TBC RESEARCH

# Monthly Update

**September 2018**

Prepared by TBC Bank Economic Team

- **External Environment**

Slowdown in some economic partners negatively affects currency inflows, but overall growth of inflows remains in double digits in USD terms. While Georgia's total exposure to oil prices is reasonably balanced, higher oil prices still should have somewhat net positive impact on inflows.

- **Turkey in Focus**

In USD terms, exports and remittances from Turkey declined in August YoY, however number of visitors went up. Overall growth of exports, tourism and remittances is estimated to be at 4.0% YoY over the same period. Imports from Turkey went down in August reflecting some one-offs and probably also price effect due to sharp lira fall against USD.

- **GDP Growth**

Real GDP growth stood at 5.5% YoY in Q2 2018 - solid growth especially taking into account the temporary negative contribution from the fiscal spending. According to the initial estimates GDP increased by 2.0% YoY in August. Slowdown is mostly due to negative contribution of fiscal spending and one-offs related to large infrastructure projects and exports. While overall growth rate of inflows is slowing, one-offs in exports were particularly important in August.

- **Fiscal Sector**

Consolidated budget tax revenues increased by 10.3% YoY in Aug 2018. Annual change of fiscal balance in July-Aug 2018 stood at -3.7% of 2017 July-Aug GDP, having temporary negative contribution to GDP growth. In Q2 2018 fiscal stance was also contractionary - annual change in fiscal balance in Q2 2018 was -3.6% of Q2 2017 GDP.

- **Trade in Goods**

Exports and imports increased by 16.6% and 8.3% respectively in August. Declining growth rate of trade deficit since March 2018 also continued in August. Slower growth of exports was primarily driven by likely one-off decline of ferro-alloys, fertilizers and petroleum products exports. Excluding these commodities, August YoY exports growth would have stood at 29% instead of 16.6%. Important to mention that this difference was not caused by lower exports to Turkey as without impact of Turkey exports growth would have increased only up to 19.3%.

- **Tourism**

Tourism revenues increased by 11.6% YoY in August and by 20.1% YoY in 8m 2018.

- **Remittances**

Remittances were up by 11.4% in August and by 17.5% YoY in 8m 2018.

- **Balance of Payments**

Current Account deficit almost unchanged QoQ at 9.2% of GDP over the last four quarters ending Q2 2018.

- **Loan Growth**

Loan growth remained strong at 19.1% in August driven by business and mortgage lending.

- **Inflation**

Inflation stood at 2.7% in September 2018, 0.4 PP lower compared to the same figure in August 2018, just around the NBG's 3% target.

- **Exchange Rates**

The real effective exchange rate appreciated by 1.7% MoM and by 4.8% YoY in August. Estimated real effective exchange rate as of October 3 was around at the same level as it was in Apr-May 2018.

- **FX Interventions**

NBG bought 25 mln USD on the FX market in September and 112.5 mln USD in 2018. 25 mln USD in September is estimated to be up to 2% of September GDP. NBG buying FX indicates that FX inflows are sufficient for higher growth and without negative impact of fiscal spending on domestic demand exchange rate would not have been necessarily depreciated.

## External environment

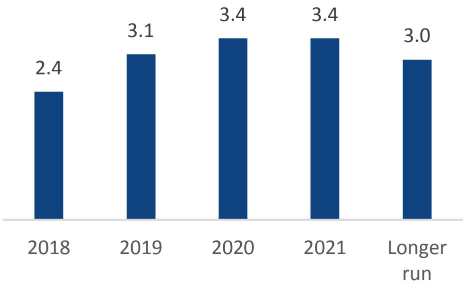
Given strong growth and upbeat labor market indicators, FED continued to tighten monetary policy and delivered another 0.25 FED funds rate increase during the FOMC's September 25-26 meeting, the move that was well expected by markets. According to the FED's updated forecasts, US economy will increase by 3.1% in 2018, 0.3 PP higher compared to June 2018 projections. US economy is expected to slow to 2.5% in 2019 as effects of Fiscal stimulus will start to dissipate. Based on September estimates, FED funds rate is projected to increase to 2.4% in 2018 and reach the peak of 3.4% by 2020 before declining to 3%, the rate currently considered by FOMC members to represent long term neutral monetary policy rate.

According to the preliminary estimates, inflation in EU is expected to accelerate slightly to 2.1% YoY in September up from 2.0% in previous month, mostly driven by higher oil prices. ECB in its monetary policy statement released on 13th of September stated that ECB policy rate will remain unchanged at least until the summer of 2019.

EU job market indicators show continued improvement. EU 28 unemployment rate in July stood at 6.8%, lowest since 2008.

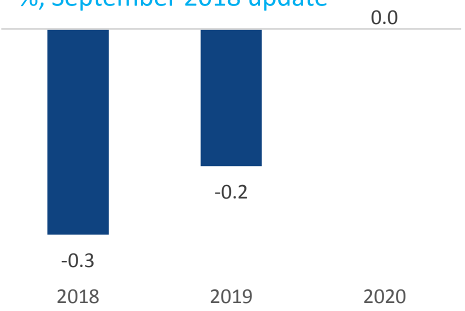
FED Funds rate projection

%, September 2018 update




3m Euribor projection

%, September 2018 update




*Sources: Geostat, NBG, ECB, FED*

Growth of exports, tourism* and remittances inflows to Georgia

%, YoY

| In USD | YoY in 8m 2018 | Contr. To growth in 8m 2018 | YoY in August 2018 | Contr. To growth in August 2018 |
|---|---|---|---|---|
| EU | 23.5 | 20.6 | 1.5 | 2.2 |
| Russia | 12.7 | 10.3 | 17.3 | 23.9 |
| Turkey | 18.5 | 7.9 | 4.0 | 2.3 |
| Azerbaijan | 73.0 | 18.3 | 47.9 | 23.9 |
| Armenia | 21.3 | 5.0 | 14.3 | 6.3 |
| Iran | 10.4 | 2.6 | -28.1 | -16.8 |
| Other CIS countries | 38.7 | 8.0 | 45.2 | 17.2 |
| USA | 14.7 | 3.0 | -30.0 | -10.3 |
| Israel | 36.2 | 5.7 | 29.0 | 8.1 |
| Ukraine | 35.8 | 4.9 | 11.0 | 3.0 |
| China | 16.4 | 2.4 | 341.2 | 33.9 |
| Saudi Arabia | 25.0 | 1.0 | 0.9 | 0.2 |
| Other | 13.8 | 10.3 | 5.7 | 6.2 |
| **Total** | **22.3** | **100.0** | **13.2** | **100.0** |

**TBC Bank economic team estimates*

# External environment cont'd

Strong growth of oil prices have been positively affecting Russian currency in September 2018. Despite the risks of upcoming sanctions, RUB strengthened by 3.4% in September. The Central Bank of Russia raised its policy rate by 0.25 PP to 7.5 %, citing the stronger than expected inflation in August as well as increased inflationary risks stemming from the RUB volatility as main reasons behind the move. To dampen the exchange rate volatility, the central bank also ceased purchasing foreign currency under the fiscal rule helping some recovery of RUB in September.

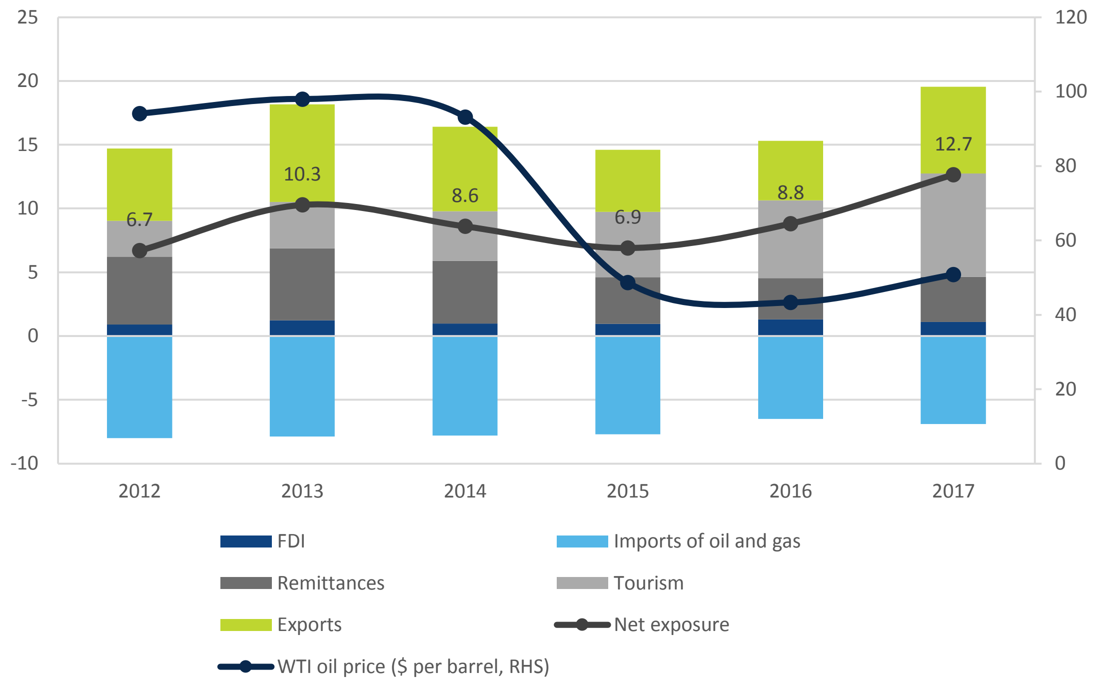
Consumer confidence continued to fall in Turkey reaching three year low in September 2018, mostly driven by Lira depreciation and accelerating inflation. The Central Bank of Turkey increased its policy rate by 625 basis points to 24%. Move by CBRT calmed the markets and Lira regained some of its value against the dollar. However, continued rise in prices still remains troubling for the central bank as annual CPI inflation reached 24.5% in September.

Slowing domestic demand is positively influencing Turkey's external accounts. Trade balance of turkey improved by 59% YoY in August 2018.

According to Fitch September 2018 forecast, Turkish economy is expected to grow by 3.8% in 2018, 1.9% in 2019 and 3.9% in 2020.

Together with upcoming sanctions on exports of Iranian oil, OPEC's decision not to increase supply resulted in higher oil prices.

Inflows from oil exporters to Georgia vs Georgian imports of petroleum products and oil prices
(% of GDP)




**Hard currency inflows from oil exporters amounts to c. 20 of GDP, while petroleum imports of Georgia amounts to c. 8 of GDP. Taking into account different elasticities of currency inflows and imports of petroleum products against oil prices, overall net exposure to oil prices appears to be reasonably balanced. For example, possible drop in oil prices should have more proportional impact on petroleum imports rather than on tourism or export inflows.*

*Sources: Geostat, NBG, Rosstat, ISbank , Central Bank of Turkey*

# Turkey in focus

Exports and remittances inflows from Turkey showed sizeable decline in August 2018. On an annual basis exports of goods to Turkey fell by 27.4% YoY in USD terms. Over the same period total exports increased by 16.6% YoY, excluding Turkey growth would have been 19.3%. As exports to Turkey mostly consists of commodities and textile products re-exported to EU, total exports is expected to be much less affected.

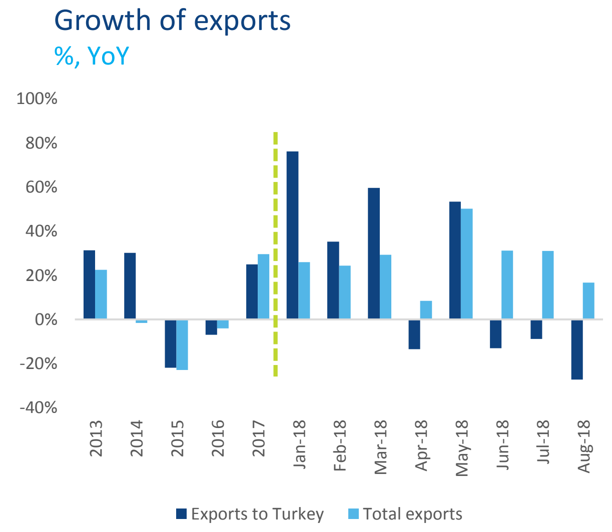
Despite the reduction of exports, trade balance with Turkey improved as imports also declined by 13.8% YoY (in USD terms) over the same period reflecting some one-offs and probably also price effect due to sharp Lira fall against USD.

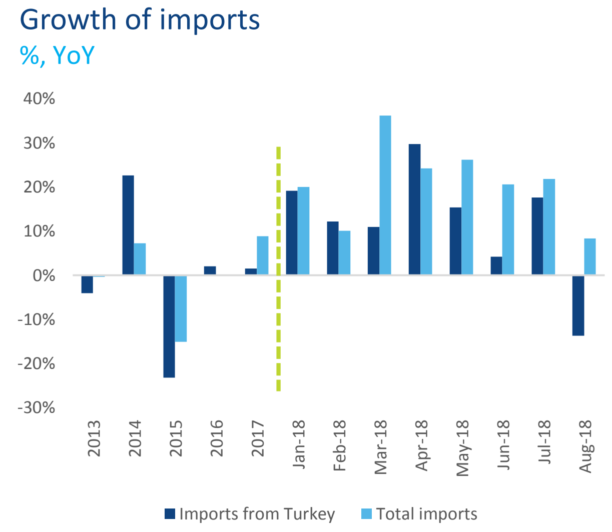
In August remittances also fell by 25.6% YoY, however, growth of the number of visitors accelerated to 24.4%.

Overall growth of exports, tourism and remittance inflows from Turkey is estimated to be at 4.0% YoY in August 2018.

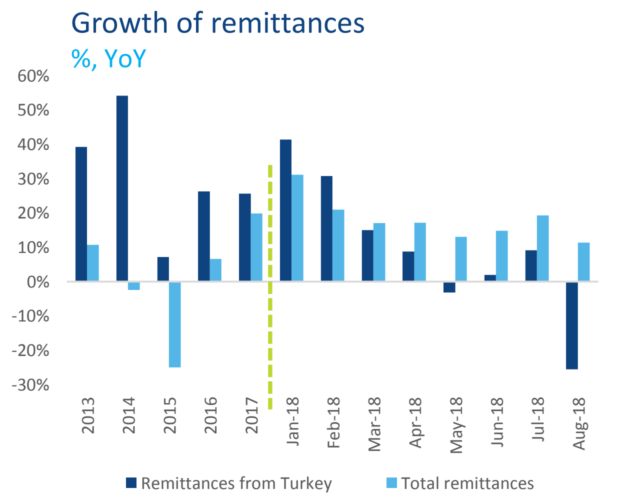
Sharp increase in September inflation up to 24.5% in Turkey has offset significant part of lira's nominal depreciation.

*Source: Geostat*







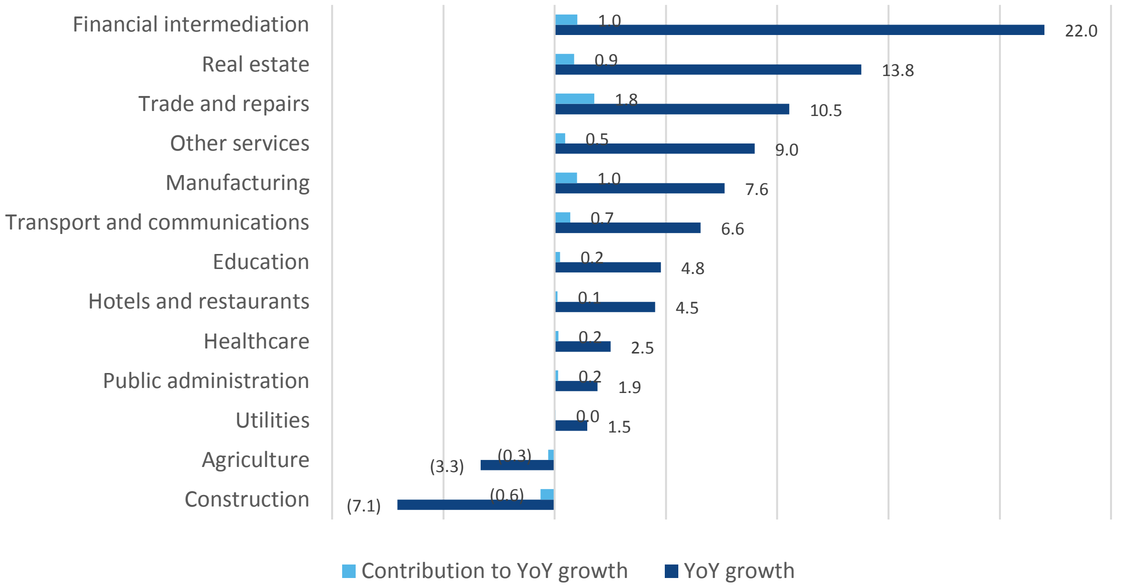

*Source: Geostat, NBG, GNTA*

***Visitors include tourists as well as transit visitors*

# GDP increased by 5.5% in Q2 2018

Quarterly GDP growth data was released in September. According to the revised figures, real GDP growth stood at 5.5% YoY in Q2 2018. In nominal terms, GDP increased by 10.6% YoY over the same period. This is solid growth especially considering the temporary negative contribution from the fiscal spending. Fiscal deficit stood at 0.4% of GDP (41 mln GEL), significantly lower compared to the 4.1% (375 mln GEL) of deficit registered during the same period previous year. Annual change in fiscal balance in Q2 2018 was 3.6% of Q2 2017 GDP.

Real GDP growth by sectors and contribution to growth in Q2 2018
(%, YoY)

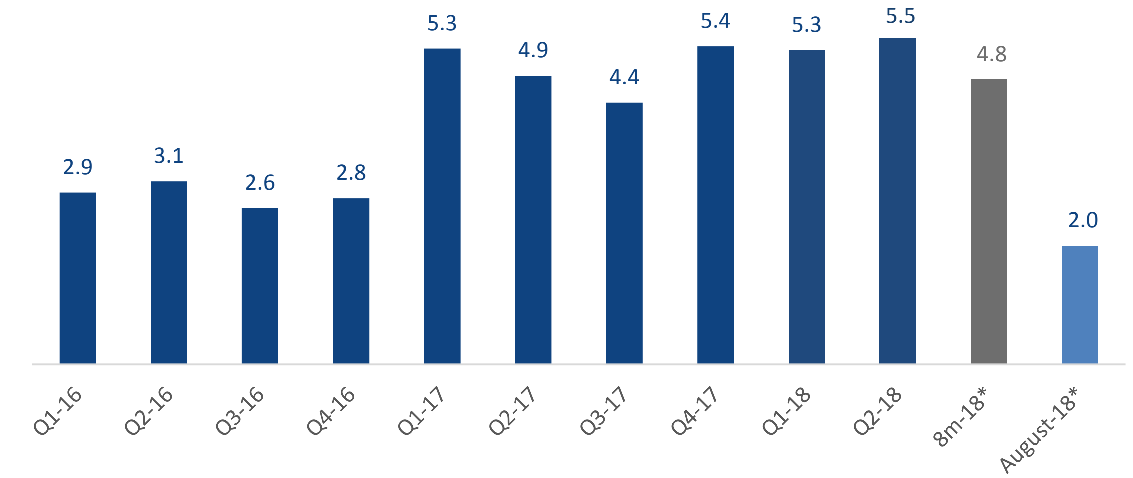



*Source: Geostat*

GDP growth in Q2 2018 was driven by wide range of sectors, primarily by trade and repairs, manufacturing, real estate, and financial intermediation. Agriculture and construction sector affected the growth negatively.
Reduction of construction sector value added was primarily due to the one-off factors related to the several large scale infrastructure projects.

Per initial estimates, real GDP growth stood at 2.0% YoY in August 2018 compared to the 4.6% YoY growth in July. Growth averaged 4.8% YoY in 8m 2018. Slowdown in growth should be explained by negative contribution of fiscal spending, some one-offs related to the large infrastructure projects as well as slower growth of external inflows, primarily related to the one-off decline of exports of several commodities.

Real GDP growth
(%, YoY)



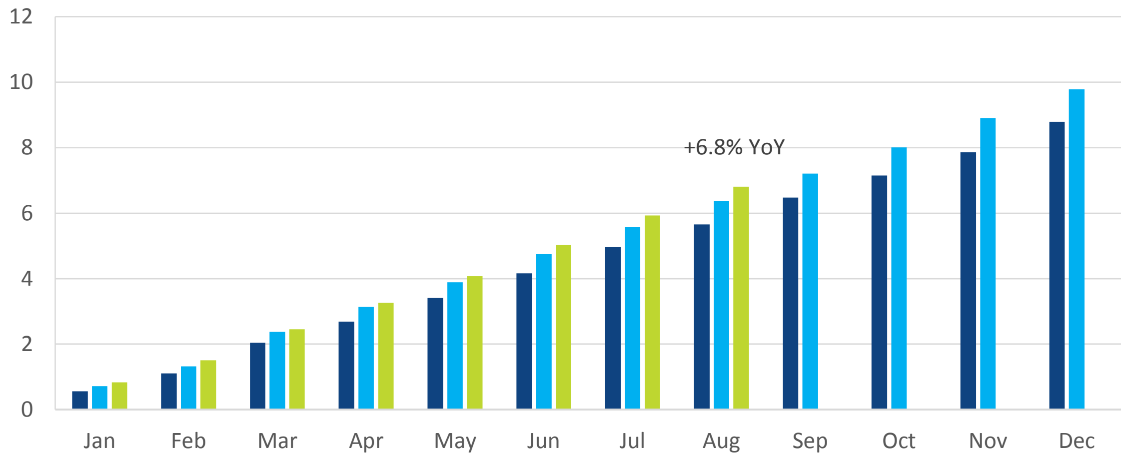

**Initial estimates*

*Source: Geostat*

# Fiscal sector

Consolidated budget tax revenues increased by 10.3% YoY in Aug 2018, while in the first eight months of 2018 the growth of tax revenues stood at 6.8% YoY. Capital spending remained broadly flat in August (+1.8% YoY) and current spending declined by 4.6% YoY, mostly due to the reduction in government purchases of goods and services.

Consolidated budget tax revenues, cumulative
bn GEL

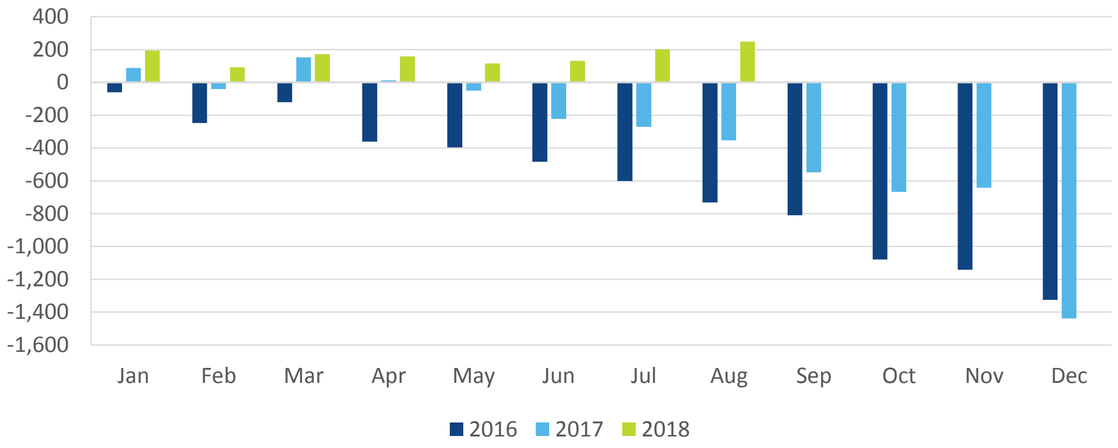



Consolidated budget remained in surplus in the first 8 months of 2018, resulting in contractionary fiscal stance. In 8m 2018 budget surplus amounted to GEL 250 mln, as opposed to the deficit of GEL 353 mln over the same period of 2017.

Source: MOF

In Jul-Aug 2018 budget surplus amounted to GEL 118 mln versus the deficit of GEL 130 mln over the same period last year. Annual change of fiscal balance in two months stood at -3.7% of Jul-Aug 2017 GDP. Same number for Q2 2018 was -3.6%.

Budget deficit, cumulative
mln GEL



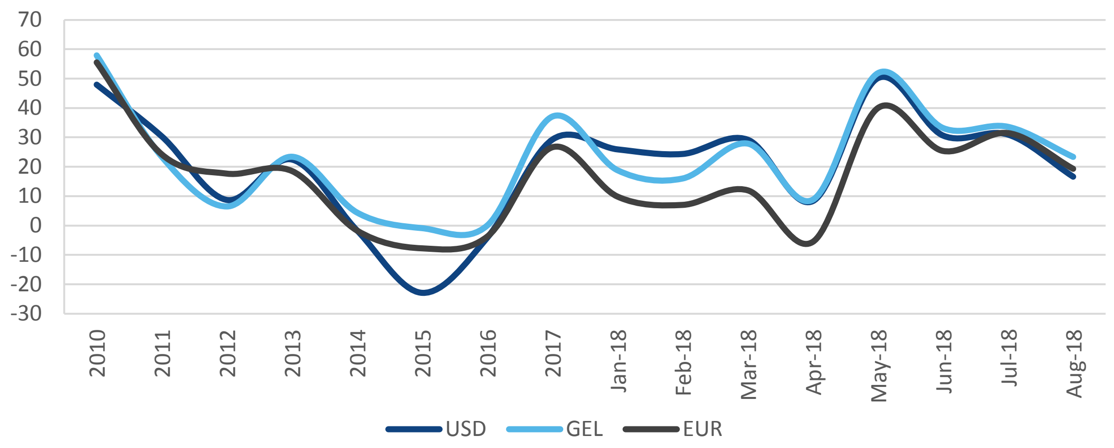

Source: MOF, TBC Bank Economic Team estimates

# Exports of goods up by 16.6% in August

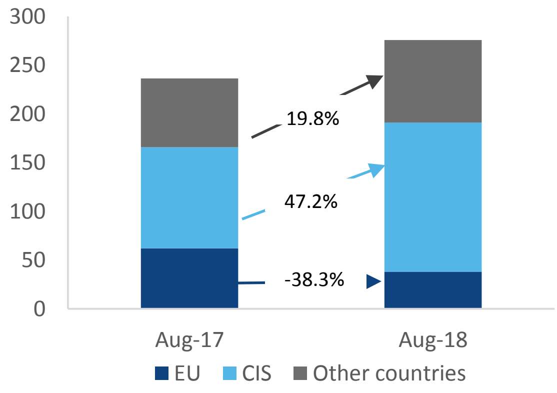
Gross exports of goods in USD terms rose by 16.6% YoY in August 2018, while growth in the first eight months of the year stood at 27.1% YoY. Exports of goods to EU decreased by -38.3% YoY, exports to CIS jumped by sharp 47.2% YoY and exports to other countries went up by 19.8% YoY over the same period. From the products perspective export growth was primarily driven by exports of cars (+19.6 mln USD), cigarettes (+12.1 mln USD) and copper ores (+9.2 mln USD) .

Slower growth of exports was primarily driven by likely one-off decline of ferro-alloys, fertilizers and petroleum products exports. Excluding these commodities, August YoY exports growth would have stood at 29% instead of 16.6%. Important to mention that this difference was not caused by slower exports to Turkey as without impact of Turkey exports growth would have increased only up to 19.3%.

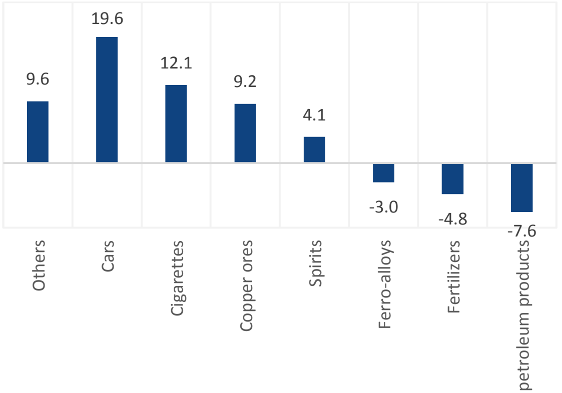
Growth of gross exports in different currencies
(%, YoY)




Exports by region
(mln USD)




Exports by goods*
(mln USD, YoY)




*Source: Geostat, TBC Bank Economic Team estimates*

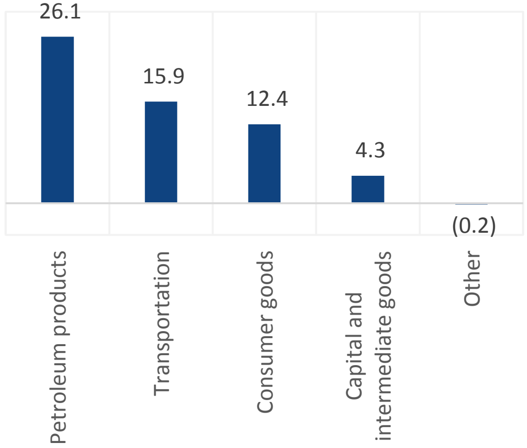
*Source: Geostat, NBG*

**Chart shows exported goods that increased/decreased most in August 2018*

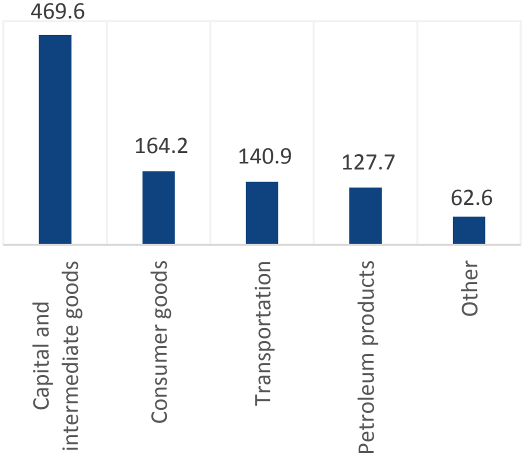
# Imports of goods increased by 8.3% in August

Imports went up by 8.3% YoY in August 2018 and by 20.8% YoY in the first eight months of the year. In August major drivers of the growth were petroleum products (+30.5% YoY) and transportation (+25.1% YoY). Annual growth of capital and intermediate goods (+1.3% YoY) and consumer goods (+5.8% YoY) imports moderated compared to the previous periods. Breakdown of consumer goods indicates that growth of imports was mostly driven by non-durable (+32% YoY) and semi-durable consumer goods (+12% YoY), while imports of durable consumer goods declined slightly (-2% YoY).

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



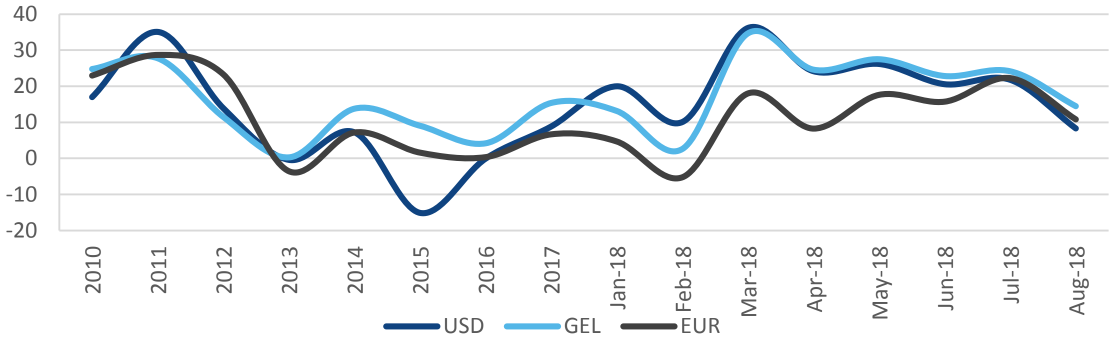

Growth of major categories of imports in the first eight months of 2018
(mln USD, YoY)




Slower growth of capital and intermediate goods imports also indicates to one-offs in capital expenditures related to fiscal spending as well as other FDI financed infrastructure projects.

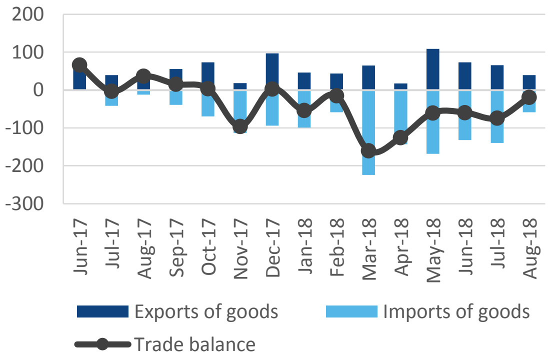
Source: Geostat

Growth of imports in different currencies
(%, YoY)

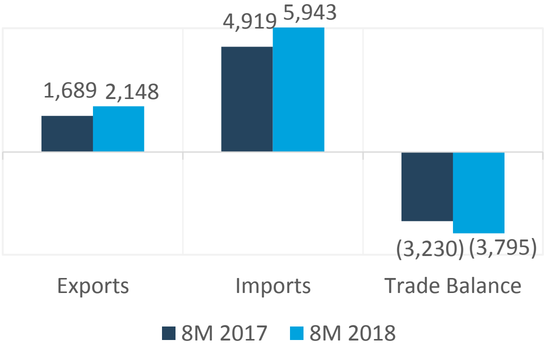



Trade balance worsened by 4.1% YoY in August 2018. Declining growth rate of trade deficit since March 2018 also continued in August.

Change of exports, imports and trade balance
(mln USD, YoY)




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



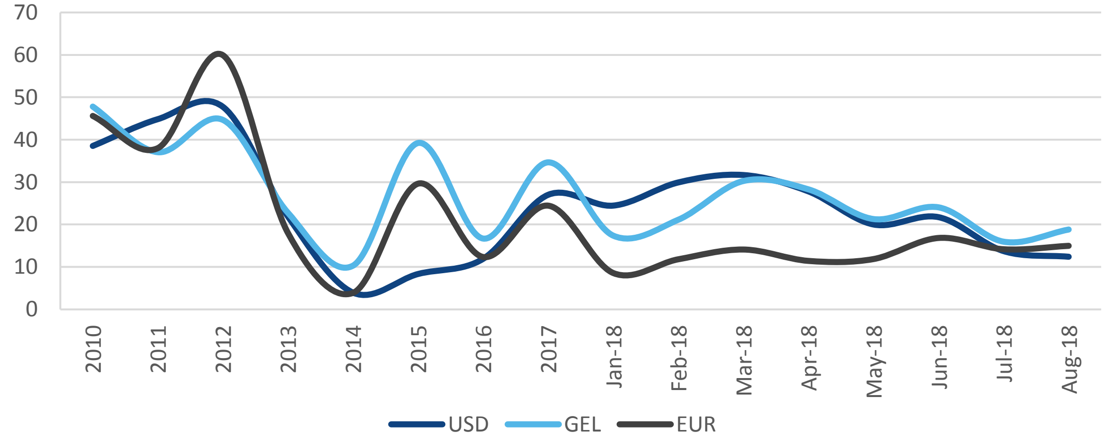

Source: Geostat

## Tourism inflows increased by 11.6% in August

The growth of tourism inflows continued in August 2018, though at a lower - 11.6% rate expressed in USD. In the first eight months of 2018 tourism revenues amounted to 2.2bn USD, which is 20.1% higher compared to that of last year.

The number of tourists* went up by 13.9% YoY in August 2018 and by 19.3% YoY in the first eight months of the year. The growth of international visitors from the EU stayed high (+39.2% YoY), while the number of visitors from the CIS (+8.3% YoY) and other countries (+11.5% YoY) also continued to grow.

Tourism receipts in different currencies
(%,YoY)

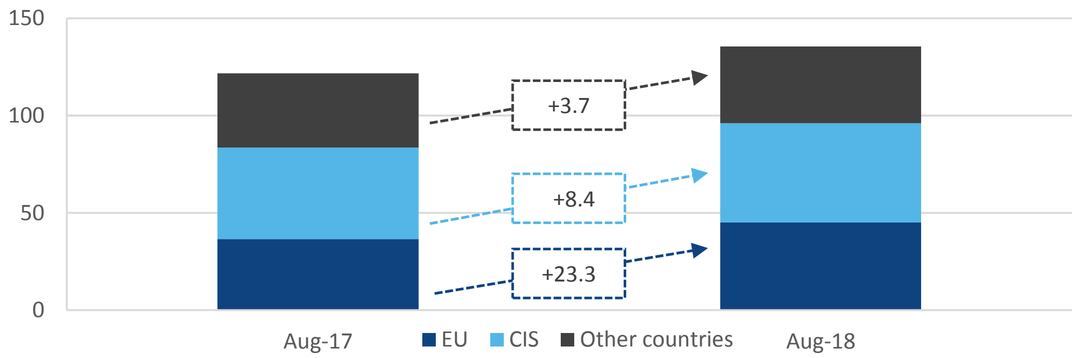



*Source: NBG, GNTA*
**Visitors staying in the country more than 24 hours*

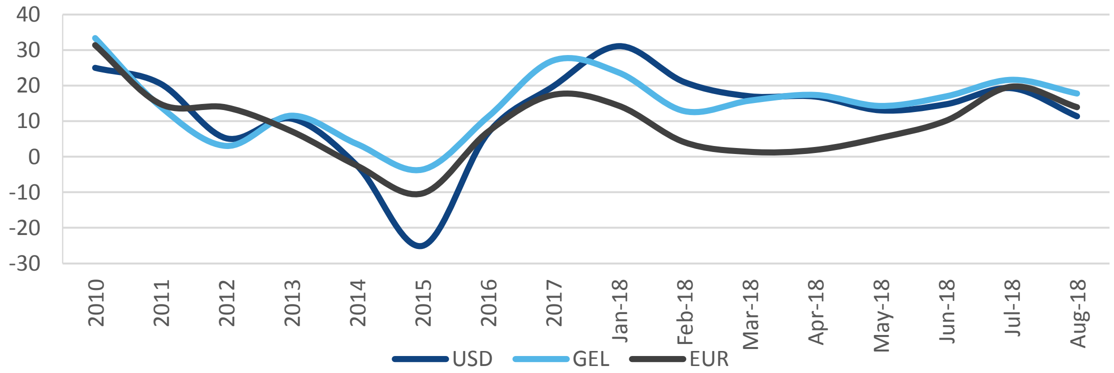
## Remittances up by 11.4 in August

Remittance inflows increased by 11.4% YoY and were primarily driven by growing remittances from the EU (+23.3% YoY). Remittances also increased from CIS (+8.4% YoY) and other countries (+3.7% YoY).

Remittance inflows by regions
(mln USD)




Remittance inflows in different currencies
(%, YoY)

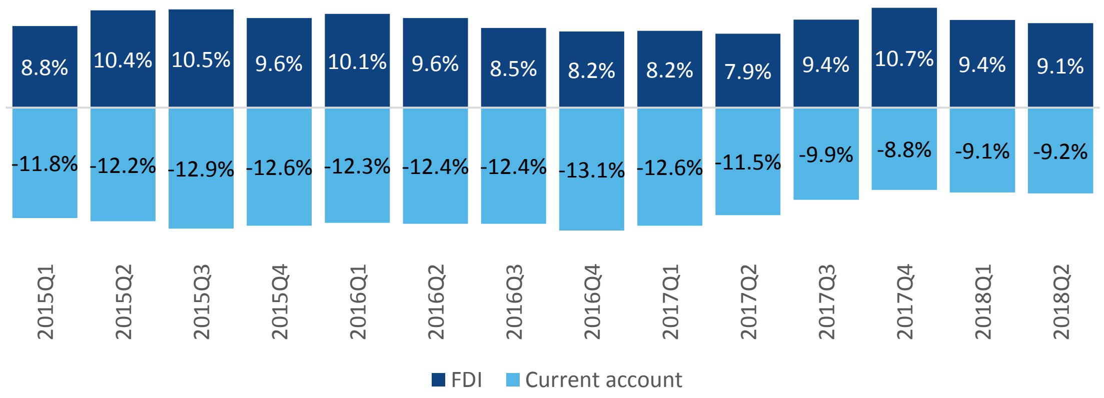



*Source: NBG*

## Current Account deficit almost unchanged

Over the last four quarters ending Q2 2018 CA deficit to GDP ratio stood at 9.2% of GDP, almost unchanged from the previous quarter. CA deficit continues to be fully financed by FDI inflows. Net FDI inflows stood at 9.1% of GDP over same period.

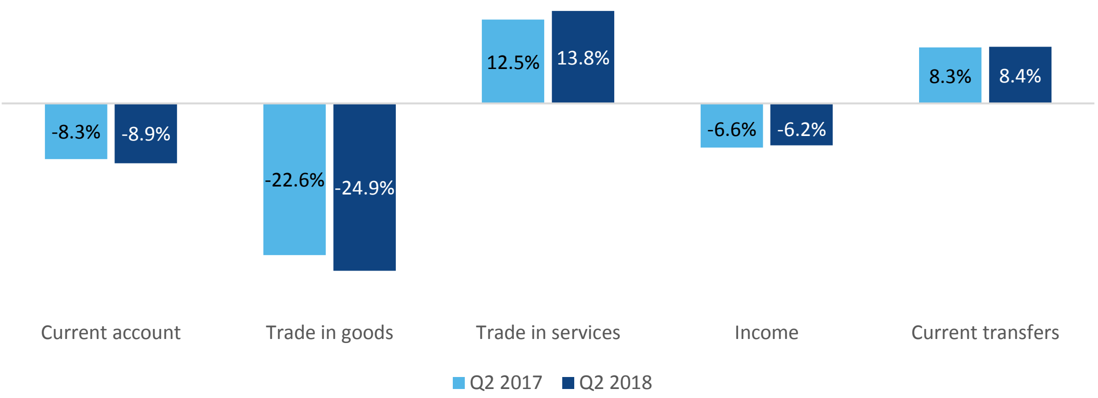
Current account and FDI
% of GDP, last four quarters




In Q2 2018 Current account deficit to GDP ratio increased to 8.9% from 8.3% in Q2 2017. In absolute terms CA balance widened by 53.5 mln USD YoY. The negative impact arising from the balance of trade in goods was mostly offset by higher exports of services (mostly tourism) as well as moderate improvement in current transfers and income account.

Source: NBG

Current account components
% of GDP




Source: NBG

## Summary of some sources of currency flows*

| (mln USD) | m/m change in August | y/y change in August | y/y change in 8m 2018 |
|---|---|---|---|
| Trade Balance | 16.9 | -19.2 | -566.4 |
| *Exports of goods* | -2.9 | 39.3 | 457.2 |
| *Imports of goods* | 19.7 | -58.4 | -1023.6 |
| Remittances | -8.6 | 13.9 | 274.2 |
| Tourism inflows | 91.9 | 130.6 | 459.9 |
| Total | 100.2 | 125.2 | 167.6 |

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

Compared to the same period of previous year, the balance of trade in goods, remittances, and tourism revenues improved substantially by 125.2 mln USD YoY in August 2018. In the first eight months of 2018, balance of inflows from these sources improved by 167.6 mln USD.

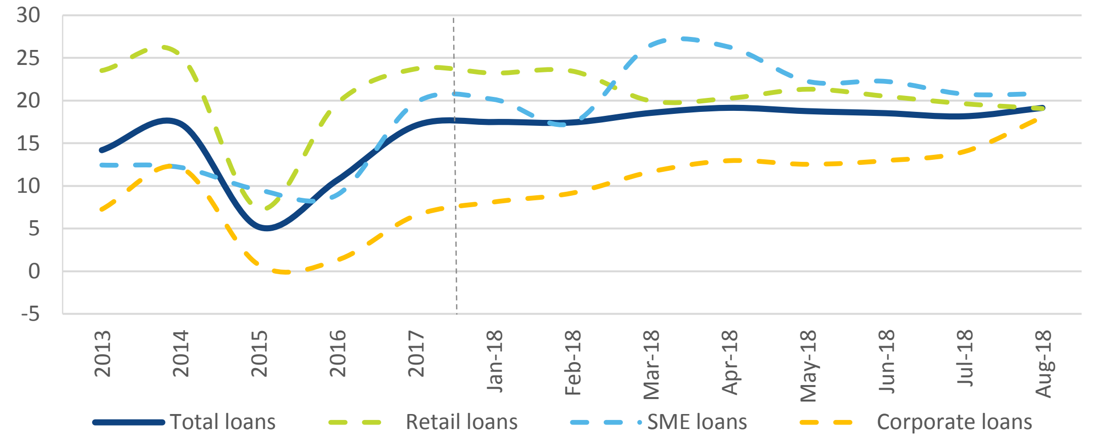
## Strong loan growth continued in August

Total loan portfolio increased by 19.1% YoY in August 2018, excluding the FX effect. From the segments perspective, retail, SME and corporate loans increased by 19.1%, 20.8% and 18.1% respectively. Growth of retail loans was mostly driven by mortgages, which went up by 34.7% YoY, while growth of non-mortgage loans slowed to 9.0% YoY. From the currency composition perspective, the growth rate of GEL loans stood at 27.8% YoY while foreign currency loans grew by 12.5% YoY in the same period, excluding the FX effect. The share of the FX denominated loans in the loan portfolio amounted 55.7% down by 3.1 PP compared to August 2017, excluding the FX effect.

*Source: Geostat, NBG*

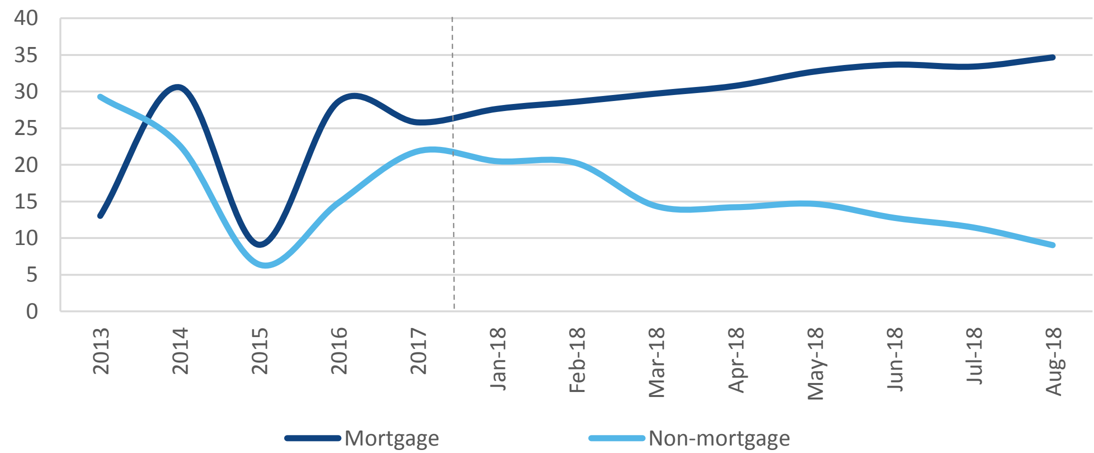
Growth of loans by segments*

YoY, excl. FX effect




Growth of retail loans by segments*

YoY, excl. FX effect




*Source: NBG, TBC Bank Economic Team estimates*

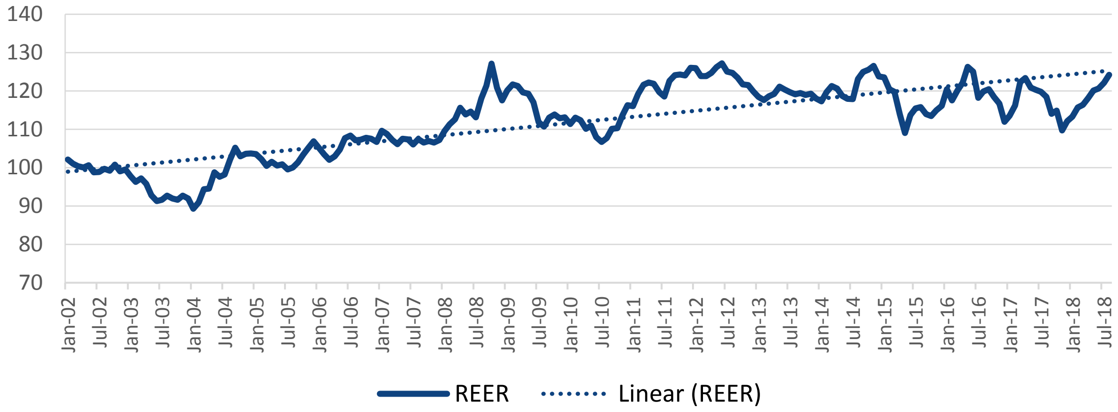
**Growth figures in 2017 exclude Credo Bank effect*

## Exchange rates

The real effective exchange rate (REER) appreciated by 1.7% MoM and by 4.8% YoY in August 2018.

Real Effective Exchange Rate as of August 2018

(Index, 2002=100)

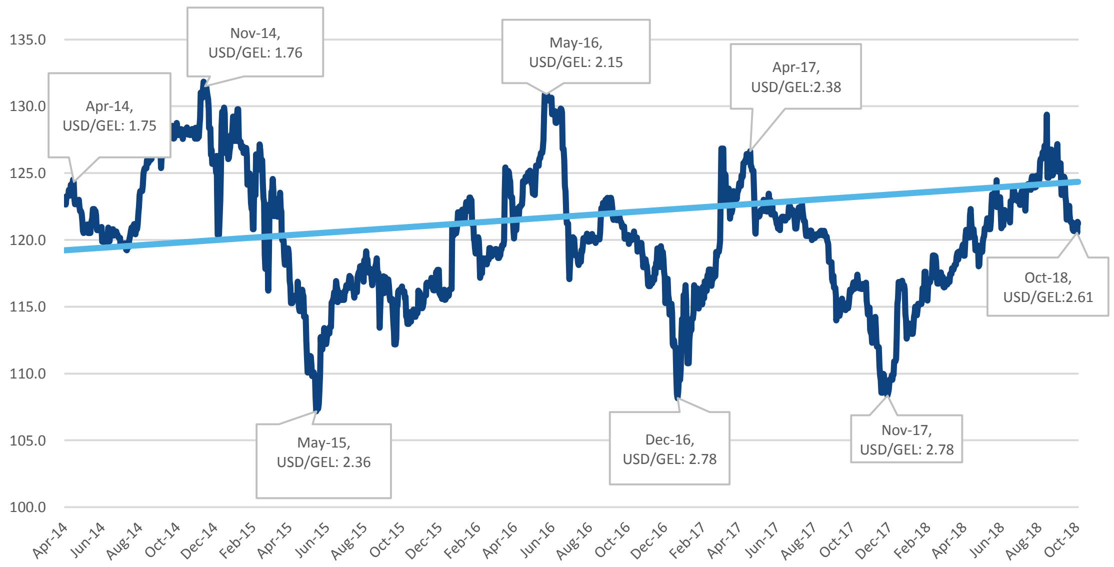



In September GEL nominal exchange rate depreciated against USD and EUR by 1.3% MoM and 0.4% MoM respectively. Over the same period GEL weakened against RUB by 4.9% MoM and by 12.4% against TRY. Nominal effective exchange rate of GEL depreciated by 3.4% MoM as of the end of month.

Estimated real effective exchange rate as of October 3 was around at the same level as it was in Apr-May 2018.

Daily estimates of real effective exchange rate and its long term trend*

(Index, 1995=100)




*Source: NBG*

**for more details see report on "[Developments in Turkey and the Impact on Georgia's Economy]"*

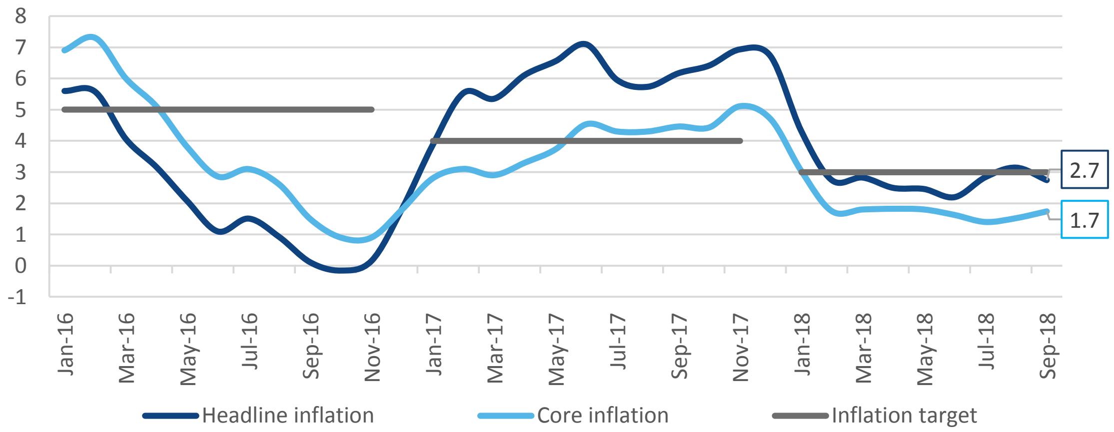
## Inflation remains close to the target

Annual inflation stood at 2.7% in September 2018, 0.4 PP lower compared to the same figure in August 2018 and just around the NBG's 3% target. Prices increased the most on transportation (+6.2% YoY) driven mainly by higher oil price. Prices also increased on healthcare (+5.7% YoY), alcoholic beverages (+4.9% YoY), and utilities (+4.4% YoY). On the other hand, prices decreased on clothing and footwear (-6.9% YoY), and communication (-1.3% YoY).

Core inflation* stood at 1.7% YoY as of September 2018, 0.2 PP higher compared to the same indicator in August 2018.

Headline and Core Inflation

(%, YoY)




*excluding prices of food and beverages, energy and administered prices

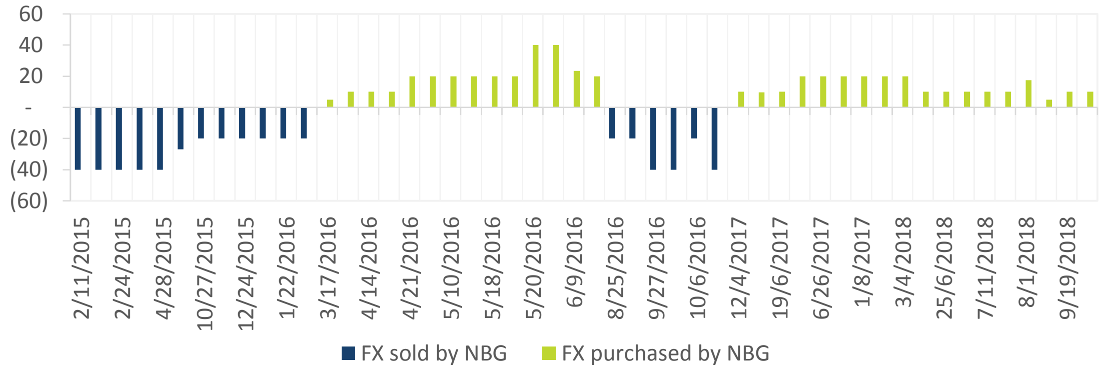
Source: Geostat

## NBG bought 25 mln USD on the FX market in September

In September 2018 NBG intervened three times on the FX market and purchased 25 mln USD in total. Since the beginning of 2018 NBG purchased 112.5 mln USD.

FX interventions

(mln USD)




Source: NBG

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