

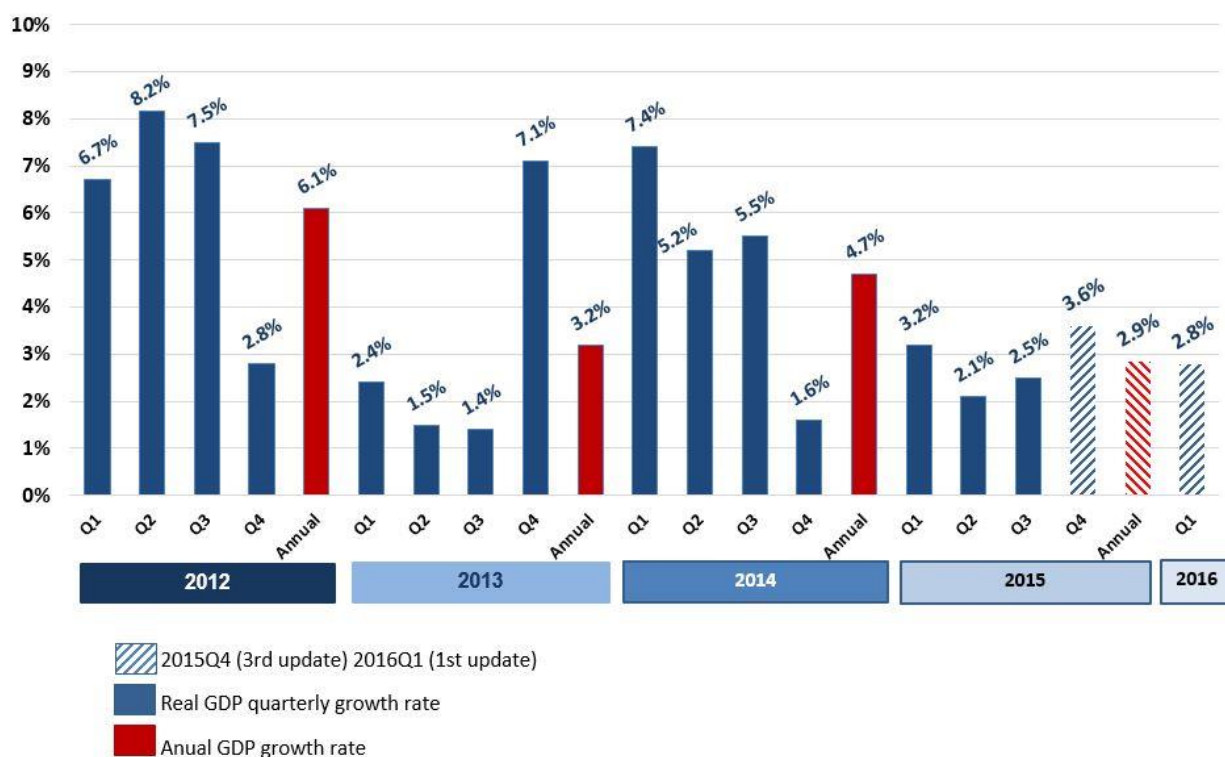
Leading GDP Indicator Forecast for Georgia

November 2015

ISET-PI has updated its forecast for Georgia’s real GDP growth rates using the September 2015 releases of various economic indicators.

- Geostat has released its preliminary estimates of GDP growth for the third quarter. The estimated Q3 growth is 2.5%, only 0.1 percentage point below the ISET-PI forecasted value.
- The forecast for GDP growth in the fourth quarter now stands at 3.6%.
- Based on the latest update, the annual growth for 2015 is expected to be 2.9%.
- According to an early forecast for 2016, the growth rate in the first quarter of next year is expected to be 2.8%.

Georgia, Real GDP Growth Rate (Y/Y)



Looking at the economic landscape from the standpoint of the September data, few variables changed significantly since August. Most of those that did relate to deposits in national and foreign currencies. Between August and September, the **volume of short-term time deposits**

(less than 3 months maturity) in the national currency increased by 10%, with a respective increase of 13% in foreign currency deposits. Moreover, compared to August, **interest rates on short-term time deposits increased** by 22% for national currency denominated deposits, and **decreased** by 15% for foreign currency ones. The increase in the interest rate differential undoubtedly reflects the tightening conditions on the national money market.

Compared to August, **money inflows posted a slight increase of 5%**. However, the annual year-on-year value of USD denominated inflows **decreased by 33%**. Another indicator affecting transportation and production costs, the **Europe Brent Spot Price FOB (dollars per barrel)**, **increased slightly** (by only 2%) in monthly terms, while showing an annual decrease of more than 50%.

How did changes in economic indicators affect the forecast? According to our econometric model, **downward pressure on the forecast** was mainly coming from the **increase in foreign currency deposits**, as well as other variables related to changes in the **reserve money held by banks, the currency in circulation**, etc. From the standpoint of economic theory, the relative increase in foreign currency deposits may be a signal of negative inflationary expectations, whereby we would observe “hedging” against expected domestic currency inflation. The amount of reserves held by the banks can be related to this as well, since an increase in foreign currency deposits triggers an increase in total reserve requirements.

The changes of some variables, in particular those related to the real effective exchange rate (REER), had a small but positive effect on our predictions of fourth quarter GDP growth. In monthly terms, the **REER against the euro and Russian ruble decreased (the GEL depreciated in real terms)** by 1% and 3% respectively. The Turkish lira was the only currency against which the real exchange rate appreciated (by 3% monthly). Generally, the depreciation of the lari against partner currencies has the potential to increase the competitiveness of Georgian products and positively affect economic growth. At the very least, it can soften the impact of negative external shocks.

The Europe Brent Spot Price FOB (dollars per barrel), which remained at a low level in September, also had a small positive effect on the growth forecast.

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 (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.