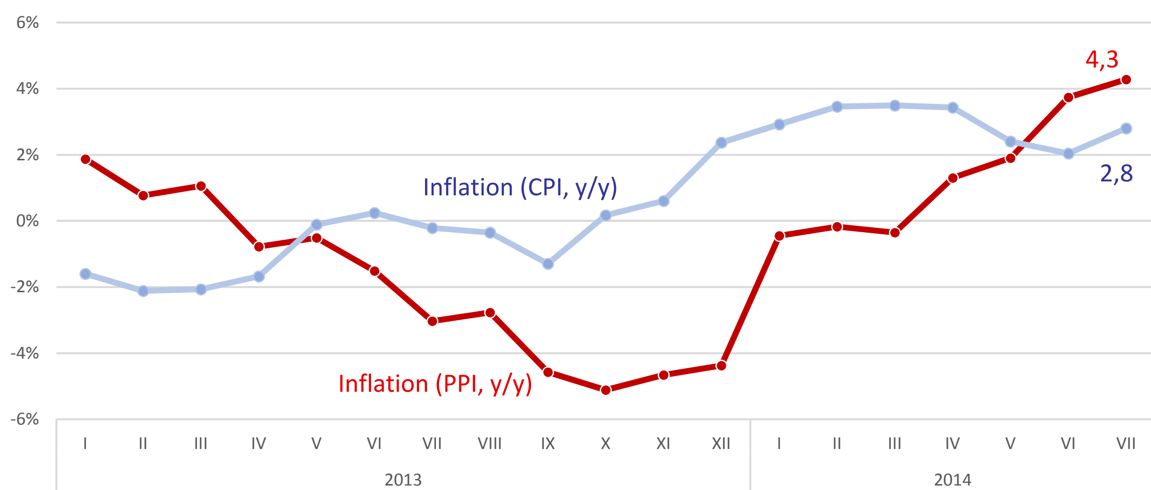
However, the optimistic growth data is not reflected in the consumer sentiment, as captured by the CCI index. In particular, after a slight increase between April and June this year, the CCI Present situation index fell in July and continued falling in August. Why are consumers not feeling the benefits of higher growth? One has to keep in mind that a significant share of population in Georgia is employed in agriculture (typically, subsistence farming), while the GDP growth is driven largely by trade and manufacturing sectors, which command a significant share of GDP - together about 40%, but a much lower share of the overall employment in the country. Therefore, the gains in these sectors are unlikely to be immediately reflected in the gains of self-employed rural population.



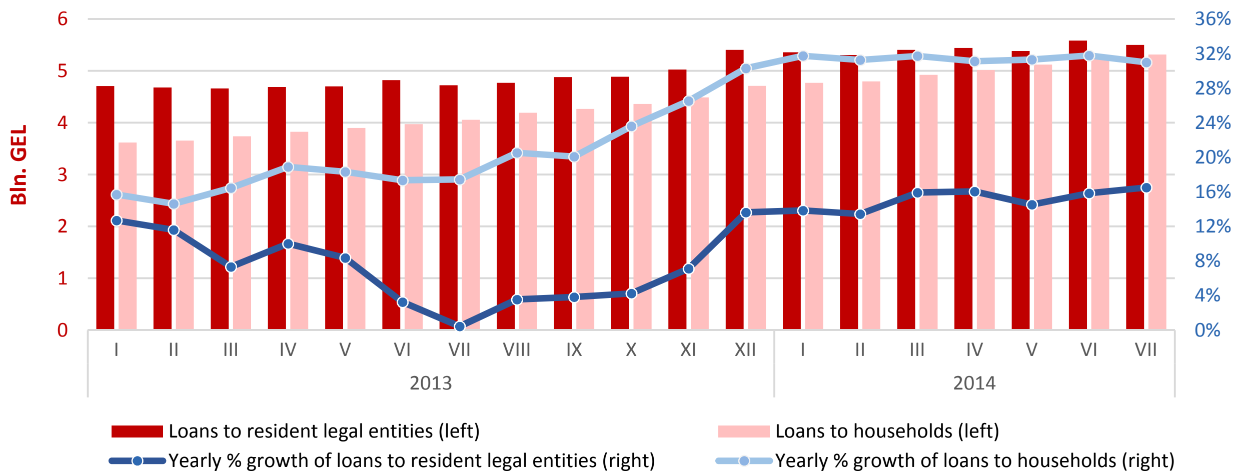
Source: Geostat, www.esco.ge



The producer price index was increasing in year on year terms, and in July the PPI-based inflation reached 4,3%. This was most likely reflecting the higher demand for inputs, which itself is a good news for the future production. After a slight decrease in the inflation rate in May and June, in July it increased up to 2.8%. Although the consumer prices are higher, the inflation rate is still well below the target set by the Georgian National Bank. Moreover, the CPI inflation has been stable during the year, which is overall a positive indicator.

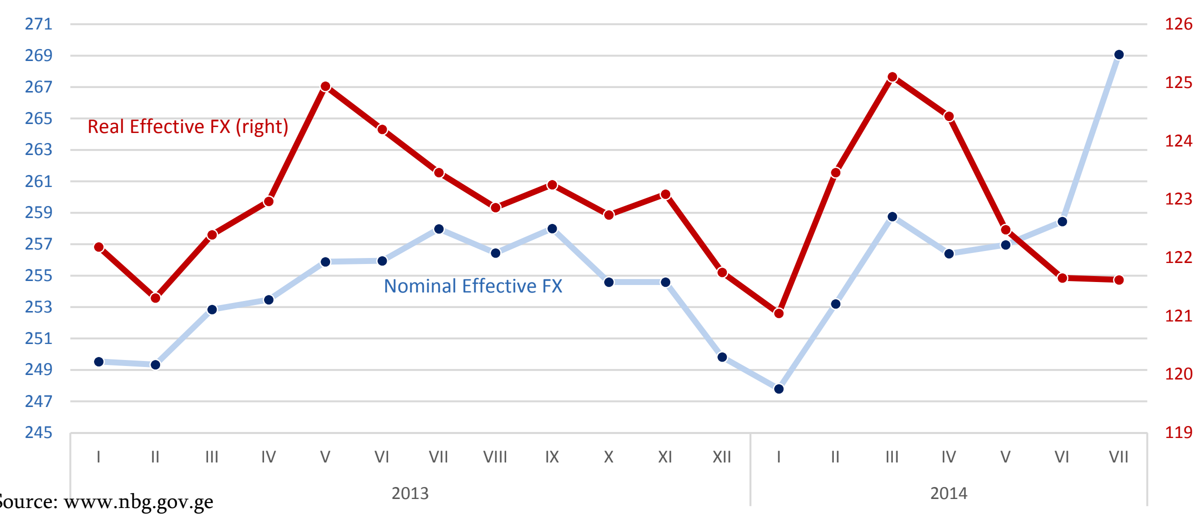


The total amount of loans to households and legal entities increased since the beginning of 2013, but the loans to households tend to grow faster. The amount of loans, to both households and legal entities, have changed very little since the beginning of the year, but there was a noticeable shift in the level of lending between 2013 and the 2014 (starting from December 2013).



source: www.nbg.gov.ge

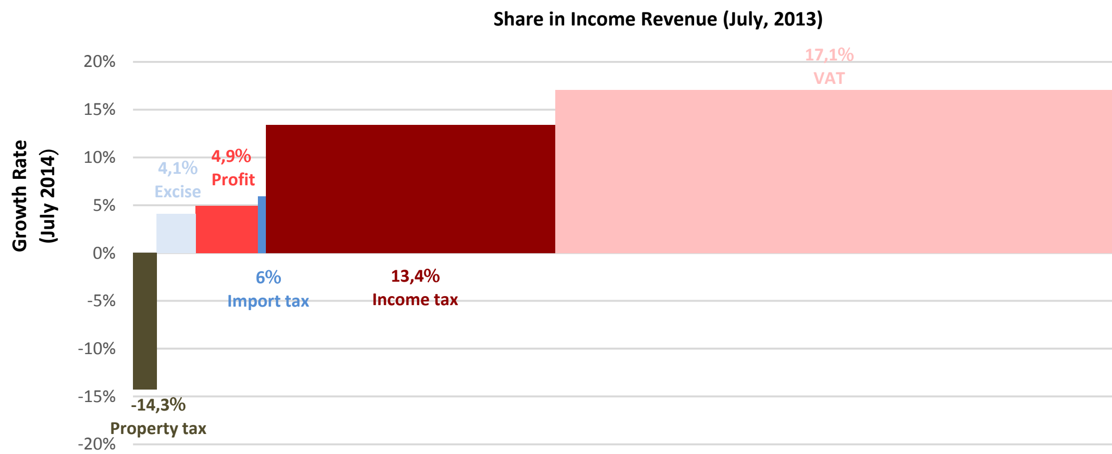
On the foreign exchange market, we see real effective depreciation of the GEL since the March peak. Lower purchasing power of GEL makes it easier for foreigners to buy goods in Georgia. Moreover, the higher inflation rates in the trade partner countries (i.e. Turkey 8.8%, Russia 7.05%, and Ukraine 6.8% January-July average) compared to Georgia affect the real exchange rate, and make Georgian goods cheaper for foreigners. At the same time, GEL has in fact appreciated quite sharply in the nominal terms (vis-a-vis the 14 trade partner countries' currencies). This can be explained by nominal depreciations in Euro as European Union is one of the main trade partner for Georgia, namely European countries collectively accounted for about 26.5% of Georgia's trade turnover in the second quarter this year.



Source: www.nbg.gov.ge

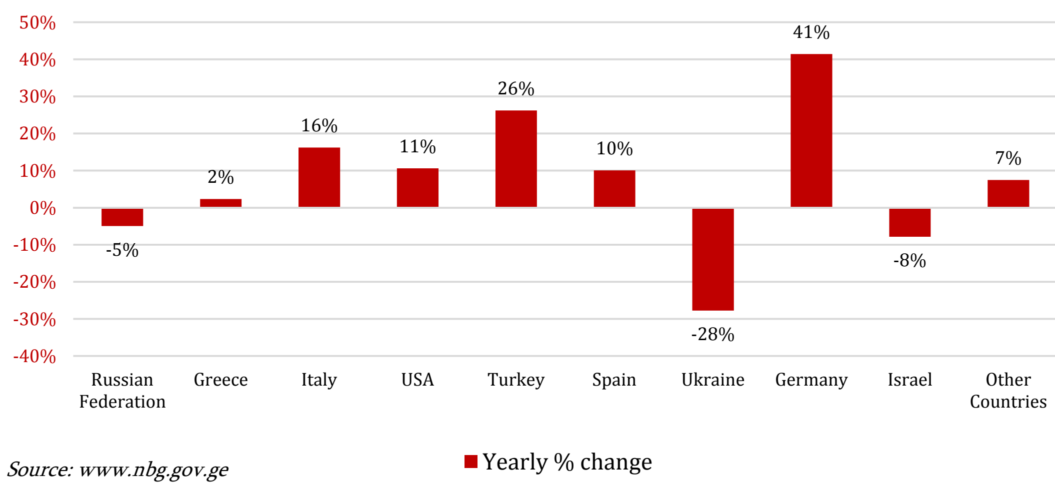
July was the month of high VAT growth. Given the importance of VAT taxes in the government revenue, the VAT contributed very significantly to budget revenue growth in

July. Other types of taxes, on the other hand (property tax, excise tax, import tax and even profit tax) contribute very little, due to their insignificant share in the total government tax revenue. For policy makers looking to simplify the tax code to promote investment, these would be the areas where the abolition of taxes (reduction of tax rates) would be least painful from the budgetary perspective.



Source: Ministry of Finance

The remittances from other countries continue to teeter on the edge – with largest absolute decline coming from Ukraine, and the largest increases from Turkey and Germany. However, the share of these countries in the overall remittances is pretty small - hence, they don't influence the overall remittance growth very much. On the other hand, the light decline in the remittances from the largest remitting country, Russia (less than 5%), had a much larger impact on the remittance growth.



Source: www.nbg.gov.ge