

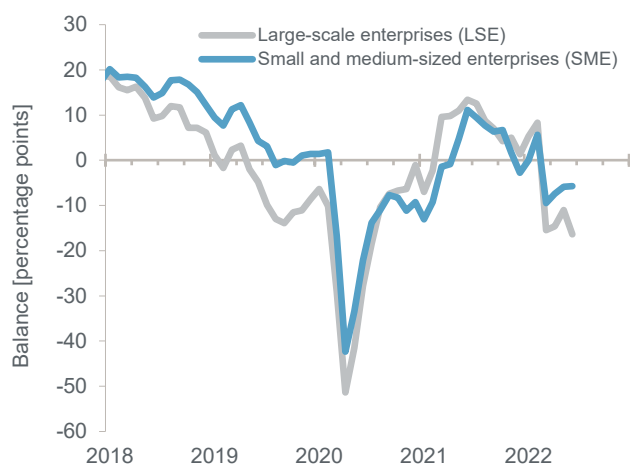
## »» Satisfactory business situation but great anxiety about what lies ahead

8 July 2022

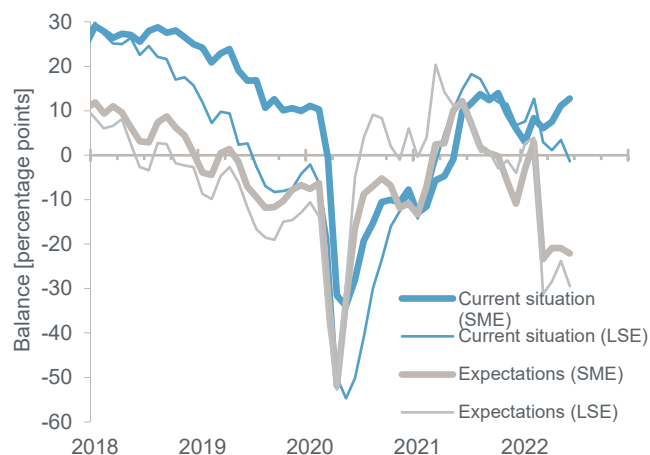
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- SME business confidence stagnated in June
- Situation assessments improved but worries about the future are mounting
- Sentiment among large enterprises deteriorated noticeably
- Losses in purchasing power and looming energy crisis are causing pessimism

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

### SME business confidence stagnated in June

While sentiment among large enterprises fell sharply in June, SMEs reported steady business confidence overall. The SME business confidence index rose by 0.1 points to -5.7 balance points. Underlying this, however, are opposing trends in situation assessments and expectations, as well as significant sectoral differences:

- After a minor setback in March, situation assessments improved for the third consecutive month. With an increase of 1.7 points to now 12.8 balance points, they are currently even more positive than in June last year, when the vaccination campaign and declining infection rates spurred German growth.
- Six-month business expectations, on the other hand, are becoming increasingly pessimistic. In June they dropped by 1.2 points to -22.1 balance points, well below the zero line which stands for the long-term average. In particular, the looming energy crisis in the coming winter from a possible halt of Russian natural gas supplies appears to be making

many enterprises anxious, although the gas alert stage was not triggered until after the end of the survey period.

### Sharp sectoral differences

Developments among SMEs are currently diverging widely across the main economic sectors. Service providers – which continue to benefit from pent-up demand in sectors such as hospitality – currently report the highest confidence levels. After strong increases in the previous months, business confidence among SME service businesses rose by 2.2 points in June thanks to improved situation assessments and expectations. At 0.8 balance points, it is now just above the long-term average. The sharpest rise in early summer occurred in the construction sector, however, where confidence increased by 4.3 points to -3.8 balance points. The sector experienced a sharp drop in confidence in March and April, probably as a result of a further strong deterioration in material shortages, among other causes. These bottlenecks are improving slightly, according to the Ifo survey. But the interest reversal is making construction finance much more expensive, which is likely a reason for, among other things, the well below-average business expectations currently observed.

The retail sector, in turn, suffered a veritable slump of 11.8 points to now only -17.8 balance points. Business expectations have clouded over here but retailers are now also reporting a significant deterioration in their current situation. The erosion in consumer purchasing power resulting from the strong increases in energy and food prices is becoming particularly obvious here. According to the GfK Consumer Survey, consumer confidence even plunged to a new all-time low in June despite the federal government's relief package. This is also dragging down SME wholesalers, whose business sentiment dropped by 4.7 points to a meagre -13.2 balance points.

Manufacturing is also facing significant problems, however. Confidence in the sector has also decreased sharply since March, particularly as a result of additional material shortages caused by the war in Ukraine and lockdowns in China, as well as the acute risk of a shutdown of gas supplies from Russia, with business sentiment among SME manufacturers falling yet again (-0.8 points to -10.5 balance points). What is remarkable, however, is that the business situation is still being assessed as better than average and has actually improved slightly of late.

### **Sharp slump in sentiment among large enterprises**

Sentiment among large enterprises was much worse than in the SME sector in June. The confidence level fell sharply by -5.4 points to a significantly below-average -16.4 balance points. Situation assessments and business expectations both took a nosedive. Particularly in the manufacturing sector,

confidence is decreasing much more rapidly among large enterprises than SMEs, after the brief sentiment improvement in May obviously turned out to be a flash in the pan.

### **Significant risk of recession in the second half-year**

Despite all adversities, the German economy and SMEs in particular experienced a reasonably satisfactory spring. Since pandemic restrictions were lifted, the services sector in particular is benefiting from high pent-up demand, which appears to have enabled it to lift economic growth into positive territory in the second quarter as well. But the generally solid assessments of the current business situation contrast with very dismal business expectations since Russia's invasion of Ukraine. Most of all, the significantly higher probability that Russia will halt its supplies of natural gas is good reason to fear a recession. But even without a suspension of gas supplies and possible energy rationing in the manufacturing sector, the inflation-related loss of purchasing power and rapid monetary tightening through interest rate reversals initiated by central banks around the world may lead to a recession or multiple stagflationary quarters. A priority now is to maintain businesses' appetite for investment, although in the past similarly pessimistic business expectations usually led to investment restraint. After all, investment is the only way to meet the current challenges, such as the energy transition which has become even more urgent since the outbreak of the war.

## KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jun 2021	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022	Jun 2022			
<b>Business climate</b>											
Manufacturing	SME	14.8	5.7	10.2	-10.5	-10.3	-9.7	-10.5	-0.8	-25.3	-12.0
	LSE	22.3	10.4	15.6	-12.1	-8.8	0.9	-9.3	-10.2	-31.6	-10.4
Construction	SME	12.2	12.0	11.2	-4.3	-14.0	-8.1	-3.8	4.3	-16.0	-14.9
	LSE	0.7	13.0	14.3	-20.8	-20.5	-10.8	-9.3	1.5	-10.0	-15.7
Retail trade	SME	15.1	-1.1	9.3	-6.2	-4.9	-6.0	-17.8	-11.8	-32.9	-10.2
	LSE	7.6	-1.7	-3.9	-14.8	-28.2	-27.6	-37.6	-10.0	-45.2	-24.3
Wholesale trade	SME	13.2	-0.9	6.2	-9.2	-6.0	-8.5	-13.2	-4.7	-26.4	-7.9
	LSE	15.1	3.4	12.1	-11.0	-9.8	-8.3	-17.3	-9.0	-32.4	-13.3
Services	SME	7.9	-7.9	-0.5	-10.3	-5.7	-1.4	0.8	2.2	-7.1	4.1
	LSE	4.5	-2.5	0.3	-16.6	-19.3	-18.3	-18.0	0.3	-22.5	-12.3
<b>Germany</b>	<b>SME</b>	<b>11.2</b>	<b>0.0</b>	<b>5.7</b>	<b>-9.4</b>	<b>-7.4</b>	<b>-5.8</b>	<b>-5.7</b>	<b>0.1</b>	<b>-16.9</b>	<b>-5.1</b>
	<b>LSE</b>	<b>13.4</b>	<b>5.3</b>	<b>8.3</b>	<b>-15.5</b>	<b>-14.6</b>	<b>-11.0</b>	<b>-16.4</b>	<b>-5.4</b>	<b>-29.8</b>	<b>-13.4</b>
Current situation	SME	9.9	3.0	8.4	6.1	7.5	11.1	12.8	1.7	2.9	4.6
	LSE	14.8	7.6	12.7	2.9	1.1	3.4	-1.4	-4.8	-16.2	-6.7
Expectations	SME	12.2	-3.1	2.9	-23.4	-20.9	-20.9	-22.1	-1.2	-34.3	-13.4
	LSE	11.8	2.7	3.9	-31.3	-28.4	-23.8	-29.5	-5.7	-41.3	-19.0
<b>Employment expectations</b>	SME	13.7	8.5	13.1	9.1	9.6	10.3	9.8	-0.5	-3.9	-0.3
	LSE	7.7	15.4	19.1	11.8	11.4	15.0	11.8	-3.2	4.1	-2.7
<b>Sales price expectations</b>	SME	27.1	35.9	35.5	47.3	53.9	46.1	43.0	-3.1	15.9	8.1
	LSE	25.2	34.4	39.7	47.1	52.8	50.4	43.2	-7.2	18.0	8.4
<b>Export expectations of manufacturing</b>	SME	11.0	0.6	3.9	-13.8	-6.9	-9.2	-8.4	0.8	-19.4	-5.1
	LSE	10.4	9.7	6.3	-10.0	-6.8	-1.7	-3.2	-1.5	-13.6	-5.9

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.