MACROECONOMICS

TBC CAPITAL

Macro-Sectoral Overview

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KEY FINDINGS

COVID-19 SPREAD DYNAMICS AND TOURISM EXPECTATIONS

- Still **high uncertainty** about the vaccination process; Also, **the risk of the third wave** has increased
- According to the baseline scenario, **25% of 2019 tourism inflows will be recovered in 2021**, while **in 2022 the figure will reach 90%**

KEY MACRO PARAMETERS

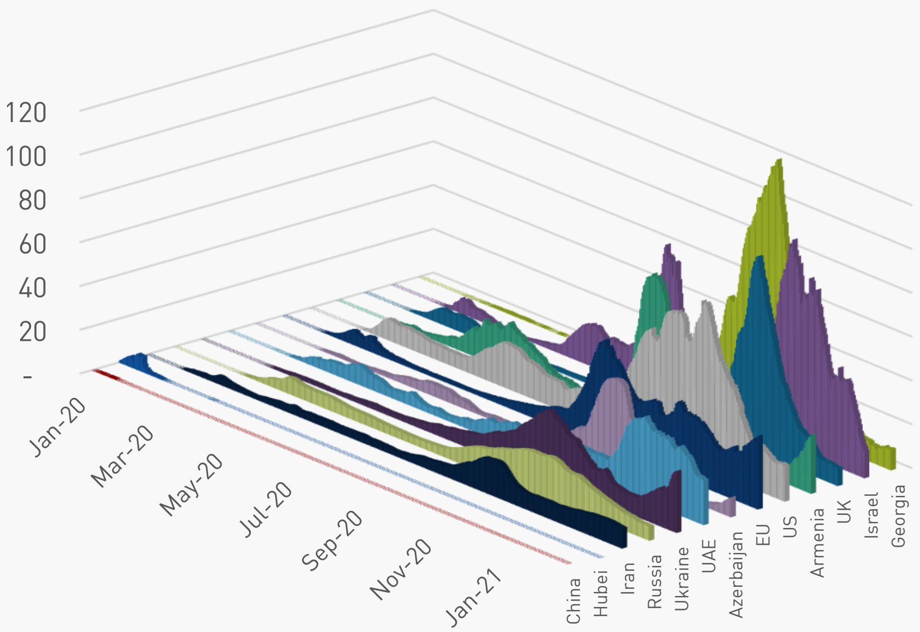
- **Non-tourism revenues showed resilience in 2020**, especially if adjusted for one-off in Q4 FDI inflows
- 2021 outlook slightly down, however, **2022 still a restart year**
- The recovery dynamics of trading partner countries, along with the virus containment, are largely in line with the TBC Capital growth forecast
- **Still sizable government financing in 2021**
- **GEL** real effective and bilateral **exchange rates remain depreciated**
- **The odds of stronger dollar are higher,** however, dollar is already strong and pro-cyclical
- Compared to our last forecast, the **GEL/USD exchange rate expectations are slightly worsened**. Our expectation for **GEL/USD exchange rate is in the 3.2-3.5 range**
- **CPI inflation is forecasted to increase by 6.0-7.0%** by the end of 2021
- **The probability of further tightening the monetary policy is increased,** however, it is worth considering that interest rate differential between FX and GEL is record high

BUSINESS SECTORS

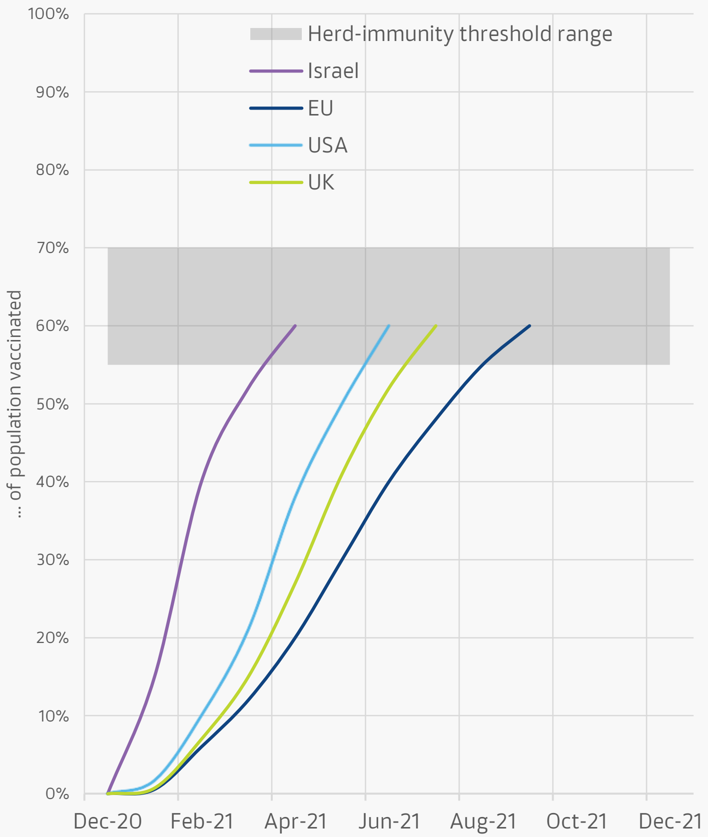
- **Recovery continues in most affected sectors globally** along with the vaccination process
- In the baseline scenario, majority of **sectors will recover to pre-crises levels** by 2022
- In the **hotel industry slight improvement is noticeable** as international flights start to return gradually
- **Rate of decline is moderating in Tbilisi and Batumi residential real estate** sales in the beginning of 2021. Return to 2019 levels in the sector is expected by 2022
- **Consumer cyclical** sector sales were heavily affected during lockdowns, however, more active e-commerce sales have somewhat cushioned the negative impact in selected sub-sectors. **Sales of electronics and furniture is expected to rebound to pre-crises levels already in 2021** while **recovery in textile sector is set to take longer**
- Drop in **commercial real estate revenues** in 2020 is mostly explained by **lower rental rates, while occupancy rates remained relatively stable. Office and retail spaces** are projected to show weaker growth over the longer term in light of long term risks emerging from shifting in consumer behavior.

STILL HIGH UNCERTAINTY ABOUT THE VACCINATION PROCESS; ALSO, THE RISK OF THE THIRD WAVE HAS INCREASED

Dynamics of COVID-19 daily cases in selected entities
(7-day MA, per 100k people, as of 26-Mar-2021)



Timeline of reaching potential herd-immunity in selected entities

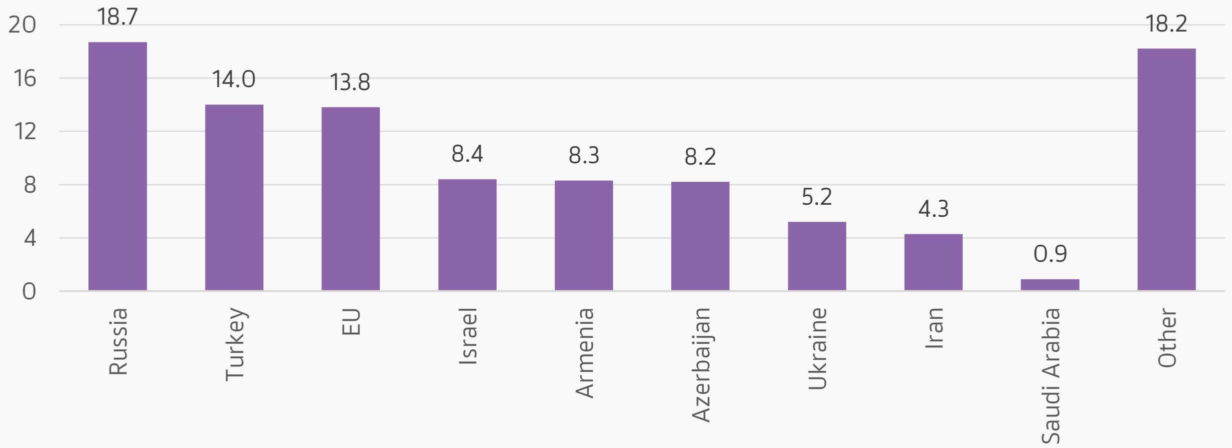


- At the beginning, the pace of vaccination programs has been slower than anticipated in most countries
- It is expected that some developed countries will be able to reach a potential herd-immunity threshold in 2021
- In addition, with the easing of mass demand and the increase in production capacity, a gradual increase in the supply of vaccines is expected
- The public acceptance rate of coronavirus vaccines is also an important factor
- According to the baseline scenario, Georgia is expected to reach a potential herd-immunity threshold in the second quarter of 2022

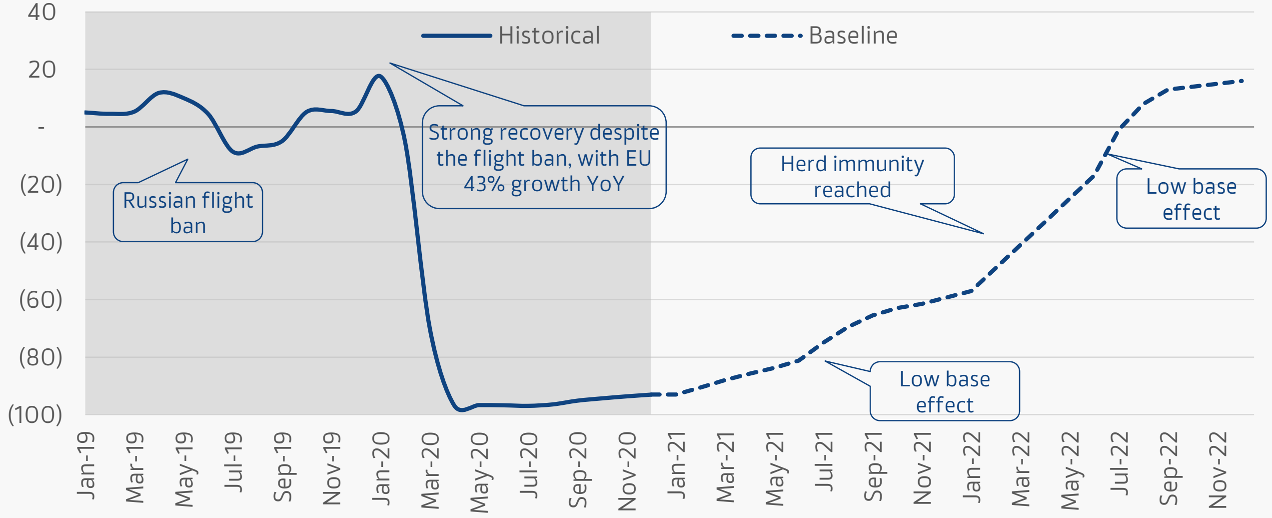
Source: John Hoppkins University, World Bank, Barclays, airfinity, Reuters, Gamaleya National Research Center, Georgian Government, TBC Capital estimates

ACCORDING TO THE BASELINE SCENARIO, 25% OF 2019 TOURISM INFLOWS WILL BE RECOVERED IN 2021, WHILE IN 2022 THE FIGURE WILL REACH 90%

Share of countries in Georgia's tourist inflows
(as of Q4 2019)



Tourism inflows' projections
(% change, relative to 2019)

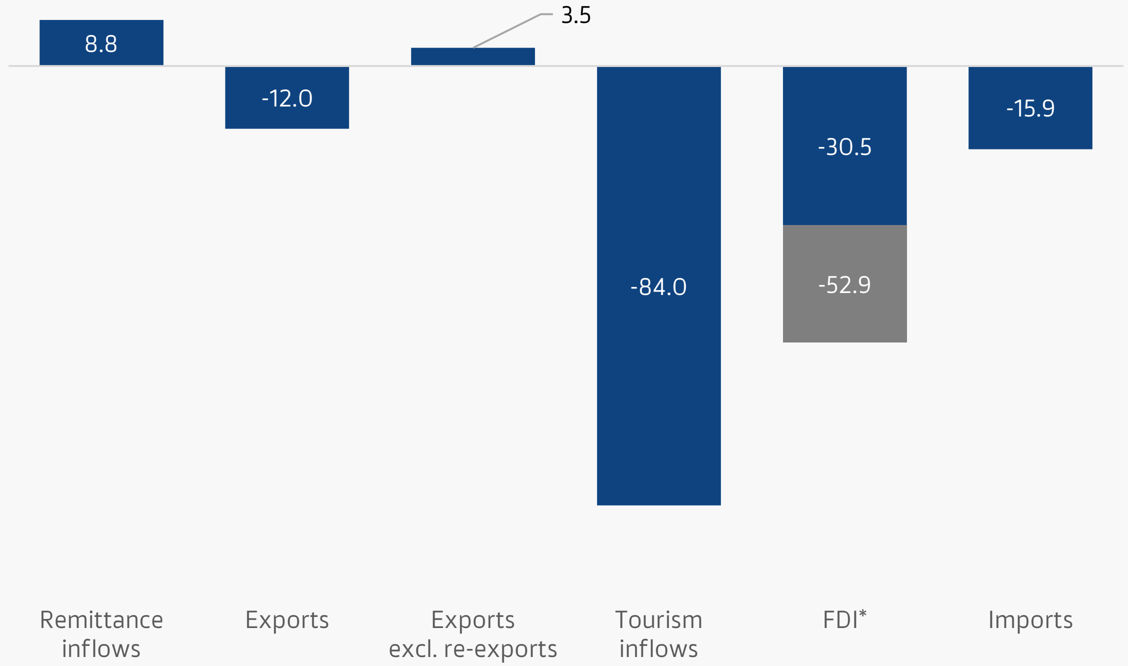


- Considering the vaccination scenarios in Georgia and selected countries, it is assumed that there will be a 25% and a 90% recovery of tourist inflows in 2021 and 2022, respectively, both compared to 2019
- The following arguments support the scenario of gradual recovery of tourism:
  - Strong 20% increase in pre-pandemic period, despite the Russian flight ban
  - Small share of long-distance and business trips in the structure of tourism in Georgia
  - High share of relatively young tourists and repeat visits
  - Abundance of open-air tourism destinations
- Amid delayed vaccination, high risk of virus relapse and severe restrictions, gradual opening of the borders is more likely

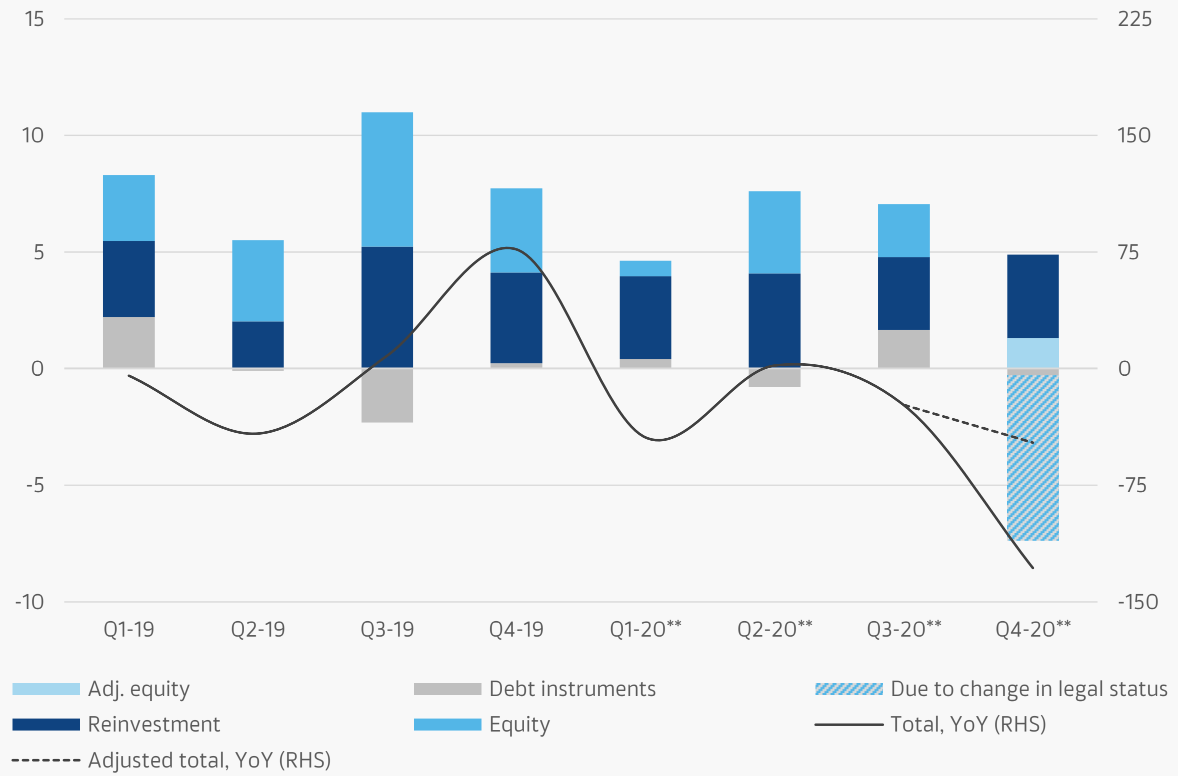
Source: NBG, TBC Capital

NON-TOURISM REVENUES SHOWED RESILIENCE IN 2020, ESPECIALLY IF ADJUSTED FOR ONE-OFF IN Q4 FDI INFLOWS

Growth of inflows and imports during 2020
(YoY, %)



FDI inflows by components
(% of GDP)



*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%, while without adjustment they fell by 52.9% YoY

** Preliminary data

Source: NBG, Geostat, TBC Capital estimates

2021 OUTLOOK SLIGHTLY DOWN, HOWEVER, 2022 STILL A RESTART YEAR

Major macro variable projections for 2021 - 2022, YoY, %

	2020	2021 March 15 projections	2021 Updated	2022 March 15 projections	2022 Updated
EXPORTS*	-12.0	+8.5	+9.5	+13.0	+13.0
TOURISM*	-84.0	+47.9% / -75% rel. to 2019	+47.9% / -75% rel. to 2019	+267.8% / -10% rel. to 2019	+267.8% / -10% rel. to 2019
REMITTANCES*	+5.0[1]	+10.0	+11.0	+10.0	+10.0
FDI*	-30.5[2]	+10.0	+10.0	+30.0	+30.0
IMPORT OF GOODS AND SERVICES*	-20.0	+14.0	+14.0	+19.0	+19.0
FISCAL DEFICIT**	9.1	7.6	7.6	4.4	4.4
BANK CREDIT***	+9.1	+9.5	+9.0	+14.0	+14.0
GDP GROWTH	-6.2%	+4.0%	+4.0%	+7.5%	+7.5%

- Compared to the March 15 Macro Insights, the export and remittance forecast for 2021 has slightly increased, while the expected growth of loans has somewhat decreased
- In the baseline scenario, full-scale lockdown is not considered
- Instead, only the re-introduction of a partial lockdown is expected
- In addition, we assume that strict controls on unvaccinated visitors will be maintained in the future, as full opening of borders is associated with high risks
- A sharp, 11.5% decline in January is in line with the 4.0% growth forecast for 2021 (see February 26 Update from the Chief Economist)
- In case of the introduction of full-scale lockdown for about two months, the 2021 growth will be reduced by around 0.5 pp, although the 2022 increase will be slightly higher due to the base effect

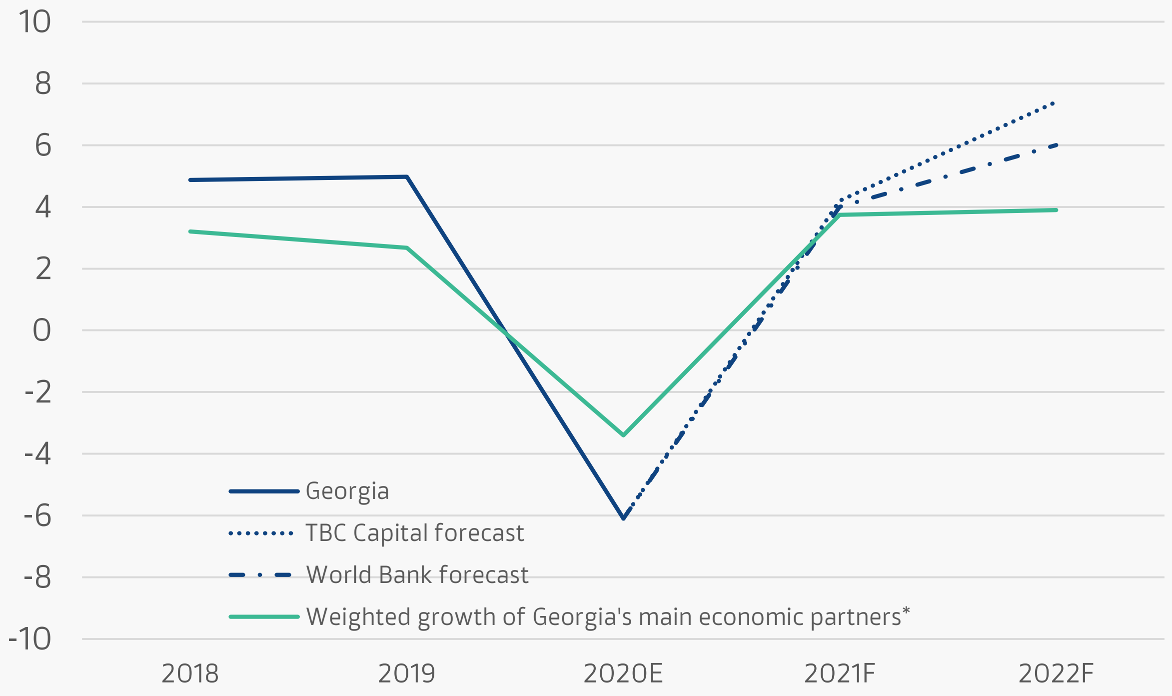
*Growth in USD ** Ratio to GDP, as planned by the MoF, IMF methodology ***End of period, constant exchange rate
For GDP estimation inflation adjusted period credit growth is used. Also, the calculation is based on the estimation of inflows in real terms in GEL, not in USD. Moreover, various other assumptions are used in terms of the impact of key macroeconomic variables on economic growth

1. Adjusted taking into account reduced cash inflows due to closed borders
2. 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.

Source: Geostat. NBG, MoF, TBC Capital

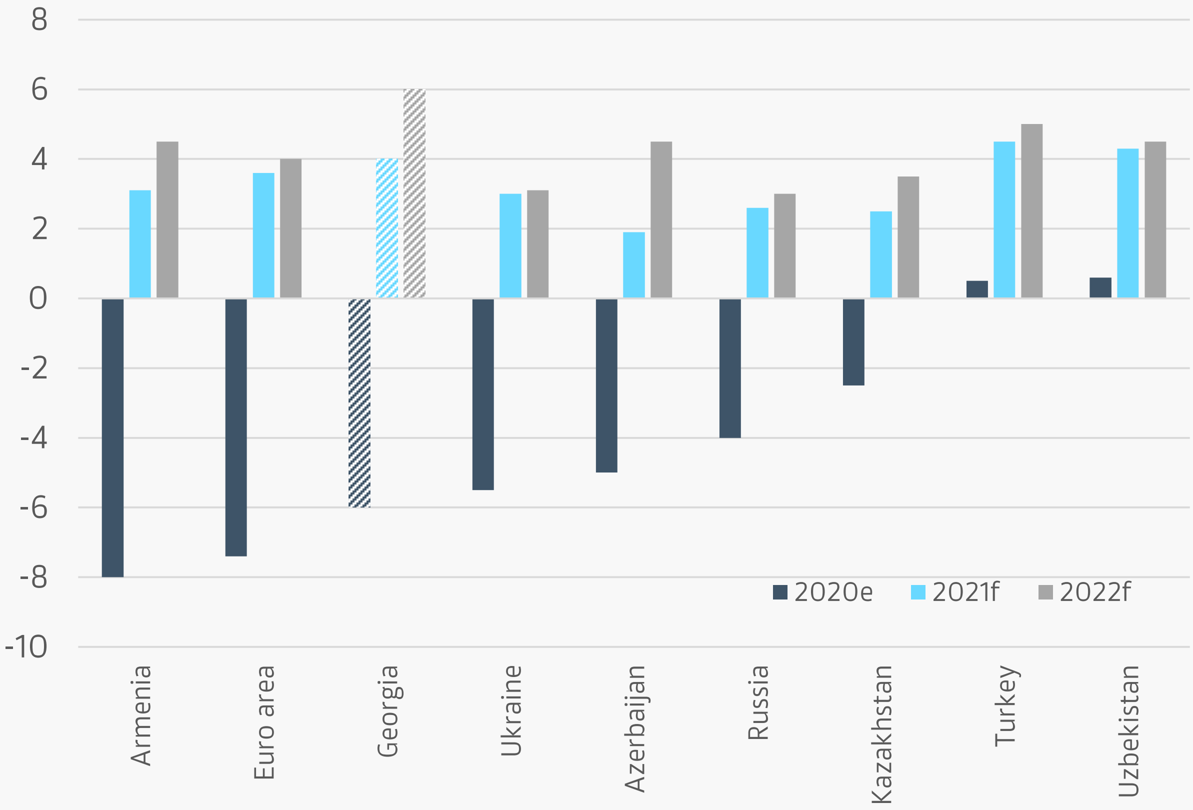
THE RECOVERY DYNAMICS OF TRADING PARTNER COUNTRIES, ALONG WITH THE VIRUS CONTAINMENT, ARE LARGELY IN LINE WITH THE TBC CAPITAL GROWTH FORECAST

GDP growth of Georgia and main economic partners
(%)



*Weighted by share in exports, remittances, direct investment and tourism revenue.

Real GDP projections in selected countries
(%)

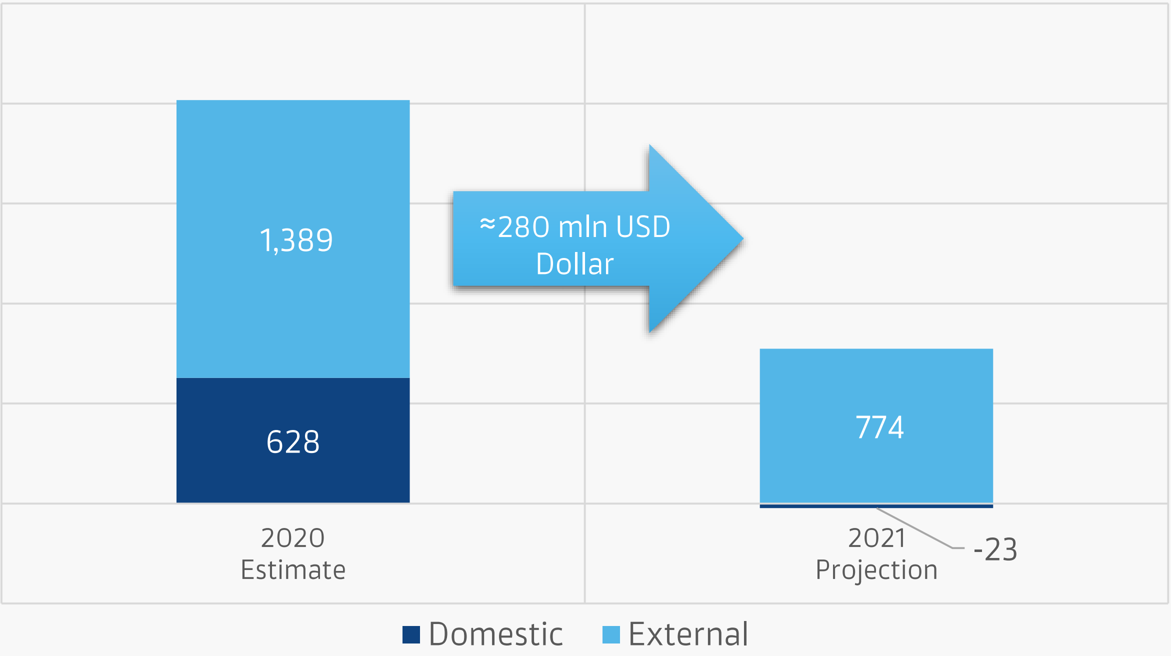


- In past years, Georgia's GDP increased faster than its trading partners'
- In addition, the sharper decline in 2020 was due to high dependence on tourism
- Given these two factors, the recovery rate in 2022 will also be faster than that of economic partners

Source: NBG, Geostat, GNTA, World Bank

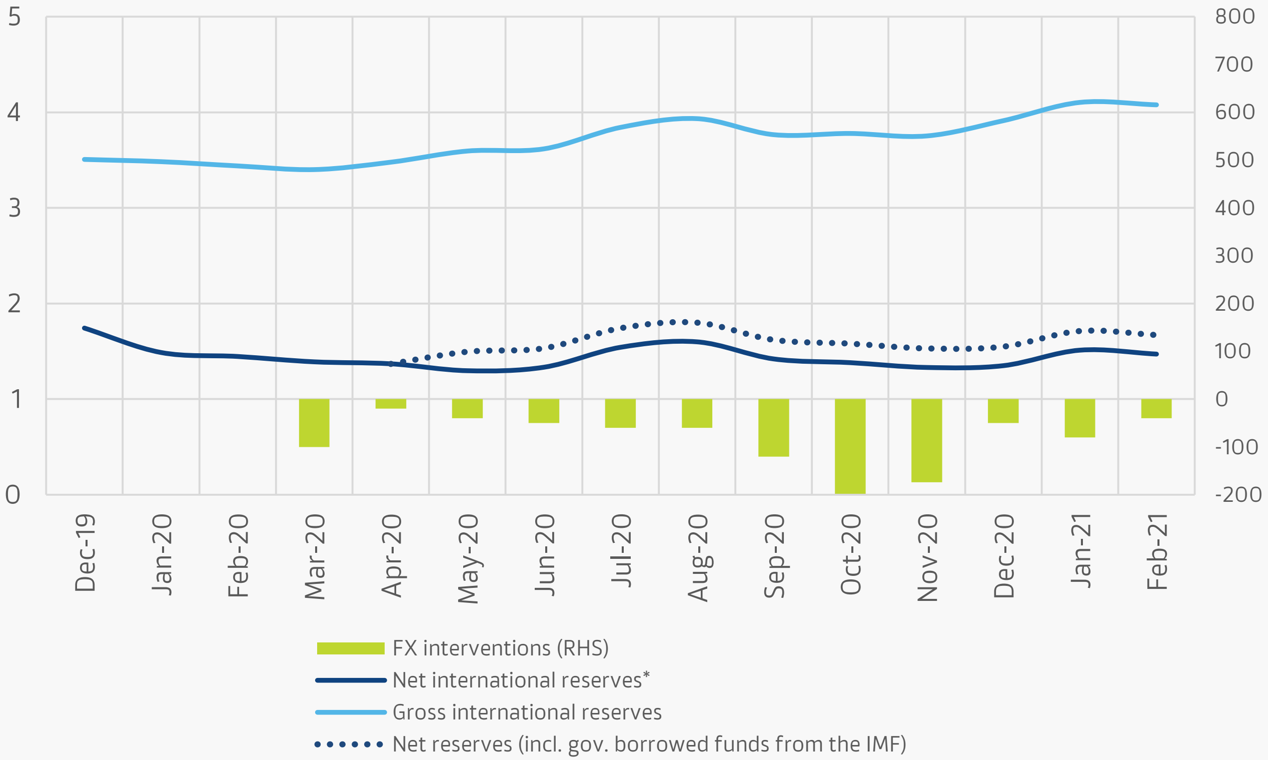
STILL SIZABLE GOVERNMENT FINANCING IN 2021

Net change in government debt
(mln USD)



TBC Capital estimates that about $ 280 million of the external funding raised by the Government in 2020 will be used in 2021, with an additional USD 774 million attracted in 2022.

NBG gross and net international reserves
(bn USD)



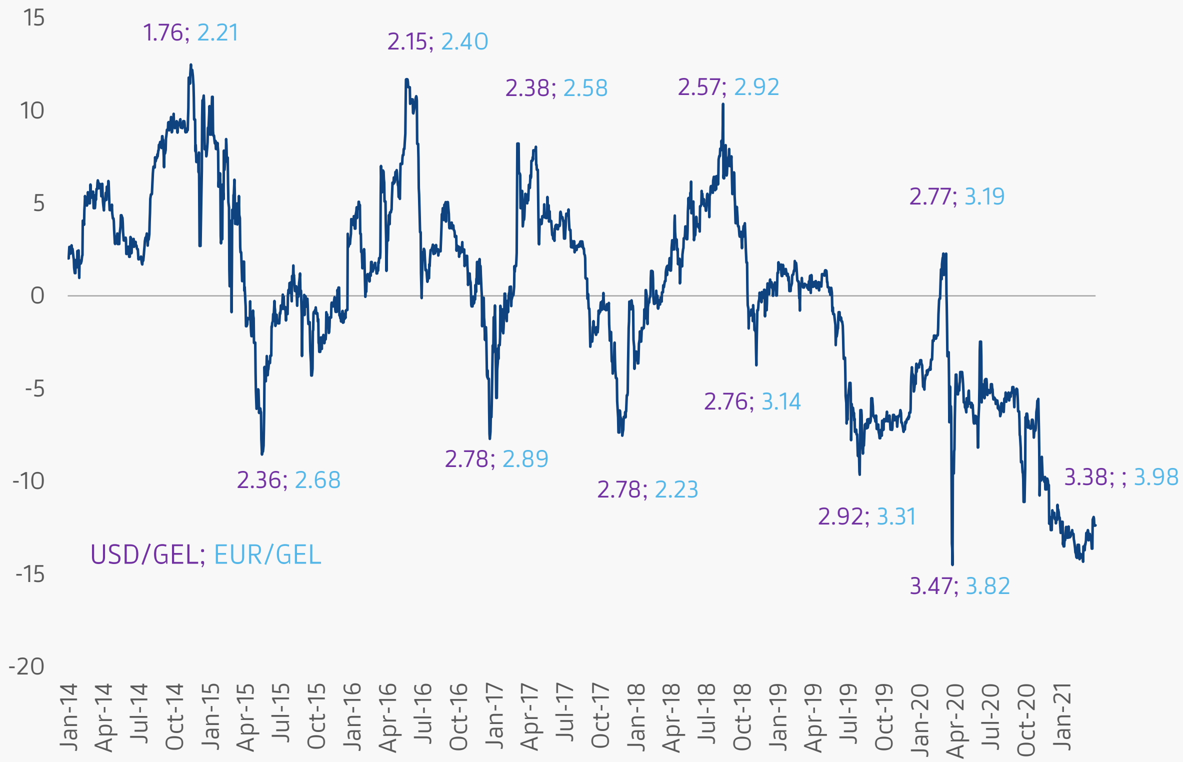
*NIR excludes gov. borrowings from the IMF of around USD 200m

- Government external funding and NBG reserves are sufficient to cover the 2021 forecasted deficit (see TBC Capital March 15 Macro Insights). Moreover, the February inflows of exports and remittances were better than expected, while the increase in imports was in line with expectations (see March 22 Weekly Review)

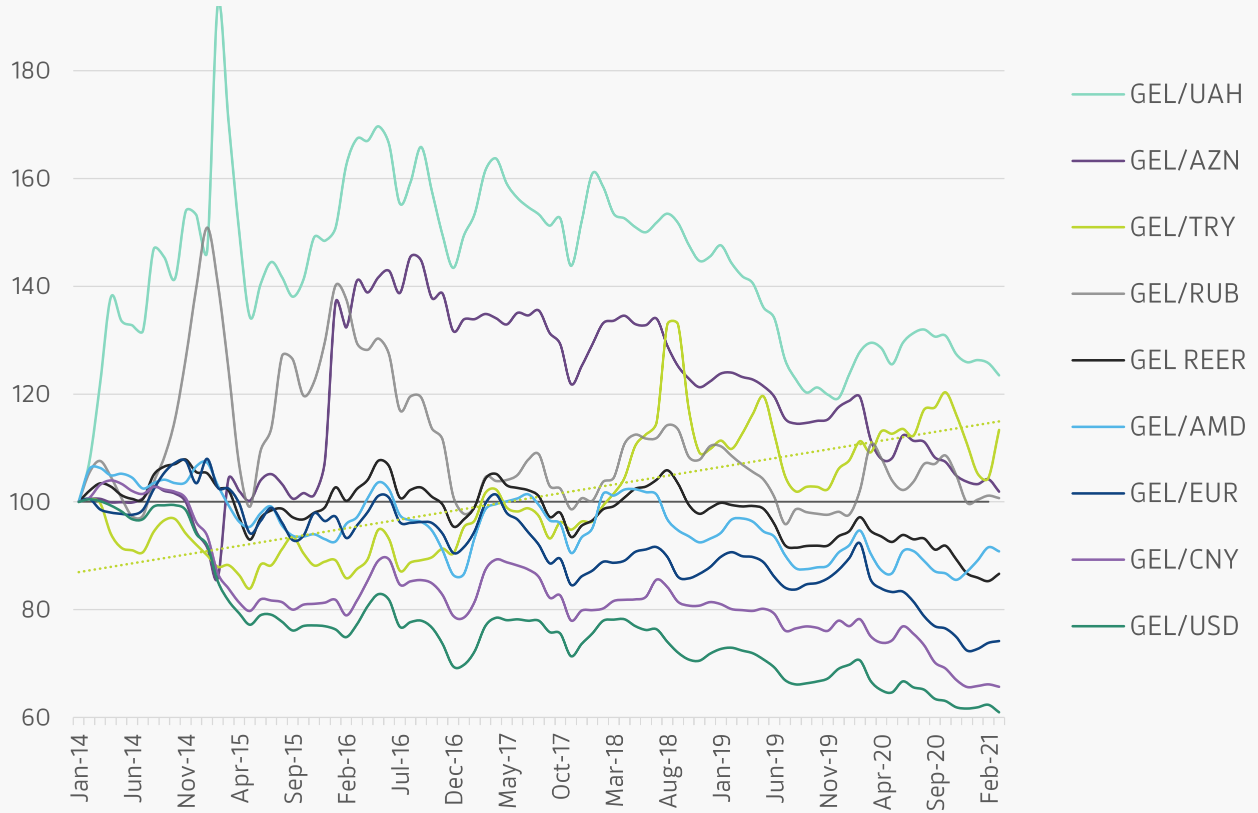
Source; MoF, Tbc Capital

GEL REAL EFFECTIVE AND BILATERAL EXCHANGE RATES REMAIN DEPRECIATED

The GEL REER, daily estimates
(% deviation from period average, as of March 29, increase means GEL appreciation)



RER indices of GEL
(Jan-14 = 100, As of 29-Mar-2021)

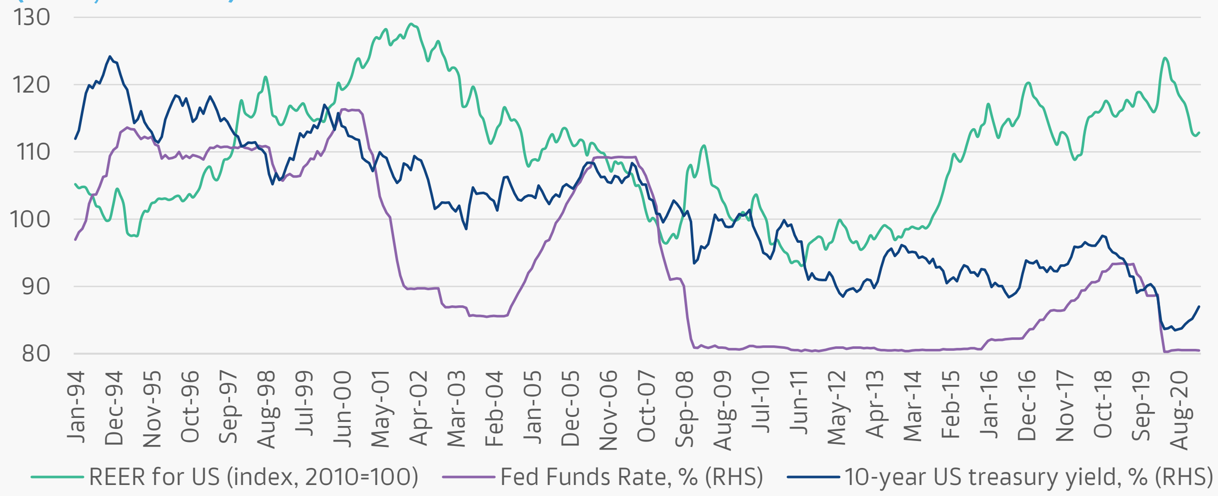


- GEL real effective and bilateral exchange rates still remain depreciated
- Despite nominal depreciation against USD, GEL real effective exchange rate appreciated slightly. It mostly stems from TRY, EUR and RUB depreciation against USD

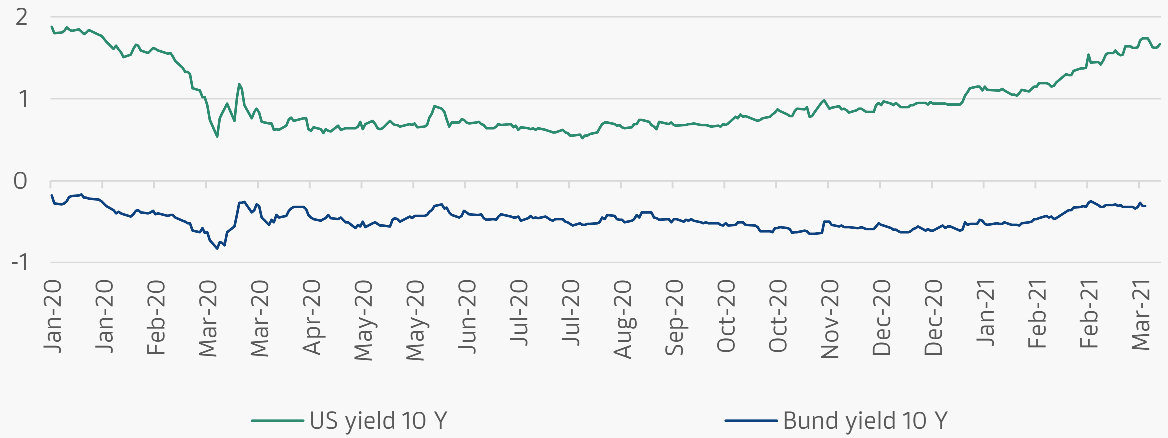
Source: NBG, World Bank, Corresponding statistical entities, TBC Capital

THE ODDS OF STRONGER DOLLAR ARE HIGHER, HOWEVER, DOLLAR IS ALREADY STRONG AND PRO-CYCLICAL

Real effective exchange rate (REER) of USD, policy rate and yield of bonds
(index, 2010=100)



Nominal yields of US and Germany bonds
(%, as of March 26, 2021)



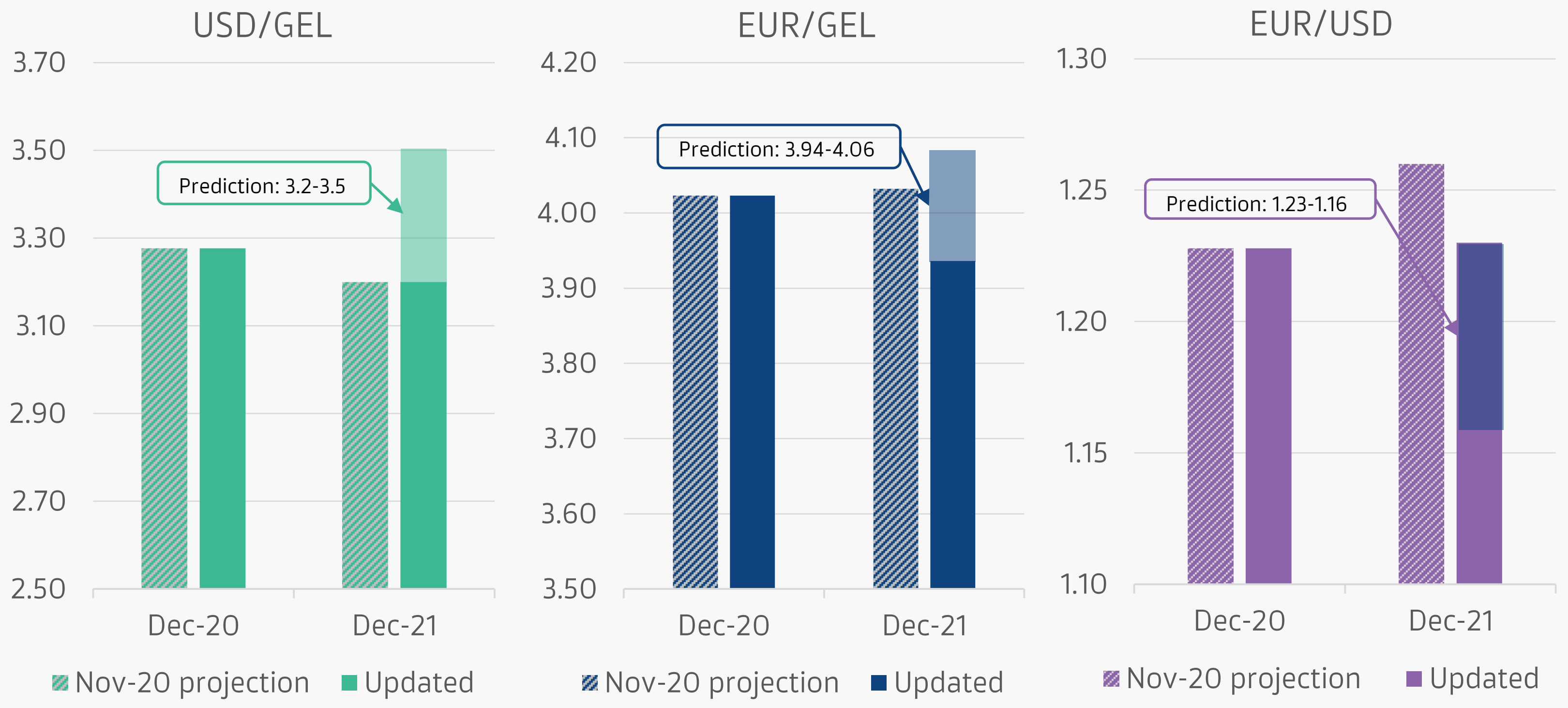
- Arguments for USD appreciation:
  - The USD 1.9 T fiscal stimulus plan of the Biden administration
  - Successfully ongoing vaccination process in the US
  - Therefore, expected recovery of the US economy, and probably employment, already in 2021
  - Increased inflation expectations
  - Market participants questioning the Fed’s ultra-dovish stance
  - Increased USD/EUR real yield differential

- Arguments for USD depreciation:
  - USD is a global safe-haven currency. Therefore, it is cyclical and tends to be weaker during recovery periods after recessions
  - According to the new monetary policy framework of the Fed, which implies average inflation targeting, higher-than-2% inflation rate is tolerable in a short-run
  - According to the Fed, there is no intent to rise the policy rate during the following three years
  - The USD REER, unlike the EUR REER, seems to be still at least somewhat overvalued, which, when coupled with large twin deficits, is a considerable argument for its depreciation

Source: FRED, US Department of the Treasury, Bundesbank

WORSENED EXPECTATIONS TOWARDS GEL

GEL a bit more than "random-walk" projection

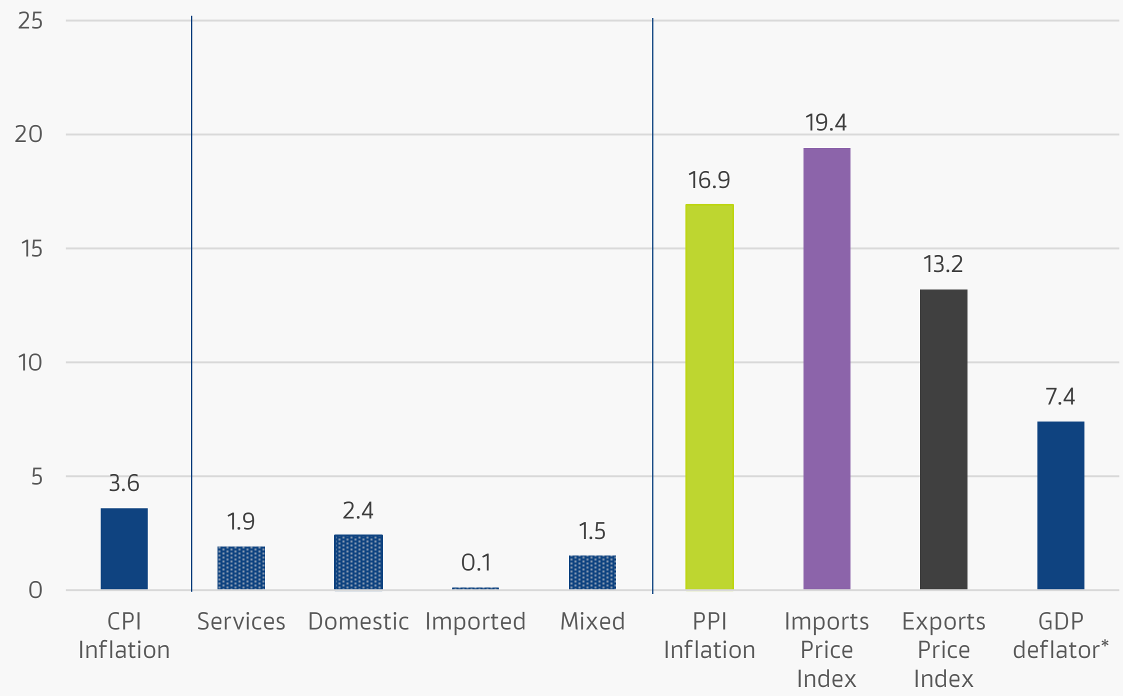


- Arguments for GEL depreciation:
  - Appreciation of USD against regional currencies
  - Delayed recovery of tourism
- Arguments for GEL appreciation:
  - Depreciation of USD towards regional currencies
  - Sufficient financing of the deficit of inflows
  - Tight monetary policy to deal with high inflation

Source: NBG, TBC Capital

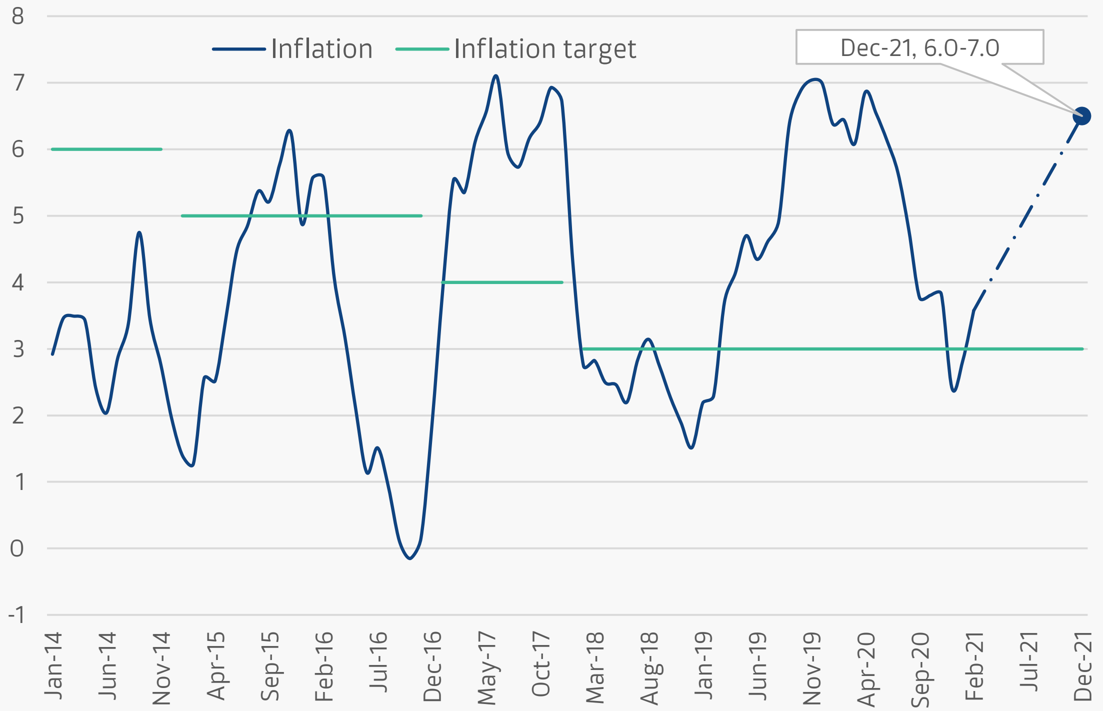
CPI INFLATION IS FORECASTED TO INCREASE BY 6.0-7.0% BY THE END OF 2021

Different measures of price growth February 2021
(%, YoY)



*As of Q4 2020

Indicators of CPI inflation and inflation target
(%, YoY)

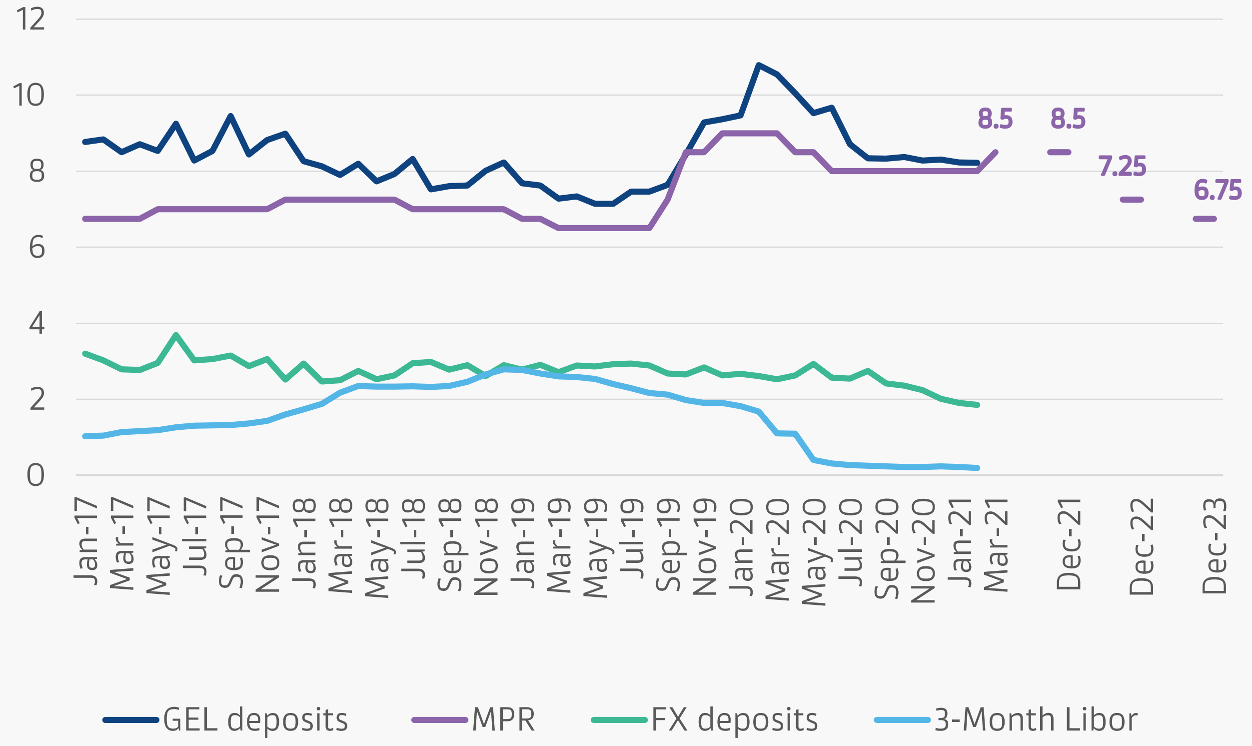


- According to the TBC Capital's previous projection, CPI inflation growth would be 6.0% by the and of 2021, which relied on depreciated GEL, rising commodity prices and other indicators of inflation being already high (see March 15 Macro Insights)
- However, the projection increases to 7.0% in case of even weaker GEL

Source: NBG, Geostat, TBC Capital

THE PROBABILITY OF FURTHER TIGHTENING THE MONETARY POLICY IS INCREASED, HOWEVER, IT IS WORTH CONSIDERING THAT INTEREST RATE DIFFERENTIAL BETWEEN FX AND GEL IS RECORD HIGH

Interest rates on GEL and FX deposits (flow), monetary policy rate and Libor
(%)

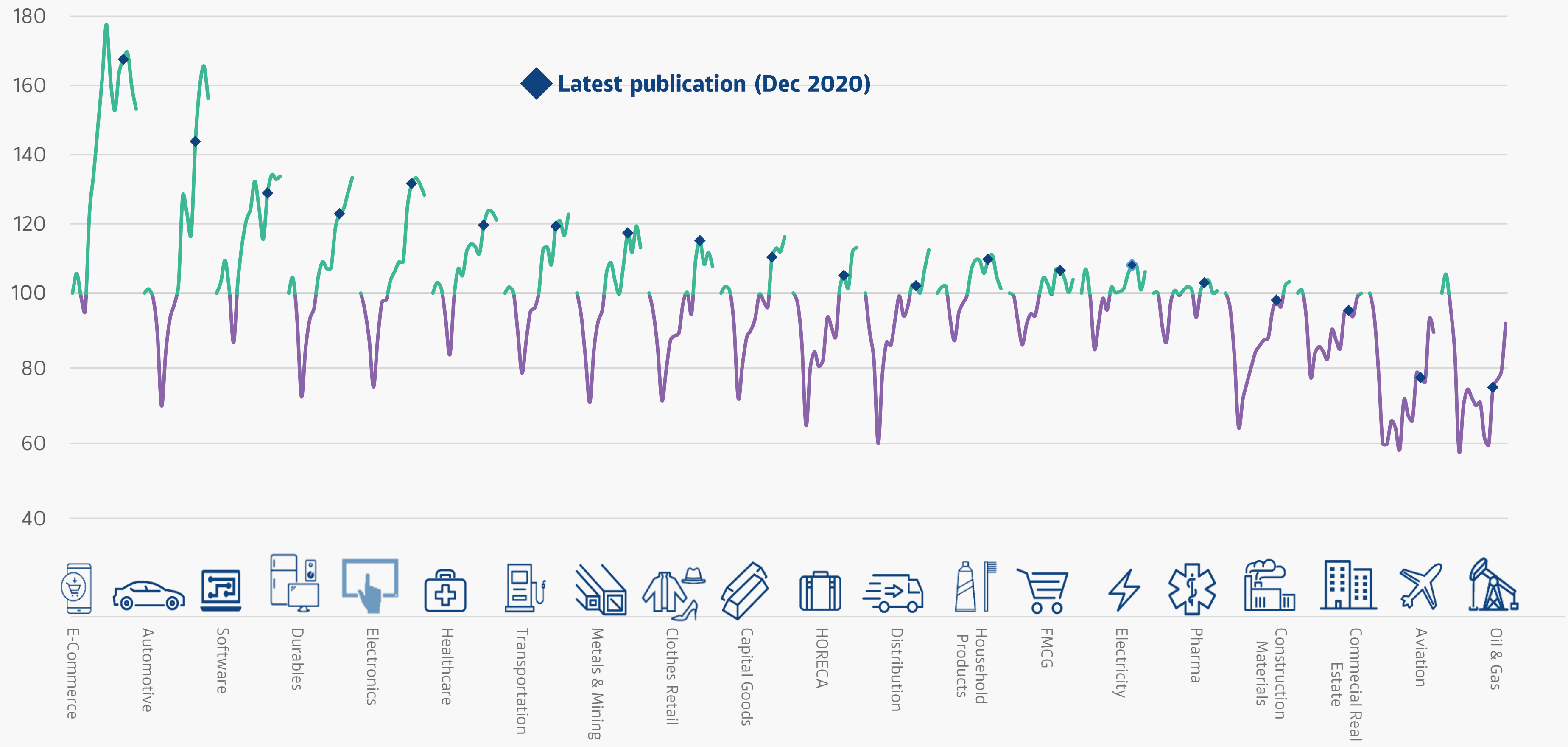


- According to the baseline scenario, the monetary policy rate will remain unchanged during 2021, and easing cycle will start in 2022
- A rate cut was predicted even by the end of 2021, however considering the GEL depreciation recently and worsened projection, the rate cut becomes less likely during this year
- Moreover, in case of a further GEL depreciation, a rate hike throughout the year is also possible
- In addition, if GEL stabilizes, the recent rate hike will not necessarily cause negative impact on economic growth (see [March 18 Update from the Chief Economist])

Source: NBG, Ministry of Finance of Georgia, St. Louis Fed, TBC Capital

ALONG WITH THE VACCINATION PROCESS, RECOVERY CONTINUES IN INDUSTRIES THAT WERE HIT HARDEST

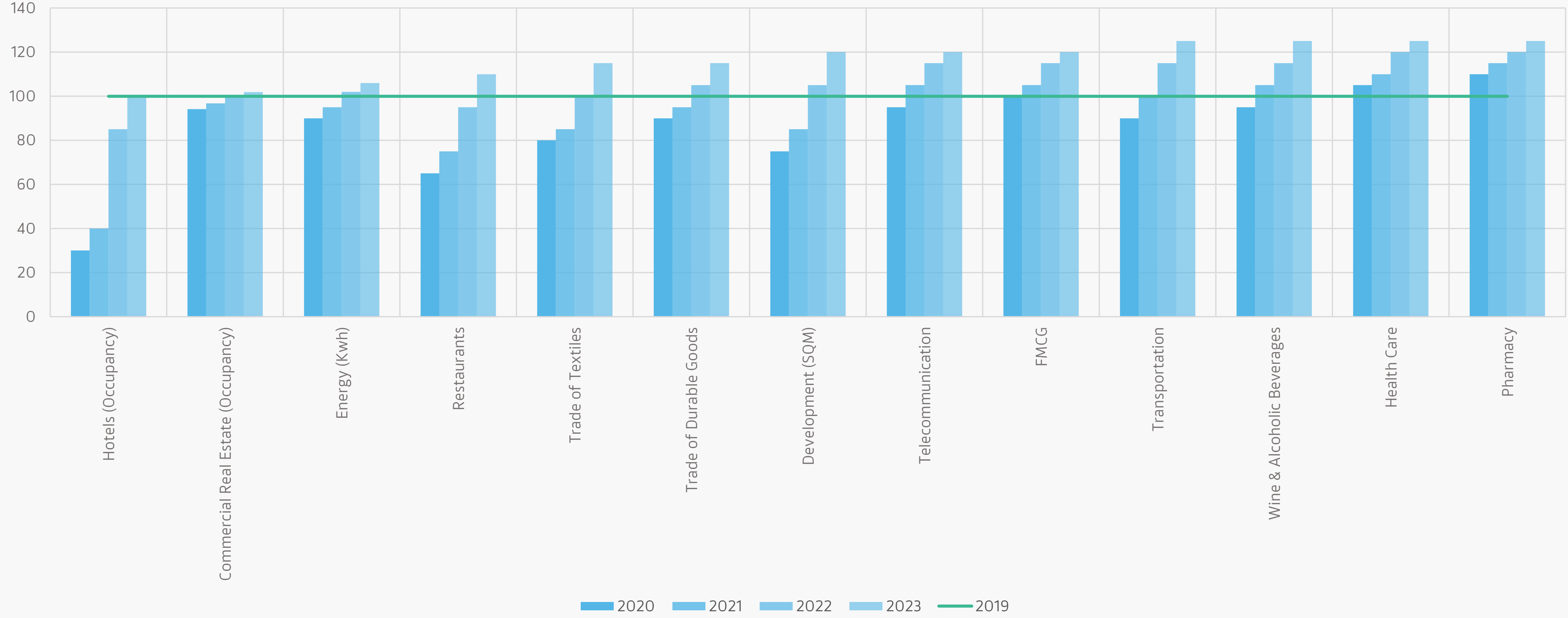
Company share price dynamics in select industries
(Dec 2019 - Mar 2021, Dec 2019 = 100, %)



- In line with the vaccination process, the **share price dynamics indicate a recovery process** in the sectors that took the biggest hit
- **The share prices are close to the pre-crisis levels** in sectors such as **aviation, oil & gas, commercial real estate**
- At the same time, **company share prices in the HORECA sector exceeded the pre-crisis level,** indicating positive expectations regarding the sector's recovery

Source: Bloomberg, TBC Capital; GICS classification, MSCI World member companies

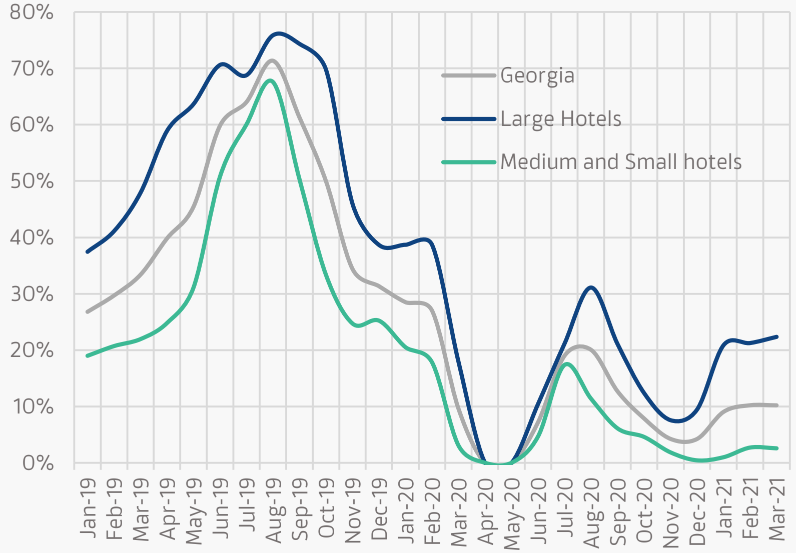
Turnover by sectors
(Turnover in GEL unless noted otherwise, 2019=100)



Source: TBC Capital

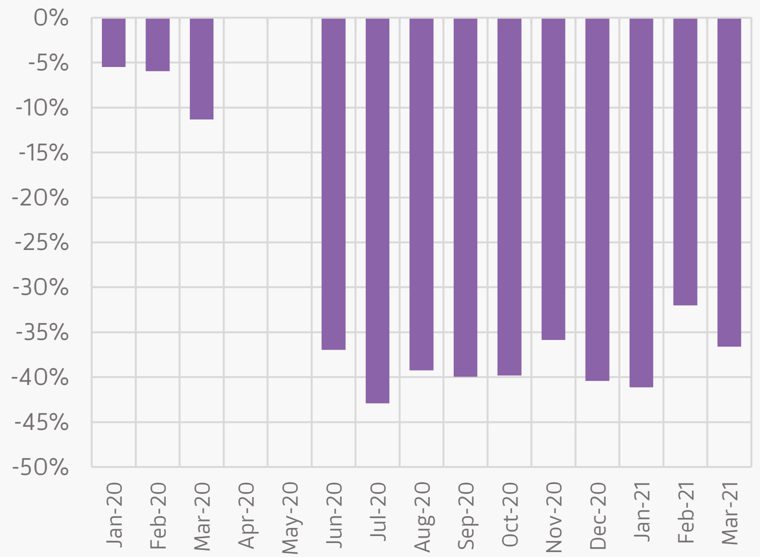
HOTELS: SLIGHT IMPROVEMENT IN LINE WITH THE PARTIAL RECOVERY OF FLIGHTS

Average occupancy rate by hotel size*
%

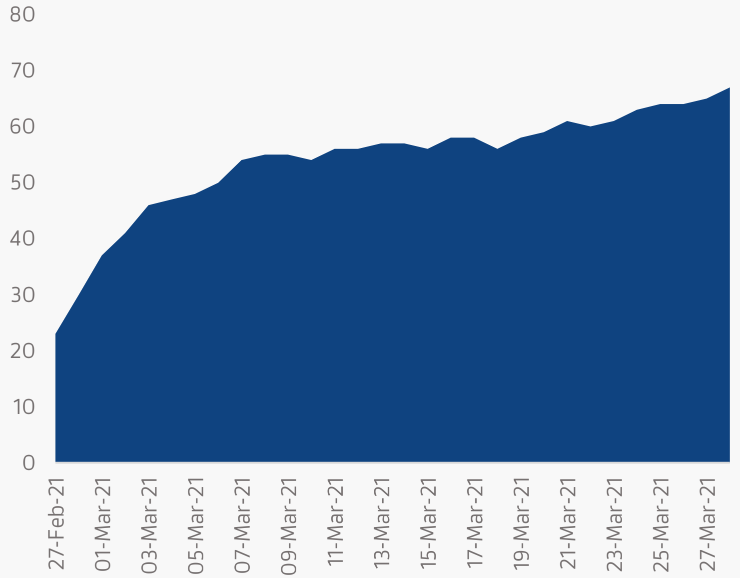


*Large hotels: more than 80 rooms; small and medium hotels: less than 80 rooms; TBC Capital survey; data for March is partially based on forward occupancy

Average daily prices, USD
YoY Change



Weekly number of flights in Tbilisi airport

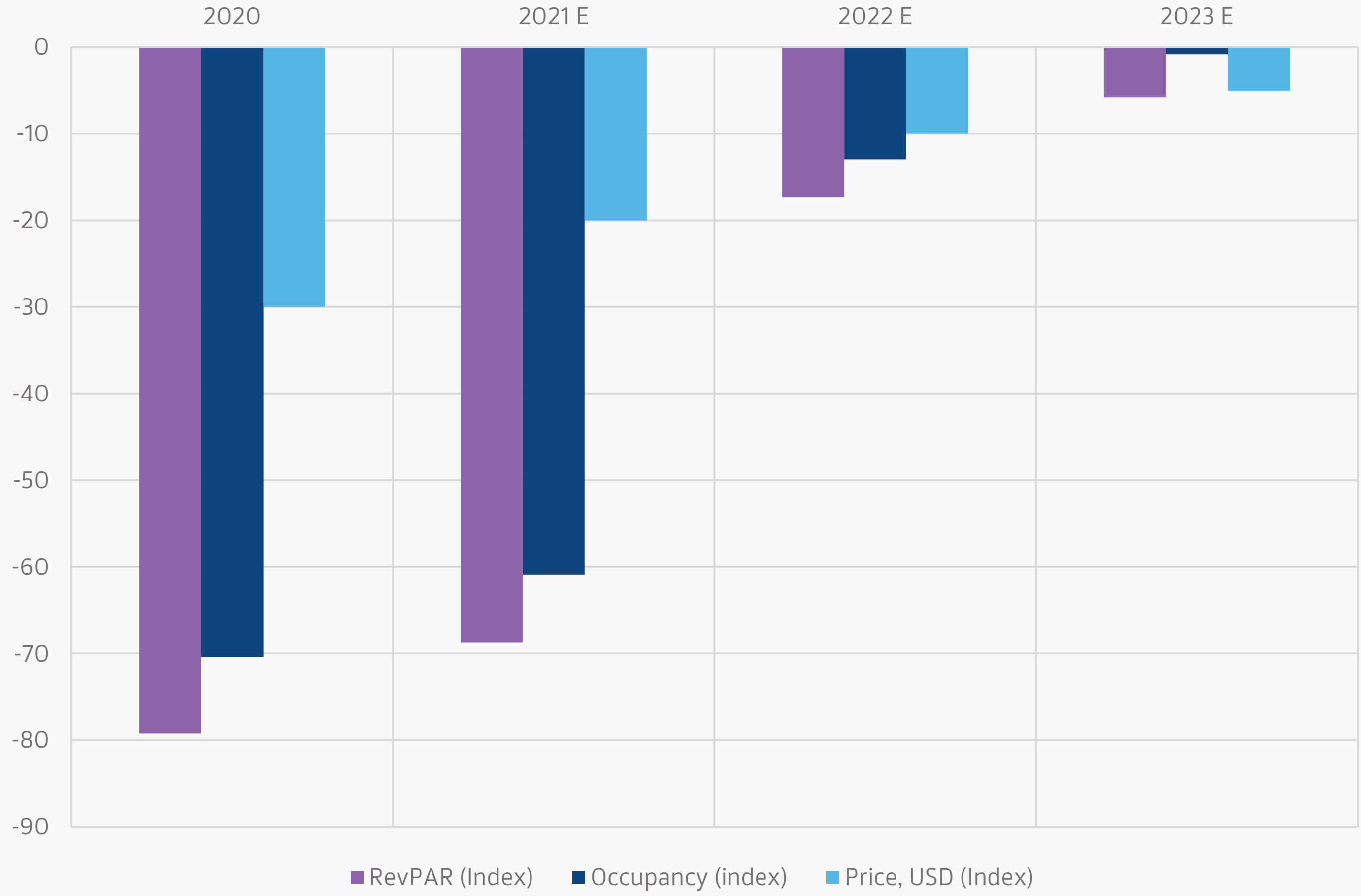


- **Hotel occupancy stands at c. 10%**. The occupancy is relatively high in large hotels, while the majority of small hotels remain closed. During the recovery phase **large hotels are expected to maintain edge** over smaller hotels in terms of recovery of occupancy rates
- **March factual occupancy rates are expected to slightly exceed the February level**, as partial recovery of flights continue
- **The average daily rates have dropped in the range of 35%-40% compared to the pre-pandemic levels**. No significant changes have been observed in this decline since summer 2020

Source: TBC Capital, Flightradar

HOTELS: A MORE SUBSTANTIAL RECOVERY IS EXPECTED BY 2022

Hotel Occupancy, Price and Revenue per room
(% change compared to 2019)

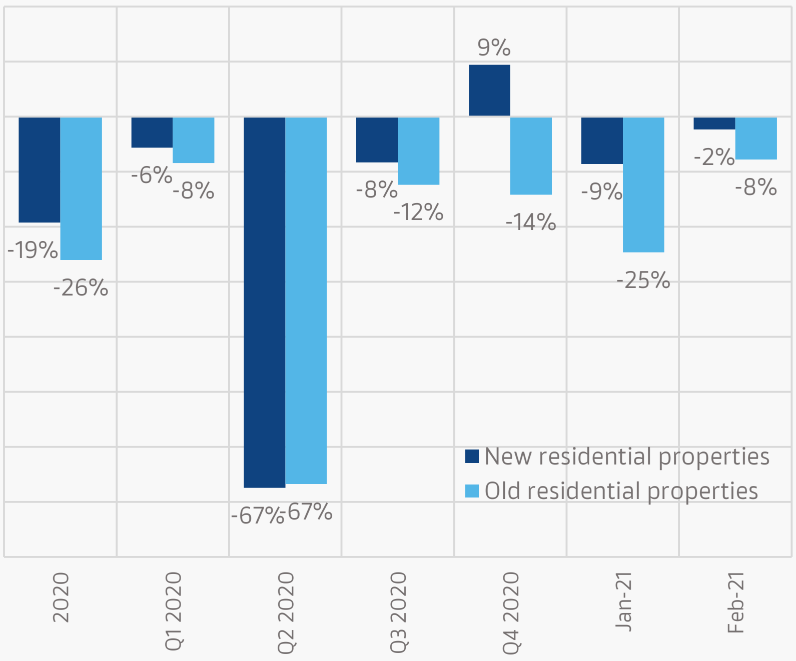


- The average occupancy rate is expected to stand circa 60% lower in 2021 as compared to 2019
- A more noticeable recovery is expected in 2022. Under the baseline scenario, the hotel industry will return to pre-crisis levels in 2023
- With the intensified competition both locally and internationally, hotel prices are expected to take relatively longer to recover

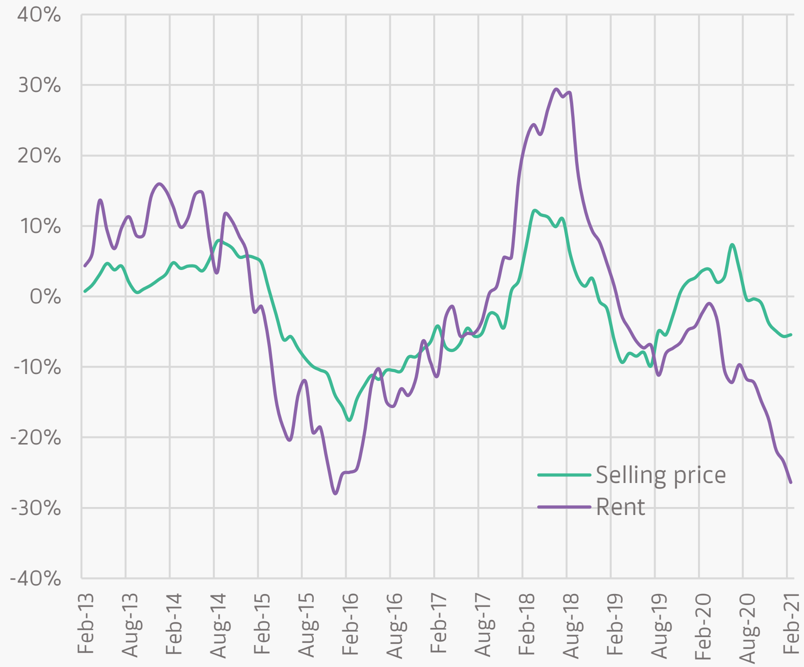
Source: TBC Capital, Flightradar

TBILISI RESIDENTIAL REAL ESTATE: DECLINE IN SALES SLOWED, HOWEVER, DESPITE A SHARP REDUCTION IN RENTS, YIELDS REMAIN HIGH COMPARED TO CAPITAL CITIES IN THE BROADER REGION

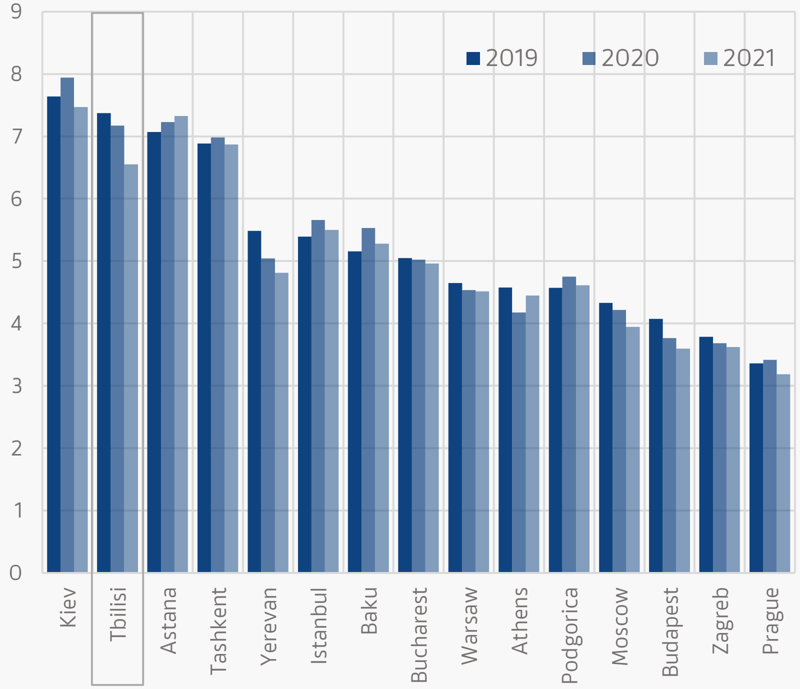
Residential real estate transactions in Tbilisi
Change YOY



Average price and rent of the apartment, USD
Change YOY



Rental income by cities
%

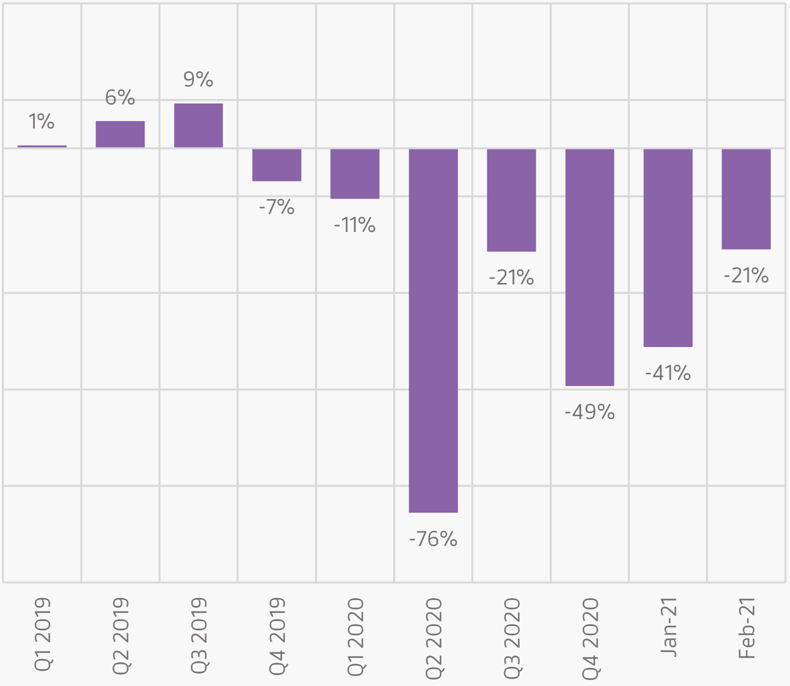


- **Some improvement is visible** for Tbilisi residential real estate market, expressed for both new and old apartments
- Rent continues to decline, with February data showing a **decline in rent of 26.4% YoY in US dollar terms.** During the same period, the prices of residential real estate in Tbilisi **decreased by 5.4% YoY**
- Despite the sharp decline of rent, **the rental yield remains high in Tbilisi**, as compared to the capital cities in the region, indicating the attractiveness of real estate investments

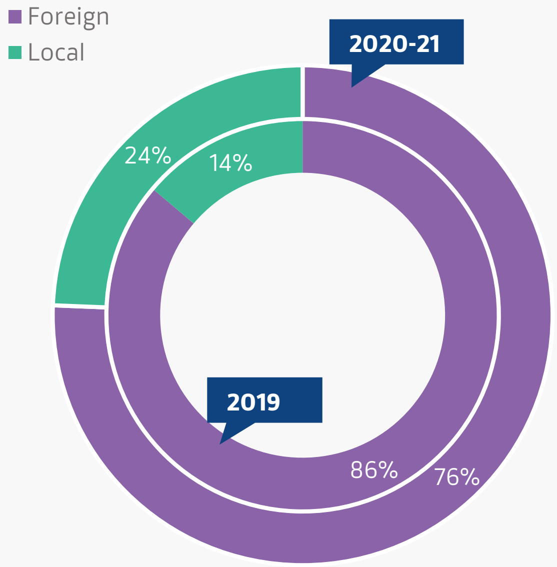
Source: NAPR, NBG, Numbeo, TBC Capital

BATUMI RESIDENTIAL REAL ESTATE: SOME SIGNS OF IMPROVEMENT AFTER A SHARP DROP IN SALES; REDUCED CONSTRUCTION PERMITS DECREASE THE RISKS OF EXCESS SUPPLY

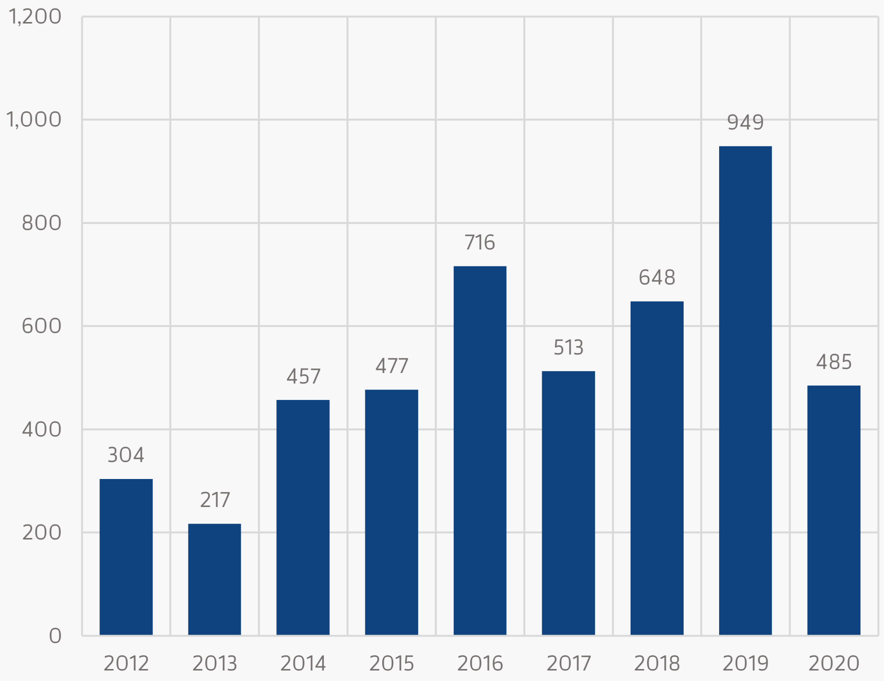
Residential real estate transactions in Batumi
Change YOY



Share of non-residents in real estate sales
Survey of selected large players



Construction permits issued in Batumi
Living area, 000 'Sqm

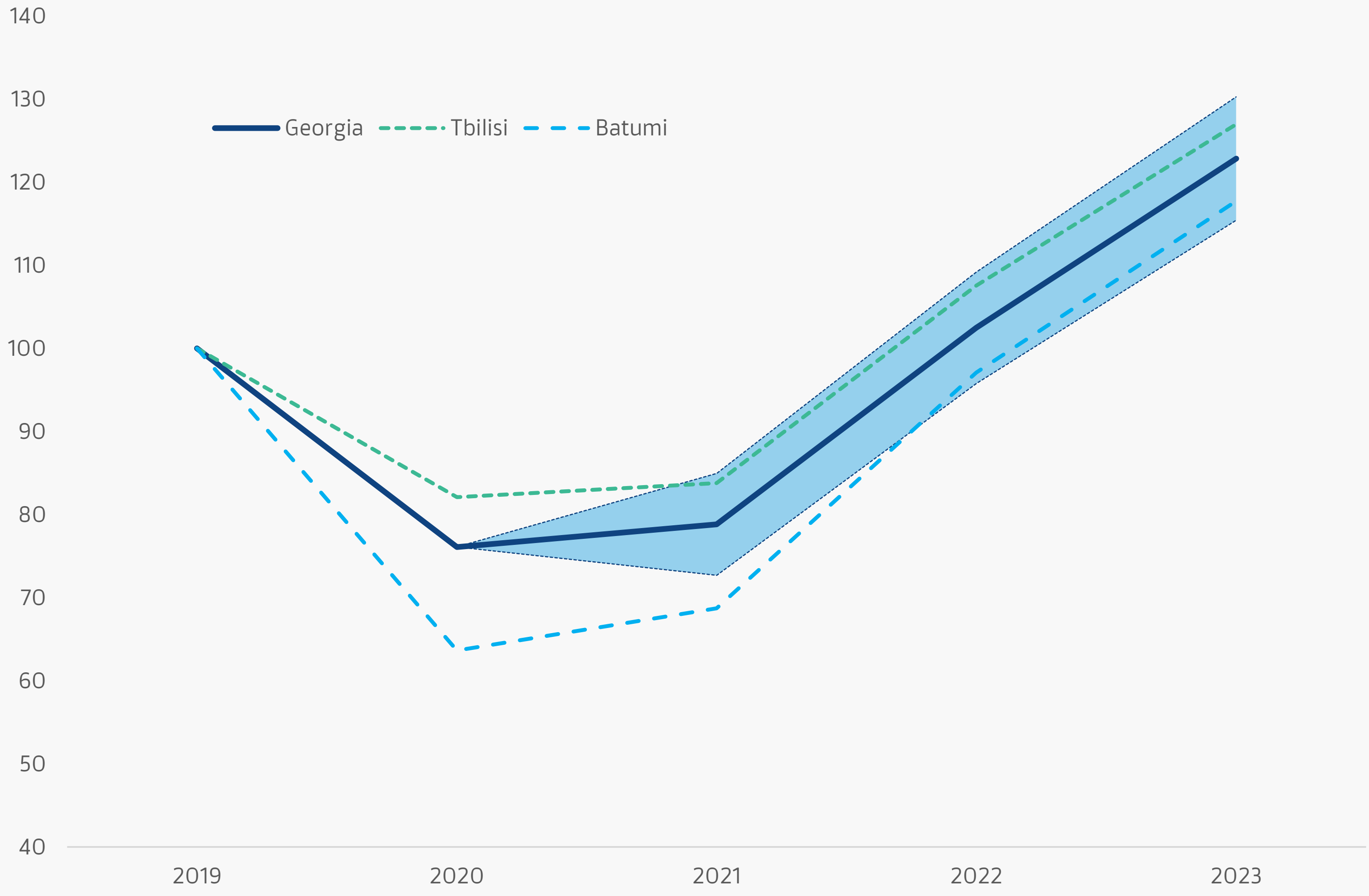


- Compared to Tbilisi, **residential property sales posted a more pronounced decrease in Batumi**, which is largely due to the reduction of demand for investment by non-residents
- In addition, **non-residents accounted for 76% of sales for the selected major players**, despite the locked borders
- The construction permit issuance hit a record high in 2019, while the residential area approved for construction decreased by 45% YoY in 2020. In case of sales returning to the level of 2016-19, significant accumulation of residential properties in stock is not expected

Source: NAPR, Survey of Selected Players, TBC Capital

RESIDENTIAL REAL ESTATE SALES WILL RETURN TO PRE-CRISIS LEVELS IN 2022, WITH A RELATIVELY QUICKER RECOVERY EXPECTED IN TBILISI COMPARED TO BATUMI

Expectations of residential real estate sales ('000 Sqm, 2019 = 100)



Factors affecting the growth of demand:

- Gradual recovery of demand for mortgage loans
- Reduced yield of dollar deposits both in Georgia and in the region
- Normalization of investment demand with the resumption of tourism
- Strong growth rate of remittances
- Improved consumer sentiments

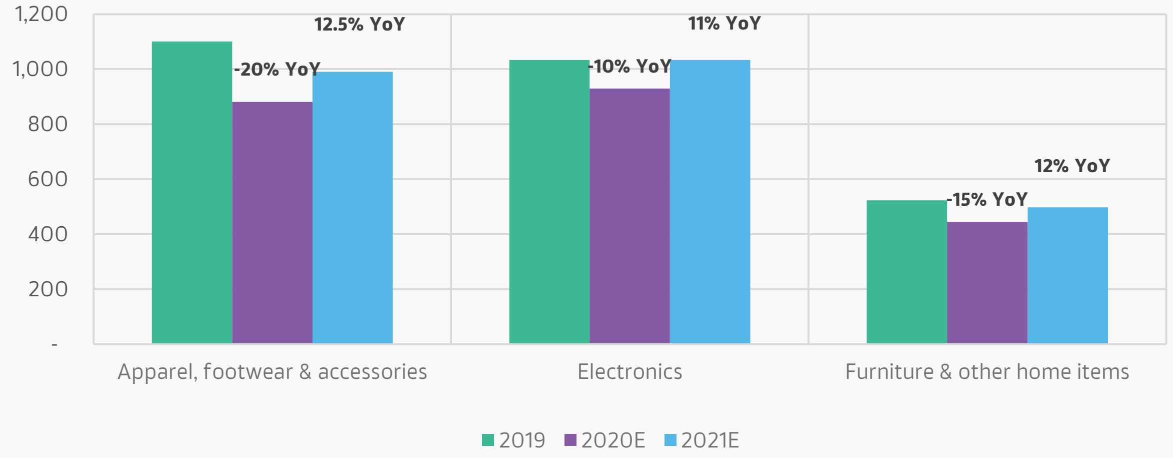
Potential risks of demand growth:

- Delayed economic recovery
- Increased exchange rate volatility poses a risk, albeit in a relatively short period of time

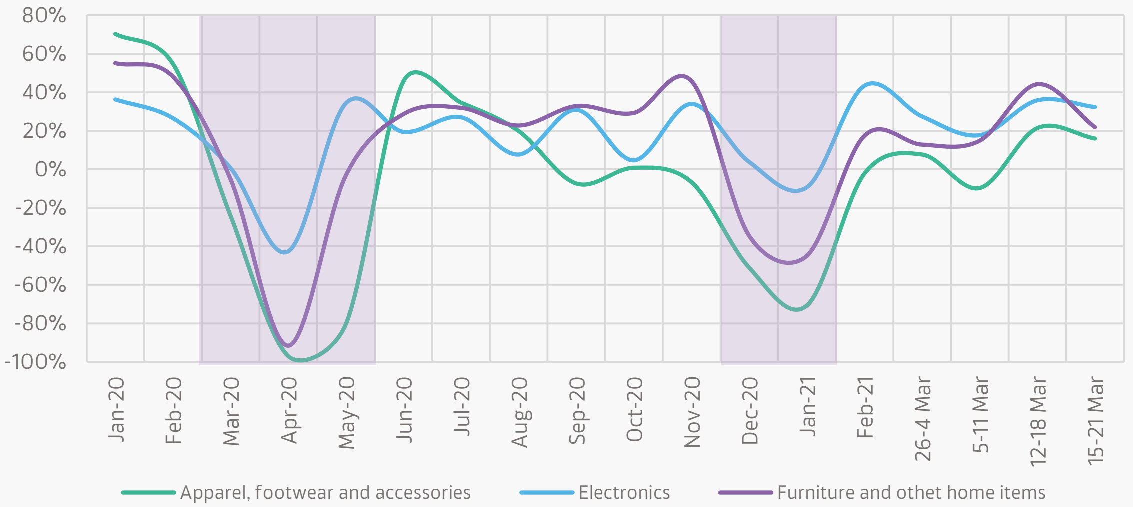
Source: TBC Capital

CONSUMER CYCLICALS SECTOR HAS BEEN HIT HARD BY RESTRICTIONS IN 2020; HOWEVER, FOR SOME CATEGORIES RECOVERY TO PRE-CRISIS LEVELS IS EXPECTED ALREADY IN 2021

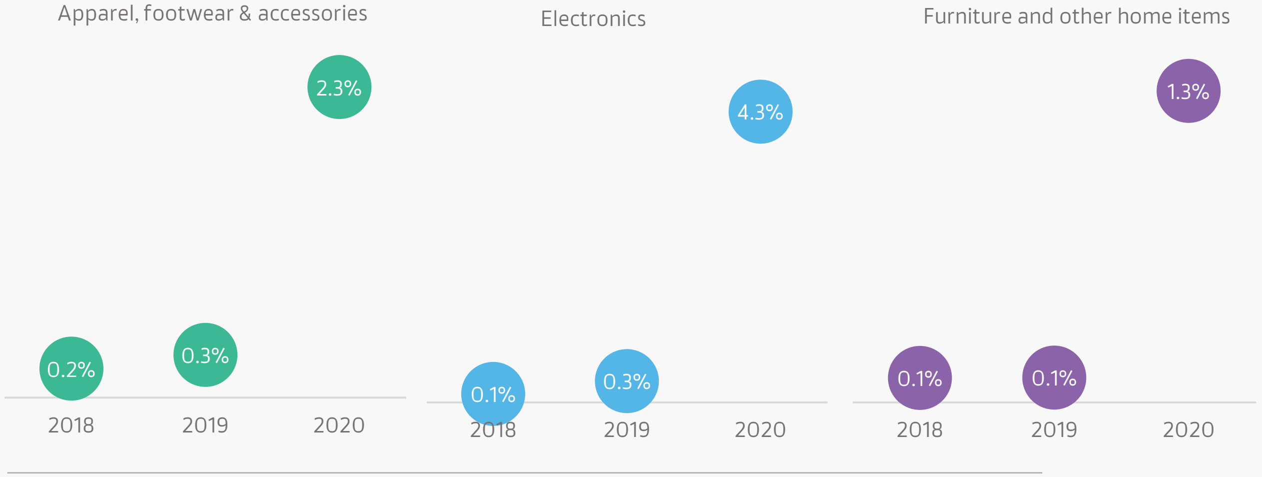
Consumer Cyclicals Turnover
Categories Turnover GEL Mln; YoY %



Non-cash spending
YoY Changes %, GEL



E-commerce Share % of Consumer Products Turnover
Categories E-commerce Share %, GEL

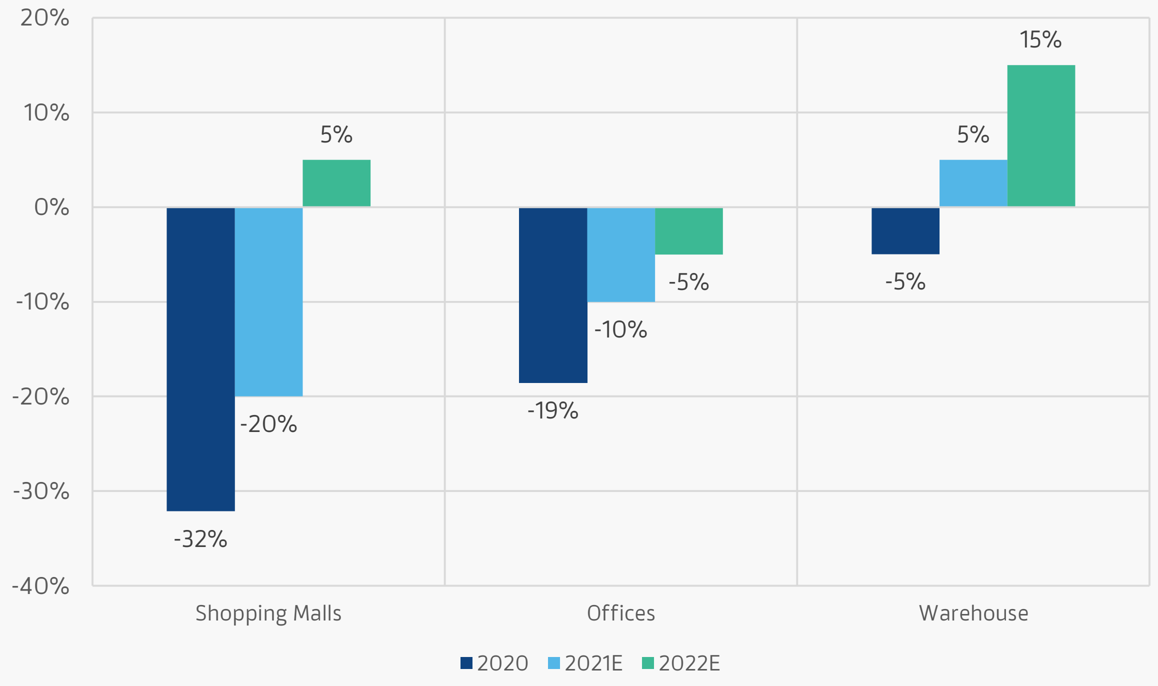


- Under the restrictions, a sharp drop was observed in sales of apparel, furniture and electronics. However, **sales of consumer electronics showed more resilience** on the back of strong demand and effective management of e-commerce
- **In 2021, a return to 2019 levels is largely expected for the sales of electronics and furniture**. However, fashion retailing will have a late recovery due to its greater reliance on tourism sector
- **Following a significant increase of online shopping, sales normalization is expected in 2021.** Moreover, well-functioning online services will give a competitive advantage to sector players in the crises episodes

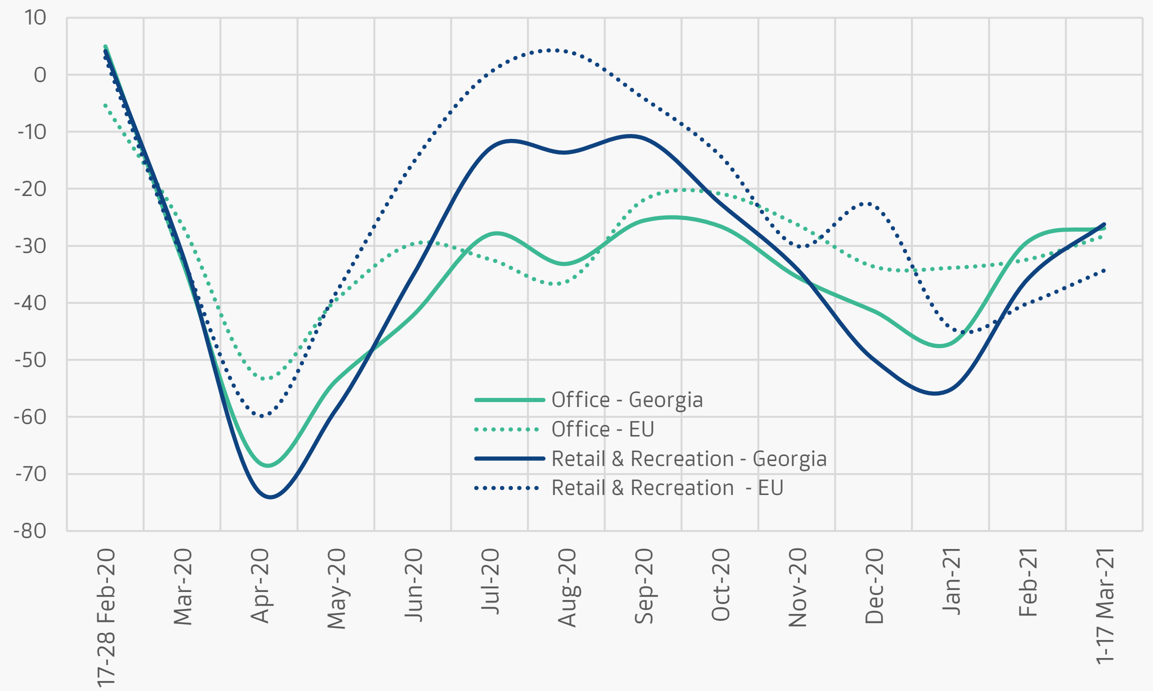
Source: Geostat, TBC Bank, TBC Capital

COMMERCIAL REAL ESTATE: IMPROVEMENTS ARE EXPECTED IN LINE WITH THE MOBILITY RECOVERY; HOWEVER, LONG-TERM RISKS IN THE SECTOR SHOULD BE TAKEN INTO CONSIDERATION

Turnover YoY Changes %, 2020-22 vs 2019, USD



Mobility in workplace and retail & recreation (monthly average)
YoY Changes % compared to the average of January, 2020



- **In 2020, the decline in sectoral turnover is mainly due to decreased rental rates** and occupancy rates remain relatively stable
- Offices and warehouse facilities mainly remain on fixed rental rates. However, a share of variable lease agreements has been increased for shopping malls and street retailers
- **Warehouses have been the least impacted by the crisis in 2020** and mainly maintained both high occupancy rates and rental prices
- Gradual rebound of rental income is expected in shopping facilities in parallel with the recovery of trade sector
- **Relatively less revenue was observed in office spaces**; At the same time **a large number of employees prefer to work remotely** which will result in downward pressure on demand for office spaces in the following years

Source: TBC Capital, Google

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