Trip Notes

Georgia, Kazakhstan, Uzbekistan

Photo: View from Esentai Tower, Almaty, the former capital of Kazakhstan

Aktia

Summary

- This report presents insights gathered during our visit to Kazakhstan (Moody's: Baa2 / S&P: BBB- / Fitch: BBB), Uzbekistan (Ba3u / BB- / BB-), and Georgia (Ba2 / BB / BB) in February, drawing from discussions with diverse stakeholders and local experts engaged in these economies.
- Strong economic indicators with moderate debt levels; Kazakhstan's economy is supported by its oil reserves, while Uzbekistan benefits from its gold resources. Georgia experienced a temporary boost from Russian visitors but should focus on developing its tourism sector and leveraging logistics opportunities arising from growing trade between Asia and Europe.
- Government reshufflings in both Kazakhstan and Uzbekistan has slowed reform progress. Elections are scheduled in Georgia for October this year, the ruling party expected to continue in power.
- Navigating challenging geopolitics necessitates countries in the region delicately balancing between various powers. With Western sanctions against Russia and concerns about potential secondary sanctions, countries visited are experiencing the repercussions as trade with Russia declines. Moreover, China's increasing dominance in trade, particularly in Kazakhstan and Uzbekistan, is evident. In response to these shifts, there is a growing emphasis on regional integration among the countries, as they explore opportunities in trade and logistics.

Photo: Featuring one of the largest spherical buildings in the world, the Nur Alem Pavilion, as the centerpiece, capturing the spirit of Astana Expo 2017, symbolizing Kazakhstan's dedication to future energy and innovation

Overview

In February, we visited three former Soviet states, all of which became members of the Commonwealth of Independent States (CIS) following the dissolution of the Soviet Union in 1991. Georgia withdrew its CIS membership after the Russo-Georgian War in 2008. Presently, Georgia is actively seeking membership in both the North Atlantic Treaty Organization (NATO) and the European Union (EU). These aspirations, alongside efforts to maintain stable relations with Russia, are expected to feature prominently in the upcoming parliamentary elections scheduled for October 26th. Following these elections, presidential contests will take place. Kazakhstan held early presidential elections in November 2022, and Uzbekistan followed suit in July 2023. Last year, Uzbekistan transitioned its parliamentary electoral system from a majoritarian model to a mixed-member one. The elections for this newly adopted system are anticipated to occur, most likely, in December, although an official date has yet to be confirmed.

The three countries we visited have experienced significant economic benefits resulting from the implications of the Russia-Ukraine war since February 2022, contrary to initial expectations. These economies have seen robust growth driven by various factors, including an influx of migrants, relocation of businesses from Russia, increased exports, and cash inflows from Russia. The labour market in Russia is currently experiencing high demand, leading to acute labour shortages, with migrant workers from Uzbekistan increasing by a third. However, the positive impact of these developments has begun to show signs of fading and is expected to moderate in this year.

Despite the economic ties with Russia that these countries have historically maintained, the effects of international sanctions and efforts to diversify economic partners are gradually reshaping trade patterns. These nations are exploring new opportunities for collaboration with countries like China, Turkiye, and Gulf countries. Additionally, countries in the Caucasus and Central Asia are drawing closer together as they endeavour to expand transport and trade corridors. The significance of the Trans-Caspian International Transport Route (TITR, Middle Corridor), which connects Asia and Europe, is expected to grow in importance as trade volumes increase between these regions.

All three economies accelerated in 2023 and are projected to remain on a strong growth trajectory in the next few years. Advancing structural reforms is key in Uzbekistan and Kazakhstan, but implementation seems politically difficult. Privatization progress is slow, with states dominating these economies. Addressing electricity deficits and energy import dependency requires investments to replace Soviet-era infrastructure. Disinflation has been occurring at varying paces, allowing the central banks of Georgia and Kazakhstan to initiate easing cycles. Inflation in Kazakhstan and Uzbekistan is expected to remain elevated this year. Both countries plan to proceed with tariff adjustments, and fiscal policies are pro-cyclical. Moderate public debt levels are maintained across all three countries, with Uzbekistan and Kazakhstan possessing sizable international reserves and national funds.

Kazakhstan

The size of Kazakhstan's economy exceeds USD 250 billion and is supported by robust economic metrics, buoyed by revenue from oil. Despite its extensive land area, Kazakhstan sustains a population of merely 20 million, yet possesses abundant natural resources including oil, gas, coal, and uranium. However, the nation grapples with outdated Soviet-era infrastructure, necessitating substantial investments. As the economy relies heavily on oil, it remains susceptible to fluctuations in global commodity prices. The Caspian Pipeline Consortium (CPC) pipeline serves as a vital export route for oil, albeit vulnerable to disruptions. Moreover, Kazakhstan faces risks associated with climate change and the transition towards green energy. Notably, Kazakhstan adopted a climate strategy aimed at achieving carbon neutrality by 2060, as of last year.

Streamlining Political Processes for Future Economic Reforms
In early February, Kazakhstan underwent another government reshuffle, resulting in the appointment of a few new ministers, including a new prime minister and finance minister. President Kassym-Jomart Tokayev has set ambitious goals, aiming to double the country's economy to USD 450 billion by the end of his presidential term in late 2029. However, achieving this target within such a short timeframe may pose significant challenges and appears rather optimistic. This renewed commitment signals a concerted effort to overcome reform inertia, addressing Kazakhstan's historical challenges with slow progress in reform implementation. Political risks have subsided since the events of January 2022 as President Tokayev has consolidated his authority. The events of January 2022 were more driven by shifts in elite power dynamics than widespread social unrest.

Fear of Secondary Sanctions
Following Russia's latest incursion into Ukraine in February 2022, a significant number of Russians sought refuge in Kazakhstan, contributing to an influx of skilled labor. Additionally, Russian companies moving to Kazakhstan facilitated skill transfer. Kazakhstan's unemployment rate currently stands at a record low of 4.7%. While Kazakhstan is part of the Eurasian Economic Union with Russia, trade between the two nations is declining, and Kazakhstan's currency, the tenge, is currently less correlated with the Russian ruble. Despite increased exports to Russia, Kazakhstan's imports have decreased. China has surpassed Russia as Kazakhstan's largest trading partner. Kazakhstan continues to attract substantial foreign direct investment (FDI), aiming to receive at least USD 25 billion annually. Kazakhstan is the largest recipient of Russian FDI in Central Asia, which is mostly concentrated in mining, extraction, and chemicals. Additionally, the construction of logistical centers has gained momentum. However, there are concerns that evading Western sanctions against Russia could harm Kazakhstan, prompting the banking regulator to adopt a strict stance.

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	3.1%	4.6%	3.3%	4.1%	-2.6%	4.1%
Inflation (% annual percent change)	7.7%	9.8%	20.3%	8.4%	7.5%	7.3%
Overall Fiscal Balance (% of GDP)	-1.1%	-0.9%	0.1%	-5.0%	-7.0%	0.5%
Government Debt (% of GDP)	23.6%	23.4%	23.5%	25.1%	26.4%	16.8%
Current Account (% of GDP)	-0.7%	-1.5%	3.5%	-1.3%	-6.4%	-0.9%

Aktia, IMF and Macrobond

Kazakhstan

Still a Largely State-Owned Economy
Kazakhstan's economy remains predominantly state-owned and controlled, with state-owned enterprises comprising nearly 60% of economic activity. While there are sizable private companies and microenterprises, the presence of middle-sized enterprises is notably lacking. Government subsidies to support public goods distort market dynamics, posing challenges to reform efforts. Many sectors benefit from highly subsidized loans from the government, skewing lending practices in the banking sector, which primarily serves large corporates or retail customers. Privatization of state-owned entities has been slow, hindered by vested interests and a lack of transparency. Until recently, privatization efforts primarily targeted smaller state-owned enterprises, with the partial privatization of Air Astana through an initial public offering (IPO) in February marking a notable shift. While the government aims to reduce its role in the economy through privatization, strategic assets will remain under the majority ownership of the National Welfare Fund Samruk-Kazyna.

Challenges for Economic Growth
The new government has set an ambitious GDP growth target of 6% for 2024, contrasting with more moderate projections from the IMF and World Bank, forecasting growth of 3.4% and 4.3% respectively. Economic expansion is anticipated to accelerate in 2025 with the completion of the delayed Tengiz oil-field expansion. Last year's real GDP growth of 5.1% was driven by increased oil production, reaching 90 million tons in 2023, and growth in the non-oil sector, particularly in construction and trade, buoyed by fiscal stimulus. The economy also witnessed a surge in retail loans, exceeding 25% in 2023. However, sluggish global demand and constraints from the OPEC+ alliance are expected to maintain oil output similar to last year's levels, although production is slated to rise to 100 million tons annually in the next couple of years. Kazakhstan is actively seeking to reduce its reliance on Russian oil logistics and diversify export routes, but significant progress is expected to take at least a decade. Infrastructure deficiencies, including an electricity deficit, pose significant bottlenecks to economic growth. Kazakhstan will hold a referendum on the construction of a new nuclear power plant this year, reflecting ongoing efforts to address energy challenges and drive economic development.

Photo: Successful partial privatization of Air Astana was completed in February 2024. Image of an Air Astana plane at Almaty airport.

Kazakhstan

Inflation Moderating at a Slower Pace
Kazakhstan's inflation rate saw a notable decrease, standing at 9.8% in 2023 compared to 20.3% in 2022, largely attributed to the high base effect. This decline in inflation led the NBK to initiate a series of policy rate cuts, totaling 100 basis points in 2023, with additional reductions of 50 basis points each in January and February of the current year, bringing the base rate to 14.75%. However, the NBK's inflation forecast for this year remains elevated at 7.5-9.5%, exceeding its 5% target. Kazakhstan maintains price regulations, and there are expectations that the government may permit further increases. Following the dismissal of the central bank governor in September, the appointment of Timur Suleimov from the president's cabinet suggests a potential shift towards greater coordination between the government and the NBK. President Tokayev's statement to increase lending to the real economy, coupled with upcoming changes in taxation policies on NBK bills, reflects ongoing efforts to align monetary policy with broader economic objectives.

Towards Fiscal Consolidation
In 2023, Kazakhstan was spending money to stimulate the economy, resulting in an estimated budget deficit of 2.7% of GDP. The government increasingly made transfers from the National Fund of the Republic of Kazakhstan (the Oil Fund) to the national budget to cover the shortfall in tax collection. Last year, the transfers totaled a record of KZT 5.3 trillion, including the amount received from the sale of KazMunayGas shares. The government aims to gradually decrease the budget deficit to 2% by 2030, with this year's target set at 2.6%. The tax reform aimed at improving tax administration will diminish the need for transfers from the Oil Fund. This year, the expected transfers from the Oil Fund total KZT 3.6 trillion. There is a plan to increase the Oil Fund's assets from USD 66.7 billion in 2023 to USD 100 billion in 2030. However, considering the country's infrastructure crisis, one would expect government spending to increase and the budget deficit to widen. Nonetheless, Kazakhstan maintains a low level of government debt, less than 25% of GDP, and possesses international reserves totaling USD 36 billion (about 15% of GDP) in addition to USD 60 billion (about 24% of GDP) held in the Oil Fund.

Shifting trade patterns have led Kazakhstan to explore new opportunities by diversifying trading partners. With a longstanding history of trade and a common market with Russia, dependencies persist, still connecting the exchange rates of the Russian rouble and the Kazakhstani tenge. Last year's current account deficit of about 3.6% stemmed from lower oil prices and heightened demand for imports. Similar trends are expected to persist this year, maintaining the current account deficit at approximately the same level. The tenge remained relatively stable against the US dollar last year, with a slight strengthening of about 2%. This year, the tenge is anticipated to experience a modest weakening against the US dollar, driven by inflation differentials, especially with expectations of government budget consolidation.

Our View: Despite the sluggish pace of reforms, Kazakhstan boasts robust economic indicators, supported by ample financial reserves. Favourable real interest rates and a relatively stable tenge have yielded satisfactory returns for our Frontier Local Currency Fund. We are comfortable with the risk at the moment considering Kazakhstan's multivector foreign policy. However, we acknowledge that the primary risks stem from political uncertainties and succession planning, which are expected to commence before 2029. In our Local Currency strategy, Kazakhstan has been one of our core frontier holdings, and our current weight is around 3 percent. We have exposure to Kazakhstan in our Hard Currency strategy, but we have been selling the name due tight spreads specially in the belly of the curve.

Uzbekistan

During our meetings in Tashkent, there was a palpable sense of positivity and enthusiasm. The Uzbek people display remarkable entrepreneurial spirit and a strong work ethic, suggesting that the impetus for reforms originates from grassroots efforts within society. Uzbekistan, with its USD 90 billion economy, boasts a significant competitive advantage with a population of over 36.5 million and an annual population growth rate of 2%, resulting in nearly one million new citizens each year. While the competence level of the workforce is steadily increasing, there remains a critical need for education and job opportunities to support this growing population.

There is a prevalent sentiment that Uzbekistan aspires to emulate the success of countries like Georgia, yet its larger size necessitates a more cautious approach to reforms. Since President Shavkat Mirziyoyev assumed office in late 2016, Uzbekistan has undergone significant reforms, particularly before the onset of the Covid pandemic. However, the pace of reform has slowed, with challenging tasks such as energy tariff reform remaining unfinished. The privatization process faces hurdles, chiefly due to the substantial improvements required in state-owned enterprises and entrenched interests. Moreover, the private sector, comprised mainly of small companies, encounters difficulties accessing finance amidst the dominance of the state in the economy.

President Mirziyoyev could stay in power until 2037

In 2023, Uzbekistan underwent significant political and constitutional changes. In April, a constitutional referendum took place, followed by early presidential elections in July. The new Constitution extended the presidential term from five to seven years and reset President Mirziyoyev's term limits, allowing him to potentially serve two additional seven-year terms. September saw the adoption of Uzbekistan's New Development Strategy until 2030, with aspirations to achieve upper-middle-income status. However, 2023 posed fiscal challenges for the government, with the budget deficit widening to 5.5% of GDP. Prior to the elections, salary increases were implemented, energy tariff reform was delayed, and taxes were reduced, exacerbating budgetary pressures. A government reshuffling further impeded reform progress initially, but stability has since been restored, as new appointees settle into their roles. To alleviate financial strain, Uzbekistan secured substantial budget support from international donors, including an USD 800 million contribution from the World Bank in December, with additional support expected this year. Efforts towards budget consolidation are underway, with a targeted deficit reduction to 4.0% this year and further consolidation planned for the upcoming year.

Rapidly Economic Growth and Infrastructure Challenges

The Uzbek economy is poised for rapid expansion, with real GDP projected to grow between 5.5% to 6% in 2024, following a solid 6% expansion in 2023, as per national statistics. This growth trajectory aligns with the ambitious goals set forth in the 2030 strategy, aiming to elevate GDP to USD 160 billion. Uzbekistan boasts a relatively diversified economy, with growth primarily fueled by the agriculture and manufacturing sectors. However, the nation grapples with significant infrastructure deficiencies, a legacy of Soviet-era infrastructure now showing signs of decay. Energy shortages have transformed Uzbekistan from a net energy exporter to an importer, exacerbated by increased energy consumption and severe winters. Efforts to address this shortfall include importing natural gas from Russia via Kazakhstan and, potentially, from Turkmenistan. Moreover, Uzbekistan is making substantial investments in renewable energy sources, although transmission remains a critical bottleneck requiring further investment.

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	5.5%	5.5%	5.7%	7.4%	2.0%	6.5%
Inflation (% annual percent change)	10.7%	9.9%	12.3%	10.0%	11.2%	12.3%
Overall Fiscal Balance (% of GDP)	-3.9%	-4.6%	-4.2%	-4.6%	-3.3%	2.0%
Government Debt (% of GDP)	34.8%	35.1%	34.9%	36.6%	37.4%	12.3%
Current Account (% of GDP)	-4.6%	-4.3%	-0.8%	-7.0%	-5.0%	0.2%

Aktia, IMF and Macrobond

Uzbekistan

Sticky Inflation Constraining Rate Cuts

In 2023, Uzbekistan grappled with sticky inflation, with the central bank reporting a rate of 8.8%. The initial phase of a challenging energy tariff reform, targeting commercial entities, was implemented last August, with an estimated inflationary impact of 0.8%. However, the full effects of this reform are expected to materialize over the next two to three quarters. The second phase, focusing on households, is slated for May this year, suggesting that inflation may remain elevated between 8-9% due to ongoing tax and tariff reforms. Consequently, the current policy rate of 14% is unlikely to see significant reductions this year, as a decline in inflation must be observed first. While Uzbekistan's capital accounts are not fully open, any rate cuts by global central banks may indirectly influence policy, particularly as the nation closely follows its key trading partners, notably China and Russia. Although there is a decreasing trend in dollarization within the economy, it still remains high, with deposits comprising 30% and loans 45%. The scarcity of long-term capital has led to local currency deposit rates surpassing monetary policy rates. Despite a low deposit base in the banking sector, there exists substantial demand for loans, particularly evident in the booming retail lending sector, where local currency term deposit rates have surged to as high as 24%.

Current Account Deficit Widened Again

The current account of Uzbekistan experienced a deterioration in 2023, driven by an acceleration in imports and declining cash inflows from Russia. Reduced gas exports to China and the onset of gas imports due to harsh winters further exacerbated the situation. Despite potential gas resources, insufficient planning for exploration has left Uzbekistan grappling with an energy deficit. While this shortfall has yet to significantly impact the balance of payments due to relatively small and seasonal import requirements, the nation's high investment needs are expected to sustain a sizable trade deficit. Following Russia's invasion of Ukraine, Uzbekistan witnessed a record year of remittances in 2022, with cross-border inflows reaching USD 17 billion, primarily from Russia. However, remittance projections for 2024 are markedly

Photo: Central Bank of Uzbekistan in the capital city, Tashkent

Uzbekistan

lower, with an estimated 35% decrease to USD 11.2 billion, underscoring the importance of remittances for Uzbekistan, particularly given its reliance on migrant laborers. Foreign direct investments are anticipated to remain a solid source of financing for the current account deficit. Notably, China has overtaken Russia as Uzbekistan's largest trading partner, with the top three trading partners being China (21.9%), Russia (15.9%), and Kazakhstan (7.0%). Currency fluctuations among these major trading partners, evidenced by the sharp depreciation of the Russian ruble last summer, have significant implications on the Uzbekistani som, as demonstrated by a significant 4% depreciation against the US dollar in a single day in August 2023, totaling a 10% depreciation for the year. Such currency volatility may necessitate constraints on currency floating to mitigate undesirable social consequences, particularly impacting remittances from migrant workers in Russia.

Government's Modest Debt Burden and Sizable Buffers
Uzbekistan maintains a commendably low government debt burden, approximately 35% of GDP, largely supported by concessional financing from international financial institutions (IFIs). This year's budget deficit can be readily covered by IFIs, although market financing remains a potential avenue contingent upon favorable conditions. Notably, a global Uzbekistan som-denominated bond is set to mature in July, alongside plans to enhance the domestic local currency market infrastructure to facilitate higher issuance and non-resident participation. Privatization proceeds also contribute to financing the budget deficit. While the government's debt ceiling is capped at 60% of GDP, a legal obligation mandates debt reduction once the threshold of 50% of GDP is breached. Uzbekistan boasts sizable foreign exchange reserves totaling USD 34.5 billion, comprising gold and foreign currency at the end of 2023, despite experiencing a significant USD 1.2 billion decline in international reserves during the year. Notably, gold production is primarily overseen by the state-owned Navoi Mining and Metallurgical Combine (Navoi), which exclusively sells its gold to the Central Bank of Uzbekistan (CBU) at global prices. With Navoi's estimated mine life exceeding 40 years, Uzbekistan's fiscal buffers are partly determined by Navoi's production capacity. Beyond gold, Uzbekistan also possesses significant copper reserves, with plans underway to triple copper production capabilities over the next five years.

State-owned Companies Dominate Economy
Navoi stands as the largest enterprise in Uzbekistan, boasting an employee base of over 45,000 individuals and wielding significant influence over the nation's economy. Despite efforts to diversify, Uzbekistan's economic landscape remains largely dominated by large state-owned enterprises and financial institutions. The privatization initiative has commenced, albeit slowly, with the sale of a select few companies. Banking sector reform took a significant step forward last year with the sale of a controlling stake in Ipoteka Bank to Hungary's OTP Bank. The government's medium-term plan aims to privatize all state-owned banks by the end of 2025, thereby reducing their policy role. Notably, two major banks, Asabank and SQB Uzbek Industrial and Construction Bank, are slated for privatization. The banking sector in Uzbekistan holds substantial growth potential, particularly in retail lending, offering a promising avenue for development in a country where such services have been largely inaccessible to the unbanked population.

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Uzbekistan

Uzbekistan's Climate Change Challenges
Uzbekistan will likely face pressing environmental challenges that demand attention to foster a sustainable economy. As an arid country, it grapples with water scarcity, posing significant risks to key sectors such as agriculture, the burgeoning textile industry, and even gold production. The capital city, Tashkent, contends with alarmingly poor air quality, highlighting the urgent need for measures to combat pollution. Furthermore, the current scarcity of energy underscores the importance of promoting more efficient resource utilization to meet growing demands sustainably.

Our View: Uzbekistan represents one of the most promising investment opportunities within our portfolio, leading to a substantial allocation in our Frontier Local Currency Fund. The appeal is driven by Uzbekistan's local currency yields, which offer attractive real rates, among the highest globally. Additionally, we have initiated a small position in our Local Currency Bond Fund to leverage this potential. We remain optimistic, yet mindful of risks, especially those related to the political landscape, given the absence of a significant opposition within the presidency and regime. We remain OW in our Hard Currency strategy but will monitor carefully developments in geopolitical landscape. Going forward we are closer to reducing than adding to our current positioning.

Photo: View on Islam Karimov Street in Tashkent. Islam Karimov was the first President of Uzbekistan, serving from the country for 25 years until his death in 2016.

Georgia

Georgia, the most developed among the three countries we visited, is currently in the process of applying for EU membership, following its acceptance as a candidate in December 2023. Despite having the smallest economy, with a population of only 3.7 million people (GDP approx. USD 30 billion), Georgia still has solid macroeconomic indicators. Following Russia's invasion of Ukraine, Georgia has seen an influx of migrants, primarily Russians, resulting in increased financial inflows and a rise in entrepreneurial activity, particularly within the IT sector. Consequently, the Georgian lari has appreciated by approx. 20% since the onset of the conflict in Ukraine, leading to a decrease in export demand. Additionally, the purchasing of real estate by migrants has driven up property prices.

Still Solid Macroeconomic Indicators

Georgia experienced two consecutive years of double-digit economic growth before recording a 7.5% growth rate last year, attributed to the fading net exports effect. The influx of migrants provided assistance in 2022, but recent data indicates a decline in financial inflows. Nevertheless, real GDP growth is projected to hover around 5% in the coming years, primarily driven by robust domestic activity.

The tourism sector in Georgia achieved record-high revenues of USD 4.1 billion in 2023, surpassing the pre-pandemic levels of 2019 (USD 0.9 billion). However, tourist arrivals still lag behind, indicating potential for further expansion. The current account balance is expected to deteriorate, with a projected deficit of -6.9% in 2024 compared to last year's -4.5%. Despite building up international reserves during periods of financial inflows, reserves dropped to USD 4.8 billion in December, equivalent to less than four months' worth of import cover.

Inflation in Georgia has been on a declining trend, prompting the National Bank of Georgia to initiate rate cuts in May, totaling 200 basis points from 11%. Another rate cut of 50 basis points was implemented in January, reducing the rate to 9%. Annual headline inflation stood at 0.0% and core inflation at 1.2% in January, with expectations for inflation to accelerate to the central bank's target level of 3.0% this year. Political considerations, particularly in an election year, may influence the central bank's decision-making regarding interest rates. Additionally, pressure on foreign exchange rate during an election year could prompt intervention from the central bank, although its official strategy is to only mitigate volatility caused by temporary factors in the currency market.

Despite efforts by authorities to reduce dollarization, the Georgian economy remains largely dollarized, albeit on a declining trend. USD deposits accounted for 50.7% and loans for 45.2% in December 2023. This exposes the economy to global inflationary pressures. Furthermore, the currency is considered overvalued in Real Effective Exchange Rate (REER) terms, with expectations for depreciation, both in nominal and real terms.)

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	4.8%	6.2%	10.1%	10.5%	-6.8%	4.7%
Inflation (% annual percent change)	3.0%	0.8%	9.8%	13.9%	2.4%	3.0%
Overall Fiscal Balance (% of GDP)	-2.4%	-3.0%	-2.6%	-6.0%	-9.3%	-1.2%
Government Debt (% of GDP)	39.3%	39.6%	39.8%	49.7%	60.2%	34.8%
Current Account (% of GDP)	-5.8%	-6.1%	-4.0%	-10.4%	-12.5%	-9.4%

Aktia, IMF and Macrobond

Georgia

Fiscal Outlook for the Election Year

Last year, Georgia demonstrated a stronger budget deficit outcome than initially anticipated, standing at -2.5% of GDP. This year, Georgia is aiming for a fiscal deficit of -2.9%, aligning with the 40% debt-to-GDP ratio, and reflecting a moderate level of government debt (2023: -39.9%). The budget prioritizes capital expenditures, including infrastructure enhancements like road improvements, major projects such as ports, and EU-supported initiatives like electricity transmission cables. With over 70% of the public debt denominated in foreign currency, there exists a risk of sharp currency depreciation, underscoring the importance of de-dollarization and the development of the domestic bond market as key objectives in public debt management.

Georgia's Public Support for European Union Membership

Last year, the European Commission officially recommended granting candidate status to Georgia, a confirmation finalized before year-end. Georgia has significant milestones ahead, which the upcoming European Parliament elections in June will not speed up. Majority of Georgians (approx. 85%) express favorability toward EU membership. The government is delicately managing relations between the EU and Russia. In its recent statement, the National Bank of Georgia referenced the country’s EU candidate status, suggesting that the neutral interest rate could slightly decrease upon EU accession.

Institutional Independence of Central Bank Causing Concern

Georgia has made significant strides in its financial sector, fostering a modern central bank with prudent policies. However, recent policy shifts raise concerns about the institution's independence. In June, amendments to the central bank law altered its governance structure. Additionally, the central bank changed the enforcement of Western sanctions on Georgian

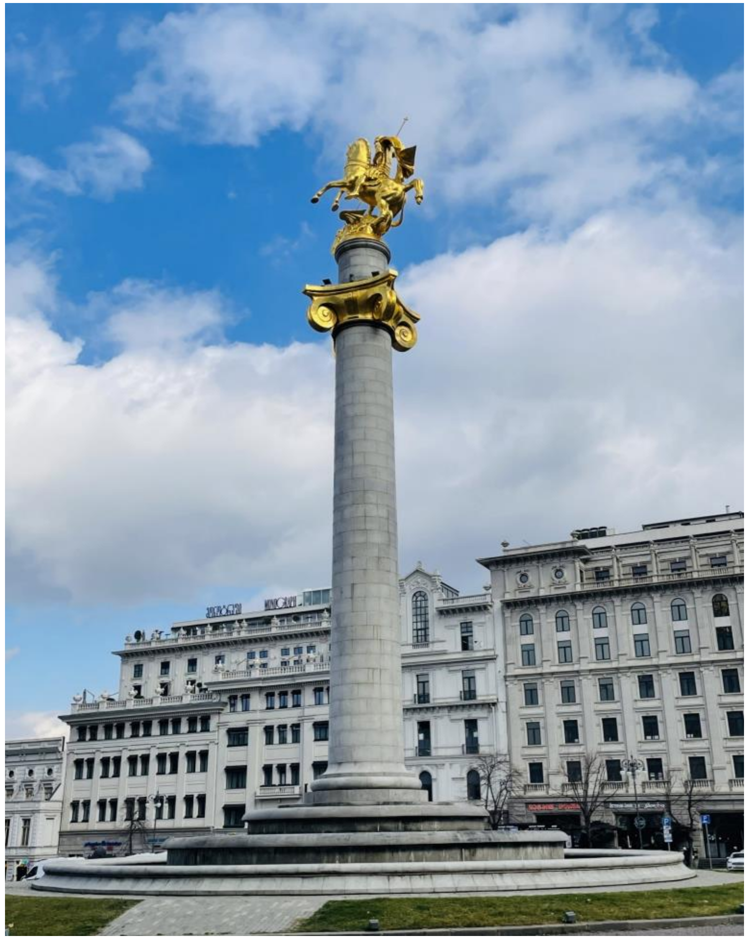

Photo: St. George Statue in Tbilisi's Freedom Square, symbolizing freedom and independence of the Georgian nation

Georgia

citizens, creating compliance challenges for commercial banks. These developments mark a slight reversal of reforms, leading to the suspension of Georgia's Stand-By Agreement with the IMF in September. Despite this setback, the IMF program remains essential for verifying Georgia's policies. To continue the program, the IMF has urged Georgia to enhance the corporate governance of its central bank through legislative changes. However, passing such laws through parliament before the October elections appears unlikely. While the ruling party, Georgian Dream, is expected to prevail, securing a majority could be challenging. While the opposition currently lacks strong momentum, unexpected outcomes cannot be ruled out.

Our View: We hold a small position in Georgia in our Frontier Local Currency Fund. Our Hard Currency Fund does not currently hold any exposure to Georgia . The scale of Georgia's unexpected benefit from the conflict in Ukraine took us a bit by surprise. While the issues with the IMF are concerning, they may not necessarily have a direct impact on the economy, given that the IMF program is only precautionary. However, they could potentially harm investor confidence, as an independent and robust central bank is crucial. Additionally, the local currency is currently overvalued. Therefore, we see no immediate need to increase our allocation to Georgia in our local currency fund, especially considering the upcoming elections, which always carry the possibility of unexpected outcomes. From our perspective on Hard Currency strategies, Georgia has only one outstanding USD-denominated bond maturing in 2026. Considering relative pricing, we currently favor issuers such as Montenegro and Northern Macedonia, as they have less direct exposure to Russian trade and the risk of escalation in the Russia-Ukraine conflict. Additionally, these issuers offer more attractive pricing compared to Georgia.

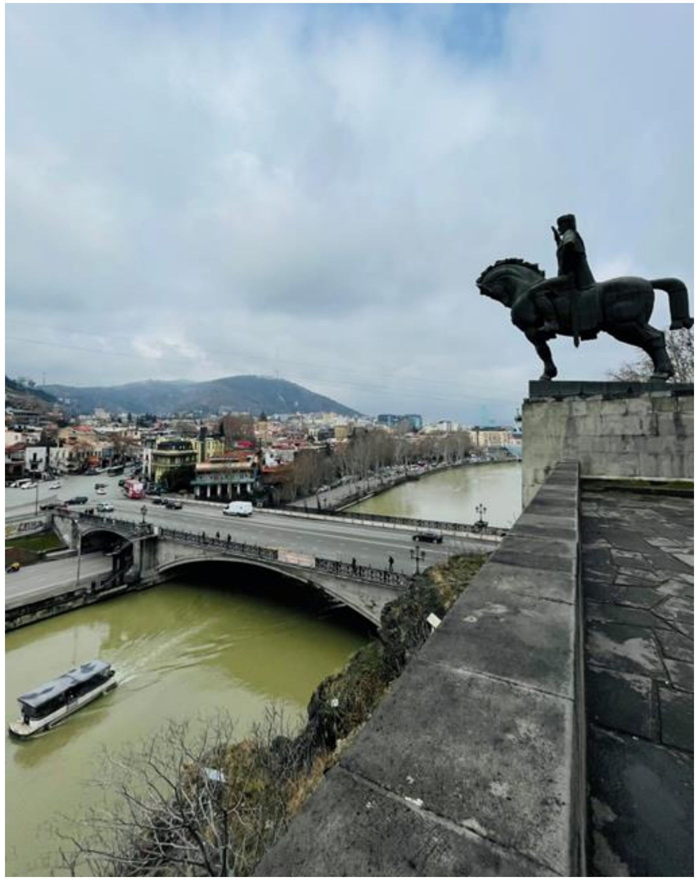

Photo: Statue of the founder of the city, King Vakhtang Gorgasali, on the banks of the Kura river in Tbilisi

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