

Georgia in mid-2018: positive economic trend continues

In 2017, the Georgian economy developed well. By mid-2018 we observe a continuation of this trend. GDP increased by 5.0% in 2017 and in the period of January-April 2018 growth even accelerated to 5.5%. Economic growth is broad based – whereas agriculture is the only exception with a decline in 2017.

Inflation now amounts to moderate 2.5%. It can be expected that the National Bank will largely meet its inflation target of 3.0% in 2018. Thus, the country enjoys price stability.

After a significant depreciation in autumn 2017, the Lari has regained value, without sizeable interventions by the National Bank. A flexible exchange rate is essential for stability, even though the National Bank has been repeatedly criticised for its policy.

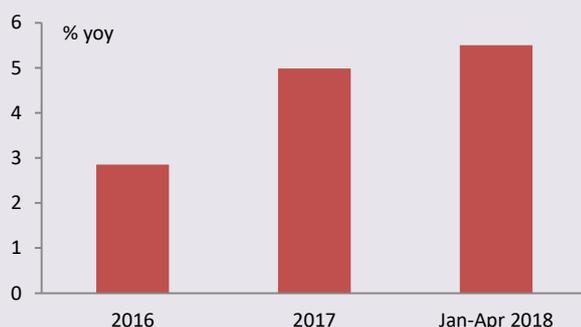
External trade has strongly expanded in 2017 and in the period of January-May 2018, boosted by the regional economic recovery. Last but not least, the fiscal situation is stable with the budget deficit amounting to 2.9% of GDP in 2017.

Against this background, the smooth implementation of the IMF programme and the expected disbursement of the third tranche in June do not come as a surprise. From today's perspective, the resignation of the government on 13 June should not affect the country's economic outlook in a negative way.

High economic growth

Real GDP growth amounted to 5.0% in 2017. In 2018, this positive economic trend continues. According to preliminary estimations, economic growth amounted to 5.5% yoy in the period of January-April 2018. For 2018, the IMF foresees a further expansion of economic growth of 4.5%. Local investment banks even expect 5.4%.

Real GDP growth



Source: NBG

In 2017, growth was broad based, driven by private consumption, investment and net exports. On the supply side, the picture was different. Services (6.0%) and industry (4.5%) increased significantly in 2017, while agriculture declined by 2.7%. This sharp disparity is a clear sign of structural problems and shows a need for vast reforms in the sector.

Price stability

In 2017, inflation amounted to 6.0% and has thus exceeded the National Bank's inflation target of 4.0%. Importantly, the underlying reasons for this development have a rather fiscal than monetary nature. In the beginning of 2017, excise taxes for mineral oil, cars, tobacco and gas have been increased remarkably and this in turn affected consumer prices.

Now, however, inflation declined significantly and amounted to only 2.5% yoy in May 2018. The increase of the policy rate by the National Bank in 2017 has most likely contributed to this stabilisation.

NBG policy rate



Source: NBG

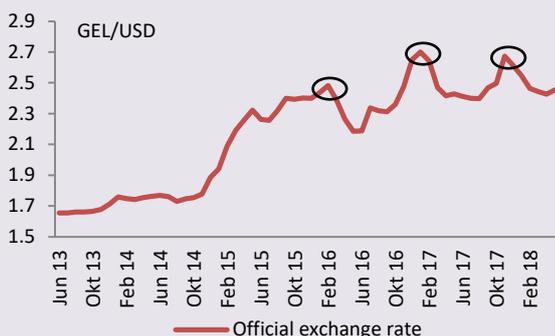
Due to the ceased fiscal effect and the tight monetary policy, the inflation target of 3.0% will most likely be largely met in 2018. In order to sustainably reduce dollarisation in Georgia, the long-term stabilisation of the inflation rate on a low level is essential. Currently, high dollarisation poses a significant risk to the country's macroeconomic and financial stability.

Lari appreciates after seasonal fluctuations

In autumn 2017, the Lari has significantly depreciated versus the US dollar with the exchange rate increasing from 2.4 to 2.7 GEL/USD. This depreciation caused concern and many discussions, also with respect to the exchange rate policy by the National Bank. By now, the exchange rate has "normalised" and amounts to 2.5 GEL/USD (June 2018). Apparently, the depreciation was caused by seasonal factors (energy imports and

fewer tourists in autumn/winter), which have ceased by now. It was important that the National Bank has refrained from any major interventions on the foreign exchange market in order to support the local currency. Instead, it allowed the exchange rate to fluctuate and let the people understand that the exchange rate can go both ways: upwards and downwards. This is also important in order to sustainably reduce dollarisation.

Exchange rate



Source: NBG

External trade

In 2017, Georgian exports profited from the regional economic recovery and increased by 29.1%. Imports increased by 9.4%.

These dynamics continue in 2018, with significant export growth in the period of January-May, especially to Azerbaijan (+156%), Ukraine (+93%), Armenia (+36%) and Russia (+13%). Also, export to the EU further increased by 14%. Increasing exports are a welcome development, especially considering the still significant trade deficit of 11.7% of GDP in 2017. Export promotion remains a key target of the government.

Reasonable budget deficit

Finally, the country's budgetary situation appears to be stable. The fiscal deficit amounted to 2.9% of GDP in 2017 and is supposed to decrease to 2.3% by 2022. This planned fiscal consolidation is remarkable, given that public investment is planned to increase significantly at the same time. That combination shall be realized through significant reductions in consumptive expenditures from 26.0% in 2016 to 20.6% of GDP in 2022. Such a shift in fiscal spending, however, is only possible due to the country's high economic growth. This clearly indicates the interdependence between the economic and the fiscal situation.

Outlook

The clearly positive economic situation has decisively contributed to the smooth implementation of the IMF programme and the planned disbursement of the third tranche in June 2018, amounting to USD 44 m. The strict implementation of practically all IMF conditions is to be seen positively and clearly makes the Fund's work a different experience compared to other countries in the region.

It remains to be seen whether the government's resignation on June 13 will affect the country's economic situation. From today's perspective, a destabilisation is not to be expected, especially as the National Bank, which acts independently from the government and where no changes in staff have been made, is responsible for a large share of economic stability. This proves once more the essential role that independent institutions play for a country's stability.

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