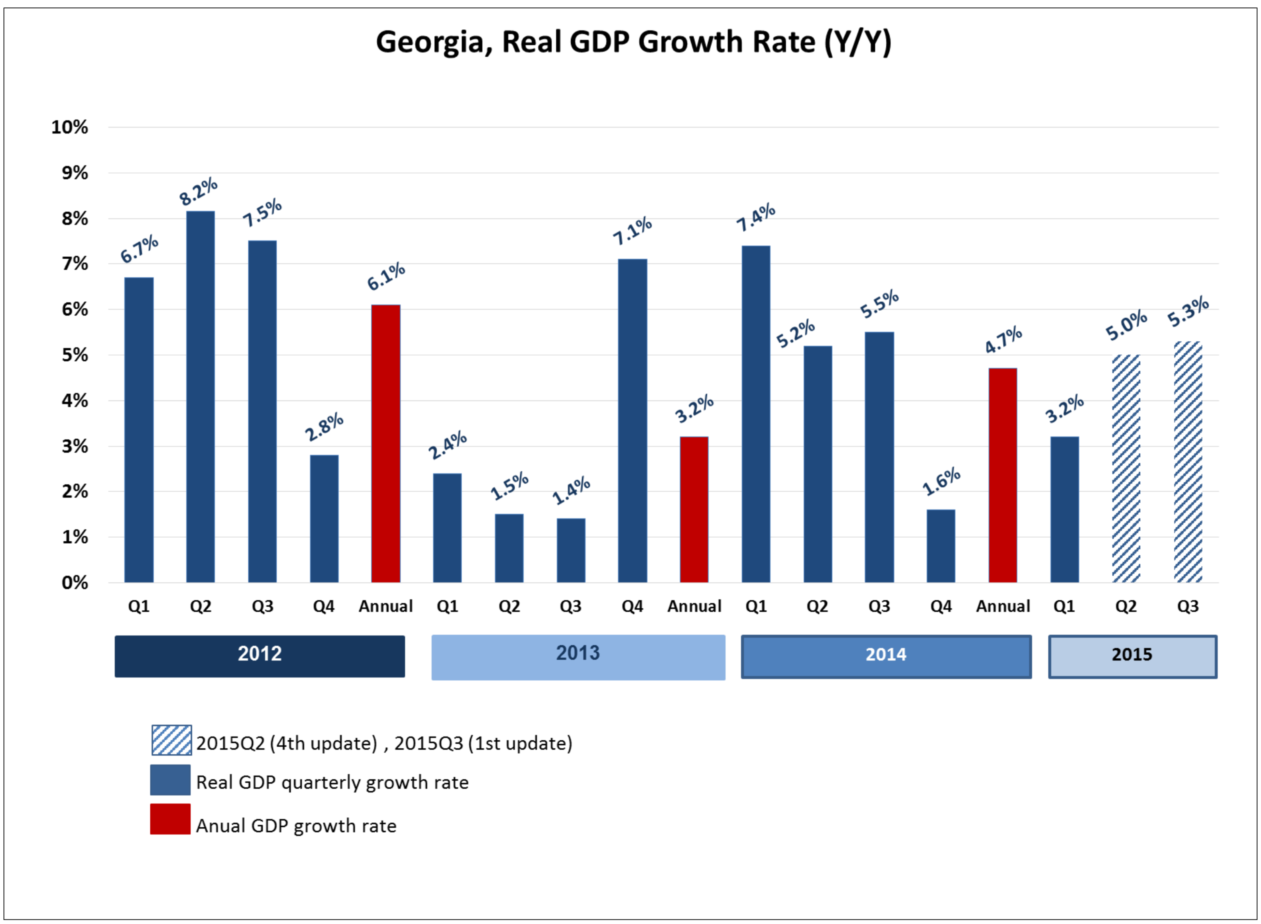
Leading GDP Indicator Forecast for Georgia

June, 2015

Cautious consumers save more at shorter maturities

ISET-PI has updated its forecasts for Georgia's real GDP growth rates using an updated forecast model and the April 2015 releases of various economic indicators.

- The growth forecast for the second quarter of 2015 was revised slightly downward from 5.1% to 5.0%.
- The growth forecast for the third quarter of 2015 has been targeted at 5.3%.
- Meanwhile, Geostat updated its GDP growth estimate for April 2015 to 0.9%
- From the beginning of last year, we started drawing conclusions about the annual growth rate for the ongoing year (see our January 2014 and February 2014 publications for a note on methodology). Based on the data from March, we expect annual growth in 2015 to be 4.8% in the worst-case or "no growth" scenario, and 5.1% in the best-case or "average long-term growth" scenario.



In April a number of variables, in particular the ones related to the banking sector, contributed to the downward revision of the second quarter growth forecast.
While current accounts and demand deposits denominated in national currency edged slightly upward in April, we also see a small decline in long-term deposits across all maturities. In contrast, foreign currency deposits continued to grow, and the growth was particularly pronounced for short maturity deposits.

Some of the changes could be attributed to the monthly exchange rate fluctuations, however the general trend points toward more savings and less consumption on the part of the households and businesses. This is most likely due to the record low consumer and business confidence in the spring months of 2015.

The average maturity of deposits had a negative impact on the forecast. While the maturity of foreign and local currency deposits were increasing overall (except for long term deposits on foreign currency), the pace of growth has slowed down relative to March.

While the amount of loanable funds is increasing, people opt for shorter maturities on their deposits, reflecting the caution and uncertainty on the part of household and businesses.
Variables related to currency in circulation and money aggregates also had negative effects on the forecast. The amount of currency in circulation outside the banks grew only slightly, by 0.97% between March and April, while the bank reserves increased by nearly 10% over the same period. Growing reserve accounts could be indicative of the reluctance to lend on the part of commercial banks – either because of the lack of viable projects, or increased risks associated with lending.

Currency kept depreciating against the US dollar in April, although the pace of depreciation slowed down considerably. The exchange rate of Lari to USD nearly stabilized. The changes in variables related to nominal and real effective exchange rate had an overall positive effect on our forecast. The nominal exchange rate with the Euro stayed nearly the same in annual terms and depreciated by less than 3% on the month-to-month basis.

As far as other variables of interest, VAT turnover declined by 7.7% between March and April, while annual growth constituted nearly 5.6%. The volume of exports in April was 3.7% higher than in March, although we continue seeing the annual decline in exports, driven by the collapse of the car re-export business last year.

Imports continued to decline both in monthly and annual terms, which resulted in the decrease of trade deficit by 25% and 18% in monthly and annual terms respectively. The decrease in imports was one of the factors that contributed to the stabilization of the Lari exchange rate.

As usual energy sector is doing well, hydropower electricity generation increased by 35% and 15.3% in monthly and yearly terms respectively. Total amount of energy produced declined but this can be explained by decline in electricity consumption, which has a seasonal character. In annual terms electricity consumption increased by 8.4%, which is generally interpreted as a good sign for the economy.

Our forecast also considers different price indices, although their direct effect on the forecast revisions were negligible. Producer Price Index increased only by 8% in annual terms, despite a considerable devaluation of the national currency, The Consumer Price Index was 0.3% higher than in March and only 2.5% higher than a year ago. The Transportation Price Index increased by 13.1% in annual terms, whereas the Construction Price Index decreased by 2.2% over the same period.

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.