GALT & TAGGART RESEARCH

Georgian Economy
Solid Growth despite Challenges

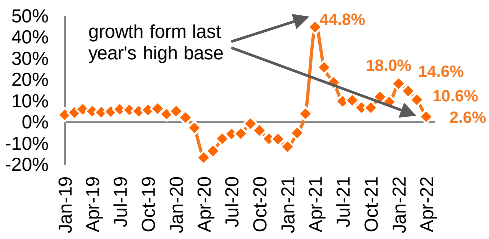
Georgia | Economy
June 9, 2022

Georgian economy continued strong recovery with real GDP growth at 10.8% in 4M22, despite another challenging year. The GEL also strengthened amid sustained external inflows and tight monetary policy. Meanwhile, commencement of the new IMF program will strengthen investor confidence in the continuation of prudent macroeconomic policy. Considering high 4M22 growth, strong external earnings and positive preliminary May data, we revise our GDP growth forecast significantly upwards to 7.6% for the full year 2022, from our previous forecast of 4.5%. Geopolitical challenges and related uncertainty are key risks to growth and if negative spillovers intensify in 2H22, we do not expect growth to soften below 5.0% in 2022. Notably, Georgian economy benefits also from better-than-expected growth in other neighboring and EU countries, which limits negative spillovers from Russia-Ukraine war.

Better-than-expected growth

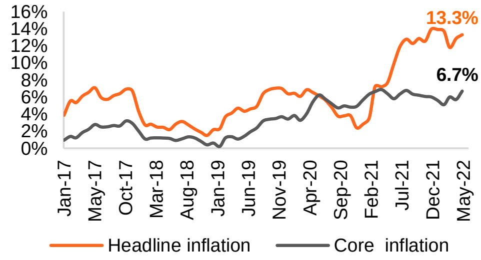
Georgia's economy continued robust recovery, with real GDP growth at 10.8% in 4M22. The part of this growth reflects last year's low base (in Jan-Feb 2021), and better-than-expected growth in Apr-22 at 2.6% vs last year's very high base at 44.8% (key level for the 2022 full year growth projection), as well as boosting hospitality sector due to lifting of COVID restrictions. Continued growth in external inflows, including tourism revenues - reflecting inflow of Russians, Belarusians and Ukrainians since the war started at end-February, are another growth drivers. We estimate that around 80,000-120,000 persons (mostly high-paid IT specialists) reallocated to Georgia to live and work since end-February, providing significant boost to the local economy, including sectors like real estate, cafes and restaurants, transport, financial services and others. Considerable growth is also expected in IT/BPO sectors, as international companies are reallocating to Georgia. The influx of foreigners for leisure and for work is visible on real estate market as rents skyrocketed - up by 71.6% y/y in April. Redirection of international cargo flows through Georgia is another upside to growth as media reports increased cargo turnover through all means of transportation. Considering these factors, we revised growth projection upwards to 7.6% for the full year 2022 (part of this revision is technical due to strong 4M growth and positive preliminary macro data in May), up from our previous **4.5% growth** projection. Geopolitical challenges and related uncertainty are key risks to growth, while pandemic risk is significantly reduced. If negative spillovers intensify in 2H22, we do not expect growth to soften below 5.0% in 2022, amid strong 1H.

Figure 1: Real GDP growth



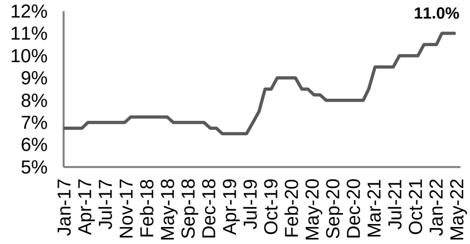
Source: Geostat

Figure 2: Annual inflation



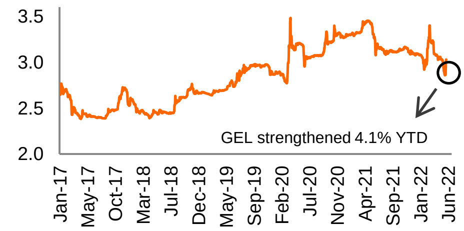
Source: Geostat

Figure 3: Monetary policy rate



Source: NBG

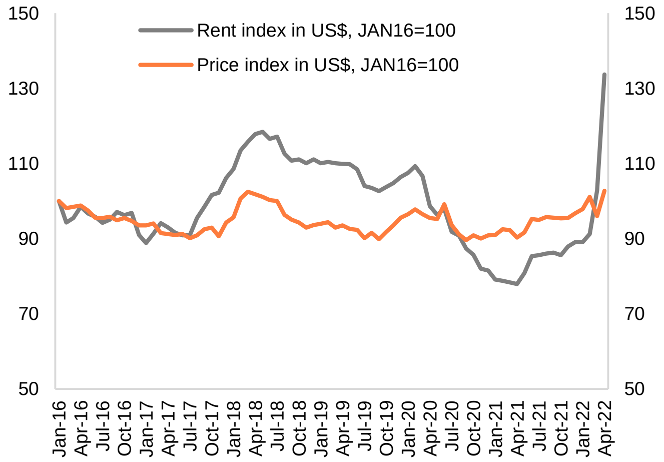
Figure 4: GEL/US$



Source: NBG

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

Figure 5: Price and rent index in US$ in Tbilisi, Jan-16=100



Source: NBG, Galt & Taggart Research

External sector - sustained inflows

As expected, remittances and exports remained resilient despite geopolitical challenges.

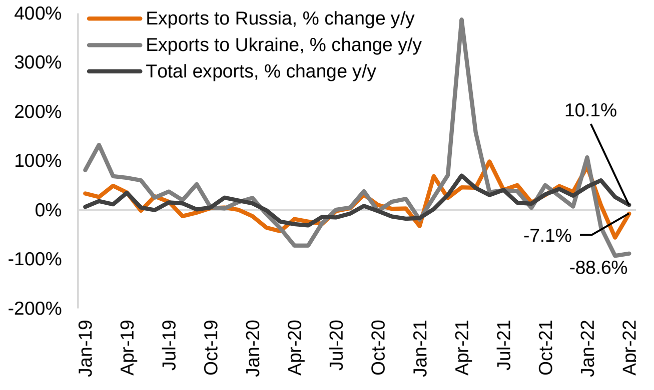
Goods **exports** continued strong growth in March (+26.3% y/y) and April (+10.1% y/y from last year's high base), overall, despite reduced exports to Russia (-55.8% y/y and -7.1% y/y, respectively) and Ukraine (-93.1% y/y and -88.6% y/y respectively). Being a commodity exporter (ferroalloys, fertilizers, gold, copper - mostly re-exports), Georgia benefits from booming global commodity prices, absorbing growing imports due to higher oil import bill. We expect export growth to remain positive in 2022 (15-20% y/y growth).

Remittances also remained resilient in March (up 2.6% y/y) and posted surprising growth of 58.8% y/y in April. Notably, strong growth of inflows from counties like EU, US, Israel, fully compensated decline of remittances from Russia (its share reduced to 14.0% of total in March) and Ukraine (from which remittances fell to zero) in March. In April, remittances from Russia surged 4x y/y (43.2% of total), likely related to influx of migrants since the war started. We expect remittances to continue growing.

Despite geopolitical challenges and increased risks, **tourism** recovery continues. In 4M22, tourist arrivals stood at 642,343 persons – up 233.9% y/y and accounting for 52.2% of 2019 level. Tourism revenues recovered markedly at 71.3% of 2019 level in March, highest recovery since tourism resumed, and positive trend continued also in April. In 4M22, most visitors came from Turkey (19.1% of total), followed by Russia (14.4% of total), and Armenia (12.5% of total). Notably, number of arrivals from Israel, Kazakhstan, Belarus, Saudi Arabia, and Uzbekistan surpassed 2019 levels. Currently, tourism industry is benefiting from inflows of Russians, Belarusians and Ukrainians arriving for longer term - we estimate that around 80,000-120,000 persons reallocated to Georgia to live and work since end-February, providing significant boost to the local economy, and this trend expected to continue. Considering inflows of visitors from neighboring countries, we expect tourism revenues to recover at 80-85% of 2019 level in 2022 before full recovery in 2023.

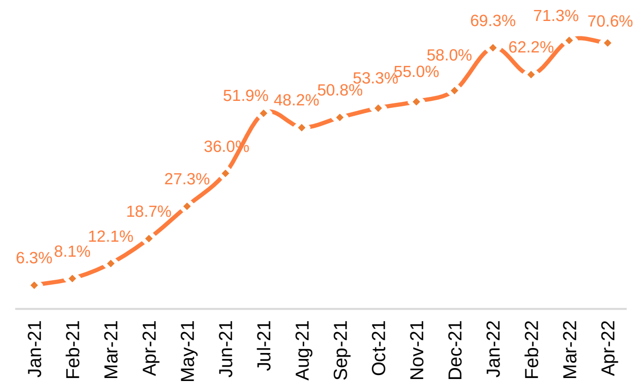
Sustained external earnings supported external balance to improve considerably in March and April, compared to previous months and y/y as well. We expect, current account deficit to narrow to 9.0% of GDP in 2022 from 9.8% in 2021.

Figure 6: Goods exports



Source: Geostat

Figure 7: Tourism revenues, as % of 2019 levels



Source: NBG

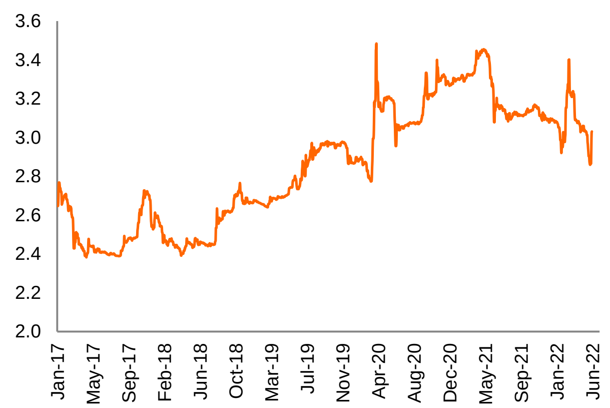
Monetary policy - tight

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 in 2021, with average inflation at 9.6%. There was an expectation of inflation deceleration from 2022, however spike in global commodity prices due to Russia-Ukraine war and supply disruptions due to China lockdown accelerated inflationary pressures in Georgia. Therefore, inflation unexpectedly spiked in April and May, to 12.8% and 13.3%, respectively (food and energy contributing 9.4ppts to headline inflation) up from 11.8% in March-22. Notably, inflation in May also reflected housing rentals growth due to surge in demand from migrants. The NBG maintains a view that inflation in Georgia is mainly driven by exogenous external factors, and sees the policy sufficiently tightened. Therefore, regulator kept the key rate unchanged at 11.0% on 11 May meeting and intends to keep current tight policy longer. However, the regulator announced possible rise in FX reserve requirements ceiling, which is currently at 25%. This will effectively tighten the policy on FX lending side if realized. We revise inflation forecast upwards to 11.5% (average) from previous forecast of 9.5%, considering rising world commodity prices, as well as planned gas tariff growth for commercial users. We expect first rate cut in 2Q23 if inflationary pressures subside.

GEL – appreciation

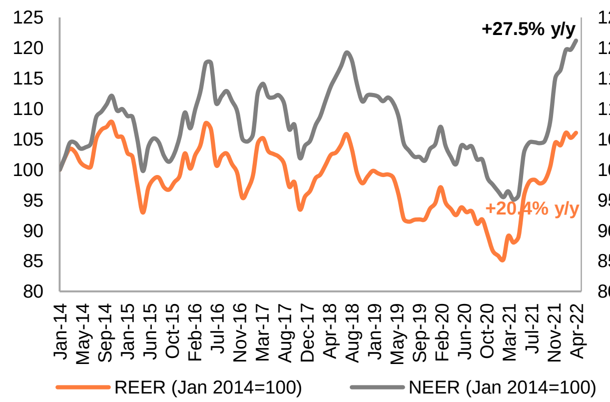
After short-lived depreciation sparked by Russia-Ukraine war in the beginning of March, the GEL strengthened markedly by 15.8% from March 11 to May 30, trading at 1$/2.87. GEL regained its value supported by tight monetary policy coupled with sustained external inflows, as well as FX intervention in March (US$ 40mn) to limit panic sell-off (generally the market assumes, that if during GEL depreciation episodes the NBG is inactive, then depreciation will continue). GEL appreciated also in effective terms as regional currencies depreciated - NEER strengthened by 27.5% y/y and REER by 20.4% y/y in April, hinting on overvaluation. This enabled the NBG to intervene on FX market and purchase US$ 10mn on 24 May 2022, the first purchase-side intervention since June 2019. The GEL moved to relatively fair value of close to $1/3.0 from end-May, which is 4.1% stronger vs dollar YTD. We do not rule out short-term volatility in GEL and expect to remain close to 3.0 vs dollar in near-term and average 3.0-3.1 in 2022.

Figure 8: GEL/1$ exchange rate



Source: NBG

Figure 9: REER and NEER



Source: NBG

Fiscal policy - government keeps 2022 growth projection at 6.0% and reduces fiscal deficit

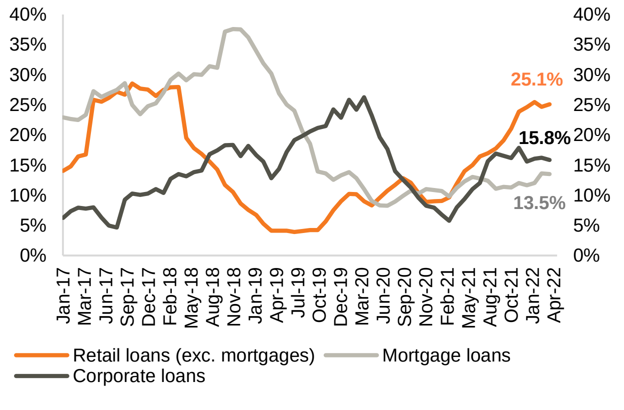
Strong growth supported fiscal performance on revenue side in 4M22, with tax revenues up 35.8% y/y, accounting for 33.8% of annual plan. On expenditure side, capex growth accelerated in March (up 35.4% y/y) before cooling down again in April, and expected to accelerate in coming months as capex budget is planned at all-time high level. On 31 May 2022 the government submitted to the parliament revised macroeconomic forecasts for 2022-26 and key directions document. Considering strong 4M22 growth, government keeps 2022 GDP growth forecast at 6.0% and projects average growth at 5.2% in 2023-26. Meanwhile, government revised other key indicators for 2022 – budget deficit revised down to 3.6% from 4.4% of GDP (reflecting better-than-expected tax revenues and higher nominal GDP growth), public debt revised down to 45.3% of GDP from 51.1% of GDP (largely reflecting GEL appreciation) and revised deflator up to 9.0% from 4.5%. We see no risks to medium-term fiscal sustainability as Georgia and IMF concluded staff-level agreement on a 3-year US$ 289mn program, which aims to reduce the deficit to comply with the fiscal rule by 2023 (3.0% of GDP deficit target) and above mentioned revisions are consistent with the government's commitment to fiscal sustainability. The program will also seek to improve public financial management and limit fiscal risks, especially through finalization and implementation of a strategy to enhance governance of state-owned enterprises. Georgia's fiscal rule also puts ceiling on public debt at 60% of GDP. In 2020, government debt increased to 60.2% of GDP up 19.8ppts y/y, but quickly fell to 49.5% of GDP in 2021, reflecting strong growth and GEL appreciation. The government aims to maintain downward trend in debt indicators, and in latest forecasts debt reduces to 41.4% of GDP in 2026. External debt remains high in the government debt structure (80%), however government aims to gradually reduce external debt portion and intensify issuance of local treasuries.

Banking sector - healthy growth

Banking sector loan portfolio increased by 18.2% y/y (exc. FX-effect) in 2021 and continued strong growth in 4M22, up 17.9% y/y. This growth was driven by both corporate (+15.8% y/y) and retail lending (19.9% y/y) as of April 2022, and the latter was driven by different types of consumer loans. NPLs improved further amid strong recovery standing at 1.9% in April (-0.3ppts y/y). Dollarization ratios also continue to improve, with loan dollarization at 49.6% (-5.8ppts y/y) and deposit dollarization at 59.5% (-3.2ppts y/y). We expect credit growth at 14-16% y/y in 2022 up from our previous forecast of 11-13%.

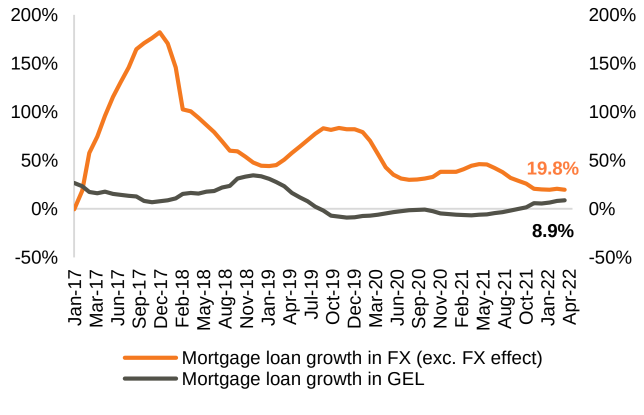
Despite various challenges in recent years, financial sector remains healthy and well-capitalized. Credit growth is on a healthy footing with loan to GDP ratio improving to c. 70% in 2021 and further to 68.6% 1Q22, from c.80% in 2020 as nominal GDP grew above 20%. We see no risks to financial stability as the regulator remains strict, introducing different macroprudential measures (e.g. recalibration of CICR buffer, reduction of the maximum tenor of FX mortgages, etc.) to reduce dollarization-related risks.

Figure 10: Loan portfolio growth, exc. FX effect



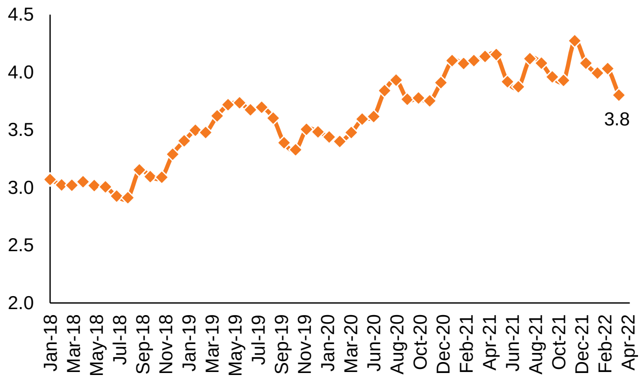
Source: NBG

Figure 11: GEL and FX mortgages growth, stocks



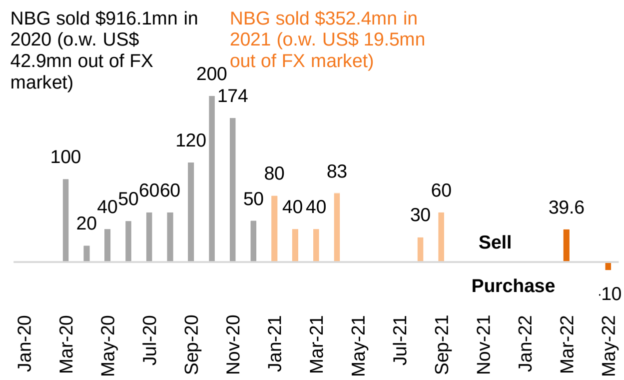
Source: NBG

Figure 12: Gross international reserves, US$ bn



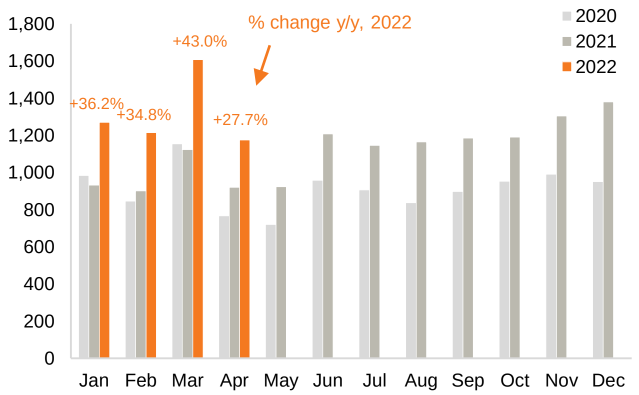
Source: NBG

Figure 13: NBG's net interventions, US$ mn



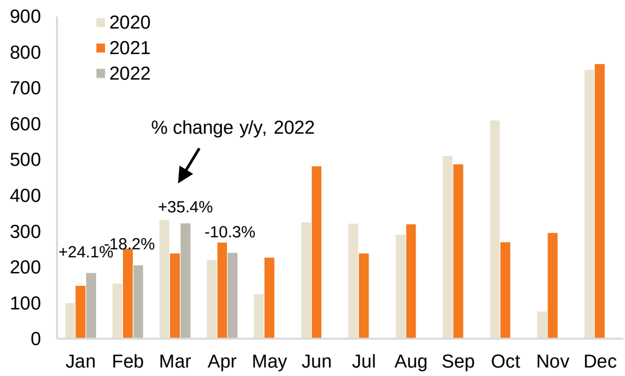
Source: NBG

Figure 14: Consolidated budget tax revenues, GEL mn



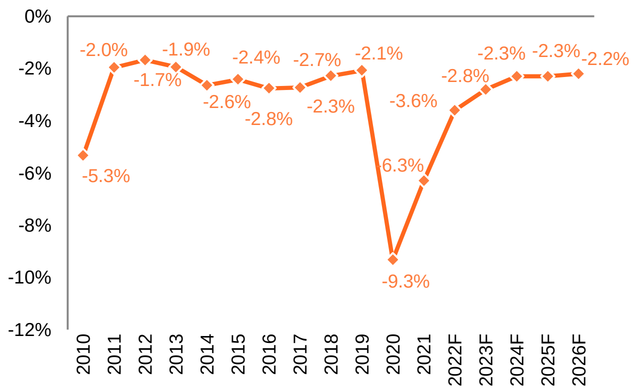
Source: MOF

Figure 15: Consolidated budget capex, GEL mn



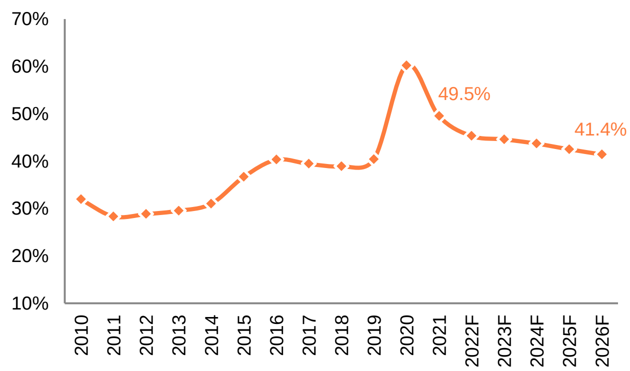
Source: MOF

Figure 16: Fiscal deficit, as % of GDP



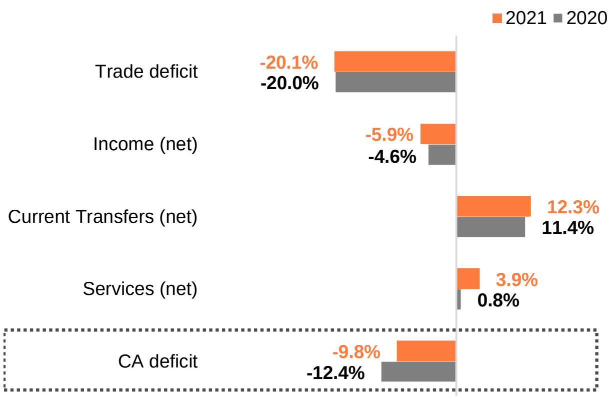
Source: MOF, forecasts based on BDD as of 31 May 2022

Figure 17: Public debt, as % of GDP



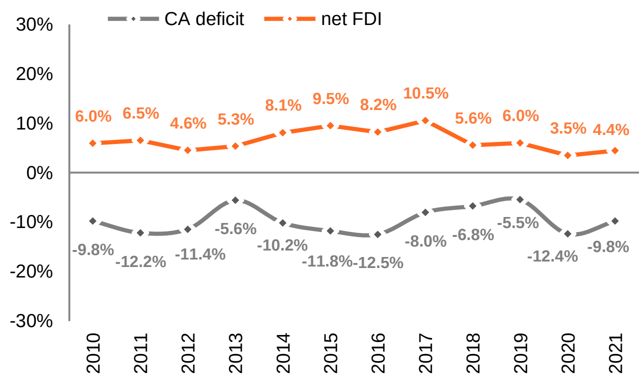
Source: MOF, Geostat, forecasts based on BDD as of 31 May 2022

Figure 18: CA balance and its components, as % of GDP



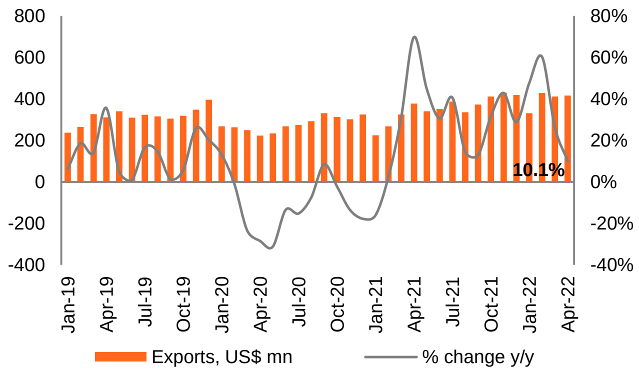
Source: NBG, Geostat

Figure 19: CA and net FDI, as % of GDP



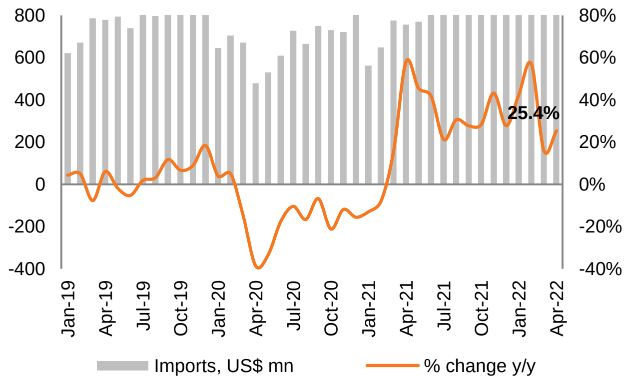
Source: NBG, Geostat

Figure 20: Goods exports



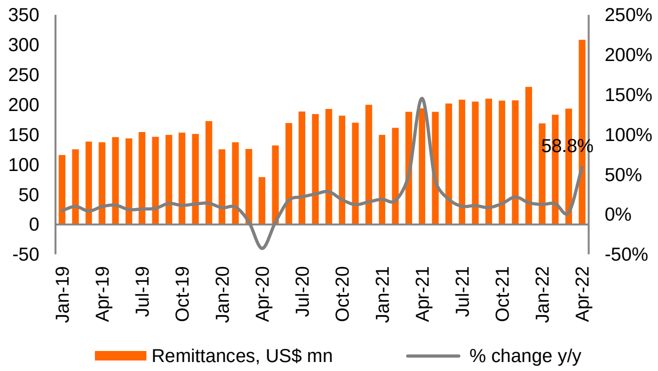
Source: Geostat

Figure 21: Goods imports



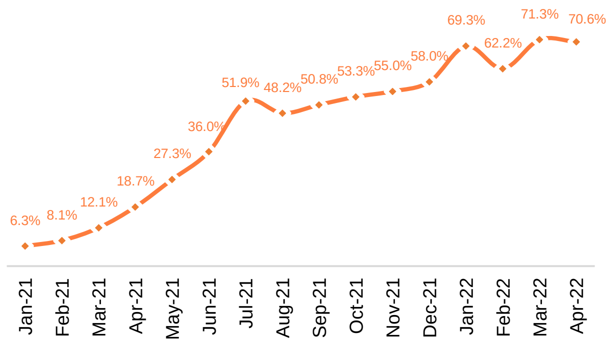
Source: Geostat

Figure 22: Remittances in Georgia



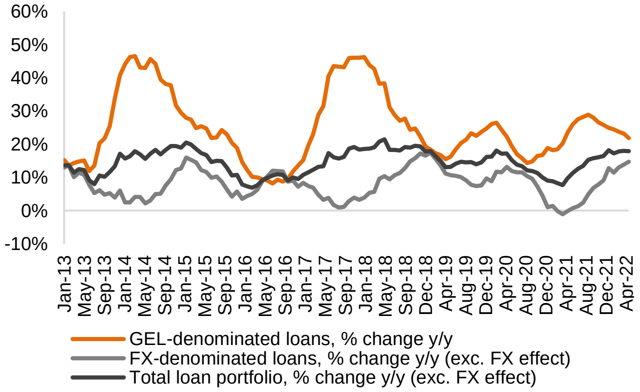
Source: Geostat

Figure 23: Tourism revenues, as % of 2019 level



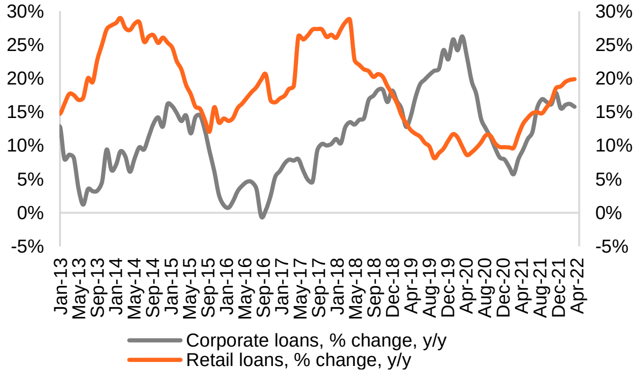
Source: NBG

Figure 24: Banking sector loan growth



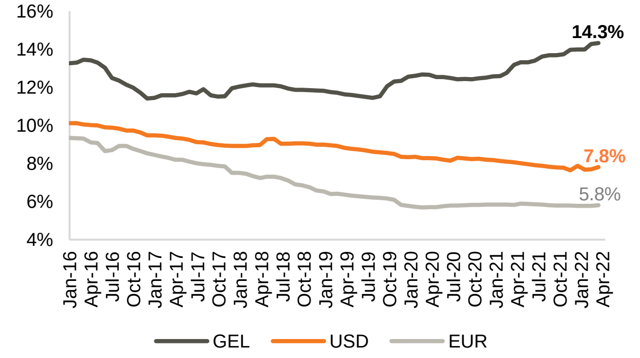
Source: NBG

Figure 25: Loan book growth: corporate vs. retail (exc. FX effect)



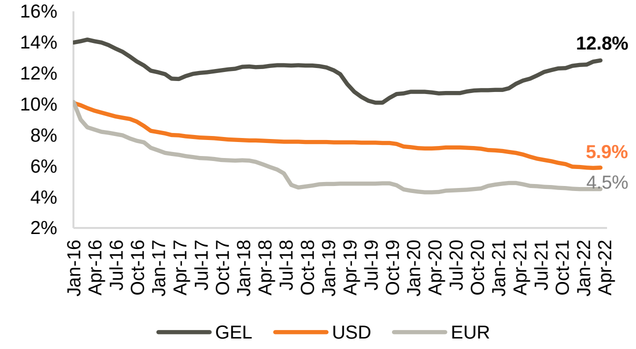
Source: NBG

Figure 26: Interest rates on loans to legal entities



Source: NBG

Figure 27: Interest rates on mortgage loans



Source: NBG

Macro data and forecasts

Georgia	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	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	49.3	60.2	70.6
Nominal GDP, US$ bn	12.2	15.1	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.5	15.8	18.7	22.9
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	4,256	5,017	6,215
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%	-6.8%	10.4%	7.6%
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%	9.6%	11.5%
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%	13.9%	9.2%
GEL per US$, average	1.78	1.69	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.82	3.11	3.22	3.08
Population, mn	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances													
Budget revenues, % of GDP	26.9%	28.5%	28.8%	26.4%	26.5%	27.5%	28.0%	27.4%	27.0%	26.6%	25.6%	25.8%	26.4%
Budget expenses, % of GDP	32.3%	29.4%	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	29.4%	34.9%	32.1%	29.8%
Fiscal balance (-deficit), % of GDP	-5.3%	-2.0%	-1.7%	-1.9%	-2.6%	-2.4%	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.3%	-3.6%
Public debt, % of GDP	31.9%	28.3%	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.4%	60.2%	49.5%	45.3%
External Sector													
Current account, US$ bn	-1.2	-1.8	-1.9	-1.0	-1.8	-1.8	-1.9	-1.3	-1.2	-1.0	-2.0	-1.8	-2.0
Current account, % of GDP	-9.8%	-12.2%	-11.4%	-5.6%	-10.2%	-11.8%	-12.5%	-8.0%	-6.8%	-5.5%	-12.4%	-9.8%	-9.0%
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	5.9	8.1	9.2
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	11.1	12.4
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	2.3	2.4
Net FDI, US$ bn	0.7	1.0	0.8	0.9	1.4	1.4	1.2	1.7	1.0	1.1	0.5	0.8	0.9
Net FDI, % of GDP	6.0%	6.5%	4.6%	5.3%	8.1%	9.5%	8.2%	10.5%	5.6%	6.0%	3.5%	4.4%	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	4.3	4.6
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	11.1	11.7	13.9	15.9
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%	77.6%	71.4%	68.3%
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%	10.5%	11.0%

Source: NBG, MOF, Geostat, Galt & Taggart

Note: Fiscal balance according to IMF Program Definition

Disclaimer

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

Head of Sector Research
Bachana Shengelia | bshengelia@gt.ge

Senior Associate
Mariam Chakhvashvili | mchakhvashvili@gt.ge

Senior Associate
Kakhaber Samkurashvili | ksamkurashvili@gt.ge

Senior Analyst
Tatia Mamrikishvili | tmamrikishvili @gt.ge

Senior Analyst
Nino Peranidze | ninoperanidze@gt.ge

Analyst
Nikoloz Ghambashidze | nikolozghambashidze@gt.ge

Analyst
Giga Nozadze | gnozadze@gt.ge

Address: 3 A. Pushkini street, Tbilisi 0105, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge