Rating-Agentur Expert RA confirmed at 'BB' the ratings of Georgia. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Georgia at 'BB' (Sufficient level of creditworthiness of the government) in national currency and at 'BB' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The fiscal deficit increased up to 0,9% of GDP in 2018 and it has been fairly stable. Moreover, the augmented balance calculated by the IMF, which includes budget lending, stood slightly wider at around 2,5% of GDP as of the same date. This was a result of strong revenues on the back of the SME tax reform combined with higher capital spending as well as budgetary lending. In the mid-term, we expect continued augmented deficits as capital spending will be higher; but we also anticipate better revenue income. This has already been recorded in 7M 2019 as the purchase of nonfinancial assets grew by 58% y-o-y while tax income has increased by 10%. In the long-term, we expect the fiscal discipline to continue as the government has a strong commitment towards to fiscal sustainability;
- Economic growth was solid in 2018 posting an increase of 4,7% due to higher productivity in the manufacturing and retail sectors, as well as strong external demand which translated in higher exports. As of 2Q 2019, y-o-y real output growth declined slightly to 4,5% as the manufacturing and construction sectors have slowed down. Despite this, we anticipate the economy to continue growing at a stable pace going forward;
- Yearly inflation as of the end of 2018 stood at 1,5% in 2018; however, it has been edging up in 2019 as it recorded a figure of 4,9% as of August 2019 as a result of higher food, alcohol and tobacco prices. The latter was due to increases in excise on tobacco and can be considered as one-time effect;
- The level of credit to the economy remains at favourable levels. Bank assets to GDP grew by 5p.p. and domestic credit to GDP by around 6p.p. in order to post figures of 97% and 72% respectively in 2018. However, this growth has been somewhat disproportionate as it has been mainly driven by corporate and individual entrepreneur loans, which is a good sign, as these are funds which will be transformed into goods and services, while consumer loans have been declining due to the intervention of the government to curve this segment. However, there was an important uptick in mortgage financing as this type of financing grew by 36% y-o-y as of July 2019;
- The banking sector remains quite stable with solid capitalization, profitability and asset quality. As of the end of 2Q 2019, the ratio of regulatory capital to risk-weighted assets stood at 18,2% while profitability once again was positive with a ROA of 2,1% and ROE of 16,2%. Moreover, asset quality continued to be stable as the NPLs to total loans stood at 2,9%. Loan dollarization in the system remains high, especially for mortgage loans; however, the level has declined in the past months due to the introduction of new regulation;
- FDI net inflow in the country has been solid and stood at 7,3% of GDP in 2018; however, this figure showed a decline as compared to 2017 due to the fact that some substantial

projects were completed. We anticipate the level of FDI to increase going forward as the reform program advances;

- The quality of the fiscal policy is favourable. Even though the official fiscal deficit increased marginally, the augmented deficit (which includes budget lending) decreased in 2018. Moreover, the government has shown commitment to responsible public financing by meeting goals and objectives in terms of spending. Also, the authorities have complied with the established benchmarks from the IMF in terms of the augmented fiscal balance;
- The quality of the monetary policy is positive. Georgia has a floating exchange rate regime, which is optimal to absorb external shocks, and a monetary policy based on achieving price stability. Even though the inflation rate was low in 2018 at 1,5% remaining below the National Bank of Georgia (NBG) target of 3%, it has picked up substantial steam in 2019 as it stood at 4,9% y-o-y by the end of August 2019. Even though we consider this uptick to be a one-off effect resulting from the aforementioned excises, it has also been caused by the depreciation of the GEL. As a result of these events, the NBG already increased the refinancing rate twice this month by 100b.p. from 6,5% up to 7,5%.

Restricting factors:

- Gross government debt stood at 44,9% of GDP and 156,7% of budget revenues in 2018, which we consider to be acceptable. Moreover, the figures have remained stable and we expect them to remain so going forward as the government has a clear strategy in place, which includes clear and concise actions in order to maintain debt sustainability;
- The structure of government debt is contrasting. In regard to maturity, short-term debt remains low as it was only 3,7% of GDP and 8,6% of total debt as of 1Q 2019 and is covered by international reserves by 6x. Even though the share of FX-denominated debt remains elevated at 81% of total debt, most of it is concessional as only 7,8% is from an Eurobond issuance. Going forward, we anticipate the government to issue more domestic bonds in order to propel corporate financing through capital markets;
- Georgia's GDP per capita indicator in PPP terms for 2018 stood at USD 11 500 and is at an acceptable relative to its peers[1];
- The banking sector's concentration remains elevated as the top three banks (TBC Bank, Bank of Georgia and Procredit Bank) account for about 77% of the total banking system's assets, which carries negative effects for the competition level in the country;
- Institutional development in Georgia remains moderate. The country has a Human Development Index (HDI) adjusted for inequality score of 0,680 and, while most governance indicators improved slightly, political stability remains a challenge for the country. Moreover, it is ranked 41st out of 180 in the Corruption Perceptions Index and 66th out of 140 countries in the Competitiveness Index from the World Economic Forum. However, conditions for business are favorable as the country ranked 6th out of 190 countries in the Doing Business ranking published by the World Bank in 2019.

Negative factors:

- Georgia's external exposure remains a key negative factor for the country's creditworthiness. Both the trade and current account deficits remain quite wide at 11,6% and 7,7% respectively in 2018; however, we expect both figures to remain stable going forward. The Georgian economy remains highly reliant on imported goods as well as remittances inflow and foreign investment; of which the latter contributes substantially to financing the current account. Moreover, external debt of the economy stood at 113% of GDP and financial dollarization remains high. In addition, we have already seen GEL depreciation in 2019 as a result of lower external demand;
- Contingent liabilities stemming from inefficient and unprofitable SOEs, as well as power purchasing agreements (PPAs) attributed to hydropower companies with attached

[1] Even though Azerbaijan's metric is higher, it is mainly inflated due large part of GDP being made of the hydrocarbon sector.

government guarantees and public-private partnerships (PPPs) remain elevated and the risk of materialization is moderately high;

- The level of unemployment rate remained elevated at 12,7% in 2018 according to the local statistical service; but has been gradually declining over the past six years;
- Even though the stock and bond markets remain undeveloped as compared to mature markets, it is ahead of the regional pack. As of August 2019, the stock market capitalization stood at around 4,5% of GDP and the number of corporate bonds trading in the Georgian stock exchange is limited. We still expect further development of the capital markets in the long-term perspective, as there are plans to strengthen this segment.

Stress factors:

- Financial dollarization is high in Georgia; loans and deposits in FX were equivalent to 56% and 64% of total portfolio as of July 2019 (moderately weak stress-factor);
- Political risk stemming from the unresolved conflict of South Ossetia and Abkhazia with Russia (moderately weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Decrease of external exposure by reducing FX-denominated debt, advancing de-dollarization measures, increasing national savings, buffering-up international reserves and further developing productive sectors of the economy in order to reduce reliance on imports;
- A substantial reduction in the amount of contingent liabilities which would reduce the overall government debt level.

The following developments could lead to a downgrade:

- Unexpected negative external developments which would negatively affect the exchange rate causing asset deterioration in the financial system and reduction in international reserves as well as economic volatility;
- Deterioration of the fiscal position by widening the fiscal deficit and increasing government debt including contingent liabilities' materialization.

"The confirmation of Georgia's 'BB' sovereign government credit ratings reflects the continued high economic growth supported by structural reforms, stable public finances with an acceptable fiscal stance, efficient monetary policy focusing on price stability, as well as a solid and growing banking sector.

However, the country's main downside risk is the high external exposure, which could potentially cause spillover effects in case of external shocks, as the economy remains highly dependent on imports, FDI and remittances as well as elevated financial dollarization.

The stable outlook reflects that in the mid-term perspective we anticipate with a high probability that all underlying factors affecting creditworthiness will behave according to our base forecast scenario." – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Georgia is available at:

https://raexpert.eu/reports/Research_report_Georgia_04.10.2019.pdf

Next scheduled rating publication: TBD in December 2019. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

For further information contact:

Responsible expert:
Hector Alvarez, Associate Director of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 1213
alvarez@raexpert.eu

Reviewer:
Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 1211
gorchakov@raexpert.eu

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
05.04.2019	First assignment of both types of ratings for the country	BB	BB	Stable	Stable

Minute's summary

The rating committee for Georgia was held on 2 October 2019. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from April 2019). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, National Bank of Georgia, National Statistics Office Georgia, Ministry of Finance of Georgia, Georgian Stock Exchange, Cbonds.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

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The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.