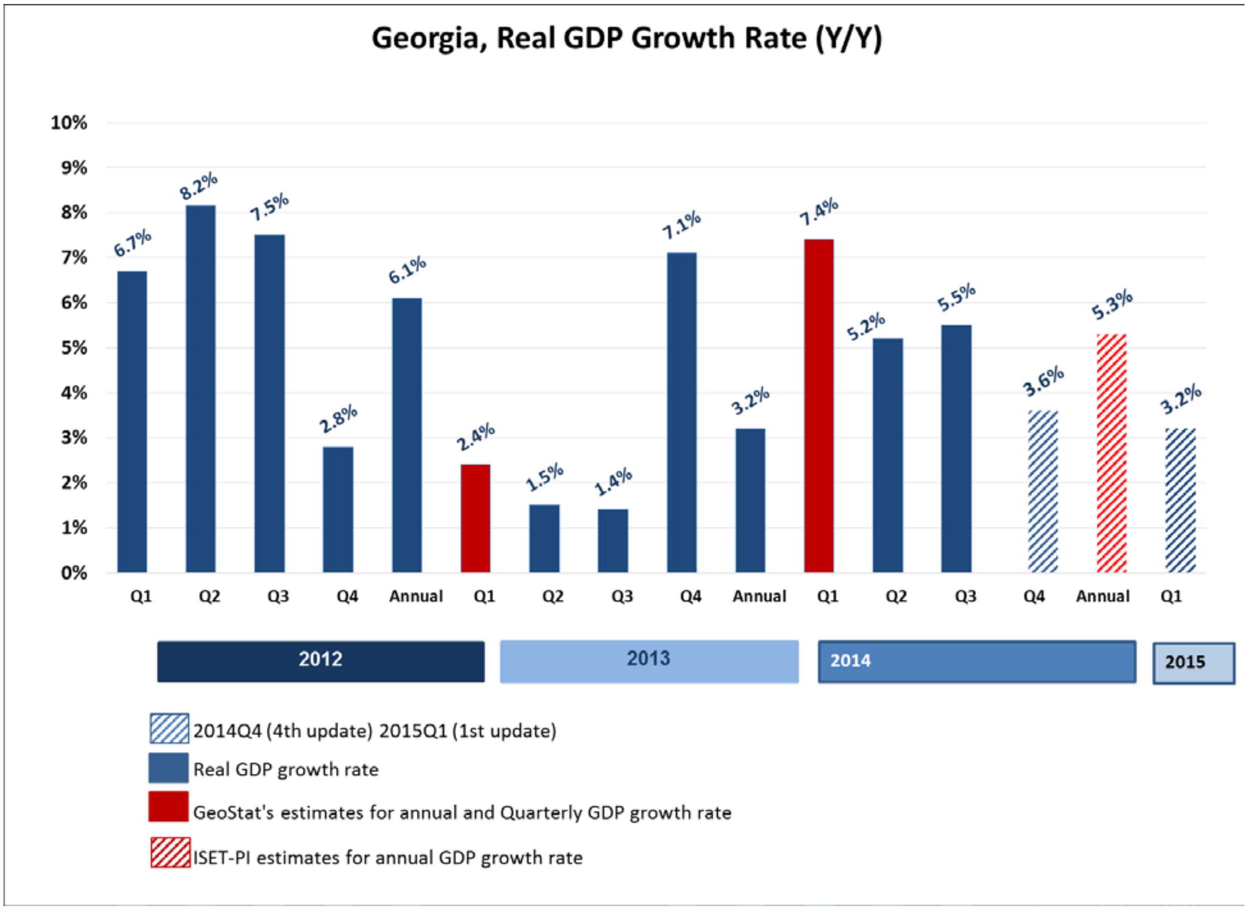
Leading GDP Indicator Forecast for Georgia

December, 2014

The Georgian economy looks forward to a robust growth result for 2014

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

- Based on the October data, the growth forecast for the last quarter of 2014 was revised upward from 1.1% to 3.6%.
- We have started to forecast the first quarter of 2015, with the initial forecast standing at 3.2%.
- Meanwhile, Geostat's "rapid estimate" growth forecast for the month of October is 3.5%.
- We started drawing conclusions about the annual growth rate for 2014 at the beginning of the year (see our January and February publications for a note on our methodology). We used the forecasts available for each quarter to predict that Georgia's GDP growth in 2014 will be 5.3%. This figure is quite close to the official 5% annual growth forecast made by the Georgian government.



With 2014 drawing to a close, new data has helped us bring the general economic situation in Georgia into sharper focus. As we have discussed in previous publications, the economic indicators of the past few months have been a mixed bag of competing trends – positive as well as negative. Taken in isolation, none of these developments were strong enough to have had a clear impact on the forecast. However, over time the predictions for the fourth quarter growth rates were revised upward and the latest revision (based on the first data available for the actual quarter) registered a significant improvement from 1.1% to 3.6%.

Our prediction for the fourth quarter, combined with the official estimates of the first three quarters, point to a robust 5.3% annual growth rate for 2014. This result is very close to the official government annual GDP growth forecast of 5%. Given the strong downside economic pressures affecting Georgia's main economic partners and the wider region, this can be considered a very good outcome for the country.

While there were no significant changes in most economic indicators in Georgia between September and October, positive developments were seen in the export of manufacturing goods and the electricity sectors. Exports, for example, increased by 14% month-on-month (which was due to the seasonal harvest effect). Total electricity generation increased by 7.5% and the net export of goods increased by 5% (and were less negative than in September).

The news from the financial sector was quite encouraging. Demand on deposits increased by 5% month-on-month and by almost 21% in year-on-year terms. There was significant growth in term deposits as well (52% in year-on-year terms), despite lower interest rates. Consumer credit growth in the economy (both short and long term) was quite strong, averaging 38.5% in annual terms. However, consumer credit can be a double-edged sword. Excessive lending can compromise the stability of the banking system in the future.

In order to better understand the reasons for the upward revision of fourth quarter growth we not only analyzed the changes in variables, but also the effects of different variable groups on the overall growth forecast. We found that a number of variables had a small but positive effect on growth. Among these were the real effective exchange rate and the GEL/RUR exchange rate. The positive effects of the GEL appreciation against partner currencies in October might seem counterintuitive in light of it making Georgian exports less competitive, but we must remember that in this context real appreciation can be interpreted as an indicator of robust demand for the local currency, which itself is a good sign for the economy.

In addition, the cost of living, measured by the Consumer Price Index (CPI) and the Khachapuri Index did not increase between September and October. The CPI increased relatively little in annual terms, by 3.5%.

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.