

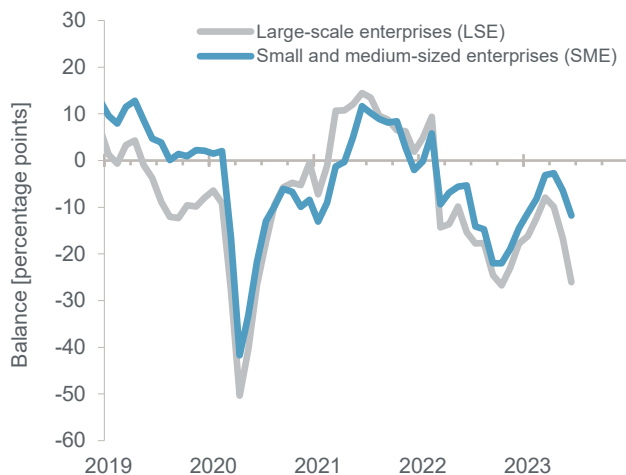
Business sentiment in freefall

4 July 2023

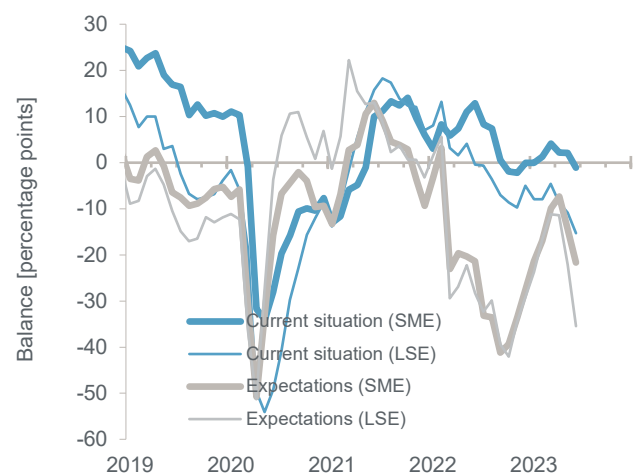
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- SME business confidence dropped sharply in June
- Outlook was much more pessimistic but situation assessments were also worse than in May
- Sentiment among large enterprises deteriorated even more than among SMEs.
- Sales price expectations are now back to normal

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

Business sentiment in freefall

SME business confidence literally plummeted in June. It fell by 5.4 points on the previous month, a drop nearly as steep as immediately after natural gas deliveries stopped last September. The key sentiment indicator of the KfW-ifo SME Barometer has thus fallen by -11.8 balance points, slipping well below the zero line again, which marks the historical average. The main cause was a surge in pessimistic expectations but situation assessment also fell noticeably.

- In late summer and autumn of 2022, business expectations had dropped to a level previously seen only during the financial and COVID-19 crisis. After the threat of a gas shortage dissipated, a recovery followed but six-month expectations are now plummeting again. In June they dropped by 7.3 points after already falling by 7.0 points in May, thus slipping to a well below-average level of -21.7 balance points.

- Business situation assessments also dropped by a palpable 3.2 points in June. At -1.1 balance points, their level is only just average and a downward trend appears to be taking hold here as well.

Sentiment is deteriorating across all sectors

SME business confidence is on the decline in all sectors. Retailers, however, recorded the steepest drop in June, with sentiment plunging by 10.0 points. The main cause was a sharp deterioration in situation assessments. It is plausible for the mood in the sector to deteriorate, to be sure, as it has been suffering real turnover losses for a long time. But the massive extent of the variation in the absence of a singular event such as a lockdown, for example, suggests special effects that might reverse in the months ahead. Sentiment in manufacturing fell particularly sharply as well, dropping by 7.5 points to -18.1 balance points. The main cause here was a significant decline in business expectations combined with sharply lower export expectations (-7.1 points), while situation

assessments worsened only moderately. Both the recently disappointing economic recovery in China and the widely expected technical recession in the US are likely to cloud the prospects in manufacturing enterprises. Furthermore, some sectors are worried about international competitiveness and geopolitical difficulties with the important trading partner China. Wholesalers, services businesses and construction firms also reported a drop in business sentiment in June, although the decline here was slightly less pronounced. The gap in sentiment between the large sectors manufacturing and services is thus widening even more than before, at the expense of manufacturing.

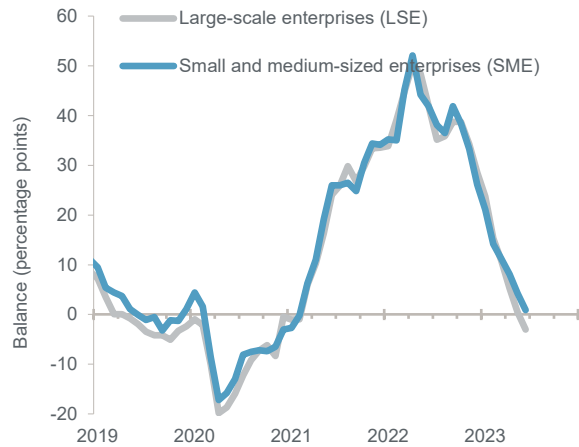
Sentiment among large enterprises plunged

Business confidence in the large enterprise sector took an even steeper nosedive than among SMEs. Their sentiment level fell by 9.4 points in June to only -26.0 balance points. Business expectations here also fell particularly steeply (-13.3 points) and, at -35.4 balance points, are now almost as pessimistic as at the height of the energy crisis in late summer of 2022. Furthermore, at -15.3 points, situation assessments among large enterprises remain significantly worse than in the SME sector.

Inflation trend is the only good news

The only good news which the KfW-ifo SME Barometer for June has to offer relates to future inflation trends, as the decline in sales price expectations of the past nine months continues unabated. With +0.9 and -3.1 balance points, sales price expectations in the SME and large enterprise sector are now very close to or even just slightly below the historical average, which accompanied an inflation averaging around 2% since the beginning of the KfW-ifo time series in the year 2005. The employment expectations of businesses of both size classes have almost fully returned to normal again as well, which suggests that wage pressure on inflation will tend to ease again going forward.

KfW-ifo sales price expectations



Sources: KfW Research, ifo Institute

Business cycle expectations are dimming

The KfW ifo Business Climate Index in June joins the string of disappointing economic indicators. The temporary business optimism of the spring has now evaporated. Instead, the German economy is currently in a kind of limbo. Sentiment indicators have weakened again significantly, especially in manufacturing. The surge in pessimism that has emerged among businesses surely represents a downside risk to the current forecasts issued by the leading economic research institutes, the Deutsche Bundesbank and KfW Research. All of them expect moderately negative growth for 2023 as a result of the weak start to the year but predict a more or less vigorous economic recovery to set in not later than from the second half of the year. However, with significant nominal wage increases and simultaneously easing inflation, the conditions for a moderate recovery in consumption in the coming quarters are still in place. Besides, as a positive side of the weaker economic outlook, the signs of a continuing decline in inflation are strengthening.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jun 2022	Jan 2023	Feb 2023	Mar 2023	Apr 2023	May 2023	Jun 2023			
Business climate											
Manufacturing	SME	-10.3	-12.1	-8.9	-6.1	-5.2	-10.6	-18.1	-7.5	-7.8	-2.3
	LSE	-8.7	-10.8	-8.2	-2.8	-2.7	-7.7	-22.7	-15.0	-14.0	-3.8
Construction	SME	-2.4	-16.4	-14.9	-12.0	-13.1	-12.7	-15.1	-2.4	-12.7	0.8
	LSE	-7.0	-10.5	-6.1	-11.1	-0.4	-7.6	-2.9	4.7	4.1	5.6
Retail trade	SME	-19.3	-9.9	-0.5	1.4	5.3	-4.4	-14.4	-10.0	4.9	-1.5
	LSE	-33.3	-17.9	-8.9	-11.5	-16.4	-15.7	-21.8	-6.1	11.5	-5.2
Wholesale trade	SME	-14.5	-11.9	-8.6	-9.7	-11.4	-21.0	-26.0	-5.0	-11.5	-9.4
	LSE	-15.9	-19.9	-17.8	-16.7	-18.7	-34.3	-35.1	-0.8	-19.2	-11.2
Services	SME	0.9	-8.9	-5.8	1.8	0.5	0.7	-3.5	-4.2	-4.4	3.5
	LSE	-16.5	-22.1	-20.2	-17.1	-19.3	-24.1	-28.5	-4.4	-12.0	-4.2
Germany	SME	-5.3	-11.2	-8.2	-3.1	-2.7	-6.4	-11.8	-5.4	-6.5	0.5
	LSE	-15.3	-16.1	-12.3	-7.9	-9.9	-16.6	-26.0	-9.4	-10.7	-5.4
Current situation	SME	12.9	0.0	1.3	4.1	2.2	2.1	-1.1	-3.2	-14.0	-0.7
	LSE	-0.4	-7.9	-7.9	-4.6	-8.6	-10.8	-15.3	-4.5	-14.9	-4.8
Expectations	SME	-21.4	-21.4	-17.0	-10.0	-7.4	-14.4	-21.7	-7.3	-0.3	1.6
	LSE	-28.3	-23.7	-16.6	-11.2	-11.4	-22.1	-35.4	-13.3	-7.1	-5.8
Employment expectations	SME	8.6	5.5	3.8	5.4	4.8	1.8	0.5	-1.3	-8.1	-2.5
	LSE	11.6	4.4	3.8	3.0	1.9	-0.9	-2.3	-1.4	-13.9	-4.2
Sales price expectations	SME	41.9	21.1	14.2	11.2	8.1	4.2	0.9	-3.3	-41.0	-11.1
	LSE	41.9	23.7	15.3	10.8	5.2	0.4	-3.1	-3.5	-45.0	-15.8
Export expectations of manufacturing	SME	-7.8	-9.7	-10.9	-10.6	-8.4	-11.0	-18.1	-7.1	-10.3	-2.1
	LSE	-0.9	-0.1	2.5	1.5	1.7	-4.0	-11.6	-7.6	-10.7	-5.9

Sources: 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 timeseries 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 timeseries 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.