GEORGIA'S BANKING SECTOR TRENDS AND IMPACT ON LOCAL ECONOMY DURING THE PANDEMIC AND POST-PANDEMIC PERIOD

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Abstract

The banking sector is a key driver of economic growth in Georgia. The sector has been resilient during the COVID-19 pandemic, with low levels of non-performing loans and strong capital buffers. However, the pandemic has had a negative impact on the local economy, leading to a decline in economic activity and a slowdown in credit growth. The post-pandemic period is expected to be challenging for the banking sector, as it will need to support the recovery of the local economy. The sector will need to focus on providing credit to businesses and households, as well as on developing new products and services to meet the needs of customers.This paper discusses the current trends in the development of the banking sector in Georgia in 2019-2022, in relation to the issues of economic growth and the problems and challenges that the pandemic and post-pandemic periods have shown us.

Keywords: banking sector, Georgia, pandemic, economic growth, digitalization, competition, customer service, inclusive growth.

Introduction

The development trends of the banking sector and its impact on the local economy include the paradigm of the development of the banking sector (Anguridze et al., 2015) in terms of overall economic development and the impact of the global shock of the Covid pandemic in the pandemic and post-pandemic period, 2019-2022. It should be noted that this is the first complex research of its kind in the direction of the economy and the banking sector in the recent past.

The second thing, which is very interesting, is the connection between the banking system and the economy of Georgia, what is the impact of innovative and digital products on the banking sector, especially in the pandemic and post-pandemic periods, and on the other hand, the impact of the banking system on the economy, as well as the impact of the macroeconomic background (Dilanchiev, Taktakishvili, 2021; Wang et al., 2018) on the development of the banking system in general in crisis and post-crisis periods.

The financial shock caused by the COVID-19 pandemic has put severe pressure on global financial markets and the banking sector. In December 2019, a novel coronavirus (COVID-19) emerged in the city of Wuhan, China, and spread globally (Gautam et al., 2022, Zhou et al., 2021). The World Health Organization (WHO) declared COVID-19 a global pandemic on March 11, 2020, and declared a public health emergency (Gautam et al., 2022). The COVID-19 pandemic suddenly appeared in a world that was not prepared for such an event, which devastated the economies of countries around the world and also seriously and rapidly affected the global economy (Duan et al., 2021, Fernandes, 2020). Its losses exceed the global financial crisis of 2008 (Hanif et al., 2021).

COVID-19 poses a significant threat to public health and economic development (Zhou et al., 2021). This disease has increased uncertainty and risks, drastically reducing global activity (Padhan and Prabheesh, 2021). Notably, studies examining the impact of COVID-19 have rapidly emerged. Researcher Fernandes (Fernandes, 2020) stated that COVID-19 has reduced global demand and supply. Yue, Giselle Korkmaz, and Zhou (Yue et al., 2020) showed a reduction in consumption and investment. Research by Devpura and Narayan (2020) found that COVID-19 cases and deaths exacerbated oil price fluctuations. Gubareva (Gubareva, 2021) and Cholak and Öztekin (Çolak and Öztekin, 2021) analyze credit crunch due to COVID-19. Researchers Akhtaruzzaman, Boubakeri, Luci and Sensoi (Akhtaruzzaman et al., 2021) investigated the role of gold as a hedge during the COVID-19 pandemic crisis, also known as coronomic crisis (Papava, Charaia, 2020). COVID-19 is also negatively affecting the performance of various firms and industries (Fu and Shen, 2020, Gamsakhurdia, Fetelava, 2023; Shen et al., 2020) and the insurance sector (Wang et al., 2020).

The paper discusses the impact of innovative technologies and digitization on the banking sector, digital banking essentially refers to the use of modern technology to deliver banking products. Some believe that digital banking essentially means an online or mobile banking platform, but to truly grow digital, we believe it should go beyond that.

The transition from the existing banking service platform to a digital one implies the use of the latest technologies at all functional levels and on all service delivery platforms, where financial education takes a significant impact (Kvirkvaia et al., 2018; Zivzivadze et al., 2021). Digital banking should similarly be considered not only on the internet or mobile banking platform (Abashidze, Dąbrowski, 2016), but also at the branch, head office, online service delivery platform, ATMs and points of sale. The paper shares a study published in 2022 on these issues - The Impact of Fintech on Financial Institutions: The Case of Georgia (Charaia et al., 2021; Lashkhi et al., 2022).

Research Methodology

The effectiveness of the banking sector's financial condition is determined by economic performance, commercial and financial performance, and others. Otherwise, the successful implementation of financial plans of commercial banks will have a positive impact on its financial situation. In the opposite case, the cost of production increases, the income from sales decreases, and the financial condition and solvency of the firm are threatened.

The research is based on analytical, synthetic, structural, trend, grouping and comparison methods. The objects of the research are the limited liability enterprises: "Engurhesi" and "Gardabni thermal station". The companies operate in the field of energy. The research was conducted based on the financial statements of commercial banks in 2019-2022.

During the dynamic analysis, a comparison of each indicator of the financial statement with the previous period is used. Through it, the management can analyze the multi-year financial situation of the enterprise to find out what causes specific changes. Base indicators can be used for the analysis, in particular, the data of any past period, which may be presented as a percentage. At this time, each subsequent year is compared to the base year and deviations are determined. Dynamic analysis is also called horizontal analysis.

Structural analysis shows the structural composition of financial indicators as a percentage. At this time, each article and/or group of articles of the financial statement is presented as a percentage with respect to the main (base) indicator of the statement. In contrast to the dynamic analysis, at this time the financial statements of a specific period will be analyzed. Because of this, it is static and non-dynamic.

During the comparative analysis, specific indicators are compared at the intra-enterprise and inter-enterprise levels. If the comparison of individual indicators of enterprises and their subsidiaries is considered at the domestic production level. At the inter-enterprise level, the performance of a particular enterprise is compared with that of a competing enterprise or with the industry average of a given industry. Both comparisons are made with the help of trend analysis, reflecting changes in financial indicators over a specified period of time.

Statistical materials from the database of the National Bank of Georgia, commercial banks, the Ministry of Finance, Saxstat, the International Monetary Fund and the World Bank are widely used in the work.

Banking Sector Trends in Georgia

As already mentioned, according to 2021-2022, the market of banking services was represented by 15 commercial banks, where the level of business concentration is quite high. The correlation of system concentration index and interest rates was also used to evaluate the banking system. The specific share of the 3 largest banks in relation to total assets is taken as the international level of concentration. The banking system of Georgia with the level of concentration of assets (77%) passes by such countries as Montenegro (83%), Moldova (70%) and Iceland (100%), however, if we take into account another parameter, the annual interest rate of basic lending, according to all credit products (meaning both retail lending, mortgage and business loans), Georgia has one of the highest interest rates (11.8%). And with this rate, we have the highest rate in Europe and the region of Azerbaijan (17.18%) and Ukraine (14.24%), together with Somkheti (11.62%).

In the post-crisis period, bank assets increased from 60.5 billion GEL to 70.3 billion GEL, or by 56%. From this, the share of the two largest commercial banks (TBC Bank and Bank of Georgia) in the total assets of the system is 44% and 38% respectively, which is 72% in total, the credit portfolio is 77%, and the share of net profit was 71% of the total profit of the system. If we add one more systemic "Liberty Bank" to these two banks (4.7%), their specific share in total assets, i.e. the level of concentration, is already close to 77%.

Assets (thousand Gel)	2022	2021	2019
TBC Bank	24,135,160,161	20,145,371,858	18,032,113,318
Bank of Georgia	26,625,502,407	21,788,183,848	17,139,080,625
Liberty Bank	3,623,271,954	3,111,348,075	2,144,192,712
Total	54,383,934,522	45,044,903,781	37,315,386,655
Total System Assets	70,350,872,000	60,568,539,000	47,183,367,000
Concentration level	77%	74%	79%

It should be noted that since 2015, according to 2022, the specific share of system-forming banks in total assets has increased from 59% to 77%, i.e. by 22 percentage points. Likewise, the rate of credit investments has increased, up to 55% and 82%.

Credit portfolio	2022	2021	2019
TBC Bank	17 834 148 836	16 739 135 187	12,616,108,774
Bank of Georgia	16 316 961 029	15 385 154 749	11,165,922,704
Liberty Bank	2 501 952 397	1 975 000 866	1,240,836,088
Total Credit Portpholio	36 653 062 262	34 099 290 802	25,022,867,566
The volume of total loans	44 224 210 000	42 189 443 000	31,078,641,000
As a percentage of profit	82,88%	80,82%	81%

The net profit rate has increased even more. In 2021, the net profit of the leading 2 banks alone amounted to 85% of the entire system, and in 2022 it reached a record 90%.

Net Profit	2022	2021	2019
TBC Bank	967,251,772	940,330,426	392,114,132
Bank of Georgia	924,342,950	831,973,935	390,435,262
Net profit	1,891,594,722	1,772,304,361	782,549,394
Total net profit	2,090,774,000.00	2,082,611,000	953,635
As a percentage of profit	90.47%	85.10%	82.00%

The increase in the assets of systemic banks is largely due to the significant increase in the assets of the first two largest banks, at the expense of the increase in retained earnings. It should be noted here that the rate of banking concentration in the listed countries varies between 55-68%. Accordingly, we have a banking concentration rate higher than the European average (71.12%), and we also have a lending rate much higher than the European average (10.4%).

These data also show that in conditions of high banking concentration, high interest rates should also be explained due to relatively low competition. Higher than the European average and with 100% banking concentration, the base lending rate in Iceland (100%) is 5.76%, in Montenegro 5.92% with 72% concentration, and 6.12% with 74% concentration in Albania. The relatively high lending rate in Romania is 6.49%, much lower than our banking concentration of 67%. Credit rates higher than the European average are in Belarus - 9.03% and Moldova - 8.18%, and in the South Caucasus countries: Armenia - 11.62% and Azerbaijan - 17.8%, although the level of banking concentration does not exceed 68% (Chart 7).

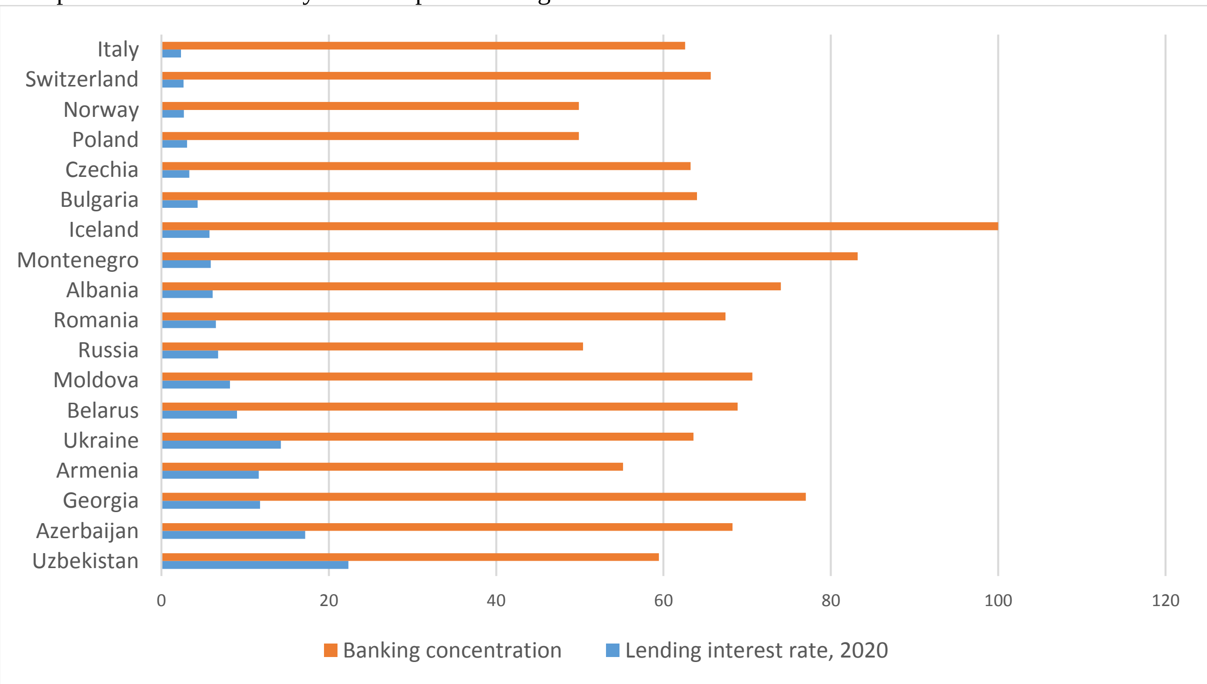

Diagram 1. Banking concentration and lending interest rates, 2020-2021, years %

Source: The World Bank.

The assets of "Bank of Georgia" increased from 9 billion GEL to 26.6 billion GEL from 2015 to 2022, which is equivalent to an increase of 38% from 29% in the system index. The growth of TBC Bank's assets was even higher, increasing from 6.9 billion GEL to 24.3 billion GEL in the same period, which is a systematic increase from 23% to 34%.

At a certain stage of development of the banking services market, high market concentration should not be evaluated negatively. The leading system-forming banks also represent a unique business barometer, both in terms of attracting investors (Lashkhi, Charaia, 2017; Charaia et al., 2020; 2022; Sikharulidze, Charaia, 2018) in the sector, as well as offering the rules of the game to other market participants, introducing innovative banking products, and pricing banking products. However, on the other hand, high market concentration, due to the enterprise-wide effect, gives certain advantages to leading banks compared to competitors and primarily in dealing with customers, which is then expressed in a positive correlation between concentration and profitability.

In fact, such a high concentration naturally bears the hallmarks of an oligopoly, where there is such a market structure when two. A large bank offers a large part of all products to its clientele. In an oligopoly, enterprises compete in different ways. They care more about product differentiation so that consumers know the difference between the products they manufacture. In an oligopoly, firms are price seekers, although there are few in the market

Profitability of the Georgian Banking Sector

Naturally, with the increase in assets, the profits of the banking sector also increase. The past 2 years ended with a record profit of 2 billion GEL, which is not so much business, but retail lending growth, which contains certain risks and which is discussed in the liquidity analysis.

We believe that despite a number of problems, the banking sector of Georgia is one of the most successful sectors of Georgian business, we also see that according to the statistics of the last five years, the net profit of the banking sector is increasing, if according to the same data of 2019, the net profit was 953 million GEL, at the end of 2022, the profit rate has increased to 2,090 million GEL, or 2.1 times, and the average annual profit is 1.3 billion GEL, without looking at 84 million GEL in 2020 or reduction to profit.

The growing profit of the banking sector in the country can be explained especially by the double-digit economic growth of 2021-2022 and the improved banking supervision and service system in accordance with international standards, but on the other hand by higher lending rates than the size and partially high interest spread, the analysis of which will be offered in the relevant part of the study.

Higher interest income from loans to individuals is due to higher interest rates compared to business loans, on the one hand, due to risk factors, and on the other, to the relatively short term of the loans. It is interesting that the interest income of the banking sector grew by an average of 14% per year, including the increase in the crisis year 2020 by 12% compared to 2019.

Its disproportionate connection with the sharply reduced profit of 2020 is explained by the fact that according to the banking reporting methodology, the system suffered a loss of -943 million in March 2020, due to the increased volume of possible losses on loans, which amounted to - 1,165,198 million GEL and was caused by the uncertainty that led to the shutdown of the economy during that period due to the Covid pandemic.

In the vertical segment of interest income, the specific share of interest income received from lending to individuals was stable in the range of 53%, although in 2022 this indicator decreased to 50%, which is explained by the decrease in the rate of lending, although in the case of legal entities, if in 2019-2021 it was 35% of the total interest income, 20 In 2012, it was slightly reduced to 34%.

The fact that the pace of lending to individuals has been increasing in recent years is related to the development and availability of retail products, including installments, services, both in terms of reducing interest rates and extending maturity. I would also like to point out that this trend is also noticeable in EU member states. Trends and modern integrated banking products and technologies are still identical everywhere.

The total credit portfolio of commercial banks increased from 31 billion GEL to 44.2 billion GEL in 2019-2022, which is 42%, and by 11% in the average annual rate. In addition, in the credit portfolio, loans granted to households, including entrepreneurs, have increased by 49%, with an average annual increase of 12%, including individuals by 47%, while loans granted to legal entities have increased by only 35%, with an average annual increase of 9%. While, loans issued to legal entities in 2022 compared to 2021 decreased by 82 million GEL, which is mainly explained by the effect of the exchange rate, the dollarization of loans on loans issued in foreign currency (70%) is much higher than the base rate and, accordingly, it was also reflected in the volume of loans under the conditions of 16% strengthening of the GEL.

This trend is more noticeable if we consider the credit portfolio in a vertical section (Graph 16). It can be seen from the graph that the ratio of loans to households and legal entities in total loans, %, was almost equal in 2019-2022 and was within 51-49 percent, and in the crisis year 2020, it was at all equal. This proportion changed in 2022, when the share of household loans in total loans increased from 51% to 54%, and on the contrary, it decreased from 49% to 46% in 2022, which confirms the effect of the exchange rate.

We believe that this transformation of the system, which is reflected in the equal proportional development of lending to individuals and legal entities, in contrast to the years 2012-2017, when the specific share of lending to individuals increased to 56%, will be reflected in the expansion of new banking services, increased digitization, increased service quality and new products. All this will contribute to the modernization of the country's economy. As we can see, in 2012-2017, the rate of retail lending by commercial banks was increasing, which was taking place against the background of the decrease in business lending activity, and naturally cannot be evaluated positively. Despite such a high growth of the credit portfolio, its structure gives a very interesting picture in terms of business lending and loans to households.

We believe that the decrease in retail lending rates is still related to the new banking regulations, as for the growth of business lending, it can be an echo of high economic growth on the one hand, and state programs supporting business on the other hand.

Georgian banks really need to introduce innovative approaches even more actively in business relations, by introducing new business models of digital banking. Recently, banks are increasingly actively moving to new B2B models, which is only welcome, because the bank should become a partner of the entrepreneur in the form of a financial advisor and consultant. It is significant that, according to research commissioned by the European Commission, the growth rate of small businesses is on average 3 times higher if the organization is led by digital technologies. Due to high competition and lack of capital, a small or medium-sized company that wants to raise awareness, stimulate sales or generally position the company is faced with a choice - to use traditional, expensive media or to give preference to Internet communications, spend minimal resources and continuously monitor what customers think about their company, practically switching to a marketing research and sales platform.

The change in the mentioned proportion and the growth of retail lending rates significantly led to an increase in the profitability of the banking sector, because compared to business loans, consumer loans are on average 3-4% more expensive, and the maturity is shorter. This problem creates serious risks for the banking sector, especially as it has already been mentioned that 85% of the profit of the system falls on the share of the three commercial banks forming the system.

Profitability of banks, on assets and capital

Return on assets (ROA) and return on equity (ROE) at the end of 2022 were 3.8% and 30.2%, indicating a fairly large equity multiplier of 7.9. It is true that as of the end of 2022, as of the 4th quarter, the rates of return on both capital and assets have decreased compared to 2021 (4.1% and 37.3%, respectively), when the capital multiplier was 9, although it is still at a high level. For comparison, in the fourth quarter of 2019, the rate of return on assets and capital was 2.4% and 19%, respectively, although with a high (8%) capital multiplier. Naturally, in the crisis year 2020, due to the loss of the system in the first 3 quarters, the indicators of the multiplier were negative, this is especially true for the 1st quarter, when the indicators of returns on assets and capital were -6.9% and -64%, respectively. However, in 2021-2022, following the growth of assets, we see a significant increase in profitability, which also indicates an improvement in the efficiency of scale, in terms of a decrease in the ratio of expenses to income, although, as we mentioned, this indicator is still on a growth trend.

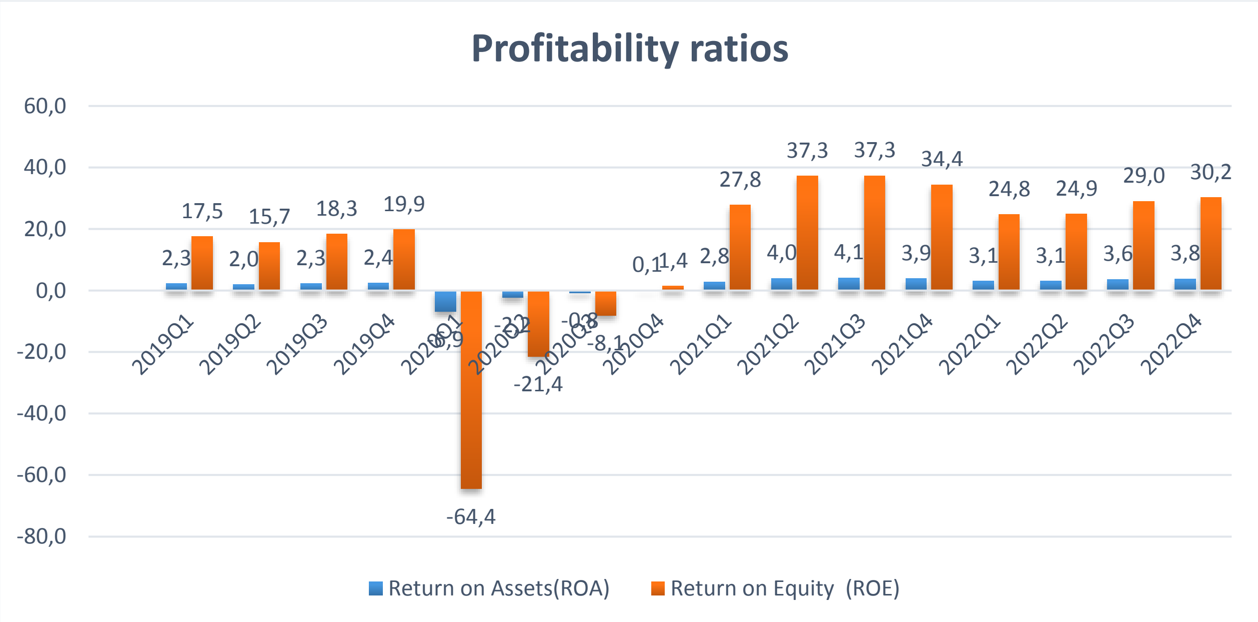

Diagram 2. Rates of return on assets and capital (%)

Source: National Bank of Georgia.

Both ROA and return on equity (ROE) measure how well a company is using its resources. But one of the main differences between the two is how they treat a company's debt. ROA determines how much leverage a company has or how much debt it has (Papava, Charaia, 2021). After all, its total assets include any capital it borrows to run its operations.

On the other hand, ROE measures only the company's return on equity, which does not include its liabilities. Thus, ROA accounts for the company's debt and ROE does not. The more leverage and debt a company takes on, the higher ROE will be relative to ROA. Thus, when a company takes on more debt, its ROE will be higher than its ROA. Assuming that income is constant, assets are now greater than equity and the denominator of the return on assets calculation is also higher. This means that the company's ROA falls while its ROE remains at the previous level.

One of the biggest problems with ROA is that it cannot be applied across industries. This is because companies in one industry have a different asset base than those in another. So the asset base of companies in the oil and gas industry is not the same as in the retail industry. Some analysts also believe that the basic ROA formula is limited in its applications, which are most suitable for banks. Bank balance sheets are a better representation of the true value of their assets and liabilities because they are recorded at market value based on market accounting of historical value.

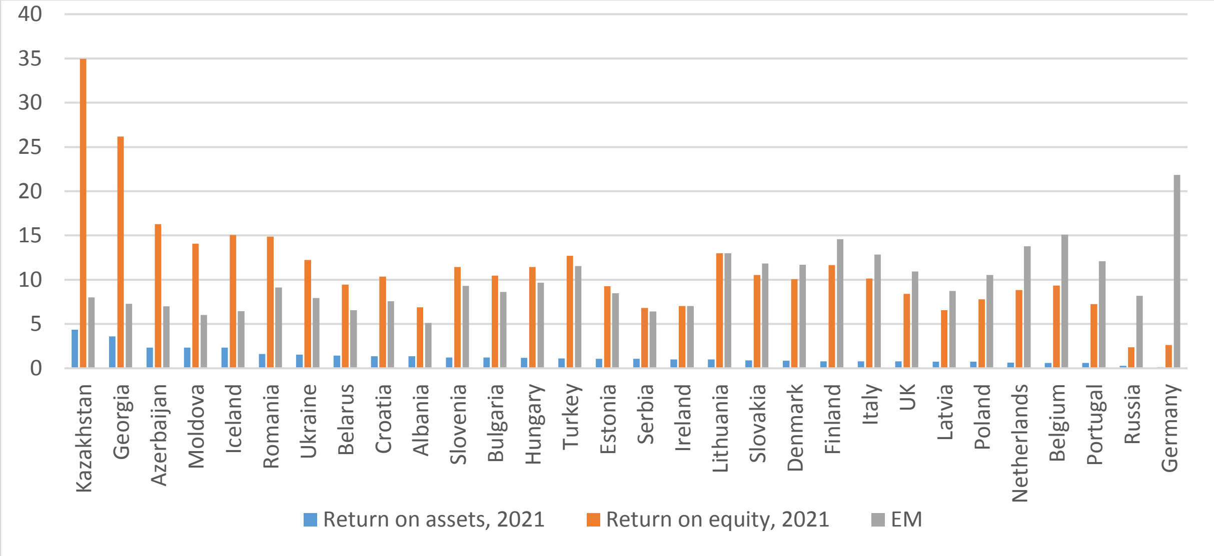

Diagram 3. Equity multiplier, return on assets and return on equity figures, 2021

Source: Bank return on equity, in percent, 2021

The study uses the equity multiplier, which is a risk indicator that measures the portion of a company's assets that is financed by shareholders' equity rather than debt. The equity multiplier is calculated by dividing the value of the company's total assets by the total equity in the company's shares. In our case it is the ROE/ROA ratio. A high equity multiplier indicates that the company is using a large amount of debt to finance its assets. The equity multiplier is also known as the leverage ratio or financial leverage ratio and is one of three ratios used in the DuPont analysis.

A high equity multiplier indicates that the company is using a large amount of debt to finance its assets. Companies with higher debt burdens will have higher debt service costs, meaning they will need to generate more cash flow to maintain a healthy business (Gamsakhurdia et al., 2017). The structural analysis of income also shows that the annual growth of non-interest income in the horizontal segment after a 3% drop during the corona shock period of 2020, which was also reflected in an 11% decrease in commission income, is characterized by a ZTRD trend. If interest income grew steadily by 19% in 2021-2022, on the other hand, non-interest income increased by an average of 44%, including commission income by 33%.

The impact of non-interest income on financial performance has been the subject of several studies. Return on assets (ROA), obtained by dividing net income by total assets, is one of the most widely used metrics of financial success. Return on equity (ROE), calculated by dividing net income by total equity, is another measure of financial performance. According to studies, interest-free income and financial success are positively correlated. Profitability determined by ROA and ROE was determined to be significantly affected, in particular, by non-interest income. It should be noted that the COVID-19 pandemic also had its impact on this particular issue as well. Hasko et al (2021) based on 51 banks in Europe (a study based on the period January-September 2020) showed that a 10% loss in non-interest income compared to the same period in 2019 was mainly due to a decline in trading and fee income. However, the impact on financial performance was minimal as banks were able to rely on government support and liquidity infusions.

After the covid pandemic shock, the specific share of interest income in total income decreased from 82% to 75%, and the share of non-interest income increased from 18% to 25%, which is 4 percentage points higher than in 2019, and should be evaluated positively in terms of the dependence of interest income and therefore the reduction of risks, although from commissions The received incomes remain stable within 8%. In the structure of non-interest income, the leading position is still the income from conversion operations, i.e. from currency purchase and sale operations, the rate of which exceeded the percentage rate of 2019 itself, and the total income has increased from 8% to 12%, from 359.8 million GEL to 886 million GEL, and by 4 percentage points even the income from commissions itself circle (570 million GEL).

Important factors driving the dollarization of deposits are the inflation rate and volatility, as well as currency depreciation, in low-income countries (Charaia, Papava, 2019; 2022). And the asymmetric exchange rate policy encourages depositors to have deposits mostly in foreign currency in order to maintain their purchasing power. From the point of view of de-dollarization of deposits and credits, the development of the liquid capital market in local currency will be important in the medium term, along with the development of the stock market in the long-term, which with the de-dollarization of deposits, as we can see, the Georgian banking system is distinguished by one of the highest profitability and Net interest margin, equity multiplier and debt service leverage are at the European average. In addition, in countries with dollarized and highly import-dependent economies, interest rates and their differentials are high, resulting from risks arising from currency devaluation. Consequently, price elasticity to monetary and credit shocks is often higher in countries with dollarized economies, because inflation is more responsive to monetary and credit shocks due to weak policy transmission mechanisms.

In the conditions of high concentration and oligopoly market, where the assets of two banks are up to 75% of the total banking assets, which is discussed in detail in the corresponding chapter of this paper, the SEB is obliged to intervene more actively in the market for the sake of macroeconomic stabilization and limit the profits of banks, both in the direction of increasing the refinancing rate, interest margin and interventions in the market.

Conclusions

The Georgian economy has been resilient in the face of global shocks, but the high dollarization of the economy and the current account deficit remain challenges. The banking sector is in a good position, with decreasing dollarization of both loans and deposits.

The economy grew by 10.3% in 2021-2022, but unemployment and poverty remain high. The government should focus on inclusive growth, which means promoting the growth of micro and small businesses and employment.

Digital technologies can help small businesses grow, but they need access to capital and support. The Georgian economy has been resilient in the face of global shocks, but the high dollarization of the economy and the current account deficit remain challenges.

The banking system in Georgia is facing a number of challenges, including a high net interest margin, low non-interest income, and a lack of guarantee mechanisms for small and medium-sized businesses. The development of the stock market could help to reduce the banks' reliance on interest income and increase non-interest income. The future of Georgian commercial banks will depend on their ability to adapt to the new digital era and provide customers with fast and secure services. The main problem of lending to small and medium-sized businesses in Georgia is access to capital and lack of guarantee mechanisms.

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