

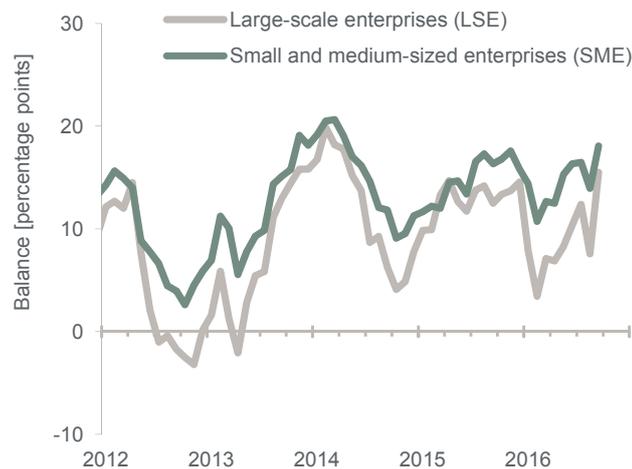
»» German SME business confidence brightened in sunny September

4 October 2016

Author: Dr Klaus Borger, phone +49 69 7431-2455, klaus.borger@kfw.de
Press contact: Christine Volk, phone: +49 69 7431-3867, christine.volk@kfw.de

- SME sentiment surged to highest level in two and a half years
- Situation assessments and expectations improved significantly
- Sentiment rose even more strongly among large enterprises
- German economy defies global pressures

KfW-ifo business climate



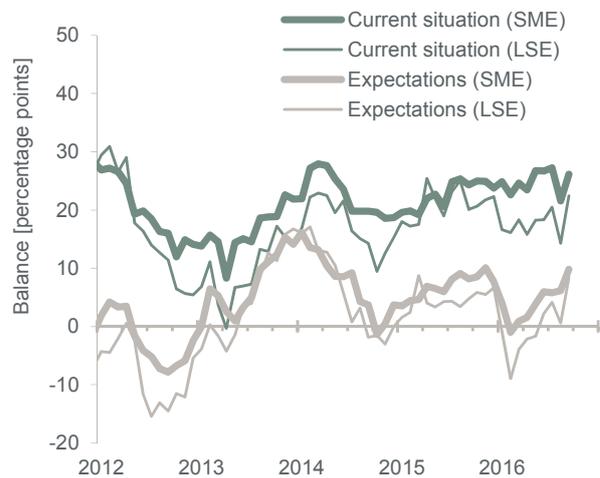
Source: KfW, ifo

SMEs have recovered from the slump

Small and medium-sized enterprises have quickly and convincingly regained the confidence they lost in the previous month. Their business climate improved by 4.2 points to 18.1 balance points in September. That is the strongest increase in a single month since August 2013. It also sends the indicator soaring to the highest level in more than two years. Both the noticeably more favourable assessment of ongoing business and the considerably more optimistic view of the future explain why the business climate shines literally as bright as the late summer sun.

- Assessments of SMEs' current business situation rose by 4.6 points, double the usual monthly variation, to 26.1 balance points. The strong increase on the previous month is a clear indication that one-off factors such as the dispute between VW and its suppliers and the volatile weather played a decisive part in the August slump. The dark clouds have drifted away and now open the view on Germany's continuing healthy economic performance.

KfW-ifo climate components



- Business expectations of small and medium-sized companies improved by a vigorous 3.7 points to 9.9 balance points in September, underscoring the recovery that cautiously began in the previous month.

The return to a significantly more positive assessment of the future underscores two things. First, SMEs – most of which focus on the domestic market – expect domestic demand to remain lively. Second, the higher expectations are probably due to the fact that, contrary to initial fears, the dampening effects of the Brexit vote will not become apparent immediately but rather in the medium and long term. The forecast horizon surveyed for business expectations is six months, so it currently extends until March 2017. It is still entirely unclear whether by that time the UK government will have clarified its intended future relationship with the EU and invoked exit Article 50. For the time being, all existing rules remain in force while the UK economy is even receiving a short-term stimulus from the devaluation of the pound sterling and the expansionary measures of monetary policy in response to the vote.

Sentiment rose even more strongly among large enterprises

Three months after the disappointing outcome of the Brexit referendum, businesses appear to have at least emerged from the immediate state of shock and are now viewing the consequences much less dramatically, especially in the shorter term, as evidenced by the responses from large enterprises in particular. These are usually integrated much more strongly into the international division of labour and therefore respond particularly sensitively to changes in the external environment. Not only did large enterprises rate their current business situation substantially more positively in September (+8.1 points to 22.4 balance points), they also corrected their expectations upwards very strongly (+7.8 points to 8.4 balance points). All in all, large enterprises' confidence rose even more strongly, by 7.9 points to 15.5 balance points, than among SMEs, where confidence already saw an exceptionally high increase.

Manufacturing stages a comeback while construction climbs to an all-time high

Heavily export-driven large manufacturers, however, reported the highest surge. Their business climate improved by an as yet unprecedented 10.5 points to 14.7 balance points on August. This indicator has not seen a higher or even similar rise since the beginning of the time series in January 1991. Small and medium-sized manufacturers, wholesalers and construction firms also reported very strong improvements in confidence levels, with construction indicators climbing to all-time highs in both enterprise size classes. Construction activity is and remains a very reliable mainstay of the economy. Sentiment among retailers, on the other hand, hardly moved at all in September and remains on a very high

level, particularly among SME retailers. On the labour market conditions for continuing robust consumption momentum remain good. The clearest evidence of this are companies' employment expectations. With their renewed rise in September they have now reached the highest level since early 2012 among both SMEs and large enterprises.

Germany is on track for solid growth

Germany remains on a path of solid economic growth. For us this is the most important message of the current KfW-ifo SME Barometer. According to our current prediction, the German economy will grow by an estimated 1.8% this year, and even a positive surprise can no longer be ruled out following the very broad and unusually strong improvement to the business climate in September

At the same time it should be kept in mind that, irrespective of the improved sentiment, the external environment in particular continues to harbour several possibly significant negative factors. Even if the immediate dampening effects of the Brexit are likely to remain limited, they are merely postponed, not eliminated. The fundamental uncertainties over the EU's future relationship with the UK will persist for some time to come and resurface when the exit negotiations have begun. That is likely to dampen corporate investment in the UK, but also in Germany, not least because capital goods are German manufacturers' top export items. Further considerable political uncertainties are already emerging this autumn, including the presidential elections in the USA and Austria, possible new elections in Spain and the constitutional referendum in Italy. By contrast, employment, consumption and residential construction will probably continue to reliably sustain the German economy. ■

KfW Research

KfW-ifo SME Barometer: September 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 | |
|---------------------------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|------------|
| | | Sep/15 | Apr/16 | Mai/16 | Jun/16 | Jul/16 | Aug/16 | | | | Sep/16 |
| Business climate | | | | | | | | | | | |
| Manufacturing | SME | 12.2 | 7.2 | 10.0 | 10.7 | 10.8 | 8.3 | 12.5 | 4.2 | 0.3 | 1.2 |
| | LSE | 9.0 | 3.7 | 3.3 | 6.6 | 8.9 | 4.2 | 14.7 | 10.5 | 5.7 | 4.7 |
| Construction | SME | 22.6 | 22.7 | 26.6 | 26.9 | 27.8 | 28.3 | 30.4 | 2.1 | 7.8 | 3.4 |
| | LSE | 18.3 | 25.2 | 22.7 | 27.4 | 26.6 | 29.3 | 33.3 | 4.0 | 15.0 | 4.6 |
| Retail trade | SME | 28.6 | 19.8 | 23.9 | 23.2 | 22.5 | 20.7 | 23.3 | 2.6 | -5.3 | -0.1 |
| | LSE | 14.9 | 5.8 | 10.8 | 6.4 | 13.0 | 7.3 | 6.5 | -0.8 | -8.4 | 1.3 |
| Wholesale trade | SME | 18.3 | 15.6 | 19.7 | 23.4 | 22.1 | 15.0 | 24.1 | 9.1 | 5.8 | 0.8 |
| | LSE | 21.4 | 17.0 | 20.4 | 23.4 | 19.8 | 16.4 | 20.4 | 4.0 | -1.0 | -1.4 |
| All economic sectors | SME | 16.3 | 12.5 | 15.3 | 16.3 | 16.5 | 13.9 | 18.1 | 4.2 | 1.8 | 1.5 |
| | LSE | 12.5 | 6.9 | 8.3 | 10.3 | 12.4 | 7.6 | 15.5 | 7.9 | 3.0 | 3.3 |
| Current situation | SME | 24.3 | 23.5 | 26.8 | 26.7 | 27.2 | 21.5 | 26.1 | 4.6 | 1.8 | -0.7 |
| | LSE | 20.1 | 15.8 | 18.3 | 18.3 | 20.5 | 14.3 | 22.4 | 8.1 | 2.3 | 1.6 |
| Expectations | SME | 8.2 | 1.6 | 3.9 | 6.0 | 5.8 | 6.2 | 9.9 | 3.7 | 1.7 | 3.5 |
| | LSE | 4.7 | -2.1 | -1.6 | 2.2 | 4.2 | 0.6 | 8.4 | 7.8 | 3.7 | 4.9 |
| West Germany | SME | 17.0 | 13.0 | 15.9 | 16.8 | 17.3 | 14.7 | 18.8 | 4.1 | 1.8 | 1.7 |
| | LSE | 12.5 | 7.1 | 8.4 | 10.5 | 12.8 | 8.1 | 15.9 | 7.8 | 3.4 | 3.6 |
| East Germany | SME | 12.7 | 9.6 | 11.8 | 13.6 | 11.5 | 9.2 | 13.5 | 4.3 | 0.8 | -0.3 |
| | LSE | 12.4 | 2.1 | 5.2 | 5.8 | 2.8 | -4.4 | 5.3 | 9.7 | -7.1 | -3.2 |
| Employment expectations | SME | 8.3 | 7.3 | 8.5 | 10.1 | 9.6 | 10.0 | 11.6 | 1.6 | 3.3 | 1.8 |
| | LSE | 8.1 | 7.6 | 10.1 | 11.7 | 10.5 | 11.8 | 12.8 | 1.0 | 4.7 | 1.9 |
| Sales price expectations | SME | -2.5 | -5.8 | -1.4 | -1.5 | -0.3 | 0.0 | 0.5 | 0.5 | 3.0 | 3.0 |
| | LSE | -7.2 | -4.6 | -3.6 | -1.3 | 0.0 | -4.4 | -1.9 | 2.5 | 5.3 | 1.1 |

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.