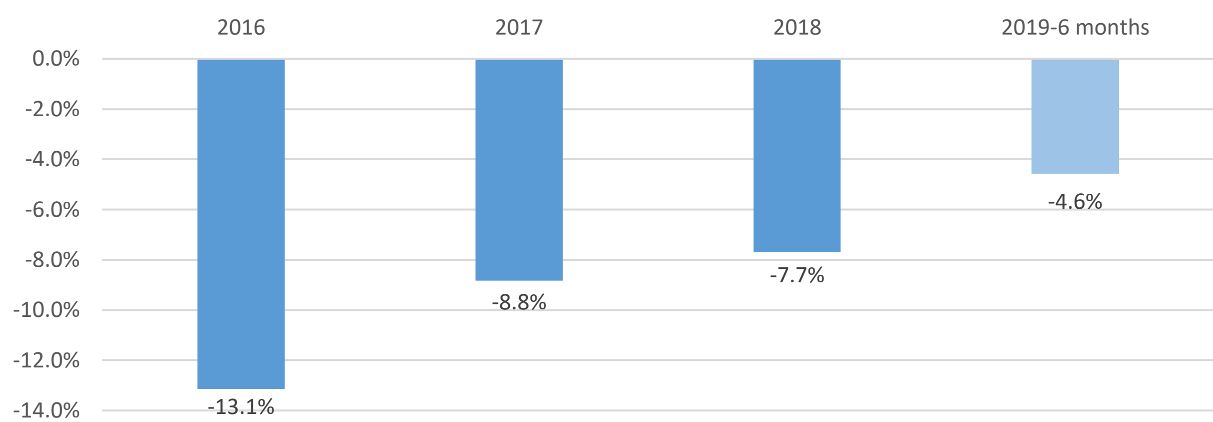
Ladies and gentlemen,

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.

As the preliminary data show, in January-August economic growth was quite high, at around 5%. The main driver of economic growth was external demand, which was reflected in increased exports and money transfers. Since July, tourism revenues have been shrinking due to flight ban from Russia, although number of visitors from other countries are on the rise. In September, for the first time, the tourism revenues from European Union exceeded those from Russia. Money transfers from European Union are also rising. These factors are reflected on current account balance, which was improved to -4.6% of GDP in the first half of 2019. (see Diagram 1). Current account has an improving trend during last several years. We expect that positive dynamics in the external sector will persist and, together with the monetary policy tightening, should support the strengthening of the exchange rate through expectations channel.

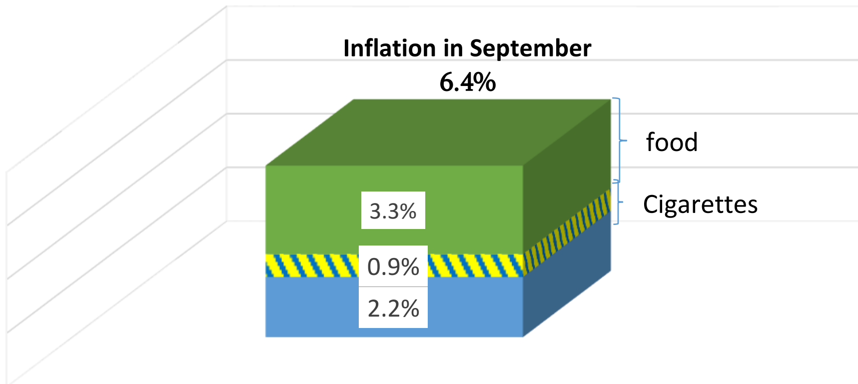
Diagram 1 - Current Account Deficit to Gross Domestic Product



The sovereign credit ratings are the best indicators of macroeconomic stability and investment environment. As you already know, in October, the credit rating agency, Standard & Poor's, increased Georgia's rating to BB, making it equal that to recently raised ratings by Moody's and Fitch. The NBG's policies of floating exchange rate regime and reserve accumulation, along with other factors, were named as important contributors to rating hike. These policies are also crucial for external sustainability.

Inflation stood at 6.4% in September (see Diagram 2). Overshooting of the inflation target was caused by several factors. Along with one-off factor, such as excise tax increase on cigarettes (0.9 percentage points contribution), the food prices also rose (3.3pp contribution). Moreover, in recent periods, the nominal exchange rate depreciation pass-through to inflation also increased.

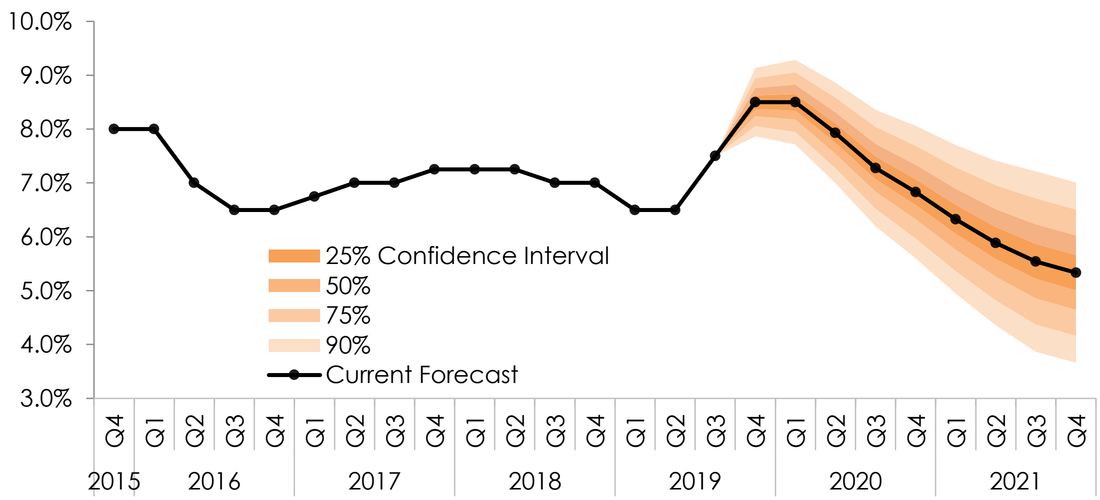
Diagram 2 - Inflation



Over the last two meetings in September, the Monetary Policy Committee raised the policy rate in total by one percentage point. As it was noted in the statements, the policy tightening would continue until the pressure from exchange rate receded.

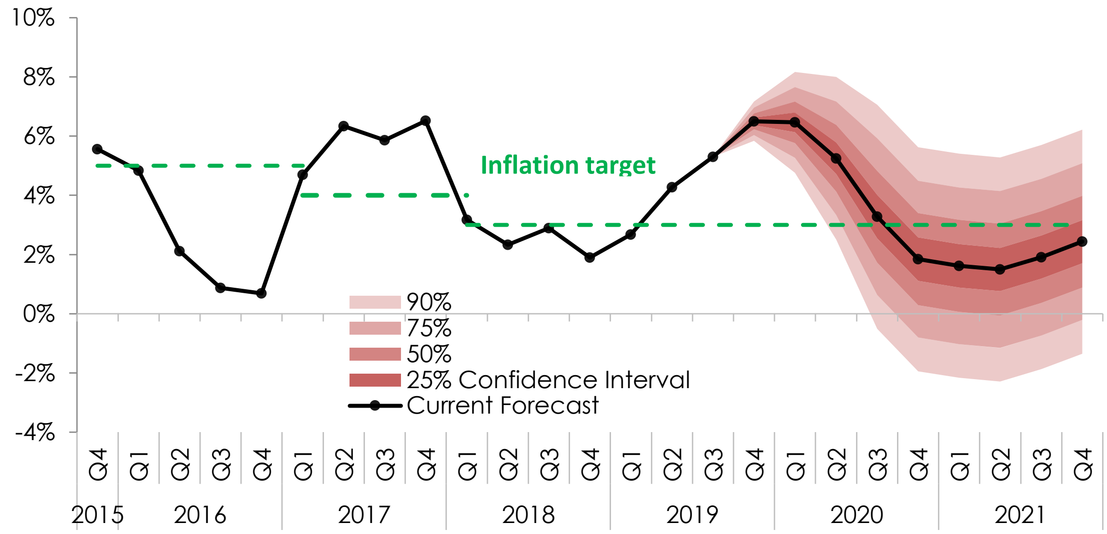
The GEL nominal effective exchange rate remains undervalued, exerting upward pressure on inflation. Hence, on October 23 meeting, the Monetary Policy Committee increased the refinancing rate by one percentage point. The future decisions of the committee will depend upon the speed of neutralization of exchange rate pressure stemming from the exchange rate depreciation (see Diagram 3).

Diagram 3 - Monetary Policy Rate Trajectory



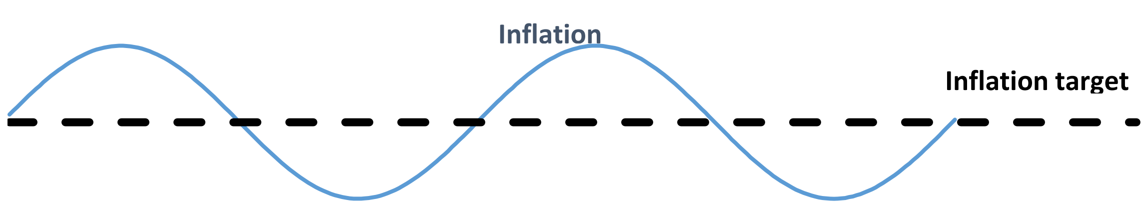
The persistence of positive dynamics in the external sector, together with needed monetary policy tightening, should support the strengthening of the exchange rate through expectations channel, and, hence, support the reduction of future inflation. At the same time, policy tightening would gradually contribute to inflation reduction through other different channels. According to the forecast, other things equal, the inflation will remain above the target during this year, will start to decline from March 2020 and decrease below policy rate in the second half of the year. Afterwards, it will gradually increase to target level and stay close to it in the medium term.

Diagram 4 – Forecast of the 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



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!