



Georgian Economy

Lari – Better than Regional Currencies

Georgia | Economy

March 6, 2015

The strengthening dollar and an unfavorable external environment have been pressuring the lari since 4Q14. The relative stability of US\$/GEL at 1.75 over 4M14-9M14 resulted in real appreciation of the lari on the back of currency depreciations among Georgia's main trading partners. The spike in the US\$/GEL rate in November/December 2014 was probably a necessary correction to rectify appreciation of the REER, which had strengthened in previous months. A second correction took place in late January-February 2015. Overall, we believe that depending on FDI/tourism inflows and import performance, pressure on the lari might subside and the US\$/GEL rate should remain within the 2.10-2.30 band in 2015.

Appreciating dollar pressuring lari. The improved US growth outlook and looming Fed interest rate increases have resulted in the dollar gaining 19.6% against a basket of major world currencies during 7M14-2M15. The lari remained broadly stable against the dollar until November 2014, strengthening against other currencies. As a result, the lari REER appreciated starting from August 2014. The lari appreciation prompted the NBG to buy US\$ 120mn in August 2014 to build up reserves.

Lari started weakening as external financial inflows decreased significantly in 4Q14. The drop in exports (-22.5% y/y), decreased remittances (-17.7% y/y), and weaker tourism inflows (+0.5% y/y) in 4Q14-1M15, totaling a US\$ 338mn (-16% y/y) aggregate drop, resulted in rapid depreciation of the lari since the end of November 2014. In less than two months, the lari weakened by 6.2% against the dollar, and the accompanying market overreaction led to further depreciation by another 9.2% in January 2015 and 5.3% in February 2015. Cumulatively, the lari has weakened by 23.3% against the dollar since 1 January 2014. The lari's 1.1% appreciation against the euro and minor 1.5% depreciation against the Turkish lira over the same period (1 January 2014 - 6 March 2015) is an indication that the current trend in the US\$/GEL rate is more heavily related to general dollar appreciation. By losing some value against the dollar, the lari actually corrected against other major currencies.

Central bank interventions to support lari were limited. To counter rapid depreciation, the NBG sold US\$ 200mn since November 2014 (compared to US\$ 440mn in November 2013 – January 2014). Further devaluations in Ukraine and Azerbaijan in February, along with relative stability of imports versus falling exports, plus a market overreaction resulted in the lari hitting 2.26 US\$/GEL on February 26. Assurances from the authorities and a possible decrease in imports (February data is not available yet) probably helped the lari to regain 5.4% of its value within a few days of February 26. Although annual inflation remained low (1.4% in January and 1.3% in February), we do expect some price pressures. However, with the NBG inflation target of 5.0% in 2015, its commitment to price stability, and the still accommodative monetary policy, the central bank has significant policy space to respond to inflationary pressures.

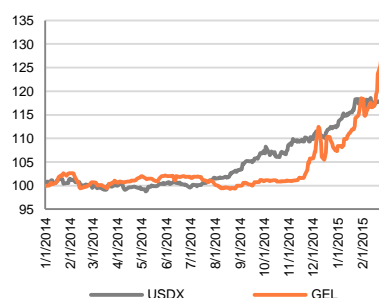
Depending on the dynamics in tourism/FDI inflows and imports, we expect the US\$/GEL to remain within the 2.10-2.30 range for the remainder of the year. The expected drop in imports and a relatively limited shrinkage of external inflows will probably keep the rate closer to 2.1 US\$/GEL.

Figure 1: Exchange rate performance



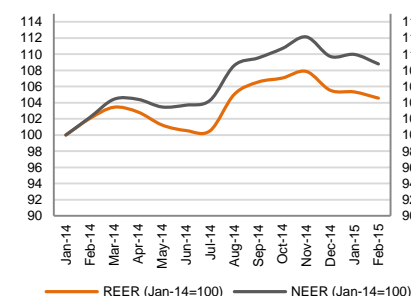
Source: NBG

Figure 2: USD index vs major currencies and USD/GEL



Source: Bloomberg, NBG

Figure 3: Lari's NEER and REER



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

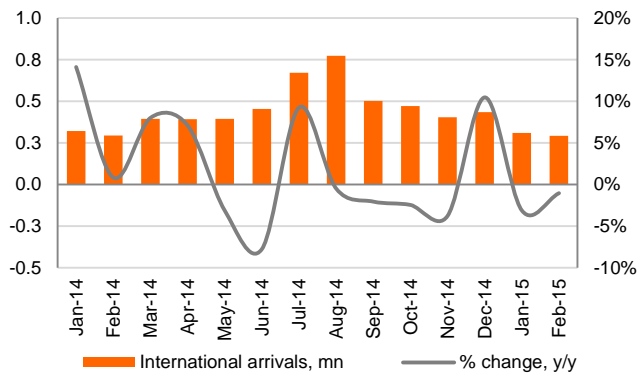
Nino Papava
Head of Research | n.papava@gt.ge | +995 322 401 111 ext.4693

Eva Bochorishvili
Economist | evabochorishvili@gt.ge | +995 322 401 111 ext.8036

Alim Hasanov
Economist | ahasanov@gt.ge | +995 322 401 111 ext.3933

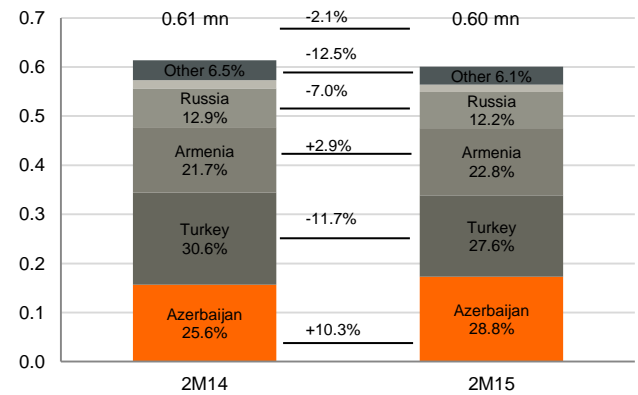


Figure 4: International arrivals



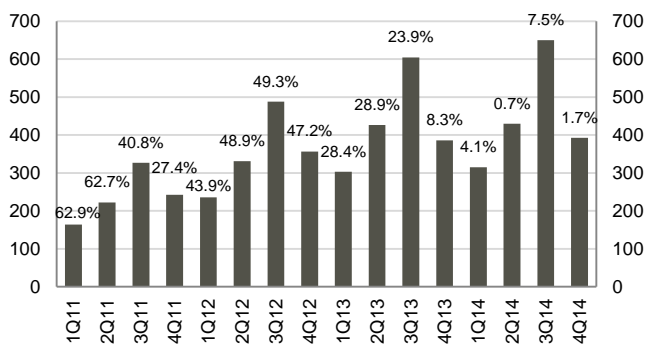
Source: GNTA

Figure 5: International arrivals (mn) and growth, 2M15 vs 2M14



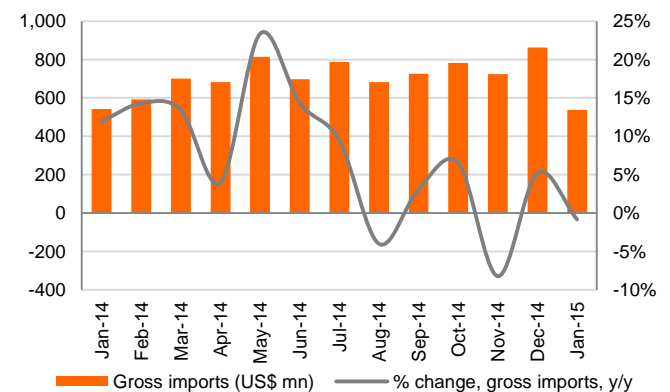
Source: GNTA

Figure 6: Tourism inflows (US\$ mn) and growth (%)



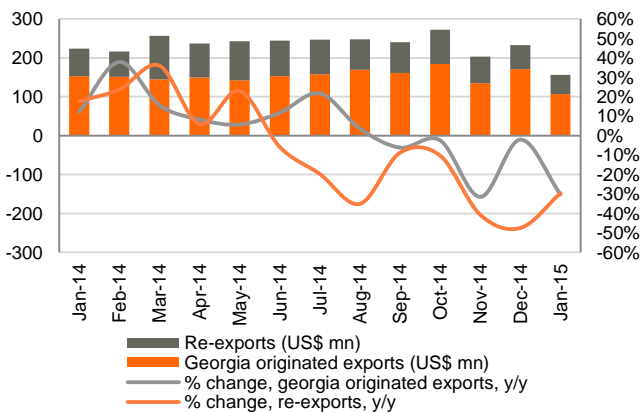
Source: NBG

Figure 7: Imports



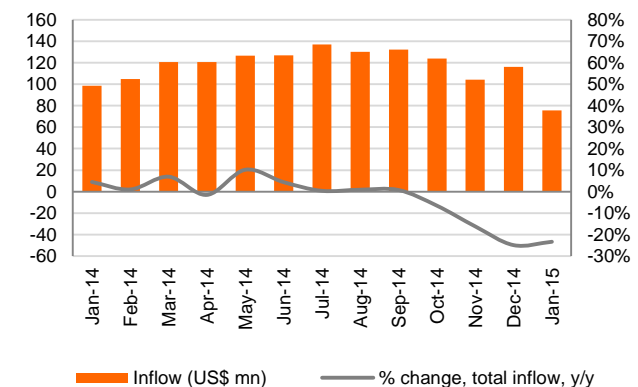
Source: GeoStat

Figure 8: Exports



Source: GeoStat

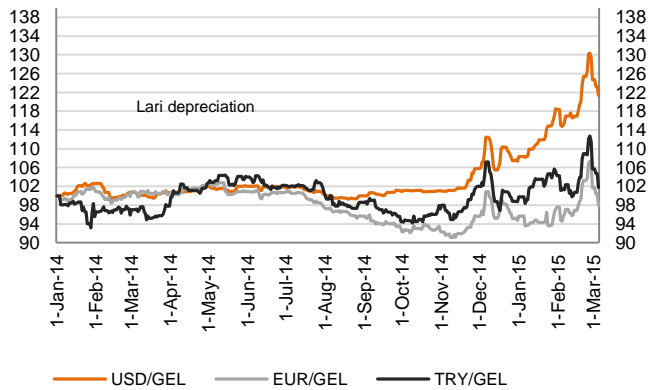
Figure 9: Remittances



Source: NBG

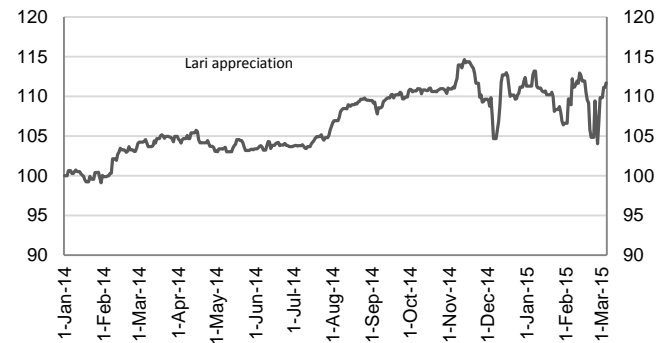


Figure 10: Bilateral nominal exchange rates, rebased



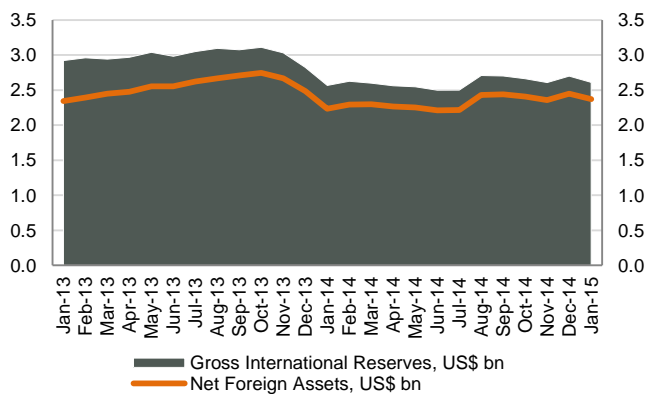
Source: NBG

Figure 11: Lari's daily NEER



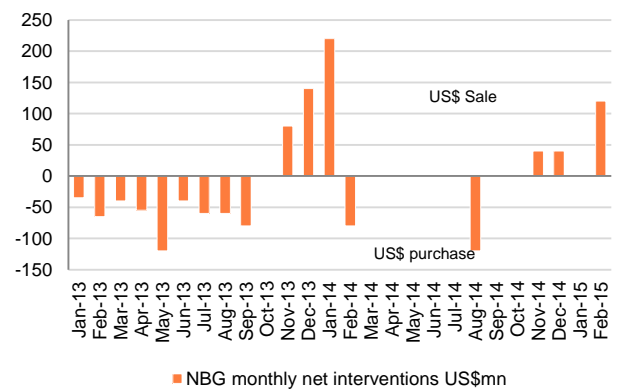
Source: NBG

Figure 12: International reserves



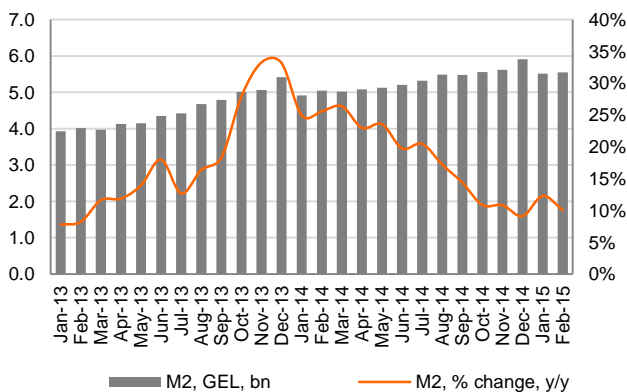
Source: NBG

Figure 13: NBG FX interventions



Source: NBG

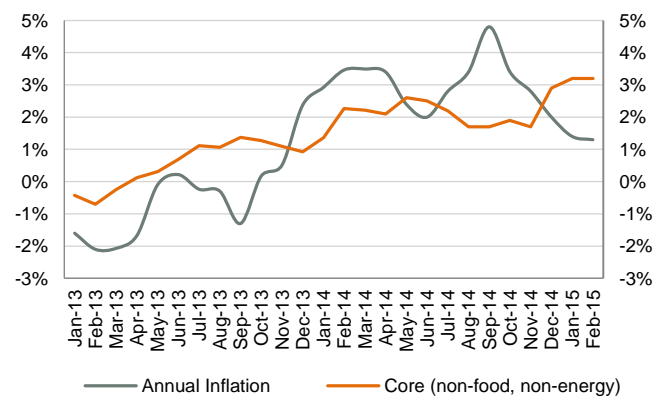
Figure 14: Broad Money M2



Source: NBG

* Preliminary data for February 2015

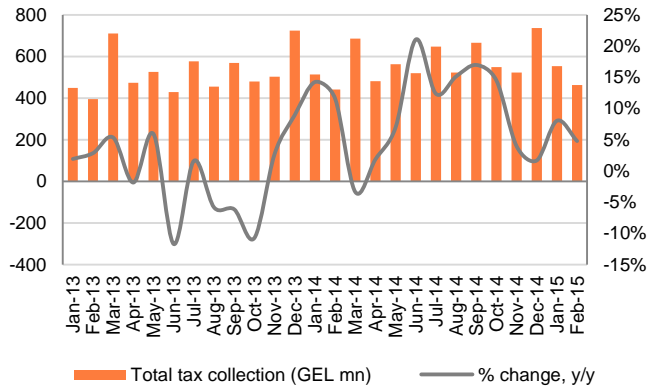
Figure 15: Annual CPI inflation



Source: GeoStat, NBG

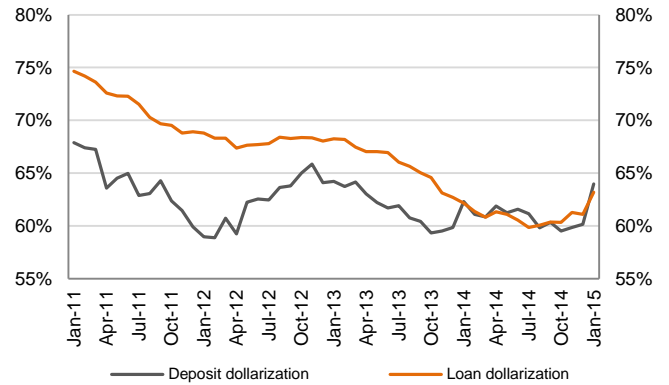


Figure 16: Total tax collection (state budget)



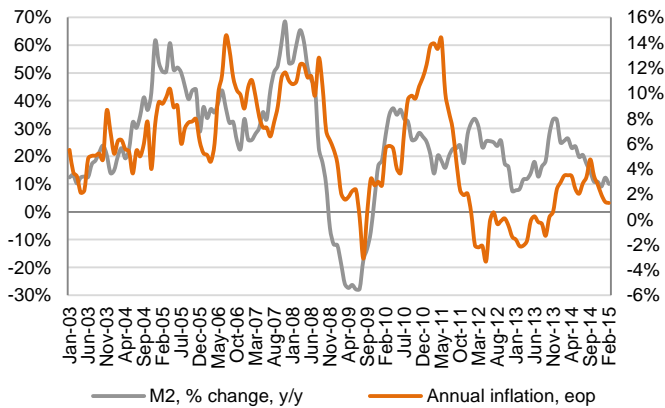
Source: MOF, Treasury Service

Figure 17: Loans/deposits dollarization



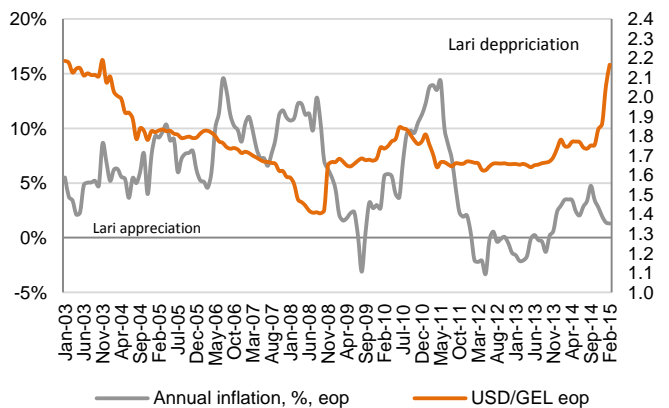
Source: NBG, G&T research

Figure 18: M2 and annual inflation



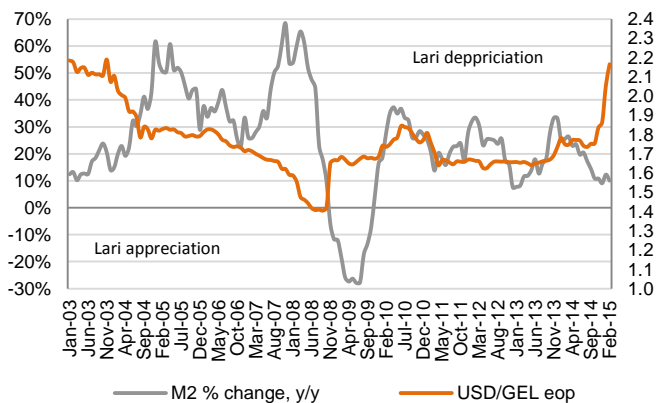
Source: NBG, G&T Research

Figure 19: Annual inflation and USD/GEL exchange rate



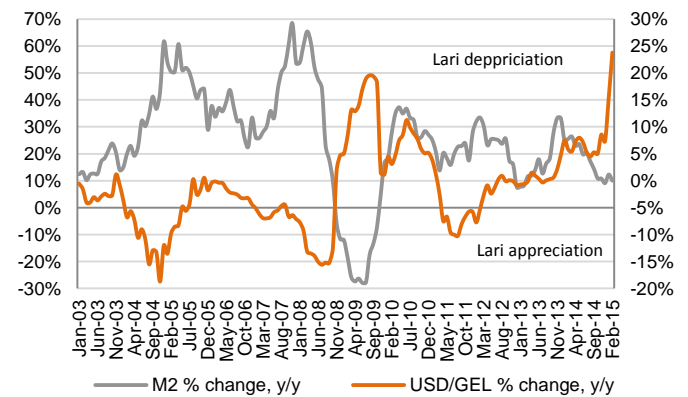
Source: NBG, G&T Research

Figure 20: M2 and USD/GEL



Source: NBG, G&T Research

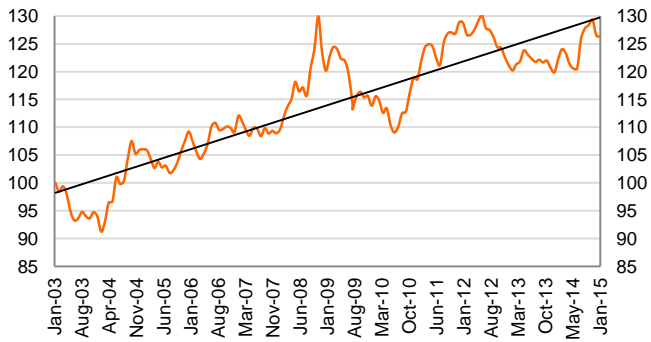
Figure 21: M2 and USD/GEL



Source: NBG, G&T Research

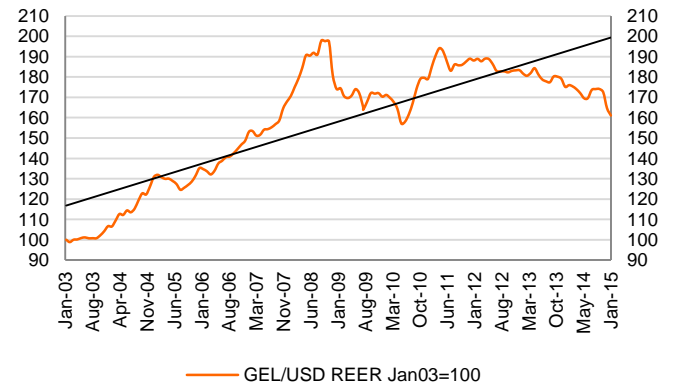


Figure 22: REER



Source: NBG

Figure 23: REER GEL/USD



Source: NBG



Disclaimer

This document is strictly confidential and has been prepared by JSC Galt & Taggart ("Galt & Taggart"), a member of JSC Bank of Georgia group ("Group") solely for informational purposes and independently of the respective companies mentioned herein. This document does not constitute or form part of, and should not be construed as, an offer or solicitation or invitation of an offer to buy, sell or subscribe for any securities or assets and nothing contained herein shall form the basis of any contract or commitment whatsoever or shall be considered as a recommendation to take any such actions.

Galt & Taggart is authorized to perform professional activities on the Georgian market. The distribution of this document in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by Galt & Taggart to inform themselves about and to observe any and all restrictions applicable to them. This document is not directed to, or intended for distribution, directly or indirectly, to, or use by, any person or entity that is a citizen or resident located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would require any registration or licensing within such jurisdiction.

Investments (or any short-term transactions) in emerging markets involve significant risk and volatility and may not be suitable for everyone. The recipients of this document must make their own investment decisions as they believe appropriate based on their specific objectives and financial situation. When doing so, such recipients should be sure to make their own assessment of the risks inherent in emerging market investments, including potential political and economic instability, other political risks including without limitation changes to laws and tariffs, and nationalization of assets, and currency exchange risk.

No representation, warranty or undertaking, express or implied, is or will be made by Galt & Taggart or any other member of the Group or their respective directors, employees, affiliates, advisers or agents or any other person as to, and no reliance should be placed on, the fairness, accuracy, completeness or correctness of this document and the information contained herein (and whether any information has been omitted from this document) and no reliance should be placed on it. This document should not be considered as a complete description of the markets, industries and/or companies referred to herein. Nothing contained in this document is, is to be construed as, or shall be relied on as legal, investment, business or tax advice, whether relating to the past or the future, by Galt & Taggart any other member of the Group or any of their respective directors, employees, affiliates, advisers or agents in any respect. Recipients are required to make their own independent investigation and appraisal of the matters discussed herein. Any investment decision should be made at the investor's sole discretion. To the extent permitted by law, Galt & Taggart, any other member of the Group and their respective directors, employees, affiliates, advisers and agents disclaim all liability whatsoever (in negligence or otherwise) for any loss or damages however arising, directly or indirectly, from any use of this document or its contents or otherwise arising in connection with this document, or for any act, or failure to act, by any party, on the basis of this document.

The information in this document is subject to verification, completion and change without notice and Galt & Taggart is not under any obligation to update or keep current the information contained herein. The delivery of this document shall not, under any circumstances, create any implication that there has been no change in the information since the date hereof or the date upon which this document has been most recently updated, or that the information contained in this document is correct as at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. No representation or warranty, expressed or implied, is made by Galt & Taggart or any other member of the Group, or any of their respective directors, employees, affiliates, advisers or agents with respect to the accuracy or completeness of such information.

The information provided and opinions expressed in this document are based on the information available as of the issue date and are solely those of Galt & Taggart as part of its internal research coverage. Opinions, forecasts and estimates contained herein are based on information obtained from third party sources believed to be reliable and in good faith, and may change without notice. Third party publications, studies and surveys generally state that the data contained therein have been obtained from sources believed to be reliable, but that there is no guarantee of the accuracy or completeness of such data. Accordingly, undue reliance should not be placed on any such data contained in this document. Neither Galt & Taggart, any other member of the Group, nor their respective directors, employees, affiliates, advisers or agents make any representation or warranty, express or implied, of this document's usefulness in predicting the future performance, or in estimating the current or future value, of any security or asset.

Galt & Taggart does, and seeks to do, and any other member of the Group may or seek to do business with companies covered in its research. As a result, investors should be aware of a potential conflict of interest that may affect the objectivity of the information contained in this document.

This document is confidential to clients of Galt & Taggart. Unauthorized copying, distribution, publication or retransmission of all or any part of this document by any medium or in any form for any purpose is strictly prohibited.

The recipients of this document are responsible for protecting against viruses and other destructive items. Receipt of the electronic transmission is at risk of the recipient and it is his/her responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

Head of Research

Nino Papava | n.papava@gt.ge | [+995322401111](tel:+995322401111)

Economist

Eva Bochorishvili | evabochorishvili@gt.ge

Economist

Alim Hasanov | ahasanov@gt.ge

Senior Associate

Giorgi Iremashvili | giremashvili@gt.ge

Analyst

David Kutidze | dkutidze@gt.ge

Analyst

David Ninikelashvili | dninikelashvili@gt.ge

Analyst

Tamar Kurdadze | tamarkurdadze@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia

Tel: + (995) 32 2401111

Email: research@gt.ge