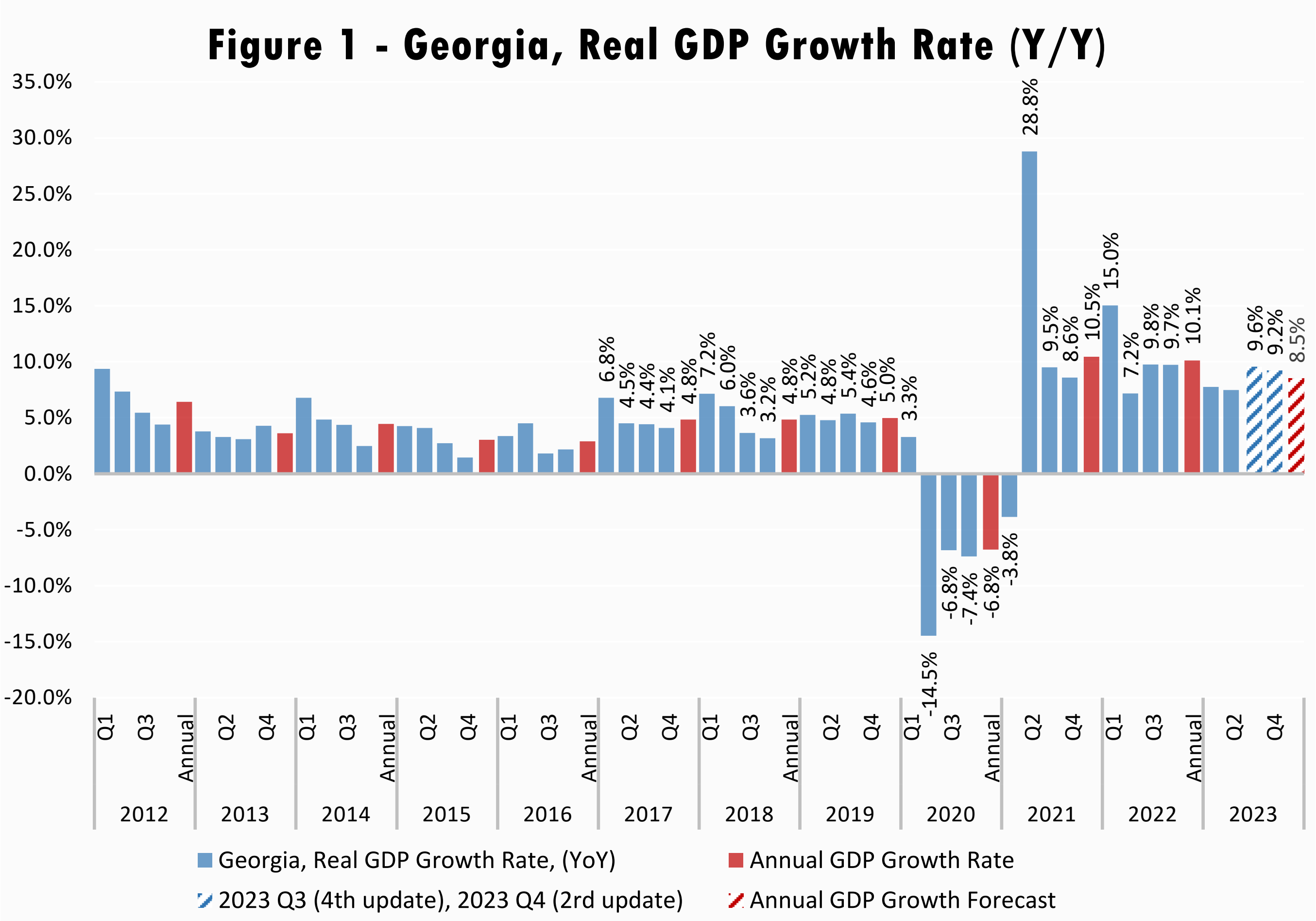
Authors: Tornike Surguladze and Davit Keshelava

Georgia's growth forecast soars on exchange rate appreciation and remittance data



ISET-PI has updated its real GDP growth forecast for the third and fourth quarters of 2023. Here are the highlights of this month's release:

HIGHLIGHTS

- Geostat has released its rapid estimate of real GDP growth for July 2023. The estimated growth stands at 5.5%, while the average real GDP growth for January-July 2023 reached 7.2%.
- ISET-PI predicted 9.6% and 9.2% growth for the third and fourth quarters of 2023 respectively.
- Based on July data, the annual growth in 2023 is expected to be 8.5%. This number is most likely **overestimated by the model at the current point in time**. This is due to the fact, that Russia's war in Ukraine, sanctions, and large-scale migration had not had relevant analogs in the Georgian data.
- In addition, the National Bank of Georgia revised its expectation for real GDP growth from 5% to 6% in 2023. According to the Monetary Policy Report, among the reasons behind the prediction's upward revision are production factors' rising productivity and investments along with large foreign inflows due to the ongoing geopolitical condition to stimulate domestic spending.

Variables behind the GDP growth forecast:

National and Foreign Currency Deposits. The first set of variables with a moderate effect on our forecast relates to commercial banks' national and foreign currency deposits. All categories of national currency deposits experienced growth in annual terms, while some of them (e.g., demand deposits and time deposits with maturity of less than 3 months) declined on a month-to-month basis in July. In particular, national currency demand deposits saw an annual increase of 57.1%, while time deposits increased by 29.8% annually. **Consequently, national currency total deposits increased by 41.6% yearly.** *The national currency deposits had a notable positive contribution to the real GDP growth.*

In contrast to domestic currency deposits, **foreign currency total deposits increased relatively moderately by 7.3%** compared to the same month of the previous year. At the same time, foreign currency current account and demand deposits increased by 3.2% and 14% respectively in annual terms, while foreign currency time deposits increased by 4.2% yearly. The slowdown of the annual growth of foreign currency deposits is partially driven by the appreciation of the national currency. As a result, the dollarization ratio of deposits, included in broad money, increased by 0.2 percentage points monthly, however, decreased by 13.1 percentage points yearly. Despite *the positive annual trends, foreign currency deposit-related variables still had a slight negative contribution to real GDP growth based on our model.*

Merchandise Trade. In July, Georgia's exports experienced a moderate 0.7% annual decline. This was mainly driven by a decline in the export/re-export of *copper ores and concentrates* (decreased by 55.3% YoY), Ferroalloys (decreased by 97% YoY), and *mineral or chemical fertilizers, nitrogenous* (decreased by 50.3% YoY). On the contrary, the export/re-export of *motor cars* (increased by 83.3% YoY) and *wine of fresh grapes* showed a significant annual growth (increased by 13.9% YoY).

During this period, the import of goods increased by 1.2%, driven by an increased import/re-import of *motor cars* (increased by 35.4% YoY), *petroleum gases and other gaseous hydrocarbons* (increased by 6.5% YoY), and *medicaments put up in measured doses* (increased by 11.8% YoY). In contrast, imports/re-imports of *copper ores and concentrates* (decreased by 73.8% YoY) and *petroleum and petroleum oils* (decreased by 21% YoY) experienced an annual decline. **Consequently, the trade deficit decreased by 7% yearly and amounted to 683.7 million USD.** *Overall, trade-related variables still had a slight but positive contribution to the GDP growth forecast.*

Remittances. In July, remittances decreased by 1.6% annually and reached 301.1 million USD. The main contributors to this decrease were the *Russian Federation* (decreased by 26.6% YoY, -8.7 ppts), *Armenia* (decreased by 80.7% YoY, -2.1 ppts), *Kyrgyzstan* (decreased by 65.1% YoY, -2 ppts), *Tajikistan* (decreased by 63% YoY, -0.7 ppts), *Uzbekistan* (decrease by 55.4% YoY, -0.4 ppts), and *Azerbaijan* (decreased by 23.7% YoY, -0.3 ppts). Whereas money inflows increased from *Italy* (increased by 26.1% YoY, 3.1 ppts), *the United States of America* (increased by 40.1% YoY, 3.7 ppts), *Germany* (increased by 40.3% YoY, 1.9 ppts), *Greece* (increased by 12.9% YoY, 0.8 ppt), *Kazakhstan* (increased by 62% YoY, 2 ppts), *Israel* (increased by 6.2% YoY, 0.3 ppts), *Turkey* (increased by 2.7% YoY, 0.1 ppts), *Spain* (increased by 11.6% YoY, 0.2 ppts), *France* (increased by 27.8% YoY, 0.3 ppts), and UK (increased by 46.7% YoY, 0.5 ppts). Despite the current tendencies, money inflow grew rapidly in the second quarter due to increased migration, leading to *a positive contribution to the growth forecast.*

Exchange Rate. In July, Georgian lari depreciated against the Dollar (1% in monthly terms) and **Euro** (1.6% in monthly and 2.7% in yearly terms). However, the **GEL/USD** exchange rate appreciated by 4.4%

in yearly terms. Similarly, the **GEL/TRY** exchange rate appreciated by 2.3% and 36.5% monthly and yearly respectively, while the **GEL/RUB** exchange rate appreciated by 3.3% monthly and 34.7% yearly. Furthermore, **REER appreciated by 2.4% and 13.8% monthly and yearly correspondingly. REER appreciation is mostly related to the relocation of Russian citizens.** On one hand, the rise in the value of the Georgian lari has favorable effects on the Georgian population as the country relies heavily on imports and has high levels of debt dollarization (businesses having income and liabilities in different currencies). However, the appreciation also leads to a reduction in the competitiveness of exports, which could have negative impacts on Georgia's growth in the medium to long term. *Overall, REER-related variables had a relatively small positive contribution to the real GDP growth projections.*

Money Supply. In July, all monetary aggregates including the narrowest, Narrow Money (M0) and Broad Money (M3), experienced notable growth in annual terms. Monetary aggregates M2 and M3 saw a yearly growth of 31.5% and 16.6%, respectively. The currency in circulation and Narrow Money (M0) increased by 16.1% and 15.3% in annual terms, respectively. *Overall, money supply-related variables had a positive contribution to the real GDP growth for the third quarter of 2023 based on our model.*

Consumer Credit. In July 2023, the total volume of commercial banks' consumer credit increased by 2% monthly and by 21% yearly. However, the credit volume of commercial banks' short-term consumers increased by 2.2% and declined by 3.4% in monthly and yearly terms, respectively (the main driver behind this negative trend was short-term consumer loans in foreign currency, which went down by 44.1% in yearly terms). Whereas the credit volume of commercial banks' long-term consumer credits increased by 2% monthly and 21.8% yearly. *Overall, the variables related to consumer credit have had a negative impact on the growth forecast.*

Inflation. In July, the annual inflation of consumer prices amounted to 0.3%, which is notably lower than the targeted 3%. The decreasing trend in CPI inflation is mainly related to exogenous factors, such as decreasing prices on international commodity markets and oil prices. **The latter trend is mostly a reflection of decreased oil prices on the global market (Euro Brent Spot Price (COP) decreased by 28.4% yearly).** All this, alongside with appreciated exchange rate of the GEL, reduces the prices of imported goods. It is also worth noting, that locally produced goods' inflation decreases as well. Despite the positive trends, risks that may lead to higher inflation in the international commodity market are high due to the current geopolitical situation, and the realization of this risk will increase the prices of imported goods. Overall*, CPI-related variables had an insignificant 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.