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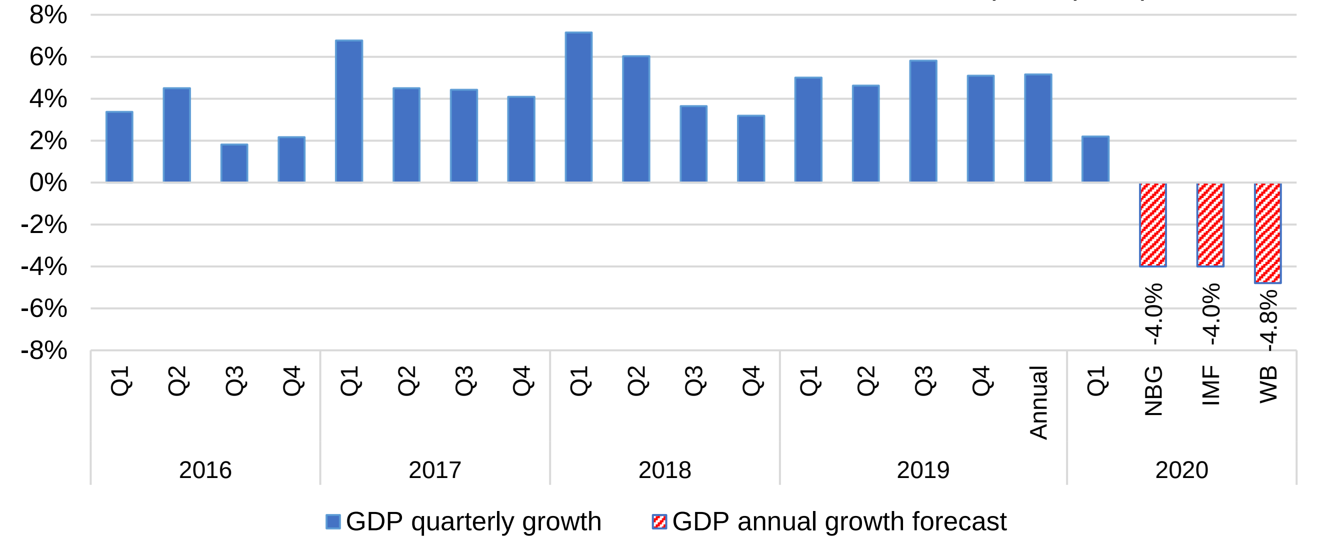
Early Signs of Pandemic

Economic Growth

In March 2020 as a result of the COVID-19 pandemic the global economy started to sink into what is expected to be the deepest worldwide recession since World War II. Despite unprecedented policy support, the majority of countries have failed to soften the fallout from the crisis. According to World Bank estimates, global GDP will contract by 5.2% year over year (y/y) in 2020. The United States and Euro Area are projected to shrink by 6.1% and 9.1% respectively, while the Chinese economy is expected to grow at just 1% in 2020. In addition, all of Georgia's neighbors are expected to face an economic contraction this year: from -2.6% (Armenia) to -6% (Russia).

Thus, the COVID-19 pandemic is expected to negatively impact the Georgian economy due to both internal and external factors. Reductions in tourism, remittances, trade and foreign direct investment (FDI), coupled with declines in consumption, domestic investment, domestic production, and service provision will hit the economy in 2020. Real GDP growth is expected to decrease significantly, the extent depends on the length and severity of the pandemic. According to the National Bank of Georgia (NBG) and the International Monetary Fund (IMF), Georgia's annual real GDP growth forecast amounts to -4%, while the World Bank predicts -4.8% in 2020.

Real GDP Growth, Y/Y Change
Source: GeoStat, NBG, IMF, World Bank



According to Geostat's latest estimates of GDP growth, Georgia's economy expanded at 2.2% y/y in the first quarter of 2020. These growth estimates already reflect early signs of the COVID-19 pandemic, as in March 2020 the economy contracted by 2.7% y/y, while showing positive growth in January and February.

Inflation

In Q1 2020, annual CPI inflation stood at 6.3%, which is 3.3 percentage points (pp) higher than the targeted 3%. Among the main drivers of inflation were increased food prices (+12.5% y/y), (contributing 3.9 pp to annual inflation). Prices of cheese, meat, potatoes, and apples were the most important contributors to inflation in the food category. At the same time, prices of clothing and footwear dropped by 2% y/y. Together with communication (-1.5% y/y) these categories drove inflation down by 0.2 pp in Q1 2020.

The high inflation in the food category, which began in the middle of 2019, continues to be the main driver of CPI inflation in 2020. It is partially attributable to the increased costs of certain foods. Food prices in general are characterized by high volatility, as they are influenced by seasonality, productivity, and oil prices. However, food products' consistently increasing prices point to systematic problems which exist in the value chains of specific food products. These problems need to be addressed on the policy level in the near future. Additionally, inflationary pressure comes from the depreciation of the GEL against the USD and the currencies of major trade partners.

Going forward, we expect inflation to decline towards the end of the year: the future dynamics of price changes will be determined by lower aggregate demand, as supply is expected to recover after the lifting of COVID-19-related restrictions. Therefore, holding other things constant, inflation is expected to go down in upcoming quarters.

The Monetary Policy Committee of NBG met two times in Q1 2020. Considering the high level of uncertainty, NBG decided to maintain the monetary policy rate unchanged.

External Sector: Trade, Tourism, Remittances, FDI

The restrictive measures to prevent the spread of COVID-19 which were introduced by the majority of countries have negatively affected not only Georgia's internal economic activity, but also international trade, tourism, and FDI. Negative growth in Georgia's main economic partners means that the demand for exports of goods and services from Georgia is lower. In addition, Georgians living abroad earn, and consequently send, less money to their homeland, while increased economic uncertainties negatively affect investment decisions. Exports of goods, revenues from international travel, and FDI have already started to decline, while the growth of remittances has decelerated. Imports of goods and services also declined due to weaker domestic demand. However, the full effect of the pandemic on the global and Georgian economies is expected to kick in over the coming quarters.

In the first quarter of 2020, Georgia's external merchandise trade decreased by 2.7% y/y, as both exports and imports showed negative growth. The negative trade balance remained almost unchanged at 1,218 million USD.

Total exports decreased by 5.9% y/y, and amounted to 778 million USD. This decline was driven by lower exports of ferro-alloys, natural wines, and mineral waters to Russia, re-exports of motor cars to Armenia, and copper ores to Romania. At the same time, re-exports of motor cars, cigarettes, and fertilizer to Azerbaijan, re-exports of copper ores to Bulgaria, Spain, and China showed positive annual growth in 2020. The main destination markets for Georgian export products in Q1 were Azerbaijan (+42.6% y/y), China (+185.9% y/y), and Russia (-32.6% y/y). Exports to other top destination countries also showed very different growth patterns with 222.6% y/y increase to Spain and 53.5% y/y contraction to the United States. The top ten destination countries for Georgian exports accounted for 77.9% of total exports, underlining the problem of low export diversification.

Imports amounted to 1,996 million USD in Q1 2020, a 1.4% annual decrease. This figure was mainly driven by reduced import of medicaments (-19.6% y/y) and copper ores (-7.6% y/y). At the same time, imports of motor cars and petroleum gases showed an annual increase in import values. The main source markets for Georgian imports in Q1 were Turkey (+8.7% y/y), Russia (+9.7% y/y), and Azerbaijan (-1.6% y/y).

The number of international visitor trips showed positive annual growth in January (+19.8% y/y), no growth in February and a huge drop (-58.6% y/y) in March 2020. Overall, Georgia saw a 16% drop in international visitors and a 13.2% drop in tourist visits in Q1 2020 compared to the same period last year. In addition to COVID-19's effects on international travel, the annual growth rate of international visitor trips is still affected by the ban on flights from Russia instituted in late June 2019. As a result, the number of international traveler trips from Russia declined the most (-32.3% y/y). Among the top 15 countries by international visitor trips, only Poland (+47.1 y/y) showed positive growth in Q1 2020.

According to NBG, the volume of total remittances to Georgia amounted to 389 million USD in Q1 2020, a 2.4% annual increase. Money inflow from Russia was down by 15.2% y/y, while other primary source countries for money inflows to Georgia showed a positive growth trend, especially Italy (+11.3% y/y), Greece (+9.3% y/y), Ukraine (+54.3% y/y) and Germany (+27.1% y/y). However, a drastic drop in remittances is expected in Q2 2020 due to COVID-19.

FDI in Georgia amounted to 165 million USD in Q1 2020, which is 41.7% lower than the preliminary data from Q1 2019 and the lowest quarterly figure since Q1 2006. According to GeoStat, the main reasons for decreasing FDI included completion of a pipeline project and reduction in liabilities to non-resident direct investors. We expect even further reduction in FDI in the upcoming quarters due to increased uncertainties in the global and local economic climates.

Public Finances

Budget data in Q1 2020 did not show any sign of COVID-19's impact on the Georgian economy. Total revenues of the general budget amounted to 3,233 million GEL, a 9.3% y/y increase. The latter was driven by stronger tax collection (+15.1% y/y): revenues from income tax (+20.9% YoY), profit tax (+58.3% y/y), and VAT (+11.3% y/y) showed a positive trend in Q1 2020. However, revenues from excise taxes decreased by 21.3% y/y, which potentially could be explained by substitution of expensive imported tobacco products by cheaper local alternatives in consumption.

Current governmental expenditures increased by 21.1% y/y in Q1 2020 (and amounted to 3,040 million GEL). This growth was manly driven by higher spending on social benefits (34.2% y/y). All other categories of government current spending also showed notable positive annual growth in the first quarter. In addition, the Georgian Government continued the course of high capital spending—net acquisition of non-financial assets increased by 29.9% y/y in Q1 2020 to 510 million GEL.

Overall, in Q1 2020, strong tax collection was balanced out by the accelerated current and capital spending, which resulted in a budget deficit of 317 million GEL. Governmental debt increased by 28% y/y and amounted to 23,046 million GEL. Furthermore, the share of foreign debt in total debt stood at 77.5% level.