PASHA Holding

Georgian Economy in the 2nd Quarter of 2020

The economy has shrunk due to the pandemic & containment measures, however, the signs of recovery are already visible:

- Georgia like the rest of the world economy has been experiencing an unprecedentedly abrupt and a considerable decline in economic activity in 2020. The real Gross Domestic Product (GDP) shrank by 5.8% y-o-y in the first half of 2020. The pandemic had a significant impact on Georgia's economy in the second quarter, as the economy contracted by 12.6% y-o-y, interrupting a 2.2% y-o-y positive economic growth of the first quarter;
- Taking into consideration that the trigger of this downturn was not the economic factor, but the cause was the COVID-19 spread, gives hope for a faster recovery of the economy. The signs of recovery are already visible. The recovery is facilitated by stronger credit activity, fiscal stimulus, and better-than-anticipated remittance inflows. Regarding the effects of lockdown, Google mobility dynamics have been signaling a strong recovery;
- Moreover, the significant foreign aid received from international financial institutions should partially offset the impact of the severe shock and help on the recovery;

The deceleration has been continuing in the headline inflation since May 2020:

- Consumer prices decreased by 1.4% m-o-m in June and annual inflation stood at 6.1%, which is above the central bank target of 3%. The inflation is the outcome of two opposite effects: a decrease in the aggregate demand and an increase in the unit labor costs triggered by COVID-19-related supply-side constraints;
- Annual core inflation* rose by 6.6%, while the annual core inflation without tobacco** stood at 6.2%, implying that the annual headline inflation is persistent;
- In the breakdown of annual inflation:
  - ✓ Food & non-alcoholic beverages turned out to be the major contributor to the overall 6.1% annual inflation. The prices increased by 13.6%, adding 4.15 percentage points (p.p.);
  - ✓ Prices of health services surged by 7.5%, pulled inflation up by 0.61 percentage points to the annual inflation. The prices went up for out-patient services (11.6%) and medical products, appliances, and equipment (10.2%);
  - ✓ Prices of furnishings & household equipment raised inflation by 0.58 p.p. in June, partially driven by the better-than-expected dynamics of consumer loans (10.3% y-o-y, 4.1% y-t-d with the constant exchange rate);
- On the flip side,

- ✓ Transport dragged the headline down by 1.08 p.p., as the prices dropped for the operation of personal transport equipment (-11.8%);

- Meanwhile, the domestic PPI (DPPI) increased by 4.6% compared to June 2019. The DPPI for manufactured products increased by 6.1% compared to the same month of 2019, resulting in a 5.17 p.p. contribution to the overall annual DPPI change;
- 46% of annual domestic PPI change comes from food products, which went up by 6.7% y-o-y. The Import Price Index (MPI) for food products increased by 6.8% y-o-y, which implies that there is cost pressure on the consumer food inflation, and subsequently on the headline inflation, however, the pressure has been decelerating since May.

*The core inflation is calculated by excluding food and non-alcoholic beverages, energy, regulated tariffs, and transport (specific tariffs) from the consumer basket.

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The trade deficit decreased mainly driven by shrinking imports triggered by economic contraction:

- In the first half of 2020, the external merchandise trade turnover of Georgia shrank by 18.2% y-o-y and amounted to USD 5055 mln.;
- The exports equaled USD 1504 mln. (15.9% decrease)***, while the imports stood at USD 3550 mln. (19.1% decline);
- The trade deficit abated by 21.3% and amounted to USD 2046 mln. Its share in external trade turnover constituted 40% (2019 H1: 42%);
- The exports to the EU countries stood at USD 338 mln. (20.8% ↓ compared to 2019 H1) and reached nearly a fifth of total exports. Meanwhile, the imports equaled USD 856 mln. (22.8% drop) with 24% share in total imports;
- The exports to the CIS countries amounted to USD 651 mln. (30.1% ↓) and constituted about half of the total exports, while the imports amounted to USD 1106 mln. (1% ↓) with a 31% share in total imports;
- The export market concentration is higher: the share of the top five trading partners by exports in the total exports amounted to 57.3%. The top partners were China (13.6% in total), Azerbaijan (13.5%), and Russia (12.5%);
- The share of the top five trading partners by imports in the total imports account for 49.7%. The top partners were Turkey (16.8%), Russia (11.2%), and China (9.2%).

***The exports excluding re-exports contracted by 2.9% y-o-y and amounted to USD 1079 mln.

Stronger credit activity: consumer loans grew moderately, while the corporate side expanded considerably**:**

- As of June 2020, total assets of the commercial banks increased by approximately 10.7% compared to the same month of 2019 (y-t-d 2.5%↑) and stood at GEL 49.3 bln.;
- The total loan portfolio rose by 13.3% y-o-y (2.4% y-t-d) and amounted to GEL 33 bln. In y-o-y terms, loans to households (exc. individual entrepreneurs) went up by 8.9% (GEL 14.6 bln.; 2.6% y-t-d), while the consumer loans experienced a 10.3% y-o-y growth (4.1% y-t-d) and accounted for GEL 4.2 bln;
- The corporate loan portfolio (inc. individual entrepreneurs) grew by 17.3% y-o-y (2.3% y-t-d) and stood at GEL 18.4 bln. The main drivers of the growth were loans to industry (24% of the growth), construction (22%), and transactions in real Estates (20%);
- The share of non-performing loans in total loans realized as 5.5%, which is 0.2 percentage points lower comparing to June 2019, while it is 1.2 p.p. higher comparing to December 2019;
- Deposit portfolio of non-financial borrowers (individuals & legal entities) expanded by 11.1% y-o-y to GEL 29.6 bln. The main drivers were time deposits

of legal entities in NC and time deposits of individuals in FC, constituting 44% and 18% of the growth, respectively. While 16% (NC: 5%; FC: 11%) of the total deposit growth was driven by individuals' demand deposits, demand deposits of legal entities comprised 8% (NC: -5%; FC: 13%) of the total growth;

- Dollarization of the total deposits stood at 62% (2019 Dec: 65%), while it was 75% (2019 Dec: 75%) for individuals' deposits and 48% (2019 Dec: 53%) for legal entities;
- During the reporting period, the Return on Assets ratio (ROA) of the sector stood at -2.4%, while Return on Equity ratio (ROE) was -21.7%. The negative returns are driven by significantly higher loan loss provisions due to the COVID-19 and its economic effects.

****In this section, all growth rates exclude the effect of the exchange rate depreciation

In the August meeting, the NBG has continued the gradual exit from the tightened policy:

- National Bank of Georgia (NBG) abated the policy rate to 8%, as of 5th of August, from 9% at the end of Q1;
- Given the expected reduction in the demand, in the August meeting, the MPC continued the gradual exit from the tightened policy announced in April;
- According to the NBG forecasts, other things equal, inflation will decrease over the rest of 2020, drop below the target level in the first half of 2021 and then, approach it from below. The decline in inflation will be driven by the weak aggregate demand;
- The NBG emphasized that will use all instruments at its disposal to ensure the price stability;
- The next meeting of the Monetary Policy Committee is scheduled on September 16, 2020.