



Georgian Economy

Economic Fundamentals Supporting Stable Lari

Georgia | Economy

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Lari remained broadly stable in 2014 while other currencies significantly lost their values against dollar. However, weaker external environment supported depreciation pressures as was anticipated and since mid-November lari has shown greater volatility. Lari lost 12.4% of its value against the dollar and 0.8% against the Euro year to date. However, it seems that lari is oversold and should more closely reflect fundamentals in the medium term. Inflation remains subdued (2.8% in November) and falling world commodity prices are helping economy to contain inflationary pressures in the face of currency depreciation. However, weaker lari is probably a gain for the economy, as depreciation could lead to substantial gains for price competitiveness and improve current account deficit through weakening Lari's NEER and REER in the medium-term.

Lari remained broadly stable in 2014 while other currencies significantly lost their values against dollar. However, as we pointed out in our previous notes, moderate pressure on lari, owing to weaker external environment, was anticipated.

The lari's recent depreciation against the dollar helped economy to absorb short-term imbalances. From February to mid-November 2014 lari remained mostly stable against the US\$; it even appreciated by 2.3-2.6% against the dollar in summer, which prompted NBG to build reserves with a purchase of US\$ 120mn. Since mid-November the lari has shown greater volatility, as was anticipated by weaker external environment (increased trade deficit, moderate growth of remittances and tourism revenues and weak FDI). Lari lost 4.7% against the dollar at the end of November and another 6.3% on 6 December. As a result, lari lost 12.4% of its value against the dollar, but just 0.8% against the Euro year to date.

Central bank interventions for defending lari were limited compared to the last year, when NBG sold US\$ 220mn in November and December 2013. On 25 November 2014, NBG intervened and sold US\$ 40mn to curb excessive lari volatility when currency weakened by 1.6% during a course of the day, and sold another US\$ 40mn on 2 December.

We think that lari seems oversold and should more closely reflect fundamentals in the medium term. In recent weeks, the extent of depreciation was triggered by market overreaction, as was adjusting to weaker external environment and there was growing demand for imports owing to seasonality and increased government spending, in our view. However, some relief for the lari could come in the medium term as winter season will attract tourists, and falling world prices on Georgia's major commodity imports (oil, food) could help to save on imports in coming months.

Figure 1: Official foreign reserves

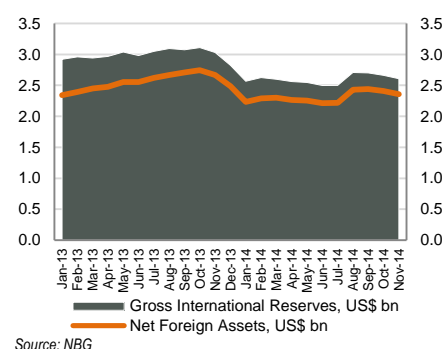


Figure 2: NBG FX interventions

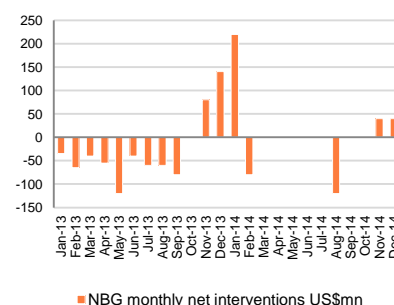
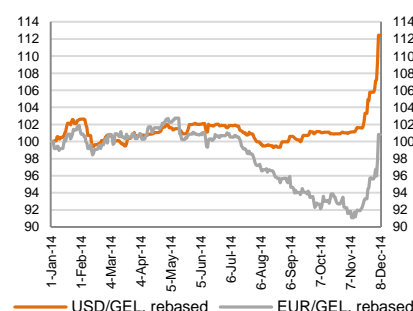


Figure 3: Exchange rate performance



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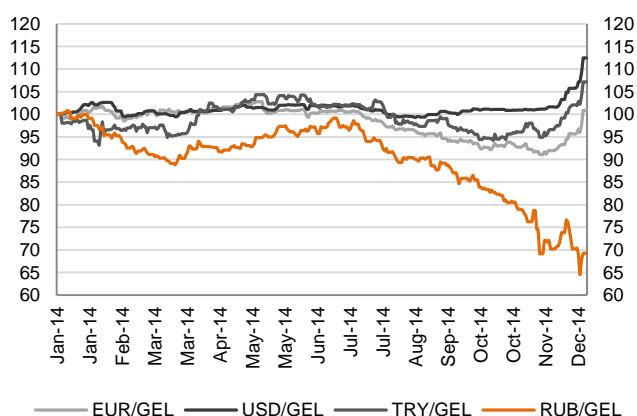
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Weaker lari is probably a gain for price competitiveness and current account.

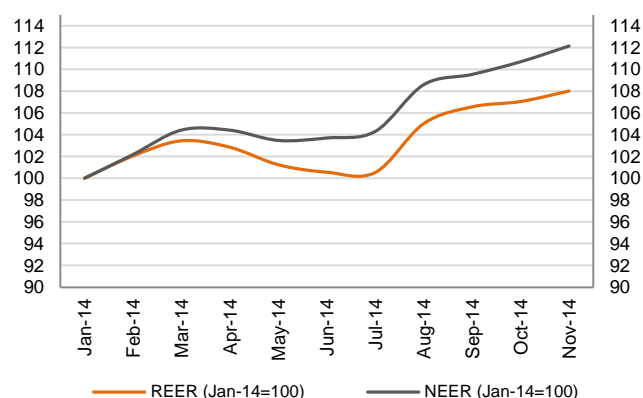
Although the lari depreciated by 5% against the US\$ and 10% against the Euro by end-2013, currency weakness in Turkey, Russia, and Ukraine led in little changes in Georgia's nominal and real effective exchange rates. As lari remained strong for the most 2014 while Georgia's trading partners' currencies continued weakening, this meant that both nominal and real exchange rates strengthened significantly. Lari NEER appreciated 12.1% in November and REER appreciated 7.0% in October compared to January. Therefore, recent depreciation may support to weakening Lari's NEER and REER. This may lead to substantial gains for price competitiveness for Georgia's exports and tourism sector and could improve current account deficit, without significant pressure on prices in the face of falling world commodity prices.

Figure 4: Bilateral nominal exchange rates, rebased



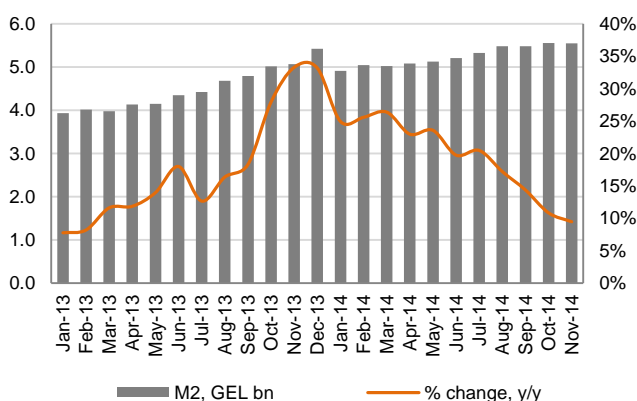
Source: NBG, G&T Research
Note: As of 8 December 2014

Figure 5: Lari's NEER and REER



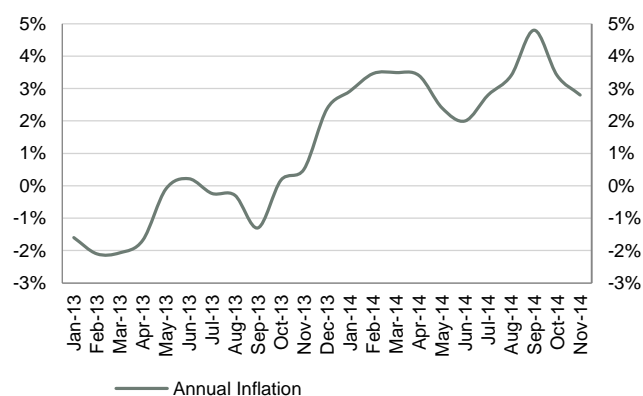
Source: NBG, G&T Research
Note: November REER is a projection

Figure 6: Broad Money M2



Source: NBG
* Preliminary data for November 2014

Figure 7: Annual CPI inflation



Source: GeoStat



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