GEORGIA

Highlights

- **Economic growth remained strong in 2019, but is contracting in 2020.** The hospitality sector, the main driver of robust economic growth in recent years, has become a key source of vulnerability during the Covid-19 pandemic.
- **The policy response to Covid-19 went hand in hand with securing support from international partners.** Total funding pledged by official creditors, including under the augmented International Monetary Fund (IMF) programme, is expected to cover the external and budget gaps in the near term.
- **The adoption of key energy laws marks a new stage in the sector's development.** The laws outline the upcoming energy market reform, establish a renewable energy framework and support energy efficiency in construction.

Key priorities for 2021

- **The authorities should strengthen the resilience of the economy through diversification.** Policies to support the export of information technologies services and to benefit from the expected post-Covid-19 shifts in global supply chains could enhance the growth potential of the economy and its resilience.
- **Governance standards need to remain high on the reform agenda.** Strong institutions, an impartial judicial system and independent market regulatory bodies are key for attracting investments in higher value-added sectors and speeding up the convergence process.
- **Human capital development through investments in education would help improve the overall productivity of the economy.** Digital technologies capabilities and vocational skills will become important factors in directing post-Covid-19 investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.9	4.8	4.8	5.1	-5.0
Inflation (average)	2.1	6.0	2.6	4.9	5.3
Government balance[1]/GDP	-1.3	-0.9	-0.7	-2.7	-8.1
Current account balance/GDP	-12.5	-8.0	-6.8	-5.4	-10.8
Net FDI/GDP [neg. sign = inflows]	-8.2	-10.5	-5.5	-5.8	-5.2
External debt/GDP	105.3	106.6	101.3	105.0	n.a.
Gross reserves/GDP	18.2	18.7	18.7	19.8	n.a.
Credit to private sector/GDP	51.7	53.4	58.1	62.2	n.a.

[1] According to the definition by the Ministry of Finance (GFS-2001).

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Covid-19: macroeconomic implications

The Covid-19 pandemic is particularly disruptive for the small and open Georgian economy. The impact of the external pandemic shock was wide-ranging, hitting export of goods, tourism and remittances, all very important pillars of the Georgian economy. Strict virus containment measures, imposed in March 2020, hit domestic demand and many small service providers. Growth slowed from 5.1 per cent in 2019 to 2.2 per cent year-on-year in the first quarter of 2020, and GDP fell by 12.3 per cent year-on-year in the second quarter, with the trough of the cycle reached in April. Preliminary indicators show that economic output contracted by 5.0 per cent year-on-year in the first nine months of 2020. Tourism, which brought foreign exchange inflows close to one-fifth of GDP in 2019, recorded a 78 per cent year-on-year fall of foreign visitors in the period January to September 2020, as international borders remained largely closed. An increase in domestic tourism helped to somewhat soften the blow to the sector. After growing by four consecutive years, money transfers fell by more than 40 per cent year-on-year in April 2020, before returning to growth in June. Depreciation pressures prevailing throughout 2019 resumed in March 2020 on the back of looming uncertainty. This added to the inflationary pressures and the consumer price level remained above the 3 per cent level targeted by the National Bank of Georgia (NBG). However, on the back of significantly subdued demand, the NBG cautiously lowered the policy rate three consecutive times, from 9.0 to 8.0 per cent, between March and August 2020.

The authorities secured substantial foreign financing to help fund the crisis response. An increase in government expenditures combined with weaker economic activity led to a sharp rise in the budget deficit, and the loss of tourism revenues has resulted in a widening of the current account deficit. To help stabilise internal and external imbalances and provide an additional liquidity buffer, the authorities asked for augmentation of the Extended Fund Facility programme with the IMF, thus securing finances of more than US$ 400 million for 2020-21. This is expected to more than cover the external and budget gaps in the near term.

Economic recovery depends on the rebound of tourism. We project a GDP contraction of 5.0 per cent in 2020 followed by a recovery of 3.5 per cent in 2021. The speed of recovery and overall economic health in 2021 will be dictated by the developments in the hospitality sector and the inflow of foreign visitors, both of which are highly uncertain at present. The crisis emphasises the need for advancing structural reforms that would attract stronger efficiency-enhancing foreign investments, and lead to productivity increases and economic diversification.

Policy response to Covid-19

The government prepared a comprehensive package of measures to support the economy. The measures first adopted in March and then extended in May 2020 include increased health sector funding, postponement of certain tax payments, doubling of value-added tax refunds by the end of 2020, a scaling up of the credit guarantee scheme and the state programme 'Produce in Georgia', and exemption from income tax for low-paid jobs. Social assistance measures include coverage of utility fees for smaller household users, deferred loan repayments for household loans and support for those affected by the pandemic, the self-employed and vulnerable groups. The NBG lowered capital and liquidity requirements, relaxed regulatory requirements to support loan restructuring and loosened monetary policy in light of lower inflationary pressures.

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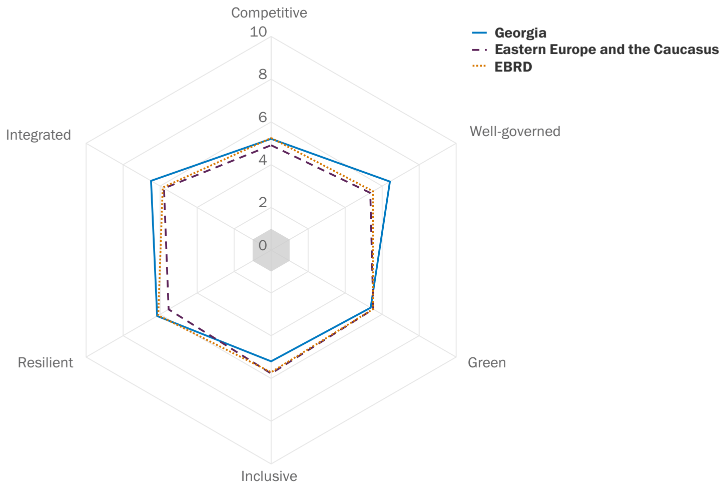
Assessment of transition qualities (1-10)



Structural reform developments

A number of key energy laws and regulations were adopted. The Law on Energy and Water Supply outlines the overarching energy sector reform while the Renewable Energy Law sets renewable energy targets. Both were adopted at the end of 2019 and define the general framework for the upcoming markets, set deadlines and determine the government bodies responsible for their implementation. Secondary legislation setting out the details of the new market organisation and implementation action plans is being developed. Following the adoption of the National Energy Efficiency Action Plan, also at the end of 2019, the authorities adopted the Law on Energy Efficiency and the Law on Energy Performance of Buildings in May 2020. The regulation will help improve the energy performance standards for new constructions and building retrofits, in line with European Union (EU) standards. All these laws are important milestones in meeting requirements under the EU-Georgian Association Agreement as well as Georgia's membership of the Energy Community.

The NBG has strengthened its regulatory power. In a series of moves in the past year the NBG amended regulations on consumer lending to give more discretionary power to the banks and enhanced its transparency and communication. The framework for the recovery of banks and resolution, approved in December 2019, strengthens Georgia's financial resilience. The resolution framework is an alternative to bank liquidation, to be used in cases where liquidation would lead to significant risks to financial system stability. The framework will become effective by the end of 2020. The regulation on consumer lending, adopted at the end of 2018, was adjusted with the aim to move from a rules-based to a principle-based approach, giving banks more freedom to manage risks. The amendments include deregulating the way the borrower's income is determined while keeping the obligation of income verification, introducing risk management requirements for consumer lending in banks and microfinance institutions, reducing the number of income brackets for payment-to-income limits, and increasing the maturity for mortgages in local currency. Publication of the Financial Stability Report, an annual assessment of risks and vulnerabilities in the financial system, resumed in September 2019 after eight years. In the same month, the NBG published a macro-prudential policy strategy, which identifies intermediate objectives to promote financial stability. The Supervisory Strategy 2020-22 sets the strategic priorities for the regulator and lays out specific activities for the execution of those priorities.