

BAG INDEX

BUSINESS
CLIMATE



საქართველოს ბიზნეს ასოციაცია
BUSINESS ASSOCIATION OF GEORGIA

ifo INSTITUTE

Leibniz Institute for Economic Research
at the University of Munich



Research

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CONTENTS

BAG Index	1
BAG Business Climate	1
BAG Business Climate by sector	3
Employment, sales and sales prices by sector.....	5
Factors hindering business activity	9
Financing	11
Exchange rate expectations	12

BAG INDEX

Prepared by PMC Research Center and ifo Institute.

The Business Association of Georgia (BAG) Index is a joint product of the Business Association of Georgia, PMC Research Center and the ifo Institute for Economic Research. The BAG Index summarizes the BAG Business Climate, BAG Employment Barometer and BAG Investment Environment, which are calculated according to the assessments of the top managers of BAG member businesses and companies in their corporate group.¹ PMC Research Center publishes the BAG Index on a quarterly basis.

BAG BUSINESS CLIMATE

The BAG Business Climate is based on the responses of BAG member businesses and companies in their corporate group. Companies assess their present business situation and outline their expectations for the next six months.² Apart from this, businesses are also asked to assess their situation regarding sales, sales prices, and the number of employees for the last quarter, current quarter and the next quarter. Moreover, companies are asked questions related to factors hindering their business activity, access to finance, exchange rate expectations and investment environment. For the purposes of this index, BAG members are divided into the following four sectors: trade, service, manufacturing and construction. The survey was conducted in Q3 of 2021 in period 2-16 of August.

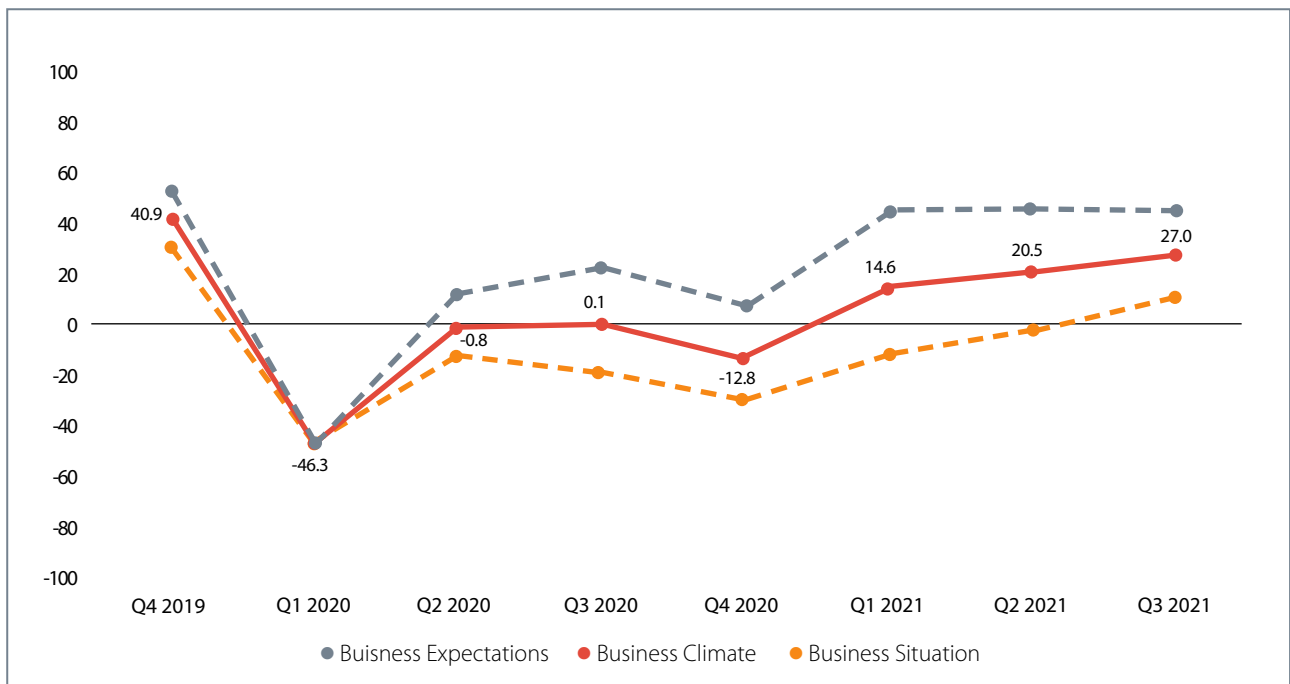
IN Q3 OF 2021, THE SURVEYED BUSINESSES ASSESS THEIR PRESENT BUSINESS SITUATION AND EXPECTATIONS FOR THE NEXT SIX MONTHS POSITIVELY. THE BAG BUSINESS CLIMATE INDICATOR AMOUNTS TO 27 POINTS IN Q3 OF 2021, WITH THE PRESENT BUSINESS SITUATION INDICATOR SITTING AT 10.8 AND THE BUSINESS EXPECTATIONS INDICATOR AT 44.5.

In Q3 of 2021, compared to Q2 of 2021, the BAG Business Climate improved by 6.5 points. Moreover, in this period, the assessment of the present business situation improved by 13 points, while business expectations for the next six months worsened by 1.3 points.

The figures for Q3 of 2021 demonstrate a significant improvement compared to Q3 of 2020. In Q3 of 2020, the BAG Business Climate indicator amounted to 0.1, the present business situation indicator amounted to -19, while business expectations indicator was 21.8 (see Graph 1).

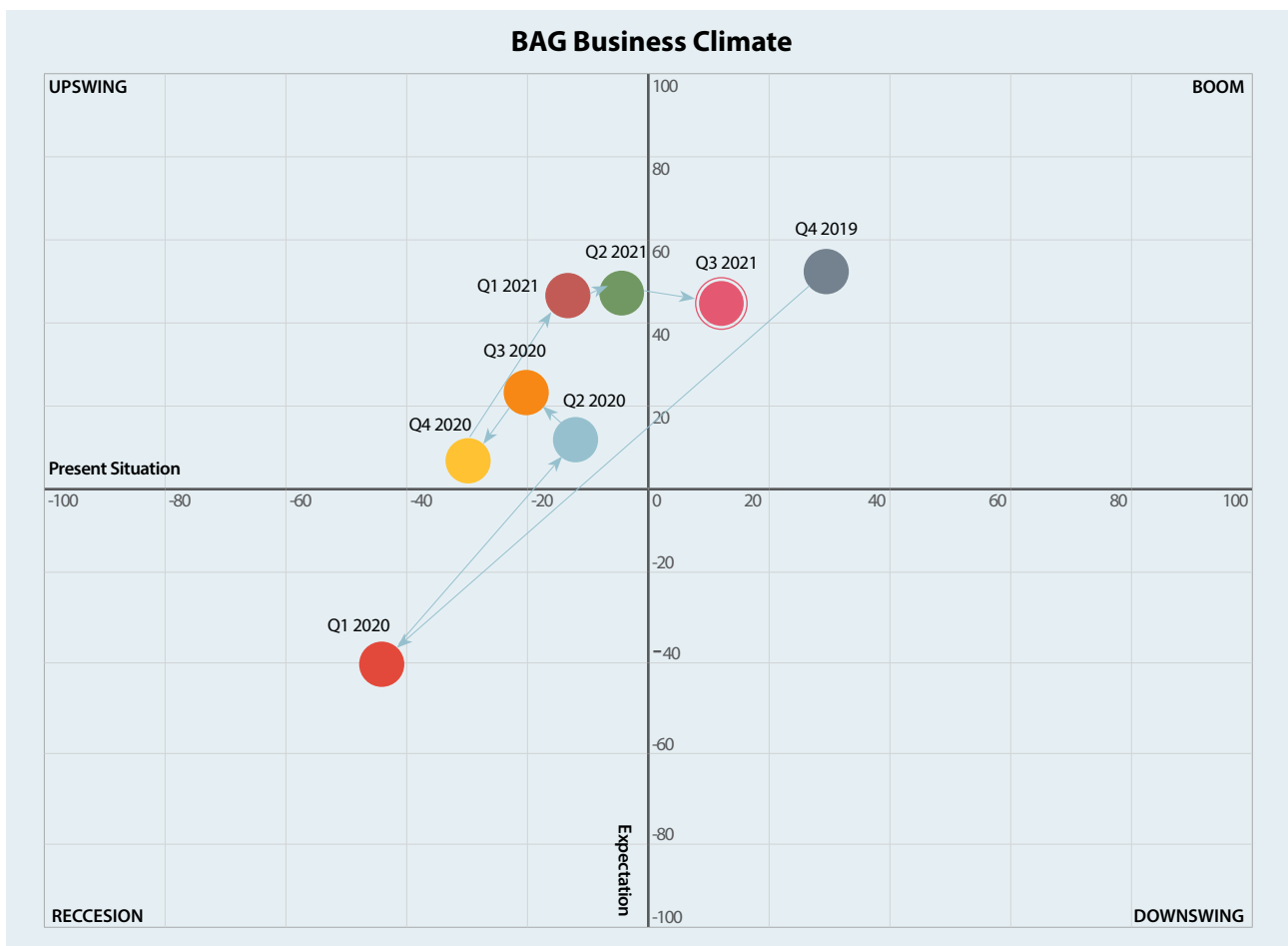
¹ In the first quarter of 2021, a change was made in the methodology of the BAG Index. As a result, the number of companies surveyed increased: enterprises that belong to the corporate group of member companies were added to the existing survey respondents.

² The balance value for the present business situation is the difference in the percentage shares of the "good" and "bad" responses, and the balance value for the expectations for the next six months is the difference in the percentage shares of the "more favorable" and "less favorable" responses. The BAG Business Climate is a transformed mean of the balance values of the present business situation and the expectations for the next six months. The BAG Business Climate can be between -100 and +100. +100 means that all surveyed businesses assess the business climate positively, while -100 means all surveyed businesses assess the business climate negatively.



Graph 1: BAG Business Climate, Business Expectation, and Present Business Situation

In Q3 of 2021, for the first time since Q4 of 2019, the BAG Business Climate Indicator is in the **boom** phase.



Graph 2: BAG Business Climate

The Graph 2 depicts the relationship between the present business situation and business expectations for the next six months in a four-quadrant diagram. The quadrants are labeled “upswing,” “boom,” “downswing,” and “recession” and each of these are explained below:

- ✖ If survey participants assess the present business situation negatively but have positive business expectations for the next six months on balance, then the BAG business climate indicator falls in the “**upswing**” quadrant.
- ✖ If survey participants assess both the present business situation and business expectations for the next six months positively on balance, then the business climate indicator resides in the “**boom**” quadrant.
- ✖ If survey participants assess the present business situation positively but have negative business expectations for the next six months on balance, then the BAG business climate indicator is in the “**downswing**” quadrant.
- ✖ If survey participants assess the present business situation negatively and also have negative business expectations for the next six months on balance, then the BAG business climate indicator is placed in the “**recession**” quadrant.

BAG BUSINESS CLIMATE BY SECTOR

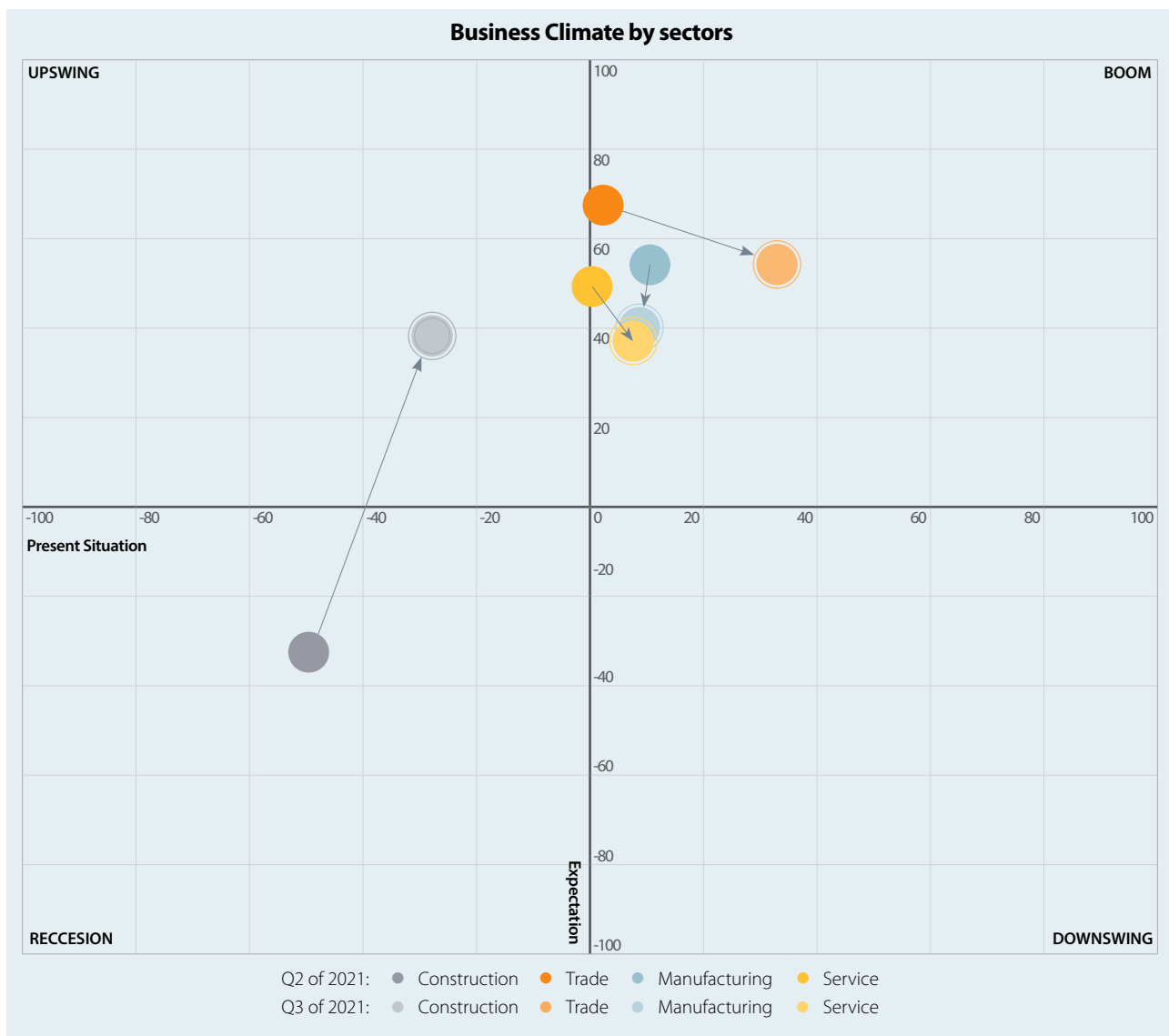
In Q3 of 2021, the **business climate indicator** was positive for all sectors. Compared to Q2 of 2021, this indicator improved in the construction and manufacturing sectors, but worsened in the service and trade sectors (see Graph 4). It is worth noting here that Q3 of 2021 is the first quarter of the year in which the business climate indicator in the construction sector has been positive.

In Q3 of 2021, compared to Q2 of 2021, the **present business situation indicator** improved in all sectors, except manufacturing. Nevertheless, despite the overall view of the present business situation in manufacturing worsening compared to the previous quarter, the surveyed businesses still assessed the present situation positively. Regarding the construction sector, despite the fact that the business situation indicator improved in Q3 of 2021, compared to Q2 of 2021, the assessment remains negative. The most positive assessment with respect to the present business situation was recorded in the trade sector, which could be attributed to an increase in sales in Q3 of 2021 (43.2% of surveyed companies stated an increase in sales).

In Q3 of 2021, the **business expectations indicator** was positive for all sectors. However, expectations worsened for the majority of sectors compared to Q2 of 2021. This could be attributed to rising COVID-19 rates, which constrained the mobility of the labor force and led to further COVID-19 mitigation measures being imposed in the country.

Table 1: Balance values by sector in Q3 of 2021

	Business Climate	Present Business Situation	Business Expectation
Trade Sector	43	32.4	54.1
Service Sector	23.2	6.8	40.9
Manufacturing Sector	24.3	7.1	42.9
Construction Sector	2.1	-27.3	36.4
All Sectors	27	10.8	44.5



Graph 3: Business Climate by sectors in Q2 and Q3 of 2021

During 2021, the business climate indicator has been positive in the trade, service, and manufacturing sectors. In Q1 of 2021, the most positive assessment of the business climate was recorded in the service sector, while in Q2 and Q3 it has been the trade sector (see Graph 4).

The business climate indicator has been improving for the trade sector since Q1 of 2021 and reached its peak in Q3 of 2021. This could be attributed to the positive outlook in the sector and the positive assessment of the present situation recorded in both Q2 and Q3 of 2021.

In 2021, the positive assessment of the business climate in the service sector has mainly stemmed from positive expectations about the near future. In the manufacturing sector in particular, such assessment has been attributed to both optimistic expectations as well as positive assessment of the present situation.

In the construction sector, the business climate indicator was negative in Q1 and Q2 of 2021. However, the indicator significantly improved in Q3 of 2021 and turned positive. The negative assessment of the business climate by respondents from construction sector in Q1 and Q2 of 2021 was due to a negative assessment of the present situation. In Q3 of 2021, the assessment of the present business situation in the construction sector improved (see Graph 4).



Graph 4: BAG Business Climate, Business Expectation, and Present Business Situation in trade, service, manufacturing and construction sectors

EMPLOYMENT, SALES AND SALES PRICES BY SECTOR

Employment

Assessment of Q2 of 2021

- ✖ 25.5% of surveyed companies stated the number of employees increased in Q2 of 2021, compared to Q1 of 2021. For the majority of respondents (66%) the number of employees was unchanged, while 8.5% stated a decrease.
- ✖ Across all sectors covered, the construction and the service sectors were the ones with the largest share of the surveyed companies (27.3%) claiming that the number of employees had increased in Q2 of 2021, compared Q1 of 2021 (see graph 5).

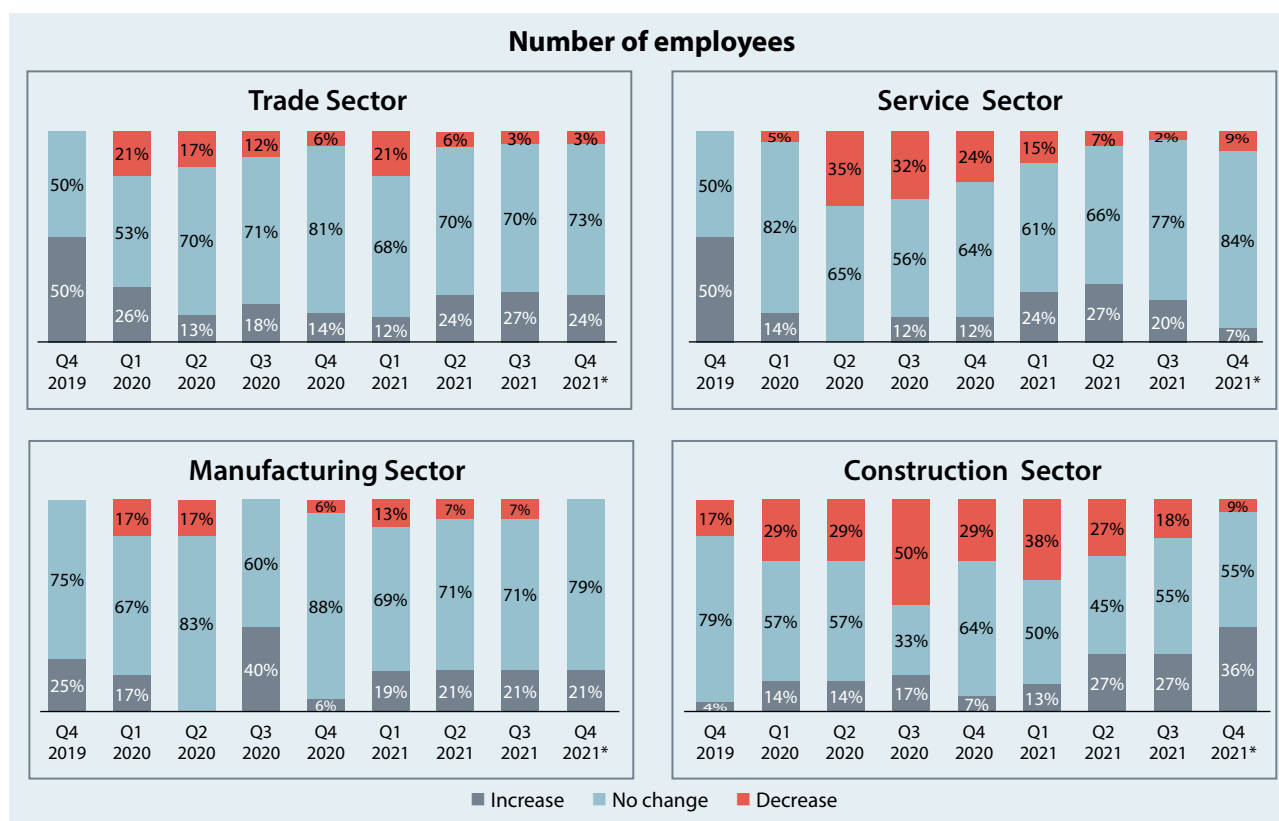
Situation in Q3 of 2021

- ✖ 23.6% of the surveyed companies stated that in Q3 of 2021, compared to Q2 of 2021, the number of employees increased, while 4.7% recorded a decrease. The majority of companies (71.7%) stated that the number of employees had not changed.
- ✖ A significant share of respondents in the construction (27.3%) and trade (27%) sectors stated that the number of employees had increased in Q3 2021, compared to Q2 2021.

Expectations for Q4 of 2021

- ✖ 18.1% of the surveyed companies expect that in Q4 2021, compared to Q3 2021, the number of employees will increase, while 5.7% expect a decline. The majority of companies (76.2%) does not expect change in the number of their employees in this period.
- ✖ The most optimistic outlook regarding employment was found in the construction sector. In Q4 2021, compared to Q3 2021, 36.4% of the respondents in the construction sector stated that they expect an increase in the number of employees. This could be explained by the optimistic outlook regarding sales in this sector.

- ✖ The largest share of respondents in the service sector expect that the number of employees will not change in Q4 of 2021, compared to Q3 of 2021. Despite the fact that the majority of companies in this sector predicts increase of sales in Q4 of 2021, only 7% expect the number of employees to increase. This could be attributed to the intensive growth of the number of employees in the previous quarters in the service sector.



Graph 5: The number of employees in trade, service, manufacturing and construction sectors³

To sum up, it could be argued that the manufacturing and construction sectors have been experiencing positive dynamics regarding employment since Q1 of 2021. It is expected that in Q4 of 2021 the positive trend will continue in both sectors.

In the trade sector, a stronger rise in employment has been noticed since Q2 of 2021, and 24% of surveyed companies in this sector have a positive outlook for Q4 of 2021. In the service sector, a rising trend in employment was noticed in Q1 and Q2 of 2021, but in Q3 the share of surveyed companies that increased their number of employees decreased and this trend is expected to continue in Q4 of 2021.

Sales/demand/domestic production

Assessment of Q2 of 2021

- ✖ The majority of companies surveyed in the service and trade sectors claimed that their sales increased in Q2 of 2021, compared to Q1 2021.
- ✖ In Q2 of 2020 the situation regarding sales was assessed the most negatively in the construction sector, where 36.4% of surveyed companies stated that their contracts/presales decreased, compared to the previous quarter (see Graph 6).

³ Due to the rounding of number, in some graphs the sum of the data does not always equal 100%.

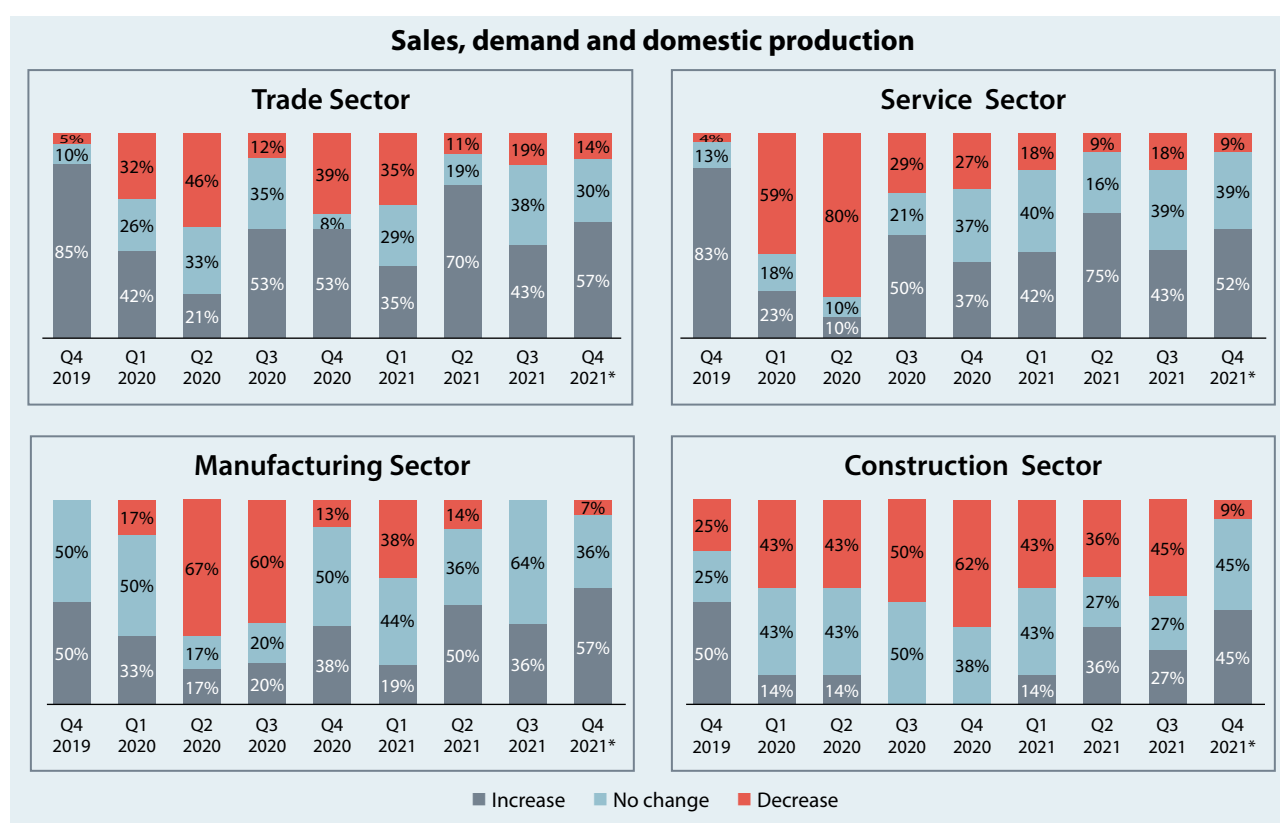
* Expectation.

Situation in Q3 of 2021

- Similar to Q2 of 2021, in Q3 of 2021 the situation regarding sales was assessed most positively by representatives of the service and trade sectors. In both sectors 43.2% of surveyed companies recorded growth in sales in this period.
- In Q3 of 2021, the worst situation regarding sales was recorded in the construction sector. According to 45.5% of surveyed companies in the construction sector their sales decreased.

Expectations for Q4 2021

- For Q4 of 2021, compared to Q3 of 2021, the outlook regarding sales in all sectors is positive as large share of companies expect sales to increase. More than 50% of companies in trade, service and manufacturing sectors expect sales to increase, while in the construction sector the figure amounts to 45%.
- The highest share of companies expecting sales price to decrease for Q4 of 2021, compared to Q3 2021, is in the trade sector (13.5%).



Graph 6: Sales, demand and domestic production in trade, service, manufacturing, and construction sectors

In summary, during the Q1 2020 - Q3 2021 period, across the covered sectors, the trade and service sectors recorded the most positive trends regarding sales, with the majority of companies increasing their sales volume every quarter. Meanwhile, the worst situation regarding sales has consistently been recorded in the construction sector since Q1 of 2020, where for the significant share of surveyed companies the volume of sales has been decreasing every quarter. The manufacturing sector has been characterized by stability since Q4 of 2020 with the majority of companies stating no change in sales. It is worth noting that in Q4 of 2021 the significant share of companies in all four sectors expect their sales to increase.

Sales prices

Assessment of Q2 of 2021

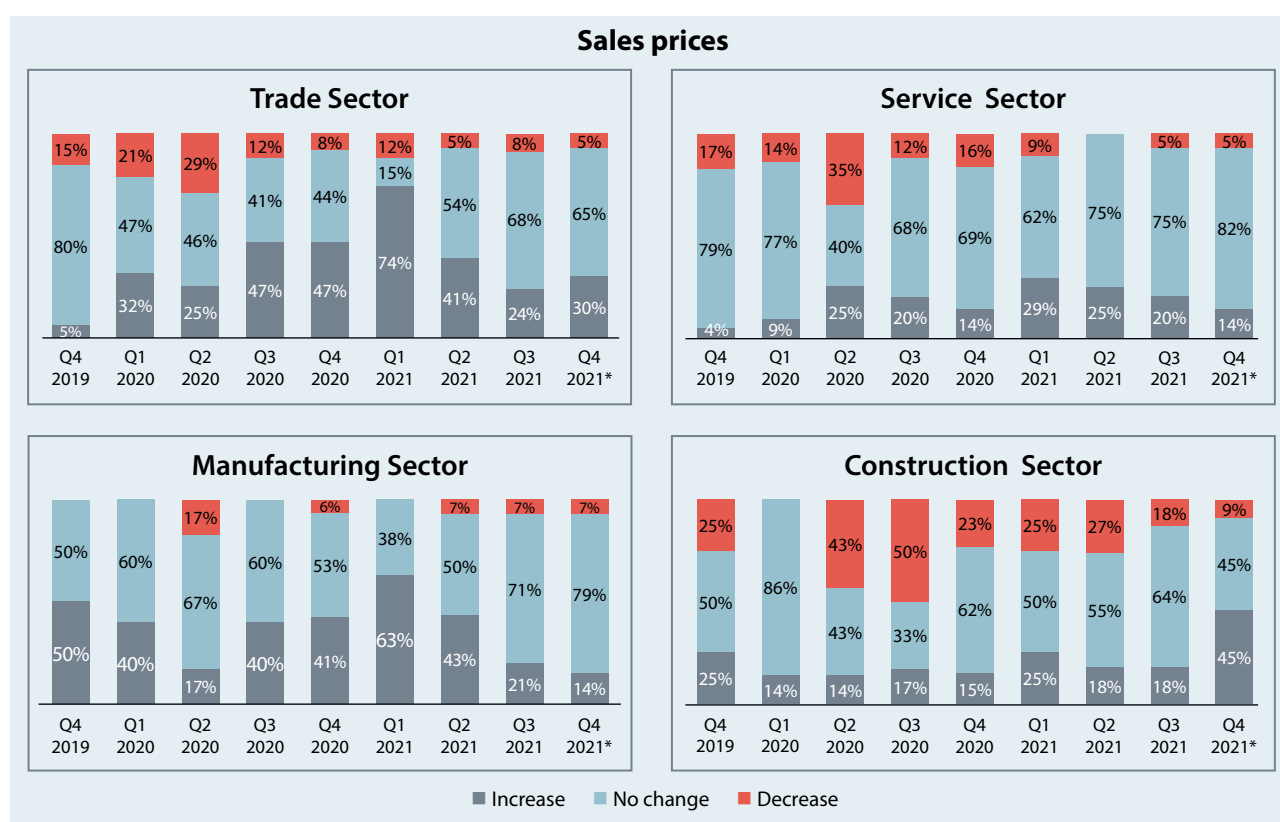
- ✖ Overall, a large share of surveyed companies (62.3%) stated that in Q2 of 2021, compared to the previous quarter, sales prices had not changed, while 32 % stated that prices had gone up. According to 5.7% of respondents, sales prices had decreased in this period.
- ✖ Across the covered sectors, the majority of surveyed companies in the trade and manufacturing sectors recorded an increase in sales prices in Q2 of 2021, compared to Q1 of 2021 (see Graph 7).

Situation in Q3 of 2021

- ✖ In total, 21.7% of the surveyed companies stated that in Q3 of 2021, compared to Q2 of 2021, sales prices had increased, while 70.8% stated that sales prices remained unchanged, and 7.5% claimed that sales prices had decreased.
- ✖ The most positive outlook regarding sales prices is recorded in manufacturing and trade sectors with 21.4% and 24.3% of surveyed companies stating that sales prices had increased in Q3 of 2021, compared to Q2 of 2021.
- ✖ Across the covered sectors, the construction sector had the largest share of respondents to report a decrease in sales prices in Q3 of 2021, compared to Q2 of 2021.

Expectations for Q3 of 2021

- ✖ Overall, 22.6% of surveyed companies expect sales prices to increase in Q4 of 2021, compared to Q3 of 2021, while 71.7% do not expect this figure to change, and 5.7% expect a decrease.
- ✖ Across the covered sectors, the construction sector had the largest share of respondents (45.5%) expecting an increase in sales prices in Q4 of 2021, compared to Q3 of 2021.

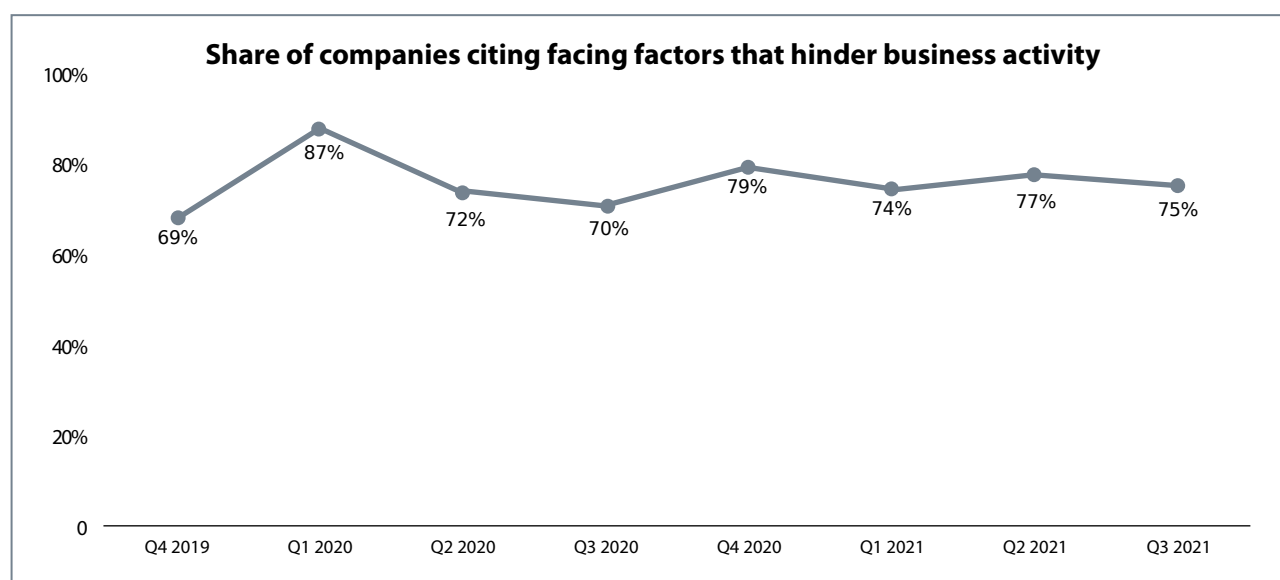


Graph 7: Sales prices in trade, service, manufacturing, and construction sectors

To sum up, in the Q1 2020 – Q3 2021 period, among all of the covered sectors, prices did not change in the majority of the surveyed companies. However, since Q1 of 2021 a significant proportion of companies from all sectors have recorded an increase in their sales prices. Among the covered sectors, the most increasing tendencies in sales prices have been seen in the manufacturing and trade sectors regarding sales prices.

FACTORS HINDERING BUSINESS ACTIVITY

In Q3 of 2021, compared to Q2 of 2021, the share of surveyed companies to claim there are factors hindering their business activity decreased by 2 percentage points and reached 75%.



Graph 8: Existence of factors hindering business activity

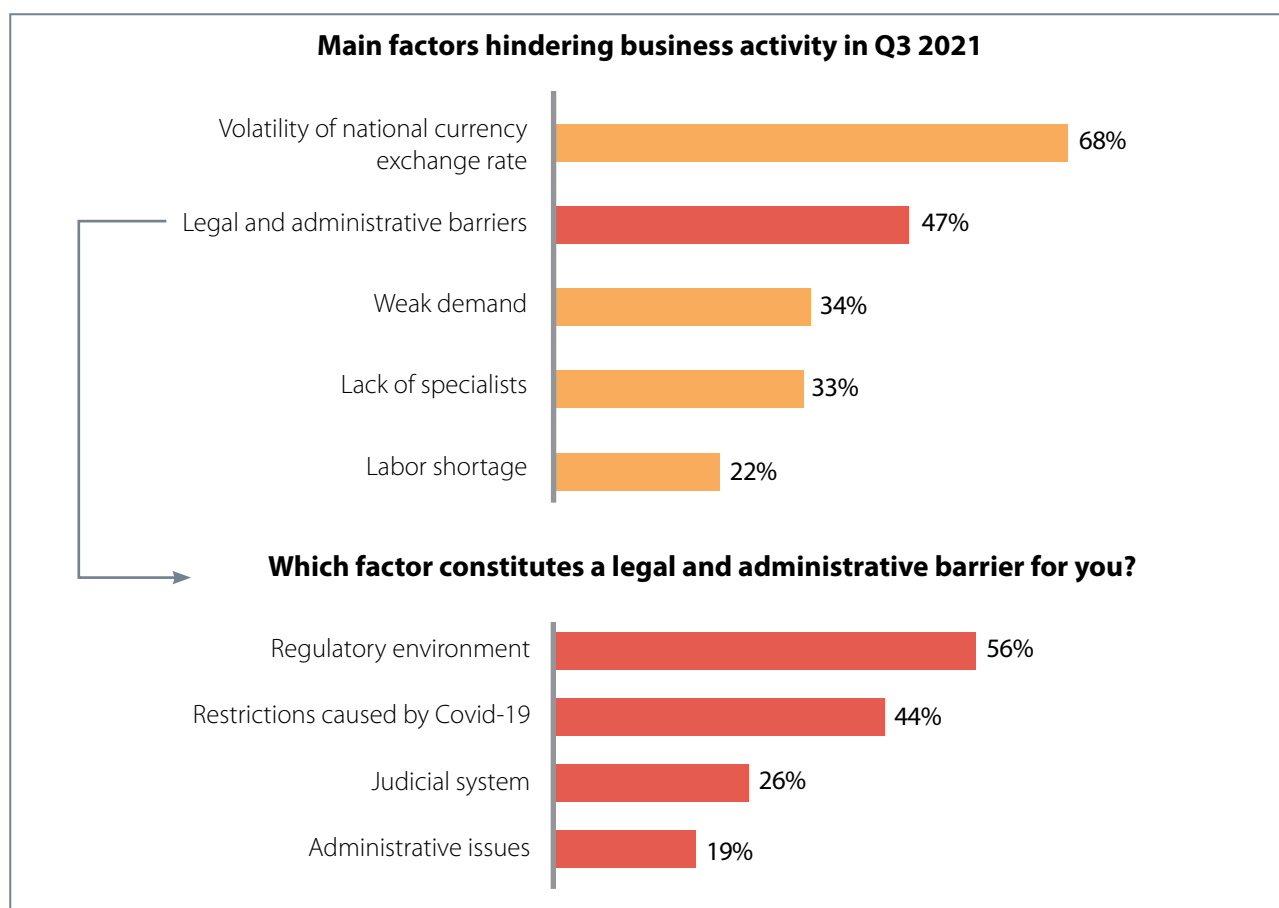
In Q3 of 2021, five factors were emphasized as the most hindering for business activity: volatility of national currency exchange rate⁴, legal and administrative barriers, weak demand for products and services, a lack of specialists and labor shortage (See Graph 9). It is noteworthy that in Q3 of 2021, financial constraints were no longer cited among the five most important hindering factors, while in the previous quarters this factor was always among the most important impediments mentioned by surveyed companies.

In Q3 of 2021, similar to the previous quarter, the volatility of the national currency exchange rate was cited as the top factor hindering business (68% of surveyed companies cited this factor as the most hindering). It was cited by 78% of companies in the manufacturing sector, 74% of in the trade sector, 67% in the construction sector and 62% in the service sector.

In Q3 2021, compared to Q2 2021, among the factors hindering business activity, the share of companies citing volatility of national currency exchange rate and legal and administrative barriers as hindering factors decreased the most, each by 8 percentage points. While the share of companies citing labor shortage as a hindering factor increased the most (8 percentage points).

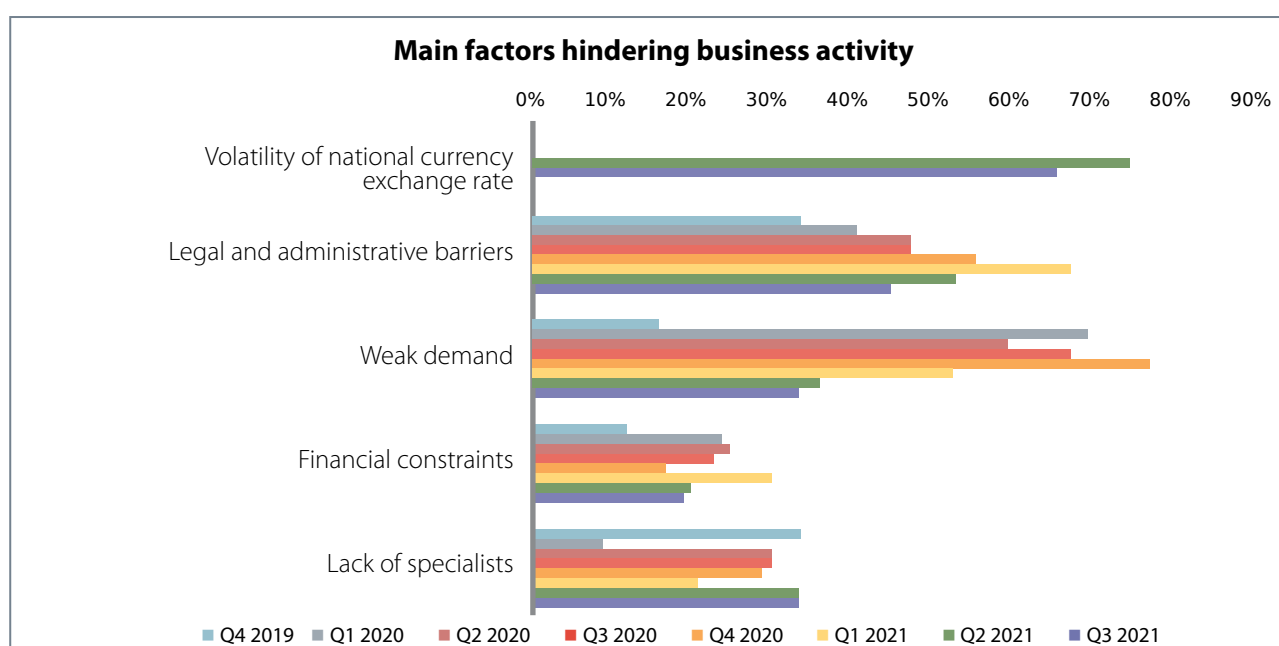
It should be noted that until Q3 of 2021, the issue of a labor shortage was not cited among the five most hindering factors. Since Q2 of 2021 however, the share of companies citing a labor shortage as a hindering factor has been increasing though. Moreover, it should be noted that the share of companies citing weak demand as a hindering factor has been decreasing in recent periods: in Q4 of 2020, 78% of companies cited this as a hindering factor, while in Q3 of 2021 this had reduced to 34%.

⁴ Volatility of national currency exchange rate as a factor hindering business was added to the survey questionnaire in Q2 of 2021.



Graph 9: The main challenges that BAG businesses face in Q3 2021

In Q3 of 2021, the regulatory environment is the main reason why legal and administrative barriers are named amongst the factors hindering business activity. This impediment was followed by the restrictions imposed to mitigate the impact of COVID-19. It is noteworthy here that compared to the previous quarter, in Q3 of 2021, the share of companies to cite COVID-19-related restrictions as a hindering factor decreased significantly (by 35 percentage points), while the share of companies citing the regulatory environment as a hindering factor increased the most (by 14 percentage points).

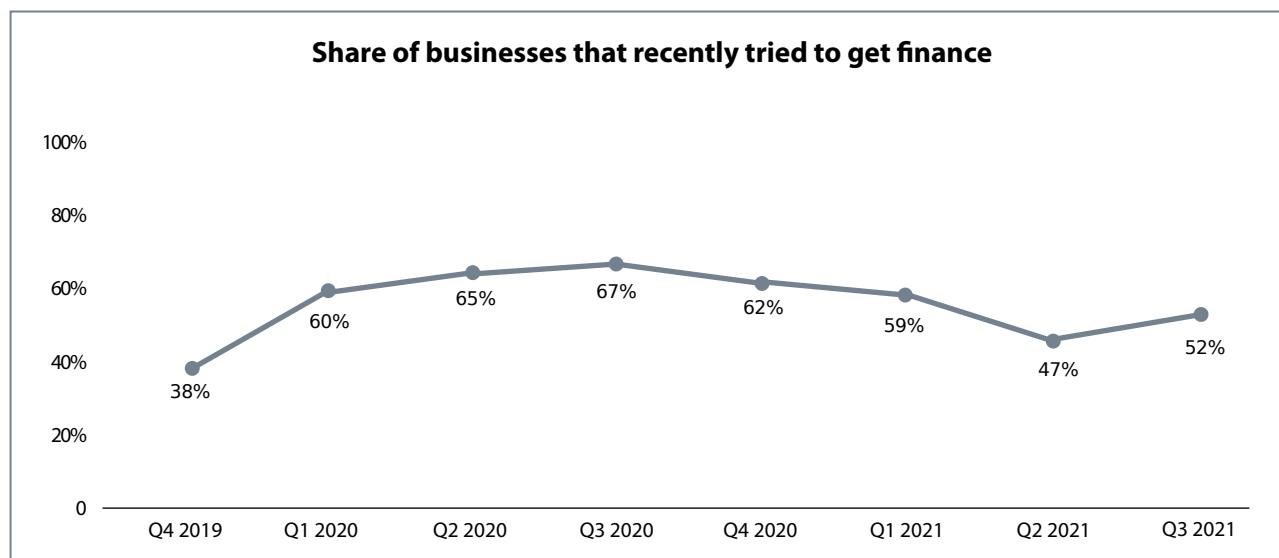


Graph 10: Main factors hindering business activity

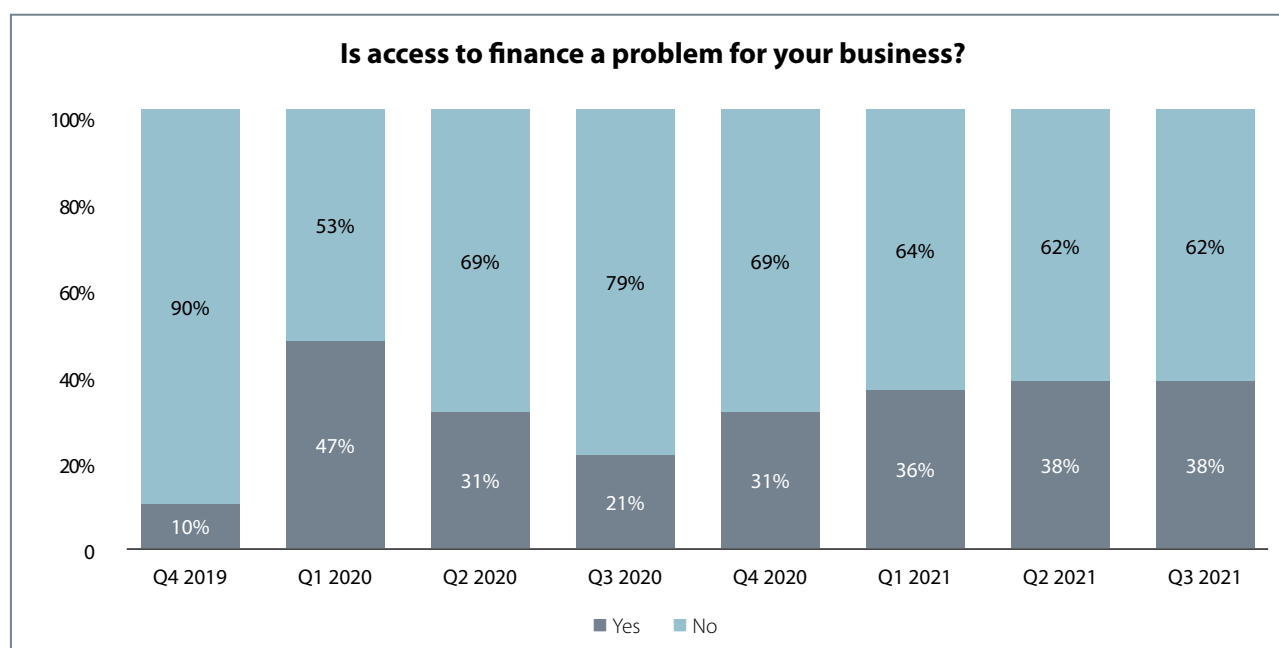
FINANCING

In Q3 of 2021, 52% of surveyed companies claimed to have recently tried to obtain finance, which is a bit higher than the figure recorded in the previous quarter.

In Q3 of 2021, similar to Q2 2021, 38% of those companies that recently tried to access finance also noted that access to finance was a problem for their business.



Graph 11: Businesses that recently tried to get finance

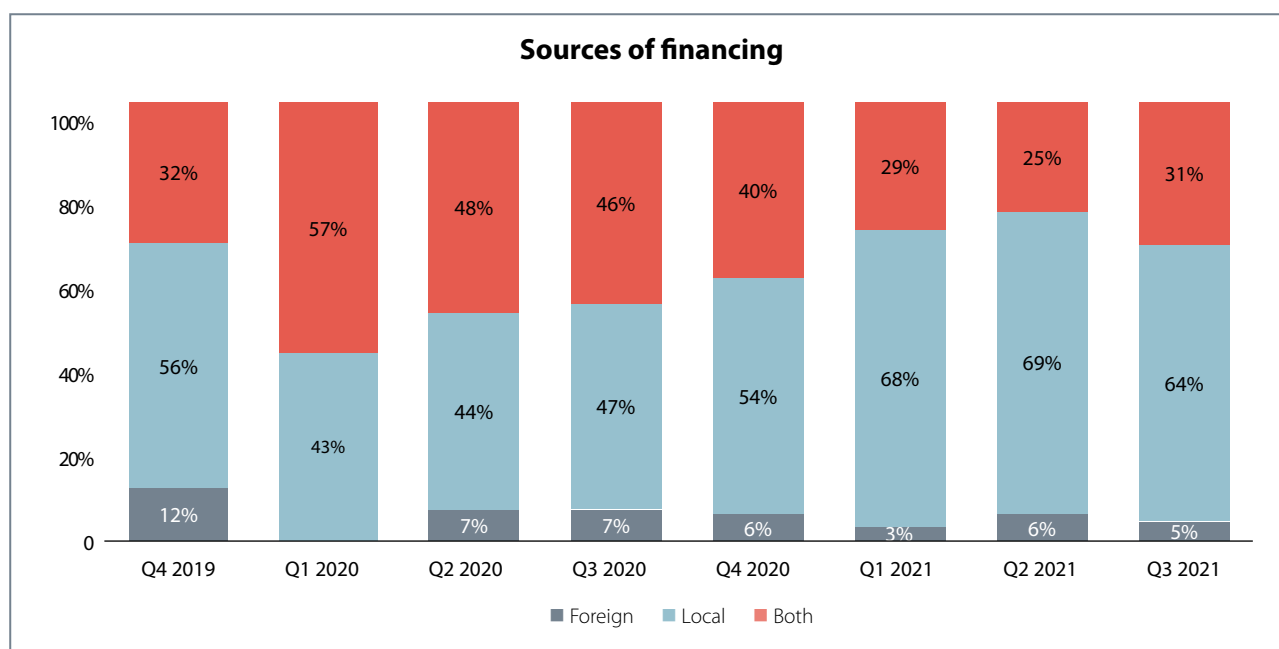


Graph 12: Access to finance⁵

Regarding sources of financing⁶, in Q3 of 2021, similar to previous quarters, the majority of surveyed companies stated that they were financed by local sources. Compared to the previous quarter, this indicator has dropped by 5 percentage points, while the share of companies financed by local as well as foreign sources has increased by 6 percentage points.

⁵ The question was only answered by those companies that stated they had recently sought finance.

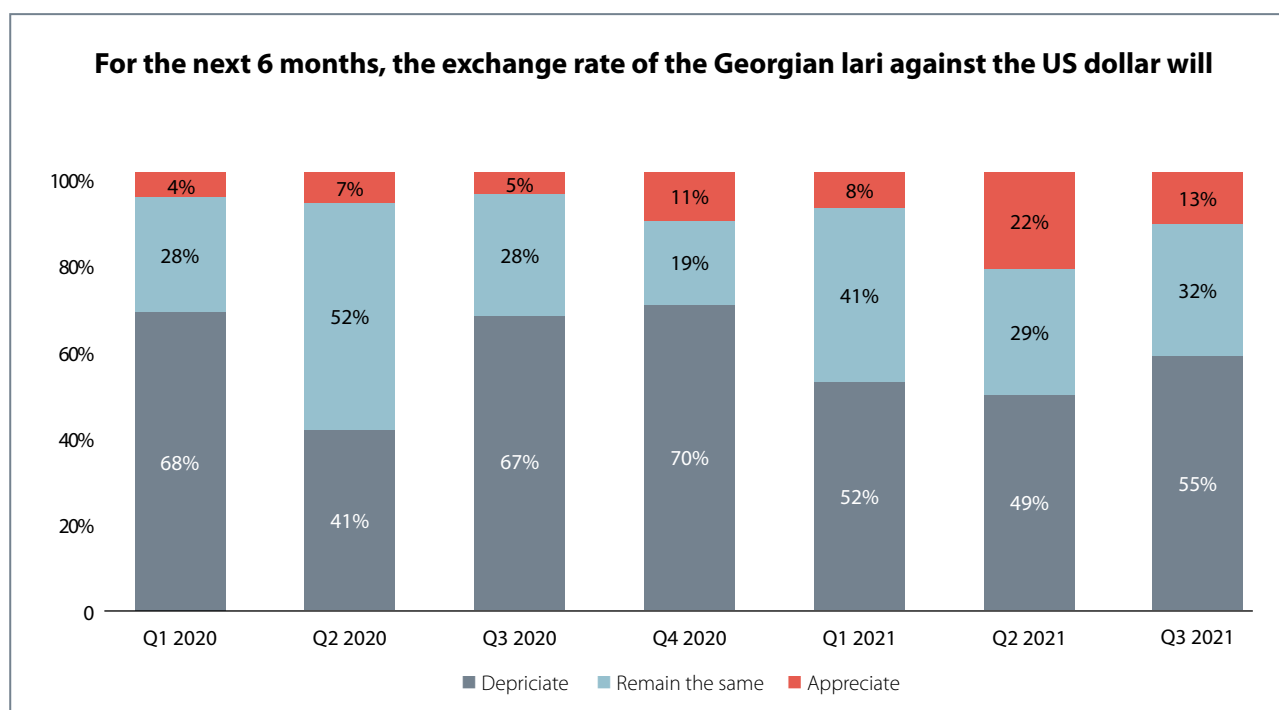
⁶ The change in methodology in Q1 of 2021 (the increase in the number of surveyed companies) altered the financing structure. This methodological change did not affect significantly any other indicators.



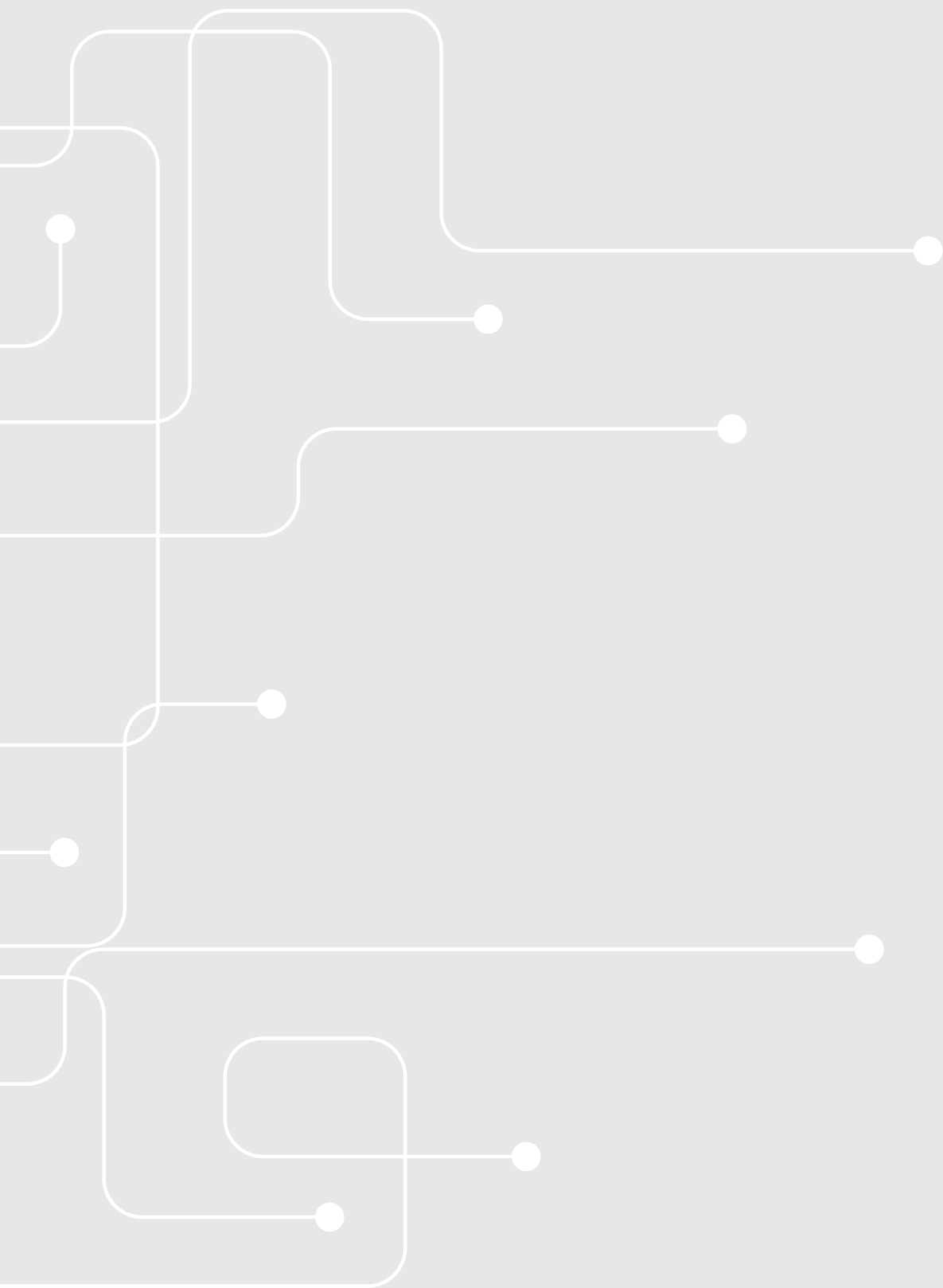
Graph 13: Sources of financing

EXCHANGE RATE EXPECTATIONS

In Q3 of 2021, compared to Q2 of 2021, the share of companies expecting that the national currency would depreciate against the US Dollar increased by 6 percentage points. Moreover, in Q3 of 2021, compared to the previous quarter, the share of companies expecting that the national currency exchange rate would remain the same increased by 3 percentage points.



Graph 14: Exchange rate of the Georgian Lari against the US Dollar



CONTACT:

2 Leonidze Street, Tbilisi, Georgia

☎ +995 32 2 202-215

✉ info@bag.ge

f Business Association of Georgia

www.bag.ge