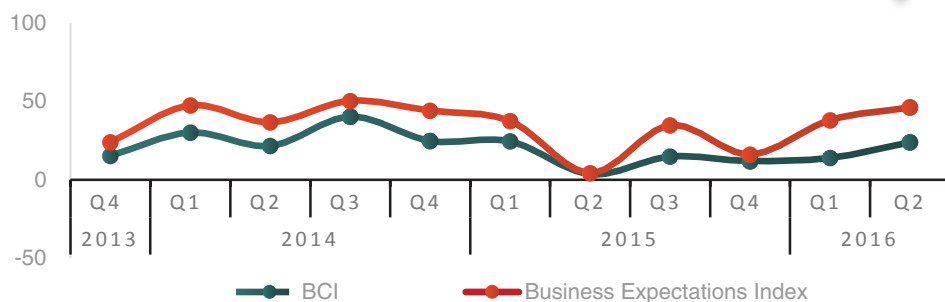


BUSINESS CONFIDENCE INDEX (BCI)



The Georgian Business Confidence Index (BCI) continues to improve. Unlike last quarter, the second quarter increase in the index was mostly driven by a significant improvement in performance rather than in business expectations, which kept rising albeit at a marginal pace.

Overall, the BCI gained 10 points (on a [-100/100 scale]) compared to Q1 2016. The expectations of the private sector in Georgia improved and reached 46 index points (up from 38 points in Q1). Businesses' performance over the past 3 months increased significantly and became positive, rising from -0.7 to 19.7, indicating a rise in production/turnover/sales. The performance of the past 3 months alongside improved expectations thus maintained overall the BCI at a stable, optimistic level and trend.

The significant improvement in the BCI was counter-cyclical. In the previous two years, performance in Q2 was the poorest of all four quarters, even reaching a historic minimum level in Q2 2015.

The gradual improvement of the Georgian BCI from the desperate situation in the second quarter of last year can potentially be attributed to the policy measures that helped create a reassuring environment for the business community. The stabilization of the Georgian lari, and improvement in external conditions, etc. have certainly played a role in strengthening business confidence. One could also argue that this improvement in current performance is, at least partially, due to self-fulfilling expectations. In the previous quarter we reported a dramatic increase in business expectations, and speculated that this optimism could be attributed to the policies promoted by the Prime Minister. Elevated expectations about the future could have driven business performance in such a way that led to actual improvement in current performance. For example, positive expectations might motivate firms to invest in capital and hire more labor, which increases overall demand and positively affects firms' economic outcomes.

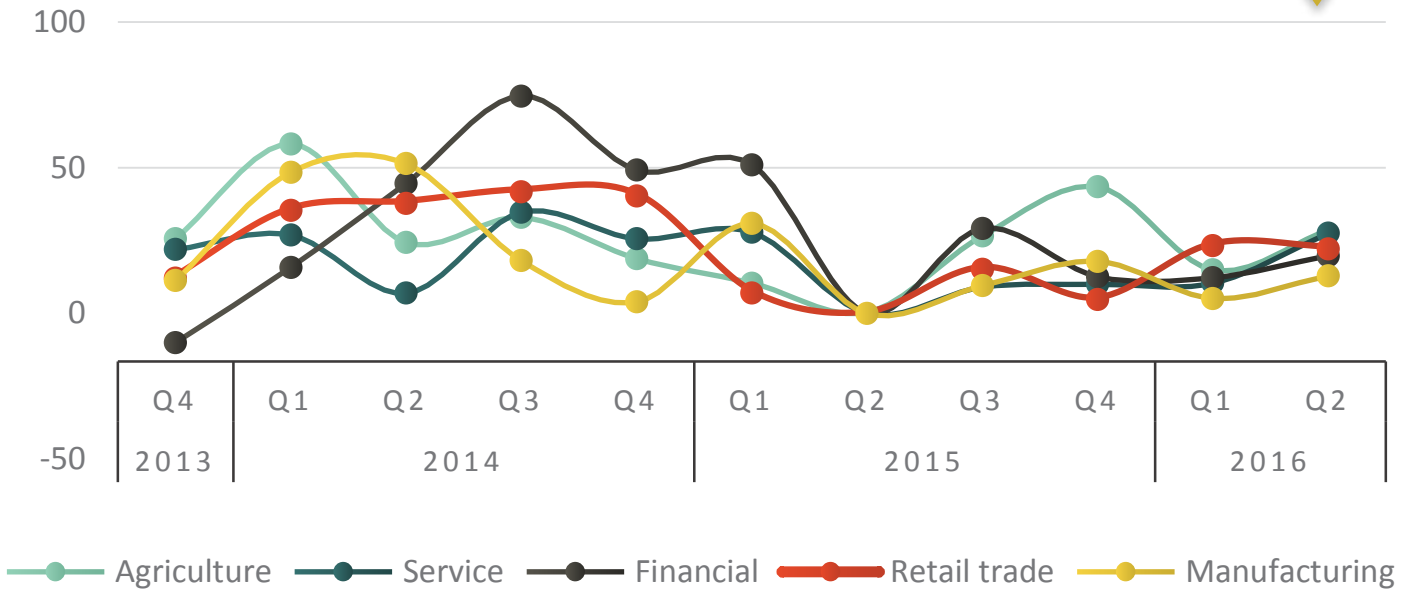
The BCI has improved for all sectors aside from retail trade. In the face of booming tourist activity, this result might be surprising; however, recent evidence from our Food Price Index (starting from March 2016, the Food Price Index decreased by an average 1% compared to the previous month) reflects harsh competition between retailers (one of the major supermarket chains even hired a whole new marketing team) and provides a possible explanation for this outcome.

OVERALL BUSINESS CONFIDENCE by sector for large firms and SMEs

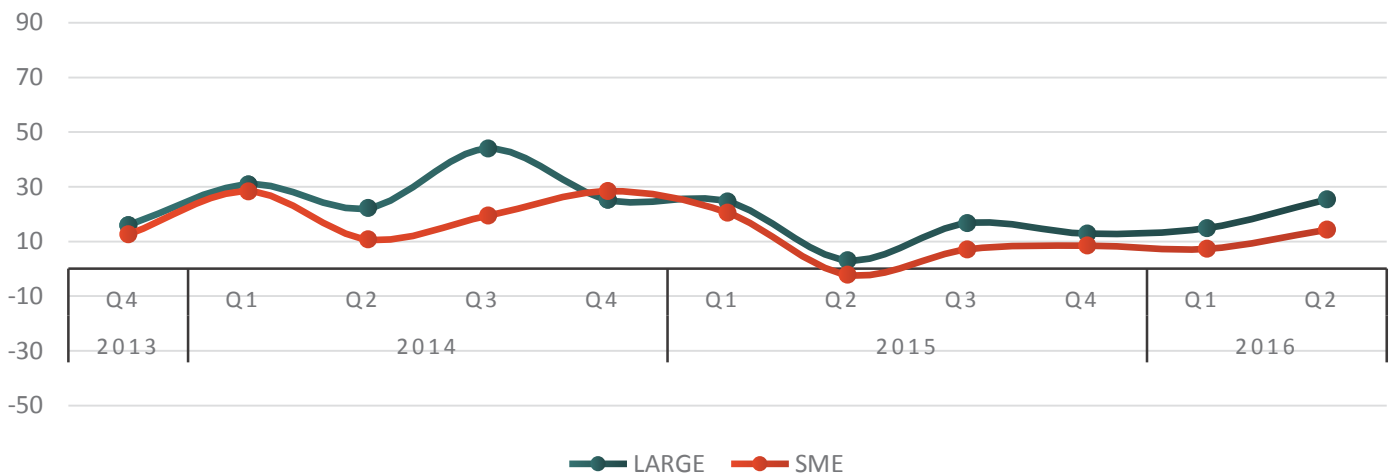


¹ In the second quarter of 2016, the Business Confidence Index registered 24 on a scale of [-100; 100] points. The positive number on the index indicates that confidence among businesses is about 24 index points more positive than negative or neutral. A confidence index of 100 would indicate that all 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).

BCI BY SECTOR



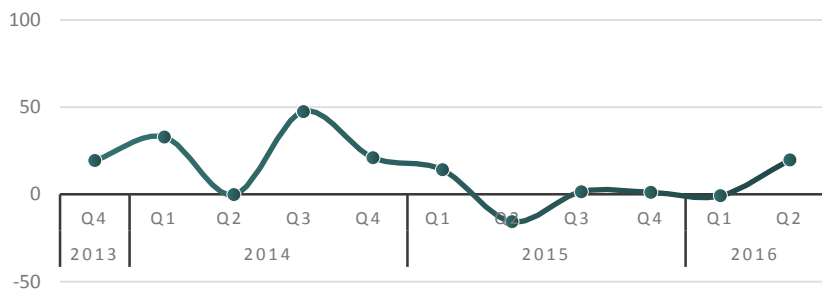
BCI: LARGE VS. SME



Business confidence in the second quarter of 2016 notably improved for large firms and SMEs equally. The overall trends for large firms as well as SMEs are stable and positive.

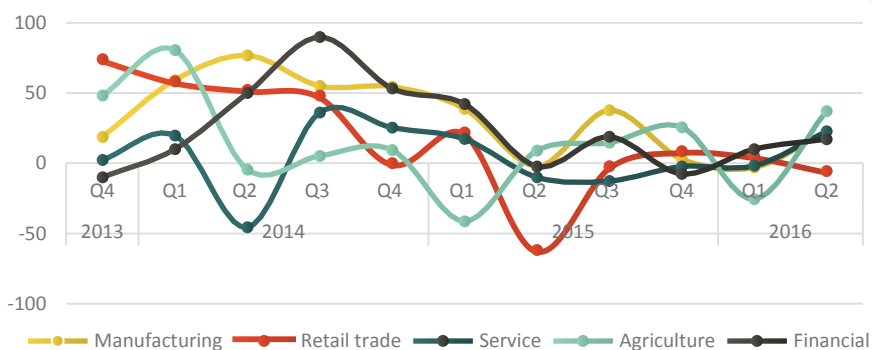
It should be noted that the BCI results presented here may be overestimated as the survey only covers businesses currently operating, and not those that have already exited the market. Firms still in operation are more likely to have a positive outlook.

PRODUCTION/TURNOVER/SALES PAST 3 MONTHS



In the Q2 2016 reporting period, the sales (production or turnover) of the 370 firms surveyed turned positive, increasing from -0.7 (Q1 2016) to 19.7 (Q2 2016). This indicator describes the activities of businesses in January, February and March. The actual performance of businesses notably improved compared to the first quarter of the year.

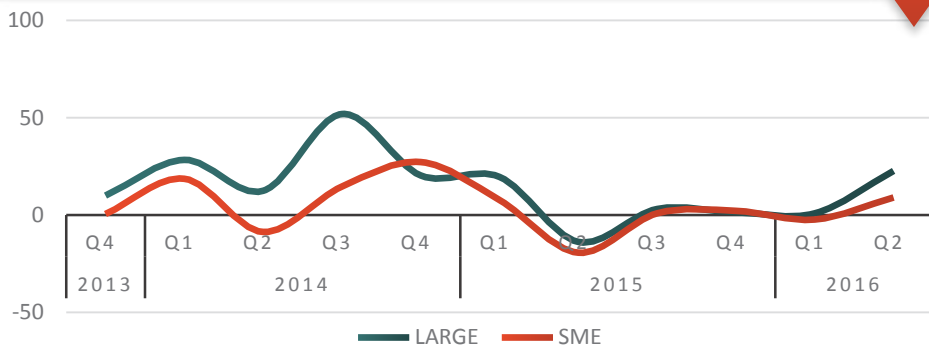
PRODUCTION/TURNOVER/SALES PAST 3 MONTHS BY SECTOR



The current situation for most firms significantly improved. It only turned negative for the retail trade sector, which, as argued above, might be explained by rivalry in the retail market. The increase in the agriculture sector was marginally the highest. More farmers assessed their performance as being positive than as either negative or neutral in the second quarter.

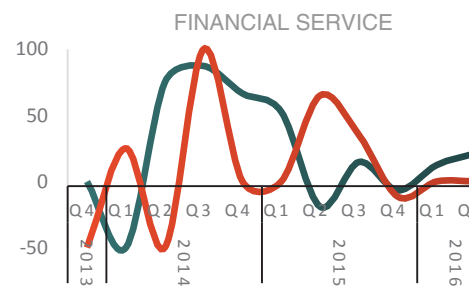
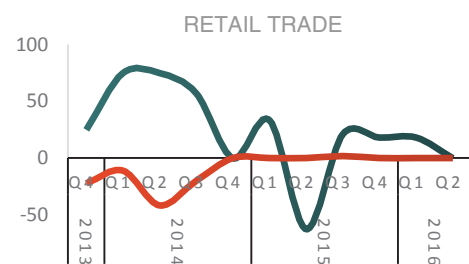
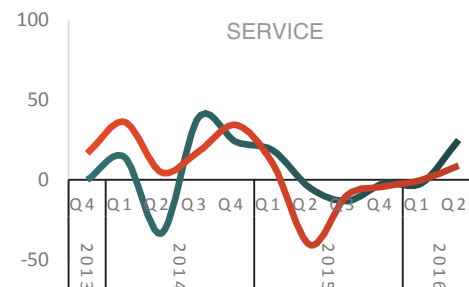
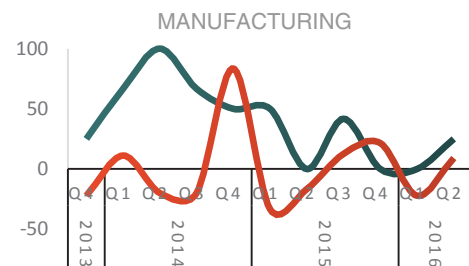
Overall, significant positive improvements in the agriculture, service, manufacturing and financial sectors overshadowed the slight rise of pessimism in the retail trade sector, which led to a noticeable improvement in business activities.

PRODUCTION/TURNOVER/SALES PAST 3 MONTHS



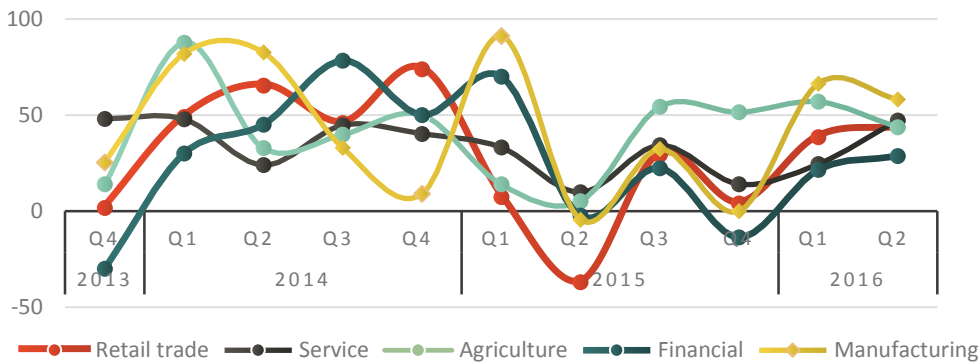
Analyzing the data in terms of business size, it is evident that business activities improved for both large firms and SMEs. For large firms, the business activities indicator increased from 0.8 points in Q1 to 22.7 in Q2; for SMEs the indicator increased from -2 to 9 over the same period.

SALES/PRODUCTION/TURNOVER FOR PAST 3 MONTHS by sector for large firms and SMEs



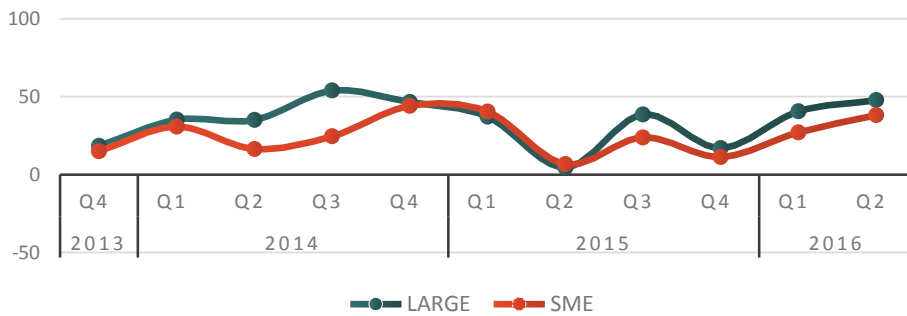
— LARGE — SME

EXPECTATIONS INDEX BY SECTOR



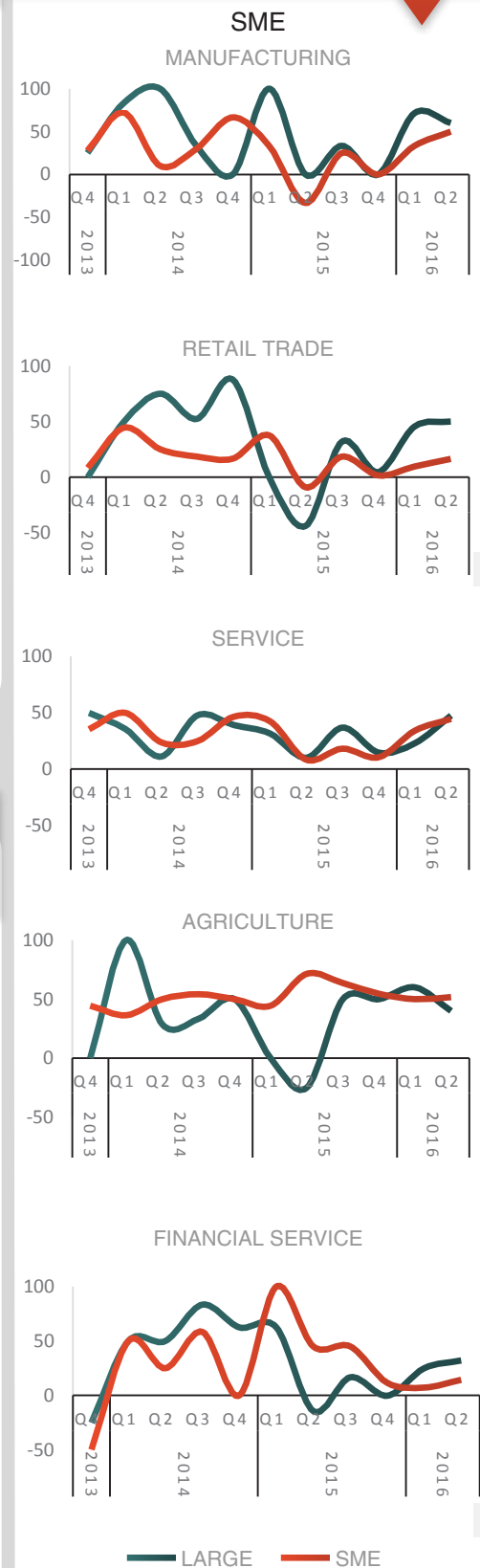
The expectations index increased by 8 points in the second quarter of 2016. Expectations about the next three months improved in all sectors, except for agriculture and manufacturing. The pessimism of the latter two sectors might stem from the appreciation of the Georgian lari against the US dollar, which worsens our terms of trade and export competitiveness.

EXPECTATIONS: L.VS.SME

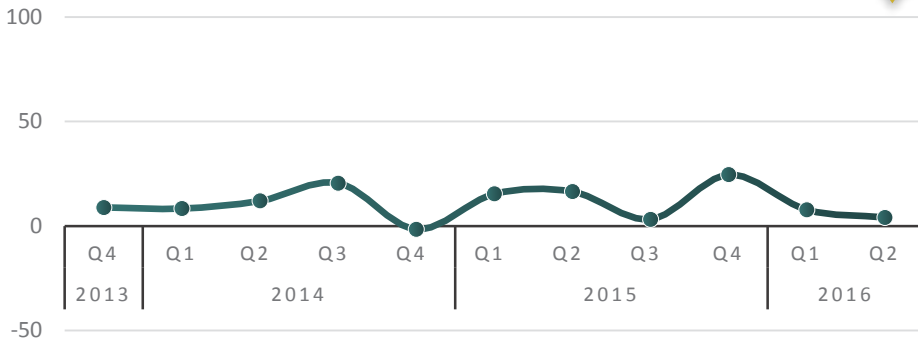


As one can see from the graph above, business expectations for the next three months (April, May, and June) increased for both large firms and SME. The marginal increase for SMEs is higher than that for large companies. Optimism stemming from SMEs is promising, since smaller companies are more vulnerable to fluctuations in external conditions and their economic performance and expectations usually lag behind those of large companies.

EXPECTATIONS INDEX by sector for large firms and SMEs

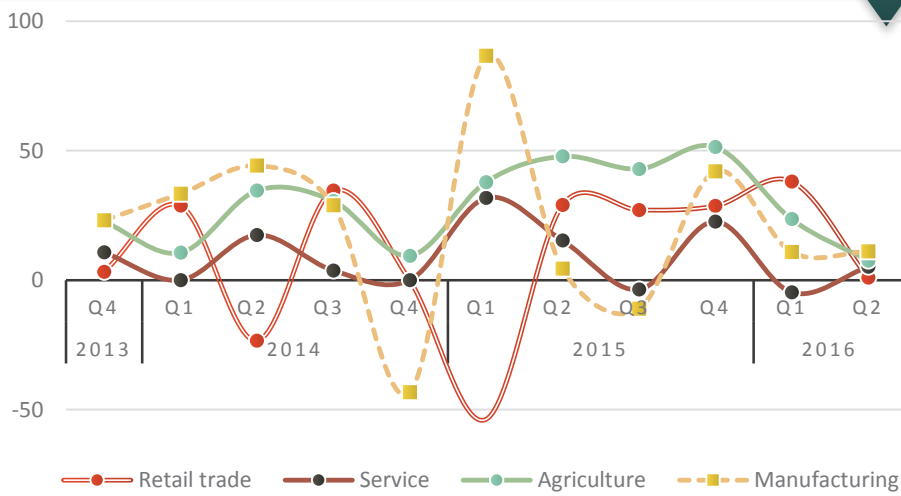


SALES PRICE EXPECTATIONS



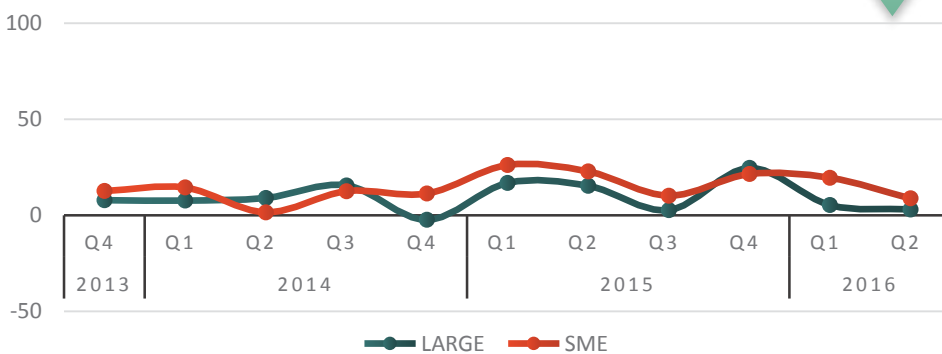
The sales price expectation index decreased from 7 points (Q1 2016) to 4 points (Q2 2016).

SALES PRICE EXPECTATIONS BY SECTOR



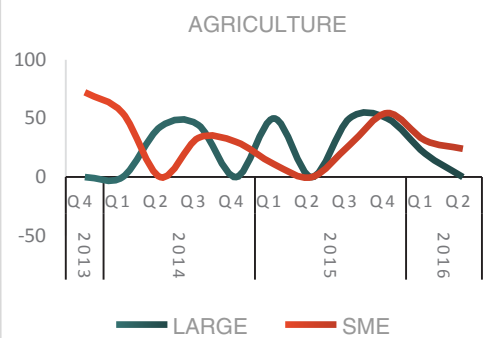
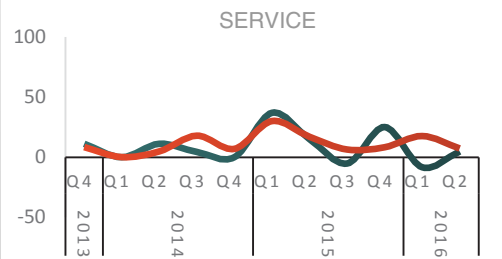
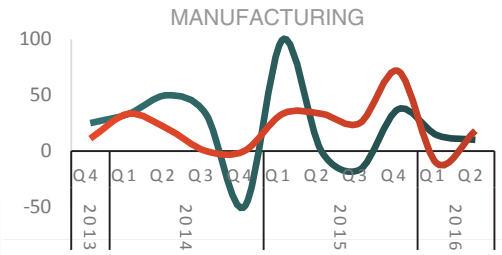
Sales price expectations decreased for the retail trade and agriculture sectors. The service sector's sales price expectations increased and escaped negative levels, reflecting relatively high demand on service activities at the beginning of summer. The manufacturing sector does not expect significant changes in prices in the next three months.

PRICE EXPECTATION

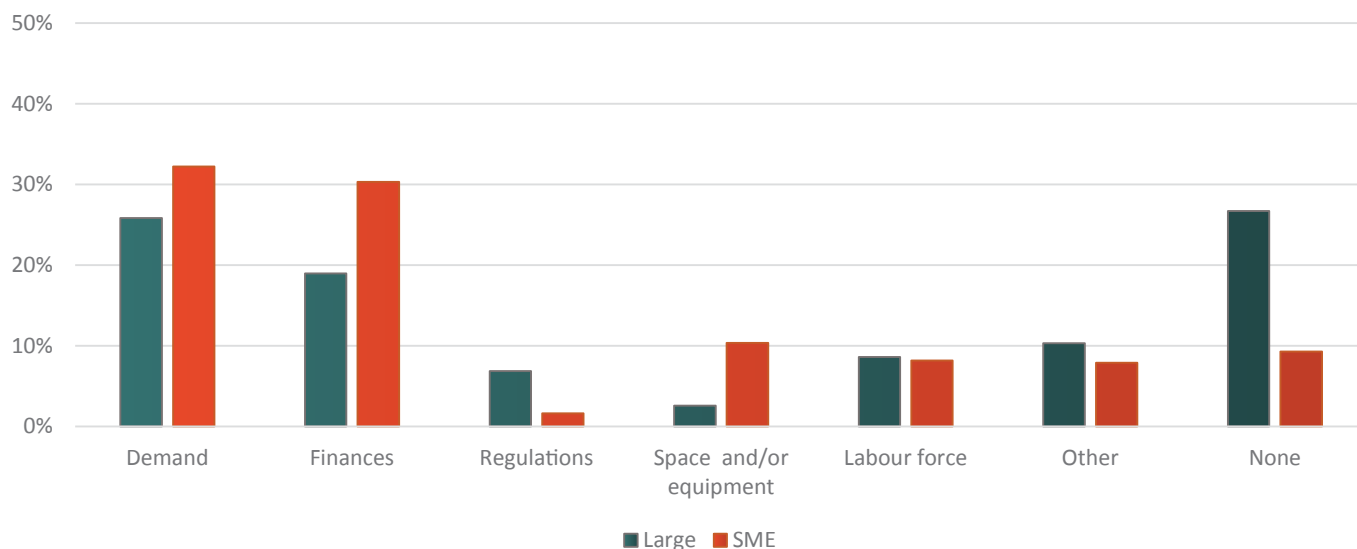


The overall sales price expectations index slightly decreased for large companies and dropped for SMEs. Neither SMEs nor large companies appear to be planning to increase prices for their production/services in the near future.

SALES PRICE EXPECTATIONS INDEX by sector for large firms and SMEs



WHAT ARE THE MAIN FACTORS CURRENTLY LIMITING YOUR BUSINESS? Quarter 2, 2016



Lower consumption activities and financial issues are becoming a severe problem for businesses. The most limiting factor for doing business for both large firms and SMEs in Q2 2016 was insufficient demand. A total of 26% 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 32% for SMEs.

SMEs typically have more trouble attracting financial resources than larger companies and this pattern was enhanced during the 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 (see methodology)

| | Sector | Firm Size | | Total |
|---------|------------------------|------------|------------|------------|
| | | Large | SME | |
| Q2 2016 | Construction | 9 | 30 | 39 |
| | Financial Service | 14 | 14 | 28 |
| | Manufacturing Industry | 10 | 11 | 21 |
| | Retail Trade | 15 | 60 | 75 |
| | Service | 42 | 111 | 153 |
| | Agriculture | 5 | 29 | 34 |
| | Other | 9 | 11 | 20 |
| | Total | 104 | 266 | 370 |

Interviews were conducted between 17 March and 5 May 2016.

DISTRIBUTION OF PARTICIPATING FIRMS BY SECTOR

Table 1 – Distribution of Firms Participating in the BCI Survey

| Sector - Number of firms | 2016 Q2 | 2016 Q2 | 2016 Q1 | 2016 Q1 |
|--------------------------|------------|-------------------|------------|-------------------|
| Construction | 39 | 11% | 23 | 10% |
| Financial Service | 28 | 8% | 15 | 7% |
| Manufacturing Industry | 21 | 6% | 16 | 7% |
| Retail Trade | 75 | 20% | 53 | 24% |
| Service | 153 | 41% | 81 | 36% |
| Agriculture | 34 | 9% | 21 | 9% |
| Other | 20 | 5% | 13 | 6% |
| Total | 370 | # of firms | 222 | # of firms |

Source: BCI Survey Data

Table 2 – Distribution of firms by turnover

| Sector | %in total |
|------------------------|-----------|
| Construction | 8% |
| Financial Service | 9% |
| Manufacturing Industry | 10% |
| Retail Trade | 17% |
| Service | 47% |
| Agriculture | 7% |
| Other | 3% |

Source: Geostat

The number of firms participating in the BCI survey in Q2 2016 was 370. This is almost the double the previous maximum. Despite this unprecedented increase 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).

Even if the distribution of the firms in our sample is well aligned with the economy, we still use turnover weights to correct for small differences between our shares (share of 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.

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

| VARIABLE | SCORE |
|----------|-------|
| Positive | +1 |
| Neutral | 0 |
| egative | - |

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.

² 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%20metodologia.pdf).