

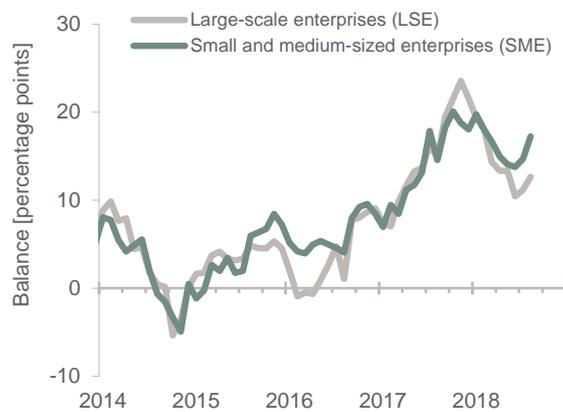
## »» SMEs' optimism rebounds sharply

6 September 2018

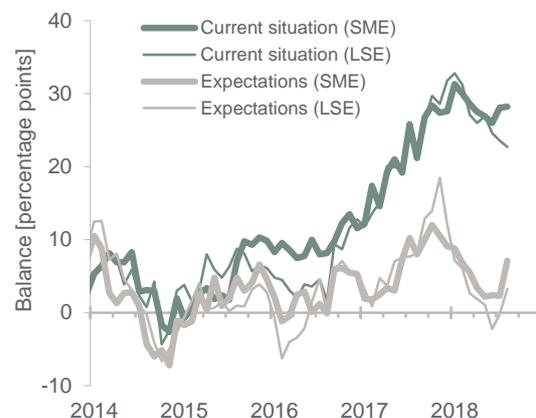
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- German SME business sentiment brightens up significantly thanks to improved expectations
- SMEs' situation assessments are steady on a high level
- Large enterprises are also more optimistic again
- Germany's upswing continues despite considerable risks

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### SMEs are more confident about the future

In August, sentiment among SMEs improved for the second consecutive month. The SME business climate rose by a noticeable 2.6 points to now 17.3 balance points, a six-month high. The fact that the rise last month was more than a flash in the pan underlines the ongoing robust state of the business cycle. The increase is largely due to companies' substantially more optimistic outlook on the future:

- SMEs' expectations jumped by 4.8 points, nearly twice the typical monthly variation. After the gradual decline in optimism since autumn last year, in one fell swoop the indicator now returned to 7.1 balance points, which is close to the level it reached at the start of the year.
- Situation assessments remain steady on the historically very high level of 28.2 balance points (+0.1 points on July). Companies are still very satisfied with current business – a sign of continuing solid economic momentum in the present third quarter.

### Large firms are also more optimistic again

The trend in sentiment among large enterprises is comparable to the situation in the SME sector, even though the variations here are slightly more subdued and on a lower level. Large firms corrected their expectations by 3.5 points to now 3.3 balance points, up from slightly below-average levels in the two previous months – a noticeable increase. At the same time, large enterprises' assessments of the current business situation remain quite positive, irrespective of the minor setback in August (-0.9 points to 22.7 balance points). Overall, business sentiment among large enterprises rose by 1.5 points to now 12.6 balance points, which is still the highest level since May of this year.

### Relief over signs of easing trade tensions

The dominant factor for the recent rise in sentiment is likely to have been the truce agreed between European Commission President Juncker and US President Trump in the trade conflict that was sparked by the US. In late July the two politicians agreed to hold talks on reducing industrial tariffs on both sides and reforming the World Trade Organisation and to refrain from imposing new tariffs in the meantime. Trump had previously threatened punitive tariffs on imports of cars from the EU to the US, which would hit

Germany particularly hard. Thus, the sign of easing tensions was sent out right in the middle of the current survey period, while the downturn in business sentiment in the past months was most noticeable in segments that had the closest links to global trade and were therefore most concerned about protectionism: manufacturing and wholesale, especially the large enterprises. This picture is consistent with the fact that the export-oriented segments of the German economy recorded more or less significant sentiment improvement in August, led by large wholesalers (+5.7 points to 13.3 balance points). Large manufacturers reported an improved business climate but, most of all, significantly higher export expectations (+5.1 points to 5.3 balance points).

#### **Domestically-oriented sectors are also more upbeat**

In addition, almost all of the sectors with a predominantly domestic focus were more optimistic than in July, confirming that domestic demand remains solid. The only exception in August were SME service providers, whose sentiment indicator slipped slightly on a high level (-1.1 points to 18.5 balance points), contrasting very sharply with the strong increase in large service providers (4.8 points to 17.3 balance points). The construction sector highlighted its current special position yet again, with business sentiment climbing to the second new consecutive all-time high among both SMEs (+1.5 points to 38.2 balance points) and large construction enterprises (+6.2 points to 38.8 balance points). Construction sentiment is now far better than in the other sectors – which are anything but downbeat.

#### **Upswing remains robust, but with many risks**

The KfW ifo SME Barometer shows brighter business sentiment driven by improved expectations, a welcome trend indeed that is likely due primarily to the sign of easing tensions in the transatlantic trade conflict that emerged from the meeting between Juncker and Trump. But this means that businesses' expectations for further progress on global trade issues are also quite high. The most recent deal between the US and Mexico demonstrates that agreements are generally possible. But given the erratic behaviour of the US president we remain sceptical that the truce can already be interpreted as a very significant reduction in the risk of protectionism. Now that hopes have been raised, a renewed escalation in the trade conflict with Europe would cause great disappointment and uncertainty, as a result of which companies could be significantly more reluctant to invest. Many other imponderables also remain. US protectionism continues to be an indirect risk as well if the spiral of higher tariffs between China and the US should continue spinning and start weighing on the global economy. The uncertain outcome of the ongoing Brexit negotiations, the Italian government's plans for very expansionary fiscal policy despite high debt, the US sanctions against Iran and Russia and the crisis in Turkey are also spreading uncertainty. We therefore do not expect growth to accelerate in the second half of the year and predict that gross domestic product will grow by 1.8% in 2018 as a whole. Growth will therefore just miss the two per cent mark that has recently been achieved several times but in our forecast this year's growth will still be nearly half a percentage point higher than the average rate since unification. In other words: The upswing will continue at a solid pace in challenging international conditions. ■

# KfW Research

## KfW-ifo SME Barometer: August 2018

### KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Aug/17	Mar/18	Apr/18	May/18	Jun/18	Jul/18	Aug/18			
<b>Business climate</b>											
Manufacturing	SME	16.7	15.0	13.0	12.9	12.4	12.4	13.0	0.6	-3.7	-1.0
	LSE	19.0	16.5	13.3	11.3	10.3	9.8	11.5	1.7	-7.5	-3.2
Construction	SME	23.7	27.5	28.9	28.4	27.2	36.7	38.2	1.5	14.5	5.8
	LSE	32.0	22.8	27.6	29.9	31.2	32.6	38.8	6.2	6.8	7.4
Retail trade	SME	11.3	9.7	11.1	13.2	9.6	11.8	12.3	0.5	1.0	-0.1
	LSE	-4.2	-3.0	1.7	2.6	-4.4	-7.5	-6.0	1.5	-1.8	-6.4
Wholesale trade	SME	15.7	15.0	5.4	12.6	10.7	10.3	11.6	1.3	-4.1	-0.1
	LSE	16.9	9.2	5.1	9.7	5.8	7.6	13.3	5.7	-3.6	0.9
Services	SME	10.0	16.0	12.7	11.6	12.2	12.5	17.3	4.8	7.3	0.6
	LSE	11.4	18.9	17.9	19.6	14.7	19.6	18.5	-1.1	7.1	-1.2
<b>Germany</b>	<b>SME</b>	<b>14.6</b>	<b>16.7</b>	<b>15.0</b>	<b>14.1</b>	<b>13.8</b>	<b>14.7</b>	<b>17.3</b>	<b>2.6</b>	<b>2.7</b>	<b>0.0</b>
	<b>LSE</b>	<b>14.8</b>	<b>14.3</b>	<b>13.3</b>	<b>13.3</b>	<b>10.4</b>	<b>11.1</b>	<b>12.6</b>	<b>1.5</b>	<b>-2.2</b>	<b>-2.3</b>
Current situation	SME	21.2	28.6	27.5	26.9	26.0	28.1	28.2	0.1	7.0	-0.2
	LSE	21.7	27.1	26.0	26.9	24.6	23.6	22.7	-0.9	1.0	-3.0
Expectations	SME	8.0	5.5	3.4	2.2	2.4	2.3	7.1	4.8	-0.9	0.2
	LSE	8.2	2.7	1.9	1.1	-2.2	-0.2	3.3	3.5	-4.9	-1.6
<b>Employment expectations</b>	SME	7.1	13.3	12.6	12.8	13.2	12.5	12.3	-0.2	5.2	-0.2
	LSE	13.9	16.8	16.8	16.6	17.3	19.6	19.0	-0.6	5.1	1.9
<b>Sales price expectations</b>	SME	5.9	11.6	9.9	11.4	12.4	14.6	15.1	0.5	9.2	3.1
	LSE	3.9	4.8	11.1	7.1	9.8	10.9	10.0	-0.9	6.1	2.6
<b>Export expectations of manufacturing</b>	SME	4.9	2.9	3.0	1.9	1.1	2.9	2.0	-0.9	-2.9	-0.6
	LSE	12.2	5.0	6.3	2.3	1.0	0.2	5.3	5.1	-6.9	-2.4

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.