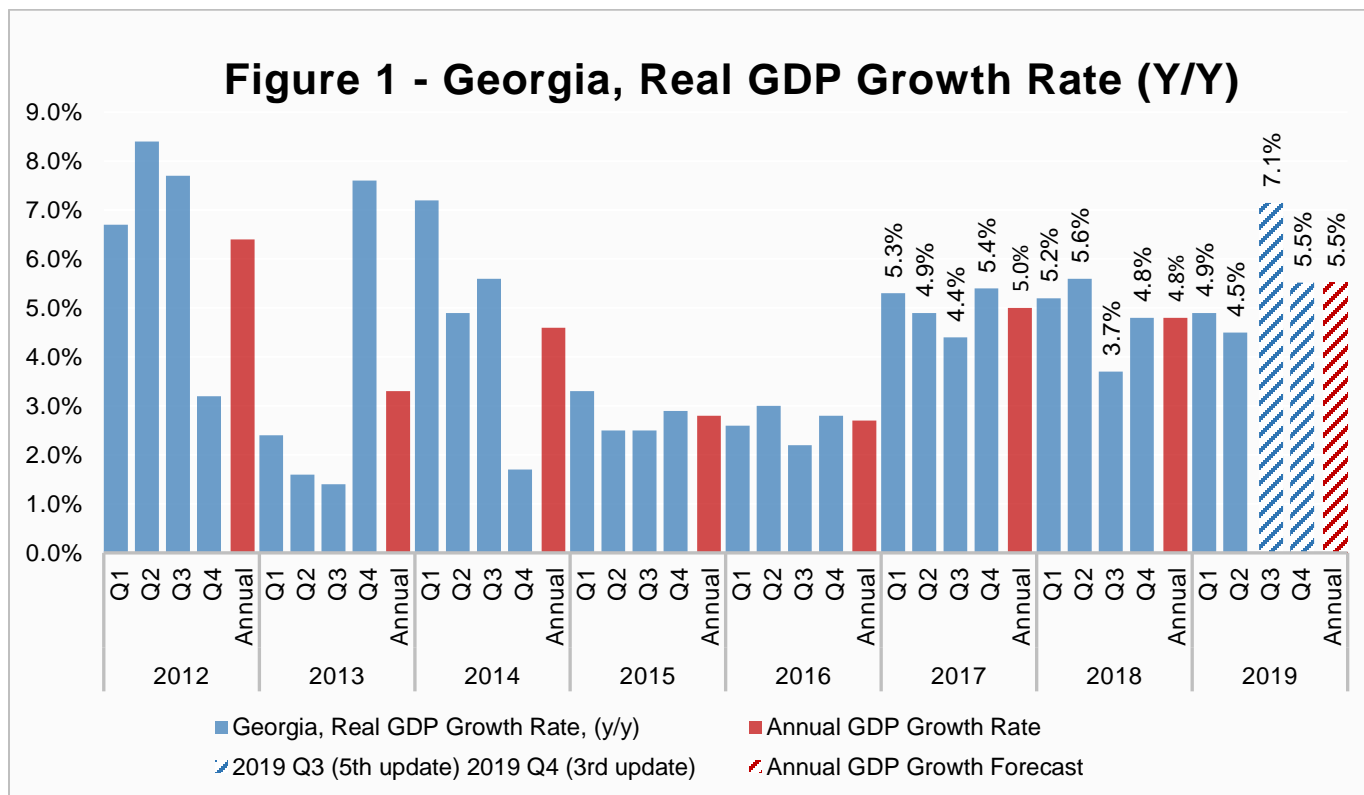




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August data keeps growth forecast steady, but downward correction looms



ISSET-PI has updated its forecast of Georgia’s real GDP growth rate for the third and fourth quarters of 2019. The highlights of this month’s release are as follows:

HIGHLIGHTS

- ISSET-PI’s forecast of real GDP growth for the third quarter (July-September) of 2019 remains at 7.1%, unchanged from last month’s prediction. While, the third estimate for the fourth quarter (October-December) growth forecast stands at 5.5%.
- Geostat recently published its preliminary estimate of real GDP growth for August, which currently stands at 5.8%. As a result, the real GDP growth estimate for the first eight months of 2019 was reduced to 5%.
- Based on the data from August, annual growth in 2019 is expected to be 5.5%. Although the growth forecast remains stable, we expect a downward correction of annual GDP growth towards the end of the year because we have not fully taken into consideration impeded tourist inflows, deteriorated foreign direct investments, and the increased risk of negative external shocks.



It is notable that the average real GDP growth in the first two months of the third quarter of 2019 was around 6.0%. Due to a combination of factors, ISET-PI's growth projection for the third quarter of 2019 has likely overestimated the actual quarterly growth rate. Crucially, our model has not yet wholly factored in the negative consequences of significantly deteriorated tourist rates (Gavrilov's effect), reduced foreign direct investment at its historic minimum since 2011, and the increased risk of negative external shocks. Nevertheless, considering the economic landscape, using data from August, several variables have changed significantly and affected growth predictions in a variety of ways. **In particular, improved external statistics and increased domestic currency deposits contributed to the overall growth projections, whereas higher-than-targeted inflation and the restrictive monetary policy dampened the growth forecast.**

Georgia's external statistics continue to improve; with exports growing by 12.3% year-over-year in August 2019. This was largely driven by an increased export/re-export of copper ores and concentrates to Romania and Bulgaria; significantly larger re-exports of motor cars and trucks to Armenia; increased exports of mineral fertilizers and mechanical equipment to Turkmenistan; and raised exportation to Uzbekistan, Kyrgyzstan, the United Kingdom, and Poland. However, Georgian exports to Russia (with a reduced export of ferroalloys) and China (a reduced re-export of copper ores and concentrates) experienced a notable drop in August. During the same period, **imports** decreased by 3.7%.

The trade balance thus improved significantly, by 12.5%, compared to August 2018 and reached 435.1 million USD. Furthermore, both remittances and tourism showed yearly increases. Money transfers increased by 7.8% in the eighth month of 2019, driven by a rise in remittances from Kazakhstan (69.8%),¹ Italy (25.6%), Greece (16.9%), Poland (69.1%), and Ukraine (68.8%). However, remittances from Russia declined significantly (-2.8 ppt).

The number of international visitors to Georgia increased by only 4.4% in August 2019 compared to the previous August (the growth rate reduced notably compared to previous months), while **the number of tourists** increased by 2.3% annually and accounted for 69% of all international visitors. According to our model, remittances made a substantial positive contribution to the GDP growth forecast, though the positive impact of tourism on GDP growth in August was quite limited. It is, however, significant that our model cannot yet fully take into consideration the markedly deteriorated growth rate of tourism inflow.

The Real Effective Exchange Rate (REER) depreciated by 0.5% relative to July, and by 13.6% relative to the same month of the previous year. Notably, the lari real exchange rate depreciated against the national currencies of the major Georgian trading partners. The GEL/TRY and GEL/RUB real exchange

¹ Contributed to the annual growth by 0.8 percentage points.



rates depreciated compared to the same month of the previous year, by 23.3% and 13.7% respectively. The lari real exchange rate experienced moderately less depreciation against the US dollar and the euro (falling by 10.7% and 7% respectively in annual terms, and decreasing by 1.2% and 0.4% respectively in monthly terms). Overall, REER-related variables had a negative contribution to the Q3 and Q4 real GDP growth projections.

The other group of variables that experienced remarkable monthly and yearly changes, and made a significant positive contribution to the Q3 and Q4 forecasts, was the volume of **domestic currency deposits** in commercial banks. In particular, the total volume of domestic currency deposits increased by 11.7% annually. The largest yearly increase was observed in **national currency time deposits** with a maturity of more than 12 months – a 59.3% increase relative to the same month of the previous year. The second largest yearly increase was experienced within currency in circulation – a 30.9% increase year-over-year. Whereas, national currency time deposits decreased annually by 7.4%. The accumulation of national currency deposits further promotes savings, which will consequently be transformed into investments and thus foster economic growth. Undeniably, National Currency Deposit related variables have made a positive contribution to our GDP growth projection.

The recent depreciation of the lari against the currencies of major trading partners will most probably lead to increased prices of imported products, which would further exacerbate the upward pressure on prices and therefore inflationary expectations will emerge. **Hence, the National Bank of Georgia increased the Monetary Policy Rate (MPR) twice in September,² by 0.5 percentage points each, reaching a level of 7.5%, which restricts borrowing and is expected to have a negative impact on the future growth rate.** In addition, **Consumer Price Index (CPI) inflation** amounted to 4.9% in August,³ and annual inflation of food prices even reached 8.5%. According to our model, the inflation rate has a negative contribution to the growth forecast.

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 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.

² The Monetary Policy Committee (MPC) of the National Bank of Georgia (NBG) held an extraordinary meeting on 25 September 2019 and decided to raise the refinancing rate by 0.5 percentage points up to 7.5 percent.

³ The annual inflation rate reached 6.4% in September.