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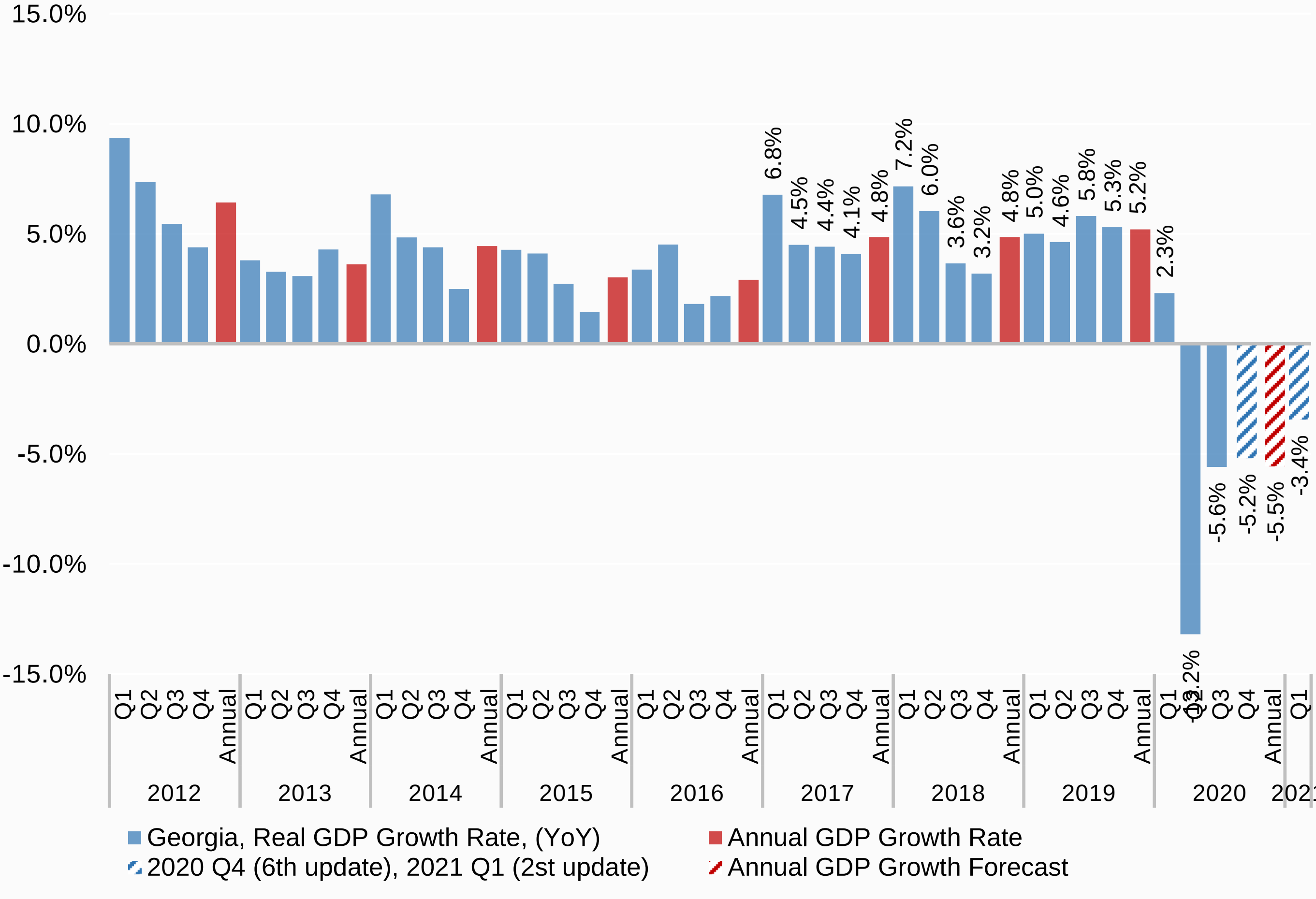
GDP Growth Projections for 2020 currently at -5.5%, but a Two Month Lockdown Means More Bad News for Growth Are Yet to Come

Figure 1 - Georgia, Real GDP Growth Rate (Y/Y)



ISET-PI has updated its real GDP growth forecast for the fourth quarter of 2020 and the first quarter of 2021. Here are the highlights of this month's release:

HIGHLIGHTS

- The real GDP growth rate amounted to -7.7% year-on-year for November 2020. Consequently, the estimated real GDP for the first eleven months of 2020 was -5.9%.
- Recently, Geostat has released its preliminary estimate of real GDP growth for the third quarter of 2020. The Q3 growth rate was -5.6% (down by 0.5 ppt relative to the forecast).
- Thus, the growth forecast for Q4 of 2020 was revised downward to -5.2%. ISET-PI's second forecast for Q1 of 2021 puts GDP growth at -3.5% (1.9 ppts lower than our previous prediction).

- Based on Novembers's data, we expect annual growth in 2020 to be -5.5%, which is 0.9 percentage points lower than the previous prediction.

ISET-PI typically provides the most accurate annual growth forecast after September data is incorporated in the forecast model, but this year the economic landscape is riddled with significant uncertainties related to COVID-19 pandemic (unpredictable epidemiological situation and different type of government regulations). The forecast, based on the past and current data does not yet fully account for the negative impacts of the second wave of COVID-19 outbreak[1] on the national economy, thus, quarterly and annual predictions tend to notably overestimate the reality[2]. Otherwise, looking at the economic landscape from the standpoint of the November data, several variables changed significantly and affected growth predictions in different ways.

External Merchandise Trade. In the face of the harsh measures that governments[3] in different countries have taken to overcome the second outbreak of the COVID-19 pandemic, trade in all commodities, except very few sectors (such as healthcare sector), is declining since the beginning of the healthcare crisis. In November, **Georgia's exports experienced a 13.4% annual decline.** This drop was driven by a reduction in the re-export of motor cars and trucks from Armenia, alongside the declining re-export of motor cars from Azerbaijan; export/re-export of motor cars, medicines, natural grape wines and mineral waters to Kyrgyz Republic; and export of copper ores and concentrates to Romania and China. There was, however, a slight increase in the export of precious metals, and copper ores and concentrates to the United States and Spain; and the export of nuts and walnuts to Germany.

During this period, **the import of goods decreased by 12.1%**, driven by a reduction in petroleum and fuel product imports from Russia (mostly due to a significant annual reduction of crude oil prices on the international market) and imports of motor cars from Turkey. Among other affected imports were: motor cars from USA; coper ores and concentrates from Chile; oil coke-bitumen and paving slabs from Iran; and motor cars from Germany. In contrast, Georgian imports of copper ores and concentrates from Brazil and Peru; and imports of oil and petroleum products from Azerbaijan experienced yearly growth. Consequently, **the trade deficit shrank dramatically by 11.3% yearly**, and amounted to 417.8 million USD. *Overall, trade related variables had a positive contribution to the GDP growth forecast.*

Money Inflow. After a significant slowdown in money inflows in the beginning of the year, remittance inflows were on the path of recovery. In October, **remittances increased by 12.5% yearly.** The main contributors to this increase were Ukraine (by 124.4% YoY, contributing 3.5 ppts), Italy (by 27.7% YoY, 3.6 ppts), USA (by 35.6% YoY, 3.4 ppts), Greece (15.4% YoY, 1.6 ppts), Germany (by 65% YoY, 2 ppts), Azerbaijan (by 208.1% YoY, 2.5 ppts), and Turkey (by 14.7% YoY, 0.76 ppt). Whereas money inflows decreased from the Kyrgyz Republic (by 66.4% YoY, -2 ppts), Russia (by 16% YoY, -4 ppts), Kazakhstan

[1] There is no consensus among epidemiologists that recent outbreak of COVID-19 is a second wave of health crisis (some of them claim that is actually the first wave of the COVID-19 outbreak in Georgia).

[2] Especially taking into consideration the fact that the average real GDP growth in October-November amounted to -5.8, and epidemiological situation and government restrictions were even more severe in December.

[3] Including Georgia and most of the trade partner countries.

(by 26% YoY, -0.5 ppt) and Poland (by 15% YoY, -0.3 ppt). *The recovery of remittances flows made a positive contribution to the growth forecast.*

International Visits and Tourism. Tourism arrivals and receipts declined sharply as a result of numerous travel bans, as well as precautionary behaviors on the part of potential tourists. In November, **the number of international visitors[4] decreased by 91.6% yearly** (driven by Russia [-14.4 ppts], Azerbaijan [-20.4 ppts], Armenia [-19.9 ppts] and Turkey [-11.8 ppts])[5], while the decline in tourist numbers (visitors who spent 24 hours or more in Georgia) amounted to 88%. *Overall, dramatically declining numbers of visitors and tourists, along with a sharp decrease in touristic spending has made a significant negative contribution to the growth forecast.*

Real Effective Exchange Rate. In November, the Georgian lari real exchange rate sharply depreciated in both monthly and yearly terms against all main trading currencies. **The Real Effective Exchange Rate (REER) depreciated by 2.8% relative to the previous months, and also by 2.8%, relative to the same month of the previous year.** Notably, the lari real exchange rate depreciated with respect to the euro and the US dollar by 2% and 1.8% respectively in monthly and by 12.7% and 8% respectively in yearly terms. REER depreciated with respect to the two major trading partners – Turkey and Russia by 3.5% and 3.4% respectively in monthly terms and appreciated by 13.5% and 7.5% in yearly terms. **It is also notable that during November-December of 2020 NBG sold about 223.6 million USD in foreign currency reserves** (173.8 million USD in November and 49.8 million USD in December)[6]. **In addition, the Monetary Policy Committee (MPC) of the National Bank of Georgia (NBG) met on December 9, 2020, and decided to keep its Policy Rate unchanged at 8%.** The committee has taken into consideration dynamic of the annual inflation, weak aggregate demand due to health crisis, expected increase of pandemic-related fiscal measures for social and economic support, increased production costs due to additional restrictions in the wake of the pandemic, and high dollarization of the economy[7]. Depreciation of the REER is typically associated with domestic export goods gaining competitiveness on the foreign markets, but it also translates into increased prices on imported goods. *Overall, REER-related variables had a small negative contribution to the real GDP growth projections.*

Inflation. In November, the annual inflation of consumer prices amounted to 3.8%, which is only slightly higher than the targeted 3%. Notably, inflation converged to the targeted value at the end of 2020. Approximately 1.7 percentage points of CPI inflation were related to higher food prices (6% annual increase), while tobacco prices contributed 0.3 percentage points (10% annual growth). However, decreased oil prices made a notable negative contribution (0.8 ppts) to the annual inflation measure. **The latter trend is mostly a reflection of significantly weakened oil prices on the global market (Euro Brent Spot Price (COP) decreased by 32.5% yearly).** Meanwhile, the measure of core inflation amounted to 4.8%. *Overall, CPI related variables had a positive contribution to the GDP forecast.*

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[4] While international travel trips decreased by 93.1% annually.

[5] Countries from Central and Eastern Europe accounted for 61.4 ppts of annual reduction of international visitors.

[6] In 6th January, NBG sold 40 million USD reserves n the foreign exchange market.
[7] For more information please see the following source: https://www.nbg.gov.ge/index.php?m=340&newsid=4107&lng=eng.

World Prices. The other variables highlighting a negative contribution to the growth forecast are the Metals Price Index (PMETA) and the Agricultural Raw Materials Index (PRAWM). Metals form a significant share in Georgia's exports, while food and oil are among the main imports. Therefore, a global increase in the price of metal will likely cause improvement to the Georgian economy, whereas an increase in the price of agricultural products will be damaging. **In annual terms, metal prices increased by 18.4% in November, while raw agricultural material prices increased by 9.3%.** *Adding the PMETA and PRAWM indicators to the model thus decreases the growth forecast for both quarters.*

Money Supply. All monetary aggregates, including the largest, Broad Money (M3), and the smallest, Narrow Money (M0), experienced significant yearly growth: 18.9% and 9,7%, respectively. Moreover, currency in circulation increased by 9% yearly. However, some of the monetary aggregates, including currency in circulation, M0, M1 and M2 aggregates, declined in monthly terms. *Overall, money supply related variables had a slight negative contribution to the real GDP growth for the last quarter of 2020 and slight positive contribution to the real GDP growth for the first quarter of 2021 based on our model.*

Our forecasting model is based on the Leading Economic Indicator (LEI) methodology developed by the New Economic School, Moscow, Russia. We have constructed a dynamic model of the Georgian economy, which assumes that all economic variables, including GDP itself, are driven by a small number of factors that can be extracted from the data well before the GDP growth estimates are published. For each quarter, ISET-PI produces five consecutive monthly forecasts (or "vintages"), which increase in precision as time passes. Our first forecast (the 1st vintage) is available around five months before the end of the quarter in question. The last forecast (the 5th vintage) is published in the first month of the next quarter.