03.02.2021

Ladies and gentlemen,

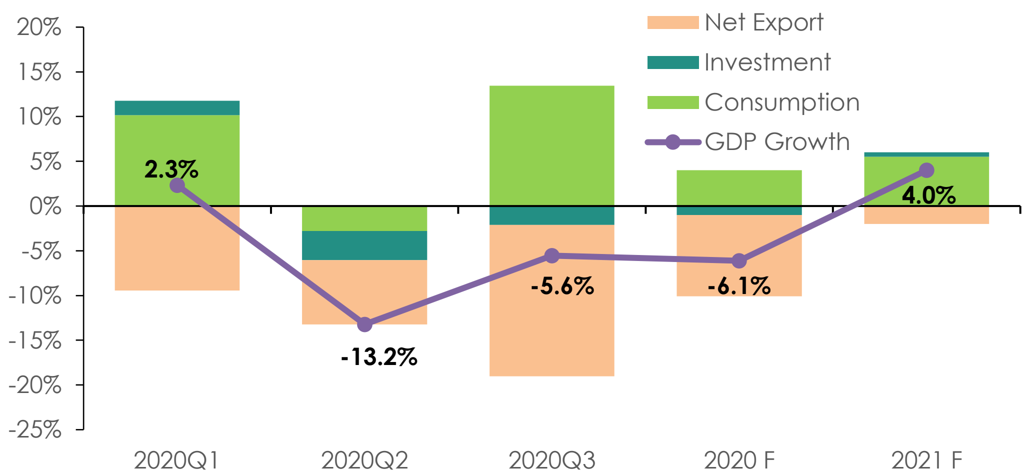
The National Bank of Georgia (NBG) publishes quarterly Monetary Policy Report, providing detailed forecasts of inflation and other macroeconomic indicators, which play a key role in the formation of monetary policy.

The coronavirus pandemic caused an unprecedented kind of economic crisis in the world. Restrictions on international flights and various types of bans have primarily affected the tourism industry, which has been the main driver of economic growth in Georgia in recent years. Tourism integrates such interrelated sectors as hotels, restaurants, travel agencies, real estate market, various types of services, etc. This industry, as a whole, covers a fairly large part of the economy.

In the third quarter of 2020, strict restrictions introduced to prevent the spread of the virus were eased. Domestic mobility and domestic tourism activity increased compared to the second quarter. The economic contraction reduced to 5.6% in the third quarter (see Diagram 1). According to preliminary data, the economy declined by 6.1% in 2020. The negative contribution of net exports to economic growth, a large share of which comes from tourism exports, has widened even more. This impact was only partially offset by increased consumption. In turn, this increase in consumption can be linked to stronger fiscal stimulus to mitigate the effects of the pandemic and credit activity.

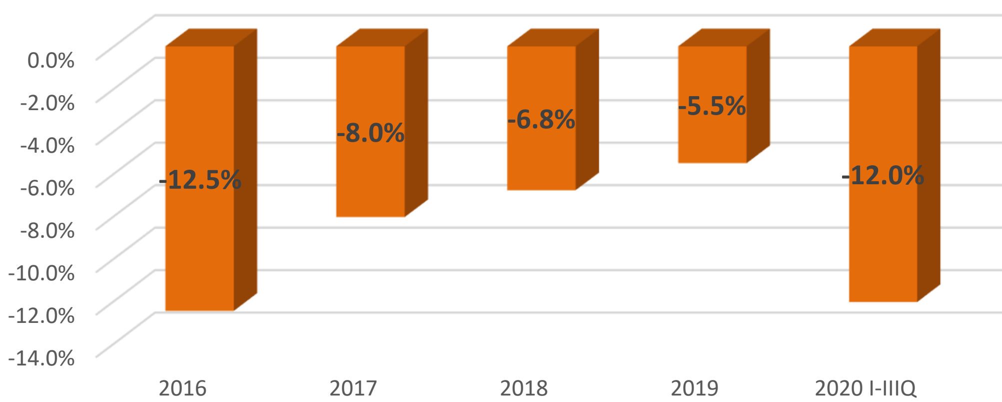
According to the current forecast, growth is expected at around 4% in 2021. The negative contribution of net exports will narrow, while consumption will be the driving force of the growth.

Diagram 1 - Economic growth



The sharp decline in tourism exports has led to a significant deterioration in the positive dynamics of the current account in recent years. During the first three quarters, the current account deficit to GDP ratio increased to 12.0% (see Diagram 2).

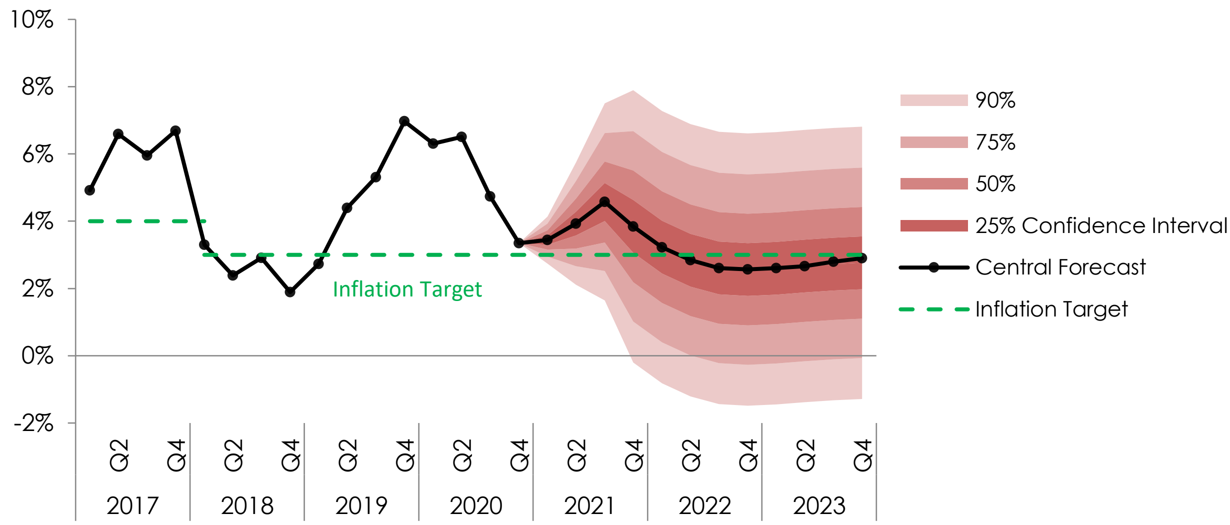
Diagram 2 - Current Account Deficit to GDP



From May last year to the end of the year, inflation had a declining trend. As a result of a temporary partial subsidy of utility fees, annual inflation fell to 2.8% in January. According to the current forecast, other things being equal, inflation will average around 4% in 2021 and then gradually approach the target (see Diagram 3).

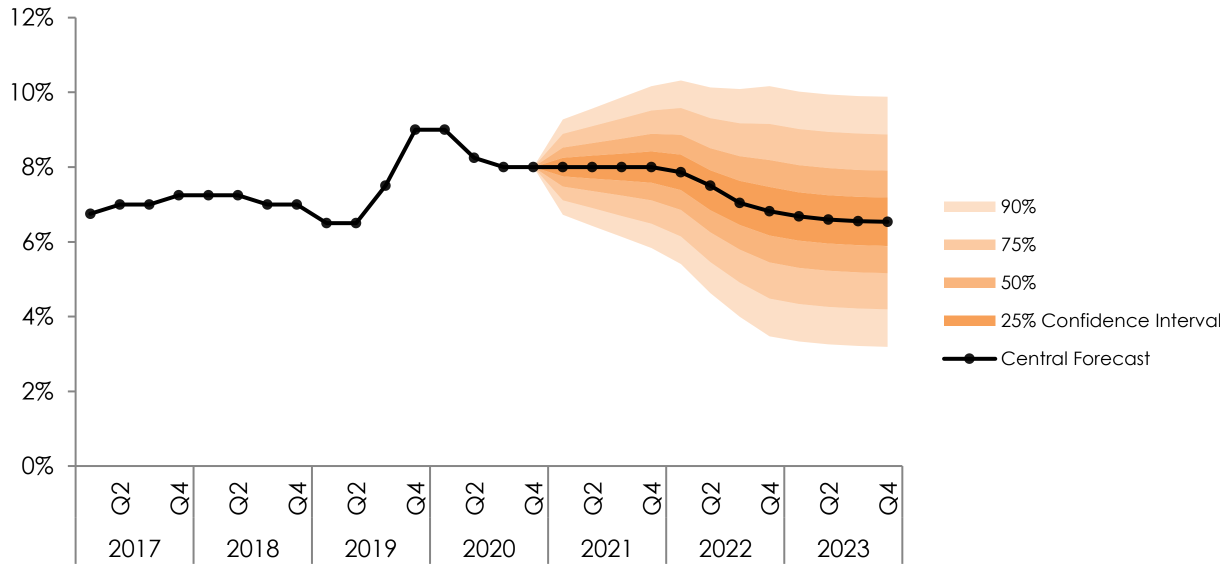
A significant increase in prices in international commodity markets is notable among the factors affecting the dynamics of inflation, which was especially prominent in January. Moreover, upward pressure on inflation persists due to rising production costs stemming from prolongation of pandemic-related restrictions and depreciated exchange rate. The latter, in turn, increases imported inflation and intermediate costs. On the other hand, it should be noted that, despite relatively strong domestic demand, due to the sharp decline in external demand, aggregate demand is still weak. However, the downward impact of weak aggregate demand on forecasted inflation is weakened by the depreciation of the nominal effective exchange rate, while the high dollarization of the economy fortifies the transmission of exchange rate fluctuations to inflation.

Diagram 3 - Inflation Forecast



Taking into account the inflation forecast and risks, at this stage, we decided to keep the monetary policy rate unchanged at 8.0% (see Diagram 4). According to the current assessment, it is necessary to maintain a tight monetary policy and we do not rule out an increase in the policy rate in the future either.

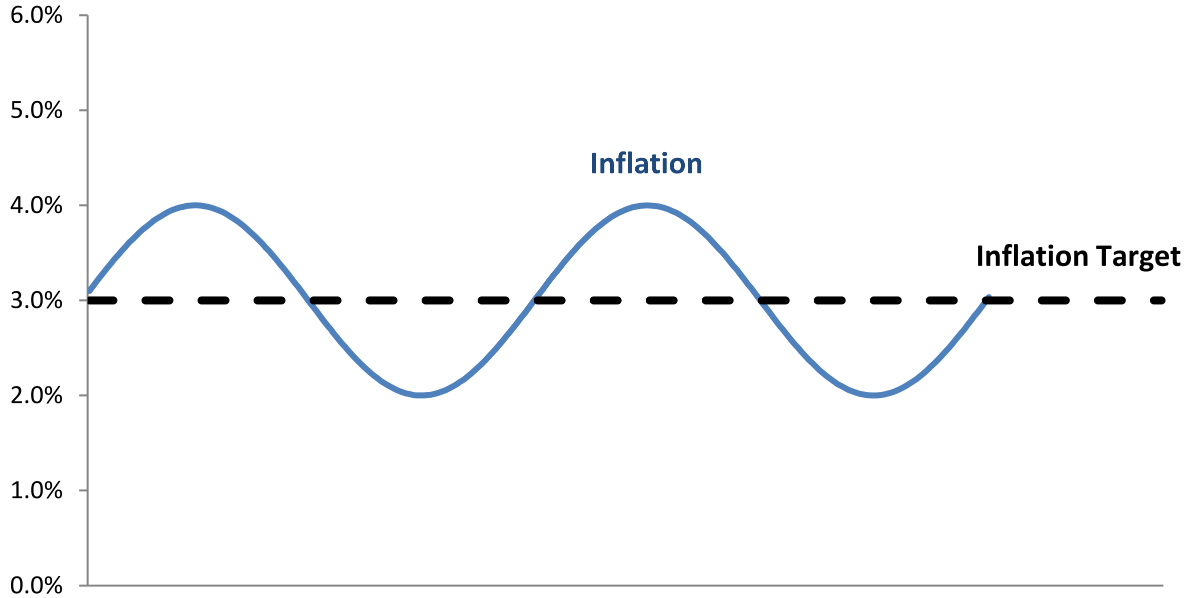
Diagram 4 - Monetary Policy Trajectory



It should be noted that the forecast of the monetary policy rate does not represent the promise of the NBG regarding future monetary policy decisions. It reflects the presumable trajectory with the assumption that exogenous factors will develop according to the scenario provided in the forecast or that no new exogenous shocks will occur. Consequently, if the external and internal factors are different from what is expected, it will affect the forecasted macroeconomic indicators and, consequently, the future decisions of the National Bank.

I also would like to remind you that, from 2018, the inflation target in the medium term is 3%. Focusing on the medium term is key, as exogenous shocks (independent from monetary policy) are imminent and, hence, can cause actual inflation to deviate from the target level: as it is shown on the graph (Diagram 5). Inflation may be higher or lower than the target level of 3%. However, as a result of the policy pursued by the NBG, inflation will always move towards the target over the medium term. Moreover, inflation target does not imply the upper and lower bound for inflation. In particular, when we state that inflation target is 3%, we do not imply inflation from 0 to 3%; instead we mean a symmetric target with inflation close to 3% in the medium term. Under the inflation targeting framework, the price stability is achieved with the lowest social cost, while the economic growth is the highest, compared to other existing alternative frameworks.

Diagram 5 - Movement of Inflation around its Target



The NBG continues to monitor the developments in the economy and financial markets and it presents to the public the overview of economic conditions and updated macroeconomic forecasts in the Monetary Policy Report.

Thank you for your attention!