

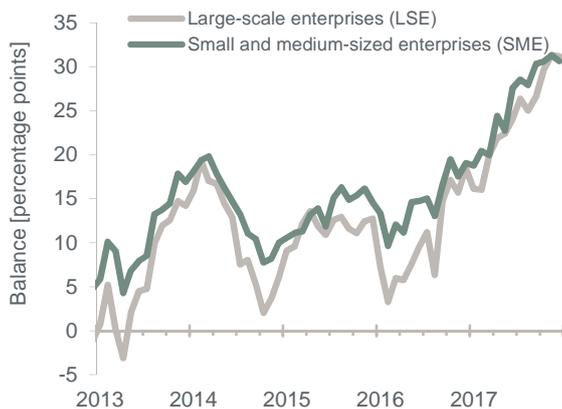
»» Business climate: slight dip at the end of an outstanding year

2 January 2018

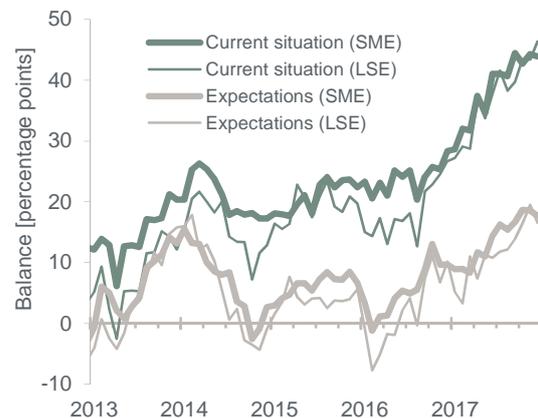
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- SMEs look back on an outstanding year
- Business climate is down just slightly from all-time high
- Little variation in large enterprises' high confidence level
- Higher price expectations signal normalisation of inflation rate

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, ifo Institute

Slight dip at the end of a record year

After shattering one record after another throughout 2017, small and medium-sized enterprises' confidence slipped slightly towards the end of the year. The key indicator of the KfW-ifo SME Barometer dropped by 0.7 points in December to now 30.6 balance points. This was due to minor declines in situation assessments and expectations.

- Situation assessments shed a very moderate 0.4 points. But in light of the 43.9 balance points and the rise of 15.6 balance points in the course of the year, 2017 can definitely be described as a stellar business year.
- Although the situation is already outstanding, the majority of SMEs expect their business to run even better in the six months ahead. This is demonstrated by their expectations, which remain very optimistic despite the minor decline by one point to 17.6 balance points.

Large enterprises are taking the lead

The business situation of large enterprises is the best it has been since surveys were first conducted for unified Germany

in January 1991. After rising by 3.0 points in the course of the month, the indicator closed the year at 46.4 balance points. Large enterprises thus overtook SMEs in December. Against the backdrop of what is already a very good business cycle, it is not surprising that future business expectations are now decreasing somewhat (-3.0 points to 16.5 balance points). Overall, large enterprises remain extremely confident (-0.1 points to 31.2 balance points).

Confidence in the construction sector knows no bounds

There was little change in the individual sectors towards the end of the year. Above-average increases in confidence levels were recorded only in large construction firms (+3.9 points to 45.8 balance points), which may be hoping for higher public investment expenditure in the new legislative period. The most recent increases among large, small and medium-sized construction firms corrected the declines in the previous month, so there is no end in sight to the construction boom. Retailers gave mixed signals with respect to Christmas sales. While confidence levels among SME retailers dropped slightly, they rose among large enterprises. However, given the very volatile trend, the rise of 5.2 points

is not higher than average.

Manufacturing posted particularly strong gains in 2017

In the course of 2017, business confidence in manufacturing rose at a particularly high rate (industrial SMEs: +16.3 points compared with December 2016; large-scale industry: +13.9 points). Construction and wholesale also posted significant increases. The mood among SME retailers, in turn, only moved sideways. On balance, this constellation illustrates that exports and corporate investment are again becoming increasingly important for the business cycle. This can be explained by the accelerating pace of global economic growth and increasing capacity utilisation in Germany. With employment expectations on record levels, however, enterprises are also signalling the continuation of a dynamic labour market, which should drive consumption.

Sales price expectations have risen further

Sales price expectations of SMEs increased significantly in December (+2.7 points), confirming the upward trend in the course of the year (+10.9 points). The current level of 15.6 balance points signals that a much higher number of enterprises expect an increase than a decrease in domestic sales prices in the coming three months. Price expectations among large enterprises recently rose by +4.7 points to 8.6 balance points, a rate even higher than in SMEs. After strong fluctuations they closed the year 2017 with an overall increase of 8.1 points.

Enterprises' sales price expectations reflect the strong demand. According to a study by the Ifo Institute, they are quite well suited for predicting the core inflation rate (consumer prices excluding energy). After many years of mostly negative price expectations, the generally positive and mostly increasing values since autumn of 2016 give rise to hopes for an ongoing normalisation of the inflation rate.

Much optimism for 2018

The mood in the German economy has been on an unbroken upward trend since the spring of 2016, which is reflected in an 11.6 point year-over-year improvement of the SME business climate in December 2017. The mood was even better among large enterprises with an increase of 12.7 points. This is particularly noteworthy because previously such steep increases in the course of the year could be observed only after phases of weak business cycles. We expect real growth of gross domestic product to reach 2.3 % for 2017 – a result that is clearly above the long-term trend rate, despite a considerable calculated reduction due to the year's relatively low number of working days. For 2018 we expect continuing high real growth of 2.5 %. For all the optimism in the business sector, however, we must also keep an eye on the downward risks. These include US foreign and trade policy and the situation in China, especially with respect to the enormous increase in private-sector debt. We expect the Trump administration's tax cuts to have hardly any effect on the business cycle because the resulting income gains should largely fall flat through higher savings of enterprises and wealthy households. ■

KfW Research

KfW-ifo SME Barometer: December 2017

Annex: SME business cycle in figures

KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Dez/16	Jul/17	Aug/17	Sep/17	Okt/17	Nov/17	Dez/17			
Business climate											
Manufacturing	SME	13.8	27.3	26.9	29.9	29.0	30.6	30.1	-0.5	16.3	1.8
	LSE	19.5	27.7	27.1	28.3	32.7	35.1	33.4	-1.7	13.9	6.0
Construction	SME	31.1	34.4	35.6	36.7	40.5	37.1	37.5	0.4	6.4	2.8
	LSE	37.9	43.9	47.7	47.2	46.0	41.9	45.8	3.9	7.9	-1.7
Retail trade	SME	23.9	25.0	21.3	22.7	25.8	25.1	23.7	-1.4	-0.2	1.9
	LSE	4.8	11.9	3.1	7.4	16.0	12.4	17.6	5.2	12.8	7.9
Wholesale trade	SME	23.0	30.4	27.7	31.6	28.3	29.9	29.2	-0.7	6.2	-0.8
	LSE	21.9	30.8	30.8	31.9	26.9	31.2	32.4	1.2	10.5	-1.0
All economic sectors	SME	19.0	28.5	27.9	30.4	30.6	31.3	30.6	-0.7	11.6	1.9
	LSE	18.5	26.4	25.0	26.6	29.7	31.3	31.2	-0.1	12.7	4.7
Current situation	SME	28.3	41.1	40.7	44.4	42.7	44.3	43.9	-0.4	15.6	1.6
	LSE	26.7	41.6	38.2	39.7	43.4	43.4	46.4	3.0	19.7	4.5
Expectations	SME	9.7	16.2	15.4	16.7	18.7	18.6	17.6	-1.0	7.9	2.2
	LSE	10.2	11.8	12.2	13.9	16.4	19.5	16.5	-3.0	6.3	4.9
West Germany	SME	19.6	29.5	29.0	31.3	31.9	32.7	31.8	-0.9	12.2	2.2
	LSE	18.9	26.6	25.2	27.0	30.0	31.8	31.7	-0.1	12.8	4.9
East Germany	SME	15.6	22.7	21.5	24.6	22.7	22.6	23.3	0.7	7.7	-0.1
	LSE	9.5	21.5	21.2	16.9	23.1	20.6	19.8	-0.8	10.3	1.3
Employment expectations	SME	12.2	16.8	17.2	17.4	19.1	21.5	21.6	0.1	9.4	3.6
	LSE	16.3	20.8	22.2	21.1	22.7	23.0	26.0	3.0	9.7	2.5
Sales price expectations	SME	4.7	8.5	7.3	9.0	11.0	12.9	15.6	2.7	10.9	4.9
	LSE	0.5	4.5	2.1	6.9	4.3	3.9	8.6	4.7	8.1	1.1

Source: KfW Research, ifo Institute

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.