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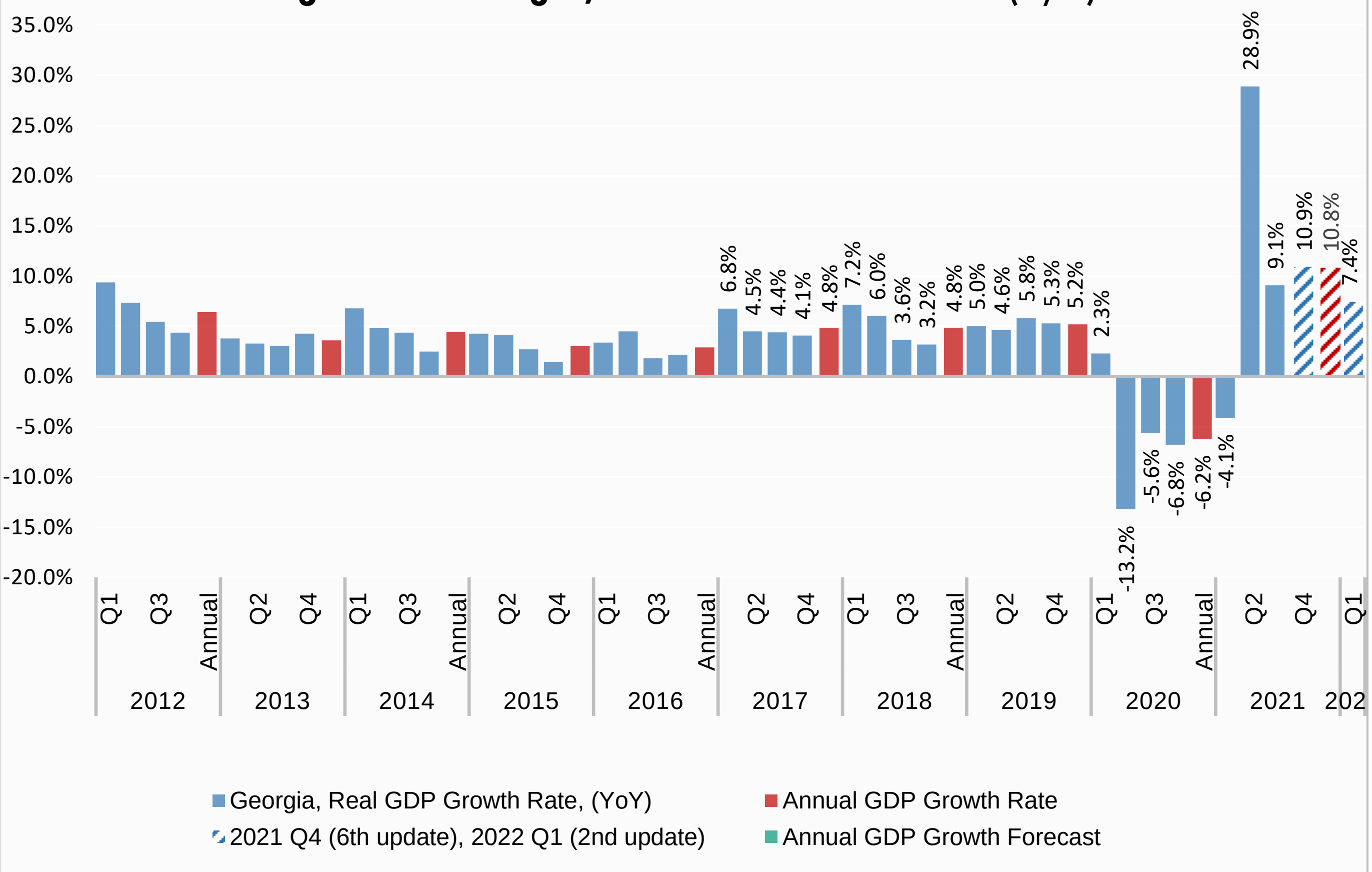
Georgian Economy Continues to Recover from Covid-19 Impact, but Inflation Threatens Stability as Food Prices Soar by 17.7 percent.

Figure 1 - Georgia, Real GDP Growth Rate (Y/Y)



ISET-PI has updated its real GDP growth forecast for the fourth quarter of 2021 and the first quarter of 2022. Here are the highlights of this month's release:

HIGHLIGHTS

- Recently, Geostat revised upward its real GDP growth for the third quarter of 2021 to 9.1% (by 0.1 ppt).
- The real GDP growth rate amounted to 12% year-on-year for November 2021. Consequently, the estimated real GDP growth for the first eleven months of 2021 was 10.7%.
- As a result of the update, the growth forecast for Q4 of 2021 increased by 0.1 ppt to 10.9%. ISET-PI's second forecast for Q1 of 2022 puts GDP growth at 7.4%.
- **Based on November's data, we expect annual growth in 2021 to be 10.8%,** which is 0.1 percentage point higher than the previous forecast.

Variables behind the GDP growth forecast:

Money Supply. All monetary aggregates except the narrowest, Narrow Money (M0), experience notable growth in annual terms. Monetary aggregates M2 and M3 experienced yearly growth of 19.7% and 12.1%, respectively. Meanwhile, currency in circulation increased relatively moderately by 0.7% yearly. However, the Narrow Money (M0) decline by 2.4% in monthly terms. *Overall, money supply related variables had a slight negative contribution to the real GDP growth for the last quarter of 2021 and the first quarter of 2022 based on our model.*

Merchandise Trade. In November, Georgia's exports experienced an 42.9% annual growth, which was mainly driven by increased export/re-export of copper ores and concentrates (contributing by 11.8 percentage points), mineral and chemical fertilizers (by 6.1 ppts), motor cars (by 5.0 ppts), natural grape wines (by 1.4 ppts), ferro alloys (by 1.2 ppts), hazelnuts and other nuts (by 1.1 ppts), alcohol spirits (by 0.9 ppt), and mineral and still water (by 0.3 ppt).

During this period, the import of goods increased by 39.6%, driven by an increased import of copper ores and concentrates (contributing by 9.5 percentage points), petroleum and petroleum products (by 1.1 ppts), motor cars (by 1.1 ppts), and telephones (by 0.5 ppt). **Consequently, the trade deficit widened dramatically by 37.3% yearly, and amounted to 576.9 million USD.** *Overall, trade related variables still had a small positive contribution to the GDP growth forecast.*

Remittances. In November, remittances increased by 22.0% annually and reached 207.3 million USD (the growth was partially driven by increased use of bank transfers rather than physically carrying money via border due to COVID regulations[1])**.** The main contributors to this increase were Kazakhstan (by 309.3% YoY, contributing 4.1 ppts), Italy (by 26.6% YoY, 4.0 ppts), Kyrgyz Republic (by 315.2% YoY, 2.8 ppts), USA (by 22.1% YoY, 2.6 ppts), Germany (by 45.0% YoY, 2.0 ppts), Israel (by 23.7% YoY, 1.9 ppts), Russian Federation (by 8.0% YoY, 1.5 ppts), Azerbaijan (by 30.6% YoY, 1 ppt), France (by 34.2% YOY, 0.5 ppt), Greece (by 3.6% YoY, 0.4 ppt), Tajikistan (by 106.7% YOY, 0.4 ppt) and Poland (by 23.8% YOY, 0.3 ppt). Whereas money inflows decreased from Ukraine (by 21.8% YoY, -1.2 ppts), and Turkey (by 7.9% YoY, -0.4 ppt). *Overall, the recovery of remittances flows made a positive contribution to the growth forecast.*

Tourism. Tourism arrivals and receipts only partially recovered in November of 2021 after a sharp decline in 2020. **In November, the number of international visitors increased by 267.2% yearly** (decreased by 69.3% compared to the same month in 2019), **while the increase in tourist numbers (visitors who spent 24 hours or more in Georgia) amounted to 283.2%** (decreased by 55.3% compared to the same month in 2019). *Overall, recovering numbers of visitors and tourists, along with a moderate increase in touristic spending has made a small positive contribution to the growth forecast.*

Real Effective Exchange Rate (REER). REER appreciated by 2.3% monthly and 12.5% yearly in November. The Lari Real Exchange Rate (RER) appreciated monthly with respect to the currencies of the major partner countries: Turkish Lira (TRY) (by 10.7%)[2], Euro (EUR) (by 1.8%), Russian Ruble (RUB) (by

[1] The latter statistics cannot properly be tracked.
[2] Turkey is currently in the midst of an economic crisis, with the Turkish lira plummeting in value and inflation hitting its highest level.

1.5%), and US Dollar (USD) (by 0.2%). **Moreover, the GEL/TRY, GEL/EUR, GEL/USD, and GEL/RUB real exchange rate appreciated compared to the same month of the previous year by 28.3%, 17.2%, 11.1%, and 3.3% respectively.** Appreciation of the REER is typically associated with domestic export goods losing competitiveness on the foreign markets, but it also translates into less pressure on the prices of imported goods. *Overall, REER-related variables had a small negative contribution to the real GDP growth projections.*

Inflation. **In November, the annual inflation of consumer prices amounted to 12.5%, which is notably higher than the targeted 3%.** Approximately 4.9 percentage points of CPI inflation were related to higher food prices, which increased 17.7% annually (this was driven by the hike in food prices worldwide – FAO Food Price Index increased by 27.8% yearly). Furthermore, increased oil prices made a notable positive contribution (2.0 ppts) to the annual inflation measure. **The latter trend is mostly a reflection of significantly increased oil prices on the global market (Euro Brent Spot Price (COP) increased by 89.9% yearly.** The other important contributors were increased prices on healthcare (0.6 ppts), tobacco (0.2 ppt) and utilities (1.6 ppts)[3]. Meanwhile, the measure of core inflation amounted to 6.1%. *Overall, CPI related variables had a slight negative contribution to the GDP forecast.*

World Prices. The other variables of interest in our growth forecast were Metals Price Index (PMETA) and the Agricultural Raw Materials Index (PRAWM). Metals form a significant share in Georgia's exports, while food and oil are among the main imports. Therefore, a global increase in the price of metal will likely cause improvement to the Georgian economy, whereas an increase in the price of agricultural products will be damaging. **In annual terms, metal prices increased by 26.3% in November, while raw agricultural material prices increased by 3.5%.** On the balance, *adding the PMETA and PRAWM indicators to the model thus increases the growth forecast for both quarters.*

Consumer Credit. The other group of variables that had an important impact on the GDP growth predictions is related to consumer credit. **In November 2021, the total volume of commercial banks' consumer credit increased by 31.3% yearly and 4.3% monthly.** However, the volume of commercial banks' short-term consumer credits decreased by 13.7% yearly and 5.7% monthly. The negative annual growth was driven by short-term consumer credit in both national (declined by 9.3% yearly) and foreign (declined by 31.4% yearly) currencies. **Whereas, the volume of commercial banks' long-term consumer credits increased by 33.3% and 4.6% yearly and monthly respectively.** *Overall, the variables related to consumer credit have had a slight positive impact on 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 passes. Our first forecast (the 1st vintage) is available around 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.

[3] Mostly due to Completion of government program of utility subsidy.