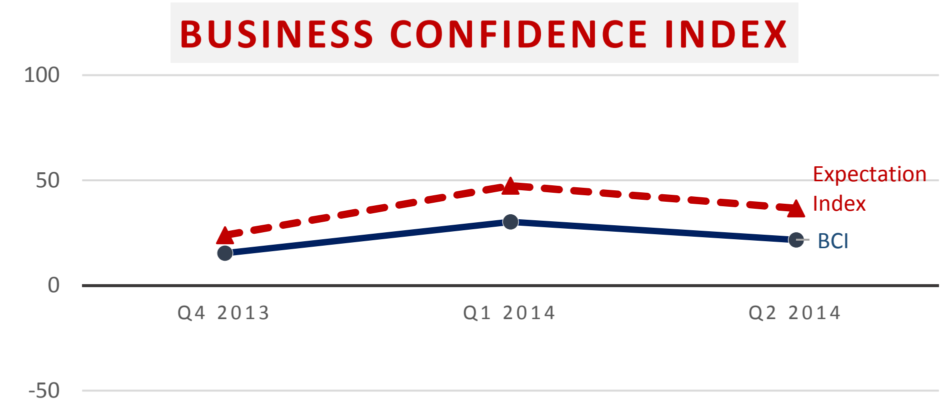
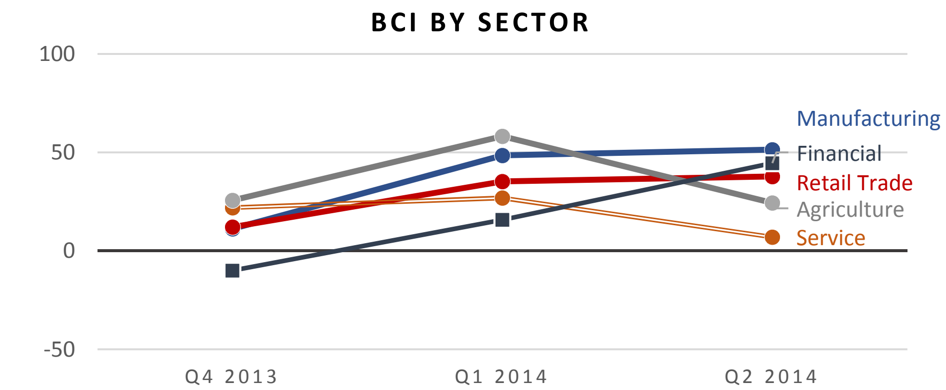
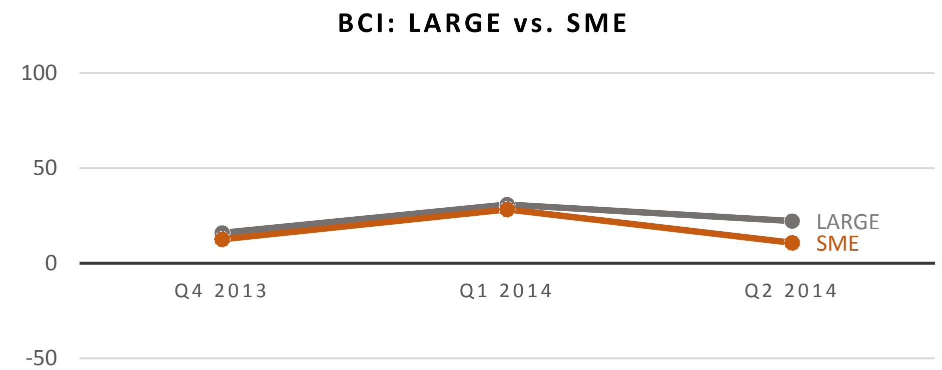


In the second quarter of this year, the ISET Business Confidence Index registered 21.7 on a scale of 100 points (see methodology below). This is down from the 30.2 recorded in the first quarter of the same year. The positive number nevertheless indicates that confidence factor among businesses is about 21.7 more positive, rather 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).

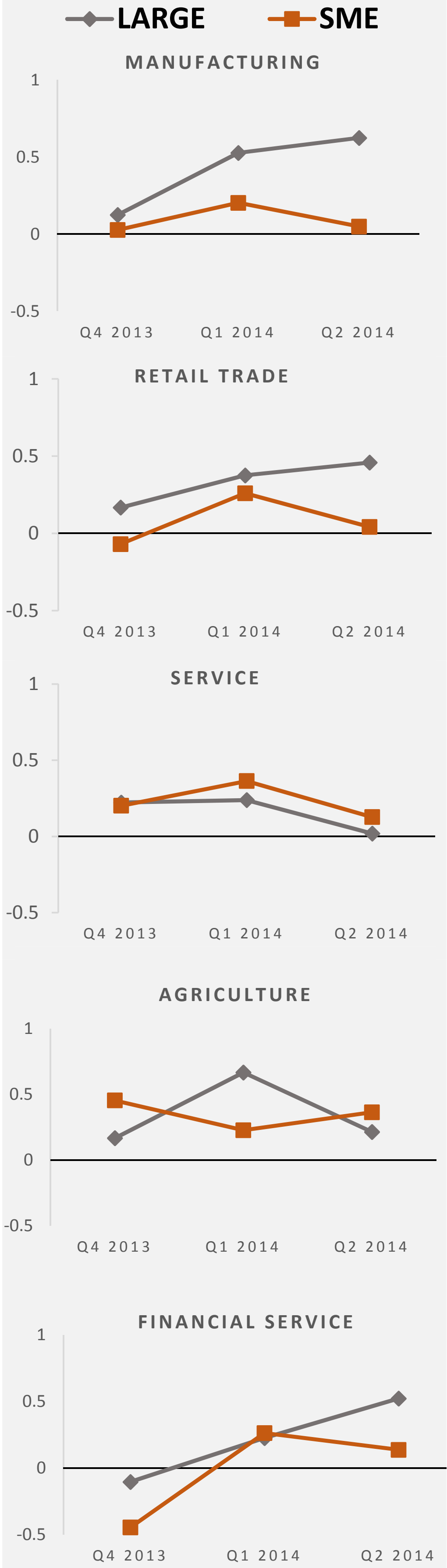


Sectoral breakdown of the BCI shows that marginally positive outlook dominates in all sectors. In particular, the financial sector outlook as improved considerably since the last quarter of 2013.

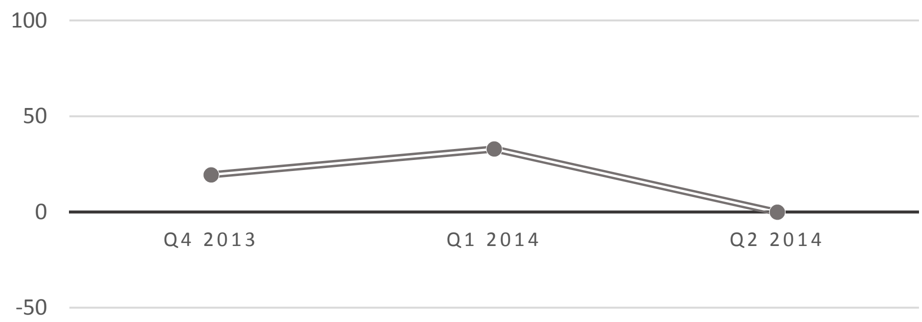


The BCI for large and small firms has started to diverged in Q2 2014. This divergence is primarily driven by the responses of the firms in the two largest sectors - manufacturing and retail trade. The large firms in these sectors are on balance more optimistic, while the small firms are on balance neutral.

Overall business confidence by sector, for large firms and SMEs

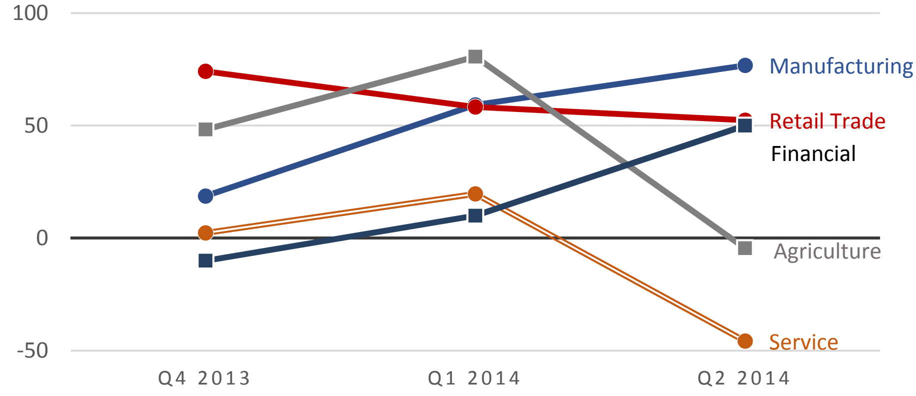


SALES/PRODUCTION/TURNOVER PAST 3 MONTHS



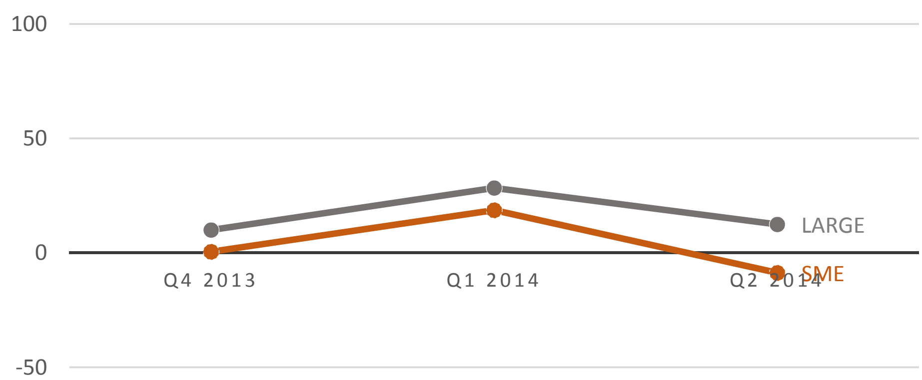
In Q2 2014, the sales (production or turnover) of the surveyed firms has on balance remained unchanged, corroborating the evidence of “business as usual” from other macroeconomic indicators. In the same time, we note that the sales/production index for Q1 2014 (which covers the New Years and Christmas period) is not surprisingly higher.

SALES/PRODUCTION/TURNOVER PAST 3 MONTHS, BY SECTOR



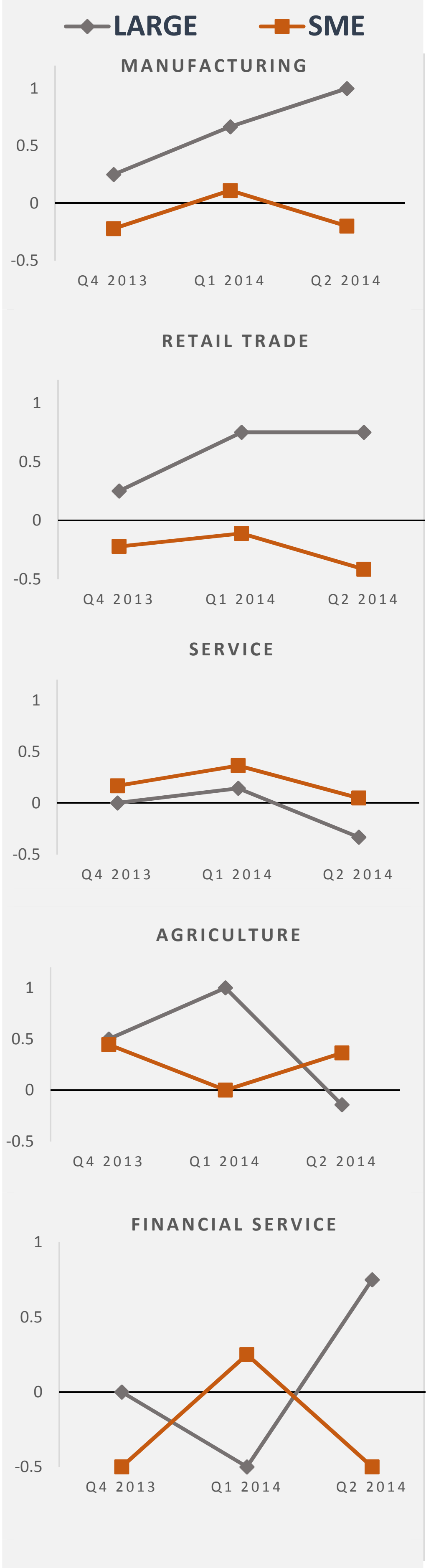
Increases in production were reported by all of the large manufacturing firms in the sample. Small and medium manufacturing firms, however, saw a decrease in production in the three months prior to the time of the survey (May 2014). The decrease in turnover was felt by small/medium retailers as well as large service providers. SMEs in the agricultural sector, on the other hand, reported an increase in turnover (demand) for their products in the past 3 months. This, however, is not the case for large agribusinesses. The divergence may be driven by the government programs targeting smallholder farming support.

SALES/PRODUCTION/TURNOVER PAST 3 MONTHS: LARGE vs. SME

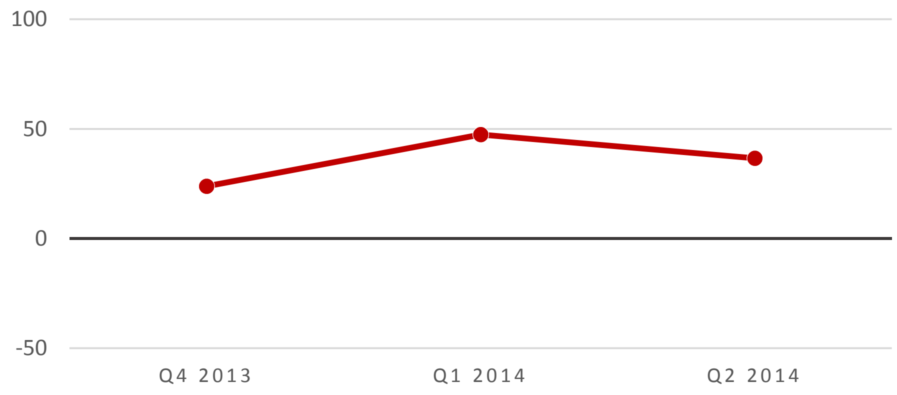


Overall, in the three months preceding May, SMEs in Georgia have fared worse in terms of sales (turnover) than larger firms.

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

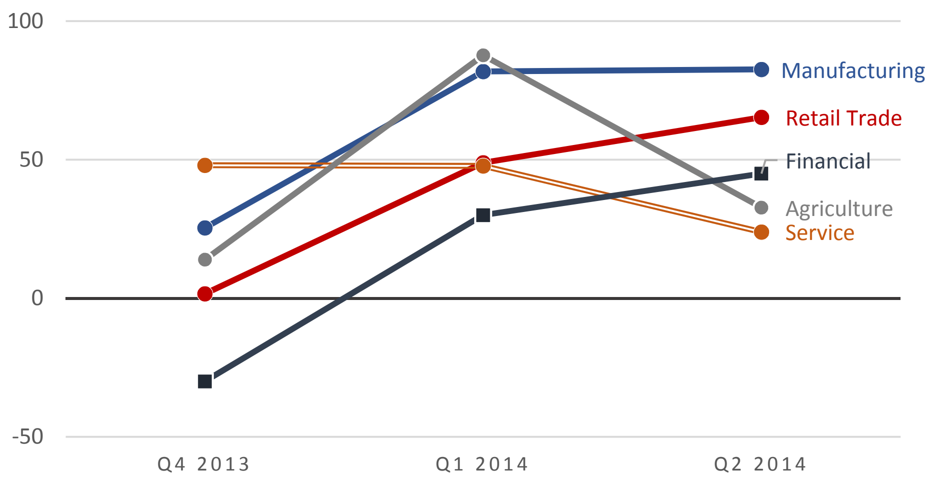


EXPECTATIONS INDEX



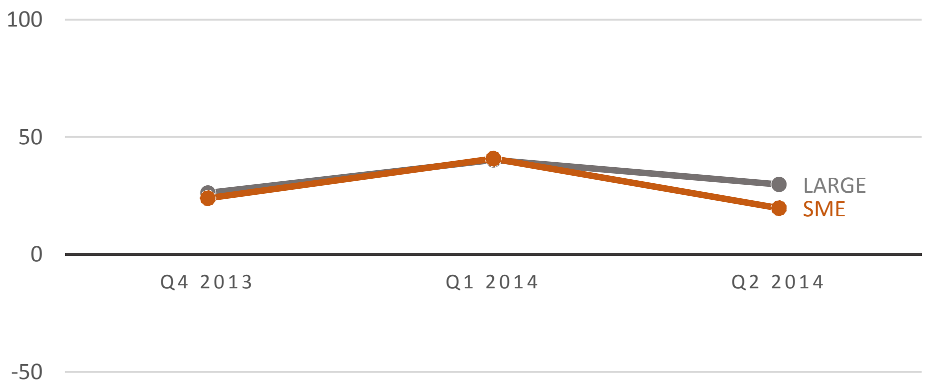
Notably, the economic outlook for the next three months has been positive for all sectors. However, the optimism is a bit dampened relative to the first quarter of the year.

EXPECTATIONS INDEX BY SECTOR



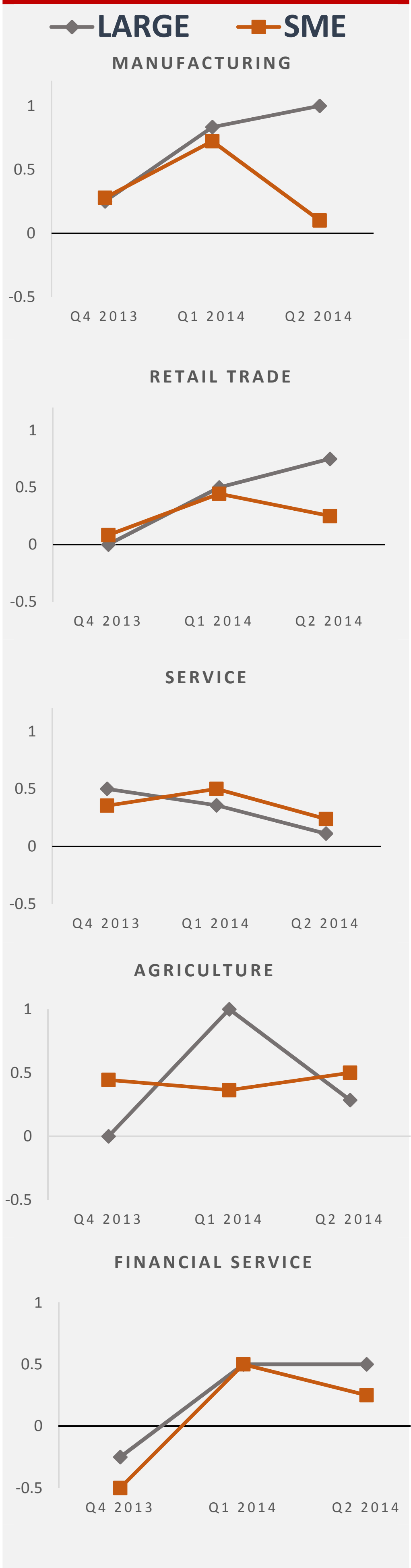
Manufacturing sector is the leader in business expectations, with all large firms reporting expected improvements in the business situation. Retail trade is second, showing relatively strong confidence in future improvements. The expectations in agricultural sector, however, have been dampened significantly relative to the first quarter of 2014. This is primarily driven by large agribusinesses. The small agricultural firms maintain roughly the same levels of confidence.

EXPECTATIONS INDEX: LARGE vs. SME

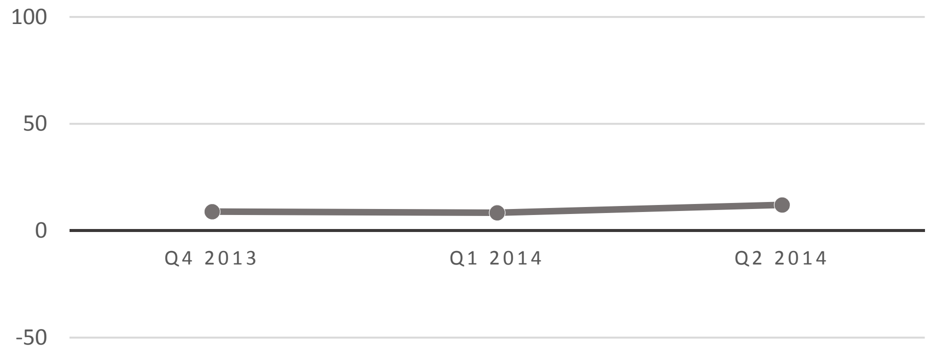


Once again, expectations of the future are slightly more positive for larger firms than for SMEs.

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

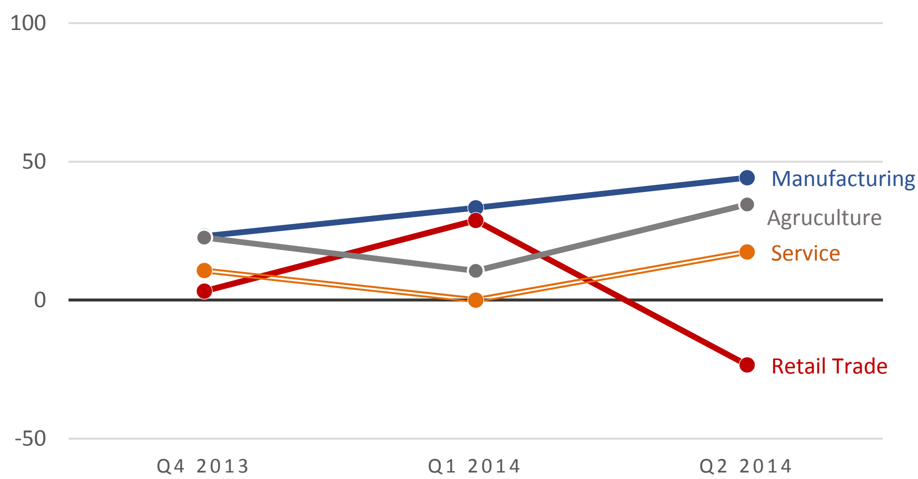


SALES PRICE EXPECTATIONS



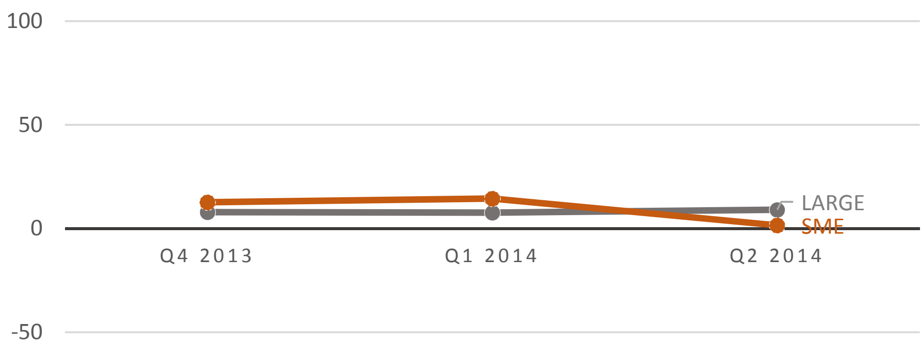
Sales price expectations have remained roughly the same as in the previous quarter, with more firms reporting an expected increase in their sales prices.

SALES PRICE EXPECTATIONS BY SECTOR



The notable outlier is the retail trade sector, where large firms as well as SMEs are reporting the expected decrease in sales prices.

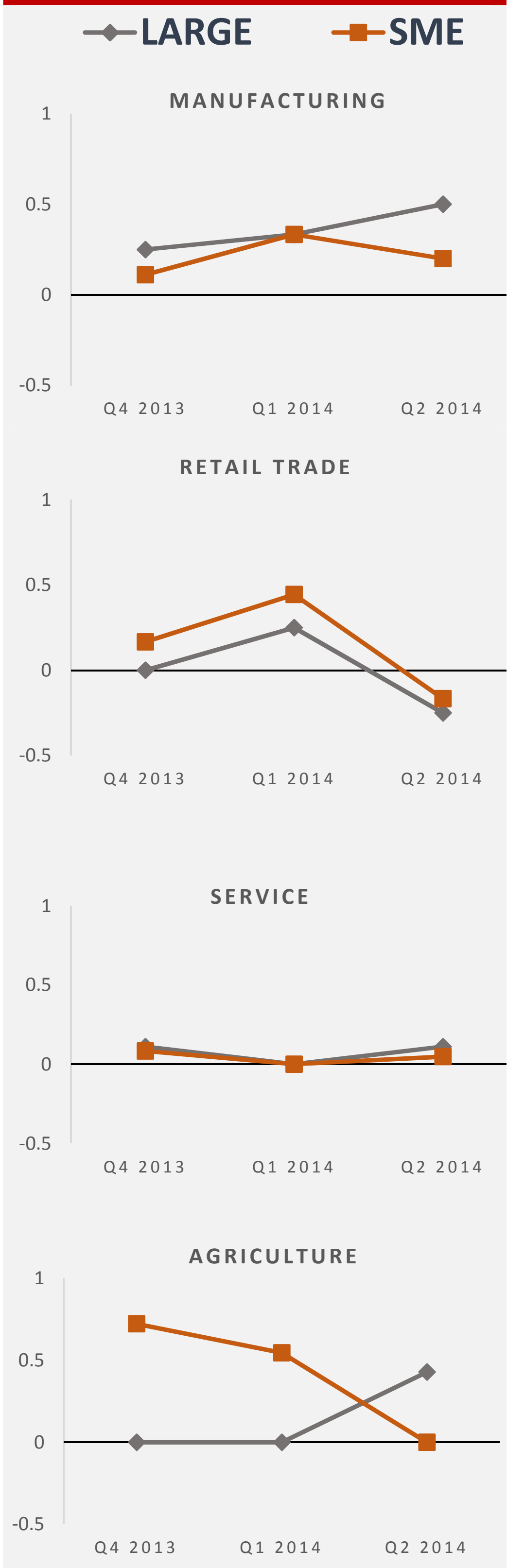
SALES PRICE EXPECTATIONS: LARGE vs. SME



Overall, small and medium size firms in Georgia as expecting little change in their sales prices, while large firms are on balance expecting price increases. The divergence in price expectations may be explained by the fact that smaller firms are mostly selling their goods on the domestic market and directly to final consumers. Their view is therefore heavily influenced by the developments in CPI (consumer price index). At the same time, large firms may be either exporters or suppliers of inputs on the domestics market, whose expectations may be more influenced by the PPI (producer price index) developments.

In support of this hypothesis, we note the monthly CPI has been largely decreasing (annual inflation rate was tempering), while PPI was slightly increasing in the recent months.

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



FACTORS LIMITING BUSINESS PERFORMANCE, NUMBER OF FIRMS

	Q4 2013	Q1 2014	Q2 2014
none	14	5	13
insufficient demand	28	16	34
shortage of labour force	9	6	4
shortage of material and/or equipment	3	4	6
financial constraints	27	11	12
other factors	12	7	15
Sample size	**91**	**65**	**80**

SAMPLE SIZE BY SECTOR (see methodology)

		Firm Size		
	Sector	**Large**	**SME**	**Total**
Q4 2013	Construction	1	2	3
	Financial Service	2	4	6
	Manufacturing Industry	4	9	13
	Retail Trade	1	12	13
	Service	9	24	33
	Agriculture	2	18	20
	Other	2	1	3
	Total	**21**	**70**	**91**
Q1 2014	Construction	0	0	0
	Financial Service	4	2	6
	Manufacturing Industry	3	9	12
	Retail Trade	4	9	13
	Service	7	11	18
	Agriculture	2	11	13
	Other	2	1	3
	Total	**22**	**43**	**65**
Q2 2014	Construction	0	0	0
	Financial Service	4	2	6
	Manufacturing Industry	2	5	7
	Retail Trade	4	12	16
	Service	9	21	30
	Agriculture	7	11	18
	Other	3	0	3
	Total	**29**	**51**	**80**

*Methodology

ISET Policy Institute, working in partnership with International Chamber of Commerce in Georgia (ICC), started to implement the Business Confidence Survey from December 2013 and will publish the Business Confidence Index (BCI) on quarterly bases.

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

- **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;
- **Expectations index** calculated based on the two questions: production/sales/turnover for the next three months and employment plans for the next three months;
- **Large**[1] firm is If yearly average of employed people is more than 100 or yearly average turnover exceeds 1.5 million GEL;
- **Small** firms is if average of employed people is less than 20 and at the same time, the yearly average turnover is less than 0.5 million GEL);
- **Medium** is if it is 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)