



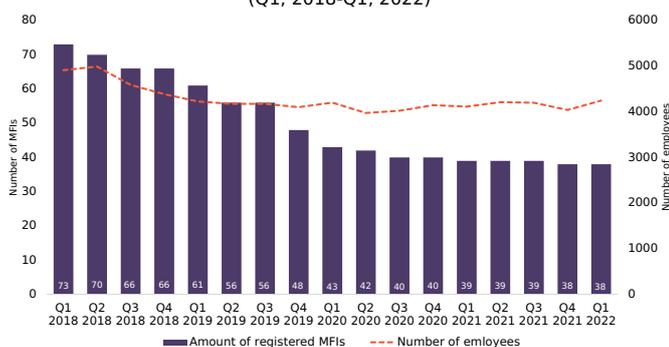
Financial institutions play a pivotal role in the development of the Georgian economy. Indeed, while the financial system remains dominated by commercial banks, microfinance institutions (MFIs) are the biggest non-bank lending institutions based on portfolio volume.

The PMC RC periodically publishes sector snapshots on state of MFI sector in Georgia and in this bulletin the state of sector during the period of 2018-Q1 2022 will be overviewed.

In the period of 2018-Q1 2022, MFIs faced a number of challenges mainly associated with the ongoing COVID-19 pandemic and economic recession. However, as a result of the regulations introduced by the National Bank of Georgia from 2017¹ onwards, MFIs faced the pandemic with sufficient levels of liquidity and capital, improved risk management, and had better corporate rules in place. To help MFIs overcome the crisis, in 2020 the NBG supported MFIs with a USD 200 mln swap tool in order to improve their access to GEL resources. In addition, with the SME Liquidity Support Facility² developed by the NBG, MFIs were able to attract additional loans from commercial banks. Another important factor in the period of 2018-Q1 2022 was the gradual increase of the refinancing rate³ by the NBG, making resources from commercial banks more expensive for MFIs. As a result, it has become harder for MFIs to issue substantial business and agro loans⁴.

The microfinance sector expects serious changes in the coming years. The NBG, supported by the IMF, has proposed a strategy of introducing a middle step between MFIs and commercial banks, giving microbanks the ability to take deposits and have deposit insurance as well as access to GEL from the NBG, which would in turn significantly alleviate the sector's dependence on foreign currency and thus its exposure to GEL fluctuations. The draft version of the relevant law is expected to be introduced to Parliament in 2022.

Amount of registered MFIs and number of employees (Q1, 2018-Q1, 2022)



Source: National Bank of Georgia

From Q1 2020 to Q1 2022, the number of MFIs decreased slightly, dropping from 43 to 38. Interestingly, the number of employees in microfinance organizations during the same period had a slight upward trend, going from 4202 to 4246.

It is worth noting here that the decrease in the number of MFIs seemingly steadied after significant trend of decrease due to imposed regulations in 2018-2019 and a number of institutions remained stable despite the crisis.

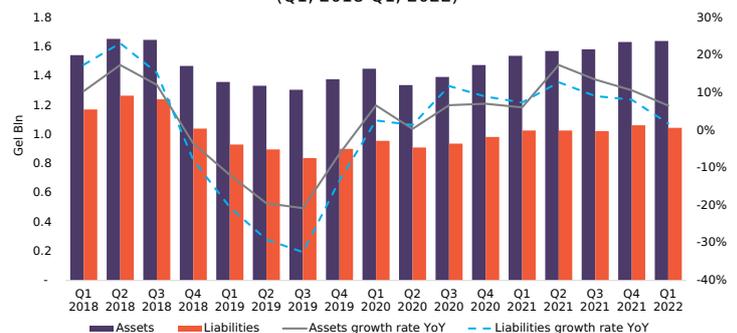
Currently, according to the NBG, only six microfinance institutions are in the process of liquidation (these MFIs are not included in the total number of 38).

In the period of Q1 2020 to Q1 2022, the consolidated assets and liabilities of the MFI showed noteworthy tendencies.

In Q1 2022, assets owned by MFIs amounted to GEL 1.64 bln, which represented a 7% increase, compared to Q1 2021. Meanwhile, the liabilities of MFIs amounted to GEL 1.06 bln, representing an 2% increase, compared to the corresponding period of 2020.

Assets have seen an upward trend since Q2 2020, mainly due to an increased demand for pawn shop loans which could be seen as a direct consequence of the COVID-19 pandemic. Increased demand for pawn shop loans has seemingly outweighed the decrease in demand for business loans during the pandemic.

Assets, liabilities and growth rates YoY (Q1, 2018-Q1, 2022)



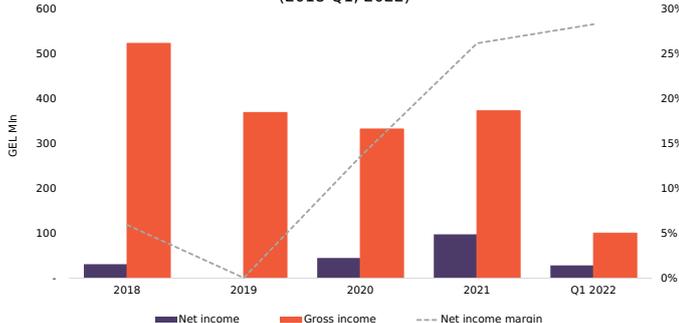
Source: National Bank of Georgia

It is also important to explore the fluctuations with respect to gross income⁵ (revenue), net income⁶, and net income margin⁷ of MFIs in 2018-Q1 2022.

In 2021, compared to 2020, gross income increased by 12% and amounted to GEL 373.4 mln. Moreover, net income also increased compared to 2020 and reached GEL 97.8 mln. In this same period, net income margin increased by 13 percentage points and reached 26%.

The gradual increase in net income and its margin of MFIs since 2019 could be attributed to the liquidation of several MFIs with a significant share of non-performing loans in portfolio, as well as overall loan portfolio growth and economic growth in 2021.

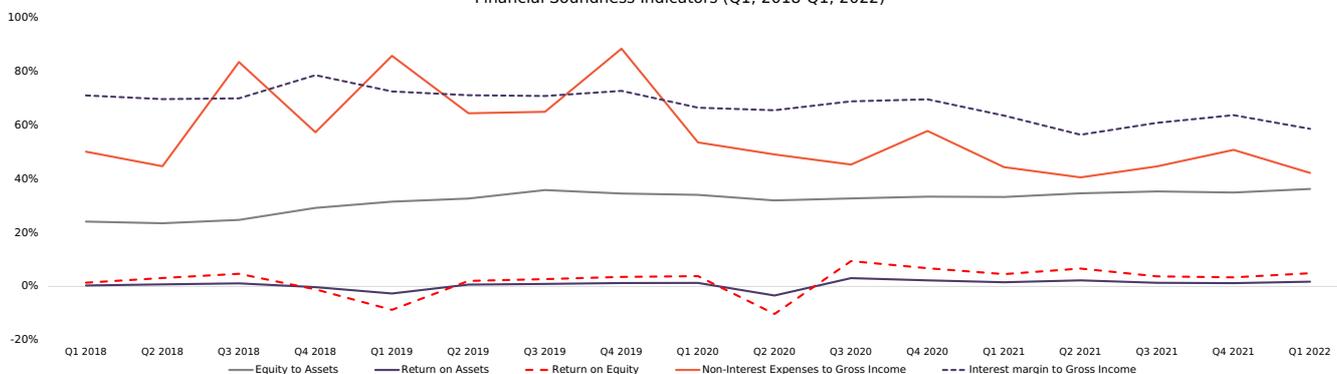
Gross income, net income and net income margin of MFIs (2018-Q1, 2022)



Source: National Bank of Georgia

1 More information on regulations associated with MFIs can be viewed in SS1 - Microfinance sector in Georgia. Source: https://www.pmcgresearch.org/publications_file/e7a7609a809c0eee5.pdf
 2 The SME Liquidity Support Tool enables MFIs to attract funding from commercial banks with the support of the National Bank within the limits of their SME loan portfolios meeting the criteria established by the National Bank.
 3 In March 2022, the National Bank of Georgia increased refinancing rate to 11%.
 4 Source: <https://bm.ge/ka/article/archil-bakuradze-refinansirebis-zrdis-shedegad-finansuri-xarji-gagvezarda#82924/>
 5 Gross income (revenue) is equal to the sum of total interest income and total non-interest income of MFIs combined.
 6 Net income is equal to gross income minus all costs.
 7 Net income margin shows how much net income is generated as a percentage of gross income.

Financial Soundness Indicators (Q1, 2018-Q1, 2022)



Source: National Bank of Georgia; PMC RC's calculations

In Q1 2018 - Q1 2022, financial ratios based on the consolidated income statements of MFIs in Georgia underwent notable fluctuations.

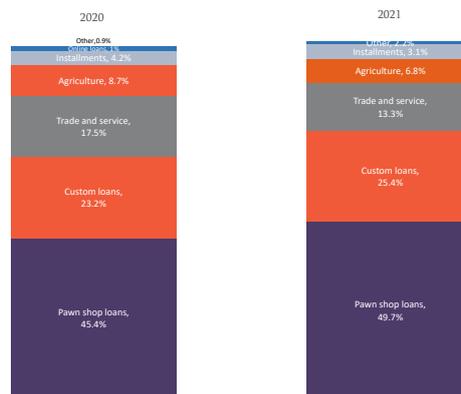
Return on Assets (ROA), which shows the profitability of MFIs relative to their assets, reached its lowest point in the analyzed period (Q1 2018 - Q1 2022) during the first outbreak of COVID-19 pandemic in Q2 2020, when it amounted to -3.4%. Its highest point was recorded in Q3 2020 (3.1%). In Q1 2022, the ratio amounted to 1.7%, which marked a 0.2 percentage points increase compared to Q1 2021. On a yearly basis, ROA amounted to 0%, 3.1% and 6.1% in 2019, 2020 and 2021, respectively.

Return on Equity (ROE), which shows the profitability of MFIs relative to their equity, reached its lowest point in the analyzed period in Q2 2020 (-10.3%). Meanwhile, its highest point was recorded in Q3 2020 (9.4%). ROE reached 4.9% in Q1 2022, which represented a 0.3 percentage points decrease compared to Q1 2021. Looking at the figures per year, ROE amounted to 0%, 9.2%, and 17.3% in 2019, 2020, and 2021, respectively. It is also worth noting that the results of the economic recovery in Q2 2021 is visible in the spikes for ROE and ROA as well.

The Non-interest expenses to Gross Income ratio, which shows the operating costs incurred to earn GEL 1 of revenue, showed significant fluctuations in the analyzed period. In particular, the ratio dropped by 34.9 percentage points in Q1 2020, compared to Q4 2019, which could be explained by a decrease in non-interest expenses resulting from the pandemic. Its highest point in the analyzed period was 88.5% in Q4 2019, while the lowest was recorded in Q2 2021 (40.6%). In Q1 2022, the ratio amounted to 42.2%, which marked a 2.2 percentage points decrease compared to Q1 2021.

By the end of 2021, the portfolio of loans issued by MFIs (both to individuals and to legal entities) amounted to GEL 1.32 bln, while the number of loans in the portfolio amounted to 0.72 mln, which represented a 16% increase and a 10% increase, respectively, compared to the figure recorded by the end of 2020.

Portfolio of loans issued to individuals by purpose (2020-2021)



Source: National Bank of Georgia; PMC RC's calculations

In 2021, only 3% of loans (by volume of loans) were issued to legal entities. Furthermore, in 2020, the figure was identical and also amounted to 3%.

In 2021, compared to 2020, significant increases in the shares of pawn shop loans and custom loans (by four and two percentage points, respectively) were recorded. Interestingly, trade and service loans and agricultural loans experienced decreases in this period (by four and two percentage points, respectively).

Pertinently, pawn shop loans alone represented 26.6% and 35.3% of the total loan portfolio in 2018 and 2019, respectively.

As mentioned in the introduction, the NBG is working on a draft law to introduce microbanks into the Georgian financial system. The idea is to create a step between MFIs and commercial banks that is regulated more strictly than MFIs with regard to risk management and corporate governance, but not controlled as rigorously as banks. The main advantage that microbanks have against MFIs is their ability to use monetary resources from the NBG including access to GEL, enhanced ability to accept deposits, as well as involvement in the state system for deposit insurance.

Consultations with the microfinance sector have already been conducted and the NBG has discussed the following possible requirements for microbanks⁸: 1. Minimum regulatory capital of GEL 10 mln (which is 10 times higher than the current requirement for MFIs and five times less than the requirement for banks) 2. 70% of the loan portfolio should be attributed to business and agri loans⁹ 3. A ceiling for issuance of loans set at GEL 1 mln.

To conclude, the COVID-19 outbreak and associated economic recession had its impact on MFI sector but it could be argued that the impact had already been offset and followed by growth in overall loan portfolio.

⁸ Source: <https://bm.ge/ka/article/ra-motkovnebi-egnebat-mikrobankebs-193296/>

⁹ Categorization of business and agri loans differs from one represented on the graph *Portfolio of loans issued to individuals by purpose.

| Basic Economic Indicators | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------|----------|----------|----------|----------|-----------|
| Nominal GDP (mln USD) | 16 248.5 | 17 596.6 | 17 470.7 | 15 888.1 | 15 888.1* |
| GDP per Capita (USD) | 4 358.5 | 4 722.0 | 4 696.2 | 4 274.6 | 5 015.3* |
| GDP Real Growth (%) | 4.8% | 4.8% | 5.0% | -6.2% | 10.4% |
| Inflation | 6.0% | 2.6% | 4.9% | 5.2% | 9.6% |
| FDI (mln USD) | 1 978.3 | 1 306.3 | 1 310.8 | 616.9 | 1 152.8* |
| Unemployment Rate (%) | 21.6% | 19.2% | 17.6% | 18.5% | 20.6% |
| External Debt (mln USD) | 5 177 | 5 434 | 5 741 | 7 535 | 7 535 |
| Poverty Rate (relative) | 22.3% | 20.5% | 20.1% | 20.1% | - |

*preliminary data



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