



## Georgian Economy Ongoing Recovery Despite Labor Market Weakness and Tough Times for Tourism

Georgia | Economy  
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Georgia maintains its position as a stellar performer globally in terms of COVID-19 response, with one of the lowest active coronavirus cases at three per 100,000 people. Since lifting quarantine restrictions, daily new cases have remained very low (unlike in many other countries, including neighboring Azerbaijan and Armenia), at between one and 10 cases, mostly related to transit cargo drivers. Notably, despite the earlier communication that Georgia's borders would be open for international tourism from 1 July 2020, the government extended the restrictions, with regular flights suspended until further notice. Later, the government announced that it would unconditionally reopen borders to the citizens of five EU countries – Germany, France, Estonia, Latvia, and Lithuania – arriving via direct flights, and business travelers from all countries with the prior approval of the relevant government agency. This worsens the outlook for international tourism, but a strong rebound in remittances, a V-shaped recovery in consumer expectations, the resumption of domestic tourism and normalized business activity make us optimistic about recovery dynamics.

### Recent economic trends

April and May reported almost similar economic contraction (-16.6% and -13.5%, respectively), as both months were non-working, with a nationwide curfew and lockdown restrictions in force. Economic uncertainty remained at a record high, according to the consumer confidence index by ISET, but consumer expectations saw a V-shaped recovery in May, amid a stabilized GEL, success in fighting COVID-19 and the imminent economic reopening. Unemployment increased considerably in May-June, with 105,000 self-employed workers receiving a one-off GEL 300 subsidy, and 125,000 people who had lost their formal jobs receiving a GEL 200 monthly subsidy. However, recovery dynamics were strong as remittances improved in May and grew strongly (+17.8% y/y) in June, alleviating the pressure from labor market weakness and the absence of tourism. Notably, the increased unemployment is mostly concentrated in tourism-related sectors where wages are generally low. As a result, consumer demand improved in June, based on banking card payment data; spending on non-essential goods and services saw a V-shaped recovery in June and growth in non-discretionary spending was flat vs. April despite front-loaded demand. VAT turnover statistics (a good proxy for economic activity) also demonstrate a recovery in business activity, mostly in trade, construction, real estate and manufacturing. This also implies that the contraction in April-May was mostly due to restrictions on physical access to goods and services rather than demonstrating the extent of demand collapse. External trade statistics for June also support the argument for domestic/external demand as reduction in both exports and imports halved (-14.0% y/y in exports and -22.0% y/y in imports) after exports decreased by an average of 29.9% y/y and imports fell 37.9% y/y in April-May. Considering June's statistics, we expect the economic contraction to fall to a single digit rate (-5-7%) in June with further improvements anticipated in the coming months.

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Notably, weakness in economic activity also reflected significantly reduced government spending in April-May (especially in May with capital expenditure down 41.1% y/y), which is set to recover with the resumption of economic activity. The government's business support measures and mortgage interest rate subsidies are also expected to boost bank lending recovery. Additionally, consumer spending should be helped by increased wages (+200mn) for soldiers, nurses, teachers, etc. and increased pensions from July.

Tourism remains a major weakness. Therefore, before any full-scale recovery in international travel, the industry will need a prolonged period of banking loans interest rate subsidies and property and income tax relief, in our view. However, we expect Georgian tourists to spend US\$ 500mn locally in 2H20 (of which US\$ 300mn will be generated from locals not traveling abroad and US\$ 200mn generated from ordinary local tourist spending), bringing some relief to the industry. In our base case scenario, we expect a weak recovery in tourism (with revenues projected to decrease by 64% y/y in 2H) and GDP growth at -5.1%, down from our -4% growth projection in April. Even with sharper decline in tourism, recovery dynamics can be supported by election related spending, acceleration in public capital expenditures (with c.70% of budgeted amount to be spent in 2H) and growing remittances, which we hope to continue. However, we do not rule out the likelihood of a pessimistic scenario – generally, the neighboring countries of Turkey, Azerbaijan, Armenia and Russia account for 70% of total arrivals, and as the epidemiological situation remains unfavorable in these traditional source markets, the timeline for reopening borders is still unclear. Visitors from other countries could therefore barely compensate for the revenue shortfall from neighbors. In our pessimistic scenario we project the economic contraction to widen to 8.6% in 2020, assuming tourism revenues to fall by 90% y/y in 2H20, underspending in public capital expenditures and further deterioration in expectations. Therefore, there is a likelihood of a V-shaped recovery in the Georgian economy, but if the weakness in tourism persists and consumer and business confidence deteriorates, we might see a U-shaped scenario in which the utilization of government deposits in 4Q20 and 1Q21 and policy easing from the central bank will be instrumental in supporting the economy.

### **Currency**

The GEL hit a record low of 3.48 vs. US\$ on 27 March 2020, then stabilized at 3.2/US\$ (supported by the NBG's interventions) and started to appreciate from mid-May, trading at close to 3.0/US\$ since June. The currency's trajectory reflects a combination of different factors: the conversion of FX deposits into GEL (while the inverse was one of the major reasons for the GEL weakness in March), low demand and a similar trend of appreciation amongst other regional currencies. By our rough estimates, the external balance deteriorated by US\$ 306mn (netting out trade balance, remittances and tourism) in 1H20. The NBG's FX sales, to the sum of US\$ 215mn in 1H, largely offset the FX shortfall. With the ongoing recovery and increased demand for imports from public capex and businesses, the NBG is expected to intervene to ease pressure on the GEL, and we expect additional FX sales totaling US\$ 200mn this year. However, despite these interventions, international reserves are anticipated to increase from the current US\$ 3.6bn at the end of 2020 as reserves are replenished by borrowing from donors.



Annual inflation has retreated gradually since the start of the year, reaching 6.1% in June 2020, though still far above the central bank's 3% inflation target. We forecast 5.2% annual average inflation in 2020. The increase in inflation is related to the strengthening influence of GEL weakness and disruption to supply chains. The NBG cut rates twice this year, to 8.25%, to support economic activity despite the ongoing high inflation. We expect additional rate cuts of 0.5-0.75ppts until the end of 2020, and given the time delay in interest rate transmission, a rate cut in August is desirable. We expect further cuts if Georgia takes longer than currently projected to recover.

### Government measures

The government's revised 2020 budget document was approved by parliament in June 2020. The revised budget incorporates the fiscal parameters agreed with the IMF, US\$ 1.5bn in donor funding and fiscal stimulus measures for businesses and households affected by the coronavirus pandemic. The budget framework assumes -4.0% GDP growth in 2020 and sets the deflator at 4.8%. The fiscal deficit is projected to increase to 8.5% of GDP due to the shortfall in revenues (GEL 1.45bn reduction compared to the initial budget) and an increase in expenditure for anti-crisis measures (GEL 1.4bn increase compared to the initial budget). To meet its spending needs, the government plans external borrowing to increase by GEL 4.3bn, and domestic debt is set to rise by GEL 649mn, with total public debt projected at 54.4% of GDP in 2020. The government plans to return to its pre-crisis debt parameters in the medium term. Notably, the government is borrowing more from donors than it currently needs, building a fiscal buffer totaling GEL 2.7bn into the revised budget. Such a buffer builds confidence as funds can be utilized if the crisis deepens or a recovery takes longer than currently projected to materialize. Importantly, the government needs to put more emphasis on the timely implementation of infrastructure projects to support economic recovery, as generally these projects lag budgeted figures.

**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%
<b>Total</b>		<b>1,889</b>	<b>3.8%</b>

Source: MOF

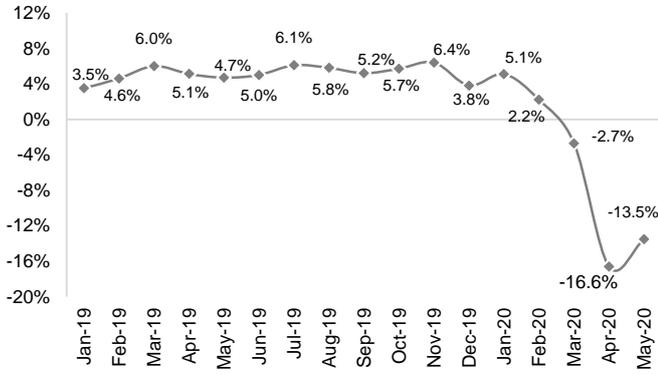
**Table 2: Government's Social Assistance Measures, 2020 budget**

#	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 <sup>3</sup> per month	170	0.3%
<b>Total</b>		<b>1,375</b>	<b>2.7%</b>

Source: MOF

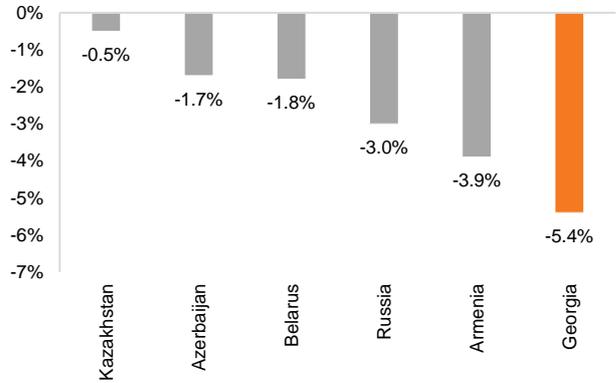


Figure 1: Real GDP growth, % change y/y



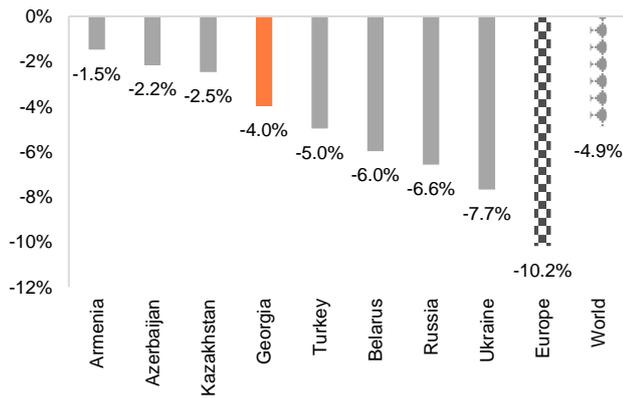
Source: Geostat, rapid estimates

Figure 2: Real GDP growth in 5M20, % change y/y



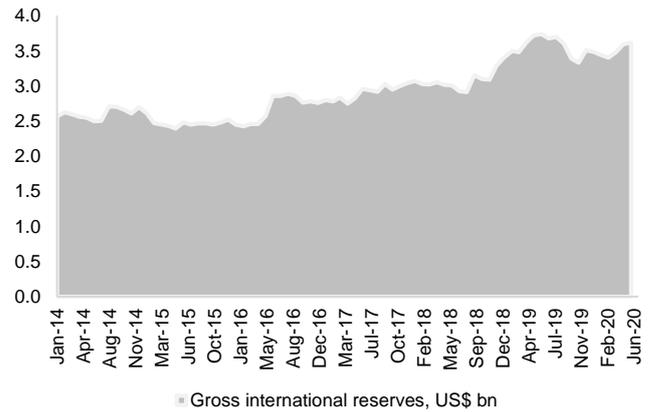
Source: Statistic offices

Figure 3: IMF's GDP forecast for 2020



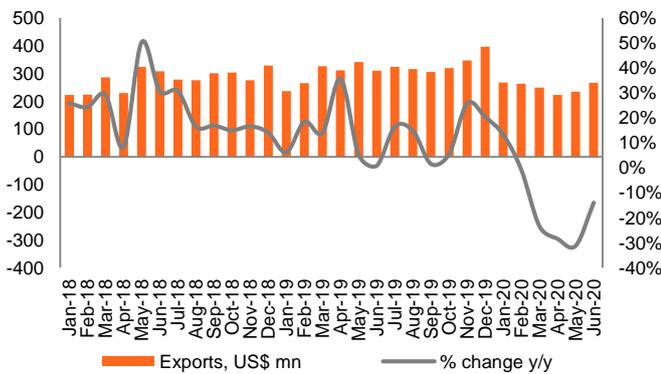
Source: IMF, Latest-2020

Figure 4: Georgia's international reserves



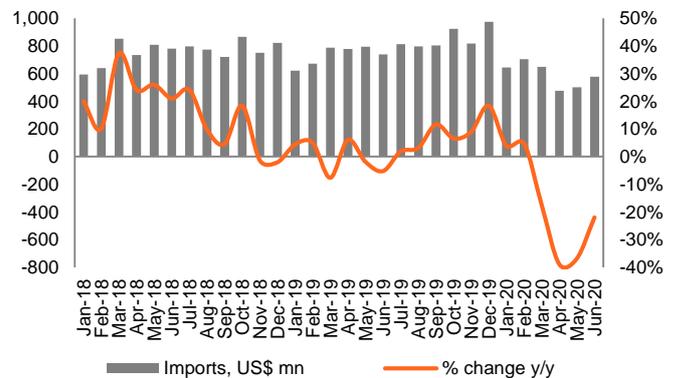
Source: NBG

Figure 5: Goods exports



Source: Geostat

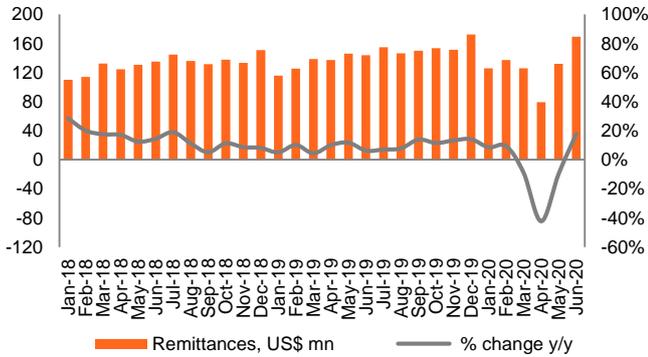
Figure 6: Goods imports



Source: Geostat

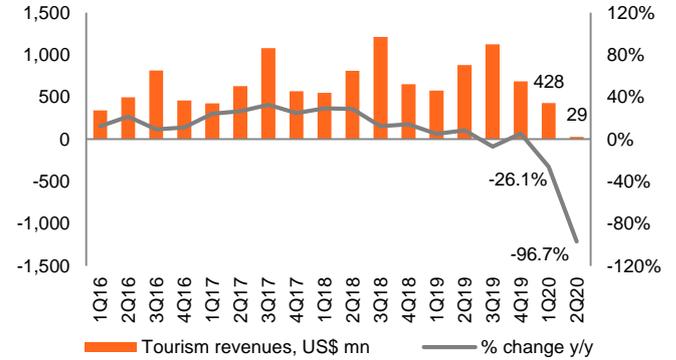


**Figure 7: Remittances in Georgia, US\$ mn**



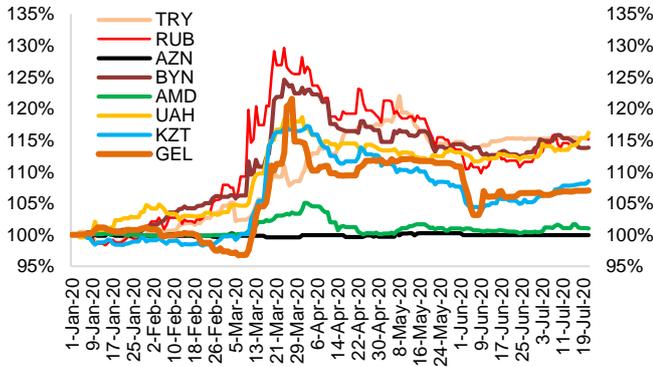
Source: NBG

**Figure 8: Tourism revenues, US\$ mn**



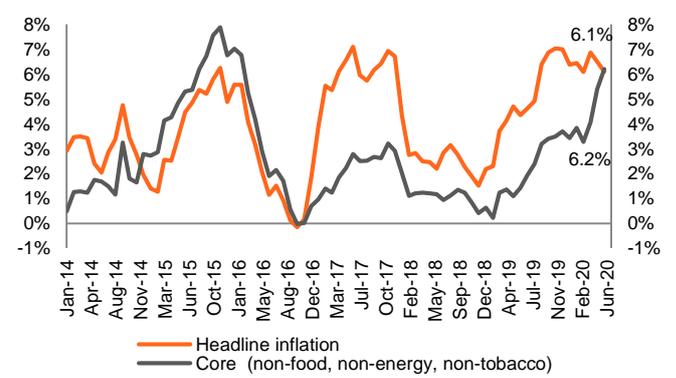
Source: NBG

**Figure 9: Currency vs. US\$, (index, 1 Jan 2020 = 100)**



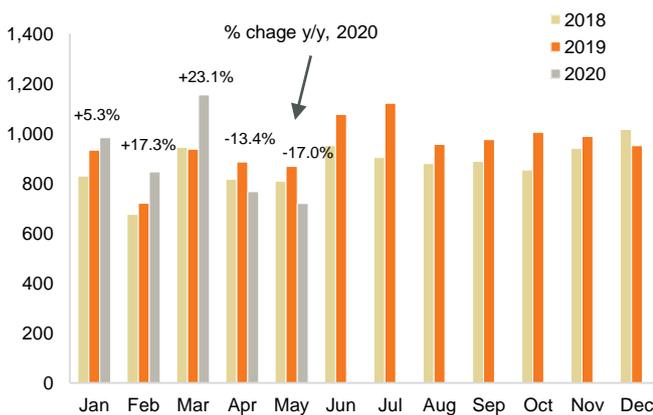
Source: Bloomberg

**Figure 10: Inflation in Georgia**



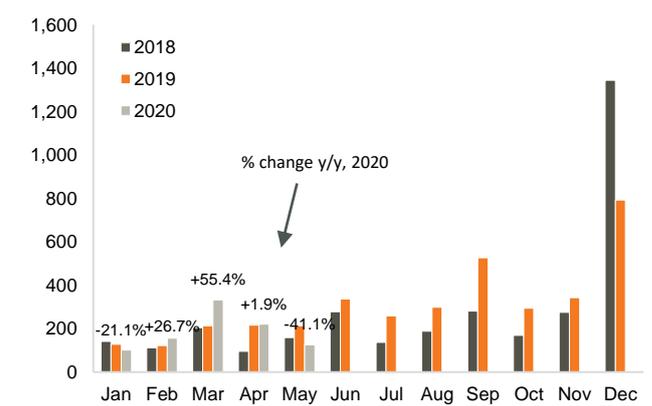
Source: Geostat

**Figure 11: Consolidated budget tax revenues, GEL mn**



Source: MOF

**Figure 12: Consolidated budget capex, GEL mn**



Source: MOF

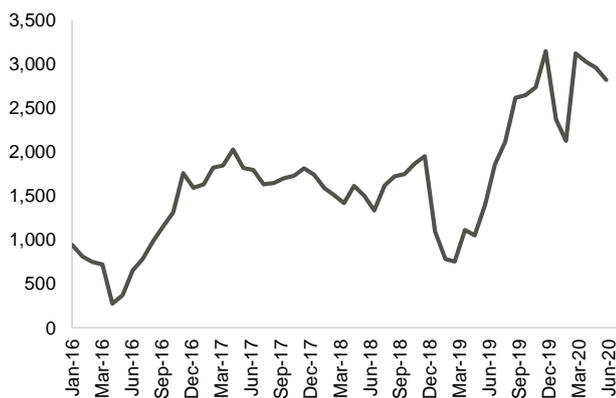


**Table 3: External flows: goods exports & imports, remittance and tourism revenues**

	1H17	1H18	1H19	1H20
<b>Exports, US\$ mn</b>	<b>1,244</b>	<b>1,605</b>	<b>1,789</b>	<b>1,503</b>
<i>% change y/y</i>	30.9%	29.0%	11.5%	-16.0%
<b>Imports, US\$ mn</b>	<b>3,621</b>	<b>4,513</b>	<b>4,389</b>	<b>3,550</b>
<i>% change y/y</i>	9.1%	24.6%	-2.7%	-19.1%
<b>Trade deficit, US\$ mn</b>	<b>-2,377</b>	<b>-2,908</b>	<b>-2,600</b>	<b>-2,047</b>
<i>% change y/y</i>	0.3%	22.4%	-10.6%	-21.3%
<b>Remittances inflows, US\$ mn</b>	<b>633.4</b>	<b>746.5</b>	<b>806.1</b>	<b>769.0</b>
<i>% change y/y</i>	20.6%	17.9%	8.0%	-4.6%
<b>Remittances outflows, US\$ mn</b>	<b>96.6</b>	<b>110.1</b>	<b>108.8</b>	<b>106.1</b>
<i>% change y/y</i>	4.4%	14.0%	-1.1%	-2.6%
<b>Net Remittances, US\$ mn</b>	<b>536.8</b>	<b>636.4</b>	<b>697.3</b>	<b>662.9</b>
<i>% change y/y</i>	24.0%	18.6%	9.6%	-4.9%
<b>Tourism inflows, US\$ mn</b>	<b>1,056</b>	<b>1,361</b>	<b>1,456</b>	<b>456.5</b>
<i>% change y/y</i>	25.7%	28.9%	7.0%	-68.6%
<b>Tourism outflows, US\$ mn</b>	<b>190.9</b>	<b>232.3</b>	<b>299.4</b>	<b>124.1</b>
<i>% change y/y</i>	2.5%	21.7%	28.9%	-58.5%
<b>Net Tourism Revenues, US\$ mn</b>	<b>865</b>	<b>1,128</b>	<b>1,157</b>	<b>332</b>
<i>% change y/y</i>	32.2%	30.5%	2.5%	-71.3%
<b>Net external flows, US\$ mn</b>	<b>-975</b>	<b>-1,143</b>	<b>-746</b>	<b>-1,052</b>

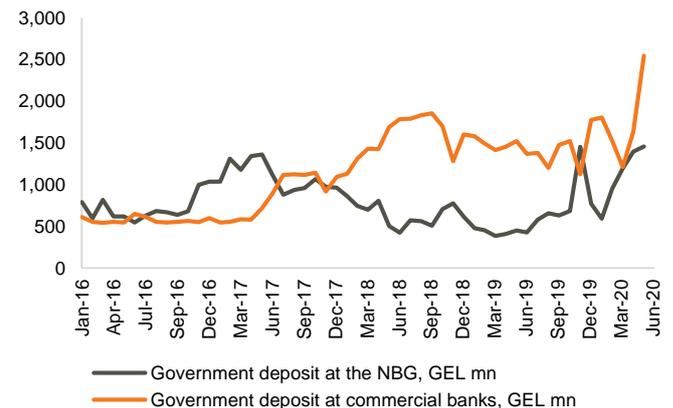
Source: NBG, Geostat, Galt & Taggart

**Figure 13: NBG's loans to banks**



Source: NBG

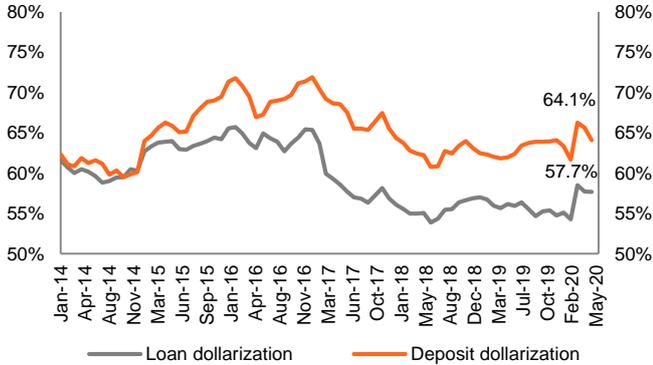
**Figure 14: Government deposits**



Source: NBG, Treasury



**Figure 15: Dollarization**



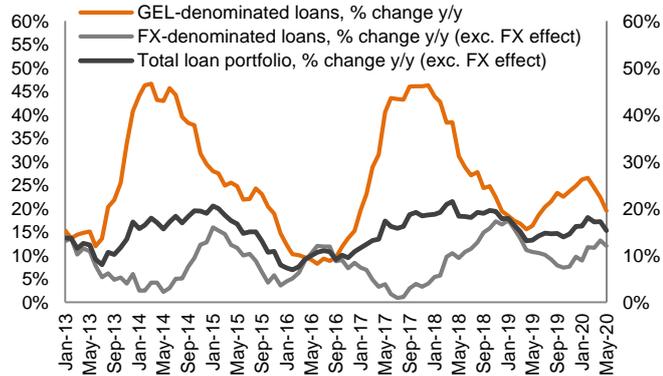
Source: NBG

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



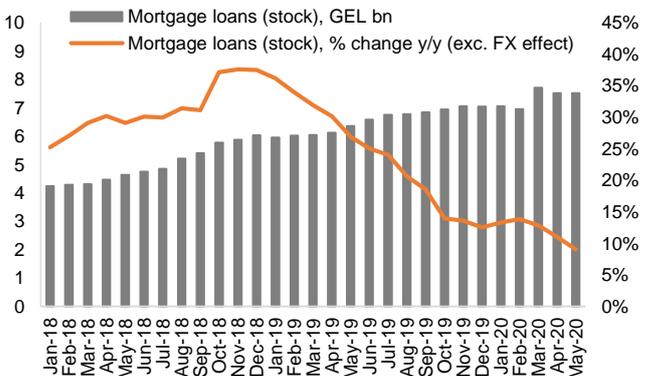
Source: NBG

**Figure 17: Banking loans growth**



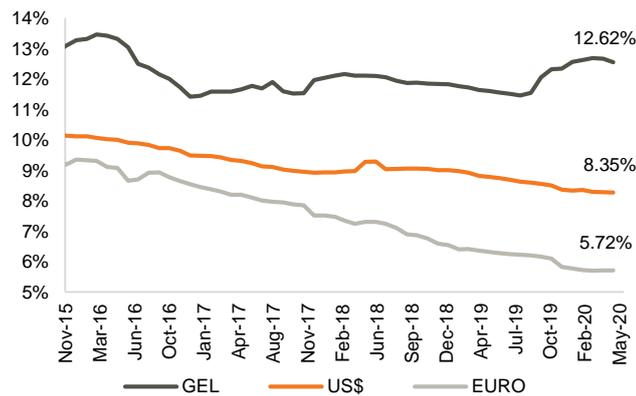
Source: NBG

**Figure 18: Mortgage loans**



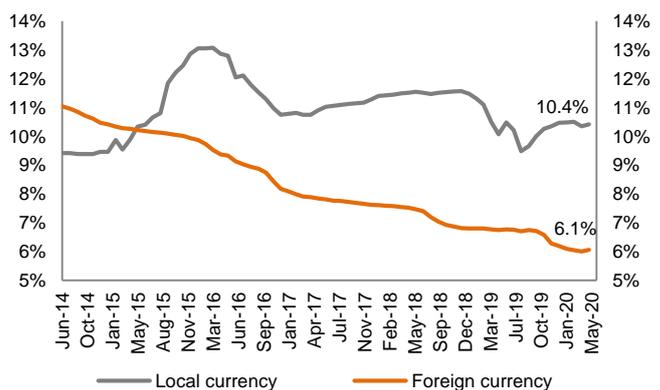
Source: NBG

**Figure 19: Interest rates on loans to legal entities**



Source: NBG

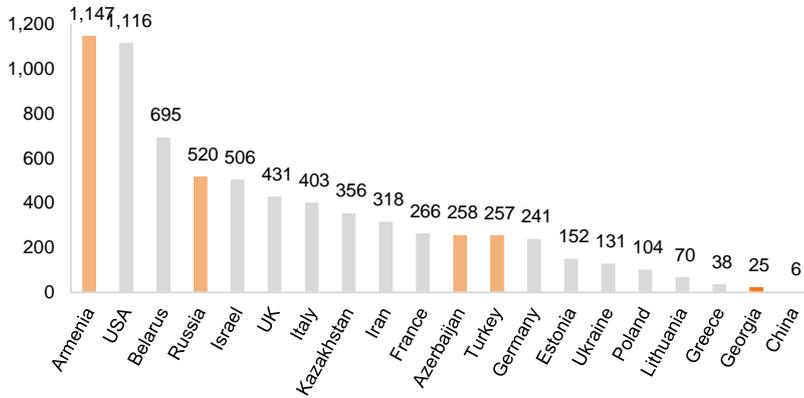
**Figure 20: Interest rates on mortgage loans**



Source: NBG

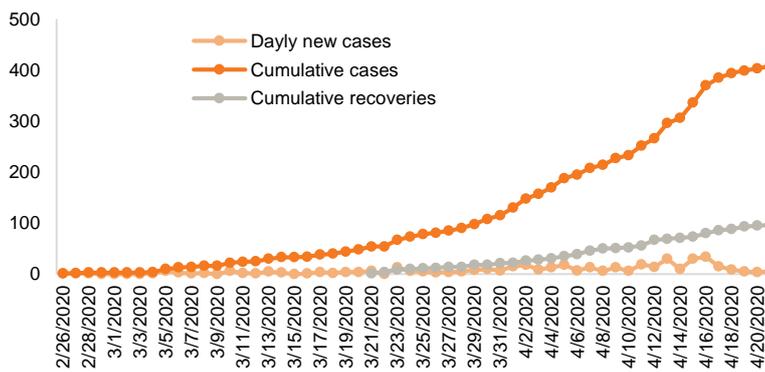


**Figure 21: Total COVID-19 cases per 100,000 persons**



Source: Johns Hopkins, Worldometers  
Note: as of 7/17/2020 11:00 AM

**Figure 22: COVID-19 statistics in Georgia, persons**



Source: NCDC  
Note: as of 7/17/2020 11:00 AM



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