GALT & TAGGART
RESEARCH

Georgian Economy
Sufficient Policy Space to Limit Coronavirus Impact

Georgia │ Economy
February 28, 2020

2020 started with significant uncertainty around the world. Coronavirus has threatened human health and slowed economic activity in China, which also has an impact globally - stock prices are plummeting, currencies are weakening, travel is restricted, etc. Georgia temporarily suspended the movement of visitors from China and Iran to prevent the spread of coronavirus. We hope that virus will not take the form of a global pandemic and economies will revive. However, uncertainty persists and it is difficult to make accurate estimates. With this in mind, we try to identify threats to the Georgian economy and allow for the development of various adverse scenarios.

Georgian economy demonstrated resilience to various global and regional shocks in recent years. For example, despite the Russia's ban on direct flights in 2019, the Georgian economy has grown at the fastest pace since 2012, by 5.2%. The current account deficit fell to record low 4.4% of GDP, but the lari depreciated amid negative expectations about a flight ban. The depreciation of the lari pressured prices, and by the end of 2019, inflation rose to 7%. In response, the National Bank raised the interest rate, sold FX, and also reduced the FX reserve requirements. These measures had a positive effect on the lari, and since mid-December 2019, the lari has been appreciating.

At the end of 2019, we updated the forecast for Georgia's economic growth to 4.7% for 2020 and identified two key risks - tightened monetary policy and 2020 parliamentary election-related uncertainty. But now we have a different view about these risks. An increase in interest rates in GEL led to an increase in demand for loans in foreign currency, where interest rates decreased as a result of lower reserve requirements, and total lending increased more than expected. At the same time, a statement by the President of the NBG that FX purchases will not take place this year, and the readiness of senior government officials not to introduce any new regulations in the election year positively affect the mood of business circles, which is reflected in the increase in GEL deposits and strengthened currency. Thus, we see that these two risks are weakened, but the new risk emerged - coronavirus. At the moment, it is difficult to give an accurate assessment of the impact of the virus on the Georgian economy: 1) flights with China and Iran are banned, but Georgia does not have significant tourism revenues from these two countries and the impact will be weak; 2) but if virus causes global recession (as many fear) than negative impact will be stronger.

We hope that coronavirus will be a short-term problem, but if the virus continues to spread globally, there will be some challenges:

1. A negative impact on tourism is expected regardless of how long the virus spreads. Georgia temporarily suspended direct flights to China and Iran. The share of these countries in the total visitors and tourism revenues is small, and revenues will be reduced before resuming flights. However, due to the panic caused by virus, visitors from other countries are also likely to refrain from traveling, and consequently tourism losses will increase. However, making predictions on tourism revenue shortfall in advance is difficult.

2. The expected reduction in tourism will negatively affect real estate, as sales may slow down, including from foreigners. Consequently, housing construction will likely slow, but the continuation of public infrastructure projects will somewhat contain slowdown of the construction sector.

3. As a result of the spread of the virus, world oil prices are falling, benefiting oil-importer Georgia. However, a significant drop in oil prices also has a negative effect, as cash inflows from oil-exporters Russia and Azerbaijan will decrease. Consequently, the overall impact may be negative (as it was in 2015-16).

4. The expected decline in tourism revenues will have a negative impact on the lari, although we believe that the National Bank has instruments (reserves, the policy rate, etc.) to curb the excessive depreciation.

5. If coronavirus persists, world commodity prices will continue declining, which will contain a sharp increase in prices in Georgia along with weak domestic demand, in our view.

6. In the event of a sharp decline in tourism revenues, the government and the National Bank have the appropriate policy tools to maintain economic growth at 3%, we believe. The government has enough fiscal space - public debt and budget deficit are low, and already incorporates a buffer of GEL 700mn from domestic debt issuance. This money is accumulated on government deposit under 2020 budget and can be used, if necessary, to stimulate the economy.

Eva Bochorishvili
Head of Research │ evabochorishvili@gt.ge │ +995 32 2401 111 ext. 8036
Lasha Kavtaradze
Head of Macroeconomic Analysis and Forecasting │ lashakavtaradze@gt.ge │ +995 32 2401 111 ext. 7473

Table 1: Georgia's external earnings from China in 2019

	Exports	Tourism	FDI	Remittances	Total
Earnings from China, US$ mn	228	30	36	1	**294**
China's share in total earnings, %	6.0%	0.9%	3.9%	0.1%	**3.0%**
Earning from China as % of GDP	1.3%	0.2%	0.2%	0.0%	**1.7%**

Georgia introduced temporary direct flight ban from China on coronavirus fears. We estimate monthly tourism revenue loss and arrival loss at c. US$ 2.5mn and c. 4,000 arrivals, respectively, from China due to flight ban, which expires in April 2020.

In 2019, Georgia received c. US$ 300mn in revenue from China, accounting for 1.7% of GDP and only 3% of total foreign source revenues (with copper re-export excluding only 0.8% of GDP). In the last five years, foreign revenue from China increased by only US$ 100mn, mainly related to increased copper re-exports.

- The bulk of total inflows is exports, where copper re-exports hold a significant share (c. 70% of total exports to China). Therefore, the direct negative impact of China's coronavirus on Georgia is small (reduction in copper re-export will also reduce copper imports, and the final impact will be minimal).

Source: NBG, GNTA, Geostat, Galt & Taggart
Note: FDI as of 9M19

Table 2: Georgia's external earnings from Iran in 2019

	Exports	Tourism	FDI	Remittances	Total
Earnings from Iran, US$ mn	71	105	1	0	**177**
Iran's share in total earnings, %	1.9%	3.2%	0.1%	0.0%	**1.8%**
Earning from Iran as % of GDP	0.4%	0.6%	0.0%	0.0%	**1.0%**

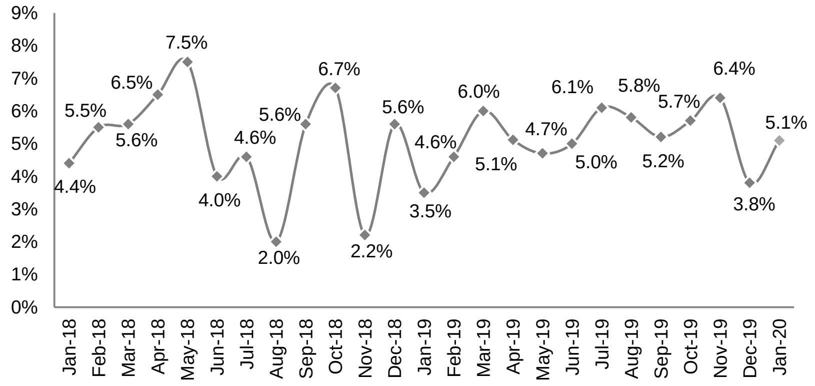
Georgia introduced temporary travel ban from Iran on coronavirus fears. We estimate monthly tourism revenue loss and arrival loss at c. US$ 8mn and c. 11,000 arrivals, respectively, from Iran due to travel restrictions, which currently is introduced for two weeks.

In 2019, Georgia received a total of US$ 177mn in revenue from Iran, accounting for 1.0% of GDP and only 1.8% of total foreign source revenue. In the last five years, inflows from Iran have increased by US$ 127mn, mainly related to the tourism sector:

- Tourism accounts for the bulk of total external inflow from Iran. In 2019, 142,000 Iranians traveled to Georgia and spent US$ 105mn.
- Georgia's export to Iran stood at US$ 71m in 2019. The main export products are ferro-alloys, meat and wood.

Source: NBG, GNTA, Geostat, Galt & Taggart
Note: FDI as of 9M19

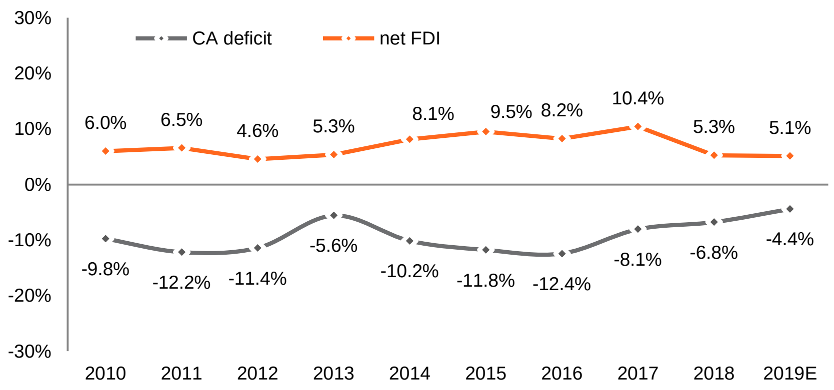
Figure 1: Real GDP growth, % change y/y



Source: Geostat

Despite the Russia's ban on direct flights since July 2019, the Georgian economy has grown at the fastest pace since 2012, by 5.2%.

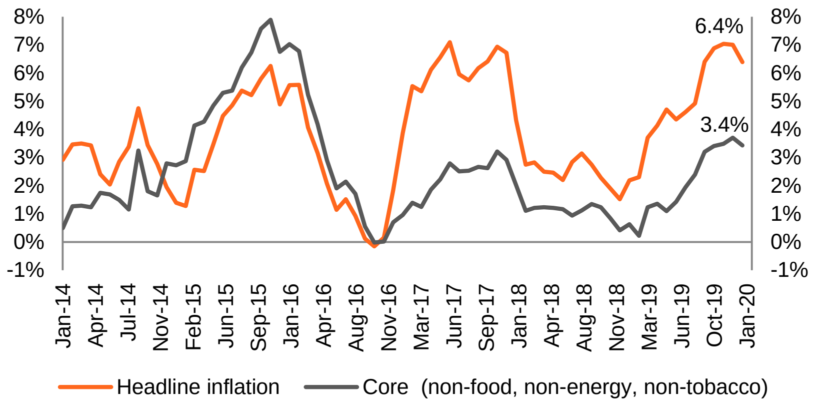
Figure 2: Current account deficit and net FDI, % of GDP



Source: NBG, Geostat, Galt & Taggart

The current account deficit fell to record low 4.4% of GDP in 2019, as exports, remittances and tourism revenues increased while imports reduced (due to lower oil prices and lower FDI-related imports).

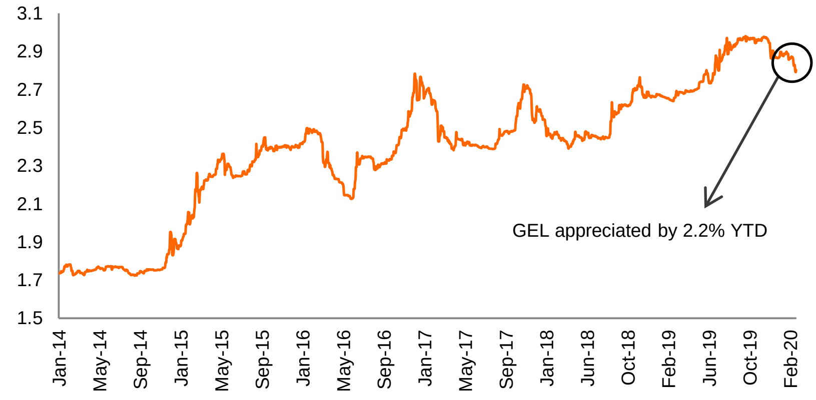
Figure 3: Annual inflation, %



Source: Geostat

Annual inflation rose to 7% in 2019 due to GEL depreciation pass-through. Inflation retreated to 6.4% in January 2020.

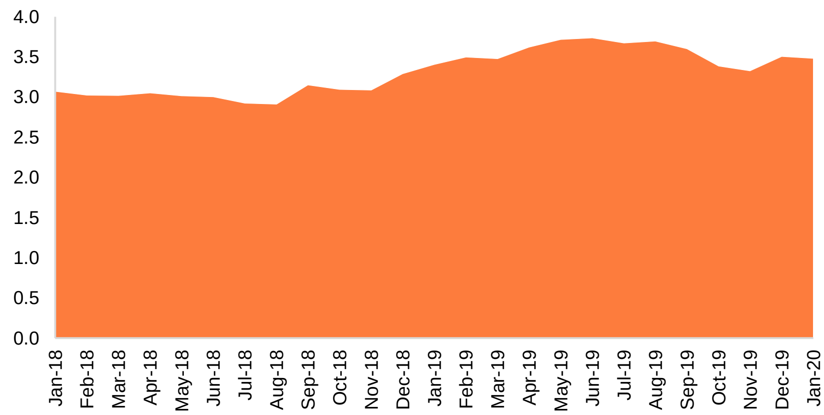
Figure 4: GEL/US$ exchange rate



Source: NBG

NBG's measures (policy rate increase, FX sale and reduction in FX reserve requirements in 2H19) stabilized GEL and put on appreciation trajectory since mid-Dec. Intensified purchases of treasuries by non-residents since Dec-19 were instrumental for currency appreciation along with reduction in deposit dollarization. Moreover, market fundamentals continued improvement, positively affecting expectations.

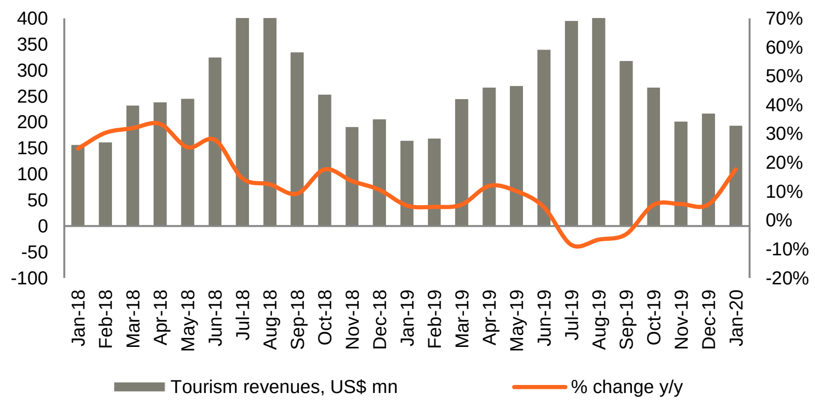
Figure 5: Gross official reserves, US$ bn



Source: NBG

Despite challenging environment, international reserves increased by 6.6% y/y to US$ 3.5bn in 2019, which is sufficient to finance more than 3 months of goods and services imports.

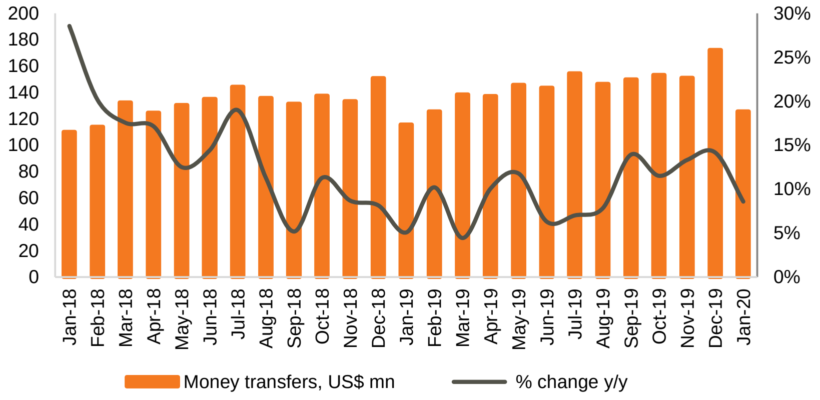
Figure 6: Tourism revenues



Source: NBG

Tourist arrivals and revenues continued growing in 2H19 despite reduced Russian visitors. In 2019, tourism revenues increased by 1.4% y/y to US$ 3.3bn. In January 2020, international arrivals surged by 19.8% y/y.

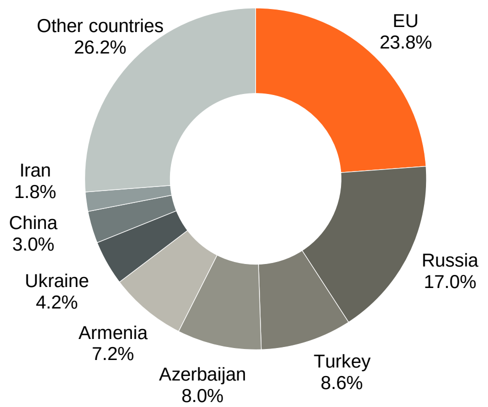
Figure 7: Remittances



Source: NBG

Money transfers increased by 9.7% y/y to US$ 1.7bn (9.9% of GDP) in 2019. In January 2020, transfers were up 8.6% y/y.

Figure 8: Economic linkages (exports, tourism, FDI and remittances), share in total, 2019

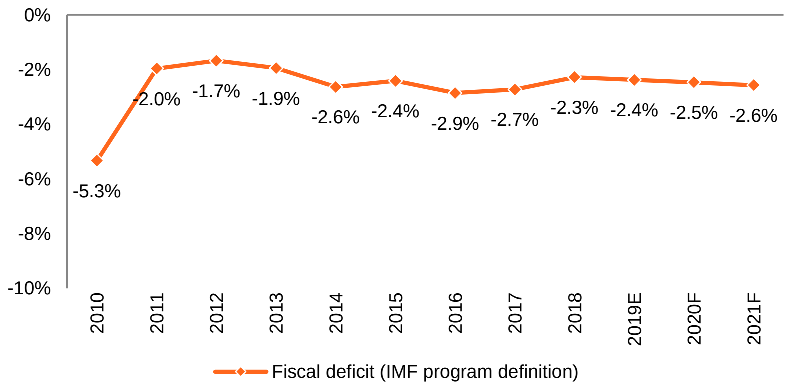


Source: NBG, GNTA,Geostat, Galt & Taggart

Georgia has a diversified economic linkages which minimizes potential negative impact from any particular country. In 2019:

- EU (38% of total) was the largest source of remittances, while Russia's share continued to decline (25% of total)
- The EU remains Georgia's largest FDI provider
- Azerbaijan was the top export market accounting for 13% of the total
- Tourism sector demonstrated resilience to Russia's direct flight ban - strong growth of tourist arrivals from EU and other countries fully compensated reduced Russian tourist in 2H19.

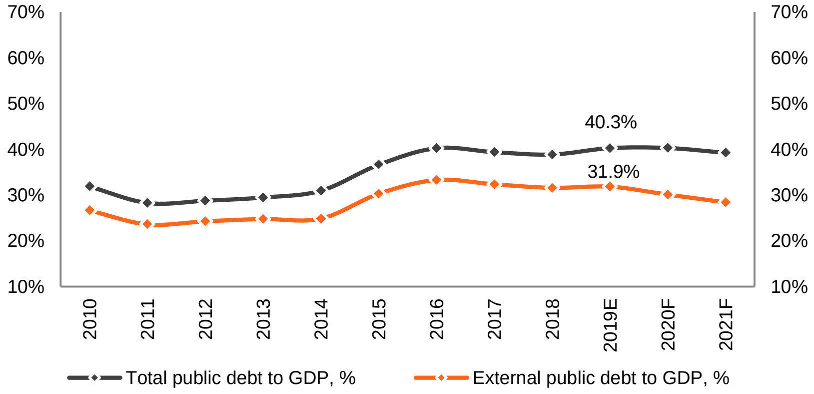
Figure 9: Fiscal deficit as % of GDP



Source: MoF, Geostat

Public debt and budget deficit are low, and 2020 budget plan already incorporates a buffer of GEL 700mn from domestic debt issuance. This money is accumulated on government deposit under 2020 budget and can be used, if necessary, to stimulate the economy.

Figure 10: Public debt as % of GDP



Source: Geostat, MoF

Georgia's public debt remained low at 40.3% of GDP in 2019, o/w 31.9% of GDP was external debt and 8.4% of GDP - domestic debt. External public debt is borrowed on concessional terms, with debt portfolio weighted average interest rate at 2.1% and contractual maturity of 22 years.

Macro Data and Forecasts

Georgia	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020F
GDP and Prices										
Nominal GDP, GEL bn	25.5	27.2	28.6	31.1	33.9	35.8	40.8	44.6	49.4	53.7
Nominal GDP, US$ bn	15.1	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.6	19.2
Nominal GDP per capita, US$	4,023	4,422	4,624	4,739	4,013	4,062	4,359	4,722	4,716	5,161
Real GDP, % change y/y	7.4%	6.4%	3.6%	4.4%	3.0%	2.9%	4.8%	4.8%	5.2%	4.7%
CPI Inflation, average	8.5%	-0.9%	-0.5%	3.1%	4.0%	2.1%	6.0%	2.6%	4.9%	3.6%
CPI Inflation, eop	2.0%	-1.4%	2.4%	2.0%	4.9%	1.8%	6.7%	1.5%	7.0%	1.9%
GEL per US$, average	1.69	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.81	2.79
Population, mn	3.9	3.8	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances										
Budget revenues, % of GDP	27.0%	27.8%	26.0%	26.1%	26.4%	27.0%	26.8%	26.5%	25.7%	25.3%
Budget expenses, % of GDP	29.4%	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	28.3%	28.4%
Fiscal balance (-deficit), % of GDP	-2.0%	-1.7%	-1.9%	-2.6%	-2.4%	-2.9%	-2.7%	-2.3%	-2.4%	-2.5%
Public debt, % of GDP	28.3%	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.3%	40.3%
External Sector										
Current account, US$ bn	-1.8	-1.9	-1.0	-1.8	-1.8	-1.9	-1.3	-1.2	-0.8	-0.9
Current account, % of GDP	-12.2%	-11.4%	-5.6%	-10.2%	-11.8%	-12.4%	-8.1%	-6.8%	-4.4%	-4.5%
Exports of goods and services, US$ bn	5.3	6.0	7.2	7.1	6.2	6.2	7.6	8.9	9.5	10.5
Imports of goods and services, US$ bn	8.0	9.2	9.3	10.1	8.7	8.5	9.4	10.8	11.0	12.1
Net Current transfers, US$ bn	1.3	1.4	1.5	1.4	1.1	1.1	1.3	1.4	1.4	1.4
Net FDI, US$ bn	1.0	0.8	0.9	1.4	1.4	1.2	1.7	0.9	0.9	1.0
Net FDI, % of GDP	6.5%	4.6%	5.3%	8.1%	9.5%	8.2%	10.4%	5.3%	5.1%	5.3%
Gross international reserves, US$ bn	2.8	2.9	2.8	2.7	2.5	2.8	3	3.3	3.5	3.8
Financial sector										
Bank loan portfolio, US$ bn	4.5	5.1	6.0	6.8	6.7	7.1	8.6	9.9	11.1	12.5
Bank loan portfolio, % of GDP	29.5%	31.2%	36.1%	40.8%	47.2%	52.8%	54.7%	59.6%	64.5%	66.5%
Monetary policy rate, %	6.75%	5.25%	3.75%	4.00%	8.00%	6.50%	7.25%	7.00%	9.00%	8.00%

Source: NBG, MOF, Geostat, Galt & Taggart Research

Note: Fiscal balance according to IMF Program Definition

Disclaimer

This document is the property of and has been prepared by JSC Galt & Taggart ("Galt & Taggart"), a member of Bank of Georgia group PLC ('Group") solely for informational purposes and independently of the respective companies mentioned herein. This document does not constitute or form part of, and should not be construed as, an offer or solicitation or invitation of an offer to buy, sell or subscribe for any securities or assets and nothing contained herein shall form the basis of any contract or commitment whatsoever or shall be considered as a recommendation to take any such actions.

Galt & Taggart is authorized to perform professional activities on the Georgian market. The distribution of this document in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by Galt & Taggart to inform themselves about and to observe any and all restrictions applicable to them. This document is not directed to, or intended for distribution, directly or indirectly, to, or use by, any person or entity that is a citizen or resident located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would require any registration or licensing within such jurisdiction.

Investments (or any short-term transactions) in emerging markets involve significant risk and volatility and may not be suitable for everyone. The recipients of this document must make their own investment decisions as they believe appropriate based on their specific objectives and financial situation. When doing so, such recipients should be sure to make their own assessment of the risks inherent in emerging market investments, including potential political and economic instability, other political risks including without limitation changes to laws and tariffs, and nationalization of assets, and currency exchange risk.

No representation, warranty or undertaking, express or implied, is or will be made by Galt & Taggart or any other member of the Group or their respective directors, employees, affiliates, advisers or agents or any other person as to, and no reliance should be placed on, the fairness, accuracy, completeness or correctness of this document and the information contained herein (and whether any information has been omitted from this document) and no reliance should be placed on it. This document should not be considered as a complete description of the markets, industries and/or companies referred to herein. Nothing contained in this document is, is to be construed as, or shall be relied on as legal, investment, business or tax advice, whether relating to the past or the future, by Galt & Taggart any other member of the Group or any of their respective directors, employees, affiliates, advisers or agents in any respect. Recipients are required to make their own independent investigation and appraisal of the matters discussed herein. Any investment decision should be made at the investor's sole discretion. To the extent permitted by law, Galt & Taggart, any other member of the Group and their respective directors, employees, affiliates, advisers and agents disclaim all liability whatsoever (in negligence or otherwise) for any loss or damages however arising, directly or indirectly, from any use of this document or its contents or otherwise arising in connection with this document, or for any act, or failure to act, by any party, on the basis of this document.

The information in this document is subject to verification, completion and change without notice and Galt & Taggart is not under any obligation to update or keep current the information contained herein. The delivery of this document shall not, under any circumstances, create any implication that there has been no change in the information since the date hereof or the date upon which this document has been most recently updated, or that the information contained in this document is correct as at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. No representation or warranty, expressed or implied, is made by Galt & Taggart or any other member of the Group, or any of their respective directors, employees, affiliates, advisers or agents with respect to the accuracy or completeness of such information.

The information provided and opinions expressed in this document are based on the information available as of the issue date and are solely those of Galt & Taggart as part of its internal research coverage. Opinions, forecasts and estimates contained herein are based on information obtained from third party sources believed to be reliable and in good faith, and may change without notice. Third party publications, studies and surveys generally state that the data contained therein have been obtained from sources believed to be reliable, but that there is no guarantee of the accuracy or completeness of such data. Accordingly, undue reliance should not be placed on any such data contained in this document. Neither Galt & Taggart, any other member of the Group, nor their respective directors, employees, affiliates, advisors or agents make any representation or warranty, express or implied, of this document's usefulness in predicting the future performance, or in estimating the current or future value, of any security or asset.

Galt & Taggart does, and seeks to do, and any other member of the Group may or seek to do business with companies covered in its research. As a result, investors should be aware of a potential conflict of interest that may affect the objectivity of the information contained in this document.

Unauthorized copying, distribution, publication or retransmission of all or any part of this document by any medium or in any form for any purpose is strictly prohibited.

The recipients of this document are responsible for protecting against viruses and other destructive items. Receipt of the electronic transmission is at risk of the recipient and it is his/her responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

Head of Research
Eva Bochorishvili | evabochorishvili@gt.ge

Head of Macroeconomic Analysis and Forecasting
Lasha Kavtaradze | lashakavtaradze@gt.ge

Head of Analytics
Giorgi Iremashvili | giremashvili@gt.ge

Analyst
Nika Megutnishvili | nmegutnishvili@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge