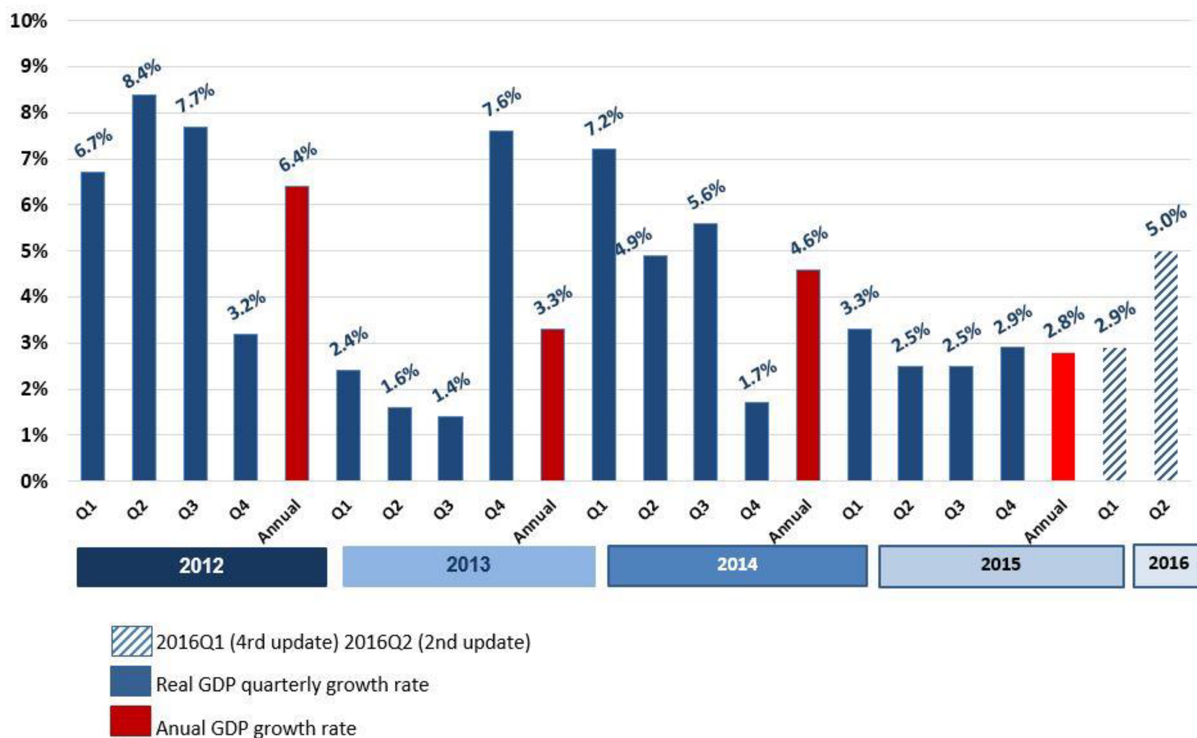
ISET-PI has updated its forecast for Georgia's real GDP growth rate for the first two quarters of 2016. Here are the highlights of this month's releases:

- ISET-PI's forecast for the first two quarters of 2016 remains at 2.9% and 5.0% respectively.
- We started forecasting the annual growth rate at the beginning of 2014 (see our January 2014 and February 2014 publications for a note on methodology). Based on this month's data, we expect annual growth in 2016 to be 2.0% in the worst-case or "no growth" scenario, and 4.5% in the best-case or "average long-term growth" scenario. Our "middle-of-the-road" scenario (based on average growth in the last four quarters) predicts a 3.3% real GDP increase in 2016. This is just 0.3 percentage points above the recently released annual economic growth projection of 3% from the National Bank of Georgia.



Based on February 2016 data, our forecast for the first two quarters of 2016 has not meaningfully changed. This was mainly because most of the explanatory variables in our model remained quite stable in February. The most significant monthly changes were observed for variables related to the current account (i.e. the variables that encompass deposits of various maturities in commercial banks and the interest rates paid on those deposits).

In particular, **Interest Rates on Time Deposits of less than 3 months** increased for both national and foreign currencies by 13% and 23% respectively, compared to January 2016. However, the long-term picture shows that interest rates are

decreasing on Foreign Currency Time Deposits (long-term deposits) by 12% annually, while **increasing on National Currency Time Deposits** by 25%, compared to the same month in the previous year. These dynamics indicate that although banks are trying to attract more deposits in the national currency, this policy is not working for the long term. The **amount of Time Deposits** is still **decreasing** annually in the **National Currency** and **Increasing in Foreign Currency**, by 18% and 25% respectively. The combination of these factors has had an overall negative (albeit slight) effect on our model's prediction of GDP growth.

The set of variables with a sharp monthly increase that had a *slight positive effect* on our forecast for first two quarters' growth were **Import-Export** as well as **Money Inflow and Outflow.** In February 2016, Export and Import rose by 30% and 79% respectively, compared to the previous month – these monthly increases were primarily just a reversion of the sharp monthly decrease seen in January 2016. The annual effect was actually slightly negative for exports, which declined by 5% compared to the same month in the previous year. Similarly, **Money Inflow** and **Money Outflow** increased by 20% and 32% respectively in monthly terms.

There were also a few variables that had a notably *slight negative effect* on our predictions. These variables were mostly related to **Consumer Credit**. Annually, **the Volume of Commercial Banks' Consumer Credit in Foreign Currency** was increasing for both short- and long-term loans – by 35% and 32% respectively. As these variables are quoted in lari terms, part of this increase must be attributed to the devaluation of the lari. The overall effect, however, is still positive as the annual depreciation against the USD was only 19%.

The Long-Term Credit Volume of Commercial Banks' Consumer Credits in the National Currency also increased insignificantly, by 3%, but **Short-Term Consumer Credits in National Currency** *declined* by a substantial 26% in annual terms (despite the annual decrease in short-term interest rates on national currency loans). The latter suggests that short-term borrowing in the national currency is still not attractive, especially compared to short-term foreign currency borrowing, where interest rates are lower by a factor of two.

From September, we started to include the **Metals Price Index (PMETA)** and the **Agricultural Raw Materials Index (PRAWM**) as explanatory variables in our forecast. The purpose of adding these series was that metals form a significant share of Georgia's exports, while food is one of the main import items. Therefore, a global increase in the price of metals should help the Georgian economy, while an increase in the price of agricultural produce is more likely to hurt it. In January, **metal and agriculture prices both decreased** by 16% and 21% respectively in yearly terms.
The addition of these series into the model turned out to have a very small (but overall positive) effect on our prediction of the first and second quarters′ GDP growth, increasing both by 0.01%.

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.