



Georgian Economy The Recovery Continues

Georgia | Economy
September 17, 2020

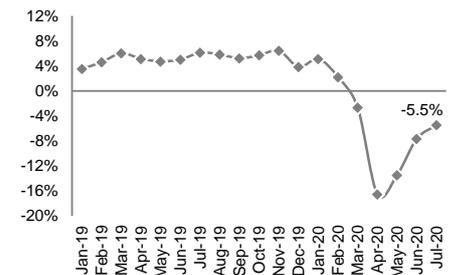
The economic recovery continues to strengthen in Georgia despite the halt in international tourism. Decent fiscal stimulus is supporting domestic demand, along with strong growth in remittances since June 2020 and continuation of bank lending. Notably, VAT revenue growth turned positive in August 2020 for the first time since March this year, hinting at better-than-expected recovery dynamics. We do not assume the reimposition of strict lockdown measures in our base case scenario, though the risk has increased in recent days amid rising COVID-19 cases. We maintain our growth forecast (-5.1% in 2020), but note that our GEL forecast (GEL3.1/US\$ in 2H20) is skewed to the weaker side. This, however, supports further adjustment in imports and a current account deficit of below 9% of GDP in 2020, in our view. The NBG maintained its key rate at 8.0% on September 16, despite the pullback in inflation, as the regulator remains cautious of GEL weakness and a possible deterioration in sentiment due to the recent increase in COVID-19 cases and approaching elections.

Economic activity continues to strengthen

Preliminary data for August hints at a better-than-expected recovery: VAT revenues increased 2.3% y/y in August, for the first time since March, and the reduction in exports slowed 2x to -7.5% y/y, significantly improving the trade deficit. Notably, COVID-19 cases have risen in recent days, prompting the government to reintroduce some light restrictions (e.g. banning wedding celebrations) and postpone the opening of some businesses (indoor concerts, sporting events), regular international flights (until November 1, 2020) and schools (physical learning process suspended in big cities until October 1). However, we believe that the enhancement of the healthcare system and the government's efforts to strengthen compliance with precautionary measures (wearing masks and social distancing, mostly poorly observed in Georgia's regions) should limit the rate of virus spread and reduce the probability of a reintroduction of strict restrictions, as the Prime Minister and other high level officials communicated recently.

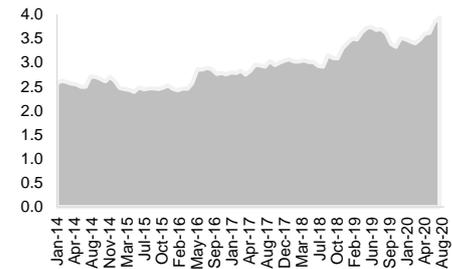
Economic contraction in Georgia slowed to 5.5% in July from 7.7% in June and 12.6% in 2Q20, in line with our expectations. Notably, this recovery took place without sizable easing of monetary policy, with the key rate at 8.0% (reduced by 1ppts YTD), far above the 6.5% neutral level. These recovery dynamics have improved market expectations somewhat (as reflected in reduced deposit dollarization and a recovery in consumer demand for furniture and electronics, etc.) as many anticipated more negative results in the tourism-dependent economy.

Figure 1: Real GDP growth, % change y/y



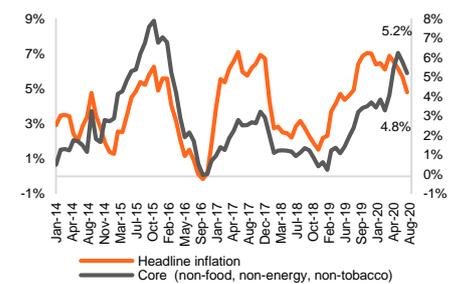
Source: Geostat, rapid estimates

Figure 2: Georgia's gross international reserves, US\$ bn



Source: NBG

Figure 3: Annual inflation



Source: Geostat

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Importantly, the continuation of bank lending also supported the economic recovery, with credit growth at 13.4% y/y in July excluding FX effects (and 0.9% growth compared to March 2020), and we expect growth to remain positive at c.5-10% through to the end of the year. Judging by financial sector data, activities in most sectors have returned to normal levels, with only tourism (hotels, restaurants, travel agencies) dragging down growth. We expect the GDP contraction to slow to 5.2% in 3Q20 and to 4.2% in 4Q20, resulting in a total contraction of 5.1% for 2020 in our base case scenario, which we maintain despite rising COVID-19 cases in recent days.

For a more pessimistic scenario regarding a second wave of the virus and strict lockdown measures, we maintain our forecast for an 8.6% contraction in 2020. For 2021, we expect the economy to move into positive growth territory and forecast 5.0-5.5% growth, assuming the gradual return of international tourists.

Fiscal support is a significant driver of recovery in 2020, with government support for businesses at 3.8% of GDP and for households at 2.7% of GDP. Notably, capital expenditure partly recovered in June (-3.1% y/y) and increased strongly in July (+24.4% y/y), having fallen 41.1% y/y in May 2020 due to the lockdown. The government's mortgage interest rate subsidies are also supportive of bank lending, with demand for new apartments peaking. In addition, the government announced that it would use a portion of its fiscal buffers (total of GEL 2.7bn – for more information see our note from July 21, 2020) to finance households' utility costs from November to February (like it did during March-May 2020), allocated GEL 200mn to infants and adults (0-17 years old), and to fund tuition fees for socially vulnerable students.

Adjustment in external balance continues

The goods trade balance improved, with exports performing better than expected and savings from oil imports. In 8M20, exports decreased by 14.7% y/y (with drop reducing 2x in August to -7.5% y/y) and imports fell 17.5% y/y, resulting in a 19.3% y/y improvement in the trade deficit (a saving of US\$ 689mn y/y), a trend we expect to continue. Furthermore, remittances rebounded strongly from June (+22.1% y/y in July and +25.8% y/y) after sinking in April. This rebound was supported by growing transfers from the EU (accounting for c. 42.0% of total inflows), as well from other countries (USA, Turkey, Ukraine, etc.). Notably, the absence of international tourism is partly counterbalanced by Georgians not traveling abroad (by our estimates, local tourists are expected to compensate for c.30% of lost international tourism revenues). Assuming a continued adjustment in the trade balance and continued growth in remittances, we expect the current account deficit below 9% of GDP in 2020.

Price pressures are easing

Annual inflation retreated to 4.8% in August as the pass-through effect of GEL depreciation diminished and a good harvest and subdued demand limited food price increases. We forecast inflation to reduce further to around 3.5% through 2020, helped by last year's high base (c.7% from September through December 2019). The NBG has cut the key rate by 1ppt to 8.0% YTD. We see room for a further cut of 0.5-0.75ppts in 2020, but assume this will happen at the end of this year, with the regulator remaining



cautious of GEL weakness, rising oil prices and deterioration in sentiment due to the recent increase in COVID-19 cases and imminent elections. We expect inflation to converge to the 3.0% target in 2021 and an additional rate cut in 1H21 (up to 1.0ppts).

Currency

The GEL was trading at close to 3.06/US\$ in June-August 2020, before weakening to 3.15/US\$ in mid-September. We expect the GEL to sit at c.3.1-3.2/US\$ through 2020. Fresh donor funding, reduced deposit dollarization and NBG FX sales were instrumental in stabilizing the currency during the summer. Recent weakness may be attributed to increased fiscal spending and some deterioration in expectations due to rising COVID-19 cases as well as the upcoming elections (after which many Georgians believe the GEL will weaken). By our rough estimates, the external balance deteriorated by c.US\$ 770mn y/y (netting out trade balance, remittances and tourism) in 8M20. The NBG's FX sales, to the sum of US\$ 421.2mn (monthly sales of c. US\$ 40-80mn) YTD, largely offset the FX shortfall. Importantly, despite these interventions, international reserves reached an all-time high of US\$ 3.9bn in August 2020, replenished by donor funding. The NBG will continue interventions to ease pressure on the currency and as the governor commented recently additional FX sales expected at over US\$ 200mn through year end.

Table 1: Government's Business Assistance Measures, 2020 budget

#	Covid-19 one-off business supporting measures	GEL mn	As % of GDP
1	Credit-guarantee scheme	330	0.7%
2	Flight subsidies and quarantine service	45	0.1%
3	Loan interest rate subsidy for hotels	70	0.1%
4	Property tax exemption for hotels	45	0.1%
5	Small grants	20	0.0%
6	Construction sector support (including mortgage subsidies)	40	0.1%
7	Support to agriculture	139	0.3%
8	Additional VAT refunds	600	1.2%
9	GEL liquidity injection in commercial banks	600	1.2%
Total		1,889	3.8%

Source: MOF

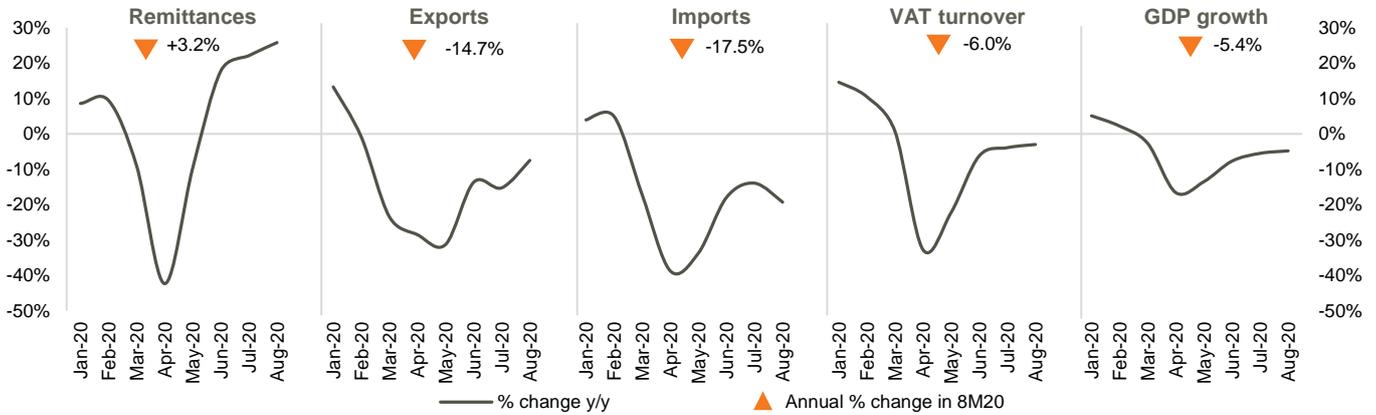
Table 2: Government's Social Assistance Measures, 2020 budget

#	Covid-19 one-off social assistance measures	GEL mn	As % of GDP
1	Healthcare-related costs of Covid-19 (testing, treatment, etc.)	285	0.6%
2	Health system preparedness improvement	60	0.1%
3	Compensation for self-employed persons who lost jobs (one-off GEL 300)	75	0.1%
4	Compensation for private sector employees who lost jobs (GEL 200 for 6 months)	450	0.9%
5	Income tax relief to businesses who retain workers for 6 months	250	0.5%
6	Direct transfers to vulnerable families for 6 months	48	0.1%
7	Direct transfers to large families for 6 months	13	0.0%
8	Direct transfers to disabled adults and children for 6 months	24	0.0%
9	Subsidies for utility bills (electricity, natural gas) to households that consume < KV200 and 200m ³ per month	170	0.3%
Total		1,375	2.7%

Source: MOF

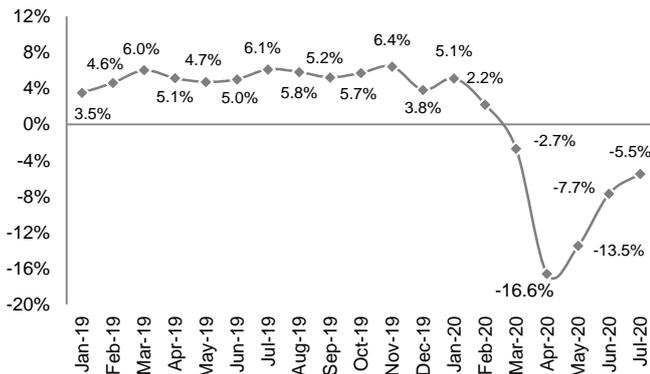


Figure 4: Tracking Georgia's Economic Recovery



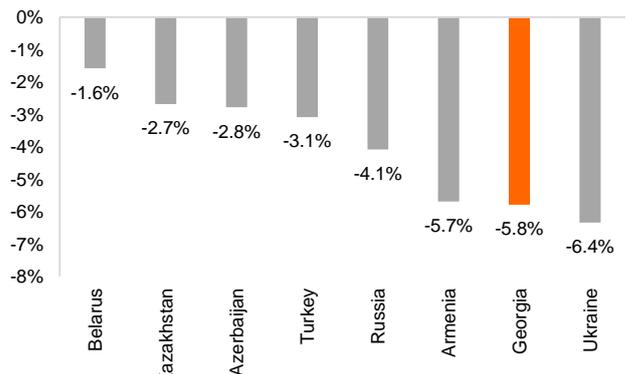
Source: Geostat, NBG, MOF, Galt & Taggart estimate for August figure of VAT and GDP

Figure 5: Real GDP growth, % change y/y



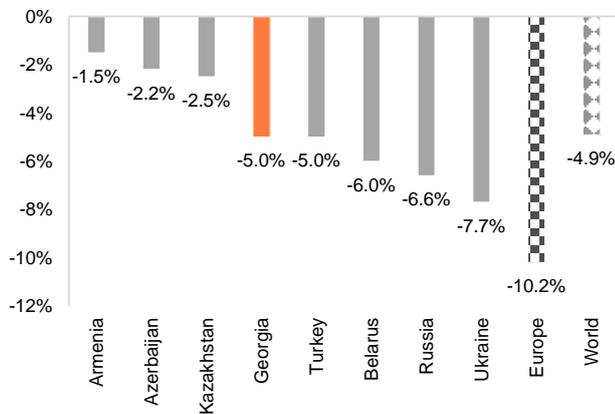
Source: Geostat, rapid estimates

Figure 6: Real GDP growth in 7M20, % change y/y



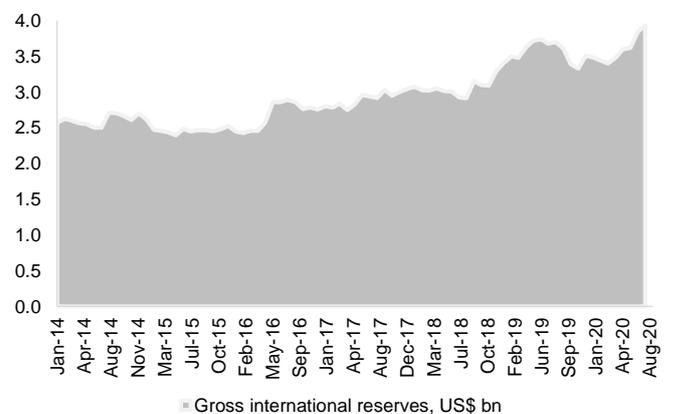
Source: Statistic offices, Note: 1H20 data for Ukraine and Turkey

Figure 7: IMF's GDP forecast for 2020



Source: IMF, Latest-2020

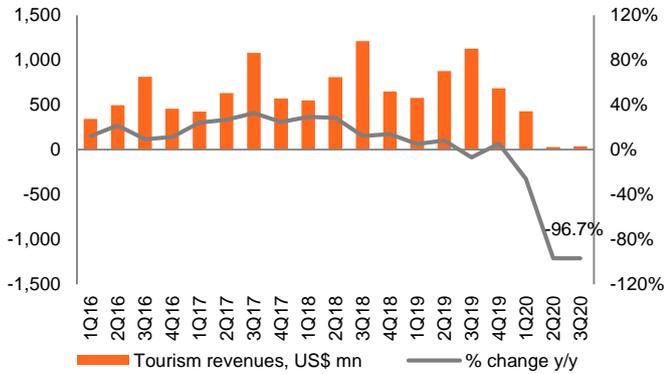
Figure 8: Georgia's international reserves



Source: NBG

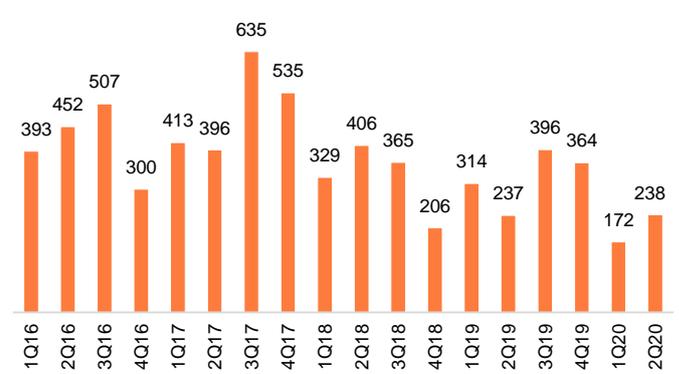


Figure 9: Tourism revenues, US\$ mn



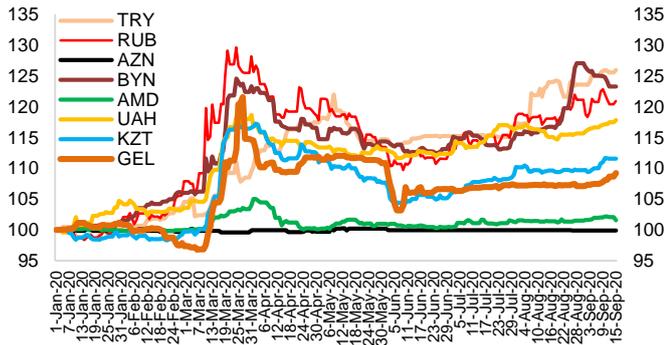
Source: NBG
Note: 3Q20 data is Galt & Taggart's estimate

Figure 10: FDI in Georgia, US\$ mn



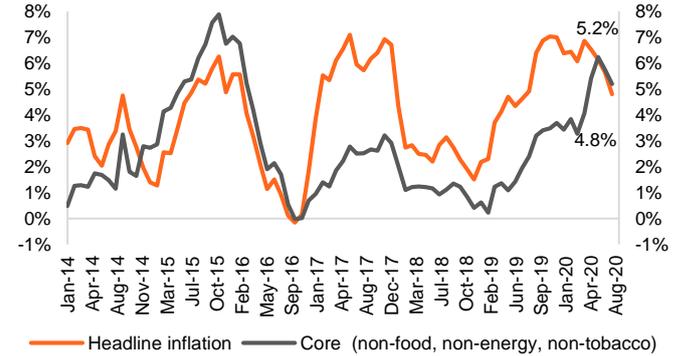
Source: Geostat

Figure 11: Currency vs. US\$, (index, 1 Jan 2020 = 100)



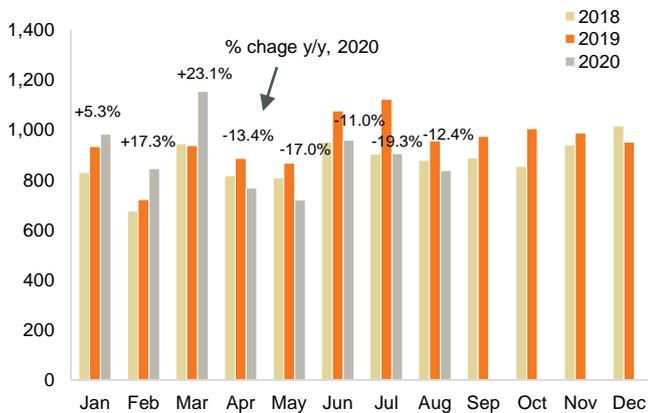
Source: Bloomberg

Figure 12: Inflation in Georgia



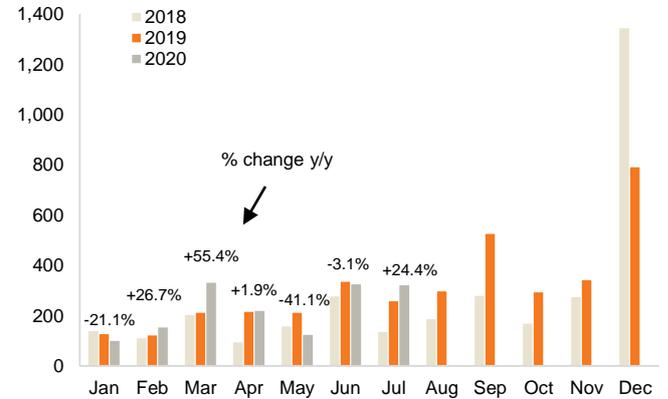
Source: Geostat

Figure 13: Consolidated budget tax revenues, GEL mn



Source: MOF
Note: Tax revenue reduction since May 2020 reflects significant tax relief for different business

Figure 14: Consolidated budget capex, GEL mn



Source: MOF

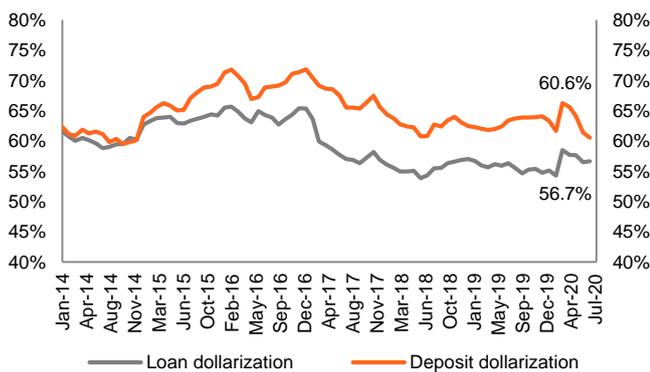


Table 3: External flows: goods exports & imports, remittance and tourism revenues

	8M17	8M18	8M19	8M20
Exports, US\$ mn	1,694	2,163	2,430	2,071
% change y/y	29.1%	27.7%	12.3%	-14.7%
Imports, US\$ mn	4,990	6,118	5,999	4,951
% change y/y	8.0%	22.6%	-2.0%	-17.5%
Trade deficit, US\$ mn	-3,295	-3,955	-3,569	-2,880
% change y/y	-0.4%	20.0%	-9.8%	-19.3%
Remittances inflows, US\$ mn	877	1,027	1,107	1,142
% change y/y	19.8%	17.1%	7.8%	3.2%
Remittances outflows, US\$ mn	132	148	147	151
% change y/y	5.1%	12.1%	-0.6%	2.9%
Net Remittances, US\$ mn	745	879	960	991
% change y/y	22.8%	18.0%	9.2%	3.2%
Tourism inflows, US\$ mn	1,868	2,236	2,264	484
% change y/y	29.6%	19.7%	1.3%	-78.6%
Tourism outflows, US\$ mn	292	332	420	130
% change y/y	13.3%	13.7%	26.5%	-69.1%
Net Tourism Revenues, US\$ mn	1,576	1,904	1,844	354
% change y/y	33.2%	20.8%	-3.1%	-80.8%
Net external flows, US\$ mn	-975	-1,173	-765	-1,536

Source: NBG, Geostat, Galt & Taggart

Figure 15: Dollarization



Source: NBG

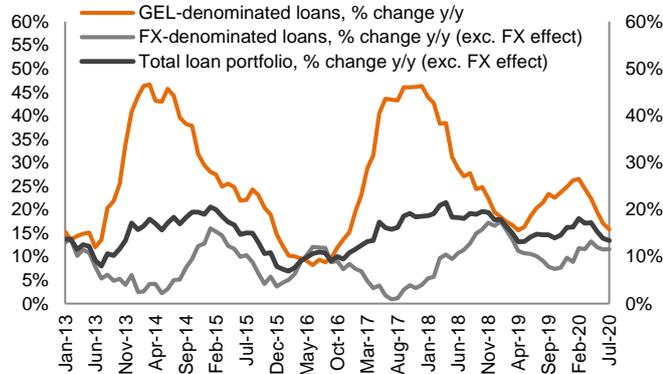
Figure 16: Non-performing loans, % of total loans



Source: NBG

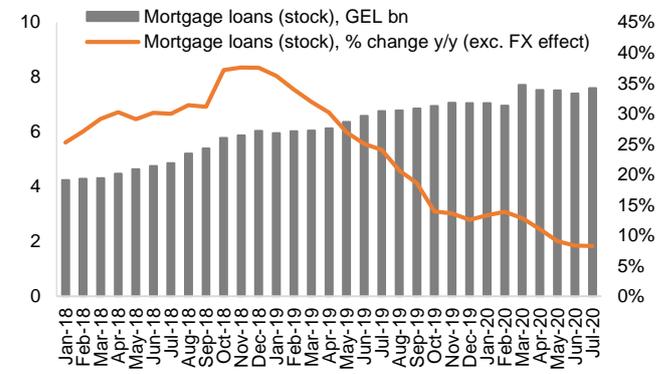


Figure 17: Banking loans growth



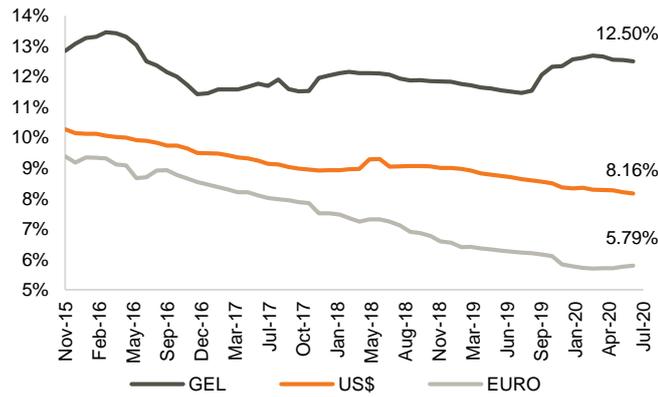
Source: NBG

Figure 18: Mortgage loans



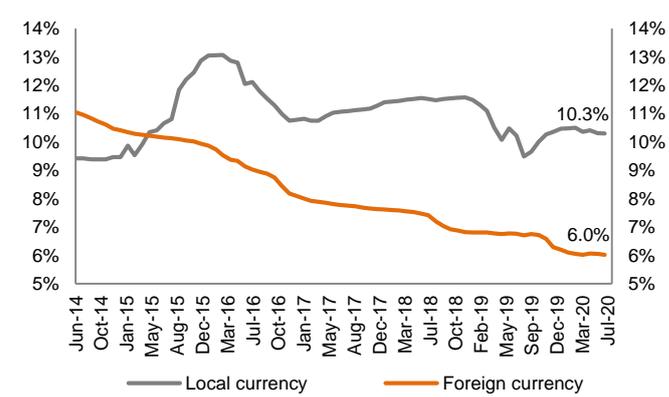
Source: NBG

Figure 19: Interest rates on loans to legal entities



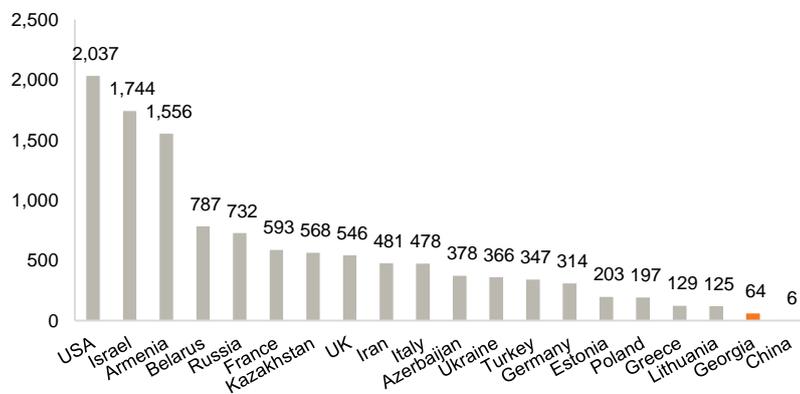
Source: NBG

Figure 20: Interest rates on mortgage loans



Source: NBG

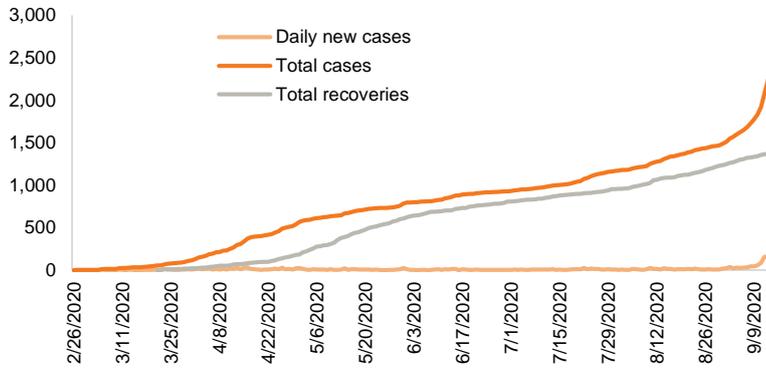
Figure 21: Total COVID-19 cases per 100,000 persons



Source: Johns Hopkins, Worldometers
Note: as of 9/15/2020 11:30 AM



Figure 22: COVID-19 statistics in Georgia, persons



Source: NCDC
Note: as of 15/09/2020 11:30 AM



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