



# Georgian Economy Inflation Expectations

Georgia | Economy  
January 5, 2021

In December 2020, CPI inflation came in below expectations. There was 1.0% deflation m/m, while annual inflation rose 2.4%. NBG's inflation expectation for the 4Q was above 3.0% inflation target in its Monetary Policy Report published in November 2020, while we expected end-year prices at 4%. The main reason behind lower than expected inflation in December was government subsidies for utility bills, subtracting 1.94ppts from overall inflation rate. The core inflation (excluding food and energy prices) remained high at 5.3% y/y compared to the headline, as food price dynamic and low energy prices along with lower utility bills dragged headline inflation down. The exchange rate pass-through could be one of the factors to affect non-food prices, given higher share of imports in the domestic non-food market. Meanwhile, inflation in services remained muted due to both quarantine restrictions and absence of international tourism.

### Utility subsidies drove CPI inflation down

In December, prices decreased in 4 out of the 12 main spending groups on an annual basis. The largest contribution came from utility category, where prices decreased by 21.7% y/y (with water supply prices down 36.5% y/y, and electricity, gas and other fuels prices down 30.1% y/y), pulling annual inflation down by 1.94ppts in December. Based on Geostat, this reduction reflected utility (electricity, gas and water) subsidies for low-energy consumers by government for 4 months (from November to February), based on government decree of 30 October 2020 (notably, the same subsidies have not been considered by Geostat in spring and November 2020). The prices reduced slightly in 3 other categories: clothing and footwear (-0.9% y/y), transport (-2.3% y/y) and recreation and culture (-2.8% y/y). The prices increased in 7 out of 12 categories, while prices remained flat in communication. In food and non-alcoholic beverages category (with largest 31.3% share in consumer basket), the prices increased by 6.8% y/y adding 2.19ppts to the overall annual inflation rate. Within the group the prices of most of the goods increased, while the prices decreased for fruit and grapes (-4.5% y/y). In healthcare category the prices went up by 9.6% y/y, contributing 0.76ppts to the overall annual inflation rate.

### Expectations on inflation

In the coming months, the inflation outlook expected to be driven by the balance of inflationary and disinflationary risks, exchange rate developments, along with domestic demand:

- The uncertainty over the balance of disinflationary and inflationary risks prevail more in 2021 than in 2020. On the one hand, utility subsidies for households already in place for January and February and prolongation of subsidies for low energy users communicated by the government to mitigate recent rise in utility prices will push inflation down. On the other hand, utility price increase for commercial users will ultimately be reflected in final prices as increase in supply-side costs and the effect of the pandemic reduce incentives to price competition.
- We expect an economic recovery from 2Q21 and inflation at 4.5% in 2021. The key indicators to determine monetary policy decisions, in our view, are: 1) GEL exchange rate, 2) risks related to more prolonged pandemic/quarantines effects, and 3) sustained growth in world commodity prices. In our view, these factors will impede a disinflation momentum and delay key rate cut. Furthermore, as utility subsidies will continue in 2021 we see core inflation dynamic to be more relevant for evaluating price dynamic and monetary policy considerations. We see more chances for the key rate cut in 2H21 if tourism resumes and GEL appreciates against dollar at 3.1/\$.

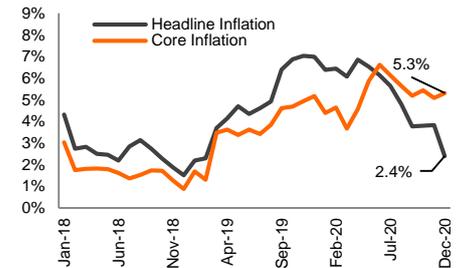
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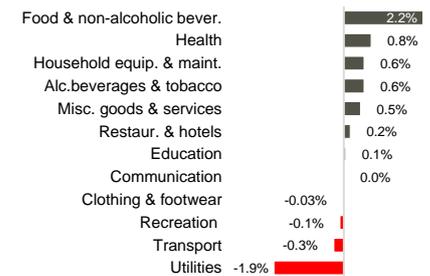
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Figure 1: Annual inflation



Source: Geostat

Figure 2: Contributions to the annual CPI inflation, December 2020



Source: Geostat

Table 3: CPI inflation, December

Period	2018	2019	2020
Monthly	0.5%	0.4%	-1.0%
Annual	1.5%	7.0%	2.4%
Average	2.6%	4.9%	5.2%

Source: Geostat



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