

BUSINESS CONFIDENCE INDEX

Expectations Linger, While Performance Catches Up

Q4 2016

Participating Companies

Large



71

SMEs



137

SURVEY HIGHLIGHTS

-7.4

DECREASE

Business Confidence Index (BCI)



• The Georgian Business Confidence Index (BCI)* has decreased by 7.4 percentage points (-7.4, QoQ), but at 17.6 it remains higher than it was in the same quarter last year (12.0). The fourth quarter decrease in the index was mostly driven by a significant decline in expectations.

• With 44% of business executives reporting unchanged performance in the last three months, the past performance index actually posted a slight increase, rising by 0.4 points to 30.8. Compared to other sectors, the manufacturing sector saw the highest increase.

• Business optimism about the overall economy dropped to below the Q3 2016 (-12.2, QoQ) level, but remained higher than Q4 2015 at 25.0 percentage points. The majority of business respondents expect their economic performance to improve, and 18% expect it to decrease. The highest drop in expectations about the end of the autumn season was present in the retail trade sector.

• The sales price expectation index increased (+2.3 QoQ) and turned negative for the construction sector.

• Usually, business expectations and past performance indices move together, but according to the last two quarters of 2016, the past performance index started to increase and expectations began to fall. Regardless of the pessimistic business expectations data, however, surveyed businesses reported a stronger actual performance compared to the previous quarter (Q3/16), with the past performance index's third sequential improvement. Therefore, it can be implied that the downward trend in expectations is a result of concerns, rather than alarming conditions of the Georgian economy.

• While two consecutive quarters of declining survey results clearly shows that businesses are realigning their expectations down from the highs of Q2/2016, we aren't observing overwhelming evidence that supports an extensively depressed outlook.

* In the fourth quarter of 2016, the Business Confidence Index registered 18.4 on a scale of [-100; 100] points. The positive number on the index indicates that confidence among businesses is about 18.4 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 7.4 points (on a [-100/100 scale]) compared to Q3 2016. Expectations of the private sector in Georgia weakened by 12.2 percentage points and reached 25.0 index points (down from 37.2 points in Q3). Businesses' performance over the past three months increased slightly and reached 30.8 points (rising from 30.4), indicating a rise in production/turnover/sales. However, the performance of the past three months did not improve expectations, and as a result, the overall BCI decreased.

BCI QoQ change by sector

Unlike other sectors, the manufacturing (rising by 16.0), construction (rising by 15.4) and agriculture (rising by 8.9) sectors' BCI significantly improved.

Sectors	Q4/16		Change
Manufacturing	22.2	▲	16.0
Construction	15.1	▲	15.4
Retail Trade	-19.9	▼	-36.8
Service	23.1	▼	-9.4
Agriculture	35.8	▲	8.9
Financial	42.7	▼	-1.3
Other	20.5	▼	-0.2



Business confidence in the fourth 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 slightly improved compared to the third quarter of the year. In the Q4 2016** reporting period, the sales (production or turnover) of the 208 firms surveyed increased and remained positive, rising from 30.4 (Q3 2016) to 30.8 (Q4 2016).

Past 3 Months QoQ change by sector

The current situation for the firms operating in the manufacturing and construction sectors significantly improved, meaning that in these sectors, more firms assessed their performance as positive in the fourth quarter than as either negative or neutral (for more information, see Appendix 1). However, in all the other sectors, the production/turnover/sales of the past three months worsened, with the highest drop in the retail trade (-9.9 percentage points).

Sectors	Q4/16	Change
Manufacturing	66.0	▲ 49.1
Construction	24.5	▲ 23.5
Retail Trade	-5.1	▼ -9.9
Service	32.0	▼ -8.7
Agriculture	67.2	▲ 3.8
Financial	35.0	▼ -3.7
Other	16.7	▼ -22.5

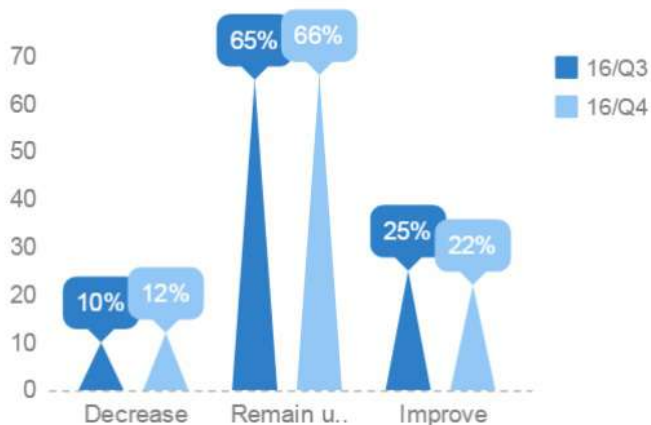
The significant positive improvements in the manufacturing and construction sectors, dominated the slow performance in other sectors and led to a slight overall improvement in business performance.



Business activities improved for SMEs and decreased for large ones. For large firms, the business activities indicator decreased from 34.5 points in Q3 2016 to 32.2 in Q4 2016; for SMEs, the same indicator increased from 15.5 to 21.2 over the same period.

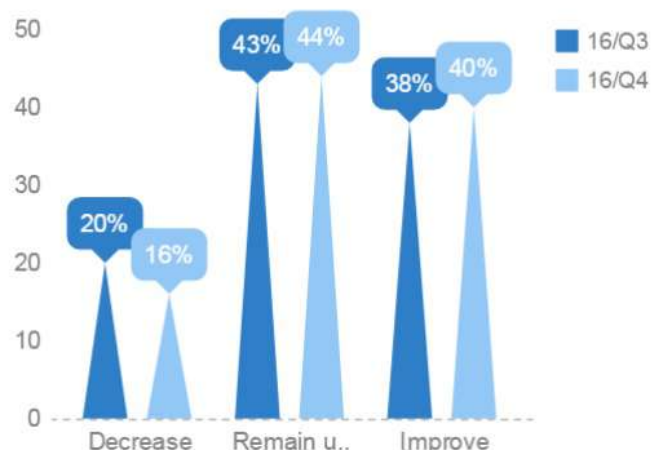
** This indicator describes the activities of businesses in July, August and September.

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



For the majority of surveyed firms (66%), employment remained the same over the past three months, and was higher compared to the previous quarter (65%). It is also worth noting that employment over the past three months decreased in 2016/Q4, from 25% to 22% of the firms surveyed.

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



Moreover, 44% of firms claimed that their business activities remained unchanged over the past three months, while 40% of participants stated that they had improved their performance (which was an increase from 38% in the previous quarter).

Expectations Index



The expectations index decreased by 12.2 points in the third quarter of 2016. Expectations about the next three months weakened in retail trade, service and other sectors. The highest decrease was reported in the retail sector (for more information, see Appendix 1).

Besides the huge drop in retail trade sector, manufacturing, construction, agriculture and financial sectors seem to be optimistic about the future (with the highest improvement in expectations in the construction sector).

Expectations QoQ change by sector

Sectors	Q4/16	Change
Manufacturing	22.7	▲ 13.7
Construction	53.4	▲ 38.3
Retail Trade	-42.0	▼ -80.9
Service	32.3	▼ -11.7
Agriculture	67.2	▲ 29.7
Financial	51.0	▲ 8.0
Other	50.0	▼ -8.9

SME



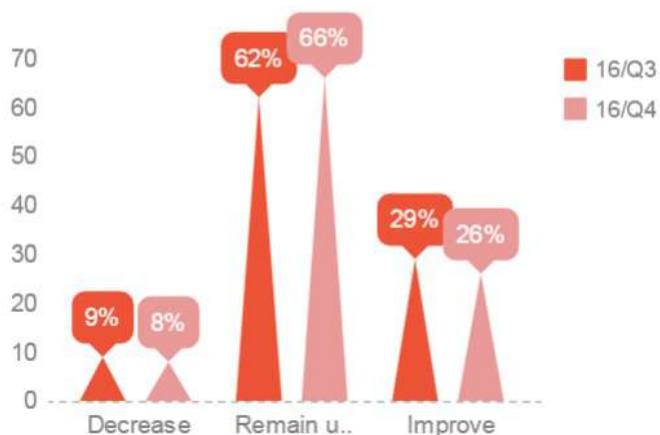
Large



Q4/16	Change	Q4/16	Change
32.2	▼ -5.3	23.1	▼ -14.2

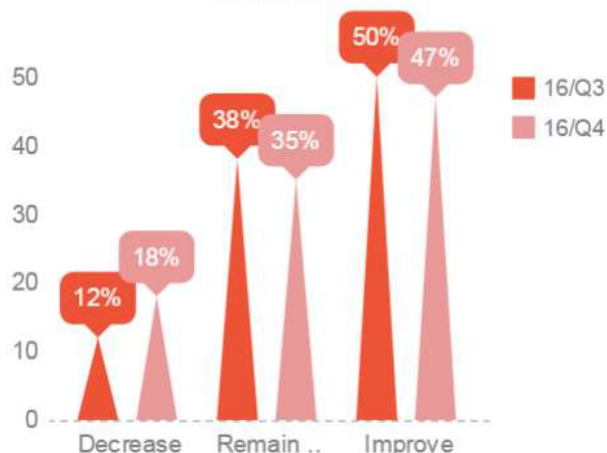
As one can see from the table, business expectations for the next three months (October, November and December) decreased for both large firms and SMEs. The marginal decrease for SMEs was lower than that of large companies. Less pessimism from SMEs is encouraging, since smaller companies are more vulnerable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

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



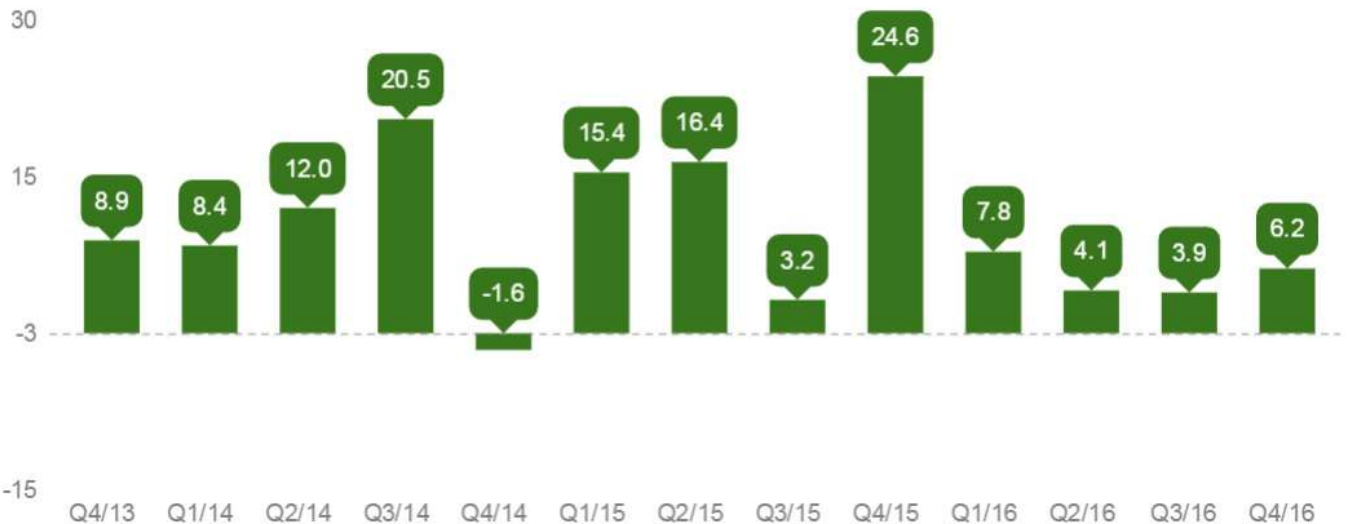
The majority (66%) of surveyed businesses did not expect any changes in employment over the next three months. Furthermore, 26% of firms thought that they will employ more employees in future (although this is a lower figure compared to 29% in the previous quarter).

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



Given the pessimistic attitudes towards changes in total employment, 47% of the surveyed firms expected that the economic conditions of their business would improve over the next three months, and 35% did not expect any changes in the future.

Sales Price Expectations



The sales price expectation index slightly increased from 3.9 points (Q3 2016), to 6.2 points (Q4 2016).

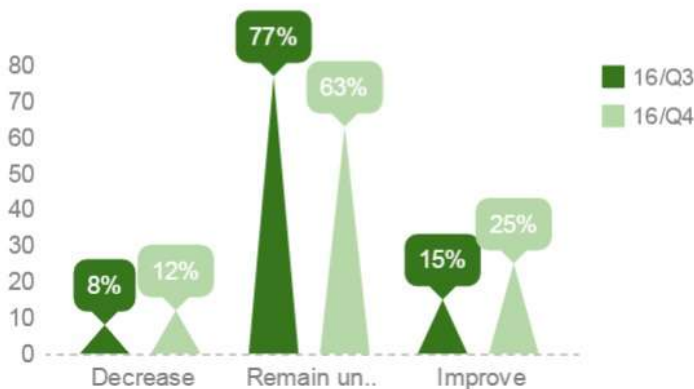
Sales price expectations decreased for the manufacturing, construction and agriculture sectors. The construction sector's sales price expectations returned to negative levels, reflecting the relatively decreased demand on its products/goods at the beginning of winter. The retail trade, service and other 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	Q4/16	Change
Manufacturing	5.4	▼ -11.5
Construction	-11.9	▼ -37.7
Retail Trade	24.8	▲ 16.0
Service	1.3	▲ 6.6
Agriculture	12.5	▼ -1.8
Other	36.2	▲ 27.7

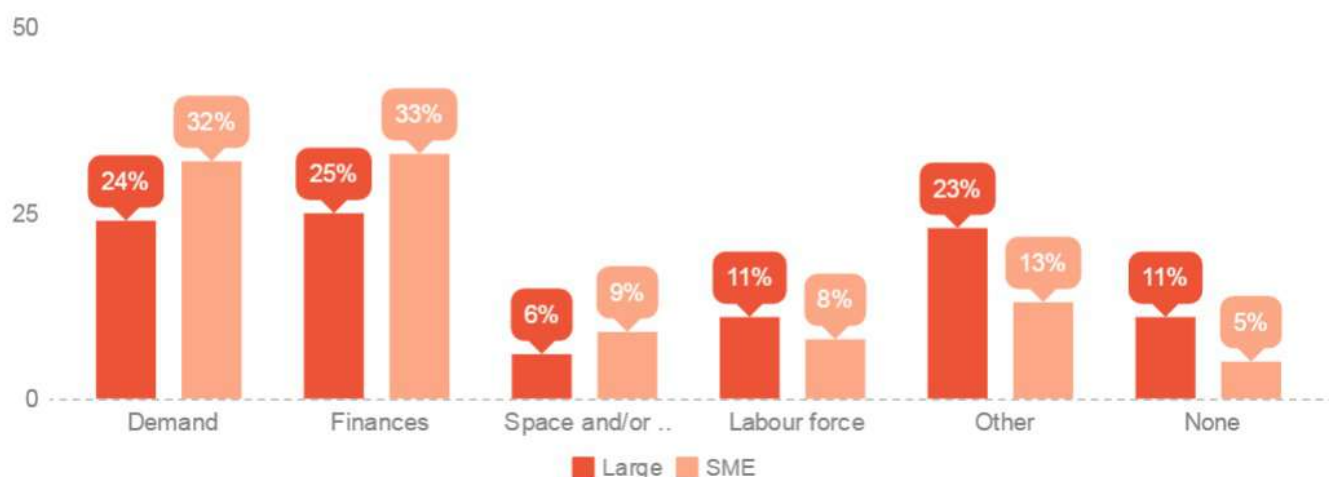
The overall sales price expectations index increased for large companies and SMEs. However, SMEs appear to be planning a significant change in prices for their production/services in the near future compared to large companies.

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



The majority (63%) of surveyed firms are not going to change the prices they charge over the next three months. Only 12% of firms expect to decrease prices, and 25% 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. One of the most limiting factors for doing business for both large firms and SMEs in Q4 2016 was insufficient demand. A total of 24% of large companies reported low consumer demand as their main obstacle. SMEs found it even harder to operate with unstable demand on the market, with this index reaching 32% for these companies.

SMEs typically have more trouble attracting financial resources than larger companies, and this pattern was enhanced during the fourth quarter. Financial constraints were thus listed as being more problematic compared to insufficient demand for SME business operations.

Sample Size by Sector

Sectors	Firm Size		Total
	Large	Small	
Manufacturing	5	5	10
Construction	7	16	23
Retail Trade	12	25	37
Service	27	65	92
Agriculture	4	10	14
Financial	8	10	18
Other	8	6	14
Total	71	137	208

Distribution of Participating Firms by Sector

Table 1 - Distribution of firms participating in the BCI survey

Sectors - Number of firms	16/Q4	16/Q4 %	16/Q3	16/Q3 %
Manufacturing	10	5%	13	4%
Construction	23	11%	29	10%
Retail Trade	37	18%	50	17%
Service	92	44%	141	47%
Agriculture	14	7%	29	10%
Financial	18	9%	23	8%
Other	14	7%	16	5%

Source: BCI Survey Data **208** % share **301** % 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 Q4 2016 was 208. This is a reduction of nearly 31% compared to the previous quarter's level of participation. Despite the decrease in the number of participating firms, the distribution of the participating firms across sectors remained stable, and was well aligned with the distribution of 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 the International Chamber of Commerce in Georgia (ICC), implemented the Business Confidence Survey beginning in 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 services 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

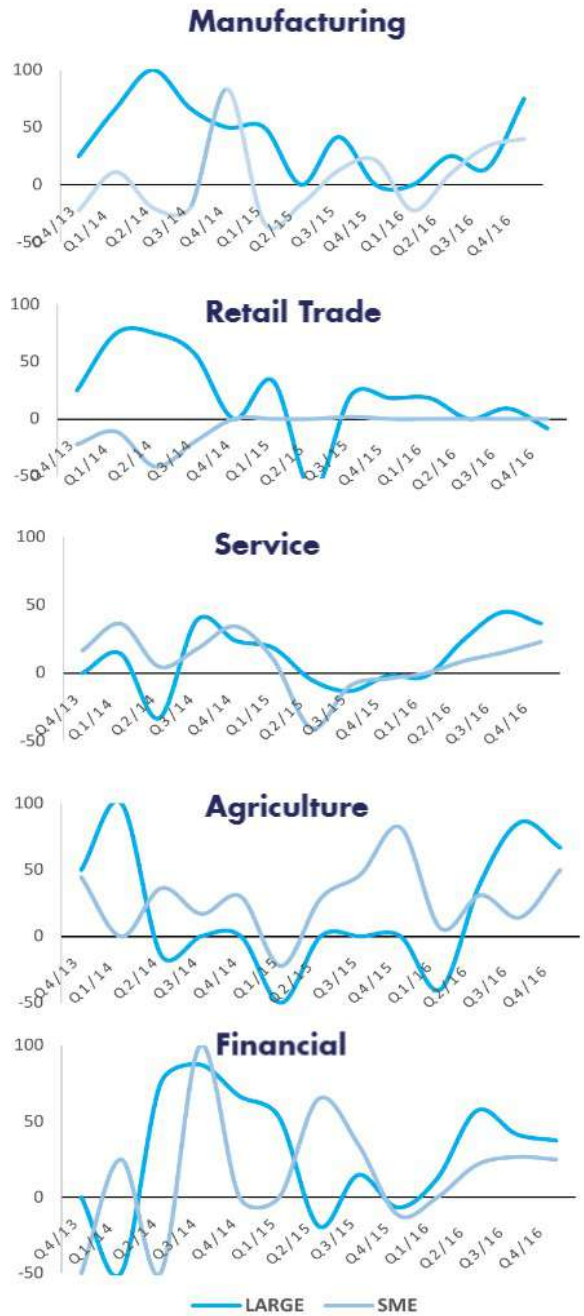
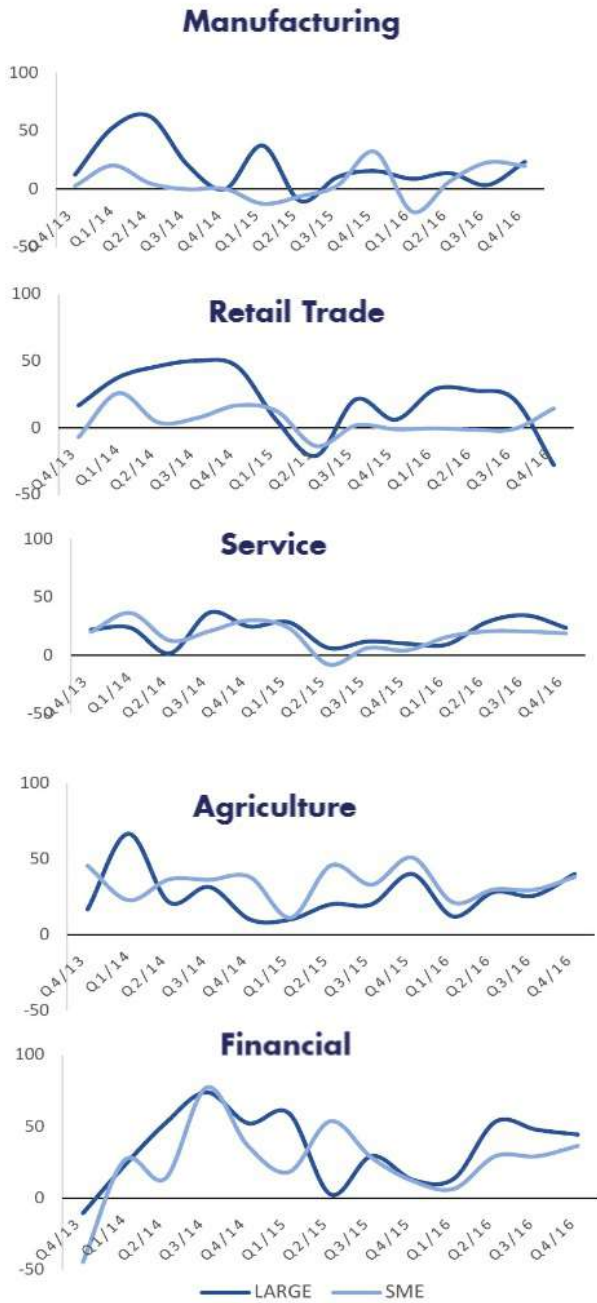
- The Business Confidence Index is calculated as a weighted average of the balances induced from all the answers about production/sales/turnover, competition, order books, volume of stock, demand evaluation, operation costs, profit, employment, and sales price setting.
- The expectations index is calculated 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).

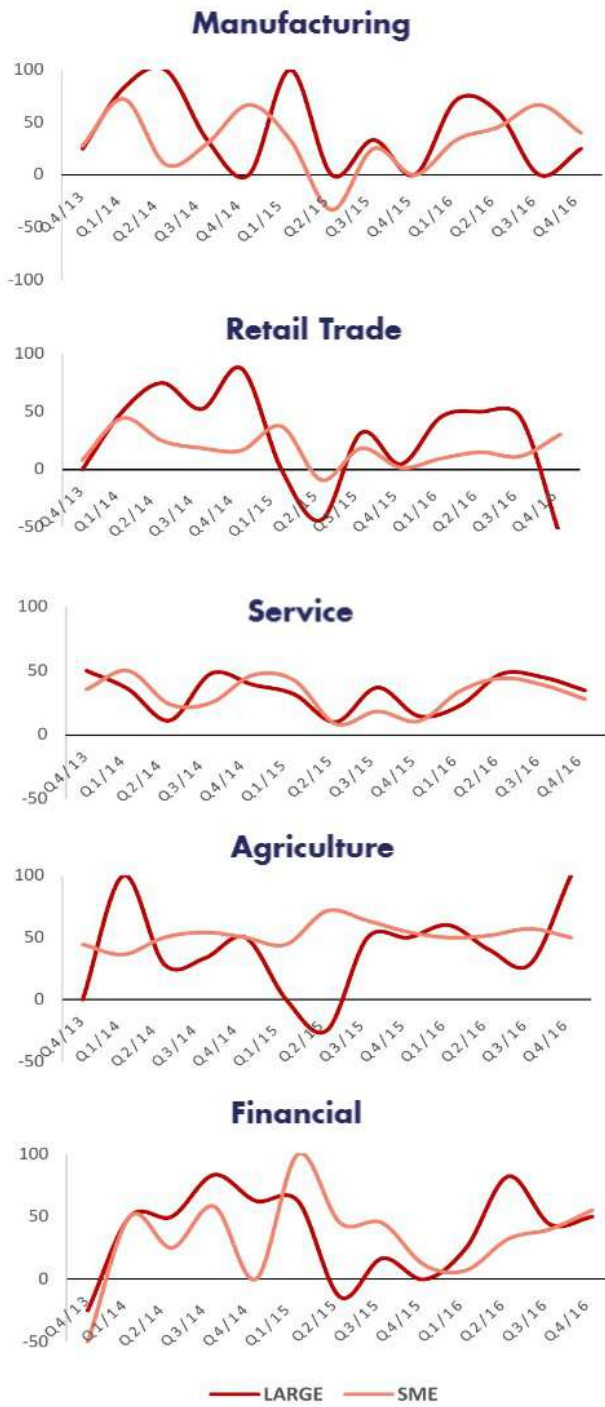
APPENDIX 1 – BCI, Production/Turnover/Sales, Expectations, Sales Expectations by Sectors and Sizes

Overall BCI

Sales/Production/Turnover for past 3 months



Expectations Index



Sales Price Expectations Index

