

»» SME business sentiment: the euphoria is gone as downward risks increase

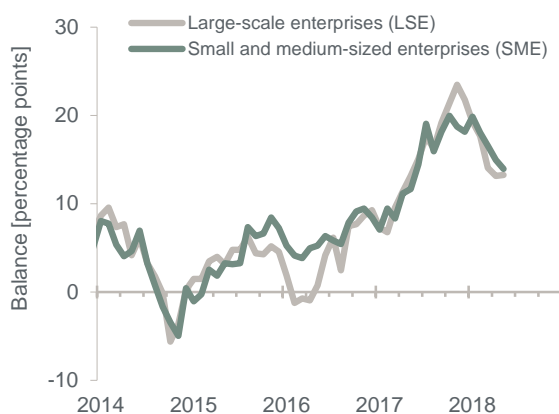
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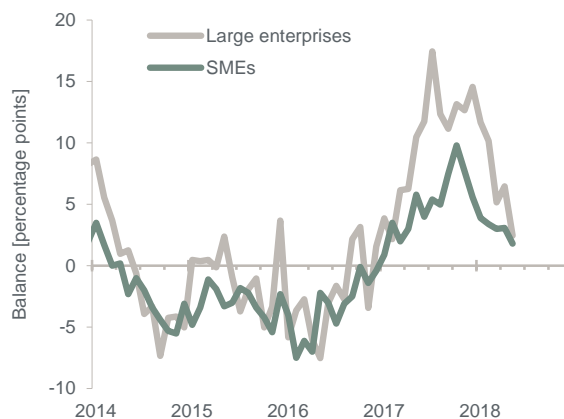
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- Global political risks weigh on business sentiment
- SMEs' situation assessments and business expectations have dropped again slightly
- Business confidence stabilises among large enterprises as situation improves
- Falling export expectations reflect concern over protectionism and Italy

KfW-ifo business climate



KfW-ifo export expectations



Source: KfW Research, ifo Institute

SME business confidence has dropped again

Business confidence among SMEs has deteriorated for the fourth consecutive month. It fell by one point to 13.9 balance points. The protectionist policies of the US administration, as well as news surrounding the formation of an eurosceptic government in Italy, increased risks for Germany's export-oriented firms during the survey period. Business expectations in particular were down:

- After a renewed 1.4-point drop, small and medium-sized enterprises' expectations were just slightly above their long-term average since 2005, at 2.1 balance points. The euphoria of 2017 regarding future business trends has subsided and the positive ratio of optimistic to pessimistic enterprises is shrinking.
- After several declines, SMEs' business situation deteriorated only slightly by -0.6 points in May. At 26.6 balance points, however, the business situation remains on an exceptionally high level. It far exceeds the levels of previous boom phases such as the year 2007.

Confidence stabilises among large enterprises except manufacturers

After falling sharply in the previous months, confidence among large enterprises has stabilised somewhat overall (+0.1 points to 13.3 balance points). This is primarily due to positive developments among large construction firms, service providers and wholesalers. Confidence among manufacturers, however, has fallen again (-2.1 points to 11.3 balance points), mostly as a result of lower expectations. At -2.2 balance points, business expectations of large manufacturers are now even slightly below average.

Export expectations reflect bad news

Although business confidence among SME manufacturers stagnated in May, sentiment overall has deteriorated noticeably over the past months – mostly because of reduced expectations. The widespread slump in manufacturers' business expectations is linked to lower export expectations. After rising to peak levels amid enthusiasm over higher global growth momentum in 2017, the deterioration of the past months reflects businesses' concern that the US may be unleashing a wave of protectionism. The threat of tariffs on steel and aluminium was compounded in May by the dispute

over the US administration's unilateral withdrawal from the Iran nuclear deal. The order to investigate imposing tariffs on automobile exports from the European Union, however, did not become known until the end of the survey period so that the business confidence level captured in May was probably largely unaffected by this move. The easing of tensions in the trade conflict between China and the US, on the other hand, may have had a positive effect. What was more important than individual news items, however, was the recognition that US economic policy will adopt and implement the measures that were announced. The election in Italy has also prompted worries about the stability of Germany's neighbour to the south.

No end in sight to the construction and employment boom

In spite of the very long duration of the ongoing construction boom and reports of imminent capacity constraints, sentiment in the construction sector remains excellent. The business situation climbed to a new record level among both SMEs and large construction firms in May, reaching 46.3 and 53.6 balance points. While large enterprises' business expectations also rose somewhat, those of SMEs dropped slightly. Overall, a clear majority of construction firms expect the business situation to continue improving (SMEs: 12.0 balance points; large enterprises: 8.0 balance points). Confidence among SMEs was down slightly by -0.8 points overall but remains on an outstanding level of 28.8 balance points, while large construction firms saw an increase of 2.3 points to 30.3 balance points.

Large construction firms that have particularly broad hiring plans are driving the booming labour market as well, according to the KfW-ifo SME Barometer. Employment expectations in May remained on a high level overall (SMEs: +0.1 points to 13.0 balance points, large enterprises: -0.4 points to 16.8 balance points).

Economic outlook is shaped by risk

We recently corrected our growth forecast downward to 2.1% for the current year after a first quarter that was weakened primarily by special factors. Thanks to high employment and strong wage growth, consumption demand and construction activity should continue to sustain the upturn. The clearly positive employment expectations shown in the KfW-ifo SME Barometer are another indication of this. However, weakening business expectations highlight the existence of significant downward risks. The new government in Italy will create conflicts in the euro area and the US administration has adopted a confrontational approach to foreign and trade policy. The growth rate in Germany will probably be crucially determined by how corporate investment responds to the increased uncertainty and lower business expectations. ■

KfW Research

KfW-ifo SME Barometer: May 2018

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		May/17	Dec/17	Jan/18	Feb/18	Mar/18	Apr/18	May/18			
Business climate											
Manufacturing	SME	11.6	19.5	20.3	17.6	15.3	13.0	13.0	0.0	1.4	-5.4
	LSE	17.1	23.9	23.9	19.4	17.1	13.4	11.3	-2.1	-5.8	-8.5
Construction	SME	22.1	26.8	26.9	24.5	28.1	29.6	28.8	-0.8	6.7	2.8
	LSE	24.0	31.1	27.8	27.0	23.5	28.0	30.3	2.3	6.3	-1.4
Retail trade	SME	9.8	16.4	17.1	16.5	9.9	11.5	13.4	1.9	3.6	-5.1
	LSE	0.1	12.2	5.9	5.0	-3.0	2.2	2.0	-0.2	1.9	-7.3
Wholesale trade	SME	12.5	19.8	16.5	19.5	15.3	5.6	12.7	7.1	0.2	-7.4
	LSE	9.8	16.8	16.3	15.4	9.5	5.4	9.7	4.3	-0.1	-8.0
Services	SME	8.7	15.6	18.6	16.0	15.9	12.6	11.5	-1.1	2.8	-3.4
	LSE	8.3	22.6	17.7	20.4	18.6	17.6	19.3	1.7	11.0	-1.7
Germany	SME	11.6	18.1	19.8	18.0	16.5	14.9	13.9	-1.0	2.3	-3.5
	LSE	13.2	21.8	19.3	17.7	14.1	13.2	13.3	0.1	0.1	-6.1
Current situation	SME	20.8	27.3	31.2	30.0	28.4	27.2	26.6	-0.6	5.8	-2.1
	LSE	19.5	31.5	32.4	30.8	26.6	25.6	26.4	0.8	6.9	-5.4
Expectations	SME	3.0	9.5	9.1	6.9	5.5	3.5	2.1	-1.4	-0.9	-4.8
	LSE	7.2	12.7	7.3	5.8	2.6	1.8	1.3	-0.5	-5.9	-6.7
Employment expectations	SME	4.0	13.2	14.7	14.3	13.5	12.9	13.0	0.1	9.0	-0.9
	LSE	10.8	19.3	21.3	19.2	17.3	17.2	16.8	-0.4	6.0	-2.8
Sales price expectations	SME	3.6	12.0	12.1	13.1	11.9	10.1	11.6	1.5	8.0	-1.2
	LSE	4.3	10.1	9.3	7.6	5.0	11.2	7.4	-3.8	3.1	-1.1
Export expectations of manufacturing	SME	5.8	5.6	3.9	3.4	3.0	3.1	1.8	-1.3	-4.0	-1.7
	LSE	10.5	14.6	11.7	10.2	5.2	6.5	2.5	-4.0	-8.0	-7.4

Source: KfW Research, ifo Institute

Explanations and abbreviations:

*Seasonally and mean adjusted (long-term mean since January 2005 = 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. The KfW-ifo SME Barometer was fundamentally revised for the reporting month of April 2018 (new aggregation process, inclusion of services, start of time series now 2005 instead of 1991, consideration of sport expectations, discontinuation of regional indicators for western and eastern Germany). Publications prior to and from April 2018 are therefore comparable to a limited extent only.

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 ifo economic surveys which are used to calculate, among other things, the well-known ifo Business Climate Index. Each month about 9,500 enterprises from trade and industry, construction, wholesale, retail and services (without the banking and insurance sectors or the state) are polled on their business situation, among them some 8,000 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 distinctions have to be drawn more narrowly for retail trade (maximum annual turnover of EUR 12.5 million), the building and the construction industry (up to 200 employees) and services (maximum annual turnover of EUR 25 million). 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 and – exclusively for manufacturing – export expectations are also captured as balance figures for the next three months. All time series are seasonally and mean adjusted. The zero line therefore marks the long-term 'cycle-neutral' average since January 2005. Indicators above (or below) zero point to an above average or favourable (below average or negative) business situation.