08 June 2018

Public Finance

# Republic of Georgia Rating Report

STABLE OUTLOOK

BB

## Credit strengths

- Sustained economic performance
- Commitment to structural reform
- Fiscal consolidation

## Credit weaknesses

- Reliance on external financing
- Low per-capita income
- Elevated dollarization level

**Rating rationale and Outlook:** Georgia's BB rating reflects improving economic resilience underscored by structural reform measures, including strengthening institutional framework and business environment, the commitment to the Association Agreement with EU, and fiscal consolidation anchored around the EFF's arrangement to create room for capital spending. Georgia's ratings are constrained by its reliance on external financing and persistently large current account deficits, reflecting low domestic savings on the back of low per-capita income and narrow economic base, and high dollarization in the banking sector exposing the economy to currency movements.

**Figure 1: Sovereign scorecard results**

| Scope's sovereign risk categories | Georgia | Peer comparison | | |
|---|---|---|---|---|
| | | Average | Russia | Turkey |
| Domestic economic risk | | | | |
| Public finance risk | | | | |
| External economic risk | | | | |
| Financial risk | | | | |
| Political and institutional risk | | | | |
| Qualitative adjustment (notches) | - | | 2 | 1 |
| Final rating | BB | | BBB- | BB+ |

AAA AA A BBB BB B CCC CC C

Source: Scope Ratings GmbH

NB. The comparison is based on Scope's Core Variable Scorecard (CVS), which is determined by the relative rankings of key sovereign credit fundamentals. The CVS peer group average is shown together with two selected countries chosen from the entire CVS peer group. The CVS rating can be adjusted by up to three notches depending on the size of relative credit strengths or weaknesses.

## Positive rating-change drivers

- Sustained reduction in external imbalances
- Implementation of structural reforms driving higher productivity
- Strong fiscal results improving fiscal sustainability

## Negative rating-change drivers

- Steep decline in capital inflows
- Reversal of fiscal consolidation
- Heightened geopolitical risks or re-emergence of institutional challenges

## 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 |


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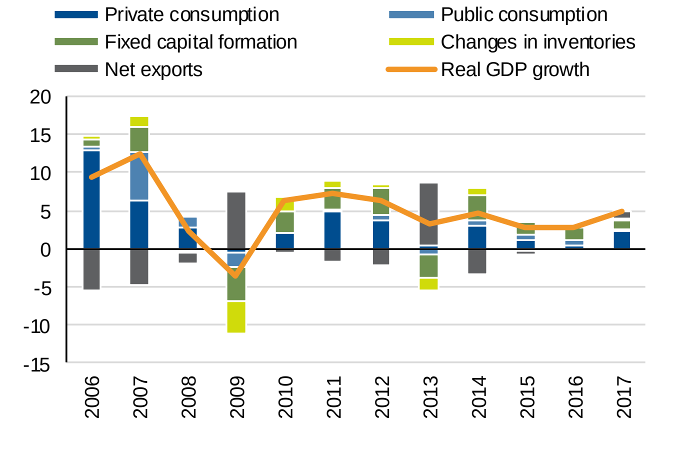
## Domestic economic risk

### Growth potential of the economy and economic policy framework

**Sustained performance in recent years despite external shocks**

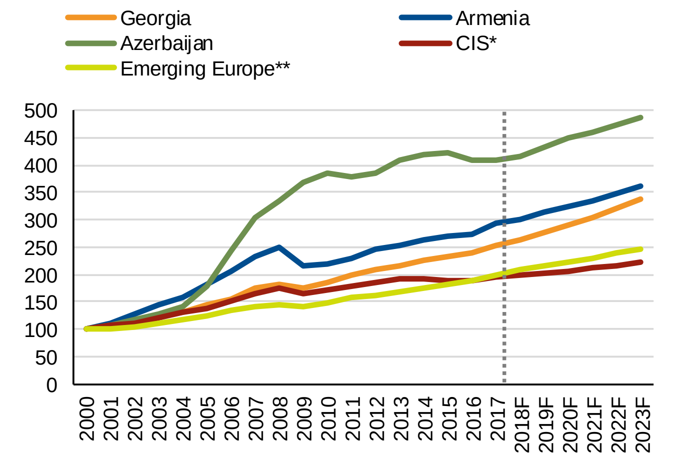
Georgia's economic performance is gaining momentum. After two consecutive years of moderate, albeit resilient growth at close to 3% despite external shocks – well above most regional peers' levels – real GDP growth accelerated to 5% in 2017, driven by robust external demand and private consumption. The growth has been broad-based across economic sectors. Besides trade and tourism, growth has also been supported by construction and manufacturing.

**Figure 2: Percentage-point contribution to real growth**




Source: National Statistics Office of Georgia, Scope Ratings GmbH

**Figure 3: Real GDP, 2000=100**




Source: IMF, Scope Ratings GmbH; *ARM, AZE, BLR, GEO, KAZ, KGZ, MDA, RUS, TJK, TKM, UKR, UZB; **ALB, BIH, BGR, HRV, HUN, XKX, MKD, MNE, POL, ROU, SRB, TUR.

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Scope expects the Georgian economy to continue growing by 5% on average over the medium term, due to strong demand from main trading partners, consumption and large investment projects. The government's structural reform measures, as well as improvements in Russia trade relations and better economic ties with both the EU and China, should also support growth going forward. The downside risks to the medium-term economic outlook primarily stem from the external sector.

Georgia benefits from improving governance indicators and business environment, a result of its commitment to successive market reforms. Notably, according to World Bank the country ranks ninth among 190 countries in terms of ease of doing business[1], the highest in Europe and Central Asia, owing to improvements in investor protection, insolvency proceedings and the electricity grid.

However, several structural weaknesses weigh on Georgia's performance. While investment is increasing and is expected to reach around 35% of GDP in 2018, the country remains reliant on external funding for investment, reflecting the low levels of domestic savings and financial intermediation.

**Potential growth impeded by significant structural challenges**

The narrow economic base and low productivity levels curb Georgia's per-capita income. Agriculture accounts for around 43% of employment but produces less than 10% of GDP. Potential growth is further affected by negative demographic trends (according to the UN, the working-age population in Georgia is expected to decrease by -0.7% annually on average between 2017-30) and hence dependent on increases in productivity to compensate for the shrinking pool of workers.

[1] http://www.worldbank.org/en/news/press-release/2017/10/31/doing-business-2018-georgia-ranked-highest-in-europe-and-central-asia-region

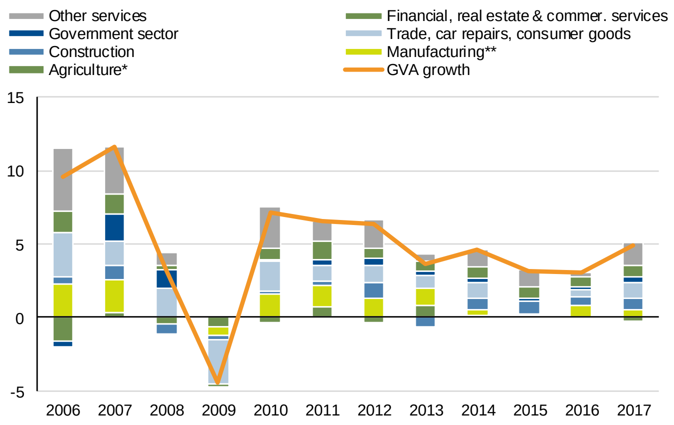
**Commitment to structural reform**

Acknowledging this, the government introduced the Four Point Reform Plan in 2017. This programme focuses on four areas: i) fostering job creation and productivity through education reform; ii) enhancing infrastructure projects via increased capital spending; iii) making public administration more efficient; and iv) further improving the business environment. The programme's implementation is supported by the IMF's Extended Fund Facility (EFF) arrangement amounting to USD 285.3m[2] (around 2% of GDP) for 2017-20. Georgia successfully completed the EFF's first review in December 2017 and reached a staff-level agreement on completing the second semi-annual review in April 2018.

Georgia's structural reform is further underpinned by EU's financial allocation of between EUR 371m-453m[3] during 2017-20 to support economic development, government effectiveness and environment, among other areas, as well as by the EUR 45m[4] macro-financial assistance aimed at mitigating difficulties with the current account.

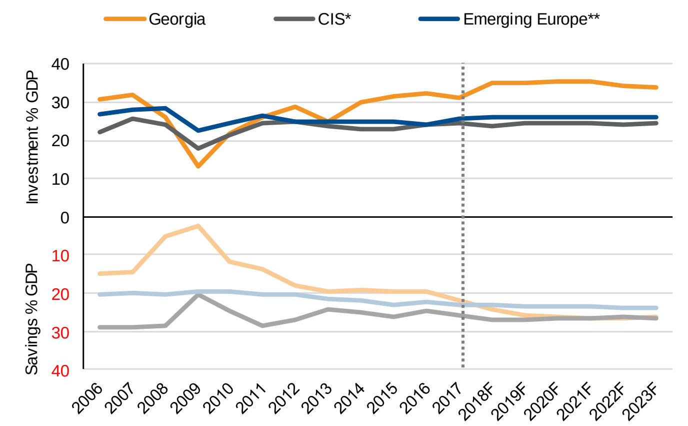
Scope views positively the government's commitment to introducing a funded pension pillar in 2018, which can support the savings and investor base over the medium to long term.

**Figure 4: Percentage-point contribution to gross value-added growth**




Source: National Bank of Georgia, Scope Ratings GmbH; *Agriculture, hunting, forestry and fishing; **Manufacturing, mining and quarrying, electricity, gas and water supply, processing of goods by households

**Figure 5: Investment-saving balance**




Source: IMF, Scope Ratings GmbH; *ARM, AZE, BLR, GEO, KAZ, KGZ, MDA, RUS, TJK, TKM, UKR, UZB; **ALB, BIH, BGR, HRV, HUN, MNE, POL, ROU, SRB, TUR.

**Macroeconomic stability and sustainability**

The National Bank of Georgia (NBG) has overall been effective in both maintaining price stability over the past four years and preserving exchange rate flexibility in light of high dollarisation in the banking sector and external exposures. In Scope's view, the NBG's gradual reduction of the inflation target is appropriate in the current economic setting.

Inflation picked up in 2017 to a full-year average of 6% from 2.1% in 2016 due to a recovery in global oil prices and one-off factors such as excise tax increases, which caused almost half of the price growth. In response to emerging inflationary expectations the NBG increased its policy rate three times by 0.25 pp in 2017 to 7.25%.

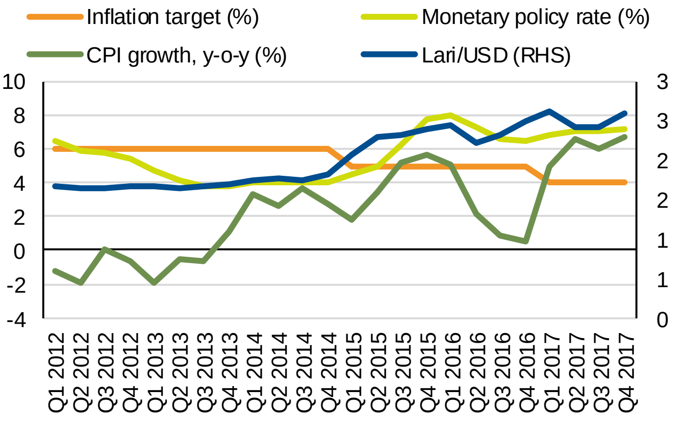
**Easing inflationary pressures, but risks remain**

In line with the fading of one-off effects, inflation came close to the 3% target at the beginning of 2018, and thus Scope anticipates a gradual easing of the policy over the year. The main risk to the inflation outlook of Georgia stems from currency depreciations among major trading partners and the consequent transition of inflationary pressures.

[2] http://www.imf.org/en/News/Articles/2017/04/12/pr17130-georgia-imf-executive-board-approves-us-285-3-million-extended-arrangement-under-eff
[3] https://eeas.europa.eu/headquarters/headquarters-homepage_en/23634/EU-Georgia%20relations,%20factsheet
[4] http://www.consilium.europa.eu/en/press/press-releases/2018/04/12/georgia-council-approves-45-million-in-financial-assistance/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Georgia%3a+Council+approves+%E2%82%AC45+million+in+financial+assistance

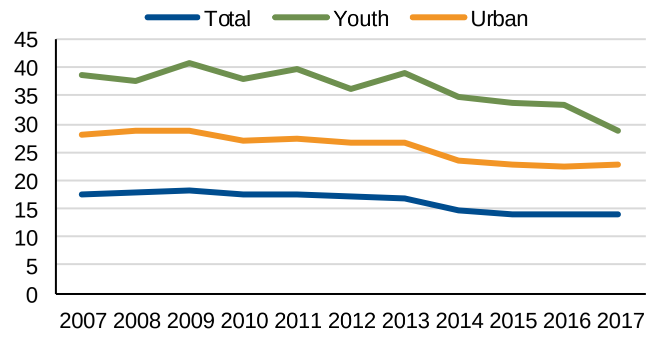
The strong economic growth of Georgia has led to only a slight improvement in labour market outcomes. The unemployment rate stood at 13.9% in 2017[5], almost unchanged compared to the 2016 figure, indicating persistent labour-market rigidities such as a shortage in skilled labour, high youth and urban unemployment. Poverty continues to decline gradually, reaching 21.9%[6] in 2017.

**Figure 6: Inflation and exchange rate developments**




Source: National Bank of Georgia, Scope Ratings GmbH

**Figure 7: Unemployment rate (%)**



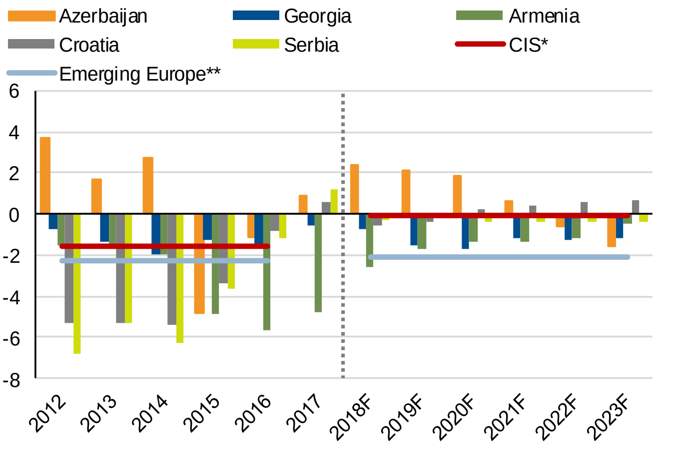

Source: National Statistics Office of Georgia, Scope Ratings GmbH

## Public finance risk

### Fiscal policy framework

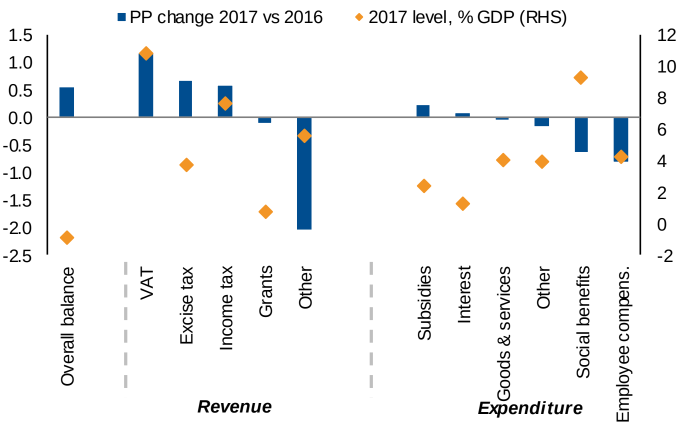
Georgia is progressing with fiscal consolidation, underscored by the EFF's arrangement to support fiscal sustainability by providing structural benchmarks and performance criteria[7], all met by the country as of December 2017. Scope expects Georgia to continue to comply.

**Figure 8: Fiscal balances, % GDP**




Source: IMF, Scope Ratings GmbH; *ARM, AZE, BLR, GEO, KAZ, KGZ, MDA, RUS, TJK, TKM, UKR, UZB; **ALB, BIH, BGR, HRV, HUN, XKX, MKD, MNE, POL, ROU, SRB, TUR.

**Figure 9: Percentage-point change and composition of Georgia's budget balance, % GDP**




Source: Ministry of Finance of Georgia, Scope Ratings GmbH

[5] http://geostat.ge/index.php?action=page&p_id=146&lang=eng. According to the IMF, the unemployment rate was 11.8% in 2016.
[6] Share of population under absolute poverty line (%). http://www.geostat.ge/index.php?action=page&p_id=188&lang=eng
[7] The ceiling target on augmented General Government deficit on cash basis was 1% of GDP for end-June 2017, while the outturn was 0.3%. The ceiling targets for end-December 2017 and end-June 2018 are respectively 3.7% and 0.7% of GDP.

Georgia's fiscal metrics improved in 2017. The headline deficit reached 0.5% of GDP[8] according to IMF, around a 1 pp decrease since 2016 (over the same period the primary balance improved from -0.4% to 0.7% of GDP), due to higher-than expected revenues driven by strong economic performance. Net capital spending increased by more than 1 pp to 4.2% of GDP.

Despite internationally lauded improvements in governance effectiveness and transparency, the country's extensive shadow economy remains a long-term problem that the government has been trying to address through multiple measures, to date with limited success.

**Fiscal consolidation measures and increasing capital spending**

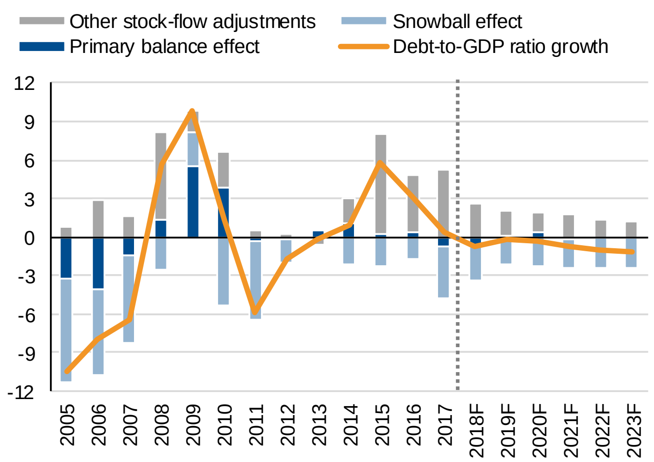
The 2018 budget reflects the government's plan to further increase capital outlay while keeping the current balance in check. Main consolidation measures include: i) reforming the remuneration system by containing wage growth; ii) privatising loss-making publicly owned corporations; iii) improving tax compliance; and iv) optimising social spending. Scope notes that the government is committed to allocating extra revenues primarily to high-priority investment projects.

Scope expects the headline deficit to remain within 1-1.5% of GDP in the medium term, underpinned by improving fiscal prudence. The need to modernise infrastructure and improve social safety nets is likely put pressure on public finances over the coming years.

**Debt sustainability**

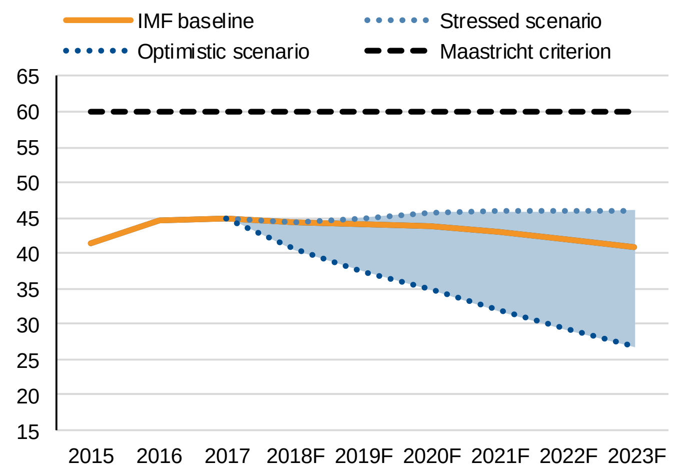
According to the IMF, general government debt stood at 45% of GDP in 2017 and is forecasted to fall to 41% of GDP by 2023, driven by robust economic performance and budget consolidation measures.

**Figure 10: Contribution to gov't debt changes, % GDP**




Source: IMF, Scope Ratings GmbH

**Figure 11: General government debt, % GDP**




Source: IMF, Scope Ratings GmbH

Scope stressed the IMF's underlying assumptions with a combined economic and financial shock including lower economic growth, higher interest payments and fiscal loosening (see the table below). This resulted in a moderate additional borrowing of 5% of GDP (compared to the baseline) over the forecast horizon. Still, the build-up of new liabilities or fiscal slippages may lead to higher indebtedness for the sovereign.

[8] The deficit was 0.85% of GDP according to the Ministry of Finance of Georgia.

**Important challenges to the fiscal outlook**

The fiscal outlook is constrained by generally weak tax revenues and is susceptible to the sizable contingent liabilities, as well as potential risks from the banking sector due to the high level of dollarization[9]. The IMF estimates combined contingent liabilities for public corporations and power-purchase agreements at around 36% of GDP[10].

| Scenario | Period | Real GDP growth (%) | Primary bal. (% of GDP) | Real eff. int. rate (%) | Debt end period (% of GDP) |
|---|---|---|---|---|---|
| History | 2013-2017 | 3.7 | -0.3 | -1.2 | 44.9 |
| IMF baseline | 2018-2023 | 5.0 | 0.1 | -0.2 | 40.8 |
| Optimistic scenario | | 5.7 | 0.6 | -0.4 | 26.8 |
| Stressed scenario | | 3.5 | -1.4 | 0.7 | 46.0 |

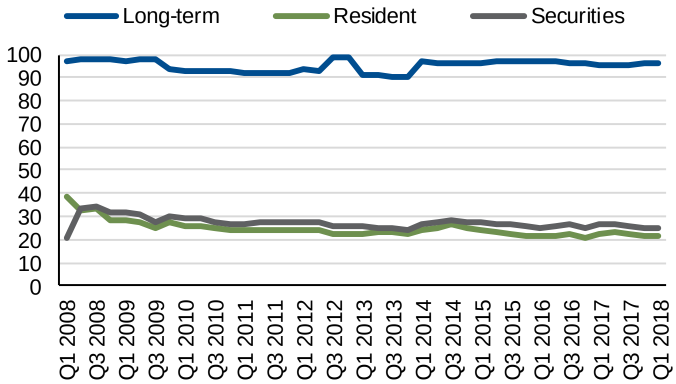
Source: IMF, Scope Ratings GmbH

### Market access and funding sources

Although Georgia's capital market remains underdeveloped, government securities are characterized by high demand and liquidity. The government supports the creation of a long-term institutional investor base for lari-denominated assets. The high proportion of foreign-exchange public debt exposes the budget to currency risk.

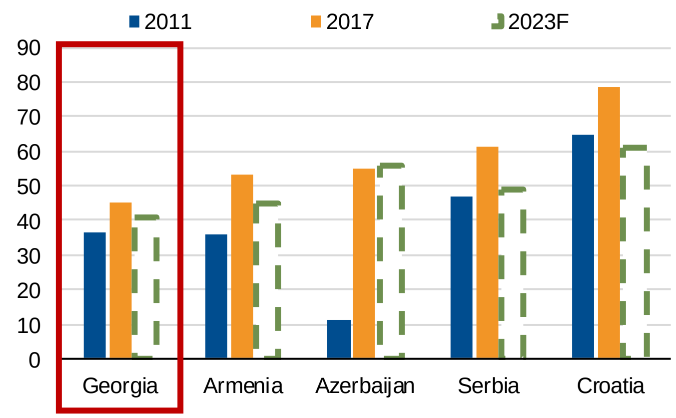
Georgia's debt is held largely by international financial institutions at favourable terms (around 60% of the stock), resulting in a low weighted average interest rate of 3.2% and a long average time to maturity of 7.3 years for the entire portfolio at the end of 2017. The dominance of fixed-rate debt provides a cushion against interest rate fluctuations.

**Figure 12: Development of Georgian government debt structure, % of total debt stock**




Source: Ministry of Finance of Georgia, Scope Ratings GmbH

**Figure 13: General government debt, % GDP**




Source: IMF, Scope Ratings GmbH

## External economic risk

### Current-account vulnerability

**Small open economy vulnerable to external shocks**

Georgia's weak external position remains a key credit challenge. Georgia has persistently posted large current-account deficits relative to GDP, reflecting low domestic savings rate, a narrow export base, high foreign direct investments and a dependency on imports. Thus, its small open economy is vulnerable to external shocks and reliant on external financing.

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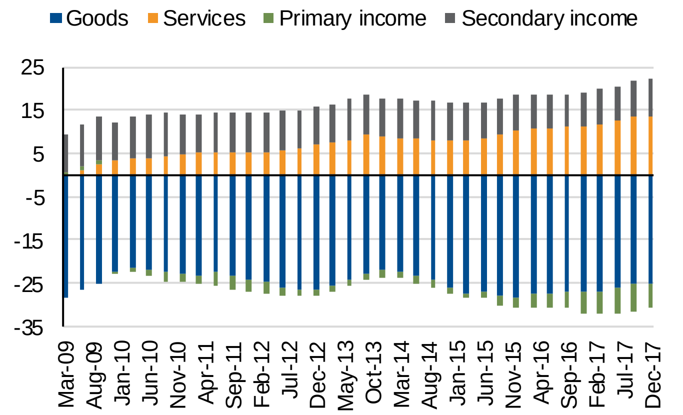
[9] Scope notes that to date banking sector dollarization has not had fiscal impact.
[10] https://www.imf.org/en/Publications/CR/Issues/2017/09/27/Georgia-Fiscal-Transparency-Evaluation-45274

At the end of 2017, Georgia's net international investment position (NIIP) deteriorated to USD -22.8bn or -150.1% of GDP[11], from -137.1% in 2016[12]. These risks are partly mitigated by the fact, that foreign direct investments have financed almost three-quarters of the current-account deficits on average for the last decade.

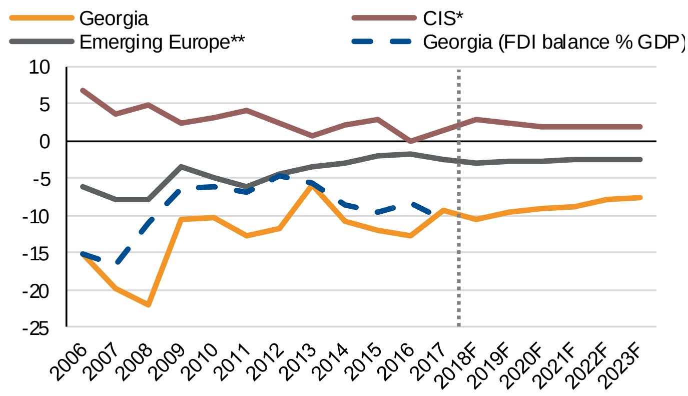
Georgia's current-account deficit improved markedly in 2017, falling below double-digits (8.7% of GDP) for the first time since 2013, in line with strong demand from Russia, the EU, Azerbaijan, Armenia and the USA. Inflows of foreign direct investment increased to 12.3% of GDP in 2017 from 11.1% in 2016, driven by stronger performance in the construction, energy and financial sectors.

**Figure 14: Composition of current-account balance, % GDP**




Source: National Bank of Georgia, Scope Ratings GmbH

**Figure 15: Current-account balances, % GDP**

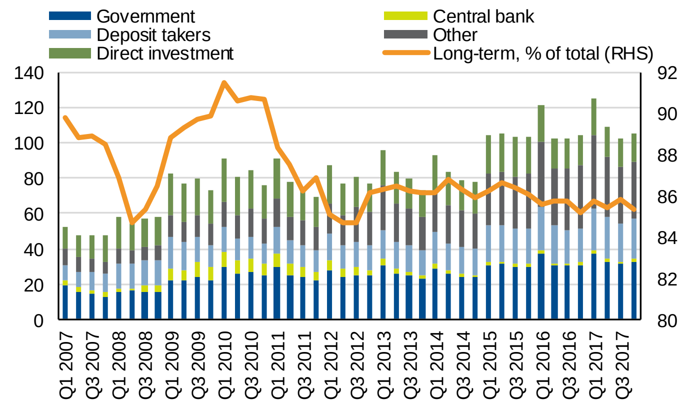



Source: IMF, National Bank of Georgia, Scope Ratings GmbH; *ARM, AZE, BLR, GEO, KAZ, KGZ, MDA, RUS, TJK, TKM, UKR, UZB; **ALB, BIH, BGR, HRV, HUN, XKX, MKD, MNE, POL, ROU, SRB, TUR.

### Commitment to trade and investment diversification

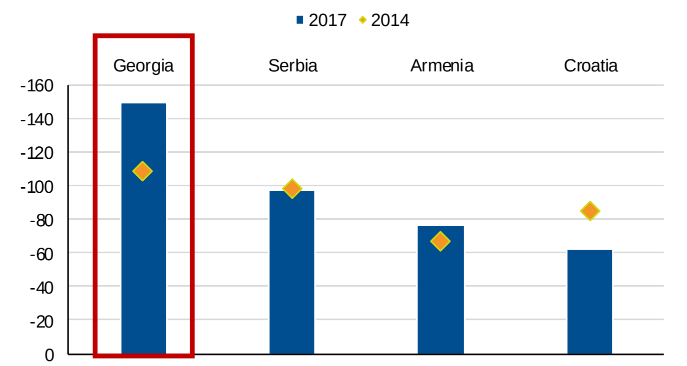
Scope believes, that Georgia's commitment to the Association Agreement with the EU (which introduces a preferential trade regime and provides financial and technical assistance) and free-trade agreements with China, European Free Trade Association countries and Hong Kong (final phase) will mitigate the external vulnerabilities through improved investment activity and export potential over the medium to long term.

**Figure 16: External debt, % of GDP**




Source: National Bank of Georgia, Scope Ratings GmbH

**Figure 17: NIIP, % GDP (reverse scale)**




Source: Central banks and statistical offices, Scope Ratings GmbH

[11] https://www.nbg.gov.ge/index.php?m=340&newsid=3319
[12] https://www.nbg.gov.ge/index.php?m=340&newsid=3064&lng=eng

### External debt sustainability and vulnerability to short-term external shocks

**Risks posed by high foreign-currency debt mitigated by favourable terms**

External debt stood at a high 113.4% of GDP in 2017, almost unchanged compared to the level in 2016. More than 90% of the debt is in foreign currency, leaving the economy vulnerable to exchange rate movements. However, external risks are moderated by the long-term debt maturity profile, and the fact that the major portion of the stock consists of concessional debt.

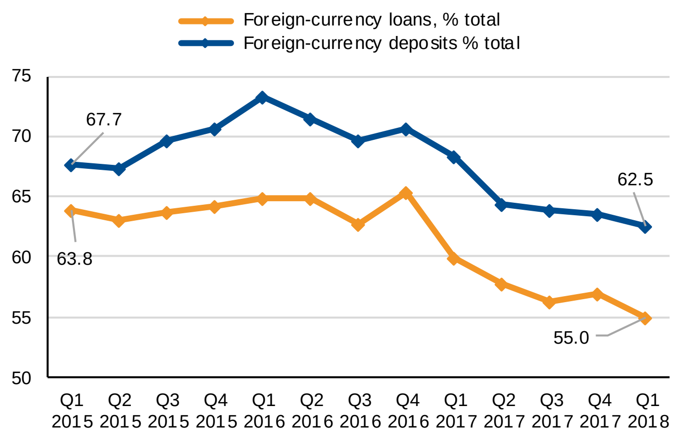
## Financial stability risk

### Financial imbalances and fragility, and banking sector oversight and governance

**Though decreasing, dollarisation remains elevated**

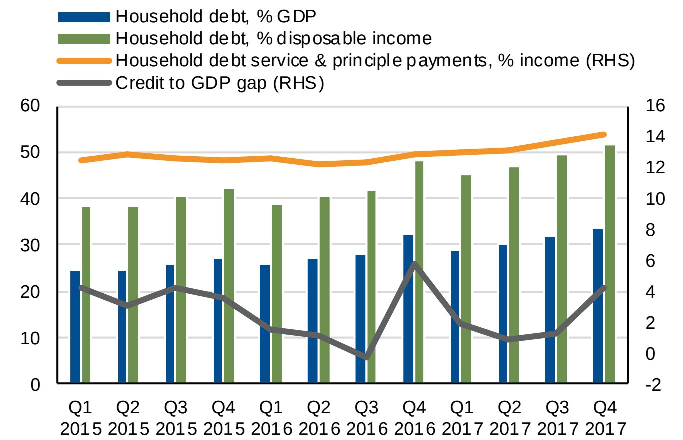
Georgia's banking sector is susceptible to external shocks stemming from the high level of dollarisation in banks' assets and liabilities. As of Q1 2018 the foreign-currency exposure in loans and deposits (predominantly US dollars and euros) stood at 55% and 62.5% respectively.

**Figure 18: Dollarisation**




Source: National Bank of Georgia

**Figure 19: Household debt**

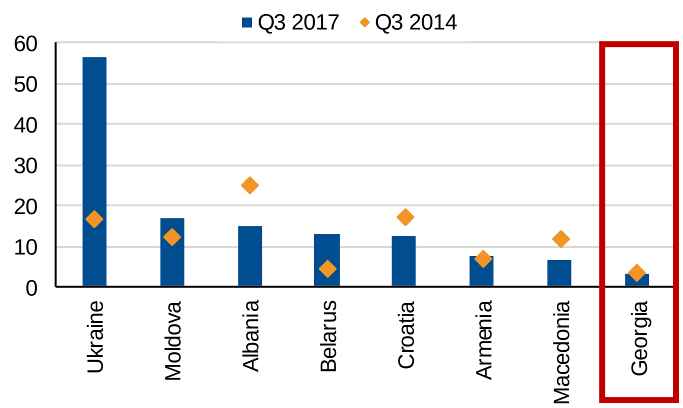



Source: National Bank of Georgia, Scope Ratings GmbH

However, Scope notes that dollarisation has been declining over the past decade, accelerating since 2017 due to measures taken by the NBG and the Government, including the improved access to long-term local currency resources, preferential treatment of the local currency under new prudential regulations and the subsidised conversion of US dollar-denominated mortgages.

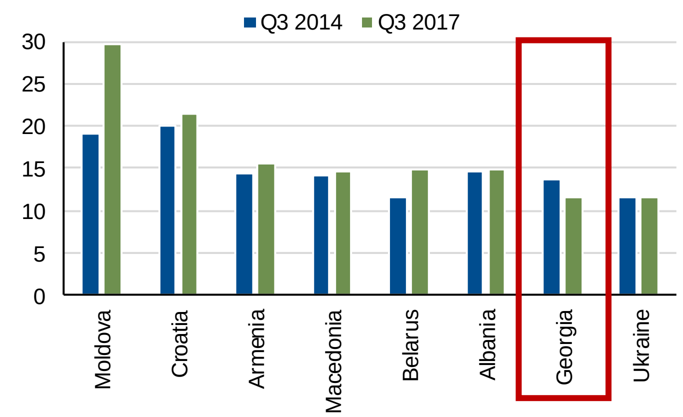
Strong economic performance drove private-sector credit growth to 18% YoY in 2017. The expansion has been in line with economic fundamentals, indicated by the almost closed credit-to-GDP gaps. Household debt stood at 33.7% of GDP at the end of 2017.

**Figure 20: Non-performing loans (% of total)**




Source: IMF

**Figure 21: Tier 1 capital to risk-weighted assets (%)**




Source: IMF

### Banking sector performance

**Well-capitalised banking sector**

Georgia's financial sector is dominated by foreign-owned commercial banks. The asset quality of banks has not been compromised by the currency depreciation at the end of 2017, reflected in non-performing-loan ratios of below 3%[13]. Banks are well capitalised overall, which mitigates the risks stemming from the foreign-currency-dominated banking structure. System-wide Tier 1 capital stood at 14.2% of risk-weighted assets as of Q1 2018.

## Institutional and political risk

### Recent events and policy decisions

Georgia is a semi-presidential representative democratic republic. The prime minister is the head of government and the president is the head of state.

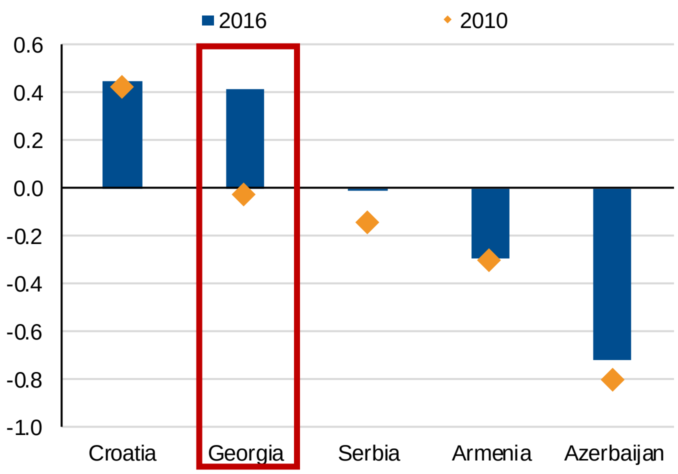
In March 2018, after a parliamentary process lasting several months, Georgia ratified constitutional amendments to give the country fully proportional parliamentary representation by 2024, with the president elected indirectly by lawmakers. The electoral threshold will be reduced from 5% to 3%, allowing for the involvement of a larger number of political parties.

These changes will take effect after the 2018 presidential elections, for which Scope does not expect any material policy change, also because the president's power is considerably curtailed as a result of the constitutional change.

**Improving governance indicators, but weaknesses remain**

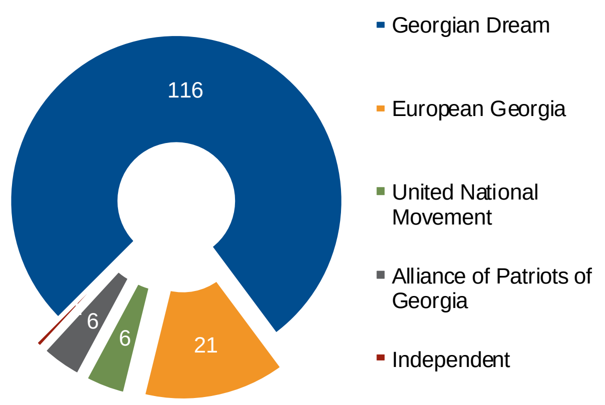
Georgia scores stronger than most of its 'bb' and regional sovereign peers on institutional metrics such as the World Bank's Worldwide Governance Indicators, reflecting its significant progress in both improving its public administration's quality and effectiveness and enhancing transparency. However, the lack of an established system of checks and balances and a fully functioning independent judiciary system remain challenges.

**Figure 22: World Bank Governance Indicators (average)**




Source: World Bank, Scope Ratings GmbH

**Figure 23: Political party representation in the Georgian parliament**




Source: Parliament of Georgia

[13] According to the IMF definition, the NBG estimated the level to be 5.5% in Q1 2018.

The ruling party, Georgian Dream, holds an absolute majority of 116 mandates in the 150-member unicameral parliament. The party further strengthened its power by winning a majority of seats in all electoral districts in the October 2017 municipal elections. Scope notes that Bidzina Ivanishvili, a wealthy businessman and founder of Georgian Dream who, even after quitting politics in 2013, is widely believed to have a considerable influence on the party, is set to lead the party again.

**Geopolitical risk**

Georgia remains exposed to geopolitical risks of the unresolved conflict of South Ossetia and Abkhazia with Russia. The recent agreement between Russia and South Ossetia, which partly incorporates the South Ossetian military into the Russian armed forces, and the opening of a customs post in Abkhazia have strengthened Russia's ties with both territories.

Scope currently expects no material escalations and views positively that Russia recently signed a contract on trade monitoring with a Swiss testing and inspection company, which enables the implementation of the 2011 Georgian-Russian agreement and creation of three "trade corridors" between Georgia and Russia, two of which pass through Abkhazia and South Ossetia. Georgia concluded a similar agreement in December 2017.

## Methodology

The methodology applicable for this rating and/or rating outlook, 'Public Finance Sovereign Ratings', is available at www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on at https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA.

Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA) at http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope's definition of default and definitions of rating notations can be found in Scope's public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is not automatically ensured, however.

# I. Appendix: CVS and QS results

## Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on the relative rankings of key sovereign credit fundamentals, signals an indicative 'BB' ('bb') rating range for Georgia. This indicative rating range can be adjusted by up to three notches on the Qualitative Scorecard (QS) depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative findings.

For Georgia, the QS signals a relative credit strength for the following analytical category: i) growth potential of the economy. Relative credit weaknesses are signalled for: i) current account vulnerability; ii) vulnerability to short-term external shocks; iii) geopolitical risks; and iv) financial imbalances and financial fragility. The combined relative credit strengths and weaknesses indicate a sovereign rating of BB for Georgia. The results have been discussed and confirmed by a rating committee.

| Rating overview | |
|---|---|
| CVS category rating range | bb |
| QS adjustment | BB |
| Final rating | BB |

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 24 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates to an indicative rating range that is always presented in lower case.

Within the QS assessment, analysts conduct a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, a review of debt sustainability, fiscal and financial performance assessments, and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analysts' recommendation to the rating committee.

## Foreign- versus local-currency ratings

The debt of the Republic of Georgia is primarily issued in foreign currency. While the government is committed to increasing the importance of the Georgian lari in the financial system, such actions will only have a material impact in the long term. Scope sees no evidence that the Republic of Georgia would differentiate among any of its contractual debt obligations based on currency denomination.

## II. Appendix: CVS and QS results

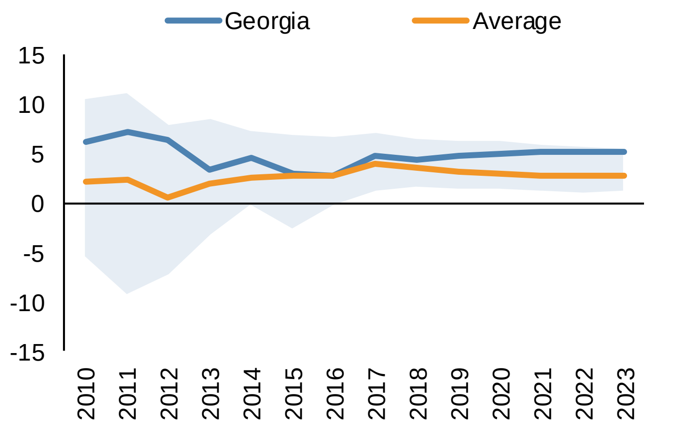
| CVS: Rating indicator | Category weight | QS (Maximum adjustment = 3 notches) | +2 notch | +1 notch | 0 notch | -1 notch | -2 notch |
|---|---|---|---|---|---|---|---|
| **Domestic economic risk** | 35% | Growth potential of the economy | Excellent outlook, strong growth potential | ◉ Strong outlook, good growth potential | Neutral | Weak outlook, growth potential under trend | Very weak outlook, growth potential we under trend or negative |
| Economic growth<br>Real GDP growth<br>Real GDP volatility<br>GDP per capita<br>Inflation rate | | Economic policy framework | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| Labour & population<br>Unemployment rate<br>Population growth | | Macro-economic stability and sustainability | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| **Public finance risk** | 30% | Fiscal policy framework | Exceptionally strong performance | Strong performance | ◉ Neutral | Weak performance | Problematic performance |
| Fiscal balance<br>GG public balance<br>GG primary balance<br>GG gross financing needs | | Debt sustainability | Exceptionally strong sustainability | Strong sustainability | ◉ Neutral | Weak sustainability | Not sustainable |
| Public debt<br>GG net debt<br>Interest payments | | Market access and funding sources | Excellent access | Very good access | ◉ Neutral | Poor access | Very weak access |
| **External economic risk** | 15% | Current account vulnerability | Excellent | Good | Neutral | ◉ Poor | Inadequate |
| International position<br>International investment position<br>Importance of currency<br>Current-account financing<br>Current-account balance | | External debt sustainability | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| T-W effective exchange rate<br>Total external debt | | Vulnerability to short-term external shocks | Excellent resilience | Good resilience | Neutral | ◉ Vulnerable to shock | Strongly vulnerable to shocks |
| **Institutional and political risk** | 10% | Perceived willingness to pay | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| Control of corruption<br>Voice & accountability | | Recent events and policy decisions | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| Rule of law | | Geopolitical risk | Excellent | Good | Neutral | ◉ Poor | Inadequate |
| **Financial risk** | 10% | Banking sector performance | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| Non-performing loans<br>Liquid assets | | Banking sector oversight and governance | Excellent | Good | ◉ Neutral | Poor | Inadequate |
| Credit-to-GDP gap | | Financial imbalances and financial fragility | Excellent | Good | Neutral | ◉ Poor | Inadequate |
| **Indicative rating range** | **bb** | | | | | | |
| **QS adjustment** | **BB** | | | | | | |
| **Final rating** | **BB** | | | | | | |

* Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10

Source: Scope Ratings GmbH

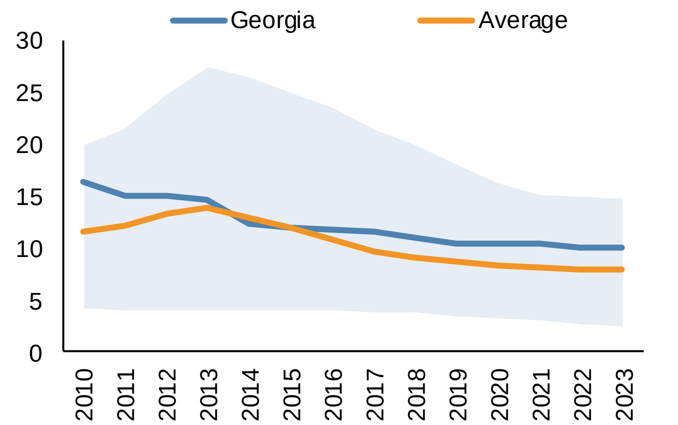
## III. Appendix: Peer comparison

**Figure 24: Real GDP growth, %**



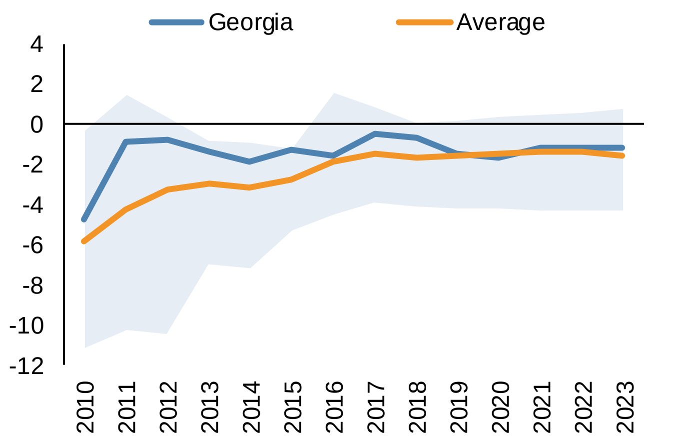

Source: IMF, Calculations Scope Ratings GmbH

**Figure 25: Unemployment rate, % of total labour force**



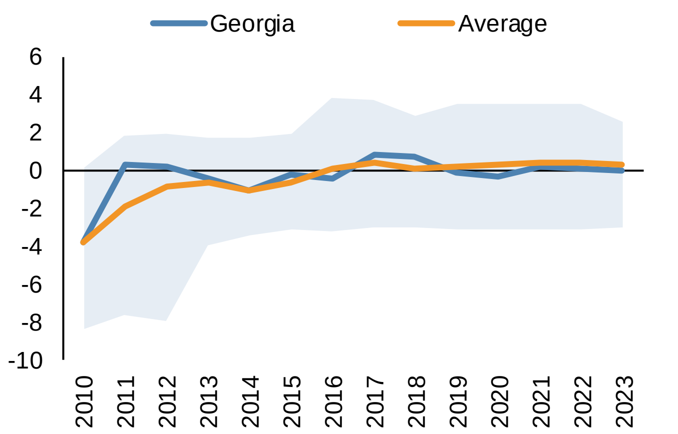

Source: IMF, Calculations Scope Ratings GmbH

**Figure 26: General government balance, % of GDP**



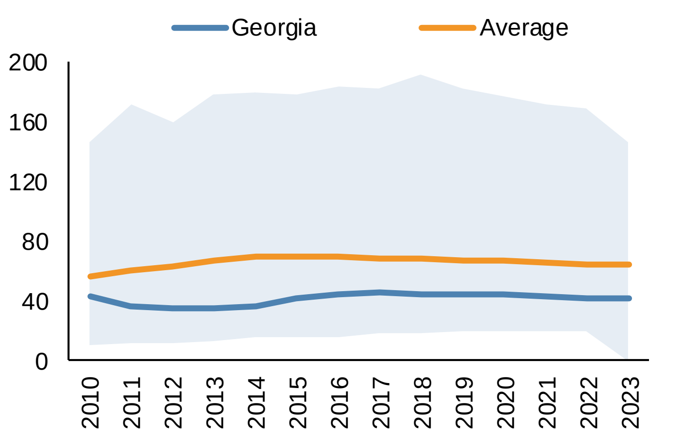

Source: IMF, Calculations Scope Ratings GmbH

**Figure 27: General government primary balance, % of GDP**



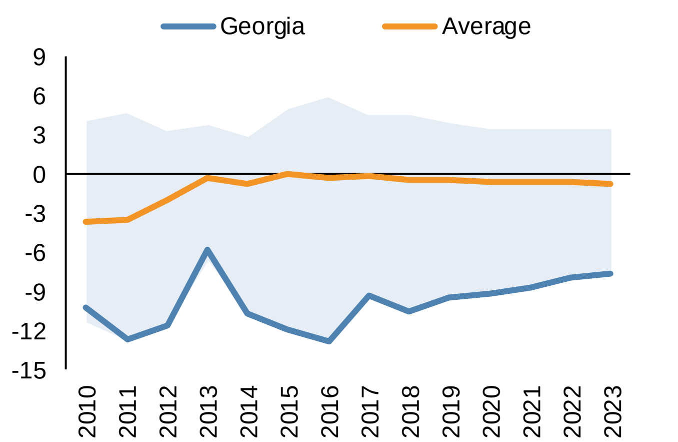

Source: IMF, Calculations Scope Ratings GmbH

**Figure 28: General government gross debt, % of GDP**




Source: IMF, Calculations Scope Ratings GmbH

**Figure 29: Current-account balance, % of GDP**




Source: IMF, Calculations Scope Ratings GmbH

## IV. Appendix: Statistical tables

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018E | 2019F |
|---|---|---|---|---|---|---|---|
| **Economic performance** | | | | | | | |
| Nominal GDP (GEL bn) | 26.8 | 29.2 | 31.8 | 33.9 | 38.0 | 41.4 | 44.7 |
| Population ('000s) | 3,783.0 | 3,730.0 | 3,720.0 | 3,701.0 | 3,694.0 | 3,694.0 | 3,695.0 |
| GDP per capita PPP (USD) | 8,541.8 | 9,216.7 | 9,610.5 | 10,004.5 | - | - | - |
| GDP per capita (GEL) | 7,096.8 | 7,816.2 | 8,535.5 | 9,165.0 | 10,286.1 | 11,214.4 | 12,107.3 |
| Real GDP, % change | 3.4 | 4.6 | 2.9 | 2.8 | 5.0 | 4.5 | 4.8 |
| GDP growth volatility (10-year rolling SD) | 4.5 | 4.5 | 4.4 | 4.2 | 3.1 | 3.0 | 1.5 |
| CPI, % change | -0.5 | 3.1 | 4.0 | 2.1 | 6.0 | 3.6 | 3.0 |
| Unemployment rate (%) | 14.6 | 12.4 | 12.0 | 11.8 | 11.5 | 11.0 | 10.5 |
| Investment (% of GDP) | 24.8 | 29.8 | 31.5 | 32.4 | 31.2 | 34.8 | 35.2 |
| Gross national savings (% of GDP) | 19.5 | 19.1 | 19.5 | 19.6 | 21.9 | 24.3 | 25.7 |
| **Public finances** | | | | | | | |
| Net lending/borrowing (% of GDP) | -1.4 | -1.9 | -1.3 | -1.6 | -0.5 | -0.7 | -1.5 |
| Primary net lending/borrowing (% of GDP) | -0.5 | -1.1 | -0.2 | -0.4 | 0.7 | 0.6 | -0.2 |
| Revenue (% of GDP) | 27.5 | 28.0 | 28.1 | 28.4 | 29.1 | 28.4 | 27.7 |
| Expenditure (% of GDP) | 28.9 | 29.9 | 29.4 | 30.0 | 29.6 | 29.1 | 29.3 |
| Net interest payments (% of GDP) | 0.9 | 0.9 | 1.0 | 1.2 | 1.3 | 1.4 | 1.4 |
| Net interest payments (% of revenue) | 3.2 | 3.0 | 3.7 | 4.2 | 4.4 | 4.8 | 4.9 |
| Gross debt (% of GDP) | 34.7 | 35.6 | 41.4 | 44.6 | 44.9 | 44.2 | 44.1 |
| Net debt (% of GDP) | - | - | - | - | - | - | - |
| Gross debt (% of revenue) | 126.0 | 127.1 | 147.5 | 157.1 | 154.4 | 155.6 | 159.0 |
| **External vulnerability** | | | | | | | |
| Gross external debt (% of GDP) | 83.3 | 84.7 | 108.5 | 110.1 | 113.4 | - | - |
| Net external debt (% of GDP) | 53.9 | 51.7 | 67.3 | 66.1 | 66.6 | - | - |
| Current account balance (% of GDP) | -5.8 | -10.7 | -12.0 | -12.8 | -8.7 | -10.5 | -9.5 |
| Trade balance (% of GDP) | -31.7 | -34.8 | -36.4 | -36.2 | -34.7 | - | - |
| Net direct investment (% of GDP) | -5.6 | -8.5 | -9.6 | -8.3 | -10.5 | - | - |
| Official forex reserves (EOP, mil USD) | 2,601.5 | 2,490.6 | 2,321.0 | 2,562.8 | 2,832.9 | - | - |
| REER, % change | -3.9 | 1.9 | -4.6 | 3.4 | -2.2 | - | - |
| Nominal exchange rate (EOP, GEL/USD) | 1.7 | 1.9 | 2.4 | 2.6 | 2.6 | - | - |
| **Financial stability** | | | | | | | |
| Non-performing loans (% of total loans) | 3.0 | 3.0 | 2.7 | 3.4 | 2.8 | - | - |
| Tier 1 ratio (%) | - | 13.1 | 12.0 | 10.5 | 14.0 | - | - |
| Household debt (% of GDP) | 20.0 | 24.4 | 27.2 | 32.1 | 33.7 | - | - |
| Domestic credit-to-GDP gap (EOP, %) | -2.7 | 0.1 | 3.5 | 5.8 | 4.2 | - | - |

Sources: IMF, World Bank, National Bank of Georgia, National Statistics Office of Georgia, Scope Ratings GmbH

## V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

Rating prepared by Levon Kameryan, Lead Analyst

Person responsible for approval of the rating: Dr Giacomo Barisone, Managing Director

The ratings/outlook were first assigned by Scope on 30.06.2017.

The senior unsecured debt ratings as well as the short-term issuer ratings were first assigned by Scope on 30.06.2017.

The main points discussed by the rating committee were: i) Georgia's growth outlook; ii) economic imbalances and structural reforms; iii) EU-Georgia Association Agreement; iv) fiscal consolidation measures and debt sustainability; v) external vulnerabilities and exposure to currency movement; vi) financial sector risks and performance; vii) recent geo-political developments; and viii) peer considerations.

## Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: National Bank of Georgia, National Statistics Office of Georgia, Ministry of Finance of Georgia, IMF, OECD, World Bank and Haver Analytics.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

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