

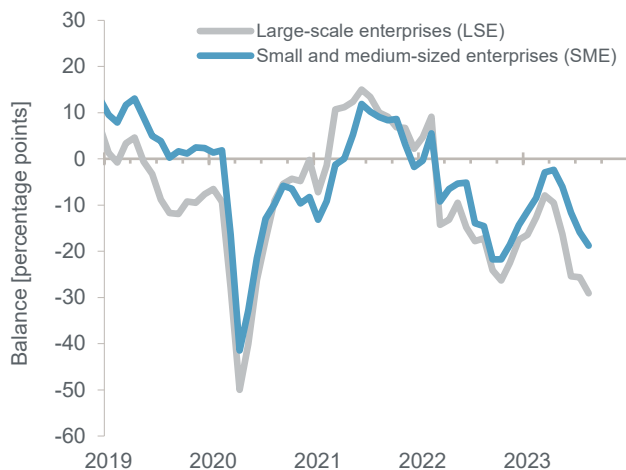
Business sentiment: Dry spell is getting longer and longer

19 September 2023

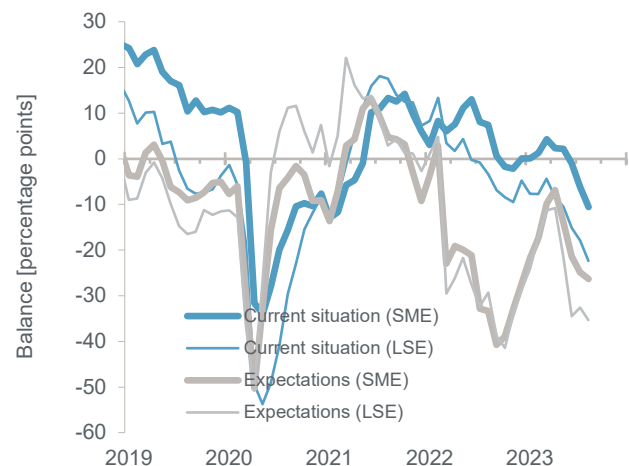
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- Fourth consecutive drop in business sentiment
- Situation assessments fell sharply but expectations dipped only moderately
- Large enterprises experienced a steeper decline in confidence
- Economic outlook remains muted

KfW-ifo Business Climate Index



KfW-ifo sentiment components



Sources: KfW Research, ifo Institute

SME business sentiment dips for fourth month in a row

The already poor sentiment among SMEs has deteriorated further. Their business confidence fell to -18.7 balance points in August, down by 2.9 points on July to mark the fourth consecutive decline. This is the lowest level of the sentiment indicator since the acute energy worries of October last year. Again, situation assessments fell more sharply than expectations, as they did in the previous month:

- Situation assessments plunged by 4.5 points to now -10.6 balance points, with the zero line representing the long-term average. The last time they exhibited a double-digit negative balance was towards the end of the COVID-19 restrictions in February 2021. Monetary policy tightening appears to be reaching the real economy, while inflation-induced price and cost pressures are slowly easing.
- Business expectations, on the other hand, dipped by a mere 1.5 points to now -26.3 balance points. After the strong declines in recent months, the outlook for the future nevertheless remains very pessimistic.

SMEs of all sectors are more downbeat

SMEs across all economic sectors were more pessimistic in August than in July. The lowest downturn was reported by retailers, whose business sentiment fell by an immaterial 0.3 points at the height of the summer. With -17.3 balance points, retailers are now in second place on the sentiment leaderboard behind service providers, which have long benefited from the post-pandemic rebound of services consumption. This boom now appears to be ending, however, as services now reported a drop of -6.4 points to -12.1 balance points, coming down from the positive sentiment level of May that had set them apart from all other segments. The falling inflation rate and foreseeable increases in real wages, however, are at least creating prospects for a pickup in consumption and, thus, retail spending and services. Sentiment is significantly more subdued in manufacturing (-3.4 points to -24.8 balance points), construction (-3.0 points to -24.6 balance points) and wholesale (-1.3 points to -30.1 balance points), sectors that are being negatively impacted by weak demand and increased costs.

Sentiment among large enterprises dropped more sharply

Sentiment among large enterprises was nearly unchanged in July but has now cooled off all the more. It fell by 3.5 points to -29.1 balance points, which is much lower than that of SMEs. The only times the business climate of large enterprises was lower than now was at the beginning of the global financial crisis in 2009 and the COVID-19 crisis in 2020. While large enterprises reported the same drop in situation assessments as SMEs (-4.5 points to -22.4 balance points), they downgraded their expectations in August more sharply (-2.7 points to -35.3 balance points). At sector level, only wholesalers reported a minor sentiment improvement of 0.8 points. At -36.5 balance points, however, the mood among wholesalers is more pessimistic than in any other economic sector. By contrast, the sentiment indicators of large enterprises fell noticeably in some of the remaining economic sectors. At -7.0 points, the drop was most pronounced among large construction firms, which focus on commercial construction and public infrastructure. However, this is put into perspective by the fact that despite the significant deterioration, sentiment there was still less depressed than in any other sector and size class.

Sales price expectations are slightly below average

Inflationary pressure continues to ease. For the first time in two and a half years, sales price expectations in both size classes fell slightly below the historic average again (SMEs: -0.7 points to -0.6 balance points; large enterprises: -0.2 points to -0.8 balance points). At the same time, employment expectations remained negative in August (SMEs: -2.1 points to -4.1 balance points; large enterprises: +2.5 points to -3.9 balance points). Nonetheless, growing skilled labour shortages make it unlikely that businesses will reduce their workforces noticeably in response to the cyclical weakness, as underscored for example by the recent upward revision made by large enterprises.

Economy will not return to growth until 2024

Following the mild technical recession in the past winter half-year and stagnation in the spring quarter, the German economy has stalled for quite some time now, with business sentiment ensnared in a dry spell for a further month – the fourth consecutive one. As the KfW-ifo SME Barometer for August shows, confidence has fallen more or less significantly in almost all economic sectors and enterprise size classes. Expectations are marked by unusually strong scepticism, and after the slight recovery in the first half of the year businesses are now also clearly more negative about the current situation. But there is reason for at least cautious hope. Noticeable wage increases, an employment level that appears to be nearly steady in light of the growing skills shortages and an inflation rate that, although still high, is on the decline will likely give new impetus to consumption in the foreseeable future and mitigate the dampening effects of increased financing costs. For manufacturers, however, the situation remains difficult amid weak global demand, although incoming orders recently stabilised somewhat, with strongly fluctuating large contracts, and firms still have a very decent volume of orders in their books. In June the stock of orders was 23% above the historic average since the beginning of the time series in January 2015 and 0.8% higher than in May. Overall, the German economy will likely need to take baby steps to work its way out of the broad economic trough. After the unfavourable start to the year, we expect GDP to drop by 0.4% across 2023 as a whole despite the consumption-driven stabilisation expected for the coming months. Growth is unlikely to resume until 2024, and our summer forecast predicts a moderate rate of 0.8%.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Aug 2022	Mar 2023	Apr 2023	May 2023	Jun 2023	Jul 2023	Aug 2023			
Business climate											
Manufacturing	SME	-19.3	-6.1	-5.1	-11.5	-18.1	-21.4	-24.8	-3.4	-5.5	-13.9
	LSE	-12.7	-1.8	-2.6	-9.6	-22.5	-22.4	-27.5	-5.1	-14.8	-19.5
Construction	SME	-6.6	-11.7	-13.0	-12.9	-16.3	-21.6	-24.6	-3.0	-18.0	-8.3
	LSE	-7.8	-11.2	-0.3	-7.7	-3.2	-4.2	-11.2	-7.0	-3.4	0.2
Retail trade	SME	-28.6	0.9	5.8	-5.8	-13.7	-17.0	-17.3	-0.3	11.3	-16.3
	LSE	-29.8	-12.0	-16.4	-15.6	-21.2	-18.1	-24.7	-6.6	5.1	-6.7
Wholesale trade	SME	-24.6	-9.7	-10.7	-20.8	-25.1	-28.8	-30.1	-1.3	-5.5	-14.3
	LSE	-26.0	-16.6	-18.8	-33.5	-35.2	-37.3	-36.5	0.8	-10.5	-13.4
Services	SME	-10.9	2.0	0.7	0.9	-3.3	-5.7	-12.1	-6.4	-1.2	-8.2
	LSE	-16.9	-16.7	-18.9	-23.7	-28.1	-29.2	-31.4	-2.2	-14.5	-9.8
Germany	SME	-14.5	-2.9	-2.3	-6.0	-11.6	-15.8	-18.7	-2.9	-4.2	-11.6
	LSE	-17.2	-7.9	-9.5	-16.3	-25.4	-25.6	-29.1	-3.5	-11.9	-15.5
Current situation	SME	7.4	4.2	2.3	2.1	-1.0	-6.1	-10.6	-4.5	-18.0	-8.8
	LSE	-3.4	-4.4	-8.5	-10.6	-15.2	-17.9	-22.4	-4.5	-19.0	-10.7
Expectations	SME	-33.3	-9.8	-6.8	-13.8	-21.3	-24.8	-26.3	-1.5	7.0	-14.0
	LSE	-29.3	-11.3	-10.8	-21.6	-34.5	-32.6	-35.3	-2.7	-6.0	-19.6
Employment expectations	SME	2.9	5.4	4.8	1.6	0.1	-2.0	-4.1	-2.1	-7.0	-5.9
	LSE	8.2	3.0	1.8	-1.1	-2.6	-6.4	-3.9	2.5	-12.1	-5.5
Sales price expectations	SME	36.4	11.4	8.0	4.1	0.8	0.1	-0.6	-0.7	-37.0	-7.7
	LSE	36.2	11.2	5.2	0.4	-2.8	-0.6	-0.8	-0.2	-37.0	-7.0
Export expectations of manufacturing	SME	-15.0	-10.7	-8.5	-11.1	-18.2	-18.8	-19.0	-0.2	-4.0	-8.6
	LSE	-7.8	1.7	1.6	-4.2	-11.9	-14.6	-11.4	3.2	-3.6	-12.3

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.