

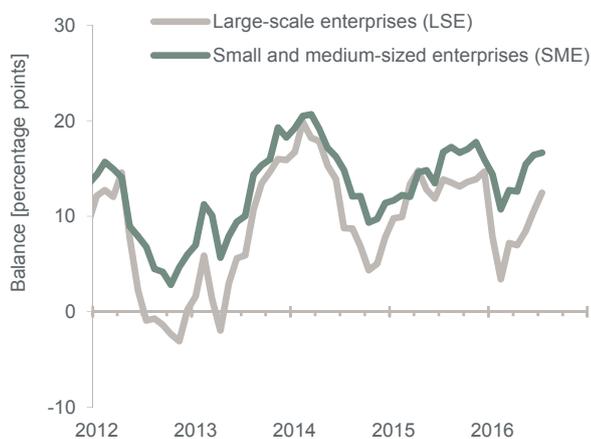
## »» SMEs react fairly calmly to Brexit shock

2 August 2016

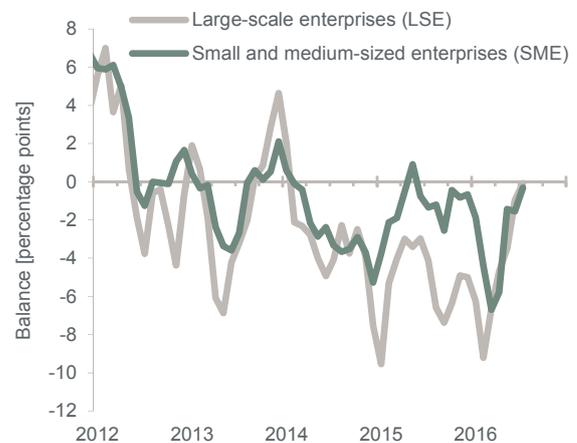
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- Slight improvement in business climate for small and medium-sized enterprises
- Assessments more positive, expectations virtually steady
- Sales price expectations returning to normal
- German economic growth reasonable thanks to construction and consumption

### KfW-ifo business climate



### KfW-ifo sales price expectations



Source: KfW, ifo

### SME business climate improving moderately

Fears of an immediate and severe collapse in sentiment as a result of the Brexit vote appear unfounded, at least outside the United Kingdom. The business climate of small and medium-sized enterprises, the key indicator of the KfW-ifo SME Barometer, has increased by a moderate 0.3 points and, at 16.7 balance points, is in July at its highest level since last November. This indicates that German SMEs are reacting quite calmly to the Brexit shock, at least for now. Furthermore, neither the attempted Turkish coup and its aftermath nor the renewed terrorism in Europe appear to have had much impact. The improving climate is predominantly due to the somewhat more favourable assessments of the current business situation:

- At 27.6 balance points – 0.6 points higher than in June – small and medium-sized enterprises have a more positive assessment of their current operations in July than at any time since April 2014. This supports the view that the economy will continue its very solid upwards trend as the third quarter begins.
- At the same time, SME business expectations appear almost stable (-0.1 points to 5.7 balance points). In view of the significant rise in uncertainty since the Brexit referendum, this is a reassuring and somewhat unexpected signal. It remains to be seen, however, whether companies will maintain this rather relaxed view of the future in coming months, once the current fog of uncertainty begins to lift. Trends in export-sensitive economic sectors, industry and wholesale, will be particularly instructive in this regard.

### First signs of slowdown in export-sensitive sectors

The first signs of slowdown are already apparent in July in both of these economic sectors. Sentiment among industrial SMEs is virtually static (+0.1 points to 10.9 balance points), and manufacturing continues to lag behind in last place in the climate table. Sentiment in the wholesale sector, which plays an intermediary role between the domestic and international markets, continues to be quite positive, although cracks are beginning to appear. The SME wholesale climate weakened by 1.2 points to 22.4 balance points in July. Small and medium-sized retail enterprises displayed a similar trend (-0.5 points, 22.9 balance points). This should be treated with caution, though, given the good prospects for continued solid consumption dynamics, primarily driven by employment. This is underscored not least by employment expectations of the companies surveyed for the KfW-ifo SME Barometer, which have been continuously positive since spring of 2010.

### Sentiment in construction at all-time high

The uncontested frontrunners in terms of sentiment are currently construction SMEs, whose climate indicator rose 1.3 points in July and reached a new all-time high of 27.9 balance points. In particular, housing construction, which is especially important for small and medium-sized construction companies, may remain a key pillar of the German economy for some time to come, not only because of interest rates remaining low, but also because the number of new homes completed (220,197 in 2015) is still significantly lower than forecasted demand (350,000 to 400,000 per year).

### Sales price expectations back to normal

On the other hand, business investment, which began the year strongly, has become the wild card among GDP components since Brexit. Worsening economic prospects in Europe and a lengthy period of uncertainty regarding its future

relationship with the United Kingdom, Germany's third most important export market, could make companies reluctant to invest. This makes the noticeable relaxation for sales prospects, at least on the price side, all the more welcome. SME sales price expectations (+1.3 points to -0.3 balance points) are almost back to their long-term average (indicated by the zero line) for the first time since the start of 2014.

### German economy expanding at potential rate

All in all, the latest results of the KfW-ifo SME Barometer seem to agree with our economic forecast for 2016 and 2017, which we recently revised slightly downwards (see our Brexit update for the KfW Business Cycle Compass for Germany and Europe of 11 July). While we continue to expect solid growth in employment, consumption and housing construction, exports and business investment is expected to be less dynamic compared with the previous forecast under the new conditions arising from Brexit. The upside and downside risks of our current forecast may roughly balance out in view of the mild reaction of sentiment indicators in July.

In concrete numbers, we expect growth of the German economy to be 1.5% for 2016 and 1.2% for 2017. However, the reduction in GDP growth forecast for 2017 is solely attributable to the markedly lower number of working days in the coming year compared with 2016, while the current year is benefiting from a slight increase in working days compared with 2015. When adjusted for working day effects, all three years from 2015 to 2017 have a stable "underlying" real growth rate of 1.4%. In other words, the underlying economic trend roughly equates to the German potential rate, i.e. the GDP growth rate that can be produced by the economy without strain in the long term and with no sharp fluctuations in production capacity utilisation rates. While the economic outlook is rather unspectacular, it is still quite good given the conditions – thanks to domestic demand. ■

# KfW Research

## KfW-ifo SME Barometer: July 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
		Jul/15	Feb/16	Mrz/16	Apr/16	Mai/16	Jun/16	Jul/16			
<b>Business climate</b>											
Manufacturing	SME	14.3	5.1	8.3	7.3	10.1	10.8	10.9	0.1	-3.4	3.7
	LSE	12.1	-1.6	2.4	3.8	3.3	6.6	8.8	2.2	-3.3	4.7
Construction	SME	19.4	21.9	21.0	22.9	26.8	26.6	27.9	1.3	8.5	5.2
	LSE	14.8	26.8	21.7	25.3	22.9	27.6	27.1	-0.5	12.3	1.3
Retail trade	SME	24.5	18.6	20.5	19.8	24.1	23.4	22.9	-0.5	-1.6	3.9
	LSE	11.1	8.6	11.6	5.9	11.0	6.9	13.1	6.2	2.0	1.7
Wholesale trade	SME	19.6	13.9	16.6	15.7	19.9	23.6	22.4	-1.2	2.8	6.6
	LSE	21.8	10.8	17.0	17.1	20.6	23.9	20.6	-3.3	-1.2	6.7
<b>All economic sectors</b>	<b>SME</b>	<b>16.7</b>	<b>10.7</b>	<b>12.7</b>	<b>12.6</b>	<b>15.4</b>	<b>16.4</b>	<b>16.7</b>	<b>0.3</b>	<b>0.0</b>	<b>4.2</b>
	<b>LSE</b>	<b>13.8</b>	<b>3.4</b>	<b>7.2</b>	<b>7.0</b>	<b>8.5</b>	<b>10.5</b>	<b>12.5</b>	<b>2.0</b>	<b>-1.3</b>	<b>4.6</b>
Current situation	SME	25.2	22.7	24.7	23.6	27.0	27.0	27.6	0.6	2.4	3.5
	LSE	23.2	16.2	18.4	16.0	18.5	18.6	20.5	1.9	-2.7	2.3
Expectations	SME	8.1	-1.1	0.9	1.6	3.9	5.8	5.7	-0.1	-2.4	4.7
	LSE	4.4	-9.0	-3.8	-2.1	-1.5	2.3	4.2	1.9	-0.2	6.7
West Germany	SME	17.8	11.0	13.5	13.1	16.0	16.9	17.5	0.6	-0.3	4.3
	LSE	14.1	3.2	7.3	7.2	8.6	10.7	12.8	2.1	-1.3	4.8
East Germany	SME	9.8	9.3	8.2	9.7	11.8	13.7	11.5	-2.2	1.7	3.3
	LSE	7.9	10.4	5.3	2.1	5.2	6.1	3.2	-2.9	-4.7	-1.1
<b>Employment expectations</b>	SME	9.0	8.3	8.2	7.4	8.5	10.2	9.6	-0.6	0.6	1.5
	LSE	11.1	5.7	6.8	7.7	10.2	11.9	10.7	-1.2	-0.4	4.2
<b>Sales price expectations</b>	SME	-1.3	-4.4	-6.7	-5.8	-1.4	-1.6	-0.3	1.3	1.0	4.5
	LSE	-4.1	-9.2	-6.6	-4.7	-3.5	-1.0	-0.1	0.9	4.0	5.3

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.