



BAG INDEX

BUSINESS
CLIMATE



საქართველოს ბიზნეს ასოციაცია
BUSINESS ASSOCIATION OF GEORGIA



Leibniz Institute for Economic Research
at the University of Munich



Research

II QUARTER 2022

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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 group¹. 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 months². 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, and exchange rate expectations. In Q2 2022, the companies also assessed the impact of the Russia-Ukraine war on their business activity. 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 Q2 of 2022 in period 10 – 30 May.

IN Q2 OF 2022, THE SURVEYED BUSINESSES ASSESS THEIR PRESENT BUSINESS SITUATION AND EXPECTATIONS FOR THE NEXT SIX MONTHS POSITIVELY. THE BAG BUSINESS CLIMATE INDICATOR AMOUNTS TO 38.4 POINTS IN Q2 OF 2022, WITH THE PRESENT BUSINESS SITUATION INDICATOR SITTING AT 21.6 AND THE BUSINESS EXPECTATIONS INDICATOR AT 56.5.

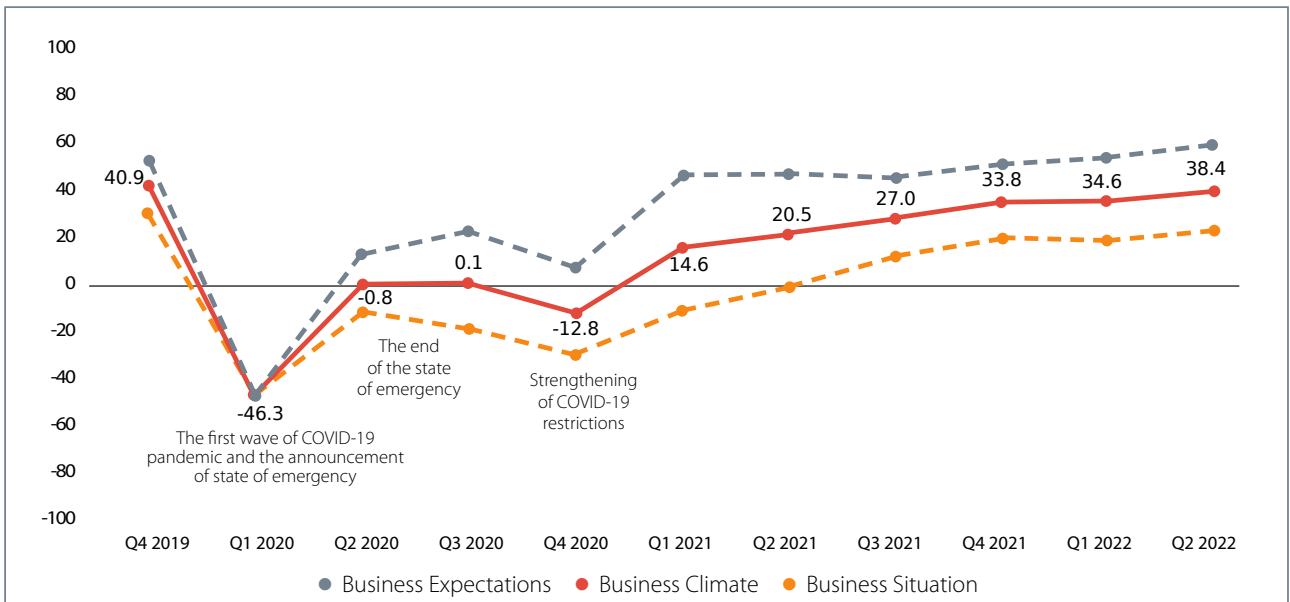
In Q2 of 2022, compared to Q1 of 2022, the BAG Business Climate improved by 3.8 points. Moreover, in this period, the assessment of the present business situation and business expectations improved (by 3.5 points and 4.2 points, respectively).

The figures for Q2 of 2022 demonstrate an improvement compared to Q2 of 2021. In Q2 of 2021, the BAG Business Climate indicator was 20.5, the present business situation indicator equaled -2.2, while the business expectations indicator sat at 45.8.

It is worth noting that starting from Q1 of 2021, the BAG Business Climate indicator has been positive and gradually improving. In Q1 and Q2 of 2021, this was mostly caused by optimistic business expectations, while from Q3 of 2021 onwards the positive assessment of the present business situation by the majority of businesses played a part too (see Graph 1).

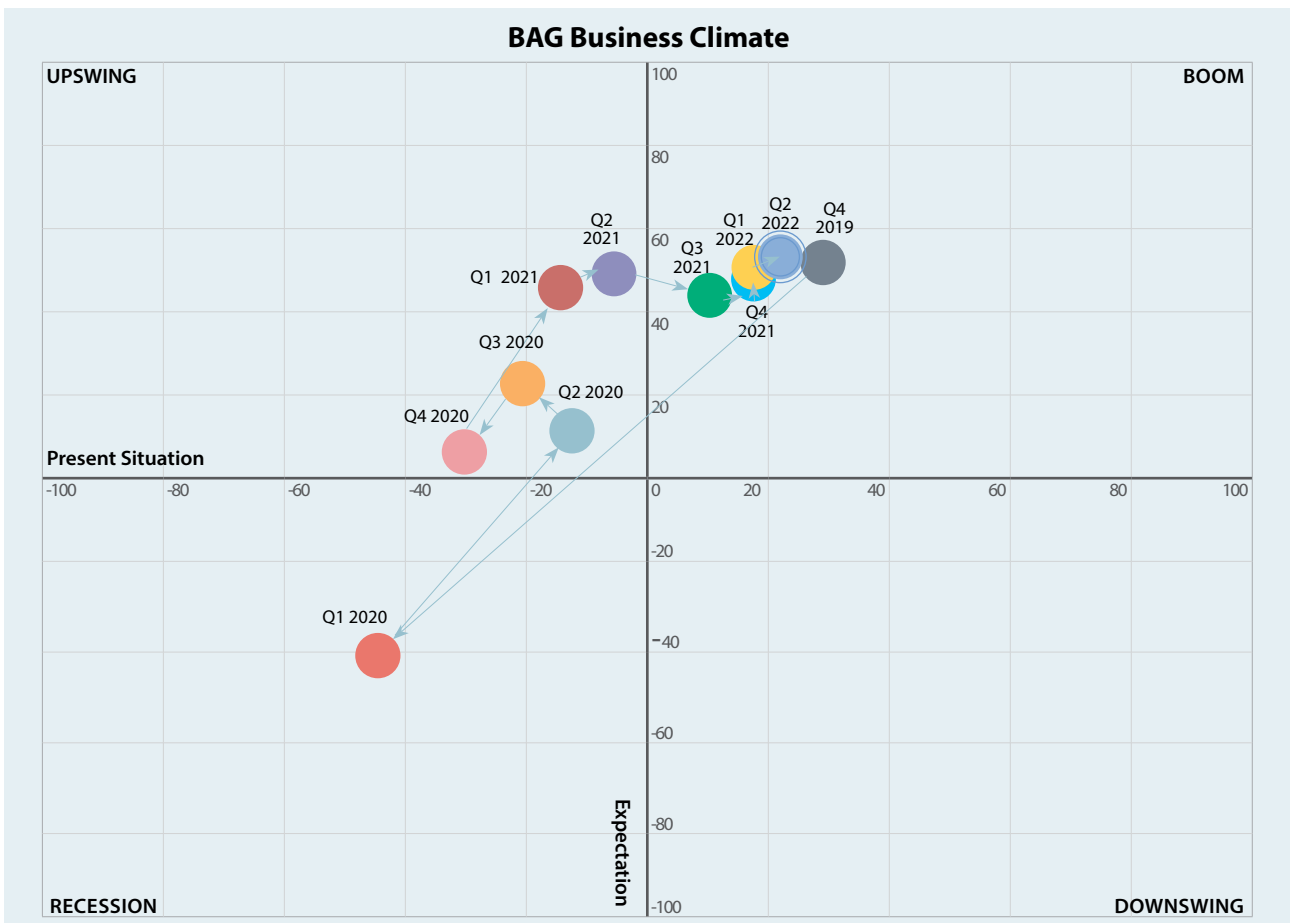
¹ In the first quarter of 2021, a change was made in the methodology of the BAG Index. As a result, the number of companies surveyed increased: enterprises that belong to the corporate group of member companies were added to the existing survey respondents.

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 Q2 of 2022, as in Q1 of 2022, 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

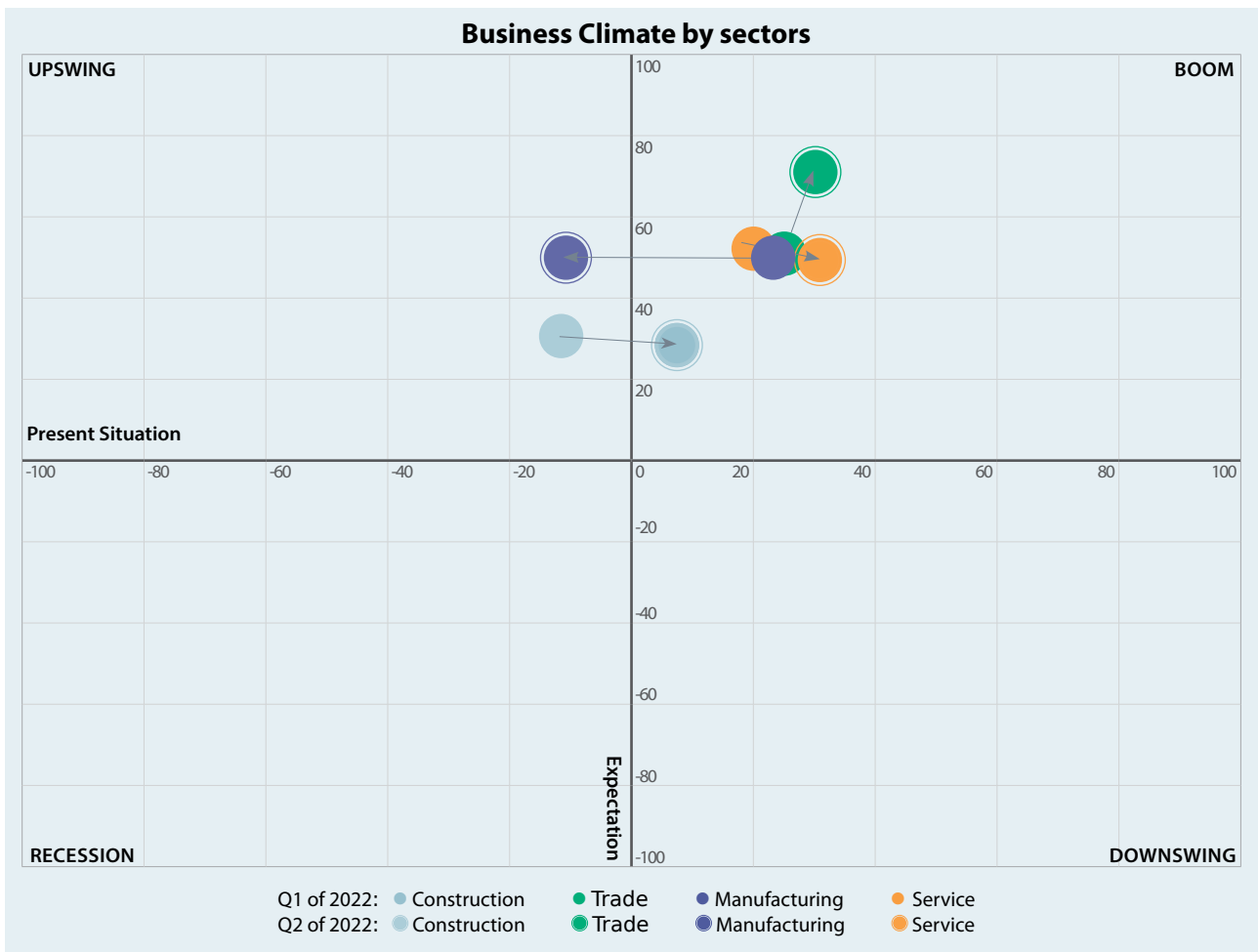
In Q2 of 2022, **the business climate indicator** was positive for all sectors. Compared to Q1 of 2022, in Q2 2022 the indicator improved in the trade, construction and service sectors but worsened in the manufacturing sector (see Graph 3).

In Q2 of 2022, compared to Q1 of 2022, **the present business situation indicator** improved in trade, service and construction sectors and worsened in manufacturing sector. Regarding the manufacturing sector, it is worth noting that the indicator is negative. The most positive assessment with respect to the present business situation was recorded in the trade sector, which could be attributed to increased sales in the sector (the largest share of companies surveyed in the trade sector (57%) indicated an increase in sales in Q2 2022).

In Q2 of 2022, **the business expectations** indicator was positive for all sectors. It is worth noting that expectations slightly worsened for the service and construction sectors compared to Q1 of 2022. Elsewhere, the business expectations indicator improved in trade and manufacturing sectors. The most optimistic expectations were recorded in the trade sector, which could be explained by the positive expectation regarding sales in Q3 2022. 69% of companies surveyed in the sector indicated an expected increase in sales in Q3 2022.

Table 1: Balance values by sector in Q2 of 2022

	Business Climate	Present Business Situation	Business Expectation
Trade Sector	50.6	31.4	71.4
Service Sector	39.9	28.3	52.2
Manufacturing Sector	17.9	-12.5	53.3
Construction Sector	22.3	9.1	36.4
All Sectors	38.4	21.6	56.5

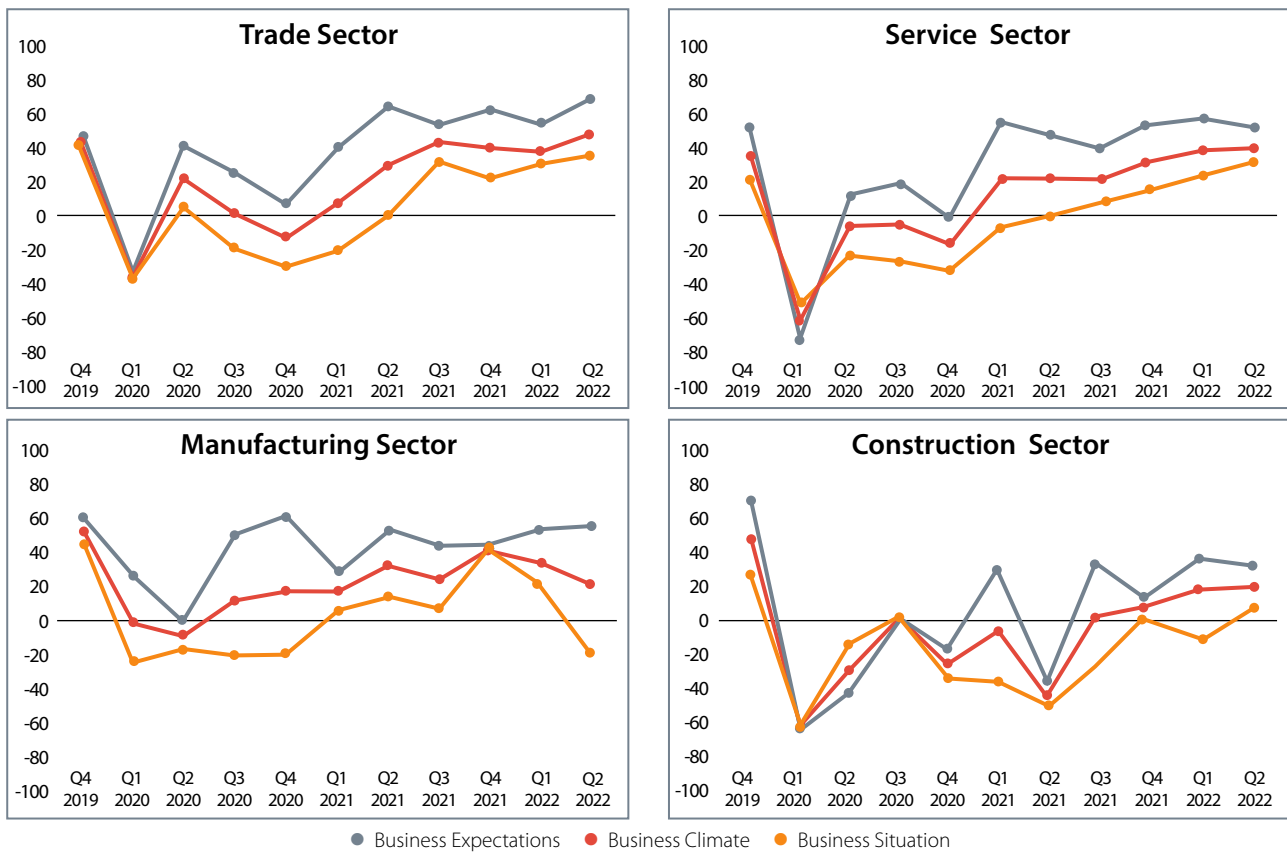


Graph 3: Business climate by sector in Q1 2022 and Q2 2022

Since Q1 of 2021, the business climate indicator was consistently positive in the trade, manufacturing, and service sectors. The positive assessment of business climate could be attributed to optimistic business expectations as well as positive assessment of present business situation.

The business climate indicator has been improving for the trade, service and manufacturing sectors since Q1 of 2021, compared to the corresponding periods of the previous year. Trade and service sectors sustained tendency of improvement in Q2 of 2022, while in manufacturing sector the indicator worsened in Q2 of 2022, compared to Q2 of 2021.

Regarding the construction sector, the business climate indicator was negative in Q1 and Q2 of 2021, however it has been positive since Q3 of 2021 and gradually improving, compared to the corresponding periods of the previous year. This improvement has been mainly due to the optimistic business expectations (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 Q1 of 2022

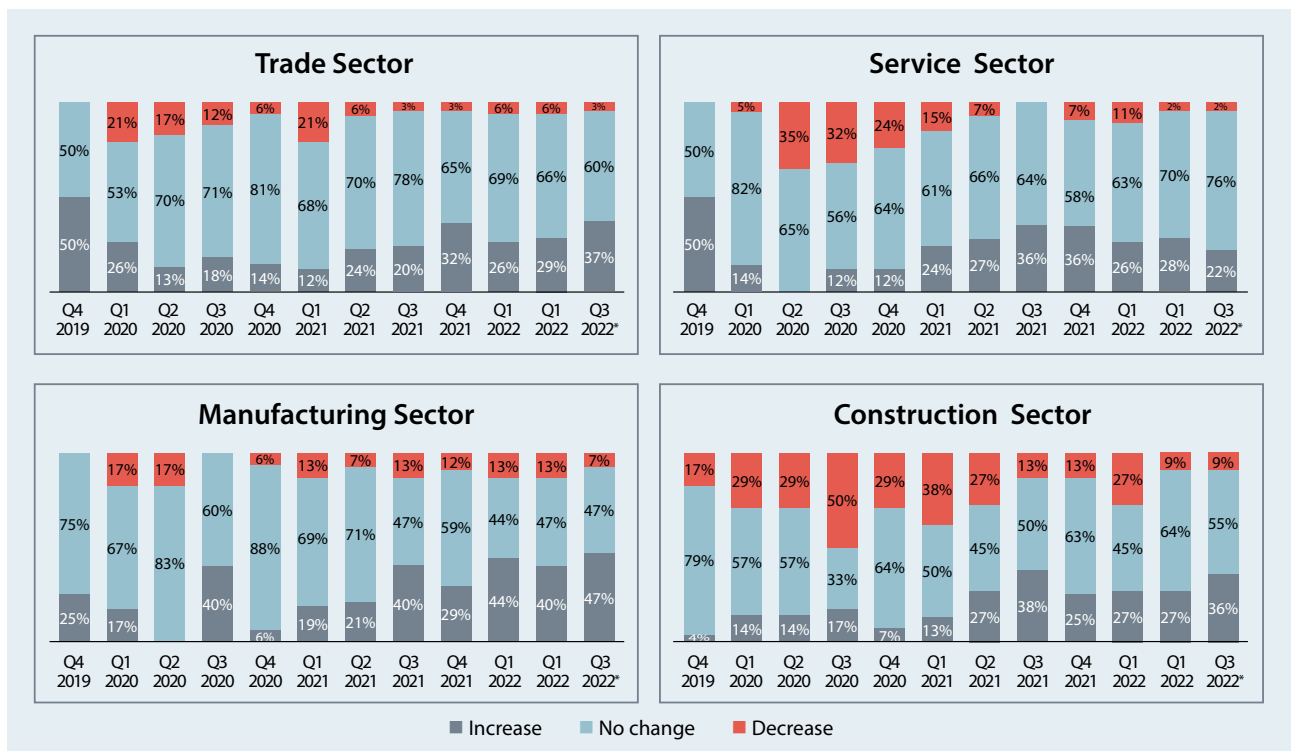
- ✘ 28.7% of surveyed companies stated that the number of employees increased in Q1 of 2022, compared to Q4 of 2021. For the majority of respondents (60.2%) the number of employees was unchanged, while 11.1% reported a decrease.
- ✘ Across all sectors covered, the manufacturing sector was the one with the largest share of the surveyed companies (43.8%) claiming that the number of employees had increased in Q1 of 2022, compared to Q4 of 2021 (see Graph 5). This could be due to the rise in demand for production experienced by the majority of companies (43.8% of surveyed companies recorded an increase in demand for their production in Q1 of 2022).

Situation in Q2 of 2022

- ✘ 29.9% of the surveyed companies stated that in Q2 of 2022, compared to Q1 of 2022, the number of employees increased, while 5.6% recorded a decrease. The majority of companies (64.5%) stated that their number of employees had not changed.
- ✘ Across all sectors covered, the largest share of companies surveyed in the manufacturing sector (40%) indicated that the number of employees had increased in Q2 of 2022, compared to Q1 of 2022.
- ✘ A significant share of respondents in the trade, construction and service sectors (65.7%, 63.6% and 69.6%, respectively) stated that the number of employees had not changed in Q2 of 2022, compared to Q1 of 2022.

Expectations for Q3 of 2022

- ✘ 31.8% of the surveyed companies expect that in Q3 2022, compared to Q2 2022, the number of employees will increase, while 3.7% expect a decline. The majority of companies (64.5%) does not expect change in the number of their employees in this period.
- ✘ The most optimistic outlook regarding employment was found in the manufacturing sector. 46.7% of the respondents in the manufacturing sector stated that they expect an increase in the number of employees in Q3 2022, compared to Q2 2022. This could be explained by the optimistic outlook regarding sales in this sector.
- ✘ Across the sectors covered, the largest share of respondents in the service sector (76.1%) expect that the number of employees will not change in Q3 of 2022, compared to Q2 of 2022.



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

In summary, the manufacturing and construction sectors appear to have been experiencing positive dynamics with regard to employment since Q1 of 2021, as throughout this period the share of the companies stating an increase in employment rose. However, in Q4 of 2021, compared to the previous quarter, this figure decreased for both sectors by 11 and 13 percentage points, respectively. Meanwhile, from 2022, a positive trend in employment is still observed in both sectors, and for Q3 of 2022, significantly higher shares of companies in both sectors are expected to increase their number of employees.

In the service sector, the share of companies to have recorded an increase in their number of employees has also been rising since Q1 of 2021. However, in Q1 of 2022, compared to the previous quarter, the share of companies to have recorded an increase in employment decreased considerably, by 10 percentage points. For Q3 of 2022, only 22% of companies in this sector will increase their number of employees, while the majority of companies do not expect the number of employees to change.

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

* Expectation.

Throughout 2021, unlike other sectors, the share of companies reporting an increase in their number of employees in the trade sector was relatively unstable. This figure fluctuated notably between 12% and 32% over the course of the year. However, since Q2 2022, the figure increased, compared to the previous quarter, and looking ahead to Q3 of 2022, it is expected that more companies in the trade sector will increase their number of employees.

Sales/demand/domestic production

Assessment of Q1 of 2022

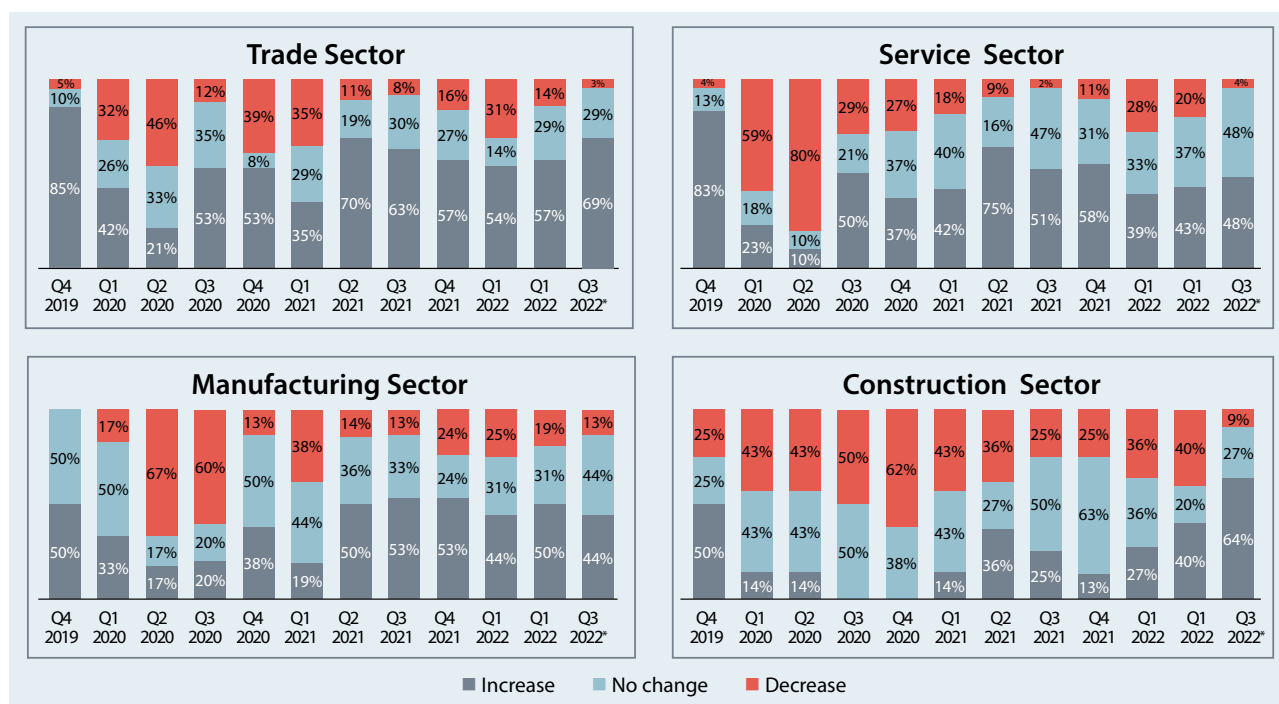
- ✘ In Q1 of 2022, the situation regarding sales was assessed most positively in the trade sector, where 54.3% of surveyed companies stated that their sales had increased, compared to Q4 of 2021 (see Graph 6).
- ✘ In Q1 of 2022, the situation regarding sales was assessed most negatively in the construction sector, where 36.4% of surveyed companies stated that their contracts/presales had decreased, compared to Q4 of 2021.

Situation in Q2 of 2022

- ✘ In Q2 of 2022 the situation regarding sales was assessed the most positively by representatives of the trade sector. 57.1% of surveyed companies recorded growth in sales in this period.
- ✘ In Q2 of 2022, as in Q1 of 2022, the worst situation regarding sales was recorded in the construction sector. According to 40% of surveyed companies their sales decreased, compared to previous quarter.

Expectations for Q3 of 2022

- ✘ The most positive outlook for Q3 of 2022 regarding sales was recorded in the trade sector, where 68.6% of surveyed companies stated that they expect sales to increase.
- ✘ Comparing sectors, the highest share of companies to predict sales to decrease in Q3 of 2022 was recorded in the construction (9.1%) and manufacturing (12.5%) sectors.



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

Overall, in 2021 there were some positive tendencies regarding sales in the trade, manufacturing, and service sectors, in which the majority of companies reported an increase in quarterly sales volumes. However, in Q1 of 2022, the proportions of companies in all three sectors reporting such an increase, dropped. It is worth noting, that in Q2 of 2022, a positive tendency returned.

It is worth noting that compared to other sectors, the construction sector has had unstable tendencies regarding sales in Q1 and Q2 of 2022. During this period, the share of companies that recording sales growth gradually increases, while the number of companies expecting a decrease in sales also increases.

Sales prices

Assessment of Q1 of 2022

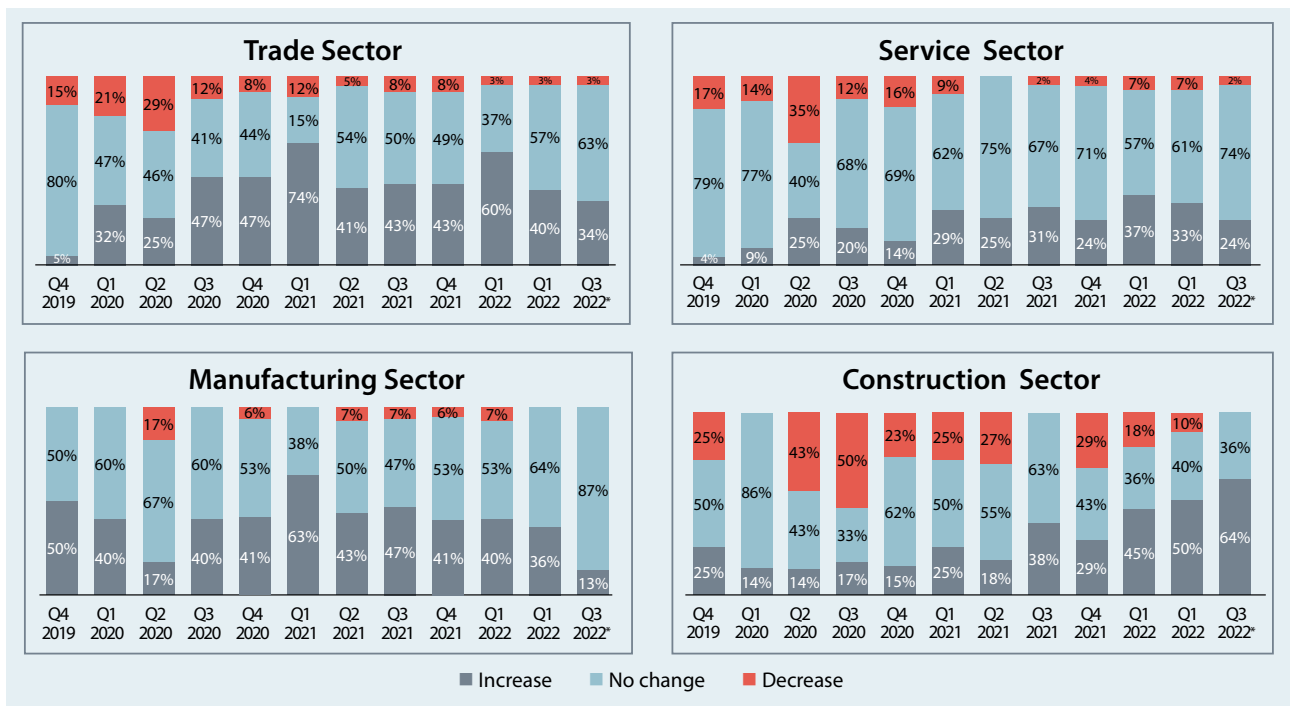
- ✘ A large share of surveyed companies (47.7%) stated that in Q1 of 2022, compared to Q4 of 2021, sales prices had not changed, while 45.8% stated that prices had gone up. According to 6.5% of respondents, sales prices had decreased in this period (see Graph 7).
- ✘ Across the covered sectors, the majority of the surveyed companies in trade sector (60%) stated that prices has increased in Q1 of 2022, compared to Q4 2021.

Situation in Q2 of 2022

- ✘ 37.1% of the surveyed companies stated that in Q2 of 2022, compared to Q1 of 2022, sales prices had increased, while 58.1% stated that sales prices remained unchanged, 4.8% claimed that sales prices had decreased.
- ✘ The most positive outlook regarding sales prices is recorded in the construction sector with 50% of surveyed companies stating that sales prices had increased in Q2 of 2022, compared to the previous quarter.
- ✘ It must be noted that none of the companies in the manufacturing sector stated that prices have decreased in Q2 of 2022, compared to Q1 2022.

Expectations for Q3 of 2022

- ✘ 29.9% of surveyed companies expect sales prices to increase in Q3 of 2022, compared to Q2 of 2022, while 68.2% do not expect this figure to change, and only 1.9% of the companies expect a decrease.
- ✘ Across the covered sectors, the construction sector had the largest share of respondents (63.6%) expecting an increase in sales prices in Q3 of 2022, compared to Q2 of 2022.
- ✘ It must be noted that none of the companies in the manufacturing and construction sectors stated that prices are expected to decrease in Q3 of 2022, compared to Q2 of 2022.



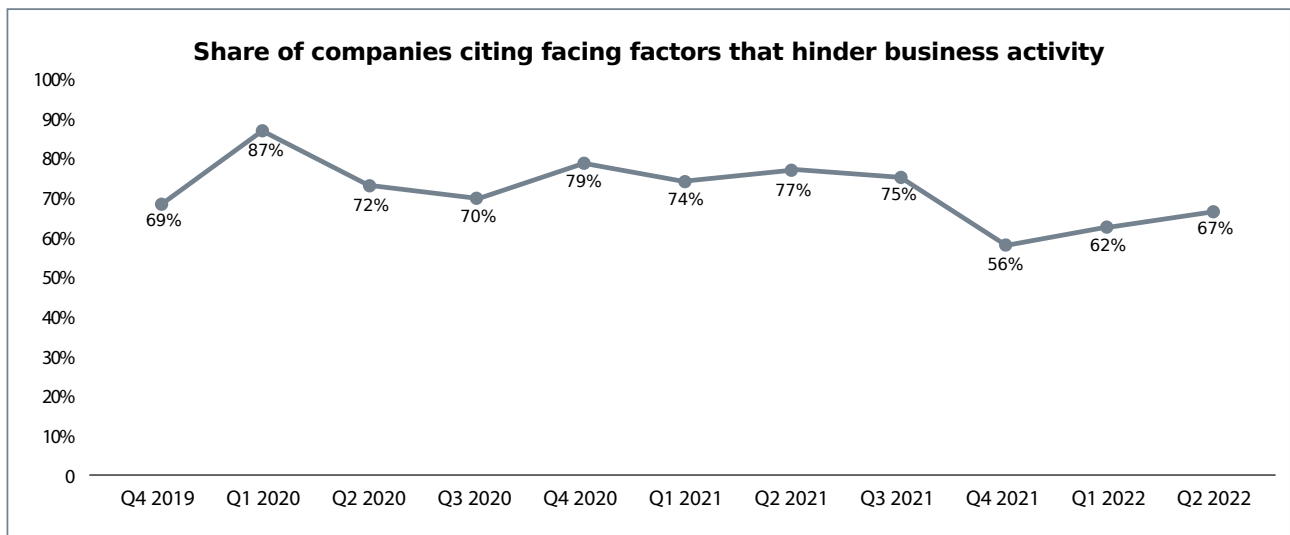
Graph 7: Sales prices in trade, service, manufacturing, and construction sectors

In summary, during 2021, among the trade and manufacturing, sales prices were increasing in the majority of the surveyed companies. This tendency is also persistent in 2022.

In the service sector, from the first quarter of 2022, compared to the corresponding periods of 2021, the share of companies that recorded an increase in sales prices increased. As for the construction sector, since Q1 of 2022 the share of the companies recording an increase in their sales prices has been rising. For the construction sector, the expectation of the price increase is especially high in Q3 of 2022. This could be attributed to increased prices for construction materials and demand due to the Russia-Ukraine war.

FACTORS HINDERING BUSINESS ACTIVITY

In Q2 of 2022, compared to Q1 of 2022, the share of surveyed companies to claim there are factors hindering their business activity increased (by 5 percentage points). It must be noted that, in Q2 of 2022, compared to Q2 of 2021, the share of companies claiming that there are factors hindering their business activity decreased markedly (by 10 percentage points).



Graph 8: Existence of factors hindering business activity

In Q2 of 2022, the following five factors were emphasized as the most hindering for business activity: volatility of national currency exchange rate⁴, legal and administrative barriers, a lack of specialists, labor shortage, and weak demand for products and services (see Graph 9).

In Q2 of 2022, similar to the previous four quarters, **the volatility of the national currency exchange rate** was cited as the top factor hindering business (53% of surveyed companies cited this factor as the most hindering). From a sector-by-sector view, this factor was most frequently pointed out in the construction sector (90%), while it was considered the least hindering for the service sector (40%) (see Graph 10).

In terms of the size of the enterprise⁵, the volatility of the national currency exchange rate was most cited by medium enterprises as a factor hindering business activity (60% of surveyed medium companies cited this factor as hindering) (see Graph 11).

In Q2 of 2022, **legal and administrative barriers** was the second-most cited hindering factor (cited by 41% of surveyed companies). Across the covered sectors, this factor was most frequently pointed out in the construction sector (50% of surveyed companies in this sector cited this factor as the most hindering) and was considered the least hindering for the manufacturing sector (22%). Legal and administrative barriers are most hindering for small enterprises (47% of them cited this factor as hindering).

In Q2 of 2022, **a lack of specialists** was cited as a hindering factor by 36% of surveyed companies. This issue was felt most acutely in the trade (42%), while it was less of a hindrance for the manufacturing sector (22%). A lack of specialists was considered most problematic for large enterprises (cited by 38% of them as a hindering factor).

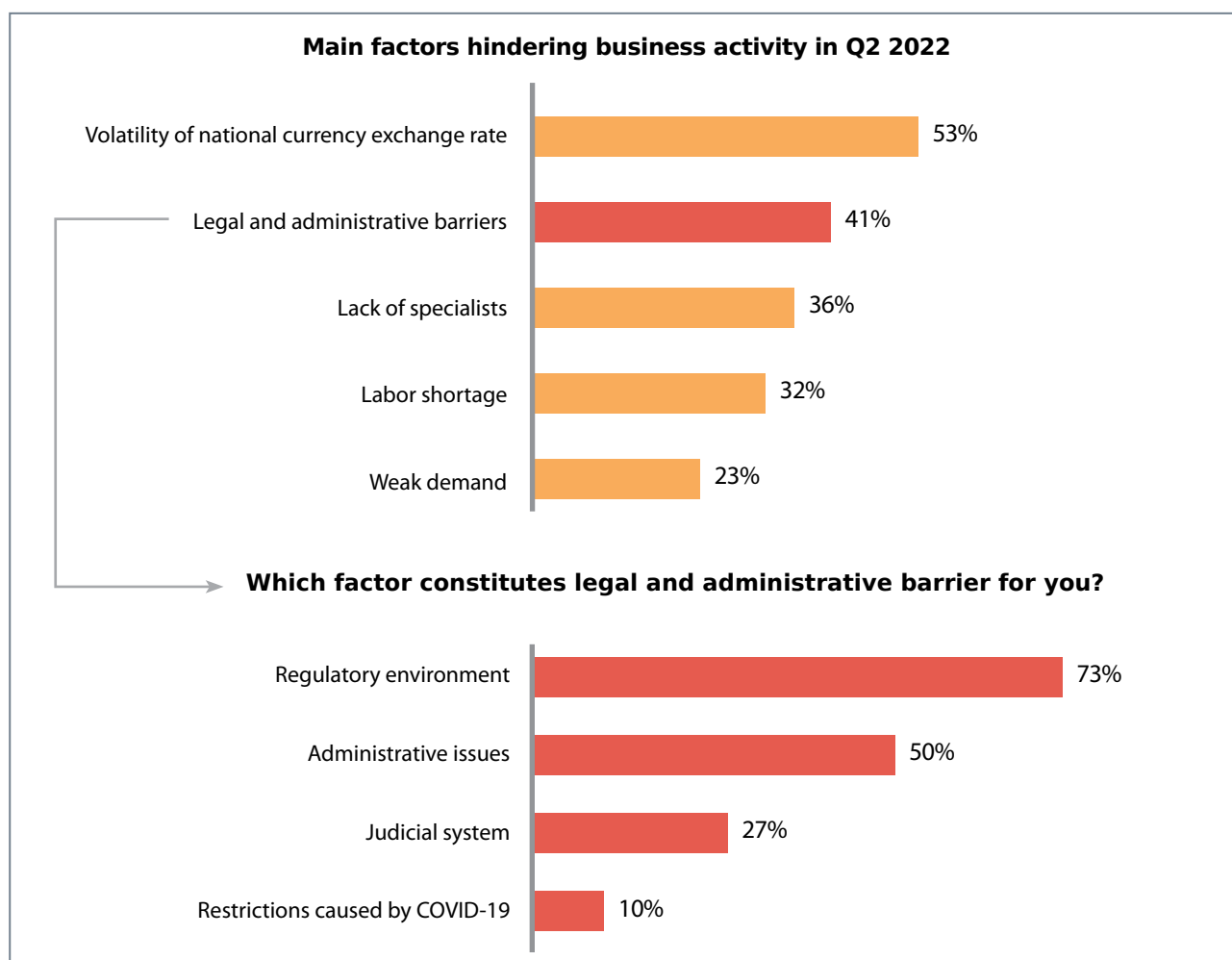
In Q2 of 2022, **labor shortage** was cited as a hindering factor by 32% of surveyed companies. Across the covered sectors, this factor was deemed most hindering for the trade sector (46%). In Q2 of 2022, labor shortage was considered most problematic for large enterprises (cited by 41%).

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

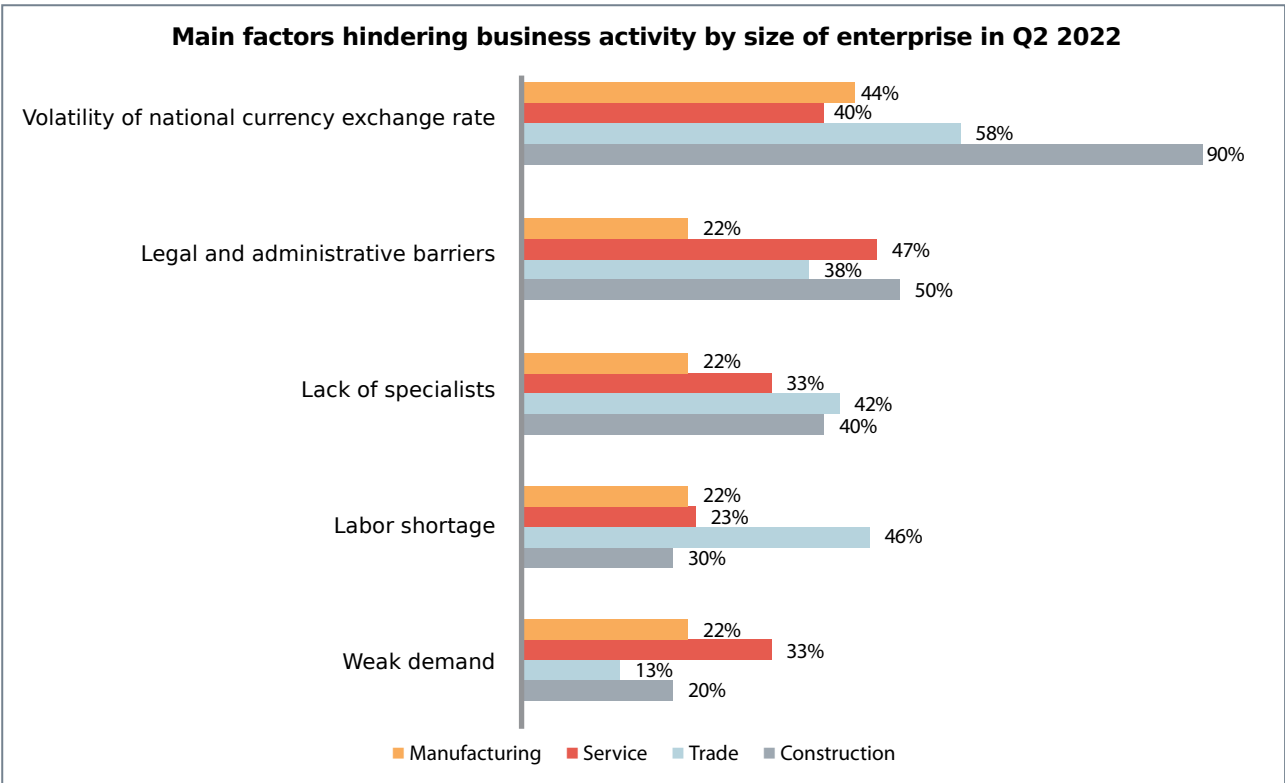
⁵ The size of enterprise was determined according to the methodology of the National Statistics Office of Georgia (i.e. small, medium, or large).

Weak demand for products and services was cited as a hindering factor by 23% of the surveyed companies in Q2 of 2022. This factor was most cited in the service sector (33%). Indeed, it was considered most problematic for small enterprises (40%).

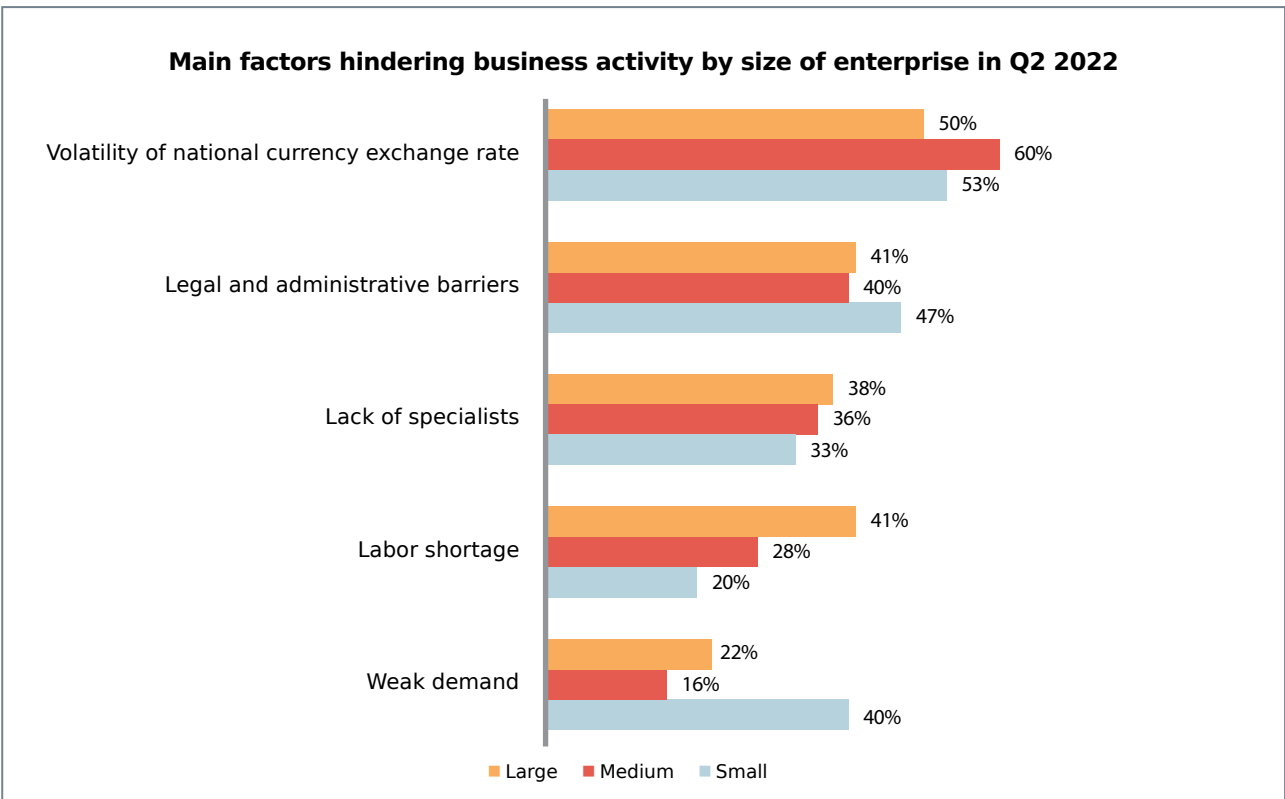
In Q2 of 2022, compared to Q1 of 2022, among the factors hindering business activity, the share of companies citing volatility of the national currency exchange rate decreased the most (by 9 percentage points), this is linked to the recent appreciation of GEL against the USD in May 2022. Elsewhere, the share of companies citing financial constraints as a hindering factor increased the most (by 6 percentage points) over the same period (See Graph 12).



Graph 9: Main factors hindering business activity for surveyed companies in Q2 2022



Graph 10: Main factors hindering business activity by sectors in Q2 2022



Graph 11: Main factors hindering business activity by size of enterprise in Q2 2022

Legal and administrative barriers

In Q2 of 2022, similar to the previous quarter, the **regulatory environment (73%)** has been considered the main element of legal and administrative barriers hindering business activity. Meanwhile, looking from a sector-by-sector view, the regulatory environment was most cited as a hindering factor in the construction (All companies surveyed in the construction sector for which there are legal and administrative barriers named the regulatory environment as a hindrance). The regulatory environment is deemed less hindering for the manufacturing sector (50%).

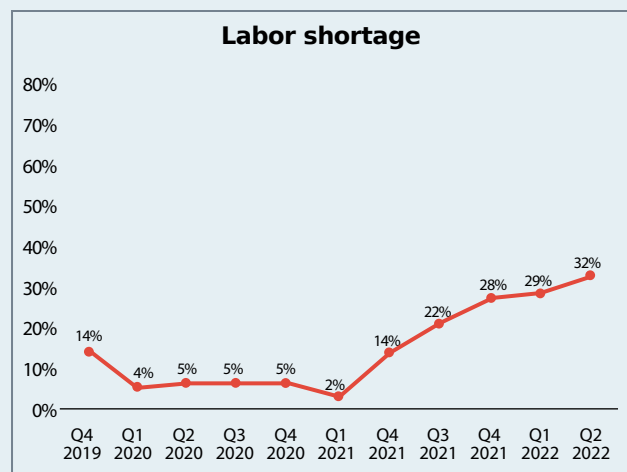
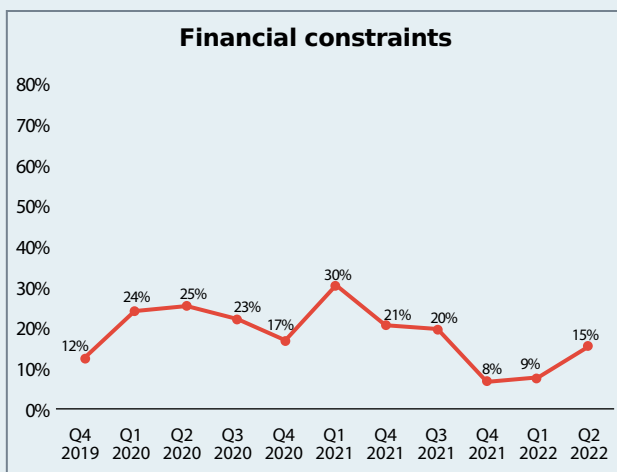
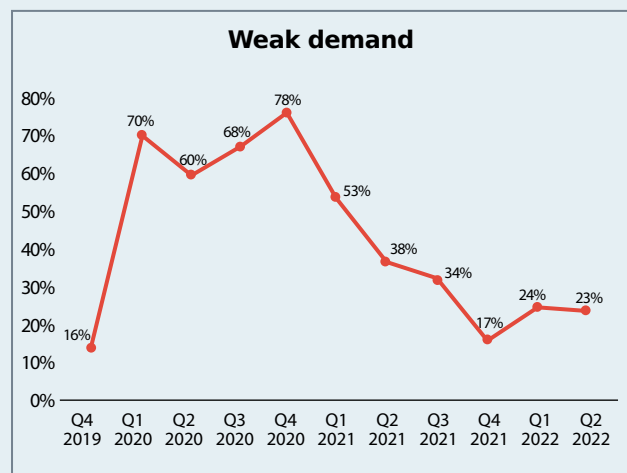
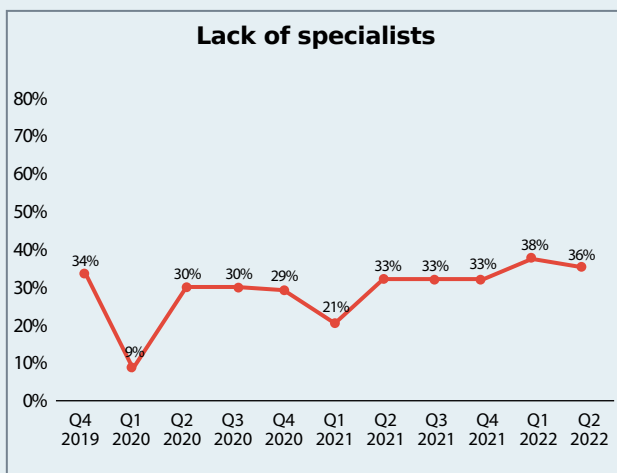
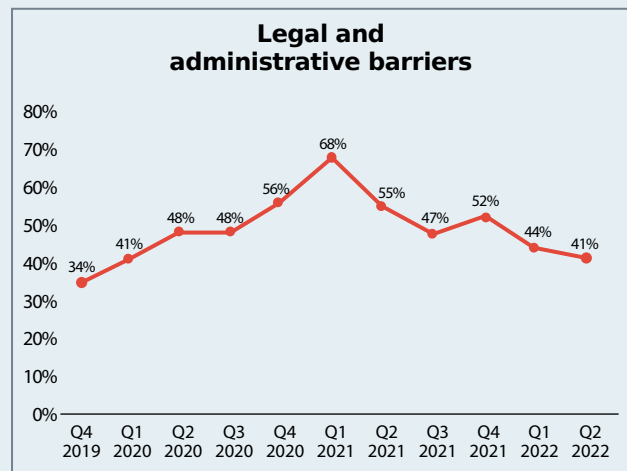
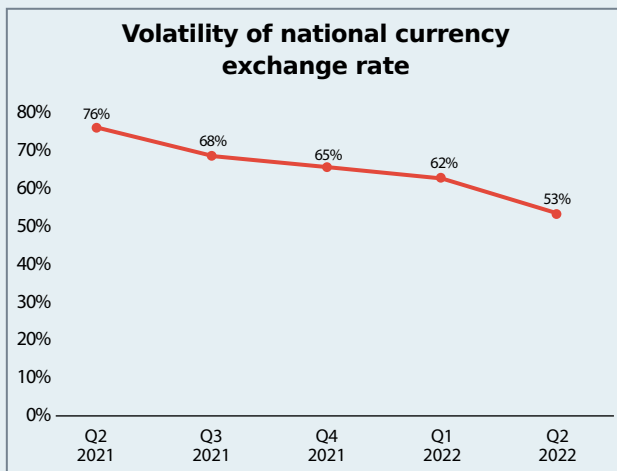
Among legal and administrative barriers, **administrative issues (50%)** were the second-most cited hindering factor. This was deemed the most hindering in the construction sector (60%), while it was least cited in the service sector (43%).

Meanwhile, the **judicial system** was the most cited as a hindering factor under legal and administrative barriers in the manufacturing sector (cited by 50% of companies), while for the construction sector judicial system was not considered a hindrance.

Among legal and administrative barriers, **COVID-19-related** restrictions were cited by only 10% of companies. This was deemed the most hindering in the trade sector (22%), while for the construction and manufacturing sectors COVID-19-related restrictions were not considered a hindrance.

In summary, in Q2 of 2022, compared to the previous quarter, the share of companies to cite COVID-19-related restrictions and the judicial system as a hindering factor decreased (by 38 and 18 percentage points accordingly), while the share of companies citing regulatory environment as a hindering factor increased the most (by 7 percentage points).

Hindering factors for business activity Q4 2019-Q2 2022⁶



Graph 12: Main hindering factors for surveyed companies

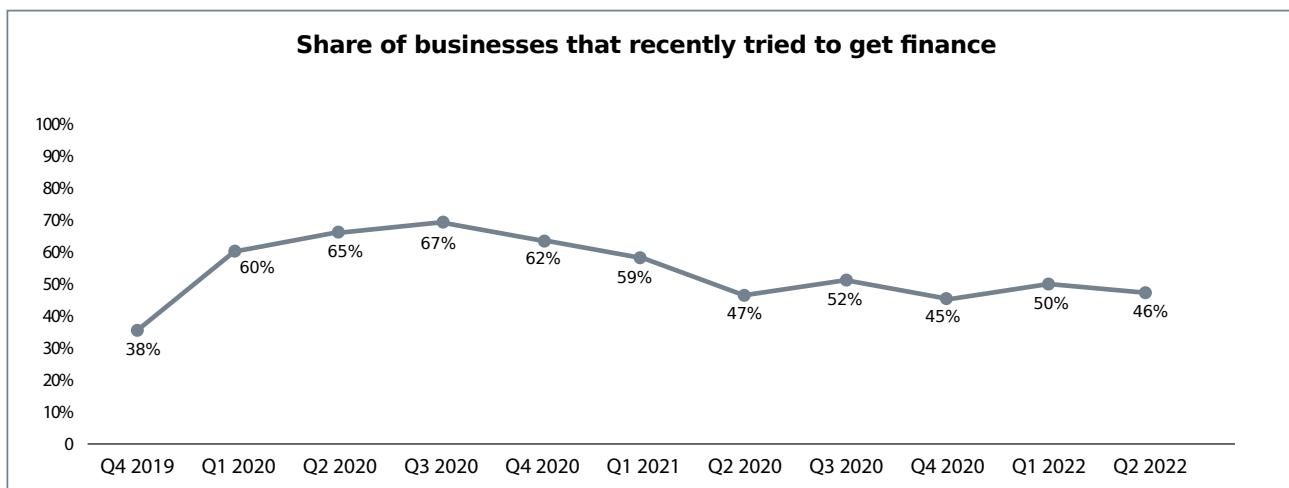
⁶ Volatility of national currency exchange rate as a factor hindering business was added to the survey questionnaire in Q2 of 2021.

FINANCING

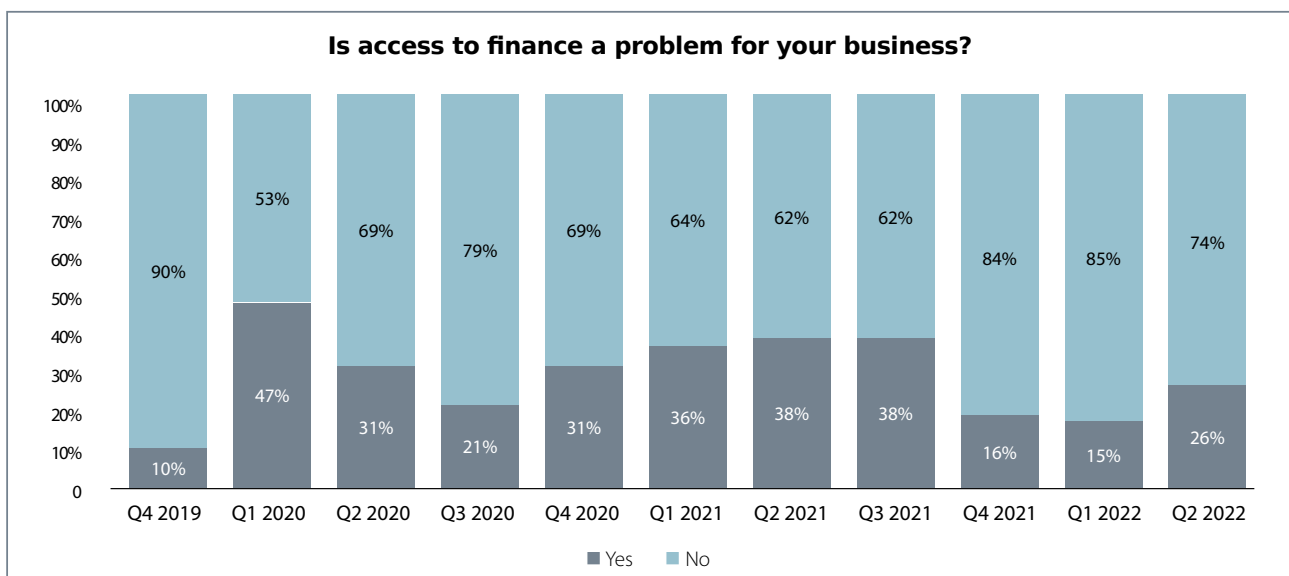
In Q2 of 2022, 46% of surveyed companies claimed to have recently tried to obtain finance, which is 4 percentage points lower than the figure recorded in the previous quarter (see Graph 13).

In Q2 of 2022, 26% of those companies that recently tried to access finance also noted that access to finance was a problem for their business. This figure is significantly higher (11 percentage points) than that of the previous quarter (see Graph 14).

From an enterprise size perspective, in Q2 of 2022, access to finance was most cited as a problem by medium enterprises (33%). Access to finance was considered less problematic for small enterprises (only 9% cited it as a problem), while 30% of large enterprises stated that access to finance was a problem for their business.



Graph 13: Businesses that recently tried to get finance

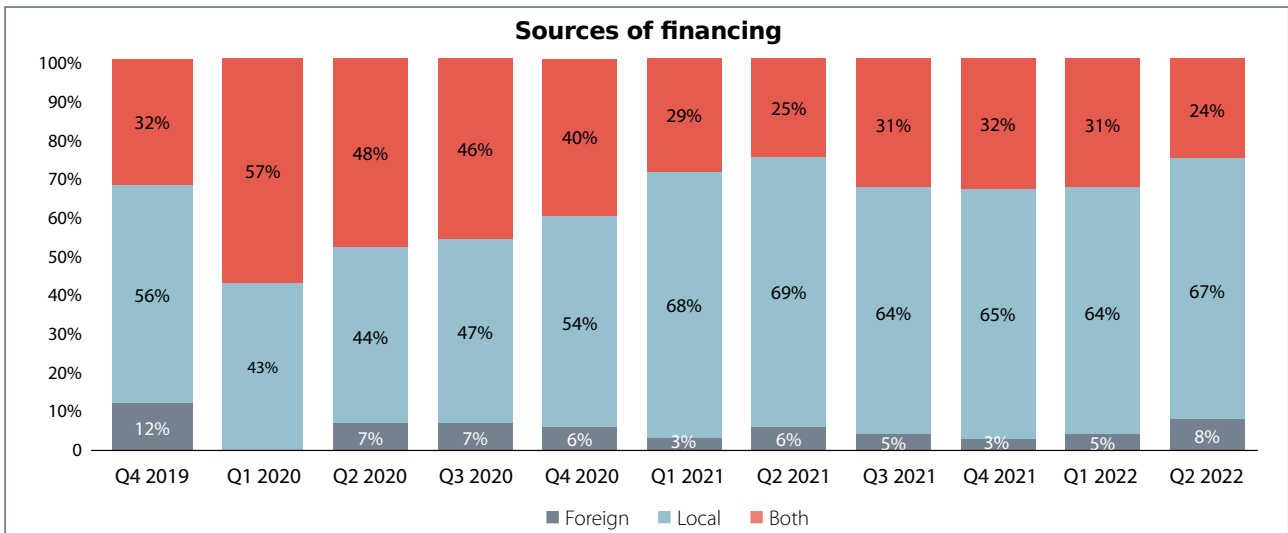


Graph 14: Access to finance⁷

Regarding sources of financing⁸, in Q2 of 2022, similar to previous quarters, the majority of surveyed companies stated that they were financed by local sources. The share of companies stating that they were financed by foreign sources increased by 3 percentage points in Q2 of 2022, compared to the previous quarter.

⁷ The question was only answered by those companies that stated they had recently sought finance.

⁸ 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.

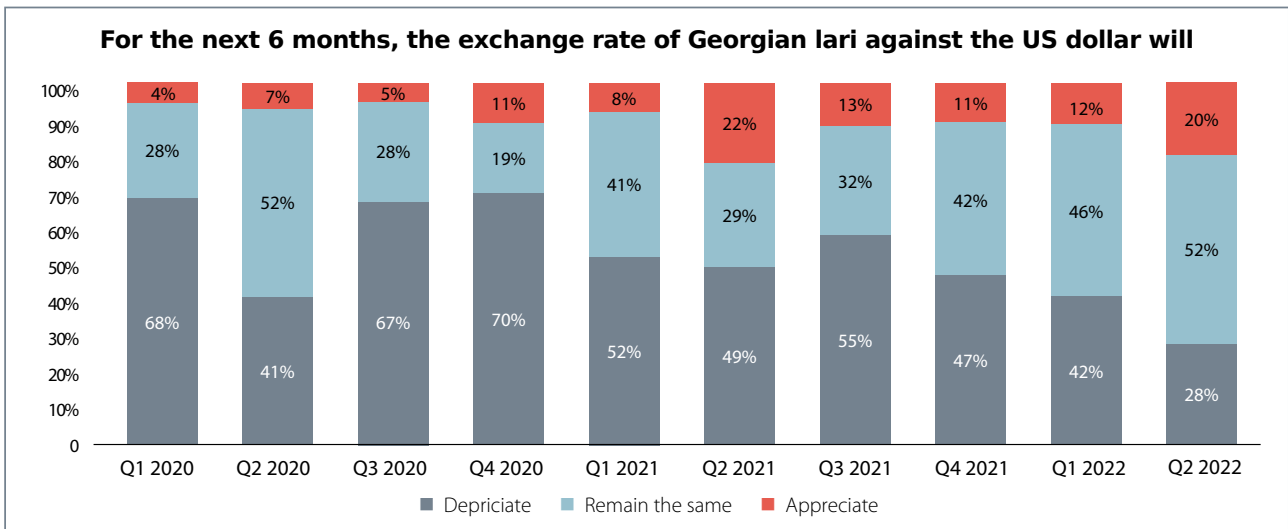


Graph 15: Sources of financing

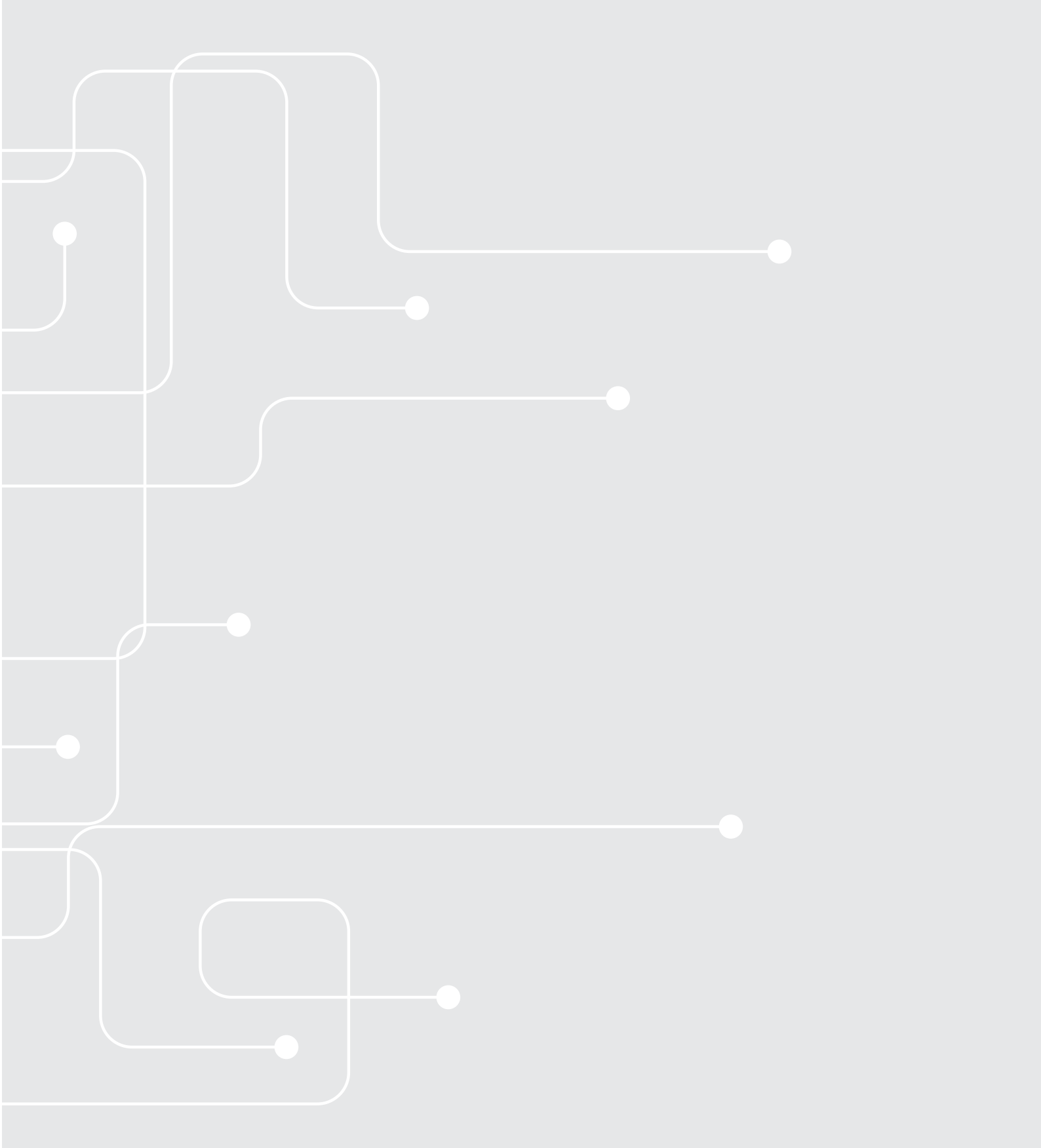
EXCHANGE RATE EXPECTATIONS

In Q2 of 2022, compared to Q1 of 2022, the share of companies expecting that the national currency would depreciate against the US Dollar decreased significantly (by 14 percentage points). Moreover, in Q2 of 2022, compared to the previous quarter, the share of companies expecting that the national currency exchange rate would appreciate throughout the next 6 months, increased by 8 percentage points. The optimism of respondents goes in line with the recent GEL appreciation trend against the USD in May 2022.

It is worth noting that from Q4 2021 the share of companies expecting that the national currency would depreciate is decreasing quarterly.



Graph 16: Exchange rate of the Georgian Lari against the US Dollar



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