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Depreciation of the Georgian National Currency: Economic, Psychological, Administrative and Political Factors

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Author: Vladimer Papava, Senior Researcher at Rondeli Foundation

Not only in Georgia, but in general, it has become a tendency that governments and the media turn to economists only when the country, region or the world are facing economic difficulties or, even worse, a crisis. Ostensibly, this might be the only positive outcome during troubling economic times, and only for representatives of the profession at that…

In the last four years, economists in Georgia have only seen the limelight when the national currency – the lari (GEL) – is struggling. Although research was conducted as early as in 2015 with regard to its devaluation and relevant recommendations were issued, unfortunately, no substantial steps have been made in this regard and the problem remains acute.

Against the background of a fluctuating national currency exchange rate, the balance of payments, one of whose comprising components is the current account including the balance of trade of goods and services – is very important for the stability of the GEL. For the stability of a national currency, especially for developing countries, the ratio between the country's export and import is critical, since the former brings foreign currency into the country and the latter requires the currency to leave the country. The balance between the two creates the economic basis for the stability of the national currency.

According to 2017's data, import was 3.8 times greater than export (excluding re-export) in Georgia. This, in turn, is the number one reason as to why the GEL does not have a strong economic basis for stability.

It is true that the number of tourists arriving in Georgia and the foreign currency they spend here is growing; however, we should not forget that on average 80% of this currency flows out of the country due to the undeveloped real sector of the national economy where the ratio between imported and domestic products for both consumer as well as the food basket is 4:1. In other words, an average of 80% of the amount spent by each tourist flows out of the country to import the products required by this tourist for consumption. Admittedly, due to the large amounts of money spent by tourists during the tourist season, the absolute value of the 20% they leave in the country is growing although as soon as this season ends, the funds substantially decrease as well.

Besides this, the stability of the GEL is heavily influenced by the stability (or instability) of the respective national currencies of Georgia's main trading partner nations. Georgia's main trading partners are Turkey, Russia, Azerbaijan and Ukraine. Specifically, combined imports from these countries amounted to 37.3% of total imports in 2017. Unfortunately, in recent years, these countries have been characterized by a devaluation of their respective national currencies. In turn, and in line with the basic principles of economics, this promotes the growth of exports as exporters want to acquire as much foreign currency as they can and as quickly as possible due to the devaluation of their own national currency.

Georgia's two primary trading partners account for more than a quarter of total imports. The national currencies of these two countries – the Turkish lira (TRY) and the Russian ruble (RUB) – are and have been experiencing virtually irreversible devaluation in recent years. The reasons for this include the strengthening of authoritarian tendencies in the governing systems of the countries as well as their confrontations with the United States.

It should be noted that Georgia has had a free trade agreement (FTA) with its main trading partner – Turkey – since 2008; however, this FTA is unambiguously unfair: there are far less barriers imposed on goods imported from Turkey to Georgia than there are on goods exported from Georgia to Turkey. In this context, the devaluation of the TRY stimulates the growth of Turkish product imports in Georgia; however, in reality, the depreciation rate of the GEL is much quicker and greater than the actual growth of the aforementioned imports due to this devaluation. The reasons for this are no longer economics – this is brought on by psychological and administrative factors.

In the last few years, businesses and, frankly, the entire population of Georgia have been characterized by a tendency to expect an "inevitable" depreciation of the GEL as soon as information spreads about the depreciation of the TRY or the RUB. This expectation increases the demand for US dollars (USD) which accelerates the depreciation of the GEL even further, despite the fact that due to the depreciation of the TRY or RUB, imports from these countries grow.

Taking advantage of these psychological factors is nothing short of the *modus operandi* of commercial banks. Keeping in mind that two large banks hold the dominant position in the Georgian banking system, their behavior requires special attention. In particular, it has been substantiated on numerous occasions that precisely these banks have been the initiators of a spasmodic increase in the demand for the USD or GEL on the currency market, especially and specifically when information is spread about the depreciation of the TRY or RUB. The chiefs of these banks understand well that the depreciation of the GEL will be "blamed" not on them but on the depreciation of these foreign currencies. As a result, large-scale banks receive additional profits from these speculative operations. And here we have come to the "administrative" factor.

Supervision of the banking sector is bestowed upon the National Bank of Georgia (NBG); however, it has never had a conflict or been at odds with these large banks. Furthermore, suspicion has taken root in Georgian society (not without reason) that it is not the NBG that carries out supervision of these two large banks but, rather, it is these banks that dictate actions to the management of the NBG.

Unfortunately, even when currency fluctuations are clearly noticeable and when the GEL is experiencing leaping devaluations, the NBG often chooses to remain silent as if the fate of the GEL is of no concern to it instead of trying to calm the currency market with public announcements. With such actions (or more accurately: a lack thereof), it unfortunately promotes elements of panic in the market.

The NBG has numerous tools and instruments at its disposal to curtail the drastic depreciation of the GEL but the Bank uses them far too late in the best-case scenario and in the worse case, not at all. Currency reserves, for example, are intended to alleviate just such a crisis. When the GEL is depreciating, using these reserves in small doses is necessary not to maintain the exchange rate at what it is (that would be a mistake!) but to avoid leaps and bounds in the depreciation. This could and should be a useful tool for the prevention of possible panic on the currency market.

The inflation targeting – which the NBG implements obediently according to recommendations of the International Monetary Fund (IMF) – represents a separate problem. At this time, no one can argue with Nobel laureate in economics, Joseph E. Stiglitz, in his claim that in countries where import significantly exceeds export, an inflation targeting is not viable, and the corresponding monetary policy is a failure. Sadly, the IMF's bureaucracy is obsolete to this argument; nor does the leadership of the NBG adhere to Joseph Stiglitz's and other renowned economists' argumentation – this is especially noteworthy considering Georgia's imports are 3.8-times its exports.

And lastly, it is necessary to say at least a few words on the political component of the problem.

It is unfortunate, but nevertheless true, that the depreciation of the GEL is beneficial to the political opposition, especially when this depreciation is turbulent in character and leads to substantial discontent among businesses and the general population. This is not surprising as the devaluation of the GEL allows for criticism of the ruling political party and the government's economic policies. Regrettably, the political opposition does not consider the role of the NBG at all since this does not meet its political interests. If we consider that the "parent" of the GEL is the NBG, then first and foremost the NBG should be held accountable for the stability of the GEL and only afterwards – the government. Lamentably, the government administration plays into the hands of these opposition games when its finance and economic ministers and their deputies make comments on the devaluation of the currency while the NBG officials fails to utter a word.

Resultantly, what is happening around the GEL is due to many objective and subjective factors – all of which require a deliberate and consistent solution.