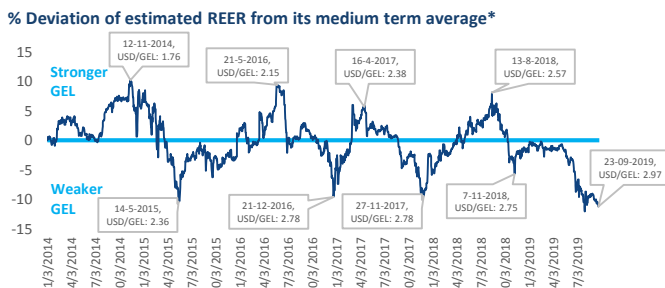
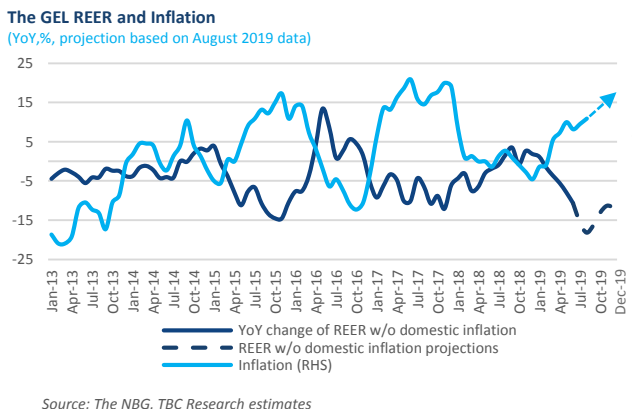
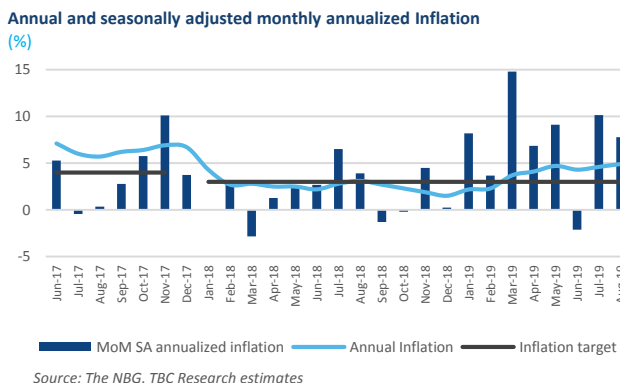
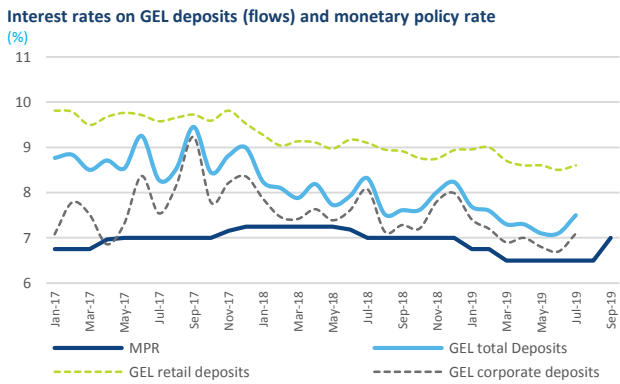


The NBG's ahead of schedule move is likely to make the GEL appreciation a one-way bet



*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 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: The NBG, TBC Research Estimates

The NBG announced last Friday it will hold an extraordinary meeting of the Monetary Policy Committee on 25th of September, delivering on its promise to act further unless the exchange rate pressures on inflation subside (see latest [monthly update](#), note on the monetary policy and inflation).

Recently published more detailed information on the price dynamics in August reveal that together with the pick-up in overall inflation rate, it is broad-based across the increasing number of goods and services, potentially impacting the expectations as well. Importantly, prices went up on imported as well as on domestic products, the latter increasing at even somewhat higher rate*. As for the producer price index, often seen as a leading indicator for consumer price dynamics, it went up by 11.1% YoY. Exports and imports prices also increased at solid rates by 13.2% YoY and 13.6% YoY, respectively. At current level of GEL REER and the commodity prices, we maintain our earlier projection of CPI inflation reaching around 7% by the end-2019.

We expect an additional 0.5 PP rate hike and do not rule out the FX interventions to follow. While in the medium term the reserve accumulation stays as a priority, in the short term the central bank may even sell reserves more actively as the existing level already exceeds the target set by the IMF program earlier in Spring, when the external sector was stronger, by around 80 mln USD, per our estimates. Also, some form of quantitative tightening may be used as a policy tool. These measures should do the trick to reverse currently sizeable GEL REER weakness.

Reasonably strong external sector is also an argument for the stronger GEL. At the same time, even if the external sector is weaker than believed, still the NBG has demonstrated the commitment to the price stability as its primary goal and, in our view, will tighten sufficiently, using the range of available tools, to counteract the inflation pressures.

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