

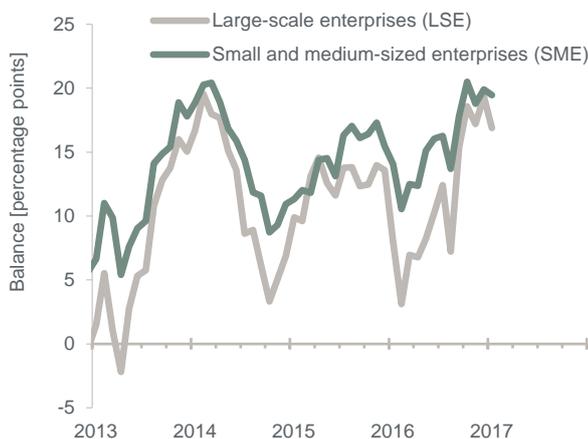
## »» Worry lines have grown deeper since the start of the year

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- Growing scepticism is pushing SME business confidence slightly into negative territory
- Sharp drop in sentiment among large enterprises driven by lower expectations
- Construction industry has stopped chasing records for now, retail sentiment is down as well
- Medium-term risks to Germany's upswing are growing

### KfW-ifo business climate



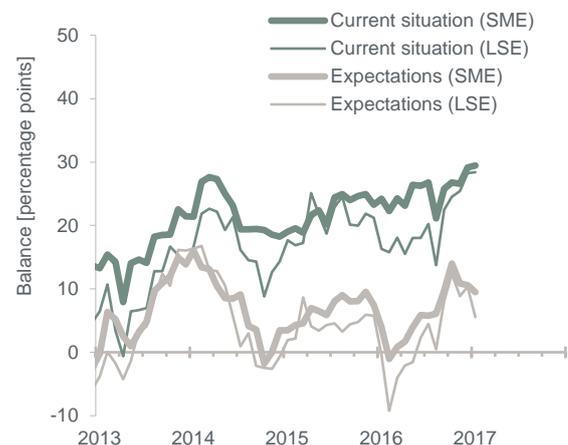
Source: KfW, ifo

### A botched start to the year

Fears of rising protectionism in the global economy brought down confidence among Germany's globally interconnected businesses at the start of the year. The hard Brexit being pursued by the UK government and the new isolationist US policies, the outlines of which are only beginning to emerge, are leaving a distinct imprint on the internationally focused sectors in particular. Unlike in large enterprises, however, SME business confidence has dropped only minimally.

- In January the SME business climate dropped by 0.4 points on the previous month to 19.5 balance points. It thus remains on a high level in a long-term comparison.
- Lower business expectations are the sole driver of the downturn in sentiment. They dropped by 1.1 points to 9.5 balance points. In light of the risks, the increasing scepticism is understandable.

### KfW-ifo climate components



- SMEs, on the other hand, rate their current business situation slightly better than in December (+0.3 points to 29.4 balance points). The continuing outstanding situation assessments – the best in more than five years – indicate that growth will remain strong for the time being at least.

### Large enterprises are less confident

In large enterprises, on the other hand, a higher degree of uncertainty is palpable at the start of the year. They continue to be extremely satisfied with their current business situation (+0.2 points to 28.4 balance points). At the same time however, they have corrected their expectations downward considerably (-4.7 points to 5.6 balance points). As a result, their business climate indicator (-2.4 points to 16.9 balance points) fell noticeably behind that of SMEs. Industrial firms are the main drivers behind the deteriorating confidence level among large enterprises (-3.2 points to 16.9 balance points), but so are wholesalers (-1.9 points to 21.4 balance points)

– precisely those sectors that play a prominent role for international business. In the large construction and retail companies, on the other hand, sentiment hovers just above the December level. For us this is a clear indication that the growing fear of new trade barriers is the main cause for the downturn in business confidence.

### **Confidence outside export industries is also lower**

But the gloom has spread beyond the export industries. SMEs in the construction sector, for which residential construction is the main business area, reported a significant drop in confidence (-1.6 points to 31.2 balance points). It bears remembering, however, that the level of confidence among SME construction firms was literally smashing records in 2016 and closed the month of December on its seventh new all-time high in eight months. We are therefore not worried about the latest consolidation, especially since the need for additional homes will remain high for some time to come. This is reflected not least in the 17-year high in building permits (340,000 from January to November 2016; up 23.0% year-on-year). One reason for the recent slump in confidence among construction firms might be the onset of a moderate rise in interest rates, which will make the financing of construction projects slightly more expensive.

### **Sentiment among SME retailers is down significantly**

The business climate in the SME retail sector actually fell by a considerable margin (-6.7 points to 18.4 balance points) after climbing to a 13-month high in December. Given the pronounced volatility of this sub-indicator, the drop should not be dramatised. Nevertheless, the decline in retail confidence on what remains a high level is definitely plausible. After what has been very strong consumer spending growth by German standards in the past two years (by a price-adjusted 2% annually), signs are pointing to continuing healthy but not quite as vigorous growth rates for 2017.

A major reason for this is the slower increase in real wages resulting from the recovery of inflation – a welcome development from the aspect of monetary policy. The growth in employment is also likely to flatten out, presumably also in response to the numerous political imponderables at global level and the resulting tendency of firms to hold back on investment decisions. Not least, the specific expectation indicators of the KfW-ifo SME Barometer also point to rising sales prices and slightly less expansionary hiring plans.

### **A positive exception: SME manufacturers**

The business climate among small and medium-sized manufacturing enterprises at least can buck the general trend (+1.4 points to 15.8 balance points). That in itself is pleasing, but we are sceptical that this trend will be sustainable under the circumstances. This is also because it is merely the improved situation assessments that sustained the improved business climate among SME manufacturers in January. Businesses' expectations, in turn, remained on a level that is already low in comparison with the other economic sectors. Small and medium-sized industries, as an important component of Germany's export industry, are apparently eyeing the global economic developments with due caution.

### **Mixed signals for the future**

The KfW-ifo SME Barometer is sending out mixed signals at the start of the year. The decline in January in itself does not fundamentally question the upward trend that emerged in the course of 2016; a single monthly decline is not sufficient. Besides, the assessments of the current business situation do not reveal any weakness yet. Germany's recovery is therefore not under threat in the short term. Accordingly, first-quarter growth in 2017 might once again achieve roughly the high level of the final quarter of 2016. We currently forecast growth rates of around half a per cent for both quarters. What will happen to the economy after that is becoming increasingly unclear, however. At any rate, we note with concern the falling expectations of firms, particularly in the export industries. It is true that Germany's reliable domestic economy with its strong labour market, consumer spending, residential construction and, lately, expanding public investment, offers good prospects that the national growth rates will remain above the zero line. However, we do see increasing question marks hanging over the continuation of the stable and very solid upswing of the past three years at a time of US isolationism, Brexit, important elections in core Europe and ongoing geopolitical risks in the Middle East. Obviously, Germany and the partner countries in Europe have it in their hands to respond to the challenges with a determined and joint approach that strengthens their economies. ■

# KfW Research

## KfW-ifo SME Barometer: January 2017

### Attachment: SME business climate in figures

KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jan/16	Aug/16	Sep/16	Okt/16	Nov/16	Dez/16	Jan/17			
<b>Business climate</b>											
Manufacturing	SME	9.8	8.1	12.3	15.9	13.7	14.4	15.8	1.4	6.0	2.5
	LSE	6.0	3.6	14.8	18.4	15.3	20.1	16.9	-3.2	10.9	5.2
Construction	SME	23.2	28.0	30.2	32.3	31.9	32.8	31.2	-1.6	8.0	1.8
	LSE	18.9	29.0	33.2	31.2	37.4	39.1	38.7	-0.4	19.8	7.2
Retail trade	SME	25.5	20.6	23.0	23.5	23.5	25.1	18.4	-6.7	-7.1	0.0
	LSE	5.6	7.0	6.4	7.8	14.9	5.9	5.3	-0.6	-0.3	1.6
Wholesale trade	SME	17.1	14.9	23.2	20.3	20.7	23.8	23.9	0.1	6.8	3.3
	LSE	14.5	16.5	19.8	23.5	21.4	23.3	21.4	-1.9	6.9	2.1
<b>All economic sectors</b>	<b>SME</b>	<b>14.1</b>	<b>13.7</b>	<b>17.8</b>	<b>20.5</b>	<b>18.8</b>	<b>19.9</b>	<b>19.5</b>	<b>-0.4</b>	<b>5.4</b>	<b>2.0</b>
	<b>LSE</b>	<b>8.0</b>	<b>7.2</b>	<b>15.4</b>	<b>18.6</b>	<b>17.2</b>	<b>19.3</b>	<b>16.9</b>	<b>-2.4</b>	<b>8.9</b>	<b>4.1</b>
Current situation	SME	24.2	21.1	25.8	26.8	26.6	29.1	29.4	0.3	5.2	3.8
	LSE	16.3	13.7	22.5	24.5	25.4	28.2	28.4	0.2	12.1	7.1
Expectations	SME	3.9	6.1	9.7	14.0	10.8	10.6	9.5	-1.1	5.6	0.4
	LSE	-0.4	0.5	8.1	12.4	8.9	10.3	5.6	-4.7	6.0	1.3
West Germany	SME	14.5	14.5	18.5	21.2	19.3	20.4	20.0	-0.4	5.5	1.8
	LSE	7.8	7.7	15.8	19.2	17.7	19.7	17.2	-2.5	9.4	4.0
East Germany	SME	11.6	8.9	13.8	16.1	15.9	17.0	16.4	-0.6	4.8	3.5
	LSE	13.6	-3.9	5.8	4.1	5.1	9.3	9.5	0.2	-4.1	5.9
<b>Employment expectations</b>	SME	9.6	9.8	11.7	12.8	12.2	13.5	12.4	-1.1	2.8	1.3
	LSE	6.4	11.5	12.8	15.3	14.7	18.1	16.9	-1.2	10.5	3.4
<b>Sales price expectations</b>	SME	-2.2	0.0	0.5	3.0	4.4	5.2	7.0	1.8	9.2	4.3
	LSE	-6.4	-4.4	-1.6	1.8	0.3	1.9	5.6	3.7	12.0	4.0

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.