



# MACRO UPDATE

## BEHIND THE GEL STRENGTHENING

11 FEBRUARY 2025

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TBC Group Chief Economist Office

# KEY TAKEAWAYS

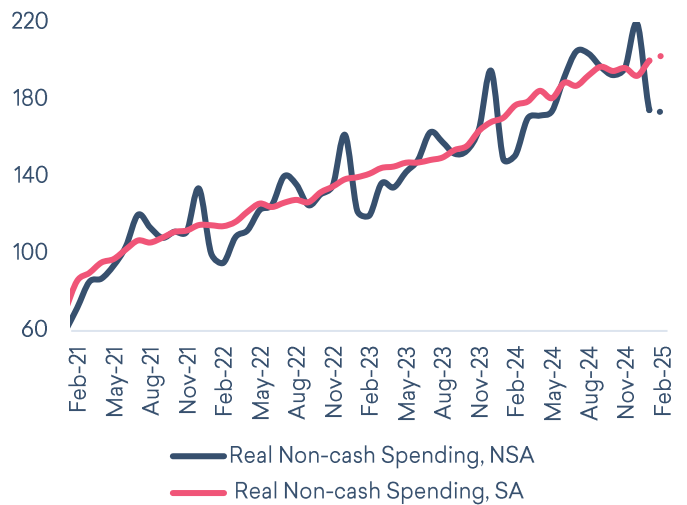
- First of all, we note that, as discussed in our [previous macro update](#), based on the main sources of net FX inflows, we are not betting on even somewhat large GEL swings in the near term;
- In fact, unlike most market participants, the recent slight GEL appreciation came as no surprise;
- [Once again](#), to illustrate the relative importance of FX flows, we highlight the major sources (4Q23-3Q24): imports of goods (\$14.7 bn); exports of goods (\$8.3 bn); gross tourism revenues w/o migration (c. \$4.0 bn); migration impact (c. \$1.1 bn); tourism outflows (\$490 mn); net remittances (\$4.0 bn); net dividends (\$1.1 bn); net reinvestment (\$1.0 bn); net FDI without reinvestment (-\$147 mn); net portfolio investments, loans and other investments by sector: government (\$309 mn), private sector (\$192 mn), commercial banks (-\$133 mn);
- Which of these flows are most impacted? Tourism inflows, including the import component of up to 45%; demand for durables, which are almost entirely imported in Georgia; and investments;
- While looking at the latest data, including February, the impact appears to be growth-negative, especially on imports, but not GEL-negative;
- Furthermore, as of early February, we observe some recovery in tourism revenues, while the demand on durables has remained subdued;
- Not to forget the so-called good time buffer, estimated at around or more than a billion USD, stemming from higher deposit dollarization and credit larization, with the latter stocks, as of Dec-24, standing at a sizeable \$12.6 bn (USD equivalent) for GEL credit, \$9.6 bn for FX credit, \$9.8 bn for GEL deposits and \$10.9 bn for FX deposits;
- In this regard, lately we observe no significant further deposit conversions, while, on the credit side, FX loans have relatively accelerated, which is GEL-positive;
- Last but not least, in the context of the [GEL/EUR/USD strategy](#), considering heightened uncertainty, we reiterate our recommendation for diversification and for staying [medium-to-long run indicators-oriented](#), so as to avoid short-term overreaction, which often, if not always, has led to significant losses.

The efficient market hypothesis postulates that changes in asset prices stem from new information, i.e. all available information at any given moment is already priced in. The same holds true for nominal exchange rates. Lately, the GEL has experienced sizeable volatility, with the USD/GEL depreciating by over 5% from 2.74 on November 28 to 2.88 in exactly two months as of January 28, reflecting the pricing in of worsening sentiments on the markets. Since then, however, the GEL has gained back some ground, appreciating to c. 2.78 as of February 10. We argued in [our previous update](#) that our stance on the GEL in 2025 was broadly neutral, perhaps slightly tilted towards somewhat weakening, with USD/GEL c. 2.90 in our mind. Absent new material shocks in either direction, domestically or internationally, we keep the broadly neutral stance. To build on our previous arguments, let's dive further into the reasoning behind our position and why, from this perspective, the GEL has been appreciating recently.

The central point, perhaps, that we would like to make is that the economic nature of the ongoing tensions is a confidence shock, which is growth-negative but not necessarily so for the GEL. Deteriorating sentiments have resulted in a cutback of consumer expenditures, lowering overall demand. Non-cash spending through TBC channels, our proxy for economic activity, slowed down in the last quarter of 2024, particularly in December, when, in seasonally adjusted terms, it fell slightly below the level reached four months prior in August (Figure 1). In January 2025, spending recovered after the December fall and, in seasonally adjusted terms, overtook the Nov-24 level as well. Moreover, as of the 1<sup>st</sup> week, February is on course to continue the pick-up.

At the same time, importantly, spending growth remains weaker compared to previous years.

**FIGURE 1: NON-CASH SPENDING THROUGH TBC CHANNELS RECOVERED SINCE DECEMBER BUT GROWTH HAS DECELERATED COMPARED TO PREVIOUS YEARS** (Index, 2021 = 100, As of 06-Feb)



Source: TBC Capital

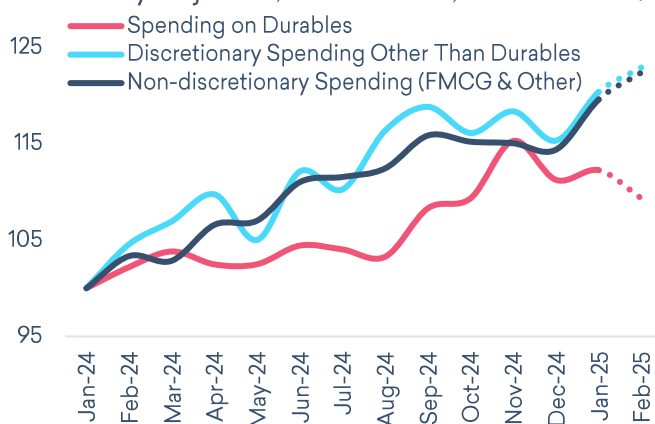
Note: Non-cash spending dynamics partially reflect the expenditure switching trend to digital channels as well as the growing number of available digital payment platforms.

Weaker domestic demand, contrasted to a decline in external inflows, which is both GEL- and growth-negative, implies weaker demand for imports and therefore a twofold impact – growth-negative but GEL-positive. During confidence crises, the most vulnerable part of consumption is on durable goods, which imply relatively large outlays, are non-essential in the short term and, in case of Georgia, happen to be almost entirely made up from imports. Consumer durables, together with residential investment, are most sensitive to changing sentiments and, therefore, often a reliable leading indicator for the business cycle. In order to identify the drivers behind reduced expenditures, we group non-cash spending through TBC channels into three categories:

- Non-discretionary spending (FMCG and other, e.g. utilities, pharmacy, etc.);
- Spending on durables (e.g. electronics, furniture);
- Discretionary spending other than durables (e.g. eating out, entertainment, delivery services, etc.).

Figure 2 plots spending in these categories in seasonally adjusted terms, with Jan-24 indexed to 100. What can we infer from this data? First, December slowdown was by far and large driven by a plunge in durables and other discretionary spending, which are highly elastic to confidence shocks; second, while other categories have seen a recovery in January and the beginning of February, durables have remained depressed.

**FIGURE 2: SPENDING ON DURABLES PLUNGED IN DECEMBER AND HAS SEEN LITTLE RECOVERY IN JANUARY-FEBRUARY** (Index, Seasonally Adjusted, Jan-24 = 100, As of 06-Feb)

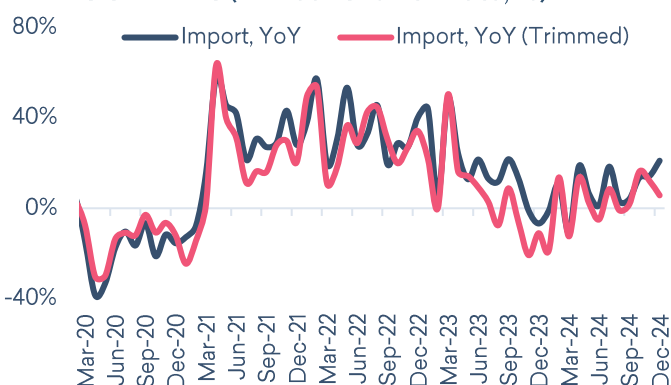


Source: TBC Capital

Note: Non-cash spending dynamics partially reflect the expenditure switching trend to digital channels as well as the growing number of available digital payment platforms.

The accompanying slowdown in imports is not readily visible in December data, as the growth rate, in fact, accelerated – a counterintuitive development. However, upon further inspection, this acceleration was driven by a few outliers, and, examining trimmed imports, the slowdown is evident (Figure 3).

**FIGURE 3: DESPITE SLOWDOWN IN DEMAND, IMPORTS ACCELERATED IN DECEMBER, BUT THIS GROWTH WAS LARGELY DRIVEN BY A FEW OUTLIERS** (Annual Growth Rate, %)



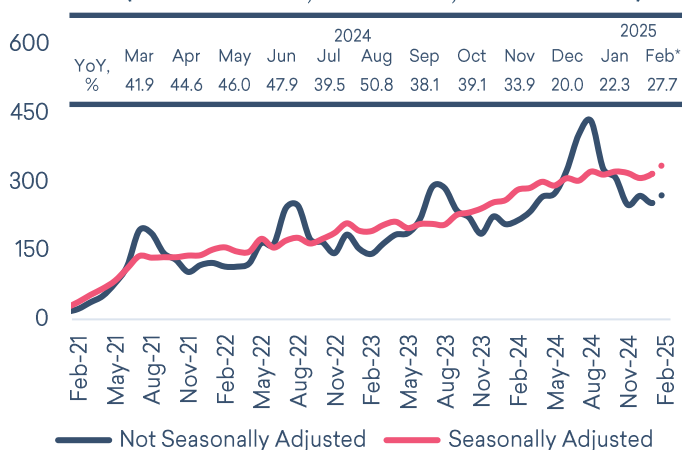
Source: Geostat, TBC Capital

Note: Top and bottom 10 products with respect to overall value are excluded from trimmed imports for each month.

With imports of goods accounting for almost 45% of GDP in the last four quarters, only slightly lower than goods exports (25%), tourism revenues (13%) and money transfers (12%) altogether, import slowdown is a material development for the GEL outlook. At the same time, out of these three major sources of inflows, tourism revenues are most vulnerable to internal tensions, while money transfers entirely and merchandise exports, at least to a large extent, are driven by exogenous factors and, therefore, ought to be unaffected. Moreover, tourism revenues incorporate a significant import component, up to 50% per our estimates, which also needs to be considered.

This vulnerability in the hospitality sector was evident in the dynamics of non-resident non-cash spending through TBC channels, our proxy for conventional tourism. In January, non-resident expenses a) fell harder than those of residents, and b) although growing on a monthly basis, remained well below the November level (Figure 4). However, in the 1<sup>st</sup> week of February, non-resident spending has accelerated significantly, both in monthly and annual terms. This could be linked with the European Youth Olympic Festival, which is held during February 6-16.

**FIGURE 4: NON-CASH EXPENSES OF NON-RESIDENTS IN TBC CHANNELS RECOVERED MILDLY IN JAN-25 BUT LOOK STRONG IN FEB-25 SO FAR** (Index in USD, 2021 = 100, As of 06-Feb)



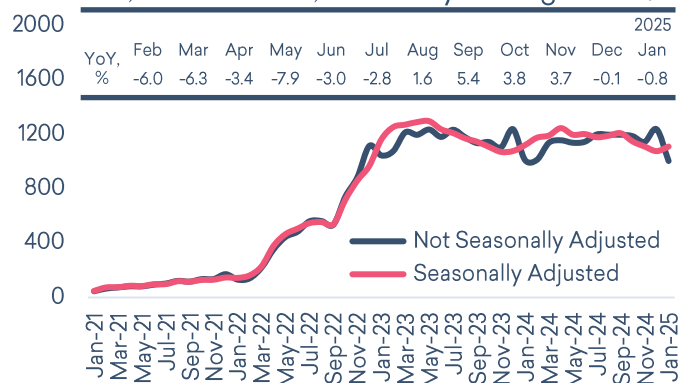
Source: TBC Capital

Note: Non-cash spending dynamics partially reflect the expenditure switching trend to digital channels as well as the growing number of available digital payment platforms.



In January, similar dynamics can be observed for migrant expenses with TBC cards, which recovered from a 12-month low as of December, but fell short of the Nov-24 level (Figure 5). Here we again note that shrinking migrant expenses are not necessarily driven by [outflows](#), but, rather, likely following the same pattern as resident spending, in light of both being affected by a similar confidence shock.

**FIGURE 5: NON-CASH EXPENSES OF RUSSIANS, BELARUSSIANS AND UKRAINIANS WITH TBC CARDS HAVE ALSO DECLINED IN DEC-JAN (As of 31-Jan, Index in USD, 2021 Daily Average = 100)**



Source: TBC Capital

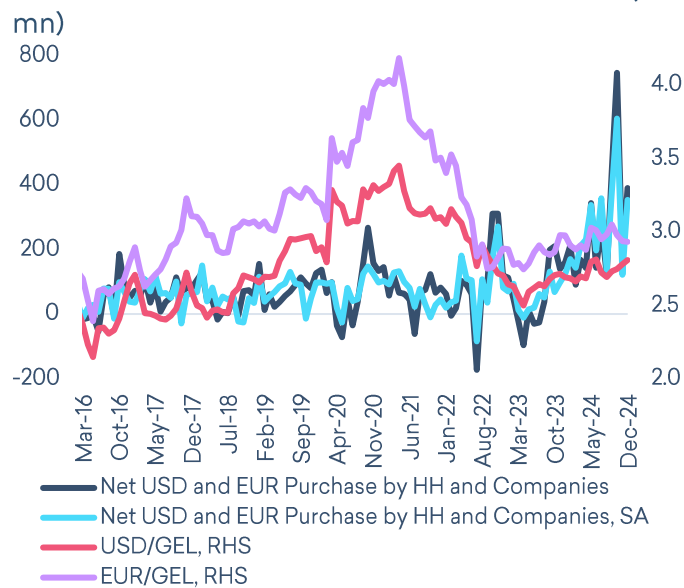
Note: The Data includes Local POS and E-Com Payments. Payments outside Georgia are excluded. Non-cash spending dynamics partially reflect the expenditure switching trend to digital channels as well as the growing number of available digital payment platforms.

While discussing vulnerability towards sentiments from the external sector perspective, we would also like to highlight the sensitivity of investment decisions, for the same exact reason as durables. Therefore, the distribution of FDI-generated profits between reinvested earnings and dividends will be another key player in determining the FX inflow-outflow balance going forward, as, in case of higher dividend distribution, lower reinvested earnings certainly would be an outflow. One can read more about this and the structural decomposition of Georgia's external balance sheet [in our previous note](#).

So far, we have touched upon the external sector drivers of the GEL. What about the domestic component? Deterioration in sentiments is also visible on the FX market, for which we now have December data, fully in line with our expectations.

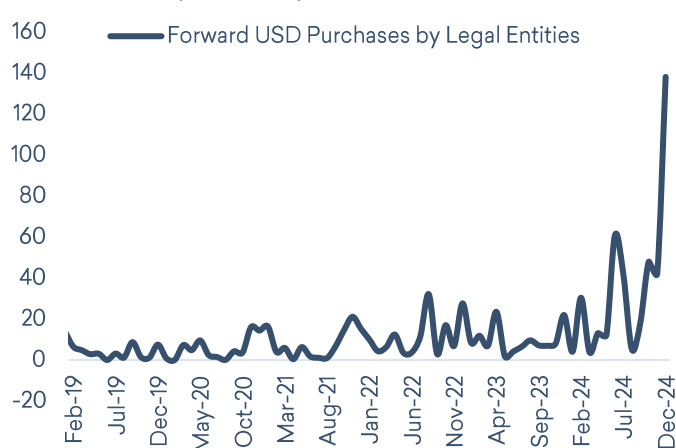
After demand on foreign currency normalized in November, following the [pre-election flight to FX assets](#), December saw both net FX purchases as well as overall FX market turnover spike again, with net purchases lower than in September-October but higher than in May (Figure 6). Moreover, similar to pre-election dynamics, activity in FX forwards surged, pointing at the perceived need by market participants to lock in the exchange rate (Figure 7). Even though conversion costs are far from minor expenses, particularly as net FX purchases have been dominated by legal entities which require the GEL for current expenditures, the continued switching to FX positions indicates the extent of worsening sentiments and risk aversion.

**FIGURE 6: NET USD AND EUR PURCHASE BY HOUSEHOLDS AND LEGAL ENTITIES ON THE FX MARKET INCREASED AGAIN IN DECEMBER (USD mn)**



Source: NBG, TBC Capital

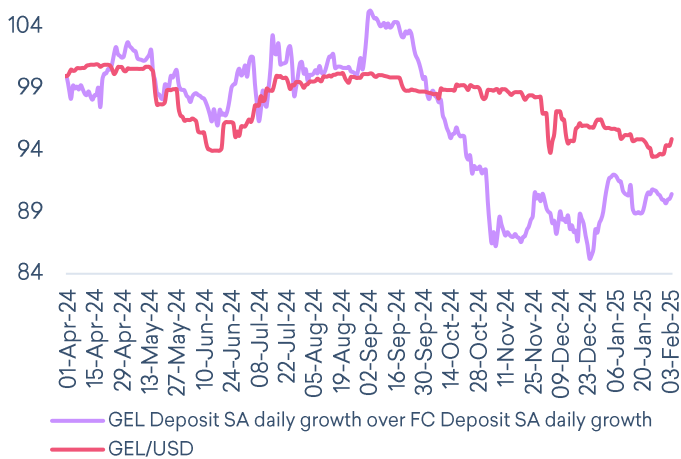
**FIGURE 7: FORWARD USD PURCHASES BY LEGAL ENTITIES REACHED A HISTORIC HIGH IN DECEMBER (USD mn)**



Source: NBG, TBC Capital

This was accompanied by continued deposit conversions in December (Figure 8), as early signs of switching back to the GEL in the 1<sup>st</sup> half of November – materialization of the “[good time buffer](#)” – reversed again. However, compared to the pre-election period, conversions have not been as sizeable, which is a result of a significant amount of FX accumulation by corporates and households, [more than a billion USD per our estimates](#), having already taken place. Therefore, even though the gap between GEL and FX deposits continued to widen and, while further worsening is certainly not ruled out, the marginal (additional) effect of deposit switching has been lower this time, taking into account the [pricing-in phenomenon](#). In January, based on our daily estimates, conversions were largely flat, while the beginning of February has seen a slight increase in GEL deposits thus far.

**FIGURE 8: DAILY CUMMULATIVE ESTIMATES OF DEPOSIT CONVERSIONS INDICATE RELATIVE NORMALIZATION IN JANUARY (31-Mar = 100, seasonally & fc-adjusted, as of 04-Feb-25)**

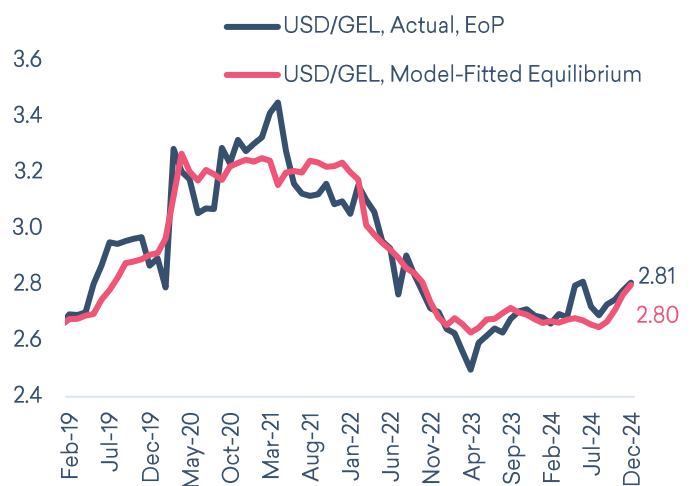


Source: NBG, TBC Capital

Our short-run equilibrium USD/GEL estimate, [incorporating sentiments with macroeconomic drivers](#), weakened again in December, as per our expectations, reflecting weaker external terms as well as rising deposit dollarization (Figure 9).

At the same time, contrary to previous months, FX loans accelerated in December, which is a GEL-positive factor (Figure 10). Based on our preliminary estimates, FX lending has been strong in January as well. We expect the equilibrium USD/GEL estimate to remain broadly unchanged in January, for which data will become available towards the end of the month, since daily estimates of deposit conversions indicate no significant movements and external terms look to have relatively improved compared to December, although the USD strengthened further globally.

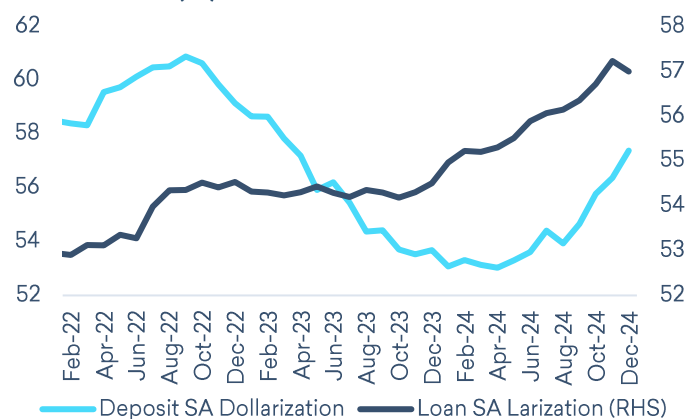
**FIGURE 9: THE GEL EQUILIBRIUM ESTIMATE HAS BEEN WEAKENING SINCE OCTOBER, REFLECTING WEAKER EXTERNAL TERMS AS WELL AS RISING DEPOSIT DOLLARIZATION**



Source: TBC Capital

**Note:** We estimate the USD/GEL exchange rate as a function of GEL and FX deposits and loans, foreign currency inflows (sum of merchandise exports, tourism revenues and remittances) and global USD dynamics (proxied by the DXY index, measuring the value of USD against a basket of global currencies). The model is estimated in log form by the seemingly unrelated regression (SUR) method, allowing error terms to be correlated across the equations.

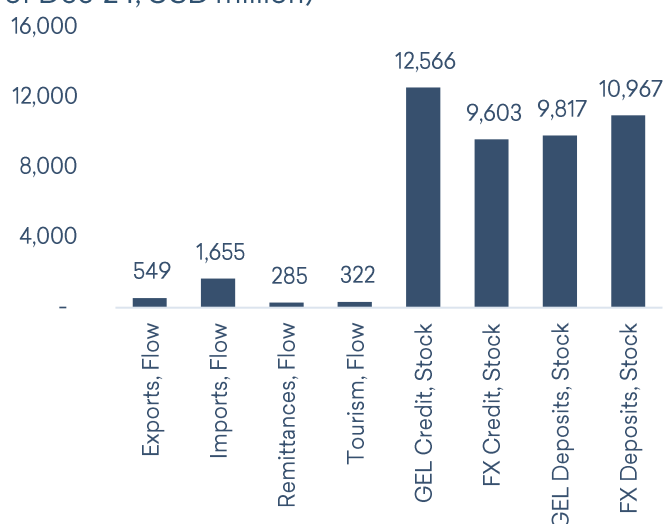
**FIGURE 10: LOAN LARIZATION DECLINED IN DECEMBER (%)**



Source: NBG, Geostat, TBC Capital

We note that, considering the size of deposit and loan stocks in the banking system, as compared to foreign currency inflows, a relatively small change on a monthly basis could have just as much of an impact on the exchange rate, if not larger (Figure 11).

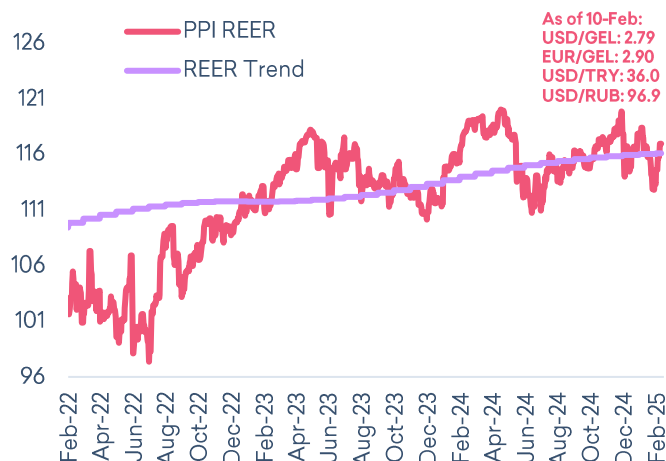
**FIGURE 11: DUE TO THE SIZE OF DEPOSIT AND LOAN STOCKS, A RELATIVELY SMALL CHANGE COULD BE AKIN TO AN EXTERNAL SHOCK** (As of Dec-24, USD million)



Source:NBG, Geostat, TBC Capital

From a longer-run perspective, the GEL real effective exchange rate (REER) fell below the long-term trend in January, particularly towards the end of the month, but, as of February 10, has converged to the trend again (Figure 12).

**FIGURE 12: GEL REER HAS CONVERGED WITH ITS LONG-RUN TREND FOLLOWING JAN-25 WEAKNESS** (As of 10-Feb, Increase Means GEL Appreciation)



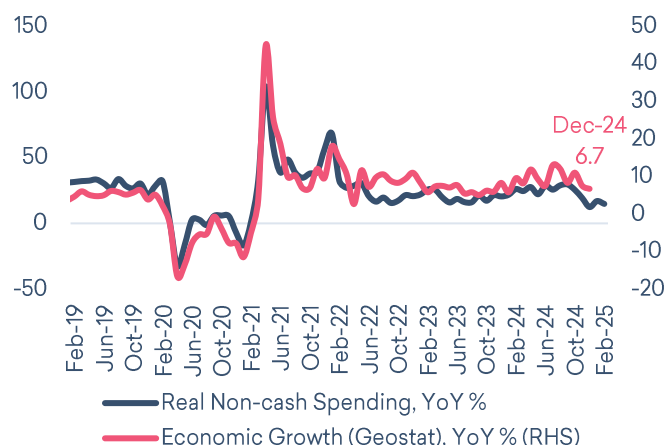
Note: PPI REER data is estimated from January 2013  
REER Trend is estimated based on GDP per capita growth differential between Georgia and its main trading partners using relative trade weights and adjusted for the share of non-tradable sector  
Source: NBG, IMF, WB, TBC Capital

Therefore, both our short- and long-run equilibrium estimates indicate that the GEL is broadly in line with its macro-implied level, also keeping in mind [where the greenback is likely to stand going forward](#). Conversely, further strengthening beyond this level could be a sign of potential overvaluation. However, we do not expect pronounced GEL appreciation in either case, [based on several arguments](#).

Despite GEL depreciation, the NBG remained on the buying side in December, [conforming to our expectations](#), purchasing a net amount of \$29 million on top of \$125 million in November. In January, the data for which will become available at the end of the month, we estimate no significant interventions have taken place. The same is true for the 1<sup>st</sup> week of February thus far, although we expect the NBG to move to replenish reserves should the GEL not weaken going forward.

Elsewhere, economic growth came in at 6.7% in December, rather higher than our expectations as implied by non-cash spending through TBC channels, our proxy for economic activity (Figure 13), as well as other high frequency indicators. The full year growth at 9.5% is, therefore, also higher than our 9.3% estimate.

**FIGURE 13: REAL NON-CASH SPENDING THROUGH TBC CHANNELS AND ECONOMIC GROWTH** (As of 06-Feb, YoY, %)

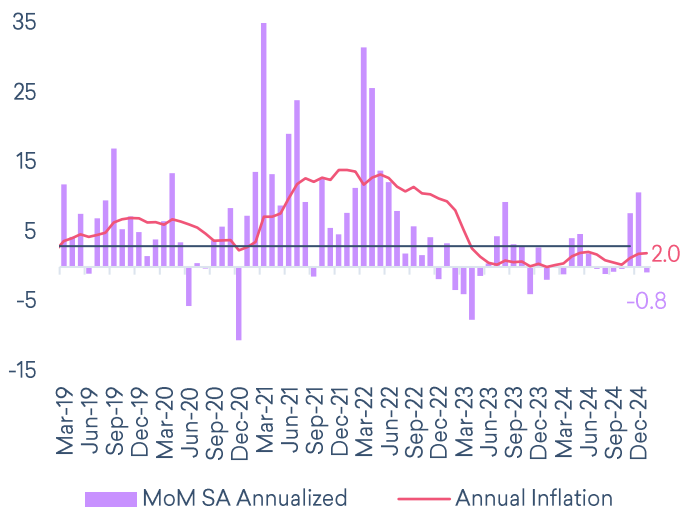


Source:Geostat, TBC Capital

While higher-than-expected Geostat estimates could be a potential argument for an upside to our forecast, we expect growth to moderate in 2025 at somewhat lower than our previously estimated trend of around 5.5% in the baseline scenario. Due to the ongoing events, the degree of uncertainty remains particularly high, also internationally, and alternative scenarios imply larger than usual divergence, albeit, important to keep in mind, mostly concerning the medium term. In the immediate short run, we do not bet on an outsized impact in either direction, absent material shifts, taking into account the existing macroeconomic environment.

Finally, annual inflation came in at 2% in January 2025, slightly lower than our expectations and negative in seasonally adjusted terms (Figure 14), following two consecutive months of elevated MoM inflation in Nov-Dec 2024.

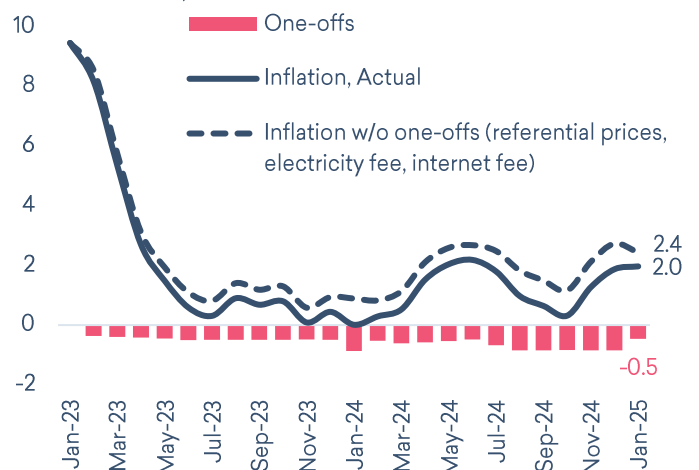
**FIGURE 14: SEASONALLY ADJUSTED INFLATION WAS ELEVATED IN NOV-DEC 2024 BUT CAME IN LOWER THAN EXPECTED IN JAN 2025 (%)**



Source: NBG, TBC Capital

This is despite the expiration of the one-off impact from the lower electricity fee, which came into effect in Jan-24, and had been lowering annual inflation by 0.3 percentage points throughout 2024. Annual inflation without one-offs, therefore, declined from 2.7% in December to 2.4% in January (Figure 15).

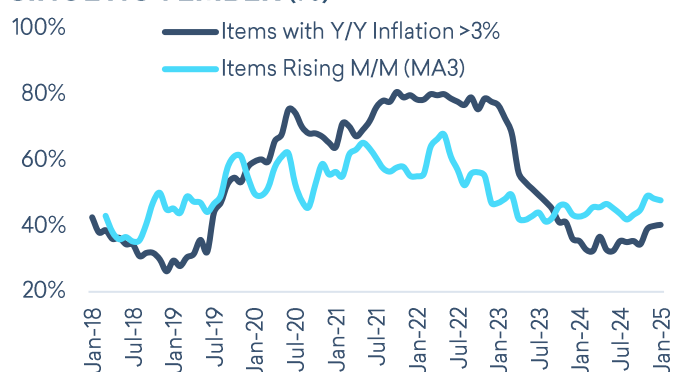
**FIGURE 15: ONE-OFF EFFECTS, LOWERING INFLATION, ARE SET TO EXPIRE IN 2025 (%)**



Source: NBG, TBC Capital

Compared to the previous month, prices fell on durables, including furniture, electronics and utensils, as well as on hotel services, most probably reflecting the demand slowdown. At the same time, we note that trimmed monthly inflation was 0.4% in January, slightly higher than in the previous month, and the share of items in the consumer basket with annual inflation over 3% reached 40.3%, highest since November 2023 (Figure 16). We expect inflation to approach the target in the 1<sup>st</sup> quarter of the year, followed by subsequent slight overshooting, partially aided by the expiration of last year's one-off effects and the excise tax rate hike on cigarettes. By virtue of implying a tight monetary stance, per the [TBC capital three-pillar approach](#), inflation gaining pace is GEL-positive in the short run.

**FIGURE 16: THE SHARE OF ITEMS IN THE CONSUMER BASKET WITH ANNUAL INFLATION OVER 3% HAS BEEN ELEVATED SINCE NOVEMBER (%)**



Source: NBG, TBC Capital



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