

Supply shortages are temporarily slowing down the recovery

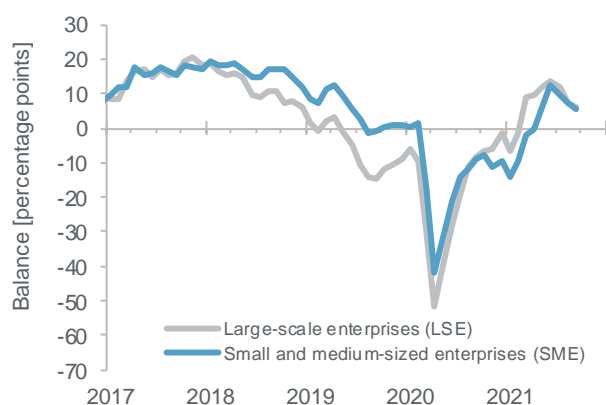
4 October 2021

Author: Dr Philipp Scheuermeyer, phone +49 69 7431-4017, philipp.scheuermeyer@kfw.de

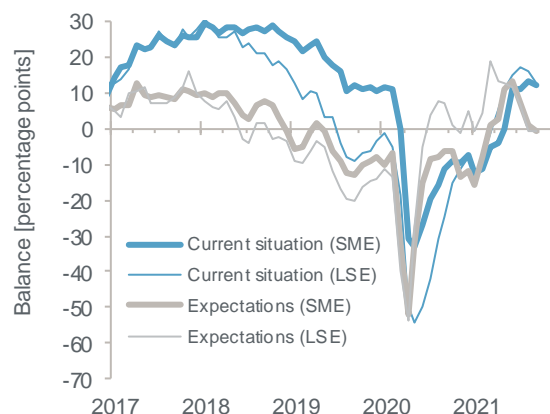
Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- SME business sentiment drops for the third consecutive month
- Situation assessments slip for first time since January, expectations trending downward
- Manufacturing is dragging down sentiment but construction is much more confident
- Economic growth is set to flatten out in the fourth quarter but remain positive

KfW-ifo business climate



KfW-ifo climate components



Source: KfW Research, Ifo Institute

SME business confidence trending downward

Business sentiment among small and medium-sized enterprises has embarked on a downward trend, dropping for the third consecutive month. Just like the weather, economic activity this late summer was a mixed bag. SME business sentiment dropped by 1.7 points to an only slightly above-average 5.3 points, particularly as a result of a sharp drop in confidence in the manufacturing sector.

- Business expectations for the next six months continue on the downward trend that began in July. The renewed decline by 2.0 points shows that the euphoria of early summer has evaporated. At -0.9 balance points, expectations are now slightly below the zero line, which stands for the long-term average.
- For the first time since January, business situation assessments have now also dropped, down by 1.4 points to 11.9 balance points. As the catch-up effect in the services sector is gradually coming to an end, economic growth is likely to flatten out at the start of the cold season.

Business sentiment has also cooled in large enterprises

Business confidence among large enterprises dropped at a similar rate as in SMEs (-1.6 points to 5.9 balance points). Here, however, lower situation assessments are the sole cause. SMEs' expectations, in turn, stagnated in September, after dropping sharply in the two preceding months. Expectations among large enterprises also fell slightly below the long-term average and are down -0.6 points.

Sharp drop in sentiment in manufacturing

The manufacturing sector in particular is dragging down sentiment. This is particularly the case among manufacturing SMEs, whose business confidence in September plunged by 7.8 points to now just 7.0 balance points. After reaching very high levels in the preceding months, their situation assessments fell sharply. Above all, expectations are deteriorating rapidly and are now slightly below average. Export expectations, on the other hand, remain on their high level. Although demand for German manufactured goods is high, numerous material shortages and bottlenecks in transport capacities are hampering production. It appears that SME manufacturers are losing hope that the situation will improve. On the other hand, business expectations among large manufactur-

KfW Research KfW-ifo SME Barometer: September 2021

ing firms were slightly higher than in the previous month. Significantly lower situation assessments here were the only driver of the sentiment drop of 4.6 points to what still remains an exceptionally good 12.5 balance points.

Construction firms, on the other hand, gave much more positive responses to the survey. Although record-high supply shortages have prevailed here too since the beginning of the year, business sentiment has steadily improved among small and medium-sized construction and civil engineering firms, jumping noticeably by 4.0 points to 17.7 balance points last month. Unlike in the manufacturing sector, the bottlenecks in the construction sector appear to have been easing somewhat since the summer. According to the ifo Institute, in September the share of construction firms hit by material shortages was a very high 36% but in June even half of all businesses were affected. Furthermore, the world market price of timber and steel has also dropped significantly since peaking in the spring.

There are bright spots in the segment of SME service businesses as well, where business sentiment improved by 1.2 points to 3.2 balance points. With declining infection rates, businesses in the fields of arts and culture, entertainment, hospitality and personal services, all of which form part of the services segment, are probably a bit more at ease now about the further progression of the pandemic. After literally collapsing in July and August, expectations are improving quite clearly and overcompensating a slight drop in situation assessments. The latter might signal the end of catch-up growth, although situation assessments edged up to only a slightly above-average level in the summer. Among retail SMEs, on the other hand, business sentiment is currently stagnating at a solid 8.2 points. Situation assessments are well above average while business expectations are hovering

on a slightly below-average level, presumably also as a reflection of persistent supply chain disruptions. In wholesale SMEs, a sector that is even more closely integrated with manufacturing, supply chain problems are also likely to be the cause of the minor drop in confidence (-1.1 points to 9.3 balance points), even though sentiment remains very high.

Growth is flattening

The last yards are the most difficult. The KfW-ifo SME Barometer shows that this also applies to the pathway of Germany's SMEs out of the coronavirus crisis. Shortages of materials, intermediate inputs and freight capacity, in particular, have already slowed production for the past months and could increasingly weigh on retail trade as well. Given the multitude of disruptive forces, however, it is difficult to predict when the supply situation will improve. For example, China's strict zero-COVID policy may lead to recurring supply chain problems and pronounced shortages of fossil fuels from Europe to China have recently exacerbated the situation. Against this backdrop, the small dip in sales price expectations (-1.0 points to 28.2 balance points) is a relatively good sign, even though the share of enterprises expecting a price increase continues to be much higher than it ever was before the crisis. The drop in infection rates during the survey period is encouraging for service industries that were particularly affected by the pandemic. Even if infection rates will presumably rise again in the autumn or winter, the use of vaccination certificates, tests and face coverings makes broader shut-downs unlikely. All in all, aggregate economic growth is likely to flatten in the coming months but remain positive. In addition, pent-up demand in the manufacturing sector also provides potential for a growth surge when the current supply chain bottlenecks gradually ease. However, this will probably only be the case in the course of the coming year.

KfW Research
KfW-ifo SME Barometer: September 2021

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year									
		Sep 2020	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021	m-o-m	y-o-y	3m-o-3m
Business climate											
Manufacturing	SME	-11.3	10.1	12.2	16.1	16.9	14.8	7.0	-7.8	18.3	0.1
	LSE	-12.0	19.9	20.9	23.8	24.4	17.1	12.5	-4.6	24.5	-3.5
Construction	SME	11.1	7.8	10.4	11.6	12.5	13.7	17.7	4.0	6.6	4.7
	LSE	-6.9	-1.5	1.7	1.1	5.3	9.6	9.8	0.2	16.7	7.8
Retail trade	SME	6.4	-1.8	5.5	15.5	15.3	8.2	8.2	0.0	1.8	4.2
	LSE	-2.4	-4.4	-0.1	7.5	3.7	1.1	-7.5	-8.6	-5.1	-1.9
Wholesale trade	SME	-11.1	3.3	12.3	13.3	13.6	10.4	9.3	-1.1	20.4	1.5
	LSE	-3.0	10.4	14.6	15.0	15.0	8.5	6.9	-1.6	9.9	-3.2
Services	SME	-11.8	-14.1	-2.3	8.8	5.1	2.0	3.2	1.2	15.0	6.0
	LSE	-7.0	-2.9	4.8	4.7	2.8	3.4	2.3	-1.1	9.3	0.6
Germany	SME	-8.7	-0.5	5.8	12.3	9.3	7.0	5.3	-1.7	14.0	1.3
	LSE	-8.5	9.5	12.1	13.5	11.7	7.5	5.9	-1.6	14.4	-3.3
Current situation	SME	-11.1	-3.9	0.0	10.9	11.2	13.3	11.9	-1.4	23.0	9.8
	LSE	-24.5	5.4	10.9	15.0	17.2	16.1	12.5	-3.6	37.0	4.8
Expectations	SME	-6.4	2.7	11.2	13.5	7.3	1.1	-0.9	-2.0	5.5	-6.6
	LSE	6.9	12.9	12.6	11.7	6.3	-0.6	-0.6	0.0	-7.5	-10.7
Employment expectations	SME	-2.3	3.6	8.0	14.1	11.3	12.3	12.6	0.3	14.9	3.5
	LSE	-11.6	-0.3	3.7	7.9	12.0	11.7	14.3	2.6	25.9	8.9
Sales price expectations	SME	-3.9	14.9	23.4	29.8	28.9	29.2	28.2	-1.0	32.1	6.1
	LSE	-4.4	14.4	20.5	27.4	28.4	32.1	29.5	-2.6	33.9	9.2
Export expectations of manufacturing	SME	-8.9	7.3	9.2	12.3	9.4	7.0	7.1	0.1	16.0	-1.8
	LSE	5.6	19.5	13.4	12.6	15.8	4.0	14.8	10.8	9.2	-3.6

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.