

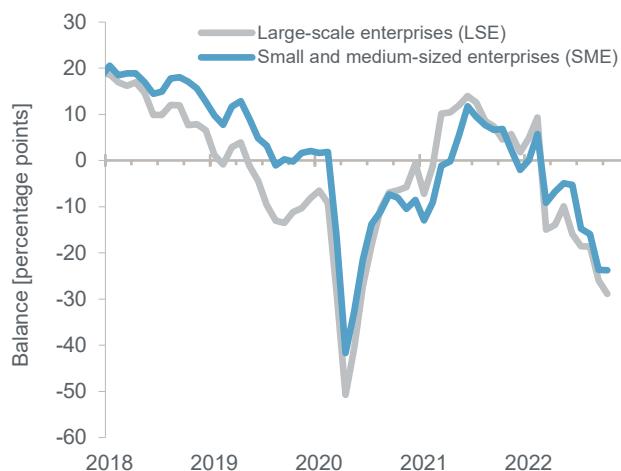
# »» Have business expectations bottomed out?

8 November 2022

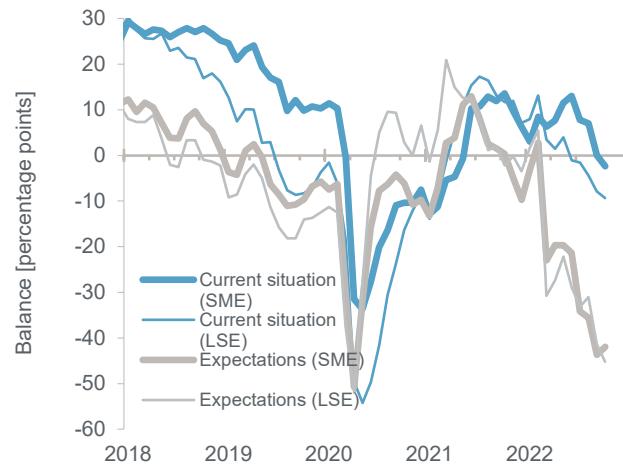
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- SME business sentiment moved virtually sideways in October
- Extremely pessimistic expectations have brightened somewhat, situation assessments worsened further
- Sharp drop in sentiment among construction SMEs
- The contraction is coming, it's just late: economic output is set to shrink in the winter half-year.

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

## The slump has at least slowed down

Whereas small and medium-sized enterprises repeatedly saw their confidence levels literally plummet in the previous months, sentiment fell by only 0.1 point in October, thus moving virtually sideways on a very low level of -23.8 balance points in what remains a difficult environment shaped by material shortages, an inflationary surge and the war in Ukraine.

- The partial stabilisation is due to the somewhat less pessimistic business expectations. Starting from a near record-low level, business expectations for the next six months rose by 1.7 points to -42.0 balance points in October. The fiscal support package announced by the Federal Government in September and the decreased likelihood of a gas shortage are both likely to have stabilised expectations on their low level. But as business expectations were already near their historic low at the beginning of the coronavirus crisis, perhaps there is simply not much lower it can drop.
- By contrast, assessments of the current business situation are falling nearly unabated. After dropping from 0.0 points to

-2.4 balance points, they are now below the long-term average represented by the zero line.

## Sentiment has deteriorated greatly in the construction sector

The current energy and inflation crisis has led to significant real wage losses and consumer confidence in Germany is deep in the doldrums. As a result, business sentiment among SME retailers is also dropping to new record lows. But with a drop of only 0.3 points to -37.5 balance points, the nosedive at least slowed in October. The situation is similar for wholesalers, where business sentiment has fallen by 1.1 points to now -31.4 balance points. The mood is not quite as bad among SME service providers, which depend only partly on the development of private consumption and therefore benefited from post-pandemic pent-up demand. They were the only SME segment to record a minor sentiment improvement (+0.3 points) thanks to slightly brighter expectations. But at now -18.4 balance points, the mood here is also anything but euphoric. Sentiment among manufacturing SMEs, on the other hand, moved more or less sideways on a very low level, with expectations brightening slightly but situation assessments

worsening. The strongest decline in business sentiment in October was recorded by construction firms (-3.4 points to -19.1 balance points). This particularly interest rate-sensitive sector is likely to feel the ECB's rapid interest rate turnaround most of all, even if ongoing and firmly planned construction projects will probably prevent a hard fall. Situation assessments and expectations thus both fell in October.

### **Confidence among large enterprises continued to plunge**

Unlike in SMEs, sentiment among large enterprises continued to plummet almost unabated, dropping by 2.9 points to -28.8 balance points. What is particularly striking is that despite the slightly improved conditions such as the announced fiscal support package, expectations failed to brighten in this segment.

### **Price expectations have fallen slightly**

The figures of the current KfW-ifo SME Barometer provide a glimmer of hope for the development of prices. At least in the SME sector, sales price expectations dropped again sharply after rising in the previous month (from 43.2 to 40.1 balance points), resuming the downward trend that became apparent in May. Furthermore, the fact that businesses' employment expectations also continued their downward trend does not point to a wage-price spiral.

### **GDP will contract – but with a delay**

At the end of October the Federal Statistical Office surprised with the announcement of positive third quarter GDP growth which, as the icing on the cake, was actually driven mainly by household consumption despite the depressed mood among consumers and retailers. Excess savings and pent-up demand from the lockdown periods are still likely to play a role here and purchasing power losses resulting from the energy crisis can also be offset by a declining savings rate. These effects are set to stabilise consumption in the winter half-year as well but they will not completely prevent a drop in consumption. Furthermore, the ECB's rapid interest rate turnaround, the continuing very pessimistic business expectations and banks' increasingly restrictive lending policies – particularly towards small and medium-sized enterprises – are creating strong headwinds for investment.<sup>1</sup> If that were to cause the cancellation of, in particular, investments needed to achieve a future-proof and net-zero economy, the damage would be great.<sup>2</sup>

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<sup>1</sup> Cf. KfW Research, [KfW ifo Credit Constraint Indicator Q3 2022](#) and ECB, Bank Lending Survey Q3 2022.

<sup>2</sup> Cf. Köhler-Geib, F. (2022). [A boost in investment for the transformation – what exactly is needed?](#) KfW Research Position Paper, November 2022.

## KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year								m-o-m	y-o-y	3m-o-3m
		Oct 2021	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022	Oct 2022				
<b>Business climate</b>												
Manufacturing	SME	8.8	-9.7	-10.5	-18.2	-21.0	-26.9	-27.0	-0.1	-35.8	-12.2	
	LSE	9.6	0.2	-7.6	-10.3	-15.1	-19.1	-22.9	-3.8	-32.5	-13.1	
Construction	SME	18.4	-7.2	-4.0	-10.6	-8.9	-15.7	-19.1	-3.4	-37.5	-7.3	
	LSE	11.7	-9.4	-7.8	-16.3	-8.7	-18.3	-15.9	2.4	-27.6	-3.1	
Retail trade	SME	2.3	-7.3	-18.7	-28.4	-30.9	-37.2	-37.5	-0.3	-39.8	-17.1	
	LSE	-11.9	-26.7	-36.2	-35.5	-32.5	-39.6	-37.1	2.5	-25.2	-3.6	
Wholesale trade	SME	2.5	-8.8	-13.7	-20.4	-26.1	-30.3	-31.4	-1.1	-33.9	-15.0	
	LSE	2.1	-8.3	-17.6	-23.7	-27.8	-32.1	-32.9	-0.8	-35.0	-14.4	
Services	SME	3.7	-0.9	1.2	-9.2	-11.4	-18.7	-18.4	0.3	-22.1	-13.2	
	LSE	4.4	-17.4	-17.3	-21.8	-18.0	-30.1	-32.4	-2.3	-36.8	-8.0	
<b>Germany</b>	<b>SME</b>	<b>6.8</b>	<b>-5.0</b>	<b>-5.3</b>	<b>-14.8</b>	<b>-16.0</b>	<b>-23.7</b>	<b>-23.8</b>	<b>-0.1</b>	<b>-30.6</b>	<b>-12.8</b>	
	<b>LSE</b>	<b>4.6</b>	<b>-9.9</b>	<b>-15.9</b>	<b>-18.5</b>	<b>-18.6</b>	<b>-25.9</b>	<b>-28.8</b>	<b>-2.9</b>	<b>-33.4</b>	<b>-9.7</b>	
Current situation	SME	13.6	11.5	13.0	7.8	7.0	0.0	-2.4	-2.4	-16.0	-9.2	
	LSE	11.6	3.9	-1.1	-1.6	-4.4	-7.9	-9.4	-1.5	-21.0	-7.6	
Expectations	SME	0.3	-19.7	-21.4	-34.2	-35.6	-43.7	-42.0	1.7	-42.3	-15.3	
	LSE	-2.2	-22.2	-29.0	-33.2	-31.1	-41.4	-45.2	-3.8	-43.0	-11.1	
<b>Employment expectations</b>	<b>SME</b>	<b>12.2</b>	<b>10.1</b>	<b>8.6</b>	<b>4.0</b>	<b>2.6</b>	<b>0.4</b>	<b>-1.9</b>	<b>-2.3</b>	<b>-14.1</b>	<b>-7.2</b>	
	<b>LSE</b>	<b>12.5</b>	<b>14.9</b>	<b>11.4</b>	<b>10.1</b>	<b>8.3</b>	<b>2.7</b>	<b>2.4</b>	<b>-0.3</b>	<b>-10.1</b>	<b>-7.7</b>	
<b>Sales price expectations</b>	<b>SME</b>	<b>32.1</b>	<b>45.2</b>	<b>42.6</b>	<b>38.0</b>	<b>37.0</b>	<b>43.2</b>	<b>40.1</b>	<b>-3.1</b>	<b>8.0</b>	<b>-1.8</b>	
	<b>LSE</b>	<b>31.3</b>	<b>49.7</b>	<b>42.5</b>	<b>34.9</b>	<b>35.4</b>	<b>39.4</b>	<b>40.3</b>	<b>0.9</b>	<b>9.0</b>	<b>-4.0</b>	
<b>Export expectations of manufacturing</b>	<b>SME</b>	<b>1.4</b>	<b>-9.2</b>	<b>-8.5</b>	<b>-11.8</b>	<b>-16.2</b>	<b>-20.1</b>	<b>-20.6</b>	<b>-0.5</b>	<b>-22.0</b>	<b>-9.1</b>	
	<b>LSE</b>	<b>6.9</b>	<b>-1.2</b>	<b>-2.9</b>	<b>-8.6</b>	<b>-9.1</b>	<b>-10.0</b>	<b>-9.4</b>	<b>0.6</b>	<b>-16.3</b>	<b>-5.3</b>	

Source: KfW Research, ifo Institute

## Explanations and abbreviations:

\*Seasonally and mean adjusted (long-term mean since January 2005 = 0)

S(mall) M(edium-sized) E(nterprises).

L(arge-)S(e)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.