



# Georgian Economy Fiscal is Central

Georgia | Economy  
December 23, 2020

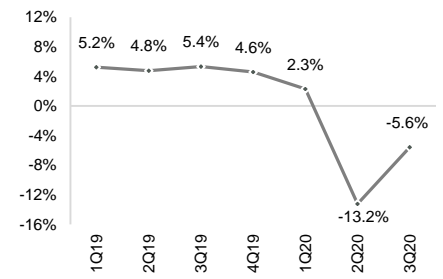
The pace of economic recovery in Georgia has been affected by post-election street protests and re-imposition of lockdown measures amid surge in COVID cases. The government announced a fresh support program for affected businesses and households in the amount of GEL 1.1bn. We note that a reduction in virus cases recently and minimal changes in the new cabinet will help to improve sentiments and minimize delays in decision making. In 2021, the fiscal policy continues to have a central role in stabilizing the economy with deficit set at 7.6% of GDP, and capex at 8.1% of GDP. We note that the deficit funding structure is also GEL supportive with government planning to rollover Eurobond in 2021, preserving international reserves. We see recovery in tourism as a key factor for GEL in 2021, otherwise we do not rule out the rate increase from NBB to support the currency along with FX interventions. We expect economy to rebound to 5.0-5.5% growth in 2021 assuming tourism to recover to 50% of its 2019 level; without recovery in tourism we expect growth at around 3.7% in 2021. Notably, the new cabinet of Prime Minister Gakharia faces a confidence vote this week, as well as a 2021-24 government program – “Building of a European State”.

### Political situation stabilized

On 31 October 2020, Georgians voted to elect the parliament members - 120 lawmakers elected through proportional vote and 30 lawmakers elected through single-mandate constituencies (majoritarian). This was final election in the form of current system and there will be transition to a fully proportional electoral system in 2024, reflecting constitutional amendments. Soon after the preliminary election results were released, elected 8 opposition parties rejected the election results due to allegations on violations, refused to face Georgian Dream (GD) in second rounds (16 majoritarian districts) and to enter the parliament until a new election was called, followed by peaceful street protests in November 2020. GD leaders denied the allegations. International observers ([US](#), [EU](#)) also did not question the integrity of the overall process, stating that the election had been competitive, though raised criticisms over a set of components of the election process. To overcome a post-election political standoff, the EU and US Ambassadors facilitated talks between GD and opposition. During month-long talks, parties brought closer their positions on a few issues, including electoral reforms ahead of 2021 local and 2024 parliamentary elections, but this was insufficient for opposition to enter the new parliament. It is expected the talks to continue and parties to get closer on certain issues. At this stage, we do not see the possibility the opposition to gain support of the majority of population and drive street protests again.

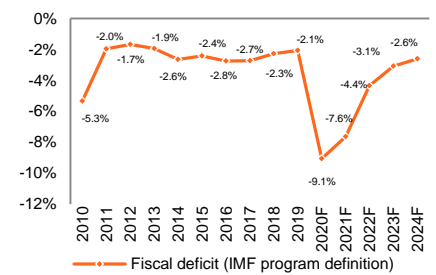
The inaugural session of the new parliament took place on December 11, with only 90 lawmakers elected from GD. The new cabinet of Prime Minister Gakharia faces a confidence vote this week, as well as a 2021-24 government program – “Building of a European State”, and at least 76 lawmakers votes are required for approval. Notably, 10 of the 11 candidates in the cabinet remain unchanged, while former deputy Justice Minister is nominated as a Minister. Government program aims to overcome the COVID-pandemic related crisis, restore the economy, aspire to European and Euro-Atlantic integration and make Georgia ready (institutionally, socially and economically) to apply for membership in the EU by 2024.

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



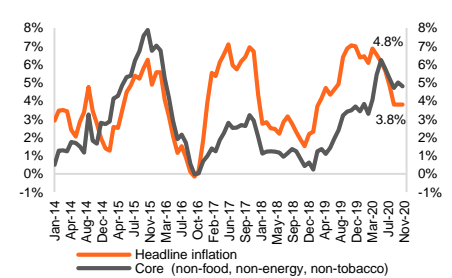
Source: Geostat

Figure 2: Fiscal deficit



Source: MOF, final draft of 2021 budget

Figure 3: Annual inflation



Source: Geostat

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### Economic recovery halted due to 2<sup>nd</sup> lockdown

Georgian economy was negatively affected by the COVID-19 pandemic this year because of the lockdown and halt in international tourism. Based on preliminary estimates, economy contracted by 5.8% in 9M20, with GDP contraction easing to 5.6% in 3Q from 13.2% decline in 2Q (notably, Geostat revised downwards both 2Q and 3Q GDP growth figures from 12.3% and 3.8% rapid estimates, respectively). However, rising COVID cases ([for details see our report on healthcare sector](#)) in recent months deteriorated sentiments and this along with post-election political uncertainty weighed on GEL. With absence of international tourism, hospitality and other tourism-related sectors were hit hard, but with lockdown measures re-imposed in other countries, Georgia's exports recovery worsened in Oct-Nov 2020 also. Meanwhile, remittances continued strong growth supporting domestic demand along with sizable fiscal stimulus and implementation of public capex.

Notably, surge in COVID-19 cases prompted the government to reintroduce lockdown restrictions from 28 November 2020 till 31 January 2021 (see pages 4 and 5 for details), however these restrictions are softer compared to the 1st lockdown when most of the economic activities were banned. Notably, the number of new cases reduced since the 2nd week of December despite increased daily testing after 3 months of uninterrupted growth, and we expect a smooth decline in active cases to continue. Taking into account downward revisions in 2Q and 3Q growth figures and the 2nd lockdown measures, we expect economic contraction at 6.0% in 2020, revised downwards from our pre-lockdown forecast of -5.1%. We expect economy to rebound to 5.0-5.5% growth in 2021 assuming tourism to recover to 50% of its 2019 level, which will support tourism-related sectors to turn into growth. In this regard, positive news on vaccine and the fact that over 70% of total arrivals travel by car to Georgia make us optimistic on tourism recovery dynamics. Without recovery in tourism, we expect growth at around 3.7% in 2021 and in this scenario, we project economic activity to be positive in agriculture, mining, manufacturing and construction, amongst others. We note that, with limited room for the rate cut in 2021, the fiscal policy will continue to have a central role in stabilizing the economy, with fiscal deficit set at 7.6% of GDP.

Fiscal support is a significant driver of recovery in 2020, with targeted stimulus for affected businesses and households. Notably, public capital expenditure increased by 14.8% y/y in 10M20, with 72.8% of the annual plan already disbursed. Notably, tax revenue performance was better-than-expected, and government revised 2020 tax revenue plan up by GEL 540mn to GEL 11.1bn.

Importantly, the continuation of bank lending also supported the economic recovery, with credit growth at 11.4% y/y (+0.9% m/m) in October 2020 excluding FX effects. The government's mortgage interest rate subsidy is also supportive of bank lending, as demand for new apartments rose. We expect credit growth to continue in double digits in 2021, supported by growth rebound.

### Adjustment in external balance

The goods trade balance continued improvement, with exports performing better than expected and savings from oil imports. Notably, exports drop widened in November compared to previous months, likely reflecting reduced foreign demand due to lockdowns in trading partners. In 11M20, exports decreased by 11.3% y/y and imports fell by 15.9% y/y, resulting in a 18.9% y/y improvement in the trade deficit. Furthermore, remittances rebounded strongly from June, and stood at US\$ 1.7bn in 11M20, up 8.0%



y/y. This rebound was supported by growing transfers from the EU (accounting for c. 41.5% of total inflows), as well from other countries (USA, Turkey, Ukraine, Azerbaijan, etc.). Tourism receipts came to standstill since the pandemic hit. Notably, external funding has been secured by IFIs loan disbursements, while FDI stood at US\$ 719.0mn (6.2% of GDP), down 24.0% y/y in 9M20. Assuming adjustment in the trade balance and growth in remittances, we expect the current account deficit at c.9.5% of GDP in 2020 and at c. 8.7% in 2021, in our base case.

### Currency

The GEL was trading at close to 3.06/US\$ in June-August 2020, before weakening from mid-September and now is trading at 3.3/US\$. Recent weakness may be attributed to deteriorated fundamentals as well as increased fiscal spending, weakened sentiments due to pandemic and political uncertainty. NBG's FX sales, totaling US\$ 855mn YTD, largely offset the FX shortfall due to tourism revenue loss. We see recovery in tourism as a key factor for GEL in 2021, and do not rule out the rate increase from NBG to support the currency along with FX interventions if tourism recovery delays. We expect the GEL at c.3.1/US\$ in 2021 if tourism recovers; without recovery in tourism we see GEL at 3.3-3.4/US\$. Importantly, despite interventions, international reserves increased 12.8% y/y to US\$ 3.8bn in November 2020, replenished by donor funding. The NBG communicated that it will continue interventions to ease pressure on the currency in 1H21 also.

### Price pressures expected

Annual inflation retreated to 3.8% in November, unchanged for last 3 months. This reduction in inflation reflected last year's high base (c.7% from September through December 2019) as well as reduced oil prices. The pass-through effect of GEL depreciation, planned gas price increase for commercial users from January 2021 and anticipated increases in utility prices expected to lift price pressures in 2021 (though government might subsidize certain categories). Therefore, we expect inflation to remain above 3% target in 2021, dictating hold on the rate cut and see GEL as a key factor for monetary policy considerations if currency's weakness persists. The NBG cut the key rate three times this year by cumulative 1 ppts, with final cut in August to 8.0% and kept rate unchanged thereafter being cautious of GEL weakness. According to NBG's latest forecast, the inflation rate will hover close to the target level of 3.0% in 1H21. Regulator commented that a tight policy stance might be necessary to last for longer period, due to inflation expectations and the dynamics of economic activity, and an increase in the key rate in the future could not also be ruled out.

### Budget

Government submitted the final draft of 2021 budget to the parliament on 30 November 2020, currently discussed at parliament. The fiscal deficit remains high in 2021 at 7.6% of GDP with both opex (+3.8% y/y) and capex growing (+5.2% y/y), the latter growth positive. In 2021, government plans to rollover the Eurobond (preserving international reserves) and not to raise domestic debt, which is GEL positive. Due to stimulus measures and GEL depreciation, government debt is set at 60.1% of GDP in 2021 and will reduce to 57.6% of GDP in medium term. To maintain capex at high level (8% of GDP) in coming years will be one of the challenges considering need for fiscal consolidation, as law allows deficit to be above 3% of GDP for only 3 years. We see



positives that in recent TV conference the Minister of Finance stressed the importance of improving fiscal parameters as well as tax administration. With limited fiscal space to support economy, the government is also active in attracting FDI and new supportive measures have been introduced recently (e.g. FDI grant program for up to GEL 1mn (US\$ 300,000)). Additionally, government works on post-COVID economic recovery plan with the participation of foreign experts, where we think that emphasis will be on further diversification of the economy.

### **2nd lockdown restrictions**

On 26 November 2020, the Government of Georgia tightened and extended the existing COVID restrictions from November 28, 2020 through January 31, 2021 in the country, taking into account the epidemic situation. In addition, on 22 December 2020, government revisited the decision to relax some restrictions during 24 December - 2 January. Notably, the 2nd lockdown measures are softer compared to the 1st lockdown, allowing many types of economic activity to continue.

#### **Nationwide restrictions**

- Country-wide curfew from 21:00 to 05:00, with 2 exceptions on New Year's and Christmas nights. The government also ensures one-off travel passes for the representatives of all religions and confessions to attend religious celebration, involving overnight stay.
- Halting of intercity public transportation. Restriction does not apply to light vehicles (including taxis).
- Closing of restaurants and other food facilities, except for takeaway, delivery, and drive-in services.
- Closing of gyms and swimming pools.
- Conferences, trainings, and all kinds of cultural and entertainment events have to move online.
- Halting activities of sport, art, and cultural clubs.

#### **Additional measures in large cities/ski resorts**

The following additional restrictions will apply to the 8 largest cities: Tbilisi, Kutaisi, Batumi, Rustavi, Zugdidi, Poti, Gori and Telavi, as well as the ski resorts of Bakuriani, Gudauri, Goderdzi and Mestia:

- Halting of municipal transportation.
- Shops (except for groceries, animal food stores, pharmacies, veterinarian drug stores, household chemicals and hygiene shops, printed media boxes) will operate only by distance service delivery.
- Open and closed markets will suspend operation. Fruit and vegetable markets will continue to operate.
- Schools, vocational training centers, higher education institutions (except for medical education programs) will be entirely move to distance learning.
- Private and public kindergartens will suspend operation.
- Hotels in winter resorts can only be used for quarantine purposes, and ski lifts will have to shut down.



### Easing of restrictions

- During the 2nd lockdown, no restrictions will apply to the work of banking and finance institutions, all types of industries and construction activities, beauty salons, taxi services/private transportation.
- From December 24 to January 2, shopping malls and non-essential shops will reopen from 07:00 to 19:00, with certain regulations. From January 3, the restrictions are again re-imposed, and public holidays are declared till January 15 to reduce mobility (but essential businesses will remain open).
- Starting on January 16, most measures, except for the curfew and restrictions on intercity transport, restaurants, gyms and swimming pools, will be lifted on workdays and continue to be effective on weekends. The remaining restrictions will end on February 1, 2021.

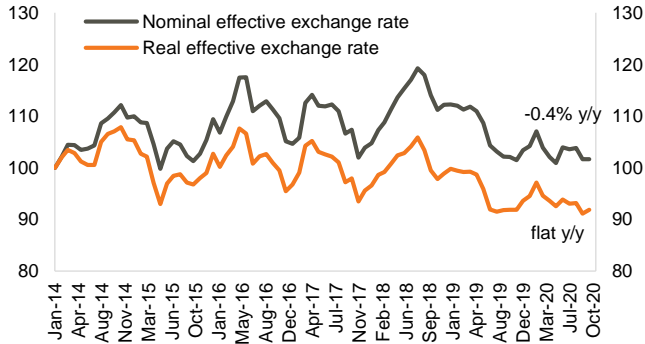
**Table 1: Comparison of restrictions imposed during 1st and 2nd lockdowns**

Key restrictions	1st lockdown	2nd lockdown
Borders closed with neighboring countries	Yes	Yes (remains closed since 1st lockdown)
Borders closed with other countries	Yes	Partially (flights resumed to several countries)
Learning process shifted online	Yes	Yes (except medical institutions)
Light vehicles (including taxis) prohibited	Yes (during 10 days)	No
Public transportation prohibited	Yes	Partially (only in big cities and ski resorts)
Intercity transportation prohibited	Yes (to/from big cities)	Partially (intercity transportation is allowed by light vehicles)
Strict quarantine in several municipalities	Yes	No
Curfew (09:00 PM to 05:00 AM)	Yes	Yes
Gathering of 3+ citizens prohibited in public space	Yes	No
Prohibition of retail trade	Yes Only groceries and pharmacies remained open	Partially shops operate by distance service delivery only in <b>big cities</b> , except for groceries, animal food stores, pharmacies, veterinarian drug stores, household chemicals and hygiene shops, printed media kiosks
Prohibition of economic activity	Yes most of economic activities prohibited	Partially most of economic activities are allowed, except for hotels in winter resorts and restaurants, gyms, swimming pools
Duration	Approximately 2 months	Approximately 1.5 month (Restrictions easing between December 24th and January 2nd; public holidays in 3-15 January 2020)

Source: Stopcov.ge

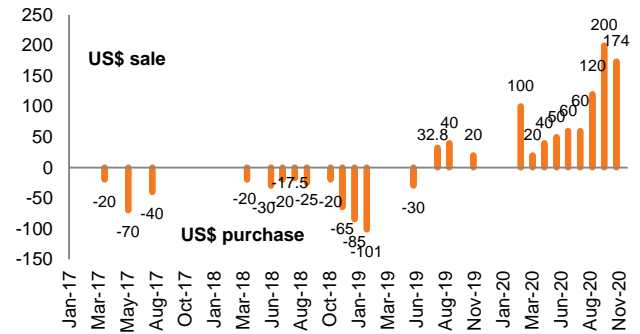


Figure 4: REER and NEER (index, Jan 2014 = 100)



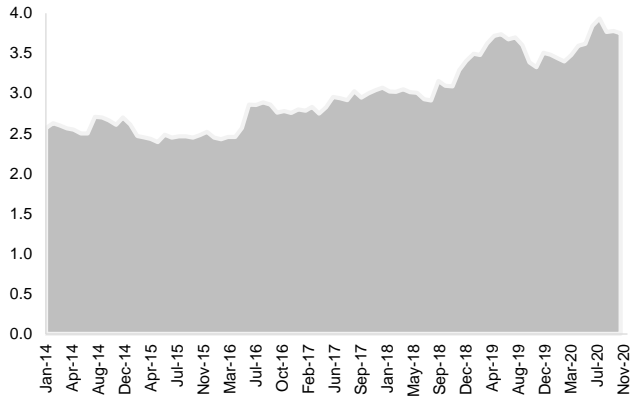
Source: NBG

Figure 5: NBG's net interventions, US\$ mn



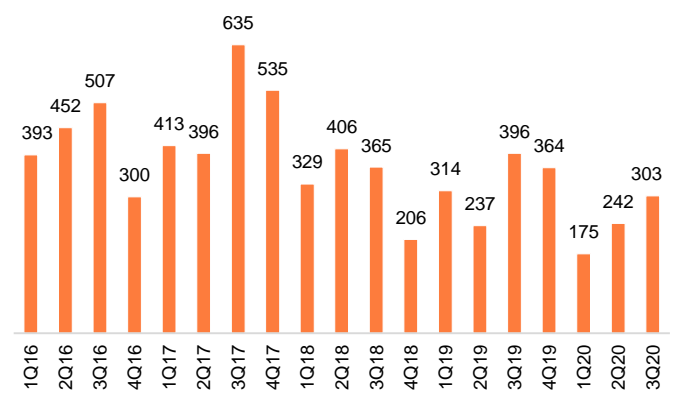
Source: NBG

Figure 6: Georgia's gross international reserves, US\$ bn



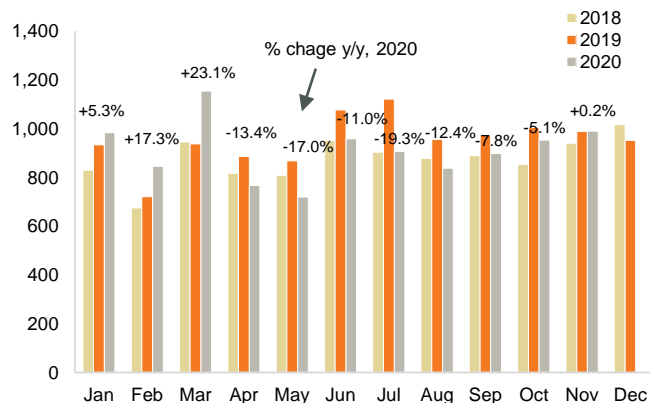
Source: NBG

Figure 7: FDI in Georgia, US\$ mn



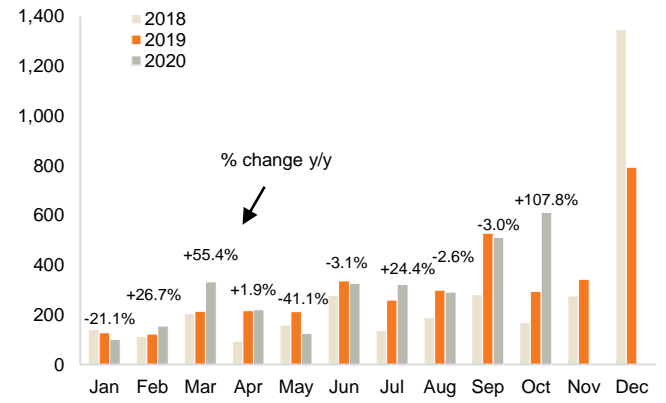
Source: Geostat

Figure 8: Consolidated budget tax revenues, GEL mn



Source: MOF  
Note: Tax revenue reduction since May 2020 reflects significant tax relief for different business

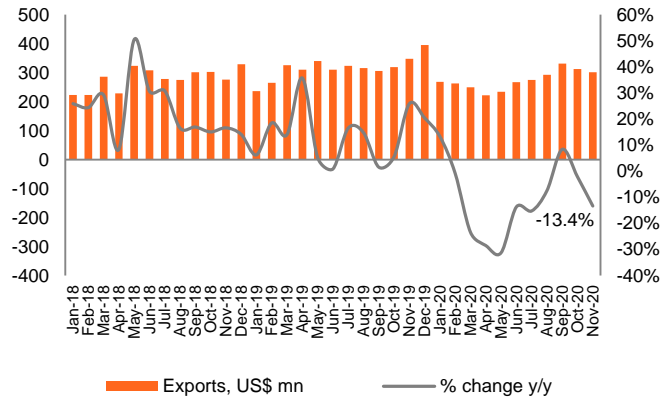
Figure 9: Consolidated budget capex, GEL mn



Source: MOF

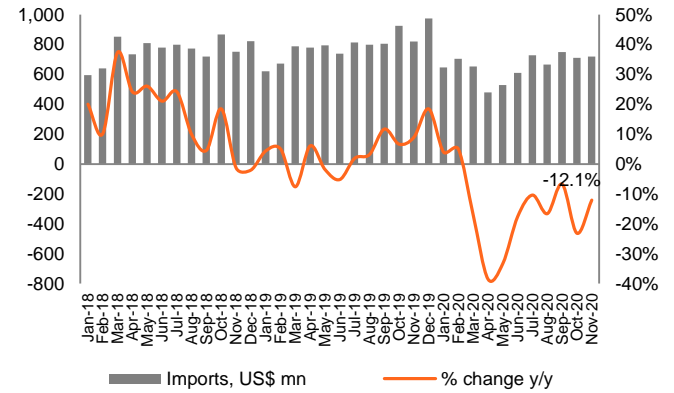


**Figure 10: Goods exports**



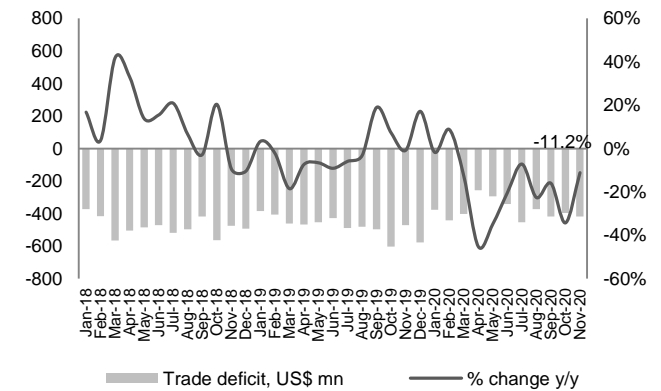
Source: Geostat

**Figure 11: Goods imports**



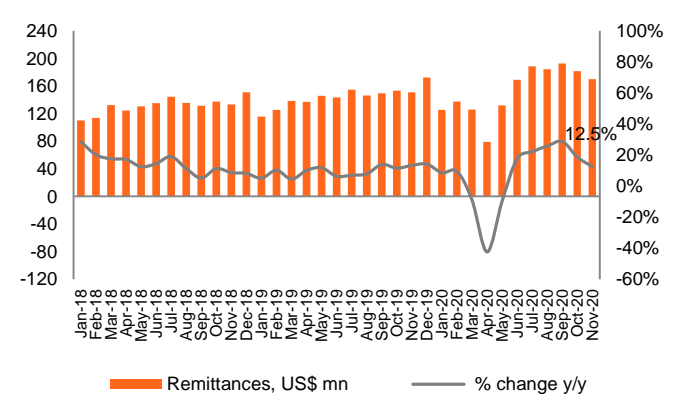
Source: Geostat

**Figure 12: Goods trade deficit**



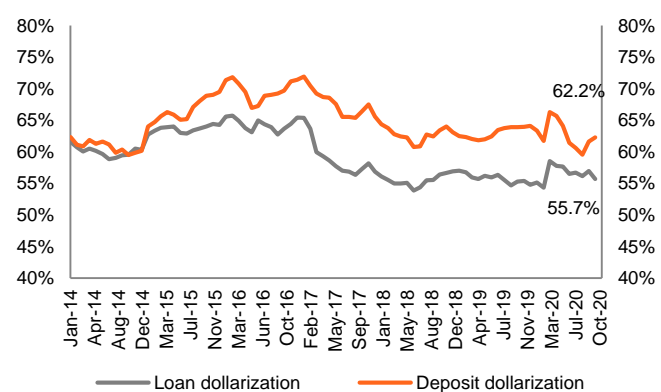
Source: Geostat

**Figure 13: Remittances inflows**



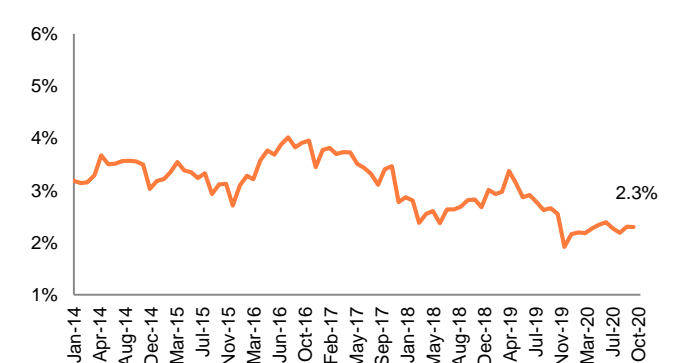
Source: NBG

**Figure 14: Dollarization**



Source: NBG

**Figure 15: Non-performing loans, % of total loans**

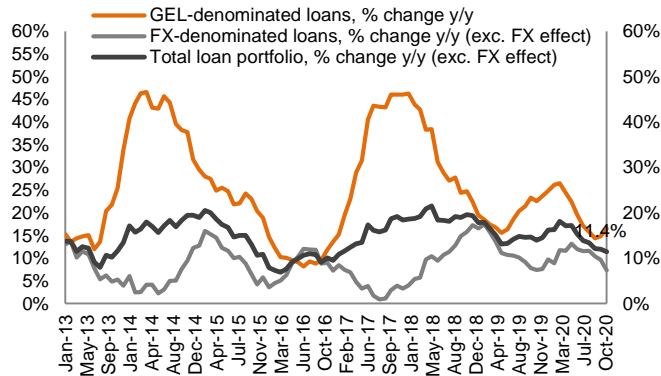


Source: NBG



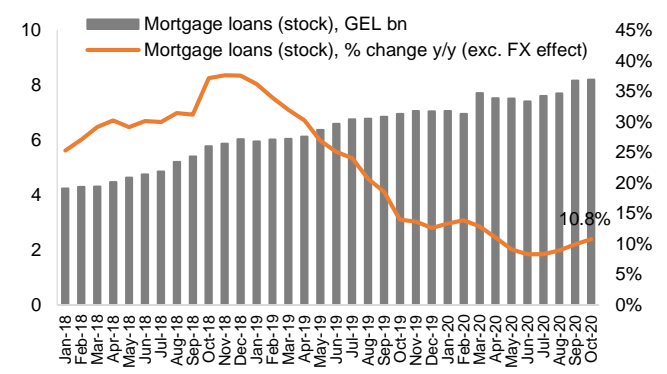


Figure 16: Banking loans growth



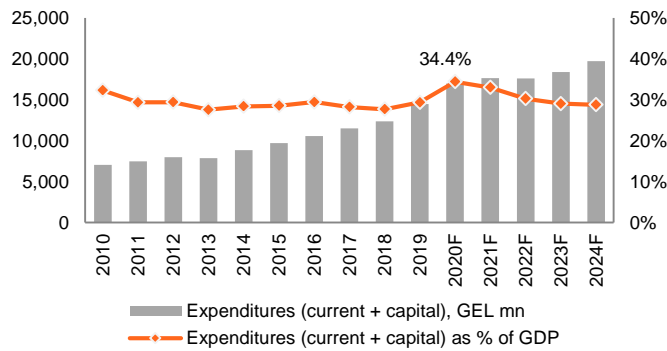
Source: NBG

Figure 17: Mortgage loans



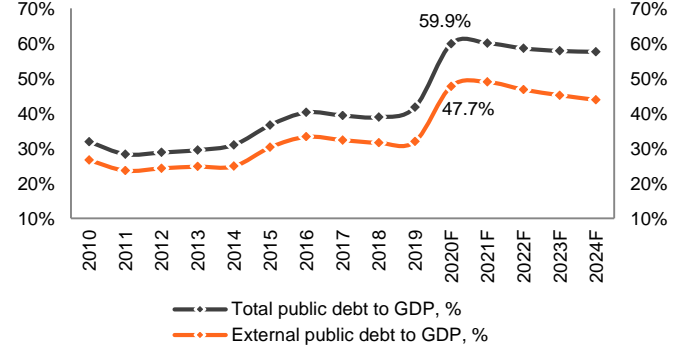
Source: NBG

Figure 18: Budget expenditures



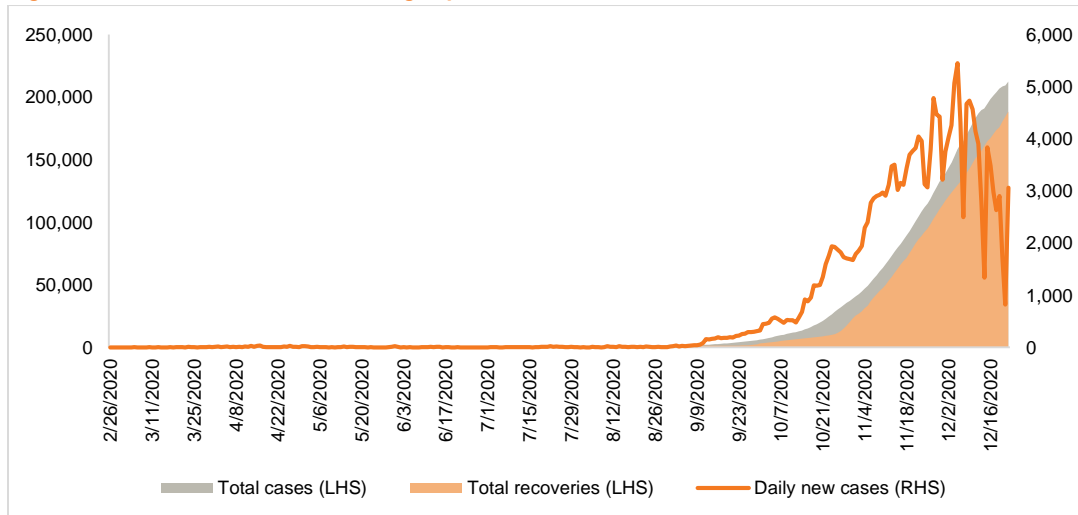
Source: MOF, final draft of 2021 budget

Figure 19: Public debt, as % of GDP



Source: MOF, final draft of 2021 budget

Figure 20: COVID-19 statistics in Georgia, persons



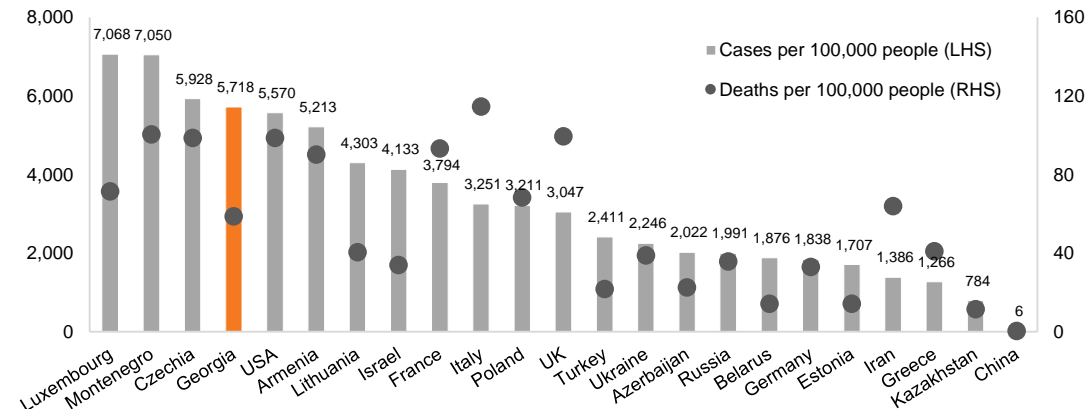
Source: NCDC

Note: as of 22/16/2020 12:00 PM





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



Source: Johns Hopkins University, Galt & Taggart Research  
Note: as of 22/16/2020 20:00

**Table 2: Government's support to businesses in relation to 2nd lockdown**

#	Business support	Description	GEL mn
1	Personal income tax exemptions	Persons with a salary of up to GEL 1,500 will be exempt from income tax on up to GEL 750 in December-May 2021. Estimated number of beneficiaries: 33,000 companies and 425,000 employees	260
2	Property tax exemptions for the tourism sector	Hotels, restaurants, and properties involved in similar activities will be exempt from property tax in 2021	45
3	Tax write-offs for 4 months of deferred income tax payments in 2020	Deferred income tax payments in the tourism sector (hotels, restaurants, and properties involved in similar activities) as of 1 December 2020 will be written off	20
4	Interest subsidies for the bank loans of hotels and restaurants	For hotels will continue; additionally, interest subsidies will be provided for the bank loans of restaurants over a period of 6 months. Estimated number of beneficiaries: 3,700 companies	
5	Microgrant program	A microgrant program for entrepreneurship is underway, which will fund thousands of new business projects (2020 program)	40
6	Credit-Guarantee Fund	In 2021	100
7	Bank loan rescheduling for companies whose operation will be restricted in the December-January period		
<b>Total</b>			<b>515</b>

Source: stopcov.ge



**Table 3: Government's support to households in relation to 2nd lockdown**

#	Households support	Description	GEL mn
1	Utility subsidies	Electricity and natural gas consumption of KV200 and 200m <sup>3</sup> per month during November-February. Estimated number of beneficiaries: 1.1mn households	270
2	Compensation for private sector employees who lost jobs (GEL 200 for 6 months)	Formal sector employees who will temporarily lose their jobs will receive monthly assistance in the amount of 200 GEL for 6 months starting from January 2020. Estimated number of beneficiaries: 125,000 individuals	150
3	Compensation for self-employed persons who lost jobs (one-off GEL 300)	Will be issued to individual entrepreneurs and persons employed in the outlets or facilities whose operations will be suspended in December and January as a consequence of the additional restrictions. Estimated number of beneficiaries: 100,000	30
4	Direct transfers to vulnerable families for 6 months	GEL 100 to be provided for 6 months starting from January. Estimated number of beneficiaries: up to 72,000 families (220,000 individuals)	55
5	Direct transfers to large families for 6 months	GEL 100 to be provided for 6 months (January-June). Number of beneficiaries: 24,000 families.	15
6	Direct transfers to disabled adults and children for 6 months	GEL 100 per month to be provided for 6 months. Number of beneficiaries: 43,000 individuals	27
7	Possibility of deferment of bank loans for persons employed in the outlets or facilities whose activities will be restricted		
<b>Total</b>			<b>545</b>

Source: stopcov.ge



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