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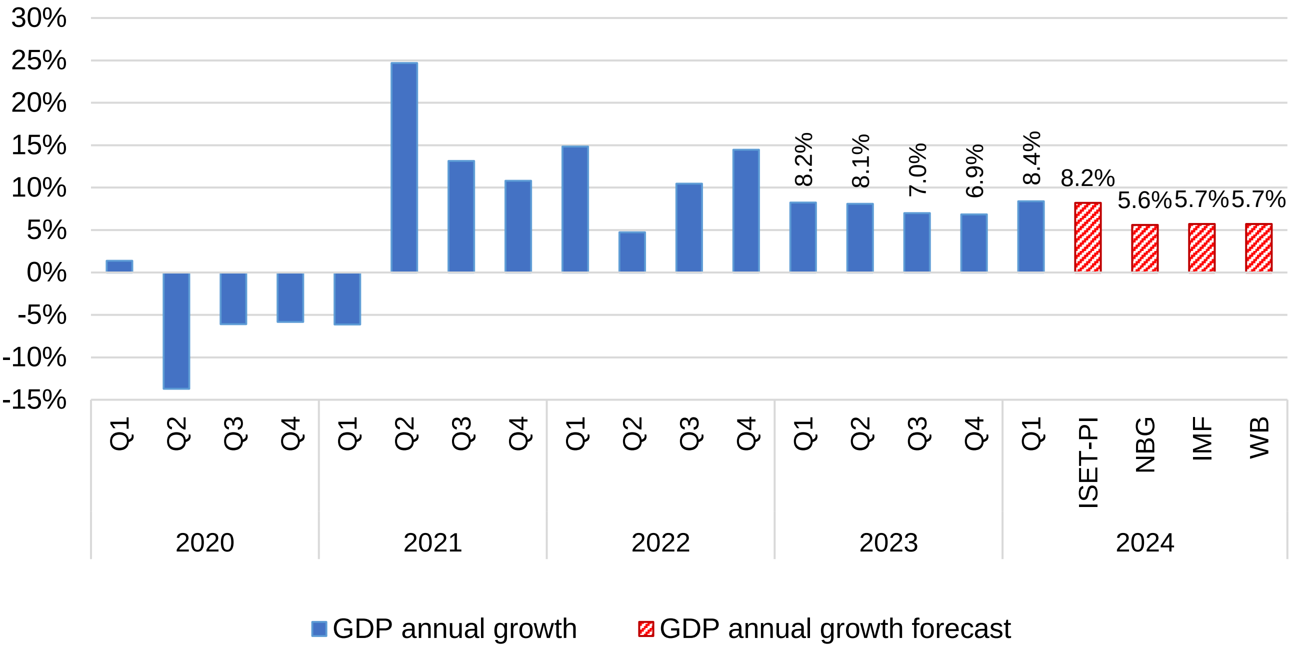
GEORGIA'S ROBUST GROWTH AMID GLOBAL RECOVERY CHALLENGES

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



SUMMARY

According to GeoStat's preliminary estimates in the first quarter of 2024, Georgia's nominal GDP reached GEL 18,913.2 million, with a year-over-year real GDP growth of 8.4% and a GDP deflator change of 3.1%. The growth was driven by significant increases in value-added across various sectors: Real estate activities rose by 18.8%, Education by 29.1%, Public administration and defense, including social security, by 13.0%, Construction by 10.3%, Information and communication by 12.2%, and Transportation and storage by 9.7%. Conversely, there was a decline in value-added in electricity, gas, steam, and air conditioning supply by -11.6%, Other service activities by -11.2%, and Mining and quarrying by -1.8%. Trade accounted for the largest GDP share at 13.5%, followed by Real estate activities at 11.1%, Manufacturing at 9.2%, Public administration at 8.3%, Construction at 7.5%, Education at 6.6%, Financial and insurance activities at 6.0%, and Information and communication at 5.9%. The projected real GDP growth for 2024 from NBG is 5.6%, which is slightly below the IMF and WB projection of 5.7% y/y growth (Figure 1).

In 2023, Georgia's economic growth was primarily fueled by strong domestic demand. Conversely, foreign demand waned, contributing negatively to growth in the fourth quarter due to the diminishing migration effect. The previous year's surge in migration had significantly boosted traveler revenue, with service exports soaring by 87.9%. However, the growth rate of income from travelers fell in 2023 because of the base effect and a reduction in migrant numbers. Despite this, structural changes in the economy, particularly a rise in information and computer service exports from 0.4% to 2.6% of GDP, helped offset the decline and propelled the economy's overall potential.

In the first quarter of 2024, the Georgian Lari (GEL) appreciated compared to the previous year, driven by a robust nominal effective exchange rate. This was offset by Georgia's relatively lower consumer price inflation, which helped maintain its economic competitiveness. GEL's real effective exchange rate appreciation is attributed to deep-seated changes in the current account structure, not merely to short-term economic cycles. These changes, which began with the Russia-Ukraine conflict in 2022, are reflected in the increased service exports from Georgia, particularly in the IT and transportation sectors. The country's strategic position as a transit hub has also led to a surge in cargo and logistics services, indicating that GEL's exchange rate may stabilize without significant depreciation.

Georgia's stringent monetary policy has effectively curbed inflation expectations, bringing domestic inflation closer to the target level. The decrease in service prices has been a significant factor in this reduction, alongside the diminishing effect of previously increased apartment rental costs due to a surge in foreign visitors. These factors have collectively contributed to a more stable inflation rate, aligning with the country's monetary goals (NBG, May 2024).

Compared to the increasing unemployment in Q1 of 2023 (18%), the unemployment rate in Q1 of 2024 fell to 14% (Geostat). Average annual labor force participation has also increased by 3.0 pp, reaching 55.0%. Based on Geostat's preliminary estimate, in the first quarter of 2024, average monthly nominal earnings reached 1943.4 GEL.

In conclusion, **Georgia's economy in the first quarter of 2024 has shown robust growth with a notable increase in nominal GDP and real GDP growth. This positive trend is reflected across various sectors, particularly in real estate, education, and public administration. Despite a decline in foreign demand, domestic demand remains strong, and the Georgian Lari has appreciated, supported by structural changes in the economy and a strategic position in regional trade.**

INFLATION

Since the start of the year, inflation in Georgia has remained below its anticipated target and previous projections (GeoStat). This trend has led to a decline in inflation expectations, alongside an improved current account deficit and an increase in the real exchange rate of the Georgian Lari. The latest forecast suggests that inflation will average around **1.5%** for 2024, which is significantly lower than earlier estimates. Despite this, the strong economic performance is expected to continue, with real GDP growth projected at **5.6%** for the year. Consequently, while the initial stages of monetary policy normalization have been somewhat hastened due to lower inflation expectations, it is anticipated that any further normalization will proceed cautiously. This cautious approach is influenced by the potential risks arising from increased demand and ongoing uncertainties in both local and global geopolitical landscapes, which could lead to inflation rates exceeding the current forecast (NBG, May 2024).

In the first quarter of 2024, the Georgian Lari (GEL) experienced a year-on-year appreciation, influenced by a stronger nominal effective exchange rate. This appreciation was balanced by Georgia's lower consumer price increase compared to its trading partners, mitigating potential negative effects on economic competitiveness.

The appreciation of the GEL's real effective exchange rate is seen as a result of not just short-term cyclical factors but also significant structural shifts in the current account, particularly since the onset of the Russia-Ukraine conflict in 2022. These shifts are evident in the growth of Georgia's service exports, especially in the information, computer, and transport sectors, bolstered by an influx of skilled migrants and the country's enhanced role as a key transit hub in the Middle Corridor. This strategic position has led to a notable rise in cargo turnover and logistics services exports through Georgia, suggesting that the normalization of the GEL's exchange rate might not necessitate substantial nominal depreciation.

Specific currency movements in the first quarter of 2024 included a 0.9% depreciation of the GEL against the US dollar and a 0.1% appreciation against the euro. The GEL appreciated by 8.5% against the Turkish lira but depreciated by 1.0% against the Russian ruble. Overall, the nominal effective exchange rate of the GEL appreciated by 1.9% quarterly and 13.1% annually. However, the real effective exchange rate saw a 1.3% quarterly depreciation but a 0.6% annual appreciation, primarily due to its real appreciation against the Russian Ruble (NBG, May 2024).

In the first quarter of 2024, Georgia's monetary policy led to a downward trend in national currency interest rates. **Deposit interest rates** in the national currency fell by **0.3 percentage points** to **10.5%**, while foreign currency deposit rates rose to **2.3%**. **Lending rates** also decreased, with mortgage and corporate loans in the national currency seeing a reduction, influenced by the cut in the monetary policy rate. The average interest rate for corporate loans dropped by **1.9 percentage points** from the previous year to **11.9%**.

Despite a rise in interest rates for foreign currency loans in 2023 due to global financial tightening, rates began to decline in 2024. The gap between local and foreign rates has lessened. Post-policy easing in March, rates for consumer, business, and mortgage loans all saw a decrease. Business loan demand grew in Q1 2024, and lending conditions for such loans in the national currency softened. The banking sector anticipates further mild relaxations in lending conditions for the upcoming quarter for both local and foreign currency loans.

Georgia's tight monetary policy has led to a decline in inflation expectations since last year, with domestic inflation stabilizing near the 3% target. As of April, inflation was at 2.5%, mainly due to long-term factors and expectations. Service prices, contributing 2.9 percentage points to the change, have been decreasing since early 2023, helping to lower overall inflation. The impact of higher apartment rental costs, linked to an influx of foreign visitors last year, has lessened, now adding only 0.06 percentage points to service inflation.

Imported goods prices, which had been falling since early 2023, thus reducing imported inflation, rose by 3.5% in April, largely due to higher fuel prices amid increasing global oil prices. Shipping costs, which spiked due to tensions in the Red Sea region at the end of the previous year, decreased steadily until the end of April but surged again in early May. While the immediate risk of these transportation costs affecting product prices has diminished, the recent uptick in shipping prices is still a concern that could influence future inflation (NBG, May 2024).

EXTERNAL SECTOR: TRADE, TOURISM, REMITTANCES, FDI

At the start of 2024, Georgia faced a decline in external demand, leading to a significant drop in foreign currency inflows and domestic exports. The demand for motor cars and their re-exports also slowed down. Migration effects diminished, with reduced revenues from Russia, Belarus, and Ukraine due to a base effect and migrant outflow. However, import expenses decreased, and structural economic changes positively impacted on the current account balance, particularly through rising service exports in the information, computer, and transport sectors. Consequently, the current account deficit improved to a historic low of 4.3% of GDP in 2023.

In Q1 2024, despite the weak external demand and reduced trade competitiveness due to an appreciated Lari exchange rate, exports of goods fell by 9.3% nominally and 8.9% in real terms. The decline was mainly in intermediate goods, notably copper ores and concentrates re-exports, affected by China's reduced demand from its slowing construction sector. Ferro-alloy exports remained low due to price drops, with minimal sales to Turkey, Egypt, and the USA. Exports of chemical and mineral fertilizers to India and Peru also declined.

Conversely, re-exports of motor cars, particularly to Central Asian countries, supported a modest increase in consumer goods exports, despite a deceleration in growth rate. Additionally, exports of natural grape wines, alcoholic beverages, mineral waters, and medicaments saw an uptick. Investment goods exports fell, primarily due to decreased exports of large transport vehicles and data processing equipment (GeoStat).

In the first quarter of 2024, Georgia saw an **8.6%** increase in international visitors compared to the previous year, yet this was still **13.2%** below the numbers seen before the pandemic. The rise in visitors from Russia, Belarus, and Ukraine, which began with the onset of the Russia-Ukraine conflict in 2022, has since been on a decline. Conversely, visitor numbers from the EU, Türkiye, and Kazakhstan have increased. Despite the higher visitor count, revenue from international travel grew only modestly by **1.5%** annually, reaching **USD 808 million**. This limited growth in revenue is attributed to the diminishing migration effect and the reclassification of some migrants as residents. Nonetheless, revenues from visitors from the EU and other non-regional countries have continued to grow (GNTA, 2024).

During Q1 2024, Georgia received USD 806 million in instant money transfers, marking a 35.8% decrease from the previous year (NBG). This decline is attributed to a base effect and a reduction in transfers from Russia. The initial surge in transfers, linked to a one-time migration influx, has subsided. Nonetheless, despite the downturn in Russian transfers, remittances from other nations, notably the US, Israel, and the EU, have seen a significant uptick, buoyed by stronger economic performance in these regions.

In the first quarter of 2024, despite a vibrant economy, Georgia saw a reduction in the demand for imported goods. The imports decreased nominally and even more so when adjusted for inflation, with a notable drop in the import of motor vehicles intended for re-export contributing to this overall decline (NBG, May 2024).

During the first quarter of 2024, Georgia's import sector saw a significant decrease in intermediate goods, which had the most substantial impact on the overall reduction in imports. This was mainly due to a drop in the importation and re-exportation of copper ores and concentrates, as well as petroleum gases. The decline in copper ore imports, particularly from Armenia for re-export purposes, was notable. Consumer goods, especially motor cars, also saw a marked decrease in imports, influenced by both a decrease in re-exports and new regulations. The introduction of Euro 5 Standards, which prohibits the import of cars made before 2013, has led to a decline in demand for such vehicles, which previously made up a significant portion of car imports. Conversely, there was an increase in the import of investment goods, driven by a rise in the purchase of motor vehicles for transportation and special purposes, also intended for re-export (GeoStat).

In 2023, Georgia's trade deficit expanded due to an increase in goods imports, which outpaced the exports of goods, particularly in the latter half of the year amid weak external demand. However, the country saw a significant rise in service exports, driven by high international trade revenue and structural shifts within the service industry, notably in transportation and IT services. Although wage growth was moderate, employee compensation remained high, contributing positively to the reduction of the current account deficit to a record low of 4.3% of GDP

In 2023, foreign direct investments (FDI) were the primary means of financing Georgia's current account deficit. The FDI inflow decreased by 24% from the previous year, totaling USD 1.6 billion, which represented approximately 3.9% of the country's GDP. This decline was mainly due to a decrease in debt instruments and reinvestments. Notably, equity investments constituted the most significant portion of FDI, with the manufacturing and finance sectors receiving the bulk of these investments. The current account balance saw an improvement in 2023, largely attributed to a significant increase in savings, even though investment growth was only moderate. In the first quarter of 2024 FDI accounted to USD 201.5 million, which represents 1.07% of the Q1 nominal GDP (GeoStat).

PUBLIC FINANCES

According to the Ministry of Finance, current governmental expenditures amounted to 4,512 million GEL in the first quarter of 2024, showing a 19.75% y/y increase compared with the same period of previous year. This growth was mainly driven by higher spending on social benefits (+16.75% y/y) and use of goods and services (+20.78% y/y), also remarkable was percent growth (+36.17% y/y) and grants' growth (46.59% y/y).

At the same time, total revenues to the general budget amounted to 5,593 million GEL, a 26.46% y/y increase. The latter was driven by the increased volume of Value Added Tax collection (9.74% y/y), revenues from Personal Income Tax (12.73% y/y), and excise tax (18.71% y/y). Overall, the budget surplus in Q1 of 2024 amounted to 281.2 million GEL (1.5% of GDP) (Ministry of Finance of Georgia, 2024).

Central Government debt liabilities (which includes both domestic and foreign debt) increased by 6.85% y/y and amounted to 32,376.2 million GEL in Q1, 2024 (40.3% of GDP). Furthermore, the share of foreign debt in total debt stood at 73%, slightly maintaining the country's exposure to exchange rate risk.