

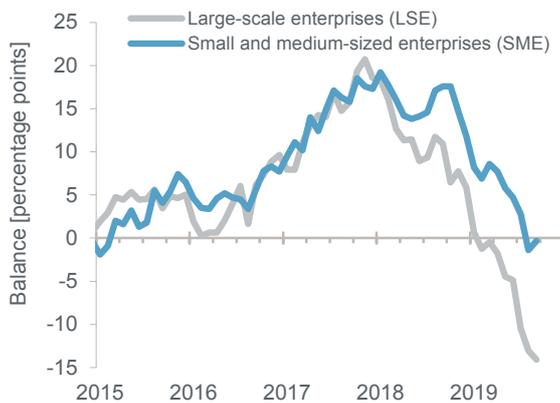
»» Sentiment improves slightly among SMEs but not in large enterprises

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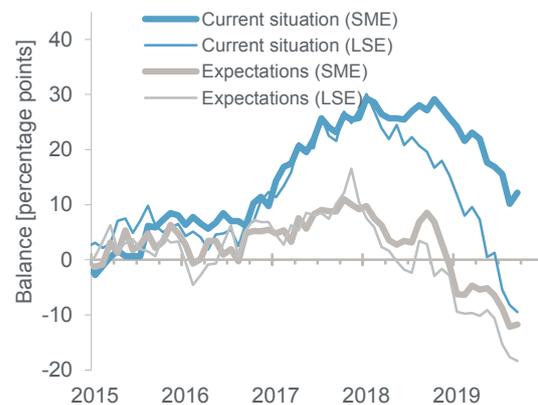
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- SME business climate has stabilised slightly
- Situation assessments have improved moderately but expectations remain virtually unchanged
- Confidence among large enterprises is still in freefall
- The divide in Germany's business sector continues for now

KfW-ifo business climate



KfW-ifo climate components



Sources: KfW Research, ifo Institute

Sentiment improves somewhat among SMEs

After deteriorating sharply in the previous month, business sentiment in the German SME sector recovered slightly in September. The downward trend that started in autumn last year has been interrupted by the recent 1.1 point increase. At -0.3 balance points, sentiment has returned to a level that roughly matches the long-term average. The main causes for the recovery are businesses' situation assessments.

- SMEs' situation assessments improved by 2.0 points to 12.2 balance points. On average, however, assessments in the third quarter dropped by -6.2 points on the second quarter. Overall, that indicates that the economic output of the SME sector contracted slightly in summer, as it did in the previous quarter.
- The business expectations of small and medium-sized enterprises for the coming six months are also very low, at -11.8 balance points. A minimal increase by 0.4 points in September has done little to dispel the pessimism that has prevailed among SMEs as well since the end of 2018.

Sentiment among large enterprises is still in freefall

Business sentiment among large enterprises currently knows just one direction – and that is downward. Situation assessments dropped in September (-1.3 points), as did business expectations (-0.7 points). Apart from a brief convergence in the previous month, the business climate of large enterprises (-14.1 balance points) and SMEs (-0.3 balance points) has been drifting further and further apart since early 2018. Particularly remarkable is the disparity between situation assessments, which are almost 22 points higher in the SME sector than in large enterprises. While the latter rate their situation unusually poorly at -9.5 balance points, most SMEs are still content with their business situation. With a strong external headwind, the rather more domestically oriented small and medium-sized enterprises still appear to be benefiting from robust domestic demand. However, they have similarly negative expectations, which shows that the crisis will probably hit small and medium-sized enterprises as well in the medium term.

SME sector is split

The split between SMEs of different industries also proves to be persistent. Manufacturers and the closely connected wholesale sector are very downbeat. On the other hand, confidence among retailers and, above all, construction firms continues on an unusually high level. Sentiment in the manufacturing sector remained nearly on the same low level in September (-0.1 points to -13.3 balance points), while it continued to worsen among wholesalers (-2.5 points to -10.7 balance points). Construction firms, on the other hand, remain in a very good mood, at 30.0 balance points, after a minimal change of -0.4 balance points. The retail business climate dropped by 3.5 points but sentiment continues on quite a high level for the whole year (currently 9.9 balance points), with similar monthly variations.

SME service providers are more optimistic again

The business climate in the SME services sector briefly dipped into negative territory in August. But in September it recovered again by a similarly strong 4.8 points to 4.0 balance points. Large service providers experienced a completely different development, with another drop in confidence to -6.7 balance points, which is already clearly below average. They are likely to include a relatively high number of business-related service providers which have been hit by the crisis in the manufacturing sector.

No end in sight to the industrial recession

There is still no end in sight to the industrial recession. Both SME manufacturers and large industrial firms were almost consistently pessimistic in September. Export expectations worsened yet again (SMEs: -1.8 points to -14.5 balance points; large enterprises: -4.8 points to -19.4 balance points). The causes for the problems in the manufacturing sector effectively remained almost unchanged during the survey period. A hard Brexit on 31 October has become less probable as a result of legislation passed by the UK Parliament but cannot yet be ruled out, especially at a later date. The trade conflict between China and the US is unpredictable despite minor signs of easing tension. For internationally oriented businesses, political uncertainty thus remains very high, leading to investment restraint in Germany, but globally too. This is harmful to the generally very cyclical German industry, especially to the mechanical and plant engineering sector. The automotive industry faces structural challenges associated with high costs and uncertainties, such as the conversion to new drive technologies.

How long will the labour market remain stable?

In the course of the year, the industrial crisis has also affected wholesalers and parts of the services industry. Contagion effects on other industries mainly depend on the labour market, which has proven to be quite robust so far. While the KfW ifo employment expectations are trending downward, in the more labour-intensive SMEs they are still just barely above the zero line, which stands for the long-term average. The skills shortage is causing many businesses to put off job cuts for as long as possible despite their pessimistic expectations. But the longer the cyclical downturn continues, the more likely that is to change, as indicated by the generally more and more negative employment expectations of the manufacturing sector.

A gloomy outlook for autumn

After the initially published Purchasing Manager's Index provided by IHS Markit delivered abysmal data on the economic trend in September, the subsequently reported minor improvement of the ifo business climate was a positive surprise. The KfW-ifo SME Barometer shows that the recovery in September is exclusively attributable to small and medium-size enterprises, while sentiment among large-scale enterprises deteriorated again. Nevertheless, the summer quarter that has now ended has generally not been a good one for SMEs either. SMEs' output has likely contracted slightly and we expect negative quarterly growth for gross domestic product as well. At the end of two consecutive negative quarters, Germany is most likely in a technical recession. Unfortunately, an economic recovery is not foreseeable in autumn either. Brexit may end up being postponed yet again but a no-deal exit from the EU would then loom again within a matter of a few months. And the decision scheduled for November on the imposition of special tariffs on European automobile imports threatened by the US government could also create increased uncertainty. We expect an overall growth rate of 0.4% for 2019 but only because of the good start to the year. For 2020 we hope that growth will normalise around the middle of the year, which could raise the annual rate to 0.6%. Some hope for a deescalation of the trade war may come from the US election campaign, for which the US administration could use some good economic figures and a stable stock market. ■

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Sep/18	Apr/19	May/19	Jun/19	Jul/19	Aug/19	Sep/19	m-o-m	y-o-y	3m-o-3m
Business climate											
Manufacturing	SME	15.1	-4.2	-4.1	-5.8	-11.1	-13.3	-13.4	-0.1	-28.5	-7.9
	LSE	12.5	-11.6	-12.9	-15.9	-23.6	-22.3	-22.2	0.1	-34.7	-9.2
Construction	SME	38.4	27.3	31.2	29.7	30.9	30.4	30.0	-0.4	-8.4	1.0
	LSE	33.6	28.0	31.1	28.6	25.3	14.3	25.1	10.8	-8.5	-7.7
Retail trade	SME	13.9	10.4	11.1	14.1	11.7	13.4	9.9	-3.5	-4.0	-0.2
	LSE	0.5	2.0	4.3	12.2	-1.3	5.7	1.4	-4.3	0.9	-4.2
Wholesale trade	SME	11.2	1.0	-1.1	-1.3	-4.7	-8.2	-10.7	-2.5	-21.9	-7.4
	LSE	10.1	-0.3	-0.3	-2.1	-16.6	-11.0	-17.0	-6.0	-27.1	-14.0
Services	SME	16.3	9.8	6.3	4.6	4.3	-0.8	4.0	4.8	-12.3	-4.4
	LSE	16.4	8.9	0.7	4.0	2.5	-5.9	-6.7	-0.8	-23.1	-7.9
Germany	SME	17.6	7.7	5.8	4.7	2.8	-1.4	-0.3	1.1	-17.9	-5.7
	LSE	10.9	-1.8	-4.5	-4.9	-10.5	-13.1	-14.1	-1.0	-25.0	-8.8
Current situation	SME	27.2	22.0	17.7	16.9	15.6	10.2	12.2	2.0	-15.0	-6.2
	LSE	19.6	7.3	0.5	1.3	-5.4	-8.2	-9.5	-1.3	-29.1	-10.7
Expectations	SME	8.5	-5.5	-5.2	-6.5	-8.9	-12.2	-11.8	0.4	-20.3	-5.2
	LSE	2.8	-10.2	-9.2	-10.7	-15.4	-17.7	-18.4	-0.7	-21.2	-7.1
Employment expectations	SME	13.0	4.8	4.9	2.2	3.0	0.2	0.9	0.7	-12.1	-2.6
	LSE	16.7	4.5	1.2	1.2	-4.0	-1.7	-3.3	-1.6	-20.0	-5.3
Sales price expectations	SME	13.8	6.5	4.3	3.6	2.4	3.1	0.8	-2.3	-13.0	-2.7
	LSE	8.7	3.1	1.9	1.1	-1.1	-0.9	-0.4	0.5	-9.1	-2.8
Export expectations of manufacturing	SME	2.5	-7.9	-6.0	-10.2	-12.3	-12.7	-14.5	-1.8	-17.0	-5.1
	LSE	3.6	-12.1	-12.8	-12.9	-15.4	-14.6	-19.4	-4.8	-23.0	-3.9

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 9,000 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 7,500 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.