

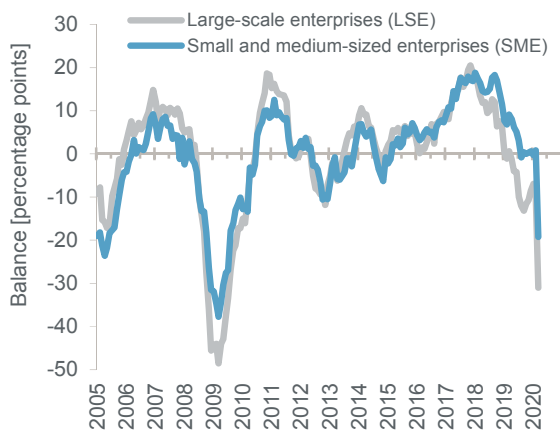
»» SME business confidence collapses under the strain of the coronavirus crisis

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Author: Dr Philipp Scheuermeyer, phone +49 69 7431-4017, philipp.scheuermeyer@kfw.de
Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- SME business confidence sustained a historic slump in March
- Expectations are now close to their all-time low. Most situation assessments do not yet reflect the lockdown
- Germany's retailers and service providers experienced an extreme drop, while construction remained relatively robust
- A very deep but probably relatively short recession is looming

KfW-ifo business climate



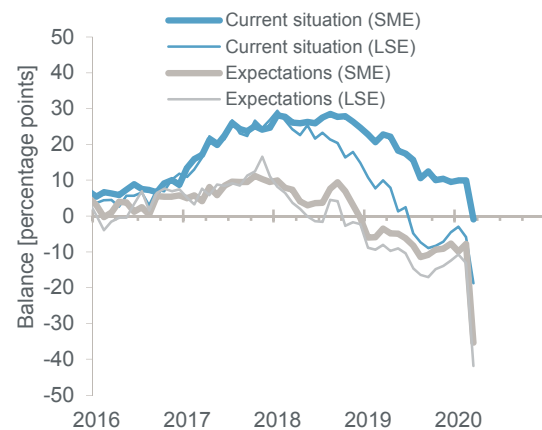
Source: KfW Research, ifo Institute

SME business sentiment suffers an historic collapse

Within a matter of weeks, the coronavirus epidemic evolved into a global pandemic that also hit Germany head-on. In order to contain the spread, authorities have ordered the gradual closing of catering and hospitality operations, bricks-and-mortar retail stores and many personal services since mid-March. On 22 March, social distancing regulations were introduced nationwide, placing the country in lockdown. Rarely before has a slump in business confidence therefore been so predictable. Nevertheless, the historically unique 20-point collapse in the SME business climate to -19.2 balance points underscores the magnitude of the crisis. The sharpest previous monthly decline, during the financial crisis in November 2008, was -8.2 points:

- Business expectations in particular crashed through the floor. After dropping by 27.5 points, they plunged to -35.3 balance points, close to the previous all-time low of -35.7 in December 2008.
- The business situation also deteriorated quickly by -10.9 points but only half as sharply as expectations. At

KfW-ifo climate components



-0.9 balance points, situation assessments actually indicate a continuing average economic environment. But a large portion of responses were given before the most stringent containment measures entered into effect. Around 90% of questionnaires arrived at the Ifo institute before 18 March. On the same day, Bavaria was the first federal state to order a general closure of businesses.

Large enterprises are even more pessimistic than SMEs

As in previous economic shocks, in March the business climate of large enterprises was even slightly lower than in the SME sector. They experienced the first fallout of the coronavirus crisis in February, while it was still largely confined to China. Missing inputs and diminishing sales opportunities are mainly affecting the very internationally oriented large-scale manufacturing industry. As the crisis spilled into Europe, large enterprises suffered a 21.4-point drop in confidence to -31.0 balance points in March. Lower levels were recorded only during the peak of the financial crisis in 2008/2009. Large enterprises' expectations in particular are also at a disastrously low level. But unlike SMEs, their situation assessments were already well below average.

The retail and service sectors are hardest hit

Although the manufacturing recession has been going on since the summer of 2018, small and medium-sized retailers and service providers in particular have been able to benefit from robust domestic demand thus far. This is changing radically with the restrictions imposed on public life to contain the spread of the novel coronavirus. Business confidence among SME service providers has dropped by 25.7 points to -24.6 balance points. While situation assessments nosedived by 18.9 points, expectations plunged by an almost unimaginable 31 points. SME retailers and wholesalers are in a similar situation, with their business sentiment plummeting by 22.6 and 21.0 points. Wholesalers were in a weaker position to begin with, which currently makes it the most downbeat sector of all, at -27.9 balance points, followed by service providers, whose business sentiment is now -24.6 balance points. Retail sentiment is down from a high starting level, which is why it is still a 'moderate' -12.3 balance points.

Manufacturing SMEs are hardly experiencing any restrictions from official infectious disease control measures. Nevertheless, they reported an unprecedented drop in business confidence. International value chains have already been severely disrupted since February. Moreover, national and global demand is falling sharply, which is also underscored by the rapid drop in export expectations of 17.6 points.

Construction is the only sector that remains relatively unfazed by the coronavirus crisis, recording a drop in sentiment of a mere 6.3 points. A large number of orders on hand will likely see the construction sector through several crisis months but tighter government restrictions and the absence of workers due to illness or quarantine measures can lead to losses here as well.

Full extent of the crisis is not yet known

To someone who spent the last weeks on a desert island, the sudden collapse of the KfW-ifo SME Barometer in March would seem like a typing error. But yet it fails to capture the

full extent of the crisis so far. During the survey period, while it became apparent that the pandemic would escalate and the resulting restrictions would be intensified, most of them were not yet in force in Germany. The full impact, particularly on business activity but also on expectations, is not likely to be mapped until April. Furthermore, all sentiment indicators – as well as the KfW-ifo SME Barometer – generally tend to capture the breadth of the crisis rather than its depth. In the survey, businesses describe their situation as poor regardless of whether their turnover dropped by 20 or 100%.

How deep and long will the V become?

The results of the KfW-ifo SME Barometer underscore that the German economy is facing an economic downturn of historic proportions. Unlike in previous recessions, the slump is not primarily being caused by cyclical and export-oriented industrial sectors. Rather, many parts of the domestic economy have been deliberately shut down. Small and medium-sized enterprises are therefore being hit harder than in the financial crisis of 2009, for example. This is likely to be reflected in the next KfW-ifo SME Barometer. For example, the OECD estimates that the lockdown in Germany has directly shut down almost 30% of economic activity. After the containment measures are lifted, however, the normalisation can be expected to lead to a very strong temporary growth surge. If the measures are eased quickly, as early as at the beginning of May, average GDP for 2020 will likely see a massive plunge reminiscent of the financial crisis of 2009. However, because the duration of the pandemic is difficult to predict and given the danger of a second wave of infections, the risk of a prolonged recession is high. In that case, the decline in GDP would be even sharper and the hypothesis of a V-shaped recovery would also be endangered by macroeconomic knock-on effects.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Mar/19	Oct/19	Nov/19	Dec/19	Jan/20	Feb/20	Mar/20			
Business climate											
Manufacturing	SME	0.2	-14.5	-13.3	-13.8	-11.2	-7.7	-22.5	-14.8	-22.7	0.1
	LSE	-7.4	-19.2	-20.6	-17.9	-16.0	-16.4	-36.2	-19.8	-28.8	-3.6
Construction	SME	28.2	28.1	28.4	24.6	20.2	18.6	12.3	-6.3	-15.9	-10.0
	LSE	26.5	19.2	14.1	18.2	14.6	17.0	6.5	-10.5	-20.0	-4.5
Retail trade	SME	14.9	8.4	12.2	12.1	8.5	10.3	-12.3	-22.6	-27.2	-8.7
	LSE	3.5	-2.6	-4.6	-5.6	-2.5	-1.4	-22.3	-20.9	-25.8	-4.5
Wholesale trade	SME	1.8	-8.9	-9.0	-10.8	-6.5	-6.9	-27.9	-21.0	-29.7	-4.2
	LSE	4.4	-13.6	-9.0	-10.9	-6.4	-5.1	-28.0	-22.9	-32.4	-2.0
Services	SME	11.1	3.1	3.0	5.1	1.8	1.1	-24.6	-25.7	-35.7	-11.0
	LSE	10.7	-4.2	-0.8	0.4	1.7	-3.4	-29.6	-26.2	-40.3	-8.9
Germany	SME	9.1	0.0	0.3	0.6	-0.3	0.8	-19.2	-20.0	-28.3	-6.5
	LSE	0.6	-11.6	-10.6	-8.5	-6.9	-9.6	-31.0	-21.4	-31.6	-5.6
Current situation	SME	22.8	10.1	10.4	9.5	10.0	10.0	-0.9	-10.9	-23.7	-3.6
	LSE	9.9	-8.4	-7.2	-4.5	-3.0	-6.0	-18.8	-12.8	-28.7	-2.6
Expectations	SME	-3.5	-9.4	-9.1	-7.7	-9.9	-7.8	-35.3	-27.5	-31.8	-8.9
	LSE	-8.1	-14.9	-14.0	-12.5	-10.8	-13.2	-41.9	-28.7	-33.8	-8.2
Employment expectations	SME	7.4	0.9	3.4	1.6	1.9	1.2	-8.5	-9.7	-15.9	-3.8
	LSE	6.3	-2.0	-2.0	-4.6	-5.0	-8.7	-15.4	-6.7	-21.7	-6.8
Sales price expectations	SME	8.4	3.1	3.0	4.8	8.2	4.2	-4.5	-8.7	-12.9	-1.0
	LSE	4.7	-0.5	1.8	2.6	3.1	0.8	-5.1	-5.9	-9.8	-1.7
Export expectations of manufacturing	SME	-5.4	-12.8	-11.1	-10.4	-9.7	-8.8	-26.4	-17.6	-21.0	-3.5
	LSE	-9.8	-11.6	-9.8	-4.2	-8.5	-13.4	-34.2	-20.8	-24.4	-10.2

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.