

CONSTRUCTION SECTOR

Sector Snapshots

Issue 6

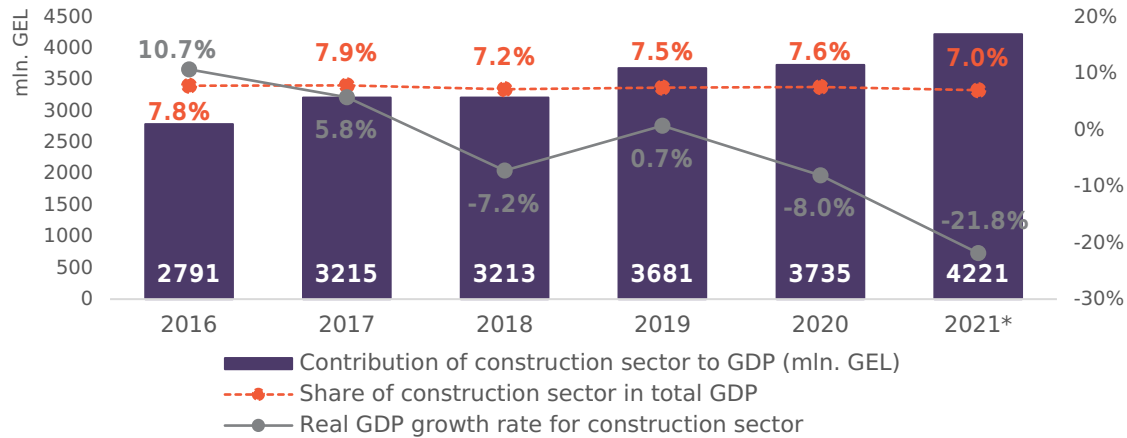
June 2022



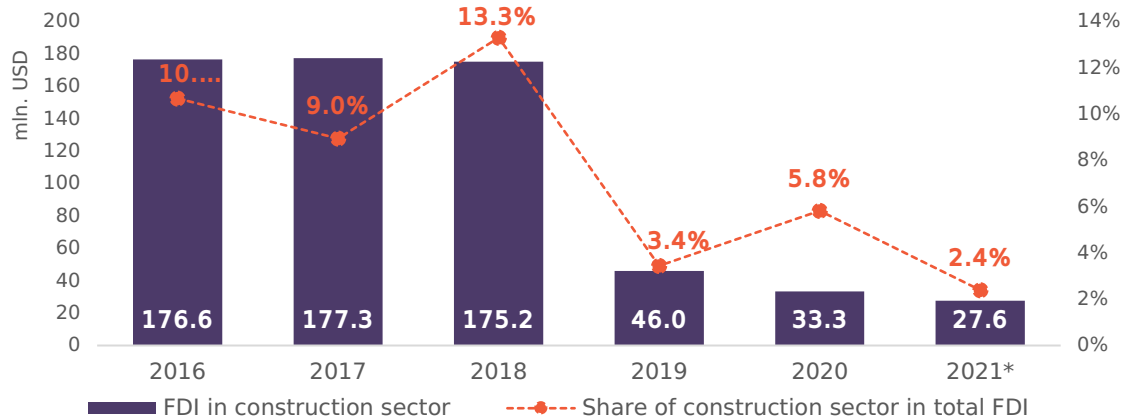
Research

- Construction sector is among the top 5 contributors to the total GDP of Georgia and has been contributing to an average of 7.5% of GDP throughout 2016-2021 years. However, the real GDP growth rate in construction sector has been negative in 2020 (-8.0%) and 2021 (-21.8%).
- The FDI in the construction sector, following the relatively stable period, has shown a significant decline in 2019 and onwards.
- The employment in the construction sector has been showing a slight decline (average annual decline of 4.2%) between 2016 and 2021, however, the average monthly remuneration sector has been increasing with an average growth rate of 9.3% over the same period.
- Throughout the 2016-2021 period, the volume of commercial bank mortgage loans issued to households showed a striking increase from GEL 33.6 mln in 2016 to GEL 105.2 mln in 2021 (213% growth).
- The outbreak of the COVID-19 pandemic had a marked effect in 2020, when the number of construction permits in Georgia dropped by 11%, compared to 2019.
- In 2020, as part of an anti-COVID economic strategy, the Georgian government introduced a mortgage subsidy program worth of GEL 70 mln, which alleviated the impact of the pandemic on the sector. Decline in the construction GDP in 2021 can be partially attributed to the expiration of the program in 2021.
- Construction costs were already increasing before the Russia-Ukraine war, largely explained by the pandemic and corresponding supply chain disruptions. Georgia's Construction Cost Index (CCI) by Geostat increased by 14% in Q4 2021 Year over Year (YoY).
- In the face of the ongoing Russia-Ukraine war, construction material input prices, which were already being impacted by the pandemic, increased further. In Q1 2022, as the war started in the latter half of the quarter, CCI increased by 13% YoY. In May 2022, according to Geostat's Price Index for Material Inputs to Construction Industries, the prices in Georgia have increased by 19% compared to May 2021 and by 55% compared to May 2019.
- The rise in prices in Georgia's construction sector is related to the considerable share of construction input materials being imported to Georgia from Russia and Ukraine. More precisely, in 2021 Georgia imported 12% of iron, steel, and articles produced from those materials from Ukraine and 8% from Russia. Additionally, Georgia relies on imports of wood and wooden articles (17%), as well as glass and glassware (26%) from Russia.
- According to the BAG index, despite sales prices increasing in 50% of surveyed businesses in the construction sector in Q2 of 2022, compared to the previous quarter, the sales have also shown an increase in 40% of the businesses. In addition to that, 64% of the companies expect the sales prices and sales to increase even more in Q3 of 2022. This could be attributed to the increased demand for real estate by the rapid inflow of migrants due to the external shock of the Russia-Ukraine war and consequent sanctions imposed on Russia.

Contribution of construction sector to GDP and real GDP growth rate for construction sector (2016-2021)



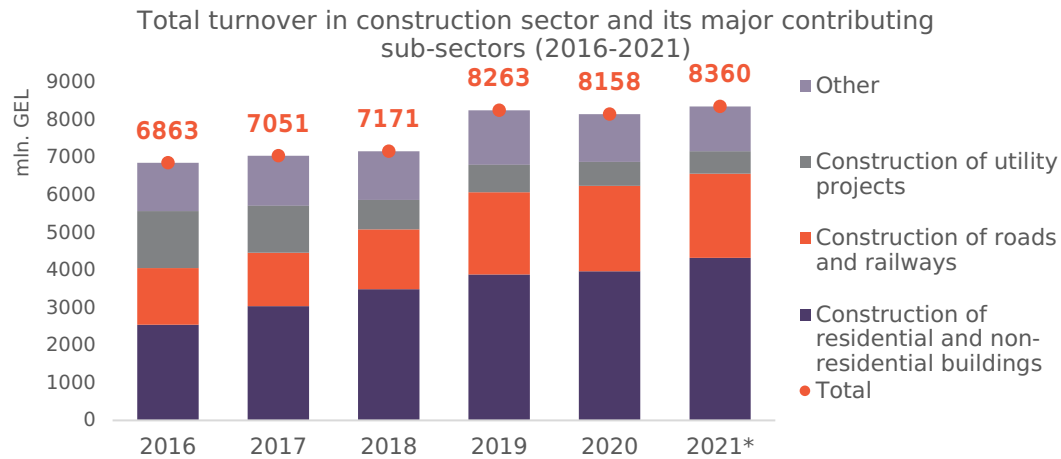
FDI in construction sector and its share in total FDI (2016-2021)



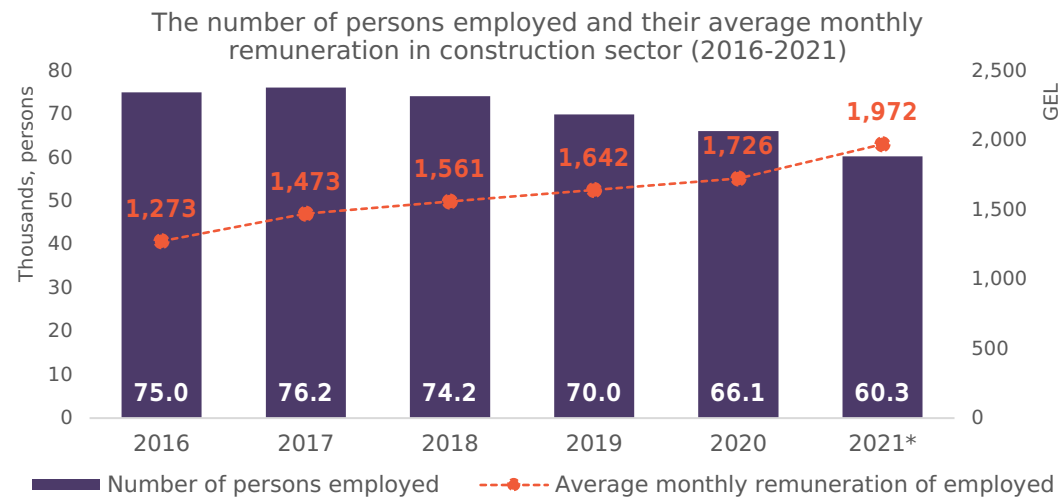
Source: National Statistics Office of Georgia

*Note that the values for 2021 are preliminary.

- The construction sector is among the top five contributors to the total GDP of Georgia and contributed an average of 7.5% of the national GDP between 2016 and 2021.
- The real GDP growth rate of the construction sector in this period peaked in 2016, and reached 10.7%, hitting a low of -21.8% in 2021 after a continuous decline from 2020 onwards.
- From 2016 to 2020, construction in Tbilisi, on average, contributed 67.9% of total value-added annually, while the corresponding figure in Adjara for the same period was 16.6%. Construction in Racha-Lechkhumi and Kvemo Svaneti region, on average, contributed the least of the sector's total value-added (0.3%).
- FDI in the construction sector was relatively stable throughout the 2016-2018 period with an annual average of USD 176.4 mln. In 2018, the share of construction in total FDI reached a maximum of 13.3% between 2016 and 2021.
- In 2019, FDI in the construction sector has shown a significant decline both in absolute terms and as a share of total FDI. In 2021, annual construction FDI reached only USD 27.6 mln, amounting to 2.4% of the total FDI in Georgia.
- Throughout the 2016-2020 period, in the construction sector, investment in fixed assets increased on average, with an average annual growth rate of 5%, peaking at USD 269.4 mln in 2019.

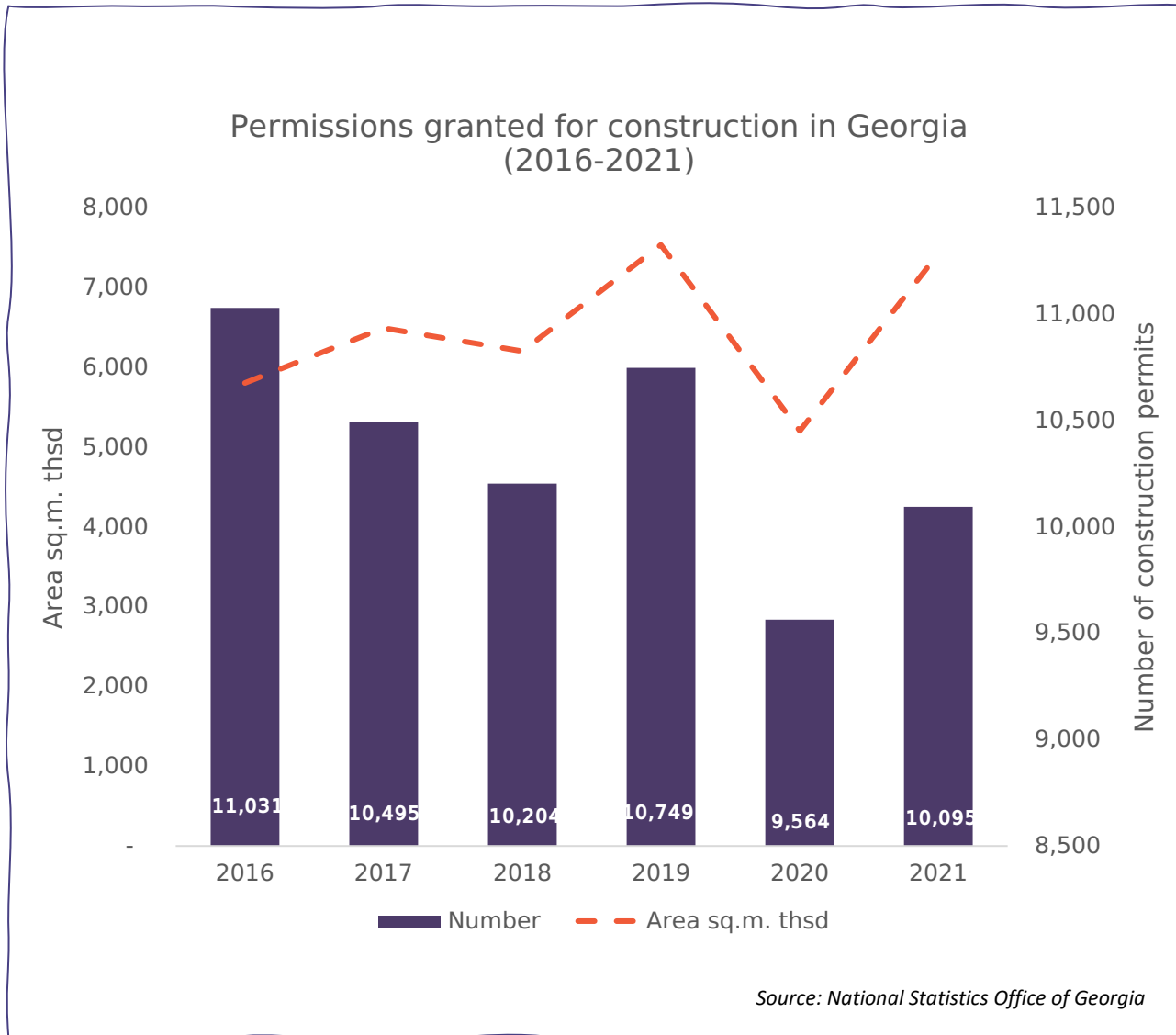


- Throughout the 2016-2021 period, the total turnover in the construction sector showed a steady increase albeit with a jump of 15.2% in 2019. In 2020, total turnover in the construction sector showed a slight decline (-1.3%), however, in 2021, the turnover hit a peak of GEL 8.4 bln.
- The main sub-sector contributing to total turnover in construction was the construction of residential and non-residential buildings, which on average contributed to 46.1% of total turnover throughout the 2016-2021 period.
- Employment in the construction sector showed a slight decline (average annual decline of 4.2%) throughout the reporting period, reaching a minimum of 60,200 persons employed in 2021.
- Over the course of the 2016-2021 period, average monthly remuneration in the construction sector has been increasing with an average growth rate of 9.3%, peaking at GEL 1 972 in 2021.



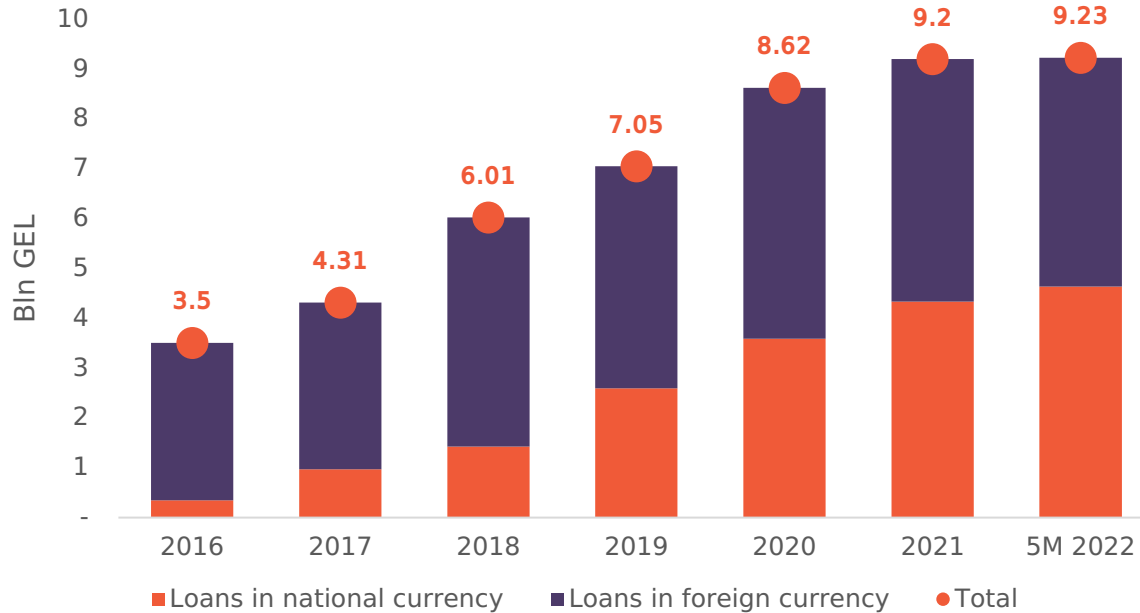
Source: National Statistics Office of Georgia

*Note that the values for 2021 are calculated as the sum of quarterly data in case of turnover and as the average of quarterly data for the number of persons employed and their monthly remuneration.



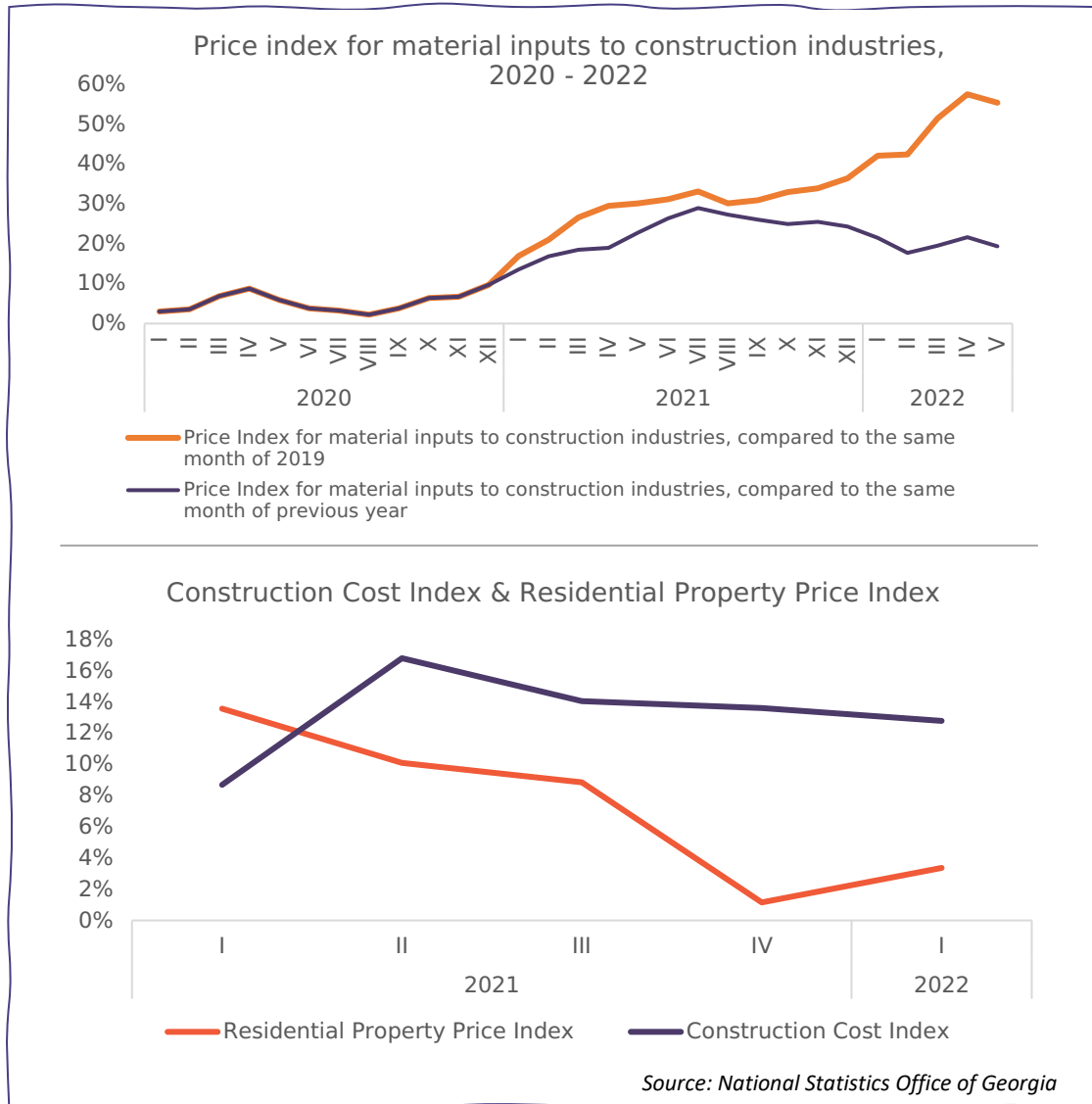
- Throughout the 2016-2021 years, the number of permissions granted for construction in Georgia showed significant fluctuations. The number of construction permits in 2021 decreased by 8%, compared to 2016.
- The COVID-19 outbreak effect can be observed in 2020, when the number of construction permits in Georgia dropped by 11%, compared to 2019.
- In the analyzed period, the highest number of construction permits was reported in 2016 (11,031 sqm.), while the highest area of construction permits was recorded in 2019 (7,538,398 sqm.).
- In 2021, residential buildings occupied 72% of permissions granted for construction. Moreover, trade buildings, industrial buildings and warehouses and farm buildings had shares of 6%, 5% and 4%, respectively.

Commercial bank mortgage loans to households for real estate purchase and repair (stock amounts, as of given date) (2016 - 5M 2022)



Source: National Bank of Georgia

- Throughout the 2016-2021 years, the volume of total commercial bank mortgage loans issued to households showed a steady increase from 3.5 bln GEL to 9.2 bln GEL in 2021 (24% average yearly growth).
- As of start of May 2022, the volume of total mortgage loans to households for real estate purchase and repair amounted to 9.2 bln GEL, which is 5% higher than the corresponding period of 2021.
- In the analyzed period, the share of loans denominated in national currency showed a significant increase. While in 2016 it only amounted to 10% of total loans, in 2021 it reported 47% of total loans for real estate purchase and repair.
- As of start of May 2022, share of loans to households denominated in national currency amounted to more than half of total loans (50.2%). To compare, in the corresponding period of 2016 the figure amounted to only 12%.
- In 2020, as part of anti-COVID economic strategy, the government introduced a mortgage subsidy program, which resulted in increase of mortgage loans even during the waves of lockdowns and restrictions. As part of the program the state subsidizes 4% of the interest rate of mortgage loans with a maturity of to 5 years. The budget of the program was estimated at 70 mln GEL.



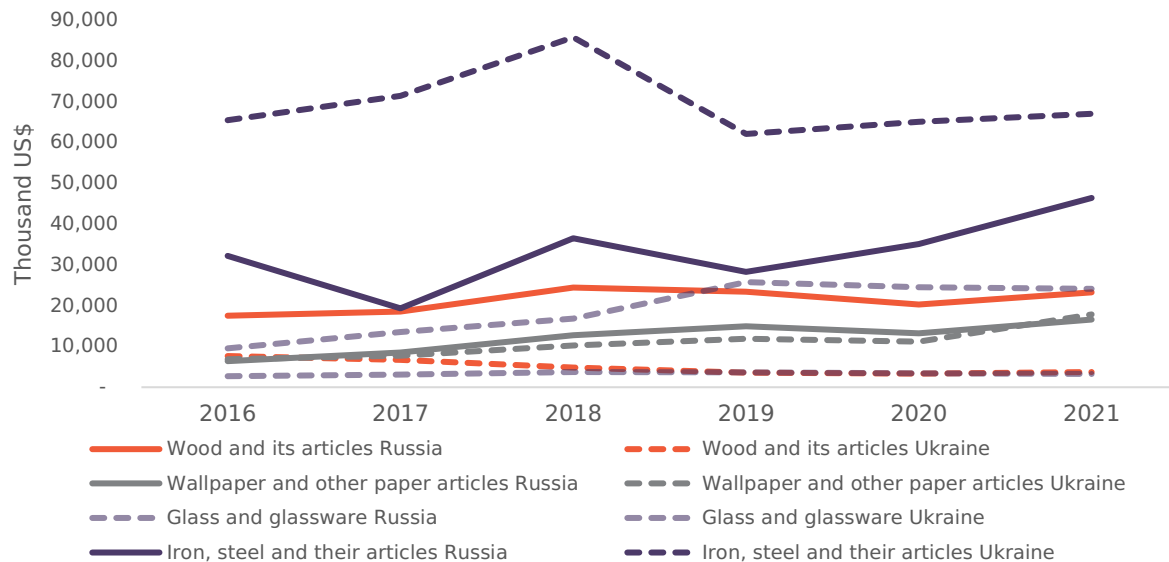
- ❑ In May 2022, according to Geostat's Price Index for Material Inputs to Construction Industries, corresponding prices in Georgia have increased by 19% compared to the same month of the previous year (May 2021) and by 55% compared to the pre-pandemic period of May 2019.
- ❑ Steep growth trend of prices of material inputs to construction has been evident since the beginning of 2021: in January 2021 prices were 14% higher compared to January 2020 and 17% higher compared to January 2019. This growth in construction input prices in 2021 was related to the pandemic and associated supply chain disruptions.
- ❑ Construction costs index (CCI)¹ increased by 13% in Q1 2022 compared to the same period of the previous year. The increase in the index was mainly due to the rise in material inputs to construction prices, which was reflected in the total index change by 8.12 percentage points. Besides increased prices for material inputs in construction, the ongoing war, which started in the latter half of the first quarter, is likely to increase costs of transportation as well, so it is expected that in the upcoming quarters construction costs will increase substantially.
- ❑ Increasing construction costs will be reflected in increasing residential property prices². In Q1 of 2022, the residential property price index (RPP) increased by 3% compared to Q1 of 2021, and it is expected that residential prices will increase further in the upcoming quarters.

¹ Construction Cost Index measures the average price level of construction materials and services used for the construction, covering five categories: Construction materials, Wages of construction sector employees, Machinery, Transportation, fuel and electricity, and other costs

² Residential property price index (RPPI) measures the price evolution for residential properties in Georgia. The coverage of the RPPI is limited to Tbilisi and covers only the market of new dwellings for both multi-dwelling buildings (flats) and detached houses

- The rise in prices in Georgia's construction sector (material inputs, construction costs, residential property) is related to the considerable share of construction input materials being imported to Georgia from Russia and Ukraine.
- Looking at Georgia's expenditure on imports of construction materials, Georgia imports a substantial amount of iron, steel, and articles produced from those materials from Ukraine - 12% of imports of those materials came from Ukraine in 2021 and 8% from Russia.
- Other construction materials being imported in considerable amounts to Georgia from Russia (13%) and Ukraine (14%) include wallpaper and other paper articles.
- Moreover, Georgia relies on imports of wood and wooden articles (17%), as well as of glass and glassware (26%) from Russia.

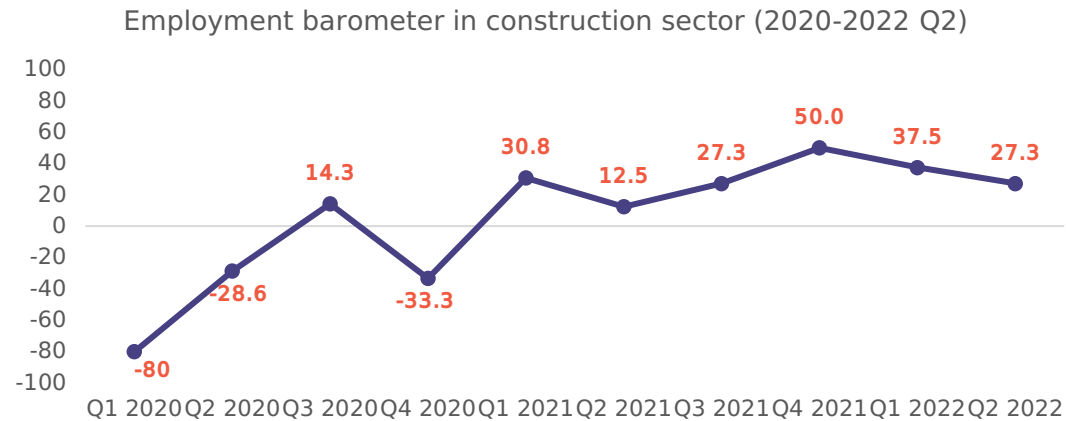
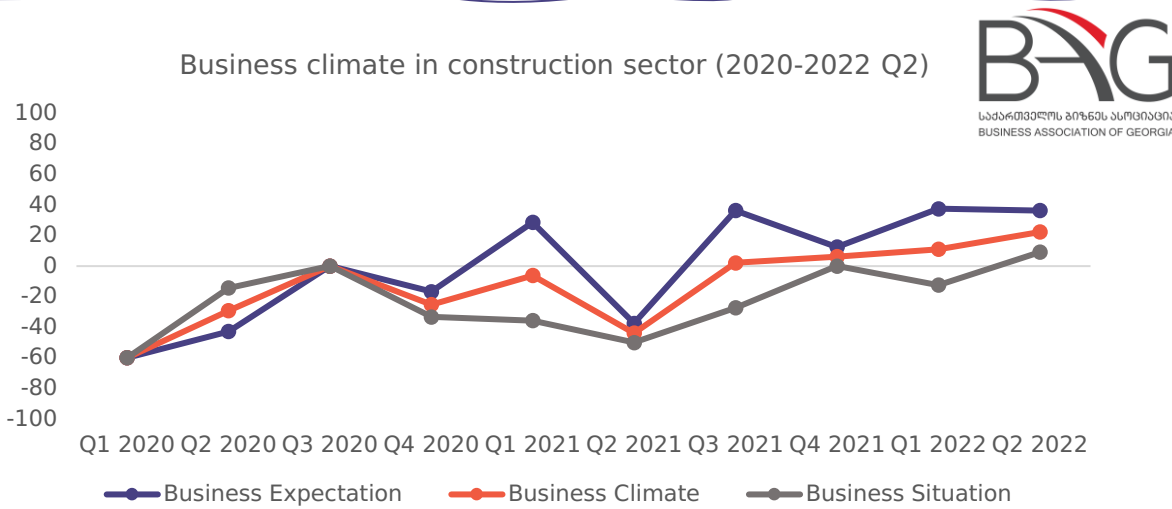
Georgia's expenditure on construction materials imported from Russia and Ukraine, 2016-2021



Georgia's expenditure on construction materials imports from Russia and Ukraine, 2021



Source: National Statistics Office of Georgia's External Trade Portal



Source: BAG Economic Climate Index and BAG Employment Barometer

- The **BAG business climate indicator**³ was negative in Q1 and Q2 of 2021, however it has been positive since Q3 of 2021 and gradually improving, compared to the corresponding periods of the previous year. This improvement has been mainly due to the optimistic business expectations.
- In Q2 of 2022 40% of surveyed construction sector companies stated that their **sales** increased, compared to the previous quarter. In addition to that, 50% of surveyed companies stated that **sales prices** had increased in Q2 of 2022, compared to the previous quarter. Moreover, 64% expected an increase in sales and sales prices in Q3 of 2022, compared to Q2 of 2022.
- The legal and administrative barriers, such as regulatory environment and administrative issues, were cited by 50% of the companies to be the **hindering factor for business activities** in the construction sector.
- Among the **hindering factors caused by the Russia-Ukraine war**, in the construction sector, the most often stated factors were the increased prices on intermediate goods (78%) and logistical problems in the global market (78%). On the other hand, the least stated factor was aggravation of trade relations with Russia (33%), such as payment, freight insurance, and reputational issues.
- In Q2 the majority of surveyed companies in the construction sector (64%) stated that the number of employees did not change compared to Q1 of 2022, and 55% of them do not expect the number of employees to decline. In Q2 of 2022, compared to Q1 of 2022, **the employment barometer indicator**⁴ decreased by 10.2 points, reflecting less positive expectations compared to the previous quarter.

³ The balance value for the present business situation is the difference in the percentage shares of the “good” and “bad” responses, and the balance value for the expectations for the next six months is the difference in the percentage shares of the “more favorable” and “less favorable” responses. The BAG Business Climate is a transformed mean of the balance values of the present business situation and the expectations for the next six months. The BAG Business Climate can be between -100 and +100. +100 means that all surveyed businesses assess the business climate positively, while -100 means all surveyed businesses assess the business climate negatively.

⁴ Respondents could describe their plans regarding the number of employees for the next three months as “increasing,” “stable,” or “decreasing”. The balance value of these plans is the difference in the percentage shares of the “increasing” and “decreasing” responses.

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