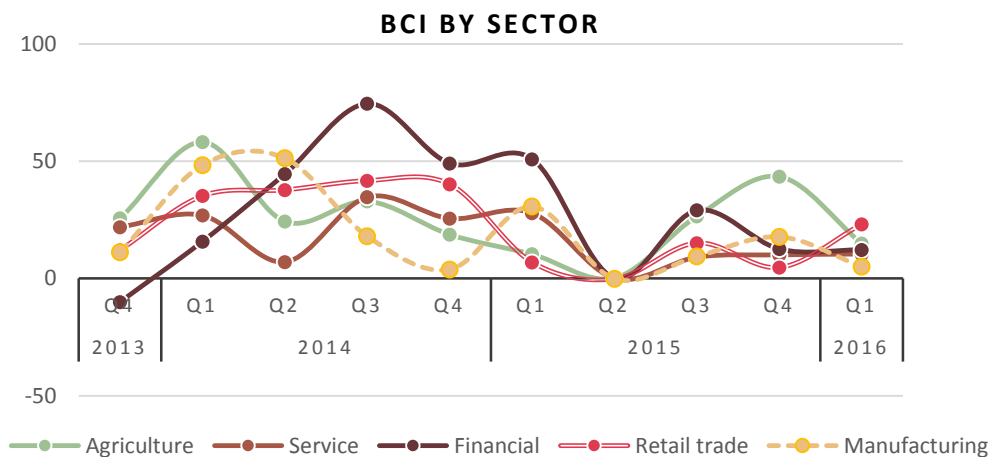


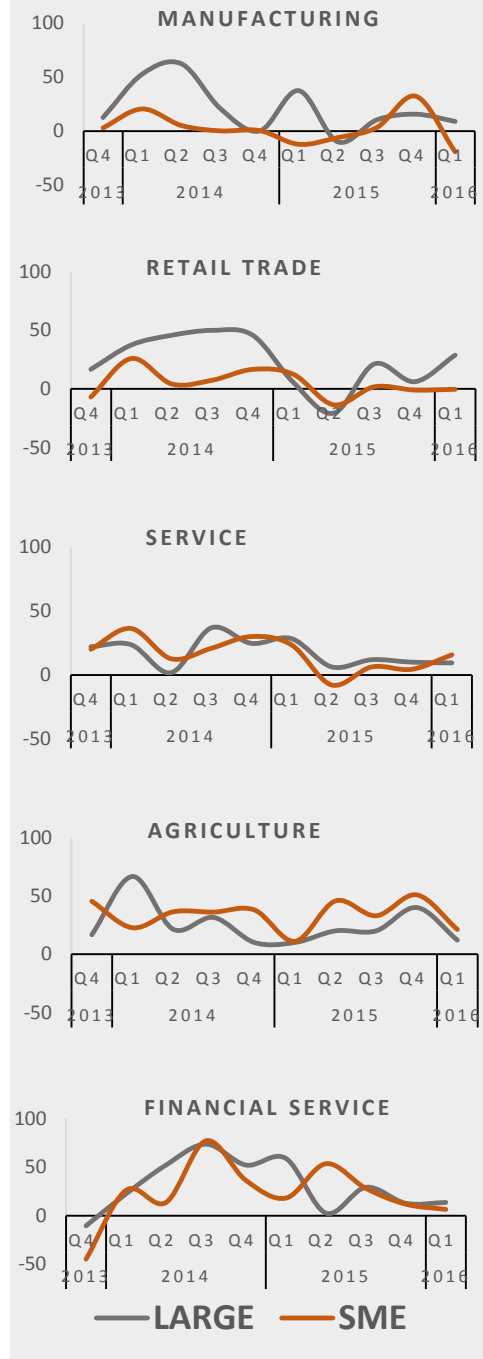
The Georgian Business Confidence Index (BCI) has gained 3 points (on a [-100/100 scale])<sup>1</sup> due to the strengthening of business expectations.

All of a sudden, the expectations of the private sector in Georgia improved and reached 38 index points. This is an improvement from 16 points in the fourth quarter of 2015. Since there is no particular rationale to explain this sharp advance in expectations, the new approach of reforming investment environment of new Prime Minister can inform this optimism. Kvirikashvili prioritized business environment problems. Proposition of the pro-private sector solutions could be reason for such improvement. The Estonian corporate tax system, abolishment of VAT on imported capital goods, simplified tax administration, and resolving insolvency are some of the reforms that are being actively discussed in the quick manner after Kvirikashvili became PM.

On the other hand, the performances of businesses in the past three months remained at a very low level and turned negative, indicating stagnation in production/turnover/sales. This poor performance of the past three months partially offset the improved expectations and the overall BCI increased very slightly, maintaining stability at a low-optimistic level.

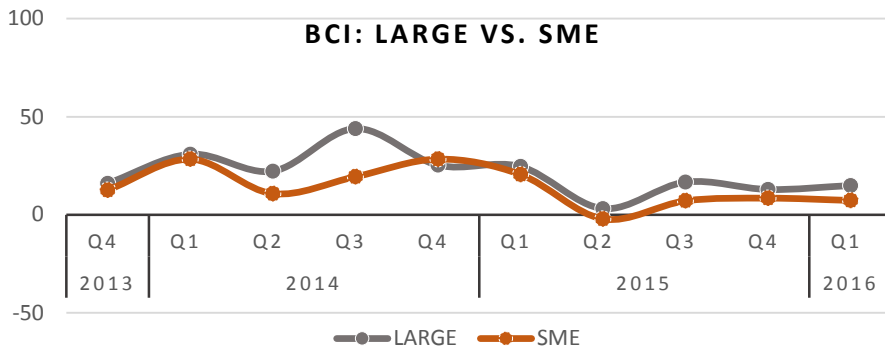


## OVERALL BUSINESS CONFIDENCE by sector for large firms and SMEs



<sup>1</sup> In the first quarter of 2015, the Business Confidence Index registered 14 on a scale of [-100; 100] points. The positive number on the index indicates that confidence among businesses is about 14 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).

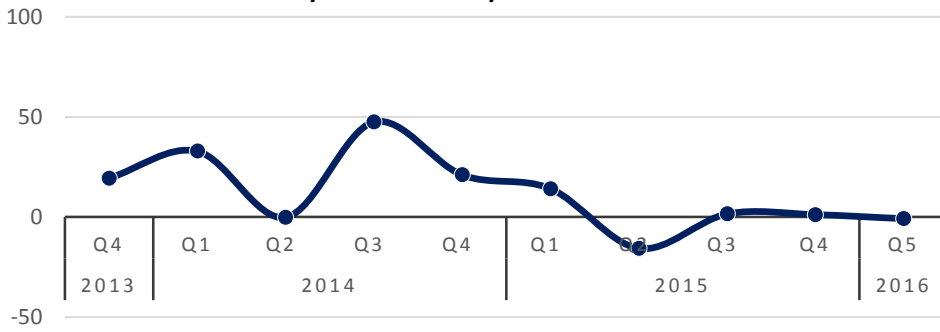
BCI across sectors has diverse trends. The retail sector is recovering from FX depreciation pressure, manufacturing sector confidence decreased, and the financial service and service sectors remained stable.



Business confidence in the first quarter of 2016 slightly improved for large companies and declined for SMEs. However, the overall trends for both large firms and SMEs are stable and positive.

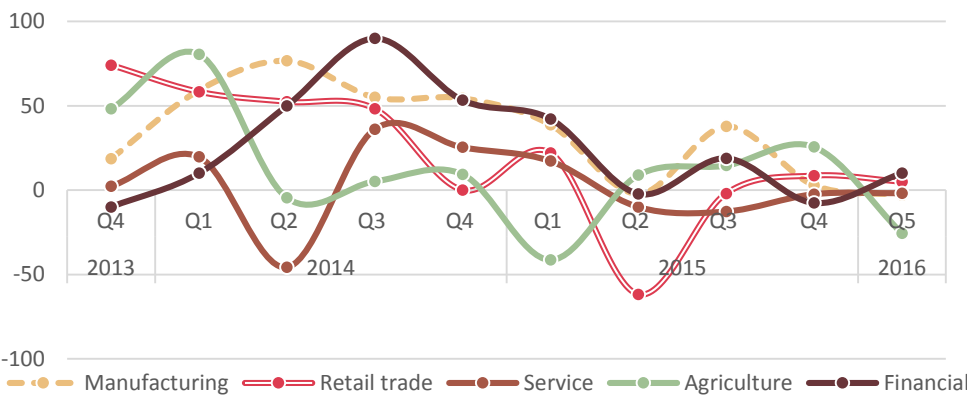
It should be noted that the BCI results presented here may be overestimated as the survey only covers businesses currently operating, and not those that have already exited the market. Firms still in operation are more likely to have a positive outlook.

### PRODUCTION/TURNOVER/SALES PAST 3 MONTHS



In the Q1 2016 reporting period, the sales (production or turnover) of the 222 firms surveyed turned negative, from 1.2 (in Q4 2015) to -0.7 (Q1 2016). This indicator describes the activities of businesses in November, December, January and part of February. The performance of businesses has stagnated and been declining since Q3 2015.

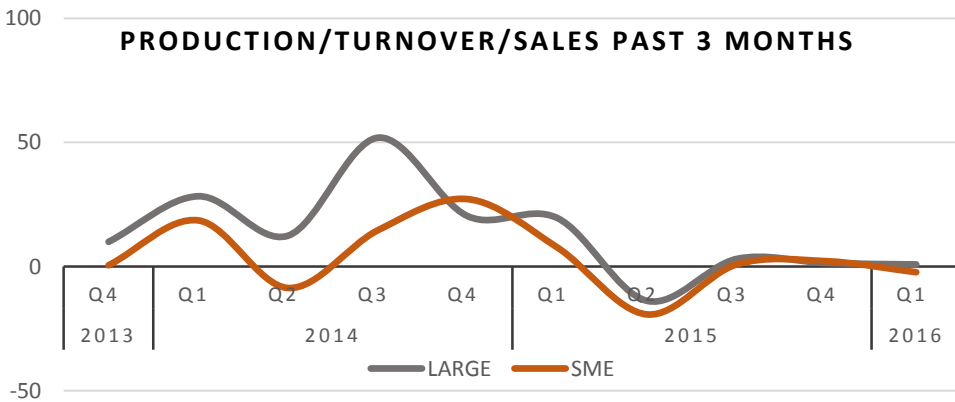
### PRODUCTION/TURNOVER/SALES PAST 3 MONTHS BY SECTOR



The current situation index for many firms has remained low and for some sectors has even become negative. The decrease in the agriculture sector was the highest, with more farmers assessing their performance as being negative than as either positive or neutral in the current quarter.

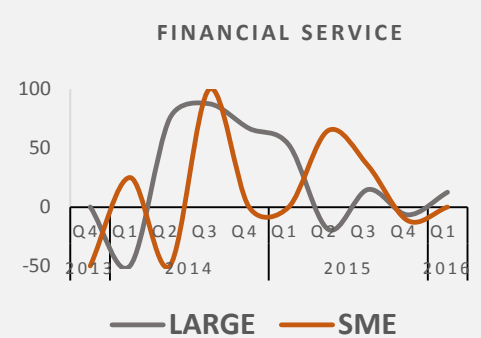
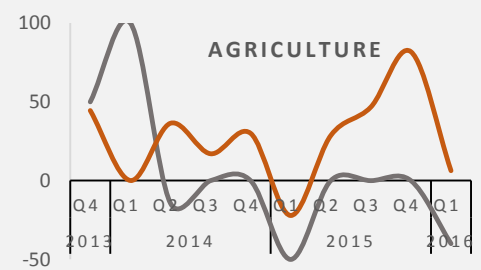
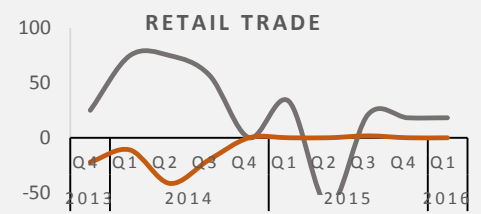
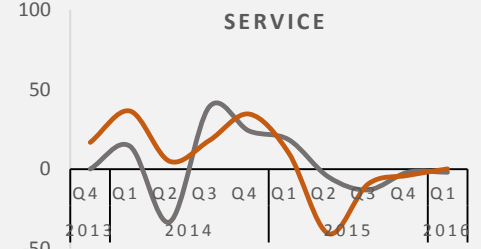
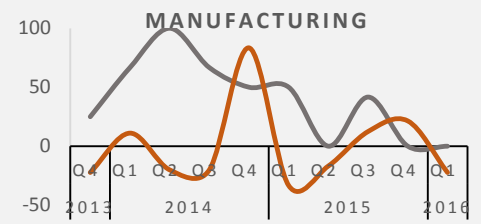
However, the increase in financial intermediaries' performance this winter compensated for the rise of pessimism in the agriculture sector.

### PRODUCTION/TURNOVER/SALES PAST 3 MONTHS

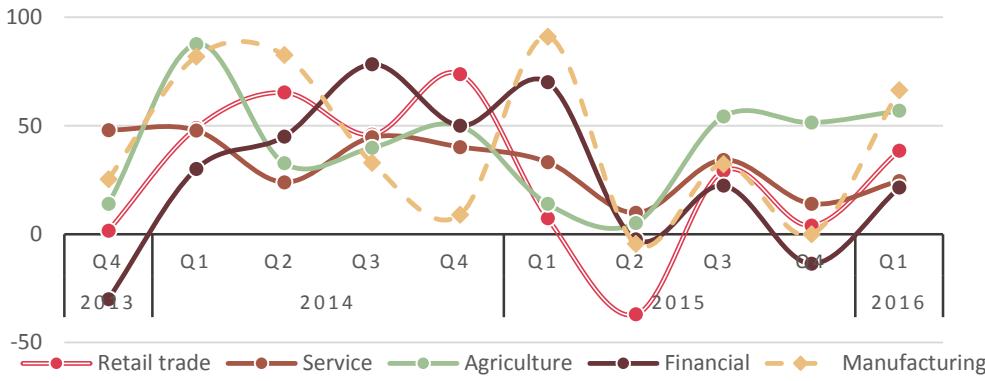


Analyzing the data in terms of business size, it is evident that 2016 got off to a rough start for both large firms and SMEs. The Georgian private sector fared worse in terms of sales (turnover) in the first quarter of 2016 than it did during the same period in 2015.

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

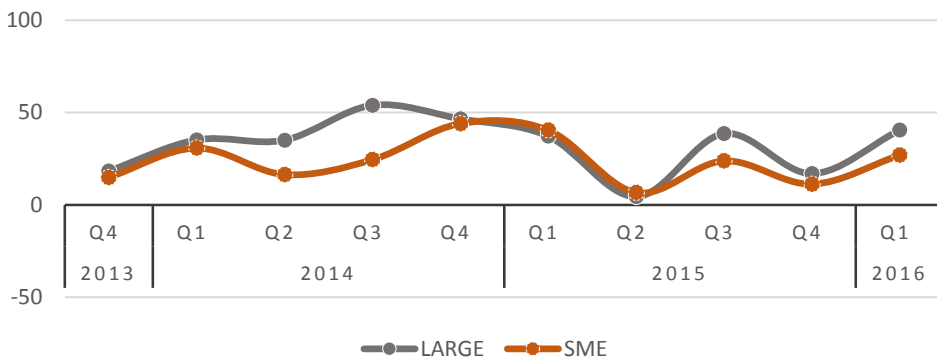


### EXPECTATIONS INDEX BY SECTOR



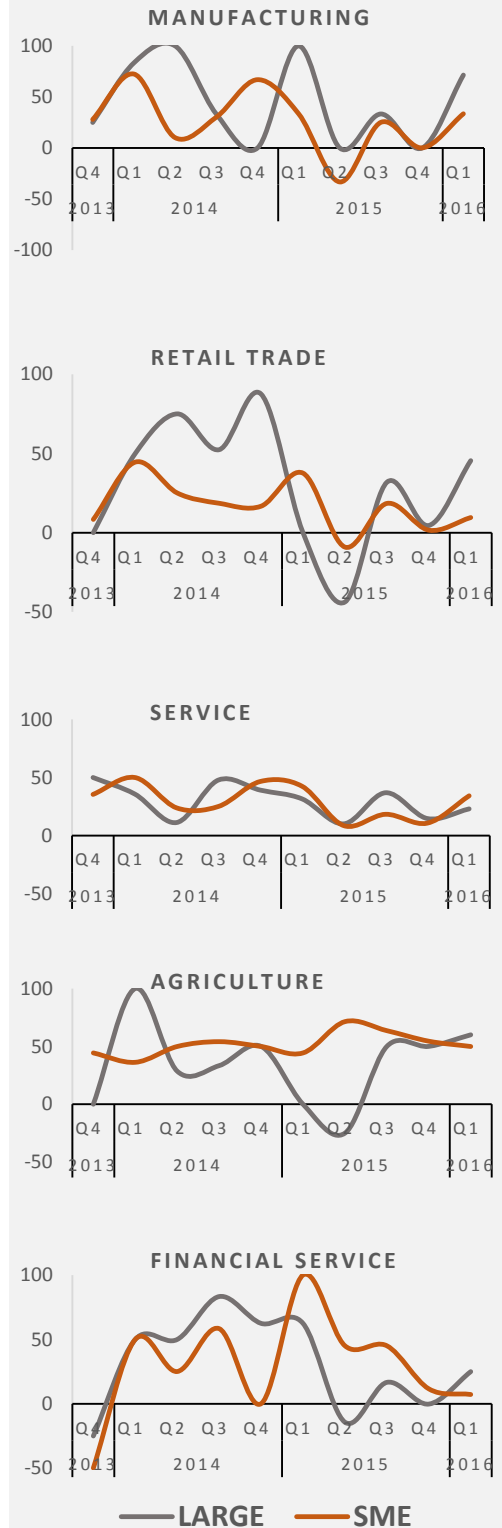
The expectations index doubled in the first quarter of 2016. As mentioned above, as there is no seasonal evidence, or other direct clarifications, to explain this change, the current PM's approach towards investment and business environment reforms offers a good explanation. Expectations about the next three months have increased in all sectors. Large companies, in particular, are confident of future success. This might really become the beginning of the activation of the business sector in Georgia, but it is important to ensure that this optimism is not dispelled by unexpected and unwanted changes.

### EXPECTATIONS: L.VS.SME

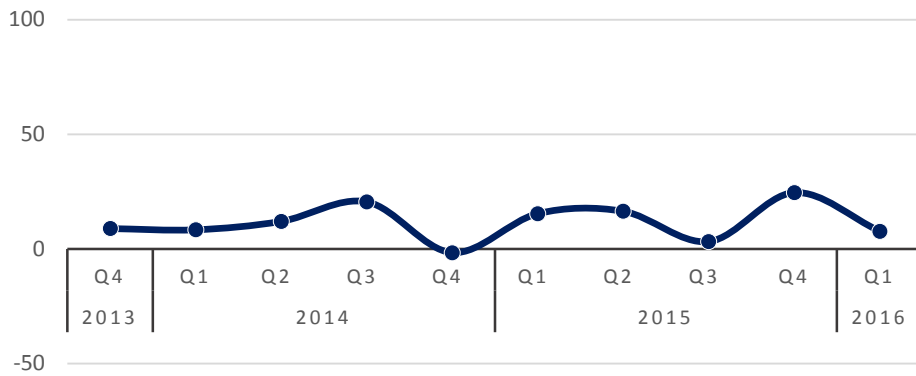


As one can see from the graph above, business expectations for January, February, and March increased for both large companies and SMEs. The increase for large companies was marginally higher. Optimism driven by large companies can be considered somewhat promising, since their expectations are more likely to reflect a production strategy and not dreams alone. It is thus more likely that their positive outlook will turn out to be reality, rather than in the case of SME expectations.

## EXPECTATIONS INDEX by sector for large firms and SMEs

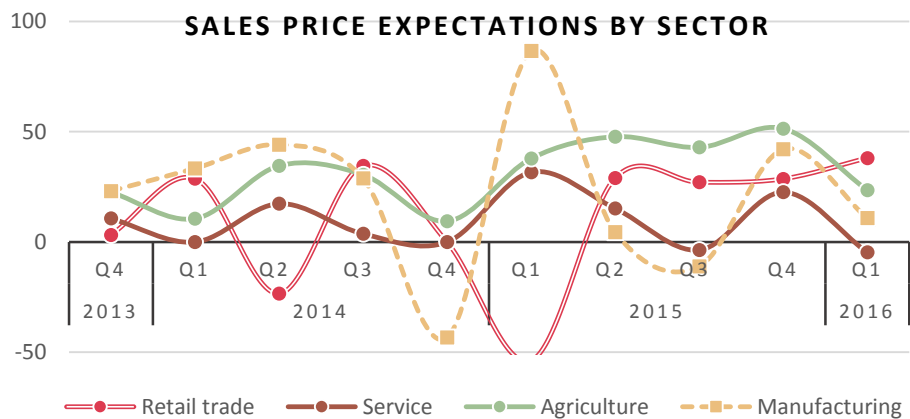


### SALES PRICE EXPECTATIONS



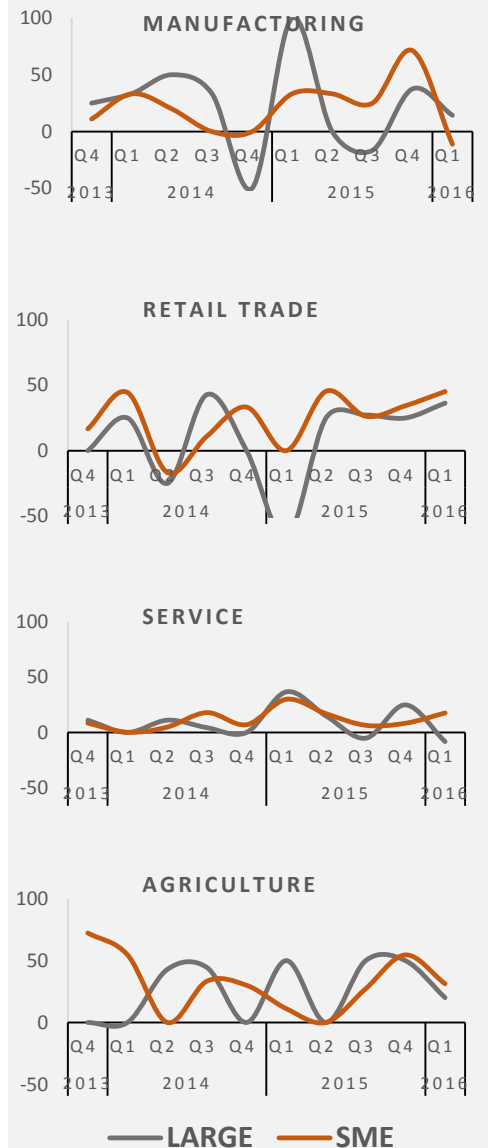
Sales price expectations decreased substantially from 24 index points in Q4 2015 to 7 points in Q1 2016). The previous quarter saw a peak of the expected sales price. Indeed, annual inflation in January 2016 was one of the highest for the last period at 5.6%, and it thus slightly overshoot the NBG’s target of 5%. The NBG forecasts that the inflation rate will remain the same during the first quarter and will decrease thereafter. The main source of inflation will be the supply side – in particular, increased debt service costs due to the already depreciated lari exchange rate and higher prices of imported durable goods. Against this, downward pressure on inflation will come from weak demand and low global prices of food and oil.

### SALES PRICE EXPECTATIONS BY SECTOR



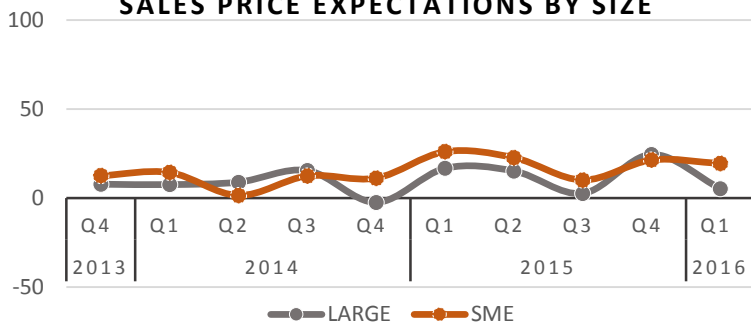
Sales price expectations decreased for all sectors other than the retail sector. The service sector’s sales price expectations became negative, reflecting the low demand on service activities during spring. The New Year period allowed the economy to adjust prices driven by the exchange rate depreciation, and companies are not expecting a further increase in sales prices.

## SALES PRICE EXPECTATIONS INDEX by sector for large firms and SMEs



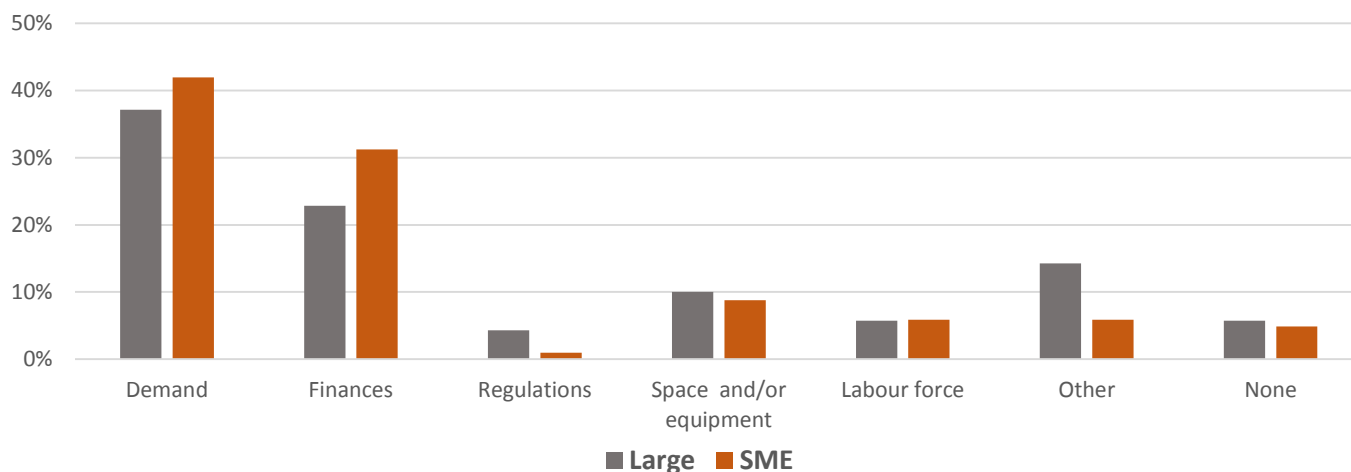
Representatives from the service, manufacturing and agriculture sectors all decided not to increase their prices further.

### SALES PRICE EXPECTATIONS BY SIZE



The overall sales price expectations index softened for SMEs and dropped for large companies. Large companies appear to be planning no increase of prices on their production/services in the near future.

## WHAT ARE THE MAIN FACTORS CURRENTLY LIMITING YOUR BUSINESS? Quarter 1, 2016



Lower consumption is becoming a severe problem for businesses. The most limiting factor for doing business for both large and SMEs in Q1 2016 was *insufficient demand*. A total of 37% of large companies reported low consumer demand as the main obstacle. SMEs found it particularly hard to operate with unstable demand on the market, and this index stood at 41% for SMEs.

SMEs typically have more trouble attracting financial resources than larger companies and this pattern was enhanced during the quarter. Payback abilities and the unstable financial environment worsened SME access to finance. Financial constraints were thus listed as being almost as problematic as insufficient demand for SME business operations. On the other hand, government intervention was not considered to be a significant problem for SMEs.

### SAMPLE SIZE BY SECTOR (see methodology)

Q1 2016	Sector	Firm Size		Total
		Large	SME	
	Construction	6	17	23
	Financial Service	8	7	15
	Manufacturing Industry	7	9	16
	Retail Trade	11	42	53
	Service	24	57	81
	Agriculture	5	16	21
	Other	3	10	13
	<b>Total</b>	<b>64</b>	<b>158</b>	<b>222</b>

Interviews were conducted between 15 January and 25 February 2016.

## 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.

VARIABLE	SCORE
Positive	+1
Neutral	0
Negative	-1

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.

### 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<sup>2</sup> 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.

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<sup>2</sup> 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](http://geostat.ge/cms/site_images/files/georgian/methodology/business/BS%20metodologia.pdf))