Rating-Agentur Expert RA confirmed at 'BB' the ratings of Georgia. The rating outlook is stable.

Rating-Agentur Expert RA 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:

- As anticipated, the fiscal deficit, according to preliminary figures from the Ministry of Finance, is expected to have increased up to 2,9% of GDP in 2019 as capital expenditures increased substantially throughout the year, while social benefits also saw an important hike in 2019. The acquisitions of non-financial assets saw an increase of 35% y-o-y supported by a solid increase in revenues of around 9,2% due to solid goods and services, as well as income tax collection. Moreover, the augmented fiscal balance, which includes budget lending, is expected to have widened to around 3,1% of GDP, a narrower gap as compared to the official balance as budget lending has decreased substantially. Even though we anticipate fiscal discipline to continue going forward, recent measures as a result of the coronavirus crisis will expand fiscal spending;
- In 2019, the economy posted another year of strong growth at 5,1% as compared to a metric of 4,7% in 2018. The retail and real estate sector showed a solid hike of 9% and 6% respectively in real terms. On the other hand, household consumption remained stable throughout the year and posted an increase of 12,8% while government spending saw a deceleration toward 4Q 2019 but was overall solid growing at 8,7% by year-end 2019. We expect the economy to lose momentum in 2020 as a result of the crisis related to COVID-19. Moreover, the IMF is already working with the authorities to provide aid under the Extended Fund Facility arrangement;
- The inflation rate stood at 7% at the end of 2019 as a result of higher food, alcohol and tobacco prices. Even though we expect the metric to decline by the end of 2020, it may not be accomplished as a result of the impact from the coronavirus crisis;
- Credit to the economy continued to increase in a sustained manner. By the end of 2019, banks' assets to GDP stood at 104,4%, while we forecast the level of domestic credit to have stood at around 78% of GDP as of the same date. Moreover, the share of corporate and individual entrepreneur loans (55,1% of the total portfolio) continues to increase and remains larger than that of individual loans (44,9% of the total portfolio), reflecting increasing financing to the productive sector of the economy. In addition, we saw the level of growth in mortgages decline since August 2019;
- The banking sector remains solid. As of the end of 2019, the NPLs to total loans ratio decreased down to 1,9%, the ratio of regulatory capital to risk-weighted assets was 19,5%, while, despite slightly declining, profitability indicators remain positive posting a ROA of 2,5% and ROE of 20,3%. Moreover, amidst the coronavirus crisis, the government has indicated that banks will restructure loans of businesses, which may confront repayment issues, while household loans will obtain a 3-month grace period to repay debt. In

addition, the central bank has already alleviated capital requirements in order to cushion losses;

- FDI net inflow is expected to have remained stable and solid in 2019 at around 6% of GDP. This was mainly propelled by the financial and energy sectors. However, it has been declining for the past two years as a result of some projects being finalized. We expect the level of FDI to remain solid, however, in case of materialization of external shocks, foreign investments could unwind causing economic instability;

- The quality of the fiscal policy remains adequate; however, even though the official and augmented deficits widened, these have remained broadly within the IMF's objectives. Additionally, the government has shown commitment to responsible public finances by meeting goals and objectives set. However, as mentioned previously, the government will expand fiscal spending to cushion the shock of the coronavirus crisis as it recently pledged around GEL 2 bn (around 4% of GDP) to support the economy. Moreover, the authorities have also announced measures to postpone taxes and increase VAT refunds to companies engaged in tourism-related activities;

- The quality of the monetary policy is favourable. Georgia has a floating exchange rate regime, which is optimal to absorb external shocks, and a monetary policy based on achieving price stability. As previously mentioned, inflation picked up substantially in 2019 up to 7%, far away from the 3% target of the National Bank of Georgia (NBG); however, we consider this increase to be a result of a one-off event. As a result, the NBG continues to tighten monetary conditions as it has already increased the policy rate twice since our last revision and now stands at 9%. Despite the current situation as a result of the coronavirus spread, the NBG has committed to keep a tight policy in order to bring inflation back to the target. In our opinion, the view of the NBG could rapidly change depending on the real impact of the coronavirus crisis on the economy.

Restricting factors:

- The level of gross government debt recorded acceptable figures of 45,7% of GDP and 163,3% of budget revenues in 2019. Moreover, the readings have remained stable and we expect them to remain so going forward as the government targets consolidation and debt sustainability. However, as mentioned previously, the government has committed to spend around 4% of GDP to reduce the coronavirus crisis impact, which, as a result, could cause debt levels to rise;

- The structure of government debt remains contrasting. As of 3Q 2019, short-term debt stood at 4% of GDP and accounted for 8,7% of total debt, and was covered 5,5x by international reserves remaining at favorable levels. However, 79% of the debt is denominated in foreign currency, which poses a repayment risk in case of a currency depreciation. This is partially mitigated by the fact that most of Georgia's debt remains concessional. In addition, more domestic issuance is expected by the government in the medium term;

- Georgia's GDP per capita metric in PPP terms is expected to stand at around USD 12 227 for 2019 and remains at an acceptable level 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.

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

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:

- Despite having shown resilience to external events, Georgia still has substantial external weaknesses. The trade deficit decreased slightly to 10% of GDP while the current account was also lower at 5,7%; however, both remain quite wide and show the country's dependence on imports and foreign inflows in the form of remittances and investments. In addition, the level of external debt in the economy remained at 113% of GDP as of 3Q 2019 while dollarization is still elevated. Due to the substantial external exposure, the coronavirus crisis could impact the economy as FDI could decline and currency depreciations may cause imports to be more expensive and exacerbate inflationary pressures;
- 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;
- The level of unemployment rate, remained high at 11,6% in 2019 according to the local statistical service; but has been gradually declining over the past six years;
- Even though the stock and bond markets remain undeveloped as compared to mature markets, it is ahead of regional peers. As of March 2020, the stock market capitalization stood at around 3,8% of GDP, a steep decline in the last month due to the impact of the coronavirus crisis. 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 54% and 62% of total portfolio as of February 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' mainly reflects solid economic growth, stable public finances supported by a sound fiscal policy, a prudent monetary policy and a sound banking system.

However, the ratings were limited mostly by the weak external position as shown by large trade and current account deficits, high dependence on imports and external funds, as well as high levels of dollarization.

Moreover, we expect the coronavirus crisis to have a direct impact on the economy and public finances as the government has already announced support measures. We could also see an impact on inflation due to the depreciation of GEL and the high level of imports." – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Georgia is available at:

https://www.raexpert.eu/reports/Research_report_Georgia_03.04.2020.pdf

Next scheduled rating publication: 2 October 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
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 2 April 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

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.