



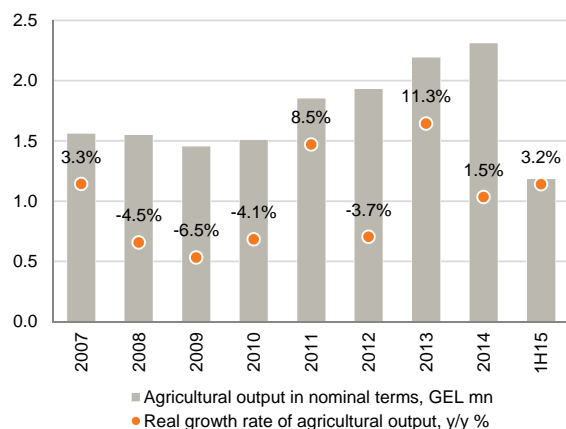
Georgia's Agricultural Sector Sustaining Growth

Georgia | Agriculture
Industry Overview
October 27, 2015

The agricultural sector posted real growth of 3.2% y/y in 1H15, with output rising to GEL 1.2bn, making up 9.4% of Georgia's 1H15 GDP. Lower world food prices led to an improved trade balance in primary agricultural commodities in 9M15, while processed products saw a decline on the back of lower wine exports to Russia. The largest share (54.9% of the total) of agricultural exports was directed to the EU. In line with the signing of the DCFTA, approximation procedures with EU legislation are being launched, supported by the government, donors and IFIs; successful implementation should stimulate agriculture FDI and exports. Significant progress has been made in expanding irrigation and drainage coverage. Land registration issues remain a major concern; a project is underway to develop a comprehensive national land register.

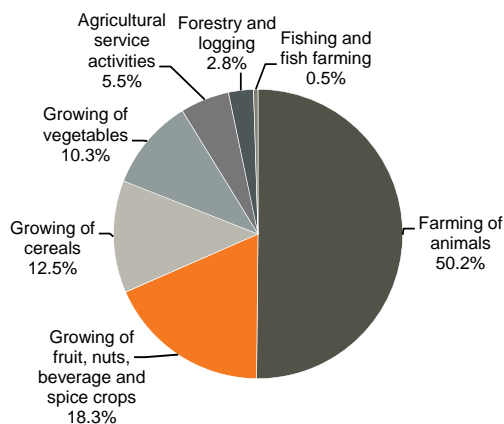
Agricultural output expanded 3.2% y/y in real terms in 1H15, constituting 9.4% of Georgia's 1H15 GDP. Livestock farming remained the leading driver, accounting for half of total agricultural output. The second largest contributor was the growing of fruit, nut, beverage, and spice crops, which made up 18.3%, while cereals and other crops accounted for 12.6% of total agricultural GDP.

Figure 1: Agricultural output, GEL bn



Source: Geostat

Figure 2: Agricultural output breakdown, 1H15



Source: Geostat

Processed food, beverage, and tobacco contracted 1.7% y/y in nominal terms, with output amounting to GEL 477.2mn in 1H15. The average annual growth rate over the preceding five years was almost 20%. The largest contributor to the decrease was alcoholic beverages (20.5% of the total), with output down 33.5% y/y in 1H15. The drop was due mainly to lower demand for alcoholic beverages from the CIS countries. There was also a 50% increase in excise taxes on alcohol in March 2015, which resulted in a rise in alcohol prices and dampened domestic demand. Mineral water and non-alcoholic beverages (28.3% of the total) posted 7.4% y/y growth in 1H15.

Nino Papava

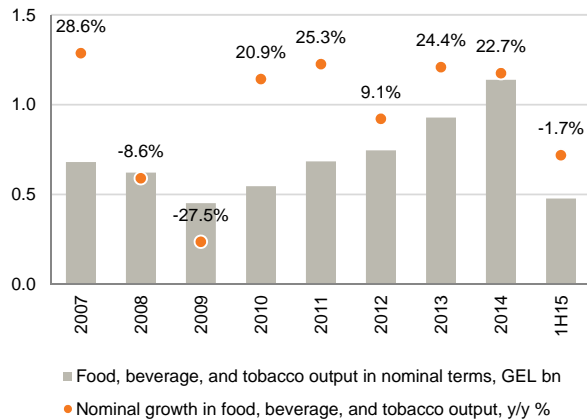
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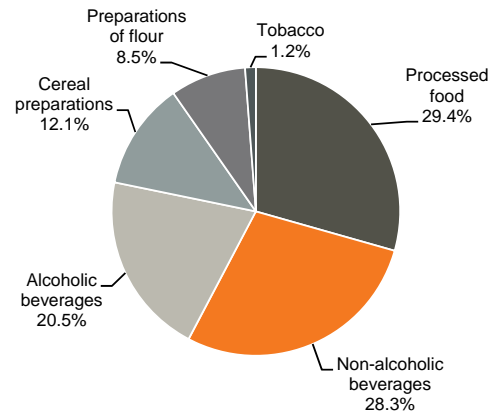


Figure 3: Food, beverage, and tobacco output, GEL bn



Source: Geostat

Figure 4: Food, beverage, and tobacco output breakdown, 1H15

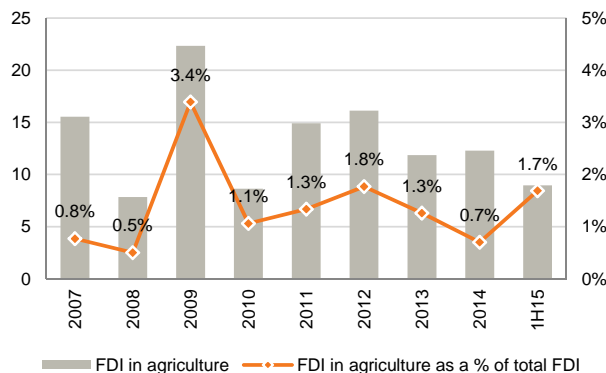


Source: Geostat

The ban on the sale of agricultural land was lifted in December 2014, which should be favorable for attracting FDI. The ban, subsequently deemed unconstitutional by the Constitutional Court of Georgia, was introduced by parliament in the spring of 2013 with the aim of organizing the Georgian land market, formulating a clear understanding of how much land the state owned, and creating a unified land register. Although the ban has now been lifted, land registration remains a major issue due to delayed implementation of the court's decision. The alternative to land ownership for investors is a long-term lease (up to 49 years) from the state.

FDI in agriculture remained low at 1.7% of the total in 1H15 (0.7% in FY14). Land registration is still a pressing issue for the development of the agricultural sector. The lack of data in the current land register remains a problem, as an efficient land development policy and investment in the sector will depend heavily on proper segregation of state-owned and/or municipal land from that which is owned privately, as well as a clear distinction between agricultural and non-agricultural land. A project is underway to develop a digital cadaster and land register, which would include all land plots rather than just registered plots, as is the case with the current registry.

Figure 5: FDI in agriculture, US\$ mn



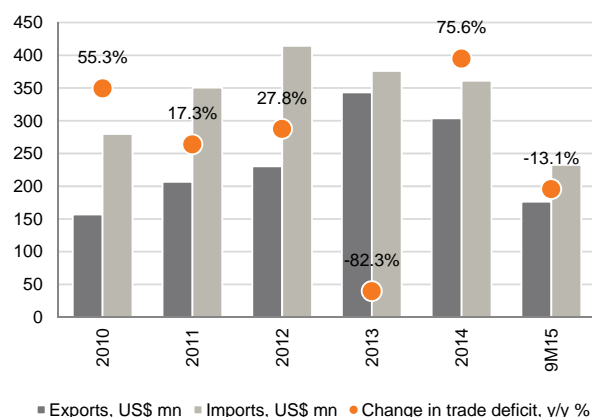
Source: Geostat

Foreign trade

Primary agricultural commodities

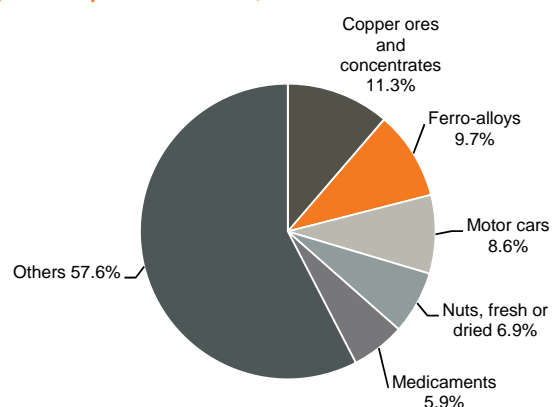
The trade deficit for primary agricultural commodities declined 13.1% y/y in 9M15. Imports decreased 8.2% y/y to US\$ 232.6mn on the back of lower global commodity prices. Exports decreased 6.5% y/y to US\$ 176.5mn. Nuts were among Georgia's top four exports, generating US\$ 113.9mn in export revenue, increasing 6.3% y/y and constituting 6.9% of gross exports in 9M15, compared to 5.0% in 9M14. The EU accounted for 54.9% of primary agricultural commodity exports (US\$ 97.0mn), with the CIS coming in second at 26.8% (US\$ 47.4mn).

Figure 6: Primary agricultural commodities trade, US\$ mn



Source: Geostat

Figure 7: Exports breakdown, 9M15



Source: Geostat

Nuts made up 64.5% of total primary agricultural commodities exports from Georgia and 97.6% of total primary agricultural exports to the EU in 9M15. Roughly 83.0% of total nut exports from Georgia in 9M15 went to the EU, where prices were 43% higher on average than in the CIS in 2014 (World Bank estimates). Georgian hazelnut exports spiked in 1H15, increasing 162.6% y/y to US\$ 73.4mn. However, the bulk of hazelnut exports falls on the second half of the year, after the July-August harvest, and due to a good harvest in Turkey, prices fell from US\$ 9.0-14.0/kg of shelled hazelnut in 2014 to US\$ 8.0-8.5 in the current season, according to the Hazelnut Exporters Association (HEA). Turkey is the price setter on the world hazelnut market as it produces nearly two-thirds of total supply. Shelled hazelnut traded at US\$ 9.0 on average on Turkey's Giresun Commodity Exchange in August 2015, exerting downward pressure on Georgian hazelnut prices in comparison to last year, when prices were higher due to a hazelnut shortage on the world market. The prices for the rest of the hazelnut season will also depend on the capacity to store and dry the harvest, which allows hazelnut farmers to sell off-season for higher prices.

The government has commissioned a hazelnut drying and storage facility in Darcheli, Zugdidi, close to the hazelnut growing area. The facility is to have drying and storage capacities of 24 tons and 500 tons, respectively, according to the MoA. Upon completion, the facility will be transferred to Darcheli Tkhili, a 500-member cooperative, as part of an effort to stimulate the development of farming cooperatives in Georgia. Further investment will be necessary, as the current post-harvest handling capacity is far from sufficient to accommodate the total harvest, according to the Hazelnut Exporters Association (HEA).



The EU DCFTA creates further upside. The Deep and Comprehensive Free Trade Agreement (DCFTA) stipulates removal of import barriers from Georgia to EU member countries. Georgia already benefits from reduced or zero tariffs under two other major trade regimes: the Free Trade Agreement (FTA) with the CIS countries and Turkey and the General Scheme of Preferences (GSP+) agreement with the US, Canada, Japan, Switzerland, and Norway.

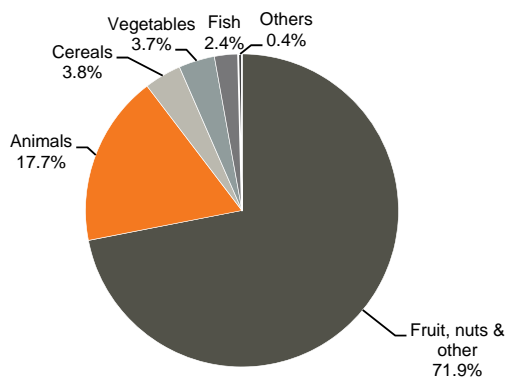
Imports of live animals and live animal products surged 115.5% y/y to US\$ 23.4mn in 9M15. The largest component of imported live animals and live animal products was frozen bovine semen, which made up 52.2% of total imports in this category, increasing from a negligible US\$ 24,000 in 9M14 to US\$ 12.2mn in 9M15. There was also a notable growth in sheep imports from US\$ 1.7mn in 9M14 to US\$ 3.3mn in 9M15, making up 14.0% of total live animal and live animal products imports, while dairy product imports increased 1.7% y/y in 9M15, constituting 9.0% of the total.

Exports of live animals and live animal products dropped 17.4% y/y in 9M15. The decrease was due mostly to a drop in demand from the CIS countries, mainly Azerbaijan, which had been the top importer of Georgian cattle. Cattle exports amounted to US\$ 14.8mn (down 41.2% y/y) in 9M15, making up 47.4% of total live animal and live animal products exports. Sheep exports increased 25.4% from US\$ 11.7mn in 9M14 to US\$ 14.7mn in 9M15, and represented 47.0% of total live animal and live animal products exports. According to industry sources, the increase in sheep exports can be attributed in part to imported Armenian sheep being re-exported from Georgia.

In 9M15, domestic shelled egg production almost fully displaced imports, which had peaked at US\$ 3.1mn in 2013. Fish exports increased almost threefold y/y to over US\$ 4.3mn in 9M15. Black Sea anchovies made up 91.5% of fish exports. Exports of anchovies, along with herbs and honey, could commence to Russia if Russian officials, who are expected to visit Georgia, deem the local standards satisfactory.

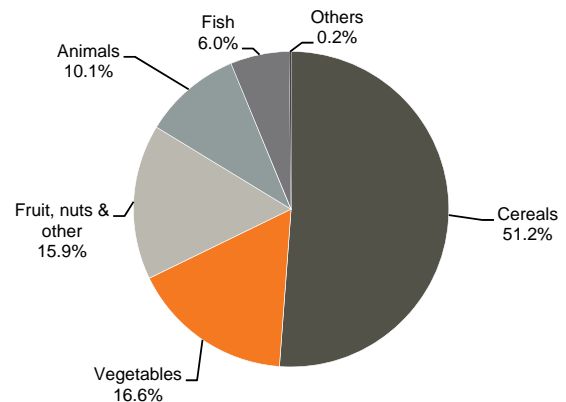
Georgian honey production and exports (currently negligible) are expected to rise. According to the MoA, Georgian honey and honey products are likely to be admitted to the European market in February 2016, if the samples are approved by the EC monitoring mission and can receive the necessary certification. The ministry is fully subsidizing the costs of honey sample analysis for quality control purposes at the local state-sponsored laboratory through the end of December 2015. Importantly, the laboratory is currently not equipped to perform the full range sample analysis required under EU regulations; samples have to be sent abroad for such testing. It is expected that the laboratory will have such capability by the end of 2015.

Figure 8: Agricultural exports breakdown, 9M15



Source: Geostat

Figure 9: Agricultural imports breakdown, 9M15



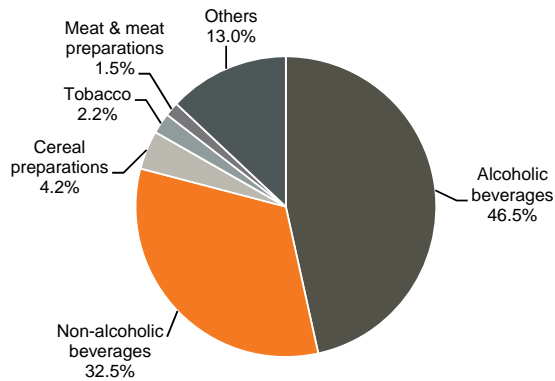
Source: Geostat



Processed agricultural products

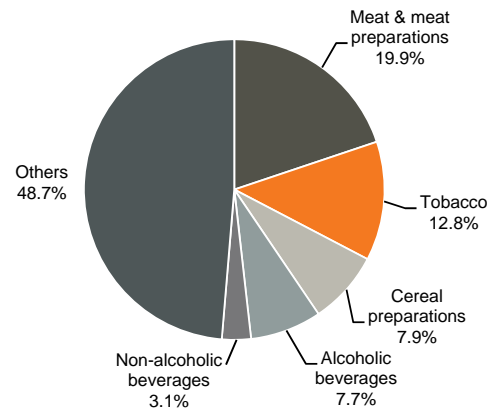
Exports of food, beverages, and tobacco declined 39.3% y/y to US\$ 238.2mn in 9M15, on the back of declining alcoholic beverage exports (-43.8% y/y). Alcoholic and non-alcoholic beverages, representing 79.1% of total food, beverage, and tobacco exports, declined 43.9% y/y in 9M15. This category also saw imports fall 15.2% y/y in 9M15 in nominal terms, with imports of meat and meat preparations being among the major contributors to the decline, along with dairy and ice cream.

Figure 10: Food, beverage, and tobacco exports breakdown, 9M15



Source: Geostat

Figure 11: Food, beverage, and tobacco imports breakdown, 9M15



Source: Geostat

State Support and Subsidies

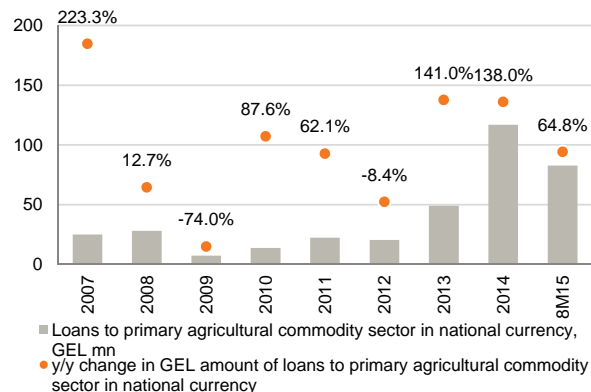
The MoA's share in the state budget has remained steady at 3% over the last two years, reaching GEL 267.5mn in 2015 and increasing to GEL 281.4mn in the preliminary 2016 budget. The government is committed to easing access to financing for agricultural entrepreneurs, promoting agricultural cooperation as a way to eradicate the small-scale inefficiencies in Georgian agriculture, and aiding the development of the sector in general. The government introduced a pilot program for agricultural insurance in September 2014 and a total harvest value of GEL 190.0mn for 25,000 beneficiaries has been insured as of September 2015, according to the Agricultural Project Management Agency. The effectiveness of this project in its first year was questionable due to misalignment of incentives, but the lessons learned are in the process of being applied, as the agency is working on a long-term sustainable plan for commercially viable agricultural insurance in Georgia with the support of KfW, the German development bank. In line with KfW's recommendation, GEL 10.0mn has been allocated in the 2016 preliminary budget for agricultural insurance.

The state-owned Georgian Amelioration Company (GA) has made significant headway in expanding irrigation and drainage coverage. Expanding coverage is of paramount importance, as eastern Georgia has little rainfall and needs irrigation, while the western part receives excessive rainfall and needs to be equipped with drainage systems. Of the 290,800 hectares of sown area, 97,000 hectares are irrigated as of October 2015 (up 10.2% y/y in 2015). Drainage infrastructure is provided for 28,375 hectares of land (up 5.1% y/y in 2015). GA plans to provide irrigation for a total of 278,000 hectares of land (3x more than is currently irrigated) and drainage systems for 105,000 hectares (almost 4x more). The irrigation fee stands at GEL 75.0/ha for Eastern Georgia and GEL 45.0/ha for Western Georgia; the drainage fee is GEL 40.0/ha. The fees are not reflective of the actual costs that GA incurs for irrigation and drainage provision, as the services are heavily subsidized by the government. The MoA budget allocation to GA for 2015 is expected to amount to GEL 67.1mn, including service subsidies and expenditures for modernization and development of irrigation and drainage infrastructure.

The Agricultural Project Management Agency (APMA) facilitated concessional loans totaling GEL 723.0mn in 2013-2014 through the commercial banking sector. The total number of concessional loans at the end of 2014 was 27,177, with the government subsidizing 11.0% interest on loans issued to purchase fixed assets for agricultural enterprises. Loans issued for working capital were subsidized at 8.0% interest. According to APMA this practice will be discontinued, except for some specific instances (e.g. seasonal: grapes, tangerines). Loans are administered by commercial banks and the applicants must meet the bank's requirements to qualify as commercially viable. The government has allocated GEL 30.0mn for the subsidies in 2015, down 30.0% y/y from 2014 actual expenditure of 42.8mn. The loan portfolio in the sector has been expanding since 2013, with 8M15 growth rates of 64.8% y/y and 6.0% y/y in national and foreign currencies, respectively. Loans to the primary agricultural commodity sector made up 1.6% of the total banking sector GEL loan portfolio and 2.9% of the total FX loan portfolio in 8M15.

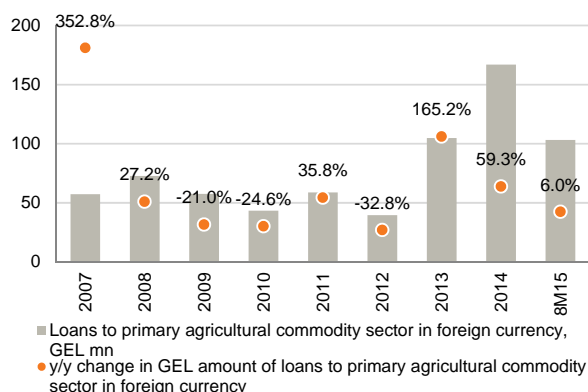


Figure 12: Agricultural sector GEL loan portfolio dynamics, GEL mn



Source: National Bank of Georgia

Figure 13: Agricultural sector FX loan portfolio dynamics, GEL mn

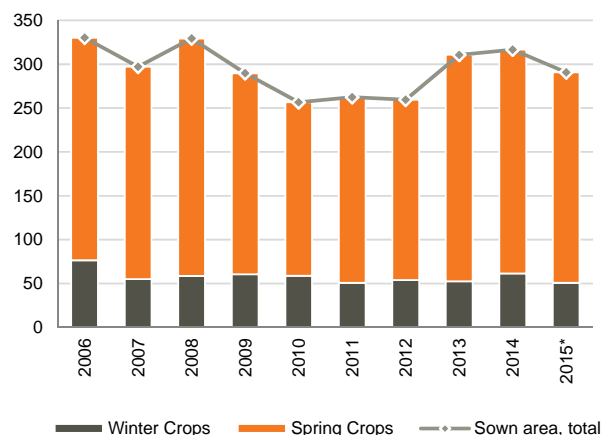


Source: National Bank of Georgia

The government is supporting the development of agricultural cooperatives to battle the inefficiency caused by the prevalence of small land plots and large number of smallholder farmers. APMA promotes cooperation among smallholder farmers, facilitates donor and IFI funding for rural development, supports training programs, and organizes agricultural cooperative fairs to promote cooperation in the agricultural sector. Ministry of Agriculture has GEL 3.3mn allocated in the 2015 budget for the purposes of supporting cooperative development. Some consolidation has taken place on the land market since the last census in 2004, according to which almost three-fourths of total agricultural holdings were between 0.1 and 1 hectare. The final 2014 census results regarding the land market are to be published in April 2016.

GEL 61.1mn has been allocated by the MoA to the smallholder farmer support program in the 2015 budget. GEL 59.5mn worth of seeds, fertilizers, pesticides, and land-sowing machinery has been supplied to farmers with land holdings below 1.25 hectares. Assistance was provided to approximately 800,000 farmers with total land holdings of 290,000 hectares (up 25% y/y in 2015). Despite government efforts, total sown area decreased 8.1% y/y in 2015, with declines in sown areas for wheat, barley, rye, and maize being the largest contributors, according to rapid estimates from the National Statistics Office of Georgia (Geostat). The government will not be subsidizing smallholders in 2016, according to the preliminary budget.

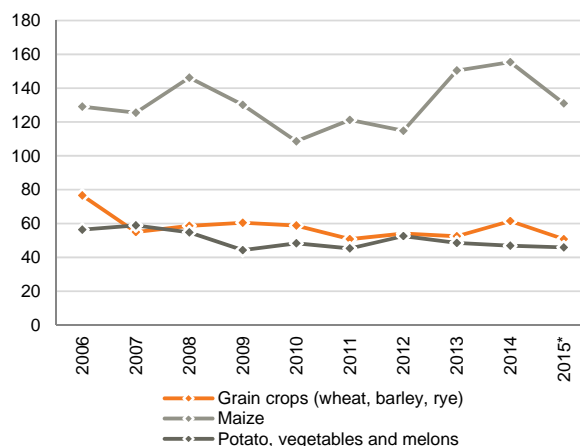
Figure 14: Total sown area, '000 hectares



Source: Geostat

* Preliminary data, exact numbers will be available on June 2016

Figure 15: Total sown area for selected crops, '000 hectares



Source: Geostat



Subsidized crops include grapes, apples, and citrus fruits. Due to low external demand in 2015, white grapes (Rkatsiteli, Kakhuri Mtsvane) are subsidized at GEL 0.35/kg and red grapes (Saperavi) at GEL 0.15/kg. As of October 2015, a total of GEL 22.0mn has been paid out in subsidies, according to the National Wine Agency (NWA). More than 124,000 tons of grapes were processed under the 2014 government subsidy program and the sale of grapes amounted to GEL 175.0mn, according to the MoA. According to the NWA, over 141,000 tons of grapes have already been sold in 2015, generating revenue of GEL 101.4mn. A support program for apples in 2014 provided a total budget allocation of GEL 3.0mn for subsidizing misshapen apples from the Shida Kartli region, whereby the government set a price floor of GEL 0.1 for the processing plants which buy these apples. Tangerines received a subsidy of GEL 2.0mn in 2014. Recent announcements indicate that citrus subsidies are highly likely to be introduced at the last minute, as was the case for grapes. In the preliminary 2016 budget, a new tea support program will receive GEL 3.5mn.

Foreign aid

Donor programs are in place to foster competitiveness in the Georgian agricultural sector, increase food security, and reduce rural poverty. EU assistance has been aimed largely at strengthening cooperation amongst small farmers. Donors see agricultural cooperatives as a way to reduce small-scale inefficiencies and ease access to extension services (research, consulting). A number of bilateral donors and IFIs have been active in providing support to the MoA and to the agricultural sector in the form of grants, loans and budget support programs. The bulk of this assistance is implemented through donor agencies.

Approximation with EU legislation is in process as certain standards must be met in order for EU countries to import Georgian products. There are up to 400 points in the approximation program for the agricultural sector regarding phytosanitary, food safety, and veterinary measures. EUR 2.3mn has been allocated by the EU ENPARD program to the National Food Agency for support in this area. Successful implementation is expected to boost agricultural exports to the EU and lead to diversification of the export portfolio.

The MoA strategy for 2015-2020 was approved by government decree in February 2015. The strategy was developed with funding support from ENPARD. The document aims to promote competitiveness and sustainability in agricultural and food processing sector, and encompasses a number of strategic directions. Please see Appendix 2 for further details of the strategy.



Appendix 1: Classification of Agricultural Products

Agricultural products

Primary agricultural commodities	Food	Beverages and tobacco
<ul style="list-style-type: none">• Growing of cereals and other crops• Growing of fruit, nuts, beverage and spice crops• Growing of vegetables, horticultural specialties and nursery products• Livestock farming• Agricultural service activities• Forestry and logging• Fishing and fish farming	<ul style="list-style-type: none">• Manufacture of grain mill products, starches and starch products; manufacture of prepared animal feed• Manufacture of bread; manufacture of fresh pastry goods and cakes; manufacture of rusks and biscuits; manufacture of preserved pastry goods and cakes• Meat and meat preparations; fish products• Animal and vegetable fats• Dairy and ice cream• Other food products	<ul style="list-style-type: none">• Production of mineral water and soft drinks• Manufacture of alcoholic beverages• Manufacture of tobacco products

Source: UN SITC, Geostat, G&T Research



Appendix 2: MoA Strategy Directions and Measures

Strategy Directions and Measures

Strategy directions	Enhanced competitiveness of rural entrepreneurs	Institutional development	Amelioration and soil fertility	Regional and sectorial development - value chain development	Ensuring food security	Food safety, veterinary, and plant protection	Climate change, environment, and biodiversity
Measure 1	Improved farmer knowledge and information, and the delivery of efficient agricultural extension service support	Improved MoA organizational structure and human resource management and training	Improved irrigation and drainage system	Defining and supporting rural development and investment strategies for each region	Monitoring food security	Developing efficient and flexible food safety system consistent with EU legislation and reflecting specific features of the agricultural market	Maintaining good agricultural practices, biodiversity, and environmental sustainability programs
Measure 2	Improved quality of vocational educational training (VET), university education and research within the food and agricultural sector	Supporting an efficient market information collection, processing, and dissemination among the various stakeholders engaged in agriculture	Rational use of soil	Development, implementation and monitoring of sectorial agricultural programs		Veterinary	Gene bank development/ management for conservation of agro-diversity and endemic species
Measure 3	Developing agricultural land market and introducing modern approaches to land use	Creating a farm registry		Supporting the further development of geographic indication schemes and appellations of origin		Plant protection and phytosanitary reliability	Promoting climate smart agriculture (CSA) practices
Measure 4	Developing specific tools to strengthen the agricultural credit and leasing system	Strengthening coordination between the MoA, donor community, and other stakeholders		Supporting the development of seed and planting material production		Laboratory capacity enhancement and establishment of modern testing techniques compliant with international standards	
Measure 5	Supporting development of agricultural insurance market			Supporting the seed/planting material certification process		Reviewing and developing border control veterinary and phytosanitary inspection points for agriculture import/export monitoring	
Measure 6	Supporting development of cooperation in agriculture			Development of breeding system			



Measure 7	Developing tools to increase awareness of agricultural investment opportunities	Strengthening post-harvest services, facilities, and operations
Measure 8	Implementing national agricultural products and food promotion program	Improving access to input supply services
Measure 9		Improving access to agricultural machinery

Source: Ministry of Agriculture



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