

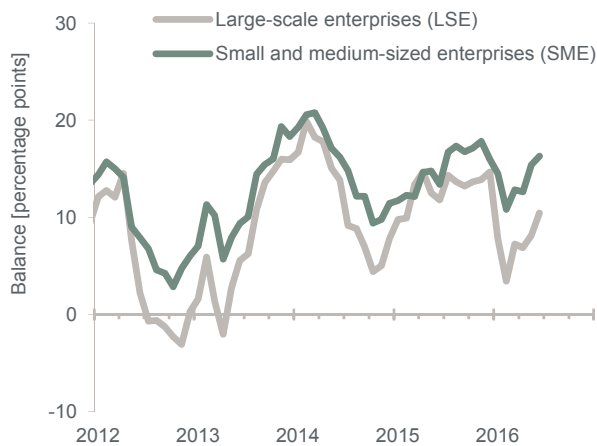
»» Brexit vote: German SMEs are well equipped for uncertain times

13. July 2016

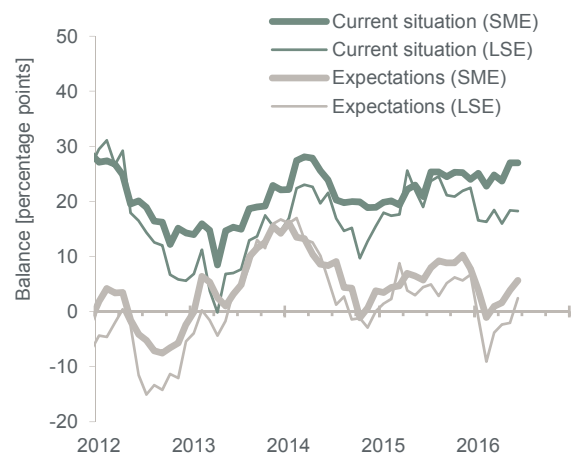
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- SME expectations jump to a year's high ahead of the Brexit referendum
- Situation assessments stabilise at a very high level
- For the first time this year, a majority of large enterprises are optimistic
- However, Brexit vote dashes hopes of an economic upturn

KfW-ifo business climate



KfW-ifo climate components



Source: KfW, ifo

Growing confidence – before the Brexit shock

German firms took a fairly calm view of the Brexit referendum and the associated economic risks ahead of the vote. The business climate of small and medium enterprises – the central indicator of our KfW-ifo SME Barometer, sampled in the weeks before the Brexit referendum on 23 June – even rose in June to a new year's high (climbing by 0.9 to 16.3 balance points). This was mainly due to increased confidence among companies, for the fourth time in a row, that business will continue to improve on a six-month view:

- SME business expectations rose by 1.8 to 5.7 balance points. However, we think this positive outlook is hardly worth the paper it is written on following the surprise decision by British voters to leave the EU. The coming months will be characterised by great uncertainty and a weaker economy – particularly in the UK but also in the rest of Europe. Therefore we firmly believe that expectations and hence the business climate will deteriorate significantly, at least in July.

- SMEs' assessments of the current business situation remained stable in June at a two-year high of 27.0 balance points. In the second quarter as a whole, they improved by 1.7 points compared with the average of the first quarter. Looking back, this suggests a very solid upward economic trend during the early part of the year, even if quarterly growth may turn out somewhat weaker than the rate of GDP growth recorded in the first quarter (+0.7 % on the previous quarter), which was exaggerated by unusually favourable weather conditions.

Same mood tendency among large enterprises

Large enterprises signalled almost the same mood tendency in June: their situation assessments were likewise virtually stable (down 0.1 to 18.3 balance points), while their expectations improved – from a lower level – even more strongly than those of SMEs (up 4.4 to 2.4 balance points). For the first time this year, optimists among the large companies – which are particularly dependent on international demand – were slightly in the majority. All in all, their business climate score rose by 2.2 to 10.4 balance points.

Brexit creates a new paradigm

Without the Brexit vote, we would have regarded the encouraging June figures of the KfW-ifo SME Barometer as affirmation of our optimistic economic forecast for this year and next year published in May. At the time we made it clear that our forecasts were wholly dependent on Britain voting to remain in the EU. However, the world after 23 June looks different to what it was just a few weeks ago. Today, those encouraging figures at least tell us one thing: German companies are well equipped for uncertain times ahead.

Investment and exports weaker

In Germany, exports and business investment in particular are likely to be negatively affected by the Brexit decision. Not only are exports to the UK itself likely to be weaker – the UK accounted for 7.5 % of all German goods exports in 2015; exports to other important European countries will also be affected, as their own economies are likely to be weaker as a result. Given the poorer sales outlook coupled with a likely prolonged period of uncertainty about Germany's future relationship with the UK, and hence with its third most important export market, companies will probably hold back from investing.

Domestic demand mitigates external headwinds

By contrast, the German labour market and domestic demand – particularly consumption and residential construction – are expected to go on steadily rising, thereby alleviating external headwinds. This is underlined not least by generally very high business confidence levels in the domestic sectors of construction and retail in June.

Expected economic upturn will not now occur

In view of the Brexit decision, we have officially revised our economic forecast outside the usual quarterly cycle, even if the many currently unanswered questions mean an enormous, almost impenetrable degree of uncertainty in the short term (see our Brexit Update to the KfW Business Cycle Compass for Germany and Europe of 11 July). We now expect the German economy to grow by only 1.5 % in 2016 (previous forecast: 1.7 %) and 1.2 % in 2017 (previous forecast: 1.8 %). This is not a disaster for Germany, but it is regrettable. After all, had the UK decided otherwise, it is very likely the external economic environment would have steadily improved – not least from the perspective of companies themselves, as can be seen from the current KfW-ifo SME Barometer. Together with a healthy domestic economy, this would have led to higher growth in Germany and ultimately higher investment. Unfortunately, the expected economic upturn will not now occur. ■

KfW Research

KfW-ifo SME Barometer: June 2016

Attachment: SME business climate in figures

KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year						m-o-m	y-o-y	3m-o-3m	
		Jun/15	Jan/16	Feb/16	Mrz/16	Apr/16	Mai/16				Jun/16
Business climate											
Manufacturing	SME	10.3	10.3	5.2	8.4	7.4	10.1	10.8	0.7	0.5	1.5
	LSE	11.0	6.0	-1.7	2.5	3.6	2.9	6.6	3.7	-4.4	2.1
Construction	SME	20.2	22.9	22.0	21.1	23.0	26.8	26.6	-0.2	6.4	3.4
	LSE	14.6	18.5	26.9	21.8	25.4	22.8	26.8	4.0	12.2	2.6
Retail trade	SME	20.5	25.1	18.8	20.6	19.9	24.1	23.5	-0.6	3.0	1.0
	LSE	6.6	4.8	8.6	11.6	6.0	11.0	6.0	-5.0	-0.6	-0.7
Wholesale trade	SME	11.0	17.7	14.0	16.7	15.8	19.9	23.5	3.6	12.5	3.6
	LSE	16.8	14.0	10.8	17.1	17.2	20.7	24.3	3.6	7.5	6.7
All economic sectors	SME	13.4	14.5	10.8	12.8	12.6	15.4	16.3	0.9	2.9	2.1
	LSE	11.8	7.8	3.4	7.3	6.9	8.2	10.4	2.2	-1.4	2.3
Current situation	SME	20.9	25.1	22.8	24.8	23.7	27.0	27.0	0.0	6.1	1.7
	LSE	19.0	16.6	16.3	18.5	16.0	18.4	18.3	-0.1	-0.7	0.5
Expectations	SME	5.7	3.9	-1.0	1.0	1.6	3.9	5.7	1.8	0.0	2.4
	LSE	4.4	-1.0	-9.1	-3.8	-2.3	-2.0	2.4	4.4	-2.0	4.0
West Germany	SME	14.3	14.9	11.1	13.6	13.2	16.0	16.8	0.8	2.5	2.1
	LSE	12.0	7.6	3.2	7.3	7.1	8.3	10.6	2.3	-1.4	2.6
East Germany	SME	7.9	12.3	9.4	8.2	9.7	11.8	13.7	1.9	5.8	1.8
	LSE	8.5	14.0	11.0	5.5	2.0	5.0	5.8	0.8	-2.7	-5.9
Employment expectations	SME	7.9	9.9	8.4	8.2	7.4	8.4	10.3	1.9	2.4	-0.1
	LSE	10.6	6.7	5.8	6.9	7.7	10.6	11.8	1.2	1.2	3.6
Sales price expectations	SME	-1.0	-1.8	-4.4	-6.7	-5.7	-1.8	-1.9	-0.1	-0.9	1.2
	LSE	-3.1	-6.2	-9.2	-6.5	-4.7	-3.6	-1.2	2.4	1.9	4.1

Source: KfW, ifo

Explanations and abbreviations:

*Seasonally and mean adjusted (long-term mean since January 1991 = 0)

S(mall and) M(edium-sized) E(nterprises)

L(arge-) Scale E(nterprises)

Change in percentage points m(onth)-o(ver)-y(ear)

Change in percentage points y(ear)-o(ver)-y(ear)

Change in percentage points 3 m(onths period)-o(ver)-3 m(onths period)

Revisions relative to previous publications may occur due to seasonal and mean adjustments as well as rounding

Construction and interpretation of the KfW-ifo SME Barometer

The KfW-ifo SME Barometer indicator family is based on a scale-of-enterprise evaluation of the well-known ifo business climate index for which about 7,000 enterprises from trade and industry (manufacturing, construction, wholesale and retail trades) from western and eastern Germany are polled every month on current and future business, including around 5,600 SMEs. Enterprises are generally classed as small to medium-sized if they employ a workforce of not more than 500 and record an annual turnover not exceeding EUR 50 million. For a more accurate analysis, however, these quantitative limits have to be drawn more narrowly for retail trade (maximum annual turnover of EUR 12.5 million) and the construction industry (up to 200 employees). All enterprises that exceed at least one of these thresholds are classed as large-scale enterprises. The KfW-ifo SME Barometer reports the balance of current business assessments (percentage of positive answers less percentage of negative answers), the balance of business expectations for the next six months, ascertained in a similar way, and the inferred mean average value for the business climate. Moreover, the enterprises' employment and domestic sales price expectations are also expressed as balance figures. All time series are seasonally and mean adjusted. The zero line therefore marks the long-term 'cycle-neutral' average. Indicators above (or below) zero point to an above average or favourable (below average or negative) business situation.