RAEX-Europe confirmed at 'BB' the ratings of Georgia. The rating outlook is stable.

RAEX-Europe confirmed the sovereign government credit rating (SGC) of Georgia at 'BB' (Sufficient level of creditworthiness of the government) in national currency and at 'BB' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The fiscal deficit expanded up to 1,8% of GDP in 2019, after investment in capital hiked during the year; while, in the same period, the augmented balance, which includes budget lending, shrunk to 2% of GDP as a result of reduced fiscal lending. Nevertheless, we anticipate the fiscal deficit to widen up to 8,2% of GDP in 2020 (8,5% for the augmented balance) as a result of the measures implemented by the government to reduce the impact of the pandemic in the economy. Income tax waivers, unemployment support, subsidies, healthcare and medical equipment acquisitions, are among the many initiatives adopted to provide economic relief. As of 8M 2020, we have observed a hike in overall expenditures by 16,7% y-o-y as a result of the execution of these programs, while lower economic activity has caused budget revenues to decline by 5% y-o-y over the same period;
- The inflation rate has declined consistently in 2020, despite GEL depreciation, as prices for food and beverages have increased at a slower pace due to a steep decline in domestic demand. As of August 2020, the y-o-y inflation rate stood at 4,8% as compared to a reading of 7% by end-2019. As the effect of the pandemic lingers in the economy, we anticipate the inflation rate to stand at 3,5% by the end of 2020;
- Domestic credit and bank assets increased in 2019 standing at 69,8% and 94,4% of GDP respectively; an increase of 3,5p.p. and 5,4p.p. accordingly. We expect both metrics to decline in 2020 as a result of the pandemic;
- FDI net inflow stood at 7,2% of GDP in 2019 mainly propelled by the financial and energy sectors. However, it has been lower as compared to 2014-2017 as a result of some projects being finalized. We expect the level of FDI to decline in 2020 due to COVID-19 implications, but it will remain solid in the mid-term horizon;
- The fiscal policy has remained generally within IMF's objectives. We anticipate a looser fiscal policy and, thus, wider deficits for 2020 as the government implements a substantial fiscal package to cushion the effects of the crisis combined with a decline in fiscal revenues;
- The quality of the monetary policy remains acceptable. The National Bank of Georgia (NBG) continues to maintain a tight policy but has slightly relaxed it in order to incentivize economic growth and credit to the economy. Evidence of this is that, since the beginning of 2020, the regulator has slashed the reference rate three times to go from 9% to a current metric of 8%. Despite the reduction, inflation is declining fast and, due to the lagging effect of monetary policy in inflation, we still expect the NBG to have room to reduce rates even further without an increase in inflationary pressures.

Restricting factors:

- The banking sector metrics remain stable, but already deteriorated. As of 2Q 2020, the NPLs to total loans ratio increased slightly up to 2,4%, the capital adequacy ratio declined to 18%, while ROA and ROE stood at -2,4% and -21,7%. However, we have already seen support from the government and the NBG;
- After a strong growth in 2019, the economy already contracted by 12% y-o-y in 2Q 2020 and an accumulated -5,6% in 1H 2020 as a result of the pandemic, which has caused tourism to come to a complete halt, exports to decline substantially and consumption to slow considerably. Thus, we anticipate the economy to contract by around 4% by end-2020, but to recover in 2021;
- Gross government debt stood at 42,7% of GDP and 160% of budget revenues in 2019. However, we have already seen the level of obligations increase in 2020 in order to finance coronavirus relief measures. As of August 2020, the level of government debt had hiked by 24% in absolute terms as compared to end-2019 and we expect it to be at 62,8% of GDP in 2020;
- The level of short-term debt increased slightly in 1Q 2020 and currently stands at around 4,5% of GDP and covered 5x by international reserves. Despite this, as of August 2020, 78% of the government debt was FX-denominated which increases the repayment risk in case of a sharp currency depreciation. However, only 8% is represented by the FX-denominated Eurobond, which matures in April 2021 for which USD 500 m will have to be repaid. The other 92% of the external debt is with bilateral and multilateral creditors at favorable terms;
- Georgia's GDP per capita metric in PPP terms was around USD 12,3th in 2019 and remains at an acceptable relative to its peers[1];
- The banking sector's concentration remains elevated as the top three banks (TBC Bank, Bank of Georgia and Procredit Bank) account for about 77% of the total banking system's assets, which carries negative effects for the competition level in the country;
- Institutional development in Georgia remains moderate. The country has a Human Development Index (HDI) adjusted for inequality score of 0,69 and, while most governance indicators improved slightly, political stability remains a challenge for the country. Moreover, it is ranked 44th out of 180 in the Corruption Perceptions Index and 74th out of 141 countries in the Competitiveness Index from the World Economic Forum. However, conditions for business are favorable as the country ranked 7th out of 190 countries in the Doing Business ranking published by the World Bank in 2019.

Negative factors:

- The key negative factor for Georgia remains the exposure to external shocks. In 2019, the trade balance of goods and services stood at -8,9% and the current account balance stood at -5,1%. Both metrics reflect Georgia's dependence on imported goods, remittances and foreign investment. Moreover, as of end-2019, the external debt of the economy was around 107% of GDP and the banking sector remains highly dollarized. We expect the current account balance to worsen further down to -11,3% of GDP as a result of lower income from tourism and interests, as well as lower remittances; while the deep decline in exports will balance out with the deterioration of imports. Finally, we expect the GEL to remain pressured by external imbalances from trade partners, as well as lower tourism;
- Contingent liabilities stemming from inefficient and unprofitable SOEs, as well as power purchasing agreements (PPAs) attributed to hydropower companies with attached government guarantees and public-private partnerships (PPPs) remain elevated and the risk of materialization is moderately high;

[1] Even though Azerbaijan's metric is higher, it is mainly inflated due large part of GDP being made of the hydrocarbon sector.

* The level of unemployment rate, as expected, climbed up to 12,3% as of 2Q 2020;
* Even though the stock and bond markets remain undeveloped as compared to mature markets, it is ahead of regional peers. As of September 2020, the stock market capitalization stood at around 4,8% of GDP. Moreover, the number of corporate bonds trading in the Georgian stock exchange is limited. We still expect further development of the capital markets in the long-term perspective, as there are plans to strengthen this segment.

Stress factors:

* Financial dollarization remains high in Georgia; loans and deposits in FX were equivalent to 56% and 60% of total portfolio as of August 2020 (moderately weak stress-factor);
* Political risk stemming from the unresolved conflict of South Ossetia and Abkhazia with Russia (moderately weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

* Decrease of external exposure by reducing FX-denominated debt, advancing de-dollarization measures, increasing national savings, buffering-up international reserves and further developing productive sectors of the economy in order to reduce reliance on imports;
* A substantial reduction in the amount of contingent liabilities which would reduce the overall government debt level.

The following developments could lead to a downgrade:

* Strong negative impact from the coronavirus crisis, which would negatively affect the exchange rate causing asset deterioration in the financial system and reduction in international reserves as well as economic volatility;
* Deterioration of the fiscal position by widening the fiscal deficit and increasing government debt including contingent liabilities' materialization as a result of additional spending needs due to the coronavirus crisis.

ESG Disclosure:

Inherent factors

* Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

* None.

"The confirmation of Georgia's ratings at 'BB' reflects our view that the negative fiscal and economic effect from the pandemic will be short-lived and it will be cushioned by external financing at concessional terms. We also expect the economy to recover in 2021. Moreover, the monetary policy has been adequate, adapting to the current economic situation and stabilizing the level of inflation, while the banking sector metrics remain quite satisfactory under the current circumstances.

However, the coronavirus crisis has had a direct impact on the economy and has worsened the country's external position. Moreover, the measures implemented by the government combined with the depreciation of the GEL will have a negative impact on the fiscal budget and public debt in 2020." – Clarified Hector Alvarez, Associate Director of RAEX-Europe.

Research report on Georgia is available at:

https://www.raexpert.eu/reports/Research_report_Georgia_02.10.2020.pdf

Next scheduled rating publication: TBD December 2020**.** The full sovereign rating calendar can be found at Sovereign Rating Calendar 2020

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
03.04.2020	Schedule review of both types of ratings for the country	BB	BB	Stable	Stable
04.10.2019	Schedule review of both types of ratings for the country	BB	BB	Stable	Stable
05.04.2019	First assignment of both types of ratings for the country	BB	BB	Stable	Stable

Minute's summary

The rating committee for Georgia was held on 1 October 2020. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from April 2019). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, National Bank of Georgia, National Statistics Office Georgia, Ministry of Finance of Georgia, Georgian Stock Exchange, Cbonds.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.