The Georgian economy – a long and uncertain road to recovery

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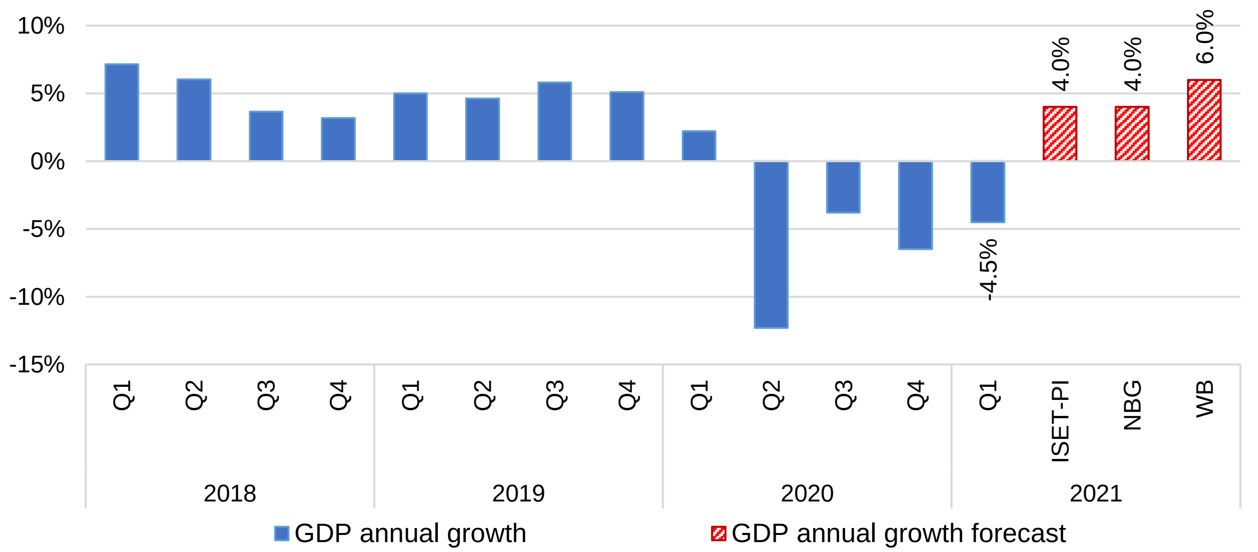
Economic growth

The World Bank (June 2021) estimates that global GDP growth will reach 5.6% year over year (y/y) in 2021. Though thus rebound is uneven, with growth concentrated mainly in advanced economies and developing countries set for a slower recovery. This is driven by unequal access to vaccines, different paces lifting virus containment restrictions, and the scale of fiscal support to the economy. This year the United States and Euro area are projected to expand by 6.8% and 4.2%, respectively, while the Chinese economy is expected to grow by 8.5%. In addition, Georgia's neighbors are each projected to show moderate growth this year: Armenia (+3.4% y/y), Azerbaijan (+2.8% y/y), Russia (+3.2% y/y), and Turkey (+5% y/y). While a recent World Bank assessment forecasts Georgian annual real GDP growth at 6% y/y in 2021 – up 2 percentage points (pp) compared to January's projections. At the current pace, most economies will recover to 2019's GDP per capita level by 2022. However, the emergence of more deadly and resistant variants of the virus create new uncertainties and further risks to global growth.

According to Geostat's latest GDP growth estimates, Georgia's economy contracted by 4.5% y/y in the first quarter of 2021, once again reflecting the impact of COVID on the economy. Despite strong fiscal stimulus and a rebound in the external sector, pandemic-related restrictions drove growth into negative territory compared to last year's pre-pandemic period. Reductions in tourism revenue and foreign direct investment (FDI), coupled with a decline in domestic demand, were the main channels the pandemic affected the Georgian economy in Q1 2021. The full impact of COVID-19 on the economy was uneven: sectors unrelated to tourism showed double digit annual growth (e.g., mining, manufacturing, financial and insurance activities, information and communication, etc.), while tourism-related sectors (especially accommodation and food services) showed a significant annual decline in Q1.

Real GDP Growth, Y/Y Change
Source: GeoStat, ISET-PI, NBG, WB



According to NBG's recent macroeconomic forecast, economic activity will gradually recover this year – with real GDP growing by 4%. Based on March data, ISET-PI's GDP forecast places the 2021 annual real GDP growth at 3.9% in the worst-case scenario and 4.3% in the best-case scenario, with our middle-of-the-road scenario predicting a 4% increase in real GDP.

It should be mentioned that real GDP expanded by 44.8% and 25.8% y/y in April and May, respectively, offering a stronger outlook for the Georgian economy in 2021. These growth estimates were mainly driven by the low base effect, strong fiscal stimulus, and external demand. However, the slow vaccination process, the possibility of new waves of the pandemic, and the introduction of mobility restrictions and other virus-containment measures each create additional risks for Georgia's economic recovery.

Inflation

In Q1 2021, annual CPI inflation stood at 4.5%, 1.5 pp higher than the targeted 3%. Among the main drivers of inflation were higher food prices, with a 6.1% y/y increase (contributing 2 pp to annual inflation). With the price of sunflower oil, eggs, cheese, and sugar proving the most important contributors to inflation in the category. These products combined contributed 1 pp to overall inflation. All other product categories saw an annual increase in prices, except for housing, water, electricity, gas, and other fuels. In this category prices declined by 11.3% y/y in Q1, driven by governmental subsidies on utilities that 'artificially' reduced the inflation rate over winter.

Despite weak internal demand in Q1 2021, increasing food prices on the international market, the depreciated nominal effective exchange rate on the lari, and supply-side factors drove inflation above the target level. Going forward, inflation is expected to continue rising, with existing factors and elevated oil prices further contributing to inflationary pressure. Under NBG's monetary policy report, "inflation is expected to average 6-6.5% this year". Considering mounting inflation, NBG has started to tighten monetary policy, and it increased the policy rate by 0.5 pp in March and 1 pp in April 2021.

The persisting trend of high annual food inflation over the last few years, together with the economic impacts of COVID-19, has exacerbated food insecurity and threatens to increase poverty. Furthermore, due to high aggregate inflation, monetary policy cannot be used to support economic growth; rather, as it tightens to curb inflation, it may slow down economic recovery.

External sector: trade, tourism, remittances, FDI

The restrictive measures used to prevent the spread of COVID-19, and which remain in the majority of countries, have negatively affected Georgia's international trade, travel, and FDI. Additionally, external demand was still weak in Q1 2021, though it did show signs of recovery.

In the first quarter of 2021, Georgia's external merchandise trade increased by 0.8% y/y, as higher exports were overbalanced by the decline in imports. The negative trade balance slightly shrank to 1,162 million USD. However, both exports and imports were lower than Q1 2019.

Exports increased by 5.2% y/y and amounted to 820.6 million USD. This increase was driven by the greater export of metal waste and scrap, and clothes to Turkey; ferro-alloys, mineral water, fruit, and tobacco products to Russia; and automatic data processing machines, copper scrap, and alcoholic beverages to Ukraine. Concurrently, the re-exports of motor cars to Armenia and Azerbaijan showed negative annual growth in Q1. The main destination markets for Georgian export products in Q1 were China (13.4% of the total), Russia (13.3%), Azerbaijan (12.7%), Turkey (9.2%), and Ukraine (8.1%). The top ten destination countries for Georgian exports accounted for 76.7% of total exports, thus underlining the problem of low export diversification.

Imports amounted to 1,982 million USD in Q1 2021, a 0.9% annual decrease. This figure was mainly driven by the reduced import of petroleum (-5.6% y/y), iron and steel structures (-43.7%), poultry (-36.1 y/y), and telephone sets (-11.6% y/y). While boring machines (+1556% y/y), copper ores (+31.2% y/y), petroleum gases (+11.2%), and motor vehicles for the transport of goods (+87% y/y) and the transport of ten or more persons (+1020 y/y) were the main products driving import in Q1. The main source markets for Georgian imports were Turkey (17.4% of the total), Russia (11.1%), China (9.2% y/y), the USA (7.5%), and Azerbaijan (7.4%).

As many travel restrictions were still in place around the world, international tourism to Georgia remained low in Q1. The number of international visitors showed an 88.4% y/y decrease, while the revenues from foreign travelers dropped by 87.5% y/y in the first quarter. As a result, economic sectors linked to the tourism industry showed negative annual economic growth in Q1: accommodation and food service activities (-56% y/y); arts, entertainment and recreation (-22% y/y); transportation and storage (-6.4% y/y); and other service activities (-33.7% y/y).

By NBG estimations, the volume of total remittances to Georgia amounted to 499.3 million USD in Q1 2021, a 28.4% annual increase. All primary source countries for money inflows also showed a positive growth trend, especially from Italy (+43.9% y/y), USA (+42.4% y/y), Greece (+24.1% y/y), Azerbaijan (+203.5% y/y), Ukraine (+100.4% y/y), and Germany (+59.9% y/y).

Foreign direct investment to Georgia amounted to 125.4 million USD in Q1 2021, which is 28.3% lower than the preliminary data from Q1 2020, and also the lowest quarterly figure since Q1 2006. The majority of FDI was directed towards the financial, energy, manufacturing, and real estate sectors. With uncertainty in both global and local economies, we expect FDI to remain at a low level in 2021.

Public finances

The total revenue of the general budget amounted to 3,378 million GEL, a rise of 4.5% y/y – largely driven by an increased number of grants (+981.8% y/y). However, tax collection showed a slight decline (-0.9% y/y).

Current governmental expenditures increased by 11.7% y/y in Q1 2021 (amounting to 3,396 million GEL). This growth was mainly driven by higher spending on social benefits (12.8% y/y) and other expenses (+18% y/y). All other current government spending also showed positive annual growth in the first quarter, with the exception of grants (-4.1% y/y). In addition, the Georgian government continued its course of high capital spending – the net acquisition of non-financial assets increased by 11.7% y/y to 570.1 million GEL in Q1.

Strong fiscal stimulus resulted in a budget deficit of 588.3 million GEL, as increased revenues were balanced out by accelerated current and capital spending. Governmental debt increased by 32% y/y and amounted to 30,332 million GEL. Furthermore, the share of foreign debt in the total debt increased to 80.7%. The proportion of governmental debt to GDP slightly exceeded the 60% threshold, and the budget deficit is above the 3% threshold (provided in the Economic Liberty Act). Considering these issues, debt management and expenditure optimization will remain the most crucial tasks for the government in the medium term.