GEORGIA

Highlights

- **Growth in Georgia in 2016 is improving.** Growth in the first half of 2016 reached 2.9 per cent and it is expected to exceed 3.0 per cent for the full year, compared with 2.8 per cent in 2015. While the external environment remains challenging, the country is enjoying a strong tourism season and increased investor confidence, supported by the business-friendly policies of the government and the National Bank of Georgia (NBG).
- **Progress is being made on the EU Deep and Comprehensive Free Trade Area (DCFTA) commitments.** Over the last two years, Georgia resolved the liberalisation of trade and trade-related issues by introducing necessary amendments to food safety, veterinary and customs legislation, and has also met the benchmarks set out in the visa liberalisation action plan.
- **Parliament passed a bill on corporate income tax reform in April 2016, known as the "Estonian model", to support investment.** According to the bill, corporate income tax will only apply to distributed profit; undistributed profits, reinvested or retained, will not be subject to income taxation.

Key priorities for 2017

- **Private sector competitiveness needs to be strengthened** through innovation, enhanced value added and convergence with DCFTA standards and obligations. While Georgia's investment climate is favourable, much of the economy is dominated by low-value industries and the country is below its innovation potential.
- **Inter-regional connectivity needs to be enhanced.** Key priorities include the establishment of adequate capacity and a legislative framework for more public-private partnership (PPP) projects, and the development of transport, energy and logistics infrastructure to strengthen the country's strategic position as a transit link between Europe and Turkey on the one side, and Central Asia and China on the other, as well as facilitating north-south links.
- **Support for renewable energy, resource efficiency and climate change adaptation should be stepped up.** Resource efficiency needs to be improved across sectors, through enhancing the institutional framework and improving the capacity of the public and private sector for resource efficiency projects. Implementation of the commitments under the COP 21 agreement, including mainstreaming climate change mitigation measures in key sectors, should be a priority.

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Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	6.4	3.4	4.6	2.8	3.4
Inflation (average)	-0.9	-0.5	3.1	4.0	3.5
Government balance/GDP	-2.8	-2.6	-3.2	-3.8	-3.0
Current account balance/GDP	-11.7	-5.8	-10.6	-11.8	-12.1
Net FDI/GDP [neg. sign = inflows]	-5.8	-5.9	-10.6	-9.6	-9.0
External debt/GDP	83.8	82.3	83.2	107.3	n.a.
Gross reserves/GDP	18.1	17.5	16.3	18.0	n.a.
Credit to private sector/GDP	32.0	37.7	42.8	48.0	n.a.

Macroeconomic performance

Economic growth slowed to 2.8 per cent in 2015, after reaching 4.6 per cent in 2014. The slow-down in 2015 reflected mainly a deteriorating external environment, with remittances and exports negatively affected by the recession in Russia and a sharp slow-down among regional trading partners (such as Azerbaijan and Ukraine). Domestic political uncertainty also affected consumer and business confidence, as well as growth. External trade turnover shrank by 13 per cent, with exports down by 23 per cent and imports down by 10 per cent; remittances inflows dropped by 25 per cent in 2015 year-on-year, due to sharply declining money transfers from Russia and Greece. Foreign direct investment (FDI) was also negatively affected, declining by 23 per cent in 2015 year-on-year. GDP growth reached 2.9 per cent in the first half of 2016 driven by strong performance in construction, hotels and restaurants and mining and quarrying sectors, as well as supported by an increase in tourism revenues, with tourist arrivals reaching 2.2 million persons – up by 19.8 per cent in January to September 2016 year-on-year.

The Georgian lari depreciated significantly over 2015, but has been stable since March 2016. As a result of the challenging external environment, the lari depreciated by 21.4 per cent over 2015. In response to currency and inflationary pressures, the NBG gradually raised the monetary policy rate from 4 per cent in 2014 to 8 per cent by the end of 2015. However, the situation has been stabilising since March 2016, with decreasing inflation expectations and strengthening of the currency. The monetary policy rate was reduced to 6.5 per cent in September 2016. The NBG's interventions in the currency market to support the lari were relatively modest and international reserves cover around three months of imports. The NBG started purchases of foreign currency in March 2016, leading to a rebound in reserves (up by 16.7 per cent in July 2016 year-on-year), however, in August to October it sold around US$ 180 million to support the currency. Annual inflation eased to 0.9 per cent in August 2016, down from 5.6 per cent in February year-on-year.

The banking sector remains resilient, well capitalised and with a low level of non-performing loans (3.7 per cent in June 2016), but risks are increasing as the lari depreciation is having an effect on the asset quality of banks, particularly clients who have borrowed in foreign currency. Dollarisation in the banking sector stood at 64.2 per cent on the loan side and 66.6 per cent on the deposit side as of the end of August 2016.

Fiscal and external balances remain under pressure. The budget deficit reached around 3.8 per cent in 2015 and is planned to reach 3.0 per cent in 2016. The government is maintaining a fiscal stimulus, backed by lending from international financial institutions (budget support and infrastructure financing). This has pushed up the public debt-to-GDP ratio to around 41.5 per cent in 2015, compared with 35.7 per cent in 2014, with a significant part of the increase attributed to exchange rate depreciation. The current account deficit reached 11.8 per cent of GDP in 2015, and total external debt was 86.0 per cent (or 107.0 per cent including intercompany lending), putting further pressure on the currency and making the country more vulnerable to domestic and external shocks.

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In 2016, growth is expected to improve to 3.4 per cent, compared with 2.8 per cent in 2015. While the external environment remains challenging, the country is enjoying a strong tourism season – benefiting from security concerns in rival tourism destinations – and increased investor confidence, which is supported by the business-friendly policies of the government and the central bank. In 2017, growth is projected to increase to 3.9 per cent, supported by the progressive benefits of DCFTA implementation and improved competitiveness, as well as strong domestic and FDI in infrastructure and other sectors. However, downside risks remain, as Georgia's large current account deficit and high levels of external debt expose it to external shocks.

Major structural reform developments

Georgia has progressed on its commitments under the DCFTA. The agreement is a key anchor for further reforms, improvements in standards and competitiveness. Implementation of DCFTA commitments is gradually bringing the country's legislation closer to that of the European Union in areas such as: rules for export of agricultural goods, food safety, sanitary requirements, management of customs including enforcement of property rights at the border, rules on public procurement, and so on. In the past year, Georgia made progress in the liberalisation of trade and trade-related issues by introducing necessary amendments in food safety, veterinary and customs legislation. Georgia has also met the benchmarks set out in the visa liberalisation action plan. However, hopes for finalising the visa liberalisation process in summer 2016 have been delayed until the end of the year. In 2015, Georgia's trade turnover with the European Union increased to US$ 3.2 billion (or 32 per cent of total trade turnover) compared with US$ 3.0 billion (26 per cent) in 2014. The gradual approximation to EU rules is expected to further improve the investment climate and provide more stable and predictable governance rules, especially for small and medium-sized enterprises (SMEs), and increase their competitiveness on export markets, including beyond the European Union.

Electricity tariffs have been increased. From August to September 2015, the tariffs were raised from 4.0 to 7.5 US cents to 5.75 to 9.00 US cents depending on the electricity consumption level – for more than one million customers in the regions of Georgia and for customers in the capital city, Tbilisi. The government is subsidising the rate hike in the regions by providing Lari 20 million (around US$ 8.9 million) for socially vulnerable households; the same subsidy scheme is applied to Tbilisi customers.

The parliament passed a bill on corporate income tax reform in April 2016, known as the "Estonian model", to support investment. According to the bill, corporate income tax (currently 15 per cent in most cases) will only apply to distributed profit; undistributed profits, reinvested or retained, will not be subject to income taxation as of January 2017. Banks, insurance companies, microfinance institutions and pawnbroking businesses will benefit from the rule from 2019. The introduction of this model may bring benefits in terms of improving the investment attractiveness of Georgia and, more generally, increased competitiveness and growth. However, this change also carries risks, including a potentially larger than expected drop in the government's tax income which may put pressure on the government's finances and widen the fiscal deficit unless fully offset with compensating measures.

The first Georgian non-financial sector company has been listed on the London Stock Exchange. Georgia Healthcare Group (GHG), a healthcare subsidiary of Bank of Georgia Holdings PLC, announced the successful pricing of its initial public offering (IPO) on 9 November 2015. The transaction is a significant milestone for the country as GHG is the first non-financial sector Georgian company to be listed on the London Stock Exchange (LSE). The offering comprised 38,681,820 shares, equating to an offering size of approximately 29 per cent of GHG's share capital on admission. Also, ordinary shares of TBC Bank Group have been admitted to the premium listing segment of the Official List of the UK Listing Authority and to trading on LSE's main market. With this, the bank becomes the third Georgian company to secure a premium listing on the LSE, following the Bank of Georgia and GHG.