

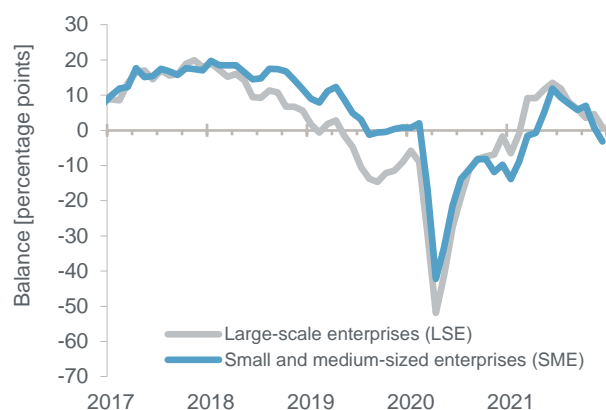
## »»» Omicron is clouding business sentiment and economic outlook for 2022

27 December 2021

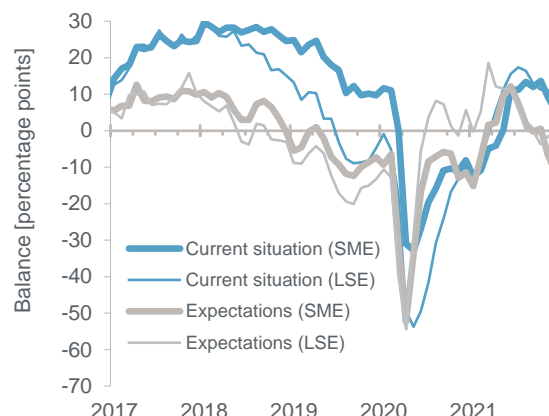
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- SME business sentiment is continuing to fall rapidly
- Expectations and situation assessments of SMEs are down sharply
- Sentiment among large enterprises has also weakened significantly
- Dark clouds are gathering on the economic horizon this winter

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### SME business sentiment has dropped below the zero line

The new Omicron variant is drawing new worry lines on the faces of managers in small and medium-sized enterprises. SME business sentiment worsened by 4.0 points in December, continuing the downward trend that began in July and paused only in October. For the first time since April, sentiment has fallen below the zero line to now -3.1 balance points, which is lower than the historic average. Both components of the business sentiment indicator have dropped noticeably:

- Assessments of the current business situation are now at just 5.5 balance points, down 3.6 points. On average for the months of October to December, they even fell by 6.0 points on the three preceding months, indicating fundamentally weak economic activity in the final quarter of 2021.
- Business expectations for the next six months even worsened by 4.5 points. They are now again deep in pessimistic territory at -11.3 balance points – a déjà vu of the previous year. SMEs were similarly downbeat about their business outlook in December 2020 as well.

### Large enterprises are back in a downward spiral

Large enterprises, too, are being drawn into a downward spiral again in December, after their sentiment stabilised temporarily in November. Their business confidence dropped at practically the same rate as that of SMEs, falling by -3.8 points to 0.8 balance points. However, it was their business situation assessments, which fell by -4.9 points to 6.1 balance points, that contributed slightly more to the deterioration than their expectations (-2.9 points to -4.3 balance points).

### Service providers and retailers are particularly worried about Omicron

Sentiment plunged abruptly among services businesses (SMEs: -6.9 points to -11.9 balance points; large enterprises: -9.0 points to -10.6 balance points) and retailers (SMEs: -8.0 points to -9.8 balance points; large enterprises: -8.4 points to -18.1 balance points) in December. The declines in business confidence here were up to three times the typical monthly variation. This icy sentiment comes as little surprise. The Delta wave, which was just beginning to flatten out on a high level, already made it necessary to restrict capacities at certain venues to vaccinated or recovered persons and caused some patrons to stay away from contact-intensive venues such as restaurants, leisure, entertainment and

recreational facilities as well as stationary retail outlets for fear of infection. Initial findings indicate that the new virus variant is particularly infectious and likely to more easily evade vaccine protection than previous variants. Therefore, despite progress in the booster campaign, stricter contact restrictions are looming to prevent the health care system from becoming overwhelmed, as the Omicron wave is expected to surge at the start of the new year 2022.

#### **Inflation and supply bottlenecks are additional burdens**

Besides the pandemic, the strong energy price-driven increase in consumer prices is another major burden. The sales price indicators of SMEs (-1.7 points to 35.8 balance points) and large enterprises (-1.0 points to 35.8 balance points) remain on a near-record level despite easing slightly in December. The currently high rate of inflation is reducing household purchasing power and, thus, demand for services and retail goods. In addition, retailers are lamenting ongoing disruptions to global supply chains, which are limiting the choice of products during the important Christmas sales. Despite very strong order volumes, the production in manufacturing has been slowed down by material bottlenecks all through the year already. Nevertheless, manufacturing was able to maintain a slightly positive sentiment level in December (SMEs: unchanged at 2.6 balance points; large enterprises: -1.9 points to 7.2 balance points). Construction remains the sector with the highest sentiment level by far, despite the decline at the end of the year (SMEs: -3.9 points to 13.6 balance points; large enterprises: -4.8 points to 10.6 balance points).

#### **Dark clouds on the economic horizon this winter**

Dark clouds are gathering on the economic horizon this winter and dimming the outlook for 2022. That is the anxious message with which the KfW-ifo SME Barometer is ending the second year of the coronavirus pandemic. Business confidence fell quite sharply yet again in December 2021, after falling steeply already in November. The concerns are justified because the Omicron variant is threatening to derail the economy once again, while the Delta wave is now starting to subside on a high level. Because of the higher transmissibility of Omicron even by the vaccinated, the only way to stop a renewed rise in infections and pressure on hospitals is with additional contact restrictions. How extensive these will have to be still depends on many unknowns. It is therefore possible that the dark clouds hanging over the economy will dissipate again. However, from our perspective it is more likely that Germany's economic output will shrink at the beginning of 2022 because the industrial sector cannot act as a sufficient counterweight to the affected services sector for now due to persistent material bottlenecks. But with likely vaccine mandates, warmer weather and modified vaccines coming, there is reason to hope that the situation among service providers will ease in the second quarter. At the same time, new global supply chain disruptions will also become more likely if Omicron leads to closures of production facilities or logistics hubs at major trading partners and the turnaround in the manufacturing sector is delayed. China, which will probably adhere to its strict zero-COVID policy, is particularly critical in this regard. That is why the economic dip in the winter half-year will probably be deeper than was anticipated just a few weeks ago, and the subsequent recovery will move at a slower pace at first.

KfW Research  
KfW-ifo SME Barometer: December 2021

**KfW-ifo SME Barometer in figures**

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Dec 2020	Jul 2021	Aug 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021			
<b>Business climate</b>											
Manufacturing	SME	-5.1	16.2	13.7	7.6	7.9	2.6	2.6	0.0	7.7	-8.1
	LSE	-1.0	23.8	15.9	13.3	8.5	9.1	7.2	-1.9	8.2	-9.4
Construction	SME	6.7	12.0	13.4	17.1	19.2	17.5	13.6	-3.9	6.9	2.6
	LSE	-6.5	4.8	9.7	9.6	12.2	15.4	10.6	-4.8	17.1	4.7
Retail trade	SME	2.8	14.5	7.0	6.3	3.8	-1.8	-9.8	-8.0	-12.6	-11.9
	LSE	-5.4	3.9	0.4	-8.2	-13.3	-9.7	-18.1	-8.4	-12.7	-12.4
Wholesale trade	SME	-7.3	13.6	9.8	8.3	2.2	-1.7	-5.1	-3.4	2.2	-12.1
	LSE	-2.5	13.6	7.8	6.3	1.2	0.7	-0.8	-1.5	1.7	-8.9
Services	SME	-19.6	5.3	2.2	3.4	3.4	-5.0	-11.9	-6.9	7.7	-8.1
	LSE	-10.3	3.2	3.8	2.7	3.6	-1.6	-10.6	-9.0	-0.3	-6.1
<b>Germany</b>	<b>SME</b>	<b>-9.7</b>	<b>9.4</b>	<b>7.6</b>	<b>5.8</b>	<b>7.0</b>	<b>0.9</b>	<b>-3.1</b>	<b>-4.0</b>	<b>6.6</b>	<b>-6.0</b>
	<b>LSE</b>	<b>-1.7</b>	<b>11.9</b>	<b>7.9</b>	<b>6.1</b>	<b>3.5</b>	<b>4.6</b>	<b>0.8</b>	<b>-3.8</b>	<b>2.5</b>	<b>-5.7</b>
Current situation	SME	-8.1	11.2	13.4	12.0	13.6	9.1	5.5	-3.6	13.6	-2.8
	LSE	-9.6	17.4	16.4	12.9	11.3	11.0	6.1	-4.9	15.7	-6.1
Expectations	SME	-11.4	7.5	2.0	-0.2	0.6	-6.8	-11.3	-4.5	0.1	-8.9
	LSE	5.7	6.6	0.0	-0.2	-3.7	-1.4	-4.3	-2.9	-10.0	-5.3
<b>Employment expectations</b>											
Sales price expectations	SME	-3.8	11.1	12.0	11.8	12.4	11.0	8.2	-2.8	12.0	-1.1
	LSE	-10.7	12.0	11.3	13.8	13.0	12.7	15.1	2.4	25.8	1.2
Export expectations of manufacturing	SME	-1.2	28.3	29.0	28.1	33.7	37.5	35.8	-1.7	37.0	7.2
	LSE	1.8	27.9	31.7	29.3	32.7	36.8	35.8	-1.0	34.0	5.5
Export expectations of manufacturing	SME	-11.1	9.3	6.6	5.3	0.1	1.1	-2.3	-3.4	8.8	-7.4
	LSE	-3.5	15.4	5.4	15.1	7.0	9.0	6.5	-2.5	10.0	-4.5

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.