



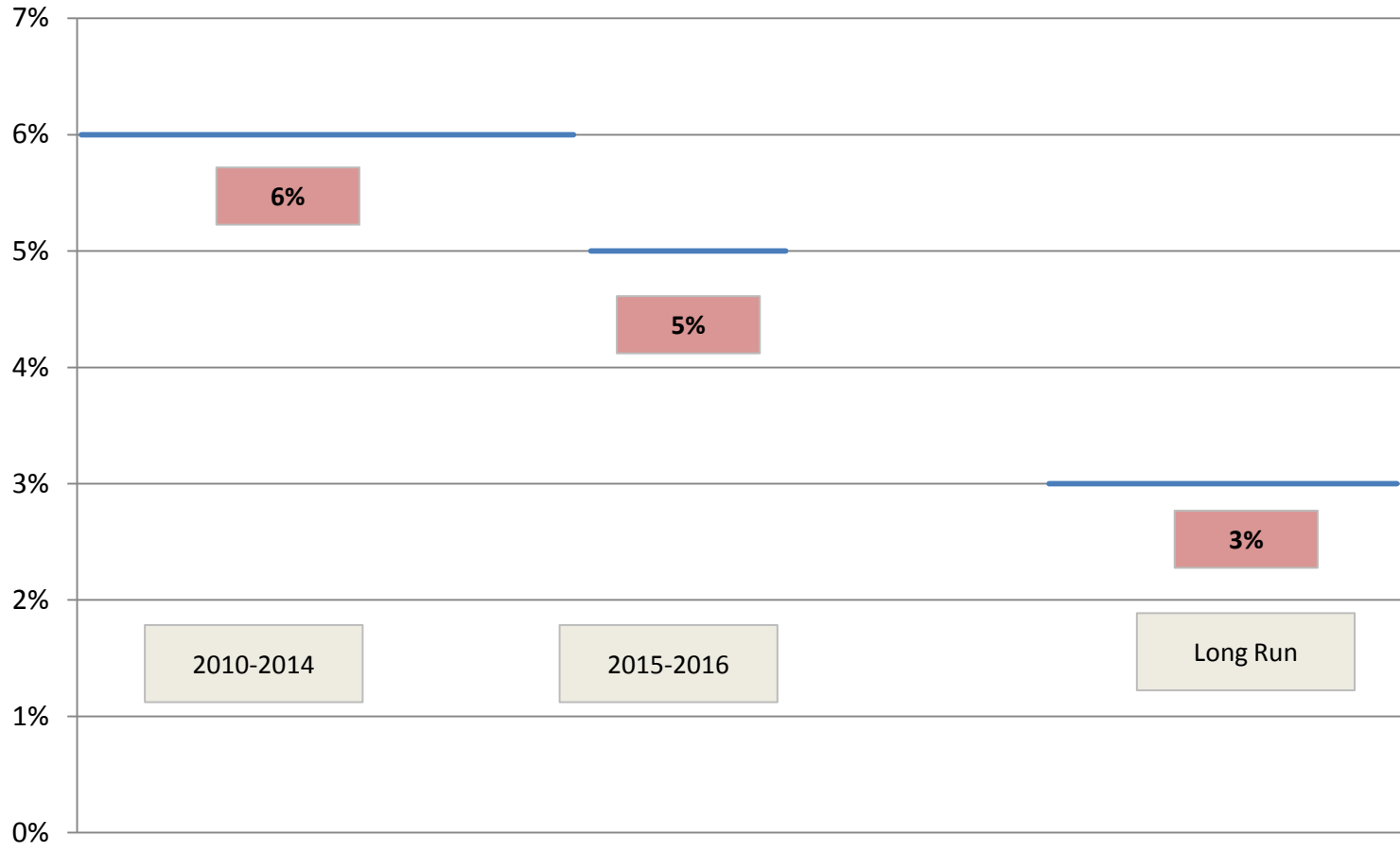
საქართველოს ეროვნული ბანკი
National Bank of Georgia

Monetary Policy Development in Georgia

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Vice Governor
March 2014



Evolution of the Inflation Target in Georgia



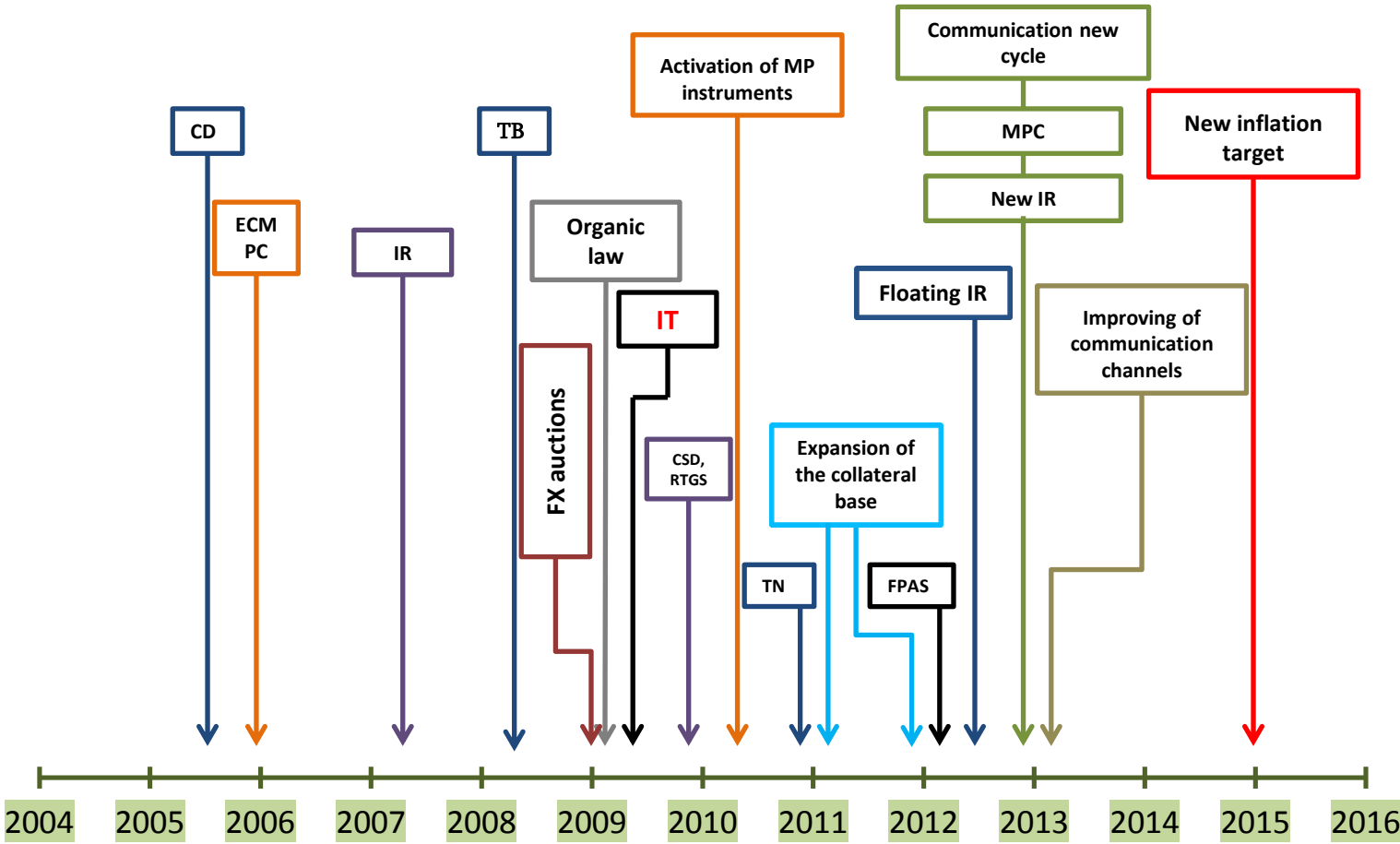
The long-run inflation target of the NBG is 3%



IT Preconditions

1. legal and institutional framework
 - mandate to achieve inflation target
 - instrument independence
2. capacity to influence real economy through monetary policy instrument
3. financial system health
4. Sound methodology for macroeconomic forecasting and policy analysis
5. Effective organizational arrangements within central bank
 - monetary policy committee
 - Clarification and redefinition of functional responsibilities
 - Efficient coordination of work between departments
6. Transparency mechanisms and communication strategy to build credibility and accountability

Enhancing the efficiency of the of monetary policy



OUTLINE

- Exchange Rate regime
- Monetary Policy Instruments
- Development of forecasting capacity
- Communication of monetary policy
- Capital Market development

EXCHANGE RATE REGIME



Exchange Rate Regime

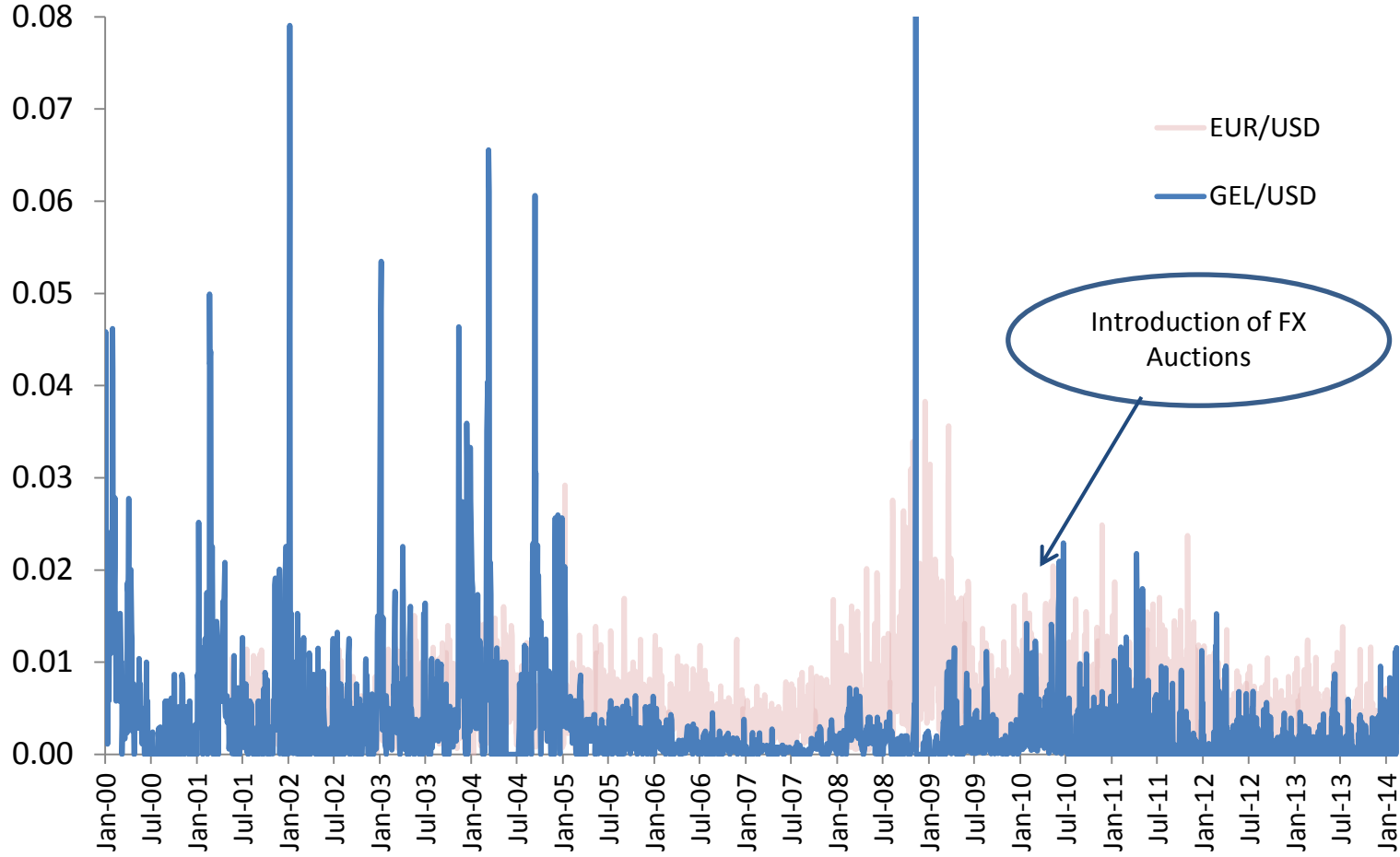
- Georgia has floating exchange rate regime
 - Given open capital account, independent monetary policy requires floating exchange rate regime
- Flexibility of exchange rate serves as a buffer and mitigates the impact of negative shocks on the economy (inflation, economic growth)

Exchange Rate Reform

- Exchange rate reform was implemented in 2009
 - introduction of FX auctions
- Foreign exchange policy of the NBG implies minimum intervention on the foreign exchange market.
- The main goals of FX auctions are:
 - Accumulation of international reserves
 - Smoothing out excessive short-term volatility in the exchange rate due to temporary surges in inflows or outflows of foreign capital
 - Partially balancing the private and government FX financing gap
- Flexibility of the exchange rate significantly increased due to the reforms
 - short-term fluctuations became unpredictable that decreased speculative pressures on FX market

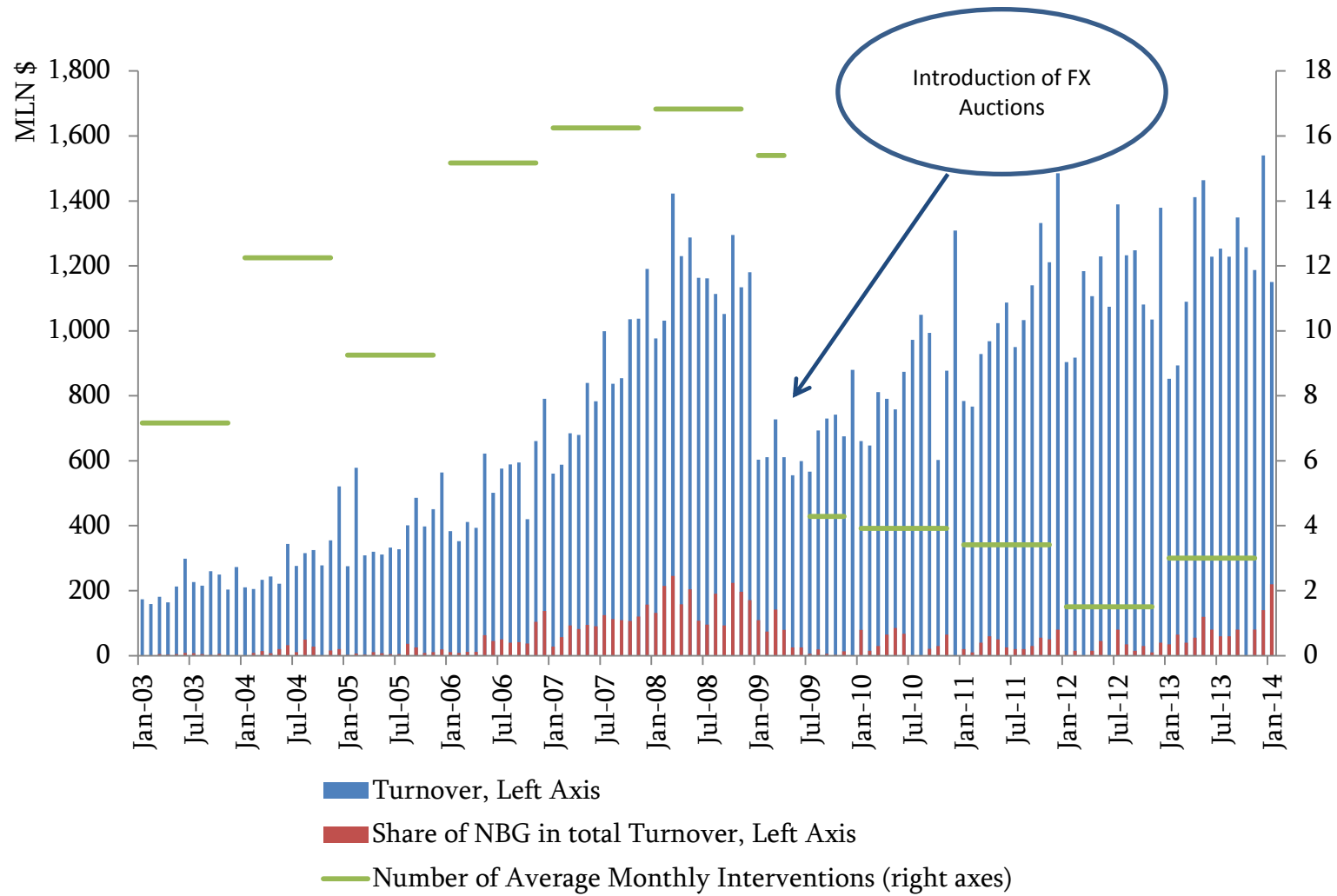
FX Market

3-Day Standard Deviation



FX Market

FX market is stable, characterized with short-term fluctuations of the exchange rate that is natural to floating exchange rate regime



Source: NBG



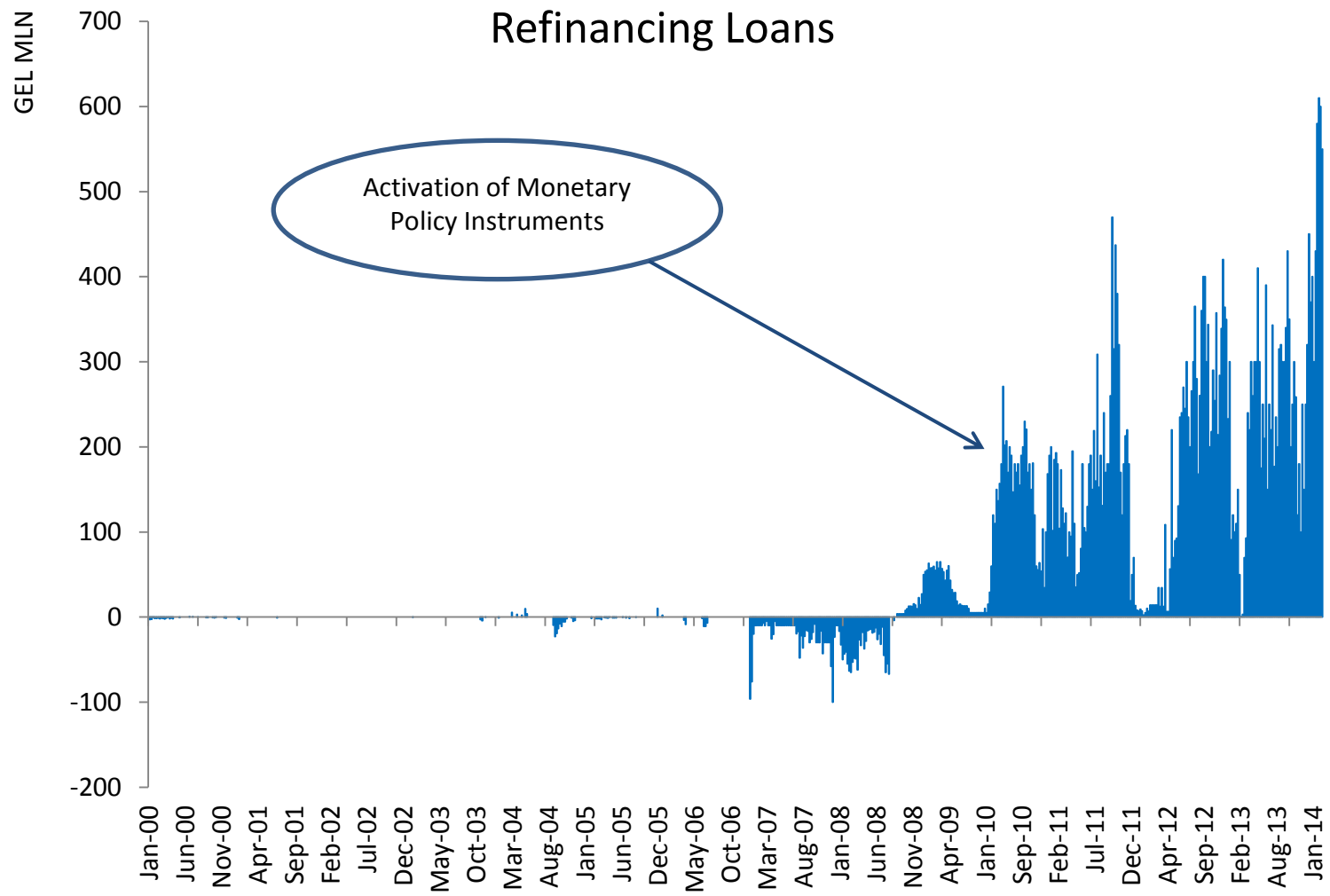
MONETARY POLICY INSTRUMENTS



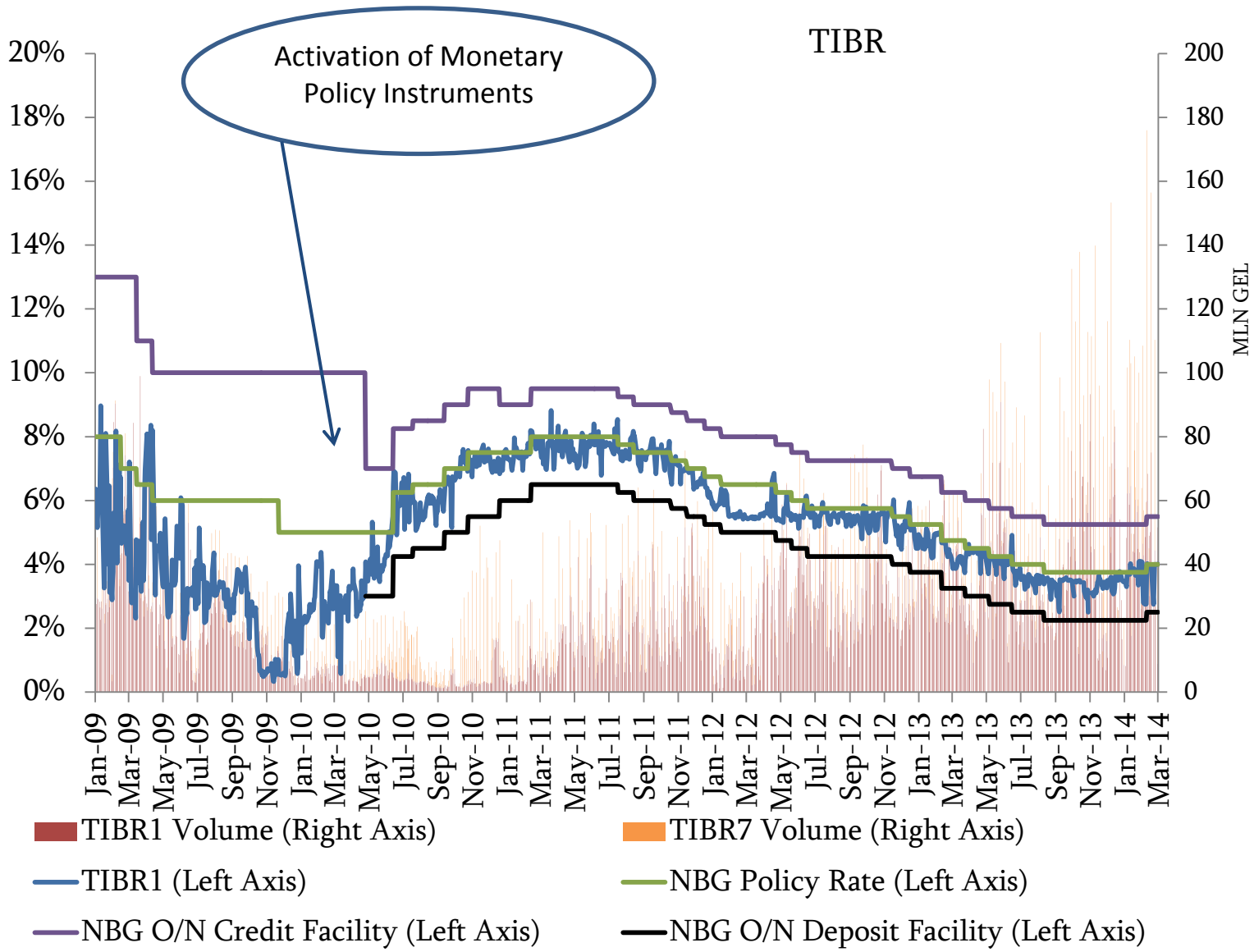
Monetary Policy Instruments

- **Monetary policy rate (refinancing loans)**
 - The main instrument of monetary policy is one-week refinancing rate
 - Used to manage short-term liquidity, so that market rates hover around the policy rate
- **Standing facilities: overnight loans and deposits**
 - Activated in 2010
 - Creating +/-1.5 pp. interest rate corridor, volatility in interest rates decreased
 - In 2010 NBG introduced one week guaranteed refinancing loans: refinancing risk decreased for commercial banks, confidence increased in refinancing loans and commercial banks started using this instrument more actively
- **Reserve requirements**
 - Differentiated depending on currencies and maturities, so that domestic currency liabilities and long-term borrowings are encouraged

High Demand for Refinancing Loans



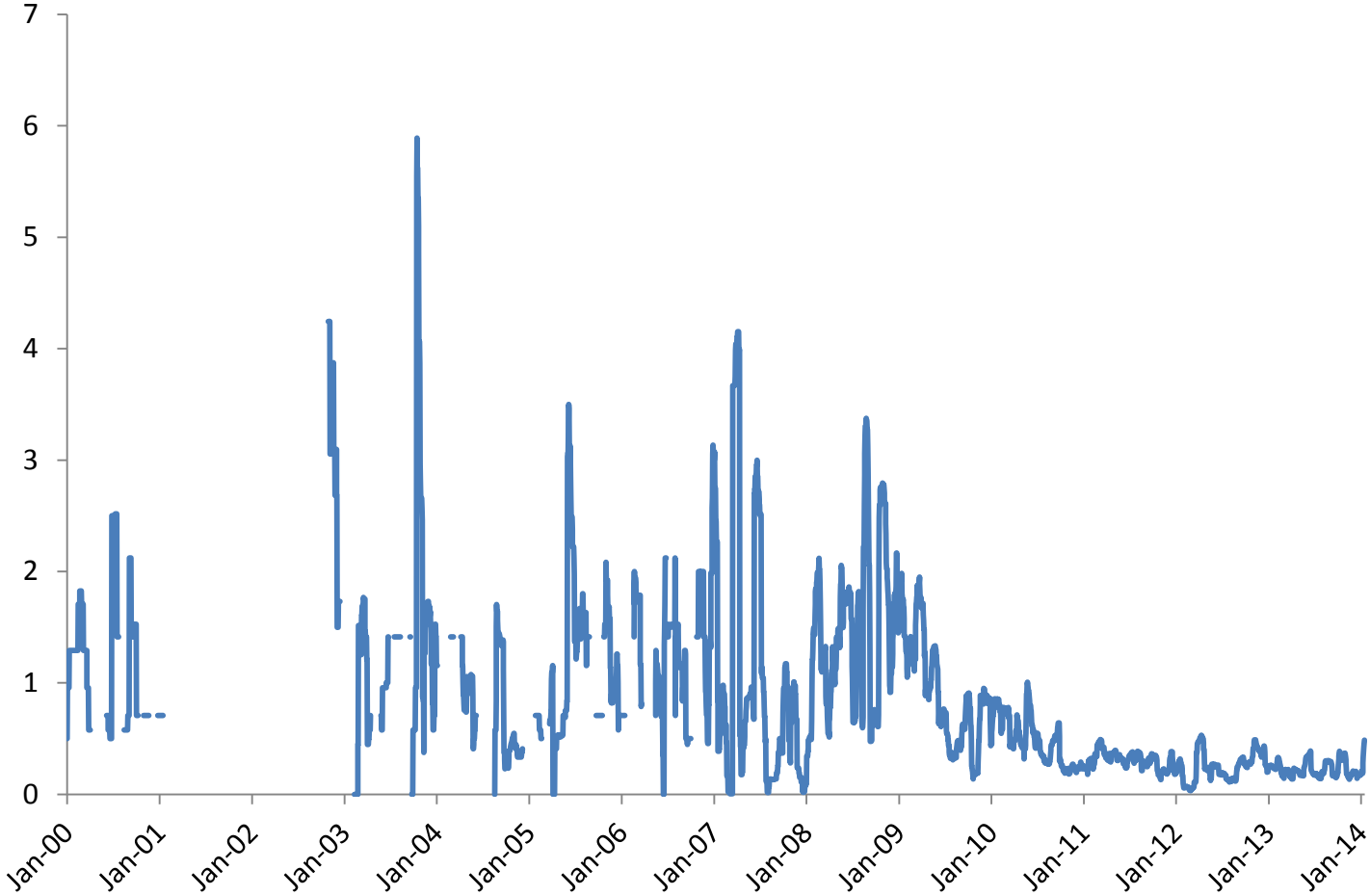
Money Market Rates Hover Around the Policy Rate...



Source: NBG

Interest Rate Volatility is Low

Interest Rate Volatility (1 month St. dev.)

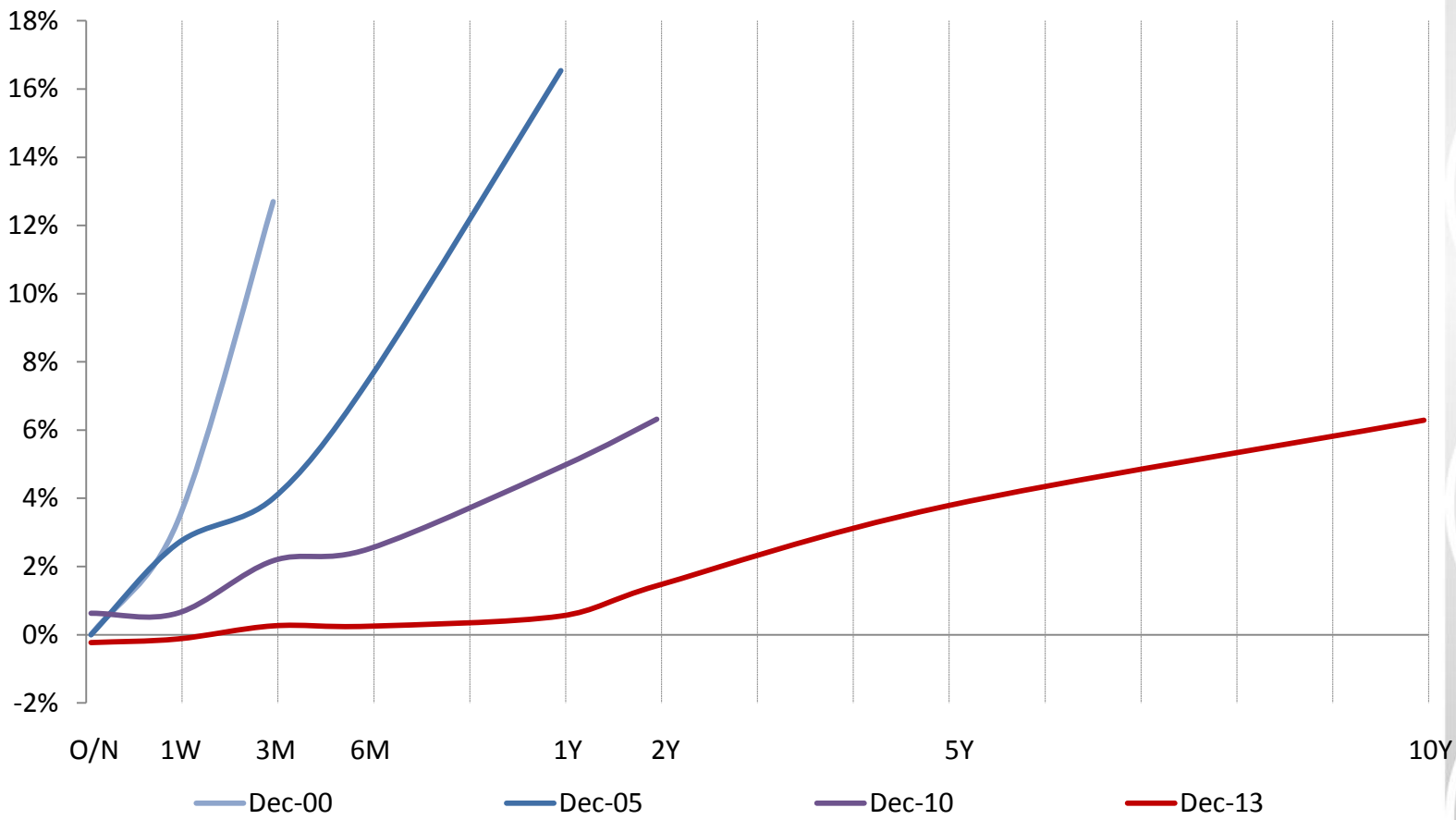


Source: NBG

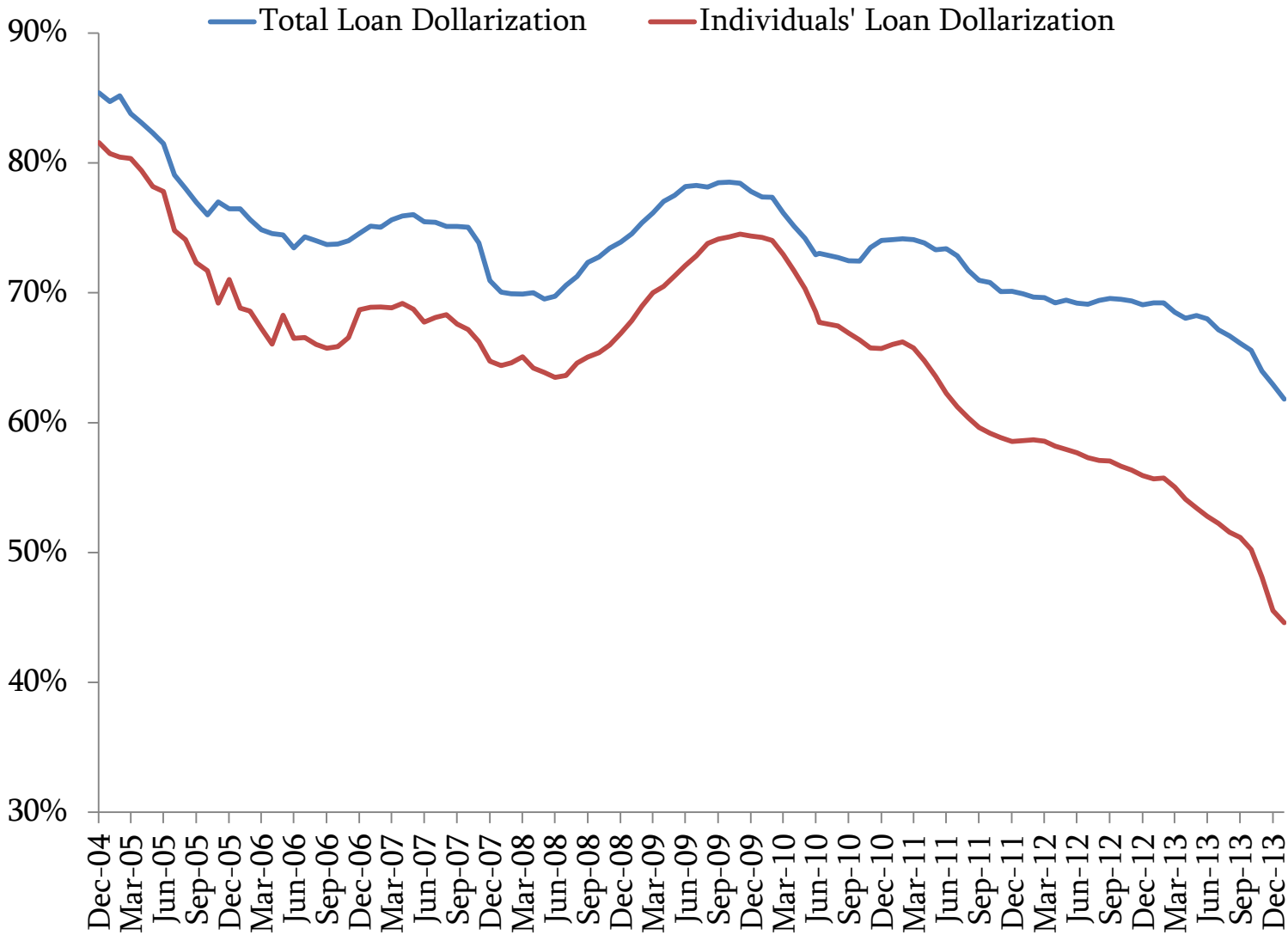


Spreads to Policy Rate

Interest rate spreads of long-term assets to policy rate is decreasing



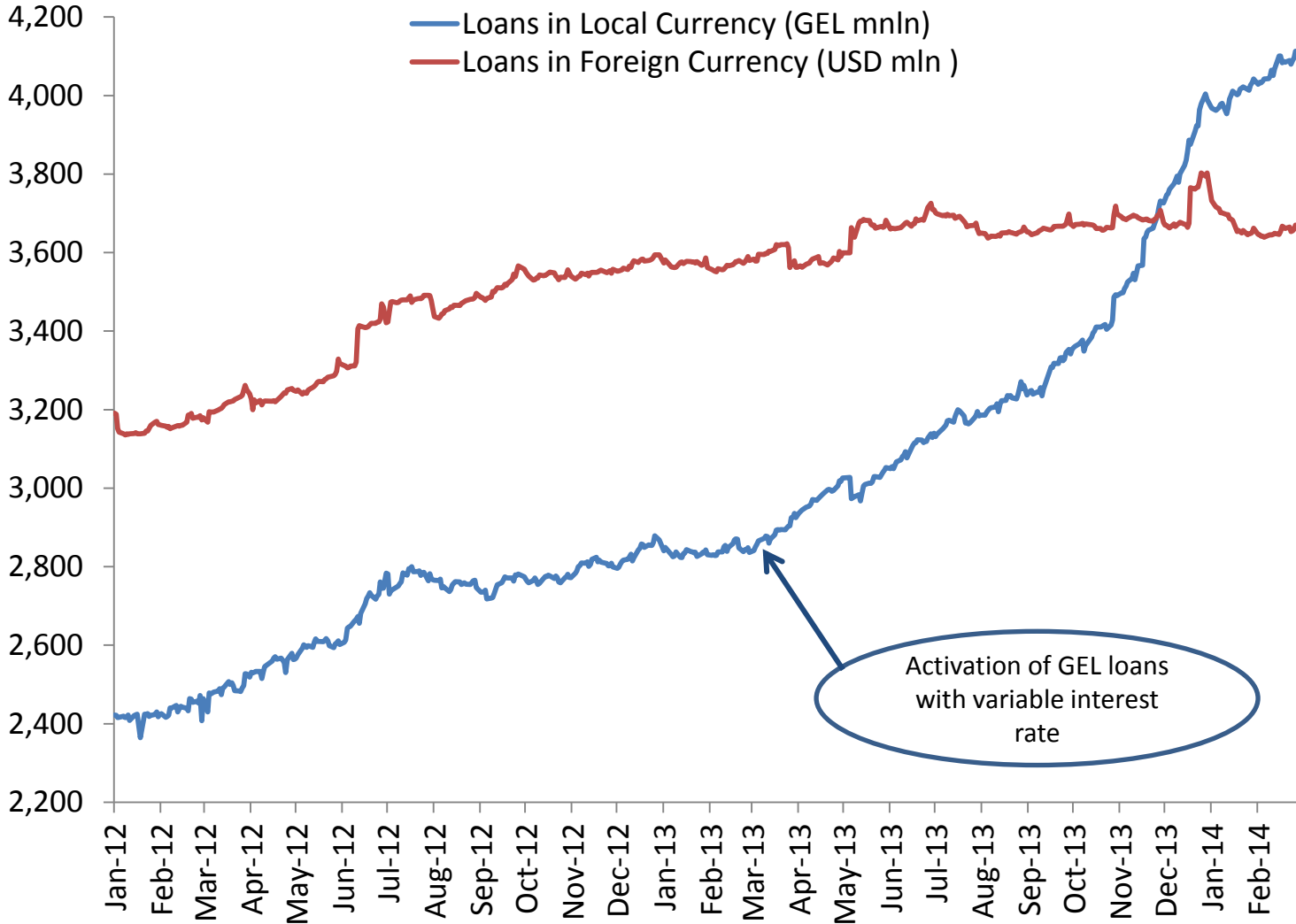
Main Challenge of Monetary Policy: Dollarization



Source: NBG



Loans in Domestic Currency is Increasing- supporting de-dollarization

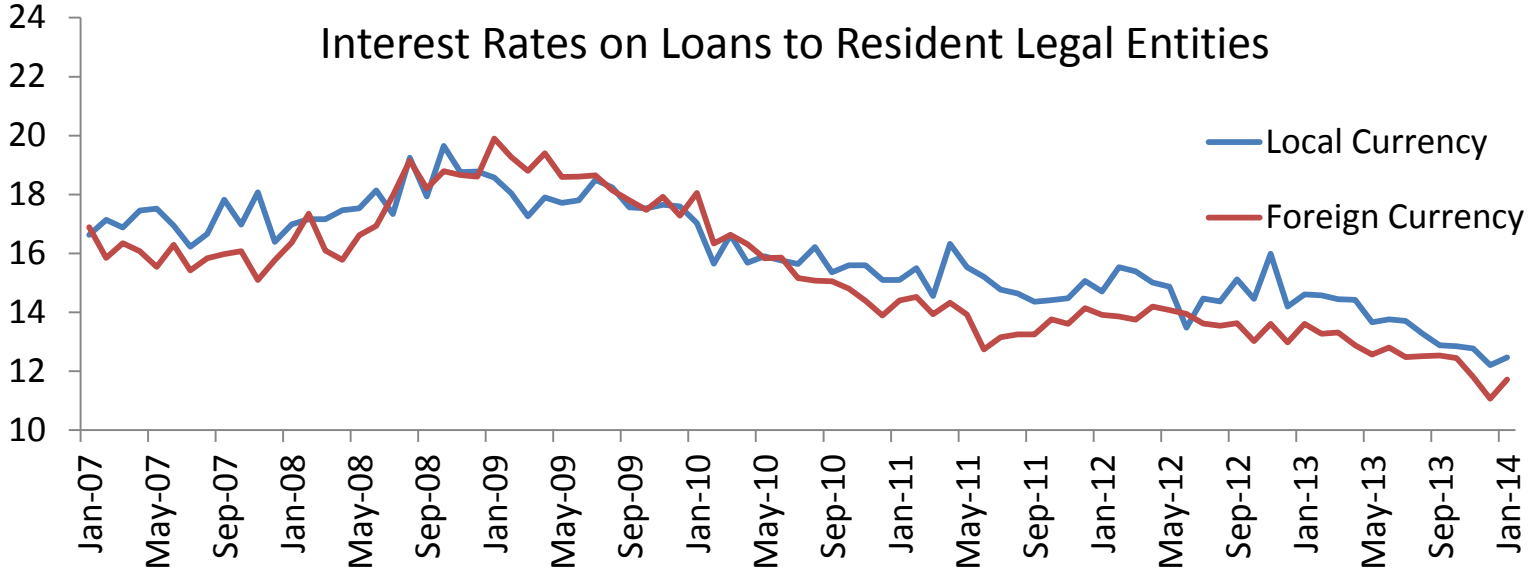


Source: NBG

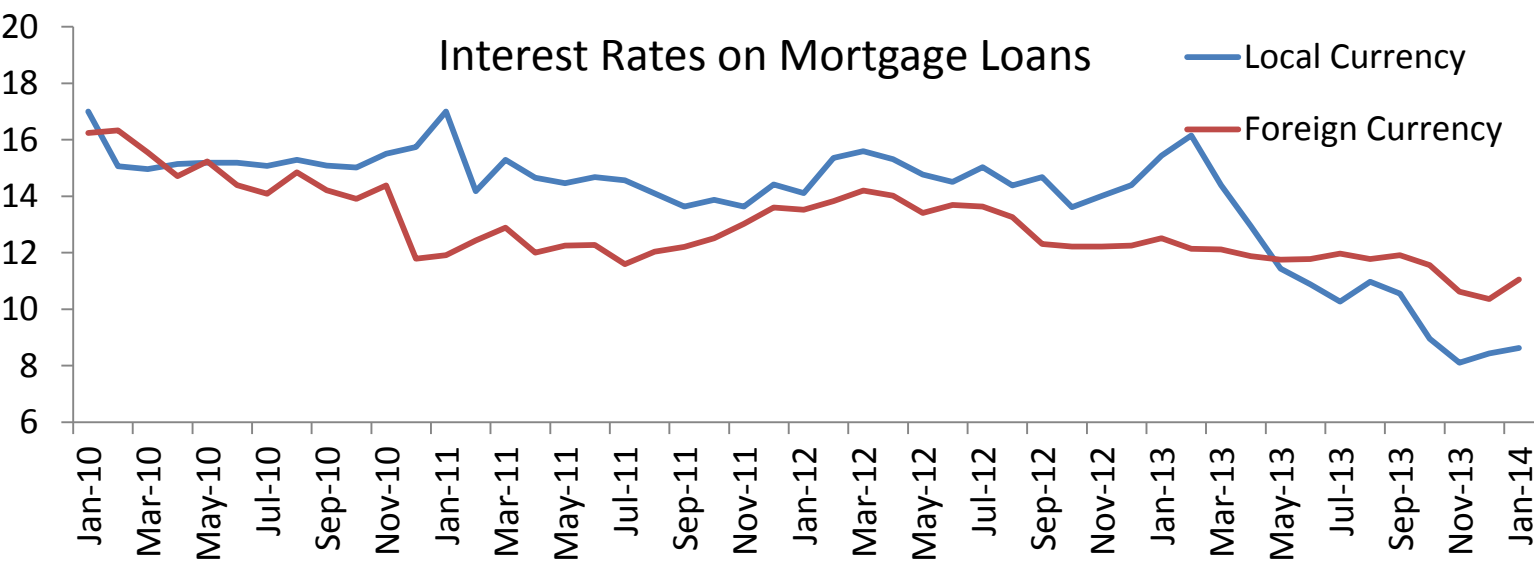


Interest Rates

Interest Rates on Loans to Resident Legal Entities



Interest Rates on Mortgage Loans



Source: NBG

Commercial Banks' CDs (CBCDs)

- In 2012 NBG approved the decree on the “Regulation on Standard Commercial Bank Certificates of Deposit”
- Features of Standard CBCDs
 - Only in local currency
 - Lower reserve requirements
 - Exemption from liquidity requirement (for CBCDs with remaining maturity <6 mos.)
- Increase average maturity of GEL deposits

Development of forecasting capacity



Forecasting and Policy Analysis System (FPAS)

- To conduct an efficient monetary policy, the NBS relies on economic analysis and macroeconomic modeling
- Macroeconomic models represent an effective tool for forecasting, taking into account the endogeneity of monetary policy
- Models generate useful forecasts, but also provide clear instructions on how to set monetary policy instruments to return inflation to the target and to avoid the formation of incorrect expectations



Forecasting and Policy Analysis System (FPAS)

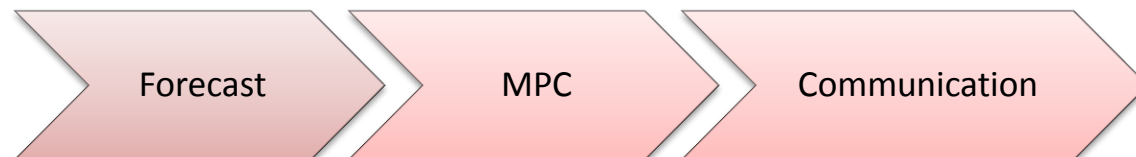
- Incorporates several analytical tools classified in three categories
 - Short term forecasting instruments:
 - BVAR
 - ECM
 - Factor models

Short term forecasts (one-two quarters) of main macroeconomic variables are based on the output of these models

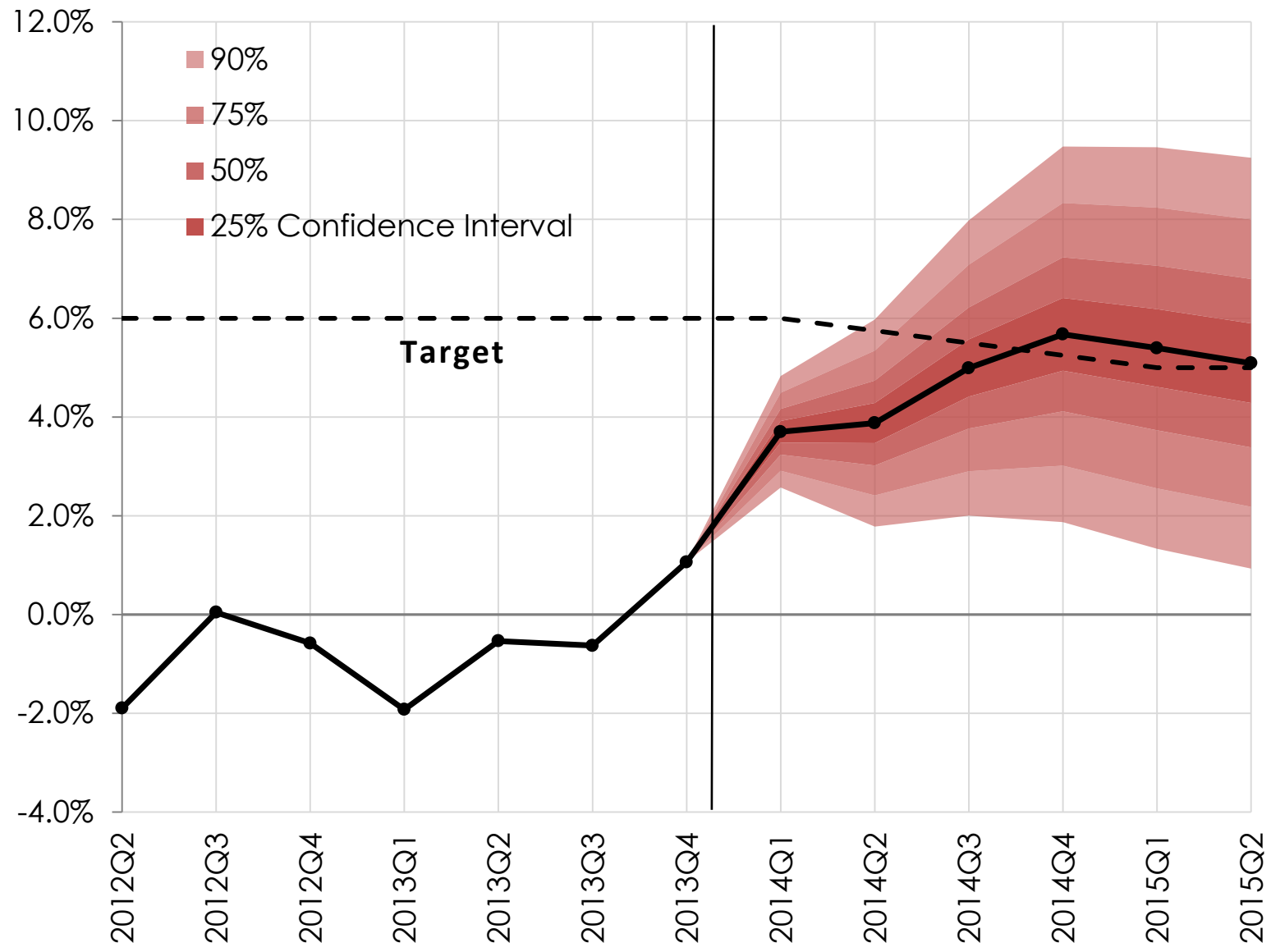
- Medium term forecasting tool (core model)
 - Semi structural model based on the new Keynesian approach (DSGE)
- Additional satellite models

Economic Analysis and Modeling

- Decisions on monetary policy are made by the Monetary Policy Committee
- Decisions are based on forecast results
- Alternative scenarios are also considered
- Information on monetary policy committee decisions are published upon the completion of the meeting in the form of press releases
- Inflation Report is the main document for communication of monetary policy decisions and forecasts
- Inflation Report is focused on future forecasts and analysis



Forecast- CPI Inflation (Annual, end of period)



Source: NBG

COMMUNICATION OF MONETARY POLICY



Communication

- High credibility of the central bank ensures better management of inflation expectations
- Gaining the credibility needs:
 - Clear mandate
 - Independence
 - Transparency
- Policy transparency:
 - Press-releases on MPC decisions, Press-conference after MPC meeting, Inflation report (revised: – forecast-based form) and presentation, Strategy
- Communication with market participants:
 - Regular meetings with analysts
 - Close communication with commercial banks
 - Additional lectures and presentations on different topics
 - Surveys on inflation expectations, lending conditions and business activities
 - Improved access to statistical data

Contents of Monetary Policy Strategy

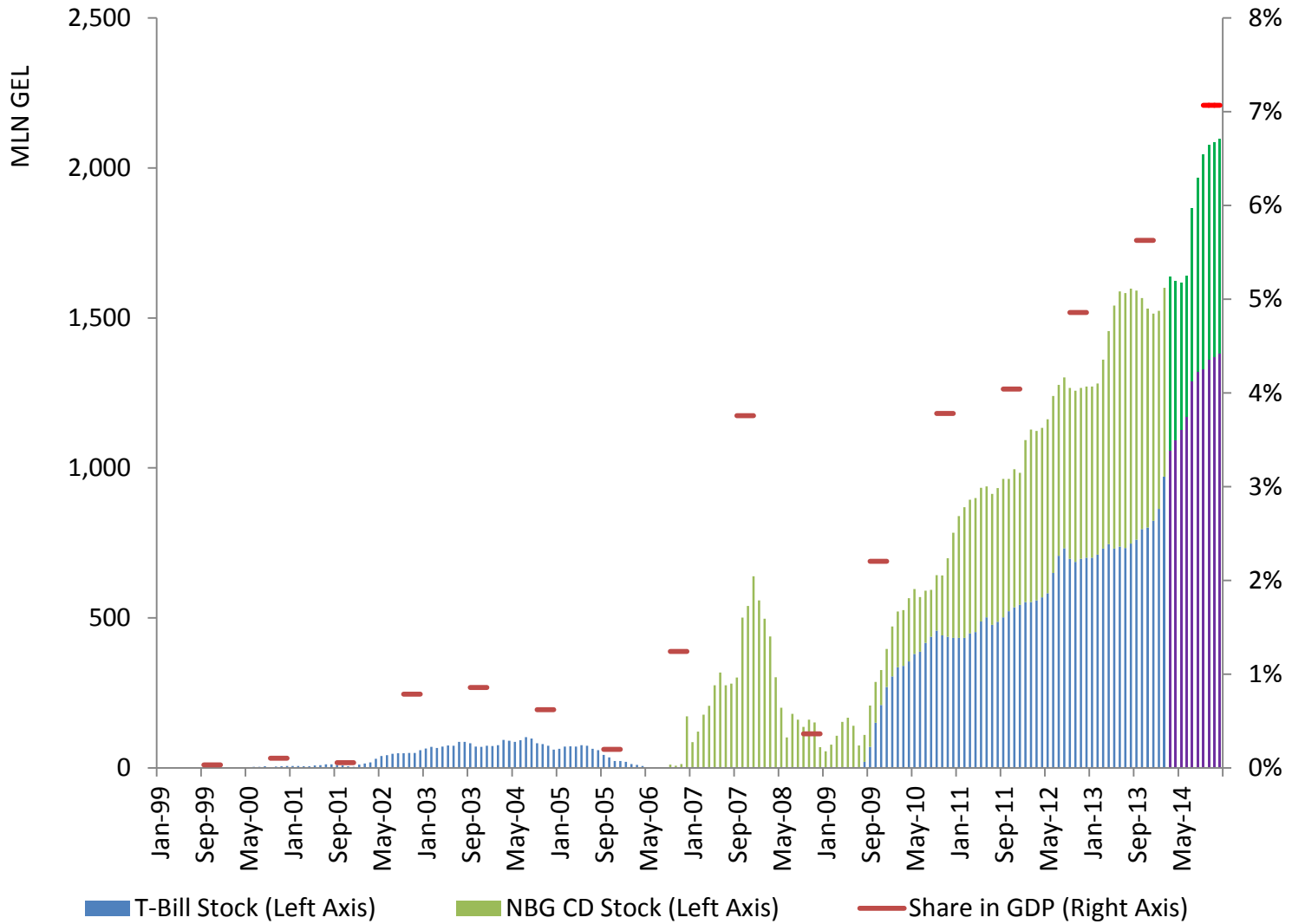
- Inflation targeting regime and its framework
- Exchange rate regime and its importance
- Recent reforms carried out to enhance the efficiency of monetary policy
- The role of communication

CAPITAL MARKET DEVELOPMENT



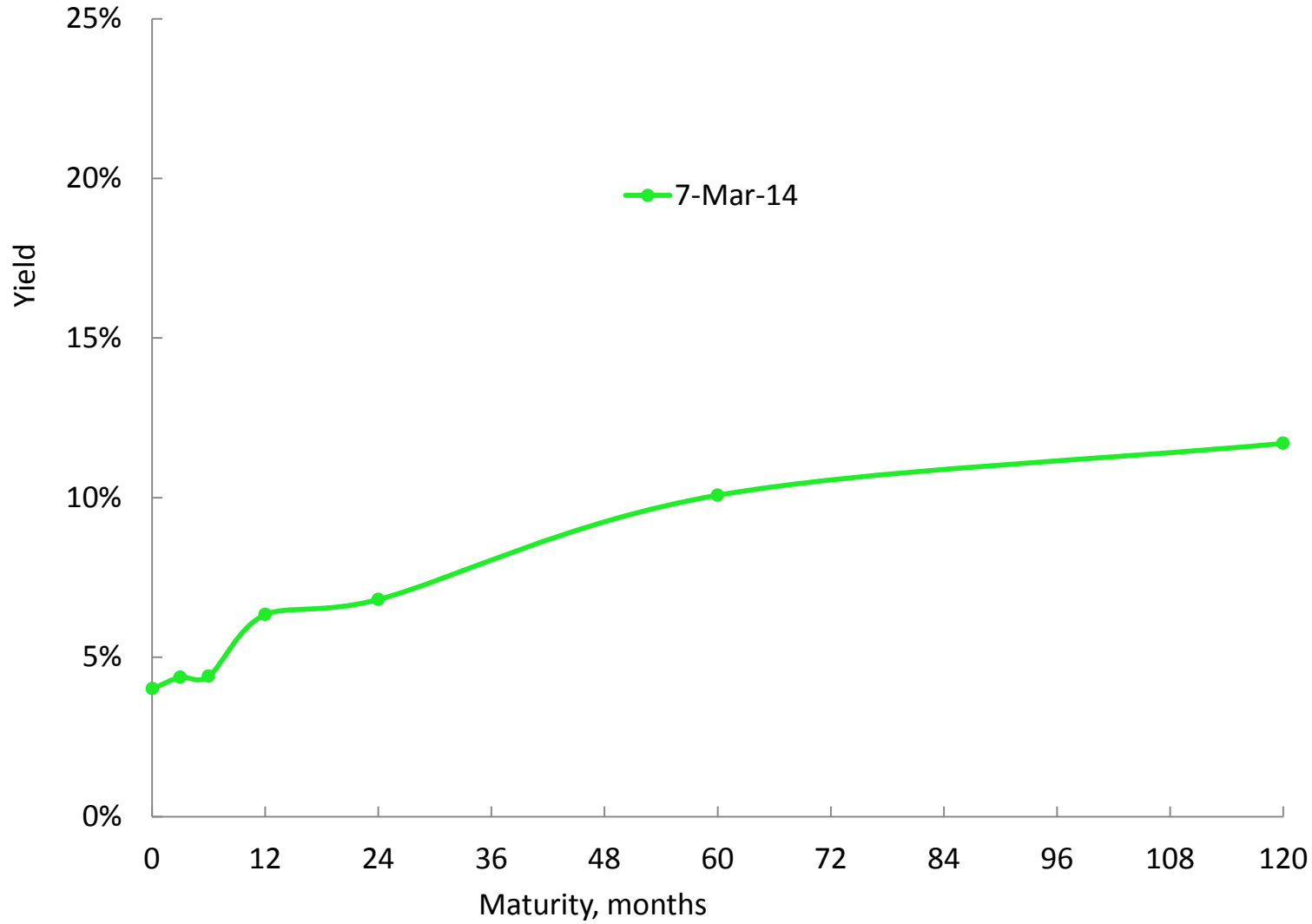
Financial Markets: Increased Portfolio of Gov't Securities

Government Financial Papers

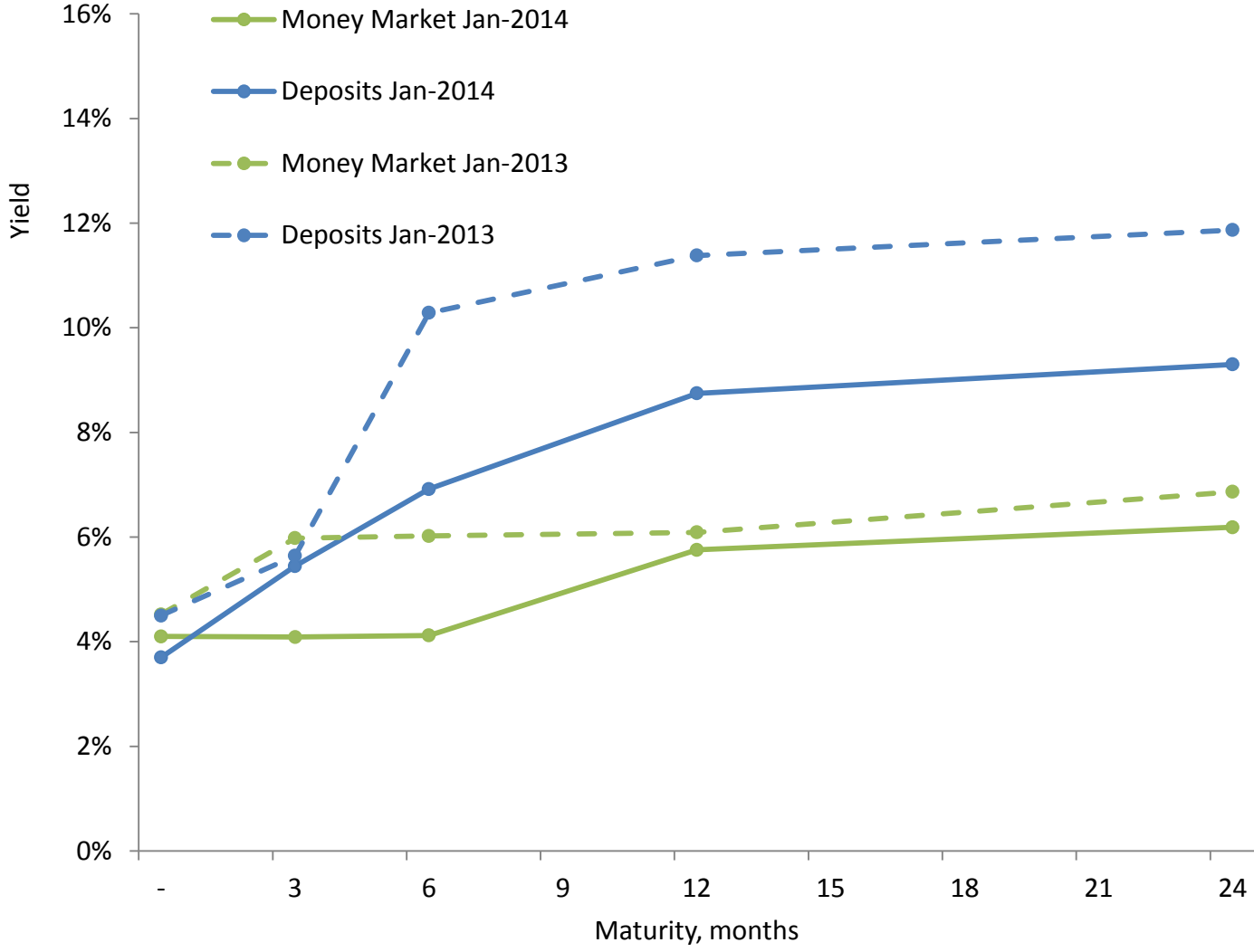


Source: NBG

Yield curve



Liquidity Risks



Source: NBG



Financial Market Development

- Capital market development needs successive evolution of various markets
 - Money (short-term, liquid funds);
 - FX
 - Government Securities

 - Corporate bonds
 - Derivatives
 - Stocks
- The more developed capital market is, then monetary policy becomes more efficient.
- Therefore, it is in the interests of the NBG (as well as public) to promote development of these markets

EBRD bond in GEL

- The first GEL bond issued by IFI
- Support of capital market development
- Encourage other IFIs and domestic private companies to issue bonds in domestic currency



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Questions?

