ISSUE NO. 34 | MAY - JUNE 2020

NEWSLETTER

German Economic Team

GEORGIA

Georgia's economic situation in light of COVID-19

Georgia will be severely hit by the COVID-19 pandemic. While economic fundamentals were good going prior to the crisis, forecasts now show a strong deterioration. Most visibly, real GDP growth is expected to change its sign, from a previous forecast of +4.3% to -4.0%.

The Lari experienced significant volatility at the beginning of the crisis in March, but has since stabilized at around 3.00 GEL/USD, in part due to FX interventions by the NBG. Inflation is expected to reach 3.5% at year-end, only slightly above the NBG's 3% target.

More pronounced is the effect on the current account balance. The deficit, now expected to reach 11.3% of GDP, will be more than double of the previous forecast due to declining exports, tourism revenues and remittances. The tourism sector, which accounts for 8% of GDP, will experience a sharp downturn. It is an open question whether at least some tourists will be able to visit during the main season of July and August.

Public finances are greatly impacted, with a forecasted deficit of 8.5% of GDP. On a positive note, Georgia has been able to secure international funding which is expected to cover the cost of the additional deficit, including an augmented IMF programme, of which approx. USD 200 m are available for immediate budget support.

Deep impact of COVID-19 on fundamentals

Georgia's economy was in good shape before the outbreak of the COVID-19 pandemic: real GDP growth was projected to be 4.3%, only slightly lower than in previous years. The pandemic reverses the sign: current forecasts show a drop of 4% in real GDP. The change of 8.3 percentage points indicates a strong impact of the crisis. Georgia is projected to pick up growth again in 2021, with 4%, slightly lower than previously forecast.

Change in forecasts for 2020 due to COVID-19

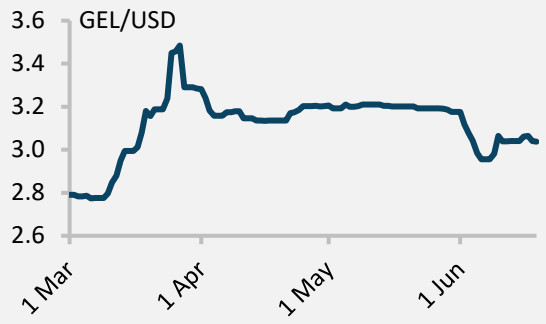
	current	before
Real GDP growth, % change yoy	-4.0	4.3
Current account balance, % of GDP	-11.3	-5.3
Budget balance, % of GDP	-8.5	-2.4
Gross government debt, % of GDP	59.6	48.3

Source: IMF

The decline in GDP is driven by a decline in investments, exports and particularly private consumption. This is only partially offset by increased government spending and a reduction of imports.

When the crisis intensified worldwide in March and investors started a flight for save heaven currencies, the Lari experienced significant volatility. Starting the year with an exchange rate of around GEL/USD 2.90, a sizeable depreciation set in, culminating in a rate of GEL/USD 3.48 on 27 March. The NBG reacted by selling around USD 210 m of reserves between March and June. Until mid-June, the exchange rate appreciated to around GEL/USD 3.00, thus limiting the pass-through effect on inflation.

Exchange rate



Source: National Bank of Georgia

Inflation is expected to be only marginally affected by the crisis. Even though it currently stands at around 6 to 7% yoy, inflation at year-end is forecast to be around 3.5% yoy, due to declining economic activity. This is only slightly above the previous forecast of 3% (equal to the NBG's target).

At the end of last year, the NBG raised its policy rate to 9.0% to combat inflation. This created some policy space to reduce the rate to 8.5% to fight the crisis. However, the policy rate also affects the exchange rate, and decreases may risk pushing inflation above the desired target. Thus, there is only a limited role of monetary policy to support the economy.

Current account deficit to double

The pandemic will also have a great impact on trade. Before the COVID outbreak, the current account deficit was expected to reach 5.3% of GDP. This has been revised to 11.3% of GDP due to expected lower exports of goods, collapse of tourism revenue and reduction of remittances.

Exports and imports of goods are both projected to decline sharply by 24% and 21%, respectively. However, these figures are exaggerating the effect due to the inclusion of imports and re-exports of cars and copper. The decline in exports and imports thus goes hand in hand. Domestically, imports are decreasing as a result of declining investments and lower consumption. Additionally, production in other countries is down as well and the crisis has disturbed global supply chains.

With an estimated 8% of GDP, tourism is an important sector of the economy. In 2019, there were 7.7 m international visitors. Following border closures in March and worldwide restrictions on flights, tourism came to a halt. The number of international visitors was down approx. 59% yoy in March and 94% yoy in April. There is some degree of seasonality, with the main season in summer still ahead. For the sector, it is a key open question whether at least some tourists will be able to visit.

Another impact channel is the expected reduction in remittances. Since 2015, they have been continuously increasing and reached USD 1.7 bn last year. This corresponds to approx. 10% of GDP. Remittances originate mainly from the EU and Russia, making up 38% and 25% of total remittances, respectively. The NBG estimates a drop of 30% for the full year of 2020. An early indication is the reduction between March and May, with April showing a drop by 42.3% yoy. As remittances are an important source of household income, the reduction will lead to lower consumption and lower imports.

Public finances and international support

Public finances are expected to deteriorate sharply. Initially, the budget deficit was forecast at 2.4% of GDP. It is now projected to increase to 8.5% of GDP in light of the necessary anti-cyclical spending to counteract the recession. The projected deficit in 2021, 4.8% of GDP, is above previous estimates, but shows that consolidation is expected in the future. The sizeable increase in government spending will also affect public debt, which will increase to 59.6% of GDP in 2020, but is expected to decrease afterwards.

As a result of the crisis, authorities requested an augmentation of the existing IMF programme by approx. USD 325 m, which was granted in early May. Of this sum, USD 200 m are available for immediate budget support.

Georgia was also able to secure funding from other IFIs and donors, including the EU and the KfW. In total, there are international contributions of USD 1.5 bn available for the budget and an additional USD 1.5 bn is potentially available to the private sector, according to PM Gakharia. The amount of attracted international support can be expected to finance the additional budget deficit caused by the pandemic.

The quick approval of the augmented IMF programme underlines the good relations Georgia enjoys with the IMF.

Outlook

Looking forward, a central question is the re-start of tourism. Initially, authorities had hoped to open the country for international tourists on July 1 through bilateral "safe corridors". However, negotiations have proven to be difficult. At the moment, the situation remains unclear and very dynamic.

However, the pandemic has also highlighted the problems associated with the high dependence on services, especially tourism. Services made up 79% of GDP in 2019. A more diversified economy, with strengthened agro and industrial sectors, is necessary to be less prone to shocks in the future.

Author
Sebastian Staske, staske@berlin-economics.com

This newsletter is based on the 12th issue of our Economic Monitor Georgia.

Editor
Dr Ricardo Giucci

Subscribe / unsubscribe newsletter

German Economic Team

www.german-economic-team.com

The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. It is funded by the Federal Ministry of Economics and Energy and implemented by the consulting firm Berlin Economics.