

## Return to growth path after crisis year

After last year's economic downturn, Georgia is returning to the growth path. The economy is expected to grow by 3.5% this year, mainly driven by consumer spending.

The lari has stabilised at around 3.30 GEL/USD after high volatility and a 14% depreciation against the US dollar last year. The National Bank (NBG) continues to intervene in the foreign exchange market and has raised its policy rate to 9.5% to prevent rising inflation expectations.

The budget deficit is shrinking only slightly to 7.4% of GDP, partly due to the continuation of economic stimulus programs. The IMF programme was recently completed, and a follow-up programme is still under discussion. The successful placement of a Eurobond (USD 500 m) is evidence of investor confidence.

The current account deficit (10.9% of GDP) is driven by weak tourism. As the crisis subsides, the economy is expected to return to normal with a growth rate of 5.8% in 2022.

### Consumption drives moderate GDP growth

After a sharp decline in real GDP in 2020 (-6.2%), the latest IMF estimate sees growth at 3.5% in 2021. The main reasons for the moderate growth are the second lockdown in Q1-2021 and the limited outlook for the tourism sector. In a regional comparison, both the decline last year and the recovery this year are more pronounced than in the peer countries. It should not go unnoticed that other forecasts, e.g. from the World Bank (6.0%), are more optimistic.

### Selected economic indicators

	2020	2021*	2022*
Real GDP growth, % yoy	-6.2	3.5	5.8
Inflation, % yoy (end of period)	2.4	5.0	2.4
Current account balance, % of GDP	-12.3	-10.9	-7.9
Budget balance, % of GDP	-9.3	-7.6	-4.0
Gross government debt, % of GDP	60.0	60.8	58.2

Source: IMF, Geostat; \*estimation/forecast

Growth is predominantly driven by private and public consumption, which contribute at a similar level as last year. The recovery in exports is supporting growth. Among the main reasons is the improvement in tourism

receipts (albeit from a low base). Additionally, there is a slight positive contribution by investments. Remittances continue their positive trend, which started around the second half of last year, despite ongoing weakness in source countries.

### Lari depreciation influences monetary policy

The lari experienced strong volatility and depreciated by 14% against the US dollar in 2020. At the same time, there was an appreciation against the Russian ruble and the Turkish lira. So far this year, the lari is relatively stable around 3.30 GEL/USD. The NBG continues its interventions in the FX market: after sales of USD 873 m in 2020, the central bank sold additional USD 243 m in 4M2020. However, FX reserves remain strong due to loans from IFIs.

### Exchange rate and FX reserves



Source: NBG

The pass-through effect of the currency depreciation is one of the reasons for upward pressure on the inflation rate, along with rising international commodity prices and higher production costs. The inflation rate at year-end 2020 was only 2.4% due to temporary utility subsidies by the government. For 2021, the estimate stands at an average of around 6 to 6.5% yoy, and thus above the NBG's 3% target. In order to limit the risk of higher inflation expectations, the NBG raised its policy rate by a combined 1.5 percentage points to 9.5%. With the stability-oriented monetary policy, economic stimulus has to come from the fiscal side.

### Fiscal policy and public finances

And indeed, the government continues its expansionary fiscal policy stance. The public deficit is expected to reach 7.6% of GDP in 2021, only slightly below last year's figure of 9.3% of GDP. This is partly due to the continuation of fiscal support, which alone accounts for 2.3% of GDP. The package is distributed roughly evenly among household, business and healthcare support. As a result of the sizeable deficits in 2020/21 and the lower

GDP base, gross government debt is estimated to reach 60.8% of GDP. The fiscal rule mandates that the deficit and debt may not be above 3% and 60% of GDP respectively by 2023, when the escape clause activated during the pandemic expires.

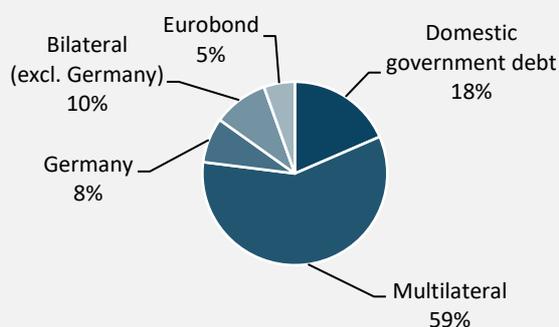
### COVID-19 fiscal support measures in 2021

	GEL m	% of GDP
Households	427	0.8
Business	370	0.7
Healthcare	450	0.8
<b>Total</b>	<b>1,247</b>	<b>2.3</b>

Source: own display based on data by IMF

In this context, two positive aspects should also be noted. First, the IMF programme was successfully completed in April. A follow-up programme is still in discussion. Second, Georgia placed a 5-year Eurobond (USD 500 m) at the London Stock Exchange in the same month, replacing the previous 10-year bond. Investor interest was strong and yield at issuance was a low 2.875%, providing an FX buffer at a favourable rate.

### Composition of government debt



Source: Ministry of Finance, data as of 30 April 2020

### Weak tourism drives current account deficit

The current account balance is strongly affected by the ongoing crisis. The deficit for 2021 is estimated to be 10.9% of GDP, only slightly lower than last year (12.3%). A major reason for this outlook is the low level of services exports. The tourism outlook for this year remains subdued as the vaccination campaign in main origin countries continues to progress slowly. The summer season will therefore likely be weak again and Georgia will experience two consecutive bad years for tourism. On the other hand, there are tentative signs that the situation is slowly improving compared to last year, as illustrated by the increasing number of tourists in the last months (albeit from a very low base). Trade in goods is expected to increase again, with exports (9.3% yoy) growing stronger than imports (4.3% yoy).

### Outlook

The high twin deficits in the current account and the budget pose a risk to macroeconomic stability. In this context, the fiscal rule, which provides for lower deficits in the medium term, is an important anchor. The various growth forecasts for 2021 are evidence of uncertainty about the state of the Georgian economy. Much will depend on the tourism situation, even beyond the current year. As the crisis fades, growth is expected to reach 5.8% in 2022. In the medium term, diversification of the economy remains a key concern in order to reduce dependence on the service sector.

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