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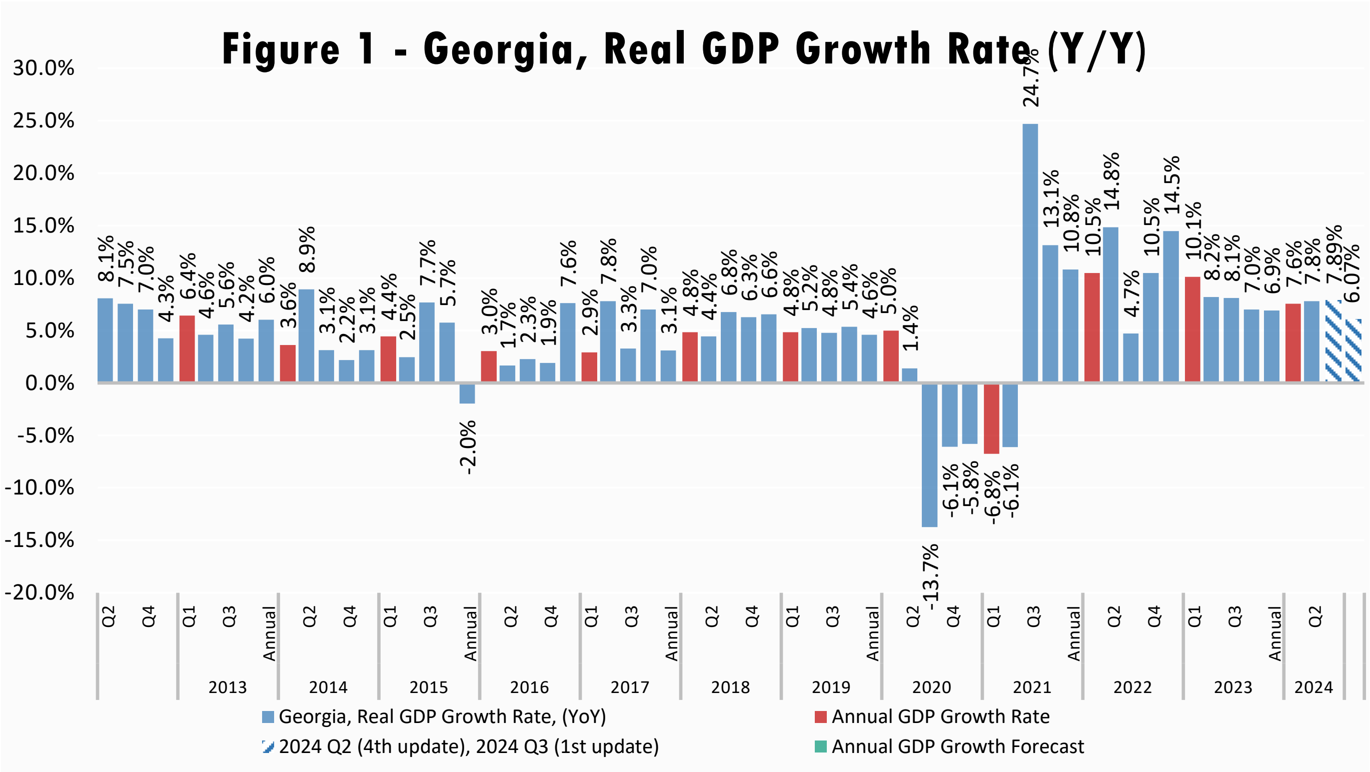
Economic growth stays strong despite risks: export/import drops, remittance challenges, and low inflation



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

HIGHLIGHTS:

- Geostat has published its preliminary estimate of real GDP growth for March 2024, which stands at 8.2%. In addition, the estimated growth for the first quarter of 2024 reached 7.8%.
- Following a recent update in Geostat's GDP calculation methodology in December, the revised growth rates exhibit an upward trend compared to the previous months' figures since the previous release. Consequently, our GDP growth forecast has been adjusted upwards to reflect this change.
- ISET-PI forecasts Georgia's economy to grow by 7.9% in the second quarter and 6.1% in the third quarter of 2024.
- According to March data, the annual growth in 2024 is projected to be 7.1% in the worst-case scenario and 8.8% in the best-case or average long-term growth scenario. Our median scenario, reflecting the average growth from the past four quarters, forecasts an 8.2% increase in real GDP.

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

National and Foreign Currency Deposits. The first set of variables with a moderate impact on our forecast pertains to national and foreign currency deposits in commercial banks. All major categories of national currency deposits showed annual growth. Specifically, national currency demand deposits increased by 26.9% year-over-year, while time deposits rose by 33.1% annually. As a result, total national currency deposits grew by 29.8% on an annual basis. *Overall, national currency deposits had a relatively low positive contribution to the real GDP growth forecast.*

Total foreign currency deposits increased by 12.5% compared to the same month of the previous year. During this period, foreign currency current accounts rose by 8.7%, while foreign currency demand deposits decreased by 0.6% annually. On the other hand, foreign currency time deposits saw a significant annual increase of 30.7%. *Consequently, variables related to foreign currency deposits contributed negatively to the real GDP growth forecast according to our model.*

Merchandise Trade. In March, Georgia's exports experienced a 4.4% annual decrease. This decline was primarily driven by a significant reduction in the export/re-export of mineral or chemical fertilizers, nitrogenous, which fell by 64.4% year-over-year, and copper ores and concentrates, which decreased by 80.2% year-over-year. On the other hand, there was an annual increase in the export/re-export of motor cars, which rose by 3.6%, and wine made from fresh grapes, which surged by 63.7%.

During this period, the import of goods decreased by 14.7% year-over-year, driven by a significant drop in the import/re-import of motor cars, which fell by 41.3% YoY. In contrast, there were annual increases in the import/re-import of petroleum gases and other gaseous hydrocarbons (up 16.4% YoY), petroleum and petroleum oils (up 10.1% YoY), telephone sets, including those for cellular and other wireless networks (up 42.8% YoY), and medicaments put up in measured doses (up 14.5% YoY). **Consequently, the trade deficit decreased by 21.41% year-over-year, amounting to 654 million USD.** *Overall, trade-related variables had a slight positive influence on the GDP growth forecast.*

Remittances. In March, remittances decreased by 36.5% year-over-year, reaching 278.5 million USD. The primary contributors to this decline were the Russian Federation (down 76.3% YoY, -38.9 percentage points), Kazakhstan (down 32.2% YoY, -1.2 percentage points), Turkey (down 19.5% YoY, -0.5 percentage points), Kyrgyzstan (down 51.6% YoY, -0.7 percentage points), and Azerbaijan (down 15.9% YoY, -0.15 percentage points). Conversely, money inflows increased from Italy (up 7.5% YoY, 0.74 percentage points), the United States (up 24.4% YoY, 2 percentage points), Germany (up 14.7% YoY, 0.6 percentage points), and Greece (up 7.1% YoY, 0.3 percentage points). The reduction in money inflow can be again attributed to the base effect. In 2022, there was a substantial surge in the influx of Russian citizens relocating to Georgia following Russia's war in Ukraine, and they subsequently remitted funds for their expenditures. As the transient impact of this event diminishes, Georgia is observing a return to more typical patterns in money transfers. *Consequently, money transfers still have a slight positive contribution to the growth forecast.*

Exchange Rate. In March, the Georgian Lari depreciated against the **Dollar** (1.3% in monthly terms), **GEL/EUR** (1% in monthly terms), against the **Ruble** (0.4% in monthly terms). Furthermore, **REER depreciated by 1.7% yearly** and **appreciated for TRY** (2.3% in monthly terms)**.** The depreciation of the Georgian Lari negatively 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 increases the competitiveness of exports. Overall, REER-*related variables had a negative influence on the real GDP growth projections.*

Exchange Rate. In March, the Georgian Lari depreciated against the Dollar by 1.3%, against the Euro by 1%, against the Turkish Lira by 1.6%, and against the Russian Ruble by 0.4% on a monthly basis. Furthermore, the Real Effective Exchange Rate (REER) depreciated by 1.7% year-over-year. The depreciation of the Georgian Lari negatively impacts the Georgian population due to a heavy reliance on imports and significant levels of debt dollarization, with many businesses having income and liabilities in different currencies. However, it simultaneously increases the competitiveness of exports. *Overall, REER-related variables had a negative influence on the real GDP growth projections.*

Consumer Credit. In March, the total volume of commercial banks' consumer credit increased by 26.8% year-over-year. The volume of short-term consumer credits rose significantly by 52.2% annually, driven mainly by increases in both domestic and foreign currencies, which grew by 25.3% and 195%, respectively, on a yearly basis. Furthermore, the volume of long-term consumer credits provided by commercial banks increased by 26.1% annually. *Despite these increases, the variables related to consumer credit had a small negative impact on the growth forecast.*

Inflation. In March, **the annual inflation rate for consumer prices was 0.5%, which is significantly lower than the targeted 3%.** Stable international commodity prices have played a key role in mitigating inflationary pressures. It is expected that inflation will gradually realign with the medium-term target. **Oil prices on the global market (Euro Brent Spot Price) decreased by 8.9% year-over-year.** However, inflationary risks persist. *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.