

- *The economy contracted sharply by 11.5 percent yoy in January 2021 on the back of continuing mobility restrictions; high frequency indicators point to some recovery since.*
- *Trade deficit narrowed by 19 percent yoy in January-February as export recovered slightly and import remained weak.*
- *FDI dropped by 53 percent yoy in 2020.*
- *After experiencing some volatility during February, the lari has stabilized in recent weeks.*
- *Inflation increased in February driven by food inflation.*
- *Credit growth slightly moderated but remains robust.*
- *The fiscal deficit widened in January, driven by higher spending, although revenue collection remained robust.*

The pace of economic contraction intensified in January as COVID-19 related restrictions remained in place; however, activity started to recover more recently. The economy contracted by 11.5 percent yoy in January as compared to 7.9 percent yoy in December. The contraction remained broad-based, with construction particularly hard-hit, as import of construction materials fell 18 percent yoy. Air and road transport activities fell sharply due to mobility restrictions, and tourism related activities remained subdued as arrivals of international visitors were 94 percent below of January 2020 level. Finance, IT and communication, and water supply and waste management were the only sectors posting positive growth in January. As restrictions eased in February, mobility in Tbilisi recovered from an average of 41 percent of pre-COVID levels in January to an average of 51 percent in February, which may signal stronger economic activity in February. A gradual pick-up in flights and robust tax collection also suggest firming of economic activity.

A lower goods trade deficit and higher transfers were offset by still weak tourism on the current account. Exports and imports of goods both contracted by over 16 percent yoy in January, resulting in narrowing of the deficit by 17 percent yoy. Exports of domestic products (excluding re-exports) declined by 6.4 mainly driven by wine and nitrogen fertilizers, which dropped by 42 and 49 percent yoy respectively. China, Bulgaria and Azerbaijan were major export markets for Georgia. Meanwhile exports to the EU increased by 11 percent yoy and reached 22 percent of total in January. Import composition was relatively diverse and was led by the natural gas, oil and oil products from Azerbaijan. Also, machinery from China moved up in the list of key import products. Per express statistics, trade balance improved strongly in February as export recovered by 2.9 percent and import fell by 12.2 percent. Remittances from abroad rose by 18 percent yoy in January and February which could be reflecting increased formalization of transfers. Tourism revenues remained depressed.

Foreign direct investment (FDI) inflows turned negative in Q4 2020 as compared to \$365 million inflows in Q4, 2019. This drove annual FDI to 3.9 percent of GDP in 2020 as compared to 7.5 percent of GDP in 2019. Investments in

hotels, restaurants and energy sectors fell sharply while financial, mining and real estate sector managed to attract more investment. The balance of financing fully shifted towards reinvestment and away from equity financing. UK and the Netherlands were the largest countries of origin for investments, representing 95 percent of total inflows, while outflows were largest to Panama (at around 1.3 percent of GDP). As a result, the FDI gross inflows covered around one third of the external financing gap, while official and private borrowing covered the rest of the gap in 2020.

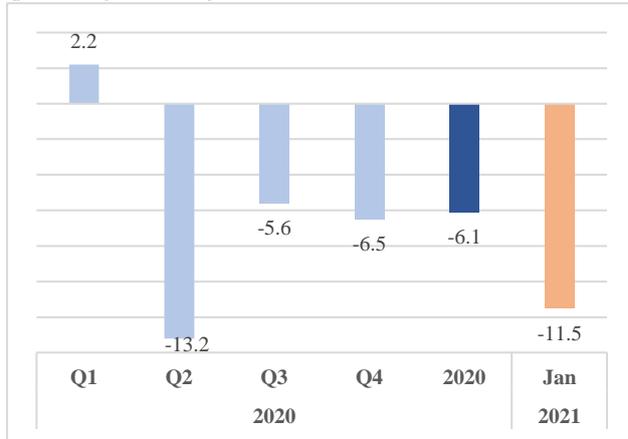
The lari fluctuated in February reflecting heightened political tensions but has stabilized more recently. The lari strengthened in early-February but shed the gains towards the end of the month and by end-February was 0.7 percent weaker on mom and 19 percent weaker yoy. The National Bank of Georgia (NBG) sold \$40 million in February to smoothen exchange rate volatility. Reserves declined marginally, but at USD 4.1 billion provided over 5 months of goods and services import cover.

Inflation increased to 3.6 percent yoy in February picking up from 2.8 percent yoy in January. Food prices increased by about 1 percent mom and contributed almost 2 percentage points (pp) to the overall inflation rate. Transport prices increased in February as global oil prices recovered and recorded their first yoy increase since March 2020. Core inflation, excluding food, alcohol, transport and administrative prices, increased considerably to 6.6 percent yoy in January. The price of health services also increased sharply by 9.8 percent yoy, contributing 0.8 pp to overall inflation. The headline inflation continues to include an almost 2 percentage point downward adjustment of annual inflation introduced in December on account of the state subsidy of the utility costs for households. The NBG kept the policy rate unchanged in February but increased it by 50 bps to 8.5 percent in March, driven by concerns of inflationary pressures, arising from the risks of lari depreciation feeding into higher prices and trend of price increases in international commodity markets, among other factors.

Credit growth moderated but remained robust at 10.6 percent yoy (excluding FX effect) in February. Growth of lari loans was strong at 20 percent yoy and FX lending increased by 6 percent yoy. The stronger growth in lari loans helped maintain credit dollarization at pre-COVID 19 levels. Deposits grew by 21 percent yoy in February with deposits in lari increasing by 34 percent yoy. Banking sector profits increased by 18 percent yoy in nominal terms in January, with 11 banks out of 15 showing positive returns. The profitability of the banking sector improved in January with net income up 22 percent yoy. The share of non-performing loans fell slightly to 2.7 percent; however, increasing confiscated assets could signal concerns.

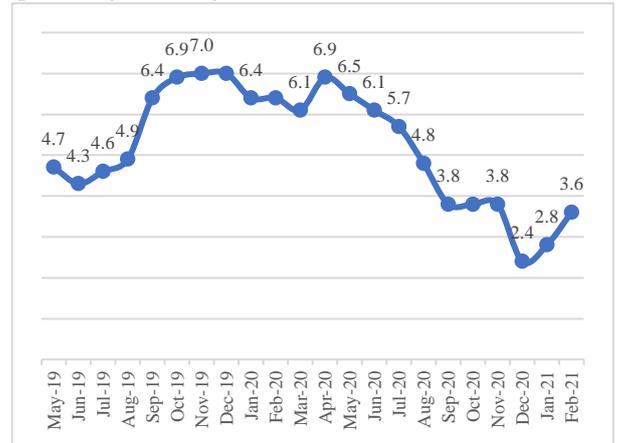
The fiscal deficit widened in January. Government spending accelerated by 16 percent yoy driven by subsidies and social spending. Tax collections fell by 5.2 percent yoy in January, but overall revenues benefited from strong external grants. As a result, nominal revenue collection increased by 13 percent yoy. The fiscal deficit widened in January, and public debt increased to 61.7 percent of GDP.

Figure 1. The economy contracted sharply in January 2021
(year-on-year, in %)



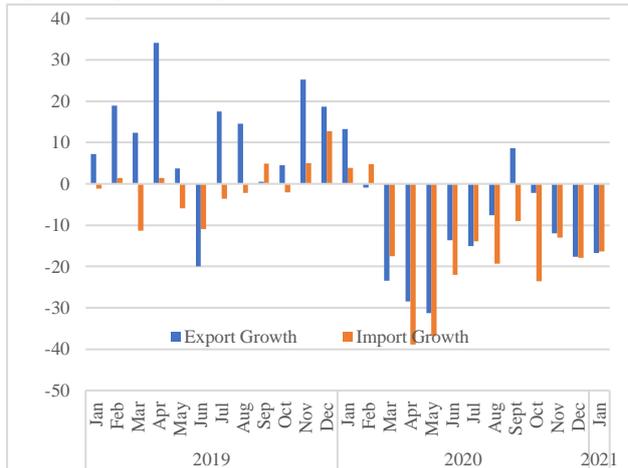
Source: Geostat

Figure 2. Inflation continued to increase in February driven by food prices
(year-on-year, in %)



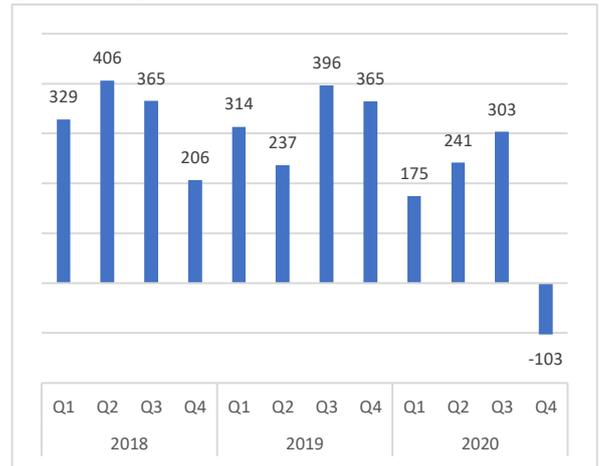
Source: Geostat

Figure 3: The trade balance improved in January 2021
(year-on-year, in %)



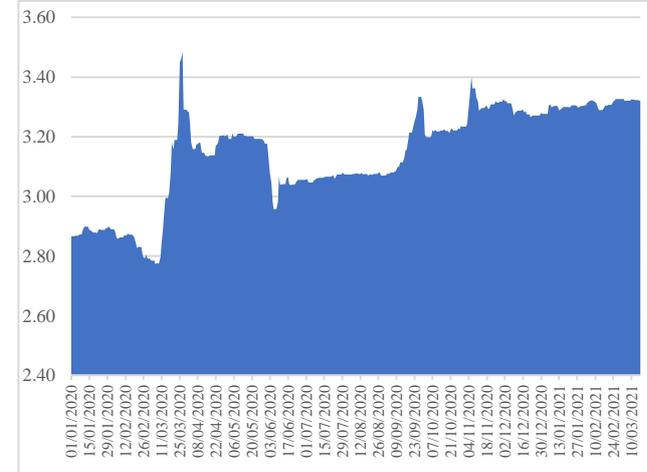
Source: Geostat

Figure 4. FDI sharply declined in 2020
(million US\$)



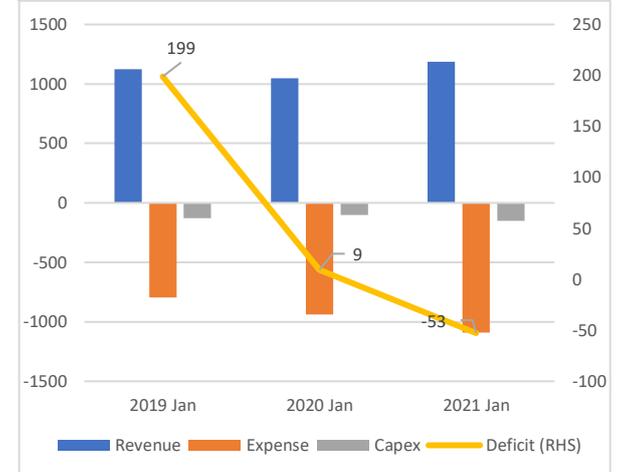
Source: NBG

Figure 5: The lari depreciated marginally in February
(GEL/US\$)



Source: NBG

Figure 6: Fiscal deficit widened further in early 2021
(GEL m)



Source: MOF