

Overview

- GDP growth to increase to 3.5% in 2017 after only 2.7% in 2016
- Stronger growth due to investment and recovering external sector
- Fiscal consolidation limits the increase of the budget deficit to 3.7% of GDP in 2017
- Share of investment expenditures increased in growth-oriented state budget
- Inflation forecast for 2017 increased to 5.7% due to higher excises
- Industrial sector recovers slightly, stronger contribution to economic growth

Topics

- **New IMF programme signed.** Important stability signal for investors
- **GET Georgia recommends economic policy priorities.** Comprehensive package of measures by all relevant government departments is needed
- **Unlocking the export potential of Georgian agriculture.** Land consolidation and productive alliances can help exploit the export potential
- **DCFTA implementation in Georgia.** Implementation mostly on track

Basic indicators

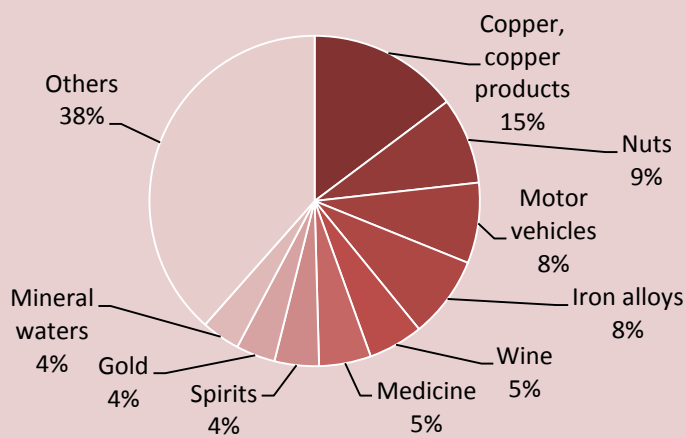
	Georgia	Moldova	Belarus	Ukraine	Russia
GDP, USD bn	13.7	7.4	54.7	95.9	1,560.7
GDP/capita, USD	3,715	2,089	5,787	2,262	10,886
Population, m	3.7	3.5	9.5	42.4	143.4

Source: IMF, estimation for 2017

Trade structure

Export

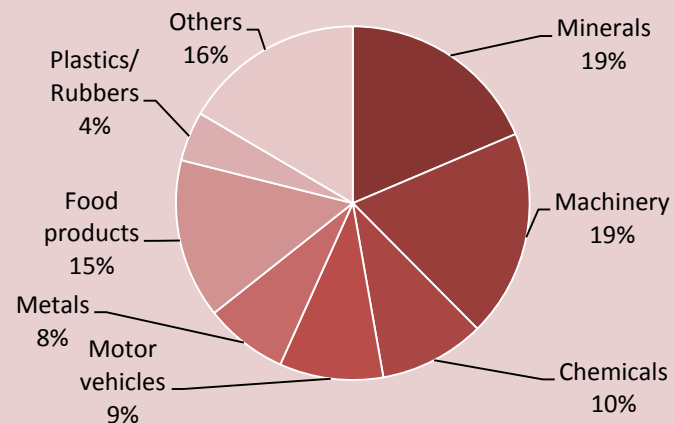
EU 27% | CIS 35% | Others 38%



Source: Geostat, 2016; Note: Trade in goods

Import

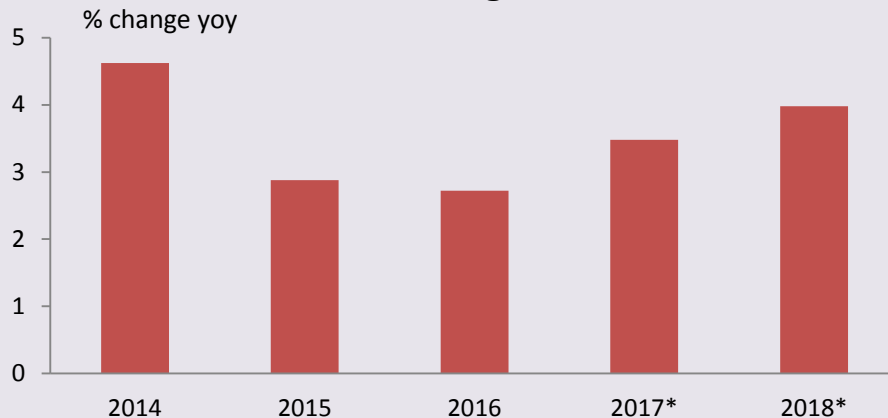
EU 30% | CIS 27% | Others 42%



Source: Geostat, 2016; Note: Trade in goods

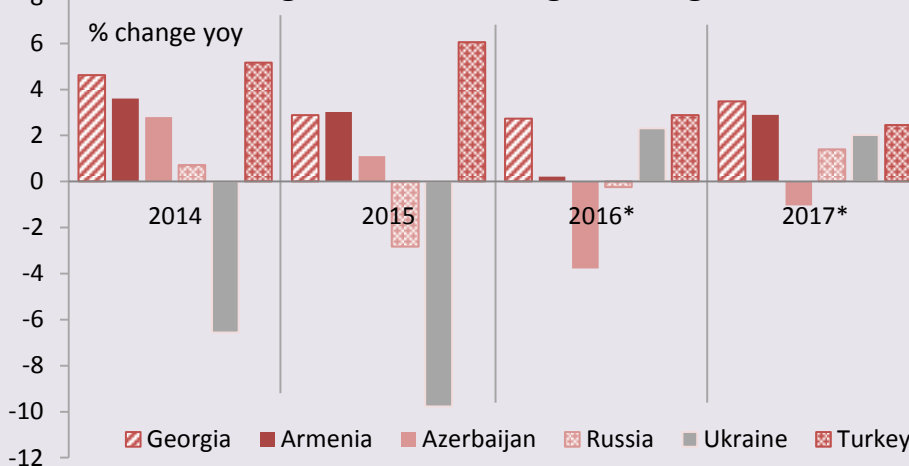
Economic growth

Real GDP growth



Source: IMF; *Projection

Real GDP growth in the neighbouring countries



Source: IMF; *Estimation/Projection

GDP

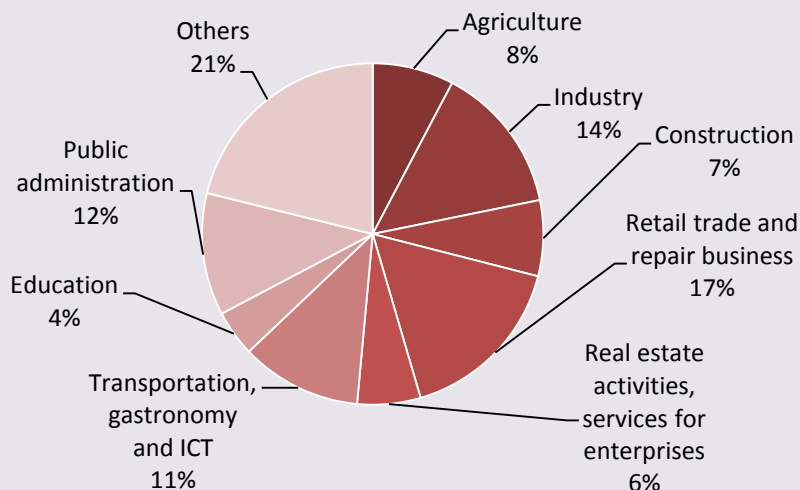
- 2016: GDP growth of 2.7%
- Decent economic performance in spite of weak growth of regional trade partners
- 2017: GDP growth of 3.5%
- Reasons:
 - Stronger public investment
 - Expectation of increasing private investment
 - Recovery of external sector

Conclusion

- Stable and positive economic growth despite difficult external conditions
- Potential for yet higher growth rates exists

Sectoral perspective

Composition of GDP



Source: Geostat, 2016

Sectoral dynamics



Source: Geostat, 2016; Note: Annual growth of gross value added (GVA)

Agriculture

- 2016: Stagnation compared to 2015

Industry

- Positive development in 2016 (+4.8%)
- Catch-up needs persists as sector remains small

Construction

- Growth in 2016 slightly weaker, but still positive at 8.1%
- Reason: Stable investment flows, especially FDI in infrastructure and hydropower

Tourism

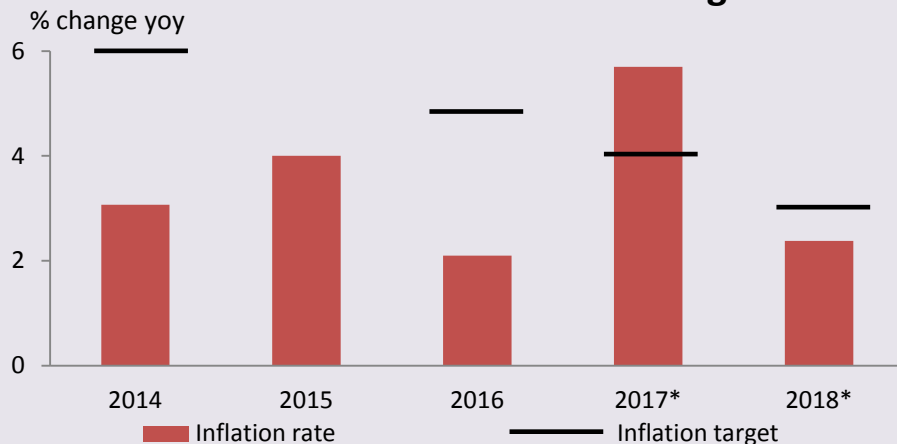
- Growth remains positive at 6.9% in 2016
- Constant growth in the last years

Conclusion

- Construction and tourism remain key drivers
- Industry still underrepresented compared to other sectors
- Performance of agricultural sector remains weak

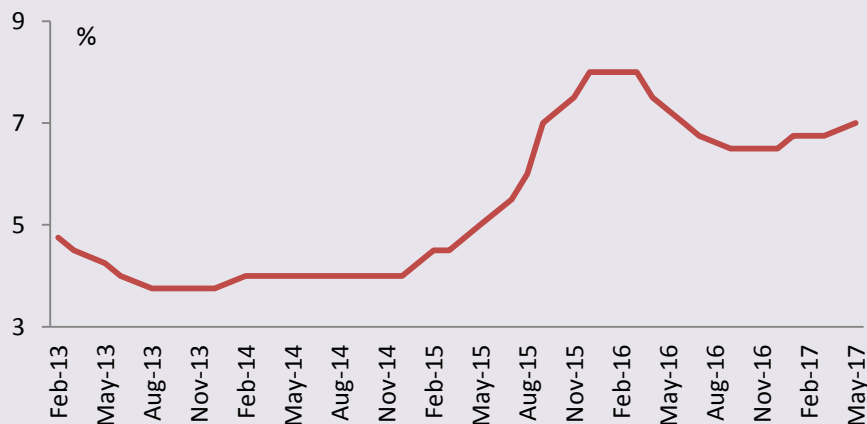
Inflation and monetary policy

Inflation rate and inflation target



Source: IMF, *Projection; Note: Annual average (consumer prices)

NBG policy rate



Source: National Bank of Georgia

Inflation

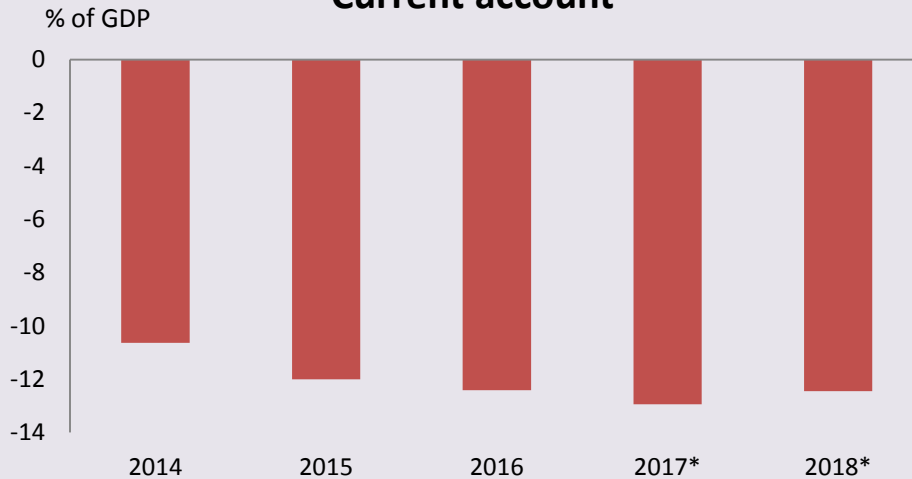
- National Bank (NBG) reduces the inflation target from 5.0% in 2016 to 3.0% in 2018
- 2016: Inflation at 2.1% below target of 5.0%
- Reasons: Weak demand, low oil prices, high base effect after 2015
- Reaction NBG: Decrease of policy rate
- 2017: Inflation expected to increase to 5.7%
- Reason: Significant increase of excise taxes
- Reaction of NBG: Increase of policy rate in early 2017 from 6.5% to 7.0%
- 2018: Expectation of inflation meeting its target

Conclusion

- Increase of inflation due to higher excises
- NBG reacted by increasing its policy rate

Current account and exchange rate

Current account



Source: IMF; * Forecast

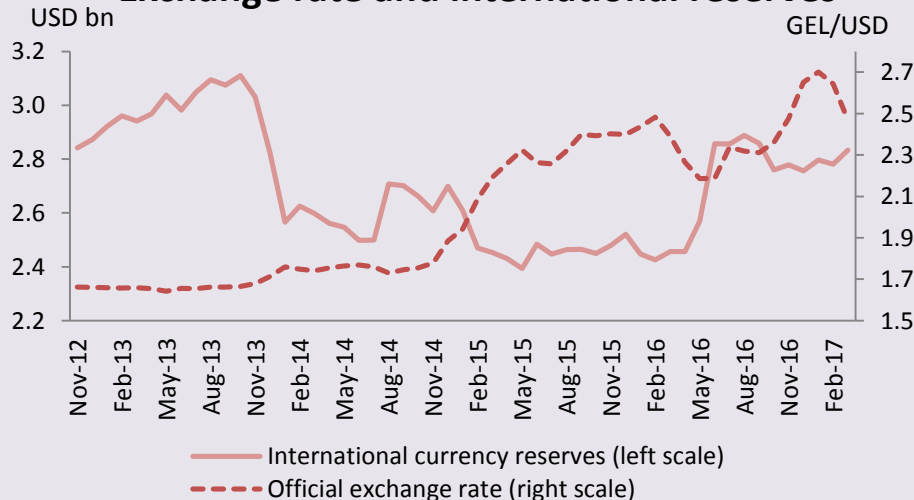
Current account

- Current account deficit remains at approx. 13% of GDP
- Reason: Structural weakness of exports
- So far stable financing of deficit through strong FDI (11% of GDP)

Exchange rate and international reserves

- Flexible exchange rate of the NBG
- Exchange rate reacts to strong fluctuations of main trade partners' exchange rates
- NBG intervened carefully by selling Lari in the recent past
- Aim: Increase of international currency reserves as stipulated in the IMF programme

Exchange rate and international reserves



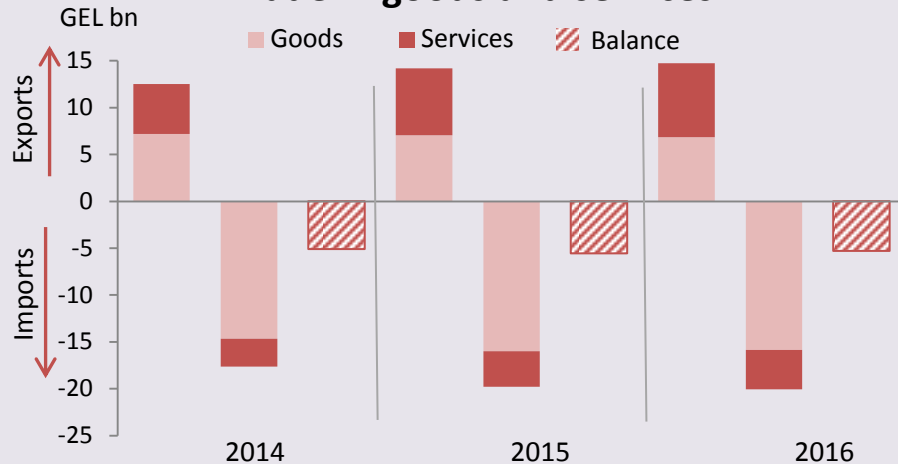
Source: National Bank of Georgia

Conclusion

- Current account deficit remains source of risk
- Flexible exchange rate allows rapid economic adaptation to external shocks

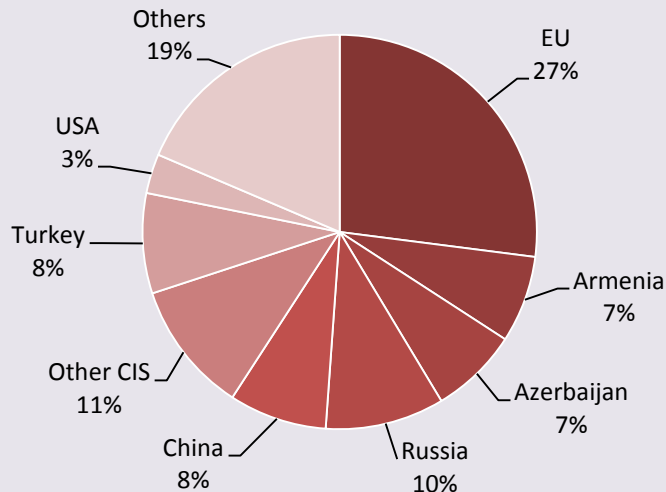
External trade

Trade in goods and services



Source: Geostat

Export by countries



Source: Geostat, 2016; Note: Trade in goods

Goods

- Large, structural trade deficit is main reason for current account deficit
- 2016: Exports decreased by 4.2%, imports by 0.1%
- Goods exports account for only 47% of total exports

Services

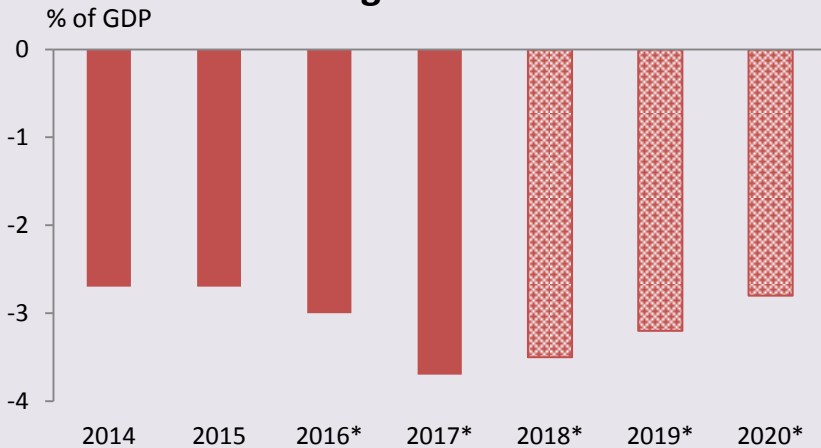
- Increase of exports by 10% and imports by 11%
- Georgia is net exporter of services
- 53% of total exports are services
- Strongest sectors: Transport and tourism
- Revenues generated by tourism sector exceeds total export of goods

Conclusion

- Persistent structural weakness in export of goods
- Trade surplus in services
- Due to low level of diversification, goods exports strongly depend on commodity prices

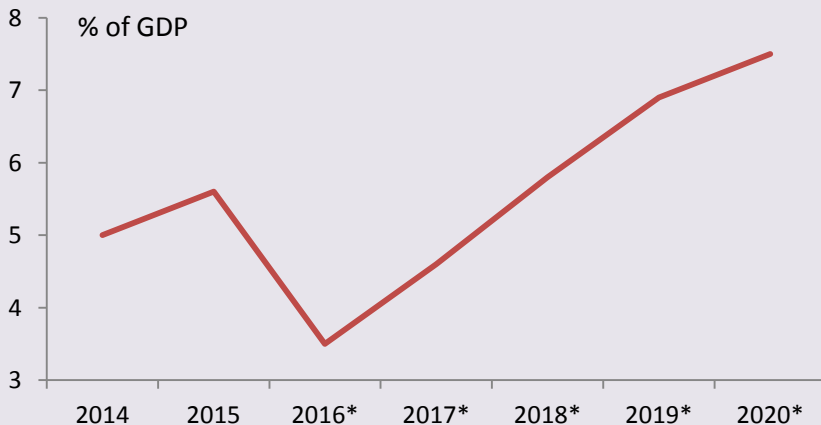
State budget and public spending

Budget deficit



Source: IMF; *Estimation/projection; Note: According to GFSM 1998 definition

Public investment



Source: IMF, *Estimation/Projection

Budget deficit

- Fears of an increase of budget deficit to 5% in 2017 in the context of elections 2016
- Reasons: Planned corporate tax reform, increased public investment
- After elections: Corrections, esp. through increased excise taxes
- Budget deficit planned at 3.7% of GDP in 2017
- New IMF programme: Deficit to be reduced to 2.8% of GDP by 2020

Public expenditures

- Increased investment expenditures, reduced public consumption expenditures; positive for growth

Conclusion

- Increased excises stabilise budget
- New IMF programme secures fiscal consolidation

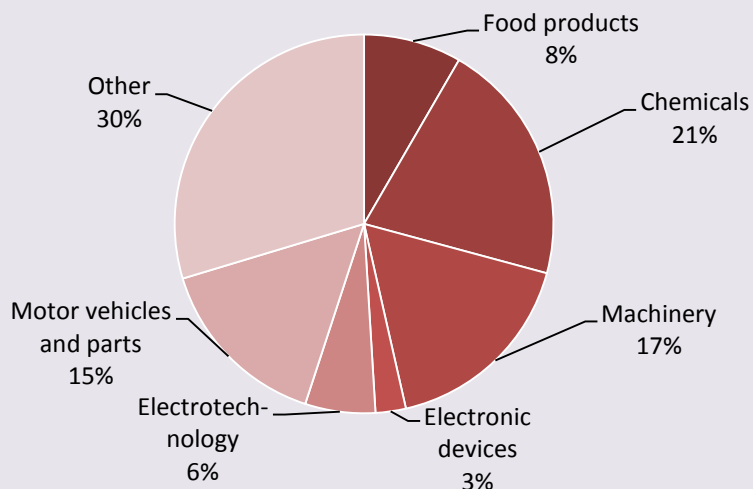
Bilateral trade between Germany and Georgia

German trade with Georgia



Source: German Federal Statistics Office

German exports to Georgia



Source: German Federal Statistics Office, 2016; Note: Trade in goods

Trade turnover

- Trade turnover between Georgia and Germany amounted to EUR 425 m in 2016

Exports to Georgia

- Decrease of German exports to Georgia by 7.3% in 2016
- Reason: Decrease of Georgian re-exports of used motor vehicles since 2015

Imports from Georgia

- German imports from Georgia have decreased by 2.8% in 2016
- Main reason are low prices for key Georgian export commodities like nuts

Balance

- German trade surplus with Georgia decreased from EUR 268 m (2015) to EUR 245 m (2016)

Conclusion

- Bilateral trade has potential for growth in the context of the DCFTA

New IMF programme signed

Background

- From July 2014 to March 2017: Stand-by Agreement (SBA) worth USD 135 m
- SBA derailed in 2016 due to fiscal risks in the run-up to elections and dispute about plans to remove financial supervision from the National Bank

New Programme

- In March 2017, the Georgian government requested a so-called „Extended Arrangement“
- Long-term programme (3 years), higher volume (USD 285 m)

Programme priorities

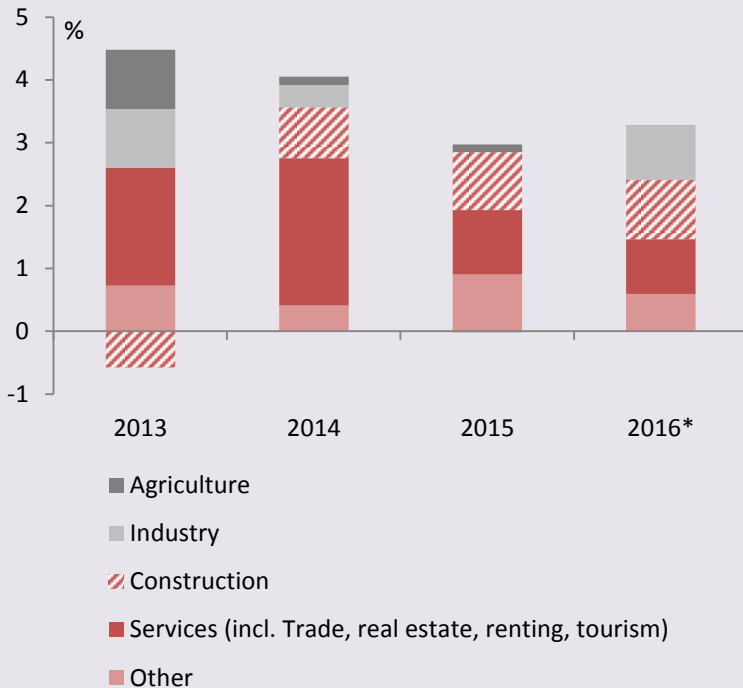
- Fiscal policy: Reduction of budget deficit (3.7% in 2017), consolidation of public spending, increase of share of investments in public spending
- Monetary policy: Maintenance of flexible exchange rate, strengthened banking supervision
- Structural reforms: FDI attraction to export-oriented sectors, capital sector development (incl. partly capital funded pension system), reform of education system

Conclusion

- New programme is important signal of economic stability for investors
- Programme supports economic growth

GET Georgia recommends economic policy priorities

Economic growth by sectors



Source: Geostat; *Estimation

Challenges to growth

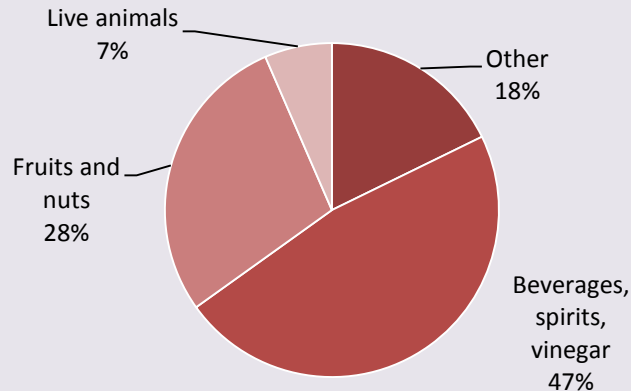
- GDP growth constant, but well below potential
- Weak performance especially of agriculture and industry
- Service sectors have significantly contributed to growth in the past
- Risk of unbalanced growth, too strong dependency on few services sectors

Recommendations

- Conditions to be created to increase investment in
 - Light industry
 - Agriculture
- GET Georgia recommends comprehensive package of measures by relevant government departments
- Elements:
 - Creation of clusters in growth sectors
 - Improvement of export promotion
 - Disentangling agricultural and social policies
 - Improvement of professional education

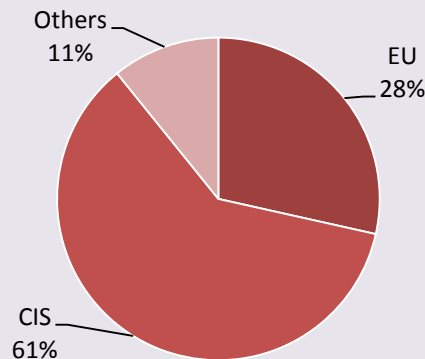
Unlocking export potential for agriculture

Structure of agricultural exports 2014 - 2016



Source: UN Comtrade

Sales markets of agricultural products 2014 - 2016



Source: Geostat, UN Comtrade

Current situation

- Georgia imports more agricultural products than it exports despite large agricultural sector
- Agricultural exports concentrated in few goods
- Example: 65% of exports to EU are hazelnuts

Potential and challenges

- High potential for valuable niche products due to diversity of climatic conditions
- Low productivity of agricultural sector because of highly fragmented land and lack of investment
- Inefficient organisation of export chains results in lack of quality control and origin documentation

Recommendations

- Land consolidation is necessary
- Productive alliances between supply chain participants contribute to improved quality
- Government can support productive alliances and target them with state programmes

DCFTA implementation: Current situation

Topic	Current status	Measures	Main tasks ahead
Market access	On schedule	<ul style="list-style-type: none"> Duty-free access Joined Pan-Euro-Med (2016) 	<ul style="list-style-type: none"> Amendments to current FTAs to use Pan-Euro-Med
Technical barriers to trade	On schedule	<ul style="list-style-type: none"> Progress in horizontal approximation 6 out of 21 technical regulations aligned 	<ul style="list-style-type: none"> Legal approximation Capacity development
Food safety	On schedule	<ul style="list-style-type: none"> Submitted list for SPS harmonisation Food safety control intensified <u>But</u>: Low effectiveness of the system 	<ul style="list-style-type: none"> Legislative approximation Capacity development Getting individual access
Customs service	On schedule	<ul style="list-style-type: none"> New customs legislation drafted Accession to Common Transit Convention in progress 	<ul style="list-style-type: none"> Adoption of new customs legislation Capacity development
Public procurement	On schedule	<ul style="list-style-type: none"> Roadmap and Action Plan for the implementation of the public procurement chapter adopted 	<ul style="list-style-type: none"> Legal approximation Capacity development
Protection of intellectual property rights	In line with commitments	<ul style="list-style-type: none"> Consolidation of IPR related powers <u>But</u>: Low IPR protection in practice 	<ul style="list-style-type: none"> Legal approximation Capacity development
Competition policy	In line with commitments	<ul style="list-style-type: none"> Amended Competition Law Independent competition authority established 	<ul style="list-style-type: none"> Better coordination among stakeholders Improved law enforcement

German Economic Team Georgia



The German Economic Team (GET Georgia) has been supporting the Georgian government in designing the necessary reform process since 2014.

In a dialogue with the Georgian Government, we identify existing economic problems and develop actionable policy recommendations to overcome them. Our advisory work is based on independent analysis and impartial recommendations.

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