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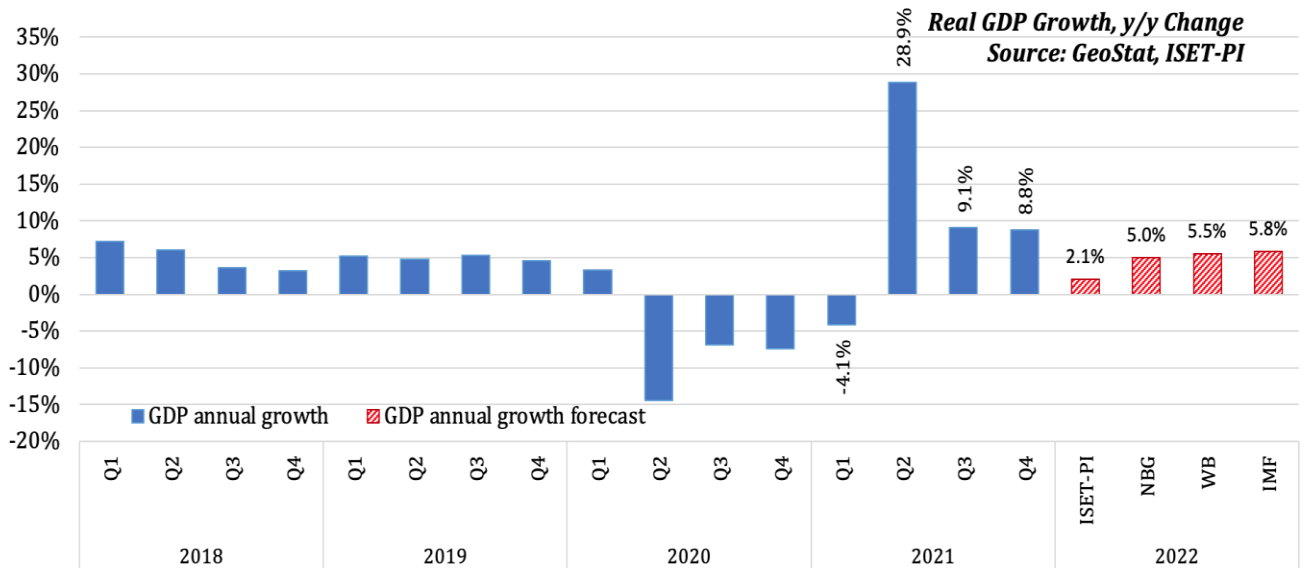
Georgian economy 2021 – the year in review



Summary

For the Georgian economy, 2021 was a year of gradual recovery from the COVID-19 pandemic. According to Geostat rapid estimates, the real GDP expanded by 10.7%, coming within 0.1 percentage points of the ISET-PI forecast from November 2021 and surpassing the NBG and IMF mid-year projections, which ranged between 8% - 8.5% y/y. While the high growth rate was driven in part by the low base of 2020, it was not merely a recovery from the pandemic-driven shock. The real GDP of 2021 went above the corresponding periods of 2019, implying a positive net increase in GDP. This GDP growth was fueled mainly by increased consumption and net exports, as the progressive restoration of international tourist flows significantly boosted the export of services and pent-up demand lifted consumer spending.

The GDP expansion process was challenged by rising inflation. Rising prices of international commodities fueled by the COVID-19-related restrictions, logistical challenges, and increased demand put an upward pressure on inflation in both developed and developing countries. Georgia was no exception, with the inflation rate reaching double digits in the second half of the year. The unemployment rate in 2021 increased by 2.1 percentage points y/y, reaching 20.6%. However, one could observe a declining trend in the unemployment indicator, as in the fourth quarter of 2021 the unemployment rate decreased by 1.4 pp compared with the corresponding period of 2020, and amounted to 19% y/y. Average annual labor force participation increased by 0.65% y/y; the number of hired employees contracted by 1.88% y/y, while the number of self-employed people decreased by 2.21% y/y. In the second half of 2021, labor productivity significantly increased. Correspondingly, gross salaries of employees averaged 1,463.8 GEL, showing a nominal annual growth of 22.9%. Additionally, according to the NBG Monetary Policy Report, the unit labor cost increased in 2020 due to economic contraction

followed by a smaller decline in wages. As output started to recover, so did the productivity of labor, driving the decrease in unit labor cost.

The gradual removal of COVID-19-related restrictions positively affected FDI and international trade in goods and services. The reopening of the borders significantly increased the number of international visitors. Yet, the number of visitors registered in Q4 2021 was still lower than in Q4 2019. The lifting of COVID-19 restrictions also encouraged both export and import activity. As a result, the negative trade balance rose by 24% y/y and amounted to 5.8 million USD.

Overall, the Georgian economy saw a strong rebound in 2021. In the same time, the COVID-19 pandemic left the economy weaker in several key areas: higher government debt/GDP ratio (60.7% in 2020), inflation pressures (9.6% annual average in 2021) and higher, albeit decreasing, CA deficit (12.4% of GDP in 2020 and 9.8% of GDP in 2021 according to the latest NBG data).

Georgia and international partners: economic spillover effects

The new political and economic uncertainty brought about by Russia's invasion of Ukraine on February 24th, 2022 brought into focus several of Georgia's key economic dependencies on its partner countries and the region as a whole. Table 1 features the links between Georgia's top economic partners with respect to trade, FDI, remittances, and the number of international arrivals in 2021. Darker blue colors reflect stronger connections, thus stronger spillover effects from other countries, while lighter blue colors indicate weaker linkages. For example, China was the main export destination country, taking up 14.5% of total exports, marginally edging out Russia. The EU block was collectively more important than Russia or China as an export and import partner for Georgia. The EU has also surpassed Russia and others as a source of remittances for Georgia. At the same time, Russia remains the largest single-country source of remittances. As far as international arrivals, the main single-country source was Turkey, while the UK acquired the largest share of foreign direct investments with 51.8%. With the high share of imports, exports, international arrivals and the largest source of money transfers, the Georgian economy is still significantly linked to the economic performance of Russia. Other than FDI, Georgia is also strongly linked with Armenia and Azerbaijan—exports to these two countries amount to nearly 20% of total exports. Ukraine is another significant partner in every dimension with significant export and import shares, thus, economic developments in these countries strongly affected the Georgian economy in 2021.

Partners	Linkages with partners in 2021, % of total					Real GDP Growth, %		
	Export	Import	FDI	Remittances	Int. Arrivals	2020	2021	2022*
CIS	47.6	27.9	5.9	27.2	41.3			
Russia	14.4	10.1	5.1	17.51	11.3	-3	4.7	2.9
Armenia	6.1	4.1	0.6	0.55	8.8	-7.4	6.5	4.5
Azerbaijan	12.5	5.9	0.0	3.63	4.4	-4.3	3	2.3
Ukraine	7.2	4.5	0.9	3.95	7.7	-4	3.5	3.6
Uzbekistan	2.0	0.3	0.2	0.31	1.9	1.7	6.1	5.4
EU	16.9	22.9	28.4	45.83	7.4			
Italy	1.4	2.5	0.2	16.42	0.2	-8.9	5.8	4.2
Spain	2.1	1.2	0.9	2.35	0.2	-10.8	5.7	6.4
Germany	1.6	4.8	2.7	4.82	1.1	-4.6	3.1	4.6
France	0.8	1.9	1.6	1.61	0.6	-8	6.3	3.9
Greece	0.2	0.5	0.1	10.22	0.3	-8.2	6.5	4.6
Bulgaria	6.0	1.8	0.4	0.05	0.2	-4.2	4.5	4.4
Romania	0.8	1.8	0.0	0.01	0.1	-4.2	7	4.8
Other Countries	35.5	49.2	65.3	23.28	51.3			
Turkey	7.6	18.1	5.6	4.45	17.4	1.8	9	3.3
China	14.5	8.6	1.7	0.04	0.2	2.3	8	5.6
USA	4.6	6.4	0.5	12.10	1.0	-3.4	5.7	5.2
Iran	0.6	1.4	0.1	0.00	1.0	3.4	2.5	2
Israel	0.5	0.1	0.8	7.95	5.4	-2.2	7.1	4.1
Korea	0.2	0.7	0.3	0.02	0.0	-0.9	4.3	3.3
Switzerland	1.9	0.8	0.6	0.09	0.1	-2.5	3.7	3
UK	0.6	0.8	51.8	0.90	0.4	-9.8	6.8	5

The three columns on the right-hand side of Table 1 represent the growth rates for 2020 and 2021, and 2022 projections. According to the IMF, most of Georgia's neighboring countries and main economic partners showed improved economic performance in 2021. The United States and the Euro Area expanded by 5.7% and 5.2% respectively. At the same time, the Chinese economy grew by 8% y/y. Likewise, Armenia, Turkey and Uzbekistan showed positive growth in 2021. According to the IMF forecast made prior to the Russian invasion of Ukraine, most of Georgia's partner countries were projected to maintain a positive growth rate in 2022. The war will obviously change projections in a significant way for many countries in the region, including for Russia. Currently the most sanctioned country in the world, even ahead of Iran and North Korea, Russia is expected to post negative growth of -10% in 2022, while the Ukrainian economy is expected to shrink by 20% in wartime.

According to NBG's monetary report from February, Georgian GDP was expected to increase by 5% y/y in 2021. This figure is 0.5% point lower compared to the World Bank's estimates made in January, while the IMF projections from January predict 5.8% y/y growth rate. The latest data from ISET-PI's GDP forecast predicted the 2022 annual real GDP growth to be 1.7% in the worst-case scenario and 2.8% in the best-case scenario. Our middle-of-the-road scenario predicted a 2.1% increase in real GDP. These figures should be treated as baseline estimates, since the forecast relies only on historical data and does not take into account the current Russia-Ukraine war scenario.

One can note significant variations in these baseline growth projections for Georgia for 2022. The variations were driven in part by the economic uncertainties related to the pace of vaccination both within the country and in its partner states, accompanied with the slow recovery of the labor market. The fallout from the Russia-Ukraine war is likely to have a significant impact on the region and Georgia in particular. EBRD has already updated its forecast for Georgia's growth to 2% in 2022. Some of the factors influencing this change were already highlighted in the ISET Economist blog from February 28, 2022. More detailed analysis of the situation will be provided in our next blog posts.

Inflation

The year 2021 was characterized by high headline inflation, which increased to 13.9% y/y in December. This rising trend was caused by several factors. Increasing oil prices combined with COVID-19-related restrictions put pressure on logistics networks and upped transportation costs. This resulted in a significant increase in commodity prices worldwide. Together with disruptions in supply caused by the pandemic, these global inflationary factors have contributed to high inflation in Georgia. Rising domestic demand also contributed to inflation. The demand was driven by the realization of pent-up demand after the reopening of the economy, strengthened by credit activity and continued fiscal stimulus.

Additionally, the end of government price subsidy programs on utility bills and some food products automatically implied further increases in the prices of these goods and services in 2021. According to NBG, utilities made a 3.6 pp contribution toward annual inflation (compared to 1.6 pp in November). Amid increasing global food prices, food prices in Georgia rose by 16.1% in December 2021 compared to the previous year and contributed 4.7% to inflation. From the imports side, a notable rise in the prices of sunflower oil, sugar, chocolate and bread contributed 1.5 pp (combined) to inflation.

Overall, average annual CPI inflation reached 9.6% y/y in 2021, 6.6 pp higher than the 3% inflation target. Increased prices on transport, health, and utilities were the largest contributors to inflation in 2020 (contributing about 2 pp, 0.8 pp and 0.7 pp respectively). Only communications drove inflation down, yet their contribution was negligible, -0.01pp.

As a response to increasing inflation dynamics, the National Bank of Georgia tightened the monetary policy rate to 10.5% by the end of 2021. At the same time, NBG made several interventions in the foreign exchange market to curb the Lari depreciation and manage its impact on inflation. The National Bank held 9 selling auctions, selling almost 333 million USD.

On the foreign exchange market, GEL was depreciating against USD in the first months of 2021, but by the end of the year the dynamics reversed, and GEL started to gain value. Overall, GEL depreciated on average by 3.6% against the USD y/y while the nominal effective exchange rate remained almost unchanged (a 0.5% appreciation). The real effective exchange rate, on the other hand, depreciated by around 1.7%, resulting in the Georgian export sector's better competitiveness.

External Sector: Trade, Tourism, Remittances, FDI

The COVID-19-related restrictions have been gradually phased out. This positively affected international trade in goods and services and FDI. The reawakening of international tourism resulted in increased

numbers of international visitors. In the fourth quarter, Georgia received 269.3% more visitors y/y, yet the number of visitors is still almost 70% lower compared to Q4 2019. Revenues from international travelers follow the same trend, rising 8.9 times annually, but still remaining 44.7% below the revenues observed in the fourth quarter of 2019.

Both exports and imports showed strong growth in 2021, more than 25% y/y. Moreover, both exports and imports were higher than exports/imports observed in 2019, which means that the base effect was not the sole contributor to this growth. As a result of these dynamics, the trade deficit rose by 24% y/y and amounted to 5.8 million USD.

Imports of consumer and intermediate goods were the main contributors to the increasing imports in the fourth quarter. Imports of consumer goods mainly rose because of the increased purchases of petroleum products (+65% y/y) motor cars (+19.7% y/y), and medicaments (+16.9%), while the increase in imports of intermediate goods was a reflection of higher imports of copper ores and concentrates (+26.4% y/y), petroleum gases (+8.7% y/y) and immune serums (vaccines, blood and immune products) (+170% y/y). The larger purchases of automatic data processing machines (+128% y/y) contributed toward higher import of investment goods. The geographical diversification of Georgian imports improved as the share of top ten trading partners in the total imports of Georgia amounted to 67% in 2021, compared to 69.9% in 2020.

The export growth was mainly caused by the increased demand for consumer and intermediate goods. Investment goods, on the other hand, contributed only moderately. Motor cars (+13% y/y) were the largest contributor to increased purchase of consumer goods, while ferro-alloys (+93% y/y) were the drivers of increased purchase of intermediate goods. The export of construction machinery played a major role in the growth of exports of investment goods.

Exports to all the destination markets have increased. Exports to the USA have more than doubled, while exports to China rose by 129%. Similar to 2020, China remained the top destination country for Georgian exports in 2021. The geographical diversity of Georgian exports declined as the share of the top ten export destination countries in total exports increased from 75.9% in 2020 to 77.2% in 2021.

As in the case of external trade, money transfers to and from Georgia have also risen. The volume of remittances to Georgia grew by almost 25%, reaching 2.349 million USD. The growth was mainly driven from increased inflow of money from the Russian Federation (+13% y/y), Italy (+29.6% y/y), the United States (+30.2% y/y) and Greece (+9.59% y/y).

After falling drastically in 2020, foreign direct investment more than doubled in 2021, reaching 1,153 billion USD. The Current Account deficit was high, reaching 9.8% of GDP in 2021. Still, the deficit was lower compared to the -12.4% of GDP in 2020.

Public Finances

According to the Ministry of Finance, current governmental expenditures amounted to 15,369 million GEL in 2021, showing a 14.7% y/y increase compared with the previous year. This growth was mainly driven by higher spending on social benefits (+13.76% y/y) and use of goods and services (+17.1% y/y). At the

same time, total revenues to the general budget amounted to 15,143 million GEL, a 22.05% y/y increase. The latter was driven by increased volume of Value Added Tax collection (24.65% y/y), revenues from Personal Income Tax (13.50% y/y), excise tax (15.40% y/y), and profit tax (10.43% y/y). Overall, the budget deficit in 2021 amounted to 3,768.3 million GEL (6.2% of GDP)—showing a 17.62% increase compared to the corresponding period in 2020.

Central Government debt liabilities (which includes both domestic and foreign debt) increased by 0.5% y/y and amounted to 29,761.1 million GEL in Q4, 2021 (49.4% of GDP). Furthermore, the share of foreign debt in total debt decreased by 0.5 pp and stood at 80.5%, slightly decreasing the country's exposure to exchange rate risk.