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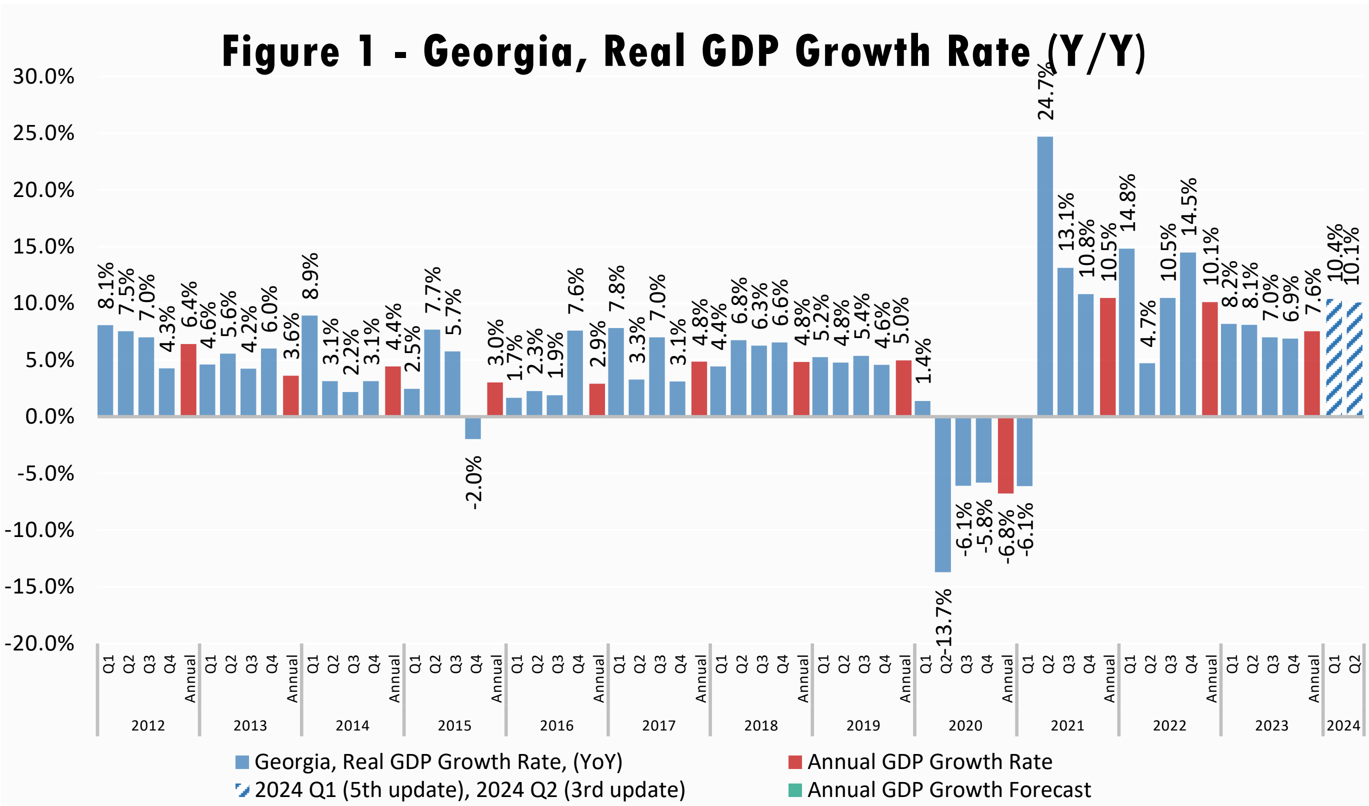
National and foreign currency deposits, merchandise trade, and remittances: key drivers of Georgia's April 2024 GDP forecast



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 February 2024. The estimated growth stands at 9.5%.
- 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 forecast for GDP growth has been adjusted upwards to reflect this change.
- ISET-PI forecasts Georgia's real GDP to grow by 10.4% and 9.8% in the first and second quarters of 2024, respectively.
- Based on February 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, conflict in the Middle East, and other Geopolitical tensions.

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

National and Foreign Currency Deposits. The first set of variables with a moderate effect on our forecast relates to commercial banks' national and foreign currency deposits. All major categories of national currency deposits experienced growth in annual terms. In particular, national currency demand deposits saw a yearly increase of 26.9%, while time deposits increased by 30.4% annually. **Consequently, national currency total deposits increased by 28.1% yearly.** *The national currency deposits had a relatively small positive contribution to the real GDP growth forecast.*

In contrast to domestic currency deposits, **foreign currency total deposits increased relatively moderately by 5.9%** compared to the same month of the previous year. In the same period, foreign currency demand deposits decreased by 5.6%, in annual terms. On the other hand, foreign currency time deposits increased by 23.7% yearly. *As a result*, *foreign currency deposit-related variables positively contributed to the real GDP growth forecast based on our model.*

Merchandise Trade. In February, Georgia's exports experienced a 2% annual increase. This low growth rate was mainly influenced by a significant decrease in the export/re-export of copper ores and concentrates, which dropped by 99.9% year-over-year. In contrast, there was an annual rise in the export/re-export of motor cars by 13.6% and wine made from fresh grapes by 58.9%.

During this period, the import of goods increased by 9.1% year-over-year, primarily driven by a 40.47% rise in the import/re-import of petroleum and petroleum oils. In contrast, there were annual decreases in the import/re-import of motor cars by 13.7%, petroleum gases, and other gaseous hydrocarbons by 30.4%, and medicaments put up in measured doses by 10.9%. Consequently, the trade deficit grew by 14.4% year-over-year, reaching 701 million USD. Overall, trade-related variables had a negligible positive impact on the GDP growth forecast.

Remittances. In February**, remittances decreased by 29% annually, reaching 264.3 million USD.** The primary contributors to this decrease were the Russian Federation (down 70.8% YoY, -35.6 percentage points), Kazakhstan (down 18.4% YoY, -0.6 percentage points), and Turkey (down 11.8% YoY, -0.3 percentage points). In contrast, money inflows increased from the United States (up 35.3% YoY, 2.9

percentage points), Italy (up 13% YoY, 1.4 percentage points), Germany (up 23.3% YoY, 0.9 percentage points), Greece (up 9.3% YoY, 0.4 percentage points), and Israel (up 24.5% YoY, 1.1 percentage points). The reduction in money inflow can be attributed to the base effect. In 2022, there was a significant surge in the influx of Russian citizens relocating to Georgia due to 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 February, the Georgian Lari appreciated against the **Dollar** (0.8% in monthly terms), **GEL/EUR** (1% in monthly terms), **GEL/TRY** (3.5% in monthly terms), and **Ruble** (3.5% 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 negatively influenced the real GDP growth projections.*

Money Supply. In February, 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 29.6% and 17.4%, respectively. The currency in circulation and Narrow Money (M0) increased by 16.7% and 24.1% annually, respectively. As a result, *money supply-related variables had a strong positive contribution to the real GDP growth based on our model.*

Inflation. In February**, the annual inflation of consumer prices amounted to 0.3%, 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) increased by 1.1% yearly. Hence, inflationary risks persist.** Economic growth, despite being positive, may result in demand outpacing supply, which could exert 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.