At a Glance

- Georgia is experiencing a recovery in 2017 on the back of stronger growth in the United States, Europe, and Russia. Exports rose by 30% in the first half of 2017.

- Remittances also recovered significantly, with a positive impact on the non-tradable sectors. Pulled by the resulting boost in domestic demand and net exports, real GDP grew by 4.9% in the first six months of the year (year-on-year [y-o-y]).

- Annual inflation increased to 5.7% by end-August, largely reflecting the effect of higher excise taxes. The National Bank of Georgia expects this effect to expire by early 2018, with inflation returning to its target by the end of that year.

- To support growth, the Government boosted capital spending by 32% and current spending by 7% in the first half of 2017. Nevertheless, the fiscal deficit narrowed as revenues overperformed, increasing by 18% y-o-y in the same period.

Country Context

Over the past decade, Georgia’s economy has grown at an average annual rate of 5%. This was in spite of numerous shocks, including the global financial crisis of 2007–08, the conflict with Russia in 2008, and the regional headwinds of 2014.

Economic growth is projected to increase to an average rate of 4.5% a year over the medium term, but downside risks to growth remain.

In 2017, the fiscal deficit is expected to remain at 4.1% of GDP due to larger investment spending, in line with the International Monetary Fund–supported program. Poverty declined from 35% in 2006 to 21% in 2015. The poverty rate is projected to decline through 2019, reaching 20.9%.

Inequality, which was higher in Georgia than in most other former Soviet states, also declined during the same period, indicating that prosperity was increasingly shared. However, although incomes have increased, the economy has not managed to expand the supply of jobs and reduce unemployment.

Georgia’s key macroeconomic vulnerabilities involve risks to external and fiscal sustainability. The pace of poverty reduction may continue to slow and eventually stall if the recent rate of private sector employment growth were to decline.
The World Bank and Georgia

The World Bank Group has been a key development partner for Georgia since 1992, supporting investment projects and the reform agenda in almost every sector. In 2014, Georgia graduated from the International Development Association (IDA) to become an International Bank for Reconstruction and Development (IBRD)-only borrower, and it has recently moved from the lower-middle-income to upper-middle-income country classification.

The overarching objective of the current Country Partnership Strategy (CPS) for FY14–17 has been to achieve faster, inclusive, and sustainable growth while seeking a greater focus on social outcomes and poverty reduction. To achieve this objective, two strategic areas of focus were outlined: (i) strengthening public service delivery to promote inclusive growth and (ii) enabling private sector–led job creation to improve competitiveness.

As the CPS draws to a close, a Systematic Country Diagnostic (SCD) is currently under way to identify the most critical constraints and opportunities facing Georgia as it works to end extreme poverty and promote shared prosperity in a sustainable manner. The SCD will underpin the next Country Partnership Framework (CPF) and help identify a solid value proposition and principles of engagement to support the country’s development challenges and reform agenda for the next four-year period.

Key Engagement

The World Bank is actively supporting the authorities of Georgia with major structural financial sector reforms aimed at fostering financial sector stability, improving access to finance for small and medium enterprises, and developing a deeper and inclusive financial system. The current engagement is aligned with the International Monetary Fund (IMF)-World Bank Financial Sector Assessment Program (FSAP) 2014 recommendations, with support delivered through several lending, advisory, and technical assistance projects. These include the Georgia Financial Advisory Project (2016–18); the Financial Sector Deepening and Inclusion Technical Assistance program (2017–19), financed by the Financial Sector Reform and Strengthening Initiative (FIRST); and the Deposit Insurance Reform project (2015–18) financed by the Government of Austria through the World Bank Financial Advisory Center (FINSAC).

The Private Sector Competitiveness Development Policy Operation has supported private and financial sector reforms, including restructuring the deposit insurance system (DIS), improving financial reporting and disclosure, increasing the soundness and solvency of the insurance market, and reforming the pension system to protect the interests of pensioners and incentivize long-term savings in Georgia.

The recent enactment of a deposit insurance law in May 2017 was a major step toward enhancing financial stability and protecting consumer interests in the case of a bank failure. The DIS law, passed by Parliament in May 2017 and enacted in June, created a simple pay-box DIS to protect individual depositors up to GEL 5,000 per depositor per bank. Banks are required to be DIS members.

The Deposit Insurance Agency (DIA) was created in July 2017 and the DIS is expected to be introduced for households beginning in January 2018, with a potential expansion of scope and coverage after 2020. The World Bank continues to assist the authorities and the DIA with reform implementation.

WORLD BANK PORTFOLIO

| No. of Projects: 14 |
| Lending: $839 Million |
| IBRD: 682 Million |
| IDA: $157 Million |
Recent Economic Developments

Georgia is experiencing an economic recovery in 2017 on the back of stronger growth in the United States, Europe, and Russia. Exports rose by 30% in the first half of 2017. Similarly, remittances recovered significantly (by 20% year-on-year [y-o-y]), with a positive impact on the non-tradable sectors. Pulled by the resulting boost in domestic demand and net exports, real GDP grew by 4.9% in the first six months of the year (y-o-y).

The recovery in exports and remittances, along with an accelerated adjustment of imports, helped to narrow the current account deficit from 13.5% of GDP in the first quarter of 2016 to 11.8% in the same period this year. Foreign direct investment (FDI) financed nearly 93% of the deficit. The external debt stock rose by 6.6% (y-o-y) by end-March 2017, driven by the higher external financing needs. However, external debt still declined in terms of GDP, standing slightly above 100% of GDP.

Fiscal policy was expansionary in the first half of 2017. To support growth, the Government boosted capital spending by 32% and current spending by 7%. Nevertheless, the fiscal deficit narrowed as revenues overperformed, increasing by 18% y-o-y in the same period. The sharp increase in excise tax rates beginning in January 2017 contributed to the solid tax collections.

The National Bank of Georgia (NBG) raised the monetary policy rate twice in six months of 2017 (by 50 basis points) to tackle rising inflation expectations. Annual inflation increased to 5.7% by end-August, largely reflecting the effect of higher excise taxes. The NBG expects this effect to expire by early 2018, with inflation returning to its target by the end of that year.

Prudent banking supervision reinforced banking sector stability. The sector has remained profitable, yielding a return on assets of 3% and a return on equity of over 20% as of end-June 2017.

Economic Outlook

Economic growth is projected to increase to an average rate of 4.5% a year over the medium term, but downside risks to growth remain. The pickup in growth in 2017 will largely be driven by high public investment and the recovery in the export markets—propped up by the uptick in global oil prices and the improving growth prospects in Georgia’s key trading partners, including Russia.

FDI inflows, which largely originate from Azerbaijan and Turkey, remain resilient. In the outer years, growth prospects are a factor in the continuously strengthening economic ties with the European Union (EU).

At the domestic level, Georgia’s growth recovery is predicated on a sustained reform program. In particular, this would entail continuing recent policies that have created favorable conditions for private investment and an enhanced business climate, productivity growth, and greater export competitiveness, as well as ensuring that a prudent macroeconomic policy framework remains well-embedded.

Fiscal sustainability is expected to strengthen through revenue-enhancing measures announced in the 2017 budget to counter the impact of the adoption of an Estonian-type tax model. The latter, which replaced the corporate income tax with a dividend tax, came into effect in January 2017 and is expected to lower tax revenues by 1.5% of GDP. To offset this loss, the Government increased the excise tax for tobacco and fuel and introduced an excise tax on cars.

The Government also committed to restraining current spending. As a result of these measures, the fiscal deficit is expected to narrow in 2017–20, though in 2017, the fiscal deficit is expected to remain at 4.1% of GDP due to larger investment spending, in line with the IMF-supported program.
Project Spotlight

Irrigation and Land Market Development Project

Given that agriculture employs over 50% of the population and contributes to roughly 25% of exports, it remains a critically important sector in Georgia.

The share of agriculture to GDP significantly declined from 25% in 1999 to about 8% in 2012, but has started to increase again in recent years.

Although Georgia has lost its position in many markets (notably Russia), there is untapped potential for the country to regain its position in domestic and export markets by raising productivity and quality. The Rural Investment Climate Assessment (World Bank, 2012), a survey of 3,000 rural households, found that 49% of households considered the lack of irrigation or drainage to be a severe or major constraint to rural investment. In addition, the majority of land ownership rights are not registered in a public registry, which limits land owners’ access to capital.

The Irrigation and Land Market Development Project, through a US$50 million IDA credit approved in 2014, addresses two priorities of the Government’s Socioeconomic Development Strategy 2020: (i) increasing the competitiveness of farmers and agricultural enterprises, which specifically refers to the importance of land market development; and (ii) improving agricultural infrastructure, which focuses on the importance of irrigation improvement.

The project contributes to these goals by rehabilitating the irrigation and drainage systems in the project areas and strengthening the capacity of water institutions to manage these systems more sustainably. These activities will contribute to increased agricultural productivity and allow diversification into higher-value crops, and thus help foster increased employment in rural areas, including in upstream and downstream agribusinesses.

The project will also contribute to strengthening the security of land tenure, which would give households greater access to capital and stimulate investment. The aim is that eventually all rural households in Georgia holding unregistered agricultural land plots (approximately 640,000 households) will similarly benefit.

The “Country Snapshot” is a bi-annual update, highlighting the country’s recent developments, economic outlook and major overview of the World Bank’s partnership with the country. You can find the latest updates at http://www.worldbank.org/georgia