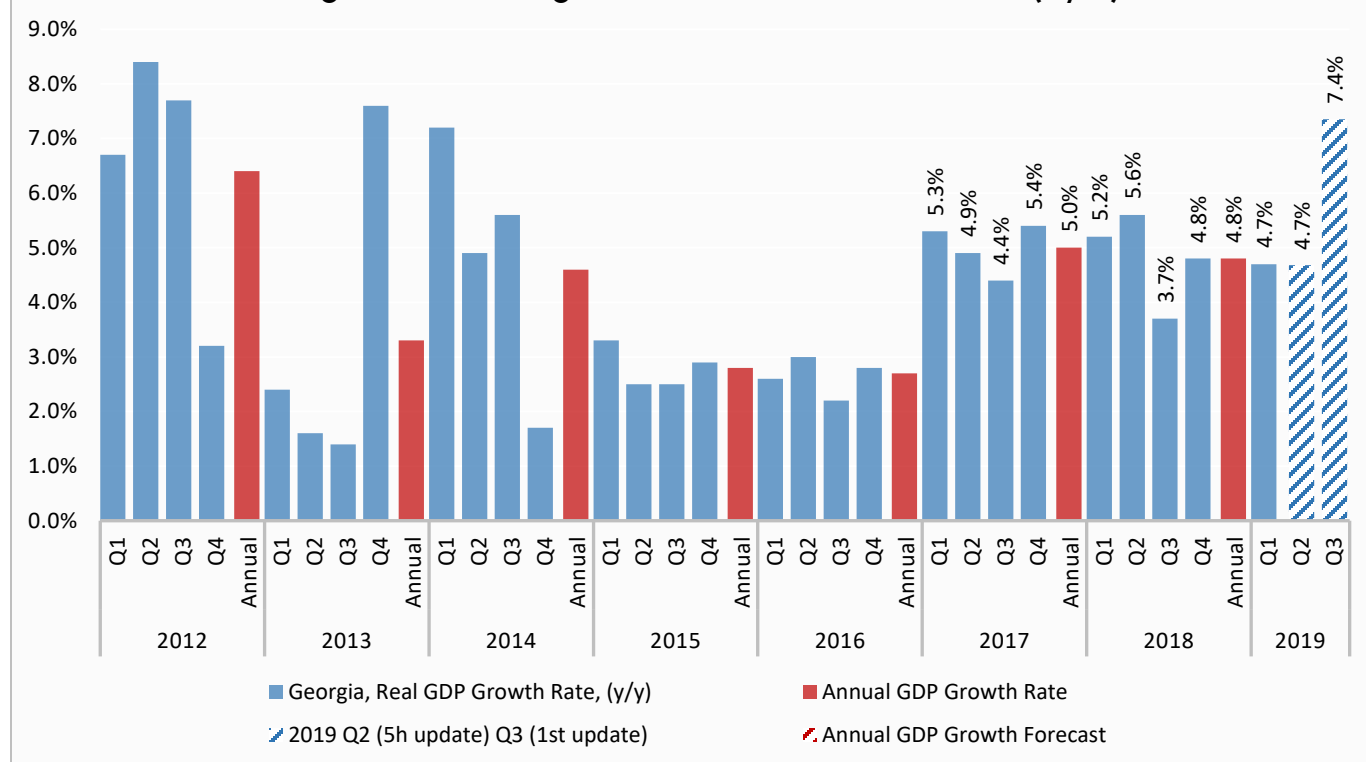




By Davit Keshelava and Yasya Babych

Trade Deficit Shrinks, as Exports, Tourism and Remittances Show Strong Growth in April

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



ISSET-PI has updated its forecast of Georgia's real GDP growth rate for the second quarter of 2019. Here are the highlights of this month's release:

Highlights

- ISSET-PI's forecast of real GDP growth for the second quarter of 2017 has not changed and stands at 4.7%. The first estimate of the third quarter growth forecast is at 7.4%¹.
- The real GDP growth rate reached 5.1% year-on-year for April 2019. Consequently, the estimated real GDP for the first four months of 2019 amounted to 4.8%.

¹ Based on the historical observations of ISSET-PI's model, the first estimate of third quarter GDP growth forecast is expected to overestimate reality at least a few percentage points. This is mainly due to the timing of information flow, with data being available only for the 1st month of the 2nd quarter.



- Based on April's data, we expect annual growth in 2019 to be **5.5% in the worst-case or “no growth” scenario, and 5.9% in the best-case or “average long-term growth” scenario. Our “middle-of-the road” scenario (based on average growth over the last four quarters) predicts 5.6% real GDP growth in 2019.**

Sharp ups and downs of the year-on-year growth rate from one quarter to the next are not usual. Typically, quarterly growth rates follow particular patterns, which are captured by ISET-PI's empirical forecast model. Therefore, the unusually high growth in the first quarter could result in overly optimistic predictions about next quarter's performance.

Indeed, the forecast for Q3 is largely influenced by the high Q1 actual growth and is expected to overestimate reality. Yet, looking at the economic landscape from the standpoint of the April data, several variables changed significantly and effected growth predictions in different ways. The increase of money supply and significant improvements in external statistics (exports, imports) are the main positive drivers of the optimistic growth figures, while moderately high inflation and credit restrictions had a negative impact on the forecast value.

The first set of variables that had a significant positive effect on our forecast is related to the money supply.

The Monetary Policy Committee of the National Bank of Georgia met in May, and decided to leave the monetary policy rate unchanged at 6.5%². Moreover, the National Bank of Georgia did not make any foreign exchange market interventions in April 2019. However, all of the monetary aggregates, including the largest—Broad Money (M3)—experienced significant yearly growth (M3 aggregate rose by 18.9% yearly). The largest increase was observed for Monetary Aggregate M1, which went up by 23.7% relative to the same month in the previous year. Moreover, Currency in Circulation increased by 19.5% in yearly terms (all of the monetary aggregates increased in monthly terms as well).

Rapid expansion of monetary aggregates contributed positively to the real GDP growth forecast.

The other set of variables that had a notable positive impact on the GDP forecast is related to external factors.

A great majority of the countries in the wider region continued their strong growth path in the first quarter of 2018. According to the rapid estimates of real GDP growth, Armenia and Azerbaijan maintain relatively high annual growth rates: 6.6% and 3.0% in the first quarter of 2019. Moreover, Russia advanced on average by 0.7%, in April-June 2019, compared to this period the previous year³. Only the Turkish economy is still far behind its peer countries, shrinking by 2.6% yearly in the first quarter of 2019, following a 3% contraction in the previous period and compared with market expectations of a 2.5% contraction⁴. **Favorable economic conditions in the wider neighborhood stimulated the Georgian economy through the trade, remittance, and tourism channels. However, political instability and deteriorated economic conditions in Turkey still remain the primary external threat to the Georgian economy.**

² It is notable that the Monetary Policy Committee of the National Bank of Georgia reduced the monetary policy rate by 0.25% twice, in January and March of this year.

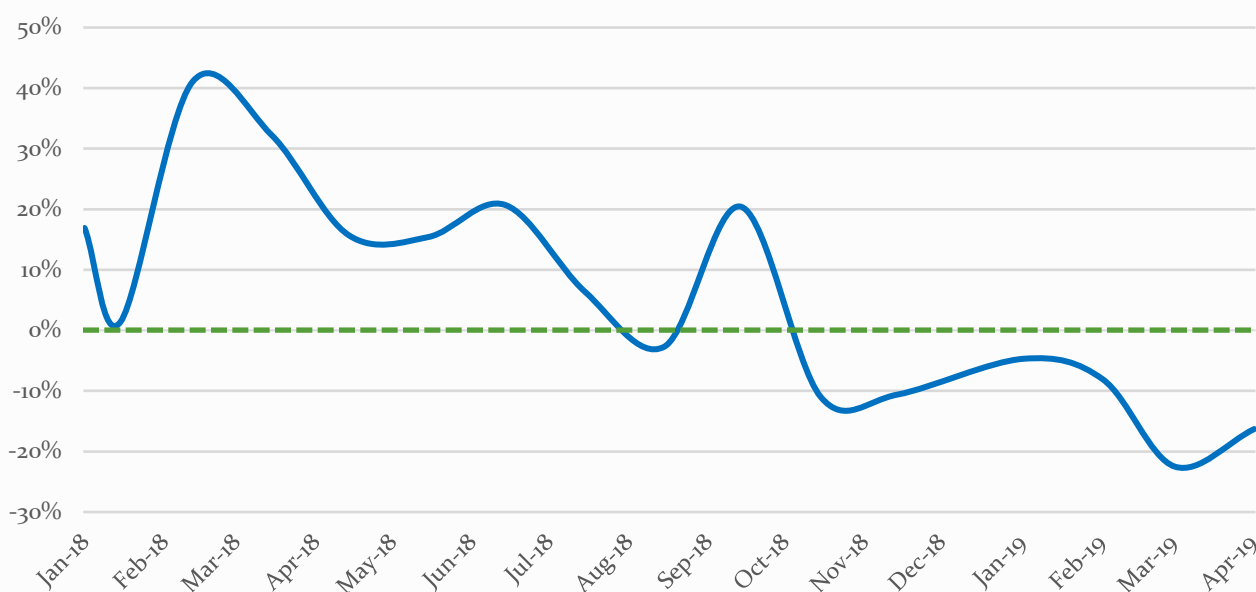
³ It is notable that even though the Russian economy contracted by 0.1% yearly in March, it still maintains a positive growth rate quarterly.

⁴ It was the second straight quarter of GDP decline, as household consumption and gross fixed capital formation continued to decrease while government expenditure advanced faster and net foreign demand contributed positively to growth.



As mentioned earlier, the improved economic conditions in Georgia's partner countries contributed to real GDP growth through trade, remittances, and tourism. Notably, exports grew by 34.2% year-over-year in April of 2019, driven by significantly larger exports/re-exports of copper ores and concentrates (surprisingly increasing by 2.7 times yearly), and motor cars (up by 99% yearly). However, the exports of cigars, cheroots, cigarillos and cigarettes, and ferro alloys declined by 45.5% and 26.9% respectively compared to the same month of the previous year. During the same period, imports increased by only 0.6%, driven by the import of copper ores and concentrates, packed medicines (the latter two used mostly for re-export), and digging and drilling machines, while the import of petroleum (notably, world prices of crude oil decreased by 1.2% yearly and increased by 7.7% monthly) and motor cars had a negative contribution to imports. **As a result, the trade balance improved by 16.3%, compared to the same month in 2018, and reached -423.1 million USD.**

Figure 2: Growth Rate of the Trade Deficit



Source: National Statistical Offices

Both remittances and tourism showed significant yearly increases in April 2019. Money transfers rose by 10.1% yearly in the fourth month of 2019, driven by remittances from the USA (up by 15.2% yearly), Italy (up by 25.8% yearly), Greece (up by 8.6% yearly), France (up by 41.1% yearly), and Ukraine (up by 30.8% yearly). Remittances from the Russian Federation and Turkey experienced a slight yearly decline and had a 0.6 and 1.4 percentage point negative contribution to the total growth of remittances, respectively. In addition, the number of international visitors increased by 3.7% in April, compared to the same month of the previous year, while the number of tourists increased by 4.2% annually and reached 63% of total international visitors. **According to the model, both tourism and remittances had a significant positive contribution to the GDP growth forecast.**



The one variable that had a slight negative contribution to the growth figure was the Metals Price Index (PMETA). The reason for including this variable in our forecast model was that metals form a significant share of Georgia's exports. Therefore, a global increase in the price of metals should help the Georgian economy. In April, metal prices went down by 5.6% annually, but increased by 0.6% in monthly terms. **Overall, the Metals Price Index had a very small, but overall negative effect on our predictions of GDP growth in the second and third quarters.**

On the negative side, the increase in Consumer Price Index (CPI) dampened our growth predictions. In April, the annual inflation rate reached 4.1%, which is 1.1 percentage points higher than the targeted 3%. The main contributor to the annual price increase was the increased excise tax on tobacco (making the excise tax equal on filtered and unfiltered cigarettes⁵) and increased food prices, which contributed to annual inflation by 1.3 and 1.7 percentage points respectively. However, one should note that this type of tax hike (excise on tobacco) can increase only the level of prices, not the inflation rate going forward (it is a one-time factor) and is expected to be exhausted next year. It is worth mentioning that core inflation (inflation excluding the most volatile petroleum and food prices) remains at a low level of 1.4%.

As we mentioned in our previous report, new lending regulations could potentially have a negative impact on short-term growth predictions. In April 2019, the *total volume of commercial banks' consumer credit* increased by only 1.1% yearly and even decreased by 0.1% monthly. However, the *volume of commercial banks' short-term consumer credits* decreased by 62.9% and 5.2% in yearly and monthly terms respectively (the main driver behind this negative trend being consumer loans in the national currency). Whereas, *the volume of commercial banks' long-term consumer credits* increased by 30.9% and 4.3% yearly and monthly respectively. **Overall, the variables related to consumer credit have had a slightly negative impact on the growth forecast.**

Our forecasting model is based on the Leading Economic Indicator (LEI) methodology developed by the [New Economic School](#), Moscow, Russia. We 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 goes on. Our first forecast (the 1st vintage) is available about 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.

⁵ After equalizing the excise tax on filtered and unfiltered cigarettes, the price on unfiltered cigarettes increased by 103%, while the annual growth of prices for filtered imported and local cigarettes was 30% and 31% respectively.