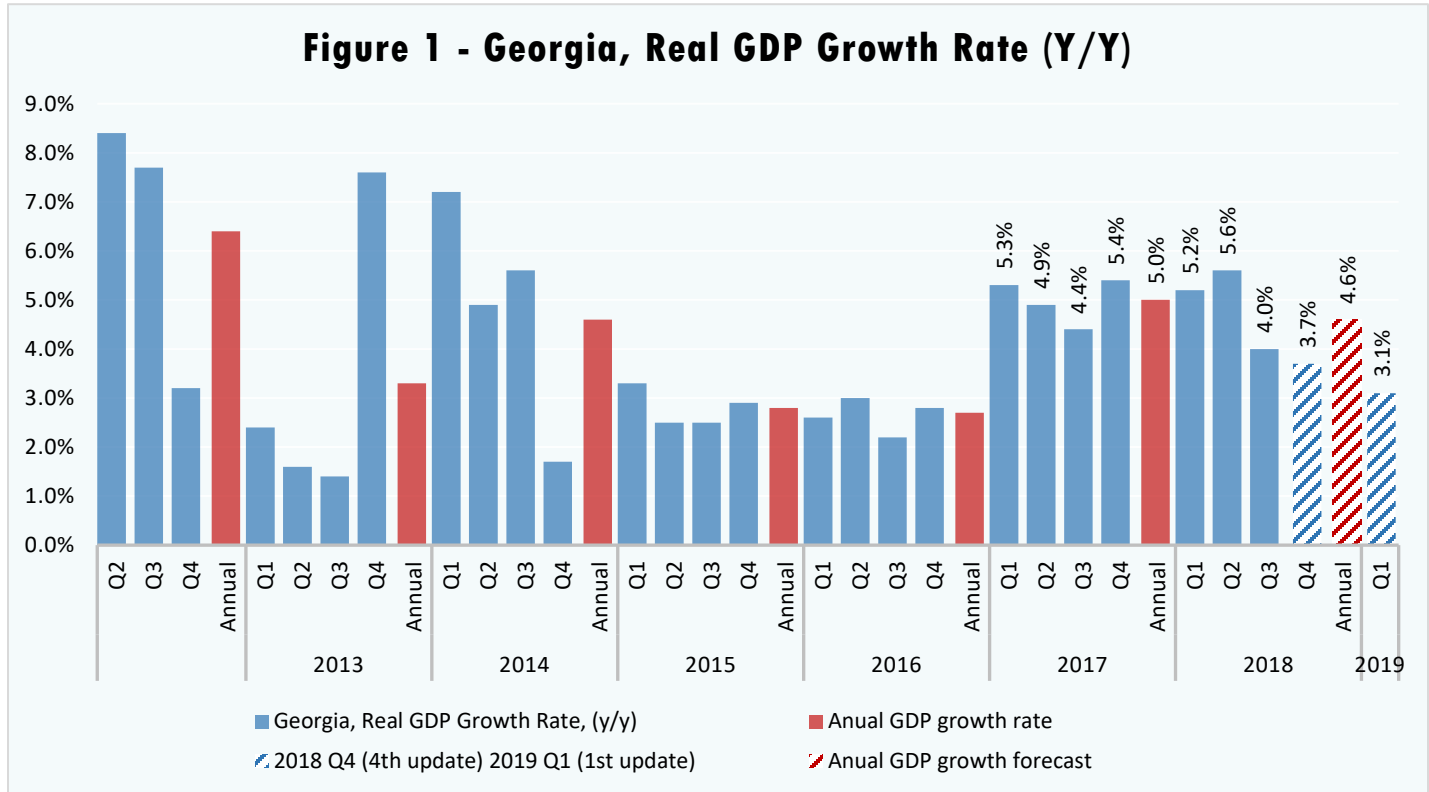




Real GDP growth is expected to reach 4.6% in 2018, as manufacturing, trade and construction sectors drive strong performance in October

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ISSET-PI has updated its forecast of Georgia's real GDP growth rate for the fourth quarter of 2018, and the first quarter of 2019. These are the highlights of this month's release:

Highlights

- Geostat recently updated its preliminary estimate of real GDP growth for the first and second quarters of 2018. The Q1 and Q2 GDP growth estimates were revised downward to 5.2% and 5.6%, respectively. The third quarter estimates so far remained unchanged.
- The real GDP growth rate reached 6.7% year-on-year for October 2018. Consequently, the estimated real GDP for the first ten months of 2018 was 5.1%.
- ISET-PI's real GDP growth forecast for the fourth quarter of 2018 remains at 3.7%.
- Based on October's data, we expect the annual growth in 2018 to be 4.6%.
- The growth rate in the first quarter of 2019 is predicted to be 3.1%.

Based on the available data from October, the growth forecast for 2018-2019 remains largely stable. While the changes in the current GDP forecast do not appear to be significant, a few variables deserve our attention. In particular, **rapidly increasing national currency deposits; relatively high growth in manufacturing, trading and construction; improved tourism statistics; and reduced energy consumption** each played an important role in establishing the current GDP forecast.

National Currency Deposits

The first set of variables that have had a significant positive effect on our forecast relate to **national currency deposits in commercial banks**. In October, all types of national currency deposits from the most liquid - **currency in circulation (up by 10% yearly)** - to the least liquid - **time deposits with a maturity of more than 12 months (up by 39% yearly)** - experienced double-digit growth in annual terms. The largest yearly increase was again observed for **national currency time deposits with a maturity of less than 3 months**, which increased by 73%, relative to the same month of the previous year.

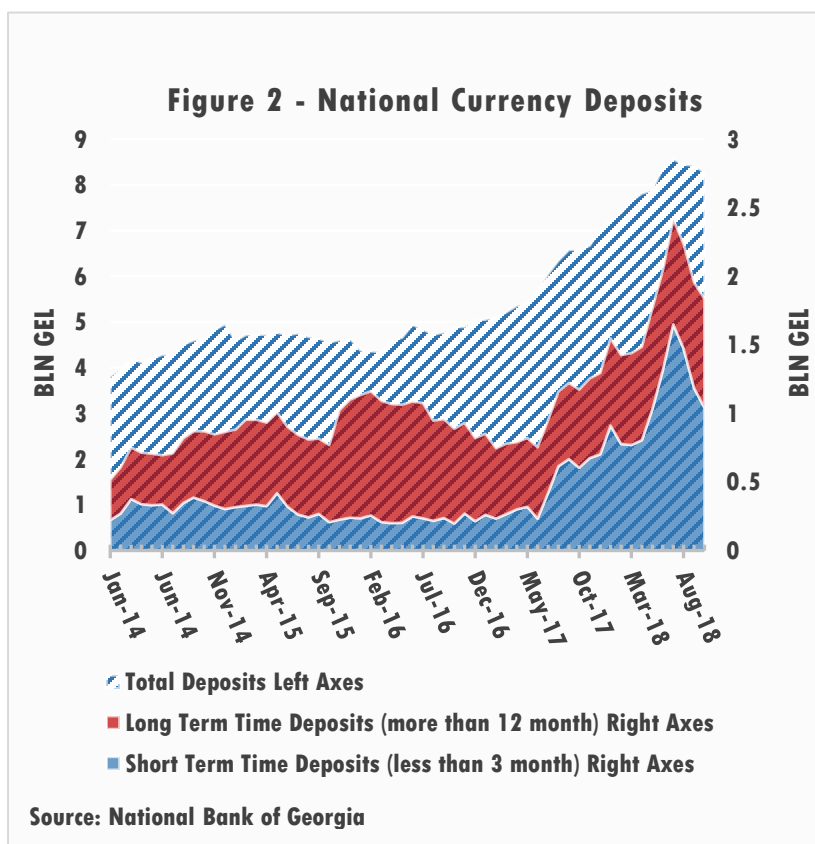
It is noteworthy that in a modern economy, the greatest proportion of a money supply is in the form of deposited currency, which is

created by commercial banks - banks accumulate the minor savings of individuals, and provide funds for investment projects that contribute to higher GDP growth. In Georgia, the money supply is principally measured by **broad money (M3 aggregate)**, and has increased significantly (14%) compared to October 2017.

Growth in Trading, Manufacturing, and Construction

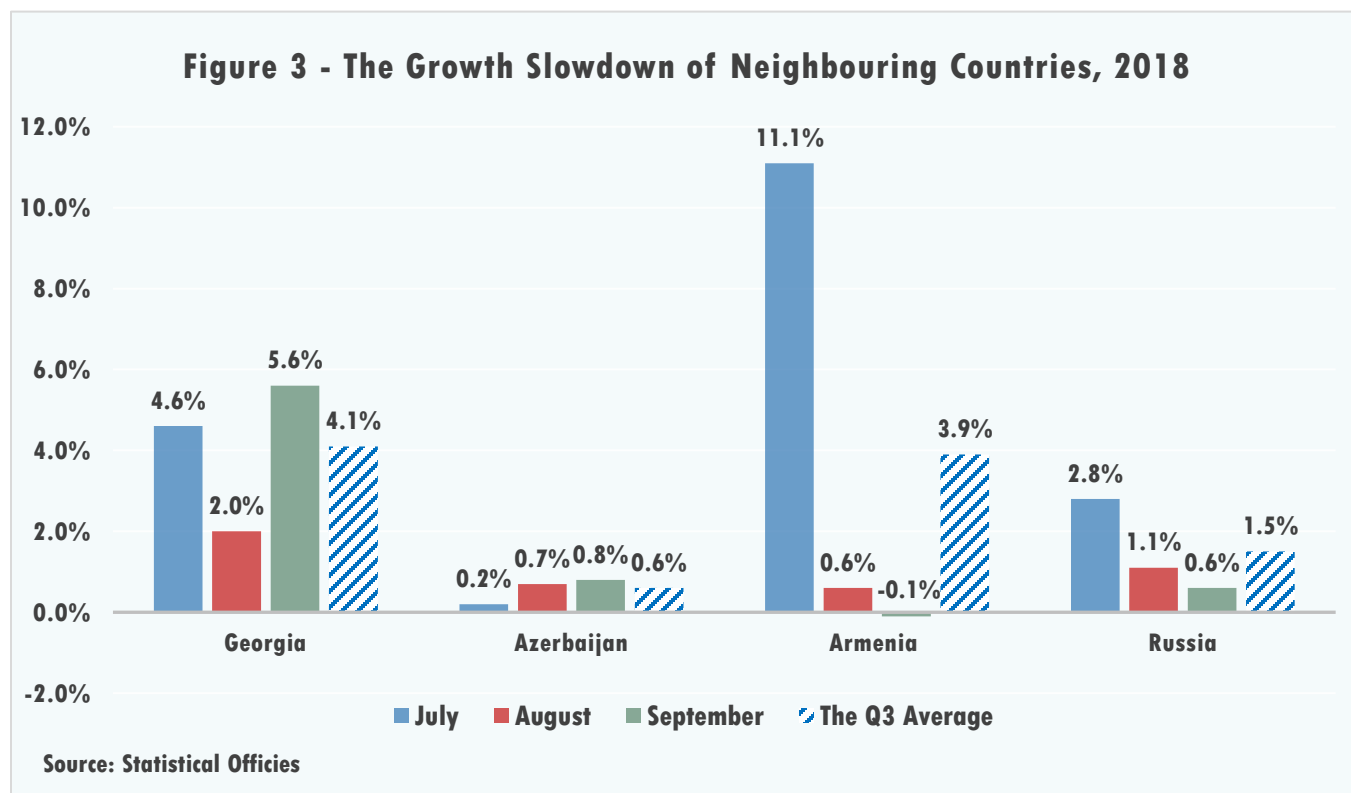
Developments in manufacturing and trade have positively affected our growth forecast. According to Geostat, the **manufacturing, trading and construction sectors** were the most important contributors to real GDP growth in October. Despite the region’s slowdown in growth (the average growth rate, in Q3 2018, for neighboring countries has reduced markedly - 3.9% in Armenia¹, 1.5% in Russia and only 0.6% in Azerbaijan), **Georgian exports**

¹ It is notable that the Armenian economy contracted by 0.1% in September compared to the same month of the previous year.





continued to expand, increasing by 15%, relative to the same month of the previous year. Moreover, **the re-export of Automobiles and export (partly re-export) of Cigarettes and Cigars** to Azerbaijan were the main contributors to total export growth.



Despite a reduction in Ferro-alloys exports to Russia and the re-export of Copper Ores and Concentrates to China, the overall export of Ferro-alloys and Copper Ores and Concentrates increased respectively by 65% and 12%, compared to the same month of the previous year (the main factors were the export of these goods to Spain and Bulgaria).

According to Geostat, the construction sector was another key contributor behind real GDP growth. The development of this sector was due to **infrastructural projects undertaken by the government of Georgia, in particular the building of roads and bridges.** In the first nine months of 2018, the Georgian government executed only slightly fewer than 81% of its planned infrastructural projects (as measured by the increase in non-financial assets). It is worth mentioning there is still no information available about the number of permits given to construction companies in October (this number reduced by 4.6% from January-September). **The development in the construction sector therefore contributes to the positive outlook on growth - it is widely recognized that infrastructural investment is one of the precursors of long-term growth.**

Tourism and Energy Sectors

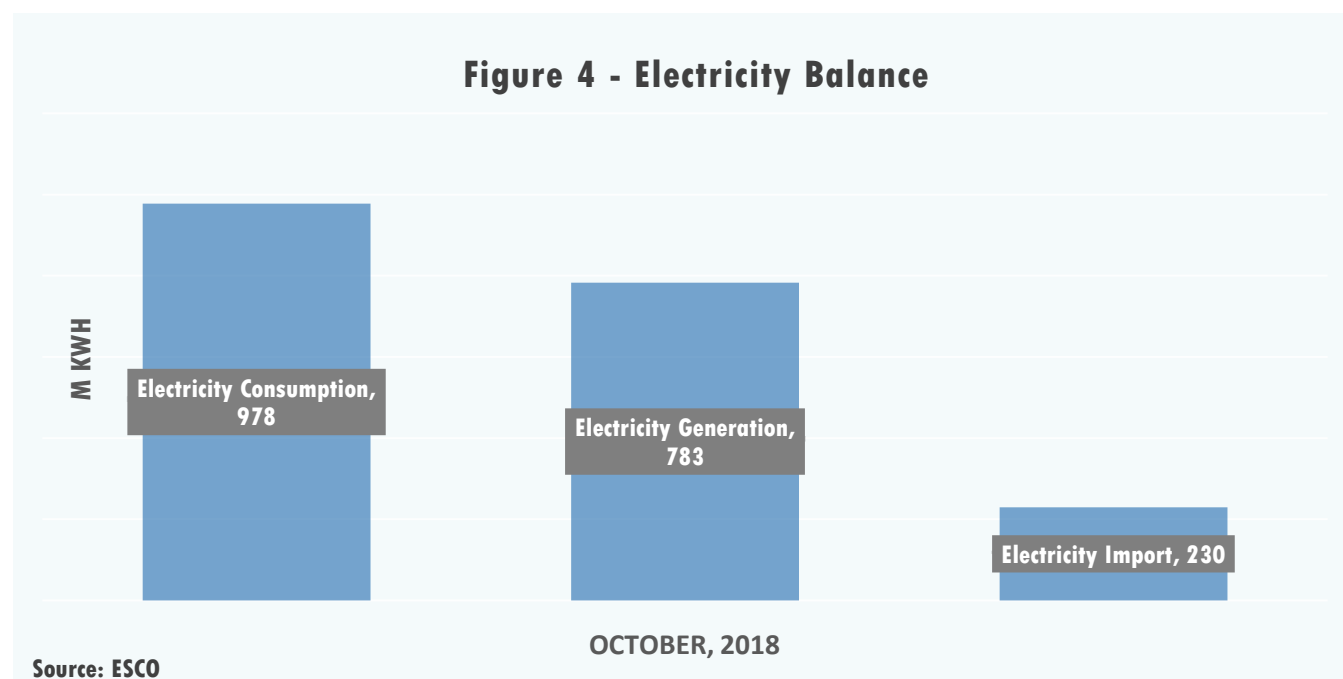
Another significant factor that contributed substantially to real GDP growth was the increasing number of tourists in Georgia. The number of international visitors to Georgia increased by 8.5% in October compared to the



same month of the previous year, moreover, the number of tourists annually rose by 15.1% and accounted for 67% of all international visitors. **According to our forecasting model, tourism made a significant positive contribution to the GDP growth forecast.**

However, the energy sector made a small negative contribution to the growth forecast. After the generation deficit of September, the trend in decreasing generation continued into October, while the gap between consumption and production kept widening. In particular, the total electricity generation decreased by 5% compared to the same month of the previous year. This reduction, on a yearly basis, is specifically due to the decrease in hydropower (-1%) and thermal power generation (-17%), which more than offsets the increase in wind power plant generation (+4%). Moreover, electricity consumption increased by 3% compared to the same month of 2017. In order to satisfy this demand for electricity, and close the gap between generation and consumption, Georgia had to increase the amount of electricity imported. The volume of imported electricity increased by 46% in annual terms.² It is also significant that imports in October 2018 reached their greatest extent for the last 11 years.

Figure 4 - Electricity Balance



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 (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 further information, please read [the recent read](#) on the ISET Economist Blog.