GEORGIA

Highlights

- **Strong foreign direct investment (FDI) and a favourable external economic environment are fuelling growth.** GDP grew by 5 per cent in 2017 and at a similar pace in the first nine months of 2018, while FDI inflows amounted to a sizeable 12 per cent of Georgia's GDP in 2017.
- **The authorities introduced mandatory retirement savings as part of the pension reform.** Contributions by an employee and an employer will be matched by the state, with each contributing party providing 2 per cent of gross salary into the pension fund.
- **Taxation of small businesses was further simplified.** The rate of turnover tax was lowered and the turnover ceiling was raised to broaden the pool of eligible enterprises. The system of advance tax payments was abandoned in favour of monthly tax declarations and payments.

Key priorities for 2019

- **The justice administration system requires further reform.** Enhancing the transparency and efficiency of law enforcement, and ensuring the independence and competence of courts, including commercial chambers, would further increase public trust in the system.
- **The development of multimodal infrastructure should be stepped up.** To enhance Georgia's role as a regional hub economy for sectors such as tourism, trade and logistics, the country needs to make further progress in developing connectivity-enhancing infrastructure.
- **The new public-private partnership (PPP) framework should be put into operation promptly.** This can help mobilise private sector participation in various priority infrastructure schemes in a financially sustainable manner.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	4.6	2.9	2.8	5.0	4.5
Inflation (average)	3.1	4.0	2.1	6.0	2.8
Government balance[1]/GDP	-3.2	-3.7	-4.0	-3.9	-3.3
Current account balance/GDP	-10.8	-12.6	-13.1	-8.8	-10.5
Net FDI/GDP [neg. sign = inflows]	-8.5	-9.6	-8.1	-10.7	-8.7
External debt/GDP	84.6	109.0	110.4	113.8	n.a.
Gross reserves/GDP	16.4	18.0	19.2	20.0	n.a.
Credit to private sector/GDP	44.5	50.4	55.6	58.6	n.a.

[1] According to the definition by the Ministry of Finance.

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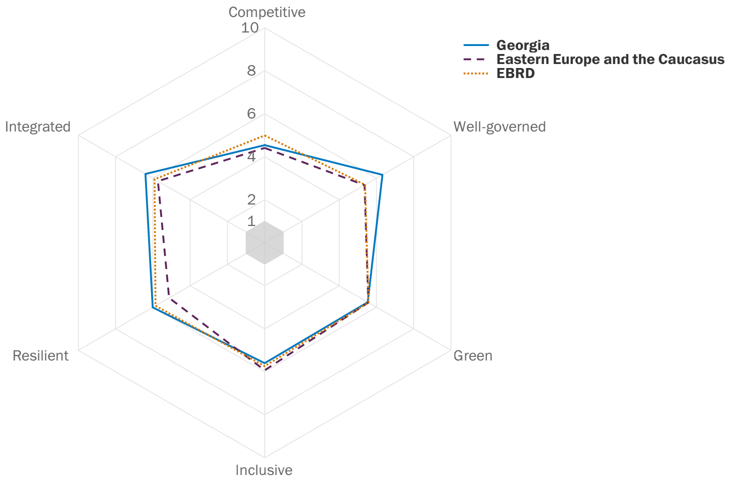
Macroeconomic performance

The economy is expanding at a brisk pace. GDP growth picked up from an average of 2.9 per cent in 2015-16 to 5.0 per cent in 2017, supported by an upswing in exports of goods and services and household consumption. Economic growth is estimated to have accelerated to 5.4 per cent in the first half of 2018, before slowing down to an estimated 4.0 per cent year-on-year in the third quarter. Exports of goods and services in nominal US dollar terms increased by approximately one-fifth in 2017 and in the first half of 2018, supported by the burgeoning hospitality sector. The influx of international travellers to Georgia increased sharply by 17.6 per cent in 2017 and by 11.2 per cent year-on-year in the first nine months of 2018. The inflow of money transfers increased by 19.8 per cent in 2017 and by 16.0 per cent in the first half of 2018 in US dollar terms, and amounted to approximately 9.1 per cent of GDP in 2017. The trade, construction and transport sectors were the largest contributors to GDP growth last year.

FDI remains the key source of external financing. On the back of strong export revenues and remittances, the current account deficit dropped to a still-significant 8.8 per cent of GDP in 2017 after averaging 12.9 per cent of GDP in 2015-16. This deficit was more than offset by FDI inflows reaching approximately 12.1 per cent of GDP in 2017 and directed mostly to infrastructure, financial intermediation and energy. The Georgian lari was stable against the US dollar in the first seven months of 2018, although more recently exchange rate pressures were triggered by volatility in large trading partners among other factors. Inflation slowed from an average of 6.0 per cent in 2017 to 2.7 per cent year-on-year in September 2018. In July 2018, the National Bank of Georgia (NBG) lowered its refinancing rate by 0.25 percentage points to 7 per cent.

Economic growth prospects are predominantly positive. With an extensive network of free trade arrangements, as well as its attractiveness as an investment and tourism destination, Georgia is well positioned to benefit from favourable external economic conditions. GDP growth is forecast at 4.5 per cent of GDP in 2018 and 2019. Downside risks stem from a possible deterioration in external economic conditions and geopolitical vulnerabilities.

Assessment of transition qualities (1-10)



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Major structural reform developments

Georgia is on track with implementation of the IMF-supported reform programme. As of September 2018, US$ 127 million has been disbursed out of US$ 285 million envisaged under the three-year Extended Fund Facility arrangement signed in April 2017. The main pillars of the programme include improvements to the fiscal framework and administration, strengthening financial supervision and regulation, and advancing growth-enhancing reforms, in particular those related to infrastructure and education. The second programme review was successfully completed in June 2018, with Georgia making notable progress according to the IMF. In October 2018, the IMF reached staff-level agreement with the authorities on the third review.

Macroprudential regulation was strengthened and steps were taken to promote responsible lending practices. In December 2017, the NBG introduced countercyclical capital buffers for the banking sector and additional capital requirements for three systemically important banks, which are to be phased in by 2021. New regulations for responsible lending came into force in May 2018, aiming for better alignment with the European directives, raising underwriting standards and improving loan portfolio quality. To enhance institutional capacity, the NBG has created a new financial stability department and strengthened the operational framework of the Financial Stability Committee. At the end of 2017, the NBG's supervisory powers were expanded to include microfinance institutions, credit unions, currency exchange units and money transfer agents.

Improvements in public finance management are under way. The changes are focused on streamlining the public sector wages bill and on optimisation of the Revenue Service (RS). In December 2017, civil service remuneration reforms were introduced, involving grade structures with a corresponding compensation grid, aiming to improve the link between performance and remuneration. In the first half of 2018, the authorities reorganised the RS and transferred all core functions from field offices to the headquarters. A specialised unit was created at the RS to review overdue VAT refund obligations.

A new PPP law has been adopted. The Parliament of Georgia adopted the PPP law in May 2018. The new law is a significant step towards more active participation of the private sector in the national infrastructure development agenda. It was developed according to the best practices and internationally accepted standards. Work is under way on reviewing and amending primary and secondary legislation. The PPP framework aims to scale up private sector involvement in infrastructure investments while keeping contingent fiscal liabilities at bay.

Pension reform is advancing. A pension reform law was adopted by the Parliament of Georgia in July 2018 with the aim of improving pension replacement rates for workers. This marks the transition to compulsory retirement savings, although the merits of the new system are yet to be tested. The new funded pillar will be additional to Georgia's existing universal basic pension coverage. Contributions into individual retirement accounts will become mandatory for the employed population under the age of 40 and will require monthly contributions from the employee, employer and the state, each in the amount of 2 per cent of gross salary. Contributions from the self-employed and those aged over 40 will be optional. The law also provides for setting up a dedicated pension agency. At the same time, Georgia's track record of macroeconomic volatility and its underdeveloped domestic capital market pose significant challenges for the new system's long-term viability.

The authorities have broadened tax initiatives for small businesses. Before the recent changes, small businesses were defined as companies with an annual turnover of up to 100,000 Georgian lari (approximately US$ 40,000) and were subject to a 5 per cent turnover tax. From July 2018, this tax regime has been applied to enterprises with an annual turnover of up to 500,000 lari (US$ 200,000), thus widening the spectrum of businesses eligible for favourable tax treatment. The turnover tax rate was lowered to one per cent and its advance payment was abandoned. Tax declarations and payments by small businesses are now performed monthly, based on simplified tax accounting.