

3. SPECIAL TOPICS

BOX 1. THE IMPACT OF THE ONGOING MIDDLE EAST CONFLICT ON GEORGIA'S ECONOMY

The ongoing conflict in the Middle East represents another severe global supply-side shock, increasing stagflationary risks. Its impact has already been reflected in international commodity prices (particularly energy resources, food, and fertilizers) as well as in financial markets. A particularly important risk factor is the blockade of the Strait of Hormuz, through which roughly one-third of the world's oil and fertilizer supplies, along with significant volumes of liquefied natural gas (LNG), are transported. Consequently, any disruption to this route would place substantial upward pressure on international commodity prices (see Chapter 1). At the same time, a closure of the Strait of Hormuz would heighten the risks of supply-chain disruptions and consequently, increase transportation costs. Notably, the impact of this shock is asymmetric across global economies; however, rising energy prices generate inflationary pressures worldwide.

Georgia is a small open economy and, therefore, remains vulnerable to external shocks. Consequently, it is important to assess both the direct and indirect transmission effects of the current shock on the Georgian economy. The assessment presented in this box is based on the central scenario assumption that the ongoing conflict will end in the second quarter. However, the overall economic impact of the war will depend significantly on its duration and intensity.

The direct impact of the war on Georgia's net external balance, through goods trade, tourism, and remittances, is moderate, reflecting the relatively small share of the Middle East in Georgia's overall trade structure. However, the war has led to a significant increase in international commodity prices, which has notably affected the domestic market. At the same time, heightened riskiness has resulted in tighter financial conditions globally, which are also being transmitted to the domestic financial market. In general, during periods of crisis, demand for safe-haven assets increases. This was reflected in the initial appreciation of the U.S. dollar at the onset of the war, which in turn created cyclical pressure on the Georgian lari (GEL) and the currencies of Georgia's main trading partners. Currently, the U.S. dollar maintains a relatively weak position, which is contributing positively to the stability of the GEL.

Among the direct transmission channels, one of the most tangible effects is observed in the tourism sector. Revenues from travel account for a significant share of the Georgian economy, amounting to 12.3% of GDP as of 2025. Against the backdrop of the conflict, restrictions on flights from Middle Eastern countries and India, together with rising airfare prices, have reduced tourist inflows, leading to a slowdown in the growth of tourism revenues (see Figure 3.1). As a result, the growth rate of travel revenues stood at 0.5% in the first quarter of 2026 (see Figure 3.1). In turn, the slowdown in tourism revenues also has a negative impact on the current account balance. Under the central scenario, if the conflict ends in the second quarter and flights from the Middle East and India gradually resume, the negative effect of travel export revenues on the current account balance during 2026 is expected to remain relatively limited (All else equal, the current account deficit-to-GDP ratio may widen by around 0.3–0.4 pp due to this effect). However, if the conflict is prolonged and airfare prices continue to rise, particularly amid higher jet fuel prices, global tourism activity

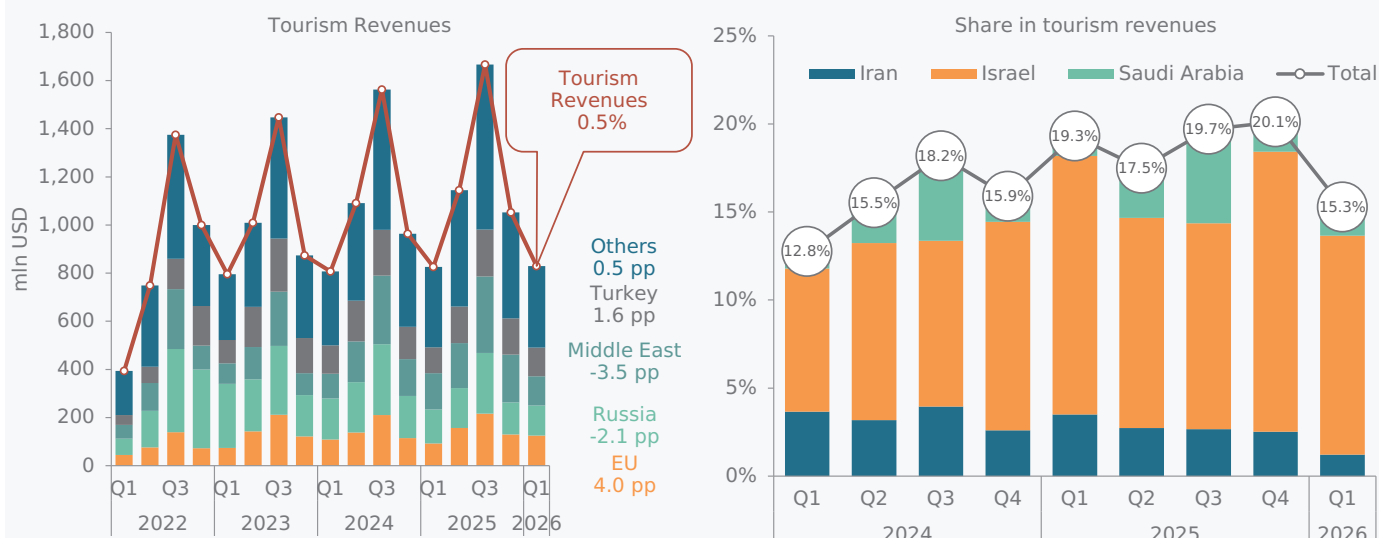


Figure 3.1. Dynamics of Tourism Revenues and the Share of Middle Eastern Countries in Total Tourism Revenues

Source: NBG, Geostat.

may weaken further. This could also slow the growth of tourism revenues from other countries. A slowdown in the tourism sector would also negatively affect related sectors, including hotels and restaurants, as well as transportation services.

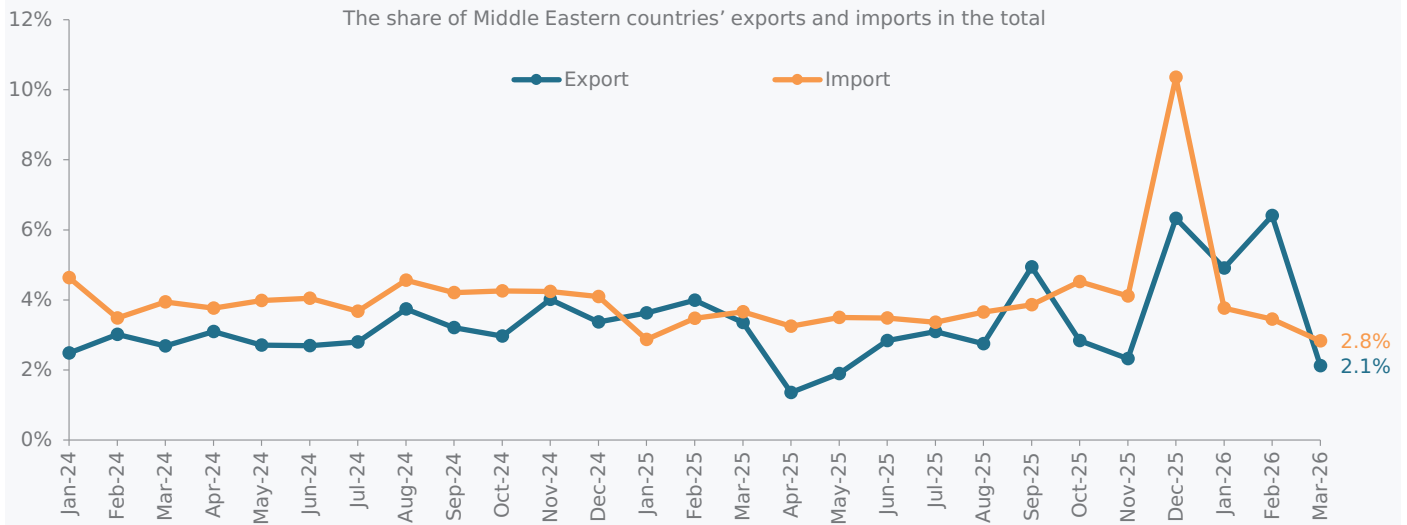


Figure 3.2. Share of Middle Eastern Countries in Total Exports and Imports.

Source: NBG, Geostat.

The effect of the Middle East war on remittances is mostly moderate and, in the short run, tends to have an upward impact. Notably, remittances from Iran are negligible for Georgia, whereas the share of Israel is significant. In the first quarter of 2026, the contribution of remittances from this region to total growth amounted to approximately 1.7 pp, which was largely explained by a 19.2% YoY increase in remittances from Israel (see Figure 3.3). Experience from previous periods suggests that at the initial stage of geopolitical shocks, remittances typically tend to increase. However, in the event of a deepening or prolonged conflict, risks rise: a slowdown in economic activity in remittance-source countries could negatively affect remittance volumes and, consequently, the current account balance. Accordingly, their dynamics are to some extent dependent on the duration and intensity of the geopolitical shock.

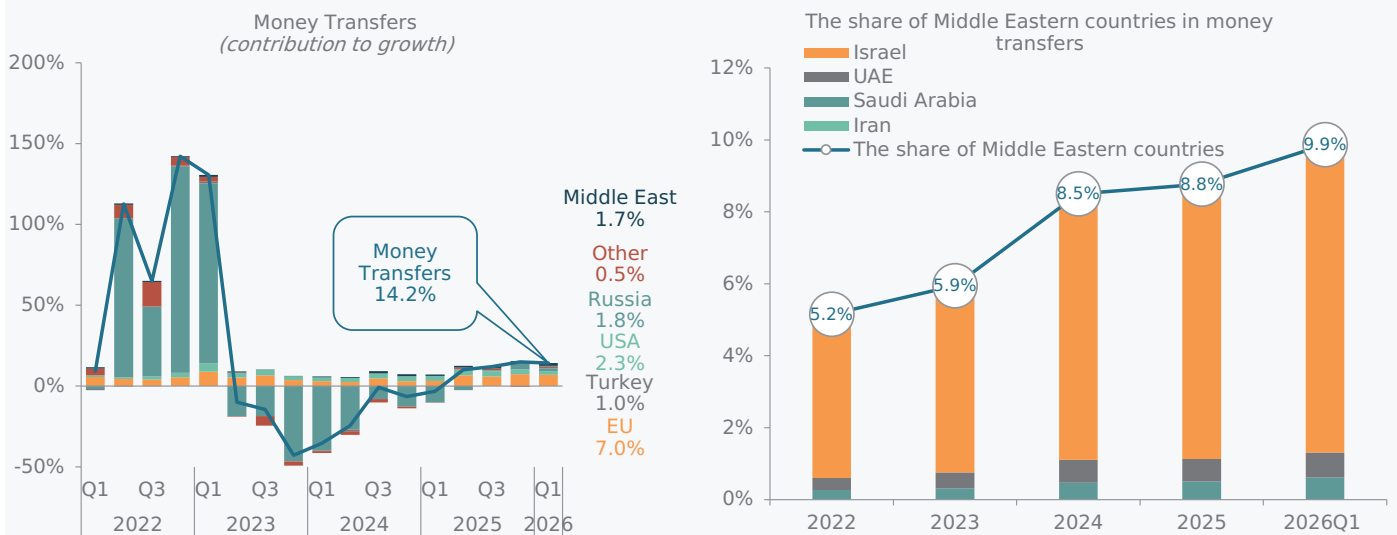


Figure 3.3. Dynamics of Remittances and the Share of Middle Eastern Countries in Total Remittances

Source: NBG, Geostat.

Ultimately, taking into account the above assumptions and transmission channels, under conditions of a relatively swift resolution of the conflict and accounting for the price effects, the additional effects on goods exports and imports and tourism revenues, would largely balance each other. As a result, the current account is expected to remain within its equilibrium level (5%). On the other hand, the impact of the net external balance on real GDP, all else being equal, would be approximately -1 pp.

Beyond the external channels discussed above, notable risks are also emerging regarding inflation. In particular, when assessing inflationary effects, the impact of this supply shock can be divided into three main

channels: direct, indirect, and second-round effects. Through the direct channel, the rise in energy prices has already been reflected in inflation dynamics (see Chapter 2.1). Specifically, the increase in Brent crude oil prices to 100 U.S. dollars per barrel is reflected in April's inflation figures (see Figure 3.4, as well as Chapter 2.1). The further rise in oil prices to 120 U.S. dollars at the end of April is expected, all else being equal, to increase inflationary pressures in the coming months.

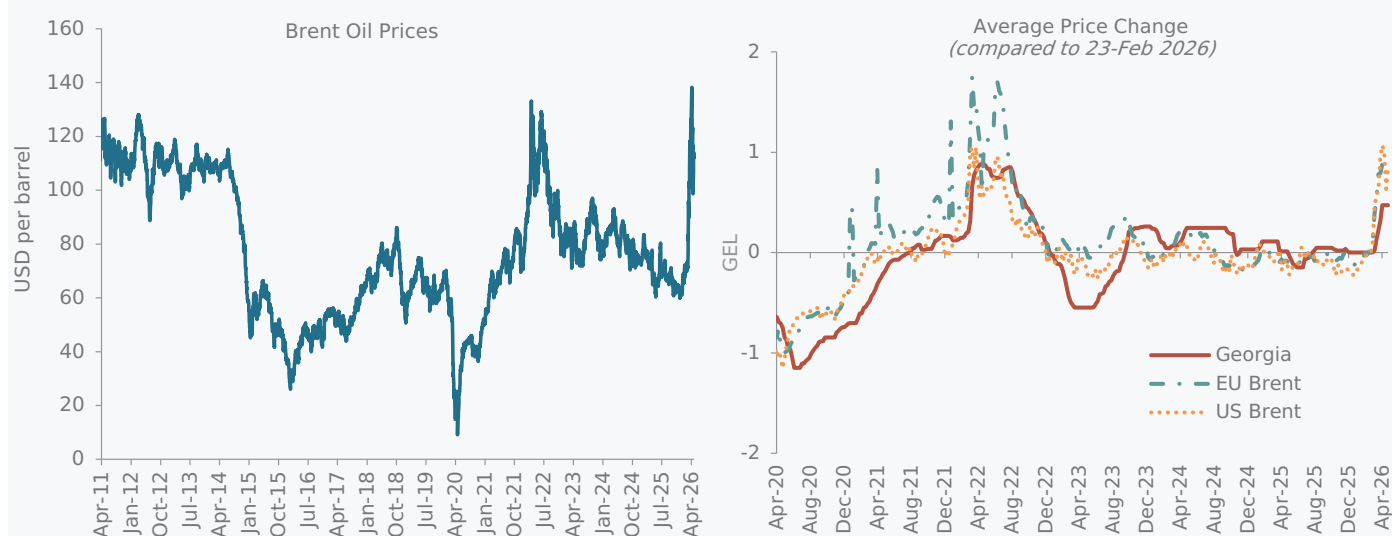


Figure 3.4. Brent Crude Oil Prices and the Fuel Price Index for Georgia

Source: FRED, NBG.

Through indirect channels, the rise in energy prices increases transportation costs and overall production costs, which are gradually transmitted to the prices of goods and services associated with fuel consumption. Higher production costs and price increases further intensify and prolong inflationary processes, including through the inertia component.

In terms of indirect effects, it should be noted that the Middle East conflict has also led to an increase in fertilizer prices, which, all else being equal, puts upward pressure on global food prices. This, in turn, strengthens the risk of higher imported inflation through the international food price channel (see Chapter 1.2).

In general, central banks typically do not respond to supply-side shocks, as their ability to influence supply conditions is limited. However, when a supply shock is strong and large-scale, the risk of so-called second-round effects increases. In particular, in an environment of rising inflation expectations, higher consumer spending can increase pressure in the labour market, which subsequently feeds into price increases for other goods and services. Accordingly, anchoring of inflation expectations becomes especially important. Therefore, when risks of second-round effects and rising inflation expectations emerge, central banks may respond to supply shocks by tightening monetary policy. The objective is to ensure that, once the impact of exogenous factors on inflation dissipates, inflation returns to its target level.