WORLD BANK GROUP
Macroeconomics, Trade & Investment

- *Economic activity remains dynamic, supported by improving labor markets.*
- *Inflation inched up further in November to 7 percent yoy, its highest level since mid-2017.*
- *Higher exports and contracting imports resulted in a lower trade deficit compared to a year ago.*
- *The lari stabilized following depreciation pressures through July-September.*
- *Credit growth remained stable at 13 percent yoy in October, driven by lari denominated loans.*
- *The government is on track to meet the target deficit of 2.7 percent of GDP for the year.*

Economic activity[1] expanded by a strong 5.7 percent year-on-year (yoy) in October, bringing the expansion since the start of the year to 5.2 percent. Net exports contributed positively, as goods exports and tourism receipts recovered while imports remained contained. Despite stagnant consumer and investor sentiments, domestic demand benefited from higher public investments and tighter labor markets. Also, foreign direct investment rose in the third quarter by 13.7 percent, driven by reinvestments. Growth for the year is expected to be around 5.2 percent while emerging weaknesses in the external environment are projected to add to adverse factors in 2020 and slow growth to 4.3 percent.

Labor market outcomes have improved. The unemployment rate was 11.1 percent in the third quarter of 2019, a 1.1 percentage point (pp) drop compared to a year ago, with a growing share of wage employees compared to self-employed. At the same time, wages rose by 10.9 percent yoy (5.3 percent in real terms). The highest paid workers were employees offering professional and technical services (GEL2,128 or US$760/month) while the least paid professions were in non-subsistence agriculture (GEL681 or US$243/month) and education (GEL840 or US$300/month). Real wages grew fastest in entertainment and recreation (13.4 percent yoy) and education (11 percent yoy). Agricultural wages declined by 8.8 percent.

Inflation inched up further to 7.0 percent yoy in November. Prices for imported products increased by 5.5 percent, reflecting the pass-through from a weaker lari, while prices of domestically produced goods increased by 7.5 percent (as of October). Food products contributed 4 pp to the inflation, while tobacco prices accounted for 1 pp. After hiking the policy rate by a cumulative 200 basis points to 8.5 percent between September and October, the central bank increased the policy rate by additional 50 basis points in December.

The foreign exchange market has stabilized since October. Between end-June and end-September 2019, the lari lost around 8 percent of its value against the US$. The exchange rate has stabilized since and strengthened in early December to 2.90GEL/US$. The nominal effective exchange rate depreciated in November by 0.6 percent compared to October and by 8.8 percent yoy.

A modest recovery in exports and a decline in imports helped to lower the trade deficit in October 2019. Exports grew by 4.5 percent yoy, up from 0.5 percent in September, but weaker than the 10.4 percent average growth rate so far in 2019. Around 60 percent of exports in 2019 were bunched in six categories: copper ores (17.4 percent), used cars (17.2 percent), ferro-alloys (8.3 percent), wine (5.8 percent), pharmaceuticals (5.0 percent) and mineral water (3.7 percent). Russia and Azerbaijan were the top export destinations, each accounting for 13 percent of exports. After increasing by 4.9 percent in September, imports returned to negative growth in October falling by 2.1 percent yoy, bringing the reduction since the start of the year to 3.1 percent. With this, the trade deficit declined by 10.8 percent yoy in the first ten months of 2019.

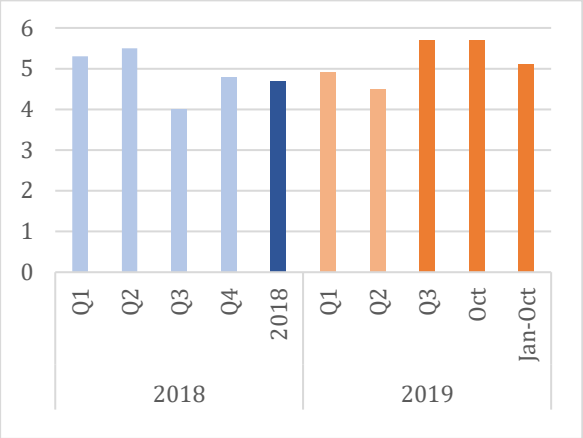
Transfers and tourism receipts also improved. Money transfers from abroad rose by 11.7 percent due to higher transfers from Italy, Greece and the US. Tourism revenues increased by 5.2 percent yoy in October, the first increase since July 2019 when Russian authorities introduced a ban on flights between Russia and Georgia.

The stock of credit by banks increased by 13.2 percent yoy in October (excluding foreign exchange impact). This was driven mainly by corporate loans, which surged by 20.3 percent yoy, while consumer loans grew by 7.3 percent yoy, reflecting more stringent conditions on retail lending introduced by NBG. Profitability remains strong, with Return on Equity and on Assets at 16.7 percent (1.5 pp lower than a year ago) and 2.1 percent (0.3 pp lower than a year ago), respectively in October 2019. The share of non-performing loans, at 2.7 percent, remains low.

The performance of the budget in the ten months of 2019 was in-line with the annual fiscal framework. Revenue collection was at 84 percent of the annual plan and 10 percent higher compared to the same period of 2018, mostly due to strong Value Added Tax performance. With expenditures increasing by 19 percent yoy, including due to better capital spending execution, the budget registered a deficit of 1.6 percent of GDP in the ten months of 2019. This puts the Budget well placed to meet the deficit target of 2.7 percent of GDP for the year.

[1] Rapid Estimate of Economic Growth by GEOSTAT. The rapid estimate relies significantly on VAT which has seen improved administration recently.

Figure 1. Growth was robust in October 2019
(year-on-year, in %)

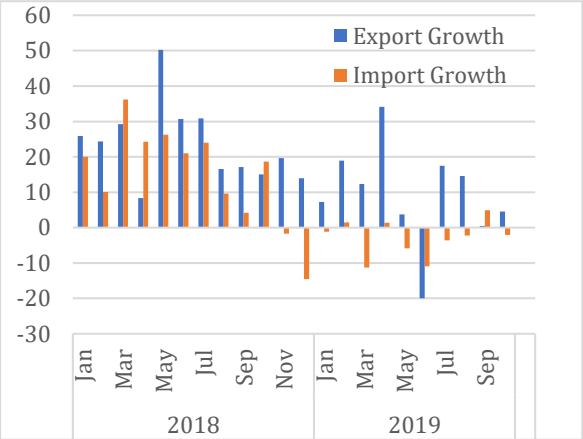


Source: Geostat

Figure 2. Inflation inched to 7 percent
(year-on-year, in %)

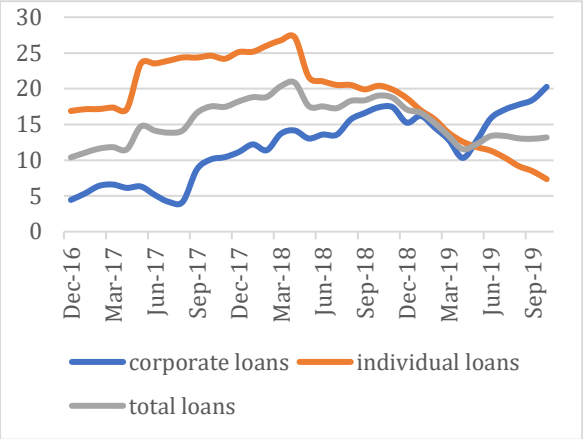
Source: Geostat

Figure 3: Exports recovered slightly while imports relapsed
(year-on-year, in %)



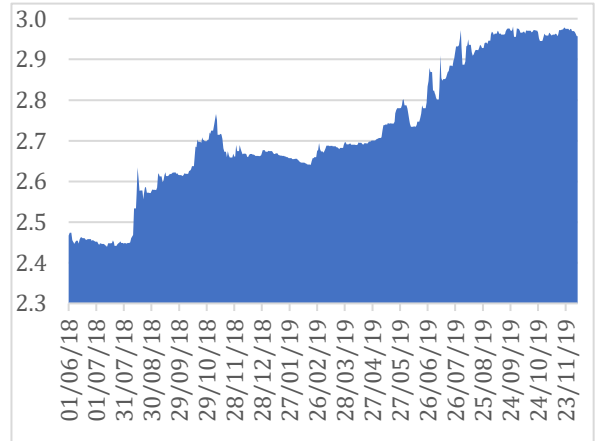
Source: Geostat

Figure 4. Credit growth remains robust driven by corporate lending
(year-on-year, in %)



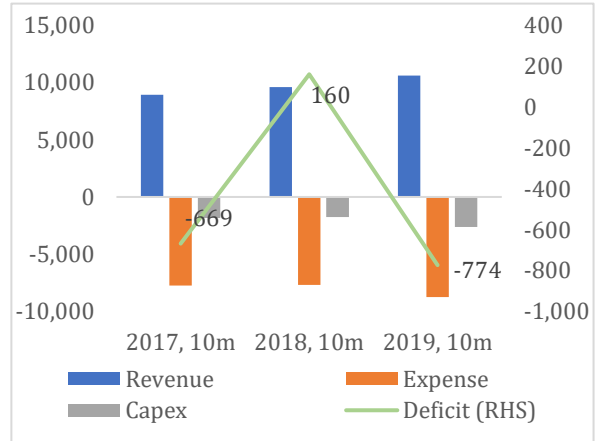
Source: NBG

Figure 5: The lari stabilized in November after depreciation pressures since July
(GEL/US$)



Source: NBG

Figure 6: In line with budget plans, the fiscal deficit is up as capital spending increased
(GEL million)



Source: MOF