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RESEARCH

Georgian Economy
Inflation Focus

Georgia │ Economy
December 21, 2021

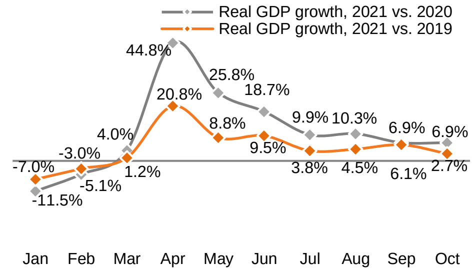
Georgia continues to deliver the strongest economic recovery in the region with real GDP growth at 10.5% in 10M21 (up 3.7% vs 10M19). The GEL also strengthened amid recovery of external inflows and tight monetary policy. We expect growth at 10.5% for the full year 2021 and forecast growth at 5.0% in 2022. NBG hiked the key rate by 50bps to 10.5% at December meeting, remaining concerned about high running inflation (12.5% in November) and inflation expectations. We expect inflation to decelerate from spring 2022 and see room for the rate cut by 200bps in 2H22.The banking sector loan portfolio growth is healthy (up 16.1% y/y exc. FX-effect, and up 14.7% y/y in nominal terms), below nominal GDP growth (22.0%), and we expect it to continue double digit growth amid decent recovery dynamics despite tight monetary policy.

Growth outlook - surpassing 2019 level

In 10M21, Georgia's economy continued robust recovery, with real GDP growth at 10.5% (up 3.7% vs 10M19). While growth cooled down to c.7% in last 2 months, we expect November-December to show some acceleration amid last year's low base (result of 2nd lockdown), and expect 10.5% growth for the full year 2021. The growth is recorded in all key sectors – manufacturing, trade, transportation, real estate and hospitality, with only construction posting decline (which we expect to recover in 4Q as levels of construction materials imports and bank lending to construction sector hint on growth). The growth is fuelled by robust exports and remittances, and ongoing recovery in tourism along with strong bank lending and fiscal stimulus. We expect growth at 5.0% in 2022 which is below IMF and government's projections (5.8% and 6.0%, respectively). We see upsides to our growth projection if tourism recovers stronger than we currently expect (we assume 80-85% recovery in tourism vs 2019 in our baseline scenario for 2022), while pandemic and regional geopolitical tensions remain downside risks.

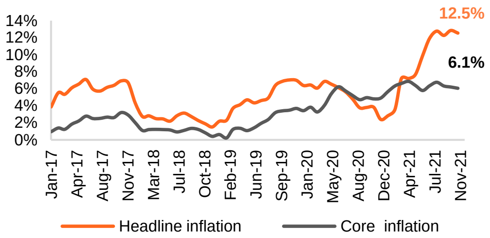
Amid strong growth, unemployment rate reduced to 19.5% in 3Q21 for the first time after growing during 4Q20-2Q21, however it still exceeds pre-COVID level of 17-18%. Notably, labor force participation rate at 52.8% exceeds pre-COVID level, driving the unemployment rate higher. Increase in hired employment (c. 70% of total employed) contributed to a reduction in unemployment. Self-employment (c. 30% of total employed) has also recovered but at a slower pace. We expect the labor market to return to pre-COVID trajectory from 2022, supported by tourism (services account for c. 70% of total employment). In 3Q21 nominal wage growth softened to 10.4% y/y (-1.7% y/y in real terms) after growing

Figure 1: Real GDP growth



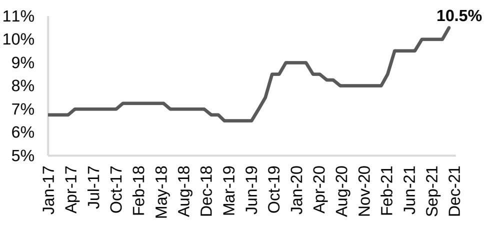
Source: Geostat

Figure 2: Annual inflation



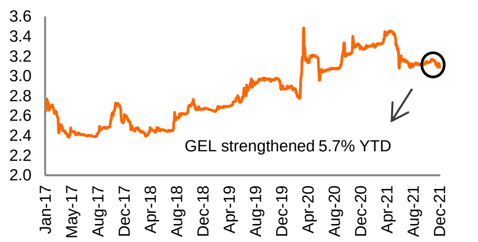
Source: Geostat

Figure 3: Monetary policy rate



Source: NBG

Figure 4: GEL/US$



Source: NBG

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by 15.5% y/y (+6.7% y/y in real terms) in 2Q21, limiting pressure on prices.

COVID-19 infections daily cases have declined recently from its peak in November, but remain high at around 2,000-3,000 cases in mid-December. Notably, vaccination picked up recently (now 37.6% of adult population is fully vaccinated corresponding to 29.0% of total population) related to incentives introduced by the government. Starting 1 December 2021, COVID-19 green pass is linked to vaccination status, and is required for entering both open-air and indoor spaces (excluding public transport) and GEL 200 is granted to elderlies (60+ years) if they get vaccine shot.

External sector - strong recovery

Goods exports and remittances rebounded strongly from the start-2021. Exports were boosted (up 26.7% y/y in 11M21) by recovery in Georgia's trading partners' economies along with high world commodity prices. Imports also grew strongly (up 24.5% y/y in 11M21) amid strong local demand and higher world commodity prices. Despite widening of goods trade balance, external balance strengthened supported by robust remittances (up 25.7% y/y in 11M21) and better-than-expected recovery in tourism (revenues at 36.7% of 2019 level in 11M21). Notably, international arrivals recovered markedly from Ukraine, Israel, Saudi Arabia, Belarus and Uzbekistan. There is a room for recovery from neighboring countries (Russia, Turkey, Armenia, and Azerbaijan) from which arrivals are significantly below pre-pandemic levels, explained by travel restrictions, expected to be lifted in 2022 amid better epidemiology. Importantly, based on different analyses there are factors - closeness to key tourism markets, limited business travel, and younger visitors - supporting faster recovery in tourism and these factors are favorable for Georgia. Namely, share of visitors arriving to Georgia via land transport stood at 75% in 2019, share of visitors arriving to Georgia for business purposes stood at only 8% in 2019 and share of visitors below 50 years old stood at 74% in 2019, and we believe that faster recovery in Georgia's tourism industry is quite likely. In our baseline scenario we forecast tourism revenues to recover to 80-85% of 2019 level in 2022 and considering above mentioned favorable factors, full recovery is also likely. With rebound in external flows, current account deficit expected to narrow to 9.1% of GDP in 2021 from 12.4% in 2020 and further to 7.0% of GDP in 2022.

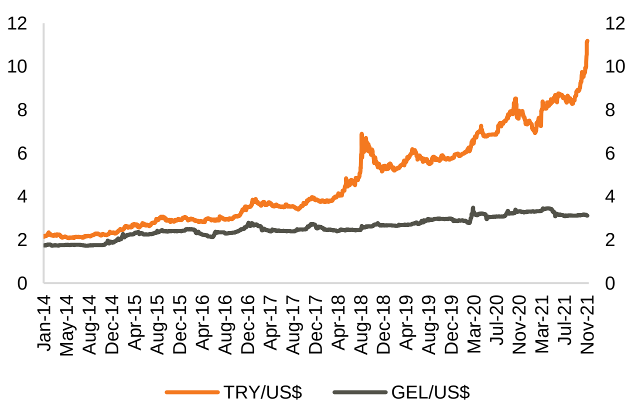
Monetary policy - tight

Inflation accelerated markedly in 2021, and NBG has addressed it by policy tightening. On 8 December meeting the regulator raised the key rate further by 50bps to 10.5% and cumulatively by 250bps since start-2021. We see recent rate increase as signal from NBG to contain inflation expectations in medium term, while it still sees inflation as transitory and driven by factors outside monetary policy (based on NBG, these exogenous factors contributed 9ppts to overall inflation). 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 12.5% in Nov-21. The 3 categories (transport, food and utilities) contributed the most (9.5ppts) to headline inflation. Core inflation posted marginal decline in last 3 months reaching 6.1% in November, hinting on a temporary nature of price growth with limited secondary effects. Interestingly, the NBG mentioned nothing in its monetary policy committee statement about TRY depreciation and its repercussions, which it usually sees as a threat to GEL. However, in the following press conference, central bank governor pointed that this time TRY depreciation is immediately filtered in Turkish inflation and therefore imports from Turkey not expected to increase pressure on the currency. In our previous note, we pointed out different risks to inflation (possible GEL depreciation, continued growth in energy prices and wage growth), but most of inflationary risks seem weaker now. Therefore, we expect inflation to decelerate from March 2022 and see room for the rate cut by 200bps in 2H22; we forecast average inflation at 4.1% in 2022 vs NBG's forecast of 7.2%. The regulator intends to keep a tight policy stance longer, until inflation declines, which it expects to happen in spring 2022.

GEL - stability

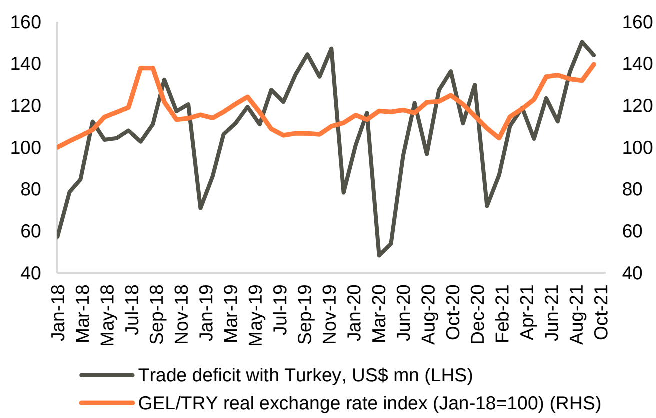
GEL remained stable starting from May 2021 trading at 3.1-3.2 vs dollar in 2H21, supported by tight monetary policy, improved fundamentals (strong growth, reduced CA deficit) and FX interventions to eliminate pre-election one-off pressures in August and September. We see gradual recovery in tourism as important component for GEL stability in 2021. Notably, recent TRY depreciation does not have an impact on GEL, opposite to previous episodes when TRY caused GEL's depreciation through expectations channel. Generally, change in external flows from Turkey have no sizable impact on Georgia, and if there is an impact, it is mostly short-lived. Markedly, the impact of the TRY on GEL through trade channel is small - we estimate, that a 10% depreciation of TRY vs. USD causes GEL to depreciate by 1.2% in the short term (up to one year) and then other factors may strengthen/weaken this impact. This time, there are factors neutralizing TRY depreciation impact, namely, stable regional currencies, high GEL rates, continued recovery in external earnings and muted negative expectations. However, if market expectations change, we might see some impact on GEL in short term. We see GEL's appreciation potential from 2022 toward 3.0-3.15 vs dollar amid continued recovery in tourism. However, there are risks related to pandemic, domestic and regional political instability.

Figure 5: GEL/1$ and TRY/1$, spot rate



Source: NBG

Figure 6: Trade deficit with Turkey and real GEL/TRY



Source: NBG, Geostat

Banking sector - healthy growth

Banking sector loan portfolio growth accelerated in 2021 fuelling growth, increasing by 16.1% y/y excluding FX effect (up 1.1% m/m) in Oct-21. Growth was driven by both corporate and retail lending, and the latter was driven by different types of consumer loans, while mortgage growth was stable. The 2021 monetary policy tightening and stricter FX lending regulation (see below) expected to have an effect in 2022, and soften lending growth to 11-13%.

The NBG's Financial Stability Committee introduced 2 measures in Dec-21 entering into force from 1 January 2022 to soften FX lending, which accelerated in recent months. This issue was raised by NBG in recent communications, referring mostly to mortgages. The new decisions simultaneously affect supply and demand for FX lending and are as follows:

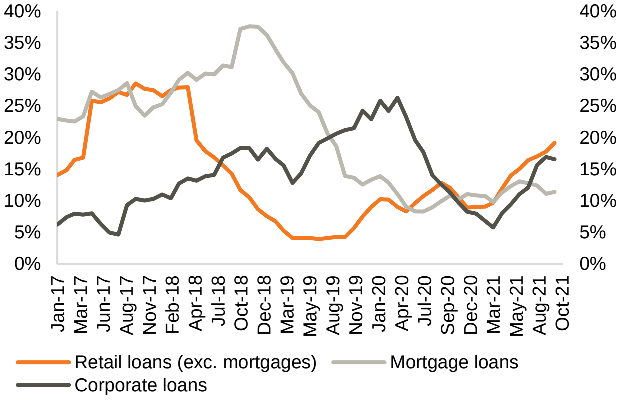
- From supply side, currency induced credit risk (CICR) buffer is linked to loan portfolio dollarization. Up to 40% loan dollarization, a bank's individual CICR buffer will be set at 40% risk-weight and above this cap, each percentage change in loan dollarization will increase the CICR risk-weight by 3ppts until it reaches 100%. With this change, asset side of bank balance sheet is regulated similarly to liabilities side, which was modified in Jul-21.
- From demand side, the regulator lowered the maximum tenor of FX mortgages from 15 to 10 years to protect FX borrowers from interest rate and currency risks.

These new rules expected to make FX loans more expensive, although the impact will depend on the level of dollarization of each bank's portfolio. We do not expect this regulation to have a large impact on banking sector loan dollarization structure in short to medium term, given the existing restrictions on FX lending (CICR buffer at 75% risk-weight and GEL 200,000 cap per retail loan to be issued only in local currency).

In recent months, FX mortgages accelerated, reflecting favorable interest rate differential vs GEL (spread widened by c. 2ppts starting from Apr-21) and local currency stability (GEL strengthened by 5.7% YTD). Since Mar-21, the newly issued FX mortgages above 10-year tenor accounted for c. 35% of total mortgages in value terms, while before it was c. 30%. However, in quantity terms, this loan portfolio accounted for only c. 8% of total number of newly issued mortgages.

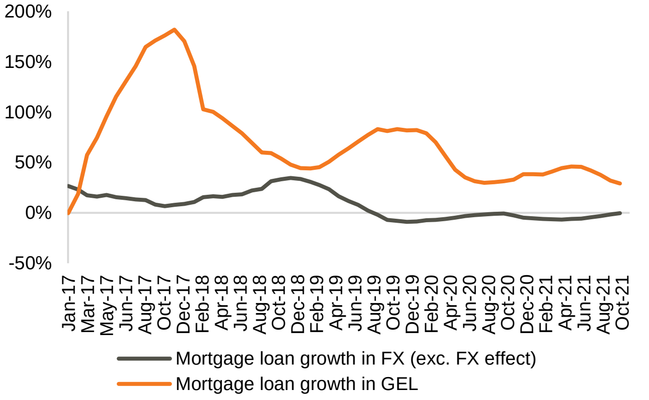
Given the salary distribution of employees, the reduction of FX mortgage tenor is expected to affect around half of FX borrowers above 10-year tenor through payment-to-income (PTI) limits. As this type of borrowers may switch to GEL lending, the final impact on mortgage demand is unclear now and not necessarily means a slowdown (e.g tourism is one of the drivers of real estate demand). The impact on real estate market will be smaller in our view, as mortgages generally account for 45% of total sales, and they may be substituted by construction companies' inner installment scheme, which is widespread practice in Georgia (e.g. c.50% of total sales is funded by this scheme, based on our survey).

Figure 7: Loan portfolio growth, exc. FX effect



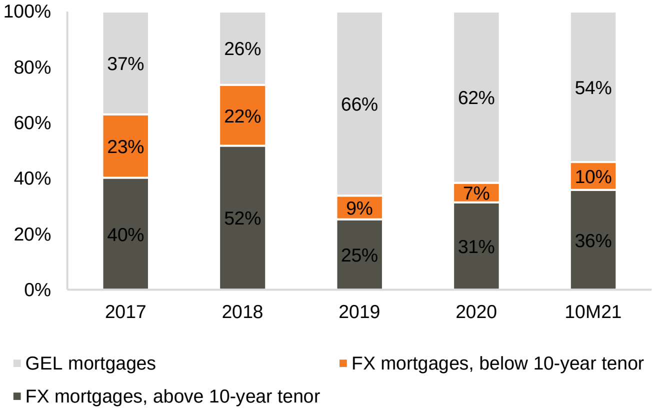
Source: NBG

Figure 8: GEL and FX mortgages growth, stocks



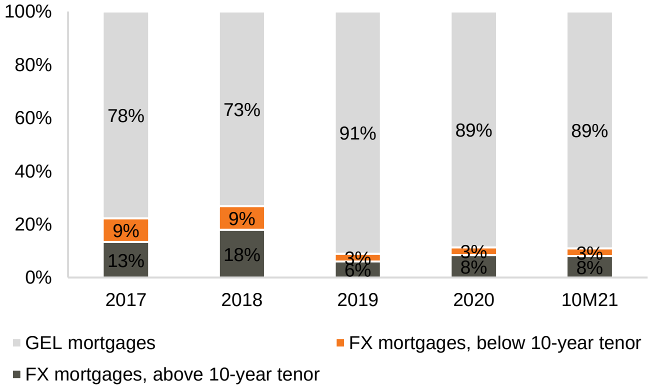
Source: NBG

Figure 9: Mortgage issuance breakdown by value



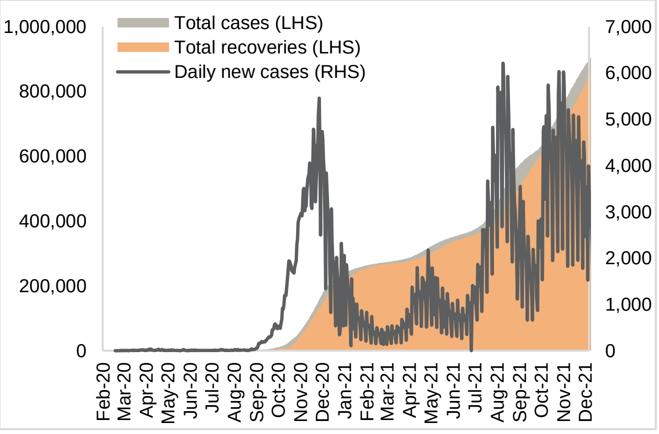
Source: NBG

Figure 10: Mortgage issuance breakdown by number of loans



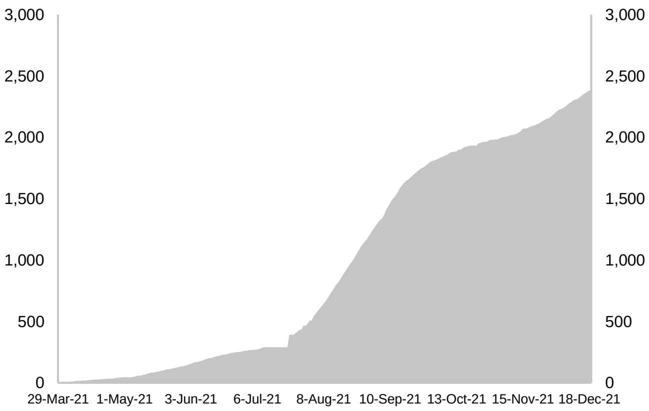
Source: NBG

Figure 11: COVID-19 statistics in Georgia, persons



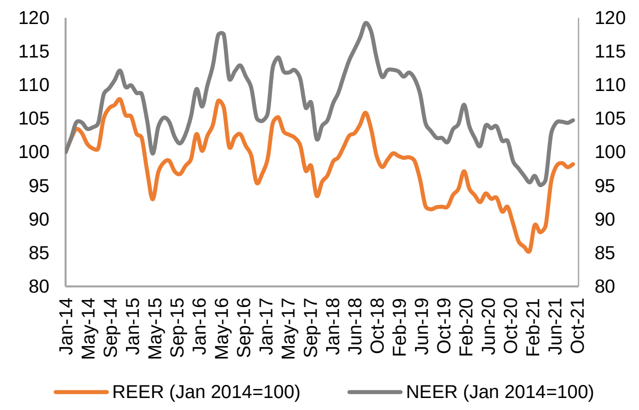
Source: NCDC, as of 20.12.2021

Figure 12: Cumulative COVID vaccination, 000' doses



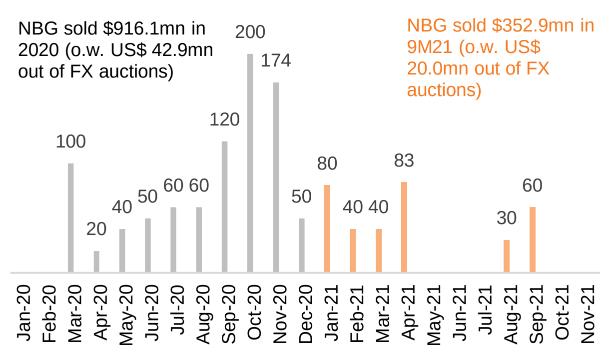
Source: NCDC

Figure 13: REER and NEER (index, Jan 2014 = 100)



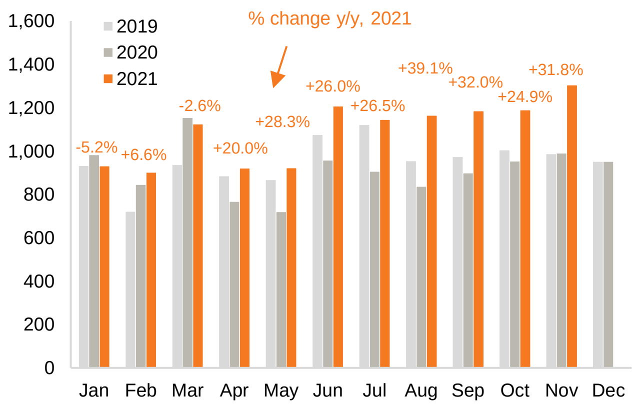
Source: NBG
Note: +/- means appreciation/depreciation

Figure 14: NBG's net interventions, US$ mn



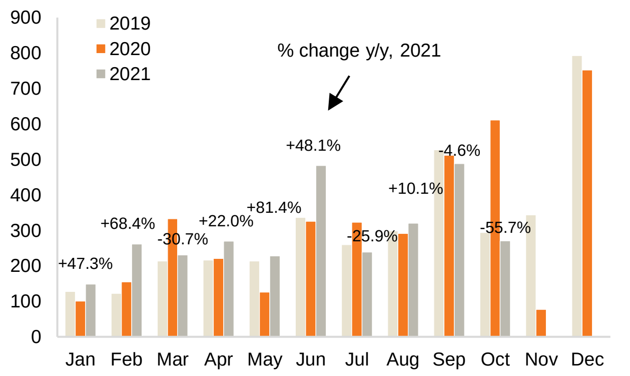
Source: NBG

Figure 15: Consolidated budget tax revenues, GEL mn



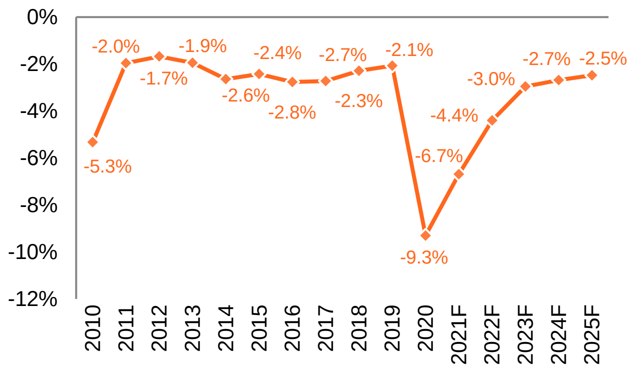
Source: MOF

Figure 16: Consolidated budget capex, GEL mn



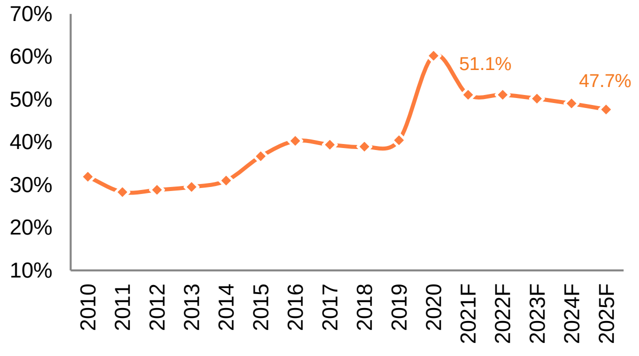
Source: MOF

Figure 17: Fiscal deficit, as % of GDP



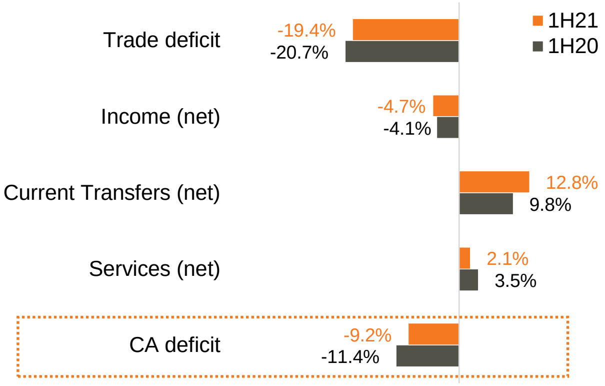
Source: MOF, Geostat, forecasts as of 3rd draft of 2022 budget

Figure 18: Public debt, as % of GDP



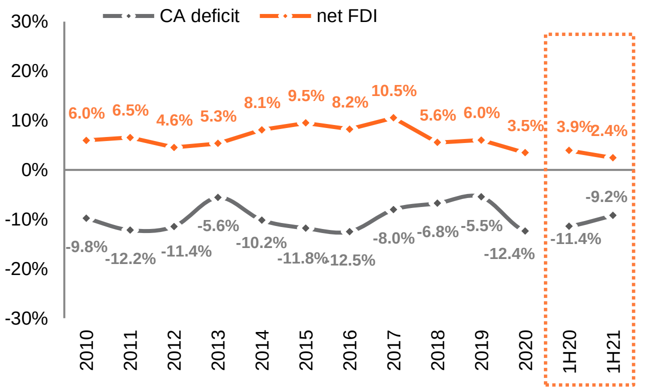
Source: MOF, Geostat, forecasts as of 3rd draft of 2022 budget

Figure 19: CA balance and its components, as % of GDP



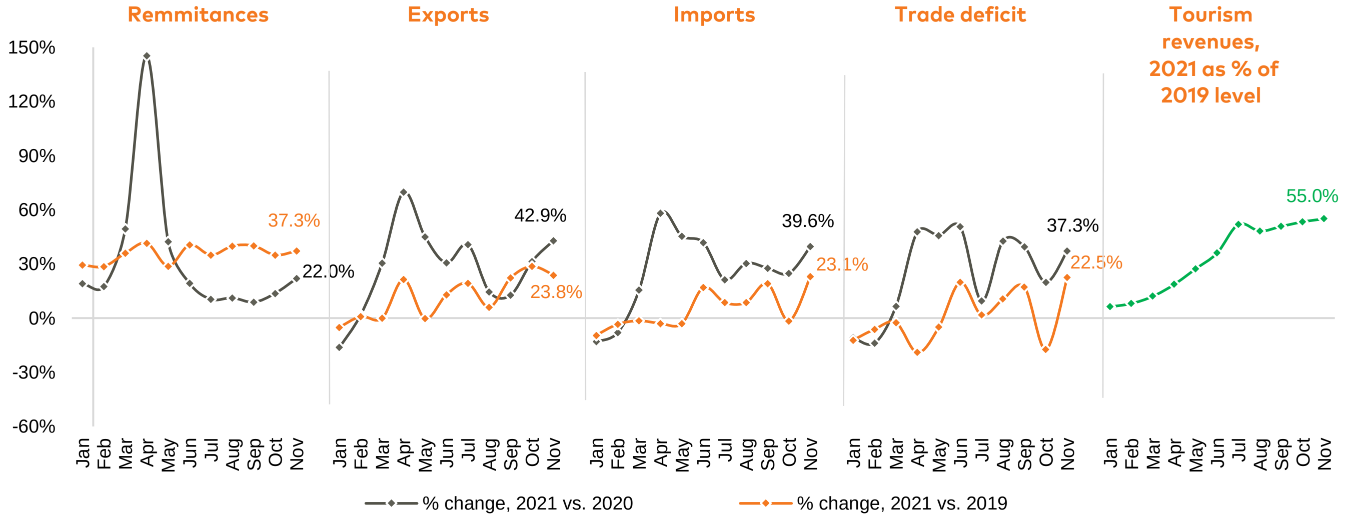
Source: NBG, Geostat

Figure 20: CA and net FDI, as % of GDP



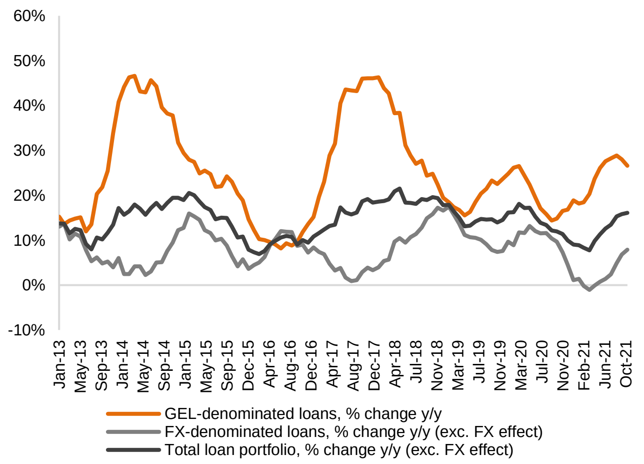
Source: NBG, Geostat

Figure 21: Foreign inflows



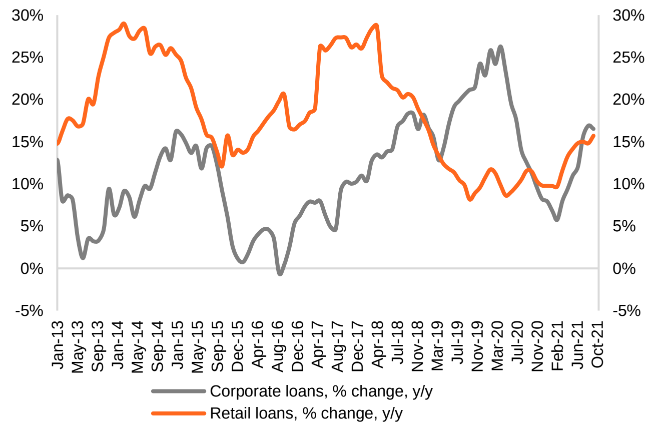
Source: Geostat, NBG

Figure 22: Banking sector loan growth



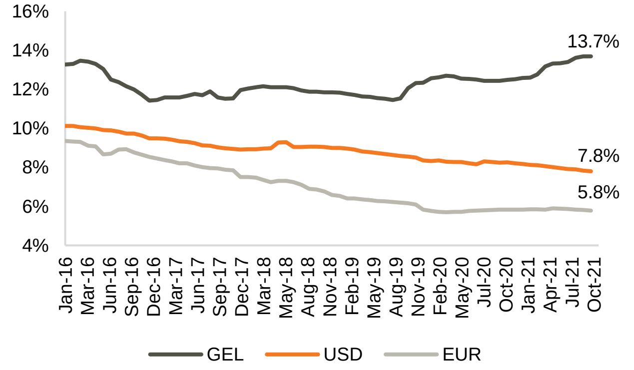
Source: NBG

Figure 23: Loan book growth: corporate vs. retail (exc. FX effect)



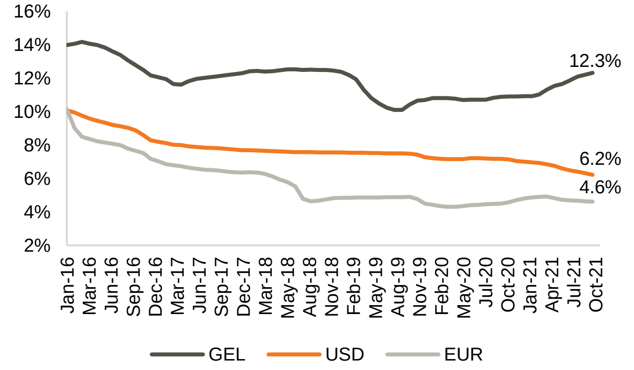
Source: NBG

Figure 24: Interest rates on loans to legal entities



Source: NBG

Figure 25: 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	49.3	59.6	65.4
Nominal GDP, US$ bn	12.2	15.1	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.5	15.8	18.5	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	4,256	4,951	5,623
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%	-6.8%	10.5%	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%	9.6%	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$, average	1.78	1.69	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.82	3.11	3.23	3.12
Population, mn	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances													
Budget revenues, % of GDP	26.9%	27.0%	27.8%	26.0%	26.1%	26.4%	27.0%	26.8%	26.5%	26.2%	25.6%	26.3%	27.2%
Budget expenses, % of GDP	32.3%	29.4%	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	29.4%	34.9%	33.1%	31.5%
Fiscal balance (-deficit), % of GDP	-5.3%	-2.0%	-1.7%	-1.9%	-2.6%	-2.4%	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.7%	-4.4%
Public debt, % of GDP	31.9%	28.3%	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.4%	60.2%	51.1%	51.1%
External Sector													
Current account, US$ 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%	-12.4%	-9.1%	-7.0%
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	5.9	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	1.1	0.5	0.9	1.0
Net FDI, % of GDP	6.0%	6.5%	4.6%	5.3%	8.1%	9.5%	8.2%	10.5%	5.6%	6.0%	3.5%	4.9%	4.8%
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%	73.5%	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%	10.5%	8.5%

Source: NBG, MOF, Geostat, Galt & Taggart

Note: Fiscal balance according to IMF Program Definition

Disclaimer

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