Leading GDP Indicator for Georgia

September, 2014

Sharp fall in growth rates predicted for the second half of the year

ISET-PI has updated its forecasts for Georgia's real GDP growth rates using the July 2014 releases of various economic indicators.

- Based on the data from July, we have made the fourth update of the Q3 forecast. The Q3 growth forecast was revised downward from 7.6% to 3.7%.
- The first forecast for the last quarter of 2014 stands at just 1.7%
- Meanwhile, Geostat has released the official quarterly GDP growth rate for the second quarter of 2014. The official Q2 growth rate is 5.2% (but this data is still preliminary and will be revised in the future).
- From the start of the year, we started to draw some conclusions about the annual growth rate for 2014 (see our January and February publications for a note on the methodology). We have used the forecasts available for each quarter to predict that GDP growth in Georgia in 2014 will be 4.3%.[1] This forecast is quite close to the estimates of EBRD and the World Bank, which are 4% and 5% annually, respectively.

[1] The 4.3% annual growth forecast carries through even if we use the historical average of all previous quarters instead of the first vintage of the fourth quarter.

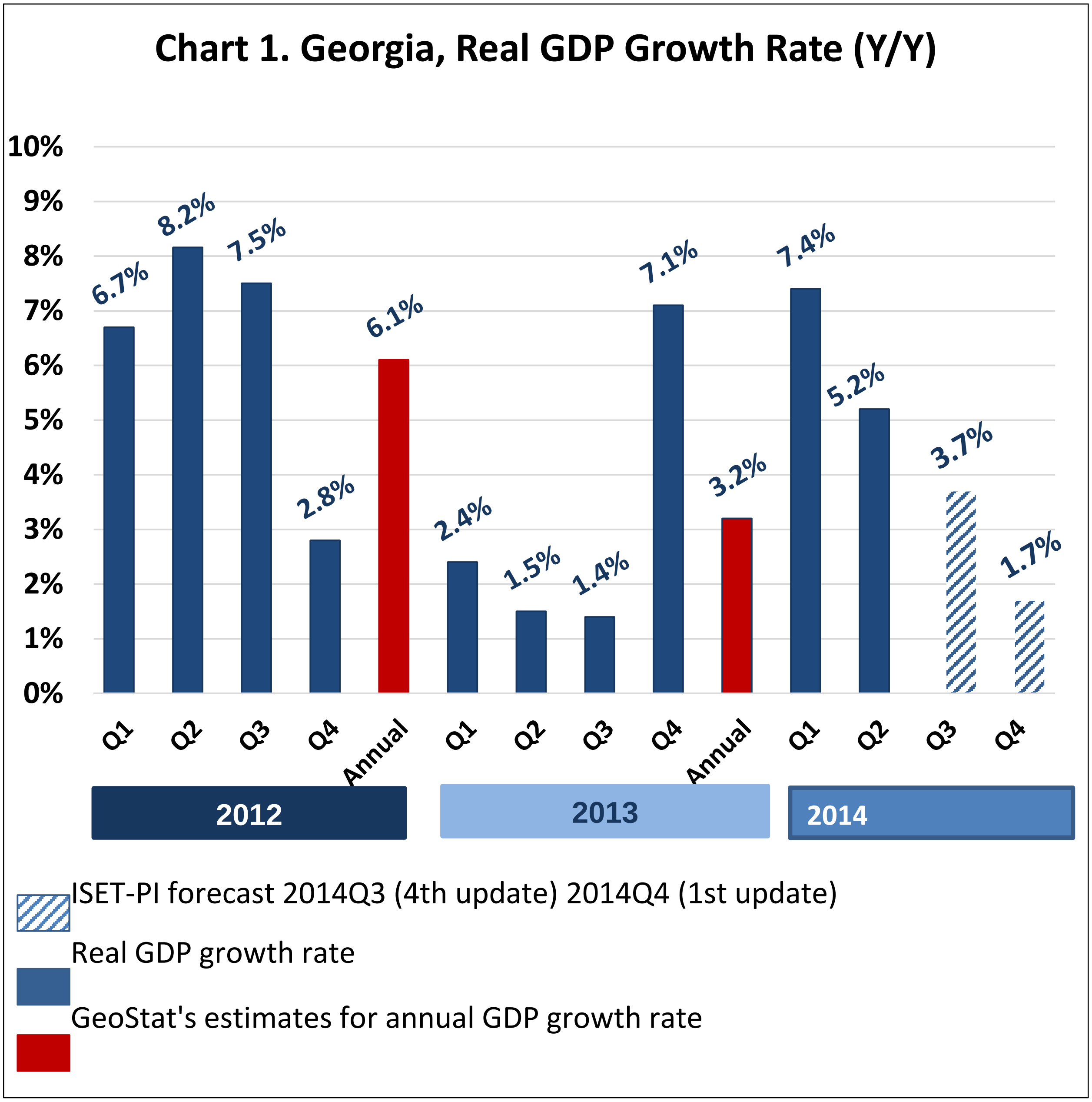
Chart 1. Georgia, Real GDP Growth Rate (Y/Y)
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
6.7%
8.2%
7.5%
2.8%
6.1%
2.4%
1.5%
1.4%
7.1%
3.2%
7.4%
5.2%
3.7%
1.7%
Q1
Q2
Q3
Q4
Annual
Q1
Q2
Q3
Q4
Annual
Q1
Q2
Q3
Q4
2012
2013
2014
ISET-PI forecast 2014Q3 (4th update) 2014Q4 (1st update)
Real GDP growth rate
GeoStat's estimates for annual GDP growth rate

Based on July's data, the predicted growth rate for Q3 of 2014 took an unexpectedly sharp fall from 7.6% to 3.7%. What could have changed from June to July to have caused such a decline in growth rates?

The decline cannot be explained by this year's drought, as these events are not yet reflected in July's data. In addition, the overall economic landscape in Georgia has changed very little between June and July 2014.

On the other hand, the regional geopolitical events affecting two of Georgia's main trading partners, Ukraine and Russia, have certainly influenced the economic landscape. The question is: which variables reflect such influences and just how much might the slowdown of the Russian economy and the war in Ukraine be affecting Georgia?

Indeed, the most important negative change between June and July came from a sharp drop in the net export of goods. In July, net exports stood at a negative 541 mln USD, which is close to a historical maximum deficit. Between June and July, the trade deficit in goods increased by 19%. In annual terms, this represented an increase of 16%. Since trade deficit growth directly affects real GDP growth, such a sharp fall in net exports would have a very significant impact on the predicted GDP growth for the third quarter.

Other GDP indicators looked much more encouraging in July. For example, in the energy sector, between June and July, the electricity generation and net export of electricity increased by 17% and 62% respectively. Moreover, the levels of both exports and generation of electricity now stands at a historical high.

Even with the discouragingly low growth prospects of the last two quarters, an annual growth forecast of 4.3% is not alarmingly bad. The development of GDP growth prospects in 2014 will largely depend on which factors dominate the economic landscape in the second half of the year.

On the upside, because of issues with the availability of data, our forecast does not reflect the export and import of services. Generally, exports of services are significant. For example, in the first quarter of 2014 exports of services totaled nearly 70% of the total exports of goods, whereas imports were much lower. As our forecast only uses goods trade data, this may introduce a downward bias to the forecast numbers for the third quarter. This is especially true for the summer months, when the net export of services is high due to the tourist season. As this year's tourist season was quite successful, we can expect an upward revision of the GDP numbers.

On the downside, as a result of the drought, this year's agricultural output is expected to be much lower than last year. Even though the share of agricultural production in GDP is not very high, it tends to be higher during the fall harvest season. Thus, taking last year's fourth quarter as a base, it is hard to envisage higher growth rates.

As the next round of data becomes available, it will become apparent whether positive or negative factors dominate Georgia's economic landscape.

The Consumer Price Index has slightly decreased by 1.5% in annual terms. Despite the relatively low level of the May Khachapuri Index (2.97 GEL), this indicator of the basic cost of living increased by 9% compared to July 2013.

An addition, in line with our growth forecast, the Consumer Confidence Index also decreased in July.

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.