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NEWSLETTER

German Economic Team

GEORGIA

Strong growth despite war in Ukraine

Despite headwinds from the war in Ukraine and sanctions against Russia, Georgia's economy remained resilient, growing by 10.5% in 6M2022. The National Bank estimates growth for the full year of 9.0%. Another year of double-digit growth seems possible.

The Lari appreciated to 2.80 GEL/USD as a result of strong inflows, 7.7% higher than at the start of the war. Inflation remains elevated due to rising food and energy prices, reaching 11.5% yoy in July. The National Bank raised its policy rate to 11.0% in March.

The recovery in the tourism sector continued, with revenues reaching 87% of the 2019 level in 7M2022. After initial problems, goods exports to Russia remained resilient (7M2022: 1%).

A crucial factor for Georgia's economy this year (and beyond) is the relocation of approx. 45,000 people from Russia and Belarus. The additional consumption spending of an estimated 1.8% of GDP is a positive shock to aggregate demand.

Growth prospects stronger than before start of war

After very strong growth in 2021 (10.4%), estimates for 2022 were around 5% before the start of the war in Ukraine. Initially, observers were pessimistic about growth prospects after the war started, due to Georgia's strong exposure to Russia.

Selected economic indicators

	2021	2022*	2023*
Real GDP growth, % yoy	10.4	9.0	5.0
Inflation, % yoy (end of period)	13.9	7.0	3.0
Current account balance, % of GDP	-8.4	-7.6	-6.6
Budget balance, % of GDP	-6.3	-3.6	-2.8
Gross government debt, % of GDP	49.4	45.3	44.6

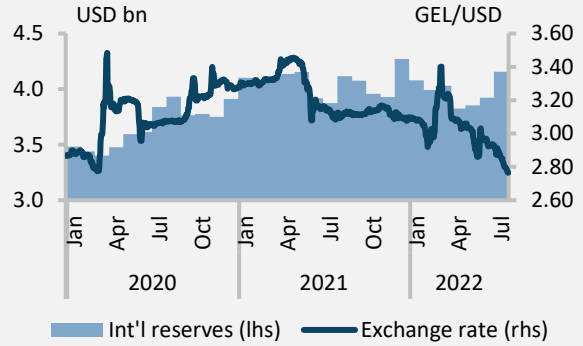
*Sources: Geostat, NBG, Ministry of Finance; *estimate/forecast*

However, economic growth has proved resilient, reaching 10.5% yoy in 6M2022. The National Bank estimates growth for the full year of 9.0%, while major Georgian banks already consider another year of double-digit growth possible. With this strong growth, Georgia is also the leader in the regional peer group.

Lari appreciation, but inflation remains high

In the run-up to the war in Ukraine and initially afterwards, the lari depreciated sharply, reaching a low of 3.40 GEL/USD in March. However, the current level of around 2.80 GEL/USD is 7.7% higher than at the start of the war. Lari appreciation has been driven by the continued recovery in tourism inflows, increased export revenues and increased remittances. The relocation of people from Russia and Belarus to Georgia has also added to appreciation.

Exchange rate and FX reserves



Source: NBG

The supply shock in international commodity prices that started in 2021 has continued against the backdrop of the war in Ukraine. The prolonged rise in food and energy prices (33.1% and 5.2% of the CPI basket, respectively) has caused inflation to remain elevated, reaching 11.5% yoy in July. In order to prevent a rise in inflation expectations, the National Bank raised the policy rate to 11.0% (+0.5 pp) in March.

Relocation from Russia drives money transfers

A crucial factor for the economy this year is the relocation of people from Russia and Belarus to Georgia. Overall, approx. 45,000 people have come since the start of the war until end of May. Next to their impact on consumption, the effects are also visible in money transfer statistics. The initial expectation after the start of the war was that money transfers from Russia would decline due to the economic downturn. Instead, there has been a sizeable increase by 278% yoy in 7M2022. For comparison, transfers from other regions increased by only 16.5% yoy. Currently, the high value for Russia is best explained by the relocation of Russians and sales of Russian assets. Thus, it does not represent remittances in the usual sense and, more importantly, does not indicate increased incomes for Georgian households. Decreasing figures for June and July indicate that the surge in Russian money transfers is temporary.

Recovery in tourism continues

The recovery in the tourism sector that started in 2021 has continued in 7M2022, with revenues reaching 87% of its 2019 level. Vacation tourism from Russia is likely to remain subdued due to the economic crisis there. However, part of this loss will be offset by the aforementioned relocation of Russians so that in 7M2022 a total of 66% of the 2019 level was realised. Important key source regions such as the EU (66%) and Turkey (62%) still have further catch-up potential, while countries with increasingly growing importance such as Israel (118%) and Saudi Arabia (154%) already exceed their pre-COVID-19 level. The outlook for the sector is positive and the 2019 level is expected to be reached or even exceeded this year.

Goods exports to Russia remain resilient

With Russia accounting for approx. 18% of domestic Georgian goods exports in 2021, uncertainty was high at the start of the war. In fact, both prices and volumes for most products declined initially. As an example, mineral water exports were adversely affected by the temporary suspension of Borjomi production (due to the majority ownership by the sanctioned Russian Alfa Group). The problems have since been solved, with the state becoming a co-owner.

Goods exports to Russia in 7M2022

		% yoy		
	USD m	Total	Price	Vol.
Ferro-silico-manganese	92.7	10	49	-26
Wine	71.8	1	-5	5
Spirits	28.7	56	42	10
Water, unsweetened	23.8	-34	-5	-30
Water, sweetened	16.2	1	-8	10
Other	129.4	-8		
Total	**293.8**	**1**		

Sources: Geostat, own calculations; includes only domestic exports

However, after initial disruptions, trade dynamics resumed. Overall, exports in 7M2022 remained stable (+1% yoy). Strong growth in January and February are not the only explanation. Higher export prices, esp. for Georgia's main product ferro-silico-manganese, offset most losses. Additionally, volumes for important products like wine and spirits started increasing again in recent months. While the recession in Russia is likely to depress Georgian exports to Russia, a recent (ex-ante) analysis by the German Economic Team highlighted that Georgia may be well-positioned to become a substitute supplier for Western products.

Outlook

Despite strong economic exposure to Russia, Georgia's economy has proven to be resilient to the effects of the war in Ukraine. With 9.0%, the growth outlook now far exceeds pre-war estimates. The recovery in tourism was not affected and is likely to continue. The recent agreement with the IMF on a Stand-By Arrangement (USD 280 million) anchors the sound macroeconomic framework. A key point for Georgia this year (and beyond) is the influx of approx. 45,000 relocated people from Russia and Belarus. According to an estimate by the German Economic Team, their expenditures are expected to reach USD 330 m (1.8% of GDP) in 2022. This is a positive shock to aggregate demand. It partially explains why Georgia's economy is only moderately affected by the war. While this influx has also has distributional effects (e.g. rising rent prices), the relocation of mostly high-skilled people (many with a background in ITC) may be a chance for further economic growth.

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Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*