- *The pace of contraction eased in July as COVID-19 related restrictions were loosened. Contraction has continued to slow but infections spread has accelerated.*
- *Exports recovered in August while imports faltered, helping narrow the goods trade deficit.*
- *Inflation moderated to 4.8 percent in August from 5.7 percent in July.*
- *Exchange rate remained stable in August but lost about 2 percent of its value against the USD in early September.*
- *Credit and deposit growth remained strong in August.*
- *The fiscal deficit widened in July, with accelerated social spending and a sharper decline in revenue collection.*

Economic contraction moderated to 5.5 percent yoy against 7.7 percent yoy in June. Fiscal stimulus of over GEL1 billion as of end-July, robust credit growth and recovery in remittance inflows supported domestic demand, while external demand remained weak. On the supply side, except for mining and manufacturing, all other sectors of the economy remained in contractionary territory. Construction, transport, warehousing, hotels and restaurant services continue to be hard hit. This brought the decline in economic activity in the first seven months of 2020 to 5.8 percent yoy.

High-frequency indicators point to continued recovery in August and September, but this has coincided with a sharp increase in COVID-19 infections. Mobility reached 86 percent of pre-COVID levels in early September and tax collection and electricity consumption improved. Domestic tourism picked up but tourism overall remains depressed as restrictions on foreign tourists remain in place. COVID-19 infections have risen sharply in September, prompting re-introduction of some restrictions, such as on large gatherings, as well as the postponement of the start of the school year.

Exports continued to recover in August, while imports faltered. Foreign trade turnover declined by 15.9 percent yoy in August, a considerable improvement compared to the 36 percent yoy contraction in April. Exports contracted by 7.6 percent yoy in August driven by the decline in re-exports, offset partly by a continued pick up in exports of copper ores, gold, alcohol and walnuts. Imports declined by 19 percent yoy in August reflecting the drop in imports of used cars, machinery and equipment and the weakness in global oil prices. With imports contracting more than exports, the trade deficit narrowed by 27 percent yoy in August and by 19.3 percent yoy in the first eight months of 2020.

While tourism proceeds remain depressed, other external inflows strengthened. Remittances through the banking system increased by 22 percent yoy in July and further by 26 percent in August; however, this may reflect a shift away from cash transfers rather than an increase in flows. Tourist arrivals remain limited and the number of persons crossing the borders has declined by 95 percent since March 2020. On the financing side, after dropping sharply in Q1, FDI in Q2 2020 recovered to levels from a year earlier, with major origin countries being UK, the Netherlands and Turkey. Substantial public external concessional borrowing helped Georgia maintain stable reserves.

Following a period of stability since early June, the lari depreciated by 2 percent against the US dollar in September. The renewed pressure on the lari coincides with the acceleration in the rate of spread of COVID-19 infections. The NBG sold USD 60 million in August (in 2 interventions) and USD 80 million so far in September at the foreign exchange market to smooth the volatility and prevent overshooting. Disbursements from the IMF, the World Bank and other development partners have helped reserves to increase to USD 3.9 billion as of mid-September, which provides about 6 months of goods and services import cover, from USD 3.4 billion as of end-February 2020 (3.6 months of goods and services import cover).

The stability of the lari in August as well as yoy decline in global oil prices helped to bring inflation down to 4.8 percent in August from 5.7 percent in July. However, the renewed pressure on the lari, if sustained, could reverse this. Despite declining by 1.6 percent on month-on-month (mom) basis in August, food prices remain 11.5 percent above their July 2019 level, reflecting earlier transmission of local currency depreciation. Taking into account the risks of inflation expectations associated with increased volatility in foreign exchange markets, the Monetary Policy Committee of the National Bank of Georgia (NBG), at its September meeting, decided to refrain from further reduction in the policy rate.

Credit portfolio of the banking sector grew robustly at 15.5 percent yoy in August. Growth of foreign currency loans was mostly driven by corporates, while lari-denominated loans surged driven by mortgage loans reflecting the new government program supporting developers in the construction sector. Deposits grew by 19.5 percent yoy in August, accelerating slightly from 18 percent in July. The banking sector posted profits in recent months, though profitability indicators remain impacted by the March 2020 requirement from NBG for preemptive provisioning of potential COVID-19 losses. The share of non-performing loans (NPL) at 2.3 percent remains low, though some sectors, such as construction, appear to be more affected.

The fiscal deficit continued to increase as spending under fiscal stimulus programs accelerated. The growth in government spending accelerated to 27 percent yoy in July as compared to 17 percent yoy in June, driven by increases in social and capital spending. Tax collections also declined by 19 percent yoy in July, or by 3 percent ytd as of end-July. As a result, the deficit in July increased by 1.2 percent of annual projected GDP, bringing the deficit in the first seven months of 2020 to 3.6 percent of GDP. Under current trends, the authorities should be able to meet the 8.5 percent of GDP deficit target for the year. Public debt, as of end-July was up 29 percent yoy, reaching 50 percent of GDP (compared to 40 percent pre-COVID).

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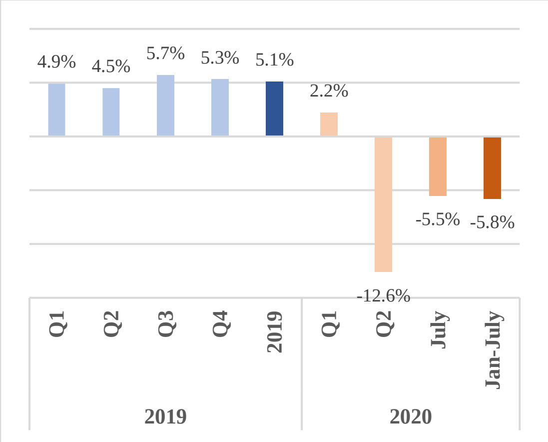
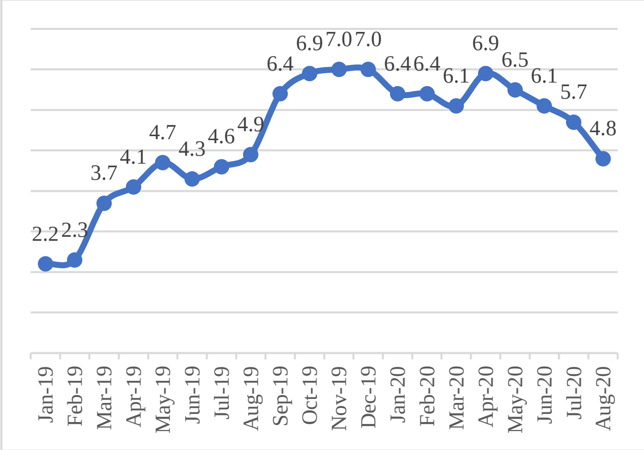
Figure 1. The pace of economic contraction continued to ease in July
(year-on-year, in %)



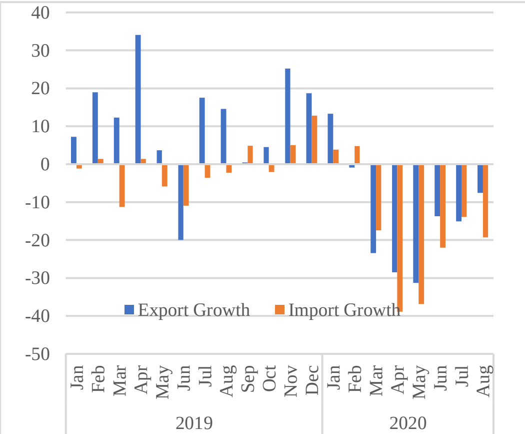
Source: Geostat's

Figure 2. Inflation declined in August amidst still weak domestic demand and stable lari
(year-on-year, in %)



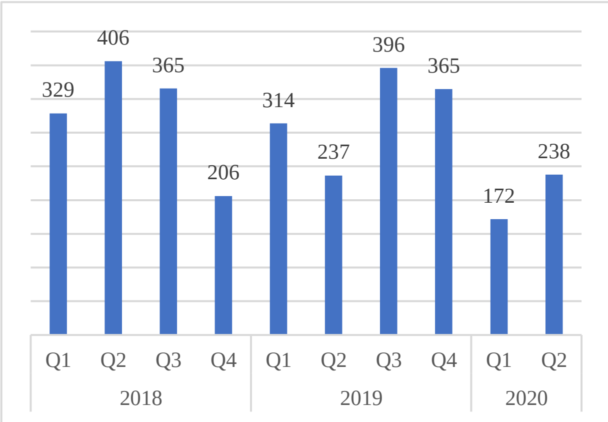
Source: Geostat

Figure 3: Exports recovered while imports faltered in August
(year-on-year, in %)



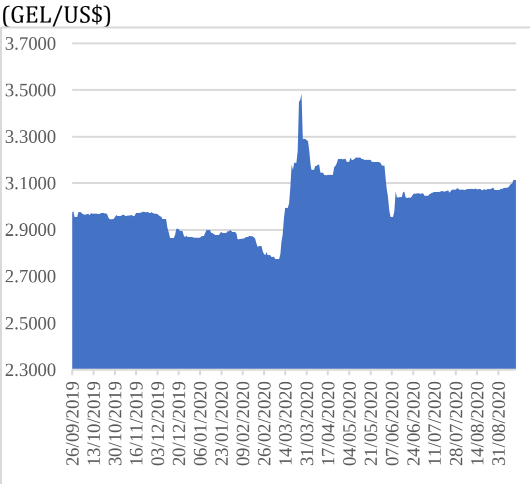
Source: Geostat

Figure 4. FDI recovered slightly in the second quarter
(Million US$)



Source: Geostat

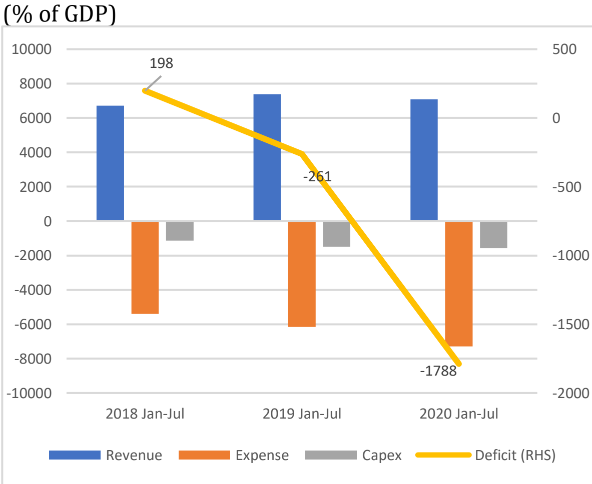
Figure 5: The lari came under slight pressure in September
(GEL/US$)



Source: NBG

Figure 6: The fiscal deficit continued to widen

(% of GDP)



Source: MOF