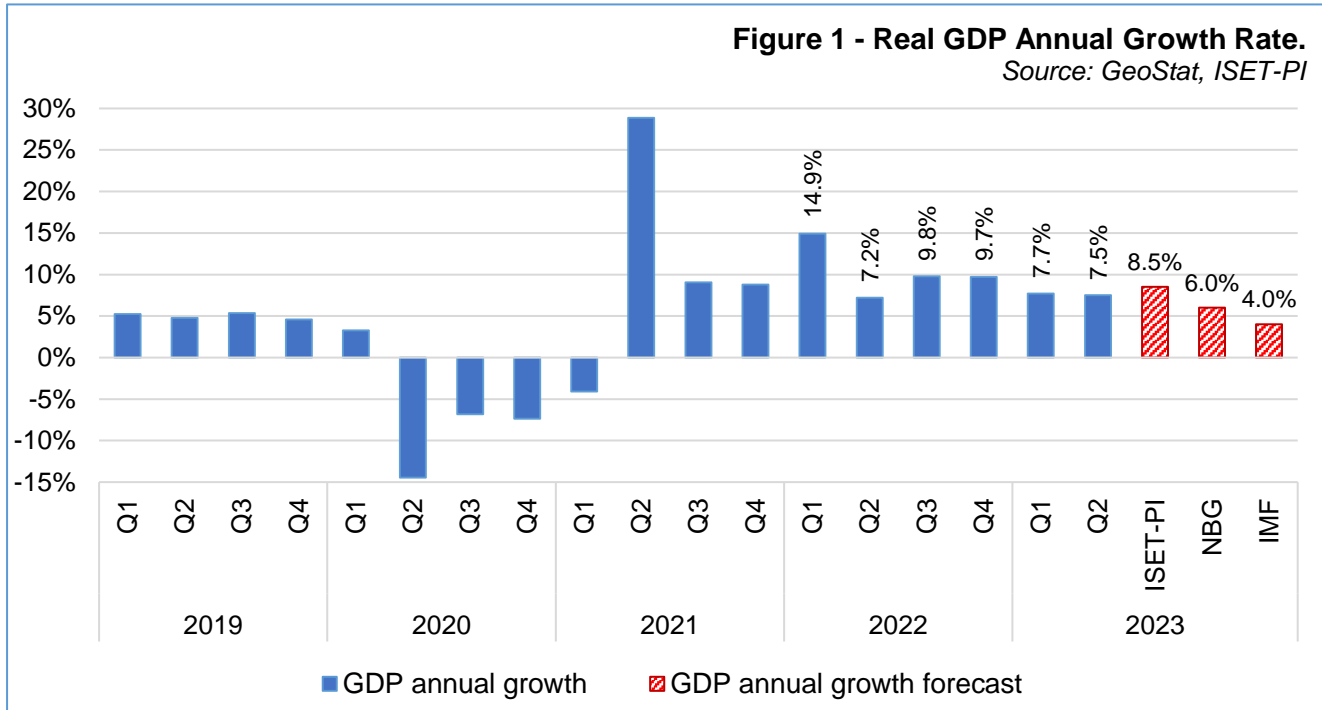




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**ANNUAL ECONOMIC REVIEW: UNPACKING THE SLOWER GDP GROWTH, INFLATION STABILITY, AND CHANGING THE FX STREAM DYNAMICS**



**SUMMARY**

Global economic growth is anticipated to decrease from 3.5 percent in 2022 to 3.0 percent in both 2023 and 2024. In comparison to the April 2023 World Economic Outlook (WEO) projections, there has been a modest 0.2 percentage point improvement in the growth forecast for 2023, while the 2024 projection remains unchanged. It's important to note that this forecast for 2023-24 falls considerably short of the historical annual average of 3.8 percent observed between 2000 and 2019. Furthermore, it lags the historical averages for various income groups when considering both overall GDP and per capita GDP. The decrease in growth from 2022 to 2023 is primarily driven by advanced economies, which are experiencing weaker manufacturing activity and certain unique factors, even though there is stronger performance in the services sector. In contrast, emerging markets and developing economies are expected to maintain relatively stable growth in 2023 and 2024, though there are noticeable variations among regions. On a year-over-year basis, global growth hit its lowest point in the fourth quarter of 2022. However, in some major economies, this decline is not expected to bottom out until the second half of 2023 ([IMF, July 2023](#)).

If we take a close look at the south Caucasus region, Georgia's neighbors are expected to show moderate to weak growth for 2023: [Armenia](#) (+5.5 percent y/y), [Azerbaijan](#) (+3 percent y/y), [Türkiye](#) (+3.0 percent y/y), and the [Russian](#) economy is also expected to show positive 1.5 percent y/y (adjusted from 0.7) growth. The output in emerging markets and developing economies (EMDEs) is expected to grow by 4.0 percent in 2023, and by 4.1 percent in 2024.

[According to GeoStat's latest GDP growth statistics](#), the Georgian economy grew by 7.7 percent and 7.5 percent y/y in the first two quarters of 2023. Moreover, it is expected that improved investment dynamics will persist, hence, the National Bank of Georgia adjusted the real GDP growth expectations for 2023 to 6 percent ([NBG, August 2023](#)), compared to the previous estimate of 5



percent ([NBG, May 2023](#)).

ISET-PI's GDP forecast placed the 2023 annual real GDP growth at 8.5 percent y/y (see Figure 1 above) ([September 2023](#)). However, these numbers may be **overestimated by the model at the current point in time**. This is due to the fact, that Russia's war in Ukraine, sanctions, and large-scale migration had not had relevant analogs in the Georgian data.

## INFLATION

According to recent [GeoStat](#) data, annual inflation in the Consumer Price Index (CPI) stood at 1.6 percent in Q2 2023, 1.4 pp lower than the targeted 3 percent. The influence of external factors on inflation has notably diminished. Specifically, over the past year, global prices for basic food commodities have dropped, and international shipping expenses have nearly returned to their pre-pandemic levels. These factors, coupled with the strengthening of the GEL, have led to a decrease in the prices of imported goods in Georgia. In addition, the combination of a stringent monetary policy and low inflation expectations is playing a substantial role in driving down inflation. To continue with statistics, food prices showed a moderate increase compared to Q1, only 3.1 percent, contributing the highest, 1.0 pp to the annual inflation. Housing, water, electricity, gas, and other fuel prices contributed 0.6 pp to the annual inflation, with the price level increasing by 6.2 percent y/y.

As per the latest projection of NBG ([NBG, September 2023](#)), assuming no significant changes in other factors, inflation is expected to stay below the 3 percent target in the upcoming months of 2023 and is anticipated to remain in proximity to this target over the medium term. It's important to highlight that the short-term trend of inflation remaining below the target level is helping in the normalization of long-term inflation expectations.

## EXTERNAL SECTOR: TRADE, TOURISM, REMITTANCES, FDI

External trade in Georgia is experiencing a resurgence. There are two key factors at play. First, the strengthening of the GEL exchange rate has reduced the competitiveness of the country's exports, resulting in a decrease in domestic exports ([NBG, August 2023](#)). However, on the flip side, there is an increased demand for motor vehicles from neighboring countries, leading to higher re-exports from Georgia. Overall, this increase in re-exports has outweighed the decline in domestic exports, resulting in a significant uptick in the export of goods (14.8 percent y/y) ([GeoStat](#)).

This surge in exports, particularly in real terms, has been primarily driven by heightened demand for consumer goods. In addition, investment goods have also made a modest positive contribution to overall export growth ([NBG, August 2023](#)).

The increase in consumer goods exports is largely attributed to the re-export of motor vehicles, which are not only sold to regional countries but also to Central Asian nations. Georgia has also seen substantial exports of mineral waters, alcoholic beverages, cigarettes-cigarillos, and grape wines. However, there has been a decrease in the export of intermediate goods, mainly due to lower exports of ferro-alloys to the United States and Russia, reduced exports of copper ores and concentrates to China and Bulgaria, and declined exports of chemical fertilizers to Peru and Armenia ([GeoStat](#)). In terms of investment goods, motor vehicles for transporting tractors, motor vehicles for carrying goods, and automatic data processing machines have played significant roles in the overall export growth.

Due to robust economic activity and the strengthened exchange rate of the GEL, the demand for imports has continued to rise. Import of goods experienced an 11.8 percent annual growth in the second quarter of 2023, driven mainly by increased imports of consumer goods, including motor cars, medicaments, and telephone sets. Imports of intermediate goods remained relatively stable. However, purchases of iron and steel structures and glassware were high ([GeoStat](#)).



Imports from regional countries, particularly Turkey (largely due to medicaments), and other nations like Germany, the United States, and Japan (mostly attributed to motor cars), have significantly contributed to the overall import growth. In contrast, imports from Armenia declined due to reduced purchases of copper ores and concentrates.

In the second quarter of 2023, the current account deficit came to USD 363 million ([NBG, BOP-6](#)). This improvement was primarily driven by higher revenues from services, including an increase in income from travelers and a growing volume of remittances from workers abroad. It's important to note that international travel revenues are expected to rise further later in the year. However, the stronger exchange rate of the Georgian Lari is expected to impact competitiveness and result in a trade deficit increase. Taking these trends into account, the current account deficit as a percentage of GDP is expected to reach 5.5 percent ([NBG, August 2023](#)).

With the active tourism season approaching, Georgia has seen a notable increase in the number of international visitors ([GNNTA, 2023](#)). During the second quarter of 2023, the annual growth in international visitor numbers reached an impressive 59 percent y/y. However, it's important to note that these figures still fell short of the same period in 2019, showing a 23 percent decrease y/y. The influx of visitors includes not only migrants from Russia, Belarus, and Ukraine but also an increase in visitors from the European Union (EU), Israel, and India.

The growth in the number of foreign visitors, along with a continued high level of migrant inflow, has resulted in international travel revenues amounting to USD 1 billion in the second quarter of 2023 ([NBG, BOP-6](#)). This represents a substantial annual growth of 34.8 percent. In addition to revenues from visitors from neighboring countries, which were partially due to migration, revenues from visitors from other countries have also been in recovery mode. This includes visitors from Turkey and the EU.

During the second quarter of 2023, instant money transfers to Georgia totaled USD 1.1 million, reflecting a 10.5 percent annual decline ([NBG](#)). This decline is primarily attributed to the base effect. While money transfers from Russia continue to constitute a significant portion, there has been a decline in these transfers, causing an overall slowdown in growth. Notably, transfers from other countries have continued to increase, with contributions from the EU (5.1 pp), the United States (2.5 pp), and Israel (0.4 pp) being the most significant drivers of total growth.

During the second quarter of 2023, foreign direct investments (FDI) were the primary source of financing the current account deficit. FDI saw an annual increase of 30 percent, amounting to USD 506 million. Most of the FDI went into the manufacturing, energy, and retail sectors. ([GeoStat](#)).

## **PUBLIC FINANCES**

The total revenue of the general budget amounted to 5.8 billion GEL, a rise of 24.2 percent y/y that was mainly driven by increased tax collection (+23.9 percent y/y). It should be noted that the collection of tax on goods and services (+13.9 percent y/y), income, profit, and capital gains (32.8 percent y/y) primarily contributed to this growth ([Ministry of Finance of Georgia, 2023](#)).

Current government expenditures also rose by 12.5 percent y/y in the reported quarter (amounting to 4.5 billion GEL). From this expenditure, spending on interest has been increased by 28.7 percent (y/y), and spending on the following categories has also been increased: subsidies (+12.9 percent y/y), use of goods and services (+21.2 percent y/y), and compensation for employees (20.4 percent y/y). In addition, the net acquisition of non-financial assets increased by 50.5 percent y/y, amounting to 1,214.5 million GEL in Q2. The second quarter of 2023 recorded a budget surplus of 77.4 million GEL. Governmental debt increased by 4.4 percent from 27.7 billion GEL and amounted to 29.0 billion GEL. The share of foreign debt in the total figure stood at 73.2 percent indicating the higher exposure of the Georgian economy to exchange rate volatility ([Ministry of Finance of Georgia, 2023](#)).