Authors: Yaroslava Babych and Giorgi Mzhavanadze

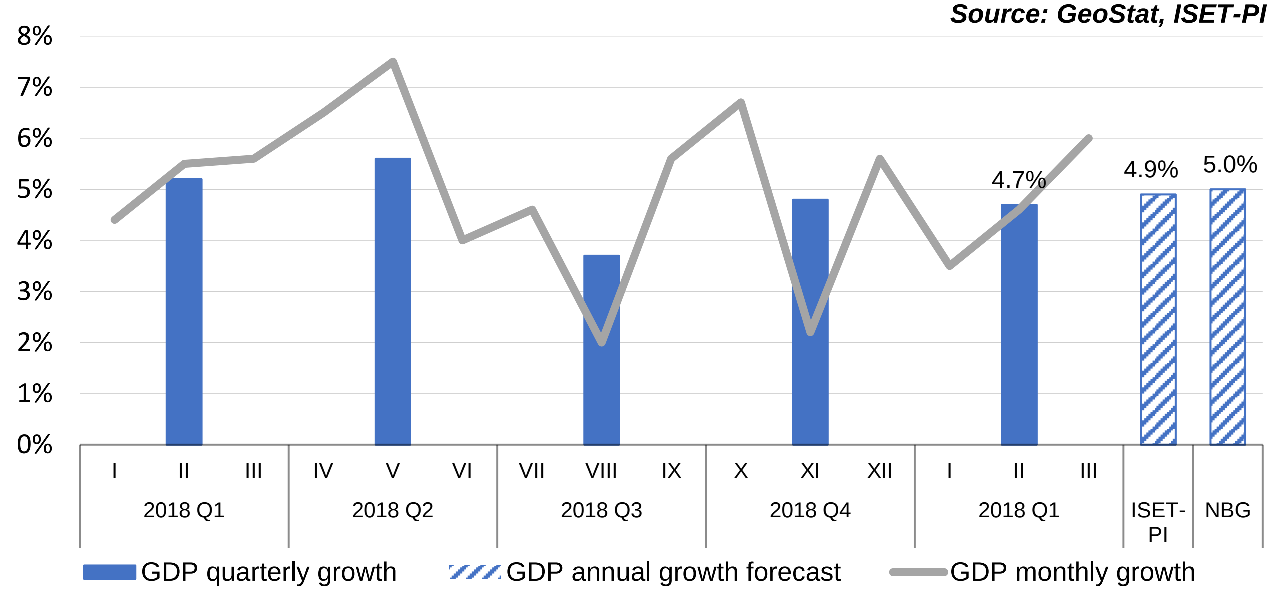
Georgian economy in Q1: the calm before the (possible) storm

Economic Growth

According to Geostat's rapid estimates of GDP growth, Georgia's economy continues expanding at a moderately high pace, reaching 4.7% in the first quarter of 2019. Geostat's Q1 growth figure fell below the National Bank of Georgia's (NBG) 5% projection for annual growth in 2019. Meanwhile, based on the March data, ISET PI's annual GDP growth forecast was 4.9%.

The main external driver of GDP growth in the reporting period was increasing net export, while remittances from abroad and tourism inflows had a limited impact in Q1 2019. Fiscal stimulus was the main internal factor which accelerated the economy, while deteriorating business sentiments and the new wave of credit regulations had a negative impact on growth. The further worsening of the economic situation in Turkey caused by currency crisis and political instability is the main potential risk for economic growth in 2019, transmitting through the trade, remittances, and tourism channels.

Real GDP Growth, ISET-PI Forecast, YoY Change
Source: GeoStat, ISET-PI



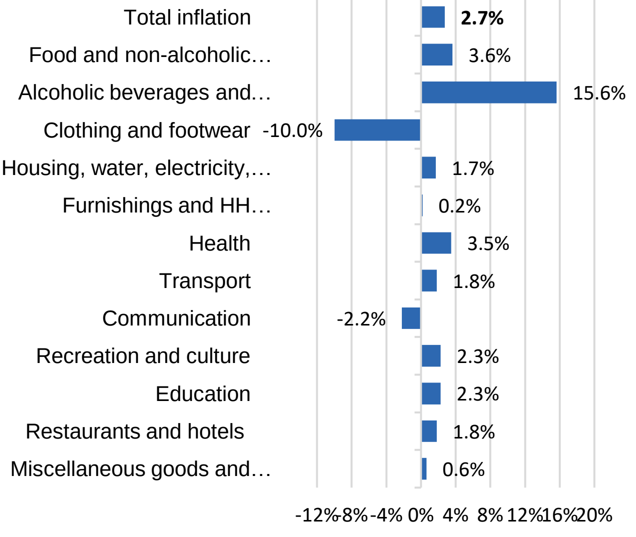
Inflation

In Q1 2019, the CPI inflation rate fluctuated around the targeted level as the new increase in the excise tax rates on tobacco products was balanced by downward pressure on inflation from weak aggregate demand. Overall, the annual inflation in January-March stood at 2.7% YoY.

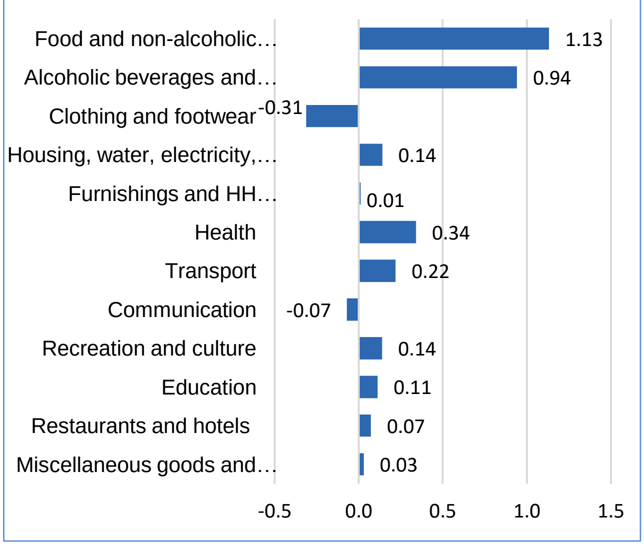
Driven by higher bread prices, inflation of Food and Non-alcoholic Beverages reached 3.6% YoY. Together with alcoholic beverages and tobacco products (+15.6% YoY), these categories contributed 2.1 percentage points (pp) to overall CPI inflation. Prices of clothing and footwear dropped by 10% YoY. This decrease is explained by the depreciating Turkish lira, as Turkey remains the main import source of textiles and apparel in Georgia. Together with communication (-2.2% YoY) these categories drove annual inflation down in Q1 2019 (contributing -0.4 pp to total inflation).

The Monetary Policy Committee of NBG met two times in Q1 2019. Each time, the NBG decided to cut the refinancing rate by 25 basis points. This decision was explained by the fact that “the demand-side inflation pressure is still weak, as are the macroeconomic risks coming from the external sector.” Furthermore, the slowdown in retail lending is pulling inflation downwards.

CPI Inflation, YoY Change in Q1 2019
Source: Geostat



Contribution to CPI Inflation, pp in Q1 2019
Source: Geostat



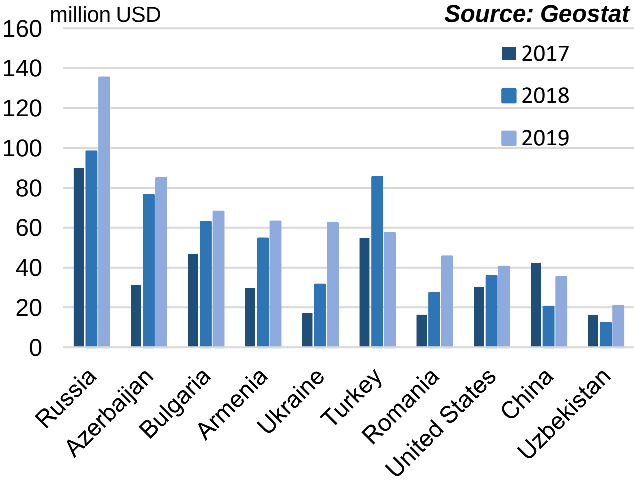
External Sector: Trade, Tourism, Remittances

In the first quarter of 2019, the external merchandise trade of Georgia decreased by 0.1% YoY as growth in exports was overbalanced by a decrease in import figures.

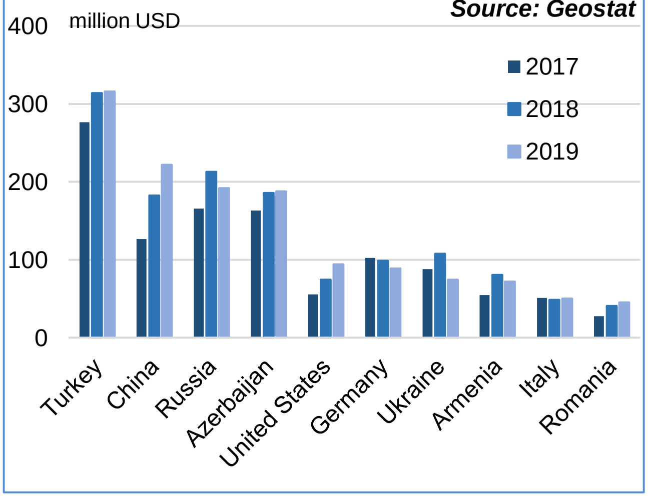
Total exports surged by 12.8% YoY, and amounted to 826 million USD. This growth was driven by higher re-exports of cars (mainly to Azerbaijan), re-exports of copper to EU countries and re-export of medicines. Exports of ferro-alloys, wine, mineral water, and fertilizers also showed high annual growth in the reporting period, while export values of spirituous beverages, tobacco products, and gold constituted a negative change in annual terms.

The main destination markets for Georgian export products in Q1 were Russia (16.4% of total), Azerbaijan (10.3%), and Bulgaria (8.2%). Exports to Turkey contracted by 33% YoY reflecting the economic situation in the country and possible risks for Georgia’s economy. The top ten destination countries for Georgian exports accounted for 74.2% of total exports, underlining the problem of low export diversification.

Top Export Destinations in Q1
Source: Geostat



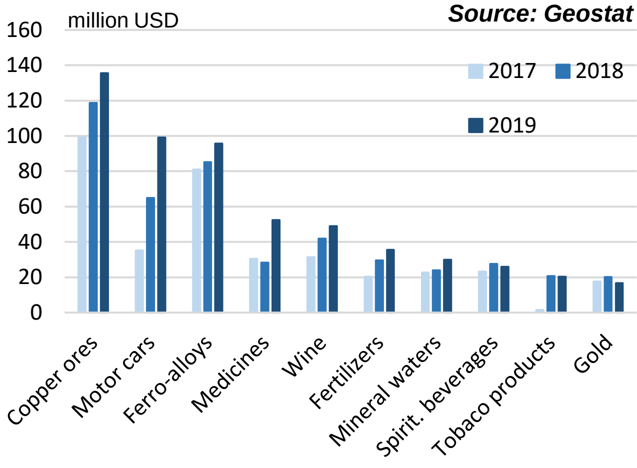
Top Import Source Markets in Q1
Source: Geostat



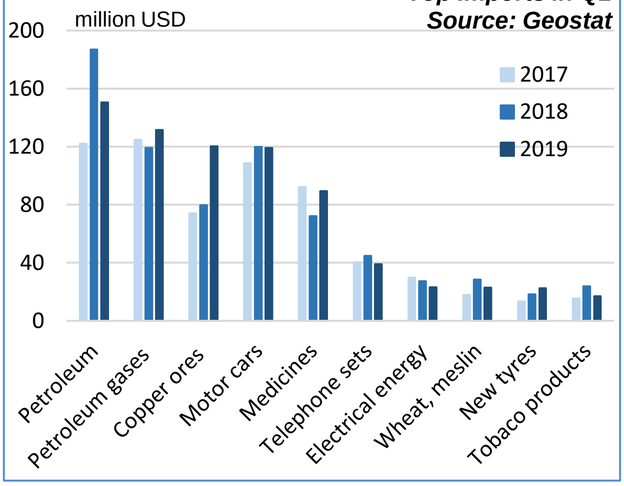
Imports amounted to 1,981.3 million USD in Q1 2018, a 4.7% annual decrease. This figure was mainly driven by reduced imports of petroleum (-19.5% YoY) which could be explained by the high base of petroleum imports in the first quarter of 2018 (in this period imports hiked by 53.3% YoY). Furthermore, other top import products also showed an annual decrease in import values, while only imports of copper ores, petroleum gases, medicines, and car tires drove imports up in Q1 2019.

The main source markets for Georgian imports in Q1 were Turkey (16% of total), China (11.2%), and Russia (9.7%). As a result of growing exports and decreasing imports the negative trade balance shrank by 14.2% compared to the same period the previous year.

Top Exports in Q1
Source: Geostat

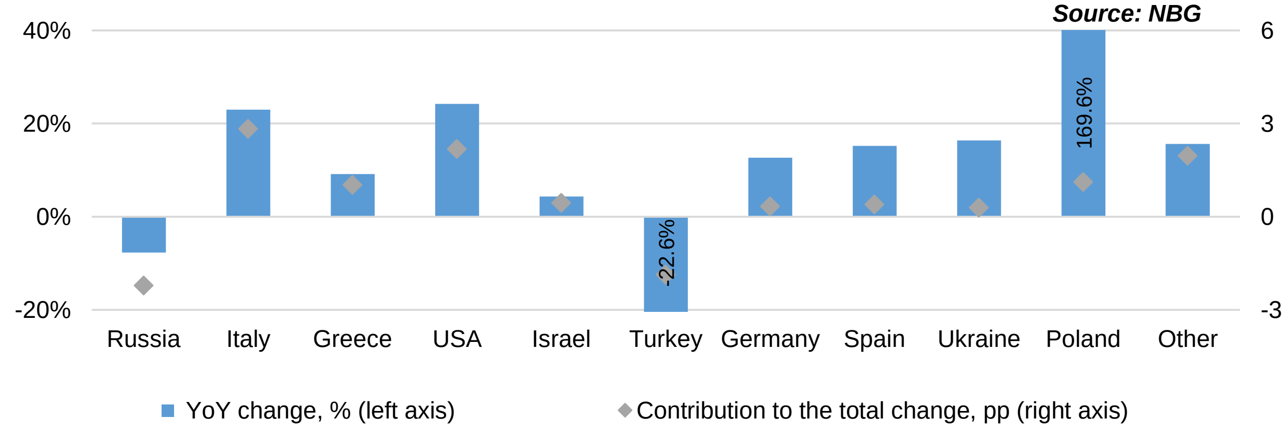


Top Imports in Q1
Source: Geostat



Both tourism and remittance transfers showed positive but slower growth in the first quarter of 2019 than in the same period last year. The number of international visitors increased by 1.1% YoY, while the change in tourist numbers (visitors who spent 24 hours or more in Georgia) was 5.1% YoY. International tourism receipts were flat and reached 578 million USD in Q1. The main reason for low growth rates of international visitors and tourism revenues were reports about the deportation or entry ban of dozens of Iranian citizens from Georgia in December 2018, which was followed by the Iranian Foreign Ministry advising their citizens not to travel to Georgia. Consequently, the number of visitors from Iran (the fifth largest source of tourists to Georgia) dropped by 56.5% YoY in Q1 2019. At the same time, the number of international visitors from Turkey (the fourth largest source of tourists to Georgia) dropped by 15.7% YoY. Together the decrease in number of visitors from these countries drove down the total number by 5.8 pp in the first quarter. Leaders in the YoY percentage increase of international visitors in the reporting period were Israel (+114.6% YoY), Poland (+79.1% YoY), Kazakhstan (+41.5% YoY) and Russia (+21.7% YoY). The latter contributed 3.4 pp to the total change of international visitors' number.

Remittances by Country, Q1 2019
Source: NBG

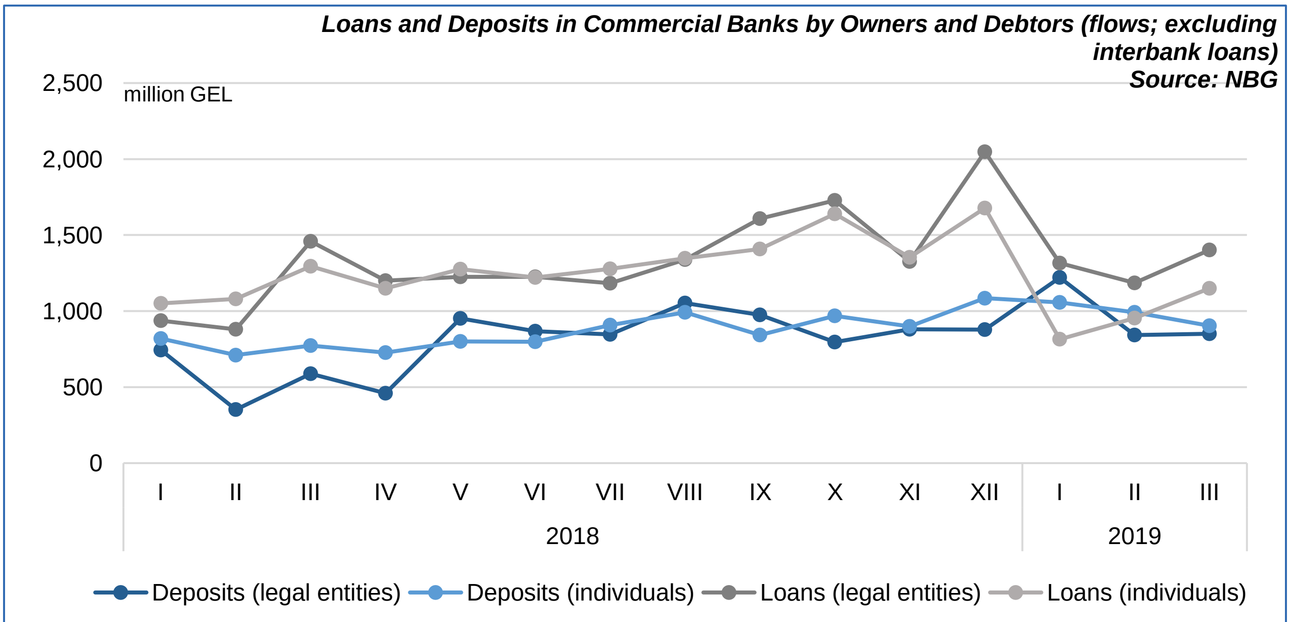


According to the NBG, the volume of total remittances to Georgia amounted to 379.5 million USD in Q1 2019, a 6.5% annual increase. Money inflows from Russia and Turkey were down by 7.7% and 22.6% YoY respectively, while other primary source countries for money inflows to Georgia showed a positive growth trend, especially Poland (+169.6% YoY). The hike in remittances from Poland is caused by rapidly growing labour force emigration from Georgia, explained by simple procedures for getting work permits (about 12,000 Georgian workers received temporary work permits in Poland last year).

Credit Market

To promote sustainable credit practices, NBG tightened lending regulations for retail credits in May 2018, and introduced additional changes at the beginning of 2019. The new standards for retail loans aimed to avoid the extensive growth of retail loans over transitional periods and decrease the number of high-risk financial products on the market. Indirectly, these regulations limit consumption, which could have a negative effect on economic growth in the short run. However, they will equally stimulate savings and investments, accelerating growth in the long run.

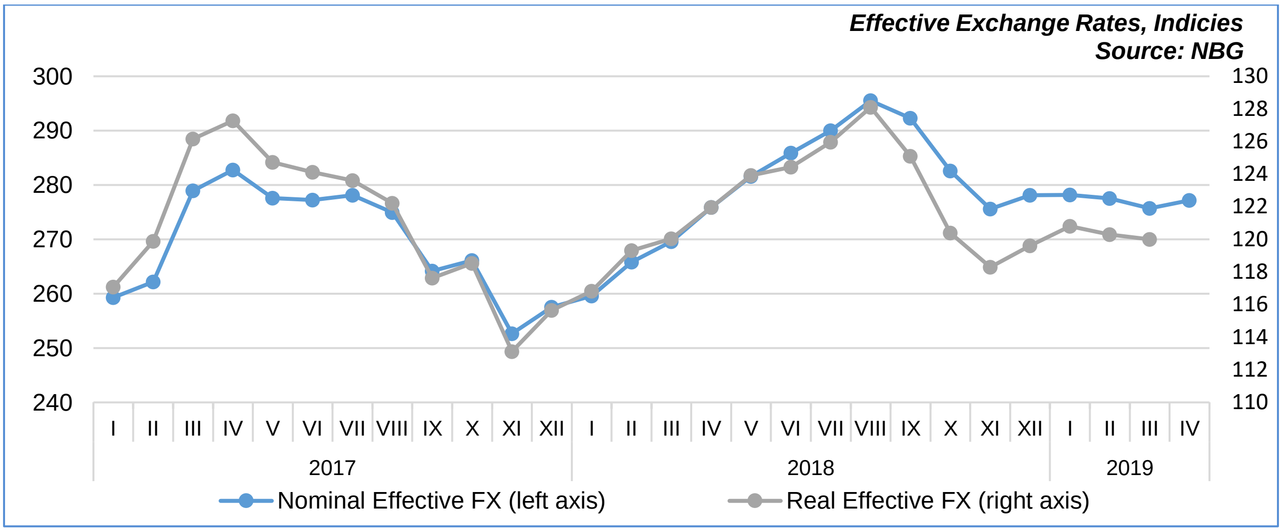
Due to new regulations, total loans extended by commercial banks in Q1 2019 (excluding interbank loans) constituted only 1.8% YoY growth. As expected, the value of retail loans decreased significantly – by 14.8% YoY in Q1 (mainly driven by short-term consumer loans). On the contrary, loans granted to legal entities were up by 19.2% YoY in the reporting quarter. Term deposits allocated in commercial banks in the reporting period (excluding interbank deposits) jumped by 47.2% YoY. Deposits from both legal entities and households increased by 73.1% and 28.2% YoY correspondingly.



Exchange Rate

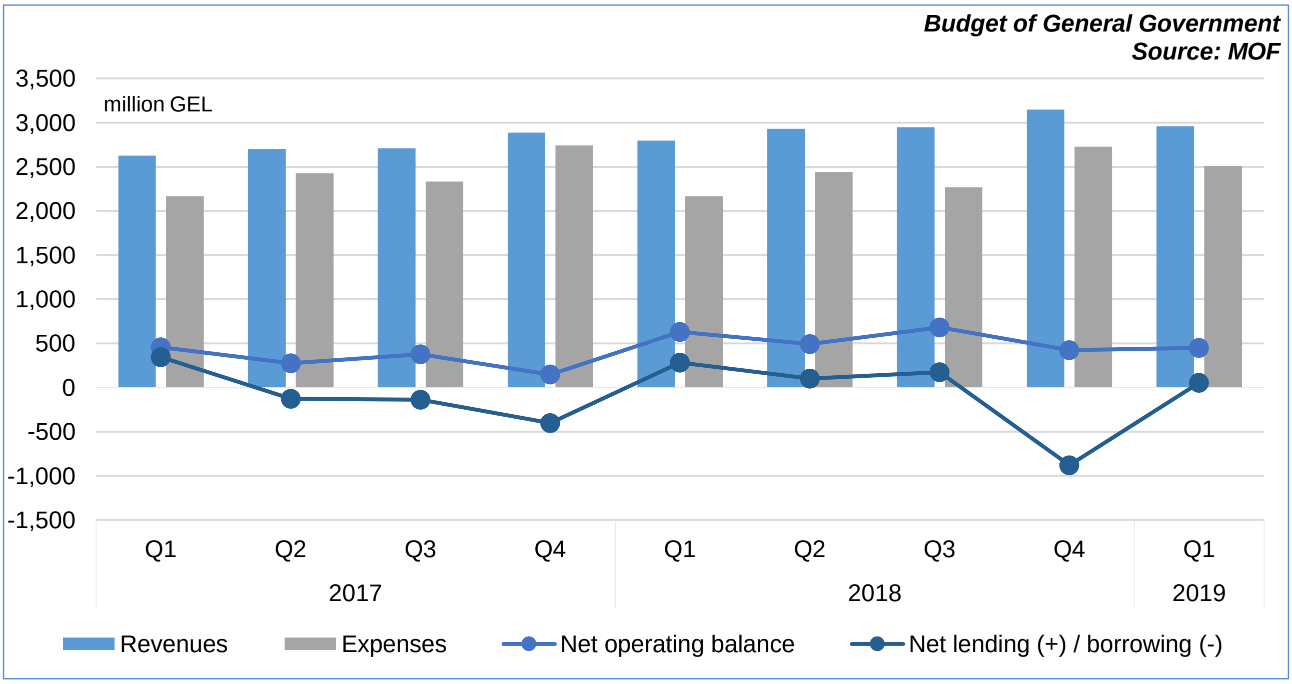
In Q1 2018, the nominal exchange rate of the lari against the US dollar and Euro was flat, averaging 2.67 USD/GEL and 3.03 EUR/GEL level. Compared to the same period in the previous year, the lari depreciated against the US dollar on average by 7.4% and gained 0.7% against the Euro. However, the currencies of Georgia's main trading partners (primarily the Turkish lira) depreciated to a higher extent, as a result, the Georgian lari on average appreciated in both nominal and real terms by 4.6% and 1.4%, respectively.

During the Q1 2019 NBG managed to buy 135 million US dollars across 9 auctions, in order to fulfill the IMF foreign reserve requirements.



Public Finances

In Q1 2019, the total revenues of the general budget amounted to 2,958 million lari, a 5.8% YoY increase. The latter was driven by stronger tax collection (+5.8% YoY): revenues from income tax (+4.8% YoY), profit tax (+18.6% YoY), and VAT (+2.6% YoY) showed positive trends in Q1 2019. However, revenues from excise taxes decreased by 6.6% YoY, which is explained by the substitution in consumption of expensive imported tobacco products with cheaper local alternatives.



Overall in Q1 2019, strong tax collection was balanced by the accelerated current and capital spending, which resulted in a budget surplus of only 55.3 million lari, an 80.3% YoY decrease. Governmental debt increased by 7.7% YoY and amounted to 17,334 million lari. Furthermore, the share of foreign debt in total debt increased to 81.1% level.