TBC CAPITAL

Inflationary Pressures Contained Though Middle East Risks Return

Macro Update – Georgia

8 July 2026

TBC Group Chief Economist Office

KEY TAKEAWAYS

- Annual inflation edged up to 5.8% in June from 5.7% in May, with momentum strengthening more in monthly terms. While on the firmer side, these dynamics are broadly consistent with our 5.1% end-year inflation forecast;

- However, Wednesday saw another flare-up in the Middle East conflict, triggering a surge in oil prices and bringing back considerable uncertainty for the inflation outlook;

- For the time being, it is unclear whether the renewed escalation is temporary or not. Should full-scale hostilities resume, inflationary pressures will naturally intensify again, bringing end-year inflation back closer to our previous 6% forecast;

- Higher uncertainty also supports the case for keeping the monetary policy rate tighter for longer. The policy rate is expected to be held at 8.25% in 2026;

- Back to June, annual inflation remains driven by food and fuel, the two key drivers for the outlook, with further normalization conditional on the Middle East escalation proving limited;

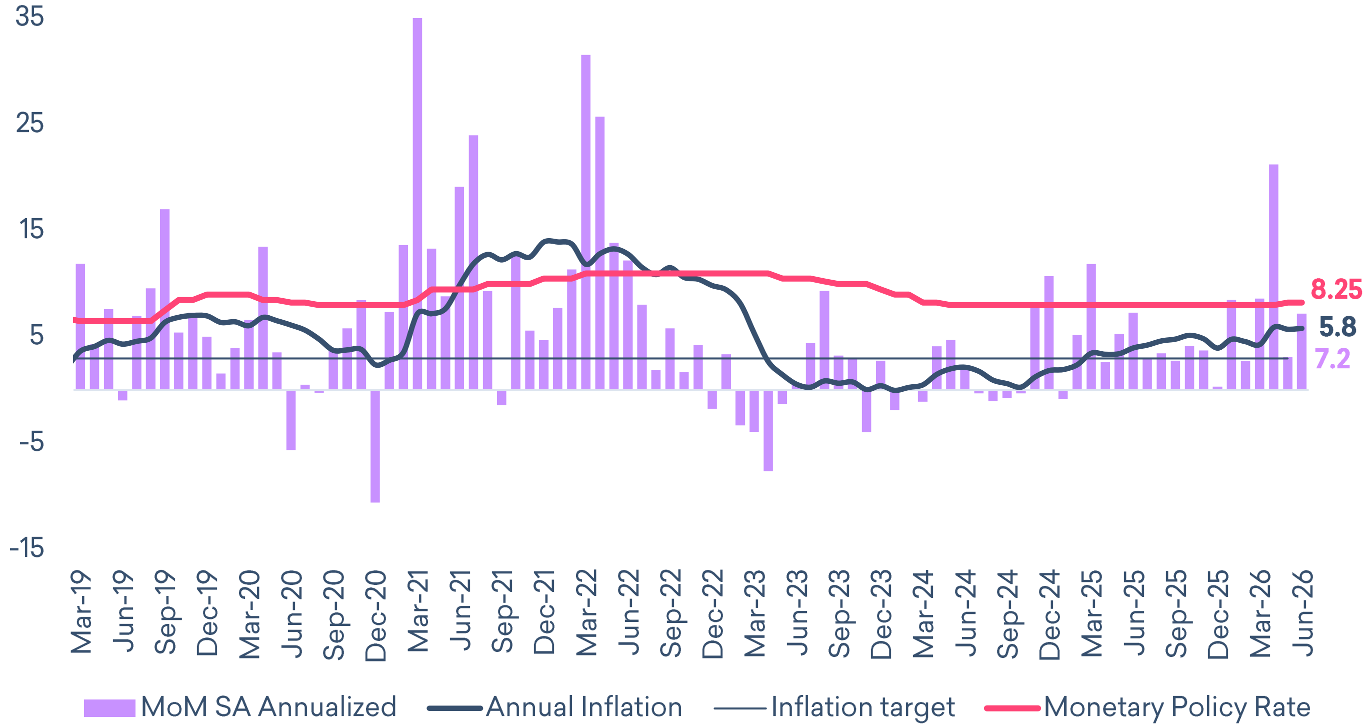
- Elsewhere, economic growth came in at 6.4% in May, slightly higher than the 6.2% print in April, in line with our expectations;

- Coincident indicators point to a slightly weaker June so far, though air traffic data shows a significant acceleration in flight numbers since late June, hinting at stronger tourism demand in July;

- We expect the surplus on the FX market to have persisted through June, further supported by continued non-resident purchases of Georgian treasuries, with gross international reserves reaching USD 7.1 billion by the end of the month.

Annual inflation edged up to 5.8% in June from 5.7% in May. The monthly momentum also strengthened, with prices rising by a seasonally adjusted 0.6% against 0.3% in May (Figure 1). While on the firmer side, these dynamics are broadly consistent with our 5.1% end-year inflation forecast. With inflation set to stay above the 3% target throughout the year, and the NBG consistently emphasizing that they consider "dissipation of the inflationary shock" as a prerequisite for easing, we continue to expect the policy rate to be held at 8.25% in 2026.

FIGURE 1: MONTHLY MOMENTUM IN INFLATION STRENGTHENED EVEN IF ANNUAL INFLATION WAS ALMOST UNCHANGED (%)



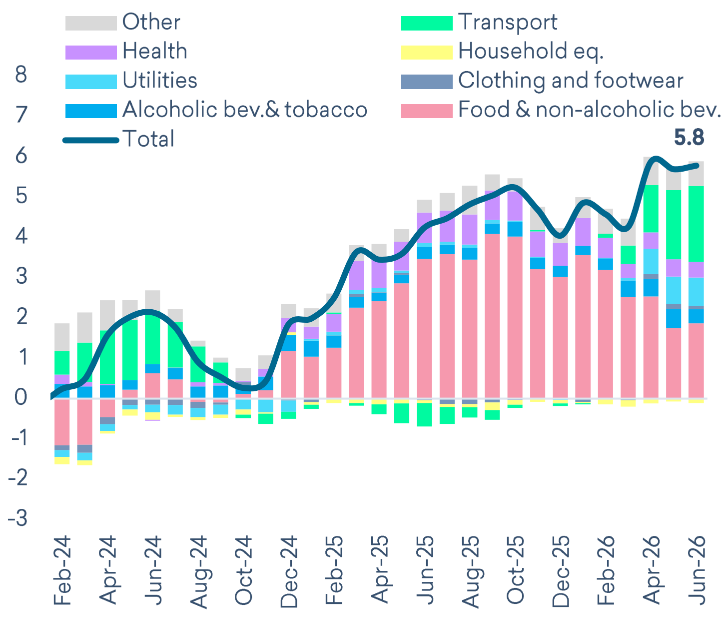
Source: Geostat, NBG, TBC Capital

Before diving further into June data, this week's developments need to be highlighted separately. Wednesday saw another flare-up in the Middle East conflict, with the US launching strikes in retaliation for Iranian attacks on commercial vessels on Tuesday. This was followed by Iran targeting US military facilities in the region. As we have repeatedly argued, the agreement signed in June to end hostilities is not a final deal but a deal to make the final deal, which carries a sizeable degree of uncertainty with it, even if the markets had already largely priced the truce. For the time being, it is unclear whether the renewed escalation is temporary or not. On the one hand, the exchange of fire has so far been relatively limited. On the other hand, both sides have publicly questioned the memorandum of understanding that formally ended the conflict. Furthermore, the decision by the US Treasury to revoke the license for selling Iranian oil is a significant step. All in all, the situation remains rather unpredictable. Should full-scale hostilities resume, inflationary pressures will naturally intensify again, bringing end-year inflation back closer to our previous 6% forecast, which we lowered last month in light of the plunge in commodity prices triggered by the markets running with the framework agreement. Higher uncertainty, of course, also supports the case for keeping the monetary policy rate tighter for longer.

Back to June, fuel remained the dominant contributor to annual inflation, with petrol and diesel adding 0.9 and 0.3 percentage points (pp), respectively. Beyond this, sizeable one-offs include price-level shifts in bread (+0.5 pp), the electricity fee (+0.5 pp), imported cigarettes (+0.2 pp) and the internet fee (-0.2 pp). Together with the fuel contribution, these effects account for a large portion of the headline and are set to unwind as base effects fade.

Underlying inflation measures point to somewhat higher, though still contained, pressures. Median annual inflation accelerated to 2.5% in June from 1.9% in May, though has now marked three full consecutive years below the 3% target.

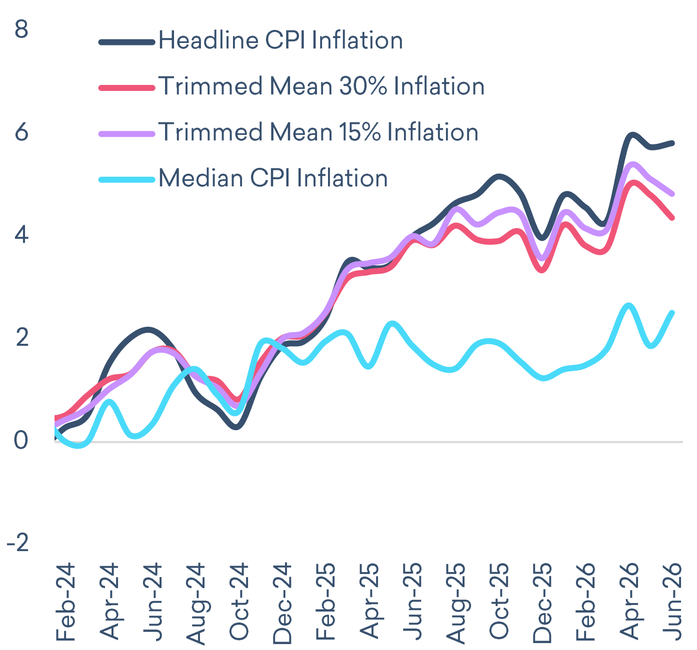
FIGURE 2: FOOD AND FUEL REMAIN THE LARGEST INFLATION COMPONENTS (PP)



Source: Geostat

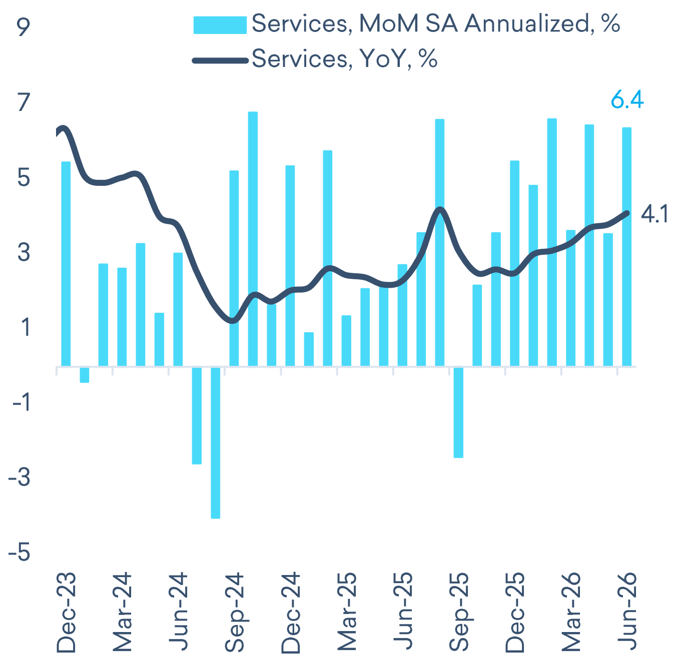
Trimmed mean measures sit closer to 5%, below the headline yet above the median (Figure 3). This points in two directions: outliers are still lifting the headline, yet price growth remains relatively elevated even after the extremes are stripped out, suggesting a broader base. The diffusion index tells a similar story. Service inflation, perhaps best suited to assess underlying trends, rose to 4.1% from 3.8% in May (Figure 4). In 2026, stronger service inflation has been led by housing (rent, repairs) and transport services (air travel, intra- and intercity transport).

FIGURE 3: HEADLINE INFLATION REMAINS WELL ABOVE UNDERLYING MEASURES (%)



Source: Geostat, TBC Capital

FIGURE 4: SERVICE INFLATION SLIGHTLY ACCELERATED IN JUNE (%)



Source: Geostat, TBC Capital

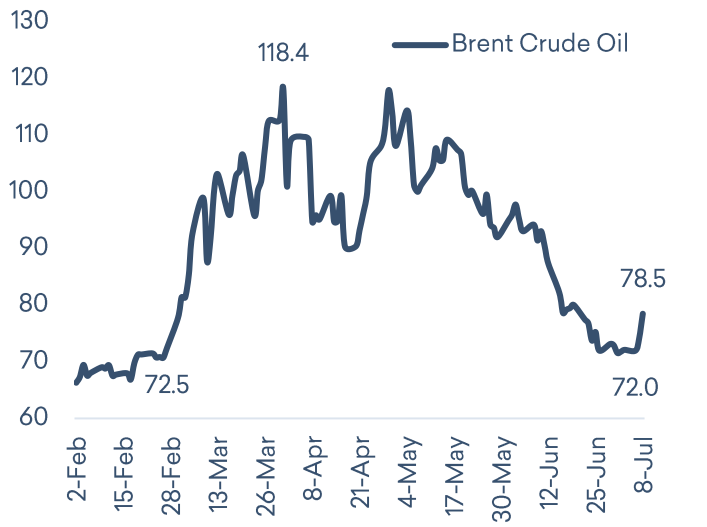
As argued in our previous update, food and oil prices are the two key drivers of the near-term outlook.

The benchmark Brent oil price had traded below pre-escalation levels around USD 72 since 25 June before surging to above USD 78 on Wednesday morning amid renewed hostilities in the Middle East (Figure 5). The passthrough from global to local fuel prices has historically been rather strong. Daily trackers indicate that several major stations have begun to lower petrol prices in early July, with diesel prices already seeing first cuts in June. Since March, petrol prices have risen by 22%, while diesel prices have surged by 39%. Should the conflict escalation prove temporary, this normalization will continue, with imported inflation – up to 6.1% in June, the highest since November 2022, from -0.7% in February – set to moderate accordingly. However, as argued above, risks have risen significantly in this regard. That said, even Brent at USD 78 implies disinflation from current levels.

Meanwhile, the food inflation outlook is also ambiguous, though external signals have somewhat improved. The FAO food price index fell for a second straight month in June, reversing its four-month climb (Figure 6), while fertilizer prices held broadly stable after retreating from April peaks, with several benchmarks now below pre-escalation levels. We expect food to remain the largest driver of inflation in 2026, albeit pressures should ease on relative normalization and last year's base effects.

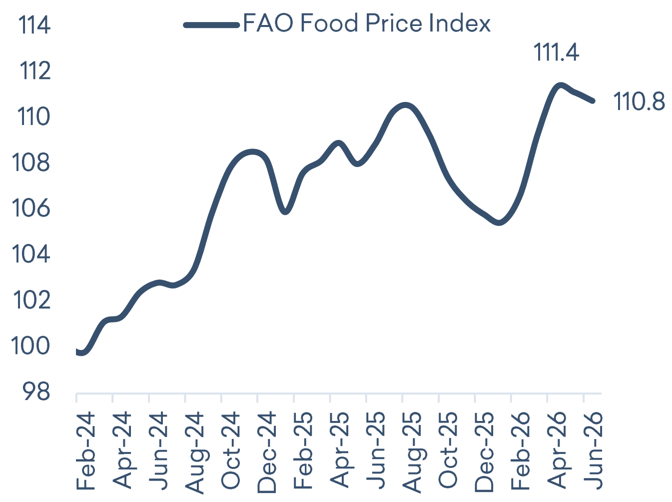
Elsewhere, economic growth came in at 6.4% in May, slightly higher than the 6.2% print in April, in line with our expectations (Figure 7). Growth has averaged 7.8% in January-May.

FIGURE 5: OIL PRICES HAVE SURGED ON THE BACK OF RENEWED HOSTILITIES (USD)



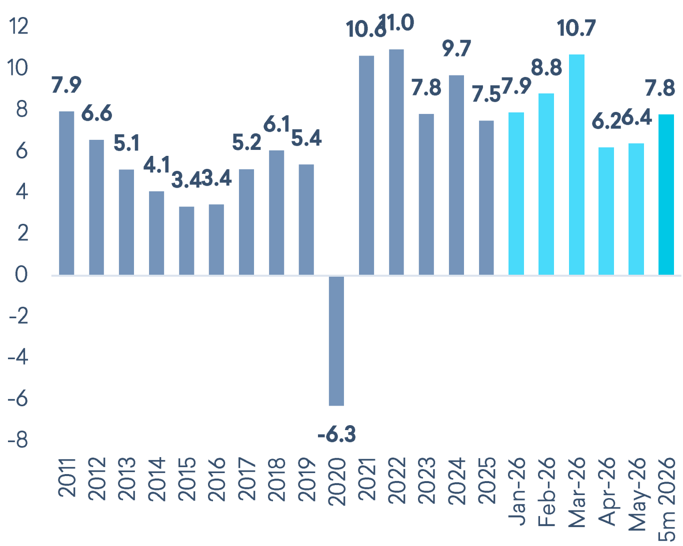
Source: Bloomberg

FIGURE 6: FOOD PRICES HAVE DECLINED SINCE THE APRIL PEAK (Index, Jan-24=100)



Source: FAO

FIGURE 7: ECONOMIC GROWTH HAS AVERAGED 7.8% IN JANUARY-MAY 2026

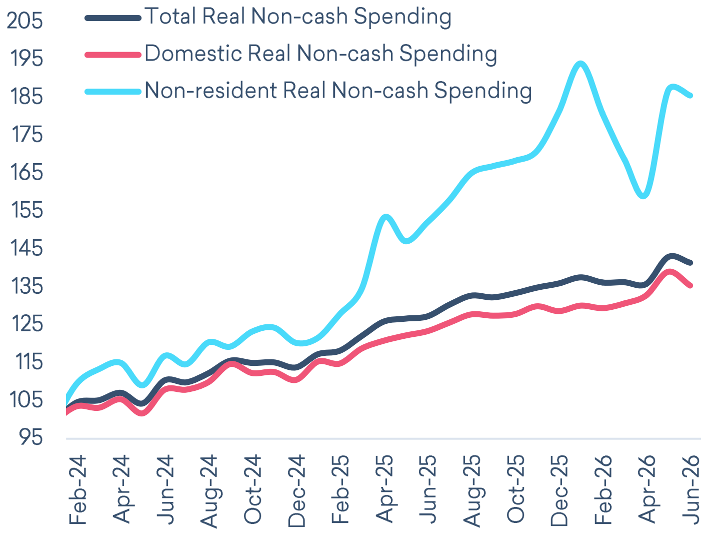


Source: Geostat

At the same time, coincident indicators point to a slightly softer June. Seasonally adjusted resident non-cash expenditures, our proxy for domestic activity, moderated compared to May, though held above the April level. Non-resident expenses, our proxy for tourism revenues, also dipped marginally in seasonally adjusted terms compared to the previous month (Figure 8).

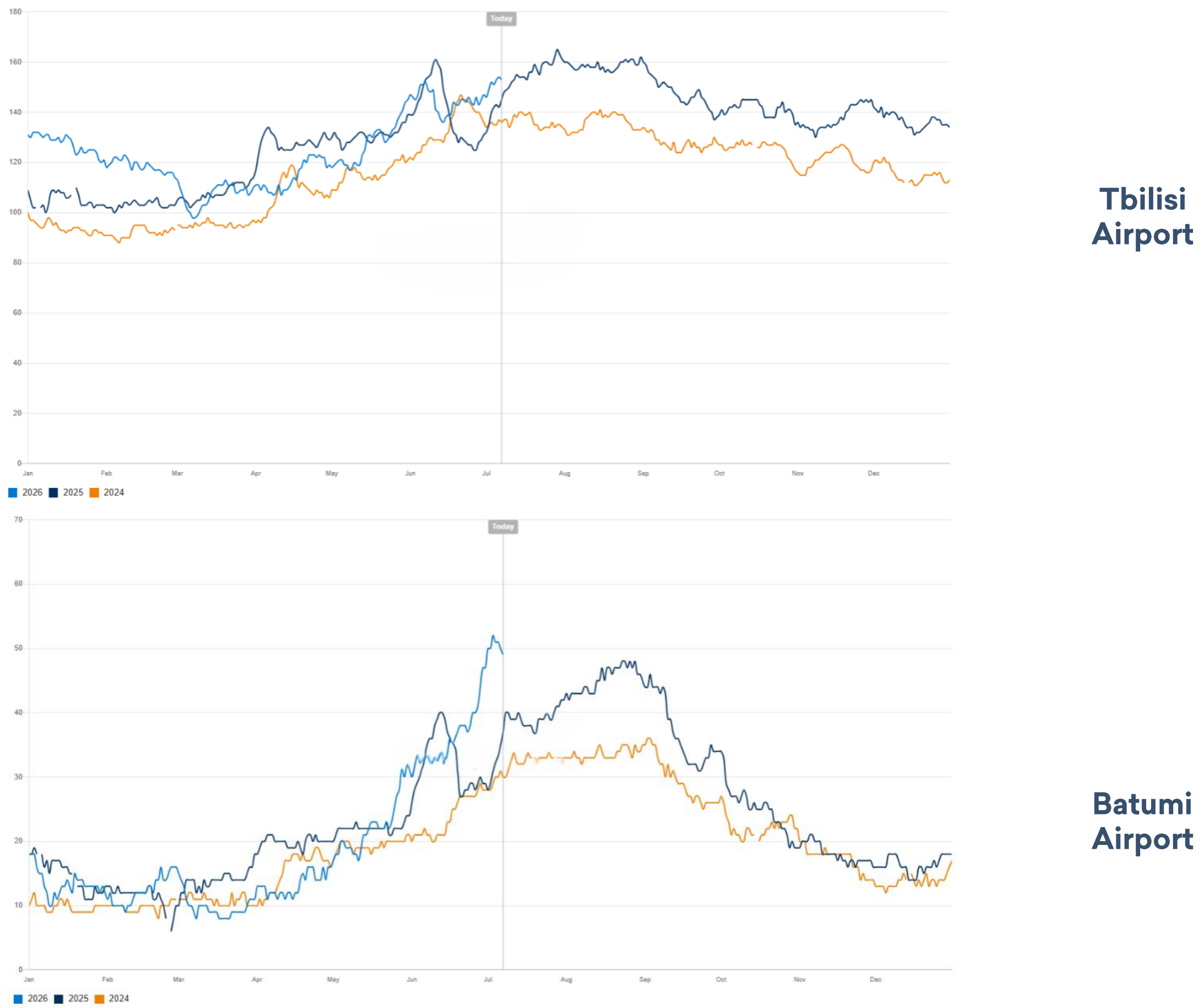
That said, the number of flights in the Tbilisi and, particularly, Batumi airports has increased notably since late June, now standing well above 2025 levels, hinting at stronger tourism demand in July (Figure 9).

FIGURE 8: NON-CASH SPENDING HAS RELATIVELY SLOWED IN JUNE COMPARED TO THE PREVIOUS MONTH (Index in GEL, Jan-2024=100, SA, As of 30-Jun-2026)



Source: TBC Capital

FIGURE 9: AIR TRAFFIC IN GEORGIAN AIRPORTS HAS ACCELERATED SINCE LATE JUNE (Number of Flights, 7-day Moving Average, As of 7 July)

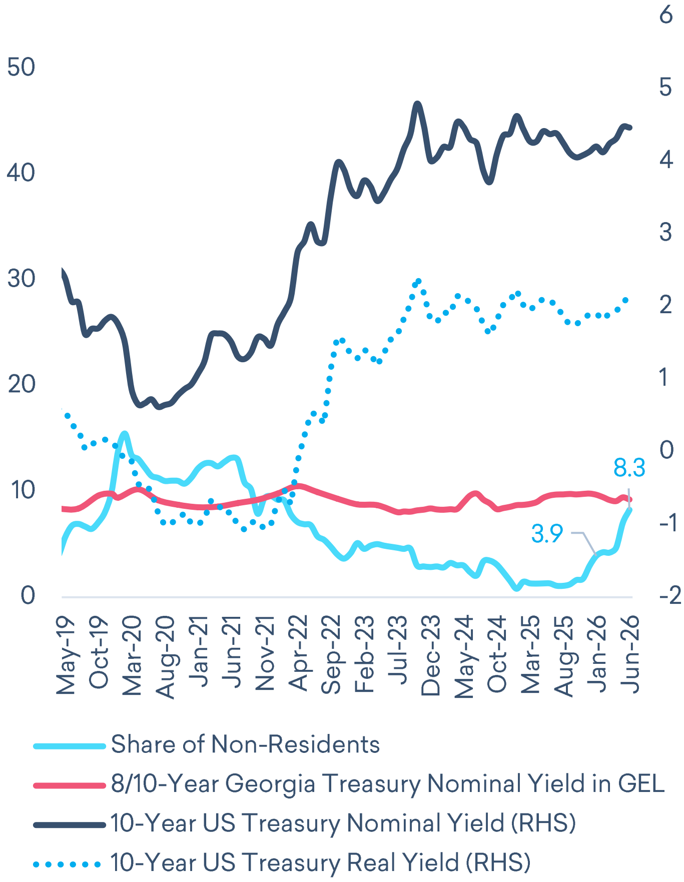


Source: Flightaware

Altogether, we expect the surplus on the FX market that has been supporting the GEL and reserve accumulation to have persisted through June and into early July. Inflows were further boosted for the second consecutive month by non-resident purchases of Georgian treasuries. The overall stock of foreign holdings exceeded GEL 1 billion by the end of June, double the end-April level and triple the end-2025 level. Subsequently, the share of non-residents in treasury holdings reached 8.3% in June, the highest since February 2022 (Figure 10).

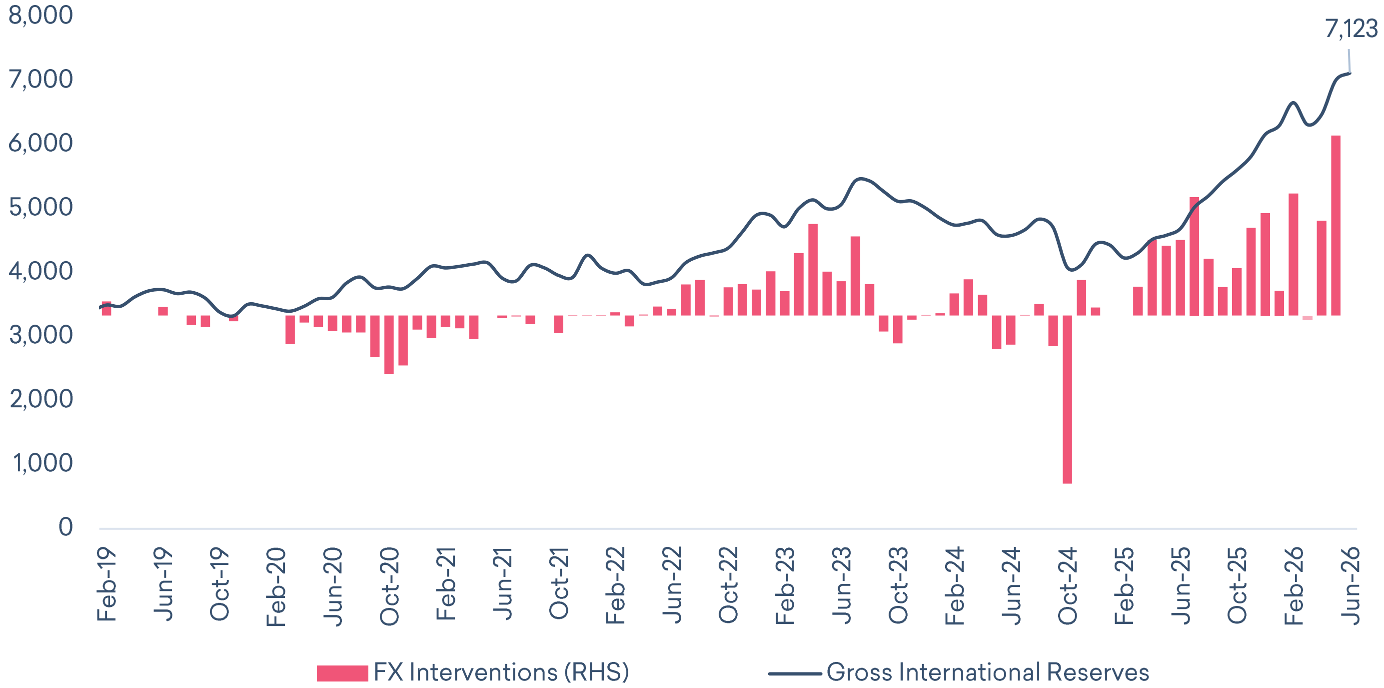
Against this backdrop, gross international reserves reached USD 7.1 billion by the end of June, in line with expectations, up by 51.9% compared to a year ago (Figure 11). Following the purchase of monetary gold worth USD 100 million in June, the share of gold in gross reserves now stands at 14.2%. We expect reserve accumulation to continue, including in July, albeit at a relatively moderate pace.

FIGURE 10: THE SHARE OF NON-RESIDENT HOLDERS OF GEORGIAN TREASURIES HAS CONTINUED TO CLIMB IN 2026 (%)



Source: NBG, FRED, TBC Capital

FIGURE 11: GROSS RESERVES REACHED USD 7.1 BN BY THE END OF JUNE, UP C. 52% Y/Y



Source: NBG

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