

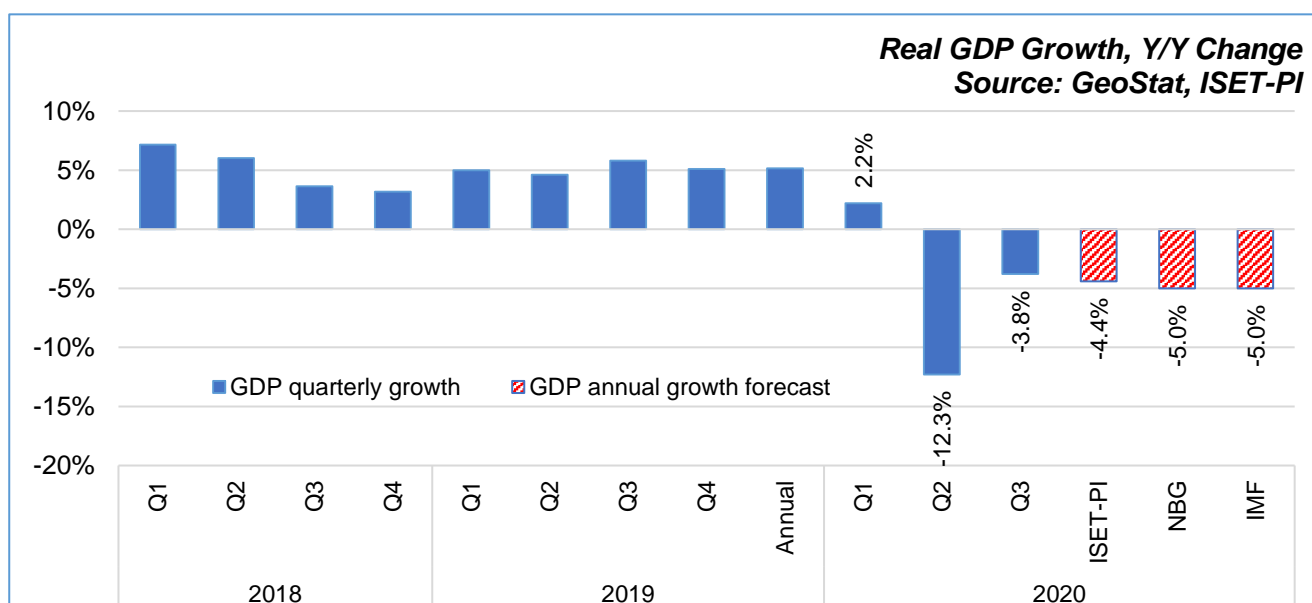


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Georgia's Q3 economic blues reflect the realities of the global supply and demand double shock

Economic Growth

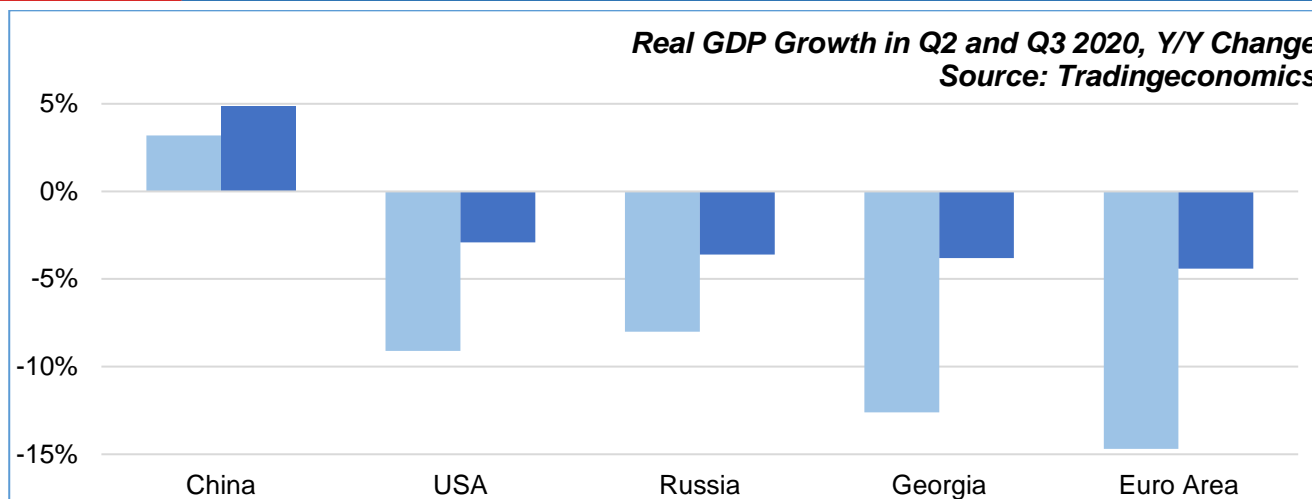
According to the preliminary statistics released by GeoStat, Georgia's real GDP contracted by 3.8% year over year (y/y) in Q3 2020. As a result, the estimated real GDP declined by 5.0% in the first nine months of 2020, which is in line with the [International Monetary Fund's \(IMF\)](#) and [National Bank of Georgia's \(NBG\)](#) latest projections of -5% y/y (from October and November correspondingly). Meanwhile, based on October's data, ISET-PI expects lower GDP contraction in 2020, as the [forecast](#) stood at -4.4%.



In Q3 2020, the economy showed signs of revival after the lifting of COVID-19-related restrictions. Fiscal spending combined with improved credit activity and increased remittances helped domestic demand to rebound. At the same time, external demand remains weak mainly due to the unprecedented decline in international travel. Increased production costs caused by pandemic-related constraints and disruption in value chains were additional factors responsible for negative growth rates in the reported quarter.

As Georgia is a small open economy, its economic performance strongly depends on what happens in large advanced economies and the main trading partners. After an extraordinarily deep decline in Q2, the global economy improved somewhat in Q3. While economic growth in all major economies remained negative, China's economy expanded by 4.9% y/y.

According to the IMF's latest [World Economic Outlook](#), global economic growth will be -4.4% in 2020, which is 0.5 percentage points (pp) higher than the previous forecast. However, uncertainties related to the duration of the COVID-19 pandemic and the scale of the second wave could trigger deterioration in growth prospects. Many countries have already slowed business reopening and some have reinstated partial lockdowns. Global growth is projected to be at 5.2% in 2021. As a result of the 2020 contraction, global GDP is expected to be just 0.6% higher than in 2019.



The speed of economic recovery in advanced economies is expected to be even lower than in the rest of the world. The IMF projects that following a 4.3% contraction in 2020, the US economy will only grow by 3.1% in the following year, whereas the Euro Area is expected to experience a deeper recession in 2020 (-8.3% y/y) and a higher partial recovery in 2021 (+5.2 y/y). Notably, according to the forecast, neither the US, nor the Euro Area will be able to reach 2019 GDP levels in 2021. China is currently the only major economy that is projected to grow in 2020 (at 1.9% y/y) and experience substantial economic growth in 2021 (at 8.2% y/y).

Lower oil prices were an additional negative factor affecting growth in the Caucasus region. The Azerbaijani and Russian economies were affected directly through lower exports of oil products in the third quarter. As a result, their real GDPs are expected to shrink by 4% and 4.1% y/y respectively in 2020. Real GDP growth in Armenia and Turkey will also be negative in 2020, at -4.5% and -5.0% y/y respectively. According to the IMF, inflation will be below 3% in Azerbaijan, Armenia, and Russia, while Turkey will continue to struggle with exchange rate depreciation and double-digit inflation in 2020. Georgia's neighbors will partially rebound in 2021, however, similarly to the US and the Euro Area, they will fall behind 2019 GDP levels.

Inflation

As expected, inflation in Georgia has started to decline: in Q3 annual CPI inflation fell to 4.7% from 6.5% in Q2. While reduced aggregate demand drove prices down, the depreciation of the lari nominal effective exchange rate earlier this year and increased production costs continued to put pressure on inflation in the reported quarter. According to the latest [NBG forecast](#): "...all else equal, inflation will remain above the target in 2020. But inflation is expected to fall below the target next year before subsequently approaching it from below".

Among the main drivers of inflation in the third quarter were again higher food prices (+9% y/y, contributing 2.8 pp to annual inflation). Prices on alcoholic beverages and tobacco increased by 8.9% y/y, contributing 0.6 pp to annual inflation. At the same time, transport prices, driven by lower oil prices on world markets, dropped by 8.4%. Together with recreation and culture (-2% y/y) these categories drove inflation down by 1.1 pp in Q3 2020.

NBG continued to gradually unwind the tighter monetary policy stance and reduced the policy rate by 0.25 pp (to 8%) in August. Subsequently, in September the monetary policy committee decided to leave the policy rate unchanged. The decision was explained by the existing uncertainties connected to the second wave of COVID-19 and risks of higher inflation expectations stemming from volatility in foreign



exchange markets. Consequently, the gradual reduction in monetary policy rate will be slower than initially anticipated.

External Sector: Trade, Tourism, Remittances

Negative growth in Georgia's main economic partners reduced external demand in Q3. While trade of goods partially rebounded, the tourism sector experienced an unprecedented decline in revenues. Surprisingly, remittances showed positive growth in the reported quarter.

In Q3 2020, Georgia's external merchandise trade decreased by 10.6% y/y (which was a significant improvement compared to Q2 when trade turnover dropped by 29.7% y/y). Both exports and imports showed negative growth. The negative trade balance shrank by 17.9% as imports fell more sharply than exports.

Total exports in Q3 decreased by 5% y/y, and amounted to 899 million USD. This decline was mainly driven by lower re-exports of motor cars and alcoholic beverages to Armenia and re-exports of motor cars and tobacco to Azerbaijan. At the same time, re-exports of motor cars, exports of wine, alcoholic beverages, and chemical fertilizers to Ukraine increased. Exports of ferro-alloys, medicaments, mineral water, and fruits to Russia increased, as well as exports of copper and gold to the EU and China. On the bright side, in September, for the first time in the last 8 months, exports showed a positive year on year growth (+8.6%) driven mainly by higher exports of copper (+77% y/y), nuts (+75.3% y/y), wine (+13.8% y/y) and ferro-alloys (+5.9% y/y).

China was the top export destination country for Georgia accounting for 16.7% of total exports in Q3 2020, followed by Azerbaijan (13.8% of total) and Russia (13.4% of total). Interestingly, China became the major importer of Georgian products for the first time in Q2 2020, when exports to this country increased six-fold in annual terms. In Q3, exports to China doubled, once again reflecting its better economic position compared to other trading partners.

During the same period, imports to Georgia declined by 12.8% y/y and amounted to 2,103 million USD in Q3 2020. The decrease in imports is explained by lower internal demand and exchange rate depreciation. Imports of almost all top products decreased in the third quarter, with imports of motor cars (-46.4% y/y) and petroleum products (-49.8% y/y) affected the most. At the same time, imports of copper ores (+19.9% y/y), wheat (+25.5% y/y) and composite diagnostic or laboratory reagents (+80.6% y/y) showed positive growth. Despite the unprecedented decline in values, the main source markets for Georgian imports in Q3 remained the same with Turkey (-7.8% y/y), Russia (-5.4% y/y), and China (-14.9% y/y) leading the list.

COVID-19 continued to affect export of services (mostly tourism). As international travel was broadly banned and Georgia resumed international flights with only a limited number of countries, the number of international travelers declined by 94.9% y/y. At the same time, revenues from international travelers fell to nearly zero in Q3 2020—Georgia lost 1,127 million USD from tourism revenues compared to the same period of 2019.

Money transfers to Georgia, surprisingly, hiked in Q3 2020. According to NBG, the volume of total remittances amounted to 566 million USD in the reported quarter, a 25.5% annual increase. This figure was mainly driven by higher money inflows from Italy (+36.3% y/y), the USA (+44.5% y/y), Ukraine (+181.7% y/y), Greece (+30.9% y/y) and Azerbaijan (+240.5% y/y). Remittances from only Russia (-0.2% y/y) and Israel (+1% y/y) showed nearly zero annual changes in Q3.



According to the IMF's updated projections, the current account deficit is expected to increase to 10.8% of GDP in 2020 (which is 0.5 pp higher compared to the previous forecast), from a record low of 5.1% in the previous year. This increase will be mainly driven by lower revenues from export of services (tourism).

Public Finances

Budget data in Q3 2020 fully reflected the impact COVID-19 had on the economy. Total revenues to the general budget amounted to 2,887 million GEL, a 13.4% y/y decrease. The latter was driven by lower tax collection (-13.5% y/y) as revenues from all taxes, except excise tax (+11% y/y), showed significant annual reduction.

On the contrary, budget spending increased to mitigate the impact of COVID-19. The support package includes healthcare and virus management costs, targeted direct and indirect income transfers to affected households, tax relief, introduction of credit guarantee schemes for businesses, payroll support, etc. As a result, current governmental expenditures increased by 33.3% y/y in Q3 2020 (and amounted to 3,472 million GEL). This growth was mainly driven by higher spending on social benefits (+47.8% y/y). In addition, the Georgian Government renewed infrastructural projects paused earlier this year due to the pandemic—net acquisition of non-financial assets increased by 10% y/y in Q3 2020 to 1,086 million GEL.

Overall, in Q3 2020, the budget deficit amounted to 1,671 million GEL, 6.5 times higher than in the same period of the previous year. According to a revised version of the State Budget, the deficit would constitute 8.5% of GDP in 2020. The Government is financing its economic support measures by borrowing, mainly from international financial institutions. Government debt hiked by 38.8% y/y and amounted to 27,110 million GEL in Q3 2020. Furthermore, the share of foreign debt in total debt increased by 1 pp to 78.9%, increasing exposure to exchange rate volatility.