საქართველოს ეროვნული ბანკი
National Bank of Georgia

MONETARY POLICY REPORT

JULY 2026

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 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 make 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 through which it improves the transparency and comprehensibility of the monetary policy reaction function, thereby strengthening the effectiveness of the policy transmission channels.

Under the scenario-based approach, the National Bank of Georgia publishes **three relevant scenarios**, given the existing uncertainty:

- **The Central Scenario**, which incorporates a broad set of current information, including assumptions on exogenous factors and economic transmission mechanisms. It reflects a monetary policy path that is calibrated by the policymaker through a careful assessment and balancing of heterogeneous risks.
- **The High-Inflation Risk Scenario**, which, compared to the central scenario, incorporates risks that are more inflationary over the monetary policy horizon.
- **The Low-Inflation Risk Scenario**, which, compared to the central scenario, incorporates more disinflationary risks over the monetary policy horizon.

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MONETARY POLICY DECISION

The National Bank of Georgia decided to keep the monetary policy rate unchanged at 8.25 percent.

On July 29, 2026, the Monetary Policy Committee (MPC) of the National Bank of Georgia (NBG) decided to keep the monetary policy rate unchanged. The monetary policy rate stands at 8.25 percent.

In June 2026, headline inflation in Georgia stood at 5.8 percent. Inflation above the target level is still primarily driven by higher energy prices. Amid the renewed escalation of geopolitical tensions in the Middle East, volatility in international oil prices has increased again. However, current market trends indicate that oil prices remain below the levels observed during the previous escalation. At the same time, the prolonged conflict has heightened the risk of indirect inflationary effects stemming from higher energy prices. The sticky inflation indicator, which better captures underlying inflationary dynamics and inflation expectations, has remained close to the target. Specifically, in June, core inflation (excluding food, energy, and tobacco) stood at 3.2 percent. However, service sector inflation accelerated to 4.1 percent, indicating that despite the moderate level of core inflation, the risks of strengthening second-round effects remain a noteworthy factor.

According to the NBG's updated central scenario, energy prices are expected to remain a significant contributor to inflation this year. Consequently, average inflation is projected at 5.2 percent in 2026. From the second half of 2026 onwards, inflation is expected to decline gradually and converge to the 3 percent target over the medium term.

Economic activity has remained resilient in the face of external shocks. In May 2026, based on the preliminary data, economic growth stood at 6.4 percent, while average growth for the first five months of the year reached 7.8 percent. Growth continues to be driven primarily by high-productivity, service-oriented sectors, which mitigates demand-side inflationary pressures. At the same time, in line with expectations, the adverse impact of the ongoing conflict in the Middle East on external demand has remained limited. Accordingly, under the updated central scenario, the forecast for Georgia's economic growth in 2026 remains unchanged at 6.5 percent.

The geopolitical situation and its economic consequences remain one of the main risks shaping the outlook for the global economy. Against the backdrop of heightened uncertainty, in addition to the central scenario, the MPC considered both high-inflation and low-inflation risk scenarios.

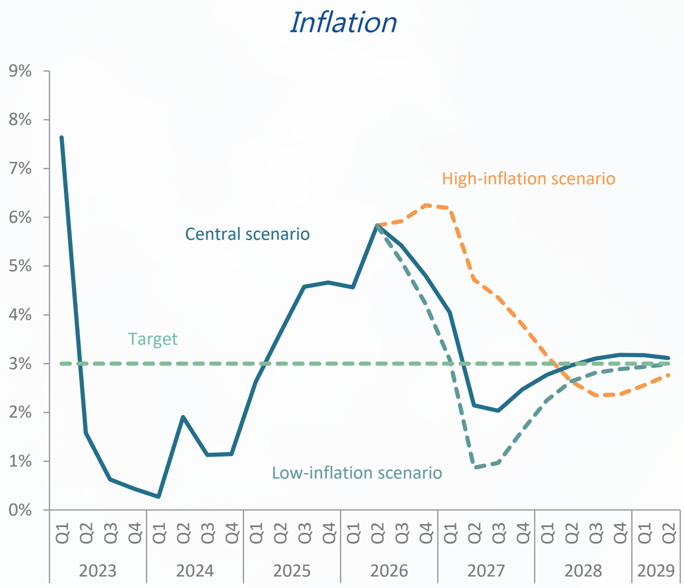
In the event of the realization of the high-inflation risk scenario, fundamental processes require a higher trajectory of the monetary policy rate than the central scenario. The high-inflation scenario assumes a more prolonged escalation of geopolitical tensions, resulting in a further increase in energy prices on international commodity markets. Higher energy prices will be reflected in higher domestic fuel prices and will also be transmitted to the prices of other goods and services through increased transportation and production costs. In addition, recent adverse weather conditions pose an additional risk of higher international food commodity prices. In the event of the realization of these risks, inflation would be higher compared to the central scenario.

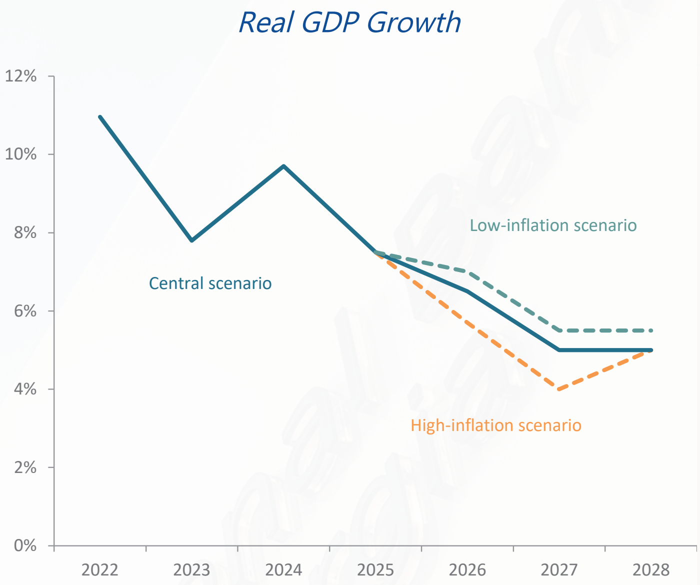
On the other hand, under the low-inflation risk scenario considered by the MPC, the realization of the risks would allow a faster normalization of monetary policy rate compared to the central scenario. In recent years, structural changes in the economy have increased the contribution of relatively high-productivity and less import-intensive sectors, which has strengthened Georgia's external position. According to the central scenario, this trend is expected to normalize gradually, although there is a possibility that it could persist over the longer term. In such a scenario, on the one hand, higher long term potential growth would reduce demand-side inflationary pressures. On the other hand, a stronger external position and a lower sovereign risk premium would support a fundamental appreciation of the real effective exchange rate, further strengthening disinflationary impact. Furthermore, a rapid de-escalation of geopolitical tensions, leading to a faster decline in energy prices, would represent another key driver of the low-inflation scenario. As a result, headline inflation would converge to the target more rapidly than in the central scenario.

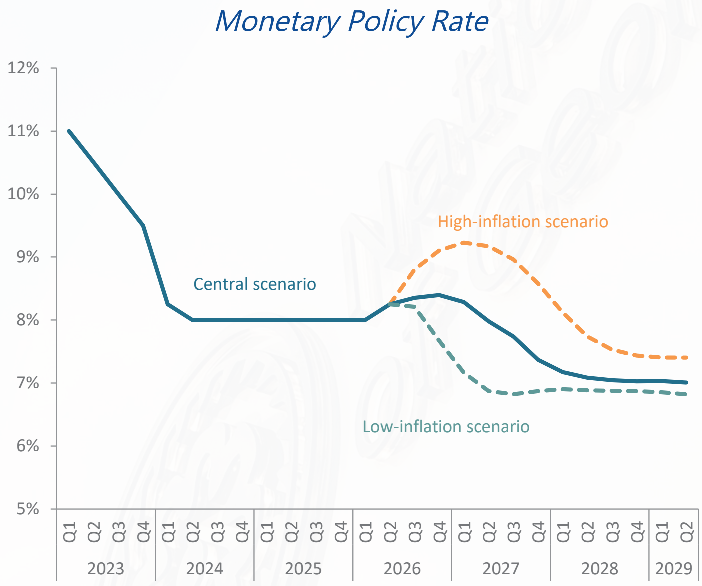
Based on its assessment of the current macroeconomic environment, the updated scenarios, and the balance of risks, the MPC considered it appropriate at this stage to keep the monetary policy rate unchanged.

However, given the elevated inflationary risks, the tightened monetary policy stance is expected to be maintained for an extended period. The NBG continues to closely monitor the transmission of external shocks to the Georgian economy and their impact. Should inflationary risks, including second-round effects and inflation expectations, intensify beyond current expectations, the NBG stands ready to tighten monetary policy further. The monetary policy response aims to ensure that, once the supply-side inflationary shock dissipates, inflation returns to the 3 percent target in a timely manner.

NBG's Macroeconomic Forecast Scenarios







1. OVERVIEW OF THE GLOBAL MACROECONOMIC ENVIRONMENT

The ongoing conflict in the Middle East remains a significant downside risk to global economic activity, as disruptions to trade routes and higher energy prices adversely affect consumption and investment.

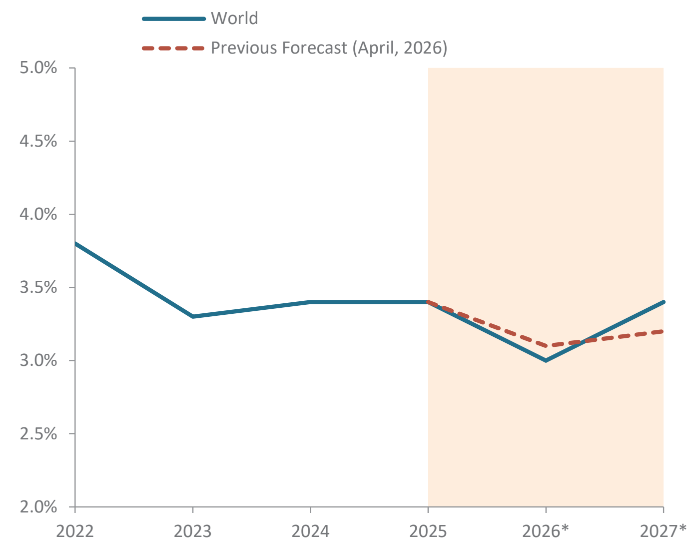


Figure 1.1. Global Real Economic Growth Dynamics

Source: IMF.

The effects of geopolitical shocks on economic growth differ across countries, depending on their economic structures, energy dependence, and external-demand dynamics.

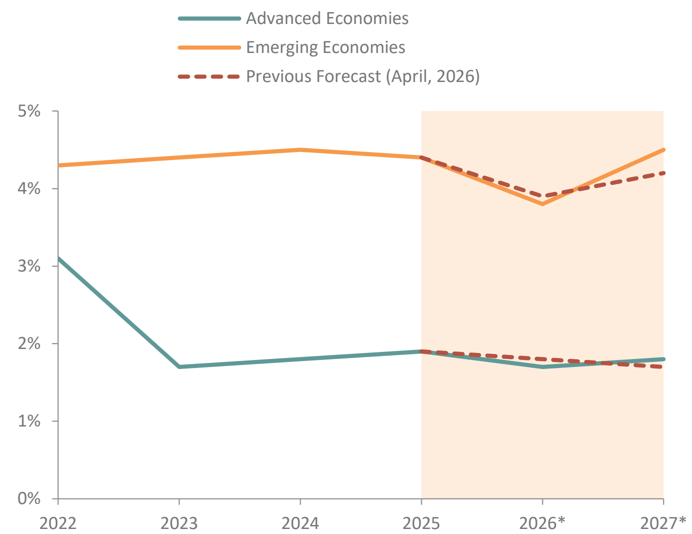


Figure 1.2. Real Economic Growth Dynamics in Advanced and Emerging Economies

Source: IMF.

Global economic growth remains resilient, although the outlook has deteriorated. The global environment continues to be characterized by elevated uncertainty. Renewed geopolitical tensions in the Middle East have increased the risks of weaker economic activity and higher inflation. These adverse effects are partly offset by continued investment in artificial intelligence (AI) and digital technologies, which, together with expansionary fiscal policy in some economies, continue to support economic activity.

The resilience of economic activity is particularly evident in the United States, despite signs of a gradual normalization in the labor market. This resilience is supported in part by favorable stock-market conditions, which are largely associated with growing optimism about AI. In turn, rising equity prices support consumer spending through the wealth effect[1]. Financial conditions have also eased somewhat, providing additional support to activity even though interest rates remain relatively high. The ongoing investment cycle in the technology sector also supports high-tech manufacturing and exports in economies such as China, where it partly offsets weak domestic demand and persistent problems in the real estate sector. However, this growth structure increases China's vulnerability to changes in external demand and trade tensions. In the euro area, fiscal and infrastructure spending supports activity, although weak industrial performance and elevated uncertainty remain constraints on growth.

Against this backdrop, the escalation of the conflict in the Middle East has worsened the global outlook by increasing risks to energy markets, transport routes, and supply chains. Higher energy prices reduce households' purchasing power and raise firms' production costs, although the impact differs across countries (see Figure 1.2). For energy-importing economies, this worsens the terms of trade, whereas energy exporters benefit from higher export revenues. Russia benefits mainly through the latter channel, although

1 *The wealth effect refers to the tendency of households to increase consumption when the value of their assets rises, thereby increasing their perceived wealth.*

The renewed conflict also increases inflation risks, as additional pressure on energy prices and supply-chain disruptions may slow the disinflation process.

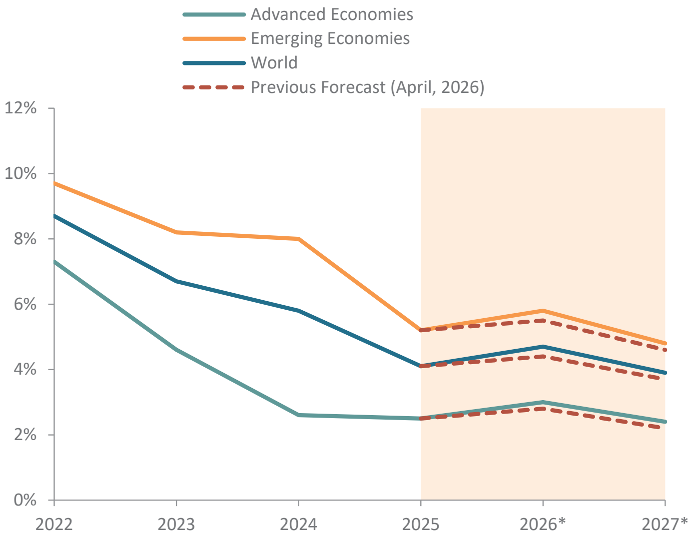


Figure 1.3. Global Inflation Dynamics

Source: IMF.

Oil prices remain volatile amid geopolitical risks. The decline in June reflected a reduction in the geopolitical risk premium, while renewed tensions in the Middle East pushed prices up again in July. Nevertheless, oil prices remain below the levels observed during the previous escalation, although risks in the oil market remain elevated amid ongoing geopolitical uncertainty.

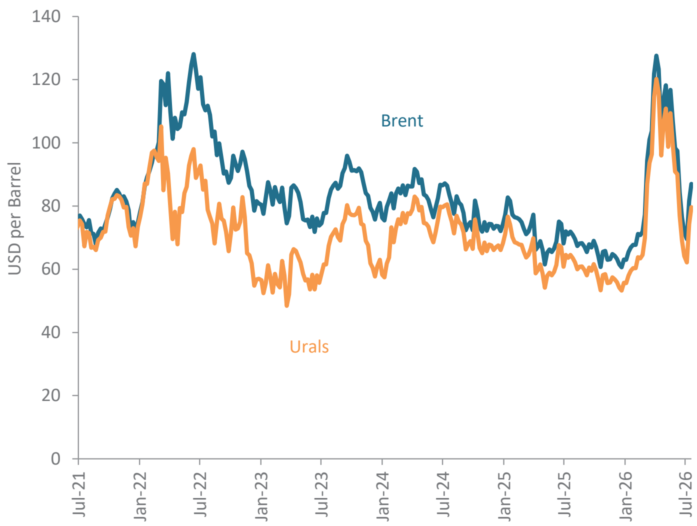


Figure 1.4. Brent and Urals oil prices

Source: FRED, Tradingeconomics.

structural constraints - including sanctions, labor shortages, and high interest rates - continue to weigh on its medium-term outlook.

According to the IMF's July assessment, the forecast for global economic growth in 2026 was revised down from 3.1% to 3.0% (see Figure 1.1), while the inflation forecast was revised up from 4.4% to 4.7% (see Figure 1.3). Accordingly, the balance of global risks has shifted toward weaker economic growth and higher inflation. At the same time, high public debt and the slow pace of fiscal consolidation, particularly in major economies, increase medium-term vulnerabilities. Conversely, stronger-than-expected productivity gains from investment in artificial intelligence and technological development could support economic activity without a significant increase in inflationary pressures.

Commodity-market developments remain one of the main sources of inflation risk. Renewed geopolitical tensions have increased uncertainty in global commodity markets, particularly in the oil market. Oil prices declined in June as the geopolitical risk premium eased, but renewed tensions in July again placed upward pressure on prices (see Figure 1.4). Although relatively weak global demand partly restrains further price increases, the tense geopolitical environment, amid a significant decline in inventories, remains a source of high price volatility. Consequently, risks to oil prices remain elevated in both directions. The main concern is the potential persistence of the shock. A temporary increase in oil prices primarily affects inflation through fuel and energy prices. However, if prices remain high for an extended period, other things being equal, higher transportation and production costs (see Figure 1.5) will feed through to a broader range of inflation components. In addition, higher transportation costs and pressure on supply chains may pass through to prices with a lag, increasing the risk of imported inflation.

International food markets also remain an important source of uncertainty. Although price developments differ across individual products, international food prices remain relatively high (see Figure 1.6). Lowered fertilizer prices partly ease cost pressures in agricultural production, while geopolitical uncertainty, transportation costs, and adverse weather conditions continue to create upside risks to prices. The risk of extreme weather events is particularly noteworthy, as such events could place additional pressure on international food prices by reducing crop yields and constraining supply.

Accordingly, a prolonged commodity-market

The Global Supply Chain Pressure Index increased amid the conflict, while average transportation costs also edged up. Other things being equal, these developments increase inflation risks in international commodity markets.

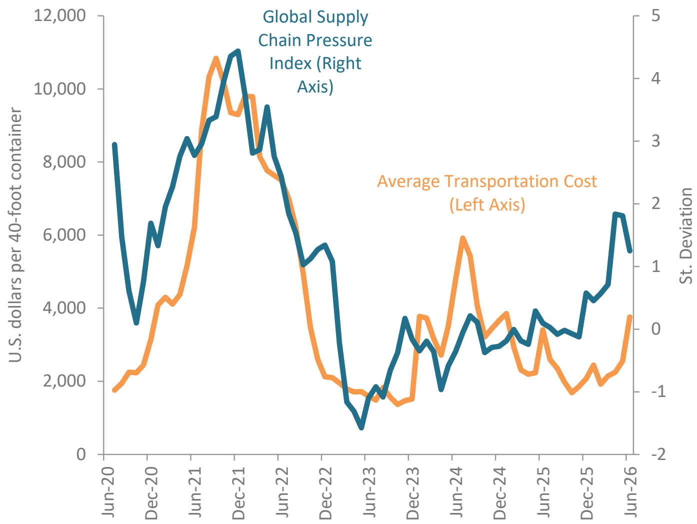


Figure 1.5. Average Transportation Cost Index and Global Supply Chain Pressure Index

Source: Drewry World Container Index (WCI), New York Fed, Global Supply Chain Pressure Index (GSCPI).

International food prices remain relatively high. Supply-chain disruptions, transport-cost risks, and climatic and geopolitical uncertainty continue to generate inflationary pressure on food prices, while lower fertilizer prices partly ease pressure on agricultural production costs and food prices over the medium term.

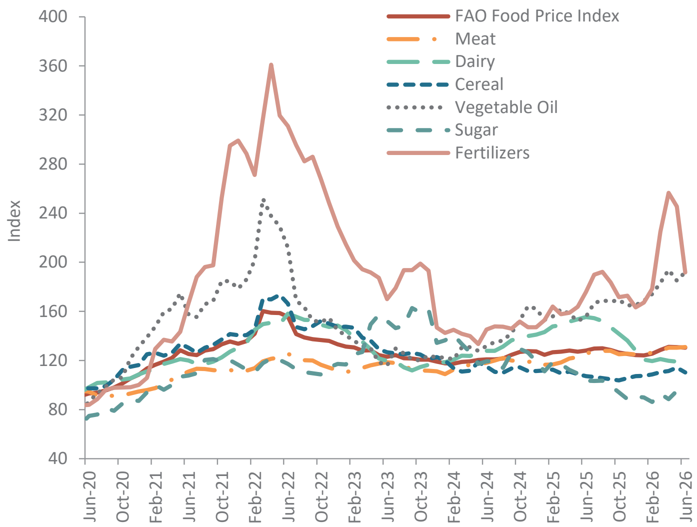


Figure 1.6. FAO Food Price and Fertilizer Price Indices, Dec-2019=100

Source: FAO, World Bank, NBG calculations.

shock could slow the global disinflation process and increase the risk of second-round inflationary effects.

At present, the inflation risks described above are prompting a cautious global monetary policy stance and upward revisions to expected policy-rate paths. Of particular concern is that relatively sticky price indicators in major economies, including the United States and the euro area, remain significantly above target. Moreover, the major economies entered the renewed conflict in the Middle East with elevated sticky-price inflation, making another supply shock particularly important because of the risk of second-round effects. These risks are already reflected in financial-market expectations. Compared with May, the expected path of the Federal Reserve's policy rate has shifted upward (see Figure 1.7), while inflation risks in the euro area have strengthened expectations of additional monetary policy tightening (see Figure 1.8). Under heightened uncertainty, however, policy decisions by major central banks are likely to become increasingly dependent on incoming macroeconomic data.

Despite higher policy-rate expectations, international financial markets have remained relatively resilient, supported in part by higher valuations of companies associated with artificial intelligence and relatively low corporate bond spreads (see Figure 1.9).

For Georgia, current global developments primarily affect inflation. As a net energy importer, Georgia is affected by higher international energy prices both directly, through domestic fuel prices, and indirectly, through higher production and transportation costs. If the shock persists, it will also increase the risk of higher inflation expectations.

The effect on economic growth is more mixed. Higher international commodity prices support export revenues, while weakness in some components of external demand is partly offset by higher revenues from other sources.

If global inflation remains elevated for longer than expected, central banks in advanced economies may maintain restrictive monetary policy for an extended period. Global financial conditions would consequently remain tight, which, other things being equal, would tighten foreign-currency financing conditions in Georgia. However, strong external inflows, a high level of international reserves, and a lower risk premium are important mitigating factors.

Amid persistent inflationary pressures and uncertainty, the expected path of the Federal Reserve's policy rate shifted sharply upward relative to May over both the short and medium term.

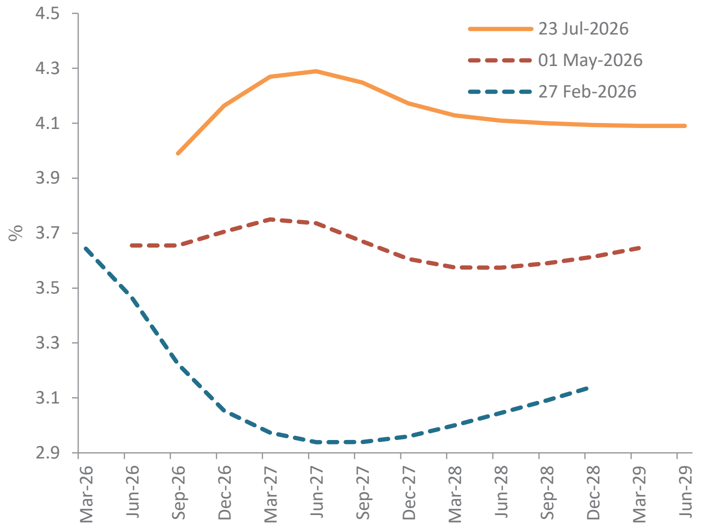


Figure 1.7. Market Expectations of Fed Funds Rate Path

Source: Atlanta Fed.

Inflation risks in the euro area have increased the probability of tighter monetary policy. As a result, the expected policy-rate path implied by financial markets has shifted upward.

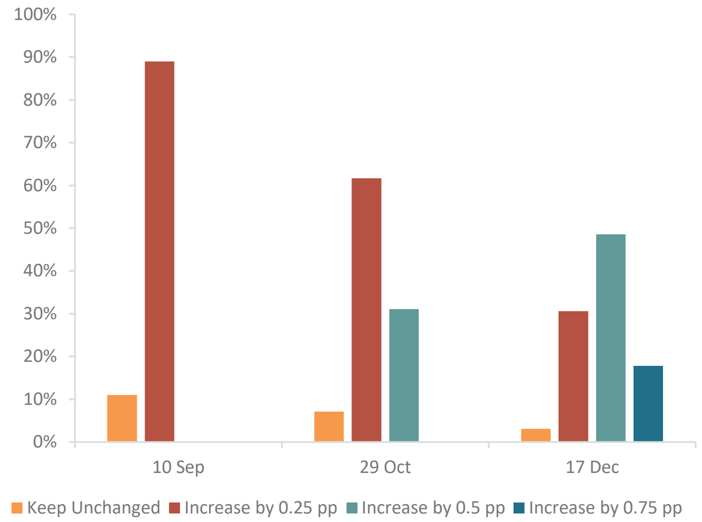


Figure 1.8. Financial-Market Expectations for the ECB Policy Rate*

Source: ECB Watch.

* Data as of 27 July

The spread between 10-year and 2-year government bond yields has narrowed in major economies, partly reflecting expectations that a restrictive monetary policy stance will be maintained for longer than previously anticipated and/or tightened further.

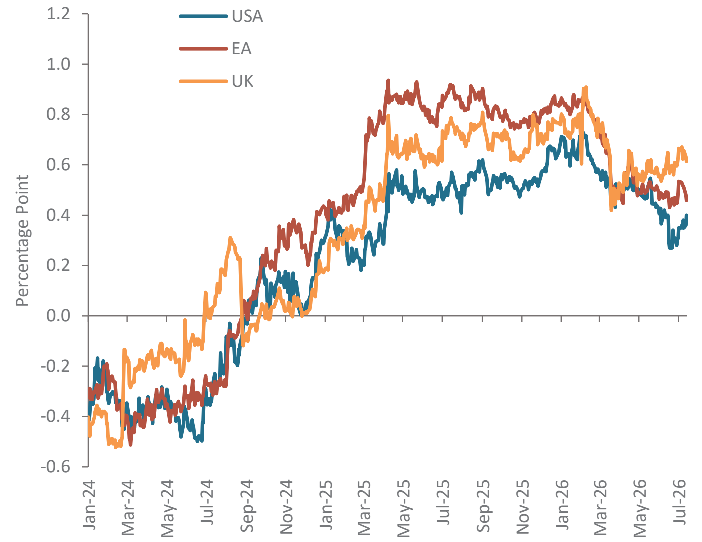


Figure 1.9. Spread between yields on 10-year and 2-year government securities

Source: investing.com, ECB.

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

2.1. OVERVIEW OF THE CURRENT MACROECONOMIC ENVIRONMENT IN GEORGIA

High-productivity sectors remain the main drivers of economic growth.

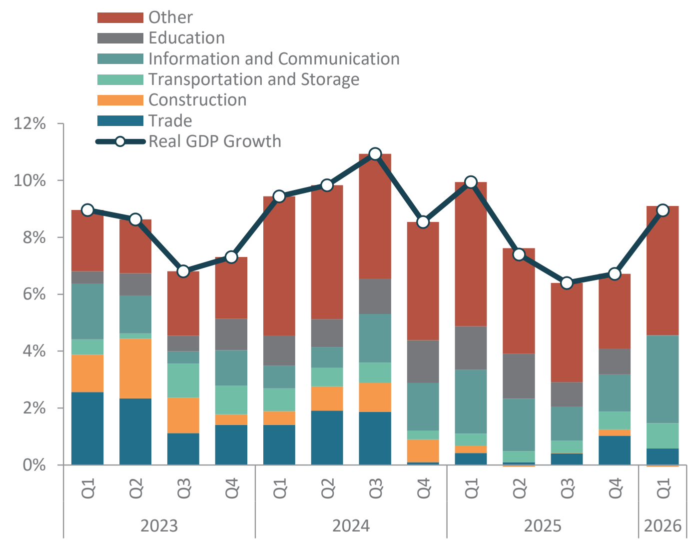


Figure 2.1.1. Sectoral Decomposition of Real GDP growth (Contribution to the Growth)

Source: NBG, Geostat.

High productivity growth in the information and communication sector has been maintained.

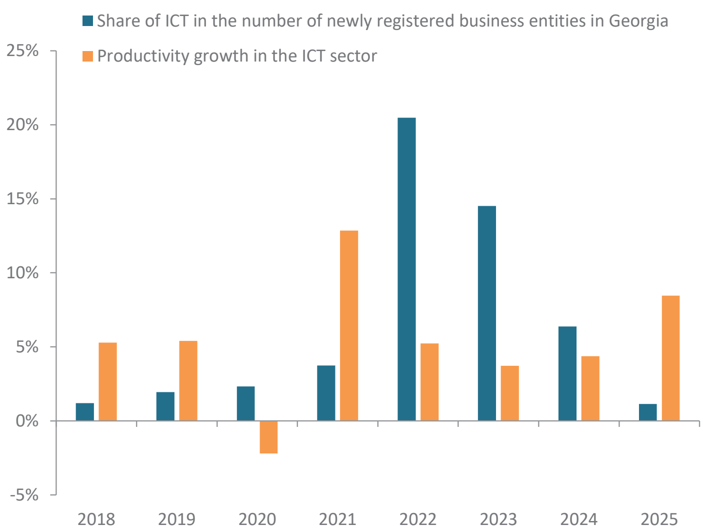


Figure 2.1.2. Share of ICT in the number of newly registered business entities in Georgia

Source: NBG, Geostat.

* Note: Calculations are based on data available as of 1 July 2026.

Georgia's strong economic growth was maintained in the first half of 2026. Real GDP grew by 9.0% in the first quarter (see Figure 2.1.1), while, according to the preliminary estimate, average economic growth in January-May amounted to 7.8%. From a sectoral perspective, growth was driven mainly by relatively high-productivity service sectors, particularly information and communication technology (ICT), transportation, and financial activities (see Figure 2.1.1). In turn, the strong performance of these sectors increases external inflows and has a positive effect on domestic economic activity.

The high contribution of the ICT sector is largely attributable to strong productivity growth. Following the high level of activity observed in 2022-2023, the share of ICT in newly registered business entities declined, while labor productivity in existing business entities continued to rise (see Figure 2.1.2), which supports potential economic growth. At the same time, the sector's performance helps preserve a relatively less import-intensive structure of the economy (see Figure 2.1.3). Meanwhile, growth in some sectors that support the economy's long-term potential is gradually normalizing. In particular, the contribution of construction to economic growth has declined progressively in recent quarters (see Figure 2.1.1).

Alongside the strengthening of supply-side factors, domestic demand is increasing, supported by stable growth in bank lending. The credit portfolio has been growing at a sustainable rate of around 14-15%, broadly in line with the economy's long-term growth rate (see Figure 2.1.4).

Business loans continue to make the major contribution to credit growth. Recently, however, against the background of exchange-rate stability, growth in business lending has largely been driven by foreign-currency denominated loans. Growth in loans denominated in domestic currency moderated in recent months, although it accelerated slightly again in June (see Figure 2.1.4), partly reflecting lower interest rates on lari loans (see Figure 2.1.5). It should also be noted that the tightening of global financial conditions has affected the local market, and, despite a small decline in June, foreign-currency lending rates re-

Amid ongoing structural changes in the economy, the trend of less import-intensive economic growth has continued.

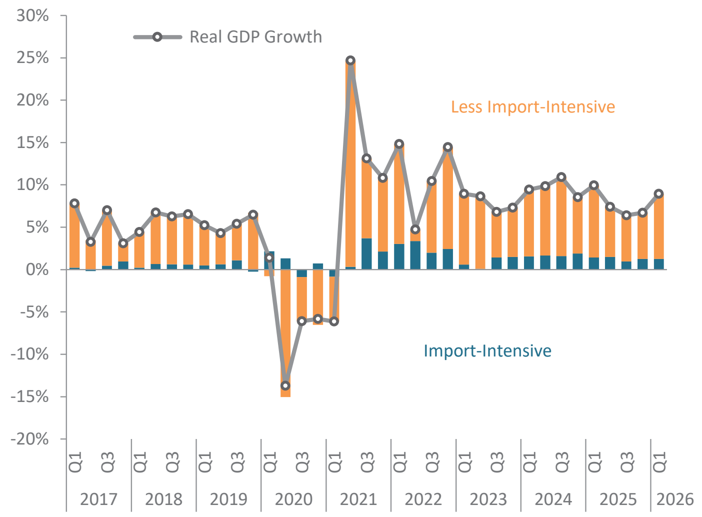


Figure 2.1.3. Sectoral Composition of Real GDP Growth by Degree of Import Dependence (Contribution to Growth)

Source: NBG, Geostat.

Credit growth has remained close to its equilibrium level, supporting stable domestic demand.

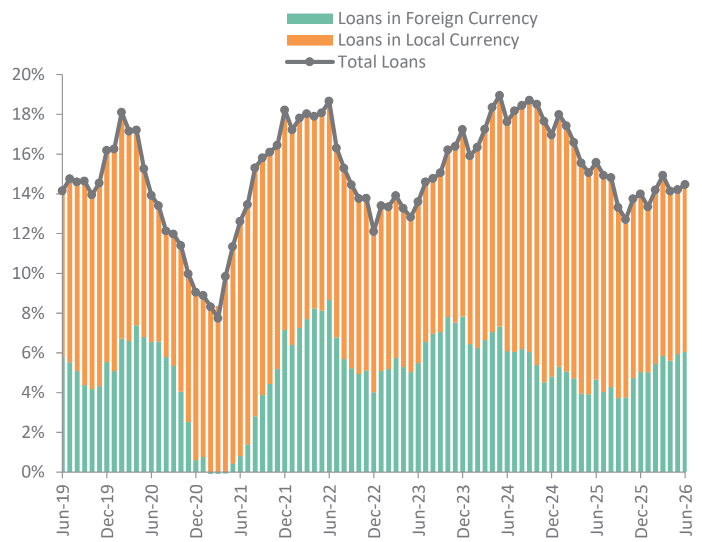


Figure 2.1.4: The annual growth rate of loans and the contribution of loans in local and foreign currency to it

Source: NBG.

main relatively high.

Despite the geopolitical situation in the Middle East, Georgia's external demand remains stronger than expected. The conflict is transmitted mainly through the tourism channel, although its effect on overall external demand has been limited. Tourist inflows from Middle Eastern countries and India declined in the second quarter, but this was largely offset by higher tourism inflows from other markets, including the European Union and Azerbaijan. Consequently, tourism revenues in the second quarter of 2026 declined by 3.8% year-on-year, less than expected. At the same time, strong growth in exports of services and goods supports the upward trend in external inflows. Revenue from ICT exports continued to rise and reached 4.8% of GDP in the first quarter of 2026, the highest level on record. Goods exports also continued to grow in the second quarter of 2026, increasing by 17.2% year-on-year, partly reflecting the impact of higher commodity prices in international markets. On the other hand, higher international prices for oil and other commodities increase the value of imports. Overall, high revenues from exports of services and goods offset the negative effects of lower tourism revenues and higher petroleum-product imports, improving net external inflows (see Figure 2.1.6).

As a result of stable external inflows, the current account deficit remained low in the first quarter of 2026, at 3.8% of GDP (see Figure 2.1.7). Higher-than-expected net external inflows and the addition of new air routes, including the launch of direct flights to China, will support external inflows in the coming months, other things being equal. Accordingly, under the updated central forecast, the current account deficit is expected to remain below its long-term equilibrium level of 5% in 2026, at around 3-3.5% of GDP.

The improved current account balance has also supported an appreciation of the nominal effective exchange rate of the lari. At the same time, lower inflation in Georgia relative to its trading partners has helped the real effective exchange rate return to its equilibrium level and eliminated the deviation accumulated in the previous period (see Figure 2.1.8). Consequently, its impact on the competitiveness of exported goods is broadly neutral.

Against the background of the lari's stable position, the declining trend in deposit dollarization has continued. In June 2026, total deposit dollarization fell to 43.8%, the lowest level historically observed (see Figure 2.1.9). Dollarization has declined in both household and corporate deposits. Along with exchange-rate stability, the larization

As of June 2026, financial conditions had eased slightly in both lari and foreign currency. Overall, however, they remained relatively tight, helping to keep credit activity close to equilibrium.

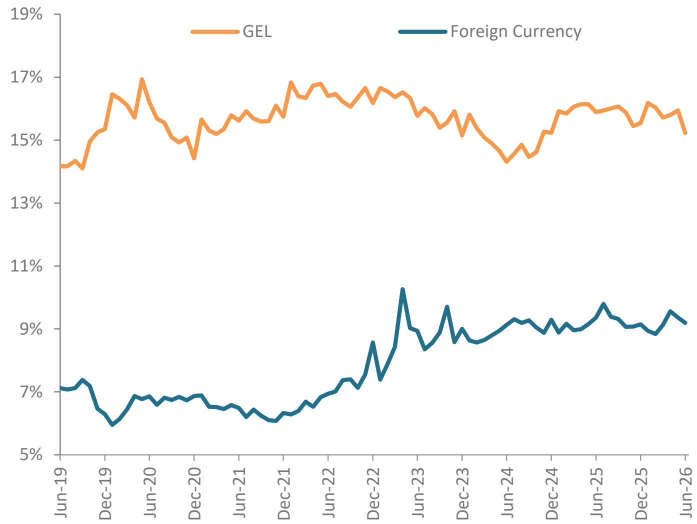


Figure 2.1.5. Interest Rates on Loan Flows in National and Foreign Currencies

Source: NBG.

International inflows have remained strong despite the conflict in the Middle East.

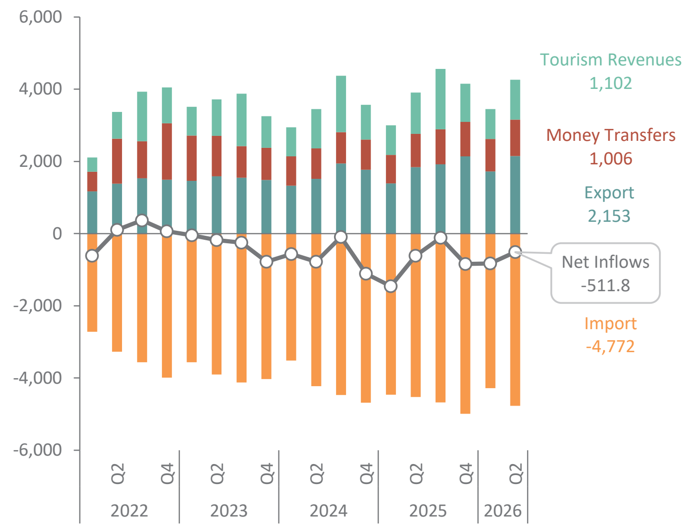


Figure 2.1.6. The dynamics of inflow/outflows from goods export and imports, tourism and remittances

Source: NBG, Geostat.

process is supported by the persistently wide interest-rate differential between deposits denominated in lari and foreign currency (see Figure 2.1.10).

The stable position of the exchange rate is also supported by the sovereign risk premium remaining low. This is reflected in the declining spread between the yields on five-year government securities issued by Georgia and the United States (see Figure 2.1.11). At the same time, the narrowing differential also reflects increased international investor interest in Georgia, which, in turn, is also a source of financial inflows.

Against the background of strong external inflows, the accumulation of international reserves has continued. Gross international reserves exceeded USD 7.1 billion in June 2026 (see Figure 2.1.12), improving reserve adequacy and thereby reducing vulnerability to external shocks.

The external and domestic factors described above affect inflation in different directions. At the current stage, inflation remains above target mainly because of higher energy prices and their direct and indirect effects. In particular, amid the rise in oil prices in the second quarter of 2026, the contribution of fuel prices to inflation increased significantly and amounted to 1.3 percentage points of the 5.8% annual inflation rate in June (see Figure 2.1.13). In addition, higher fuel prices, as an increase in the cost of an intermediate input, also affect the prices of other goods and services.

At the same time, risks to food inflation remain elevated amid geopolitical developments and climatic conditions. Price dynamics in international markets differ across products relevant to Georgia (see Chapter 1), affecting domestic inflation in different ways. Nevertheless, from the second half of the year, high base effects are expected to reduce inflationary pressure on some food components. In addition, the effect of the one-off adjustment in bread prices will drop out from October 2026, which, other things being equal, will have a disinflationary effect. Despite these developments, food remains the largest contributor to inflation at the current stage.

Disinflationary trends are also evident in the labor market. Against the background of a gradual normalization in nominal wage growth and sustained high productivity, unit personnel costs have declined (see Figure 2.1.14). This, in turn, reduces pressure on firms to revise prices upward.

For the stability of long-term inflation expectations, it is important that core inflation remains close to the 3% target and stood at 3.2% in June (see Figure 2.1.15). At the same time, however, *The current account deficit in the first quarter of 2026 was lower than expected. Under the central forecast, it is expected to remain below its equilibrium level in 2026.*

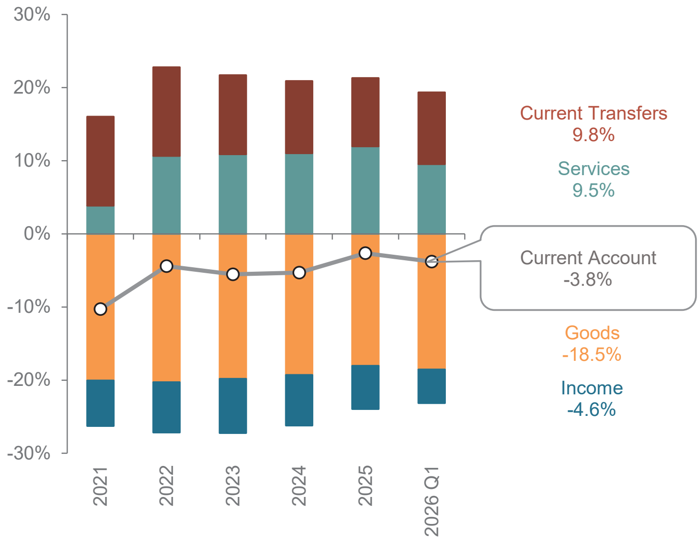


Figure 2.1.7: Current Account Balance Decomposition (% of GDP, according to BPM5)

Source: NBG.

the acceleration of relatively sticky price indicators, including services inflation, warrants close attention. A prolonged period of elevated flexible-price inflation, particularly in food and fuel, could further accelerate sticky price inflation. This, in turn, increases the risk of second-round effects and warrants maintaining a cautious monetary policy stance.

The real effective exchange rate is close to its long-term equilibrium level; consequently, its effect on the competitiveness of export goods is broadly neutral.

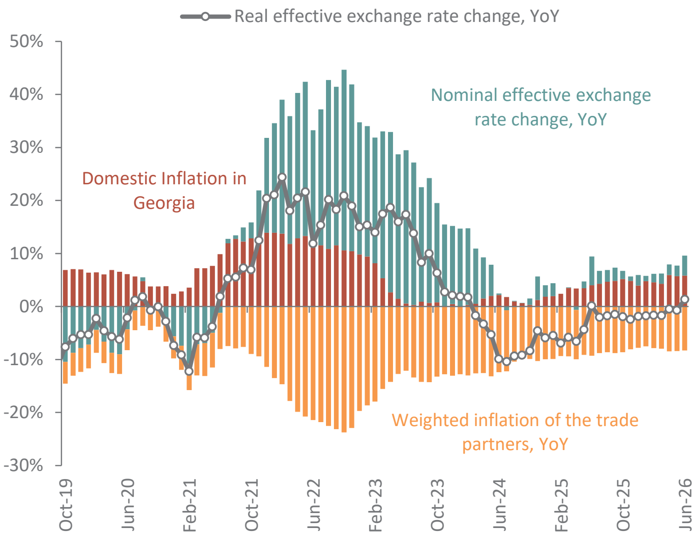


Figure 2.1.8. Decomposition of the Year-over-year Change in the Real Effective Exchange Rate of the Georgian lari*

Source: NBG.

* 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.

Against the background of a relatively strong lari and macroeconomic stability, deposit dollarization continues to decline in both household and corporate deposits.

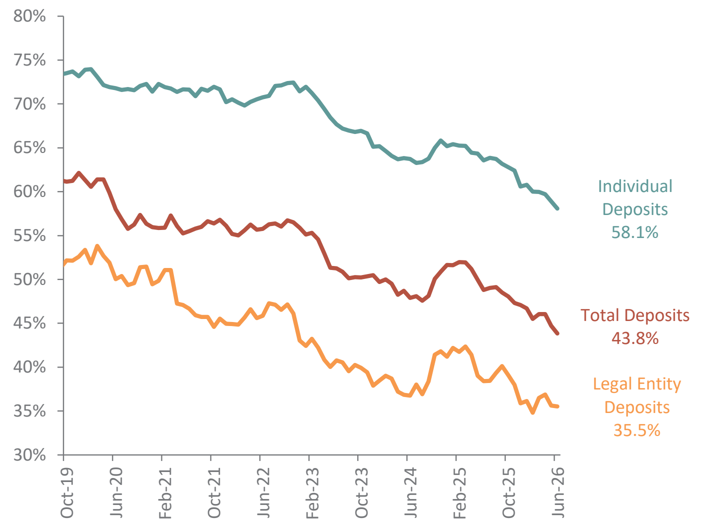


Figure 2.1.9. Deposit Dollarization (Excluding Exchange Rate Effects)

Source: NBG.

The high interest-rate differential between deposits denominated in lari and foreign currency provides additional support to larization.

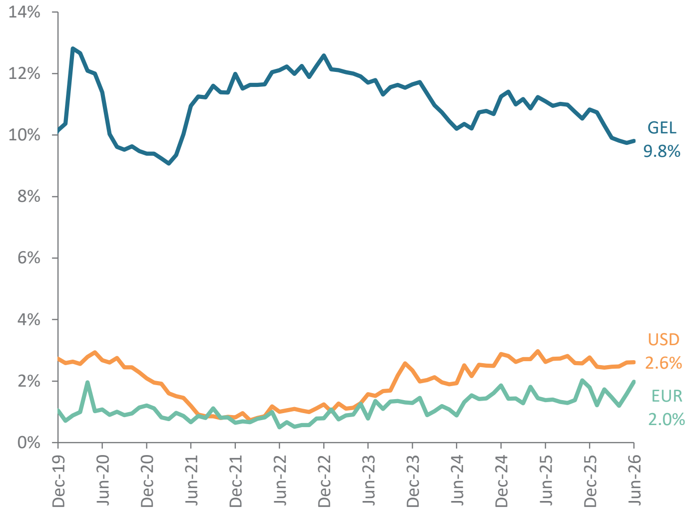


Figure 2.1.10. Interest rates on residents' term deposits in lari and foreign currency, excluding government, flow

Source: NBG.

Despite elevated global uncertainty, Georgia's sovereign risk premium remains below its equilibrium level, pointing to strong macroeconomic fundamentals and favorable international investor sentiment toward Georgia.

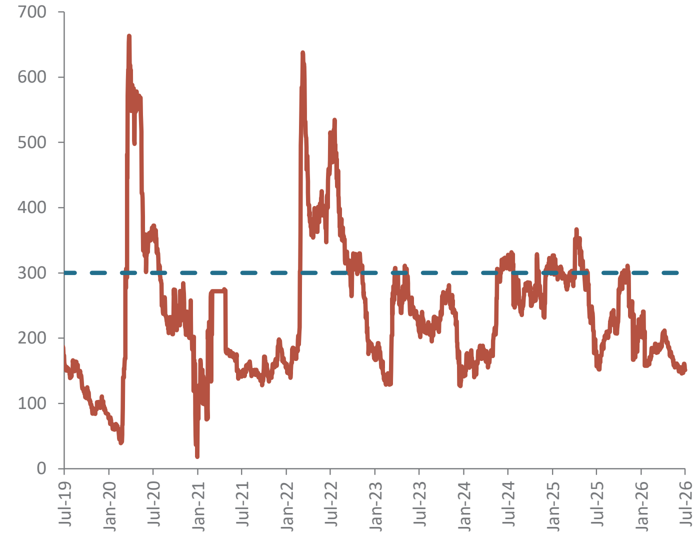


Figure 2.1.11. Spread Between 5-Year USD-Denominated Government Bond Yields of Georgia and the United States

Source: Bloomberg, NBG.

Strong external inflows and increased confidence in the lari support the accumulation of gross international reserves, which, in turn, reduces vulnerability to external shocks.

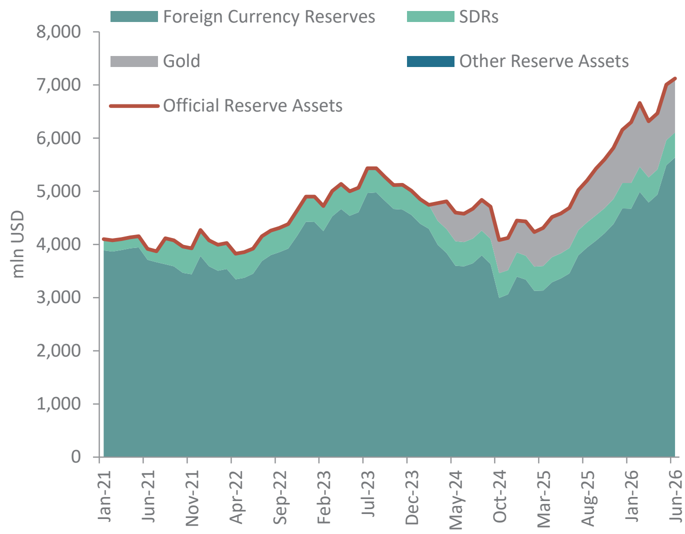


Figure 2.1.12. Decomposition of Georgia's Gross International Reserves

Source: NBG.

In the second quarter of 2026, the contribution of energy prices was one of the main factors behind inflation's deviation from target.

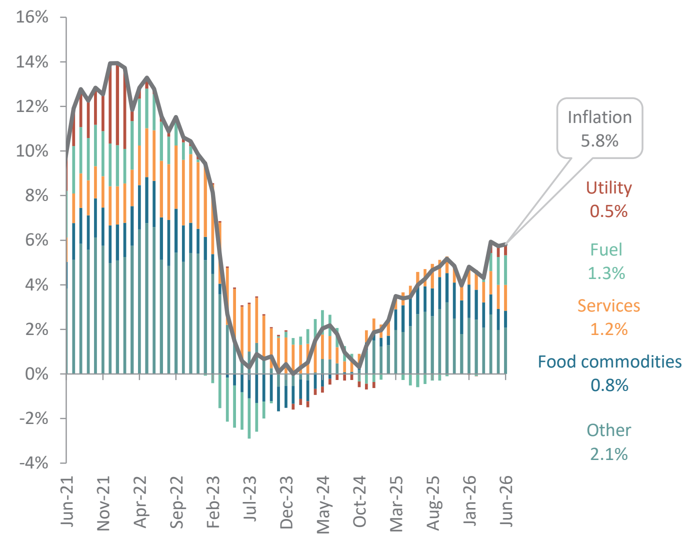


Figure 2.1.13. Inflation by Components

Source: Geostat, NBG.

Against the background of gradually normalizing wage growth and high productivity, unit personnel costs declined, weakening inflationary pressure from the labor market.

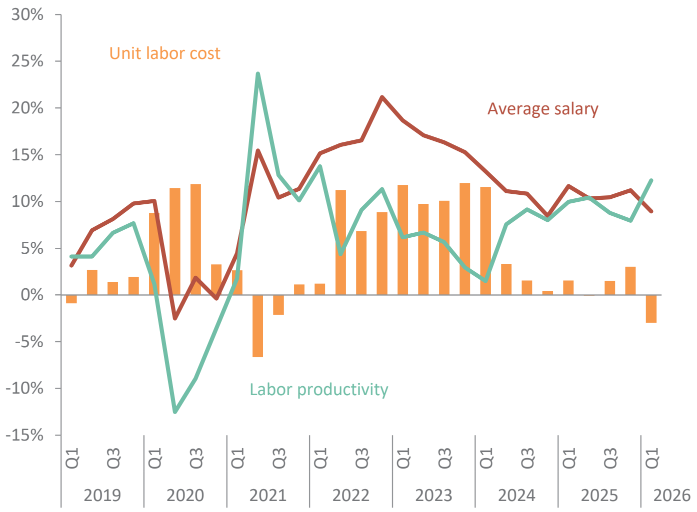


Figure 2.1.14. Average Wage, Labor Productivity, and Unit Labor Cost, Year-over-year Growth Rate

Source: Geostat, NBG.

A prolonged period of elevated flexible price inflation increases the risk of an acceleration in sticky price inflation.

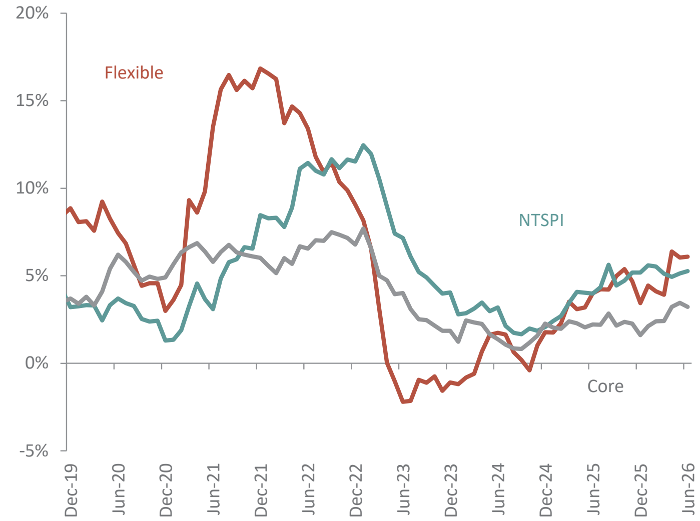


Figure 2.1.15. Core, Flexible and Non-Tradable Sticky Price (NTSPI) Year-over-year Inflation Measures.

Source: Geostat, NBG's Calculation.

2.2. CENTRAL SCENARIO

Similar to the global economy, developments in international commodity markets remain an important driver of inflation dynamics in Georgia. As noted in the overview of the global macroeconomic environment chapter, geopolitical tensions in the Middle East, following a temporary improvement in June, deteriorated again in July. The resumption of military operations between the United States and Iran led to new supply disruptions in international commodity markets, which prolonged the global supply shock. The renewed escalation of the conflict put upward pressure on international oil prices; however, current market dynamics indicate that prices remain below the levels recorded during the previous escalation period.

The National Bank of Georgia's updated central scenario assumes that the current geopolitical tension will gradually ease in the third quarter. Accordingly, the oil price is expected to remain around USD 85 per barrel on average in the third quarter, before declining to approximately USD 80 per barrel by the end of the year. However, risks to the oil price trajectory are two-sided. Although the global economy exhibited high flexibility in response to the shock during the first phase of the conflict, its vulnerability to further supply disruptions has increased due to reduced buffers and deteriorated initial conditions. On the one hand, prolonged supply disruptions in the Strait of Hormuz, damage to energy infrastructure, or a regional expansion of the conflict could exert additional upward pressure on oil prices. On the other hand, a rapid de-escalation of the geopolitical tensions could lead to a faster-than-expected decline in oil prices. Possible scenarios related to the realization of geopolitical risks and their implications on Georgia's economy are discussed in the risk analysis section.

The National Bank of Georgia's central scenario is based on an analysis of current economic conditions and assumptions regarding the future development of the external environment. The monetary policy path presented in the central scenario represents the NBG's optimal trajectory, which takes into account not only the economy's development consistent with the central scenario but also the possible outcomes of risk scenarios. This approach aims to select a monetary policy trajectory that minimizes economic losses even under the realization of various risks.

Regarding **the outlook for economic growth**, the strong dynamics of economic activity in the first half of 2026 was in line with the central scenario's expectations. Highly productive, services-oriented sectors are expected to remain the main drivers of economic growth this year, contributing to an increase in the country's production capacity. Amid the structural changes, the growing tendency in the ICT sector partly reflects the effect of the sector's accelerated development, including technological advances associated with artificial intelligence. Hence, according to the central scenario, the growth rate of the ICT sector will gradually normalize over the long term, although its contribution to the country's potential GDP level will remain significant. Meanwhile, the impact of the geopolitical situation in the Middle East on Georgia's economic growth is transmitted primarily through the tourism channel, although its overall effect on economic growth is limited. The decline in tourism inflows from Middle Eastern countries, amid ongoing tourism diversification, is largely balanced by tourism revenues received from other countries. Furthermore, services exports and revenues from goods exports will maintain strong growth and increase at a faster pace than imports. As a result, external demand will remain one of the significant drivers of economic growth in 2026. Ultimately, the current economic growth outlook is consistent with the previous central scenario, and **the economic growth forecast for 2026 remains unchanged at 6.5%.** In the next year, economic growth is expected to return to its long-term rate of 5% (see Figure 2.2.1).

Amid strong external demand, economic activity is in line with expectations. The real GDP growth forecast for 2026 remains unchanged at 6.5%, before returning to its long-term growth rate of 5%, thereafter.

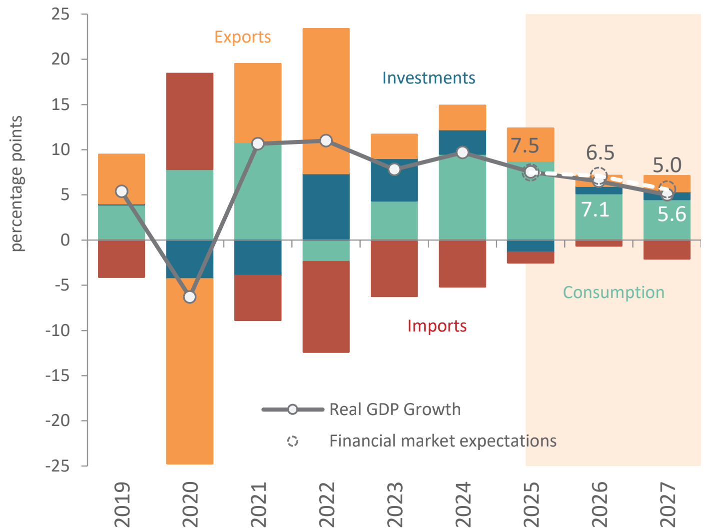


Figure 2.2.1. Central Scenario for Real GDP Growth and Financial Market Participants' Expectations of Economic Activity

Source: NBG, Financial Market Participants, Geostat.

Amid improved macroeconomic fundamentals, **financial market participants** raised their real GDP growth forecasts from 6.2% to 7.1% for 2026 and from 5.2% to 5.6% for 2027. However, since the survey data was collected before the re-escalation of geopolitical tensions in the Middle East, the potential effects of this development are not reflected in the presented forecasts.

Amid the significant share of petroleum products, food, and other imported goods in the consumer basket, persistently high volatility in global commodity markets remains one of the key determinants of **inflation dynamics** in Georgia.

According to the central scenario, inflation is expected to remain above the target in 2026, mainly due to the impact of an energy-driven supply shock. The impact of the geopolitical situation in the Middle East on Georgia's economy is transmitted primarily through the inflation channel. Meanwhile, the rise in energy prices affects inflation not only directly, but also through increased production, transportation, and other intermediate costs. In turn, these indirect effects have been significantly amplified by the increase in electricity tariffs domestically, which has also heightened the risk of a broadening of inflationary pressures. The geopolitical developments also affect inflation through the channel of international food prices. High energy prices increase intermediate costs in agriculture, while climate conditions heighten the risk of lower crop yields in some regions, putting upward pressure on international food prices. Nevertheless, considering the high base effect and factors present in the domestic market, domestic food inflation is expected to maintain its downward tendency.

Despite the supply shock, under the central scenario, inflationary pressures will not be broad-based. On the one hand, economic growth is primarily driven by supply-side factors and an expansion of the country's production capacity, limiting inflationary pressures stemming from aggregate demand. On the other hand, as a result of lower inflation in Georgia compared to its trading partner countries in recent years, the overvaluation of the real effective exchange rate compared to its trend has gradually been eliminated, and the real effective exchange rate will return to its equilibrium level. At the same time, the nominal exchange rate against the U.S. dollar maintains a strong position, supported by the sustained low level of Georgia's sovereign risk premium and its strong external position. As a result, through the real effective exchange rate channel, imported inflation will support the disinflationary processes. The strong position of the nominal exchange rate, amid still-high dollarization, will also contribute

Amid higher-than-expected inflation inertia in the current period and the re-escalation of the conflict, the inflation forecast has been revised up to 5.2%. However, the supply-side shock is expected to be temporary, and, amid the gradual normalization of exogenous factors, inflation is projected to average 2.7 percent in 2027.

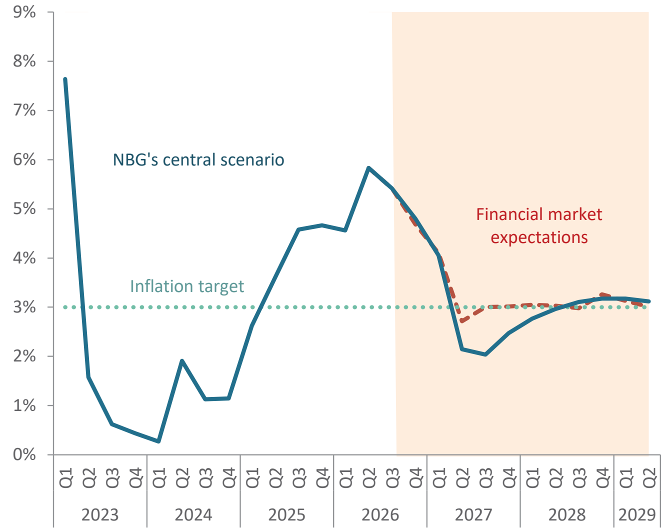


Figure 2.2.2. Central scenario of annual inflation and inflation expectations of financial market participants

Source: NBG, Financial Market Participants.

The fading of commodity price effects and base effects related to certain products will support inflation's gradual return to the target. At the same time, the normalization of aggregate demand will also exert downward pressure on inflation dynamics.

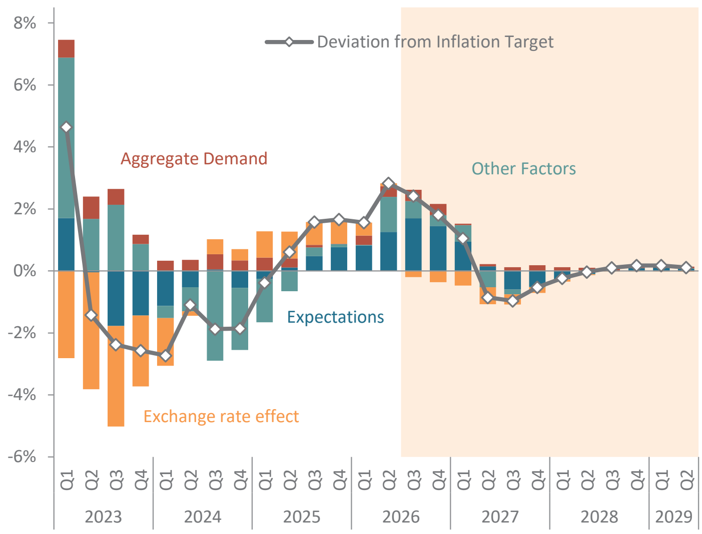


Figure 2.2.3. Decomposition of annual inflation deviations from target under the central scenario

Source: NBG, Geostat.

to reducing inflation through the balance sheet channel.

Moreover, amid the NBG's relatively tight monetary policy and the moderation in inflation dynamics from the second half of 2026, inflation expectations will also follow a downward tendency. As a result, the direct and indirect effects of the temporary energy-driven shock are not expected to generate second-round effects. Ultimately, considering the strong but **temporary** impact of the supply shock, **headline inflation will increase to an average of 5.2% in 2026, but will approach the target rate again in 2027, declining to 2.7%** (see Figures 2.2.2–2.2.3). In turn, the stabilization of inflation around its target level, alongside the dissipation of the exogenous shock, will be supported by the normalization of aggregate demand and stable inflation expectations, following the tight monetary policy stance.

Compared with the previous central scenario, inflation forecast for 2026 and 2027 has been revised upward by 0.3 pp and 0.2 pp, respectively. The current inflation outlook has shifted slightly towards the high-inflation scenario published in the previous quarter, reflecting the impact of the prolonged conflict and the strengthening of indirect effects from energy prices. However, in contrast, it should be noted that, unit labor costs and the exchange rate position have proven to be more disinflationary than expected.

Inflation expectations of financial market participants are consistent with the NBG's central scenario. Compared to the previous quarter, the average inflation forecast for 2026 was revised upward by 0.6 pp to 5.1%. While, the forecast for 2027 was revised slightly downward to 3.2% (see Figure 2.2.2). In turn, as noted above, financial market forecasts do not incorporate the effects of a renewed escalation in the Middle East.

As noted above, in the central scenario, the inflationary effect of the supply shock stemming from the Middle East is temporary. Central banks typically do not react to one-off supply shocks, as monetary policy cannot eliminate the underlying supply disruptions, while the full transmission of monetary policy takes time. Accordingly, if the shock is transitory, a monetary policy response will lead to excessive volatility in the economy. However, if the supply shock is strong and persistent, resulting in higher inflation expectations and the materialization of second-round effects, a monetary policy response becomes necessary to ensure that inflation returns to its target over the medium term. Meanwhile, amid elevated global uncertainty and heightened risks, when assessing the duration and intensity of the shock becomes more challenging, the optimal monetary policy

The National Bank of Georgia maintains a tight monetary policy stance to keep inflation expectations well anchored in the face of temporary but strong supply-side inflationary pressures.

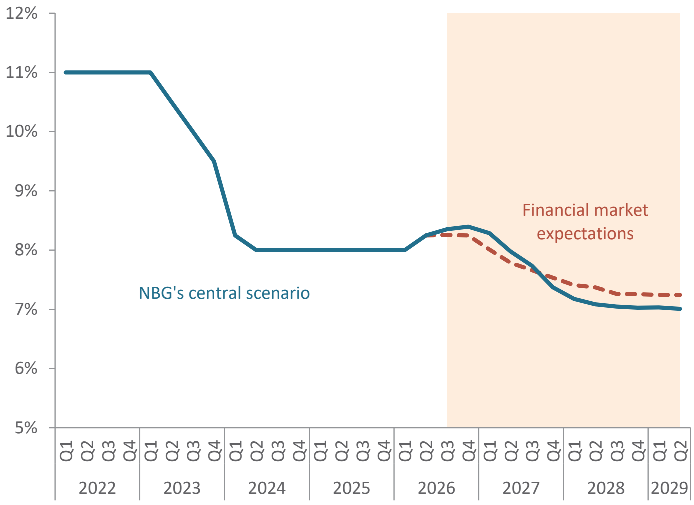


Figure 2.2.4. Central scenario of the monetary policy rate and expectations of financial market participants

Source: NBG, Financial Market Participants.

response should also account for the probability of the shock persisting for longer and possibility of inflationary risks increasing in the future. At the current stage, uncertainty is primarily related to the likelihood and potential magnitude of this risk materializing.

Although the deviation of inflation from its target in both the current and forecasted periods is driven by exogenous supply shocks, amid heightened uncertainty and inflationary risks, the NBG is pursuing a relatively tight monetary policy stance, in order to manage inflation expectations and ensure that the supply shock does not evolve into broad-based and persistent inflationary processes. Moreover, if necessary, the National Bank of Georgia will further tighten monetary policy and maintain a relatively tight stance for an extended period (see Figure 2.2.4). This tight policy stance will limit the pass-through of supply shock-driven inflationary pressures and their entrenchment into long-term inflation expectations, supporting the return of inflation to the 3% target after the shock dissipates. Such a risk management approach will, over the medium term, ensure the minimization of the economic loss required to stabilize inflation.

It should be noted that the monetary policy path is consistent with the current assumptions underlying the central scenario and the current balance of risks. Therefore, it does not represent a commitment by the NBG and is adjusted at each meeting of the Monetary Policy Committee based on updated information. A further materialization of high-inflation risks would warrant an additional policy response, while a faster-than-expected reduction in these risks and a sustained convergence of inflation towards the target would provide a room for a faster-than-expected normalization of monetary policy.

2.3. HIGH-INFLATION SCENARIO

Amid high uncertainty, the **High-Inflation Scenario** is as relevant as the central scenario and considers the realization of the identified risks that would result in a higher inflation than in the central scenario. In particular, the scenario assumes a more pronounced materialization of both domestic and global inflationary risks identified in the current data, compared to the central scenario. In this context, one of the main risks is the prolonged persistence of the conflict in the Middle East, which would sustain elevated energy prices over an extended period (see Table 2.3.1). Accordingly, if these risks materialize, the NBG will pursue a tighter monetary policy compared

The high-inflation scenario is based on a renewed escalation and prolonged conflict in the Middle East, which would intensify inflationary pressures arising from petroleum product and food prices, and heighten the risk of second-round effects materializing.

High-Inflation Risks	
◦ A renewed escalation and prolonged persistence of geopolitical tensions in the Middle East. ◦ Elevated international oil and domestic fuel prices and pronounced second-round effects. ◦ An increase in international food prices stemming from elevated transportation and production costs and adverse climate conditions.	
Indicators of risk realization	**Impact on inflation**
Elevated domestic inflation driven by increases in international commodity prices.	↑
A deterioration of short-term inflation expectations.	↑
Deterioration of the current account balance amid strong imports and declining tourism revenues.	↑
In the short-run, an increase in the regional and country risk premiums.	↑
A reduction in investment and consumer spending.	↓

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.

with the central scenario to prevent a deterioration of long-term inflation expectations.

At the beginning of the current year, the escalation of the conflict in the Middle East further heightened the already elevated level of uncertainty surrounding the global economy and generated significant volatility in international commodity markets. Amid oil supply disruptions and elevated oil prices, strategic oil reserves were utilized to mitigate the short-term impact of the shock, increasing the vulnerability of energy markets to similar shocks in the future. Although an agreement has been reached between the parties of the conflict, periodic escalations of tensions continue to occur, which are immediately reflected in global oil price volatility. Meanwhile, uncertainty surrounding the resumption of oil flows through the Strait of Hormuz has been accompanied by emerging risks of disruptions along alternative transportation routes (notably, the Bab el-Mandeb Strait), further exacerbating the vulnerability of the global oil market. Accordingly, **the high-inflation scenario envisages a continuation of the active phase of the conflict in the Middle East.** The latter would continue to pose risks to oil infrastructure in the region and further reduce global oil supply (due to disruptions along alternative transportation routes), which, amid heightened market vulnerability, would lead to an increase in international oil prices and their persistence at elevated levels for an extended period.

A prolonged escalation of geopolitical tensions in the Middle East will worsen both regional and country risk, and, amid a slowdown in regional economic activity, would lead to a deterioration in domestic investment sentiment and capital outflows towards safe-haven assets. This, in turn, would reduce external inflows and tourism revenues. Consequently, in the high-inflation scenario, **economic activity is projected to moderate in 2026,** and, amid lower investment expenditure and weaker external demand, real GDP growth **will amount to 5.7%** (see Figure 2.3.1).

The deterioration in commodity market conditions would also be reflected in domestic fuel prices in energy-importing countries, including Georgia. Furthermore, amid the higher cost of energy product imports, a decline in tourism revenues would lead to deterioration of the current account balance, which, amid capital outflows towards safe-haven assets, will exert depreciation pressure on the exchange rate. Furthermore, deteriorating climate conditions and the potential decline in agricultural output, alongside higher production and transportation costs stemming from elevated petroleum product prices and ongoing supply chain disruptions, will result in

Amid a slowdown in external inflows and reduced domestic investment expenditure, real GDP growth will be 5.7% in 2026, while in 2027, amid tighter monetary policy in response to inflationary pressures, it will stand at 4.0%.

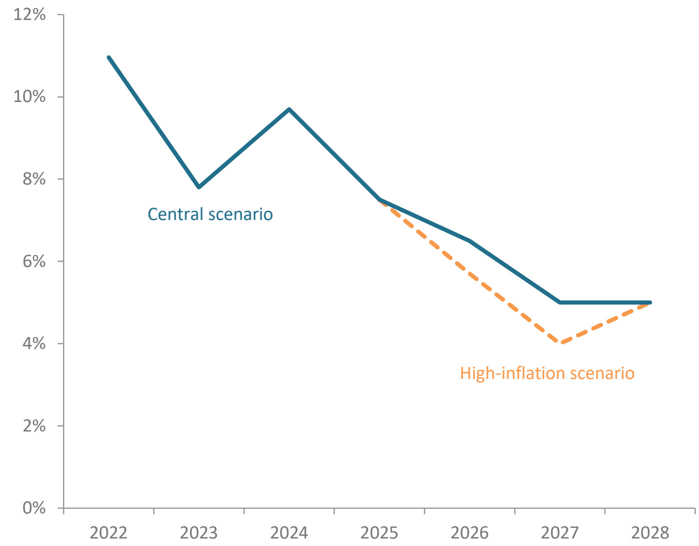


Figure 2.3.1. Real GDP Growth Under Central and High-Inflation Scenarios

Source: NBG, Geostat.

upward pressure on international food prices. Ultimately, these developments would increase imported inflation and transmit to the domestic market through the indirect cost channel. Accordingly, in the high-inflation scenario, **inflation will be higher by 0.5 pp and 2.1 pp in 2026 and 2027**, compared to the central scenario, **respectively averaging 5.6% and 4.8%** (see Figure 2.3.2). Strong inflationary pressures would significantly increase the risk of second-round effects and threaten the stability of inflation expectations, against which the NBG exhibits a low tolerance. Consequently, the above-mentioned developments would lead to an additional tightening of monetary policy and a prolonged maintenance of a tighter policy stance: **the monetary policy rate will be higher** than in the central scenario **by 0.3 pp in 2026 and by 1.1 pp in 2027**. **As a result, real GDP growth would moderate to 4.0% in 2027**. At the same time, it is noteworthy that, on the one hand, elevated global uncertainty and, on the other hand, the persistence of weaker fundamental factors will lead to an upward revision of the domestic neutral interest rate **to 7.5%.** Over the medium term, the policy rate's normalization toward this level will continue gradually, contingent on the dissipation of inflationary risks and the stabilization of the inflationary environment (see Figure 2.3.3).

Pressures stemming from international commodity markets and the depreciation of the exchange rate will significantly increase inflationary pressures over the monetary policy horizon and will delay the return of inflation to the target level for an extended period.

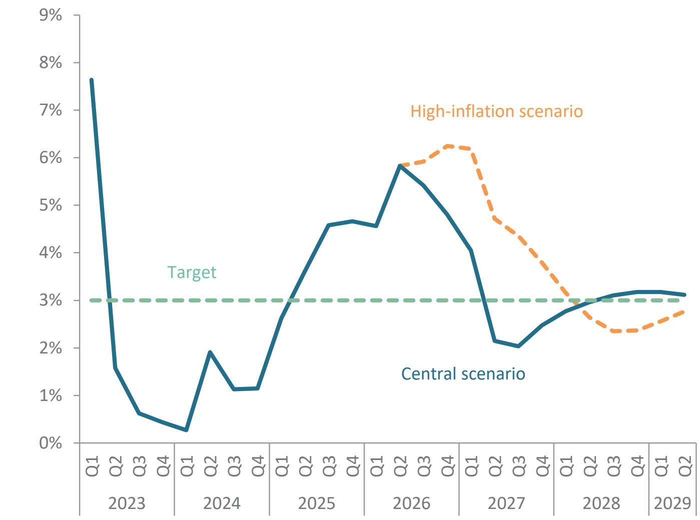


Figure 2.3.2. Year-over-year Headline Inflation Under Central and High-Inflation Scenarios

Source: NBG, Geostat.

The National Bank of Georgia has a low tolerance against the rise in inflation expectations. Consequently, the high inflationary environment in this scenario, compared to the central scenario, will lead to a tightening of monetary policy. Its normalization will begin at a gradual pace, contingent on the stabilization of the inflationary environment, towards 7.5% level.

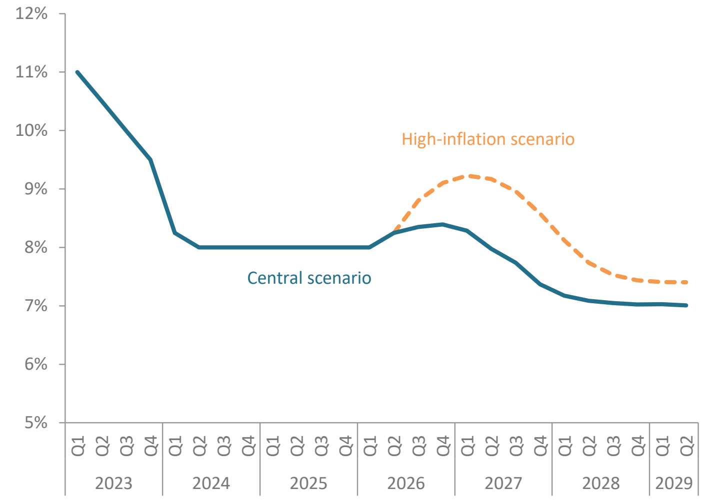


Figure 2.3.3. Monetary Policy Rate Under Central and High-Inflation Scenarios

Source: NBG.

The low-inflation scenario, relative to the central, envisions a rapid de-escalation of geopolitical tensions in the Middle East and a strong pass-through of lower international oil prices to the domestic market. Moreover, the scenario envisions the maintenance of high productivity growth.

Low-Inflation Risks
◦ Amid a rapid de-escalation of the ongoing conflict in the Middle East and excess supply, a strong pass-through of lower oil prices on international commodity markets to the domestic market. ◦ Reallocation of global supply chains and the growing role of Georgia as the Middle Corridor country. ◦ Amid the slow normalization in the growth of highly productive sectors and improved investment confidence, maintenance of productivity at a relatively high level.

Indicators of risk realization	**Impact on inflation**
Low prices of petroleum products in the domestic market.	↓
The sustained high potential economic growth.	↓
The maintenance of a low domestic sovereign risk premium.	↓
Amid strong external inflows, the maintenance of an improved current account balance.	↓

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.

2.4. LOW-INFLATION SCENARIO

The Low-Inflation Scenario is as relevant as the central and high-inflation scenarios. It envisions the materialization of relevant risks that are less inflationary compared to the central scenario (see Table 2.4.1). Particularly, this scenario assumes a rapid de-escalation of the ongoing geopolitical tensions in the Middle East and a strong pass-through of lower oil prices in international commodity markets to the domestic market. Moreover, productivity is expected to remain at a relatively high level, which, in turn, will reduce capacity utilization and exert downward pressure on inflation. Furthermore, compared to the central scenario, the current account deficit will improve, which will also support the Georgian Lari exchange rate.

A rapid de-escalation of the conflict in the Middle East will contribute to the normalization of geopolitical risks, and the resulting improvement in investment sentiment will have a positive effect on the domestic economic potential. Additionally, in recent years the acceleration in the potential economic growth rate has also been supported by ongoing structural changes in Georgia. The low-inflation scenario assumes that even under the de-escalation of the Middle East conflict, the accelerated global trade diversification process will be maintained. As a result, the realignment and regionalization of supply chains will further strengthen Georgia's role as a Middle Corridor country, additionally boosting the international transportation flows. Accordingly, highly productive sectors including transportation and storage, will remain the primary drivers of economic activity and its potential growth. This will also be supported by the information and communication sector, partly reflecting the active process of integrating artificial intelligence. Eventually, under this scenario, **real GDP growth is projected to average 7% in 2026. Meanwhile, strengthened macroeconomic fundamentals lead to a revision of long-term potential growth to 5.5 percent, and economic growth in 2027 will stabilize around this level (see Figure 2.4.1).**

The economic growth driven by improvements in potential output **will mitigate the inflationary pressures** stemming from strong aggregate demand. However, under the low-inflation scenario, assumptions regarding international **commodity markets** remain a significant driver of inflation dynamics. In particular, this scenario envisages a rapid de-escalation of the ongoing conflict in the Middle East and a strong pass-through of lower oil prices, partly driven by excess supply, to domestic petroleum prices, putting downward pressure on inflation and its expectations.

Meanwhile, a rapid normalization of the geopo-

Under the low-inflation scenario, amid rising external inflows and sustained strong fundamental factors, real GDP growth will remain at a higher level compared to the central scenario, averaging 7.0% and 5.5%, in 2026 and 2027, respectively.

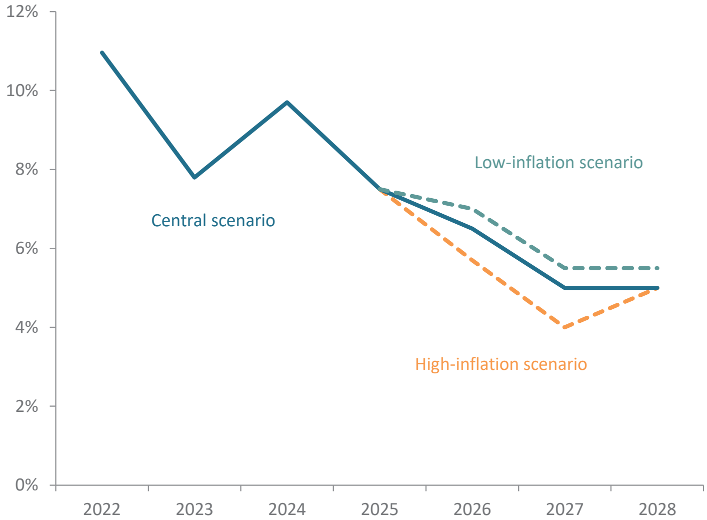


Figure 2.4.1. Real GDP Growth Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG, Geostat.

Amid the prolonged maintenance of high productivity and a strong pass-through of lower international oil prices to the domestic market, inflation will average 4.9% in 2026 and 1.6% in 2027, before eventually stabilizing around its target.

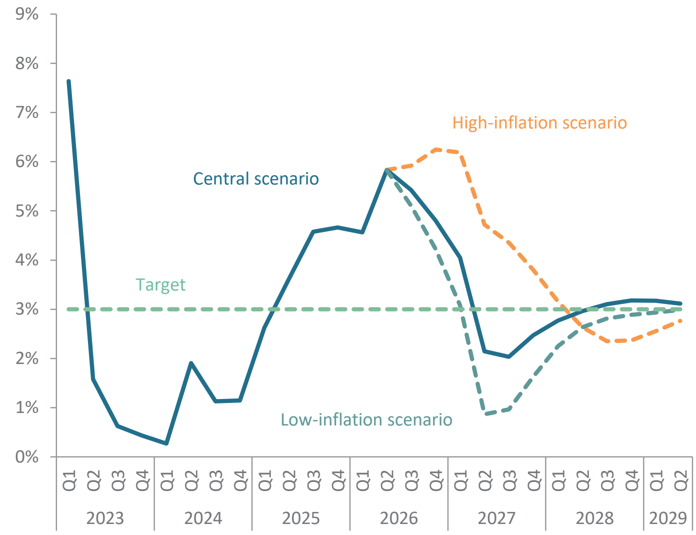


Figure 2.4.2. Year-over-year Headline Inflation Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG, Geostat.

litical tensions and the maintenance of Georgia's sovereign risk premium at a low level, will support stronger external inflows. In particular, increased services exports (including tourism and transportation), alongside less import-intensive economic growth, will have a positive impact on the current account balance and contribute to the exchange rate appreciation. This will be further reinforced by the normalization of demand for safe-haven assets amid easing turbulence, and accelerated de-dollarization tendency. All the aforementioned, ultimately, will significantly reduce headline inflation through the **imported inflation** channel. Meanwhile, as a result of strong productivity growth and reduced inflation expectations, unit labor costs will remain at a low level, further reducing domestic inflation. Thus, under the realization of this scenario, **headline inflation, compared to the central scenario, will decline already in the current period and average 4.9% in 2026. While, the average annual rate in 2027 will be 1.6%** (see Figure 2.4.2).

Amid fading inflationary risks and the maintenance of strong fundamental factors, monetary policy normalization will proceed at a faster pace compared to the central scenario. Particularly, the full pass-through of lower international oil prices to domestic fuel prices, as well as, strong productivity growth, will generate significant disinflationary effects, and alongside an exchange rate appreciation, will reduce inflation expectations. Accordingly, **the monetary policy rate is projected to be on average 0.25 pp lower in 2026 compared to the central scenario and stabilize around its long-term neutral level of 7% in 2027** (see Figure 2.4.3).

Amid stronger disinflationary dynamics compared to the central scenario, monetary policy will normalize at a faster pace.

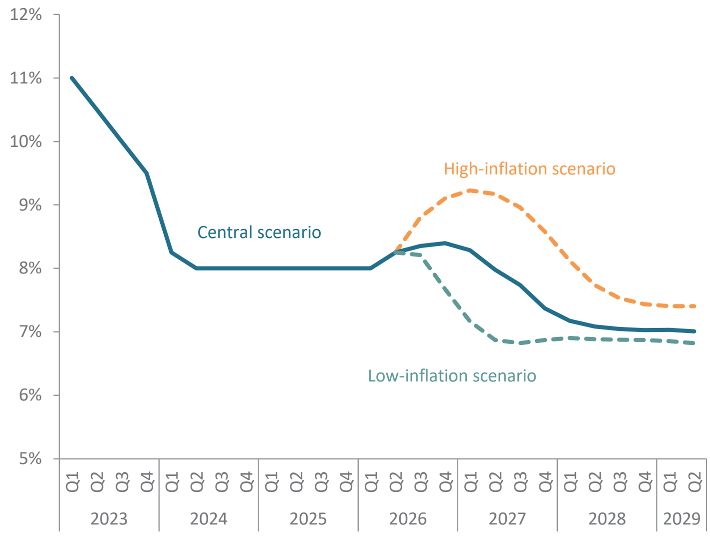


Figure 2.4.3. Monetary Policy Rate Under Central, High-Inflation, and Low-Inflation Scenarios

Source: NBG.

3. SPECIAL TOPICS

BOX 1. 2022-2026 GEOPOLITICAL SHOCKS: FINANCIAL CHANNEL AND TRANSMISSION TO GEORGIA

The 2026 Middle East conflict, similar to Russia's invasion of Ukraine in 2022, generated a significant adverse supply shock to the global economy. Both episodes were accompanied by sharp increases in energy prices, disruptions to global supply chains, and a deterioration in the terms of trade. Despite the broadly similar nature of these shocks, their impact on financial markets differed markedly, primarily due to their different initial macroeconomic and financial conditions.

The 2022 shock unfolded against a backdrop of already elevated inflationary pressures and strong pent-up demand following the pandemic. Consequently, major central banks embarked on a rapid monetary policy tightening cycle, resulting in a sharp rise in the cost of dollar funding, a broad tightening of global financial conditions, and significant capital outflows from emerging market economies as investors shifted toward safer assets (flight-to-quality). Consequently, beyond its inflationary effects, the 2022 geopolitical shock significantly amplified the transmission of the shock through the financial channel[2].

By contrast, When the Middle East conflict erupted in 2026, the major monetary policy tightening cycle had largely run its course, and several economies, including the major advanced economies, had already begun the process of policy normalization. However, policy rates remained significantly higher than at the beginning of 2022 (see Figure 3.1.1). Against this backdrop, the conflict heightened global uncertainty but has, so far, not triggered the broad-based tightening of financial conditions for emerging market economies observed in 2022. It is important to note, however, that only one quarter has elapsed since the onset of the conflict, and its full macro-financial implications are still unfolding and remain subject to ongoing assessment.

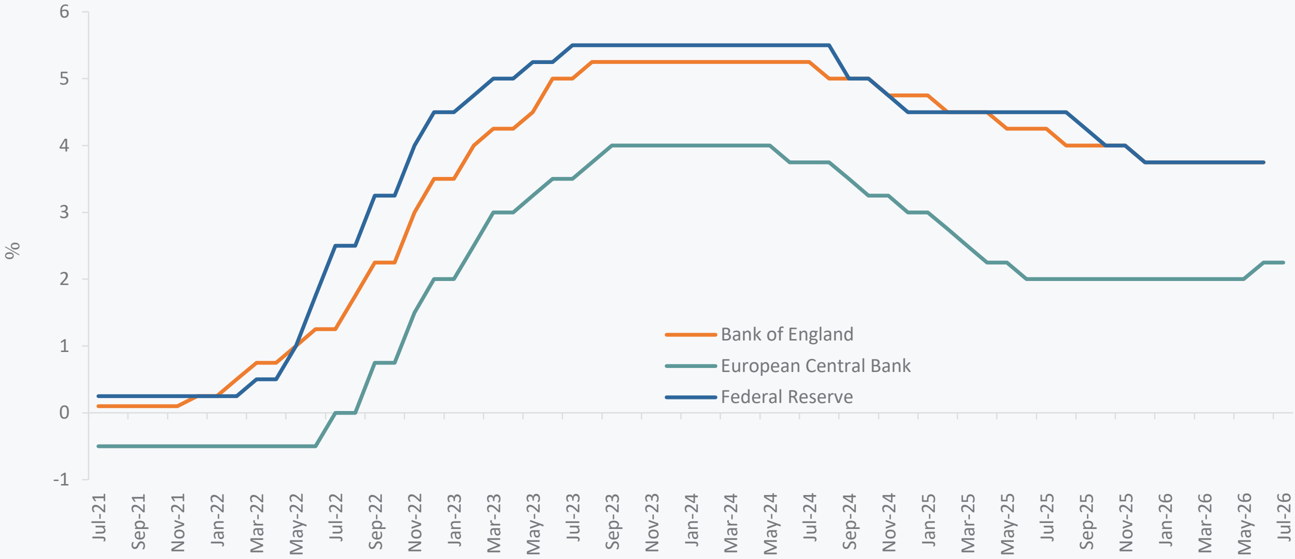


Figure 3.1.1. Monetary Policy Rates.

Source: Relevant central banks.

The divergent response of financial markets across the two episodes largely reflects the different initial macroeconomic and financial conditions prevailing in emerging market economies. While some economies entered the current shock with stronger external positions, lower external vulnerabilities, higher real yields, and improved macroeconomic fundamentals, structural weaknesses remained pronounced in others. As a result, investors' decisions in the current episode were determined more by the country-specific fundamental and to a lesser extent by the increase in geopolitical risk alone.

These differences were also reflected in international capital flows. Specifically, the escalation of geopolitical tensions in March 2026 triggered a temporary but sizeable net outflow of portfolio capital from emerging market economies. However, according to the Institute of International Finance (IIF)[3], capital flows rebounded significantly as early as April. Thereafter, capital flow dynamics became increasingly differentiated across countries: inflows stabilized in economies with relatively strong macroeconomic fundamentals, while structurally

2 *These developments are discussed in detail in the International Monetary Fund's 2022 Global Financial Stability Report. See. https://www.imf.org/-/media/files/publications/gfsr/2022/october/english/text.pdf*
3 *See. https://www.iif.com/Products/Capital-Flows-Tracker*

more vulnerable economies continued to experience sustained capital outflows.

This pattern is also corroborated by financial market indicators. Despite the sharp decline observed in March, the MSCI Emerging Markets Stock Index resumed its upward trajectory during the current period, while sovereign bond spreads in emerging economies (EMBI Global Diversified Index), despite an initial increase, have returned to pre-conflict levels (see Figure 3.1.2–3.1.3). Accordingly, there is no sign of a large-scale repricing of emerging market risk at this stage.

Figure 3.1.2: MSCI Emerging Market Stock Index, Dec-1987=100

Source: MSCI.

Figure 3.1.3: EMBI Global Diversified Index, Jan-2022=100

Source: NBG calculation.

This pattern of financial market behavior partly reflects structural changes in the international financial system. Whereas international banks played a dominant role in financing emerging economies prior to the 2008 global financial crisis (GFC), non-bank financial institutions (NBFIs) - particularly portfolio investors - have since become increasingly important providers of cross-border financing (see Figure 3.1.4). According to the IMF and the BIS, in such conditions, international capital flows have become increasingly sensitive not only to country-specific macroeconomic fundamentals but also to the type of specific investor and its tolerance for risk. As a result, capital flows are no longer uniform even in conditions of global uncertainty. The IMF describes this phenomenon as "K-shape investing," reflecting the increasingly divergent performance of different categories of capital flows and asset classes. In particular, portfolio debt inflows to emerging market economies have remained relatively resilient, whereas the recovery in foreign direct investment (FDI) and portfolio equity flows has been more subdued. Within portfolio debt flows, investor demand has remained robust and has been concentrated primarily in bond instruments, supported by relatively attractive yields.

At the same time, the traditional behavior of safe-haven assets has also partially changed during the current episode. Despite heightened geopolitical tensions, long-term US government bonds (10- and 30-year) yields increased rather than declined (see Figure 3.1.5). This appears to reflect, to a significant extent, rising concerns over fiscal sustainability, a higher term premium, and persistently elevated real interest rates. Consequently, financial market dynamics are increasingly being shaped by fiscal and structural factors in advanced economies, partially reducing the extent to which geopolitical shocks alone drive capital flows to and from emerging market economies.

From a monetary policy perspective, these developments carry two important implications. First, the transmission of geopolitical shocks through financial channels now depends more on the country-specific macroeconomic fundamentals and the policy credibility rather than on the rise in global risk alone. Second, strong external positions, low sovereign risk premium, and credible monetary policy substantially reduce the likelihood that a geopolitical shock will evolve into a systemic financial stability risk. As a result, the inflationary impact transmitted through capital outflows channel (exchange rate) is likely to be more limited.

It is noteworthy that the geopolitical shock of 2026 did not result in large-scale capital outflows from Georgia. Against the backdrop of a more differentiated allocation of capital by global investors and the country's improved macroeconomic fundamentals, Georgia's sovereign risk premium remained low (see Chapter 2, Figure 2.1.11), while the non-residents' interest in domestic treasury securities remained high (see Figure 3.1.6).

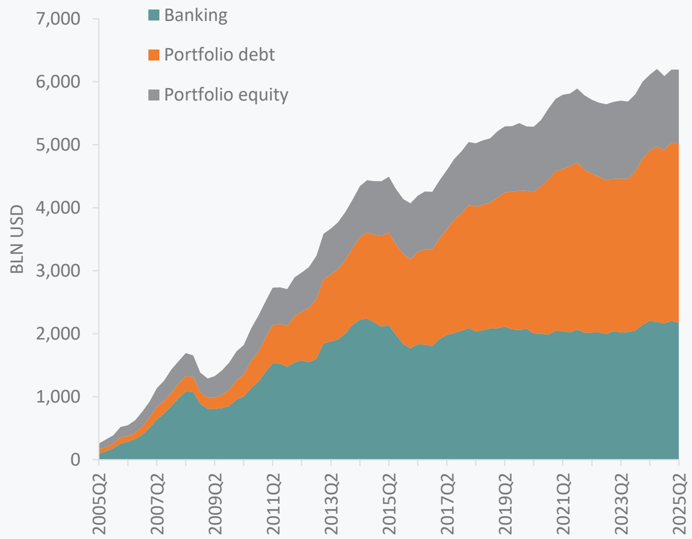


Figure 3.1.4: Cross-Border Investment by Nonbank Financial Investors in Emerging Markets

Source: IMF, Global Financial Stability Report 2026.

Figure 3.1.5: 10 and 30-year US government bonds yields

Source: Fred.

This pattern is consistent with the IMF's "K-shaped" investment behavior, whereby periods of heightened uncertainty lead investors to become more selective, allocating capital toward economies with stronger fundamentals and more favorable risk-return profiles. In this environment, sovereign credit ratings assigned by the major international rating agencies become an increasingly important signal of creditworthiness, influencing investors' portfolio allocation decisions. In Georgia's case, the reaffirmation of its sovereign credit rating following the outbreak of the 2026 conflict helped strengthen investor confidence and mitigate the risk of capital outflows.

The relatively stable dynamics of financial flows have also contributed to the resilience of the external sector. Notably, since 2022, the current account balance has improved significantly, reflecting migration-related inflows and subsequent structural changes in the economy (see Chapter 2, Figure 2.1.7). As a result, the exchange rate - which amplified imported inflation during the pandemic - has continued to serve as a shock absorber in the current episode, albeit with a disinflationary effect. In particular, the strengthening of both the actual and equilibrium levels of the real effective exchange rate slows down imported inflation (see Figure 3.1.7). At the same time, the accumulation of international reserves (see Chapter 2, Figure 2.1.12), together with improvements in reserve adequacy indicators serve as a buffer for the country's external liquidity and further reduce its vulnerability to external shocks.

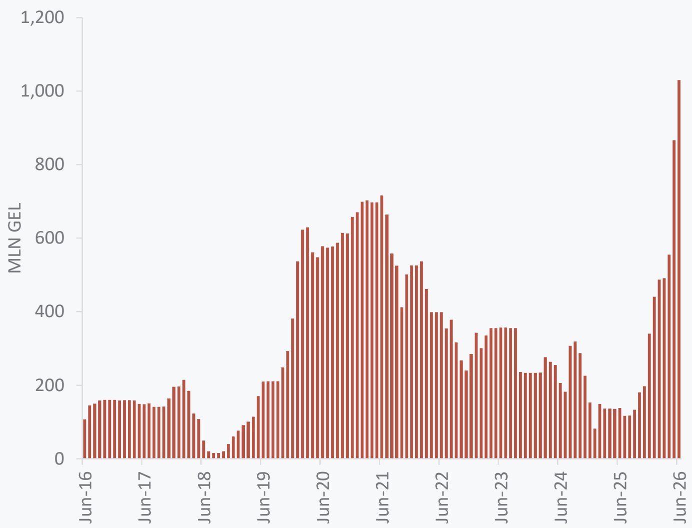


Figure: 3.1.6 Treasury securities held by non-residents

Source: NBG.

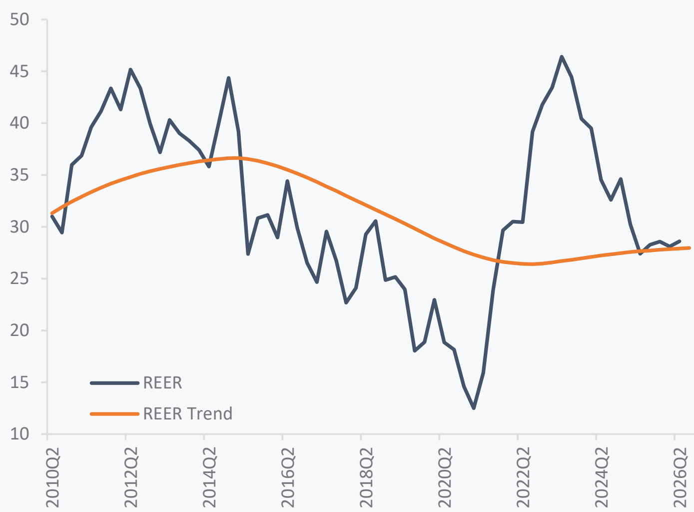


Figure: 3.1.7 REER and its trend

Source: NBG's Estimation.

From an inflation perspective, both geopolitical shocks were accompanied by increases in energy and other commodity prices, leading to an acceleration in flexible price inflation in Georgia. However, when Russia's invasion of Ukraine began in 2022, Georgia was already experiencing relatively elevated underlying inflationary pressures, including higher sticky-price and services inflation, which significantly increased the risk of second-round effects. By contrast, at the onset of the 2026 Middle East conflict, underlying inflationary pressures were more subdued. Nevertheless, should elevated flexible price inflation prove more persistent, the risk of second-round effects warrants close attention.

Overall, compared with the 2022-2023 episode, the current geopolitical shock is being transmitted to the Georgian economy primarily through inflationary channels, while spillovers through financial channels have so far remained relatively limited. Nevertheless, as the conflict remains ongoing, its ultimate macroeconomic and financial implications will depend critically on how the geopolitical situation evolves.

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			High-Inflation Scenario			Low-Inflation Scenario		
	2025	2026	2027	2028	2026	2027	2028	2026	2027	2028
Inflation (%)	3.9	5.2	2.7	3.0	5.6	4.8	2.6	4.9	1.6	2.6
Real GDP Growth (%)	7.5	6.5	5.0	5.0	5.7	4.0	5.0	7.0	5.5	5.5
Monetary Policy Rate (%)	8.0	8.2	7.8	7.1	8.5	9.0	7.7	8.0	6.9	6.9

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

Source: NBG, financial market participants, Geostat.

* The table reports annual averages for the variables.

FORECASTS OF FINANCIAL MARKET PARTICIPANTS

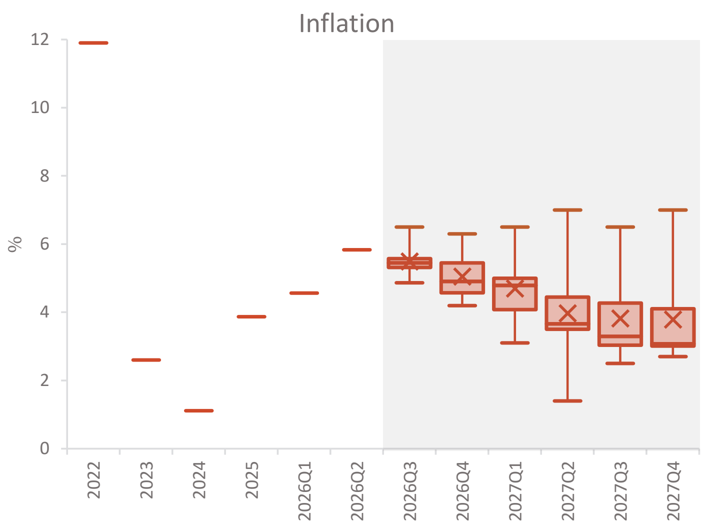


Figure 4.1. Actual average inflation and the distribution of market participants' forecasts

Source: NBG, financial market participants, Geostat.

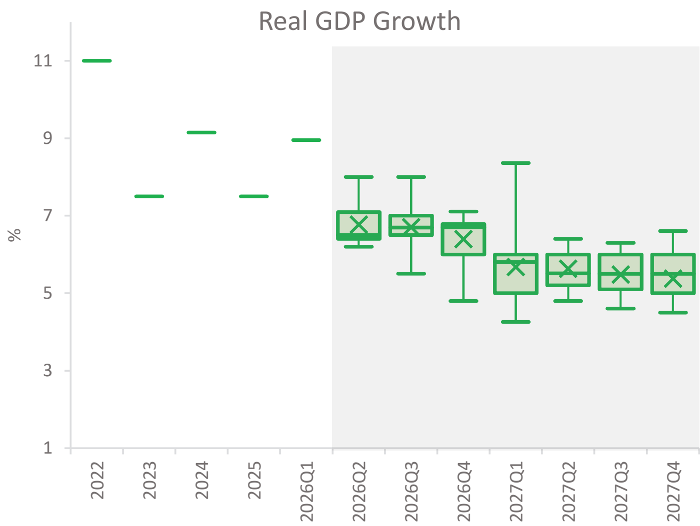


Figure 4.2. Actual real GDP growth and the distribution of market participants' forecasts

Source: NBG, financial market participants, Geostat.

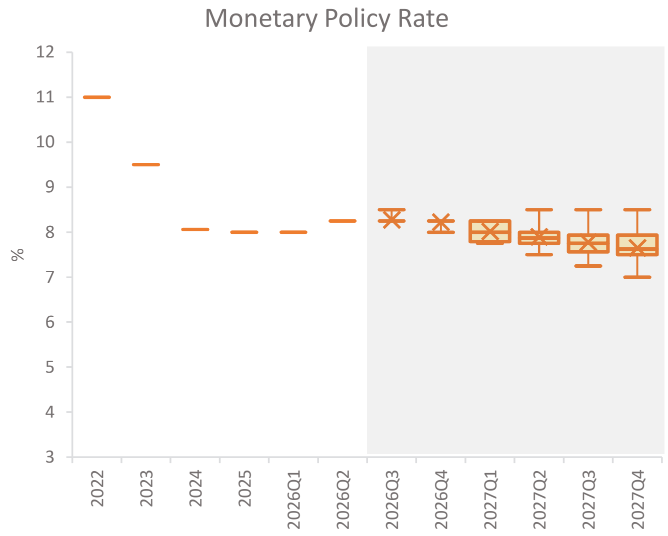


Figure 4.3. Actual monetary policy rate and the distribution of market participants' forecasts

Source: NBG, financial market participants.

1, Zviad Gamsakhurdia Embankment, Tbilisi 0114, Georgia
Tel.: (995 32) 240 6480; Fax: (995 32) 240 6571; Hot line: (995 32) 240 6406
E-mail: info@nbg.ge; www.nbg.ge

საქართველოს ეროვნული ბანკი
National Bank of Georgia