

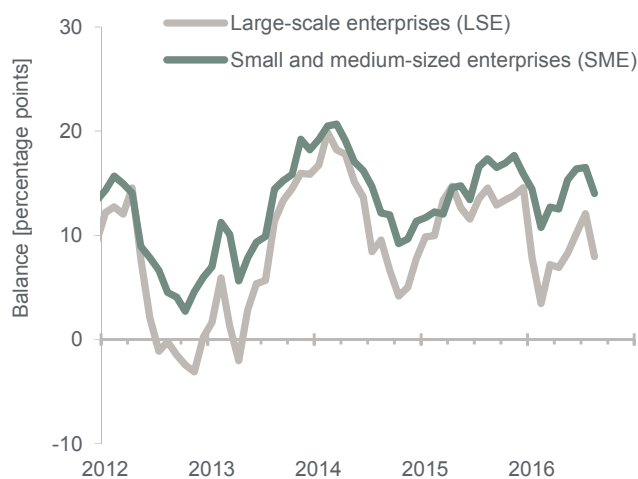
»» SMEs suddenly have the summer blues

8 September 2016

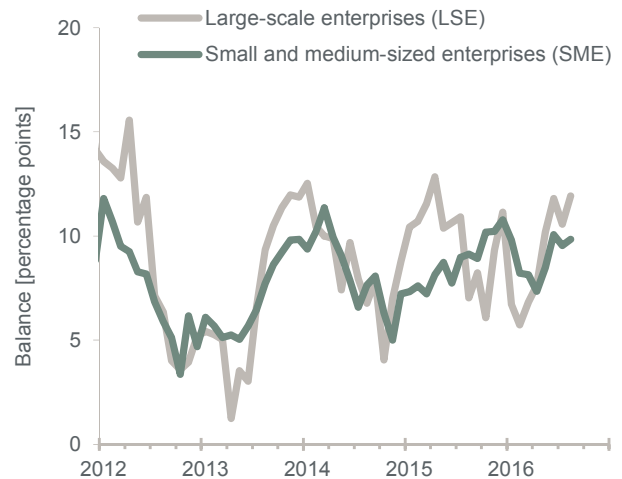
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- SME business sentiment drops as situation assessments clearly deteriorate
- Expectations: SMEs show more optimism, large enterprises more pessimism
- Employment plans in both enterprise size classes remain clearly expansive
- German economic outlook remains good – despite Brexit

KfW-ifo business climate



KfW-ifo employment expectations



Source: KfW, ifo

SME business sentiment has dropped significantly

In August small and medium-sized enterprises were suddenly hit with the summer blues, after neither the Brexit vote nor the failed coup attempt in Turkey were able to affect their mood the month before. SME business sentiment fell noticeably by 2.5 points to 14.0 balance points. It almost seemed as if SMEs did not start to register the new burdens on the economy until after a certain period of incubation. But this view is short-sighted because the drop in sentiment is exclusively due to their significantly less favourable view of current business:

- SMEs' assessments of their current business situation fell to 21.7 balance points – a massive drop of 5.6 points on the previous month that is too steep to be explainable only by events with long-term impacts such as the Brexit. Just two months after the vote, its specific consequences are still hardly measurable. Other major reasons could be the now resolved dispute between Volkswagen and two of its suppliers and the long period of volatile weather, which may have hampered the sale of summer goods. At

any rate, both retailers and manufacturers reported substantially poorer situation assessments in August.

- SMEs' business expectations, in contrast, improved slightly by 0.4 points in August and reached their highest level this year, at 6.1 balance points. Amid the increased uncertainties about external trade, this is a reassuring sign. It underscores that – given most small and medium-sized enterprises' strong focus on the national market – the German economy can continue to rely on domestic demand.

Large firms are clearly more pessimistic

The new external burdens, most of all the Brexit, however, have now made visible impacts on some of the other sub-indicators, especially on those of the large enterprises which regularly operate internationally. Not only did they lower their situation assessments to a similar degree as the SMEs in August (-5.9 points to 14.4 balance points). Very unlike the SMEs, they are also much less optimistic about the half-year ahead (-2.5 points to 1.3 balance points). Altogether, large

enterprises' business sentiment has thus dropped sharply by 4.1 points to 8.0 balance points. The relatively pronounced decline in sentiment in the two export-oriented sectors, manufacturing and wholesale, rounds off this diagnosis at sector level. This contrasts sharply with the trend in the construction sector as a classic domestic industry. Among small and medium-sized construction firms, the mood climbed to a new all-time high for the fourth consecutive month now (+0.4 points to 28.3 balance points), and the sentiment indicator for large construction firms is nearing that level, at 29.6 balance points, 2.6 points more than in July. There is no end in sight to this upbeat mood in the construction industry. In the first half of 2016 the number of residential building permits spiked by an enormous 30.4 % on the same period last year.

Recruitment plans signal optimism

Notwithstanding the noticeable cooling of the business climate, businesses' recruitment plans, which have consistently been expansive since the spring of 2010, signal unwavering optimism. In the SME sector they rose very moderately by 0.2 points to 9.8 balance points and in the large enterprise sector by a slightly stronger 1.3 points to 11.9 points, practically offsetting the previous month's declines. Employment plans remain on a good level, even in a long-term comparison. Companies' declared readiness to continue creating jobs is a strong signal that they generally

expect the positive economic trend to continue. On the jobs side, the prerequisites for continuing robust consumption momentum remain intact.

Downturn in sentiment will likely remain a one-off

Thus, all things considered, the chances that the gloomy mood caused by the situation assessments in August will remain a one-off are very good. We therefore do not see the findings of the KfW-ifo SME Barometer as a reason to move away from our generally optimistic economic forecast for 2016 and 2017. Employment, consumption and residential construction will likely continue to drive the German economy while the Brexit will probably reduce the momentum of exports and corporate investment noticeably at least in the second half of 2016.

Our current prediction is that the German economy will grow by 1.8 % this year. The 2016 annual growth rate will benefit from a very strong first half-year. Next year real growth will slow to 1.3 %, which seems like a stronger cyclical slowdown than it actually is, however. In fact, the decline in average growth in 2017 will be due for the most part to next year's significantly lower number of working days compared with 2016. In our forecast, the underlying economic momentum in both years is almost the same and, as in 2014 and 2015, slightly above Germany's potential rate of roughly one and a half per cent. ■

KfW Research

KfW-ifo SME Barometer: August 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
		Aug/15	Mrz/16	Apr/16	Mai/16	Jun/16	Jul/16	Aug/16			
Business climate											
Manufacturing	SME	14.3	8.3	7.3	10.1	10.7	10.8	8.3	-2.5	-6.0	1.4
	LSE	10.8	2.4	3.8	3.3	6.4	8.3	4.7	-3.6	-6.1	3.3
Construction	SME	20.4	21.0	22.8	26.7	26.8	27.9	28.3	0.4	7.9	4.2
	LSE	15.6	21.6	25.2	22.8	27.5	27.0	29.6	2.6	14.0	4.8
Retail trade	SME	28.9	20.5	19.8	24.0	23.2	22.5	21.0	-1.5	-7.9	0.8
	LSE	20.6	11.6	5.9	10.9	6.4	13.2	7.3	-5.9	-13.3	-0.5
Wholesale trade	SME	19.0	16.6	15.7	19.8	23.5	22.0	15.5	-6.5	-3.5	3.0
	LSE	21.2	17.1	17.0	20.4	23.4	19.9	16.9	-3.0	-4.3	1.9
All economic sectors	SME	17.4	12.7	12.5	15.3	16.4	16.5	14.0	-2.5	-3.4	2.1
	LSE	14.5	7.2	6.9	8.3	10.2	12.1	8.0	-4.1	-6.5	2.6
Current situation	SME	25.5	24.7	23.6	26.9	26.8	27.3	21.7	-5.6	-3.8	0.2
	LSE	25.1	18.4	16.0	18.3	18.1	20.3	14.4	-5.9	-10.7	0.0
Expectations	SME	9.1	0.9	1.6	3.9	6.0	5.7	6.1	0.4	-3.0	3.8
	LSE	4.0	-3.9	-2.2	-1.7	2.1	3.8	1.3	-2.5	-2.7	5.0
West Germany	SME	18.4	13.5	13.1	16.0	16.9	17.3	14.8	-2.5	-3.6	2.2
	LSE	14.6	7.3	7.1	8.4	10.4	12.5	8.5	-4.0	-6.1	2.8
East Germany	SME	11.1	8.2	9.6	11.8	13.5	11.5	9.1	-2.4	-2.0	1.5
	LSE	12.5	5.2	2.1	5.2	5.7	2.7	-4.3	-7.0	-16.8	-2.8
Employment expectations	SME	9.1	8.1	7.4	8.5	10.1	9.6	9.8	0.2	0.7	1.8
	LSE	7.0	6.8	7.6	10.2	11.8	10.6	11.9	1.3	4.9	3.2
Sales price expectations	SME	-1.2	-6.7	-5.8	-1.4	-1.5	-0.3	0.1	0.4	1.3	4.1
	LSE	-6.4	-6.5	-4.7	-3.5	-1.1	0.0	-4.4	-4.4	2.0	3.0

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.