

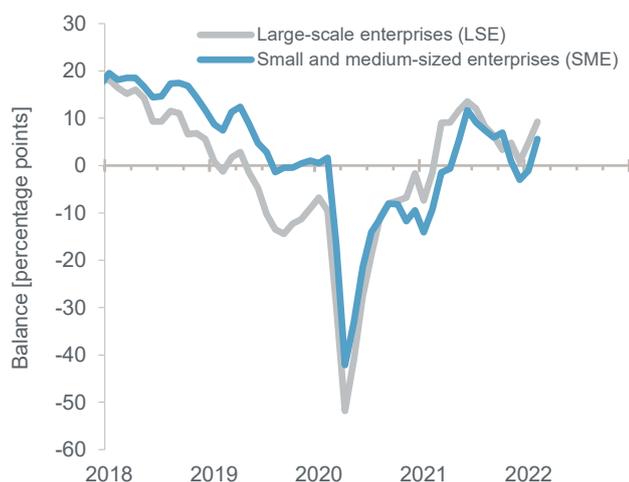
»» Sentiment improved strongly – but before Russia's attack on Ukraine

2 March 2022

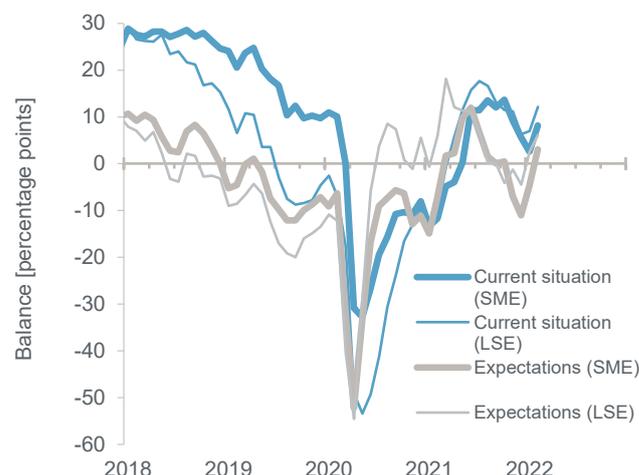
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- SME business confidence surged in February – before war broke out
- Both expectations and situation assessments were clearly up on the previous month
- Confidence among large enterprises also brightened noticeably
- Economic outlook between easing pandemic and new war in Europe

KfW-ifo Business Climate



KfW-ifo Business Climate Components



Source: KfW Research, ifo Institute

Business confidence improved strongly before the war

Directly before Russia attacked Ukraine, the easing of the pandemic led to a strong rise in SME business confidence, which climbed 6.7 points to 5.6 balance points in February. The reason was that the Omicron wave passed its peak in February and policymakers announced their intention to end nearly all economically relevant coronavirus restrictions by the second half of March at the latest. Both components of the sentiment indicator are clearly up.

- Assessments of the current business situation rose by 5.6 points to 8.2 balance points, reaching a three-month high.
- Expectations increased even more strongly, rising by 7.8 points to 3.1 balance points. With pandemic worries fading, businesses looked to the spring with renewed optimism. However, their expectations could not yet reflect the war in Ukraine, which began shortly after the completion of the survey.

Sentiment rebound in services and trade

Services SMEs reported the strongest rise in sentiment in February (+7.5 points to -0.7 balance points), closely followed by retailers (+7.0 points to 7.2 balance points) and, at some distance, wholesalers (+3.3 points to 3.3 balance points). This can be seen as a sentiment rebound following the coronavirus-related burdens of the previous months. At the beginning of autumn, new coronavirus infections had first surged in the Delta and then in the Omicron wave, leading to a renewed tightening of contact and capacity restrictions in a bid to protect the healthcare system from being overwhelmed after a relatively relaxed summer. This weighed not just on trade but particularly on social consumption services, the vast majority of which are provided by small and medium-sized enterprises. Now that the pandemic situation is easing again, those businesses are regaining confidence quickly. Measured against the SME sector as a whole, though, the sentiment improvement in manufacturing was rather modest (+2.4 points to 9.3 balance points). Construction even virtually stagnated in February (+0.2 points to 12.7 balance points). It is important to bear in mind, however, that the sentiment level in both sectors

dropped significantly less sharply than in trade or services in the preceding months and is therefore already relatively high. Construction remains the sentiment leader in the SME sector.

Business sentiment in large enterprises also improved

Confidence improved among large enterprises as well in February, although the rise of 4.4 points to 9.2 balance points was much lower than among SMEs. Here, situation assessments (+5.2 points to 12.2 balance points) improved slightly more than expectations (+3.6 points to 6.2 balance points). However, as the drop in business confidence in the past months was noticeably more moderate among large enterprises than SMEs, which were relatively more strongly affected by coronavirus restrictions particularly in the services segment, the confidence level of large enterprises remains in the lead. In the breakdown of large enterprises by main economic sector, sentiment improved the most in wholesale (+6.6 points to 10.2 balance points), followed by services (+2.9 points to -0.3 balance points) and manufacturing (+2.7 points to 15.5 balance points). In the latter, the confidence level is higher than in any other economic sector, although export expectations fell slightly on a good level (-2.0 points to 9.5 balance points). This could be a sign that the availability of materials has improved, which is also suggested by the delivery times indicator from Markit's PMI business survey of February, for example. By contrast, business sentiment stagnated among the large construction and retail firms, and just barely in the latter.

Economic outlook between easing pandemic and new war in Europe

In ordinary times one would have been able to openly rejoice about the February figures of the KfW-ifo SME Barometer. Confidence improved very significantly across almost all sectors and business size classes thanks to the easing of the pandemic, and the much higher expectations – after the economic dreariness of the winter half-year – gave hope for an economic recovery. But with Russia's attack on Ukraine these are anything but ordinary times. Rather, the sword of Damocles of a new war in Europe and the resulting sanctions now hangs over further economic developments. A drawn-out open war would not just have enormous humanitarian consequences such as countless fatalities, injuries and refugee movements. It would also drive energy prices and, thus, inflation even higher and call into question the EU's energy security. Germany meets around 14% of its energy needs with Russian natural gas alone and would therefore surely be hit hard. Besides affecting economic output through loss of purchasing power, some of which, however, could be at least partially mitigated with the buffer of excess household savings built up during lockdowns, energy-intensive production would also suffer, especially if the need arises to ration energy supplies. So far, it is hardly possible to estimate the impact on Germany's economy reliably, as it depends in part on how long the war will last and how far the spiral of escalation will continue to turn. Now anything is possible – from a renewed recession to around 3% growth in 2022, provided a recovery of consumption-related services and then also of manufacturing against the backdrop of easing material bottlenecks lead to a growth spurt from spring.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Feb 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan 2022	Feb 2022			
Business climate											
Manufacturing	SME	-1.7	7.3	7.9	2.8	3.7	6.9	9.3	2.4	11.0	0.6
	LSE	9.2	12.9	8.7	10.1	8.5	12.8	15.5	2.7	6.3	1.7
Construction	SME	4.0	16.8	19.3	17.0	13.3	12.5	12.7	0.2	8.7	-4.9
	LSE	-6.1	9.6	12.1	15.2	10.3	14.4	14.4	0.0	20.5	0.7
Retail trade	SME	-22.8	5.9	3.8	-0.5	-9.7	0.2	7.2	7.0	30.0	-3.8
	LSE	-25.4	-8.6	-12.9	-6.7	-17.1	-0.9	-1.5	-0.6	23.9	2.9
Wholesale trade	SME	-15.1	8.0	2.3	-1.0	-3.5	0.0	3.3	3.3	18.4	-3.2
	LSE	-3.5	6.1	1.3	1.4	0.5	3.6	10.2	6.6	13.7	1.8
Services	SME	-19.2	3.5	3.5	-4.8	-11.7	-8.2	-0.7	7.5	18.5	-7.6
	LSE	-12.5	2.9	3.8	-1.4	-10.4	-3.2	-0.3	2.9	12.2	-6.4
Germany	SME	-9.3	5.9	6.9	0.9	-3.0	-1.1	5.6	6.7	14.9	-4.1
	LSE	-1.5	6.3	3.3	4.8	0.8	4.8	9.2	4.4	10.7	0.1
Current situation	SME	-11.7	12.1	13.7	9.3	5.7	2.6	8.2	5.6	19.9	-6.2
	LSE	-9.6	13.1	11.5	11.2	6.3	7.0	12.2	5.2	21.8	-3.4
Expectations	SME	-7.1	0.1	0.5	-6.9	-11.0	-4.7	3.1	7.8	10.2	-2.1
	LSE	6.1	0.0	-4.1	-1.2	-4.4	2.6	6.2	3.6	0.1	3.2
Employment expectations	SME	-5.5	11.5	12.3	11.0	8.4	8.8	12.4	3.6	17.9	-1.7
	LSE	-8.0	13.5	12.7	12.6	15.4	16.8	19.0	2.2	27.0	4.1
Sales price expectations	SME	1.1	27.8	33.4	37.1	35.8	36.5	36.2	-0.3	35.1	3.4
	LSE	0.0	28.9	32.6	36.7	35.3	35.5	39.9	4.4	39.9	4.2
Export expectations of manufacturing	SME	-2.6	5.4	0.0	1.5	-1.1	1.5	4.3	2.8	6.9	-0.7
	LSE	5.2	15.0	7.0	9.3	7.6	11.5	9.5	-2.0	4.3	-0.9

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 9,500 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 8,000 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.