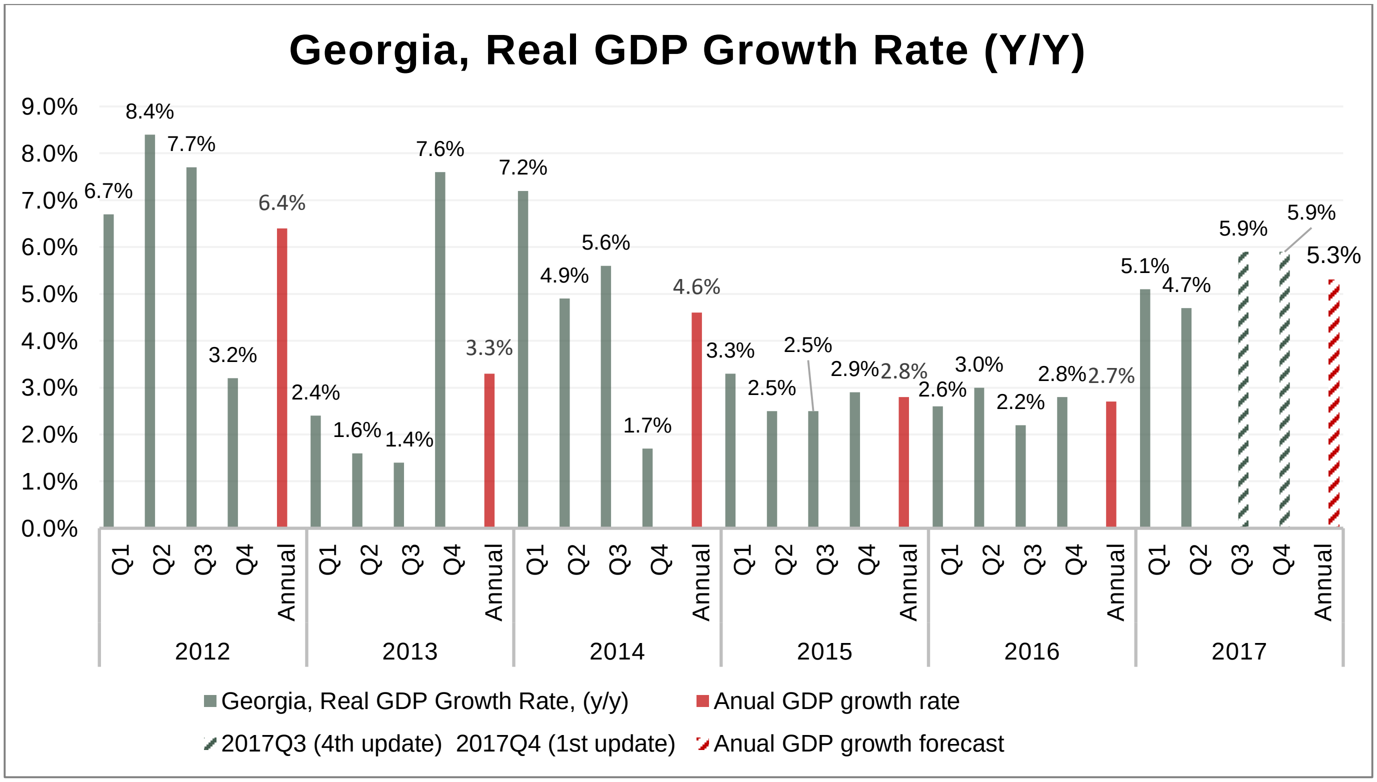
Authors: Davit Keshelava and Yasya Babych

Strong trade, tourism, and remittances growth drive an optimistic forecast for 2017

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

- Recently, Geostat published the preliminary estimate of real GDP growth for the second quarter of 2017, which now stands at 4.7%. This is 0.7 percentage points above the previously estimated average growth rate for Q2. As a result, the real GDP growth for the first half of 2017 reached 4.9%.
- The ISET-PI real GDP growth forecast for both the third and the fourth quarter of 2017 has been revised to 5.9%.



- Based on July data, we expect the annual growth in 2017 to reach 5.3% – the highest growth since 2012! The more optimistic forecast is consistent with evidence coming from international development institutions. For example, the Asian Development Bank (ADB) recently revised its expectations for real GDP growth in Georgia from 3.8% to 4.2% in 2017. According to the ADB's updated report, Georgia is ahead of the majority of countries in the region, such as Armenia, Azerbaijan, Kazakhstan and Kyrgyzstan1. Among the reasons behind the revision are the increased funding of infrastructure projects in Georgia, increased tourist flows, improved remittances, and export statistics.

[1] The average growth forecast for the Central Asian region amounted to 3.3%. Source: https://www.adb.org/data/central-asia-economy#tabs-0-0

As far as the ISET-PI forecast, we observe an upward revision of quarterly GDP to 5.9% in both the third and the fourth quarters of the year. This has to do with the update of the Q2 growth estimates (from 4% to 4.7%) rather than any significant changes in the model's core explanatory variables. Yet, a few variables in the model did change substantially, both in annual and monthly terms.

The most significant changes were observed in national currency deposits in commercial banks.

The largest yearly increase was observed for the National Currency Time Deposits with maturity of less than 3 months – a 79% increase relative to the same month of the previous year. The second largest yearly increase was experienced by the National Currency Demand Deposits – a 49% increase year over year. Overall, the *National Currency Total Deposits increased by more than 25% yearly*. *Accumulation of the national currency deposits further raises savings that will be transformed into investments and foster economic growth*. Indeed, the National Currency Deposits related variables had a positive contribution on our GDP growth projection.

In contrast, **foreign currency deposits in Georgian banks changed only moderately in yearly terms**. For instance, Foreign Currency Total Deposits increased by only 6% year over year.

The Dollarization Ratio of total non-bank deposits decreased by 3% in monthly, and 5% in yearly terms. According to our model, deposit dollarization had a small, but positive impact on real GDP growth.

Improvements in external trade statistics had a significant positive effect on the GDP forecast.

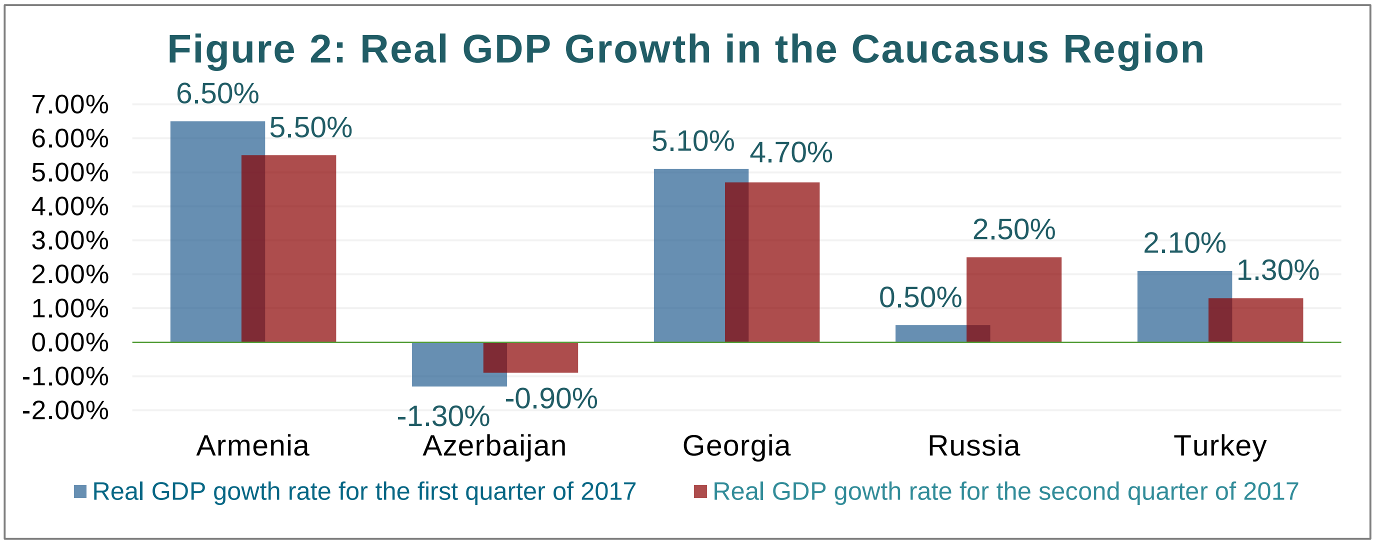
2017 is shaping up to be a very good year in the South Caucasus, in particular for Georgia and Armenia. Armenia, recovering from a slump of 2016 (0.2% real growth), is now catching up and enjoying particularly high growth rates (6.5 and 5.5% y/y growth rates in the first and second quarters of 2017, respectively; and 7% growth in July!). However, its economy slowed down in August (grew by only 2.4%), allowing Georgia to jump ahead (up 4.3%).

Both countries appear to have fully recovered from the 2015-2016 slump in performance, helped by higher commodity prices, stronger demand for export products, growth in tourism and remittances. Despite higher oil prices, Azerbaijan is pulled back by cuts in oil production. Its GDP remained below its last year levels in both the first and second quarters of 2017 (-1.3 and -0.9%, respectively). The negative trend was extended in July and August, with the economy posting negative growth rates of 1.0 and 1.1%.

	Real GDP Growth		Rapid estimate of GDP Growth	
Country	Quarter 1	Quarter 2	July	August
Georgia	5.1	4.7	3.8	4.3
Armenia	6.5	5.5	7.0	2.4
Azerbaijan	-1.3	-0.9	-1.0	-1.1

Source: Trading Economics

Moreover, Azerbaijan was the only country among Georgia's immediate neighbors that still was unable to overcome a painful recession (see the figure 2).



Source: Trading Economics

The increased demand for Georgian goods and services dramatically boosted Georgia's exports. In July, exports increased by 22% in yearly terms. The main contributors to the export increase were: (re)export of motor cars (48%[2]); wine (38%); medicaments (105%); alcoholic beverages (52%); and, copper ores and concentrates (21%).

Imports to Georgia increased moderately, by 6% year on year, thus improving the trade balance by 0.6%. Other variables, representing external sectors, were also on the rise. Remittances increased by 20% year-on-year, and the number of tourists (visitors who spent 24 hours or more in Georgia) increased by 32.9% year-on year.

An improved trade balance, strong money inflows, and an impressive increase in tourism in July all made a significant positive contribution to the growth forecast.

Among the **variables which dragged the growth forecast down were consumer and producer price increases**. The July increase in the Consumer Price Index (CPI) amounted to 6% yearly, while the Producer Price Index (PPI) increased by 11%.

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.

[2] All the percentages represent the growth relative to the same month of the previous year.