

Economy

Georgia's "Green Friday"

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When talking about the strengthening of the American dollar in Georgia, we must take two factors into account:

Firstly, this is not necessarily a Georgian trend but a global one. This is an American response to the global financial crisis and the outcome of a historic decision by the US administration to inject 700b USD to support financial markets. This has resulted in gradual appreciation of the American currency and the current global trend.

Secondly, the sharp drop of the Georgian lari against the dollar is credited to factors of Georgian origin.

While the world is tackling the global financial meltdown, Georgia has seen a dramatic slump in foreign investments. The five-day war in August has further scared off investors. They are still worried about the stability of the investment environment and fear that a Russian invasion may occur again. This has led to the fall of foreign currency inflows into Georgia.

The global financial crisis has also affected the remittances which Georgians living abroad send to their families back home as their earnings shrank. This has further weighed down the GEL.

Under these circumstances Georgia has two options: the first is that the national currency will start a gradual, creeping devaluation which allows banks, businesses and people to adapt to the changes as they witness the downturn and it becomes more predictable. There are no drastic changes and everyone proceeds with their financial operations. The second option is the sharp fall of the GEL when the central bank decides to turn the currency from one rate to another abruptly.

Furthermore, the creeping devaluation of the lari engenders Georgian exports as local entrepreneurs prefer foreign currency and view exports as the best way to get it.

Given that imports outnumber exports in Georgia by a factor of four, the slow devaluation of the lari is a very good scheme for promoting exports.

The creeping devaluation itself has two scenarios: one is when the downturn is very slow and is difficult to even notice and the second when the lari slides 0.5 tetri a day on average. In Georgia's case it would be certainly better if the lari decreased 0.5 tetri per day which would allow businesses and people to adapt and the Georgian central bank – the National Bank of Georgia (NBG) would have to spend fewer reserves.

However, the policy which the NBG has been pursuing was based on creating illusory stability. The lari was falling 0.1 tetri average which suggested nothing. There was an illusion that nothing was happening. In reality, if we look at the data posted on the NBG website, we will see that this cost NBG dear. The average demand was 10-25m USD per day and the NBG had to sell reserves to meet the demand. As a consequence it sold 300m USD from its reserves during a month which resulted in depreciation of GEL only for 3.5 tetri.

Interesting as it is, after the August war the IMF earmarked 750m USD for a Stand-By arrangement and the money went to the NBG reserves to maintain the lari's stability. 250m USD has been already provided and it has been already spent.

The second option is a sharp fall of the lari as the NBG abruptly decides to turn the currency from one rate to another. This would cause shock and panic unless the government follows up with a timely explanation. When the currency slumps, the feeling of stability disappears. Everyone tries to get rid of lari from their pockets or deposits and convert it into the dollar or euro and this process causes a snowball effect increasing the demand on foreign currency and further drowning the lari. This causes an artificial stimulation of sharp devaluation. As a consequence the dollarisation of economic growth, banks refuse to issue credits in lari as trust towards the government and the NBG declines. Such a fall is destructive for the banking sector and for the monetary system as a whole.

80 percent of Georgian consumer products are imported and the price of the imported goods is certainly tied to the foreign currency. When the downturn is slow importers are able to adapt to it.

But when the GEL slumps, say 21 points (depreciation by 15 percent), and importers take losses, they have to think of getting it back by setting a higher margin. Besides, the price would also reflect the expectations that importers have after having seen slumps in the exchange rate.

It should be taken into account that, after the American dollar gained heavily, the NBG withdrew lari surpluses from the market and this seems to be a good thing as reducing the money supply in general curbs inflation. But to cut inflation you need not just withdraw the money supply but also focus on where the remaining money will go.

During the crisis consumers have to redistribute their resources to primary needs which cost more. In the end this leads to a decline in the standard of living.

However, what benefits does the government receive from the sharp fall in the national currency?

At a glance, this generates additional revenues from imports initially, as the price of imported commodities is tied to the foreign currency, to the American dollar or euro. This is an ad valorem tax which is paid to the budget in lari. Additional revenues in GEL will be generated from international donor support, as well. As the American dollar rises, more tax revenues flow into the budget and the government seems to have profited. But the government in reality is losing. In economic theory this is known as the Oliver-Tanzi Effect. Although more money comes in, the purchasing power of the currency is low and the effect of government expenditures is less effective. So, the government loses.

Trading at the Interbank Currency Exchange (ICE) started as usual on Friday, November 7. The demand by commercial banks was 31m USD. Once the first operation at 270,000 USD was over, the ICE suddenly stopped trading, citing technical reasons, malfunctioning of the computer networks, as the reason.

This move, given the fact that there was no trading at ICE over the following weekend, caused a panic. The banks could not meet the demand from customers, who then turned to the Exchange, who could not do so either. This touched off a general panic which already showed signs of impacting the lari late Friday evening. The American dollar edged higher and in most cases the rate was fixed, but in reality no one could offer it. ATMs were soon emptied. All these processes were the result of the falling lari.

On Monday, November 10, the NBG Acting President David Amaghlobeli said that everything was predetermined and planned as well as the timing; the Exchange purposefully stopped on Friday as they had the weekend ahead. Friday, November 7, was the day of the dollar's victory over the lari – an artificially provoked drastic decline and therefore this day should be dubbed “Green Friday” in the annals of modern Georgian history.

If the action was preplanned, as they claim, then Friday was really a very bad time for it, as businesses continue working unlike government officials and retail trading occurs on a daily basis.

Therefore, if the government wanted to switch from one rate to another abruptly, it should have done so at the beginning of the week or at least in the middle of the week and the NBG administration should have explained their actions publically the same day. Moreover, in a TV broadcast on November 8, Zurab Melikishvili, Chair of Parliamentary Committee for Finance and Budget, said that nothing new was happening and the global financial crisis is ongoing. This confirms that the government did not really plan anything in advance.

Nonetheless, what happened on Green Friday? There are three possible answers to the question: First, there was a lack of competence and professionalism. Second, this was a deliberate action to allow some people to earn fortunes by speculating. Third, some people took advantage of the situation to make some money.

I believe that the third answer is most likely true.

What does the future hold for us? Are there any real grounds for a currency crisis in Georgia?

There are no economic grounds for a currency crisis in Georgia. In all accounts, the NBG still has over 1.1b USD in its reserves which would allow a creeping devaluation of the lari.

It should be also taken into account that out of the donor's conference in Brussels 4.5b USD was pledged in aid to Georgia. Given that this money will come to us over 26 months, there is no objective reason that we are in danger of a currency crisis in the coming months or in the near two years.

But the crisis may still worsen – this cannot be ruled out. However, unless somebody is held accountable for Green Friday, this may reoccur.

Moreover, analysts speculate that, given the artificial shakeups of the rate of the lari, some want to increase it to 1.90 or even 2.00.

If people continue to lose faith in the lari, the decline in the lari will become a self-fulfilling prophecy.

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