## Macroeconomic Review - October 2014 Issue

### Concern about the economy, as export growth turns negative in August

According to preliminary estimates, Georgian economic growth declined from 7.2% to 5.2% between July and August 2014. Although the August estimate is still quite high, there is increasing concern that the national economy is set to slow down in the second half of the year.

On the downside, the ISET-PI Leading Economic Indicators have revised the growth forecast for the third quarter of 2014 downward from 3.7% to 2.2%, and yearly growth to 3.8%. This implies a possibility of a significant economic slowdown in the last four months of 2014.

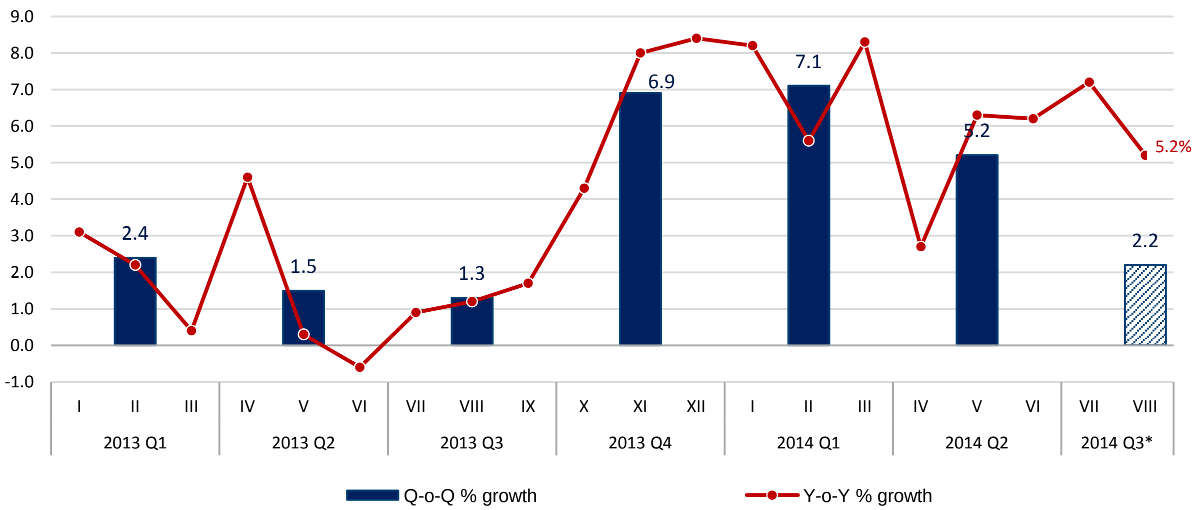


**Chart 1.** Y-o-Y (red line) and Q-o-Q (blue bars) % growth rate of real GDP.
Growth rate for Q3 of 2014 represents ISET-PI Forecast (* dashed blue bar). Source: GeoStat, ISET-PI

Secondly, the Consumer Confidence Index, and especially its Present Situation component, has had a declining trajectory since June (see Chart 2.). Although the index increased in Tbilisi from July to August, this was offset by the decline in the rest of Georgia, which was mainly a result of the drought and expected bad harvest.

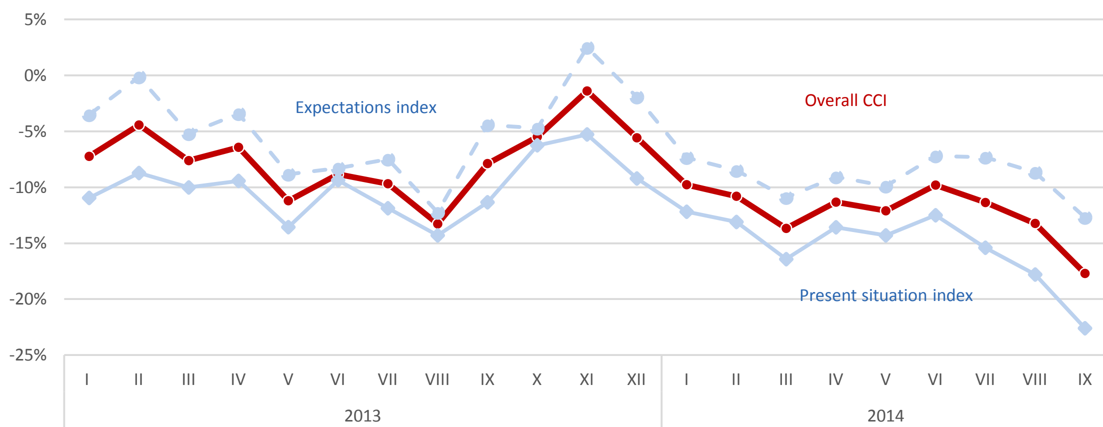


**Chart 2.** Source: ISET-PI Consumer Confidence

The main reason behind such grim forecasts for the last months of 2014 lays in the external trade data. Exports constitute 44% of Georgia's GDP. In June and July, despite being relatively low, the growth rates of exports remained positive, however, in August exports were 13% lower than the level in August 2013. One of the largest export categories was car re-exports to Azerbaijan (which encompassed nearly 20% of total exports in 2013). However, new regulations in Azerbaijan have largely closed this market. These new regulations were set to become effective in April, but Azerbaijan delayed their implementation until 1 August (see http://agenda.ge/news/19069/eng), which gave Georgian car exports a bit more breathing room. Despite this, car exports still significantly declined in June and July by almost 20% and 40% respectively. This was followed by a more dramatic fall in August with car re-exports decreasing by 51% compared to the corresponding month of 2013.

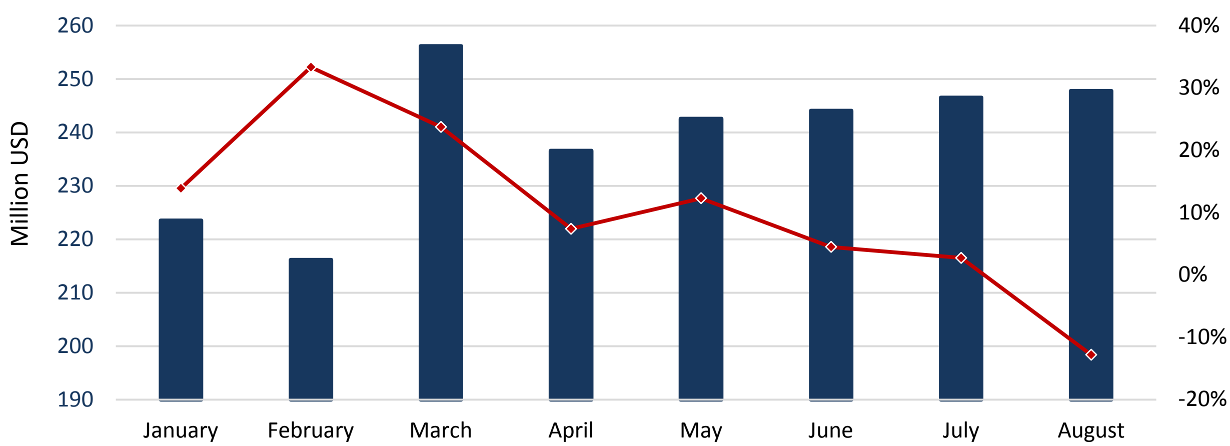


**Chart 3.** Y-o-Y (red line) % growth rate and level (blue bars) of export in 2014.
Source: GeoStat

Other categories of exports have declined in July-August as well. In addition to motor cars, exports of fertilizers, gold, iron and non-alloy steel products have decreased significantly (see Chart 4). However, the export of other products, such as ferro-alloys, mineral water, nuts, medicine have each exhibited a high annual growth rate in the reporting period.

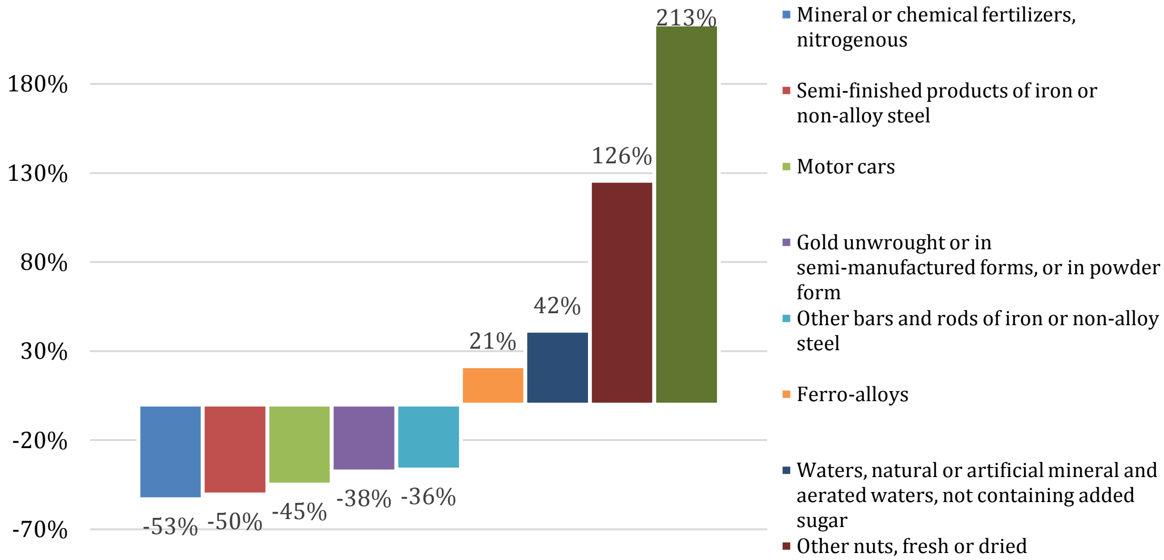


**Chart 4.** Yearly % change of product export in July-August 2014
Source: GeoStat

However, on the upside, however, we can note that signals coming from other economic indicators are mostly positive. These suggest that growth rates will be far from catastrophic in the second half of the year. First, electricity consumption has grown steadily during the summer and in August was 9.9% higher than in August 2013.

The inflation rate for consumer goods, though increasing in August, remains relatively low and has been stable throughout the year. Producer prices, after an increasing trend during the past several months, have decreased from 4.3% in July to 3.8% in August.

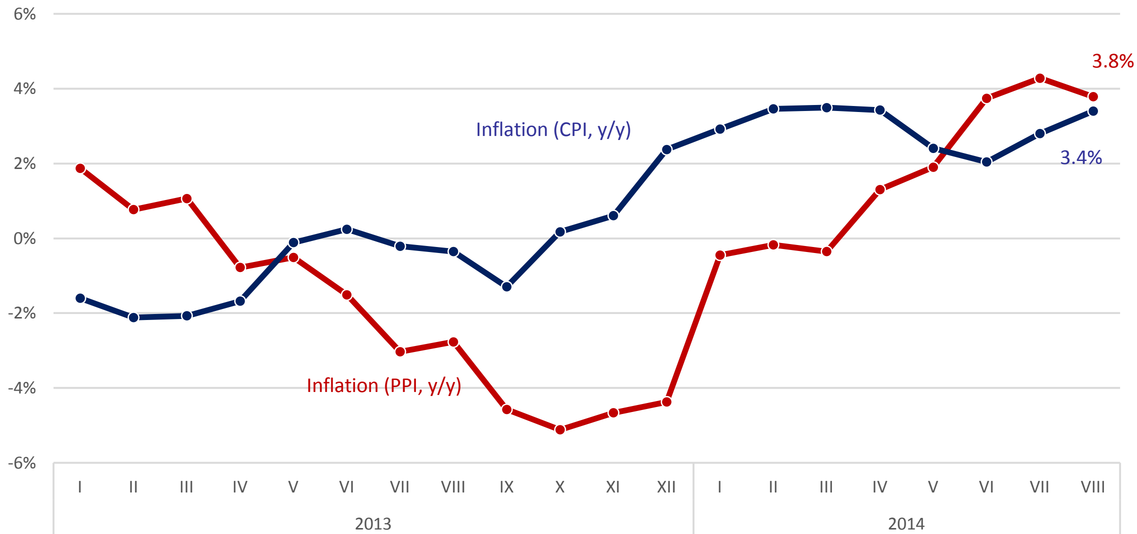


**Chart 5.**
Source: GeoStat

As for other developments, we have seen a steady decline in loan dollarization rates. The dollarization rate fell from almost 68% at the beginning of 2013 to 59.7% by August 2014. However, the dollarization of deposits has retained a relatively stable pattern.

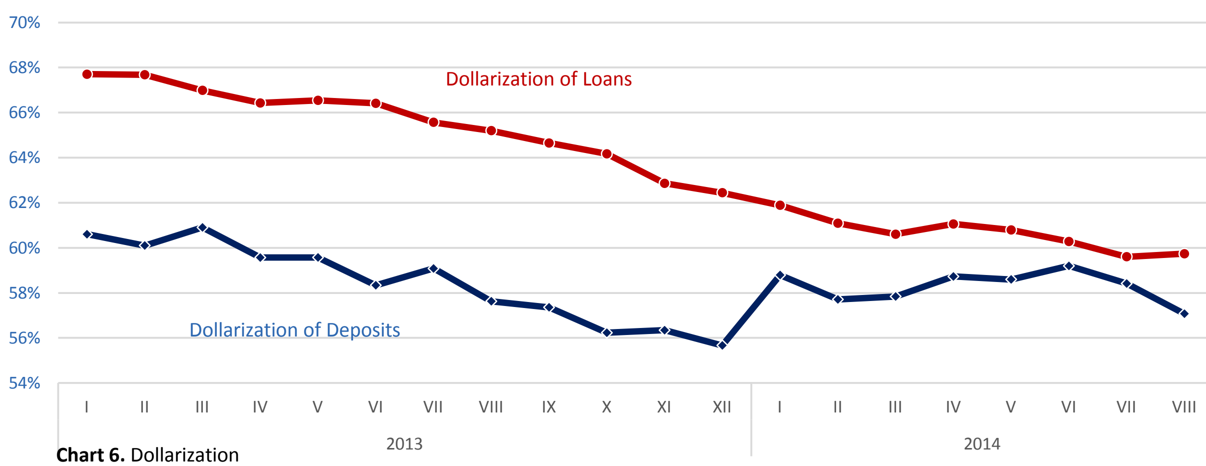


**Chart 6.** Dollarization
Source: nbg.gov.ge

Although commercial loans have decreased slightly in August, consumer loans have been steadily increasing so that total loans to the economy have increased to amount 10.83 billion lari. Growth rates of both consumer and commercial loans have decreased, but remain quite high, especially for consumer loans. Cheap agricultural loans are seen as one of the reasons behind the overall increased in the amount of loans in 2014.

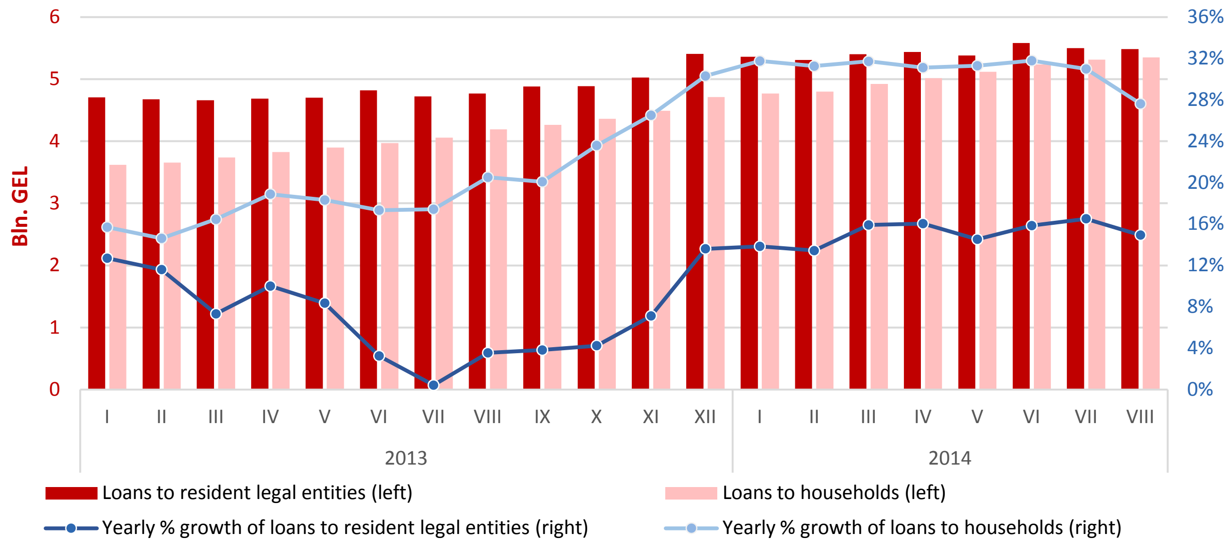


**Chart 7:** Loans
*source: www.nbg.gov.ge*

In August, the flow of remittances increased for all major source countries, aside Russia and Ukraine. Even though remittance flows from Turkey, Germany, Israel, Spain, Italy, and Greece have gone up, this has not helped to fully offset the losses from the traditionally large Russian market. As a result, remittances only increased by 0.9% compared to the corresponding month in 2013.

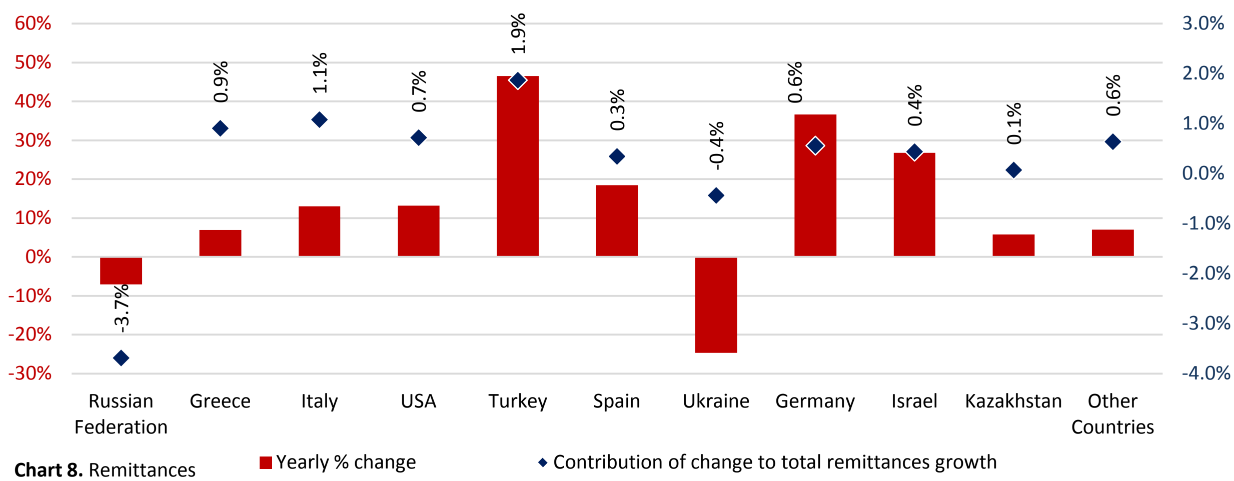


**Chart 8.** Remittances
Source: nbg.gov.ge

Foreign direct investment decreased in the second quarter of 2014, compared to the first quarter of 2014 and the corresponding quarter of 2013. The amount of FDI increased from EU and CIS countrie, but decreased from international organizations and other countries, mainly from Japan and Saudi Arabia. When we look at sectorial breakdown of FDI, we can see very large FDI outflows in the financial sector amounting to about -126 million USD. Despite the outflow, we argue that there is no cause for panic about the future of the financial sector in Georgia.

There are two main reasons for the change. Both concern one of the largest Georgian banks, the TBC bank. First, the EBRD's share in the bank's total assets decreased from 19.65% in March to 12.5% by June; also, IFC's share in the bank decreased from 19.65% to 6.2% in the same period. The pullout of international organizations' capital is related to TBC's listing on the London Stock Exchange. Second, TBC bank purchased Oikocredit's shares in Bank Constanta in April 2014. Essentially, these changes amount to the substitution of international organization's capital for private capital and can therefore be interpreted as a good sign for the country's maturing banking sector.

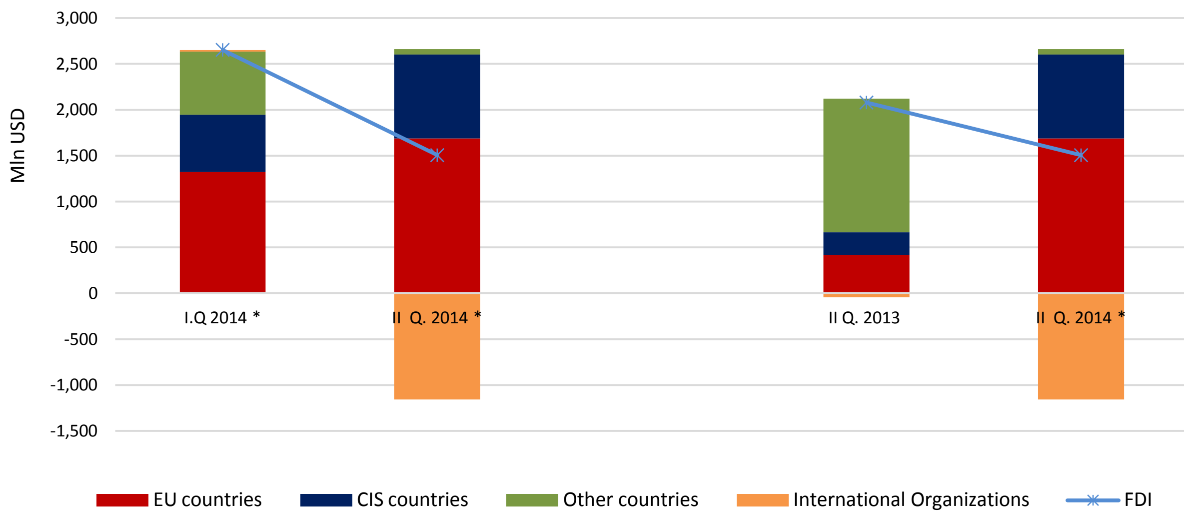


**Chart 8.** FDI quarterly and annual changes: change between Q1 and Q2 of 2014 as well as between Q2 2013 and Q2 2014.