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RESEARCH

Georgian Economy
Key macro themes in focus

Georgia | **Economy**
January 27, 2023

Georgian economy performed strongly in 2022 as expected adverse impact from Russia's war in Ukraine did not materialize. War-related immigration, a surge in financial inflows, a rebound in investments and a rise in cargo transit strengthened growth and the GEL. Inflation has remained high despite easing at end-22, reflecting strong domestic demand and increased housing rents, on top of persistent food price pressures. We expect growth momentum to continue and forecast close-to-potential growth at 4.8% in 2023 and 5.0% in 2024.

Key economic themes in 2023

Amid geopolitical tensions, uncertainty surrounding growth outlook remains high. In this report we consider key themes for 2023:

1. 2023 baseline growth forecast and alternative scenarios
2. Inflation and monetary policy rate
3. Exchange rate
4. War-related flows
5. Real estate market
6. Cargo transportation
7. Labor market and wages
8. Debt sustainability in high interest rate environment.

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1. 2023 baseline growth forecast and alternative scenarios

Baseline growth

The Russia's war in Ukraine was expected to slow growth in Georgia. Contrary to expectations, in 2022, the economy experienced a fast recovery in tourism, a surge in war-related immigration and financial inflows, a rise in transit trade and local investments. FDI also recovered strongly supported by favorable business environment and opportunities in real estate, industry, energy and financial sectors. In 9M22, FDI more than doubled y/y and stood at US$ 1.7bn (9.7% of GDP). We anticipate investments to continue strong growth in 2023 and beyond.

We expect growth at 4.8% in 2023 after 10.2% growth in E2022. Continued recovery in tourism (+15.0% y/y growth), continued growth in investments and lasting impact of immigration expected to drive 2023 growth along with decelerating inflation pushing up consumer demand.

In 2024 we project growth at 5.0% fueled by consumption, strong investments (infrastructure, energy, logistics, and undersea cable project) along with more favorable external environment.

Alternative scenarios

As uncertainty remains high amid regional geopolitical tensions, we put together several risk scenarios which may affect 2023 growth. We estimate following impact on growth vs baseline:

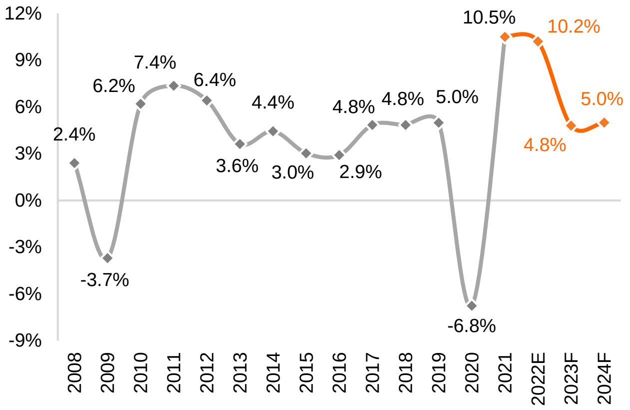
- Lower migrant related inflows (remittances, tourism) would subtract 1.0ppts from growth.
- Financial outflows (non-residents deposits) would lower growth by 0.19ppts.
- House market downturn would subtract an additional 0.75ppts from growth.
- Low growth in key trading partners would lower Georgia's growth by 1.6ppts.
- Continued immigration from Russia is estimated to add 2.1ppts to growth.

If all downside risks realize, then cumulatively growth may slow to 1.2% from 4.8% baseline projection in 2023. In upside scenario, growth may reach 6.9%.

The realization of downside scenarios will contribute to inflationary pressures and GEL depreciation. In this case, GEL may climb to 3.0-3.5 vs dollar, inflation rise further and policy rate may be raised to 12-14% in 2023. However, Georgia's rebuilt fiscal buffers and replenished international reserves create sound ground to deal with the shocks effectively.

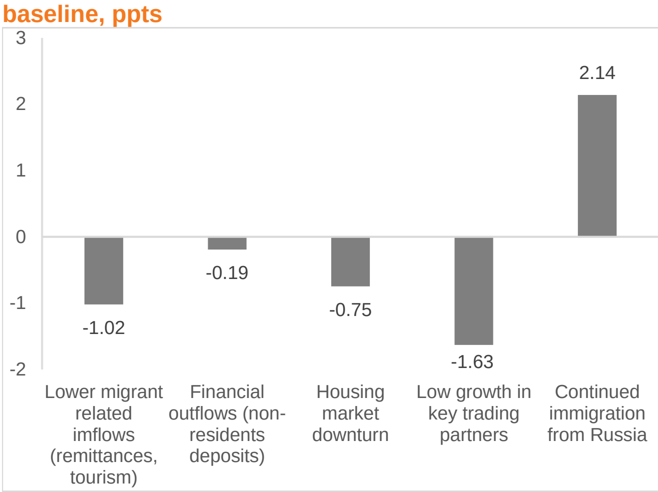
In upside scenario, inflationary pressures expected to be persistent and further policy rate tightening can't be ruled out also.

Figure 1: Real GDP growth



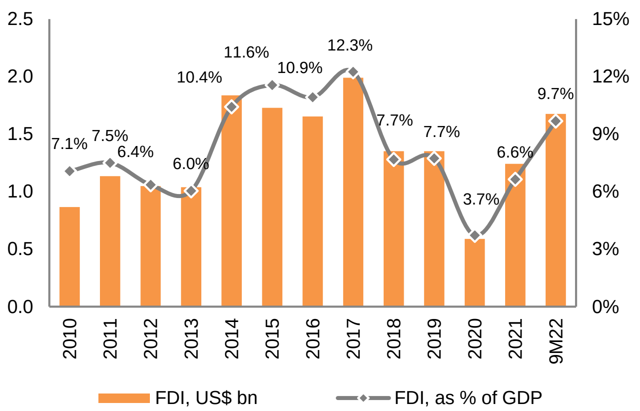
Source: Geostat, Galt & Taggart

Figure 2: Real GDP growth – alternative scenarios vs. baseline, ppts



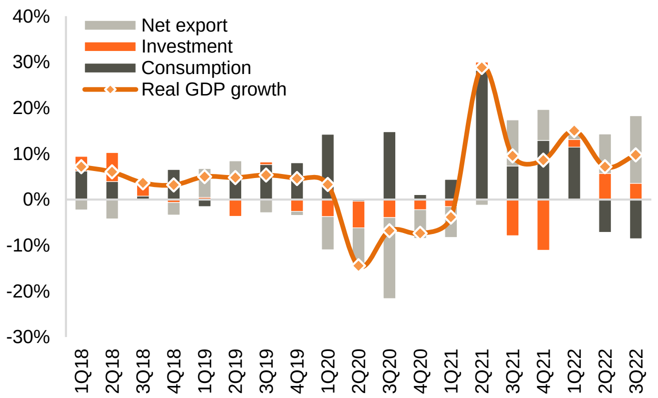
Source: Galt & Taggart

Figure 3: FDI in Georgia



Source: Geostat

Figure 4: Contribution to GDP growth



Source: Geostat, Galt & Taggart

2. Inflation and monetary policy rate

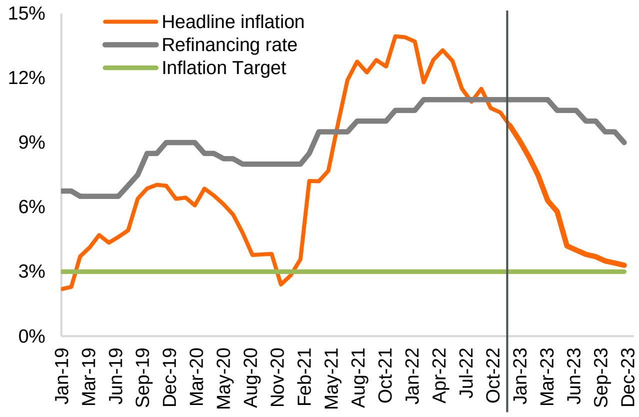
Inflation reduced from its 13.9% peak in Jan-22 to 9.8% in Dec-22, supported by decelerating commodity prices and GEL appreciation. Price pressures have been driven by strong demand and rising housing rents (affected partly by migrants), on top of persistent increase in food prices.

The NBG kept the policy rate at 11.0% since Mar-22 and also implemented several macroprudential measures to limit bank credit growth.

As uncertainty and risks remain high, the NBG intends to keep its policy rate at 11.0% until a clear trend of decreasing inflation is observed. We expect Inflation to decelerate in 2023 and project average annual inflation at 5.2% down from 11.9% in 2022 and see inflation close to target by end-23.

In our inflation forecast, we expect food price pressures to ease this year driven by delayed effects of GEL appreciation and reduction in global food prices. Therefore, we see room for policy rate cut from spring 2023 and expect policy rate at 9.0% at end-23. We believe that continued global tightening will be transmitted to Georgia and therefore reduction in GEL rates will be necessary to escape overtightening. However, the risk of capital outflow amid raising global rates may make NBG reluctant to cut GEL rate.

Figure 5: Inflation and monetary policy rate – baseline scenario

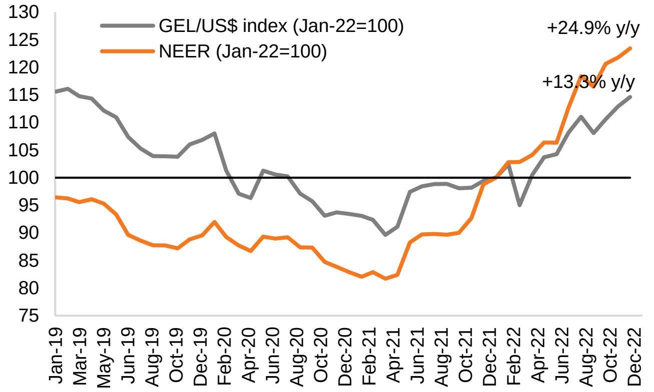


Source: NBG, Geostat, Galt & Taggart

3. Exchange rate

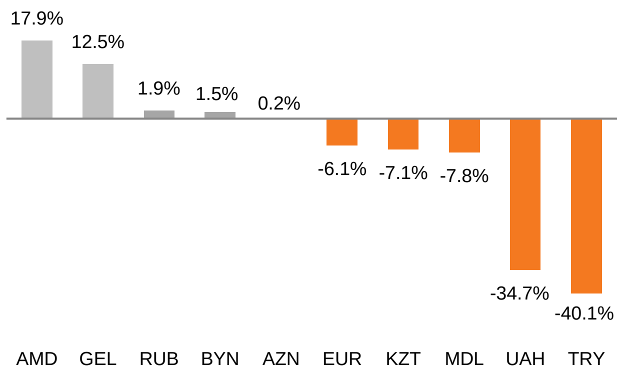
The GEL appreciated by 12.5% vs USD and by 24.9% in nominal effective terms (NEER) in 2022 (and by 10.0% and 20.0% respectively from its pre-war levels). Currency strengthening was supported by tourism and migrant-related FX inflows (including remittances). NBG was net buyer of US$ 564.6mn during 2022 raising international reserves to record high US$ 4.9bn. In baseline scenario, we see average GEL rate at 2.8 vs dollar in 2023 (down from 2.9 in 2022), as FX inflows (including from tourism) remain solid.

Figure 6: GEL/US$ and NEER index



Source: NBG
Note: Index growth means GEL appreciation

Figure 7: Currencies vs dollar, 1/Jan/22 – 31/Dec/22



Source: Bloomberg
Note: +/- means appreciation/depreciation.

4. War-related flows

War-related inflows of capital as well as relocation of workers and companies boosted demand and strengthened GEL since Mar-22. Notably, these inflows continue currently as we observe in high frequency data.

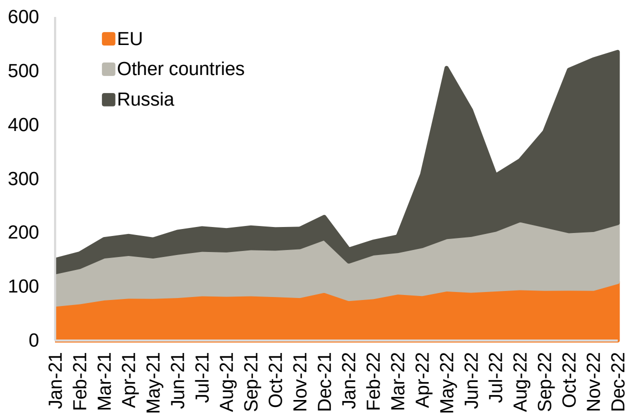
Overall in 2022, inflows from exports of goods, remittances and tourism stood at US$ 13.5bn (up 72.0% y/y), while outflows from these channels reached US$ 14.2bn (up 34.1% y/y), resulting substantial US$ 2.0bn improvement in net FX inflows compared to previous year.

We estimate direct impact of war-related positive shock (migration, high commodity prices, strong growth in CIS countries, etc.) adding 2-3ppts to 2022 growth, stemming from:

- Remittances – the effect was US$ 1.8bn (o.w. US$ 1.6bn from Russia)
- Tourism – the effect was c. US$ 600mn (o.w. c.50% from Russia)
- Exports – the effect was c. US$ 700mn
- Migration boosted real estate market and investments (FDI more than doubled in 9M22)
- Cargo transit also increased
- Imports increased by additional US$ 1.8bn.

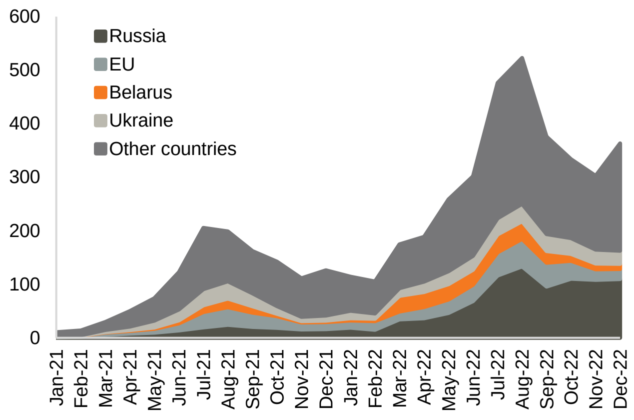
There is a high uncertainty currently as there might be a reversal in war-related inflows or these flows could increase further under intensified geopolitical tensions. However, we acknowledge that risks are balanced as the possible reversal should be gradual and part of migrants are returning Russian citizens of Georgian origins, which might stay in the country longer.

Figure 8: Remittances, US$ mn



Source: NBG

Figure 9: Tourism revenues, US$ mn



Source: NBG

5. Real estate market

Migrants boosted housing market and rents skyrocketed. Notably, real estate price and rent growth was more pronounced in dollar than in GEL terms, as prices experienced larger upward correction in dollar amid GEL appreciation.

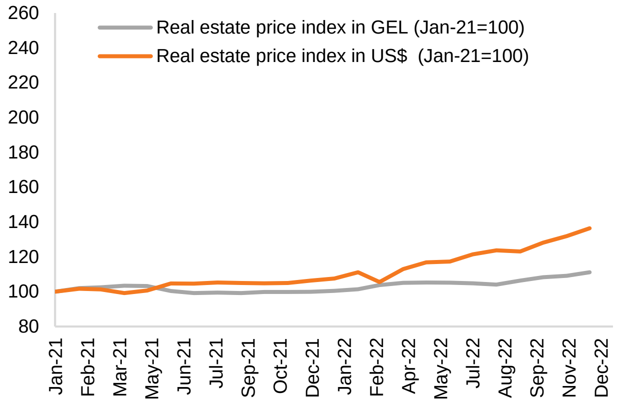
Migration mostly affected rent market. Real estate rent index in Tbilisi increased by 83.9% y/y in GEL and by 112.0% y/y in dollar terms in Dec-22 from its pre-war levels. In the same period, real estate prices increased at a slower pace, up by 11.2% y/y in GEL and 28.3% y/y in dollar terms. Apart from migrants, real estate price growth was driven by rising input costs (construction materials, wages and land).

Currently, there is no clear evidence that migrants are switching to buying apartments rather than renting. Unless this happens, we expect moderate real estate price growth as input cost pressures have eased recently.

Taking this into consideration, in 2023 we expect real estate price growth at 5.0% y/y in GEL and at 8.0% y/y in USD. After extraordinary growth in 2022, we anticipate correction in rent market and expect close to zero growth of rents in both GEL and US dollar terms in 2023.

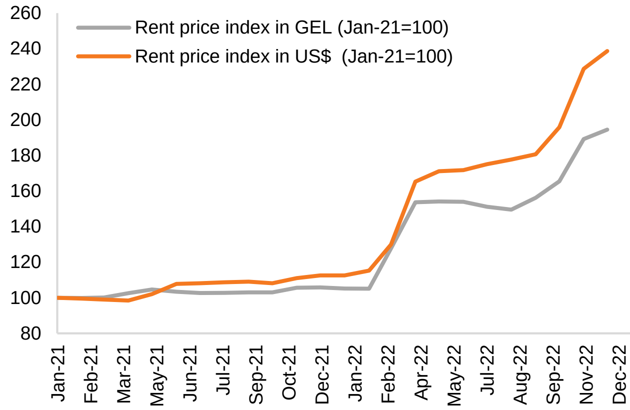
However, in case of sudden reversal in inbound and outbound migration flows or switching to apartment purchases, housing market prices may adjust substantially.

Figure 10: Real estate price index in Tbilisi



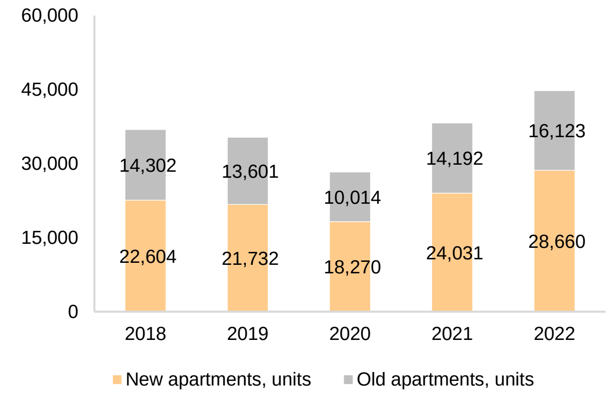
Source: NBG

Figure 11: Real estate rent index in Tbilisi



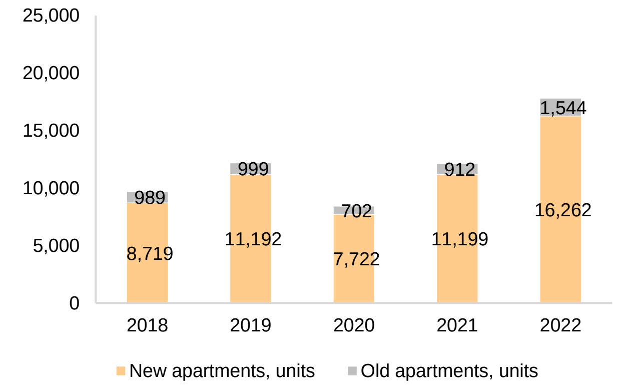
Source: NBG

Figure 12: Apartment sales in Tbilisi, units



Source: NAPR, Galt & Taggart

Figure 13: Apartment sales in Batumi, units

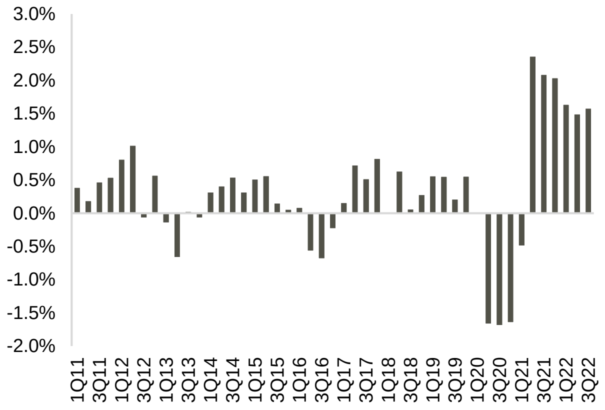


Source: NAPR, Galt & Taggart

6. Cargo transportation

Sanctions on Russia shifted cargo flows from traditional to alternative routes. Companies that were using Northern route are now facing challenges in cargo security, uncertainty about insurance coverage and extended queues at border crossings. As a result, demand for the alternative routes, including Middle Corridor (running through Georgia), increased and expected to rise further as geopolitical challenges persist. Therefore, Georgia's transport and logistics sector increased by 28.6% in real terms and contributed 1.6ppts to real GDP growth in 9M22. We expect this trend to continue in coming years as Georgia is becoming more attractive and investments expected to increase in transport and logistics projects.

Figure 14: Transport and storage sector's contribution to real GDP growth, ppts



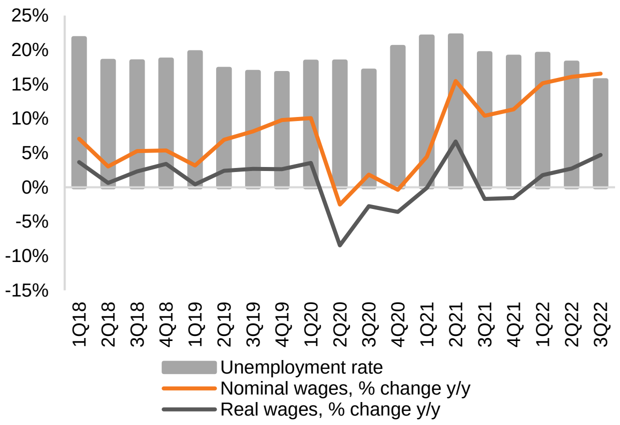
Source: Geostat

7. Labor market and wages

Economic recovery supported reduction in unemployment in 2022. Notably, services sector posted strong rebound and helped unemployment to decrease to record low 15.6% in 3Q22. Inflationary pressures and economic recovery fueled wage growth – nominal wages increased by c.16% y/y and real wages were up by 3.1% y/y in 9M22.

We expect wage growth to continue at c.10% y/y in 2023 (notably, wages in public sector increased by 10% y/y from Jan-23). However, considering ongoing productivity growth, wage pressure on prices seems manageable.

Figure 15: Unemployment and wage growth



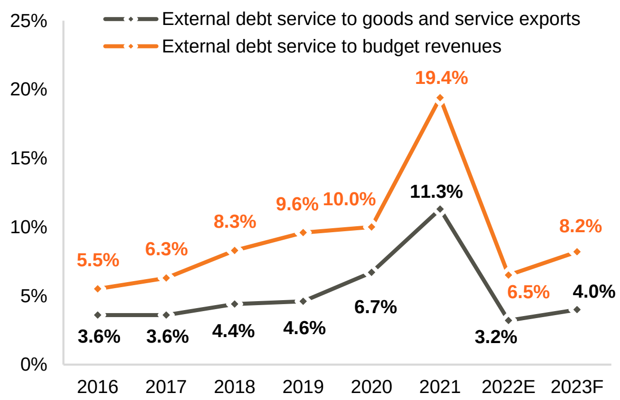
Source: Geostat

8. Debt sustainability in high interest rate environment

Public debt-to-GDP ratio was back to pre-pandemic level below 40% in 2022 from its 60% peak in 2020 due to COVID-19, reflecting GEL appreciation and strong nominal GDP growth. In medium term fiscal framework, debt-to-GDP ratio remains stable below 40% in 2023-26. Government debt management strategy envisages to continue efforts to increase the share of local currency debt from 24.9% in 2022 to 35.3% in 2026 to ease exchange rate risks.

Despite tighter global financial conditions, Georgia's debt service ratios significantly improved in 2022 amid strong economic growth and GEL appreciation. The ratios expected to slightly deteriorate in 2023, but remain at comfortable level based on IMF/WB external debt service matrix. Generally, exchange rate remains key risk as 75.1% public debt is in FX.

Figure 16: External debt service to export and revenue



Source: MOF, Geostat, Galt & Taggart

Macro data and forecasts

Georgia	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022E	2023F	2024F
GDP and Prices													
Nominal GDP, GEL bn	27.2	28.6	31.1	33.9	35.8	40.8	44.6	49.3	49.3	60.0	72.1	79.0	85.8
Nominal GDP, US$ bn	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.5	15.8	18.6	24.7	28.2	30.6
Nominal GDP per capita, US$	4,422	4,624	4,739	4,013	4,062	4,359	4,722	4,696	4,256	5,015	6,702	7,644	8,308
Real GDP, % change y/y	6.4%	3.6%	4.4%	3.0%	2.9%	4.8%	4.8%	5.0%	-6.8%	10.5%	10.2%	4.8%	5.0%
CPI Inflation, average	-0.9%	-0.5%	3.1%	4.0%	2.1%	6.0%	2.6%	4.9%	5.2%	9.6%	11.9%	5.2%	3.8%
CPI Inflation, eop	-1.4%	2.4%	2.0%	4.9%	1.8%	6.7%	1.5%	7.0%	2.4%	13.9%	9.8%	3.3%	3.5%
GEL per US$, average	1.65	1.66	1.77	2.27	2.37	2.51	2.53	2.82	3.11	3.22	2.92	2.80	2.80
Population, mn	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Government Finances													
Budget revenues, % of GDP	28.8%	26.4%	26.5%	27.5%	28.0%	27.4%	27.0%	26.6%	25.6%	25.9%	27.2%	26.5%	25.9%
Budget expenses, % of GDP	29.4%	27.6%	28.4%	28.6%	29.4%	28.2%	27.7%	29.4%	34.9%	32.3%	30.0%	29.5%	28.1%
Fiscal balance (-deficit), % of GDP	-1.7%	-1.9%	-2.6%	-2.4%	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.1%	-3.1%	-2.8%	-2.3%
Public debt, % of GDP	28.8%	29.5%	31.0%	36.7%	40.3%	39.4%	38.9%	40.4%	60.2%	49.7%	39.6%	38.3%	37.8%
External Sector													
Current account, US$ bn	-1.9	-1.0	-1.8	-1.8	-1.9	-1.3	-1.2	-1.0	-2.0	-1.9	-0.8	-1.5	-1.6
Current account, % of GDP	-11.4%	-5.6%	-10.2%	-11.8%	-12.5%	-8.1%	-6.8%	-5.8%	-12.5%	-10.4%	-3.1%	-5.5%	-5.1%
Exports of goods and services, US$ bn	6.0	7.2	7.1	6.2	6.2	7.6	8.9	9.6	5.9	8.1	13.3	14.8	16.3
Imports of goods and services, US$ bn	9.2	9.3	10.1	8.7	8.5	9.4	10.8	11.2	9.0	11.2	15.5	17.3	18.7
Net Current transfers, US$ bn	1.4	1.5	1.4	1.1	1.1	1.3	1.4	1.4	1.8	2.3	3.2	2.8	3.0
Net FDI, US$ bn	0.8	0.9	1.4	1.4	1.2	1.7	1.0	1.1	0.6	0.9	2.0	1.8	1.8
Net FDI, % of GDP	4.6%	5.3%	8.1%	9.5%	8.2%	10.6%	5.7%	6.1%	3.6%	4.9%	8.3%	6.4%	5.9%
Gross international reserves, US$ bn	2.9	2.8	2.7	2.5	2.8	3.0	3.3	3.5	3.9	4.3	4.9	5.2	5.4
Financial sector													
Bank loan portfolio, US$ bn	5.3	6.0	7.0	6.7	7.1	8.6	9.9	11.1	11.7	13.9	16.6	17.2	18.5
Bank loan portfolio, % of GDP	31.2%	36.1%	40.8%	47.2%	52.8%	54.7%	59.6%	64.8%	77.6%	71.4%	62.1%	60.9%	60.5%
Monetary policy rate, %	5.3%	3.8%	4.0%	8.0%	6.5%	7.3%	7.0%	9.0%	8.0%	10.5%	11.0%	9.0%	8.0%

Source: NBG, MOF, Geostat, Galt & Taggart

Note: Fiscal balance according to IMF Program Definition

Disclaimer

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