



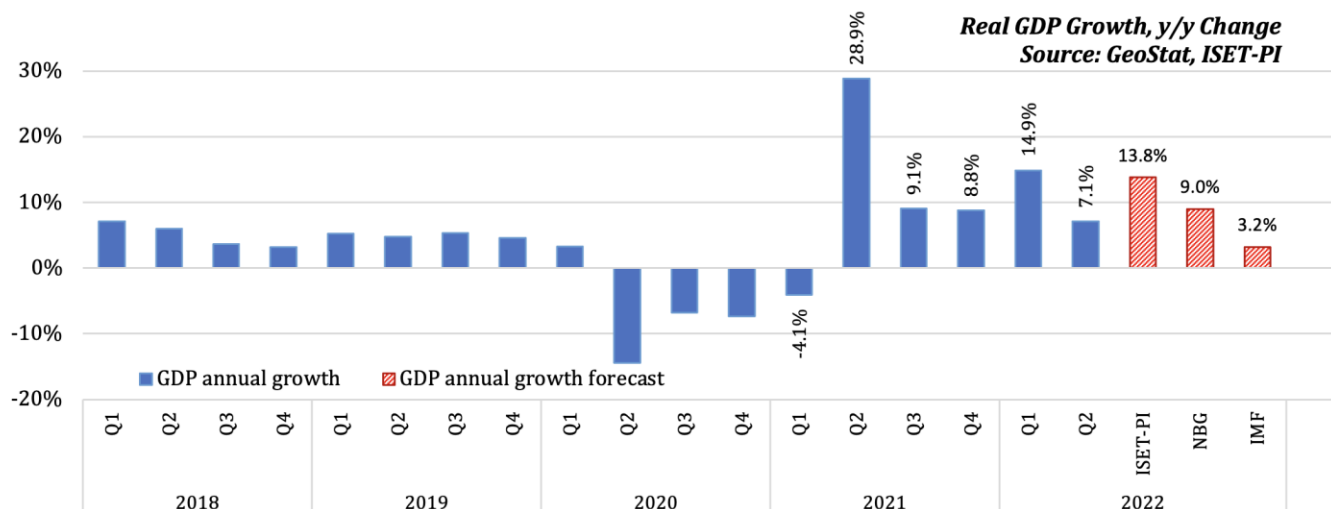
The Georgian economy shows resilience in Q2 2022, despite the global headwinds from the war on Ukraine

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Summary

Following the tentative recovery observed in 2021, global economic conditions worsened significantly in 2022 ([IMF, July 2022](#)). Russia's invasion of Ukraine on 24 February 2022 caused global economic growth estimates to drop for the first time since 2020. Besides the direct consequences of the war on Ukraine (i.e. the rise in oil and gas prices, global staple food shortages), increasing inflation in the United States, Europe, and the rest of the world has led to tightened financial conditions, which in turn has made it more difficult for developing and emerging countries to borrow on international markets. Furthermore, the resumption of lockdowns in China caused by recent outbreaks of COVID-19 and negative effects stemming from Russia's invasion of Ukraine have put the brakes on Chinese economic growth. These developments have led the [IMF](#) to adjust their expected global economic growth downward to 3.2% from the baseline of 6.1% last year. They also predict Georgia's neighbors to show slow to moderate growth in 2022: [Armenia](#) (+1.5% y/y), [Azerbaijan](#) (+2.8% y/y), and [Türkiye](#) (+4% y/y). The [Russian economy](#), on the other hand, is expected to fall by 6% y/y. The projected growth in emerging markets and developing economies (EMDEs) has been adjusted downward as well. Currently, EMDEs are expected to grow by 3.6% y/y compared to the 6.8% growth in 2021 ([IMF, July 2022](#)).

The prospect for growth in Georgia received a surprising boost this year. [According to GeoStat's latest GDP growth estimates](#), due to higher aggregate demand, the Georgian economy grew by 7.1% y/y in the second quarter of 2022 ([National Bank of Georgia, August 2022](#)). This could be attributed in part to the increased inflow of Russian citizens into Georgia since the beginning of the war in Ukraine, alongside an unprecedented inflow of money transfers from Russia (e.g., in the first seven months of 2022, the inflows from Russia were seven times higher than during the corresponding period of 2021). Because of the improving external sector and high credit activity, NBG's real GDP growth expectations have been adjusted up to 9% y/y from the previous estimate of 4.5% y/y ([NBG, May 2022](#)). **ISET-PI's GDP forecast placed the 2022 annual real GDP growth at 13.8% y/y** (Figure 1 below). This increased economic growth will also have a negative effect on inflation, which has already reached double digits – standing at 10.9% y/y in August 2022 ([GeoStat, September 2022](#)).



Inflation

In Q2 2022, average quarterly CPI inflation stood at 13%, 10 pp higher than the targeted 3% ([National Bank of Georgia, 2022](#)). [GeoStat](#) (2022) data identifies that among the main drivers of inflation were higher prices of food and non-alcoholic beverages, with an increase of 21.7% y/y (contributing 7 pp to annual inflation); transport – 20.6% y/y growth (a 2.7 pp contribution to annual inflation); and housing, water, electricity, gas, and other fuels – a 12.8% y/y increase (a 1.16 pp contribution).

The root of such high inflationary pressure can be traced back to both COVID-19 and the war on Ukraine. Russia’s invasion of Ukraine has exacerbated the existing post-pandemic-related stress on commodity markets. It has also weakened already disrupted supply chains (caused by COVID-19) and deepened demand-supply imbalances. Given that Russia and Ukraine are major trading partners with Georgia, the ongoing war directly affects our economy.

According to the United Nations Comtrade database, Russia and Ukraine combined accounted for roughly a quarter of global wheat exports before the war. As the FAO [“Food Outlook”](#) (June, 2022) highlights, global wheat production in 2022, due to the ongoing military conflict, is therefore expected to decline by 0.8 per cent compared to 2021. Meanwhile, the FAO wheat price index for January-May 2022 recorded a 45.4% y/y increase, putting further upward pressure on inflation. For Georgia, the effect of a global wheat price rise has been exacerbated by the country’s notable dependence on Russian wheat and wheat flour (in 2021 wheat flour from Russia constituted 97% of the imports in this category). This high dependency on the Russian market for staple foods and animal feed has thus contributed to uncertainty and raised fears of food insecurity in Georgia.

Concurrently, sanctions restricting the sale of energy resources imposed on Russia have raised fuel prices globally. A significant increase in the price of fuel was consequently observed on the Georgian market as well.

In addition, the unprecedented influx of migrants, particularly from Russia (e.g., an estimated 100,000 Russian citizens remained in Georgia between February and May 2022), has expanded the overall aggregate demand. It has also had a particularly strong impact on the demand for property rentals, which has resulted in rising prices for rental units. According to a recent publication from [TBC Capital](#), in April 2022, asking rental prices reached 83% y/y – with accelerated growth continuing since March 2022 – while asking sale prices exceeded the 2021 level by 11%.



Despite strong inflationary shocks, [the National Bank of Georgia](#) forecasts a gradual decline of inflation towards the end of 2022. This will be achieved through a combination of tight monetary policy alongside the exhaustion of supply-side shocks towards the end of the year.

External Sector: Trade, Tourism, Remittances, FDI

The second quarter of 2022 was characterized by increasing external demand, which was fueled by recovering production and strong economic growth by Georgia's trade partners. This led to an improvement in the current account deficit. The CA deficit shrank by almost 50% compared to Q2 2021 and by almost 60% compared to Q1 2022, and it amounted to 252.1 million USD, only 4.2% of the quarterly GDP.

In Q2 2022, Georgia's external merchandise trade expanded by 35% y/y and was driven by greater export and import. The negative trade balance, however, worsened, reaching 1,895 million USD. It should be mentioned that exports and imports were both higher compared to the same period of 2019, meaning that the base effect is not the sole contributor to this growth.

The registered export of goods increased by 29.8% y/y ([GeoStat, 2022](#)), and according to [NBS](#) (August 2022) such growth can largely be attributed to the swelling prices of exported goods, while the real export of goods has hardly changed. Exports to Bulgaria (due to greater trade of copper ores and concentrates ([NBS, August 2022](#))) were major contributors to overall growth (+6.3 pp y/y), followed by Türkiye (+6.1 pp y/y), Peru (+6 pp y/y), and Armenia (+5.4 pp y/y). Because of the existing armed conflict, exports to Ukraine have fallen by 24% compared to the first quarter, while exports to Russia have risen by 34% compared to the first quarter of 2022 and have declined by only 7% y/y ([GeoStat, 2022](#)).

This rise in exportation was driven by the further export of intermediate goods (mainly due to higher prices). Nevertheless, the contribution from consumer and investment goods remained only moderate ([NBS, August 2022](#)). Notably, the export of motor cars was a major contributor to the export of goods (+16.3 pp y/y), followed by that of ferro-alloys (13.2 pp y/y) and wine from fresh grapes (5 pp y/y).

Imports, on the other hand, rose by 37.3% y/y, and were driven by accelerating economic activities and higher internal demand. It should be noted that rising global prices in USD terms also contributed to the increasing value of imports ([NBS, August 2022](#)). Imports from Russia were major contributors to the growth of imports (+7.8 pp y/y), which outweighed even the combined contribution of EU countries (+ 6.9 pp y/y). Imports from Ukraine, on the contrary, have fallen due to the ongoing war. From regional countries, Türkiye and Armenia contributed 5.95 pp and 2.84 pp, respectively. Furthermore, imports from USA and China also rose, contributing 5.88 pp and 4.23 pp to the overall growth of imports.

The import of consumer and intermediate goods were major contributors to the overall growth of imports. Greater purchase of consumer goods – motor cars (+18.9 pp y/y), petroleum and petroleum oils (+13.9 pp y/y), medicaments (+4.6 pp y/y), as well as intermediate goods, namely, copper ores and concentrates (+7.3 pp y/y) – were the main contributors to enlarged importation. While considering the import of investment goods, larger purchases of automatic data processing machines and their units also drove imports upwards (+2.2 pp y/y).

Despite the tense geopolitical situation (and in part because of it), Georgia saw an increase in the number of international visitors. In the second quarter of 2022, the total number of international visitor trips increased by 176% y/y – reaching 922,221 visits, which is more than half the total number of international visits registered throughout 2021 ([GNTA, 2022](#)). Although 55% of visitors came from neighboring countries, the increase in visitors from Russia (+411% y/y) and Armenia (+334% y/y) are especially noticeable, and together account for more than a third of these visitors. The increased number of international visitors has



also had a positive effect on revenues from international travelers, which more than tripled in Q2 2022 (compared to Q2 2021) and almost reached the levels observed in the same period of 2019 ([NBS, 2022](#)). Revenue from Russian visitors has nearly quintupled, while revenue from Belarussians has risen ninefold compared to Q2 2021. With an increasing number of Russians and Belarussians coming into the country, a drastic increase in revenue from international travelers can naturally be expected.

By [NBS](#) estimates, the volume of instant money transfers to Georgia amounted to 1.24 billion USD in Q2 2022, recorded as a 112.7% annual increase. Russia was the main contributor to the rise in money transfers, with a 551% annual increase, and amounting to 54% of total remittances. Instant money transfers from Kazakhstan (480% y/y), Kyrgyzstan (347% y/y), Italy (+11% y/y), the USA (9% y/y), and Germany (+43% y/y) also showed positive growth rates in the second quarter of 2022. However, other primary source countries for monetary inflows showed a negative growth trend – Greece (-8% y/y) and Turkey (-5% y/y). Moreover, due to the war, the inflow significantly decreased from Ukraine (-99% y/y).

Foreign direct investment into Georgia amounted to 351.8 million USD in Q2 2022, which is 9.07% higher than the preliminary data from Q2 2021 ([GeoStat, 2022](#)). The majority of FDI was directed towards the energy (21.8%), real estate (21.5%), financial (13.5%), manufacturing (11.5%), and construction (7.6%) sectors.

Public Finances

The total revenue from the general budget amounted to 4.67 billion GEL, a rise of 33.7% y/y ([Ministry of Finance, 2022](#)). This growth was mainly driven by increased profit tax receipts (+254.3% y/y), value added tax (+20.4% y/y), and other revenues (+ 63.1% y/y). Current governmental expenditures increased by 6.4% y/y in Q2 2022 (amounting to 4 billion GEL). Such growth was mainly driven by higher spending on subsidies (21.8% y/y) and the use of goods and services (+11.8% y/y). Additionally, the net acquisition of non-financial assets decreased by -2.5% y/y to 806.8 million GEL in Q2. After the budget surplus observed in Q1, the second quarter was characterized with a budget deficit of 143.6 million GEL, caused by strong fiscal stimulus. However, this deficit is almost 90% below the deficit observed in the same period of 2022.

Central government debt liabilities (which include both domestic and foreign debt) decreased by -5.0% y/y and amounted to 28,1 billion GEL ([Geostat, 2022](#)). Furthermore, the share of foreign debt in total debt equates to 77.9%, which indicates the country's exposure to exchange rate risks.