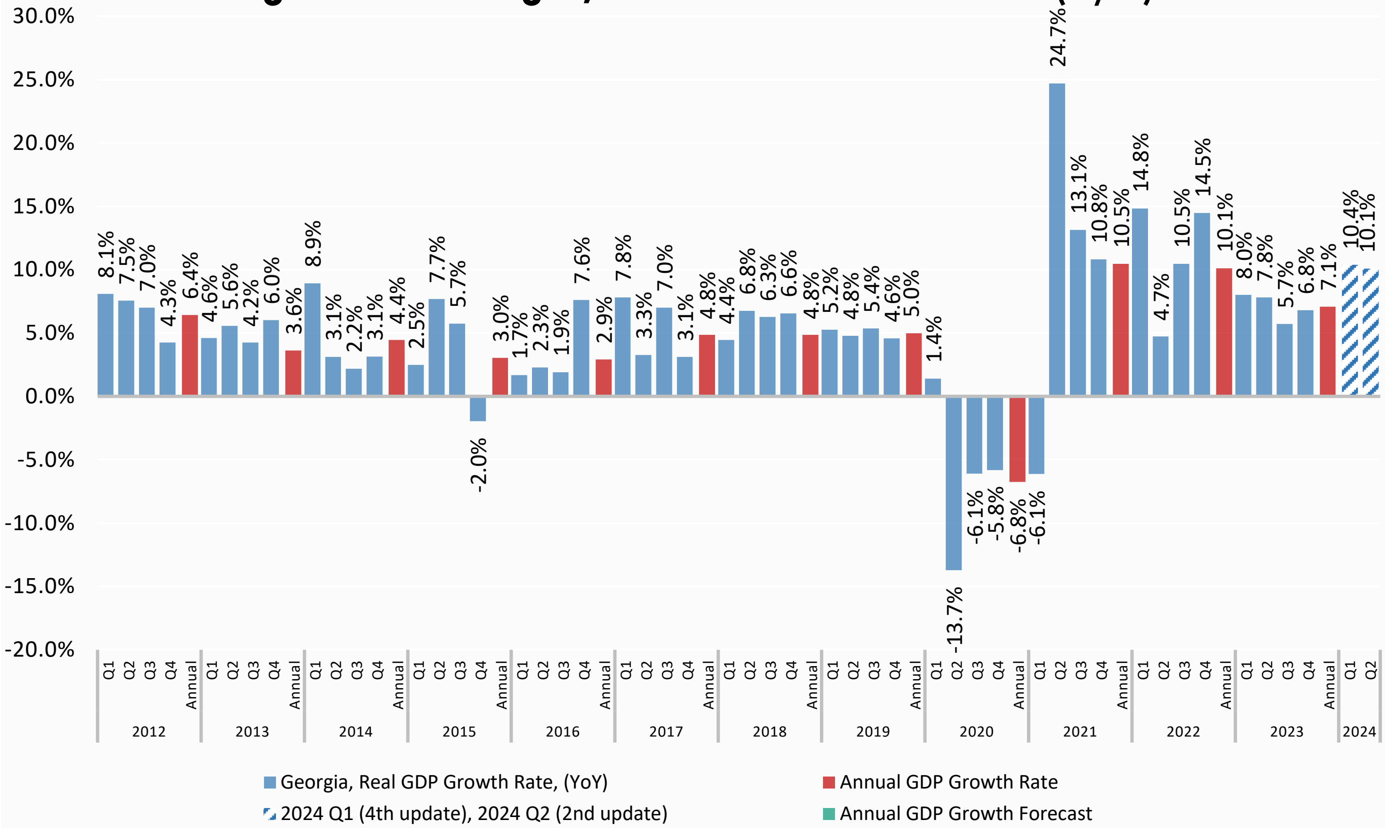
Authors: Tornike Surguladze and Davit Keshelava

Growth surge or temporary blip? ISET-PI unveils key factors shaping Georgia's economy

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



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 January 2024. The estimated growth stands at 5.8%, while the estimated growth of 2023 reached 7.5%.
- 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 January 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.
- ISET's forecast for robust economic growth in 2024 might be overly optimistic. Our models may not fully capture the disruptive effects of the ongoing war in Ukraine.

Variables behind the GDP growth forecast based on the January data:

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 25.4%, while time deposits increased by 33% annually. **Consequently, national currency total deposits increased by 29.6% yearly.** Overall, *the national currency deposits had a relatively low positive contribution to the real GDP growth forecast.*

In contrast to domestic currency deposits, **foreign currency total deposits increased relatively moderately by 5%** compared to the same month of the previous year. In the same period, foreign currency current accounts and demand deposits decreased by 4.3% and 4.4%, respectively, in annual terms. On the other hand, foreign currency time deposits increased by 24.3% yearly. *As a result*, *foreign currency deposit-related variables had a negative contribution to the real GDP growth forecast based on our model.*

Merchandise Trade. In January, Georgia's exports experienced a 26.2% annual decrease. This was mainly driven by the decreased export/re-export of *mineral or chemical fertilizers, nitrogenous* (decreased by 57.8% YoY), and *Ferro-alloys* (decreased by 61.9% YoY). On the contrary, the export/re-export of *motor cars* (increased by 7.4% YoY) and *wine of fresh grapes* (increased by 13.6% YoY) showed an annual increase.

During this period, the import of goods decreased by 10.1% yearly, driven by a decreased import/re-import of *motor cars* (decreased by 35.5% YoY), *petroleum gases and other gaseous hydrocarbons* (decreased by 25.2% YoY), and *petroleum and petroleum oils* (decreased by 2.3% YoY). In contrast, imports/re-import of *telephone sets*, including *telephones for cellular networks or other wireless networks* (increased by 17.9% YoY) and *medicaments put up in measured doses* (increased by 159.9% YoY) experienced an annual increase. **As a result, the trade deficit increased moderately by 1.24% yearly and amounted to 664 million USD.** *Overall, trade-related variables had a slight positive influence on the GDP growth forecast.*

Remittances. In January, remittances decreased by 40.9% annually and reached 263.2 million USD. The main contributors to this decrease were the *Russian Federation* (decreased by 74.7% YoY, -44.9 ppts), *Turkey* (decreased by 14.9% YoY, -0.3 ppts), and *Azerbaijan* (decreased by 2.8% YoY, -0.02 ppts). Whereas money inflows increased from *Italy* (increased by 11.4% YoY, 1 ppts), *United States of America* (increased by 33% YoY, 2.1 ppts), *Germany* (increased by 13.6% YoY, 0.4 ppts), *Greece* (increased by 2.2% YoY, 0.1 ppt), *Kazakhstan* (increased by 7.4% YoY, 0.1 ppts), and *France* (increased by 11.4% 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 expenditures. Consequently, Georgia is now observing a return to more typical patterns in money transfers as the transient impact of this event diminishes. *As a result, money transfers still have a slight positive contribution to the growth forecast.*

Exchange Rate. In January, Georgian Lari appreciated against the **Dollar** (0.2% in monthly terms), **GEL/EUR** (2.3% in monthly terms), and **GEL/TRY** (2.9% in monthly terms), while it depreciated against **Ruble** (0.5% in monthly terms). Furthermore, **REER appreciated by 1.9% 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 January, 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 28.5% and 16.7%, respectively. The currency in circulation and Narrow Money (M0) increased by 16.3% and 22.8% 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 January, the total volume of commercial banks' consumer credit increased by 25.5% yearly. Furthermore, the credit volume of commercial banks' short-term consumer credits increased by 46.4% yearly (the main drivers behind this positive trend in short-term consumer loans are domestic and foreign currencies, which went up by 24.4% and 153.2% respectively in yearly terms). Furthermore, the credit volume of commercial banks' long-term consumer credits increased by 25% yearly. *Overall, the variables related to consumer credit have had a small negative impact on the growth forecast.*

Inflation. In January, the annual inflation of consumer prices amounted to 0%, which is notably lower than the targeted 3%. Importantly, stable international commodity prices continue to dampen inflationary pressures. Inflation is then expected to gradually realign with the medium-term target. It is also worth noting that **oil prices on the global market (Euro Brent Spot Price (COP) decreased by 2.9% yearly. However, inflationary risks remain.** Economic growth, while positive, could lead to demand exceeding supply, putting upward pressure on prices. *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.