POLICY BRIEFING 03|2022

German Economic Team

GEORGIA

Economic implications for Georgia of the war in Ukraine and the sanctions against Russia

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Berlin, April 2022

Summary

- **GEO economy** is adversely affected, but the effect is not very large
- **Goods exports** are likely to drop by USD 65 m or 0.4% of GDP in 2022
- Effect relatively small as transport routes are not affected and there is strong potential for GEO to be substituting other suppliers
- Effects for **tourism revenues** are ambiguous, but the recent influx of Russians to Georgia present potential for additional revenues
- **Remittances** from RUS to drop by USD 210 m or 1.0% of GDP in 2022
- **Oil imports** to become much more expensive (additional cost of 2.1% of GDP), but no issue regarding energy security
- Higher commodity prices (esp. food and energy) further fuel **inflation** in GEO; National Bank needs to combat inflation; no room for supporting the economy
- **Public finance** affected by weak economy, but new IMF programme agreed

➢ **Limited economic shock for GEO**

➢ **Crucial factors for size of shock: oil prices and remittances**

Outline

1. Introduction
2. Economic outlook in Russia in 2022
3. Implications for goods exports to Russia
4. Implications for tourism revenues from Russia
5. Implications for remittances from Russia
6. Implications of higher commodity import prices
7. Implications on energy security
8. Macroeconomic implications

1. Introduction

The war in UKR and sanctions against RUS affect GEO economy in many ways:

- There are strong links between RUS and GEO economy
- The RUS economy is severely weakened and incomes will decline
- Potential spillovers for GEO include goods exports to RUS as well as tourism revenues and remittances from RUS
- The rise in global oil prices will create additional import costs
- Globally, energy and food prices have increased significantly, putting additional pressure on already high inflation in GEO
- Finally, the weaker growth outlook could burden public expenditure

Aim of the briefing:

- Analysis of key economic implications of war in UKR & sanctions against RUS
- Recommendations on policy reaction to this shock

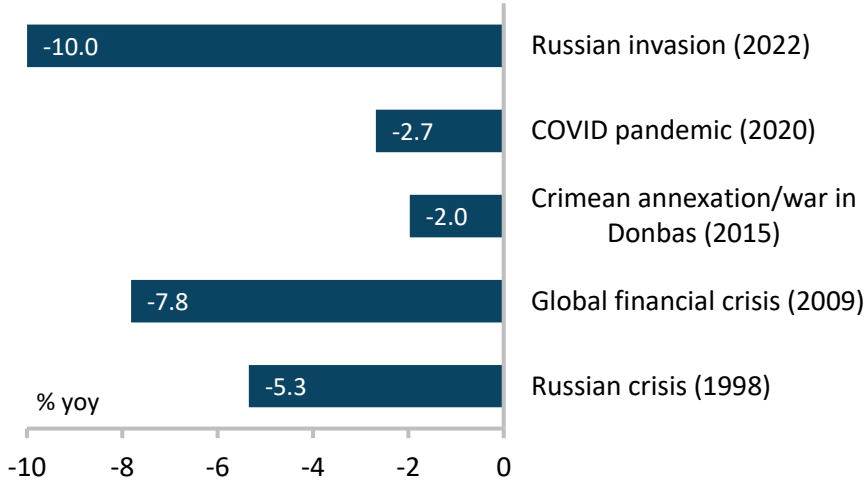
2. Economic outlook in Russia in 2022

Selected economic indicators

Indicators	2022
Real GDP growth, %	-10%
Nominal USD GDP growth, %	-34%
Inflation, % eop	20%
Exchange rate, RUB/USD	120

Sources: Goldman Sachs, CBR, own assumptions/calculations

Historic GDP declines



Sources: Rosstat, own calculations

Severe economic and financial damage

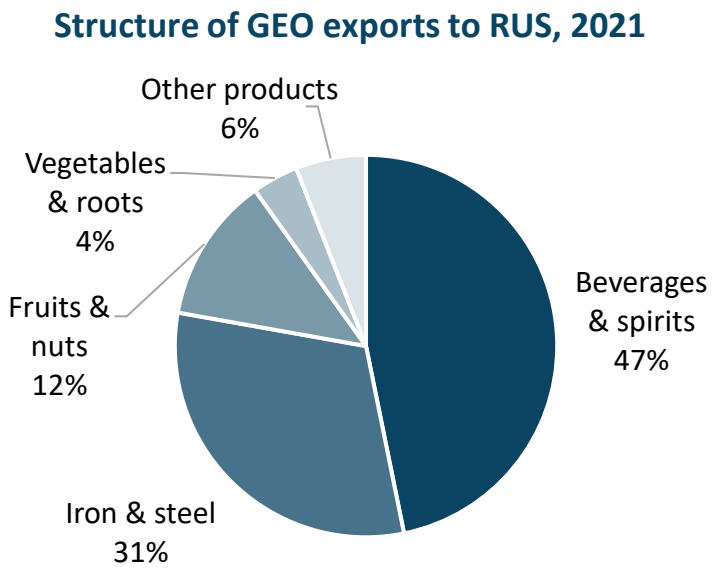
- The war has led to a wave of sanctions on Russia by Western countries
  - Significant impediments to trade (including logistics) as well as to foreign investments
  - Russia reacted by tightening financial conditions, e.g. emergency CBR rate hike to 20% p.a.
  - Material risk that RUS defaults, ratings only slightly above „Default“ status

Still high uncertainty

- As war continues, new sanctions may follow & target the crucial energy sector

➢ **Russia’s real GDP likely to decline by 10% in 2022, which is unprecedented in modern history**

3. Implications for goods exports to Russia



Source: WITS; exports of goods without re-exports based on information provided by WITS

GEO exports of goods to RUS, 2021:

- Value: USD 555 m
- Growth, 2021/2020: 38%
- Share in total goods exports: 18%*
- Share in GDP: 3.4%

➢ **Significant role of RUS market**

Export structure by sectors, 2021:

- Food & beverages: 48%
- Metals: 31%
- Plant products: 17%
- Other sectors: 3%

➢ **Agro-food exports is most exposed**

** Excluding copper ore exports (which are not relevant for trade with Russia) would put the share of Russia at 24%.*

Estimation of impact on goods exports

		GEO exp to RUS, USD m, 2021*	Exp loss to RUS, USD m, 2022	Total exp loss, USD m, 2022
1	Ferro-silico-manganese	172	-28	0
2	Wine of fresh grapes	130	0	0
3	Mineral waters, unsweetened	60	0	0
4	Spirits obtained by distilling grape	41	-17	-17
5	Flavored/sweetened waters	26	0	0
6	Peaches, including nectarines	24	-12	-12
7	Mandarins, including tangerines	16	-4	-4
8	Fresh or chilled potatoes, excl. seed	14	-3	-3
9	Apples	8	0	0
10	Cranberries, blueberries	5	-3	-3
	Other products**	58	-26	-26
	Total	**555**	**-93**	**-65**
	% of GDP	**3.0%**	**-0.6%**	**-0.4%**

*Source: WITS, ITC Trade Map, own estimates (see GEO/PB/01/2022 for details); * only domestic exports; ** benchmark response for RUS total imports of products that RUS imports from GEO (excl. top-10 products), 2015 vs 2013: 1.32*

Conclusions on goods exports

Explanation

- RUS GDP decline will result in lower income to be used for imports
- But: GEO can be a substitute supplier for countries that stopped exports to RUS
- Additionally, there may be opportunities for reorientation to other destinations

Effects on main GEO exports to RUS

- Ferro-silico-manganese
  - Global commodity with potential for reorientation
  - Result: exports to RUS reduced, but more exports to other countries
- Wine and waters
  - GEO can substitute other suppliers, which do not export to RUS anymore
  - Result: exports to RUS likely not affected
- Fruits and spirits
  - Only limited possibilities for substitution or reorientation
  - Result: strongest reaction in goods exports

Results

- GEO drop in exports to RUS estimated at **USD 93 m or 0.6% of GDP in 2022**
- Potential for reorientation reduces total losses of exports to **USD 65 m or 0.4% of GDP**

4. Implications for tourism revenues from Russia

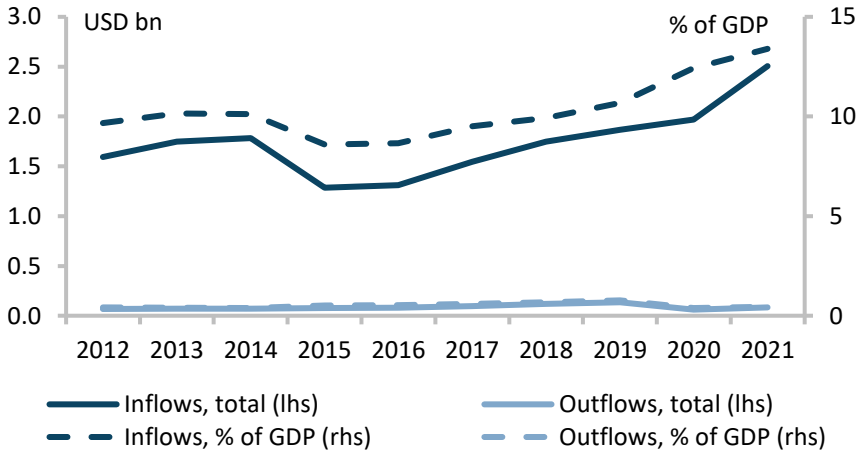
Russia's invasion of UKR will affect GEO tourism revenues in 2022 in three main ways:

1. **Price & income effect → negative**
   - Russia's GDP will strongly decline in 2022 (esp. in USD terms)
   - The resulting income shock will lower propensity to spend money on tourism
2. **Substitution effect → positive**
   - Without the war, many Russians would have spent their vacation in popular tourist destinations (e.g. in Western Europe)
   - However, due to the war, Russian tourists face obstacles when visiting countries which introduced sanctions (e.g. payment systems, airline connections etc.)
   - As a result, some Russians will spend their vacation in RUS. However, others look for substitute destinations (such as GEO)
3. **Influx effect → positive**
   - The war has caused a significant influx of (high-skilled) Russians into GEO, whose expenditures will (temporarily) increase tourism revenues
   - Effect is difficult to estimate due to high uncertainty of underlying factors (number of people, avg. expenditure, length of stay, etc.)

➢ **Forecast not feasible, but we do not expect a massive reduction in tourism**

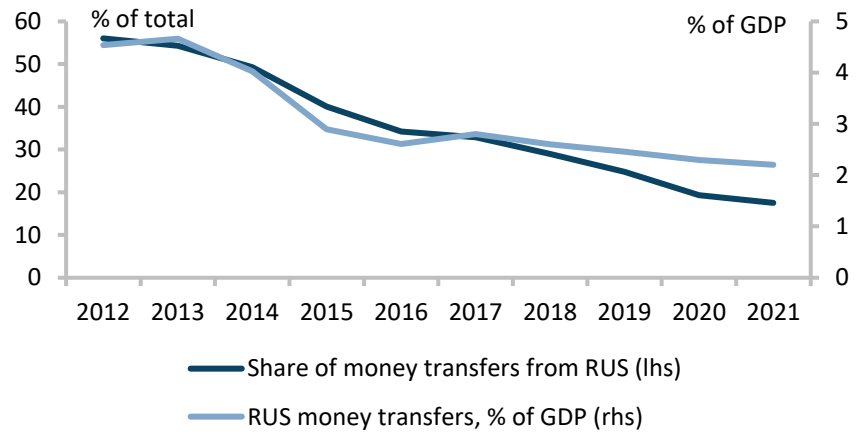
5. Implications for remittances from Russia

Personal remittances inflows to Georgia (gross)



Source: National Bank of Georgia; data refers to „Personal remittances"

Money transfer inflows from Russia



Source: National Bank of Georgia

- Remittances play a key role for the economy of GEO
  - USD 2.5 bn or 13.4% of GDP in 2021
  - No component of GDP but support economic demand
- Share of RUS in money transfers* has declined to 17.5% of total in 2021, but remains important
  - 2012: USD 748 m, 4.5% of GDP
  - 2021: USD 411 m, 2.2% of GDP
  - In parallel: money transfers from the EU increased to USD 956 m or 5.1% of GDP in 2021

➢ **Remittances from RUS still an important source of income for many households**

** Data on individual countries is only available for money transfers, not personal remittances. However, money transfers correlate strongly with personal remittances. Therefore, money transfers are used as a proxy for remittances here.*

Expected shock and economic effects

	Shock: Reduction in remittances from Russia		Effect on GDP		Effect on consumption		Effect on investment	
	USD m	*% of GDP*	USD m	*% of GDP*	USD m	*% of GDP*	USD m	*% of GDP*
Expected shock	**-209.9**	***-1.0%***	**-60.5**	***-0.3%***	**-124.9**	***-0.6%***	**-23.8**	***-0.1%***
Maximum exposure	-392.7	*-1.9%*	-132.2	*-0.6%*	-280.3	*-1.3%*	-44.5	*-0.2%*

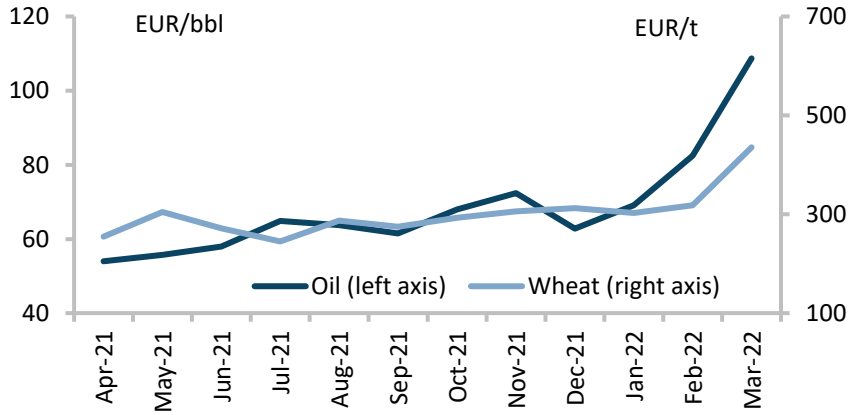
Source: Own calculations; note: economic effects calculated as a short-term demand shock caused by declining remittances, methodology analogous to GET MDA, PP/03/2014

- Economic sanctions will decrease remittances from Russia by ca. 50%
- Effects on GDP, consumption and investment are moderated by high import share in Georgian economy and usage of savings by recipients of remittances
- Effects are likely most severe for individual households

➢ **Sizeable economic effects: -1.0% of GDP in remittance income, -0.3% of GDP effect on growth**

6. Implications of higher commodity import prices

Global oil and wheat prices (2021/22)



Selected energy & food imports: Aggregate price shock

	Oil	Wheat
Net quantity imported p.a.	9.1 m bbl	365 thsd t
Import price before war*	63.07 EUR/bbl	255 EUR/t
Expected import price**	101.22 EUR/bbl	349 EUR/t
Price differential	38.15 EUR/bbl	94 EUR/t
Additional cost p.a.	EUR 347 m	EUR 34 m
Additional cost p.a., % GDP	**2.1 %**	**0.2 %**

*Source: IEA, U.S. EIA, World Bank, Marketwatch, own calc.; *20 Sep 2021 for oil, avg. 2021 for wheat; **28 Mar 2022 for oil, weighted average between Urals and Brent (assuming 25% RUS share); avg. 2022 future prices for wheat*

Oil

- Oil prices increased strongly due to sanctions against RUS
- Assuming prices remain high and GEO imports ¼ of oil from RUS, expenditures of EUR 347 m or 2.1% of GDP in 2022

Wheat

- Wheat prices increased strongly due to war in UKR & RUS export ban
- Assuming prices remain high, GEO will face additional expenditures of EUR 34 m or 0.2% of GDP in 2022

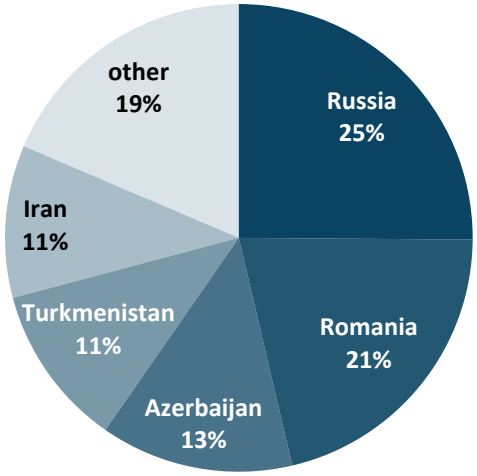
➢ **Energy shock of 2.1% of GDP due to higher oil prices**

7. Implications on energy security

GEO energy supply and Russian imports (2019)

	Share in TES*	Gross import share	RUS share in imports	RUS share in TES*
Solid fossil fuels	5%	100%	92%	4%
Oil and oil products	28%	98%	25%	7%
Natural gas	47%	100%	6%	3%
Renewables	21%	-	-	-

GEO oil & oil products import shares (2019)



**Total Energy Supply* *Sources: IEA, Eurostat, Geostat, own calculations*

- Cement & steel industries rely on RUS coal imports
  - Reason: GEO coal mines closed in 2018 due to safety issues
  - But: no reason to assume disruptions in coal imports from RUS
- 25% of oil and oil products imported from RUS
  - No reason to assume disruptions in oil imports from RUS
  - Additionally, oil imports diverse and resilient against supply shocks
- Virtually no gas from RUS
  - Long-term contract with AZE

➢ **No impact on energy security**

8. Macroeconomic implications

Russia's invasion of Ukraine has various macroeconomic implications beyond the transmission channels discussed above, to which policy makers have to react:

Monetary policy must address inflationary pressures

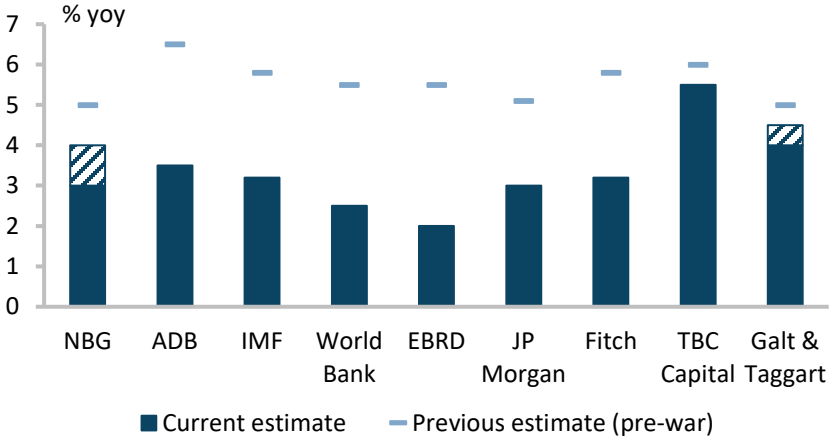
- Inflation will accelerate from the supply shock on top of existing pressures
- Depreciation pressures on the Lari will deepen as currency inflows from remittances are affected

Fiscal policy will play a key role in limiting the implications on the real economy

- Measures to support the economy and households, as well as additional expenditure on refugees
- Financial support by IFIs and partner countries will be key

Economic growth

Real GDP growth in 2022



Source: respective institutions

Regional comparison of real GDP estimates for 2022

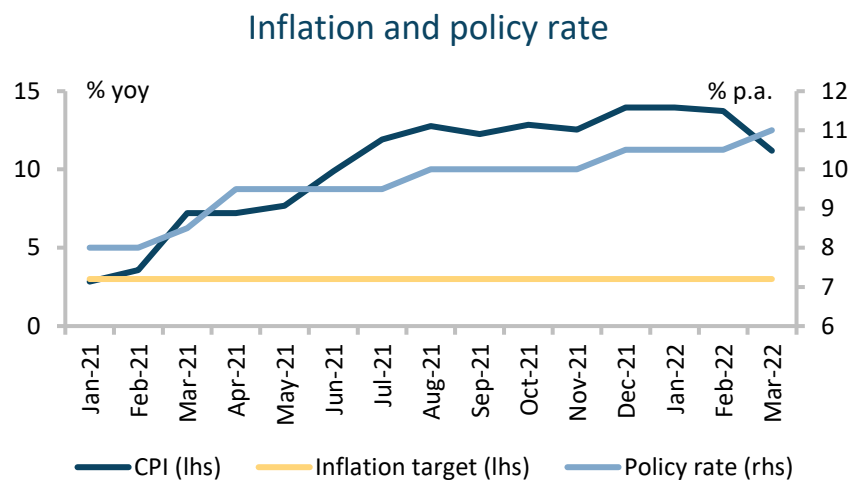
	Current estimate (% yoy)	Change in estimate (pp)
Georgia	**3.5**	**-1.5**
Armenia	1.6	-3.7
Azerbaijan	3.7	1.2
Russia	-10.0	-12.0
Germany	2.1	-1.9
EU-27	2.8	-0.7

Sources: NBG, CBA, ADB, Goldman Sachs, IfW Kiel

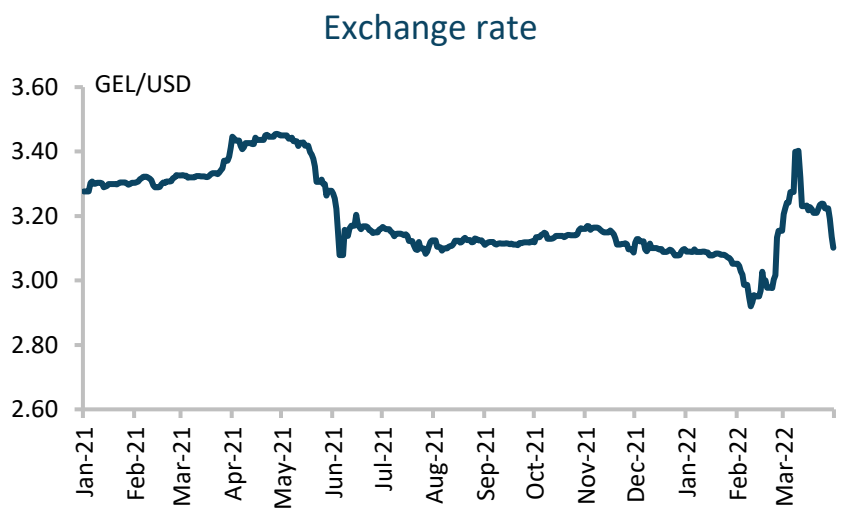
- Strong growth before start of the war; 2M2022: 16.3% yoy, due to base effect of COVID-19
- Estimate for full year 2022 before the war: around 5% yoy
- New forecast (under high uncertainty): approx. 3.5% yoy
- Potential upsides through high-skilled migration, relocation of firms and re-routing of trade through GEO

➢ **Moderate effect of war on GDP**

Monetary and exchange rate policy



Source: NBG



Source: NBG

Inflation

- High inflation: 13.7% in Feb-22
- War leads to higher commodity prices, esp. for food and energy (33.1% and 9.0% in CPI basket, respectively)
- Result: inflationary pressure
- Mar-22: NBG raised policy rate to 11.0%, further hikes might be needed to bring inflation back to target (3%)

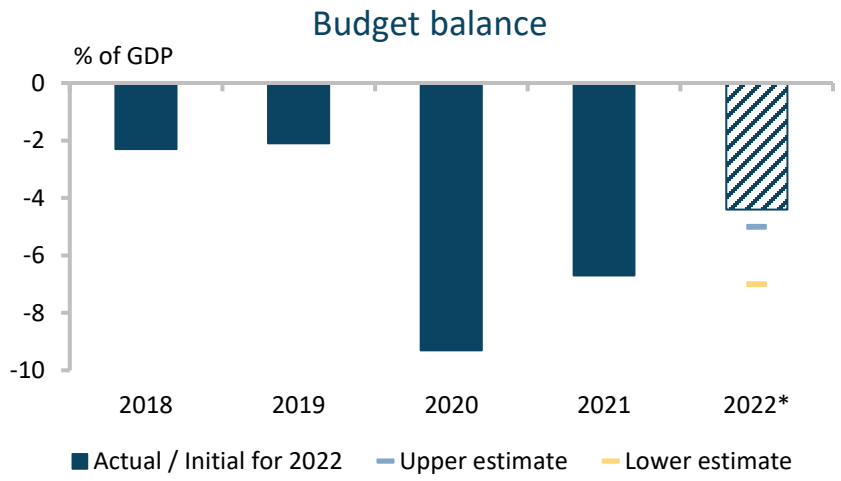
Exchange rate

- NBG sold FX reserves (USD 39.6 m) for exchange rate stabilisation
- Lari: back to level from 1 Jan 2022 after strong volatilily in March

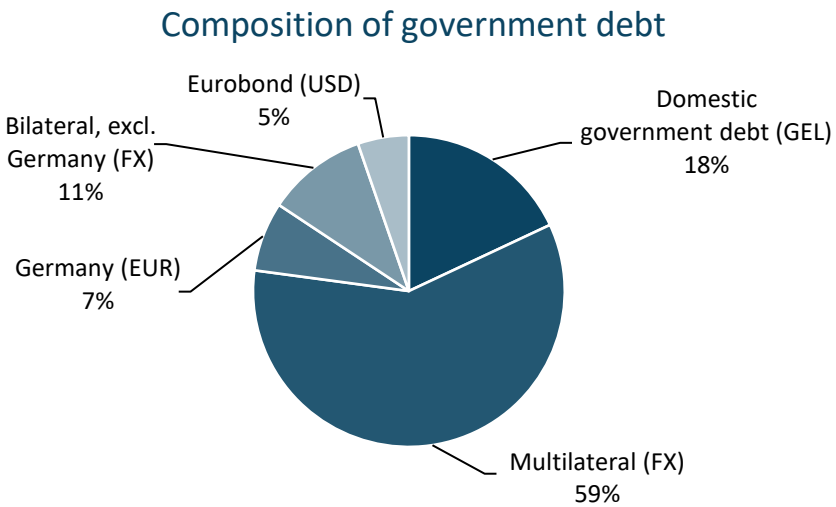
➢ **Tight monetary policy stance will need to be continued**

➢ **Monetary policy cannot support the economy, despite sizeable shock**

Fiscal policy



*Source: Ministry of Finance, TBC Capital, Galt & Taggart; * estimate*



Source: Ministry of Finance, data as of 31 December 2021

- Budgetary risks due to war in UKR, on top of a pre-war planned deficit of 4.4% of GDP
- New estimates for public deficit by Georgian banks: 5-7% of GDP
- Only 18% of public debt in Lari, FX debt almost exclusively by donors
- Eurobond spread increased strongly, but maturity until 2026, no immediate concern
- Staff-level agreement on new IMF programme (USD 289 m)

➢ **Fiscal policy and financing of budget deficit is a challenge**

About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*

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