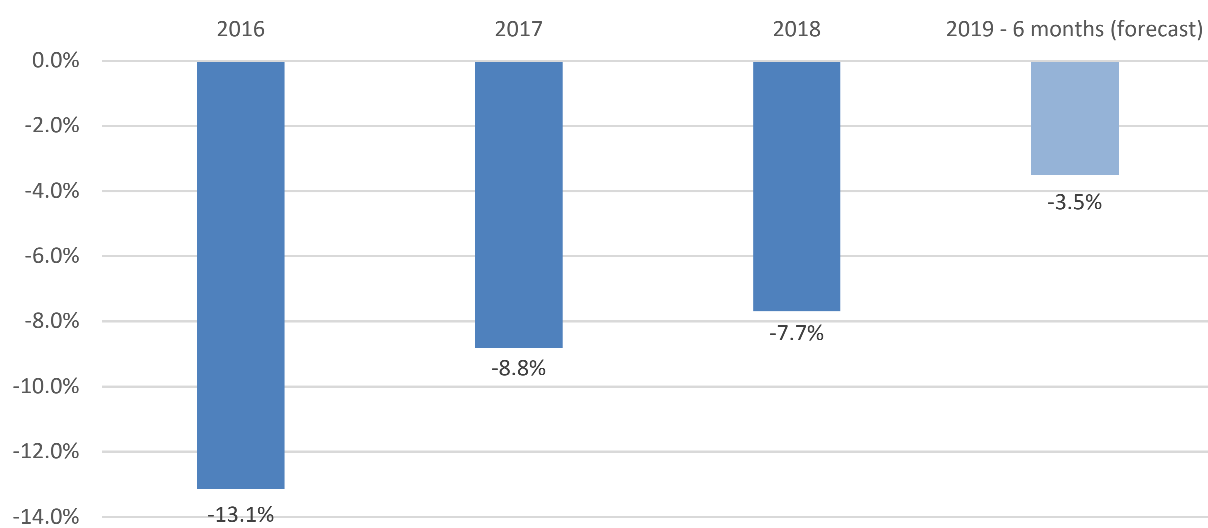
Ladies and gentlemen,

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.

As you all know, the main objective of the NBG is to maintain price stability, which, in turn, is a necessary precondition for long-term economic growth and employment.

The diagram 1 depicts the current account deficit with respect to GDP. It shows the favorable trends of the latest years in external sector, which positively affects the credit ratings and international investor sentiments for Georgia. In 2018, the current account deficit amounted to 7.7% of GDP, which is the best result of the last years. The improvement continued this year as well and, according to the preliminary data, in the first half of 2019 the current account deficit is around 3.5% of GDP. Overall, in the first half of 2019, merchandise goods exports grew by 11% annually, revenue from tourism grew by 7%, meanwhile money transfers increased by 8%. During the same period, the merchandise goods imports decreased by 5%.

*Diagram 1 - Current Account Deficit to Gross Domestic Product, 2016-2019**

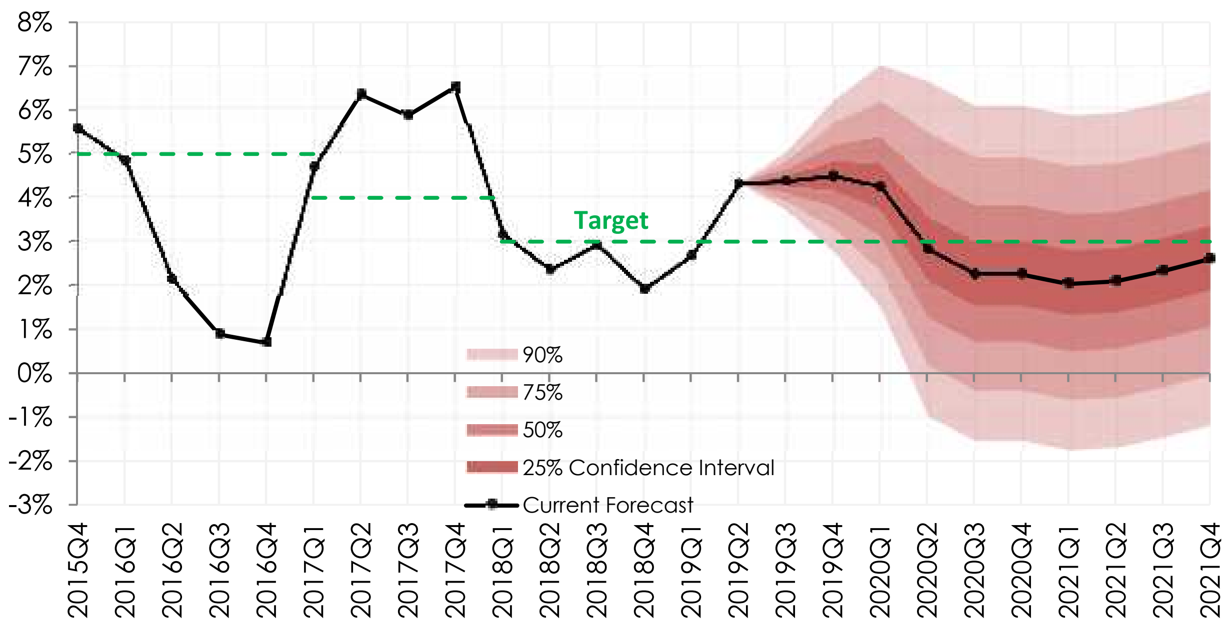


However, at the end of the second quarter, risks coming from the external sector aggravated – namely, expected revenues from tourism declined.

Russia is one of the biggest trade partners for Georgia, thus it is important to assess the impact of recent events on Georgian economy, as well as the monetary policy reaction to this kind of shock. According to our assumptions, in the second half of 2019, the expected shortage in revenues from tourism is estimates to be around USD 300 mln. Based on current projections, despite this shock, the current account deficit is still expected to improve in 2019.

The Diagram 2 of inflation forecast shows, that, all else equal, the inflation will remain above the target during this year, it will start to decline from March 2020 and it will stay close to the target in the medium term. Despite the fact, that in light of external shock, the pressure on inflation from exchange rate increased, the demand is still weak and thus inflation will be maintained close to the target in the medium term. Moreover, current nominal effective exchange rate seems to be undervalued more than the size of the current shock would suggest. Hence, the possible appreciation of the nominal effective exchange rate is expected to exert a downward pressure on inflation.

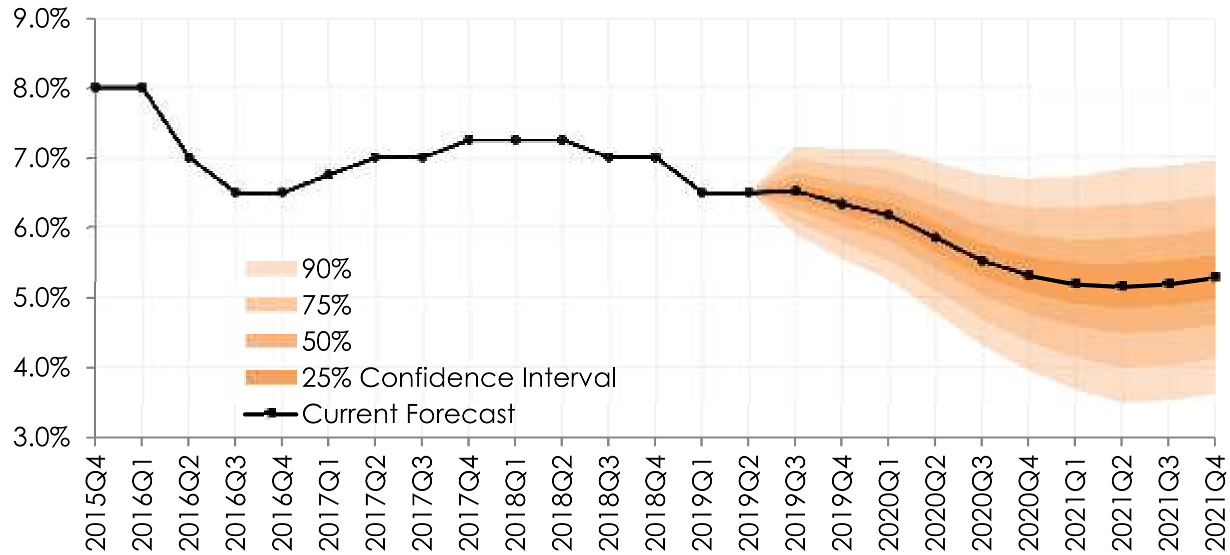
Diagram 2 – Forecast of the Inflation



Therefore, at a current stage, the Monetary Policy Committee deemed appropriate to keep monetary policy unchanged. However, if the upward pressure on inflation stemming from the exchange rate will persist, then the Committee will consider the possibility of the monetary policy tightening.

The baseline scenario still implies the normalization process to be implemented gradually in the medium term (see Diagram 3). However, I would like to highlight that the monetary policy rate forecast is not a commitment to future decisions made by the National Bank of Georgia. Rather, it is the expected trajectory of the policy rate, including all the recent available information and the forecasts.

Diagram 2 - Forecast of the Monetary Policy Rate

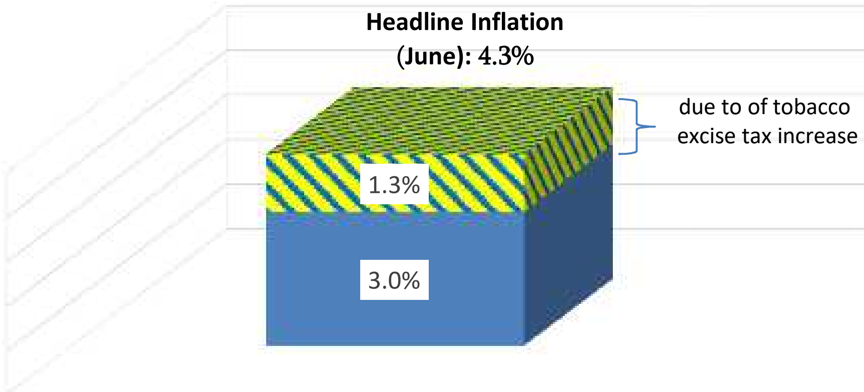


From the beginning of the year 2019, the economic activity has been growing moderately. The growth amounted to 4.9% in the first 5 months of the year. Taking into account the probably weakening of the external demand, the revised forecast of GDP equals 4.5%.

The credit growth is moderate from the beginning of the year. In June, the annual growth of credit portfolio, excluding exchange rate effects, is 14%, which is moderate for our economy. It is of utmost important, that business loans and mortgage loans denominated in GEL are active. It is worth noting, that the credit growth is mainly driven by increase in loans denominated in national currency. During such turbulent times, the importance of growth in national currency loans is further heightened. In order the country to be resilient against external shocks, it is important that the currency risks to be minimized, which stem significantly from the loans denominated in the foreign currency.

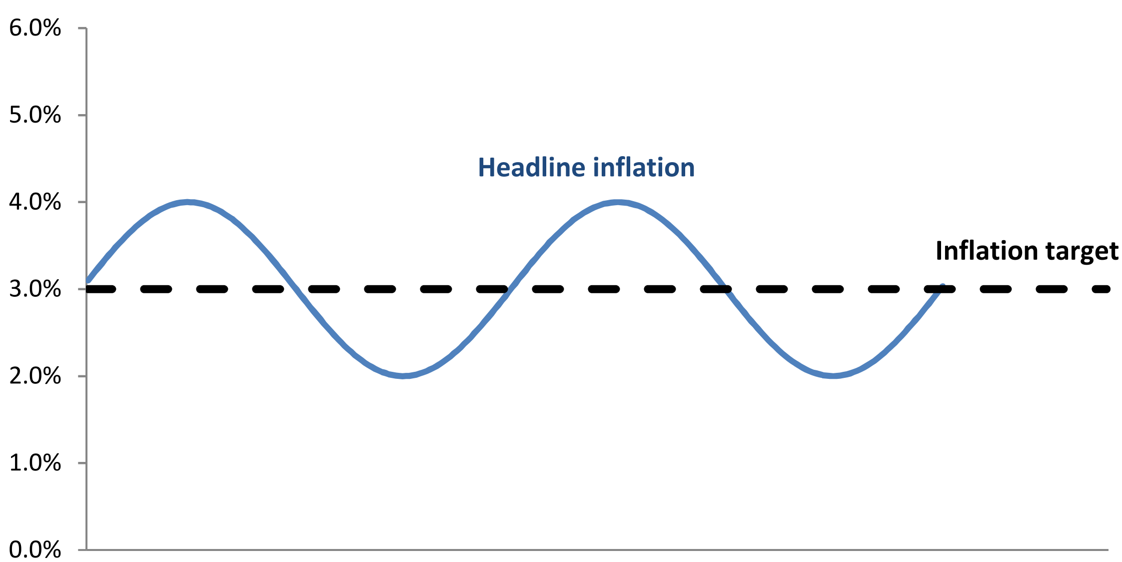
In June, the annual inflation stood at 4.3%, out of which the increase in excise taxes on tobacco accounted for 1.3 percentage points and it has only temporary effect on inflation level. It is worth to note that core inflation that excludes food, energy and tobacco prices is 1.4% and also indicates that increase in inflation rate is temporary and the price stability will be maintained in future.

Diagram 4 – One-off Factors in Headline Inflation



I also would like to repeat that the inflation target in the medium term is 3% starting from 2018. Focusing on the medium term is the key factor, as exogenous shocks always affect the economy and, hence, it pushes inflation away from the target: at any moment it 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 (see diagram **5Error! Reference source not found.**). Moreover, inflation target does not imply the upper bound for inflation. In particular, when we state that inflation target is 3%, we do not imply inflation from 0 to 3%; rather than we imply an inflation level close to 3% - either above or below - in the medium term. Within the inflation target regime, the price stability is achieved with the lowest social cost, while the economic growth is the highest and strong, compared to the other alternative frameworks.

Diagram 5 - Movement of Inflation around its Target



Source: National Bank of Georgia

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!