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2024 End of Year Economic Update

Blurring lines between Economy, Democracy and Governance...

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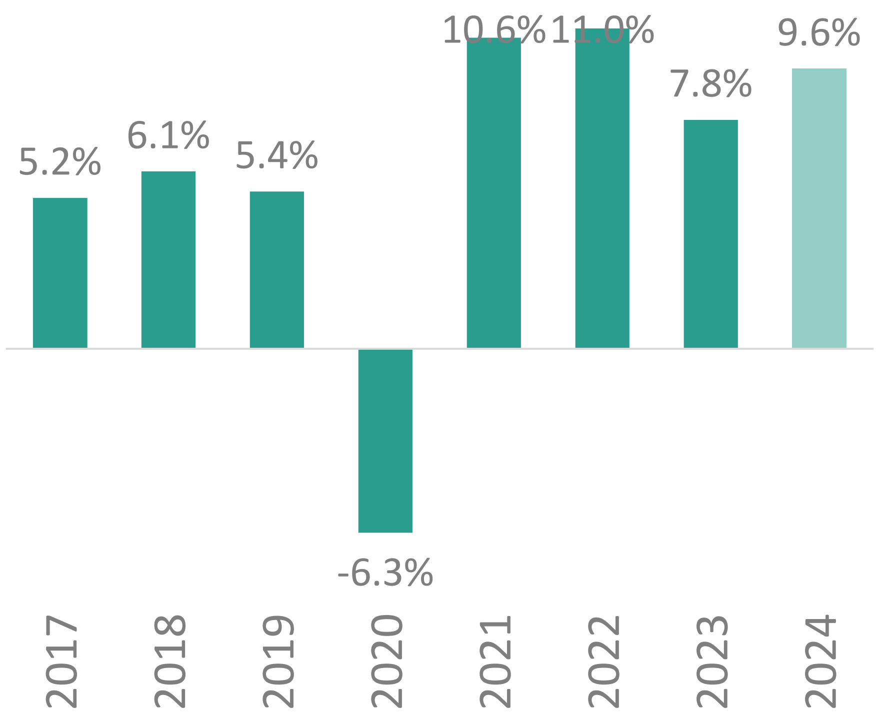
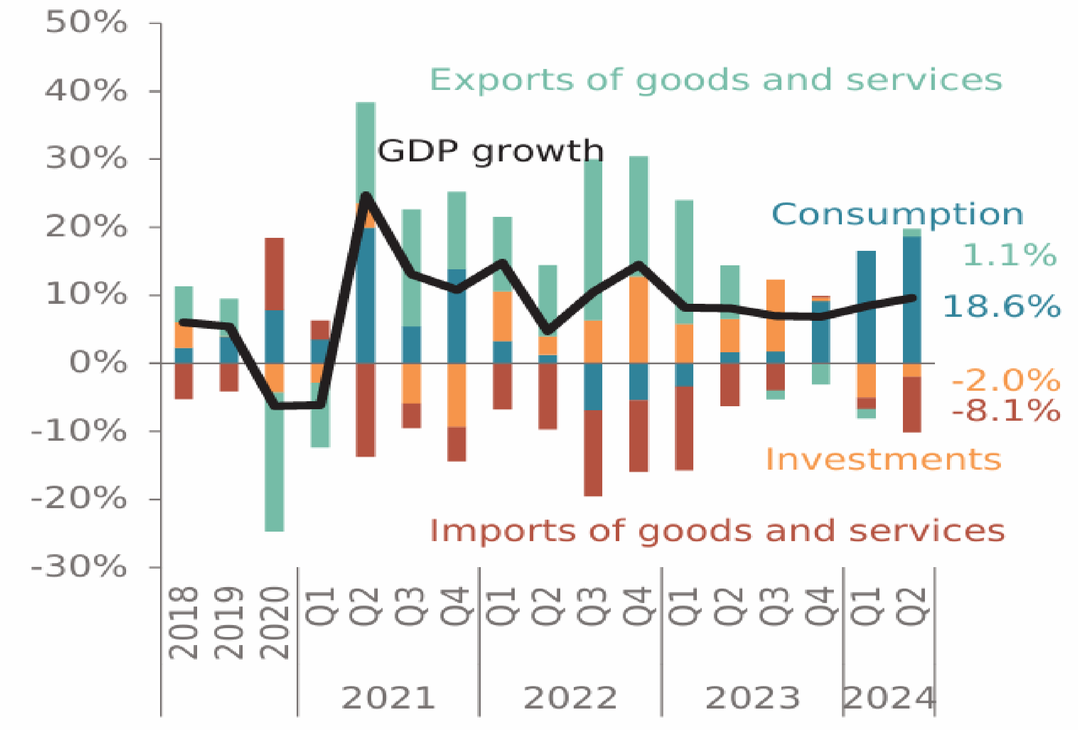
Growth Fueled by Consumption, Risks Ahead

Still Strong after two-digit growth in last few years



However, growth comes mainly from consumption, creating concerns of future unsustainability



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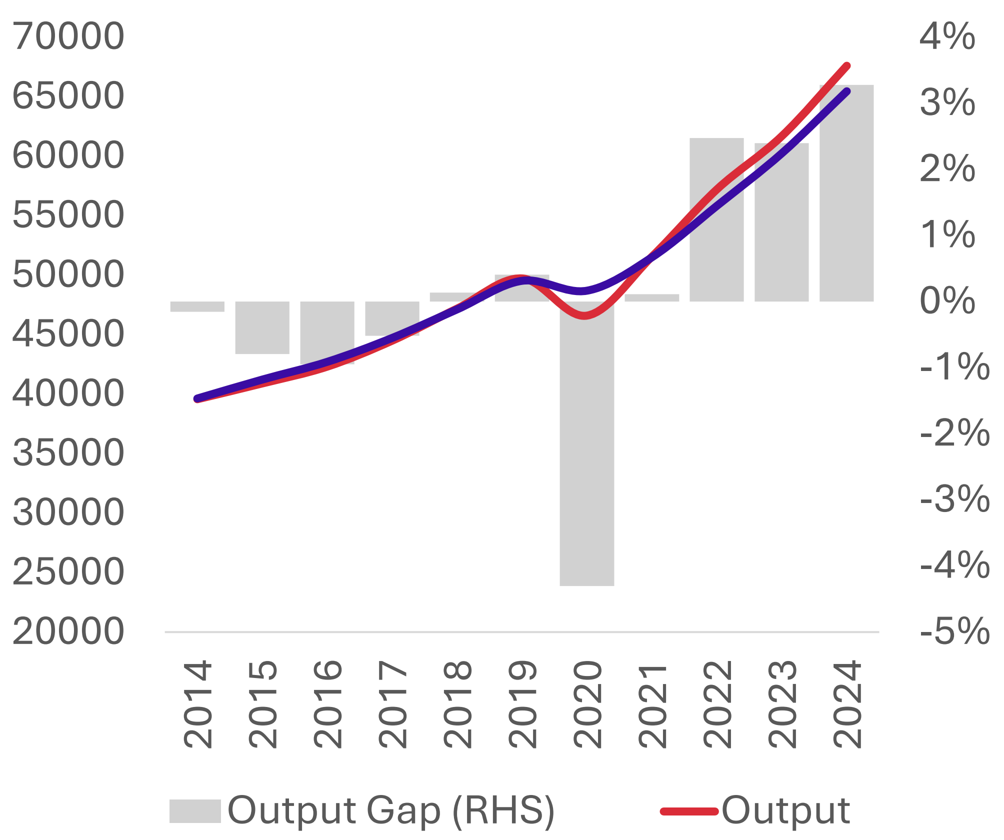
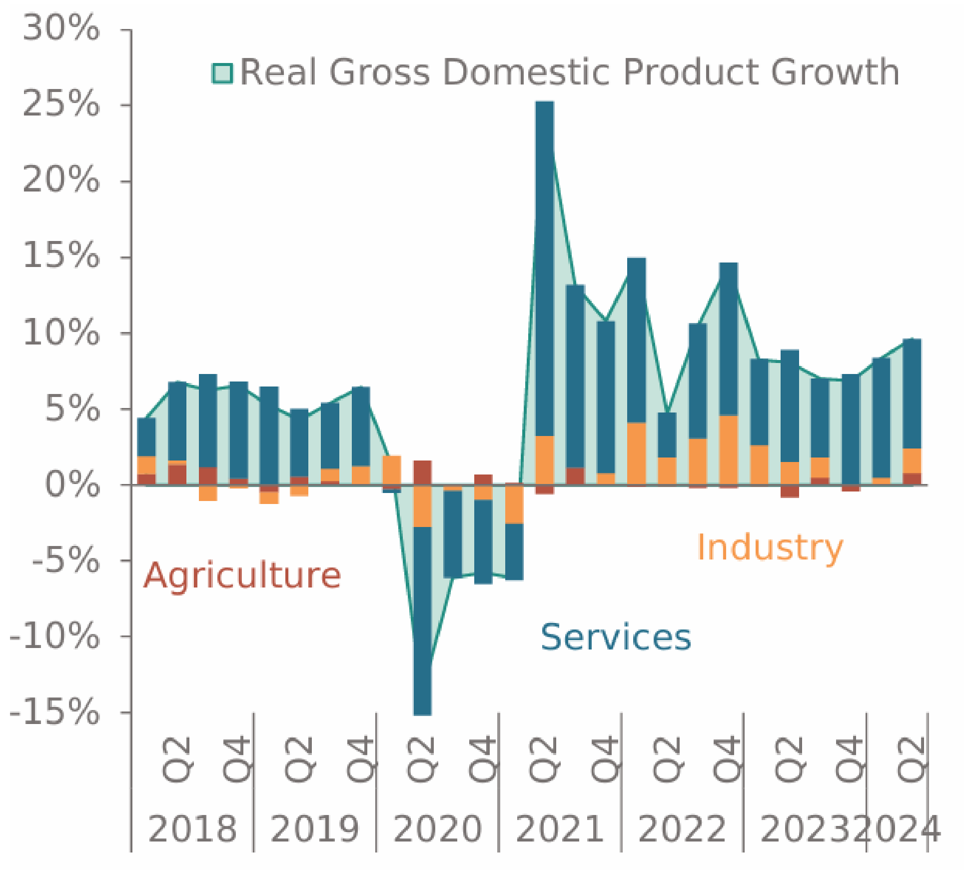
Real GDP surpasses its potential level

Mainly driven by impacts of Russia's war in Ukraine

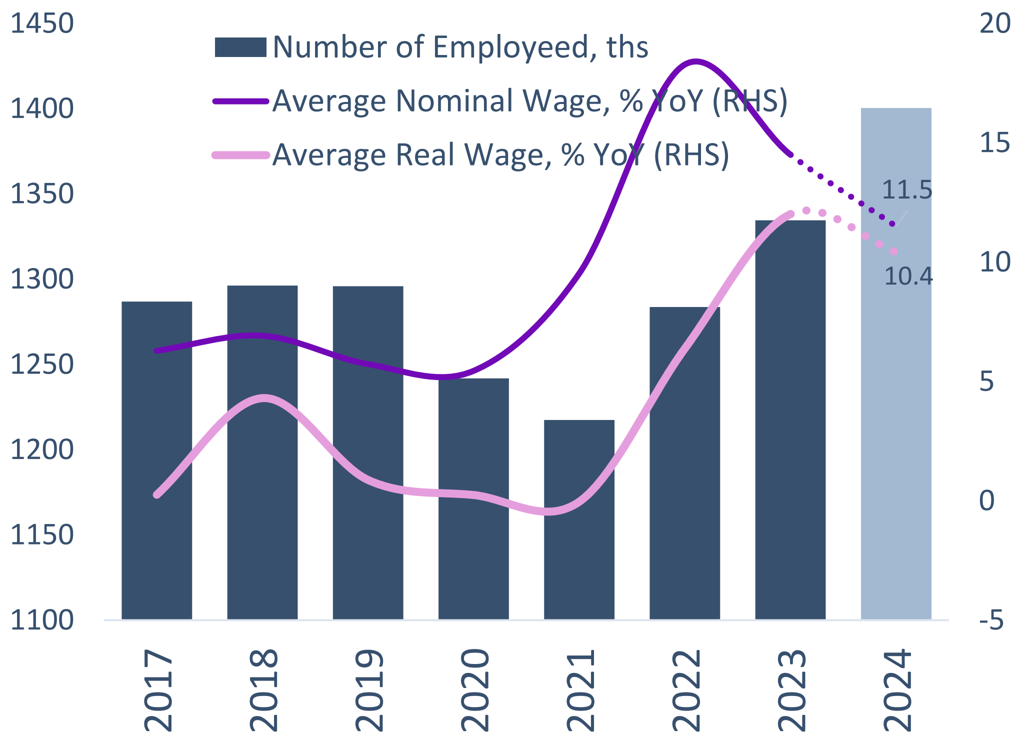


Growth driven mostly by services – tourism and IT



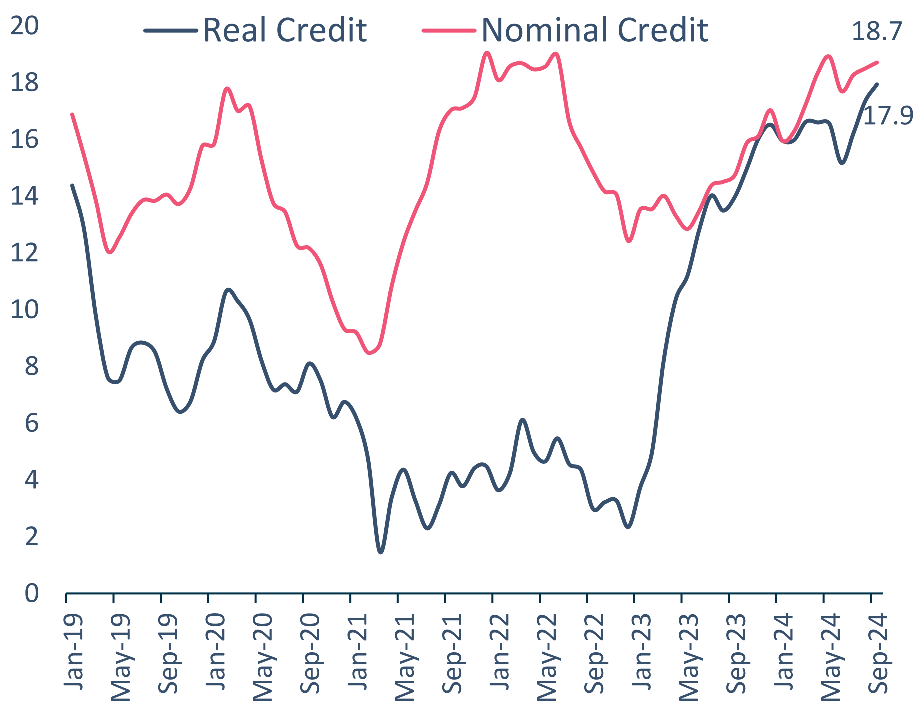
Drivers of consumption growth

Wages increased, however expecting decrease



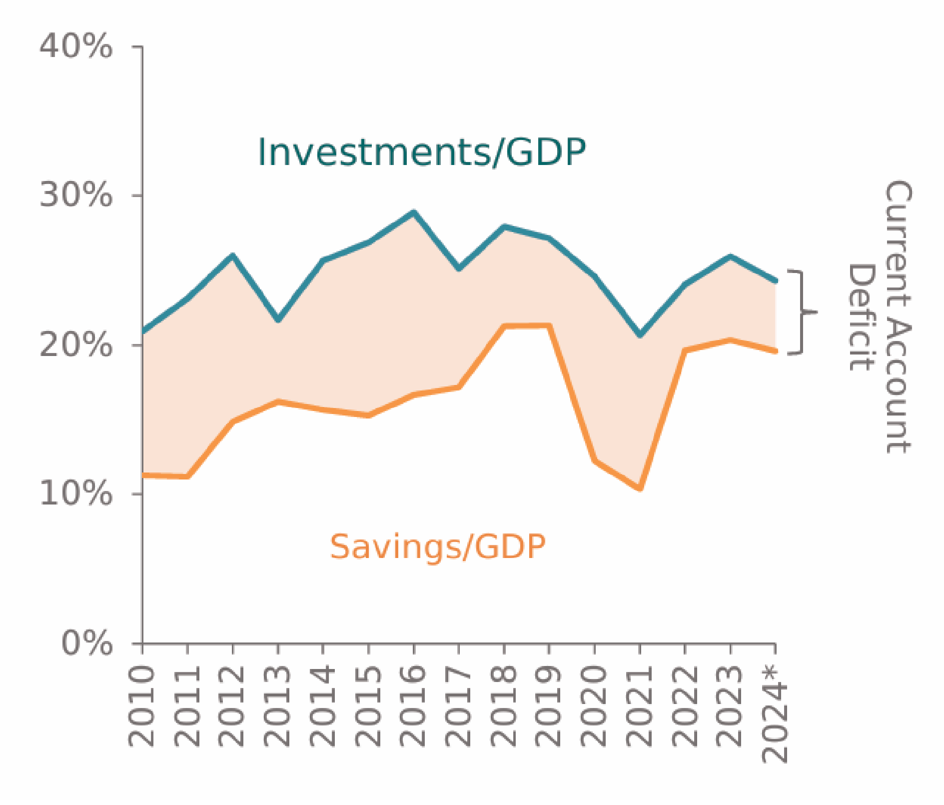
Real credit activity has been the driving factor of the growth also

CREDIT GROWTH (YoY, excl. FX effect, %)

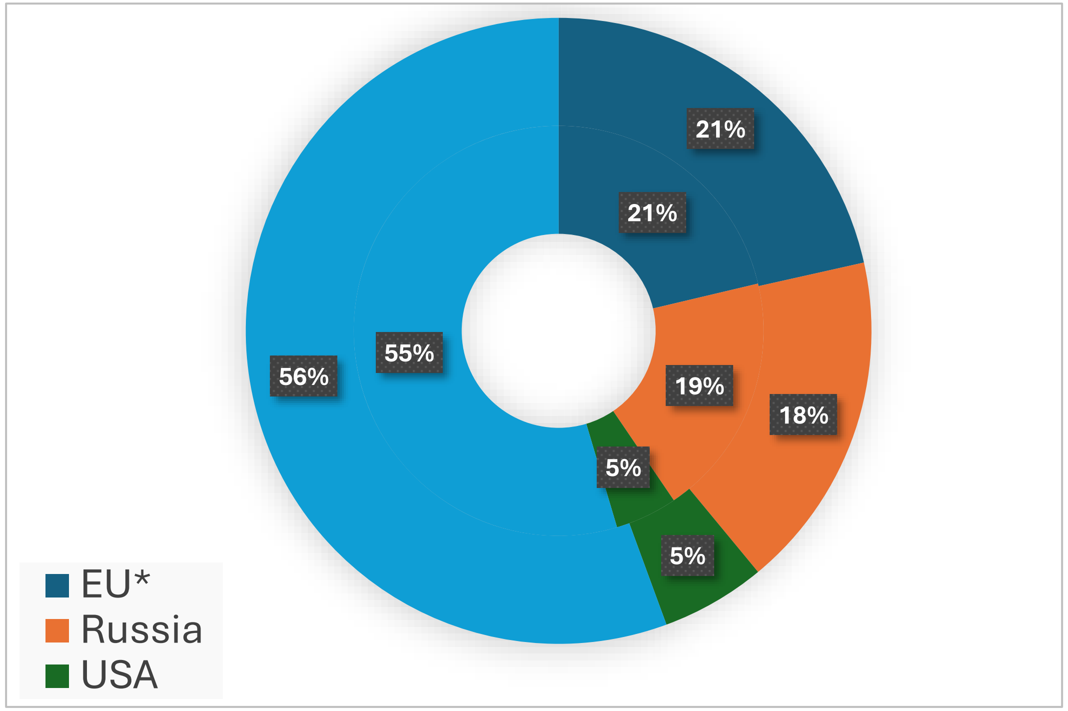


2024: A Turning Point? Real Growth Surpasses Potential

Investment financed from foreign sector, however Current Account Deficit` narrows



External Inflow vulnerable against the political risks from US and EU



Inflation below target

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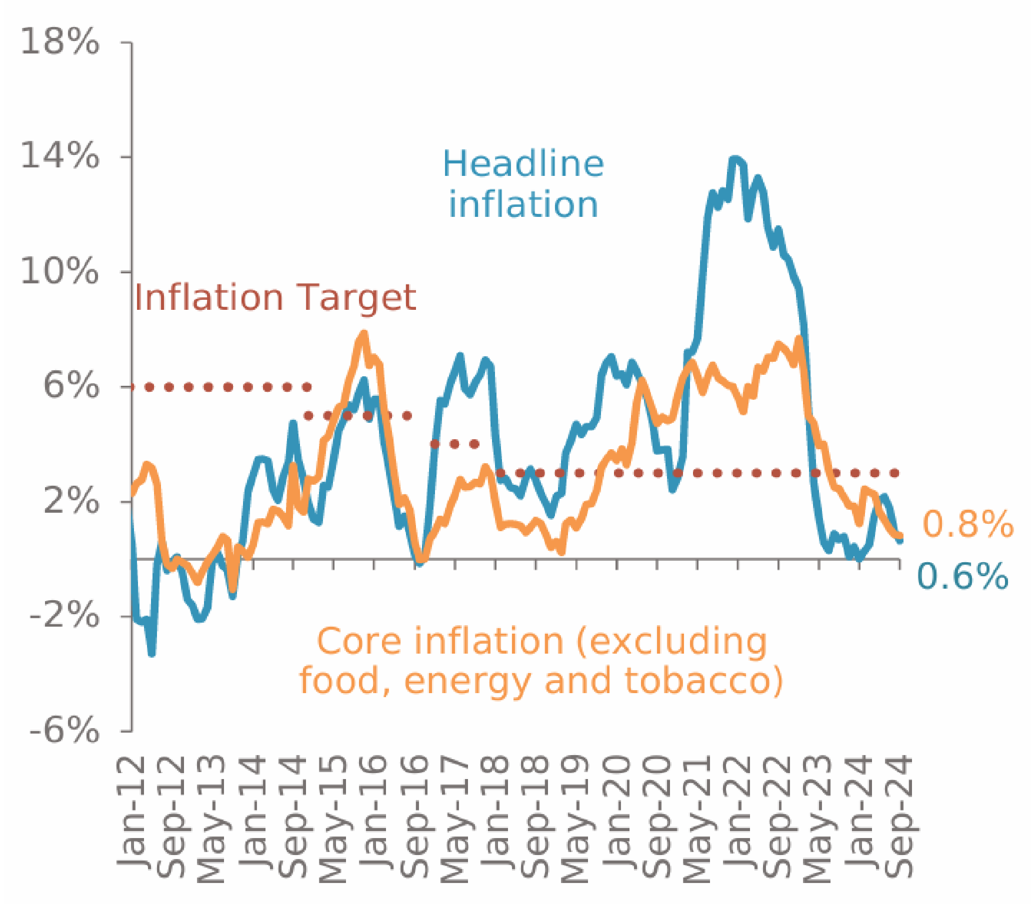
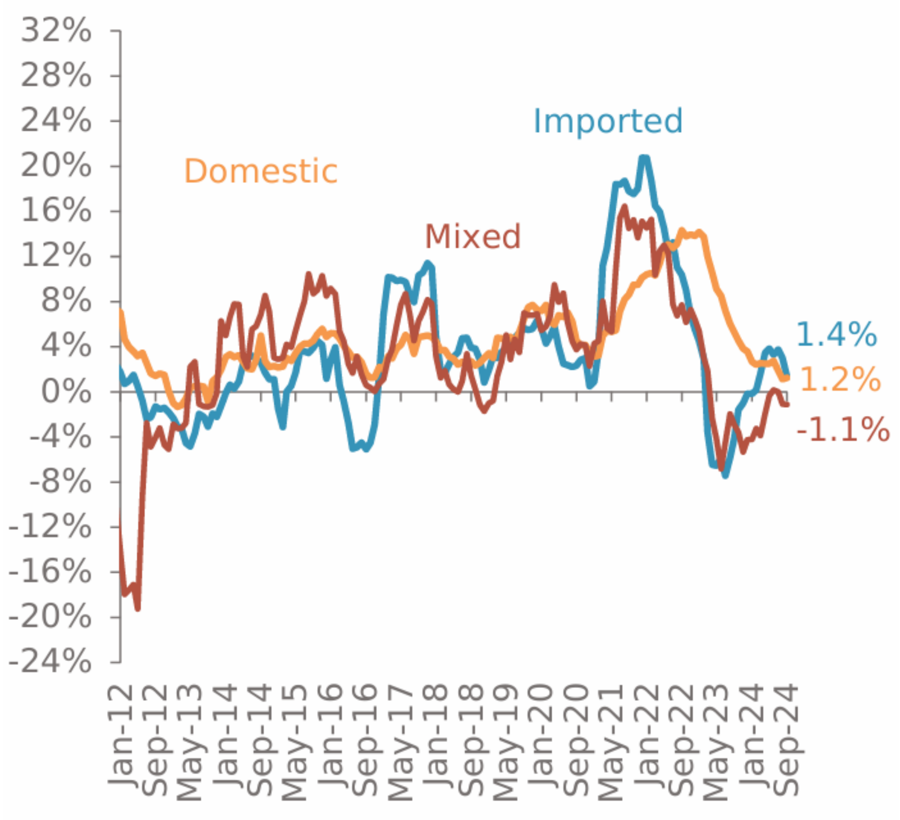
Below the target inflation

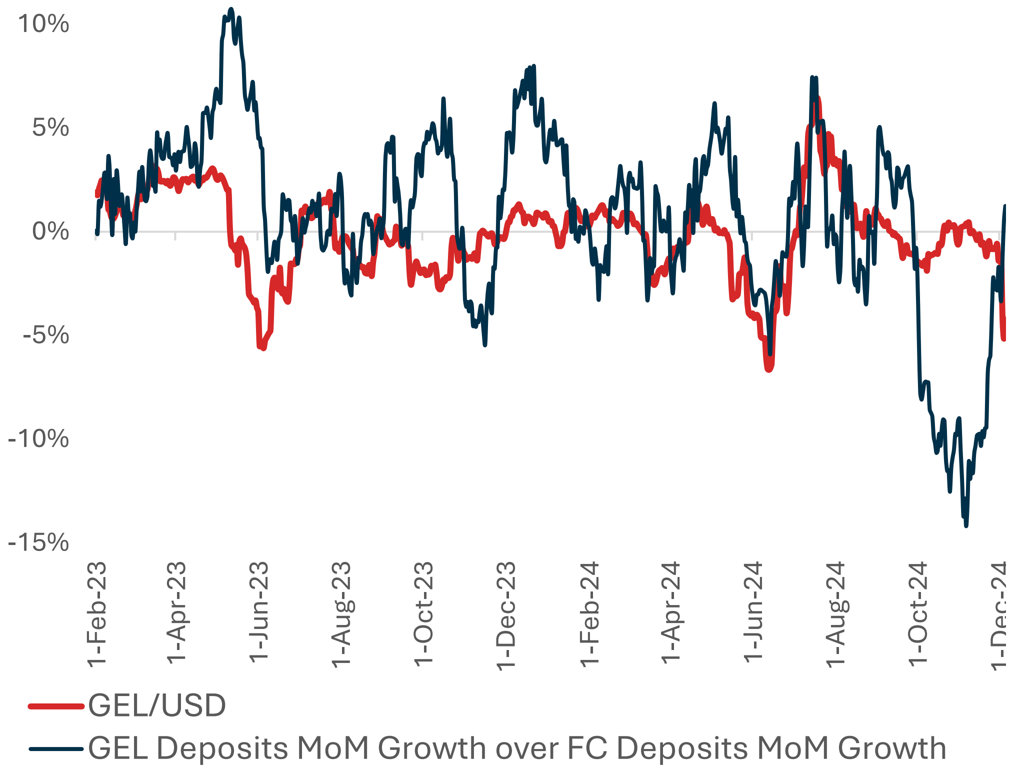


Risk from imported inflation due to currency fluctuations remains

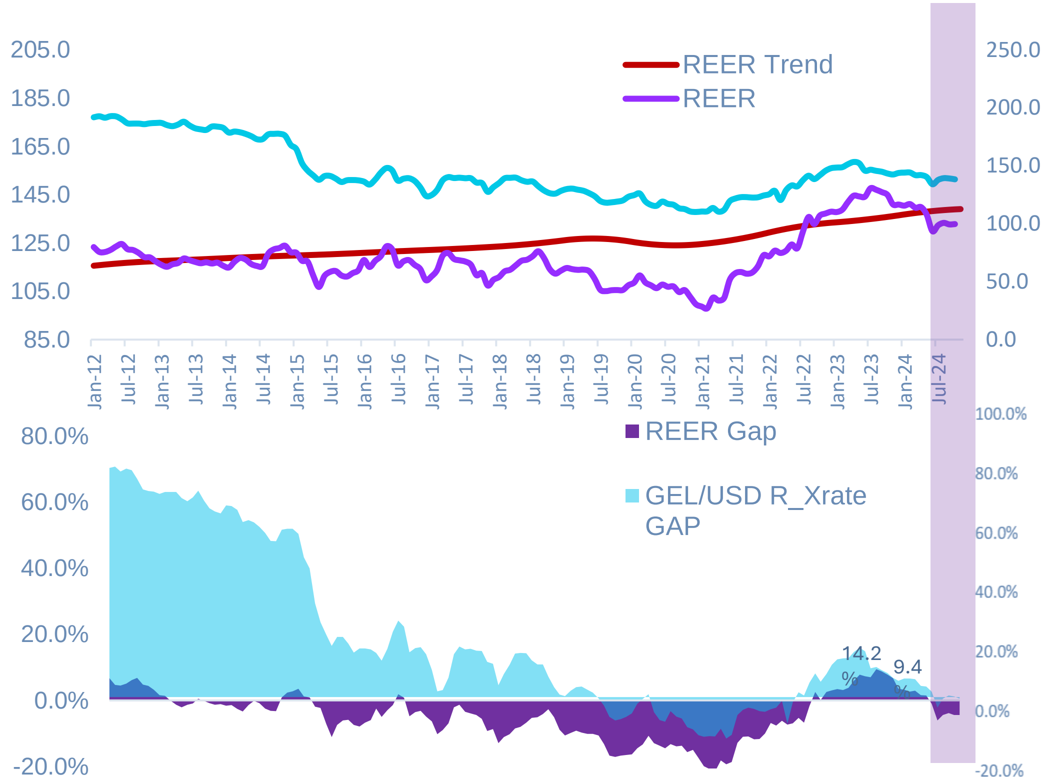


Exchange Rate

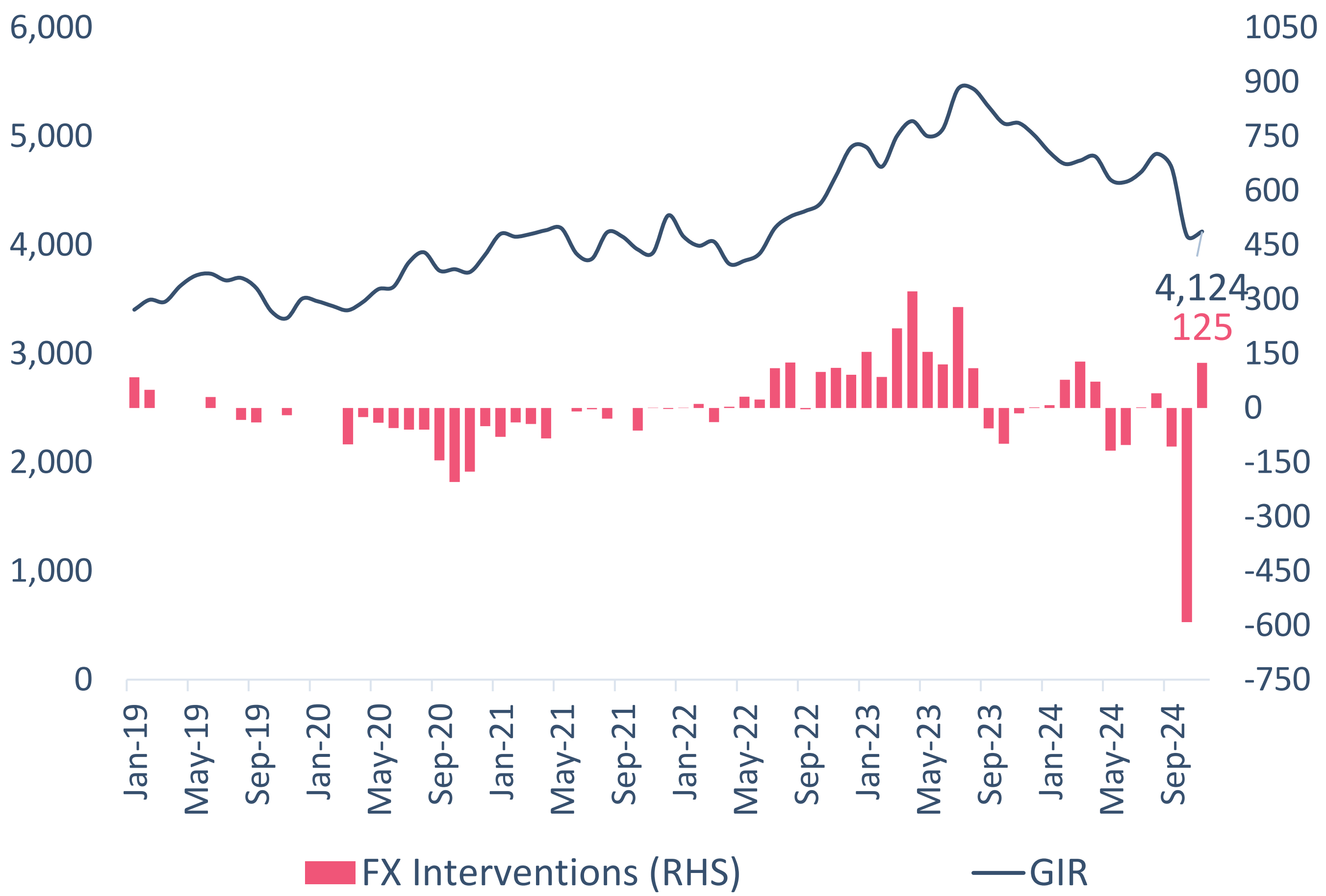
Latest depreciation driven by worthened sentiments



However, still close to its long-term trend



Currency reserves at critical level

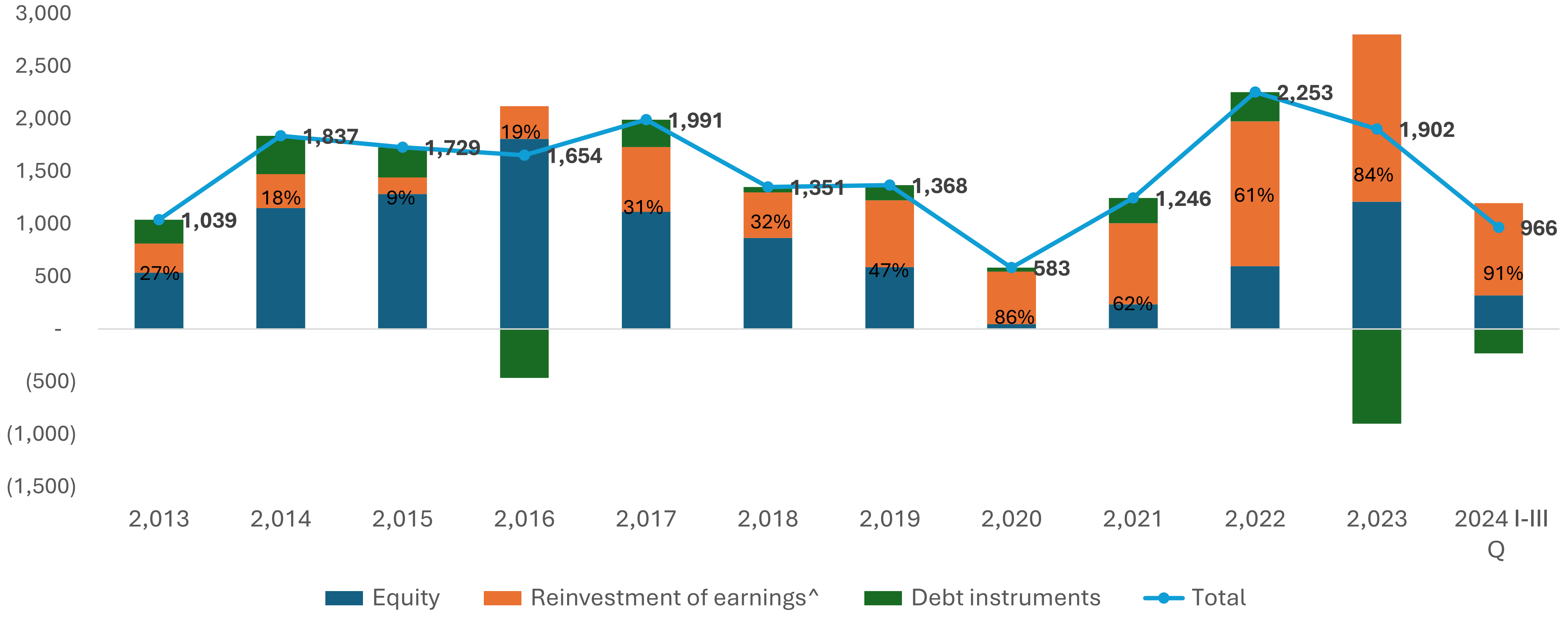


Reserves stand at a critical point, and now cover 3.1 months of imports, slightly above the critical threshold of 3 months.

The ARA metric of IMF stands at 0.78, which falls below the safe level (less than 1), indicating potential vulnerabilities.

FDI by Components

Reinvestments have been the key contributor to FDI (more than 80% since 2023).



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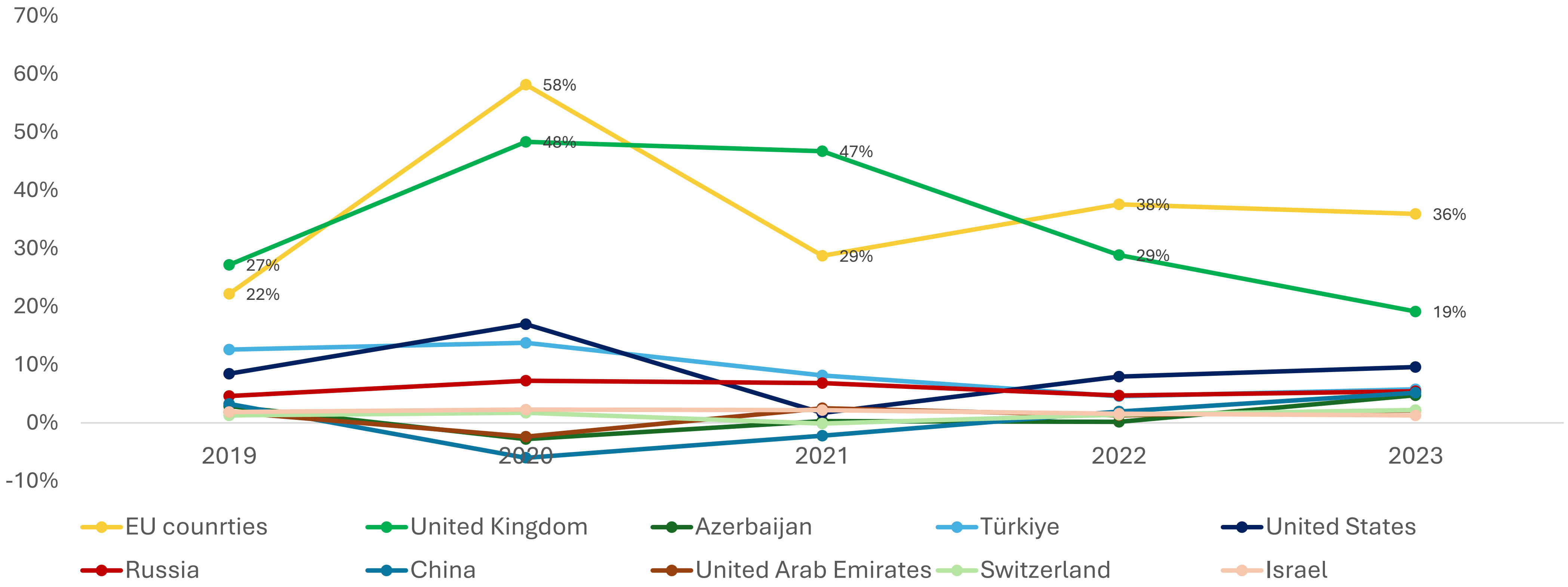
FDI in Georgia by Top 10 Countries

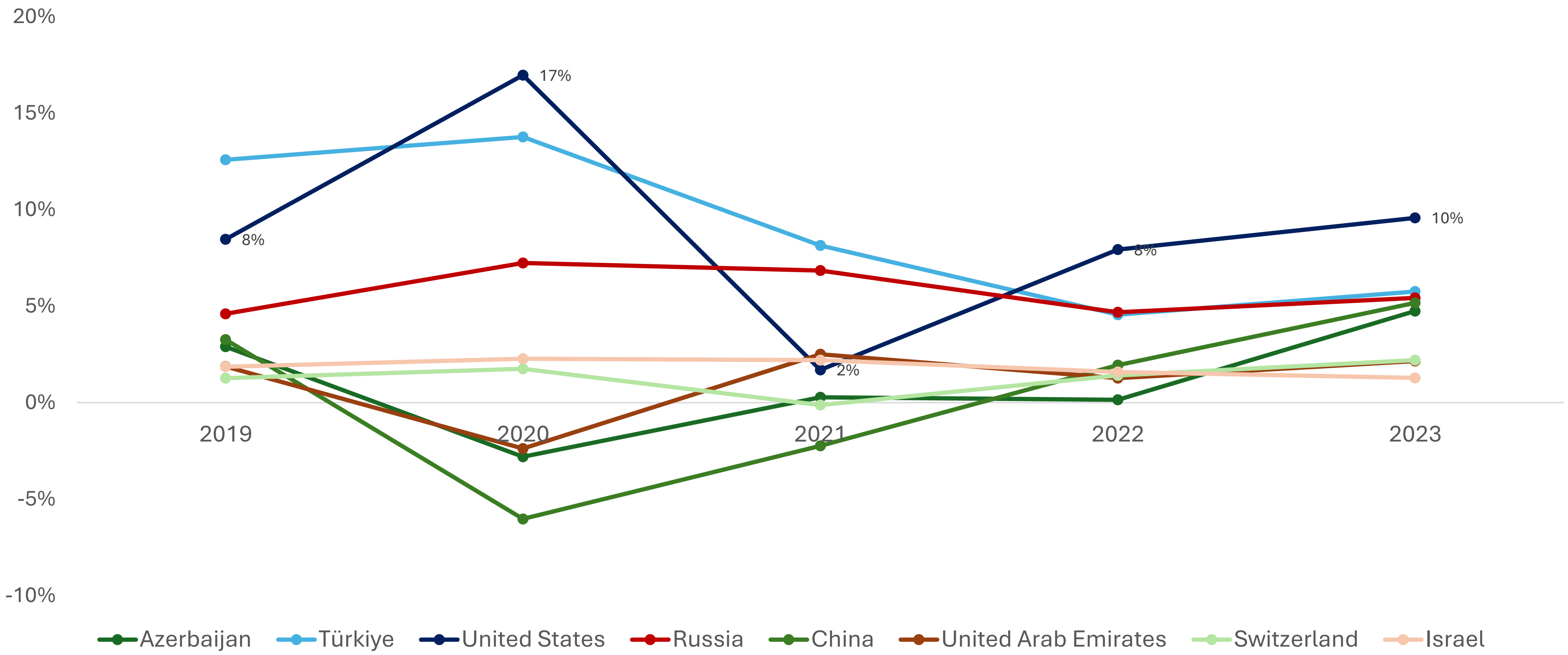
Share of EU was at a peak (58%) in 2020, further dropped and stands at 22% in 2024.

Share of UK has dropped from 47% to 19 %; Currently stands at 23% in 2024.



FDI in Georgia by Top 10 Countries

FDI from US has been rising since a significant drop in 2021; Stands at 8% in 2024.



Georgia’s exports globally (bln USD)

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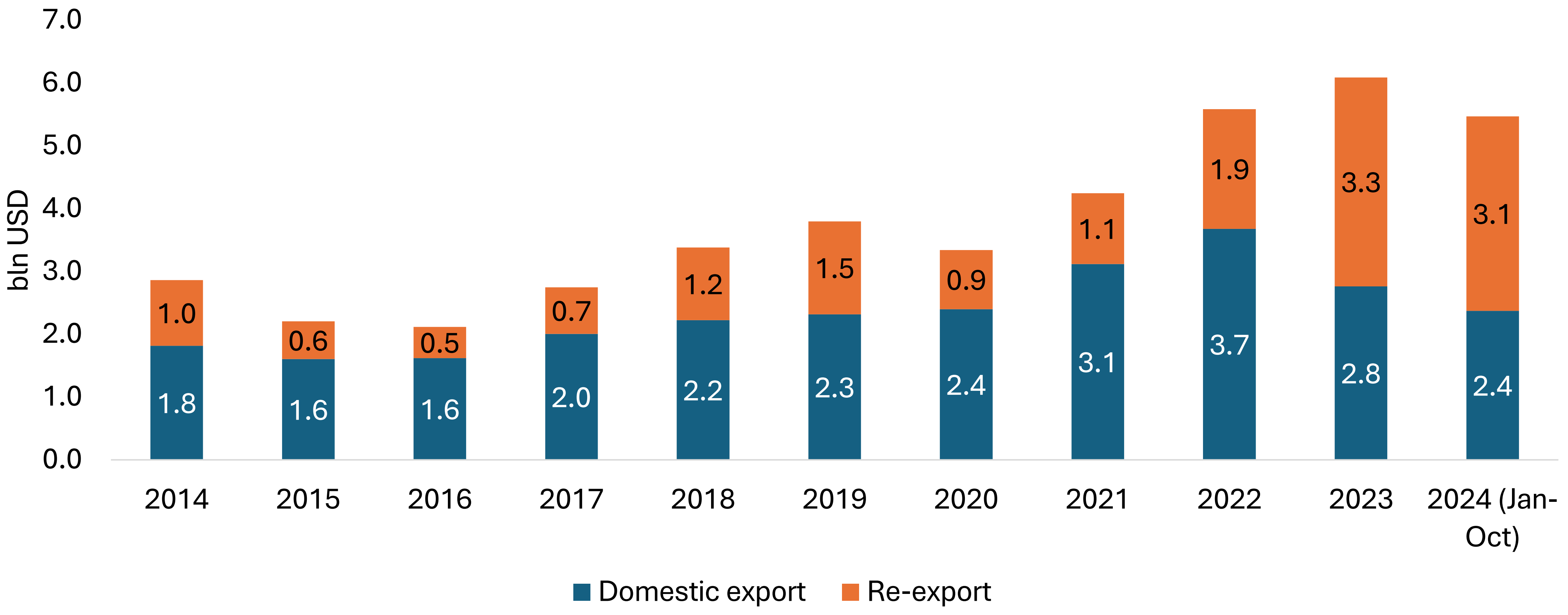
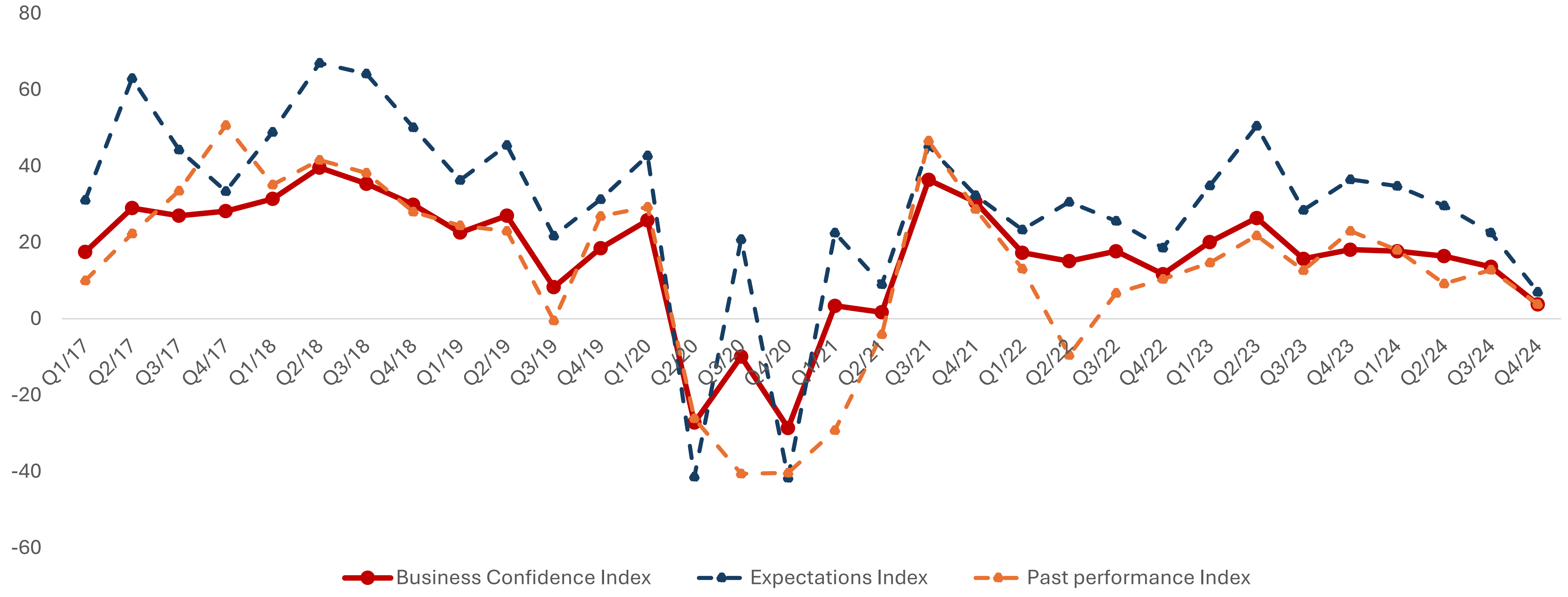
Exports of domestically produced goods is at a sharp decline.

Growth in re-exports is the driver of export growth



Business Confidence Index, Expectations Index and Past Performance Index

Business Confidence, along with its key components have been on a decline in 2024.



ISET Policy Institute Formulated Recommendations for the new Parliament, prior to elections in October 2024:

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These 5 recommendations, along with other general recommendations by the EU, US, partners (such as abolishing Foreign Agents law, speeding up EU's 9 Steps, etc.) were to set a sustainable ground for further economic development:

1. Revoke the June 4, 2024, amendment to the Tax Code of Georgia, referred to as the "**Offshore Law**", which facilitates the transfer of assets from offshores to Georgia.
    - This amendment poses significant risks of enabling money laundering and sanctions evasion.
    - Damages the investment attractiveness of Georgia.

1. Repeal the June 27, 2024, amendments to the **Law on "Funded Pensions"** to ensure the efficient functioning of the pension system.
    - Amendments risk governance efficiency and political influence on investments.
    - Reduced competition may harm participants and the capital market.
    - Raises risk of investments against pension participants' interests.

Continued: ISET Policy Institute's Recommendations:

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3. Within the scope of its mandate, ensure the full staffing of the **Board of the National Bank of Georgia (NBG)** with professionals distinguished by their impartiality and integrity.

4. Within the scope of its mandate, ensure full adherence of the country's domestic laws and regulations with the enforcement conditions of international sanctions imposed by the United States and other Western allies of Georgia.

5. Ensure the transparency of the Anaklia Deep Sea Port construction financing agreement.
   - Concerns involve fiscal risks and potential state guarantees turning into direct liabilities, impacting the budget.

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Risks for 2025 Associated with the Current Situation

Democratic backsliding and stalled EU agenda

- Erosion of democratic standards, weakening of ind. institutions, worsening economic governance
- Stalled EU accession process/dialogue
- Implementation of critical reform agenda slows down or stops
- No support from development partners for policy and institutional reforms

Macroeconomic impacts

- Growth slows. Long-Term Economic Growth at Risk.
- Continued pressure on the exchange rate is a significant risk, which may translate to inflation by mid-2025
- Rising exchange rate volatility and challenges in sustaining NBG reserves adequacy
- Limited financial resources from development partners (for infrastructure projects, for reforms TA, etc).
- The risk of an increase in lost arbitration cases with businesses poses a significant burden on the state budget

Unfavourable Investment Climate

- Changed nature of partnerships. Increased isolation from the Western allies, growing dependence on Russia
- Declining inflows of foreign support and growing dependence on neighboring countries (e.g., Russia) are increasing economic vulnerability to global and regional shocks.
- Continued decline in FDI and restricted financing for strategically important projects a

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Continued: 2025 Risks Associated with the Current Situation

Elevated Risk Perceptions locally and internationally

- Increased Risk Premium
- Country risk in direct correlation with EU accession process: Risk premium decreased upon candidate status approval and Increased once negotiations stalled
- Fitch's outlook downgraded
- Higher borrowing costs as credit costs increase due to elevated risk perceptions

Impact of local (and international) instability on Economic Sectors

- Negative impacts on Financial and Real Estate/Construction sectors
- Tourism sector decline
- The short-term impact will be seen in the retail trade sector
- Growing outmigration of highly skilled workers/brain drain will make the economy & innovation suffer
- Significant risks to technology and innovation while becoming less attractive to foreign investors

Risks to People's Wellbeing

- Rising exchange rate volatility and inflation may erode the purchasing power of low-income households more severely, further increasing income inequality.
- Limited funding might hinder improvements in public services (healthcare, education, infrastructure) negatively impacting quality of life, leaving rural areas further behind & deepening the urban-rural divide.

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We wish 2025 to be the year of democracy and resilience in Georgia!