05.08.2021

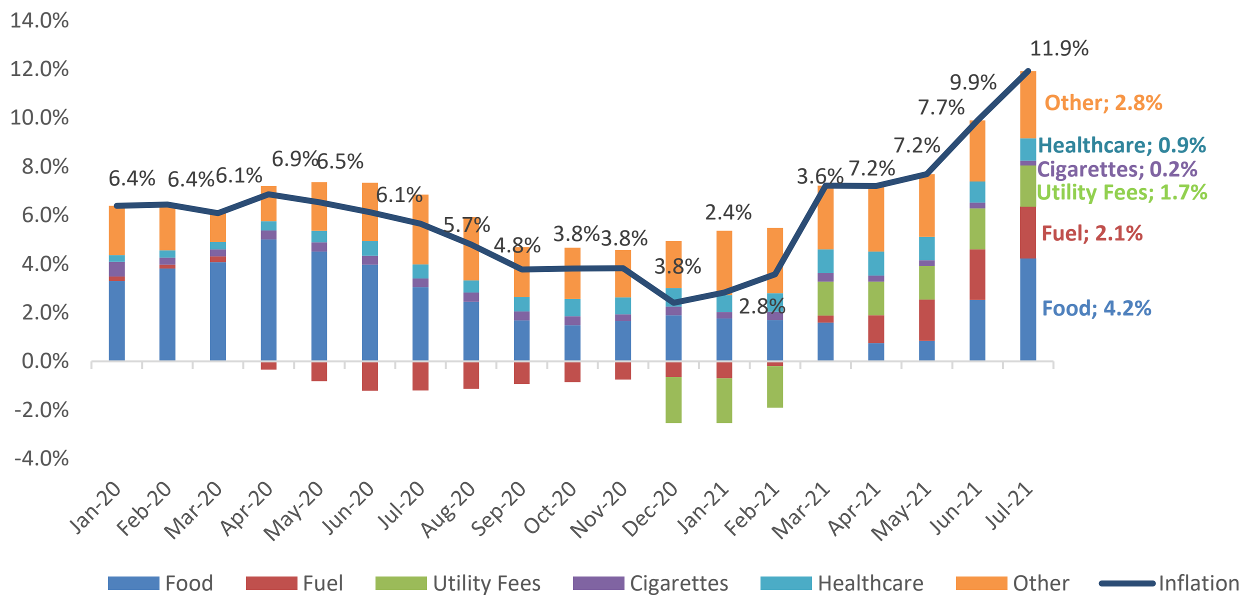
Ladies and gentlemen,

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.

In July, annual inflation was higher than expected and stood at 11.9%. This is mainly the result of the pandemic situation in the world and in Georgia and the post-pandemic recovery process. Hike in inflation in Georgia is closely linked to rising prices for consumer goods around the world. Global inflation is one of the main issues identified in the periodic reports of the International Monetary Fund, the World Bank and other international organizations. Particularly, increased prices of food items is noteworthy. Due to pandemic-related constraints, poor harvest and increased transportation costs, world food prices are at the maximum of the past ten years.

The global rise in food prices has mainly affected developing countries, where the weight of food items in the consumer basket is higher than in developed countries. The weight of food in the consumer basket of Georgia is high and stands at 29%, due to which the change in food prices has a significant impact on inflation. The Diagram 1 shows that the impact of food on inflation rose to 4.2 percentage points in July.

**Diagram 1 – Contributions to Annual Inflation**



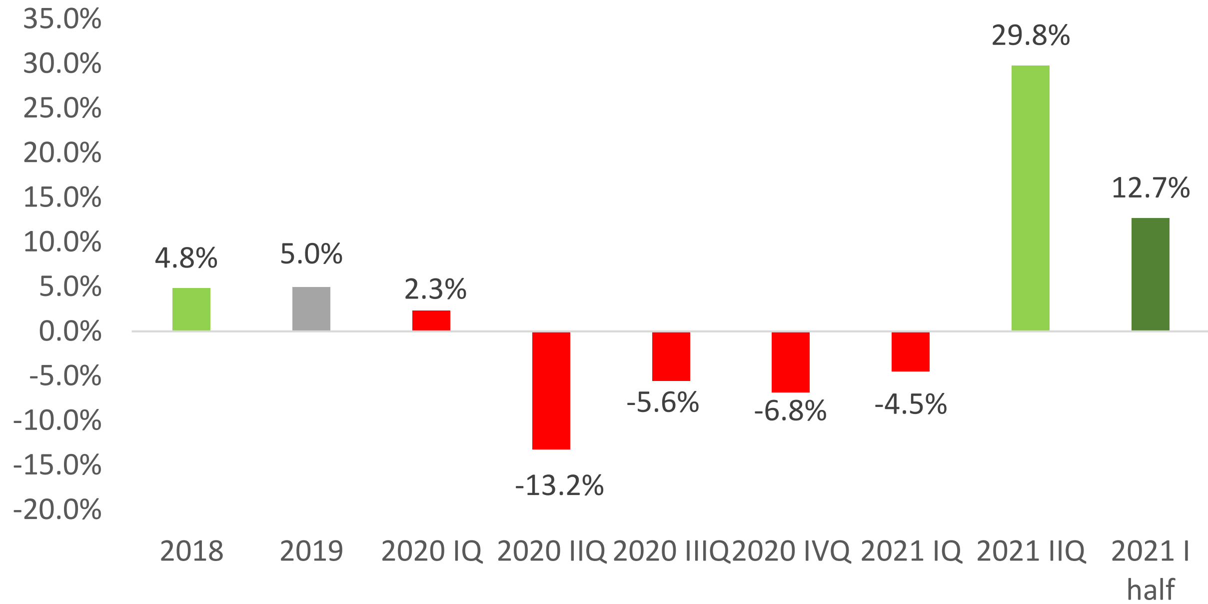

At the same time, with the restoration of mobility, the demand for oil and, consequently, the it prices in the international markets increased. World oil prices are at the maximum of the past three years, that was transmitted to fuel prices. Similar to the global dynamics, fuel prices in Georgia increased significantly - by 32 percent - since the beginning of the year, and in July its contribution to anual inflation reached 2.1 percentage points.

In addition, the impact of utility fees on inflation is still significant. In June, the increase in natural gas tariffs in Tbilisi increased the contribution of utility fees to inflation by an additional 0.3 percentage points, and it is 1.7 percentage points.

Also, amid global restrictions on the spread of coronavirus, companies' international transportation and other operating costs remain high, which is also reflected in final prices.

The increased demand creates additional upward pressure on inflation. According to the preliminary data, in the second quarter of 2021, annual growth in economic activity reached almost 30 percent year-on-year, which can be related not only to the baseline effect, but also to the unexpectedly strong delayed demand after the pandemic closures. As a result, economic growth in the first half of the year was 12.7%. At the same time, the growth rate of lending to the economy has increased and the fiscal stimulus continues.

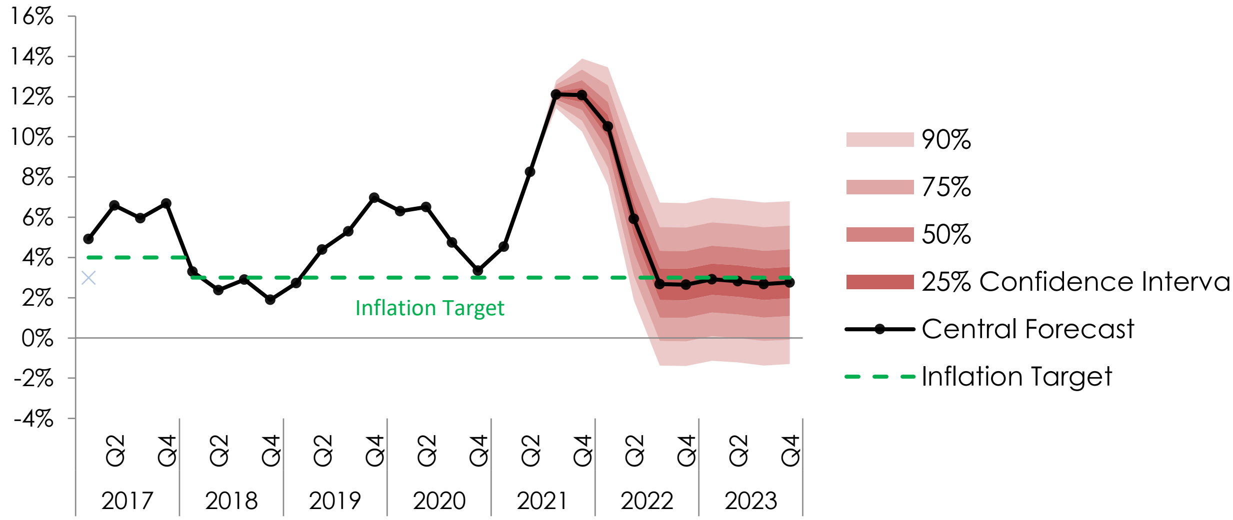
**Diagram 2 - Economic growth**




Positive dynamics are evident in the external sector. In addition to significantly increased remittances and exports of goods, positive trend has been observed in tourism: with the gradual opening of borders, the channel of tourist revenues from abroad, which has been almost completely closed for more than a year, revived slightly.

Tighter monetary policy, along with positive expectations for the recovery of tourism and the economy in general, has already yielded some results and contributed to the recent positive dynamics of the foreign exchange market. However, according to the current estimates, the transmission of the appreciation of the nominal effective exchange rate to inflation is weak at this stage. According to the current forecast, inflation will remain above 9 percent on average in 2021. With the gradual fade-out of the abovementioned temporary supply factors and the maintenance of the tight monetary policy, other things being equal, will gradually approach the target next year.

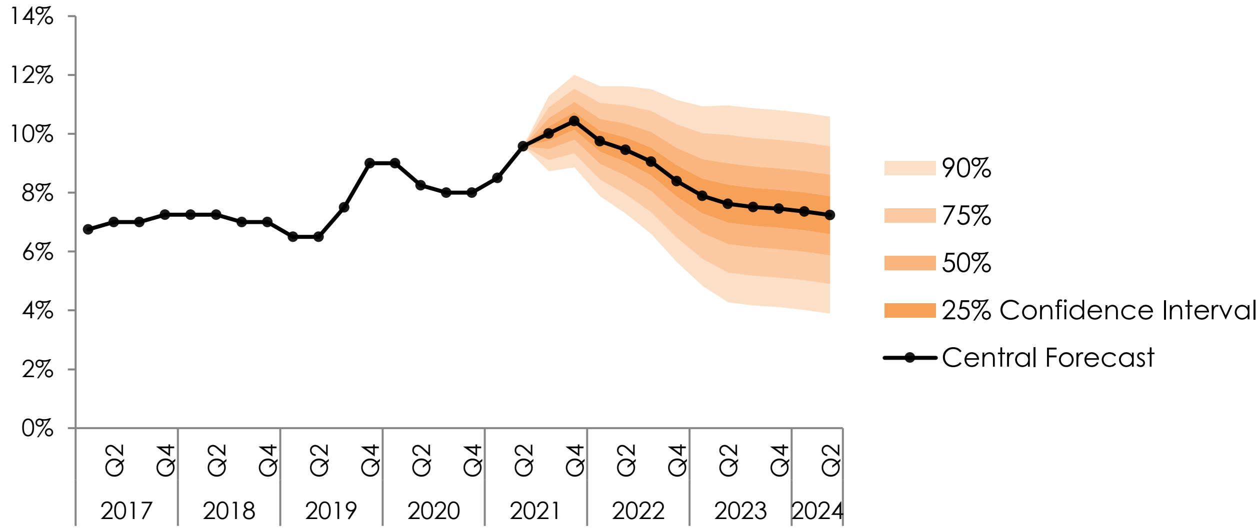
**Diagram 3 - Inflation Forecast**




It should also be noted that the positive dynamics of recent economic activity are still fragile and largely dependends on overcoming the pandemic. Elevated virus cases threaten the recovery of the economy, while the future picture remains unclear.

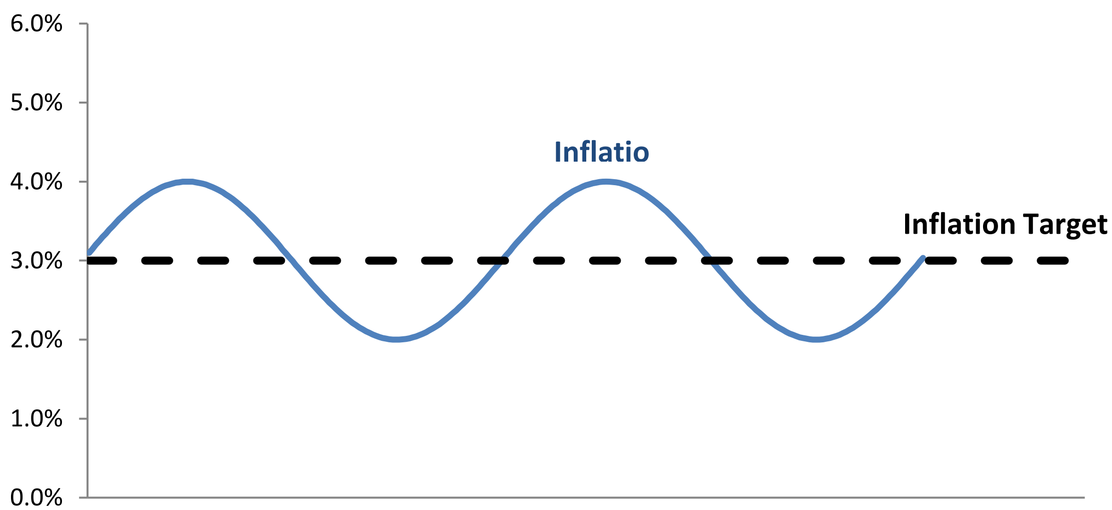
Against this background, the Monetary Policy Committee of the NBG decided on August 4 to increase the interest rate by 0.5 percentage points. In order to ensure that price increases due to temporary factors do not have a permanent impact on inflation expectations, the NBG will maintain a strict policy for a long time and/or, if necessary, tighten it further. With such a policy and the expected fade-out of one-off exogenous factors, inflation is projected to decline in 2022 and gradually approach its medium-term target.

**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 orientation trajectory coming from the current situation. With the receipt of new data, the policy is re-analyzed by the NBG, which affects the forecast of macroeconomic indicators and, consequently, the future decisions.

**Diagram 5 - Movement of Inflation around its Target**




The NBG will continue to monitor the current economic processes and present forecasts and estimates with an updated Monetary Policy Report to the interested public.

Thank you for your attention!