WORLD BANK GROUP
Macroeconomics, Trade & Investment

- *The economic recovery remained strong and broad-based in May.*
- *Inflation increased further to 9.9 percent, the highest rate in over a decade.*
- *Lari remained stable in June after appreciating in May.*
- *The foreign trade deficit increased in May as both exports and imports grew strongly.*
- *The current account deficit was 11 percent of GDP in Q1; a wider trade deficit may offset gains from improved tourism and remittances in Q2.*
- *Credit growth remained strong in June amid robust soundness indicators.*
- *The fiscal deficit widened in May, as increased expenditures offset strong tax collections. The annual budget was amended to reflect improved growth prospects.*

The economy grew at a robust pace of 25.8 percent year on year (yoy) in May, as per GEOSTAT's rapid estimates of economic growth. Growth was broad-based, with manufacturing, financial sector, trade, construction, real estate and restaurant sales all showing robust growth. This, in part, reflects a low base of activity in 2020, but it should be noted that estimated growth in April and May pushed activity above 2019 levels. Other indicators also reflect continuing recovery: mobility in Tbilisi picked up to 75 percent of pre-COVID levels in June from 66 percent in May, and electricity consumption increased by 24 percent yoy in May.

Cumulatively, after contracting in Q1, the economy returned to growth in the year to May. GDP contracted by 4.5 percent in Q1, 2021 as strong growth in agriculture, mining, trade, IT, financial and healthcare sectors was offset by contraction in tourism-related sectors, the power sector, manufacturing and construction. On the demand-side, fixed investment contracted by 17 percent in Q1, consumption was flat while net exports deteriorated by 12 percent. However, the contraction in Q1 was offset by strong growth in April and May. As a result, cumulatively, in the year to May, growth is estimated at 11.5 percent as compared to a 5.4 contraction in the same period last year.

The rate of COVID-19 infections remained high in June and early July as restrictions were further eased. Test positivity rate is on the rise exceeding 4.5 percent in mid-July (7-day average as of July 14). The average number of infections exceeded 700 in June and reached 1,800 by the mid July. Meanwhile, vaccination efforts picked up, albeit from a low base, and as of July 12, only 1.7 percent of the population had received one shot and 3 percent were fully immunized.

Inflation spiked to 9.9 percent yoy in June, the highest rate in over a decade. In addition to increase in global food and oil prices and pass-through from earlier depreciation of the lari, prices for utility services increased by 2.7 percent in June month on month (mom) and by 10.5 percent yoy. Other drivers of inflation include healthcare costs (up by 11.6 percent yoy) and repair and maintenance (up by 10.6 percent yoy). Core inflation, excluding food, alcohol, transport and administrative prices, decreased by 0.6 ppt to 5.9 in June.

The lari remained stable after appreciating sharply in May and early June. By mid-July, the lari gained 8.8 percent against the USD compared to end-April**.** This reflects increased tourism proceeds, healthy remittances and the stabilization of the political environment. The nominal effective exchange rate appreciated even more strongly, by over 10 percent mom in early June. Reserves slightly declined due to swap operations with commercial banks, but the level remained robust. At USD 3.9 billion as of end-June, reserves provided a comfortable 5.2 months of goods import cover.

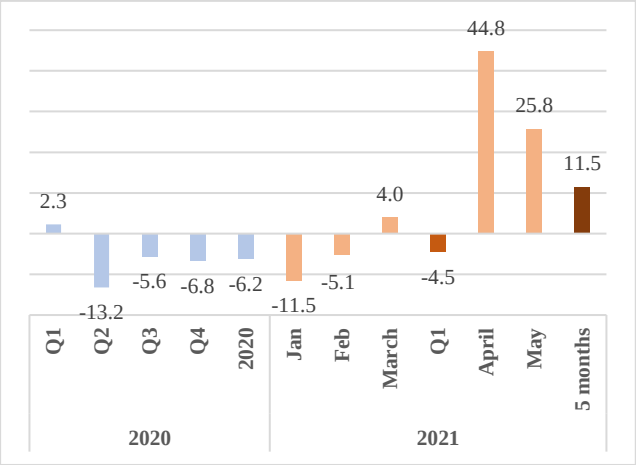
The goods trade deficit widened in June. Trade turnover increased by 35 percent yoy in June reflecting 30 percent yoy increase in exports and 38 percent yoy increase in imports**.** As a result, the trade deficit widened by 43 percent yoy in June and by 15 percent yoy since the beginning of the year. Export growth in the first half of the year was driven by export of copper ores, used cars, ferro-alloys, wine, nuts, apparel and nitrogen fertilizers. Exports of domestic products (excluding re-exports) also grew strongly (by 32.5 percent yoy in May).

The Current Account (CA) deficit remains high. In Q1, 2021, weak services exports, particularly from tourism, were compensated by strong remittances and the improved goods trade balance, keeping the deficit at around 11 percent of GDP. The deficit was financed in part by net FDI and portfolio investments (23 percent of financing needs), while higher government borrowing covered the rest of the deficit and also supported reserve accumulation. In Q2, 2021, tourism revenues started to recover, though in May 2021, revenues still remained 73 percent below May 2019 levels. In addition, remittances remained resilient (up by 42 and 19 percent yoy in May and June respectively, and by 41 percent cumulatively in the first six months of 2021) and exceeded levels in 2019, which may reflect increased formalization of transfers given reduced physical travel. However, the widening of the goods trade deficit in Q2, 2021, is likely to offset these gains, keeping the CA deficit elevated.

Credit and deposit growth remained robust in June. Credit growth (excl. FX effect) remained robust at 13 percent yoy in June, as compared to 15 percent yoy in May. Lari loans grew strongly by 26 percent yoy, and, as a result, dollarization declined by 2 ppt to 52.5 percent in June. Deposit growth decelerated slightly to 18 percent yoy in June from 23 percent yoy in May. The banking sector remained profitable, outperforming 2019 levels in the first five months of 2021. The share of non-performing loans (more than 90 days overdue) remained low at 2.4 percent in May.

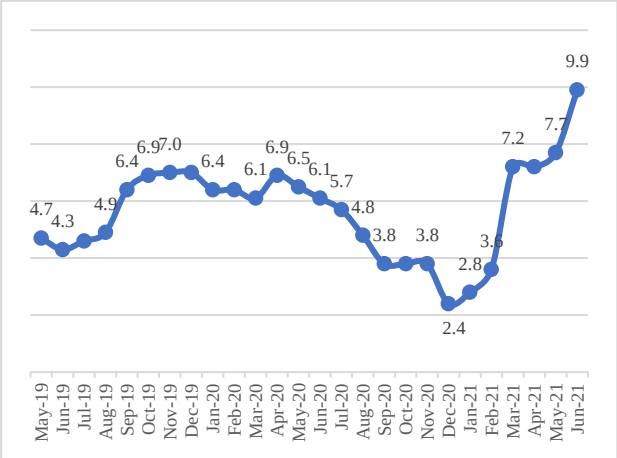
Government revenues and spending both increased considerably in May. General government tax collections increased by 28 percent yoy, driven by VAT collections, which was up by 104 percent yoy in May. Government spending increased by 23 percent yoy, counteracting the revenue increase, and pushing the deficit up by 0.7 ppt in May. With GDP growth and fiscal revenues exceeding targets, the government also submitted draft amendment to the annual budget for 2021, with a higher projected baseline GDP growth (7.7 percent) and with a plan for the fiscal deficit to not exceed 7 percent of GDP (compared to 7.5 percent of GDP in the initial budget).

Figure 1. Economic recovery continued in May
(year-on-year, in %)



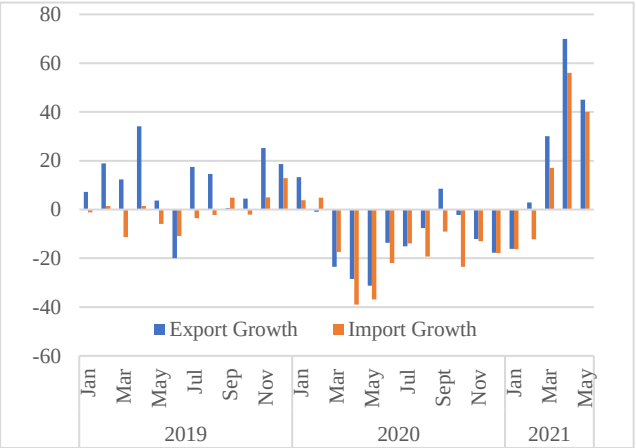
Source: Geostat

Figure 2. Inflation spiked to record levels in June
(year-on-year, in %)



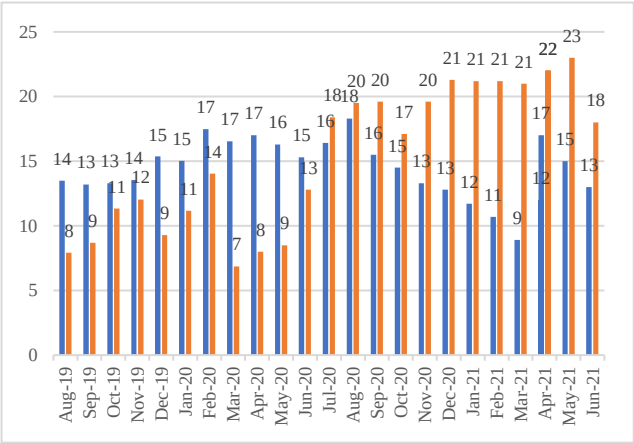
Source: Geostat

Figure 3: The trade deficit widened in May, as both imports and exports grew fast
(year-on-year, in %)



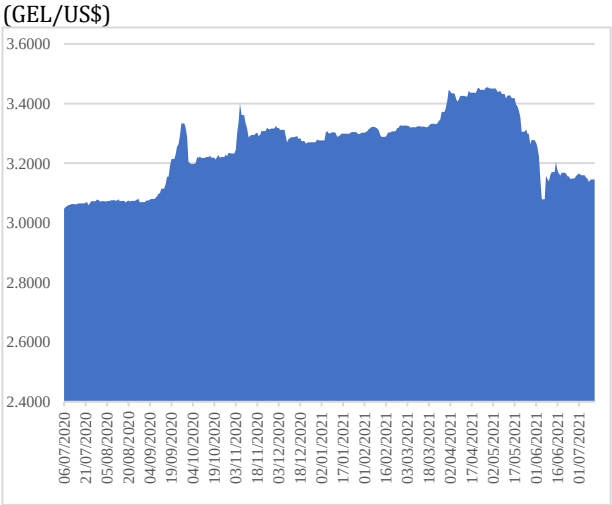
Source: Geostat

Figure 4. Credit and deposit growth was robust in June
(year-on-year, in %)



Source: NBG

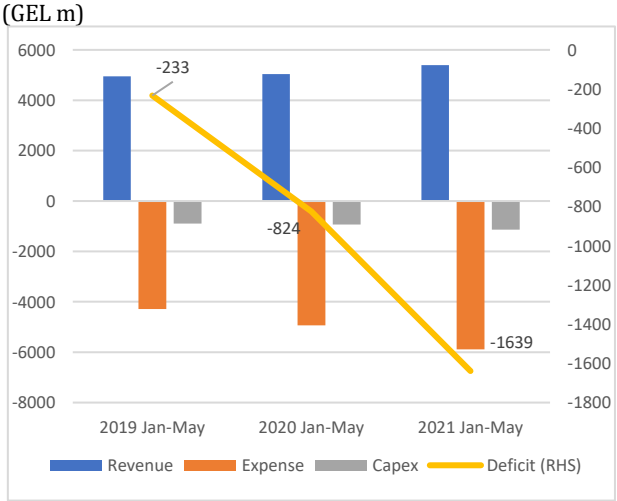
Figure 5: The lari remained stable from early June to mid-July, after strong appreciation in May
(GEL/US$)



Source: NBG

Figure 6: Fiscal deficit widened further in May

(GEL m)



Source: MOF