

## Georgian Economy in Q3

### **Economic growth accelerates further and stands robust:**

- The rapidly estimated real Gross Domestic Product (GDP) growth rate of the 3rd quarter equaled 5.7% y-o-y. An average estimated y-o-y real GDP growth equaled 5.0% for the Jan-Sep period of 2019, while it was 4.9% for the same period of 2018;
- Compared to the same period of the previous year, the estimated real growth was recorded in the construction, transport, trade, hotels & restaurants, and manufacturing sectors, while a decrease was registered in mining & quarrying in September 2019.

### **Unemployment data indicates continuing easing in the labor market partially driven by the decline in labor force participation:**

- In the 3rd quarter of the current year the unemployment rate decreased by 1.1 percentage point compared to the corresponding period of the previous year and equaled 11.1%;
- This is attributable to the decline in the labor force participation and the employment rate by 1.8 and 0.9 percentage point, respectively;
- The share of hired employees in total employed persons was 50.6%, which implies a 0.6 percentage point decline compared to the corresponding period of the previous year.

### **There is an acceleration in core and headline inflations mainly driven by cost channel:**

- Consumer prices increased by 1.7% m-o-m in September and annual inflation stood at 6.4%, which is above the central bank target of 3%. The overshooting the target was caused by the increased pass-through from the nominal exchange rate depreciation to inflation in recent periods;
- Annual core inflation\* increased to 4.6% from 3.6% in June, implying that a significant part of the annual headline inflation is persistent. The annual core inflation without tobacco\*\* rose by 1.8 percentage point compared to June and stood at 3.2%;
- In the breakdown of annual inflation:
  - ✓ Food & non-alcoholic beverages turned out to be the major contributor to the overall 6.4% annual inflation. The prices increased by 11.7%, adding 3.49 percentage points (p.p.);

- ✓ Alcoholic beverages & tobacco pulled inflation up by 0.97 p.p. in September driven by the increase in tobacco prices (29%);
- ✓ Transport was another driver, adding 0.47 p.p., triggering by the higher prices for the purchase of vehicles (9.1%);
- On the flip side,
  - ✓ Clothing & footwear dragged the headline down by 0.21 p.p.;
  - ✓ Communication costs reduced the headline by 0.08 p.p.;
- Meanwhile, Domestic Producer Price Index (DPPI) for industrial products rose by 0.8% compared to the previous month, while the index growth amounted to 10.4% y-o-y;
- The domestic PPI for manufactured products increased by 12.6% compared to the corresponding period of 2018, resulting in a 9.82 percentage points contribution to the overall annual DPPI change;
- 46% of annual domestic PPI change comes from food products, beverages, and tobacco, which went up by 14.2% y-o-y. The Import Price Index (MPI) for food products, beverages, and tobacco increased by 15% y-o-y, which implies that there is strong cost pressure on the consumer food inflation, and subsequently on the headline inflation.

\*The core inflation is calculated by excluding food and non-alcoholic beverages, energy, regulated tariffs, and transport (specific tariffs) from the consumer basket.

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#### **Trade deficit declines mainly driven by decreasing imports:**

- In January-September 2019, the external merchandise trade turnover of Georgia expanded by 0.5% y-o-y and amounted to USD 9193.7 mln.;
- The exports equaled USD 2719.2 mln. (11.1% growth)\*\*\*, while the imports stood at USD 6474.5 mln. (3.3% decline);
- The trade deficit dropped by 11.6% and amounted to USD 3755.3 mln. Its share in external trade turnover constituted 40.8%;

- The exports to the EU countries stood at USD 620.1 mln. (16.3% higher compared to January-September 2018) and reached nearly a quarter of total exports. Meanwhile, the imports equaled USD 1667.5 mln. (10.6% drop) with 25.8% share in total imports. The EU countries accounted for 27.9% of the overall trade deficit in the reporting period;
- The exports to the CIS countries amounted to USD 1430.9 mln. (23.2% growth) and constituted half of the total exports, while the imports amounted to USD 1704.7 mln. (12.4% decline) with a quarter share in total imports. The CIS countries accounted for 7.3% of the trade deficit;
- The export market concentration is higher: the share of the top ten trading partners by exports in the total exports amounted to 72.6%. The top partners were Russia (13.6% in total), Azerbaijan (13.1%), and Armenia (9.6%);
- The share of the top ten trading partners by imports in the total imports account for 65.9%. The top partners were Turkey (17.6%), Russia (10.2%), and China (10.0%).

\*\*\*The exports excluding re-exports expanded by 1.6% y-o-y and amounted to USD 1690.5 mln.

#### **A sluggish growth on consumer loans and a stronger one on the corporate side:**

- As of September 2019, total assets of the commercial banks increased by 21.1% compared to the same month of 2018 (YTD 16.7%↑) and stood at GEL 46.3 bln.;
- The total loan portfolio rose by 20.3% and amounted to GEL 29.4 bln. In YoY terms, loans to households (inc. individual entrepreneurs) went up by 14.1% (GEL 15.2 bln.), while the consumer loans experienced a sluggish 5.3% growth and accounted for GEL 3.9 bln.;
- The corporate loan portfolio grew by 27.8% and stood at GEL 14.2 bln. The main drivers of the growth were loans to industry (32% of the growth), construction (17%), and trade (17%);
- The share of non-performing loans (NBG methodology) in total loans realized as 5.3%, which is 0.3 percentage points lower comparing to September 2018;

- Deposit portfolio of non-financial borrowers (individuals & legal entities) expanded by 16% y-o-y to GEL 26.5 bln. The main drivers were demand deposits of individuals & legal entities, constituting 54% and 25% of the growth, respectively. While 42% of the total deposit growth was driven by individuals' term deposits, term deposits of legal entities dragged down the growth (-20.4% YoY);
- Dollarization of the total deposits stood at 64%, while it was 75% for individuals' deposits and 51% for legal entities;
- During the reporting period, the Return on Assets ratio (ROA) of the sector stood at 2.4%, while Return on Equity ratio (ROE) was 18.9%.

**The NBG started to tighten monetary policy from September aiming at neutralizing inflationary pressures stemming from the depreciation:**

- National Bank of Georgia (NBG) raised the policy rate in total by 100 basis points over the two meetings in September and by 100 basis points in the October meeting. As a result, the policy rate stood at 8.5% as of October 2019;
- The decision based on two main factors:
  - (i) According to the NBG, the inflationary pressure stemming from the exchange rate depreciation is only partially offset by the aggregate demand-side factors as the economic activity is enhanced compared to previous periods;
  - (ii) The persistence of positive dynamics in the external sector, together with the monetary policy tightening, should support the strengthening of the exchange rate through expectations channel, and, hence, provide favorable inflation dynamics in the medium term.

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