Georgian Economy in the 3rd Quarter of 2020

The economy started recovering from the pandemic in the third quarter:

- The sharp contraction of economic activity in the second quarter showed recovery signs in the third quarter. The pandemic effect on the economy started to abate as a fall in economic activity was 3.8% in the third quarter, significantly lower than the fall in the second quarter of 12.3%. The real Gross Domestic Product (GDP) shrank by 5% YoY in Jan-Sep 2020;
- Manufacturing, mining & quarrying, wholesale & retail trade, financial & insurance activities experienced YoY growth in September raising hopes of a faster recovery in the economy. Taxpayers' turnover YoY growth was at 3.2% in September reaching positive territory for the first time since March. This indicator is used in rapid estimates of economic growth suggesting the economy is back on track excluding some sectors. The sectors which were severely affected by the pandemic are transportation & storage, accommodation & food service activities, and entertainment & recreation.

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

- Consumer prices increased by 0.7% m-o-m in September and annual inflation stood at 3.8%, which is above the central bank target of 3%. Pandemic-induced fall in aggregate demand helped inflation to decrease and approach the central bank target;
- Annual core inflation* rose by 5.2%, while the annual core inflation without tobacco** stood at 4.7%, 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 3.8% annual inflation. The prices increased by 6.3%, adding 1.97 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%) and medical products, appliances, and equipment (9.4%);
  - ✓ Prices of alcoholic beverages & tobacco raised inflation by 0.59 p.p. in September;
- On the flip side,
  - ✓ Transport dragged the headline down by 0.87 p.p., while recreation & culture sector prices contributed to a 0.08 p.p. fall;
- Meanwhile, the domestic PPI (DPPI) increased by 4.8% compared to September 2019. The DPPI for manufactured products increased by 5.7% compared to the same month of 2019, resulting in a 4.47 p.p. contribution to the overall annual DPPI change;

- 42% of annual domestic PPI change comes from food products, which went up by 5.5% YoY;
- The Import Price Index (MPI) increased by 3.4% YoY. Import prices of basic pharmaceutical products & pharmaceutical preparations rose by 26.2% reflecting the impact of COVID-19 on inflation.

*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 Jan-Sep 2020, the external merchandise trade turnover of Georgia shrank by 14.9% YoY due to pandemic-induced restrictions and amounted to $8121.1 mln.;
- The exports equaled $2403.5 mln. (12.1% decrease), while the imports stood at $5717.6 mln. (15.9% decline);
- The trade deficit abated by 18.5% and amounted to $3314.1 mln. Its share in external trade turnover constituted 40.8% (2019 Jan-Sep: 42.6%);
- The exports to the EU countries stood at $511.8 mln. (16.6% ↓ compared to 2019 Jan-Sep) and constituted slightly more than a fifth of total exports. Meanwhile, the imports equaled $1376.2 mln. (20.7% drop) with 24% share in total imports;
- The exports to the CIS countries amounted to $1072.9 mln. (26.3% ↓) and constituted about 45% of the total exports, while the imports amounted to $1709.1 mln. (0.4% ↑) with a 30% 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 56.8%. The top partners were China (14.8% in total), Azerbaijan (13.6%), and Russia (12.8%);
- The share of the top five trading partners by imports account for half of the total imports. The top partners were Turkey (17.2%), Russia (10.9%), and China (8.9%).

Stronger credit activity: both consumer and corporate loans experienced a significant growth*:**

- As of September 2020, total assets of the commercial banks increased by approximately 18.7% compared to the same month of 2019 (YTD 15.2%↑) and stood at GEL 54.3 bln.;
- The total loan portfolio rose by 14% YoY (6.1% YTD) and amounted to GEL 35.5 bln. In YoY terms, loans to households (exc. individual entrepreneurs) went up by 13.3% (GEL 15.7 bln.; 7.8% YTD), while the consumer loans experienced a 13.3% YoY growth (9.7% YTD) and accounted for GEL 4.5 bln;
- The corporate loan portfolio (inc. individual entrepreneurs) grew by 14.7% YoY

(4.8% YTD) and stood at GEL 19.8 bln. The main drivers of the growth were loans to Hotels & Restaurants (22% of the growth), construction (21%), and transactions in real Estates (18%);

- The share of non-performing loans in total loans realized as 6.3%, which is 1 percentage point higher comparing to September 2019, while it is 1.9 p.p. higher comparing to December 2019. The pandemic-induced decline in income of households and businesses started to show its impact on NPL;
- The deposit portfolio of non-financial borrowers (individuals & legal entities) expanded by 19.3% YoY to GEL 33.8 bln. The main drivers were time deposits of legal entities in NC and time deposits of individuals in FC, constituting 47% and 14% of the growth, respectively. While 9.2% (NC: 3.4%; FC: 5.7%) of the total deposit growth was driven by individuals' demand deposits, demand deposits of legal entities comprised 19% (NC: 4.9%; FC: 14.1%) of the total growth;
- Dollarization of the total deposits stood at 62.2% (2019 Dec: 64.8%), while it was 75.8% (2019 Dec: 74.7%) for individuals' deposits and 47.7% (2019 Dec: 52.6%) for legal entities;
- During the reporting period, the Return on Assets ratio (ROA) of the sector stood at -0.9%, while Return on Equity ratio (ROE) was -8.1%. The negative returns are driven by significantly higher loan loss provisions due to the COVID-19 and its economic effects. Profitability measures have improved compared to previous quarters in 2020 implying that the negative impact of the pandemic on the banking sector started to subside.

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

In the October meeting, the NBG maintained the current policy rate amid pandemic-induced economic uncertainty:

- National Bank of Georgia (NBG) kept the policy rate stable at 8%, as of the 28th of October. Compared to the previous quarter (2020 Q2) NBG decreased the policy rate by 25 p.p. in the August meeting;
- Given the downward trend of inflation, in the October meeting, the MPC decided to maintain the refinancing rate at its previous level. NBG stated that the pace of the exit from the tight monetary policy stance (normalization) will depend on inflation expectations and the dynamics of economic activity;
- According to the NBG forecasts, inflation will continue its decreasing trend and remain close to the target level based on weak aggregate demand. NBG noted that the fall in external demand is noteworthy in putting downward pressure on inflation;
- The NBG emphasized that will use all instruments at its disposal to ensure price stability;

- The next meeting of the Monetary Policy Committee is scheduled for December 9, 2020.