Georgia
Rating Report

SCOPE **BB** STABLE OUTLOOK

Credit strengths

- Solid medium-run growth profile
- Strong debt structure
- Strengthened macroeconomic policy framework and record of constructive engagement with multilateral partners

Credit challenges

- Elevated vulnerability to external shock(s) and reliance upon external financing
- High dollarisation in the economy
- Heightened geopolitical risk and risk from domestic political instability

Rating rationale:

Strong growth outlook: After suffering from sharp 2020 decline in output during the Covid-19 crisis, the Georgian economy has since recovered robustly. The economy benefits from strong medium-run growth potential, driven by recovery in tourism receipts and investment. Foreign direct investment (FDI) is expected to edge back to pre-crisis levels and support economic rebound.

Improved fiscal and macroeconomic policy frameworks: Georgia has established a strong track record of engagement with multilateral partners (such as the IMF and the European Union), which have anchored a constructive reform agenda during a decade leading up to the pandemic crisis. We expect the government to remain committed to prudent policy making and fiscal discipline over the medium run.

Debt profile: Georgian public debt is largely owed to official-sector creditors, on concessional terms. This allows the government to benefit from comparatively long debt maturities, modest interest costs as well as reduced refinancing risk.

Rating challenges include: i) vulnerability to external shock due to the small size of the economy (nominal GDP of USD 19.7bn in 2022) alongside high reliance on external funding; ii) financial stability risks as associated with elevated dollarisation of the economy; and iii) heightened geopolitical risk after Russian escalation of conflict in eastern Europe alongside risk from domestic political instability.

Georgia's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	b		+1/3	BB
Public Finance Risk		25%	bbb+		0	
External Economic Risk		10%	c		-2/3	
Financial Stability Risk		10%	a+		0	
ESG Risk	Environmental Risk	5%	aa		0	
	Social Risk	5%	bbb+		0	
	Governance Risk	10%	bb-		0	
Overall outcome		**bb**		**0**	**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- Implementation of reforms enhances structural features of the economy
- Improvement of fiscal sustainability
- Reduction in external sector risk

Negative rating-change drivers

- Worsening of medium-run debt trajectory
- Deterioration in institutional quality; escalation of geopolitical risk
- Increase in external vulnerabilities

Ratings and Outlook

Foreign currency

Long-term issuer rating	BB/Stable
Senior unsecured debt	BB/Stable
Short-term issuer rating	S-3/Stable

Local currency

Long-term issuer rating	BB/Stable
Senior unsecured debt	BB/Stable
Short-term issuer rating	S-3/Stable

Lead Analyst

Dennis Shen
+49 30 221823948
d.shen@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

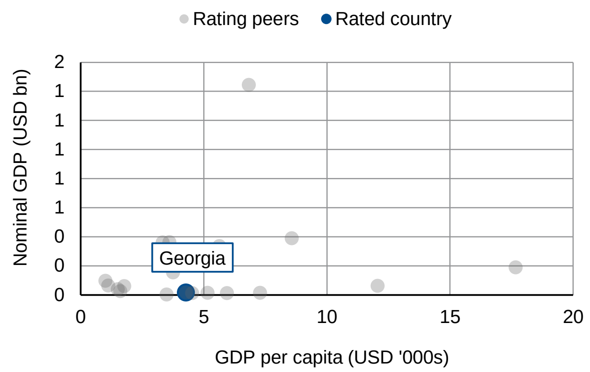
Domestic Economic Risks

- **Growth outlook:** Georgia entered the Covid-19 crisis after a period of strong economic growth, the latter averaging 4.4% a year over 2016-19. The Covid-19 pandemic caused a 6.1% dip of output in 2020. Economic activity recovered back above pre-pandemic levels by Q2 2021. Real growth was an estimated 10.6% in 2021. Georgia's medium-run growth outlook is robust, underpinned by capacity to draw in FDI. Looking ahead, we expect the Georgian economy to grow 5.5% this year, before converging back on growth potential, which we estimate of circa 5% a year, by 2023. The government has implemented a series of key reforms, such as modernisation of the country pension saving system and of VAT collection, which have enhanced business conditions. The reform agenda is advanced by the EU-Georgia Association Agreement, which, alongside other international agreements, furthermore embed annual bilateral financial assistance. Georgia is preparing to formally apply for EU membership by 2024 – although the prospect with respect to such EU accession remains unclear at this stage.
- **Inflation and monetary policy:** Inflation has accelerated. Headline inflation amounted to 13.9% YoY in January 2022, driven by base effects of a 2020 subsidy on utility bills as well as globally increasing prices of food, oil and shipping. Core inflation has decelerated, from 6.7% YoY in August 2021 to 5.6% by January 2022. Looking ahead, the National Bank of Georgia (NBG) expects inflation to moderate to 7.3% on average over 2022, once impact of exogenous, temporary supply shocks ease. However, we see upside risk to current inflation projections as oil prices spike and inflationary pressures endure for longer. The NBG has raised its policy rate 250bps since March 2021 to 10.5% by December. The lari depreciated over the crisis by circa 17% by April 2021 as compared with end-2019 levels. However, lari has recovered 10% since 2021 lows, even accounting for the sell-off in February due to Russian conflict in Ukraine.
- **Labour market:** Pre-crisis unemployment was elevated, albeit moderating to 16.6% by end-2019. Unemployment rose during the Covid-19 crisis, peaking at 22.1% in Q2 2021 and averaging 20.6% over year 2021. We see unemployment declining to 17.8% in 2022 before 17% in 2023. Informality in the Georgian labour market is high, of circa 31% of the employed during 2020, although declining from 51% in 2019 after recent changes of labour legislation and an elevated number of workers registering during this crisis for state compensation.

Overview of Scope's qualitative assessments for Georgia's *Domestic Economic Risks*

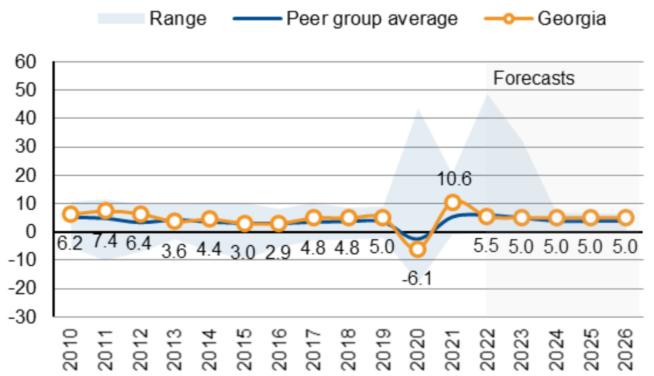
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Growth potential of the economy	Strong	+1/3	Sturdy medium-term growth potential of circa 5% annually
	Monetary policy framework	Neutral	0	Strengthened monetary policy framework, pre-pandemic track record of managed inflation, adequate monetary-policy response to higher inflation, but policy flexibility reduced by dollarisation
	Macro-economic stability and sustainability	Neutral	0	Strong FDI and domestic investment, but limited diversification, small, open economy, low domestic savings, high unemployment, and labour-force concentration in low-productivity sectors

Nominal GDP and GDP per capita, USD '000s



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

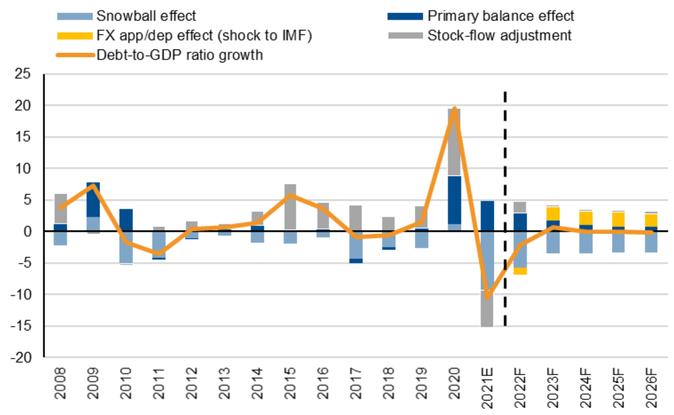
Public Finance Risks

- **Fiscal outlook:** The Covid-19 crisis came on heels of a period of modest budget deficits (of 1.2% of GDP on average over 2015-19). The headline budget balance deteriorated to -9.2% of GDP in 2020. Above-the-line budgetary measures taken during the pandemic aggregated to 14.2% of GDP by October 2021. The headline deficit is expected to have eased to circa 6.3% of GDP in 2021, thanks to gradual withdrawal of emergency measures as well as recovery in tax revenue. Looking ahead, we expect Georgia's budget deficit to moderate further to 4.1% of GDP in 2022, before nearing around 3% by 2023. Our assessment is underpinned by a record of collaboration with the IMF and commitment to pursuing growth-oriented, business-friendly reform and prudent policy making. Long-run challenges to the budgetary outlook stem from an elevated weight of the informal economy, constraining government revenue (of 25.7% of GDP in 2021). An escape clause triggered in 2020 has allowed for temporary fiscal deviations from national fiscal rules, with said rules scheduled to become binding once more in 2023.
- **Debt trajectory:** The government debt-to-GDP ratio increased nearly 20pp from 40.4% in 2019 to 60% in 2020. We estimate debt to have decreased to 49.6% of GDP by end-2021, supported by economic rebound and improvement in the budget balance. We expect the debt ratio to edge sideways over coming years, concluding a forecast horizon around 48% of GDP in 2026, supported by strong nominal growth and expected commitment to fiscal prudence although weakened by high FX-denominated debt and expectation of future lari depreciation.
- **Market access:** Government gross financing requirements are moderate, of circa 9.5% of GDP in 2022 before averaging 6.8% over 2023-26. Nearly three-quarters of government debt is on concessional terms, partially mitigating risk from a high share (around 80%) being denominated in foreign currency. The high share of official-sector loans outstanding as well allows for lowered cost of debt (average interest rate of outstanding debt of 2.4% in 2022 with net interest payments of a low 1.2% of GDP) as well as longer average maturities (7.5 years). Georgia issued a five-year USD 500mn Eurobond with a 2.75% coupon in April 2021. Five-year lari yields are presently circa 9.7% – having risen around 150bps over the past 12 months.

Overview of Scope's qualitative assessments for Georgia's *Public Finance Risks*

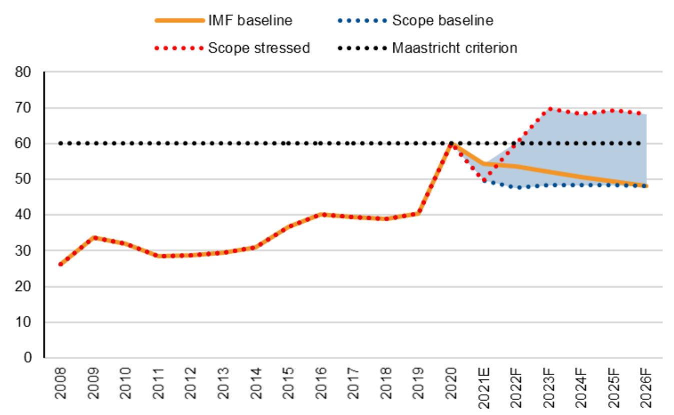
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Fiscal policy framework	Neutral	0	Track record of pre-pandemic contained fiscal deficits and fiscal prudence underpinned by successful engagement with the IMF, expectation of moderating deficits moving ahead
	Debt sustainability	Neutral	0	Expected stabilisation in debt levels over medium run, but debt trajectory exposed to significant exchange-rate risk
	Debt profile and market access	Neutral	0	More than two-thirds of debt owed to official donors on concessional terms; track record of sound access to donor financing

Contributions to changes in debt levels, pps of GDP



Source: IMF, Scope Ratings GmbH forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF, Scope Ratings GmbH forecasts

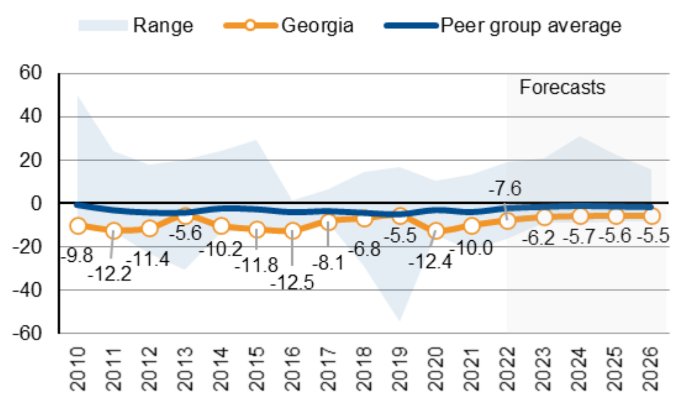
External Economic Risks

- **Current account:** Georgia experiences wide, structural current-account deficits, although deficits improved during a run-up to the crisis (12.5% of GDP in 2016 to 5.5% in 2019), due to lesser goods deficits and stronger services surpluses. Freeze of international travel caused the current-account balance to reverse to -12.4% of GDP in 2020. Tourism exports have gradually recovered to 9.7% of GDP as of 2021 Q3, above 2020 Q2 lows of 7.5% but still well under pre-crisis peaks (of 14%). This allowed the current account to improve somewhat, to -10.6% of GDP in the year to Q3 2021. Looking ahead, we expect this improving trend to continue, supported by strong remittances inflows (12.7% YoY in January) and export growth outpacing that of imports.
- **External position:** Recurrent current-account deficits have resulted in an elevated negative external liability position (net international investment position of circa -146% of GDP as of Q3 2021). Its composition is stable, with more than half of liabilities being under the form of direct investment (51%) with only a small share in portfolio investment (8%). Gross external debt stood at circa 120% of GDP as of 2021 Q3, about 13pps above pre-crisis levels, mainly due to rises of government external borrowing.
- **Resilience to shocks:** Georgia's small, open economy is vulnerable to external shocks and reliant on external financing. High dollarisation and an elevated share of foreign-currency-denominated public debt represent risks during periods of lari volatility. Risks are partially offset via an enhanced stock of official reserves, of USD 4.1bn in January 2022, having increased since March 2020 and standing near record highs. Georgia's improved external-sector performance supported slight improvement in its ranking under Scope's 2021 external vulnerabilities report to 92nd of 95 countries on aggregate.

Overview of Scope's qualitative assessments for Georgia's *External Economic Risks*

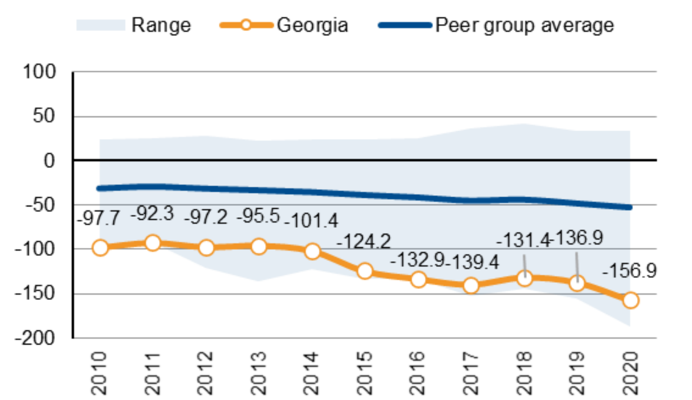
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
c	Current account resilience	Weak	-1/3	Wide structural current-account deficits, high reliance on tourism revenue and remittances inflows, but significant FDI inflow
	External debt structure	Neutral	0	Large net international liability position mitigated by a sound record of concessional donor financing
	Resilience to short-term shocks	Weak	-1/3	Dollarisation, significant external financing requirements and elevated exchange rate volatility weigh on external-sector resilience

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

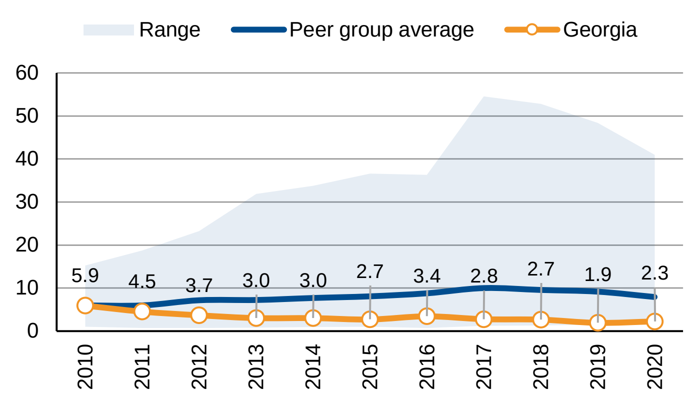
Financial Stability Risks

- **Banking sector:** The banking sector weathered the pandemic crisis comparatively well, in part due to liquidity support from NBG. The tier 1 capital ratio improved over 2021, to 15.6% of risk-weighted assets by Q4, above a pre-crisis level (14.6%) and after a decline during early 2020 (to lows of 11.8% during Q1 2020). Liquidity is sufficient (a liquidity coverage ratio of 126% as of November 2021). The non-performing loan (NPL) ratio (NBG definition) has moderated in parallel with the economic rebound, reaching 5.6% in November 2021, from 8.4% on average in 2020. Provisioning for outstanding NPLs has improved. Profitability, as measured via the return on equity, has recovered, averaging above 20% over the year to November 2021, from 1.8% in 2020.
- **Private debt:** Credit growth accelerated during the pandemic crisis and has remained robust over 2021, despite measures of monetary tightening, standing at 12.7% YoY in January 2022, mainly driven by local-currency lending (24.2% YoY). Household indebtedness is moderate, having increased to 40.2% of GDP as of Q2 2021, from 34.2% in 2019, while the debt-service-to-income ratio declined to 11.6%, from 12.1%.
- **Financial imbalances:** Dollarisation has, importantly, decreased moderately, with 50.6% of loans and 59.2% of deposits denominated in foreign currency as of November 2021, from 57.2% and 63.3% pre-crisis. The high level of dollarisation constitutes a significant vulnerability with respect to financial stability, all the more under a context of acceleration of inflation.

Overview of Scope's qualitative assessments for Georgia's *Financial Stability Risks*

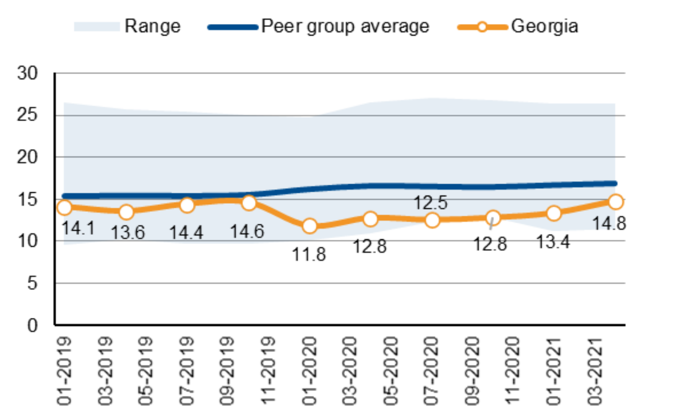
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Neutral	0	Adequate liquidity and capitalisation of the banking system with improvements in asset quality and profitability
	Banking sector oversight	Neutral	0	Strengthened financial supervision and regulatory framework including via application of IMF Financial Sector Assessment Program guidance
	Financial imbalances	Neutral	0	Elevated dollarisation with more than half of banking-system loans and deposits in foreign currency – although dollarisation levels have declined moderately

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

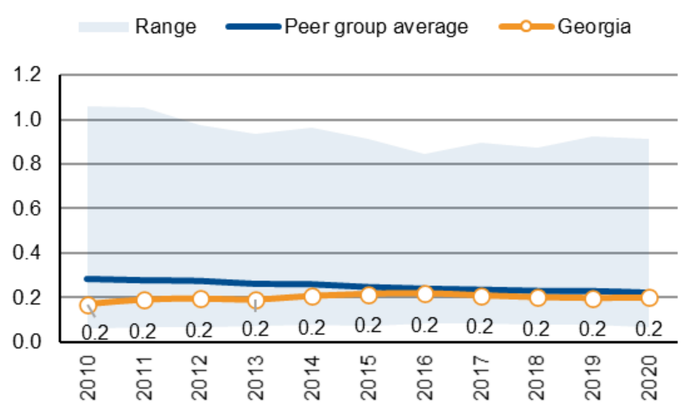
ESG Risks

- **Environment:** Georgia is exposed to substantive environmental risk, associated with elevated air pollution in main cities, illegal logging as well as cattle grazing within protected areas. This is partially mitigated via coordinated policy countermeasures such as reductions in air pollution and carbon emissions and the setting up of legislation and enforcement around waste management. CO_2 emissions intensity is moderate, due to a low usage of coal and a high share of hydropower under the aggregate energy mix (the latter accounting for above 80% of domestic electricity generation). However, the Georgian energy supply is largely imported, with natural gas and oil products making up more than two-third of energy supplies.
- **Social:** High structural unemployment and a weak social safety net represent significant longer-run challenges. After a phase of gradual improvement, the poverty rate rose to 21.3% in 2020, the first such increase since year 2016. Net emigration has resulted in the working-age population declining circa 0.8% a year over a past decade (furthermore anticipated to drop circa 0.7% a year over 2022-26), weighing on the longer-run economic outlook.
- **Governance:** Georgian governance indicators have bettered steadily over this past decade, although substantial risk remains, associated with geopolitical tensions with Russia as well as with domestic political instability. Polarisation has stayed elevated between the ruling Georgian Dream party and largest opposition group United National Movement during aftermath of a severe political crisis that followed 2020 parliamentary elections. Increased political instability could hinder a reform agenda. In the aftermath of Russia's further incursion into Ukraine, Georgia faces geopolitical risk surrounding possibility of future Russian escalation of conflict – especially surrounding separatist territories of South Ossetia and Abkhazia.

Overview of Scope's qualitative assessments for Georgia's *ESG Risks*

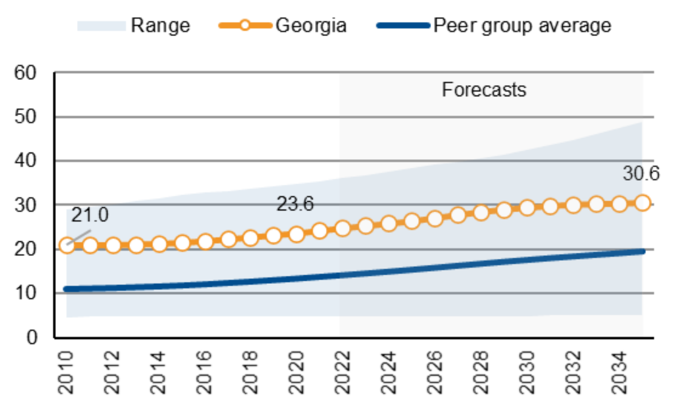
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Environmental risks	Neutral	0	Substantive environmental risk such as with relation to air pollution, but mitigated by coordinated policy countermeasures
	Social risks	Neutral	0	High, although gradually declining, rates of poverty, skills mismatches, adverse demographics, high unemployment
	Institutional and political risks	Neutral	0	Track record of significant improvement in governance as well as in quality and effectiveness of public administration, but domestic political instability as well as elevated geopolitical risk after Russian escalation of conflict in eastern Europe

CO_2 emissions per GDP, $mtCO_2e$



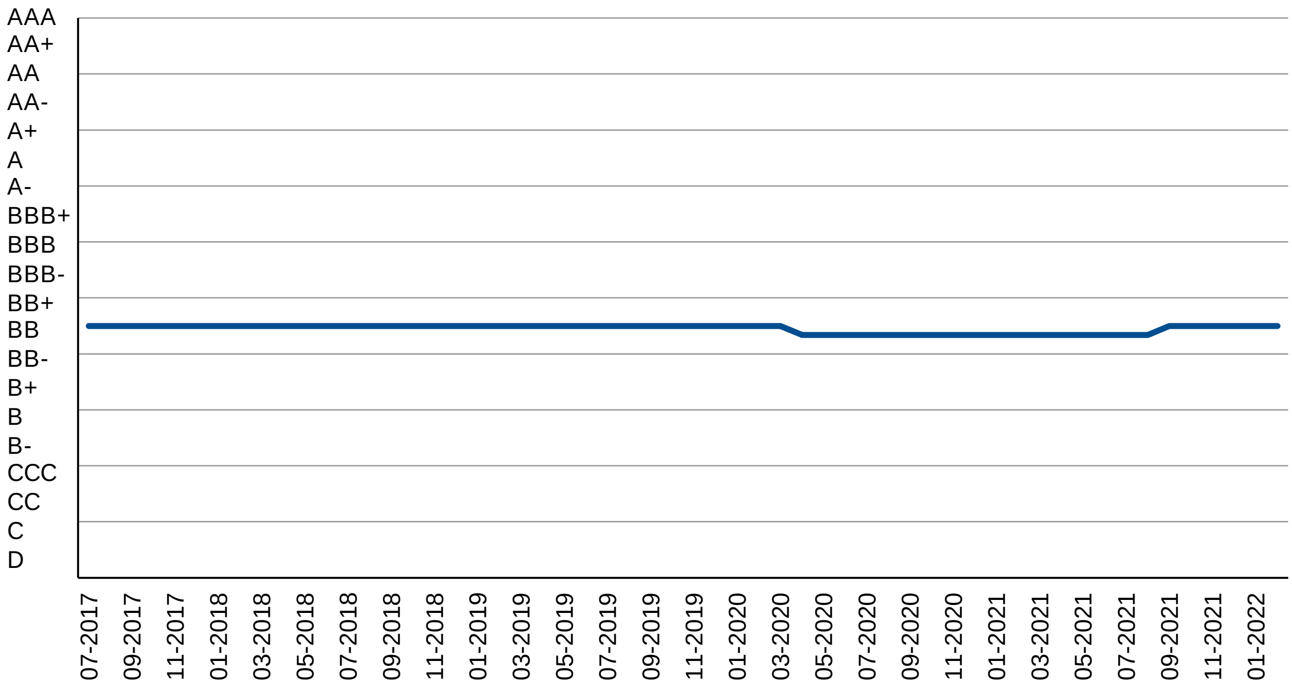
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard after the reserve-currency adjustment.

Peer group
Egypt
Greece
Ukraine

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	4.1	4.4	4.7	4.7	4.3	4.8	5.3	5.8
Nominal GDP, USD bn	15.1	16.2	17.6	17.5	15.9	17.8	19.7	21.6
Real growth, %[1]	2.9	4.8	4.8	5.0	-6.1	10.6	5.5	5.0
CPI inflation, %[1]	2.1	6.0	2.6	4.9	5.2	9.3	9.3	4.5
Unemployment rate, %[1]	21.7	21.6	19.2	17.6	18.5	20.6	17.8	17.0
Public Finance Risk								
Public debt, % of GDP[1]	40.3	39.4	38.9	40.4	60.0	49.6	47.5	48.3
Interest payment, % of government revenue	4.2	4.4	4.4	4.6	6.2	5.9	5.0	5.3
Primary balance, % of GDP[1]	-0.4	0.7	0.4	-0.6	-7.7	-4.9	-2.9	-1.8
External Economic Risk								
Current account balance, % of GDP	-12.5	-8.1	-6.8	-5.5	-12.4	-10.0	-7.6	-6.2
Total reserves, months of imports	3.3	3.2	3.1	3.2	4.4	-	-	-
NIIP, % of GDP	-132.9	-139.4	-131.4	-136.9	-156.9	-	-	-
Financial Stability Risk								
NPL ratio, % of total loans	3.4	2.8	2.7	1.9	2.3	-	-	-
Tier 1 ratio, % of risk-weighted assets	9.9	11.6	13.5	14.6	12.8	15.6	-	-
Credit to private sector, % of GDP	58.7	58.1	62.6	67.7	79.9	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	219.5	209.4	200.8	197.3	199.6	-	-	-
Income quintile share ratio (S80/S20), x	6.5	7.1	6.6	6.3	-	-	-	-
Labour-force participation rate, %	74.3	72.7	70.3	69.4	-	-	-	-
Old-age dependency ratio, %	21.9	22.3	22.8	23.2	23.6	24.2	24.8	25.3
Composite governance indicator[2]	0.4	0.4	0.4	0.4	0.4	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Middle-Income Economies
5y USD CDS spread (bps)	n/a

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 8295 8254

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer