

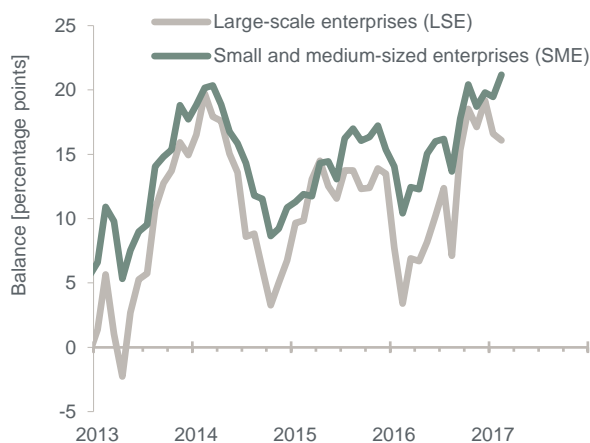
»» Germany in high spirits thanks to SMEs

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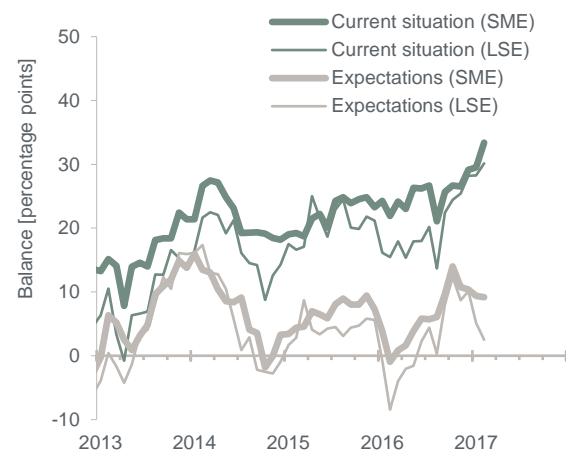
- SME business sentiment rises thanks to vastly improved expectations
- Large-scale enterprises continue to languish with more pessimistic expectations
- Employment and price expectations are on the up
- Vigorous real first-quarter growth

KfW-ifo business climate



Source: KfW, ifo

KfW-ifo climate components



SMEs have highest confidence levels

The sentiment gap between SMEs and large-scale enterprises is widening again. While large businesses are eyeing international political risks with growing scepticism, the still positive hard economic data have generated much more confidence on the executive floors of small and medium-sized enterprises.

- The business climate of SMEs improved by 1.7 points to 21.2 balance points in February. The last time this indicator was higher was in mid-2011.
- This substantial rise in confidence is driven by companies' assessments of their current business situation. They improved very significantly by 3.9 points to 33.4 balance points. That is the second-best monthly result since German unification and is indicative of vigorous first-quarter economic growth.
- SMEs' business expectations stagnated at the same time (-0.2 points to 9.2 balance points). This development is understandable given the many risks and the already very positive situation assessments, the point of reference for the expectations.

Large enterprises are almost consistently weaker

The uncertainty that was already palpable among large enterprises in January is continuing at a slightly more subdued pace. Their expectations indicator dropped by 2.7 points to now just 2.5 balance points, which is only marginally above the long-term average. However, also the large firms rate their current business situation very positively (+1.8 points to 30.1 balance points). As a result, their business climate decreased by only a moderate 0.5 points to 16.1 balance points in February, but it continued to fall behind that of SMEs. With the exception of wholesalers, who reported a rise in confidence by 1.4 points in both enterprise size classes, sentiment among large enterprises is trending consistently weaker than in the SME sector.

Consolidation on a high level in the construction industry

The divide within the construction sector is particularly striking. Among large firms, business confidence dropped by a very high 11.3 points to 26.6 balance points, which nevertheless remains far above average. But this decline should not be overrated. The business climate indicator of large construction firms is relatively volatile. Besides, February was unseasonably cold, particularly the start of the month, which

may have hampered work more than what is normal for the season, particularly in civil engineering. As prospects remain good not just for residential but also for public construction projects, we expect conditions to stabilise soon. In any case, among small and medium-sized construction firms at least, sentiment continues on a near-record level despite the slight drop (-1.0 points to 29.9 balance points). In the manufacturing sector, a noticeable rise in confidence in small and medium-sized industrial enterprises (+2.7 points to 18.4 balance points) contrasts with a sideways movement for large industrial firms (+0.2 points to 16.8 balance points). But this conceals much improved situation assessments which offset an equally pronounced drop in expectations. Given the very high export orientation of large industrial firms, we take this as an indication that the growing scepticism is significantly shaped by fear of new trade barriers.

The labour market is humming along

More good news is coming from the German labour market, however, which can look back on eleven years of uninterrupted job creation already. There is no end in sight even if the increase in the workforce will probably continue at a slightly slower pace. The continuing upward trend on the labour market is also corroborated by the employment expectations of the KfW-ifo SME Barometer, which rose in February among SMEs in particular (+2.4 points to 14.8 balance points) as well as among large enterprises (+0.9 points to 17.8 balance points). Businesses' unwavering readiness to create jobs attests to the fact that they generally expect the upturn to continue even beyond the end of the first quarter despite the current risks.

Inflation is normalising

Another trend that is now clearly pointing upwards – at similar rates in both enterprise size classes – is that of sales price expectations (+1.7 points to 8.7 balance points in SMEs and +2.0 balance points to 7.3 balance points among large

enterprises). From a monetary policy perspective, a higher inflation rate is desirable and an important prerequisite for reversing the ECB's extremely expansionary course. But higher inflation also means that real wage growth will not be as strong this year as last. In itself, this will reduce private consumption growth. It is therefore not really surprising that retail sentiment is struggling to find a clear trend between the continuing positive impetus from the labour market and dampening price effects. While confidence levels have risen among small and medium-sized retailers, they have fallen among large retailers – who presumably compete more on price.

The economy starts the year 2017 on a high note

In February the KfW-ifo SME Barometer sent out at least one very clear signal: the German economy is likely to grow strongly in the first quarter of 2017. The consistently very high levels of business situation assessments are particular signs of this. In our recently published economic forecast, we predicted real growth of 0.6% quarter-on-quarter for the first quarter (see KfW Business Cycle Compass Germany of 27 February 2017). This sentiment reading very firmly corroborates our forecast. The actual outcome may turn out even higher. It is less clear what will happen after that; in any event, businesses' more sceptical expectations show that they are worried. On balance we expect reasonable but not exuberant economic growth of 1.4% both this year and next – although with significant upward and downward forecast risks. Developments can take a turn for the worse if important trading partners adopt protectionist plans, or if Europe destabilises further. If these risks dissipate, however, growth may turn out significantly higher – especially since businesses should then quickly eliminate their investment backlog. ■

KfW Research

KfW-ifo SME Barometer: February 2017

Annex: SME business climate in figures

KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year						m-o-m	y-o-y	3m-o-3m	
		Feb/16	Sep/16	Okt/16	Nov/16	Dez/16	Jan/17				Feb/17
Business climate											
Manufacturing	SME	4.8	12.2	15.8	13.7	14.3	15.7	18.4	2.7	13.6	2.2
	LSE	-1.6	14.7	18.3	15.2	20.0	16.6	16.8	0.2	18.4	1.7
Construction	SME	21.8	30.0	32.2	31.7	32.6	30.9	29.9	-1.0	8.1	-0.2
	LSE	26.0	33.1	30.9	36.9	40.0	37.9	26.6	-11.3	0.6	1.2
Retail trade	SME	18.4	23.0	23.4	23.3	24.7	18.7	20.5	1.8	2.1	-1.9
	LSE	9.2	6.4	7.8	15.1	5.5	4.7	0.9	-3.8	-8.3	-6.0
Wholesale trade	SME	13.4	23.2	20.2	20.7	23.8	24.0	25.4	1.4	12.0	3.0
	LSE	10.2	19.6	23.5	21.3	23.2	21.3	22.7	1.4	12.5	0.9
All economic sectors	SME	10.4	17.8	20.4	18.7	19.8	19.5	21.2	1.7	10.8	1.2
	LSE	3.4	15.3	18.5	17.1	19.2	16.6	16.1	-0.5	12.7	0.3
Current situation	SME	21.9	25.7	26.7	26.5	29.2	29.5	33.4	3.9	11.5	4.4
	LSE	15.5	22.4	24.4	25.4	28.2	28.3	30.1	1.8	14.6	4.8
Expectations	SME	-0.9	9.7	14.0	10.7	10.4	9.4	9.2	-0.2	10.1	-1.8
	LSE	-8.4	8.0	12.3	8.7	10.1	5.2	2.5	-2.7	10.9	-3.8
West Germany	SME	10.7	18.5	21.2	19.2	20.4	20.0	22.5	2.5	11.8	1.3
	LSE	3.2	15.7	19.1	17.6	19.6	16.9	16.0	-0.9	12.8	0.0
East Germany	SME	9.5	13.8	16.1	15.8	16.7	16.1	13.2	-2.9	3.7	0.1
	LSE	9.7	5.8	4.2	5.4	9.5	9.6	19.1	9.5	9.4	7.6
Employment expectations	SME	8.0	11.7	12.7	12.1	13.4	12.4	14.8	2.4	6.8	1.4
	LSE	5.5	12.7	15.2	14.6	18.0	16.9	17.8	0.9	12.3	3.4
Sales price expectations	SME	-4.4	0.5	2.9	4.4	5.2	7.0	8.7	1.7	13.1	4.3
	LSE	-9.5	-1.6	1.9	0.6	1.9	5.3	7.3	2.0	16.8	4.5

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)-m(onth)

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 building 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.