

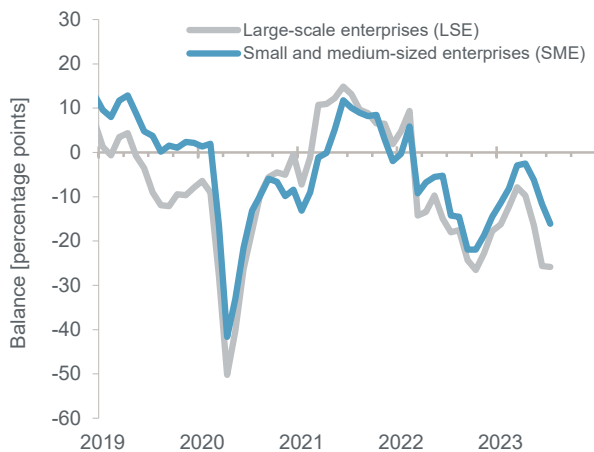
»»» The mood at the start of the summer quarter has turned sour

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- SME business sentiment fell for the third consecutive month
- Situation assessments dropped more steeply than expectations
- Confidence in large enterprises remained nearly steady
- Economic stalemate continues

KfW-ifo Business Climate Index



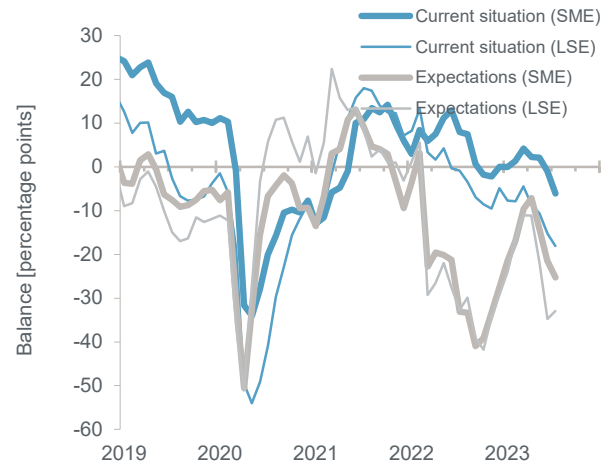
Source: KfW Research, ifo Institute

Third consecutive downturn in sentiment

In terms of sentiment, the start to the summer quarter was a failure. In July, SME business climate dropped by 4.4 points to -16.1 balance points from June. It was the lowest level of confidence since November last year and already the third consecutive decline, which is generally seen as a sign of a cyclical turnaround. This time, unlike in previous months, situation assessments plunged more steeply than expectations:

- They fell sharply by 5.1 points to -6.1 balance points and are now even further below the zero line which stands for the long-term average. While inflation-induced losses in purchasing power are slowly easing, the global restrictive monetary policy course appears to be having an increasingly heavy impact on the real economy.
- Business expectations fell by a further 3.8 points to -25.2 balance points after the preceding downturns. The view of the future is now laced with roughly the same amount of pessimism as at the end of 2022, when enterprises were consumed by worries about an energy crisis.

KfW-ifo sentiment components



Sentiment is deteriorating in all sectors

The downturn in sentiment in July permeated all main economic sectors of the SME business community. Differences were visible only in the extent of the downturn and in the business confidence level. The services sector experienced the shallowest decline, with a 2.4-point drop in business sentiment. It clearly tops the sentiment leaderboard at the same time, with -5.8 balance points. The manufacturing sector fell by a similar rate of -2.6 points, although the level of sentiment here is much more negative at -21.0 balance points. The downturn among retailers was a bit steeper but after services, this segment was less depressed than the rest (-3.4 points to -17.4 balance points). Furthermore, after steep losses in purchasing power the inflation rate is falling from a high level and, combined with foreseeable increases in real wages, this creates hope for a pickup in consumption and, thus, retail spending. The sharpest downturns in sentiment were reported by wholesalers (-4.1 points to -29.7 balance points) and construction firms (-5.2 points to -21.2 balance points), which were particularly affected by increased financing costs.

Confidence in large enterprises is nearly steady

Large enterprises, on the other hand, had better news to share. Unlike SMEs, their sentiment level in July was almost unchanged (-0.2 points to -25.8 balance points). This was supported by a mild improvement in business expectations (+1.8 points to -33.0 balance points), which nearly cancelled out the downward revision in situation assessments (-2.8 points to -18.1 balance points). At sectoral level, large manufacturers and retailers bucked the overall trend and even reported an improvement in business sentiment on June. Irrespective of the moderate convergence, however, the differences in business confidence levels and its components to the detriment of large enterprises remain large, primarily because of the significantly lower sentiment among large enterprises in services and the wholesale sector. By contrast, large construction firms, which often focus on commercial construction and public infrastructure, are currently in a much better mood than their SME counterparts, for which residential construction is the main area of activity.

Labour market is also showing first signs of weakness

The phase of cyclical weakness is now reflected in employment expectations, too. For the first time since February 2021, they have fallen below the zero line again in both enterprise size classes (SMEs: -2.1 points to -1.8 balance points; large enterprises: -3.5 points to -6.2 balance points). In the light of growing skilled labour shortages, it is nonetheless very unlikely for businesses to lay off workers to any appreciable degree. At the same time, pressure on the price pipeline continues to ease. After nosediving for more than a year, sales price expectations among businesses of both size classes are now only as high as the historic average (SMEs: -0.9 points to 0.1 balance points; large enterprises: +1.8 points to -1.0 balance points).

Economic optimism has evaporated

The cautious optimism of spring that the German economy could pick up some speed again after the technical recession of the winter half of 2022/2023 has vanished. According to the first estimate of the Federal Statistical Office, GDP stagnated in the second quarter. The economic stalemate continues for the time being, as highlighted by the KfW-ifo SME Barometer for July. The business cycle is stuck in the middle of the year in an economic no man's land between a weak recession and an anaemic recovery. Businesses are very sceptical about developments in the immediate future and, after the mild recovery in the first half of the year, are now again more pessimistic about the current situation as well. Manufacturing was most disappointing thus far, since production remains stuck in a rut despite easing supply chain problems. Despite the most recent declines, however, the order backlog in May is still a good 22% above the historical average since the start of the time series in January 2015 according to the Federal Statistical Office, which should provide at least some stability in the manufacturing sector in the coming months as well. Positive impetus, on the other hand, could come from consumption, which ended its six-month downward slide in the second quarter. In the months ahead, household purchasing power will be bolstered by easing inflationary pressure, an employment level that will likely remain almost steady despite the weak economy in view of growing skilled labour shortages, and noticeable wage increases. Besides, households still have a considerable portion of excess savings at their disposal which they put aside during the pandemic lockdowns. Along with increases in real incomes, this will presumably continue to revive consumption demand and mitigate the dampening effects of increased financing costs. All in all, however, the coming quarters will at best see small steps towards an economic recovery. For 2023 as a whole, a positive growth rate is now beyond reach.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jul 2022	Feb 2023	Mar 2023	Apr 2023	May 2023	Jun 2023	Jul 2023			
Business climate											
Manufacturing	SME	-17.2	-8.6	-6.1	-5.3	-11.4	-18.4	-21.0	-2.6	-3.8	-10.3
	LSE	-9.3	-7.7	-2.6	-2.8	-9.5	-23.0	-21.8	1.2	-12.5	-13.7
Construction	SME	-9.0	-14.7	-11.9	-13.1	-12.8	-16.0	-21.2	-5.2	-12.2	-3.4
	LSE	-15.1	-6.1	-11.3	-0.4	-7.7	-3.1	-3.9	-0.8	11.2	1.0
Retail trade	SME	-28.7	-0.3	1.3	5.8	-5.8	-14.0	-17.4	-3.4	11.3	-14.7
	LSE	-35.0	-8.8	-11.4	-16.3	-15.5	-21.7	-18.1	3.6	16.9	-6.3
Wholesale trade	SME	-20.8	-8.8	-9.7	-11.0	-21.1	-25.6	-29.7	-4.1	-8.9	-15.6
	LSE	-22.5	-17.9	-16.5	-18.7	-33.6	-35.5	-37.9	-2.4	-15.4	-18.0
Services	SME	-9.1	-5.7	1.8	0.5	0.7	-3.4	-5.8	-2.4	3.3	-1.7
	LSE	-20.6	-20.0	-16.9	-19.1	-23.8	-28.3	-29.4	-1.1	-8.8	-8.5
Germany	SME	-14.2	-8.1	-2.9	-2.5	-6.2	-11.7	-16.1	-4.4	-1.9	-6.8
	LSE	-18.0	-12.2	-7.8	-9.7	-16.4	-25.6	-25.8	-0.2	-7.8	-12.7
Current situation	SME	7.9	1.3	4.2	2.2	2.1	-1.0	-6.1	-5.1	-14.0	-4.2
	LSE	-0.9	-7.9	-4.5	-8.6	-10.7	-15.3	-18.1	-2.8	-17.2	-7.7
Expectations	SME	-33.1	-16.9	-9.6	-7.1	-14.1	-21.4	-25.2	-3.8	7.9	-9.0
	LSE	-32.7	-16.6	-11.1	-11.2	-22.0	-34.8	-33.0	1.8	-0.3	-17.0
Employment expectations	SME	4.1	3.8	5.3	4.7	1.6	0.3	-1.8	-2.1	-5.9	-4.6
	LSE	10.8	4.2	3.0	1.7	-1.1	-2.7	-6.2	-3.5	-17.0	-6.3
Sales price expectations	SME	38.1	14.2	11.2	8.1	4.2	1.0	0.1	-0.9	-38.0	-9.4
	LSE	34.9	15.3	10.9	5.3	0.4	-2.8	-1.0	1.8	-35.9	-11.6
Export expectations of manufacturing	SME	-11.9	-10.7	-10.5	-8.4	-11.0	-18.2	-18.9	-0.7	-7.0	-6.2
	LSE	-7.1	2.6	2.0	1.7	-4.3	-12.2	-15.1	-2.9	-8.0	-12.6

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 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.