SECTOR OVERVIEW

A. Economy and COVID-19

1. The Government of Georgia responded to the public health threat posed by the coronavirus disease (COVID-19) in a timely and effective manner by introducing a comprehensive package of containment measures. However, while these strict containment efforts have shielded a vulnerable public health system from being overburdened, they disrupted a trajectory of strong and inclusive economic growth, threatening the development gains achieved from 2012 to 2019. Since its outbreak in December 2019, COVID-19 has spread rapidly across the world. The World Health Organization declared it a global pandemic on 11 March 2020. The number of cases worldwide soared to 34,312,510, with 1,023,243 deaths as of 1 October 2020.[1] Georgia, with a population of 3.723 million people,[2] began the fight against COVID-19 on 28 January, 1 month before the first confirmed case of infection was reported on 26 February. A state of emergency was declared on 21 March, 2 days before community transmission was confirmed. As of 5 October 2020, 8696 cases had been reported and 52 deaths confirmed.[3]

2. **Pre-shock strong economic performance recorded.** Before the COVID-19 pandemic, economic performance was expected to remain strong, with gross domestic product (GDP) growth forecasted at 4.3% for 2020 because of good macroeconomic management. Georgia's commitment to fiscal discipline translated into robust macroeconomic fundamentals from 2014 to 2020. In 2019, Georgia achieved its lowest fiscal deficit in 10 years (2.2% of GDP), a historically low current account deficit (5.1% of GDP), the lowest unemployment rate since the country's foundation (11.6%), and its lowest rate of poverty (still high at 20.1%, but nearly halved since 2007). Public debt–GDP remained under the 60% ceiling, at 44.5%, with expenditure as a share of GDP at 28.3%. As a result, all three main credit rating agencies upgraded Georgia's sovereign credit rating to BB/Ba2 from BB–/Ba3, referring to improved economic resilience and sound macroeconomic management as the main driver. Monetary policy interventions and exchange rate flexibility were expected to remain effective in curbing inflationary pressures. The banking system's performance was expected to remain robust, with an increase in credit to the private sector, improved asset quality, and higher liquidity, despite marginally lower profitability.[4]

3. **Impact of COVID-19 on the economy.** The COVID-19 pandemic caused an immediate exogenous shock on the Georgian economy through four main transmission channels: (i) a slowdown in tourism, (ii) trade disruptions, (iii) capital outflow, and (iv) an increase in the cost of finance. Tourism, which contributed 11.6% to GDP in 2019,[5] was severely hit by travel restrictions and recorded a 94.6% year-on-year decline in international visitor trips in May 2020.[6] Reduced international trade affects exports and imports.[7] Decreased external demand is expected to shrink exports by 25.0% in 2020. Imports will reduce by 29.3% and affect the availability of intermediary goods for manufacturing. Foreign direct investment is expected to decline by 20.8% in 2020, compared with 2019. Remittances are expected to reduce by 15% in 2020 compared with 2019,

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1 John Hopkins University. Coronavirus Resource Center. COVID-19 Dashboard by the Center for Systems Science and Engineering (accessed 1 July 2020).

2 National Statistics Office of Georgia. GEOSTAT Database. Population and Demography (accessed 1 July 2020).

3 Government of Georgia. StopCoV.ge: Prevention of Coronavirus Spread in Georgia.

4 International Monetary Fund (IMF). 2019. *Republic of Georgia: Fifth Review Under the Extended Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, Modification of Performance Criteria, and an Extension of the Arrangement and Rephasing of Access-Press Release; Staff Report; and Statement by the Executive Director for Georgia.* Washington, DC.

5 World Travel and Tourism Council. WTTC Data Gateway. Total contribution to GDP (accessed 1 July 2020).

6 Georgian National Tourism Administration. International Travel (Residence).

7 IMF. 2020. *World Economic Outlook, April 2020: The Great Lockdown.* Washington, DC.

having contracted by 42.3% in April 2020 compared with April 2019, according to the National Bank of Georgia (NBG).[8] The contagion effects of the global recessionary shock caused by COVID-19 will be significantly compounded by the effect of containment measures and the lockdown imposed by the government since the declaration of the state of emergency in March 2020. These are likely to lead to a sharp decline in aggregate domestic demand,[9] which accounted for 65% of GDP in 2019, and are expected to cause cancellation of and delays in investments, affecting the business environment and investor confidence. Domestic production will also suffer because of disruptions to global value chains, trade, and investment, thus exacerbating the recessionary socioeconomic impact of the crisis. Updated estimates by the International Monetary Fund (IMF) and the Ministry of Finance project the current account deficit to widen to –11.3% of GDP in 2020, from a record low of –5.1% in 2019 and an estimated –4.9% in 2020. Real GDP is expected to contract by 5.0% in 2020—a sharp downturn from the previous estimate of 4.3% growth.

B. Finance Sector

4. Comprising 15 private banks and 48 nonbanks, the finance sector had assets totaling GEL49.94 billion or 99.87% of GDP at the end of 2019, of which banks held 94.52%. Bank assets are concentrated, with TBC Bank and Bank of Georgia accounting for 74.52%. During 2017–2019, bank loans to the private sector grew at a compound annual growth rate of 23.7%. The steep lari–United States dollar depreciation of 20% during 2017–2019 resulted in deposit growth declining below loan growth. Dollarization had decreased from 62.2% for loans and 68.2% for liabilities in 2018 to 58.1% for loans and 64.2% for liabilities in 2019. Since 2017, the NBG has mandated the use of lari in economic transactions, increased capital charges for foreign exchange-related banking transactions and exposures, tightened credit exposure limits for unhedged foreign exchange exposures, and required lari denomination for loan exposures of up to GEL200,000 to mitigate the credit risk for retail borrowers.

5. Banking system profitability remained solid, with a return on assets of 3.1% during 2019. Although net interest margins were robust, they decreased from 5.1% in 2017 to 4.5% in 2019, indicating increasing competition. Bank liquidity was stable, well exceeding the NBG minimum requirements. The capital adequacy ratio (CAR) increased to 19.4% in 2019 from 18.9% in 2017 because the Basel III regulatory framework was implemented to the CAR requirement from 2018. Asset quality has strengthened significantly since 2017, with nonperforming loan (NPL) ratios (classified overdue above 90 days) at 1.9% in 2019.[10] Deposits and loans are more concentrated in maturities of less than 12 months, and sourcing long-term funding remains challenging for banks. Georgia's financial system has deepened, with the banking sector credit–GDP ratio increasing from 55.7% in 2016 to 64.7% in 2018, exceeding that of its South Caucasus and other peer countries (Moldova, Ukraine, Romania, and Bulgaria), but still trailing the Baltic economies (Poland and Turkey).

6. Since 2010, the NBG has carried out substantial reforms of its banking supervision, including capital adequacy and liquidity management oversight of banks. Lender-of-last-resort facilities, internal capital adequacy and liquidity assessment programs, were augmented through

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8 NBG. Money Transfers Mapper (accessed 22 April 2020).

9 Spending in transportation, clothing, electronics, and domestic services is projected to decline significantly. Y. Babych, D. Keshelava, and G. Mzhavanadze. 2020. The Economic Response to COVID-19: How is Georgia Handling the Crisis? Tbilisi: The International School of Economics at TSU Policy Institute.

10 NBG. Financial Soundness Indicators. The IMF's NPL definition used here includes overdue exposures above 90 days and doubtful and loss assets. NBG's NPL definition is more conservative and includes adversely classified watch assets.

integrated micro- and macro-prudential supervision. A forward-looking approach guides banks on risk mitigation by adjusting underwriting standards that show an explicit impact on stress test results. The IMF and the Bank for International Settlements recognize the NBG's high standard and consider its innovative approach to be an important benchmark for other countries.[11] The NBG fully instituted the Basel III capital adequacy framework in 2018; and three systemically important banks (Bank of Georgia, Liberty Bank, and TBC Bank) will have to build up their capital buffers to meet individual limits of minimum CAR.[12] However, to mitigate the impact of the COVID-19 pandemic, NBG has temporarily relaxed the capital buffer requirements.

7. During 2017–2019, the average interest rate eased by 110 basis points to 15.4% for lari-denominated loans stock and dropped by 70 basis points to 7.6% for foreign exchange loans, narrowing the differential between lari and foreign exchange loan interest rates. Similarly, the average market interest rate during 2017–2019 eased by 30 basis points to 5.9% for lari-denominated deposits and by 20 basis points to 2.2% for foreign currency-denominated deposits, slightly reducing the differential between lari and foreign exchange market interest rates.[13] The high loan pricing differential reflects currency-induced credit risk and capital requirements as well as high interest rates on long-term lari facilities. Since March 2014, international financial institutions—including the Asian Development Bank, the European Bank for Reconstruction and Development, and the International Finance Corporation—have been issuing lari-denominated bonds to support the Georgian finance sector with long-term lari funding. Table 1 shows key indicators of the Georgian banking system.

Table 1: Georgia Banking System Key Indicators

Item	2015	2016	2017	2018	2019
Total loans (GEL million)	16,258.2	19,161.9	22,725.8	27,039.9	32,578.6
Loans loss reserves (balance sheet, GEL million)	1,015.8	1,177.2	1,169.2	1,300.4	1,346.6
Provisioning (income statement, GEL million)	(3.5)	9.6	(7.9)	4.2	(9.8)
Net profit (GEL million)	84.5	112.5	152.6	124.1	132.0
Nonperforming loans (% of total loans)	2.7	3.4	2.8	2.7	1.9
Regulatory CAR (%, Tier I)	12.0	10.5	14.0	13.5	14.6
Return on assets (%)	2.7	3.1	3.1	3.0	2.5
Return on equity (%)	17.6	22.1	23.3	23.3	20.3
Bank assets (% of GDP)	74.2	84.1	84.9	89.0	94.4
Deposits (% of GDP)	42.3	47.4	48.5	51.7	52.5
Loans (% of GDP)	47.2	52.8	54.7	59.6	63.8
Policy rate	9.0	7.0	7.25	6.5	8.0
Lending rate (forex)	10.3	8.7	7.9	7.6	6.3
Deposit rate (forex)	4.0	3.3	2.5	2.9	2.6
Lending rate (lari)	19.4	18.2	16.8	15.7	15.4
Deposit rate (lari)	10.0	8.6	9.0	8.2	9.4

( ) = negative, CAR = GDP = gross domestic product.
Source: National Bank of Georgia. Statistical Data (accessed 30 August 2020).

[11] Bank for International Settlements, Basel Committee on Banking Supervision. 2017. Supervisory and Bank Stress Testing: Range of Practices. Basel; IMF. 2015. Georgia: Financial Sector Assessment Program—Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision. *IMF Country Report*. No. 15/10. Washington, DC; and NBG. 2017. Annual Report 2016. Tbilisi.

[12] The NBG defines systemically important banks based on their size and impact on the financial system and the economy in the case of a bank failure. The NBG requires additional capital for such banks and may support them in case of stress.

[13] NBG. 2020. *Financial Sector Review.* Analytical Tables and Charts. June.

C. Access to Finance for Micro, Small, and Medium-Sized Enterprises

8. Limited access to finance and high collateral requirements for micro, small, and medium-sized enterprises (SMEs) remain a critical obstacle to Georgia's economic development. According to Enterprise Georgia,[14] an estimated 99.7% of all registered firms in Georgia in 2017 were SMEs, which employed 62% of all formal workers and 67% of all female hired workers.[15] To avoid mass retrenchment of workers as a result of the COVID-19 pandemic, the government adopted three measures aimed at improving access to finance for SMEs: (i) increasing the budgetary allocation to the Credit Guarantee Scheme by GEL300 million to raise the total value of cofinanced loans to SMEs to GEL2 billion; (ii) expanding and upgrading existing credit enhancement mechanisms under the Produce in Georgia program,[16] which is expected to benefit at least 300 SMEs; and (iii) extending GEL40 million in grants to micro-entrepreneurs,[17] which is expected to benefit up to 5,000 entrepreneurs. In addition to these multisector measures, the government will provide tax credits to SMEs in the tourism industry—one of the most affected segments, where 60% of workers are women, many of whom are at high risk of job loss. This includes the deferral of property and income tax until November 2020, which is expected to benefit up to 4,500 SMEs; and the provision of an 80% subsidy on interest rate payments for small and medium-sized hotels[18] for a period of 6 months, which is expected to benefit up to 2,000 of these hotels.

D. Agriculture Sector

9. Despite its relatively low contribution to GDP (7% in 2019), 40.9%[19] of all active working age persons in Georgia work in agriculture—97% of whom are self-employed and fall outside existing support systems.[20] Further, low baseline incomes in the sector suggest that loss of economic activity could have a disproportionately high impact on the rise in poverty incidence compared with other sectors. As a result, measures to support firms in the agriculture sector are expected to be effective in mitigating the resurgence in poverty incidence. They also complement the government's efforts to increase domestic food production, with a view to protecting food-insecure households.[21]

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[14] Enterprise Georgia is an agency of the Ministry of Economy and Development responsible for business support, export promotion, and investment. It contains a comprehensive registry of all SMEs.

[15] Organisation for Economic Co-operation and Development. 2019. *Monitoring Georgia's SME Development Strategy, 2016–2020*. Paris.

[16] Changes made to the terms of the Produce in Georgia program include (i) increasing the period of cofinancing of loans and leasing from 24 months to 36 months, (ii) changing the mechanism of interest cofinancing, (iii) introducing more types of activities, (iv) lowering the minimum threshold for loans and leasing, and (v) increasing funding for working capital.

[17] The maximum size of a single grant is GEL30,000.

[18] Hotels with up to 50 rooms.

[19] National Statistics Office of Georgia. GEOSTAT Database. Labour Force Survey (accessed 1 July 2020).

[20] Government of Georgia, Ministry of Economy and Sustainable Development. 2017. *Labour Market Analysis of Georgia.* Tbilisi.

[21] An estimated 1.3 million Georgians (about 35% of the population) are either moderately or severely food insecure. Food and Agriculture Organization of the United Nations. 2019. *The State of Food Security and Nutrition in the World: Safeguarding against Economic Slowdowns and Downturns.* Rome.

10. **Ensuring food security.** Georgia is a net food importer[22] and highly import-dependent for most food categories.[23] This puts food security at risk through food export restrictions. Food price inflation reached a year-on-year peak of 16.1% in April 2020 and declined to 11.5% in July 2020.[24] The average share of food consumption expenditure was 43% in 2018, which underlines the social importance of food prices. The Ministry of Environmental Protection and Agriculture has adopted a range of measures to ensure food security and spur domestic production.[25] These include (i) ensuring prices for basic foodstuffs;[26] (ii) providing crop loans; (iii) increasing the maximum government contribution to finance fixed agricultural assets from 8% to 11%; (iv) subsidizing interest rates of up to 10% for the food industry; (v) securing collateral of up to 50% for livestock working capital loans; (vi) supporting smallholder milk production with GEL3 million; (vii) subsidizing wheat imports with GEL5.2 million; (viii) expanding the Agriculture Insurance Program by GEL9 million; and (ix) renewing the Agricultural Support Program with GEL10 million. The government will focus on SMEs in the agriculture sector.

11. According to a 2014 agricultural survey,[27] 75% of farms have less than 1 hectare and largely represent subsistence farming. About 23% are small family farms of 1–5 hectares, which can produce in excess of subsistence needs. Only 2% of farms appear to have the size for commercial farming. The agriculture sector employs a large pool of self-employed persons, possibly up to half of the workforce, which is trapped in low productivity farming. Georgia's agriculture sector suffers from a lack of transportation infrastructure, supply chains, and cold storage facilities for agricultural products to permit countercyclical supply of produce (ensuring peak supply when the price is seasonally high), fragmented farmland, and a lack of financial literacy. Notwithstanding these constraints, agriculture has significant growth potential. About 11,200 medium-sized and large farms (above 50 hectares) appear to have high potential for value addition and employment. Georgia has climatic advantages, representing most world climate zones—providing opportunities for the export of wine, fruits, and nuts; and import substitution for meat, grain, fruits, vegetables, dairy products, edible oils, fats, and tea. Improving value addition by increasing the availability of storage facilities and domestic processing requires investments that improve both productivity and quality, along with the application of improved farming practices and international product standards. Georgia needs to raise the quality of its exports and enhance product uniformity to ensure standardized supply in bulk shipments. Georgian farmers cannot easily collateralize machinery to obtain a loan from a financial institution, and small farmers in particular rely mainly on nonbank financial institutions for much-needed access to finance. Knowledge acquisition and training of farmers are also lacking. Banks and nonbank financial institutions, including Credo, often offer such training in rural areas. The availability of investment capital is a serious constraint, which is exacerbated by COVID-19. Supporting lenders such as Credo in providing access to finance to the agriculture sector will be crucial to Georgia's recovery from the pandemic.

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[22] A. Simoes and C. Hidalgo. 2020. The Economic Complexity Observatory: An Analytical Tool for Understanding the Dynamics of Economic Development. Scalable Integration of Analytics and Visualization: Papers from the 2011 AAAI Workshop, WS-11-17. Palo Alto: Association for the Advancement of Artificial Intelligence. Michigan.

[23] P. Mamardashvili et al. 2020. How Does Covid-19 Affect the Food Supply Chain in Georgia? Tbilisi: International School of Economics at TSU Policy Institute.

[24] Trading Economics. Georgia Food Inflation (accessed 9 September 2020).

[25] Government of Georgia, Ministry of Environmental Protection and Agriculture. 2020. The Ministry of Environmental Protection and Agriculture of Georgia is Taking Complex Measures to Reduce Economic Damage in the Agricultural Production. News release. 24 April.

[26] Food categories covered are rice, pasta, buckwheat, vegetable oil, sugar, wheat, wheat flour, milk powder, and beans. P. Mamardashvili et al. 2020. How Does COVID-19 Affect the Food Supply Chain in Georgia? Tbilisi: International School of Economics at TSU Policy Institute.

[27] Government of Georgia, Ministry of Agriculture. 2014. *Strategy for Agricultural Development, 2015–2020*. Tbilisi. Table 3.