

Macroeconomic Outlook of Georgia, 2021



Annual Review



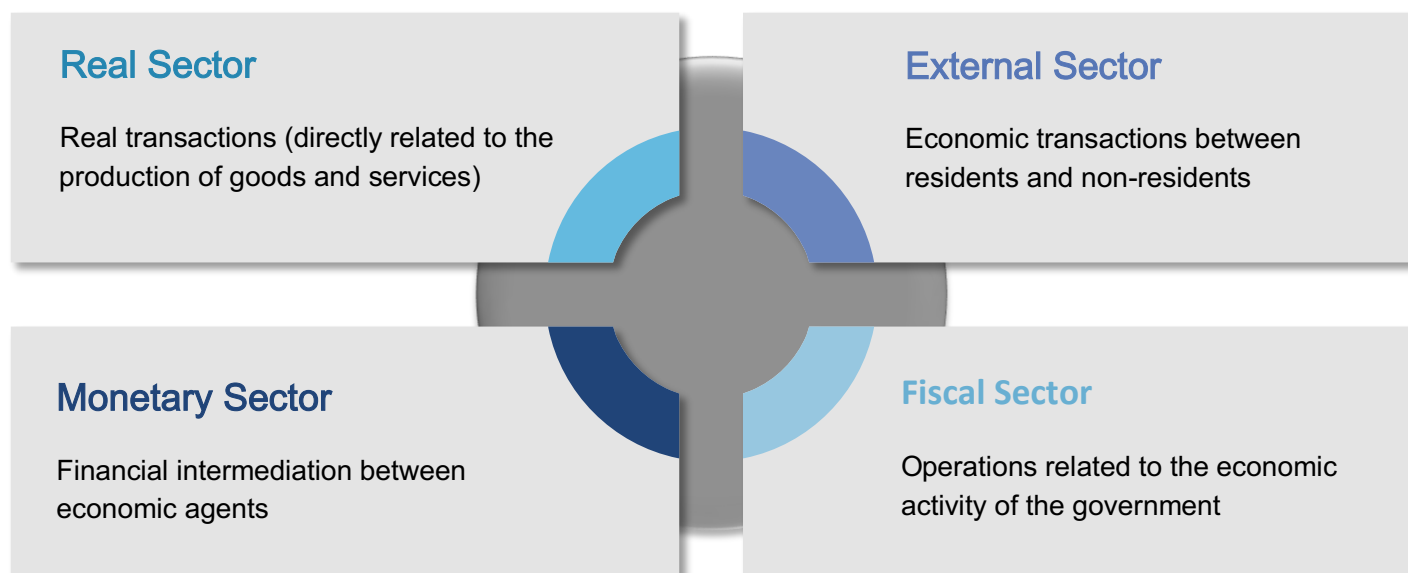
Parliamentary Budget Office of Georgia, 2022

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Introduction

The Parliamentary Budget Office, in line with its mandate, provides an annual macroeconomic outlook, which aims to analyse and review key indicators of economic sectors (real, external, fiscal and monetary), as well as to assess the links between macroeconomic indicators during the reporting period.



1. Real Sector

Dynamics of the main indicators:

- **Real Gross Domestic Product (GDP) annual growth rate amounted to 10.4% in 2021, while nominal GDP amounted to 60 232 million GEL. Compared to 2020 figure, GDP per capita increased by 2 920 GEL, and nominal value amounted to 16 154 GEL (5 015 USD).**

Commentary: Gross Domestic Product (GDP) is defined as a total market value of all final goods and services produced within the economic territory of the country in a given period of time. GDP is the sum of all sectors' value added, which, in turn, is equal to the difference between gross output and intermediate consumption. Nominal GDP assess output at current prices, while real GDP in constant prices. The GDP to population ratio is a widely used measure for assessing the development level of a country.

- **As a result of the economic growth in 2021, the deviation from the potential level of actual GDP decreased significantly and the negative gap of GDP showed a significant rate of decline, in particular, economic activity in 2021 was 0.7% below its potential level.**

Commentary: Potential GDP is an estimate of the value of the output that the economy would have produced if labor and capital had been employed at their maximum sustainable rates - that is, rates that are consistent with steady growth and stable inflation. The GDP gap reflects the level of deviation of actual GDP from the potential level, which provides information about inflationary or deflationary pressure. At any point in time actual GDP may differ from potential, due to economic cycles.

- **In 2021, total factor productivity played a leading role in economic activity.**

Commentary: Total factor productivity reflects the impact of unobservable factors on output that are not related to factors of production: labor and capital. The concept of Total Factor Productivity (TFP) includes technological progress, institutional framework and structural changes.

1.1 Gross Domestic Product by types of economic activities and categories of use

In 2021, compared to 2020, according to preliminary estimates, the real GDP growth of Georgia amounted to 10.4%, which is 6.1 percentage points higher than the forecast which was made by the government in December 2020 (4.3%) and is 5.2 pp higher than the forecast of the Parliamentary Budget Office (5.2%). In the same period, nominal GDP increased by 10,964.9 million GEL (by 22.3 pp) and amounted to 60,231.6 million GEL.

GDP per capita reached 16,154 GEL (5,015 USD) in 2021, i.e. 2,920 GEL (760 USD) more than the previous year.

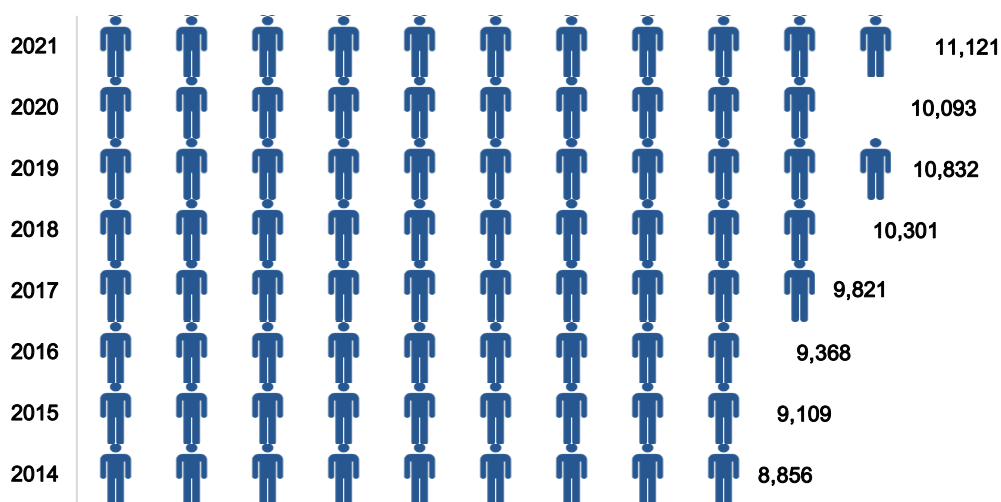


Figure 1: GDP per capita, GEL. Source: Geostat

As for quarterly performance, in the first quarter of 2021, compared to the corresponding period of the previous year, the country's economy was characterized by a decreasing trend and the real growth of the gross domestic product amounted to -4.1%, although a significant revival of the economy was observed from the second quarter, when the growth rate of the real GDP was 28.9%; As for the growth rates in the third and fourth quarters, it was 9.1% and 8.8%, respectively. It seems that high economic activity in Georgia has been observed since the second quarter of 2021, which was caused by the so-called base effect of the high decline in 2020 due to COVID-19 pandemic and growth in both demand and supply as well as significantly revived foreign trade pace amid easing/removal of restrictions.

The 2021 budget was planned based on the forecasts of macroeconomic and fiscal parameters available at the end of 2020. The mentioned forecasts, in turn, were based on the assumptions of negative consequences caused by the COVID-19 pandemic and the spread of post-pandemic waves. However, the mentioned forecast indicators changed after the higher-than-expected growth of the economy observed from the II quarter of 2021. As a result, in relation to the real GDP growth rate in 2021, the forecasts of the real GDP growth rate changed and according to the government's forecast made in December 2021 it became 10.0%, and according to the Budget Office forecast it increased to 10.4%.

Structural analysis of GDP is showing that all sectors, except agriculture, construction, public administration, education and subsidies, had a positive impact on economic growth. From the second quarter of 2021, the gradual easing/cancellation of the restrictions imposed due to the coronavirus pandemic and the increase in both demand and supply, as well as the vaccination process and increased foreign trade, led to the revival of economic activity, which had a positive impact on economic growth. Particularly, contributions of trade (2.58 percentage points (pp)), industry (1.96 pp), transport (1.48 pp), arts, entertainment and recreation (1.15 pp), healthcare (1.11 pp) and financial activity (1.04 pp) were noteworthy. It is also interesting to analyze the sectoral structure of GDP in 2011-2021. The main driving sectors of economic growth during this period were financial activities, industry, real estate activities and trade.

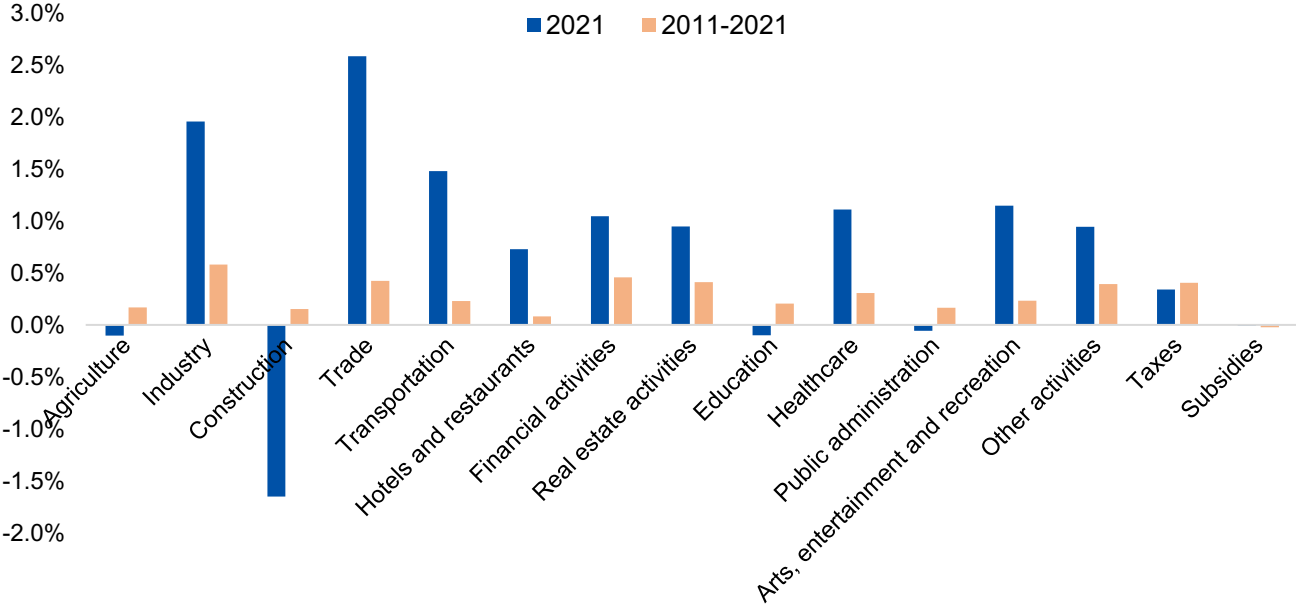


Figure 2: Contribution of sectors to GDP growth. Source: Geostat. Budget Office Calculation

As for the analysis of GDP by categories of use, based on preliminary data for 2021, according to the budget office estimate, the contribution of aggregate consumption to real GDP growth of 10.4% reaches 8.9 pp, investments contributed negative 3.1 pp, while net exports contributed positive 4.5 pp. In 2020, the economy was characterized by a different structure and dynamics compared to previous years, due to the Coronavirus pandemic. Compared to 2020, amid significantly revived economic activities, in 2021 the foreign trade increased significantly, including a positive trend in the export of services due to the increase in tourism activity. In 2021 exports of services increased by 57.1%, while total exports increased by 25.0%. The average growth rate of this component in 2015-2019 was 8.9%, while in 2020, a significant 37.6% decrease was observed. Imports of goods and services also increased significantly (by 8.5%) (16.6% decrease in 2020). In 2021, consumption increased by 9.4%, while the decline in real investment amounted to 12.9% (15.2% decrease in 2020).

Analysis of GDP dynamics in terms of expenditures shows that in 2014-2019 mainly consumption, investment and export components contributed positively to real GDP growth, while imports - negatively. However, there were exceptions when one or two components of this structure showed different dynamics. Due to the coronavirus pandemic, a different dynamic was observed in 2020, when imports along with consumption made a positive contribution to growth, while investments and exports negatively contributed. **According to preliminary data, in 2021, as in the pre-pandemic period, namely in 2019, consumption and export made a positive contribution to growth, while investments and imports had a negative contribution.**

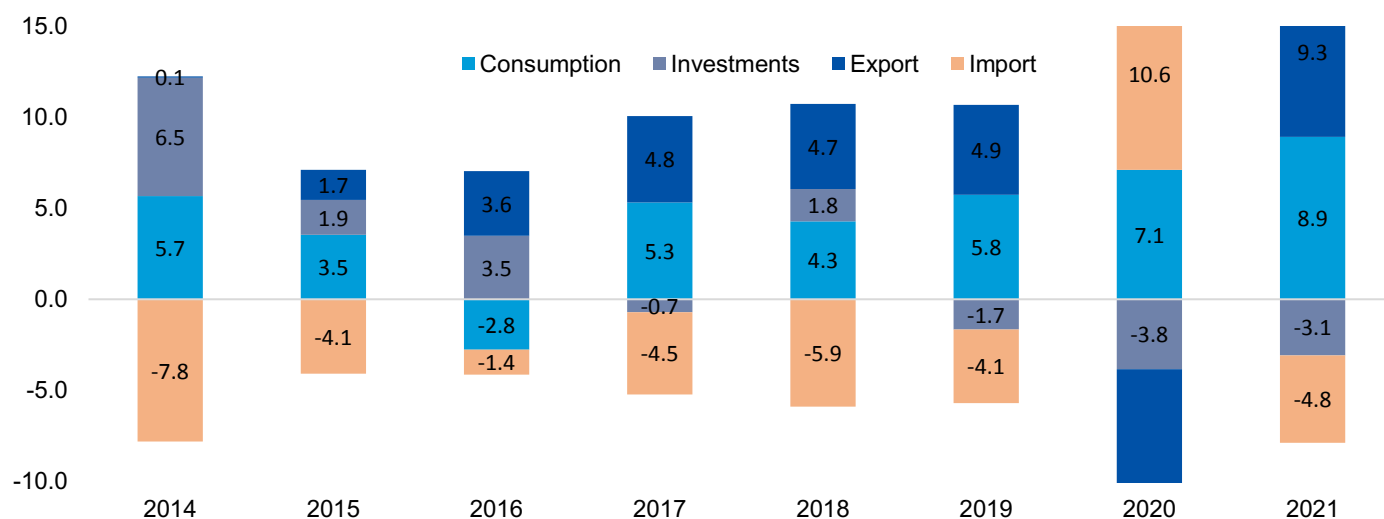


Figure 3: GDP growth by categories of use. Source: Geostat. Budget Office Calculation.

1.2 Potential Gross Domestic Product and Total Factor Productivity

GDP is formed mainly through the use of factors of production: labor and capital. The productivity of the above-mentioned production factors should also be taken into account. It is the most difficult to estimate total factor productivity because it is an unobservable factor and includes many components. **Taking into account the above mentioned, in order to get a full picture of the real sector it is important to analyze the components of GDP based on the production function.**

The PBO uses the so-called Cobb-Douglas production function for indicated analysis¹. After estimating the elasticity of capital and labor, the growth rate of total factor productivity was calculated as a residual of the Cobb-Douglas production function. The dynamic of the total factor productivity, along with the growth rates of capital and labor force, is shown in Figure 4. **As shown in the diagram, in 2021, the total factor productivity played a leading role in economic activity.** In 2021, investments decreased significantly, which reduced the total capital volume as well. It is worth noting that in 2021, along with the decrease of capital, a large negative contribution of the labor force was observed, although compared to 2020, this negative contribution was reduced.

¹ See Budget Office Annual Macroeconomic Outlook 2015

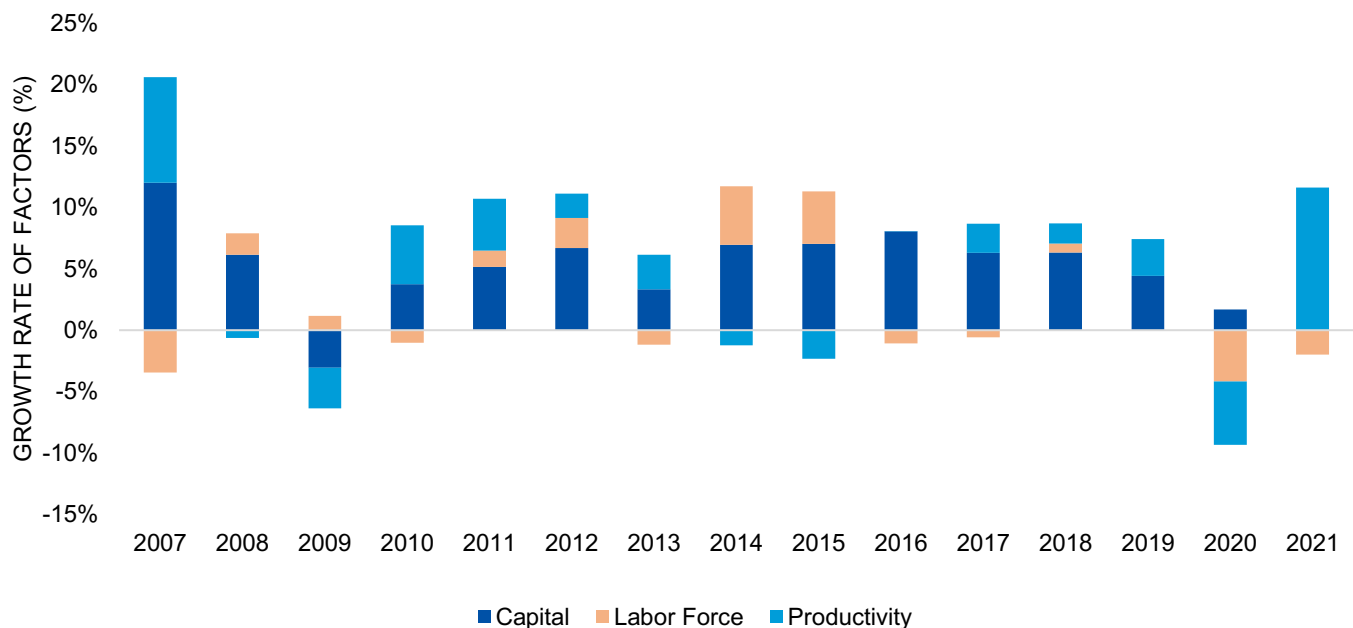


Figure 4: Analysis of GDP by production function. Source: Geostat and PBO Calculation

It is interesting to consider the relationship between total factor productivity dynamics and economic activity, for which it is important to analyze whether current economic growth is in line with the potential that the country would have under the optimal use and utilization of its resources. It is most correct to calculate the so-called potential GDP and compare it to the actual level. This difference between actual and potential GDP will be the so-called GDP gap².

If the actual GDP exceeds its potential level, then we have a positive GDP gap (inflationary gap), and if the actual GDP lags behind the potential one, then the country has a negative GDP gap, which is often called a recessive gap. Potential GDP can be estimated by statistical methods (Hodrick-Prescott, band-pass filters) as well as various estimates based on economic theory (eg. Kalman filter).

The Parliamentary Budget Office uses the so-called Kalman filter, which is based on quarterly data and links economic activity and inflation with each other. The GDP gap, based on this estimate, is represented in figure 5. As shown in the diagram, the negative GDP gap has been showing a significant improvement since 2016. However, in 2020, the problems caused by COVID-19 had a negative impact on the GDP gap and caused its significant increase. In 2020, economic activity lags behind its potential level by 4.8%. However, it should be noted that as a result of the economic growth in 2021, the negative deviation of the GDP from the potential level decreased significantly, in particular, **the activity of the economy in 2021 was 0.7% below its potential level.**

² For more information about GDP Gap, see <http://pbo.parliament.ge/media/k2/attachments/KP0215.pdf>

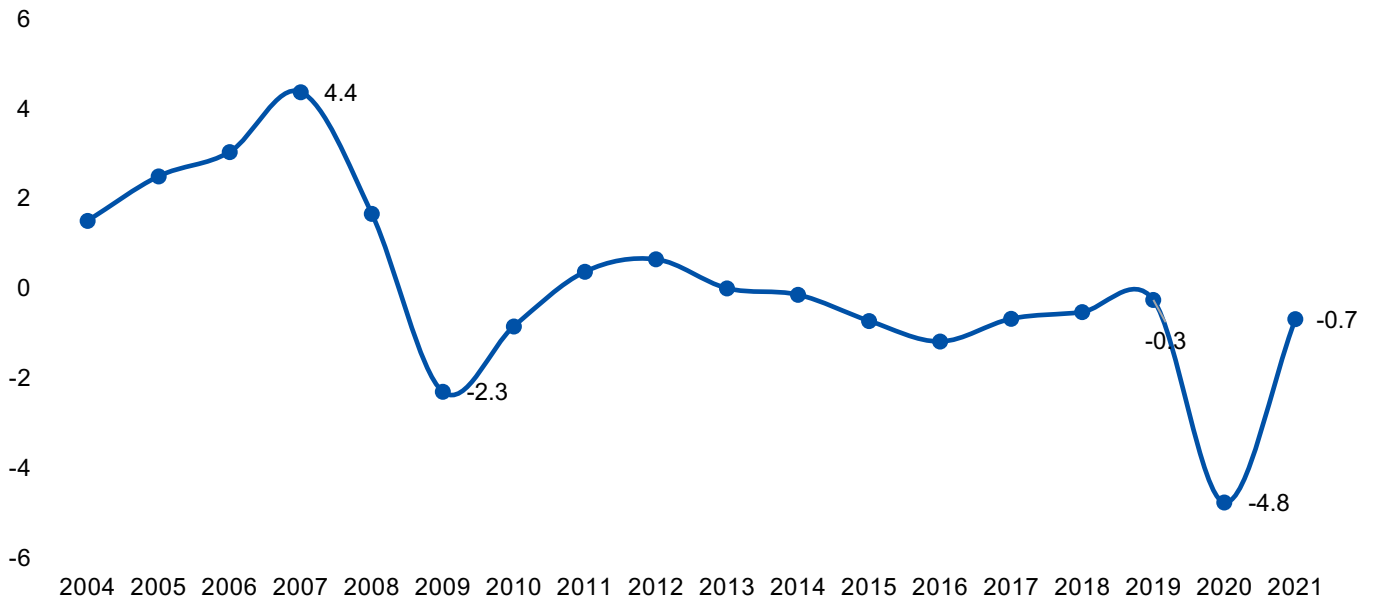


Figure 5: GDP gap. Source: PBO calculation.

It should be noted that there is a significant positive correlation between the GDP gap and the growth rate of total factor productivity (TFP): During the years when the TFP was increasing in the country, real GDP was close to or higher than its potential level, while productivity rate reduction coincided to the periods of the negative gap. This trend was maintained in 2021 when the negative GDP gap decreased in parallel with the growth of factor productivity.

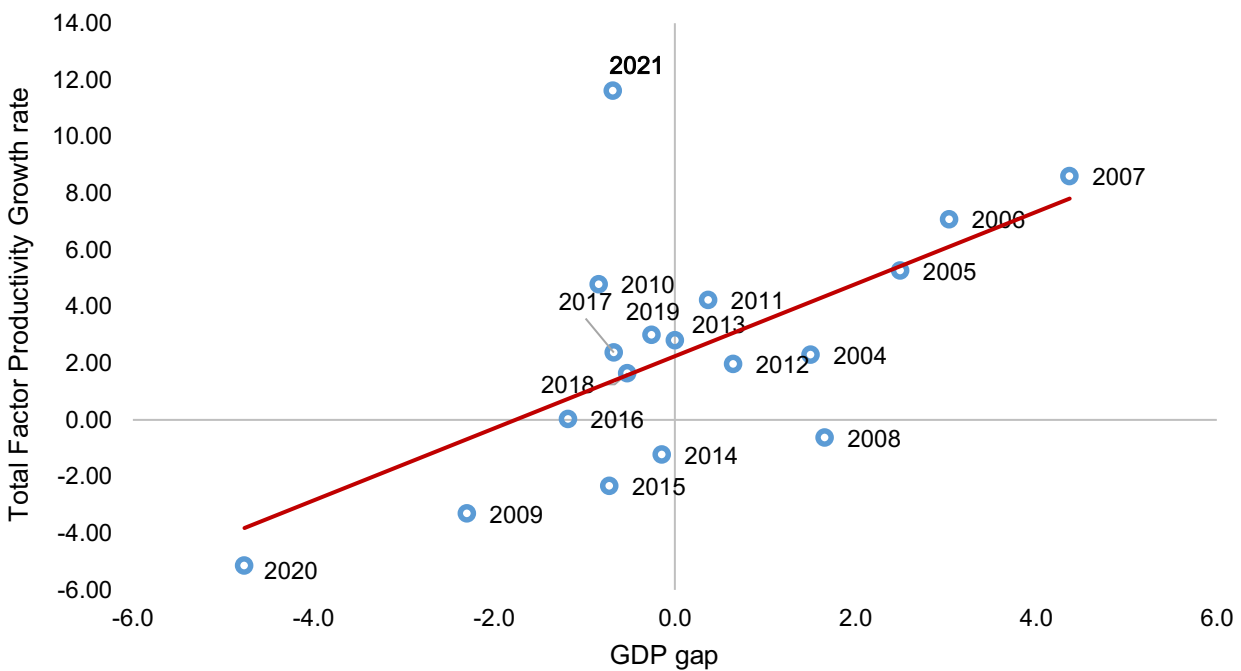


Figure 6: GDP gap and Total Factor Productivity. Source: PBO Calculation.

2. External Sector

Dynamics of the main indicators:

- **Balance of Payments Current Accounts deficit to the GDP amounted to 9.8%, which is 2.6 pp lower compared to the previous year.** This is mainly due to the fact that the trade balance of services improved during the reporting period. Also, the negative effects of the trade balance of goods and income balance and the significant positive effects of transfers on the deficit level are noteworthy.

Commentary: The Balance of Payments is a statement of all transactions related to goods, services and assets between residents and non-residents of a country over a calendar year. The Current Account is one of the components of the Balance of Payments, together with Capital and Financial Accounts. The current account includes transactions related to the export and import of goods and services, as well as revenue flows between residents and non-residents.

- **The main source of negative current account financing is other investments, the volume of which amounted to 1,782 million USD in 2021.**

Commentary: *Other investments* is a residual category of financial account that includes all financial transactions not considered as direct investment, portfolio investment, or reserve assets.

2.1 Current Account Balance dynamic

In 2021, the current account deficit in nominal terms decreased by 6.4% compared to 2020 and amounted to 1,836 million USD. This decrease in the current account balance is related to the dynamics of its components:

- In 2021, the negative impact of the Covid-19 pandemic on external demand decreased, which helped to improve the balance of payments. Compared to the last year, the negative trade balance of goods and the positive trade balance of services increased. In total, the overall negative trade balance improved in 2021. Compared to the previous year, the incomes from tourism are characterized by a positive trend, that had a positive impact on the exports of services and, accordingly, on the trade balance of services. This was mainly reflected in the 60.9% increase in exports of services, also imports of services increased significantly by 25.2%, as for the trade balance of goods - exports increased by 27.4%, while imports by 23.8%.
- In 2021, a special role was played by the improvement of the trade balance of service (mainly due to the increase of export), which ratio to GDP increased by 3.1 pp and reached 3.9%.
- As for the trade in services, tourism services were characterized by a significant positive balance (1,060.8 million USD), which increased by 699.6 million USD (193.7 percent) compared to the previous year. During the analysis period, the balances of communication (29.6 million USD), computer and information (93.7 million USD), government services (23.3 million USD), personal, cultural and entertainment services (14.2 million USD) were positive as well. On the other hand, negative balances were observed in the following services: transport (\$266.8 million), construction (\$6.5 million), insurance (\$106.1 million), finance (\$3.2 million), royalty and license tax (\$55.5 million) and other business service (\$58.3 million).
- It should be noted that the negative balance of goods increased, despite the fact that in 2021 the growth rate of exports (27.4%) exceeded the growth rate of imports (23.8%).
- The negative balance of 2021 was also positively affected by the increase in the volume of current transfers. In the mentioned period, the volume of net current transfers was determined at 2,302.5 million USD, which is 493 million USD (27.2%) more than the previous year. Among them, government sector transfers amounted to 114.4 million USD (5% of the total volume of net current transfers), and transfers from other sectors - 2,188.1 million USD (95%).
- During the same period, the negative balance (-1,103 million USD) of the income component increased by 368 million USD, which had a negative impact on the 2021 balance sheet.

Balance of Payments of Georgia (Mln USD)	2020					2021				
	I Q	II Q	III Q	IV Q	Total	I Q	II Q	III Q	IV Q	Total
Current account	-408.8	-418.4	-570.6	-564.5	-1962.3	-431.5	-483.3	-390.5	-531.1	-1836.4
A. Balance on goods	-883.4	-612.9	-783.0	-887.0	-3166.3	-806.0	-862.5	-1017.1	-1075.6	-3761.3
Export of goods	1034.9	927.8	1183.0	1226.2	4371.9	1081.0	1384.2	1445.7	1659.2	5570.0
Import of goods	-1918.3	-1540.7	-1966.0	-2113.2	-7538.3	-1887.0	-2246.7	-2462.8	-2734.8	-9331.3
B. Balance on service	248.8	5.5	-51.6	-73.8	128.8	19.5	143.0	392.7	170.1	725.2
Export of service	734.6	262.3	291.4	288.9	1577.3	323.8	548.1	911.7	755.0	2538.6
Import of service	-485.8	-256.9	-343.1	-362.7	-1448.5	-304.3	-405.1	-519.0	-584.9	-1813.4

C. Net factor income	-145.2	-149.9	-209.6	-229.7	-734.5	-142.2	-306.7	-347.4	-306.6	-1102.8
D. Net transfers	371.0	339.0	473.7	626.0	1809.7	497.2	542.9	581.4	681.0	2302.5
Capital and financial account	439.8	460.4	615.6	526.5	2042.4	451.9	437.5	347.7	576.1	1813.2
Capital account	8.9	4.4	16.0	12.0	41.3	4.5	4.3	6.6	23.4	38.9
Financial account	430.9	456.0	599.6	514.5	2001.1	447.4	433.3	341.0	552.6	1774.3
From which:										
Direct investment	131.4	151.5	177.6	88.7	549.1	49.4	219.0	221.5	340.9	830.8
Change of international reserves	97.9	-189.7	-118.2	-95.5	-305.5	-238.7	188.9	-180.1	-222.7	-452.6
Net errors and omissions	-31.0	-42.0	-45.0	38.0	-80.1	-20.4	45.8	42.8	-45.0	23.2

Table 1: Balance of Payments of Georgia. Source: National Bank of Georgia.

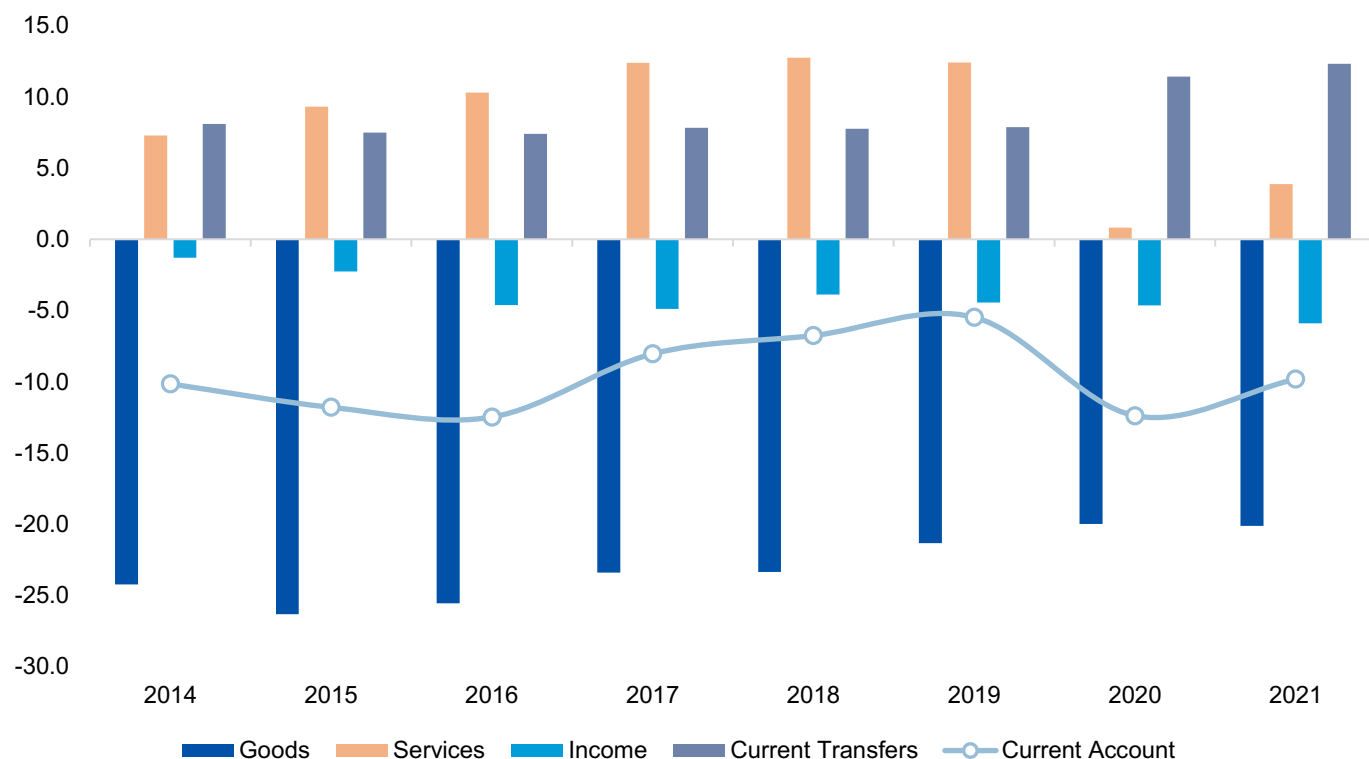


Figure 7: Current Account Balance and its components, % of GDP, 2014-2021. Source: National Bank of Georgia

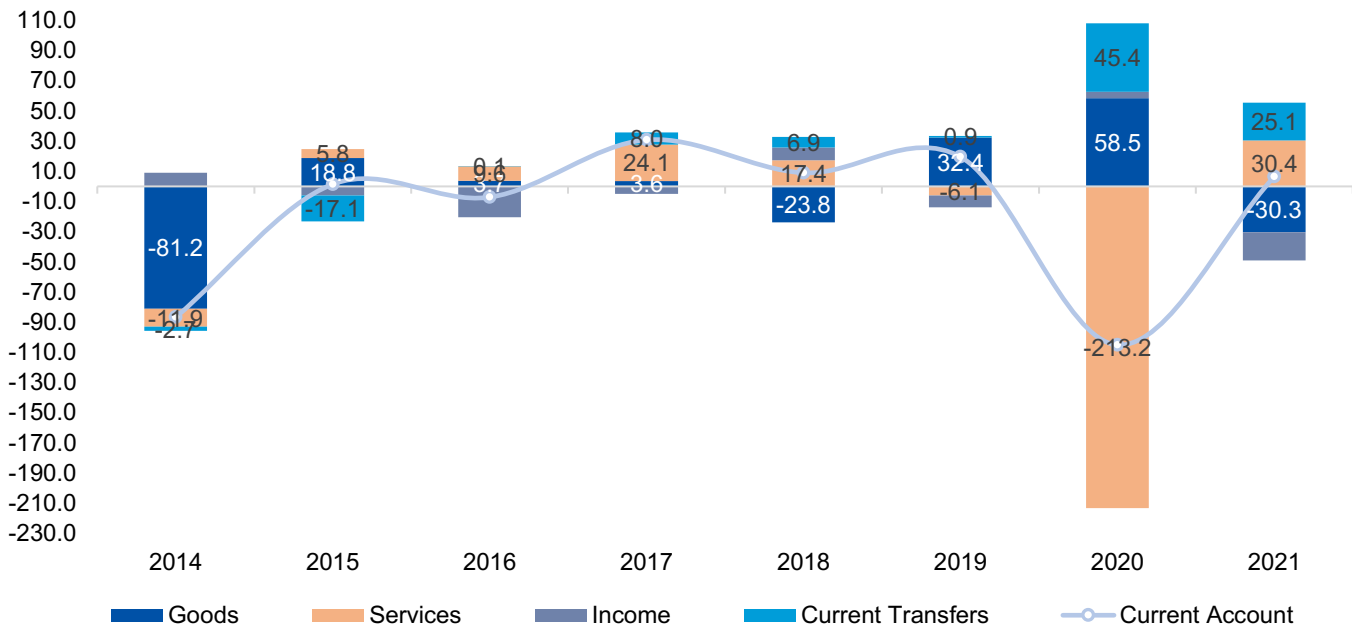


Figure 8: Growth rate of Current Account Balance and contributions of its components, 2014-2021. Source: National Bank of Georgia.

It is noteworthy to mention that, among trade in services in 2021 International traveler trips as well as trips made by international visitors increased. International traveler trips increased by 7.7% YoY and amounted to 1,881,271. International traveler trips include trips made by international visitors, that reached 1,721,242 (13.7% higher compared to the previous year).

In 2021 income from foreign travel amounted to 1,245 mln USD, which is 129.8% higher than same indicator in 2020.

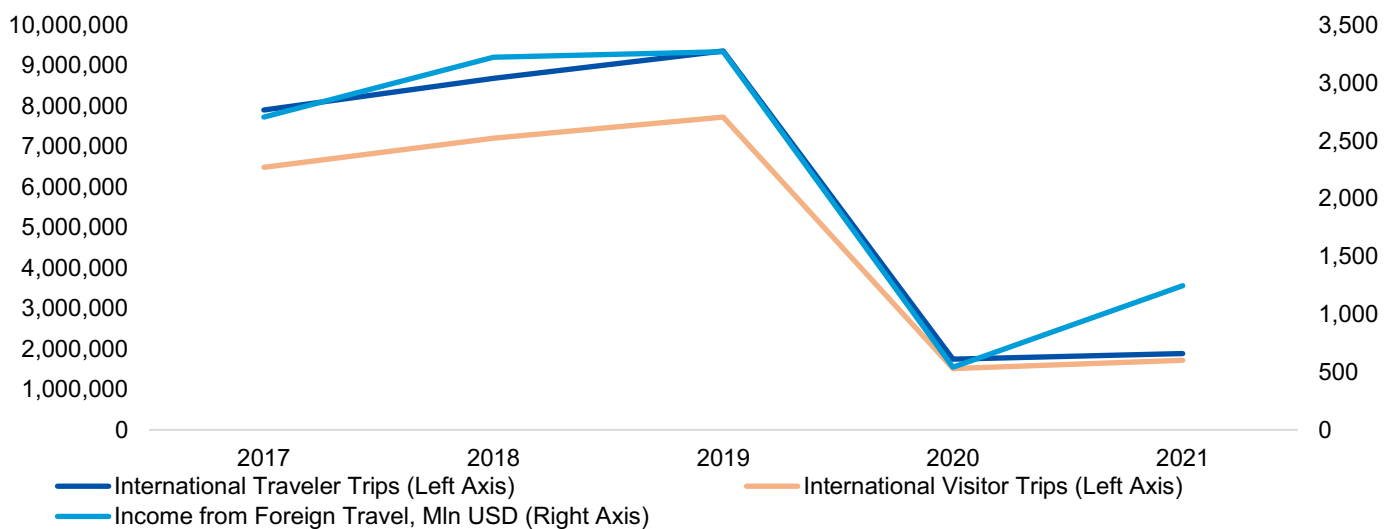


Figure 9: International traveler trips and income from foreign travel. Source: Georgian National Tourism Administration and National Bank of Georgia.

Regarding the sources of financing of the current account deficit:

- The main source of negative current account financing is other investments, the volume of which compared to the previous year decreased by 147 million USD in 2021 and amounted to 1,782 million USD.
- It should be noted that in addition to other investments from current account funding sources, net direct investments³ also made an insignificant positive contribution. It improved by 282 million USD and reached 831 million USD.
- Portfolio investments had a negative contribution to the financing, which decreased by 462 million USD and amounted to -387 million USD.
- As for the Capital account, the operations recorded in the capital component contributed a negligible negative impact to the financing of the negative current account balance, which decreased by 5.9% (2.4 million USD) compared to 2020 and amounted to 38.9 million USD.

It is important to analyze the current account balance in relation to savings and investments. In particular, the current account balance is the difference between savings and investments volumes. When total savings (the sum of government and private savings) exceed the volume of investments, a positive current account balance is generated. And when savings are smaller compared to investments, the current account balance is negative. In turn, savings are equal to the difference between disposable income and consumption. Consequently, in the case of low disposable income, the volume of savings is small. In that case, the source of investments financing is foreign funds.

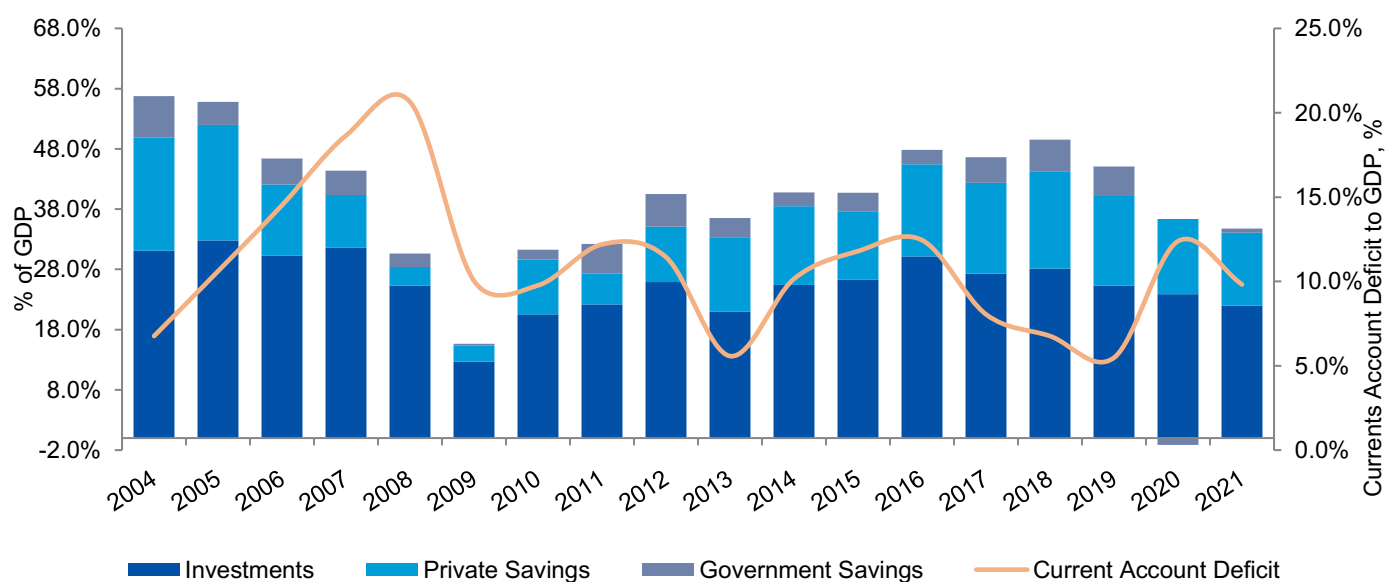


Figure 10: Savings and Investments as a % of GDP, 2004-2021. Source: Geostat, NBG, PBO calculations

The current account deficit for Georgia is caused by the small amount of savings. It should be noted, however, that the current account deficit has been declining since 2016, mainly due to the increase in total savings.

In 2021, the ratio of total investments to GDP decreased from 23.9% to 21.9%. In recent years, the ratio of investment to GDP has kept the same dynamic and was around 26%. In 2021, government savings became positive and increased from -1.1% to 0.7% of GDP, while private savings decreased from 12.5% to 12.2%. Therefore, the increase of savings and the reduction of investments had a one-way effect on the external indicators, which was reflected in the decrease of the current account deficit.

³ Investor is a direct, who owns at least 10 percent of the shares of the enterprise or the equivalent of such participation.

2.2 External trade dynamics (without undeclared trade)

In 2021:

- External trade turnover of goods (excluding undeclared trade) increased by 25.9% year-on-year and amounted to 14,346 million USD. Among them, exports increased by 26.9%, while imports by 25.5%. The export-import ratio increased accordingly and was set at 42%.
- The foreign trade deficit increased by 24.5% compared to the previous year, amounting to 5,862 million USD, and its ratio to foreign trade turnover equalized to 40.9% (in 2020, this figure was 41.3%).



Figure 11: Volume of Export-Import, mln USD, 2014-2021.
Source: Geostat.

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Export	2,377	2,910	2,861	2,204	2,117	2,746	3,380	3,798	3,343	4,242
Import	8,056	8,023	8,602	7,304	7,342	8,057	9,362	9,519	8,053	10,104
Trade turnover	10,433	10,933	11,463	9,508	9,459	10,803	12,742	13,318	11,396	14,346
Balance	-5,680	-5,112	-5,741	-5,100	-5,225	-5,311	-5,982	-5,721	-4,709	-5,862
Share of exports in turnover, %	22.8%	26.6%	25.0%	23.2%	22.4%	25.4%	26.5%	28.5%	29.3%	29.6%
Export/Import ratio, %	29.5%	36.3%	33.3%	30.2%	28.8%	34.1%	36.1%	39.9%	41.5%	42.0%

Table 2: General indicators of foreign trade of Georgia in 2012-2021 (Mln USD). Source: Geostat.

In the regional context, foreign trade turnover shows the following trend:

In 2021, the share of the EU in foreign trade turnover was 21.1%, the share of the CIS countries - 33.7%, and the share of the remaining countries - 45.2%. It is noteworthy that in recent years, trade turnover with EU countries was characterized by an increasing trend, except 2019-2020. However, a 19% increase was observed in 2021 compared to the previous year, which was caused by an increase in exports (2.9%) to EU countries, as well as in imports (25.1%) from the mentioned group. In 2021, exports to the CIS significantly increased by 33.9%, while imports increased by 16.6%, leading to an increase in total trade turnover to CIS by 23.3%. In 2021, trade turnover to other countries increased as well (by 31.5%), which was mainly due to an increase in imports from these countries (by 31.3%). As can be seen from the regional analysis of trade, in 2021, **an increase in imports and exports was observed from the markets of the EU, as well as from CIS and other countries.**

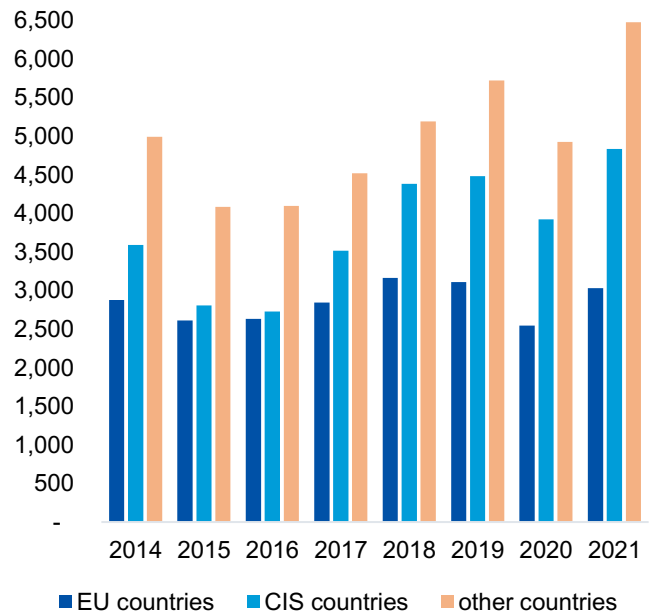


Figure 12: Trade turnover by regions, million USD, 2014-2021, source: Geostat

In 2021, Georgia's main trade partner countries were: Turkey (\$2,151 million, 15% of total foreign trade turnover), Russia (\$1,633 million, 11%), China (\$1,481 million, 10%), Azerbaijan (\$1,130 million, 8%), and USA (\$843 million, 6%). The share of these 5 largest trading partners in the total volume of trade turnover was 50%, while the share of the 10 major trading partners was 69.5%.

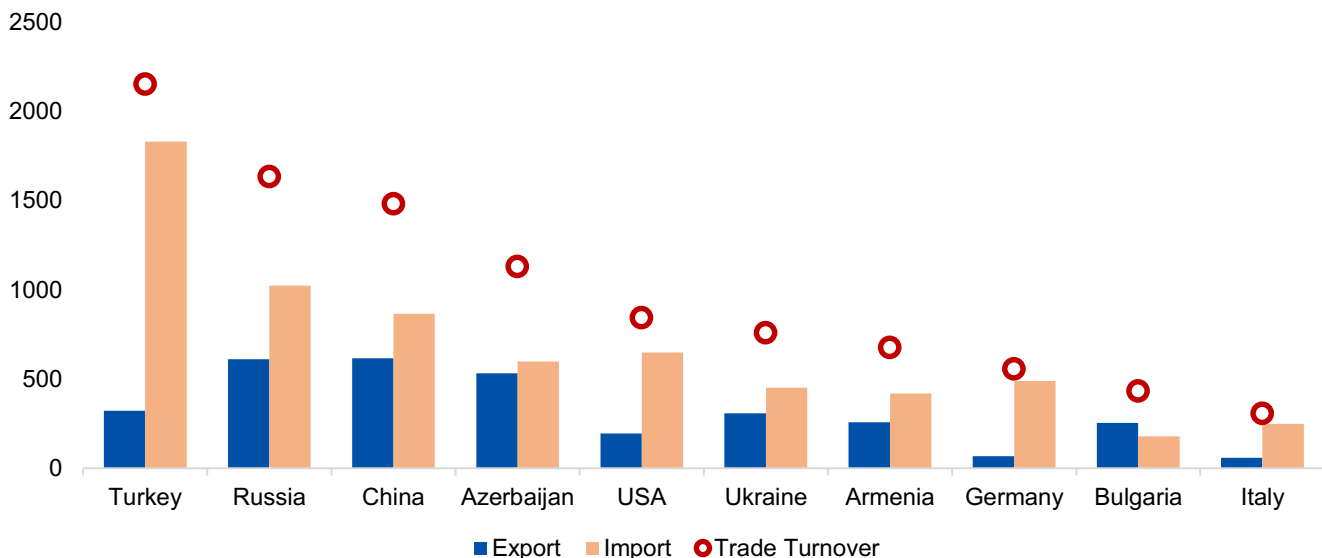


Figure 13: Major trade partners according to trade turnover, 2021. Source: Geostat

Based on export indicators, in 2021 the largest trading partners of Georgia were⁴:

- China (\$616 million, 14.5% of total exports);
- Russia (\$610 million, 14.4%);
- Azerbaijan (\$532 million, 12.5%);
- Turkey (\$322 million, 7.6%);
- Ukraine (\$307 million, 7.2%).

The share of these 5 major exporting countries in the total volume of exports in 2021 was 56.3% (52.9% in the previous year), and the 10 largest countries - 77.3% (in the previous year 74.2%), which indicates that compared to 2020, in 2021, export was less diversified by partner countries.

According to imports, in 2021, Georgia's main trade partner countries were⁵:

- Turkey (\$1,829 million, 18.1% of total imports);
- Russia (\$1,023 million, 10.1%);
- China (\$865 million, 8.6%);
- USA (\$648 million, 6.4%);
- Azerbaijan (\$598 million, 5.9%).

The share of the 5 largest importing countries in the total imports was 49.1% (previous year - 50.6%), and according to the 10 importing countries – 67% (previous year - 68.9%), therefore the diversification of importing countries slightly improved.

As for foreign trade turnover by commodity groups, the dynamics of these indicators are presented in figure 14 and figure 15.

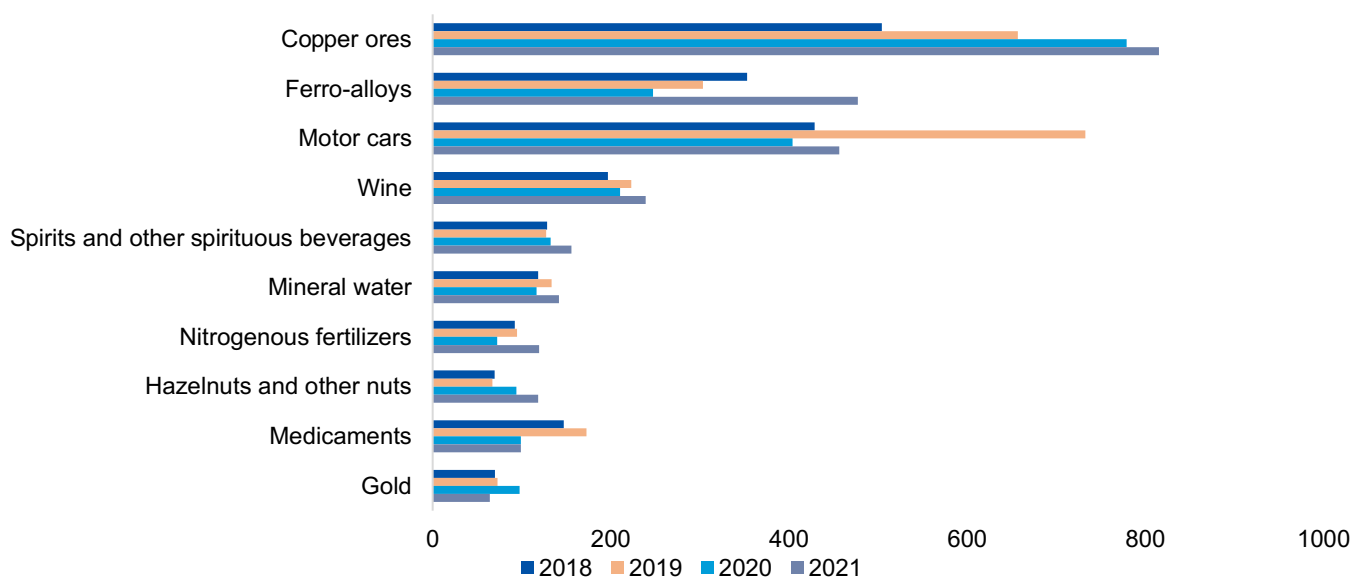


Figure 14: Dynamics of major export commodity groups, 2018-2021. Source: Geostat

⁴ In 2021, compared to the previous year, exports from Georgia to 3 largest trading partner countries: increased in China by 29% and took first place among exporting countries. It should be noted that in 2020, China occupied the first place among the exporting countries as well (mainly due to a 61% increase in copper ores and concentrates); increased by 20.5% in Azerbaijan (mainly due to increased exports of motor cars and medicaments); increased by 38.3% in Russia (mainly due to the influence of mineral waters, wine, alcoholic beverages and ferro-alloys).

⁵ In 2021, compared to the previous year, according to the 3 largest trading partner countries, the volume of imports to Georgia increased: from Turkey (by 29.9%, mainly due to the increase of imports of motor cars, medicaments, black metal, plastic products); From Russia (15.1%, under the influence of petroleum and petroleum oils, coal, electricity, telephone sets); From China (by 22%, due to increased imports of Nuclear reactors, installations and mechanical devices, their parts).

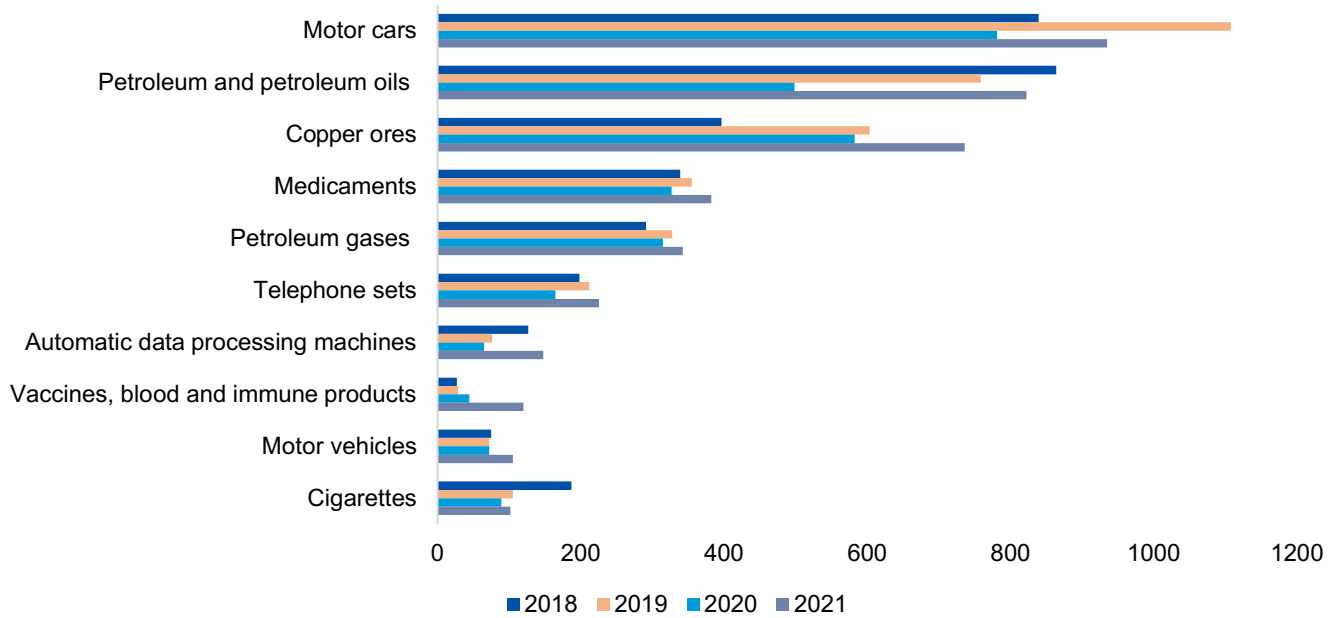


Figure 15: Dynamics of major import commodity groups, 2018-2021. Source: Geostat

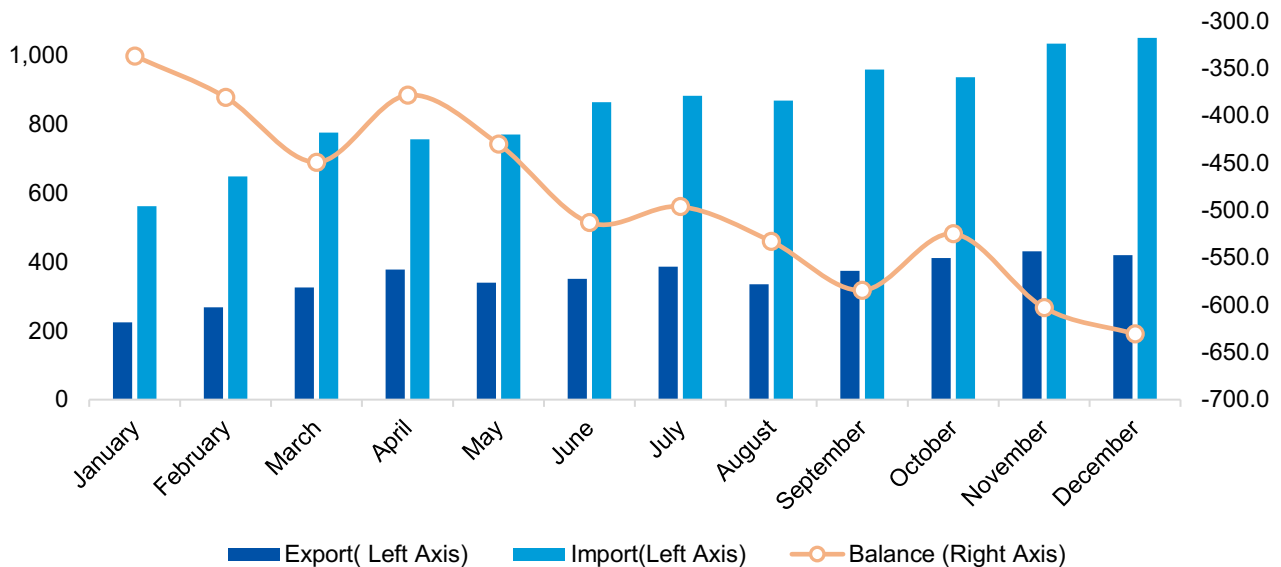


Figure 16: Georgia's foreign trade, 2021. Source: Geostat

As the diagrams show:

- Exports from Georgia are mainly concentrated on several types of goods, therefore in case of sharp fluctuations in external demand, it would be vulnerable to potential economic risks. For example, in 2012-2014, one of the largest commodities of exports from Georgia was motor cars (mainly to Azerbaijan, Armenia, Kazakhstan). After the implementation of new regulations in importing countries in 2015, this figure decreased by 65.4% compared to the previous year and amounted to only 179.1 million USD (8% of total exports). However, taking into account the new standards introduced in importing countries, growth was still noticeable in 2018 and 2019 (especially in Azerbaijan and Armenia), with a growth rate of 71% in 2019, which amounted to 732.8 million USD (19% of total

exports). In 2020, the coronavirus pandemic also affected the export of motor cars, that declined by 45% and amounted to 404.1 million USD. Being in the leading position in 2019, the motor cars export moved to the second position in 2020, while it took the third place in 2021.

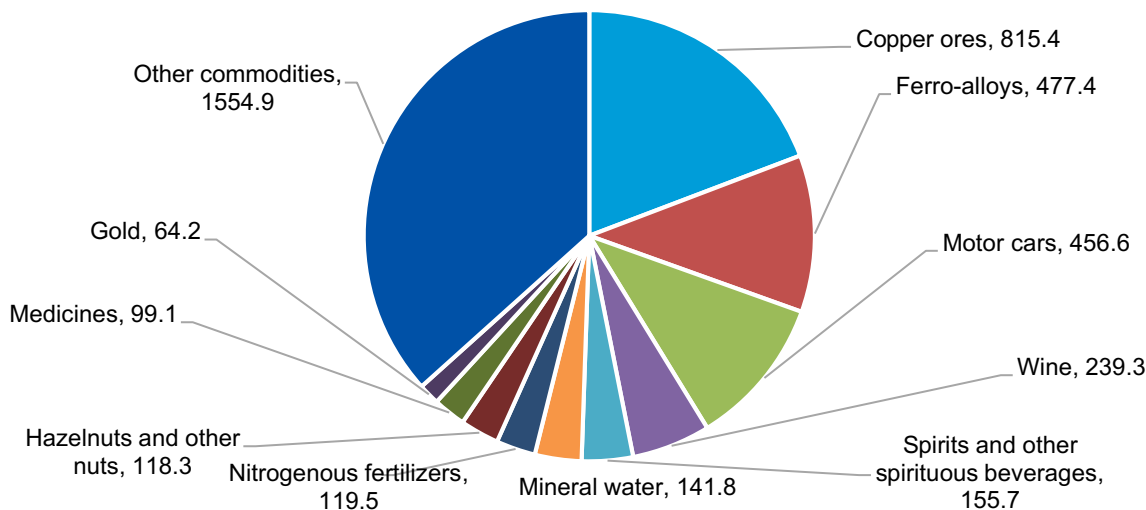


Figure 17: Export from Georgia by commodity groups, 2021, Mln USD. Source: Geostat

- In 2021, the share of 5 main commodity groups in the total volume of imports in Georgia was 31.9% (31.1% in 2020), and 38.8% of 10 main commodity groups (36.5% in 2020), which indicates a higher degree of import diversification compared to exports.

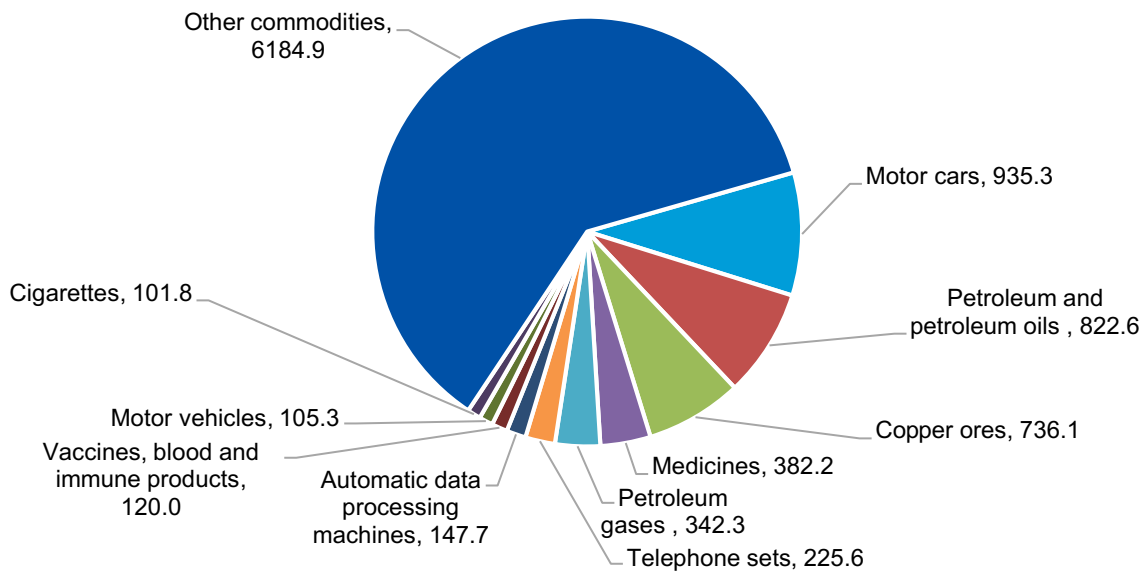


Figure 18: Imports in Georgia by Commodity Groups, 2021, Mln USD. Source: Geostat

It should be noted that some important commodity groups are still concentrated on only one or a few countries, namely, in 2021, the largest share of wheat (99%) was imported from Russia (83.2% in 2019). Although the share of petroleum gases from Azerbaijan has decreased, which amounted to 82.3% in 2020 (87.1% in 2019), it is still high.

		Commodity							
Country Shares		Copper Ores	Ferro-alloys	Motor Cars	Wine	Spirituos Beverages	Mineral and Fresh Waters	Nitrogenous Fertilizers	
	10-50%			Turkey (10.5%)		Ukraine (10.5%)			
		Bulgaria (29.6%)			Ukraine (19.3%)		Russia (26.5%)	Lithuania (13.2%)	Romania (25.4%)
				Russia (36%)			Ukraine (27.9%)	Ukraine (18.5%)	Ukraine (31.8%)
				USA (36.1%)				Russia (43%)	
	51-90%				Azerbaijan (54.4%)	Russia (54.7%)			
		China (60.9%)							

Table 3: 7 largest export commodity groups by country, 2021. Source: Geostat

The distribution of the ten largest export commodities from Georgia in 2021 by destination countries shows, that:

- Copper ores and concentrates were mainly exported to China (60.9%) and Bulgaria (29.6%);
- A large share of ferroalloys were exported to the USA (36.1%), as well as to Russia (36%) and Turkey (10.5%);
- A significant share of motor cars were exported to Azerbaijan (54.4%) and Ukraine (19.3%);
- Importing countries of Georgian wine were: Russia (54.7%) and Ukraine (10.5%);
- A significant share of spirits and spirituous beverages were exported to Ukraine (27.9%), as well as to Russia (26.5%), France (7.4%) and others;
- The largest importing country of Georgian mineral water was Russia (43%), as well as Ukraine (18.5%), Lithuania (13.2%), Kazakhstan (8.9%) and others;
- Fertilizers were mainly exported to Ukraine (31.8%) and Romania (25.4%);
- In case of the export of nuts and walnuts, the geographical area of the importing countries was quite wide, of which leading countries were: Italy (26.6%), Germany (22.5%), Armenia (6.8%), Russia (4.7%) and others;
- Medicines were mainly exported to Uzbekistan (46.8%) and Azerbaijan (18%);
- Gold was mainly exported to Switzerland (95.6%).

		Commodity							
Country Shares		Motor Cars	Copper Ores	Petroleum	Medicines	Petroleum gases	Telephone sets	Automatic data processing machines	
	10 - 50 %				Bulgaria (13.9%)	Turkey (12.2%)		The Czech Republic (11.5%)	
			Japan (17.9%)	Indonesia (18%)	Azerbaijan (15.6%)	Germany (13.4%)	Russia (26.5%)	Russia (16.5%)	China (18.7%)
				Chile (18.5%)	Romania (16.3%)			Hong Kong (24.7%)	
					Russia (16.4%)			United Arab Emirates (33.7%)	Hong Kong (39.5%)
				Armenia (47%)	Turkmenistan (23.3%)				
	51 < %								
	USA (60%)				Azerbaijan (73.2%)				

Table 4: 7 largest import commodity groups by country, 2021. Source: Geostat

The distribution of the ten largest import commodities in Georgia in 2021 by destination countries shows, that:

- Motor cars were imported mainly from the USA (60%), Japan (17.9%) and Germany (8.9%);
- Petroleum and petroleum oils were mainly supplied from Turkmenistan (23.3%), as well as from Russia (16.4%), Romania (16.3%), Azerbaijan (15.6%) and Bulgaria (13.9%).;
- Copper was supplied from Armenia (47%), Chile (18.5%) and Indonesia (18%);
- The list of countries exporting medicinal products to Georgia was quite extensive, from which the main importers were: Germany (13.4%), Turkey (12.2%), Hungary (9.7%) and others;
- Import of oil gases was carried out mainly from Azerbaijan (73.2%) and Russia (26.5%);
- Telephone sets were imported mainly from the United Arab Emirates (33.7%), Hong Kong (24.5%), Russia (16.5%) and the Czech Republic (11.5%);
- Automatic data processing machines and units thereof were imported from Hong Kong (39.5%), China (18.7%) and other countries;
- Vaccines, blood and immune products were mainly imported from China (28.3%), Switzerland (18.5%), USA (9.6%) and France (8.9%);
- Motor vehicles for the transport of goods were mainly imported from Turkey (97%);
- Cigarettes were supplied from: Ukraine (76.6%), Armenia (9.6%), United Arab Emirates (6.4%) and others.

2.2.1 Money transfers

In 2021, compared to 2020, money transfers to Georgia increased by 24.6% and amounted to 2,349.6 million USD. During the mentioned period the main source of money transfers were EU countries (40.7% of total remittances), Russia (17.5%) and USA (12.1%). It should be noted that in 2021, not only the amount of remittances made in Georgia, but also the amount of remittances transferred from Georgia to other countries increased by 28.4%, which amounted to 316.9 million USD. Compared to 2020, the volume of remittances increased significantly from the following countries:

- Italy (by 29.6%, 385.7 million USD);
- The Russian Federation (by 13.0%, 411.4 million USD);
- The USA (by 30.2%, 284.3 million USD);
- Greece (by 9.6%, 240.1 million USD);
- Israel (by 19.1%, 186.7 million USD);
- Germany (by 52.7%, 113.3 million USD);
- Ukraine (by 5.9%, 92.7 million USD);
- Azerbaijan (by 58.1%, 85.2 million USD).

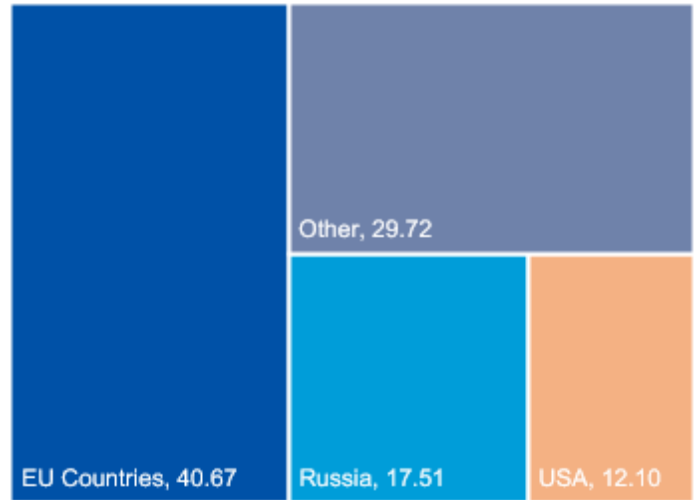


Figure 19: Country shares (%) in money transfers to Georgia, 2021. Source: NBG.

Compared to the previous year, the volume of remittances from Turkey decreased by 2.1% in 2021 and amounted to 104.5 million USD.

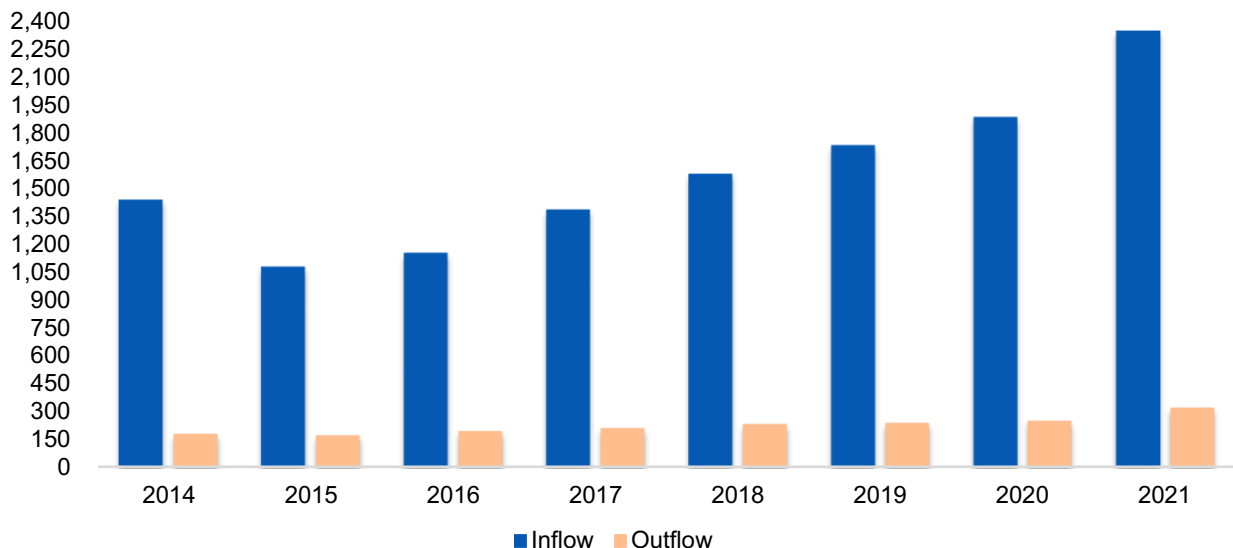


Figure 20: Money transfers to Georgia, Mn USD. Source: NBG.

2.2.2 International Reserves

By the end of 2021, the amount of international reserves was determined at 4,272 million USD (a multiple of 4.6 months of imports), which is 9.2% more than the same figure by the end of 2020. It should be noted that in 2020, the mentioned figure was 3,911 million USD, which was a multiple of 5.2 months of imports. In addition, during 2021, the National Bank of Georgia sold 333 million USD at the foreign exchange auction in response to currency depreciation.

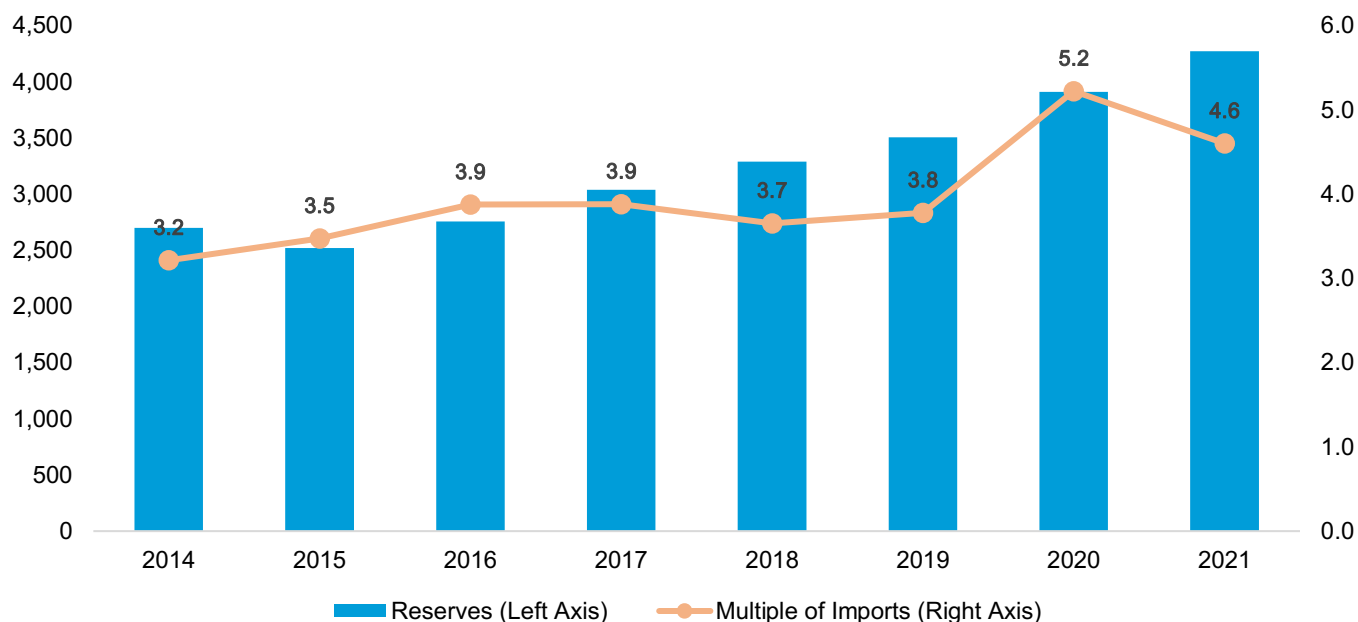


Figure 21: Official International Reserves, Mln USD. Source: National Bank of Georgia; PBO calculation.

2.3 Foreign Direct Investments

In 2021:

- **The volume of foreign direct investments in Georgia amounted to 1,153 million US dollars, which is 101.6% more than in 2020.** Among them: USD 328 million (28.4% of total foreign direct investment) from EU countries, USD 68 million (5.9%) from CIS countries, USD 757 million (65.6%) from other countries and international organizations.
- In 2021, the volume of reinvestments significantly increased in foreign direct investments, recorded in the balance of payments, which comprised 66% of total investments made in Georgia.

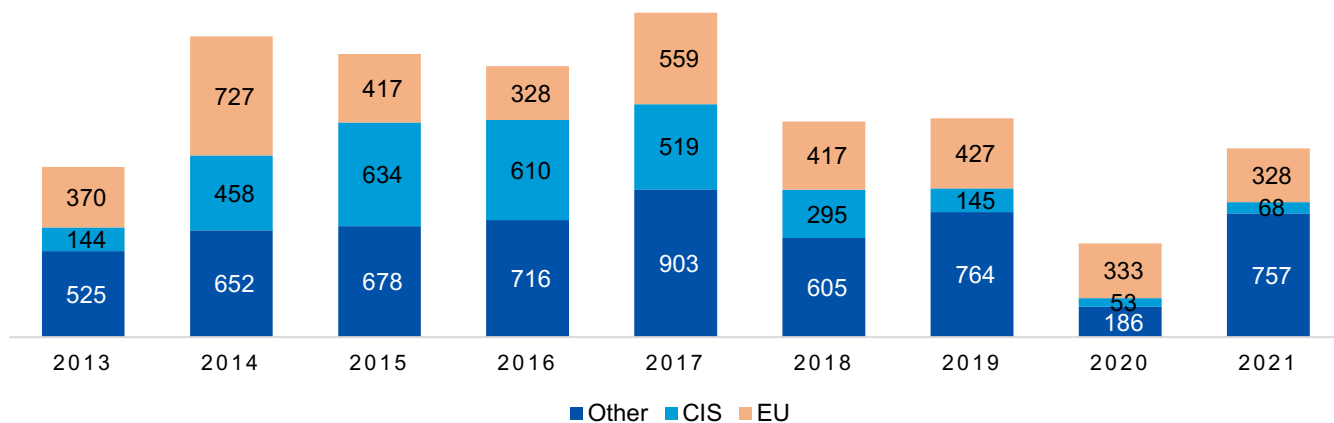


Figure 22: Dynamics of Foreign Direct Investments in the regional context, 2013-2021. Source: Geostat

In 2021, the ratio of foreign direct investment to GDP amounted to 6.2%.

In the regional context, the main investors were: United Kingdom (51.8% of FDI), Netherlands (10.9%), the Czech Republic (7.1%), Turkey (5.6%) and others. **In the industry context**, the most foreign direct investments were made in: Financial sector (38.5% of FDI), energy (13.6%), Manufacturing (12.4%), Real Estate (7.3%), and others sectors. It should be noted that energy sector is the most diversified sector among the major investment sectors, wherein in 2021 the share of 4 different countries was 87.4%. The financial sector and manufacturing are less diversified. 79.8% of foreign direct investments made in the financial sector comes from the United Kingdom, while in the manufacturing industry most of the investments were made from Netherlands (63.6%) and Russia (17.4%).

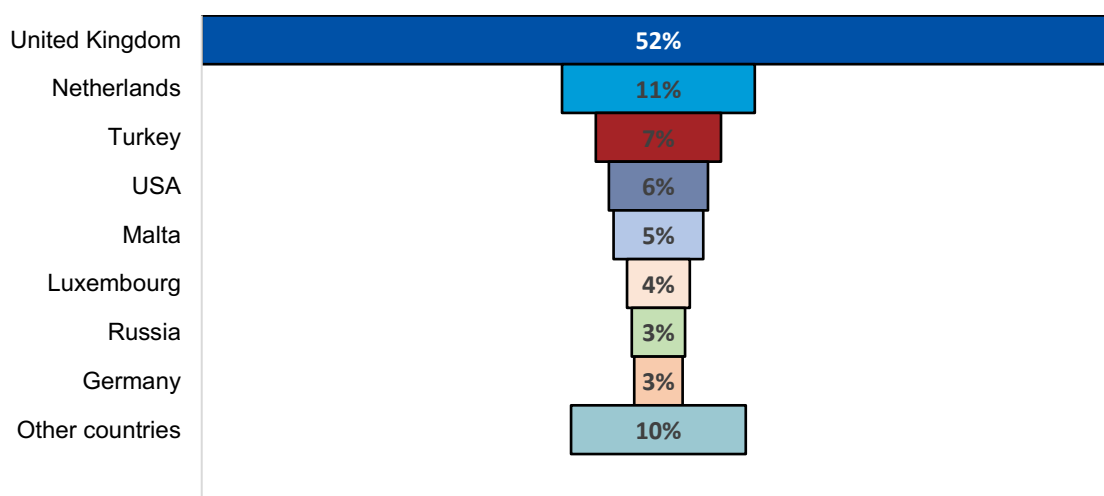


Figure 23: Structure of Foreign Direct Investments by countries in 2021. Source: Geostat.

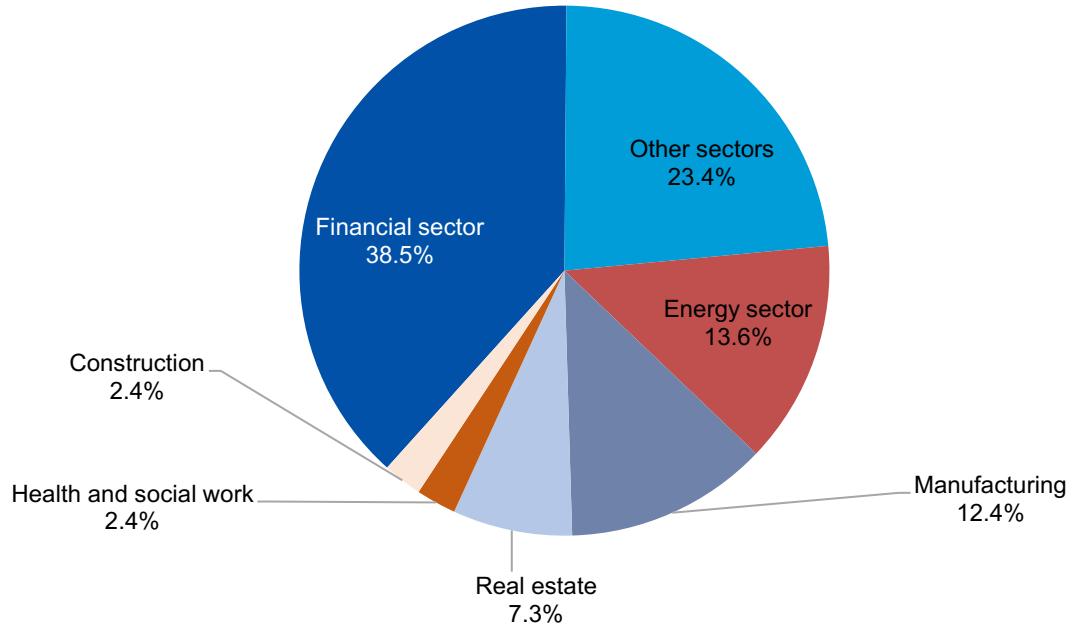


Figure 24: FDI structure by major economic sectors in 2021. Source: Geostat.

		Sectors				
		Financial	Energy	Manufacturing	Real Estate	Health and Social Work
Country Shares	10-50%		Luxembourg (10.6%)		Malta (12.7%)	Denmark (14%)
			Marshall Islands (14.5%)	Russia (17.4%)	United Kingdom (13.3%)	United Arab Emirates (14%)
			Netherlands (18.6%)		Germany (19.2%)	
					Russia (21%)	United Kingdom (28.9%)
			The Czech Republic (43.7%)		USA (37%)	
	50<%	United Kingdom (79.8%)		Netherlands (63.6%)		

Table 5: The structure of the major investment industries by countries in 2021. Source: Geostat⁶

⁶ A total share of more than 100% in this structure may be caused by the negative value of some countries.

3.

Fiscal Sector

Dynamics of the main indicators:

- **Consolidated budget revenues amounted to 15,143 million GEL in 2021, which is 22% higher compared to the previous year.**
Commentary: budget revenues include tax revenues, grant component and other revenues.
- **Expenditures, so-called current expenditures, is increased by 14.7% (by 1,970 million GEL) compared to the previous year and amounted to 15,369 million GEL. The acquisition of non-financial assets (by 4.6%, by 174 million GEL), which amounted to 3,963 million GEL, also shows a growth trend.**
Commentary: Budget expenditures (so-called current expenditures) include wages, goods and services, social security, etc. While the growth of non-financial assets includes investments in long-term assets.
- **The decrease in non-financial assets, so-called privatization, increased (by GEL 213.6 million), and in 2021 amounted to 422 million GEL.**
- **Compared to 2020, both the operating and the overall balance of the consolidated budget improved, therefore the budget deficit improved too (amounting to 6.3% of GDP).**

Commentary: The budget balance is a necessary indicator for assessing fiscal policy. Different types of balance are used for different purposes. Operating balance is the difference between budget revenues and expenditures. Overall balance (budget deficit / surplus) is the difference between the operating balance and the net change in non-financial assets.

3.1 Overview of Budget Aggregates

In 2021:

- Consolidated budget revenues amounted to 15,143 million GEL, which is 22% higher compared to the previous year. Among them, tax revenues increased by 22%, grant component decreased by 14.3%, and other revenues increased by 36.6% YoY. In 2020, growth rate of consolidated budget revenues was negative 3.9%.
- The fund mobilized in the form of grants and other revenues amounted to 11.6% of total revenues. The indicator remained unchanged compared to the previous year (11.6% in 2020).

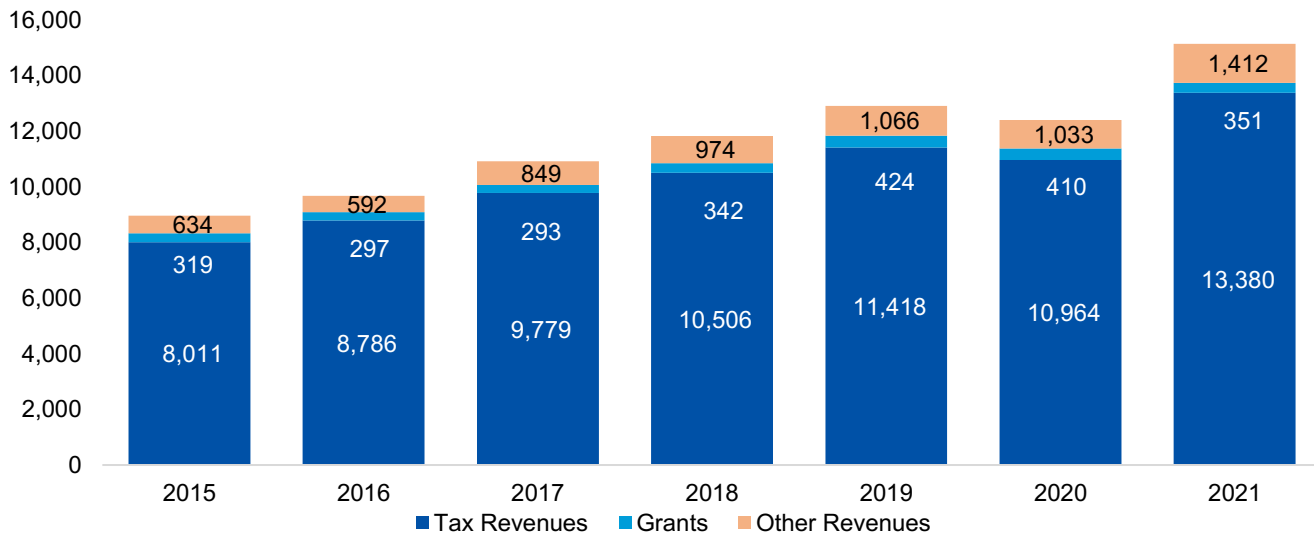


Figure 25: Budget revenue components of consolidated budget, GEL million. Source: Ministry of Finance

For the analysis of the dynamics according to the types of taxes, the treasury reform implemented in 2016 is noteworthy, on the basis of which the unified tax treasury code was enacted. As a result, the taxes are mobilized on the mentioned unified treasury code and then the tax is distributed according to the types of liabilities actually declared, in chronological order, according to the due date. This reform, on the one hand, simplified the terms of payment for taxpayers, but led to changes in the specifics of accounting and tax classification, and, in turn, created challenges in comparing revenue types by data with previous years' mobilization of revenues. In addition, the Covid-19 pandemic had a significant impact on tax revenues in 2020. Considering the above mentioned, the following trends in tax dynamics was revealed in 2021:

- After the decline observed in 2020, increase was recorded in the value added and income taxes, 24.6% and 13.5%, respectively.
- In 2021, profit and excise taxes increased by 96 and 249 million GEL, respectively. It is noteworthy that after the profit tax reform, the profit tax was increased for the third year in a row.
- Property and import taxes increased by 77 and 12 million GEL, respectively.
- In 2021, unlike to the previous year, a positive rate of other taxes was recorded and amounted to 94 million GEL. Another peculiarity of this tax is related to the reform of the treasury code and technical processes (in 2016, other taxes increased from 27 million GEL to 527 million GEL, in 2017 it decreased from 527 to 64 million GEL, and in 2018 increased to 115 million GEL, in 2019 and 2020 the indicator was negative – 230 million GEL and 246 million GEL, respectively);

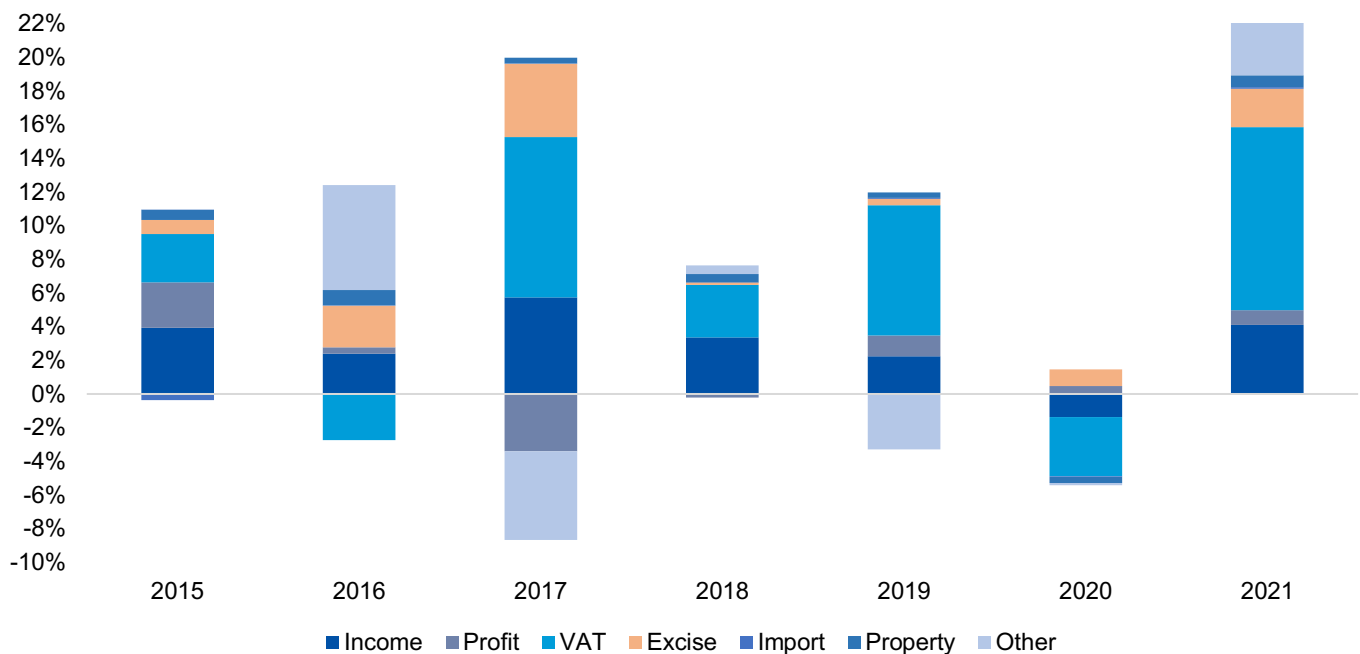


Figure 26: Contribution of Taxes to the Growth of Tax Revenues. Source: Ministry of Finance and PBO calculation.

As for the expenditure part of the consolidated budget in 2021:

- **In contrast to 2020, the so-called current expenditures increased (by 14.7%),** which together with the increase in revenues (by 766 million GEL) improved the operating balance of the consolidated budget and decreased the negative overall balance by 18% in parallel with the significantly increased non-financial assets;
- Expenditures on social security (by 767 million GEL) and goods and services (by 322 million GEL) increased the most in 2021, amounting together to 56% of total current expenditure growth;
- **The acquisition of non-financial assets increased by 174 million GEL and amounted to 3,963 million GEL;**
- **In total, the consolidated budget deficit decreased by 806 million GEL in 2021 and amounted to 3,768 million GEL (6.3% of GDP).**

In 2021, the budget deficit was financed mainly by the liabilities, which decreased by 3,836 million GEL compared to the previous year.

It should be noted that this figure of the budget deficit is 1.2 pp lower than the same figure forecasted by the government in December 2020 (7.5%), while it is 0.6 pp lower than the forecast indicator for the same period of the PBO (6.8%).

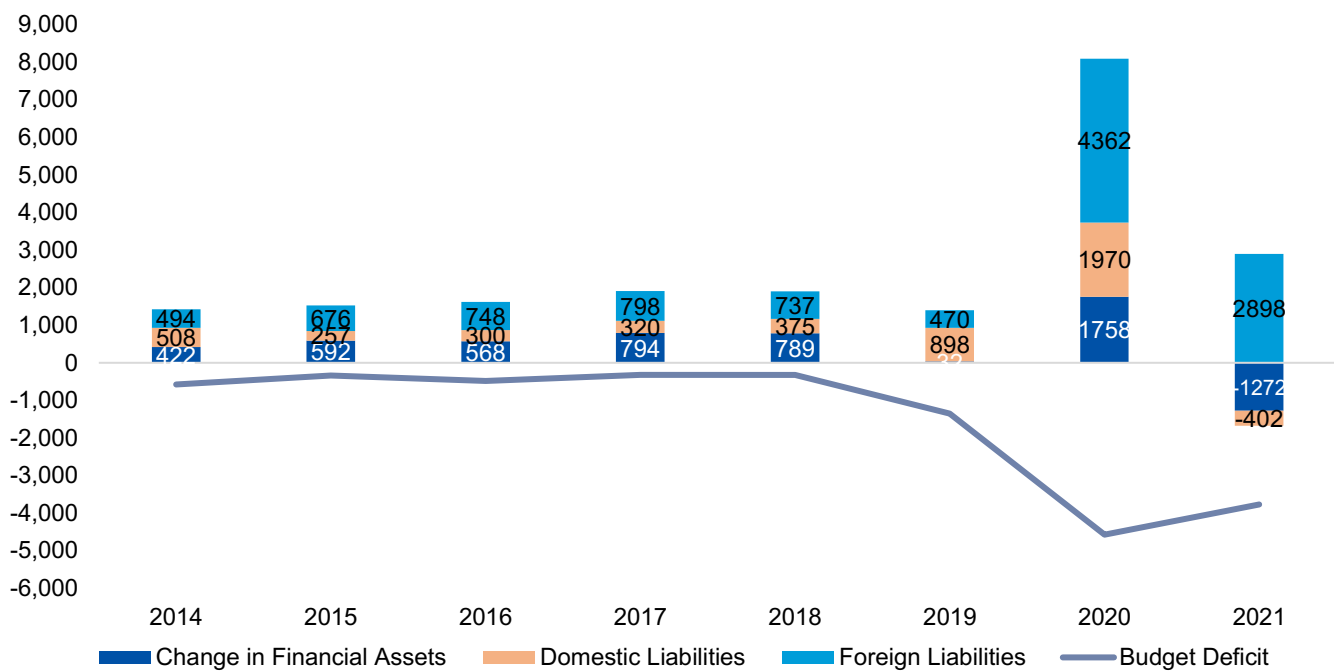


Figure 27: Structure of the budget deficit financing sources. Source: Ministry of Finance

3.2 Fiscal Policy Impulse and Fiscal Space

Along with the quantitative assessment of fiscal indicators, it is also important to assess the impact of fiscal policy on the economy. We need to determine whether fiscal policy has encouraged the economy (expansionary, stimulating) or restricted economic activity (restrictive). In addition, we should exclude from fiscal policy the so-called automatic stabilizers (which change during economic cycles) and should only consider the so-called discretionary fiscal policy. In turn, discretionary fiscal policies should be considered in relation to economic cycles. As known, for the short-term stability of the economy, except in a few exceptional cases, it is necessary for fiscal policy to facilitate the adjustment of economic cycles, to consolidate during the economic boom and expansion during the slowdown of the economy.

Accordingly, in order to assess the direction and cyclicity of fiscal policy, we must define the **fiscal position** as a cyclically adjusted primary balance and balance with a negative sign. A positive fiscal position means that the state invests more resources in the economy than it receives (fiscal expansion), while a negative fiscal position means that it receives more resources from the state economy than returns (fiscal consolidation). Also, let's define **fiscal impulse** as a change in fiscal stance. If the output gap decreases, countercyclical fiscal policy requires either less consolidation (during a positive gap) or more expansion (during a negative gap), which means that the fiscal impulse must be positive. If the output gap increases, countercyclical fiscal policy requires either more consolidation (during positive gap) or less expansion (during negative gap), which means that the fiscal impulse must be negative.⁷

In 2021, the fiscal stance was expansive or was aimed to stimulate the economy. In 2020, the lag of GDP increased from its potential level and a significant negative gap was recorded, as well as the size of the budget deficit increased and, most importantly, a negative cyclically adjusted primary total balance was recorded,

⁷ For detailed information and methodology, see the Parliamentary Budget Office Research Publication: "Fiscal Policy Assessment for Georgia: Direction, Cyclicity, Maneuvering Resource."

http://pbo.parliament.ge/media/k2/attachments/Fiscal_Stance_and_Space.pdf

which means a positive fiscal stance. It is also noteworthy that in parallel with the negative gap in GDP in 2015-2018, discretionary fiscal policies were not focused on improving the GAP. During this period, if we exclude the cyclical component from fiscal policy and interest expenses (which are not useful for discretionary policy assessments), the cyclically-adjusted budget balance was consistently positive, meaning that in 2015-2018 a negative fiscal stance was generated.

After the high negative GDP gap observed in 2020, improved economic growth in 2021 resulted in a decrease of negative gap. But GDP still slightly lags behind its potential level. Budget deficit decreased as well compared to the previous year and negative cyclically-adjusted overall primary balance was recorded, meaning positive fiscal stance.

As Figure 28 shows the combination of the GDP gap and the cyclically-adjusted overall primary balance, fiscal policy in 2021 was countercyclical, which reduced the negative GDP gap.

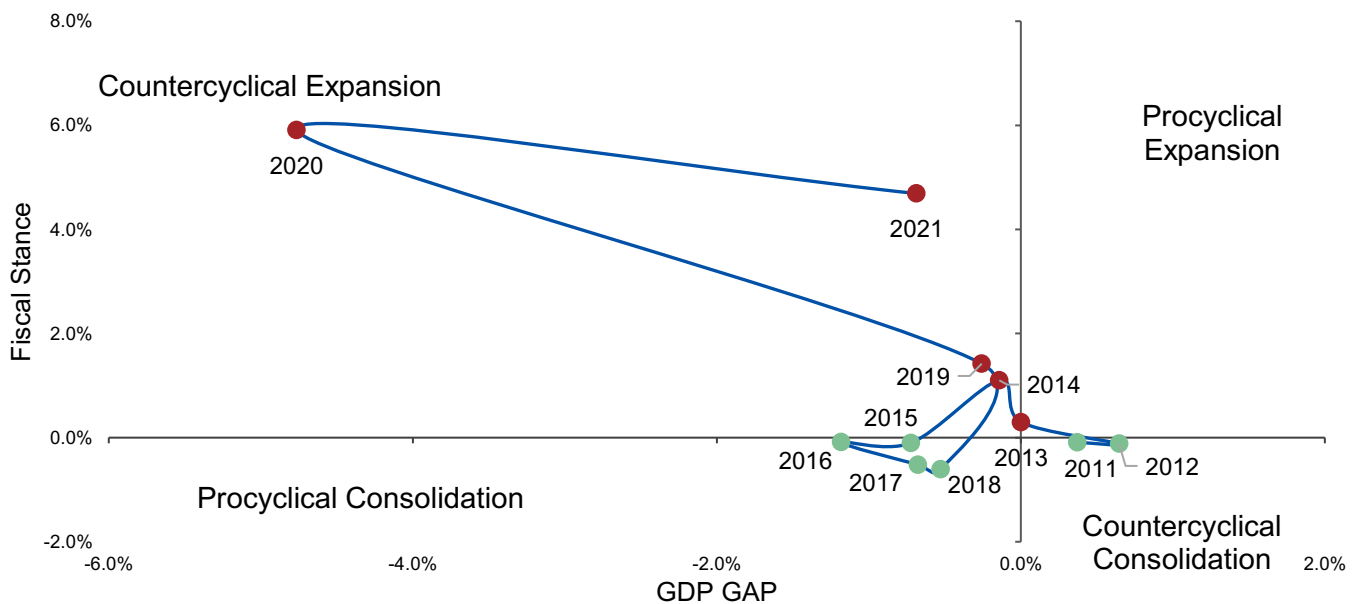


Figure 28: Fiscal Stance and GDP Gap. Source: PBO calculations

Although countercyclicality can also be assessed even more stringently in dynamics by a combination of fiscal impulse (change in fiscal stance) and GDP gap change. This indicates that the fiscal impulse in 2021 was negative in the country (fiscal policy was less expansionary compared to the previous year, as a result consolidation was observed) and since in 2021 the size of the negative GDP gap has decreased (see Figure 5), this indicates the countercyclical consolidation of fiscal policy in 2021.

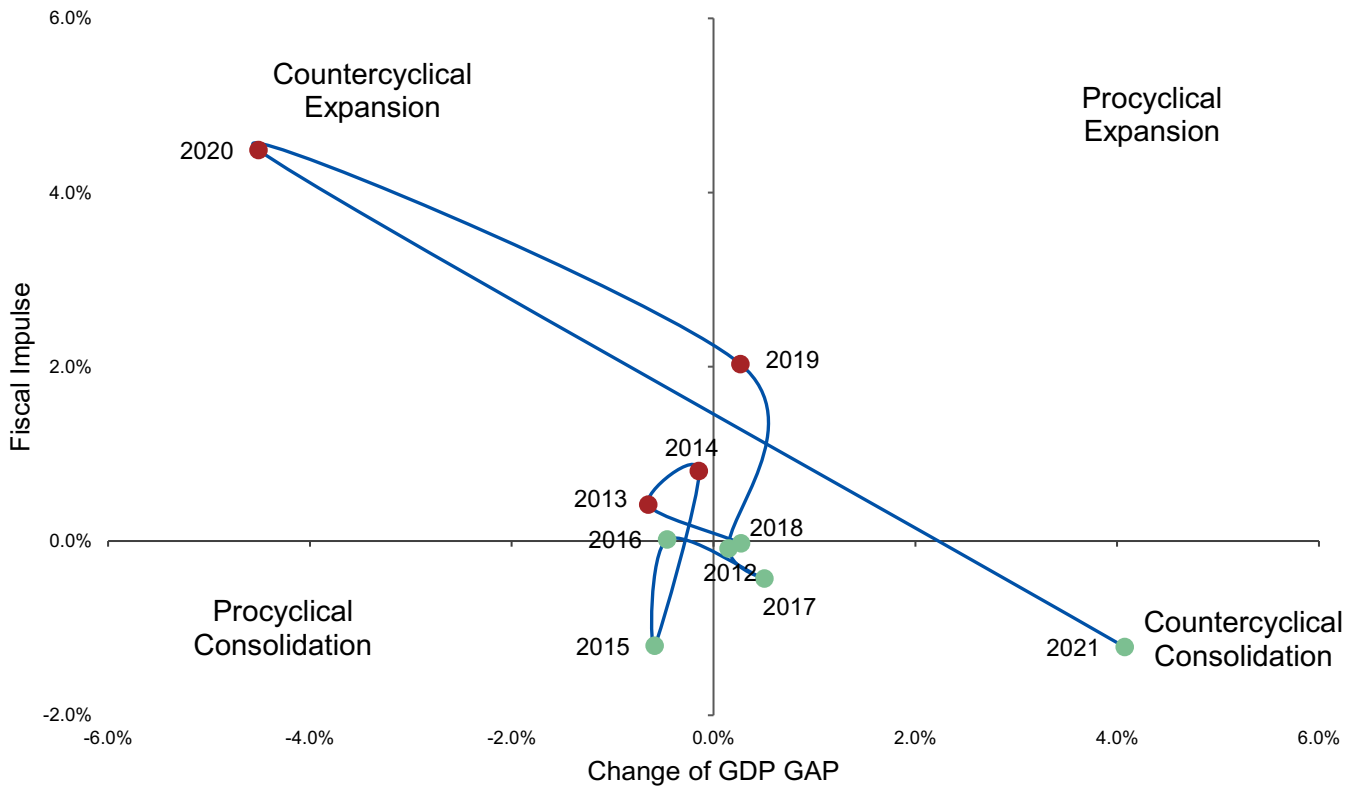


Figure 27: Fiscal Impulse and Change of GDP Gap. Source: PBO calculations.

4. Monetary Sector

Dynamics of the main indicators:

- **Average annual inflation rate was recorded 9.6% YoY, higher than the inflation target of 3%. In 2021 annual inflation was predominantly driven by dynamics of prices on the food and non-alcoholic beverages.**

Commentary: Inflation is the increase in the general level of prices of goods and services in the economy over a period of time. The Consumer Price Index (CPI) is mainly used to measure inflation, which reflects the value of a representative basket of goods and services purchased for consumption by a typical household.

- **In 2021, the dollarization rate of deposits decreased by 4.2 pp to 58.5%. The dollarization of deposits has been steadily increasing since 2013, before declining in 2017-2019.**

Commentary: Dollarization reflects the level of use of foreign currency for economic transactions in parallel with the local currency. Local currency substitution rates have a significant impact on the effectiveness of the monetary policy transmission mechanism.

- **Lending to the private sector by depository corporations increased significantly.**

Commentary: A review of depository corporations is a report of the central bank, commercial banks, credit unions, and other depository corporations that, along with reviews of other financial corporations, provide an overview of financial corporations. Overviews of depository corporations include reviews of the central bank and other depository corporations.

- **The GEL exchange rate depreciated against the US dollar and the euro.**

Commentary: The exchange rate measures the price in a foreign currency unit in terms of a local currency unit. In contrast to the nominal exchange rate, the real exchange rate reflects the relative price of local products compared to foreign goods.

4.1 Inflation Overview

In 2021, the average overall price level increased by 9.6% compared to 2020, which is 4.3 pp higher than the average annual inflation in 2020. Annual (end of period) inflation in 2021 was 13.9%. It should be noted that the National Bank's inflation target is set at 3%.

As shown in Figure 30, almost all commodity groups contributed to the increase in consumer price inflation. Food and non-alcoholic beverages (with 3.5% pp) are noteworthy in this regard.

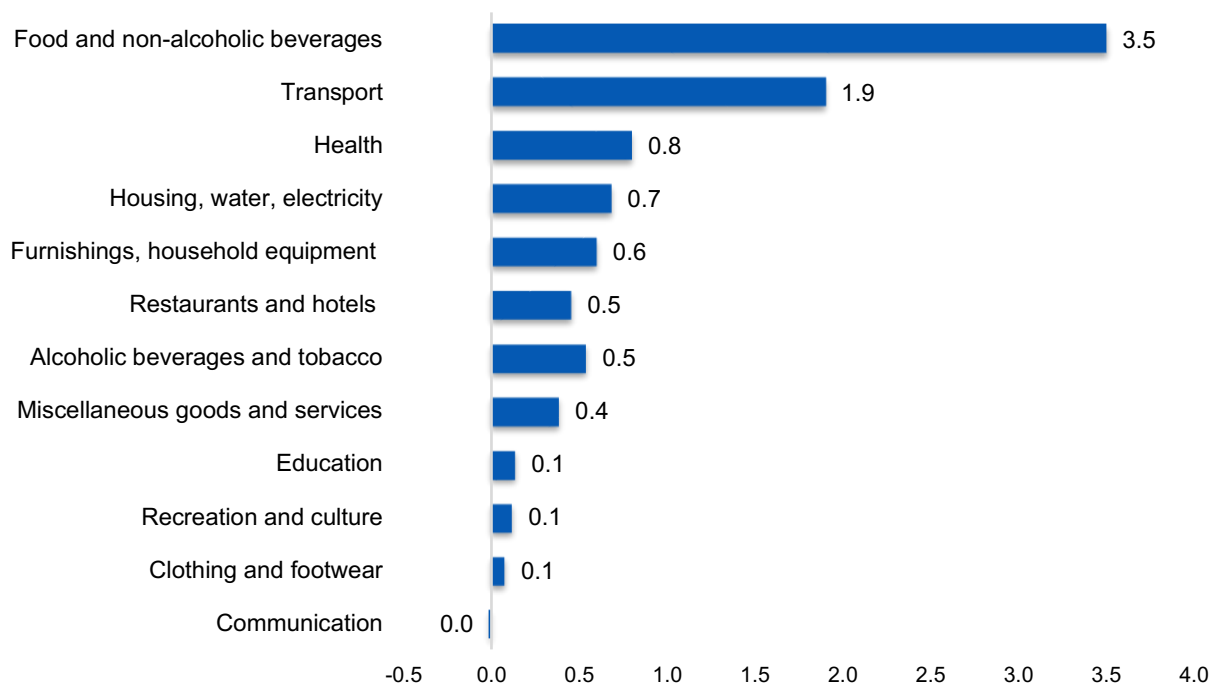


Figure 28: Decomposition of average annual inflation, 2021. Source: Geostat.

If we consider the inflation decomposition of 2021 and 2020 according to 12 commodity groups (table 6), it is clear that this structure of products with an impact on inflation in 2021 differs from the 2020 index, as well as the factors affecting them:

- In contrast to 2020, in 2021, transport and leisure, entertainment, cultural commodity groups had a increasing impact on inflation, which is naturally caused by the increase in demand for these groups due to the improved epidemiologic situation and canceling constraints related to Covid-19;
- In 2021, the contribution of food prices to inflation increased even more than in the previous year, which, among other factors, was due to a significant increase in world food prices;
- In 2021, compared to 2020, the impact of housing, water, electricity, gas and other fuels on inflation increased significantly.

2021			2020		
Food and non-alcoholic beverages	3.45	3.28	Food and non-alcoholic beverages		
Transport	1.89	0.52	Health		
Health	0.83	0.49	Furnishings, household equipment and maintenance		
Housing, water, electricity, gas and other fuels	0.69	0.47	Miscellaneous goods and services		
Furnishings, household equipment and maintenance	0.65	0.42	Alcoholic Beverages and tobacco		
Restaurants and hotels	0.54	0.30	Restaurants and hotels		
Alcoholic Beverages and tobacco	0.46	0.11	Education		
Miscellaneous goods and services	0.38	0.07	Housing, water, electricity, gas and other fuels		
Education	0.13	0.02	Clothing and footwear		
Recreation and culture	0.12	-0.01	Communication		
Clothing and footwear	0.08	-0.09	Recreation and culture		
Communication	-0.01	-0.44	Transport		

Table 6: Average Annual Inflation Decomposition 2020-2021. Source: Geostat, PBO calculation

In 2021, along with Georgia, consumer price indices of neighboring countries showed significant dynamics. Consumer price inflation were characterized with similar trends in the region countries, except Turkey. Namely, in 2021 annual inflation amounted to 19.6% in Turkey. Inflation was lower in Armenia (7.2%), Azerbaijan (6.7%) and Russia (6.7%).

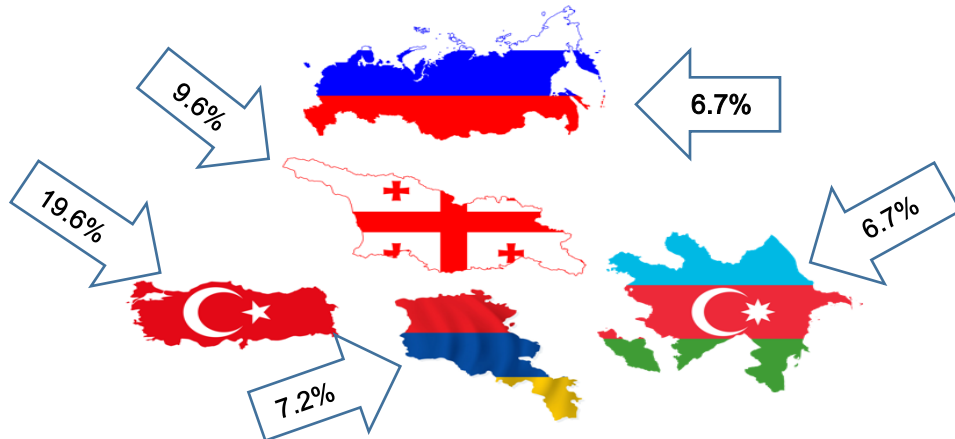
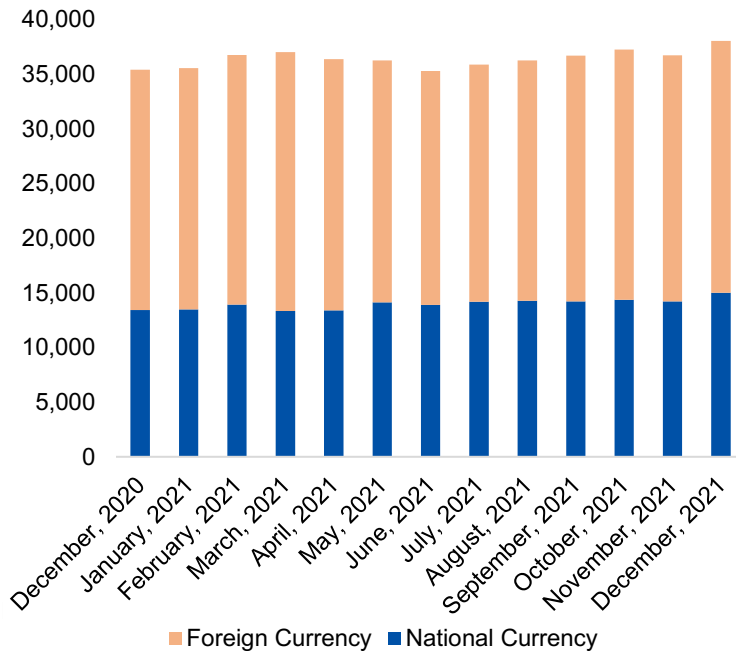


Figure 29: Average Annual Inflation of neighbouring countries, 2021. Source: International Monetary Fund.

4.2 Bank Deposits and Loans

4.2.1 Deposits



Total amount of deposits at the end of December 2021, increased by 1,315.5 million GEL MoM (increased by 3.6%) and amounted to 38,035.4 million GEL, which is 2,610.4 GEL million higher YoY (increased by 7.4%).

An amount of deposits in national currency as for the end of December 2021, increased by 803.1 million GEL MoM (increased by 5.7%) and amounted to 15,014.8 million GEL, which is 1,572.4 million GEL higher YoY (increased by 11.7%).

The share of time deposits in national currency amounted to 42.7% (6,415.4 GEL million) of total deposits, while the amount of current accounts deposits in national currency was 5,076.9 million GEL, 158.5 million GEL higher MoM (increased 3.2%) and 1,257.7 million GEL higher YoY (increased 32.9%).

The amount of deposits in foreign currency as for the end of December 2021, increased by 512.4 million GEL MoM (increased by 2.3%) and amounted to 23,020.7 million GEL, which is 1,038 million GEL higher YoY (increased by 4.7%).

The amount of current accounts deposits in foreign currency as for the end of December 2021 was 6,340.7 million GEL (previous month – 6,041.2 million GEL), 299.5 million GEL higher MoM (increased by 5.0%) and 762.2 million GEL higher YoY (increased by 13.7%). The amount of time deposits in foreign currency as for December 2021 was 9,433.7 million GEL, 73.8 million GEL lower MoM (decrease 0.8%) and 626.4 million GEL lower YoY (decrease 6.2%).

Total Bank Deposits Placed by Individuals

The amount of deposits placed in commercial banks by individuals in national currency amounted to 5,384.7 million GEL by the end of December 2021, which is 433.6 million GEL higher MoM (increased by 8.8%) and 906.4 million GEL higher YoY (increased by 20.2%).

The amount of commercial bank deposits in foreign currency placed by individuals amounted to 14,487.0 million GEL by the end of December 2021, which is 253.5 million GEL higher MoM (increased by 1.7%) and 870.5 million GEL higher YoY (increased by 6.2%).

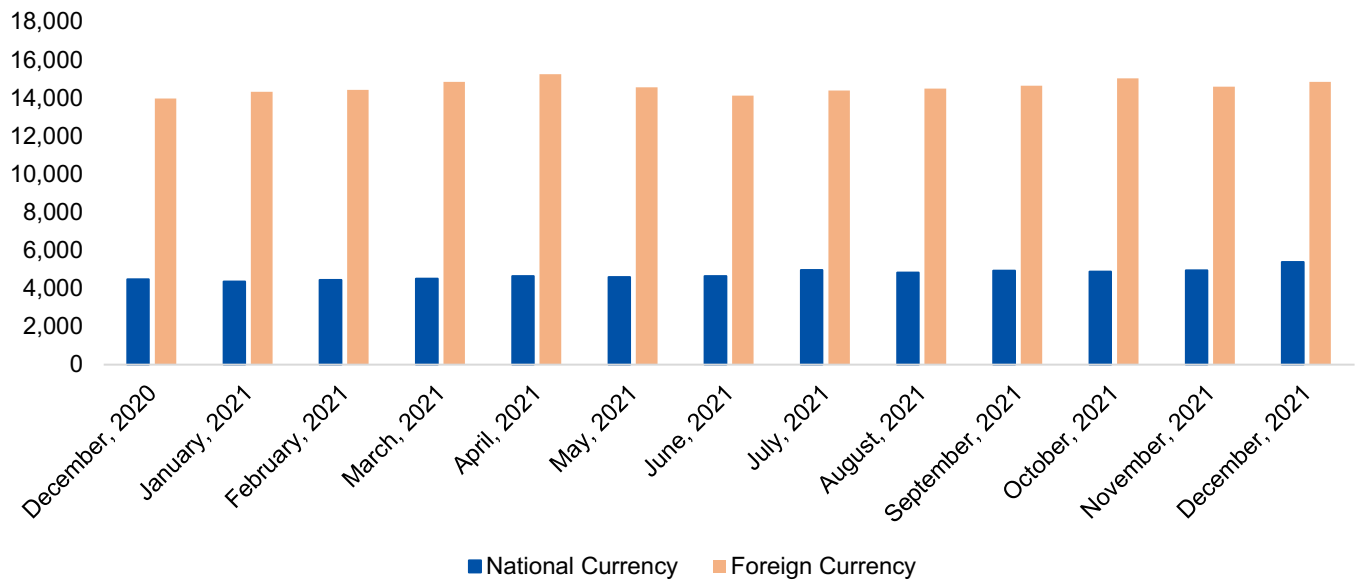


Figure 33: Commercial Bank Deposits Placed by Individuals, GEL million. Source: National Bank of Georgia.

Total Bank Deposits Placed by Legal Entities

The amount of commercial bank deposits in national currency placed by legal entities amounted to 9,630.1 million GEL by the end of December 2021, which is 369.5 million GEL higher MoM (increased by 4.0%) and 666.0 million GEL higher YoY (increased by 7.4%).

The amount of commercial bank deposits in foreign currency placed by legal entities amounted to 8,173.6 million GEL by the end of December 2021, which is 258.8 million GEL higher MoM (increased by 3.3%) and 167.4 million GEL higher YoY (increased by 2.1%).

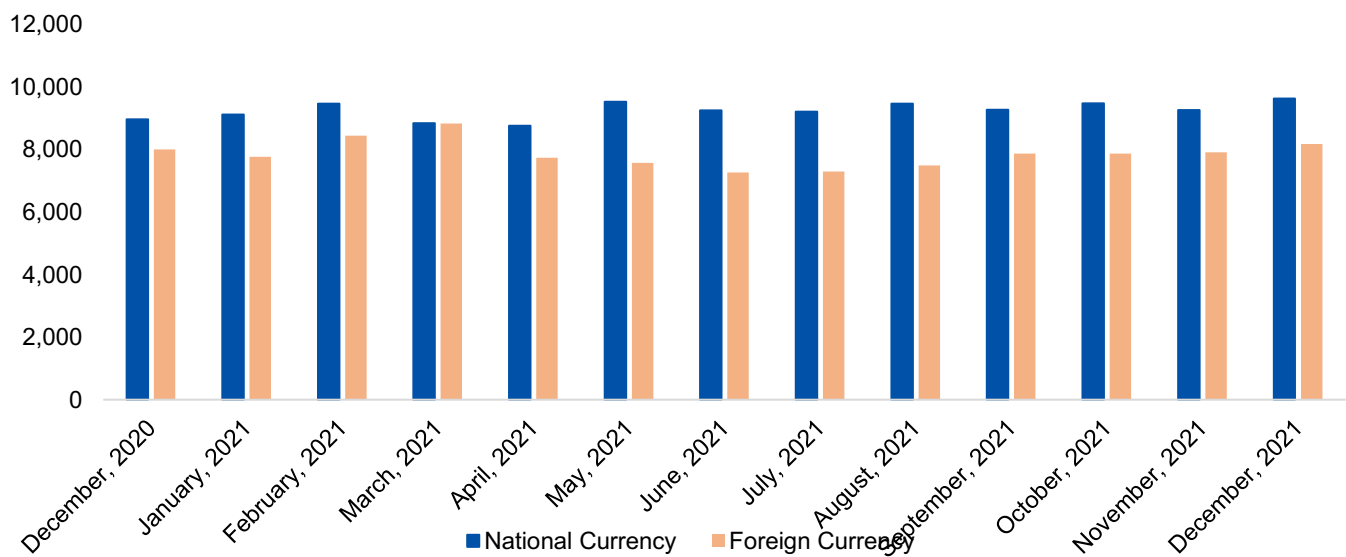


Figure 34: Commercial Bank Deposits Placed by Legal Entities, GEL million. Source: National Bank of Georgia.

4.2.2 Loans

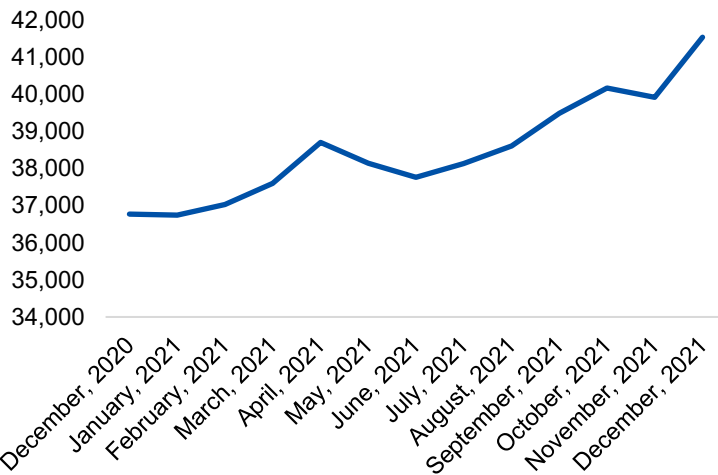


Figure 35: Commercial Bank Loans to residents in national and foreign currencies, GEL million. Source: National Bank of Georgia.

The volume of loans in national currency increased by the end of December, 2021 and amounted to 20,424.5 million GEL, which is 662.2 million GEL higher MoM (increased by 3.4%) and 4,113.0 million GEL higher YoY (increased by 25.2%). 68.8% (14,046.0 million GEL) of total loans in national currency was distributed to households.

The amount of loans in foreign currency amounted to 21,116.5 million GEL by the end of December 2021, which is 959.1 million GEL higher MoM (increased by 4.8%) and 656.3 million GEL higher YoY (increased by 3.2%). 35.5% (7,500.0 million GEL) of total loans in foreign currency was distributed to households.

In total, by the end of December 2021, the total volume of loans granted to the economy amounted to 41,541 million GEL, which is 1,621.3 million GEL higher MoM (increased by 4.1%) and 4,769.2 million GEL higher YoY (increased by 13.0%). 51.9% (21,546.0 million GEL) of total loans was distributed to households

Loans by Economic Sectors

As of December 31, 2021, the distribution of credit resources in national currency among the sectors of the country's economy shows that out of the loans issued by commercial banks to legal entities in national currency (10,640 million GEL), 3,429.5 million GEL (32.2%) were invested in industry, 3,077.1 million GEL (28.9%) in trade, 1,316 million GEL (12.4%) in financial intermediation, 1,110.7 million GEL (10.4%) in construction and 1,706.7 million GEL (16%) in other sectors.

In the same period, the distribution of credit resources to legal entities (10,420.3 million GEL) in foreign currency among the sectors of the country's economy is as follows: 2,813 million GEL (27%) in industry, 2,697.8 million GEL (25.9%) in trade, 1,820.1 million GEL (17.5%) in construction, 1,106 million GEL (10.6%) in operations with real estate and 1,983.4 million GEL (19%) in other sectors.

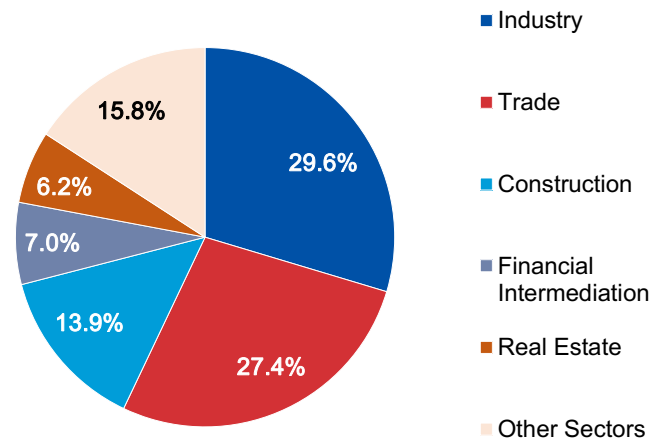


Figure 36: The Structure of Commercial Bank Loans to resident Legal Entities. Source: National Bank of Georgia.

4.3 Overview of Monetary Aggregates

In 2021, the monetary policy rate of the National Bank of Georgia was increased to 10.5%, which is 2.5 pp higher than the rate at the end of 2020. At the beginning of 2021, monetary policy rate was defined at 8%. The Monetary Policy Committee met 8 times in total during the year, of which the rate increased by 0.5 pp in March, by 1 pp in April and by 0.5 pp in August and December, amounted to 10.5% at the end of the year.

It is noteworthy that in early 2017, as a result of one-off factors (increase in excise duty and depreciation of the exchange rate) due to a temporary increase in inflation, monetary policy tightened slightly. The further increase in the rate was followed by an increase in inflation expectations in the middle of the year, and at the end of the year - a significant depreciation of the nominal effective exchange rate, which, despite the exhaustion of one-off factors, increased the pressure on inflation. In 2018, the rate cut occurred, which, among other factors, was due to the faster-than-expected appreciation of the nominal exchange rate, associated with reduced inflationary pressures, which led to the exit from the moderately tight monetary policy. The same continued in 2019, but in response to the sharp depreciation of the exchange rate in the summer of 2019, which put significant pressure on inflation, the National Bank raised its monetary policy rate from 6.5 percent in August to 9 percent in late December. In order to encourage reduced economic activities due to the restrictions introduced due to the pandemic in 2020, the National Bank reduced the monetary policy rate by 1 pp and set it at 8.0 percent by the end of the year. From the beginning of 2021, in response to the inflationary processes monetary policy rate was characterized by increasing trend and set at 10.5% at the end of the year.

In 2021, compared to 2020, market interest rates decreased on both total loans and deposits. In 2021, the average interest rate on loans was 12.1%, which is 0.1 pp lower than the same figure in 2020, while the average interest rate on deposits was 6.4% (a decrease of 0.5 pp). Accordingly, interest rate spread (difference between rates) increased by 0.4 pp and reached 5.8%.

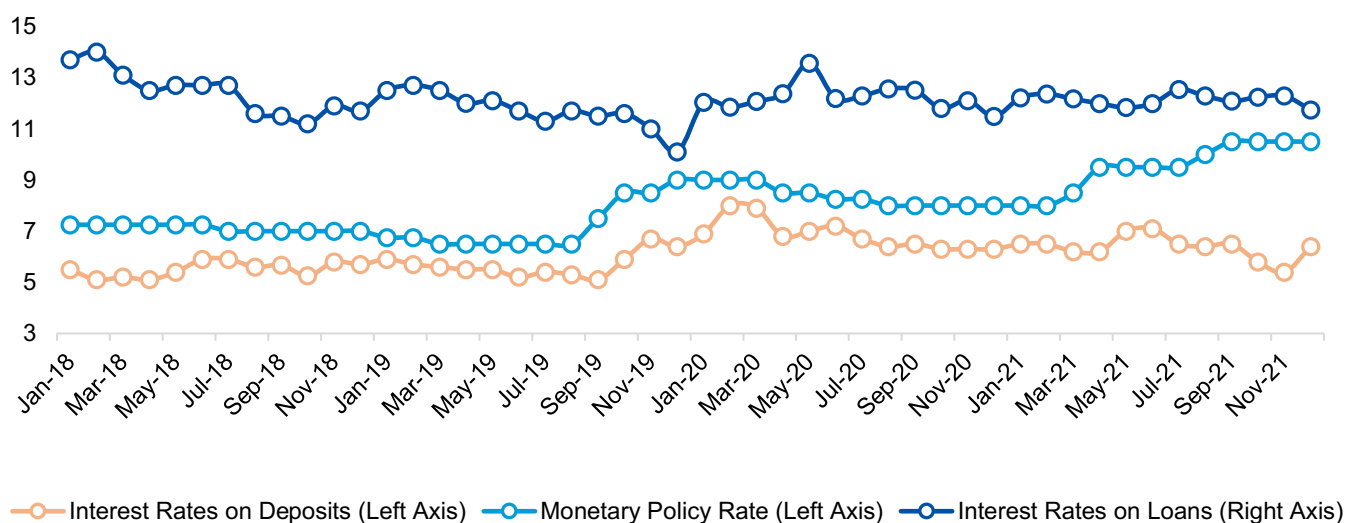


Figure 30: Interest Rates. Source: National Bank of Georgia.

It should be noted that in 2021, the average interest rates on loans in the national currency decreased (15.6%, 0.1 pp), while interest rates on deposits in the national currency increased (9.8%, 0.6 pp). However, the interest rate spread decreased to 5.9% (down 0.6 pp). Average interest rates on foreign currency loans (6.4%, -0.2 pp) and deposits (1.2%, -1.3 pp) decreased, respectively, the spread increased (5.2%, 1.1 pp).

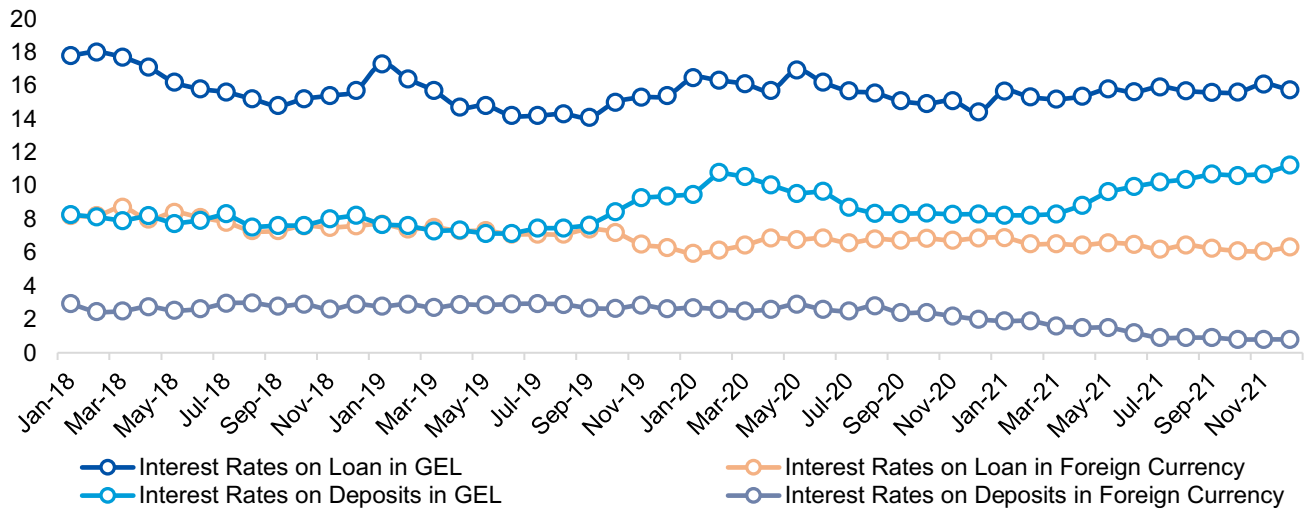


Figure 31: Interest Rates by Currency. Source: National Bank of Georgia.

4.4 Overview of Depository Corporations

In 2021, the net foreign assets of depository corporations decreased by almost 100% and amounted to -11.2 million GEL at the end of the year. Among them, the net foreign assets of the National Bank of Georgia decreased by 5.8% to 10.3 billion GEL, while the net foreign assets of other depository corporations (banking sector) decreased by 3.1% to -10.3 billion GEL.

In turn, the net domestic assets of depository corporations increased by 15% in 2021 and amounted to 33.9 billion GEL by the end of the year. Among them, net domestic lending increased by 13% to 45.4 billion GEL, while other net items decreased by 7.5% to -11.5 billion GEL.

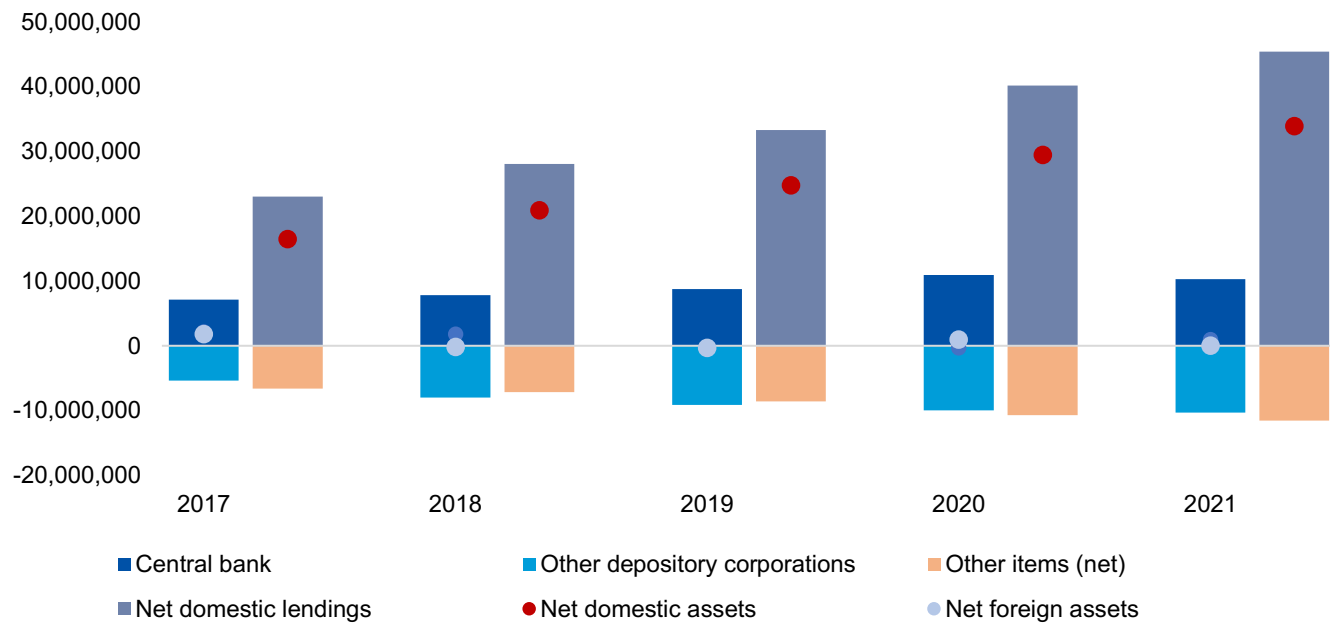


Figure 32: Overview of Depository Corporations. Source: National Bank of Georgia (thousand GEL).

By the end of 2021, the largest share (48.1%) of the net domestic lending of depository corporations was distributed as the debt of other resident sectors (individuals) - 21.8 billion GEL (growth - 14.1%). The debt of other non-financial corporations was in the next position (45.6%), which reached 20.7 billion GEL (increase - 10.7%). It should be noted, that the trend started in 2015 was maintained in 2021, when the debt of individuals exceeded the debt of other non-financial corporations for the first time in the history of data accounting and constituted the largest item of net domestic lending (before 2005 the largest item was government net debt).

As for other domestic lending items, government net debt at the end of the year was 1.9 billion GEL (increased by 30.6% YoY), debt of state non-financial corporations - 163.5 million GEL (decreased by 14.1% YoY), and debt of other financial sectors - 751 million GEL (increased by 12.6% YoY).

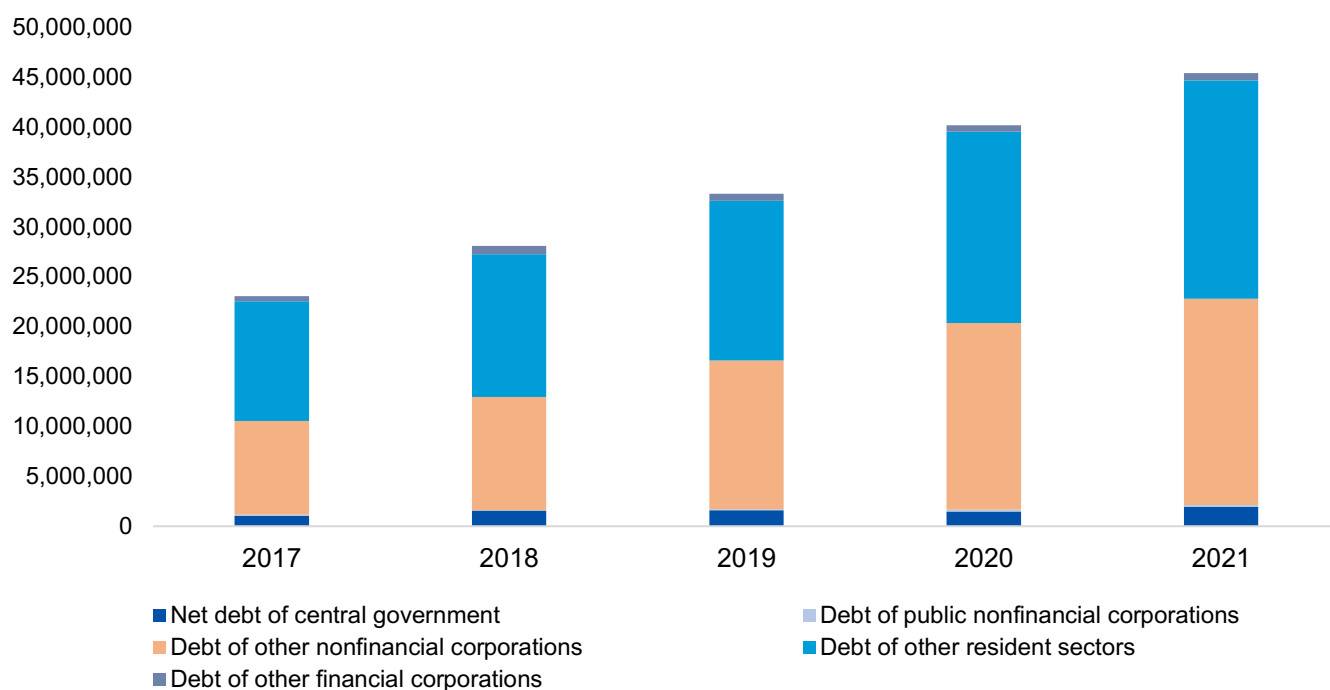


Figure 40: Net domestic lending of depository corporations and its components. Source: National Bank of Georgia (thousand GEL).

4.5 Overview of Monetary Aggregates and Exchange Rates

By the end of 2021, monetary aggregates M3 (33.8 billion GEL) and M2 (16.1 billion GEL) increased by 11.4% and 17.9% respectively, compared to the corresponding period of 2020. 12.9% growth was also observed in case of M1 (11.3 billion GEL), while M0 (3.5 billion GEL) decreased by 5.1%. As for reserve money, it decreased by 3.6% and by the end of the year amounted to 10.4 billion GEL. It should be noted, that in 2015-2021, monetary aggregates are characterized by a continuous upward trend, except in 2021, when the M0 aggregate slightly decreased.

In 2021, the dollarization rate of deposits decreased by 4.2 pp and amounted to 58.5%. It should be noted that dollarization rate of deposits was characterized by a continuous upward trend until 2017. Namely, in 2016 the indicator amounted to 69.3%. In 2017 dollarization rate started to decrease and reached 61.0% in 2019. In 2020, during the pandemic period, dollarization rate of deposits increased by 1.8 pp and amounted to 62.7% YoY.

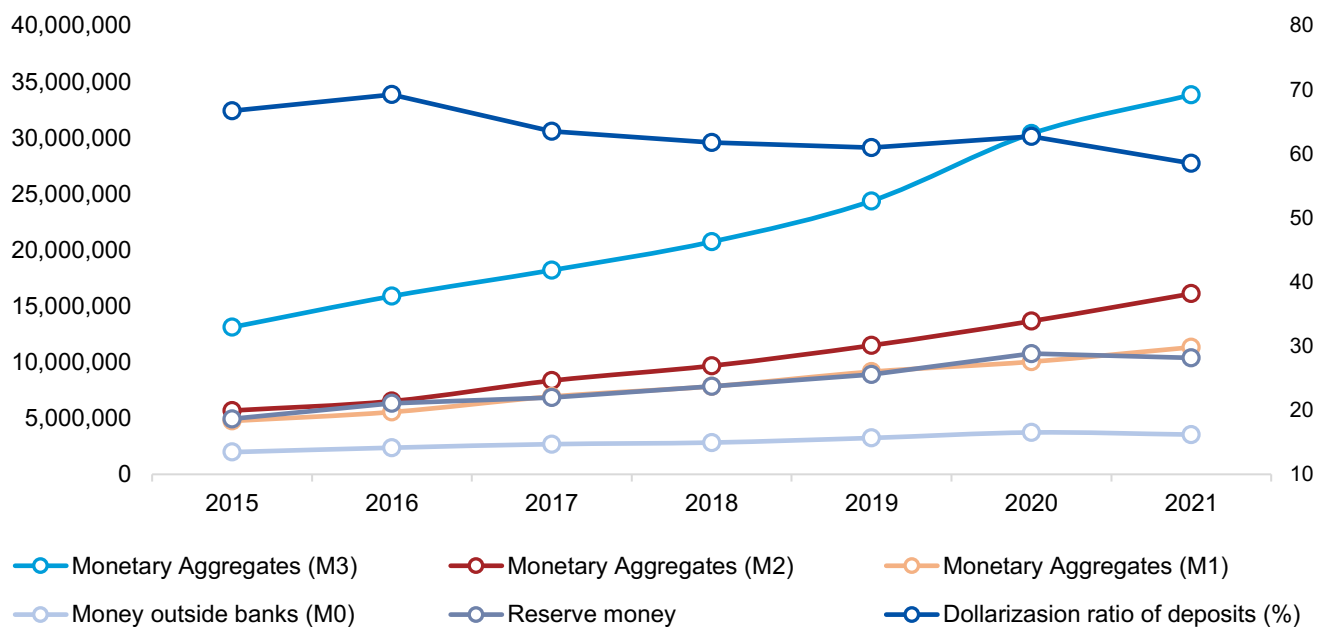


Figure 41: Monetary Aggregates. Source: National Bank of Georgia (thousand GEL).

In 2021, the GEL exchange rate depreciated against the following currencies: Euro (-6.9%), Moldovan Lei (-1.3%), US Dollar (-3.5%), Azerbaijani Manat (-3.4%), Armenian Dram (-0.5%), Russian Ruble (-1.4%) and Ukrainian Hryvnia (-2.3%). In turn, GEL appreciated against the Turkish Lira (18.7%) and the Belarusian Ruble (0.6%).

	2015	2016	2017	2018	2019	2020	2021
EURO	-6.9	-3.7	-7.6	-5.3	-5.2	-11.2	-6.9
USD	-22.2	-4.1	-5.7	-1.0	-10.1	-9.3	-3.5
Turkish Lira	-3.3	6.6	14.0	27.8	8.3	11.5	18.7
Russian Ruble	25.0	5.7	-17.5	6.2	-7.1	1.1	-1.4
Azerbaijani Manat	0.2	52.6	0.9	-2.4	-10.0	-9.3	-3.4
Belarusian Ruble	20.3	20.7	-8.3	4.4	-7.8	5.7	0.6
Moldovian Lei	3.5	2.5	-12.7	-9.8	-6.0	-10.8	-1.3
Armenian Dram	-10.8	-3.3	-5.2	-0.9	-10.6	-7.7	-0.5
Ukrainian Hryvnia	45.4	14.2	-1.6	1.2	-15.0	-5.0	-2.3

Table 7: Change in GEL Exchange Rate (Increase means appreciation). Source: National Bank of Georgia.