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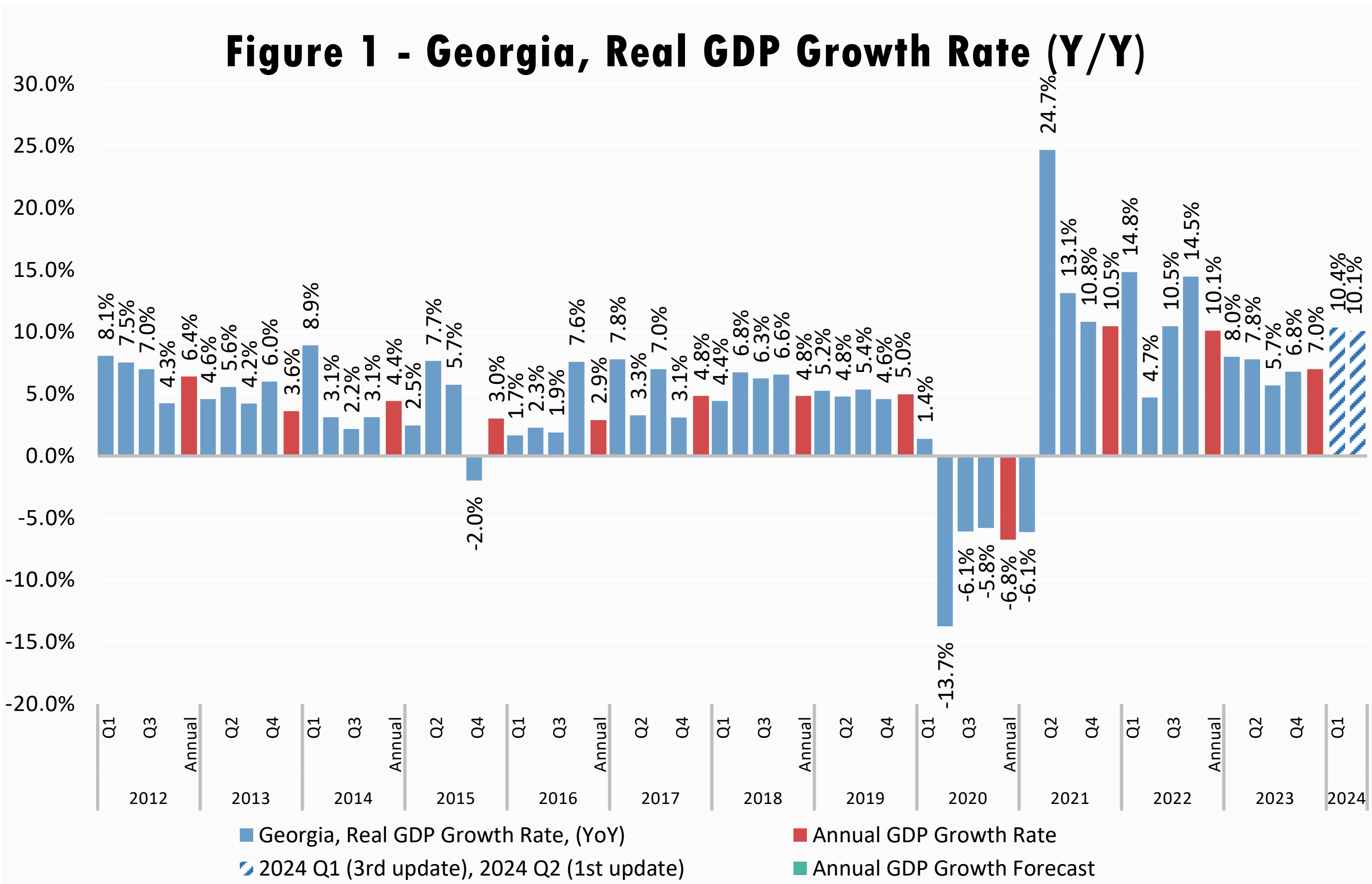
Currency gains, trade contraction, and remittance normalization: key drivers of Georgia's revised 2024 GDP forecast



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

HIGHLIGHTS:

- Geostat has released its rapid estimate of real GDP growth for December 2023. The estimated growth stands at 8.3%, while the average annual real GDP growth reached 7%.
- Due to a recent update in Geostat's GDP calculation methodology in December, revised growth rates show an upward trend compared to the previous month's figures. Consequently, our own forecast for GDP growth has been adjusted upwards to reflect this change.
- ISET-PI forecasts Georgia's economy to grow by 10.4% and 10.1% in the first and second quarters of 2024, respectively.
- Based on December data, the annual growth in 2024 is expected to be 7.8% in the worst-case scenario, and 9.4% 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) predicts an 8.9% increase in real GDP.

- It is important to note that the current forecast might be more optimistic than the official estimates provided by government institutions, like the National Bank of Georgia's 5% growth prediction for 2024. The annual growth scenarios may not fully reflect potential future developments.

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 major categories of national currency deposits experienced growth in annual terms. In particular, national currency demand deposits saw an annual increase of 29.9%, while time deposits increased by 17.6% annually. **Consequently, national currency total deposits increased by 26.9% yearly.** However, according to our model, *the national currency deposits had a relatively low negative contribution to the real GDP growth forecast.*

In contrast to domestic currency deposits, **foreign currency total deposits increased relatively moderately by 2.7%** compared to the same month of the previous year. In the same period, foreign currency current accounts and demand deposits decreased by 8.8% and 2.6%, respectively, in annual terms. On the other hand, foreign currency time deposits increased by 20.5% yearly. *Overall*, *foreign currency deposit-related variables had a small negative contribution to the real GDP growth forecast based on our model.*

Merchandise Trade. In December, Georgia's exports experienced a 7.5% annual decrease. This was mainly driven by the decreased export/re-export of *copper ores and concentrates* (decreased by 92.3% YoY), *mineral or chemical fertilizers, nitrogenous* (decreased by 65.2% YoY), and *wine of fresh grapes* (decreased by 6.4% YoY). On the contrary, the export/re-export of *motor cars* (increased by 27.4% YoY) and *ferro-alloys* (decreased by 550.8% YoY) showed a significant annual increase.

During this period, the import of goods decreased by 10.6% yearly, driven by a decreased import/re-import of *motor cars* (decreased by 19.8% YoY), *petroleum gases and other gaseous hydrocarbons* (decreased by 33.4% YoY), and *telephone sets*, including *telephones for cellular networks or other wireless networks* (decreased by 27.7% YoY). In contrast, imports/re-import of *petroleum and petroleum oils* (increased by 12.8% YoY) and *medicaments put up in measured doses* (increased by 22.1% YoY) experienced an annual increase. **As a result, the trade deficit decreased moderately by 2.5% yearly and amounted to 799 million USD.** *Overall, trade-related variables had a slight positive influence on the GDP growth forecast.*

Remittances. In December, remittances decreased by 42.4% annually and reached 308.3 million USD. The main contributors to this decrease were the *Russian Federation* (decreased by 77.8% YoY, -46.1 ppts), *Turkey* (decreased by 12.6% YoY, -0.2 ppts), and *Azerbaijan* (decreased by 11.1% YoY, -0.1 ppts). Whereas money inflows increased from *Italy* (increased by 19.7% YoY, 1.4 ppts), *United States of America* (increased by 41.6% YoY, 2.3 ppts), *Germany* (increased by 15% YoY, 1.2 ppts), *Greece* (increased by 9.6% YoY, 0.3 ppt), *Kazakhstan* (increased by 15% YoY, 0.4 ppts), *Spain* (increased by 13.2% YoY, 0.1 ppts), and *France* (increased by 12.3% 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 75.5% increase in 2023 compared to 2021. *As a result, money transfers still have a slight positive contribution to the growth forecast.*

Exchange Rate. In December, Georgian Lari appreciated against the **Dollar** (0.9% in monthly terms), **GEL/EUR** (0.1% in monthly terms), **GEL/TRY** (3% in monthly terms), and **Ruble** (1.9% in monthly terms). Furthermore, **REER appreciated by 2.1% yearly. REER's yearly appreciation is mostly related to the relocation of Russian citizens.** While the appreciation of the Georgian Lari positively impacts the Georgian population due to heavy reliance on imports and significant levels of debt dollarization (a notable portion of businesses having income and liabilities in different currencies), it simultaneously diminishes the competitiveness of exports. Overall, REER-*related variables had a negative influence on the real GDP growth projections.*

Money Supply. In December, all monetary aggregates including Narrow Money (M0) and Broad Money (M3), experienced notable growth in annual terms. Monetary aggregates M2 and M3 saw a yearly growth of 26.9% and 14.9%, respectively. The currency in circulation and Narrow Money (M0) increased by 17.7% and 21.4% in annual terms, respectively. As a result, *money supply-related variables had a strong positive contribution to the real GDP growth based on our model.*

Consumer Credit. In December, the total volume of commercial banks' consumer credit increased by 3.2% monthly and by 24.7% yearly. Furthermore, the credit volume of commercial banks' short-term consumer credits increased by 12.4% monthly and 35.8% yearly (the main drivers behind this positive trend in short-term consumer loans are domestic and foreign currencies, which went up by 17.8% and 126.2% respectively in yearly terms). Furthermore, the credit volume of commercial banks' long-term consumer credits increased by 2.9% monthly and 24.4% yearly. *Overall, the variables related to consumer credit have had a small negative impact on the growth forecast.*

Inflation. In December**, the annual inflation of consumer prices amounted to 0.4%, 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 the pandemic and the Russia-Ukraine war. It is also worth noting that **oil prices on the global market (Euro Brent Spot Price (COP) decreased by 4.1% yearly.** It is also crucial to acknowledge that there exist some risks pertaining to the potential elevation of inflation in the global commodity market. *Overall, CPI-related variables have had a positive 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.