

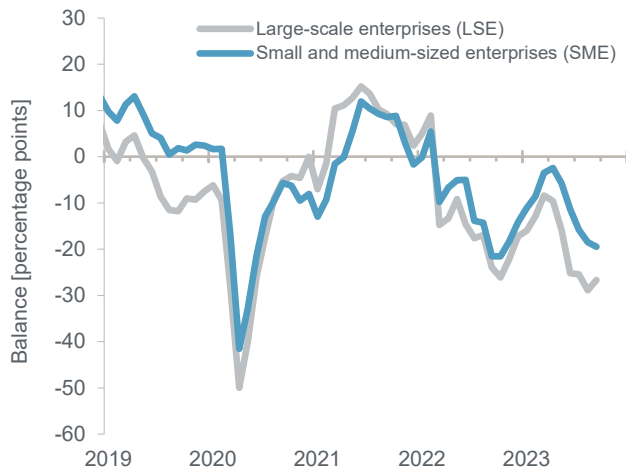
## »» SME business sentiment is bottoming out

9 October 2023

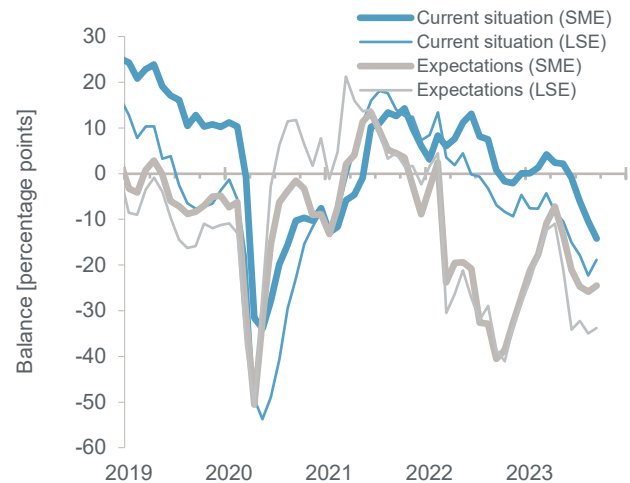
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- Business sentiment among SMEs is now declining only at a slow pace
- Expectations are slightly less pessimistic but situation assessments are still falling
- Mood among large enterprises slightly better than in the previous month
- Economic weakness is being gradually overcome

### KfW-ifo Business Climate Index



### KfW-ifo sentiment components



Source: KfW Research, ifo Institute

#### Business expectations have risen on the previous month

At the end of the summer, the mood among small and medium-sized enterprises has hardly deteriorated any further. Business confidence fell to -19.5 balance points in September, which is down by 1.0 points on August, only a good one third of an average monthly variation. After four straight downturns, some of which were very steep, business expectations are rising again slightly, thereby stabilising the sentiment indicator:

- Specifically, expectations rose by 1.3 points to now -24.5 balance points, with the zero line representing the long-term average. Irrespective of the most recent increase, however, the outlook for the future thus remains clearly pessimistic.
- SMEs' situation assessments, on the other hand, dipped by a further 3.7 points to now -14.2 balance points. In the third quarter they fell by a total of 11.5 points overall on the previous quarter, which underscores the persistently weak economic performance in the summer that resulted from monetary policy tightening and weak global demand.

#### Manufacturers and wholesalers are slightly more upbeat

A differentiated picture emerges among the main economic sectors in which SMEs operate. Service providers remain the most optimistic, even if they revised their business sentiment downward again slightly in September (-1.1 points to -13.0 balance points). The post-pandemic recovery in services consumption appears to be coming to an end. Retailers retained second place on the sentiment leaderboard, with a nearly unchanged confidence level (-0.2 points to -16.8 balance points). Construction SMEs, however, which focus on residential construction, reported another sharp downturn in confidence, making them the sector with the worst sentiment among all SMEs (-2.9 points to -27.7 balance points). Wholesalers previously occupied the last place but in September their confidence levels rose again slightly for the first time in a long while (+2.5 points to -26.5 balance points). Manufacturers are also experiencing a rise in confidence, with their business sentiment indicator improving slightly by 1.4 points to what nevertheless remains a far below-average -22.8 balance points.

### **Minor improvement in sentiment among large enterprises**

Large enterprises had good news to share in September. Their business sentiment improved by 2.2 points and now stands at -26.7 balance points, although this remains well below that of SMEs and, with the exception of the financial crisis of 2009 and the COVID-19 crisis of 2020, one of the lowest levels since the beginning of the time series in January 2005. Situation assessments (+3.4 points to -18.9 balance points) and expectations (+1.2 points to -33.8 balance points) both rose moderately. The moderate rise in sentiment rests on a broad basis because large enterprises of all main economic sectors reported an improvement on the previous month. The increase in confidence was strongest among large retailers (+7.0 points to -14.4 balance points), followed by manufacturing (+3.0 points to -24.6 balance points) and construction (+2.0 points to -9.5 balance points). Large construction firms, which focus on commercial construction and public infrastructure, thus corrected part of the sharp drop in the previous month to claim the top position on the sentiment leaderboard for all sectors and size classes. Even so, large services businesses were also somewhat more optimistic (+1.6 points to -29.8 balance points), as were wholesalers (+1.0 points to -34.4 balance points).

### **Only a minor dent in the labour market**

Businesses' sales price expectations have been hovering closely around their historic average for the past three months, although they now increased moderately in both size classes (SMEs: +1.0 points to 0.8 balance points; large enterprises: +0.6 points to -0.3 balance points). Employment expectations, on the other hand, slipped and in September dropped slightly further below their historic average (SMEs: -2.0 points to -6.1 balance points; large enterprises: -2.0 points to -5.9 balance points). Given the exacerbating skilled labour shortages, this can nevertheless be expected to make only a small dent in the labour market.

### **Economy may have bottomed out**

While sentiment indicators fell more or less clearly across all economic sectors and company size classes in the previous month, the KfW-ifo SME Barometer for September now paints a mixed picture. Opposing sentiment trends in the main economic sectors and company size classes were coupled with a slight rise in SMEs' expectations and another decline in situation assessments. By and large, however, the variations on the previous month were only minor and there is no doubt that the confidence level remains extremely subdued – even where improvements can now be observed. Such ambiguous indicator constellations can often be observed at the early stages of economic turning points and could thus be a first sign that the economy has now bottomed out. A significant portion of the current burdens for businesses is of a temporary nature, and the outlook is better than the very subdued sentiment currently suggests. Noticeable wage increases, an employment level that appears to be nearly steady and a falling inflation rate should give new impetus to consumption already in autumn and winter. Moreover, global monetary policy may then begin to ease in the later course of 2024, which is likely to be of particular benefit to Germany as a producer of interest rate-sensitive capital goods. While a moderate contraction in the current year must now be deemed an absolute certainty, we expect the German economy to gradually work its way out of the economic trough in the coming quarters and grow by 0.8% in 2024.

## KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Sep 2022	Apr 2023	May 2023	Jun 2023	Jul 2023	Aug 2023	Sep 2023			
<b>Business climate</b>											
Manufacturing	SME	-24.3	-5.1	-11.7	-18.1	-21.1	-24.2	-22.8	1.4	1.5	-11.1
	LSE	-16.9	-2.8	-9.7	-22.2	-22.2	-27.6	-24.6	3.0	-7.7	-13.2
Construction	SME	-15.3	-12.8	-12.7	-16.2	-21.6	-24.8	-27.7	-2.9	-12.4	-10.8
	LSE	-17.7	-0.3	-7.7	-3.3	-4.4	-11.5	-9.5	2.0	8.2	-4.7
Retail trade	SME	-33.3	5.3	-5.9	-13.8	-16.6	-16.6	-16.8	-0.2	16.5	-11.9
	LSE	-37.1	-17.1	-16.0	-21.2	-17.7	-21.4	-14.4	7.0	22.7	0.3
Wholesale trade	SME	-27.5	-10.9	-21.1	-25.0	-28.2	-29.0	-26.5	2.5	1.0	-8.9
	LSE	-29.1	-19.0	-33.3	-34.9	-36.7	-35.4	-34.4	1.0	-5.3	-6.4
Services	SME	-17.6	0.8	1.1	-3.1	-5.6	-11.9	-13.0	-1.1	4.6	-9.8
	LSE	-28.4	-18.8	-23.5	-28.0	-29.1	-31.2	-29.6	1.6	-1.2	-6.5
<b>Germany</b>	<b>SME</b>	<b>-21.6</b>	<b>-2.5</b>	<b>-5.8</b>	<b>-11.4</b>	<b>-15.8</b>	<b>-18.5</b>	<b>-19.5</b>	<b>-1.0</b>	<b>2.1</b>	<b>-11.4</b>
	<b>LSE</b>	<b>-24.0</b>	<b>-9.6</b>	<b>-15.9</b>	<b>-25.2</b>	<b>-25.4</b>	<b>-28.9</b>	<b>-26.7</b>	<b>2.2</b>	<b>-2.7</b>	<b>-10.1</b>
Current situation	SME	0.8	2.4	2.2	-0.9	-6.0	-10.5	-14.2	-3.7	-15.0	-11.5
	LSE	-6.9	-8.4	-10.5	-15.1	-17.9	-22.3	-18.9	3.4	-12.0	-8.4
Expectations	SME	-40.5	-7.2	-13.3	-21.0	-24.7	-25.8	-24.5	1.3	16.0	-11.2
	LSE	-38.7	-11.0	-21.1	-34.2	-32.3	-35.0	-33.8	1.2	4.9	-11.6
<b>Employment expectations</b>	SME	0.9	4.8	1.7	0.1	-1.9	-4.1	-6.1	-2.0	-7.0	-6.2
	LSE	3.1	1.9	-1.0	-2.5	-5.9	-3.9	-5.9	-2.0	-9.0	-4.7
<b>Sales price expectations</b>	SME	41.8	8.2	4.0	0.7	-0.1	-0.2	0.8	1.0	-41.0	-4.1
	LSE	38.7	5.4	0.3	-2.9	-0.6	-0.9	-0.3	0.6	-39.0	-1.5
<b>Export expectations of manufacturing</b>	SME	-17.8	-8.5	-11.2	-18.2	-18.8	-19.0	-21.7	-2.7	-3.9	-7.2
	LSE	-8.1	1.8	-4.4	-12.0	-14.8	-11.7	-18.6	-6.9	-10.5	-10.2

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.