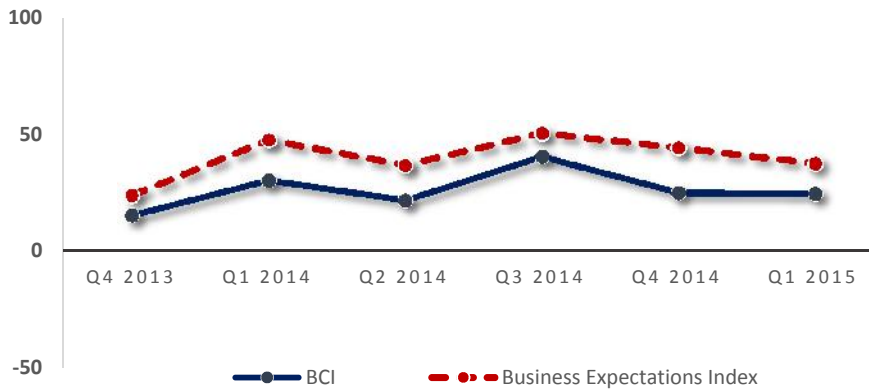
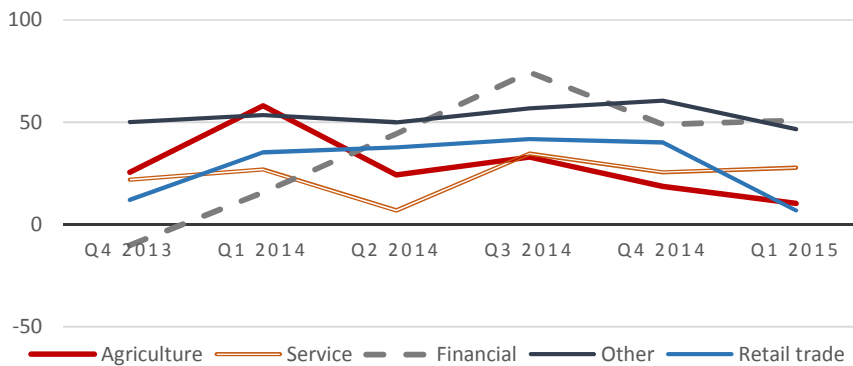


BUSINESS CONFIDENCE INDEX



In the first quarter of 2015, the Business Confidence Index decreased slightly and registered 24.5 on a scale of 100 points. This is down from the 24.9 recorded in the fourth quarter of the previous year. The positive number indicates that the confidence factor among businesses is about 24.5 index points more positive than negative or neutral (e.g. a confidence index of 100 would have indicated 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). The reduction in the confidence index was driven by both expectations for the next 3 months and current performance of the companies in almost all sectors, especially the retail sector.

BCI BY SECTOR

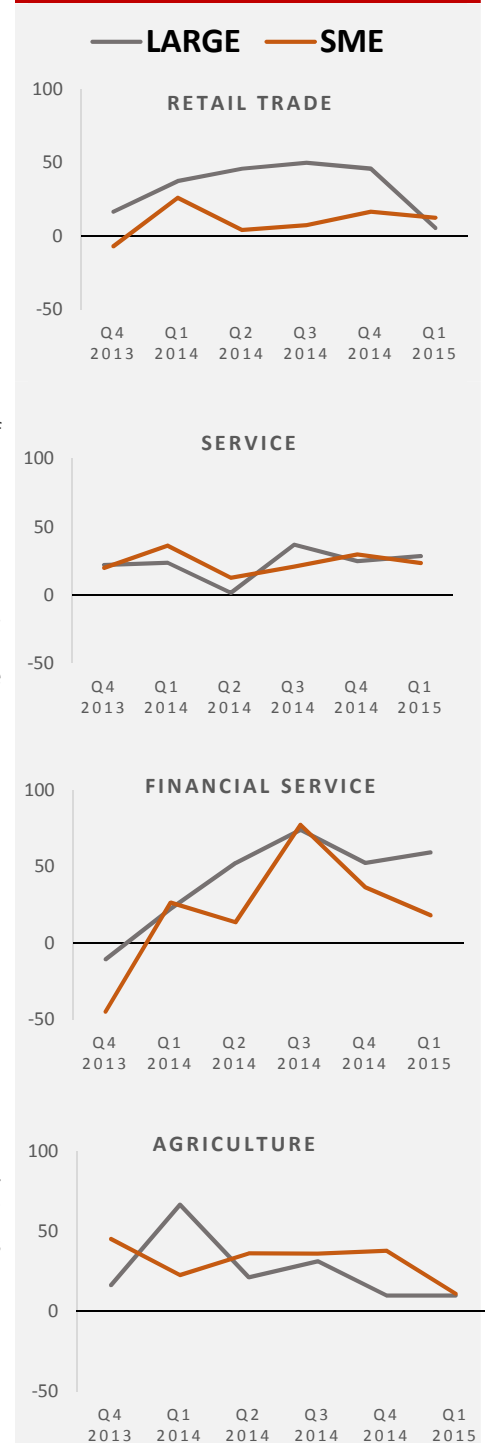


Decrease in the retail sector business confidence is marginally the highest. The retail sector is the first link in the production chain and is first to react to the changes in consumers' confidence. [The consumer confidence Index \(CCI\)](#) reached a new minimum of -25.8 points in January 2015 and it has been continually declining since November 2015. In turn, CCI decreased because of the current depreciation of GEL, which contributed to higher indebtedness among the population.

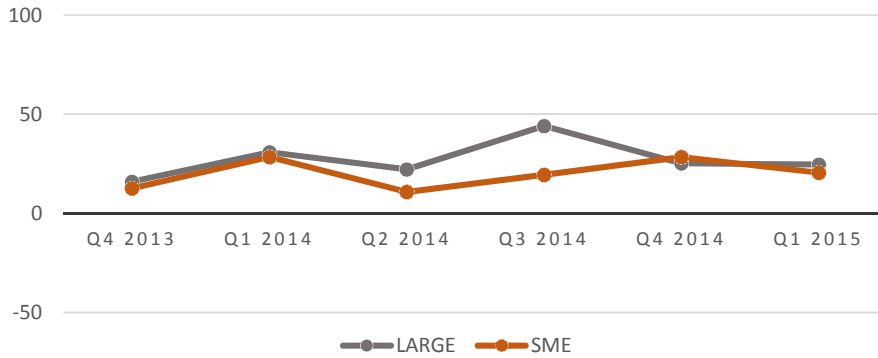
The good news is that the financial sector outlook has been stable. The stability of the sector underlies the optimistic mood of the financial institutions, which is currently the highest among the sectors.

In general, the sectoral breakdown of the BCI shows that a positive outlook dominates in all sectors. This is not surprising, considering that the survey only covers businesses currently operating on the market and not those that have exited the industry. Clearly, firms still in operation are more likely to have a positive rather than negative outlook. Looking at the BCI dynamics, we note that the decreases in the business confidence index relative to the previous quarter were recorded in 3 out of 5 economic sectors.

Overall business confidence by sector, for large firms and SMEs



BCI: LARGE VS. SME



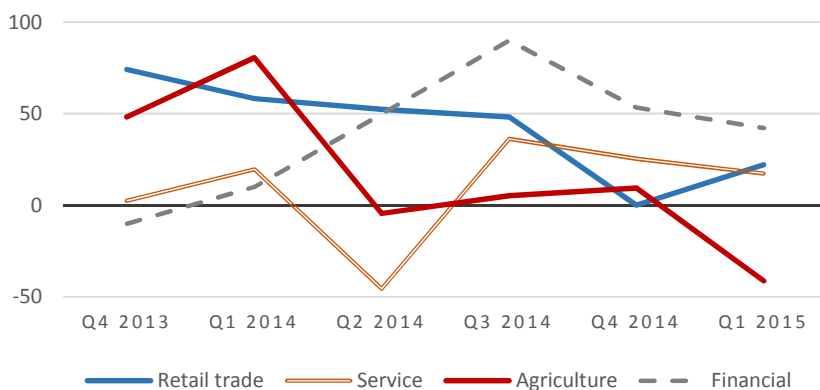
Business confidence in the first quarter of this year remains stable for large companies as well as SMEs. However, this stability is viewed against the backdrop of significant business confidence reduction for large companies in Q4, 2014. In our previous publication we suggested that the main driving factors behind this decline could have been legislative changes: the migration law that came into force in September 2014 and land ownership law, which is currently being adopted. The laws are not likely to have an immediate impact on the economy, but they will have far-reaching implications for larger companies that rely on qualified foreign labor as well as on direct links with foreign investors. Moreover, according to GeoStat, 40% of the total production value in the second quarter of 2014 was owned by foreign physical or legal persons.

Sales/Production/Turnover for PAST 3 MONTHS



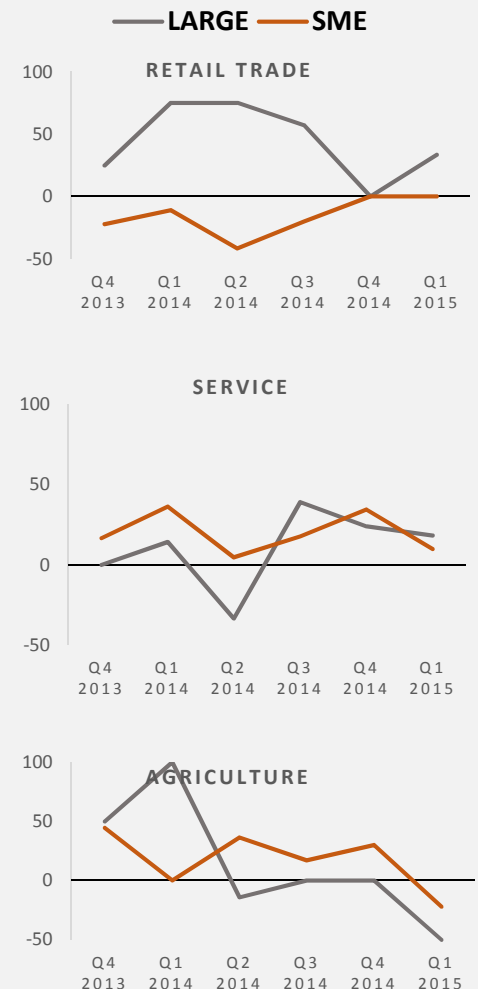
In Q1 2015 reporting period, the sales (production or turnover) of the 83 firms surveyed decreased by 7 index points, from 21.08 to 14.1.

PRODUCTION/TURNOVER/SALES PAST 3 MONTHS

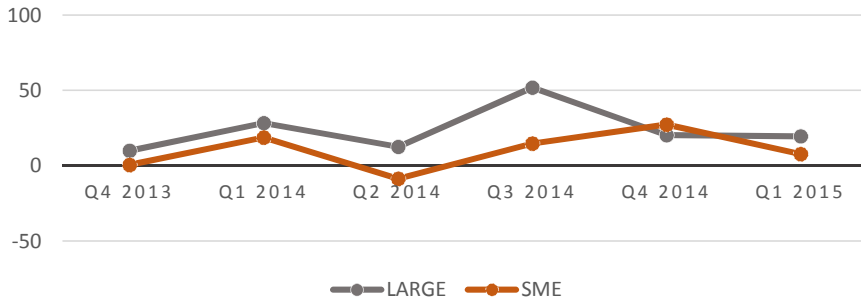


The reduction was driven by the agriculture and the service sectors. On the other hand, large retailers showed positive performance, since the New Year period was the peak of their sales season.

Sales/production/turnover for past 3 months by sector, for large and small&medium firms



PAST 3 MONTHS: LARGE VS. SME



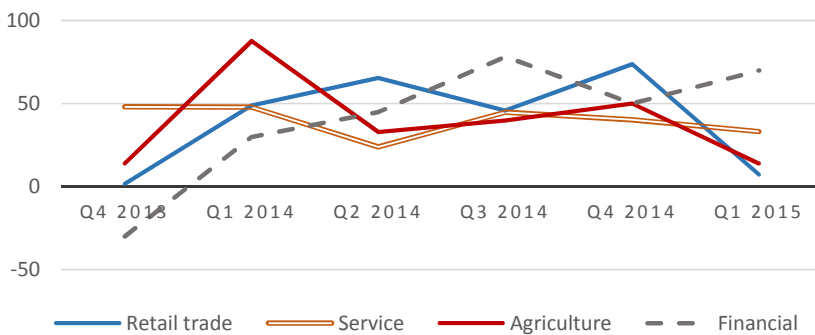
Overall, in the three months preceding October, SMEs in Georgia have fared worse in terms of sales (turnover) than larger firms.

EXPECTATIONS INDEX



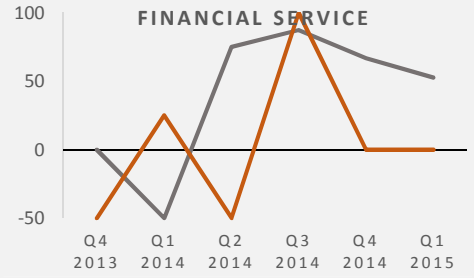
The expectations index declined by 6.5 index points for all companies. Overall, the expectations index shows that 37% more firms are optimistic (rather than pessimistic or neutral) about the next three months. This optimism was driven by the financial sector and, marginally, by SMEs.

EXPECTATIONS INDEX BY SECTOR

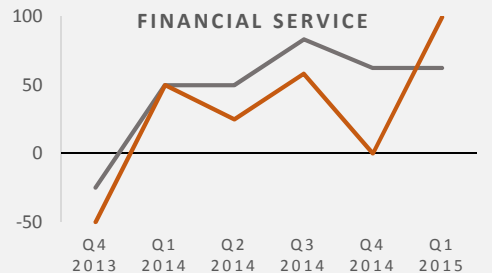
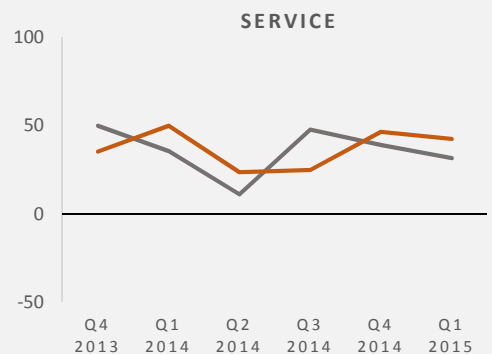
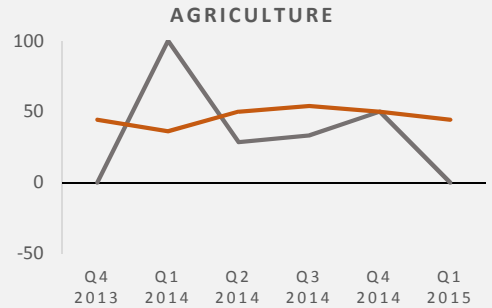
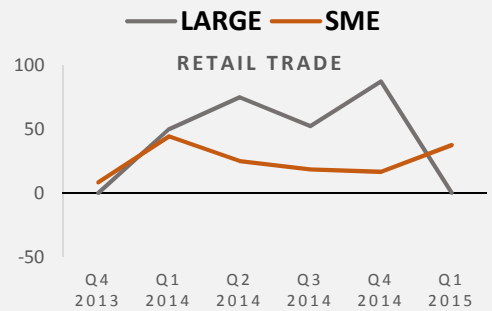


In the same time, the retail and agricultural firms' confidence decreased substantially. As we mentioned above, retailers were among the first to feel the effect of the drastically deteriorating consumer confidence. Looking at the agriculture sector, the SMEs' expectations remain stably positive, while large businesses do not expect any improvements over the next 3 months. There can be several factors causing lower expectations in the agricultural sector. The first and most important expected change is the draft of the law on agricultural land ownership, which may severely limit foreign ownership of the agricultural land. The other confounding factor could be the recent depreciation of GEL, which increased the cost of imported fertilizers and other inputs for land cultivation.

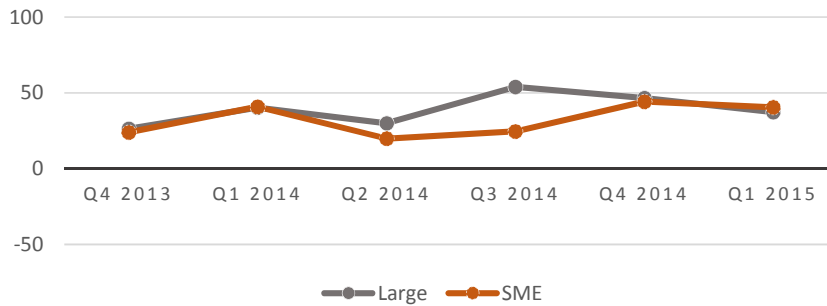
FINANCIAL SERVICE



Expectations index by sector, for large and small&medium firms

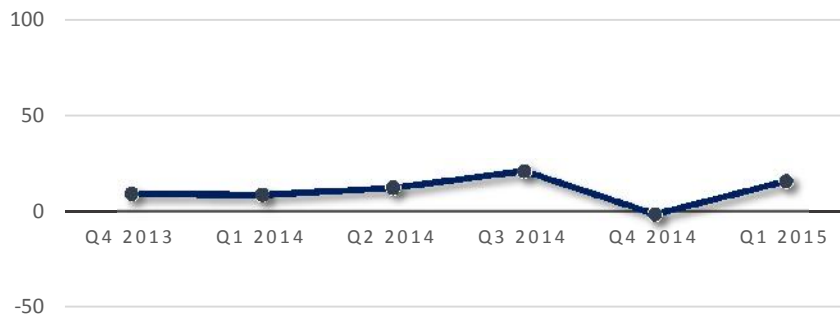


EXPECTATIONS INDEX, L. VS. SME



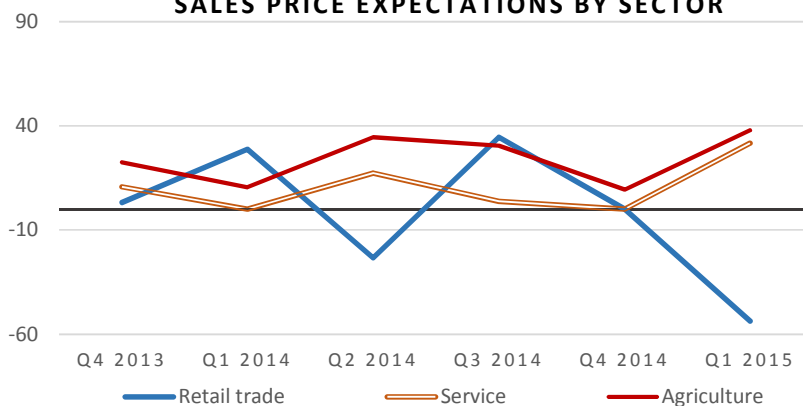
Overall, in the first quarter of the year expectations of large companies and SMEs are about the same. The expectations of SMEs kept improving since Q2 2014, but the growth dynamics halted in Q1 2015.

SALES PRICE EXPECTATION



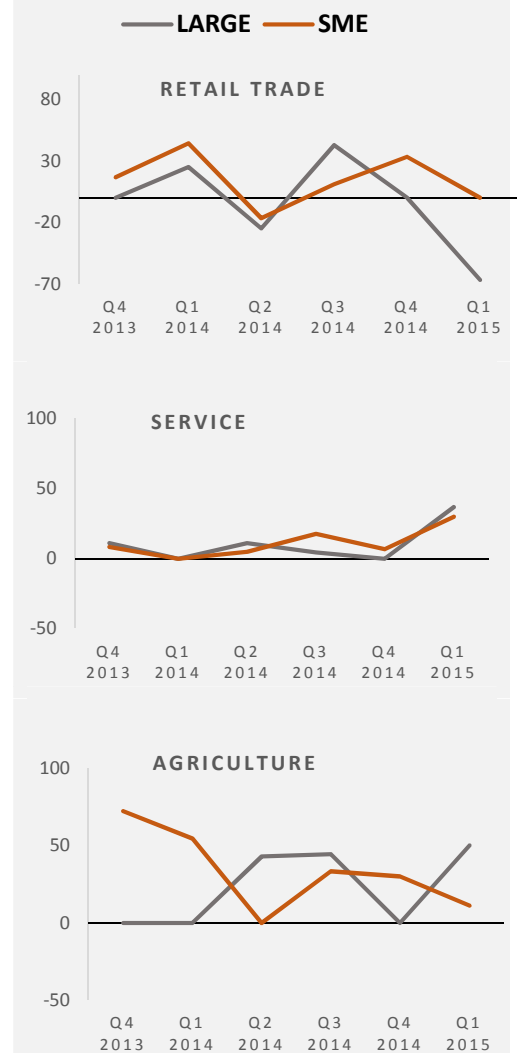
The sales price expectations turned from negative to positive this quarter, which means that more firms are expecting the prices to grow. These expectations were driven by the GEL depreciation since December 2014. Inflationary pressure in the Georgian economy remains low, with inflation standing at 1.4% in January, which is well below the central bank's target of 6%. But it should be mentioned that the inflation for different groups of products and services are different. For alcohol and tobacco the y/y inflation in 6.6% (perhaps due to the increased excise tax from the first of January) and the price for health products increased by 7.3% in the same period. Given the business community's expectations, in the near future we should expect an increase in the inflationary pressure.

SALES PRICE EXPECTATIONS BY SECTOR

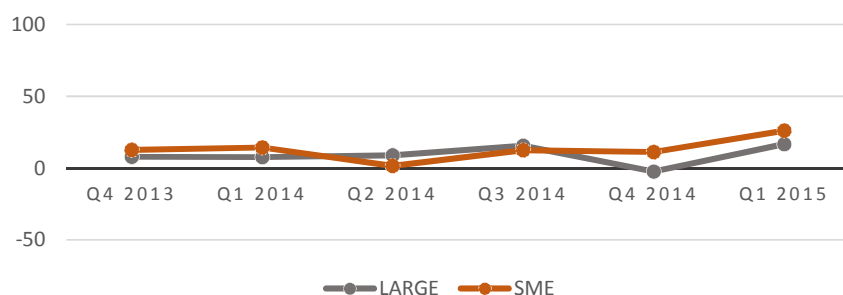


Retail sector expectations, however, tell a different story. The retail sector, it seems, does not share the inflationary expectations of service and agriculture sectors, which is most likely due to the palpable decrease in consumer confidence and retail spending. Hence, retail companies may expect to lower their prices in the future due to decreased demand.

Expectations index by sector, for large and small&medium firms

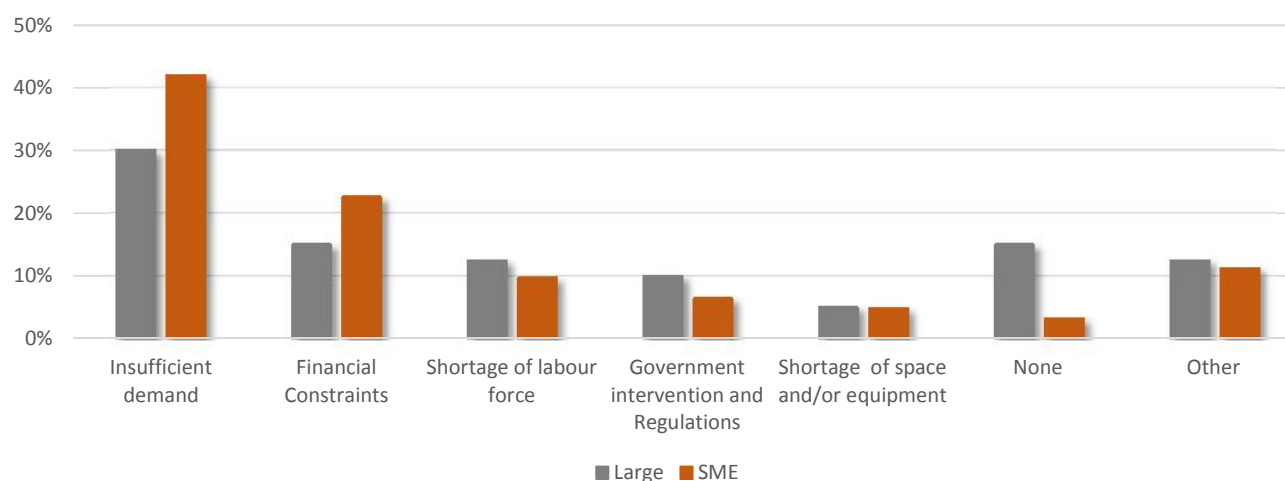


PRICE EXPECTATION: L. VS. SME



Overall, the SME's price outlook remains stable and positive. As for large companies, their expectations changed from negative to positive. Taken together, this implies an upward pressure on prices from the inflationary expectations.

WHAT ARE THE MAIN FACTORS CURRENTLY LIMITING YOUR BUSINESS? Quarter 1, 2015



As in the previous quarter, we find that the most limiting factor for doing business is *insufficient demand*. A total of 30% of large companies report a shortage of demand as the main obstacle. SMEs in particular find it hard to operate on the market with unstable demand. This index for SMEs increased from 36% to 42% compared to quarter 4, 2014. However, demand stays a severe problem for large firms as well. Lari depreciation affected 13% of large companies (this was reported in the "other" category). In Quarter 1 2015 the financial constraint softened somewhat for SMEs, as 5% less SME companies listed this as the obstacle for doing business.

Still, SMEs typically have more trouble attracting financial resources than larger companies. The pattern is preserved in this quarter as well. Yet, the financial constraint appears to be less of a problem in this quarter in general, and in particular for large companies. On the other hand, the shortage of labor continues to be more of a problem for large enterprises. This is because large enterprises typically look to attract qualified workers, while SMEs may rely on unqualified labor to a greater extent.

SAMPLE SIZE BY SECTOR (see methodology)

	Sector	Firm Size		Total
		Large	SME	
Q4 2014	Construction	2	1	3
	Financial Service	12	2	14
	Manufacturing Industry	1	3	4
	Retail Trade	3	4	7
	Service	19	20	39
	Agriculture	4	9	13
	Other	3	0	3
	Total	44	39	83

Interviews were conducted during 8 January-10 February, 2015.

*Methodology

The ISET Policy Institute, working in partnership with the International Chamber of Commerce in Georgia (ICC), has implemented the Business Confidence Survey from 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 percentages 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	SCORE
Positive	+1
Neutral	0
Negative	-1

The methodology of 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 **large¹ 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.

¹ The size of the company is defined accordingly to the Main Indicators' Calculation Methodology of Business Statistics (http://geostat.ge/cms/site_images/files/georgian/methodology/business/BS%20metodologia.pdf)