

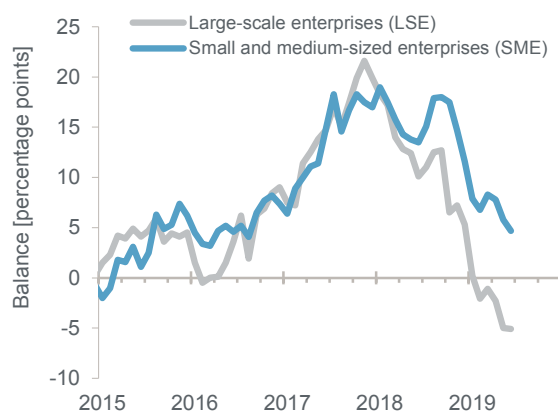
More and more cracks are appearing in the key pillars of the economy

3 July 2019

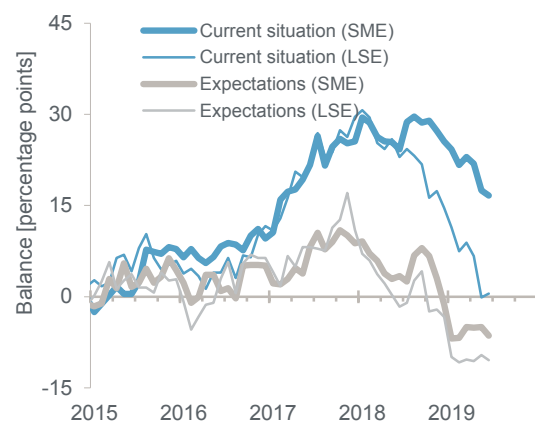
Dr Klaus Borger, phone +49 (0)69 7431-2455, klaus.borger@kfw.de
Press contact: Christine Volk, +49 (0)69 7431-3867, christine.volk@kfw.de

- SME business confidence drops to three-year low
- Large enterprises' sentiment lingers in the doldrums
- Gloom has spread to large parts of the domestic economy as well
- Expected recovery increasingly uncertain

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, ifo Institute

Dark clouds on the economic horizon

More and more dark clouds are gathering on Germany's economic horizon. SME business confidence dropped to 4.7 balance points in June, 1.1 points below the previous month's outcome. The indicator thus dropped to a level last seen in the summer of 2016 before the long and vigorous upswing began. Both sentiment components have contributed to the recent decline:

- Assessments of the current business situation dropped by 0.8 points to 16.7 balance points, underscoring the negative trend that set in last autumn. On average for the second quarter, SMEs' situation assessments were 4.3 points lower than in the previous quarter.
- At the same time, SMEs' business expectations fell by 1.4 points to -6.4 balance points, virtually wiping out the minor increase seen since February. The enterprises' outlook on the future has been consistently pessimistic since December and is marked by ongoing concern over the long list of downward risks, which the growing tensions in the Persian Gulf made even longer in June.

Large enterprises' confidence remains low

Sentiment among large enterprises remained nearly unchanged at a low level in June, after generally slipping much more sharply than in the SME sector in the preceding months. Business confidence nearly stagnated on the previous month (-0.1 points to -5.1 balance points) as a result of the opposing movements of both components: Large enterprises' business expectations fell by 0.8 points to -10.4 balance points while their situation assessments rose by 0.6 points to a modest 0.5 balance points. Despite these slight improvements on May, the quarterly change of the situation assessments for the whole second quarter was even more unfavourable among large enterprises, at -6.9 points, than among SMEs. Against this backdrop it would be an achievement already if the German economy were to see any growth at all between April and June.

Gloom has also spread outside export industries

The renewed slump in confidence among manufacturers is hardly surprising in the face of a weakening global economy, simmering trade conflicts, the still unresolved Brexit issue and growing geopolitical risks. In no other economic sector is sentiment as low as in the export-driven industries, with large-scale manufacturing suffering even more under the

current situation (-3.1 points to -16.2 balance points) than SME manufacturers (-1.0 points to -5.4 balance points). After declining further in June, manufacturers' export expectations are now deep in the red in both enterprise classes. We are therefore increasingly concerned that the hitherto strong domestic pillars of the economy are showing more and more cracks. This is true not just of the long-booming construction industry, where the euphoria suffered at least a dent in June (SMEs: -1.5 points to 29.6 balance points; large enterprises: -2.5 points to 29.1 balance points). Confidence among wholesalers and service providers has also been falling gradually for some time now, even though large service providers and SME wholesalers were able to slightly buck this downward trend in June. Business confidence among wholesalers, the link between domestic and international markets, has now dropped even slightly below the long-term average.

Retail is the positive exception

In the generally depressed mood that marks the beginning of summer, the retail sector is a positive exception. SME retailers' confidence rose by a noticeable 3.1 points to 14.5 balance points, while large retailers took a veritable leap (+7.3 points to 12.2 balance points). Only in the construction sector is confidence higher. At least in the short term, the role of consumption as a pillar of the economy is not under threat, especially as pensions are set to rise significantly at the start of the second half-year. It nevertheless remains doubtful whether retail confidence can potentially remain on this healthy level, as the reliable strong tailwind from the labour market for consumer demand is visibly subsiding.

Labour market dynamism is declining

Whereas the employment expectations surveyed under the KfW-ifo SME Barometer remained at a historically

unprecedented high level from around mid-2017 after rising for around three years, the trend has been on an undeniably downward trajectory ever since autumn of last year. After the renewed substantial drop in the SME sector (-2.3 points to 2.8 balance points), the mid-2019 indicators in both size classes point only slightly higher than the long-term average, even if large enterprises' employment expectations stabilised slightly in June (+0.6 points to 1.7 balance points). Industrial enterprises alone are already pessimistic, as they have increasingly been expecting job cuts since April.

Economic recovery has become increasingly doubtful

All in all, the message of the KfW-ifo SME Barometer in June is sobering. There is a large and growing question mark over the moderate economic recovery that is so far expected – also by us – after what now looks like a weak second quarter. Tensions in the Persian Gulf are rising, the US is now using punitive tariffs as a means of exerting pressure beyond trade policy, as the recent migration dispute with Mexico reveals, and the outcome of the Brexit drama is more open than ever under the probable new Prime Minister Johnson. Negative business expectations are therefore understandable and, not least, are likely to dampen investment plans. To prevent the dent from becoming an outright downturn, positive signals are needed more than ever. Domestic demand so far has been able to offset external stress factors, which is why we do not yet want to give up hope for a moderate recovery from the second half-year. However, this will crucially depend on whether the global risk situation eases at least in part, the global economy gathers slightly more steam, and the industrial recession ends before spilling over even more into the labour market and domestic sectors. ■

KfW Research

KfW-ifo SME Barometer: June 2019

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jun/18	Jan/19	Feb/19	Mrz/19	Apr/19	Mai/19	Jun/19			
Business climate											
Manufacturing	SME	12.0	2.1	0.9	-1.5	-4.4	-4.4	-5.4	-1.0	-17.4	-5.2
	LSE	11.3	-3.4	-5.9	-8.8	-12.0	-13.1	-16.2	-3.1	-27.5	-7.7
Construction	SME	26.3	25.9	25.2	29.0	27.8	31.1	29.6	-1.5	3.3	2.8
	LSE	29.4	31.4	24.5	22.1	28.2	31.6	29.1	-2.5	-0.3	3.6
Retail trade	SME	8.6	5.7	10.9	14.4	10.7	11.4	14.5	3.1	5.9	1.9
	LSE	-5.0	-8.9	-5.8	0.4	2.3	4.9	12.2	7.3	17.2	11.2
Wholesale trade	SME	10.0	2.5	2.1	0.5	0.3	-1.1	-0.8	0.3	-10.8	-2.2
	LSE	6.3	-6.6	-1.2	3.2	0.1	0.1	-0.4	-0.5	-6.7	1.5
Services	SME	11.3	8.2	5.1	10.4	10.0	6.3	5.0	-1.3	-6.3	-0.8
	LSE	14.0	8.4	7.2	9.5	8.5	0.3	3.3	3.0	-10.7	-4.3
Germany	SME	13.5	7.9	6.8	8.3	7.8	5.8	4.7	-1.1	-8.8	-1.6
	LSE	10.1	0.2	-2.1	-1.1	-2.3	-5.0	-5.1	-0.1	-15.2	-3.1
Current situation	SME	24.3	24.3	21.7	23.0	21.9	17.5	16.7	-0.8	-7.6	-4.3
	LSE	23.0	11.4	7.5	8.9	6.7	-0.1	0.5	0.6	-22.5	-6.9
Expectations	SME	3.4	-6.9	-6.8	-5.0	-5.1	-5.0	-6.4	-1.4	-9.8	0.7
	LSE	-1.6	-9.9	-10.8	-10.3	-10.6	-9.6	-10.4	-0.8	-8.8	0.1
Employment expectations	SME	12.8	9.0	8.9	7.0	5.3	5.1	2.8	-2.3	-10.0	-3.9
	LSE	16.7	10.1	8.4	5.4	4.6	1.1	1.7	0.6	-15.0	-5.5
Sales price expectations	SME	11.5	14.6	9.5	8.1	6.5	4.2	3.5	-0.7	-8.0	-6.0
	LSE	8.4	12.1	7.4	4.0	3.0	1.7	1.4	-0.3	-7.0	-5.8
Export expectations of manufacturing	SME	1.8	-3.5	-2.8	-7.9	-8.0	-6.6	-10.1	-3.5	-11.9	-3.5
	LSE	0.8	-6.2	-1.8	-13.4	-12.5	-13.1	-13.2	-0.1	-14.0	-5.8

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 export 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.