4.11.20

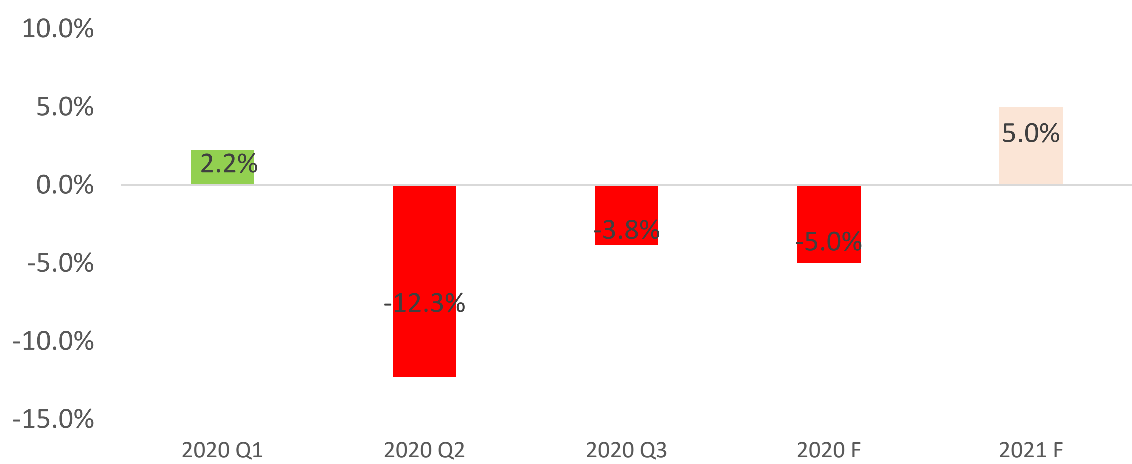
Ladies and gentlemen,

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 main task of the NBG is to maintain low inflation in the country. Low inflation, in turn, is essential to ensure long-term economic growth and a natural level of employment.

As a result of unprecedentedly strong recessions and lockdowns, the world economy, including Georgia, has been hit hard. After a 12.3% annual decline in the Georgian economy in the second quarter, according to preliminary data, the decline in the third quarter was relatively small - about 3.8%. However, it is still difficult to talk about overcoming the shock. According to the current forecast of the NBG, in 2020 the real GDP will decrease by 5%, and in 2021 it will start to recover and increase by about 5% (Diagram 1). It should be noted that the uncertainty is also large on a global scale, which is primarily related to the containment of the pandemic.

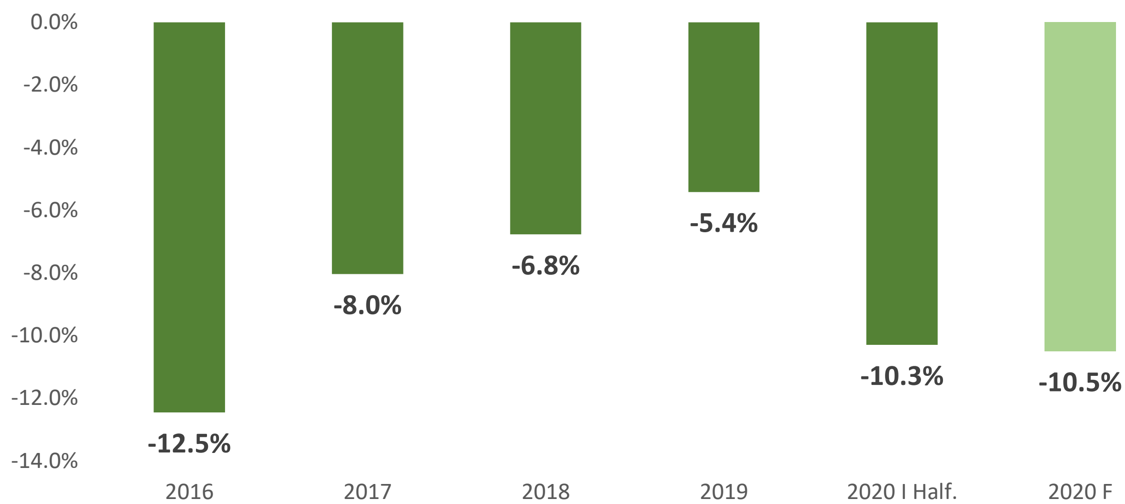
Diagram 1 - Economic growth



The biggest losses in Georgia, and worldwide, was suffered by tourism sector. In March, after the declaration of a state of emergency and the closing of national borders, the entry of foreign visitors to the Georgia basically stopped. As a result, the dynamics of reduction of the current account deficit in recent years have reversed, and in the first half of 2020 it widened to 10.3%

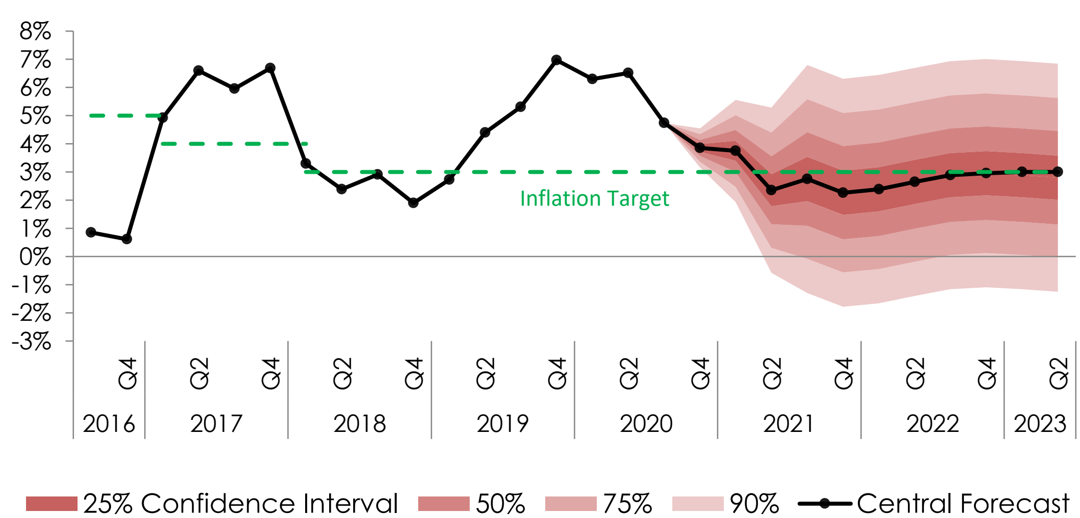
of GDP (Diagram 2). However, it should also be noted that during the pandemic the exports of goods and remittances are better than we estimated at the onset of the pandemic.

Diagram 2 - Current Account Deficit



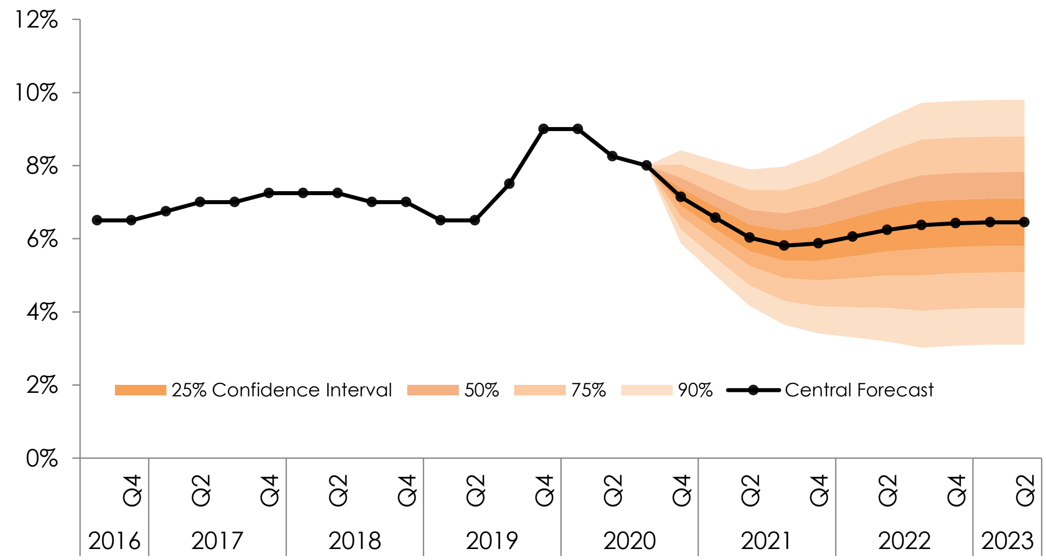
The subsequent shock caused by the global COVID-19 pandemic affected the trajectory of inflation. The main changes were mostly related to the depreciation of the lari nominal effective exchange rate and increased production costs as a result of pandemic-related constraints. On the other hand, reduced aggregate demand pushed inflation down. As expected, annual inflation continues to decline, reaching 3.8% in September. According to the current forecast, other things equal, annual inflation will have a declining trend and remain close to the target level in 2021 (Diagram 3).

Diagram 3 - Inflation Forecast



The declining dynamics of inflation is driven by weak aggregate demand, however the Monetary Policy Committee also took into account the uncertainty associated with the acceleration of the virus spread, the increase in geopolitical risks and decided to keep the refinancing rate unchanged at 8.0% (Diagram 4). According to the current estimates, the gradual exit from the tight monetary policy stance (normalization) and its pace will depend on inflation expectations and the dynamics of economic activity.

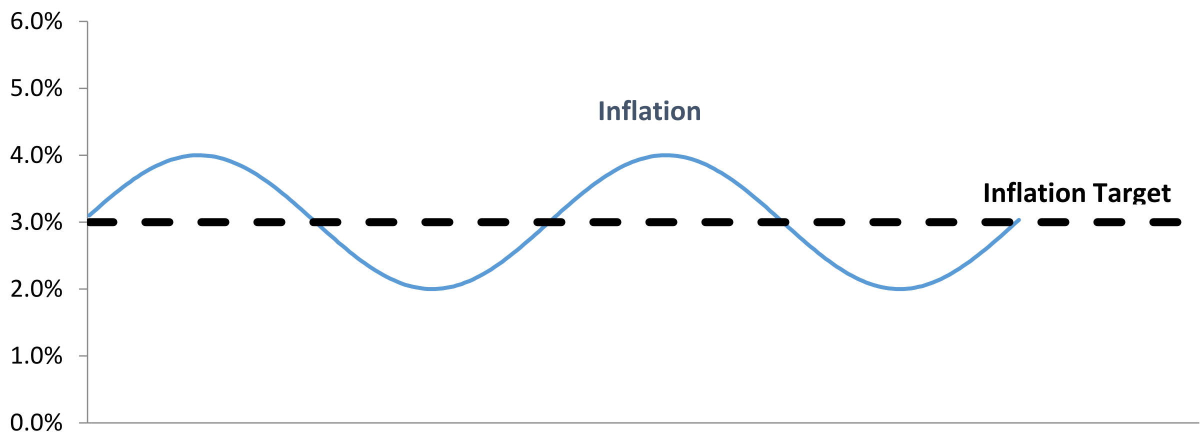
Diagram 4 - Monetary Policy Trajectory



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 the 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%; rather than we mean an inflation close to 3% - either above or below - in the medium term. Under the inflation target framework, the price stability is achieved with the lowest social cost, while the economic growth is the highest, 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!