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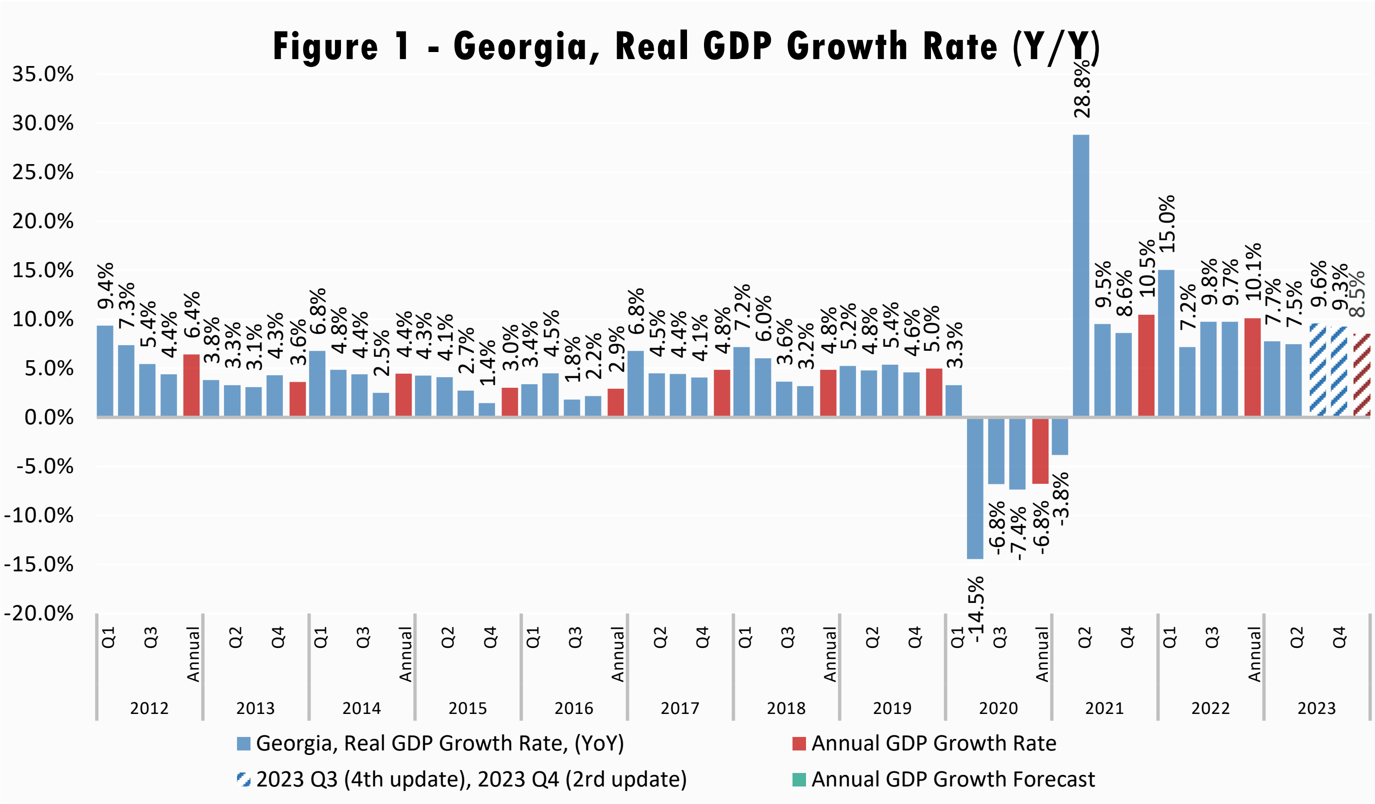
Balancing acts: Georgia's trade deficit shrinks, remittances wane, and inflation holds steady, while consumer credit and money supply surge



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 August 2023. The estimated growth stands at 5.8%, while the average real GDP growth for January- August 2023 reached 7%.
- ISET-PI predicted 9.6% and 9.3% growth for the third and fourth quarters of 2023 respectively.
- Based on August 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 national and foreign currency deposits in commercial banks. All categories of national currency deposits experienced growth in annual terms, while only the current account declined on a month-to-month basis in August. In particular, national currency demand deposits saw an annual increase of 44.9%, while time deposits increased by 34.5% annually. **Consequently, national currency total deposits increased by 38.6% yearly.** *The national currency deposits had a strong positive contribution to the real GDP growth.*

In contrast to domestic currency deposits, **foreign currency total deposits decreased relatively moderately by 3.7%** compared to the same month of the previous year. In the same period, foreign currency current accounts and time deposits decreased by 13.3% and 0.5% respectively in annual terms. On the other hand, foreign currency demand deposits increased by 2.3% yearly. The appreciation of the national currency partially drives the decrease in the annual growth of foreign currency deposits. As a result, the dollarization ratio of deposits, Included in Broad Money, decreased by just 1.9 percentage points monthly and by 16.7 percentage points yearly. Henceforth, *foreign currency deposit-related variables had a slight negative contribution to real GDP growth based on our model.*

Merchandise Trade. In August, Georgia's exports experienced a moderate 4.8% annual increase. This was mainly driven by increased export/re-export of *motor cars* (increased by 58.3% YoY). On the contrary, the export/re-export of *copper ores and concentrates* (decreased by 50.1% YoY), ferroalloys (decreased by 78.7% YoY), *mineral or chemical fertilizers, nitrogenous* (decreased by 35.9% YoY), and *wine of fresh grapes* (decreased by 24.7% YoY) showed a significant annual decline.

During this period, the import of goods increased by 0.9% yearly, driven by an increased import/re-import of *motor cars* (increased by 30.1% YoY), and *medicaments put up in measured doses* (increased by 35.5% YoY). In contrast, imports/re-import of *petroleum gases and other gaseous hydrocarbons* (decreased by 28.2% YoY), *copper ores and concentrates* (decreased by 962.1% YoY), and *petroleum and petroleum oils* (decreased by 30.1% YoY) experienced annual decline. **Consequently, the trade deficit decreased by 1.5% yearly and amounted to 778.26 million USD.** *Overall, trade-related variables still had a slight negative influence on the GDP growth forecast.*

Remittances. In August, remittances decreased by 14.1% annually and reached 287 million USD. The main contributors to this decrease were the Russian Federation (decreased by 45.6% YoY, -15.1 ppts), Kyrgyzstan (decreased by 63.4% YoY, -2.6 ppts), and Azerbaijan (decreased by 20.2% YoY, -0.3 ppts), Israel (decreased by 6.7% YoY, -0.4 ppts). Whereas, money inflows increased from Italy (increased by 23% YoY, 2.5 ppts), *United States of America* (increased by 37.6% YoY, 3.3 ppts), *Germany* (increased by 33.5% YoY, 1.5 ppts), *Greece* (increased by 6% YoY, 0.3 ppt), *Kazakhstan* (increased by 54.9% YoY, 2 ppts), *Spain* (increased by 11.6% YoY, 0.2 ppts), *France* (increased by 21.4% YoY, 0.3 ppts), and UK (increased by 15.4% YoY, 0.2 ppts). The reduction in money inflow can be attributed to the base effect. In 2022, there was a substantial surge in the influx of Russian citizens relocating to Georgia in the aftermath of Russia's conflict in Ukraine, and they subsequently remitted funds for their personal expenditures. Consequently, we are now observing a return to more typical patterns in money transfers as the transient impact of this event diminishes. To provide further clarity on this matter, it is worth noting that money inflow witnessed a remarkable 40% increase in the third quarter of 2023 when contrasted with the corresponding period in 2021. *As a result, money transfers have a slight positive contribution to the growth forecast.*

Exchange Rate. In August, Georgian Lari appreciated against **Dollar** (0.5% in monthly and 9.5% in yearly terms), **Euro** (1.5% in monthly and 2.7% in yearly terms), **Ruble** (5.9% in monthly and 42.7% in yearly terms), **TRY** (38.5% in yearly terms). However, the **GEL/TRY** exchange rate depreciated slightly by 0.2% monthly. Furthermore, **REER appreciated by 8.3% yearly, while it depreciated by 0.4% monthly. REER's yearly 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 negative influence on the real GDP growth projections.*

Money Supply. In August, 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 30.8% and 10.4%, respectively. The currency in circulation and Narrow Money (M0) increased by 17.2% and 19.6% in annual terms, respectively. *Overall, money supply-related variables had a relatively high positive contribution to the real GDP growth for the third quarter of 2023 based on our model.*

Consumer Credit. In August 2023, the total volume of commercial banks' consumer credit increased by 2.1% monthly and by 20.8% yearly. Moreover, the credit volume of commercial banks' short-term consumer credits increased by 5% and 14% in monthly and yearly terms, respectively (the main drivers behind this positive trend in short-term consumer loans in domestic and foreign currencies, which went up by 13.1% and 18.6% respectively in yearly terms). Furthermore, the credit volume of commercial banks' long-term consumer credits increased by 2% monthly and 20.9% yearly. *Overall, the variables related to consumer credit have had a positive impact on the growth forecast.*

Inflation. In August, the annual inflation of consumer prices amounted to 0.7%, 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 14.2% yearly.** In conjunction with the appreciated exchange rate of the Georgian Lari (GEL), these factors collectively contribute to a reduction in the prices of imported goods. It is noteworthy that inflation in locally produced goods is also experiencing a decrease. Notwithstanding these encouraging developments, it is crucial to acknowledge that there exist substantial risks pertaining to the potential elevation of inflation in the global commodity market, primarily stemming from the prevailing geopolitical circumstances. The materialization of these risks has the potential to result in escalated prices for imported goods. *Overall, CPI-related variables did not have a significant impact on 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.