საქართველოს ეროვნული ბანკი
National Bank of Georgia

MONETARY POLICY REPORT

MAY 2025

PREFACE

The primary objective of the National Bank of Georgia (NBG) is to ensure price stability, which, in turn, supports the country's long-term economic growth. In pursuit of this objective, the NBG operates within an inflation-targeting framework, which was formally adopted in 2009. Within this framework, the NBG conducts its monetary policy in a way that inflation approaches its target level of 3% in the medium term.

The primary tool of the NBG under its inflation-targeting framework is the monetary policy rate. When making decisions about the rate, the primary focus is on the inflation forecast, as the full economic impact of the decision takes some time (4-6 quarters) to materialize. Therefore, macroeconomic forecasts are the key component in shaping monetary policy, and their effective communication is crucial for anchoring inflation expectations. Additionally, the communication of these forecasts plays an important role in the decision-making process of businesses and households.

In recent years, amid global developments, uncertainty has increased. Given the heightened unpredictability of future economic conditions and its broad scale, it is essential for central banks to choose an optimal decision when conducting monetary policy to minimize economic losses in the event of any risk materializing. In a dynamic economic environment, a monetary policy approach focused on managing risks is critical for achieving optimal outcomes. This is evidenced by the experience of central banks in the post-pandemic period. Central banks, including the NBG, that made decisions based on the approach of minimizing the impact of risks, have managed the globally prevailing inflationary pressures with relatively greater success. Accordingly, policymakers are increasingly emphasizing the importance of a scenario-based approach, within which monetary policymakers make decisions based on the development of various relevant scenarios. This systematic assessment of scenarios and their impact enables policymakers to effectively navigate the inflation-output tradeoff.

The NBG adopted a new scenario-based approach to monetary policy communication, enhancing the transparency of its risk management and decision-making processes. This step marks another stage in the development of the NBG's monetary policy framework, where, amid deepening cooperation between the NBG and financial markets, the role of market participants' expectations has increased.

Generally, within a scenario-based approach, the first stage involves assessing market expectations both in Georgia and globally. Subsequently, the NBG analyzes a wide array of risks and, in response, prepares conditional trajectories for the monetary policy rate if those risks were to materialize. This, in turn, enhances the transparency and understanding of the monetary policy reaction function, thereby improving the effectiveness of monetary policy transmission channels.

Under the scenario-based approach, the National Bank of Georgia publishes three forecast scenarios:

- **The Central Scenario**, which incorporates a comprehensive range of current information, including expectations in both the local financial market and global markets, and accounts for risks that are consistent with this information.
- **The Higher-Inflation Risk Scenario**, which, compared to the central scenario, incorporates **risks that are more inflationary** over the monetary policy horizon and is particularly relevant in light of the prevailing uncertainty.
- **The Lower-Inflation Risk Scenario**, which, compared to the central scenario, incorporates **more disinflationary risks** over the monetary policy horizon and is particularly relevant in light of the prevailing uncertainty.

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MONETARY POLICY DECISION

The National Bank of Georgia decided to keep the monetary policy rate unchanged at 8.0%.

On May 7, 2025, the Monetary Policy Committee of the National Bank of Georgia (NBG) decided to keep the monetary policy rate (refinancing rate) unchanged. The monetary policy rate stands at 8.0%.

Inflation remains close to the target level of 3%. As of April, annual inflation stood at 3.4%, while core inflation, which excludes the prices of food, energy products, and cigarettes - items characterized by significant price volatility - was 2.3%. This year, inflation dynamics are, on the one hand, driven by the increasing international food prices, which, for now, are partially mitigated by the relatively stable exchange rate of the lari against U.S. dollar driven by the global depreciation of the U.S. dollar. On the other hand, alongside international factors, the increase in food inflation has been partly attributed to the one-off rise in bread prices in the local market starting from March 2025. It is important to note that domestic economic fundamentals continue to support price stability. Specifically, improved production capacity partially offsets the price pressures stemming from strong aggregate demand. At the same time, long-term inflation expectations remain stable, as indicated by both the domestic (excluding the bread price effect) and service inflation measures, which remain close to the target level of 3%.

Against the backdrop of global economic uncertainty, risks affecting inflation in both upward and downward directions have emerged. On the one hand, recent global developments highlight signs of economic fragmentation, which amplify stagflationary risks. This, in turn, creates risks for increased imported inflation in Georgia. On the other hand, as previously noted, the global weakening of the U.S. dollar index (DXY) has led to an improvement in the lari's position relative to the U.S. dollar. This reduces the debt burden of dollar-denominated loans and, consequently, alleviates inflationary pressures through this channel. Meanwhile, in the context of declining global demand and expectations of increased oil supply, international oil prices are falling. This, along with the lari's stable position against the U.S. dollar, has a disinflationary effect.

Economic activity in Georgia remains robust in tandem with maintained price stability. Specifically, in the first quarter of 2025, real GDP growth averaged 9.3%. This is largely driven by structural changes in the economy, as reflected in the sustained strong contribution of productive sectors to GDP growth. At the same time, strong domestic demand also plays a key role in supporting high economic growth. This leaves demand-side price pressure as a noteworthy factor to consider.

Considering increased global uncertainty, domestic tendencies and expectations in financial markets, the NBG's **central scenario** projects that inflation will temporarily exceed the target in 2025, stabilizing around 3% in the medium term. Due to the relatively slow pace of normalization of fundamental economic factors in the economy and strong current economic growth, real GDP growth in the central scenario for 2025 has been revised upwards from 5% to 6.7%, compared to the previous scenario. In the long term, it is expected to stabilize within its potential level of 5%.

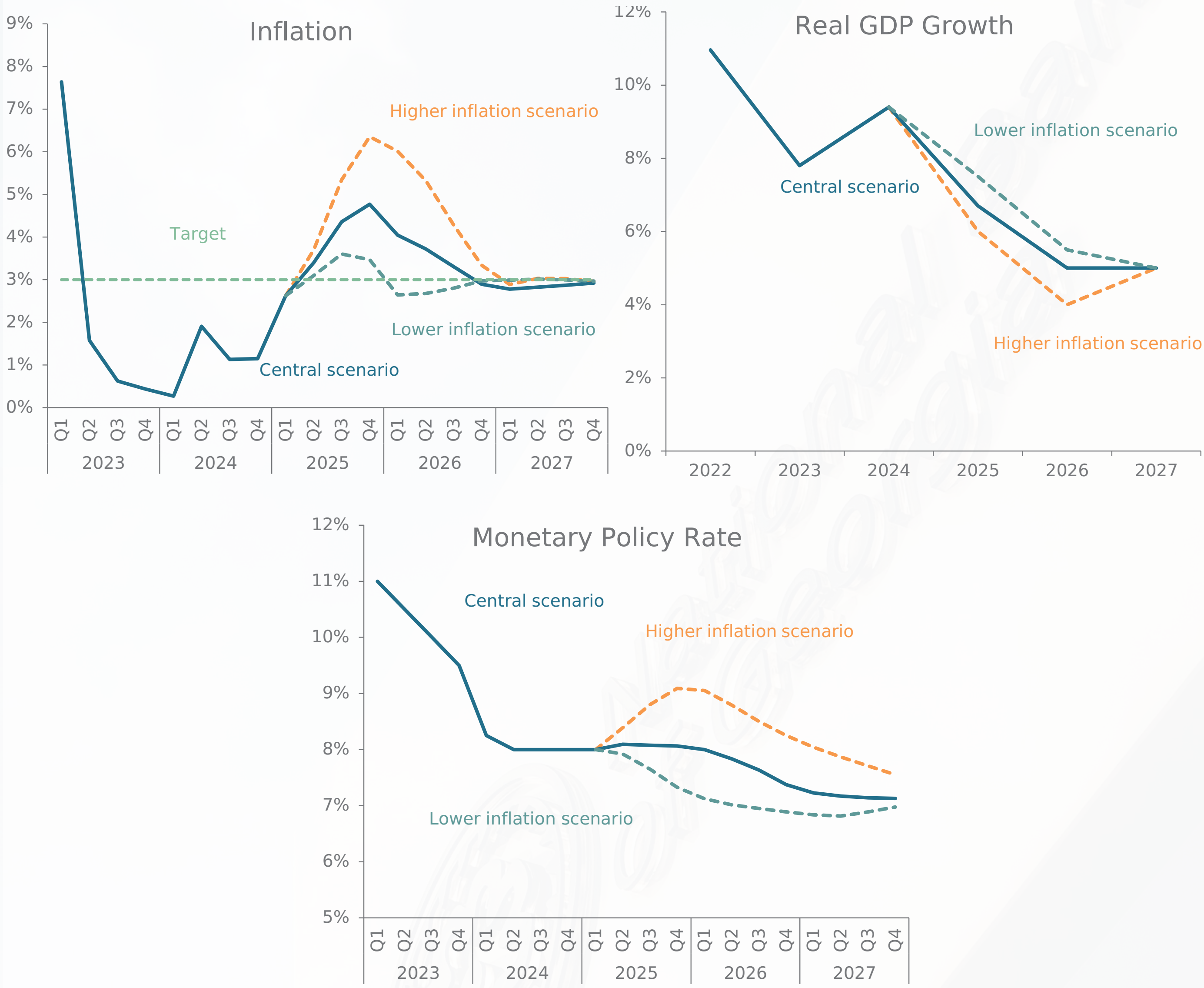
Given the increasing uncertainty, the Monetary Policy Committee has, on one hand, considered a **high-inflation risk scenario**, where the realization of fundamental factors would require a higher path for the policy rate compared to the central scenario. The high-inflation scenario is primarily based on the recent increase in uncertainty in international markets, which is fueled by tariff policy and the acceleration of economic fragmentation. The materialization of these risks, in turn, would disrupt supply chains and create a globally high-inflationary environment, which would subsequently have an impact on Georgia.

On the other hand, the Monetary Policy Committee considered the **low-inflation risk scenario**, where the realization of fundamental factors would require a lower trajectory for the monetary policy rate compared to the central scenario. The increased global uncertainty and tariff policies may accelerate the diversification of trade worldwide, resulting in the reallocation of supply chains and regionalization. In this process, Georgia's role as the "Middle Corridor" country will be further strengthened. Moreover, under this scenario, the U.S. dollar will remain globally weakened, and against the backdrop of these tendencies, the appreciated exchange rate of the lari will exert downward pressure on overall inflation through the import inflation channel.

Following discussions on all of the above, the Monetary Policy Committee has considered it optimal to maintain a cautious approach toward the further normalization of the policy rate and decided to keep the monetary policy rate unchanged at 8%. Upcoming decisions on the policy rate will depend on the analysis of risks and resulting updated macroeconomic forecast scenarios.

The NBG will use all available instruments to maintain price stability. This means keeping the overall price level increase close to the 3% target over the medium term.

NBG's Macroeconomic Forecast Scenarios



1. OVERVIEW OF THE GLOBAL MACROECONOMIC ENVIRONMENT

The Global Policy Uncertainty Index has returned to the level recorded at the peak of the COVID-19 pandemic, while the Trade Policy Uncertainty Index has reached a historically high level. This increased uncertainty is mainly driven by the United States' tariff policy, which poses risks of slowing global growth and intensifying inflationary pressures - effects that are also reflected in Georgia's economy.

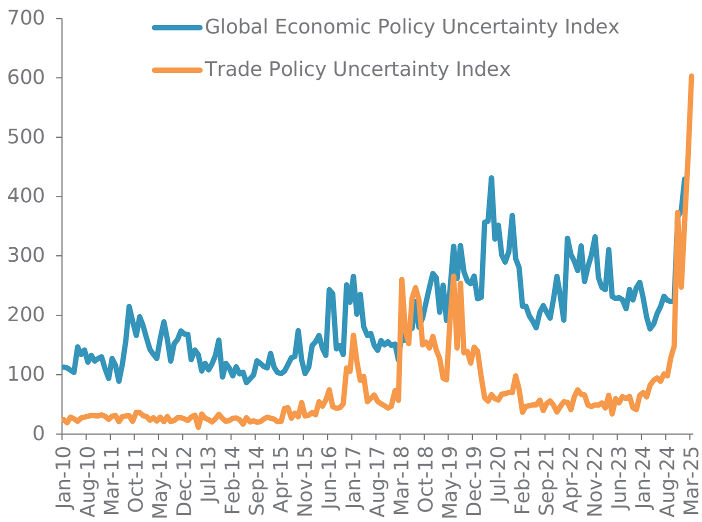


Figure 1.1. Global Economic Policy Uncertainty Index, Trade Policy Uncertainty Index

Source: FRED, Matteo Iacoviello (TPU).

* TPU index measures the monthly share of newspaper articles discussing trade policy that also mention uncertainty-related terms (relative to the total number of articles), normalized so that a 1% share corresponds to an index value of 100.

The global economy is facing renewed challenges, largely driven by shifts in U.S. tariff policy, which have already significantly impacted global economic relations and have intensified uncertainty (see Figure 1.1). In addition to trade policy uncertainty, U.S. fiscal risks further exacerbate the situation - a high debt-to-GDP ratio relative to a sustainable level increases the riskiness of U.S. Treasury securities. On the one hand, these growing risk factors accelerate economic fragmentation, posing a threat of a global economic slowdown; on the other hand, tariff-driven policies disrupt supply chains and heighten the risk of stronger inflationary pressures. According to the latest assessment by the International Monetary Fund (IMF), compared to the January forecast, the expected growth of the global economy in 2025 has been revised down by 0.5 percentage points (pp) to 2.8%, and the 2026 forecast has been lowered by 0.3 pp to 3.0%. The IMF now projects that global inflation will decline at a slower pace than anticipated earlier in the year, reaching 4.3% in 2025 and 3.6% in 2026.

Considering these shifts, expectations for the federal funds rate in U.S. markets have undergone significant changes and have been revised downward since the beginning of the year (Figure 1.2), primarily reflecting weaker growth prospects, even as inflation remains above the Fed's target. Tariffs initially act as a supply-side shock, driving up prices, while broader uncertainty dampens demand, exerting a disinflationary effect.

Beyond trade policy, restrictive immigration policies and an expansionary fiscal stance in the U.S. add to inflationary pressures. The resulting uncertainty has also been reflected in the volatility of international financial markets, particularly in the U.S. Increased uncertainty has led to a weaker DXY globally, while the U.S. 10-year Treasury yields spiked (see Figure 1.3). These risks pose uncertainties for Fed's monetary policy trajectory and are likely to place upward pressure on the neutral rate in the medium term.

Amid persistent inflation, subdued growth, and geopolitical risks, the Eurozone faces a delicate policy tradeoff. Economic activity remains weak, particularly in manufacturing. Germany's recent

The Fed's policy rate trajectory has shifted downward amid weakening growth prospects; however, renewed inflation risks -from tariffs, restrictive immigration, and expansionary fiscal policy have placed upward pressure on medium-term rate expectations.

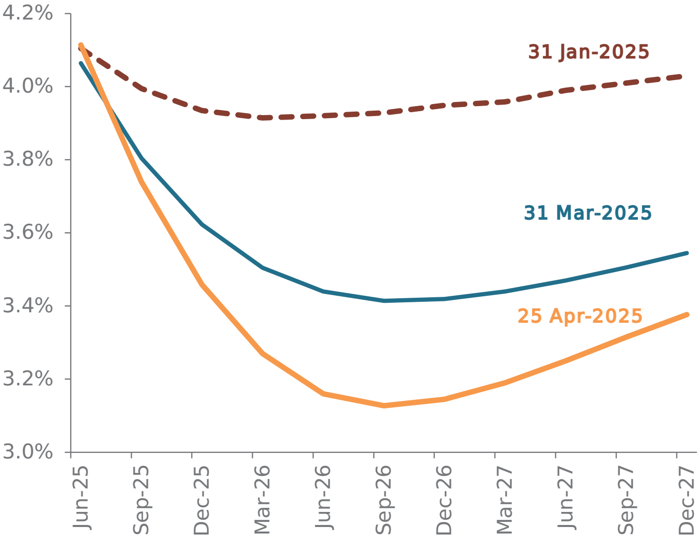


Figure 1.2. Market Expectations of Fed Funds Rate Path

Source: Atlanta Fed.

The Dollar Index (DXY) has weakened considerably the past few months amid a general decline in the expected path of the Fed funds rate. However, the most recent decline is concerning given the recent uptick in long-term interest rates in the U.S., suggesting concerns about macroeconomic imbalances.

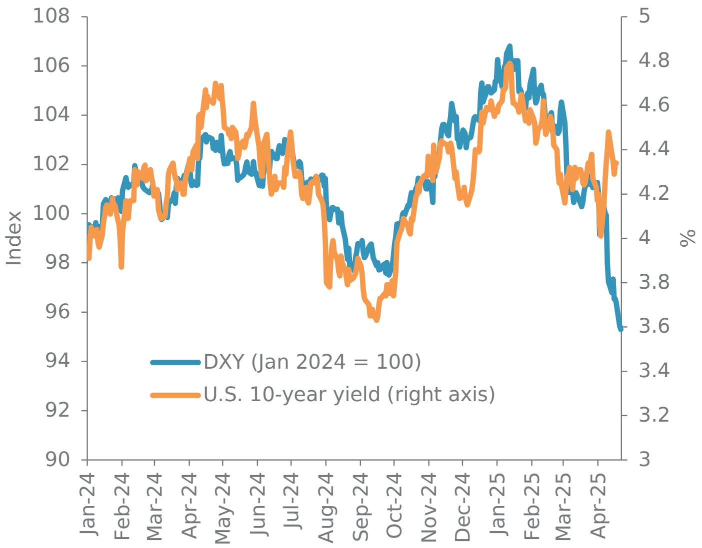


Figure 1.3. Dollar Index (DXY) and the yield of 10-year US treasuries

Source: Bloomberg, FRED.

fiscal stimulus may support long-term prospects, but broader structural issues and tighter financing conditions across member states continue to weigh on growth. Moreover, new U.S. tariffs could undermine productivity growth in the region, reinforcing subdued near-term economic growth (Figure 1.4).

China's economic outlook was looking more promising after the government issued a fiscal package aimed at addressing structural problems with domestic demand. However, that optimism has quickly moderated as the trade tension with the US has taken hold. The overall impact on China will depend on how global economic fragmentation evolves. China's export-driven growth model faces pressure from sluggish Eurozone demand, global supply chain shifts, and new U.S. tariffs (particularly those targeting high-tech and electric vehicle (EV)) on exports.

In Russia, the central bank keeps a tighter policy stance in response to persistent inflation. Growth in 2024 was supported by military spending, but this has also fueled demand-side pressures. Meanwhile, labor market frictions and underinvestment in non-defense sectors point to growing structural imbalances. Additionally, elevated geopolitical tensions, expectations of tighter sanctions, and lower export revenues stemming from declining oil prices are weighing on the medium-term economic outlook.

As a result, a general slowdown in economic activity in these countries will reduce external demand for Georgia, both through the trade and financial channels. However, the consequences of global fragmentation for Georgia's trade balance remain uncertain.

In April, the FAO's Food Price Index rose by 7.6% year-on-year (see Figure 1.5). While moderation in global demand may exert downward pressure on food prices, prevailing supply-side conditions remain inflationary. If international food prices stay elevated, they could exert upward pressure on food prices in Georgia.

Global oil markets have recently exhibited considerable volatility. As noted, U.S. economic policy contributes to the slowdown in global economic growth, which in turn reduces demand for oil and puts downward pressure on prices. Several factors could exert downward pressure on oil prices in the second half of 2025. These include the increase of oil supply. In this scenario, international oil prices are likely to exert a disinflationary effect on Georgia's inflation. However, geopolitical risks remain a significant source of uncertainty in this market.

Economic growth expectations among trade partners of Georgia have deteriorated, largely due to structural changes and global shifts in uncertainty.

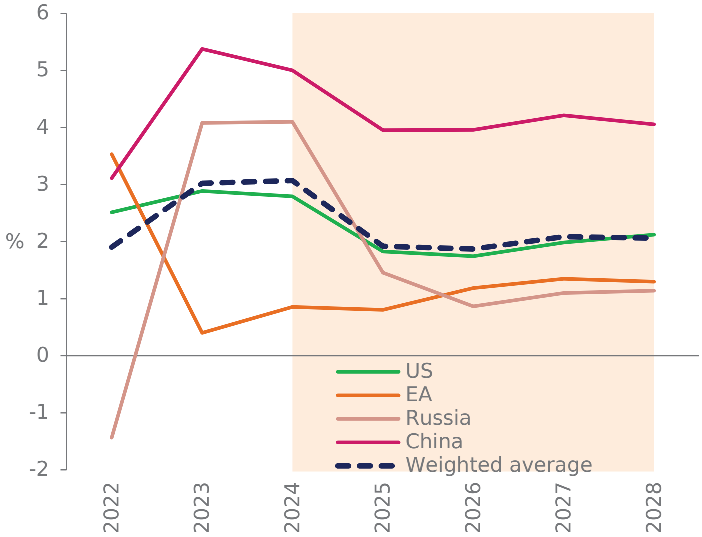


Figure 1.4. Real GDP Growth of Economic Partner Countries*

Source: International Monetary Fund (IMF), NBG.

*The weights for the **weighted average growth** are determined by the country's share in Georgia's foreign trade turnover.

US tariff policy has lowered expectations for global demand for oil with weak demand from China leading the way. Meanwhile food prices have stabilized but are currently exerting moderate inflationary pressure. The medium-term outlook for commodity prices continues to be uncertain.

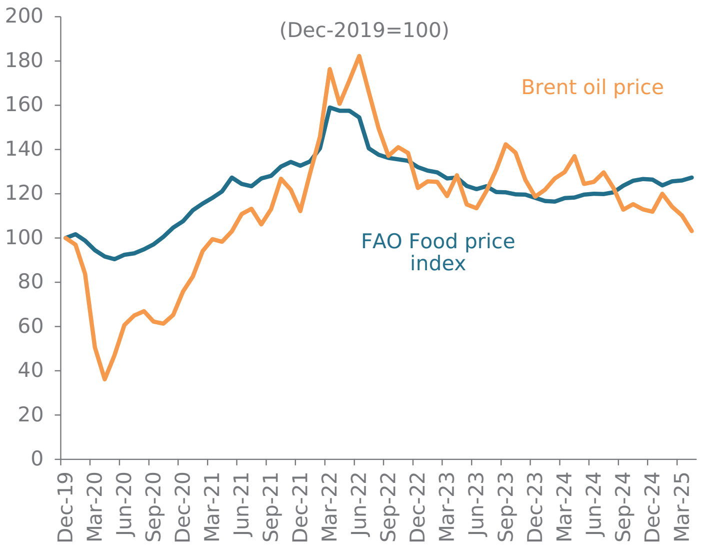


Figure 1.5. International Commodity Prices, Index, Dec-2019=100

Source: FAO, Bloomberg, NBG.

2. OVERVIEW OF THE CURRENT MACROECONOMIC ENVIRONMENT IN GEORGIA AND FORECAST SCENARIOS

High productive sectors remain one of the main driving forces of economic growth. However, their positive contribution is gradually normalizing toward the long-term economic growth.

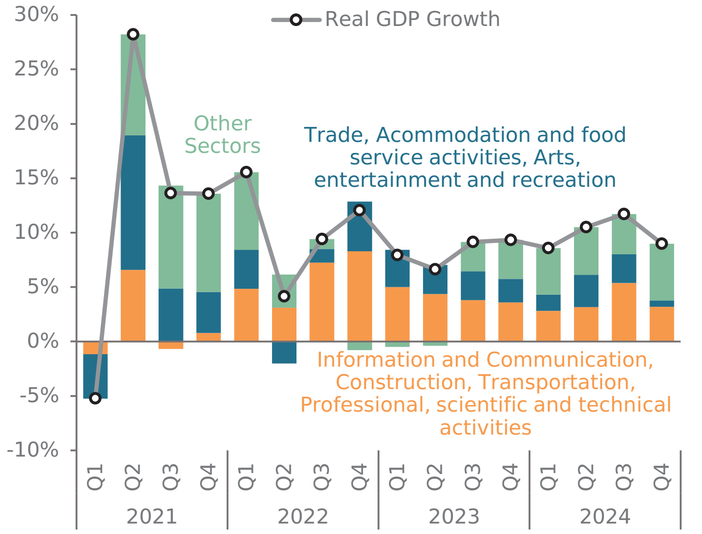


Figure 2.1.1. Sectoral Decomposition of Real GDP growth (Contribution to the Growth)

Source: NBG, Geostat.

Strong aggregate demand is largely driven by domestic factors.

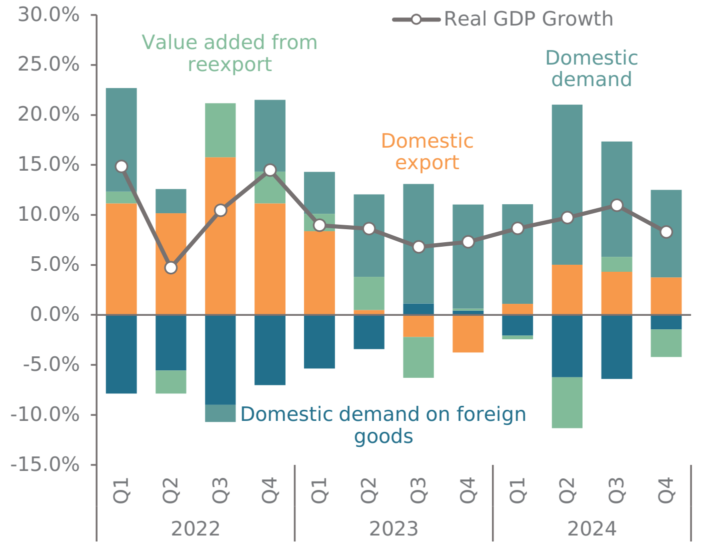


Figure 2.1.2. Decomposition of Real GDP Growth by Expenditures (Contribution to the Growth)

Source: NBG, Geostat

***Domestic demand** includes final consumption expenditures and gross capital formation (so-called absorption).

The value added from re-export refers to the revenue generated from re-exports, excluding the imports intended for re-export.

Domestic demand on foreign goods includes imports, excluding products intended for re-export.

2.1. OVERVIEW OF THE CURRENT MACROECONOMIC ENVIRONMENT IN GEORGIA

According to preliminary estimates, economic activity exceeded expectations, averaging 9.3 percent in the first quarter of 2025. Structural changes in the economy remains one of the principal driver of robust economic growth. This is evidenced by the sustained high contribution of productive sectors—such as information and communication, transportation and professional, scientific and technical activities—to real GDP growth (see Figure 2.1.1). However, it is should be noted that the rapid growth in these sectors is gradually normalizing, which supports convergence toward the economy's long-term potential growth rate of 5%. On the other hand, strong domestic demand also drives high economic activity (see Figure 2.1.2).

Despite these tendencies, elevated global risks are also having a certain impact on Georgia's economy. Notably, the yield spread between Georgia's and the U.S. government's 5-year dollar-denominated bonds widened, potentially indicating an increase in the sovereign risk premium (see Figure 2.1.3). The increase in global risks is contributing to a further tightening of financial conditions in Georgia and increase in interest rates (see Figure 2.1.4).

Against this backdrop of tighter financial conditions, credit growth has slightly decelerated. Specifically, as a result of loans denominated in both lari and foreign currency, the growth rate of the total credit portfolio continued to slow, reaching 16.6% (see Figure 2.1.5). In turn, credit activity is one of the key drivers of domestic demand. Accordingly, it is expected that certain signs of slowdown will appear in the growth rate of domestic demand.

Turning to the external sector, the slowdown in the global economy has also been reflected in the moderation of external demand. Specifically, the growth of goods exports slowed, and in the first quarter of 2025, it increased by a relatively modest 5.7% year-on-year. Notably, in recent periods, the contribution of additional revenues from re-exports to real economic activity has been declining (see Figure 2.1.2). Regarding services exports, the growth rate of travel revenues slowed in the first quarter of 2025, increasing by 2.3% year-on-year. The declining revenue tendencies from Russia continued. In addition, in the first quarter of 2025, *Globally increased uncertainty and risk have also raised Georgia's sovereign risk premium. However, at this stage, it remains close to its equilibrium level.*

Figure 2.1.3. The Spread between the Yields on 5-year Dollar-denominated Government Bonds of Georgia and the U.S.

Source: Bloomberg, NBG.

The heightened uncertainty has also tightened financial conditions, which has been reflected in rising interest rates on loans in lari.

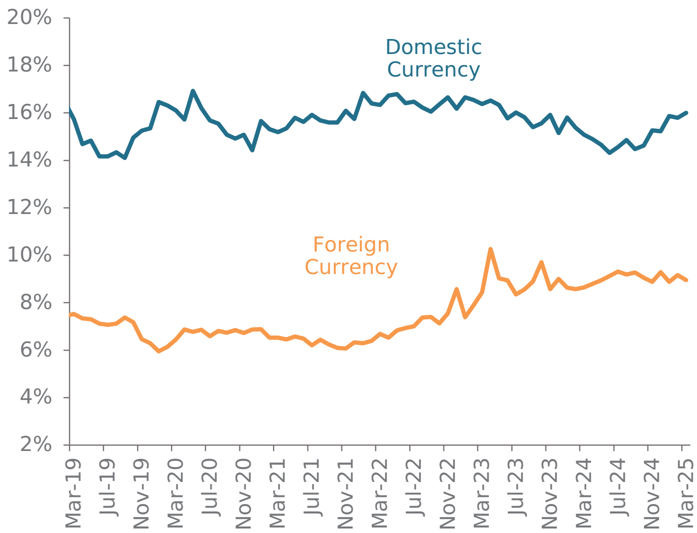


Figure 2.1.4. Interest Rates on the Loan Flows Issued in National and Foreign Currencies

Source: NBG.

the annual growth rate of domestically consumed imports[1] also slowed, reaching 3.6%. Accordingly, current developments in the external sector indicate a moderate widening of the current account deficit, bringing it closer to its equilibrium level of 5%–5.5% (see Figure 2.1.6).

It is also noteworthy that in 2024, the current account deficit stood below its estimated equilibrium level, amounting to 4.4% of GDP. This, in turn, was strengthening exchange rate positions, other things being equal. The primary source of current account financing remained foreign direct investment (FDI), which accounted for 3.9% of GDP.

As highlighted in the global macroeconomic overview section, recent economic policy developments in the Unites States have led to a sharp weakening of the U.S. dollar globally since March 2025 (see Figure 1.3), which in turn strengthened the lari against the U.S. dollar. A strong GEL position against the USD helps prevent additional inflationary pressures stemming from the servicing of dollar-denominated debt and supports the anchoring of inflation expectations near the target level.

However, Georgia's main trading partners—particularly those of the Eurozone and other EU countries—appreciated even more against the U.S. dollar, resulting in a slight depreciation of the lari against the trading partner currencies.

Alongside the depreciation of the nominal effective exchange rate (NEER), relatively low inflation in Georgia compared to its trading partners supports the country's competitiveness. Parallel with the NEER depreciation, the differential between foreign and domestic inflation leads to a weakening of the real effective exchange rate (see Figure 2.1.7). This, amplifies the risks of global inflation transmission to Georgia.

Meanwhile, the level of deposit dollarization stabilized following the observed increase in the previous period (see Figure 2.1.8). Against the maintenance of a high interest rate differential between lari- and foreign currency-denominated deposits, and the sustained strength of the lari against the U.S. dollar, deposit dollarization is expected to resume its declining trend following the recent stabilization.

The tendencies in the labor market remain disinflationary. Particularly, given the sustained high pace of productivity and the normalization of real wage growth, unit labor costs have declined. This,

1 Domestically consumed imports also exclude one-off factors in January (imports of paintings and sculptures).

Amid tighter financial conditions, the pace of credit growth continues to slow.

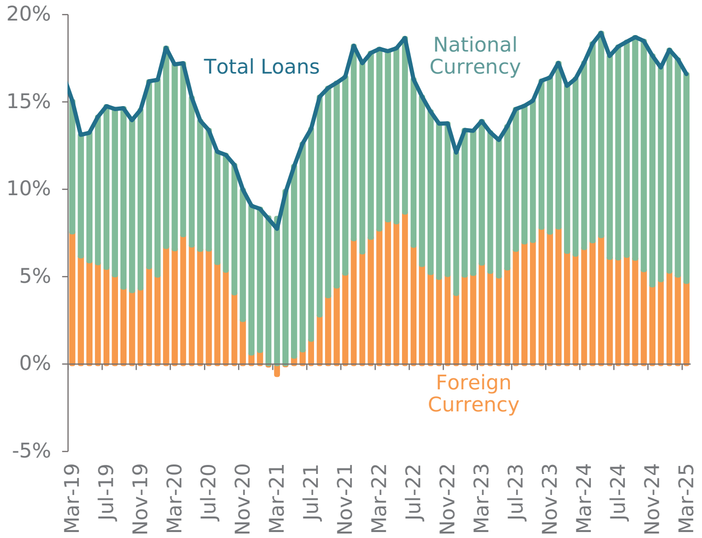


Figure 2.1.5. Year-over-year Growth Rate of Loans in Domestic and Foreign Currencies (Excluding Exchange Rate Effects)

Source: NBG.

Current tendencies in the external sector point to a moderate widening of the current account deficit, bringing it closer to its equilibrium level (5%–5.5%).

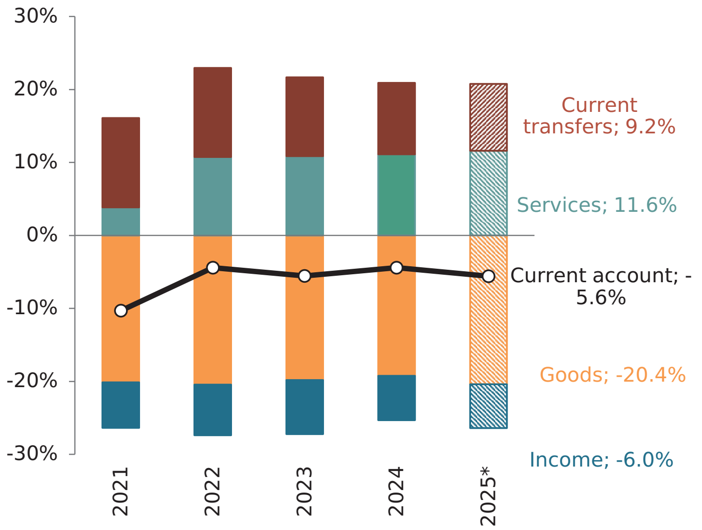


Figure 2.1.6. Current Account Balance Decomposition (% of GDP)

Source: NBG

*According to the BPM5

in turn, eases inflationary pressure in the economy from both the supply and demand sides (see Figure 2.1.9).

Based on the aforementioned tendencies, domestic economic fundamental factors continue to contribute to the price stability. In particular, the impact of strong aggregate demand on inflation is partially offset by improvements in production capacity. Concurrently, high productivity also supports low inflation, in terms of reducing production costs per unit of output. Simultaneously, long-term inflation expectations remain anchored, as evidenced by the continued low level of services inflation relative to the 3% target.

However, on the other hand, the materialization of certain risks in international markets has partially transmitted to inflation, leading to an increase in flexible price inflation. The upward tendency in international food prices, particularly the increase in vegetable oil prices, has transmitted to the domestic market, leading to the growth in mixed inflation (see Figure 2.1.10).

Moreover, in the coming months, the introduction of an import tax on sugar is also expected to affect food inflation in an upward direction.

Additionally, since March, the increase in bread prices has made a significant contribution to inflation, leading to a rise in both domestic and sticky price inflation. It is noteworthy that these inflation indicators serve as proxies for long-term inflation expectations, given that the price changes of the goods and services they encompass exhibit a high degree of persistence. However, it is also important to consider that, after excluding the one-off effect of the bread price adjustment, both domestic and sticky price inflation have remained consistently around the target level.

In contrast, the declining tendency in international oil prices exerts a disinflationary effect. As noted above, in the context of weakened global demand and higher-than-expected supply increases, the downward tendency in oil prices continues. This is expected to lead to a reduction in domestic fuel prices in the upcoming months, assuming other factors remain constant. Furthermore, the relatively stable position of the lari against the U.S. dollar further strengthens the disinflationary effect of international oil prices (see Figure 2.1.11).

The real effective exchange rate has been gradually converging toward its equilibrium level, supported by lower inflation in Georgia compared to its trading partners. Concurrently, the nominal effective exchange rate tendencies have also contributed to the alignment of the real exchange rate with its equilibrium level.

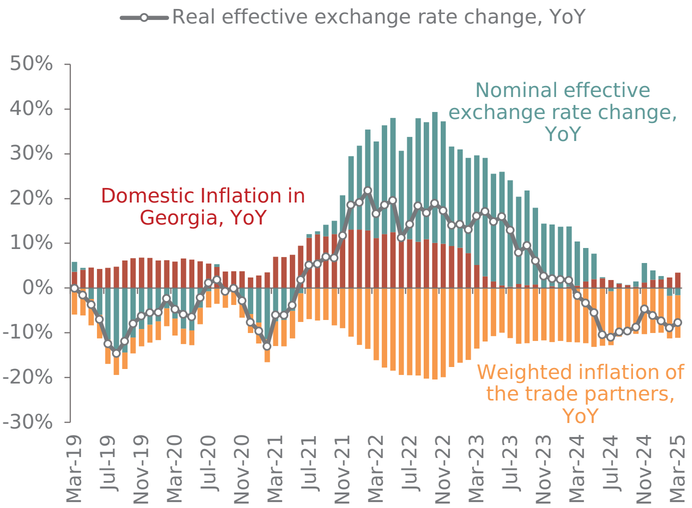


Figure 2.1.7. Decomposition of the Year-over-year Change in the Real Effective Exchange Rate of the Georgian lari (GEL).

Source: NBG, Geostat.

* **The Real effective exchange rate** and its components are presented in logarithmic terms, and, accordingly, their year-over-year changes are a first-order approximation of percentage changes.

The level of deposit dollarization has stabilized. Households and businesses are still maintaining cautious positions.

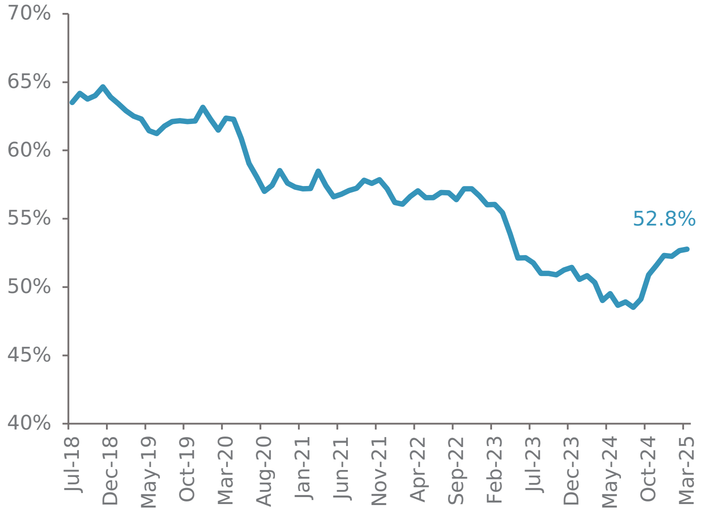


Figure 2.1.8. Deposit Dollarization (Excluding Exchange Rate Effects)

Source: NBG.

On the one hand, the slowdown in wage growth, and on the other, the decline in the unit labor cost, are contributing to a reduction in inflationary pressure stemming from the labor market.

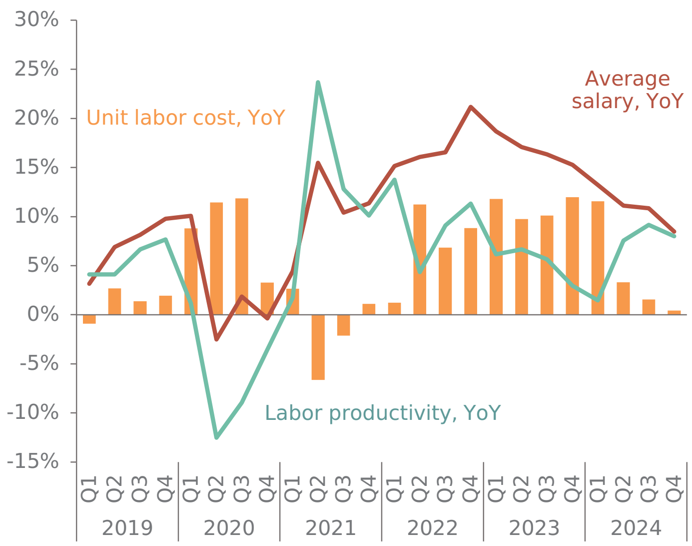


Figure 2.1.9. Average wage, labor produtivity, and unit labor cost, y-o-y growth rate

Source: Geostat, NBG.

In recent months, increases in both domestic and international food prices have led to a rise in mixed and domestic inflation. However, the imported inflation component continues to reduce headline inflation.

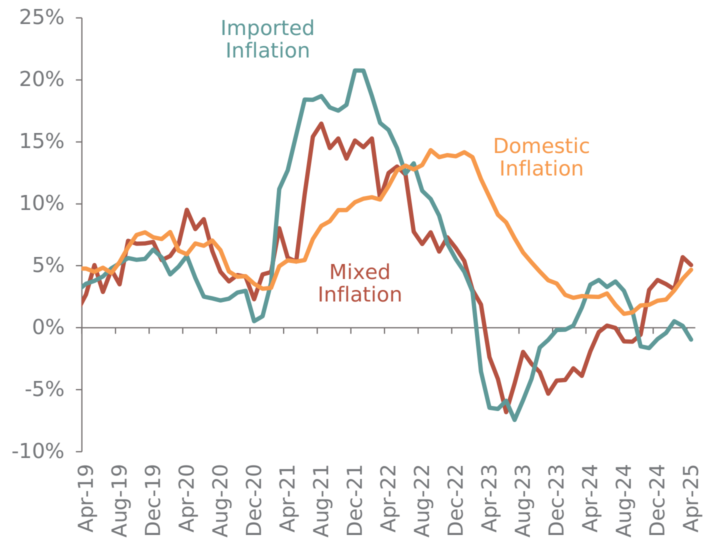


Figure 2.1.10. Mixed, Domestic, and Imported Year-over-year Inflations

Source: Geostat.

Compared to previous months, prices of food commodities on international markets continue to exert moderate upward pressure on inflation.

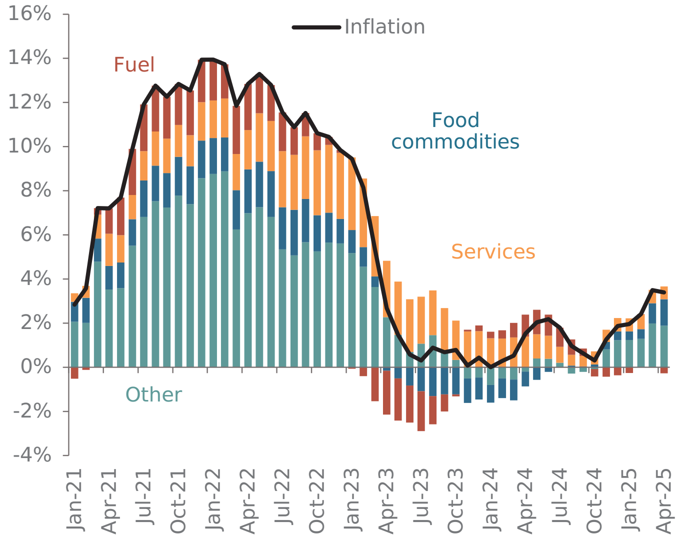


Figure 2.1.11. Inflation by Components

Source: Geostat, NBG.

2.2. CENTRAL SCENARIO

In the wake of rapidly changing trade policies, along the resulting fragmentation and increased riskiness, global economic growth has slowed.

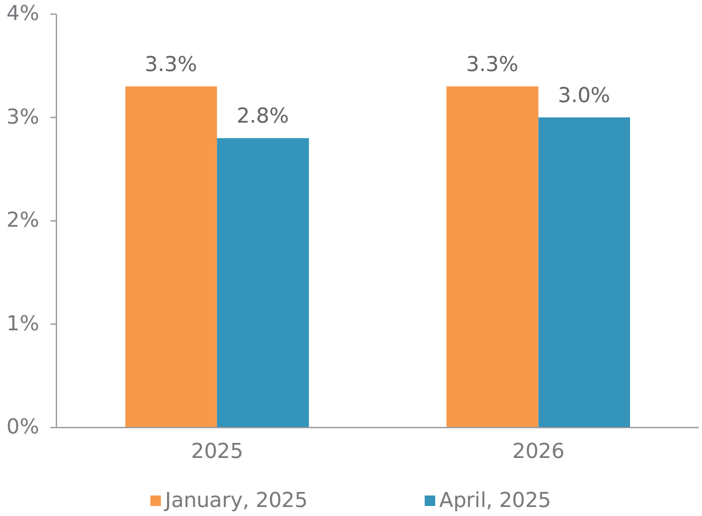


Figure 2.2.1. Global economic growth projections based on the January and April updates of the World Economic Outlook (WEO).

Source: International Monetary Fund (IMF).

Given robust economic growth in the current period and the relatively slow normalization of fundamentals, the real GDP growth projection for 2025 has been revised upward from 5% to 6.7%, despite the anticipated short-term deceleration in external demand. Furthermore, the average expectation regarding economic growth in the financial market has also been revised upward to 6.4%.

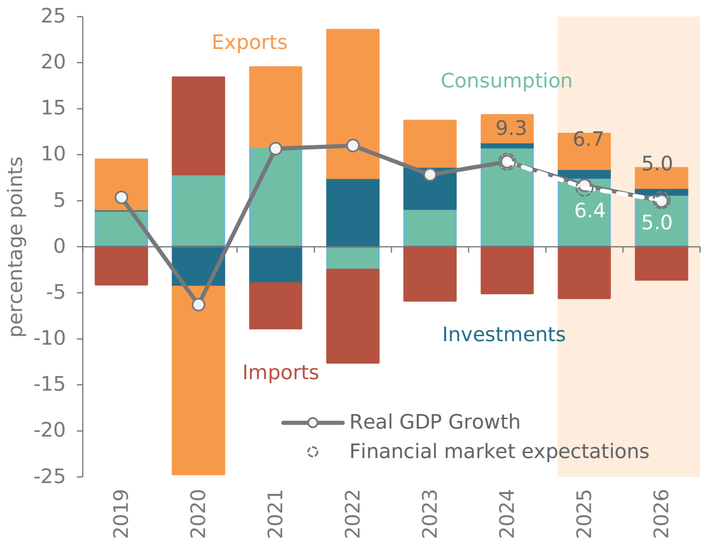


Figure 2.2.2. Real GDP Growth Under the Central Scenario and Expectations of Financial Market Participants.

Source: NBG, Financial Market Participants, Geostat.

Amid elevated global turbulence, macroeconomic forecasts continue to be characterized by significant uncertainty. In response to this uncertainty, the National Bank of Georgia (NBG) relies on a **scenario-based approach** in its monetary policy communication. Each scenario is based on assumptions about the materialization of relevant risks and incorporates the preferences[2] embedded in the NBG's reaction function. The purpose of the scenario is to describe the National Bank's response under conditions in which the mentioned assumptions are realized.

Since the main source of uncertainty in the recent period has been the rapid changes in trade policies and, in this context, the fragmentation of the global economy (see Box 1), a large share of the assumptions is related to these developments. While the direct effects of U.S. trade policy and associated retaliatory tariffs on Georgia's economy are limited, their overall impact is heterogeneous and changes over time, depending on the final state of trade policies and the configuration of trade channels. The assumptions of the NBG's **central scenario**—based on a broad range of current information, including expectations in both domestic and global financial markets—envision a moderately tight trade policy at the international level. In the short term, this will generate a moderate supply-side shock in the world economy, which, on the one hand, will slow global economic activity (see Figure 2.2.1) - including that of Georgia's trading partners - and, consequently, reduce external demand for Georgian goods and services. On the other hand, ongoing global economic fragmentation will disrupt supply chains, ultimately increasing global inflationary pressures. Against the backdrop of such a stagflationary shock, increased uncertainty, and the emergence of U.S. fiscal risks[3], interest rates in developed countries are expected to remain relatively high, further dampening the global economy. At the same time, global riskiness have risen amid the deteriorating economic outlook and heightened uncertainty (see Figure 1.1). This has also been reflected in higher credit risk premiums, leading to tighter financial conditions both globally and in Georgia. In the short term, the central scenario assumes that these elevated levels will be sustained. Noteworthy, the tightening of global financial conditions—other things being equal—creates pressure for capital outflows from emerging market economies, including Georgia. However, the global weakening of the U.S. dollar's position and the mainte-

2 The National Bank's priorities to anchor inflation expectations around the inflation target, which may include, among other measures, delayed policy normalization.

3 see "Overview of the Global Macroeconomic Environment" subsection.

According to the central scenario, in 2025, inflation will temporarily exceed the target level of 3% and will average around 3.8%. This will be driven, on the one hand, by rising imported inflation and the base effect from the previous year, and on the other hand, by the mitigating effects of low commodity prices. From the following year, inflation is expected to stabilize around its target.

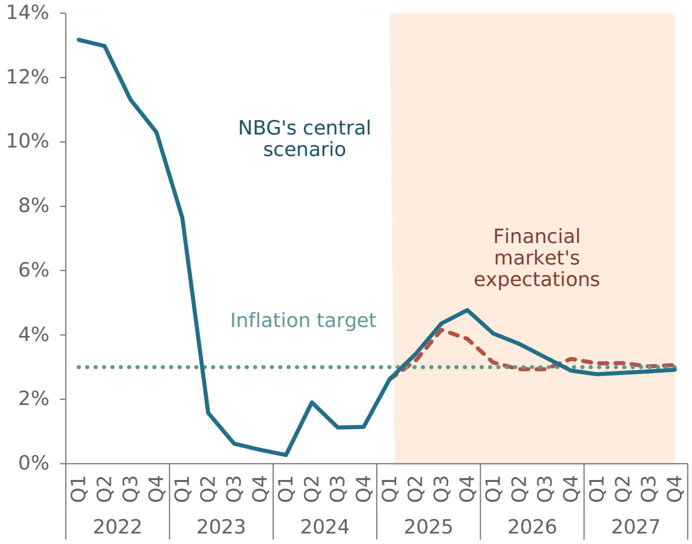


Figure 2.2.3. Year-over-year Headline Inflation Under the Central Scenario and Expectations of Financial Market Participants.

Source: NBG, Financial Market Participants, Geostat.

The normalization of inflation toward its target will be driven by opposing effects — on the one hand, the impact of the previously depreciated exchange rate and strong aggregate demand, and on the other hand, the effects of low oil prices.

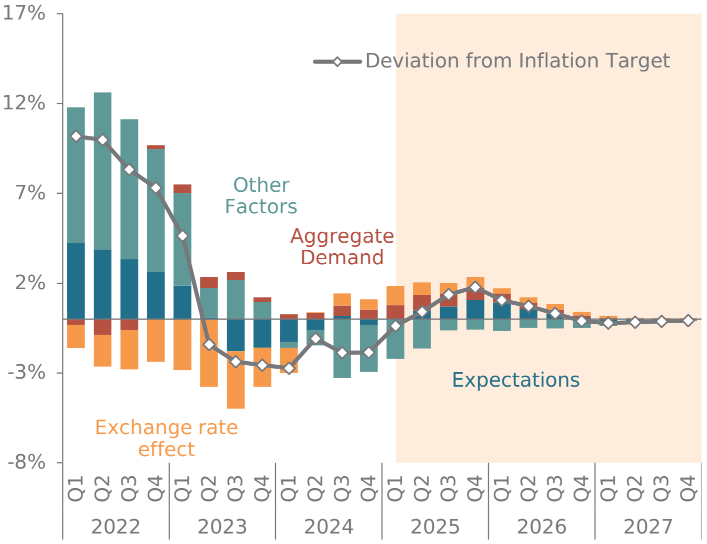


Figure 2.2.4. Decomposition of the Year-over-Year Headline Inflation Deviation from the Target Under the Central Scenario.

Source: NBG, Geostat.

nance of a tight policy stance domestically offset this pressure. Meanwhile, domestic economic activity is stronger than expected. By the end of 2024, amid both domestic and external uncertainty, a deterioration in sentiment was observed. However, this was quickly resolved, and domestic demand remains at a high level as of early 2025. Accordingly, the maintenance of high economic growth is supported, on the one hand, by strong domestic demand. On the other hand, the stability of domestic inflation and the sectoral composition of economic growth, also suggest that potential growth rate of the economy remains elevated. **Given the relatively slow normalization of fundamental factors and robust economic growth in the first quarter, the real GDP growth projection for 2025 in the NBG's central scenario has been revised upward from 5% to 6.7%** (see Figure 2.2.2), despite the anticipated short-term deceleration in external demand.

In the long run, as global production capacities are reallocated, the effects of tariff policies on the global economy - and, consequently, on foreign demand - will dissipate. Against this backdrop, economic growth will normalize around its potential level of 5%.

It should be noted that expectations regarding economic growth in the financial market largely align with the NBG's central scenario. Market participants' macroeconomic forecasts for economic growth have significantly improved, with the average market expectation for 2025 being revised upward from 4.5% to 6.4% (see Figure 2.2.2).

Against the backdrop of a slowdown in external demand, the current account is expected to stabilize around its equilibrium level of 5%–5.5% in 2025, according to the central scenario. This, through the exchange rate channel, will have an upward pressure on imported inflation. However, the lari's sustained strength against the U.S. dollar — on the one hand, through the trade channel via dollar-denominated invoices, and on the other hand, through the financial channel via debt servicing costs — does not exert additional inflationary pressure. This will enable to keep inflation expectations close to the inflation target and, amid the elimination of excessive aggregate demand, will balance the effects of imported inflation.

The assumptions underlying the central scenario also encompass international commodity markets. In particular, based on forecasts by the U.S. Energy Information Administration (EIA), weaker global demand and a larger-than-expected planned supply increase significantly reduce the oil price projection for 2025 - to around 68 USD per barrel. This, other things being equal, will exert downward pressure on domestic fuel prices. In turn, lower oil prices could

Amid heightened uncertainty and the associated relative increase in inflationary risks over the medium horizon, the monetary policy rate will be maintained unchanged during the current period, following a risk-minimization approach.

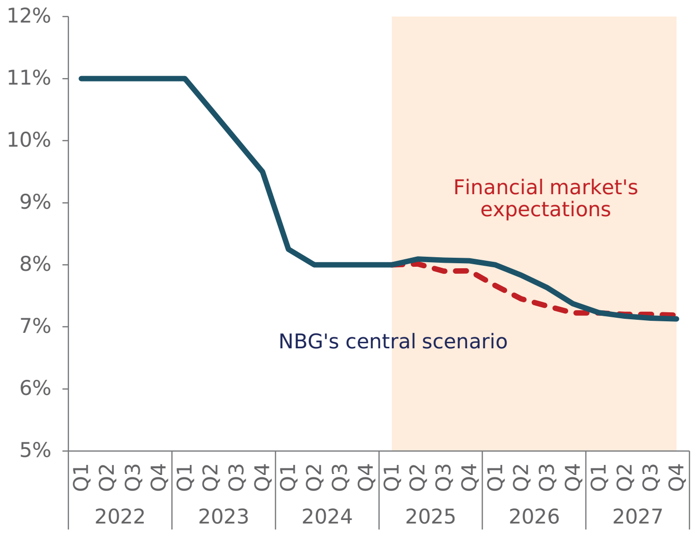


Figure 2.2.5. Monetary Policy Rate Under the Central Scenario and Expectations of Financial Market Participants.

Source: NBG, Financial Market Participants.

dampen economic activity in oil-exporting trade partner countries, potentially leading to a further deceleration in external inflows. Regarding the international food price index, the central scenario anticipates a slight increase, considering climatic and geopolitical conditions; however, its impact on inflation is expected to remains limited.

According to the central scenario, taking into account the increase in imported inflation, the base effect from the previous year, and other factors mentioned above, **inflation in 2025 would temporarily exceed the 3% target and average around 3.8%.** The normalization of inflation to its target is driven, on the one hand, by the interplay of the effects of the depreciated exchange rate in prior periods and strong aggregate demand, and, on the other hand, by the effects of low oil prices and a weak U.S. dollar (see Figure 2.2.3 - 2.2.4).

It should be noted that the inflation forecast for 2025, compared to the previous central scenario, has been revised downward by 0.4 percentage point. This revision is explained by stronger-than-expected productivity growth, the exchange rate maintaining a strong position in the current period, and reduced international price projections for commodity markets. At the same time, the inflation forecast for 2026 has been revised upward by 0.3 percentage point, reflecting the global increase in inflation expectations and uncertainty.

It is noteworthy that, similar to economic growth expectations, the inflation expectations of financial market participants are largely in line with the NBG's central scenario. In particular, according to financial market forecasts, the average inflation rate for 2025 has been revised downward by 0.1 percentage point to 3.5% compared to the previous survey, while the median forecast has been reduced from 4.1% to 3.4% (see Figure 2.2.3).

According to the central scenario, despite the reduced inflation forecast in the short term, amid increased uncertainty over the medium-term horizon and relatively heightened inflationary risks, **the monetary policy rate will remain unchanged in the current period**, following a risk-minimization approach. Amid the subsidence of inflationary risks, the NBG will continue to normalize the monetary policy rate, which largely aligns with the expectations in the financial market (see Figure 2.2.5).

2.3. HIGH-INFLATION SCENARIO

The high-inflation scenario is based on tighter tariff policies and an acceleration of economic fragmentation. It also assumes a further deterioration of the geopolitical situation compared to the central scenario, as well as inflationary pressures stemming from the international commodity markets.

High-Inflation Risks	
◦ Escalation of tariff policies globally compared to the central scenario – economic fragmentation ◦ Significant supply-side shock in the global economy ◦ Escalation of the geopolitical situation and/or its prolonged severity	
Indicators of risk realization	**Impact on inflation**
Increase in the risk premium and globally high interest rates, compared to the central scenario	↑
Weaker-than-expected external inflows and a deteriorated current account balance compared to the central scenario	↑
Sustained high-inflation environment globally	↑
Higher commodity prices on international markets compared to the central scenario	↑
More pronounced slowdown in consumer and investment spending compared to the central scenario	↓

Impact size

Neutral	Low	Medium	High

↑	Upward Pressure on Inflation
→	Same Level of Inflation
↓	Downward Pressure on Inflation

Table 2.3.1. Taxonomy of Risks in High-inflation Scenario

Source: NBG.

The High-Inflation Scenario is as relevant as the central scenario and considers a more pronounced realization of risks identified from the current data (see Table 2.3.1). In particular it envisions a tighter tariff policy both in the United States and among its trading partners. Consequently, under this scenario, global economic fragmentation would accelerate and a stagflationary environment would emerge in the world economy. Despite the global relocation of production capacities, the stagflationary shock would be persistent and inflationary expectations remain elevated for an extended period.

In turn, due to the high-inflation environment and increased riskiness stemming from heightened uncertainty, interest rates will remain elevated globally. Moreover, in the context of ongoing tensions in the Middle East, high-inflation scenario considers an even greater escalation of geopolitical turbulence, compared to the central scenario. The latter, on the one hand, alongside other aforementioned factors, will significantly slow the global economic activity relative to the central scenario, which will also be reflected in the decline of external inflows to Georgia. On the other hand, increased geopolitical risk will worsen the risk premium for the entire region, including Georgia. This, in turn will reduce consumer and investment spending, negatively influencing both economic growth and its potential. Consequently, in the high-inflation scenario, economic activity will slow relative to the central scenario: **real GDP will grow by 6% in 2025 and by 4% in 2026** (see Figure 2.3.1).

Meanwhile, under this scenario, against the backdrop of globally higher interest rates, an increased risk premium will lead to capital outflow and exert greater depreciation pressure on the exchange rate compared to the central scenario. In addition, heightened escalation in the Middle East will push international commodity prices upward, generating inflationary pressure on domestic food and fuel prices. Henceforth, these factors, amid high-inflation environment among trading partners, will result in increased imported inflationary pressures in Georgia.

Overall, if this scenario materializes, **the headline inflation will be higher** compared to the central scenario **by 0.7 pp in 2025 and by 1.2 pp in 2026, averaging 4.5% and 4.7%** respectively (see Figure 2.3.2).

Under this scenario, inflation persistently above the target naturally poses a clear threat for long-term inflation expectations. In addition, due to higher global interest rates on the one hand

Under high-inflation scenario, against the backdrop of tighter tariff policies and increased turbulence, economic growth in 2025 and 2026 will slow to 6% and 4%, respectively.

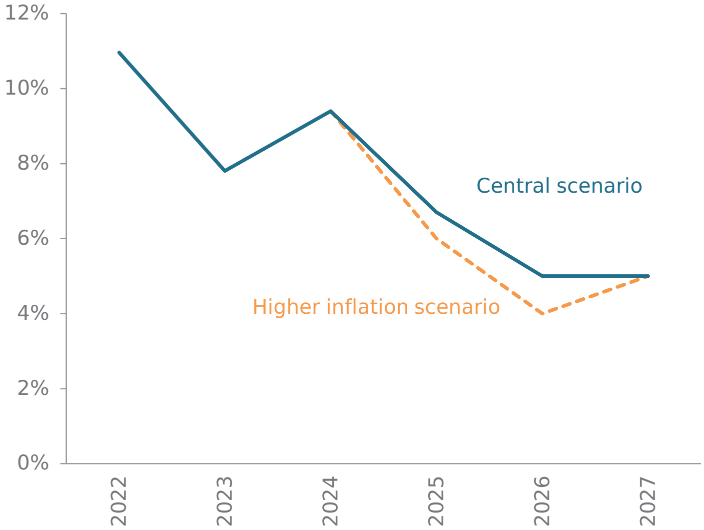


Figure 2.3.1. Real GDP Growth Under Central and High-Inflation Scenarios

Source: NBG, Geostat.

and the sustained deterioration of fundamental factors on the other, **uncertainty around the neutral interest rate will increase notably over the medium-term, leading to a revision of its estimate to 7.5%.**

The NBG exhibits a low tolerance against rising inflation expectations, which, in the event of the realization of the aforementioned scenario, **under the risk-minimization approach**, will be reflected in a tightening of monetary policy and, if necessary, the use of additional instruments. Particularly in this case, **the monetary policy rate will be higher compared to the central scenario by 0.5 pp in 2025 and by 0.9 pp in 2026. This policy response will help prevent the deanchoring of long-term expectations** in a high-inflation environment. Hence, its normalization will begin at a gradual pace, contingent on the stabilization of the inflationary environment (see Figure 2.3.3).

With tighter tariff policies and economic fragmentation in place, globally increased inflation and rising commodity prices will significantly intensify inflationary pressures on the monetary policy horizon.

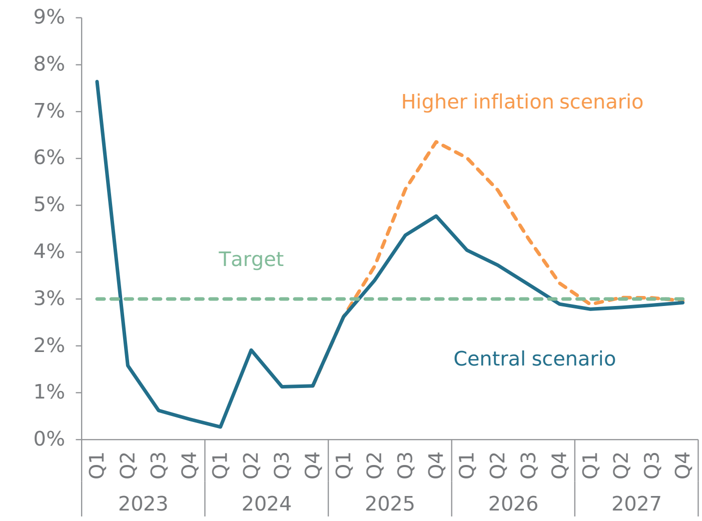


Figure 2.3.2. Year-over-year Headline Inflation Under Central and High-Inflation Scenarios

Source: NBG, Geostat.

The National Bank of Georgia has a low tolerance against inflation and/or the rise in inflation expectations, as reflected in its risk-minimization approach. Monetary policy will be tightened and, if necessary, the additional instruments will be used.

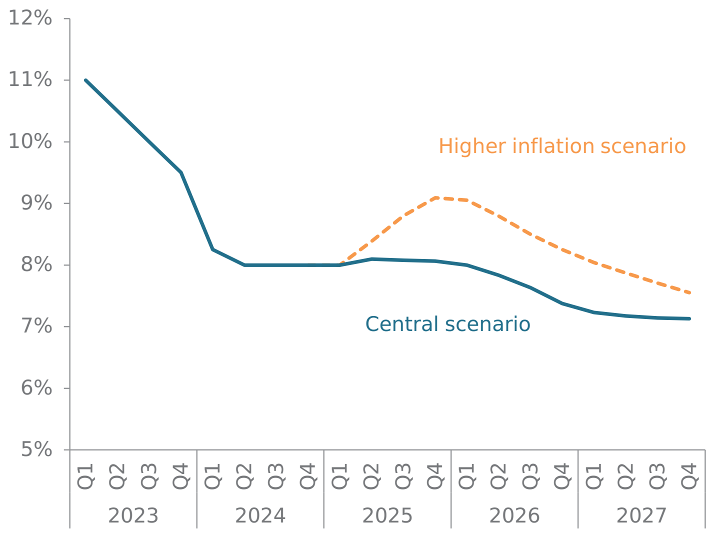


Figure 2.3.3. Monetary Policy Rate Under Central and High-Inflation Scenarios

Source: NBG.

2.4. LOW-INFLATION SCENARIO

The low-inflation scenario is based on a less aggressive global tariff policy, as well as a faster normalization of geopolitical conditions compared to the central scenario.

Low-Inflation Risks	
◦ Less aggressive tariff policy globally ◦ Reallocation of the global trade ◦ Deescalation of the geopolitical situation ◦ A faster improvement in sentiment compared to the central scenario	
Indicators of risk realization	**Impact on inflation**
Improvement in the country's sovereign risk premium compared to the central scenario	↓
Stronger external inflows compared to the central scenario	↓
Reallocation of global supply chains and the growing role of Georgia as the Middle Corridor country	↓
Faster improvement in investment and consumer sentiment compared to the central scenario	↑
Impact size	
Neutral, Low, Medium, High	
↑ Upward Pressure on Inflation	
→ Same Level of Inflation	
↓ Downward Pressure on Inflation	

Table 2.4.1. Taxonomy of Risks in Low-inflation Scenario

Source: NBG.

The Low-Inflation Scenario is as relevant as the High-Inflation and Central Scenarios. It envisions materialization of the risks that are less inflationary compared to the central scenario (see Table 2.4.1). Particularly, this scenario assumes a less aggressive tariff policy from the United States and does not consider the imposition of retaliatory tariffs by its trading partners. Consequently, compared to the central scenario, it foresees a globally less inflationary environment and relatively robust economic activity.

In this scenario, even under a mild tariff policy, the uncertainty surrounding trade policies is expected to accelerate global trade diversification. As a result, the realignment and regionalization of supply chains will further strengthen Georgia's role as a Middle Corridor country, additionally boosting international transportation sector.

In the low-inflation scenario, alongside the growth of international cargo turnover and transportation revenues in Georgia, additional foreign direct investments are considered in this sector. Moreover, amid higher global economic growth compared to the central scenario, external demand will strengthen, positively affecting the dynamics of both services (including tourism) and goods exports.

Additionally, the low-inflation scenario considers a faster normalization of current geopolitical and domestic uncertainties, relative to the central scenario. Other things being equal, this would contribute to a reduction in both regional and country risk premiums over the medium term. Consequently, consumer and business sentiments will improve, positively influencing the balance of payments and the exchange rate.

Under this scenario, which also accounts for high potential growth in Georgia, solid economic growth will be sustained relative to the central scenario: **real GDP is projected to grow by 7.5% in 2025 and by 5.5% in 2026** (see Figure 2.4.1).

Against a backdrop of strong fundamentals, aggregate demand will be less inflationary, supporting the maintenance of low domestic inflation. Furthermore, the low inflation scenario assumes a prolonged period of a relatively weak U.S. dollar globally. Latter, amid strong external inflows, will exert additional appreciation pressure on the exchange rate, contributing to the reduction of both imported and headline inflation. Meanwhile, high productivity growth will continue to reduce unit labor cost and further reinforce disinflationary pressures stemming from the labor market. As a result, **inflation will be lower**

Under the low-inflation scenario, against the backdrop of increasing external inflows and sustained strong fundamental factors, real GDP growth will remain at a higher level compared to the central scenario, reaching 7.5% and 5.5% in 2025 and 2026, respectively.

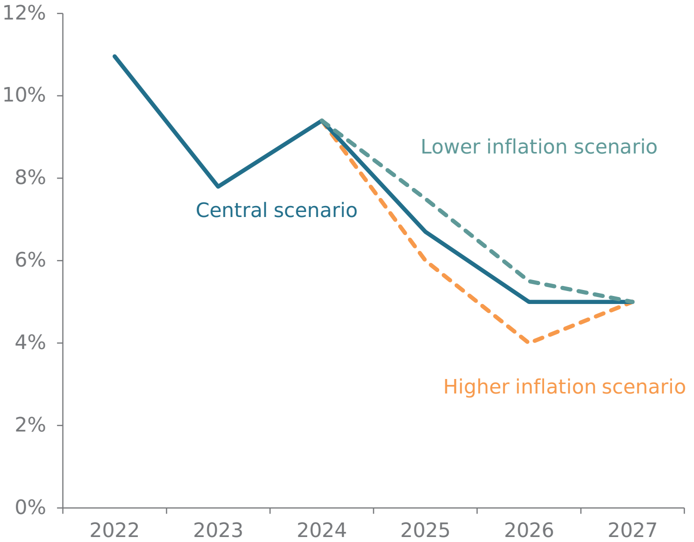


Figure 2.4.1. Real GDP Growth Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG, Geostat.

compared to the central scenario: it is projected to average 3.2% in 2025 and 2.8% in 2026 (see Figure 2.4.2).

Amid subsiding inflationary risks and sustained high productivity, monetary policy normalization will proceed at a faster pace relative to the central scenario. Specifically, **the monetary policy rate, on average, will be lower compared to the central scenario by 0.3 percentage points in 2025 and by 0.7 percentage points in 2026** (see Figure 2.4.3).

Amid the rapid normalization of the geopolitical situation and declining international commodity prices, inflation is expected to remain low. Specifically, it will be 3.2% and 2.8% in 2025 and 2026, respectively, and will stabilize around its target over the long term.

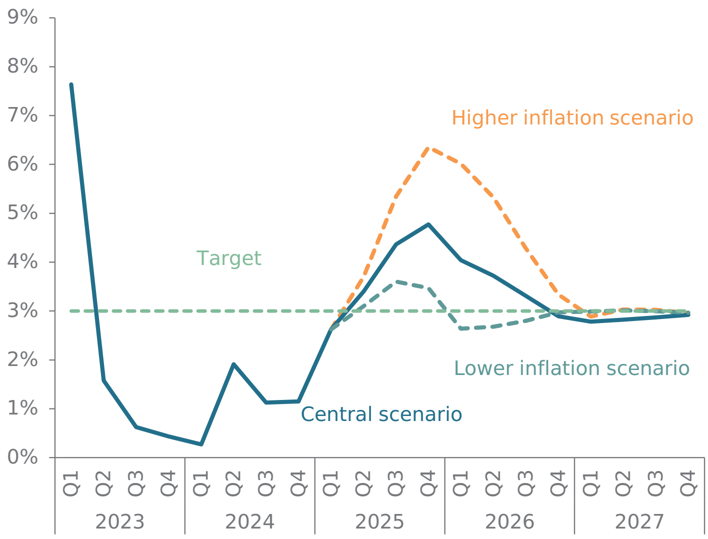


Figure 2.4.2. Year-over-year Headline Inflation Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG, Geostat.

In the low-inflation scenario, with the rapid mitigation of risks, monetary policy normalizes faster compared to the central scenario.

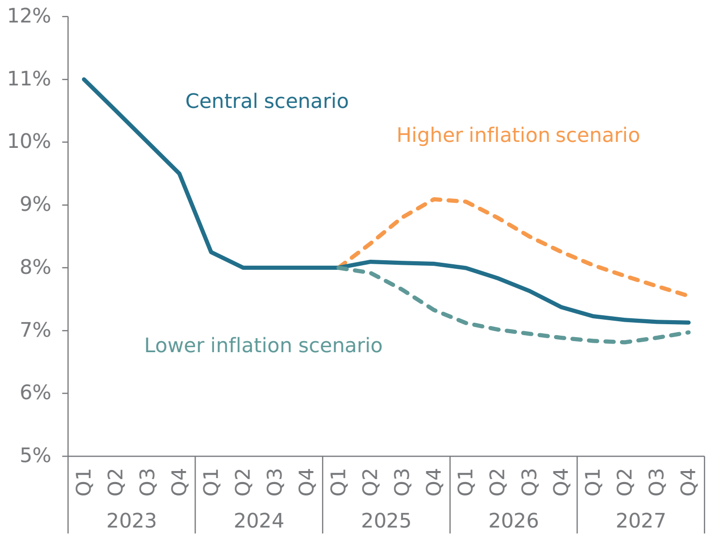


Figure 2.4.3. Monetary Policy Rate Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG.

3. SPECIAL TOPICS

BOX 1. GLOBAL FRAGMENTATION AND THE IMPLICATIONS OF TARIFFS FOR THE GEORGIAN ECONOMY

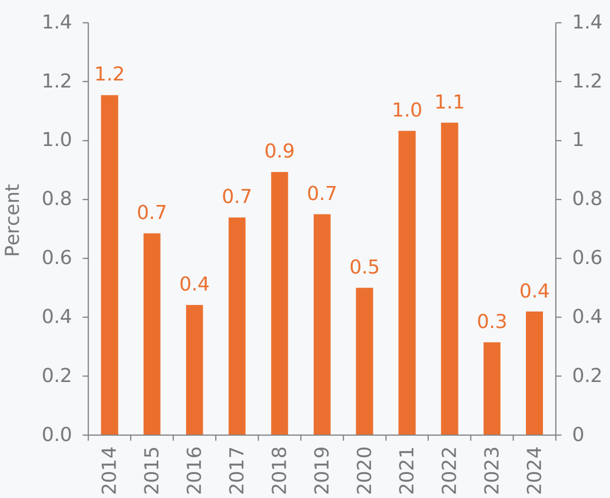
The U.S. administration's tariff policy has sent shockwaves throughout the global economy. Despite a 90-day delay in implementing reciprocal tariffs against the U.S.'s main trading partners, a universal 10% tariff on most imported goods remains in effect, while China faces a particularly high 145% tariff. These measures are framed as efforts to support U.S. manufacturing and reduce trade deficits. However, alongside other risk factors of the U.S. economy, their potential effects are widespread.

The intensification of U.S.-China trade tensions has spillover effects beyond bilateral trade. Disruptions to global supply chains could prompt multinational firms to reassess production strategies. Trade-dependent economies across the globe are facing the need to find new partners and markets. All of these factors increase the risks of fragmentation. Financial markets have reacted to this risk with considerable volatility. Global investors have cautiously diversified away from dollar-denominated assets and U.S. equity indices have undergone sharp corrections; bond yields have risen due to elevated risk perceptions, and the U.S. dollar has exhibited fluctuations linked to concerns over competitiveness.

The prevailing tendencies are exerting a negative impact on the global economic outlook. Elevated uncertainty reduces the investment incentives and worsens consumer sentiments contributing to a lower growth outlook. On the other hand, the enforcement of the announced tariff policy is expected to lead to price adjustments. At the same time, growing economic fragmentation is likely to result in supply chain disruptions. These developments pose upside risks to global inflation. As a result, monetary policymakers face a difficult situation to manage the short-term balance between price stability and output.

Against the backdrop of global trade fragmentation, it is important to assess the potential spillover effects on the Georgian economy. First, it should be emphasized that Georgia is not a direct participant in the ongoing trade disputes, and thus the direct transmission through trade channels is expected to be limited. However, it is also important to consider that Georgia is a small, open economy, and the current global economic environment can influence the economy through various indirect channels.

In 2024, exports to the U.S. accounted for only 0.4% of Georgia's GDP (see Figure 3.1.1). Therefore, the direct impact of U.S. tariff policy on the Georgian economy is expected to be relatively small. To assess this, we rely on the export price elasticity approach, which, in simple terms, reflects how sensitive external demand is to changes in the prices of exported goods. According to a World Bank study, the price elasticity for Georgia is estimated at 0.45, meaning that a 1% increase in the price of Georgian exports reduces foreign demand by 0.45%. If we assume that a 10% tariff is fully passed through to export prices (i.e., U.S. buyers pay 10% more for Georgian goods), then demand for Georgian exports in the U.S. would decline by approximately 4.5%. This would reduce the U.S. share in Georgia's total exports by only 0.1 pp - from 2.2% to around 2.1%. As a result, the ratio of exports to the U.S. relative to Georgia's GDP would remain virtually unchanged (around -0.02 pp).



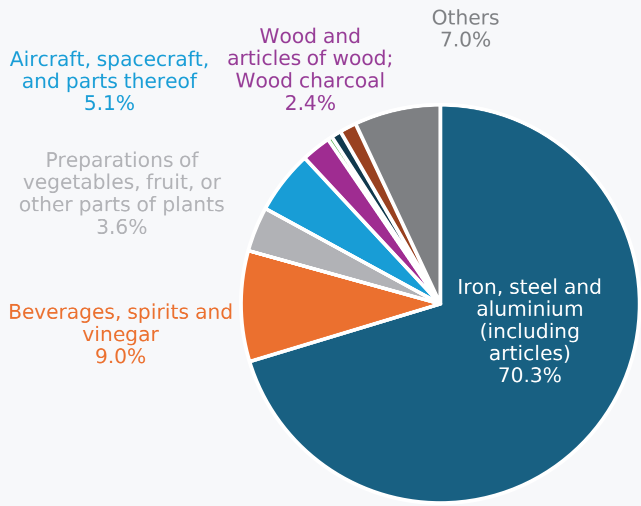


Figure 3.1.1. The ratio of exports to the U.S. relative to Georgia's GDP and the structure of exports to the U.S. in 2024

Source: Geostat, Authors' calculations.

The tariff policy through direct trade channels may have the greatest impact on the light vehicle market. As of May 2025, a 25% tariff on imported cars and key automotive parts is active in the U.S. For Georgia, 50% of imported vehicles originate from the U.S. Notably, a large portion of this import is intended for re-export, generating value add within the Georgian economy. Therefore, the implementation of the announced tariff policy would, on one hand, reduce imports due to higher prices, but on the other hand, could negatively affect economic activity by lowering the value added from re-export operations. Assuming the full 25% tariff is passed through to consumer prices, and considering an import demand elasticity of 0.79 (World Bank estimate), Georgia's vehicle imports from the U.S. could decline by approximately 10.7%. Also, assuming that the elasticity of export with respect to price is 0.45, Georgian re-export may decline by 10.8% as well. It should be noted that this is the preliminary estimate and due to the high uncertainty around the tariff policy, it may be revised when new data becomes available.

Furthermore, both new and used vehicles are components of the consumer basket, and if global car prices increase, this could contribute an additional 0.1 pp to headline inflation. Under an alternative scenario, the structure of Georgia's automobile market may shift, with imports from the United States being replaced by other sources. However, if these alternative sources cannot fully substitute for U.S. supply, this could lead to a decline in Georgia's vehicle trade with the region.

The fragmentation of trade and economic relations also affects the Georgian economy through financial channels. Specifically, the global slowdown in economic activity heightens the risks of reduced income from external demand, as well as lower remittance and capital inflows. This, in turn, puts pressure on the exchange rate. At the same time, increased global risk aversion tightens financial conditions, which also transmits to Georgia. Notably, the rise in yields on long-term U.S. Treasury securities may signal an increase in the neutral interest rate, which - under the assumption of uncovered interest rate parity (UIP) - would also raise Georgia's neutral rate. However, if global productivity declines as a result of fragmentation, slower potential growth would lead to a decrease in the neutral interest rate.

In addition to the direct impact of U.S. tariffs, indirect effects may also arise, particularly those related to a decline in global demand. Furthermore, the escalated trade tensions is expected to hit and slowdown economic growth in Georgia's main trading partners - China, the European Union, Kazakhstan, and Turkey - especially hard. The materialization of this risk could adversely affect their demand for Georgia's export products. Under such circumstances, the increasingly fragmented and uncertain nature of global trade may translate into second-round effects on Georgia's exports—even though the country itself is not directly targeted by U.S. tariffs.

On the other hand, against the backdrop of these risks, Georgia's strategic location and its role as part of the "Middle Corridor" create new types of opportunities. Specifically, in the context of export redirection resulting from trade fragmentation, revenues from transport and transit services may increase, which would contribute to an improvement in the current account balance.

The scenario-based analytical framework suggests that current global economic uncertainty gives rise to both inflationary and disinflationary pressures. The table below summarizes the main transmission channels through which these changes may be passed on to the Georgian economy and presents the potential inflationary and disinflationary outcomes.

Type of Effect	Disinflationary Risks	Inflationary Risks
Global Trade Dynamics	Exporters (e.g., China) lower prices to access alternative markets ⟶ Lower global prices ⟶ Lower imported inflation in Georgia	Tariffs raise cost of imported intermediate goods in U.S. ⟶ Global production costs rise ⟶ Higher imported inflation
	Trade reroutes through Georgia (Middle Corridor) ⟶ Higher transit revenue ⟶ Stronger lari ⟶ Lower imported inflation	Supply chain bottlenecks raise costs globally ⟶ Input shortages ⟶ Price increases across traded goods
	Global economic slowdown/recession reduces global demand ⟶ Lower prices on international markets ⟶ Lower imported inflation	Global demand shocks from tariff wars weakens external demand for Georgia's goods ⟶ Lari depreciated ⟶ Higher imported inflation

Type of Effect	Disinflationary Risks	Inflationary Risks
Financial Spillovers	To combat global disinflation, most central banks are easing policy ⟶ Interest rates are declining globally ⟶ Lari appreciates	Higher interest rate in U.S. in response to inflation ⟶ Capital outflows from developing to developed countries ⟶ Weaker lari ⟶ Higher imported inflation
Consumer/Business Behavior (Sentiments)	High uncertainty exacerbates tensions ⟶ Delayed consumption and investment in Georgia ⟶ Weak aggregate demand ⟶ Disinflationary pressure	
Remittances Channel	Global economic slowdown ⟶ Job losses or income drops for Georgian migrants ⟶ Lower remittances ⟶ Reduced household demand ⟶ Disinflationary pressure	Global economic slowdown ⟶ Job losses or income drops for Georgian migrants ⟶ Lower remittances ⟶ Weaker lari ⟶ Higher imported inflation
Commodity market	Lower Oil Prices ⟶ Lowers gasoline prices ⟶ Reduces inflation	
Cars market		Rising car prices ⟶ Increase of CPI in Georgia ⟶ Decrease in the ratio of value add from cars re-export to GDP

4. SUMMARY OF THE MACROECONOMIC FORECASTS OF THE NBG AND FINANCIAL MARKET PARTICIPANTS

SUMMARY OF THE MACROECONOMIC FORECASTS OF THE NATIONAL BANK OF GEORGIA

	Fact	Central Scenario			Higher-Inflation Scenario			Lower-Inflation Scenario		
	2024	2025	2026	2027	2025	2026	2027	2025	2026	2027
Inflation (%)	1.1	3.8	3.5	2.8	4.5	4.7	3.0	3.2	2.8	3.0
Real GDP Growth (%)	9.4	6.7	5.0	5.0	6.0	4.0	5.0	7.5	5.5	5.0
Monetary Policy Rate (%)	8.0	8.1	7.7	7.2	8.6	8.6	7.8	7.7	7.0	6.9

Table 4.1. Summary of the Macroeconomic Scenarios of the National Bank of Georgia

Source: NBG, GeoStat.

* The table displays the average annual changes of the variables

FORECASTS OF FINANCIAL MARKET PARTICIPANTS

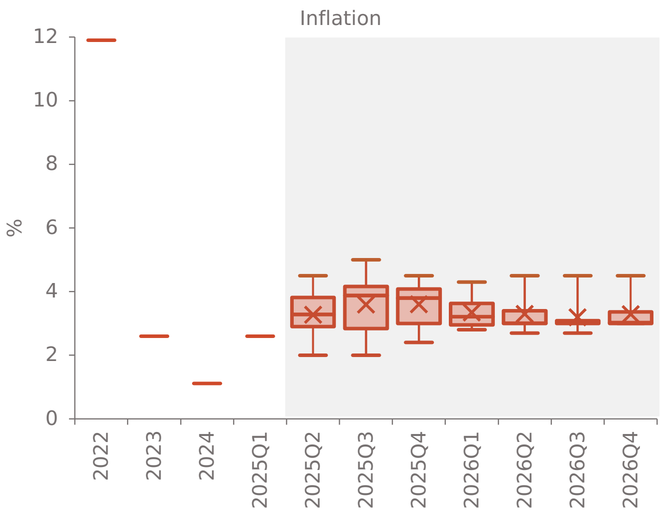


Figure 4.1. Actual average inflation and the distribution of market participants' forecasts

Source: NBG, financial market participants, GeoStat.

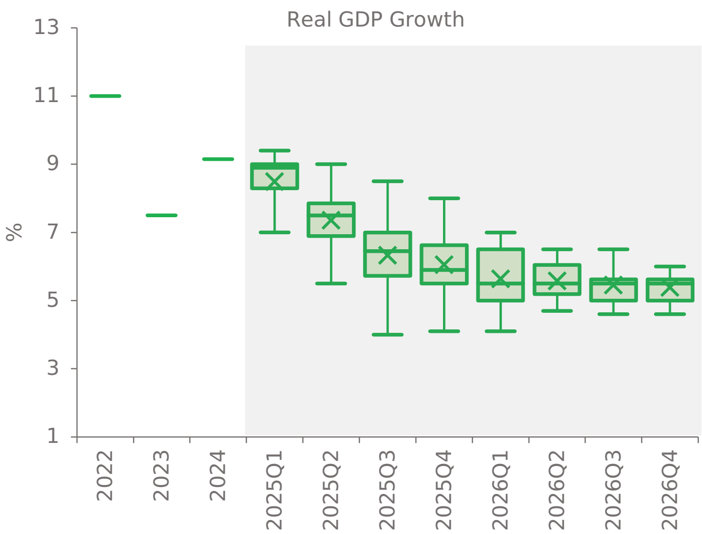


Figure 4.2. Actual real GDP growth and the distribution of market participants' forecasts

Source: NBG, financial market participants, GeoStat.

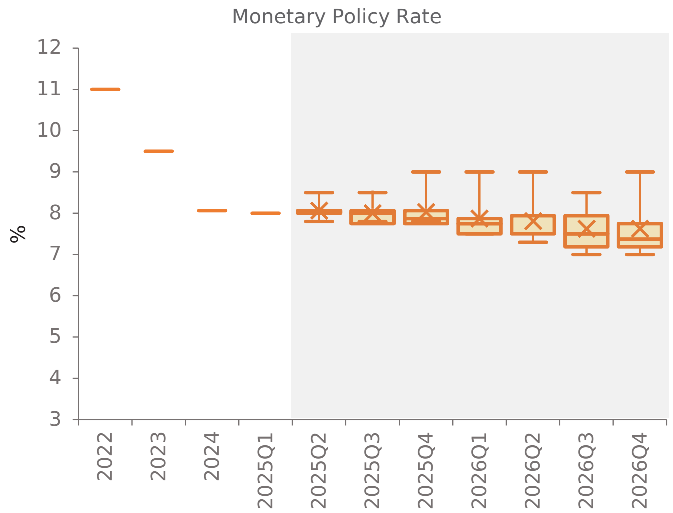


Figure 4.3. Actual monetary policy rate and the distribution of market participants' forecasts

Source: NBG, financial market participants.

The National Bank of Georgia conducts a quarterly survey of financial market participants with the aim of forming a clear picture of their short-, medium-, and long-term expectations. This practice has long been established in advanced economies and enables central banks to better assess risks related to price stability. The aggregated results of the forecasts are presented in boxplot form in the NBG's Monetary Policy Report. However, in the second quarter of each year—following the publication of official statistics for the previous year for all three variables on the webpages of the National Bank and GeoStat—the NBG identifies the organization with the most accurate forecasts based on the previous year's outcomes. The indicator used to evaluate the accuracy of the forecasts is an average root mean square error (RMSE) and the organizations with the lowest RMSE are named the best forecasters.

Notably, the evaluation of the financial market expectations for 2024 revealed three organizations that submitted the most accurate forecasts across different time horizons. Specifically, in 2022, **TBC Capital** provided the most precise forecasts for 2024, based on the lowest RMSE. In 2023, the most accurate forecasts were submitted by **Galt & Taggart**, and in 2024—by **Basis Bank.**

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