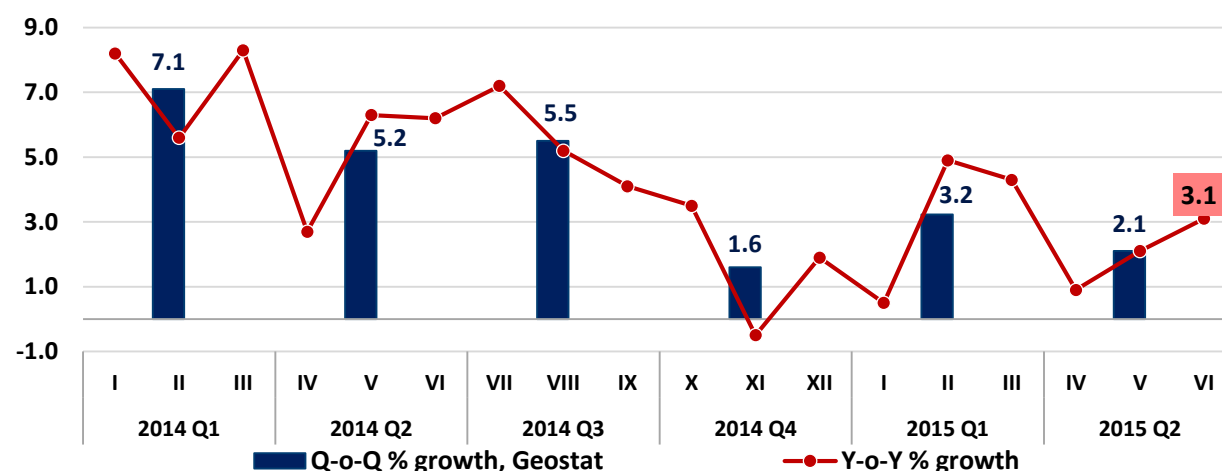


Georgian economy shows mild second quarter growth. Volume of foreign currency loans continues to increase despite lari depreciation - July 2015

According to Geostat, the economy of Georgia grew by 3.1% in June 2015 compared to last year. Although the GDP growth forecast was cut to nearly 2% by both the IMF and EBRD, in the first six months of 2015 GDP growth was 2.6%. A source of optimism might be found in the fact that VAT payers' turnover increased by 7.3% year-on-year in May and the consumption of electricity soared by 6.8% compared to May 2014.

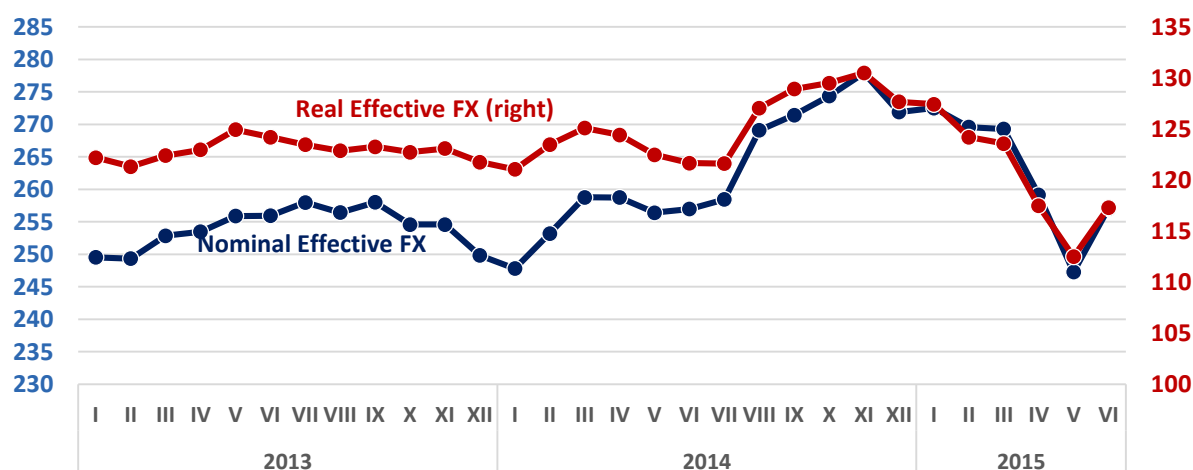
Chart 1: Growth rate of real GDP and ISET-PI Forecast, %



Source: GeoStat, ISET-PI

After depreciating by about 30% since December 2014, the Georgian lari exchange rate to the US dollar stabilized at 2.26. However, the steep depreciation of both nominal and real effective exchange rates since January 2015 was followed by a sharp appreciation of about 4% in June 2015. This indicates that the currencies of Georgia's main trading partners were losing value against the dollar while the lari managed to recover some of its value since May.

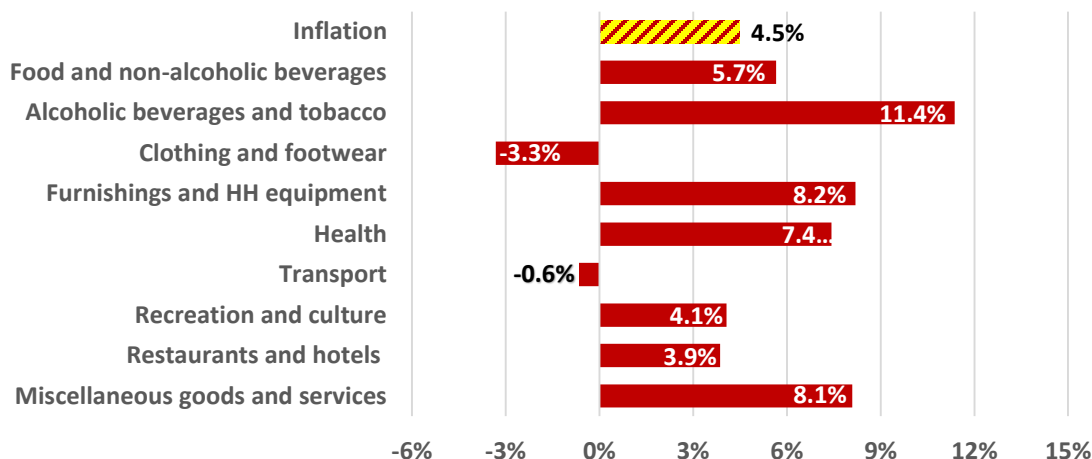
Chart 2: Real and Nominal effective exchange rate indices



Source: NBG

Lari depreciation resulted in heightened inflationary expectations, but the rate of price increases since December 2014 has been modest. Consumer price inflation only started picking up in March, and the rate of price growth was in the low single digits. In June 2015, the price level rose by 4.5% compared to June 2014, which was the largest increase in seven months.

Chart 3: Change in price level in June 2015 compared to June 2014

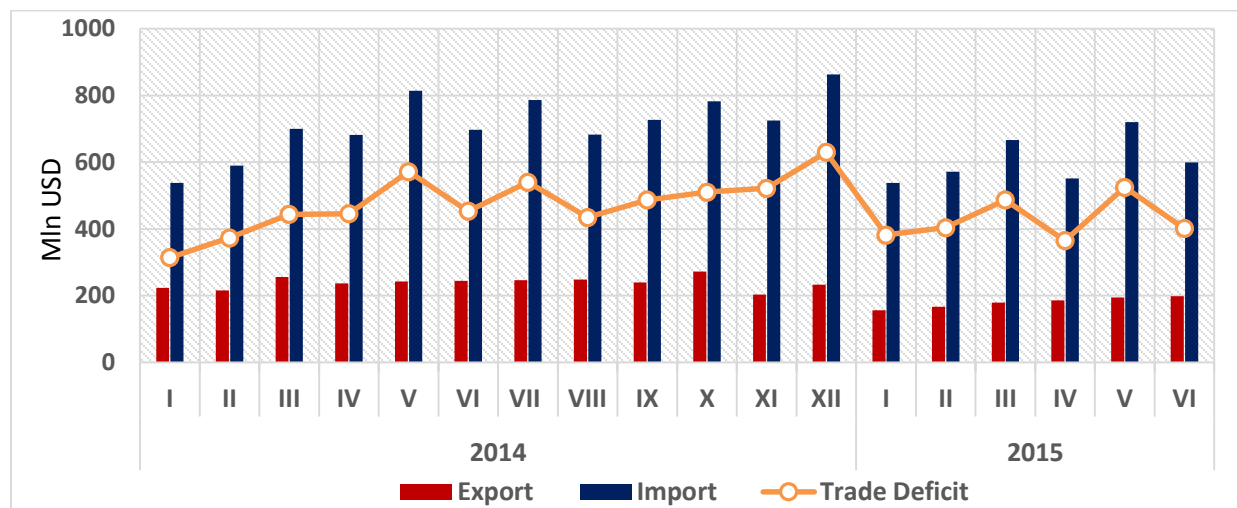


Source: Geostat

Chart 3 shows that the biggest change since June 2014 was seen 'food and non-alcoholic beverages' (11.4%) category. In contrast, prices of clothing and footwear declined by 3.3%.

Although the CPI has increased modestly, in June 2015 producer price inflation (PPI) was up by 10.2% compared to the same month of 2014, and the annual PPI in 2015 currently stands at 7.6%. Considering that producer price increases typically precede consumer price increases, the National Bank of Georgia stepped up its efforts to temper inflation, and increased the refinancing rate to 5.5% on 1 July 2015.

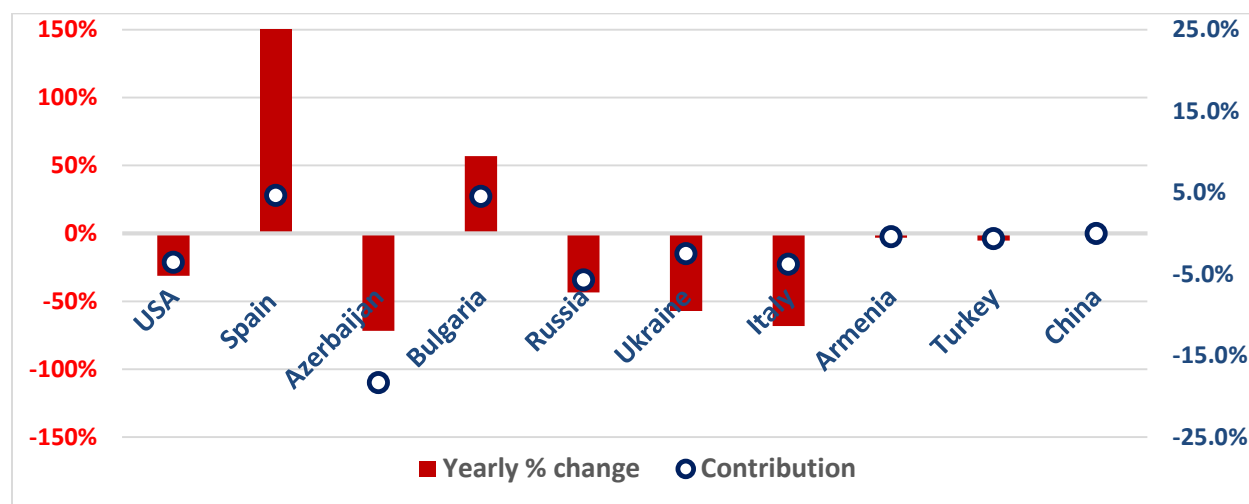
Chart 4: Export, import and trade deficit, mln USD



Source: Geostat

According to Geostat, the volume of trade declined by 13% during January-June 2015 compared to the same period of the previous year. There was a 24% drop in exports and a 9% decline in imports in the same period. Moreover, there was a 19% decline in exports in June 2015 compared to the same month of 2014, out of which the decline in exports to Azerbaijan contributed -18.3% and the increase of exports to Spain contributed 4.6%. Despite the grim annual statistics, one can observe that Georgian trade experienced a level shift in 2015. In exports, this level change was predominantly driven by the loss of the Azerbaijani car market, as well as the loss of some export markets, notably in Russia and Ukraine.

Chart 5: Exports by country, % change and contribution to total exports



Source: Geostat

On the positive side, there was a large increase (19%) in exports to EU countries in June 2015 compared to the same month of 2014. Exports to the EU accounted for 26% of total exports. It is also noteworthy that in the first six months of 2015, China took Russia's place as the third largest partner of Georgia by volume of trade.

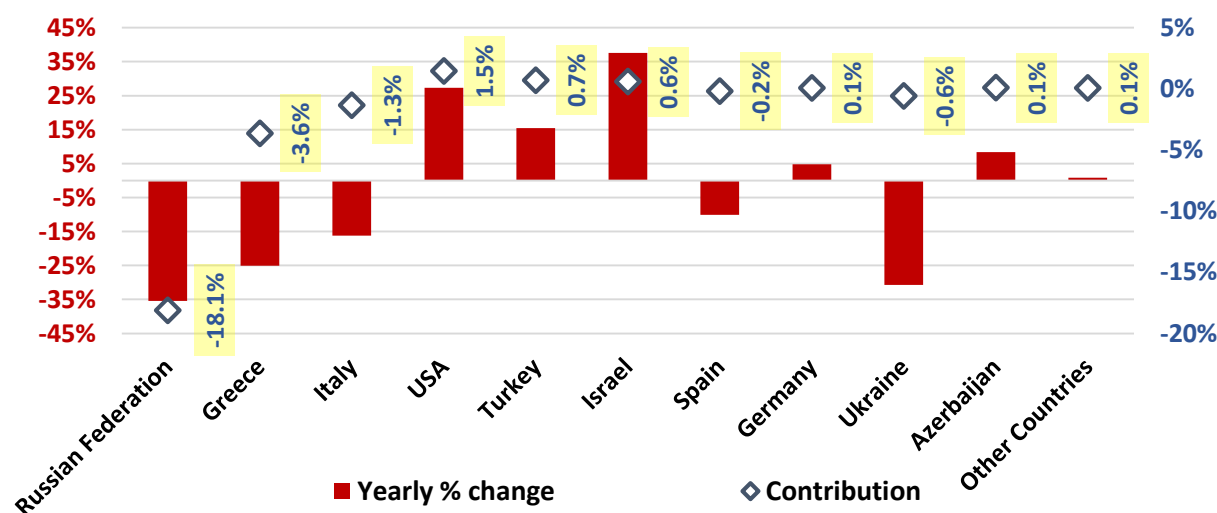
Table 1: Exports by product, June 2015, %

	Share	Change	Contribution
Total Export	100%	-19%	-19%
Waters, natural or artificial mineral and aerated waters, not containing added sugar	3%	-46%	-2%
Wine of fresh grapes	4%	-41%	-3%
Copper ores and concentrates	12%	15%	1%
Crude petroleum, oils and gases	11%	160%	5%
Electrical energy	3%	23%	1%
Medicaments put up in measured doses	8%	63%	2%
Mineral or chemical fertilizers, nitrogenous	3%	-26%	-1%
Ferro-alloys	12%	-28%	-4%
Motor cars	6%	-76%	-14%
Other products	37%	-13%	-5%

Source: Geostat

The ten biggest export products accounted for 63% of total exports in June 2015, out of which the biggest positive contribution was made by crude petroleum, oils and gases (5%) and the biggest drop was exports of motor cars (-14%). In general, the changing patterns of trade in the first half of 2015 saw a rise of the following export categories: dried and fresh nuts; medicaments; crude petroleum, oils and gases; and gold. The biggest “losers” among exports were: motor cars, wine, mineral water, ferro-alloys, copper ores, and fertilizers.

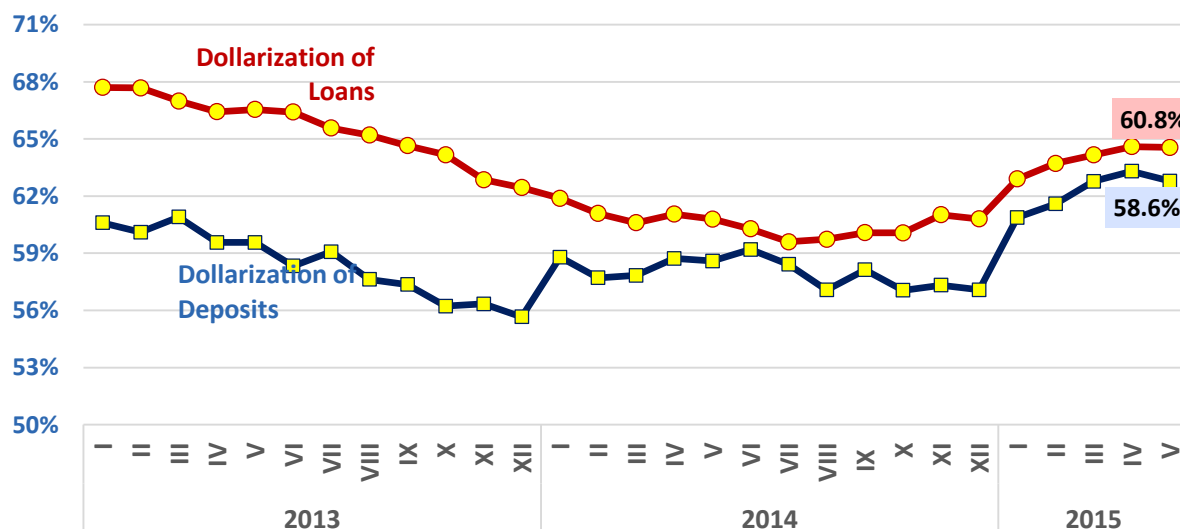
Chart 6: Remittances by country, % change and contribution



Source: NBG

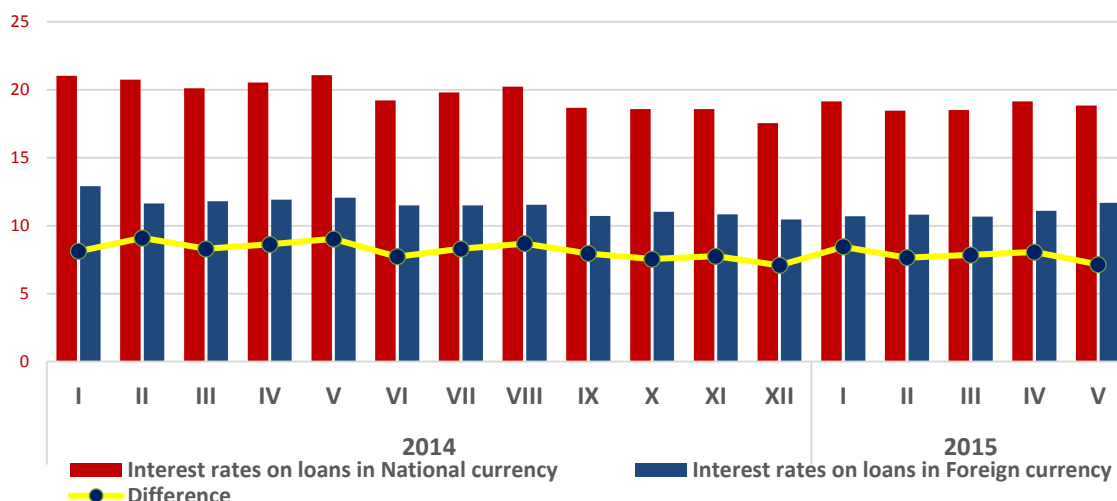
Remittances declined by 21% in June 2015 compared to 2014. The biggest drop was due to reduced transfers from Russia (-18.1%) and Greece (-3.6%). This is not surprising as Russia accounts for 41% of total remittances while Greece accounts for 14%.

Chart 7: Dollarization of loans and deposits, %



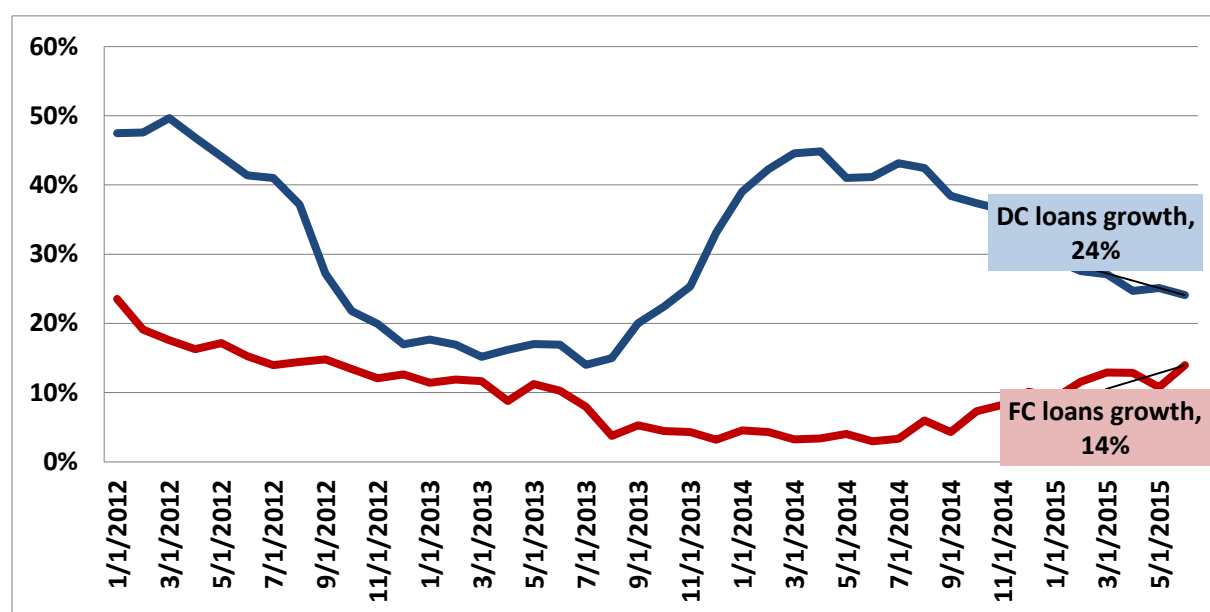
Dollarization of loans and deposits slightly declined in May 2015 compared to the previous month. Loans in USD accounted for more than 60% of total loans. Moreover, interest rates remained fairly stable and kept a downward trend.

Chart 8: Interest rates on loans in national and foreign currency, %



Source: NBG

Chart 9: Trends in Foreign and Domestic currency denominated loans

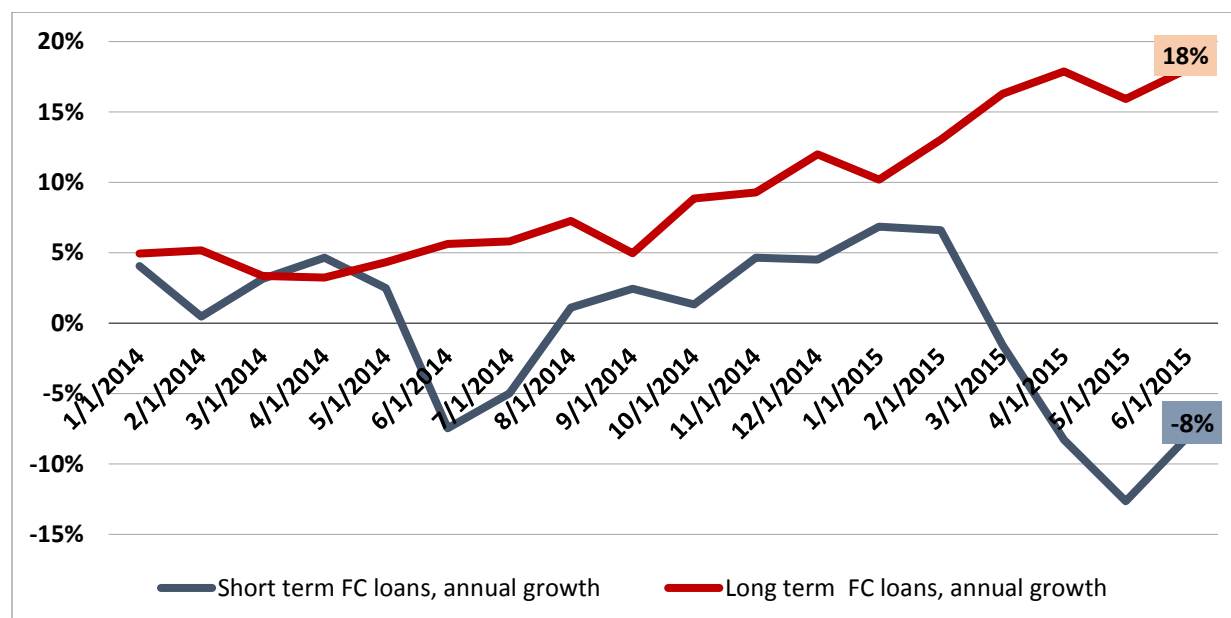


Source: NBG

The gap between interest rates on foreign and national currency loans declined somewhat, but not by enough to keep people from being tempted to borrow in foreign currency. Perhaps this is why in the first half of 2015 we witnessed the following paradox: despite the devaluation of the lari, the volume of loans in foreign currency (when expressed in USD) continued to grow, while the volume of loans in the

national currency continued to decline. The upward trend in foreign currency loans and the downward trend in domestic currency loans started in July 2014 and continued despite the devaluation of the lari.

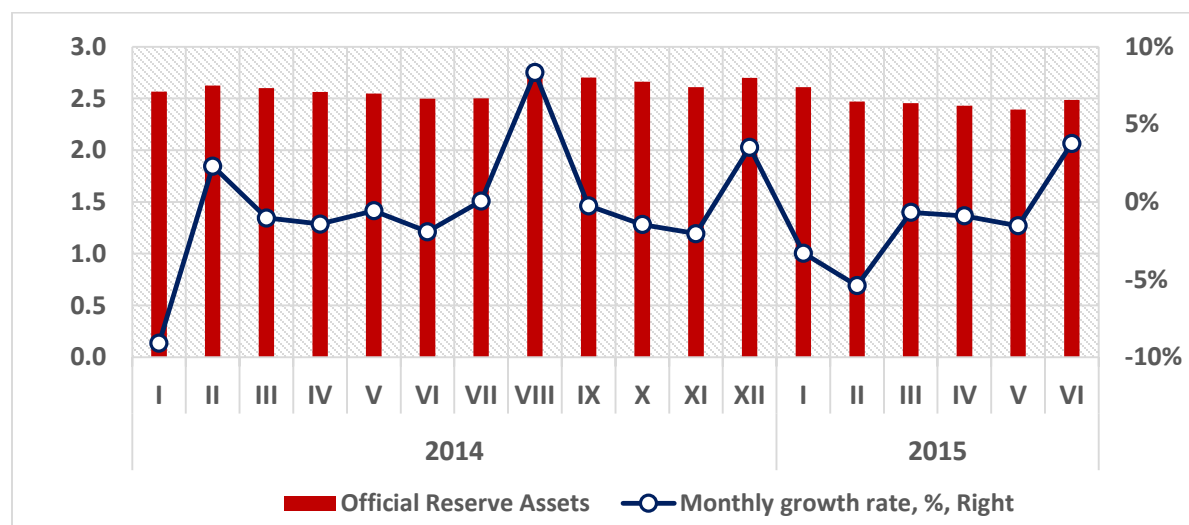
Chart 10: Short- and long-term foreign currency loans growth - total loans in USD terms



Source: NBG

The data also shows a tendency towards greater growth in long-term foreign currency lending, due in part to the restructuring of existing loans offered by commercial banks.

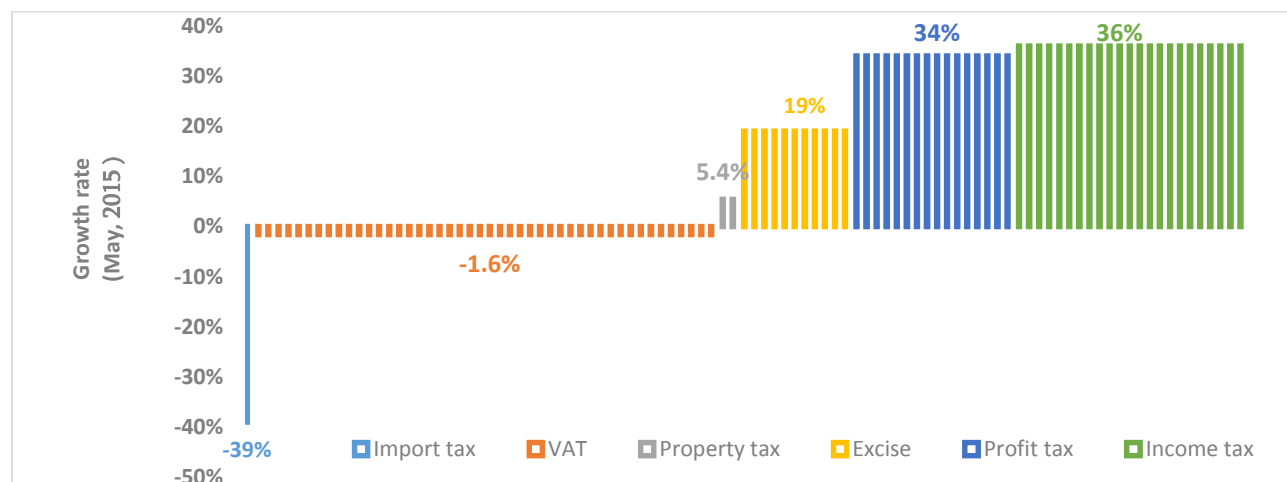
Chart 11: Official reserve assets, bln USD



Source: NBG

After the slow but steady decline since December 2014, the foreign exchange reserves of the National Bank edged upward. They are now nearly reaching last year's mark for the month of June. This is a good sign, especially given the seasonal nature of reserve accumulation. The reserves are expected to recover further during the autumn grape harvest season.

Chart 12: Growth rate of income from taxes, May 2015 (the width denotes share in total tax revenue)

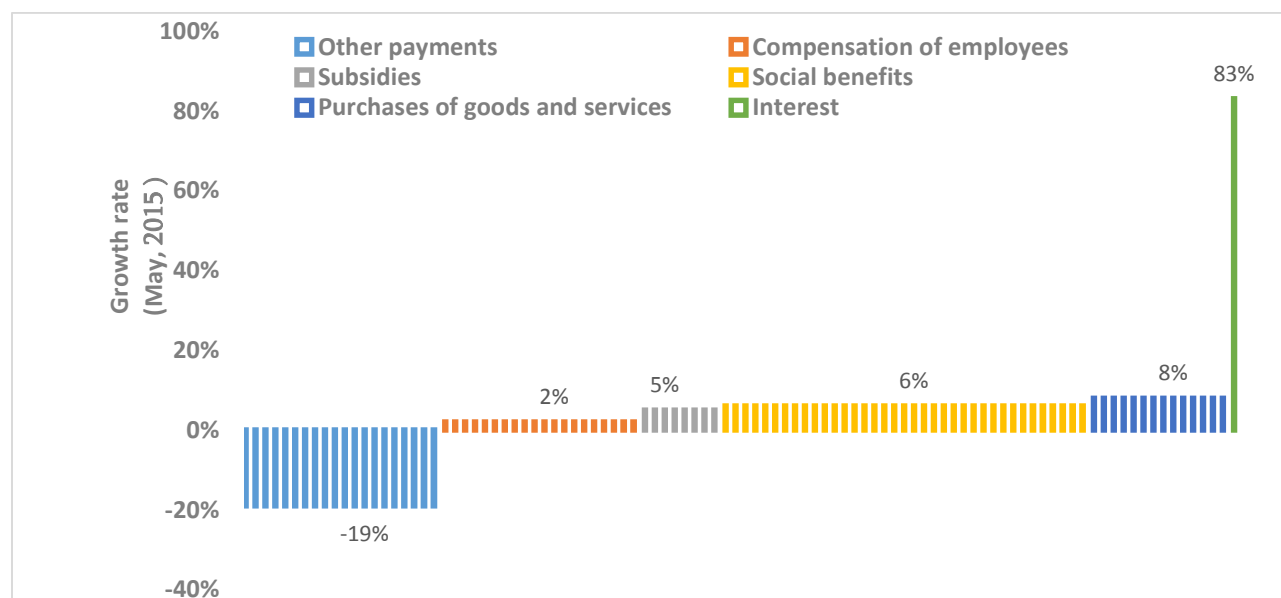


Source: Geostat

The budget was in surplus in May 2015. The main sources of income were taxes (+15%), of which VAT had the biggest share. However, the revenue from VAT declined by 1.6% compared to May 2014.

There was a 1% increase in consolidated budget expenses in May 2015. The biggest share in expenditures came from social benefits; however, there was a sharp rise in interest payments (83%).

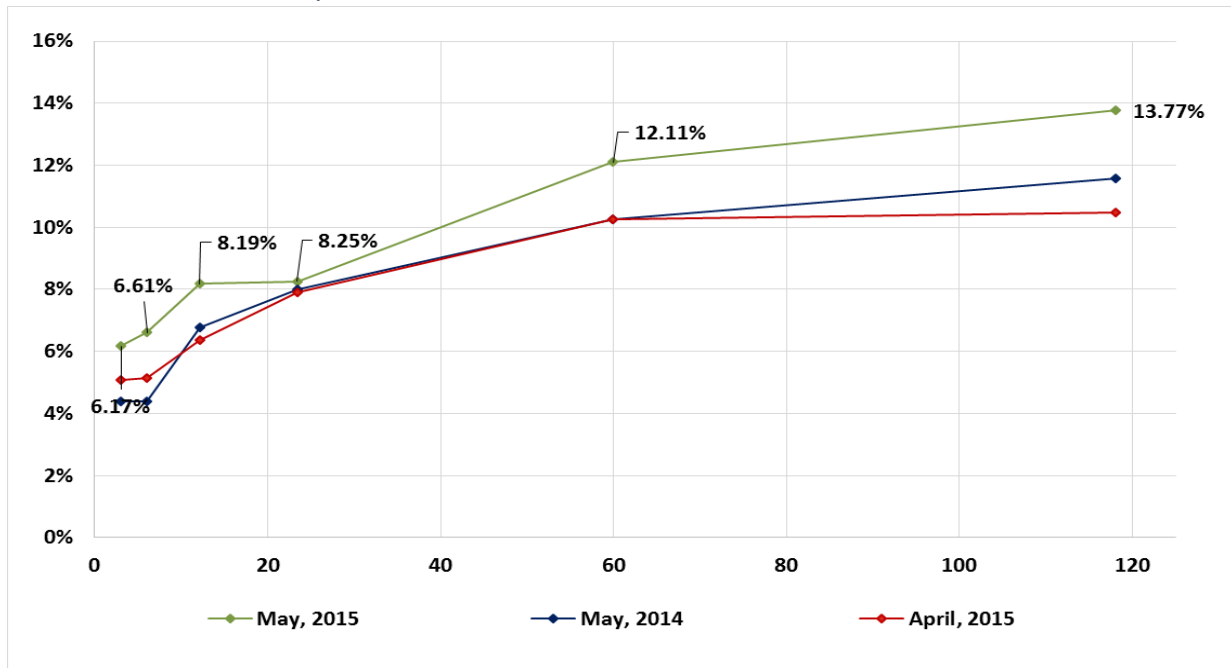
Chart 13: Growth rate of expenditures, May 2015 (the width denotes share in total expenses)



Source: Geostat

The yield curve for government bonds shifted upward in May, making government borrowing more expensive, both in the short and long term. The steepening of the yield curve may be reflecting a higher term (risk) premium on government debt.

Chart 14: Government bond yield curves



Source: NBG