

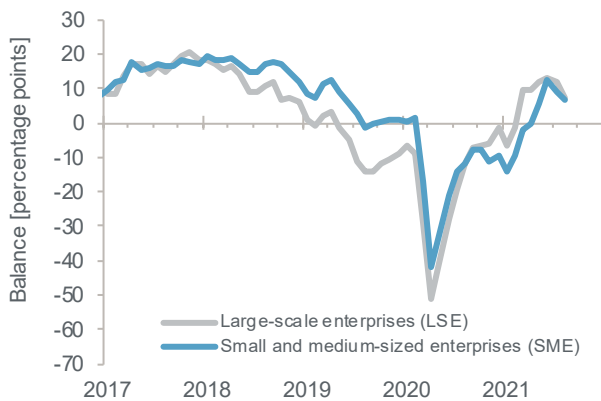
Business sentiment drops as concerns are back

6 September 2021

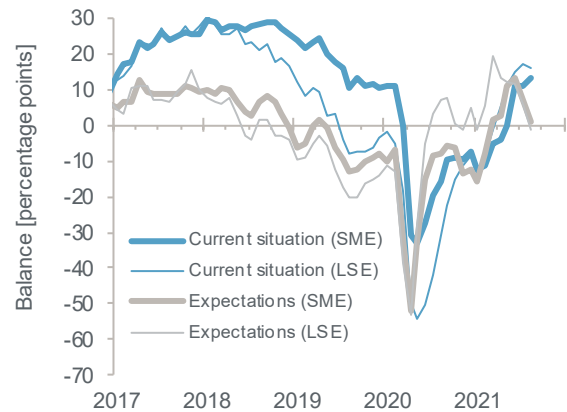
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- Further drop in expectations drags down SME business confidence
- Current situation assessments, in turn, rise for the seventh consecutive month
- Confidence in large enterprises also in decline
- Economic growth in 2021 will likely be slightly lower than expected

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, Ifo Institute

Second consecutive drop in SME business sentiment

After the lockdown measures were largely lifted, the highly transmissible Delta variant has now unleashed a fourth coronavirus wave in Germany. At the same time, the supply bottlenecks in the manufacturing sector are more persistent than initially assumed. Both of these factors are fuelling concerns over the future economic recovery, dragging down SME business sentiment in August by 2.3 points to 6.9 balance points. It had already fallen by 3.0 points in July. Again, the sole driver of the renewed drop is the expectation component of the business climate:

- SME business expectations dropped by a very significant 6.4 points. At 0.8 balance points they are now just slightly above the zero line, which represents the long-term average. In June they were still on the ten-year high of 13.4 balance points, which impressively illustrates the rapid decline in expectations within just two months.
- Business situation assessments, on the other hand, continued on their upward trend since bottoming out in January. At 13.1 balance points, 1.9 points higher than in July, they are now at the highest level this year. Economic growth should be exceptionally strong in the summer quarter.

Sentiment slips in large enterprises as well

Large enterprises were also more pessimistic in August. However, they drastically downgraded not just their expectations – as did SMEs. Expectations dropped by 7.2 points to -1.1 balance points and are now slightly below average again for the first time since the start of the year. Their business situation assessments fell at the same time, albeit not as much (-1.2 points to 16.0 balance points). Overall, business sentiment among large enterprises dropped by 4.4 points to 7.2 balance points – almost the same level as in the SME sector.

Construction is the only sector to buck the trend

An analysis by economic sectors and enterprise size classes shows that only the construction sector stood out positively in August. Sentiment improved in both small and medium-sized (+1.3 points to 13.5 balance points) and large construction firms (+4.7 points to 9.5 balance points), despite material shortages such as construction timber weighing on business activity there for several months now. The sentiment improvement suggests an at least gradual easing of these supply-side disruptions but primarily shows that business remains fundamentally good in this sector. Business confi-

dence fell more or less significantly in almost all other segments. The declines range from a rather moderate consolidation in manufacturing SMEs (-2.0 points to 15.2 balance points) and large retail firms (-2.1 points to 2.5 balance points) to significant declines in small and medium-sized retail (-8.0 points to 8.3 balance points) and large-scale industry (-9.6 points to 16.4 balance points). The rapid deterioration of business confidence in the large-scale industrial sector, which in the previous month had just reached the second highest level since the beginning of the time series in January 2005, was coupled with an equally abrupt drop in export expectations (-10.4 points to 4.6 balance points; whereas export expectations of small and medium-sized manufacturers fell by a mere 2.3 points to 7.5 balance points). It appears that the global shortages of industrial inputs such as electronic components continue to be so severe that industrial output for the time being can no longer keep pace with the very strong order volume, with new orders already at 11.2% above the pre-coronavirus crisis level in June and the stock of orders even reaching an all-time high, so that expectations were downgraded accordingly. The decline among small and medium-sized service providers remains limited but it remains palpable while taking place on a comparatively low sentiment level (-3.1 points to 2.0 balance points; large service businesses, in turn, remain stable on an equally low level, with +0.4 points to 3.2 balance points). The bulk of contact-intensive activities in the arts, entertainment, accommodation and personal services are conducted by SME service providers, which is why these are increasingly concerned about the emerging fourth coronavirus wave. At the same time, it is good to note that the level of business sentiment across all sectors remains positive, that is, sentiment in August continues to be better than the long-term average in all areas despite in part significant declines.

Price and employment expectations are plateauing

The three-month sales price expectations surveyed among businesses had increased sharply since the start of the year and reached unprecedented levels at the beginning of summer. They are now showing signs of plateauing, however.

Thus, price expectations of small and medium-sized enterprises remained virtually steady in August (+0.3 points to 29.4 balance points), sitting marginally below the all-time high two months ago (June: 30.0 balance points). Price expectations of large enterprises continued to rise but the upward momentum slowed very significantly compared with the trend so far this year (+3.8 points to 32.5 balance points). That means there is still a very good chance that the significantly higher current inflation rates – which are partly the result of special factors such as the VAT reduction in the second half of 2020 – will remain a temporary phenomenon. Employment expectations also began to plateau on a high level, moving more or less sideways in both enterprise size classes in August (SMEs: +1.0 points to 12.6 balance points; large enterprises: -0.4 points to 11.7 balance points). In the past months, service providers were rehiring workers after pandemic restrictions were largely eased, generating particularly strong impetus for employment growth. When this special effect wanes, employment growth will likely slow in the near to medium term but the positive basic trend on the labour market will remain intact.

Slight downward revision to the growth forecast

It is summer but rain clouds keep blocking out the sun. This is how the most recent KfW-ifo SME Barometer aptly describes the present mood in the German economy. Towards the end of the meteorological summer, clouds again dominate the business cycle and, although situation assessments improved yet again in August, confidence dropped for the second time after the decline in July. The deterioration in business sentiment driven by lower expectations fits the picture, as there is limited further upside potential. The material shortages in the industrial sector will ease only gradually in the months ahead and until they do they will weigh on production despite high demand. To be sure, after the lockdowns private households now have unusually high amounts of money in their wallets to buy more of the services they have long missed, such as hospitality. But with the Delta variant and the fourth coronavirus wave rolling towards us, pandemic concerns are rising again. We have therefore slightly downgraded our GDP forecast for 2021 to 3.0%.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Aug 2020	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021			
Business climate											
Manufacturing	SME	-15.5	7.0	10.1	12.2	16.4	17.2	15.2	-2.0	30.7	6.5
	LSE	-15.2	19.3	19.9	21.1	24.3	26.0	16.4	-9.6	31.6	2.1
Construction	SME	6.9	8.9	7.8	10.4	11.6	12.2	13.5	1.3	6.6	3.4
	LSE	-10.4	0.4	-1.4	1.8	1.2	4.8	9.5	4.7	19.9	4.9
Retail trade	SME	6.6	-7.7	-2.2	5.4	15.7	16.3	8.3	-8.0	1.7	14.9
	LSE	8.1	-5.6	-5.0	-0.1	7.6	4.6	2.5	-2.1	-5.6	8.5
Wholesale trade	SME	-11.2	-0.9	3.2	12.3	13.2	14.0	11.3	-2.7	22.5	8.0
	LSE	-13.7	4.5	10.3	15.1	15.3	15.9	8.1	-7.8	21.8	3.1
Services	SME	-12.9	-11.7	-14.1	-2.4	8.7	5.1	2.0	-3.1	14.9	14.7
	LSE	-6.9	-2.5	-2.9	4.7	4.6	2.8	3.2	0.4	10.1	3.8
Germany	SME	-11.7	-1.8	-0.4	5.6	12.2	9.2	6.9	-2.3	18.6	8.3
	LSE	-11.7	9.3	9.8	11.7	13.2	11.6	7.2	-4.4	18.9	0.4
Current situation	SME	-15.8	-5.2	-3.9	-0.1	10.7	11.2	13.1	1.9	28.9	14.7
	LSE	-30.8	-1.5	5.5	10.9	14.8	17.2	16.0	-1.2	46.8	11.0
Expectations	SME	-7.9	1.4	2.7	11.1	13.4	7.2	0.8	-6.4	8.7	2.1
	LSE	7.3	19.5	13.4	12.1	11.3	6.1	-1.1	-7.2	-8.4	-9.6
Employment expectations	SME	-5.4	1.2	3.6	8.1	14.3	11.6	12.6	1.0	18.0	8.5
	LSE	-13.2	-1.1	-0.2	3.8	8.0	12.1	11.7	-0.4	24.9	9.8
Sales price expectations	SME	-4.5	9.8	15.0	23.6	30.0	29.1	29.4	0.3	33.9	13.4
	LSE	-6.4	9.5	14.5	20.7	27.5	28.7	32.5	3.8	38.9	14.7
Export expectations of manufacturing	SME	-14.4	4.4	7.2	9.2	12.5	9.8	7.5	-2.3	21.9	3.0
	LSE	4.0	21.9	19.7	13.5	11.7	15.0	4.6	-10.4	0.6	-7.9

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.