TBC RESEARCH

Monthly Update

June 2018

Prepared by TBC Bank Economic Team

Economic Partners	Growth remains strong in economic partners
GDP Growth	Growth in Georgia improves further, reaching 7.5% in May
Inflation	Inflation remains close to the target in May with the monetary policy rate unchanged at 7.25%
Trade in Goods	Exports and imports increased by 50.2% and 25.2% respectively in May
Tourism	Tourism revenues increased by 20% in May
Remittances	Remittances were up by 13.0% in May
CA Balance	The CA balance remained broadly unchanged in Q1
FDI	FDI declined in Q1, reflecting one-offs
Loan Growth	Loan growth remained strong at 18.7% in May at constant exchange rate
Exchange Rates	The real effective exchange rate appreciated by 1.6% MoM and weakened by 0.6% YoY
FX Interventions	NBG bought 30m USD on the FX market in June
Fiscal Sector	Tax revenues increased by 7.0% YoY in May. The fiscal balance was in surplus in five months of 2018

Economic partners

The economic expansion of the eurozone remains solid and broad-based across countries and sectors – despite recent data and indicators being weaker than previously expected. Eurosystem staff macroeconomic projections for the eurozone in June predict that annual real GDP will increase by 2.1% in 2018.

The labor market has continued to tighten in the USA. This, alongside strengthening economic activity and inflation gradually increasing towards its target, prompted the FED to raise its target range for the policy rate to 1.75-2% and to increase the projected path for policy rates – with four rate hikes expected this year (two of which have already taken place), instead of the three previously expected.

The Central Bank of Turkey increased key policy rate to 17.75% to address rising inflation expectations. This sharp move cleared some of the concerns regarding the depreciation of the lira exchange rate. Growth remained strong in Turkey in Q1 2018, with GDP increasing 7.4% YoY.

According to CISSTAT, the strong growth in the CIS region and Ukraine seen in 2017 has continued in Q1 2018, reaching 2.1%.

According to the IMF, strong growth has also occurred in Israel, the Middle East and China.

Sources: *ECB, FED, CISSTAT, Central Bank of Turkey*

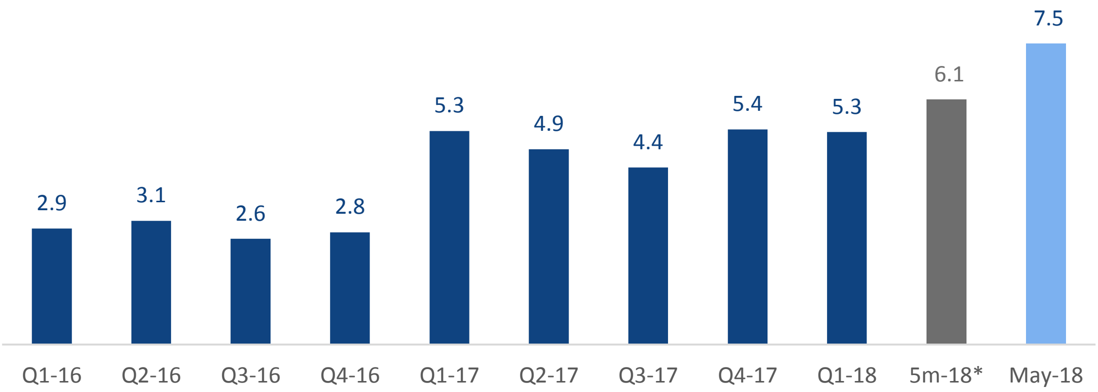
GDP increased by 7.5% in May

GDP growth accelerated and stood at 7.5% in May 2018, compared to the 6.5% growth seen in April and the 5.3% growth observed over Q1 2018.

The growth was broad-based across different sectors in Q1 2018, with the real estate (+13.4% YoY), hotels and restaurants (+10.9% YoY), construction (+8.7% YoY), manufacturing (+5.6% YoY) and trade and repairs (+5.1% YoY) sectors being the major drivers.

Real GDP growth

(%, YoY)



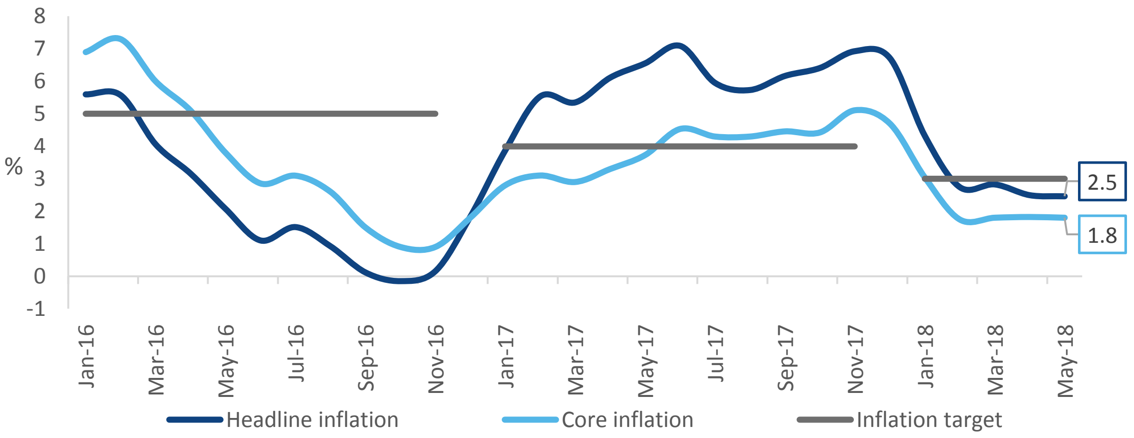
**initial estimates*

Source: Geostat

Inflation remains close to the target

In May 2017, CPI inflation stood at 2.5% YoY and was unchanged from the previous month. Compared to May 2017, CPI inflation declined by 4.1 pp. This mostly stemmed from the lower contribution of the prices of food, transport, alcoholic beverages and tobacco, health and clothing. Core inflation remained stable and stood at 1.8% YoY in May 2018.

Headline and Core Inflation
(%, YoY)



Prices of food and clothing declined on a monthly basis by -0.7% and -0.9% respectively, while the transport (+1.0% MoM) and hotels and restaurants (+0.5% MoM) sectors registered the largest increase of prices

Source: Geostat, NBG

NBG kept refinancing rate unchanged at 7.25%

Despite the deceleration of CPI inflation, the NBG's Monetary Policy Committee decided to leave the refinancing rate unchanged at 7.25% and to keep moderately tight stance. The elevated risk of regional inflation spillovers remains the major factor behind the cautious decision of the central bank.

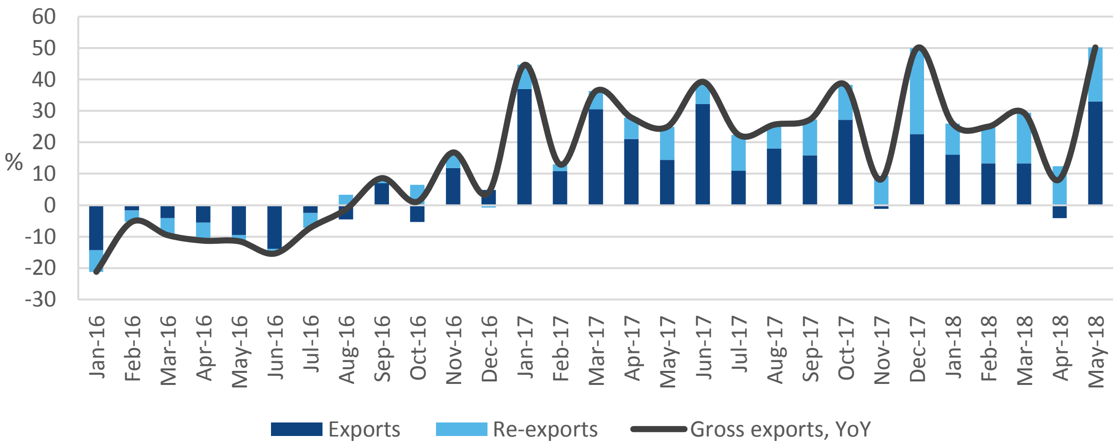
In addition, to encourage the attraction of funds in Lari, the NBG reduced the minimum reserve requirements for GEL resources to 5% (down from 7% previously).

Source: NBG

Exports of goods up by 50.2% in May

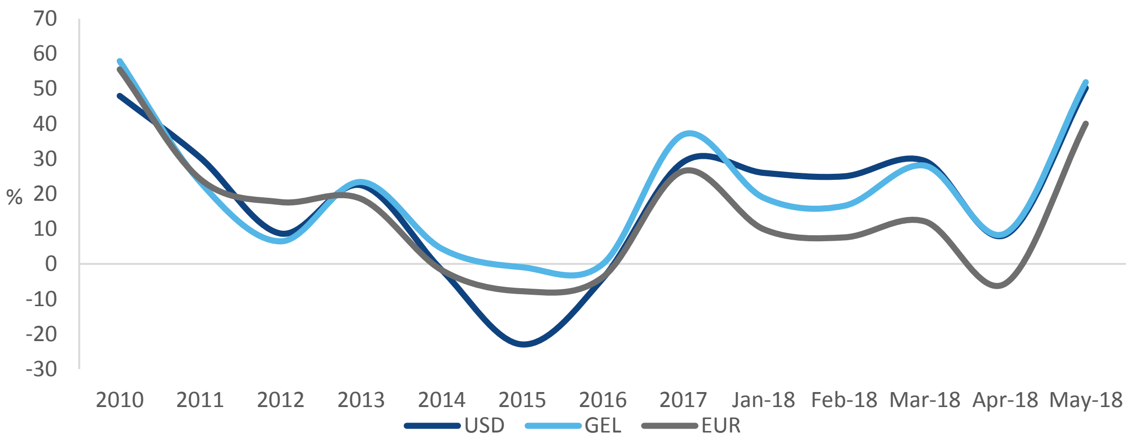
Gross exports of goods in USD terms rose by 50.2% YoY in May 2018, while growth in the first five months of the year stood at 28.0% YoY. The growth of exports was primarily driven by goods of domestic origin, but re-exports also increased substantially (+66.8% YoY) primarily driven by higher re-exports of cigarettes (+14x YoY) and cars (+67% YoY). In terms of destination, the growth was dominated by exports to the CIS (+74.9% YoY) and other countries (+84.3% YoY).

Growth of gross exports and the contribution of re-exports and exports to YoY growth
(%, YoY)

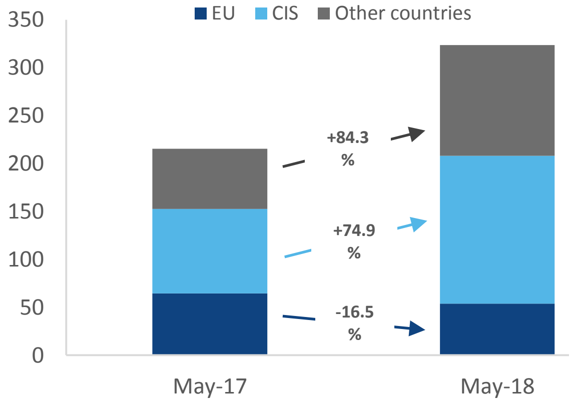


Source: Geostat, TBC Bank Economic Team estimates

Growth of gross exports in different currencies
(%, YoY)



Exports by region
(mln USD)



Exports by goods*
(mln USD, YoY)

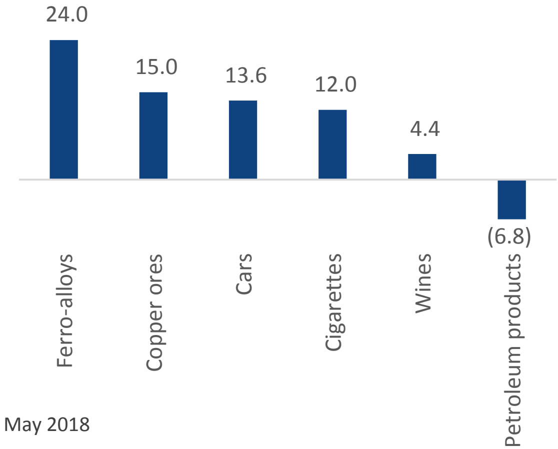


*chart shows exported goods that increased/decreased most in May 2018

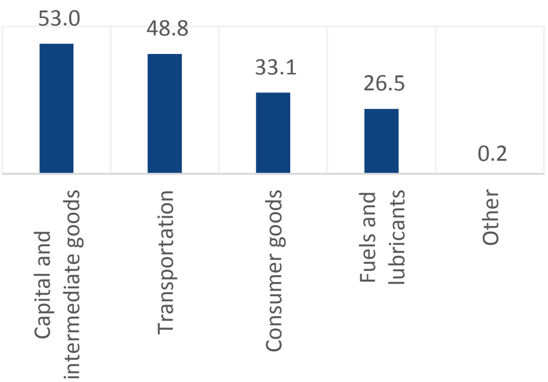
Source: Geostat, NBG

Imports of goods increased by 25.2% in May

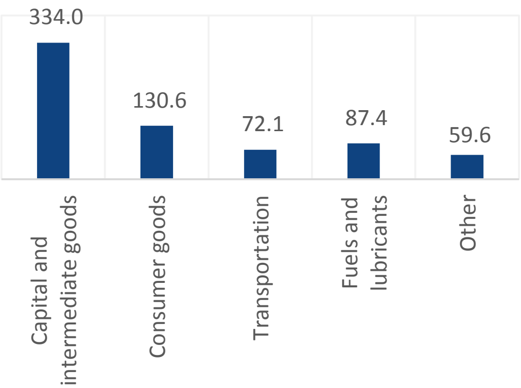
The growth of imported goods also accelerated in the wake of the continued recovery of domestic investment and consumption demand. Imports went up by 25.2% YoY in May 2018 and by 23.4% YoY in the first five months of the year. The major drivers of the growth of imports were capital and intermediate goods (+19.3% YoY), transportation (+69.8% YoY), consumer goods (+15.4% YoY) and petroleum products (+33.4% YoY).

As shown on the charts below, the growth of imports was mostly driven by the growth of capital and intermediate goods, which is related to higher investment activity.

Growth of major categories of imports in May 2018
(mln USD, YoY)

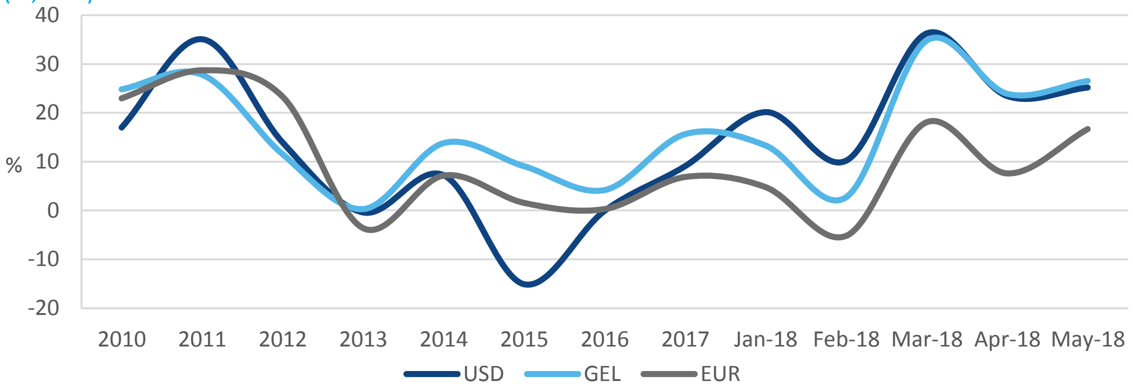


Growth of major categories of imports in the first five months of 2018
(mln USD, YoY)



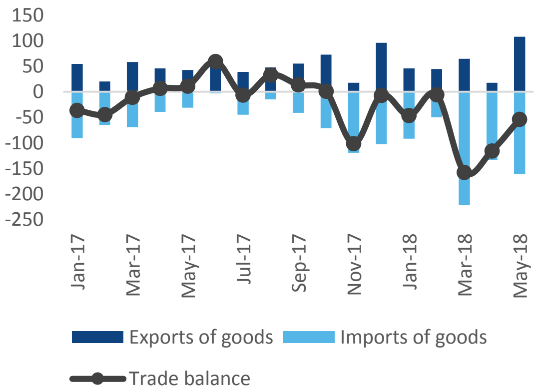
Source: Geostat, TBC Bank Economic Team estimates

Growth of imports in different currencies
(%, YoY)

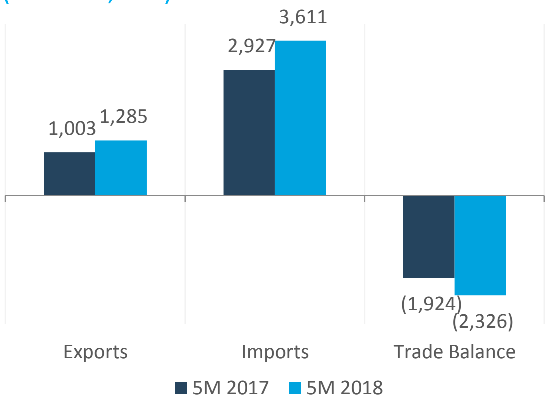


As a result of the accelerated growth of imports, the trade balance worsened by 12.5% YoY in May 2018. In absolute terms, the trade deficit widened by 53.5 mln USD over the same period. The trade balance declined by 20.9% YoY or by 402 mln USD in the first five months of the year.

Exports, imports and trade balance
(mln USD, YoY)



Exports, imports and trade balance in the first five months of 2018
(mln USD, YoY)

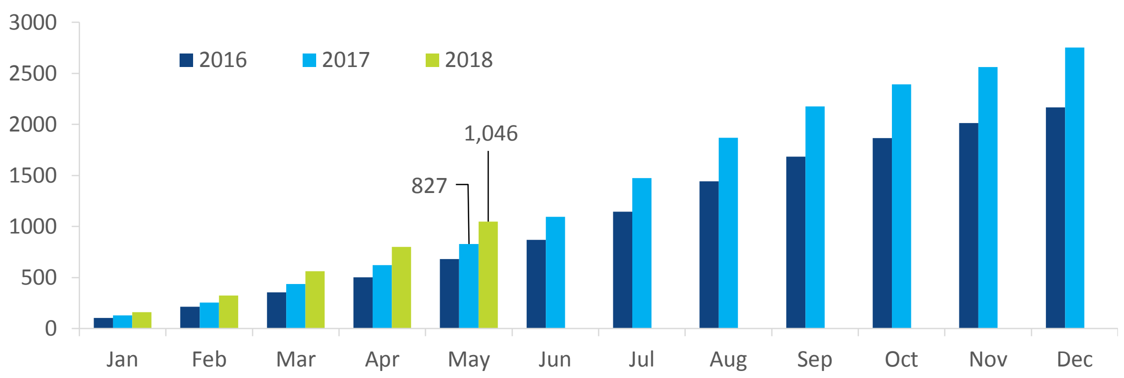


Source: Geostat

Tourism inflows increased by 20.0% in May

The robust growth of tourism inflows has continued in 2018, increasing by 20.0% in May. The number of tourists* went up by 16.1% YoY in May 2018 and by 23.5% YoY in the first five months of the year. The growth of international visitors from the EU was highest (+52.7% YoY), while the number of visitors from the CIS (+6.6% YoY) and other countries (+6.8% YoY) saw more modest growth. Tourism receipts also continued to show robust growth. In the first five months of 2018, tourism revenues amounted to 1.05bn USD, which is 26.5% higher than the same period last year.

Tourism receipts
(mln USD, YTD)



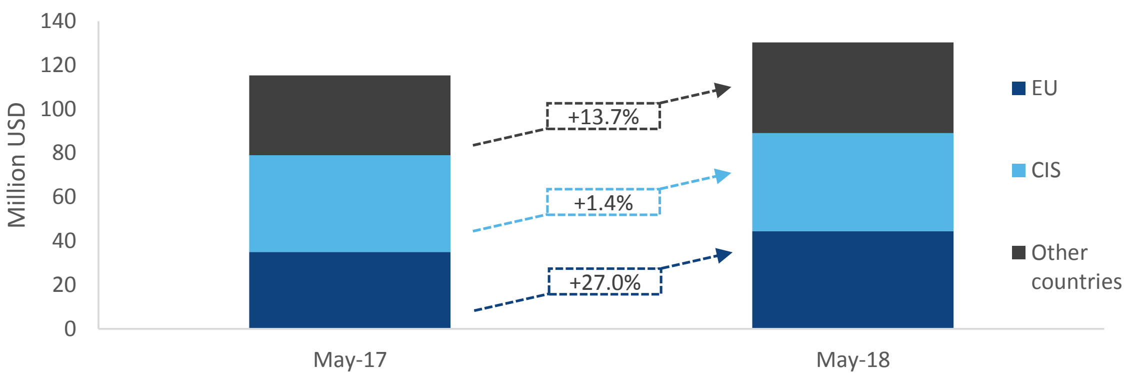
* Visitors staying in the country more than 24 hours

Source: NBG, GNTA

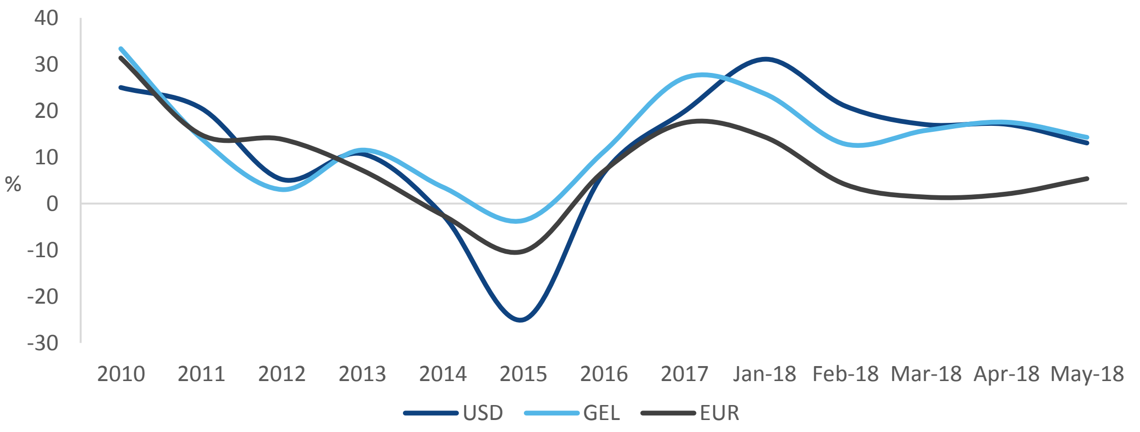
Remittances up by 13.0% in May

Remittances inflows increased by 13.0% YoY and were chiefly driven by growing remittances from the EU (+27.0% YoY). Remittances also rose from the CIS (+1.4% YoY) and other countries (+13.7% YoY), albeit at a lower rate.

Remittance inflows
(mln USD)



Remittance inflows in different currencies
(%, YoY)



Source: NBG

Summary of some sources of currency flows*

mln USD	May, MoM	May, YoY	Jan-May 2018, YoY
Trade Balance	20.6	-53.5	-402.2
Exports of goods	*94.2*	*108.1*	*281.3*
Imports of goods	*-73.6*	*-161.6*	*-683.6*
Remittance inflows	6.5	15.0	98.0
Tourism inflows	7.0	41.0	219.3
Total	34.1	2.6	-84.9

Taken together, compared to the same period of the previous year, the balance of trade in goods, remittances and tourism revenues remained flat in May 2018. The worsened balance of trade in goods was just offset by higher remittances and tourism inflows. However, in the first five months of 2018, net inflows from these sources of currency flows worsened slightly by 85 mln USD. This was mostly due to the recovery of domestic consumer and investment demand, which translated into the wider trade deficit described above.

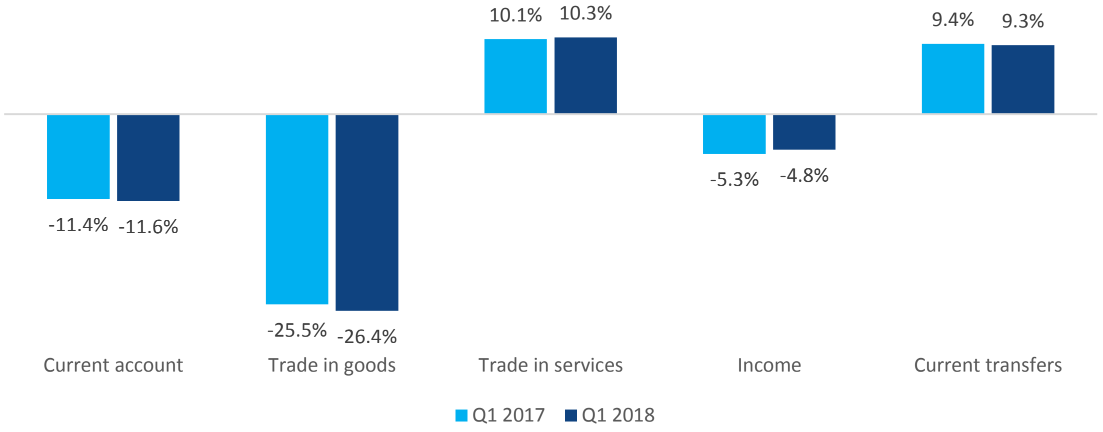
**Data given in the table are not exactly comparable to BOP figures*

Source: Geostat, NBG

Current account balance broadly unchanged in Q1 2018

In Q1 2018, the CA deficit to GDP ratio stood at 11.6%, which was 0.3 pp higher than the same figure in the previous year. The balance of trade in goods worsened by 0.9% of GDP YoY, but this was mostly offset by the improved income account and slightly improving balance of trade in services (+0.2 pp) over the same period.

Current account and its sub-components
(%, YoY)



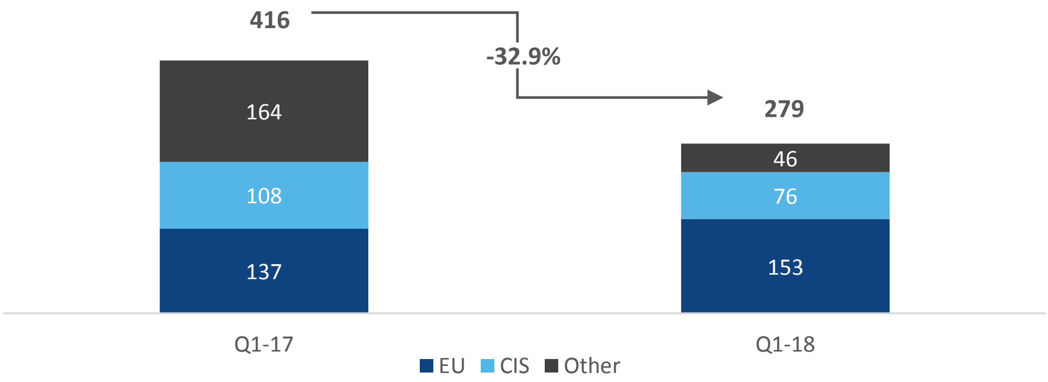
The CA deficit continues to be financed by FDI inflows and other investments, which are dominated by the foreign borrowings of the government and the private sector.

Source: NBG, Geostat

Foreign direct investments declined in Q1 due to one-offs

Foreign direct investments decreased by 32.9% YoY, falling from 416 mln USD in Q1 2017 to 279 mln USD in Q1 2018. This decline was mostly due to one-off factors such as the transfer of ownership in the communications sector from a non-resident to a resident, as well as the reduction of FDI-related debt (-86 mln USD).

FDI inflows
(mln USD)

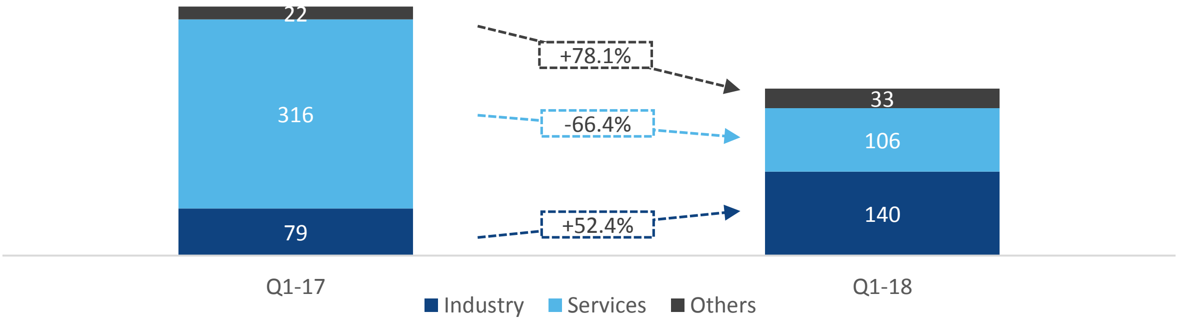


From the regional perspective, in Q1 2018 FDI rose from EU countries (+11.2% YoY), while declining from the CIS (-29.5% YoY) and other countries (-72.1% YoY). Turkey and Azerbaijan made the largest contribution to the YoY decrease of FDI.

Source: Geostat

In Q1 2018, FDI inflows increased most in the manufacturing (+527.8% YoY or 34 mln USD), financial (+41.6% YoY or 32 mln USD) and construction (+26.9% YoY or 15m USD) sectors. Over the same period, a decrease of FDI was registered in the transport (-68 mln USD YoY), communications (-89 mln USD YoY), real estate (-101 mln USD YoY) sectors.

FDI inflows by broad sectors
(mln USD)



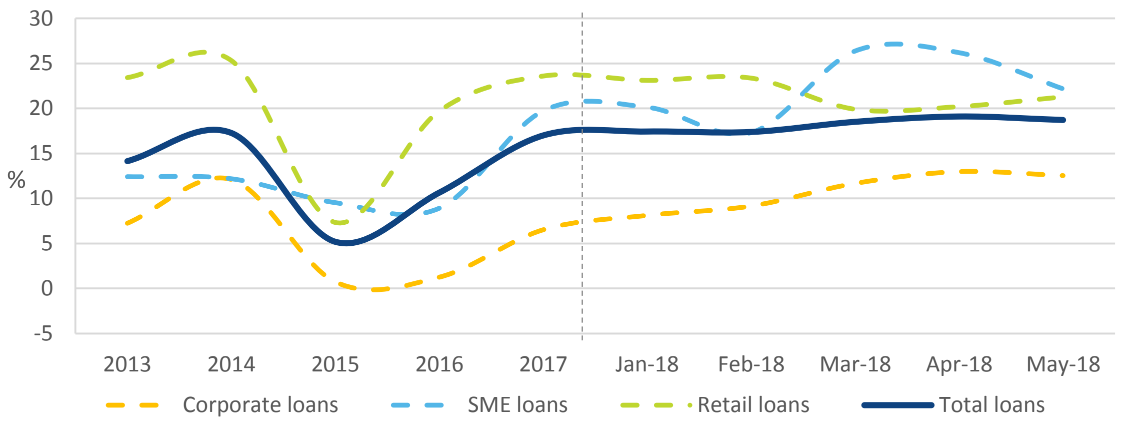
Source: Geostat

Strong loan growth reported in May

The total loan portfolio increased by 18.7% YoY in May 2018, excluding the FX effect. From the segments perspective, retail, SME and corporate loans increased by 21.3%, 22.2% and 12.5% respectively.

Growth of loans by segments*

YoY, excl. FX effect



*Growth figures in 2017 exclude the Credo Bank effect

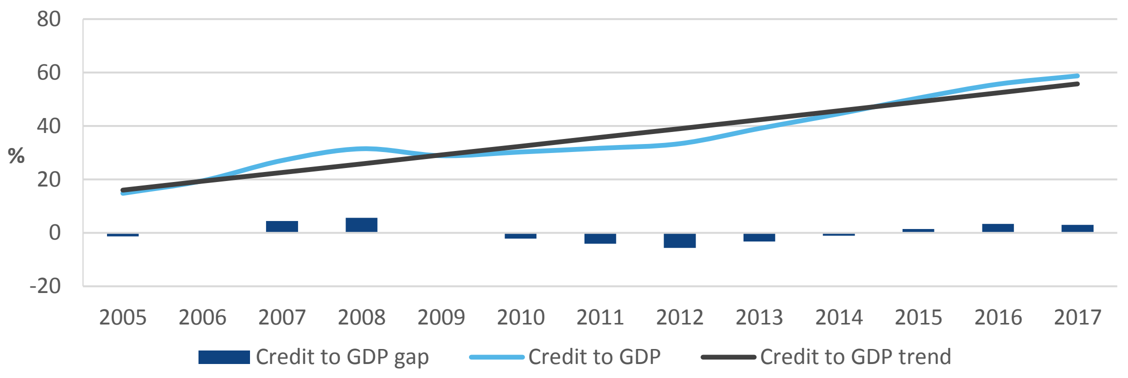
The growth rate of GEL loans was 31.2% YoY in May 2018. Foreign currency loans grew by 9.8% YoY in the same period (excluding the FX effect). The share of FX denominated loans in the loan portfolio stood at 55.1%, which was 0.3 pp (w/o FX effect) lower compared to the previous month.

Source: NBG, TBC Bank Economic Team estimates

Countercyclical buffer remained unchanged at 0%

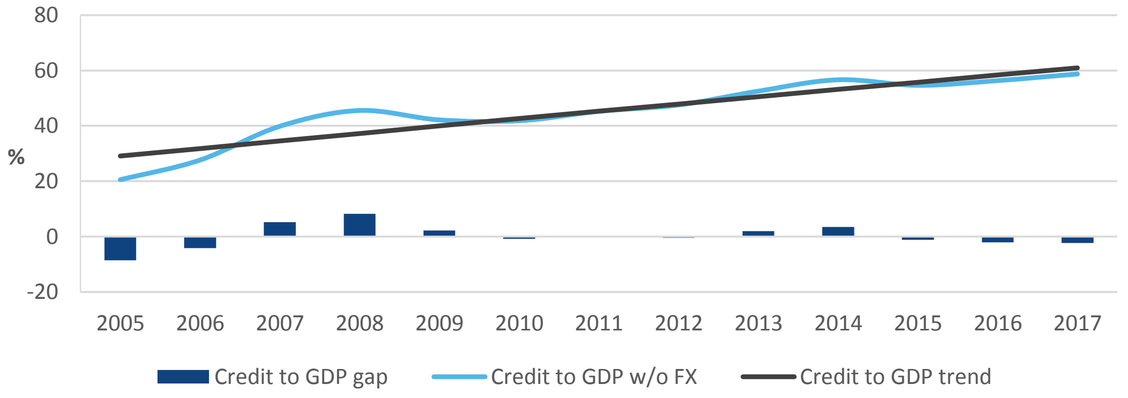
During its meeting of 14 June 2018, the Financial Stability Committee of the National Bank of Georgia decided to keep the countercyclical buffer unchanged at 0%. According to the committee's assessment, the growth of total credit is in line with its trend.

Credit to GDP



Credit to GDP

excl. FX effect)



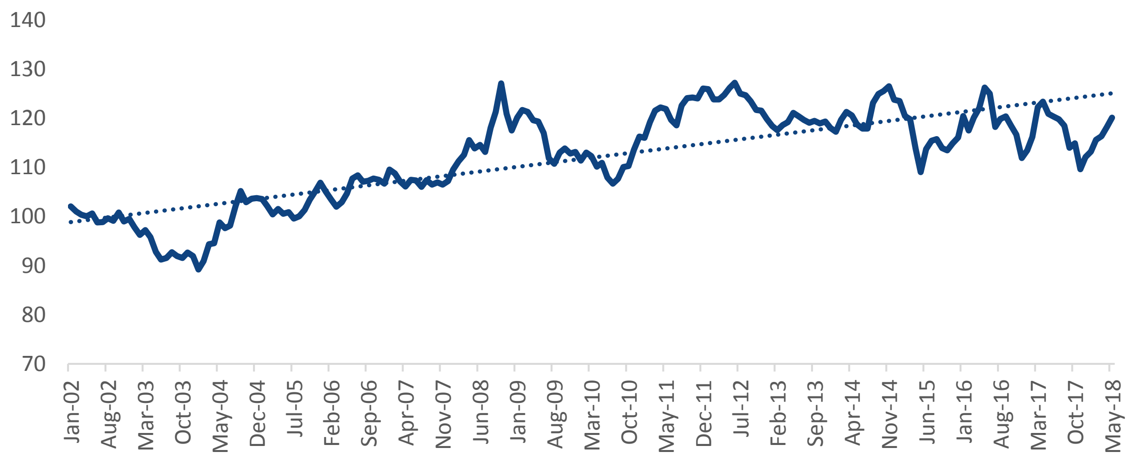
Source: NBG, Geostat, TBC Bank Economic Team estimates

Exchange rates

The real effective exchange rate (REER) appreciated by 1.6% MoM, but weakened by 0.6% YoY. The REER still appears to remain below its long-term trend.

Real Effective Exchange Rate

(Index, 2002=100)



The GEL exchange rate remained broadly stable against the currencies of Georgia's major trading partners in June 2018. Compared to the end of May, the GEL appreciated by 0.8% against the USD and by 0.6% against the EUR. Over the same period, the appreciation of the GEL was stronger against the RUB (1.3%) and the Turkish lira (3.4%).

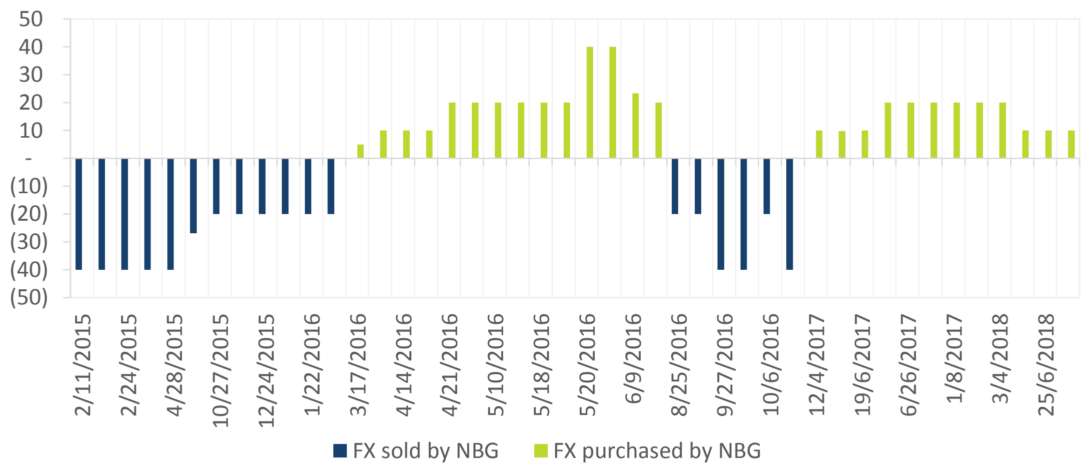
Source: NBG

NBG bought 30m USD on the FX market in June

In June 2018, the National Bank of Georgia intervened on the FX market and purchased 30m USD. This continued the trend of the NBG refilling its international reserves, which began in the beginning of 2017.

FX interventions

(mln USD)



Source: NBG

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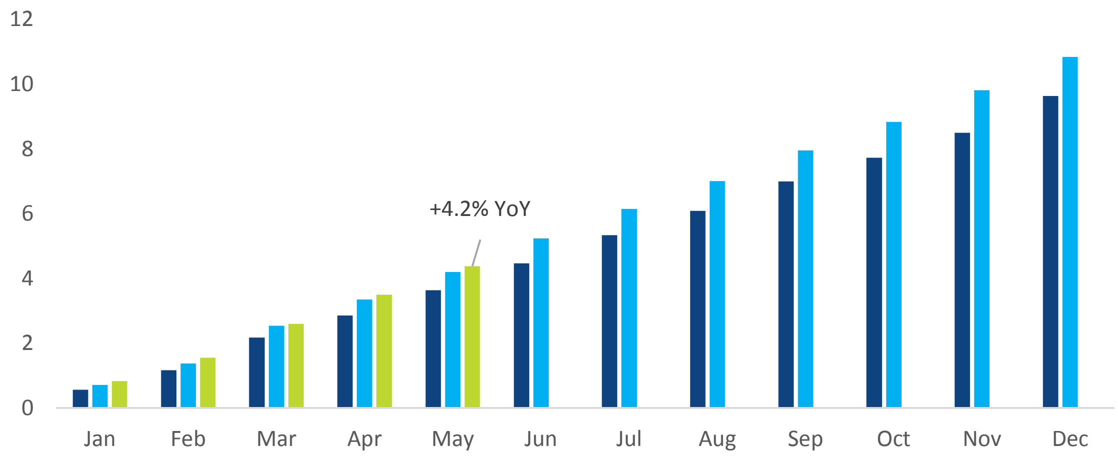
Fiscal Sector

Consolidated budget tax revenues increased by 7.0% YoY in May 2018, while in the first five months of 2018 the growth of tax revenues stood at 4.8% YoY. The growth of expenditures has been dominated by the growth of capital spending, while current spending has been expanding more moderately.

Consolidated budget tax revenues
bn GEL

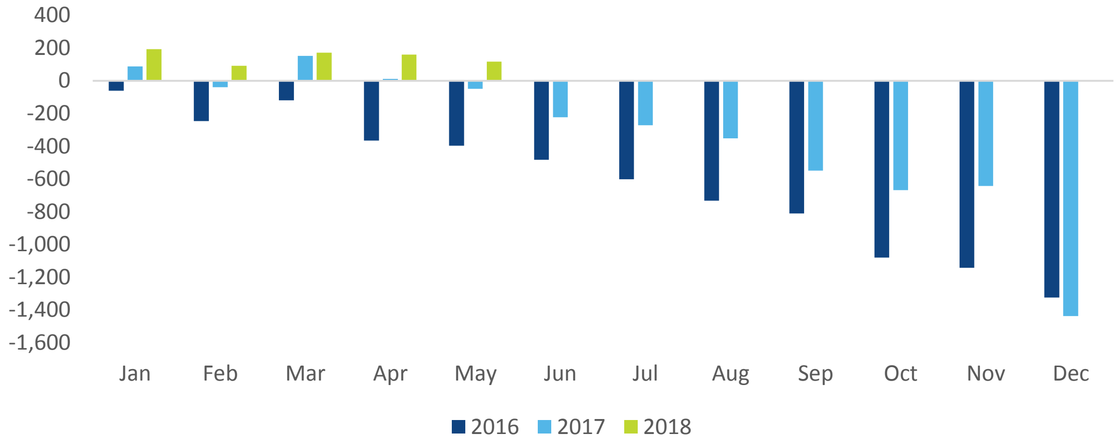


In the first five months of 2018, capital spending increased by 66.3% YoY, while current spending remained flat (-0.1% YoY) over the same period. Expenses on salaries (-4.7% YoY), government subsidies (-3.9% YoY) and other expenses (-11.3% YoY) declined most.

Source: MOF

Given the moderate growth of expenses and the continued growth of government revenues, the budget remained in surplus over the first five months of 2018.

Cumulative budget deficit
mln GEL



Source: MOF, TBC Bank Economic Team estimates

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