

Overview

- GDP returns to higher growth path; 4.3% growth expected in 2017 and 4.2% in 2018
- GDP increase driven by consumption, investment and net exports; broad-based growth
- Industry up 2.5% in 1H2017 and contributes increasingly to growth
- Smooth implementation of the IMF programme allows for disbursement of second tranche
- Depreciation of Lari during last months has mainly seasonal reasons
- Exports increased by sizeable 28% in Jan-Sep 2017
- Reallocation of public expenditures towards investment

Topics

- **Inventory write-offs.** State should allow enterprises to write off actual losses; verification by plausibility checks founded on databases
- **Remittances.** Increase by 20% in Jan-Sep 2017 supports private consumption
- **Doing Business Ranking.** Improvement from rank 16 to rank 9
- **Capital market development in the context of the DCFTA.** Possibility for larger enterprises to mobilise capital
- **Introduction of capital-funded pensions.** Successful introduction of capital-based pensions only in case of simultaneous reform of the 1. pension pillar

Basic indicators

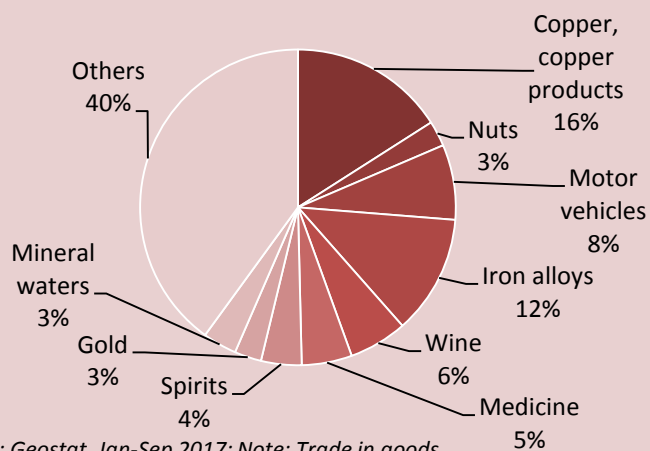
	Georgia	Moldova	Belarus	Ukraine	Russia
GDP, USD bn	15.2	7.9	52.8	104.1	1,469.3
GDP/capita, USD	4,123	2,240	5,585	2,459	10,248
Population, m	3.7	3.5	9.5	42.3	143.4

Source: IMF World Economic Outlook Oct 2017, forecast 2017

Trade structure

Export

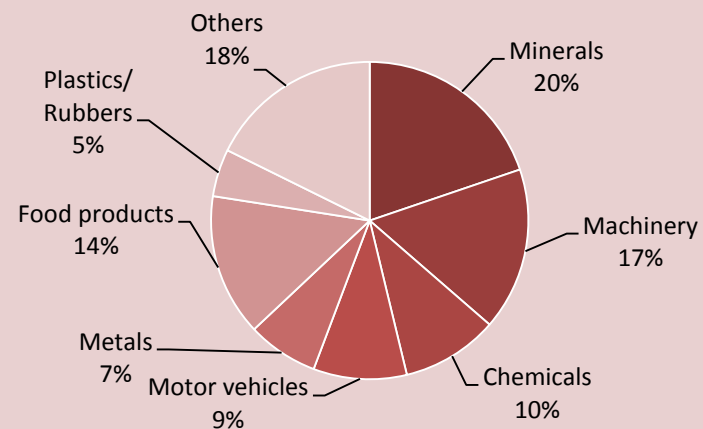
EU 24% | CIS 40% | Others 36%



Source: Geostat, Jan-Sep 2017; Note: Trade in goods

Import

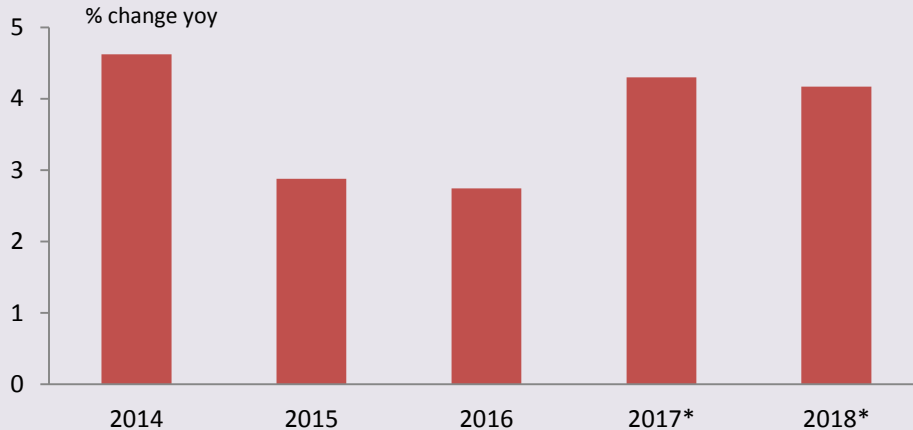
EU 29% | CIS 29% | Others 42%



Source: Geostat, Jan-Sep 2017; Note: Trade in goods

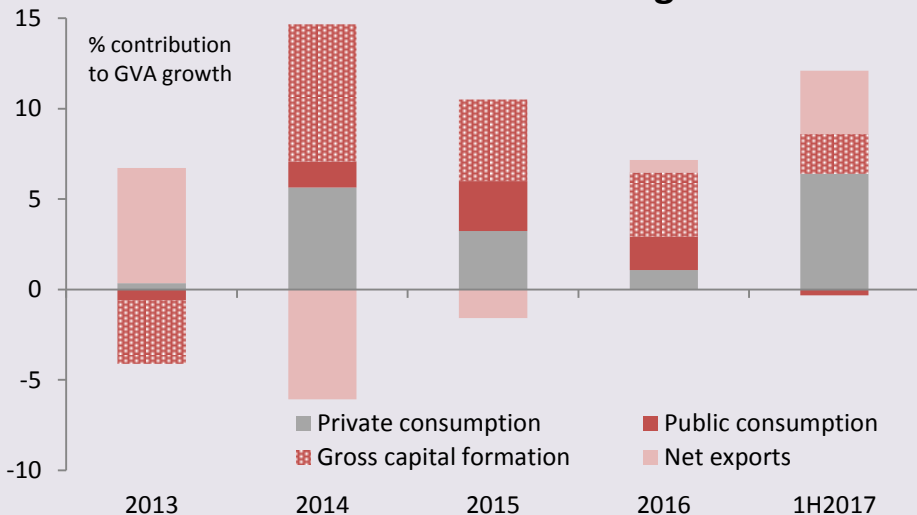
Economic growth

Real GDP growth



Source: IMF Country Report from Dec 2017; *forecast

Contribution to economic growth



Source: Geostat

GDP

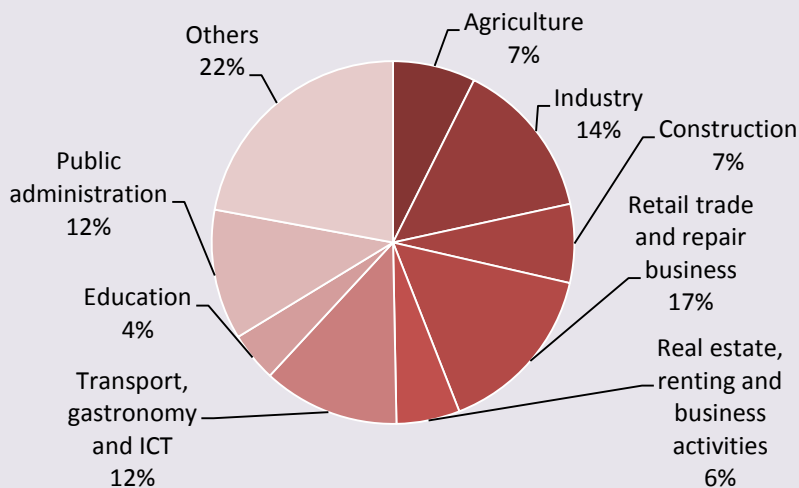
- 2017: GDP growth of 4.3%
- Reasons:
 - Increase of private consumption
 - Investment
 - Positive development of exports
- Healthy and balanced growth on the demand side
- 2018: Continuation of this trend, GDP growth of 4.2% expected

Conclusion

- After slow down in 2015/16, GDP now returns to higher growth rates
- Positive impact on state budget; revenues higher than expected

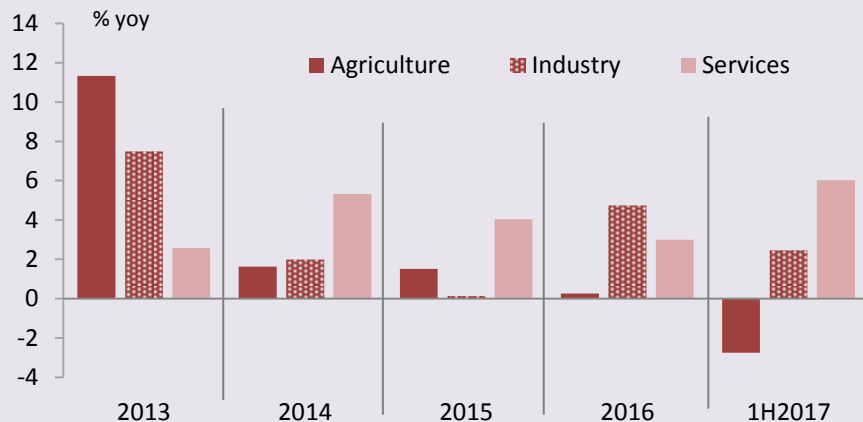
Sectoral perspective

Composition of GDP



Source: Geostat, 1H2017

Sectoral dynamics



Source: Geostat, Note: Annual growth of GVA

Agriculture

- 1H2017: Decrease by 2.7%

Industry

- Positive development in 1H2017 (+2.5%)
- Positive contribution to GDP as in the previous year

Services

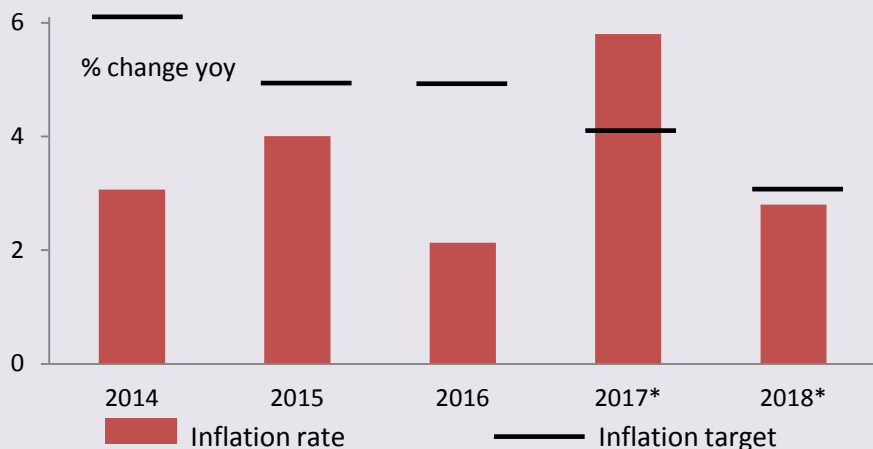
- Continue to be main driver of economic growth (+6.0% in 1H2017)
- Strong contribution of tourism: Increase of revenues in 9M2016 by 29%

Conclusion

- Services remain most important growth sector
- Also industry contributes to growth
- Agriculture maintains its weak performance

Inflation and monetary policy

Inflation rate and inflation target

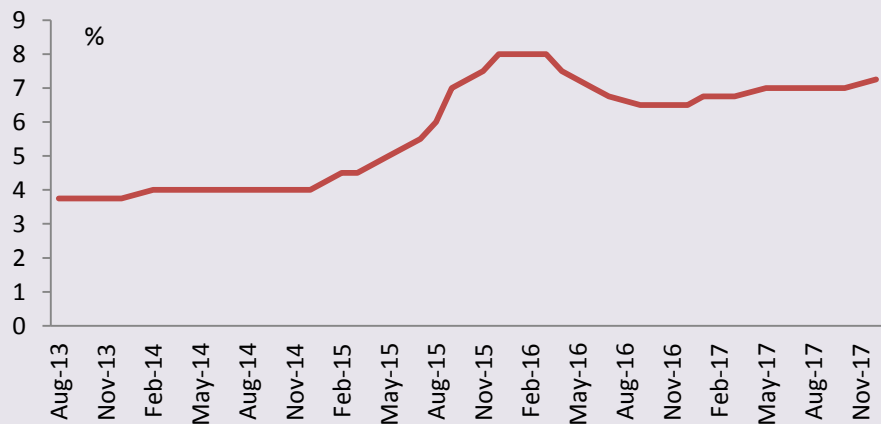


Source: IMF Country Report from Dec 2017, *forecast; Note: Annual average (consumer prices)

Inflation

- National Bank (NBG) lowers inflation target for 2018 to 3%, after 5% in 2016 and 4% in 2017
- However: Inflation target of 4% not met in 2017, annual average of 5.8%
- Reason: Increase of excise taxes on mineral oil, cars, tobacco and gas at the beginning of 2017
- Reaction of the NBG: Increase of policy rate in January, May and December 2017
- 2018: Inflation target is expected to be met

NBG policy rate



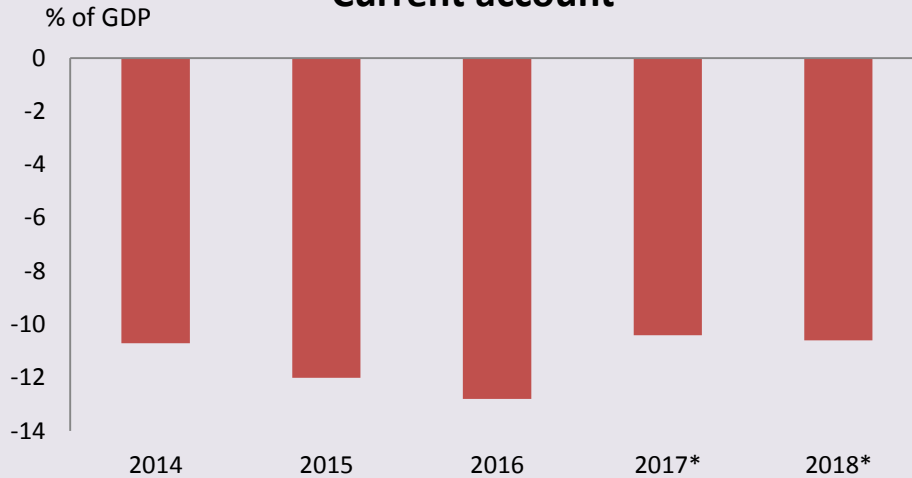
Source: National Bank of Georgia

Conclusion

- Higher inflation in 2017 due to increase in excise taxes
- Continuation of a stability-oriented monetary policy in the framework of inflation targeting

Current account and exchange rate

Current account



Source: IMF Country Report Dec 2017; *forecast

Current account deficit

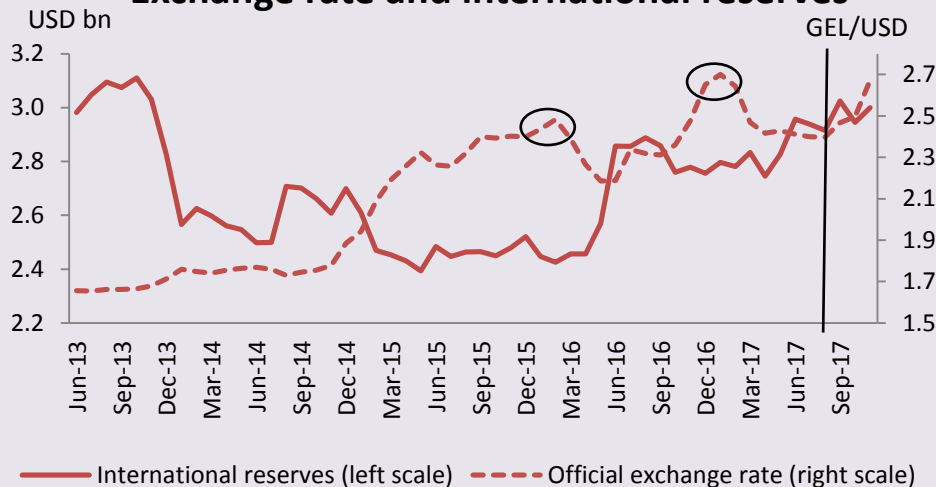
- According to IMF projection, current account deficit decreases to 10.4% of GDP in 2017
- Actual value probably even lower (7.4% of GDP in 9M2017)

Exchange rate

- Aug-Nov 2017: Much discussed depreciation of Lari vs US dollar by 11.5%
- Main reason: Seasonal development due to tourism and energy trade
- Implications

- Short-term fluctuations should not be overestimated
- No reason for interventions by the NBG
- Incentive for development of the forward exchange market

Exchange rate and international reserves



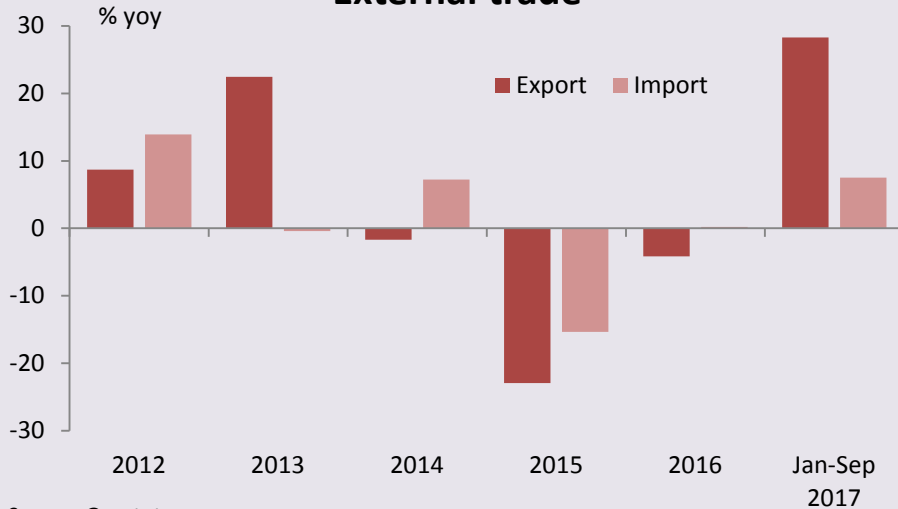
Source: National Bank of Georgia

Conclusion

- Lower current account deficit in 2017
- Depreciation of the last months no reason for interventions

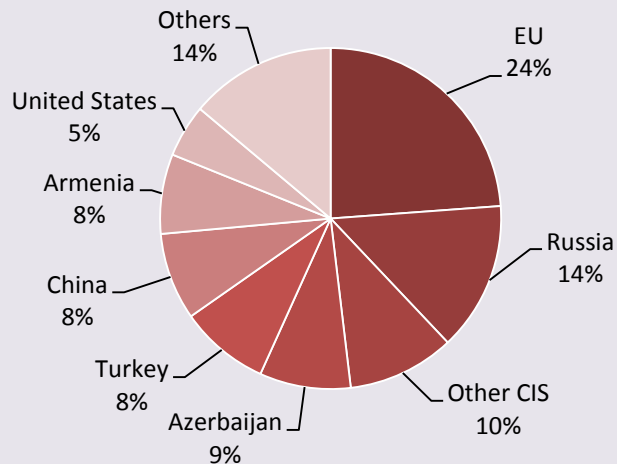
External trade

External trade



Source: Geostat

Export by countries



Source: Geostat, Jan-Sep 2017; Note: Trade in goods

Dynamics

- Jan-Oct 2017: Export of goods increases by 29.4%, imports by 7.8%

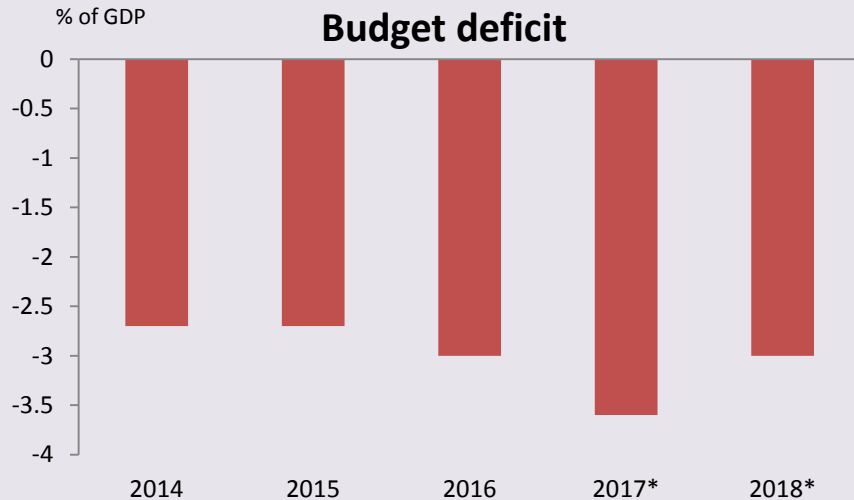
Regional structure of exports

- Strongly diversified
- Main trade partners are neighbours: Russia, Azerbaijan, Turkey, Armenia
- Regional exports make up almost 50%
- Despite its geographical distance, EU has a significant share of 24%

Conclusion

- Positive development of goods exports, partly supported by higher commodity prices
- Largest share of exports shipped to direct neighbours; EU is also an important partner

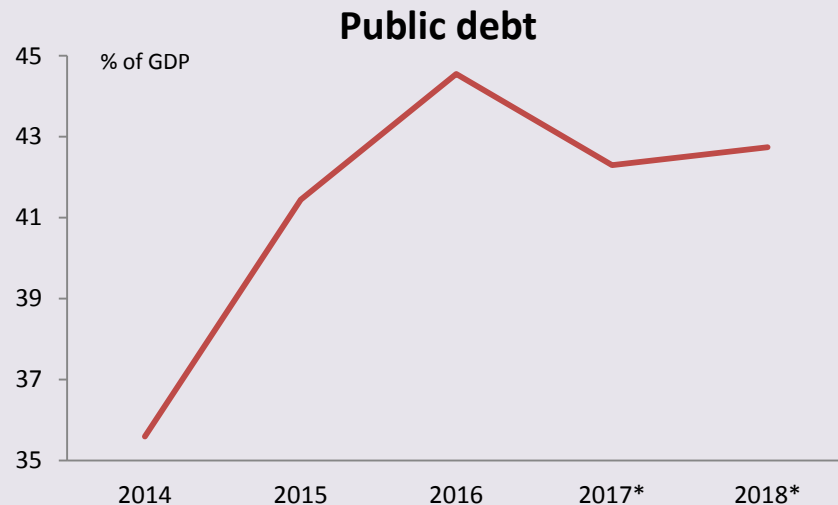
Public finances and government debt



Source: IMF Country Report from Dec 2017, *forecast; Note: GFSM 1998 definition

Budget deficit

- 2017: Deficit of 3.6% of GDP; compatible with IMF
- Revenues higher than expected
 - Better economic performance
 - Reform of corporate taxation: Revenue losses of only 1.1 of GDP instead of planned 1.5
- Spending of additional revenues: 75% on infrastructure, esp. for the development of tunnels and bridges of the East-West highway



Source: IMF Country Report from Dec 2017; *forecast

Public expenditures: Growth-oriented reallocation

- Reallocation from consumption towards investment

Conclusion

- Good budget situation
- Important factor for the smooth disbursement of the second tranche of the IMF programme

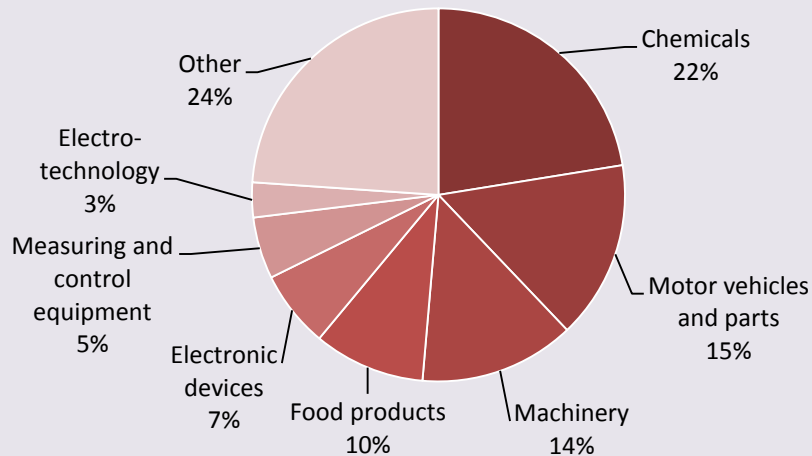
Bilateral trade between Germany and Georgia

German trade with Georgia



Source: German Federal Statistics Office, *Estimation based on Jan-Aug data; Note: Trade in goods

German exports to Georgia



Source: German Federal Statistics Office, Jan-Aug 2017; Note: Trade in goods

Trade volume

- Trade volume between Georgia and Germany in 2017 at ca EUR 445 m

Exports to Georgia

- German exports to Georgia increase by 4.3% in 2017

Imports from Georgia

- Increase of German imports from Georgia by ca 5.7% in 2017

Balance

- German trade surplus with Georgia increases from EUR 245 m (2016) to EUR 254 m (2017)

Conclusion

- Moderate intensification of bilateral trade

Tax treatment of inventory write-offs

Inventory write-offs due to natural or production losses

- Loss of material during a production process and storage have to be written off the inventory
- Can be counted as costs during VAT and profit taxation
- Risk for the tax authorities: Potential threat of tax fraud

Current tax treatment in Georgia

- Revenue Service requires physical inspection of almost all losses
- In case of difference: Losses are taxed as if they have been sold; in case the company refuses, there is a risk of severe sanctions by the Revenue Service
- Physical inspections difficult to conduct, in some cases even impossible
- Rigid practice poses a burden especially on industries with high natural and production losses, like e.g. food processing

Current approach to solve the problem in Georgia

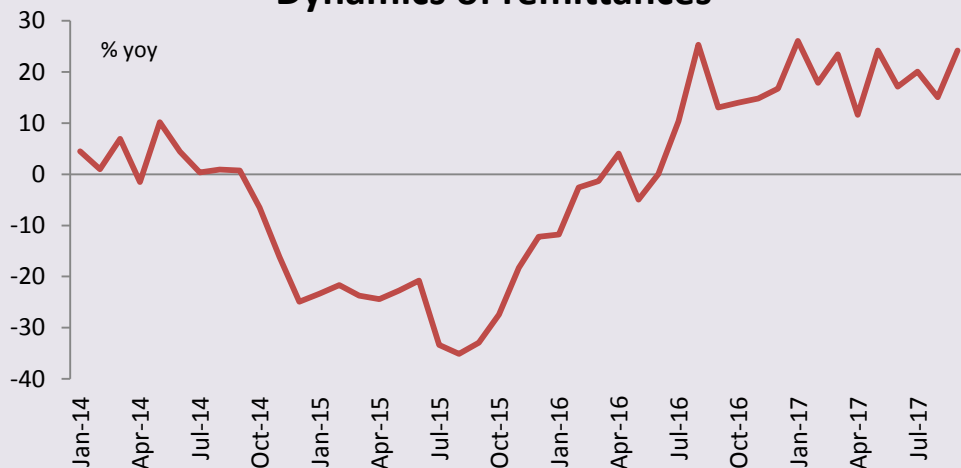
- Setting product-specific quota for permitted inventory write-offs (done for 13 products)
- Problem: Setting quotas for all products by the state is practically impossible

Recommendations by GET Georgia

- Apply international practice: Allow companies to write off their actual losses
- Avoid tax fraud by plausibility checks founded on a database

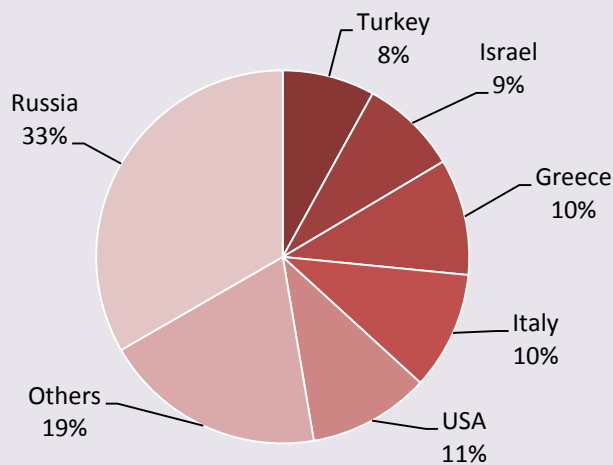
Remittances

Dynamics of remittances



Source: National Bank of Georgia; Note: Based on USD

Remittances by countries



Source: National Bank of Georgia; Jan-Sep 2017

Importance of remittances

- 2016: Remittances amounted to 6.4% of GDP
- Most important countries of origin: Russia, USA, Italy, Greece, Israel, Turkey

Development in 9M2017

- Jan-Sep 2017: Increase in remittances in USD by 20%
- Increase from all countries of origin: RUS 17%, GRC 8%, ITA 15%, USA 15%, ISR 100%
- Increase Russia: Recovery of oil price and appreciation of the rouble
- Israel as new country of origin after introduction of visa-free regime in 2014

Conclusion

- Strong increase: 20% in USD, at the same time slight depreciation of the Lari
- Positive impact on private consumption and economic growth

Georgia in the Doing Business Ranking

Categories with an improved ranking

	Ranking 2017	Ranking 2018
Starting a business	8	4
Getting electricity	39	30
Protecting minority investors	7	2
Enforcing contracts	16	7
Resolving insolvency	106	57

Source: Doing Business Report of the World Bank

Doing Business Ranking and FDI inflows

	Ranking 2018	FDI, % of GDP
Georgia	9	9.4%
Moldova	44	2.2%
Ukraine	76	1.1%

Source: Doing Business Report of the World Bank, EBRD

Latest ranking

- Improvement in the ranking from rank 16 (2017) to rank 9 (2018)

Category „Getting electricity“

- Introduction of penalties for energy suppliers in case of over proportionally many outages; recommendation by GET Georgia
- Obligatory prior notification of clients in case of planned outages

Category „Resolving insolvency“

- Easier to initiate insolvency proceedings
- Stronger involvement of the creditor during the proceeding
- Both were recommendations by GET Georgia
- Currently: More reform plans

Ranking and FDI inflows

- Strong relation between good ranking and high FDI inflows
- Georgia holds top position in the region

Introduction of capital-funded pensions

The plan

- Law has been prepared for the last two years, now commented on by social partners
- 2% of payroll paid by both employer and employee; up to 2% additional state subsidy
- Funds are managed by a new state agency

Advantages in the Georgian context

- Diversification of pension provision
- Creation of long-term domestic financing sources, ca GEL 200-300 m pa; capital market development

Risks in the pension system

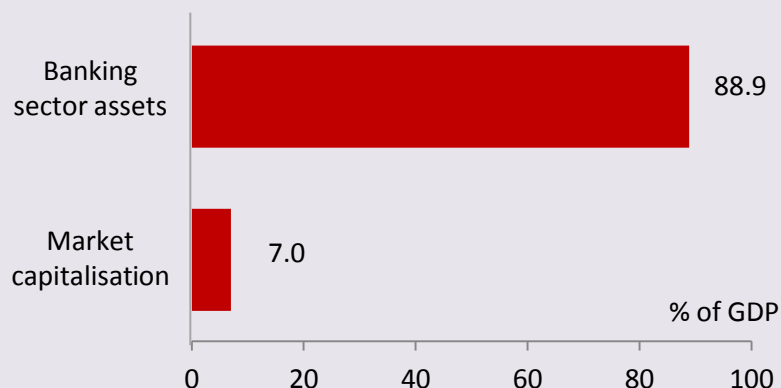
- Advantages only for a small share of the population, as only employees in regular jobs and below a certain benchmark age are included into the scheme
- Old-age poverty of employees with low income creates further fiscal risks
- Possible risk: Increase in shadow economy
- Strong liquidity inflow on the domestic capital market

Conclusion

- Successful introduction of capital-funded pension only if first pension pillar is reformed simultaneously
- Significant potential for the domestic capital market, but diversification should lead to a larger share of foreign capital

Capital market development in the framework of the DCFTA

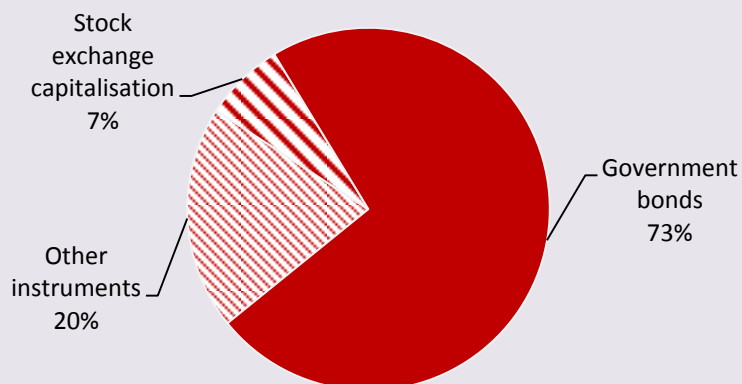
Financial market indicators, 2016



Source: Strategy for the development of capital markets in Georgia; Note: eop

Structure of the capital market, 2016

Market capitalisation = USD 1 bn respectively 7.0% of GDP



Source: Strategy for the development of capital markets in Georgia; Note: eop

Financial market is dominated by banks

- Capital market volume only ca. 7% of GDP
- Government bonds with high liquidity
 - Ca 73% of capital market volume; maturity up to 10 years
- Historic stock without turnover
- Bonds issued by international organisations and a few large enterprises

The capital market strategy of 2016

- Positive for the mobilisation of long-term capital in local currency
- Potential by issuers and local investors
- Convergence towards EU standards should be done carefully

Conclusion

- Low risks in the banking system
- Capital market development can mobilise resources for larger enterprises

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.

GET Georgia is financed by the German Federal Ministry for Economic Affairs and Energy and implemented by Berlin Economics.

Contact:

German Economic Team Georgia
c/o Berlin Economics
Schillerstraße 59
10627 Berlin

Tel: +49 30/ 20 61 34 64 0
info@get-georgia.de
www.get-georgia.de
Twitter: @BerlinEconomics
Facebook: @BE.Berlin.Economics

