

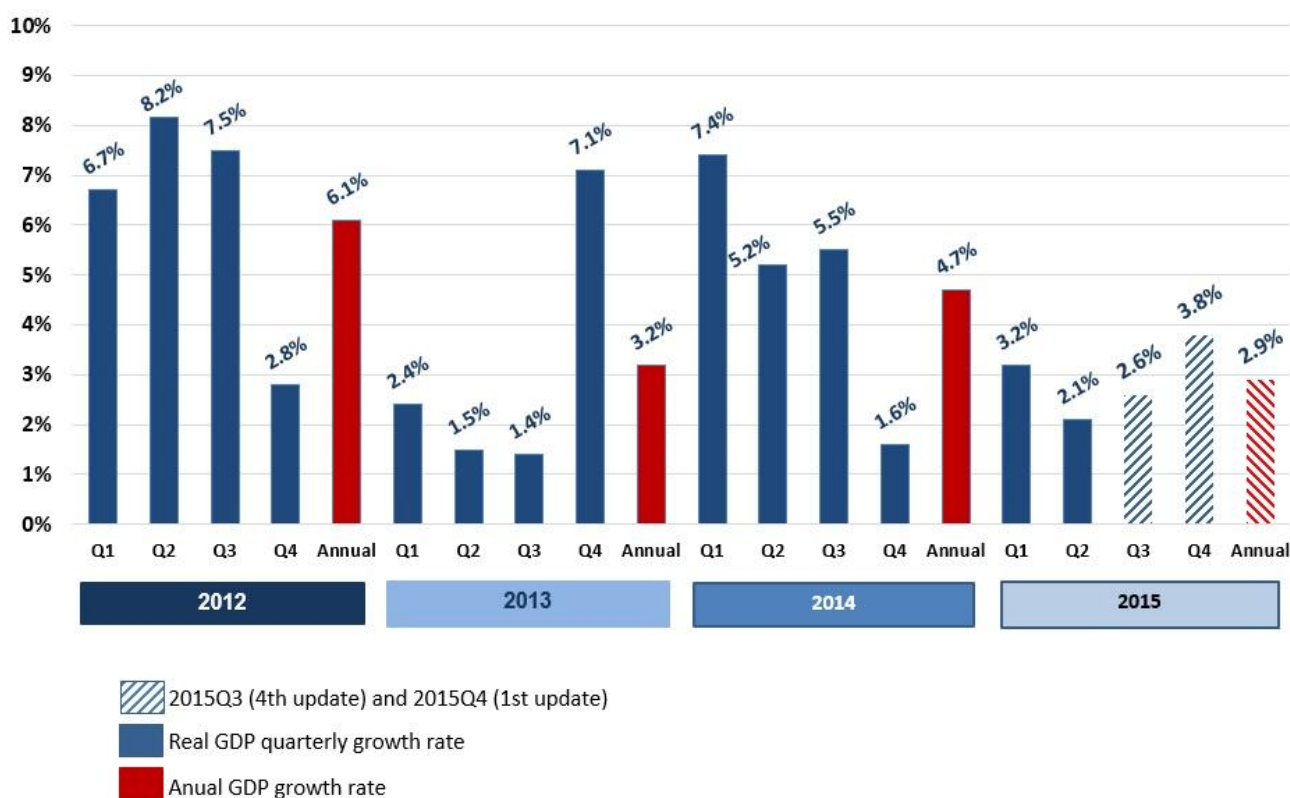
Leading GDP Indicator Forecast for Georgia

September, 2015: Third quarter growth outlook stable. Deposit dollarization gains momentum in Georgia

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

- The growth forecast for the third quarter of 2015 has not changed since last month and remains at 2.6%.
- The first forecast for the fourth quarter growth of 2015 has been targeted at 3.8%.
- Based on the new forecast, the updated annual growth projection for 2015 is 2.9%.

Georgia, Real GDP Growth Rate (Y/Y)



The GDP growth forecast has been remarkably stable since the last update. This is not surprising, given that we did not observe much movement in the indicator variables during the past month.

The only significant month-on-month change (98%), which did not materially impact the forecast, was in thermo electricity generation.

The situation is somewhat different if we look at annual changes. Significant annual increases were observed in the amounts of foreign currency deposits. Time deposits in foreign currency for less than 3 months increased by as much as 145% (when converted into GEL). Considering that GEL has lost about 30% of its value against the USD since November last year, this increase indicates the growing volume of foreign currency time deposits in Georgian banks. Deposit dollarization, which had been on a declining trajectory for nearly six years, started gaining new momentum this year and reached 63.1% in July.

The indicator that experienced the most significant decline was money inflows (-32% monthly growth). This is not surprising considering the recent limits on foreign currency transfers from Greece – a country that accounts for a large chunk of Georgian remittances. In year-on-year terms, both imports and exports decreased significantly, by 24% and 16% respectively.

Although no particular set of variables had a defining or crucial effect, some variables negatively affected our forecast. For instance, the decrease in money inflows had a clear negative (albeit small) effect on the predicted growth. The set of variables related to monetary indicators, including the dollarization rate, had a rather significant negative effect on the forecast. The dollarization ratio of deposits increased by 8% compared to the same month of the previous year. In theory, higher dollarization has a negative impact on the economy. Heavily dollarized economies find it harder to control inflation through regular monetary policy tools.

Some other variables exhibited a small positive effect on the growth forecast. The exchange rate stabilization in July was among the factors exerting a positive influence. The Real Effective Exchange Rate changed very little compared to the previous month (appreciating by only 1%) and depreciated slightly in year-on-year terms (by 2%).

This month saw an expansion of the set of leading indicator variables to include the Metals Price Index (PMETA) and the Agricultural Raw Materials Index (PRAWM) from the IMF's data. Adding these two series had a very small positive effect on our prediction of GDP growth for the third and fourth quarters, increasing the forecast by 0.004% and 0.01% respectively.

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.