14 July 2023

Sovereign and Public Sector

Republic of 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

- Heightened geopolitical risk
- Elevated vulnerability to external shock(s) and reliance upon external financing
- Elevated dollarisation
- Risk due to domestic political instability

Rating rationale:

Strong growth outlook: After suffering from a sharp decline of economic output in 2020 due to the Covid-19 crisis, the Georgian economy recovered strongly, experiencing growth of 10.5% and 10.1% in 2021 and 2022, respectively. Georgia benefits from strong medium-run economic growth potential, driven by recovery in private consumption, tourism-sector receipts and investment. Foreign direct investment (FDI) is expected to edge back towards pre-crisis levels and support growth.

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

Strong debt profile: Georgian public debt is largely owed to its 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 risks.

Rating challenges include: i) heightened geopolitical risks after Russia's escalation of conflict in neighbouring Ukraine alongside domestic political risks; ii) vulnerability to external shocks due to the small size of the economy (nominal GDP of an estimated USD 30bn in 2023) alongside high reliance on external financing; and iii) financial-stability risk associated with dollarisation in the economy.

Georgia's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	b+	GEL [+0]	0	BB
Public Finance Risk		20%	aa		+1/3	
External Economic Risk		10%	cc		-2/3	
Financial Stability Risk		10%	a+		0	
ESG Risk	Environmental Factors	5%	aa+		0	
	Social Factors	7.5%	bb+		0	
	Governance Factors	12.5%	b+		-1/3	
Indicative outcome		**bb+**			**-1**	
Additional considerations					**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 Scope's view that risks to the ratings are balanced.

Positive rating-change drivers

- Permanent reduction in security risks
- Quality of institutions is re-anchored
- Reduction in external-sector risk
- Improvement in fiscal sustainability

Negative rating-change drivers

- Escalation of geopolitical risk
- Weakening in institutions
- Increase in external vulnerabilities
- Worsening of medium-run general government debt trajectory

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:** The Georgian economy grew 10.1% in 2022, broadly stable from the previous year despite the country's significant exposure to the Russian economy. Since the escalation of the Ukraine conflict, it has benefitted from a surge in immigration and financial inflows, which have anchored domestic demand, while tourism exports continued furthermore to rebound strongly. Growth remained robust in Q1 this year (7.7% YoY), amid continued strength in services exports and investment and despite weakening of consumption dynamics. We forecast growth staying strong at 7.5% this year, before moderating to 6.1% in 2024. Robust medium-run growth potential is estimated at 5% and is supported by a capacity to attract foreign direct investment, especially in financial, energy and hospitality sectors, and by investment in public infrastructure works.

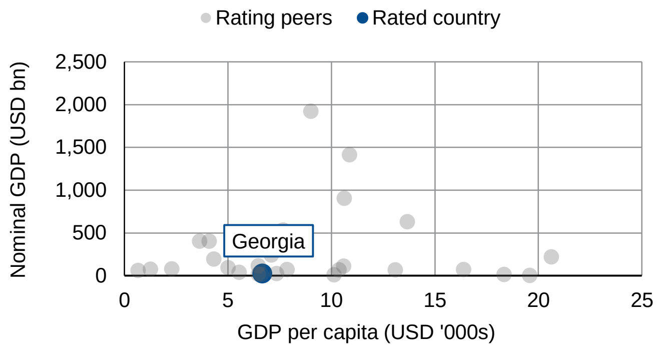
- **Inflation and monetary policy:** After previously rising rapidly after Q2 2021, headline inflation has declined markedly over the recent months, down to 0.6% YoY by June (from the 13.9% YoY at January-2022 peaks). This decrease was supported by reduced global energy and commodity prices, monetary-policy tightening and the strong lari. Core inflation is higher at 4.1% YoY – but has also receded closer to the 3% longer-run inflation target. Some inflationary pressures have derived from the labour market, with nominal wage growth of 18.7% YoY as of Q1 2023. After raising its policy rate a cumulative 300bps to 11% in the year to March 2022, the National Bank of Georgia (NBG) started exiting from its tight monetary policy this May with a 50bp rate cut. We expect inflation to average only 2.3% this year before 2.8% next year. The lari has appreciated since last year on the back of strong output growth and is up by 16.6% against the US dollar since the escalation of the Ukraine war. High dollarisation and the predominantly fixed-rate structure of lending mitigates the effectiveness of the monetary-policy transmission.

- **Labour markets:** After declining to a historical low of 15.6% by Q3 2022 within a context of robust economic recovery, the unemployment rate edged up to 18.0% by Q1 2023. We expect unemployment to average 17.1% this year (down 0.2pps from 2022) before 16.8% in 2024. Changes in labour-market legislation and workers registering for formal employment during the Covid-19 crisis enabled a reduction in the informal sector of the labour market from 51% in 2019 to 28% of aggregate employed last year.

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

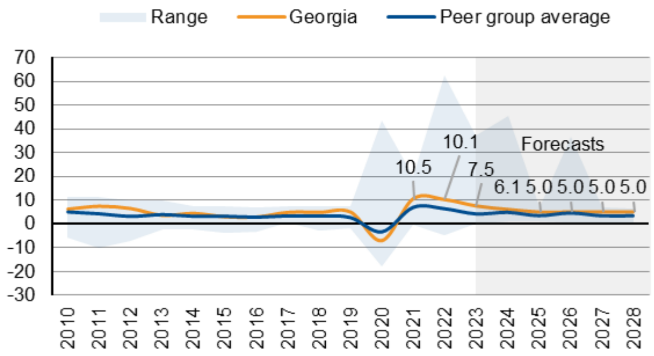
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b+	Growth potential of the economy	Strong	+1/3	Recent outperformance in recovery; strong medium-term growth potential of about 5% annually
	Monetary policy framework	Neutral	0	Strengthened monetary-policy framework, pre-pandemic track record of managed inflation, adequate monetary-policy response to higher inflation, but policy flexibility curtailed by dollarisation
	Macro-economic stability and sustainability	Weak	-1/3	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



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

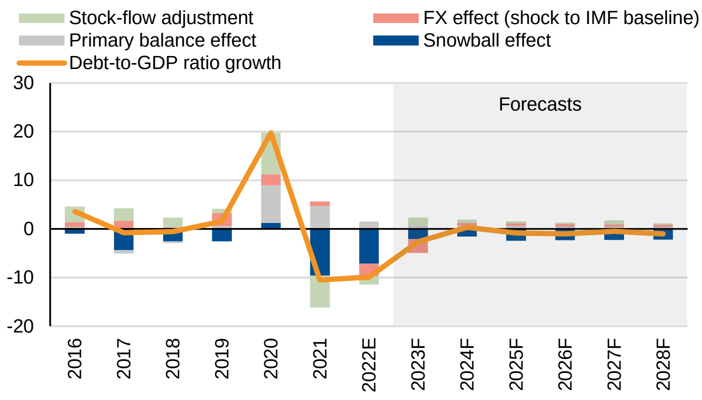
Public Finance Risks

- **Fiscal outlook:** After a period of modest budget deficits, averaging 1.4% of GDP over 2015-19, the budget balance deteriorated to -9.3% of GDP in 2020 before recovering partly to -6.3% of GDP by 2021. Strong revenue growth last year, driven by high value-added-tax collections, as well as income and import tax revenues, resulted in the sharp reduction of the budget deficit to 2.6% of GDP last year, despite a 10% increase in public-sector wages and higher expenditure related to support for vulnerable households amid higher energy and food prices. The fiscal impact of the Russia-Ukraine crisis has been small. This allowed for a faster-than-anticipated return to compliance with the 3% budget-deficit ceiling. We expect a fiscal deficit of 2.2% of GDP this year before 2.1% next year, reflecting expectation of robust revenue growth and fiscal prudence, despite robust public investment.
- **Debt trajectory:** The general government debt-to-GDP ratio increased 20pps from 40.4% in 2019 to 60.2% by 2020. It had reversed this rise entirely to 39.8% of GDP by end-2022, supported by economic rebound and improvement in the budget balance. We expect the debt ratio to decline to 37.1% in 2023 before 34.1% by 2028, advanced by strong nominal economic growth and a commitment to fiscal prudence, although weakened by an assumed depreciation of the currency over 2024-28 of 2.7% yearly against the US dollar – set equal to the average depreciation against USD during the past five years.
- **Debt profile and market access:** Around 80% of Georgian public debt is denominated in foreign currency. More than two third of government debt is on concessional-rate terms, however, which helps in curtailing debt-sustainability risks and vulnerability to exchange-rate fluctuations. Further strengths of the government-debt profile include a high share of long-term debt, accounting for nearly 99% of the aggregate debt. The debt-management strategy outlined by the Ministry of Finance for 2023-26 aims to deepen the domestic capital markets and reduce the share of foreign debt to under 70%. In this respect, planned refinancing of the USD 500m sovereign Eurobond maturing in 2026 via local-currency-denominated issuance will stand-alone allow government to cut this share of foreign debt to under 65%.

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

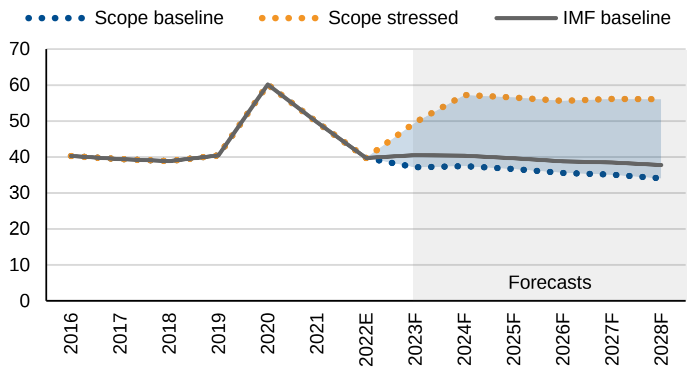
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Fiscal policy framework	Strong	+1/3	Track record of moderate fiscal deficits and fiscal prudence underpinned by successful engagement with the IMF; expectation of moderating deficits moving ahead
	Debt sustainability	Neutral	0	Expected decline in debt ratios medium run, but debt trajectory is exposed to significant exchange-rate risk
	Debt profile and market access	Neutral	0	More than two thirds of debt owed to official-sector donors on concessional terms; track record of sound access to concessional loan financing

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

External Economic Risks

- **Current account:** Georgia displays wide, structural current-account deficits. The deficit widened to 12.5% and 10.4% of GDP, respectively, in 2020 and 2021, primarily due to disruptions of international travel, before shrinking to 3.2% of GDP by the year to Q1 2023. This sharp improvement recently was driven by a strong rebound in tourism revenue and significant rises of remittances flows and transit trade following the escalation of the Ukraine war. However, the surge in re-exports from Georgia to Russia has raised concerns among Western partners around the implementation of trade sanctions against Russia, which exposes Georgia's external balance to potential additional measures aimed at limiting the circumvention of sanctions against Russia. However, the EU sanctions envoy recently visited Georgia, and received positive feedback from Georgian authorities around efforts to control the reexport of 38 sensitive battlefield products to Russia.

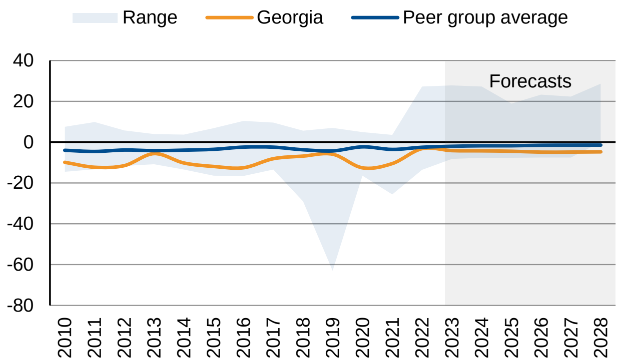
- **External position:** Recurrent current-account deficits have brought about a large net external liability position (net international investment position of -110% of GDP as of Q1 2023, but improving from -159% as of Q4 2020). More than half of external liabilities are in the form of FDI and only a small share is portfolio investment. Gross external debt had declined to 90% of GDP by Q1 2023. Most of this debt is long-term and borrowed from international financial institutions on concessional terms. Lower external financing requirements and government initiatives to reduce external borrowing should help curtail external debt to about 60% of GDP by 2027.

- **Resilience to short-term external shocks:** Georgia's small, open economy is vulnerable to external shocks and reliant upon external financing. High dollarisation and an elevated share of foreign-currency-denominated public debt represent risks during phases of lari volatility. Such risks are partially offset by a moderate stock of official reserves, of USD 5.1bn in June 2023 (or around 137% of short-term external debt), increased from the USD 3.8bn as of April 2022 following a series of net FX purchases by NBG last year during favourable FX market conditions. A USD 280m IMF Stand-By Arrangement was agreed upon in June 2022, providing support for economic policies over the following three years, with USD 120m of funding to be available following completion of the second review currently subject to IMF Executive Board approval (although said programme is treated on a *precautionary* basis).

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

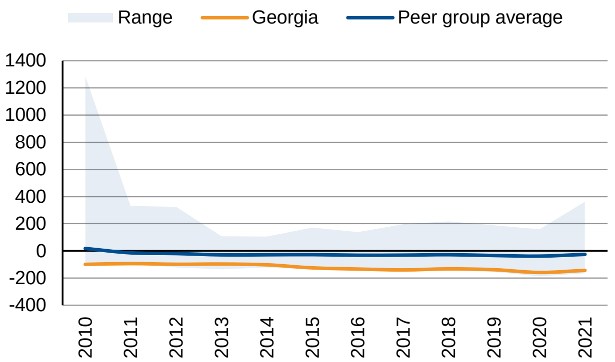
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
cc	Current account resilience	Weak	-1/3	Structural current-account deficits, high reliance on tourism sector and remittances, significant FDI inflows, risk from secondary sanctions
	External debt structure	Neutral	0	Significant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

Current-account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

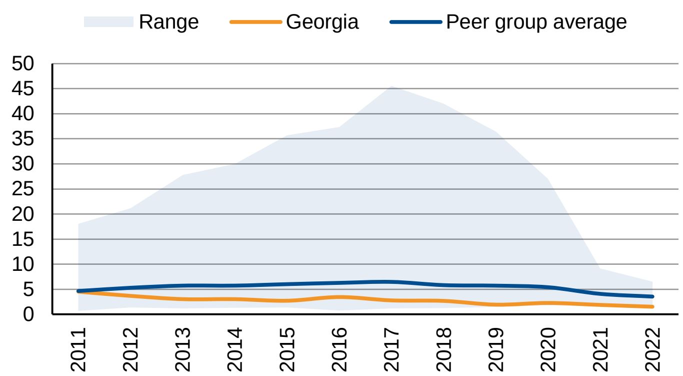
Financial Stability Risks

- **Banking sector:** The banking system has weathered recent shocks comparatively well. Tier 1 capital improved markedly during 2021 and 2022, reaching 17.5% of risk-weighted assets by Q1 2023, after decline during early 2020 (to lows of 11.8% in Q1 2020). Liquidity is adequate (with a coverage ratio of 132% as of April 2023, well above 100% regulatory requirements). Due to economic recovery and consequential improvements in household creditworthiness, the non-performing loan (NPL) ratio (NBG definition) declined from 8.3% in March 2021 to 3.8% by April 2023. Profitability, as measured by the return on equity, has moderated from a record high 30.4% in 2021, although remaining strong at 26.1% in the year to April 2023.
- **Private debt:** Credit growth stood at 5.2% YoY in May 2023, up from a recent low of 2.7% in February, albeit remaining well under the 2021-22 average (of 11.9%). NBG measures have helped contain household credit growth, while higher FX borrowing costs limit the growth in corporate credit. Household indebtedness is moderate, having nevertheless increased since the pandemic crisis due to strong credit growth and revaluations after lari depreciation against the dollar, bringing the aggregate debt burden to 37.3% of GDP by Q4 2022, up 3.1pps from Q4 2019. An increase in loan maturities, however, helped stabilise the household debt service-to-income ratio around 11.1%.
- **Financial imbalances:** Dollarisation has decreased steadily in recent years, with 44.5% of loans and 51.2% of deposits denominated in foreign currency as of May 2023, declining from 55.3% and 64.8% respectively as of end-2019. Banks are incentivised to curtail FX liabilities via lower reserve requirements in exchange for reduced deposit dollarisation. High dollarisation, especially evident in the funding structures of non-financial corporates less constrained by the high minimum size required for forex bank lending, constitutes a significant vulnerability for financial stability. Some overheating risks remain in the property sector, after a phase of significant (sale and rental) price rises, despite recent moderation in residential real estate market dynamics.

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

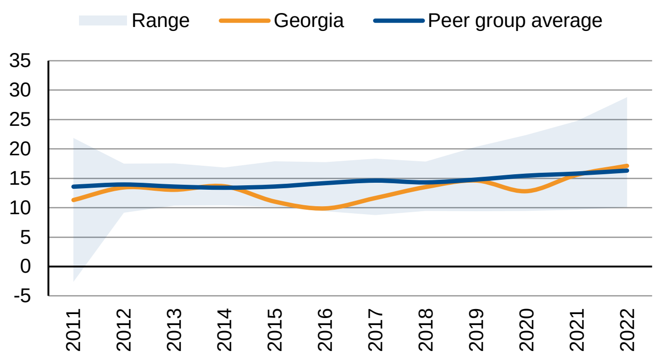
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Neutral	0	Adequate liquidity and strong capitalisation of the banking system with strong profitability
	Banking sector oversight	Neutral	0	Strengthened financial-sector supervision and regulatory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

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

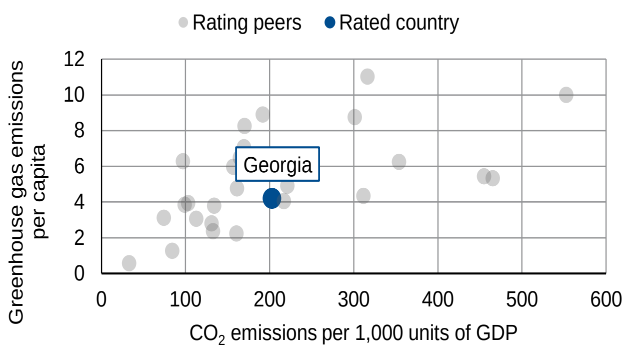
ESG Risks

- **Environment:** Georgia is exposed to substantive environmental risks, associated with elevated air pollution in main cities, illegal logging as well as cattle grazing within protected areas. This is partially mitigated by coordinated policy countermeasures such as reductions of air pollution and carbon emissions and the setting up of legislation and enforcement around waste management. CO_2 emissions intensity is moderate. However, the supply of energy remains predominantly imported. The 2030 climate-change strategy aims to curtail greenhouse gas emissions to 35% below 1990 levels for key sectors.
- **Social:** High structural unemployment and a weak social safety net represent significant longer-run challenges. The poverty ratio declined to 17.5% in 2021, from 21.3% in 2020. Net emigration has seen the working-age population declining about 0.7% a year over the past decade (furthermore anticipated to drop about 0.6% a year on average over 2023-27), weighing on the longer-run economic outlook. Some 112,000 Russians have relocated to Georgia since escalation of the Ukraine war. This represents, at least short run, a boost for the labour market.
- **Governance:** Georgia remains committed to pursuing a reform-oriented path despite increased political polarisation. Reforms are aligned with 12 priorities necessary for EU candidacy. Attempts to pass a “foreign-agents law” earlier this year reflected a concern, although this process has been cancelled. Georgia has sought to comply with sanctions adopted against Russia by the EU, the United Kingdom, the United States and other Western partners (in customs and financial sectors), but has refrained from bilateral sanctions due to the nature of Georgian exports to Russia. Georgia took proactive steps in addressing issues related to Russian-owned banks. Georgia remains in a comparatively vulnerable geopolitical position following Russia’s escalation of war in Ukraine, such as surrounding the separatist territories of South Ossetia and Abkhazia – challenging the long-run credit outlook. But Russia itself is in a weaker position than before, while western allies are stronger and more united.

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

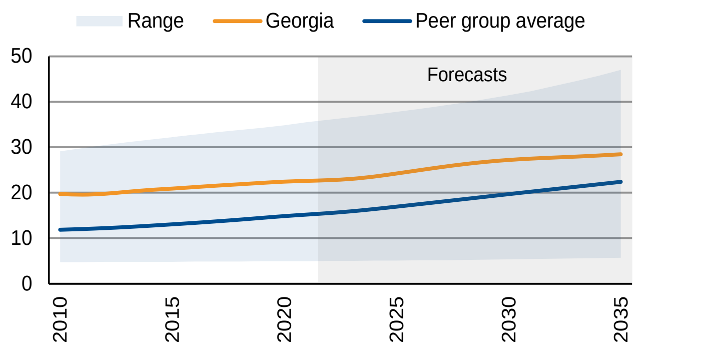
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Environmental factors	Neutral	0	Substantive environmental risk such as with relation to air pollution, but mitigated by coordinated policy countermeasures
	Social factors	Neutral	0	High, although gradually declining, rates of poverty, adverse demographics but recent significant immigration, high unemployment
	Governance factors	Weak	-1/3	Track record of high-quality and effective public administration, but domestic political risks as well as elevated geopolitical risk after Russia's full-scale war in Ukraine

Emissions per GDP and per capita, $mtCO_2e$



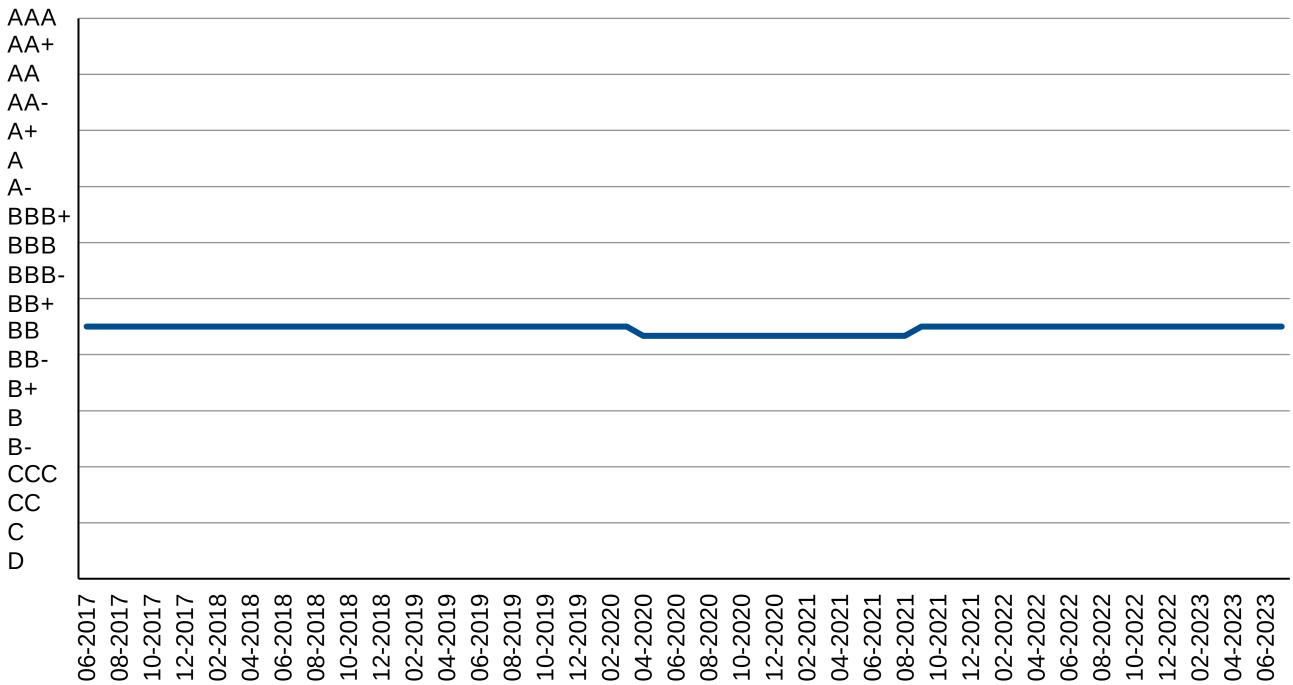
Source: European Commission, Scope Ratings

Old-age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

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, including a methodological reserve-currency adjustment.

Peer group*
Greece
Serbia
South Africa
Türkiye

*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 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022
Domestic Economic	**GDP per capita, USD '000s**	IMF	4.7	4.7	4.3	5.0	6.7
	Nominal GDP, USD bn	IMF	17.6	17.5	15.8	18.6	24.6
	Real growth, %	IMF	4.8	5.0	-6.8	10.5	10.1
	CPI inflation, %	IMF	2.6	4.9	5.2	9.6	11.9
	Unemployment rate, %	WB	12.7	11.6	11.7	12.2	11.3
Public Finance	**Public debt, % of GDP**	IMF	38.9	40.4	60.2	49.7	39.8
	Interest payment, % of revenue	IMF	4.4	4.6	6.2	5.2	3.9
	Primary balance, % of GDP	IMF	0.4	-0.6	-7.7	-4.7	-1.5
External Economic	**Current account balance, % of GDP**	IMF	-6.8	-5.9	-12.5	-10.4	-3.1
	Total reserves, months of imports	IMF	3.1	3.2	4.4	3.8	-
	NIIP, % of GDP	IMF	-131.7	-138.0	-158.6	-142.9	-
Financial Stability	**NPL ratio, % of total loans**	IMF	2.7	1.9	2.3	1.9	1.5
	Tier 1 ratio, % of risk-weighted assets	IMF	14.2	14.1	11.8	13.4	16.2
	Credit to private sector, % of GDP	WB	60.5	65.6	79.9	73.8	64.0
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	203.5	209.2	216.2	203.0	-
	Income share of bottom 50%, %	WID	13.8	13.9	13.9	14.5	-
	Labour-force participation rate, %	WB	69.7	68.4	68.7	69.1	-
	Old-age dependency ratio, %	UN	21.9	22.2	22.5	22.6	22.8
	Composite governance indicators*	WB	0.4	0.4	0.4	0.4	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Developing 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

10 avenue de Messine
F-75008 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 94 91 66 2

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

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