SME business confidence is up in December – and across the entire year 2016

The German economy is in good shape
The year is coming to a close and indicators once again confirm the good shape of Germany’s economy. The Brexit vote in June, the US election in November, the failure of Italy’s constitutional referendum and the resignation of its prime minister in December, the increasingly difficult situation in Turkey and the Middle East – none of these many and often unexpected events which 2016 held in store were able to inflict any lasting damage on the improved business climate among Germany’s SMEs. The good sentiment in December fits into this picture.

- The SME business climate followed the positive trend of the year, rising to 20.0 balance points, up 1.2 points on the previous month. The indicator has thus gained nearly ten points since the low of February.
- The main factors that drove the improvement in sentiment were SMEs’ assessments of their business situation. They rose 2.5 points to 29.0 balance points. That was the best situation assessment in five years.
- SMEs’ expectations of future business, on the other hand, just barely held steady on the previous month’s level (dropping 0.2 points to 10.8 balance points). But it must also be kept in mind that it is becoming increasingly harder to achieve further improvements using the current business situation as a benchmark because it is already being considered outstanding. The expectation indicator, which continues to be well above average, is evidence of SMEs’ positive outlook on 2017.

Large enterprises are banking on the global economy
Large enterprises are even more optimistic. They corrected their expectations upward by 1.5 points to 11.0 balance points. Internationally oriented large enterprises appear to be expecting the global economy to recover somewhat in 2017 despite challenging conditions. Since important emerging economies such as Russia and Brazil will probably come out of recession, that is definitely realistic. Situation assessments were on a similarly positive level as those of SMEs, rising 2.8 points to 28.3 balance points, so that business confidence among large enterprises improved by 2.1 points to 19.7 points in December. That was the highest level since July 2011.

Note: This paper contains the opinion of the author and does not necessarily represent the position of KfW.
Industry has cast aside concerns
The sub-indicators for the main business sectors and enterprise size classes reveal persistently strong domestic momentum that has been bolstered in the past months by noticeably higher hopes of a recovering global economy. Like no other sector surveyed by the KfW-ifo SME Barometer, large-scale industry is a seismograph of the state of global markets. Its business climate improved by a very strong 4.8 points to 20.5 balance points in December, presumably with tailwind from the most recent euro depreciation and expectations of a very expansive fiscal policy in the USA. As recently as in February, the business climate of large manufacturers was in negative territory. At the end of the year, wholesale also reported an improvement to what was already a high confidence level in the preceding months.

Construction is chasing records
The euphoria in the construction sector appears to know no bounds. The sentiment indicators in both enterprise size classes of the construction sector closed the year 2016 on new all-time highs. For large construction firms it is the third and for SME construction companies the seventh new high this year. The demand and need for residential housing combined with higher public investment in infrastructure ensure that construction activity is and remains a reliable pillar of Germany’s domestic economy.

Sentiment among retailers is divided
The only drop of bitterness was the relatively noticeable cooling of retail sentiment in December, but only among large retailers. As this sub-indicator is typically very volatile, a decrease over a single month should not be overrated. Among small and medium-sized retailers, on the other hand, sentiment continued to brighten, closing the year 2016 on an annual high. Consumption will remain on a path of solid expansion in 2017, although the increases should flatten out. The main reason for this is that higher inflation will cause real wages to rise at a lower rate than in 2016. At the same time, employment will continue to grow. These two trends – stronger price increases and continuing employment growth – are revealed not least by the specific indicators of the KfW-ifo SME Barometer: employment expectations as well as sales price expectations clearly started trending upward in the second half of 2016.

Upswing will continue in 2017
German businesses are broadly optimistic about the year ahead. The previously conspicuous gap in sentiment between SMEs and large enterprises has now closed. This is due to the persistently sound domestic demand combined with hopes of an at least moderate recovery of export markets. Nevertheless, it is important to keep an eye on the considerable political risks. What kind of trade policy the US will actually adopt next year remains unclear. Elections are scheduled in the Netherlands, France and Germany, and possibly in Italy, too. Finally, tough Brexit negotiations will probably begin from spring onwards. Against the backdrop of significantly fewer work days, we expect overall economic growth of 1.3% in 2017. Germany’s upswing will enter its fourth year in a difficult environment.
### Attachment: SME business climate in figures

#### KfW-ifo SME Barometer

**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

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#### 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.