GALT & TAGGART
RESEARCH

Georgian Economy
GDP above pre-crisis level in 1H21

Georgia | Economy
August 11, 2021

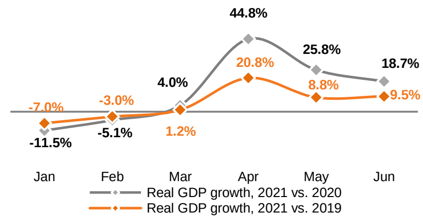
Georgian economy quickly regained COVID crisis losses in 1H21 helped by pent-up demand, strong goods exports, solid remittances, and ongoing recovery in tourism. Investments also expected to contribute positively to growth in 2021 boosted by public infrastructure spending along with increased private sector activity (corporate lending accelerated markedly from April). Real GDP growth came in at 12.7% y/y in 1H21, which is also 5.7% higher vs. 1H19 level, beating market expectations. We now expect 2021 real GDP growth at 8.6% up from 7.0% projected in June. We incorporate risks related to COVID pandemic and related impediments in economic activity in this growth projection. Inflation in Georgia remains elevated, with annual inflation at 11.9% in July. In our baseline scenario, we expect average inflation of 9.5% in 2021, up from previous 6.9% forecast. The rise in global food and oil prices and higher utility tariffs are an important factors driving inflation higher along with GEL depreciation pass-through and strong demand. The NBG raised the key rate further in August supporting the GEL to remain relatively strong in our view, as the regulator has limited ability to influence global inflationary pressures or household demand now. Uptick in growth also supported healthier fiscal parameters (lower deficit and debt), reflected in revised budget document. For 2022 we forecast growth to remain solid at 5.7% and see need for bold structural reforms to support strong growth momentum from 2023.

Solid economic recovery

The recovery has gained impressive traction since April 2021. The real GDP growth came in at 29.8% y/y in 2Q21 after shrinking 4.5% y/y in 1Q21. As a result, the economy expanded by 12.7% y/y in 1H21, surpassing also pre-pandemic level (1H19) by 5.7%. The recovery was supported by removing mobility restrictions, robust growth in remittances and exports, and a faster than expected rebound in tourism, along with fiscal stimulus. Growth was broad based with hospitality sector boosted by resumed tourism and lifting of restrictions, manufacturing benefited from global commodity price growth, while trade was supported by recovery in regional economies (notably growth in car re-exports and copper) as well as strong local demand. Construction was boosted by public infrastructure spending along with strong private sector activity on the back of improved sentiments. External inflows posted strong growth in 1H21 (remittances up 40.8% y/y, exports up 25.2% y/y with domestically produced goods driving the growth, and tourism revenues recovered to c. 21% of pre-pandemic levels), but imports (+18.9% y/y) also increased amid strong demand. Notably, remittances and goods exports surpassed pre-pandemic levels and strong external inflows expected to contribute to a narrowing of the current account deficit to 9.5% of GDP in 2021 from 12.5% of GDP in 2020.

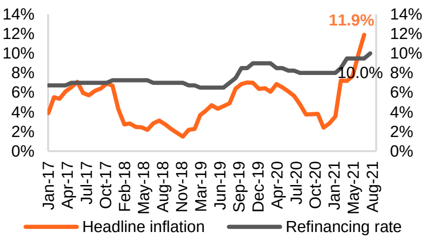
Considering the better than expected growth in 1H21, we revised 2021 growth upwards to 8.6%, from our previous forecast of 7.0%. In this updated forecast we assume single digit growth in 2H21 amid pandemic risks with the number of active virus cases peaking since mid-July 2021. On the positive side, Georgia now has sufficient vaccine supplies (Pfizer, Sinovac, Sinopharm and AstraZeneca) and there are already strong demand on vaccination boosted by new pandemic wave. That said, the pace of vaccination accelerated markedly since end-July, with daily vaccine doses administered increasing c. 8x compared to the beginning of July. As a result, vaccines administered more than doubled over the same period with c. 689 thousand vaccines managed (c. 13% of population, of which 5.7% fully vaccinated and 7.1% given 1 dose) as of 11 August 2021.

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



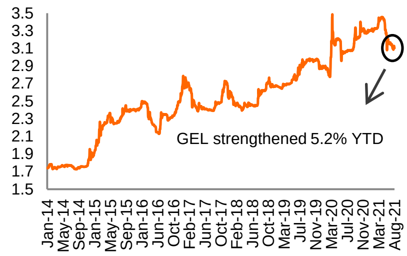
Source: Geostat, rapid estimates

Figure 2: Inflation and refinancing rate



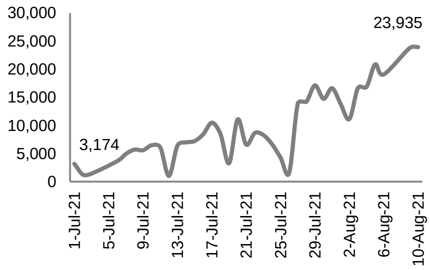
Source: Geostat

Figure 3: GEL/US$



Source: NBG

Figure 4: Daily vaccination, doses administered



Source: NCDC

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The government plans to vaccinate 60% of adult population by end-2021 and if recent pace of vaccination continues it is achievable. Despite elevated virus cases government avoids to reintroduce strict restrictions in high tourism season and considering local elections planned for 2nd October. However, Government reintroduced wearing masks in open air and some other restrictions are still in place (the work of bars and restaurants remains limited to midnight, nightclubs are closed, and large-scale entertainment and social events remain banned). If Georgia avoids strict COVID related restrictions and vaccination accelerates, we also see the likelihood of higher growth at 11.2% in 2021. For 2022, we forecast growth to remain solid at 5.7% and to support strong growth momentum from 2023 we see need to attract FDI.

Georgia's 2021 growth projection was revised upwards by different institutions also recently – Government and IMF project 7.7% growth, while NBG expects growth at 8.5%. Importantly, on 6 August 2021, Fitch Ratings revised Georgia's sovereign credit rating outlook to Stable from Negative and affirmed at BB, which is a return to pre-pandemic indicator. Based on Fitch, the outlook revision reflects a much-improved macroeconomic baseline, and Fitch's confidence that the Georgian authorities will continue implementing policies supporting macroeconomic stability and medium-term sustainability of public finances. Fitch revised up 2021 real GDP to 7.8% from 4.3%. For 2022-2023, Fitch forecasts real GDP growth to average 5.4%, above potential of 4.0-4.5%, supported by a more robust recovery in the tourism sector and an increase in investment.

Inflationary pressures persist

Inflation has been elevated since pandemic started with the exception of months when government subsidized utility tariffs for low energy users. Annual inflation accelerated further from June 2021 at 9.9% and at 11.9% in July, above average 7.4% in March-May. 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. The key factors affecting price spike in June vs previous months reflected higher contributions from food and energy prices, and utility tariffs (as gas tariff increased in Tbilisi from 1 June 2021), while July price spike also reflected termination of bread subsidy. The NBG raised the key rate three times (+50bps in March, +100bps in April and +50bps in August) this year cumulatively to 10.0%, the highest level since 2008. Keeping the key rate unchanged in June, the NBG expected inflation to start decelerating from 2H21.Inflation was unexpectedly high in July, forcing the regulator to raise the rate in August. The NBG expressed concern 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. We admit that the NBG has limited ability to influence household demand in the current recovery cycle or global inflationary pressures, but we see recent key rate increase supporting the GEL to remain relatively strong for limiting FX pass-through. The NBG introduced additional regulatory incentives for banks from July 2021 to promote the further de-dollarisation of deposits for easing the pressure on the FX market. In our baseline scenario, we expect average inflation of 9.5% in 2021 up from previous 6.9% forecast, and see inflation to decelerate from 2Q22 and room for policy rate cut by 200-250bps in 2H22.

GEL

Strong recovery along with tight monetary policy and resumed tourism helped GEL to partially regain its value vs dollar from May 2021, strengthening by 5.2% YTD at 3.1/$. We do not expect sharp volatility in FX market in 2H21, with GEL ranging 3.1-3.2 in this period. In case of sharp volatility, NBG expresses readiness to intervene, which will support to limit FX-pass through on inflation. We see GEL's strong appreciation potential from 2022 amid expected full recovery in tourism (we assume tourism to recover to 36% of 2019 level in 2021).

Banking sector

Reopening of the economy and strong recovery boosted loan growth markedly from April 2021. Notably, bank loan growth accelerated in both corporate and retail segments hinting on improved sentiments, making bank lending one of the factors supporting investment growth this year along public infrastructure spending. The deposit growth decelerated from May, which hints on continued recovery in demand. Amid stronger currency, higher interest rates and improved sentiments the deposit dollarization reduced to 60.0% in June 2021 (-1.39ppts y/y and -0.70ppts m/m). The loan dollarization also reduced to 52.4% (-4.07ppts y/y and -1.55ppts m/m) and NPLs remained low at 2.2%.

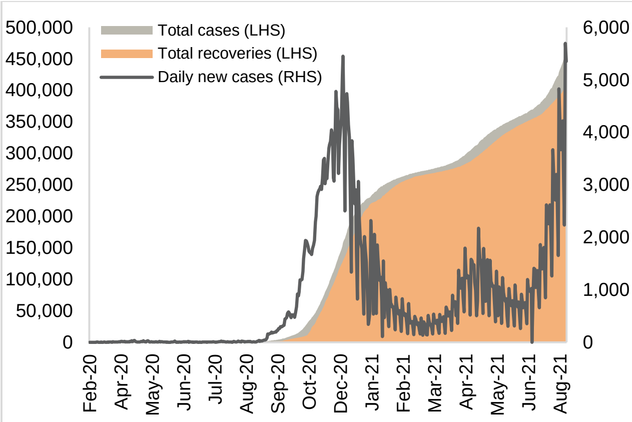
The banking sector credit portfolio growth accelerated to 11.3% y/y and 12.6% y/y in May and June 2021, respectively, excluding FX effects, after single digit growth in previous months. Notably, newly issued mortgages surged by 115.2% y/y in June, bringing mortgages stock growth to 13.0% y/y, improving compared to previous months (exc. FX effect). Amid improved growth figure, we also revised bank lending growth forecast, and expect at 15-17% y/y in 2021 up from 5-10% projected initially (exc. FX effect).

Budget

In July 2021, the parliament adopted the 2021 revised budget. The main purpose of the revisions in the budget was to reduce the deficit, promote economic recovery and manage COVID-19. In the renewed budget, government revised growth projection upwards to 7.7% for 2021 (from 4.3%) and set the deficit at 6.9% of GDP (down from 7.6%) and public debt at 54.6% of GDP (down from 60.1%) for 2021. In the revised macro framework, the budget deficit returns to 3.0% of GDP in 2023 and public debt to 48.6% of GDP, and these parameters are significantly improved compared to the previous medium term budget framework. In the revised budget, government maintains high capex in 2021 and also in outer years (8.0% of GDP in 2021 and 7.3% in 2022-25), supporting growth. Current expenditures are also set to increase in 2021, mostly reflecting increase in COVID-related healthcare expenditures (+GEL 446mn). Notably, better-than-expected tax revenues and acceleration in privatization are key funding source for increased expenditures, with no growth in borrowing.

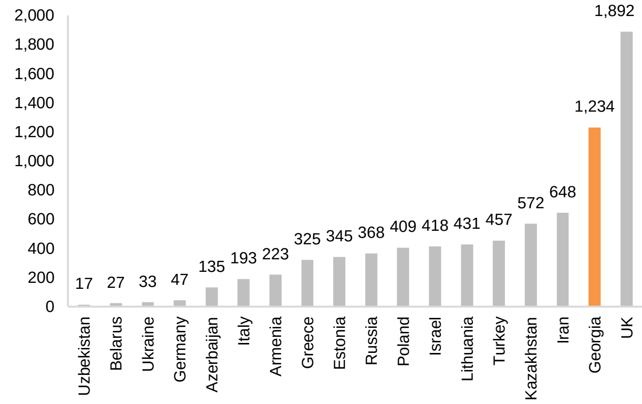
On 5 August 2021, the Minister of Finance presented the reform agenda within the framework of the 10-year government development plan. The minister highlighted reforms that are important for economic growth and for maintaining macroeconomic stability. According to the presentation the key task is to normalize the budget deficit and reduce the debt ratio. For achieving this the ministry works on four main directions: growth-oriented tax policy, friendly tax administration, tax dispute reform and capital market reform. In all these areas, the agency plans to implement business-oriented projects. According to the Minister of Finance, by 2025 the country plans to obtain an investment grade, as well as more than double GDP per capita by 2030.

Figure 5: COVID-19 statistics in Georgia, persons



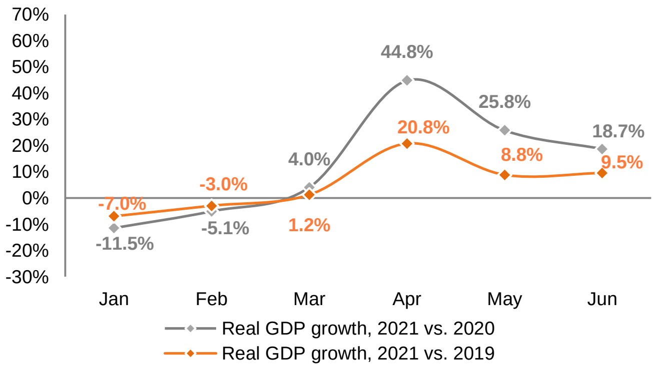
Source: NCDC, as of 11.08.2021

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



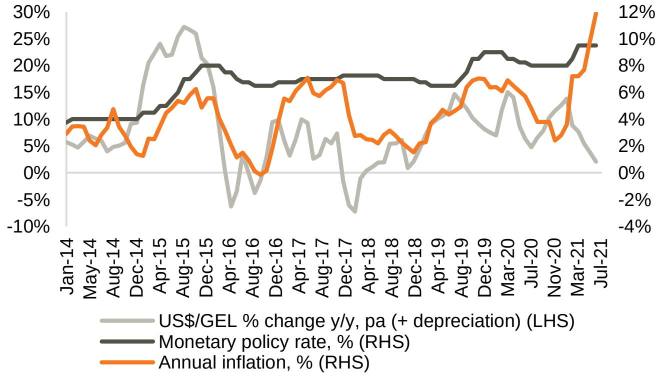
Source: Johns Hopkins University, Worldometers, as of 11.08.2021, 2:47 pm

Figure 7: Real GDP growth, rapid estimates



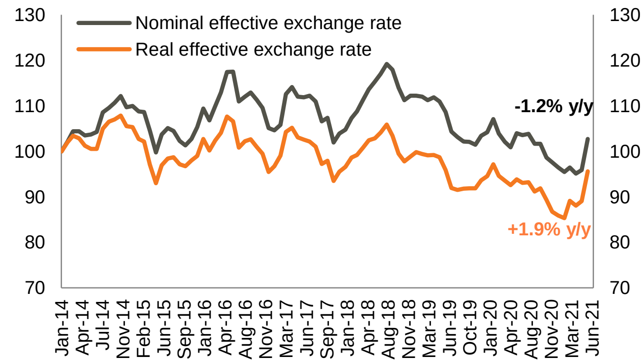
Source: Geostat

Figure 8: Monetary policy rate, inflation and FX rate



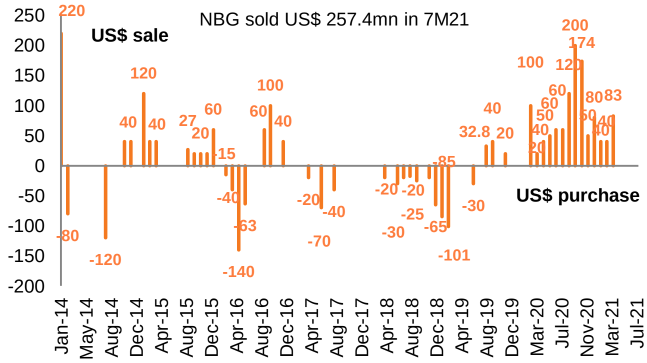
Source: NBG, Geostat

Figure 9: REER and NEER (index, Jan 2014 = 100)



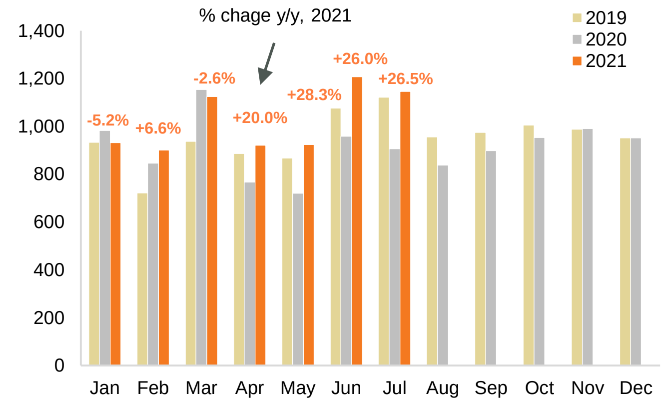
Source: NBG
Note: +/- means appreciation/depreciation

Figure 10: NBG's net interventions, US$ mn



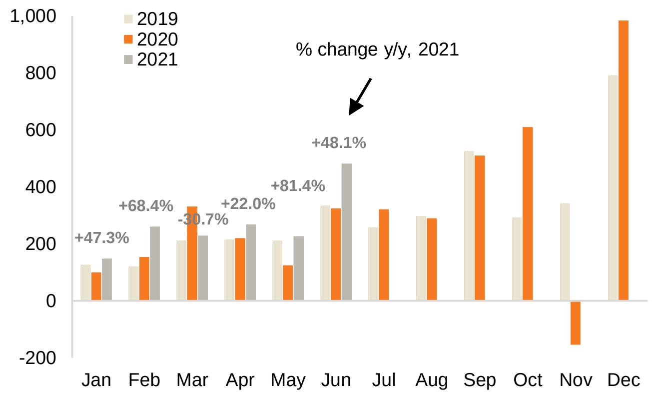
Source: NBG

Figure 11: Consolidated budget tax revenues, GEL mn



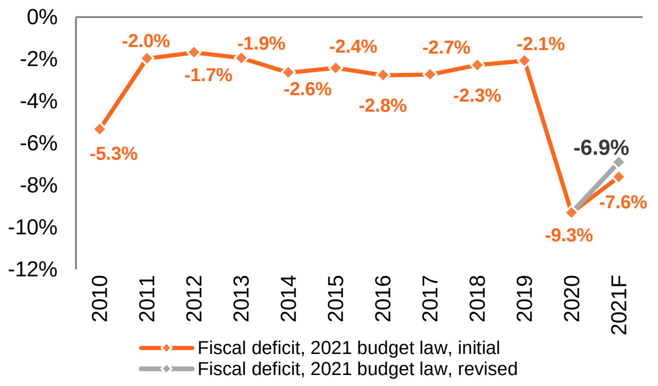
Source: MOF

Figure 12: Consolidated budget capex, GEL mn



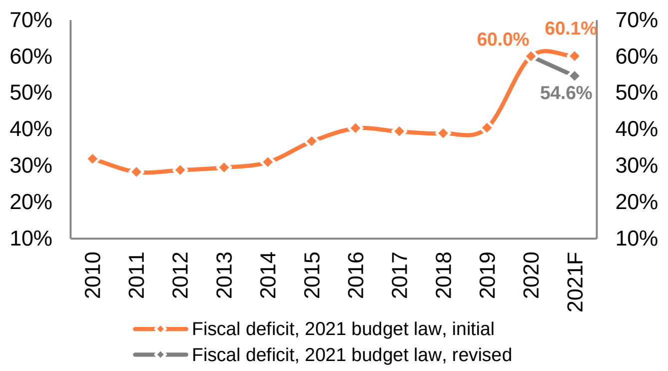
Source: MOF

Figure 13: Fiscal deficit, as % of GDP



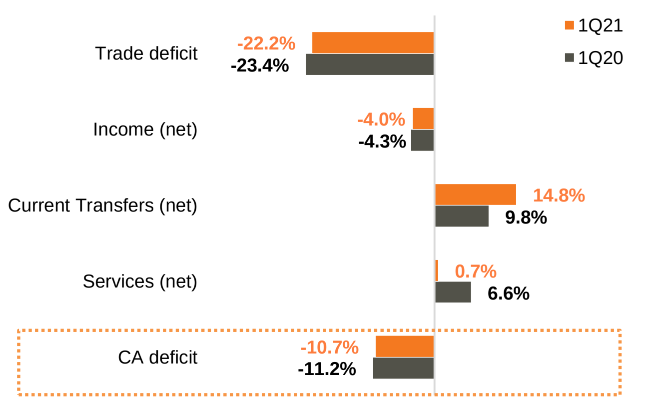
Source: MOF, Geostat

Figure 14: Public debt, as % of GDP



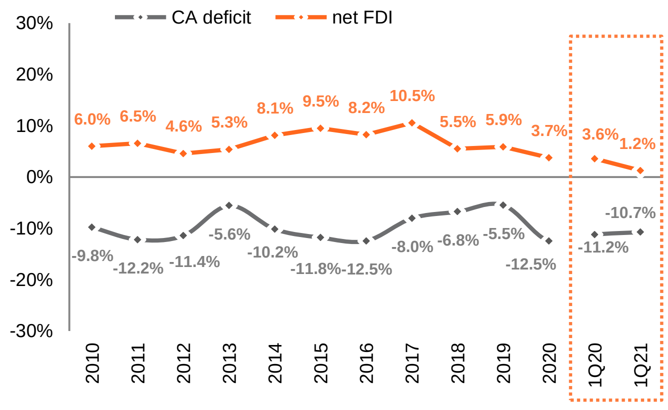
Source: MOF, Geostat

Figure 15: CA balance and its components, as % of GDP



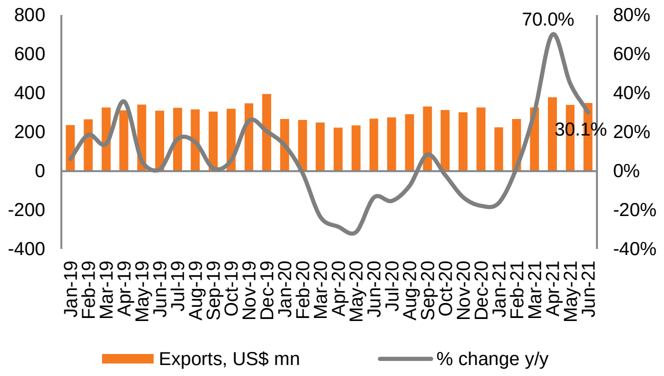
Source: NBG, Geostat

Figure 16: CA and net FDI, as % of GDP



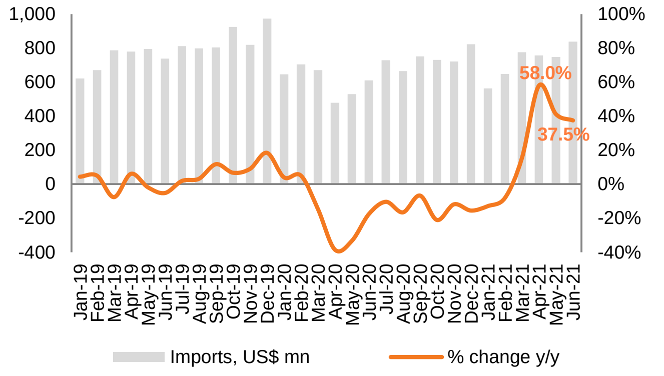
Source: NBG, Geostat

Figure 17: Exports, US$ mn



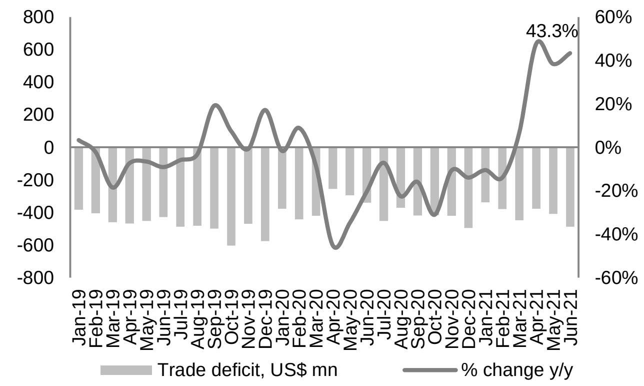
Source:Geostat

Figure 18: Imports, US$ mn



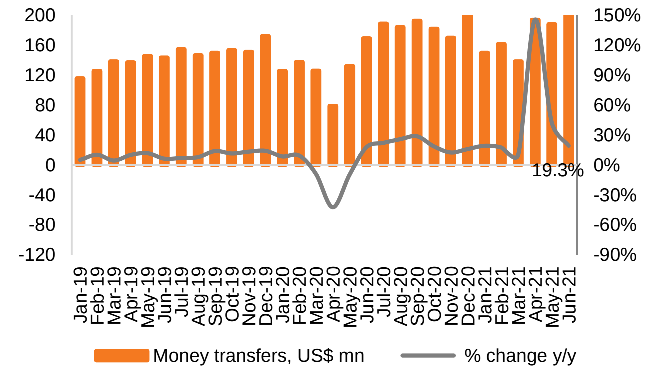
Source: Geostat

Figure 19: Trade deficit, US$ mn



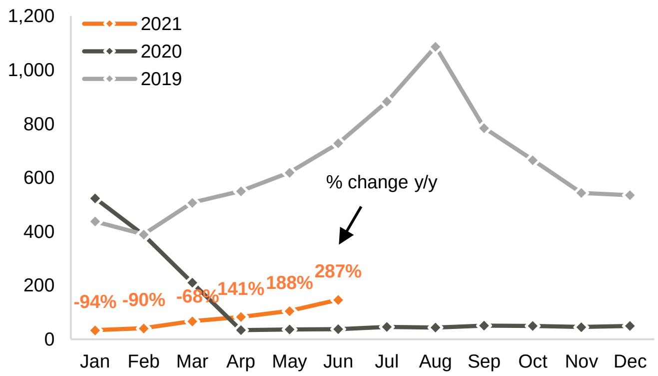
Source: Geostat

Figure 20: Remittances in Georgia, US$ mn



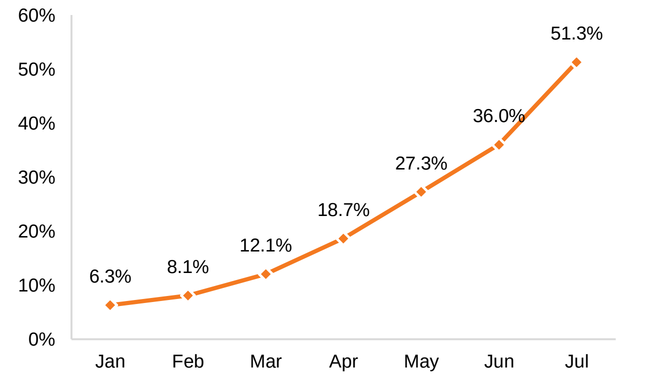
Source: NBG

Figure 21: International visitors to Georgia, 000' persons



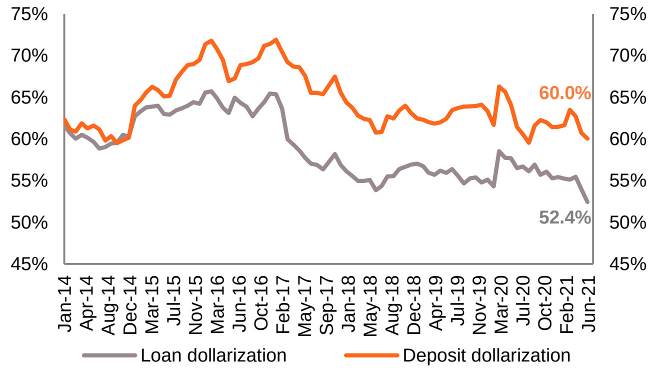
Source: GNTA

Figure 22: Tourism revenues in 2021 as % of 2019 level



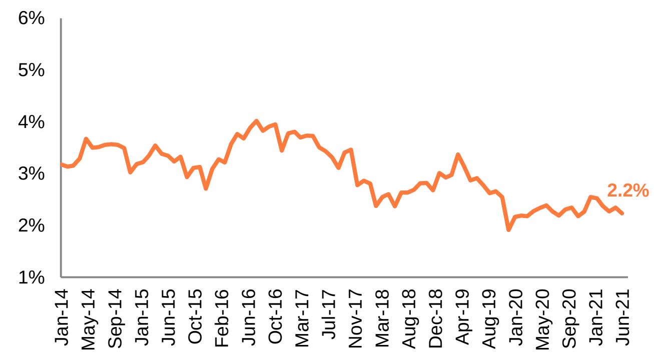
Source: NBG, Galt & Taggart

Figure 23: Dollarization



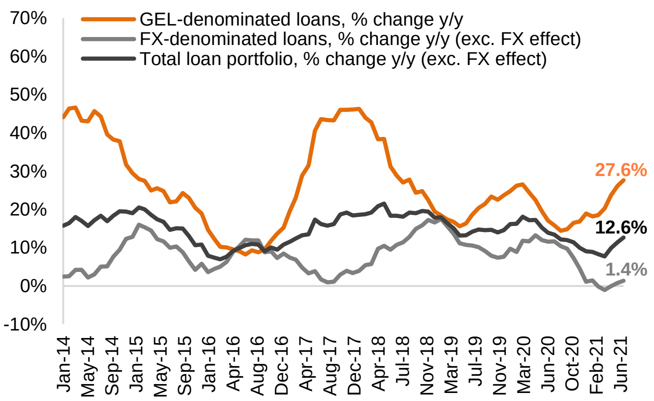
Source: NBG

Figure 24: Non-performing loans, % of total loans



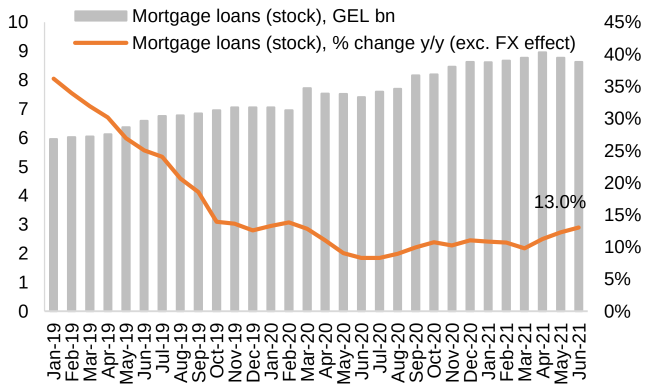
Source: NBG

Figure 25: Banking sector loan growth



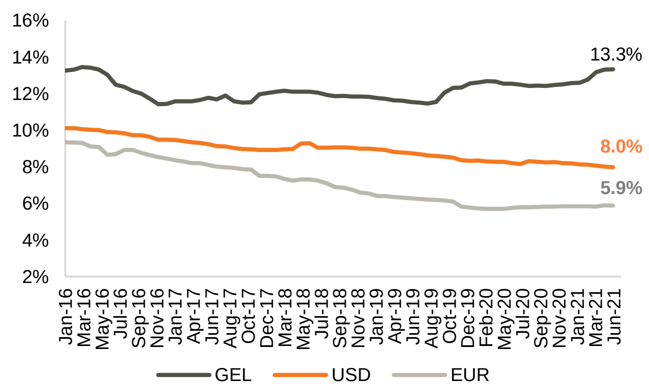
Source: NBG

Figure 26: Mortgage loans



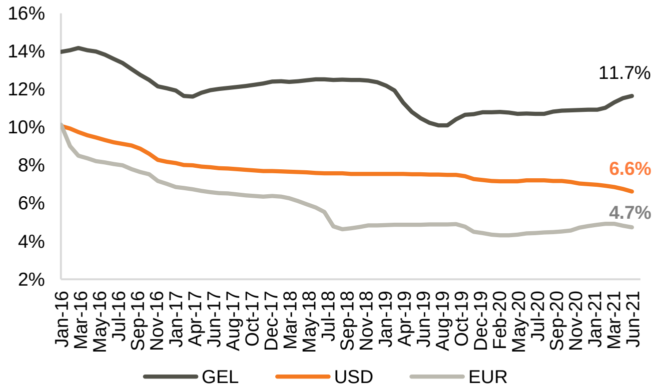
Source: NBG

Figure 27: Interest rates on loans to legal entities



Source: NBG

Figure 28: 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	58.5	64.3
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	18.1	20.6
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	4,856	5,525
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%	8.6%	5.7%
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%	13.7%	1.5%
GEL per US$, average	1.78	1.69	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.82	3.11	3.23	3.12
Population, mn	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances													
Budget revenues, % of GDP	26.9%	27.0%	27.8%	26.0%	26.1%	26.4%	27.0%	26.8%	26.5%	26.2%	25.1%	25.5%	26.0%
Budget expenses, % of GDP	32.3%	29.4%	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	29.4%	34.8%	33.3%	30.5%
Fiscal balance (-deficit), % of GDP	-5.3%	-2.0%	-1.7%	-1.9%	-2.6%	-2.4%	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.9%	-4.4%
Public debt, % of GDP	31.9%	28.3%	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.4%	60.0%	54.6%	52.9%
External Sector													
Current account, US$ 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%	-9.5%	-7.1%
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%	3.9%
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%	74.9%	72.5%
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%	7.5%

Source: NBG, MOF, Geostat, Galt & Taggart

Note: Fiscal balance according to IMF Program Definition

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