Research Report on Georgia

1 April 2022

Responsible Expert:

Hector Alvarez
Associate Director

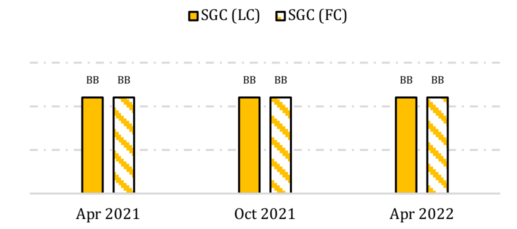
For further information contact:
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00, 1213
E-mail: alvarez@raexpert.eu
www.raexpert.eu

Ratings

Sovereign Government Credit (LC)	BB
Sovereign Government Credit (FC)	BB
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Georgia

Macro indicators	2019	2020	2021
Gross gov. debt, GEL bn	20	30	31
Nominal GDP, GEL bn	49	49	60
Real GDP growth, %	5,0	-6,2	10,4
Gross gov. debt/GDP, %	40,4	60,0	51,8
Deficit (surplus)/GDP, %	-1,8	-9,2	-6,2
Inflation rate, %	7,0	2,4	13,9
Current Account Balance/GDP, %	-	-	-10,0
External debt, USD bn	-	-	21,0*

Development indicators	2021
Inequality adj. HDI	0,72
GDP per capita, USD th	16,6

Default indicator	01.04.2022
10Y Gov Bond Yield, %	9,9**

Source: RAEX-Europe calculations based on data from the IMF, WB, NBG, UN.
* 3Q 2021 ** GEL-denominated bond

RAEX-Europe confirmed at 'BB' the ratings of Georgia. The rating outlook is stable.

RAEX-Europe confirmed the sovereign government credit ratings (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 remains stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

Summary

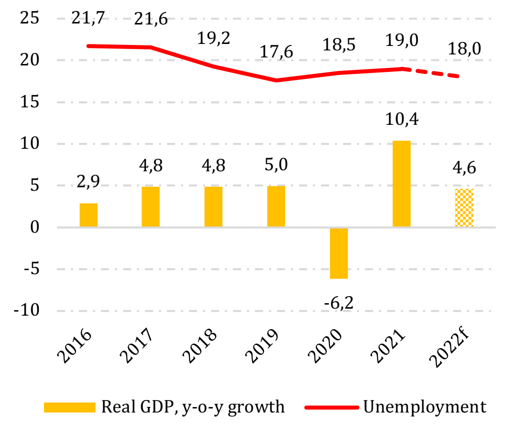
The ratings of Georgia were confirmed at 'BB' with a stable outlook mainly reflecting the sustained economic recovery from the pandemic, stable banking system metrics, and improved fiscal figures. In addition, despite the external position of the country remaining weak, it has slightly recovered.

However, the scale of the economic impact derived from the war in Ukraine along with rising political tensions is quite uncertain and must be observed closely.

The economy strengthened in 2021. The Georgian economy grew strongly by around 10,4% y-o-y in real terms in 2021 as a result of the overall economic recovery from the coronavirus crisis. This growth is better than we initially anticipated in our previous review (forecast of 7,7% y-o-y increase in real terms in 2021), but in line with our optimistic assumptions which had led us to improve the outlook from negative to stable. The main drivers of growth were the stronger demand for exports as well as a recovery of domestic consumption.

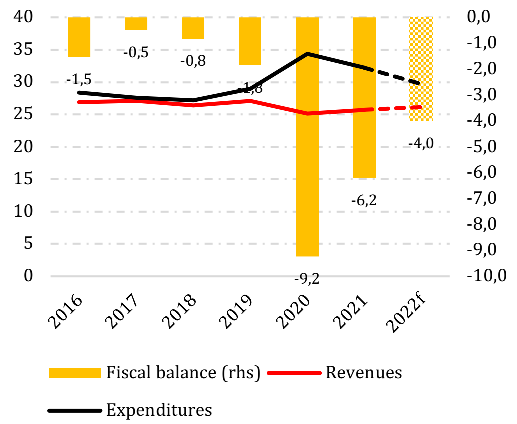
In 2022, we expect the economic recovery to continue despite the global challenges and potential spillover effects from the Russian invasion of Ukraine. The higher prices of oil and some other imports in Georgia have negatively affected inflation, but the external balance has been somewhat mitigated by higher prices of exports. Despite the uncertainties going forward stemming from the developments of the war in Ukraine, we still anticipate the Georgian economy to growth at a rate of around 4,6% in real terms in 2022.

Graph 1: Macroeconomic indicators, %



Source: RAEX-Europe calculations based on data from the IMF, Geostat and NBG

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and Ministry of Finance of Georgia

The unemployment rate stood at 19% at the end of 2021, a decline from the beginning of 2021, as we initially anticipated. The still high figure resulted from the negative effects of the coronavirus pandemic. Most of the job losses were in the leisure and tourism sector. This was further exacerbated due to the measures imposed towards the end of 2020 when cases spiked.

The relationship between the main political parties remains tense and is still a factor to observe. Moreover, the recent plan from South Ossetia to hold a referendum on joining Russia will be something to monitor as it could create further tensions in the political atmosphere in Georgia.

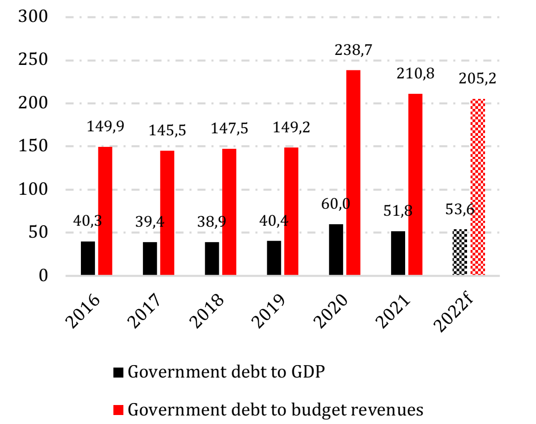
Fiscal consolidation is underway. After posting a wide fiscal deficit of 9,2% of GDP in 2020, the metric narrowed down to 6,1% of GDP in 2021 as the economy started to recover and COVID spending was reduced. We calculate that the augmented fiscal balance, which includes budget lending, was at about 6,3% in 2021.

We anticipate the balance to continue to consolidate in 2022 as the economy continues to grow and the expenses related to relieve the economy from the negative effects of the pandemic are removed. Even though the budget for 2021 includes an increase in social expenditures, such as increase in pensions and healthcare, the current outlook of economic growth provides enough revenue support. Thus, we anticipate the deficit to stand around 4% of GDP in 2022.

Monetary policy remains tight. In our view, the National Bank of Georgia (NBG) continues to manage the monetary policy in an adequate manner targeting price stability.

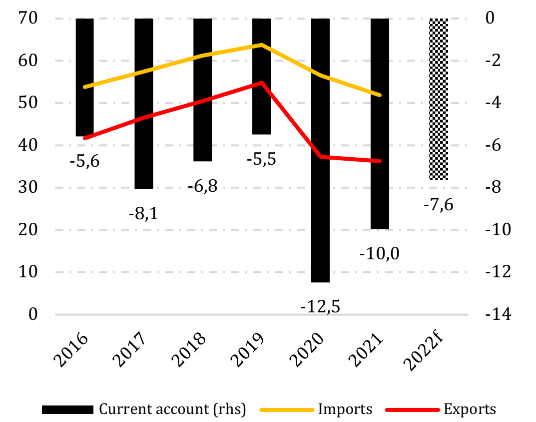
The NBG has continued to tighten monetary conditions as a result of higher prices and elevated inflation expectations due to increase in food and energy prices as well as exchange rate pass-through. As a result, the central bank has increased the rate back in December 2021 by 0,5p.p. and recently in March 2022 by another 0,5p.p. as it now stands at 11%. The latest increase in the rate is a response to the shocks already caused by the Russian invasion in Ukraine. In 2021, the y-o-y inflation rate was 13,9%, as a result of high food prices, higher energy prices and exchange-rate pass through effect, while a rate of 13,7% was recorded by the end of February 2022, which is expected to decrease in March at a slower pace than initially anticipated. The war in Ukraine, among many other effects, has caused an increase in fuel prices which will have a direct impact on Georgia's inflation rate.

Graph 3: Government debt dynamics, %



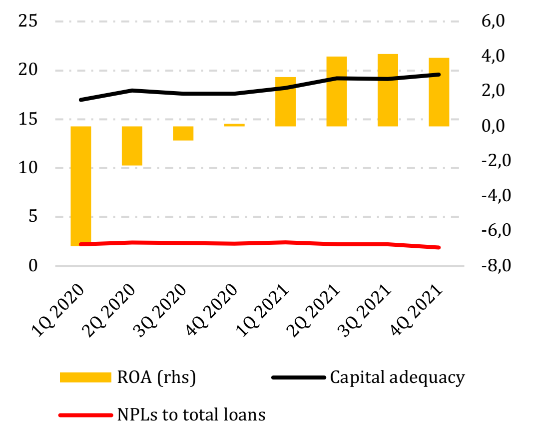
Source: RAEX-Europe calculations based on data from the IMF and Ministry of Finance of Georgia

Graph 4: External sector indicators, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and NBG

Graph 5: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the NBG and WB

We expect the inflation level to be between 3%-4% by the end of 2022; however, this will highly depend on the outcome of the ongoing war in Ukraine which could create different scenarios which are hard to predict.

As mentioned in our previous review, the NBG has intervened the FX market, when necessary, by selling more than USD 2 bn in the last two years and remains ready to do so again if required. Going forward, we expect a lot of volatility in the exchange rate as the uncertainty of the outcome of the situation in Ukraine is still very unclear.

Government debt expected to decline going forward. Gross government debt stood at 51,8% of GDP and 210,8% of budget revenues in 2021, both lower figures than what we projected in our previous review. Already showing an important decrease as compared to a year ago when the pandemic hit the hardest. It also reflects a more stable exchange rate in 2021 than what we observed in 2020.

The debt structure of the government remains quite stable. At the end of 2021, short-term debt stood at around 4,3% of GDP, a similar figure as compared to six months ago. Moreover, the share of FX-denominated debt remained practically unchanged at 81,4% of total debt as of the same period. However, the high level of foreign currency debt is still partially mitigated by the fact that 75% of debt comes from multilateral and bilateral agreements at favorable conditions. The only Eurobond Georgia has is a USD 500 m bond issued in April 2021.

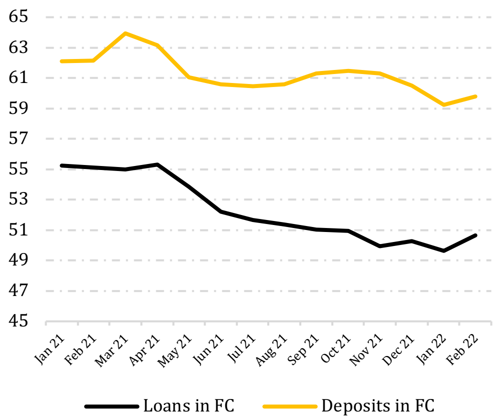
Contingent liabilities stemming from inefficient and unprofitable SOEs, as well as power purchasing agreements (PPAs) attributed to hydropower companies with attached government guarantees and public-private partnerships (PPPs) remain elevated, and the risk of materialization is moderately high.

External stance remains challenging. The economy of Georgia remains highly dependent on external factors and events, such as international trade, remittances, and tourism.

In 2021, we observed a favorable economic recovery as external demand for exports increased, the tourism sector recovered and net remittances were acceptable. Thus, we observe that the current account deficit recover slightly to post a metric of around 10% of GDP in 2021.

Our view for 2022 is mixed given the current situation in Ukraine. As a result of the war, we expect lower demand from Georgia's main trade partners, which includes Russia and Ukraine in the top destinations.

Graph 6: Financial dollarization, % of total



Source: RAEX-Europe calculations based on data from the NBG

In terms of FX reserves, after a solid build up in 2021, we already saw a slight decline in the beginning of 2022; as of February 2022, FX reserves stood at USD 3,5 bn.

Banking sector continues to remain stable. Financial soundness indicators improved consistently throughout 2021, showing the positive effects of the reopening of the economy. As of 4Q 2021, the NPLs to total loans ratio stood at 1,9%, regulatory capital to risk-weighted assets increased to 19,6%, while ROA and ROE stood at 3,9% and 34,4% (see graph 5).

Moreover, we have seen domestic credit continue to increase favorably both in the corporate and retail sectors. However, it is important to note a very rapid increase in consumer loans after 1H 2021, while corporate loans continued to increase at a declining pace.

Regarding the banking sector's concentration, it 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. Finally, the Georgian banking system remains highly dollarized; loans and deposits in FX were equivalent to 50,6% and 59,8% of total portfolio as of February 2022 (see graph 6).

Stress factors:

- Financial dollarization remains high in Georgia; loans and deposits in FX were equivalent to 50,6% and 59,8% of total portfolio as of February 2022 (moderately weak stress-factor);
- Political risk stemming from the unresolved conflict of South Ossetia and Abkhazia with Russia, including the recent plan from South Ossetia to hold a referendum on joining Russia (moderately weak stress-factor).

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:

- Strong negative impact of the Ukraine war, which would cause spill overs and 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.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None.

Next scheduled rating publication: 30 September 2022. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2022

For further information contact:

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

Reviewer:
Denys Anokhov, Rating Associate of RAEX-Europe
+49 (69) 3085-45-00, ext. 1212
anokhov@raexpert.eu

Rating-Agentur Expert RA GmbH (RAEX-Europe)
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
01.10.2021	Scheduled review of both types of ratings for the country	BB	BB	Stable	Stable
02.04.2021	Scheduled review of both types of ratings for the country	BB	BB	Negative	Negative
02.10.2020	Scheduled review of both types of ratings for the country	BB	BB	Stable	Stable
03.04.2020	Scheduled review of both types of ratings for the country	BB	BB	Stable	Stable
04.10.2019	Scheduled review of both types of ratings for the country	BB	BB	Stable	Stable
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 1 April 2022. 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 August 2020). 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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

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.