

Overview

- 2018: strong economic growth of 4.7%, driven by private consumption and investment
- 21 June: RUS bans direct flights to GEO; large impact of RUS sanctions on tourism
- GDP: reduction of growth in 2019 by ca. 1pp to 3.6%, due to RUS sanctions
- Lari depreciated against the US dollar by 5.8% between 21 June and end of July
- Inflation at 2.6% in 2018; likely higher in 2019 due to pass through effect of depreciation
- Lower tax revenues likely to contribute to a higher budget deficit in 2019
- Improved trade balance in Jan-May 2019, i.e. before Russian sanctions
- June 2019: IMF board approved fourth programme review; disbursement of USD 41.4 m
- Recently built up financial/fiscal buffers helped to absorb shock of RUS sanctions well

Topics

- **Russian sanctions.** Impact on Georgian economy
- **DCFTA.** Effect on exports to the EU
- **DCFTA.** Effect on composition of exports to the EU
- **Export potential.** Agro-food products on EU market

Basic indicators

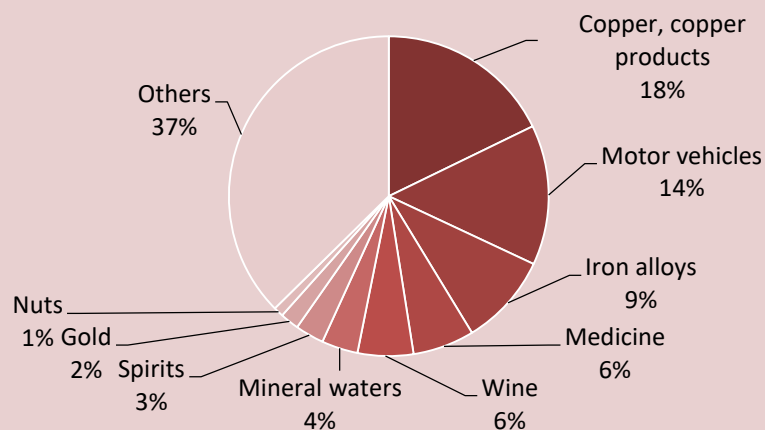
| | Georgia | Moldova | Belarus | Ukraine | Russia |
|-----------------|---------|---------|---------|---------|---------|
| GDP, USD bn | 16.6 | 12.0 | 61.0 | 134.9 | 1,610.4 |
| GDP/capita, USD | 4,661 | 3,399 | 6,477 | 3,221 | 11,191 |
| Population, m | 3.7 | 3.5 | 9.4 | 41.9 | 143.9 |

Source: IMF 2019, Forecast 2019

Trade structure

Exports

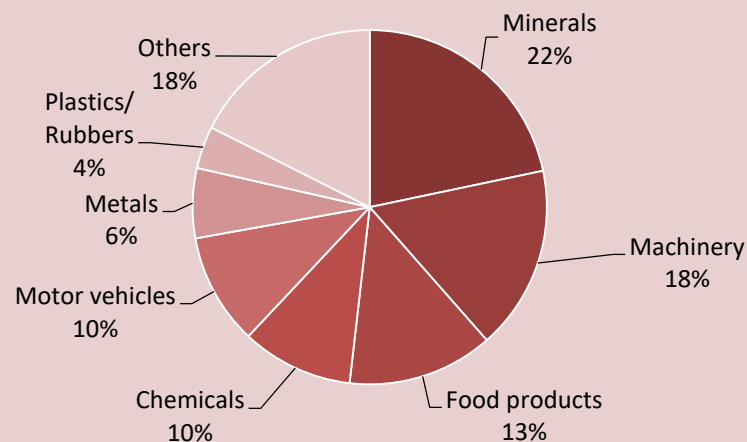
EU 25% | CIS 51% | Other 24%



Source: Geostat, Jan-May 2019; Note: Trade in goods

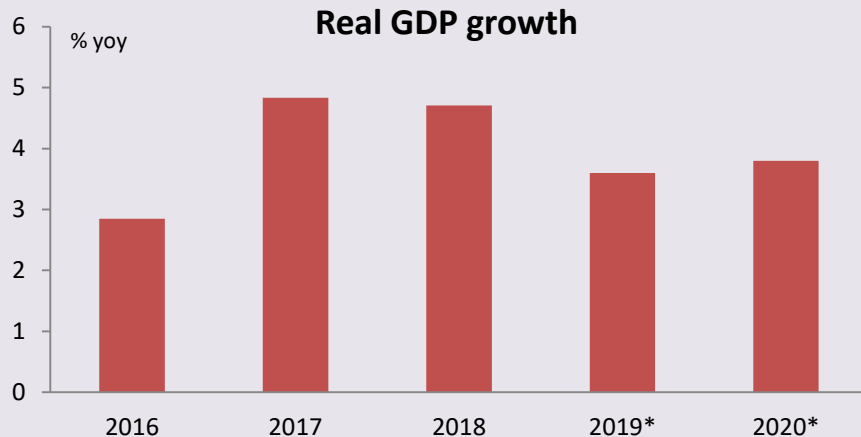
Imports

EU 25% | CIS 27% | Other 47%

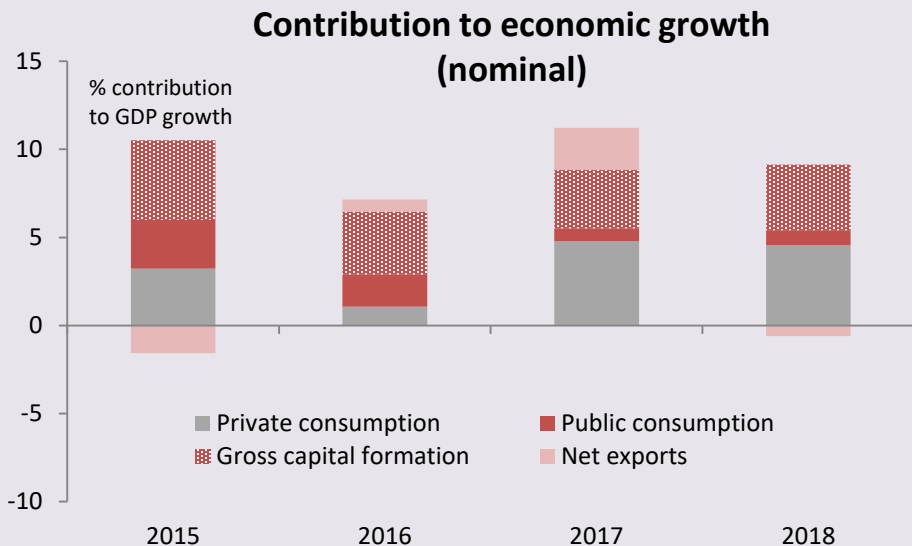


Source: Geostat, Jan-May 2019; Note: Trade in goods

Economic growth



Source: IMF June 2019; *Forecast, adjusted for preliminary estimates of effect of Russian sanctions on GDP



Source: Geostat

GDP 2018

- Economic growth: 4.7%
- Main drivers:
 - Private consumption
 - Investment

GDP 2019

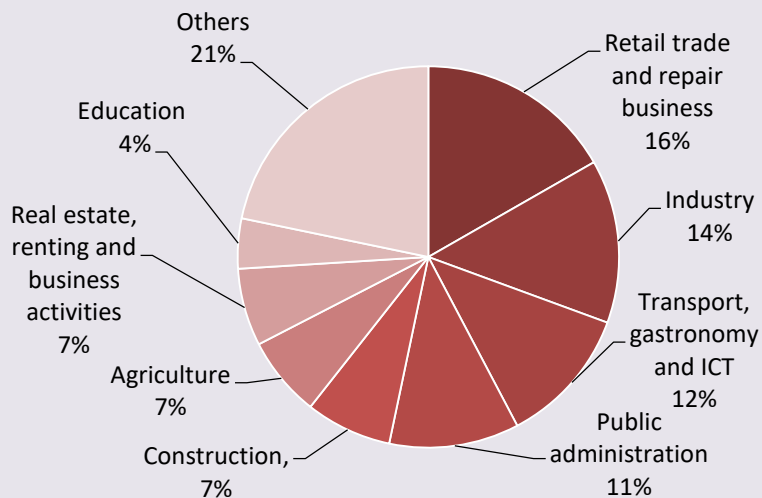
- 21 June: Russia announced a ban of direct flights to/from Georgia (starting 8 July), with major impact on tourism
- Preliminary estimates: negative effect on GDP of about 1 pp in 2019 and 2020
- Therefore: only 3.6% growth in 2019

Conclusions

- Significant macroeconomic effect of Russian sanctions on Georgian GDP
- Downside risks have increased

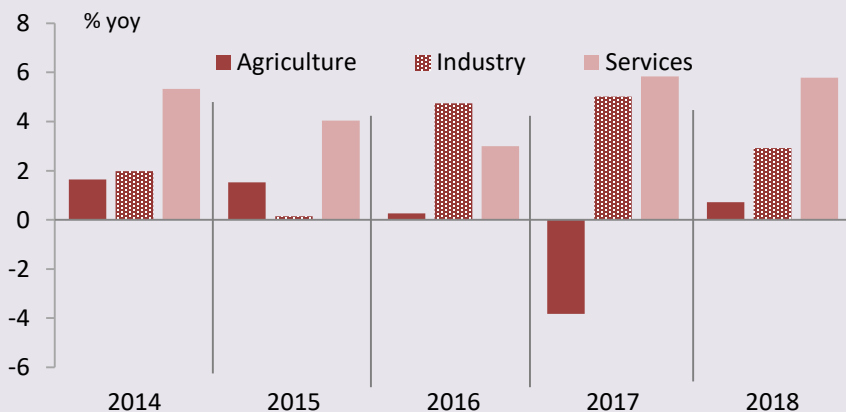
Sectoral perspective

Composition of GDP



Source: Geostat, 2018

Sectoral dynamics



Source: Geostat

Agriculture

- 2018: increase by 0.7%
- Though still weak, some improvement compared to 2017

Industry

- Lower growth than in previous years, but still positive development: 2.9% in 2018

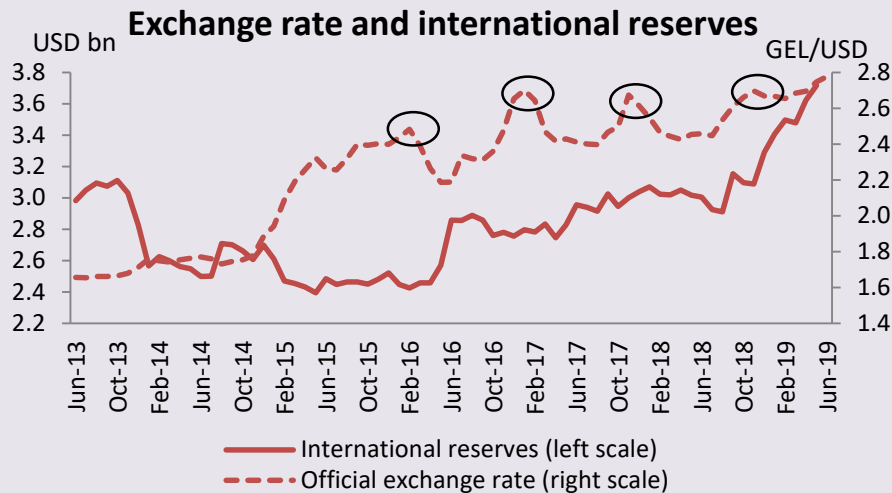
Services

- Strong expansion by 5.8% in 2018
- Continues to be main driver of growth
- Key contributor: tourism

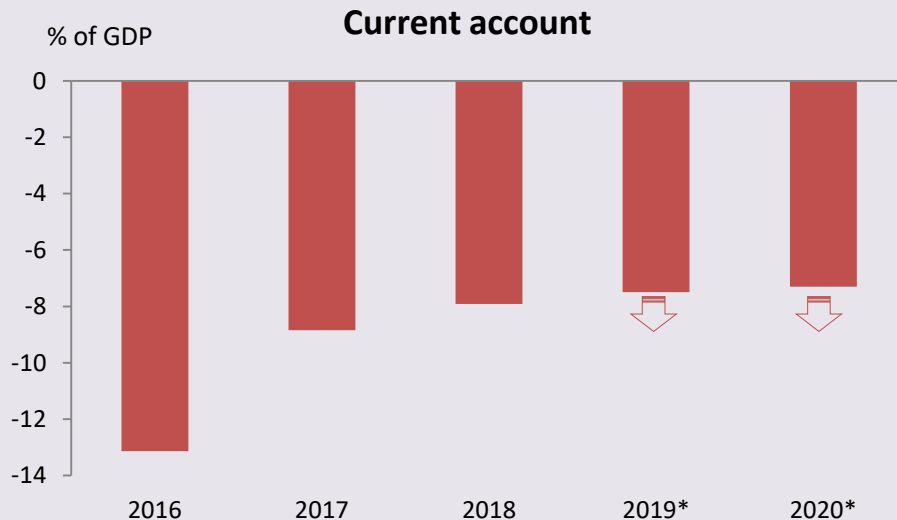
Conclusions

- Services lead sectoral growth
- Industry remains important
- Positive development of agriculture after strong contraction in 2017

Current account and exchange rate



Source: National Bank of Georgia



Source: IMF 2018; *Forecast; Forecast likely to underestimate current account deficit in light of Russian sanctions

Exchange rate

- Following the announcement of Russian sanctions, the Lari depreciated by 5.8% vs the US dollar from 21 June to end July

Current account deficit

- 2018: deficit has narrowed to 7.9% of GDP due to strong growth in exports of services and remittances
- 2019: likely larger deficit due to lower revenues from Russian tourists

International FX reserves

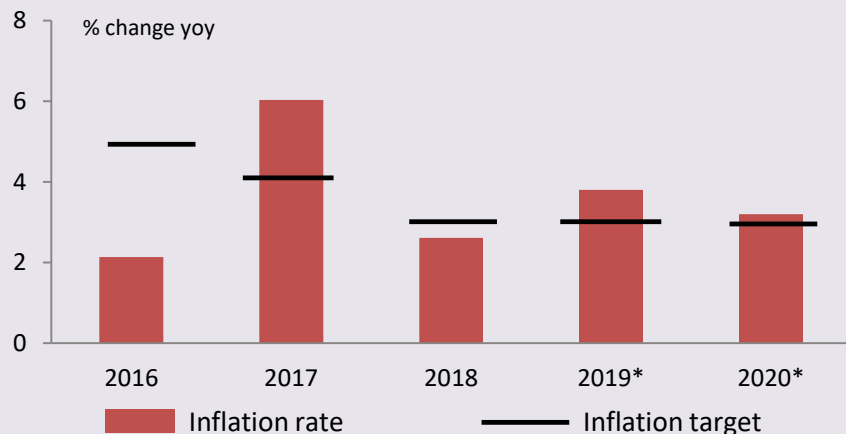
- May 2019: USD 3.7 bn or 4.7 months of imports

Conclusions

- Russian sanctions put pressure on the Lari and mitigate the previous improvements in the current account

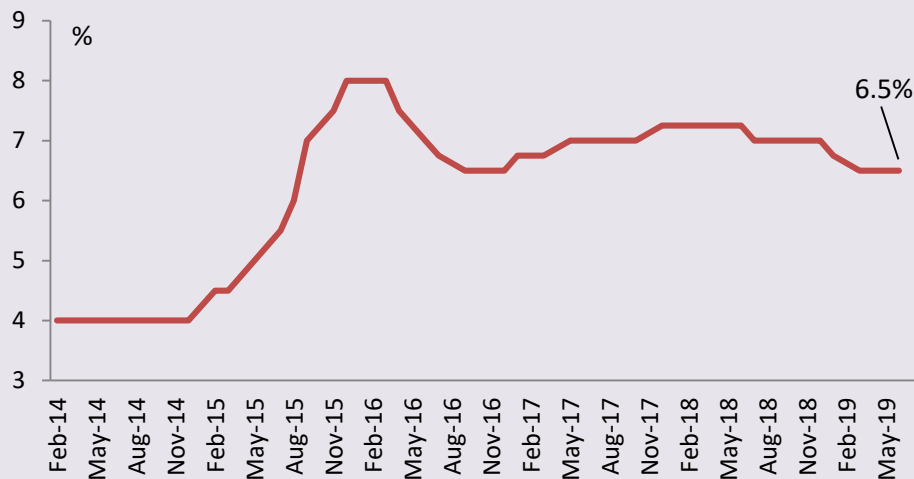
Inflation and monetary policy

Inflation rate and inflation target



Source: IMF 2019, *Forecast; Note: Annual average (consumer prices)

NBG policy rate



Source: National Bank of Georgia

2018

- Rate of inflation: 2.6% yoy
- NBG continues its prudent monetary policy and meets inflation target of 3%

2019

- Increase in inflation likely
- Reason: higher imported inflation due to Lari depreciation following Russian sanctions (“pass-through” effect)

Policy rate

- Due to stable inflation in 2018, NBG was able to continually decrease its policy rate to 6.5%

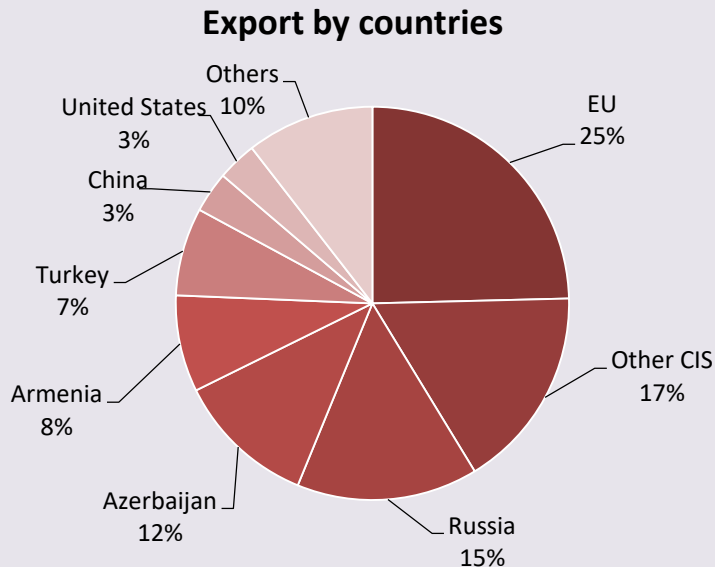
Conclusions

- Likely somewhat higher inflation in 2019 than previously expected

External trade in goods



Source: Geostat



Source: Geostat, Jan-May 2019; Note: trade in goods

Trade dynamics

- Jan-May 2019: increase in exports of goods by 14.2%; decrease in imports by 3.6%
- Very positive trend as trade deficit narrows

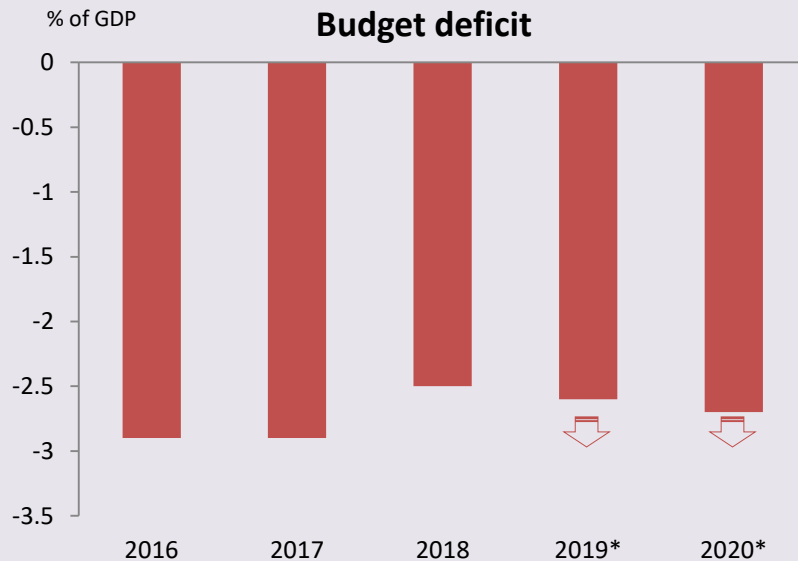
Regional structure of exports

- Diversified trade structure; EU largest market (25% Jan-May 2019)
- However: Regional focus prevails

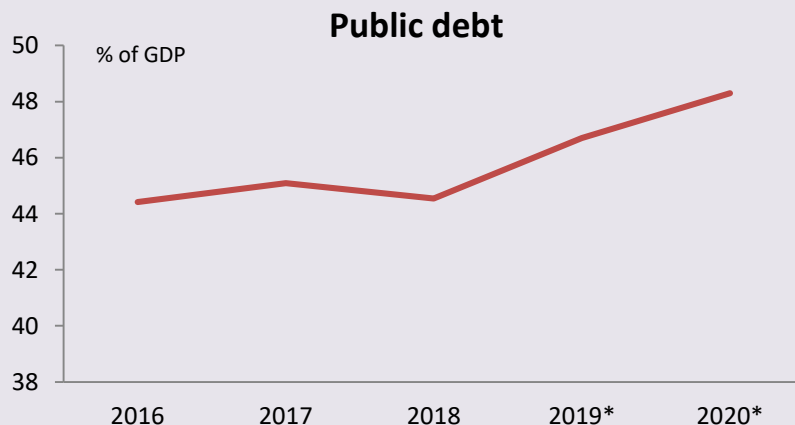
Conclusions

- Very positive development of foreign trade
- Decrease in imports combined with an increase in exports improves Georgia's trade balance

Public finances and government debt



Source: IMF, *Forecast; Note: programme definition; Forecast likely to underestimate budget deficit in light of Russian sanctions



Source: IMF, *Forecast

Budget deficit

- 2018: deficit as defined by IMF goes down to 2.5% of GDP due to higher-than-expected revenues, strong economic growth and delays in public investments
- 2019: higher budget deficit expected
- Reasons: surge in public investments, loss of tax revenues in the course of Russian sanctions

IMF programme

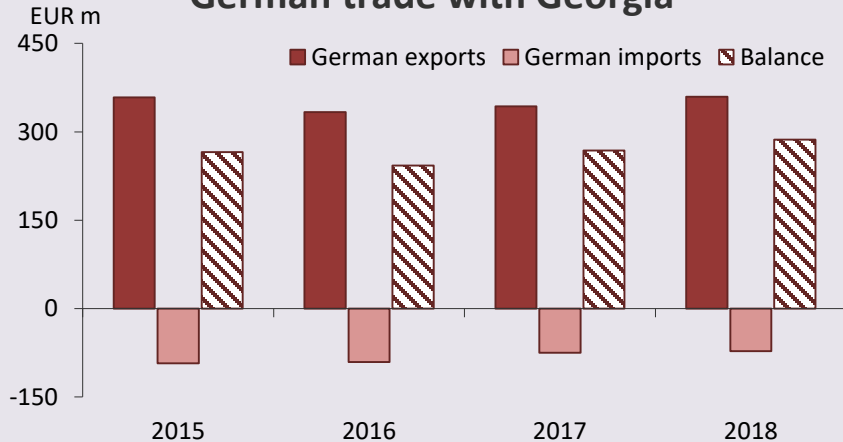
- June 2019: IMF Board approves fourth programme review
- Disbursement of ca USD 41.4 m

Conclusions

- Fiscal policy likely more expansionary in 2019
- IMF programme runs smoothly

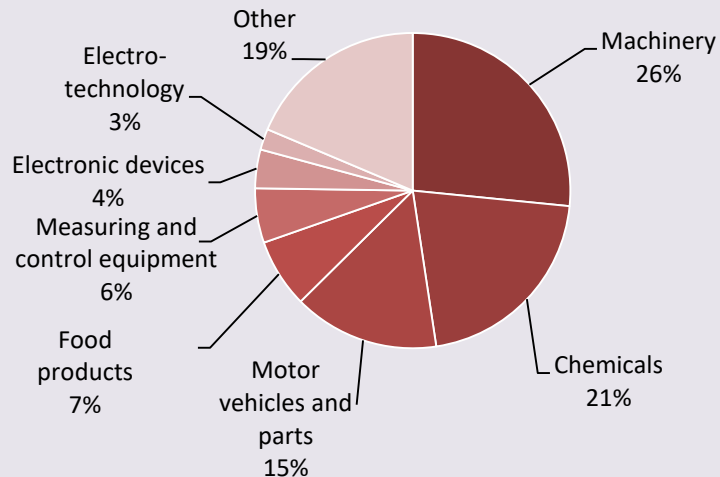
Bilateral trade between Germany and Georgia

German trade with Georgia



Source: German Federal Statistics Office, Note: trade in goods

German exports to Georgia



Source: German Federal Statistics Office, Jan-April 2019, Note: Trade in goods

Trade

- Trade between Georgia and Germany in Jan-April 2019 at EUR 153 m

Exports to Georgia

- Considerable growth in exports from Germany to Georgia by 13.2% in Jan-April 2019

Imports from Georgia

- In contrast, imports from Georgia decreased strongly by 34.0% in Jan-April 2019, caused by a sharp decline in imports of non-ferrous metals

Conclusions

- Unbalanced development of trade flows
- Germany's traditional high bilateral trade surplus widens even more

Russian sanctions: economic impact on Georgian economy

Impact of banning direct flights to/from Russia

| | |
|--|-----------------------|
| Flight passengers from RUS, p.a. | 350,000 |
| Avg. spending in USD | 1,000 |
| Total gross spending USD, p.a. | 350,000,000 |
| Export-related imports, % | 10% |
| Net gross spending, p.a. | 315,000,000 |
| Flight tourists before ban, % | 33% |
| Net gross spending, p.a. | 211,050,000 |
| Additional tourists from other countries, net spending | 50,000,000 |
| Net effect on GDP | 161,050,000 |
| GDP in 2018 | 16,210,000,000 |
| % of GDP | 1.0% |

Source: authors' estimates

What happened?

- 21 June: Russia announced to ban direct flights to and from Georgia from 8 July 2019
- Russian import restrictions for 8 Georgian wine producers; no general embargo on wine and mineral water

Macroeconomic impact

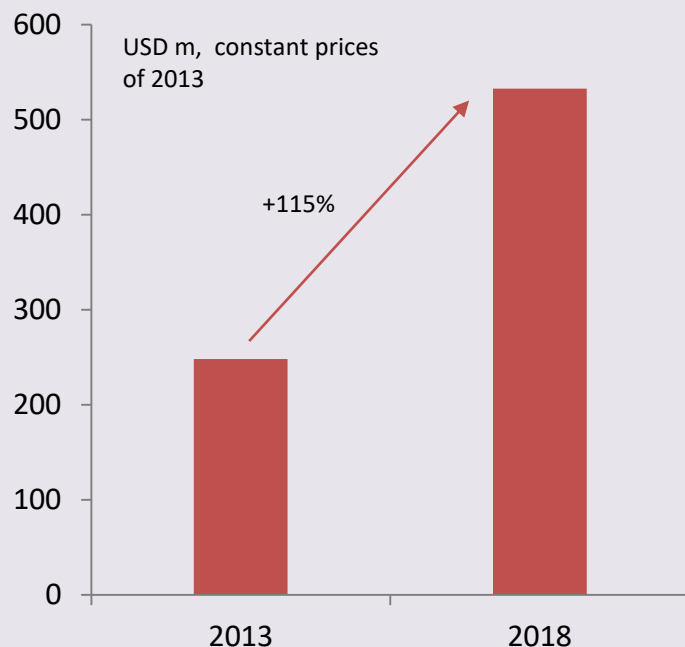
- Russian travel ban will have significant impact on all macroeconomic variables
- Estimated impact on GDP: ~1% in 2019, meaning that the economy will grow by “only” 3.6% in 2019
- Impact in 2020 most likely similar

Conclusion

- Strong, but manageable impact of Russian sanctions
- Georgia's built up of monetary and fiscal buffers pays off

DCFTA: effect on exports to the EU

Exports to the EU in constant prices, 2018 vs 2013



Source: WITS, authors' estimates; exports of domestically produced goods, excl. hazelnuts and copper ores

Background

- 2014: EU signed DCFTA with Georgia
- Almost 5 years later, we assess the effect of the DCFTA on Georgia
- Data set: removal of problematic goods such as re-exports, hazelnuts and copper ores

Effect on exports

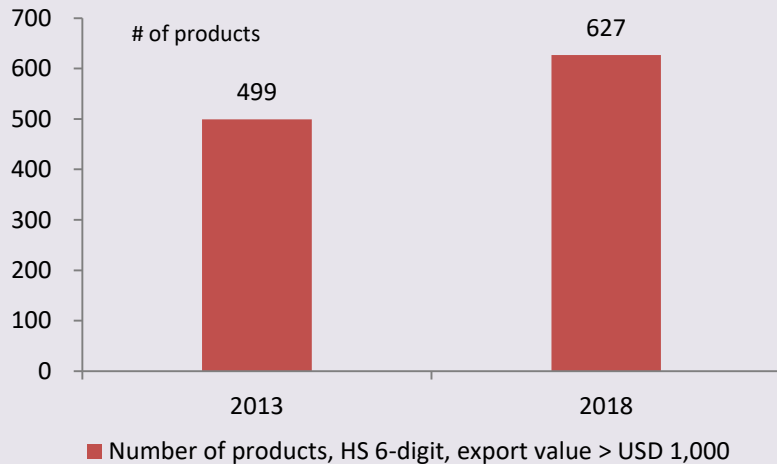
- Nominally exports grew only by low 9% from 2013 to 2018
- However, in constant prices exports grew strongly by 115%
- Reason: prices for key export products dropped

Conclusion

- Moderate, but positive effect of DCFTA on Georgian exports

DCFTA: effect on composition of exports to the EU

Number of GEO exports products to EU, 2018 vs 2013



Number of new products

- Net increase of 128 products exported to the EU from 2013 to 2018
- Gross increase even higher at 333 products
- Share of new products in exports to the EU very high: 12%

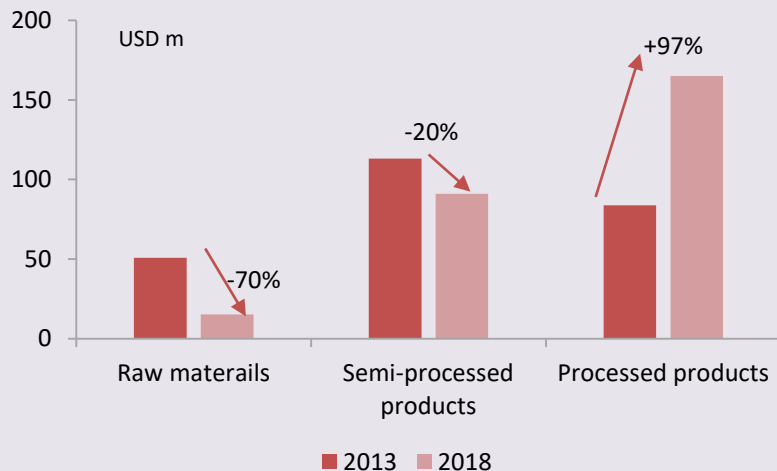
Exports by level of processing

- Shift of exports towards processed products
- Share of processed products in exports to the EU increased from 34% to 61% from 2013 to 2018

Conclusion

- Strong positive effect of DCFTA on composition of exports
- Stronger effect than in Ukraine and Moldova

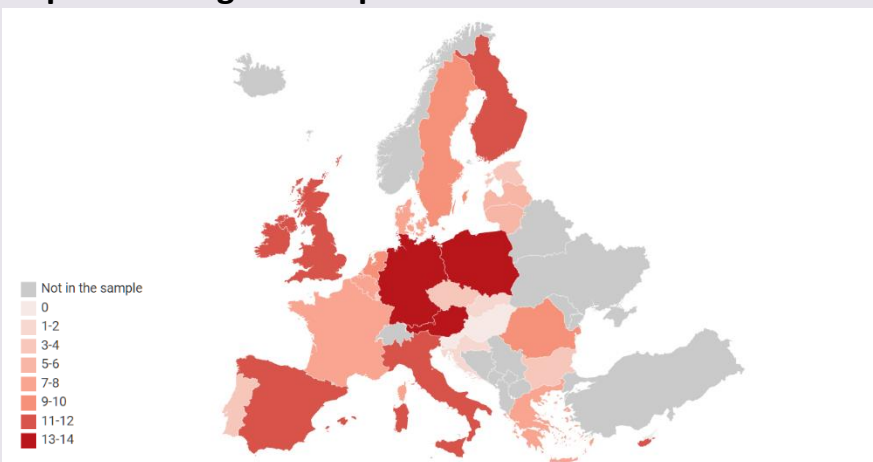
GEO exports to EU, 2018 vs 2013, level of processing



Export potential: agro-food products on EU market

| rank | Composite score (max=100) | HS 2012 Product Description | GEO total exports, 2017, USD thous |
|------|---------------------------|---|------------------------------------|
| 1 | 81 | Fresh cranberries, blueberries, etc. | 468 |
| 2 | 76 | Fixed vegetable fats and oils and their fraction | 3,275 |
| 3 | 74 | Fresh peaches, incl. nectarines | 4,219 |
| 4 | 70 | Fresh or chilled potatoes | 4,731 |
| 5 | 69 | Solid residues resulting from extraction of soya-bean oil | 3,513 |

EU member states ranked by export potential for top-20 GEO agro-food products



Situation of agro-food exports

- Agro-food exports account for 29% of total exports of goods in Georgia, however, ca 2/3 of exports are destined to traditional CIS markets

Research approach

- Identify most promising agro-food export products as well as export destinations for non-CIS countries
- Assessment based on multiple indicators covering demand, supply and trade costs

Results

- Fresh berries, juices, jams and nuts are high potential products
- Among most promising export destinations Austria, Poland and Germany stick out

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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