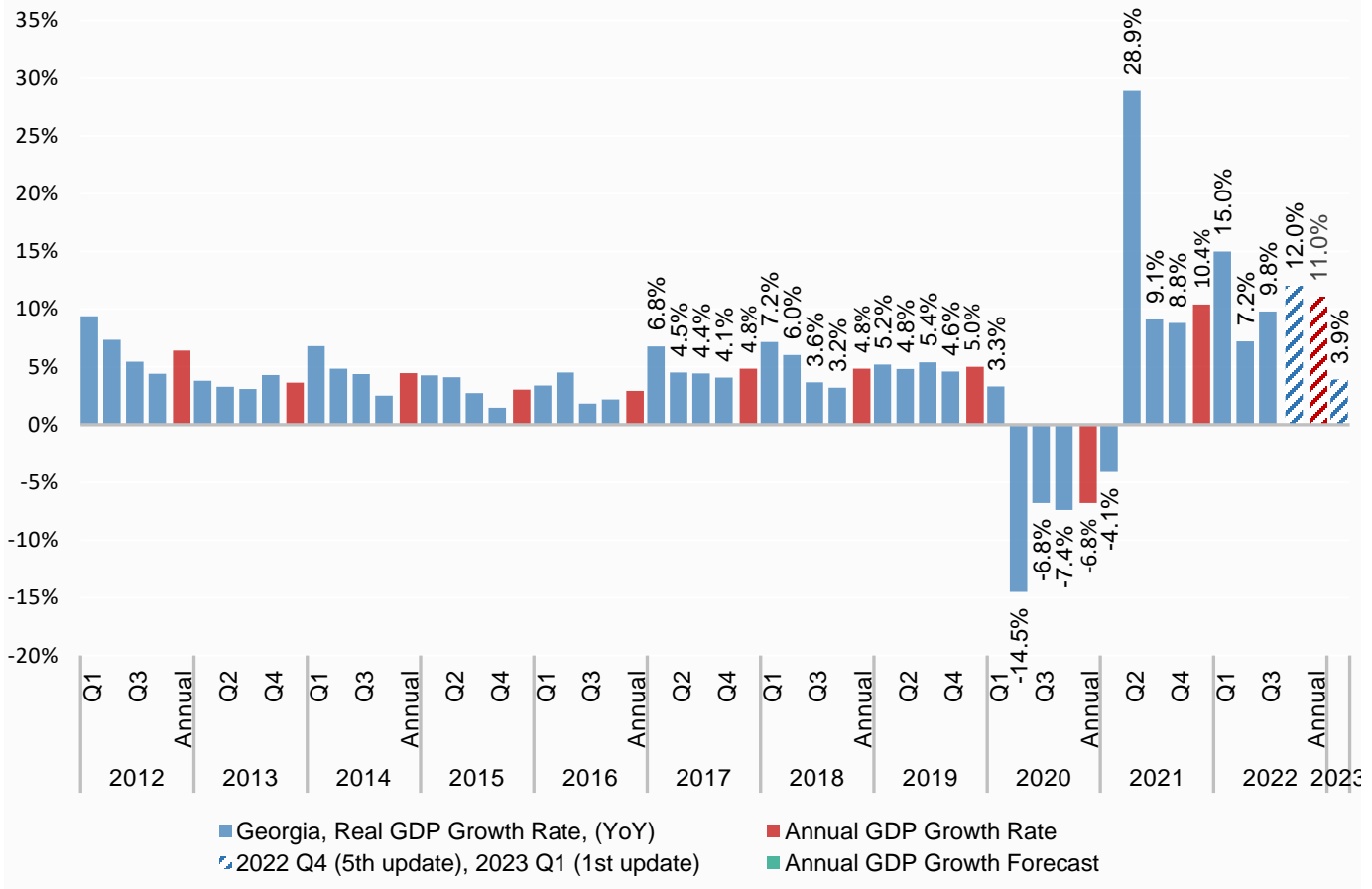




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**GDP forecast predicts a slower start to 2023 as inflation driven by food and energy prices remains a challenge to the economy.**

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



ISET-PI has updated its real GDP growth forecast for the fourth quarter of 2022 and the first quarter of 2023. Here are the highlights of this month’s release:

**HIGHLIGHTS**

- Geostat has updated its estimates for the first three quarters of 2022, **Q1 2022 growth rate now stands at 15%, while the annual growth rates for Q2 and Q3 slightly increased to 7.2% and 9.8%, respectively.** The real GDP growth estimate for the first eleven months of 2022 is 10%.
- As a result of the update, **ISET-PI growth forecast for Q4 of 2022 was changed to 12% (increased by 0.1 percentage point compared to the same figure of the previous edition). ISET-PI’s forecast for Q1 of 2023 remains unchanged at 3.9%.**
- **Based on October’s data, we expect annual growth in 2022 to be 11%.** Historically, our model’s forecast based on October data is rather accurate, but this year the number is most likely slightly



overestimated. This is because the current shock (the war, sanctions and large-scale in-migration) had not had relevant analogues in the Georgian data in the past.

### Variables behind the GDP growth forecast:

**Merchandise Trade.** In October, Georgia's exports experienced a moderate 9.2% annual growth. This was mainly driven by increased export/re-export of *motor cars* (increased by 101.8% YoY, which contributed 8.7 ppts to the overall export growth), *medicaments put up in measured doses* (increased by 108.5% YoY, contributing 1.8 ppts), *petroleum and petroleum oils* (increased by 575.8% YoY, contributing 1.4 ppts), *wine of fresh grapes* (increased by 23% YoY, contributing 1.3 ppts), and *copper ores and concentrates* (increased by 5.9% YoY, contributing 1.2 ppts). In contrast, exports of *ferro-alloys* (decreased by 73.8% YoY, decreasing overall export growth, -11 ppts), *hazelnuts and other nuts* (decreased by 23% YoY, -1.1 ppts), experienced annual decline. It is notable that increase of the goods export is mainly a reflection of higher prices, as the volume of exports increased more modestly, by 5.1% yearly.

**During this period, the import of goods increased by 28.5%**, driven by an increased import/re-import of *motor cars* (increased by 134.8% YoY, a 10.8 ppts contribution to overall imports), *petroleum and petroleum oils* (increased by 50.2% YoY, 4.1 ppts), *copper ores and concentrates* (increased by 58.5% YoY, 2.2 ppts), *other aircraft; spacecraft and spacecraft launch vehicles* (increased by 502 times, YoY, 1.4 ppts), and *telephone sets, including telephones for cellular networks or for other wireless networks* (increased by 78.6%, YoY, 1.3 ppts). In contrast, other imports experienced an annual decline. Among them *vaccines, blood and immune products* (decreased by 81.6% YoY, -1.4 ppts) and *coke and semi-coke of coal, of lignite or of peat, retort carbon* (decreased by 80.1% YoY, -1.2 ppts). However, the volume of imports increased only by 2.3% yearly (hence, the growth was mostly driven by increased prices). **Consequently, the trade deficit increased by 28.6% yearly, and amounted to 675.7 million USD.** Overall, trade related variables had a negative contribution to the GDP growth forecast.

**Remittances.** In October, **remittances (money transfers) increased by 142.9% annually and reached 502 million USD.** The main contributors to this increase were *Russian Federation* (increased by 725.6%, 127.3 ppts), *Kyrgyzstan* (increased by 163.7%, 4.9 ppts), *United States of America* (increased by 26.5%, 3.0 ppts), *Germany* (increased by 42.1%, 2.2 ppts), *Belarus* (increased by 1162.9%, 2.0 ppts), *Armenia* (increased by 345.8%, 1.9 ppts), *Italy* (increased by 8.1%, 1.3 ppts), *Tajikistan* (increased by 269.6%, 1.3 ppts), and *United Kingdom of Great Britain and Northern Ireland* (increased by 134.9%, 1.2 ppts). Whereas money inflows decreased from *Ukraine* (decreased by 99.1%, -3.5 ppts), and *Azerbaijan* (decreased by 40.5%, -1.4 ppts). Overall, the significant increase in remittances flows made a notable positive contribution to the growth forecast.

**Tourism.** Tourism arrivals and receipts notably recovered in October of 2022 after a sharp decline in 2020 and a recovery process in 2021. **In October, the number of international visitors increased by 115.2% yearly, while the increase in tourist numbers (visitors who spent 24 hours or more in Georgia) amounted to 82.6%.** Overall, recovering numbers of visitors and tourists, along with an increase in touristic spending has made a positive contribution to the growth forecast.

**Real Effective Exchange Rate (REER).** REER appreciated by 2.6% monthly and 20.9% yearly in October. The Lari Real Exchange Rate (RER) appreciated monthly with respect to the currencies of the major partner countries: Euro (EUR) (by 2.6%), Russian Ruble (RUB) (by 5.2%), Turkish Lira (TRY) (by 0.9%) and US Dollar (USD) (by 2.4%). **Moreover, the GEL/EUR, GEL/USD, and GEL/TRY real exchange rate appreciated (except GEL/RUB, which depreciated by 4.7%) compared to the same month of the**



previous year by 33.3%, 15.7%, and 35.9% respectively. REER appreciation is mostly related to the relocation of the Russian and Belarusian citizens. Overall, REER-related variables had a small negative contribution to the real GDP growth projections.

**World Prices.** The other variables of interest in our growth forecast were Metals Price Index (PMETA) and the Agricultural Raw Materials Index (PRAWM). Metals form a significant share in Georgia’s exports, while food and oil are among the main imports. Therefore, a global increase in the price of metal will likely cause improvement to the Georgian economy, whereas an increase in the price of agricultural products will be damaging. **In annual terms, metal prices as well as agricultural raw material prices decreased by 20.8% and 15.9% respectively in October.** On the balance, adding the PMETA and PRAWM indicators to the model thus decrease the growth forecast for both quarters.

**Inflation.** In October, the annual inflation of consumer prices amounted to 10.6%, which is notably higher than the targeted 3%. Approximately 4.6 percentage points of CPI inflation were related to higher food prices (this was driven by the hike in food prices worldwide – FAO Food Price Index increased by 1.6% yearly<sup>1</sup>). Furthermore, increased fuel prices made a positive contribution (0.8 ppts) to the annual inflation measure (the contribution of oil prices decreased monthly). **The latter trend is mostly a reflection of increased oil prices on the global market (Euro Brent Spot Price (COP) increased by 11.7% yearly).**

We can safely conclude that current inflation is in part driven by the increased demand related to the relocation of Russian and Belarusian citizens. However, there are two factors giving us a reason for optimism on inflation: (1) oil prices started to decrease from their peak earlier in the year and (2) GEL exchange rate appreciated against the currencies of the main trading partners. Meanwhile, the measure of core inflation amounted to 7.3%. Overall, CPI related variables had a slight negative contribution to the GDP forecast.

**Consumer Credit.** The other group of variables that had an important impact on the GDP growth predictions is related to the consumer credit. **In October 2022, the total volume of commercial banks’ consumer credit increased by 28.4% yearly and 1.3% monthly** (despite strict monetary policy aimed to curb high inflation). The volume of commercial banks' short-term and long-term consumer credits increased by 8.6% and 29.0% respectively in annual terms. There was only foreign currency short-term consumer credit that experienced notable annual decline – 23.7%. **Furthermore, short-term consumer credit decreased by 1.0% monthly while long-term consumer credit, on the contrary increased by 1.3% compared to the previous month.** Overall, the variables related to consumer credit still have had a slight negative impact on the growth 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.

<sup>1</sup> However, annual increase in food price index has decreasing trend. Since November 2022, FAO Food Price Index has started to decline even in annual terms.