Research Report on Georgia

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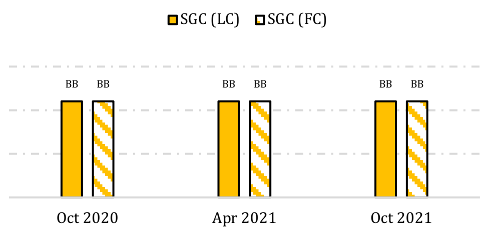
Ratings

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	2018	2019	2020
Gross gov. debt, GEL bn	17	20	30
Nominal GDP, GEL bn	45	49	49
Real GDP growth, %	4,8	5,0	-6,1
Gross gov. debt/GDP, %	37,5	40,4	60,6
Deficit (surplus)/GDP, %	-0,8	-1,8	-9,3
Inflation rate, %	1,5	7,0	2,4
Current Account Balance/GDP, %	-	-	12,5
External debt, USD bn	-	-	20,6*

Development indicators	2020
Inequality adj. HDI	0,72
GDP per capita, USD th	14,9

Default indicator	01.10.2021
10Y Gov Bond Yield, %	9,1**

Source: RAEX-Europe calculations based on data from the IMF, WB, NBG, UN.
* 1Q 2021 ** GEL-denominated bond

RAEX-Europe confirmed at 'BB' the ratings of Georgia. The rating outlook changed from negative to 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 changed from negative to stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

Summary

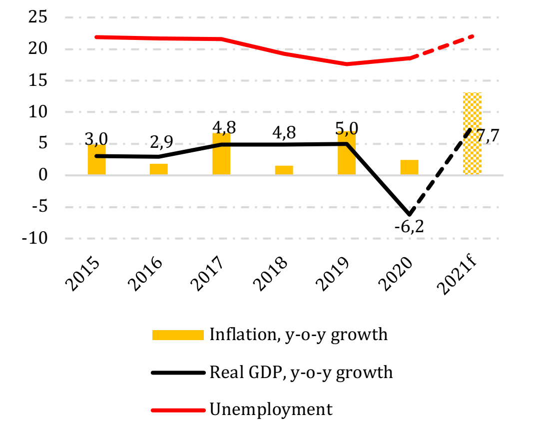
The confirmation of the ratings at 'BB' and the change of the outlook from negative to stable reflect the better-than-expected growth prospects of the economy in 2021. Alongside this, we also anticipate better figures regarding the fiscal stance as well as from the external position. Moreover, the banking system weathered the pandemic satisfactory and posted favorable metrics in 1H 2021.

Nonetheless, the country remains highly dependent on external factors and the local elections, which will take place in October 2021 and could bring additional uncertainty to the economy.

The economy shrunk in 2020 but set for a strong rebound in 2021. The Georgian economy contracted by 6,2% in 2020 as a result of the fallout from the coronavirus crisis, which affected several sectors of the economy, as well as external demand for exports. However, the economy started to gain momentum in 2Q 2021 mainly due to the base effect, but also as a consequence of the government easing lockdown measures, which propelled an increase in private consumption. Moreover, tourism picked up as travel restrictions eased in the mentioned period, while the external sector benefited from increasing foreign demand. Despite the government re-implementing lockdown measures late in the 2021 summer due to a spike in COVID-19 cases, an adequate pace of the vaccination campaign will help the economy to stay afloat for the rest of 2021. Thus, we anticipate real GDP growth to be at around 7,7% by the end of the current year (see graph 1).

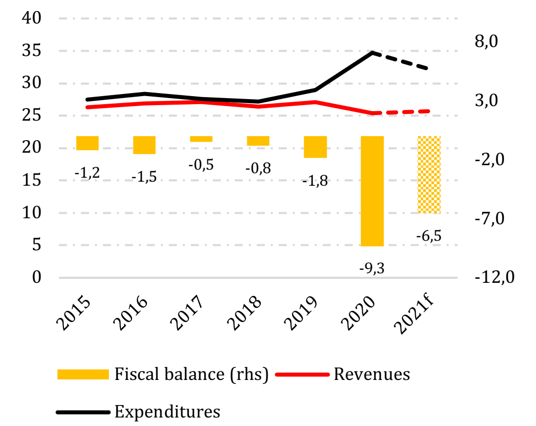
Revised figures show that the unemployment rate increased up to 22,1% at the end of 1Q 2021, a steep hike which resulted from the negative effects of the coronavirus pandemic. Most of the job losses concentrated in the

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

hard-hit tourism sector. This was further exacerbated due to the measures imposed towards the end of 2020 when cases spiked. However, we expect this figure to be lower by the end of 2021 as the economy has shown good signs of recovery and the vaccination campaign advances.

However, local elections in October 2021 may increase uncertainty in the economy as the relationship between the main political parties remains tense since the elections from October 2020.

Fiscal consolidation to resume after supportive stance during pandemic. In 2020, revised figures show that the fiscal deficit was as large as 9,2% of GDP mainly a result of strong anti-crisis spending by the government in healthcare, as well as support fort businesses and households (see graph 2). Moreover, the augmented deficit, which includes budgetary lending, posted a figure of 9,3% in 2020.

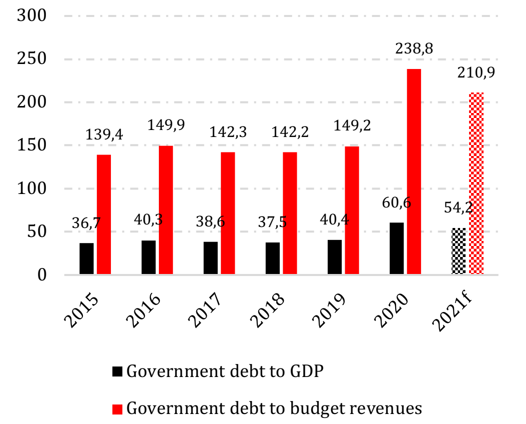
In 2021, budget figures have been better than initially anticipated. Even though the government continued to implement tax reliefs and COVID-19-related spending, budget revenues picked up strongly causing the deficit to be quite narrow in 1H 2021. In July 2021, the parliament approved a revised budget with the aim to support economic recovery, target fiscal consolidation and continue to back pandemic-related aid. Given the strong expected economic growth in 2021, we anticipate the fiscal deficit to narrow to around 6,5% of GDP, while the augmented deficit to be at 6,6% of GDP.

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. Consequently, the regulator has increased the reference rate twice since our latest review. On 29 April 2021, the hike was by 100b.p. up to 9,5%, while on 5 August 2021, the increase was by 50b.p. to stand at 10% as of today, its highest level since 2008. Once again, the depreciation effects on prices shows a reflection of outstanding dependency of Georgia on external factors and the difficulty the regulator has to manage monetary policy in a highly dollarized economy.

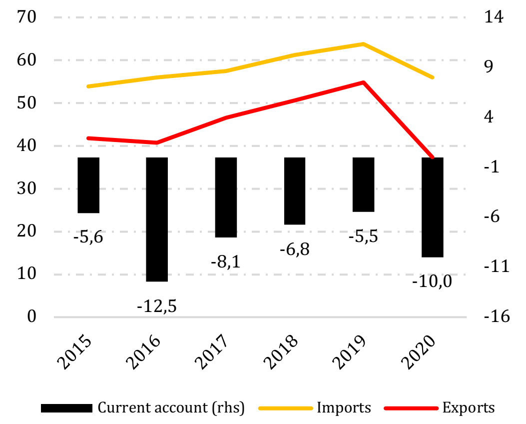
In 2020, the y-o-y inflation rate was 2,4%, while it skyrocketed up to 12,8% in August 2021. We expect the inflation level to be around 13,1% by the end of 2021 but to come back within the NBG target by year-end 2022. As mentioned in our previous review, the NBG has intervened the FX market, when necessary, by selling more than USD 2 bn in the last two

Graph 3: Government debt dynamics, %



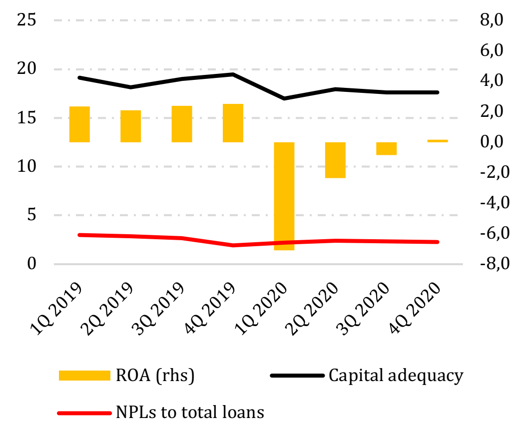
Source: RAEX-Europe calculations based on data from the IMF and Ministry of Finance of Georgia

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

years and remains ready to do so again if required. Thus, we do not anticipate a lot of volatility in the exchange rate in the short term.

The NBG continued to implement measures to contain the adverse effect from the pandemic. These include FX swap lines with banks and MFIs to provide liquidity, relaxation of regulations and requirements on the banking system, as well as tools to support financing for SMEs in order to smoothen the impact of the pandemic.

Government debt to decline going forward. Gross government debt stood at 60% of GDP and 238% of budget revenues in 2020. The steep increase related to 2019 is mainly a reflection of local currency depreciation and depressed GDP. However, we expect debt to decline substantially in 2021 down to 54,2% of GDP mainly as a result of a more stable exchange rate and a pick-up in nominal GDP (see graph 3).

The debt structure of the government stood fairly stable. As of 2Q 2021, short-term debt hiked slightly up to 4,1% of GDP. Moreover, the share of FX-denominated debt increased slightly to 82% of total debt as of the same period. Nevertheless, this remains mitigated by the fact that 75% of debt comes from multilateral and bilateral agreements at favorable conditions.

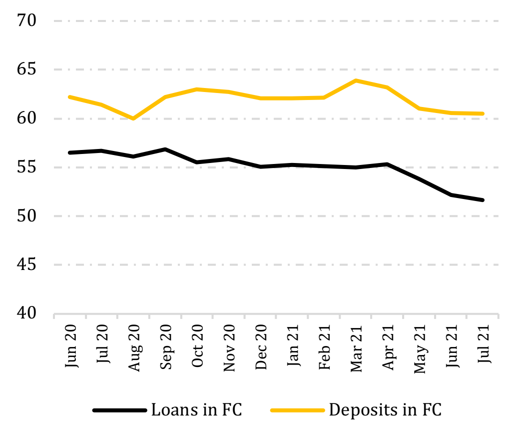
Contingent liabilities stemming from inefficient and unprofitable SOEs, as well as power purchasing agreements (PPAs) attributed to hydropower companies with attached government guarantees and public-private partnerships (PPPs) remain elevated, and the risk of materialization is moderately high.

External stance remains depressed. Georgia's economy remains highly dependent on external factors, such as international trade, remittances and tourism. In 2020, we saw the economy being highly affected by the lack of external demand and tourism, high imported inflation and low remittances. Thus, we saw both the trade of goods and services, as well as the current account deficits deteriorating in 2020.

However, the economy already experienced a positive development on the external stance in 2021. Remittances increased by 35% y-o-y in 1H 2021, while exports grew by about 27% as of the same date. Thus, we anticipate external metrics to recover; by year-end 2021 we expect a current account deficit of 10% of GDP and a trade deficit of 19% of GDP (see graph 4).

Banking sector remained stable throughout the pandemic. Financial soundness indicators improved in 1H 2021, showing the positive effects of the reopening of the economy. As of 1Q 2021, the NPLs to total loans ratio stood at 2,2%, regulatory capital to risk-weighted assets increased

Graph 6: Financial dollarization, % of total



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

to 19,2%, while ROA and ROE stood at 4% and 37,3% (see graph 5). As mentioned in our previous review, the NBG has implemented measures to support capital and liquidity.

Moreover, we have seen domestic credit increase favorably both in the corporate and retail sectors. However, 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. Finally, the Georgian banking system remains highly dollarized; loans and deposits in FX were equivalent to 51,7% and 60,5% of total portfolio as of July 2021 (see graph 6).

Stress factors:

- Financial dollarization remains high in Georgia; loans and deposits in FX were equivalent to 51,7% and 60,5% of total portfolio as of July 2021 (moderately weak stress-factor);
- Political risk stemming from the unresolved conflict of South Ossetia and Abkhazia with 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 from the coronavirus crisis, 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 as a result of additional spending needs due to the coronavirus crisis

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: TBD December 2021. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2021

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 October 2021. 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

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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.

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.