

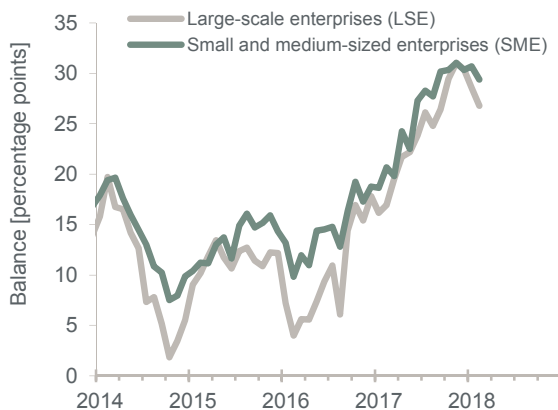
## »» SME business confidence slips despite new record situation assessments

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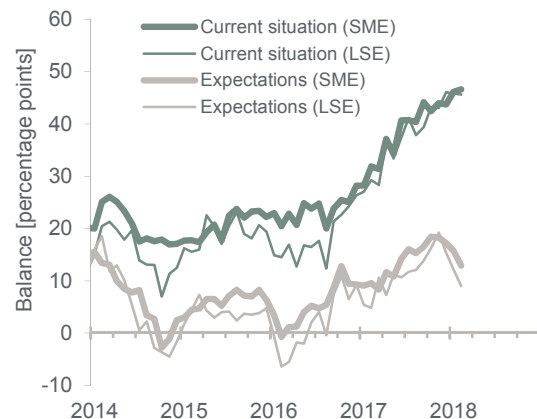
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- Falling expectations drag SME business confidence down
- But SMEs' situation assessments reach new all-time high
- Large enterprises' business confidence dips noticeably
- Business cycle appears to be reaching its peak

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### Optimism drops among SMEs

SMEs are growing increasingly sceptical as to whether the very high current pace of economic activity can be maintained in the long term. In any case, business situation assessments and business expectations are increasingly diverging. While situation assessments in February rose to a new high of 46.6 balance points thanks to a slight rise of 0.5 points on the previous month, business expectations fell for the fourth consecutive month. The latest decline has been pronounced:

- At -2.9 points, the drop was one third higher than the average monthly variation. The current level of 12.9 balance points shows, however, that on balance a larger portion of managers surveyed still expect business to grow over the coming six months.
- The business climate decreased by 1.3 points overall in February. But even so, the key indicator of the KfW-ifo SME Barometer remains on an outstanding level of 29.4 balance points.

### Large enterprises trending downward

At 26.8 balance points, confidence among large enterprises is still on a historically very high level, yet it has been trending downward since December. The current 1.8-point decline was driven by lower expectations (-3.2 points), while business situation assessments moved almost sideways (-0.2 points), very close to the all-time high.

### Retail remains robust

The retail sector continues to benefit from employment and real wage growth, so that both large and SME retailers reported another small improvement in their business climate. However, large industrial firms, which are particularly dependent on exports, posted the third decline in confidence levels and SME manufacturers were also less positive in February. SME wholesalers, on the other hand, were more confident while the business climate among large enterprises in this sector, which is typically very volatile, dipped moderately. As was the case in the previous month, the sectoral indicators thus indicate growing scepticism among export-oriented manufacturers and, in part, also among wholesalers, which is probably due to concern over an excessively strong euro and protectionist measures on the

part of the Trump administration. Finally, construction firms were less confident across all company size classes, although the decline – roughly twice the usual variation – was particularly pronounced among small and medium-sized firms. This probably also reflected the perceived skills shortage, which has a particularly strong impact on SME construction firms.

### **Employment and price expectations were lower**

In line with the less optimistic business outlook, employment expectations also fell in February. At 19.0 balance points among SMEs and 23.2 among large enterprises, however, these expectations are still near the record levels achieved in December. The same applies to sales price expectations, which dropped slightly but were clearly positive on balance. In view of the booming economy, many enterprises are planning to hire new workers and raise their prices within the next three months.

### **Is this the peak of the business cycle?**

The significantly lower business expectations and the wide gap between expectations and situation assessments raise the question of whether we are approaching a cyclical turnaround.

The usual rule of thumb is that a trend reversal is probable when the business climate points to a new direction over three consecutive periods. According to a study conducted by the ifo Institute, the business climate did not give a single false signal for industrial output during the period from 1996 to early 2014. The rule of three consecutive periods would now already have been fulfilled for large enterprises but for SMEs another two consecutive declines would have to follow. Only the component of business expectations has now dropped three times in a row already in both size classes. A look back at February 2016, however, shows that a drop in the business climate driven by expectations can be misleading. As today, the managers interviewed at the time were probably worried by volatile capital markets. But the business situation continued to be robust and the year closed with strong GDP growth.

### **High growth in 2018 but slower growth is on the horizon**

Overall, the current results of the KfW-ifo SME Barometer point to an outstanding cyclical situation with a good but less euphoric outlook than last autumn. All in all, against this background we do not see the waning business optimism as a sign of a strong downturn. Rather, it is in line with our expectation that the currently very high growth rate in Germany will slow down slightly in the course of the year in response to growing overall capacity constraints – especially on the labour market – and the global interest rate reversal that has been initiated. We remain comfortable with our forecast of 2.5% real growth for 2018 and 1.9% for 2019. ■

# KfW Research

## KfW-ifo SME Barometer: February 2018

### Annex: SME business cycle in figures

KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Feb/17	Sep/17	Okt/17	Nov/17	Dez/17	Jan/18	Feb/18			
<b>Business climate</b>											
Manufacturing	SME	18.2	29.7	28.8	30.3	29.8	30.1	27.9	-2.2	9.7	-0.3
	LSE	17.8	28.1	32.4	34.9	32.4	30.9	29.0	-1.9	11.2	-1.0
Construction	SME	29.0	36.4	40.3	36.7	37.0	37.0	33.7	-3.3	4.7	-1.9
	LSE	26.7	46.9	45.6	41.3	44.3	43.1	41.1	-2.0	14.4	-1.8
Retail trade	SME	20.0	22.6	25.7	24.9	23.7	25.3	26.1	0.8	6.1	0.6
	LSE	2.0	7.3	15.8	11.9	17.1	11.6	12.9	1.3	10.9	2.2
Wholesale trade	SME	24.0	31.4	28.1	29.7	29.0	27.5	30.9	3.4	6.9	-0.6
	LSE	22.7	31.6	26.7	30.9	32.1	30.1	27.7	-2.4	5.0	0.3
<b>All economic sectors</b>	<b>SME</b>	<b>20.7</b>	<b>30.2</b>	<b>30.3</b>	<b>31.0</b>	<b>30.3</b>	<b>30.7</b>	<b>29.4</b>	<b>-1.3</b>	<b>8.7</b>	<b>-0.4</b>
	<b>LSE</b>	<b>16.9</b>	<b>26.4</b>	<b>29.5</b>	<b>31.0</b>	<b>30.4</b>	<b>28.6</b>	<b>26.8</b>	<b>-1.8</b>	<b>9.9</b>	<b>-0.4</b>
Current situation	SME	31.9	44.1	42.4	44.0	43.8	46.1	46.6	0.5	14.7	2.0
	LSE	29.2	39.4	43.1	43.1	46.1	45.8	45.6	-0.2	16.4	4.0
Expectations	SME	9.6	16.6	18.4	18.3	17.2	15.8	12.9	-2.9	3.3	-2.5
	LSE	4.9	13.8	16.2	19.2	15.4	12.2	9.0	-3.2	4.1	-4.2
West Germany	SME	21.9	31.1	31.6	32.4	31.5	31.7	30.7	-1.0	8.8	-0.4
	LSE	16.8	26.8	29.8	31.5	30.9	28.7	27.2	-1.5	10.4	-0.4
East Germany	SME	13.0	24.5	22.5	22.4	23.1	24.1	21.4	-2.7	8.4	-0.3
	LSE	19.4	16.9	23.0	20.4	19.4	24.5	17.5	-7.0	-1.9	0.4
<b>Employment expectations</b>	SME	13.9	17.2	18.9	21.2	21.5	20.9	19.0	-1.9	5.1	1.4
	LSE	17.2	20.8	22.4	22.6	26.2	25.1	23.2	-1.9	6.0	2.9
<b>Sales price expectations</b>	SME	8.4	9.0	10.9	12.9	15.5	14.3	13.4	-0.9	5.0	3.4
	LSE	6.9	7.0	4.3	3.8	8.4	5.5	4.3	-1.2	-2.6	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.