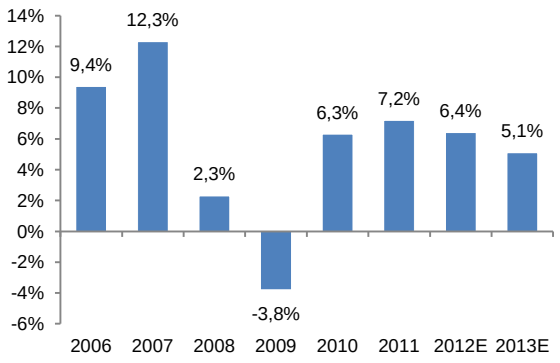
sp advisors

January 2013

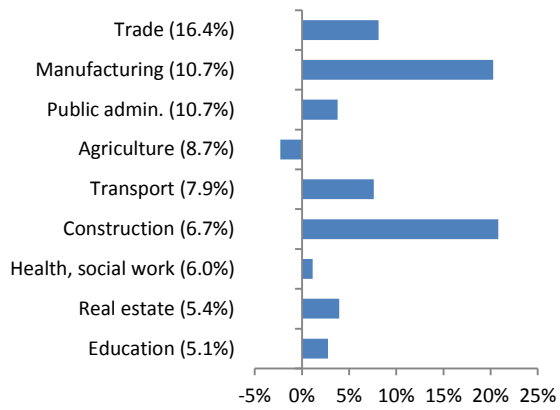
Georgian Macroeconomic Review

GDP growth rate, y/y



Source: GeoStat, SP Advisors

Growth by key sectors in 9M12*



** numbers in brackets indicate share of sector in GDP, growth rates for 9M12 are estimated based on quarterly data.*

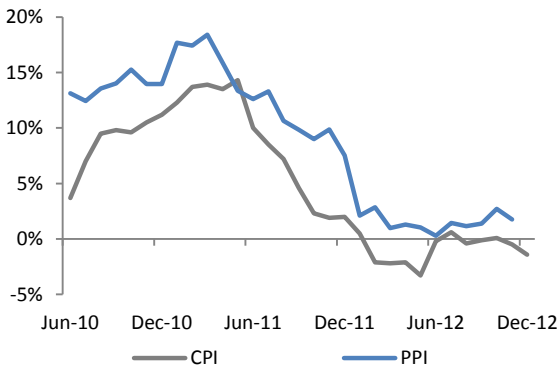
Source: GeoStat

GDP structure by categories of use

	2010	2011	9M12
Household consumption	75%	74%	72%
Gov't consumption	21%	18%	18%
Gross capital formation	22%	26%	30%
Export	35%	37%	40%
Import	-53%	-55%	-60%

Source: GeoStat

CPI and PPI



Source: GeoStat

A change in the government brought little immediate alterations in the Georgia's economic policy. Recently announced reform initiatives are broadly in line with the previous government's actions. This makes us believe there will not be any major domestic policy shifts in the nearest observed future that could have a serious effect on the economy. The only noticeable innovation being the revision of budget's spending priorities, which sees reallocation of funds from capital to current expenditures. Yet, the later adjustment is unlikely to negatively affect economic growth in the mid-term. Foreign investors are waiting for convincing signs from the government that Georgia will remain on its reform path, and it seems to be just a matter of time before FDI inflows strengthen following the post-election lull. We project the economy to continue to grow robustly while inflation to stay low in 2013. Georgia might see a moderate external financing gap on lower external borrowings this year, but that should be safely covered with the NBG reserves and poses no risk to currency stability.

Growth to slow moderately on lower private investment

We estimate that Georgian economy expanded by a healthy 6.4% in 2012, despite substantial growth deceleration to about 4.0% y/y in 4Q12E. In our view, the economy is unlikely to duplicate this kind of annual growth in 2013, and we project the country's GDP growth to slow to 5.1%. We think the slowdown will mainly be a result of weaker investments by the private sector due to post-election uncertainty. Decline in government investments is unlikely to have an immediate negative effect on the economy as it should be fully compensated by an increase in household expenditures. Higher social payments (at the expense of investments) combined with extremely low inflation should support strong real growth in private consumption. We don't rule out the latter is likely to become the key growth driver this year, even though its role in supporting economic growth was quite moderate in 2012. Exports should also pickup and contribute to output mainly on larger inflows of tourists, albeit its pace is likely to weaken vs. 2012.

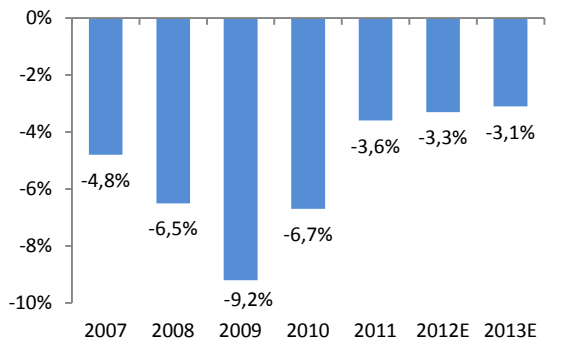
Inflationary pressures remain low

Georgia finished 2012 with deflation of 1.4% y/y on the back of a decrease in prices for food staples (-3.6% y/y), which jointly make up about 30% of the consumer basket. CPI stayed in the negative territory for most of the last year and we think it's unlikely to rise close to the NBG's target of 6% in 2013. Targeted increases in social payments should add to demand side price pressures, but is still unlikely to push the prices up substantially. Prices should also stay in check due to the new government's initiative to lower electricity tariffs for households, as the government believes they are unjustifiably high.

On a firm fiscal consolidation path

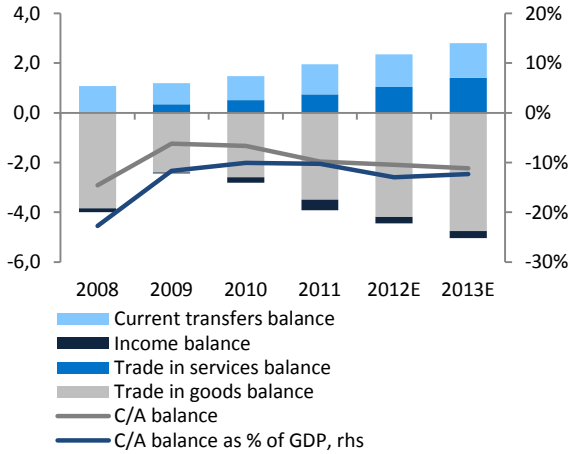
Georgia remains on a firm fiscal consolidation path. We estimate that the general government deficit decreased to 3.3% of GDP in 2012 (despite last year being an election one) from 3.6% in 2011. The government is targeting a deficit of 2.8% this year, but we are more conservative and expect 3.1% gap. The structure of budget expenditures will change considerably in 2013, as the share of capital expenditures will decline close to 20%, down from a 5-year average of 24%. This reduction will allow the government to substantially increase social payments as well as healthcare spending. Reversal of this move is very unlikely, and it will limit maneuverability of fiscal policy in the long term. Still we believe the government will be able to keep the fiscal gap in check despite the change in expenditure priorities. We are confident that the government will easily raise sufficient funds to cover the fiscal deficit. At a minimum, Georgia can tap the aid package that was approved for it in 2008 following a military conflict with Russia. In addition, the government's cash deposits remain

General budget deficit, % of GDP



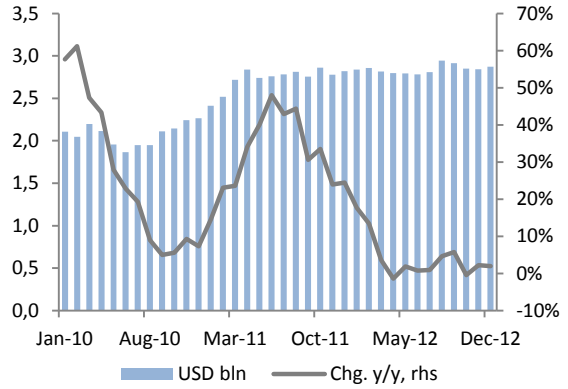
Source: Government of Georgia, SP Advisors

C/A balance structure, USD bln



Sources: NBG, SP Advisors

NBG gross international reserves



Source: NBG

Gross external debt, USD bln

	2010	2011	Sep.12
Gov't, monetary authorities	4,2	4,5	4,8
Banks	1,6	2,1	2,2
Other sectors	1,8	2,1	3,1
FDI: intercompany lending	2,5	2,8	3,0
Gross external debt (GED)	**10,0**	**11,5**	**13,1**
GED as % of GDP	86%	80%	82%

Source: NBG

robust (c. USD 700 mln as of end-November 2012) which eliminates any short term risk the country may fail to fulfill its domestic or external obligations. 2013 schedule of the government's external debt servicing is light with major repayments being the USD 145 mln for an IMF loan (provided as direct budget support in 2009) and the USD 65 mln of maturing Eurobonds (the latter being a remainder of the USD 500 mln Eurobond issue that was repurchased by the government ahead of schedule in 2011). Georgia's public debt remains at a reasonable 36% of GDP, and we expect it to remain flat in 2013.

External accounts to remain balanced in 2013

We project Georgia's current account deficit to narrow marginally from an estimated 13.1% in 2012 to about 12.6% of GDP in 2013. In absolute terms it should remain virtually unchanged at close to USD 2.2 bn.

The trade balance in goods is set to deteriorate driven down by imports on the back of increase of household expenditure. We don't expect exports to get a serious boost from renewed access to the Russian market and to be able to keep pace with imports growth. Though relations between the two countries seem to be on the mend, any meaningful increase in trade turnover with Russia still seems to be a long-term prospective. We think exports of services will continue to grow robustly and should even accelerate due to completion of tourist-related infrastructure projects. Transfers from migrants (still the largest source of sustainable FX inflows to the country) should grow by 3-5% this year. In the longer term, we project current account deficit to narrow slowly but not below 9% of GDP.

In 2013 the financial account surplus may decline slightly versus 2012. Last year was very successful for the Georgian private sector in terms of raising external debt. Georgian Oil and Gas Corporation and Bank of Georgia each attracted USD 250 mln via successful 5-year Eurobond placements. Georgian Railway issued a USD 500 mln 10-year Eurobond, while repurchasing a USD 250 mln 5-year Eurobond. Last year's debt issues largely reflected delayed demand for capital, as businesses had been long waiting for improvement in global debt markets. In 2013, the private sector is unlikely to tap public debt markets on same scale as in 2012, which gives us reason to think external borrowings may decline this year.

2013 FDI may increase only marginally as the post-election period will deter further increase in investments. Investors are waiting for more clarity regarding priorities in economic policy and may want more assurance from the government that property rights will be respected in full.

Overall we expect Georgia's financial account surplus to decline slightly to about USD 2.1 bln from an estimated USD 2.2 bln in 2012. This will leave the external financing gap (combined balances of current account and financial account) at roughly USD 50-150 mln. The gap can be safely covered with the NBG reserves and will put only moderate pressure on Georgian currency. We project end-2013 GEL:USD rate at 1.72.

Georgia is scheduled to repay USD 392 mln (including interest and a USD 145 mln portion due from the Ministry of Finance) to IMF this year. Such a sizable repayment still should not pose major threats to economic stability. Should risks arise, the NBG can tap IMF loans once again. In April 2012, the Fund launched a new USD 286 mln two-year program for Georgia, which followed the mid-2011 expiration of a 33-month Stand-By agreement. The NBG treats this loan as precautionary and has not drawn any money from it, yet. We expect the NBG's gross international reserves to decline to USD 2.5 bln from USD 2.9 bln as of end 2012. This amount will cover 2.7 months of 2013E import of goods and services, which is still a safe level.

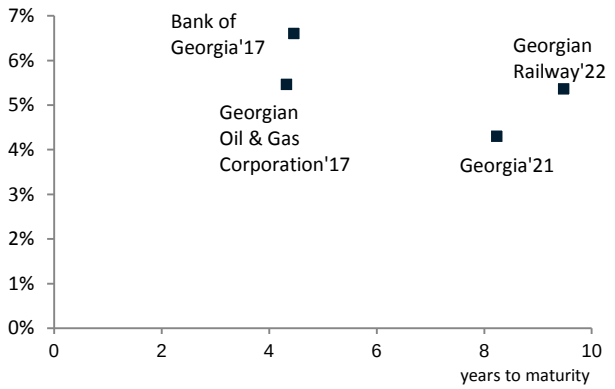
Macro Data and Projections

	2007	2008	2009	2010	2011	2012E	2013E
Economic activity							
Real GDP, y/y	12.3%	2.3%	-3.8%	6.3%	7.2%	6.4%	5.1%
Nominal GDP, GEL bln	17.0	19.1	18.0	20.7	24.3	26.3	28.8
Chg. y/y	23%	12%	-6%	15%	17%	8%	10%
Nominal GDP, USD bln	10.2	12.8	10.8	11.6	14.4	15.9	17.2
Chg. y/y	31%	26%	-16%	8%	24%	10%	8%
GDP per capita, USD	2,315	2,921	2,455	2,641	3,243	3,544	3,799
Chg. y/y	31%	26%	-16%	8%	23%	9%	7%
CPI, eop	11.0%	5.5%	3.0%	11.2%	2.0%	-1.4%	4.5%
External accounts							
Merchandise trade balance, USD bln	-2,9	-3,8	-2,4	-2,6	-3,5	-4.2	-4.8
Service trade balance, USD bln	0,16	0,02	0,34	0,51	0,75	1.0	1.4
Trade balance, USD bln	-2,7	-3,8	-2,1	-2,1	-2,7	-3.1	-3.3
% of GDP	-26.9%	-29.8%	-19.1%	-17.8%	-19.0%	-19.7%	-19.4%
Current account balance, USD bln	-2,0	-2,9	-1,2	-1,3	-2,0	-2.1	-2.2
% of GDP	-19.8%	-22.8%	-11.5%	-11.4%	-13.6%	-13.1%	-12.6%
Foreign direct investment (inward), USD bln	1,8	1,6	0,7	0,8	1,1	0.8	0.9
Capital and financial account balance, USD bln	2,4	2,3	1,3	1,2	2,3	2.2	2.1
NBG gross international reserves, USD bln	1,4	1,5	2,1	2,3	2,8	2.9	2.5
Exchange rates							
USD/GEL, eop	1.59	1.67	1.69	1.77	1.67	1.66	1.72
USD/GEL, avg	1.67	1.49	1.67	1.78	1.69	1.65	1.68
Fiscal indicators							
General budget balance, % of GDP	-4.8%	-6.5%	-9.2%	-6.7%	-3.6%	-3.3%	-3.1%
Central government debt, USD bln	n/a	3.1	3.7	4.3	4.7	5.1	5.4
as % of GDP	n/a	24%	34%	37%	33%	32%	32%
Banking sector							
Bank deposits, GEL bln	3.51	3.84	4.17	5.82	7.35	7.91	8.54
Chg. y/y	66%	10%	9%	39%	26%	8%	8%
% of GDP	21%	20%	23%	28%	30%	30%	30%
Bank loans, GEL bln	4.63	6.06	5.25	6.33	7.80	8.73	9.60
Chg. y/y	71%	31%	-13%	20%	23%	12%	10%
% of GDP	27%	32%	29%	31%	32%	33%	33%
Loan-to-deposit ratio	132%	158%	126%	109%	106%	110%	112%

Sources: GeoStat, NBG, Ministry of Finance, SP Advisors

Selected Macro and Fixed Income Trends

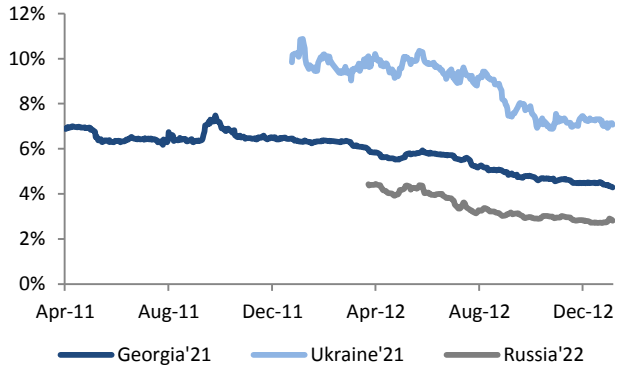
Georgia Eurobond yield map*



** data are as of Jan. 17, 2013*

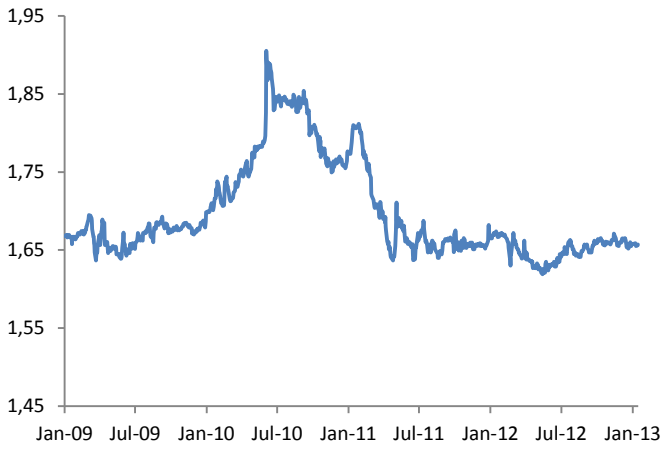
Source: Bloomberg

Sovereign Eurobond YTM: Georgia vs. peers



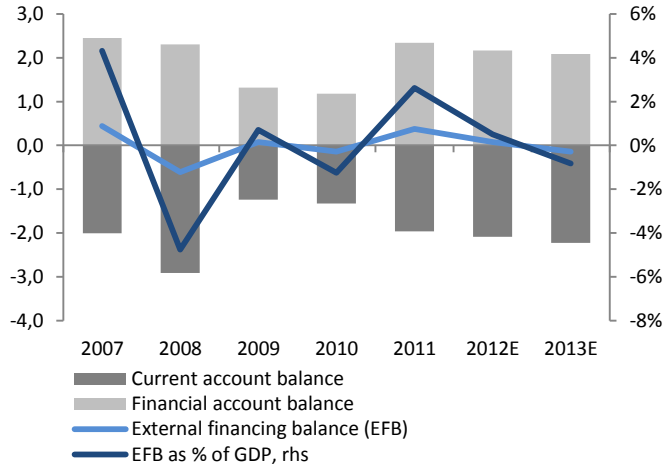
Source: Bloomberg

GEL:USD exchange rate



Source: Bloomberg

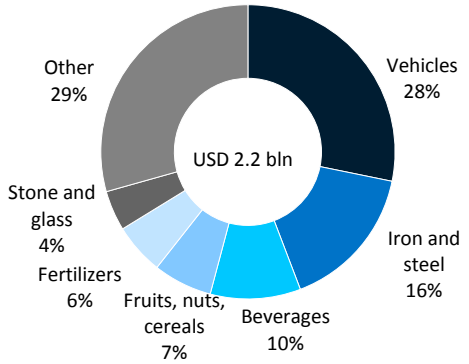
External financing balance, USD bln*



** combined balance of C/A and financial account*

Source: NBG, SP Advisors

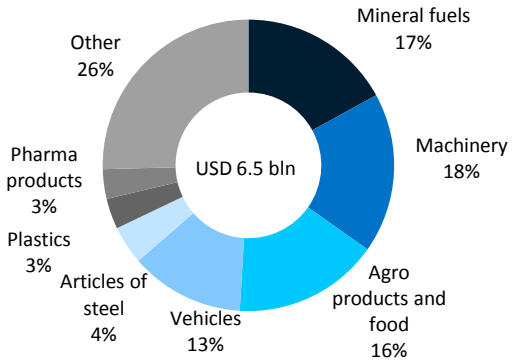
Commodity export by groups in 11M12



** export of vehicles mainly represents re-export of previously imported vehicles*

Source: NBG

Commodity import by groups in 11M12



Source: NBG

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