

BUSINESS CONFIDENCE INDEX

Weakened Business Optimism Amid Robust Performance

Q3 2016

Participating Companies

Large



74

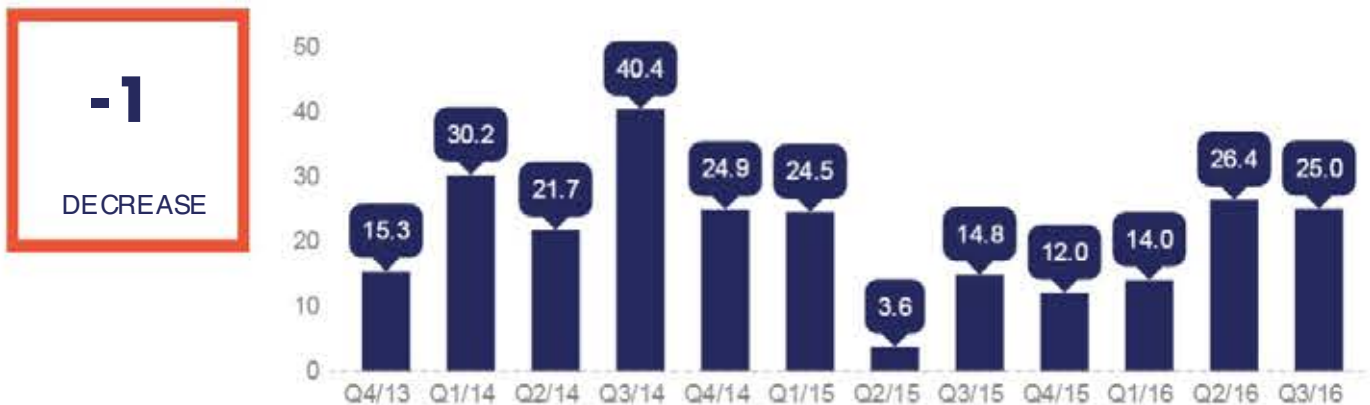
SMEs



227

SURVEY HIGHLIGHTS

Business Confidence Index (BCI)



- The Georgian Business Confidence Index (BCI)(*) has decreased marginally (-1, QoQ), but at 25.0 it remains significantly higher than it was in the same quarter last year (14.8). The third quarter decrease in the index was mostly driven by a significant decline in expectations.
- With 38% of business executives reporting 'improved' performance in the last three months, the past performance index posted a substantial increase, rising 7.9 points to a robust 30.4. The agriculture sector saw the highest increase.
- Business optimism about the overall economy dropped to below the Q2 2016 (-12.7, QoQ) level, but remained higher than Q3 2015 at 27.2 percentage points. The majority of business respondents expect their economic performance to remain unchanged and 25% expect improvement. Expectations about the end of the summer season weakened in all sectors.
- The sales price expectation index decreased (-0.2, QoQ) and turned negative for the service sector.

(*) In the third quarter of 2016, the Business Confidence Index registered 25 on a scale of [-100; 100] points. The positive number on the index indicates that confidence among businesses is about 25 index points more positive than negative or neutral. A confidence index of 100 would indicate that all firms in the sample reported a positive outlook. An index of zero would indicate that the weighted balance of positive and negative views reported by firms is about equal or, alternatively, that all firms reported no change in the current business situation (for more details, see the methodological notes).

Overall, the BCI lost 1 point (on a [-100/100 scale]) compared to Q2 2016. Expectations of the private sector in Georgia weakened by 12 percentage points and reached 37 index points (down from 50 points in Q2). Businesses' performance over the past three months increased significantly and reached 30.4 points (rising from 22.5), indicating a rise in production/turnover/sales. However, the performance of the past three months did not improve expectations, and caused a decline in the overall BCI.

The increase in the past performance index is well aligned with official business statistics. According to the latest Geostat report, Q2 2016 turnover increased by 11.8% QoQ and by 10.2% YoY.

Unlike other sectors, the service sector BCI slightly improved (rising by 5.1 QoQ). In light of the summer season and booming tourist activity, this result might not be surprising (it increased for large firms and remained the same for SMEs).

BCI QoQ change by sector

Sectors	Q3/16		Change
Manufacturing	6.2	▼	-6.7
Construction	-0.4	▼	-21.2
Retail Trade	16.9	▼	-5.2
Service	32.5	▲	5.1
Agriculture	26.9	▼	-1.6
Financial	44.0	▼	-4.4
Other	20.7	▼	-5.7

SME



Large



Q3/16	Change	Q3/16	Change
16.9	▲	0.8	
		27.0	▼
			-0.9

Business confidence in the third quarter of 2016 slightly improved for SMEs and decreased for large firms. The overall trend for SMEs is stable and positive.

It should be noted that the BCI results presented here may be overestimated as the survey only covers businesses currently operating, and not those that have already exited the market. Firms still in operation are more likely to have a positive outlook.

Production/Turnover/Sales Past 3 Months



The actual performance of businesses significantly improved compared to the second quarter of the year. In the Q3 2016(**) reporting period, the sales (production or turnover) of the 301 firms surveyed increased and remained positive, increasing from 22.5 (Q2 2016) to 30.4 (Q3 2016).

Past 3 Months QoQ change by sector

Sectors	Q3/16	Change
Manufacturing	16.8	-6.0
Construction	1.0	-29.2
Retail Trade	4.8	10.3
Service	40.7	17.9
Agriculture	63.4	26.2
Financial	38.7	-11.3
Other	39.3	-5.4

The current situation for most firms significantly improved. The production/turnover/sales of the past three months improved in the retail trade, service and agriculture sectors, with the increase of the latter being marginally the highest. More farmers assessed their performance as positive in the third quarter than as either negative or neutral (for more information, see Appendix 1).

The significant positive improvements in the agriculture, service, and retail trade sectors dominated the gloomy performance in other sectors and led to an evident overall improvement in business performance.

SME



Q3/16

Change

15.5



4.6

Large



Q3/16

Change

34.5

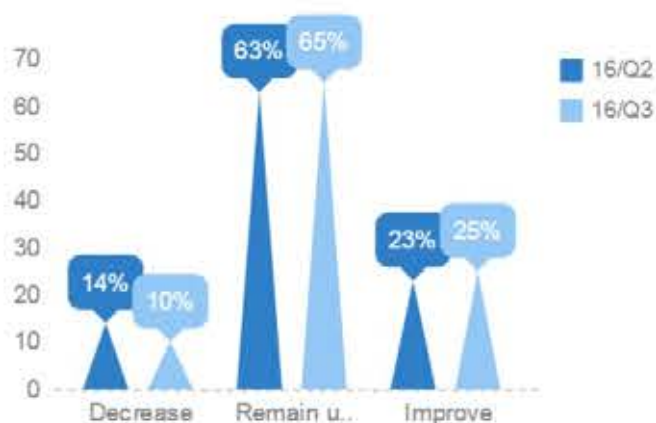


8.7

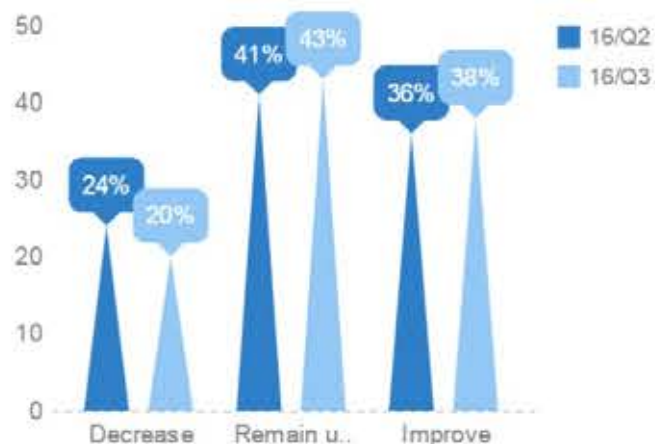
Business activities improved for both large firms and SMEs. For large firms, the business activities indicator increased from 25.7 points in Q2 2016 to 34.5 in Q3 2016; for SMEs the indicator increased from 10.8 to 15.5 over the same period.

(**) This indicator describes the activities of businesses in April, May and June.

How has your firm's total employment changed over the past 3 months?



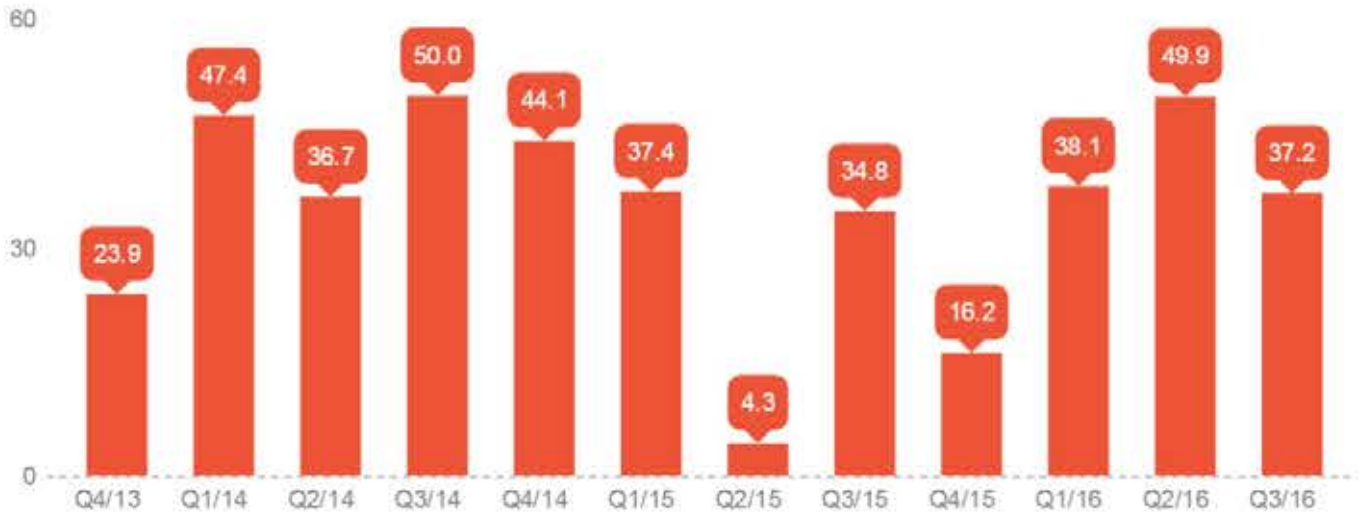
How has your business activity developed over the past 3 months?



For the majority of surveyed firms (65%) employment remained the same over the past three months, and was higher compared to the previous quarter (62%). It is also worth noting that employment over the past three months increased in 25% of the firms surveyed.

Moreover, 43% of firms claimed that their business activities remained unchanged over the past three months, while 38% of participants stated that they had improved (which was an increase from 36% reporting this in the previous quarter).

Expectations Index



The expectations index decreased by 13 points in the third quarter of 2016. Expectations about the next three months weakened in all sectors. The highest decrease was reported in the manufacturing and construction sector (for more information, see Appendix 1).

The pessimism of all sectors might have been driven by the end of the summer season, especially in the service sector as economic agents generally revert to their normal spending behavior once the holiday period is over.

Expectations QoQ change by sector

Sectors	Q3/16	Change
Manufacturing	8.9	-49.1
Construction	15.1	-29.6
Retail Trade	38.9	-4.3
Service	44.0	-3.1
Agriculture	37.5	-6.2
Financial	43.0	-29.1
Other	58.9	-7.2

SME



Q3/16 **Change**
37.5 ▼ **-2.1**

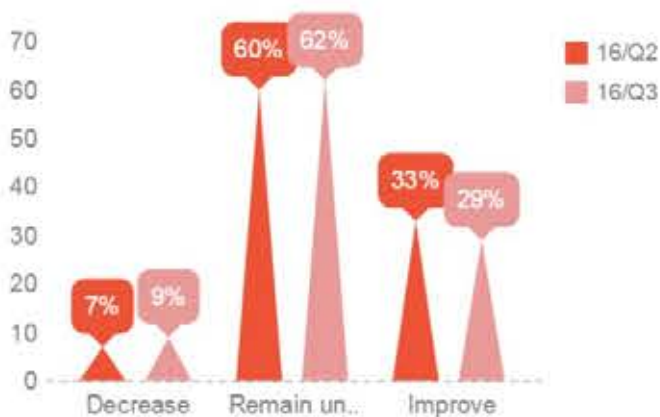
Large



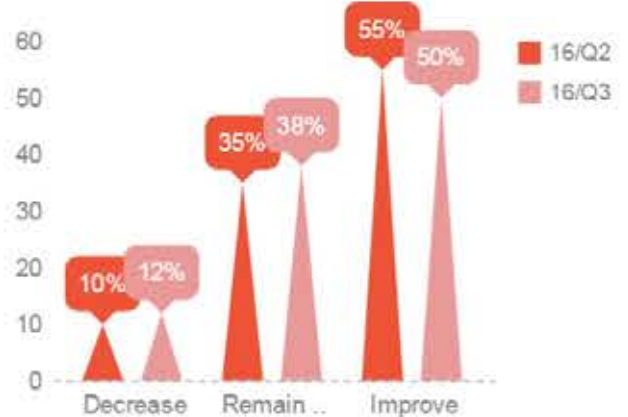
Q3/16 **Change**
37.3 ▼ **-14.8**

As one can see from the table, business expectations for the next three months (July, August and September) decreased for both large firms and SMEs. The marginal decrease for SMEs was lower than that for large companies. Less pessimism from SMEs is encouraging, since smaller companies are more vulnerable to fluctuations in external/internal conditions.

How do you expect your firm's total employment to change over the next 3 months?



How do you expect your business condition to change over the next 3 months?



The majority, 62%, of surveyed businesses did not expect any changes in employment over the next three months. Furthermore, 29% of firms thought that they will employ more employees in future (although this is a lower figure compared to the 33% answering the same in the previous quarter).

Given the pessimistic attitudes towards changes in total employment, half of the surveyed firms expected that the economic conditions of their business would improve over the next three months, and 38% did not expect any changes in the future.

Sales Price Expectations



The sales price expectation index slightly decreased from 4 points (Q2 2016) to 3.8 points (Q3 2016).

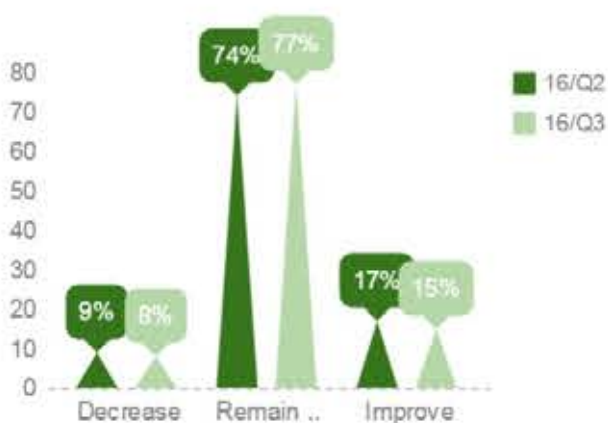
Sales price expectations decreased for the service sector. This sector's sales price expectations returned to negative levels, reflecting relatively decreased demand on service activities at the beginning of autumn. The construction, agriculture and retail trade sectors each expect noticeable improvements in prices in the next three months (for more information, see Appendix 1).

Sales price QoQ change by sector

Sectors	Q3/16	Change
Manufacturing	16.8	▲ 5.7
Construction	25.8	▲ 34.8
Retail Trade	8.8	▲ 7.9
Service	-5.3	▼ -10.4
Agriculture	14.3	▲ 6.7
Other	8.5	▼ -12.4

The overall sales price expectations index slightly decreased for large companies and increased for SMEs. Neither SMEs nor large companies appear to be planning a change in prices for their production/services in the near future.

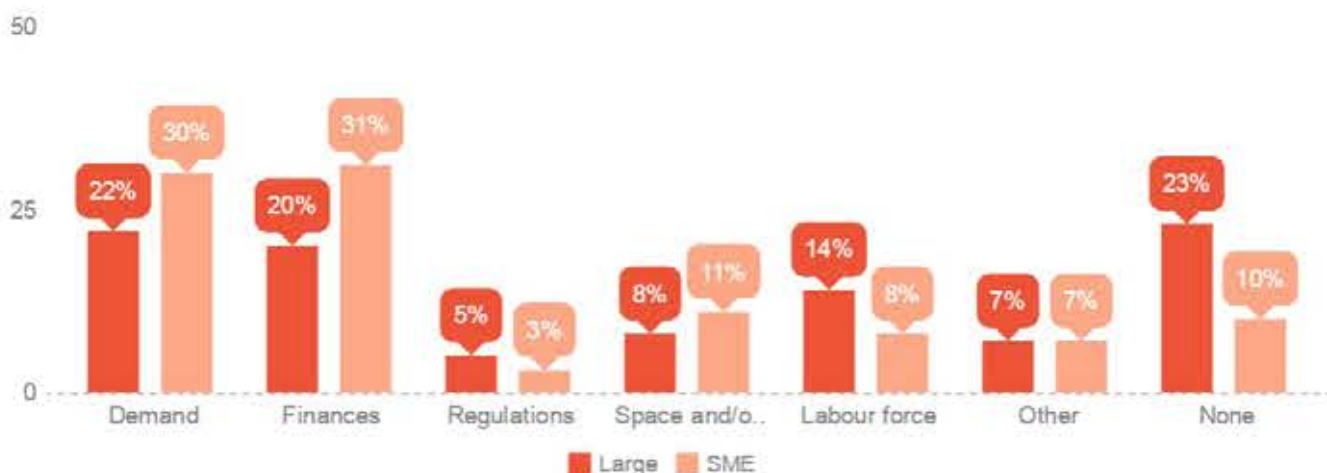
How do you expect the prices you charge to change over the next 3 months?



Q3/16	Change	Q3/16	Change
8.83	▲ 0.1	2.87	▼ -0.2

The majority (77%) of surveyed firms are not going to change the prices they charge over the next three months. Only 8% of firms expect to decrease prices and 15% expect to increase prices in the future.

WHAT ARE THE MAIN FACTORS CURRENTLY LIMITING YOUR BUSINESS? Quarter 3, 2016



Lower consumption activities and access to finance are the most significant problems for businesses. The most limiting factor for doing business for both large firms and SMEs in Q3 2016 was insufficient demand. A total of 22% of large companies reported low consumer demand as the main obstacle. SMEs found it even harder to operate with unstable demand on the market, with this index reaching 30% for those companies.

SMEs typically have more trouble attracting financial resources than larger companies and this pattern was enhanced during the third quarter. Financial constraints were thus listed as being as problematic as insufficient demand for SME business operations. On the other hand, government regulations were considered to be a greater problem for larger enterprises than for SMEs.

Sample Size by Sector

	Sectors	Firm Size		Total
		Large	Small	
Q3 2016	Manufacturing	7	6	13
	Construction	7	22	29
	Retail Trade	11	39	50
	Service	29	112	141
	Agriculture	8	21	29
	Financial	8	15	23
	Other	5	11	16
	Total	75	226	301

Distribution of Participating Firms by Sector

Table 1 - Distribution of firms participating in the BCI survey

Sectors - Number of firms	16/Q3	16/Q3	16/Q2	16/Q2
Manufacturing	13	4%	21	6%
Construction	29	10%	39	11%
Retail Trade	50	17%	75	20%
Service	141	47%	153	41%
Agriculture	29	10	34	9%
Financial	23	8%	28	8%
Other	16	5%	20	5%
	301	% share	370	% share

Table 2 - Distribution of firms by turnover

Sectors	% in total turnover
Manufacturing	10%
Construction	8%
Retail Trade	17%
Service	47%
Agriculture	7%
Financial	9%
Other	3%

Source: GeoStat

The number of firms participating in the BCI survey in Q3 2016 was 301. This is a reduction of nearly 19% compared to the previous maximum level of participants. Despite the decrease in the number of the participating firms, the distribution of the firms across sectors remained stable and was well aligned with the distribution of the firms in the economy (as depicted in Tables 1 & 2 above).

Despite the distribution of the firms in our sample being well aligned with the economy, we still use turnover weights to correct for small differences between our shares (share of the number of participating firms) and economy turnover shares, even by company size.

Methodology

The ISET Policy Institute, working in partnership with the BIA (Business Information Agency) and International Chamber of Commerce in Georgia (ICC), has implemented the Business Confidence Survey since December 2013 and publishes the Business Confidence Index (BCI) on a quarterly basis.

Business confidence for Georgia is measured by seven sector-specific indices focusing on: 1) services, 2) retail trade, 3) agriculture, 4) manufacturing industry, 5) financial service 6) construction and 7) other sectors. For each sector, confidence is measured through a simple survey instrument targeted at top business executives.

Answers obtained from the surveys are aggregated in the form of “balances”. Balances are constructed as the difference between the percentage of respondents giving positive and negative replies.

Using this method, a confidence index of +100 would indicate that all survey respondents were much more confident about future prospects, while -100 would indicate that all survey respondents were much less confident about future prospects.

Variable	Value
Positive	+1
Neutral	0
Negative	-1

The methodology for compiling the indices is based on the Joint Harmonised EU Programme of Business and Consumer Surveys.

DEFINITIONS

- The Business Confidence Index is calculated as a weighted average of the balances induced from all the answers about production/sales/turnover, competition, order books, volume of stock, demand evaluation, operation costs, profit, employment, and sales price setting.
- The expectations index is calculated based on two questions: production/sales/turnover for the next three months and employment plans for the next three months.
- A large(***) firm is one with a yearly average of over 100 people employed or a yearly average turnover exceeding 1.5 million GEL.
- Small firms are those with an average of fewer than 20 people employed over a year and an annual average turnover of less than 0.5 million GEL.
- Medium firms are those that are neither large nor small.

(***) The size of the company is defined according to the Main Indicators' Calculation Methodology of Business Statistics (http://geostat.ge/cms/site_images/_files/georgian/methodology/business/BS_metodologia.pdf).

APPENDIX 1 – BCI, Production/Turnover/Sales, Expectations, Sales Expectations by sectors and sizes

Overall BCI

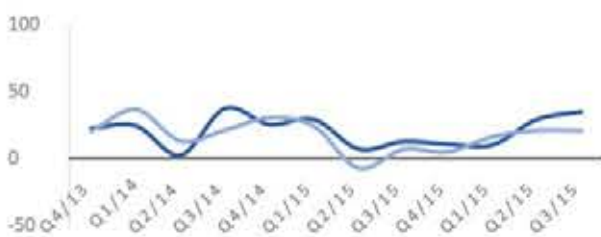
Manufacturing



Retail Trade



Service



Agriculture



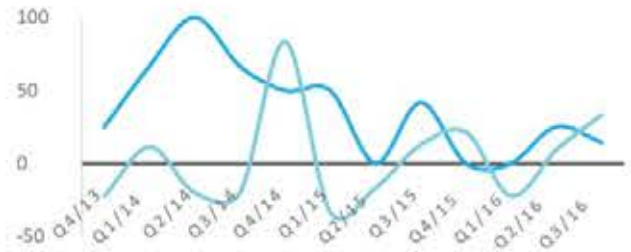
Financial



— LARGE — SME

Sales/Production/Turnover for past 3 months

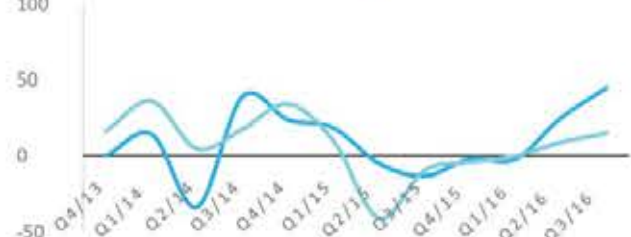
Manufacturing



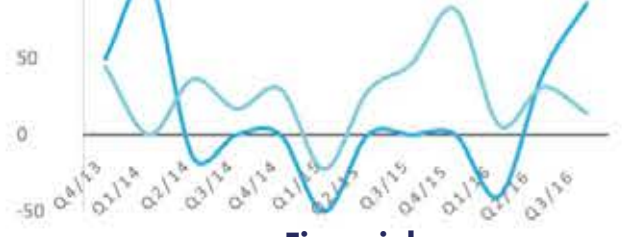
Retail Trade



Service



Agriculture



Financial



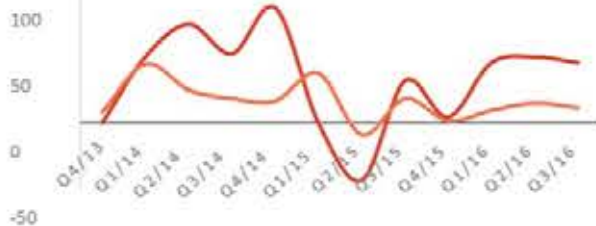
— LARGE — SME

Expectations Index

Manufacturing



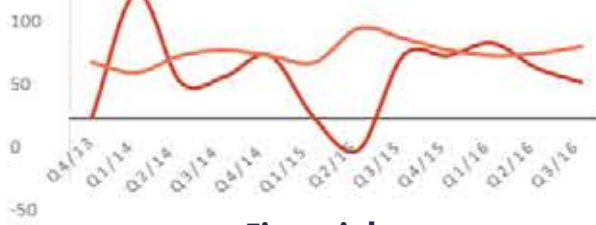
Retail Trade



Service



Agriculture



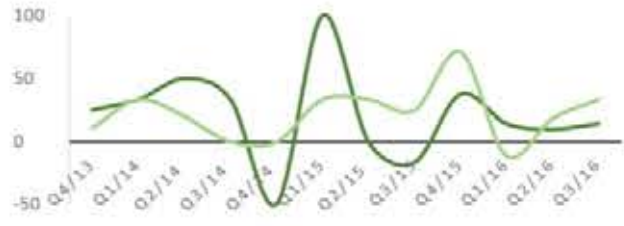
Financial



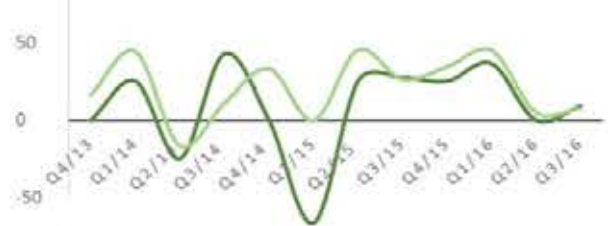
— LARGE — SME

Sales Price Expectations Index

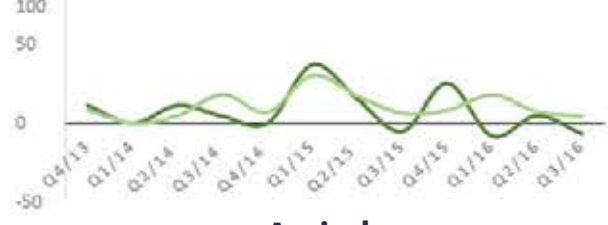
Manufacturing



Retail Trade



Service



Agriculture



— LARGE — SME