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POLICY PAPER

Georgian economy and one year of Russia's war in Ukraine: trends and risks

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ABSTRACT

Through the years, regional economic and political crises were markers for sharp economic downturns in Georgia. Being a small open economy of just 3.7 million people, with over 20% of its territory being occupied by Russia, the country typically mirrors the economic fortunes of its closest neighbors and trading partners. This time, however, the situation seems to be different. Georgian economy has not suffered as much as was initially expected, and even may have benefited from certain developments after the start of the war. However, both economic and political risks for Georgia, the region, as well as the rest of the world remain very high. This policy note details the most pronounced and significant economic trends observed in the Georgian economy in 2022, reflect on the risks the country is facing going forward in the context of the ongoing regional war. The policy note does not intend to focus on assessing current or the long-term sovereign and political risks.

INTRODUCTION

Russia's invasion of Ukraine profoundly impacted the global economy, immediately sending shockwaves across the globe. The attack of a country that was once a major energy supplier to Europe on the country who was one of the top food exporters in the world, sent food and fuel prices spiraling, caused major energy shortages and the prospect of protracted recession in the United States and the European Union.

The unprovoked and brutal aggression resulted in nearly universal condemnation and widespread sanctions placed on Russia by the United States, the EU, and other Western allies. Financial sanctions were perhaps the most unexpected and significant with a potential of immediate impact on Russia's neighbors, including those that did not formally join the sanctions regime. In addition to sanctions, the major consequence of the war were mass migration waves, particularly from Ukraine, but also from Russia and Belarus to neighboring countries.

At the start of the war, it was expected that Georgian economy would be severely and negatively impacted for the following reasons:

First, as a former Soviet republic Georgia historically maintained close economic trade ties with both Russia and Ukraine. The ties with Russia have weakened considerably in the wake of 2008 Russo-Georgian war but remained significant. Russia was the main market for imports of staple foods into Georgia, such as wheat flour, maize, buckwheat, edible oils, etc. Russia and Ukraine were both important export markets for Georgia. Russia was absorbing about 60 percent of Georgian wine exports and 47 percent of mineral water exports, while Ukraine was one of the

main importers of alcohol and spirits from Georgia (46 percent of Georgia's exports). Tourism and remittances are other areas where Georgia is significantly tied to Russia and somewhat weaker to Ukraine. Before the pandemic, in 2019 Russia accounted for 24 percent of all tourism revenues, while Ukraine for 6 percent. Remittances from Russia accounted for 16.5 percent of total incoming transfers in 2021.

Second, while the Georgian government chose to largely keep a neutral stance on the war (announcing at one point that they would not join or impose sanctions against Russia), the main financial and trade international sanctions were still in effect in Georgia due to international obligations and close business ties with the West. These factors were reinforced by strong support for Ukraine among the Georgian population, where memory of Russian invasion of Georgia in 2008 remain uppermost.

In addition, Georgia is a net energy importer, and while the dependence on energy imports from Russia is not significant, the rising prices would have affected Georgia profoundly.

EXPECTED NEGATIVE IMPACT ON THE ECONOMY AT THE START OF THE WAR

Thus, it was expected that economic growth would slow down considerably in 2022 and the major areas of expected negative impact on Georgia would work through the following channels:

Trade: primarily via costs of trade increases, including transportation and logistics disruptions and external demand slowdown.

Tourism: via increases in the cost of international and domestic travel, expected economic activity slowdown, higher food prices affecting hotel and restaurants.

High commodity prices, including food and fuel were expected to drive inflation rates up, impacting the standard of living.

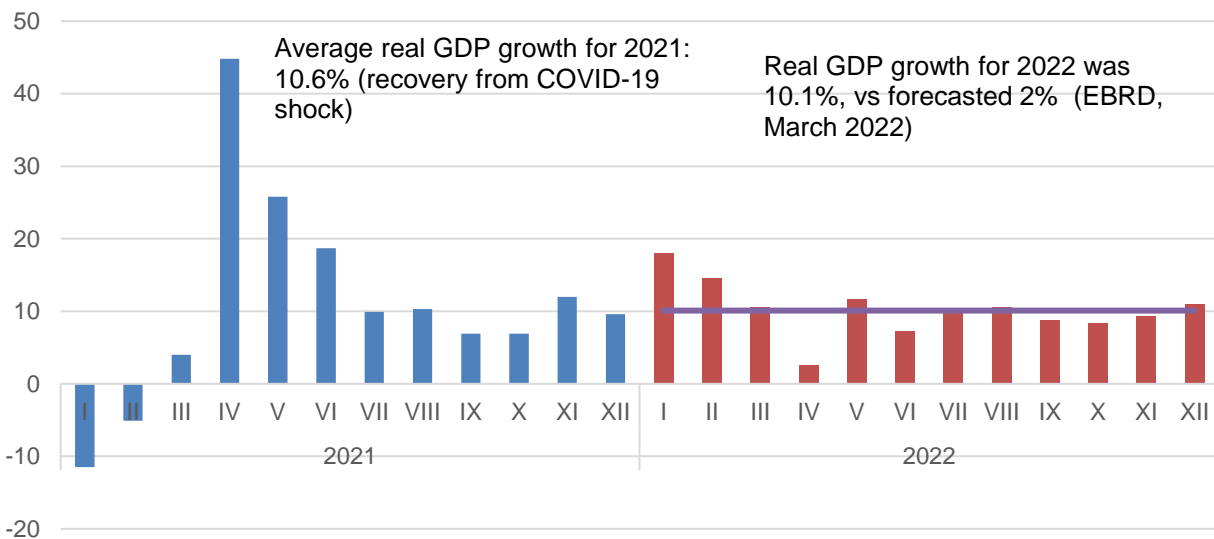
Remittances: via expected lower money inflows from Russia (Ruble was expected to lose value as well), economic slowdown in the rest of Europe.

Depreciation of the domestic currency: Depreciation was expected to be driven by slower rate of remittances and other factors which played out during the latest regional currency crisis of 2014. This would result in higher domestic prices of imported goods, adding to inflation pressures.

However, as the year progressed it became apparent that the downside risks on some of these channels did not materialize and were even reversed in some cases. There were also a few surprise developments, which bulked the historical trends for Georgia in these types of crises.

MAIN ECONOMIC TRENDS AND THE “SURPRISES” OF 2022

Figure 1. Average real GDP growth, 2022



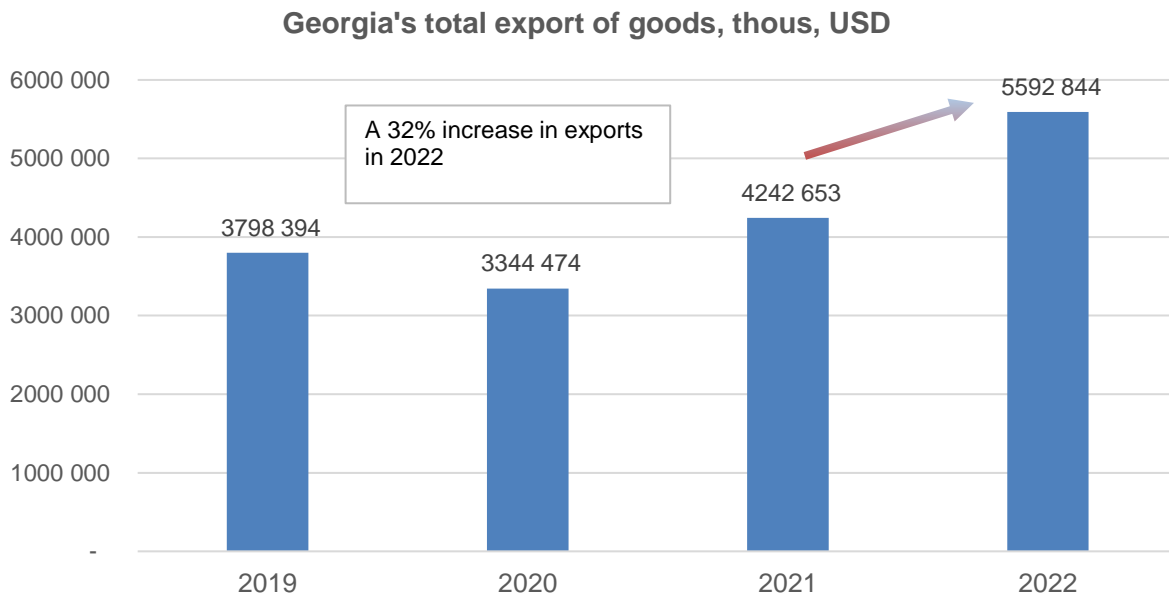
Growth

One of the main “surprises” of 2022 was the much higher than expected GDP growth rate. In March 2022 EBRD [forecast](#) was predicting 2% growth for Georgia (EBRD Regional Economic Update, March 2022). The actual preliminary estimates for real GDP growth in 2022 is 10.1% (Geostat, December 2022).

Trade

Total export growth 32% in 2022. Much of the growth was driven by the CIS countries’ trade.

Figure 2. Georgia's total exports of goods, 2019-2022



Trade with all CIS trading partners (excluding Ukraine) increased by 44%, the largest increase among all country groups in 2022. While trade with Russia went up only by 7%, trade with countries that are part of the Eurasian Economic Union increased quite considerably. For example, exports from Georgia to Armenia increase by 128%, exports to Kyrgyzstan by 201%, to Kazakhstan by 148% annually. Much of this represents re-exports of goods from other countries, e.g., cars, equipment¹, etc.

¹ Concerns were expressed that these trade flows could possibly be used by Russia to evade Western sanctions. Currently, publicly available data does not provide the evidence to this effect. Authorities in the European Union and the United States are said to be monitoring the situation and investigating whether the unusual increase in trade between EEU countries and the rest of the world can represent sanction evasion mechanisms. (Financial Times, [February 23, 2022, links](#))

Figure 3. Georgia’s exports to largest CIS partner countries 2019-2022

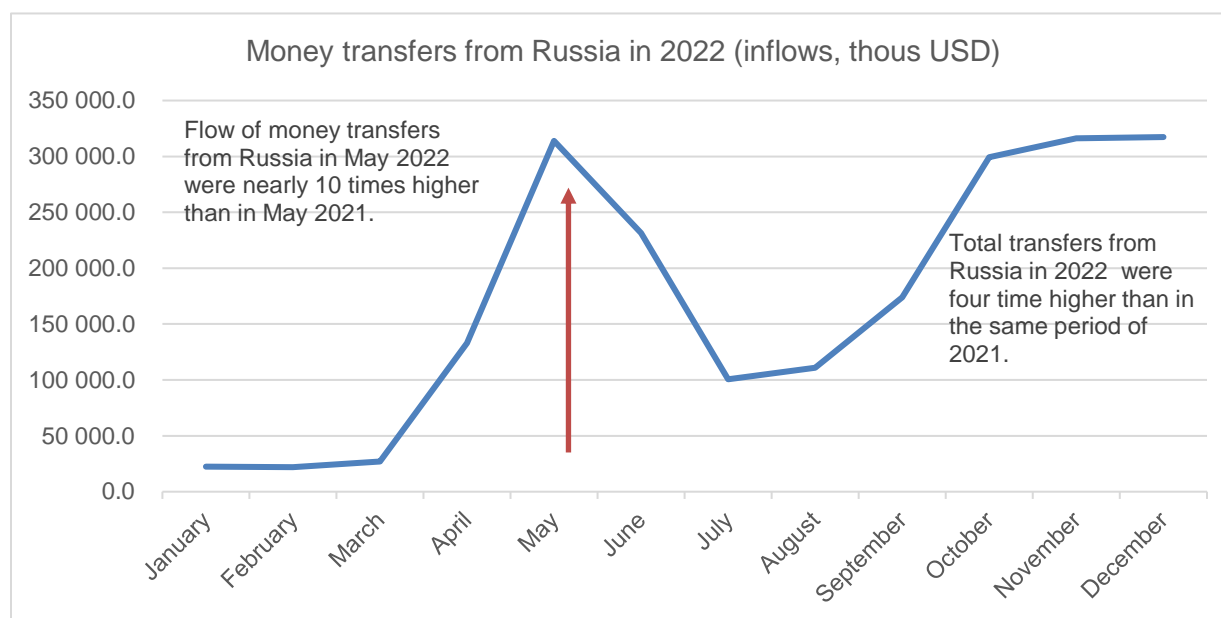


Remittances

Remittances from Russia showed an unprecedented increase since the beginning of the war. In 2022 there were over 2 billion USD money inflows from Russia, four times the amount of the previous year. Russia transfers accounted for 47% of total money inflows into Georgia. The first wave of money transfers, associated with the first wave of migrants from Russia, peaked in May 2022 but later subsided. The second wave of transfers coincided the “partial mobilization” announcement on September 21 and the second wave of migrants from Russia. Unlike the first wave of money inflows, the second wave has so far shown no signs of abating.

Large money inflows caused significant nominal and real appreciation of the Georgian lari. Between in the course of 2022 Lari appreciated by nearly 25% in nominal terms and by 15% in real terms. Lari also appreciated against the USD by 12,5% in nominal terms and 19% in real terms during the year.

Figure 4. Money transfers from Russia, 2022



Migration patterns and their impact on the economy

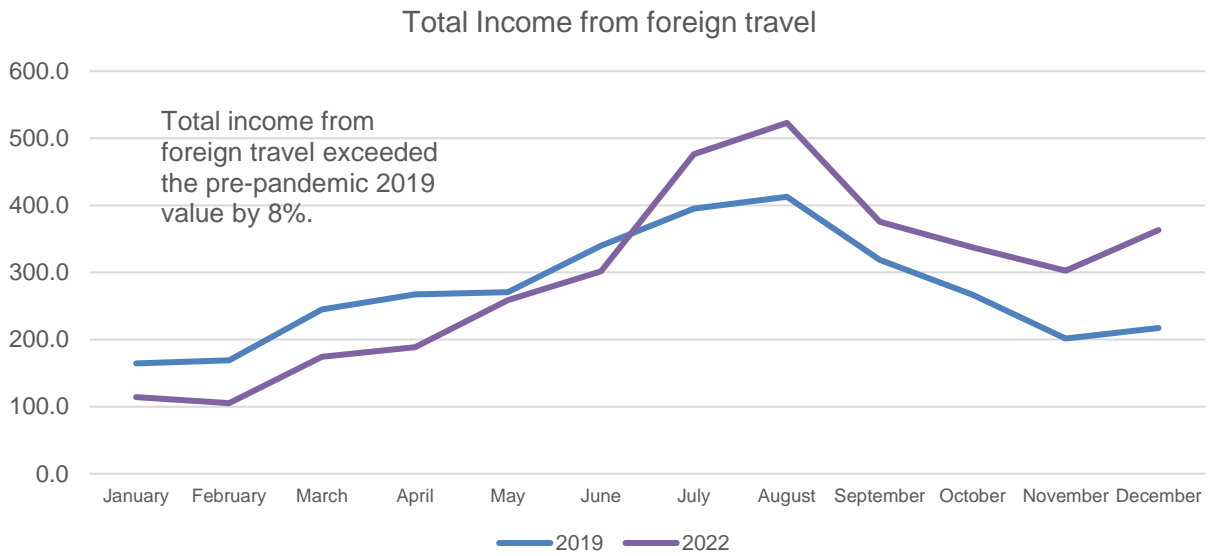
NBG reports that 70-80K more Russians came into Georgia in 2022 than would have been during the peacetime, and they could be considered as migrants. This is approximately 3% of the population, and 6% of the population of the largest cities - Tbilisi and Batumi.

The revenue from international visitors has increased above the pre-pandemic level, but much of the revenue from international travel is from long-term visitors, such as Russians.

Number of companies registered by Russian citizens skyrocketed – 10 times more than in the previous year, nearly 9,500 new companies registered between January and September. Half of the companies that are registered now in Georgia by Russian citizens were registered in the last 9 months.

As a result of migration as well as strong tourist inflow from the rest of the world, tourism revenues recovered stronger than expected (by 183% relative to 2021 and by 8% relative to the very strong pre-pandemic performance of 2019). The recovery helped drive Georgia's strong output growth and helped reduce the current account deficit (for example, in Q3, 2022 the current account turned positive for the first time since Q3 2018 and exceeded the previous record by 387 million USD).

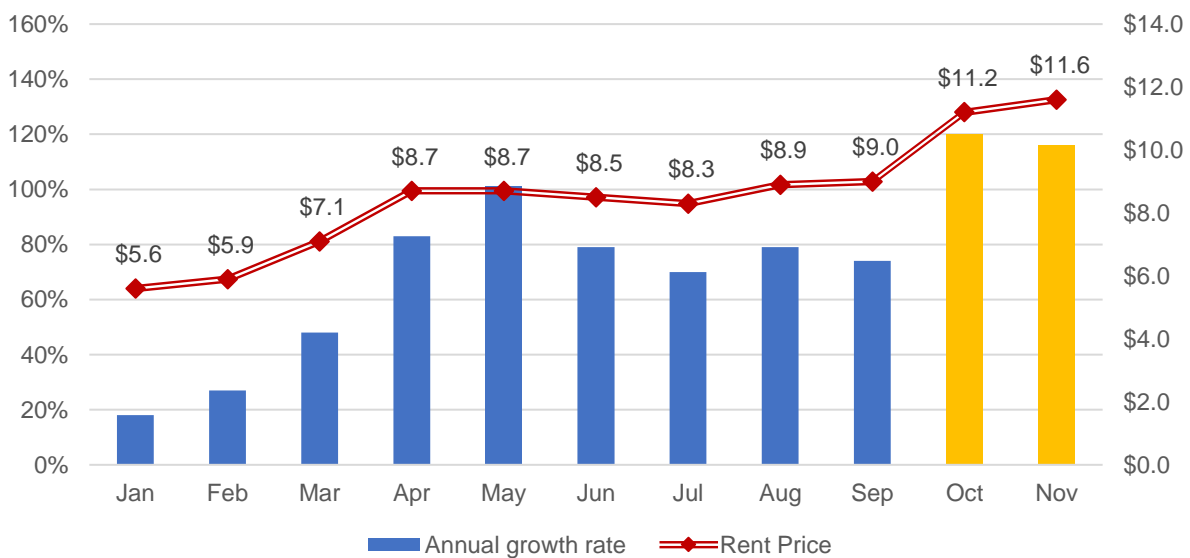
Figure 5. Recovery of income from tourism



Real estate prices

Among the negative effects on the Georgian economy caused by significant migration was the meteoric rise of real estate prices in major cities. In Tbilisi the average asking rent prices rose by 120% annually in October 2022, driven by the “second wave” of migrants from Russia.

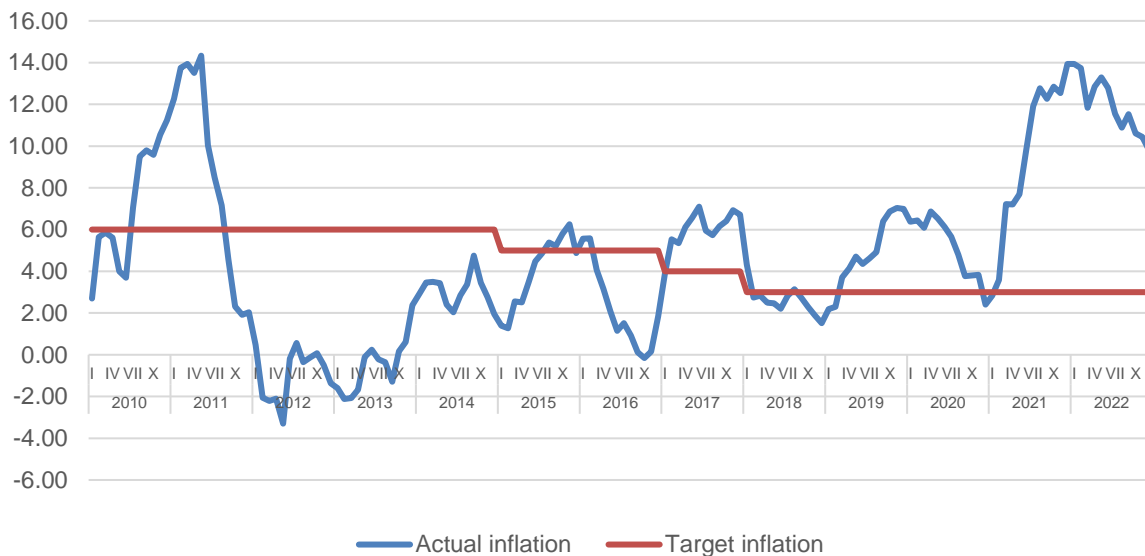
Figure 6. Average asking rent price per SQM in Tbilisi and annual growth rate



RISKS FOR THE GEORGIAN ECONOMY

Inflation, food security and poverty

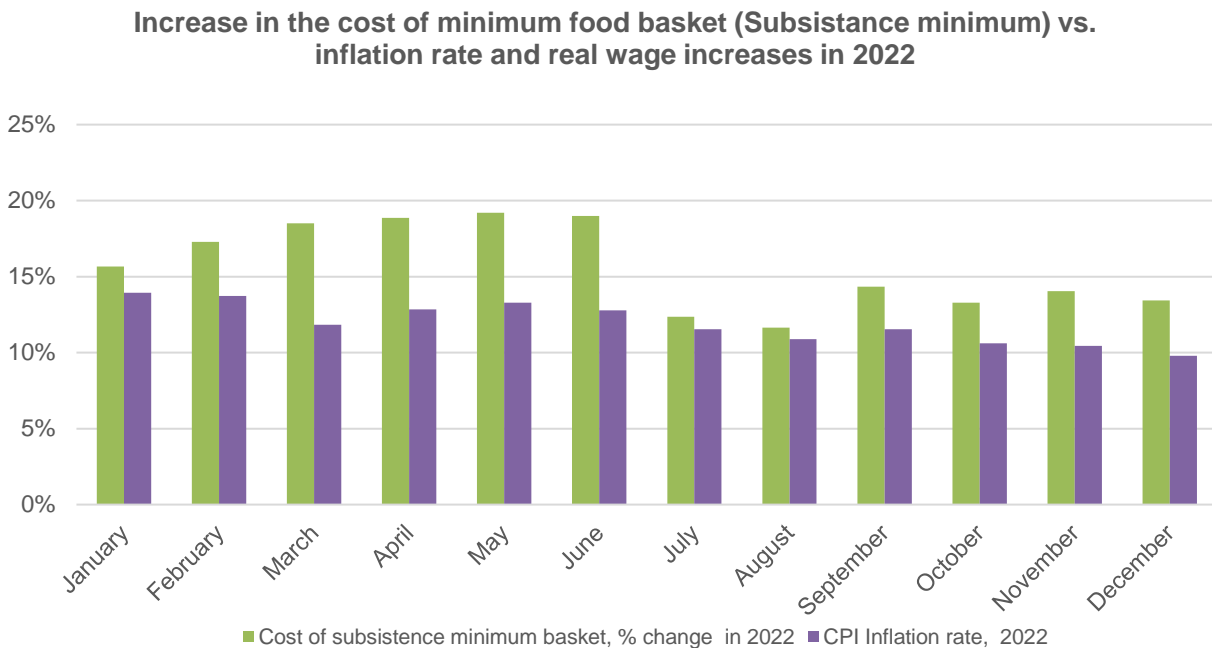
Figure 7. Actual and target inflation rate, 2022



Inflation remains one of the most significant risks to the Georgian economy. On the positive note, inflation rates are subsiding since their peak in January 2022. At the same time, however, contribution of food and fuel to consumer price increases has been significant, impacting food security and potentially poverty rates in the country.

For example, as Figure 8 below shows, the increase in the cost of subsistence minimum basket of goods was higher than the overall CPI inflation rate, especially in March-June 2022. This signals that the price increases were affecting the cost of living for poorest households more than the CPI inflation would suggest.

Figure 8. CPI inflation vs. minimum food basket price increases

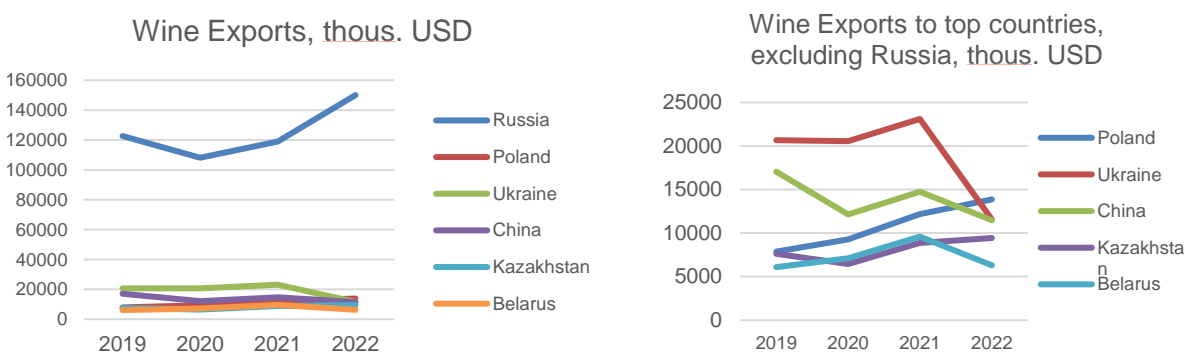


Growing dependency on the Russian market

One of the major long-term risks to the Georgian economy in 2022 is the signs of growing dependency on the Russian market of one of its most iconic domestic exports – wine. In 2022 there has been a significant growth of Georgian wine sales to Russia: 26% increase in value and 55% increase in the volume of exports. Unfortunately, this indicates that wine exports going to Russia are cheaper than before, corresponding to the 20% decrease in the USD price per unit. This may be suggesting a possible decline in quality of exported wine.

At the same time, there was only 7% increase of wine exports to Kazakhstan, a 14% increase for Poland and a 22% decrease of exports to China.

Figure 9. Georgia’s exports of wine in 2019-2022




Migration patterns

As mentioned earlier in the brief, the wave of migration from Russia to Georgia in 2022 (by NBG estimates, close to 80,000 migrants between February and October 2022) was such as Georgia never experienced before in recent decades. Therefore, the impacts of the new migrants can be both positive and negative for the country’s economy. For example, many Russian migrants come with substantial financial resources and many of them work remotely and have independent source of income. This contributes positively to Georgia’s current account balance. On the other hand, migrants’ higher income and wealth drives up rental and sales prices of real estate, pricing out local residents (students, young couples) from residential real estate markets. Other considerations, like contribution of migrants to certain types of crime, as well as overall national security issues driven by the sheer size of migration from Russia, have to be taken into account. Last, but not least, impacts on the sovereignty and security have not been assessed and call for the long-term vision and solution.

CONCLUSIONS

In 2022, after the start of Russia’s war on Ukraine, Georgia experienced unprecedented economic and social changes. The data shows that Georgia has so far been insulated from the worst of economic shocks that rocked the economies worldwide. At the same time, the country finds itself in a much riskier situation than just a year ago.

We find that despite the strong recovery of GDP growth driven by external trade, income from foreign travel, strong capital inflows, etc. the country has also seen a sharp rise in migration, a substantial increase in consumer prices (especially for the poorest cohort of the population), and a sharp increase in real estate market prices in major cities.



Government's active policies were so far aimed at managing the overall health and stability of the country's financial system, managing inflationary expectations, etc. with the focus on sustainability. However, insofar migration issues are concerned, the status quo of treating migrants as tourists has been largely maintained. Given that the war of Russia against Ukraine has entered its second year, and there are no signs that migrants will be in the position to return to Russia anytime soon, it would be advisable that Georgia assesses associated short and long-term risks and makes necessary adjustments in the migration policies in the interests of security and sovereignty on the country.

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