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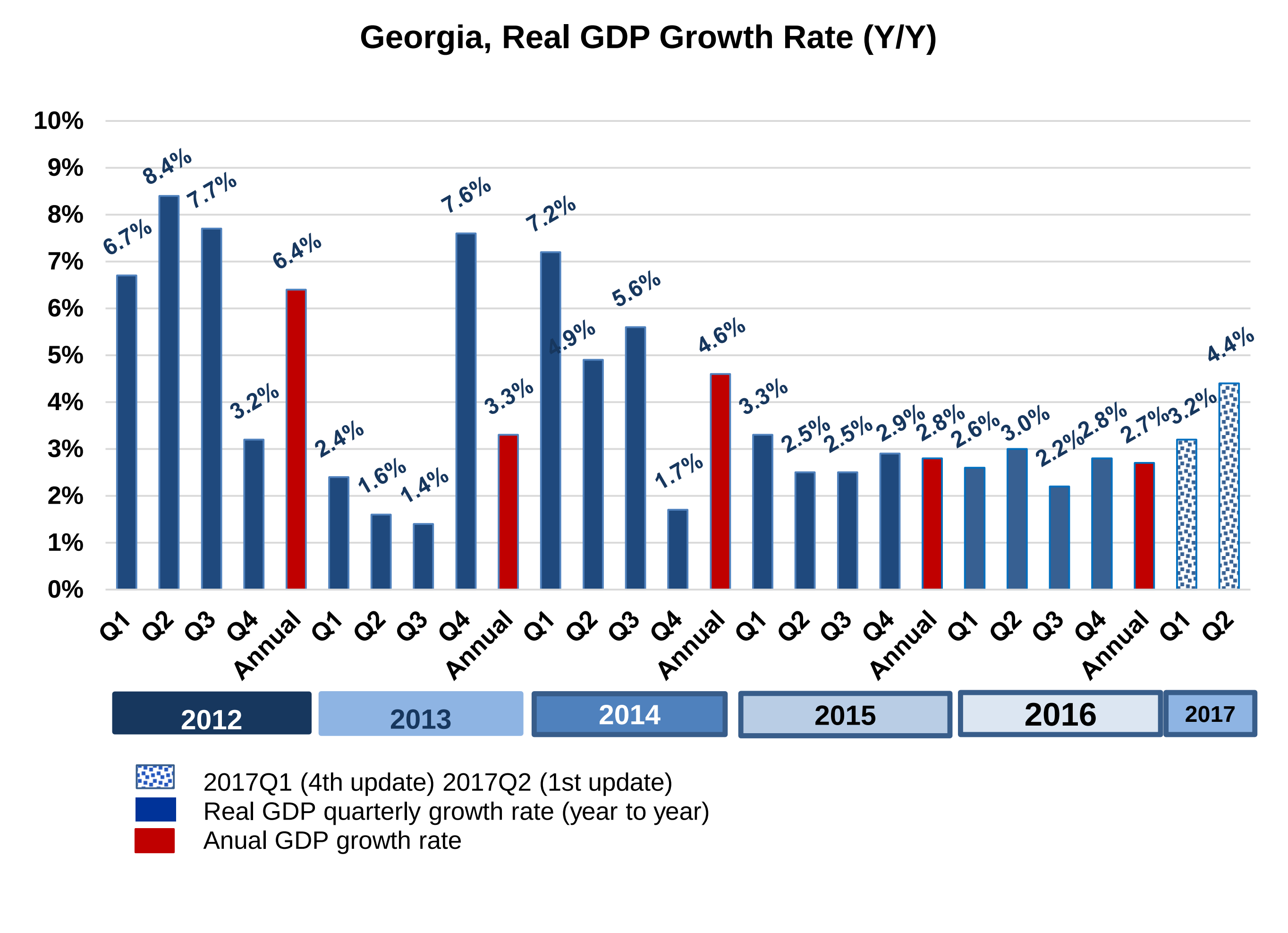
Rapidly Growing Trade is Behind the Optimistic GDP Growth Forecast

ISET-PI has updated its forecast of Georgia's real GDP growth rate for the first and second quarters of 2017. Here are the highlights of this month's release:

- ISET-PI's forecast of the real GDP growth for the first quarter of 2017 now stands at 3.2% - down from 3.5% in January. The first estimate of the second quarter growth forecast now stands at 4.4%.
- We started forecasting the annual growth rate at the start of 2014 (see our January 2014 and February 2014 publications for a note on methodology). Based on the January's data, we expect annual growth in 2017 to be 4% in the worst-case or "no growth" scenario, and 5.1% 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 4.3% real GDP growth.** Thus, the Georgian government's target of the real GDP growth (4%) does not seem to be overambitious, as it can be reached even in the worst case scenario.



Geostat revises its numbers for the last quarter of 2016.

As it was mentioned in our previous publication, Geostat's first rapid estimate of the real GDP growth in the fourth quarter of 2016 amounted only 1.2%, far below our prediction (2.9%). However, Geostat recently updated this number, and growth in Q4 2016 now stands at 2.8% - much closer to the value predicted by our forecast. The annual real GDP growth in 2016 was updated from 2.2% to a more optimistic 2.7% (our prediction was 2.8%).

Which variables influenced the forecast and how?

Looking at the economic landscape from the standpoint of the January data, increased money supply and improved external statistics were the main contributors to GDP growth, while changes in the Real Effective Exchange Rate had a negative effect on the forecast.

Monetary aggregates influenced the model's predictions quite significantly. All the monetary aggregates including the most important ones (Currency in Circulation, Narrow Money (M1) and Broad Money (M3)) increased by more than 15% yearly in January.

The external sector variables also had a positive effect on the predicted GDP growth. Georgian export increased by 45% yearly in the January of 2017 and significant part of this increase was related to the largest exported products: Ferroalloys (increased by 611% yoy), Copper ores and concentrates (34% yoy), Wine (98% yoy), Alcohol (126% yoy) and Mineral or chemical fertilizers (65% yoy). However, reductions of export in some important sectors - like the motor cars (10% yoy) and nuts (49% yoy) slightly hampered growth. In addition, Georgian import increased by 15% yearly and trade deficit still deepened by only 3%. These positive trends in the trade statistics were mainly related to the improved economic conditions in the neighboring countries (for example, Azerbaijan, a large trading partner, had positive economic growth of 0.8% for the first time in many months).

Furthermore, increased Money Inflows from abroad positively affected growth forecast. In January, remittances increased by 26% yearly that increased people's disposable income, consumption and the real GDP growth. The main contributors of this increase were Russian Federation (26% increase yoy), Italy (12% yoy), USA (26% yoy), Greece (18% yoy), Israel (99% yoy), Turkey (44% yoy) and Spain (10%).

On the down side, both CPI and PPI increases had a negative impact on the growth forecast this month.

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.