Infrastructure spending and continued export gains boosted growth in 2019. Inflation accelerated with currency depreciation. Growth is projected at zero in 2020 with continued monetary tightening and the effects of COVID-19 before recovering in 2021 on stronger demand and foreign investment. Monetary tightening is projected to slow inflation in both years. Having narrowed in 2019, the current account deficit will narrow further by 2021 with a continued decline in imports. Promoting technological innovation would spur business development.

Economic performance

Growth is estimated to have accelerated from 4.8% in 2018 to 5.1% in 2019, reflecting record spending on public investment and a sharp rise in exports. On the supply side, service growth accelerated from 5.6% in 2018 to 6.8% in 2019 on strong 15.2% expansion in information and communication technology; 14.1% in arts, entertainment, and recreation; and 9.1% in tourist-related accommodation and food services. Industry expanded by 2.7%, with gains in electricity and gas utilities by 5.5% and construction by 4.1%. Agriculture decreased by 1.0% on low investment in the sector (Figure 3.3.1).

On the demand side, preliminary data show growth in public investment more than doubling from 9.2% in 2018 to a record 25.1%. Expansion in net exports accelerated from 11.0% in 2018 to 14.5% as growth slowed in consumption from 5.1% to 2.4% and in private investment from 6.5% to 4.7%.

Average inflation nearly doubled from 2.6% in 2018 to 4.9% with currency depreciation and prices rising sharply toward year-end (Figure 3.3.2). Food prices jumped by 8.2%, and excise tax increases boosted prices for alcoholic beverages and tobacco by 16.3%. Core inflation—excluding food and nonalcoholic beverages, tobacco, energy, and regulated utility tariffs—was 2.0%.

A sharp rise in capital spending to the equivalent of an estimated 7.0% of GDP widened the fiscal deficit from 0.7% of GDP in 2018 to 2.1% (Figure 3.3.3). This occurred despite high collections of value-added tax and improved tax administration that raised tax revenue by 8.7% to equal 22.8% of GDP and total revenue by 9.2% to equal 25.8% of GDP. Outlays for wages...
expanded by only 5.9%, helping limit growth in noninterest expenditure to 10.0%. Public debt climbed from the equivalent of 44.9% of GDP in 2018 to 47.9% in part because of currency depreciation. Private debt excluding intercompany lending rose by nearly 4 percentage points to equal 58.0% of GDP (Figure 3.3.4).

To cope with rising inflationary pressures and currency depreciation due to the strengthening of the US dollar and lower than expected foreign exchange inflows, the National Bank of Georgia, the central bank, raised its policy rate by 250 basis points to 9.0% in four steps in the period from September to mid-December 2019 and maintained the rate in the first quarter of 2020, while cutting reserve requirements on deposits denominated in foreign currency by 5 percentage points to 25% in October 2019. The lari depreciated in 2019 by 8.9% against the US dollar, 6.2% against the euro, 4.9% in nominal effective terms, and 5.3% in real effective terms. The currency lost further ground in the first quarter of 2020 due to the global rise of the US dollar and risk premium that the market is perceiving amid the global COVID-19 outbreak (Figure 3.3.5). In response, the central bank sold foreign exchange in the amount of $193 million in the period from August 2019 to March 2020.

Banks remained well capitalized, with improved asset quality and higher liquidity but less profitability. Bank capital as a percentage of assets was 19.5%, the percentage of nonperforming loans 1.9%, and the liquid asset ratio 19.6%—all improvements in 2019. However, dollarization in the banking system remained high, with deposits unchanged from a year earlier at 61.1% and loans down from 56.1% to 54.6%. Average interest rates were 11.8% for loans and 5.7% for deposits.

The current account deficit narrowed from the equivalent of 6.8% of GDP in 2018 to an historic low of 4.5% in 2019, though growth in merchandise exports slowed from 22.4% in 2018 to an estimated 13.5%. Merchandise import growth plunged from 15.1% in 2018 to only 0.8% despite record high public spending on infrastructure, as the lari depreciated and oil prices fell. Growth in remittances slowed from 13.9% in 2018 to 9.7%. Tourism revenues increased by 1.4% despite a ban by the Russian Federation on direct flights to Georgia. Foreign direct investment—concentrated mainly in finance, manufacturing, tourism, and construction, increased by 0.2% despite profit repatriation and a gradual winding down of energy projects. Foreign reserves rose by $72 million to $3.3 billion at the end of 2019, while external debt reached the equivalent of 95.2% of GDP and the public portion of it 37.2%. Standard & Poor’s and Fitch raised Georgia’s credit rating at the end of 2019 from BB– to BB.
Economic prospects

Growth is projected to decline to zero in 2020 as monetary tightening and the impact of COVID-19 constrain consumption and limit expansion in tourism and trade, before recovering to 4.5% in 2021 with higher domestic demand fueled by increased bank credit to households, increased foreign direct investment, and a rebound in workers’ remittances (Figure 3.3.6). Gains in retail trade and higher government education spending are projected to boost services by 1.1% in 2020, and 6.3% in 2021, with the latter reflecting an expected recovery in tourism. Growth in industry is projected to contract to 3.1% in 2020 with a slowdown in construction and manufacturing before recovering to 2.1% in 2021 with higher mining output. Agriculture is forecast to decline marginally by 0.7% in 2020 and expand by 0.4% in 2021 as investments in the sector strengthen.

The introduction of administered prices on food, which represents 31.3% of the consumer price index, should help slow inflation to 4.5% in 2020 and 3.0% in 2021, the central bank’s target (Figure 3.3.7). Fiscal policy is projected to be expansionary, as the budget deficit is projected to widen somewhat to 2.5% in both 2020 and 2021 with social spending forecast at 9.0% of GDP. This reflects phased increases in the basic pension and a gradual rise in education outlays to 6.0% of GDP, despite savings from better targeting of social insurance benefits and improved procurement practices. A revised fiscal framework should help minimize fiscal risks by including injections to state owned enterprises and liabilities to public-private partnerships under the overall debt ceiling of 60.0% of GDP. However, public debt is expected to increase to 48.5% in 2020 and 49.5% in 2021 in part from the need to continue financing infrastructure projects (Figure 3.3.8).

Georgia’s external prospects will depend heavily on developments in its trading partners. The current account deficit is projected to narrow further, to 4.4% of GDP in 2020 and 4.2% in 2021, with a continued decline in imports as much lower oil prices help trim the trade deficit by 2.5% in 2020 and 0.5% in 2021 (Figure 3.3.9). Exports are projected to grow by 3.6% in 2020 and 11.9% in 2021, with modest domestic expansion and higher foreign direct investment raising imports by 1.1% in 2020 and 7.0% in 2021. Gross international reserves are expected to reach $3.5 billion in 2020 and $3.6 billion at the end of 2021. External debt is expected to equal 96.0% of GDP at the end of 2020 and 96.5% at the end of 2021 (Figure 3.3.10).

Risks to economic growth include greater than expected sluggishness in trading partners’ economies, weaker than expected domestic demand, slower growth in tourism revenues, and tighter liquidity in global financial markets, in part reflecting the impact of COVID-19.
Policy challenge—promoting technological innovation for business development

Georgia has made tangible progress in creating innovative digital services for business development. However, it is constrained by limited mobile broadband coverage and internet connectivity, especially in rural areas. Georgia has improved its adoption of information and communication technology (ICT), the third pillar of the enabling environment component cited in the World Economic Forum’s Global Competitiveness Index 2019, where Georgia ranks 55 of 141 economies. However, Georgia has made little progress in improving the technological sophistication of firms, ranking only 91 in innovation capability and 93 in entrepreneurial culture. The report highlighted slow progress in university–industry collaboration in research and development and digital skills of workforce, with research and development expenditure equal to only 0.3% of GDP, well below the 1.8% average for upper-middle-income countries.

To promote start-ups, the government has inaugurated two new agencies. The Georgian Innovation and Technology Agency supports competitiveness in small and medium-sized enterprises and promotes innovative start-ups. It also supports innovation laboratories, business incubators, and new technology firms. The Georgian Entrepreneurship Development Agency facilitates private sector development through a variety of financial and other facilities to support start-ups during their incubation, especially those oriented toward exports. While these efforts have helped firms advance through better use of ICT, Georgia’s Global Competitiveness Index rank remains low at 108 for growth in innovative companies and 120 for cluster development.

Advances in science and labor market analysis can help enable firms to innovate. Georgia is taking steps to integrate ICT into school curricula. ICT is a mandatory subject and part of computer-based instruction and learning. In addition, ICT modules are used to train teachers. The government has created an information system to collect and analyze labor market data to identify mismatches between labor skills and educational programs. Despite these efforts, the local workforce needs further training, especially in ICT.

The government receives international support for technological innovation, including help in formulating a development strategy for broadband infrastructure and narrowing the digital divide between urban and rural areas. Supporting dedicated and open-access digital platforms for a variety of commercial, government, and research activities would help firms integrate ICT more effectively, thereby raising their productivity. Greater openness to trade and further competition among firms would also help.
To make electronic commerce more trustworthy and viable, the government must improve its legal and regulatory framework for electronic commerce while creating more efficient mechanisms for setting taxes and tariffs. Promoting technology-oriented start-ups in business process outsourcing, information services, and computer services could help advance innovation and the use of more modern technology, thereby making firms more dynamic. Doing so would require further investments in research and development, as well as reducing the cost of doing business by extending computer systems that link business and government. Cutting operating costs for service users and other cost-cutting investments could allow firms to become more efficient and technologically sophisticated. Meanwhile, firms could do more to boost their own innovative capacity by, for example, offering ICT training to workers. Promoting cluster development, where Georgia ranks poorly by international standards, could support innovative links among firms.

The government should continue educational reform, including measures to reform vocational education and expand education in science and technology, to enhance productivity by increasing the supply of workers with relevant skills. Improving education and familiarity with digital technologies, particularly in rural areas, would make growth more broadly based and inclusive.