Leading GDP Indicator for Georgia

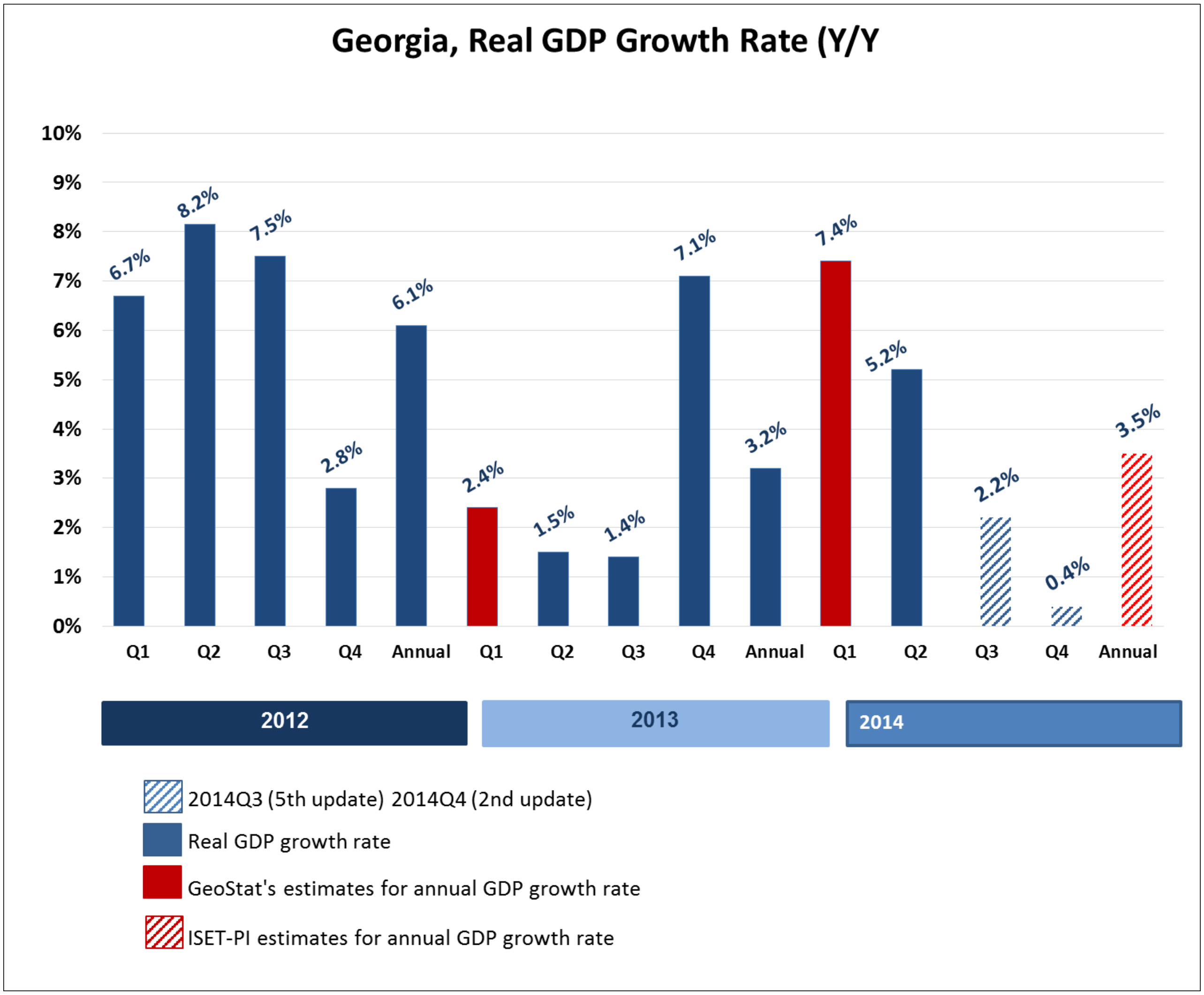
October, 2014

Predicted growth rates continue to fall

ISET-PI has updated its forecasts for Georgia's real GDP growth rates using August 2014 releases of various economic indicators.

- Based on the data from August, the fifth update of the Q3 growth forecast was yet again revised downward from 3.7% to 2.2%.
- The second update of the growth forecast for the last quarter of 2014 was also revised from 1.7% down to 0.4%.
- Meanwhile, Geostat has released the "rapid estimates" of monthly growth rate for August 2014. The August estimate is still a hefty 5.2%, although this data is preliminary and is set to be further revised in the future.
- In the beginning of 2014, we started to forecast the annual growth rate for 2014 (see our January and February publications for a note on the methodology). Based on the forecasts available for each quarter, we predict that GDP growth in Georgia in 2014 will be 3.5%. This forecast represents a downgrade from our earlier prediction of 4.3% annual growth. The downward revision carries through, even if we use a slightly different methodology to forecast annual growth.[1]

[1] For example the forecasted annual growth will be 3.8% if we use the historical average of all previous quarters in our forecast, instead of the second vintage of the fourth quarter.



In our previous publication, we commented on the unexpectedly sharp fall (from 7.6% to 3.7%) in the Q3 growth forecast. One month later, it appears that the negative shock will persist. The revised 5th update of the Q3 forecast shows a further slowdown of growth to a mere 2.2%. At the same time, the second update of the Q4 forecast has also revised the last quarter's growth downward from 1.7% to 0.4%. The decline in Q4 growth was, nevertheless, expected – we have known for some time that the last three months of 2013 were by all standards exceptionally successful (even when taking into account seasonal factors).

The growth decline suggested by our forecast must however be interpreted carefully. First, Geostats' rapid growth estimates for July and August (7.2% and 5.2% respectively) give a good reason to hope for the best. Barring a disastrous September growth performance, the third quarter will be at least moderately successful.

The discrepancy between the different forecasts stems mainly from the differences in the predictor variables and the approximation methods used. Our model's results for Q3 and Q4 are driven mainly by the observed sharp drops in the levels of merchandise exports. Exports are a very important indicator to consider, especially since they constitute about 44% of the entire GDP of Georgia.

Even though exports in August of this year were slightly higher than in the previous month (247.83 vs 246.54 mln USD), the year-on-year comparison reveals that export growth in July was positive 2.7% whereas in August it was negative 12.8%. Besides, in comparison to August of the previous year, August 2014 trade deficit increased by 6%.

Looking at the international trade data for Georgia and the top exported products, we see that export volumes in 7 out of 11 top categories declined significantly. Only agricultural product exports showed a substantial increase. In the table below we see top export product categories, their share in total exports in August 2013 and August 2014, and also the percentage change in exports from August 2013 to August 2014.

Product categories	Share in total Exports Aug'13	Share in total Exports Aug'14	Percentage change in export levels Aug'13 – Aug'14
Vehicles other than railway or tramway rolling-stock, and parts thereof	25%	20%	-51%
Iron and steel	12%	11%	-23%
Beverages, spirits and vinegar	12%	13%	10%
Ores, slag and ash	9%	9%	-22%
Fertilizers	8%	5%	-77%
Edible fruit and nuts; Peel of melons or citrus	6%	11%	119%
Cereals	3%	2%	-90%
Nuclear reactors, boilers, machinery and mechanical appliances; Parts thereof	3%	4%	49%
Live animals	3%	3%	-43%
Pearls, precious or semi-precious stones, and articles thereof	2%	2%	-36%
Mineral fuels and products of their distillation; Bituminous substances; Waxes	2%	2%	24%

Other GDP indicators that contributed to the downward revision of Q3 and Q4 forecasts between July and August were coming mainly from the Energy sector. Most importantly, electricity generation in August was 25% lower than in July, although 7% higher than in August of last year. Similarly, net export of electricity in August was lower than in July, although still a bit higher than in August of 2013.

In addition, as we mentioned in the previous publication, our forecast does not take into account exports and imports of services (the sectors which are economically important for the country, and where Georgia usually enjoys a positive trade balance). The use of only goods trade data, necessitated by the lack of data on services trade, may introduce a downward bias to the forecast numbers for the third quarter. This is especially true for August, when the net exports of services are high during a successful tourist season.

This year in particular, good weather held throughout August. In addition, the Kazantip Festival which attracted many international tourists, may give Q3 a further growth boost. These considerations give hope that the final GDP growth numbers, especially for the third quarter of 2014, will be higher than the latest forecast revisions would suggest. On the downside, however, the Consumer Confidence Index has declined in August by 14%. These expectations may exert negative influence on the consumer demand in the second half of the year.

Our forecasting model is based on the Leading Economic Indicator (LEI) methodology developed by the New Economic School, Moscow, Russia [2] 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.