

»» SMEs are trending downward, manufacturers are alarmed

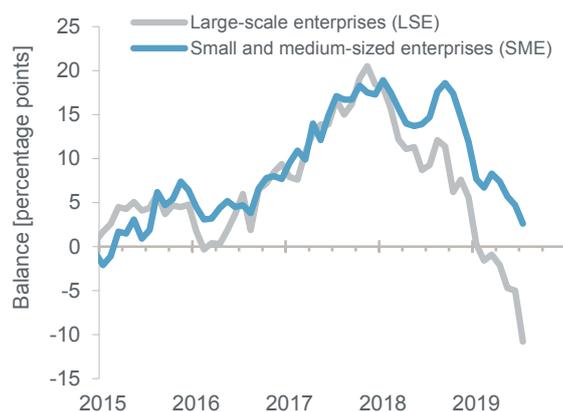
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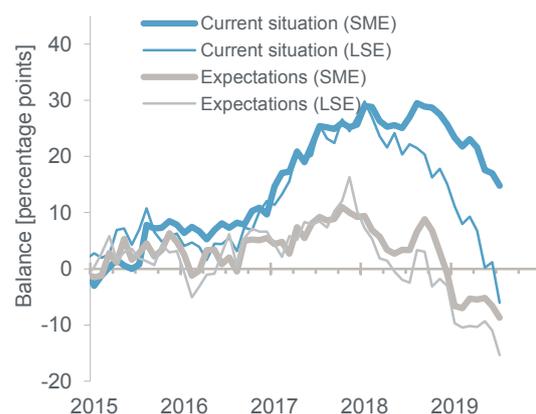
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- SME business sentiment drops as a result of low expectations and deteriorated conditions
- Manufacturers' confidence is plummeting, retailers and service providers are weaker, construction SMEs continue to soar
- Large enterprises are in freefall as gap to the SMEs widens
- Economic recovery is a long way off

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, ifo Institute

SMEs start second half of the year on a weak footing

SME business confidence fell by 2.1 points in July, continuing the downward trend that began last year. Situation assessments as well as business expectations fell.

- SMEs' business situation deteriorated by 2.2 points to 14.8 balance points in July. Prior to the peak confidence levels of 2017 and 2018, a similar level would have suggested a fairly strong economy but the downward trend is unequivocal.
- Business expectations for the next six months are below average, at -8.7 balance points. With a drop of -2.7 points, the decline in July was on a similar scale as the situation assessments.

Situation assessments are still on a relatively high level, which is in stark contrast to the significantly poorer assessments among large enterprises, but the trend is pointing downward in the SME sector as well. Manufacturers in particular are in crisis. Downward risks, such as global

trade conflicts and the increasing likelihood of a no-deal Brexit, are putting a damper on global investment activity and Germany's export-dependent capital goods industry. The sectors that rely on the automotive industry also face high technological and regulatory uncertainty.

Large enterprises are in freefall

While the business climate among SMEs remains on a slightly above-average level, confidence among large enterprises is alarmingly low already. In July, expectations and situation assessments plummeted by 4.4 and 7.2 points respectively, indicating an overall decline in business confidence of 5.8 points. The current level of -10.8 balance points is well below average and now almost as low as during the height of the euro crisis in December 2012 when it fell to a low of -12.1 points. The weakness in the large enterprise segment is mainly due to developments in the manufacturing industry, where business confidence fell by 7.1 points to -23.5 balance points in July. This slump, in turn, is primarily the result of a significant deterioration in situation assessments, which plunged from -16.9 to -28.8 balance

points, the lowest level since April 2010. Business expectations have darkened as well, however. The weakness in manufacturing is probably also the result of the rapid decline in sentiment in the wholesale sector, which literally collapsed from -0.8 to -16.9 balance points in July. Large retailers also reported a sharp drop in sentiment of 13.2 points to now only -0.4 balance points. But given the high volatility of the business climate in this segment, the response for a single month is not very meaningful.

Manufacturing SMEs are also trending downward

In the SME sector, manufacturers are leading the downward trend as well. Industrial firms reported a significant drop in sentiment of 5.6 points, around twice the usual monthly variation. Although manufacturing SMEs' business expectations were about as negative as those of large enterprises, their situation assessments were significantly better but also below average (-4.0 balance points). Besides, export expectations fell again by 2.0 points and are now deep in red territory along with those of large enterprises.

Only the construction sector is thriving

Also trending downward is the business climate among SME wholesalers, whose confidence has dropped to a level similar to that of manufacturers. Small and medium-sized service providers and retailers, however, also reported a slight drop in sentiment from the previous month. There is a strong possibility that the widespread economic worries are now starting to weigh on consumption propensity as well. But it would be premature to draw a definitive conclusion based on a single drop in business confidence, which had just risen in the previous month. Service providers, on the other hand, have been on a gradual decline for quite some time now and business services are being hit the hardest by the crisis in the manufacturing sector. The boom continues unbroken only among small and medium-sized construction enterprises, where business confidence rose by 1.4 points in July while sentiment among large construction firms dipped slightly on a high level.

The SME sector – an anchor of stability?

Even though both size classes are in a downward trend, the clouding of sentiment in SMEs has been much less

pronounced since the beginning of last year than among large companies, while both have developed very similarly in the previous upswing. The gap in sentiment between SMEs and large enterprises has now reached a value that was exceeded only in December 2008, when the last global recession began. The downturn in overall business confidence at the time was significantly stronger, however. The decisive commonality is probably the fact that in both cases the downturn was triggered by a global slump in demand for capital goods and durable consumer goods. That slump therefore affects internationally oriented large enterprises much more strongly than SMEs that are slightly more oriented towards the German or European domestic market.

Employment expectations also drifted apart in July. While they dropped sharply in the large enterprise segment – in line with the recently growing reports of planned-job cutting programmes – to a below-average level, SMEs' hiring plans expanded slightly. But the trend is pointing downward here as well. The worst outlook was again reported by manufacturers, which are now planning to reduce employment levels.

A recovery is a long way off

The KfW-ifo SME Barometer shows that large enterprises and manufacturers are alarmed after sustained drops in confidence in the preceding months and an accelerated fall in July. Other survey-based indicators (Purchasing Managers' Index, ZEW Indicator of Economic Sentiment) do not give hope for any improvement in the second half-year either. New orders received by manufacturers are also clearly trending downward despite the positive surprise in June due to a number of large orders. The domestic economy should remain relatively robust for now. But a return to steady economic growth would require a significant easing of the global risk situation, for example in the form of reliable trade agreements with the US. As the current industrial recession is primarily due to global risks, automatic stabilisers should now be strengthened before the domestic economy is further weakened through the labour market. One conceivable measure, for example, would be the generous promotion of reduced working hours, which should be used for continuing education. ■

KfW Research

KfW-ifo SME Barometer: July 2019

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jul/18	Feb/19	Mar/19	Apr/19	May/19	Jun/19	Jul/19			
Business climate											
Manufacturing	SME	12.7	1.1	-1.3	-4.4	-4.1	-5.5	-11.1	-5.6	-23.8	-5.4
	LSE	10.9	-5.8	-9.1	-12.0	-13.2	-16.4	-23.5	-7.1	-34.4	-8.7
Construction	SME	34.4	25.0	28.8	27.5	31.4	29.9	31.3	1.4	-3.1	3.8
	LSE	33.0	24.3	21.9	28.0	31.3	28.6	26.0	-2.6	-7.0	3.9
Retail trade	SME	11.5	10.9	14.4	10.6	11.2	14.3	12.2	-2.1	0.7	0.6
	LSE	-6.4	-5.6	0.3	2.2	4.6	12.8	-0.4	-13.2	6.0	6.7
Wholesale trade	SME	9.9	2.4	0.8	0.5	-1.2	-1.1	-3.9	-2.8	-13.8	-3.3
	LSE	8.3	-1.0	3.4	-0.6	-0.2	-0.8	-16.9	-16.1	-25.2	-6.6
Services	SME	12.5	5.0	10.9	9.5	6.2	5.1	3.8	-1.3	-8.7	-3.4
	LSE	12.7	7.6	10.5	8.5	0.5	4.0	2.0	-2.0	-10.7	-6.7
Germany	SME	14.7	6.7	8.3	7.4	5.7	4.7	2.6	-2.1	-12.1	-3.1
	LSE	9.3	-1.6	-0.9	-2.1	-4.7	-5.0	-10.8	-5.8	-20.1	-5.3
Current situation	SME	27.0	21.8	23.1	21.6	17.6	17.0	14.8	-2.2	-12.2	-5.7
	LSE	22.2	8.0	9.3	6.8	0.2	1.2	-6.0	-7.2	-28.2	-9.6
Expectations	SME	3.3	-7.0	-5.3	-5.5	-5.2	-6.6	-8.7	-2.1	-12.0	-0.9
	LSE	-2.5	-10.5	-10.2	-10.4	-9.4	-11.0	-15.4	-4.4	-12.9	-1.6
Employment expectations	SME	11.2	8.4	7.3	4.8	5.0	2.2	3.3	1.1	-7.9	-3.3
	LSE	17.2	8.7	5.6	4.4	1.2	1.3	-3.9	-5.2	-21.1	-6.7
Sales price expectations	SME	13.3	8.8	8.3	6.5	4.4	3.7	2.3	-1.4	-11.0	-4.4
	LSE	10.0	7.3	4.2	3.0	2.0	1.1	-1.1	-2.2	-11.1	-4.2
Export expectations of manufacturing	SME	3.5	-3.5	-6.8	-8.1	-6.2	-10.4	-12.4	-2.0	-15.9	-3.5
	LSE	1.3	-1.6	-13.4	-12.4	-13.1	-13.2	-15.7	-2.5	-17.0	-4.9

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.