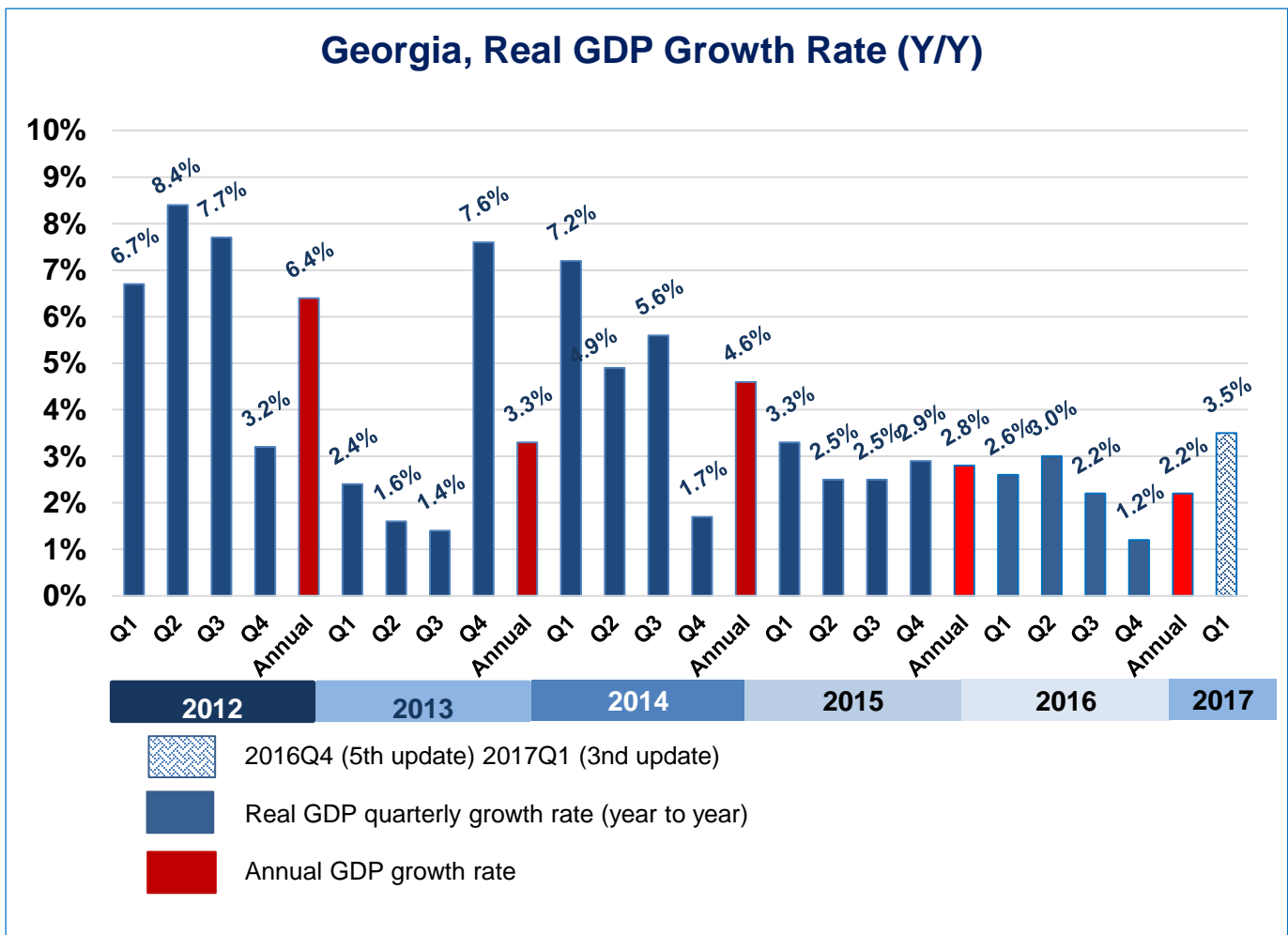*Authors: Davit Keshelava and Yasya Babych*

Growth Disappoints in the Fourth Quarter of 2016

ISET-PI has updated its forecast of Georgia's real GDP growth rate for the fourth quarter of 2016 (the final update) and the first quarter of 2017. Here are the highlights of this month's release:

- Geostat has published its rapid estimate of real GDP growth for the fourth quarter of 2016. The estimated growth stands at 1.2%, which is 1.7% lower than the value forecasted in the last update of our model.
- Given the latest data, Georgian real GDP growth in 2016 is estimated as having been 2.2% (0.5 percentage points lower than projected by our model).
- ISET-PI's forecast for the first quarter of 2017 puts GDP growth at 3.5%.

Georgia, Real GDP Growth Rate (Y/Y)

Legend:
- 2016Q4 (5th update) 2017Q1 (3nd update)
- Real GDP quarterly growth rate (year to year)
- Annual GDP growth rate

Geostat has released its first rapid estimate of real GDP growth for the fourth quarter of 2016 and it stands at a disappointingly low 1.2%. This was mainly a result of the "barely there" 0.3% real GDP growth in December (see the graph below[1]).

Several factors led to this result:

- The relatively high level of real GDP in the fourth quarter of 2015 made it harder to achieve high year-on-year growth in Q4 2016.
- Deteriorating consumer and business confidence further restricted consumption and investment.
- Negative economic growth in neighboring countries continued to affect demand for Georgian goods in the last quarters of 2016.

RAPID ESTIMATE OF THE REAL GDP GROWTH (Y/Y)
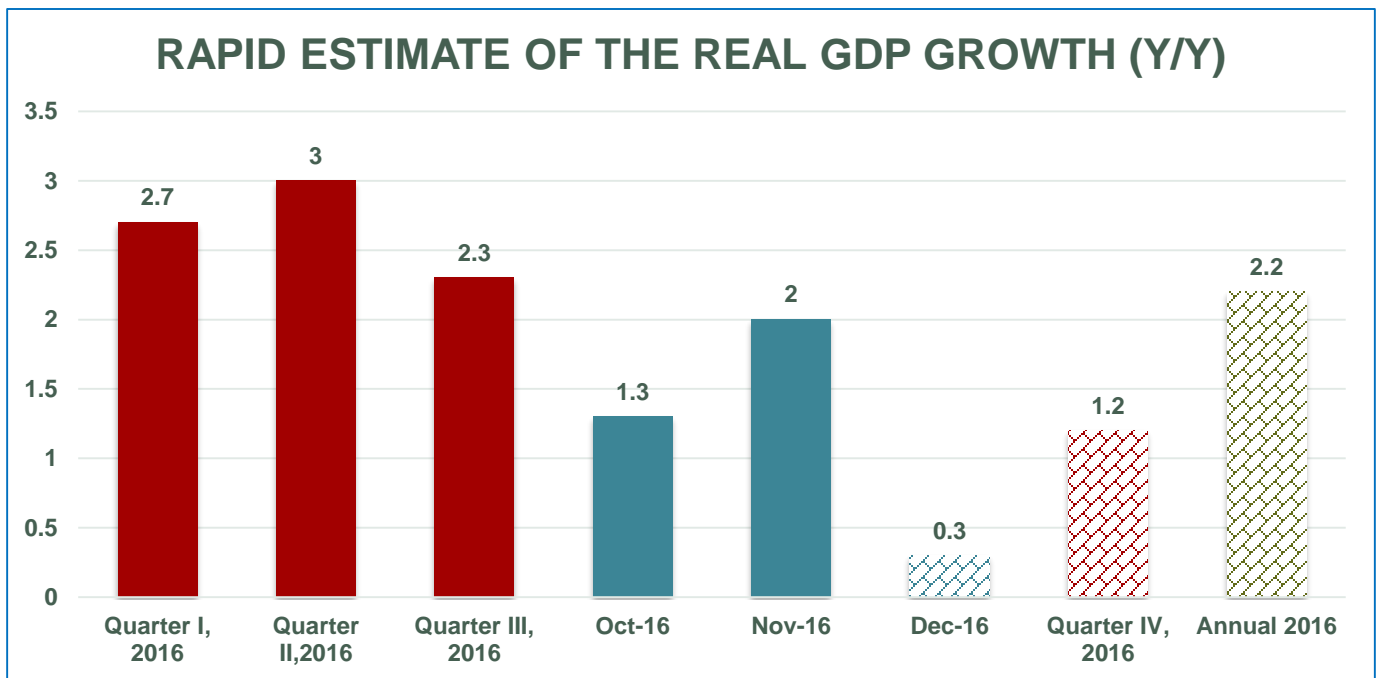
Fourth quarter annual growth depends on the economy's performance in the previous year. In 2015, the economy was recovering from the negative demand shock that started in late 2014 and affected currency values across the region. As we can see from the graph below, real GDP in the fourth quarter of 2015 showed rather strong performance, while the fourth quarter of 2016 was more in line with 2014 values.

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[1] Unless otherwise indicated, Geostat is the source of data for all graphs and tables in this publication.

Gross Domestic Product at Constant 2010 Prices, mln GEL
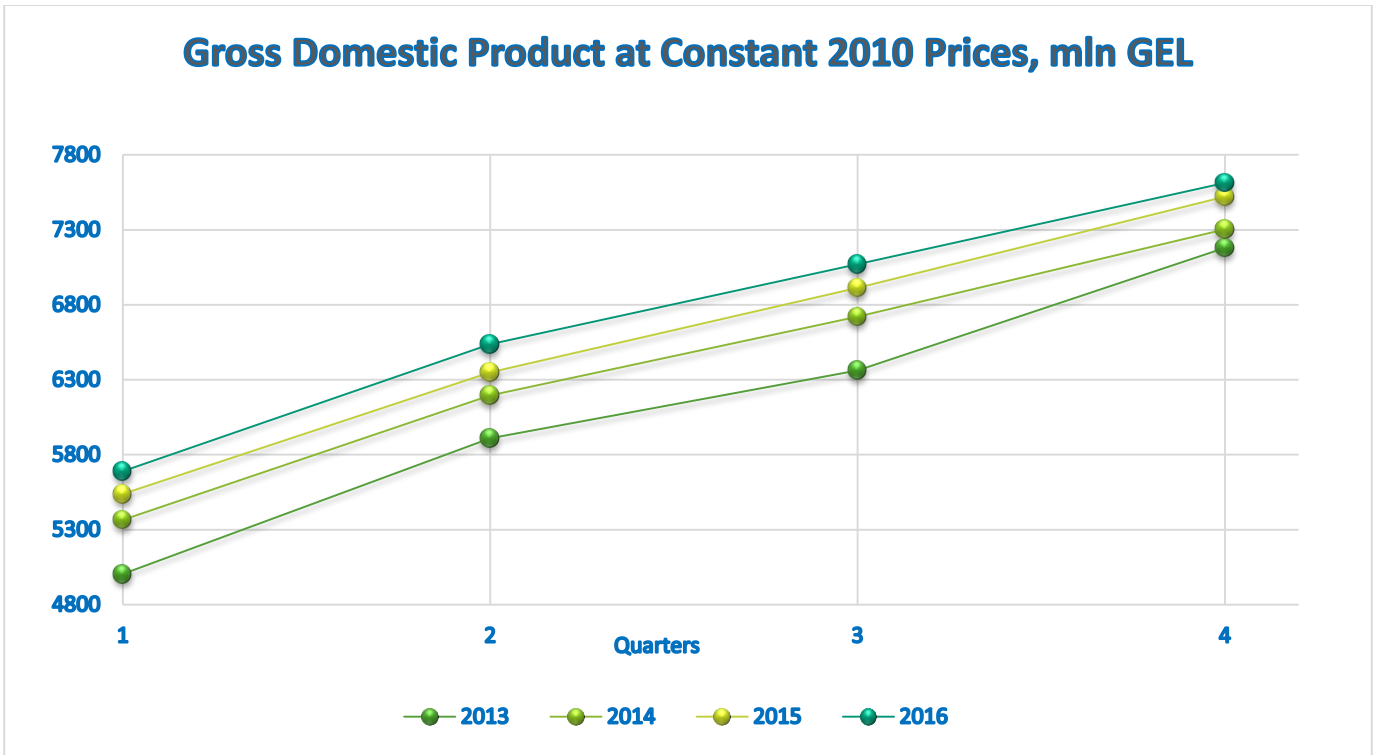
Consumer and business confidence appear to be among the strongest factors influencing growth in the last quarter of 2016. Currency depreciation (except in the second half of December) and the announcement of planned economic measures (among which were tariff hikes on cars and gasoline), played an important role in shaping consumer and business confidence.

According to ISET-PI's latest publication of the quarterly Business Confidence Index (BCI), the index dropped by 7.4 percentage points in the fourth quarter of 2016 relative to the previous quarter (although it remained slightly higher than the same quarter of 2015. See http://iset-pi.ge/index.php/en/business-confidence).

In addition, in October 2016 ISET-PI's Consumer Confidence Index (CCI) dropped substantially, and December saw the most dramatic fall of the CCI ever observed (since the index started in 2012). The CCI decreased sharply by 15 points compared to November 2016. People's pessimism can be easily explained by the post-election "blues" and the lari depreciation.[2]

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[2] Nonetheless, the December 2016 Consumer Confidence Index remained higher than the same value in the previous year. See http://iset-pi.ge/index.php/en/consumer-confidence-index/1593-december-2016-dramatic-loss-of-consumer-confidence.

Moreover, the last two quarters of 2016 were characterized by deteriorating economic activity in Georgia's neighboring countries. In the third quarter of 2016, the Turkish, Russian and Armenian economies contracted by 1.8%, 0.4% and 1.2% respectively, and, according to recent projections, these recessions will continue into Q4 (with the exception of Turkey, which is projected to grow at 0.5%). Azerbaijan's economic growth estimates were even lower, standing at -3.9% and -3.8% in the last two quarters respectively.

Quarterly Growth Rate of Real GDP (Y/Y) 2016
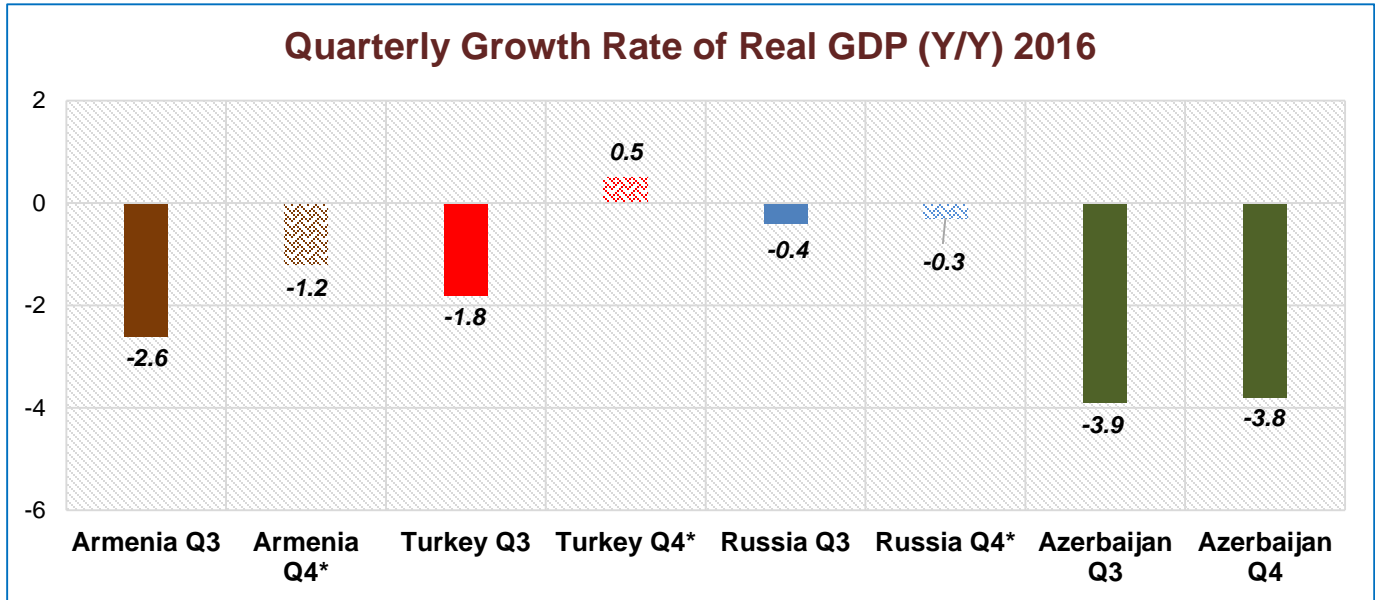
Source: Trading Economics
*indicates estimated value

Forecasting Q1 2017 for Georgia. Despite the disappointing growth figures in Q4 2016, the model predicts 3.5% growth in the first quarter of 2017. Looking at the economic landscape from the standpoint of the November data, only a few variables changed significantly since October. The most significant changes were observed in variables related to Foreign Currency Deposits with different maturities and related to Monetary Aggregates.

Foreign Currency Deposits related variables had a small but negative effect on the Q1 2017 growth forecast. The Foreign Currency Current Account (FCCA) denominated in the domestic currency increased by 14% on a year-on-year basis. These patterns were shared by Foreign Currency Total Deposits (FCTD) and Foreign Currency Demand Deposits (FCDD), which increased by 17% and 37% respectively compared to the same month of the previous year. However, when the lari depreciation against the US dollar is taken into consideration, these figures become relatively moderate. The Foreign Currency Current Account denominated in US dollars decreased by 1% on a yearly basis (see graph below), while Foreign Currency Total Deposits experienced only a small 1% increase compared to the same month of the previous year.

Foreign Currency Current Account, Denominated in US Dollar
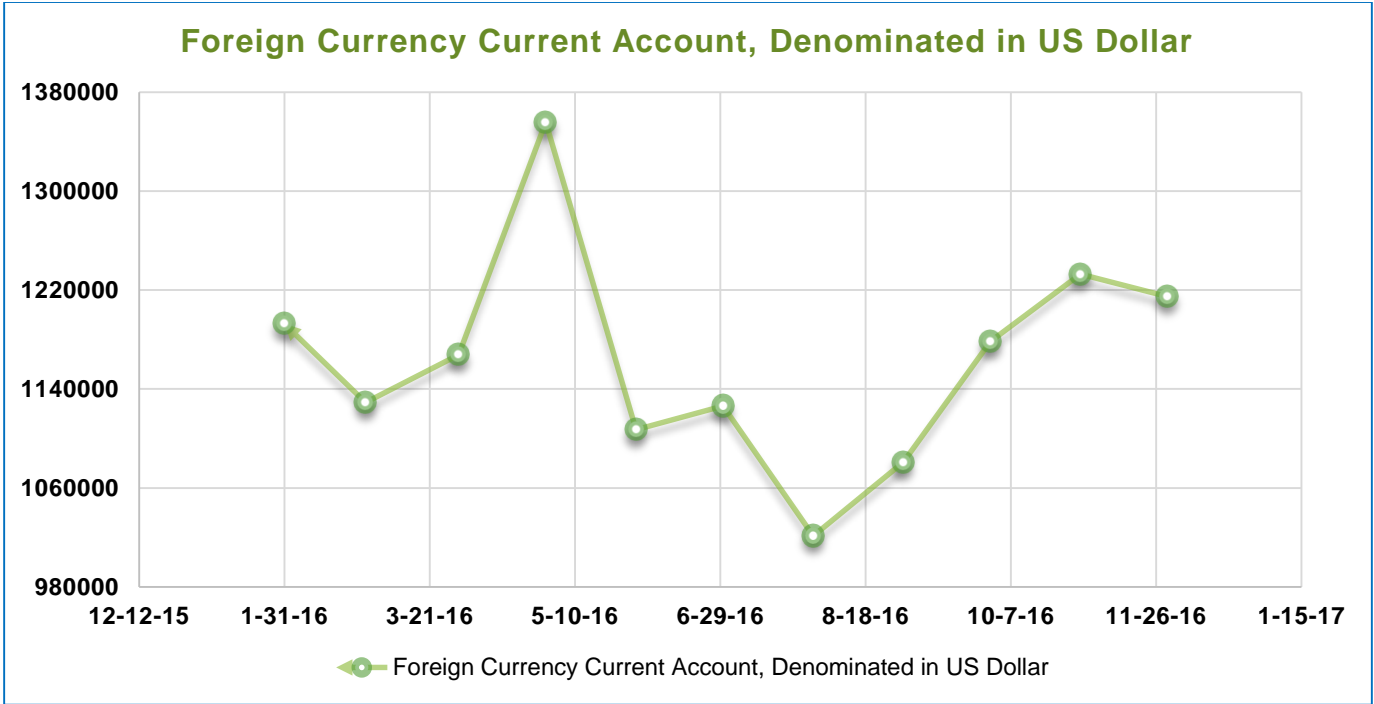
Source: NBG and authors' calculations

Currency in Circulation related variables had a significant positive impact on the growth forecast of Q1 2017. Despite the fact that the National Bank of Georgia did not carry out a single currency intervention (buying or selling foreign exchange reserves) in November, all of the monetary aggregates increased substantially compared to the same month in 2015. The highest yearly growth was experienced by Reserve Money and Broad Money (M3), increasing by 37% and 18% relative to the same month of the previous year.

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.