

Slowdown of economic growth

The overall macroeconomic situation in Georgia remains stable. Economic growth amounted to 5.4% in the first half of 2018. However, a slowdown took place in the second half of the year, which will continue in 2019. As a result, Georgia will grow at a moderate rate of 4.6% in 2019.

Inflation is under control. In 2018, consumer prices will rise by only 2.8%; thus, the National Bank will meet its target of 3%. The recent depreciation against the US dollar can be explained by seasonal factors and by the turbulent campaign preceding the presidential elections. In our view, there is no reason for sizeable action by the National Bank.

In 2018, the current account deficit will increase to 10.5% of GDP. While we see no immediate problem, such a level increases the vulnerability to external shocks. This shows the need for promoting exports.

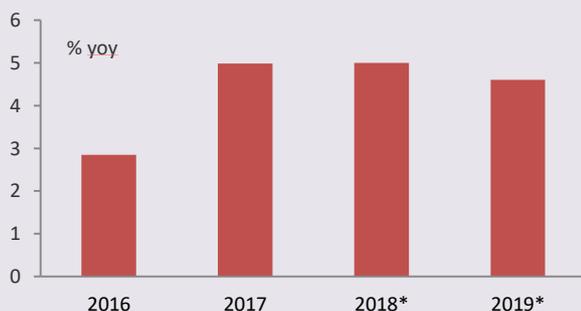
The fiscal situation is solid, with a budget deficit of 2.3% of GDP in 2018. We expect a continuation of this prudent fiscal policy in 2019.

All in all, the outlook is positive. Nevertheless, the authorities need to be vigilant, especially in light of higher external risks for the country.

Economic growth remains strong

In the first half of 2018, the Georgian economy grew at a respectable rate of 5.4%. On the demand side, growth was mainly driven by investment and private consumption which over-compensated the negative contribution of net exports. Turning the attention to the supply side sheds light on the sectors behind growth: in real terms industry grew by 7.4% and services by 6.3%. In contrast, agriculture delivered another weak performance. It declined by 2.9% in the first half of 2018, underlining the need for deep reforms in this sector.

Real GDP growth



Source: IMF; *Forecast

For 2018 and 2019, the IMF expects a slowdown in economic growth to 5.0% and 4.6%, respectively. This reflects increased external risks to the economy.

Domestically, it is expected that tougher lending regulation will – at least temporarily – dampen credit growth and thereby economic activity as a whole.

Inflation and monetary policy

In 2018, consumer prices are expected to increase by 2.8% on average. This means that the National Bank of Georgia (NBG) will most likely meet its inflation target of 3%, showing that prudent monetary policy pays off. In July 2018, the NBG was even able to slightly decrease the policy rate by 25 basis points to 7.0%.

NBG policy rate



Source: National Bank of Georgia

A lower policy rate is usually good news to borrowers as it is expected that bank lending rates decrease accordingly. However, looking ahead, the NBG might face some headwinds as monetary policy is beginning to normalise in advanced economies. This will most likely limit the space to compress rates much further.

Temporary pressure on the Georgian Lari

In autumn 2018, the depreciation of the Lari against the US dollar was again subject of public discussion. However, when taking a closer look it becomes apparent that there is no need for concern. First and foremost, the depreciation follows a typical seasonal pattern in which the Lari usually regains value in the beginning of the year. Moreover, the influence of a turbulent electoral campaign, preceding the presidential elections in November, is starting to cease. Therefore, the NBG should refrain from any sizeable interventions on the exchange market.

Nonetheless, regional instability has somewhat increased as the Turkish Lira and the Russian Ruble have

come under mounting pressure. A close monitoring of the situation is thus warranted.

Exchange rate



Source: National Bank of Georgia

Current account

In 2018, the current account deficit is expected to increase to 10.5% of GDP; up from 8.9% in 2017. This makes Georgia more vulnerable to external shocks.

The worsening of the current account can partly be explained by higher oil prices. Equally important, however, is the fact that the Georgian economy is still too import dependent. This becomes evident considering the fact that Georgia continues to be a net importer of food products. The same is true for electricity, which Georgia imported on a large scale this year even during summer, when Georgian hydro power plants can be used to their full potential.

Fiscal situation

Georgia enjoys a favourable fiscal situation in 2018. The budget deficit will most likely go down to 2.3% of GDP due to higher-than-expected revenues, strong economic growth and delays in public investments. Moreover, it is expected that public debt will decrease slightly to 44% of GDP at the end of 2018. Over the course of 2019, fiscal prudence is likely to continue.

Against this background, it comes as no surprise that the IMF reached staff-level agreement on the third review of its programme with Georgia. After the confirmation by the IMF-Board – which is expected to happen soon – a tranche of USD 41.6 m will become available.

Outlook

On the back of a well-managed monetary policy and continuous fiscal prudence, economic growth remains strong in Georgia. The smooth implementation of the IMF-programme confirms this development.

Looking ahead, the economic outlook is positive, but downside risks have clearly increased. Internally, a

tougher lending regulation is likely to weigh on growth. Externally, monetary policy in advanced economies is beginning to normalise. Some repercussions of this development – such as in Turkey – can already be felt. For Georgia, building up of fiscal buffers, exchange rate flexibility and continuous effort to implement structural reforms is the name of the game during these times.

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