# Rating-Agentur Expert RA assigned 'BB' ratings to Georgia. The rating outlook is stable.

Rating-Agentur Expert RA assigned 'BB' sovereign government credit rating (SGC) to Georgia in national currency (Sufficient level of creditworthiness of the government) and 'BB' in foreign currency (Sufficient level of creditworthiness of the government). 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:

- Georgia's fiscal deficit stood at 1,2% of GDP remaining within the 3% threshold included in the fiscal rule. However, the augmented balance calculated by the IMF, which includes budget lending, stood slightly wider at around 2,8% of GDP;
- The Georgian economy grew at an average pace of 2,9% in 2015 and 2016 and by as much as 4,7% in 2018 as a result of increased external demand for Georgian exports, tourism activity and private consumption. We anticipate the economy to continue growing at a stable pace going forward, but with downside risks stemming from external exposure;
- The inflation level in the country stood quite low in 2018 as CPI grew by 1,5% y-o-y remaining below the National Bank of Georgia's (NBG) 3% target. However, the inflation reading has remained volatile for the past years;
- The level of credit to the economy is adequate. Bank assets to GDP stood at 95,5% and domestic credit to GDP at about 70,6% in 2018. Moreover, both figures have been consistently hiking. Nevertheless, growth in credit, especially household credit, has been increasing faster than expected causing the authorities to intervene in order to curve growth;
- Indicators of the banking system are favourable. NPLs to total loans ratio stood at 2,7% while the capital to assets ratio was 12,9% and the regulatory capital to risk-weighted assets posted a figure of 18,4% in 2018. Furthermore, profitability and liquidity have also been stable and solid. Despite the high level of dollarized consumer loans, prudential regulation introduced by the NBG[1], alongside an increased stability in the exchange rate, is expected to quantify and contain potential rise in NPLs due to the income-payment currency mismatch;
- FDI in the country has been strong and consistent, but declined by around 5p.p. in 2018 down to about 7% of GDP mainly due to lower flows from Azerbaijan. Regardless, the level remains adequate showing a solid investment potential in the country;
- The quality of the fiscal policy is positive. Fiscal deficit and government debt have remained stable and within the fiscal rule thresholds. We anticipate the fiscal rule to be revamped to include contingent liabilities under the debt ceiling and to add transparency, which is credit positive;
- 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

[1] The *risk-based capital buffer* introduced back in 2017 was established to reduce risk in these types of transactions as banks have to calculate risk based on Loan-to-Value and Payment-to-Income Ratios. Most importantly, these requirements are higher for FX-denominated loans.

stability. The inflation level in 2018 stood below the NBG target of 3% and, as a result of lower inflationary pressures, the NBG trimmed the refinancing rate by 0,25p.p. back in January 2019 and by another 0,25p.p. in March 2019 down to 6,5%. Going forward, we expect the policy to loosen further and inflation levels to remain balanced as well as de-dollarization efforts to continue.

Restricting factors:

- The level of gross government debt is acceptable at 43,9% of GDP and 157,8% of budget revenues. These figures are better as compared to its regional South Caucasus peers[2] and they have remained substantially stable for the past years;
- The government debt structure remains favorable in terms of maturity as short-term obligations were as low as 8% of total government debt and 3,6% of GDP as of 3Q 2018; additionally, this type of debt is covered by international reserves by 5x. However, the currency structure in not fully ideal as external debt was 81,7% of total debt as of end-2018; despite this, only 9,5% is from the Eurobond issue while the rest is bilateral and multilateral mostly in concessional terms;
- Georgia's GDP per capita indicator in PPP terms for 2018 stood at USD 11 600 and is at an acceptable relative to its peers[3];
- The banking system in Georgia is highly concentrated as the top three banks (TBC Bank, Bank of Georgia and Liberty bank) account for about 77% of the total banking system's assets, which carries negative effects for the competition level in the country. Moreover, the sector is 90% foreign-owned;
- Institutional development in Georgia is acceptable. The country has a Human Development Index (HDI) adjusted for inequality score of 0,680 and favourable governance indicators. Moreover, it is ranked 41st out of 180 in the Corruption Perceptions Index, 66th out of 140 countries in the Competitiveness index from the World Economic Forum and 6th out of 190 countries in the Doing Business ranking published by the World Bank in 2019.

Negative factors:

- External vulnerabilities are the main threat to the sovereign's creditworthiness. The trade deficit for products and services, as well as the current account deficit, was substantially wide at 11,5% and 8% respectively in 2018 reflecting large external financing needs. Georgia depends heavily on imports (69% of GDP in 2018), mainly oil and gas, as well as remittances and FDI. In addition, the economy's external debt is wide and buffers, albeit increasing, remain insufficient to weather a potential external shock which would exert pressure on the GEL;
- The amount of contingent liabilities in Georgia is high. According to the fiscal law, the amount of such liabilities related to SOEs was equivalent to around 20% of GDP in 2018 for risky companies. This, combined with the unprofitability and lack of productivity of these types of enterprises, increases the risk of the materialization of these liabilities. Moreover, contingent liabilities for the government also arise from existing power purchasing agreements (PPAs) which have attached government guarantees as well as public-private partnerships (PPPs);
- The level of unemployment rate remains high at 12,7% as of the end of 2018;
- The stock and bond markets remain largely underdeveloped. The stock market capitalization was as low as 4,7% of GDP and there are only 16 corporate bonds trading in the Georgia stock exchange. However, there are plans in place in order to further develop the non-bank financial system.

[2] South Caucasus peers are Azerbaijan and Armenia.
[3] Even though Azerbaijan's metric is higher, it is mainly inflated due large part of GDP being made-up from the hydrocarbon sector.

Stress factors:

- Financial dollarization is high in Georgia; loans and deposits in FX were equivalent to 56% and 63% of total portfolio as of February 2019 (moderately weak stress factor);
- Political risk stemming from the unresolved conflict in South Ossetia and Abkhazia with Russia (moderately weak stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Decrease of external and FX exposure by reducing external debt, advancing de-dollarization measures, increasing national savings, buffering-up international reserves and further developing productive sectors of the economy;
- 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:

- Unexpected negative external developments which would hit 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.

"The 'BB' sovereign government credit ratings assigned to Georgia reflect solid public finances with controlled budget balances and public debt, efficient monetary policy, sound banking system metrics and lingering solid macroeconomic growth with low levels of inflation.

However, it also reflects the economy's external vulnerabilities as a result of its wide open economy, high levels of dollarization, substantial dependence on imports, FDI and remittances as well as elevated levels of external public and private debt.

The stable outlook reflects that in the mid-term perspective we anticipate with a high probability that all underlying factors affecting creditworthiness will behave according to our base forecast scenario." – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Georgia is available at:

https://raexpert.eu/reports/Research_report_Georgia_05.04.2019.pdf

Next scheduled rating publication: 4 October 2019. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

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**Minute's summary**

The rating committee for Georgia was held on 4 April 2019. 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 May 2018). 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.

**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.

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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.

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