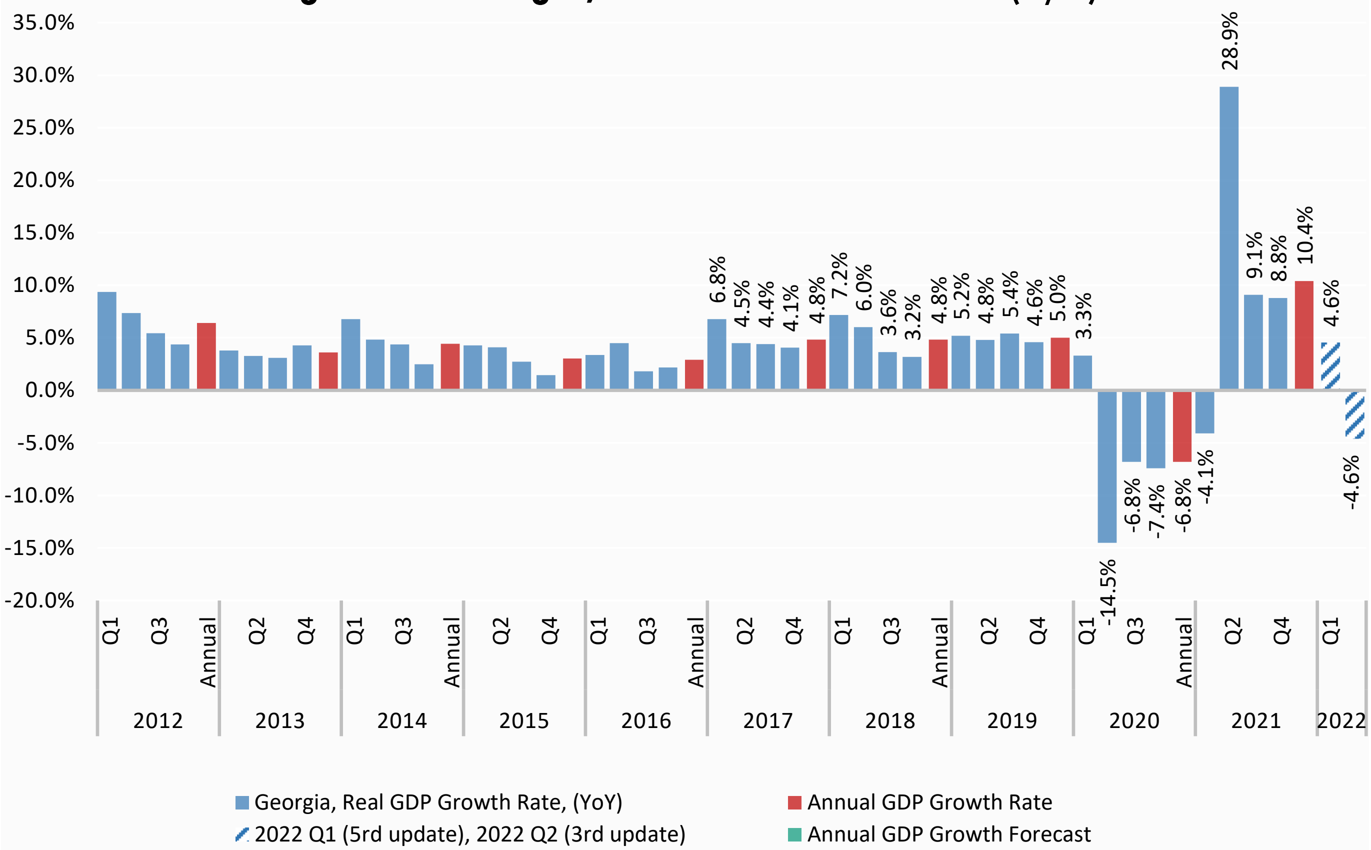
Authors: Davit Keshelava and Yasya Babych

GDP growth based on February 2022 data: a calm before the storm?

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



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

HIGHLIGHTS

- Geostat has released its rapid estimate of real GDP growth for February 2022. The estimated growth stands at 14.6%, while **the average real GDP growth for January-February 2022 reached 16.3%.**
- **ISET-PI predicted 4.6% and -4.6% growth for the first and second quarters of 2022 respectively, based on February 2022 data.** Considering the rapid estimate of economic growth for January-February 2022, Q1 forecast is expected to considerably underestimate the real GDP growth, while the negative growth in Q2 is driven in part by the high base effect from Q2 2021, when quarter's growth reached 28.9%. This data does not yet fully account for the negative impacts of the Russo-Ukrainian war on the national economy.
- Consequently, according to ISET-PI forecasting model, **the annual growth in 2022 based on February data was expected to be 0.6% in the worst-case scenario,** and 1.6% in the best-case

or an average long-term growth scenario. Our middle-of-the-road scenario (based on the average growth in the last four quarters) predicted a 1% increase in real GDP.

Variables behind the GDP growth forecast:

Merchandise Trade. In February, Georgia's exports experienced an 60.3% annual growth. This was mainly driven by increased export/re-export of copper ores and concentrates (contributing by 16.8 percentage points), ferro alloys (by 15.1 ppts), mineral and chemical fertilizers (by 10.5 ppts), and motor cars (by 4.2 ppts). In contrast, exports of alcohol spirits (by 1.0 ppt) experienced annual decline.

During this period, the import of goods increased by 53.5%, driven by an increased import/re-import of copper ores and concentrates (contributing by 16.1 percentage points), and petroleum and petroleum products (by 6.6 ppts). In contrast, re-import of motor cars (by 6.3 ppts) experienced annual decline. **Consequently, the trade deficit widened dramatically by 48.8% yearly, and amounted to 566.5 million USD.** *Overall, trade related variables still had a small positive contribution to the GDP growth forecast.*

Remittances. In February, remittances increased by 13.7% annually and reached 183.4 million USD. The main contributors to this increase were Kazakhstan (by 680.7% YoY, contributing 7.4 ppts), Italy (by 15.4% YoY, 2.7 ppts), Germany (by 61.9% YoY, 2.7 ppts), Kyrgyz Republic (by 225.2% YoY, 1.4 ppts), and USA (by 10.3% YoY, 1.2 ppts). Whereas money inflows decreased from Greece (by 21.5% YoY, -2.6 ppt), Russian Federation (by 12.7% YoY, 2.0 ppt), and Ukraine (by 31.4% YoY, -1.4 ppt). *Overall, the recovery of remittances flows made a positive contribution to the growth forecast.*

Tourism. Tourism arrivals and receipts only partially recovered in February of 2022 after a sharp decline in 2020 and a recovery process in 2021. **In February, the number of international visitors increased by 274.8% yearly** (decreased by 64.5% compared to the same month in 2020), **while the increase in tourist numbers (visitors who spent 24 hours or more in Georgia) amounted to 282.4%**. *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 1.9% monthly and 24.4% yearly in February. The Lari Real Exchange Rate (RER) appreciated monthly with respect to the currencies of the major partner countries (except Turkish Lira (TRY) - Lari depreciated by 0.6%), Euro (EUR) (by 1.9%), Russian Ruble (RUB) (by 3.3%), and US Dollar (USD) (by 2.4%). **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 56.1%, 26.0%, 16.0%, and 18.9% respectively.** *Overall, REER-related variables had a small positive contribution to the real GDP growth projections.*

Money Supply. All monetary aggregates except the narrowest, Narrow Money (M0) and Currency in Circulation, experience notable growth in annual terms. Monetary aggregates M2 and M3 experienced yearly growth of 16.1% and 7.7%, respectively. Meanwhile, Currency in Circulation decreased relatively moderately by 4.8% yearly. Nevertheless, the Narrow Money (M0) declined notably by 11.9% in annual terms. *Overall, money supply related variables had a positive contribution to the real GDP growth for the first and second quarters of 2022 based on our model.*

Inflation. In February, the annual inflation of consumer prices amounted to 13.7%, which is notably higher than the targeted 3%. Approximately 5.1 percentage points of CPI inflation were related to higher food prices, which increased 17.2% annually (this was driven by the hike in food prices worldwide – FAO Food Price Index increased by 21.3% yearly). Furthermore, increased fuel prices made a notable positive contribution (1.5 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 56.0% yearly).** The other important contributor was higher utility prices, with contribution of 3.6 ppts to inflation. Meanwhile, the measure of core inflation amounted to 5.1%. Due to higher annual inflation rate compared to the targeted 3% and risks of emerging inflationary expectations, National Bank of Georgia (NBG) increased Monetary Policy Rate (MPR) by 0.5 percentage point to 11% in March 2022. Overall*, CPI related variables had a slight negative contribution to the GDP 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.