

## Georgian economy outperformed expectations in 2017

The Georgian economy develops positively. GDP grew by 4.3% in 2017 and is expected to continue with similar speed in 2018. Economic growth occurred on a broad base: It has been supported by consumption, investment and exports.

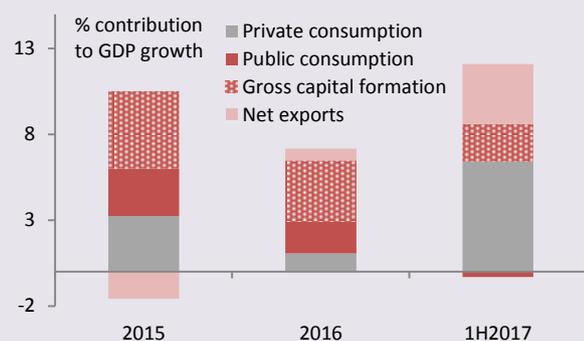
Inflation was at 5.8% in 2017 and thus exceeded the National Bank's target. The reason was a one-off increase in excise taxes at the beginning of 2017. Thus, inflation is supposed to decrease significantly during 2018 to ca. 3%. Goods exports were supported by higher commodity prices and exports of services – especially revenues from tourism – increased remarkably. Thanks to these developments, the current account deficit decreased significantly: In the period from January to September it amounted to 7.4% of GDP after 11.9% in the same period of the previous year.

The budget deficit was at 3.6% of GDP in 2017 and thus met the provisions of the IMF programme. Revenues were higher than expected and provided space for additional investment into the East-West highway. Despite this positive development Georgia is still a transition economy with a moderate GDP per capita of USD 4,100. Among the key challenges of economic policy are the modernisation of the agricultural sector, the improvement of vocational education and the reduction of dollarisation in the financial sector.

### Higher economic growth on a broad base

In the last year the country returned to a higher growth path with rates of more than 4%. This exceeded initial expectations: In the course of the year the IMF revised its growth projection from 3.5% to 4.3%, other experts expect even higher values of up to 5.0%. On the demand side growth is balanced: Consumption, but also investment and exports contributed to the positive economic development.

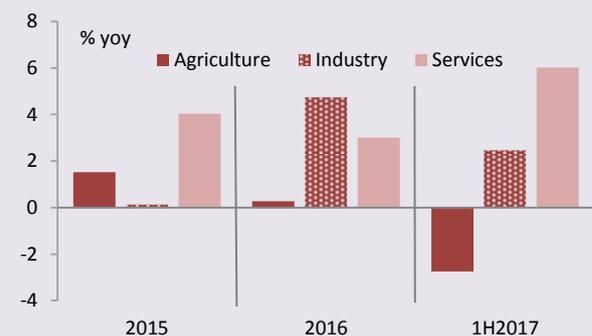
### Sectoral contribution to value added



Source: Geostat

On the supply side services remain the main driver. However, as in the previous year, industry increasingly contributes to growth, which is clearly positive. Agriculture remains the problematic sector; its contribution to growth was negative in the first half of 2017.

### Sectoral dynamics



Source: Geostat

This development is supposed to continue in 2018. The IMF expects GDP to grow at 4.2%.

### High inflation during 2017 due to one-off measures

Average inflation amounted to 5.8% in 2017 and thus clearly exceeded the National Bank's (NBS) target of 4%. The reason was a one-off significant increase of excise taxes on mineral oil, cars, tobacco and gas in the beginning of 2017. The NBS reacted in the framework of its inflation targeting policy by increasing the policy rate in January, May and December 2017. As the excise increase was a one-off measure, inflation will probably meet the target of 3% this year.

### Smaller current account deficit in 2017

Georgian external trade also gained momentum: Goods exports increased by remarkable 29% from January to September; partly supported by higher commodity prices. Imports increased by 8%.

For Georgia the export of services plays a special role being even larger than the export of goods. Tourism is the most important category in this context – revenues from this sector increased by 29% in the first three quarters of 2017.

Thanks to these factors – strong goods exports and high revenues from tourism – the Georgian current account deficit, being one of the largest weaknesses of the country's economy, decreased significantly in 2017. In the first three quarters of the past year it amounted to ca 7.4% of GDP, after 11.9% in the same period of 2016. These are undoubtedly positive news. However, the current account deficit remains one of the largest sources of risk for Georgia.

**Public finances under control**

The budget deficit was at 3.6% in 2017 and did thus not exceed the ceiling agreed upon in the IMF programme. Revenues were – due to the positive economic conditions – higher than expected. Also the fact that revenue losses from the reform of corporate taxation (since 2017 only dividends instead of profits are taxed) were lower than expected played a positive role. They amounted to only 1.1% of GDP instead of the planned 1.5%.

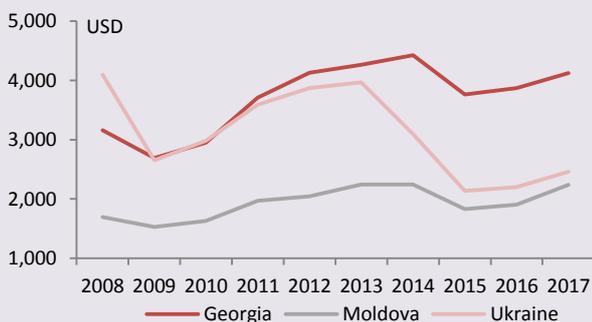
This created fiscal space: 75% of additional revenues were used for infrastructure projects, especially for the extension of tunnels and bridges on the East-West highway. Thus, the government continues its growth-oriented budget policy. Already the original budget had foreseen a significant reallocation of funds away from consumptive towards investment spending.

The good and stable budget situation was an important factor for the smooth disbursement of the second tranche of the IMF programme. The budget deficit is expected to amount to reasonable 3.0% of GDP in 2018.

**Moderate GDP per capita**

This positive development should, however, not conceal the fact that Georgia is still a transition economy with a moderate GDP per capita of ca USD 4,100. This value is much higher than in Ukraine or Moldova. At the same time it is much lower than that in other East European countries that have started reforms earlier. In Lithuania, for example, the GDP per capita amounts to USD 16,400.

**GDP per capita in regional comparison**



Source: IMF

**Conclusion**

The case of Georgia illustrates that good economic policy pursued over several years pays off in the form of a good economic development. This is shown by the fact that the Georgian GDP per capita is now much higher than that of Ukraine and Moldova.

Also the IMF seems to be confident about its cooperation with the Georgian government. Thanks to the fact that all conditions of the first review were met, the second tranche was disbursed in December even without summoning formal consultations of the Board in Washington.

Despite this positive development significant challenges persist. The modernisation of the agricultural sector – also with the help of foreign investors – should move forward. Additionally, efforts to improve vocational education need to be intensified in order to make Georgia more attractive for investors. Finally it is important, as has been recognised by the National Bank, to reduce the high level of dollarisation in the banking sector.

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