

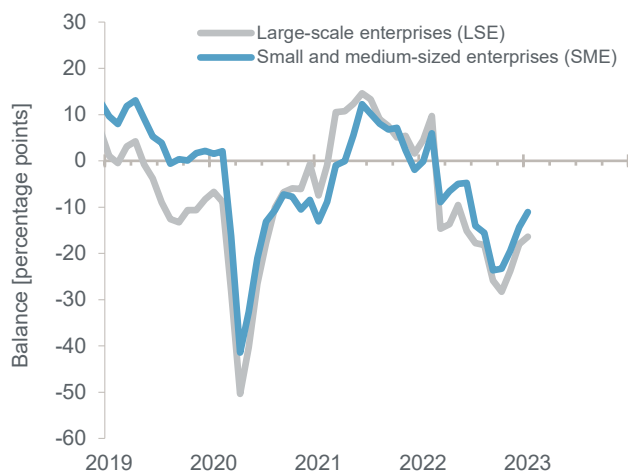
»»» The green shoot of optimism continues to grow

15 February 2023

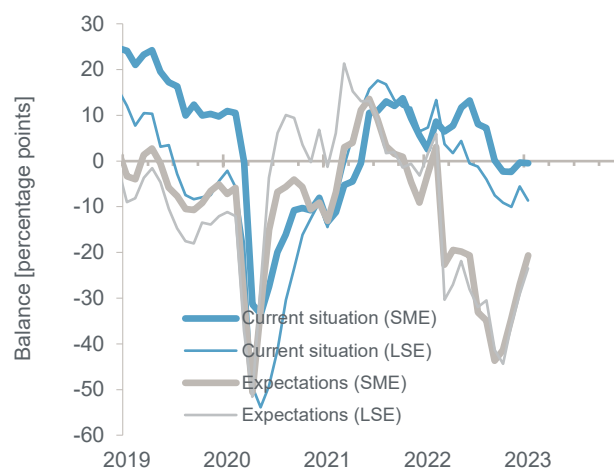
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- SME business sentiment has improved for the fourth month in a row
- Strong rise in expectations, minimal drop in situation assessments
- Businesses anticipate more employment and lower inflation
- Fears of steep economic downturn are increasingly waning

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

SMEs started the year on a more optimistic note

The mood among small and medium-sized enterprises improved yet again as they entered the new year. Their business sentiment rose for the fourth consecutive month in January, this time by 3.3 points on December to now -11.0 balance points. It is already up by 12.6 points on the low of last September. This is primarily the result of the significant improvement in business expectations for the next six months:

- Under the immediate impression of the approaching energy crisis, they had fallen to the deepest recession level in September, with fears of a broad downturn running deep. But since then, those worries have gradually eased again. In January expectations surged by a strong 6.2 points to -20.7 balance points.
- Situation assessments, however, fell by a marginal 0.1 points to -0.5 balance points and thus remain only slightly below the historic average. This level of situation assessments is roughly consistent with a stagnation of economic output at the start of the year.

More sombre mood only among SME construction firms

In January the SME sentiment trend pointed upwards in nearly all economic sectors. One exception is the construction sector, where sentiment fell by a moderate 0.7 points to -17.3 balance points. In no other economic sector is the mood among SMEs currently as gloomy as in construction. More than anything, this probably reflects the current problems in residential construction, which plays an important role for small and medium-sized construction firms. Long regarded as a cyclical stabiliser, residential construction has been suffering from expensive and scarce building materials, skills shortages and steep rises in interest rates for some time now. In the other sectors, sentiment improved by 7.3 points among SME wholesalers, 6.0 points in retail, 3.2 points in manufacturing and a relatively modest 2.7 points in services industries. However, small and medium-sized services are also the sector where – at -9.1 balance points – the confidence level is already the best, or more precisely, the least bad, given the continuing negative sentiment in all sectors.

Sentiment in large enterprises follows at some distance

Business confidence among large enterprises is following the SME sector out of the doldrums, if at some distance in January. Both the increase on the previous month (+1.6 points) and the sentiment level (-16.4 balance points) remain below the levels in the SME sector. Large enterprises also revised their business expectations upward significantly – although not as sharply as small and medium-sized enterprises (+5.6 points to -23.5 balance points) – but their assessments of the current business situation, in particular, turned out noticeably lower (-3.1 points to -8.6 balance points). As such, they are the main reason for lagging behind. In a sectoral breakdown of large enterprises, the relatively vigorous sentiment improvement among wholesalers (+4.8 points to -21.3 balance points) contrasts with what is little more than stagnation in services (+0.2 points to -22.8 balance points).

Employment expectations are growing, price expectations are falling

Businesses' specific expectations of both size classes around the labour market and inflation are showing a materially pleasing trend. Employment expectations are rising, especially among SMEs (+5.1 points to 6.4 balance points; large enterprises: +1.2 points to 4.3 balance points). Unlike business sentiment and its components, the employment indicators are almost consistently on a level above the long-term average represented by the zero line. This underscores that the labour market, which is also increasingly characterised by competition for scarce skills, remains robust in spite of the difficult economic situation. Sales price expectations fell sharply (SMEs: -5.1 points to 21.2 balance points; large enterprises: -4.8 points to 24.1 balance points) and have now left their all-time high of last April far behind. Nevertheless, they remain much higher than would be compatible with the monetary policy target of 2% inflation.

Economic risks and burdens remain considerable but are decreasing overall

The green shoot of optimism has continued to grow at the start of the new year as fears of a steep economic downturn such as that experienced in the financial crisis of 2009 or the outbreak of the coronavirus pandemic in 2020 are increasingly waning. That sums up the key message of the KfW-ifo SME Barometer in January. Germany's GDP grew by 1.8% overall in 2022, contracting only minimally even in the economically difficult final quarter (-0.2% on the previous quarter). It is encouraging that the German economy has so far shown itself to be resilient despite the numerous burdens. Furthermore, the risk of a gas shortage has now been averted at least for this winter, and the energy price brakes in place are dampening the decline in household consumption expected for 2023 as a result of sharply higher living costs. But the weak global economy is casting a shadow on the export outlook, and the ongoing war in Ukraine continues to create enormous uncertainties which make investment decisions harder for businesses. Expensive building materials, higher interest rates and skills shortages are putting particular pressure on residential construction. The natural gas supply situation in the coming winter 2023/2024 also remains difficult to predict. All in all, economic risks remain high, the burdens are still considerable but they are decreasing overall. To be sure, a minor contraction in economic output remains likely. But the upside and downside uncertainties remain considerable and now include the possibility that the recession long regarded as virtually certain may not come at all in 2023 as a whole.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jan 2022	Aug 2022	Sep 2022	Oct 2022	Nov 2022	Dec 2022	Jan 2023			
Business climate											
Manufacturing	SME	3.1	-20.8	-26.4	-25.4	-22.7	-17.9	-14.7	3.2	-17.8	5.8
	LSE	8.5	-14.7	-18.3	-21.5	-18.0	-16.7	-14.1	2.6	-22.6	1.9
Construction	SME	11.7	-8.5	-15.8	-18.4	-15.7	-16.6	-17.3	-0.7	-29.0	-2.3
	LSE	12.3	-8.3	-18.2	-16.0	-14.2	-13.3	-11.0	2.3	-23.3	1.3
Retail trade	SME	-1.3	-30.4	-35.7	-34.4	-26.9	-17.7	-11.7	6.0	-10.4	14.7
	LSE	-4.5	-32.3	-38.6	-35.5	-30.0	-23.3	-20.1	3.2	-15.6	11.0
Wholesale trade	SME	-0.7	-26.1	-29.6	-29.6	-27.1	-21.2	-13.9	7.3	-13.2	7.7
	LSE	2.3	-27.6	-31.3	-31.5	-33.8	-26.1	-21.3	4.8	-23.6	3.1
Services	SME	-7.7	-11.1	-18.4	-18.1	-16.2	-11.8	-9.1	2.7	-1.4	3.5
	LSE	-2.3	-17.6	-29.7	-32.0	-26.7	-23.0	-22.8	0.2	-20.5	2.3
Germany	SME	-0.1	-15.5	-23.6	-23.3	-19.4	-14.3	-11.0	3.3	-10.9	5.9
	LSE	4.5	-18.2	-25.9	-28.3	-23.8	-18.0	-16.4	1.6	-20.9	4.7
Current situation	SME	2.5	7.2	0.1	-2.3	-2.4	-0.4	-0.5	-0.1	-3.0	-2.8
	LSE	7.4	-4.0	-7.5	-9.1	-10.0	-5.5	-8.6	-3.1	-16.0	-1.2
Expectations	SME	-2.9	-34.9	-43.7	-41.4	-34.5	-26.9	-20.7	6.2	-17.8	12.6
	LSE	1.6	-30.5	-41.4	-44.4	-35.8	-29.1	-23.5	5.6	-25.1	9.3
Employment expectations	SME	8.4	2.7	0.5	-1.3	0.8	1.3	6.4	5.1	-2.0	2.2
	LSE	14.3	8.3	2.9	3.0	4.8	3.1	4.3	1.2	-10.0	-0.7
Sales price expectations	SME	35.3	36.8	42.7	39.7	34.2	26.3	21.2	-5.1	-14.1	-12.5
	LSE	34.2	35.7	39.2	39.9	35.4	28.9	24.1	-4.8	-10.1	-8.8
Export expectations of manufacturing	SME	0.1	-16.0	-19.7	-19.2	-17.0	-11.3	-9.9	1.4	-10.0	5.6
	LSE	10.0	-8.9	-9.2	-8.0	1.8	-0.9	0.1	1.0	-9.9	9.0

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.