Russian Sanctions: Manageable Impact on the Growth and Still Betting on the GEL

Prepared by TBC Bank Economic Team

June 2019

Otar Nadaraia

TBC Bank Chief Economist

Aleqsandre Bluashvili

TBC Bank

Head of Macro-Financial Analysis Division

Nuka Gvilia

Intern

Contact information:

7 Marjanishvili st. Tbilisi, Georgia 0102

E-mail: macro@tbcbank.com.ge

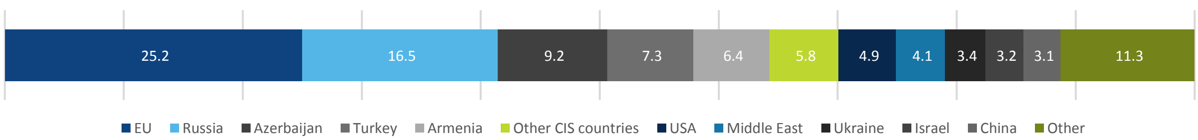
Phone number: +995 322 272727 (4188)

2018 was truly the year of resilience for the Georgian economy. Despite unfavorable regional developments and tight fiscal stance domestically, real GDP growth reached 4.7%. Furthermore, the NBG bought FX reserves of around 1.2% of GDP indicating that the inflows were sufficient even for a higher growth.

When the adverse impact arising from the regional economic partners was fading, Russia banned direct flights to Georgia effective from July 8.

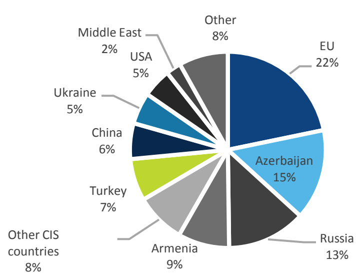
In 2018 the share of Russia in total inflows (exports of goods, tourism, remittances, and FDIs) stood at 16% with the tourism share of 19%[1] and a significant contribution to the growth. The estimated drop of tourism inflows from Russia may be as high as 50%. Even in this case, we believe the impact on growth is manageable and we bet on the GEL.

Share in exports, tourism , remittance and FDI inflows in 2018 (%)

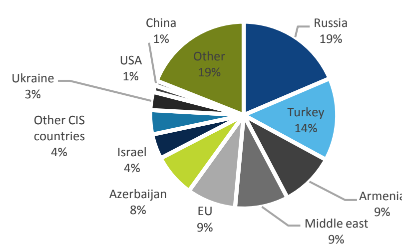


Share in exports, tourism and remittance inflows in 2018 (%)

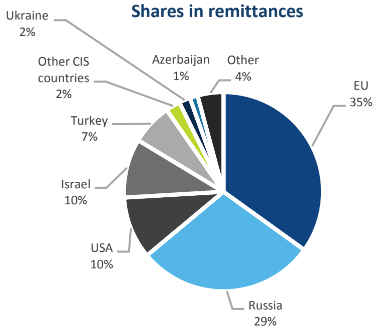
Share in exports of goods



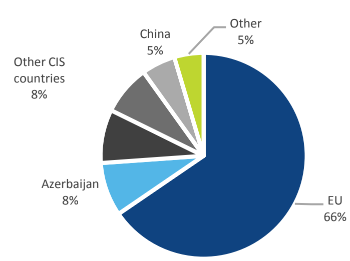
Shares in tourism



Shares in remittances



Shares in FDI inflows



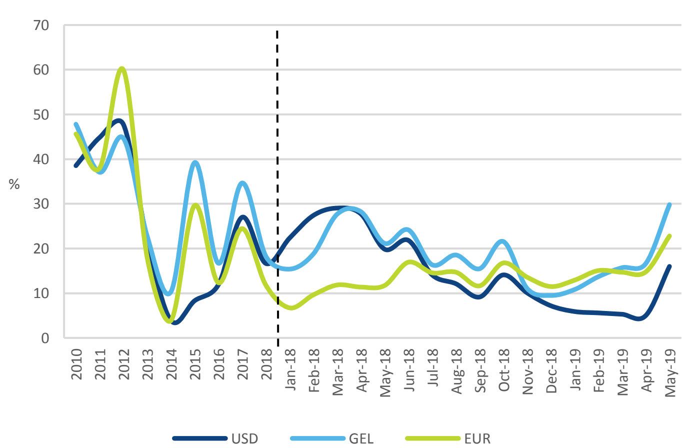
Source: NBG, Geostat, GNTA, TBC Bank Economic Team estimates

[1] NBG, Geostat, TBC Bank Economic Team estimates

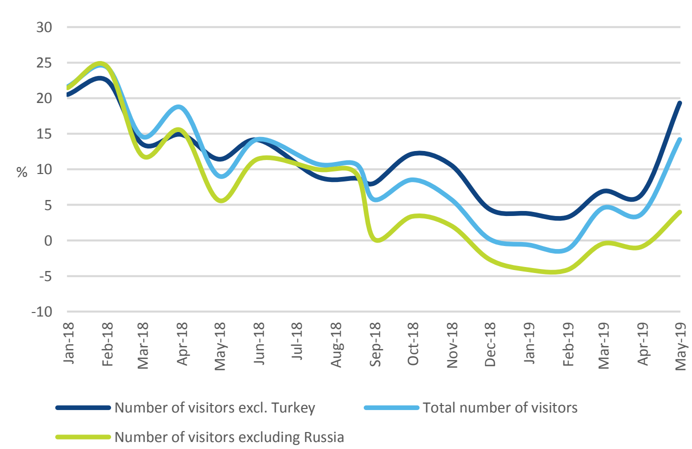
GDP growth to slow by around 1 percent

- Estimated share of Russia in tourism inflows stands at around 20% over the last twelve months as of May 2019. The USD equivalent of inflows from Russia over the same period stood at 660 mln USD. With an Assumed 50% drop and 0.75 multiplier, the impact on GDP growth would be -1.5%.
- Despite a possible sharp drop from Russia, total tourism inflows' growth is expected to remain in positive directory up to 5%, mainly due to the solid increase from other sources, such as the EU with around 10% share and the growth rate of 33.6% YoY over the last twelve months, Israel (4.5% share and 36% growth), as well as other countries. At the same time, the negative impact of visitors from Turkey is starting to fade, soon to strengthen the overall growth. In addition, in the short term, only some positive impact is assumed from the ongoing marketing campaign.
- The negative impact can be balanced by a more supportive fiscal stance as well as relaxed retail credit regulations. Those measures are likely to soften the impact to 1% of GDP. 2019 growth rate is estimated to equal 4% instead of around 5% expected previously.
- A 50% drop can be a conservative assumption as market players have already started to actively seek indirect routes; also, as only one third of Russian tourists arrive by plane, the rest of the tourists are expected to be much less impacted, as well as Georgian nationals with Russian passports arriving by different means of transportation. In addition, the interest of Russian tourists still remains high as there are no safety issues and atmosphere remains welcoming.
- The countermeasures to position Georgia more actively on other markets may be more successful even in the short term.
- Restrictions may be lifted as they are likely to appear ineffective.

YoY growth of tourism inflows* in different currencies



YoY growth of number of visitors (including same day trips)



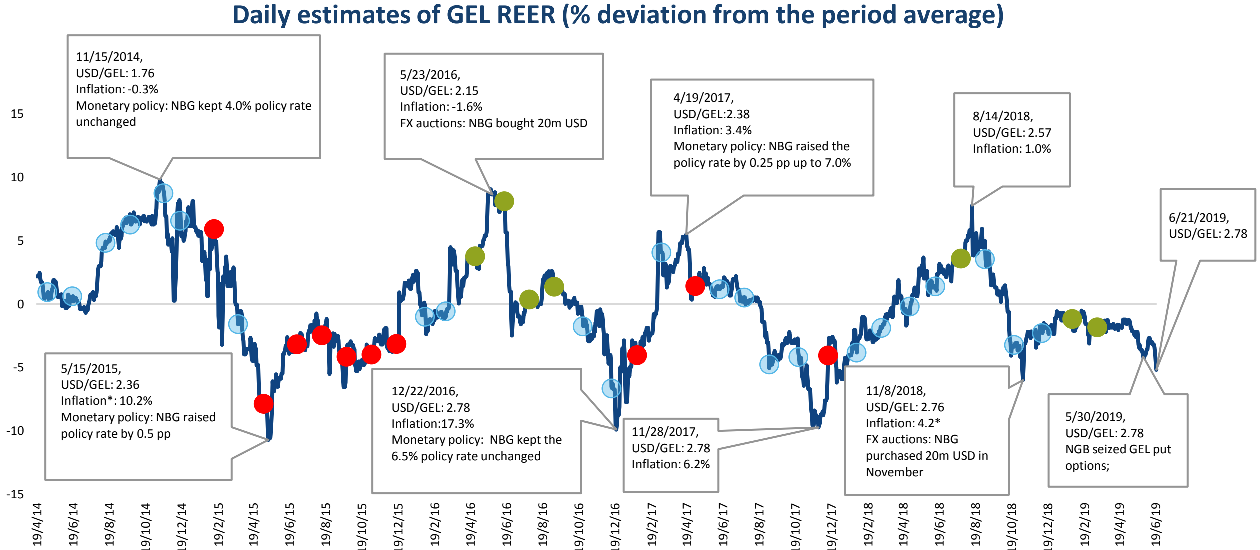
**Estimates of inflows are periodically revised as updated information is available.*

Source: NBG, TBC Bank Economic Team estimates

Still betting on the GEL

- Taking into account the estimated 330 mln USD decline of tourism inflows from Russia over the next year and assuming 60% share of domestic expenditures, projected decline adjusted for imports would be up to 200 mln USD.
- Still, external sector is likely to maintain an improving tendency. Namely, trade as well as the current account deficit have a narrowing trend. While FDIs are down, one-offs with a high import component play an important role. Furthermore, as mentioned above, total tourism inflows' growth are expected to remain positive.
- Sanctions coincide with the period of strong seasonal inflows, likely mitigating the short-term impact of the decline from Russia.
- Slower economic growth will lower the demand for imports.
- The NBG's Net International Reserves exceed the lower IMF agreement threshold of 1.52 bn USD for the end of 2019 by around 200 mln USD, implying more room for the central bank to act if necessary to smooth out unduly exchange rate fluctuations. Over the first six months of 2019, the NBG bought 216 mln USD or 3% of the same period GDP.
- The GEL REER is already assessed as undervalued, limiting the likelihood of further depreciation.
- The central bank is likely to be hawkish on the exchange rate from the perspective of inflation, which is already above the target level. While one-offs play an important role, the NBG has highlighted the risks of rising inflation expectations during the last MPC meeting on the 12th of June.
- To sum up, though the exchange rate volatility is not ruled out, the above listed arguments are in favor of the GEL.
- For more details see TBC Economic Review and latest monthly and quick updates on www.tbcresearch.ge

Daily estimates of GEL REER (% deviation from the period average)



Note: Red circles show the increase of the monetary policy rate and green circles decrease. Blue circles mean the NBG left policy rate unchanged.
**Seasonally adjusted annualized inflation in current and following month*
Sources: NBG, TBC Bank Economic Team estimates

Legal notice