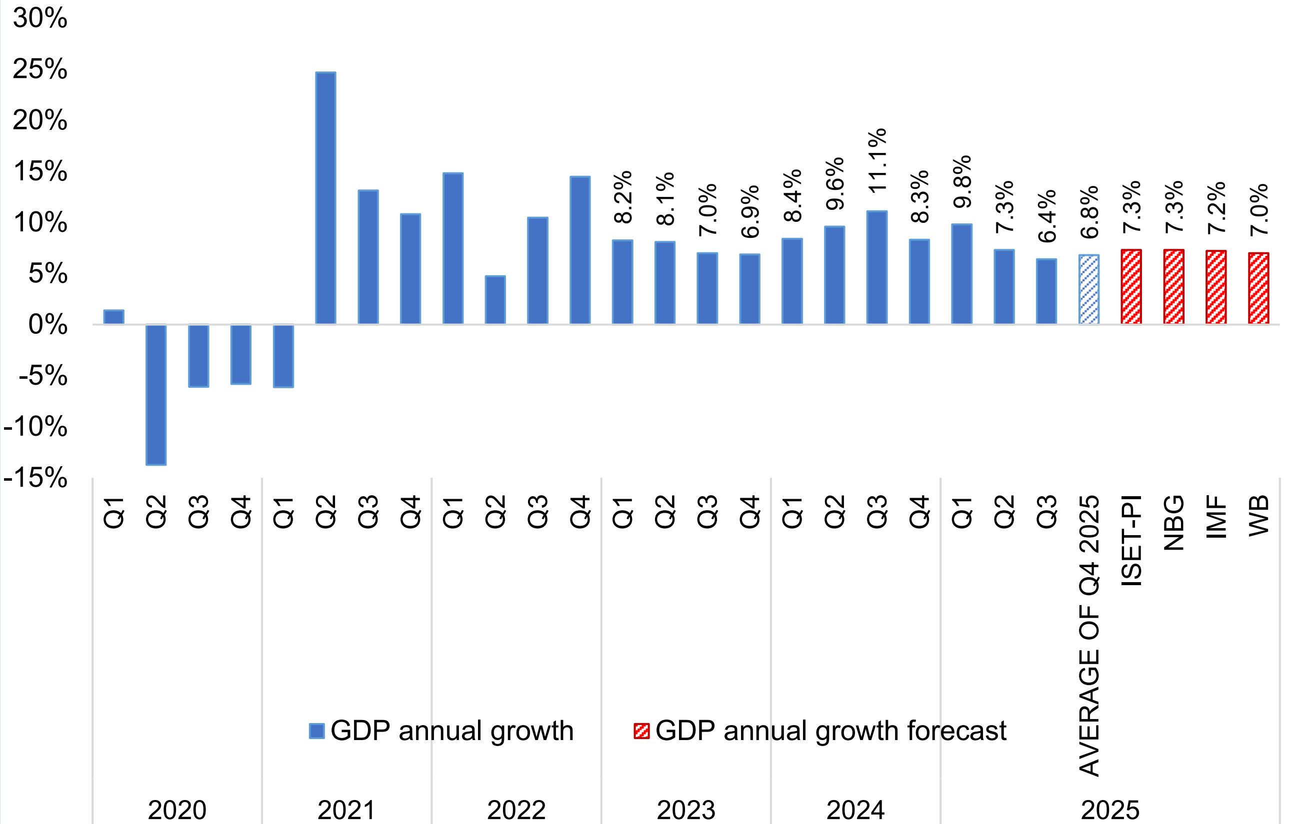
GEORGIA: INFLATION ABOVE TARGET, GROWTH CONVERGING, AND AN EXTERNAL BALANCE THAT STILL HOLDS

Figure 1 - Real GDP Annual Growth Rate

Source: GeoStat, ISET-PI



SUMMARY

Economic activity remained strong through the end of 2025, although the pace of expansion continued to normalize. According to preliminary estimates, real GDP growth reached 7.5% in 2025, indicating that output was still expanding above Georgia's longer-run trend even as the economy gradually converged toward potential. The growth mix remained favorable: less import-intensive and relatively high-productivity sectors continued to play a central role, while domestic demand showed clearer signs of normalization under still-tight monetary conditions.

Inflation remained above the 3% target around the turn of the year, but the composition of price pressures still points to a largely temporary shock profile. Realized average inflation in 2025 amounted to 3.9%, while as of January 2026 headline inflation stood at 4.8% y/y. The increase was driven mainly by food prices, one-off domestic price adjustments, and volatility in agricultural products. At the same time, underlying inflation remained much more contained: core inflation stood at 2.1%, while services inflation reached 3.0%, suggesting that broader inflation expectations remained relatively stable.

The external position improved further by the end of 2025. Structural shifts toward less import-intensive sectors, weaker import growth, stronger services exports, and firmer remittance inflows all supported the current account. Tourism revenues increased by 6.0% in 2025, ICT exports remained high at 2.9% of GDP in the first three quarters of the year, and remittances rose by 8.5% annually. Against this backdrop, the current account deficit improved relative to its estimated long-term equilibrium of about 5% of GDP, while exchange-rate conditions remained broadly supportive of macroeconomic stability and deposit dollarization declined to 47.7% by year-end.

INFLATION

Inflation stayed above target at the beginning of 2026, but the composition of price pressures matters more than the headline alone. Annual CPI reached 4.8% in January 2026 after averaging 3.9% in 2025. The main drivers were food price inflation, one-off domestic price adjustments for selected products, and volatility in agricultural prices. By contrast, broad-based inflation pressures remained more subdued. Core inflation, excluding food, energy, and tobacco, stood at 2.1%, while services inflation reached 3.0%, indicating that sticky-price dynamics remained relatively contained and long-term inflation expectations were still broadly anchored.

The imported component of inflation remained comparatively weak. Declining oil prices on international markets helped contain imported-goods inflation, while the relatively stable lari exchange rate also limited additional price pressures from abroad. Domestic demand-side inflationary pressure eased as economic growth gradually converged toward its long-term path and credit activity stayed close to equilibrium. This combination suggests that, despite above-target headline inflation, the recent price increase was still not fully broad-based across the basket.

Even so, upside risks to inflation remained more pronounced than downside risks. The main concern was that persistent food inflation and a moderate increase in sticky-price indicators could eventually affect expectations if maintained for too long. The baseline view, however, remained that the current inflation dynamics were temporary and would not generate strong second-round effects. Under the central scenario, inflation is expected to gradually converge toward target from the second quarter of 2026, averaging 3.7% over the year.

MONETARY POLICY AND DOMESTIC CONDITIONS

Monetary policy remained on hold in February 2026, with the policy rate kept unchanged at 8.0%. The stance remained moderately tight, reflecting a deliberate attempt to contain upside inflation risks while allowing the economy to continue converging toward a more sustainable pace. The decision reflected two opposing forces: on one side, headline inflation remained above target and food-related risks persisted; on the other, core inflation stayed close to target, domestic demand pressures continued to normalize, and labor-market developments were exerting some downward pressure on prices.

Domestic conditions increasingly pointed to normalization rather than overheating. Economic growth is projected at 5.0% in 2026 under the central scenario, suggesting a return toward the long-term growth rate after a very strong 2025. Credit activity remained close to its equilibrium level, while the growth structure continued to shift toward less import-intensive sectors. These developments support the view that domestic macroeconomic conditions are becoming more balanced, even if inflation remains temporarily above target.

EXTERNAL SECTOR: TRADE, TOURISM, REMITTANCES, CURRENT ACCOUNT

External demand and trade dynamics became more supportive by the end of 2025. Amid ongoing structural shifts in the economy, growth was increasingly driven by less import-intensive sectors, which helped slow the growth of imported goods. Declining global oil prices also contributed to weaker import growth. At the same time, a significant improvement in the goods balance and strong growth in services exports supported the current account. This combination indicates that Georgia entered the end of 2025 with a healthier external composition than earlier in the year.

Service exports continued to anchor the external balance. Tourism revenues increased by 6.0% in 2025, confirming that travel inflows remained an important source of foreign exchange. The performance of the information and communication sector also remained notable, with ICT exports accounting for 2.9% of GDP in the first three quarters of 2025. This points to a broader compositional shift in Georgia's external sector toward higher-productivity service activities that are less import-intensive and more resilient to external shocks.

Remittances also remained a significant stabilizing force. Annual remittance growth reached 8.5% in 2025, adding to household income, supporting private consumption, and strengthening foreign-currency inflows. Together with tourism and other service exports, these transfers helped offset an uncertain global environment and reinforced a more balanced external financing position.

Overall, the current account deficit in 2025 improved relative to its estimated long-term equilibrium of about 5% of GDP. Current external-sector tendencies therefore do not point to a destabilizing imbalance. On the contrary, the combination of stronger service exports, firmer transfers, and contained import growth suggests that Georgia ended 2025 with a broadly sustainable and more resilient external position.

EXCHANGE RATE AND EXTERNAL FINANCIAL CONDITIONS

Exchange-rate developments remained broadly supportive. The improved current account balance, together with a relatively weak U.S. dollar globally, supported the maintenance of a stable exchange rate, all else being equal. This, in turn, reduced the risks of additional inflationary pressures stemming from servicing dollar-denominated loans. At the same time, the relatively stable position of the lari helped keep imported durable-goods inflation low, reinforcing the broader disinflationary effect from lower oil prices.

Foreign-exchange stability was reflected in the dollarization trend. Deposit dollarization, excluding exchange-rate effects, declined to 47.7% by the end of 2025, with reductions visible for both households and the business sector. This suggests that confidence in the domestic currency environment remained intact. Georgia's sovereign risk premium also stayed close to its equilibrium level, helping preserve a relatively stable external financial environment even amid elevated global uncertainty.

OUTLOOK

The baseline outlook points to continued normalization rather than a hard slowdown. Real GDP growth in 2025 is preliminarily estimated at 7.5%, while the central scenario projects growth of 5.0% in 2026. Inflation averaged 3.9% in 2025 and is projected at 3.7% in 2026, implying that the return to target will be gradual rather than immediate. In this setting, the policy rate is expected to remain moderately tight on average in 2026 before declining only gradually thereafter.

The balance of risks remains two-sided but tilted somewhat upward for inflation. On the upside, stronger-than-expected food inflation, persistently high economic activity in high-productivity sectors, or renewed geopolitical tensions could delay the return of inflation to target. On the downside, continued weakness of the U.S. dollar, lower oil prices, stronger supply-side gains, and labor-market easing could reinforce disinflation. The overall picture nevertheless remains one of robust but normalizing growth, manageable inflation pressures, and a broadly sustainable external position.