BOX 1. GLOBAL ECONOMIC RISKS AND SPILLOVER TO GEORGIA

The global economy is currently navigating a landscape marked by significant uncertainty and risks. The latest IMF World Economic Outlook report projects global growth of 3.2% in 2024 and 3.2% in 2025; however, the underlying economic uncertainties remain substantial. Developments in key economies such as the United States, the EU, and China could lead to weaker-than-expected growth. Moreover, given rising geopolitical tensions, there is significant uncertainty surrounding supply chains and price dynamics in international markets. Since the United States, the EU, and China accounted for nearly half of global GDP as of 2023, the challenges these economies face may have considerable direct and indirect effects on the global economy and, consequently, on Georgia.

Table 1.1, below, illustrates a taxonomy of risks from the global economy and their impact on Georgia:

Potential Risks	Major Channels of Impact	Potential Impact on the Global Economy	Potential Impact on Georgia
Rising Escalation in the Middle East	Commodity Prices	A disruption in oil supply could put upward pressure on global oil prices, elevating inflationary risks.	Increased oil prices could put upward pressure on imported inflation in Georgia. Meanwhile, Georgia's oil-exporting trading partners could receive higher revenues, thereby positively influencing external demand.
Prolonged Weakness in the Chinese Economy	Trade Linkages	Decline in Chinese demand for imports from its key trading partners (e.g., the EU and the US), could lead to a reduction in global export demand.	Decreased demand for metals and ferroalloys, key exports from Georgia to China, could affect Georgia's GDP and current account deficit.
	Commodity Prices	A decrease in demand from China could lower global oil prices, affecting oil exporters globally.	Lower oil prices will translate into diminished imported inflation in Georgia. However, lower oil prices could reduce revenues for oil-exporting countries, including Georgia's trading partners, thereby impacting Georgia's external demand.
	Financial Linkages	Corrections in global equity markets and the potential impact on US Treasury markets if confidence declines. Additionally, there would be an initial global appreciation of the US dollar due to risk averse behavior.	Rising borrowing costs and potentially reduced access to international credit for Georgian financial institutions due to an increasing sovereign risk premium.
	Global Sentiment	Possible recessionary pressures and a deterioration of sentiment in the global economy if China faces prolonged stagnation.	A potential decrease in external demand for Georgia could weigh on aggregate demand.
Subdued growth in the EU	Trade Linkages	A decline in the EU's demand for imports from its trading partners (e.g., the US and China), potentially leading to a reduction in global demand for exports, resulting in a domino effect.	With the EU being a key trading partner, Georgia would likely experience weaker external demand.
	Commodity Prices	Prolonged periods of subdued growth in the EU could exert downward pressure on commodity prices due to diminished consumption.	A fall in imported commodity prices (all else being equal).

Table 1.1. Taxonomy of the most pronounced global risks from current perspectives

Source: NBG

One major factor contributing to these uncertainties, which is intertwined with other risks and further exacerbates them, is the potential slowdown of the Chinese economy. While a full recession in China is unlikely, the prospect of an economic deceleration poses a significant threat to global economic growth. As the world's second-largest economy, China plays a crucial role in global supply chains and commodity markets. China contributes 18% of global GDP and accounts for 15% of global oil consumption, underscoring its considerable influence on commodity prices and the broader global economy. Recently, China's economy has faced considerable strain due to structural challenges in the property market, sluggish consumer confidence, and the need to balance growth with managing financial risks. Although the recent monetary policy measures initiated by the People's Bank of China have restored some stability in Chinese equity markets, underlying vulnerabilities persist as the current measures are part of a broader effort to stabilize the markets rather than provide a long-term solution. Therefore, a weaker Chinese economy could reduce demand for goods and commodities, leading to potential disruptions in global trade and elevated uncertainties.

China's manufacturing sector is a key consumer of commodities. Therefore, if we consider a scenario under which the Chinese economy continues to weaken, reduced demand on these goods will put downward pressure on global commodity prices. This, in turn, could have a disinflationary impact on Georgia through a decline in imported inflation.

It should also be noted that uncertainty around oil prices is increasing due to rising geopolitical tensions, including the escalation of the Iran-Israel conflict. Such developments could disrupt supply chains and drive oil prices higher, ultimately increasing imported inflation in Georgia and exerting upward pressure on overall inflation.

A potential slowdown in China could also impact the Georgian economy through trade linkages. China's role in Georgian trade has been increasing, with Georgia exporting 5% of its foreign-bound total goods to China in 2023. Notably, mineral products, particularly metals and ferroalloys, make up 77% of these exports, with 33% of Georgia's total mineral products sent to China, a significant part of them being imported. Thus, a decline in Chinese manufacturing demand could somewhat reduce demand for Georgian goods and services.

Although Georgia's direct trade exposure to China is relatively low, indirect trade linkages could magnify the effects of economic disruptions. A slowdown in China would likely reduce demand for imports from major economies like the US and the EU. Additionally, as has been noted, a Chinese economic downturn could lead to lower oil prices, further squeezing the revenues of oil-exporting countries and exacerbating the global slowdown of growth. This could trigger a domino effect, weakening global trade, particularly in the EU, where 8.8% of exports are destined for China. Consequently, reduced global economic growth would likely dampen external demand for Georgian goods and services, posing further challenges to Georgia's economic growth. Weaker external demand for both goods and services could also worsen the current account balance, potentially leading to exchange rate depreciation, and partially offsetting the decline in imported inflation.

Financial contagion from China also poses significant risks. Given its roles as a significant holder of US Treasury securities and a key global investor, any crisis in China's financial sector is likely to impact international markets. Should liquidity issues arise at Chinese banks, particularly state-owned ones, these could disrupt credit flows and potentially weaken investor confidence, increasing the likelihood of substantial corrections in equity markets.

These concerns are further compounded by broader economic vulnerabilities, such as the ongoing stagnation in Europe, recent fluctuations in equity markets, and uncertainties related to US fiscal policy. A shock from China could exacerbate these existing weaknesses, likely triggering a ripple effect across global markets that may affect both developed and emerging economies.

Last but not least, Georgia has benefited from structural changes to its economy, with exports of services (especially in international transportation) generating substantial revenues due to the promotion of Georgia's strategic role in the Middle Corridor, a key trade route connecting China to Europe. Therefore, a weakening of the Chinese economy and a reduction in the transit of Chinese goods through Georgia could undermine Georgia's position in this vital trade network, ultimately negatively impacting economic growth.