

Georgian Macroeconomic Review

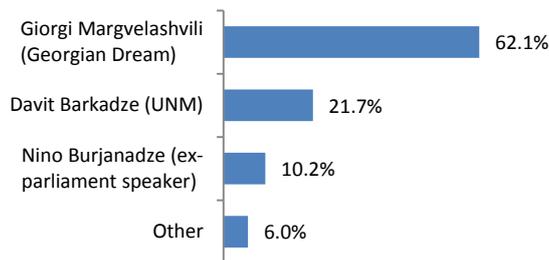
Economy

Macro Data and Projections

Selected Macro and Fixed Income Trends



Presidential vote results



Leading Georgian parties' support ratings

	Parliamentary election (Oct. 1, 2012)*	Presidential election (Oct. 27, 2013)**
Georgian Dream (PM Ivanishvili)	55.0%	62.1%
UNM (President Saakashvili)	40.3%	21.7%

* party approval according to party lists

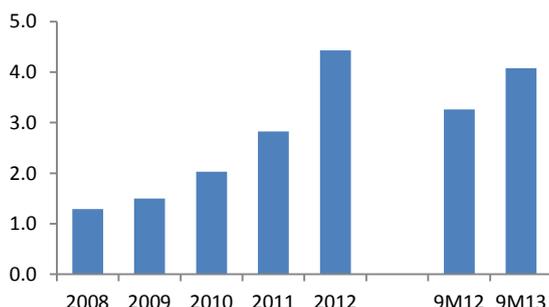
** approval of the nominated Presidential candidate

Summary of key changes to the Georgian Constitution (effective on the new president's inauguration Nov. 17, 2013)

- The president remains the head of state and commander-in-chief and will represent the country abroad, but will no longer be the top foreign relations representative
- The PM and government will now lead and exercise domestic and foreign policy instead of the president
- The president will have the right to carry out negotiations with foreign governments and sign international treaties, but only with government approval
- The president will have the right to appoint or dismiss the Armed Forces chief of staff and other top military commanders, but only with government agreement
- Many legal acts issued by the president will require authorization from the PM
- The president must seek government approval to appoint or dismiss ambassadors
- The president loses the right to initiate draft laws
- The president will have the right to veto the parliament's nominations for PM. The procedure for a non-confidence vote is lengthy and complex and may take up to 80 days in the case of a presidential veto on a PM nominee

Source: www.civil.ge

Non-resident visits to Georgia, mln



Source: Georgian National Tourism Administration

Smooth transition of power ends a year of political cohabitation

The presidential election in Georgia last Sunday ended a period of political cohabitation as Giorgi Margvelashvili from the ruling Georgian Dream coalition won a convincing victory with 62.1% of votes cast. Davit Bakradze, a close presidential ally and United National Movement (UNM) leader, secured just 21.7% of votes. Independent candidate Nino Burjanadze, the ex-parliamentary speaker and a vocal critic of the outgoing president, finished third with 10.2%. In a post-election address, Saakashvili claimed he respects the public's opinion but believes the current developments are a serious setback for Georgia.

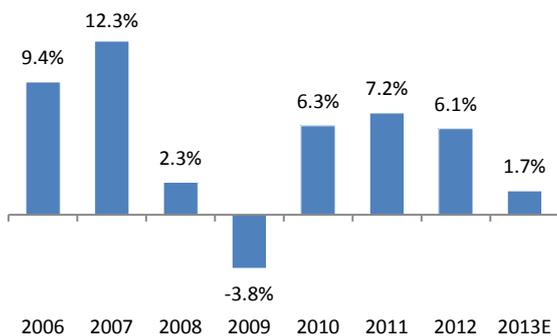
The election results represent a decline in approval ratings for Saakashvili's party, which garnered 40.3% in a party-list parliamentary vote last year. Since the October 2012 vote, 13 UNM MPs have deserted the minority parliamentary group, effectively pushing UNM to the political backstage.

Many Georgian and international political observers attribute UNM's low approval to electoral fatigue following Saakashvili's almost 10-year rule and a series of major political mistakes, including an armed conflict and reluctance to restore economic ties with Russia, in the final years of his presidency.

PM Bidzina Ivanishvili has also claimed he will quit political life after the new president's inauguration on November 17 (about a year after being elected PM). Ivanishvili claims his key goal – "the restoration of rule of law" – has been achieved. He is preparing to name a successor in the coming days and we don't anticipate any roadblocks from parliament. Although he is bowing out of public politics, we believe Ivanishvili will remain strongly involved with the party and all major political and economic decisions will likely require his consent. His Georgian Dream coalition is comprised of 6 parties and his involvement will help ensure that intra-coalition squabbles don't shake the ruling alliance.

The election of a new president will change virtually nothing in terms of economic policy. The constitutional landscape in Georgia has been considerably reshaped over the past few years and the final package of amendments will come into force with the president's inauguration on. The president will completely lose influence over government activities and will become a figurehead with no leverage to shape economic strategy. We expect the current government will maintain a focus on social issues and expedite large-scale investment projects. Needless to say, restoring economic ties with Russia will be a top priority for the government. Other than that, we see no chance for major policy changes or for a reversal of Georgia's commitment to signing an association agreement with the EU.

Real GDP, chg. yoy



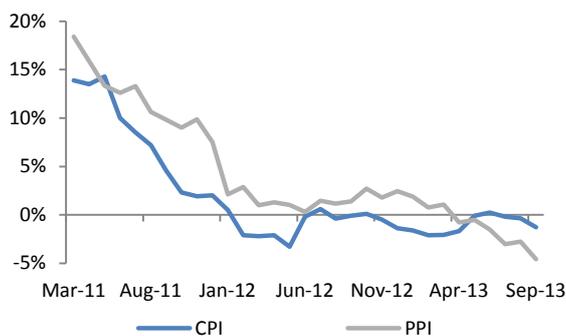
Sources: GeoStat, SP Advisors

Changes to 2013 macro projections

	New	Old
GDP, chg. yoy	1.7%	3.8%
C/A balance, % of GDP	-6.9%	-11.3%
GEL/USD, eop	1.65	1.65

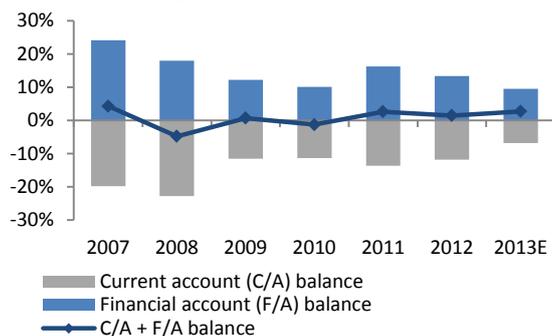
Source: SP Advisors

CPI and PPI, yoy



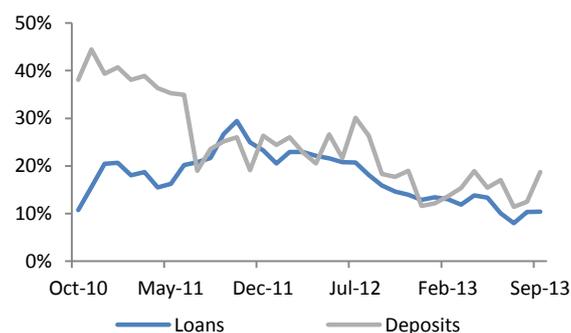
Source: GeoStat

External financing gap, % of GDP



Sources: NBG, SP Advisors

Banking sector loans and deposits, chg. yoy



Sources: NBG, SP Advisors

GDP growth to remain weak through 1H14

The Georgian economy continues to lose steam: GDP growth slowed to 1.3% yoy in 3Q13 from 1.5% yoy in 2Q13. By our estimates, export is the only demand component that continues to substantially contribute to GDP growth. Apart from the increase in commodity exports (est. 6-8% in real terms in 9M13), growth in tourist visits (+25% yoy in 9M13) is a very bright spot.

A noticeable drop in demand for investment goods remains the key impediment – the government hasn't yet revised its large-scale investment project plan and has kept infrastructure spending at a minimum. At this point, the projects currently on hold are unlikely to be re-initiated in the coming months, which suggests little chance for a major revival in economic activities through 1H14.

We estimate that private household demand has had a marginally positive contribution to GDP growth YTD, but it should lend greater support to the economy going forwards. Household income growth remains fairly strong as average salaries added 10% yoy in 2Q13 which, given the continued deflation, implies even stronger growth in real terms.

Overall, we downgrade our 2013 GDP growth outlook to 1.7% yoy from 3.8%, but continue to expect an acceleration to 2.5-3.0% in 2014 on stronger private consumption. Robust retail lending by banks (retail portfolio up 20% yoy at end-September) should also support stronger consumption and is also a sign of positive consumer sentiment.

C/A gap narrows sharply on a decline in imports

The Georgian economy has seen an unexpectedly powerful adjustment in the C/A deficit despite virtually no change in the exchange rate. The C/A gap narrowed to USD 0.45 bln in 1H13 from USD 1.0 bln in 1H12. The contraction is mainly due to a narrowing of the merchandise trade deficit as imports of investment and consumption goods slowed while commodity exports rose 7% in nominal terms. Given the stronger-than-expected trade adjustments we upgrade our projection for the 2013 C/A deficit to 6.9% of GDP from 11.3% previously. That would leave the country's smallest C/A gap in the last decade.

Capital inflows to Georgia have also subsided. While FDI inflows were relatively unchanged yoy in 1H13, corporate sector borrowings have plummeted. Three corporate Eurobond issues last year paved the way for heavy capital inflows that would be difficult to match this year.

We still expect a strong external financing surplus (combined C/A and financial account balances) of about USD 0.4 bln in 2013. NBG reserves will continue growing to exceed USD 3.1 bln (+9% yoy), an all-time high, by end-2013. The NBG continues to repay its IMF debt smoothly, and USD 440 mln of IMF funding remains outstanding. The repayment schedule is benign, with tranches stretched over the next two years.

Still committed to fiscal consolidation

Georgia's fiscal policies remain prudent even though the 2013 budget plan won't be met. Central budget tax revenues were flat yoy in 8M13 while the plan lays out 10% yoy growth for the full year. The government addressed the challenge by cutting current expenditures. A sizable increase in public wage outlays (+13% yoy in 8M13) and social protection (+16%) was more than offset by cuts in purchases of goods and services by government (-40%).

The government is targeting a budget deficit of 2.9% of GDP for 2013. Based on current performance this seems achievable.

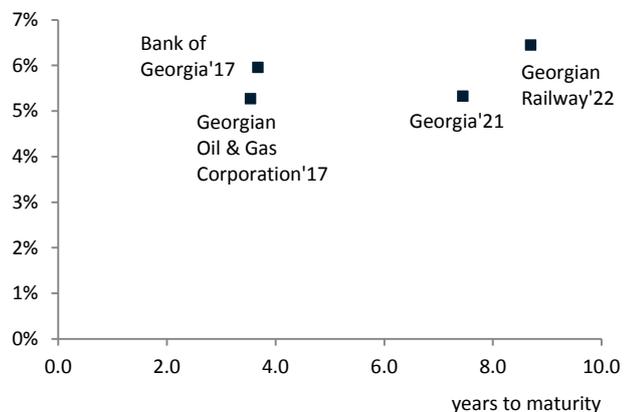
Macro Data and Projections

	2007	2008	2009	2010	2011	2012	2013E
Economic activity							
Real GDP, yoy	12.3%	2.3%	-3.8%	6.3%	7.2%	6.1%	1.7%
Nominal GDP, GEL bln	17.0	19.1	18.0	20.7	24.3	26.1	26.8
chg. yoy	23%	12%	-6%	15%	17%	7%	3%
Nominal GDP, USD bln	10.2	12.8	10.8	11.6	14.4	15.8	16.2
chg. yoy	31%	26%	-16%	8%	24%	10%	2%
GDP per capita, USD	2,315	2,921	2,455	2,641	3,243	3,521	3,582
chg. yoy	31%	26%	-16%	8%	23%	9%	2%
CPI, eop	11.0%	5.5%	3.0%	11.2%	2.0%	-1.4%	0.7%
External accounts							
Merchandise trade balance, USD bln	-2.9	-3.8	-2.4	-2.6	-3.5	-4.2	-3.8
Service trade balance, USD bln	0.2	0.0	0.3	0.5	0.7	1.1	1.4
Trade balance, USD bln	-2.7	-3.8	-2.1	-2.1	-2.7	-3.1	-2.4
% of GDP	-26.9%	-29.8%	-19.1%	-17.8%	-19.0%	-19.7%	-14.8%
Current account balance, USD bln	-2.0	-2.9	-1.2	-1.3	-2.0	-1.9	-1.1
% of GDP	-19.8%	-22.8%	-11.5%	-11.4%	-13.6%	-11.8%	-6.9%
Foreign direct investment (inward), USD bln	1.8	1.6	0.7	0.8	1.0	0.9	0.8
Capital and financial account balance, USD bln	2.4	2.3	1.3	1.2	2.4	2.1	1.6
NBG gross international reserves, USD bln	1.4	1.5	2.1	2.3	2.8	2.9	3.1
Exchange rates							
GEL/USD, eop	1.59	1.67	1.69	1.77	1.67	1.66	1.65
GEL/USD, avg	1.67	1.49	1.67	1.78	1.69	1.65	1.66
Fiscal indicators							
General budget balance, % of GDP	-4.8%	-6.5%	-9.2%	-6.7%	-3.6%	-2.9%	-2.9%
Central government debt, USD bln	2.3	3.2	4.0	4.6	5.3	5.5	5.3
as % of GDP	23%	25%	37%	39%	37%	35%	33%
Banking sector							
Bank deposits, GEL bln	3.51	3.84	4.17	5.82	7.35	8.20	9.52
chg. yoy	66%	10%	9%	39%	26%	12%	16%
% of GDP	21%	20%	23%	28%	30%	31%	35%
Bank loans, GEL bln	4.63	6.06	5.25	6.33	7.80	8.81	9.69
chg. yoy	71%	31%	-13%	20%	23%	13%	10%
% of GDP	27%	32%	29%	31%	32%	34%	36%
Loan-to-deposit ratio	132%	158%	126%	109%	106%	107%	102%

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

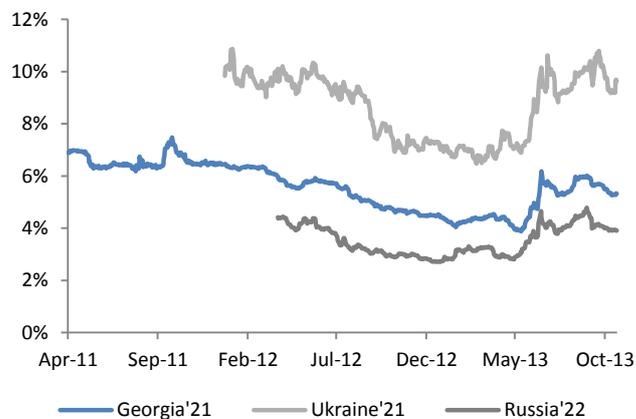
Selected Fixed Income and Macro Trends

Georgia Eurobond yield map*



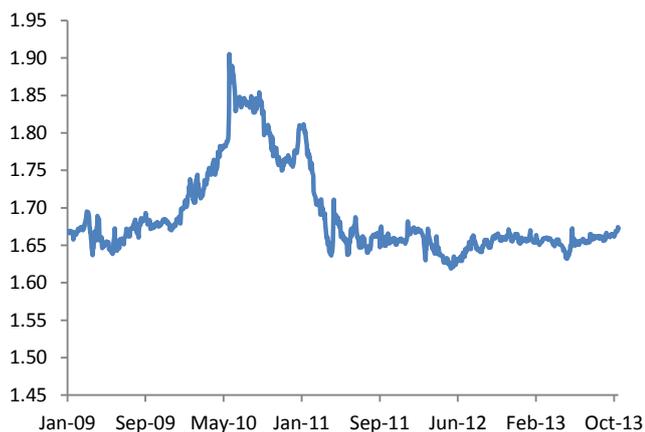
* data as of Oct. 30, 2013
Source: Bloomberg

Sovereign Eurobond YTM: Georgia vs. peers



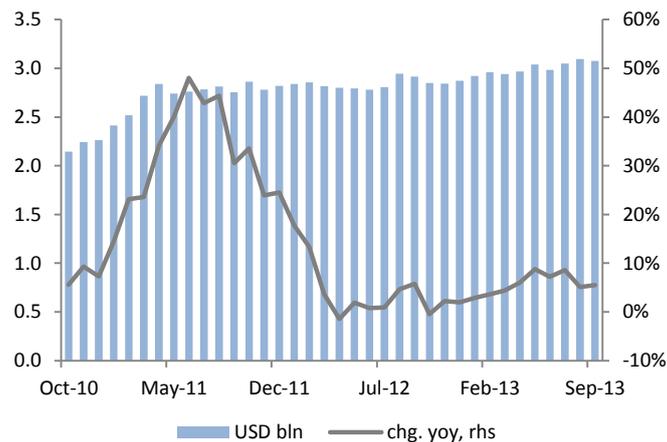
Source: Bloomberg

GEL/USD



Source: Bloomberg

NBG gross international reserves



Source: NBG, SP Advisors

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