

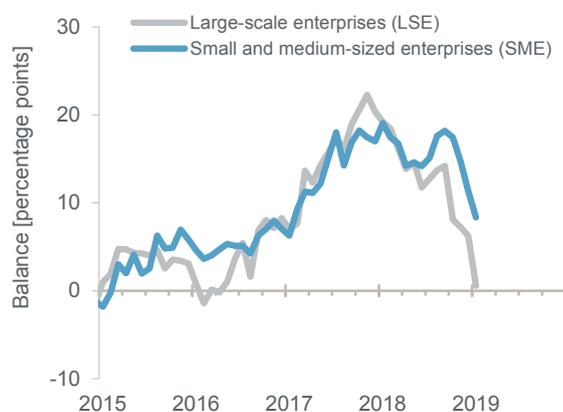
## » Rampant pessimism is spreading to Germany's SME sector

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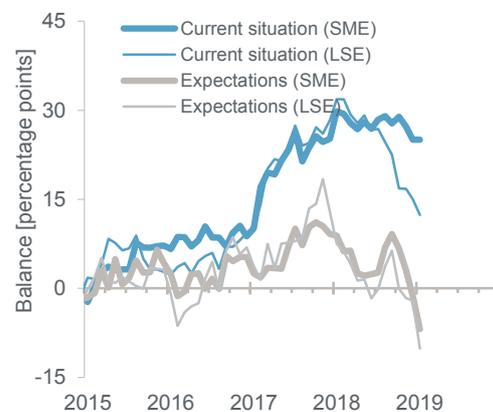
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- Drop in expectations is dragging SME business confidence down
- Situation assessments, in turn, continue to be very good and stable
- Massive deterioration in sentiment among large enterprises
- Economy starts the year on a weak note

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### SMEs are increasingly sceptical about the future

Negative economic news continued to roll in at the start of the year 2019. The business climate of small and medium-sized enterprises fell by an unusually sharp 3.0 points to now only 8.3 balance points. However, this is solely because companies are much more pessimistic about the coming half year:

- Business expectations plunged by 5.5 points and are now at -6.9 balance points, far below the zero line which stands for the long-term average. As recently as in November, the majority of SMEs were optimistic about the future, unlike the large enterprises, but now the wave of pessimism has hit them as well, albeit with some delay.
- SMEs' concerns are understandable as their economic development, which has been consistently positive, is being increasingly threatened by a number of risks. In January they confirmed the high degree of satisfaction with their current business situation once again: Their situation indicator remained unchanged at an outstanding 25.1 balance points, matching the high level already achieved around one and a half years ago.

Concerns are currently even more pronounced among large enterprises, where sentiment literally collapsed at the start of the year. The business climate plunged 5.6 points and is now at only 0.6 balance points, which is hardly any better than the long-term average. Large enterprises' business situation assessments, however, fell by a relatively moderate 2.7 points to 12.3 balance points. At the same time, their expectations literally crashed, however, dropping a full 8 points from December to now -10.1 balance points. This decline is nearly three times the typical monthly variation.

### Worries about the global economy are increasingly dragging down sentiment

It is impossible to dismiss the concerns, since global economic risks continued to increase in January. Chief among them was the unexpectedly overwhelming rejection by the UK Parliament of the withdrawal agreement painstakingly negotiated with the EU, which took place in the middle of the survey period (15 January). The United Kingdom is, after all, the destination of six per cent of Germany's exports and thus its fifth most important foreign market, not far behind China. Even if none of the partners involved has an interest in a no-deal Brexit and the return of hard borders along the English Channel that would automatically occur unless an alternative solution is found by the end of March. At the same time, the cyclical outlook in

### Large enterprises' confidence has plummeted

China and the US is increasingly uncertain and tensions in global trade relations have not eased. These imponderables have long been a burden on large export-oriented enterprises in particular but are now affecting increasingly more SMEs, many of which also operate outside Germany. Export expectations were at the lowest level in nearly three years among both large manufacturers (-4.6 points to -6.0 balance points) and SMEs (-2.6 points to -3.9 balance points). Even enterprises that focus only on the domestic market would be at least indirectly affected by an export-driven downturn and the resulting weaker overall demand.

### **Global risks leave their mark on the business sectors**

SMEs across all sectors and size classes have enjoyed above-average confidence indicators for a long time but this positive picture was significantly marred in January. Business sentiment fell clearly into negative territory among large manufacturing firms (-5.3 points to 3.1 balance points) and in the wholesale segment, where it virtually nosedived by -13.6 points to -7.2 balance points. The last time large manufacturers were less confident was in August 2016 and for wholesalers one has to go back as far as July 2013 to find a lower business confidence level. Both segments are very closely integrated into the global economy and therefore particularly sensitive to international pressures. Besides, negative sentiment is becoming increasingly entrenched among large retailers, which include a relatively high number of car dealerships. We see this as an indication that the problems resulting from the introduction of the new WLTP emissions standard on 1 September last year could be more persistent than initially thought. Sentiment has also cooled among construction firms of both size classes in January and quite substantially in SME construction firms (-9.7 points to 27.0 balance points). But for us that is no reason to be too concerned, not just because sentiment in the construction sector remains much better than in all other sectors despite the declines. Construction activity was probably impaired

significantly by the unusually cold weather in January and massive snowfalls that far exceeded normal levels and not just in southern Germany. This weighs on sentiment in the short term but once the weather normalises it is likely to recover soon.

### **Economy is shifting down two gears**

The January results of the KfW-ifo SME Barometer are a clear warning. The only positives were the consistently good business situation assessments of SMEs. They benefited from continued very sound conditions for domestic demand which include, in particular, growing employment, rising real wages, low interest rates and expansionary fiscal policy. This should prevent Germany's growth from coming to a complete standstill in 2019. But the economy is shifting down two gears, not least because this year's growth is starting from a low level after nearly stagnating in the second half of 2018 and the start to the new year will likely be rather weak as well. Overall, we currently expect Germany's real growth for the year 2019 as a whole to hover around the one per cent mark.

The KfW-ifo SME Barometer also illustrates very clearly that international conditions are responsible for the main economic worries. The controversy over Brexit is by far not the only factor to be watchful of, although it is currently the most prominent one. After all, the planned withdrawal date of 29 March is less than two months away. Under what conditions and when the United Kingdom will ultimately leave the EU, remains completely unclear. The most recent Brexit vote on 29 January revealed yet again the deep division in the UK Parliament – a reflection of sentiment within the entire country. It voted with a slim majority against an exit without an agreement but yet again also against the agreement itself as it was negotiated with the EU, including the backstop solution for open borders between the Republic of Ireland and Northern Ireland. The Brexit issue thus remains unresolved for the time being and contributes to the considerable downward risks. ■

# KfW Research

## KfW-ifo SME Barometer: January 2019

### KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jan/18	Aug/18	Sep/18	Oct/18	Nov/18	Dec/18	Jan/19			
<b>Business climate</b>											
Manufacturing	SME	20.2	12.8	15.2	11.4	9.7	6.7	2.3	-4.4	-17.9	-6.9
	LSE	24.4	11.2	12.3	5.1	5.2	2.2	-3.1	-5.3	-27.5	-8.1
Construction	SME	25.5	37.2	40.4	40.6	37.8	36.7	27.0	-9.7	1.5	-5.6
	LSE	26.6	37.8	35.0	39.2	36.5	39.5	32.9	-6.6	6.3	-1.0
Retail trade	SME	17.4	11.8	13.5	10.5	10.9	11.6	6.7	-4.9	-10.7	-2.2
	LSE	6.7	-4.7	-1.0	-13.0	-1.4	-7.0	-9.5	-2.5	-16.2	0.3
Wholesale trade	SME	16.8	11.6	12.0	10.7	9.0	7.0	2.0	-5.0	-14.8	-5.4
	LSE	16.3	13.1	10.5	7.5	5.7	6.4	-7.2	-13.6	-23.5	-8.7
Services	SME	17.3	17.3	17.1	17.2	14.6	9.5	8.0	-1.5	-9.3	-6.5
	LSE	16.6	18.8	21.3	15.2	13.8	15.0	7.9	-7.1	-8.7	-6.2
<b>Germany</b>	<b>SME</b>	<b>19.0</b>	<b>17.6</b>	<b>18.2</b>	<b>17.4</b>	<b>14.7</b>	<b>11.3</b>	<b>8.3</b>	<b>-3.0</b>	<b>-10.7</b>	<b>-6.3</b>
	<b>LSE</b>	<b>19.2</b>	<b>13.7</b>	<b>14.2</b>	<b>8.1</b>	<b>7.2</b>	<b>6.2</b>	<b>0.6</b>	<b>-5.6</b>	<b>-18.6</b>	<b>-7.3</b>
Current situation	SME	29.8	29.0	27.8	28.9	27.2	25.1	25.1	0.0	-4.7	-2.8
	LSE	31.9	24.6	22.5	16.8	16.8	15.0	12.3	-2.7	-19.6	-6.6
Expectations	SME	8.9	6.9	9.2	6.7	3.0	-1.4	-6.9	-5.5	-15.8	-9.3
	LSE	7.5	3.7	6.4	-0.1	-1.7	-2.1	-10.1	-8.0	-17.6	-8.0
<b>Employment expectations</b>	SME	14.6	12.2	12.0	12.6	11.0	9.9	9.9	0.0	-4.7	-2.0
	LSE	21.5	18.2	19.1	15.9	16.6	17.3	10.7	-6.6	-10.8	-2.9
<b>Sales price expectations</b>	SME	11.8	13.1	13.2	13.7	14.9	16.9	15.5	-1.4	3.7	2.5
	LSE	9.2	10.5	8.3	8.7	11.9	15.0	13.5	-1.5	4.3	4.3
<b>Export expectations of manufacturing</b>	SME	4.1	2.0	2.0	0.6	4.5	-1.3	-3.9	-2.6	-8.0	-1.8
	LSE	11.9	5.6	2.2	-0.8	-1.5	-1.4	-6.0	-4.6	-17.9	-5.3

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.