

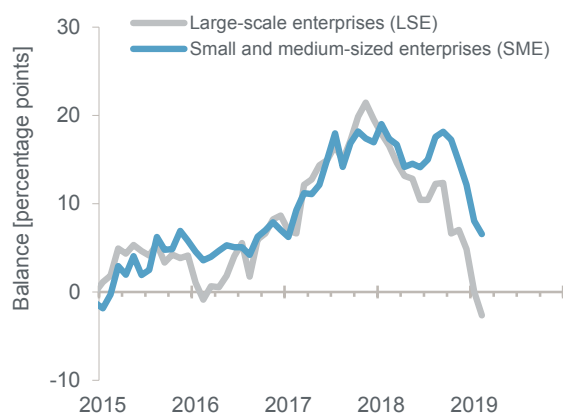
»» Deterioration of sentiment is spreading to more and more parts of the economy

8 March 2019

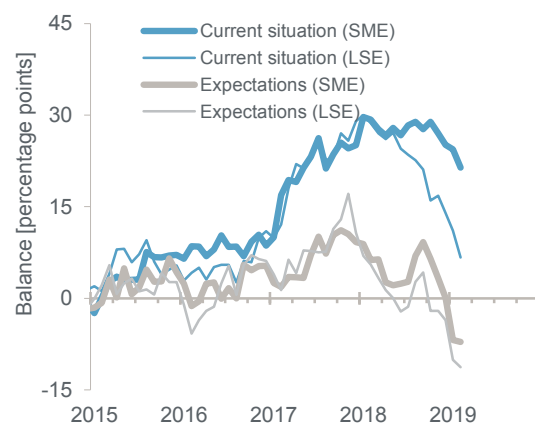
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- SME business confidence is down again
- Situation assessments are much less positive, expectations slightly more pessimistic
- Sentiment among large enterprises has dropped below historic average
- Germany has entered a cyclical slowdown

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, ifo Institute

Good economic news still in short supply

The supply of good news for the German economy was scarce in February as well. SME business confidence fell for the fifth consecutive month, this time by 1.5 points to now just 6.5 balance points. Both sentiment indicator components contributed to the renewed decline.

- Business expectations for the next six months fell by 0.3 points to -7.1 balance points. Thus, the downward trend in expectations at least slowed noticeably, after pessimism had almost skyrocketed in January. The last time businesses were more sceptical about the future was in autumn 2012.
- SMEs were much less satisfied with their current business than in the previous month. Their situation assessments dropped by 3.0 points to now 21.4 balance points. After this decline, their January and February average was a good four points below the average of the final quarter of 2018 and that raises fears of only weak quarterly GDP growth at the start of 2019.

Large enterprises' sentiment has cooled

Confidence also dropped further among large-scale enterprises, which have already been very nervous. In

February they noticeably downgraded not just their business situation assessments (-4.4 points to 6.7 balance points) but also their expectations (-1.2 points to -11.3 balance points). The downward corrections for both sentiment components were significantly stronger than among SMEs. At now -2.7 balance points, business sentiment for the first time has slipped below the zero line which represents the long-term average. The last time large enterprises were this pessimistic was in the late stages of the economically strong year 2014.

Like today, international conditions at the time were the trigger for uncertainty, notably what was seen as shaky economic performance in the euro area and the conflict in the Crimea as the major geopolitical event of the year 2014. Looking back, concerns about the German business cycle turned out to be largely unfounded. The cyclical strength diminished only for a short period of time and today statisticians conclude that the economy grew by a decent rate of 1.7% in 2015. One thing stands out clearly: Sentiment is always shaped by perceptions of the current risk situation and can quickly reverse when conditions change. Weak real growth is not the inevitable consequence. In the present situation, however, the experience of the time may allay present concerns only slightly. Brexit would have to be orderly, the US would need to back off from its threat to

impose punitive tariffs on European car imports and, in general terms, a permanent trade-promoting solution would have to be found to the numerous trade conflicts started by the US – especially with the heavyweight China, whose cyclical outlook is already more uncertain than in the past. Such positive developments are definitely possible as the year progresses but so is a continuation or even exacerbation of the global risk situation.

Domestic sectors are no longer immune

Against this background, we are quite concerned that the downward trend in sentiment is now no longer limited to business areas with significant international exposure, especially manufacturing (SMEs: -0.9 points to 1.2 balance points; large enterprises: -2.5 points to -5.8 balance points). It is increasingly spreading to the more domestically oriented segments of the economy which were still relatively immune to this trend in the past months and formed the stability anchor of the economy. This particularly affects the services sector, where sentiment indicators continue to fall in both size classes (SMEs: -3.4 points to 4.8 balance points; large enterprises: -1.6 points to 6.6 balance points). The downward trend is now also becoming apparent in the construction sector, even if the level of confidence here is still far better than in other sectors (SMEs: -0.8 points to 25.9 balance points; large enterprises: -7.1 points to 25.1 balance points).

Rays of light here and there

But there are some bright spots. Sentiment in wholesale, the sector at the junction between domestic and international markets, has recovered slightly on a low level (SMEs: +0.2 points to 2.2 balance points; large enterprises: +4.6 points to -2.6 balance points). Manufacturers' export

expectations also stabilised slightly but remained in negative territory in February (SMEs: +1.0 points to -2.6 balance points; large enterprises: +3.4 points to -2.5 balance points). The most noticeable signs of reassurance again came from the labour market. Employment expectations remained very significantly above the zero line in spite of the recent downturn among large enterprises (SMEs: +0.2 points to 8.9 balance points, large enterprises: -1.6 points to 8.8 balance points). The positive employment trend in combination with rising real incomes should provide sound, reliable underlying consumption momentum. Along with nominal wage growth, the significant decline in the inflation rate is also helping to increase purchasing power (SMEs' sales price expectations: -6.8 points to 9.4 balance points; large enterprises' sales price expectations: -4.8 points to 7.5 balance points).

Cyclical slowdown

The continuing drop in sentiment registered by the February KfW-ifo SME Barometer shows that the cyclical slowdown which began in Germany in the middle of the past year is not over. We expect real growth to remain meagre again in the first quarter before recovering as the year progresses. Because of the weak start to the year, we expect moderate GDP growth of only 0.8% for all of 2019. However, this will require an orderly Brexit and staving off any further escalation in the trade conflict of the US with China and Europe. ■

KfW Research

KfW-ifo SME Barometer: February 2019

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year						m-o-m	y-o-y	3m-o-3m	
		Feb/18	Sep/18	Oct/18	Nov/18	Dec/18	Jan/19				Feb/19
Business climate											
Manufacturing	SME	17.5	15.2	11.5	9.6	6.5	2.1	1.2	-0.9	-16.3	-8.8
	LSE	19.6	12.3	5.1	5.1	2.0	-3.3	-5.8	-2.5	-25.4	-9.9
Construction	SME	23.4	40.1	40.4	37.4	36.3	26.7	25.9	-0.8	2.5	-9.7
	LSE	26.4	34.8	39.0	36.0	38.7	32.2	25.1	-7.1	-1.3	-4.6
Retail trade	SME	15.3	13.5	10.5	10.9	11.7	6.5	10.6	4.1	-4.7	-2.0
	LSE	5.0	-0.8	-13.0	-1.4	-7.0	-9.5	-7.9	1.6	-12.9	-3.1
Wholesale trade	SME	19.0	11.9	10.7	8.9	6.8	2.0	2.2	0.2	-16.8	-6.8
	LSE	15.7	10.5	7.5	5.5	6.3	-7.2	-2.6	4.6	-18.3	-9.0
Services	SME	15.1	17.2	17.4	14.7	9.6	8.2	4.8	-3.4	-10.3	-8.9
	LSE	19.4	21.2	15.4	13.7	15.0	8.2	6.6	-1.6	-12.8	-6.8
Germany	SME	17.4	18.1	17.2	14.7	12.1	8.0	6.5	-1.5	-10.9	-7.8
	LSE	16.5	12.3	6.6	7.0	4.8	0.0	-2.7	-2.7	-19.2	-7.9
Current situation	SME	29.3	27.7	28.9	27.0	25.1	24.4	21.4	-3.0	-7.9	-4.2
	LSE	28.7	21.1	16.0	16.8	14.0	11.1	6.7	-4.4	-22.0	-7.4
Expectations	SME	6.3	9.2	6.5	3.3	0.1	-6.8	-7.1	-0.3	-13.4	-10.9
	LSE	5.5	4.2	-2.1	-2.1	-3.6	-10.1	-11.3	-1.2	-16.8	-8.3
Employment expectations	SME	14.3	11.9	12.6	10.4	10.6	8.7	8.9	0.2	-5.4	-2.2
	LSE	17.8	18.4	12.1	15.4	15.9	10.4	8.8	-1.6	-9.0	-3.6
Sales price expectations	SME	12.7	13.1	14.0	14.5	15.9	16.2	9.4	-6.8	-3.3	0.0
	LSE	7.4	7.4	6.7	10.7	13.7	12.3	7.5	-4.8	0.1	2.9
Export expectations of manufacturing	SME	3.4	2.0	0.6	4.4	-1.4	-3.6	-2.6	1.0	-6.0	-4.9
	LSE	9.6	2.2	-0.8	-1.4	-1.3	-5.9	-2.5	3.4	-12.1	-3.2

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.