



| GEORGIA | 2016 |
|---|-------|
| Population, million | 3.7 |
| GDP, current US\$ billion | 14.2 |
| GDP per capita, current US\$ | 3,833 |
| School Enrollment, primary (% gross (2015)) | 116.9 |
| Life Expectancy at birth, years (2015) | 74.5 |

At a Glance

- Georgia's economy grew by 2.7% in 2016, driven by construction and other non-tradables. Growth was supported primarily by investments. Net exports declined because of the slow adjustment of imports and continued decline in exports.
- Increases in oil prices, coupled with the doubling of fuel and tobacco excises, translated into an overall spike in inflation to 5.5% by end-February, above the inflation target of 4%.
- The fiscal deficit widened to 4.2% of GDP in 2016 as the Government boosted capital spending by 6% in an effort to support growth. This was accompanied by a 13% increase in current expenditures.
- In 2017, growth is projected at 3.5%, with a moderate recovery of external demand and increased public investment. The fiscal deficit will remain elevated at 4.1% of GDP. Poverty is expected to decrease modestly as economic growth recovers and translates into higher labor income.

Country Context

Following several years of robust growth performance in the post-financial crisis and conflict period of 2008–09, Georgia's macroeconomic outlook and fiscal position have deteriorated in recent years, amid a weak external environment and policy changes. Concerns about domestic uncertainties faded relatively quickly after the 2012 elections, but soon after, there were tensions in the country's external environment, and Georgia could not return to the earlier growth model of utilizing outside finance to support domestic growth.

The country's key economic partners saw their own growth falter as oil prices collapsed in the second half of 2014 and other geopolitical events materialized. Thus, following a very short-lived recovery in 2014, Georgia has struggled to revive its main engines of economic activity. At the same time, the external sector has weakened—the current account deficit widened back to two digits—but within a much less favorable context for the external inflows that may help sustain it.

The fiscal accounts have also weakened, partly because the authorities have sought to provide a countercyclical boost to domestic demand that has not proven fully effective, especially in the face of what seems likely to be a protracted adverse change on the country's borders. The increase in social spending, however, helped to increase incomes at the bottom 40%.

Georgia's key macroeconomic vulnerabilities include risks to external and fiscal sustainability. The pace of poverty reduction may continue to slow and eventually stall if the recent rate of private sector employment growth were to decline.

The World Bank and Georgia

The World Bank Group has been a key development partner for Georgia since 1992, supporting investment projects and the reform agenda in almost every sector. In 2014, Georgia graduated from the International Development Association (IDA) to become an International Bank for Reconstruction and Development (IBRD)-only borrower, and it has recently moved from the lower-middle-income to upper-middle-income country classification.

The overarching objective of the current Country Partnership Strategy (CPS) for FY14–17 is to achieve faster, inclusive, and sustainable growth while seeking a greater focus on social outcomes and poverty reduction. To achieve this objective, the two strategic areas of focus are (i) strengthening public service delivery to promote inclusive growth and (ii) enabling private sector-led job creation to improve competitiveness. The Bank and the Government of Georgia will soon start preparation of the Country Partnership Framework (CPF) for the next four-year period based on the findings of the Systematic Country Diagnostic that the Bank team is currently carrying out.

Key Engagement

Although the World Bank's program covers a wide range of sectors, providing infrastructure and services to facilitate growth remains a key engagement area. In addition to US\$860 million financing for the road sector of Georgia, the Bank has provided over US\$332 million for a regional and municipal development program. Ongoing Bank-financed investments in this sector include four projects with total commitments of US\$189 million.

The regional development program is one of the flagships of Georgia's cooperation with the World Bank and brings direct benefits to residents in target project regions. The program is designed to improve the quality of local infrastructure, promote cultural heritage preservation and

WORLD BANK PORTFOLIO

No. of Projects: 13

Lending: \$739 Million

IBRD: \$582 Million

IDA: \$157 Million

sustainable tourism, create job opportunities, and generate public-private partnerships (PPPs) in collaboration with IFC. The first Regional Development Project (RDP, US\$60 million) focuses on the Kakheti region, the second (RDP II, US\$30 million) on the Imereti region, and the third (RDP III, US\$60 million), on the two regions of Mtskheta-Mtinatenti and Samtekh-Javakheti.

The Bank also supports municipal development and decentralization through a series of Regional and Municipal Infrastructure Development Projects (RMIDPs). The first Project (RMIDP, US\$90 million and US\$3.7 million EU trust fund grant) closed in December 2014 and fully achieved its expected results. The second (RMIDP II, US\$30 million and US\$5.0 million trust fund grant from the Swiss Development Cooperation) aims to improve the efficiency and reliability of targeted municipal services and infrastructure by investing in high-priority local infrastructure improvements and supporting local self-governments to enhance their capacity and systems for service delivery.



Urban Regeneration in Telavi, Kakheti Region

Recent Economic Developments

Georgia's economy grew by 2.7% in 2016, driven by construction and other non-tradables. Net exports declined mainly because of the slow adjustment of imports and continued decline in exports. Growth was supported primarily by investment that exceeded 30% of GDP in 2016. Meanwhile, tourism-related services performed well, as tourist arrivals from abroad increased significantly. Similarly, remittances recovered in 2016, especially in the second half of the year. Poverty is expected to have declined slightly.

Increases in international food and oil prices, combined with the doubling of fuel, tobacco, and car excises, translated into an overall inflation spike of 5.5% by end-February 2017, notably higher than the National Bank of Georgia (NBG) target of 4%. These increases, especially in food, negatively affect household purchasing power, especially at the bottom of the distribution.

The decline in exports, along with the slow adjustment of imports, widened the current account deficit from 12% of GDP in 2015 to 12.4% in 2016. Foreign direct investment (FDI), however, financed nearly 90% of the deficit. External debt increased from 107% of GDP in 2015 to 111% in 2016 because of the higher external deficit and a 10% nominal depreciation of the lari.

The NBG responded adequately to the external shock by maintaining a floating exchange rate. As a result, the lari depreciated by 10.5% in 2016, helping the economy adjust. Despite the large depreciation and high rate of dollarization, the financial sector remains stable. Prudent banking supervision reinforced the stability of the banking sector, yielding a return on assets of 2.8% and return on equity of 19.2%. Nonperforming loans represented only 7.3% of all loans in December 2016, similar to the 2015 level.

Economic Outlook

Economic growth is projected to average 4% a year over the medium term, but downside risks to growth remain. The pickup in growth in 2017 will largely be driven by high investment and some recovery in the export markets. With the Russian economy inching toward growth in 2017 and an uptick in oil prices, growth in Georgia's trading partners is likely to increase, which will raise the demand for Georgian exports.

FDI inflows, which largely originated from Azerbaijan and Turkey in 2016, have remained resilient. All these factors should contribute to an increase in employment in the construction and tradable sectors, providing more income generation opportunities at the bottom. In the outer years, growth prospects can factor in improved economic ties with the EU. The downside risks arise primarily from a protracted period of slowdown among Georgia's trading partners.

Fiscal sustainability is expected to be achieved through the revenue enhancing measures announced in the 2017 budget to counter the impact of the adoption of the Estonian tax regime. The Estonian tax model, which replaces corporate income tax with a dividend tax, came into effect in January 2017 and will reduce tax revenues by 1.5% of GDP. To compensate for this loss, the Government increased excises for tobacco and fuel and introduced an excise tax on cars.

The 2017 budget also indicates the Government's determination to restrain recurrent spending. The fiscal deficit is expected to narrow during 2017–20 as a result of these measures. However, capital expenditures and net lending are budgeted to increase from 6.5% of GDP in 2016 to 8% in 2017 to boost growth. Georgia's public debt increased to 45% of GDP in 2016 and is likely to be maintained at this level over the medium term.

Project Spotlight

Inclusive Growth Development Policy Series

The first generation of reforms—which started a decade ago—have helped Georgia improve its business environment, achieve sustained growth rates, and maintain low inflation. However, important socioeconomic vulnerabilities persist, including as a result of recent external shocks, under which the growth performance and macro-fiscal stance have deteriorated.

Against this backdrop, further improvements in the living standards of Georgians will require investments in human capital, enhanced private sector competitiveness, and fiscal, social, and environmental sustainability. Some of these objectives are supported by this series through reforms in fiscal management and the delivery of social services. The first operation in the amount of US\$60 million was delivered in 2015 and the second and last operation in the amount of US\$50 million will be presented to the board in late April 2017.

The first pillar of the series supported improved public financial management through greater fiscal oversight of public institutions (including municipalities, legal entities of public law [LEPLs], nonprofit legal entities, and state-owned enterprises [SOEs]), an improved capital budgeting framework, and a strengthened civil service cadre, promoting better policy making and more effective public administration. The second pillar supported improvements in the coverage and targeting of social expenditures, the quality of education and health care services, and the monitoring of outcomes.

The series built on previous Development Policy Operations (DPOs), which concentrated on building competitiveness for sustained growth. The reforms were anchored in public finances (modified cash basis International Public Sector Accounting Standards [IPSAS] and coverage of LEPLs in the e-budget), the social sectors (universal health coverage, upgraded standards for hospitals and primary health care, and the increased efficiency of pensions), and improvements in competitiveness (adoption and implementation of framework laws on competition, food safety, and free movement of products; improved customs efficiency; increased power sector reliability; and curricula and related improvements in general education). The Inclusive Growth Development Policy series has laid the foundation for inclusive growth by furthering reforms in the areas of public financial management and the social sectors.

Results from the DPO series include an improved public investment framework, a reduced maternal mortality rate, the adoption of a new curriculum for preschools, better access to quality unemployment data on a quarterly basis, improved access to the financial data of SOEs, and the adoption of 12 secondary registrations to implement the law on civil services.



CONTACTS

Tbilisi

+995-32-291-30-96
5A, Nino Ramishvili Str.
Tbilisi, Georgia 0179.

Washington, DC

+1-202-458-2736
1818 H Street NW,
Washington, DC 20433,
United States.

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The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at <http://www.worldbank.org/georgia>