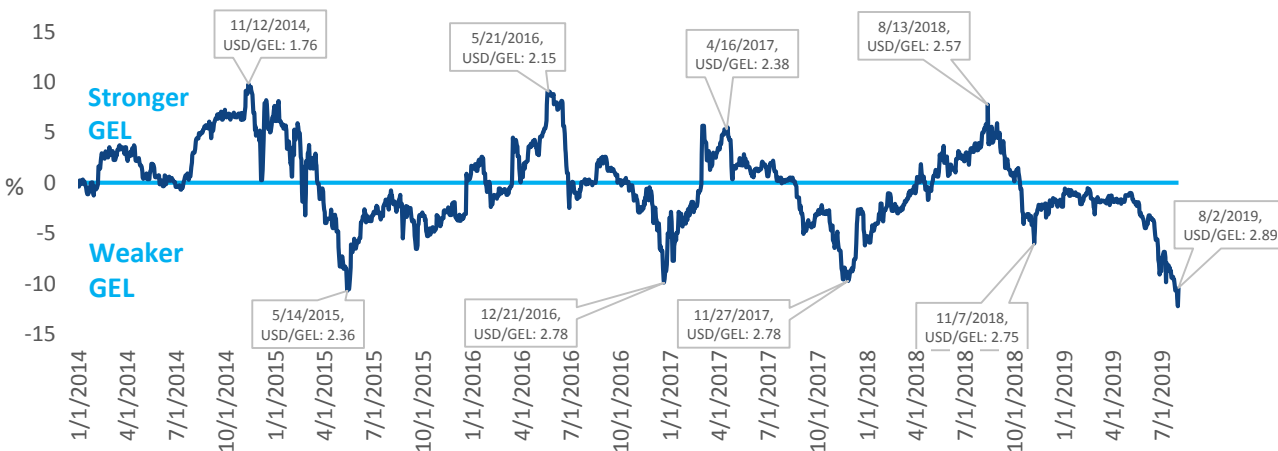


The GEL remains substantially undervalued

- ❑ The estimated GEL REER remains around 12% below its medium term average, indicating a substantial undervaluation.
- ❑ On the 31st of July the NBG stated that the recent sharp move of the GEL already creates inflationary risks and auctioned 40 mln USD on the interbank FX market. To stress its commitment, central bank announced that it will intervene again on the FX market and/or utilize other monetary policy tools as necessary to contain inflation risks.
- ❑ On the 1st of August out of the 40 mln USD 32.8 mln was absorbed by the market as the floor was defined at somewhat stronger than the same-day official exchange rate, indicating the expectations of even stronger appreciation among the market participants. These expectations were reconfirmed by the further appreciation of the GEL on the next trading day.
- ❑ Even taking into account the recent reversal of the USD/GEL and somewhat stronger dollar worldwide, the inflation is expected to pick up unless the USD/GEL strengthens further (see more on the next page).

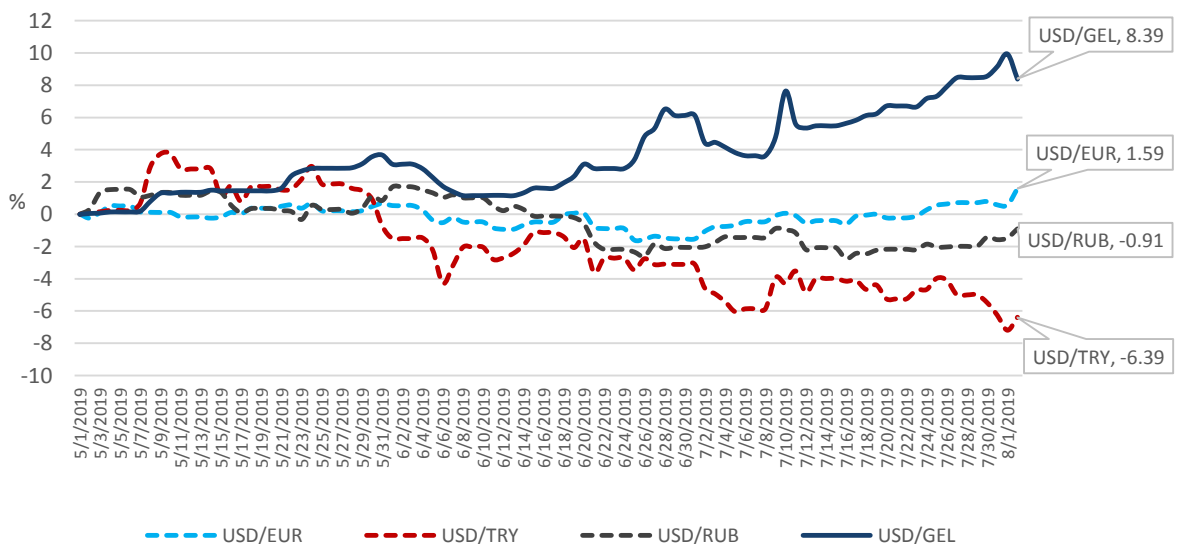
Deviation of estimated REER from its medium term average*



*Real effective exchange rate (REER) represents weighted average exchange rate of GEL against Georgia's major trading partner currencies, adjusted for inflation differential. Increase of REER means appreciation. REER below average indicates that the USD/GEL exchange rate might be undervalued and vice versa. Daily estimates of REER are calculated by using nominal effective exchange rate published daily by the National Bank of Georgia and monthly inflation differential. As Inflation data for major trading partners and Georgia is published with lag, latest inflation differential represent the estimates of the TBC Bank Economic team. Latest day exchange rate represents the results of the same day FX trading.

Source: Geostat, TBC Bank Economic Team estimates

Change of selected currencies against USD relative to 1st of May, 2019 (as of the 2nd of August 2019)

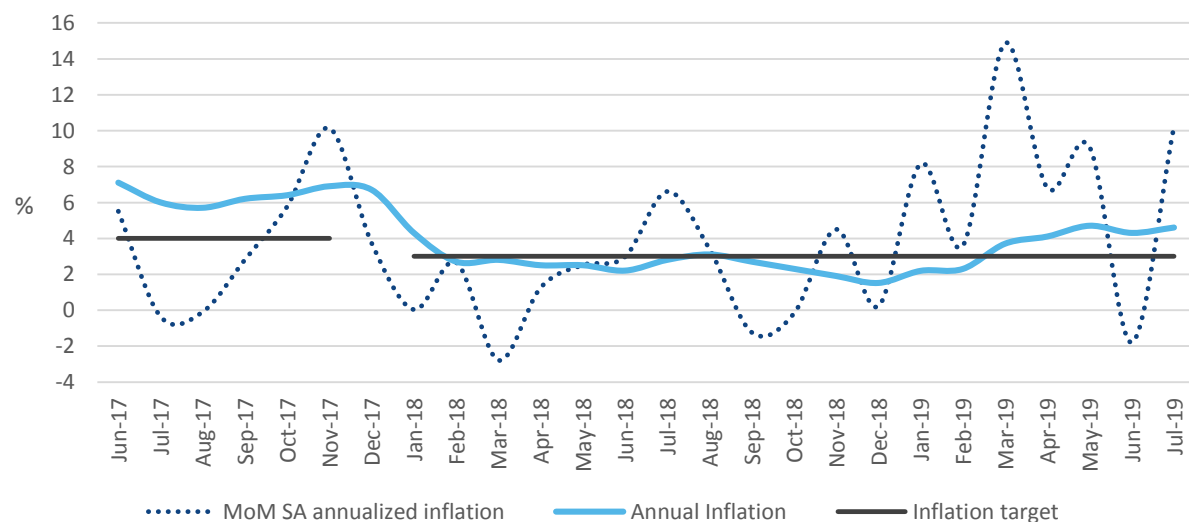


Source: NBG

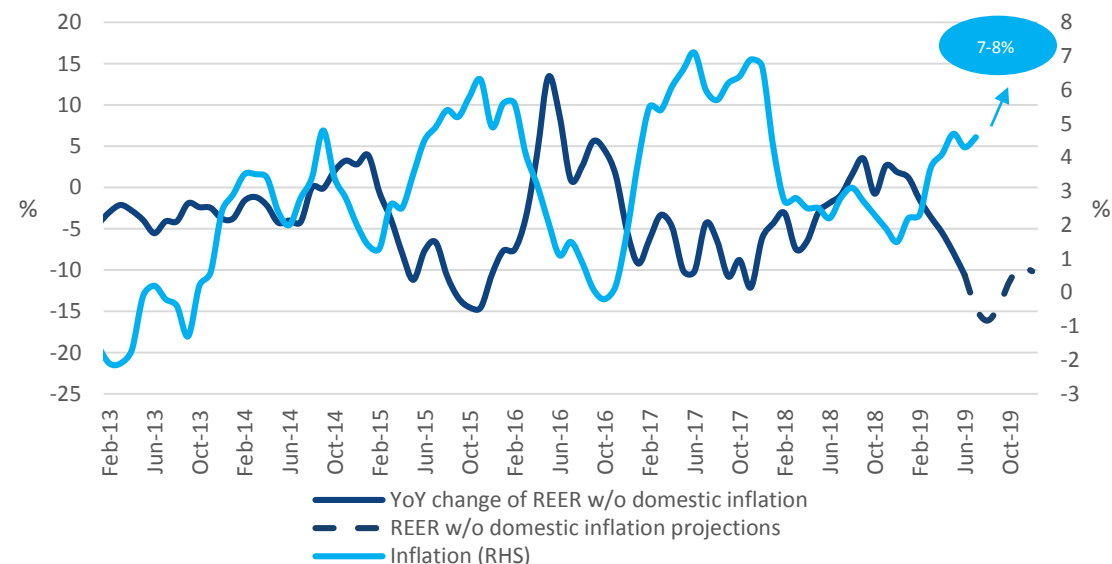
Inflation to pick up unless the GEL strengthens

- ❑ The annual inflation stood at 4.6% in July 2019, 0.3 PP higher compared to the 4.3% in the previous month. After a temporary drop in June, the seasonally adjusted annualized inflation came in at 10.2%, indicating that the inflation pressures are building up. An important driver was the weaker GEL real effective exchange rate.
- ❑ Over the same period, the annual inflation amounted to 3.9% without 0.7 pp impact of a higher excise tax on tobacco, according to the newly published estimates of Geostat.
- ❑ In terms of products, higher prices on food and non-alcoholic beverages (+7.9% YoY), alcoholic beverages and tobacco (+13.7% YoY), and transport (+3.9% YoY) contributed the most to the annual inflation. At the same time, prices went down on clothing and footwear (-7.1% YoY). A more moderate price decrease was observed in the communication sector (-2.4% YoY).
- ❑ According to the latest central bank baseline projections published in the Monetary Policy Report, inflation is expected to remain above the target level until Q2 2020 before moving closer to it.

Annual and seasonally adjusted monthly annualized Inflation



REER* and Inflation



*GEL REER projection is based on the assumption of the USD/GEL at 2.89 as of Aug the 2nd and other trading partners' currencies to remain unchanged, also, trading partners' inflation is assumed to stay unchanged.

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