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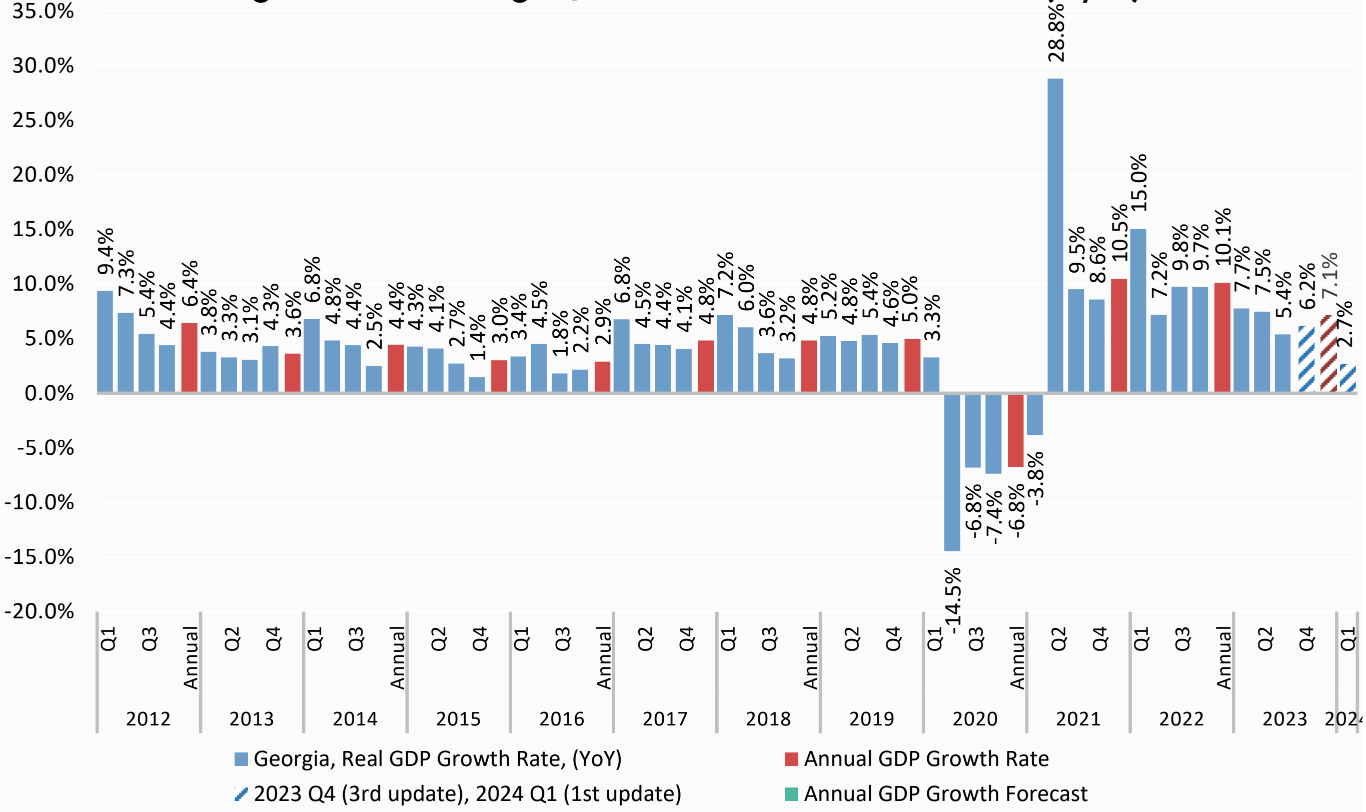
Balancing acts: Georgia's trade deficit shrinks, remittances wane, and inflation holds steady, while consumer credit and money supply surge

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



ISET-PI has updated its real GDP growth forecast for the fourth quarter of 2023 and first quarter of 2024. Here are the highlights of this month's release:

HIGHLIGHTS

- Geostat has released its rapid estimate of real GDP growth for September 2023. The estimated growth stands at 5.1%, while the average real GDP growth for January-September 2023 reached 6.8%.
- ISET-PI predicted 6.2% and 2.7% growth for the fourth quarter of 2023 and first quarter of 2024, respectively.
- Based on September data, the annual growth in 2023 is expected to be 7.1%.
- In addition, the National Bank of Georgia expects a 6% real GDP growth in 2023. According to the Monetary Policy Report, among the reasons behind the prediction are large foreign inflows, that continue to make a substantial contribution to economic activity (e.g., domestic spending and service exports), as well as production factors' rising productivity along with improved investments.

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 demand deposits and time deposits declined on a month-to-month basis in September. In particular, national currency demand deposits saw an annual increase of 37.8%, while time deposits increased by 27.3% annually. **Consequently, national currency total deposits increased by 35.7% yearly.** *The national currency deposits had a moderate positive contribution to the real GDP growth.*

In contrast to domestic currency deposits, **foreign currency total deposits increased relatively moderately by 1.5%** compared to the same month of the previous year. In the same period, foreign currency current accounts decreased by 1.7% in annual terms. On the other hand, foreign currency time deposits and demand deposits increased by 3.9% and 2.0%, respectively, yearly. The depreciation of the national currency partially drives the increase in the annual growth of foreign currency deposits. As a result, the dollarization ratio of deposits, included in Broad Money, increased by just 0.6 percentage points monthly, however, it decreased by 15 percentage points yearly. *Overall*, *foreign currency deposit-related variables had a relatively high negative contribution to real GDP growth based on our model.*

Merchandise Trade. In September, Georgia's exports experienced a moderate 0.9% annual increase. This was mainly driven by increased export/re-export of *motor cars* (increased by 97.3% YoY). On the contrary, the export/re-export of *copper ores and concentrates* (decreased by 62% YoY), ferroalloys (decreased by 58.1% YoY), *mineral or chemical fertilizers, nitrogenous* (decreased by 27% YoY), and *wine of fresh grapes* (decreased by 10% YoY) showed a significant annual decline.

During this period, the import of goods increased by 11.1% yearly, driven by an increased import/re-import of *motor cars* (increased by 52.2% YoY), and *medicaments put up in measured doses* (increased by 38.7% YoY). In contrast, imports/re-import of *petroleum gases and other gaseous hydrocarbons* (decreased by 37.2% YoY), *copper ores and concentrates* (decreased by 58.2% YoY), and *petroleum and petroleum oils* (decreased by 32.9% YoY) experienced annual decline. **Consequently, the trade deficit increased by 20% yearly and amounted to 734.71 million USD.** *Overall, trade-related variables still had a slight positive influence on the GDP growth forecast.*

Remittances. In September, remittances decreased by 26.7% annually and reached 284 million USD. The main contributors to this decrease were the Russian Federation (decreased by 65.8% YoY, -29.6 ppts), Turkey (decreased by 6.8% YoY, -0.2 ppts), Kyrgyzstan (decreased by 76.1% YoY, -3.6 ppts), and Azerbaijan (decreased by 10.9% YoY, -0.1 ppts). Whereas, money inflows increased from Italy (increased by 19.3% YoY, 1.8 ppts), *United States of America* (increased by 43.8% YoY, 3.2 ppts), *Germany* (increased by 32.8% YoY, 1.3 ppts), *Greece* (increased by 11% YoY, 0.5 ppt), *Kazakhstan* (increased by 80.6% YoY, 2.1 ppts), *Spain* (increased by 10.8% YoY, 0.1 ppts), *France* (increased by 13% YoY, 0.1 ppts), and UK (increased by 7.4% YoY, 0.1 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, Georgia is 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 September, Georgian Lari depreciated against **Dollar** (1.9% in monthly terms) and **Ruble** (0.1% in monthly terms). However, the **GEL/TRY** and **GEL/EUR** exchange rates appreciated slightly by 0.6% and 0.7% monthly, respectively. Furthermore, **REER appreciated by 10% yearly, while it depreciated by 0.7% monthly. REER's yearly appreciation is mostly related to the relocation of Russian citizens.** On one hand, the decline in the value of the Georgian Lari has negative 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 depreciation also leads to an improvement in the competitiveness of exports, which could have positive impacts on Georgia's growth in the medium to long term. It is also worth noting that the National Bank of Georgia sold 64.7 million USD in the Foreign Exchange Auctions, which helped prevent excessive devaluation of GEL/USD. Overall*, REER-related variables had a negative influence on the real GDP growth projections.*

Money Supply. In September, 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 34.2% and 15.7%, respectively. The currency in circulation and Narrow Money (M0) increased by 17.3% and 22.2% in annual terms, respectively. *Overall, money supply-related variables had small positive contribution to the real GDP growth for the fourth quarter of 2023 based on our model.*

Consumer Credit. In September 2023, the total volume of commercial banks' consumer credit increased by 1.9% monthly and by 21.3% yearly. Moreover, the credit volume of commercial banks' short-term consumer credits increased 15.1% in yearly terms (the main drivers behind this positive trend in short-term consumer loans in domestic and foreign currencies, which went up by 12.1% and 33.9% respectively in yearly terms). Furthermore, the credit volume of commercial banks' long-term consumer credits increased by 1.9% monthly and 21.5% yearly. However, despite the positive trend, the average annual growth rate from January to September 2023 was 20.6%, compared to 34.9% during the same period in 2022. This decline in the growth rate, observed in consumer credits, may explain a decrease in lending activity during this period. *Overall, the variables related to consumer credit have had a small negative impact on the growth forecast.*

Inflation. In September, 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 weakened pressure on prices resulting from pandemic and Russia-Ukraine war. It is also worth noting, that inflation on domestically produced products also decreased to 5.3%, which positively contributes to declining trend of inflation. However, **oil prices on the global market (Euro Brent Spot Price (COP) increased by 4.4% yearly.** Furthermore, depreciation of Georgian Lari (GEL) contributes to an increase in the prices of imported goods. It is also 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 have had a small negative 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.