

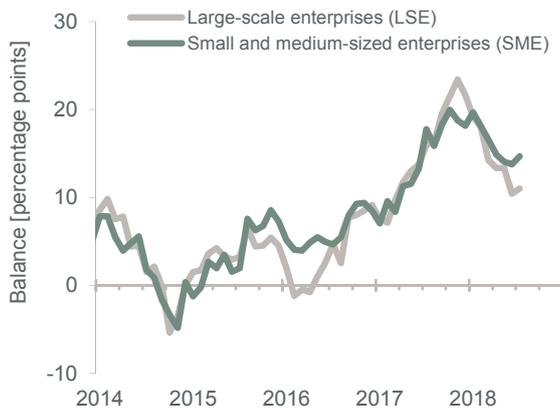
»» SMEs: satisfied but nervous about the future

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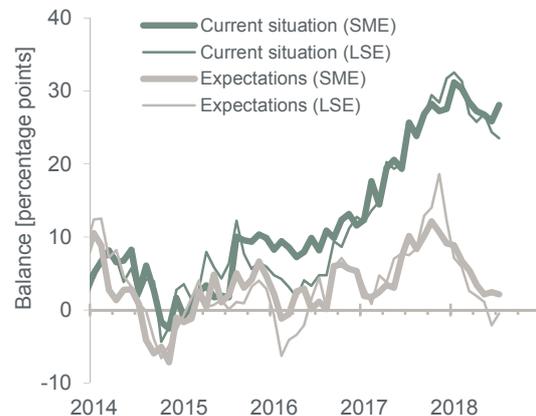
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- SME business climate brightens slightly on the back of positive situation assessments
- SMEs' business expectations continue to deteriorate slightly
- Sentiment among large enterprises slightly better than in the previous month
- Upswing is not in danger, at least not in the short term

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, ifo Institute

German SMEs: satisfied and nervous at the same time

The second half of the year began with positive news for the German economy. In July, small and medium-sized business sentiment brightened again slightly for the first time since January. The SME business climate improved by 0.9 points to now 14.7 balance points, a three-month high. But while it illustrates a high degree of satisfaction, it also reveals a substantial amount of concern over the future:

- Situation assessments gained 2.2 points, climbing to 28.1 balance points. Historically this is a top result, slightly exceeded only in the past winter half year. Given the great satisfaction with current business, the upswing does not appear to be under threat, at least not in the short term.
- At the same time, expectations decreased minimally by 0.3 points to 2.1 balance points. The gradual deterioration signals growing nervousness. Enterprises are probably increasingly worried about how long their good business situation can be sustained in times of a global trade conflict.

Wide gap among large enterprises as well

Among large enterprises, the gap between continuing very positive business situation assessments (-0.8 points to 23.5 balance points) and expectations for the coming half-year (+1.6 points to -0.5 balance points) is approximately as wide as in the SME sector. The slight corrections in July do nothing to change this, with the business climate indicator of large enterprises subsequently rising by a modest 0.6 points to now 11.0 balance points.

Despite the most recent minor upward correction, not only do large enterprises' expectations – as opposed to those of SMEs – continue to be slightly lower than the long-term average for the second consecutive month. They have also fallen nearly twice as sharply from the respective highs in autumn of last year (-19.1 points as opposed to -10.0 points for SMEs). Since large enterprises would be affected most severely and directly by a trade war because of the very high importance of their international business, this development is easy to comprehend.

Protectionism is greatest perceived risk

A look at the industries also shows that the risk of protectionism continues to influence expectations and hence the business climate. In general terms, the more closely an industry is integrated into global trade, the more its business climate has deteriorated since autumn last year. Not surprisingly, the negative trend is most pronounced among the large export-oriented industrial companies. Sentiment in the wholesale sector, which operates at the junction between national and international markets, is also darkening steadily.

Weak sentiment among large retailers

The slightly puzzling exception to this rule, however, is the strikingly poor sentiment among large retailers, a typical domestic industry. Their business climate indicator continued to decline in July (-3.0 points to -7.6 balance points), making large retailers the industry with the lowest sentiment by far. Even if this result must be interpreted cautiously because of the very high volatility of their response behaviour, it is not only in stark contrast to the good business climate of SME retailers (+2.1 points to 11.5 balance points in July) but inconsistent with the fundamental drivers of private consumption. After all, employment (+1.3% on the previous year in June) and real wages (+1.1% on the previous year in the first quarter) are growing unabated.

One possible explanation could be that the margins of large retailers are particularly tight as a result of high competitive pressure, so that goods produced cost-effectively abroad are crucial to success. Widening protectionism as the greatest current risk would jeopardise this business model. In addition, growing competition from global online platforms could play an important role but may have less of an impact on SME retailers that offer less price-elastic niche products, specific shopping experiences or goods that involve a high level of personal advice.

Unprecedented euphoria in the construction sector

Construction, by contrast, remains undisputed at the top of the sentiment table. The business climate of both SMEs (+9.2 points to 36.7 balance points) and large enterprises in this sector (+2.0 points to 33.0 balance points) climbed to an all-time high in July. But for SME construction firms it is not just the current level of the climate indicator but also its increase on the previous month that marks a new record. Never before did the business climate improve by more than six times a typical monthly variation, neither in SME construction itself nor in any other sector – a unique double record. The high demand for housing and infrastructure has generated outright euphoria, making construction a reliable mainstay of the business cycle.

The upturn is on track – but for how long?

All in all, the July results of the KfW-ifo SME Barometer show that Germany's upswing is not in danger, at least not in the short term. Enterprises are still very satisfied with current business. For the second quarter we expect real growth of just under half a per cent, which would mean a slight acceleration on the 0.3% growth rate in the first quarter. For the upswing to continue in the second half-year and beyond, it will be crucial how the global risk situation evolves and to what extent trade policy tensions and other imponderables such as Brexit impact on businesses' willingness to invest. The recent decline in business expectations to levels close to the long-term average indicates that businesses are nervously awaiting a favourable outcome – and not that pessimism is already spreading. The most recent rapprochement surprisingly achieved after the July survey between the EU and the US on trade issues means that the conflict has been defused at least for the short term. This is good news in principle for a continued upswing but the downside risks, including a renewed escalation of the trade conflict by the US, remain considerable. ■

KfW Research

KfW-ifo SME Barometer: July 2018

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jul/17	Feb/18	Mar/18	Apr/18	May/18	Jun/18	Jul/18			
Business climate											
Manufacturing	SME	17.2	17.4	15.2	13.1	13.0	12.4	12.2	-0.2	-5.0	-2.7
	LSE	20.6	19.2	16.8	13.4	11.3	10.3	9.8	-0.5	-10.8	-6.0
Construction	SME	22.4	24.1	27.7	29.1	28.5	27.5	36.7	9.2	14.3	3.9
	LSE	30.4	26.6	22.9	27.7	29.9	31.0	33.0	2.0	2.6	5.6
Retail trade	SME	16.3	16.2	9.7	11.1	13.1	9.4	11.5	2.1	-4.8	-1.0
	LSE	2.6	4.9	-3.0	1.9	2.6	-4.6	-7.6	-3.0	-10.2	-4.5
Wholesale trade	SME	19.3	19.4	15.2	5.6	12.6	10.6	10.2	-0.4	-9.1	-2.3
	LSE	17.4	15.3	9.4	5.1	9.7	5.6	7.3	1.7	-10.1	-2.4
Services	SME	17.5	16.1	15.9	12.6	11.6	12.2	12.5	0.3	-5.0	-2.8
	LSE	10.6	20.7	18.8	17.7	19.5	14.6	19.6	5.0	9.0	-1.2
Germany	SME	17.8	18.2	16.6	14.9	14.1	13.8	14.7	0.9	-3.1	-2.4
	LSE	16.0	18.0	14.2	13.3	13.3	10.4	11.0	0.6	-5.0	-3.6
Current situation	SME	25.7	30.4	28.5	27.3	26.8	25.9	28.1	2.2	2.4	-1.8
	LSE	25.0	31.3	26.8	25.7	26.8	24.3	23.5	-0.8	-1.5	-3.1
Expectations	SME	10.1	6.7	5.4	3.4	2.1	2.4	2.1	-0.3	-8.0	-3.0
	LSE	7.5	5.9	2.6	1.9	1.1	-2.1	-0.5	1.6	-8.0	-4.0
Employment expectations	SME	7.5	14.1	13.4	12.8	13.0	13.3	12.6	-0.7	5.1	-0.5
	LSE	12.9	18.8	17.0	17.0	16.6	17.1	19.9	2.8	7.0	0.3
Sales price expectations	SME	4.6	12.9	11.8	10.0	11.5	12.6	14.7	2.1	10.1	1.4
	LSE	4.1	7.3	4.8	11.0	7.2	9.8	11.1	1.3	7.0	1.7
Export expectations of manufacturing	SME	5.1	3.4	3.0	3.1	1.9	1.3	3.1	1.8	-2.0	-1.1
	LSE	17.9	10.1	5.2	6.4	2.3	1.0	0.0	-1.0	-17.9	-6.1

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.