

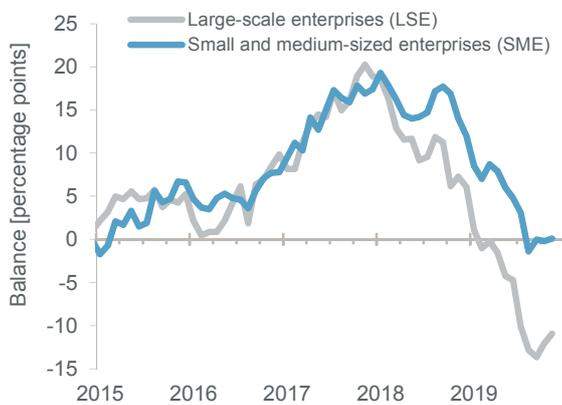
## »» SMEs are suspended in an economic no man's land

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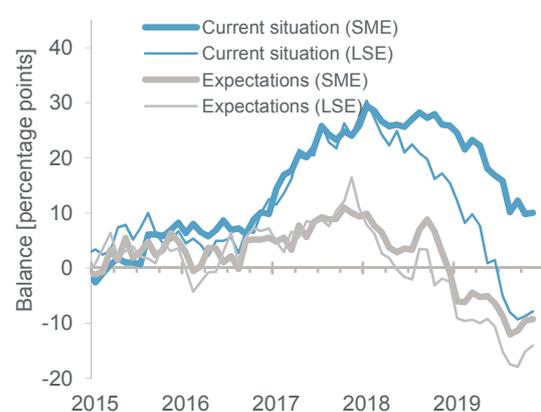
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- SME business climate remains on the long-term average level
- SMEs' situation assessments and expectations have improved only minimally
- Sentiment among large enterprises no longer quite as dismal
- Employment expectations have picked up in both company size classes

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### Negligible improvement in SME business climate

The German economy narrowly avoided a technical recession in summer but a new direction is not yet discernible. The business climate in the small and medium-sized enterprise sector is still hugging the zero line, which stands for the long-term average and thus represents economic no man's land. Specifically, the key indicator of the KfW-ifo SME Barometer rose by a marginal 0.3 points to 0.1 balance points in November. Both sentiment components contributed to the most recent minor improvement, if on very different levels:

- Assessments of the current business situation rose by an almost negligible 0.2 points on October, less than one tenth of an average monthly variation. At now 10.0 balance points, situation assessments are considerably lower than a year ago (26.0 balance points in November 2018) but still better than the long-term average.
- Expectations also improved only marginally by 0.3 points to now -9.3 balance points. Even if they have slightly recovered since the 82-month low in August, they are still dominated by pessimism.

### Sentiment among large enterprises not quite as bleak

Sentiment among large enterprises also improved in November – not strongly but by a clearer margin than in the SME sector. Large enterprises upgraded their expectations by 1.1 points to -14.1 balance points, while their situation assessments rose by 0.9 points to -7.8 balance points. All in all, their business sentiment improved to -10.9 balance points, 1.1 points more than in the previous month. Thus, sentiment among large enterprises is not quite as dismal as it was when it hit the trough in September but it remains clearly below average and lags far behind that of their SME counterparts. This is due not so much to business expectations, which are clearly pessimistic in both company size classes.

### Economic development remains split

The main reason is the current business situation, which is rated mostly positive by the rather more domestically oriented SMEs but mostly negative by the relatively more strongly export-oriented large enterprises. This shows that the split between robust domestic demand and a difficult external environment, which has characterised the German economy for quite some time, is far from overcome. At best, soft glimmers

of hope are visible, including the most recent improvement of industrial export expectations on a low level (SMEs: +2.3 points to -10.8 balance points; large enterprises: +2.9 points to -9.2 balance points). What has surely played a role here was not just the recently much reduced likelihood of a hard Brexit but the announcement of a first partial agreement in the US-Chinese trade dispute. To what extent the easing of tensions will continue remains to be seen, however, given the unpredictability of the current US administration and the many still unresolved issues surrounding the future relationship between the EU and the United Kingdom.

### **Diverging sentiment in all sectors**

Businesses themselves are very much divided about where the economy is currently headed. In none of the five sectors analysed by the KfW-ifo SME Barometer did the sentiment indicators in both company size classes move in the same direction in November. There has never been such a constellation in the history of the time series, which goes back to January 2005. Among wholesalers and service providers, sentiment improved noticeably among large enterprises but dropped marginally among SMEs. In manufacturing, construction and retail, on the other hand, small and medium-sized enterprises showed varying levels of improvement, while large enterprises were much more downbeat than in the previous month. This full-blown sentiment divergence clearly illustrates the high degree of uncertainty and imponderables weighing on the business cycle as the year 2019 draws to a close.

### **Employment expectations increased again**

Against this background, it may be at least somewhat reassuring that employment expectations are now pointing upwards again. This is because the labour market is currently one of the most reliable pillars of the business cycle. Among SMEs, employment expectations rose by 2.7 points – more than one and a half times the usual monthly variation – to now 3.4 balance points. After all, that is the highest level this indicator has reached since May. Large enterprises' employ-

ment expectations are also a bit better but still hover on a slightly below-average level (+0.3 points to -2.1 balance points). This is primarily due to the pessimistic employment expectations in manufacturing and wholesale, the economic sectors that are particularly closely connected to foreign trade. In the other sectors, by contrast, employment expectations remain clearly above average, especially in construction but also in the services sector, although business sentiment here is relatively cautious. Overall, the impetus from the labour market for consumption is likely to be less dynamic in the future but unlikely to come to a halt any time soon.

### **The economic stalemate continues for the time being**

The November findings of the KfW-ifo SME Barometer confirm our picture of the German economy. Although there is no threat of a slump, momentum will remain weak for the time being because the split in the economy is set to continue into winter. While domestic performance should remain solid thanks to construction and consumption, the manufacturing recession will likely continue at least in the fourth quarter of 2019 and, with six consecutive quarters, will then be the longest in the history of post-unification Germany. The cyclical momentum will probably be rather muted in the first quarter of 2020 as well, before improving again as the year progresses. This will require the manufacturing sector to recover at least moderately in the coming year. Given the announcement of a partial agreement in the US-Chinese trade conflict, the lapsing of the deadline for a decision on special US tariffs on car imports from the EU and the now significantly reduced likelihood of a disorderly Brexit, we are looking to such a recovery with cautious optimism. All in all, we expect the German economy to grow by 0.5% in 2019 and 0.9% in 2020. However, the growth pickup next year is exclusively due to the additional output that will result from four additional working days (calendar effect). Adjusted for calendar effects, that is, driven purely by economic activity, gross domestic product in 2020 will therefore grow by just 0.5% and, thus, at the same weak pace as this year, for which the calendar effect is negligible.

**KfW-ifo SME Barometer in figures**

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Nov/18	Jun/19	Jul/19	Aug/19	Sep/19	Oct/19	Nov/19			
<b>Business climate</b>											
Manufacturing	SME	9.6	-5.5	-10.9	-13.1	-13.2	-14.8	-12.9	1.9	-22.5	-3.8
	LSE	4.8	-15.6	-23.3	-21.8	-21.5	-18.1	-21.2	-3.1	-26.0	0.0
Construction	SME	35.5	29.5	30.7	30.1	29.7	28.9	29.4	0.5	-6.1	-0.8
	LSE	34.0	28.4	25.0	14.2	24.9	19.8	14.4	-5.4	-19.6	-2.8
Retail trade	SME	8.5	14.1	11.5	13.2	9.9	8.7	12.0	3.3	3.5	-2.7
	LSE	-2.2	12.3	-1.1	5.4	0.3	-2.3	-4.0	-1.7	-1.8	-7.5
Wholesale trade	SME	8.5	-1.2	-4.5	-8.0	-10.4	-9.5	-9.6	-0.1	-18.1	-5.3
	LSE	4.6	-1.7	-16.4	-10.7	-16.5	-15.7	-9.3	6.4	-13.9	-4.2
Services	SME	14.2	4.7	4.6	-0.7	4.2	2.8	2.6	-0.2	-11.6	0.3
	LSE	13.9	4.2	3.0	-5.7	-6.4	-4.6	-1.4	3.2	-15.3	-4.6
<b>Germany</b>	<b>SME</b>	<b>14.0</b>	<b>4.8</b>	<b>3.1</b>	<b>-1.4</b>	<b>0.0</b>	<b>-0.2</b>	<b>0.1</b>	<b>0.3</b>	<b>-13.9</b>	<b>-2.2</b>
	<b>LSE</b>	<b>7.3</b>	<b>-4.7</b>	<b>-10.1</b>	<b>-12.8</b>	<b>-13.6</b>	<b>-12.0</b>	<b>-10.9</b>	<b>1.1</b>	<b>-18.2</b>	<b>-3.0</b>
Current situation	SME	26.0	16.8	15.8	10.1	12.2	9.8	10.0	0.2	-16.0	-3.6
	LSE	17.2	1.5	-5.0	-8.0	-9.3	-8.7	-7.8	0.9	-25.0	-4.8
Expectations	SME	2.8	-6.4	-8.7	-12.1	-11.4	-9.6	-9.3	0.3	-12.1	-1.0
	LSE	-1.9	-10.6	-15.1	-17.5	-17.9	-15.2	-14.1	1.1	-12.2	-1.3
<b>Employment expectations</b>	SME	10.4	2.1	2.9	0.1	0.9	0.7	3.4	2.7	-7.0	0.0
	LSE	15.0	1.4	-3.8	-1.5	-3.0	-2.4	-2.1	0.3	-17.1	-1.2
<b>Sales price expectations</b>	SME	14.3	3.7	2.3	3.0	0.9	3.1	3.2	0.1	-11.1	-0.6
	LSE	10.0	1.2	-1.1	-0.9	-0.5	-0.2	1.9	2.1	-8.1	0.7
<b>Export expectations of manufacturing</b>	SME	4.4	-10.1	-12.2	-12.4	-14.2	-13.1	-10.8	2.3	-15.2	-1.1
	LSE	-1.2	-12.7	-15.0	-13.5	-19.9	-11.9	-9.2	2.7	-8.0	0.1

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.