Georgian Economy

Record High FDI in 3Q14, Lari Stabilized, Prudent 2015 State Budget

Georgia | Economy

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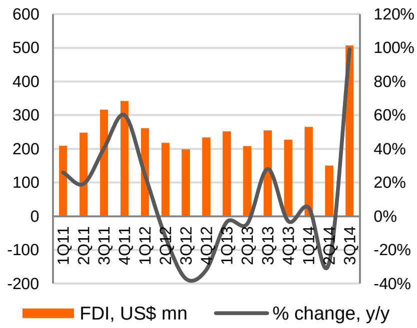
Georgia posted record FDI growth of 99% y/y to US$ 507mn in 3Q14 as its business-friendly environment continued to attract foreign investors. The strong FDI and stable economic framework eased depreciation pressures and the lari has recovered somewhat against the dollar last week, strengthening by 6.2%. While the external environment remains weak, the Georgian economy's flexibility and lower oil prices mean the outlook for the economy is healthy. The government has taken some prudent decisions: discussions about elimination of the tax-free threshold for personal income tax have been initiated and the 2015 state budget, which contains prudent fiscal parameters, has been approved. The fiscal deficit is planned at 3.0% of GDP, public debt to GDP at 37.2%, current expenditures are almost flat in real terms, and growth-enhancing capital spending increases by 19% y/y. These developments, along with the EU DCFTA (free trade agreement), support Georgia's sustainable economic growth outlook.

FDI increased 99% y/y in 3Q14 (237% q/q) to US$ 507mn, or 11.8% of GDP, a six-year high, driven by the construction sector (36% of total), the transport and communication (21%) and real estate (12%) sectors.

China topped the list of investors with US$ 149mn (29% of total), with Azerbaijan coming second at US$ 95mn (19%). FDI from Russia remained limited, amounting to US$ 16mn or just 3.2% of the total.

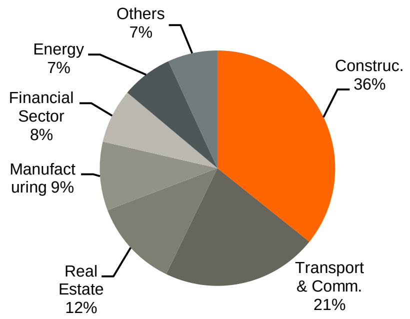
Georgia's business-friendly environment coupled with its sustainable growth prospects continues to attract foreign investment. Along with planned investment programs of cross-country significance: oil and gas pipelines, railway networks, the Anaklia deep sea port and hydro energy projects, Georgia's business-supportive environment and the EU DCFTA being in place are attracting new investment and will lead to further strong FDI inflows to Georgia in the medium term.

Figure 1: FDI



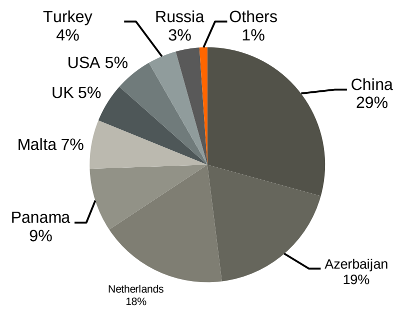
Source: GeoStat

Figure 2: FDI by sector, 3Q14



Source: GeoStat

Figure 3: FDI by country, 3Q14



Source: GeoStat

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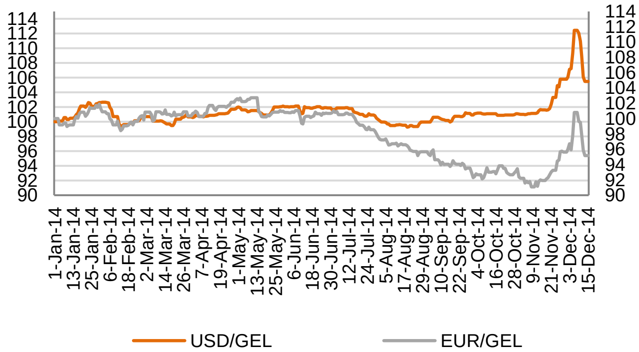
Strong economic fundamentals have helped the lari to regain some ground against the dollar as well as other currencies last week. As we pointed out in our December 8 note, a certain correction of the lari exchange rate was anticipated but in our view the market over-reacted, devaluing the lari by c. 12%. In November remittances decreased by US$ 20mn or 16.2% y/y (-6.5% y/y in October) and tourism arrivals declined 3.8% y/y. Trade statistics are not yet available for November, but we expect the weaker external environment to have impacted export growth. Nevertheless, we believe savings on oil imports, estimated to have a positive impact of 1.7% of GDP, will absorb the impact from the weaker external accounts (see our notes on December 2 and 8).

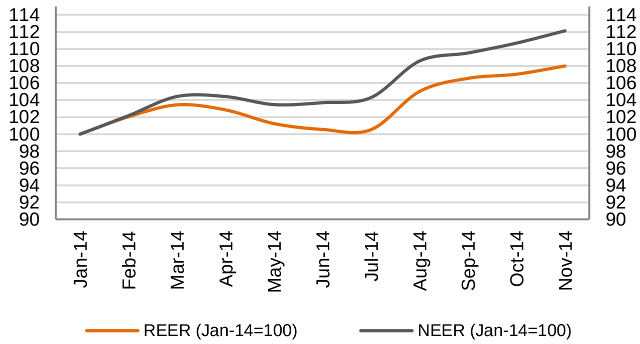
Lari subsequently corrected without significant loss of reserves (NBG intervened twice with a total sale of US$ 80mn). Starting from December 8, the lari gradually regained some lost ground against the dollar without central bank intervention, strengthening by 5-6%. Year to date, the lari has depreciated by 5.5% against the dollar (6.9ppts lower compared to December 8) and has strengthened by 4.8% against the euro. Georgia's stable macroeconomic framework, prudent monetary and fiscal policies, and sustainable growth prospects will support the lari's stability despite the regional turbulence, in our view.

Figure 4: Exchange rate performance, daily, rebased



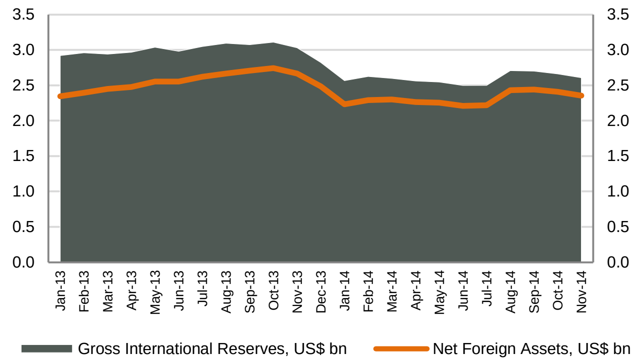
Source: NBG, G&T Research

Figure 5: Lari's NEER and REER



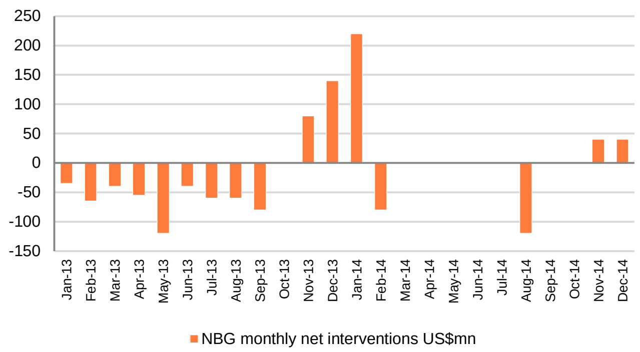
Source: NBG, G&T Research
Note: November REER is a projection

Figure 6: Official foreign reserves



Source: NBG

Figure 7: NBG FX interventions



Source: NBG
Note: Negative sign implies accumulation of reserves

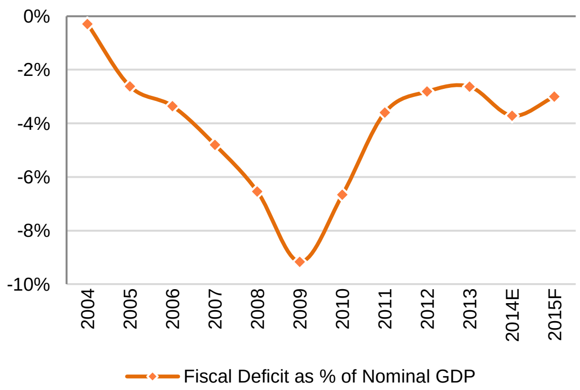
2015 state budget approved with growth-oriented fiscal parameters. On December 12, parliament approved the 2015 state budget law. The fiscal deficit is planned at 3.0% of GDP (down from 3.7% of GDP in 2014) and the government aims to decrease it to 2.0% of GDP by 2018. Public debt to GDP is set at 37.2% in 2015.

Tax revenues are planned at 25.2% of GDP and total expenditures are to remain below 30% of GDP in 2015. Current expenditures remain almost unchanged in real terms with an increase of 5.8% y/y (inflation target of 5.0%, deflator 4.0%). Notably, growth-enhancing capital spending increases 19.0% y/y.

Government's capital expenditure priorities are focused on strengthening Georgia's role as the regional hub economy and supporting the tourism industry. Priority investment projects in 2015 and beyond will support the development of road infrastructure, the energy sector, wastewater treatment and infrastructure for winter resorts.

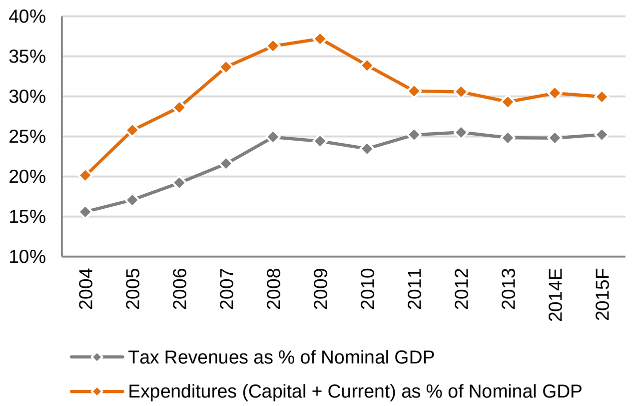
Parliament is discussing eliminating the tax-free threshold for personal income tax for low-income earners. This will save the government GEL 130-140mn pa. The existing threshold (introduced at end-2012) enables low-income groups to reclaim taxes paid to the government up to GEL 1,800 (around US$1,000) annually. The change to the threshold will save significant amounts in the budget starting from 2016 as personal income tax refunds cost GEL 130-140mn or 0.4% of GDP in 2014. GEL 140mn will be mobilized from excise tax increases on tobacco and alcoholic beverages in 2015.

Figure 8: Fiscal deficit



Source: MOF, GeoStat

Figure 9: Tax revenues and expenditures to GDP



Source: MOF, GeoStat

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