



POLICY PAPER

The Georgian economy after one year of Russia's war in Ukraine: trends and risks

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ABSTRACT

Throughout the years, regional economic and political crises have been markers for sharp economic downturns in Georgia. Being a small, open economy, housing just 3.7 million people, with over 20% of its territory occupied by Russia, the country typically mirrors the economic fortunes of its closest neighbors and trading partners. This time, however, the situation seems to be different. The Georgian economy has not suffered as much as initially expected and may even have benefited from certain developments after the start of the war. Nevertheless, both economic and political risks for Georgia, the region, as well as the rest of the world remain extremely high. This policy note details the most pronounced and significant economic trends observed within the Georgian economy in 2022, and it assesses the risks the country faces in the context of the ongoing regional war. The policy note does not focus on the current or long-term sovereignty or political risks.

INTRODUCTION

Russia's invasion of Ukraine profoundly impacted the global economy, immediately sending shockwaves around the world. An attack from a country that was once a major energy supplier to Europe on a nation which was one of the top food exporters in the world, sent food and fuel prices spiraling, caused major energy shortages, and generated the prospect of a protracted recession in the United States and across the European Union.

This unprovoked and brutal aggression resulted in nearly universal condemnation and widespread sanctions placed on Russia by the United States, the EU, and other Western allies. The financial sanctions were perhaps the most unexpected and significant of these, having the potential to immediately impact Russia's neighbors, including those that did not formally join the sanctions regime. In addition to sanctions, another major consequence of the war includes the waves of mass migration, particularly from Ukraine but also from Russia and Belarus, to neighboring countries.

At the start of the war, it was expected that the Georgian economy would be severely and negatively impacted for the following reasons:

First, as a former Soviet republic, Georgia historically maintained close economic ties with both Russia and Ukraine. The ties with Russia have weakened considerably in the wake of the 2008 Russo-Georgian war, however they have remained significant. Notably, Russia was the main market for the import of staple foods into Georgia, such as wheat flour, maize, buckwheat, edible oils, etc. Russia and Ukraine were also both important export markets for Georgia – Russia

absorbed around 60 percent of Georgian wine and 47 percent of mineral water exports, while Ukraine was one of the main importers of alcohol and spirits from Georgia (46 percent of Georgia's export). Tourism and remittances are also areas where Georgia is significantly tied to Russia and somewhat to Ukraine. Before the pandemic, in 2019, Russia accounted for 24 percent of all tourism revenues and Ukraine for 6 percent. Remittances from Russia accounted for 16.5 percent of total incoming transfers in 2021.

Second, although the Georgian government predominantly chose to keep a neutral stance on the war (announcing at one point that they would not join or impose sanctions against Russia), the main international financial and trade sanctions were still in effect due to international obligations and close business ties with the West. These factors were moreover reinforced by strong support for Ukraine among the Georgian population, for whom memory of the 2008 Russian invasion of Georgia still remain prominent.

Further to these factors, Georgia is also a net energy importer, and while the dependence on energy imports from Russia is hardly significant, rising prices would affect Georgia profoundly.

THE EXPECTED NEGATIVE IMPACT ON THE ECONOMY AT THE START OF THE WAR

With these considerations, it was expected that economic growth would slow considerably in 2022, with the primary areas of expected negative impact working through the following channels:

Trade: principally via the cost of trade increases, including transportation and logistics disruptions and a slowdown in external demand.

Tourism: via increases in the cost of international and domestic travel, expected decreases in economic activity, and higher food prices affecting hotels and restaurants.

High commodity prices: including food and fuel which were predicted to drive inflation rates upwards, thus impacting the standard of living.

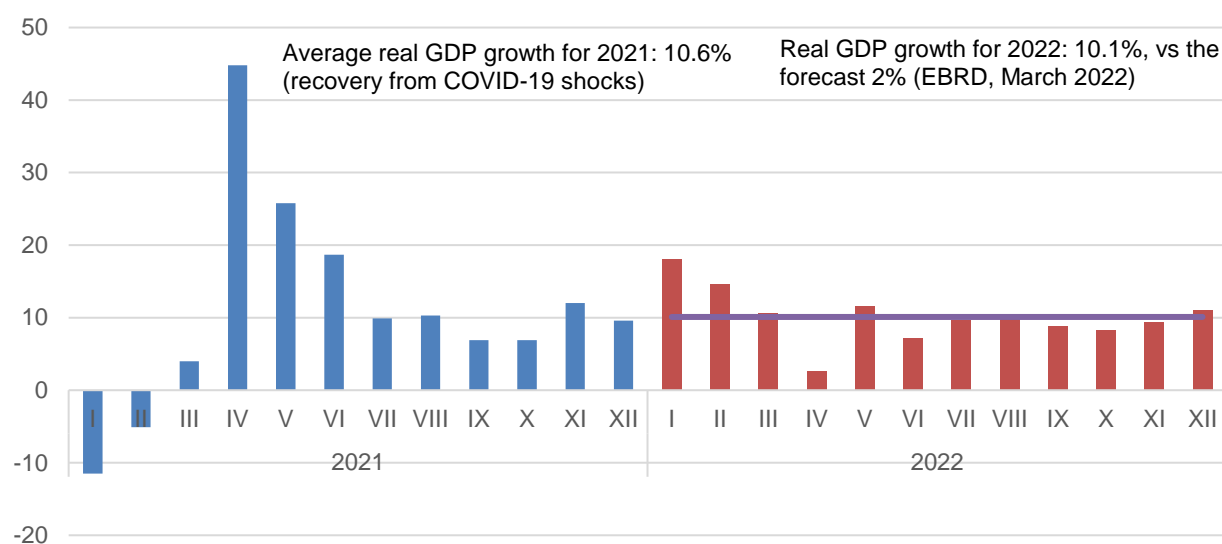
Remittances: via potentially fewer monetary inflows from Russia (the ruble was expected to lose value as well) and the economic slowdown throughout the rest of Europe.

Depreciation of the domestic currency: anticipated because of a slower rate of remittances and other factors which played out during the latest regional currency crisis in 2014. This would result in higher domestic prices on imported goods, adding to inflationary pressures.

However, as the year progressed it became apparent that the downside risks on certain channels would not materialize and in some cases they even reversed. There were also a few surprise developments, which bucked historic trends for Georgia for these types of crises.

MAIN ECONOMIC TRENDS AND THE “SURPRISES” OF 2022

Figure 1. Average real GDP growth, 2022, %



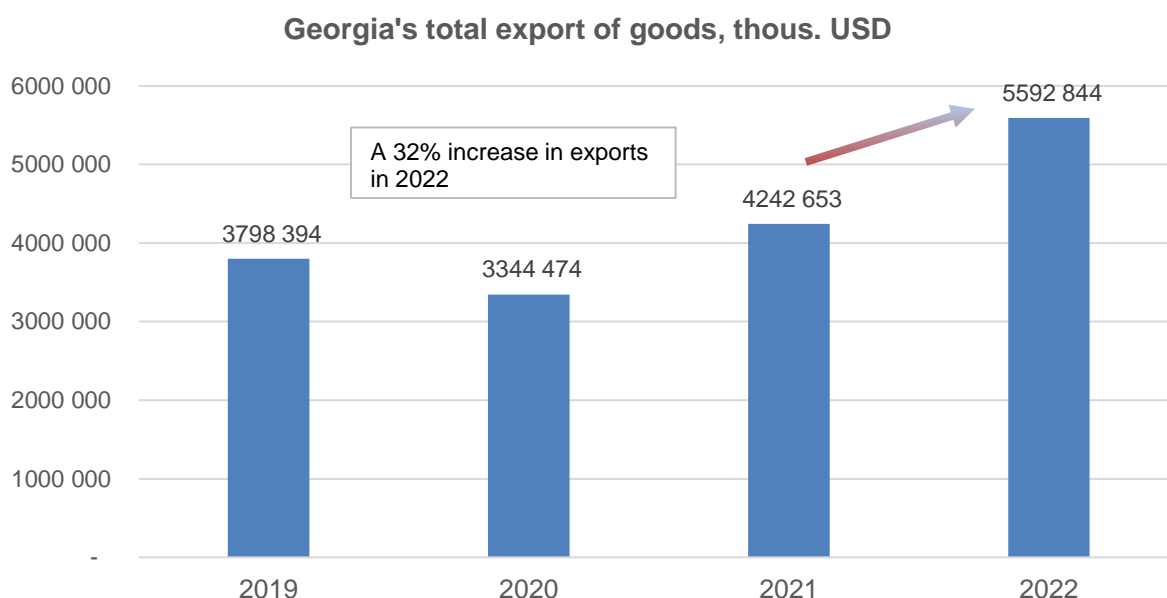
Growth

One of the main “surprises” of 2022 was the much higher than expected GDP growth rate. In March 2022, an EBRD [forecast](#) predicted 2% growth in Georgia (EBRD Regional Economic Update, March 2022), yet the actual preliminary estimates for real GDP growth in 2022 reached 10.1% (Geostat, December 2022).

Trade

Total export growth amounted to 32% in 2022. Much of this growth was driven by trade with CIS countries.

Figure 2. Georgia's total export of goods, 2019-2022.



Trade with all CIS trading partners combined (excluding Ukraine) increased by 44%, the largest increase among all country groups in 2022. Although trade with Russia rose by only 7%, trade with Eurasian Economic Union countries increased quite considerably. For example, annual exports from Georgia to Armenia increased by 128%, to Kyrgyzstan by 201%, and to Kazakhstan by 148%. Much of this represents the re-export of goods from other countries, e.g., cars, equipment, and other goods.¹

¹ Concerns were expressed that Russia could possibly use these trade flows to evade Western sanctions. Currently, publicly available data does not provide evidence to this effect. Authorities in the European Union and the United States are said to be monitoring the situation and investigating whether any unusual increase in trade between EEU countries and the rest of the world might represent sanction evasion mechanisms (Financial Times, [23 February 2022: links](#)).

Figure 3. Georgia’s exports to the largest CIS partner countries, 2019-2022



Remittances

Remittances from Russia have showed an unprecedented increase since the beginning of the war. In 2022, over two billion USD was derived from Russia – four times the amount of the previous year. Russian transfers accounted for 47% of total monetary inflows into Georgia. The initial wave of money transfers, associated with the first wave of migrants from Russia, peaked in May 2022, but it later subsided. The second wave of transfers coincided with Russia’s “partial mobilization” announcement on 21 September, alongside the second wave of migrants. Unlike the first wave of inflows, this second wave thus far shows no signs of abating.

Large money inflows caused significant nominal and real appreciation of the Georgian lari. Throughout the course of 2022, the lari appreciated by nearly 25% in nominal terms and by 15% in real terms. The lari also appreciated against the USD during the year, by 12.5% in nominal terms and 19% in real terms.

Figure 4. Money transfers from Russia, 2022



Migration patterns and their impact on the economy

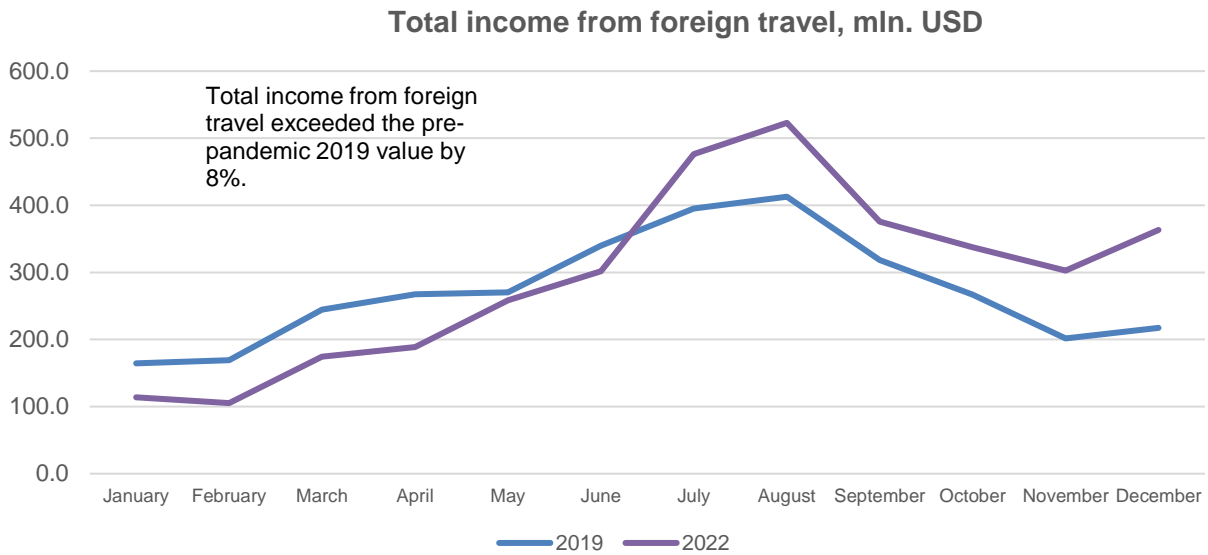
The National Bank of Georgia (NBG) reports that 70-80 thousand more Russians came into Georgia in 2022 than ordinarily expected during peacetime, and they could be considered migrants. This is approximately 3% of the total population, and 6% of the population of Tbilisi and Batumi, the two largest cities.

The revenue from international visitors has correspondingly increased above the pre-pandemic level, yet much of the revenue from international travel is from long-term visitors, such as these Russian migrants.

The number of companies registered by Russian citizens also skyrocketed, at 10 times greater than the previous year – with almost 9,500 new companies recorded between January and September. Half of the companies that have been registered in Georgia by Russian citizens were listed within the last 9 months.

As a result of migration, as well as strong tourist inflows from the rest of the world, the recovery of tourism revenues was stronger than expected (by 183% relative to 2021 and by 8% relative to the strong pre-pandemic performance in 2019). This recovery helped drive Georgia's notable output growth and reduce the current account deficit (for example, in Q3 2022, the current account turned positive for the first time since Q3 2018, and it exceeded the previous record by 387 million USD).

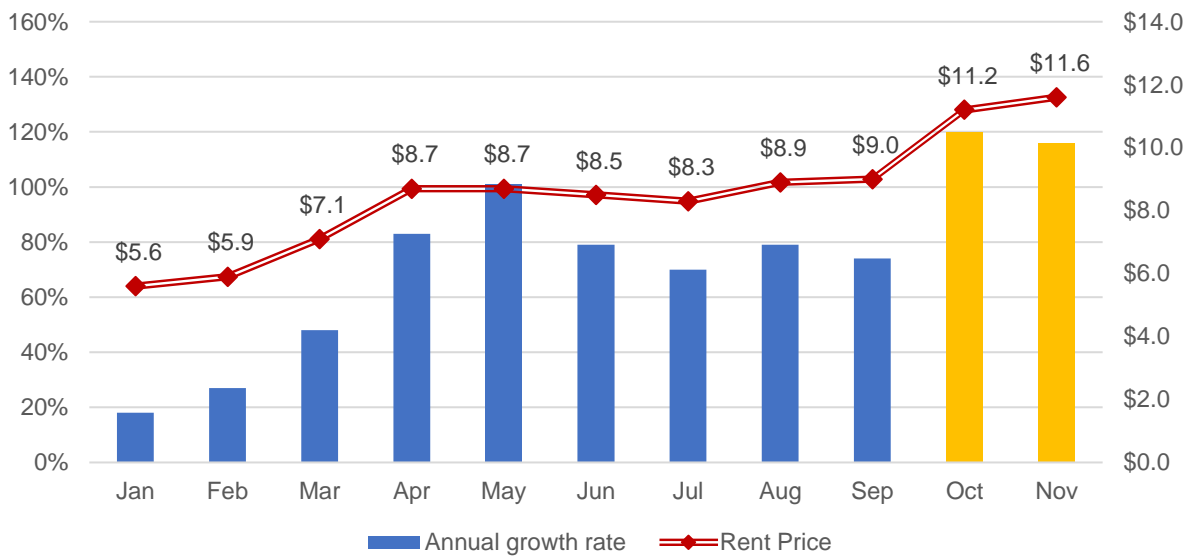
Figure 5. Recovery of income from tourism



Real estate prices

Among the negative effects on the Georgian economy caused by significant migration was the meteoric rise of real estate prices across the major cities. By October 2022, average asking rental prices had risen by 120% annually in Tbilisi, driven by the second wave of Russian migrants.

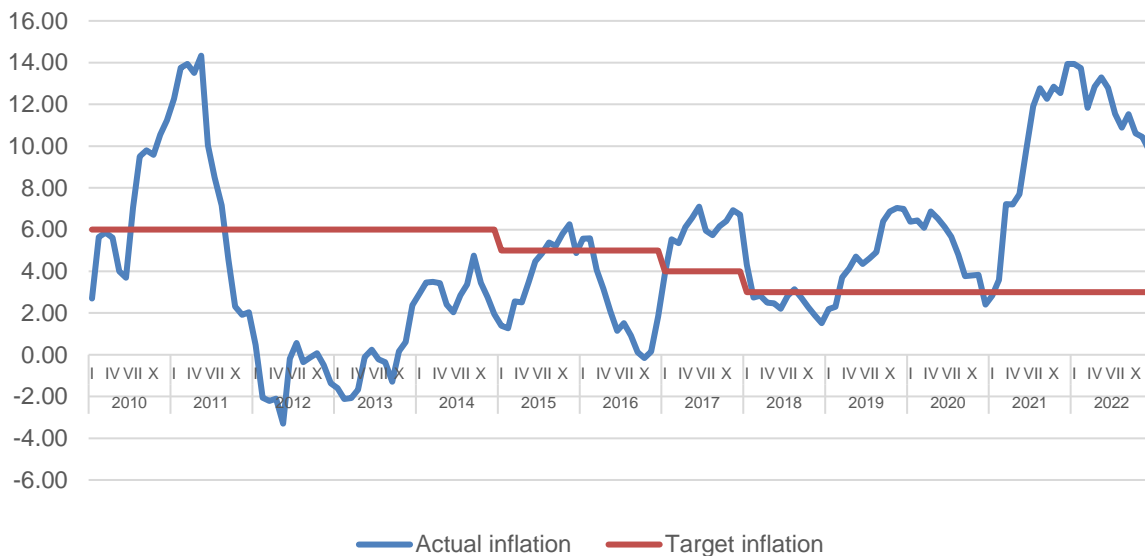
Figure 6. Average asking rental price per SQM in Tbilisi (USD) and the annual growth rate(%).



RISKS FOR THE GEORGIAN ECONOMY

Inflation, food security, and poverty

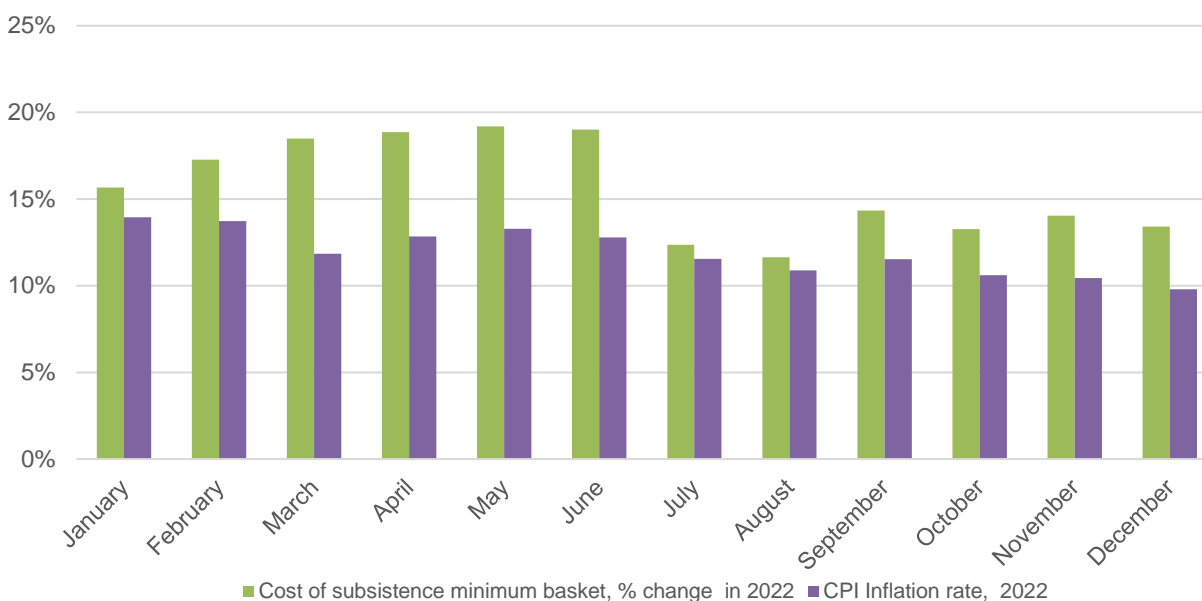
Figure 7. Actual and target inflation rate, 2022, %



Inflation remains one of the most significant risks to the Georgian economy. On a positive note, the rate of inflation has been subsiding since its peak in January 2022. Nevertheless, the contribution of food and fuel to consumer price increases has been significant, thereby impacting food security and potentially the country's poverty rates.

For example, as shown in Figure 8 below, increases in the cost of the minimum subsistence basket of goods were higher than the overall CPI inflation rate, especially between March-June 2022. This signals that price rises were affecting the cost of living for the poorest households more than the CPI inflation rate would suggest.

Figure 8. Increase in the cost of the minimum food basket (subsistence minimum) vs. the CPI inflation rate 2022, %

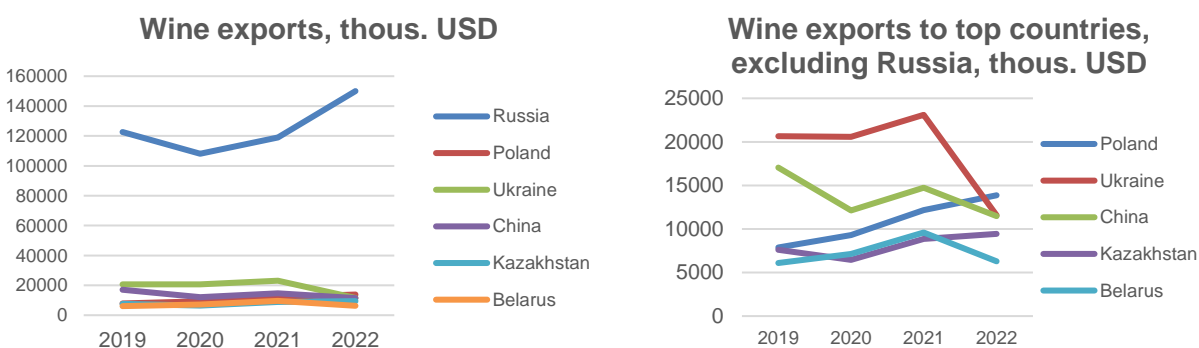


Growing dependency on the Russian market

One major long-term risk to the Georgian economy in 2022 was the growing dependency on the Russian market for one of its most iconic domestic exports – wine. There was significant growth in Georgian wine sales to Russia in 2022: a 26% increase in value and 55% increase in the volume of exports. Unfortunately, this indicates that wine exports to Russia are cheaper than in previous years, corresponding to a 20% decrease in the USD price per unit. This may also suggest a possible decline in the quality of the exported wine.

At the same time, there was only a 7% increase in wine export to Kazakhstan, a 14% rise to Poland, alongside a 22% decrease of the export to China.

Figure 9. Georgian wine exports, 2019-2022




Migration patterns

As noted earlier in the brief, the wave of Russian migrants in 2022 (close to 80,000 between February and October by NBG estimates) is unlike anything Georgia has experienced in recent decades. Therefore, the impacts of these new migrants might prove both positive and negative to the country’s economy. For example, numerous Russian migrants come with substantial financial resources, and many of them work remotely or have independent sources of income. This contributes positively to Georgia’s current account balance. On the other hand, their higher income and wealth drives up the rental and sale prices of real estate, thus pricing out local residents (students, young couples) from the residential real estate market. Other considerations, like the contribution of migrants to certain types of crime, as well as general national security issues driven by the sheer size of the migration from Russia, have to be taken into account. Last but not least, certain impacts on sovereignty and security have not yet been assessed and necessitate long-term vision and potential solutions.

CONCLUSIONS

In 2022, after the start of Russia’s war on Ukraine, Georgia experienced unprecedented economic and social changes. The data reveals that Georgia has thus far been insulated from the worst of the economic shocks that have rocked economies worldwide. However, the country finds itself in a much more precarious situation than just a year ago.

We find that despite strong recovery in GDP growth from external trade, income from foreign travel, and significant capital inflows, the country has also seen a sharp rise in migration, a substantial increase in consumer prices (especially for the poorest cohort of the population), and a huge rise in real estate prices within its major cities.



The government's active policies have to date been aimed at managing the overall health and stability of the country's financial system and managing inflationary expectations, among other issues, with a focus on sustainability. Yet, insofar as migration issues are concerned, the status quo of treating migrants as tourists has effectively been maintained. Given that the Russian war against Ukraine has now entered its second year, with no sign that migrants will soon be in the position to return to Russia, it appears advisable that Georgia reassesses any associated short- and long-term risks, and thereafter makes the necessary adjustments to its migration policies in the interest of the security and sovereignty of the country.

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