

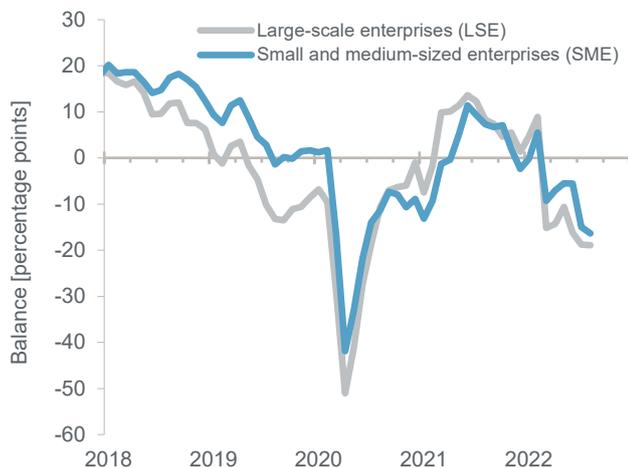
»» Muted sentiment, dismal outlook

14 September 2022

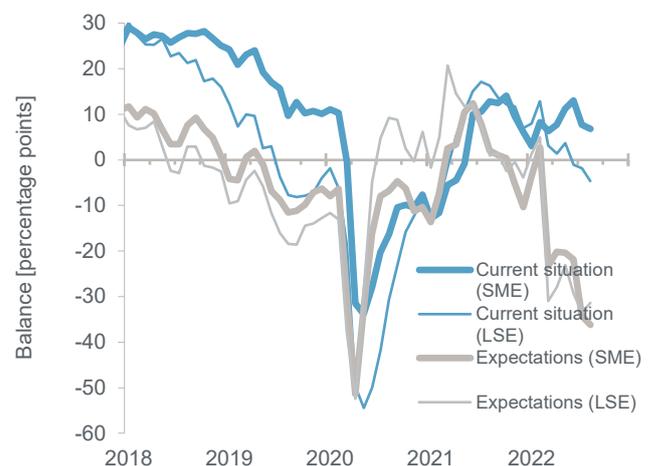
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- SME business sentiment drops for the third consecutive month
- Situation assessments continue to fall, expectations near all-time low
- Sentiment in large enterprises is very muted but almost steady
- Germany is at the beginning of a technical recession

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

SME business sentiment drops for the third month

The cocktail of exploding energy costs, waning purchasing power, major uncertainties around natural gas supplies and the ongoing war in Ukraine is increasingly spoiling the mood among SMEs. In August, SME business confidence fell by 1.4 points to -16.4 balance points. That was the third consecutive decline, which signals a sentiment trend reversal, according to the rule of thumb. Both sentiment components are down:

- Business situation assessments dropped by 0.9 points to now 6.8 balance points. As recently as in June, they stood at a much higher 13.0 balance points. The difficult environment is now affecting current business activity as well.
- Expectations are more pessimistic than almost ever before. After falling by 1.9 points to -36.2 balance points, they are now at their second lowest level since the beginning of the time series in January 2005. The only time they were even gloomier was in April 2020, shortly after the outbreak of the coronavirus crisis.

Sentiment is below average across the entire SME sector

All the main economic sectors have in common that confidence in small and medium-sized enterprises is negative, meaning worse than the long-term average. However, there are differences in the level of business sentiment and its variation on the preceding month. The least affected sector was construction (+1.6 points to -8.7 balance points), the only one to actually record a slight improvement in sentiment after the pronounced drop in July. Service providers occupy second place in the ranking. After the nearly completed catch-up process that followed the lifting of the vast majority of pandemic restrictions since April, however, their sentiment trend is now pointing downward again (-2.2 points to -11.7 balance points). Confidence in the manufacturing sector is on a downward slide (-2.5 points to -20.9 balance points), coupled with growing pessimism in export expectations (-4.0 points to -16.1 balance points). However, clearly the worst sentiment was reported by both segments of commerce (wholesalers: -5.6 points to -26.3 balance points; retailers: -2.8 points to -31.3 balance points).

Sentiment among large enterprises negative but steady

Business confidence among large enterprises is also low and indeed even worse than in the SME sector. On balance, their sentiment index remained just barely steady in August (-0.1 points to -18.9 balance points). Manufacturers reported a downturn in sentiment on the previous month (-4.5 points to -14.7 balance points), as did wholesalers (-4.0 points to -27.9 balance points). Construction firms, on the other hand, reported an improvement in sentiment (+7.8 points to -8.8 balance points), along with service providers (+3.7 points to -18.5 balance points) and retailers, which nonetheless lag far behind at the bottom of the sentiment table, as is the case among SMEs (+3.3 points to -32.8 balance points).

Price expectations are falling from a very high level

The depressed mood in both company size classes of the retail sector is consistent with other indicators of private consumption such as GfK's Consumer Confidence Index, which fell to a new all-time low in August. The general uncertainty and the enormous losses of purchasing power resulting from steep price increases, particularly for energy and food, are leaving deep traces. There is little chance of improvement in the short term. Inflation will temporarily hit double digits in the months ahead, even if the sales price expectations surveyed as part of the KfW-ifo SME Barometer are now falling slightly from a very high level across all company size classes (SMEs: -1.4 points to 36.7 balance points; large enterprises: -0.3 points to 34.9 balance points). By contrast, the tailwind for consumption generated by growing employment levels, measured here by employment expectations, is gradually weakening, although without already changing into a headwind (SMEs: -1.2 points to 2.9 balance points; large enterprises: -1.6 points to 8.9 balance points).

Technical recession until well into the year 2023

The mood is bad, the outlook is dismal. That sums up the key message of the KfW-ifo SME Barometer in August. The only times when expectations were this pessimistic was before the beginning of the global financial crisis in the winter of 2008/2009 (decline in quarterly GDP from the highest to the lowest level: -7.0%) and after the outbreak of the coronavirus pandemic in the first half of 2020 (-10.8%), which were by far the two worst recessions in the Federal Republic of Germany's history. The depressing business expectations reflect the wide variety of fears and concerns around the war and the energy crisis across the breadth of the corporate landscape. Everywhere there is great fear of a complete economic crash. Nevertheless, there are good reasons that economic output this time will drop far less dramatically than the expectations suggest at face value. Technically, business expectations as a diffusion index are a measure of how widespread the fear of an economic downturn is but not a measure of the actual depth of the feared downturn. We assume that Germany is at the beginning of a technical recession. The inflationary surge driven by energy prices is depressing purchasing power and uncertainty over future natural gas supplies is unsettling businesses and households alike. The low water levels of the Rhine river have added a further burden to this drought-stricken summer. On the other hand, record-high industrial order volumes, which are likely to at least partly go into production as supply bottlenecks are gradually easing, have a stabilising effect. According to the ifo Institute, 62% of manufacturing firms were still affected by material shortages in August but that was the lowest level in over a year. All in all, we expect the German economy to contract by 0.3% in 2023 after growing by 1.4% in the current year.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Aug 2021	Mar 2022	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022			
Business climate											
Manufacturing	SME	14.0	-10.5	-9.9	-10.1	-10.9	-18.4	-20.9	-2.5	-34.9	-6.6
	LSE	15.7	-11.9	-8.8	0.2	-8.2	-10.2	-14.7	-4.5	-30.4	-4.2
Construction	SME	13.0	-4.3	-13.9	-7.5	-4.2	-10.3	-8.7	1.6	-21.7	0.8
	LSE	9.5	-23.2	-20.1	-9.9	-8.2	-16.6	-8.8	7.8	-18.3	6.5
Retail trade	SME	5.8	-5.1	-5.1	-7.9	-19.2	-28.5	-31.3	-2.8	-37.1	-20.3
	LSE	-1.7	-14.5	-28.0	-27.1	-36.7	-36.1	-32.8	3.3	-31.1	-12.0
Wholesale trade	SME	8.9	-8.4	-5.8	-9.0	-14.0	-20.7	-26.3	-5.6	-35.2	-12.6
	LSE	9.1	-10.7	-9.7	-8.5	-17.8	-23.9	-27.9	-4.0	-37.0	-13.6
Services	SME	2.2	-10.1	-5.6	-1.2	1.1	-9.5	-11.7	-2.2	-13.9	-1.1
	LSE	3.8	-16.1	-18.9	-17.9	-17.5	-22.2	-18.5	3.7	-22.3	-1.8
Germany	SME	7.3	-9.3	-7.0	-5.5	-5.6	-15.0	-16.4	-1.4	-23.7	-5.1
	LSE	8.3	-15.2	-14.3	-10.6	-16.2	-18.8	-18.9	-0.1	-27.2	-4.6
Current situation	SME	12.8	6.3	7.7	11.2	13.0	7.7	6.8	-0.9	-6.0	0.8
	LSE	16.3	3.2	1.4	3.7	-1.0	-1.8	-4.6	-2.8	-20.9	-5.2
Expectations	SME	2.0	-23.2	-20.2	-20.4	-21.9	-34.3	-36.2	-1.9	-38.2	-9.5
	LSE	0.9	-31.0	-27.9	-23.1	-29.4	-33.5	-31.4	2.1	-32.3	-4.1
Employment expectations	SME	11.9	9.3	9.7	10.1	8.6	4.1	2.9	-1.2	-9.0	-4.5
	LSE	10.9	11.7	11.2	14.7	11.4	10.5	8.9	-1.6	-2.0	-2.3
Sales price expectations	SME	26.8	46.9	53.2	45.7	42.4	38.1	36.7	-1.4	9.9	-9.5
	LSE	29.1	46.7	52.6	50.3	42.4	35.2	34.9	-0.3	5.8	-12.4
Export expectations of manufacturing	SME	7.1	-13.9	-7.1	-9.4	-8.6	-12.1	-16.1	-4.0	-23.2	-2.1
	LSE	5.3	-9.3	-6.7	-1.7	-3.4	-9.3	-9.8	-0.5	-15.1	-1.6

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 9,500 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.