January 2015 Macro Review

The Georgian economy - weathering a not-so-perfect storm

According to Geostat's rapid growth estimates, Georgia's real GDP declined by 0.5% in November 2014 (Chart 1). Despite this, growth in the first eleven months of 2014 was a robust 5%, which is certainly a much better result than most countries in the region could boast. The ISET fourth quarter GDP forecast predicts 3.9% growth in the last three months of 2014.

Consistent with the decline of growth in November, the change in VAT payers' turnover slowed to 2.7% (Chart 2).

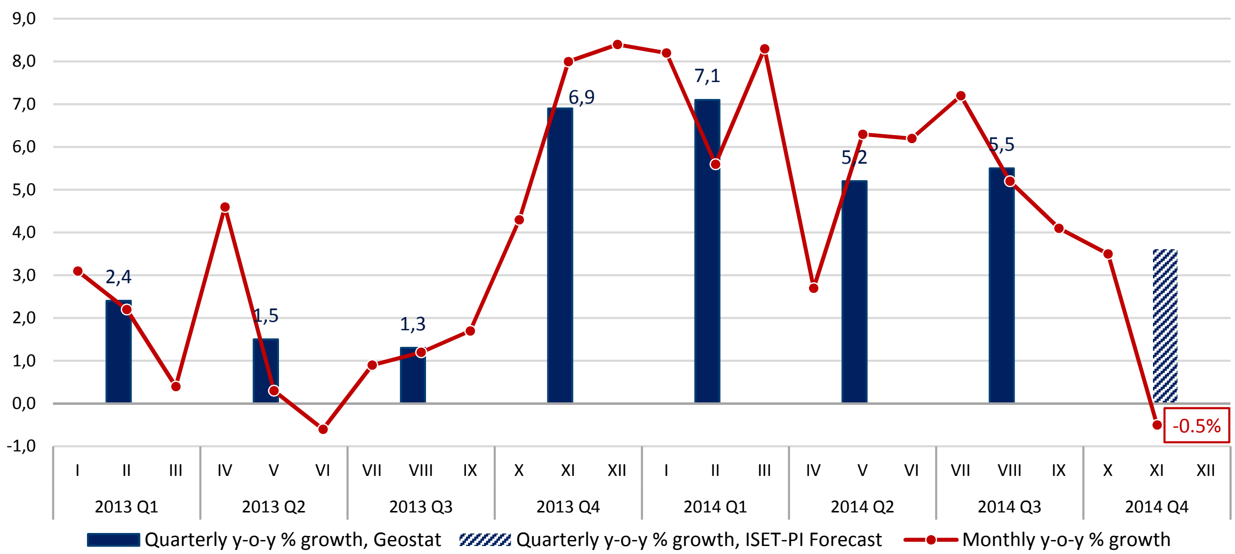


Chart 1. Year-on-year growth rate of real GDP
Source: GeoStat, ISET-PI

The slowdown of the economy was further reflected in the Consumer Confidence Index (CCI). In November, the CCI decreased to -18% and in December it reached its historical minimum of -23%. The deterioration of consumer confidence was mainly driven by the sharp depreciation of the lari, which once again stoked inflation fears among Georgian consumers.

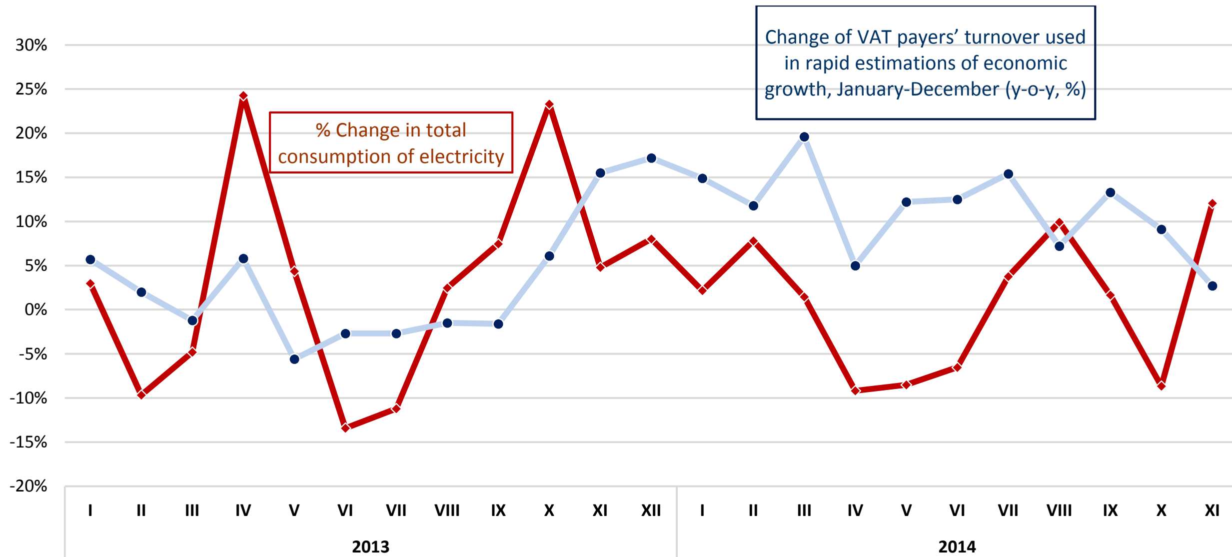


Chart 2. Source: Geostat, www.esco.ge

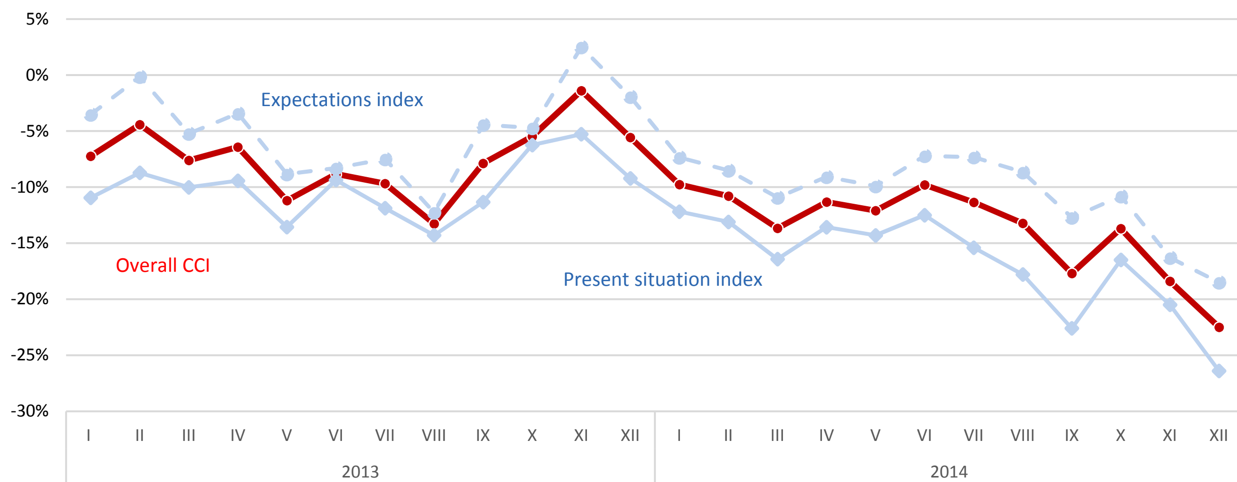


Chart 3. CCI Source: ISET-PI

Downside pressure on the Georgian economy primarily came from a combination of external factors. In November, Georgian exports declined dramatically by 35%. Imports also fell by 7%. Consequently, the country's trade deficit has increased. A breakdown of exports by destination country shows that exports to EU countries decreased by 49% and exports to CIS countries by 43%. On the bilateral level, exports to Azerbaijan decreased by 43%, to Russia by 37%, to Armenia by 32% and to Ukraine by 71%.

Such dramatic shifts in the export environment were the result of different market shocks. Trade with Azerbaijan, for example, suffered primarily because of the decline of car re-exports. For a long time, Georgia served as a base for buyers of used cars across the region, but the change in environmental regulations in Azerbaijan brought the car re-export business in Georgia to a halt. Ordinarily such abrupt declines in trade are bad news for a country. In Georgia's case, however, this decline should be regarded through the prism of opportunity. The disappearance of the car re-export market once again highlighted the overdependence of the Georgian economy on low-skilled, low-investment export activities. Leaving behind a sector that does not generate knowledge spillovers and shifting investment focus to more productive industries is now the country's biggest challenge.

Another factor which drove Georgia's export decline in November was the significant appreciation of the lari against trading partner currencies early in the month. Exports to CIS and EU countries were particularly affected (for more detailed analysis, see a recent [ISET Economist article](#)). The good news is that exports to other countries increased by 23%. This increase was mainly driven by export increases to Turkey (by 43%) and China (by 183%). After the sharp nominal depreciation of the lari from late November (see Chart 5), exports are expected to rebound. However, the slowdown of the economies of Georgia's trade partners and, consequently, the low external demand on Georgian products still puts important pressure on the national economy.

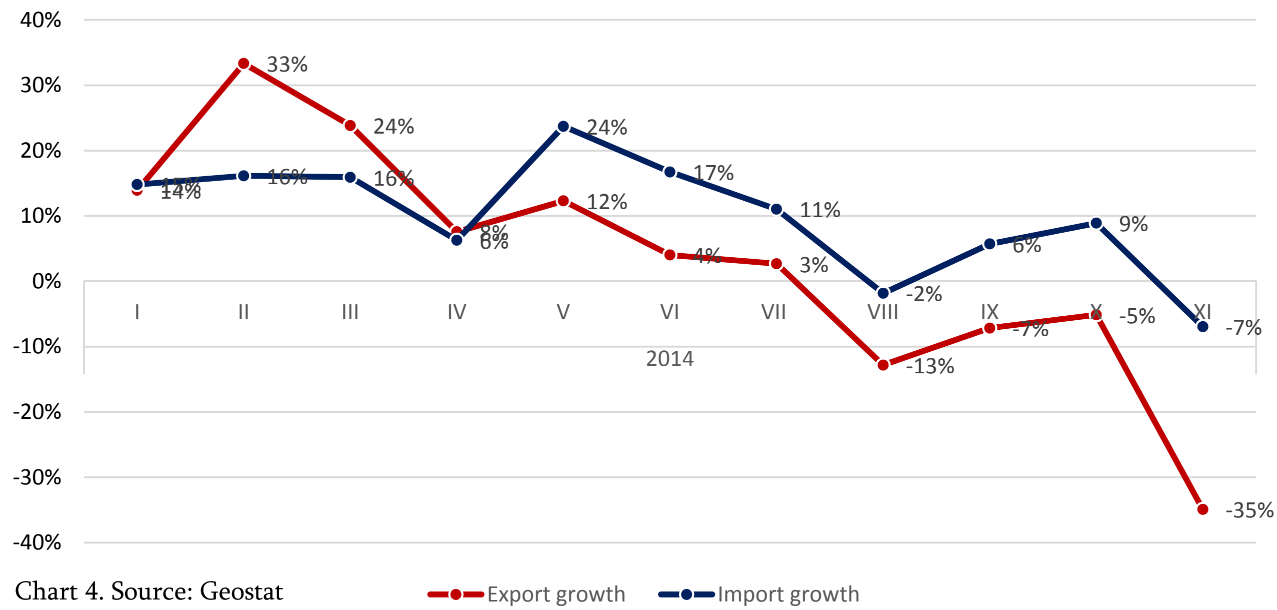
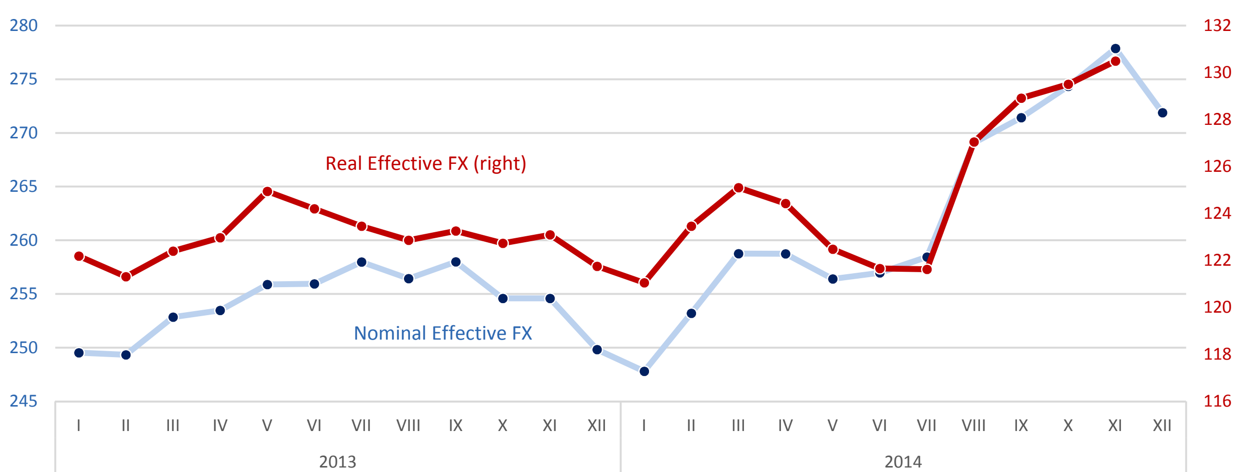


Chart 4. Source: Geostat



* Rise means the appreciation of the lari against main partner countries' currencies.

Chart 5. Source: www.nbg.ge

The main concern among Georgian consumers after the lari-dollar depreciation is the expectation of high inflation. However, in December, the CPI inflation rate actually decreased to 2%. Prices for food and non-alcoholic beverages, a big component of the consumption basket, increased by only 2.5% (see Chart 7). This slowdown in food price inflation was mainly driven by the recent decline of food prices on the world market. Similarly, prices on transport decreased by 1.6%, which is in line with the significant oil price declines affecting global markets in recent months. Georgians, however, should not expect gasoline prices to fall in proportion to the decreased price of oil as only a fraction of the gas price at petrol stations depends on the crude oil spot price – the more significant shares of gasoline retail costs include labor, operations, branding and profit margins.

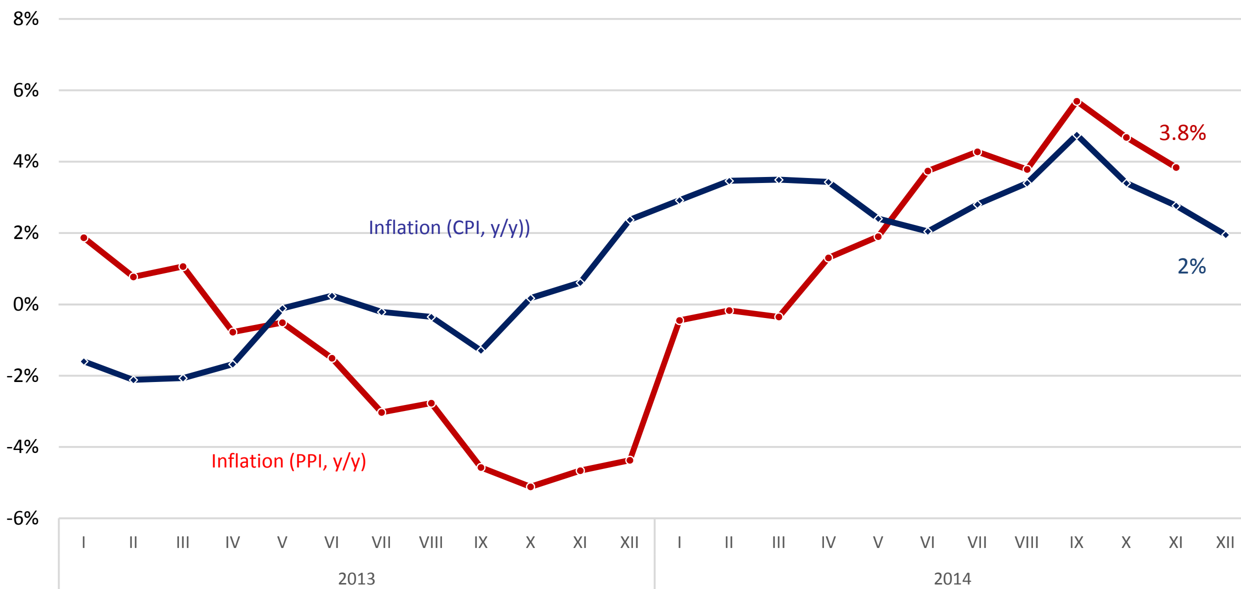


Chart 6. Source: Geostat

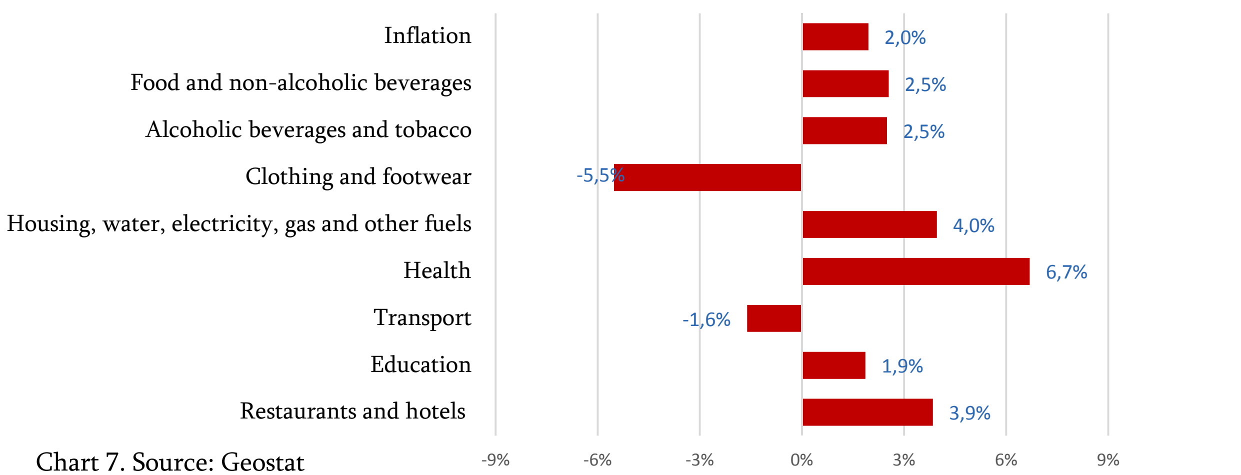


Chart 7. Source: Geostat

Other economic developments in November were mostly "business as usual". Loans to residential legal entities and households continued the same pattern as in previous months, increasing by 19% and 30% respectively. Overall, the increase of loans to legal entities is a good sign for the economy, as it can signal that investments are taking place in the private sector. A breakdown of loans to legal entities shows that loans increased to the agriculture (103%), hotels and restaurants (102%), real estate (134%) and financial intermediation (113%) sectors. Although loans to the industrial sector increased at a relatively low rate (68%), their contribution to overall loan growth was the highest at 11.7 percentage points. Loans declined in the trade (-25%, mainly driven by the collapse of the car re-export business), education (-100%), and health care (-63%) sectors.

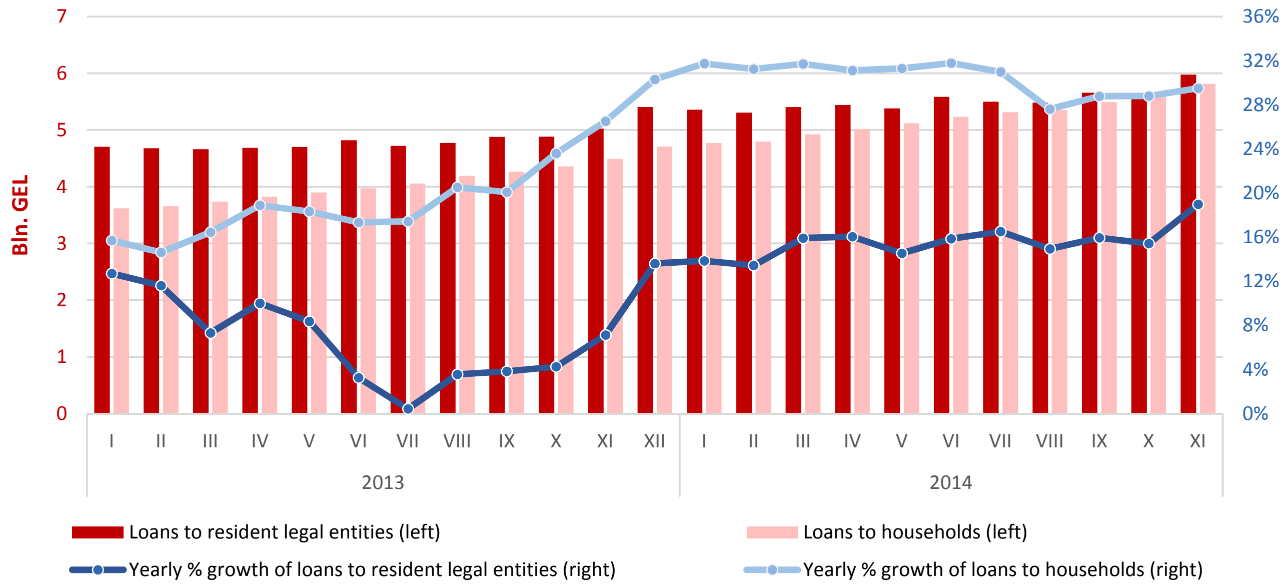


Chart 9: Loans
Source: www.nbg.gov.ge

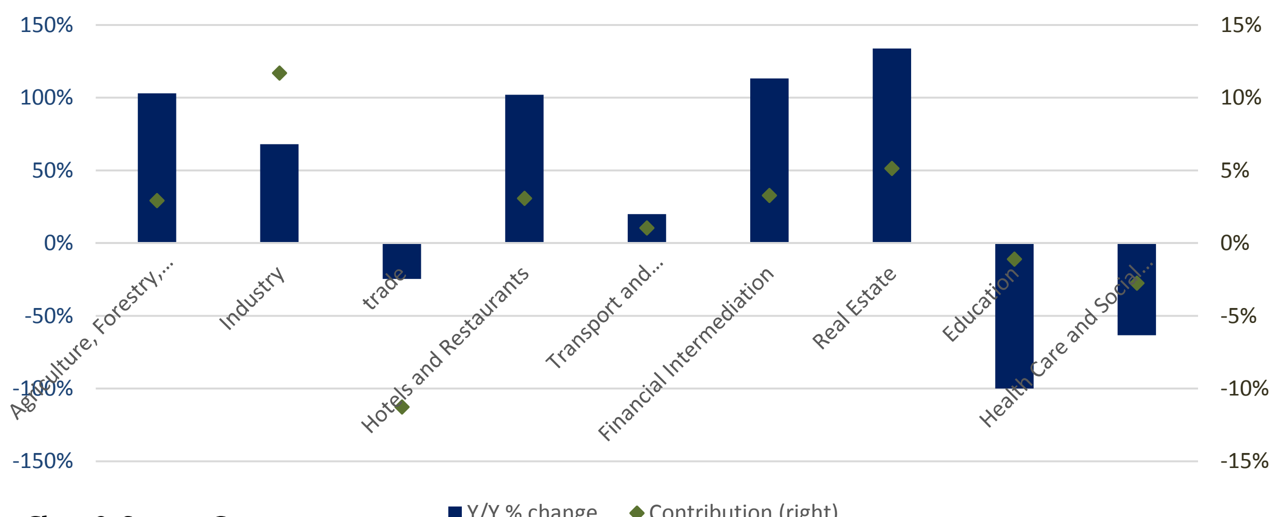


Chart 8. Source: Geostat

The economic headwinds from the rest of the world continued to affect the Georgian economy in the closing months of 2014. In December, for example, remittances to Georgia dropped by 25% compared to the corresponding month of 2013 and amounted to 116 million USD. In 2014 the total level of remittances was 1.4 billion USD, which was 2.5% lower than the amount Georgia received in 2013. The main contributors to this decline were remittance flows from Russia and Ukraine. Remittances from Russia declined by 43% and contributed more than 23 percentage points to the overall decline in 2014. Remittances from Ukraine also dropped sharply by -68%. Given that all remittances are reported in USD, while incomes are earned in local currencies, these flows were most likely affected by the sharp depreciations of the ruble and hryvna against the USD. However, the good news is that these declines were at least partially offset by significant increases of remittance flows from Turkey, Israel and Germany (58%, 47% and 31% respectively), which helped soften the shocks coming from Russian and Ukrainian sources.

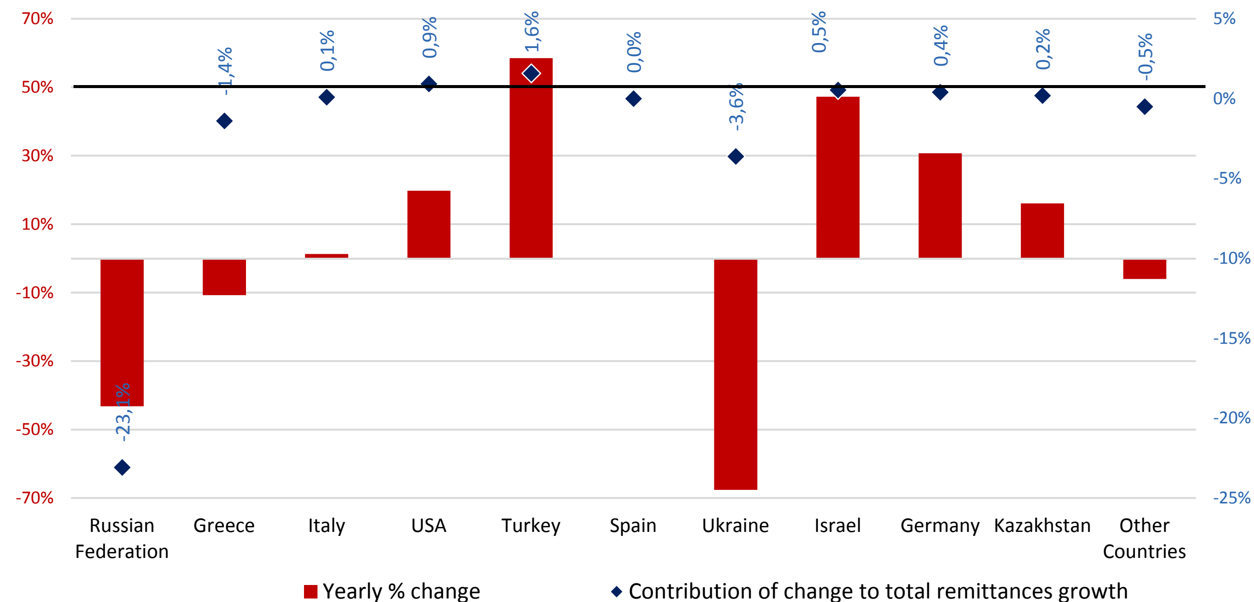


Chart 9. Source: www. nbg.ge