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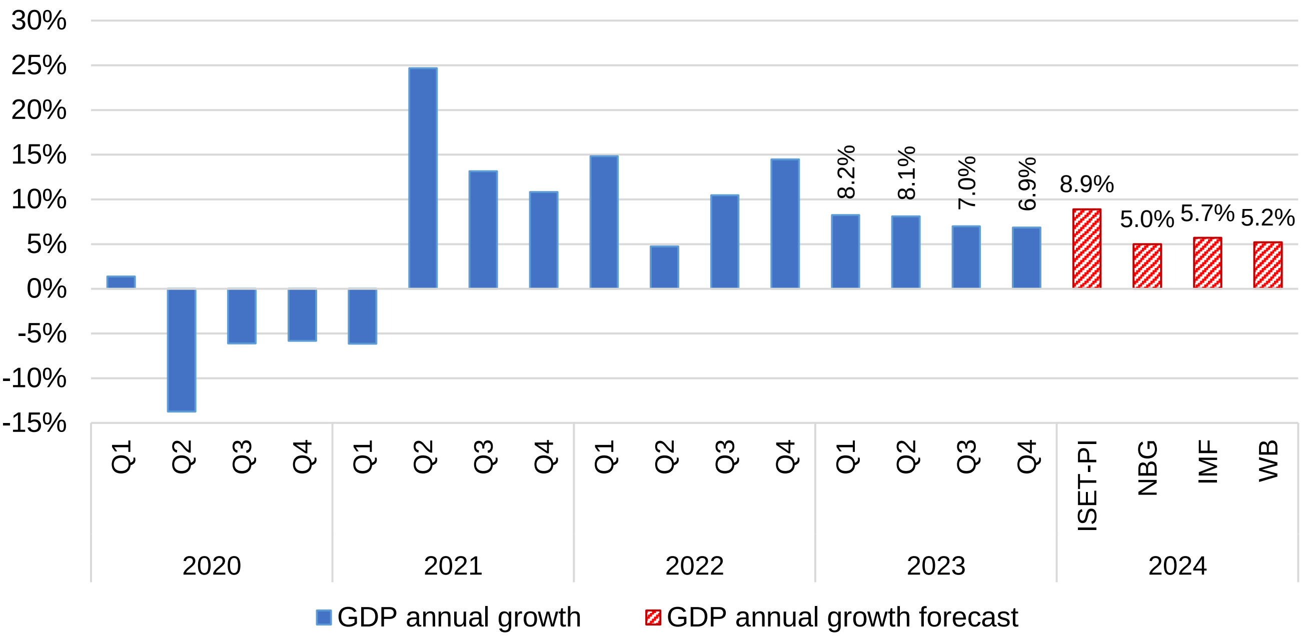
GEORGIA'S ECONOMIC RESURGENCE: GDP GROWTH EXCEEDS FORECASTS AMID GLOBAL SLOWDOWN

Figure 1 - Real GDP Annual Growth Rate.
Source: GeoStat, ISET-PI



SUMMARY

Similar to the year 2022, Georgia stayed on the path of economic recovery from COVID-19 in 2023 as well. According to GeoStat's preliminary estimates, the real GDP continues to show a relatively high growth rate, measuring at 7.5% y/y in 2023 – which is remarkably higher than the NBG's real GDP growth expectation of 6% from October 2023. In 2023, the global economy faced a slow-paced recovery due to high inflationary pressures and a tight financial environment, exacerbated by a challenging geopolitical situation. However, in Georgia, despite a slowdown in goods exports due to weak external demand in the fourth quarter, the economy remained robust. This was largely due to solid growth in travel revenues and strong domestic demand.

The Lari exchange rate strengthened, and as a result, the current account deficit deepened only slightly. Headline inflation remained low, thanks to the relative stability of international commodity prices and the maintenance of a tight monetary policy. Inflation in Georgia saw a significant decrease in 2023, reaching 0.4% by the end of the year. This decline was primarily due to the import component of inflation. Despite the tight monetary policy, robust aggregate demand exerted an opposing influence on domestic prices.

According to the baseline scenario, excess demand is expected to fully normalize throughout 2024, accompanied by only a gradual reduction in the monetary policy rate. This is anticipated to contribute to the stabilization of inflation around its target rate in the medium term (NBG, January 2024).

In the alternative scenario, which considers the recent robust growth in lending, strong demand may elevate the pressure on consumer prices to some extent. In response to this, the National Bank of Georgia will pause the monetary policy rate reduction process and, depending on credit activity, may

even resume a tightening cycle.

Compared to the increasing unemployment in 2021, the unemployment rate in 2022 fell to 16.4% - the lowest in the period of the last 16 years (Geostat). Average annual labor force participation has also increased by 1.4 pp, reaching 53.3%. Based on Geostat's preliminary estimate, in the fourth quarter of 2023, average monthly nominal earnings reached 2044.5 GEL.

In conclusion, in 2023, **Georgia experienced strong economic growth, with real GDP expanding by 7.5%, surpassing expectations. Despite global economic challenges, inflation decreased significantly to 0.4%, primarily driven by import components, while domestic demand remained robust. External inflows experienced moderation due to weak external demand, although this was partially offset by decreased imports, contributing to a relatively stable current account deficit.**

INFLATION

In 2023, amidst a challenging global geopolitical situation, the global economy faced a slow-paced recovery due to high inflationary pressures and a tight financial environment. However, in Georgia, despite a slowdown in goods exports due to weak external demand in the fourth quarter, the economy remained robust. This was largely due to solid growth in travel revenues and strong domestic demand.

Inflation in Georgia saw a significant decrease, reaching 0.4% by the end of the year (December 2023) (Geostat). This decline was primarily due to the import component of inflation, while robust aggregate demand, despite the tight monetary policy, exerted an opposing influence on domestic prices. The Lari exchange rate strengthened, and as a result, the current account deficit deepened only slightly. Headline inflation remained low, thanks to the relative stability of international commodity prices and the maintenance of a tight monetary policy.

In the fourth quarter of 2023, the GEL exchange rate remained appreciated on a year-on-year basis; however, it depreciated against both the US dollar and the euro by 2.8% and 1.6% respectively compared to the previous quarter. The GEL depreciated against the Russian Ruble by 4.3%, however, it appreciated by 3.4% against the Turkish Lira. As a result, in the same period, the nominal effective exchange rate depreciated by 1.3% quarterly and appreciated by 16.3% on an annual basis. In terms of the price-adjusted exchange rate, in the fourth quarter of 2023, the real effective exchange rate depreciated by 3.2% quarterly and appreciated by 3.7% on a year-on-year basis. The annual appreciation was due to the appreciation of the nominal effective exchange rate. However, the reduced competitiveness of the economy due to the nominal appreciation of the Lari was balanced to a larger extent by the fact that the increase in consumer prices in Georgia was lower than those in its trading partners.

Despite the above-mentioned predictions, in terms of its inflationary risks, credit growth will still need to be closely watched in the coming periods to ensure that the reinforcement of overall spending does not exert pressure on consumer prices. Furthermore, amidst the challenging global geopolitical situation, prices on international commodity markets continue to exhibit high volatility. There has also recently been an increase in uncertainty surrounding international transportation. However, as mentioned earlier, the inflation forecast for 2024 has decreased, leading to a reduction in overall inflationary risks over the medium term.

Consequently, at the current stage, the National Bank of Georgia has gradually reduced the policy rate to 8%. It is also worth noting that the European Union granting Georgia candidacy status for membership resulted in a decrease in Georgia's sovereign risk premium, which is also expected to be reflected in the neutral policy rate. The policy stance thus remains tight, and the projected interest rate trajectory still indicates the need for only a gradual exit from the tight policy stance. Likely, the policy rate will only return to its neutral level (of 6.5-7%, according to current estimates) in parallel with a significant reduction of the geopolitical risks (NBG, January 2024).

EXTERNAL SECTOR: TRADE, TOURISM, REMITTANCES, FDI

During the last quarter of 2023, weak external demand led to a moderation in external inflows. This was primarily due to a decline in domestic exports in response to the lower external demand. Concurrently, the demand for motor cars has been decreasing in recent months, leading to a slowdown in re-exports. Instant money transfers, which had surged since the outbreak of war in Ukraine in 2022, have started to approach pre-conflict levels in recent months. However, overall money transfers remain significantly higher than before the migration wave, largely driven by increased transfers from the US and EU. The moderation of external inflows was offset by weaker imports of goods, and the current account deficit is expected to widen only slightly according to recent forecasts.

In the fourth quarter, weak external demand was primarily reflected in a decline in domestic exports, including copper ores, wines, and chemical fertilizers. The appreciated Lari exchange rate has led to a decline in trade competitiveness, resulting in an overall decrease in exports. Nominal exports of goods remained largely unchanged annually in the fourth quarter of 2023, while real exports moderately declined. Consumer goods constituted a major part of goods exports, while investment goods made up only a small part of total exports. The increase in consumer goods exports was mainly driven by re-exports of motor cars, which were also resold to Central Asia, in addition to regional countries. The volume of exports of alcoholic beverages, medicaments, various fruits, and manufactured tobacco also increased (GeoStat).

The recovery of international tourism continued in 2023, and the number of incoming visitors to Georgia remained high. However, partially due to the base effect, the number of visitors decreased by 1.5% annually in the fourth quarter, amounting to 1.5 million visitors. In line with the rising number of visitors, revenues from international travel have been continuously increasing in recent years. However, due to the base effect and the deceleration of migration inflows, revenues from international travel declined by 12.6% annually in the last quarter of 2023, amounting to USD 874 million. With the exception of Turkey, revenues from visitors from regional countries, the EU, and other countries also continued to recover (GNTA, 2023).

In the fourth quarter of 2023, instant money transfers to Georgia amounted to USD 884 million, reflecting a 43.3% annual decline (NBG). This was partially related to the base effect and a gradual decline in money transfers from Russia. Since the beginning of the war in Ukraine in 2022, money transfers from Russia have been high, a result of both capital inflows and increased migrant inflows. In 2023, as had been expected, such transfers gradually declined. This induced an overall slowdown of money transfers, although transfers from other countries rose significantly, with the largest positive contributions to total growth in this period being made by transfers from the EU (3.2 pp), the US (2.3 pp), and Kazakhstan (1.1 pp).

The demand for imports of goods moderately declined. In the fourth quarter, such imports decreased by 2.7% annually, which was induced by a slowdown of prices on global markets (for food as well as energy). Consequently, expenses on import goods were substantially lowered. Due to the beginning of a slowdown of prices on commodity markets, nominal imports of goods were low. However, due to lower prices, imports of goods in real terms increased by 11% in the fourth quarter annually (NBG, January 2024).

In the fourth quarter of 2023, imports of intermediate goods made the largest negative contribution to the overall growth of imports. The decline in such imports predominantly stemmed from lower purchases of copper ores and concentrates, as well as petroleum gases; however, imports of rods of non-alloy steel, structures of iron, and immune vaccines all increased. The rise in consumer goods mostly came from higher purchases of motor cars, petroleum and petroleum products, medicaments, and mixed goods. The rise in imports of investment goods stemmed from higher purchases of motor vehicles for the transport of goods, special purpose motor vehicles, and construction motor vehicles (GeoStat).

The decline in imports from regional countries was predominantly related to a fall in imports from Russia (mostly petroleum and petroleum products) and Armenia (copper and precious metals ores and concentrates). Meanwhile, imports from other countries also fell, including from Ukraine (automatic data processing machines and units) and the United Arab Emirates (telephone sets). In contrast, imports from the US rose due to higher purchases of motor cars, while those from Bulgaria rose mostly due to petroleum products.

In the third quarter of 2023, mostly due to the active tourism season, the current account balance was positive and amounted to USD 164 million, which is 2.0% of GDP. However, the current account surplus was USD 172 million lower annually as a result of a widening trade deficit and the slowdown of money transfers. The volume of remittances and revenues from exports continued to moderate in the fourth quarter of 2023 along with lower imports of goods. Thus, in overall terms, like in the previous year, the current account deficit is expected to be at a lower level in 2023.

In the third quarter of 2023, the main source of financing the current account deficit was foreign direct investments (FDI). Inward FDI, partially due to the base effect, declined by 61% annually and amounted to USD 316 million. In overall terms, FDI comprised around 3.9% of GDP. The main reason for the decline of FDI was the reduction of debt instruments and reinvestment. Equity investments accounted for the largest part of FDI, while the majority of FDI went to the finance and insurance sectors (GeoStat).

PUBLIC FINANCES

According to the Ministry of Finance, current governmental expenditures amounted to 16,928 million GEL in 2023, showing a 10.3% y/y increase compared with the previous year. This growth was mainly driven by higher spending on social benefits (+12.5% y/y) and use of goods and services (+14.3% y/y), also remarkable was percent growth (+58.3% y/y). At the same time, total revenues to the general budget amounted to 18,716 million GEL, a 13.8% y/y increase. The latter was driven by the increased volume of Value Added Tax collection (12.6% y/y), revenues from Personal Income Tax (15.5% y/y), and profit tax (10.4% y/y). Overall, the budget deficit in 2023 amounted to 1,981.1 million GEL (2.5% of GDP)—showing almost no change from the previous year (Ministry of Finance of Georgia, 2023).

Central Government debt liabilities (which includes both domestic and foreign debt) increased by 10.1% y/y and amounted to 32,482.2 million GEL in Q4, 2023 (39.3% of GDP). Furthermore, the share of foreign debt in total debt decreased by 2 pp and stood at 73%, slightly decreasing the country's exposure to exchange rate risk.