

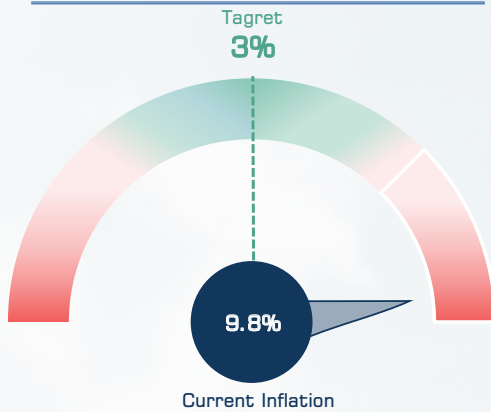
Monetary Policy Report

February
2023



საქართველოს ეროვნული ბანკი
National Bank of Georgia

INFLATION



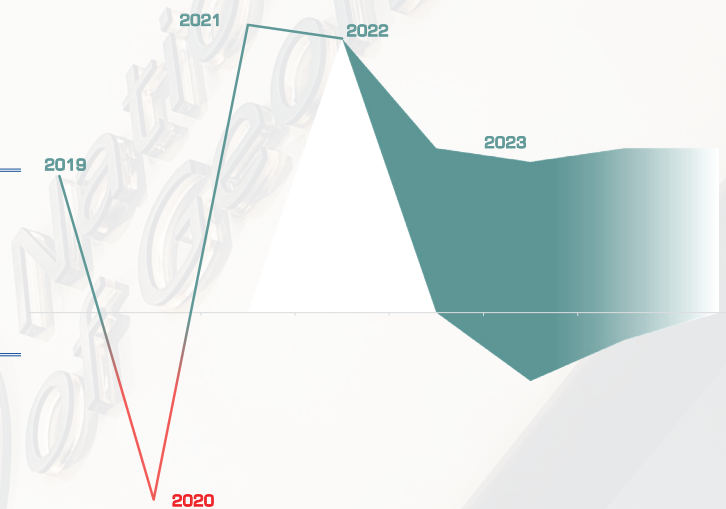
9.8%

Headline inflation has already passed its peak and is following a downward trend, although it remains at a high level.

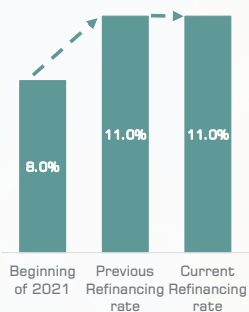
ECONOMIC GROWTH

Against the backdrop of reduced migration inflows and the expected slowdown of global economic growth, economic growth in Georgia is also expected to slow in 2023.

4%



MONETARY POLICY



11%

Taking into account the inflationary risks, the National Bank of Georgia maintained a tight monetary policy.

MONETARY POLICY DECISION

Monetary policy has been kept at a tight stance and the policy rate has been held at 11.0%.

The role of the National Bank of Georgia (NBG) is to affect aggregate demand and inflation expectations by changing the interest rate so that, in the medium term, inflation is kept near its 3% target level. Low and stable inflation supports employment and stable economic growth. Under the current uncertain circumstances, this has gained more importance.

Headline inflation in Georgia has already passed its peak and is following a downward trend, although it remains at a high level. The factors behind the high inflation – notably, increased food and energy prices on international markets, as well as rising international shipping costs – have recently been declining, which also reduces imported inflation. Meanwhile, the maintenance of tight monetary policy, fiscal consolidation, and the appreciation of the lari exchange rate also help to reduce inflation.

Despite these positive trends, inflationary risks and uncertainties remain high, necessitating the continuation of a tight monetary policy. While it is true that the positive trends on international markets are reason for cautious optimism, the future dynamics are still characterized by high uncertainty. In addition, wages in the local labor market have recently been growing more than productivity and a significant increase in the unit labor cost has thus been recorded, creating noteworthy inflationary pressure from the labor market. Other things being equal, as a result of maintaining a tight monetary policy, and with the gradual exhaustion of supply-side shocks, inflation will continue to decrease and will approach the target level from the second half of 2023. However, significant uncertainty remains and inflationary risks remain high. Accordingly, we have kept monetary policy at a tight level and have held the monetary policy rate at 11%.

Changes made to interest rates are transmitted to the economy gradually and will be fully reflected in about 4-6 quarters. If factors amplifying inflation expectations again become apparent, the monetary policy stance might need to be tightened further, or the current level maintained for a longer period. In addition, in order to avoid inflationary pressure arising from high credit activity and strong demand, the NBG considers it appropriate to use additional instruments.

Whatever the situation, we will use all the instruments at our disposal to ensure price stability and to maintain the purchasing power of the GEL. This means that the medium-term inflation rate will be close to 3%.

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BRIEF OVERVIEW

In 2022, the world faced another significant challenge: Russia's large-scale invasion of Ukraine, which caused severe humanitarian and economic damage. As a consequence of the austere sanctions imposed by the international community in response to Russia's aggression, and through the supply chains disrupted by the war, the conflict has affected the global economy, including Georgia. Although the resulting shock-induced inflation began to decline in the second half of the year, it remains high. According to the baseline macroeconomic forecast, inflation should approach the target rate in the second half 2023. However, because inflation's convergence with its target has been significantly delayed as a result of the severe shocks experienced in recent years, it is now critically important to ensure the steady reduction of inflation going forward. The National Bank of Georgia will therefore maintain its tight monetary policy stance this year as an adequate response to the increased risk of a deterioration of long-term inflation expectations.

Inflation will decrease to 5.4% on average during 2023 and will approach the target rate from the second half of the year.

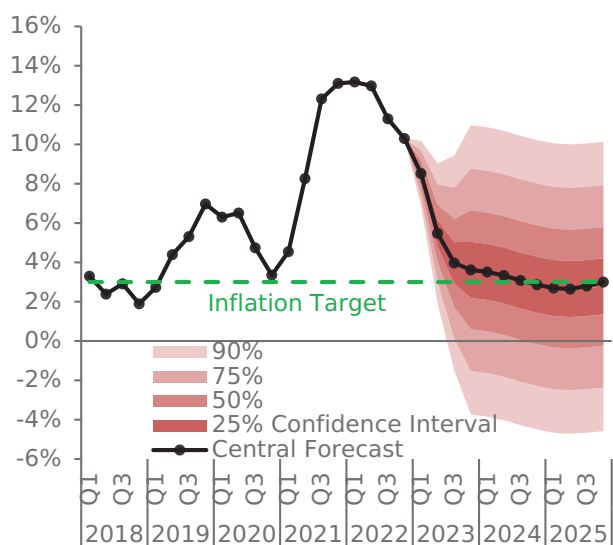


Figure 1. Headline CPI inflation forecast

Source: National Bank of Georgia (NBG), National Statistics Office of Georgia (GeoStat)

In the last quarter of 2022, inflation continued to moderate and decreased to the single-digit level of 9.8% in December. Declining imported inflation, amid the appreciation of the lari exchange rate, contributed to this, although domestic inflation has remained high. According to the baseline macroeconomic forecast, amid moderating aggregate demand, on the one hand, and the normalization of supply-side factors, on the other, **inflation will average 5.4% in 2023** while approaching the target from the second half of the year (see Figure 1).

The Russia-Ukraine war and subsequent events had a significant impact on the global economy; however, in certain cases, this process was accompanied by developments that were quite the opposite of initial expectations. Georgia, similar to several other countries in the region, received massive migration flows from Russia, which resulted in increased money inflows. This, in turn, has had a significant impact on economic activity, the exchange rate, and consumer prices. As a result, mostly as a consequence of the improving current account deficit, according to preliminary estimates, real GDP in 2022 grew by 10.1%. Naturally, the unexpectedly high aggregate demand hindered the reduction of inflation; however, the influence of this should gradually fade over the course of 2023. According to the baseline forecast, **economic growth will slow down to 4%** (see Figure 2), which, in part, will be a result of the normalization of the external sector. However, the continuation of tight monetary policy and planned fiscal consolidation will also play a critical role.

Among the supply-side factors affecting inflation, the recent significant appreciation of the exchange rate is particularly noteworthy. Although it is expected that this effect will gradually fade, its impact on infla-

Economic growth will slow down to 4% in 2023 amid the normalization of external demand, tight monetary policy and fiscal consolidation.

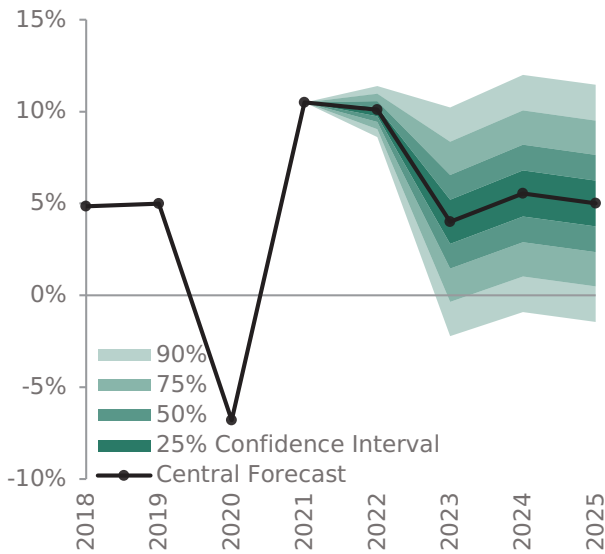


Figure 2. Annual growth forecast of real GDP

Source: NBG, GeoStat.

According to the current forecast, the National Bank of Georgia will maintain a tight monetary policy until the end of the year, with policy easing only beginning after the actual level of inflation approaches its target.

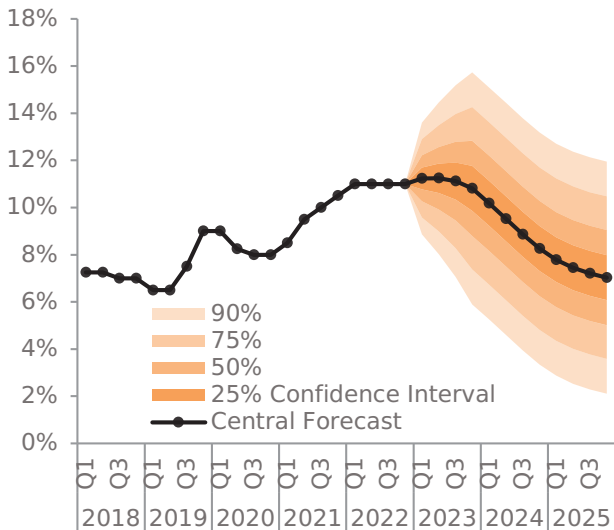


Figure 3. Monetary policy rate forecast

Source: NBG.

tion will continue to be felt in the short term. In addition, the stabilization of commodity prices on international markets, as evidenced by the global consensus forecasts, should continue, which, together with the decreasing trend of shipping costs, will strengthen the downward pressure on imported inflation. As for domestic inflation, recent trends in the labor market and potential pressures from wages on prices have become noteworthy, carrying the risk of a wage-price spiral.

Amid the severe shocks experienced in recent years, the convergence of inflation to its target has been significantly delayed. Consequently, it is critically important to ensure a steady reduction of the inflation rate, so as to ensure that the central bank’s credibility is not threatened and that inflationary expectations do not deteriorate in the long run. Considering the still-high uncertainty and the aforementioned risks, **the National Bank of Georgia will maintain a tight monetary policy stance this year** (see Figure 3). Policy easing will only begin after the actual level of inflation approaches the target, which is an adequate response to an increased threat of a deterioration of long-term inflation expectations. After inflation approaches its target, the policy rate will start to drift toward the neutral level (which is currently estimated at 7%).

It should be stressed that **the monetary policy rate forecast is not a commitment to future decisions** made by the National Bank of Georgia. Rather, it is the expected trajectory of the policy rate, assuming that all exogenous factors incorporated into the forecast materialize as expected. Hence, if external or domestic factors evolve differently than is currently expected, this may influence macroeconomic variables and, consequently, will affect future decisions made by the National Bank of Georgia.

1 CURRENT MACROECONOMIC SITUATION

Global economic activity was weak in 2022 – a consequence of the challenges surrounding the Russia-Ukraine war and the high inflationary environment. Energy and food prices remain elevated, putting pressure on consumer prices globally, including in Georgia’s main trading partners. This situation has necessitated a sharp tightening of the monetary policies of central banks. Despite the slowdown in the economic growth of partner countries, external demand in Georgia is strong, supported by enhanced migration inflows that have contributed to the high growth of travel revenues. Money transfers also increased to reach a record high. Accordingly, a historically low current account to GDP ratio is expected for 2022 (of about 3%). Considering these factors, high economic growth has been maintained overall. Although annual inflation is still high, the peak period has passed and inflation is following a downward trend.

Amid the challenges surrounding the Russia-Ukraine war and the high inflationary environment, global economic activity was weak in 2022. It is expected that the current trends will be partially maintained in 2023.

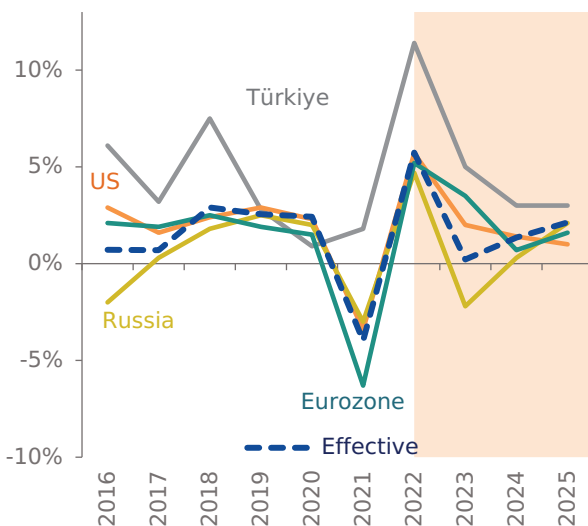


Figure 1.1.1. Real GDP growth of economic partners

Source: IMF.

1.1 OVERVIEW OF THE GLOBAL ECONOMY

1.1.1 OVERVIEW OF TRADE PARTNER ECONOMIES

In the wake of the Russia-Ukraine war, the global economy faced some severe challenges in 2022. In particular, the sanctions imposed by the international community on Russia in an effort to stop the aggressor have created temporary difficulties for the economies of many countries. Consequently, growth rates have deteriorated, especially for developed economies. In addition, there are still severe disruptions to global supply chains. As a consequence, inflation rates have increased unprecedentedly in a number of countries, and monetary policies have been tightened in response to a corresponding deterioration of inflation expectations. Therefore, according to the International Monetary Fund’s (IMF) January forecast¹, **global economic growth** in 2022 will be 3.4%, which is 0.2 percentage points (pp) higher than the previous forecast.² In 2023, growth rates are expected to deteriorate further and the world economy will grow by only 2.9%; however, this is still 0.2 pp higher than previously forecast. Also, amid increased inflation pressures, global inflation averaged 8.8% in 2022, and is projected to be 6.6% in 2023.³ For emerging and developing countries, real GDP is forecast to grow by 3.9% and 4%, respectively, in 2022 and 2023.⁴ Inflation was around 9.9% in 2022 and is expected to be 8.1% in 2023.⁵

1 International Monetary Fund. 2023. *World Economic Outlook Update: Inflation Peaking amid Low Growth*. Washington, D.C., January. (Hereafter: WEO, January update 2023).

2 International Monetary Fund. 2022. *World Economic Outlook: Countering the Cost-of-Living Crisis*. Washington, D.C., October. (Hereafter: WEO, October 2022).

3 WEO, January update 2023.

4 WEO, January update 2023.

5 WEO, January update 2023.

Amid the Russia-Ukraine war, food and oil prices on international markets remain high, boosting inflation in Georgia's trading partners, including the United States and the eurozone. Meanwhile, due to domestic factors, unprecedentedly high inflation has recently been observed in Türkiye.

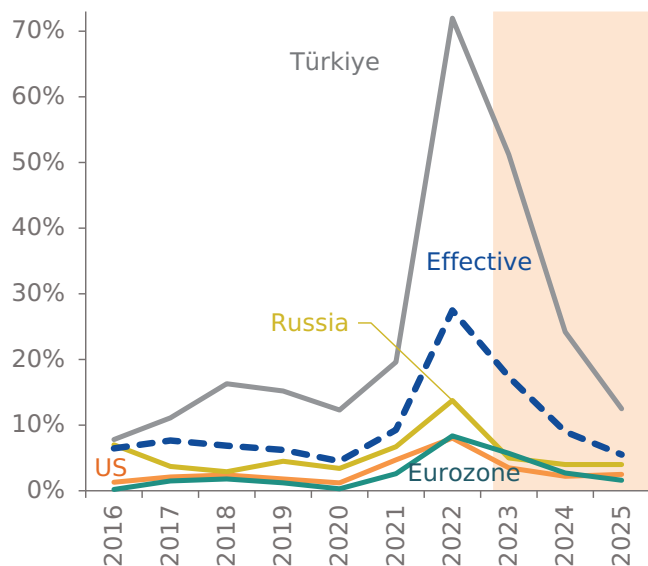


Figure 1.1.2. Headline Inflation rates of economic partners

Source: IMF.

A high inflationary environment prevailed in both developed as well as in emerging and developing countries. This was mostly related to the challenges surrounding the Russia-Ukraine war and still-high commodity prices on international markets. However, it should be noted that recently both oil and food prices have followed a downward trend (see section 1.1.2 of this report).

In the fourth quarter of 2022, the pace of growth in economic activity in the **United States** slowed. This was related to a sharp increase in consumer prices and a tightened financial environment. According to the data from November, residential investments declined along with inventory investments. However, net exports, non-residential investments and consumer expenditures all made a positive contribution to growth. Annual inflation remains high and stood at 6.5% in December. Meanwhile, in response to inflation expectations, the Federal Reserve raised its federal funds rate to the 4.25-4.5% range. According to IMF's January forecast, real economic growth in the US will be 2% in 2022, while it is expected to be around 1.4% in 2023. Annual inflation was 8% on average in 2022 and is projected to be 4% in 2023.⁶

In the fourth quarter of 2022, the pace of improvements in economic activity also slowed in the **eurozone**. This was mostly related to the challenges stemming from the Russia-Ukraine war. Due to the economic sanctions placed on Russian energy imports, the risk of a crisis in the European energy system remains. As a result, consumer and business sentiment has deteriorated. However, recently, given the warm winter, both domestic demand and the tourism sector have been active. Despite having fallen, the annual rate of inflation remains high and stood at 9.2% in December. It is also noteworthy that the packages of economic sanctions that European countries have enacted against Russia, which are designed to reduce their dependence on the latter's market, will put additional pressure on activity. According to the IMF's January forecast, real economic growth for the eurozone will be 3.5% in 2022 and is expected to be 0.7% in 2023. Annual inflation was 8.4% in 2022 and is projected to be 5.7% in 2023.⁷

In the fourth quarter of 2022, the improvement in economic activity continued at a slower pace in **Türkiye**. Both consumer sentiment and consumption remain weak, which was mostly due to the depreciation of the Turkish lira throughout last year. This caused high inflationary pressure, with annual inflation standing at 64.27% in December. Meanwhile, the volume of exports has increased. According to the IMF, real GDP growth will be 5% in 2022 and is expected to be 3% in 2023. Annual inflation was 72% in 2022 and is project-

⁶ WEO, January update 2023.

⁷ WEO, January update 2023.

In the fourth quarter of 2022, alongside rising inflation expectations, the majority of the central banks of Georgia's trading partners further raised their monetary policy rates. Türkiye is a noticeable exception to this, where, despite high inflation, the monetary policy rate has long been gradually declining.

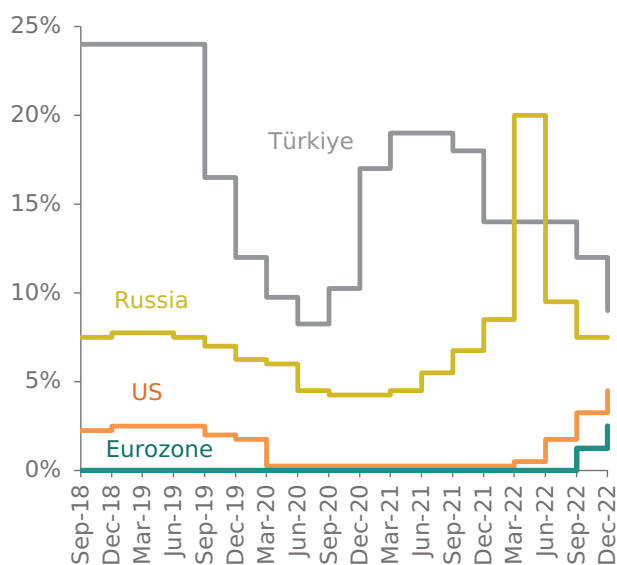


Figure 1.1.3. Monetary policy rates in Georgia's trading partners

Source: www.cbrates.com

ed to be 51.2% in 2023.⁸

Due to the economic sanctions imposed by the West, economic activity in **Russia** remained weak in the fourth quarter of 2022. Investments, consumer spending and retail sales were all down. The business environment also worsened. Soon after starting the war, amid a sharp depreciation of the Russian ruble – and despite its subsequent strengthening – annual inflation increased significantly and equaled 11.9% in December. As a result, the Central Bank of Russia decided to further tighten its monetary policy to 20%, which was then gradually reduced to 7.5% in December. It is also noteworthy that, since the end of March, as a result of active capital controls, the official exchange rate of the ruble stabilized against the US dollar. According to the IMF's January estimates, the real economy declined by 2.2% in 2022, while growth in 2023 is expected to be 0.3%. Inflation averaged 13.8% in 2022 and is projected to be 5% in 2023.⁹

Amid Russia's ongoing war, casualties in **Ukraine** are increasing daily, and some eight million Ukrainians have already left the country. Recently, energy facilities have been targeted by Russia and various other critical infrastructure has been destroyed, reducing the potential of the economy. According to the IMF, Ukraine's real economy is estimated to have declined by 35% in 2022, while inflation was 20.1%.¹⁰ It should be stressed that, amid the war, the civilized world, including Georgia, supports Ukraine.

The fourth quarter of 2022 was characterized by high economic activity in **Armenia**. This was mostly due to the increased migration of Russian citizens into the country, which raised activity in the service sector. However, the side effects of the war have still had a negative impact on the economy. The annual inflation rate was high and stood at 8.3% in December. According to the IMF, the real GDP forecast for Armenia is 7% in 2022, while it is expected to moderate to 3.5% in 2023. The annual inflation rate was 8.6% on average in 2022 and is projected to be 7% in 2023.¹¹

In the fourth quarter of 2022, **Azerbaijan's** economic activity continued to improve in both the oil and non-oil sectors. This was mostly due to the upward dynamics of oil prices on international markets and an improvement of the industrial sector. Investments also increased, which caused a stabilization of the external sector. However, the annual rate of inflation remained high and stood at 14.4% in December. According to the IMF's forecasts, real GDP growth in Azerbaijan stands at 3.7% and 2.5% in 2022 and 2023, respectively. The annual inflation rate was 13.8% on

⁸ WEO, October 2022.

⁹ WEO, January update 2023.

¹⁰ WEO, October 2022.

¹¹ WEO, October 2022.

average in 2022 and is projected to be 10.8% in 2023.¹²

In the fourth quarter of 2022, the **central banks** of the majority of Georgia’s main trading partners further tightened their monetary policies in response to higher inflation and rising inflation expectations. In particular, in December, the U.S. Federal Reserve raised its federal funds rate to the 4.25-4.5% range. Meanwhile, the European Central Bank increased its policy rate to 2.5% in December.

1.1.2 OVERVIEW OF INTERNATIONAL MARKETS

Russia’s invasion of Ukraine caused a significant increase in prices on global commodity markets, especially in terms of elevated grain prices. According to the latest data of the Food and Agriculture Organization of the United Nations (FAO), prices on international markets peaked in March and a decreasing trend has since been observed. In December, the food price index decreased by 1.0% annually and by 17.1% compared to the peak period. This index has been falling for nine months in a row (see Figure 1.1.4). Making a significant contribution to the price reduction, along with the humanitarian corridors that were created by the European Union, was an agreement reached on the export of grain from Ukraine to the Black Sea ports. In July, Ukraine and Russia reached the agreement to remove the restrictions on grain exports that had been imposed against the backdrop of the war; as a result, grain prices started to decline and this downward trend continued in the months that immediately followed. However, in September and October grain prices began to rise once more due to uncertainties surrounding the Black Sea Grains Initiative. In November, the agreement was extended for a further four months and prices then stabilized.¹³ In December, grain prices fell by 1.9% compared to previous month. However, since January 2023, Russia has increased the tax on grain exports, and uncertainties will also increase after the expiration of the aforementioned export agreement, which will naturally affect grain prices.

In 2022, a trend of stabilization and reduction of food prices was revealed. However, these remain at a high level.

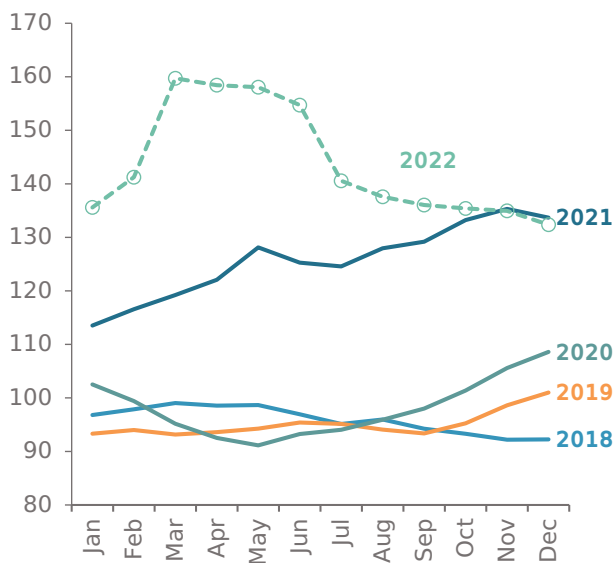


Figure 1.1.4. International food price index
Source: FAO.

In December, a declining trend in international vegetable oil and meat prices was evident. The vegetable oil price index decreased by 42.7% annually and reached its lowest rate since February 2021. The main reason for this was the decrease in prices caused by a drop in demand for sunflower, palm and soybean oils. However, this decrease was balanced by increased prices for dairy products and sugar, with the price of the latter having increased in recent months.

Despite the stabilization trend, prices are still significantly higher than pre-pandemic levels, and uncer-

¹² WEO, October 2022.

¹³ For more information, see <https://www.voanews.com/a/ukrainian-grain-export-deal-extended-four-months/6838308.html>

In 2021-2022, fuel prices increased sharply, but have seen a declining trend from the second half of 2022.

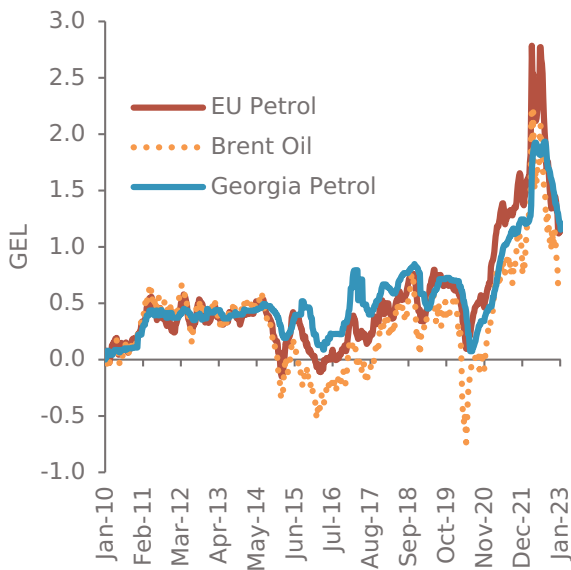


Figure 1.1.5. Petrol price index (Jan 2021=100)

Source: EU Commission, Statista, NBG calculations.

In line with the gradual easing of pandemic-related restrictions and the drop of oil prices, the cost of international transportation has continued to decline.

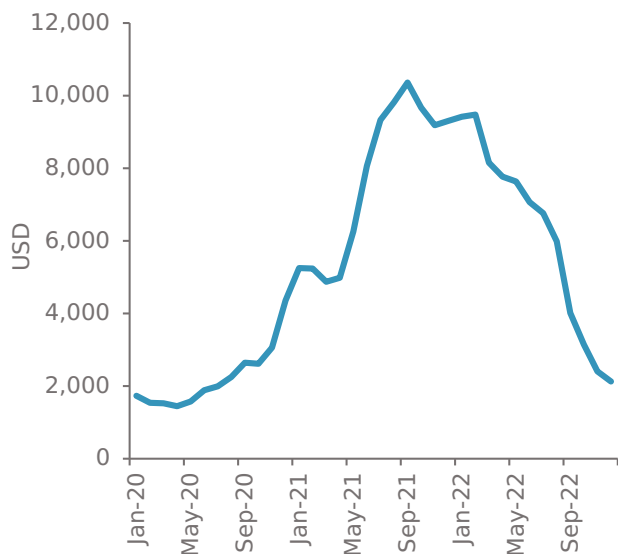


Figure 1.1.6. Average shipping cost of a 40-foot container worldwide

Source: Statista.

tainty regarding their dynamics remains high. Since Ukraine is one of the largest exporters of grain, maintaining the flow of Ukrainian grain remains crucial for ensuring global food security.

After the start of the Russia-Ukraine war a significant drop in oil supply was expected as a result of the sanctions imposed on Russia. Accordingly, oil prices rose sharply in early 2022 and peaked in June. However, recently, a positive trend in prices has been observed. In December 2022, the average price of Brent oil decreased by 34.3% compared to the peak period of June 2022, and the price per barrel amounted to USD 80.9. Yet, despite this recent decline, oil prices remain 20.3% higher than in the same pre-crisis period of 2019. Along with the fall in Brent oil prices, petrol prices in Europe and Georgia have seen a declining trend (see Figure 1.1.5). In December, petrol prices on the European market decreased by 33.1% compared to June 2022, and the average price of petrol in Georgia decreased by GEL 0.62 (by 33.7%) in the same period. According to the updated January 2023 forecast of the International Energy Association (IEA), it is expected that the price of Brent oil will remain stable throughout the year at around USD 83.0 per barrel. However, uncertainty around oil prices in the international market remains high. The recent decision by the Organization of the Petroleum Exporting Countries (OPEC) to cut oil production has increased uncertainty in the market and, consequently, has exacerbated risks of price increases. On the other hand, amid the risks of a global recession and a high inflationary environment, it is expected that demand for oil will decrease, which will lead prices to decline.

In line with the drop of oil prices and a gradual recovery of supply chains, the international cost of transportation continues to decline. The price of international transportation reached a peak in September 2021, and a downward trend has been observed since the beginning of 2022. This will slow down imported inflation. In December, sea freight prices fell by 77.1% annually and approached pre-pandemic levels (see Figure 1.1.6).

Against the background of the aforementioned price dynamics, it is expected that the pressure on inflation coming from international markets will decrease. This will be further supported by the recent strengthening of the GEL exchange rate.

1.2 EXTERNAL DEMAND AND BALANCE OF PAYMENTS

External demand is strong again and revenues from registered exports of goods continue to rise.

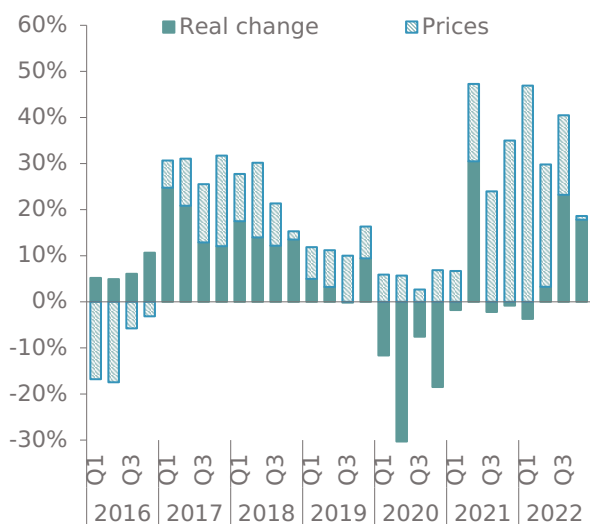


Figure 1.2.1. Annual change in registered exports of goods

Source: GeoStat.

The rise in exports of goods mainly stemmed from an increase in external demand for consumer goods.

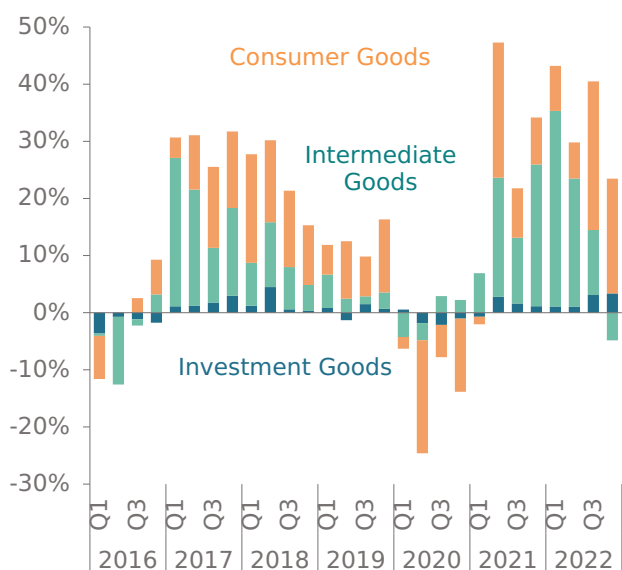


Figure 1.2.2. Annual change in registered exports of goods by category

Source: GeoStat.

In the fourth quarter of 2022, external demand remained strong. Despite the fact that new challenges to international trade arose as a consequence of Russia’s invasion of Ukraine, Georgia’s external trade turnover continued to grow. In the fourth quarter, exports of goods exceeded pre-pandemic levels, while strong domestic demand, stemming from increased inflows of immigrants, boosted imports of goods. Against the background of the severe geopolitical environment, the rise in long-term visitors arriving in Georgia from Ukraine, Russia and Belarus has supported the continued growth of revenues from international travelers. In addition, the lifting of pandemic-related restrictions on mobility and a revival of international tourism have also led to increased numbers of visitors arriving from other countries. It is also worth noting that a substantial rise in instant money transfers helped to narrow the current account deficit, which is expected to reach a historically low level (of around 3% of GDP). According to the updated projection, the expected economic slowdown in Georgia’s major trade partner countries in 2023 will deteriorate the trade of goods and services balance (in light of weaker migration flows), which will moderately widen the current account deficit compared to 2022.

Strong external demand was reflected in the rise of revenues from exports of goods. In the last quarter of 2022, registered exports of goods grew by 18.6% annually (see Figure 1.2.1). This growth was mostly driven by rising exports of goods in real terms. During this period, prices on export goods only moderately increased. In the fourth quarter, in light of the ongoing war, exports of goods to Ukraine declined, however exports had substantially recovered in the previous quarter, mainly due to a rise of re-exports of motor cars. Moreover, the 2.6 times rise in exports to Armenia was related to increased demand for motor cars and increased sales of motor vehicles for the transport of more than ten persons and those for the transport of goods. In terms of regional countries, exports to Azerbaijan and Kazakhstan were also noteworthy, while Peru (due to sales of mineral and chemical fertilizers) and China (due to re-exports of copper ores and concentrates) were the top export destinations among other countries.

Higher demand on consumer goods was a major contributor to the rise of exports of goods. Meanwhile, investment goods also made a positive contribution to the overall growth of exports (see Figure 1.2.2). The increase in exports of consumer goods was mainly driven by re-exports of motor cars to Armenia, Kazakhstan and Kyrgyzstan. Meanwhile, the lower exports of intermediate goods mainly stemmed from decreased exports of ferro-alloys to Russia and the U.S., and de-

Revenues from international travelers were on the rise and their volume outnumbered pre-pandemic levels seen in 2019.

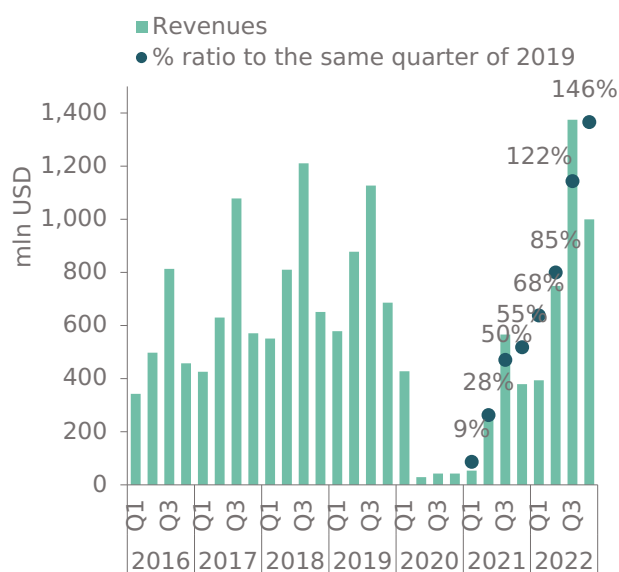


Figure 1.2.3. Annual change in revenues from international travelers

Source: NBG.

Instant money transfers were at a record-high level, mainly due to inflows from Russia.

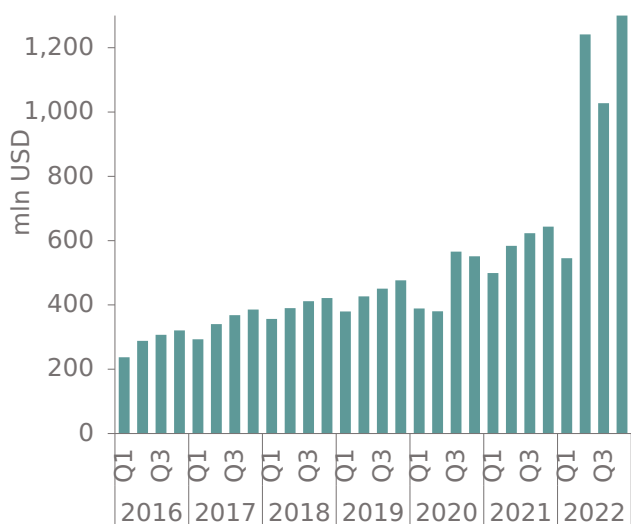


Figure 1.2.4. Annual change in money transfers

Source: NBG.

clined exports of ferrous waste and scrap to Türkiye. In terms of investment goods, exports of motor vehicles for the transport of more than ten persons and those for the transport of goods played a leading role in the overall growth.

Alongside the recovery in international tourism, the volume of migrant flows from neighboring countries remained at a high level. In the fourth quarter, the number of international visitors rose by 156.0% annually, but remained below the same period of 2019 (down by 22%). Apart from the migrant inflows related to visitors from Russia, Belarus and Ukraine, the number of visitors from the EU, Israel and Iran also increased.

Despite the fact that the number of visitors remained below pre-pandemic levels, revenues from international travelers were 37% higher than the same period of 2019. In the fourth quarter of 2022, such revenues increased 2.6 times annually (see Figure 1.2.3). The increased revenues are predominately related to the increase of long-term visitors (mostly migrants) from Russia and Belarus following the start of the war in Ukraine, but revenues from visitors of other countries also continued to rise. Expected revenues from international travelers might be lower in 2023, partly due to the global economic slowdown and a weakening of the flow of migrants to Georgia.

In the fourth quarter of 2022, instant money transfers to Georgia increased by 142.2% year on year and amounted to USD 1,558.4 million (see Figure 1.2.4). Such a high volume of transfers, as in the previous quarter, was mainly driven by increased transfers from Russia (inflows were 8.5 times higher, making a 127.8 pp contribution to the overall growth). Aside from Russia, transfers from the EU (6.3 pp), Kyrgyzstan (4.4 pp) and the U.S. (2.9 pp) made the largest contributions to total growth in this period. Similar to the previous quarter, money transfers from Ukraine were minimal, while money transfers from Georgia to Ukraine increased by 41% annually (up to USD 12.0 million).

Due to strong economic activity, imports of goods continued to grow, albeit doing so at a slower pace. In the fourth quarter of 2022, imports of goods grew by 27.3% year on year (see Figure 1.2.5). It is worth noting that in 2022 heightened global prices in USD terms were reflected in a significant rise of imports in Georgia in nominal terms. However, during the last period, in light of a moderate slowdown in domestic consumption, the growth rate of real imports of goods decelerated and grew only by 13.5% in the fourth quarter of 2022.

The rise in imports from regional countries was significant, particularly those from Russia and Türkiye; but imports from other regions, including Germany and the U.S., made the largest contributions to overall growth. In contrast, imports from Ukraine fell due to impediments in production processes and external

During the last period, the growth in imports of goods slowed down. This deceleration is a reflection of a slowdown of credit growth and fiscal consolidation.

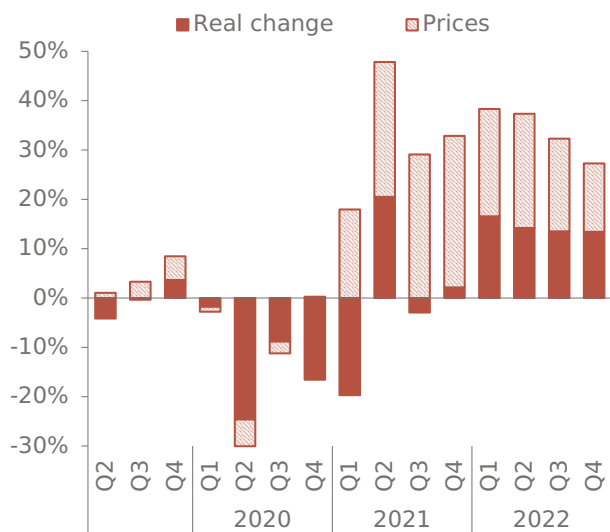


Figure 1.2.5. Annual change in registered imports of goods
Source: GeoStat

In the fourth quarter of 2022, the rise imports of goods was mainly due to growth in consumer goods.

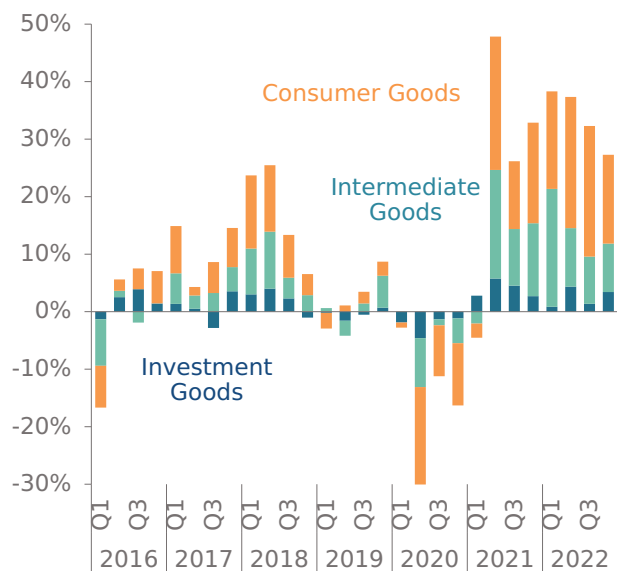


Figure 1.2.6. Annual change in registered imports of goods
Source: GeoStat

trade obstacles resulting from the war, while lower imports from Azerbaijan were related to decreased imports of petroleum products.

In the fourth quarter of 2022, imports of consumer goods made the largest contribution to the overall growth of imports (see Figure 1.2.6). The increase in such imports predominantly stemmed from higher purchases of motor cars, petroleum products and telephone sets, while the rise of imports of intermediate goods was due to higher imports of petroleum gas, precious metals ores and concentrates, as well as of semi-finished products of steel, various glassware and wheat flour. Meanwhile, the rise in imports of investment goods stemmed from higher purchases of other aircraft vehicles, telephone sets and electrical transformers.

In light of higher external inflows, in the third quarter of 2022, the current account balance was positive and reached 5.9% of GDP, which is a historic high – USD 400 million. This is the second time that Georgia has had a surplus in the current account balance (the first time was in the third quarter of 2018). A rise of exports of goods and record-high revenues from international travelers and migrants were major contributors to the improvement of the current account balance. At the same time, the high volume of workers’ remittances received from abroad continued to grow and positively impacted the balance. Revenues received from international travelers (which, due to the statistical methodology employed, also includes the expenditures of migrants) in 2022 were 108% the level of 2019. Taking into account the above-mentioned tendencies, the projected current account deficit was revised upward to 3% of GDP in 2022. This projection is based on the assumption that migrant flows will have only a temporary effect on the current account balance. However, it is expected that the global economic slowdown and exhaustion of the temporary impact of migrant flows will deepen the current account deficit to 6% of GDP in 2023.

The current account deficit was mostly financed by foreign direct investments (FDI). In the third quarter of 2022, FDI increased by 99% and amounted to USD 745 million. The rise in FDI mainly stemmed from a higher level of equity investments. In the third quarter, the majority of FDI went to the real estate and finance sectors, while investments in the energy sector substantially declined.

From the perspective of savings and investments, in the third quarter of 2022, as compared to the same period of the previous year, the improvement of the current account balance was due to a substantial increase in savings, mainly coming from the lower fiscal deficit, rather than being a result of a moderate rise in investments (see Figure 1.2.7). Similarly, in 2022 as a whole, the expected narrowing of the current account deficit was also related to the rise in savings.

In light of higher revenues from international travel and instant money transfers, the current account deficit is expected to decrease substantially in 2022.

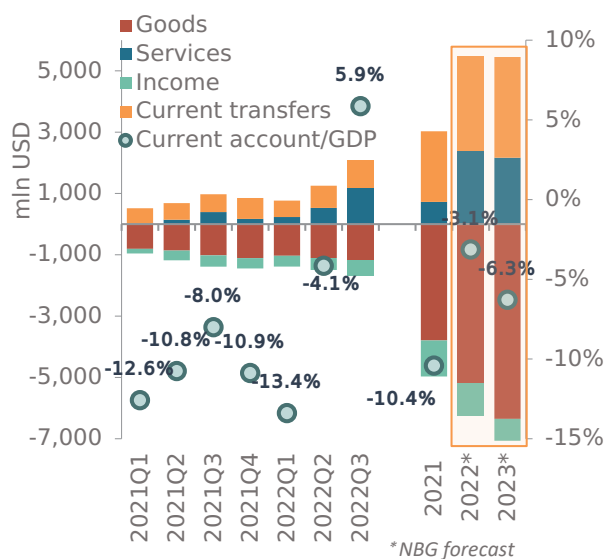


Figure 1.2.7. Current account balance and its components

Source: NBG

In 2022, the expected improvement of the current account deficit (around 3% of GDP) was mainly due to the rise of savings (along with a decline of the fiscal deficit).

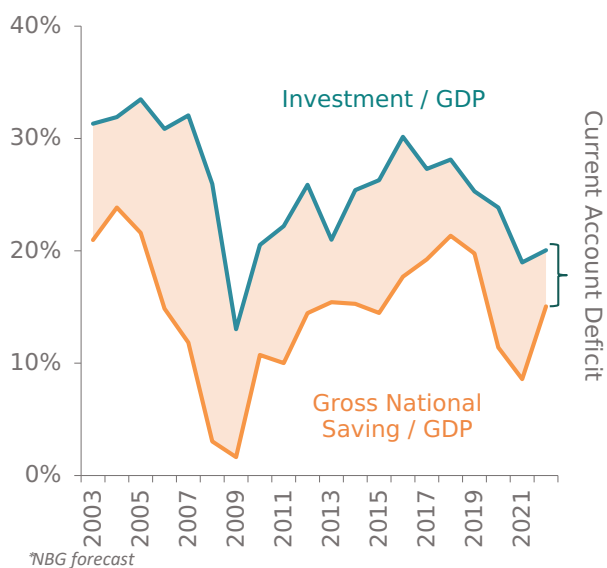


Figure 1.2.8. Investments and savings

Source: GeoStat, NBG Calculations

1.3 OVERVIEW OF THE DOMESTIC ECONOMY

1.3.1 AGGREGATE DEMAND

In the third quarter of 2022, the high growth of the economy was caused by strong foreign inflows.

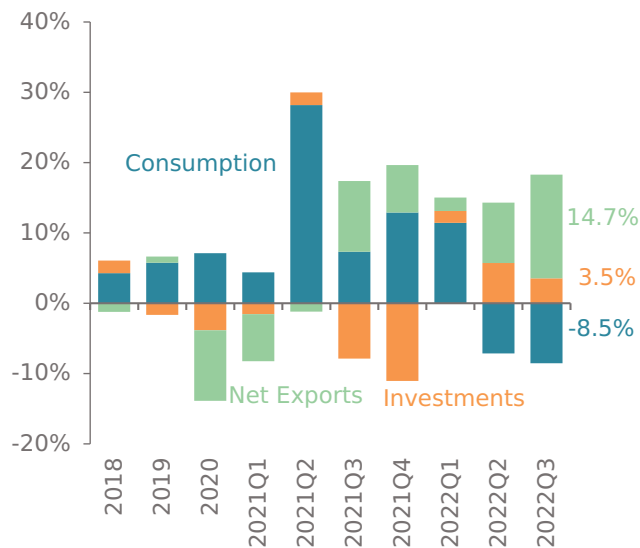


Figure 1.3.1. GDP by categories of use (contribution to growth)

Source: GeoStat, NBG calculations

In the third quarter of 2022, the real gross domestic product increased by 9.8% compared to the corresponding period of the previous year. Strong foreign inflows led to high economic growth and the tourism sector recovered. Due to the war in Ukraine, the number of migrants to Georgia significantly increased, and remittances from abroad also rose notably. Against the background of these factors, in the third quarter, exports of services increased by 87.0% year on year in real terms. In total, exports of goods and services increased by 52.9%, which significantly outweighed the increase in imports of goods and services (16.3%). Finally, net exports contributed 14.7 percentage points (pp) to the economy’s growth. Over the same period, investments increased real GDP by an additional 3.5 pp. Contrary to the growing trend of investments, the contribution of consumption to economic growth in the third quarter of 2022 was a negative 8.5 pp, which is a reflection of the recent slowdown in lending and fiscal consolidation (see Figure 1.3.1).

It should be noted that the real level of GDP in the third quarter of 2022 exceeded that of the pre-pandemic third quarter of 2019 by 12.0% (see Figure 1.3.2).

The real level of GDP in the third quarter of 2022 exceeded that of the pre-pandemic third quarter of 2019 by 12.0%.

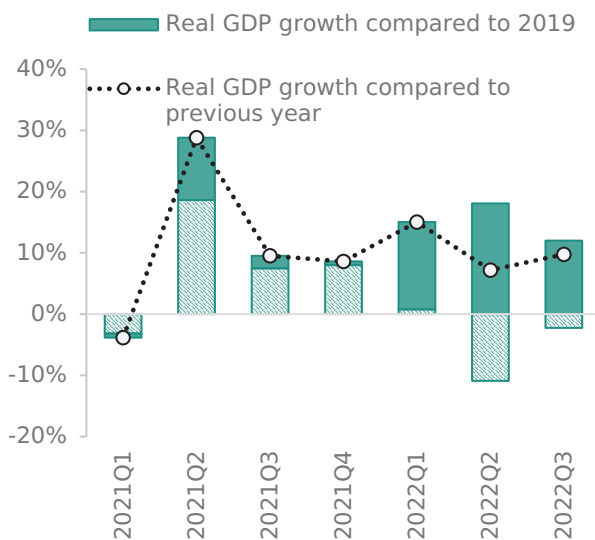


Figure 1.3.2. Comparison of the real level of GDP in 2022 with 2019

Source: GeoStat.

The largest share of economic growth comes from services, which was facilitated by an increased number of foreign citizens in Georgia.

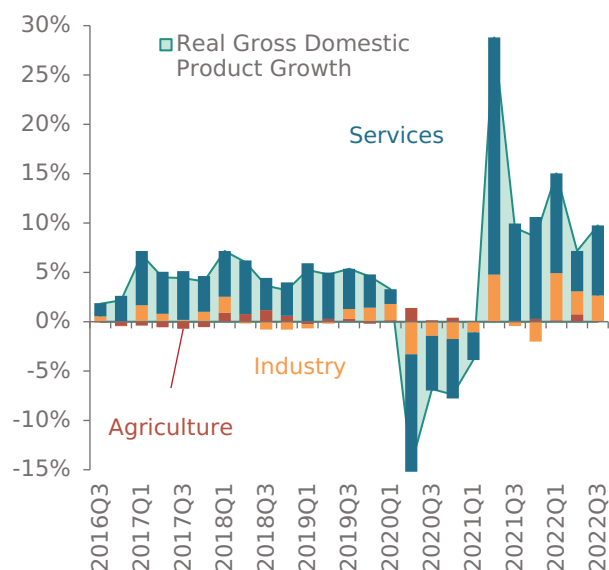


Figure 1.3.3. Contribution of sectors of the economy to real GDP growth

Source: GeoStat and NBG calculations

1.3.2 OUTPUT

In the third quarter of 2022, the services sector was the main driver of the 9.8% economic growth, making a contribution of 7.1 pp. The contribution of the industrial sectors amounted to 2.6 pp, while agriculture made only a minor contribution (see Figure 1.3.3).

As mentioned in the previous chapter, the high level of economic growth was ensured by the dynamics of the foreign sector. The sharp increase in the number of foreign citizens in the country contributed to the improvement of the service sector. The combined contribution of trade, transport, accommodation and food supply activities, information and communication, art and entertainment, and recreation to economic growth was 5.8 pp.

In terms of the industry sector, electricity, gas and water supply (a contribution to growth of 1.0 pp), construction (0.6 pp), processing (0.6 pp), and mining industry (0.4 pp) stood out.

1.4 FINANCIAL MARKET AND TRENDS

1.4.1 LOANS

In December, the growth of the annual loan portfolio decreased and equaled 12.1%, excluding the effect of exchange rate fluctuations.

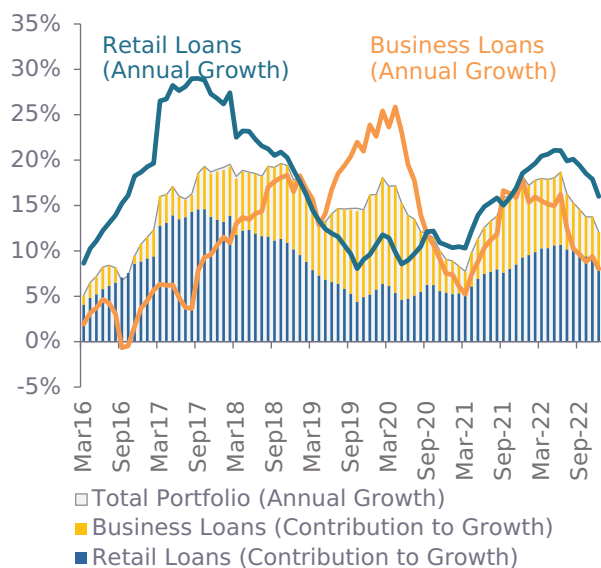


Figure 1.4.1. Annual growth rates of retail and business loans (excluding the exchange rate effect)

Source: NBG

The growth of the loan portfolio was mainly driven by an increase in domestic currency loans. The contribution of loans issued in foreign currency to the overall growth decreased due to measures taken by the NBG and increased interest rates on global markets.

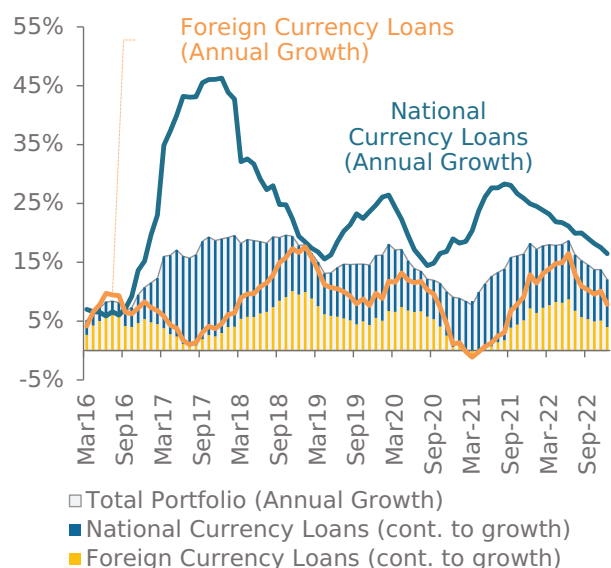


Figure 1.4.2. Annual growth rates of domestic and foreign currency loans (excluding the exchange rate effect)

Source: NBG

In December, relative to September, the growth of the loan portfolio decreased by 2.4 pp and equaled 12.1% (excluding the effect of exchange rate fluctuations). During this period, the growth rate of retail loans decreased slightly and equaled 17.9%, while the growth of loans to legal entities decreased to 9.4% (see Figure 1.4.1). The growth of business loans was primarily driven by an increase in loans issued to the trade, manufacture, and transport and communications sectors. According to the credit conditions survey, representatives of the banking sector expect a slight increase in demand for retail loans over the next quarter.

In terms of currencies, it is important to emphasize that the growth of the loan portfolio in the fourth quarter of 2022 was mainly driven by domestic currency loans (see Figure 1.4.2). It is also important to indicate that the growth of foreign currency loans continues to slow. In the fourth quarter, the annual growth rate of foreign currency-denominated loans decreased by 2.3 pp and equaled 7.9%, while the growth rate of loans issued in the domestic currency decreased by 2.6 pp and equaled 16.5%. These reductions were mainly due to the tightening of monetary policy rates by the U.S. Federal Reserve and the European Central Bank, which were reflected in increased interest rates for foreign currency loans. In addition, in the fourth quarter, the loan larization ratio increased slightly and equaled 55.0%, excluding the effect of exchange rate fluctuations. It is expected that the larization (de-dollarization) process will continue in the future. Recent changes made to reserve requirements will motivate banks to increase larization, which is one step towards reducing risks to financial stability.

1.4.2 INTEREST RATES AND CREDIT CONSTRAINTS

In December 2022, the monetary policy rate remained at 11.0%. In the fourth quarter, interest rates on government securities decreased only slightly (see Figure 1.4.3). Compared to the previous quarter, the spread between long- and short-term interest rates increased slightly. This indicator remains at a low level, which suggests the increased credibility of monetary policy instruments and the improved predictability of the monetary policy rate. Compared to long-term rates, the increase in short-term rates was, in part, a reflection of financial market expectations that, in the short term, an increase in the policy rate will cause a lowering of inflation, which will be a prerequisite for a reduction of the policy rate in the future.

In December, relative to September, interest rates

As the monetary policy rate remains high, interest rates on government securities decreased slightly in the fourth quarter of 2022.



Figure 1.4.3. Interest rates on government securities

Source: NBG

The spread between long- and short-term interest rates remained negative. This is a reflection of expectations of decreasing inflation and, consequently, of a fall in the policy rate.

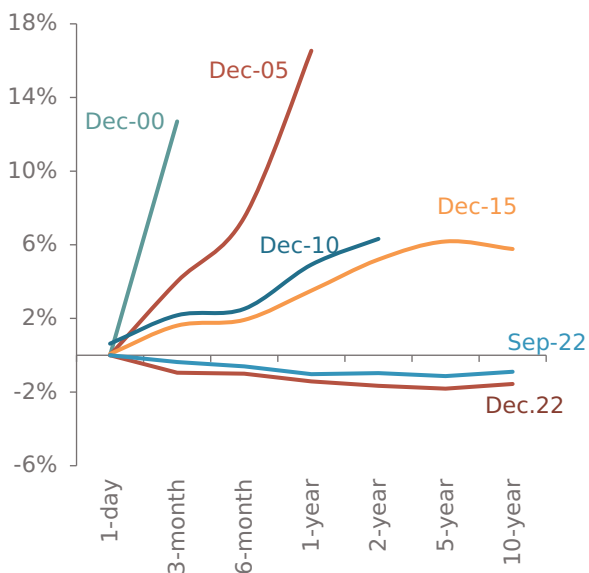


Figure 1.4.4. Spread between the monetary policy rate and the yield curve

Source: NBG

on domestic and foreign currency deposits did not change significantly and equaled 11.5% and 1.4%, respectively. According to the credit conditions survey, representatives of the banking sector expect a slight increase in the cost of funds in the next quarter. According to the same survey, interest rate conditions have tightened slightly for retail loans issued in both the domestic and foreign currencies. Representatives of the banking sector expect a further slight tightening of interest rate conditions over the next quarter.

In December, relative to September, interest rates on corporate, small and medium enterprises (SMEs), and retail loans did not change significantly. In particular, interest rates on retail and SME loans equaled 15.9% and 10.9%, respectively. While interest rates for corporate loans equaled 11.9%.

As of December, relative to September, average interest rates on the stock of legal entities loans issued in the domestic currency did not change significantly, while increasing slightly for foreign currency loans. Interest rates on domestic currency loans stood at 14.1%, while they increased by 1.4 pp for foreign currency loans and equaled 9.1% (see Figure 1.4.5). Representatives of the banking sector expect a slight increase in interest rates for foreign currency loans over the next quarter.

In December 2022, similar to previous months, average interest rates for loans to legal entities in the domestic currency remained significantly high, relative to foreign currency loans, despite an increase of the latter in recent periods.

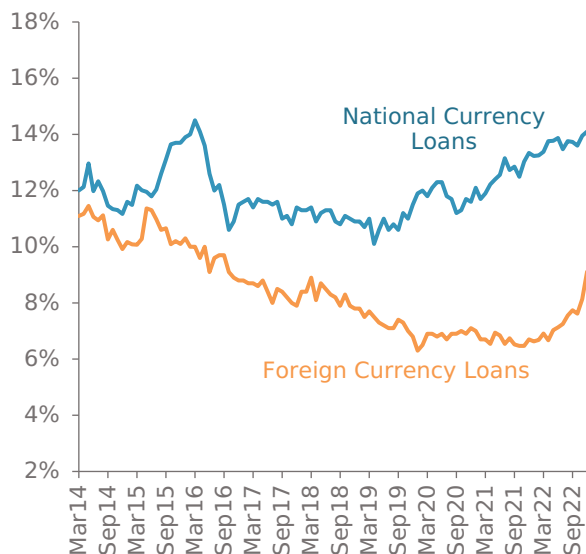


Figure 1.4.5. Average interest rates on business loans

Source: NBG

The real effective exchange rate appreciated significantly, by 18.2% on an annual basis.

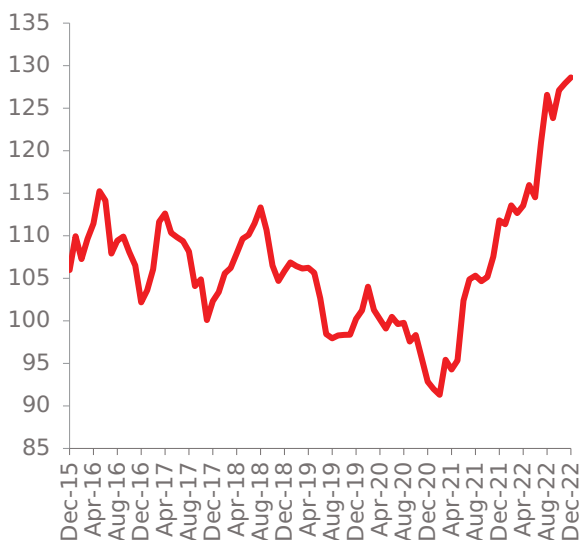


Figure 1.4.6. Real effective exchange rate (Jan 2008=100)

Source: NBG.

1.4.3 EXCHANGE RATE

In the fourth quarter of 2022, the lari exchange rate continued to appreciate: the GEL nominal exchange rate appreciated against the US dollar and against the euro on average by 3.2% and 2.3%, respectively, compared to the previous quarter. The GEL also continued to appreciate against the Turkish lira (by 6.9%) and the Russian ruble (by 7.4%). In the same period, the nominal effective exchange rate appreciated by 5.3% on a quarterly basis and by 30.0% on an annual basis.

In terms of the price-adjusted exchange rate, in the fourth quarter of 2022 the real effective exchange rate appreciated by 3.3% on a quarterly basis and by 18.2% on a year-on-year basis (see Figure 1.4.6). The annual appreciation was due to an appreciation of the nominal effective exchange rate and the increase in domestic prices. As Figure 1.4.7 shows, rebuilding the lost competitiveness of the economy due to the real appreciation of the lari will be achieved by the nominal exchange rate depreciation of the lari and/or by reducing local inflation compared to that of trading partners.

It should also be noted that the lari real exchange rate appreciated against the currencies of most of Georgia’s trading partners (see Table 1.4.1).

The annual appreciation of the real effective exchange rate was caused by both the appreciation of the lari nominal effective exchange rate and the increase in local prices.

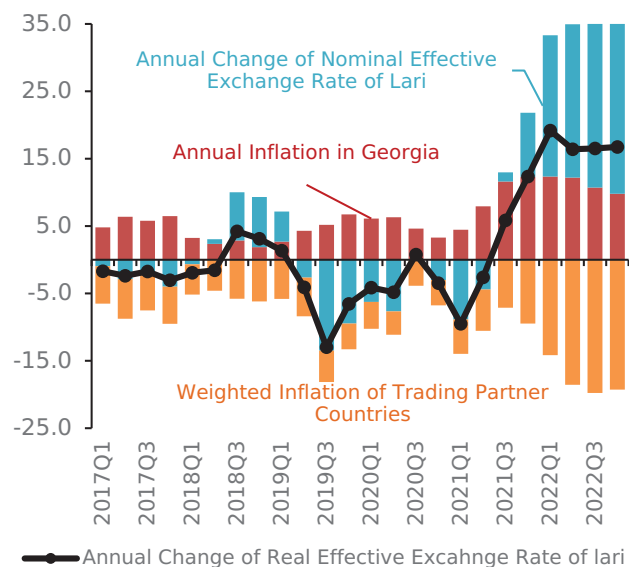


Figure 1.4.7. Decomposition of the annual change of the GEL real effective exchange rate*

Source: NBG.

* The real exchange rate and its components are presented in the form of logarithmic values, and therefore their annual changes are a first-order approximation of percentage changes.

The real effective exchange rate appreciation is caused by real appreciation of the lari against all major trading partners, except for Russia and Armenia.

	Change in Nominal Exchange Rate %	Change in Real Exchange Rate %	Contribution to the Change in Real Exchange Rate, pp
Effective exchange rate	30.0	18.2	18.2
Eurozone	28.4	28.8	5.0
Türkiye	92.5	20.5	3.9
Ukraine	58.3	37.9	2.6
Armenia	-5.6	-4.3	-0.3
US	14.3	17.8	1.3
Russia	-1.4	-3.0	-0.4
Azerbaijan	14.1	9.4	1.0
China	27.2	37.8	5.0
Bulgaria	28.4	21.0	0.8
Poland	31.5	23.6	0.4

Table 1.4.1. Effective exchange rates annual growth (fourth quarter of 2022)

Source: NBG

* Growth implies appreciation of the lari.

The unit labor cost increased by 7.5% year on year, which makes the inflationary pressure coming from the labor market noteworthy.

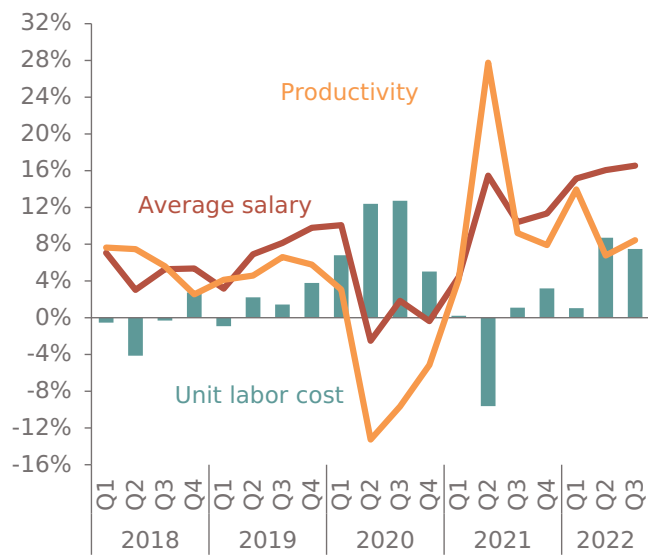


Figure 1.5.1. Productivity, average salary, and unit labor cost (annual percentage change)

Source: GeoStat

1.5 LABOR MARKET

In the third quarter of 2022, the country’s economic productivity (real value added per employee) rose by 8.4% on a yearly basis (see Figure 1.5.1).

Over the same period, the nominal wage growth for employed workers was 16.5%, and the average monthly gross wage reached 1,595 GEL.

Higher wage growth compared to productivity growth pushed up the unit labor cost by 7.5% year on year. This raises risks of the development of a so-called wage-price spiral. In this regard, inflationary pressure from the labor market becomes noticeable (see Figure 1.5.1) and necessitates maintenance of a tight monetary policy.

BOX 1. WAGE-PRICE SPIRALS AND INFLATION

Recent events – including Russia’s invasion of Ukraine, the situation caused by the prolonged war, and the disruptions in global supply chains arising from the COVID-19 pandemic – have created a high inflationary environment around the world. These events have intensified the additional inflationary risks coming from the growth in wages. In particular, as inflation has been at high level for a long period of time, wages in the labor market have a tendency to increase. In the event that wage growth exceeds inflation, aggregate demand is stimulated, and this creates inflationary pressures. In addition, when wage growth is higher than productivity growth, unit production costs increase and push prices up. This can then lead to dynamics under which prices and wages start feeding off each other, accelerating and leading to a so-called wage-price spiral.

Wage-price spiral risks have a significant role in the inflation outlook. International organizations also consider their development to be a significant risk. The National Bank of Georgia carefully monitors dynamics of changes in wages and prices in order to identify signs of such a risk and to enable the appropriate response. Thus, the evaluation of labor market tightness and its impact on wage growth is crucial. For this purpose, we analyze the Beveridge curve alongside unemployment and wage dynamics.

According to the data of the third quarter of 2022, the unemployment rate in Georgia decreased to 15.6%, while the peak rate of the second quarter of 2021 was 22.1%. A sharp increase in economic activity, amid structural challenges in the labor market, may create labor shortages. In such a case, in order to stimulate the retention of employees and/or the attraction of new personnel, companies have several levers, one of which is offering relatively higher salaries.

The Beveridge curve represents the relationship between the unemployment rate and job vacancies. A rightward shift of the dashed curve in Figure 1.5.2 indicates a decrease in labor market efficiency. Compared to the pre-pandemic period, the curve has indeed shifted to the right, and, compared to previous periods, this shift has become even more visible from the second half of 2021. Reduced efficiency of the labor market means that employers face increased difficulty in finding staff. This can also be seen from the Beveridge curve: since the first quarter of 2022, the unemployment rate has decreased, while the rate of job vacancies has increased (see Figure 1.5.2), which is a result of the rapid recovery of the economy. Overall, the shift in the curve indicates an increase in labor market tightness as companies seek to hire workers and the share of job seekers is small. An increase in market tightness, in the face of reduced efficiency, makes the risks of creating inflationary pressures more noteworthy. At the same time, during the last period, the level of employment in the labor market is increasing, and the level of unemployment, in contrast, is decreasing (see Figure 1.5.3). The dynamics of these indicators also indicate a shortage of personnel and the density of the labor market.

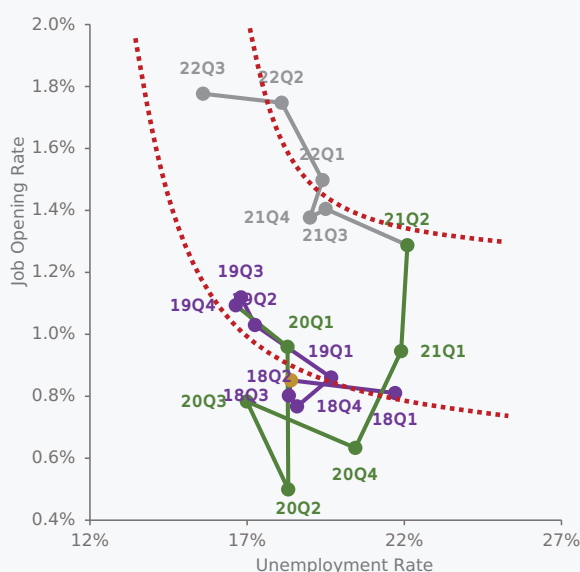


Figure 1.5.2. Beveridge Curve

Source: PMCG.

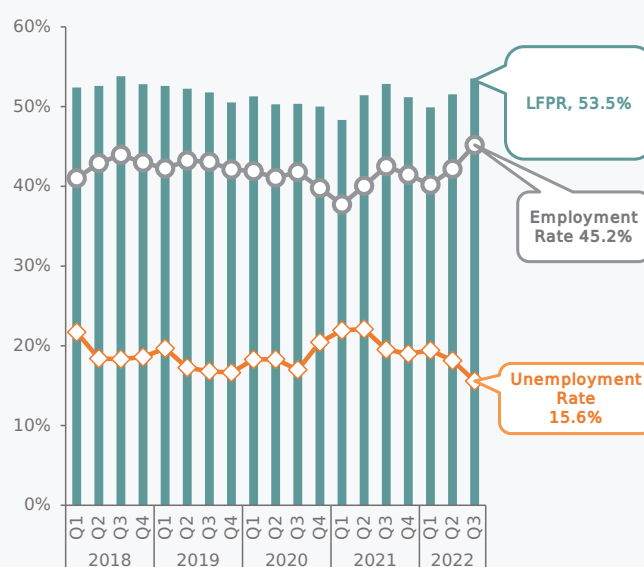


Figure 1.5.3. Labor Force Participation Rate (LFPR), Employment Rate, Unemployment Rate

Source: GeoStat, NBG.

The latest data reveal that both nominal and real wages are increasing in the industrial and service sectors (see Figures 1.5.4 and 1.5.5). In the aftermath of the COVID-19 shock, an increasing trend of nominal wages has been observed. However, along with the increase in nominal wages, productivity growth was also high. This situation did not increase production costs and, therefore, did not generate inflationary pressure. However, in the recent period, due to the slowdown in productivity growth, an increase in production costs per unit of product has been highlighted and inflationary risk arising from the labor market has emerged. At the same time, the increase in real wages from the first quarter of 2022 may be a sign that employees are taking into account inflationary expectations when forming salary expectations. This signal coming from the labor market may indicate the risk of a spiral.

The development of a spiral largely depends on the expectations of future price changes. If, after an inflationary shock (for example, shocks such as the pandemic or a large influx of migrants), an expectation is formed that the overall price level will continue to rise after the shock is over, employees and/or job seekers will have an incentive to demand higher wages. Against the background of consecutive shocks, actual inflation in Georgia has deviated from the target rate for a long time, which creates risks of the growth of medium-term inflationary expectations. Realization of this risk would lead job seekers to demand higher wages. On the other hand, high wages increase the cost of production, raise the general level of prices, and further aggravate the inflationary background. Such a relationship between inflationary expectations and wage growth provides a reason to closely monitor the dynamics of these two variables in order to permit appropriate measures to be taken in response to clear signs of a spiral developing. In order to help reduce this risk, a strict monetary policy has been maintained, despite the fact that overall inflation in Georgia is already showing a decreasing trend and international markets are also showing signs of stabilization.

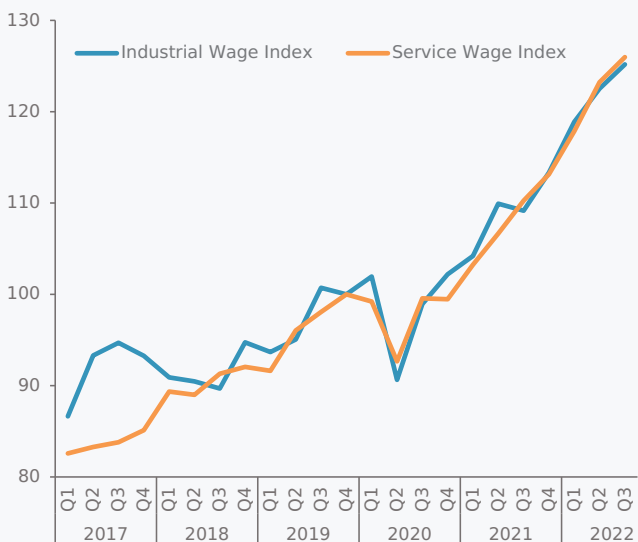


Figure 1.5.4. Nominal wage index for industrial and service sectors

Source: GeoStat, NBG

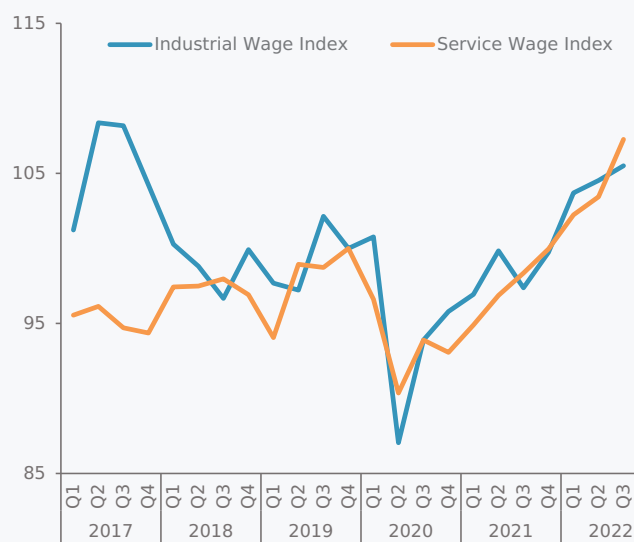


Figure 1.5.5. Real wage index for industrial and service sectors

Source: GeoStat, NBG

Inflation in Georgia has a decreasing trend. International markets have recently seen a stabilization of prices and a downward trend, which, together with the strengthening of the GEL and the tightening of monetary policy, should contribute to a reduction of inflation.

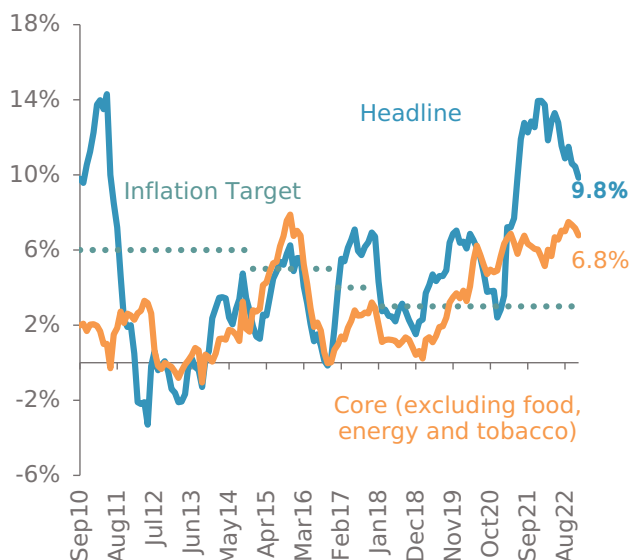


Figure 1.6.1. Headline and core inflation

Source: GeoStat

The contribution of food to inflation (4.8 pp) is still high. The contribution of fuel decreased to 0.1 pp.

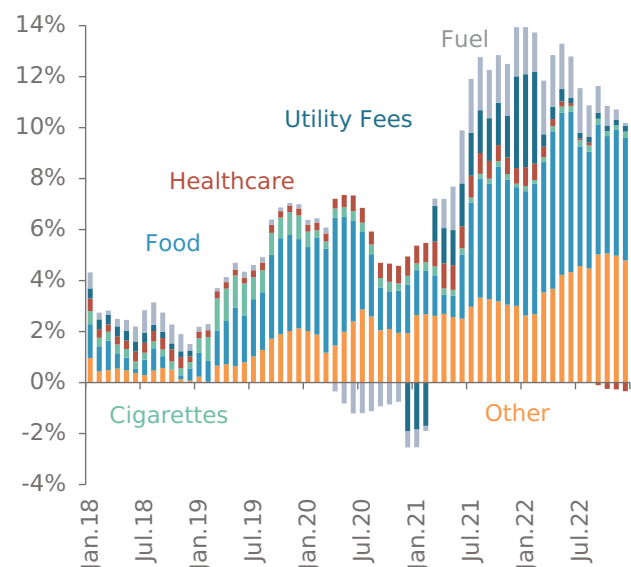


Figure 1.6.2. Contribution of different products to inflation

Source: GeoStat

1.6 CONSUMER PRICES

Inflation in Georgia has passed its peak and has a decreasing trend, which is partially related to the decrease in inflation of imported goods. At the same time, the tight monetary policy, fiscal consolidation and strengthened exchange rate have also contributed to the reduction of inflation. Yet, in spite of this reduction, inflation remains high. The overall level of consumer prices in December 2022 increased by 9.8% year on year. Core inflation, which excludes highly volatile prices of food, energy and cigarettes, was lower than headline inflation and stood at 6.8% (see Figure 1.6.1).

The main reasons for the high inflation in 2022, both in Georgia and worldwide, are geopolitical. As a result of the war started by Russia in Ukraine, prices of oil and food products on international markets have risen sharply. At the same time, amid the increased flow of migrants, aggregate demand in Georgia in 2022 was strong, putting additional pressure on prices.

A large share of inflation (4.8 pp) comes from food, of which the price increases of bread and cheese alone contributed 1.4 pp to total inflation (see Figure 1.6.2). The recent decrease in oil prices on world markets, alongside the strengthening of the GEL, contributed to a reduction of fuel prices in the local market, making a contribution of 0.1 pp to total inflation. However, the contributions other products remain at an increased level, to some extent indicating a realization of the so-called second round effects, which further stresses the need for maintaining a strict monetary policy.

From the beginning of 2022, imported inflation has had a decreasing trend. Along with a certain stabilization of commodity prices on international markets and a decrease in transportation costs, this has also been facilitated by the strengthening of the lari exchange rate. In December, imported inflation decreased to 5.5%. However, prices of domestically produced goods and services have increased at a faster rate, rising by 13.8% year on year in December. The increase in domestic inflation is related both to the increase in food (bread, cheese, and meat) prices and to the increase in the price of services, of which apartment rent and notary fees are particularly notable (see Figure 1.6.3). The increasing cost of apartment rent is a reflection of the sharply increased demand resulting from the increased number of long-term visitors (migrants) from Russia and Belarus.

The decrease in inflation is caused by a fall in inflation of imported products. However, inflation of domestic products remains at a high level, which is related to the increase in prices of both food and services, of which apartment rent and notary fees are particularly notable.

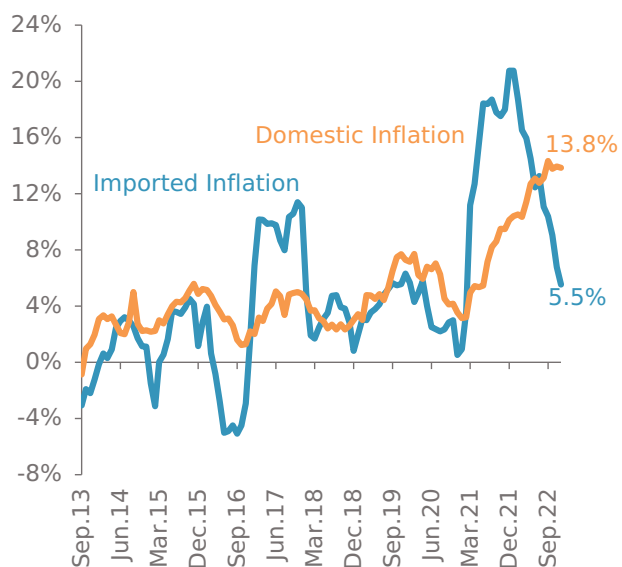


Figure 1.6.3. Domestic and imported inflation

Source: GeoStat

2 MACROECONOMIC FORECAST

According to the baseline forecast scenario, inflation will continue a gradual decline, converging with the target in the second half of 2023. Other things being equal, it will then hover around the target in the medium term. Stabilization of commodity prices, in tandem with the appreciated GEL stemming from strong foreign inflows, will help reduce inflation alongside normalized economic activity. In turn, the real GDP growth rate is expected to be 4% in 2023, in light of moderate external inflows, the base effect resulting from high growth in the previous year, the maintenance of tight monetary policy, and fiscal consolidation.

Against this backdrop, high-impact risks remain around the baseline scenario. The alternative forecast scenario considers a realization of the most acute of those risks, including a global recession caused by a stronger-than-expected response from the central banks of developed countries in reaction to the global inflationary environment, an immediate cut in foreign currency inflows from Russia, and a further escalation/prolongation of the Russia-Ukraine war. At the same time, amid the prolongation of inflation's deviation from its target, the scenario also considers the likelihood of worsening inflationary expectations and credibility shock, the further excess of nominal wage growth over productivity growth, and, accordingly, the additional aggravation of the wage-price spiral. The National Bank of Georgia has the lowest tolerance to this scenario, which implies a sharp tightening of monetary policy, including the use of additional instruments if necessary, and, subsequently, maintaining the tight monetary policy stance for a relatively long period.

Amid the tight monetary policy stance, inflation will gradually decline and is expected to converge with the 3% target in the second half of 2023.

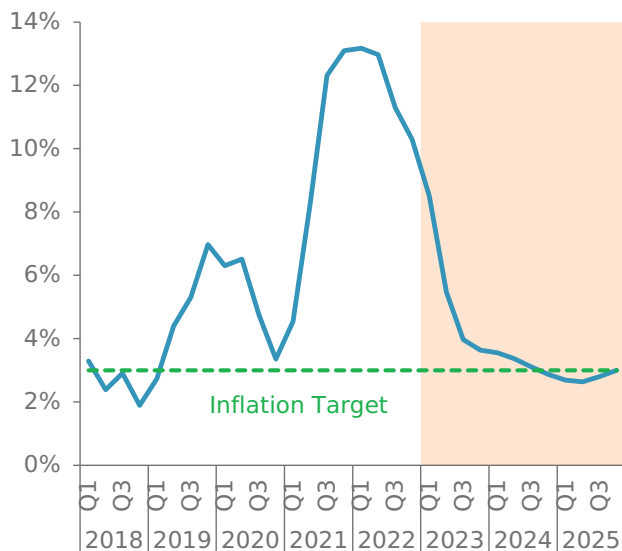


Figure 2.1.1. Headline inflation

Source: NBG, GeoStat.

2.1 BASELINE MACROECONOMIC FORECAST

In the last quarter of 2022, annual inflation declined to 10.3%, which was in line with the previous projection of the NBG. According to the updated baseline macroeconomic forecast, inflation will keep this momentum and continue falling, converging with the target rate in the second half of 2023. Other things being equal, it will then hover around the target in the medium term (see Figure 2.1.1).

Higher-than-target inflation over the future horizon is fueled by heterogeneous factors. In particular, amid a high inflationary environment, short-term inflation expectations are elevated, weakening the pace of disinflation. At the same time, in the first half of 2023, headline inflation will continue to be influenced by the stronger-than-expected foreign inflows from 2022 and aggregate demand. However, the latter will be partly counterbalanced by the strengthened lari exchange rate. As a consequence of the normalization of foreign inflows (remittances, tourism revenues, etc.), the effect of the appreciated lari exchange rate will fade away in the second half of 2023 (see Figure 2.1.2). It should further be noted that in the post-pandemic period, globally and in Georgia, against the backdrop of structural changes in the labor market and high inflationary expectations, nominal wages are increasing in specific sectors and these have already exceeded the growth rate of consumer prices – thereby carrying the risks of

The deviation of inflation from its target is still driven by elevated short-term inflation expectations and some supply-side factors. On the flip side, the normalization of commodity prices and economic activity balance these factors, and, other things being equal, will bring inflation towards the target.

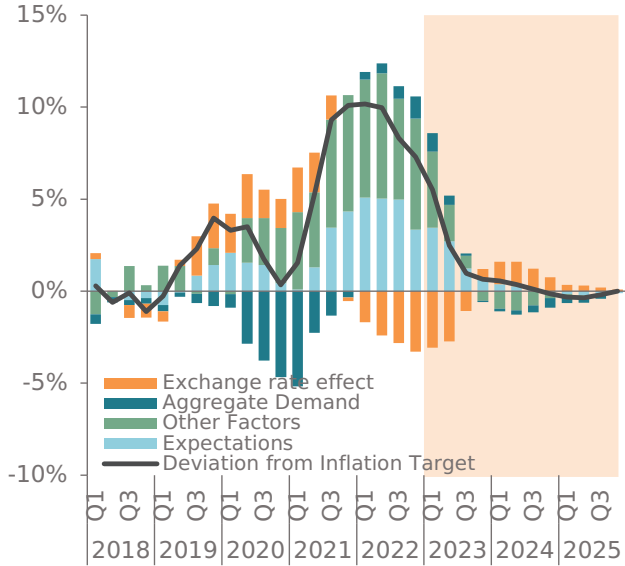


Figure 2.1.2. Deviation of inflation from the target and its decomposition

Source: NBG, GeoStat.

Higher-than-expected external demand significantly contributed to growth in 2022. Amid the normalization of foreign inflows, the growth rate will decelerate to 4% in 2023.

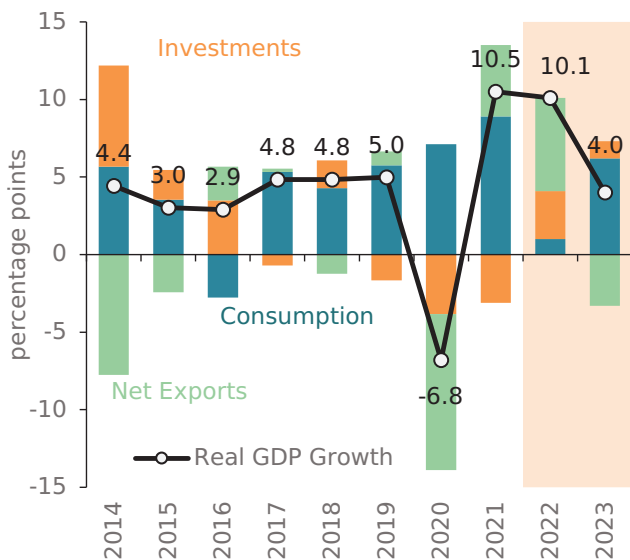


Figure 2.1.3. Real GDP growth decomposition

Source: NBG, GeoStat.

forming a wage-price spiral.¹⁴ In contrast, international commodity prices have recently been stabilizing. In particular, according to the projections of reputable international organizations (such as the Energy Information Administration (EIA), Bloomberg, etc.), food and Brent oil prices will further drop this year, which should, other things being equal, reduce inflation. It should also be noted that, alongside its tight monetary policy stance, the NBG has recently launched several macroprudential instruments that have already helped to moderate the growth of credit activity. This contractionary effect is likely to strengthen this year and, amid the planned fiscal consolidation, other things being equal, this will reduce the demand-driven pressure on inflation.

It should also be recognized that the current baseline forecast is largely in line with the inflation forecast for the fourth quarter of 2022. Nevertheless, since inflation has deviated from its target for a long time, the National Bank of Georgia has become less tolerant towards the above-mentioned risks, and has maintained a tight monetary policy stance for a longer period as compared to the previous forecasts. The policy rate will gradually decline with receding price pressures and a stabilization of inflation expectations, before approaching the neutral level (currently estimated at 7%) in the medium term.

It has been repeatedly noted that foreign inflows have increased more than had been expected in the wake of the Russia-Ukraine war, which has positively influenced Georgian economic activity. Concurrently, the overall potential of the economy is showing signs of a faster-than-expected recovery in the post-pandemic period, spurred on by growing investment, including foreign direct investment. Economic growth in 2022 is thus mainly attributed to net exports and investments. As for 2023, the growth rate of economic activity will decelerate to 4%. This decline will result from the normalization of foreign inflows, the base effect related to high growth from the previous year, and tight monetary policy and fiscal consolidation. In contrast, consumer sentiment is expected to improve in line with the gradual stabilization of geopolitical tension in the region, which will make investments and consumption the main contributors to economic growth (see Figure 2.1.3). However, it should be noted that the situation is rapidly changing and uncertainties remain acute. The current forecasts of the NBG may thus be revised in both upward as well as downward directions.

14 For further analysis regarding the mentioned risk, see Box 1 “Wage-Price Spirals and Inflation”.

2.1.1 BASELINE FORECAST SCENARIO RISKS

Increased global inflation, a slowdown of the global economy, and the prolongation of the war between Russia and Ukraine all remain global challenges.











Macroeconomic Forecast Risks	Impact on Inflation
Higher-than-expected interest rate hikes in advanced economies and a recession	
Worsening of the geopolitical situation	
Declining credibility of central banks amid increased global inflation	
Decline in foreign demand and a deterioration of the current account balance	
Aggravation of the wage-price spiral	
A faster-than-expected reduction of commodity prices on international markets	
	
Low-impact risk	High-impact risk
	Upward Pressure on Inflation
	Same Level of Inflation
	Downward Pressure on Inflation

Table 2.1.1 Baseline macroeconomic forecast risks.

Source: NBG.

Against the background of globally increased inflation, the slowdown of the global economy, and the prolongation of the Russia-Ukraine war, macroeconomic forecasts continue to be characterized by exceptional uncertainty. The high-impact risks are mostly inflationary – the realization of which would lead to a deviation from the baseline macroeconomic forecast.

The global economy, which is still in the process of a post-pandemic recovery, has faced new challenges as a result of the war between Russia and Ukraine. The already-difficult situation in international commodity markets has worsened and, together with strong demand, has become the main driver for the increase of the global inflation forecast. All this has led to a sharp tightening of monetary policy rates in leading economies (especially in the U.S.). Moreover, despite recent positive trends in international markets, if there is a necessity for higher-than-expected interest rate hikes in developed economies, the global economy will be prone to recession.

Higher-than-expected interest rates¹⁵ in developed countries would put pressure on capital outflows from open economies, like Georgia, and, consequently, can lead to local currency depreciation on foreign exchange markets. Furthermore, given the still-high level of dollarization in Georgia’s economy, a materialization of this risk would have a significant impact on inflation through the inflation expectations and input costs channels.

In the case of a global recession, a decrease in external demand and a worsening of the current account balance is expected. This would lead to upward pressure on inflation through a weakened exchange rate, which will only partially be balanced by depressed aggregate demand and decreased energy and food prices. In particular, a global recession would reduce international demand for energy resources and food, which, ceteris paribus, implies a decline in their price.

The expected trajectory of inflation also depends on the indicators of foreign currency inflows from Russia, a potential escalation/prolongation of the Russia-Ukraine war and the nature of its resolution. A sharp decrease in inflows from Russia will create pressure on the foreign exchange market to depre-

¹⁵ Only a moderate increase in interest rates in the US and the Eurozone would help reduce local demand and, therefore, slow inflation, because in such a case there will be less pressure on the GEL exchange rate to depreciate. The reason for this is the elimination of the remuneration of reserve requirements on funds raised in foreign currency, which neutralizes the incentive to transfer GEL deposits to foreign currency and, accordingly, reduces pressure on the exchange rate.

According to the updated forecast, as the latest data are consistent with the previous forecast, the expected inflation rate for the medium term has not changed significantly.

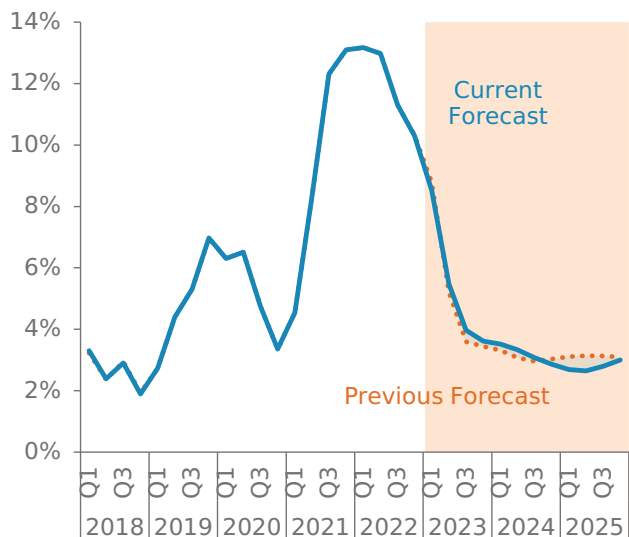


Figure 2.2.1. Changes in the forecast of headline inflation
Source: NBG, GeoStat.

The real GDP forecast for 2023 has not changed; however, the level of uncertainty remains high and the forecast could change in either direction.

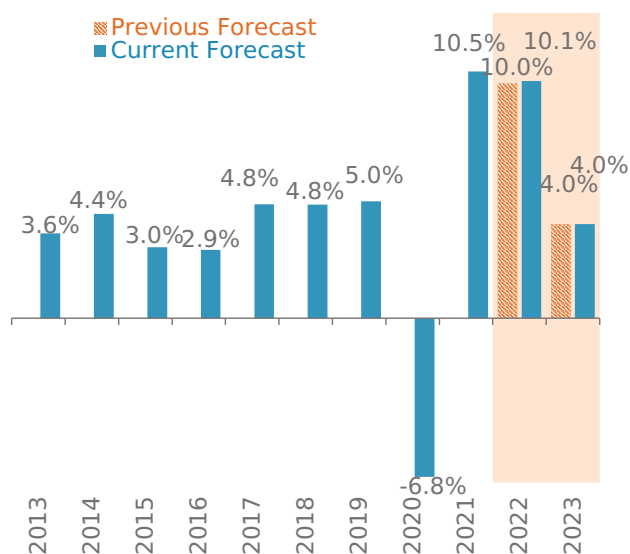


Figure 2.2.2. Changes in the forecast of real GDP
Source: NBG, GeoStat.

ciate, which, given the still-high level of dollarization, will increase inflationary pressure through the inflation expectations and input costs channels. Moreover, a further escalation/prolongation of the conflict would further weaken the war-damaged trade and financial channels, the negative effects of which have not yet been reflected on the Georgian economy in the background of capital inflows from Russia. It would also further increase the region’s risk level as well as enhancing the likelihood of supply restrictions and the imposition of additional sanctions against Russia.

In turn, it is worth noting that, in the background of consecutive shocks, a delay in the convergence of inflation with its target would significantly increase the likelihood of credibility shock. This, along with the developments mentioned above, would intensify the wage-price spiral, amid a further excess of nominal wage growth over productivity growth, and potentially additionally worsen the inflation outlook.

2.2 COMPARISON TO THE PREVIOUS FORECAST

According to the updated forecast, expected inflation in the medium term has not changed significantly (see Figure 2.2.1). However, the contributions of those factors affecting the inflation forecast have changed slightly. In particular, the forecast increased as a result of an increase in the unit labor cost, but decreased due to the slight normalization of elevated expectations, the strengthening of the exchange rate, and the stabilization of oil prices on international markets. Ultimately, these two effects balance each other out. Accordingly, under the current forecast, which is in line with the previous one, against the backdrop of the elimination of one-off shocks and the maintenance of a tight monetary policy stance for a relatively long time, inflation will converge with the 3% target from the second half of 2023.

The real GDP forecast for 2022 and 2023 has changed slightly (see Figure 2.2.2). The assumptions that determined economic growth projections for 2022-2023 are consistent with those of the previous forecast. In particular, the current account deficit has improved and is one of the most important drivers of aggregate demand. After several years of decline, investments have also increased, which has helped the potential of the economy to recover and should have the effect of easing inflationary pressure. In terms of consumption, it should be noted that, despite the recent deceleration in the growth rate of foreign currency loans (which is a result of increased interest rates on dominant currencies and strict prudential policies), credit growth will, in part, remain a stimulating factor.

Georgia is a small open economy, and the economic stances of its trading partners thus have a significant influence on the domestic economy. The macroeconomic

According to the updated forecast for 2023, amid increased inflation and interest rates globally, the outlook for inflation in Georgia's trading partner countries has worsened, while it has improved in terms of exchange rates.

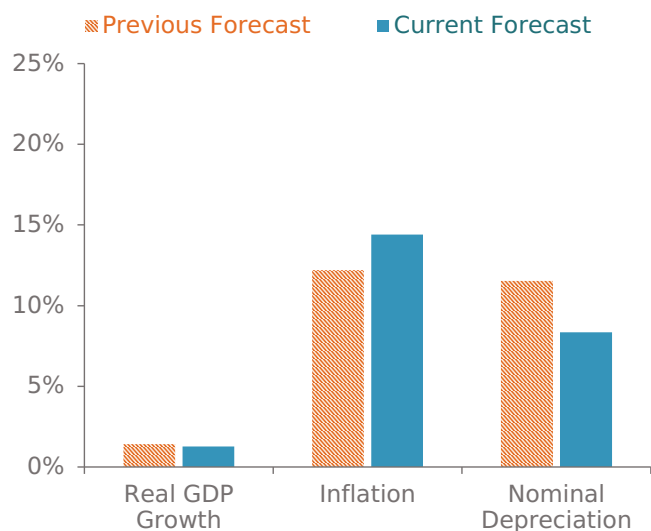


Figure 2.2.3. Changes in the forecast of external assumptions for 2023

Source: Bloomberg, NBG.

forecasts thereby strongly depend on assumptions regarding the economic growth, inflation, and exchange rates of the country's trading partners.

According to the updated forecast for 2023, amid increased inflation and interest rates globally, the outlook for inflation in trading partner countries has worsened, while for the exchange rates - improved. In turn, expectations about economic growth have not changed substantially (see Figure 2.2.3).¹⁶

¹⁶ These calculations are based on forecasts for the five main trading partners of Georgia: the US, the EU, Turkey, Ukraine and Russia.

In the alternative, particularly acute risk scenario, external demand will be constrained and the current account deficit will worsen amid global stagflation, a sharp decline in cash inflows from Russia, and a further escalation/prolongation of the Russia-Ukraine war. As a result, the size of the real economy will not increase in 2023.

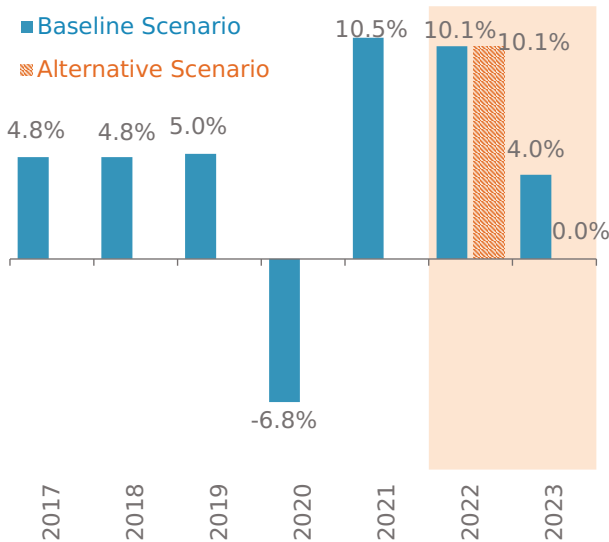


Figure 2.3.1. Real GDP growth according to the baseline and alternative forecasts

Source: NBG, GeoStat.

According to the alternative scenario, against the background of a worsening of the current account, as a result of exchange rate depreciation and raised inflationary expectations, the convergence towards the target will be delayed, which will increase the probability of a credibility shock and intensify the wage-price spiral. This, in turn, will further worsen the inflation outlook.

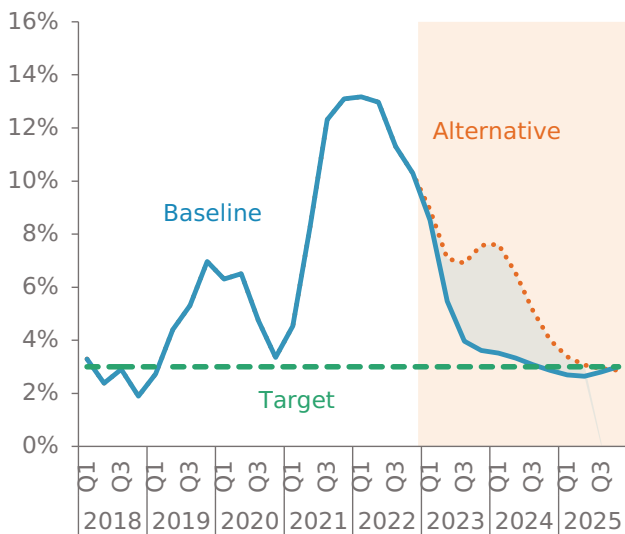


Figure 2.3.2. Headline CPI inflation according to the baseline and alternative forecasts

Source: NBG, GeoStat.

2.3 ALTERNATIVE FORECAST SCENARIO

The alternative forecast scenario considers a realization of those risks that would have an especially high impact on inflation. In particular, the current alternative scenario is mainly based on there being a global recession caused by a sharp response of the central banks of leading economies to the global inflationary environment. In addition, it envisages an immediate cut in foreign currency inflows from Russia and a further escalation/prolongation of the Russia-Ukraine war, which will further worsen the situation locally.

Under this scenario, as compared to the baseline, external demand for Georgian goods and services will fall and, ultimately, will have a negative impact on the current account balance. Regional and country risk premia will increase, which will elevate the risks of further capital outflows and hinder inflows of foreign investment. This, in turn, will put pressure on the exchange rate and inflation. As a result of a realization of these risks, the size of the real economy will not increase in 2023 (see Figure 2.3.1).

In the event of a realization of such an acute scenario, foreign demand will decrease, the expectations of economic agents will worsen, and the pressure on the exchange rate to depreciate will rise. The latter, taking into account the level of dollarization in the economy, will increase inflationary pressure through the channels of intermediate costs and expectations. In light of inflation remaining at a high level for a protracted period, the probability of a credibility shock will also increase, and long-term inflation expectations will be threatened. In turn, wage pressures will increase, and with nominal wage growth exceeding productivity growth, the inflation outlook will be further worsened. This inflationary effect will only be partially contained by lower energy resource prices (because of weak global demand). Hence, if this acute alternative scenario is realized, the convergence of inflation towards its target will be delayed and inflation will be 2.4 percentage points higher on average in 2023-2024 compared to the baseline scenario (see Figure 2.3.2).

Under this scenario, the National Bank of Georgia has the lowest tolerance, which implies a sharp tightening of monetary policy, the use of additional instruments where necessary and, subsequently, maintaining a tightened stance for a relatively long period. Under this scenario, as compared to the baseline, the trajectory of the monetary policy rate in 2023-2024 will be shifted upward by an average of 1.5 pp and will only normalize gradually after the stabilization of inflation expectations (see Figure 2.3.3).

Monetary policy will not tolerate increased inflationary pressures and credibility shocks. This implies a sharp tightening of the policy rate, the use of additional instruments when necessary, and, subsequently, the maintenance of a tight stance for a relatively long period.

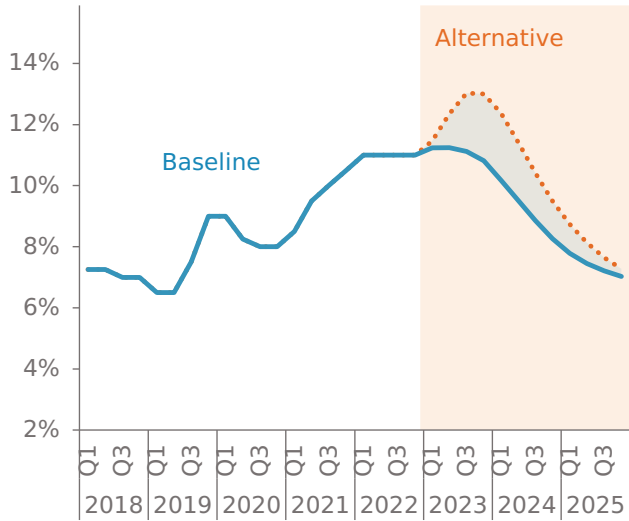


Figure 2.3.3. The monetary policy rate according to the baseline and alternative forecasts

Source: NBG.

Inflation expectations of financial market participants are gradually approaching the target of 3% in the medium term.

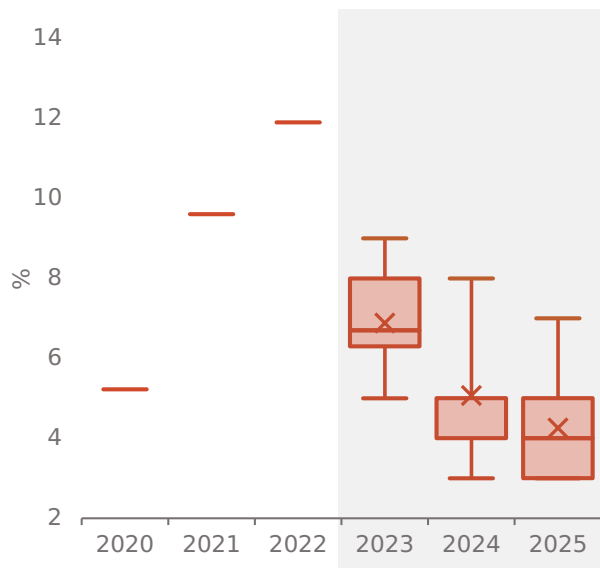


Figure 2.4.1. Actual average inflation (2020-2022) and the distribution of market participants' forecasts for 2023-2025

Source: NBG, Financial market participants, GeoStat.

2.4 FORECASTS OF FINANCIAL MARKET PARTICIPANTS

In the first quarter of 2023, 11 financial organizations participated in a survey of macroeconomic forecasts. According to the results of the survey, the financial market's economic expectations for 2023-2024 have been revised over the previous quarter.

The median of inflation expectations for 2023 decreased by 0.3 pp compared to the previous quarter, equaling 6.7%, while the average inflation forecast increased by 0.2 pp to 6.9%. Regarding 2024, the median forecast shifted up by 1 pp compared to the previous quarter to 5%, while the average is 0.6 pp higher and equals 5.1%. The inflation expectations of financial market participants gradually approach the target in the medium term. Specifically, the median forecast for 2025 declines to 4%, while the average expectation reaches 4.3% (see Figure 2.4.1).

Regarding the monetary policy rate, in light of increased inflation expectations market participants have revised their forecasts upward compared to the previous quarter. Their median projection for 2023 went up by 0.5 pp to 10%, while the average forecast rose by 0.3 pp, reaching 9.7%. As for 2024, the median and average projections for monetary policy increased by 0.7 pp and 0.3 pp to 8.7% and 8% respectively. The monetary policy outlook for 2025 is slowly approaching the neutral level in line with a curbing of inflation expectations. Specifically, the median forecast reaches 8%, while the average projection amounts to 7.6% (see

Amid elevated inflation expectations, monetary policy expectations for the coming years have been revised upward compared to the previous quarter. However, these forecasts are still highly variable.

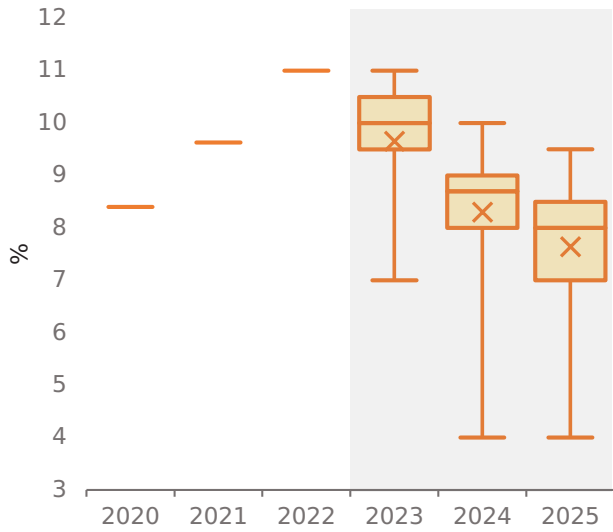


Figure 2.4.2. Actual monetary policy rate (2020-2022) and the distribution of market participants' forecasts for 2023-2025

Source: NBG, Financial market participants.

The market forecasts for economic growth over 2023-2024 have changed slightly compared to the previous quarter. However, growth expectations are still characterized by high variability.

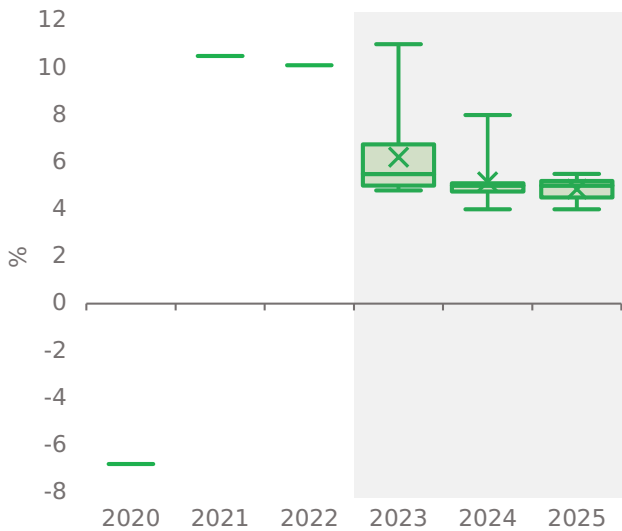


Figure 2.4.3. Actual real GDP growth (2020-2022) and the distribution of market participants' forecasts for 2023-2025

Source: NBG, Financial market participants, GeoStat.

Figure 2.4.2).

According to the current survey, the forecasts of real GDP growth are highly volatile. The median and average forecasts of economic growth in 2023 have shifted up by 0.5 pp and 0.6 pp, reaching 5.5% and 6.2% respectively. The median projection for economic growth in 2024 has not changed compared to the previous quarter and remains at 5%, while the average expectation rose by 0.1 pp to 5.2%. In 2025, the market's median real GDP growth forecast is 5%, while the average is 4.9% (see Figure 2.4.3).

BOX 2. EVALUATION OF INFLATION TARGET FULFILLMENT AND AN ASSESSMENT OF THE 2022 FORECASTS

Changes in monetary policy are transmitted to the economy gradually with a certain time lag (of 4-6 quarters). Therefore, in the formation of monetary policy, it is especially important to consider what the inflation forecast is over the monetary policy horizon. Because of this central role, in academic and institutional circles the inflation-targeting regime is also referred to as the inflation-forecast targeting regime. To assess the adequacy of monetary policy in achieving its objectives, it is important to analyze the accuracy of the forecasts made in previous periods. The inflation forecast is assessed as having been accurate if any deviations from the forecast were solely a result of exogenous factors (that are independent of monetary policy). In Georgia, as in other small open economies, exogenous shocks are an ever-present threat. Such shocks are usually transitory, of a one-off nature, and responding to them would thus induce more public costs than benefits. Consequently, central banks generally do not generally react to such shocks, except when supply shocks affect medium- or long-term inflation expectations. The analysis of the comparison of inflation forecasts with the actual dynamics is of a systematic nature and can be found in the Monetary Policy Report published at the beginning of each year. This section will thus evaluate inflation target fulfillment in 2022 and analyze the forecasts of that year.

Inflation turned out to be significantly higher than had been projected in February 2022 (see Figure 2.4.4). Based on that forecast, against the background of the elimination of supply and demand imbalances on post-pandemic international markets, the normalization of shipping costs, and the reduction of the base effect of implemented utility subsidies, inflation was supposed to follow a sharp downward trend during 2022 and, *ceteris paribus*, should have hit the target by the end of the year.

However, on 24 February 2022, Russia's invasion of Ukraine and the resulting full-scale military conflict put the world economy – which was still in the process of post-pandemic recovery – in front of a new reality. Challenges emerged that successively used to postpone the stabilization of the inflation outlook. The sanctions imposed by the West in response to Russia's aggression and additional disruptions to supply chains significantly increased the prices of food raw materials and energy resources on world markets. This has had a significant impact on Georgia too as, on average, more than 1/3 of Georgian consumers' total expenditures are on food and fuel. The shock was transmitted to many other countries too, including the U.S. and the Eurozone, where historically high rates of inflation were recorded.

In addition, increased numbers of long-term visitors to Georgia from Russia, Belarus, and Ukraine sharply and instantaneously pushed up rental prices in the local market, putting further pressure on inflation. Having expanded, contrary to expectations, aggregate demand hampered the effective taming of inflation. Migration-related record-high remittances, the recovery of tourism revenues, and increased credit activity all made significant contributions to the expansion. Despite the tightened monetary policy, consumer and foreign currency loans were the main drivers of lending – the slowdown of which, in general, is not effectively governed by monetary policy rate hikes. Subsequently, the National Bank of Georgia launched its macroprudential instruments.

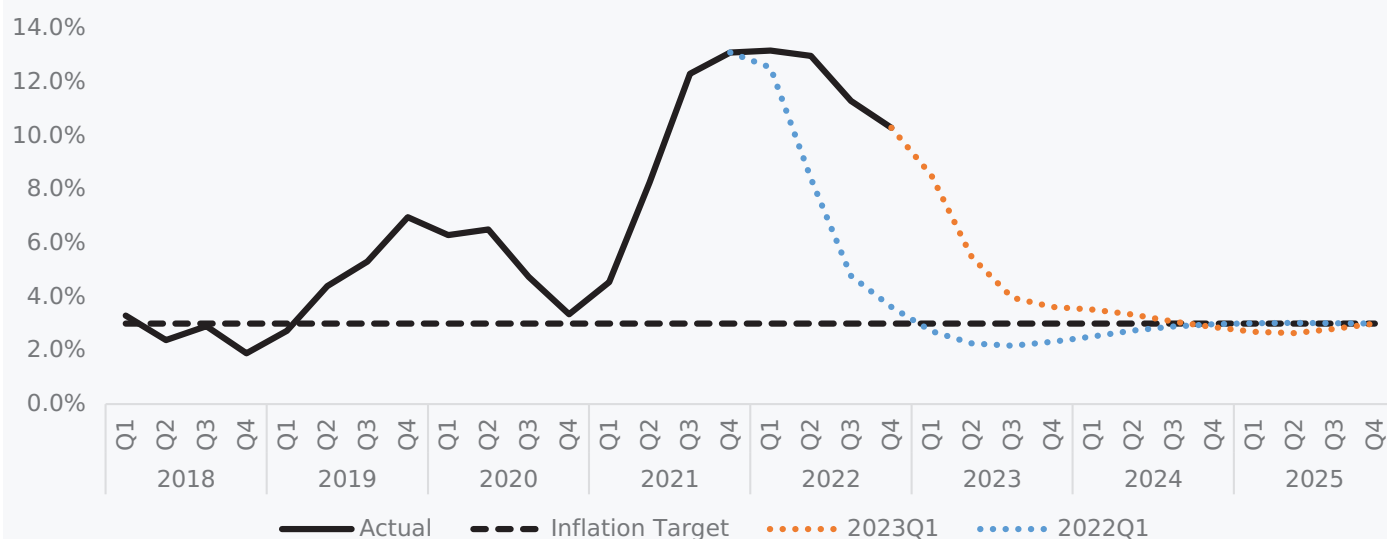


Figure 2.4.4. Comparison of the February 2022 annual inflation forecast with actual inflation and the updated forecast

Source: NBG, GeoStat.

Actual average inflation in 2022 was 4.6 pp higher than had previously been forecast (see Figure 2.4.5). According to the decomposition analysis, the higher-than-forecasted inflation was largely explained by supply-side shocks (making a contribution of 2.9 pp) and worsening short-term inflation expectations (a contribution of 1.6 pp). In turn, we can consider the supply shock as resulting from a combination of the effects of the above-mentioned disrupted supply chains and increased prices of commodities on international markets. Meanwhile, the increase in inflation expectations is a reflection of increased current inflation and heightened uncertainty. However, as a result of the Russia-Ukraine war, and contrary to initial expectations, the balance of payments improved dramatically as a result of the increased migration inflows and, accordingly, the appreciation of the lari exchange rate had a disinflationary effect (a contribution of 0.5 pp). Against the backdrop of the improved current account deficit and improving aggregate demand as a whole, the growth of the latter was also higher than expected (a contribution of 0.7 pp). However, it should be noted that, in the absence of such a tight monetary and macroprudential policy, aggregate demand would have made an even higher contribution.

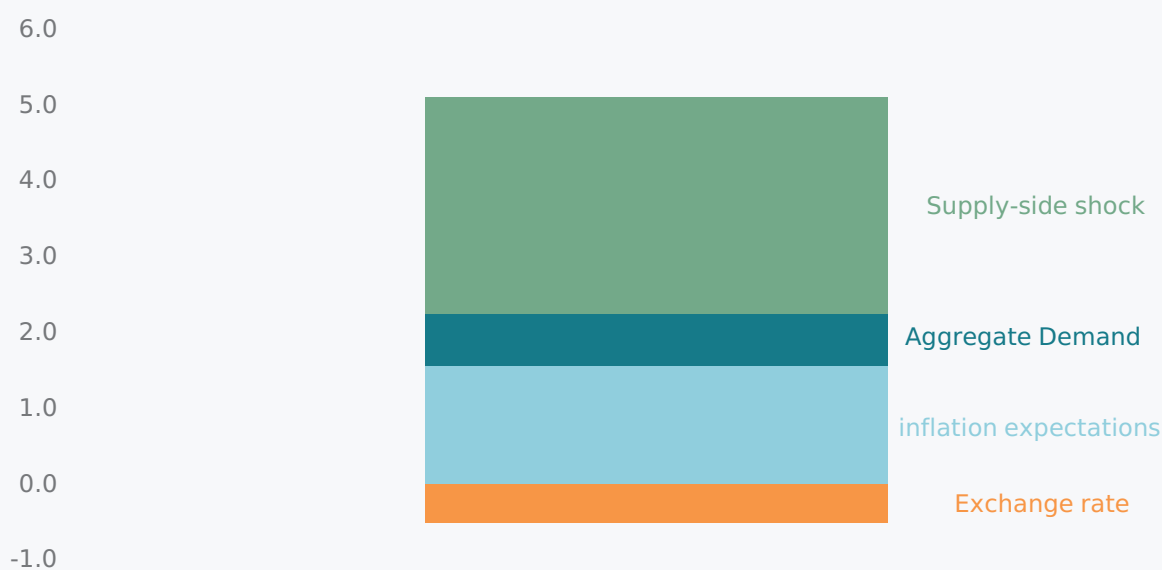


Figure 2.4.5. Decomposition of the difference between actual inflation in 2022 and the February 2022 forecast

Source: NBG, GeoStat.

The inflation forecast gradually increased over 2022 alongside the extraordinary situation and the worsening exogenous shocks (see Figure 2.4.6). However, along with the mitigation of supply shocks, a reduction of geopolitical risks, and an adequate response of the National Bank, which used all relevant instruments at its disposal, over the medium term, each forecast expected inflation to decrease and return to its target rate. It is also worth mentioning that the stabilization of inflation was predicted by both market participants and international/local research organizations.

The factors affecting inflation in 2022 were exogenous and of a one-off nature. It was thus assumed that their effects on annual inflation would be neutralized by themselves. However, in order to not elevate long-term inflationary expectations as a result of the temporarily increased inflation and so as to not aggravate “second round” effects, in March 2022 the Monetary Policy Committee increased the refinancing rate to 11% and maintained the tightened stance throughout the year. However, the quite strong lending, as driven by consumer and foreign currency loans, had been relatively less affected by the monetary policy tightening. Accordingly, the National Bank also used other instruments at its disposal: the remuneration of interest on required reserves was canceled in the case of U.S. dollar and euro funds; furthermore, the maximum term of foreign currency mortgage loans was limited from 15 to 10 years, and the maximum term of consumer loans was temporarily (for one year) reduced from four to three years.

Amid the implementation of the above-mentioned measures and the relative stabilization of the situation on international markets, the inflation forecasts made in the third and fourth quarters were almost identical, and the dynamics of actual inflation turned out to be in line with the forecasts. This, in turn, affirms the expectation that, despite the high risks, inflation will return to its target from the second half of 2023.

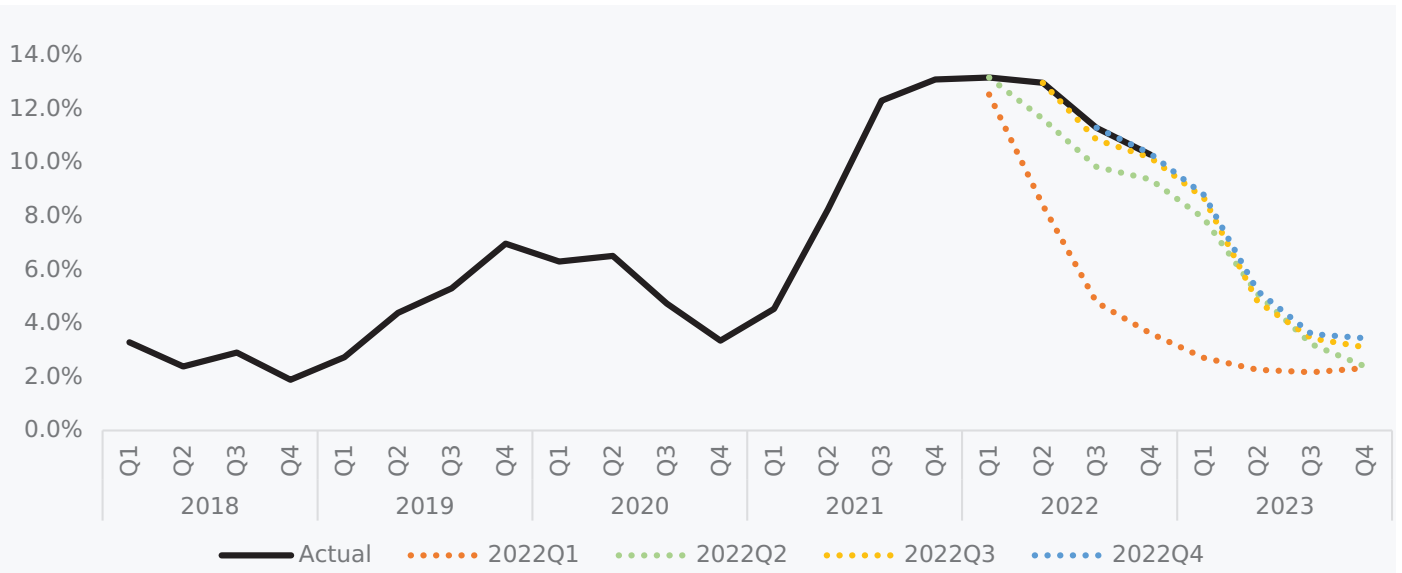


Figure 2.4.6. Comparison of headline inflation forecasts (2022Q1-2022Q4)

Source: NBG, GeoStat.

3 MONETARY POLICY

Inflation in Georgia has retreated from its peak and a declining trend has been observed. For the first time since June 2021, inflation fell below double-digits and amounted to 9.8% in December. The decrease in inflation was largely caused by a certain stabilization of prices on international markets and a decrease in international shipping costs. Moreover, the tight monetary policy, fiscal consolidation and appreciated exchange rate all contributed to its reduction. According to the current forecast, other things being equal, as a result of maintaining a tight monetary policy, inflation will continue to decrease to approach its target level in the second half of 2023. However, considerable risks and uncertainties remain. Among the various inflationary risks, particularly important are the geopolitical situation, the growth of inflationary expectations, and the increasing trend of unit labor costs. Under the conditions of a high global inflationary environment, the NBG remains focused on reducing inflation. On 1 February 2023, the NBG’s Monetary Policy Committee decided to maintain its tight monetary policy stance and left the policy rate unchanged at 11%. The tight monetary policy will be maintained in the near future and its normalization will begin gradually and only after a clear trend of decreasing inflation is observed. On the other hand, if inflation expectations rise and/or additional demand-side price pressures emerge, a further tightening of monetary policy, or maintaining the current tight stance for a longer period, might be necessary.

To eliminate additional inflationary pressures and reduce the risk of medium-term inflation expectations, on 1 February 2023, the Monetary Policy Committee decided to maintain the historically tight monetary policy stance of 11%.

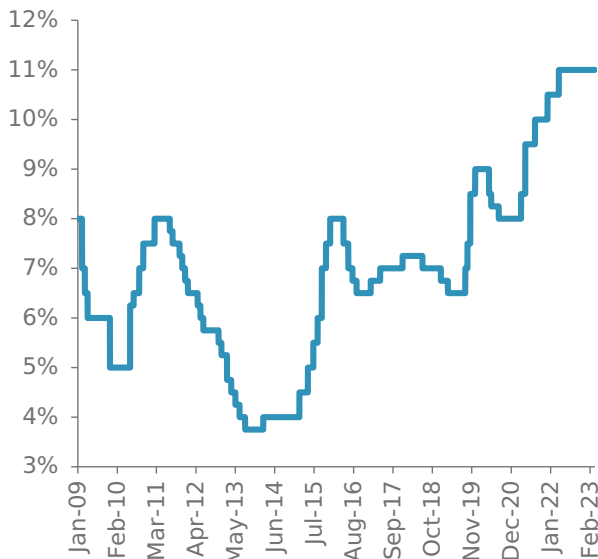


Figure 3.1. Monetary policy rate

Source: NBG.

Globally, inflationary pressures remain high and the central banks of various countries have pursued interest rate hikes. As a result of the Russian invasion of Ukraine, and against the background of a tightening of financial conditions, economic growth outlooks have worsened globally. However, the current war has had different effects on countries. Although the world faced new challenges, particularly in terms of international trade, the negative effects of the war on some countries of the region, including Georgia, due to its geopolitical location, have not yet materialized. In particular, against the background of migration and increased remittances to countries of the region, foreign demand has increased more than expected. As a result, economic activity in Georgia in 2022 turned out to be higher than expected.

Russia’s invasion of Ukraine has led to a significant increase in prices of energy resources and food products on international markets. However, from the second half of 2022, following the recovery of international commodity market supply chains, a trend of price reductions was evident. The agreement made on the export of grain to Black Sea ports, alongside the humanitarian corridors created by the European Union, made significant contributions to the price reductions. In line with the drop of oil prices and a gradual recovery of supply chains, the international cost of transportation continues to decline, which, together with the strengthened lari exchange rate, helps to reduce inflation. The current trends on international markets give grounds for cautious optimism. However, despite the stabilization of international prices, their levels re-

main significantly higher than pre-pandemic levels, and uncertainty regarding expected dynamics remains high.

Against the backdrop of increased migration flows, aggregate demand was strong in 2022, putting additional pressure on prices. However, in 2023, the impact of the migration flows is expected to decrease, which, along with the expected global economic recession, will moderate foreign demand. At the same time, as a result of the planned fiscal consolidation in 2023, fiscal stimulus will also decrease. Moreover, credit activity has slowed as a result of tightened monetary policy and the recently implemented macroprudential instruments. On the other hand, the tightened monetary policies of the European Central Bank and the U.S. Federal Reserve have had the effect of tightening foreign currency lending. Taking into account these tendencies, in 2023, economic activity will be close to its potential level, which implies a significant slowdown in the growth rate, and the resulting inflationary pressure will be neutralized.

Despite the recent positive trends, inflationary risks remain high. Under the high global inflationary environment, financial conditions are expected to be further tightened by the central banks of developed countries. The tightening of global financial conditions creates additional risks related to an increase of sovereign risk premia and enhanced inflationary risks for developing and emerging countries. As a small open economy, Georgia is vulnerable to such global developments. On the other hand, against the backdrop of inflationary shocks, local wage growth has recently exceeded the growth rate of labor productivity, which makes the inflationary pressure from the labor market noteworthy. As a consequence of a series of consecutive shocks, inflation has long been above its target level, creating risks of so-called second round effects and of inflation expectations rising over the medium term. Therefore, maintaining a low level of long-term inflation expectations remains a significant challenge. Given the current high uncertainty and inflationary risks, the National Bank of Georgia is still concentrated on reducing inflation and will maintain the tight monetary policy.

Taking these factors into account, in order to eliminate additional inflationary pressures and reduce the risk of medium-term inflation expectations, on 1 February 2023 the Monetary Policy Committee decided to maintain its tight monetary policy stance and left the policy rate unchanged at 11%. Monetary policy will remain tight until the risks of rising inflation expectations are sufficiently mitigated. If inflation expectations rise and/or additional demand-side price pressures emerge, a further tightening of monetary policy, or maintaining the current tight stance for a longer period, might be necessary.

The reduction of dollarization is an important challenge for the Georgian economy. In addition to limiting the effectiveness of monetary policy, dollarization also

The dollarization of both deposits and loans continues to decline. This is largely as a result of the impact of larization measures, which include the use of a number of macroprudential instruments.

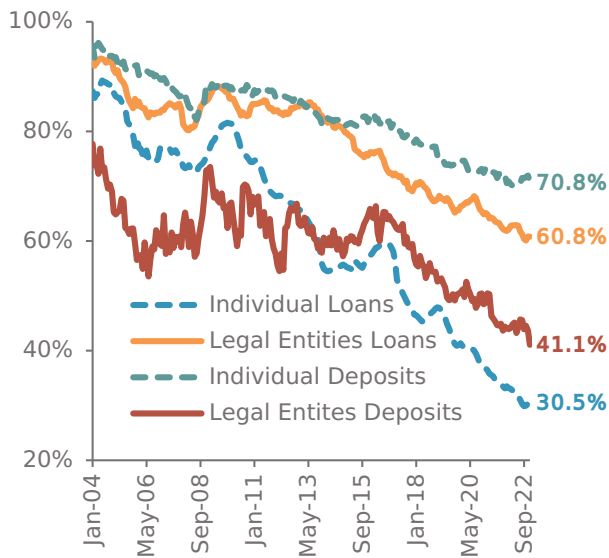


Figure 3.2. Dollarization of loans and deposits (excluding the exchange rate effect)

Source: NBG.

carries risks to financial stability. At the same time, it affects the risk premium of the country and hinders the improvement of credit ratings. The NBG thus continues to constantly analyze dollarization dynamics and will respond appropriately where necessary. As a result of the NBG’s larization (de-dollarization) policy, the dollarization of loans and deposits is gradually declining, which not only reduces currency risks and related credit risks of individual borrowers, but also promotes long-term economic growth.

The dollarization of total loans (excluding the exchange rate effect) in the last quarter of 2022 was almost unchanged compared to the previous quarter and stood at 44.7%. The downward trend of deposits dollarization continued. The dollarization of the deposits of individuals and legal entities decreased by 0.7 pp and 2.8 pp respectively to 70.8% and 41.1% (excluding the exchange rate effect) over the same period.

To ensure the efficiency of monetary policy, it is important that changes in the monetary policy rate are reflected on interbank interest rates and ultimately affect the real economy. Currently, the banking sector operates under a short-term liquidity deficit. When necessary, commercial banks can obtain additional liquidity through refinancing loans, which is the main instrument of the NBG.

The NBG provides the required amount of liquidity to ensure that short-term interest rates on the interbank money market vary around the policy rate.

Interbank money market rates vary around the monetary policy rate, which is the result of a good liquidity management framework.

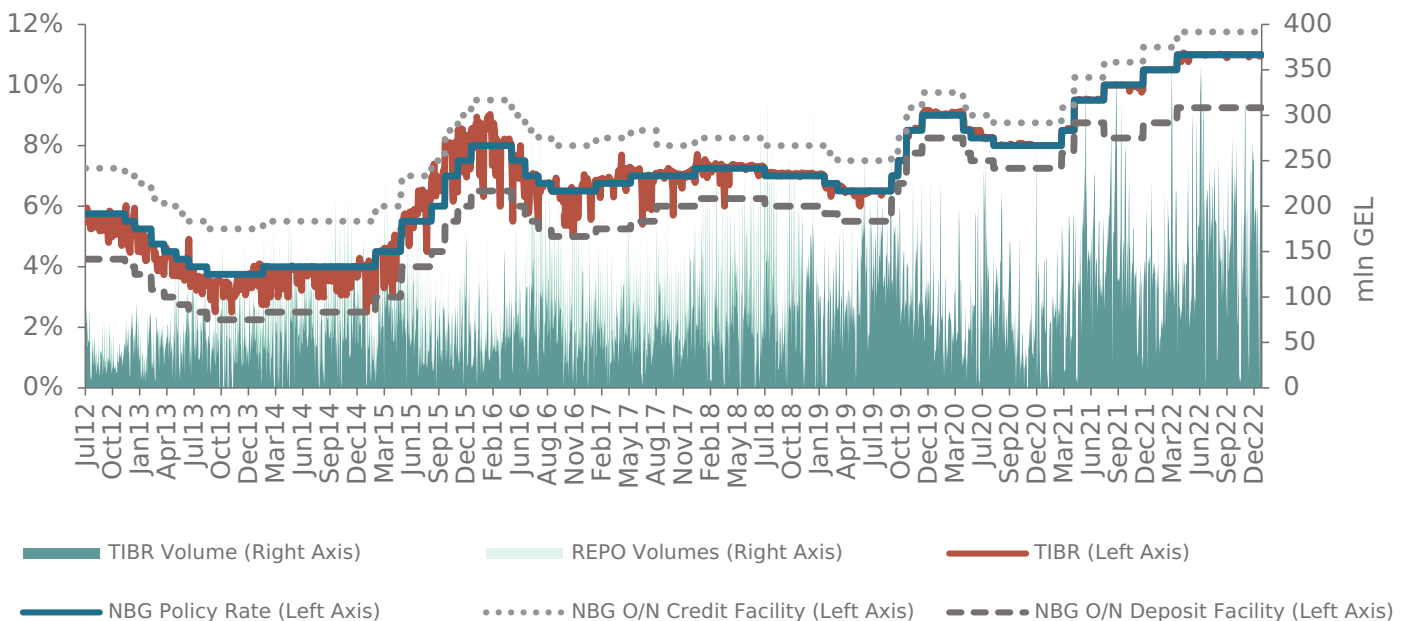


Figure 3.3. Interbank money market

Source: NBG.

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