- *GDP contracted by 13.5 percent yoy in May 2020 as COVID-19 induced restrictions remained in place until late May. Mobility indicators suggest some recovery in June and early July.*
- *Foreign trade continued to contract in May.*
- *CPI inflation declined in June to 6.1 percent yoy reflecting a slowing demand and stabilizing lari.*
- *Budget revenues gradually recovered while spending accelerated, resulting in a wider deficit.*
- *The stimulus package started reaching beneficiaries in June and is expected to widen the deficit further.*
- *The amended budget, with lari 3.4 billion additional financing for crisis measures was approved by Parliament in June.*

GDP declined by 13.5 percent yoy in May but high-frequency indicators point to a gradual recovery more recently. The contraction was broad-based reflecting the gradual relaxation of COVID-19-related restrictions. This brought the contraction of economic activity since the beginning of the year to 5.4 percent yoy against a projected contraction for the full year of 4.8 percent. With the outbreak being generally well contained, the authorities started to loosen restrictions and by end-June majority of activities were restored. As a result, high-frequency indicators point to gradual recovery in economic activity. Mobility reached around 76 percent of pre-COVID levels in June, compared to 46 percent in May and only 19 percent in April. On the demand side, consumption is gradually recovering as workers return to jobs, remittances pick up and government spending increases, while investment appears to continue to lag.

Foreign trade continued to contract sharply in May. Exports contracted by 30 percent yoy in May with most exports registering negative growth rates except for precious metals and gold exports. Imports declined by 34 percent yoy reflecting the collapse in oil prices and the decline in domestic demand. Remittances, which dropped by 42 percent in April, recovered considerably in May, declining by 9 percent yoy, and appear to have further recovered in June. Tourist arrivals remain suspended as the authorities decided to delay the border opening to August.

Inflation declined slightly to 6.1 percent yoy in June from 6.5 percent in May. This decline was mostly driven by the prices of food products and oil, which fell by 4.8 and 3.4 percent in June over the previous month. Despite declining on mom basis, food prices remain 13 percent above their June 2019 level. As the large demand shock is expected to put downward pressure on inflation in the upcoming months, the National Bank of Georgia (NBG) further lowered its policy rate in late-June 2020 by 25 basis points to 8.25 percent.

The lari has been stable recently. The Georgian lari depreciated sharply during the early days of COVID-19 outbreak in March, when it lost almost 25 percent of its value against the US dollar. The drop in aggregate demand, recovering remittances and official capital flows as well as limited NBGs interventions (NBG intervened on eight occasions since March 2020 for a total amount of nearly US$230 million), helped the lari recover some of its losses and stabilize at around 3.0 GEL/US$ since early June, around 6 percent weaker compared to its end-2019 level. Propped by the disbursement from the IMF and other development partners, reserves increased to US$3.8 billion as of mid-July.

Credit growth moderated but remains robust as the NBG ensures liquidity support. The new liquidity management mechanism developed by the NBG will operate until the end of 2023. In addition, NBG continues working on the "Recovery and Resolution Framework for Commercial Banks", which will become fully operational from 2021 once all secondary legal acts are adopted. Meanwhile, credit grew by 15 percent yoy in early July (excluding exchange rate effect), down from around 18 percent yoy growth pre-COVID. Deposits grew by 18 percent yoy, recovering from the drop in April. Following a sharp drop in March when banks frontloaded potential COVID-19 losses in line with NBG recommendations, the banking sector reported profits in April and May, though profits in May were down 17 percent yoy. Returns on assets and equity remain low, reflecting the frontloading of losses in March.

The impact of the crisis on tax revenues and the Government response are increasingly visible on the fiscal accounts. Revenues remained strong through March but dropped by 14 percent in April and May, as economic activity shrank, and tax exemptions and deferrals were introduced. Tax revenues recovered slightly in June in line with the pick-up in economic activity, but were still 11 percent lower on yoy basis. The growth in current spending accelerated to 12 percent yoy in May and further to 21 percent yoy in June, driven by social assistance spending. Capital spending, which was behind schedule during the period of mobility and social restrictions, also picked-up in June. This brought the deficit in June to around 0.6 percent of annual GDP, and in the first six months of 2020 to around 2 percent of GDP. The June amendment to the 2020 Budget envisages a budget deficit in excess of 8 percent of GDP, with GEL 3.4 billion in additional anti-crisis financing.

Disbursements on public debt exceeded fiscal needs, resulting in growing government deposits. Public debt increased by 15 percent as of end-May (to around US$7.8 billion or 47 percent of GDP) and is expected to have increased further recently reflecting disbursement from IFIs. As a result, government deposits in the treasury account as well as in commercial banks (by municipalities and other legal entities of public law) totaled GEL4 billion as of early July, a considerable increase against GEL2.6 billion at the beginning of the year.

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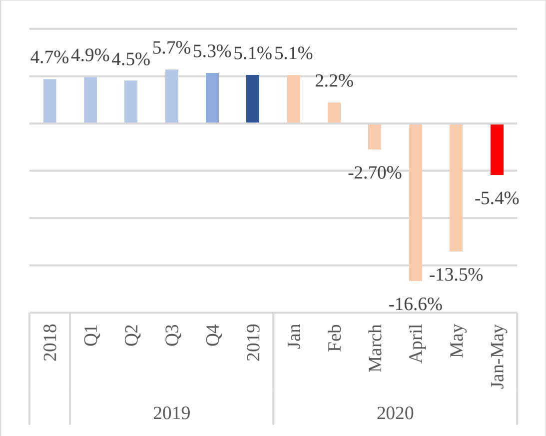
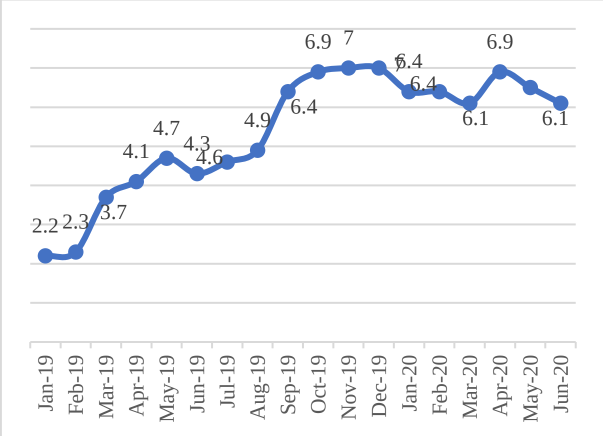
Figure 1. The economy has been contracting since March
(year-on-year, in %)



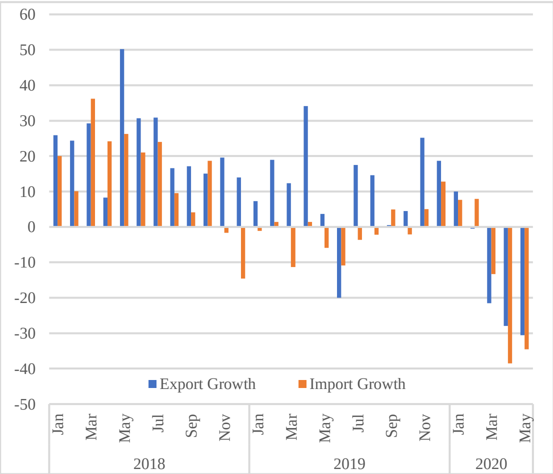
Source: Geostat's

Figure 2. Inflation declined in June
(year-on-year, in %)



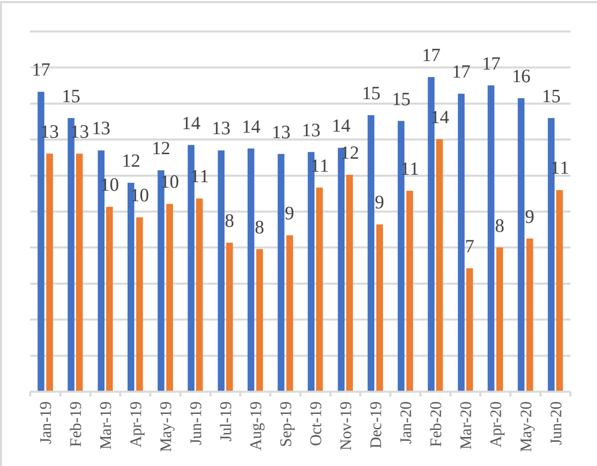
Source: Geostat

Figure 3: The contraction in foreign trade deepened further in May
(year-on-year, in %)



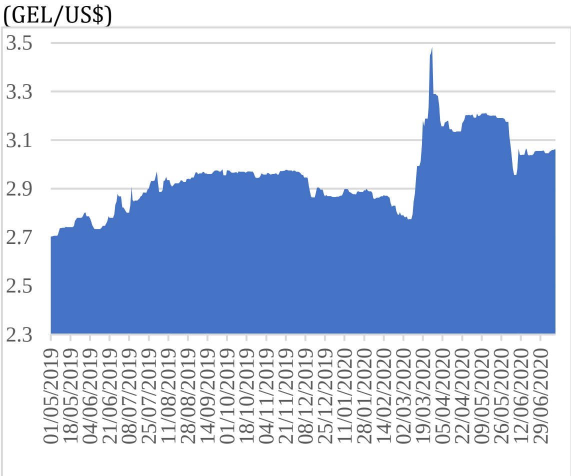
Source: Geostat

Figure 4. Credit growth show signs of decceleration while deposits are up in June
(year-on-year, in %



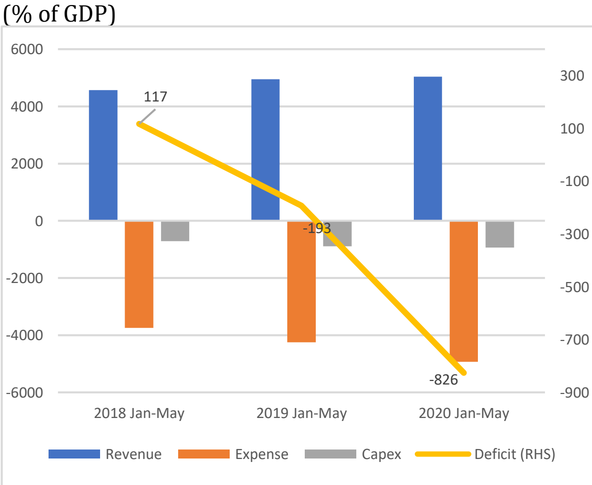
Source: NBG

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



Source: NBG

Figure 6: Fiscal deficit cotninues to widen
(% of GDP)



Source: MOF