

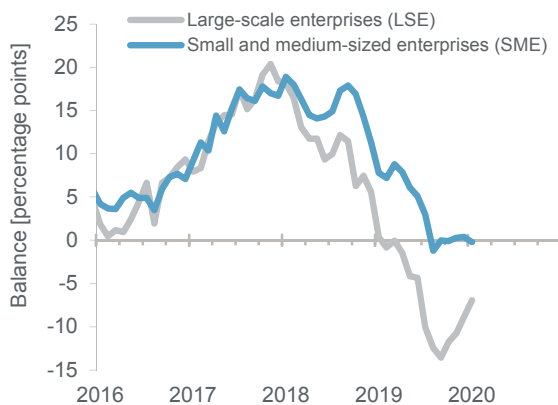
## »» A subdued start to the year for German SMEs

6 February 2020

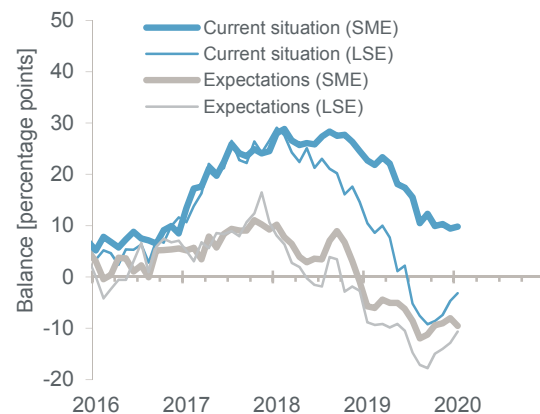
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- Business sentiment is down amid more sceptical expectations
- Some domestic sectors report a noticeable drop in confidence
- Manufacturing and large enterprises are rebounding
- Economic growth remains subdued for the time being

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### New year starts with a setback

The year 2020 began with a setback for small and medium-sized enterprises. In January their business climate dropped by 0.6 points to now -0.2 balance points, the lowest level since August of last year. That means the climate indicator has again failed to break out of the narrow corridor around the zero line, which stands for the long-term average and thus represents economic no man's land. The most recent drop in sentiment is exclusively due to the renewed decline in expectations:

- They fell by 1.5 points to now -9.6 balance points. Despite the most recent setback, the moderate upward trend in expectations remains intact, however, as illustrated by their average rise of 2.0 points over the current three months on the previous period.
- SMEs have a completely opposing view of the current business situation, which improved slightly by 0.4 points to 9.8 balance points in January. But that minor increase was not sufficient to reverse the negative trend observed over the three-month span (-1.1 points). The economic stalemate is not over yet.

### Confidence is rising in large enterprises

Large enterprises showed clear signs of life at the start of the year. Their business sentiment continued on the path to recovery which they embarked on in October, rising by -1.9 points to -6.9 balance points in January. The sentiment gap to SMEs narrowed as a result to 6.7 points from twice the level (13.5 balance points) in September 2019. While large enterprises' business situation assessments improved by 1.5 points to -3.2 balance points, their expectations rose by 2.2 points to -10.7 balance points.

### Signs of easing foreign trade tensions

The positive trend among large enterprises reflects easing tensions in the foreign trade environment. The US and China have signed a first partial agreement that brought pause to the trade conflict, and the United Kingdom exited from the EU with a proper agreement at the start of February. The segments of the economy that are particularly exposed to global developments are therefore breathing a deep sigh of relief. Thus, business sentiment improved among large service providers (+1.3 points to 1.4 balance points), wholesalers (SMEs: +3.8 points to -6.9 balance points; large enterprises: +3.7 points to -7.0 balance points) and manufacturers

## KfW Research

### KfW-ifo SME Barometer: January 2020

(SMEs: +2.1 points to -11.9 balance points; large enterprises: +1.8 points to -16.2 balance points). A slight contrast, however, is that manufacturers' export expectations improved improved only in the SME segment (+0.5 points to -9.8 balance points), while large manufacturers again lost part of the quite substantial boost of the previous month (-3.1 points to -8.1 balance points).

#### **Industrial problem is diminishing**

A healthy dose of caution is definitely in order with respect to the further foreign trade outlook. For example, the US could apply more trade policy pressure on the EU, as illustrated recently by the threat of special tariffs on European cars reiterated by President Trump on the World Economic Forum in Davos. At the same time, a new countdown has begun in the upcoming negotiations on future UK-EU relations up to the end of 2020. Furthermore it is still difficult to predict what specific consequences the novel coronavirus will have for China and the global economy. All in all, the German economy still has an industrial problem, which is also evident in the very low business confidence and export expectations levels of the manufacturing sector, but at least it is becoming smaller.

#### **Business sentiment in domestic sectors is down**

While the external situation eased somewhat at the start of the year, the hitherto reliable domestic economy lost a bit of steam. We see this as a delayed contagion effect after the long phase of international burdens. They were the cause of the manufacturing recession that began in the summer of 2018, which is now also being felt in moderate growth in un-

employment figures and weakening employment dynamic. Sentiment dropped noticeably among SME retailers (-2.9 points to 9.3 balance points), small and medium-sized service providers (-3.3 points to 1.5 balance points) and across the entire construction sector (SMEs: -4.5 points to 20.6 balance points; large enterprises: -3.4 points to 15.2 balance points). Nonetheless, confidence levels there remain quite good, especially in construction.

#### **Growth in the first quarter of 2020 will remain subdued**

In a nutshell, the January findings of the KfW-ifo SME Barometer show that economic momentum will remain subdued for the time being. There is both good and bad news at the start of the year so that hopes for a broad-based upswing would currently be just as exaggerated as fear of recession. A positive is that the conditions for the recovery of foreign trade have improved of late. On the negative side, the domestic economy, which has long been the mainstay of the business cycle, is showing cracks, while the most important global risks have diminished but not yet disappeared. It is impossible to rule out a renewed escalation of the US trade conflicts with China or the EU, nor an eventual hard Brexit should the UK and Europe fail to negotiate an agreement on trade and future relations by the end of 2020 (and should the British side continue to categorically reject the extension option for the transition phase by up to two years). At this stage, the coronavirus outbreak has become a new stress factor. Against this background, we again expect only weak economic growth in the first quarter. Our forecast of around 1% real growth for all of 2020 thus remains on track.

**KfW-ifo SME Barometer in figures**

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jan/19	Aug/19	Sep/19	Okt/19	Nov/19	Dez/19	Jan/20			
<b>Business climate</b>											
Manufacturing	SME	1.8	-13.0	-13.4	-14.6	-13.5	-14.0	-11.9	2.1	-13.7	0.5
	LSE	-3.6	-20.3	-20.9	-19.7	-20.9	-18.0	-16.2	1.8	-12.6	1.9
Construction	SME	25.7	29.9	29.3	28.3	28.7	25.1	20.6	-4.5	-5.1	-4.4
	LSE	30.6	14.0	24.8	19.7	14.5	18.6	15.2	-3.4	-15.4	-3.4
Retail trade	SME	6.1	13.0	9.6	8.4	12.0	12.2	9.3	-2.9	3.2	0.8
	LSE	-8.8	5.4	0.4	-2.2	-4.1	-5.3	-3.4	1.9	5.4	-5.5
Wholesale trade	SME	2.6	-7.9	-10.3	-9.2	-9.2	-10.7	-6.9	3.8	-9.5	0.2
	LSE	-6.9	-10.5	-15.7	-13.9	-9.2	-10.7	-7.0	3.7	-0.1	4.4
Services	SME	7.3	-0.5	4.2	2.8	2.8	4.8	1.5	-3.3	-5.8	0.9
	LSE	7.4	-5.3	-6.3	-4.6	-1.1	0.1	1.4	1.3	-6.0	5.5
<b>Germany</b>	<b>SME</b>	<b>7.8</b>	<b>-1.2</b>	<b>0.0</b>	<b>-0.1</b>	<b>0.3</b>	<b>0.4</b>	<b>-0.2</b>	<b>-0.6</b>	<b>-8.0</b>	<b>0.6</b>
	<b>LSE</b>	<b>0.4</b>	<b>-12.4</b>	<b>-13.5</b>	<b>-11.7</b>	<b>-10.7</b>	<b>-8.8</b>	<b>-6.9</b>	<b>1.9</b>	<b>-7.3</b>	<b>3.7</b>
Current situation	SME	22.7	10.5	12.3	9.9	10.3	9.4	9.8	0.4	-12.9	-1.1
	LSE	10.5	-7.6	-9.2	-8.6	-7.4	-4.7	-3.2	1.5	-13.7	3.4
Expectations	SME	-5.8	-12.0	-11.3	-9.5	-9.1	-8.1	-9.6	-1.5	-3.8	2.0
	LSE	-8.9	-17.2	-17.8	-15.0	-14.1	-12.9	-10.7	2.2	-1.8	4.1
<b>Employment expectations</b>	SME	8.1	0.1	1.0	0.8	3.5	1.8	2.0	0.2	-6.1	1.8
	LSE	10.4	-1.4	-3.0	-2.3	-2.2	-4.5	-4.6	-0.1	-15.0	-1.5
<b>Sales price expectations</b>	SME	13.5	3.0	0.8	3.0	3.1	4.8	8.4	3.6	-5.1	3.2
	LSE	11.4	-0.9	-0.7	-0.4	1.9	2.7	3.2	0.5	-8.2	3.3
<b>Export expectations of manufacturing</b>	SME	-2.9	-12.1	-14.3	-13.1	-11.2	-10.3	-9.8	0.5	-6.9	2.7
	LSE	-6.2	-13.6	-19.8	-11.9	-9.7	-5.0	-8.1	-3.1	-1.9	7.5

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.