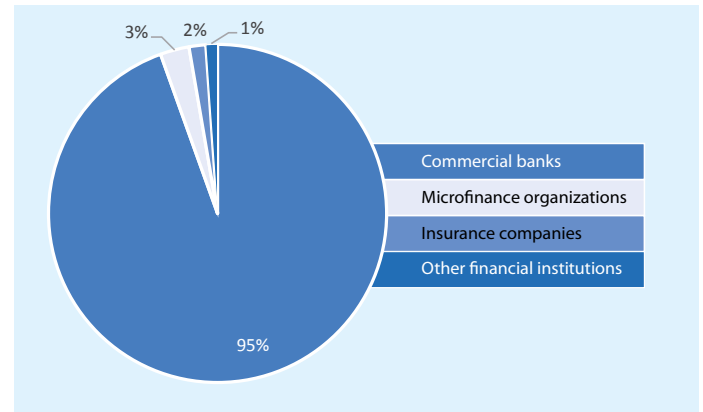


# Overview of the financial sector in Georgia



Commercial banks play a major role in the financial sector in Georgia as they hold 95% of total financial sector assets, the highest level among BSTDB member countries. The share of microfinance organizations is small at 3% but they still play an important role in providing financial services in rural areas and agriculture. The share of other financial institutions is rather small and their role in financial intermediation in the country is limited. Therefore, the present analysis will be focused on the banking sector.

Figure 1. The structure of the financial sector in Georgia, Dec 2019

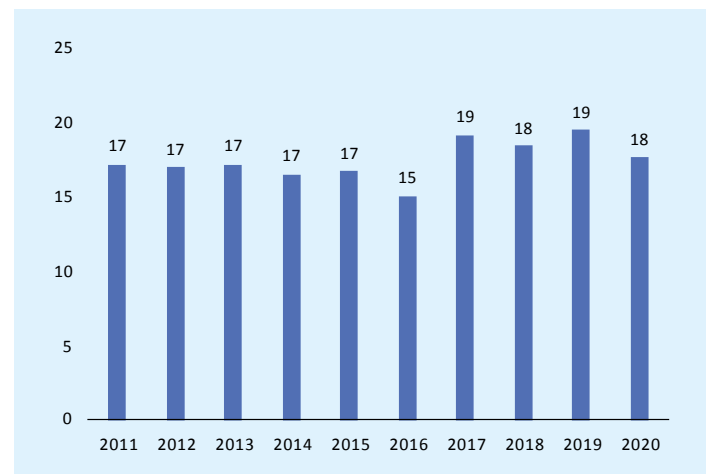


Source: National Bank of Georgia

The banking sector in Georgia is relatively large with total assets amounting to 115% of GDP as of the end of 2020. Assets mostly consist of loans, amounting to 77% of 2020 GDP. The volume of loans relative to the size of the economy in Georgia is one of the highest among the BSTDB member countries. Deposits are the main source of funding for the banking sector as they amount to 67% of total liabilities. More than half of deposits are collected from the retail sector, which is a more stable source of funding. Borrowed funds are also an important source of funding as they account for 23% of total liabilities.

Currently, 15 banks operate in Georgia, of which 13 are foreign owned. The banking sector in Georgia is highly concentrated with the two largest banks holding more than 70% of the total banking sector assets. This drives the HHI index of concentration to around 29%, one of the highest among peer countries in the region.

Figure 2. Regulatory Capital to Risk-Weighted Assets (%)

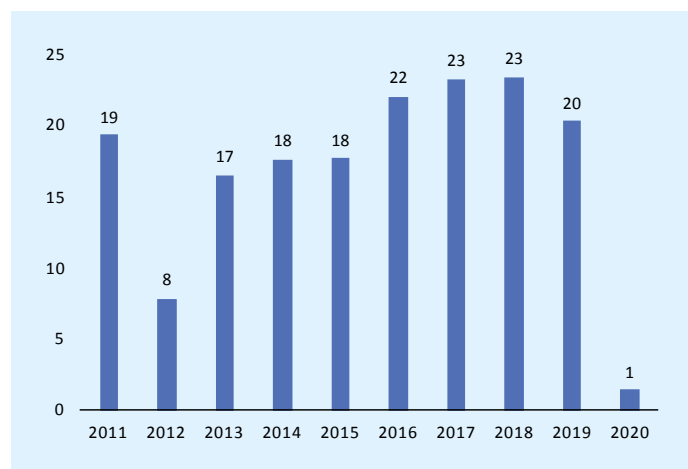


Source: Financial Soundness Indicators, IMF database

Commercial banks maintain large capital buffers, with the ratio of regulatory capital to risk weighted assets remaining above the required minimum in the last decade. At the beginning of the pandemic, the regulator introduced a temporary capital relief measure that allowed use of a capital conservation buffer. In 2020, the regulatory capital of the sector declined somewhat, but by the end of the year capital adequacy of the banking sector still exceeded the required minimum by a large margin, indicative of the strong shock absorbing capacity of the system.

The banking sector in Georgia exhibits quite high profitability. In the decade before 2020, ROE on average stood at 18%, which is in the same range as in countries with similar credit ratings. In 2020, however, the ROE in the Georgian banking sector dropped significantly to 1%. This was due to loan loss provisions, which were made in response to the negative expectations associated with COVID-19. After the pandemic, it is expected that banks will be able to recover their profitability thanks to high operating income.

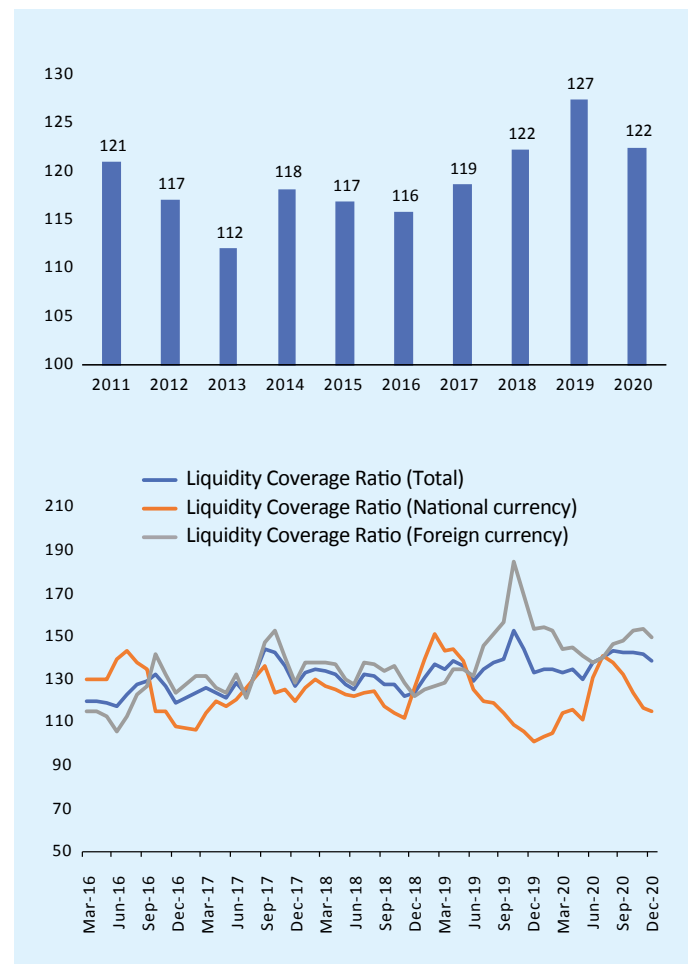
Figure 3. Return on Equity (%)



Source: Financial Soundness Indicators, IMF database

In the period prior to the pandemic, banks' reliance on borrowings increased as the loan to deposit ratio of the banking system was rising and reached 127% by the end of 2019. In 2020, due to strong growth in deposits, the loan to deposit ratio declined but still was the highest in the BSTDB Region. At the same time, banks maintain solid liquidity buffers. Liquidity Coverage Ratio (LCR) is well above the required minimum of 100% for total, local currency<sup>1</sup>, and foreign currency positions.

Figure 4. Loan to deposit ratio and LCR for the banking sector (%)

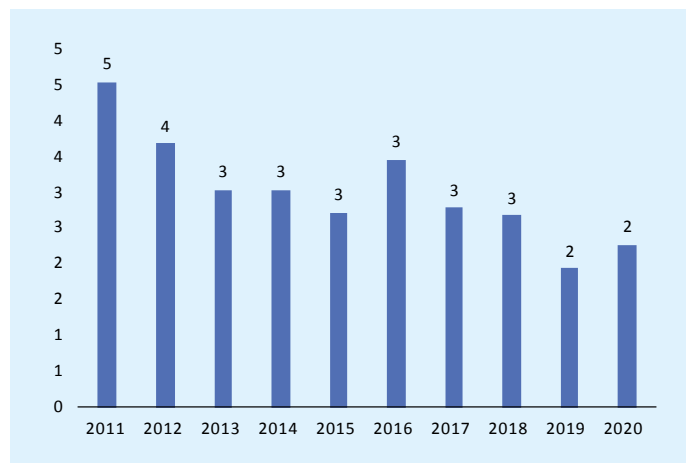


Source: Financial Soundness Indicators, IMF database, NBG website

<sup>1</sup> Minimum requirement for LCR in local currency is 75%.

The Georgian banking sector has the lowest level of NPLs among BSTDB member countries and among the lowest in the wider region. NPLs have been low for many years and by the end of 2020, they accounted for only 2% of total gross loans. Due to the subsidies introduced by the government to the sectors most hit by the pandemic and banks' moratoria decisions on debt service, the full impact of the pandemic is not yet reflected in the actual NPLs. To address the potential worsening of loan quality stemming from the current slowdown of economic activity, banks increased loan loss provisioning considerably in early 2020. As a result, the current volume of provisions is well above the actual level of NPLs. Hence, even a significant worsening of the credit portfolio could be absorbed before having material impact on banks' profitability and capital positions.

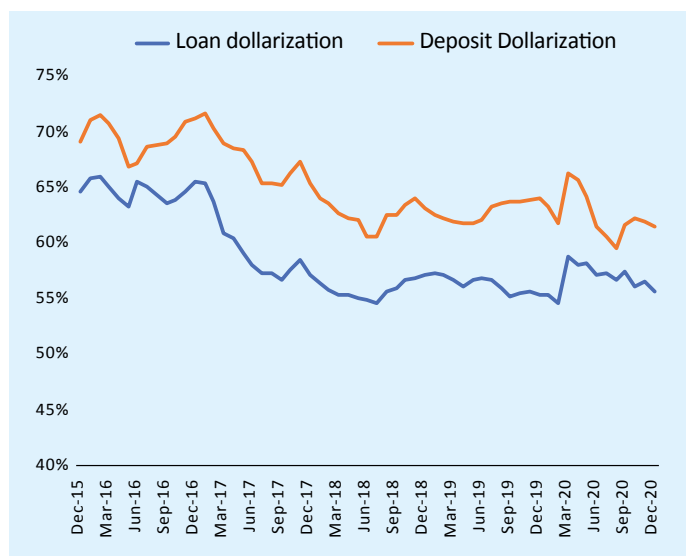
Figure 5. Non-performing loans to total gross loans (%)



Source: Financial Soundness Indicators, IMF database

One of the main challenges of the banking sector in Georgia is the high level of dollarization. The authorities have introduced various measures to counter dollarization in recent years. This resulted in a decline in dollarization, which, by the end of 2020, was down to 61% for deposits and 56% for loans. Dollarization, at 41%, is comparatively low for households, the sector that is more vulnerable to exchange rate risk. Despite the decline, dollarization is still elevated which keeps the sector vulnerable to potential exchange rate volatility. In general, dollarization in Georgia is one of the highest among BSTDB member countries.

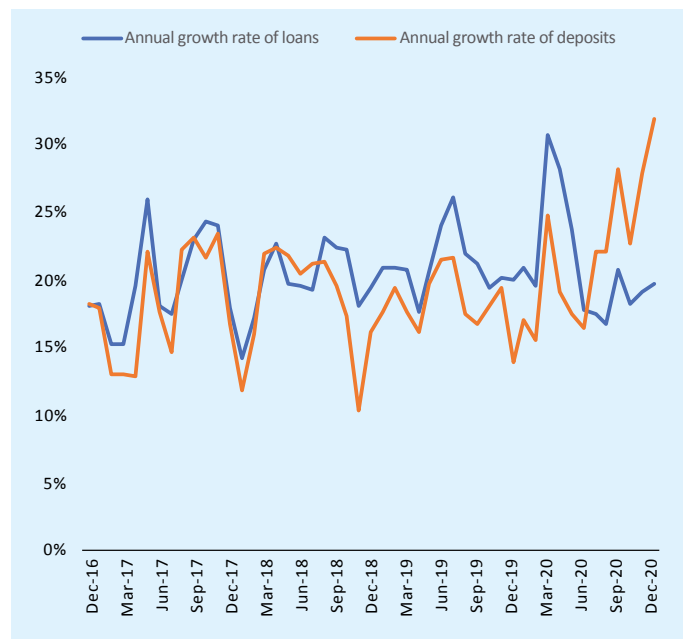
Figure 6. Evolution of deposit and loan dollarization



Source: National Bank of Georgia

The banking sector in Georgia has been growing rapidly over the last 4 years, with both deposit and loan growth rates at double digit levels. Given the high level of dollarization in loans and deposits and exchange rate fluctuations, it would be more informative to look at growth rates excluding the exchange rate effect. Before the pandemic, loans were growing on average at around 17% in annual terms. Since the pandemic, however, the growth rate slowed and by the end of 2020, it was down to 9%. Deposits, on the other hand, grew rapidly in 2020, accelerating markedly in the second half of the year; by the end of 2020 deposit growth reached 21%. Growth in local currency deposits was particularly pronounced as the annual growth rate reached 41% by the end of the year.

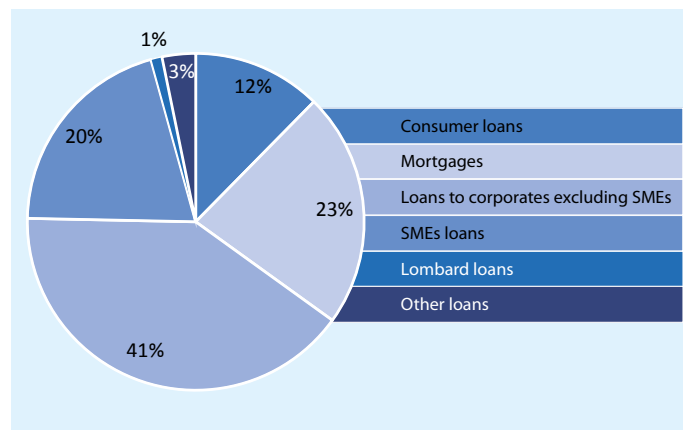
Figure 7. Annual growth rates of loans and deposits<sup>2</sup>



Source: National Bank of Georgia

Loans to corporates account for around 61% of the banking sector credit portfolio. Out of this, 20% are loans to SMEs. Dollarization for business loans is relatively high, amounting to 54% of loans to SMEs and 73% of loans to other corporates. Mortgages constitute 23% of the total portfolio and a large part of it, around 58%, is denominated in foreign currency. The share of consumer loans is relatively low at 12% and most of it is denominated in national currency with the dollarization ratio at 12%.

Figure 8. The structure of the credit portfolio

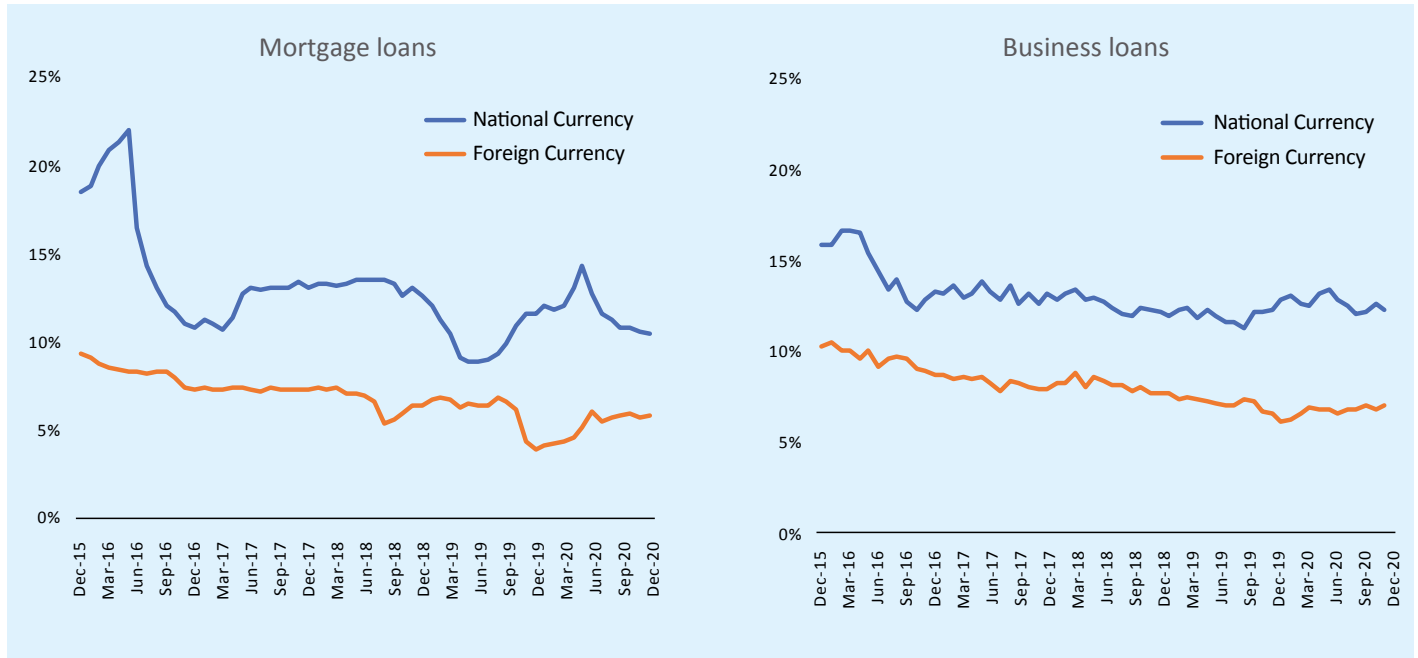


Source: National Bank of Georgia

<sup>2</sup> Exchange rate effect is excluded from growth rates.

Interest rates for business loans, in both local and foreign currencies, were declining before the pandemic crises. The downward trend stopped in 2020 and interest rates stayed relatively stable during the year. Following monetary policy tightening in the second half of 2019, interest rates for local currency mortgage loans increased. However, as the pandemic deepened, NBG started to ease monetary policy which was followed by a decline in mortgage interest rates. For foreign currency mortgages, interest rates have also been declining over the last 3 years.

Figure 9. Interest rates for business loans and mortgages



Source: National Bank of Georgia

The banking sector in Georgia accounts for most of the financial sector and is large relative to the whole economy. Despite the pandemic crisis, the sector remains healthy and maintains large capital and liquidity buffers, while NPLs remain at low levels. In addition, banks' large loan loss provisioning enables the sector to withstand potential deterioration in asset quality. As a result, possible extension of the pandemic and the economic challenges related to it will not have a material impact on financial health. The biggest challenge of the banking sector in Georgia is dollarization that has been declining for the last 5 years but remains at a relatively high level.