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საქართველოს ბიზნეს ასოციაცია
BUSINESS ASSOCIATION OF GEORGIA

LARI EXCHANGE RATE REACHED A NEW EQUILIBRIUM POINT

Average exchange rate of GEL to USD was 2.26 in June. According to the National Bank of Georgia, the exchange rate has already reflected fluctuations in economy and further depreciation is unlikely in the medium term. Together with internal factors, recent depreciation of US dollar on the world market has also contributed to stabilization of lari on the new point.

In the beginning of June 2015 GEL depreciated by 32.8% to USD and by 11% to EUR compared to September 2014. In May 2015 lari exchange rate to USD reached its five year maximum (2.3650).

In May 2015, real effective exchange rate¹ depreciated by 8.1% compared to May 2014 and by 11.9% compared to December 2014. Depreciation of the currencies of the main trading partners caused relatively weaker fluctuations in the real exchange rate as compared to the nominal exchange rate.

In 2015 low oil prices and strengthening of US dollar are the major factors influencing economic trends in the world, including Georgia. As a result, currencies of many states strongly depreciated towards USD, which was followed by the sharp decline in economic growth of oil-producing countries.

In addition, the economy of the region, including Georgia, is strongly influenced by the conflict between Russian and Ukraine, as well as economic recession in Russia, which resulted in sharp decline in remittances from Russia to the countries of the region.

Chart 1. Currency Depreciation to USD, 09.14-05.15



Source: Bloomberg.com

ACCORDING TO THE PRELIMINARY ESTIMATE, CURRENT ACCOUNT DEFICIT HAS INCREASED

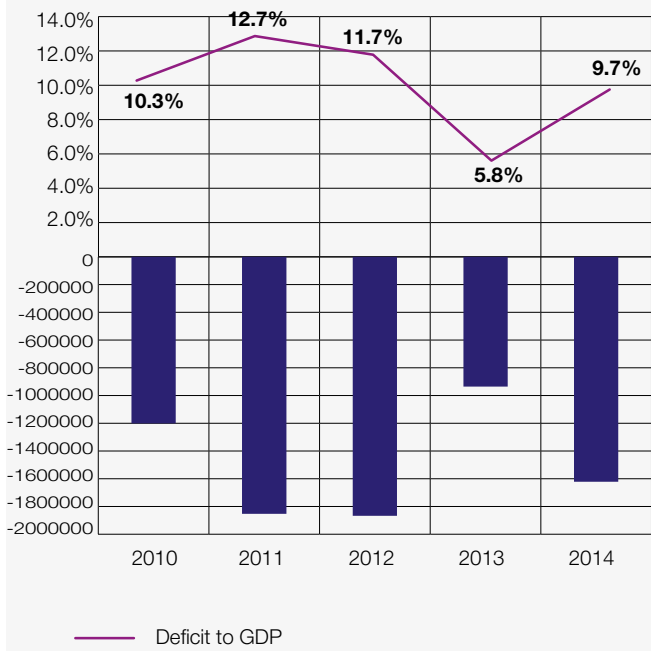
In 2014 current account deficit increased by 73.3% compared to 2013 and this trend continues. According to the preliminary estimate of National Bank of Georgia, in Q1 2015 the ratio of the current account deficit to GDP is 14.9%, 4.9% more than in 2014.

According to the International Monetary Fund, these results are influenced by the decrease in exports and remittances. However, according to the IMF, by letting the national currency depreciate, Georgia protected its foreign currency reserves and increased remittances' nominal value in GEL (IMF 2015).

Economic conditions in the region in 2015 negatively affected export. In the first five months

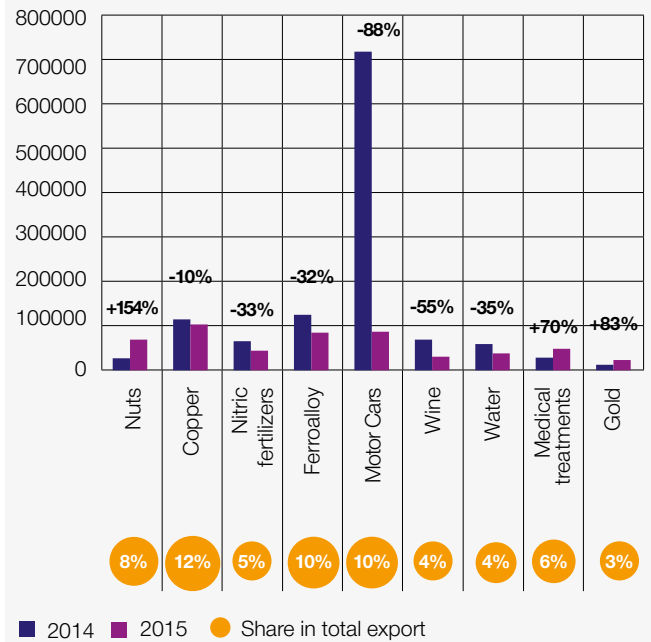
¹ Real effective exchange rate reflects change in GEL exchange rate to the currencies of the Georgia's major trading partners, considering the change in the ratio of consumer indices. Following foreign trading partners are included in the calculations: Eurozone, Turkey, Azerbaijan, Russia, Ukraine, China, Armenia, USA, Bulgaria, and Japan.

Chart 2. Current Account Deficit '000 USD



Source: Geostat

Chart 4. Export by products, January-May 2015, '000 USD



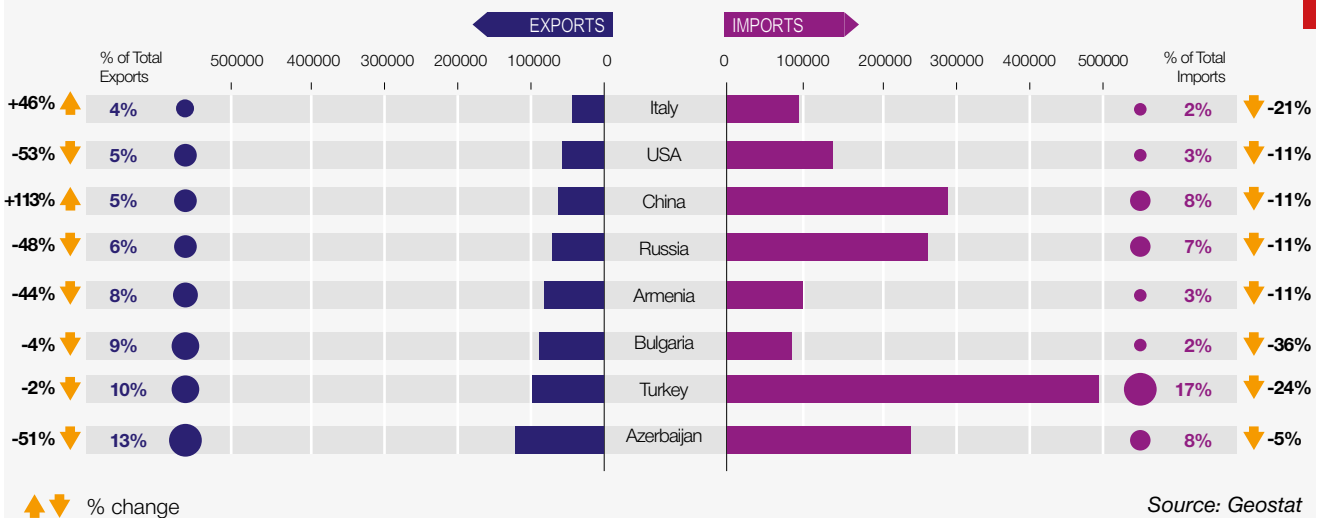
Source: Geostat

of 2015 exports decreased by 25% as compared to the same period in 2014. In addition, there is 46% decrease in exports to CIS countries and 4% decrease to the countries of the European Union. Decrease in exports started from August 2014, on the other hand, imports was increasing until the end of 2014. The latter took opposite trend from January 2015.

LARI DEPRECIATION BALANCED THE DECREASE IN REMITTANCES

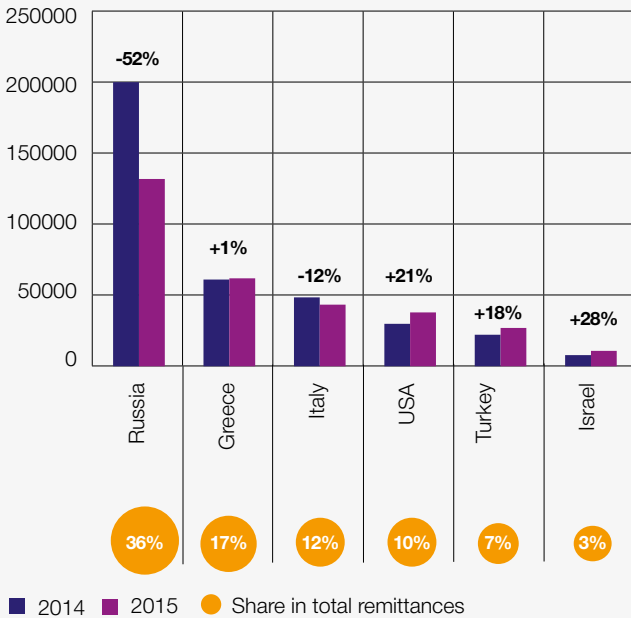
In the first five months in 2015 net remittances decreased by 27% as compared to the same period in 2014. Moreover, remittances from Russia decreased by 34.08%, from Italy – by 10.68%. The greatest growth of remittances in absolute monetary value

Chart 3. Foreign Trade by Countries, January-May 2015, '000 USD



Source: Geostat

Chart 5. Remittances by Countries, '000 USD



Source: Geostat

was from USA (USD 7,970K), the greatest decrease – from Russia (USD 67,905K). In addition, Russia’s share in remittances decreased from 39.5% to 35.7% in January-April 2015.

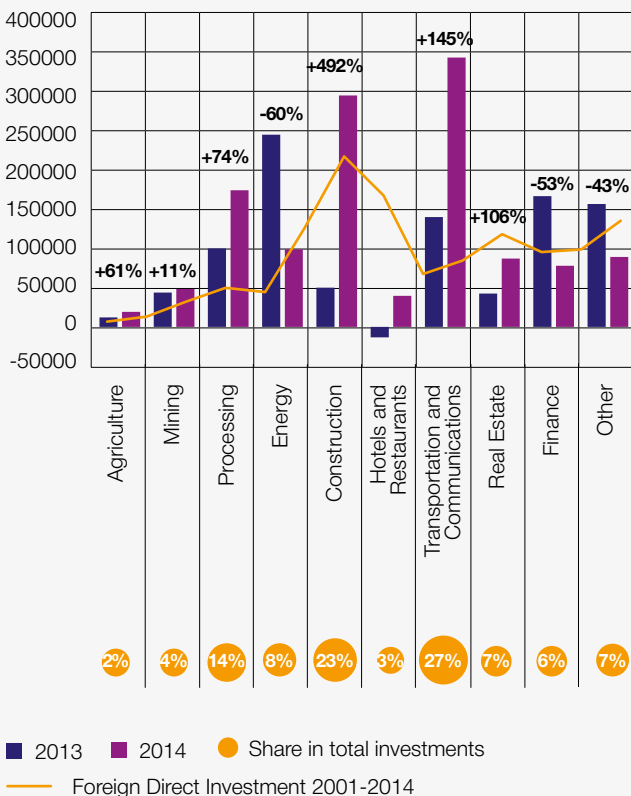
It should be noted that the value in GEL of remittances decreased only by 9.4% in the first five months in 2015. Decrease in remittances was partially balanced by the currency depreciation. For example, in May remittances in GEL decreased by 0.7, while decrease of remittances in USD was 25%.

MAJOR PART OF FDI COMES ON TRANSPORT, COMMUNICATIONS AND CONSTRUCTION

Foreign Direct Investment (FDI) has decreased significantly after the peak in 2007. However, there was a growth trend in last years. In 2014 annual increase in FDI was 35%, in spite of this, FDI decreased by 34% in Q1 2015 as compared to the same period in 2014. It is notable that in Q1 2015 there was more than USD 48m negative FDI, which significantly decreased the total amount.

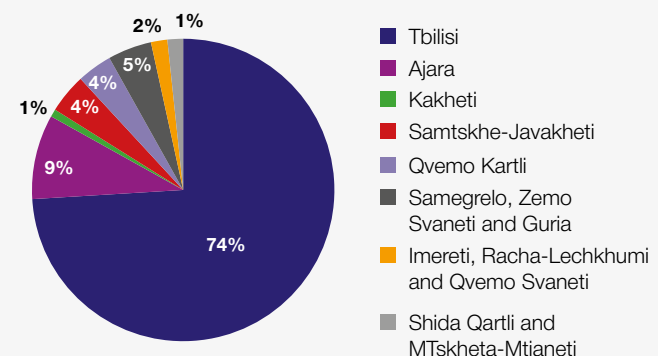
In 2014 transport and communications (27%), as well as construction (23%) sectors were the leaders in attracting FDI. In Q1 2015 the largest share of FDI again comes on transport and communications (83.5%) along with construction (14.0%).

Chart 6. Foreign Direct Investments by Sectors, '000 USD



Source: Geostat

Chart 7. FDI by Regions, %



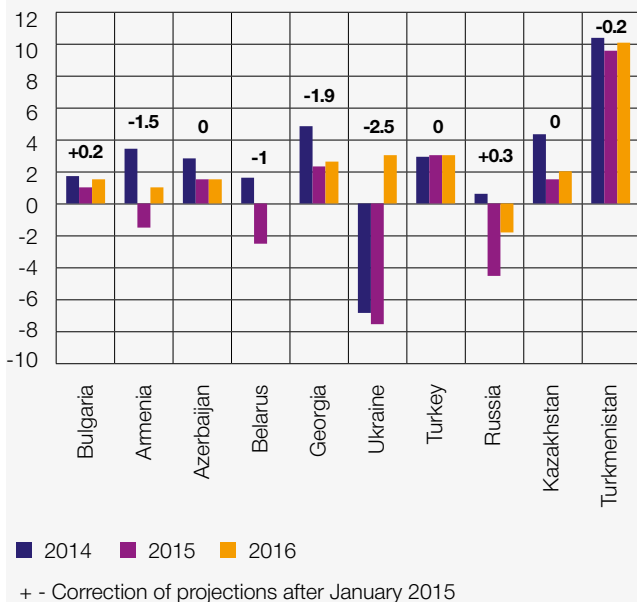
Source: Geostat

74% of FDI attracted in 2014 comes on Tbilisi and 9% on Ajara. 50% of investments come from the countries of the EU, with 26% from Netherlands. The CIS countries account for 27.7% of FDI, with Azerbaijan leading by 23.7%; China is also a significant investor with 15.3%.

PROJECTED REAL GROWTH OF GDP IN 2015 IS 2-2.3 %

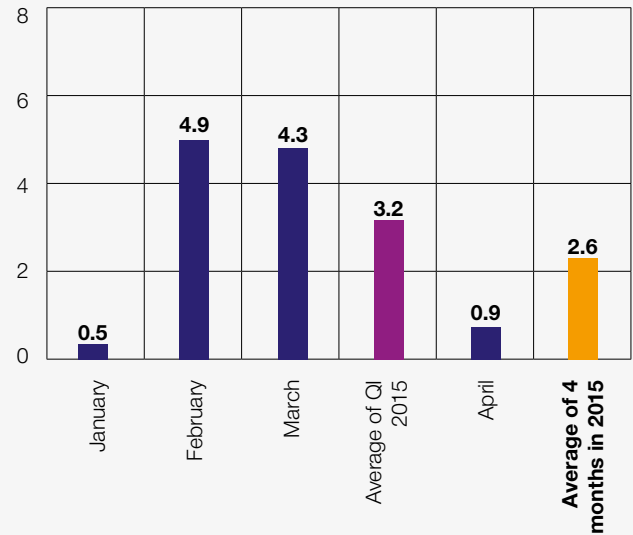
Decline in the growth of GDP is maintained as the external factors come into play. However, the change in the nominal exchange rate partially decreases the negative impact of the external shocks on the economic growth and contributes to the trade balance (NBG, Review of Inflation, May 2015). As a result, National Bank of Georgia and other international financial organizations decreased the projected growth rate to 2%.

Chart 8. Real Growth of GDP by Countries, %



Source: EBRD

Chart 9. Economic Growth in 2015, %



Source: Geostat

According to the National Bank of Georgia, the major factors influencing the decline in GDP growth are drop in exports of goods and services, and weakening of total demand. The latter is caused by the decrease in remittances and increase in the service burden of foreign currency loans. However, the economic growth rate was higher than expected in the first quarter, which might be supported by the activities in private sector.

Table 1. Real Gross Domestic Product

	Q1 2014	Q1 2015	CHANGE
GDP in current prices	6307.2	6 838,4	8.4%
GDP, million USD	3605.3	3 298,9	-8.5%
GDP per capita, GEL	1404.6	1 833,6	30.5%
GDP per capita, USD	802.9	884,5	10.2%
Real Growth in GDP	7.2 %	3,2 %	

Source: Geostat

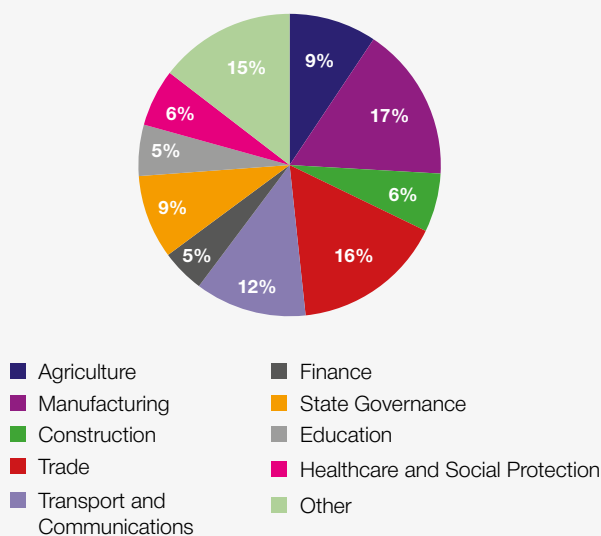
In Q1 2015 nominal GDP was GEL 6 838.4 m, which is 8.4% more than in previous quarter. However, real growth in the same period was only 3.2%².

² Real Gross Domestic Product (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). It is the basic indicator that measures the growth in the economic output.

Due to the national currency depreciation, GDP in USD decreased by 8.5%. At the same time, population decreased from 4490.5k to 3729.5k after the recent count. As a result GDP per capita in USD increased by 10.2%.

In May 2015 annual inflation was 3.5%, while the change in the prices compared to the previous month was only 0.6%. In this growth, compared to the previous month, the largest increase in prices comes on transport (3%), at the same time decrease in prices on consumer products and nonalcoholic beverages (0.6%) limits the rate of inflation.

Chart 10. GDP by Sector, Q1 2015



Source: Geostat

CURRENCY DEPRECIATION HAS NOT YET INFLUENCED PRICE LEVELS

According to the NBG, in Q1 2015 inflation reached 1.74%, and in the first five months – 2.24%, which falls below the targeted indicator. However, by the end of the year, the inflation is expected to reach the target, which is 5% for 2015-2016 and 4% for 2017. „The influence of nominal exchange rate on inflation is limited by the weak total demand. Low oil and commodity prices on international markets also contribute to the low level of inflation“ (NBG, Review of Inflation, 2015). Growth in inflation that exceeds projected margins can be caused by the increase in the prices of imported products; this trend is currently limited by the depreciation of the currencies of major trade partners, and low oil and commodity prices.

Table 2. Change in Price Levels, %

	COMPARED TO PREVIOUS MONTH	ANNUAL
Consumer products and nonalcoholic beverages	▼ -0.6	▲ +3.9
Alcohol, tobacco	▲ +0.9	▲ +11.9
Cloths and shoes	▲ +0.9	▼ -5
Housing, water, energy and gas	▲ -0.3	▲ +1.5
Furniture, household items, home maintenance	▲ +1.4	▲ +7.1
Healthcare	▲ +1.3	▲ +6.6
Transport	▲ +3	▼ -3.2
Communications	▲ +0.3	▲ +1.1
Recreation, entertainment and culture	▲ +0.9	▲ +3.9
Education	▲ +0.3	▲ +3.3
HoReCa	▲ +1	▲ +3.6
Other goods and services	▲ +1.8	▲ +6.2
Total inflation level	▲ +0.6	▲ +3.5

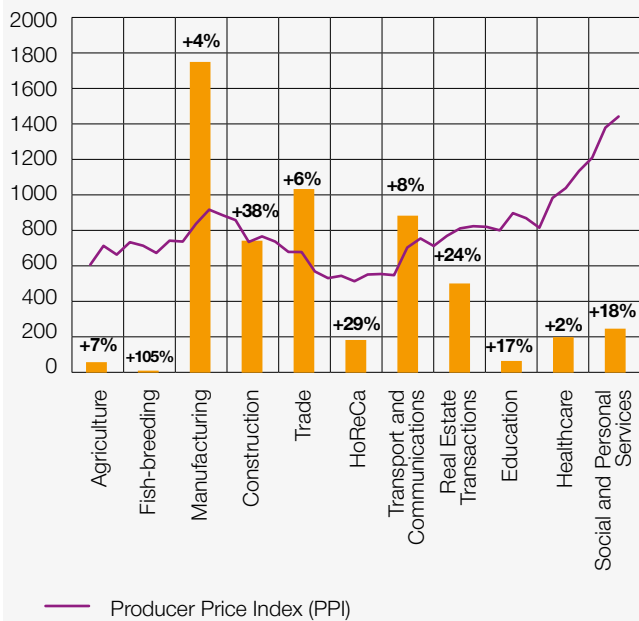
Source: Geostat

Compared to May 2015, prices have increased by 11.9% on alcohol and tobacco. In addition, there was a rise in prices on healthcare (6.6%), as well as in furniture and household items (7.1%).

BUSINESS ACTIVITY HAS INCREASED

In QI 2014 the output of business sector increased by 11.9%. The largest upsurge comes on fish-breeding (105%), while the largest increase of output in lari terms comes from the construction sector (GEL 204.3m). In April 2015 Producer Price Index (PPI)³ increased by 2.3% compared to previous month and by 8.7% compared to the same period of the previous year. In this the largest change comes on chemical production (22.8%). Turnover of enterprises increased by 10.3% compared to QI 2014. The largest growth in percentage, comes on medium enterprises (27.3%), in monetary terms the biggest growth comes on large business (GEL 741.6m). Turnover of the enterprises based in Tbilisi comprised 72.5% of the total turnover and was 2.6 times more than the total of all the regions. Output declined in Kakheti (12.0%), Racha-Lechkhumi and Qvemo Svaneti (23.5%), and Samtskhe-Javakheti (1%) compared to QI 2014. The largest growth of output is in Mtskheta-Mtianeti (36.4%).

Chart 11. Business Sector Output, GEL million



Source: Geostat

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³ Producer Price Index is an indicator of the average level of prices on products produced by manufactures compared to prices of the base period.

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