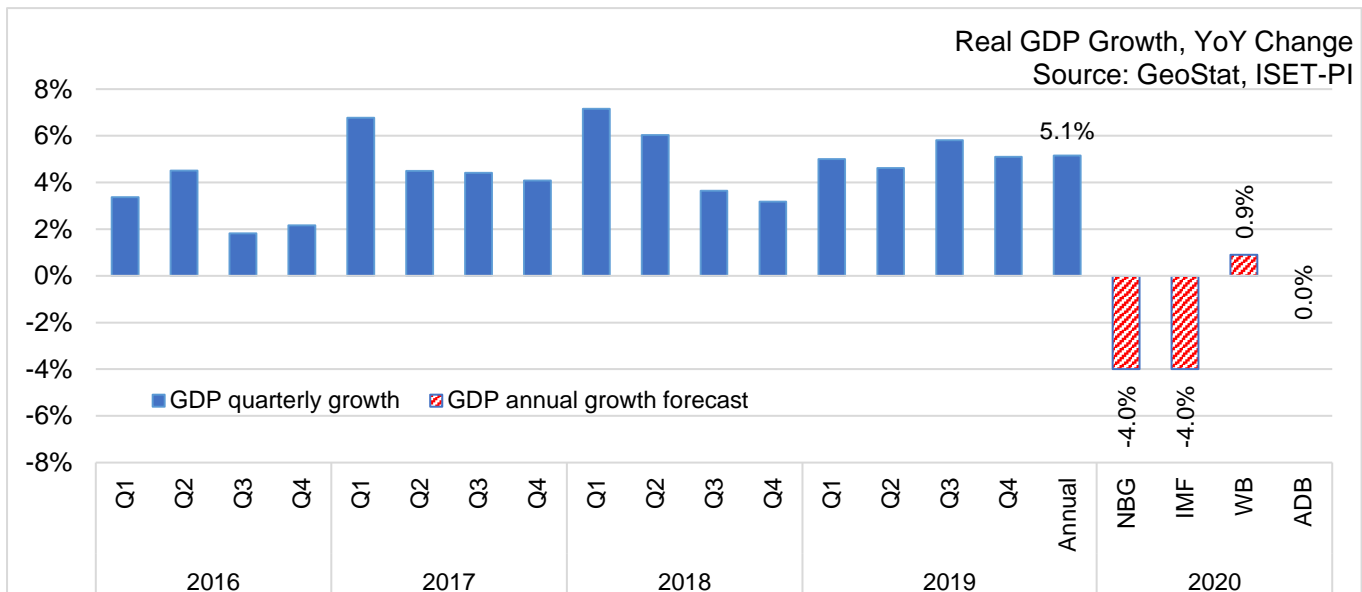




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The 2019 Georgian economy – a year in review



Economic growth – a bird’s eye view of 2019

According to Geostat, the 2019 real GDP growth in Georgia was 5.1% year-over-year (YoY). This figure moderately surpassed NBG’s, ADB’s, EBRD’s, IMF’s and the World Bank’s latest growth projections for 2019, which range from 4.5%-4.7%. However, the real winner in this race was ISET-PI’s annual GDP growth forecast; in May 2019, [we predicted](#) 4.9% annual growth. Although 2019 may now seem like the distant past in light of the coronavirus epidemic, it is worth noting that Georgia headed into 2020 with strong momentum. Therefore, the fact that the 2019 growth outcomes were strong will likely soften the impact of COVID-19 on the economy in 2020.

Georgian economic growth in 2019 was driven by both increased domestic and external demands, with strong fiscal stimulus and greater activity on the credit market as the main internal drivers of growth. Additionally, the depreciated effective exchange rate stimulated net exports, and current account deficits improved significantly. Increased money transfers also led to accelerated economic growth. Due to the Russian ban on air travel to Georgia, revenues from international travelers increased only marginally, while foreign direct investment (FDI) stood at the same level as in 2018, having no impact on growth in the reported period.

In 2019, the main Georgian trading partners exhibited, noticeably, uneven results in their economic development. Trade tensions between the USA and China resulted in a slowing of their economic activities; the IMF calculated 2019 annual real GDP growth for each country at 2.3% and 6.1%, respectively.¹ While, because of lower consumption expenditure and deteriorating business confidence, the GDP for the Euro Area increased by only 1.2% in the period. Economic growth in Russia also slackened notably after an agreement on oil production cuts with OPEC took effect at the beginning of 2019. Following a significant contraction in the second half of 2018, Turkey started to recover, benefiting from the expansion of fiscal and credit activity. According to the IMF, in 2019, the Russian economy grew by 1.4%, while real GDP growth in Turkey stood at 0.9% (notably higher than the IMF’s estimate of -2.5%).

¹ [World Economic Outlook Database, April 2020.](#)



Real GDP growth in Azerbaijan remained stable at 2.3%, and Armenia reached a remarkable 7.6% in annual growth, mainly due to boosted exports and consumption expenditure.

Prospects for 2020 and post-COVID recovery

The COVID-19 epidemic is expected to negatively impact the Georgian economy via a reduction in tourism, remittances, trade, consumption, investment, domestic production, and service provision due to the strict social-isolation measures. Real GDP growth is expected to decrease significantly, the extent dependent on the length and severity of the pandemic. ISET-PI recently released a [policy note](#) detailing its projections of the impact of COVID-19 across various scenarios. Our estimates reveal that if social isolation measures were to remain in place until the end of the year, the losses from tourism revenue alone would drive down economic growth by 5.4 percentage points compared to the baseline (no COVID-19) growth.

Most international organizations have lowered their forecasts for Georgia's 2020 real GDP growth, yet they predict a quick recovery in 2021. According to ADB's recent Asian Development Outlook, COVID-19 and monetary tightening will slow the growth rate to zero percent this year, while recovering to 4.5% in 2021. Furthermore, Georgia's real GDP growth forecast is the lowest among ADB countries. The World Bank has also revised its forecast of Georgia's real GDP growth downwards; the new predictions vary from -0.2% (the worst case) to 2% (the best case) in 2020. Among international organizations, the IMF has the most conservative prediction, -4% in 2020 and expected a rise to 3% in 2021.

Table 1 highlights the connections between Georgia's selected top economic partners, with respect to trade, FDI, remittances, and the number of international arrivals in 2019. The darker blue colors correspond to stronger linkages and, consequently, stronger spillover effects from other countries. For example, one can see that Turkey and Russia absorbed the highest proportion of Georgian exports, at 13.2%, respectively. These countries are moreover the main sources for international arrivals. Their share in total imports is also dominant, with Russia continuing to be the largest source of money transfers to Georgia. Aside from FDI, strong linkages can also be observed with Armenia and Azerbaijan in every dimension. Thus, the economic developments in those countries with darker colors have stronger effects on the Georgian economy.

Table 1: Economic linkages and real GDP growth

Partner	Linkages with partners in 2019, % of total					Real GDP growth, %		
	Export	Import	FDI	Remittances	Int. Arrivals	2019	2020	2021
CIS	53.2	26.9	9.1	30.7	62.1			
Russia	13.2	10.8	4.0	24.7	19.0	1.3	-5.5	3.5
Armenia	10.9	3.0	1.1	0.8	17.7	7.6	-1.5	4.8
Azerbaijan	13.2	6.1	3.0	1.3	19.8	2.3	-2.2	0.7
Ukraine	6.5	4.6	0.6	2.5	2.7	3.2	-7.7	3.6
Uzbekistan	2.4	0.2	0.2	0.3	0.2	5.6	1.8	7.0
EU	21.8	25.6	47.5	38.3	6.3			
Italy	1.1	2.5	0.1	13.8	0.3	0.3	-9.1	4.8
Spain	1.2	1.2	-0.1	2.7	0.2	2.0	-8.0	4.3
Germany	1.4	4.9	0.6	2.9	1.2	0.6	-7.0	5.2
France	0.8	1.8	1.4	0.1	0.4	1.3	-7.2	4.5
UK	0.8	1.1	19.7	1.0	0.5	1.4	-6.5	4.0
Greece	0.1	0.7	0.2	11.1	0.3	1.9	-10.0	5.1
Bulgaria	7.5	1.4	0.6	0.0	0.1	3.4	-4.0	6.0
Romania	4.7	2.3	0.0	0.0	0.1	4.1	-5.0	3.9



ROW	25.0	47.6	43.4	31.0	31.6			
Turkey	5.4	17.8	18.8	5.5	15.0	0.9	-5.0	5.0
China	6.0	9.5	3.2	0.1	0.6	6.1	1.2	9.2
USA	3.5	4.3	7.9	10.3	0.6	2.3	-5.9	4.7
Iran	1.9	2.1	0.1	0.0	1.8	-7.6	-6.0	3.1
Israel	0.4	0.1	1.5	9.4	2.7	3.5	-6.3	5.0
Korea	0.2	0.7	1.7	0.0	0.2	2.0	-1.2	3.4
Switzerland	2.2	0.6	0.0	1.5	0.1	0.9	-6.0	3.8
Total (million GEL)	3,765	9,066	1,261	1,733	7,727*			

* Number of international visitor trips

Source: GeoStat, NBG, IMF

The final three columns to the right side of Table 1 represents the IMF's growth estimates for 2019 and its projections for next two years. The data suggests that all of Georgia's top economic partners, except China and Uzbekistan, will fall into a deep recession in 2020, followed by a quick recovery next year.

The data also indicates that, in addition to **halted revenues from the tourism sector, the biggest hit to the Georgian economy is expected to come from trade** (Russia, Ukraine, Bulgaria and Turkey) and remittance (Russia, Italy, Greece, USA and Israel) channels.

Inflation

In 2019, annual CPI inflation reached 4.8%, 1.8 percentage points (pp) higher than the targeted 3%. The main driver of annual inflation was the increased price of food (+8.2% YoY), which contributed to inflation by 2.5 pp.² Additionally, an increase in excise tax at the beginning of the year on filtered cigarettes (the prices of alcoholic beverages and tobacco were hiked 16.4% YoY in 2019) contributed to around 1.1 pp of total annual inflation in the reported year. Concurrently, the price of clothing and footwear also dropped by 7.1 pp YoY. Alongside communication (-2.2% YoY), these categories drove inflation down by 0.3 pp in 2019.

Although the recent jump in food prices can be partially explained by the increased cost of certain goods, inflationary pressure mainly came from **depreciation of the local currency against the US dollar and the currencies of major trade partners**.

In response to rising inflation, NBG increased its monetary policy rate towards the end of 2019 – from 6.5% to 9%. Higher interest rates on GEL tend to make savings more attractive, which leads to an increased demand for the lari and, therefore, contributes to appreciation of the exchange rate. In addition, these measures restrict borrowing through increasing market interest rates and by driving inflationary expectations down. However, one side-effect is a weakened aggregate demand, which is then expected to have a negative impact on the future growth of the economy.

The external sector in 2019 – wine, cars and copper

Strong external demand and a depreciated exchange rate stimulated a net export of goods and services (through increased competitiveness). Equally, remittances continued the rising trend of previous years, however, the Russian prohibition on flights to Georgia has negatively affected revenues from tourism.

² It should be mentioned that the poor are more vulnerable to increases in food prices, as the food category has a greater share in their consumption basket.



Exports grew by 12.2% YoY in 2019, driven by the significantly increased **re-export of motor cars to Armenia, export of wine and chemical fertilizers to Ukraine, and copper ores to China and Romania**. An impressive upsurge in the export of mineral and chemical fertilizers to Lithuania also contributed to the total export growth. Nevertheless, the reduced export of ferro-alloys and medicaments to Russia, and cigarettes to Azerbaijan, negatively affected trade statistics in the reported quarter.

During this period, import growth was slightly negative (-0.8% YoY), primarily instigated by the reduced import of petroleum and petroleum oils from Turkmenistan, cigarettes from Ukraine, and wheat from Russia. The decrease in imports can be explained by a lower demand for imported goods, largely due to depreciation in exchange rates. Additionally, world petroleum prices decreased by 8% YoY in 2019,³ which partly explains the reduction in import of petroleum products. Moreover, the increased excise tax on tobacco products seems to have reduced demand (however bulk tobacco importation did increase). As a result, trade turnover increased by 2.7%, whereas the trade deficit shrank by 8.3% YoY in 2019.

As growth rates decreased notably after the ban of flights from Russia in late June, the positive external demand was not fully reflected in the export of services. According to NBG's estimation, revenues from international travelers constituted only 1.4% YoY in 2019.

The total volume of remittances to Georgia rose by 9.7% YoY in the reported period. Italy (+24% YoY), Greece (+12.7% YoY), USA (+11.8%), and Ukraine (+49.1% YoY) were the main drivers of the increase, and contributed 6.4 pp to the total growth of money transfers in 2019. Money inflows from Russia and Turkey fell by 6.2% and 10.2%, respectively, driving the total growth of remittances down by 2.5 pp. **The diversification of monetary inflows has been increasing in recent years; as the role of Russia is declining (24.7% of the 2019 total, compared to 28.9% in 2018), the importance of the EU is rising, alongside the USA and Israel.**

Exchange rate

The effect of Russian sanctions, together with fallen FDI inflow in the first three quarters of 2019, have affected movements in the exchange rate. This created the possibility of adjusting external imbalances and thus softening the negative shocks to the economy and improving the current account. However, it equally created upward inflationary expectations, through rising import inflation, which then caused economic tightening.

Overall, the lari depreciated by 11.2% and 5.4% YoY against the US dollar and the euro, respectively in 2019. The lari also depreciated against the currencies of all its neighboring countries (except Turkey), which was reflected in depreciation of the effective exchange rate. The real effective exchange rate fell by 5.4% YoY in 2019, while the nominal effective exchange rate depreciated by 5.1% YoY.

To curb depreciation, NBG sold 92.8 million US dollars over three auctions between August-November 2019. In addition, in October NBG decreased the minimum foreign currency reserve requirements for commercial banks, from a mandatory 30% to 25%, which allowed commercial banks to lend \$700 million of freed funding to the economy. Together with a tightened monetary policy, these measures helped to strengthen the exchange rate for the beginning of 2020.

³ [IMF Primary Commodity Prices.](#)



Public finances

In 2019, the general budget deficit widened to 1,351 million GEL (compared to the deficit of 323 million GEL in 2018), this was largely due to accelerated spending on infrastructural projects.

Budget revenues from taxes increased by 9% YoY in 2019, reflecting strong economic growth. The growth was primarily driven by the higher collection of VAT (+18.3% YoY) and personal income tax (+7.7% YoY). Revenues from other taxes, also showed positive annual growth.

At the same time, total current governmental expenditure exhibited 12.8% YoY growth, driven principally by a 12.5% annual increase in spending on social benefits. All other current governmental expenditures showed positive growth in the reporter period. **The government's capital spending expanded by 34.6% YoY, as infrastructural projects accelerated, positively affecting the overall economic performance.**