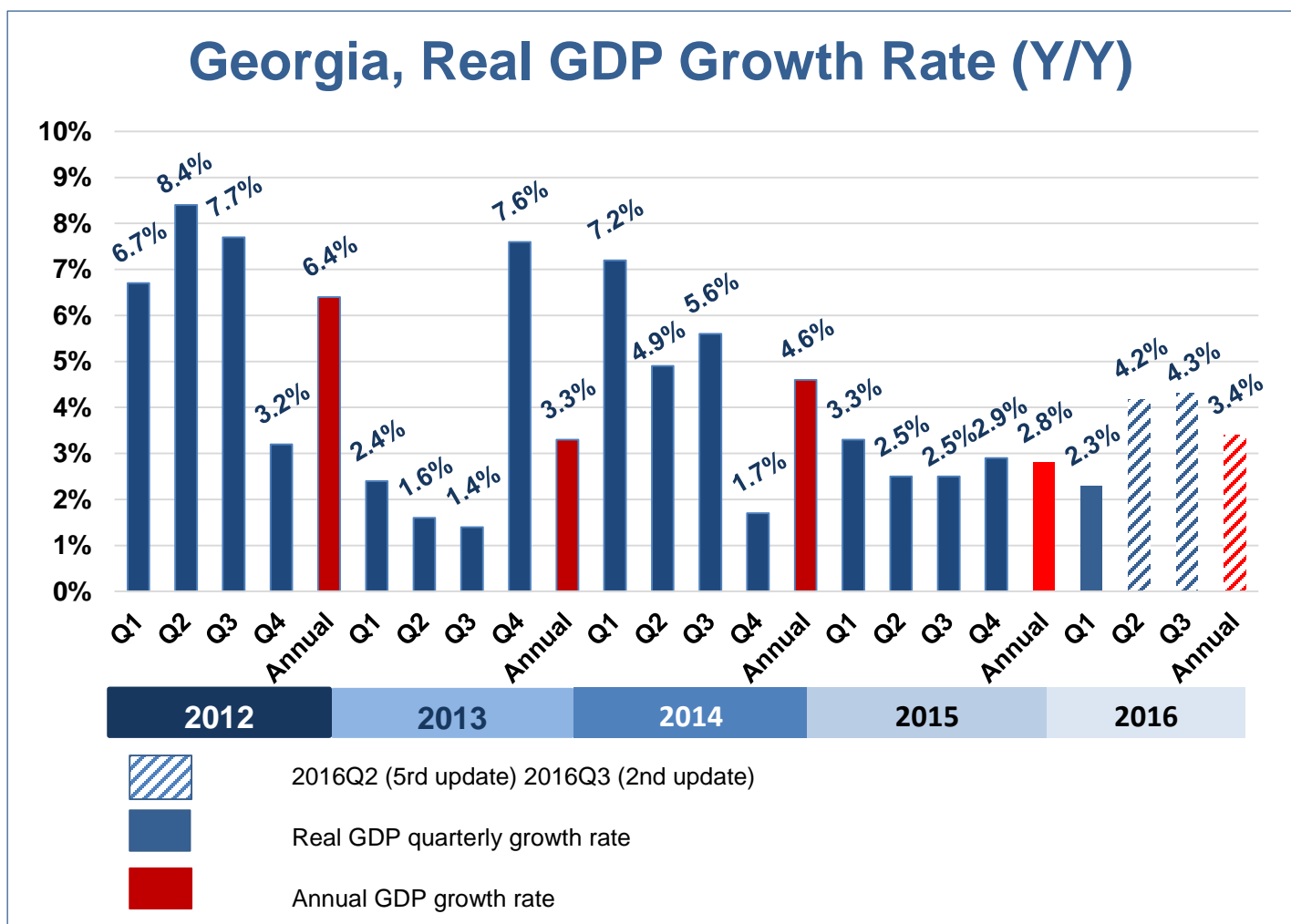# Leading GDP Indicator Forecast for Georgia | June 2016

Early Seasonal Tourist Inflow Increases Incomes and (Dollar!) Savings

ISET-PI has updated its forecast of Georgia's real GDP growth rate for the second and third quarters of 2016. Here are the highlights of this month's releases:

- The growth forecast for the 2nd and 3rd quarters of 2016 has not changed. They stand at 3.2% and 3.3% respectively.
- Based on this month's data, we expect annual growth in 2016 to be 2.7% in the worst-case or "no growth" scenario, and 4.1% in the best-case or "average long-term growth" scenario. Our "middle-of-the-road" scenario (based on the average growth in the last four quarters) predicts a **3.4% real GDP increase in 2016.**

Georgia, Real GDP Growth Rate (Y/Y)

Legend:
- 2016Q2 (5rd update) 2016Q3 (2nd update)
- Real GDP quarterly growth rate
- Annual GDP growth rate

The unusual stability of the economic indicators used in our model during April is reflected on our forecast of the second and third quarters' GDP growth. None of the forecast figures changed by even a tenth of a percentage point since the last update. However, some sets of the predictor variables exhibited relatively significant monthly and yearly changes. One such set is related to the volume of **Foreign Currency Current Accounts (FCCA)**. As these volumes are
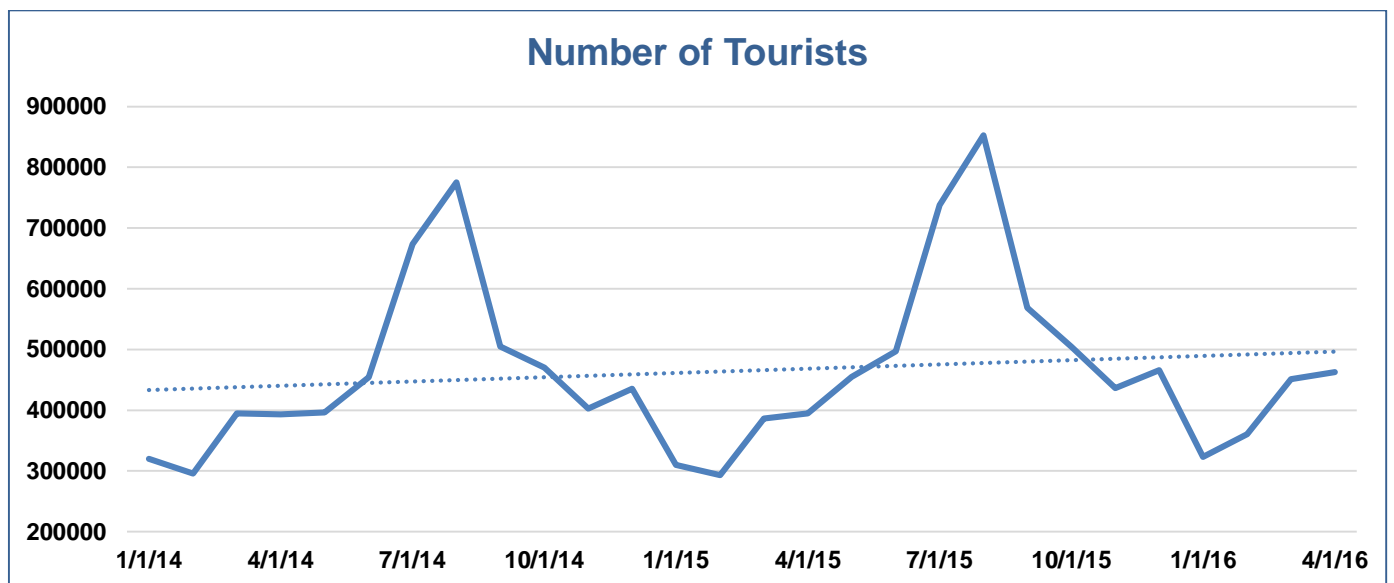
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denominated in the national currency, in order to remove the exchange rate effect we recalculated them in dollar terms. The volume increased by 10% in monthly terms and by 51% in annual terms (see the graph below).

Foreign Currency Current Accounts in USD
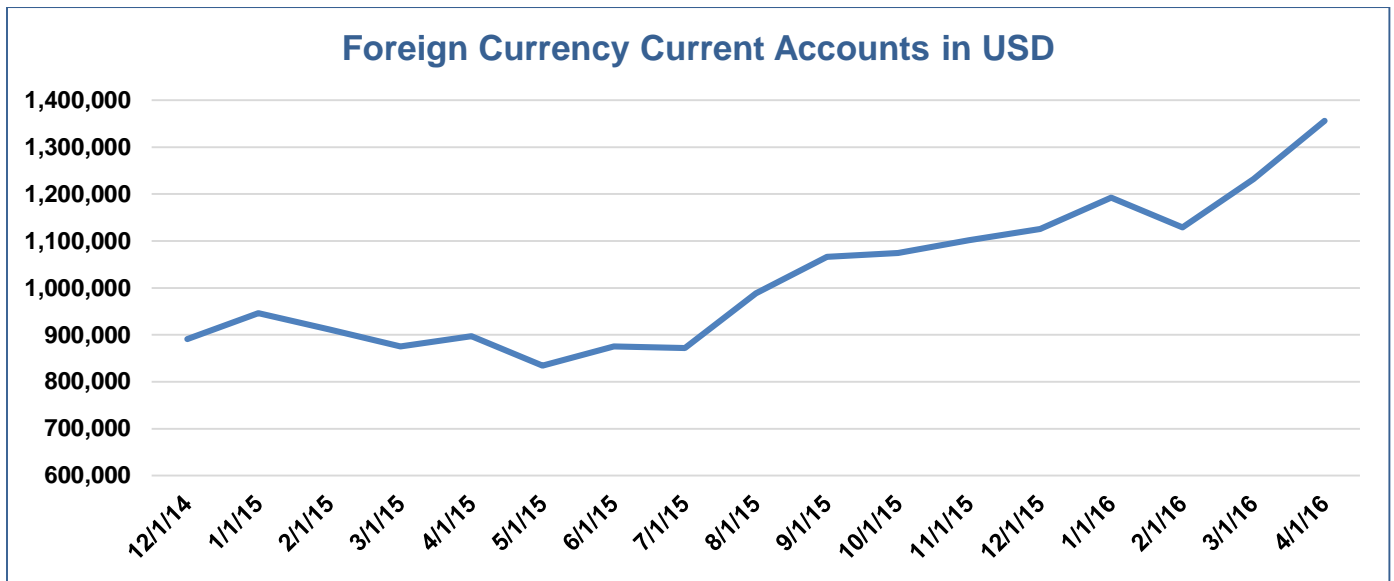
Despite the fact that **interest rates** on short-term foreign currency deposits **decreased** by 13% compared to March 2016 and by 41% compared to the same month in the previous year, **Foreign Currency Time Deposits of less than 3 months** increased quite significantly, even in lari terms (a 10% monthly increase), while the volume of short-term **Time Deposits in National Currency** continue to decline. This might be due to the influx of tourists into Georgia in the early months of 2016.

The graph below shows the number of foreigners crossing the Georgian Border since 2014. As expected, the data is strongly seasonal, but this year the tourist season has started earlier, contributing to the positive trend. The tourist inflow increases incomes and, consequently, savings. As might be expected, after a year of currency fluctuations people prefer to save in USD, despite the decreasing returns on USD deposits and the appreciating lari.

Number of Tourists

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The set of variables that had the most significant positive effect on our forecast were **Currency in Circulation**-related variables. The National Bank of Georgia has recently eased its monetary policy by lowering the monetary policy interest rate. This has resulted in the expansion of the quantity of money in circulation (M1) by 5% monthly and by 4% annually. The variables with a negative impact on our forecast were mostly related to the appreciation of the lari against all foreign currencies aside from the Russian ruble. The most significant change was with respect to the USD: the lari appreciated by 6% over last month and by 3% compared to the same month in the previous year.

From September, we started to include the **Metals Price Index (PMETA)** and the **Agricultural Raw Materials Index (PRAWM**) as explanatory variables in our forecast. The reason for adding these series was that metals form a significant share of Georgia's exports, while food is one of the main import items. Therefore, a global increase in the price of metals should help the Georgian economy, while an increase in the price of agricultural produce is more likely to hurt it. In April, **metal and agriculture prices decreased by 19% and 12%** respectively in annual terms. As was the case with other variables this month, the addition of these series turned out to have a very small (but overall negative) effect on our predictions of GDP growth in the second and third quarters. Adding the PMETA and PRAWN indicators to the model decreased the growth forecast in both quarters by less than 0.01%.

Our forecasting model is based on the Leading Economic Indicator (LEI) methodology developed by the New Economic School, Moscow, Russia. 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 (or "vintages"), which increase in precision as time goes on. Our first forecast (1st vintage) is available about five months before the end of the quarter in question. The last forecast (5th vintage) is published in the first month of the next quarter. We started forecasting the annual growth rate at the beginning of 2014 (see our January 2014 and February 2014 publications for a note on methodology).