

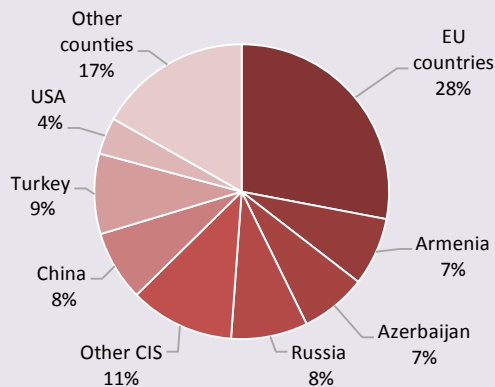
Georgia's trade with the EU: Recent developments

The EU is Georgia's main trading partner, accounting for 28% of exports and 29% of imports. In the period from July 2015 to June 2016, trade with the EU decreased significantly. However, this decrease was mainly due to a decline in the world market prices of key trade products. If we exclude this price effect (i.e. consider trade in real terms), Georgia's exports to the EU increased by 27% and imports by 1% in this period. Georgia's exports to the EU remain highly concentrated on few commodities. Nuts and fertilisers make up 58% of these exports and a sharp decrease of hazelnut prices was responsible for the decrease of exports to the EU, highlighting the need to diversify the country's export portfolio. The decrease of imports from the EU was mainly due to the oil price decline, as mineral fuels are the largest single import good. At the same time, imports of capital goods increased due to stable domestic and foreign investment. Imports of machinery and apparatus increased by 12% and 38% respectively.

EU role smaller than in other DCFTA countries

The EU is Georgia's largest export and import partner: 28% of Georgia's exports go to the EU and 29% of Georgia's imports originate in EU countries.

Georgian exports by country H2-15 – H1-16



Source: National Bank of Georgia; H2-15 – H1-16

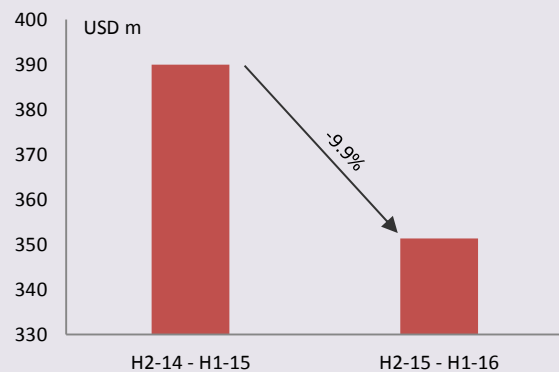
Although sizeable, the EU share of Georgian exports is lower than in the other DCFTA countries Ukraine or Moldova, where the share of exports to the EU amounts to 37% and 63% respectively. This lower EU share in exports is largely due to geographical distance. Furthermore, there is intensive trade activity between Georgia and its immediate neighbours, Turkey, Russia, Armenia and Azerbaijan. Together, these countries

account for 32% of Georgia's exports and 38% of Georgia's imports.

Sharp decrease of exports to the EU...

Most recent available data shows that Georgia exported USD 350 m of its domestic products to the EU in the composite year made up by the second half of 2015 (H2-15) and the first half of 2016 (H1-16), a decrease of almost 10% compared to the previous time period.

Development of Georgia's exports to the EU



Source: UN Comtrade

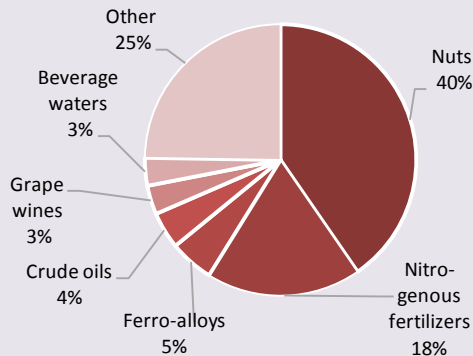
Note: Data exclude re-exports

This development looks disappointing at first glance, considering the EU-Georgian Free Trade Agreement ("DCFTA") being in place since September 2014. However, closer inspection reveals that indeed this decrease was driven exclusively by changes in the prices for Georgia's exports rather than a reduction in the amount of goods exported.

... was caused by lower prices for key exports

Georgia's trade with the EU is heavily concentrated on relatively few goods. Two products, nuts and fertilizers, account for 58% of exports of domestic products. In the time period under consideration, it was especially a large drop in the world market price for hazelnuts, which make up the overwhelming share of Georgia's nuts exports. If these price effects are neutralised and we hence move to looking at real rather than nominal exports, we find that real exports actually grew by a rather remarkable 27%.

Georgia’s exports to the EU by products, H2-15 – H1-16

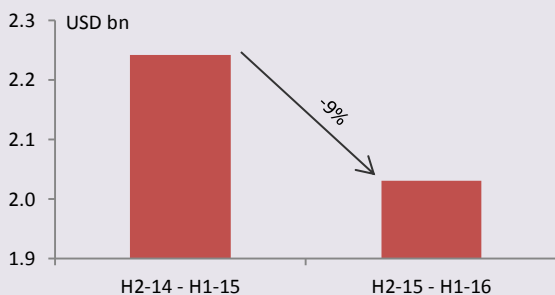


Source: UN Comtrade, own calculations

Decrease in import value...

Georgia’s imports from the EU decreased by 9% compared to the year before.

Development of Georgia’s imports from the EU



Source: UN Comtrade

Note: Data excludes a large donation of vaccines

Again, the explanation for the decrease in the import value is to be found in the development of key prices rather than changes in the quantity of imported goods. Two categories are the main components of Georgia’s imports from the EU: Mineral fuels account for 15% of imports from the EU, capital goods for 26% (machinery 15%, electronic equipment 7% and apparatus 4%).

... was also mainly caused by oil price decline

The sharp decline of the oil price alone explains most of the reduction of imports from the EU. In fact, taking out price effects, real imports from the EU grew slightly by 1% compared to the previous time period. The negative effect of the devaluation of the Georgian Lari on imports was compensated, particularly by an increase in the imports of some capital goods. The increase in this kind of imports is due to investment

activity and can be partly explained by the very stable development of domestic investment and FDI.

Conclusions

The nominal decline in trade with the EU was mainly due to changes in the prices of key products. Despite relatively weak growth in the EU economies, Georgia increased its real exports to the EU by 27%. Also, real imports from the EU grew by 1%, despite a devaluation of the national currency vs. the Euro.

The price sensitivity of exports confirms that a major challenge for Georgia remains to diversify and increase the value added of exports. While it is too early to expect big effects already, the DCFTA supports this endeavour by providing duty-free access to the EU market and by bringing regulations in line with EU best practices.

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Note: A more comprehensive analysis of the topic will be provided in the forthcoming Policy Briefing PB/08/2016 "Georgia’s trade with the EU: Recent developments"

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GET Georgia advises the Georgian government on a wide range of economic policy issues since 2014. It is financed by the German Federal Ministry for Economic Affairs and Energy.

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