SECTOR OVERVIEW

A. Economic Overview and Performance

1. **Structure and macroeconomic trends before COVID-19.** Georgia is a small open economy, strategically located at the crossroads between Europe and Asia. It is an attractive international trading partner, especially for energy product shipments in the region, because of its strategic geographic location, liberal business environment, and open and progressive institutions. As of May 2020, its major trading partners were the European Union (23.7%), Turkey (13.3%), the Russian Federation (11.7%), the People's Republic of China (10.5%), Azerbaijan (9.7%), Armenia (5.1%), Ukraine (4.9%), and the United States (4.5%). Georgia's economic growth was strong in 2019 (5.1%, up from 4.8% in 2018), reflecting record spending on public investment and a sharp rise in exports. On the supply side, services expanded by 6.8% and industry grew by 2.7%, while agriculture declined by 1.0% because of limited investment. However, Georgia's strong growth performance has not been matched by commensurate reductions in unemployment and poverty. While the unemployment rate declined marginally to 11.6% in 2019, from 12.7% in 2018, significant underemployment in agriculture and education remains. The percentage of the population living below the national poverty line was 20.1% in 2019, down from 36.9% in 2006. Potential drivers of growth include tourism, manufacturing, agribusiness, and energy exports.

2. **Pandemic economic performance.** Georgia was in a state of emergency for 63 days between April and May, and only started opening its borders with five low-risk countries in mid-July. While the country's economic performance was strong before the pandemic, the coronavirus disease (COVID-19) has negatively impacted the economy, affecting tourism, trade, remittances, and foreign direct investment. A preliminary estimate of the contraction of GDP in the first 4 months of 2020 through April is 3.6%.[1] The Asian Development Bank (ADB) projects real GDP to shrink by 5.0% in 2020 before recovering by 5.0% in 2021 because of an expected rebound in tourism and other foreign inflows, private consumption, and investment. External sector imbalances are also anticipated to widen. Expected economic decline in trading partners in 2020 is likely to reduce external demand and widen the current account deficit to double digits. Both the fiscal deficit and public debt are projected to increase sizably in the short term, with the fiscal deficit exceeding 8.5% of GDP and the public deficit around 60% of GDP in 2020.[2] Higher than expected inflation caused by exchange rate depreciation associated with deepening dollarization is a downside risk. However, lower global commodity prices and weaker domestic demand should help partly offset the impact of the exchange rate depreciation on inflation. Further, a higher than expected decline in real GDP may ease pressures on inflation, though this may worsen future expectations regarding the economic recovery and may engender additional depreciation pressures.

3. With robust international reserves of $3.6 billion as of May 2020, the Government of Georgia has regularly intervened in the foreign exchange market to defend the lari.[3] The lari depreciated by 8.9% against the United States dollar and 6.2% against the euro during 2019, or 4.9% in nominal terms and 5.3% in real effective terms, raising imported inflationary pressures. In response, the National Bank of Georgia (NBG) sold foreign exchange reserves in the amount of $93 million in 2019 and $160 million in 2020 through May 2020.

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1 National Statistics Office of Georgia (Geostat). 2020. *Rapid Estimates of Economic Growth 2020, April*. Tbilisi.
2 ADB. 2020. *Asian Development Bank Outlook Supplement, June 2020: Lockdown, Loosening, and Asia's Growth Prospects*. Manila.
3 National Bank of Georgia. 2020. *Monthly Balances*. Tbilisi.

4. **Government response to COVID-19.** The government unveiled its Anti-Crisis Economic Plan in response to the COVID-19 pandemic on 24 April 2020 and created a website with all COVID-19 related information.[4] The plan includes a social assistance package for citizens, fiscal stimulus measures in the form of tax relief, liquidity injections for businesses, and increased funding to strengthen the health care system in light of the pandemic's contagion effects. It also includes the revamp of a credit guarantee scheme to support small and medium-sized enterprises (SMEs), with priority given to women entrepreneurs and other vulnerable groups. Approximately GEL1 billion will be channeled toward meeting the emergency needs of individuals, GEL2.1 billion will be spent on supporting the needs of business and economic activity, and GEL350 million will be directed toward health care costs to fight the pandemic, as it has increased the burden on the hospital system, including disease containment spending on the creation of quarantine zones and securing medical supplies and equipment. In total, the government plans to spend GEL3.5 billion as part of this emergency package.

5. **International finance institutions' COVID-19 support.** Because of increased pressures on revenues, arising from an economic slowdown and measures related to the mitigation of the effects of the pandemic, a net revenue loss to the budget of GEL1.5 billion is expected (assuming GEL300 million in savings on current expenditures through prioritizing core public spending needs and the prudent reallocation of public outlays). The fiscal deficit is expected to widen to 8.5% of GDP in 2020 from the pre-COVID-19 projection of 2.5% for 2020. The fiscal deficit projection of the International Monetary Fund (IMF) for 2021 is 4.8% in a post-pandemic analysis. The IMF estimated urgent balance of payments needs arising from the COVID-19 shock to be about $1.8 billion in 2020–2021, of which $1.4 billion is expected in 2020, to be financed by ADB, the IMF, the World Bank, and the assistance of other international agencies.[5] The government's expectation for total external financing from official creditors is $3 billion, half of which is to support banks and real economic activity. Domestic financing of about GEL600 million or more may also happen; however, domestic borrowings will cover the remainder after external borrowings, and are expected to be derived as a residual to finance downside risks, including if a second or a third wave of the pandemic occurs, for which the government is already preparing.

6. ADB is providing exceptional allocations to Georgia to meet potential funding requirements and to bridge a fiscal gap using a crisis response mechanism. ADB's substantial package of support, totaling more than $600 million, includes: (i) a COVID-19 Active Response and Expenditure Support (CARES) Program loan of $100 million, approved on 28 May 2020;[6] (ii) a Social Protection and Fiscal Management Programmatic policy-based loan of $350 million, expected to be approved later in 2020, with a first tranche of $200 million to be committed in 2020 and a second tranche of $150 million to be committed in 2021; and (iii) the expected increase of three programs supporting reforms in energy, urban water, and education—providing up to $180 million ($50 million in budget support for the Modern Skills for Better Jobs Sector Development Program in 2020, $50 million in budget support for the Sustainable Water Supply and Sanitation Services Sector Development Program in 2020, and a policy-based loan of $80 million for the Georgia State Electrosystem Corporatization and Electricity Market Reforms Program). Such assistance will help rebuild fiscal and financial buffers for funding larger external and public sector deficits in light of increased recovery needs and sustaining economic activity in the formal sector over 2020–2021 and beyond. On a broader scale, the assistance will support inclusive and

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[4] Government of Georgia, StopCoV.ge. Prevention of Coronavirus Spread in Georgia. Tbilisi.

[5] IMF. 2020. *World Economic Outlook, April 2020: The Great Lockdown*. Washington, DC.

[6] ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Countercyclical Support Facility Loan to Georgia for the COVID-19 Active Response and Expenditure Support Program*. Manila.

resilient growth and lay the foundation for post-pandemic economic diversification, fiscal resilience, state-owned enterprise reforms, and the development of relevant skills.

B. Finance Sector Overview

7. **Georgia's finance sector dominated by a globally integrated banking system.** The banking system is private, well-capitalized, and had sufficiently liquidity prior to COVID-19, with a stable asset base. Banking system assets as a share of GDP totaled 94.4% of GDP in 2019. Georgia has 15 banks; the two largest banks controlled 75% of assets at the end of 2019, with the remainder distributed among the other 13 banks. Georgia's finance sector has shown significant resilience to external shocks. No banks failed during the 2008 global financial crisis or from COVID-19 to date. The two largest banks, TBC Bank and Bank of Georgia (BOG), are listed on the London Stock Exchange. A total of 14 out of 15 banks are foreign-controlled. More than 80% of all paid-in capital is foreign owned and nonresident shareholders control nearly 95% of total banking assets. Legislation does not discriminate between foreign and domestic ownership.

8. **High bank credit growth and profitability.** Credit growth reached 20.5% in 2019, totaling GEL32.6 billion, concentrated in industry (13.0%), trade (9.9%), and construction (6.0%). Loans to households remained sizable in the total loan portfolio, totaling 50.9%, of which 25.5% was consumer loans. Bank loans comprised 63.8% of GDP and bank deposits totaled 52.5% in 2019. Interest rates and spreads have been declining. At the end of 2019, interest rates were 6.3% on foreign currency denominated loans and 2.6% on deposits, a decrease from 2015 levels of 10.3% on foreign currency denominated loans and 4.0% on deposits. Interest rates on lari denominated loans and deposits also decreased (15.4% for loans and 9.4% for deposits). The market interest rates reflect some improvements in the monetary policy transmission mechanism, though spreads are still large. Banks posted significant aggregate profits of GEL976.4 million in 2019, an increase of 7.2% year on year. The return on assets of 2.5% and return on equity of 20.3% were high, reflecting good bank profitability.

9. **High system dollarization.** The central bank (NBG) has implemented measures to help de-dollarize the economy, which will help reduce risks for SMEs and the banking segment, overall. In 2017, the NBG increased capital charges for foreign exchange related banking transactions and exposures, tightened bank credit exposure limits for customers' unhedged foreign exchange exposures, and required lari denomination for loan exposures of up to GEL200,000. The loan dollarization rate remains high, however, at 54.6% at the end of 2019 and the finance sector has a high indirect exposure through borrowers' balance sheets even though the direct exposure (through own balance sheets) is limited.

10. **Sound regulatory environment.** The banking industry has a sound macro-prudential framework and incorporates risk-based supervision, including regulations and frameworks for credit, liquidity, operational risk, and macro-prudential oversight. The NBG restricts commercial banks operating in Georgia from non-profile activities and limits the banking system to traditional financial services. Most prudential requirements for monitoring and ratios, including with respect to capital and liquidity coverage, are in line with Basel III rules. The banking system's loan review process is comprehensive, and loan loss provisioning by asset classes is more conservative than International Financial Reporting Standards (IFRS) methodology, which, together with sound prudential ratios, underscore the relative soundness of the system.

C. Micro, Small, and Medium-Sized Enterprises

11. **High number of small and medium-sized enterprises but low contribution to gross domestic product.** Micro, small, and medium-sized enterprises (MSMEs) account for a significant portion of businesses and are important contributors to the Georgian economy and employment.[7] In 2017, MSMEs accounted for 99.7% of all private firms in Georgia, provided 62.0% of the country's jobs, and contributed 62.0% of GDP.[8] Their lower contribution to GDP is explained by their concentration in low value-added activities, which also makes MSMEs more vulnerable to the economic slowdown caused by COVID-19.[9]

12. **Limited access to finance and high collateral requirements.** While domestic credit has increased steadily to 66.6% of GDP since 2015, limited access to financial resources remains a critical obstacle to the country's economic development because of the insufficient savings and internal resources necessary for investments.[10] The estimated total finance gap in 2017 was $2.1 billion for SMEs, with enterprises owned by women accounting for 43.0% of the gap. For microenterprises, the finance gap was about $383 million, with enterprises owned by women accounting for 27.0% of the gap.[11] According to the Enterprise Surveys (2019) data, the percentage of firms whose recent loan application was rejected was 12.7% compared with 10.8% globally.[12] The proportion of loans requiring collateral totaled 80.5% compared with the 77.7% global average, and the value of collateral needed for a loan as a percentage of the loan amount was 194.2%. High collateral requirements constrain the development of SMEs, which reinforces the segment's limited contribution to GDP. According to the World Economic Forum's 2019 Global Competitiveness Report, Georgia's banking system should be doing more to ease access to loans by SMEs (Georgia ranked 83rd among 141 countries) and venture capital availability (109th).[13]

13. **Women entrepreneurship.** Although both men and women are engaged in entrepreneurship in Georgia, women are more likely to own microenterprises and least likely to own large businesses. Women still face numerous barriers in starting and succeeding as entrepreneurs, such as social norms on the accepted roles of women and men, domestic responsibilities, and limitations in access to finance and assets. In 2018, of the 50,383 newly established enterprises, 14,644 were women-owned, a relatively constant trend since 2015.[14] The main reason reported for women starting their own businesses is the need for income to support their families because of high unemployment and the need for flexible working conditions, supported by Georgia's entrepreneur-friendly state policies. The employment rate in Georgia is 65.5% for individuals aged 15–64, with a 10.4% employment gap for women.[15] As the skill level declines, men start to predominate. In Georgia, only 32% of firms with five or more employees have a woman top manager, and only 34% have female participation in ownership.[16] As such,

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[7] Microenterprises are companies with annual turnover of less than GEL1.5 million, small enterprises have annual turnover of less than GEL5 million, and medium-sized enterprises have annual turnover of less than GEL20 million.

[8] Organisation for Economic Co-operation and Development. 2018. *Mid-Term Evaluation: Georgia's SME Development Strategy, 2016–2020*. Paris.

[9] EU4Business. 2018. *Georgia Country Report: Investing in SMEs in the Eastern Partnership*. Brussels.

[10] World Bank DataBank. 2020. Domestic Credit to Private Sector (% of GDP) (accessed 22 July 2020).

[11] International Finance Corporation (IFC). 2017. *MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small, and Medium Enterprises in Emerging Markets*. Washington, DC.

[12] World Bank, European Bank for Reconstruction and Development, and European Investment Bank. 2019. *Enterprise Surveys: What Businesses Experience—Georgia 2019 Country Profile.* Washington, DC.

[13] World Economic Forum. 2019. *The Global Competitiveness Report*. Geneva.

[14] National Statistics of Georgia (Geostat). 2020. Gender Statistics (accessed 22 June 2020).

[15] UN Women. 2012. *Analysis of the Gender Pay Gap and Gender Inequality in the Labour Market in Georgia*. New York.

[16] World Bank. 2016. *Georgia Country Gender Assessment: Poverty and Equity Global Practice*. Washington, DC.

women are less frequently found in managerial positions, which may be an early sign of the glass ceiling effect (footnote 16). However, Georgia outperforms regional and world averages for SMEs with female top managers.

14. Georgia is one of the few countries in Eastern Europe and Central Asia in which women are more likely than men to have a bank account; 63.6% of women and 58.5% of men have accounts at formal financial institutions. However, men are twice as likely to borrow money to start a business, with 22.2% of men borrowing from any source compared with 11.2% of women. Borrowing from financial institutions was somewhat more equal but still favored men (27.4%) over women (20.1%).[17] Barriers encountered by women include lack of relevant skills and knowledge, and poor access to start-up capital and bank loans, in addition to a low level of property and asset ownership. For instance, collateral requirements for business loans are onerous, and difficulties in accessing financing may affect women disproportionately because they are less likely to own property, leading to smaller and higher-interest loans than for men. Offering business-oriented education and targeted training opportunities to strengthen women's involvement in entrepreneurial activities can contribute to boosting women's involvement in business.

15. **Government efforts to boost small and medium-sized enterprises and increase the availability of funding.** The government has adopted the SME Development Strategy of Georgia, 2016–2020, which aims to improve the legislative, institutional, and business environment; enhance financial accessibility; develop SME management skills; support exports; and promote innovations and research activities.[18] Special programs have been operational for innovation centers to promote growth in SMEs. The strategy underscores the importance of a strong and well-established SME segment as a major contributor to exports, innovation, and entrepreneurship culture. The government has also helped create new instruments to boost SMEs' access to finance, such as the credit guarantee scheme, by facilitating lending to companies including those managed by women. The scheme targets SMEs that lack collateral to secure access to affordable financial services. For the facilitation of exports, the government created the export credit agency under the Partnership Fund, which offers Georgian exporters different products and services. The agency issues guarantees to private companies engaged in export operations, and supplies insurance services. The guarantees are issued to cover various risks, including credit and exchange rate risks, as well as force majeure situations as determined by the government. Both local and foreign creditors are eligible to apply and obtain guarantees and insurance services from the agency.

[17] Word Bank. 2017. The Global Findex Database (accessed 22 July 2020).
[18] Ministry of Economy and Sustainable Development of Georgia. 2015. *SME Development Strategy of Georgia, 2016-2020*.