



Georgian Economic Outlook 2014

First Quarter



May 2014, Tbilisi



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Key Findings

- In April of 2014, the economic growth significantly declined, for instance even though the first quarter of 2014 had a growth of 7.4 percent, the growth in April was only 2.7 percent.
- EBRD predicts 4 percent GDP growth this year, if the crisis in Ukraine does not become more volatile. The IMF and the Georgian government predicted a 5 percent growth for the country and the World Bank had even more optimistic prediction with an expected 6.3 percent growth in 2014.
- The country managed to get out of deflation and is slowly reaching its target inflation for the year. Given the increased demand and currency depreciation according to the IMF, the inflation in the country is to reach 5 percent in 2015. The inflation remains stable in the CIS region on average; however some countries are still struggling with a high inflation rate. In the EU the inflation has been very low at around 1 percent and is expected to remain that way and Japan is only now slowly exiting the deflation this year.
- Georgia had a slight increase by approximately \$3 million in FDI flow in 2013, what was after a major decrease which happened in 2012 when the FDI decreased by 22 percent compared to the previous year. According to the World Investment Prospectus survey in 2014, the world FDI is expected to increase to 1.6 trillion in 2014 what is an approximate 150 billion increase from the previous year. Developing world attracted \$142 billion more FDI at \$703 billion than the developed one, even though it was a 4 percent decline compared to the previous year. In April of 2014, remittances flow in the country was \$120.5 million, what is a 1.5 percent decrease compared to the same month of the previous year. Remittances from Ukraine decreased by 18 percent and there is a 3 percent decrease in remittances from Greece, Turkey, Germany and the United Kingdom.
- Remittance flow remains significantly larger than the FDI flow in Georgia, in 2013 remittances exceeded FDI by over 50%. Russia remains the largest remittance source for the country. As of now regardless of the crisis between Ukraine and Russia, the first quarter of 2014 is also displaying growth compared to the first quarter of 2013, having increased to \$323.5 million from \$311 million during the first quarter of the previous year.
- The even though the export has been growing consistently over the past several years, the export import imbalance remains high in the country. Even though the imbalance decreased from the previous year, in 2013 the import exceeded export by \$4.9 billion. During the last year the export of mineral waters and wine was at an all-time high.
- Unemployment is still a lingering issue for the Georgian economy and a major challenge for the Georgian government. Since 2010 unemployment has been falling from the 16.5 percent mark, and in 2013 unemployment was at 14.6 percent, which is 0.4 percent less than unemployment rate in 2012. In 2013 the number of employed in the business sector fell by 15 362 (2.8 percent), making the total workforce employed in the business sector 519 035 people.



Economic growth in the country

Last few years Georgian economy saw a declining trend in growth, the real GDP growth has been declining since 2011 when it reached the highest growth rate in years at 7.2 percent. In 2012 the growth declined to 6.2 percent, where the country experienced even smaller economic growth in 2013 at 3.2 percent. The displayed economic growth slowdown can be attributed to different things. Decreasing trend of GDP growth started, in 2012, the year of the parliament elections in the country which led to the democratic change in power for the first time in 8 years. This might have been the cause for decreased FDI given the uncertainty for investors associated with elections - especially a regime changing elections. The similar scenario when the growth diminished happened after 2007 when the year saw the largest GDP growth since the country's independence, after that due to the Russian trade embargo in 2007 and the war in 2008 growth started to slow down and in 2009 the economy even saw a negative growth at -3.8 percent.

According to IMF increased growth is expected in years 2014 and 2015, with predicted 5 percent for both years¹. The World Bank has a more optimistic prediction for Georgia with expected 6.3 percent economic growth in 2014, 2015 is predicted to have the same real GDP growth rate as in 2014, whereas 2016 is even expected to be better for the Georgian economy with 6.5 percent growth². The optimistic prediction, can also be associated with some of the actions planned by the country to boost its economy and stimulate growth. IMF discussed this issue in its latest World Economic Outlook, stating that Georgia, as well as Armenia are planning a fiscal stimulus in 2014 along with various structural reforms directed at improving the business environment, diversifying the economy and increasing the external competitiveness³. The changes seem appropriate and make sense given the high expectation people had of this government when they came to power and also because they have been under scrutiny especially about the areas such as economy and business environment. Their performance, however, has not caught up with the expectations in the economic development, therefore the correct actions are of essence to display the stability in the country and that the country is developing at least at the same pace if not faster as it had been developing under the previous administration. According to the study conducted by NDI, only 6 percent agreed with the statement that the current government is implementing important reforms for them, whereas 49 percent agreed partially and the rest either disagreed or did not have an opinion on the matter. The same study also revealed that in most regions over 60 percent and in some regions over 70 percent of the respondents considered themselves unemployed⁴. According to Deutsche Bank Georgia is still in a very good place in the sense of business environment especially in some of the indicators such as "Doing Business index" and it is massively out performing all the other CIS countries with a top 10 spot on the list⁵.

1 <http://www.worldbank.org/en/country/georgia/overview>

2 Ibid

3 IMF world economic outlook, April 2014 please insert the link

4 National Democratic Institute, <http://www.civil.ge/files/files/2014/NDI-Poll-April2014-geo.pdf>

5 Deutsche Bank Research, "CIS frontier countries Economic and political prospects"

“Doing Business Ranking vs real GDP growth

X axis: Real GDP growth, % yoy, 2012
Y axis: DB 2012 ranking



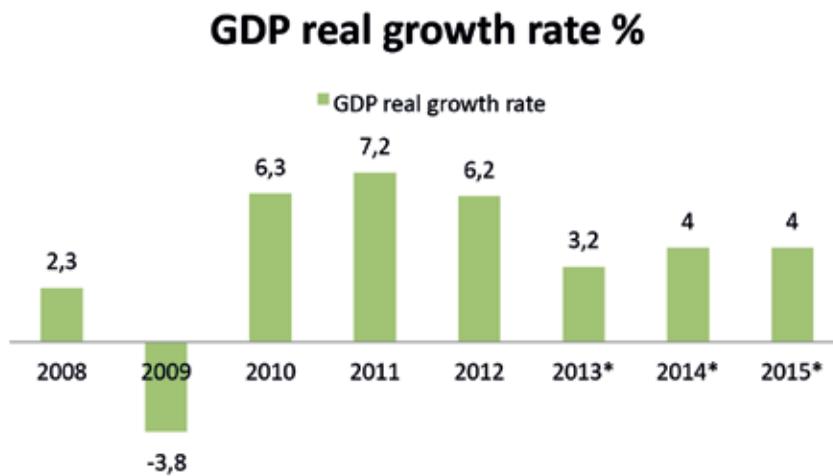
Figure 1: Doing Business Ranking vs real GDP growth. Source: Deutsche Bank Research

A lot of the above mentioned is the leftover of the previous administration therefore it is crucial for the new government to keep the policies clear and offer the initiative to keep the business environment in the favorable ranks.

Deutsche Bank expects GDP growth in CIS economies, even though similarly to other regions of the world it is expected to remain lower as compared to the pre-crisis period. They, however, have predicted 4.5 percent growth for Georgian economy in 2013, but the scenario did not develop as optimistically as predicted.

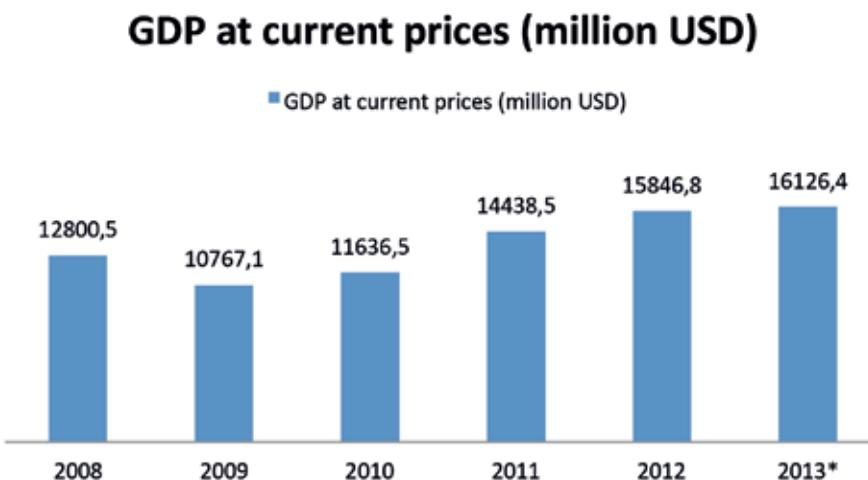
Overall, the country is doing much better compared to the CIS region, to which it is often associated and compared to, even though Georgia left the association in 2008. The overall average growth of CIS countries was only 2.1 in 2013 and their GDP is expected to grow by 2.3 in 2014 and 3.1 in 2015. According to EBRD projections, in 2014 and 2015 Georgia is expected have a decent 4 percent GDP growth, which was downsized by 0.5 percent from the earlier prediction due to the crisis in Ukraine.

Figure 2: GDP real growth (%) Source: www.geostat.ge, www.EBRD.com



The growth has been slowing down, however the growth is still well above zero, displaying the highest nominal GDP in the country's history at \$16.126 billion and GDP per capita increasing to \$3,507 from \$3,220⁶. The estimated real GDP average growth was 7.4 percent for the first quarter of 2014, what is a promising sign for the country as well as for those who predicted an increased GDP growth in the coming two years⁷. In the month of April however, 2.7 percent growth makes us consider the fact that the growth in the first quarter was due to the market effect, in particular because of the high budget spending in the fourth quarter of 2013. The work done in the end of 2013 was declared in the first quarter of 2014, what caused increased VAT flow and therefore growth of the economy.

Figure 3: GDP at current prices (million USD). Source: www.geostat.ge



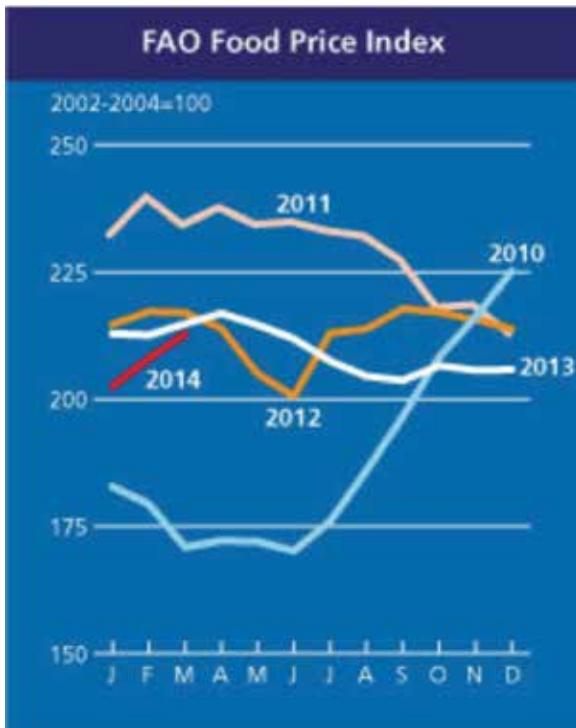
6 <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>

7 http://geostat.ge/cms/site_images/_files/english/economic/monthly%20economic%20statistics_March_2014.pdf

Consumer Price Index

Inflation has been falling considerably since 2012 after it reached very high points, with a peak in the summer of 2011 going as high as 11.4 percent. Since inflation reached its peak it has only been declining. It declined to the point of deflation and remained so until the end of 2013. The mentioned, decrease in the inflation can be attributed to the decreased global food prices at the time in 2012 and 2013 (see figure 4), as food constitutes 31% of the consumer basket in Georgia⁸. The National Bank of Georgia tried pursuing accommodative monetary policy by cutting the refinancing rates to bring the inflation to its target 6 percent in years 2012 -2014, however due to low financial intermediation, declining demand and high dollarization of loans and deposits, the effectiveness of the monetary policy of the National Bank has been constrained⁹.

Figure 4: FAO Food Prices Index. Source: www.fao.org



Only recently in 2014, the consumer price index started to rise and inflation was reached and so far it has been consistently increasing in the first quarter of 2014. First few months into this year the inflation has been around 1 percent, however it is expected to rise in 2014 to 4.6 percent, according to IMF, and rise little bit higher in 2015 reaching 5 percent, given the increase in demand and because of the currency depreciation¹⁰.

⁸ Deutsche Bank Research, "CIS frontier countries Economic and political prospects"

⁹ IBID

¹⁰ IMF world economic outlook, April 2014

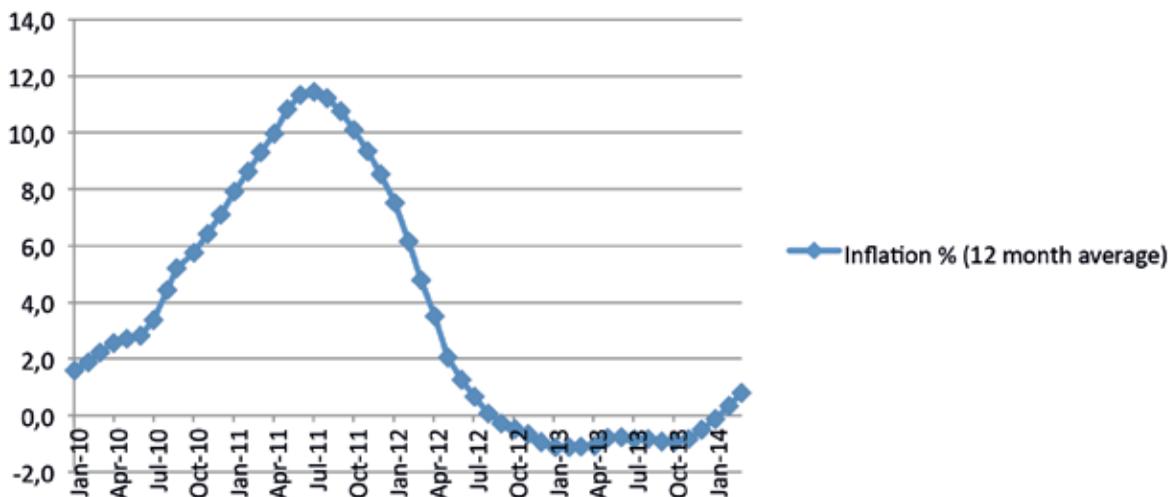
The inflation dynamics have been volatile in many parts of the world including the EU, the US and Japan, and is expected to be worse than in case of Georgia for many countries of the world for the coming month and possibly years. Japan has been in deflation even though currently the country appears to be exiting it; inflation has also been very low in both European Union and the US. In the EU the inflation is expected to be around the 1 percent mark and is expected to stay around that area through 2015, which can be attributed to the weak demand within the union, given the fact that the economic recovery has only begun¹¹. In some of the EU member countries there is a deflation and there is a treat of the negative inflation in the peripheries of some of the other countries as well.

In the CIS frontier, even though the average inflation remains stable in the association the some of the countries are struggling with high inflation, in Uzbekistan and Belarus both have inflation in double digits, while Uzbekistan is struggling with inflation at 11 percent, Belarus is in far worse state with lingering 16.8 inflation, and the expectations are not very optimistic in the area as well¹².

In Georgia, inflation is expected to come close to the 5 percent target in 2015, on a pickup in domestic demand and some recent currency depreciation. In Uzbekistan, inflation will continue to linger in the double digits because of increases in administered prices, currency depreciation, and strong credit growth. The balance of risks remains to the downside, considering rising geopolitical uncertainties following the takeover of the Crimea by Russia, tightening financial conditions, and volatile capital flows¹³.

Figure 5: Inflation (%). Source: www.geostat.ge

Inflation (%) (12 month average)



11 OECD, "Ongoing recovery for advanced economies, variation among emerging economies", March 2014

12 IMF world economic outlook, April 2014

13 IBID

External Sector

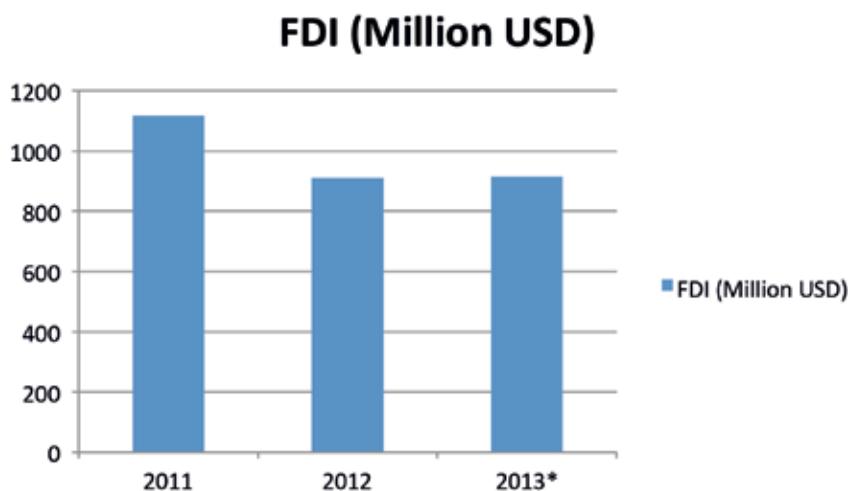
FOREIGN DIRECT INVESTMENTS

2011 attracted the most foreign direct investment during the last three years with \$1.117 billion; where 2012 saw a considerable decrease by 22 percent compared to the previous year, with the investments being worth \$911 million. In 2013 the FDI increased slightly by only \$3 million compared to 2012.

The world FDI is expected to reach \$1.6 trillion in 2014 and \$1.8 trillion in 2015, which is an increase from \$1.45 trillion in year 2013¹⁴. On the other hand this type of growth is an estimate and risks to this scenario remain, risks such as weaknesses in structure of the major developed economies, weaknesses in the global financial system, and uncertainties in the policy in different areas such as fiscal policy and investment regulations and restrictions, all very important for investor confidence¹⁵. Based on the mentioned risks the predicted scenario might take a wrong turn and recovery could be delayed further.

The FDI in the developed countries was \$561 billion, whereas in developing regions it was \$703 billion in 2012¹⁶. The FDI flow are not a huge part of development for the developed economies they are more crucial to the developing ones. For instance in Georgia there are not many large local corporations or the companies who are considered multinational and they do not generate large enough revenues and cannot reinvest into the economy enough money for it to be helping the country develop without the FDI or remittances for that matter. FDI might also be the key for at least partially solving the unemployment problem where foreign investments can start new businesses or develop existing ones what will lead to creation of more jobs.

Figure 6: FDI (million USD). Source: www.geostat.ge



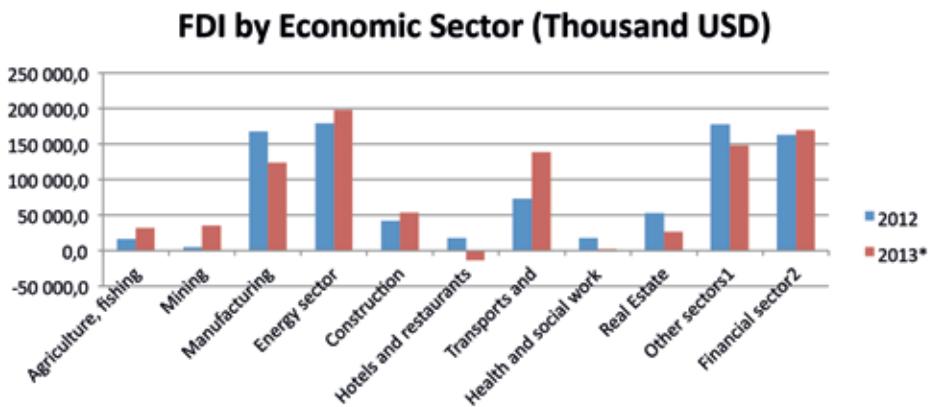
14 World Investment prospects Survey 2014-2015 http://unctad.org/en/PublicationsLibrary/webdiaeia2013d9_en.pdf

15 IBID

16 IFLR, Foreign Direct Investment Report, http://www.iflr.com/pdfs/IFLR-Foreign-Direct-Investment-Report-2014_Media-Pack.pdf

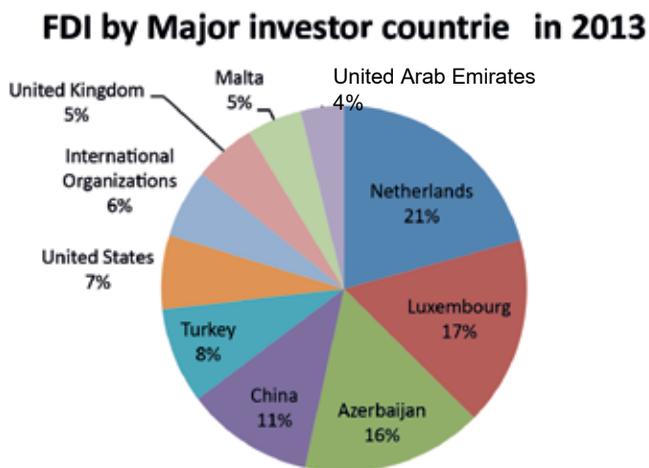
Currently during the past two years the energy sector received the largest amount of the total FDI with 197 million invested in 2013 which is 21 percent of the total FDI and 179 million invested in 2012, which was 19 percent of the total. Other large sectors in terms of the FDI inflows were, manufacturing, Transport and communication and financial sector.

Figure 7: FDI by Economic Sector (Thousand FDI). Source: www.geostat.ge



The major investment flows have been from the Netherlands with 21 percent of the total FDI, Luxemburg with 17 percent, Azerbaijan with 16 percent, China 11 percent and Turkey with 8 percent of FDI, along with others.

Figure 8: FDI by major investor countries in 2013. Source: www.geostat.ge



REMITTANCES

Remittances are strong and reliable source of monetary inflows, as it can be seen it far exceeds the amount of the FDI in Georgia, where the FDI was \$914 million in 2013 the remittances were over 50% more at \$1.476 billion. Throughout the years remittances have been a big part of the Georgian economy and have only been increasing for the past several years, 2014 is also promising to be a strong year for the remittance flow in Geor-



gia, with first three month delivering roughly 323 million to the Georgian economy. For the first three month of the year remittance flow has been stable from all countries comparing to the first three month of the 2012 and 2013, in some countries there is a slight decrease and in case of some countries a slight increase comparing to the previous two years. In total, however there has been a roughly \$12.5 million increase in the first three months of 2014 compared to the first three months of 2013. In April of 2014, remittances flow in the country was \$120.5 million, which presents a 1.5 percent decrease compared to the same month of the previous year. Remittances from Ukraine decreased by 18 percent and there is a 3 percent decrease in remittances from Greece, Turkey, Germany and the United Kingdom.

Current crisis in Ukraine and western sanctions on Russia and the countersanctions from Russia, could potentially negatively affect remittance flow in Georgia in the medium term. For the last few years there has not been a change in top remittance sender countries. Largest remittance flow by far is from Russia, three times the amount of remittances entered from the country second on the list which is Greece, therefore currently deteriorating Russian economy and even more as a result of the sanctions could translate into decrease remittance flow in Georgia over time.

Figure 9: Remittance inflow (million USD). Source: www.geostat.ge

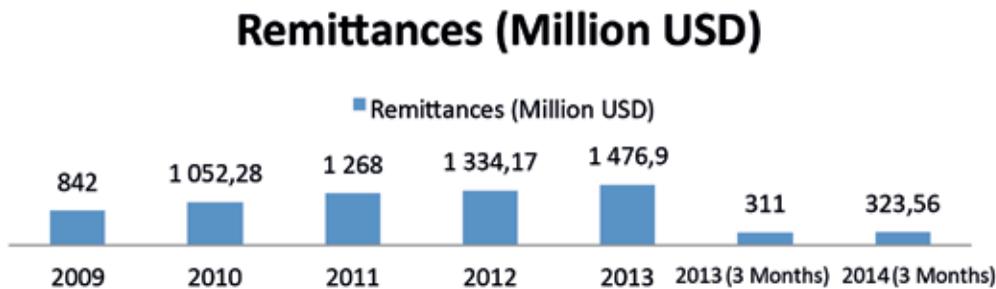
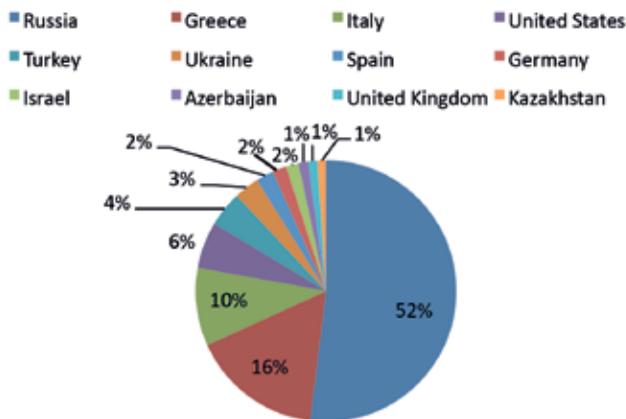


Figure 10: Remittances by country. Source: www.nbg.ge

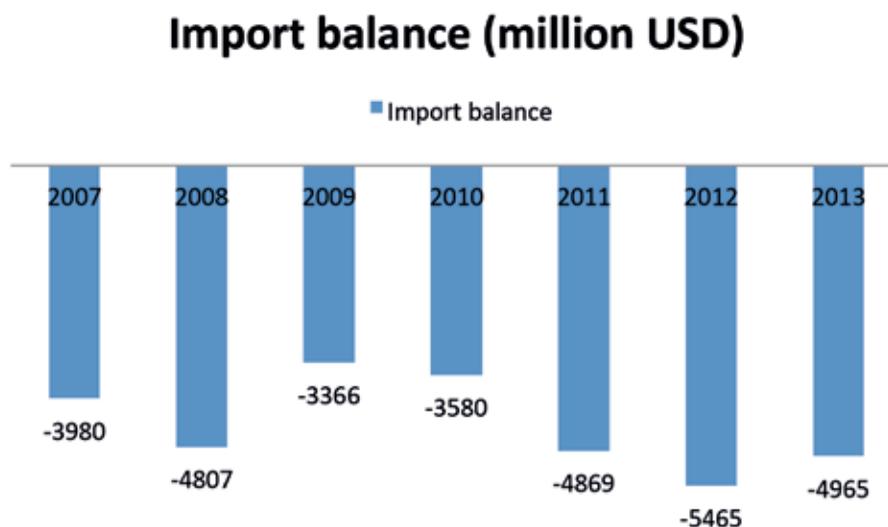
Remittances by country in 2014 (three months)



TRADE

At the moment the country has a large trade imbalance where amount of imports far outweighs the export. The imbalance has grown during the last three years, even though in 2013 the imbalance decreased it has experienced a significant increase since 2010. In 2011 the import balance was -\$4869 million in 2012 it decreased even further to -\$5465 million, whereas in 2013 it decreased to -\$4965 million, even though the imbalance was less than in 2012 it was still more than the several previous years before 2012. It is obvious that the country is heavily dependent on import and does not get to export a lot of its products abroad.

Figure 11: Import balance (million USD). Source: www.geostat.ge



Georgia had \$7874 million worth of imports which was a slight increase from previous \$7842 million, export on its own, even though far outweighed by imports has only been increasing since 2010. Regardless of the Russian embargo in 2007 the exports have maintained stability with displayed growth in 2008. Regardless of the fact that Georgia has shown ability to replace the Russian market, historically it has always been one of the major export countries for Georgia, since the embargo, 2013 is showing a clear trend of improved trade relations with Russia and the export has significantly increased as compared to the previous several years, therefore overall increase of the export amount should be further expected. In 2014 so far decent export trend has been displayed based on the first three month data, where \$696 million worth of exports have been made.

On the other hand, however the country should not heavily depend on the Russian market, given the historic reasons and the current diplomatic relations, which could take a wrong turn at any moment given the fact that there is a heavy occupational presence in two regions of the country. Furthermore given the situation in eastern Ukraine between Ukraine and Russia, the Russian market might become more unstable and unpredictable. Sanctions to Russia and countersanctions from Russia could negatively affect trade and financial assets, which will also have an impact on different countries in the region of the involved countries in these sanctions¹⁷. Furthermore lowered growth in

17 IMF world economic outlook, April 2014



Russia and Ukraine could have an impact on neighboring countries, even without the sanctions.¹⁸ The mentioned crisis and the deteriorating economy of Russia can certainly have a negative impact on rest of the CIS as it remains the major export market for the CIS countries, what could potentially be even more damaging for the Georgian market than the absence of Russian market, as most of the exports from Georgia go to the CIS.

The EU is the next biggest export market for Georgia, and Georgia's increasing trade relations with the European Union is outlining the fact that the country is trying to establish a strong presence in Europe and not only be dependent on the eastern markets and markets in the region where the country is located. The additional fact that the United States has been a bigger market for Georgia than Russia, during the last several years, is a further indication of that fact.

Figure 12: Export vs Import (million USD). Source: www.geostat.ge

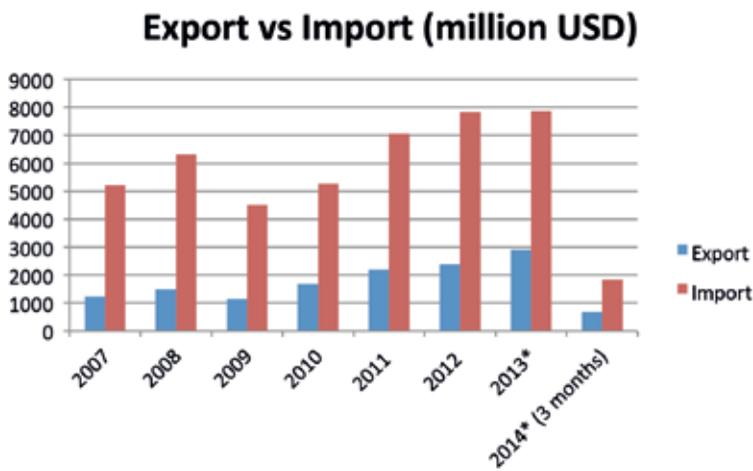
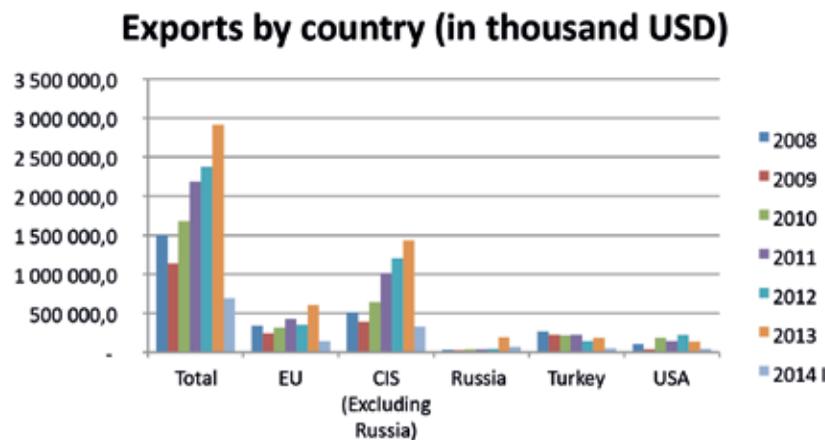


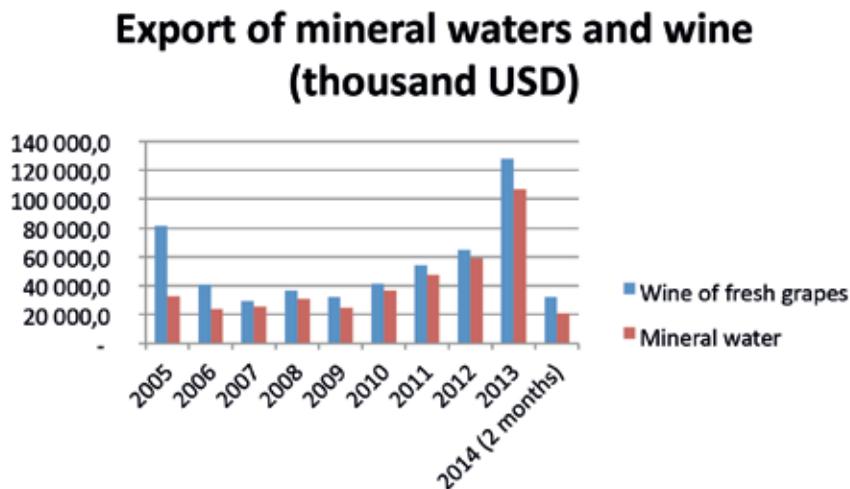
Figure 13: Export by country (thousand USD). Source: www.geostat.ge



18 IBID

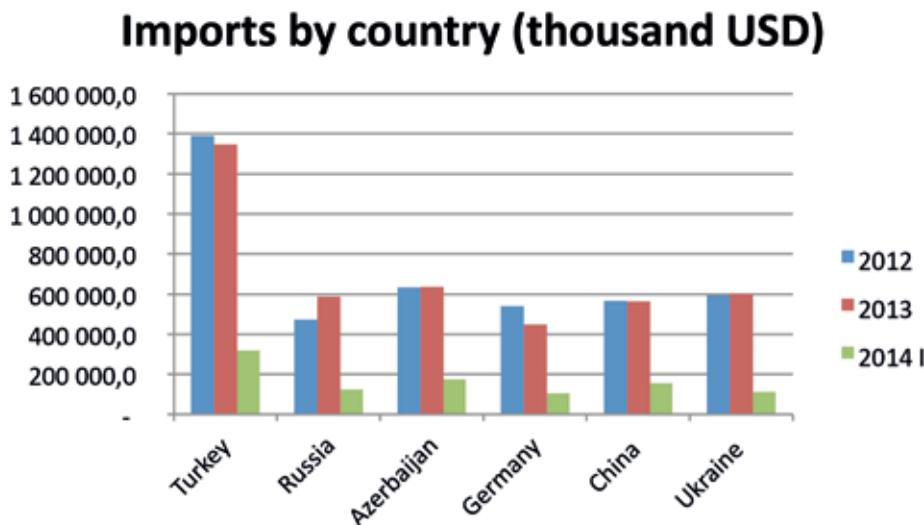
Mineral waters and wine remain as the main agricultural export products in the country. Even since the Russian embargo the export of these products has been increasing, except in 2009 which was the year after a brief war with Russia. In 2013 export of wine reached more than \$127 million, whereas mineral water exports were worth more than \$106 million, combined together it was roughly 8 percent of the total exports in 2013.

Figure 14: Export of mineral waters and wine (thousand USD). Source: www.geostat.ge



The largest import partner in Georgia remains to be Turkey, the amount of imports from Turkey far exceeds the imports from any other country in Georgia. For instance Azerbaijan has the second place as a supplier on the Georgian market for the last few years, however their imports in Georgia are exceeded by the Turkish import by more than twice.

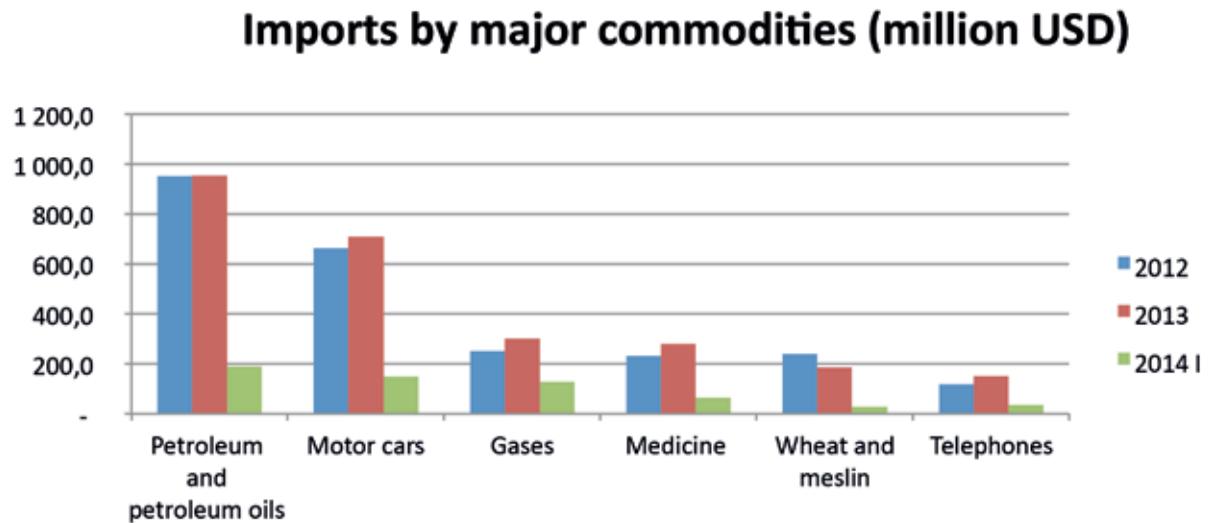
Figure 15: Imports by country (thousand USD). Source: www.geostat.ge





Major commodities imported were petroleum products, motor cars, gases, medicine, wheat and meslin, and telephones (see figure 20).

Figure 16: Imports by major commodities (million USD). Source: www.geostat.ge





Employment

Georgia has been struggling with unemployment for many years now, there are years when it decreases and years when it increases, however through all those times the unemployment remains to be very high. Since 2010, the lowest unemployment rate has been in 2012 at 15 percent which was quite an improvement for the country's economy since 2010 when the unemployment rate was as high as 16.3 percent. Unemployment rate was 15 percent in 2013 and was expected to go as high as 17.3 percent in 2014 by IMF, however that projection has been withdrawn since then and new number was not provided as of now. This issue is the largest public policy issue in Georgia. The economic transformation has led to the demise of many industries leaving many people out of jobs, where the newly emerged industries did not display large enough growth to accommodate and replace all the lost jobs through the transformation¹⁹. Most of the people are employed in agriculture and most of those are self-employed in subsistence agriculture rather than hired in the sector²⁰. The employment through agriculture is a very vague term and could potentially mean that Georgia's already officially high unemployment might be even higher, especially given the fact that the approximate 55% percent of the whole workforce which is employed in agriculture only constitute to 8.2 percent of the national GDP²¹. During the last several years over 60 percent of people were self-employed and only 38 percent of people had employment by being hired. In 2013 61.3 percent of the workforce was self-employed and only 38.7 percent were hired (see graph 18).

In 2013 the number of people employed in the business sector was under 520 000 only, which decreased from previous years approximate labor force of 530 000 people. The majority were employed in the Wholesale and Retail trade sector and in the industry sector with over 100 000 people in each of the two sectors and the least amount of people from the business sector were in Fishing sector and ironically in the Agriculture, Hunting and Forestry sector, where as mentioned, in total the most of the Georgian workforce is employed.

Unemployment has remained constant in the EU and the Euro zone, in the EU the rate has been a little bit less than 11 percent, while the Euro zone had a little higher rate at around 12 percent²². The situation in other parts of the developed world has been much better, in Japan the unemployment has been under 5 percent for the last years since 2012 and has even been under 4 percent in some month of the 2013²³. In the UK and the US the unemployment rate has been kept at around 8 percent and for the past two years with the rate dropping even more at the end of 2013 and in the UK below 7 percent unemployment has been displayed in the beginning of 2014.

As the European Union is also struggling with the unemployment and the rest of the world has employment of their citizens as the major priority, the unemployment remains to be a major setback in the development

19 World Bank, country review, <http://www.worldbank.org/en/country/georgia/overview>

20 IBID

21 IBID

22 European Commission - European Economic Forecast, Winter 2014.

23 OECD, "Ongoing recovery for advanced economies, variation among emerging economies", March 2014



of Georgia and it remains as the major issue for the economy of the country in the present day. Even the unemployment rate displayed in the official statistics is a high rate of unemployment, however the problem of employment is looking to have much deeper roots than it appears on the surface. All of the additional employment statistics discussed above and the some of the conducted statistics are indication of that. Any level of unemployment is negative for economies, as they are negative to the single individuals and their quality of life, therefore they have a negative effect on the quality of the country as a whole.

In order for Georgia to keep progressing it is of crucial importance to solve the employment problem, which will deal with official unemployment number as well as the unofficial cases which cannot be ignored. To do that the jobs must be created and that can be effectively achieved by promoting development and letting the business sector develop.

Figure 17: Unemployment Rate. Source: www.geostat.ge and www.CIA.com

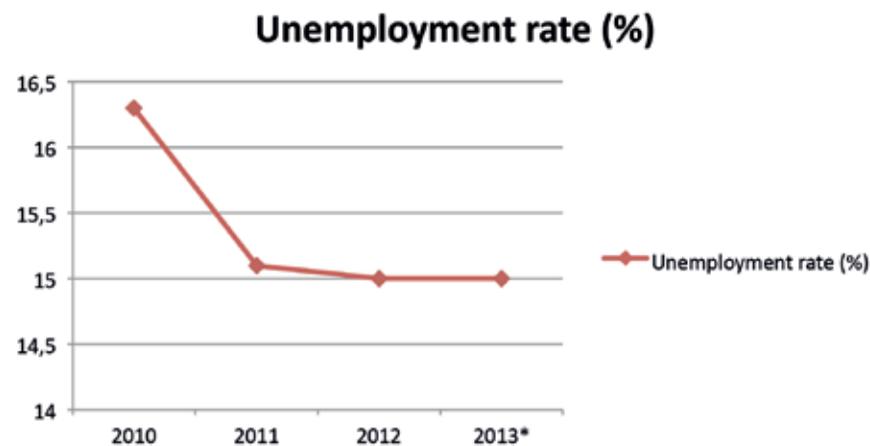


Figure 18: Distribution of employed (%). Source: www.geostat.ge

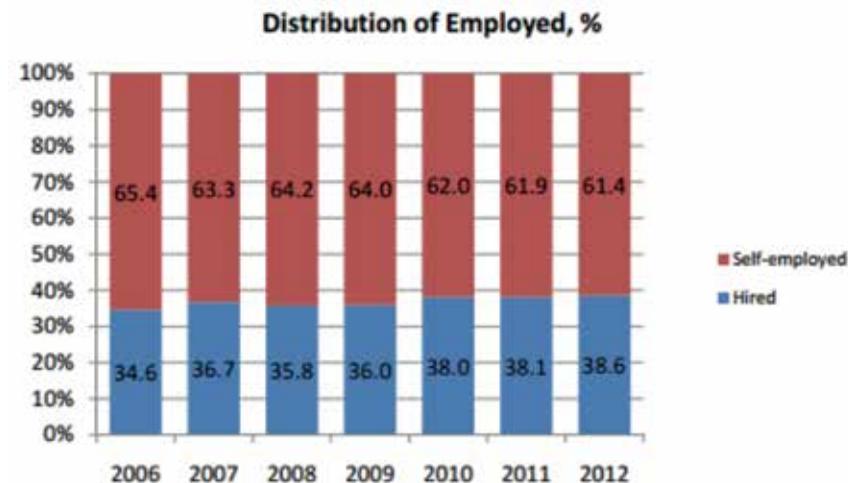


Figure 19: Number of employed in the business sector. Source: www.geostat.ge

Number of employed in the business sector

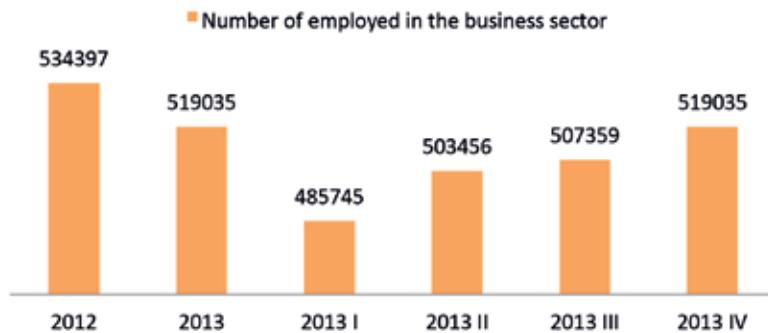
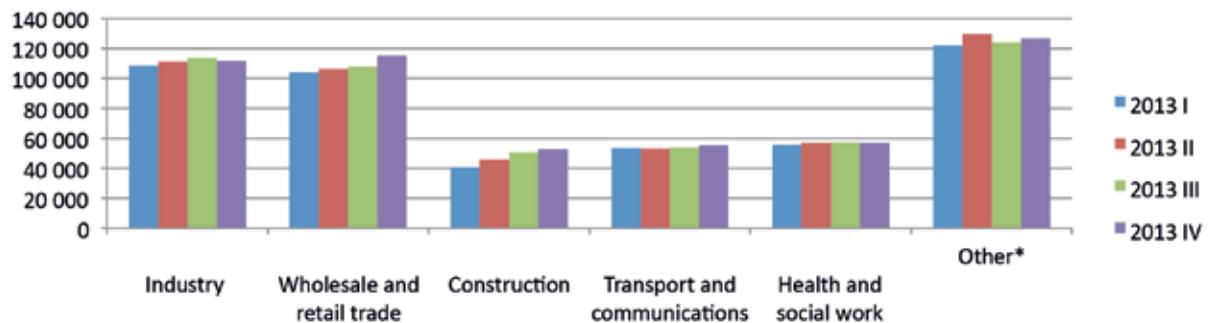


Figure 20: Employed in the business sector by economic activity. Source: www.geostat.ge

Employed in the business sector by economic activity



* community, social and personal service activities, Fishing, Education Agriculture, hunting and forestry, Hotels and restaurants, Real estate, renting and business activities



Conclusion and Recommendations

In April of 2014, the economic growth significantly declined, for instance even though the first quarter of 2014 had a growth of 7.4 percent, the growth in April was only 2.7 percent. According to the data in 2013, unemployment rate fell by 0.4 percent to 14.6 percent.

In the first quarter of 2014 most economic indicators are looking healthy for the country, including the export where first three months of the year has displayed a growing tendency. As previously, mentioned even though resumed trade relations with Russia could positively impact the Georgian economy, the country should try to minimize its dependence on that market and continue to establish itself on the other markets as well as seek new ones.

Unemployment issue remains the largest challenge for the country. For the jobs to be created the government should encourage the development of businesses in Georgia, which would also include development of different industries and its infrastructure. The government should create a well-defined long-term economic strategy for ensuring stable business environment. It is important for the local businesses to develop, and at this point capital and business venture from foreign firms are very important for the rapid development of the country. The current administration should not only create a favorable business environment, but also communicate its presence and attract FDI from the foreign firms.



Economic Policy Research Center (EPRC)
85/24 Paliashvili/Mosashvili str. Building I. Floor IV. 0162. Tbilisi.Georgia.
Tel/Fax: (995 32) 2 207 305
e-mail: info@eprc.ge
www.eprc.ge