

# **Economic impact of Turkish Lira depreciation on Georgia**

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## Summary

- Large nominal TRY depreciation vs. GEL (42%)
- Real TRY/GEL depreciation is only 20%; thus: sizeable, but not so large
- Impact so far: less GEO exports of consumer & capital goods; more imports from TUR; both in line with the theory
- But: higher GEO exports of raw materials and intermediary goods to TUR; reason: global value chain effect
- Estimated impact in the future: moderate impact on aggregate trade in goods, but strong sectoral impact on textile exports (esp. T-Shirts)
- Services, remittances: moderate impact expected
- FDI, banking: little impact expected
- However: impact would change in case of higher depreciation of TRY and/or recession in TUR
- Thus: need to monitor the situation

## Motivation

- From January to August 2018, the Turkish Lira (TRY) depreciated by ca. 42% against the USD and same 42% against the Georgian Lari (GEL)
- Turkey is an important trade partner for Georgia, accounting for 8% of goods exports and 17% of goods imports, as well as for about 16% of incoming tourists
- Furthermore, Turkey is also a large investor in Georgia, especially in infrastructure and in the energy sector
- Finally, Georgia receives sizeable remittances from Turkey

**Goal of this policy briefing:** what is the expected economic impact of Turkish Lira depreciation on Georgia?

**Focus:** impact on trade, FDI, remittances and banking

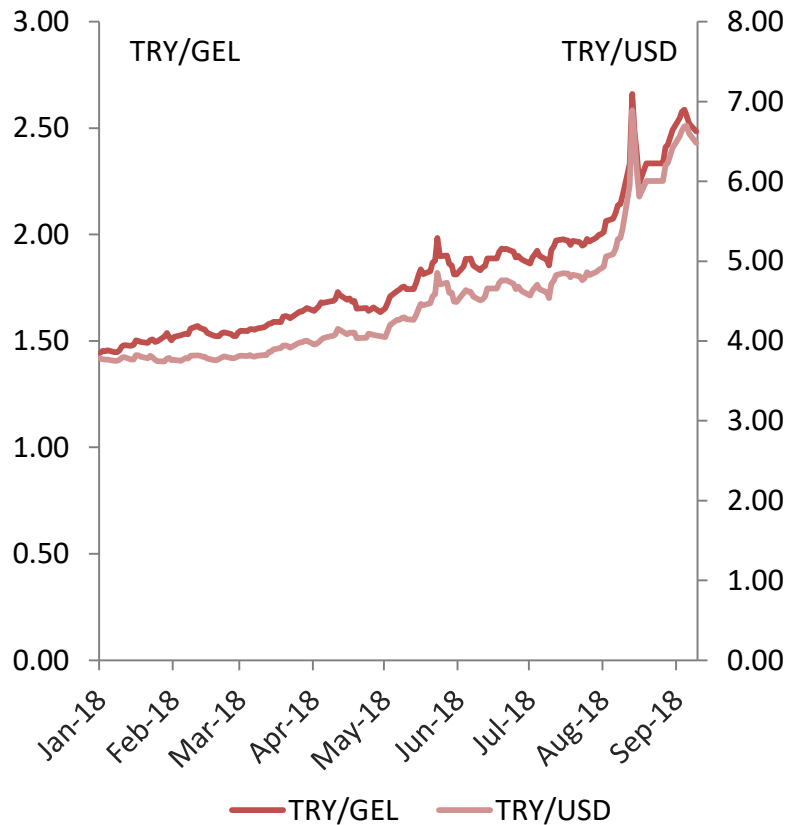
## Structure

1. Turkish Lira depreciation
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  - iii. Method for estimating the potential impact
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6. Conclusions and policy implications

Annex

# 1. Turkish Lira depreciation

## Turkish Lira nominal exchange rate



Source: Central Bank of the Republic of Turkey

## TRY nominal exchange rate, Jan-Aug 2018:

- TRY/USD: -42%
- TRY/GEL: -42%
- Hike in August 2018:
  - TRY/USD: -24%
  - TRY/GEL: -19%

→ Heavy nominal depreciation of TRY vs GEL, but...

## TRY real exchange rate, Jan-Aug 2018:

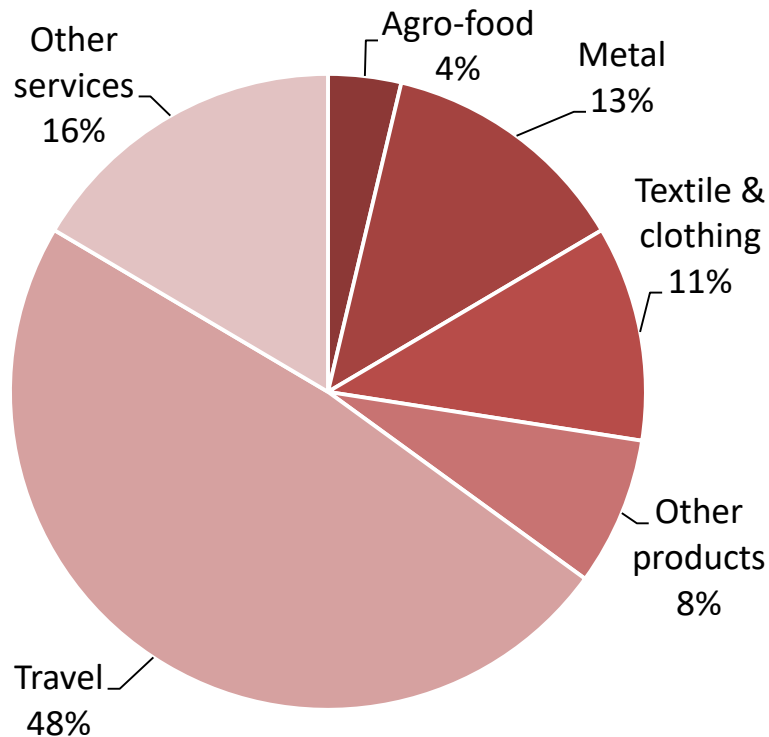
- PPI-based real exchange rate for TRY/GEL: -20%

→ Real exchange rate depreciation is much more moderate

## 2. Impact on Georgian trade

## i. Relevance of trade with Turkey: exports

### Georgia's exports to Turkey, g&s, 2017



Source: ITC Trade Map, authors' estimates

### Exports of goods to Turkey, 2017

- Nominal: USD 216 m
- Share: 8% of total
- Key products: metals and apparel
- Raw materials & intermediate goods: 60% of goods exports  
(see Annex I for classification note)

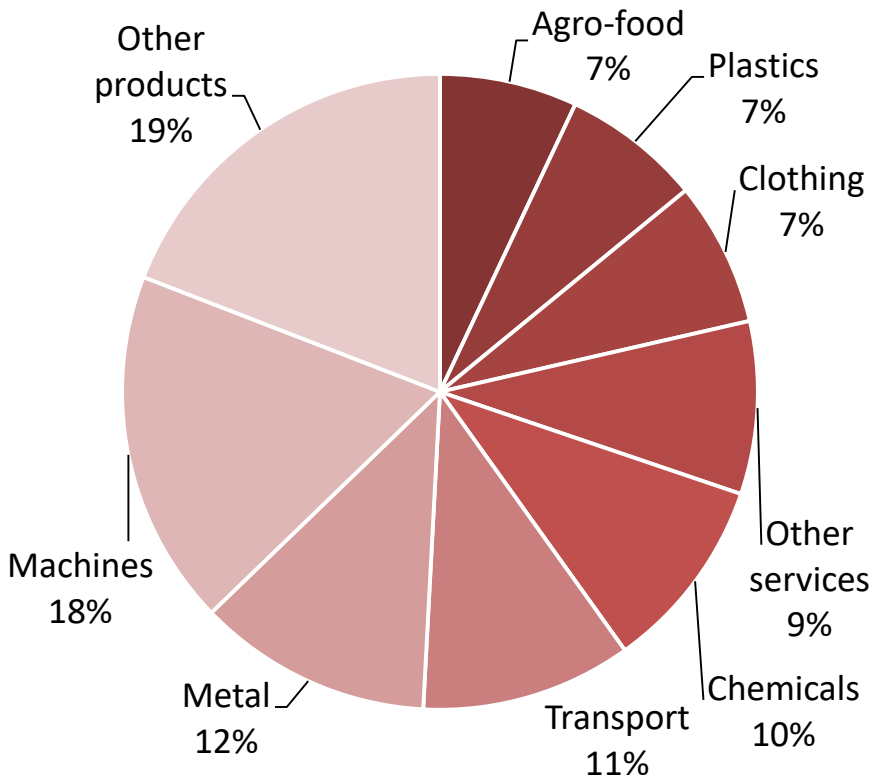
### Exports of services to Turkey, 2017

- Nominal: USD 404 m (est.)
- Share: 10% of total (est.)
- Key services: travel

→ **Services dominate GEO exports to TUR**

## i. Relevance of trade with Turkey: imports

### Georgia's imports from Turkey, g&s, 2017



Source: ITC Trade Map, authors' estimates

### Imports of goods from Turkey, 2017

- Nominal: USD 1,374 m
- Share: 17% of total
- Key products: machines, metals
- Consumer goods incl. cars: 50% of goods imports  
(see Annex I for classification note)

### Imports of services from Turkey, 2017

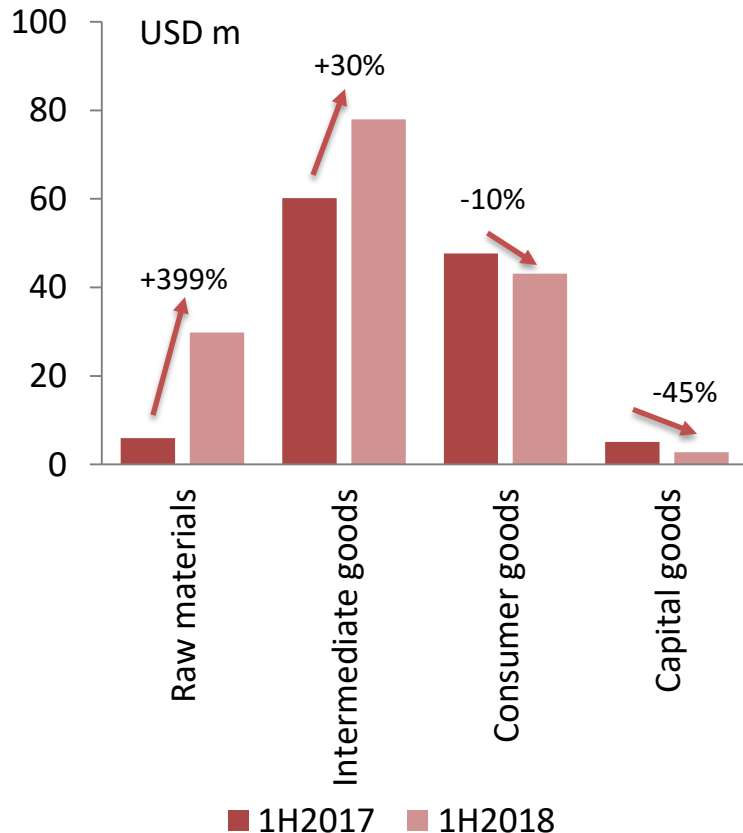
- Nominal: USD 333 m (est.)
- Share: 17% of total (est.)
- Key services: transport

→ Imports from TUR is dominated by consumer goods



## ii. Impact of depreciation on exports of goods so far

### Georgia's exports of goods to TUR, 1H2017 vs. 1H2018

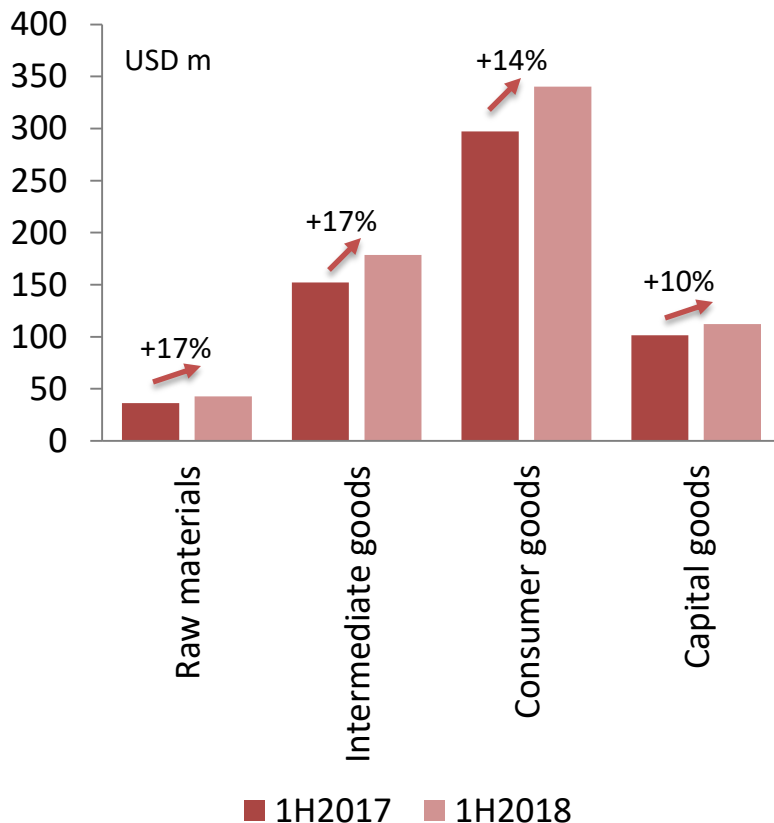


- **Theory:** depreciation of partner currency hinders exports of goods
  - **But: exports of goods to TUR grew by 30% in Jan-Jun 18 (Jan-Jun 17: +13% yoy)**
  - Exports dynamics varied depending on the purpose of goods – inputs vs final goods
  - **Expansion of exports of inputs:**
    - Raw materials: +399% yoy
    - Intermediate goods: +30% yoy
  - **Export of final goods dropped:**
    - Consumer goods: -10% yoy
    - Capital goods: -45% yoy
- **Different reaction** (“elasticity”) of GEO inputs used in TUR industry and final GEO products

Source: UN ComTrade, WITS, authors' estimates

# Impact of depreciation on imports of goods so far

## Georgia's import of goods to TUR, 1H2017 vs. 1H2018



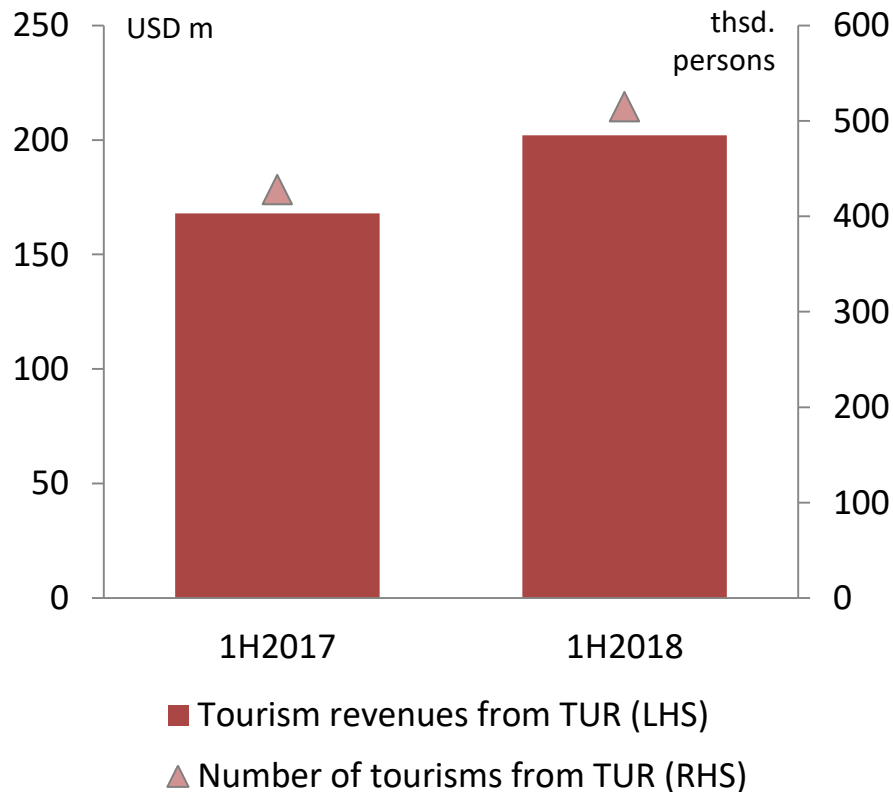
- **Theory:** depreciation of partner currency stimulates imports of goods
- **Imports of goods** from TUR increased by 15% in Jan-Jun 18 (Jan-Jun 17: -9% yoy)
- Expansion of exports across all usage categories:
  - Raw materials: +17% yoy
  - Intermediate goods: +17% yoy
  - Consumer goods: +14% yoy
  - Capital goods: +11% yoy

→ Imports reacted in line with theory

Source: UN ComTrade, WITS, authors' estimates

## Impact of depreciation on trade in services so far

Georgia's revenues from TUR tourists,  
1H2017 vs. 1H2018 (est.)



Source: G&T estimates based on GNTA data

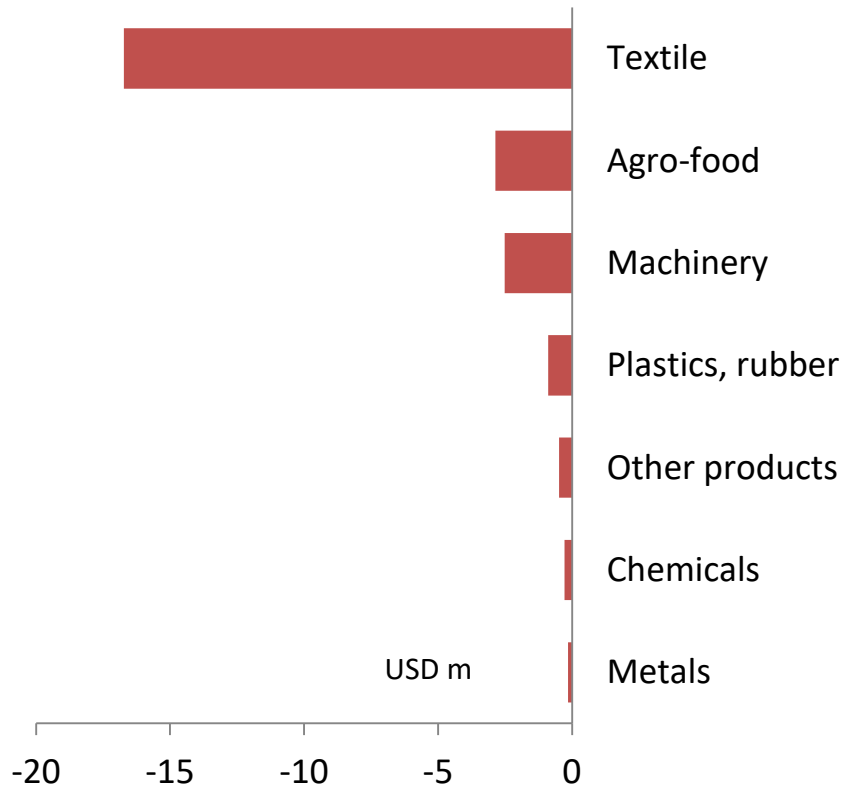
- **Theory:** depreciation of partner currency hinders exports and stimulates imports of services
- **Exports of tourism** services to TUR continued to **grow** in Jan-Jun 18:
  - Number of arrivals: +20% yoy
- **No impact of depreciation on TUR tourists inflow so far** (reasons to be studied separately)
- No reliable data on trade in other services with Turkey – especially important for service-based economy

### iii. Method for estimating the potential impact

- To assess the impact of TRY depreciation on trade, we treat this shock as increased trade costs
- Estimation is based on partial equilibrium approach, so short-term impact
- Base year for trade figures: 2017
- For trade in goods, import price elasticity by product (HS 6-digit) is applied:
  - For exports to Turkey: import price elasticity of Turkey. It is assumed that raw materials and intermediate products are inelastic to negative real exchange rate shocks ('global value chain' effect)
  - For imports from Turkey: import price elasticity of Georgia
  - Source: WITS
- For trade in services, import price elasticity is taken from the literature
- See Annex II for links to relevant literature
- Assumptions: no further depreciation of TRY, no change in GEL exchange in reaction to TRY depreciation

## iv. Estimated impact on exports of goods

### Impact of TRY depreciation on GEO exports to TUR



Source: WITS, authors' estimates

### Estimated impact on exports of goods to TUR (other things equal; not a forecast)

- Nominal: - USD 24 m (0.2% of GDP)
- Change: -11%

#### Most affected category: textile

- Estimated change: -25%
- Change in 1H2018: -11%
- TUR: 70% of GEO exports

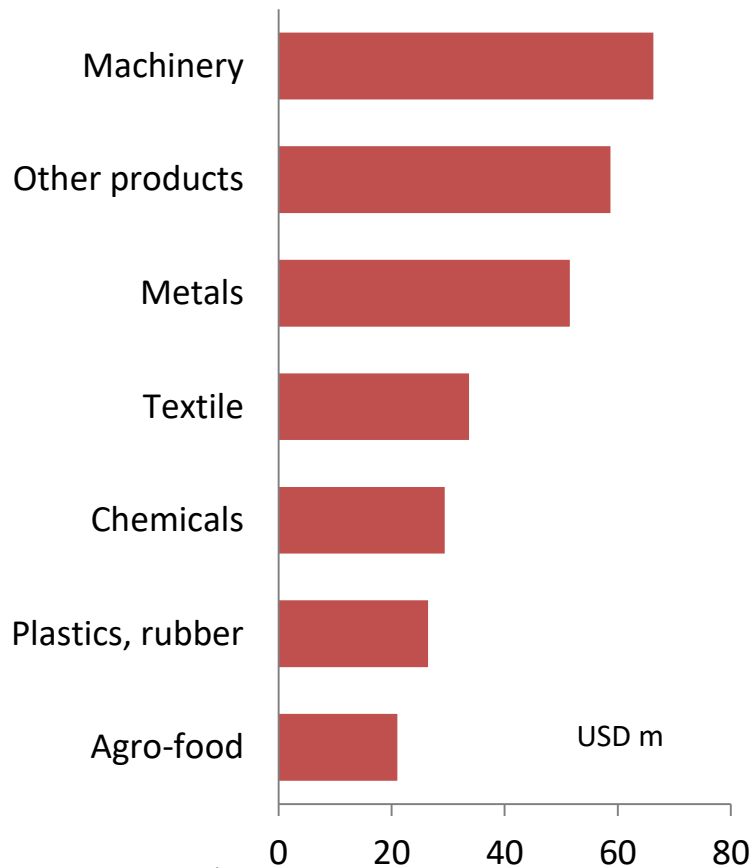
#### Most affected good: T-shirts

- 16% of exports to TUR
- Estimated change: -24%
- Change in 1H2018: -17%

→ **Aggregate impact is moderate, but significant shock on textile**

## Estimated impact on imports of goods

### Impact of TRY depreciation on GEO imports from TUR



Source: authors' estimates

### Estimated impact on imports of goods to TUR (other things equal; not a forecast)

- Nominal: + USD 287 m (1.9% of GDP)
- Change: +21%

### Most affected category: machinery

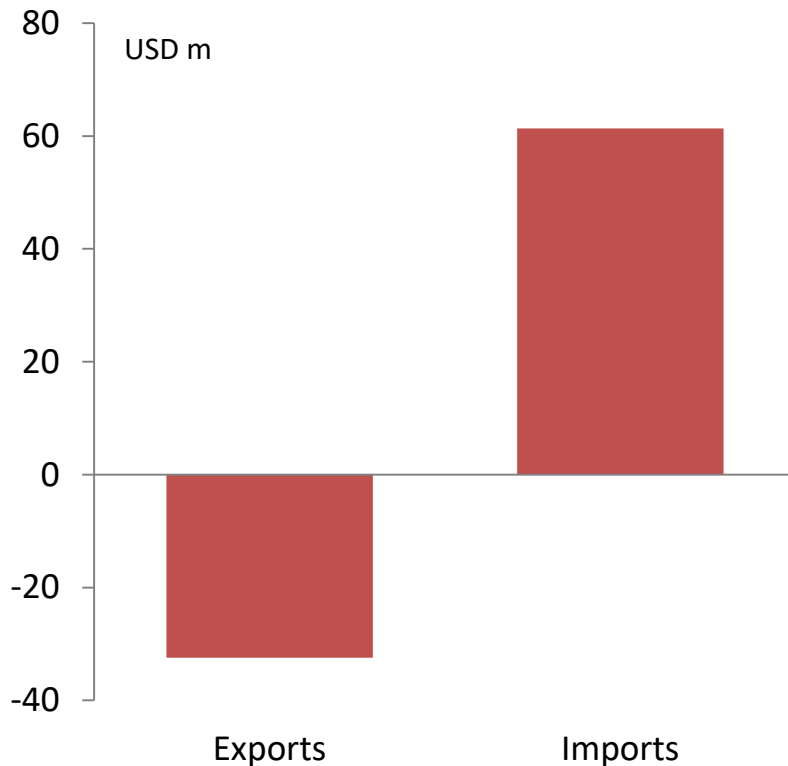
- Estimated change: +22%
- Change in 1H2018: +17%
- Competition with other importers

→ Imports from TYR partly substitutes imports from other countries (extent of substitution is to be studied separately)

→ **Bilateral impact is strong, but impact on trade balance is smaller**

## v. Estimated impact on trade in services

### Impact of TRY depreciation on GEO trade in services



Source: authors' estimates

### Estimated impact on exports of services to TUR (other things equal; not a forecast)

- Nominal: - USD 32 m (0.2% of GDP)
- Change: -8%
- So far, no impact on travel: risk of behavior adjustment in the future

### Estimated impact on imports of services to TUR (other things equal; not a forecast)

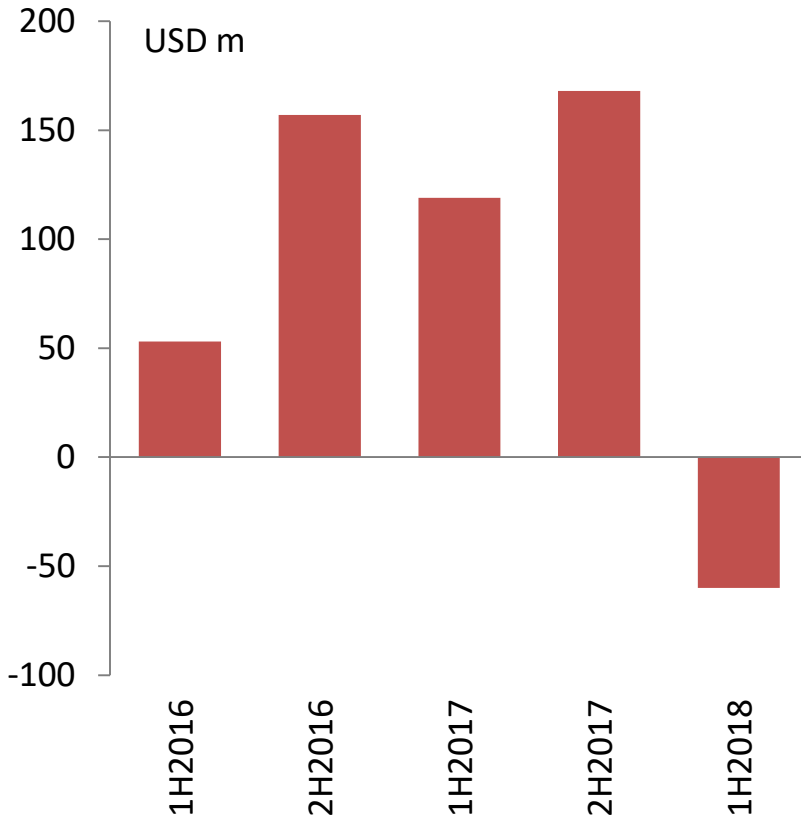
- Nominal: + USD 61 m (0.4% of GDP)
- Change: +18%

→ **Bilateral impact is moderate**

**Remark:** Actual impact could differ from estimation as there is no official data on bilateral trade in services

### 3. Impact on FDI

FDI inflow from TUR to GEO



Source: National Bank of Georgia

#### Foreign direct investments from Turkey

- 2017 stock: USD 1.59 bn
  - Key sectors: transport, energy
- 2017 inflow: USD 286 m (2% of GDP)
  - Share: 15% of total inflow
  - Growth: +36%
- Jan-Jun 18: outflow at USD 60 m
  - Change in ownership in telecom
  - Not caused by TRY depreciation

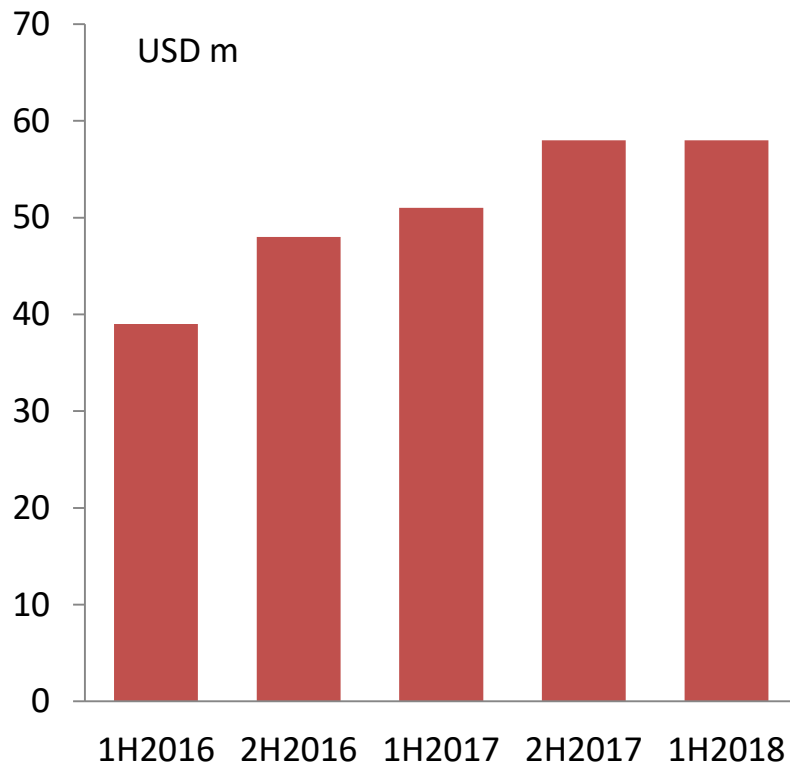
→ **Direct impact on TRY depreciation on FDI inflow is limited**

→ **But TRY depreciation could hinder attraction of new projects**



## 4. Impact on remittances

### Money transfers from TUR to GEO



Source: National Bank of Georgia

### Inflow of remittances from Turkey

- 2017: USD 109.4 m (0.7% of GDP)
    - Share: 7.9% of total
    - Growth: +26%
  - Jan-Jun 2018: USD 58.1 m
    - Share: 7.8% of total
    - Growth: 13% vs Jan-Jun 2017
- Remittances from Turkey continued to grow at slower pace in 1H2018
- Aug 2018: -26% vs Aug 2017
- Sharp reduction after TRY depreciation accelerated in Aug 2018
- **Moderate aggregate impact**

## 5. Impact on banking sector

There are **two Turkish banks** in GEO

- Isbank with assets of GEL 273 m; 0.84% of total assets of banking sector
- Ziraat Bank with assets of GEL 77 m; 0.23% of total assets of banking sector
- **Aggregate share:** 1.07% of total assets of the banking sector
- Activities: corporate and retail banking services

→ **Importance of Turkish banks is limited**

**Jan-Jun 2018:** no observable changes in behavior due to TRY depreciation

→ **No impact on banking sector so far**

**Expectation:**

Future changes will have a very limited impact due to the limited role

## 6. Conclusions

- TRY depreciated by 42% against USD and GEL in Jan-Aug 2018, but real depreciation of TRY, i.e. controlled for inflation, was much more moderate
- Exports of goods
  - So far: growth in exports of inputs in value chains hide the reduction in final products' exports. Textile is the most sensitive sector to depreciation
  - Estimated impact in future: moderate impact on aggregate exports, but strong sectoral impact on textile exports (esp. T-Shirts)
- Imports of goods
  - So far: growth in imports across all categories in the line with theory
  - Estimated impact in future: strong impact on bilateral imports, but smaller impact on aggregate imports
- Trade in services, remittances: moderate impact expected
- FDI, banking: little impact expected
- However: impact would change in case of higher depreciation of TRY and/or recession in TUR. Thus: need to monitor the situation

## Policy implications

### Exchange rate policy

- Keeping a flexible exchange rate is crucial to partly absorb the shock created by recent and possible further depreciation of TRY

### Labour market / regional policy

- Pursuing active labour market and regional development policies could be needed to mitigate the regional shocks (e.g. negative impact on textile manufacturing oriented on the TUR market and located in particular in Adjara)

### Statistics

- Developing the bilateral statistics for trade in services (the key component of GEO exports) as a basis for the policy decisions would be advisable

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## Annex I: data notes

### Georgia-Turkey trade in services

- Both Georgia and Turkey do not report their foreign trade in services by partner countries
- The estimate of trade in services is done based on:
  - For tourism exports: number of tourists coming to the country multiplied by average spending per tourism (using TBC and G&T estimates)
  - For other services: the share of Turkey in services trade is assumed to be proportional to the share of the country in the trade in goods

### Classification of products by use

- The classification of products by their use is developed by UNCTAD
- Source: WITS (<https://wits.worldbank.org/referencedata.html>)

## Annex II: links

- Literature on price elasticity in goods trade
  - <https://www.econstor.eu/handle/10419/182400>
  - <https://www.sciencedirect.com/science/article/abs/pii/S0954349X11000543>
  - <https://www.mitpressjournals.org/doi/abs/10.1162/003465305775098189>
  - <https://wiiw.ac.at/import-demand-elasticities-revisited-dlp-4075.pdf>
- Literature on price elasticity in services trade
  - <https://www.federalreserve.gov/pubs/ifdp/2005/836/ifdp836.pdf>
- Literature on WITS and partial equilibrium
  - <https://wits.worldbank.org/data/public/SMARTMethodology.pdf>