

WHAT DOESN'T KILL US, MAKES US STRONGER

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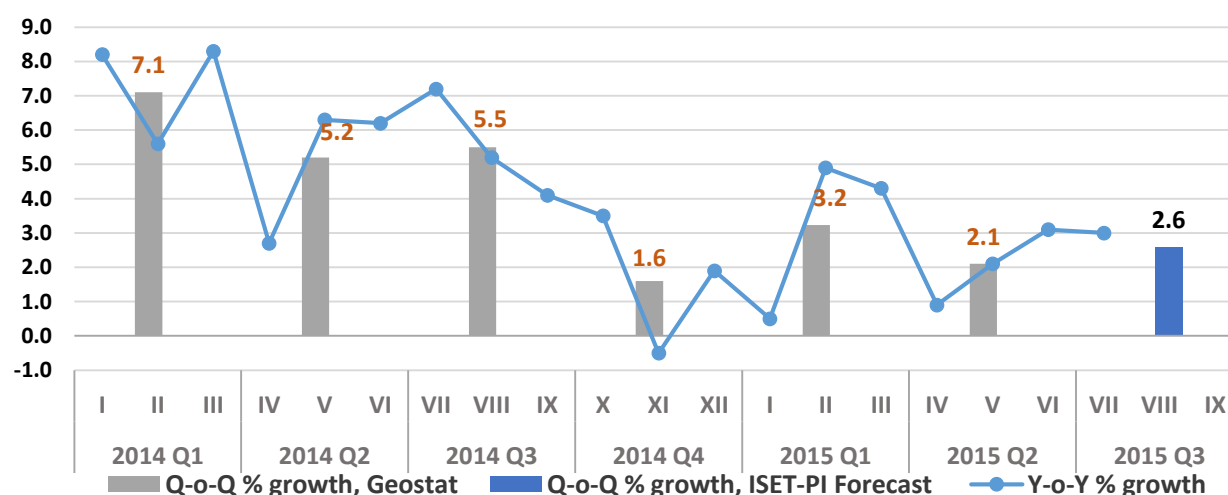
TRENDS SUMMARY

- In July 2015, domestic production in Georgia increased by 3% annually, maintaining a stable and positive trend.
- Consumer price inflation reached the highest value (4.9%) in two years. The 1 August 2015 increase in electricity tariffs is likely to put some additional upward pressure on consumer price inflation in the coming months.
- Compared to the previous month, the value of the Georgian lari has stabilized against the dollar in July and appreciated slightly against the currency basket of Georgia's trading partners.
- Export growth continued to decline in annual terms, reflecting the declining demand for Georgian exports from main trading partners, including Russia, Azerbaijan, Turkey and Ukraine.
- Bulgaria became Georgia's fastest growing export destination in July.
- The new excise tax adopted by government at the beginning of the year increased annual tax income from excise by 44%, and contributed 37% to the total increase in government income from all taxes.

According to Geostat's rapid estimates for July, Georgia's real GDP increased by 3% annually. This growth rate, although not spectacular, comes as welcome news for the economy. The July estimate is still above the official IMF and EBRD forecasts for Georgia's annual growth, and is the fourth highest growth rate value since the beginning of the year.

Figure 1: GDP Growth

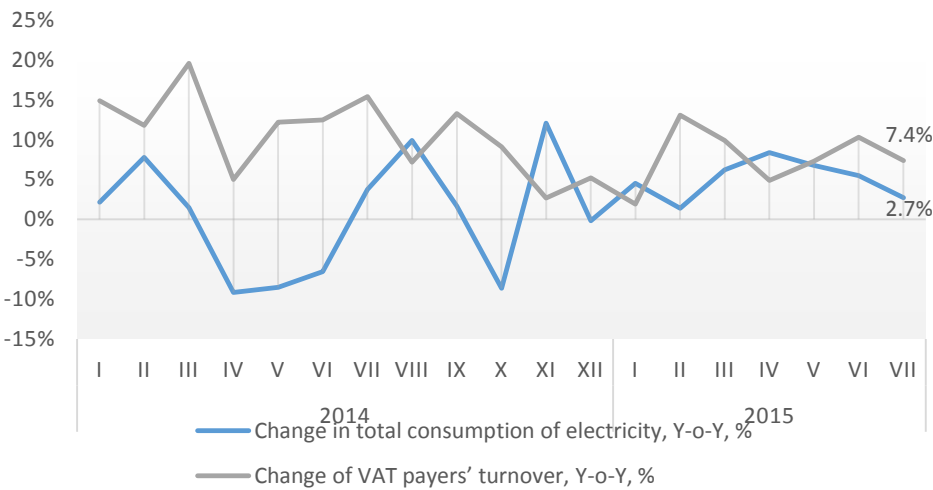
Source: Geostat, ISET-PI



Related indicators that closely track monthly production changes, like VAT payer's turnover and electricity consumption, both increased in July, by 7.4% and 2.7% respectively.

In the coming months, however, we should expect a fall in total consumption of electricity due to the roll out of new tariffs instituted on 1 August this year. The tariffs are expected to increase the average price of electricity for consumers by 25-35% per kWh.

Figure 2: VAT Turnover and Electricity Consumption



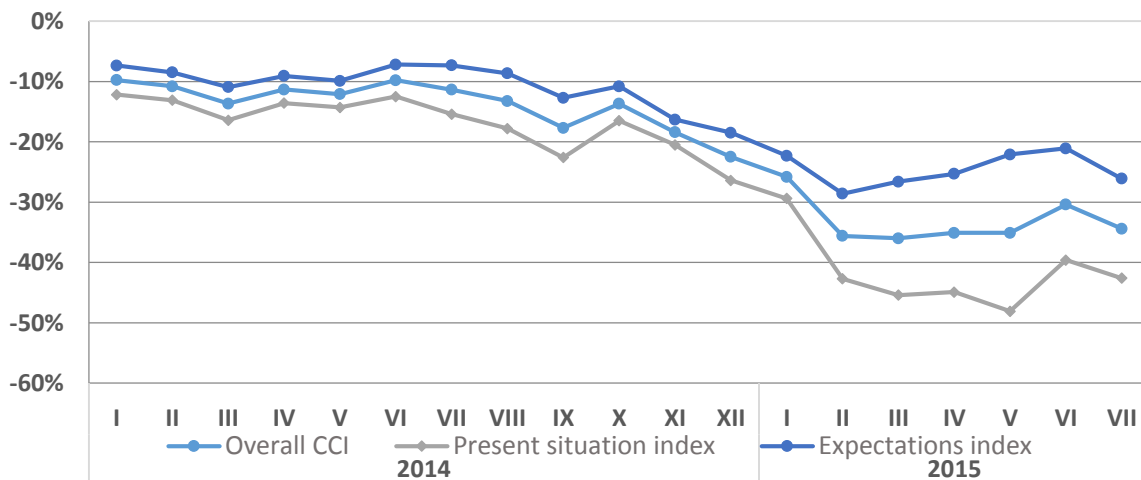
Source: Ministry of Energy of Georgia, GeoStat

The ISET-PI indicator of consumer sentiment, the [Consumer Confidence Index \(CCI\)](#), also took a hit in July. The announcement of hikes in electricity tariffs may have been the most important reason behind the falling CCI. After four consecutive months of marginal improvement in consumer confidence, in July the CCI dropped again by 4 points. This setback was particularly disheartening given that in June the CCI had increased by a solid 4.7 points.

The downturn in the present situation index was primarily driven by people's pessimism regarding the general economic situation.

In July, 64% of respondents thought that the economic situation had worsened over the last 12 months, while in June 51.3% gave the same answer.

Figure 3: Consumer Confidence Index



Source: ISET-PI

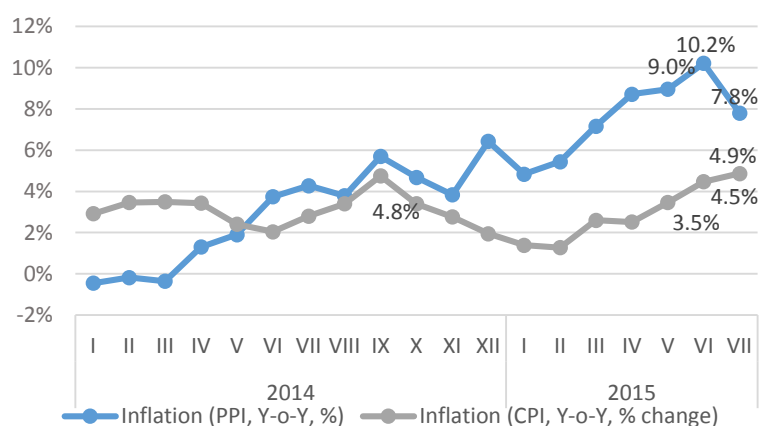
Annual CPI inflation reached 4.9% in July – a two-year record. The increase in consumer prices was to a large extent driven by the food and non-alcoholic beverages (7.1%), healthcare (7.3%), and alcoholic beverages and tobacco (11.7%) categories. The latter could be explained by the recent increase in excise tax on alcohol and cigarettes.

Taken together, these three categories contributed over 3.36 percentage points to the CPI inflation rate.

Producer price index inflation, which is based on the prices Georgian producers charge for their products, reached 7.8% annually. The PPI has been increasing more rapidly than the CPI since November 2014. *This was expected, given that costs typically increase more rapidly for producers following national currency depreciation.*

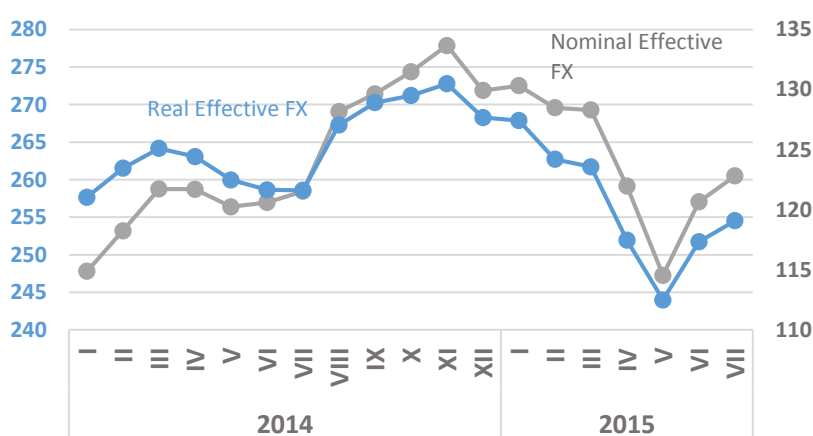
Furthermore, some producers, particularly those who service both domestic and export markets, may continue to price their goods in dollars, which implies that the lari value of their products increases as a result.

Figure 4: Inflation Rates



Source: Geostat

Figure 5: Effective Exchange Rates



Source: National Bank of Georgia

In June and July, after six consecutive months of depreciation (November-May 2015) the lari started to appreciate in both nominal and real terms. In annual terms, the nominal effective exchange rate appreciated slightly relative to last year, while the real effective exchange rate depreciated by 2.1%. *This discrepancy between the two measures could be explained by the fact that Georgia's trading partners have experienced relatively high annual inflation rates since July 2014.*

In the first seven months of 2015, Georgia's external trade volume shrank by 14% year on year. Exports fell by 23.8%, while imports were 10.6% lower than in the same period last year. The trade deficit constituted 54% of total trade volume. *Once again, the challenging economic situation in Georgia's main trading partner countries contributed to the decline in trade.*

In comparison, in January-July Georgia's exports to its largest trading partners declined significantly - Azerbaijan (-55%), Armenia (-35%) and Russia (-47%). At the same time, exports increased significantly to Bulgaria (19%) and China (55%).

With an export volume of 128 million USD, in January-July Bulgaria became the second largest importer from Georgia (after Azerbaijan). In July 2015, Bulgaria displaced Azerbaijan as the number one importer country.

Figure 6: Trade Balance

Source: Geostat

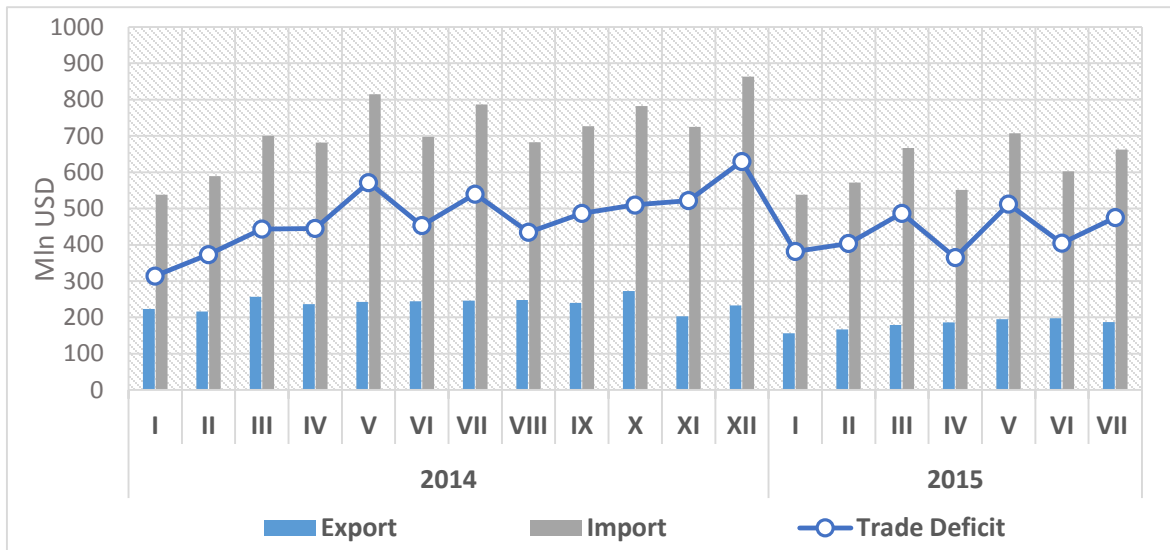
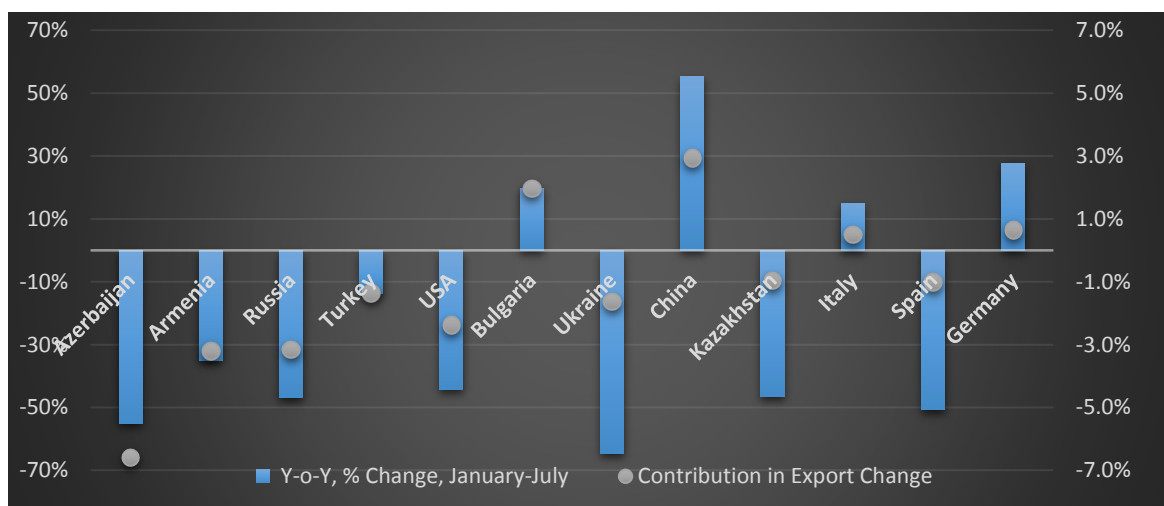


Figure 7: Exports by Country, January - July

Source: Geostat

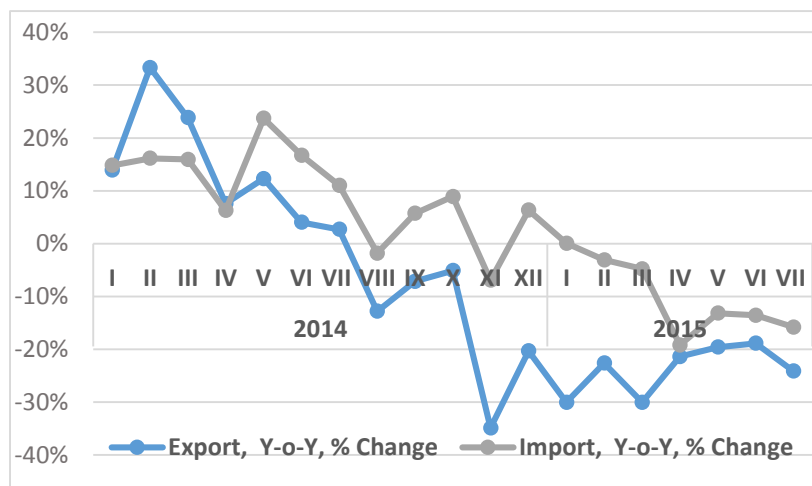


As can be seen from the graph below, imports and exports continue to exhibit a negative growth dynamic. The annual growth rate of exports stands at -24.2%, while imports have decreased by 15.8%.

However, it should be noted that USD denominated import and export statistics for 2015 can be a bit misleading and are biased downward. This downward bias lies in the fact that Georgia's trading partners have also experienced devaluations of their national currencies against the dollar, which would have forced them to revise dollar prices. Thus, if trade volumes remain the same, but Georgia and its partner countries now charge each other lower dollar prices for their products, we would see a decline in both imports and exports denominated in USD.

Figure 8: Trade, Y-o-Y, % Change

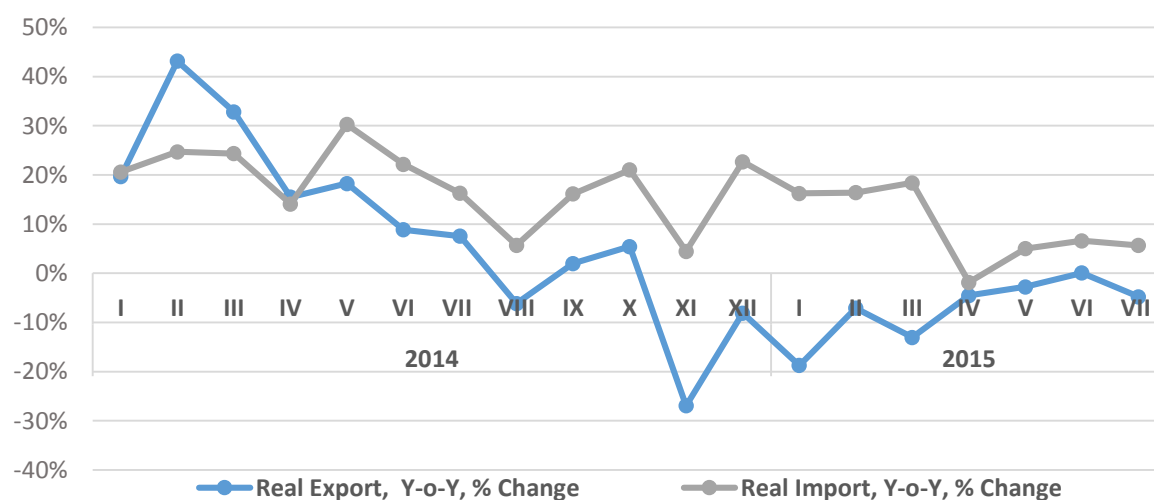
Source: Geostat



“Real” trade data shows a less dramatic pattern – real exports decreased by 4.8% annually, while real imports increased by 5.7%.

Figure 9 below shows the trends in “real trade”, which is calculated by multiplying trade denominated in lari by the real effective exchange rate to catch changes in exchange rates and in relative prices with trading partners. Not surprisingly, the real trade data shows less dramatic patterns. After declining sharply in November, “real exports” have been slowly recovering pace throughout 2015.

Figure 9: Real Trade, Y-o-Y, % Change

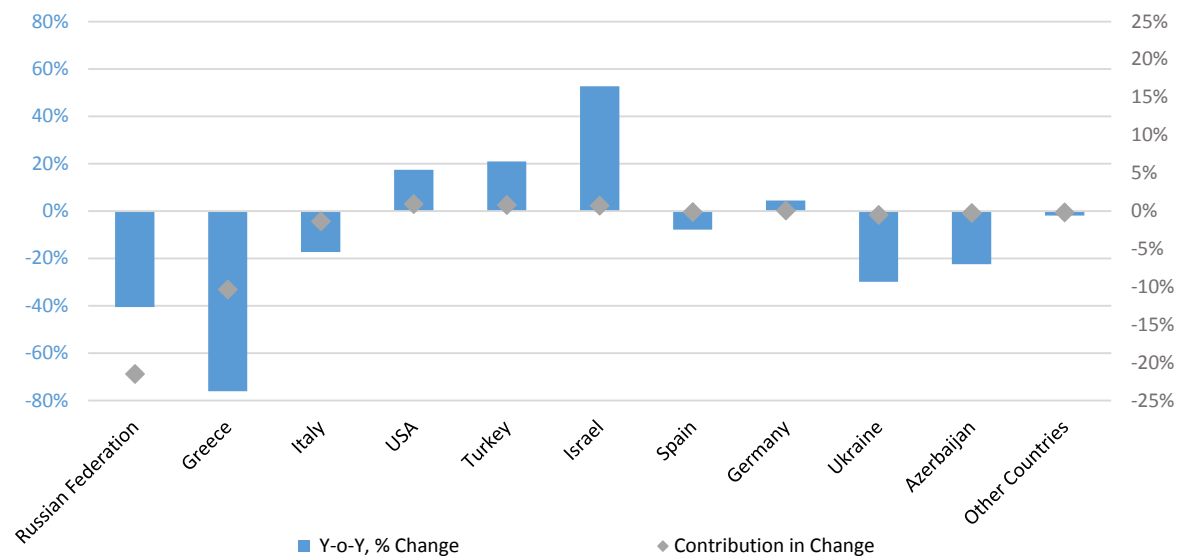


Source: Geostat, National Bank of Georgia, ISET-PI

Remittances decreased by 32% annually in July and amounted to 93 million USD. *This drop was mainly caused by the negative economic situations in Russia and Greece. Remittances from these countries decreased by 41% and 76% respectively. Russia and Greece together account for nearly 67% of all remittance transfers to Georgia.* The fall in inflows from Greece was a particularly dramatic 68%, following the 29 June restrictions on money transfers from that country.

Figure 10: Remittances by Country

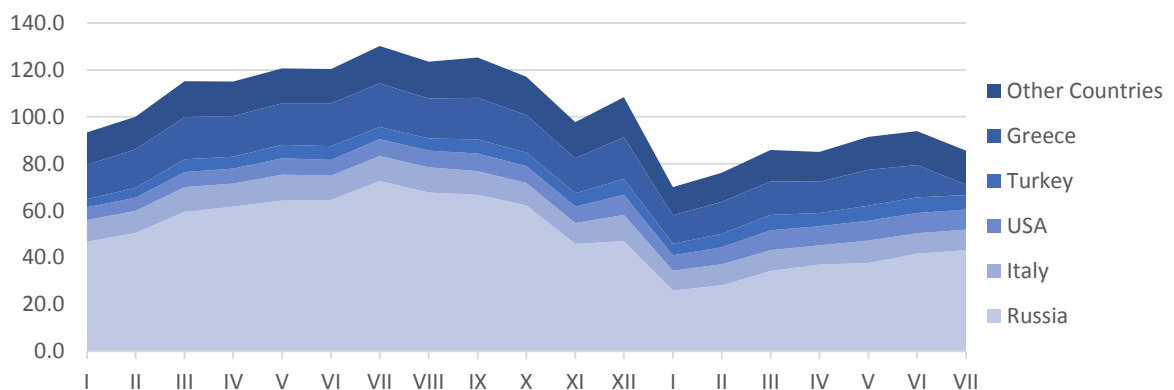
Source: National Bank of Georgia



In the first seven months of 2015, overall remittances to Georgia decreased by 24% compared to the same period of 2014.

Figure 11: Remittances, Levels by Country in million USD

Source: National Bank of Georgia

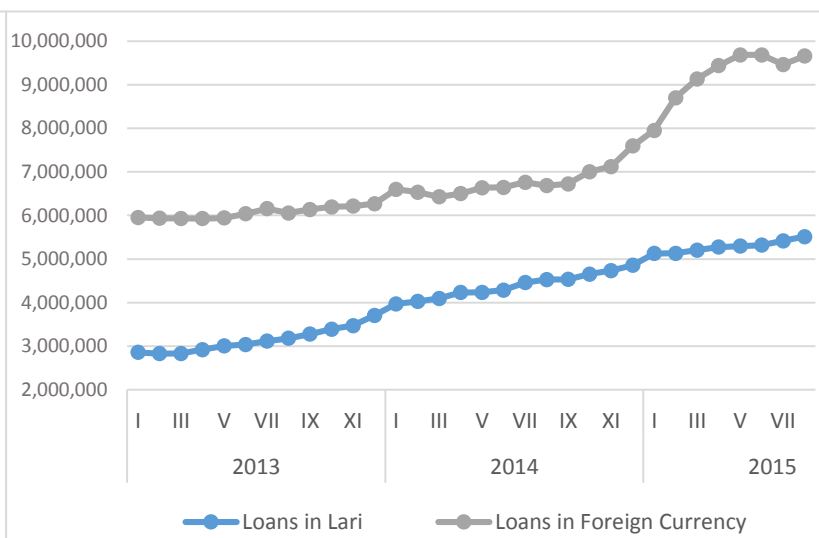
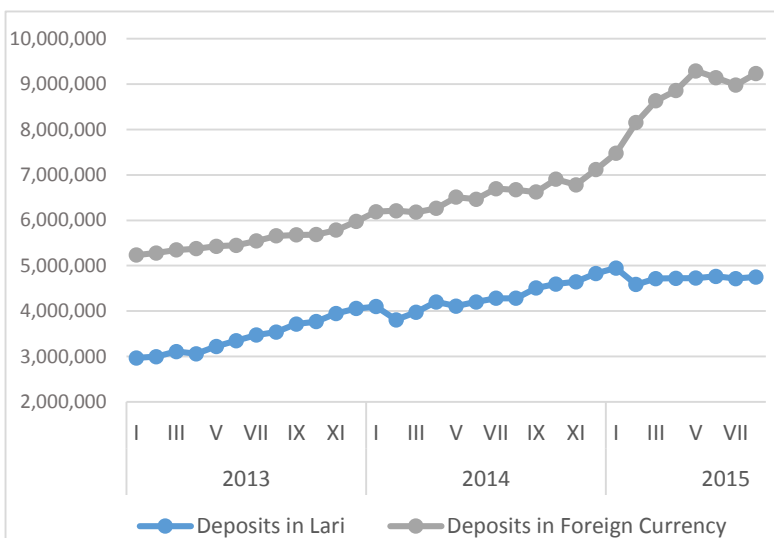


Interest rates and deposits, the overall monetary and banking sectors indicators, remained stable in July. Total deposits in the banking system increased by 1.6% (199 million GEL) compared to June and amounted to 12.8 billion GEL.

The high degree of deposits and loans dollarization (63.1% and 63.6% respectively) continues to persist.

Figure 12: Deposits, in thousand GEL

Figure 13: Loans, in thousand GEL



Source: National Bank of Georgia

Source: National Bank of Georgia

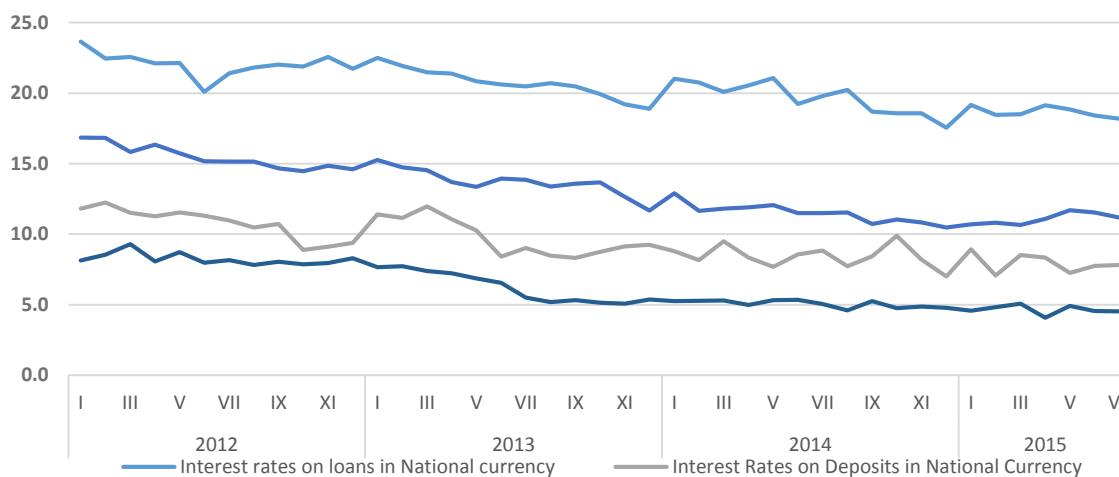
The total loan volume in the economy decreased slightly, by 0.8%, since June, and amounted to 14.9 billion GEL. The year-on-year growth rate of loans was 32.7%.

Interest rates remain remarkably stable, although there has been an evident downward trend in both deposit and lending rates since 2012.

In July, average bank interest rates on loans decreased by 0.2 percentage points compared to June and equaled 14.8%. Lari lending rates also decreased by 0.2 percentage points and stood at 18.2%. The lending rate in foreign currency decreased by 0.3 percentage points to 11.2%.

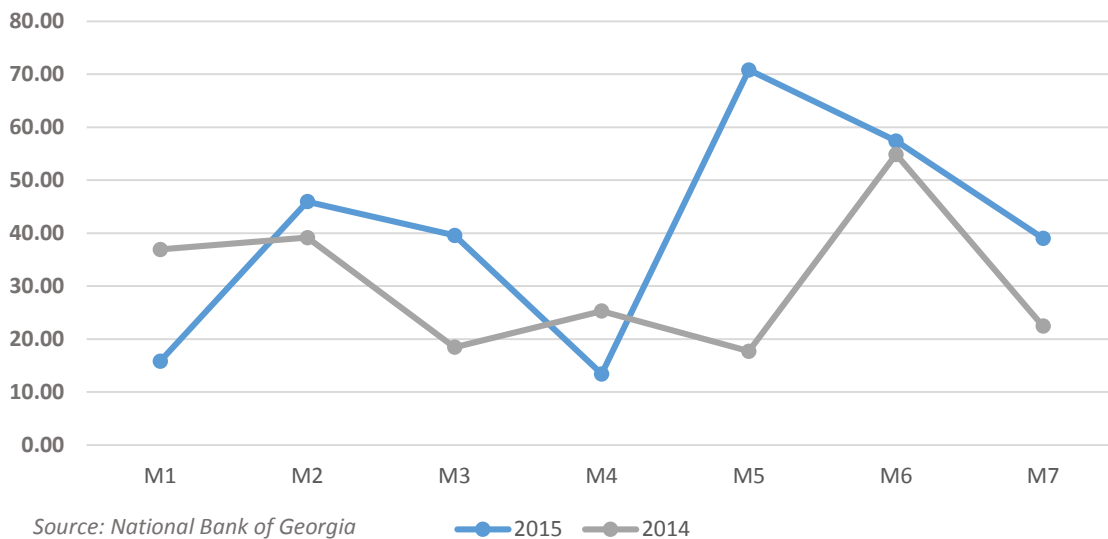
Figure 14: Interest Rates

Source: National Bank of Georgia



After a period of negative annual growth, the **net profits of commercial banks started to rise in May and continued to increase throughout June and July**. In July 2015, the year-on-year percentage change of net profit was 31%. *The share of overdue loans in the banking sector changed very little and stood at 2.3% in July.*

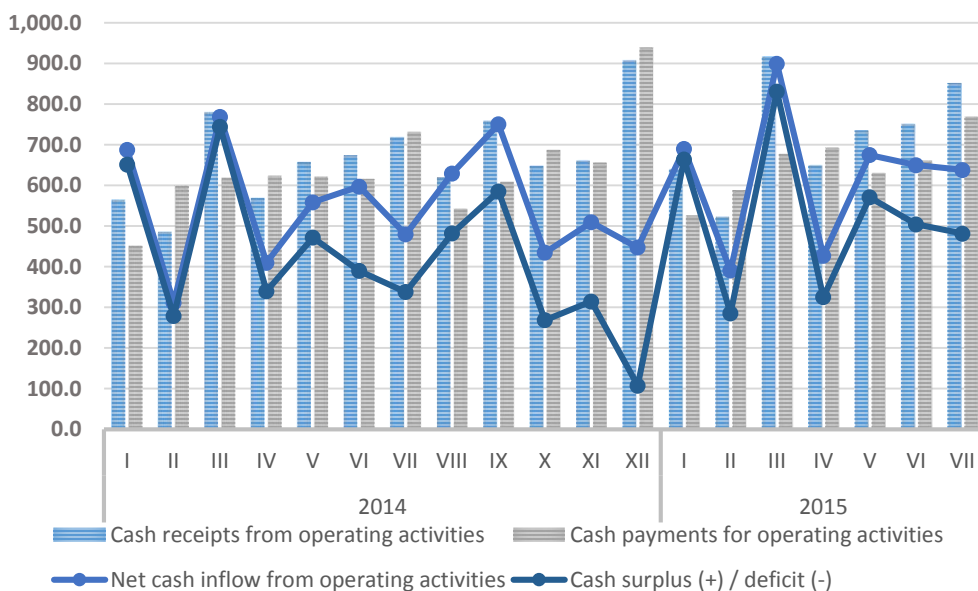
Figure 15: Net profits of commercial banks measured as: Net Income of Deposit Takers after Extraordinary Items and Taxes, mln. GEL



In July, the government's budget was in surplus by about 82.8 million GEL. This improvement is largely due to the 13% (89 million GEL) increase in total government income. Income from taxes represent as much as 89% of this amount.

Figure 16: Common Budget, in million GEL

Source: Ministry of Finance of Georgia



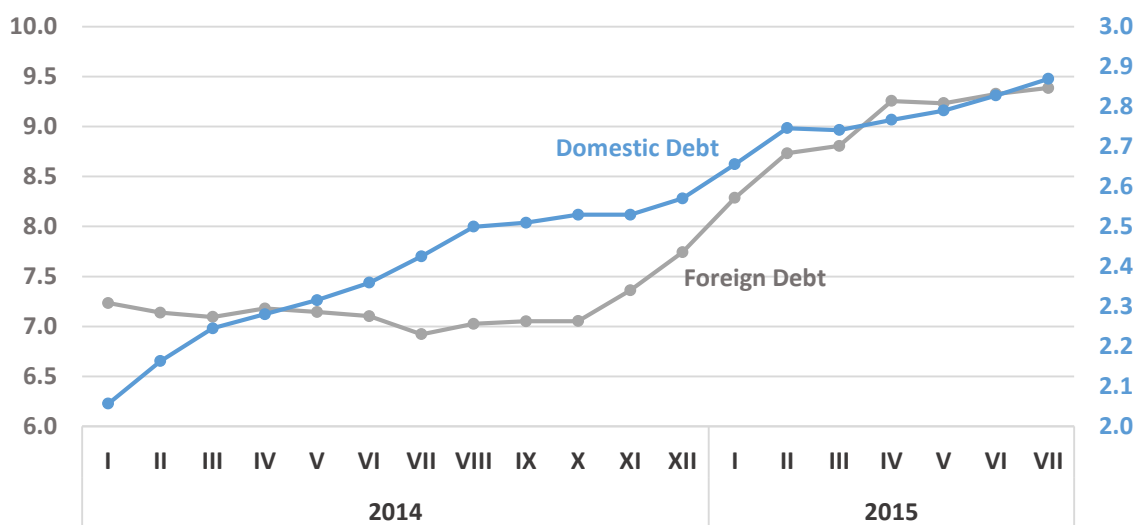
Thus the main contributor to the government income surplus was the income from excise tax (accounting for more than a third of the total tax income increase in July).

The increase in excise tax did not at first generate the expected rapid increase in tax revenues. The revenues from excise grew by only 10.5% annually in January-July 2015, while in July the increase in excise revenues amounted to as much as 44%. *The increase in the price of alcoholic*

beverages and tobacco might have meant that people started to substitute towards cheaper, homemade alcohol. In July, however, the influx of tourists spurred the consumption of store-bought alcohol and increased excise tax revenues.

As of July 2015, public debt stood at about 12.3 billion GEL, of which 23.4% is domestic debt. The rest is external debt in the form of multilateral and bilateral debt and Eurobonds. Figure 17 shows the dynamics domestic and foreign public debt denominated in GEL. *During May-July, domestic debt was increasing faster (month on month) than foreign debt. This tendency is a result of the lari stabilization against the dollar and euro.*

Figure 17: Public Debt, in billion GEL



Source: Ministry of Finance of Georgia