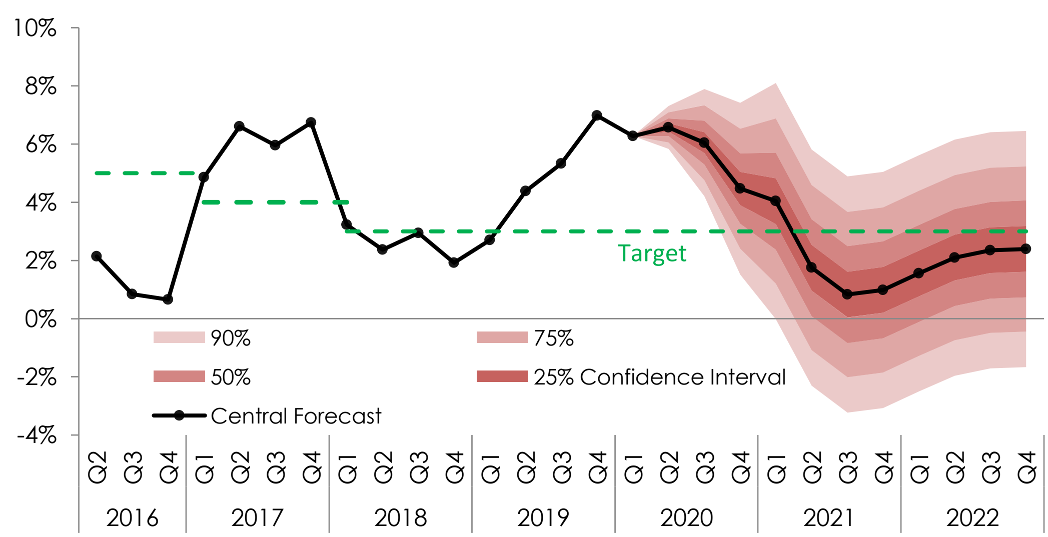
Ladies and gentlemen,

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 global COVID-19 pandemic has radically changed the course of the world economy affecting Georgia as well.

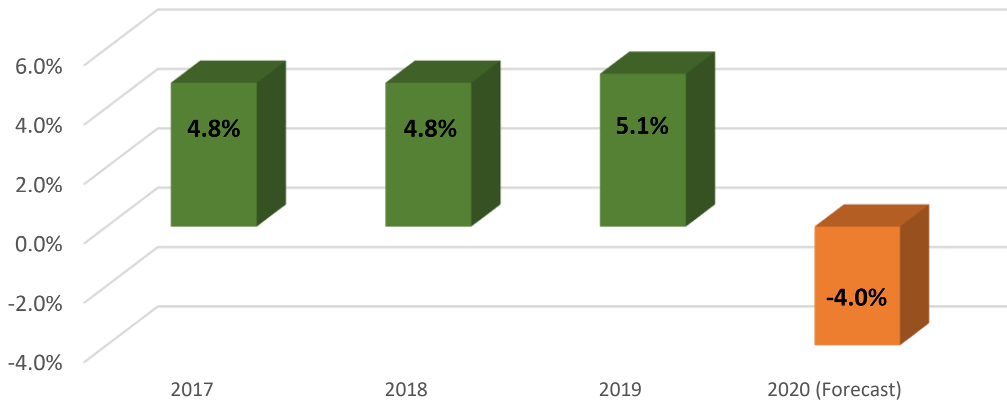
In early 2020, as expected, inflation began to decline and in January and February the annual inflation stood at 6.4%. However, subsequent events related to the global pandemic of COVID-19 also affected inflation level in Georgia. The growth in inflation, on the one hand, is driven by the depreciation of the nominal effective exchange rate of the lari, and on the other, by the increase in the cost of production of various products and services as a result of restrictions imposed aimed at preventing the spread of the virus. Hence, annual inflation fell less than expected in March and rose to 6.9 percent in April. At the same time, the sharp decline in external and domestic demand is expected to exert a downwards pressure on inflation over the year. According to the current forecast, inflation is expected to stay above the target longer than previously expected. However, inflation will begin to decline in the second half of the year and approach the target in early 2021.

Diagram 1 –Inflation Forecast



As I mentioned, the aggregate demand will be an important determinant of the long-term dynamics of inflation. According to the updated forecast, decrease in both exports and tourism revenues, as well as a decrease in domestic demand is expected to lead to a reduction of the economy by 4% in 2020.

Diagram 2 – Economic growth



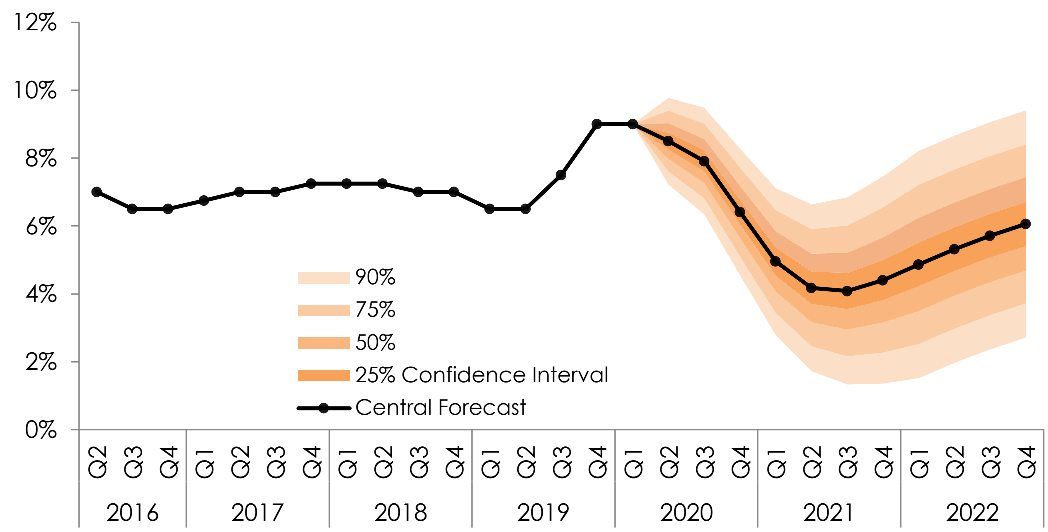
The expected decline has already appeared in recent data. In March, exports of goods decreased by 22 percent annually, while revenues from international travelers decreased by almost 70 percent. A decline of 9 percent was also observed in remittances. In the same period, imports of goods fell by 13 percent, indicating a weakening domestic demand.

Diagram 3 – March 2020

Given the expected reduction in the demand, there is no need to further maintain such tightened policy stance. Hence, the Monetary Policy Committee started the gradual exit from the tightened policy and on April 29 meeting reduced the policy rate by 0.5 percentage points to 8.50%. One may ask why the NBG is lowering the monetary policy rate when inflation is above the target. In this regard, I would like to note that we do not make the decisions based on current inflation, but based on the medium-term inflation forecast.

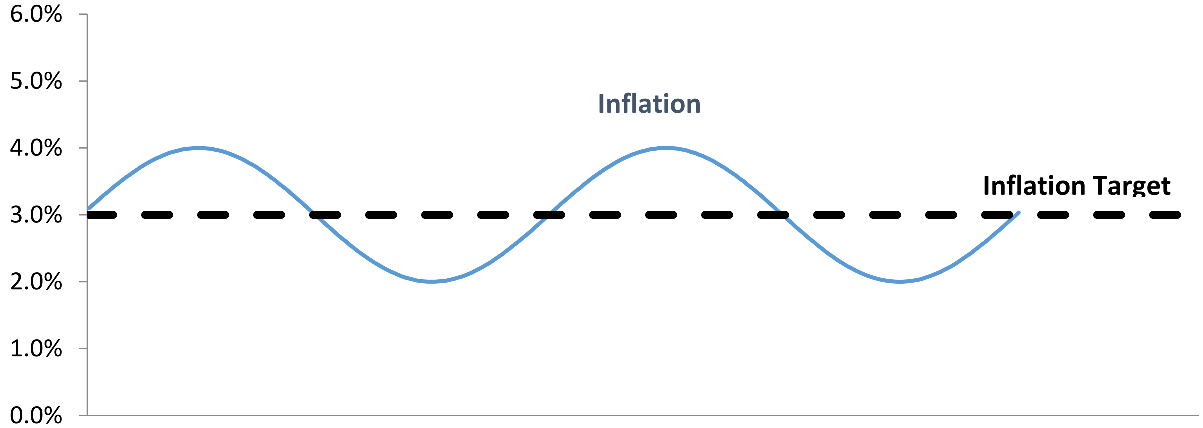
Despite the rate cut, the monetary policy remains tight. It is important that the exit from the tightened policy is carried out gradually, which is necessary to ensure that inflation expectations do not rise. I also would like to repeat, that the monetary policy rate forecast is not a commitment made by the NBG. The forecast is based on a today's outlook and if the new factors occur, it may be revised.

Diagram 4 - Monetary Policy Rate Trajectory



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 (see 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!