



National Bank
of Georgia

INFLATION REPORT

February

2014



MONETARY POLICY IN GEORGIA

- The aim of the monetary policy is to maintain low and stable inflation and thus promote macroeconomic stability, which in turn is a precondition for robust and sustainable economic growth, low interest rates and decreasing unemployment.
- The CPI inflation target is set at 6% for the years 2013-2014 and 5% from the year 2015. The inflation target of the National Bank of Georgia is planned to decrease gradually to 3% in the long term, parallel to the development of the economy.
- Since monetary policy decisions impact the economy with a certain time lag (4-6 quarters), the formulation of the monetary policy is done according to inflation forecasts in order to hit the target in the medium term. The medium term horizon depends on shocks and exogenous factors that influence the rate of inflation and the aggregate demand.
- The primary tool of the monetary policy is the refinancing rate. The change of the policy rate is transmitted to the economy through market rates, exchange rate and credit activity, thus influencing the aggregate demand. The difference between the actual and the natural level of demand is the main determinant of inflation in the medium term.
- Monetary policy decisions are communicated to the general public via press releases. The vision of the bank with regard to ongoing and expected macroeconomic activity is published in the Inflation Report in the second month of every quarter.

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1. BRIEF OVERVIEW

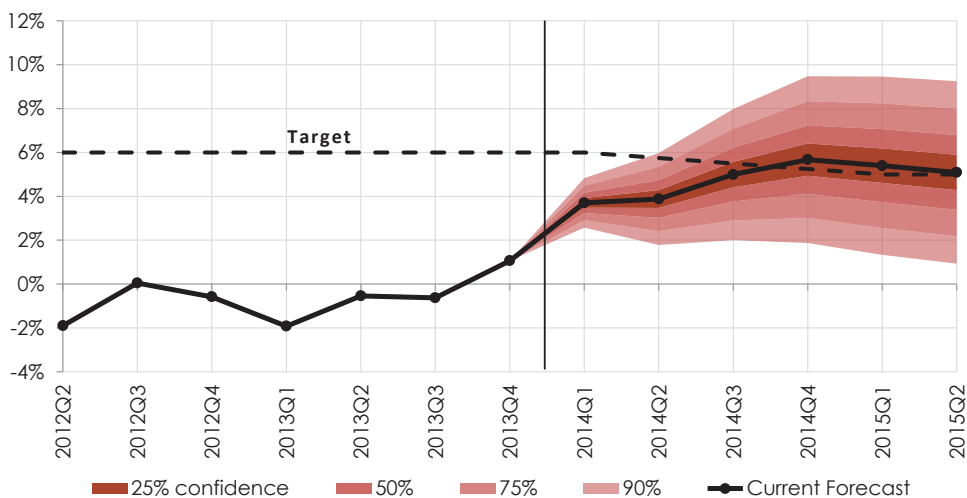
Economic activity started to recover in the fourth quarter of 2013. The year-on-year real GDP growth was 6.9%, owing to an increase in capital expenditures, an improvement in business sentiment and greater credit activity. In 2013 the real economy grew by 3.1%. The lower-than-average growth rate of recent years was reflected in a decline in private and public investment, which was partially compensated by a high growth in net exports. The latter, amid an ample harvest in 2013, was due to the deepening of trade with Russia and the utilization of existing stock. In terms of the contributions of the main sectors of the economy, the slowdown was quite homogenous among all major sectors, but the construction and service sectors had the highest negative contributions.

Along with economic activity, the inflation rate rose in the fourth quarter of 2013, and the year-on-year inflation rate was 2.9% in January 2014. The increase in inflation was a result of the reduction of deflationary pressures affecting food prices from the beginning of 2012. In addition, deflationary pressure on import prices was enforced by the appreciation of the nominal effective exchange rate. Amid the eased monetary policy, the recovery in credit activity and the increase in government spending strengthened aggregate demand in the second half of 2013. This has had a positive impact on inflation, reducing the gap from the 6% target.

The banking sector’s activity was modest in 2013, but began increasing in the second half of the year. In December, the year-on-year loan growth rate increased to 16%¹, owing to an increase in market demand. In terms of currency denomination, the growth was largely caused by loans in the national currency, supported by the provision of floating-rate lari loans amid the relaxed monetary policy.

According to the NBG’s forecasts, the inflation rate will continue to rise to that of the target by the second half of 2014. The forecast assumes that the depreciation of the nominal effective exchange rate will be reflected in the prices of imported goods, and that fiscal stimulus measures, amid the growth in economic activity, will create positive pressure on domestic prices (see Figure 1.1).

Chart 1.1 Annual Inflation

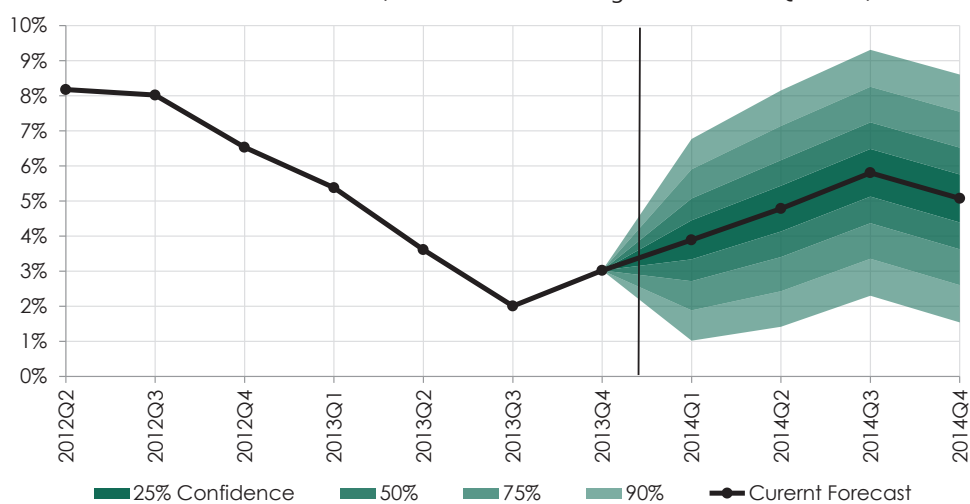


Source: National Bank of Georgia

1 With the exchange rate effect excluded.

The NBG forecasts that economic growth will pick up to 5% in 2014, which takes into account improving business sentiment amid a softer monetary policy and fiscal stimulus measures (see Figure 1.2). Capital formation is expected to have a significant positive contribution in 2014. Consumption is also expected to have a positive contribution. Consistent with the forecast, the contribution of net exports will be modest compared to 2013. This is due to the base effect and the high growth of imports, as triggered by stronger aggregate demand. GDP growth will be distributed among all major sectors, but the growth of the construction and service sectors will be most prominent. The contribution of the agricultural sector will be modest compared to 2013 as a consequence of the base effect.

Chart 1.2 Real GDP Annual Growth (Annual Growth During the Last Four Quarters)



Source: National Bank of Georgia

The forecast varies and is highly dependent on exogenous factors on the market; however, it is balanced by risks on both sides. On the one hand, the weaker than expected economic growth of Georgia's trade partners, as well as reduced foreign investment flows to developing countries – triggered by the reduction of monetary stimulus measures in the U.S. – could negatively affect economic growth in Georgia. Furthermore, business sentiment is still fragile, which greatly determines the level of domestic investment. On the other hand, the increased activity of the co-investment fund and of capital expenditures, and the improvement in business sentiment, along with the prospect of moving to a European free trade regime, might lead to higher than projected economic growth. These factors also affect the risks associated with inflation. In particular, higher than expected economic activity will create additional pressure on local prices. Furthermore, a rise in the budget deficit might be reflected in prices to greater extent than expected. In addition, a major risk factor to the inflation forecast is again attributed to the supply-side: the seasonality of agricultural crop harvests can be expected to put high pressure on food prices in 2014.

The global economic recovery is expected to continue in 2014, though it may be uneven among developed and developing countries. The IMF forecasts global activity to rise by 3.7% in 2014, and the recovery of developed economies will be a major contributor to that growth. Relatively lower economic growth is expected in Georgia's neighboring trading partners such as Turkey, Ukraine and Russia. Global economic activity transmits to the Georgian economy through several channels, in particular, through demand on exports, remittances and foreign investment.

Based on the analysis of the NBG's forecasts and associated risks, the Monetary Policy Committee decided to increase the policy rate by 0.25 percentage points to 4% on February 12, 2014. This decision reflects the view of the NBG concerning the inflation forecast and other macroeconomic indicators.

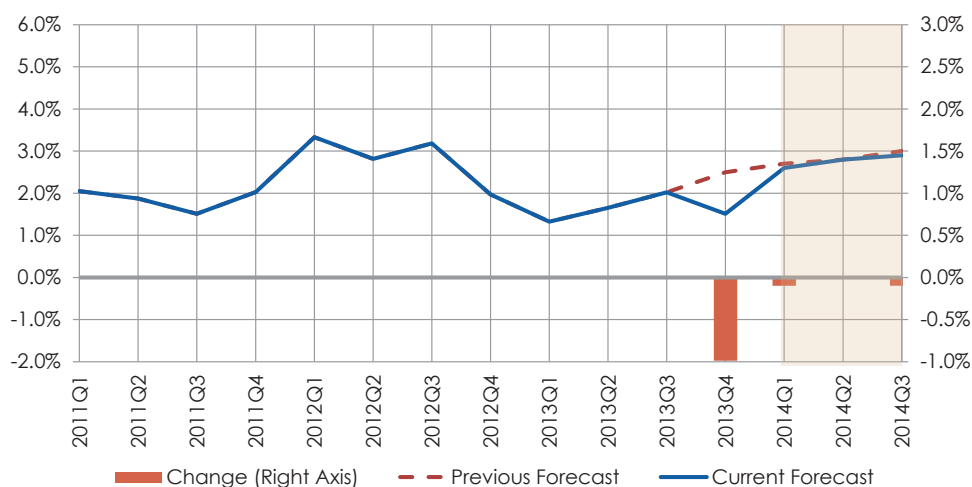
2. MACROECONOMIC FORECAST

2.1 EXTERNAL SECTOR OVERVIEW

The second half of 2013 was marked by the predicted recovery of global economic activity. Additional improvement in global economic growth is expected in 2014-15, largely due to the economic recovery of developed countries. The IMF predicts global growth to reach about 3.7% in 2014 and 3.9% in 2015. However, as some countries' economic growth forecasts emphasize existing imbalances it is important to consider some risks. Developed countries still lag behind their natural levels of output, which leads to prolonged expansionary monetary policy and fiscal consolidation. When it comes to emerging and developing countries, increased demand from developed countries will contribute to their economic growth, but domestic risks still remain. In some countries there is a need to eliminate imbalances associated with weakened credit quality and capital outflows.

The U.S. economic growth forecast for 2014 equals 2.8%, which is higher than it was for 2013 (1.9%). The total improvement in domestic demand since the second half of 2013 will be added to an increased demand for inventories in 2014 (IMF forecast), which is caused by the easing of the fiscal burden as a consequence of a recently reached agreement. Nevertheless, this agreement also ensures that the fiscal position next year will be more consolidated, and the U.S. economic growth rate is predicted to total 3% in 2015.

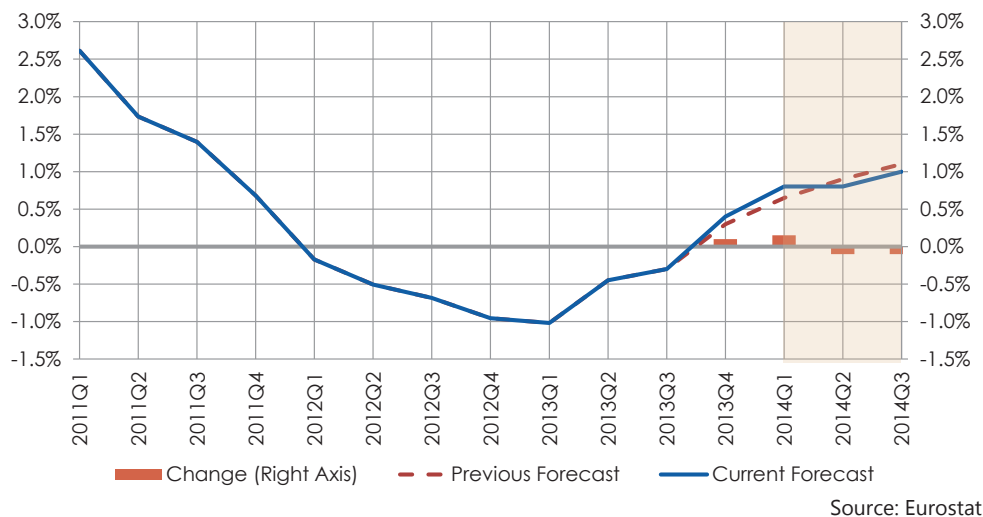
Chart 2.1 U.S. Real GDP Annual Growth



Source: OECD

The eurozone is coming out of recession and the recovery process is proceeding steadily. According to the IMF forecast, the economic growth of the eurozone will reach 1% in 2014 and 1.4% in 2015. However, economic recovery remains uneven amongst the member countries. In particular, a relatively slow pace of economic recovery will be observed in many countries under stress (except Spain) because of reduced domestic demand as caused by higher private and public debt and financial fragmentation. The eurozone growth will average 1.2% for the years 2014-15, but significant economic imbalances remain.

Chart 2.2 Eurozone Real GDP Annual Growth



In emerging and developing countries, the IMF forecasts economic growth of about 5.1% for 2014 and 5.4% for 2015. Despite previous negative expectations, China’s economic growth remained high in the second half of 2013 (due to increased investment), which will have a positive impact on other emerging and developing countries. However, it should be noted that these markets are under high risk of capital flight caused by the reduction of monetary stimulus measures in the U.S.

The economic growth of Turkey, Georgia’s largest trading partner, has recently been called into question as a result of the ongoing political crisis in the country. The deep current account deficit is an additional source of concern for investors. IMF forecasts of October 2013 predicted Turkey’s economic growth for 2014 to be around 3.5%, but it is clear that this forecast will be revised downward. A far more serious political crisis is unfolding in Ukraine – another important trading partner for Georgia. As for the Russian economy, it remains sensitive to changes in the international prices of oil and gas. Higher than expected capital outflows, unemployment and weak domestic demand were also observed. In light of this, in January, the IMF predicted that the Russian economy would grow 2% in 2014, which is 1 percentage point less than the forecast of October 2013.

According to the IMF forecast, there is no major pressure expected on the main commodity products in the international market in 2014.² Remarkable exceptions to this are corn and wheat – a result of the poor yields in Western countries in 2013. Inflation Forecast in Eurozone is around 1% (see Figure 2.3). Moderate inflation expectations are predicted for Georgia’s main trading partners. In 2014, inflation rates in Turkey and Russia will be maintained around the targets of 5% and 5-6% respectively.

Rising interest rates have recently been observed in European financial markets and these are likely to be maintained at a low level. The European Central Bank triggered this process in January 2014 by expressing its readiness to further reduce the monetary interest rate if necessary, in order to prevent an unwanted increase in short-term rates. Similar to the European Central Bank, the central banks of other developed countries also maintain relaxed monetary policies.

2 IMF. *Commodity Price Outlook & Risks, January 2014.*

Chart 2.3 Eurozone CPI Annual Inflation

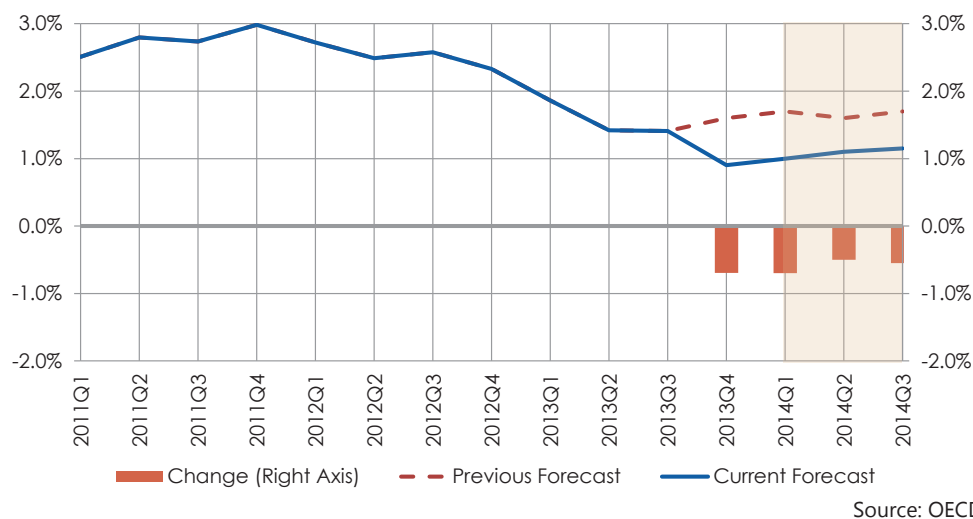
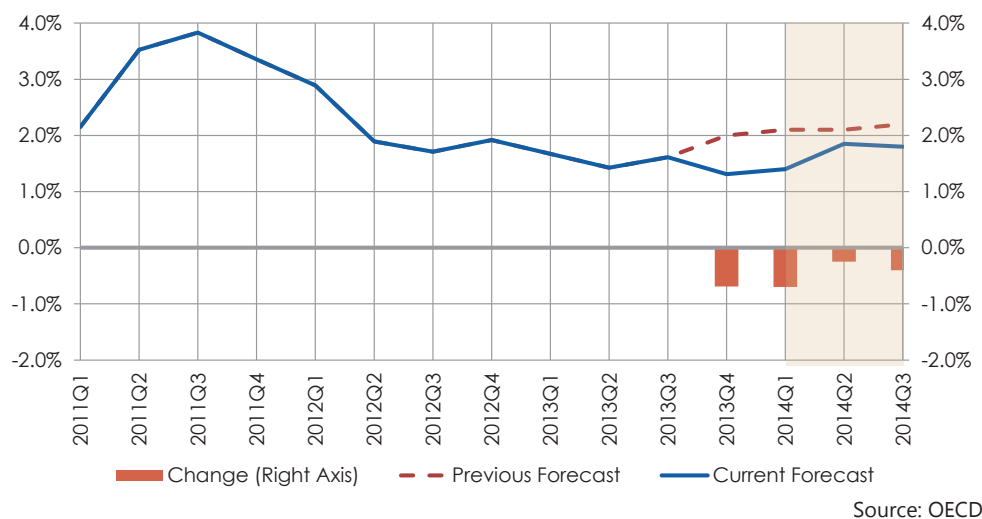


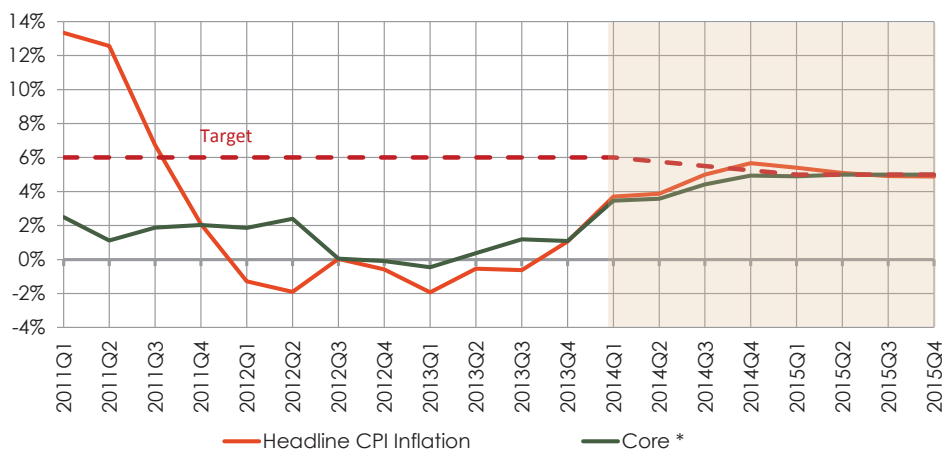
Chart 2.4 U.S. CPI Annual Inflation



2.2 MACROECONOMIC FORECAST

In the fourth quarter of 2013, inflation had an increasing trend and in December the annual inflation rate was 2.4%. In the same period, core inflation, which implies a change in consumer prices excluding food and energy, was 0.9% (see Figure 2.5). Despite the elimination of deflation, the annual inflation rate is still below the National Bank of Georgia’s target of 6%. This undershooting was largely due to exogenous factors, but insufficient pressure on consumer prices from the demand side was also an important factor. The inflation dynamics of the fourth quarter were mainly determined by the elimination of deflation shocks that existed in previous quarters. In addition, because of improved economic activity, there has been an increase in domestic prices. However, due to the level of economic activity still being low in comparison to its potential, inflationary pressure from the demand side is not enough (see Figure 2.6).

Chart 2.5 Headline and Core Inflation

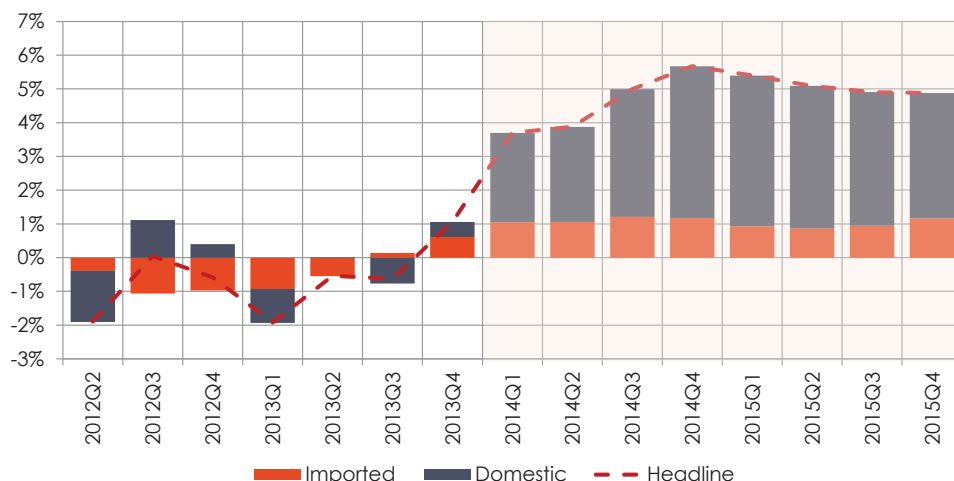


* Core inflation excludes food, energy and utilities' prices from the basket

Source: National Bank of Georgia

External factors also contributed to inflation in the fourth quarter of 2013. The depreciation of the nominal effective exchange rate caused an increase of imported inflation (see Figure 2.6). The depreciation of the nominal effective exchange rate was mainly due to the depreciation of the GEL against USD.

Chart 2.6 Headline Inflation Decomposition



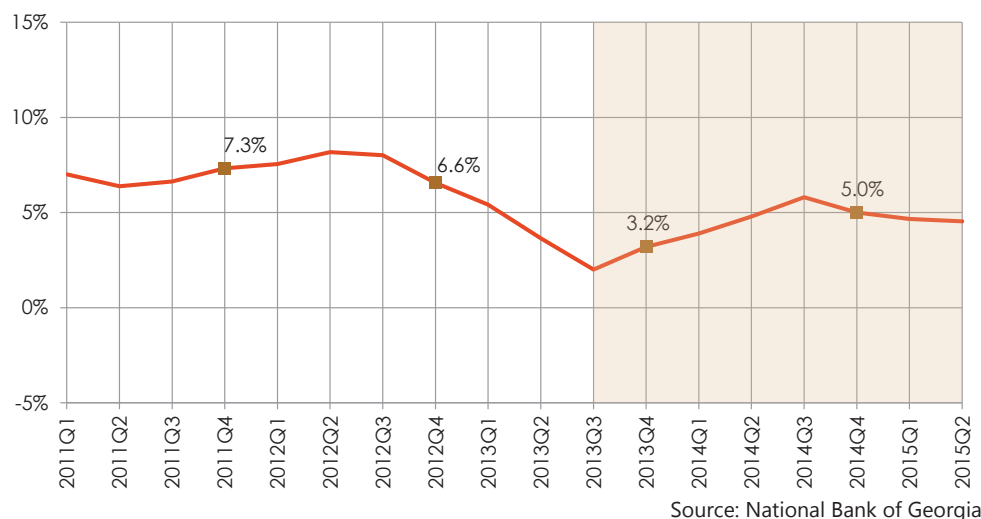
Source: National Bank of Georgia

According to the current forecasts, it is expected that the upward trend of consumer prices will be maintained in 2014. Annual inflation will reach its target in the second half of 2014 (see Figure 2.5).³ The major risk factor for the forecast remains in the supply side, namely the seasonality of agricultural crop production, which may cause a higher than expected increase in food prices in 2014. The demand side is also important. Moreover, the increase in the budget deficit may have a greater than expected effect on prices. A rise in domestic prices (see Figure 2.6), which should be facilitated by the expected growth in economic activity, will lead to an increase of inflation.

According to preliminary data, in the fourth quarter of 2013 the growth of economic activity was greater than expected, with an annual growth rate of 6.9% (see Figure 2.7). The high level of economic growth was a result of a number of important factors. There was an improvement in both business and consumer confidence, which, compared to the previous quarters, was reflected in increased consumption and economic activity. Increased demand also improved activity in the financial sector, which was reflected in the high growth of loans in the fourth quarter. An increase in government spending also contributed to the improvement of economic activity. Other factors behind the high growth in the fourth quarter included the significantly increased export of goods and tourism.

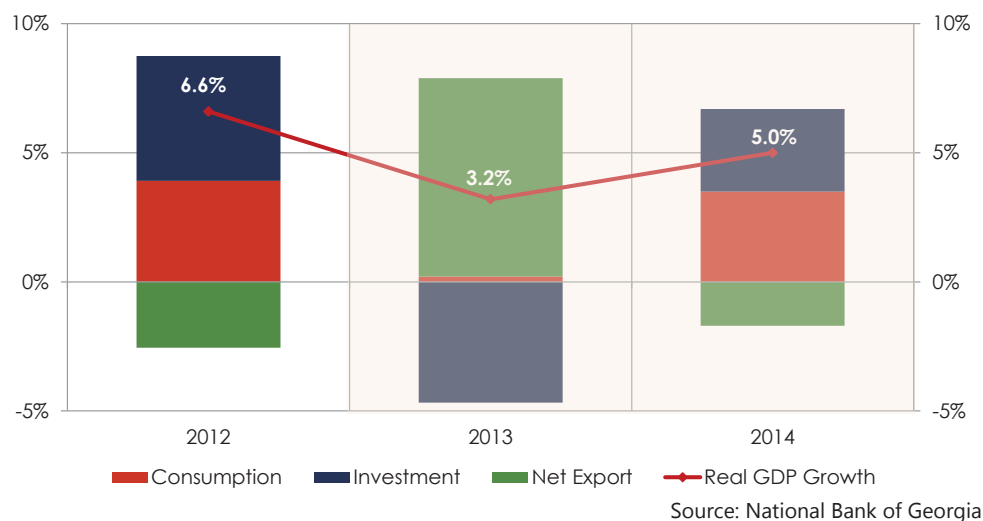
³ Note that the inflation target will be reduced to 5% in 2015.

Chart 2.7 Real GDP Growth (Annual Growth of Last four Quarters)



According to the current baseline forecast, real GDP growth in 2014 will be around 5% (see Figure 2.7). The forecast is based on strong fiscal stimulus measures and, partly, on the private sector’s recovery. The forecast is balanced by risks existing in both directions. On the one hand, possible low levels of foreign investments, caused by global economic activity and the reduction of U.S. monetary stimulus measures, may have a negative impact. On the other hand, an increase in the co-investment fund’s activity and the government’s capital expenditures, alongside an improvement in business confidence with the prospect of a free trade regime with Europe, may lead to higher than expected economic activity.

Chart 2.8 Components of Real GDP



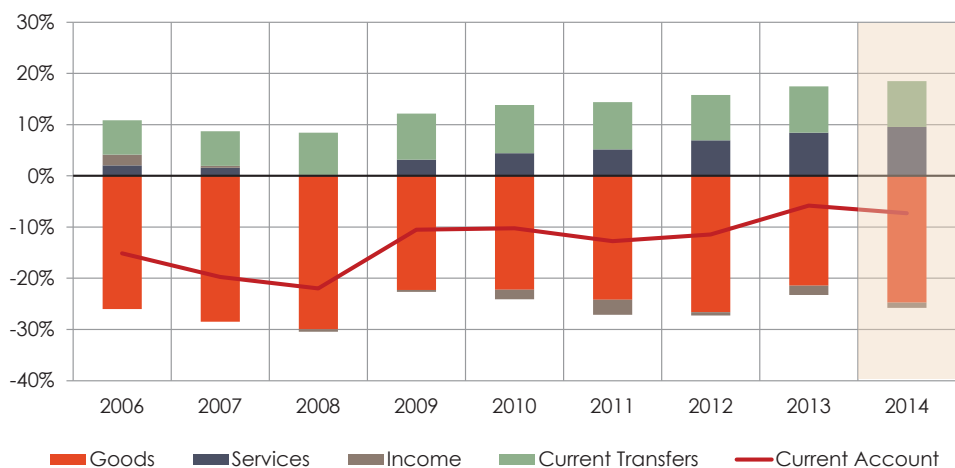
In 2013, net exports made the largest contribution to real GDP growth. After the high growth of 2013, the contribution of net exports will decrease in 2014 (see Figure 2.8). According to the forecast, the contribution of consumption to GDP growth will significantly increase to become one of the major determinants of growth in 2014. The slowdown of economic growth in 2013 was largely due to a reduction in investments, whose share in the growth was negative. However, investments are projected to positively contribute to economic growth in 2014.

Due to significantly increased exports compared to imports, in 2013 the trade balance improved by 9.1%, amounting to 499 million USD. According to preliminary

data, in the fourth quarter the export of goods increased by 46%, while imports of goods and services increased by 14.4% annually. This export growth has largely come from consumer goods, but the contribution of investment goods also increased. The export of goods largely depends on both the domestic demands of trading partner countries and on global economic growth. The service sector's (including tourism) potential for growth also contributes to export growth. After the reductions of the previous quarters, in the fourth quarter of 2013 there was an increase in imports. Consumer goods were the major determinant of growth, while the contributions of investment goods continued to decline.

The improved trade balance had a positive impact on the current account deficit for 2013, which is an important indicator of macroeconomic imbalances. The current account deficit in 2013 was 5.8% of GDP. The reduction of the current account deficit was due to an increase in exports and a decline in investment goods imports. It is expected that imports of these types of goods will increase in subsequent years alongside the inflow of foreign capital. In the short term, this will have a negative impact on the current account deficit. According to the current forecast, the current account deficit in 2014 will be within 8% of GDP.

Chart 2.9 Current Account Components Ratio to GDP

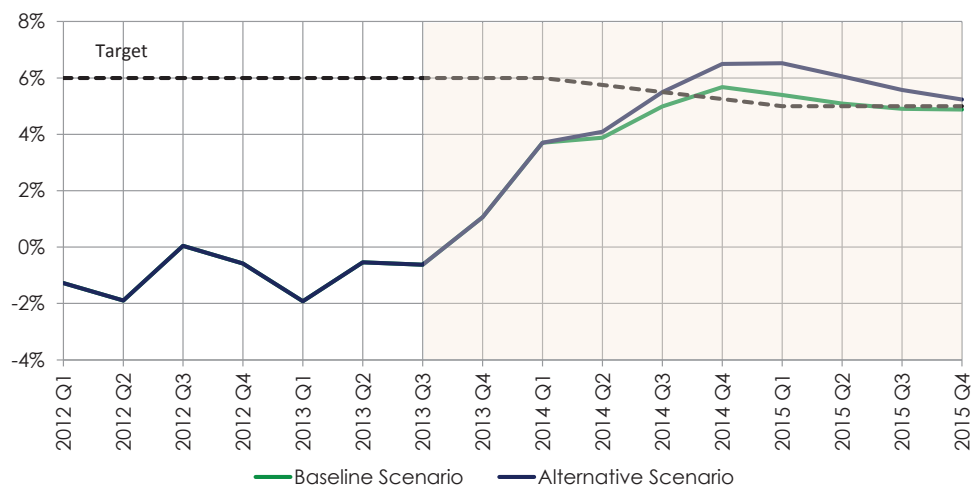


Source: National Bank of Georgia

2.3 ALTERNATIVE FORECAST SCENARIO

The alternative forecast scenario considers the impact of macroeconomic risks affecting the inflation forecast. In particular, economic growth may be higher than expected due to greater than expected activity in public and private investments. The scenario also discusses the effect of faster than expected exchange rate depreciation on imported prices. The possible impact of these risk factors is discussed in the alternative forecast scenario (see Figure 2.10).

Chart 2.10 CPI Inflation According to Baseline and Alternative Forecasts



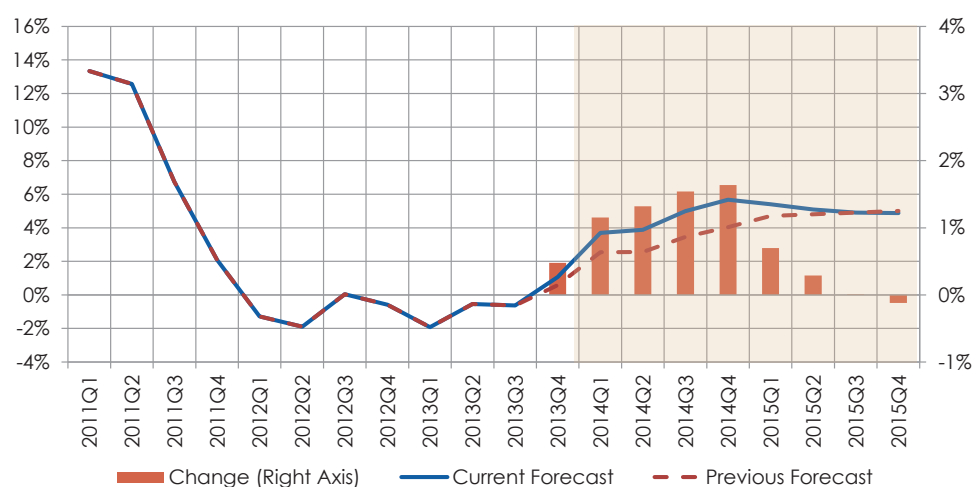
Source: National Bank of Georgia

The growth of aggregate demand caused by a positive shock will be positively reflected in economic growth. In particular, in the alternative scenario GDP growth in 2014 will be 6%. High aggregate demand growth will create upward pressure on inflation forecasts, which will be partly mitigated by a tightening of monetary policy in line with the forecast. According to the alternative scenario, the inflation rate will increase up to 7% in the second half of 2014 and will approach the central bank's target rate of 5% in the second quarter of 2015.

2.4 COMPARISON WITH THE PREVIOUS FORECAST

The economic growth forecast for 2014 has not changed compared to the previous quarter. The inflation forecast, however, has been revised upward – largely as a result of nominal effective exchange rate depreciation. In particular, according to the current forecast, the nominal effective exchange rate will have a moderate positive effect on imported prices, which is reflected in the projected rate of inflation as well (see Figure 2.11).

Chart 2.11 Change in Forecast of Real GDP Growth



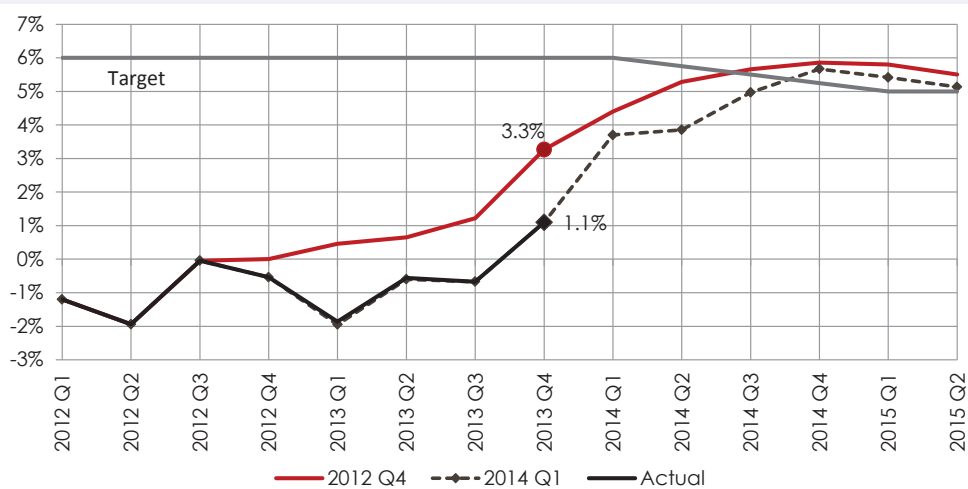
Source: National Bank of Georgia

Box 1 INFLATION TARGET ACHIEVEMENT AND FORECAST PERFORMANCE

In the fourth quarter of 2013 the annual inflation rate was 1.1%, which is below the target level. In order to evaluate the achievement of the inflation target, we should look at the National Bank of Georgia's past projections and the formation of monetary policy. As the monetary policy is aimed at targeting forecasted inflation four to eight quarters ahead, it is desirable to start with an analysis of the inflation report from the fourth quarter of 2012.

The lower than target inflation rate at the end of 2013 is partly in line with the forecast that was presented in the inflation report from the fourth quarter of 2012. According to that forecast, it was expected that inflation would rise to 3.3% in the fourth quarter of 2013 and would be close to the target level in the second quarter of 2014. The increase in the inflation rate was largely due to the vanishing deflationary impact of exogenous factors. In particular, a reduction of deflationary pressure on food prices from the supply side and an increase in imported prices were the main contributors to the increase of the inflation rate. The latter was characterized by deflation in the second half of 2012. Together with the supply factors, it was expected that a recovery in aggregate demand would lead to higher prices on services. The forecast also partially took into account the effect of a one-time price reduction of utility prices.

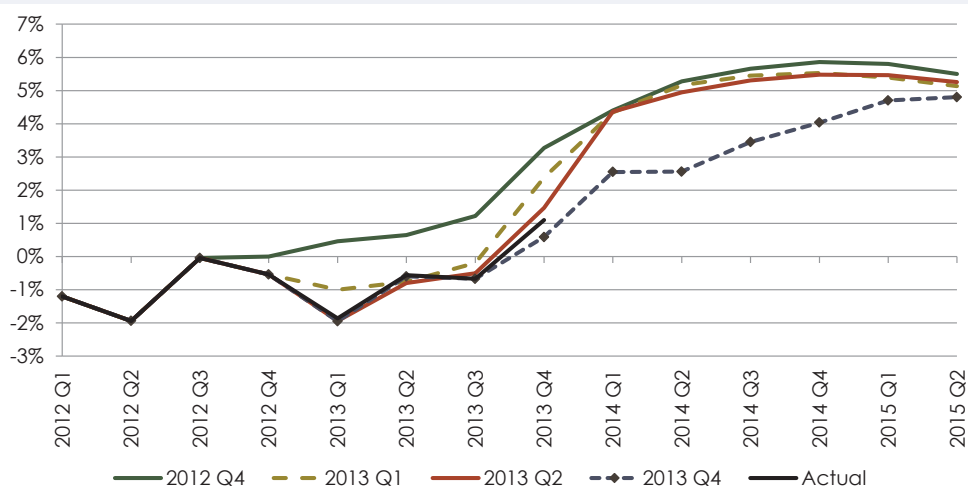
Chart 2.12 Annual Inflation



Source: National Bank of Georgia

ment, and that government spending would be implemented according to the planned budget. According to these assumptions, in 2013 economic growth was predicted within 6%, which would increase inflationary pressure from the aggregate demand side (see Figure 2.14).

Chart 2.13 Annual Inflation Forecasts



Source: National Bank of Georgia

The actual rate of inflation was lower than had been predicted in 2012 (see Figure 2.12), however, this was largely in line with the forecast made at the beginning of 2013 (see Figure 2.13). The downwards revision of the inflation forecast was mainly caused by changes in assumptions on both supply and demand side factors.

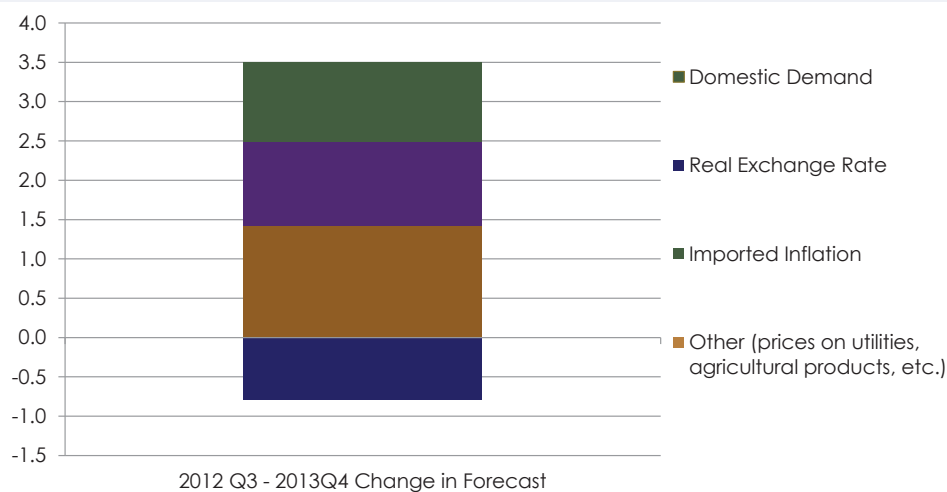
In particular, in light of a good harvest, neither the reduction of food prices nor the cut in administered prices were fully taken into account in the forecast. In addition, the projection was based on the assumptions that, from the beginning of 2013, investors' confidence would increase, which would be reflected in a growth of invest-

External factors have also had an important impact on the deviation from the forecast. Import prices from the second half of 2012 were characterized by deflation. This deepened in the first half of 2013, and was thus only partially included in the forecast. In addition to the reduction of global demand, this deflation was largely caused by the depreciation of the Turkish lira and the EUR. Higher depreciation of the real effective exchange rate, compared to the trend rate, affected the projection error in the opposite direction (see Figure 2.14).

From today's perspective, the dynamics that followed the 2012 fourth quarter forecasts

can be summarized as follows: aggregate demand growth in 2013 was significantly lower than the forecasted rate, which was due to extended low business activity. In addition, in light of fiscal consolidation, the optimization of infrastructure projects resulted in a negative contribution of capital formation to aggregate demand growth; followed by low activity in the banking sector and less than projected consumption growth. In terms of supply factors, the sudden decrease in prices for agricultural products and the reduction of utility prices both played an important role.

Chart 2.14 Change in Forecast, 2012 Q3 - 2013 Q4



Source: National Bank of Georgia

For making monetary policy decisions assessments of the risks related to the forecast were also important. In light of the typical uncertainty in the wake of an election period, in the fourth quarter of 2012 inflationary risks were balanced on both sides; the inflation forecast was revised downward, and the risks tilted slightly towards deflation. As a result, the Monetary Policy Committee decided to reduce the refinancing rate, with the total reduction equaling 50 basis points by the end of 2012.

We can summarize monetary policy after the fourth quarter of 2012 as follows: in line with the reduction of the inflation forecast, the National Bank of Georgia carried out monetary policy

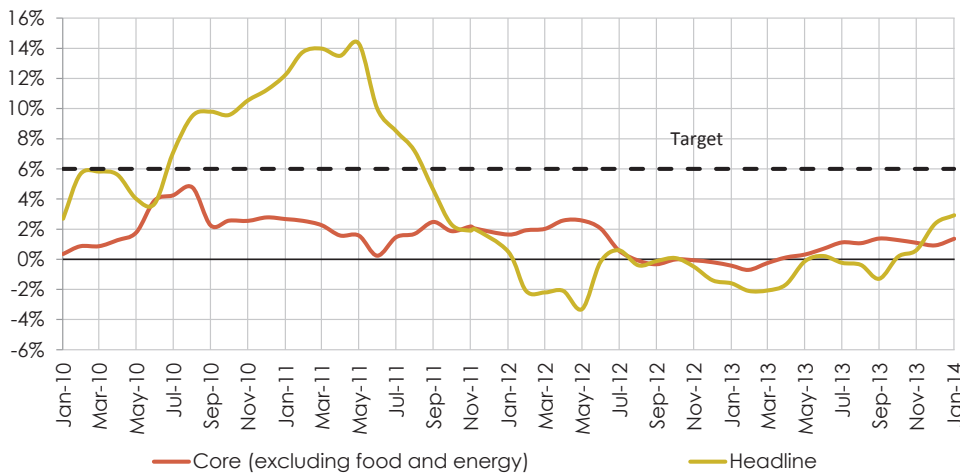
easing. During that period, the refinancing rate was reduced by 200 basis points to 3.75%. Based on this, the market interest rates for loans to individuals and legal entities also decreased. In order to increase the availability of credit resources and to stimulate aggregate demand, in the beginning of 2013 the National Bank of Georgia made the decision to expand the collateral base for monetary operations. In response, during the second half of the year, lari denominated loans increased significantly. In general, we can conclude that monetary policy was consistent with the existing forecasts.

3. CONSUMER PRICES

The decline of the overall price level did not continue during the fourth quarter of 2013. Consumer prices increased by 2.4% during this period, as compared to the same quarter in 2012. An increase of the overall price level took place during the first month of 2014. Thus, by the end of January 2014, the annual CPI inflation rate increased and stood at 2.9%. Despite this growth, one can see that headline inflation is at a lower level than the NBG’s medium-term target of 6%.⁴ In the backdrop of growing headline inflation, core inflation (excluding food and energy) is gradually increasing. Core inflation stood at 1.4% by the end of January (see Figure 3.1).

« Headline inflation in January 2014 is at a lower level than the NBG’s target and stands at 2.9%.

Chart 3.1 CPI and Core Inflation



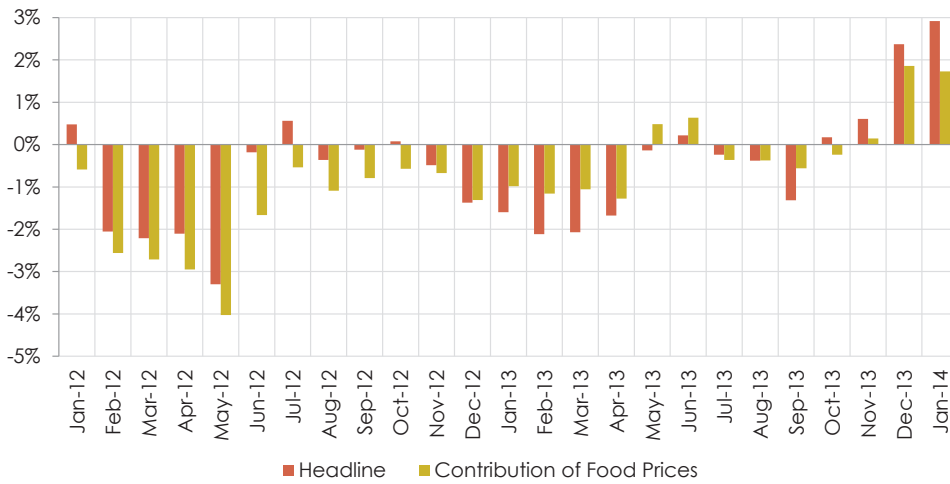
Source: National Bank of Georgia

Changes in food prices are still important for the dynamics of the development of the consumer price index. From November, the overall price level of food started to rise. During the next couple of months food inflation further increased. The annual price change on food products stood at 6.3% by the end of 2013 and 5.7% by the end of January 2014, contributing approximately 1.7 percentage points to headline inflation (see Figure 3.2).

« Increase in the inflation rate was mainly caused by the increase in food prices.

4 The inflation target will decrease to 5% in 2015.

Chart 3.2 Contribution of food inflation in headline inflation



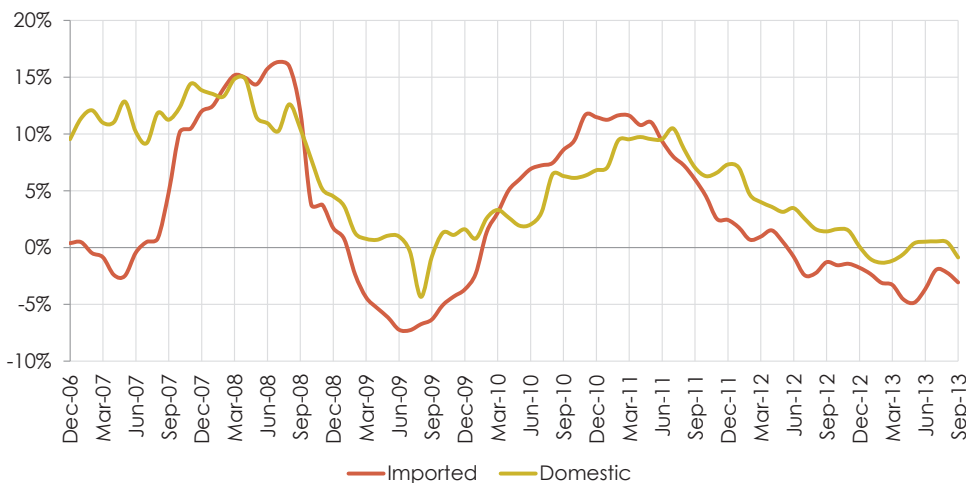
Source: GeoStat and National Bank of Georgia

The price cut on utility services implemented during 2012-2013 had a significant negative effect on the overall price level in the country. Electricity tariffs were reduced from the beginning of 2013 and gas tariffs were cut in March. The decline of these utility prices has contributed -0.3 percentage points to the annual inflation rate by the end of January 2014. However, it should be noted that this base effect will end soon, which will place upward pressure on the overall price level.

In terms of supply factors, it is worth noting that the growing deflation on imported goods, as observed during the first three quarters of last year, exhibited a strong downward trend in the fourth quarter. According to the data, in December annual imported inflation decreased to -1.2%, down from -3.1% at the end of the third quarter. The rate of declining prices on imported goods has become lower since the beginning of 2014. By the end of January, the annual rate of changes in the overall price level of imported consumer goods amounted to -0.1% and its contribution to headline inflation is negligibly small (see Figure 3.3).

- « A decline in administered prices creates a negative base effect on annual inflation.
- « The negative inflation rate on imported goods significantly decreased and stood at -0.1% by the end of January.

Chart 3.3 Imported and Domestic Inflation



Source: GeoStat and National Bank of Georgia

During the last quarter of 2013, the negative impact on overall prices from factors existing on the demand side of the economy declined. Against the backdrop of soft monetary policy, low interest rates in the economy resulted in a sufficient growth of credit activity. Increased lending to the economy caused domestic demand to rebound. Furthermore, the growth of budget expenditures had a stimulating impact on the economy by the end of year. It should be noted that external sector indicators also point towards improving aggregate demand. At the end of year, sharp increases in imports from the previously very low levels were observed. At the same time, a growing volume of remittances played an important role in stimulating domestic de-

- « Factors strengthening aggregate demand have also caused the rate of inflation to increase.

mand. The increase in foreign demand was evidenced by high growth rates in both goods and services exports.

Thus, against the backdrop of loose monetary and fiscal policies, economic activity started to increase in the fourth quarter of 2013. The Gross Domestic Product gap remains negative, but in line with growing aggregate demand, the gradual closing of that gap is expected, which will place inflationary pressure on price levels and ensure an increase of the inflation rate to the target level.

Box 2 CHANGES IN THE CONSUMER BASKET

The rate of changes to the consumer price index (CPI) is generally used as an indicator of inflation. This is calculated based on a consumer basket, which represents the list of goods and services most frequently consumed in the country and reflects the expenditure pattern of an average consumer. Since the pattern of consumption expenditure changes over time, the CPI basket regularly needs to be updated. From 2012, the procedures and periodicity of basket updating changed and the determination of the weights for individual consumer basket components became based on the system of national accounts. The use of national accounts in the process of defining consumer basket weights represents one of the important recommendations that Eurostat, the EU's main statistical office, has provided to its member countries. The updating of the basket takes place every year. For 2014, the consumer price index will be calculated using a basket based on national accounts data from 2012.

Consumer prices are registered during the 10th and 20th days of each month in five Georgian cities: Tbilisi, Batumi, Kutaisi, Gori and Telavi. While determining the weight in the city, the expenditure pattern of the whole region is taken into account and the regional weights are defined in line with the scope of regional expenditures. During the survey, all districts in the cities and all types of retail outlets and service facilities are taken into account. The selection process of the surveyed outlets is based on business statistics data, taking into account the turnover volumes of these outlets and facilities. As of today, the number of surveyed objects equals almost 1,300. According to the 2012 national accounts' data, new weights were assigned to the different regions. In case of Tbilisi, the decreasing trend continued and its weight declined to 53.1%. The Batumi and Gori regions have lower weights compared the previous basket, 11.1% and 5.8% respectively. Conversely, a growth of weights took place in Kutaisi and Telavi. It should be noted that the weight of the Kutaisi region increased by 2.8 percentage points, exceeding 21%.

Table 3.1 Coverage Area and Regional Weights

Regions	2013	2014
Tbilisi	54.5%	53.1%
Kutaisi	18.3%	21.2%
Batumi	11.9%	11.1%
Gori	6.4%	5.8%
Telavi	8.8%	8.9%

Source: GeoStat

The consumer basket is identical for every city and comprises 12 commodity groups in line with the international classification (COICOP). The weights and distribution of the main groups did not change significantly in 2014. The largest share, about 30% is still held by the food and non-alcoholic beverages category, which is typical of low-income countries. However, the weight of this group decreased slightly compared with 2013. The share of alcoholic beverages and tobacco products reduced as well. The group comprising clothing and footwear will have a larger share in the consumer basket in 2014. As for the services category groups, the changes in weights have different directions. During 2014, the main groups of "housing, water, gas, electricity, and other fuels", "transport", "communication", "recreation and culture", "hotels, cafes and restaurants" and "miscellaneous goods and services" will all be represented with smaller weights in the consumer basket. In contrast, the weights of the "furnishings, housing appliances and equipment, routine house maintenance", "education" and "healthcare" groups will increase compared with 2013.

Table 3.2 Weights of Main Groups in the Consumer Basket

Main Groups	2013	2014
Food and Non-alcoholic beverages	30.7%	30.2%
Alcoholic beverages, Tobacco	5.4%	5.1%
Clothing and footwear	2.6%	2.9%
Housing, water, gas, electricity, and other fuels	8.8%	8.4%
Furnishings, housing appliances and equipment, routine house maintenance	4.8%	6.2%
Healthcare	9.0%	10.1%
Transport	12.7%	11.8%
Communication	4.1%	3.6%
Recreation and culture	6.7%	6.6%
Education	4.9%	5.4%
Hotels, cafes and restaurants	5.2%	5.0%
Miscellaneous goods and services	5.1%	4.7%

Source: GeoStat

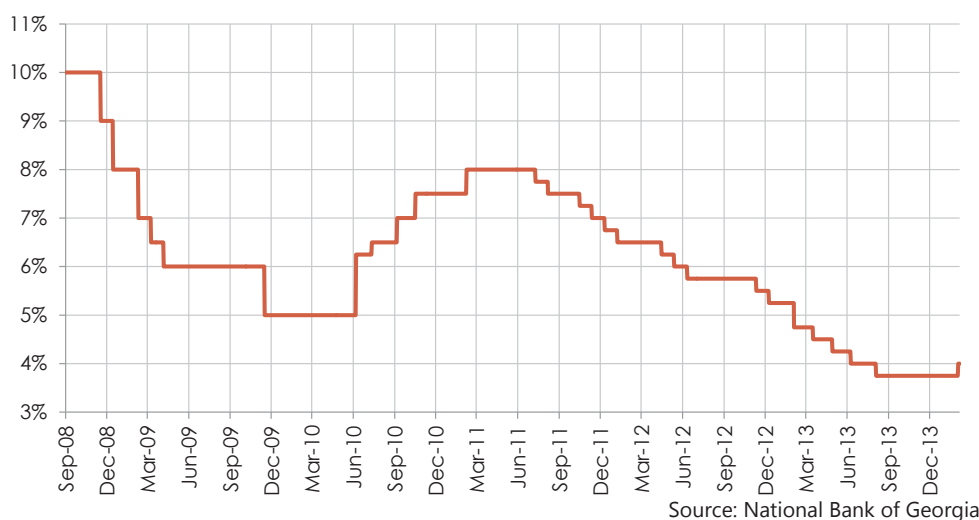
According to the 2012 national accounts, the consumption structure of the country has changed. As a result, in 2014 both the number of consumer goods and services in the consumer basket, and the weights proportionally assigned to overall consumption, have changed. During 2012-2013 the consumer basket contained 288 goods and services, but for 2014 this number has increased to 295 (eleven new products were added to the basket, while four items were dropped). The weight of goods and services already existing in the basket have thus changed. The added products mainly belong to the category of consumer goods, rather than services. Despite the lowering of the food group's weight, five new products were included in this group. The weights of dairy, wheat, flour and confectionery products increased as compared to the previous basket. In contrast, the weights of meat and meat products, oil and fats, some vegetables and watermelons have been reduced. According to the 2012 national accounts data, consumption expenditures on tobacco products and alcoholic beverages have reduced. In the new basket, fuels, in total, will have smaller weights (the weights of petroleum and natural gas fuel have been reduced, while the share of diesel fuel has increased). In the transport group, the weight of suburban transport fares have declined, but the shares of city bus and minibus fares have increased. As mentioned above, the weight assigned to the goods and services included in the healthcare category increased, mainly because of the addition of a new service ("hospital services") to the consumer basket. At the same time, the weight of therapist's advice increased significantly in this group. However, it is noteworthy that the shares of maternity care and medications in the consumption basket have been reduced. Increased expenditures on universities, private tutors and schooling resulted in an increase in the weight of the education group. Consumer products such as natural gas and cleaning services have higher weights in the upgraded consumer basket, but the weights for water and electricity supply fees have decreased. According to the 2012 national accounts, consumption expenditure on home appliances and other household equipment increased. As a result, these products will have higher weights in the 2014 consumer basket in proportion with expenditures.

4. MONETARY POLICY

The NBG implemented a loosening of its monetary policy from July 2011 until September 2013. The monetary policy rate decreased by a cumulative 4.25 percentage points to 3.75%. Taking into account the forecasts of the time, the NBG maintained the policy rate at the existing level of 3.75% from the fall of 2013. It was thought that the effects of the loose monetary policy had not been fully realized in the economy and that, at that stage, the impact of further loosening would have been marginal. The forecasts existing at that time indicated that the inflation rate would reach its target level by the end of 2014.

« The NBG starts the process of exiting its loose monetary policy stance and increases the policy rate to 4%.

Chart 4.1 Monetary Policy Rate



The last Monetary Policy Committee meeting was held on 12 February. It was decided that the NBG would start the process of exiting its loose monetary policy stance and the policy rate was thus increased by 25 basis points to 4%. This decision was based on the existing inflation forecasts and on the macroeconomic analysis of ongoing events in both Georgia and outside its borders.

Price developments follow the dynamics forecasted by the NBG. Starting from the fall of 2013, the inflation rate has exhibited a growth trend. Overall annual CPI inflation in January was 2.9%, whereas monthly inflation was 0.8%.

Higher economic activity has been observed since the fourth quarter of 2013. According to preliminary estimates, economic growth amounted to 7.1% in the fourth quarter, with annual economic growth standing at 3.2%. Even though the GDP gap remains negative, against the backdrop of increased domestic demand, this is expected to gradually decline – thus putting upward pressure on prices.

Against the backdrop of loose monetary policy, decreased interest rates led to higher credit activity, with the latter supporting the growth of domestic demand. At the end of 2013, the growth rate of commercial bank loans amounted to 16%⁵, while in 2012 the same indicator stood at 12.8%. Increased credit activity was observed from August 2013. The growth of domestic demand is also manifested in external sector data: according to preliminary estimates, imports grew by 14.8% on annual terms in January. As for remittance inflows, in the fourth quarter of 2013 the annual growth rate amounted to 13.9%, which further stimulated domestic demand. The annual growth rate of remittance inflows in 2013 stood at 10.7%. Moreover, external demand showed significant evolution: the annual growth rate of goods ex-

5 Excluding exchange rate effects on the volume of credit portfolio.

ports amounted to 47.4% in December. According to preliminary data, these positive trends in the external sector were retained in January 2014 as well.

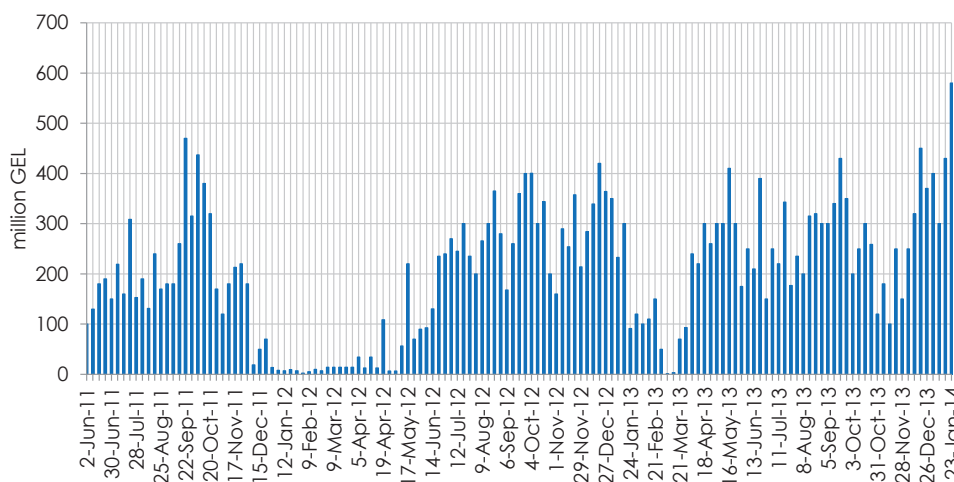
As temporary supply-side factors faded out starting from the spring (e.g. the base effect, the reductions of gas and electricity consumption tariffs, etc.) upward pressure will be put on prices, along with recovered economic activity.

As a result of the existing forecasts, it was found necessary to start the exit from the accommodative monetary policy stance in a timely fashion in order to meet the inflation target in the medium term. At this stage, this implies increasing the policy rate by 25 basis points. The target rate of inflation is set at 6% for 2014 and will decrease to 5% in 2015. Based on the aforementioned points, the Monetary Policy Committee decided to start the gradual exit process from the loose monetary policy stance.

In order to ensure the efficiency of monetary policy, it is important for changes in the monetary policy rate to be reflected on interbank interest rates, and ultimately affect the real economy. With the given level of short-term liquidity in the banking system, commercial banks are capable of raising necessary additional funds through the refinancing loans of the NBG. At this stage, demand for this instrument is high, which improves the transmission of changes in the policy rate to interbank market interest rates. Short-term interbank rates remain stable and hover around the policy rate.

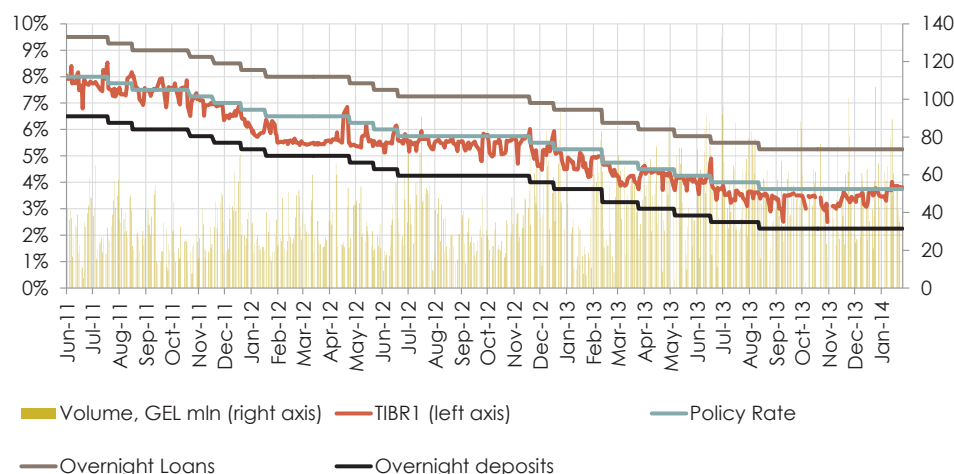
« Interbank rates hover around the policy rate.

Chart 4.2 Refinancing Loans



Source: National Bank of Georgia

Chart 4.3 Interbank Money Market



Source: National Bank of Georgia

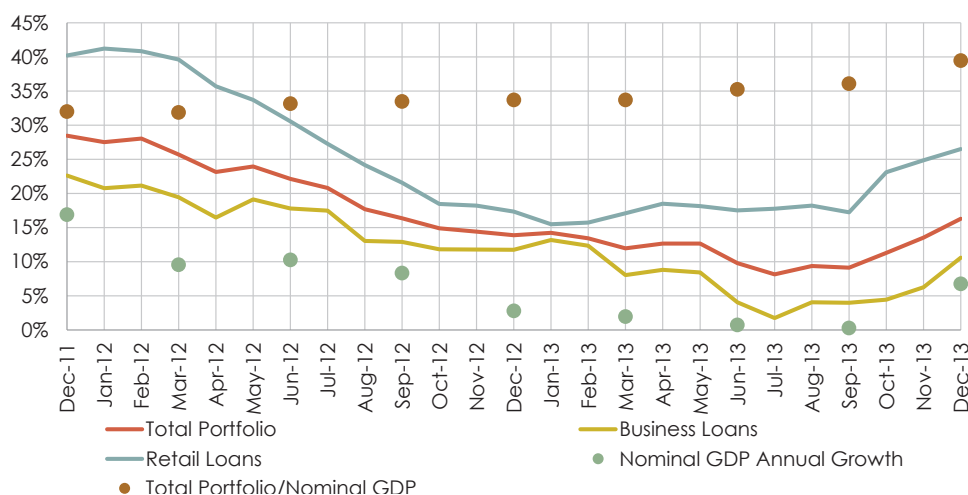
5. FINANCIAL MARKET AND TRENDS

5.1 LOANS

In December 2013, the annual growth rate of the loan portfolio increased by 7.2 percentage points compared to September and amounted to 16%.⁶ In the fourth quarter, the recovery of credit activity was due to an increased demand for loans, an easing of credit conditions, and a rise of capital expenditure by the government. In the context of currencies, the growth of the loan portfolio was largely caused by an increase in domestic currency loans, which, in turn, was due to an increase of loans with floating interest rates.

« The growth of the loan portfolio was largely caused by an increase in domestic currency loans, which, in turn, was due to an increase of loans with floating interest rate, given the loose monetary policy.

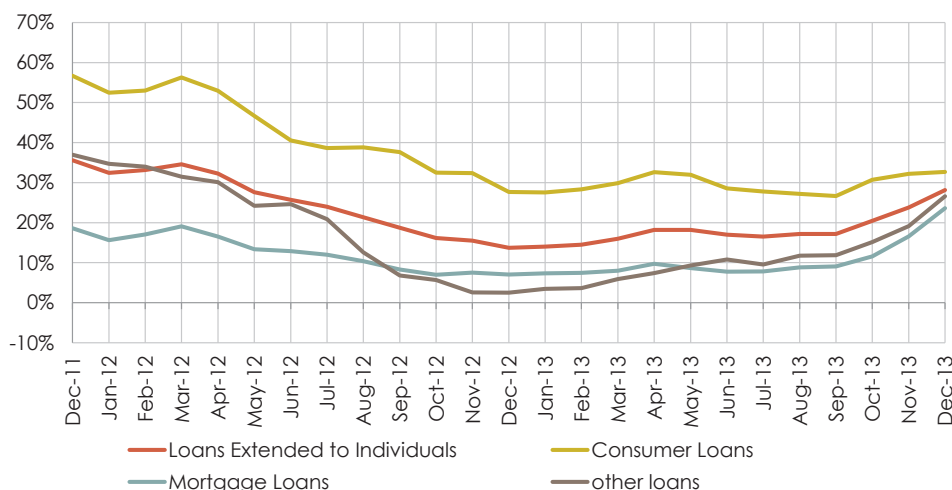
Chart 5.1 Credit Portfolio Annual Growth



Source: National Bank of Georgia

Retail loans, which predominantly include consumer and mortgage loans, exhibit a high growth rate. This is largely due to a decline in interest rates and the base effect. As compared to September 2013, in December the growth rate of consumer loans increased by 6 percentage points and amounted to 33%, while the growth rate of mortgage loans increased by 15 percentage points and amounted to 24%. It should also be noted that, compared to September, instant credit volume increased by 55% in December.

Chart 5.2 Retail Loans Annual Growth



Source: National Bank of Georgia

⁶ The growth rate does not account for the effect of exchange rate movement on the loan portfolio,

In the fourth quarter of 2013 there was significantly increased demand for business loans, as compared to the previous quarter. The annual growth rate of the loan portfolio to legal entities amounted to 10%, which indicates a recovery of economic activity in the same period. According to the credit conditions survey, it is expected that this increased demand for business loans will be preserved in the current quarter.

An analysis of business loans by sector reveals that the transport, energy, agriculture and trade sectors posted growth in terms of credit, while the volume of outstanding loans disbursed to the construction and manufacturing sectors increased only slightly. The continued high growth of loans to the agricultural sector was mainly due to the state assistance program. In December, loans to the agricultural sector grew by 150%. It should be noted that agricultural sector loans make up only a small proportion of the total loan portfolio (1.5% of loans to legal entities).

The share of non-performing loans decreased by 1.4 percentage points in the fourth quarter of 2013, as compared to the previous quarter, and stood at 7.5%. According to the data from December, the share of non-performing loans in the national currency decreased by 0.8 percentage points compared to September, amounting to 4.9%, while the share of non-performing loans in a foreign currency decreased by 1.5 percentage points and amounted to 9.1%. In the fourth quarter the number of loans written off amounted to 60 million GEL, which is 15% less than in the previous quarter.

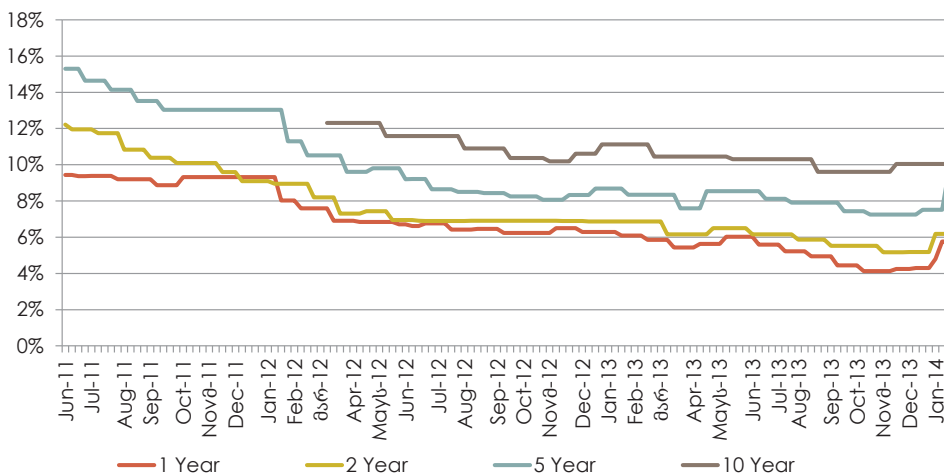
« According to the credit conditions survey, it is expected that this increased demand for business loans will be preserved in the current quarter.

« The share of non-performing loans significantly decreased for both national and foreign currency loans, as compared to the previous quarter.

5.2. INTEREST RATES AND CREDIT CONSTRAINTS

In February 2014 the monetary policy rate increased by 25 basis points in line with macroeconomic forecasts and stands at 4%. Changes in monetary policy are transmitted to the real economy with a time lag. However, the easing of monetary policy over the past quarters reduced interest rates. In the fourth quarter, the interest rate on deposits and loans significantly decreased, while the rate on government securities increased – supposedly as a result of a rise in inflationary expectations.

Chart 5.3 Interest Rates on Government Securities

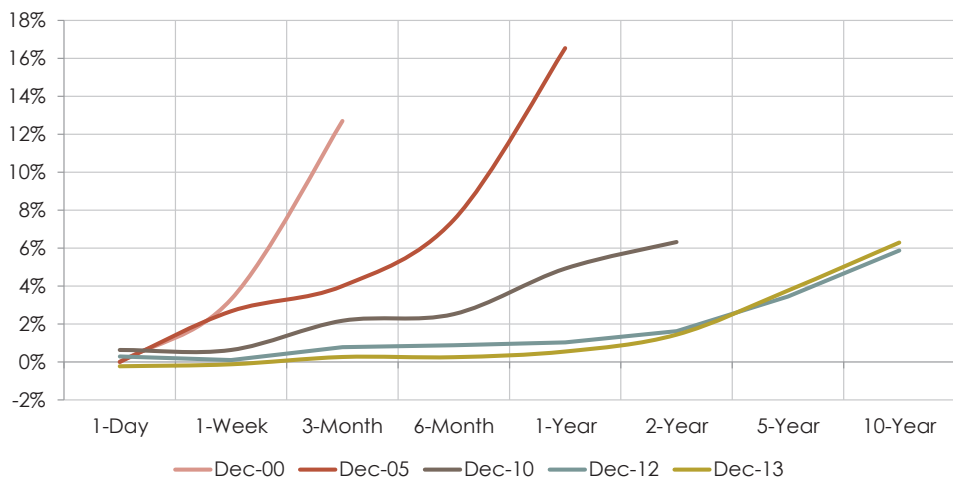


Source: National Bank of Georgia

« The interest rate on deposits and loans significantly decreased, while the rate on government securities increased – supposedly due to a rise in inflationary expectations.

It should be noted that the spread between long-term assets and the monetary policy rate has increased. However, the slope of the yield curve displays a declining trend. The National Bank's monetary policy agenda reduces liquidity and interest rate risks. Additionally, the improvement of the interbank market reduces the liquidity risk of securities. These tendencies should reduce the price of long-term assets and thus promote internal investments and economic growth.

Chart 5.4 Spread between the Monetary Policy Rate and the Yield Curve

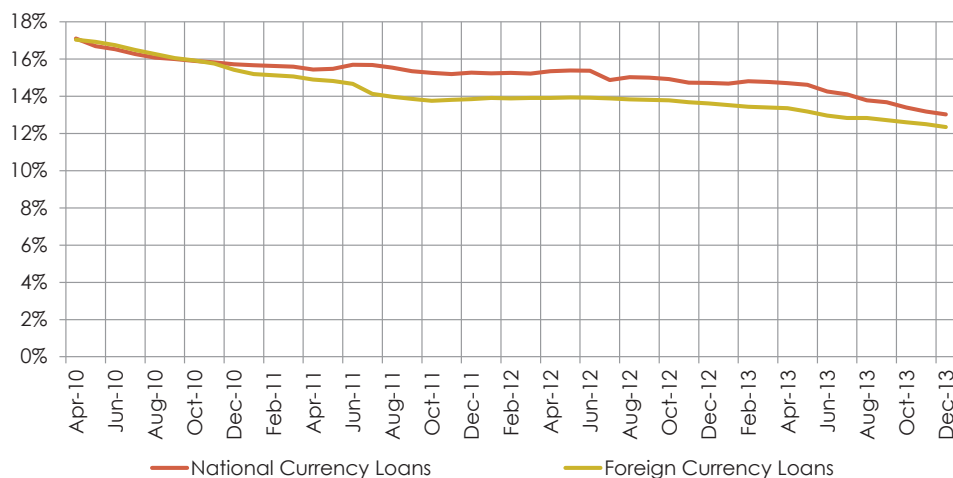


Source: National Bank of Georgia

Because of increased competition among banks and the eased monetary policy, interest rates have declined on loans to both the business and retail sectors. In December, as compared to September, interest rates on business loans in the domestic currency have declined by 0.7 percentage points, amounting to 13%, while for foreign currency business loans the interest rate declined by 0.4 percentage points and amounted to 12.4%.

« Interest rates continue to decrease on loans to both the business and retail sectors.

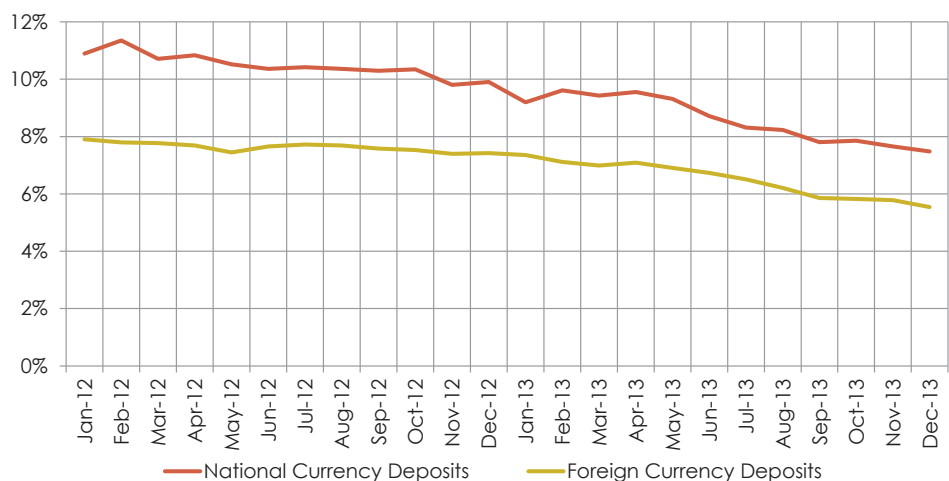
Chart 5.5 Average Interest Rates on Loans



Source: National Bank of Georgia

The reduction of interest rates on deposits continues in both domestic and foreign currency. Compared to the previous quarter, the interest rate on deposits has declined by 0.3 percentage points. The decline in interest rates is partly a result of the monetary policy easing. In addition, the contributions of both fundamental and other factors are significant. Fundamental factors include: risk premium reductions, macroeconomic stability, the growth of savings, and the improvement of banking sector efficiency. The reduction of deposit rates was also due to the accumulated excess liquidity of banks.

Chart 5.6 Average Interest Rates on Deposits

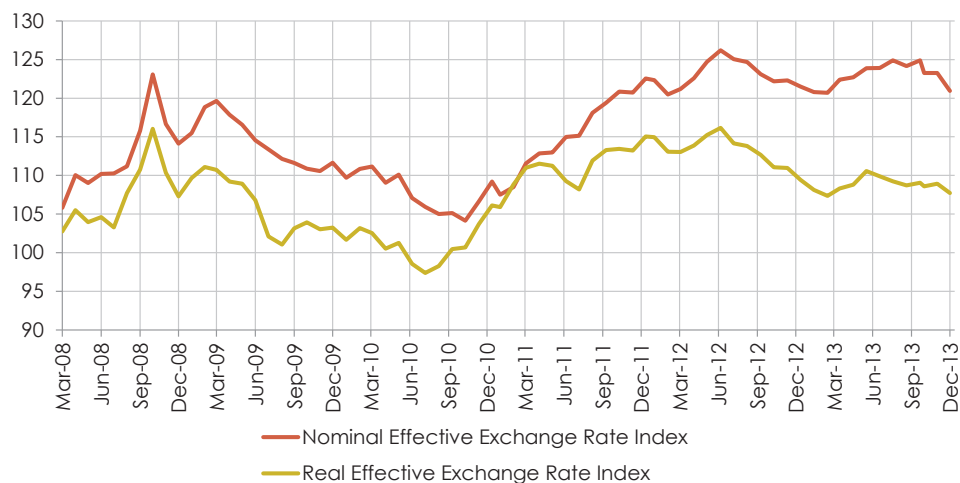


Source: National Bank of Georgia

5.3. EXCHANGE RATE

The GEL exchange rate to the U.S. dollar continued the slight depreciation that started from the previous period. It depreciated by 1.6% against the U.S. dollar and by 4.4% against the euro in the fourth quarter of 2013. The lari appreciated by 1.2% against the Turkish lira during the same period. As a result, the GEL nominal effective exchange rate depreciated by 1.7% in quarter-on-quarter terms and appreciated slightly, by 0.4%, in annual terms.

Chart 5.7 Effective Exchange Rates (Jan 2008 = 100)



Source: National Bank of Georgia

The real effective exchange rate has depreciated once again, by 1.9% in annual terms and by 0.5% in quarter-on-quarter terms. The real exchange rate depreciated against all trade partners' currencies, except the Turkish lira. The main contributors to the depreciation of the real effective exchange rate were the eurozone and Azerbaijan.

Table 5.1 Effective Exchange Rate Annual Growth

	Change of Nominal Effective Exchange Rate, %	Change of Real Effective Exchange Rate, %	Share in Real Effective Exchange Rate
Effective Exchange Rate	-0.5	-1.5	-1.5
Turkey	11.9	6.6	1.5
EU	-7.3	-6.2	-1.0
Ukraine	-3.1	-1.3	-0.2
Armenia	-3.2	-6.2	-0.3
USA	-3.1	-2.3	-0.1
Russia	3.7	-0.4	0.0
Azerbaijan	-3.1	-4.3	-0.7
Other	-5.4	-4.4	-0.7

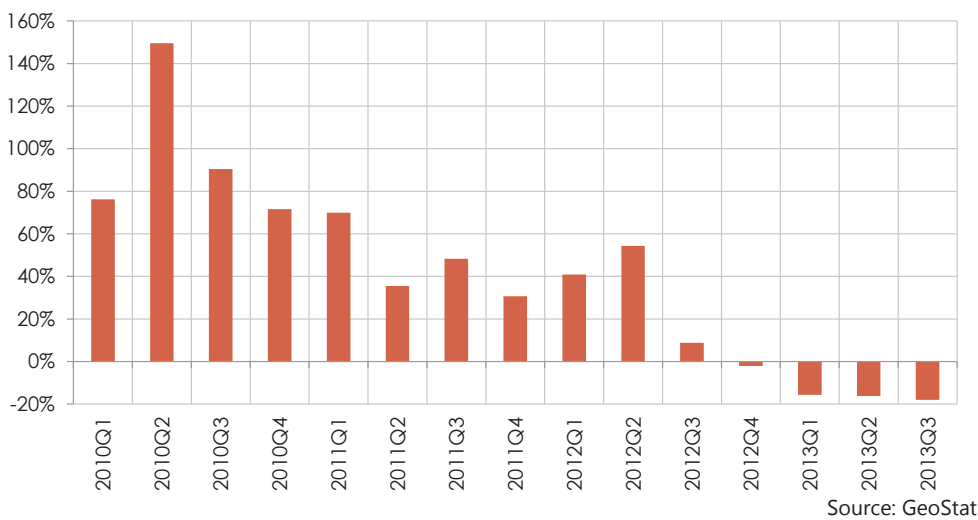
Source: National Bank of Georgia

6. DOMESTIC DEMAND

Real GDP growth amounted to 1.4% in the third quarter of 2013. As in the two previous quarters, the decline in investments and consumption (government and private) were the main determinants of the reduced growth. The growth rate of the economy increased to 7.1% in the fourth quarter, while net exports were the main contributor to GDP growth in 2013.

« Real GDP growth amounted to 7.1% in the fourth quarter of 2013.

Chart 6.1 Annual Growth Rate of Capital Formation



The growth rate of capital formation remained negative in the third quarter of 2013, posting -18%, and, as a result, played an important role in slowing down GDP growth. Capital formation is expected to rise in the last quarter of 2013, which causes the forecast of the real growth rate to be high.

« The growth rate of capital formation remained negative in the third quarter of 2013, standing at -18%.

The export of goods and services increased by an annual 23.7 percent, while imports declined by 0.4 percent in the third quarter of 2013. It should be noted that net exports were the main determinant of GDP growth in the third quarter. According to preliminary results, imports increased significantly in fourth quarter of 2013. Despite that, net exports made a positive contribution to GDP growth in the last quarter of 2013 as a result of the high growth level of exports.

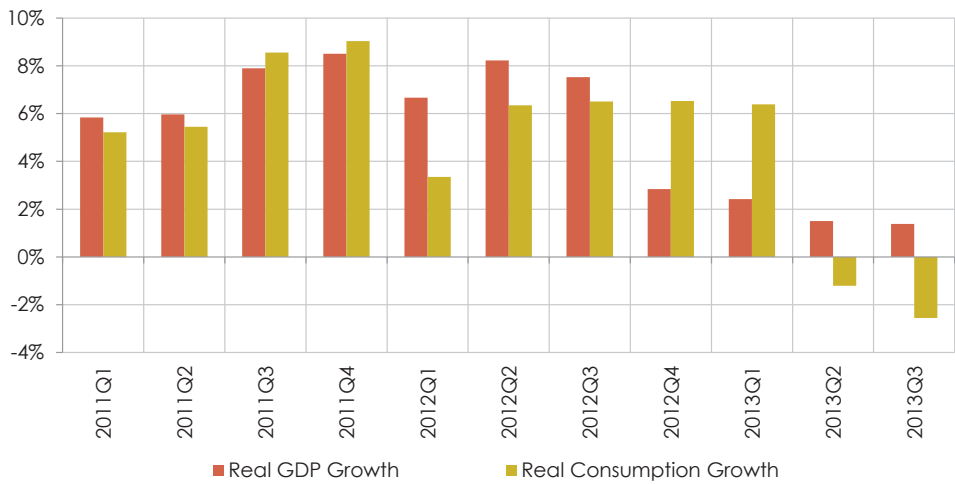
« Net exports were the main determinant of GDP growth in the third quarter.

Seasonally adjusted real consumption⁷ remained negative on an annual basis in third quarter of 2013 (see Figure 6.2) and posted -2.6%. Consumption has declined in both the government and private sectors. According to preliminary estimates, private consumption increased in the fourth quarter, which is due to an increase in the credit activity of commercial banks. Increased consumption will ensure a high GDP growth rate.

« Real consumption growth remained negative on an annual basis in the third quarter of 2013 and posted -2.6%.

7 The real growth of consumption is calculated using average annual inflation.

Chart 6.2 Real GDP and Real Consumption Growth

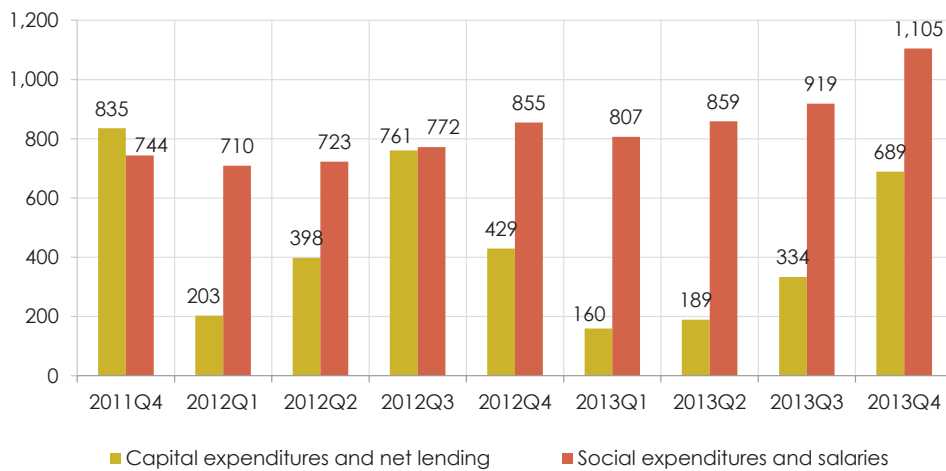


Source: GeoStat and National Bank of Georgia

Consolidated budget expenditures increased by 26.9% during the last quarter of 2013 as compared to the previous year. Unlike the previous quarters of 2013, capital expenditures grew significantly, together with social expenditures. The rise in capital expenditures will be reflected in an increase of government investments, which itself will support the growth of capital formation.

« Consolidated budget expenditures increased by 26.9% in the fourth quarter of 2013

Chart 6.3 Capital and Social Expenditures of Consolidated Budget (mln GEL)



Source: Ministry of Finance of Georgia

7. EXTERNAL DEMAND AND BALANCE OF PAYMENTS

In 2013 the current account (CA) deficit improved sizably compared to the previous year. The CA deficit to GDP ratio stood at 5.8%, which is 5.7 percentage points less than the same indicator in 2012. During the first three quarters of 2013 the CA deficit sharply improved, partly due to the declining volumes of imports of goods and services, and partly because of the rising exports of goods and services. In the last quarter of 2013, along with increased domestic demand, there was a sharp growth in imports of goods and services, which led to the deterioration of the current account deficit. Based on preliminary information, the CA to GDP ratio reached 8.4% in the last quarter of 2013. In absolute terms, the CA deficit reached 382.4 million USD in the last quarter of 2013, which is 12.2 million USD more than the same period in 2012.

« In 2013 the current account (CA) deficit to GDP ratio improved sizably compared to the previous year and stood at 5.8%, which is 5.7 percentage points less than the same indicator in 2012.

Chart 7.1 Ratio of Current Account to GDP



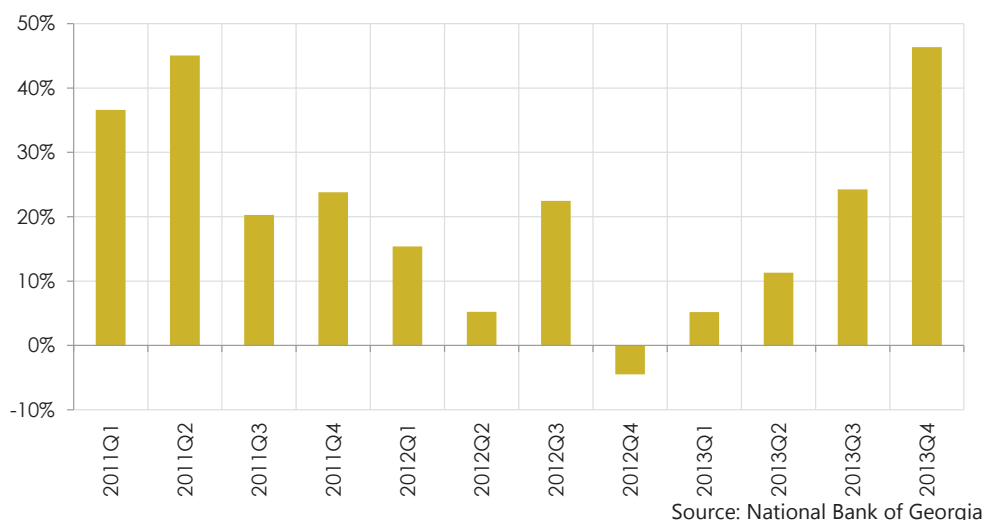
Source: National Bank of Georgia

In 2013, exports of goods grew at an increasing pace. In the fourth quarter, the annual growth rate of goods exported stood at 46.3%. Overall, exports increased by 22.4% in 2013 and reached 2.9 billion USD. It is worth mentioning that exports of agricultural goods and locally produced food products saw high growth during 2013. On top of that, exports of nuts and wine doubled during the year; exports of citruses increased sharply; and exports of mineral waters also increased by 80%. Each of these products accounted for a significant portion of the growth of total exports. Car exports remained the biggest export commodity in 2013, comprising 24.2% of total exports.

« In 2013, exports grew at an increasing pace and in the fourth quarter, the annual growth rate stood at 46.3%.

« During 2013, exports of nuts and wine doubled; exports of citruses increased sharply; and exports of mineral waters also increased by 80%.

Chart 7.2 Annual Growth Rate of Export



According to the International Monetary Fund’s economic outlook for 2014, the economic condition of Georgia’s main trading partners is projected to become more favorable. The improvement of the external environment will be positively reflected in the growth of Georgian exports. Nevertheless, ongoing political and economic tensions in Ukraine contain risk for Georgian exports, although these threats are limited by the small share of the Ukrainian market in total Georgian exports and by the possibility of exports switching to different markets. During the last quarter of 2013, despite the unstable situation in Ukraine, Georgian exports to Ukraine increased by 59% annually. Overall, in 2013 Georgian exports to Ukraine increased by 15.4%, accounting for 6.6% of total Georgian exports in 2013.

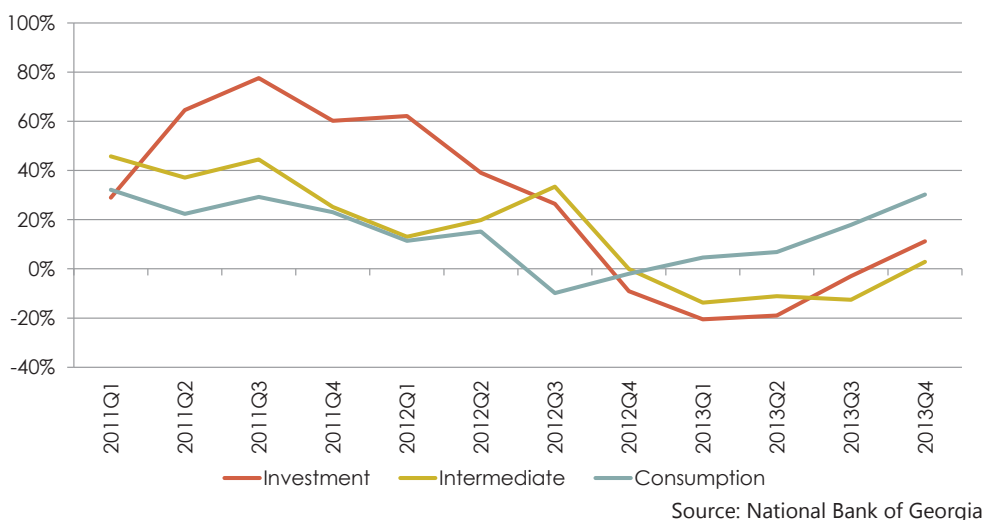
« Ongoing events in Ukraine contain risk for Georgian exports, although these threats are limited by the small share of the ukrainian market in total Georgian exports and by the possibility of exports switching to different markets.

Imports of goods rapidly increased in November and December 2013, by 22.1% and 21.4% respectively. This end of year growth spurt in imports is related to increased domestic demand and increased budgetary expenditures. Imports of goods in the last quarter of 2013 increased by 14.4%. Overall, imports of goods increased by a modest 0.41% in 2013.

« Imports of goods rapidly increased in November and December 2013, by 22.1% and 21.4% respectively. This end of year growth spurt in imports is related to increased domestic demand and increased budgetary expenditures.

The growth of imports during the fourth quarter of 2013 was chiefly driven by an increase in the import of consumption goods, but imports of both intermediate and investment goods also saw growth during that period.

Chart 7.3 Annual Growth Rate of Imports Across the Product Groups



« Although imports of investment goods started to increase, its share in total imports remain low.

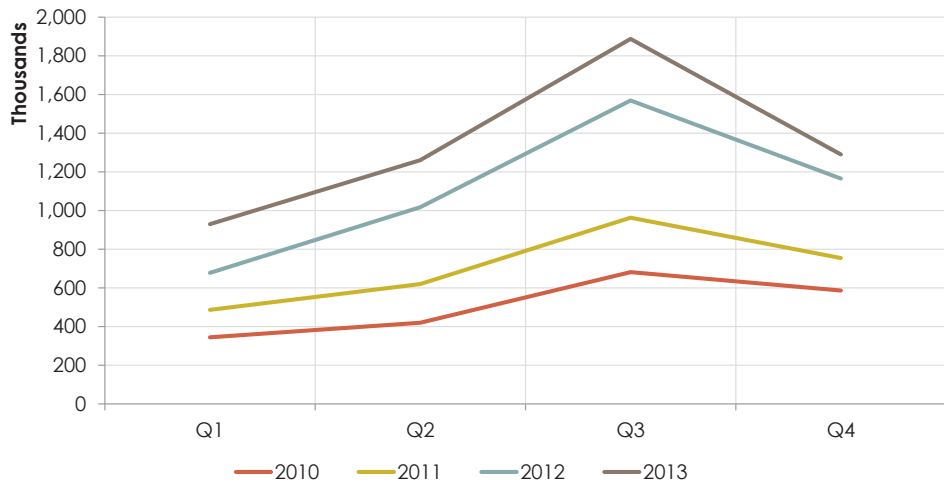
In the last quarter of 2013, the import of goods to Georgia mainly increased from CIS countries and Turkey, whereas imports from the EU continued to shrink. At the same time, exports to EU countries increased 1.5 times during this period. These developments considerably changed the geographical orientation of the goods trade.

During the last quarter of 2013, CIS countries accounted for 37.2% of the total trade in goods with Georgia; the EU was the second largest trading partner of Georgia with 26.8% of the total trade; next came Turkey, with 14% of total trade; other countries accounted for 21.9% of the total trade.

Tourism receipts have continued to grow steadily and positively contribute to the improvement of the current account deficit. In 2013 tourism income increased by 21.2% over that of 2012. In absolute terms, tourism receipts reached 1.7 billion USD in 2013. The annual growth rate of the number of incoming visitors slightly decelerated and stood at 10.7% in the fourth quarter of 2013.

« Tourism receipts grow steadily and positively contribute to the improvement of the current account deficit.

Chart 7.4 Number of Incoming Visitors



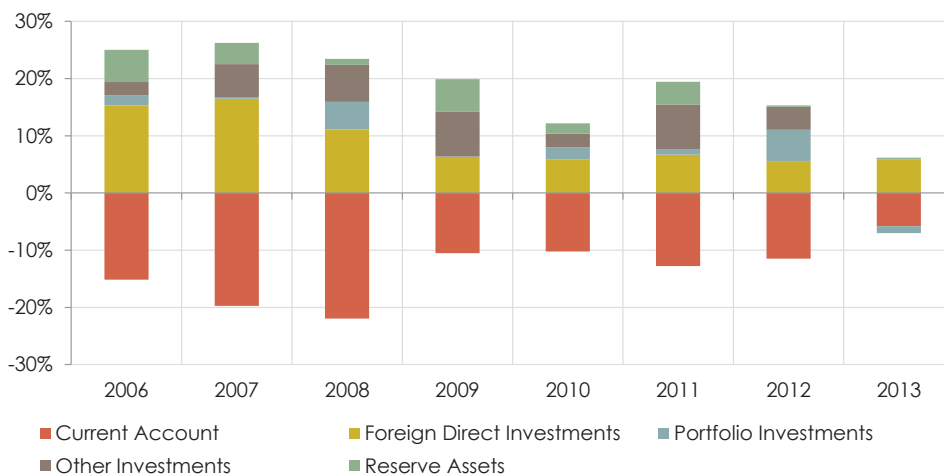
Source: National Bank of Georgia

In the fourth quarter of 2013 money transfers from abroad increased by 13.9% in year-on-year terms and transfers reached 410.6 million USD in absolute terms. In 2013 money transfers from abroad reached 1.48 billion USD, 10.7% higher than the previous year.

« In 2013 money transfers from abroad reached 1.48 billion USD, 10.7% higher than the previous year.

Foreign direct Investments represented the main source for financing current account deficit in 2013. Compared to 2012, foreign direct investments increased by 7% and reached 975.1 million USD in 2013.

Chart 7.5 Sources of Current Account Deficit Financing



Source: National Bank of Georgia

8. OUTPUT AND LABOUR MARKET

8.1 OUTPUT

GDP increased by 1.4% annually in the third quarter of 2013. The growth was chiefly driven by an expansion of the services sector. Industrial production contributed negatively to the overall growth of GDP, mainly due to a fall in the construction sector as compared to the previous year.

Decomposition of production by sector reveals high growth in the agricultural (+9.5%) and financial intermediation (+7.5%) sectors in the third quarter of 2013. The high growth in agriculture was mainly caused by the government’s initiative to subsidize various agricultural activities. After a 2% decline in the first half of 2013, the transportation sector expanded by 9.5%, mainly due to the accelerated import of goods and a higher inflow of tourists. The latter also contributed to the increase of the hotels and restaurants sector.

The slowdown of construction and other related businesses, which had impeded growth in the first half of 2013, continued in third quarter. During the first and second quarters of 2013 the construction sector contracted by 8.5% and 14.1% respectively, with a marked decline of 16.9% during the third quarter of 2013. The decline in the construction sector was mainly a result of the decline of public funding going to infrastructural projects. The construction of motorways, roads and sport complexes fell by 47.8% compared to the first three quarters of 2012. At the same time, other types of construction work related to the above mentioned construction activities reduced by 23.5% over the same period.

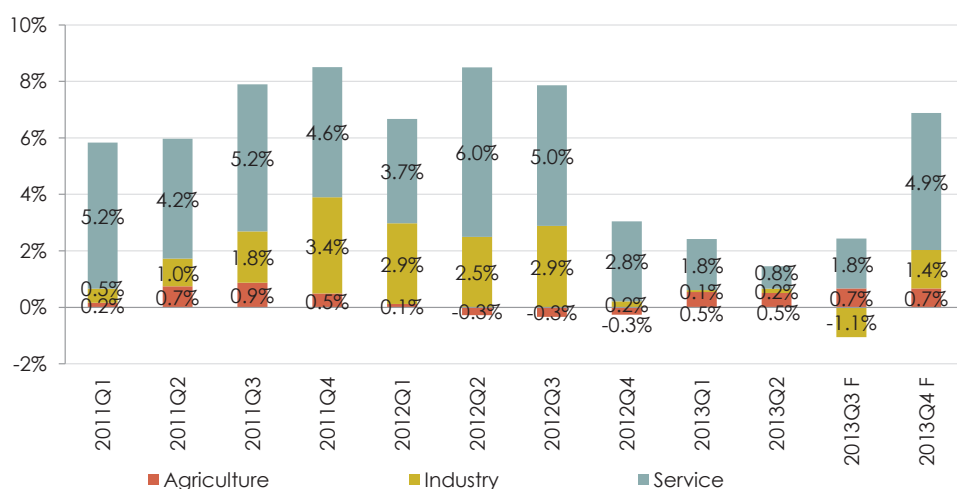
During the first three quarters of 2013 the mining and quarrying sector contracted significantly (-10%), this decline is mainly related to the decline of exports (-17%) of fully or partially processed gold.

Based on preliminary statistics, economic activity increased by 7.1% in the last quarter of 2013, which translates into 3.2% annual growth of GDP in 2013.

« High growth was observed in the agricultural sector during the year.

« The slowdown of construction and other related businesses.

Chart 8.1 Contribution of Sectors of Economy to Real GDP Growth



Source: GeoStat, National Bank of Georgia

The acceleration of economic growth during the last quarter of 2013 was the result of the end of post-election period ambiguity. The growth rate of exports was high during the first three quarters of 2013 (+14.1%), and was particularly high during the last quarter (+46.3%). Export growth mainly derived from the growth of the processing and trade sectors. The loosened monetary policy pursued by the National Bank of Georgia was yet another factor that contributed to increased activities on the

mortgage market via decreased interest rates on loans – especially on national currency loans with interest rates tied to the key policy rate of the NBG. Part of the high economic growth of the last quarter of 2013 is due to the base effect.

8.2 LABOR MARKET

The growth rate of labor productivity decreased in the third quarter of 2013 as compared to the previous quarter. According to Geostat, the productivity of the labor force increased by 2.8% in year-on-year terms during the third quarter, which is 1.3 percentage points less than it had been in the second quarter. The increase of productivity can be largely attributed to the agriculture sector, where the annual rate of growth significantly improved, exceeding 12%. After growing in the previous quarter, labor productivity in the industrial sectors started to decline. However, it should be noted that the rate of this decline was not high, amounting to 0.6%. Labor productivity in the service sector declined, unlike in the previous periods, but did so at a slow pace. The real value added per employee in services decreased by 0.2% compared to the third quarter of 2012 (see Table 8.1)

« Labor productivity increased by 2.8% during the third quarter of 2013. This increase of productivity can be largely attributed to the agriculture sector.

Table 8.1 Index of Value Added Produced per Worker in 3rd Quarter of 2013 Relative to the Corresponding Period of the Previous Year

	Real value added per employee (growth index)
Agriculture and processing of agricultural products by households	112.8
Industrial sectors	99.4
Service sectors	99.8
Overall in the economy	102.8

Source: GeoStat and National Bank of Georgia

As the sectoral breakdown of the economy shows, in a manner similar to the previous quarter, labor productivity in manufacturing declined, but did so at a lower rate. An annual drop was observed in construction as well. As with the preceding periods, labor productivity significantly decreased in the financial intermediation sector.

« After increase, labor productivity in manufacturing resumed declining.

The annual growth rate of the nominal salaries of employees declined during the third quarter of 2013, with the average monthly nominal salary standing at 800 GEL, according to the latest data from Geostat. The growth of the average salary amounted to 6.2% during that period, which is 3.9 percentage points less than in the previous quarter.

« According to Geostat, the annual growth rate of the nominal salaries of employees declined.

In terms of sector analysis, an increase in the annual growth rate of salaries is evident in the public administration, education and transport sectors. In contrast, during the third quarter of 2013, average salaries decreased in the agriculture and construction sectors (see Table 8.2).

Table 8.2 Index of Average Monthly Nominal Wage of Employers in 3rd quarter of 2013 Relative to the Corresponding Period of the Previous Year

	Average nominal wage (growth index)
Agriculture, hunting and forestry	82.3
Fishing	200.2
Mining and quarrying	104
Manufacturing	101.3
Production and distribution of electricity, gas and water	101.6
Construction	90.7

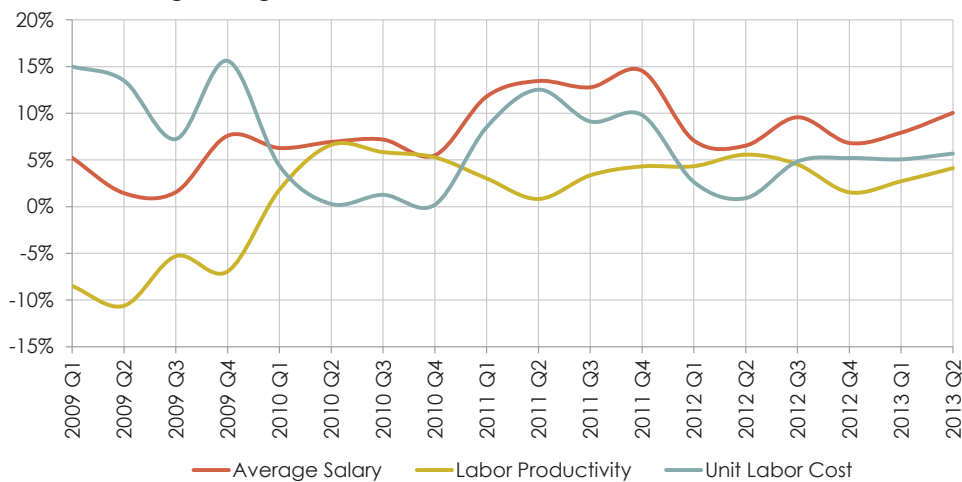
	Average nominal wage (growth index)
Wholesale and retail trade; repair of motor vehicles and personal and household goods	108.8
hotels and restaurants	106.6
Transport and communication	112
Financial intermediation	95.8
Real estate, renting and business activities	105.4
Public administration	121.8
Education	116.4
Health and social work	111.7
Other community, social and personal service activities	109.5
Overall, in the Economy	106.2

Source: GeoStat

To sum up, against the backdrop of a declining annual growth rate of both employees' average salaries and labor productivity, the annual growth rate of unit labor cost⁸ (personnel expense per production unit) slightly decreased and stood at 3.3% by the end of the third quarter of 2013 (see Figure 8.2). That indicates the absence of inflationary pressure from the labor market.

« The annual growth rate of unit labor cost decreased and thus does not create pressure on prices.

Chart 8.2 Labor Productivity, Average Monthly Salary and Unit Labor Cost, 2009-2013 Q III (Annual Percentage Change)



Source: GeoStat and National Bank of Georgia

8 The same as salary expenditures as a share of aggregate real value added (GDP).

2, Sanapiro Str., Tbilisi 0114, Georgia
Tel.: (995 32) 240 6251; Fax: (995 32) 240 6571; Hot line: 240 6406
E-mail: Info@nbg.ge; www.nbg.ge

