

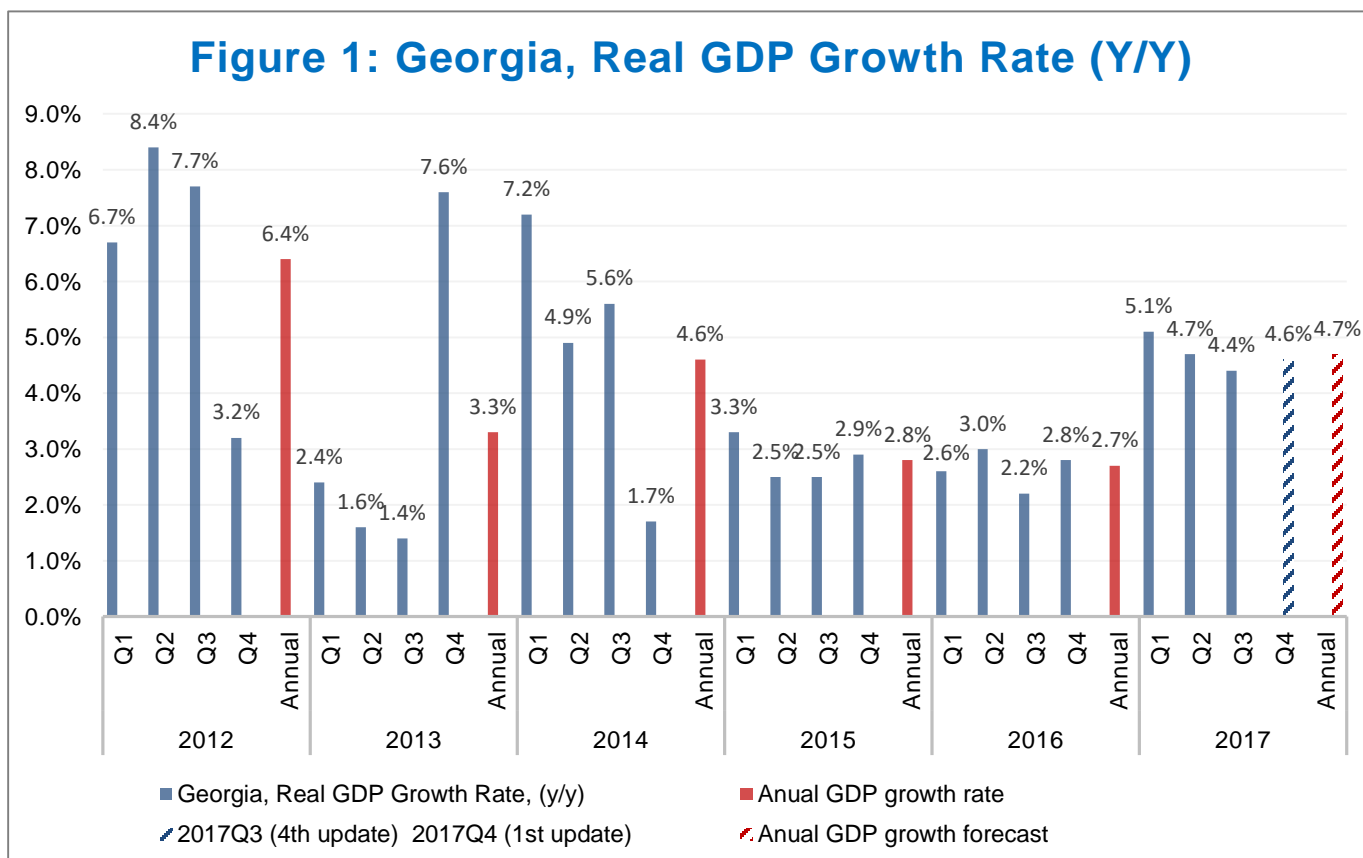


Authors: Davit Keshelava and Yasya Babych

The end (of the year) is near. ISET-PI GDP growth forecast predicts 4.7% real growth in 2017

ISET-PI has updated its forecast of Georgia’s real GDP growth rate for the fourth quarter of 2017. Here are the highlights of this month’s release:

- Recently, Geostat has released the preliminary estimate of the real GDP growth for the third quarter of 2017. The Q3 growth rate now stands at 4.4%, which is 1.5% below the ISET-PI’s last forecasted value. As a result, the estimated real GDP growth for the first nine months of 2017 amounted to the 4.7%.
- ISET-PI’s revised its forecast of real GDP growth for the fourth quarter of 2017 to 4.6%.
- Based on September’s data, **we expect annual growth in 2017 to be 4.7%**. This number is in line with the National Bank of Georgia’s growth forecast for 2017 (the forecast was recently revised by NBG upward from 4% to 4.5%). According to the latest Monetary Policy Report¹, the upward growth revision is based on the *improved trade balance, increased consumption and investment, supported by rising money inflows and improved business confidence*.



Source: National Bank of Georgia (NBG)

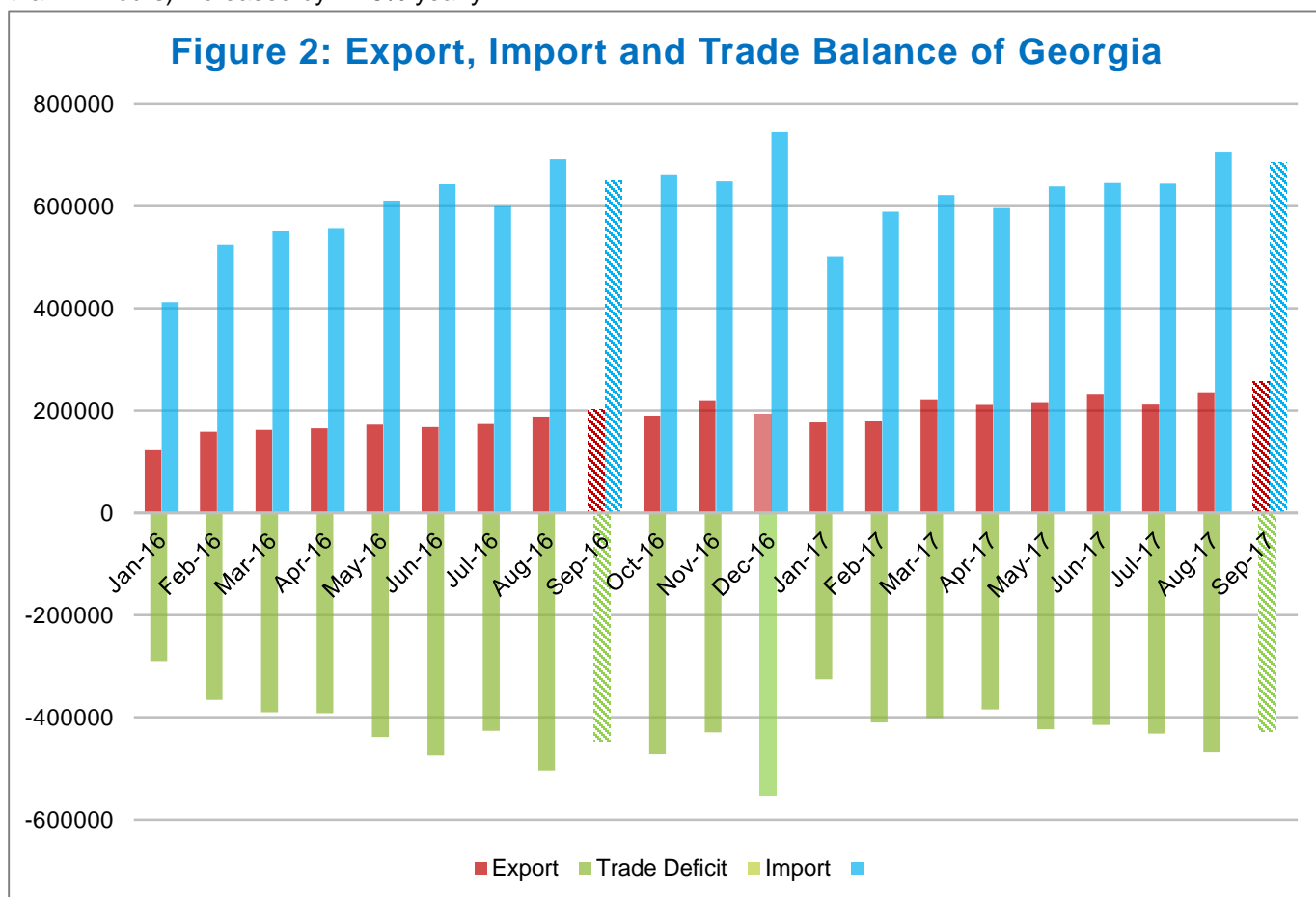
¹ November 2017, https://www.nbg.gov.ge/uploads/publications/inflationreport/2017/mpr_2017q4_publish_eng_brief.pdf



Since our last forecast, a few changes in the economic data landscape stand out as significant:

1. Trade, remittances and tourism

External sector had a large and positive effect on the GDP forecast. A surging demand from the neighboring countries **dramatically boosted Georgia’s exports** – 27.3% relative to the same month of the previous year. **Imports of goods and services** increased only moderately by 5.5% in yearly terms. As a result, the **trade balance (net-export)** improved by 4.3% (trade deficit was reduced by 427.3 million US Dollar, see the graph below). In addition, **remittances inflows and tourism** maintained double-digit growth in September. Money inflow increased by 23.8% compared to the same month of the previous year, while the number of tourists (visitors staying in Georgia for more than 24 hours) increased by 24.8% yearly.



Source: National Bank of Georgia (NBG)

2. National currency deposits of various maturities in commercial banks

Nearly all types of national currency deposits *increased significantly* both in yearly and monthly terms between August to September. **Demand Deposits, Time Deposits, and Time Deposits with maturity less than 3 month** increased dramatically by 65%, 63% and 181% respectively compared to the same month of the previous year. The increase was palpable, but much more moderate for the large and very liquid **National Currency Current Account**, which



went up “only” by 10% yearly and 5% monthly. The only variable that experienced a decline in this group was **Time Deposits with maturity more than 12 month** (decreased by 23% in yearly terms).

Thus, the aggregate measurement of the national currency deposits – **National Currency Total Deposits** - increased by more than 38% yearly.

3. Deposit Dollarization

A variable which is related to national currency deposit accumulation and also influences the ability of NBG to conduct monetary policy is **Dollarization Ratio of the total non-bank deposits**. This variable was reduced by 0.1 percentage points to **65.4% in September**. (In the meanwhile, Dollarization Ratio of the total credit portfolio was reduced by 0.6 percentage point and amounted to 56.7%.)

From the standpoint of our forecast, even a slight reduction in deposit dollarization ratio is welcome news, as the accumulation of national currency deposits increases national savings, investments and fosters economic growth in the long run. **Indeed, we can see from the forecast that an increase in the National Currency Deposits related variables had a positive contribution to the GDP growth projection.**

4. Currency in Circulation

The other set of variables that had a significant positive effect on our forecast is related to **currency in circulation**.

The Monetary Policy Committee (MPC) of the National Bank of Georgia (NBG) met on September 6th and decided to leave the policy rate unchanged at 7%. NBG also did not intervene in the foreign exchange market in September. However, all monetary aggregates, including the largest **Broad Money (M3)**, increased significantly (by 4% monthly and 19% yearly) in September. The largest yearly increase was observed for **Monetary Aggregate (M2)** which went up by 22% relative to the same month of the previous year. Moreover, **Currency in Circulation** itself increased by 14% in yearly terms.

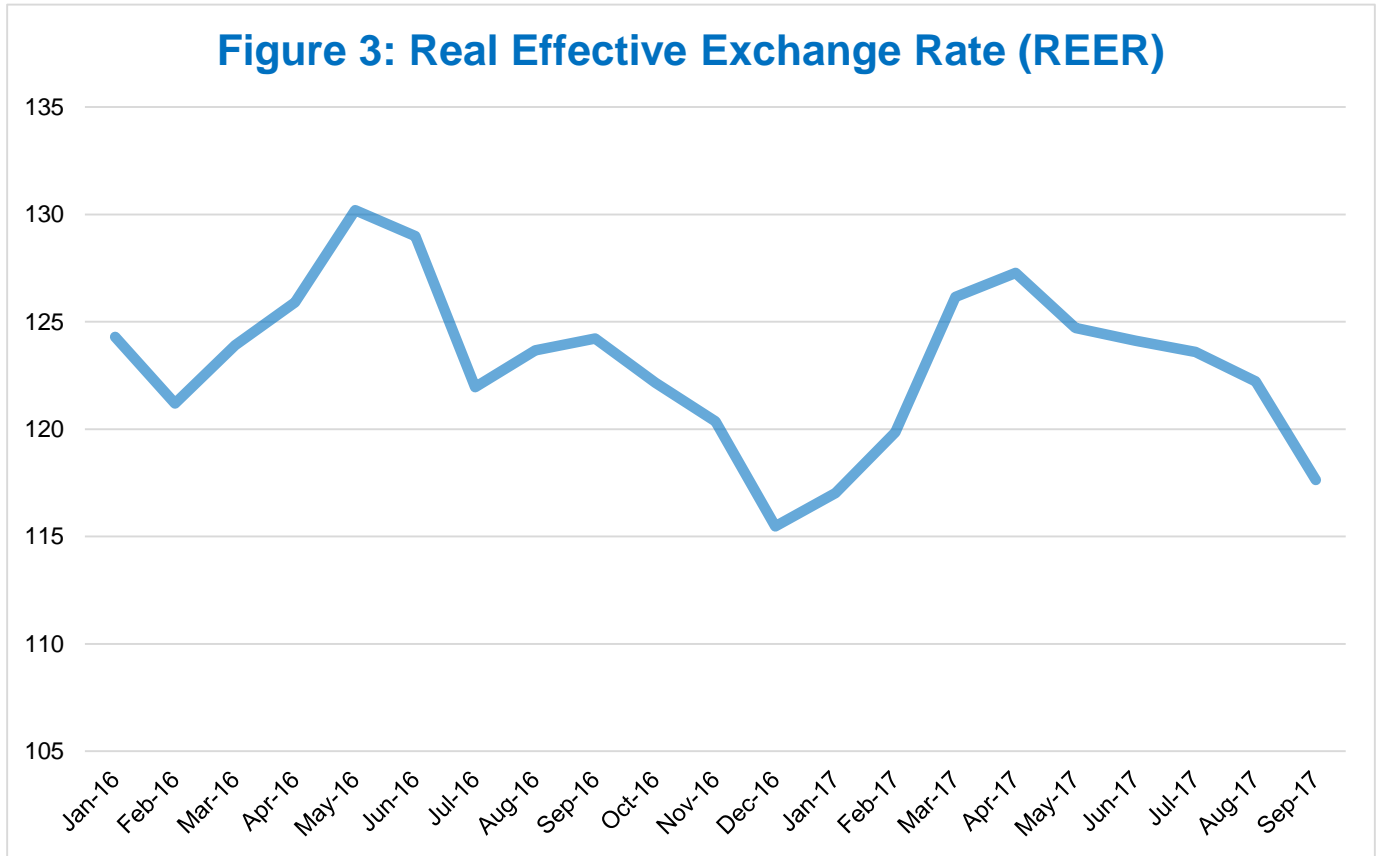
5. Exchange rate measures

The depreciation of the **Real Effective Exchange Rate (REER)** had a small but negative contribution to the Q4 real GDP growth projections.

REER depreciated by 4% monthly and 5% yearly in September (see the graph below). The **Lari Real Exchange Rate (RER)** depreciated monthly with respect to the national currencies of the United States (3%), Russia (5%), The EU (4%), and Turkey (4%). Theoretically, the negative impact of REER depreciation should not be surprising, given that



the overall impact of REER on real GDP growth is ambiguous². Nevertheless, the negative impact of lari depreciation in September was likely quite small and counterbalanced by significant growth in the external sector variables.



Source: National Bank of Georgia (NBG)

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 the 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 (1st vintage) is available about five months before the end of the quarter in question. The last forecast (5th vintage) is published in the first month of the next quarter.

² For more information see the end of the second page: http://iset-pi.ge/images/GDP_Forecast/2016_GDPForecast_October.pdf