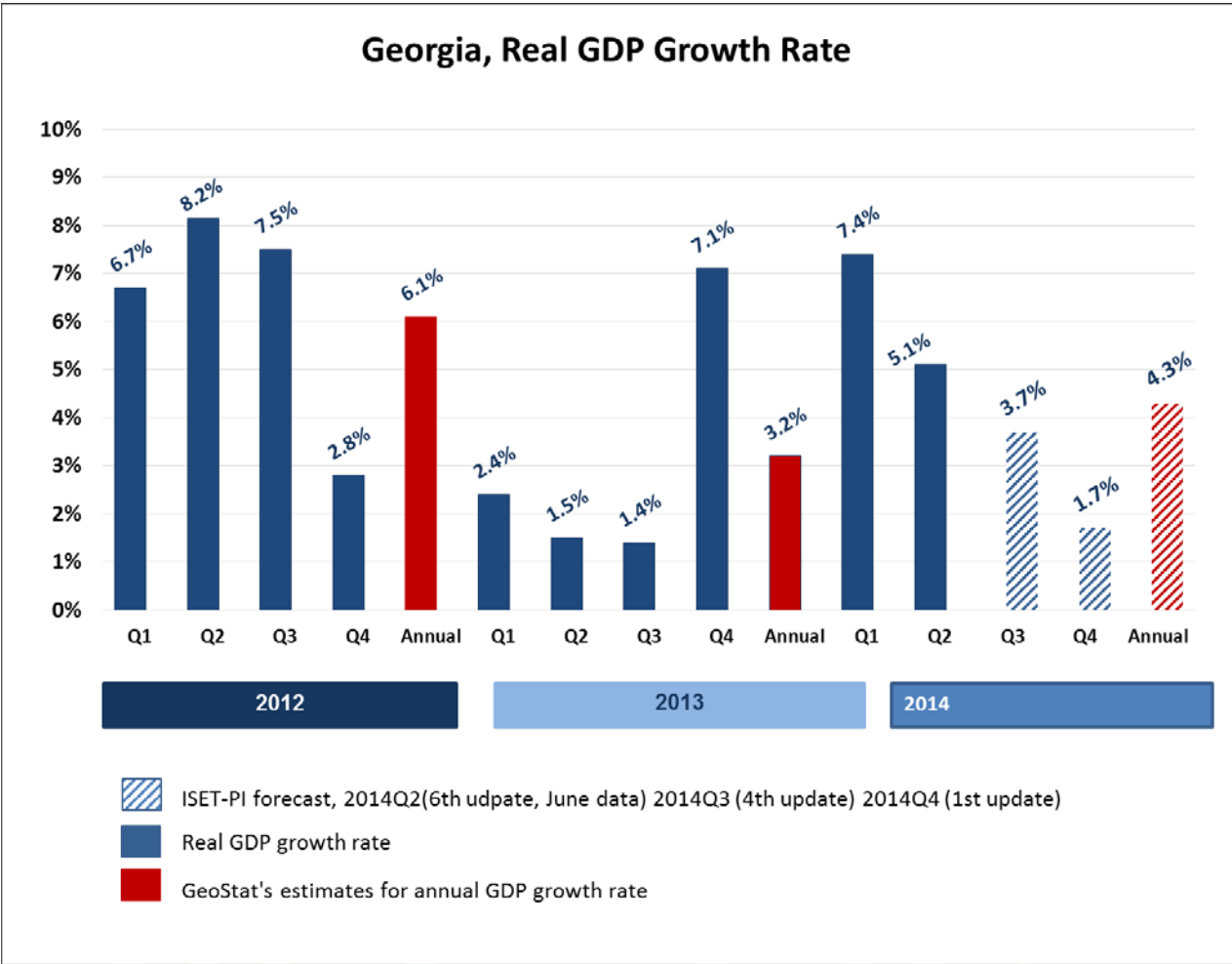# Leading GDP Indicator for Georgiass

September, 2014

Alarming fall of growth rates.

ISET PI has updated the forecasts for Georgia's real GDP growth rates using the July 2014 releases of various economic indicators.

- Based on July data we made 4th update of Q3 forecast, and it was revised down from -7.6%, down to 3.7%.

- We also begin to forecast the last quarter of 2014, the forecast is not promising, it is just 1.7%

- Meanwhile, Geostat has released official quarterly growth GDP rate for the second quarter of 2014 and it is 5.2% (This data is still preliminary and will be revised in the future).

- From 2014 we started to draw some conclusions about annual growth rate for year 2014. Since we have already final figures or forecast for each quarter of 2014 we will not use the methodology which we have used in previous months and which is explained in our February and January publications. Yearly growth in 2014 is estimated to be 4.3%. If instead of our first vintage of fourth Quarter we will take historical average of all previous quarters we will get the same 4.3% annual growth in 2014, which in itself is quite close to EBRD-s and World Banks estimation of GDP growth of Georgia, they are respectively 4 and 5%

Georgia, Real GDP Growth Rate

Legend:
- ISET-PI forecast, 2014Q2(6th udpate, June data) 2014Q3 (4th update) 2014Q4 (1st update)
- Real GDP growth rate
- GeoStat's estimates for annual GDP growth rate

Nothing could have anticipated such an alarming fall in growth rates of third quarter, from 7.6% to 3.7%. What has changed from June to July so that growth rates declined so much? The results of this year drought should not be yet reflected in July's data. The economic landscape in Georgia has changed very little between June and July 2014. May be it is due external sector? Slowdown of Russian economy and war in Ukraine will definitely affect Georgia's economy, however how strong is that effect is another question, and another question is through which variables are they affecting growth?

Looking at our explanatory variables it is difficult to indicate variables affecting such fall. Especially when noticing encouraging development of the energy sector. In July electricity generation and net export increased in comparison to June respectively by 17 and 62%. Moreover they are higher than their previous historical Maximum. (They stand at their historical maximum)

The most important and most negative change from June to July was in net export of goods. It was -541mln USD, not historical maximum but very close to it. It is 19% higher than in the previous month and 16% higher than the same figure in July 2013. Since net exports directly enter to nominal GDP it has also significant influence on real GDP growth and since July is the one of the months of third quarter such a decrease of net export can explain well drop of growth forecast of the third Quarter.

As we see estimated growth is quite low in the last two quarters, but still yearly 4.3% is not alarmingly bad. Generally what are our hopes about the GDP growth in the second half of 2014?

On the positive side, there is one sedative factor. In Geostat data which we use, export and import of services are not included. We are not using them due to availability problem. In summer net export of services is high since it is touristic season, and this year it was quite successful one. Generally export of services is not negligible. For example In the first quarter of 2014 exports of services were nearly 70% of exports of goods, whereas imports were much lower. Thus total net exports will not be as low as we might think after looking at net exports of goods and respectively using only about goods but not services might cause underestimation of growth of third Quarter.

On the negative side, comparing to last year due to draught harvest in this year would be much less than in the last year. Even though share of agricultural production in GDP is not that high, having as a base last year's fourth quarter it will be difficult to reach high growth rates.

Consumer Price Index has decrease slightly by 1.5% in yearly terms. Despite the relatively low level of May Khachapuri Index (2.97 GEL), this indicator of the basic cost of living has increased by 9% compared to July of last year.

An addition, in line with our growth forecast consumer confidence index in July has also decreased.

Our forecasting model is based on the Leading Economic Indicator (LEI) methodology developed by the New Economic School, Moscow, Russia [2] We constructed a dynamic model of the Georgian economy which assumes that all economic variables, including the 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 ("vintages"), which increase in precision as time goes on. Our first forecast (1st vintage) is available about 5 months before the end of the quarter in question. The last forecast (5th vintage) is published in the first month of the next quarter.