



# Restart in action

ONLY PARTIALLY LED BY THE  
TOURISM RECOVERY

## MACRO INSIGHTS

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**Otar Nadaraia**

Chief Economist, TBC Group

**Ana Mjavanadze**

Acting Head  
Macro-financial Analysis Division

**Juli Avlokhshvili**

Analyst  
Macro-financial Analysis Division

**Levan Mikeladze**

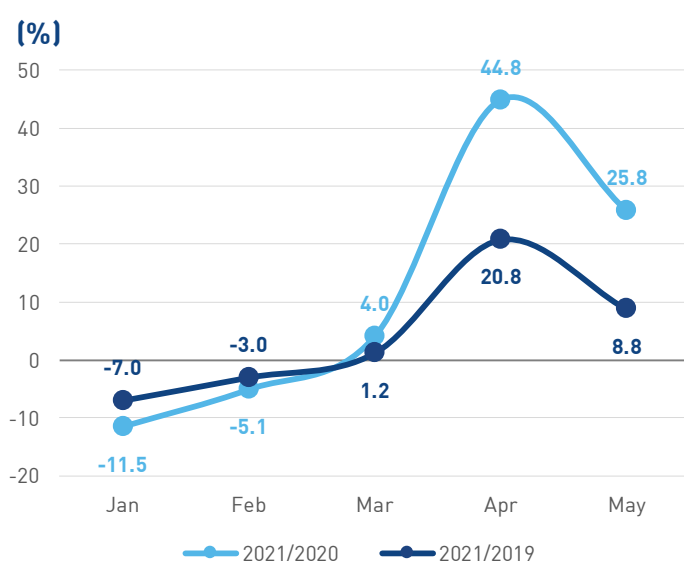
Analyst  
Macro-financial Analysis Division

## Content

- **Growth beating all, even the most bullish expectations, while the sufficient vaccination level still in pipeline.....3**
- **Odds of the Fed rate hikes higher, however, not necessarily deteriorating the outlook.....8**
- **Inflation close or above the NBG's tolerance level in 2021, though vice versa a year after.....11**
- **We remain broadly neutral on the USD/GEL and EUR/GEL, while being somewhat bullish on the GEL REER.....13**

# Growth beating all, even the most bullish expectations, while the sufficient vaccination level still in pipeline

## Real GDP growth

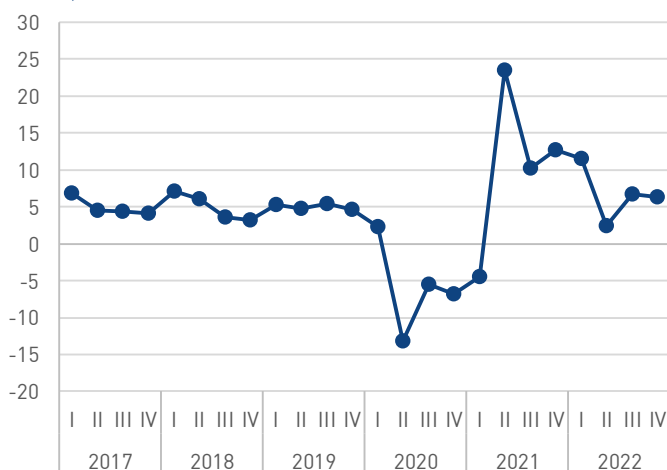


Source: Geostat, TBC Capital estimates

Like most of the world, Georgia endured an economic downturn in 2020 as a result of the COVID-19 pandemic, with real GDP down by 6.2%. Though, the economic outcomes varied significantly over the course of this year - the first quarter real GDP growth came in at a negative 4.5%, yet affected by the pandemic-related restrictions and still relatively high base effect a year before; thereafter, amid easing COVID-related restrictions and global recovery, the economy has embarked on a rebound path. Georgia's economy showed unexpected strength in April with real GDP expanding by 44.8% year-on-year and by an approximate 20.8% compared to the same month of 2019, according to the rapid estimates released by Geostat. The economy has sustained continuous, solid growth for the second month in a row, as in May real GDP grew by 25.8% year-on-year or by 8.8% relative to 2019. Importantly, the growth is broad-based supported by the strong exports and remittances as well as gradual recovery in tourism inflows coupled with strong domestic demand.

## Real GDP growth projection

(YoY, %)

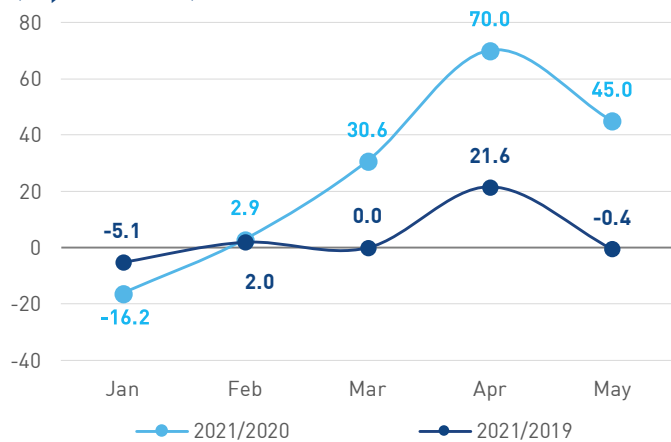


Source: Geostat, TBC Capital

The large fiscal support - equivalent to 9.3% of GDP in 2020 - is expected to be supportive in 2021 again with a planned budget deficit at 7.6% of GDP. Thereafter, fiscal stimulus is partially to be unwound with 4.6% of GDP next year, though being more than compensated by the almost full recovery in the tourism inflows. We stick to our view - in fact, confirmed by the 2021 tourism recovery even under curfew and only partially opened borders - that the Georgian tourism industry has the strong rebound capacity with still untapped potential.

## Exports

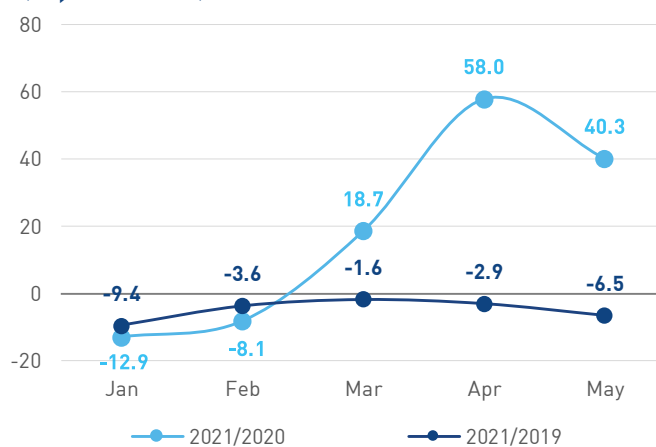
(%, US dollar)



Source: NBG

## Imports

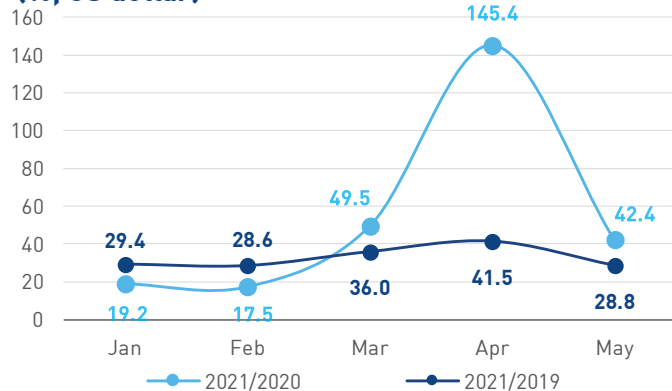
(%, US dollar)



Source: NBG

## Remittances\*

(%, US dollar)

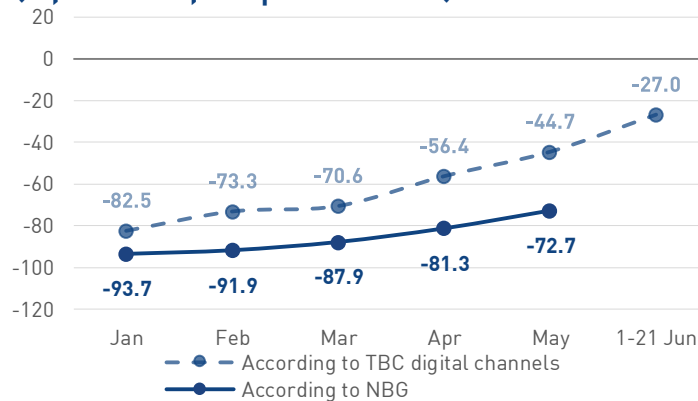


\*Before Apr-2021, some of the increase was due to the reduced cash inflows and increased digital transfers as a result of the closed borders

Source: NBG

## Tourism inflows\*\*

(%, US dollar, compared to 2019)

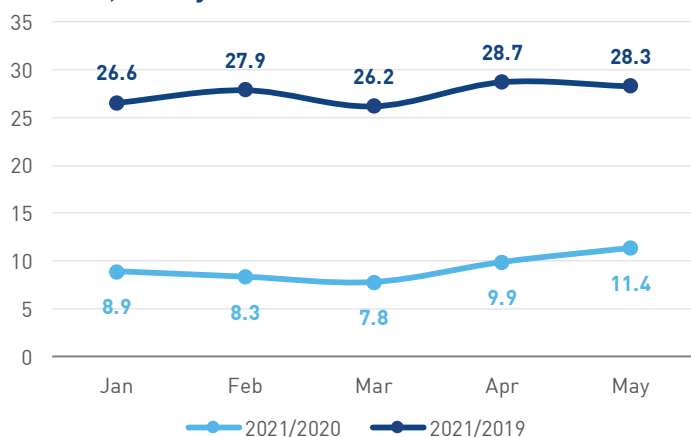


\*\*The growth of non-cash expenses of non-residents is based on POS and E-commerce payments through TBC ct share of non-cash transactions and TBC market share

Source: NBG, TBC Bank, TBC Capital estimates

## Loans

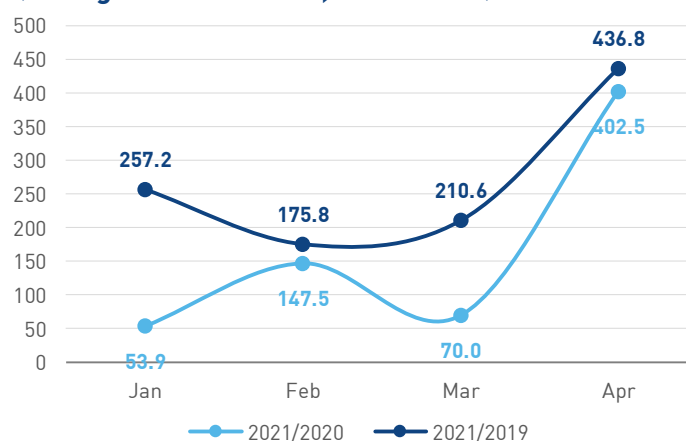
(% GEL, FX adjusted)



Source: NBG, TBC Capital estimates

## Budget deficit

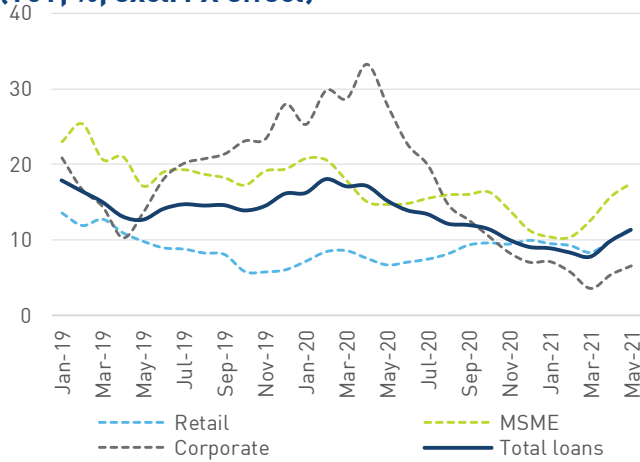
(Change in million GEL, cumulative)



Source: Ministry of Finance, TBC Capital estimates

## Growth of loans by segments

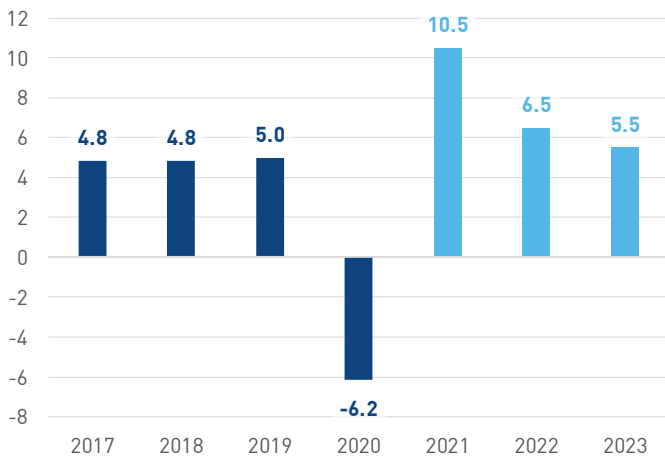
(YoY, %, excl. FX effect)



Source: NBG, TBC Capital estimates

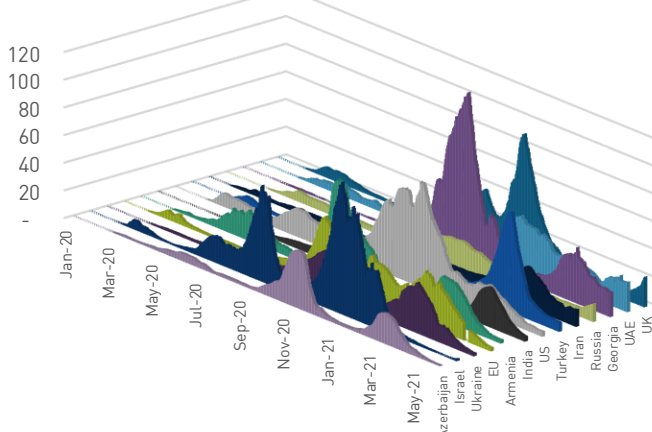
## Real GDP growth projection

(%, YoY)



## Dynamics of COVID-19 daily cases in selected entities

(7-day MA, per 100k people, as of 27-Jun-2021)



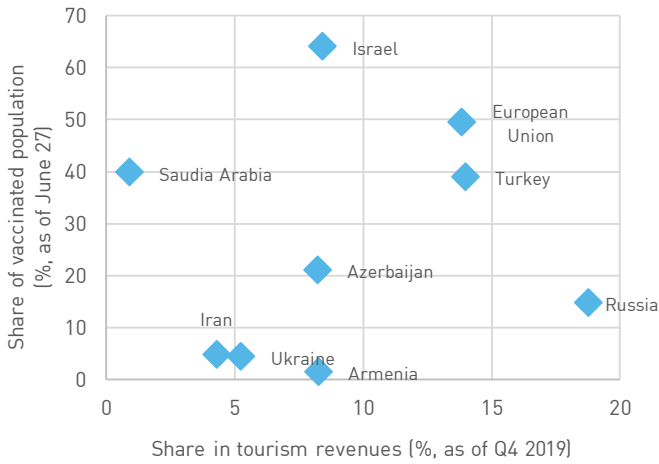
On the credit side, following relatively moderate growth rates in 2020, activity in 2021 on the back of strong rebound in the economy, inventory buildup, and elevated inflation is expected to be quite high. Interestingly, although business loans act as a cyclical play during the usual business downswings and take more time to recover, this time as the pandemic is an exogenous, rather than endogenous shock, the traditional time lag seems to be non-relevant (see [July 2020 Comparing the 2008 and 2020 Shocks](#)).

Although high annual prints in April and May were backed by the low base effect from a year ago, the robust growth yielding better-than-expected results even compared to 2019 indicates to a powerful restart of the economy. Pent-up demand in certain areas of the economy likely supported the strong rebound in spring months. This effect will gradually wane, thus, in seasonally-adjusted quarter-on-quarter terms the third quarter's GDP is assumed to be flat or even below the second one. Even so, the 2021 growth is expected at around 10.5% despite the fact that sufficient vaccination level is still in pipeline.

After declining in early 2021, daily new COVID-19 cases accelerated alongside the emergence of new variants and increased population mobility in spring. Currently, the number of new cases are still high, but with declining tendency and the 14-day positivity rate within the recommended range.

Although the start of vaccinations in most region economies is a positive development, progress remains uneven with number of countries lagging behind the world average. Georgia, among other region countries, faces vaccine procurement challenges, which most likely is temporary and will be resolved. As enough vaccine supplies will enter the country, administration challenges and low take-up rate owing to resistance in the society still remain in place. Accordingly, we maintain our view that the herd-immunity threshold for Georgia will be reached in the second quarter of 2022.

## Vaccination in important countries for Georgian tourism

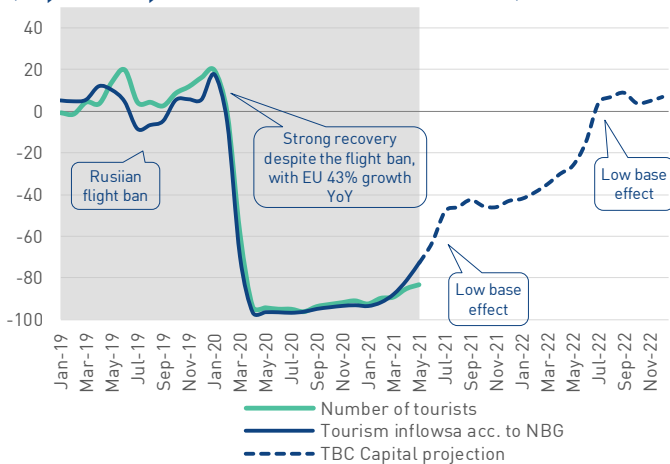


Source: Our World In Data, NBG, GNTA

As all restrictions on mobility, including land-border closures from June 1<sup>st</sup> and night curfew from July 1<sup>st</sup>, are being lifted, the rebound is expected to be fueled by the domestic demand as well as boosted tourism recovery. However, having in mind the low vaccination rate, the risks of accelerating the infection rate is considerable. Thus, in the baseline scenario, we assess the probability of introducing a partial lockdown during the fall with 50%. Even with the lockdown, we believe the restart will be only postponed somewhat with minor impact on 2021-2022 growth outlook, assuming the worldwide progress in containment of the pandemic is maintained.

## Tourism inflows

(%, in USD, from 2021 relative to 2019)

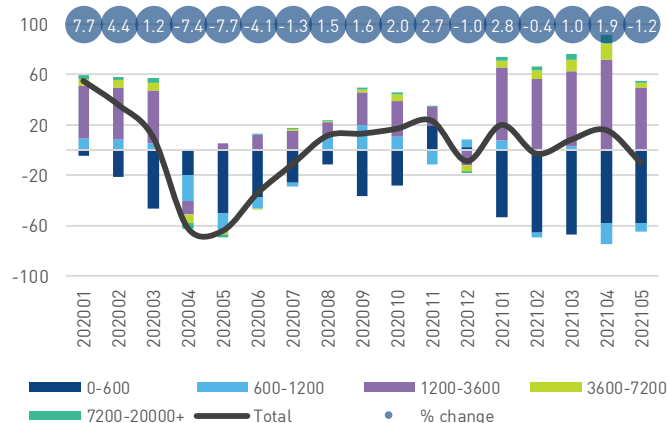


Source: NBG, GNTA, TBC Capital estimates

The restart is also visible in the labor market data based on the number of hired employees, likely reflecting some substitution effect between more and less damaged sectors as well as some trend of stronger hired employment in Georgia. Important to mention that quite strong hired labor market data is not driven by the increased share of low-wage salary employment, which could be the case when employees lose their jobs but maintain only a small fraction of their pre-pandemic salaries. At the same time, more comprehensive analysis is required once the relevant Geostat data is released.

## Hired employees by wage groups

(Compared to 2019, thousand people)



Source: Ministry of Finance

## Major macro variable projections for 2021 – 2022 according to TBC Capital

(YoY, %)	2021		2022		
	2020	April projections	Updated projections	April projections	Updated projections
EXPORTS*	-12.0	+16.5	+23.5	+12.0	+12.0
TOURISM*	-84.0	+47.9% / -75% rel. to 2019	+138.7% / -60% rel. to 2019	+267.8% / -10% rel. to 2019	+128.6% / -10% rel. to 2019
REMITTANCES*	+5.5 <sup>1</sup>	+18.0	+24.5	+10.0	+11.0
FDI*	-30.5 <sup>2</sup>	+10.0	+10.0	+30.0	+30.0
IMPORT OF GOODS AND SERVICES*	-20.0	+14.5	+21.0	+19.0	+18.0
FISCAL DEFICIT**	9.3	7.6	7.1	4.4	4.4
BANK CREDIT***	+9.1	+12.0	+16.2	+14.0	+13.6
GDP GROWTH	-6.2%	+5.5%	+10.5%	+7.0%	+6.5%

\*Growth in USD \*\* Ratio to GDP, as planned by the MoF, IMF methodology \*\*\*End of period, constant exchange rate

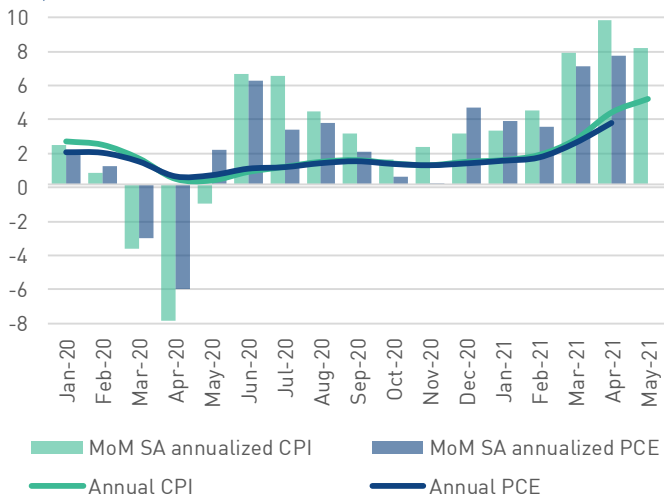
For GDP estimation inflation adjusted period credit growth is used. Also, the calculation is based on the estimation of inflows in real terms in GEL, not in USD. Moreover, various other assumptions are used in terms of the impact of key macroeconomic variables on economic growth

- Adjusted taking into account reduced cash inflows due to closed borders
- In Q4 2020, the main reason for the decline of FDI was transferring of ownership from non-resident to the resident companies, without cash outflow, but still reducing FDI by around 295 m USD. Adjusting for this component, FDI fell by 30.5% YoY, while without adjustment they fell by 52.9% YoY

# Odds of the Fed rate hikes higher, however, not necessarily deteriorating the outlook

## CPI and PCE inflation in USA

(%, MoM SA & YoY)



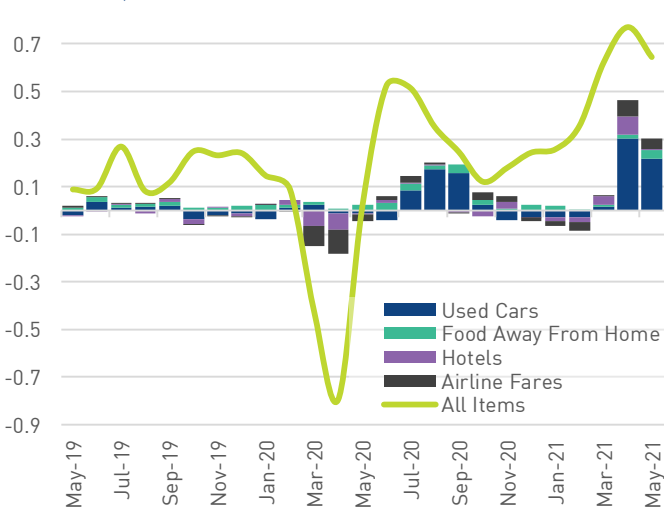
Source: St. Louis Fed

The US economy, being one of the most important engines of global growth, is certainly leading the restart on the back of the successful vaccination and large fiscal and monetary stimulus. At the same time, the positive US outlook can counterintuitively be unfavorable for the number of emerging economies dependent on the commodity prices and the USD funding as higher USD yields and the stronger dollar traditionally impact the abovementioned economies negatively (see [May 2019 TBC Economic Review](#)).

During its June FOMC meeting, the Fed brought slightly forward the rate hike projections to 2023 and used relatively more hawkish tone. Higher increase in prices in the US was well expected, however 5% YoY CPI inflation caught both markets and Fed by surprise. Fears of prolonged inflationary pressures can be easily played down when considering that most of the price spikes were due to the pandemic affected products like used cars, hotels, airline fares etc. There are additional arguments bolstering the transitory position, including weak payrolls and the market sentiment which does not expect rampant inflation with 5 year breakeven well under 2.5%. At the same time, the importance of the share of international freight bottlenecks in the overall inflation was likely somewhat exaggerated. Prices on the goods will eventually hit the ceiling, whereas services account almost two thirds in the CPI basket and haven't surpassed pre-pandemic growth levels yet. Eviction moratorium has further subdued shelter prices, but the surging cost of the housing, which has surpassed that of the

## US CPI inflation decomposed

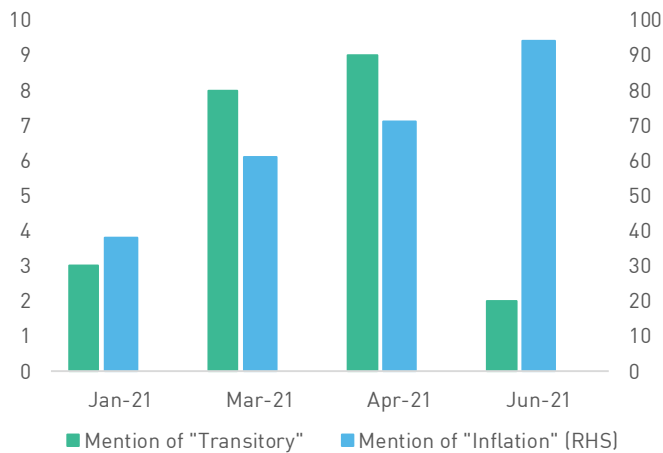
(MoM SA, %)



Source: Bureau of Labor Statistics



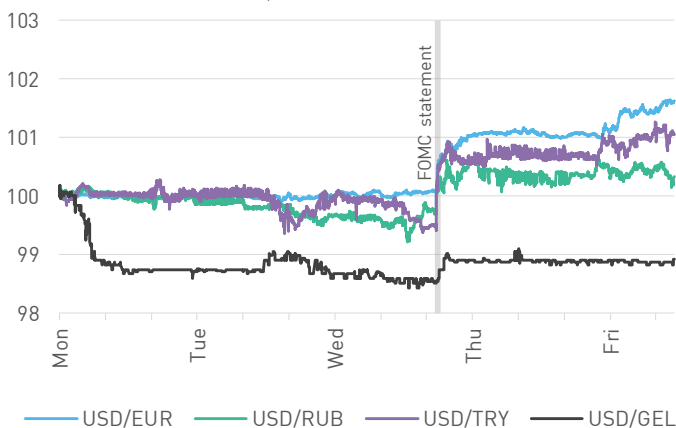
## Emphasis on “Transitory” and “Inflation” at FOMC meeting



Source: CitiFX (Strategy – Monday Macro Fix, 22-Jun-2021)

## FX indices

(15-Jun-2021 = 100, as of 18-Jun-2021)

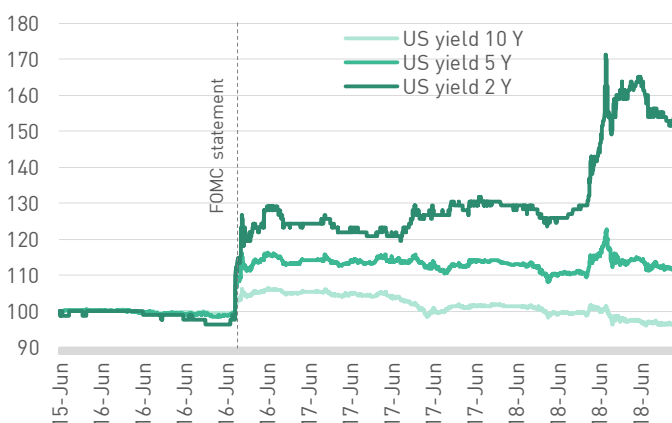


Source: Bloomberg

Note: times are adjusted depending on market opening

## US nominal yield

(June 15 20:00 = 100, as of June 18)



Source: Bloomberg

global financial crisis, is casting doubt on the transitory nature of inflation. Furthermore, improving labor market and shortages in number of sectors will likely at some point lead to stronger unit labor costs.

Immediately after the FOMC statement was disclosed, the US treasury yields spiked, equities corrected somewhat and the USD strengthened against Georgia's major economic partner currencies. However, thereafter the yields and some of the currencies retreated somewhat back. The 10 year yield has stayed below 1.6% since the March FOMC meeting. One important reason behind is Fed's quantitative easing program: the asset purchase program has exceeded total UST issuance in the last few months further decreasing the supply of the bonds<sup>1</sup> and consequently curbing yields and the term premium with it.

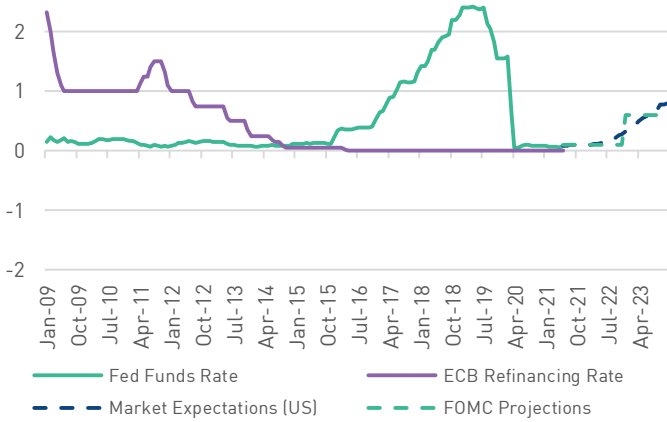
Unlike the EM meltdown caused by the Fed in 2014, the possible surge mainly in the short term yields and emerging market runs are not necessarily expected due to the fact that market pricing for the rate hikes has already slightly overshoot the FOMC projections. While hawkish outlook and strong US recovery may work in tandem to strengthen the USD, at the core of this growth is widening current account deficit and household leverage cycle – both weighing negatively on the greenback<sup>2</sup>. Furthermore, as the rest of the world is catching up with the restart, the demand for the safe haven is decreasing. The futures market is also betting short on the dollar and long on the euro. Indeed, it could be too early for the dollar to divert from its REER cycle, even under slightly above target inflation going forward keeping in mind the Fed's dual mandate and new average inflation targeting framework. In this case, inflation might not be fully transitory, but the strong dollar is still more likely to be.

As for the FX risk-taking with a GEL income stream, we haven't changed our view and advise to stay diversified on euro and dollar (See [March 2021 TBC Capital Macro Insights](#)).

[1] U.S. department of the Treasury, St. Louis Fed  
[2] Oxford Economics, Global Asset Allocation, March 2021.

## US and EUR rates

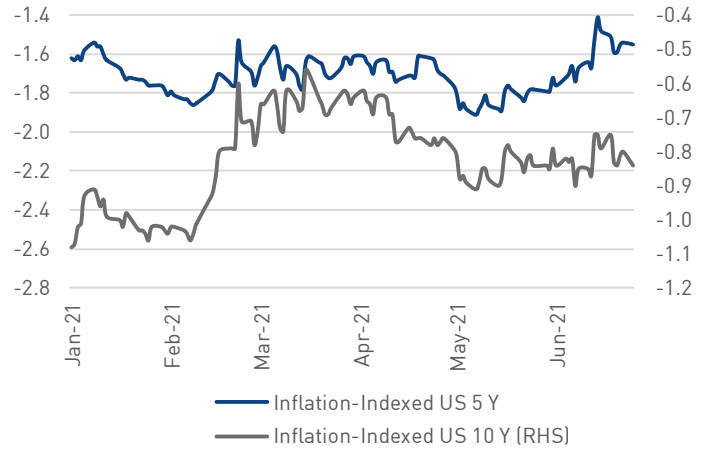
(%)



Source: St. Louis Fed, ECB, Chicago Mercantile Exchange

## US real yields

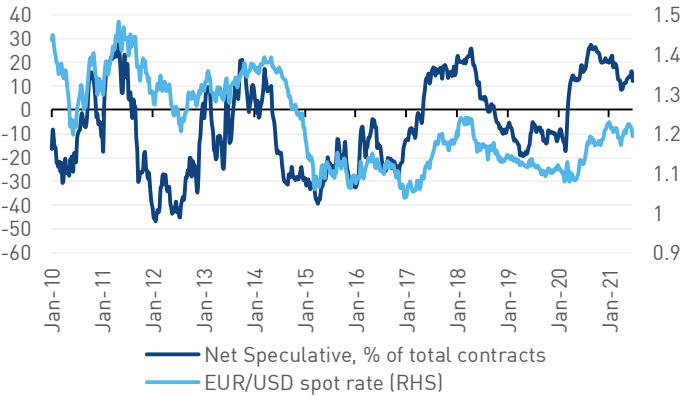
(%)



Source: St. Louis Fed

## Net speculative positions in USD against EUR

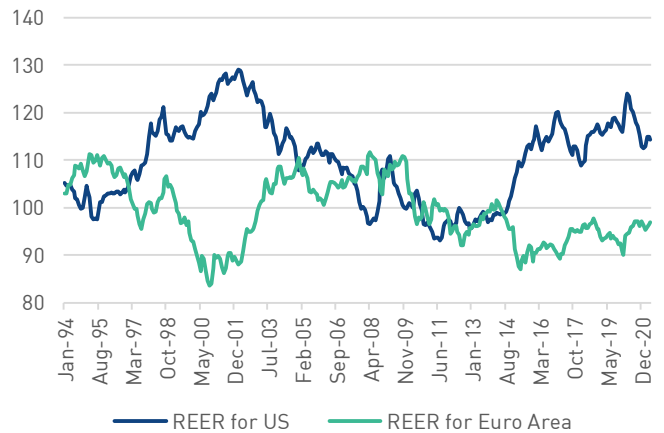
(%)



Source: U.S. commodity futures trading commission, St. Louis Fed.  
 Note: above 0% is net long, below 0% is net short, calculated as % of open interest

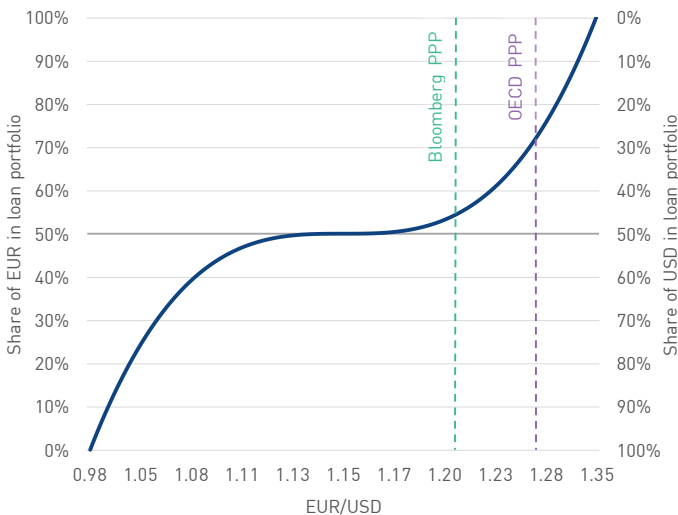
## Real effective exchange rates for US and Euro Area

(Index, 2010 = 100)



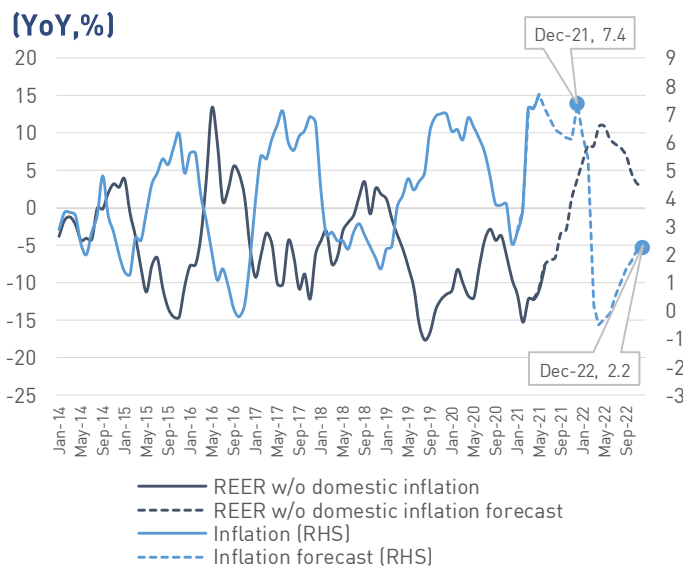
Source: St. Louis Fed, ECB

## Possible optimal structure of loan portfolio when taking FX risk



# Inflation close or above the NBG's tolerance level in 2021, though vice versa a year after

## The GEL REER and inflation



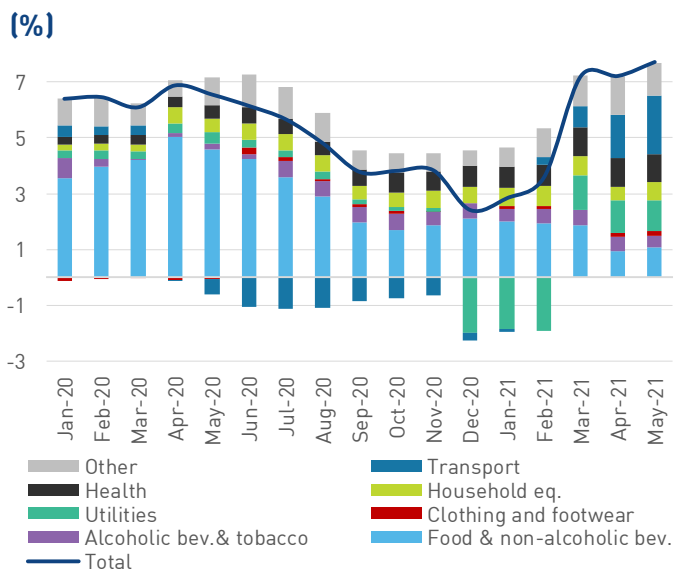
Source: Geostat, NBG, TBC Capital estimates

Ceasing state subsidy program, coupled with the increased commodity prices and depreciated GEL, has led to a fairly high level of annual inflation in recent months.

Along with CPI inflation, various price measures have also increased significantly lately, which strongly affects inflation perceptions and expectations. Moreover, commodity prices are expected to increase further at least somewhat, which puts even greater pressure on inflation. Furthermore, amid increased gas tariffs in Tbilisi from June, the impact of utility bills on inflation will increase even more.

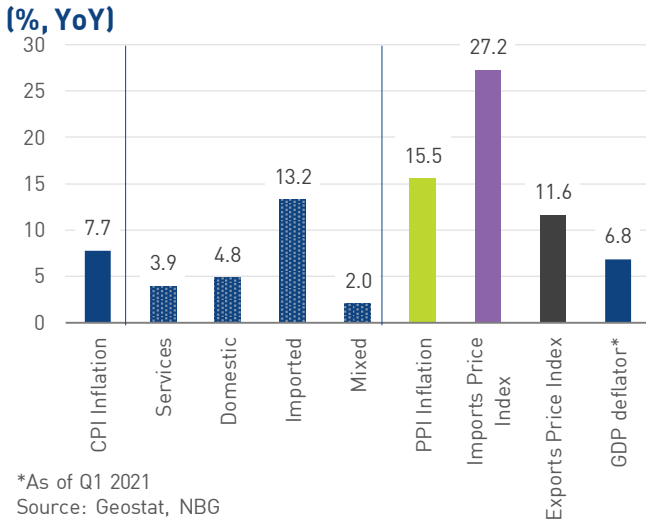
On the contrary, despite the high annual inflation, it should be noted that seasonally adjusted monthly annualized inflation has somewhat decreased recently and is expected to continue a declining tendency over the coming months mainly on the back of stronger GEL. Going forward, we do not expect depreciation of the lari in real effective terms. Moreover, in case of continuation of the recent trend of inflows, a partial strengthening of the GEL is assumed. In particular, the real effective exchange rate excluding domestic inflation should appreciate by around 6% by the end of 2022 with broadly equal strengthening in 2021 and 2022. This, coupled with GDP growth of around 10.5% in 2021 and 6.5% in 2022 and stronger commodity prices with Brent price at around 75 USD and 85 USD in 2021 and 2022, respectively, should leave the inflation elevated in 2021, while the target of 3% is expected to be reached the year after. Namely, in the second half of 2021, we expect a gradual decline in annual

## Annual CPI inflation and contributions (PP) of the groups



Source: Geostat

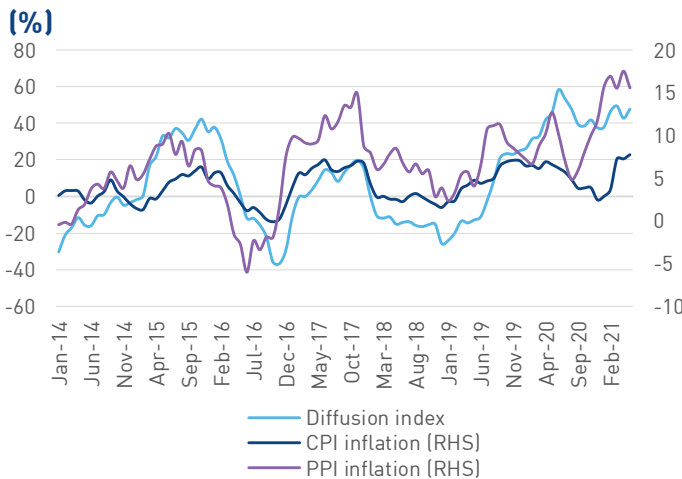
## Different measures of price growth May 2021



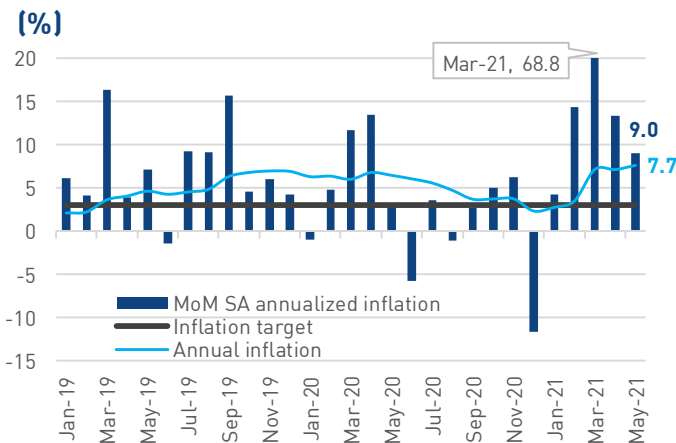
inflation to around 6.1% by November, while in December 2021, inflation will rise sharply to 7.4% due to the low base effect. The high inflation caused by the subsidy program is also expected to be in place in January and February 2022, however, annual inflation will continue to decline once a high base effect is no more included in the calculation. As for the end 2022, around 2% inflation is projected, not ruling out inflation being close to zero or slightly negative throughout the year.

As inflation is expected to moderate and inflows to strengthen further with increasing contribution of tourism recovery, we expect the NBG rate cut cycle to start already this year. Furthermore, record high interest rate differential between the GEL and USD deposit rates is also a strong argument for the central bank's more dovish stance, though not related to further weakening of the GEL, especially in real effective terms and at least in 2021 taking into account already above the tolerance level inflation pressures. At the same time, possible reintroduction of the state mortgage subsidy program, similar to 2020, will act effectively as a rate cut and, therefore, is likely to lead to some relative hawkishness expressed as less aggressive policy rate cuts.

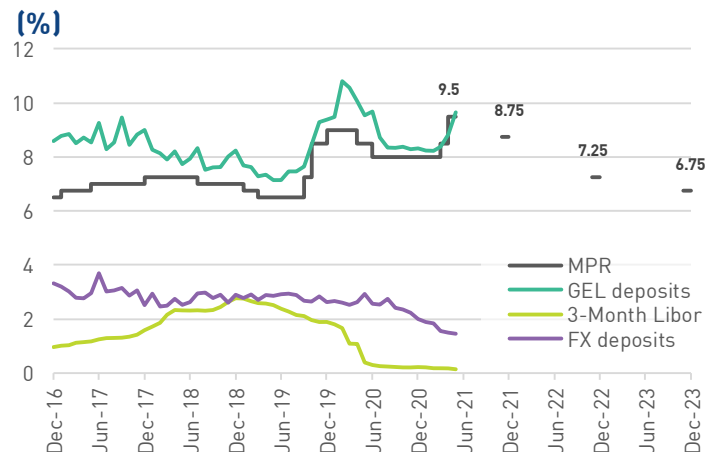
## Different measures of price dynamics



## Annual and seasonally adjusted monthly annualized Inflation



## Interest rates on domestic and foreign currency denominated deposits, monetary policy rate and LIBOR



# We remain broadly neutral on the USD/GEL and EUR/GEL, while being somewhat bullish on the GEL REER

## The GEL REER, daily estimates

(% deviation from period average, as of June 30, increase means GEL appreciation)



Source: NBG

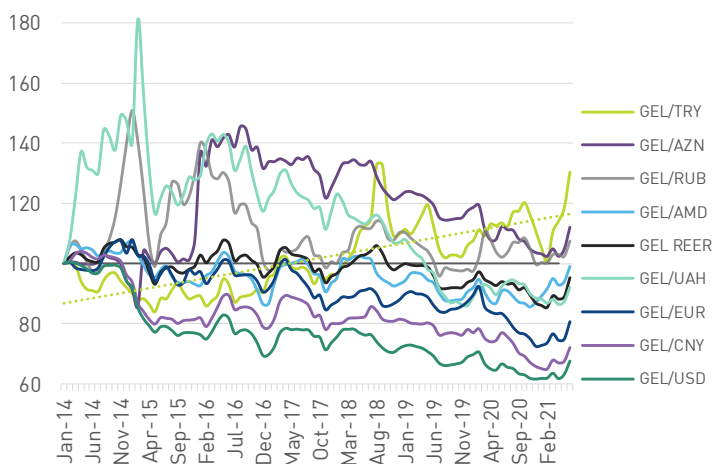
The strengthening of the GEL REER, taking into account strong recovery in net inflows, FX credit, sufficiency of NBG international reserves and government's external financing coupled with inflation pressures and tight GEL stance, should be well justified. However, the EUR/GEL and USD/GEL dynamics traditionally would also depend on the developments of the EUR/USD and regional currencies.

While upsides are strong, the downsides are also considerable likely most important being the possible worldwide USD strengthening and due to country-specific drivers further weakening of the Turkish lira. The latter should not necessarily lead to a weaker GEL (see [TBC Capital March Macro Insights](#)), though historically the correlation exists.

For year-end 2021, we project EUR/GEL in the range of 3.69-3.86 and the USD/GEL in the range of 3.00-3.30.

## RER indices of GEL

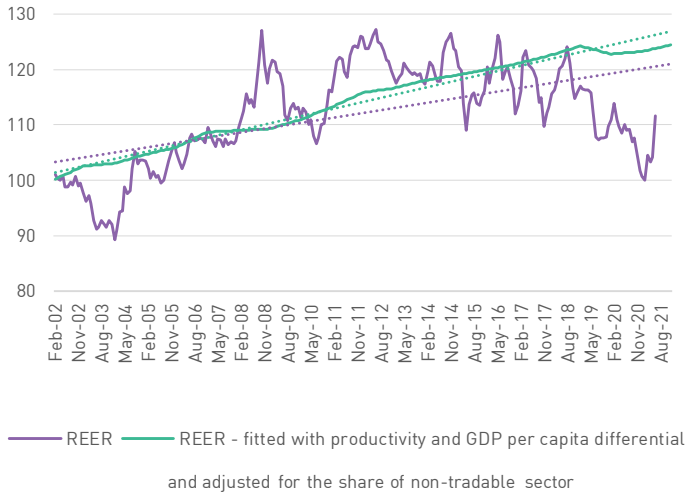
(Jan-14 = 100, as of 30-Jun-2021)



Source: NBG, corresponding statistical offices, TBC Capital estimates

## GEL actual and fitted REER

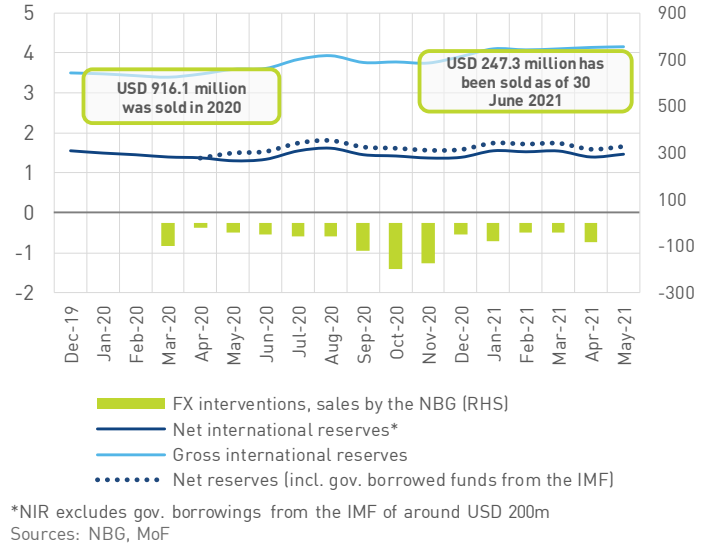
(As of 30-Jun)



Source: NBG, World Bank, TBC Capital estimates

## NBG gross and net international reserves

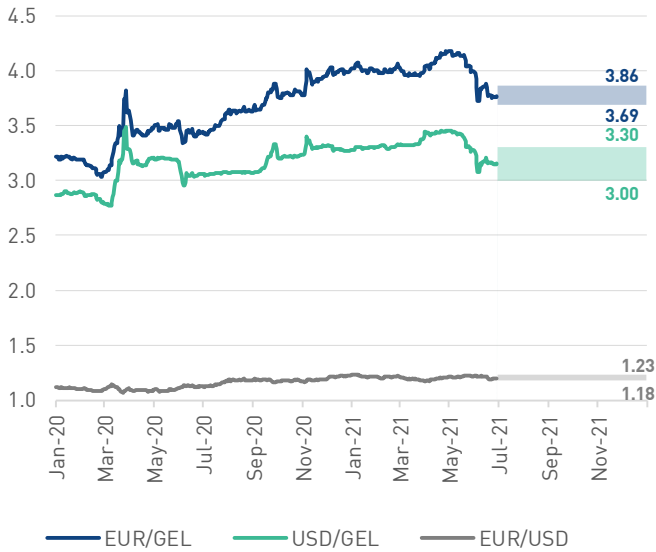
(Billion USD LHS, million USD RHS)



## CA balance and its major financing sources for 2021 (The projection is based on major, rather than all BoP items)

	million USD	Comment
CA balance	-1,569	
FDI	653	<i>Based on the projections of ongoing projects</i>
out of which: reinvested	455	
Government	1,054	<i>Out of which around USD 280m was raised in 2020</i>
Banks	-200	<i>Could turn even positive in case of hedging</i>
Other private (non-bank)	250	<i>Partially through the IFI's financing of the private sector</i>
Non-resident holding of GEL Treasury securities	100	<i>Taking into account the large interest rate differential</i>
NBG reserves	-250	<i>Excluding reserves sold on the back of the government borrowings</i>
CA Financing	1,607	
FX credit	USD 500 m equivalent (incl. EUR)	<i>Only USD 60m equivalent in 2020 (incl. EUR) See discussion on "shock amplifier" in <a href="#">March 15 TBC Macro Insights</a></i>

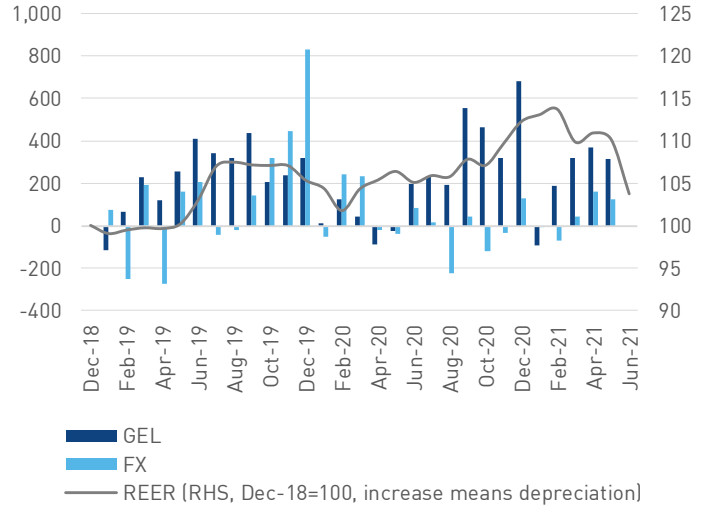
## The GEL outlook



Source: NBG

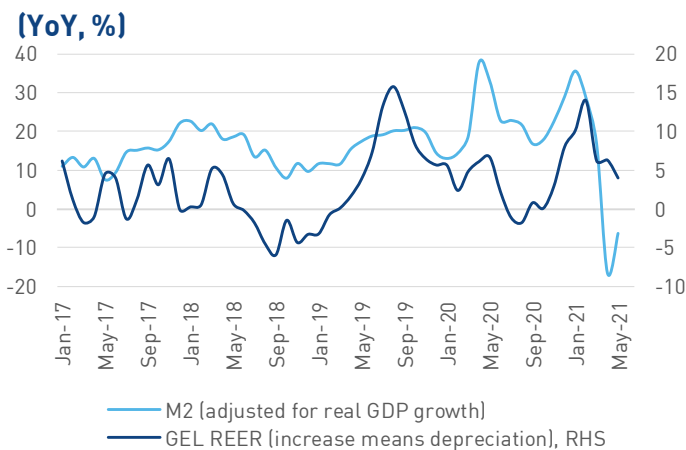
## Growth of portfolio by currencies and the GEL REER

(MoM, m GEL, excl. FX effect)



Source: NBG

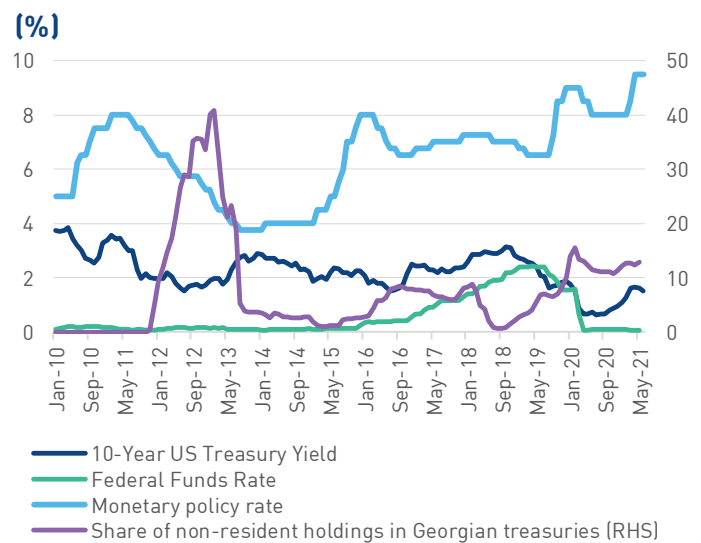
## GEL monetary aggregate (M2) and REER



Note: Assuming GEL REER without domestic inflation at around same level and 6% inflation in Georgia, the GEL REER is implied to appreciate by 6%; M2 adjusted for real GDP growth is assumed to increase by 17.6%, the growth being 24.6% in unadjusted terms

Source: NBG, TBC Capital estimates

## US rates and share of non-resident holding in Georgian treasuries



Source: St. Louis Fed, NBG

## TBC BANK ECONOMIC TEAM

**Otar Nadaraia** | Chief Economist |  
[onadaraia@tbcbank.com.ge](mailto:onadaraia@tbcbank.com.ge)

**Ana Mjavanadze** | Acting Head |  
Macro-financial Analysis Division |  
[anmzhavanadze@tbcbank.com.ge](mailto:anmzhavanadze@tbcbank.com.ge)

**Juli Avlokhshvili** | Analyst |  
Macro-financial Analysis Division |  
[javlokhshvili@tbcbank.com.ge](mailto:javlokhshvili@tbcbank.com.ge)

**Levan Mikeladze** | Analyst |  
Macro-financial Analysis Division |  
[lemikeladze@tbcbank.com.ge](mailto:lemikeladze@tbcbank.com.ge)

## TBC CAPITAL RESEARCH

**Mary Chachanidze, CFA** | Managing Director |  
[mchachanidze@tbccapital.ge](mailto:mchachanidze@tbccapital.ge)

**Andro Tvaliashvili** | Senior Associate |  
[atvaliashvili@tbccapital.ge](mailto:atvaliashvili@tbccapital.ge)

**Luka Chigilashvili** | Associate |  
[lchigilashvili@tbccapital.ge](mailto:lchigilashvili@tbccapital.ge)

**Revaz Maisuradze** | Research Analyst |  
[ReMaisuradze@tbccapital.ge](mailto:ReMaisuradze@tbccapital.ge)

**Maka Koridze** | Junior Research Analyst |  
[Mkoridze@tbccapital.ge](mailto:Mkoridze@tbccapital.ge)

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# MONTHLY BUDGET

A monthly budget worksheet with the same categories as the family budget. Budgets are made with spreadsheets and graphs.

## APPROXIMATE SUMMARY



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