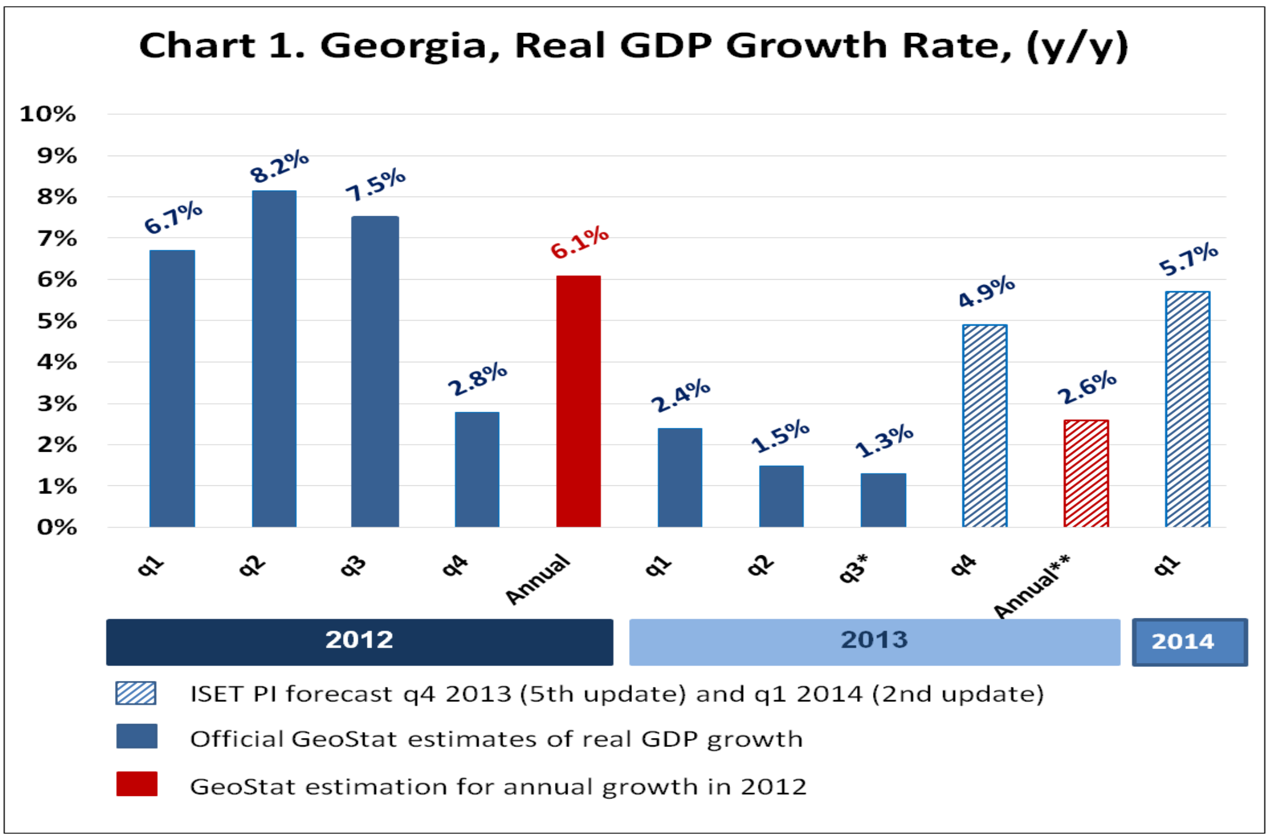
Leading GDP Indicator for Georgia

January, 2014

HIGH HOPES MAINTAINED

ISET PI has updated the forecasts for Georgia's real GDP growth rates using the November 2013 releases of various economic indicators.

- The growth forecast for the 4th quarter of 2013 has been revised downward from 5.2%to 4.9%. The forecast for the first quarter of 2014 has also been reduced from 6.5% to 5.7%.
- Given the Geostat data for the first three quarters and the ISET-PI forecast for the 4th quarter, the annual growth rate for 2013 is projected to be 2.6%.
- Given these developments, we expect the annual growth rate in 2014 to be 3.6% at the very least and more likely somewhere around 5.8%.



DEVELOPMENTS IN 2013

The annual GDP growth rate in 2013 is projected to be significantly lower than in any of the previous years since 2009. This economic predicament has created a lot of anxiety in the

Georgian society since the beginning of 2013, and has also generated a whirlwind of accusations on both sides of the political spectrum. But was the growth slowdown of 2013 a temporary phenomenon, or did it represent a structural shift in the economy?

In our earlier publications (see the March 2013 and September 2013LGI reports), we have argued that the growth decline was caused by a significant drop in the level of output in the fourth quarter of 2012 (after the parliamentary elections in October that year). Our researchers havealso suggested (see ISET Economics blog posts "Georgia's Growth Slowdown – The Case of a Political Business Cycle?" and "Georgia Riding the Waves of a Political Business Cycle") that the dip in the level of output appeared to be a one-time phenomenon, which affected primarily the level of GDP in 2013, but less so the general growth trend established in the previous years. With this in mind, a recovery of y/y growth in the fourth quarter of 2013 was expected. The expectations of the higher growth rate in quarter four of 2013 were reinforced by the low base level of GDP in 2012Q4.

However,it is not only the low base of GDP that explains the robust growth forecasts in the last quarter of 2013. Nearly all economic indicators have significantly improved in comparison with the same period of the previous year. For example, exportsin January-November have increased by 20%compared to the same period year earlier. VAT turnover,having kept its upward trend from May 2013 onwards,grew by 15%, the highest rate in the year.Imports in November have increased by 22% (y/y) after growing by only 1% in October and falling by 6% in September, reflecting a possible acceleration in domestic demand. The consumer price inflation grew by 2.4% after floating below zero for several months due to economic slowdown.

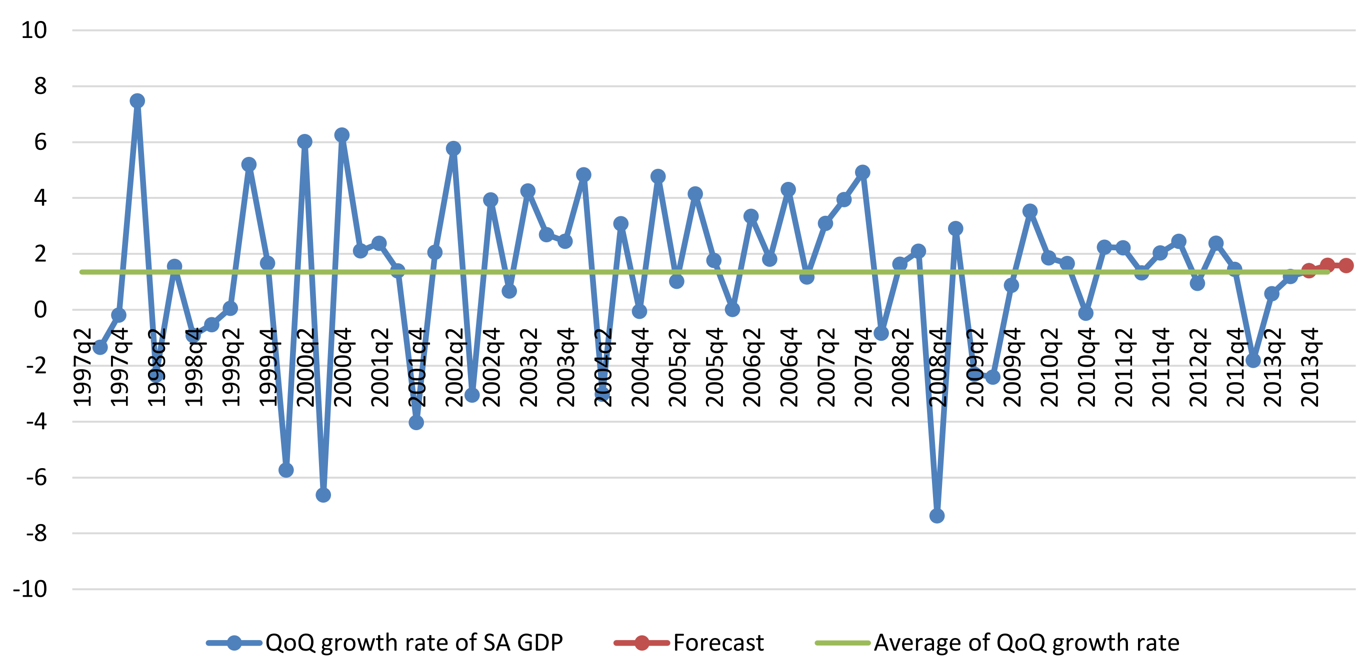
Evidence from Consumer Confidence Index (CCI) also suggests that the economic uncertainty may have eased, as consumers' expectations index increased substantially between October and November 2013.

As mentioned above, economic data released in November led to a minor downward revision of the forecasts both for the last quarter of 2013 and the first quarter of 2014. These data releases indicate a slightly weaker growth rate of total money inflows, (13% in November after 16% in October) and electricity consumption (a decline of 5% (y/y) in November after an 11% increase in October).

WHERE DO WE GO FROM HERE?

Even though our method does not allow to forecast the annual growth rate for 2014, we can draw some conclusions about the range of possibilities. The methodologythat we use relies on the socalled seasonally adjusted GDP[1](calculated using the X-12 filter), where volatility due to seasonal factors (less activity in winter, more activity in summer and autumn) is "evened out." By examining the trends in this smoothed time series, we can build a few possible scenarios.

Chart 2. Quarterly Growth Rate of Seasonally Adjusted Real GDP 1997Q2-2014Q1(q/q)



Scenario 1 – No Subsequent Growth: The simplest scenario would be the one where the seasonally-adjusted GDP remains at the same level as it is forecast to be in 2014Q1, registering no subsequent quarter-on-quarter growth. While such a scenario seems at this stage rather implausible (since 2009Q2, quarter-on-quarter growth was at least 0.6% with two exceptions, 2010Q3 and 2012Q4), it allows us to establish a sort of a "floor" for the annual growth in 2014, a level below which the GDP growth is unlikely to fall. As our calculations show, this floor is 3.6%.

Scenario 2 - **Historical Average:** An alternative would be to use the average quarter-on-quarter growth rate of the seasonally adjusted GDP observed since 1997. While the growth rate itself is very volatile (ranging from -7.4% in 2008Q3 to +7.5% in 1997Q4), its average is a rather

[1] Seasonally adjusted GDP series is available upon request free of charge from ISET-PI. Please send your inquiry to the following email: g.tsutskiridze@iset.ge. Please indicate your name and professional or institutional affiliation (when applicable).

reasonable rate of 1.3%. If the seasonally-adjusted GDP were to grow at that rate in every remaining quarter of 2014, the yearly growth rate would be 5.8%.

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 ("vintages"), which increase in precision as time goes on. Our first forecast (1st vintage) is available about 5 months before the end of the quarter in question. The last forecast (5th vintage) is published in the first month of the next quarter.