transportation, information and communications, accommodation services, food delivery, as well as growth in arts, entertainment, and recreation, which collectively contributed 3.9 pp to the overall growth. From industry, the construction sector exhibited significant growth of 13.0%, contributing 0.9 pp to GDP growth.

BOX 2. HIGHER GROWTH OF REAL INCOME DRIVES STRONGER CONSUMPTION

Since the beginning of 2024, stronger-than-expected economic growth has been observed in Georgia. Based on incoming data, the primary driver of GDP growth from the expenditure side has been consumption, which increased by 22% in real terms during the first half of the year. The acceleration of households' real income and wage growth that occurred in 2023, which was the highest in recent years, had a significant role in this development, as real wages grew by 24% and overall real household income increased by 18% (see Figure 1.3.3). Additionally, low inflation this year has had a positive impact on real incomes. The improvement in households' financial conditions has driven the increase in consumer spending in 2024.

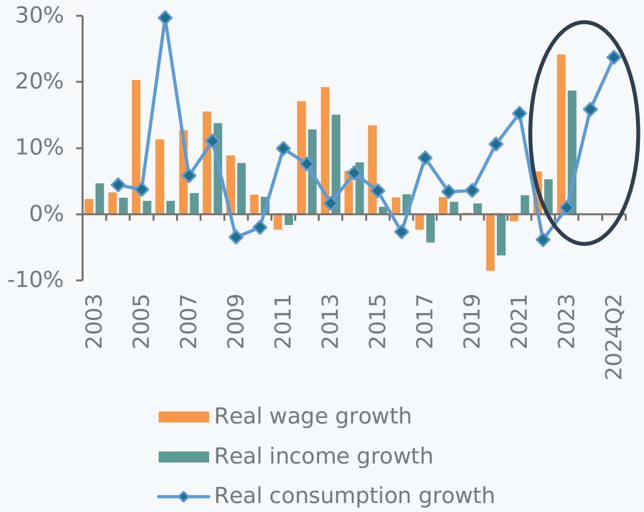

Figure 1.3.3. Households' real wage and income growth.

Source: GeoStat

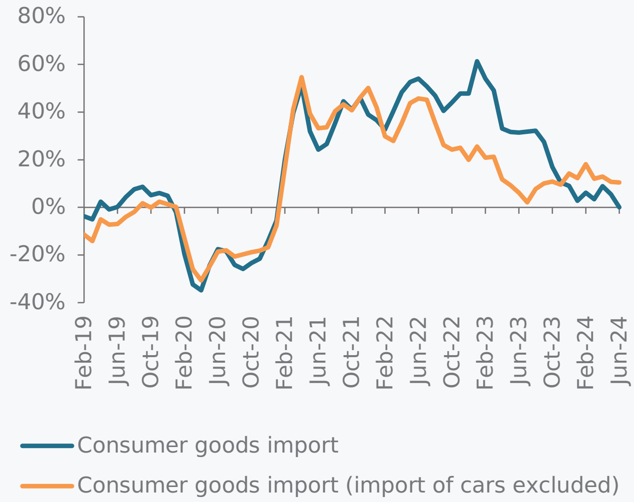

Figure 1.3.4. Nominal imports growth in USD.

Source: GeoStat

An increase in consumer spending, ceteris paribus, typically leads to higher imports and a worsening of the current account balance. However, a positive dynamic is noticeable in this regard too, with the growth in imports, including of consumer goods, remaining low (see Figure 1.3.4). It is important to consider that a slowdown in the import of certain products intended for re-export has also contributed to the overall deceleration of imports. For example, excluding imports of vehicles, the annual growth rate of consumer goods imports has been quite strong over recent months, fluctuating at around 10%. The moderate growth in imports has also been driven by price stability in certain commodity products, particularly food prices. While consumption is growing, investment remains weak. However, it should be noted that the decline of investments in the first half of the year was mainly driven by a sharp decline in inventories, whereas investments in fixed capital have been steadily increasing (see Figure 1.3.5).

The decline in inventories may also explain the relatively weak growth in imports against the backdrop of strong consumption. It is likely that firms are utilizing the inventories accumulated in previous periods to meet currently strong consumption, resulting in a relatively modest growth in imports and stability in the current account. Moreover, it is possible that the increased consumption is more directed toward services rather than goods, reflecting a growing trend in demand for services in the post-pandemic period. During the pandemic, disruptions in service provision led to higher spending on goods; however, as is shown in Figure 1.3.6, there has been a marked increase in household expenditures on services in the post-pandemic period. Although spending on services has yet to reach pre-pandemic levels, it is expected that this trend will continue in the future.

Additionally, the role of commodity products is noteworthy, as the increase in their prices—as driven by the pandemic and then the Russia-Ukraine war—has contributed to shifts in global spending patterns. Currently, the stability of commodity prices supports an increased share of services in consumer expenditures.

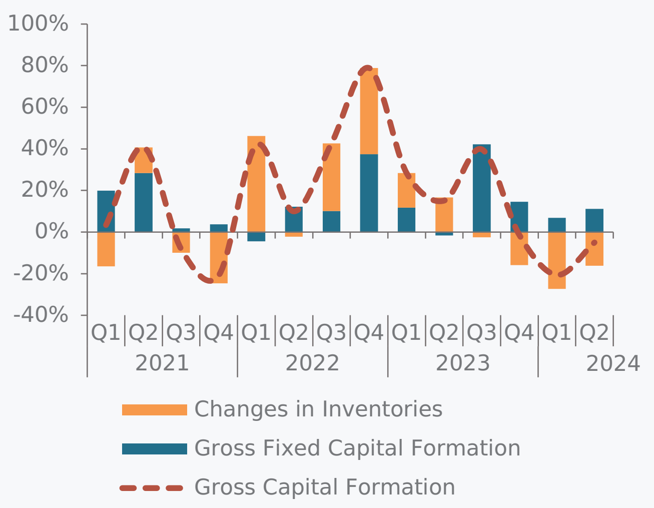

Figure 1.3.5. Growth decomposition of gross nominal capital formation.

Source: GeoStat

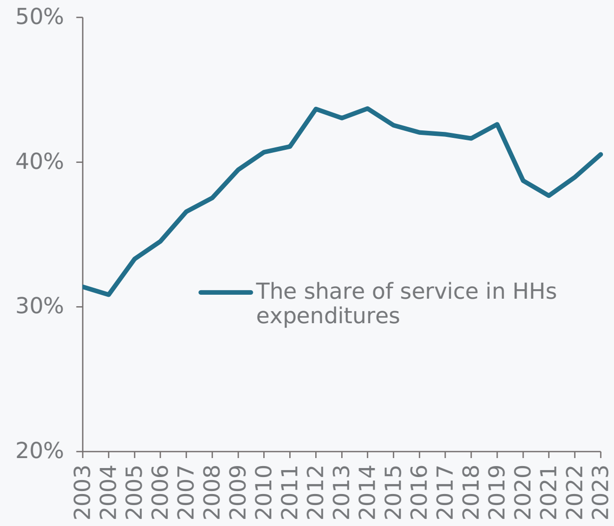

Figure 1.3.6. The share of services in households' expenditure.

Source: GeoStat

In summary, the increase in real wages and incomes last year has supported strong consumption, which in turn influences economic growth. Against this backdrop, the relative weakness in consumer goods imports can be explained by a decrease in specific components of imports unrelated to local consumption and an increased reliance on inventories (which could lead to increased imports in the future under similar conditions). Furthermore, an increase in demand for services has been observed globally in the post-pandemic period, and is also evident in the local economy. However, in this context, it is important to note that the inflation rate for services, while low, remains relatively high compared to headline inflation.

1.4 FINANCIAL MARKET AND TRENDS

1.4.1 LOANS

Credit activity is robust and stimulates overall demand in the economy. Following the NBG's decision to reduce the monetary policy rate, lending accelerated to 18.6%, marking an increase of 5.8pp.

Following the normalization of monetary policy, credit activity has strengthened and is stimulating overall demand in the economy. In August 2024, lending increased by 18.6% (excluding the exchange rate effect). Since the NBG began reducing the monetary policy rate in May 2023, lending has accelerated by 5.8 pp (see Figure 1.4.1). The rise in business loans made a significant contribution to credit activity. Alongside the normalization of monetary policy, the NBG's increase in the maximum maturity for unsecured consumer loans has also stimulated lari-denominated consumer lending, further boosting total credit (see Figure 1.4.1). However, it should be noted that the impact of this change in the maximum maturity for consumer loans on overall lending is gradually diminishing due to base effects. The growth rate of consumer loans thus moderated in August.

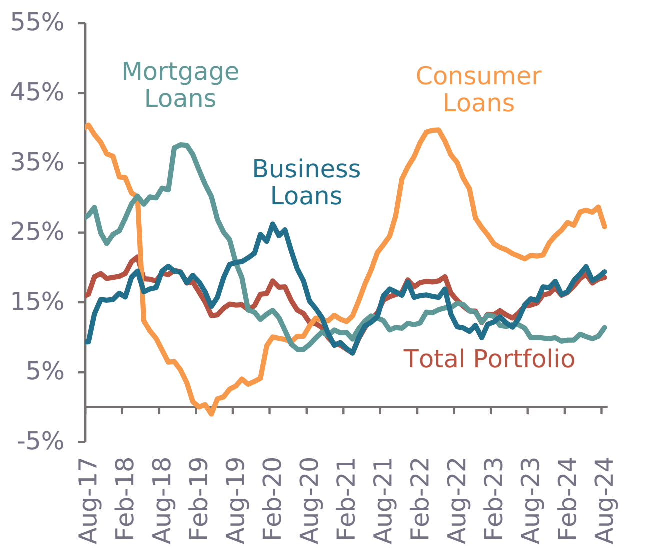

Figure 1.4.1. Annual growth of loans by purposes (excluding the exchange rate effect)

Source: NBG

As a result of the policies implemented by the NBG, domestic currency lending is on the rise, while foreign currency lending has slowed compared to the previous year (see Figure 1.4.2). Specifically, since the beginning of the year, lending in foreign currency to individuals has been declining, facilitated by an increase in the limit for unhedged foreign currency loans to GEL