Republic of Georgia
Rating Report

SCOPE BB STABLE OUTLOOK

Credit strengths	Credit challenges
• Solid medium-run growth profile • Strong debt structure • Strengthened macroeconomic policy framework and record of constructive engagement with multilateral partners	• 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 2020 decline of economic output during the Covid-19 pandemic crisis, the Georgian economy has since recovered strongly. The economy benefits from strong medium-run economic growth potential, driven by recovery of 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 during 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 risk.

Rating challenges include: i) heightened geopolitical risks after Russia's escalation of conflict in Ukraine on top of risk from domestic political instability; ii) vulnerability to external shocks due to the small size of the economy (nominal GDP of an estimated USD 29bn in 2023) alongside high reliance on external financing; 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%	c		-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 over the next 12-18 months.

Positive rating-change drivers	Negative rating-change drivers
• Permanent reduction in security risk • Reduction in external-sector risk • Implementation of reforms enhances structural aspects of the economy • Improvement of fiscal sustainability	• Escalation of geopolitical risk • Deterioration in institutional quality • 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

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Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** Georgia's economy recovered strongly in 2021, growing by 10.4%, after the 6.7% decline in output in 2020 at Covid-19 pandemic crisis peaks. Despite tight economic links with neighbour Russia, which accounted for 14% of Georgian exports, 64% of net remittances and almost 28% of tourism inflows in 2022, economic growth has thus far outperformed expectations after the Russian full-scale invasion of Ukraine. Real output continued to grow by 9.3% YoY in November 2022, driven by recovering tourism-services revenues, high war-related inward migration and financial inflows, which support domestic demand, stronger exports and a strengthened lari exchange rate. After an estimated 10% growth in 2022, we expect growth to stay strong at 6.8% this year before 6% next year, on the back of easing external inflows, less favourable global economic and financial conditions alongside National Bank of Georgia (NBG)'s tighter monetary policy. Robust medium-run growth potential estimated at 5% is supported by a capacity to attract FDI, especially in financial, energy, hotels and restaurant sectors, and investment in public infrastructure works.

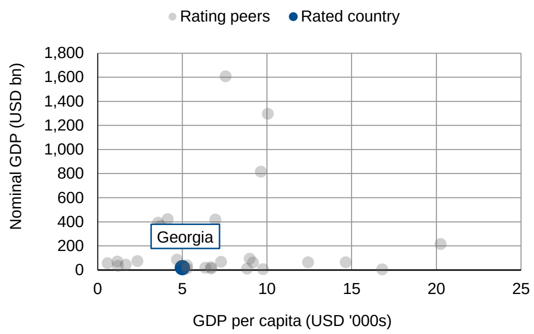
- **Inflation and monetary policy:** Sustained growth in domestic demand and higher energy and commodities prices held inflation at a high 11.9% annual average in 2022. A moderation in energy prices in the 2H of the year led to slightly eased inflationary pressures, with the inflation rate down to 9.8% YoY by December, although core inflation is elevated at 6.9%. Some inflationary pressures have derived from the labour market, with nominal wage growth of 16.5% YoY as of Q3 2022. To counter price pressures, the NBG has raised its policy rate a cumulative 300bps to 11% by March 2022 and left rates unchanged since then. We expect inflation to continue moderating this year, reaching an annual average of 5.7%, before 3.7% in 2024. The lari appreciated significantly last year, by 11.4% and 6.1% against the euro and US dollar, respectively, on back of strong economic performance. High dollarisation and the predominantly fixed-rate structure of lending mitigates effectiveness of the monetary-policy transmission.

- **Labour markets:** Due to economic recovery, the unemployment rate decreased to 15.6% in Q3 2022, from 21.9% in Q1 2021. We expect an average unemployment rate of 14.5% in 2023 before 14.2% in 2024, after the 17.1% in 2022. Changes of labour 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 31% of aggregate employed in 2020.

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

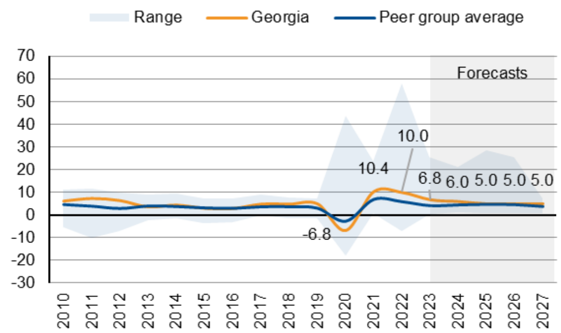
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Growth potential of the economy	Strong	+1/3	Strong medium-term growth potential of about 5% annually
	Monetary policy framework	Neutral	0	Strengthened monetary policy framework, pre-pandemic track record of managed inflation, 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

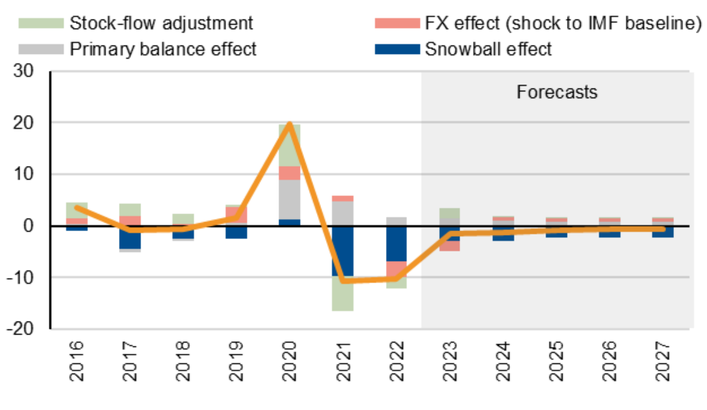
Public Finance Risks

- **Fiscal outlook:** After a period of modest budget deficits, averaging 1.2% of GDP over 2015-19, the headline budget balance deteriorated to -9.3% of GDP in 2020 before recovering partly to -6.0% of GDP by 2021. The strong revenue performance in 2022, driven by high VAT collections, as well as income and import tax revenues, resulted in significant reduction of the budget deficit, which we estimate at 2.8% last year, despite higher expenditure related to support for vulnerable households given higher energy and food prices. This would represent an overperformance compared with an initial government objective of 4% for the year – resulting in compliance with a 3% budget-deficit ceiling quicker than anticipated. We expect a fiscal deficit at 2.5% of GDP in 2023 before 2.1% in 2024. More generally, the fiscal impact of the Russia-Ukraine crisis is anticipated to be comparatively small, as the positive effects of higher inflation on revenue largely offset impact from reduced growth and economic support.
- **Debt trajectory:** The general government debt-to-GDP ratio increased 20pps from 40.4% in 2019 to 60.2% in 2020. It then decreased to 49.5% of GDP by end-2021, supported by the economic rebound and improvement in the budget balance. We expect the debt ratio to decline to 37.6% in 2023 before 34.4% by 2027, advanced by strong nominal economic growth and a commitment to fiscal prudence, although weakened by an assumed depreciation of the currency of 2.7% yearly over 2024-27 against the US dollar – set as 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. Nearly three-quarters of government debt, however, is on concessional rate terms and this helps in curtailing debt-sustainability risks and vulnerability to exchange-rate fluctuations. Further strengths of the government debt profile include a large share of long-term debt, accounting for nearly 99% of aggregate debt. The debt management strategy outlined by the Ministry of Finance for 2023-26 aims to deepen the domestic capital market 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 the share of foreign debt below 65%.

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

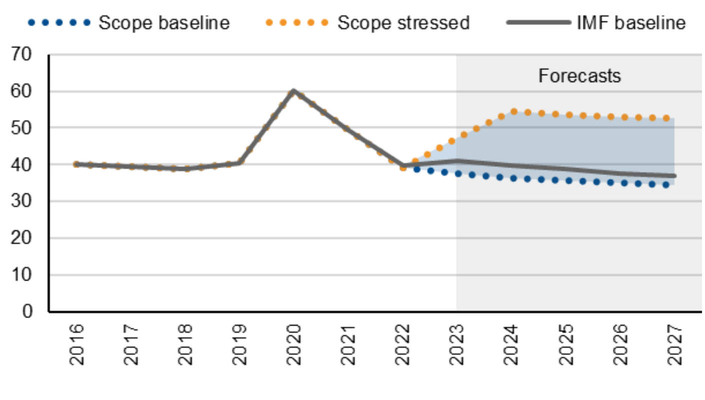
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Strong	0	Track record of contained fiscal deficits and fiscal prudence underpinned by successful engagement with the IMF; expectation of moderating deficits moving ahead
	Debt sustainability	Neutral	0	Expected decline in debt ratios medium run, but debt trajectory 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 concessional 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

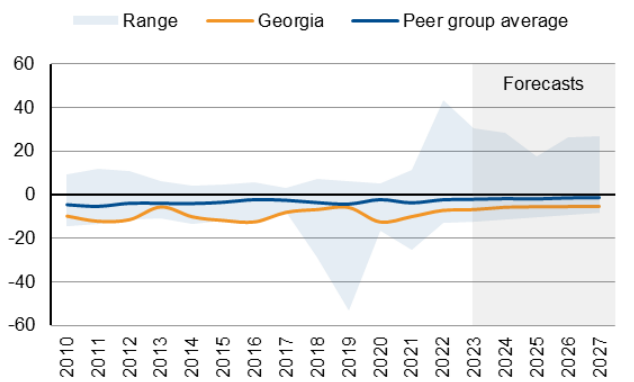
External Economic Risks

- **Current account:** Georgia displays wide, structural current-account deficits, although some improvements were observed in said deficits during years before the Covid-19 crisis, when this deficit shrunk to 5.9% of GDP in 2019 from the 12.5% of GDP as of 2016. The deficit widened in 2020 to 12.5% of GDP, mostly due to a freeze in international travel. The current account thereafter improved in 2021 to 10% of GDP and it is estimated to have further moderated to 5.1% of GDP in 2022, supported by buoyant tourism revenues (+174.9% YoY in November 2022 after arrivals of Russians, Belarusians and Ukrainians) and net remittances (+155.6% YoY in December, mostly from Russia), which outpaced growth in imports and offset a rising effect of lari appreciation. There have furthermore been some efforts at export-market diversification, with China emerging as the largest export market during January-May 2022.
- **External position:** Recurrent current-account deficits have brought an elevated net external liability position (net international investment position of about -100% of GDP as of Q3 2022, but improving from -174% as of Q1 2021). However, more than half of external liabilities is in the form of foreign direct investment and only a small share is portfolio investment. External debt has declined recently to 97% of GDP by Q3 2022, and 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. The weighted-average maturity of external public debt is above eight years.
- **Resilience to short-term external shocks:** Georgia's small, open economy is vulnerable to external crises 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 an adequate stock of official reserves, of USD 4.9bn in December 2022 (around 21.5% of GDP), increased from USD 3.8bn as of April 2022, after a series of net FX purchases by NBG 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 next three years, with USD 80m of funding available after completion of the first review (although said programme is expected to be treated on a *precautionary* basis).

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

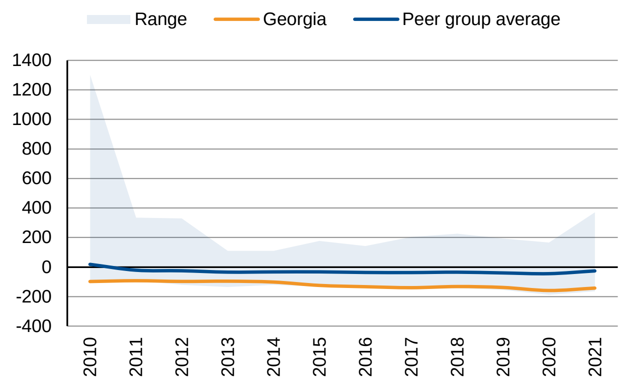
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
c	Current account resilience	Weak	-1/3	Wide structural current-account deficits, high reliance on tourism-sector revenues and remittances inflows, but significant FDI inflows
	External debt structure	Neutral	0	Significant 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 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

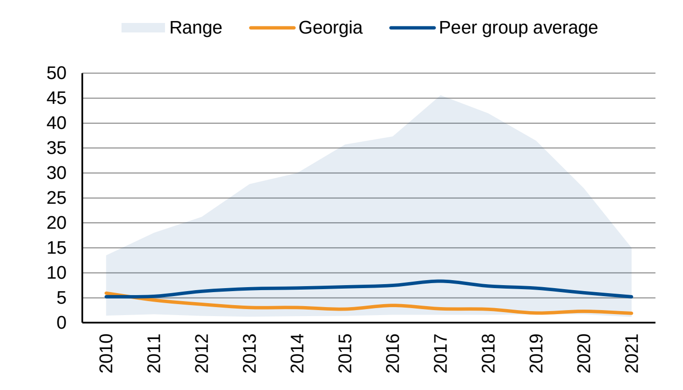
Financial Stability Risks

- **Banking sector:** The banking system has weathered recent crises comparatively well. Tier 1 capital improved during 2021 and 2022, reaching 17% of risk-weighted assets by Q3 2022, after decline during early 2020 (to lows of 11.8% in Q1 2020). Liquidity is adequate (with a coverage ratio of 109.9% for GEL assets and 144.4% for FX assets as of September 2022, each 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 4.5% by September 2022. Restructured loans have risen from 5.3% in March 2021 to 16.1% in September 2022 and are mostly concentrated in hotel, restaurants and tourism sectors. Profitability, as measured via the return on equity, has moderated since a record high 30.9% in 2021, although remaining strong at 24.8% in Q3 2022.
- **Private debt:** Credit growth has recently cooled, reaching 4.9% YoY by December 2022, mostly driven by lending in domestic currency (16.4% YoY). NBG measures have helped contain household credit growth, while higher FX borrowing costs limit growth in corporate credit. Household indebtedness is moderate, having nevertheless risen since the pandemic crisis due to strong credit growth and revaluations after lari depreciation against the US dollar, bringing the aggregate debt burden to 41.3% of GDP by Q2 2021, 3.7pps above that as of Q2 2020. An increase in loan maturities, however, helped stabilise the household debt service-to-income ratio around 12%.
- **Financial imbalances:** Dollarisation, crucially, steadily decreased, with 44.0% of loans and 57.0% of deposits denominated in foreign currency as of December 2022, declining from the 65.3% and 64.8%, respectively, as of the end of 2019. Banks are incentivised to reduce 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, all the more under current conditions of high inflation. Some overheating risks are evident in the property sector, with major (sale and rental) price rises.

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

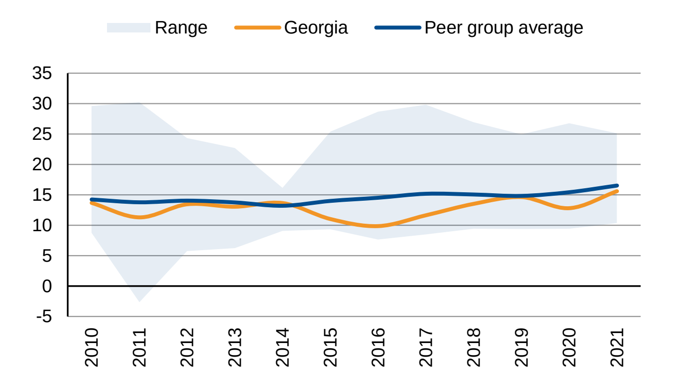
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Neutral	0	Adequate liquidity and strong capitalisation of the banking system with strong profitability
	Banking sector oversight	Neutral	0	Strengthened financial supervision and regulatory framework including via application of IMF Financial Sector Assessment Program advice
	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

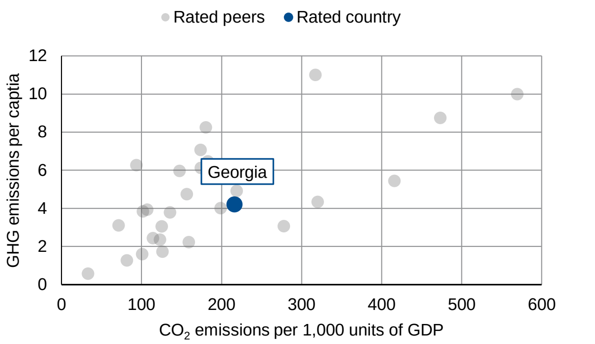
ESG Risks

- **Environment:** Georgia is exposed to substantive environmental risks, associated with elevated air pollution in its 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, with natural gas and oil products making up more than two thirds of energy supply – and most natural gas coming from Azerbaijan. 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, after an increase to 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. Up to 90,000 Russians, Belarusians and Ukrainians have relocated to Georgia since escalation of the war in Ukraine. This represents, at least short run, a boost for the labour market.
- **Governance:** Divisions remain elevated between ruling party: centre-left Georgian Dream and the largest opposition group: United National Movement in an aftermath of a severe political crisis that came after 2020 parliamentary elections. Compared to an historical record of EU-oriented reform, Georgia has recently observed democratic backsliding. While Ukraine and Moldova were granted candidate status for EU accession in June 2022, Georgia was granted a "European perspective" – e.g., candidacy only upon meeting specified institutional and governance objectives. The Georgian Dream government did not immediately participate in western sanctions, treading carefully so as to not aggravate Russia. However, authorities have more recently implemented sanctions on Russia, overseen change of ownership of one major Russian-owned bank and taken control of a formerly Russian-owned mineral water producer. Outside of Ukraine, we consider Georgia as the most geopolitically at-risk country of our rated sovereign universe to Russian aggression – challenging Georgia's long-run credit outlook. This includes risks surrounding separatist territories of South Ossetia and Abkhazia.

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

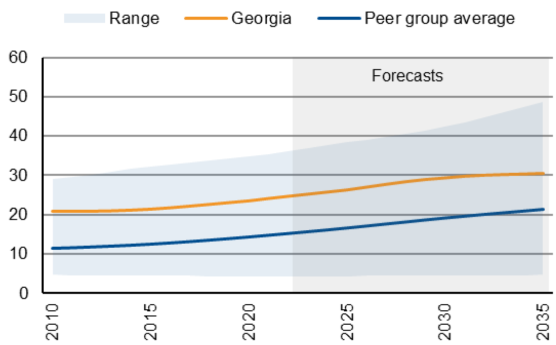
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Environmental factors	Neutral	0	Substantive environmental risk such as with relation to air pollution, but mitigated by coordinated policy countermeasures
	Social factors	Neutral	0	High, although gradually declining,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

Emissions per GDP and per capita, $mtCO_2e$



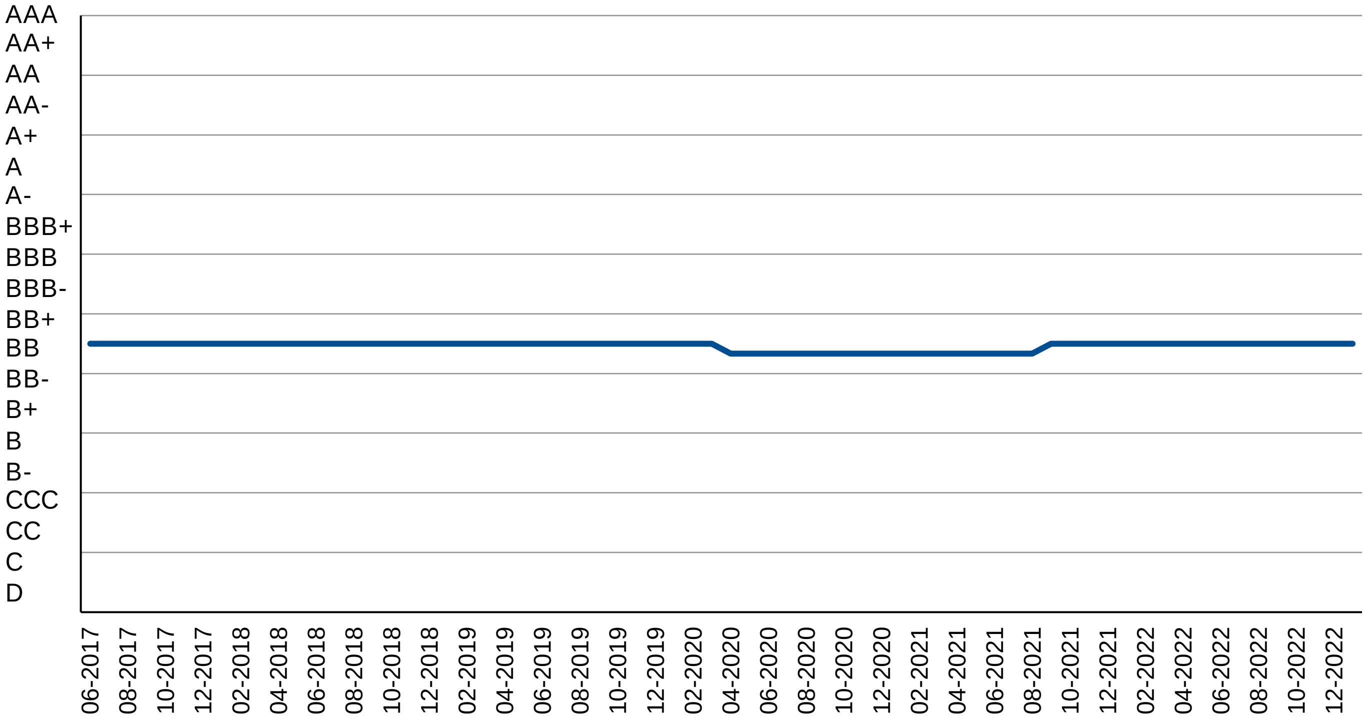
Source: European Commission, Scope Ratings

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
Turkey

*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	2017	2018	2019	2020	2021
Domestic Economic	GDP per capita, USD '000s	IMF	4,359	4,719	4,694	4,263	5,014
	Nominal GDP, USD bn	IMF	16.2	17.6	17.5	15.8	18.7
	Real growth, %	IMF	4.8	4.8	5.0	-6.8	10.4
	CPI inflation, %	IMF	6.0	2.6	4.9	5.2	9.6
	Unemployment rate, %	WB	13.9	12.7	11.6	18.5	10.7
Public Finance	Public debt, % of GDP	IMF	39.4	38.9	40.4	60.2	49.5
	Interest payment, % of revenue	IMF	4.4	4.4	4.6	6.2	5.2
	Primary balance, % of GDP	IMF	0.7	0.4	-0.6	-7.7	-4.7
External Economic	Current account balance, % of GDP	IMF	-8.0	-6.8	-5.8	-12.5	-10.1
	Total reserves, months of imports	IMF	3.2	3.1	3.2	4.4	3.8
	NIIP, % of GDP	IMF	-139.6	-131.7	-138.0	-158.6	-142.3
Financial Stability	NPL ratio, % of total loans	IMF	2.8	2.7	1.9	2.3	1.9
	Tier 1 ratio, % of risk-weighted assets	IMF	12.7	14.2	14.1	11.8	13.4
	Credit to private sector, % of GDP	WB	55.8	60.5	65.6	79.9	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	215.0	203.5	209.2	216.2	203.0
	Income share of bottom 50%, %	WID	13.7	13.8	13.9	13.9	13.9
	Labour-force participation rate, %	WB	72.7	70.3	69.4	-	-
	Old-age dependency ratio, %	UN	21.6	21.9	22.2	22.5	22.6
	Composite governance indicators*	WB	0.4	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

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