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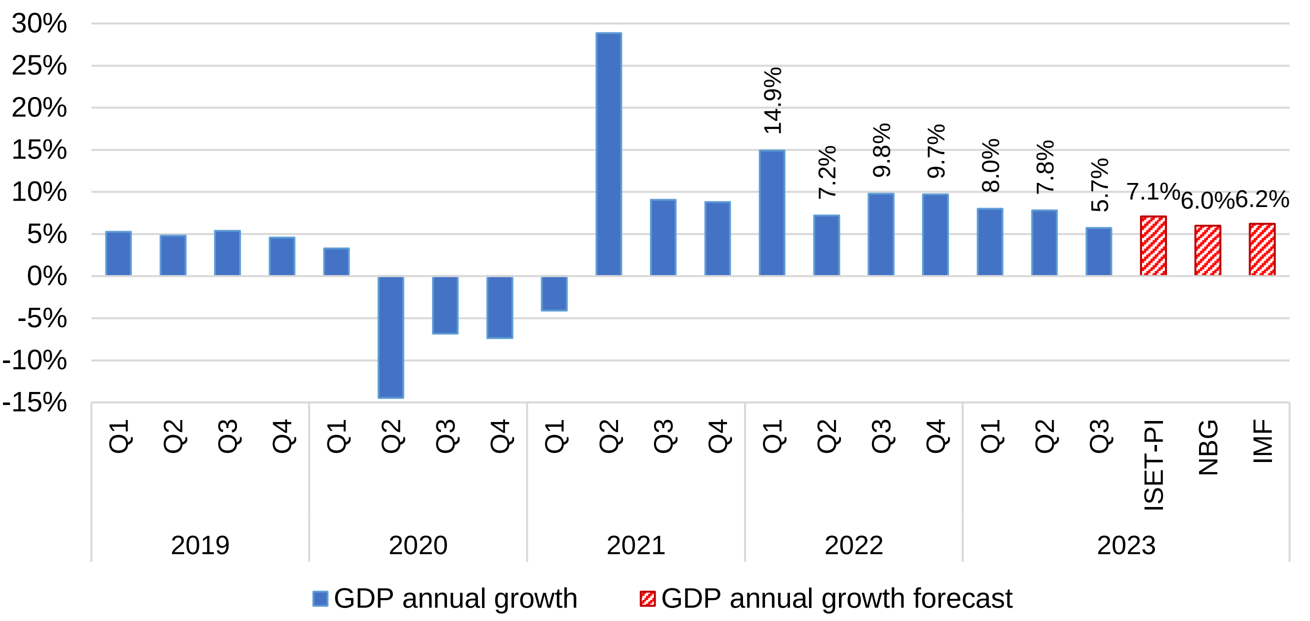
ECONOMIC LANDSCAPE IN GEORGIA: NAVIGATING GROWTH AMIDST GLOBAL UNCERTAINTIES AND REGIONAL DYNAMICS

Figure 1 - Real GDP Annual Growth Rate.

Source: GeoStat, ISET-PI



SUMMARY

The global recovery from both the COVID-19 pandemic and Russia's invasion of Ukraine is progressing slowly and unevenly. While there was initial economic resilience earlier in the year, marked by a rebound in reopening and efforts to reduce inflation, it is premature to feel reassured. Economic activity has yet to fully return to pre-pandemic levels, particularly in emerging market and developing economies, and regional disparities are widening. Various factors are impeding the recovery, including the enduring effects of the pandemic and the war in Ukraine, as well as increasing geoeconomic fragmentation. Additionally, cyclical challenges, such as the impact of necessary monetary policy tightening to curb inflation, the withdrawal of fiscal support amid high debt levels, and extreme weather events, contribute to the complexities of the global economic landscape. IMF World Economic Outlook projects that the anticipated global growth is expected to decelerate, decreasing from 3.5 percent in 2022 to 3.0 percent in 2023 and further to 2.9 percent in 2024. These forecasts fall below the historical average of 3.8 percent observed in 2000-2019 (IMF, October 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 (+7.0 percent y/y), Azerbaijan (+2.5 percent y/y), Türkiye (+4.0 percent y/y), and the Russian economy is also expected to show positive 2.2 percent y/y (surged from 1.5%) growth. The output in emerging markets and developing economies (EMDEs) is expected to grow by 4.0 percent in 2023, as well as in 2024 (adjusted from 4.1%) (IMF, October 2023).

According to GeoStat's latest GDP growth statistics, the Georgian economy grew by 5.7 percent in the third quarter of 2023. Moreover, it is expected that improved investment dynamics will persist, hence, the National Bank of Georgia sticks with the previous real GDP growth expectations for 2023

as 6 percent (NBG, August 2023).

ISET-PI's GDP forecast placed the 2023 annual real GDP growth at 7.1 percent y/y (see Figure 1 above) (November 2023) downgraded from the October forecast's 8.5 percent (October 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 0.6 percent in Q3 2023, 2.4 pp lower than the targeted 3 percent. The influence of external factors on inflation has notably diminished. The stability in inflation levels was achieved through a decrease in the prices of imported goods, experiencing deflation of 4.1% and 2.9% for imported and mixed goods, respectively, in September. Although domestic inflation remains relatively high, reaching 5.3% in September, it is gradually decreasing. This reduction is influenced by the diminishing impact of the base effect related to certain services and food items.

Robust external monetary inflows lead to the appreciation of both the nominal and real Georgian Lari (GEL) exchange rates. The strengthened Lari, coupled with declining international commodity prices, has resulted in a reduction in the prices of imported goods in Georgia (NBG, October 2023). However, according to the Commodity Markets Outlook, the recent conflict in the Middle East has introduced uncertainty into commodity markets, already dealing with various shocks. Before the conflict, intentional oil supply reductions led to a 9% increase in energy prices, pushing the World Bank's commodity price index 5% higher, standing at a 45% increase from 2015 to 2019. Presently, the conflict has had a subdued impact on commodity prices, with oil and gold experiencing moderate increases while others remain stable. However, there is a significant risk of escalation, potentially causing a surge in commodity prices and worsening global food insecurity. The report suggests that, if the conflict doesn't expand, its impact on commodity prices is likely to be limited, forecasting a slight decline over the next two years. The assessment also considers three risk scenarios in case of escalation, depending on historical precedents for disruptions to global oil supply. Factors like trade restrictions, weather disruptions, and weaker-than-expected global growth pose key downside risks to commodity prices (IMF, October 2023).

EXTERNAL SECTOR: TRADE, TOURISM, REMITTANCES, FDI

In the third quarter of 2023, external demand remained strong, although the growth rate slowed down.

In the third quarter of 2023, there was a 24.5% annual decline in the export of domestic goods. However, the increased external demand for motor cars from regional countries counteracted the overall decline in domestic exports, leading to a modest overall increase in the export of goods, albeit at a slower pace. Meanwhile, due to the appreciated exchange rate and robust economic activity, the import of goods continued to grow, albeit at a reduced rate. The heightened exchange rate has impacted competitiveness negatively, and as a result, it is anticipated that the trade deficit will expand. Additionally, the current account balance is expected to widen due to the decrease in money transfers (NBG, October 2023).

Despite a robust external demand, the growth rate of registered exports of goods experienced a slowdown in the third quarter of 2023, increasing by only 1.6% annually. This deceleration was primarily driven by a decline in domestic exports, particularly in the sales of ferro-alloys and copper ores. Although exports of goods exhibited moderate growth, there was a decline in real terms

(GeoStat).

The increase in exports of consumer goods played a significant role in driving overall export growth, with higher demand for these goods. However, investment goods made a small negative contribution to the overall export growth. The surge in consumer goods exports was notably fueled by the re-export of motor cars to central Asian and regional countries. The rise in exports of medicaments, mixed goods, and alcoholic beverages also contributed significantly (GeoStat).

Conversely, lower exports of intermediate goods were observed, primarily due to decreased exports of ferro-alloys to the US and Russia, reduced exports of copper ores and concentrates to China, a decline in exports of mineral fertilizers to Peru, and lower exports of motor cars to Ukraine. The decrease in investment goods exports was led by a decline in exports of other aircraft vehicles and live bovine animals, playing a pivotal role in the overall export decline (NBG, October 2023).

In the third quarter of 2023, the notable growth in imports (16.0 percent y/y) was primarily driven by consumer goods, making the most substantial contribution to the overall increase (NBG, October 2023). This surge in consumer goods imports was largely attributed to heightened purchases of motor cars (particularly for re-export), medicaments, mixed goods, and telephones. The decrease in intermediate goods imports was mainly due to reduced purchases of copper ores, wheat flour, and petroleum gases. However, imports of ferrous semi-products and manganese concentrates saw a significant increase. The rise in imports of investment goods was fueled by heightened purchases driven by increased demand for tractors, motor vehicles for goods transport, and construction motor vehicles (GeoStat).

During the summer season, international travel witnessed significant activity. In the third quarter, there was a 21.0% annual increase in the number of international visitors to Georgia. However, the figures still fell short of the same period in 2019, experiencing a decrease of 16.5%. While there was a slowdown in migrant inflows associated with visitors from Russia, Belarus, and Ukraine, there was an uptick in the number of visitors from the European Union, Turkey, and Kazakhstan (GNTA, 2023).

In the third quarter of 2023, instant money transfers to Georgia totaled USD 872 million, reflecting a 15.1% annual decline (NBG). This decrease is partially attributed to the base effect and the gradual reduction in money transfers from Russia. Since the onset of the war in Ukraine in 2022, money transfers from Russia had been substantial, influenced by both capital inflows and increased migrant inflows. As anticipated, these transfers have gradually decreased. Despite the ongoing annual decline in money transfers from Russia, contributing to an overall slowdown, transfers from other countries experienced a significant increase. Notably, transfers from the European Union (6.5 percentage points), the United States (3.4 percentage points), and Kazakhstan (2.1 percentage points) made substantial positive contributions to the overall growth during this period (NBG, October 2023).

During the third quarter of 2023, foreign direct investments (FDI) emerged as the primary source of financing for the current account deficit. Inward FDI exhibited a substantial annual increase of 30%, reaching USD 506 million. The predominant portion of FDI took the form of increased reinvestments in the finance and energy sectors, although there was a decline in annual investments in the real estate and construction sectors (GeoStat).

PUBLIC FINANCES

The total revenue of the general budget amounted to 5.4 billion GEL, a rise of 24.2 percent y/y that was mainly driven by increased tax collection (+21.7 percent y/y). It should be noted that the collection of tax on international trade & transactions (+22.0 percent y/y), income, profit, and capital gains (+17.2 percent y/y) primarily contributed to this growth (Ministry of Finance of Georgia, 2023).

Current government expenditures also rose by 17.2 percent y/y in the reported quarter (amounting to 4.7 billion GEL). From this expenditure, spending on interest has been increased by 70.1 percent (y/y), and spending on the following categories has also been increased: subsidies (+24.1 percent y/y), social benefits (+23.3 percent y/y), and compensation for employees (20.3 percent y/y). In addition, the net acquisition of non-financial assets increased by 24.9 percent y/y, amounting to 1,557.8 million GEL in Q3. The third quarter of 2023 recorded a budget deficit of -834.5 million GEL. Governmental debt increased by 2.2 percent from 29.0 billion GEL and amounted to 29.6 billion GEL. The share of foreign debt in the overall figure stood at 73.0 percent, signaling a heightened vulnerability of the Georgian economy to fluctuations in exchange rates (Ministry of Finance of Georgia, 2023).