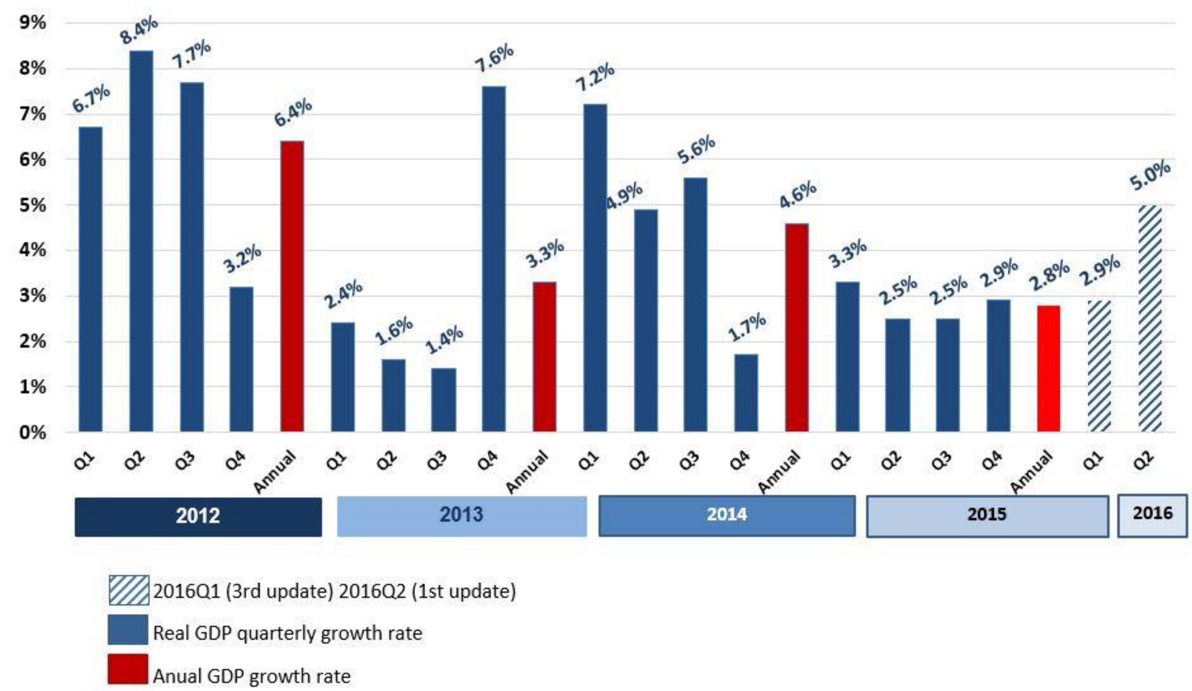
Leading GDP Indicator Forecast for Georgia

March 2016

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 has not changed from the previous prediction and stands at 2.9% and 5.0% respectively.
- We started forecasting the annual growth rate at the start 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 the average growth in the last four quarters) predicts a 3.3% real GDP increase in 2016.

Georgia, Real GDP Growth Rate (Y/Y)



Looking at the economic landscape from the standpoint of the January data, a few variables changed significantly since December. The most significant monthly decrease was in **money inflow and outflow**, which declined by 35% and 33% respectively compared to the last month of 2015. The **Europe Brent Spot Price FOB (dollars per barrel)**, declined by 19% month on month and by 36% annually.

Sharp monthly decreases were also seen in the **Trade Balance** and **Value Added Tax** variables. In January 2016, VAT declined by 21% compared to the previous month and by 25% in annual terms. Similarly, exports and imports fell by 34% and 52% month on month and by 22% and 25% compared to the same month of the previous year.

Although our GDP forecast has not changed since last month, there are a few variables worth mentioning that had a slight positive effect on our predictions. The **interest rate on 1-3-month foreign currency deposits** continued to decline following the large drop in the previous month, decreasing by 42% in annual terms. **Demand deposits in GEL** also decreased by 11% month on month, reversing the growth of the previous month. As for the currency market, the **lari** depreciated by 2-3% against all foreign currencies except the Russian ruble, which had a slight but negative effect on our prediction of GDP growth. The **ruble** continued to lose its purchasing power by 8% in January, once again facilitating imports from Russia.

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 reason for 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 1% in monthly terms and by 16% and 26% respectively in annual terms. Adding these series to the model turned out to have a very small (but overall positive) effect on our predictions for the GDP growth of the first and second quarters, increasing both forecast values by one basis point, or 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.