WORLD BANK GROUP
Macroeconomics, Trade & Investment

- *The economy contracted at a slower pace (7.7 percent) in June as compared to May (13.5 percent), supported by accelerated government spending, robust credit growth and higher remittances. High frequency data points to further recovery in July.*
- *Foreign trade also recovered slightly; with turnover down by 20 percent yoy in June as compared to 35 percent yoy in May.*
- *Inflation moderated from 6.1 percent in June to 5.7 percent in July. NBG reduced the policy rate by 25 basis points to 8 percent.*
- *Exchange rate remained stable in July.*
- *Credit and deposit growth accelerated in July.*
- *The fiscal deficit widened in July, with accelerated social spending and a slight moderation in revenue decline due to pick-up in economic activity.*

The economy is gradually recovering from the COVID-19 shock, with real GDP contracting by 7.7 percent year-on-year (yoy) in June as compared to 13.5 percent yoy in May. Acceleration of government social spending, robust credit growth and increased remittance inflows partially offset the impact of the remaining restrictions on mobility and economic activity and weak consumer sentiments. Nevertheless, the economy remains in contractionary territory, with decline in all sectors, except in mining, and in sewage and water supply. High-frequency indicators point to further recovery in July as remaining domestic restrictions were largely lifted; however, restrictions on external tourists remain in place and will be most strongly felt in the summer months. Mobility was stable at a relatively high 76 percent of pre-COVID levels in July, up from 46 and 19 percent in April and May, respectively. Tax collection and non-cash payments improved while business confidence strengthened. Despite the opening up, the number of new COVID-19 infections remains low.

Foreign trade turnover declined by 20 percent yoy in June improving from a 35 percent yoy decline in May. Exports contracted by 14 percent yoy in June due to a 40 percent yoy decline in re-exports. Domestic exports were up 4 percent yoy, as exports of copper ores, gold, fats and oils and walnuts registered strong growth. Imports declined by 22 percent yoy reflecting the drop in imports of used cars, machinery and equipment and the collapse in oil prices. With imports contracting more than exports, the trade balance improved. Remittances, which dropped by 42 percent yoy in April and 9 percent yoy in May, fully recovered in June, growing at 18 percent yoy. Tourist arrivals remain suspended as land borders remain closed while flights were restored to only few European destinations in early August.

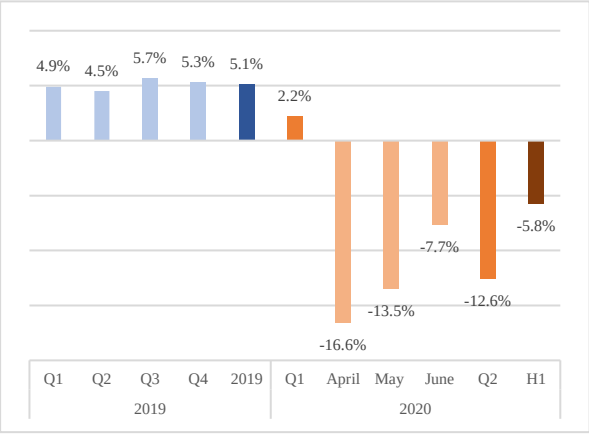
Inflation moderated from 6.1 percent in June to 5.7 percent in July. This decline was driven by the prices of transport services, which fell by 9.3 percent yoy, as the slump in global oil prices was transmitted to retail prices in Georgia. Despite declining by 1.6 percent on month-on-month (mom) basis in July, food prices remain 11.5 percent above their July 2019 level, reflecting earlier transmission of local currency depreciation. Looking ahead, the large demand shock created by COVID-19 is expected to put downward pressure on inflation. In response, the National Bank of Georgia (NBG) further lowered its policy rate in early August 2020 by 25 basis points to 8.0 percent.

The lari remained stable in July. After overshooting in the early days of the COVID-19 pandemic and losing 26 percent of its value between March 9 and 27, 2020, the lari gradually recovered to around 3 GEL/US$ in early June, or around 6 percent weaker compared to its end-2019 level. The lari has been more stable since, losing only around 2.5 percent of its value. The stability of the lari has been supported by the improving trade balance, higher remittances and interventions from the NBG, which sold US$60 million in July. Disbursements from the IMF, the World Bank and other development partners helped reserves to increase to US$3.8 billion as of mid-July from US$3.4 billion pre-COVID-19 (end-February 2020).

Credit portfolio grew robustly in July. Accelerated government social spending and liquidity support provided by the NBG helped to maintain credit growth at 16 percent yoy in July, compared to 15 percent in June. The volume of new mortgage loans recovered in June with foreign currency denominated loans almost tripling as compared to April and May. Further acceleration is expected in July due to the new government program supporting developers in the construction sector. The share of non-performing loans in total loans edged up slightly but remains low at 2.4 percent at the end of June. Deposits expanded by 18 percent yoy in July, improving from 13 percent in June. Deposit dollarization declined from 64.2 percent in June to 61.8 in July. Banking sector profits recovered strongly in June; however, the frontloading of potential losses in March continues to weigh on the profitability indicators.

The fiscal deficit continued to expand with rising social spending and a slight moderation in the pace of revenue decline. Tax revenues declined 7 percent yoy in July, as compared to 11 percent in June, reflecting the gradual recovery in economic activity. The growth in government spending accelerated to over 40 percent yoy in July as compared to 21 percent yoy in June, driven by increases in social spending and in capital spending, which was behind schedule during the period of mobility and social restrictions. The deficit rose by 1 percent of annual projected GDP in July, bringing the deficit year-to-date to 3.4 percent of GDP, as compared to the 8.5 percent of GDP target for the year. Public debt, as of end-June was up 22 percent yoy (to around US$7.7 billion or 47 percent of GDP) with domestic and external debt growing at 27 and 20 percent respectively. In early August, due to the delayed recovery, the authorities extended and relaxed the requirements on some of the anti-crisis social measures and announced new programs.

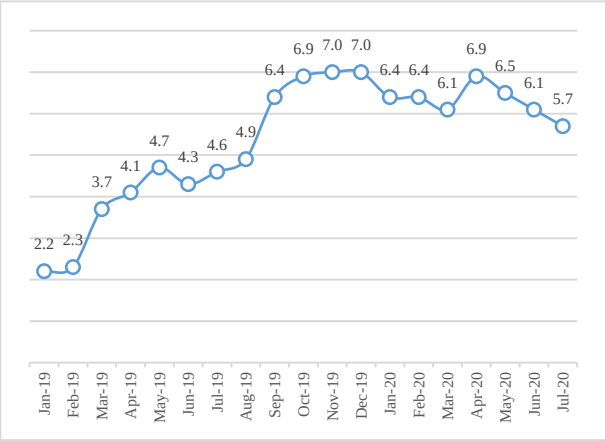
Figure 1. The economy has been contracting since March, but the pace of contraction has slowed in June
(year-on-year, in %)



Source: Geostat's

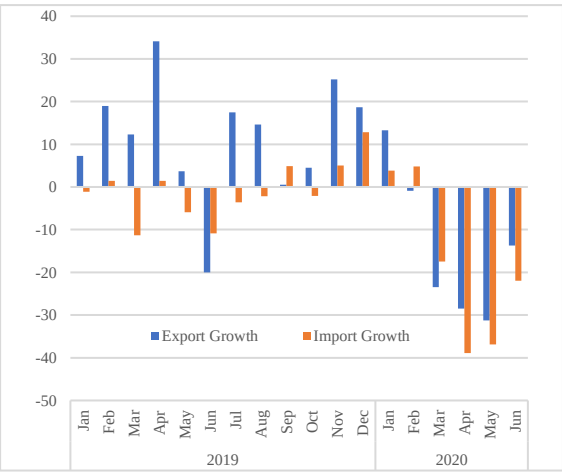
Figure 2. Inflation declined in June, amidst still weak domestic demand

(year-on-year, in %)



Source: Geostat

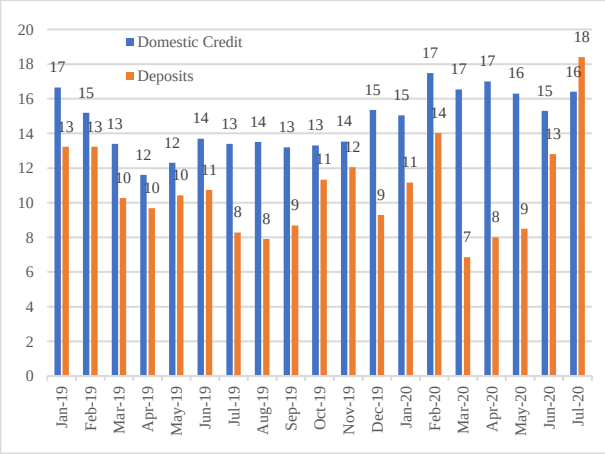
Figure 3: The pace of contraction in foreign trade slowed in June
(year-on-year, in %)



Source: Geostat

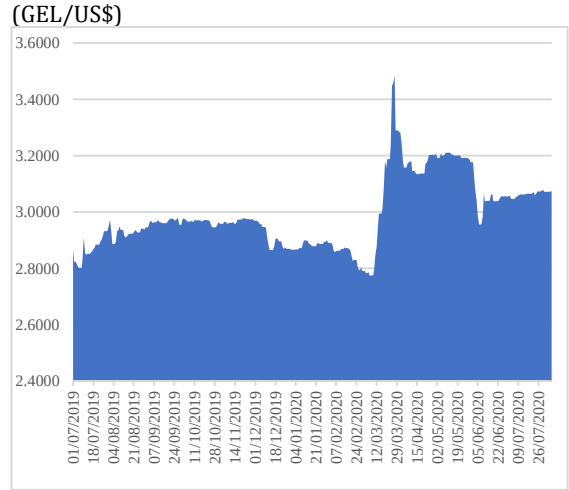
Figure 4. Credit and deposits are up in July

(year-on-year change, in %)



Source: NBG

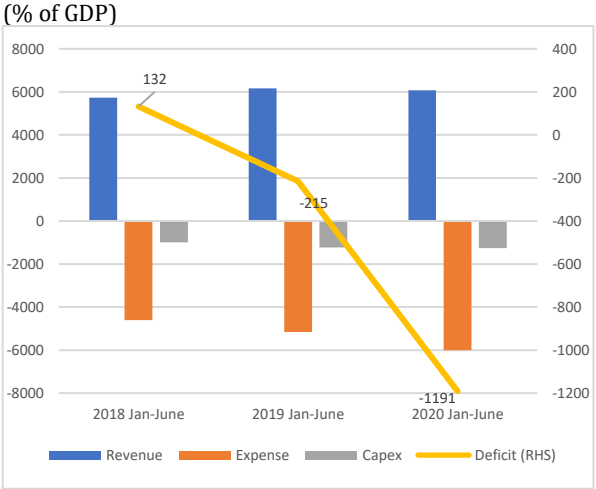
Figure 5: The lari appreciated in the second half of May and has remained stable since
(GEL/US$)



Source: NBG

Figure 6: Fiscal deficit continued to widen

(% of GDP)



Source: MOF