GALT & TAGGART
RESEARCH

Georgian Economy
High growth, high inflation

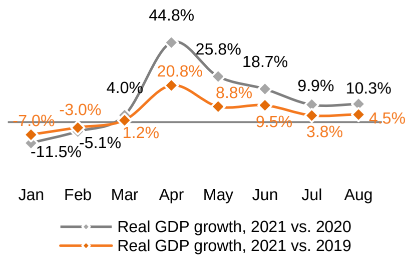
Georgia | Economy
October 6, 2021

The pace of economic recovery continues to beat expectations

Economic rebound strengthened further in August, contrary to expectations. Despite surge in virus cases and some mobility restrictions in Aug-21, growth came in at 10.3% y/y, after 9.9% y/y growth in July, from where expectations for more flatter growth was in place. Overall in 8M21, real GDP increased faster than expected by 12.0% y/y. The part of this growth is explained by last year's low base (economy contracted by 5.6% y/y in 8M20), but economy also surpassed pre-pandemic level of 8M19 by 5.5%. Growth is broad-based in 2021, supported by fiscal spending, robust growth in exports and remittances, gradual recovery in tourism (revenues at 31.1% of 2019 level), as well as strong loan portfolio growth (expanding by 15.3% y/y excluding FX effect in August). As we noted in our previous report, monetary tightening has little or no impact on demand for lending in the current recovery cycle, as consumers increased spending after lockdowns and business sentiment also improved. Notably, 29.9% y/y growth in 2Q21 (for which sectoral growth figures are available), was supported not only by gradual return of tourists boosting hospitality sector, but larger contributions came from trade, manufacturing and transportation, fuelled by pent-up domestic demand, as well as strong foreign demand on Georgia's exports. Generally, preliminary growth estimates are subject to revisions by statistical office (revised down in 2020 pandemic year), but this time 2nd estimate by Geostat remained unchanged for 1H21, and this along with growth estimate for Jul-Aug largely affect 2021 full year growth projection. Therefore, considering 8M21 actual growth figure, we now expect growth at 9.5% for the whole 2021 year (revised upwards from 8.6%), assuming recovery to flatten gradually in the coming months, while we keep our optimistic growth scenario at 11.2%. Risks to growth are weaker now as no strict lockdown is expected and there is low probability of possible post-election domestic political instability to weigh on growth (usually, the latter does not have effect on short-term growth in Georgia). We expect growth at 5.0% in 2022 (with more upside if tourism recovers faster than expected).

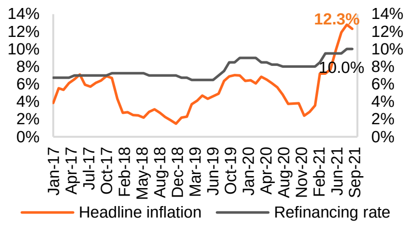
Meanwhile, labor market indicators were mixed. Despite strong pace of recovery, unemployment continued to rise in 2Q21, standing at 22.1%, up 3.8ppts y/y and up 4.9ppts vs pre-Covid level of 2Q19. This is explained by lagged impact of growth on job creation on the one hand and increased labor participation rate on the other hand, recovering to almost pre-pandemic level. We expect the labor market to be back to pre-crisis trajectory from 2022, supported by tourism recovery (services account for c. 70% in total employment). Contrary to employment, wage growth was strong in 2Q21, up 15.5% y/y (real wages up 6.7% y/y) and up 12.6% vs 2Q19. This is partly explained by reduced contribution from low paid employees in hospitality sector in average wage calculation, in our view. Therefore, we do not expect wage pressure on prices to continue in 2022 as tourism resumes.

Figure 1: Real GDP growth



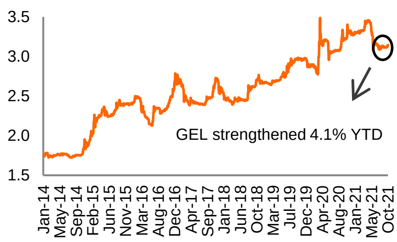
Source: Geostat, rapid estimates

Figure 2: Inflation and refinancing rate



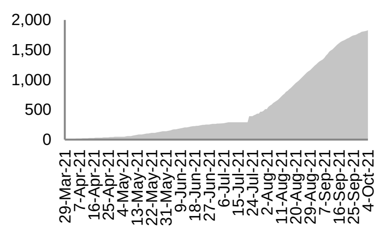
Source: Geostat

Figure 3: GEL/US$



Source: NBG

Figure 4: Cumulative vaccinations in Georgia, 000



Source: NCDC

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Monetary policy – both scenarios possible

Inflation accelerated markedly in 2021, and NBG has addressed it by policy tightening, raising key rate cumulatively by 200bps to 10.0% in August 2021. The global food and energy inflation, higher utility tariffs, GEL depreciation pass-through, and the acceleration of local demand have been the major drivers for inflation in Georgia, standing at 12.3% in Sep-21. The NBG is concerned that running high inflation would accelerate inflation expectations. For addressing this risk, the regulator intends to keep a tight policy stance longer, while not ruling out further hikes. At the same time, NBG sees banking sector loan portfolio growth healthy, which is up by 16.1% y/y (15.3% y/y excluding FX effect) in Aug-21. As factors driving inflation are one-off in nature and expected to fade from 2Q22, we expect inflation to decelerate, and project average inflation at 4.1% in 2022, above the 3.0% target level. Given temporary nature of inflationary pressures, we do not think further rate hike is necessary and see room for policy rate cut by 200-250bps in 2H22. However, we see need for further rate hike if GEL weakens contrary to our expectations for stronger GEL (in case of slower recovery in tourism, weakening of trading partners' currencies and continued growth in energy prices) and wages continue to grow in 2022. In this case, we expect rate hike by 100-150bps in next 6 months and easing cycle to be postponed to end-2022. In both scenarios, we expect lending growth at double digits in 2022, in line with nominal GDP growth.

GEL - sharp volatility not expected

Gel remained stable starting from May 2021, supported by tight monetary policy, improved fundamentals (strong growth, reduced CA deficit) and FX interventions to eliminate one-off pressures in August and September. The latter was related to pre-election uncertainty, when NBG sold US$ 60mn on 30 September, keeping GEL unchanged vs dollar during intraday trading. However, after 2 October local elections GEL weakened slightly, trading at 3.14/$ vs 3.12/$ pre-election. We see gradual recovery in tourism as important component for GEL stability in 2021. Given seasonality of GEL, we expect some pressure from increased energy and New Year related imports through end-2021, though do not expect sharp volatility. We see GEL in the range of 3.1-3.2 vs dollar through 2021, and in case of a sharp volatility we expect NBG to intervene to limit market overreaction. Possible political instability is another risk factor and may trigger some GEL sell-off, like before, but we see this as temporary factor. We see GEL's appreciation potential from 2022 toward 3.0-3.15 vs dollar amid expected recovery in tourism (we do not rule out full recovery in tourism in 2022 vs 2019 level).

Budget - deficit returns to fiscal rule from 2023

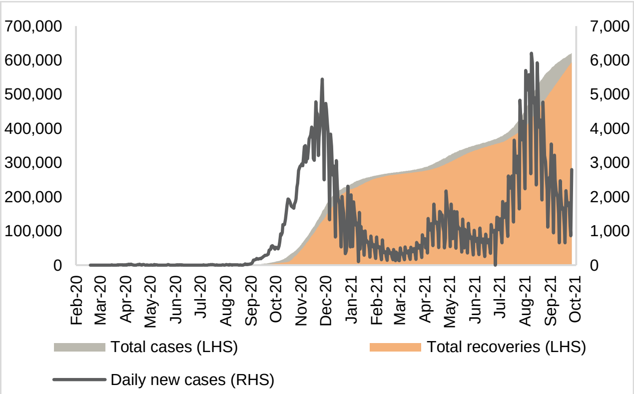
The government has submitted to the parliament the first draft of 2022 budget and medium-term forecasts for 2023-25 (draft budget is subject to revisions for 2 times before approving at end-December). The draft budget assumes 6.0% real GDP growth and nominal growth is set at 10.8% for 2022. Notably, government also revised 2021 growth projection to 9.5% from 7.7%, improving deficit and debt parameters as a share to GDP. The draft budget for 2022 remains growth-friendly as capex is maintained at a high level – 8.5% of GDP, while current expenditures are set to decrease to pre-Covid level of 22.0% of GDP (standing at 26.2% and 24.7% in 2020 and 2021, respectively). Notably, tax revenues are set to increase by 17.8% y/y in 2022, above nominal GDP growth, implying the effect of termination of Covid-related tax reliefs. Government sets fiscal deficit at 4.4% of GDP in 2022, down from 6.7% in 2021, and assumes deficit to return to 3.0% cap from 2023. This deficit reduction is assisted by reduced capex to 7.0% of GDP in 2023-25, and government sees the need to mobilize non-debt resources (e.g. privatization) to lift up the capex in coming years.

The government's net borrowing is set at GEL 3.2bn in 2022, of which GEL 1.3bn through treasuries and GEL 1.9bn donor loans. As a result, public debt stabilizes at 51.1% of GDP in 2022 down slightly from 51.2% of GDP in 2021E, gradually decreasing to 48.5% of GDP in 2025.

COVID-19 - vaccination pace slowed

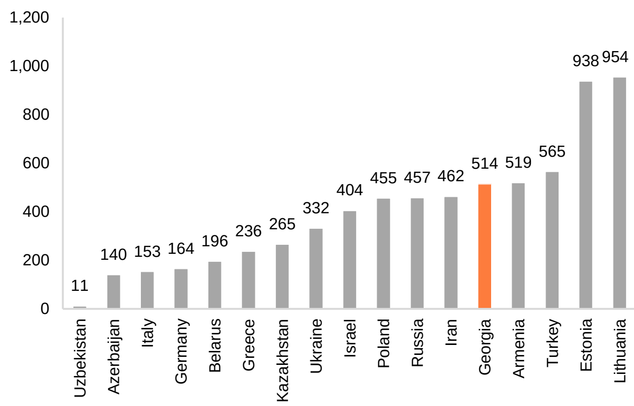
Covid-19 situation improved in Georgia recently, after the country went through the 4th wave during Jul-Aug 2021. Some restrictions were re-introduced from mid-Aug (ban on public transportation, etc.), but all these temporary restrictions are lifted now and learning process also resumed at schools. The pace of vaccination was strong during August and slowed from mid-September, as fear of virus faded amid reduced mortality and new infection rates. Therefore, there are talks of mandatory vaccination for certain groups of population as public is reluctant to vaccinate due to low trust in vaccines. Currently 29.5% of adult population is fully vaccinated which corresponds to 22.6% of total population. Vaccination pace is slow for meeting government plan to vaccinate 60% of adult population in 2021. If number of virus cases rise again, we do not rule out tightening of certain restrictions (switch to remote work, on-line learning, limiting working hours of restaurants/bars), but do not expect a lockdown.

Figure 5: COVID-19 statistics in Georgia, persons



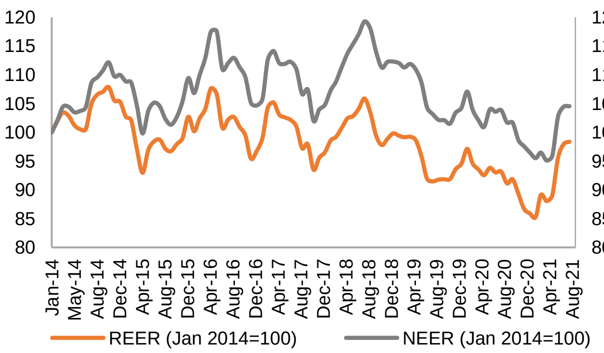
Source: NCDC, as of 05.10.2021

Figure 6: Active COVID-19 cases per 100,000 persons



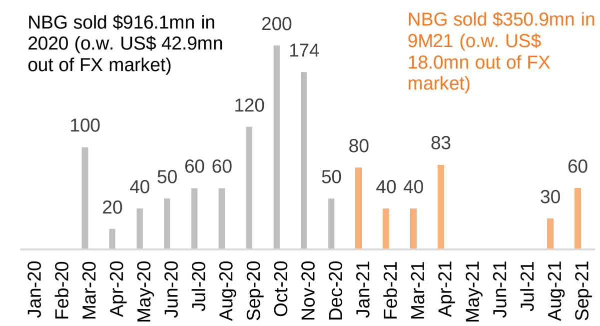
Source: Johns Hopkins University, Worldometers, as of 05.10.2021

Figure 7: REER and NEER (index, Jan 2014 = 100)



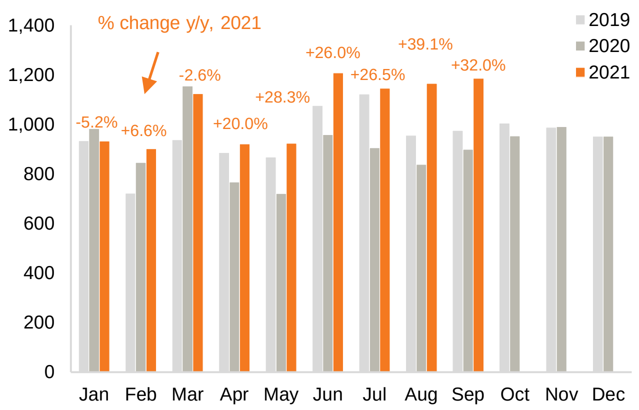
Source: NBG
Note: +/- means appreciation/depreciation

Figure 8: NBG's net interventions, US$ mn



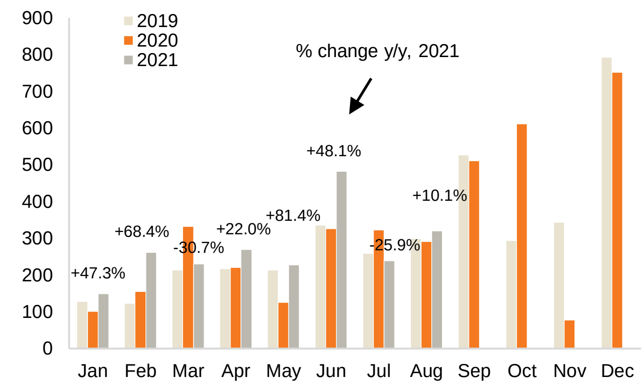
Source: NBG

Figure 9: Consolidated budget tax revenues, GEL mn



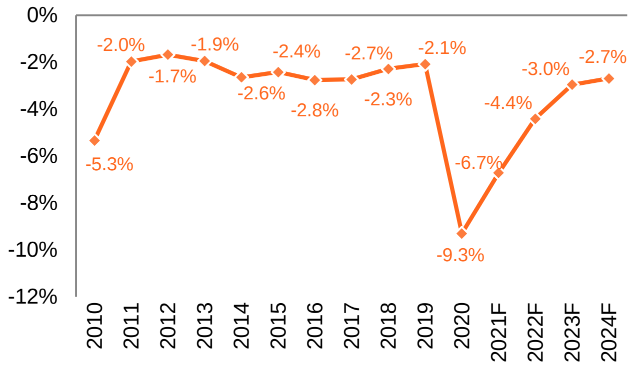
Source: MOF

Figure 10: Consolidated budget capex, GEL mn



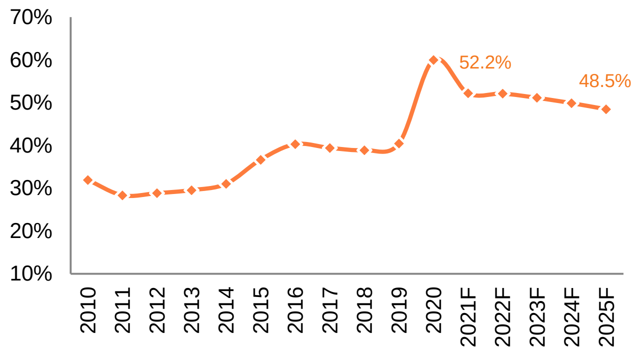
Source: MOF

Figure 11: Fiscal deficit, as % of GDP



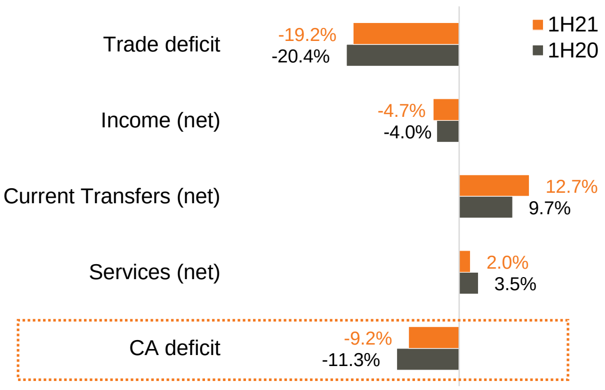
Source: MOF, Geostat, forecasts as of 1st draft of 2022 budget

Figure 12: Public debt, as % of GDP



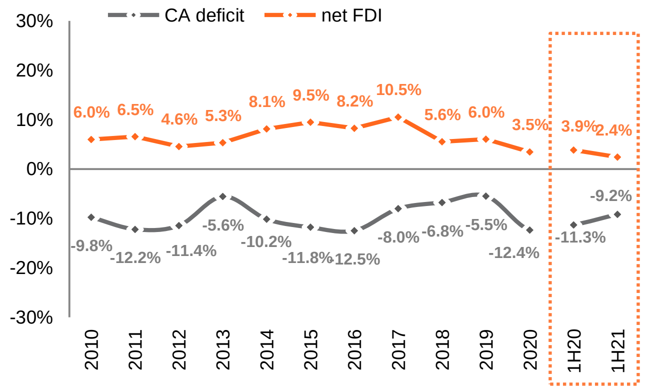
Source: MOF, Geostat, forecasts as of 1st draft of 2022 budget

Figure 13: CA balance and its components, as % of GDP



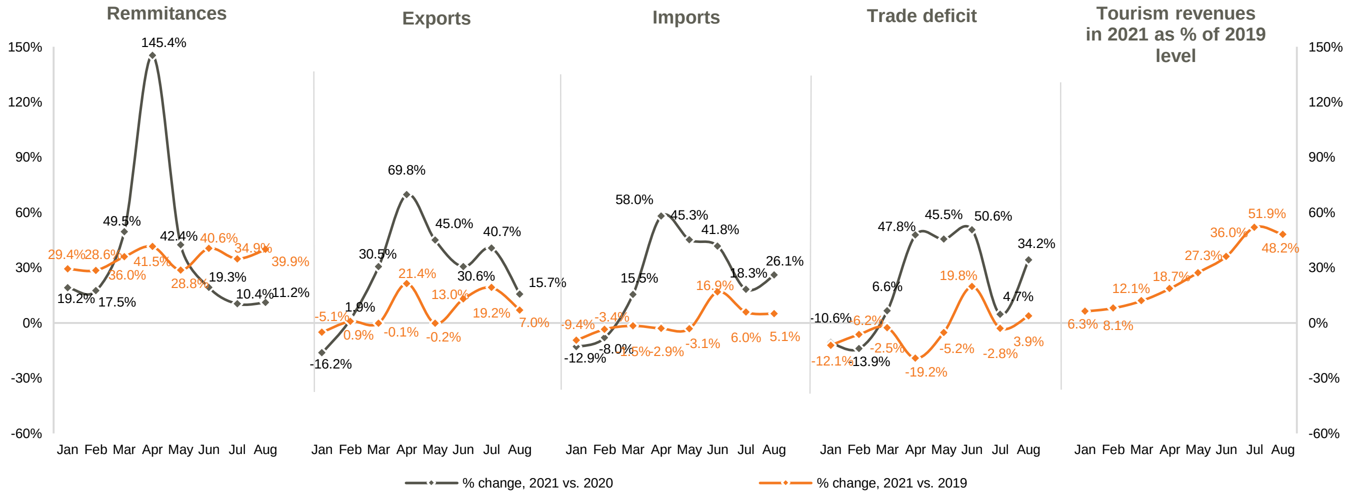
Source: NBG, Geostat

Figure 14: CA and net FDI, as % of GDP



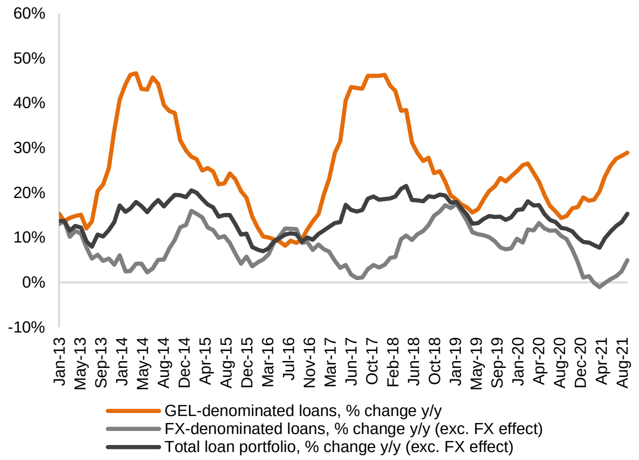
Source: NBG, Geostat

Figure 15: Foreign inflows



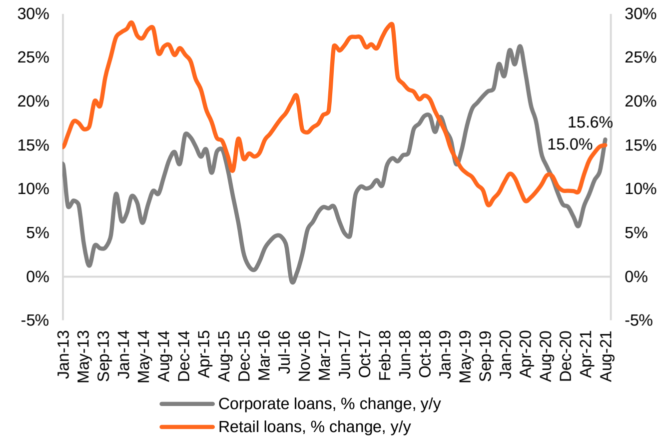
Source: Geostat, NBG

Figure 16: Banking sector loan growth



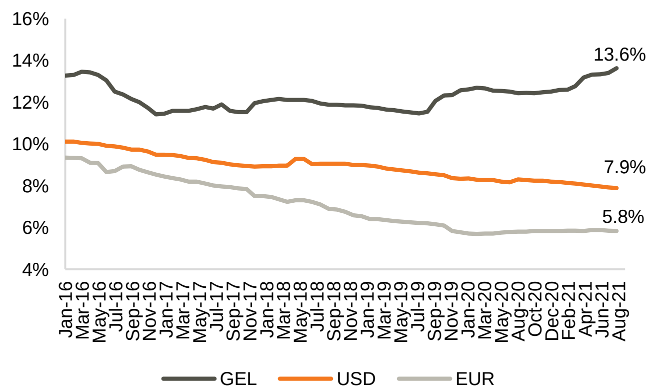
Source: NBG

Figure 17: Loan book growth: corporate vs. retail (exc. FX effect)



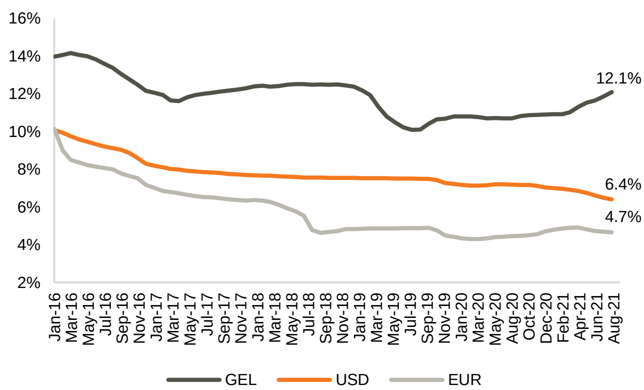
Source: NBG

Figure 18: Interest rates on loans to legal entities



Source: NBG

Figure 19: Interest rates on mortgage loans



Source: NBG

Macro data and forecasts

Georgia	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
GDP and Prices													
Nominal GDP, GEL bn	21.8	25.5	27.2	28.6	31.1	33.9	35.8	40.8	44.6	49.3	49.4	59.2	65.0
Nominal GDP, US$ bn	12.2	15.1	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.5	15.9	18.3	21.0
Nominal GDP per capita, US$	3,233	4,023	4,422	4,624	4,739	4,013	4,062	4,359	4,722	4,696	4,275	4,919	5,624
Real GDP, % change y/y	6.2%	7.4%	6.4%	3.6%	4.4%	3.0%	2.9%	4.8%	4.8%	5.0%	-6.2%	9.5%	5.0%
CPI Inflation, average	7.1%	8.5%	-0.9%	-0.5%	3.1%	4.0%	2.1%	6.0%	2.6%	4.9%	5.2%	9.5%	4.1%
CPI Inflation, eop	11.2%	2.0%	-1.4%	2.4%	2.0%	4.9%	1.8%	6.7%	1.5%	7.0%	2.4%	13.9%	1.7%
GEL per US$, average	1.78	1.69	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.82	3.11	3.23	3.10
Population, mn	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances													
Budget revenues, % of GDP	26.9%	27.0%	27.8%	26.0%	26.1%	26.4%	27.0%	26.8%	26.5%	26.2%	25.1%	25.8%	25.9%
Budget expenses, % of GDP	32.3%	29.4%	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	29.4%	34.8%	32.6%	30.2%
Fiscal balance (-deficit), % of GDP	-5.3%	-2.0%	-1.7%	-1.9%	-2.6%	-2.4%	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.7%	-4.4%
Public debt, % of GDP	31.9%	28.3%	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.4%	60.0%	52.2%	52.1%
External Sector													
Current account, US$ bn	-1.2	-1.8	-1.9	-1.0	-1.8	-1.8	-1.9	-1.3	-1.2	-1.0	-2.0	-1.7	-1.5
Current account, % of GDP	-9.8%	-12.2%	-11.4%	-5.6%	-10.2%	-11.8%	-12.5%	-8.0%	-6.8%	-5.5%	-12.5%	-9.4%	-6.9%
Exports of goods and services, US$ bn	4.1	5.3	6.0	7.2	7.1	6.2	6.2	7.6	8.9	9.6	6.0	7.3	10.1
Imports of goods and services, US$ bn	6.1	8.0	9.2	9.3	10.1	8.7	8.5	9.4	10.8	11.1	9.0	10.3	12.8
Net Current transfers, US$ bn	1.1	1.3	1.4	1.5	1.4	1.1	1.1	1.3	1.4	1.4	1.8	2.1	2.2
Net FDI, US$ bn	0.7	1.0	0.8	0.9	1.4	1.4	1.2	1.7	1.0	1.0	0.6	0.6	0.8
Net FDI, % of GDP	6.0%	6.5%	4.6%	5.3%	8.1%	9.5%	8.2%	10.5%	5.5%	5.9%	3.7%	3.3%	3.8%
Gross international reserves, US$ bn	2.3	2.8	2.9	2.8	2.7	2.5	2.8	3.0	3.3	3.5	3.9	4.0	4.3
Financial sector													
Bank loan portfolio, US$ bn	3.4	4.6	5.3	6.0	7.0	6.7	7.1	8.6	9.9	10.7	11.8	13.6	14.9
Bank loan portfolio, % of GDP	29.3%	29.5%	31.2%	36.1%	40.8%	47.2%	52.8%	54.7%	59.6%	64.8%	77.4%	74.0%	71.2%
Monetary policy rate, %	7.5%	6.8%	5.3%	3.8%	4.0%	8.0%	6.5%	7.3%	7.0%	9.0%	8.0%	10.0%	8.0%

Source: NBG, MOF, Geostat, Galt & Taggart

Note: Fiscal balance according to IMF Program Definition

Disclaimer

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