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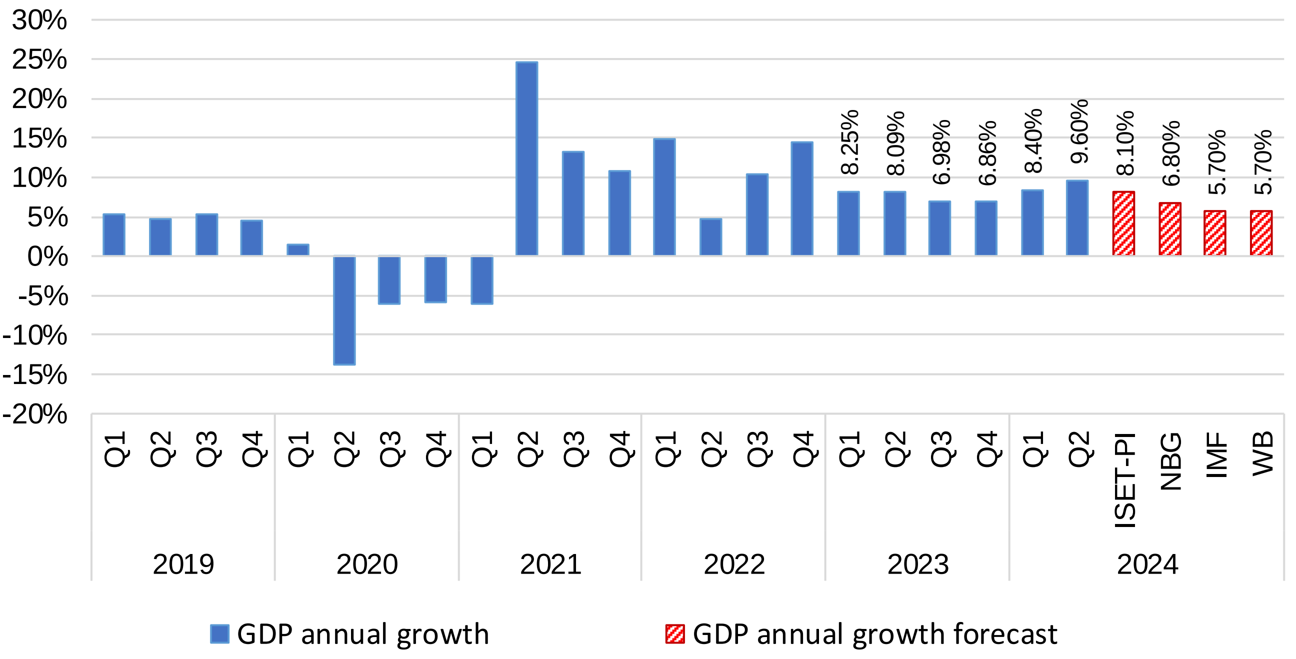
STRONG GDP GROWTH DRIVEN BY KEY SECTORS AMID GLOBAL AND DOMESTIC CHALLENGES

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



SUMMARY

According to GeoStat's preliminary estimates in the second quarter of 2024, Georgia's nominal GDP reached GEL 22,101.7 million, with a year-over-year real GDP growth of 9.6% and a GDP deflator change of 2.5%. The growth was driven by significant increases in value-added across various sectors: Accommodation and food service activities rose by 35.7%, Education by 21.3%, household activities as employers and producers of goods and services for personal use by 17.3%, Transportation and storage by 16.1%, Public administration and defense, including social security, by 13.3%, and Construction by 13%. Conversely, there was a decline in value-added in electricity, gas, steam, and air conditioning supply by -6.3% and in other service activities by -1.4%. Trade accounted for the largest GDP share at 15%, followed by Real estate activities at 9.8%, Manufacturing at 9.1%, Construction at 8.4%, Public administration at 7.4%, Agriculture, forestry and fishing at 7.2%, Education at 6%, Transportation and Storage activities at 5.9%, Information and communication at 5.9%, and Financial and insurance activities at 5.1%. The projected real GDP growth for 2024 from NBG is 6.8%, 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 second quarter of 2024, the 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 below 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 Q2 of 2023 (16.7%), the unemployment rate in Q2 of 2024 fell to 13.7% (Geostat). Average annual labor force participation has also increased by 1.3pp, reaching 54.5%. Based on Geostat's preliminary estimate, in the first quarter of 2024, average monthly nominal earnings reached 2004.9 GEL.

In conclusion, **Georgia's economy in the second 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 GEL 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 GEL. The latest forecast suggests that inflation will average around **1.9%** for 2024, which is higher than earlier estimates. Despite this, the strong economic performance is expected to continue, with real GDP growth projected at **6.8%** 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).

To analyze inflation dynamics and market expectations, in addition to observing the overall inflation rate, the non-tradable sticky price index (NTSPI) developed by the Federal Reserve Bank of Atlanta provides valuable insights. The NTSPI, which measures inflation in consumer prices for goods and services with inflexible prices, averaged 3.22% in the second quarter of 2024. Despite overall inflation remaining at relatively low levels, the NTSPI remains above the target, suggesting that long-term inflation expectations continue to exceed the desired benchmark (NBG).

In the second quarter of 2024, 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.

In the second quarter of 2024 the GEL's real effective exchange rate depreciated against all trading partner countries. This might be attributed to not just the 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 second quarter of 2024 included a 2.6% depreciation of the GEL against the US dollar and a 1.7% against the euro. The GEL appreciated by 2.1% against the Turkish lira but depreciated by 3.0% against the Russian ruble. Overall, the nominal effective exchange rate of GEL depreciated by 1.5% quarterly but appreciated by 4.6% annually. However, the real effective exchange rate saw a 1.3% quarterly and 6.2% annual depreciation. (NBG, July 2024).

In the second 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 **0.2 percentage points** to **10.3%**, while foreign currency deposit rates rose to **2.4%**. **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 **1.94 percentage points** from the previous year to **11.8%**.

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 May, rates for consumer, business, and mortgage loans all saw a decrease. Business loan demand grew in Q2 2024, and lending conditions for such loans in the national currency softened. However, the conditions have slightly tightened for business loans in foreign currency. 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 June, inflation was at 2.8%, mainly due to long-term factors and expectations. Service prices, contributing 1.9 percentage points to the change, have been decreasing since early 2023, helping to lower overall inflation.

Imported goods prices, which had been falling since early 2023, thus reducing imported inflation, rose by 3.3% in June, largely due to higher fuel 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 experienced a decline in external demand, resulting in a significant drop in foreign currency inflows and domestic exports. However, later increases in foreign currency inflows helped improve the current account balance. In the second quarter, demand for motor vehicles and their re-exports slowed, leading to a decrease in export revenues. On the other hand, import expenses declined, and structural economic changes positively impacted the current account balance, particularly through increased service exports in the transport sector, driven by Georgia's promotion as a Middle Corridor country. Despite a decrease in exports of information and computer services, these sectors remained significant contributors to export revenues. As a result, the current account deficit improved to a historic low of 4.3% of GDP in 2023.

In Q2 2024, declining external demand for motor vehicles and the re-export of copper led to an overall decrease in Georgia's goods exports. Overall, goods exports declined by 4.4% in real terms and 2.2% in nominal terms. The main contributor to this decline was intermediate goods, especially the re-export of copper ores and concentrates, driven by China's reduced demand due to its slowing construction sector. Ferroalloy exports remained low, impacted by price drops and limited sales to Turkey, Egypt, and the USA. Additionally, exports of chemical and mineral fertilizers to India and Peru also decreased.

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 second quarter of 2024, Georgia saw an **4.6%** increase in international visitors compared to the previous year, yet this was still **19.3%** 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. This slowdown of migration was balanced by the increasing visitor numbers from the EU, Türkiye, and Kazakhstan. Despite the higher visitor count, revenue from international travel grew by **8.1%** annually, reaching **USD 1,091 million** (GNTA, 2024).

During Q2 2024, Georgia received USD 844 million in instant money transfers, marking a 24.5% 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.

Despite the initial downturn, demand for imported goods picked up in the second quarter of 2024. While imports increased by 1.9% in nominal terms, they dropped by 6.2% in real terms. Additionally, the sharp decline in purchases of motor vehicles intended for re-export limited the overall growth of goods imports (NBG, July 2024).

During the second 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. Despite the decline in purchases of consumer goods, especially motor cars, the imports of these goods increased. The fall in purchases was 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 2024, despite a decrease in imports, Georgia's trade deficit widened as goods exports fell even more sharply. However, the country experienced a substantial increase in service exports, fueled by strong international trade revenues and structural changes in the service sector, particularly in transportation and IT services. Although wage growth was moderate, employee compensation remained high, contributing to a significant reduction in the current account deficit, which reached a record low of 5.0% of GDP, showing improvement in annual terms.

In the first quarter of 2024, long-term loan liabilities were the primary means of financing Georgia's current account deficit. Inward foreign direct investment (FDI) contributed less to the financing of the deficit. The FDI inflow increased by 10% from the previous year, totaling USD 0.57 billion, which represented approximately 2.6% of the country's GDP. This increase was mainly due to a increase in debt instruments and equity. The current account balance saw an improvement in 2023, largely attributed to a significant increase in savings, even though investment growth was only moderate (GeoStat).

PUBLIC FINANCES

According to the Ministry of Finance, current governmental expenditures amounted to 4,794.1 million GEL in the second quarter of 2024, showing a 17.5% y/y increase compared with the same period of previous year. This growth was mainly driven by higher spending on social benefits (+14.9% y/y) and use of goods and services (+23.3% y/y), also remarkable was percent growth (+28.8% y/y) and grants' growth (44.2% y/y).

At the same time, total revenues to the general budget amounted to 5,308.9 million GEL, a 13.7% y/y increase. The latter was driven by the increased volume of Value Added Tax collection (10.1% y/y), revenues from Personal Income Tax (23.6% y/y), and excise tax (25.4% y/y). Overall, the budget surplus in Q2 of 2024 amounted -365.9 million GEL (-1.7% of GDP) (Ministry of Finance of Georgia, 2024).

Central Government debt liabilities (which includes both domestic and foreign debt) increased by 11.8% y/y and amounted to 32,388.7 million GEL in Q2, 2024. Furthermore, the share of foreign debt in total debt stood at 72.2%, slightly maintaining the country's exposure to exchange rate risk.