



# Georgian Economy First Draft of 2021 Budget – a Plan to Repay a Sovereign Eurobond

Georgia | Economy  
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- The government submitted the first draft of its 2021 budget to parliament, together with the medium-term forecasts for 2021-24. It must pass three parliamentary hearings before it becomes law, and changes to the first draft estimates are in practice very frequent. Given parliamentary elections on October 31, 2020, the final draft will be discussed by a new parliament.
- The MOF (Ministry of Finance) forecasts growth to rebound to 5.0% in 2021. The draft budget sets the GDP deflator at 4.0% in 2021.
- Capital expenditures are set to increase by 22.8% y/y to 8.3% of GDP in 2021, supporting growth. Current expenditures are set to decrease by 5.2% y/y to 22.5% of GDP in 2021 from 25.9% in 2020, however is subject to revisions in final draft based on MOF.
- Fiscal deficit is set at 5.1% of GDP, however the need for further anti-crisis fiscal stimulus in 2021 expected to widen the fiscal deficit to 5.5% of GDP versus 5.1% in the initial budget document, in our view.
- Explanatory note to the budget states that the final parameters will be more accurate after incorporating discussions with the IMF in October, updated world economic forecasts by the IMF, and taking into account the need for additional support to the economy.
- We believe that outcome of the elections will not impact fiscal consolidation path considering Georgia's track record, fiscal rule and ongoing IMF program. Government plans to achieve 3.0% of GDP fiscal deficit from 2023, as law allows the deficit to exceed the cap - 3% of GDP - for only 3 years.
- Government plans to repay US\$ 500mn Eurobonds and also reduce net domestic debt by GEL 855mn y/y in 2021. As a result, public debt is projected to decrease from 57.9% of GDP in 2020 to 55.9% in 2021.

## Key parameters

Based on the explanatory note by MOF, the first draft of the 2021 budget and the baseline scenario incorporate relatively conservative medium-term forecasts for 2021-24, and revisions will be made to the final version. According to the Budget Code of Georgia, the final version of the budget must be submitted to the parliament by November 30, by which time the MOF expects to have more complete information about the vaccine, the IMF's updated world economic forecasts (which will be released during the 2020 annual meeting on October 12-18) and to have consulted with the IMF mission in Georgia in October. According to the MOF, this information will help it to more accurately determine the current state of the economy, the resources required by the healthcare system and the financial packages needed to support the population, individual sectors and the economy as a whole in 2021.

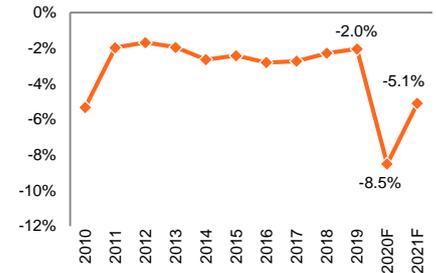
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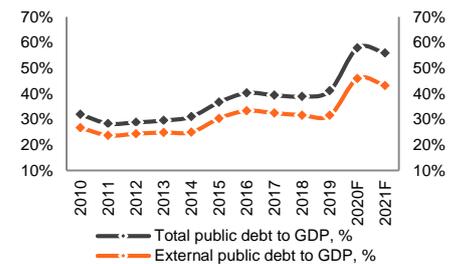
**Figure 1: Fiscal deficit to GDP**



Source: MOF, Geostat

Note: Fiscal deficit is defined according to IMF program definition

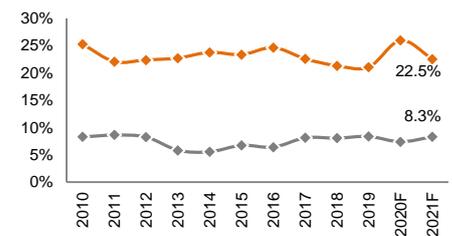
**Figure 2: Public debt to GDP**



Source: MOF, Geostat

Note: Based on 1<sup>st</sup> draft of 2021 budget

**Figure 3: Budget expenditures to GDP**



Source: MOF, Geostat

Note: Based on 1<sup>st</sup> draft of 2021 budget



The draft budget is based on the MOF's revised forecast, with the 2020 GDP contraction widening to 4.9% (from -4.0%), which is now close to both our forecast and IFI projections. The MOF forecasts growth to rebound to 5.0% in 2021. The draft budget sets the GDP deflator at 5.0% in 2020 and 4.0% in 2021. Tax revenues are set to increase by 16.1% y/y, above nominal growth, to 22.4% of GDP (still below 22.8% in 2019), from 21.0% in 2020, mostly reflecting the end of some tax exemptions in 2020, in our view. The MOF also plans to continue to refund VAT arrears to businesses in the amount of GEL 1bn in 2021 from over GEL 1bn in 2020. The fiscal deficit is projected to reduce to 5.1% of GDP (IMF methodology) in 2021 from 8.5% in 2020. Government plans to achieve 3.0% of GDP fiscal deficit from 2023 (law allows the deficit to exceed the cap - 3% of GDP - for only 3 years). Georgia's track record, fiscal rule and ongoing IMF program are supporting fiscal discipline.

### **Expenditures**

Current expenditure is set to decrease by 5.2% y/y to 22.5% of GDP in 2021 from 25.9% in 2020, however, it is subject to revisions. Notably, the deputy finance minister commented that "Part of the measures against the pandemic have not yet been included in the budget, neither in the direction of health, nor in support of social and economic directions, because there is still a lot of uncertainty". Meanwhile, 2021 current expenditure reflects a legislative initiative regarding the indexation of pensions (GEL 200mn needed, this change de-links political cycle and budget formation preserving fiscal sustainability), and the full-year effect of salary increases for teachers, soldiers, police officers, etc, being raised from 2H20. We therefore expect current expenditure to increase in the final draft to c. 24% of GDP and anti-crisis fiscal stimulus to widen the fiscal deficit to 5.5% of GDP from 5.1% in the initial budget document (this may be financed through government deposits and debt parameters discussed below will be changed accordingly, in our view. Notably, debt parameters are also subject to exchange rate, MOF does not make exchange rate forecast and foreign debt parameters are calculated using official exchange rate as of submission date of the budget to the parliament). In the medium term, however, current expenditures remain at around 23% of GDP based on 2021-24 medium-term government forecasts.

Based on the draft budget, capital expenditures are set to increase 22.8% y/y to 8.3% of GDP in 2021. This reflects the continuation of large infrastructure projects starting in 2019-20, such as the East-West highway and the North-South route. However, given plans to reduce the fiscal deficit in 2022-24, the government intends to decrease capital expenditure to an average 6.4% of GDP in 2022-24 (which is still high in Georgia compared to peer countries).

### **MOF plans to repay more debt than it borrows in 2021**

Based on a debt sustainability analysis, which is an integral part of the 2021 draft budget package, government deposits are expected to reach GEL 4.2bn at the end of 2020 (this is the sum of deposits accumulated in 2019 and extra funds borrowed from IFIs in the amount of GEL 2.7bn in 2020). In the event that there are no complications with the virus and economic parameters are in line with projections, then the accumulated deposits will be used to fulfill fiscal needs such as the repayment of US\$ 500mn in Eurobonds due in 2021. During a TV interview, the finance minister also stated that the government is "seriously working on a scenario" to repay its Eurobond debt. Taking into account the Eurobond repayment and reduction in net domestic debt by GEL 855mn y/y, public debt is projected to decrease from 57.9% of GDP in 2020 to 55.9% in 2021 and gradually to 44.0% by 2030.



**Table 1: 2021 consolidated budget parameters, first draft**

Consolidated budget	2019	2020F, budget law approved last year	2020F, revised budget	First draft 2021F
Real GDP growth	5.1%	4.5%	-4.9%	5.0%
Nominal GDP growth	12.1%	8.2%	-0.1%	9.2%
Nominal GDP, GEL bn	50.0	53.1	49.9	54.5
GDP deflator	6.6%	3.5%	5.0%	4.0%
CPI inflation, average	4.9%	3.0%	5.1%	3.2%
Tax revenue growth, y/y	8.7%	8.8%	-8.0%	16.1%
Tax to GDP	22.8%	23.2%	21.0%	22.4%
Current spending to GDP	21.0%	21.5%	25.9%	22.5%
Capex + net lending to GDP	8.1%	7.1%	7.2%	8.0%
Consolidated budget receipts, GEL bn	15.6	17.0	20.4	17.1
Consolidated budget payments, GEL bn	15.7	16.3	17.7	19.5
Net change in government deposits (+accumulation), GEL mn	-96.6	700.0	2,725	-2,307
Net domestic borrowing, GEL mn	898	1,131	1,780	925
Net external borrowing, GEL mn	470	888	5,199	-430
Fiscal deficit to GDP (IMF definition)	2.0%	2.5%	8.5%	5.1%
Government debt to GDP	41.2%	42.5%	57.9%	55.9%

Source: MOF, 2021 budget first draft



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