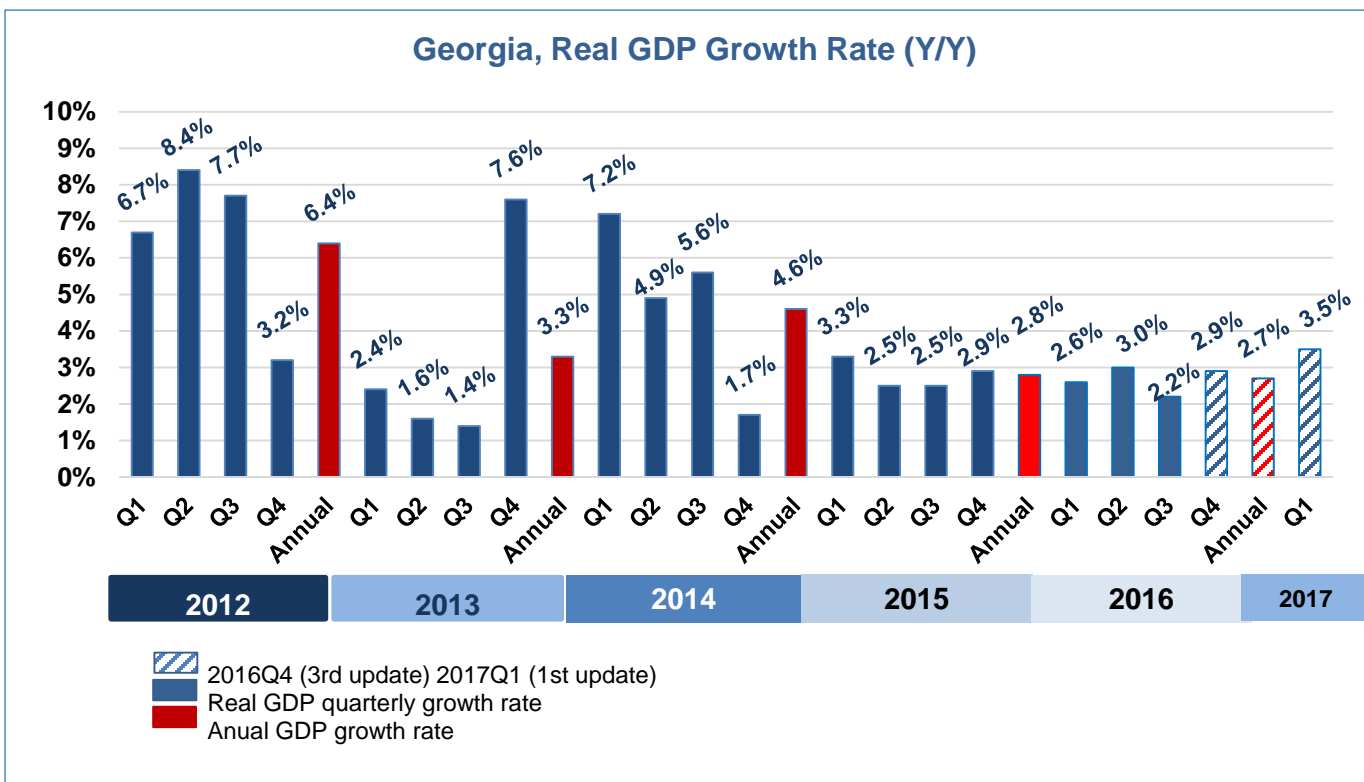


Authors: Davit Keshelava and Yasya Babych

## Exports Show Annual Growth for the First Time in Two Years

ISSET-PI has updated its forecast of Georgia’s real GDP growth rate for the fourth quarter of 2016 and the first quarter of 2017. Here are the highlights of this month’s release:

- Geostat has updated its GDP growth estimate for the third quarter of 2016. The Q3 growth rate stands at 2.2%, which was 1.3% below the ISET PI’s forecasted value.
- As a result of the update, the growth forecast for Q4 of 2016 was revised downward to 2.9% from the 4.1% projected in October.
- ISET-PI’s first forecast for Q1 of 2017 puts GDP growth at 3.5%.



If we look at the model’s explanatory variables, the 1.2% drop in the 4th quarter GDP growth forecast seems unexpected. Despite the increasing trend of the foreign currency deposits, improved trade balance and expansionary monetary policy, the core explanatory variables in our model remained quite stable in September. The only changes were related to the newly arrived data about the 3rd quarter economic growth, provided by Geostat. According to the latest Rapid Estimate of Economic Growth, - GDP growth in Q3 amounted to 2.2%, which was 1.3% lower than the latest estimate of our model.

Looking at the economic landscape from the standpoint of the September data, a few variables changed significantly since August. The most significant changes were observable for variables related to the foreign currency deposits of various maturities in commercial banks. All types of the foreign currency deposits increased significantly in yearly and monthly terms.



The very liquid Foreign Currency Current Account (FCCA) increased slightly by 7% in yearly terms and 9% in monthly terms. Even if we disregard the exchange rate effect by denominating this variable in US dollars, the outcome does not change and FCCA still increases by 9% monthly and 11% yearly.

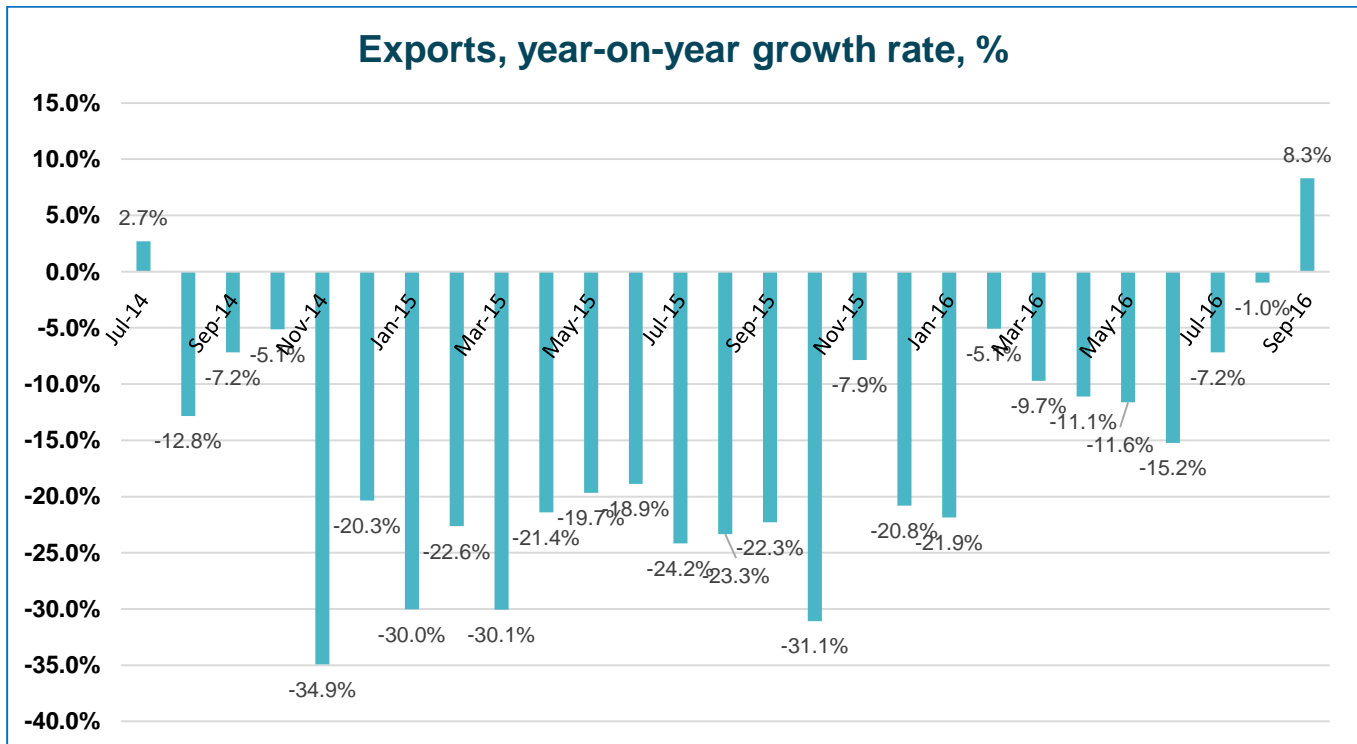
In addition, the largest yearly increase was observed for Foreign Currency Demand Deposits (FCCD) , as this variable increased by 22% relative to the same month of the previous year. Thus, aggregate measurement of the foreign currency deposits - Foreign Currency Total Deposits (FCTD) increased by 9% yearly and 3% monthly.

Despite the fact that the accumulation of the foreign currency deposits increases dollarization (we observe only moderate changes of dollarization in September), it also rises saving that will be transformed into the investment and foster economic growth. Indeed, the Foreign Currency Deposits related variables had a positive contribution on the GDP growth projection.

The set of variables that had a significant positive effect on our forecast is related to currency in circulation. The Monetary Policy Committee (MPC) of the National Bank of Georgia met on September 7th and decided to reduce the refinancing rate by 0.25 percentage point to 6.5% that further stimulated money supply. However, at the end of this month the risk of currency depreciation increased significantly and National Bank of Georgia sold 60 million USD in two separate auctions. Overall, all monetary aggregates including the largest Broad Money (M3) increased significantly (by 3% monthly and 9% yearly) in the corresponding month. Moreover, the largest yearly increase was observed for Currency in Circulation (CCIR) that increased by 12% relative to the same month of the previous year.

The other set of variables that had a positive effect on the predicted GDP growth were the variables related to the trade balance. For the first time in more than 2 years (since July 2014), export volume has increased in yearly terms. The increase was moderate and amounted to 8% (it is notable that the prices on the main exported products further decreased, otherwise the increase would have been much higher).

Moreover, import (excluding import related to the C Hepatitis elimination program) went down by 1% in yearly terms. Indeed, the trade balance was improved and these variables positively affected the GDP forecast.





Remittance, together with the foreign direct investment (FDI) represents main source of the external funding for Georgia. In September, remittance increased by 13% relative to the same month of the previous year. This had moderate, but still positive impact on the projected real GDP growth in Q4 of 2016 and Q1 of 2017.

Indeed, remittances are an important source of income for many low and middle-income households in Georgia. Consumption and investment tend to benefit from increase in remittances, thus positively affecting the GDP growth.

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.