Macroeconomic effects of the global oil price decline on Georgia

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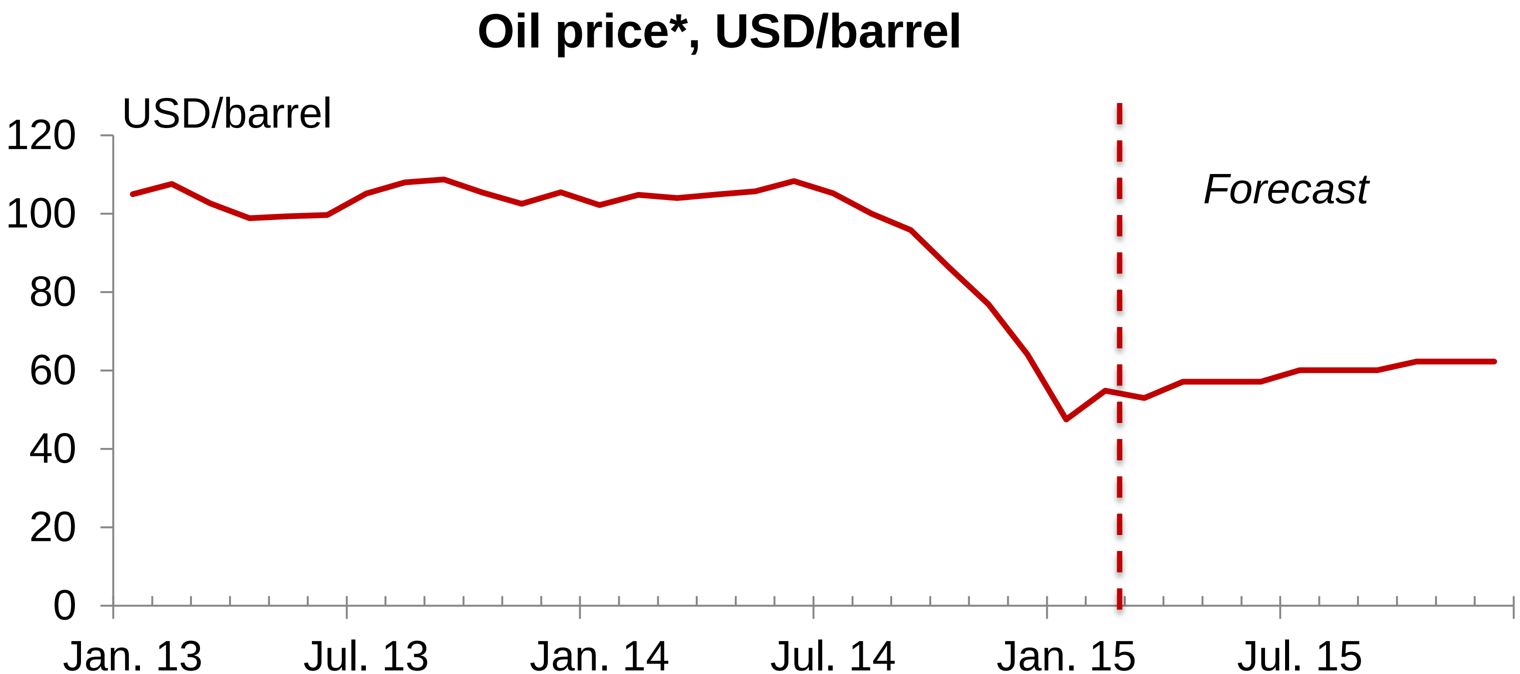
Large and persistent decrease of oil prices



Source: IMF primary commodity prices, forecast after Feb 2015
** Average spot price for U.K. Brent, Dubai and West Texas Intermediate*

- Global oil prices have decreased to ~ USD 55/barrel in Feb 2015
- Expected to stabilise around USD 60/barrel
- Price decrease largely due to increased production (OPEC constant, more elsewhere)
- Global demand weakness plays smaller role

Direct economic effect: A terms-of-trade shock

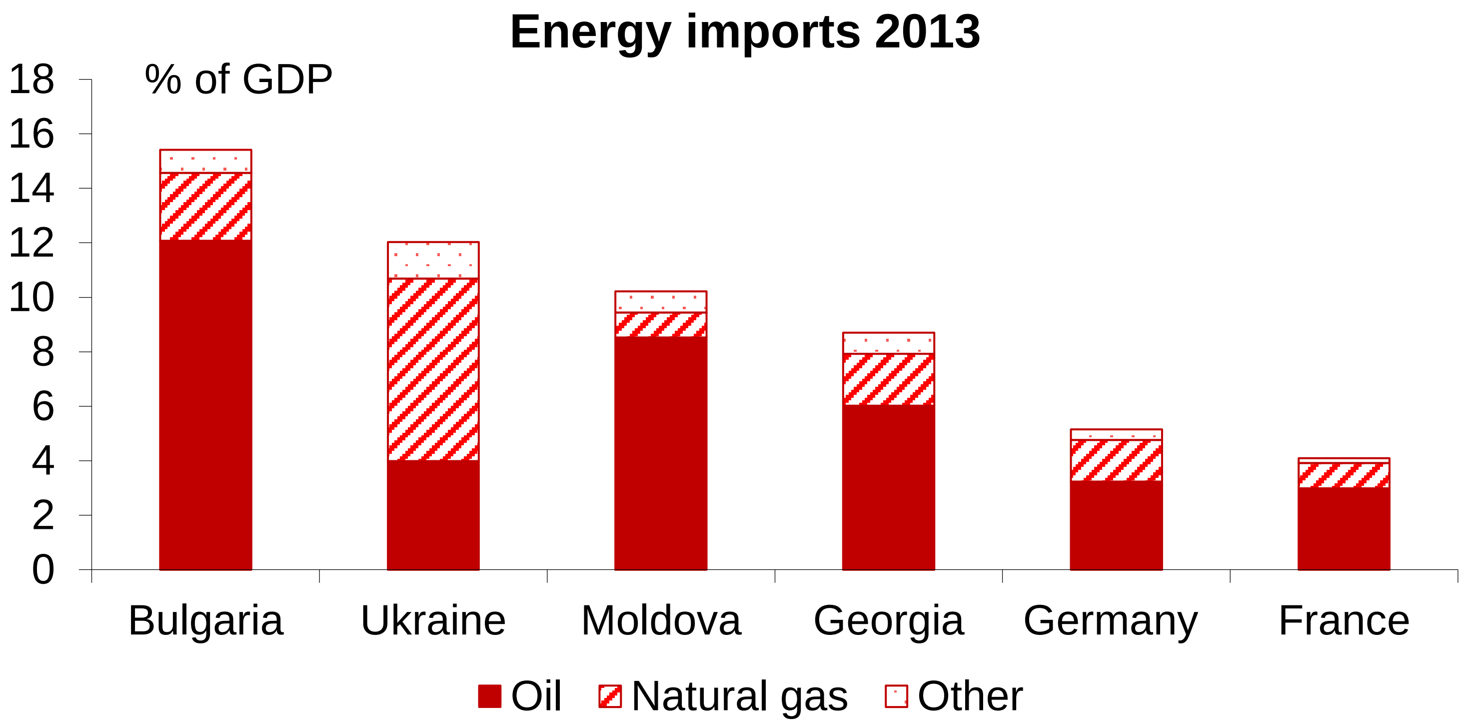
- **Direct effect: Improved „terms of trade“**
  - A decrease in the price of an import good without a decrease in export prices.
  - Effect: More income left after buying normal quantity of oil
  - Increased demand for domestic production and imports

- **Also: Indirect effect – changed demand for GE goods by trade partners**
  - Sign depends on whether trade partners are oil exporters or importers

➢ **We focus on the direct effect of an oil price decrease in 2015**

➢ **Exclude other, contemporaneous macro shocks (USD/GEL depreciation, effect of crisis in Ukraine etc.)**

High share of oil imports in Georgia

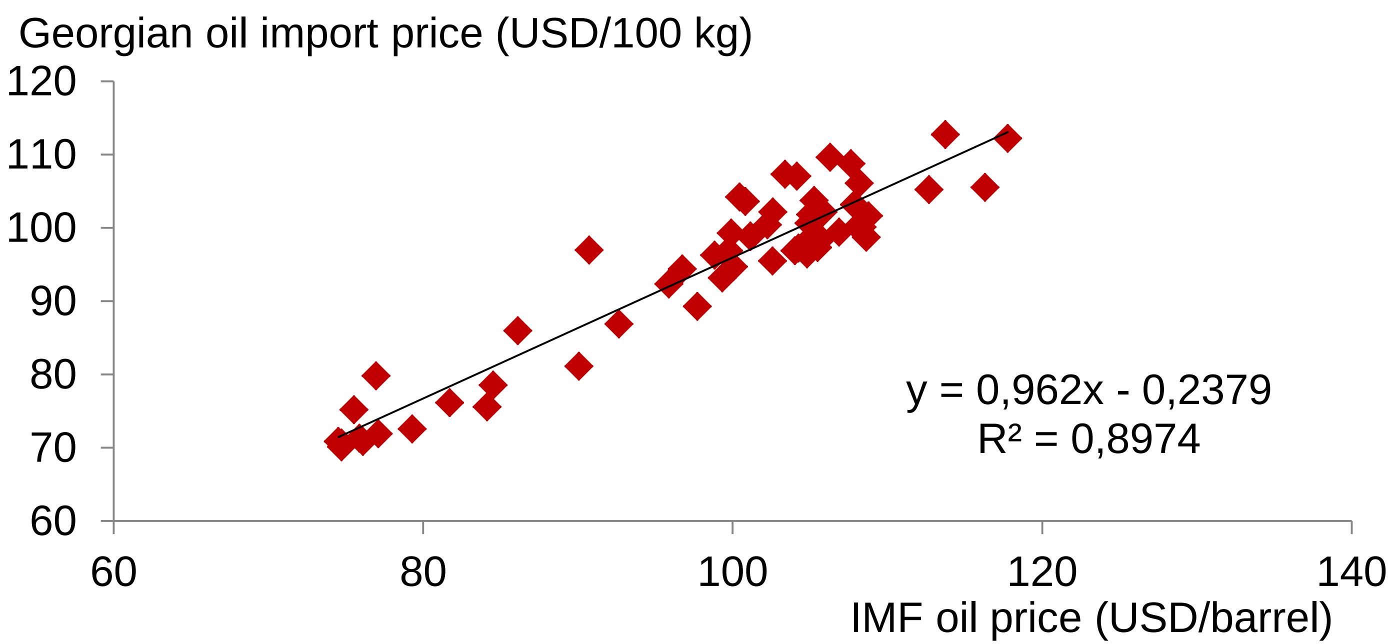


Source: UN Comtrade, IMF

- Lower share of energy imports/GDP in Georgia than in UA or MD, but bigger than in large EU states
- GE Oil imports 2013: 6% of GDP, Gas imports: 1.9% of GDP
- Due to high share of oil imports on GDP, terms-of-trade effect may be big

Oil import price in Georgia follows global oil price

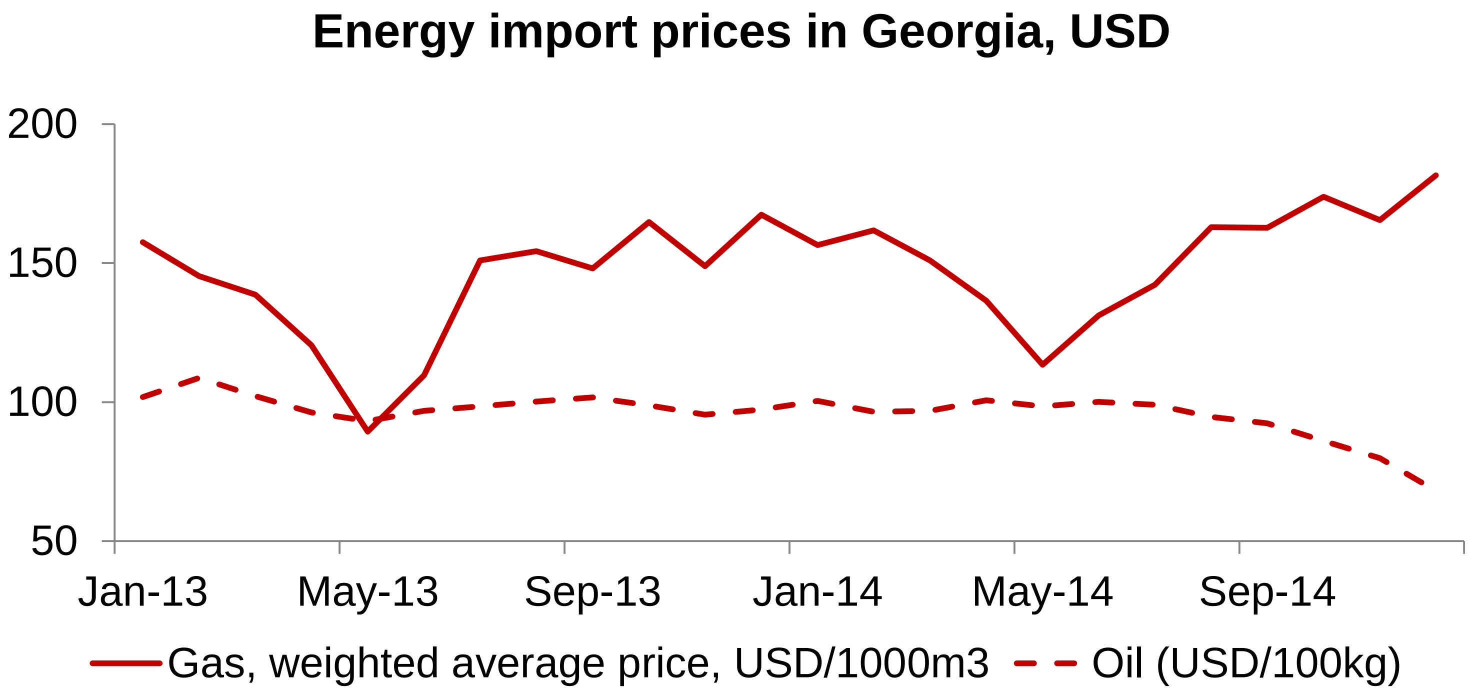
Relation of Georgian oil import price with world market oil price*



Source: UN COMTRADE, IMF primary commodity prices
** Average spot price for U.K. Brent, Dubai and West Texas Intermediate*

- World market price changes effectively fully transmit into Georgian oil price
- Can expect immediate effect of global oil price decrease on GE economy

Gas price not immediately connected to oil price



Source: UN Comtrade, Geostat

- 78% of gas imports in 2014 from Azerbaijan, with long-term contracts
- Partially depend on import volumes
- Oil and gas only imperfect substitutes
- Different markets (Oil: global. Gas: more regional, depends on pipe networks)
- ➢ **So far no indication that gas import prices will decline**

Modelling approach

- We model the effect of a **41% decrease in world market oil prices** (IMF forecast for 2015 vs 2014) on Georgia
- Absolute figures refer to **current prices in 2015**
- We use **current USD/GEL exchange rates** as of February 2015, therefore **excluding** the macroeconomic effect of the USD/GEL **depreciation**

➢ Assume that the full **41% oil price decline is transmitted to Georgia**

- First calculate **saving** from reduced oil price (same import quantity)
- Then: Assume all savings result in **increased demand**
- Calculate macro effects (using national average shares of e.g. consumption, imports)

➢ **We only model the effect of the oil price decrease. This is not a complete macroeconomic forecast!**

41% oil price decline: GEL 503 m saving in 2015

World oil prices per barrel, current prices*

	USD	GEL
2014	96.3	194.5
2015 forecast	56.7	114.6

Source: IMF, own calculations

** Applying Feb 2015 GEL/USD exchange rate of 2.02*

- Assuming constant oil import volume (2015=2014), 9.3 million barrels
- How much does Georgia save compared to previous oil prices when purchasing this amount of oil?

Georgian savings on oil imports

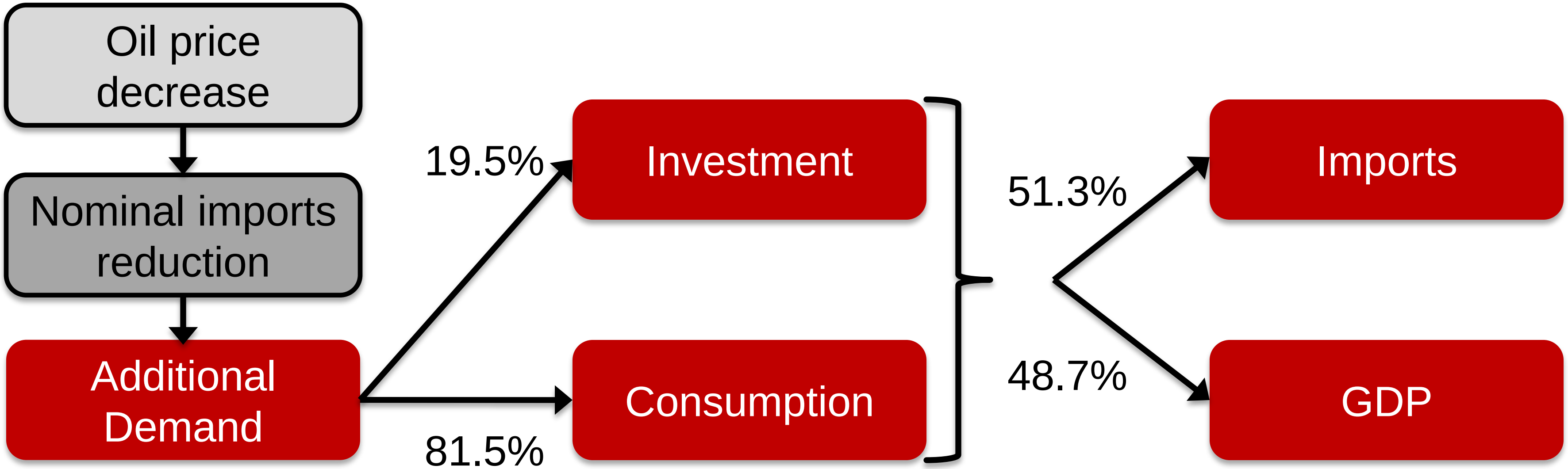
Price reduction 2015/2014	**41%**
Saving in 2015, GEL m	**740.2**
Share of 2015 GDP	**2.3%**

Source: IMF, Own calculations

- **2.3% of GDP additional (real) disposable income** – not a GDP increase!

Calculating macroeconomic effects

- Macroeconomic effects against benchmark: IMF World Economic Outlook forecast for 2015 (GEL, current prices)
- We assume that the saved money will enter the economy as additional real demand
- Distribution into categories of use according to Geostat 2013 shares



- **Major outcomes: Effects on GDP and current account balance**

1.1% real GDP increase due to oil price decrease

- Initially: Imports and consumption decrease by 2.3% of GDP (saving: mechanic effect of oil price decrease)

- **Macroeconomic effects**:
  - **Increase of real GDP by GEL 360.7 m = 1.1%**
  - **GDP effect** equals the **additional spending on domestically produced goods and services** (reduced nominal imports)
  - Therefore, also improvement in the **current account balance** by GEL 360.7 m = **1.1% of GDP**

  - Increase of **real consumption** by GEL 595.7 = 1.9% of GDP
  - **Investments** increase by GEL 144.5 m = 0.4% of GDP

➢ **Significant, positive effect of oil price on GDP (1.1%) to be expected**

➢ **Not surprising due to large volume of oil imports**

Indirect effect: Changed demand for Georgian exports

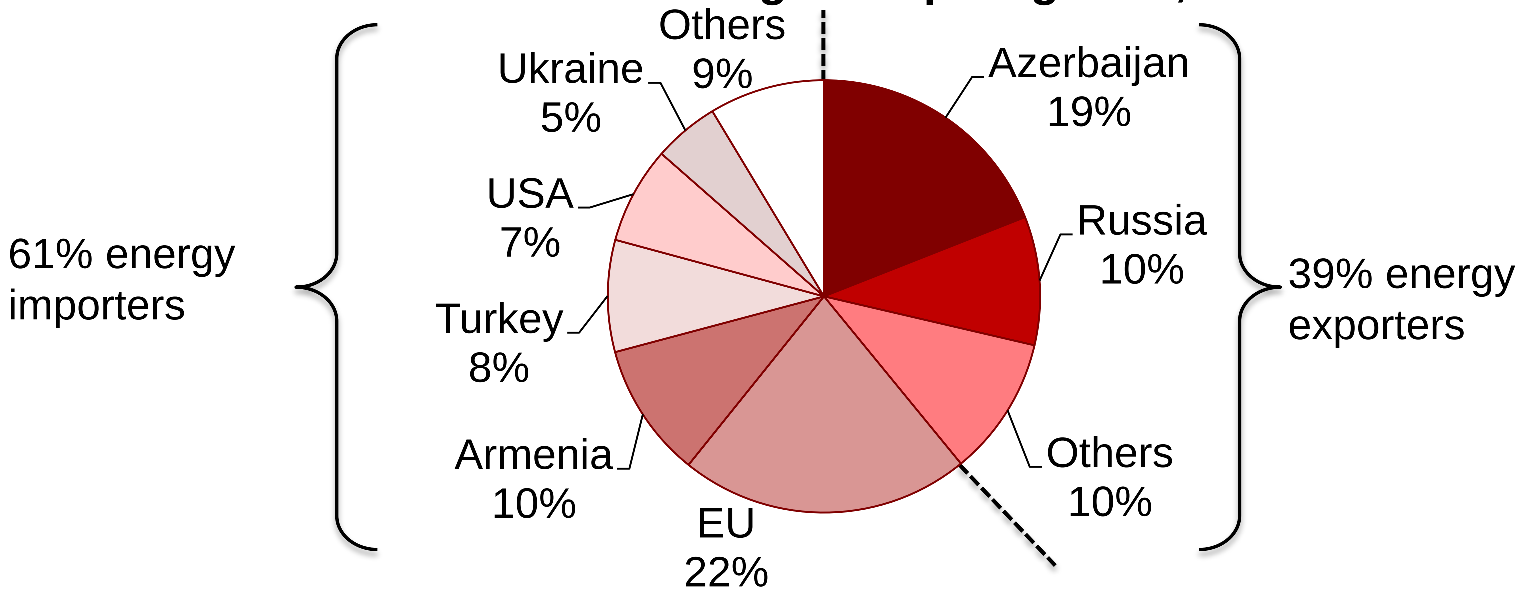
- Oil price decrease also affects trade partners of Georgia
- Oil importers (e.g. Turkey, EU) will also experience a positive direct effect.
- Oil exporters will experience negative direct effect of oil price decrease

- However, oil price effect on demand for Georgian goods is difficult to measure
- Depends on oil export volumes (political decisions)
- Depends on relative demand for goods
  - Georgian exports are mainly consumption goods => usually more stable demand than for investment goods.

➢ We only give a qualitative indication of possible indirect effects

Unclear effect of oil price on Georgian exports

Destinations of Georgian export goods, 2014



Source: Geostat, UN Comtrade

- Larger share of energy importers in export destinations
- However, effects of low energy prices on energy exporters likely to be stronger than on energy importers.
- No clear forecasts of the effect of the oil price on import demands exist
- We expect a limited decrease in exports

Summary

- 41% decrease of global oil prices will have strong effect on Georgia due to the large volume of oil imports (6% of GDP)

- **Direct effect of oil price decrease** in isolation:
  - **+1.1% GDP growth** and **current account balance**
  - **+1.9% of GDP real consumption**
  - **+0.4% of GDP investment**

- GDP growth in 2015 depends on all macro shocks
- Other macro shocks (reduced exports to region, lower remittances) are negative
- Net effect of shocks probably negative: Reduced GDP growth

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