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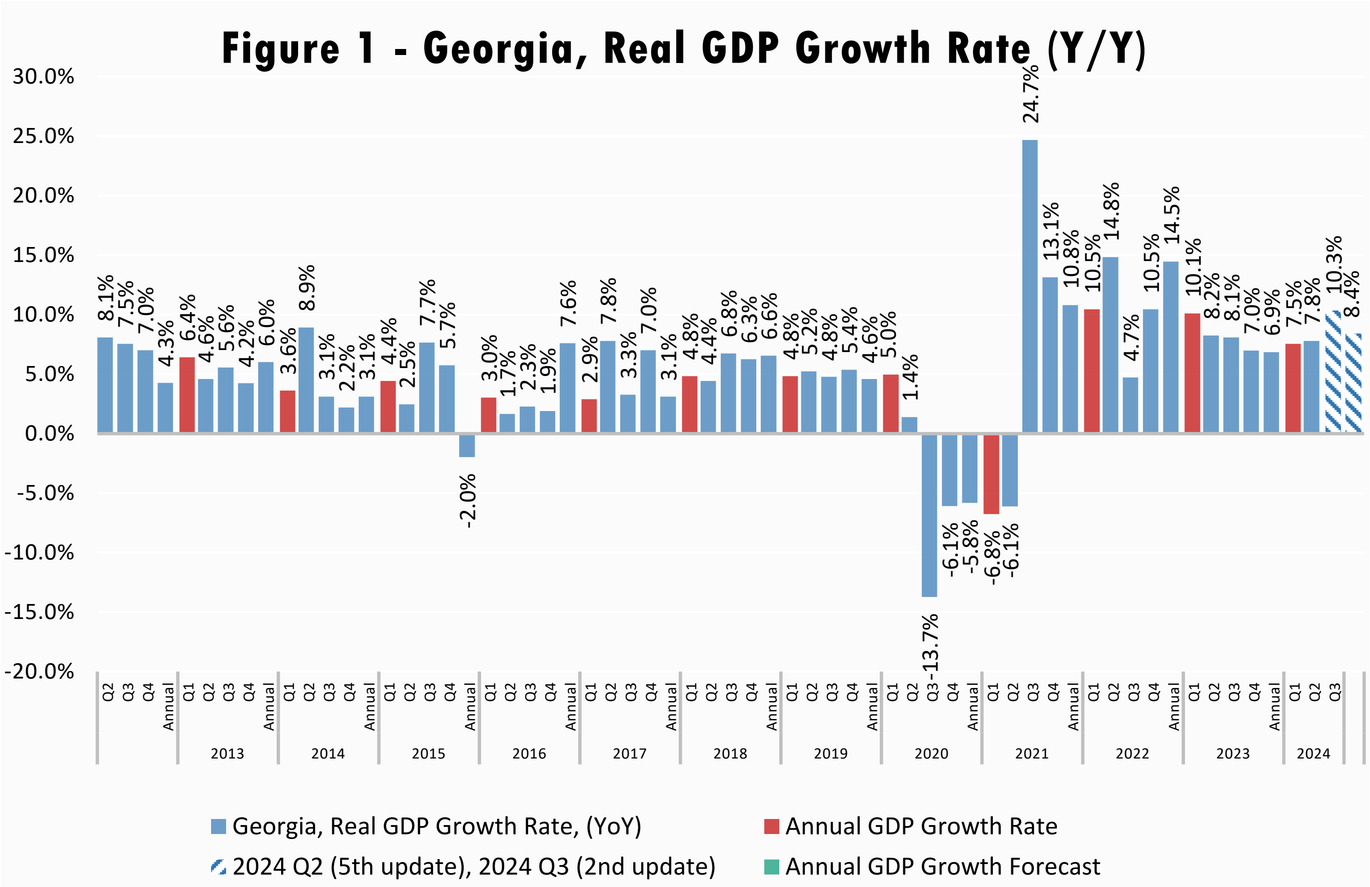
Strong growth forecast persists despite May 2024 trade decline, remittance drop, and lari depreciation



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 May 2024, which stands at 9.2%. In addition, the estimated growth for the first quarter of 2024 reached 8.4%, which is 0.6 ppt higher than the previous estimate. As a result, the average real GDP growth for January - May 2024 reached 9.3%.
- ISET-PI forecasts Georgia's economy to grow by 10.3% in the second quarter and 8.4% in the third quarter of 2024.
- According to May data, the annual growth in 2024 is projected to be 8.3% in the worst-case scenario and 10% in the best-case or average long-term growth scenario. Our median scenario, reflecting the average growth from the past four quarters, forecasts a 9.5%

increase in real GDP. The model most likely overestimated these numbers at the current point in time.

Variables influencing the GDP growth forecast based on the May 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 16.8% year-over-year, while time deposits rose by 26% annually. As a result, total national currency deposits grew by 18.3% on an annual basis. **Total foreign currency deposits increased by 17.6% compared to the same month of the previous year.** In the same period, foreign currency current accounts and demand deposits increased by 8% and 2.6%, respectively, in annual terms. Furthermore, foreign currency time deposits saw a significant annual increase of 43.4%. *However, according to our model, variables related to the national and foreign currency deposits still had a slight negative contribution to the real GDP growth forecast according to our model.*

Merchandise Trade. In May, Georgia's exports experienced a 7.3% annual decrease. This decline was primarily driven by a significant reduction in the export/re-export of motor cars (fell by 18.5% YoY), copper ores and concentrates (fell by 83.6% YoY), wine of fresh grapes (fell by 43.3% YoY), and electric energy (fell by 19.6% YoY).

During this period, the import of goods decreased by 0.8% year-over-year, driven by an annual decrease in the import/re-import of motor cars (fell by 28.3% YoY), medicaments put up in measured doses (fell by 20.6% YoY), and telephone sets and apparatus for the transmission or reception of voice, images or other data (including wired/wireless networks) (fell by 41% YoY). In contrast, there was an increase in the import/re-import of petroleum and petroleum oils (up 11.9% YoY) and automatic data processing machines and units thereof (up 270.4% YoY). **Consequently, the trade deficit increased by 3.6% year-over-year, amounting to 817 million USD.** *Overall, trade-related variables had a slight negative influence on the GDP growth forecast.*

Remittances. In May, remittances decreased by 27.1% year-over-year, reaching 284.3 million USD. The primary contributors to this decline were the Russian Federation (down 69.5% YoY, -28.1 percentage points), Kazakhstan (down 43.4% YoY, -2.2 percentage points), and Turkey (down 41.8% YoY, -1.9 percentage points). Conversely, money inflows increased from the United States (up 22.1% YoY, 2.2 percentage points), Italy (up 7.7% YoY, 0.9 percentage points), Germany (up 7.7% YoY, 0.4 percentage points), Greece (up 2% YoY, 0.1 percentage points), and Israel (up 20.3% YoY, 0.9 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. *However, money transfers still had a positive contribution to the growth forecast according to our model.*

Exchange Rate. In May, the Georgian Lari depreciated against the **Dollar** (4.2% in monthly terms), **Euro** (5.2% in monthly terms), **Ruble** (8% in monthly terms), and **Turkish lira** (4.5% in monthly terms). Furthermore, **REER depreciated by 5.3% yearly.** 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). 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 May, the total volume of commercial banks' consumer credit increased by 29.4% year-over-year. The volume of short-term consumer credits rose significantly by 81.7% annually, driven mainly by increases in both domestic and foreign currencies, which grew by 25.7% and 391.5%, respectively, on a yearly basis. Furthermore, the volume of long-term consumer credits provided by commercial banks increased by 28.1% annually. *As a result, the variables related to consumer credit had a positive impact on the growth forecast.*

Inflation. In May, **the annual inflation rate for consumer prices was 2%, 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. It is also worth noting, that **oil prices on the global market (Euro Brent Spot Price) increased by 8.3% year-over-year.** Consequently, inflationary risks persist. *Overall, CPI-related variables have had a slight 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.