

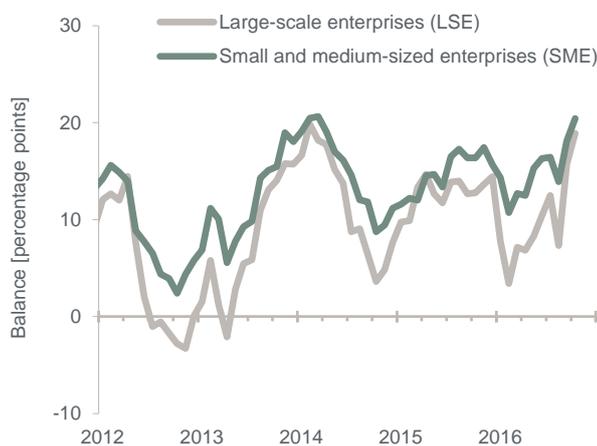
»» Confidence of German SMEs is increasing in leaps and bounds – despite global risks

3 November 2016

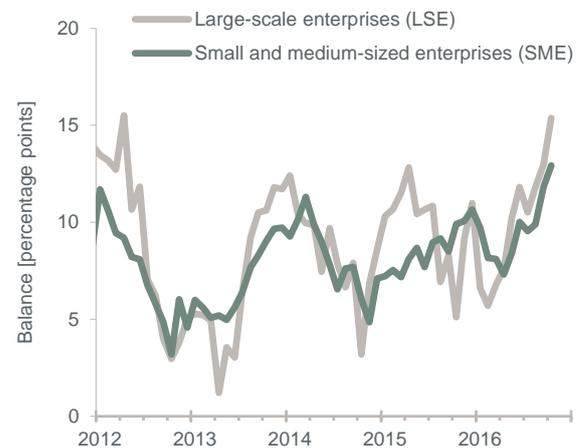
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- Growing optimism is boosting German SME's business confidence
- Large enterprises, especially manufacturers, are also more upbeat
- Employment expectations in both business size classes reach multi-year highs
- Widespread positive price expectations for the first time in almost three years

KfW-ifo business climate



KfW-ifo employment expectations



Source: KfW, ifo

Not a trace of autumn doldrums

The German economy does not even show a shadow of a trace of autumn melancholy at the start of the final quarter of 2016. In fact, the KfW-ifo SME Barometer has a whole series of impressively good news in store, including the main indicator of the barometer, the SME business climate. After the unusually strong increase in the previous month, it rose again strongly by 2.3 points to 20.4 balance points in October – primarily because of the renewed noticeable improvement in SMEs' business outlook:

- SMEs' business expectations increased by an unusually strong 3.7 points to 13.7 balance points, the highest level since early 2014.
- At the same time, small and medium-sized enterprises remained extremely satisfied with their ongoing business operations. In October they rated their current business situation at a very high 26.9 balance points, 0.9 points more than in September.

The good mood is no coincidence. Businesses can continue to rely on healthy German domestic demand, which is primarily sustained by persistent job growth, consumption and residential construction activity. At the same time, the immediate Brexit shock appears to have been digested while the global economy is finally sending out some positive signals again. After four successive monthly declines, German exports rebounded again in August with a solid rise of 3.4%, export orders probably grew noticeably in the third quarter, and the industrial firms surveyed by the Ifo Institute had more optimistic export expectations in October than they had in almost three years.

Differences between size classes are levelling out

The signs of global economic recovery are also spreading optimism among large enterprises. Their business confidence grew even more strongly than among SMEs, by 3.2 points to 18.9 balance points, with the expectation component making up the lion's share here as well. Thus, the previously striking gap in sentiment between the business size classes almost closed within just two months.

Industrial business climate improving fast

The increasingly positive sentiment is broad-based across industries. The highest increase in business confidence was reported by large manufacturing export heavyweights, which respond particularly sensitively to global cyclical variations. Their business climate improved in October by 3.8 points to 18.9 balance points after a record increase already in September – unprecedented in this time series that stretches back to early 1991. Manufacturing SMEs also reported a strong increase in confidence of 3.2 points to 15.8 balance points. The broad and rapid sentiment improvement in industry is particularly good news as manufacturing traditionally sets the pace of the German economy. Sentiment in the retail and wholesale sectors as well as construction also remained good. Small and medium-sized construction firms, for which residential construction is the most important activity, even achieved their sixth consecutive new all-time high in October, their confidence rising by another 2.2 points to 32.6 balance points. The cyclical outlook for residential construction remains excellent.

Employment expectations are at a multi-year high

But it is not only the general expectations and situation assessments of October that are encouraging. Enterprises' specific expectations about sales prices and employment are also developing very positively. On balance, the number of large enterprises planning to create jobs is back to the level of April 2012 (+2.4 points to 15.4 balance points), while the employment indicator among SMEs (+1.1 points to 12.9 balance points) is on a level that has not been higher since July 2011. This demonstrates their trust in the way the economy is developing, given that a steady, positive sales outlook is an important prerequisite for businesses' willingness to hire workers.

Prices are normalising

Another factor that should sustain the growth in employment is that enterprises are increasingly confident of achieving higher sales prices again. For the first time in nearly three years, both SMEs (+2.2 points to 2.9 balance points) and large enterprises (+3.2 points to 1.6 balance points) anticipate rising prices at the same time. This is good for profit expectations and investment.

Upward risks to forecasts are on the rise

The economic outlook for Germany is positive. After the recent broad improvement in sentiment documented in the KfW-ifo SME Barometer, we see clear upward risks to our current economic forecast for the year 2016 (+1.8%). A positive surprise can now no longer be ruled out for 2017 either; we currently expect economic growth of 1.3% in the coming year. Particularly with a view to 2017, however, a degree of caution is appropriate because the potential for disappointments from possible disruptions is quite high since enterprises have now reached a high level of expectations as well. One predictable source of disruption is still the Brexit, which the UK government currently plans to initiate in March 2017. The fundamental uncertainties over the future relationship between the EU and the UK can then be expected to resurface more forcefully, particularly if the exit negotiations should run into controversy and delays. The inner-European squabbles over CETA which have just been laboriously overcome could be a foretaste of what may come. Particularly the willingness of enterprises to invest and hire staff in the UK itself would be reduced considerably. Such uncertainties would also put a damper on German economic growth, however, as the United Kingdom is Germany's third most important export market. We plan to present our revised economic forecast at the end of November. ■

KfW Research

KfW-ifo SME Barometer: October 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	
		Okt/15	Mai/16	Jun/16	Jul/16	Aug/16	Sep/16				Okt/16
Business climate											
Manufacturing	SME	12.2	10.0	10.7	10.8	8.3	12.6	15.8	3.2	3.6	1.7
	LSE	9.7	3.2	6.7	9.1	3.8	15.1	18.9	3.8	9.2	6.3
Construction	SME	22.2	26.6	26.7	27.8	28.3	30.4	32.6	2.2	10.4	3.4
	LSE	19.1	22.5	27.2	26.6	29.3	33.4	31.2	-2.2	12.1	5.9
Retail trade	SME	30.5	23.9	23.1	22.4	20.8	23.2	23.6	0.4	-6.9	-0.6
	LSE	13.3	10.9	6.4	13.2	7.3	6.5	7.5	1.0	-5.8	-3.1
Wholesale trade	SME	20.6	19.7	23.3	21.8	15.0	23.5	20.6	-2.9	0.0	-1.9
	LSE	20.7	20.3	23.4	19.8	16.6	20.3	23.6	3.3	2.9	-1.0
All economic sectors	SME	16.4	15.3	16.3	16.4	13.9	18.1	20.4	2.3	4.0	1.5
	LSE	12.8	8.3	10.4	12.5	7.3	15.7	18.9	3.2	6.1	3.6
Current situation	SME	24.8	26.7	26.7	27.1	21.4	26.0	26.9	0.9	2.1	-2.0
	LSE	20.1	18.2	18.3	20.5	14.0	22.7	24.6	1.9	4.5	1.4
Expectations	SME	7.9	3.9	6.0	5.8	6.2	10.0	13.7	3.7	5.8	4.8
	LSE	5.3	-1.6	2.3	4.4	0.4	8.5	12.9	4.4	7.6	5.6
West Germany	SME	17.2	15.9	16.8	17.3	14.7	18.8	21.2	2.4	4.0	1.6
	LSE	13.0	8.4	10.6	12.9	7.8	16.1	19.5	3.4	6.5	3.9
East Germany	SME	11.5	11.8	13.6	11.4	9.0	13.8	16.1	2.3	4.6	0.7
	LSE	8.2	5.4	6.0	2.9	-4.8	5.7	4.1	-1.6	-4.1	-3.1
Employment expectations	SME	9.9	8.4	10.0	9.6	9.9	11.8	12.9	1.1	3.0	2.2
	LSE	5.1	10.2	11.8	10.5	11.8	13.0	15.4	2.4	10.3	2.5
Sales price expectations	SME	-0.9	-1.5	-1.5	-0.3	-0.1	0.7	2.9	2.2	3.8	2.2
	LSE	-7.1	-3.6	-1.3	0.0	-4.4	-1.6	1.6	3.2	8.7	0.1

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.