

## »» Worry lines in SMEs are deepening again

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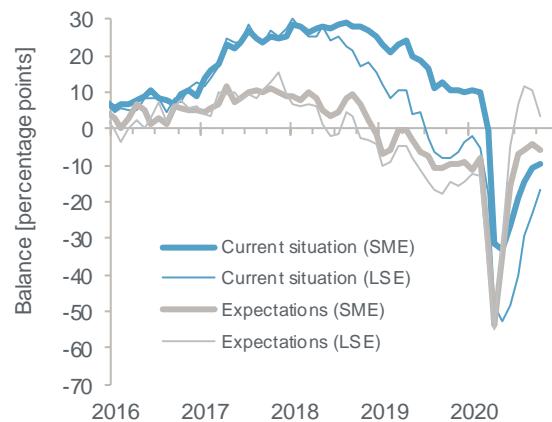
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- Second wave of infections led to a slight drop in SME sentiment in October.
- Expectations fell slightly, while situation assessments saw another moderate improvement.
- Large enterprises' expectations fell significantly.
- The November lockdown will likely interrupt the economic recovery.

**KfW-ifo business climate**



**KfW-ifo climate components**



Source: KfW Research, ifo Institute

### Dark clouds on the horizon

The outlook for small and medium-sized enterprises is darkening amid the second wave of infections. In October the containment measures, still mild and mostly local, hardly disrupted business activity but tighter restrictions were foreseeable as new infections were rising fast. SME business confidence fell by 0.4 points:

- With a decline of -3.9 to -5.7 points, the drop in expectations among SMEs remains moderate overall. The extent of the partial lockdown imposed on the hospitality, arts, entertainment, sport and recreation sectors and some personal services at the end of October was not yet known at the time of the survey. Besides, expectations were already on a fairly low level in the previous month to begin with and there was (reasonable) hope that the new restrictions would affect only specific sectors directly.
- Assessments of the business situation, by contrast, improved moderately. But although they rose by 0.9 points in October, they remained at -9.6 balance points, well below the pre-crisis level of 10.2 points in February.

### Large enterprises' expectations have dropped

Large enterprises' situation assessments and expectations moved even more strongly in opposite directions. While situation assessments improved significantly by 6.6 points, expectations fell sharply by -7.4 points. On balance, overall business sentiment changed only little (-0.2 points to -6.3 balance points). Large service enterprises, some of which are also affected by the November lockdown, reported the strongest decline in sentiment. Indirectly, however, the rapid surge in new infections is likely to have weighed on the confidence of large retailers as well (-2.3 point). In large manufacturers, on the other hand, the business situation is recovering in leaps and bounds, although their outlook is dimming here as well, so that their sentiment improved by a mere 3.8 points overall.

### Manufacturing sentiment continues to improve

Small and medium-sized industrial firms, too, continued to rebound sharply in October. Thanks to a noticeable improvement in situation assessments, their sentiment rose by 3.1 points to -8.1 points. Export-oriented manufacturers in particular are likely to be benefiting from the vigorous recovery in China and the US and the high catch-up potential after the very deep slump in the spring also plays a role for the

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current momentum. Weakening business and export expectations however, especially among large industrial firms, now point to slowing momentum already. A similar trend as in manufacturing can be seen in the often closely connected wholesale sector.

What is somewhat surprising is that sentiment among small and medium-sized service businesses has fallen less steeply than among large enterprises (-2.0 points vs. -4.2 points). After all, the sectors most affected by the measures imposed to contain the pandemic, such as hospitality, include many small businesses. The main reason is probably the lower starting level (-13.4 balance points).

The rapidly rising new infection rates hardly disrupted the business operations of small and medium-sized retailers in October. Their business climate even improved on a high level (+2.8 points to 11.2 points). The pandemic appears to have had little impact on the appetite for spending so far and the temporary value added tax reduction and catch-up effects are also contributing. Nevertheless, it is difficult to explain the discrepancy to the significantly more pessimistic large enterprises. Real-time data shows that the number of people in downtown areas in Germany is currently declining, so that sentiment at least in physical retail stores is set to deteriorate again soon.

### **November lockdown will interrupt the recovery**

The German economy powered its way out of the spring slump in the third quarter, with GDP growing at a rate of 8.2%. But the KfW-ifo SME Barometer shows that the business situation of small and medium-sized enterprises is still well below the very good levels at the start of the year. Furthermore, the partial lockdown imposed for November in Germany and almost all other European countries will set their performance back slightly again. However, the fairly prompt response, at least in Germany, means there is a good chance that the damage can be confined to the particularly contact-intensive sectors. The planned compensation payments are not just important for those businesses that have already been hit hard and now have to close again but are designed to prevent worse outcomes for the aggregate economy. As other sectors and, in particular, manufacturing industries can still operate with relatively little disruption, economic output in the current quarter is likely to drop only moderately. But there is still a long winter ahead and the downside risks are therefore high.

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**KfW-ifo SME Barometer in figures**

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Oct/19	May/20	Jun/20	Jul/20	Aug/20	Sep/20	Oct/20			
<b>Business climate</b>											
Manufacturing	SME	-14.5	-40.0	-27.9	-17.7	-16.3	-11.2	-8.1	3.1	6.4	16.7
	LSE	-19.0	-49.8	-38.0	-24.3	-16.1	-10.2	-6.4	3.8	12.6	26.5
Construction	SME	27.3	-3.2	2.4	6.2	8.3	12.9	10.0	-2.9	-17.3	8.6
	LSE	20.1	-19.0	-16.4	-10.0	-10.3	-5.6	-8.3	-2.7	-28.4	7.1
Retail trade	SME	8.3	-21.5	-0.9	8.6	7.7	8.4	11.2	2.8	2.9	13.7
	LSE	-1.2	-27.4	-12.9	-8.6	8.3	-1.4	-3.7	-2.3	-2.5	17.4
Wholesale trade	SME	-9.7	-36.9	-28.1	-15.3	-11.9	-9.7	-9.6	0.1	0.1	16.4
	LSE	-13.9	-30.2	-22.7	-12.8	-14.4	-4.5	-1.0	3.5	12.9	15.3
Services	SME	3.6	-38.3	-23.1	-15.6	-12.3	-11.4	-13.4	-2.0	-17.0	13.3
	LSE	-4.0	-38.0	-18.3	-10.0	-2.6	-2.5	-6.7	-4.2	-2.7	18.2
<b>Germany</b>	<b>SME</b>	<b>0.1</b>	<b>-33.8</b>	<b>-20.9</b>	<b>-12.7</b>	<b>-10.0</b>	<b>-7.1</b>	<b>-7.5</b>	<b>-0.4</b>	<b>-7.6</b>	<b>14.3</b>
	<b>LSE</b>	<b>-11.2</b>	<b>-41.3</b>	<b>-26.6</b>	<b>-17.1</b>	<b>-8.8</b>	<b>-6.1</b>	<b>-6.3</b>	<b>-0.2</b>	<b>4.9</b>	<b>21.3</b>
Current situation	SME	10.3	-33.0	-26.5	-19.1	-14.8	-10.5	-9.6	0.9	-19.9	14.6
	LSE	-7.8	-52.8	-48.5	-40.3	-29.1	-23.2	-16.6	6.6	-8.8	24.2
Expectations	SME	-9.5	-34.7	-15.6	-6.6	-5.5	-3.9	-5.7	-1.8	3.8	13.9
	LSE	-14.7	-30.5	-4.4	6.7	11.5	10.7	3.3	-7.4	18.0	17.9
<b>Employment expectations</b>	<b>SME</b>	<b>0.9</b>	<b>-16.8</b>	<b>-10.7</b>	<b>-8.3</b>	<b>-5.3</b>	<b>-2.3</b>	<b>-2.1</b>	<b>0.2</b>	<b>-3.0</b>	<b>8.7</b>
	<b>LSE</b>	<b>-2.2</b>	<b>-25.9</b>	<b>-19.0</b>	<b>-17.9</b>	<b>-13.0</b>	<b>-10.8</b>	<b>-8.4</b>	<b>2.4</b>	<b>-6.2</b>	<b>10.2</b>
<b>Sales price expectations</b>	<b>SME</b>	<b>3.5</b>	<b>-11.6</b>	<b>-8.8</b>	<b>-4.1</b>	<b>-3.0</b>	<b>-2.5</b>	<b>-2.6</b>	<b>-0.1</b>	<b>-6.1</b>	<b>5.5</b>
	<b>LSE</b>	<b>0.1</b>	<b>-15.0</b>	<b>-12.4</b>	<b>-9.0</b>	<b>-5.0</b>	<b>-2.8</b>	<b>-0.9</b>	<b>1.9</b>	<b>-1.0</b>	<b>9.2</b>
<b>Export expectations of manufacturing</b>	<b>SME</b>	<b>-12.4</b>	<b>-40.5</b>	<b>-19.7</b>	<b>-15.2</b>	<b>-14.7</b>	<b>-9.7</b>	<b>-10.4</b>	<b>-0.7</b>	<b>2.0</b>	<b>13.5</b>
	<b>LSE</b>	<b>-13.5</b>	<b>-29.5</b>	<b>-4.6</b>	<b>11.6</b>	<b>5.2</b>	<b>11.7</b>	<b>6.3</b>	<b>-5.4</b>	<b>19.8</b>	<b>15.2</b>

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.