



Scientific Report

The inflationary effect of geopolitical risks and economic growth

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Abstract

In recent years, geopolitical risks have become a major factor influencing the dynamics of the global economy and trade. Unfavorable geopolitical events in global markets become the catalyst for significant fluctuations, which leads to a decrease in economic activity, affects inflation, which can lead to price changes. Geopolitical risks and inflation are interconnected. Geopolitical tensions can affect the state of the economy, macroeconomic indicators and lead to an increase in inflation. During geopolitical risks, investors believe that the country is unstable and begin to withdraw their assets. This will certainly lead to a depreciation of the currency and an increase in imported goods. In Georgia and similar developing countries, geopolitical risks have a significant impact on inflation rates. Georgia's main trading partners are China, the European Union, Russia, and Turkey. The deterioration of geopolitical relations with the above-mentioned countries affects exports and imports, which in turn affects inflation.

Keywords: Geopolitics, risk, inflation, economic growth.

Introduction

Geopolitical risks often have a short-term impact on the market, but they can also become long-term if they develop into a long-term conflict and inflationary pressures become long-term. In such cases, it is important for governments and central banks to pursue sound monetary and fiscal policies to ensure economic stability and limit inflation.

Geopolitical risks lead to a weakening of international trade, increasing commodity prices, which leads to an increase in inflation. In addition, geopolitical shocks can undermine investment and consumption, but tightening financial conditions are accompanied by a decrease in inflation. Against the background of a geopolitical crisis, governments may increase spending and taxes, and central banks may change



monetary policy, depending on the current economic situation [1].

Geopolitical risks and demand, supply. A one standard deviation increase in the geopolitical risk index (GPR index) can lead to an average increase in inflation in the country by about 2% and a decrease in GDP by 1.5%.

Geopolitical shocks cause a change in supply, the fact of deficit appears, and the risk of wars increases, which is accompanied by a decrease in human and physical capital, all of which is directly related to the

increase in inflation, the concomitant process of which is a decrease in GDP. As for demand, along with the increase in public debt and money supply, geopolitical shocks cause an increase in public spending [2].

1. The chart shows the historical genesis of the relationship between geopolitical risk and inflation in both developed and developing economies. It clearly increased during the First and Second World Wars and in the 1970s, although a downward trend is observed in the 1980s and 1990s.

Global inflation and global geopolitical risk /1 chart/

---- Global inflation /left scale/

---- Geopolitical Risk Index /Right scale/



Source: Caldara, D., et al., Do Geopolitical Risks Raise or Lower inflation? /2024/

The demand side plays an important role in raising inflation - increasing government spending, money supply, although it should be noted that geopolitical shocks mainly act as supply shocks [3].

Geopolitical risks have increased significantly since the outbreak of the war between Russia and Ukraine, which led to an increase in global inflation to 1.2% by the end of 2022, and a decrease in global GDP by 1%. Against the background of increasing geopolitical risks, it is important to implement the right monetary and fiscal policies so as not to

worsen the economic downturn.

New challenges for the world economy.

After the post-pandemic period, a new stage begins in the global economy, the main challenge of which is the differences in inflation and economic growth dynamics between the economies of different countries of the world. The USA, China, and Europe are worth noting.

It is worth noting that global inflation is approaching the pre-pandemic trend and is steadily slowing. Here is the updated



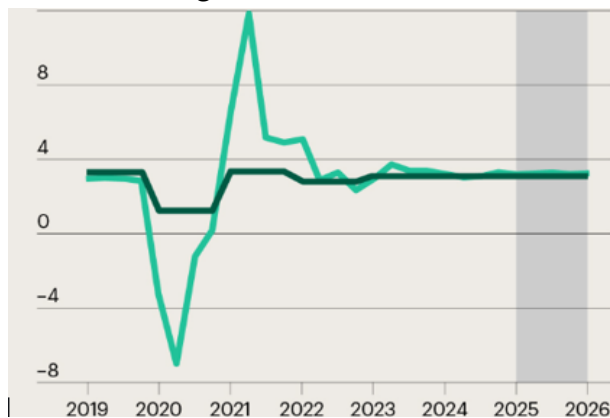
economic forecast of the IMF: The average global GDP growth rate in 2000-2019 was 3.7%, and is forecast to be 3.3% in 2025 and

2026. In 2015-2019, global inflation was 3.2% before the pandemic, and will decrease to 4.2% in 2025 and 3.5% in 2026. /See chart 2/

Completion of the post-pandemic cycle

Global GDP, %

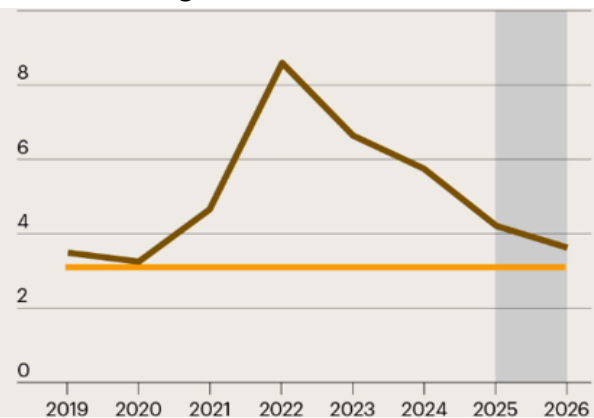
--- Real GDP growth
--- Potential growth in real GDP



Global inflation, %

--- On average per year
--- On average for 2015 – 2019

Chart 2



Source: International Monetary Fund / Year / Title of the report. URL

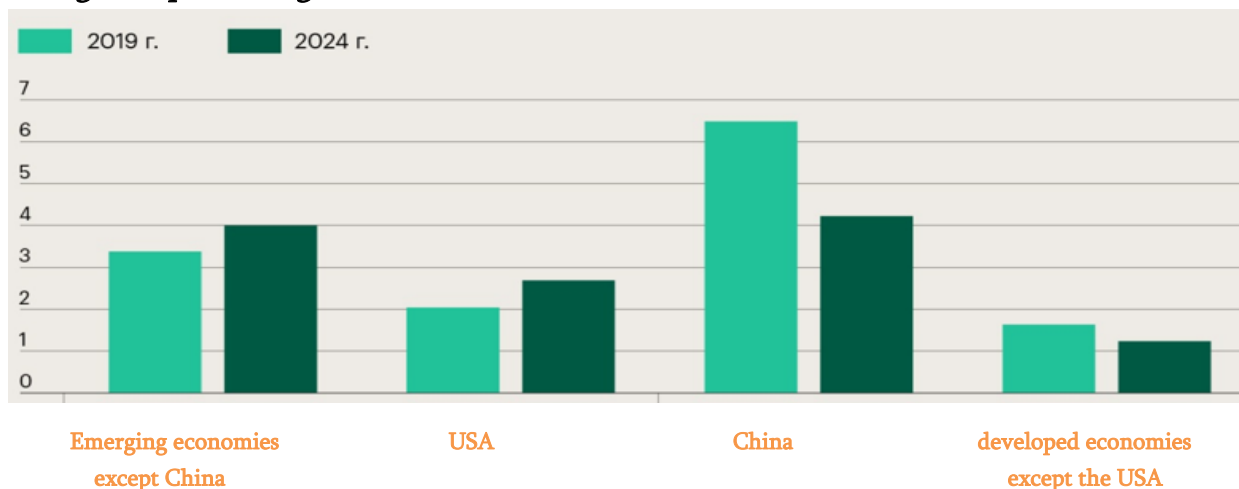
<https://econs.online/articles/ekonomika/novyj-etap-mirovoj-ekonomiki/>

It is noteworthy that there is a large difference between the world's largest economies. For example, compared to the pre-pandemic period, the US economy is growing above

Its potential and economic growth is fixed, while Europe, on the contrary, is facing slow growth, and China is undergoing a rather sluggish recovery. /See chart 3/

divergence: potential growth of economies, %

Chart 3



Source: International Monetary Fund <https://econs.online/articles/ekonomika/novyj-etap-mirovoj-ekonomiki/>



The rapid increase in the US standard of living compared to other developed economies is due to increased productivity, driven by innovations in the technological sector, a more favorable business environment, more capital inflows, and increased investment, which provides higher incomes. China's economic growth rate has almost caught up with the economies of developing countries, while it was much higher before the pandemic [4].

Inflationary effect of geopolitical risks in Georgia. Geopolitical risks have a significant impact on inflation rates in Georgia and in developing countries in general. The increase in geopolitical risks leads to a decrease in investor confidence, which is followed by a depreciation of the Lari and an increase in inflation. The depreciation of the Lari, in turn, leads to an increase in prices for imported goods, especially for products such as food, medicines and fuel.

Global and regional events have a significant impact on the Georgian economy. The deterioration of geopolitical relations with Georgia's main trading partners /China, the European Union, Russia, Turkey/ affects exports and imports, which creates inflationary pressures.

Several directions for reducing geopolitical risks can be identified in Georgia:

- Diversification of the economy, with the support of new partners;
- Increasing foreign exchange reserves to

regulate inflation;

- Strengthening energy independence;
- Increasing and stimulating national production, which will ensure a decrease in dependence on imports.

All of the above will contribute to reducing inflation and the country's economic stability.

Geopolitical risks, inflation and economic growth are interconnected in Georgia. In 2020-2024, inflation in the country increased as a result of the impact of the global pandemic and the Russia-Ukraine war. The National Bank regulates the inflation rate through monetary policy, using monetary instruments, namely interest rates and managing foreign exchange reserves. The National Bank of Georgia aims to maintain an inflation rate of 3%. In 2024, the inflation rate in Georgia was relatively stable, although minor fluctuations were still observed.

Monitoring inflation rates is important because it reflects price stability, which is directly related to the purchasing power of the population and the economic well-being of the country in general [5-10].

Conclusion. Inflation management remains a key challenge in Georgia amid global challenges. After the restoration of tourism, economic growth was strong in 2021-2023, with increased engagement in regional economic activities and investment attraction, which directly impacts the country's economic well-being.



გეოპოლიტიკური რისკების ინფლაციური ეფექტი და ეკონომიკური ზრდა

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აბსტრაქტი

ბოლო წლებში, გეოპოლიტიკური რისკები გლობალური ეკონომიკისა და ვაჭრობის დინამიკაზე გავლენის ძირითად ფაქტორად იქცა. გლობალურ ბაზრებზე არასასურველი გეოპოლიტიკური მოვლენები ხდება სწორედ მნიშვნელოვანი რყევების კატალიზატორი, რაც იწვევს ეკონომიკური აქტივობის შემცირებას, გავლენას ინფლაციაზე, რამაც შეიძლება გამოიწვიოს ფასების ცვლილება. გეოპოლიტიკური რისკები და ინფლაცია ურთიერთდაკავშირებულია. გეოპოლიტიკურმა დამაბულობამ შეიძლება გავლენა მოახდინოს ეკონომიკის მდგომარეობაზე, მაკროეკონომიკურ მაჩვენებლებზე და გამოიწვიოს ინფლაციის ზრდა. გეოპოლიტიკურ რისკების დროს ინვესტორები თვლიან, რომ ქვეყანა არასტაბილურია და იწყებენ თავიანთი აქტივების გატანას. ეს, რა თქმა უნდა, გამოიწვევს ვალუტის ვარდნას და ზრდის იმპორტირებულ საქონელს. საქართველოსა და მსგავს განვითარებად ქვეყნებში, გეოპოლიტიკური რისკები მნიშვნელოვან გავლენას ახდენს ინფლაციის მაჩვენებლებზე. საქართველოს მთავარი სავაჭრო პარტნიორები არიან ჩინეთი, ევროკავშირი, რუსეთი, თურქეთი. გეოპოლიტიკური ურთიერთობების გაუარესება ზემოაღნიშნულ ქვეყნებთან გავლენას ახდენს ექსპორტსა და იმპორტზე, რაც გავლენას ახდენს ინფლაციაზე.

საკვანძო სიტყვები: გეოპოლიტიკა, რისკი, ინფლაცია, ეკონომიკური ზრდა.

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