

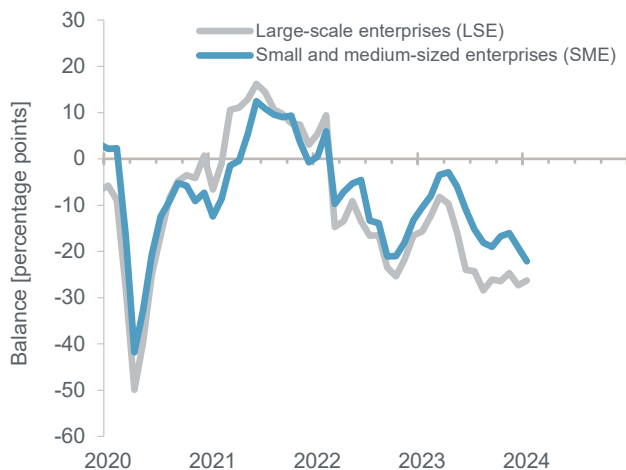
»» SMEs start the new year with subdued sentiment

2 February 2024

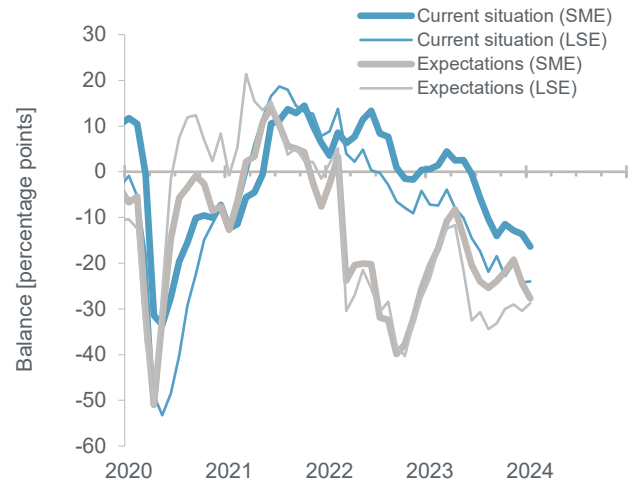
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- SME business confidence dropped to lowest level since outbreak of COVID-19 pandemic
- Expectations and situation assessments both deteriorated
- But large enterprises were more upbeat than in the previous month
- Economic burdens are likely to ease in the course of the year

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

Second straight decline in business sentiment

The mood among SMEs in Germany worsened further at the start of the new year, after already dropping in December. Sentiment fell to -22.1 balance points, a 3.0-point drop on the previous month. The last time it was even lower was during the lockdown that was imposed in response to the COVID-19 pandemic in the spring of 2020 (around -30 balance points on average from March to May). Both sentiment components deteriorated at a similar rate:

- Situation assessments dropped by 2.7 points to -16.3 balance points. The January level was 3.7 points lower than the average of the final quarter, signalling a growing risk of a technical recession in the winter half-year.
- Business expectations fell by 3.3 points to now -27.4 balance points, with the zero line representing the long-term average, as it does for the other indicators. SMEs' outlook on the future is and remains very pessimistic.

Sentiment has deteriorated in all main economic sectors

The renewed downturn in sentiment among SMEs was recorded across all main economic sectors; the only difference was the rate at which it deteriorated. SME construction firms with their focus on residential construction reported the smallest decline, although starting from what was already a very low level (-2.0 points to -31.0 balance points). The steepest drop, on the other hand, was reported by wholesalers (-5.4 points to -35.1 balance points), so they continued to occupy the tail end of the field. Retailers experienced declines between these two poles (-5.0 points to -17.6 balance points), as did services (-2.8 points to -14.8 balance points) and manufacturing (-2.7 points to -27.5 balance points). In a cross-comparison, when measured by the level of the sentiment indicator, sentiment among retailers and service providers is still the least depressed.

Large enterprises mustered some courage again

Unlike SMEs, large enterprises at least mustered some courage again in January. Their business confidence rose by 1.0 points to -26.3 balance points, which still remains lower

than that of SMEs. The situation assessments of large enterprises improved minimally (+0.2 points to -24.0 balance points), while their expectations rose moderately (+1.7 points to -28.7 balance points). The mild improvement in sentiment rests on a narrow basis, however, as large manufacturing firms were the only ones to report an improvement on the previous month (+3.5 points to -24.8 balance points). In all other main economic sectors, large enterprises reported a deterioration in sentiment – the smallest among service providers and the largest among retailers. Here, too, it is striking that the lowest business confidence level among large enterprises was reported by wholesalers – as it was among SMEs. This could indicate that the current problems are cumulating here, including lingering purchasing power losses and concerns over the stability of global trading routes, since wholesalers operate at the junction between international and national markets.

A dent in the labour market

Whereas sales price expectations fell again noticeably at the beginning of the year after reaching an eight-month high in December, at least among SMEs (-2.3 points to 4.9 balance points; large enterprises: +1.5 points to 2.1 balance points), employment expectations in both company size classes raise concerns about a dent in the labour market (SMEs: -1.1 points to -4.8 balance points; large enterprises: -0.8 points to -9.8 balance points). Given the increasing shortage of skilled labour, we nevertheless expect unemployment and employment to remain nearly unchanged on the previous year.

Consumption as a beacon of hope

The mood among Germany's SMEs at the beginning of 2024 is, without a doubt, very subdued, as illustrated by the current KfW-ifo SME Barometer. After falling again, business confidence is heading back to the lows recorded during the first COVID-19 lockdown in the spring of 2020 and, looking further back, during the global economic and financial crisis of 2009, when business sentiment also stood at around -30 balance points on average from January to July. Back then, however, annual economic output slumped by nearly 4% in 2020 and even by almost 6% in 2009. Amid a generally modest economic outlook, even the most pessimistic of all the forecasts currently available are miles away from such scenarios for the year 2024 that has just begun. It is perplexing to see what is historically very poor sentiment, given that the economy is merely treading water. This is likely a sign of significant uncertainty against the backdrop of a very confusing set of circumstances. At the moment, it is hard to separate temporary economic influences from the structural challenges facing Germany's long-successful, manufacturing- and export-driven growth model in the light of geopolitical shifts, the unfavourable demographic trend and the climate-neutral transformation of production methods. Positive news is having a hard time getting through, but it does exist. One such silver lining is the foreseeable recovery of household purchasing power. As inflationary pressures ease and real wages rise, key stressors are likely to diminish in the course of this year and a primarily consumption-driven recovery should begin. Germany should therefore grow at least moderately again in 2024.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Jan 2023	Aug 2023	Sep 2023	Oct 2023	Nov 2023	Dec 2023	Jan 2024			
Business climate											
Manufacturing	SME	-11.2	-23.4	-21.6	-21.0	-19.0	-24.8	-27.5	-2.7	-16.3	-1.8
	LSE	-10.7	-25.9	-23.3	-23.7	-23.2	-28.3	-24.8	3.5	-14.1	-1.1
Construction	SME	-14.0	-24.8	-26.9	-27.6	-25.2	-29.0	-31.0	-2.0	-17.0	-2.0
	LSE	-8.7	-11.0	-8.9	-7.9	-9.7	-15.9	-20.5	-4.6	-11.8	-6.1
Retail trade	SME	-9.3	-15.6	-15.3	-13.9	-12.2	-12.6	-17.6	-5.0	-8.3	0.8
	LSE	-18.2	-20.9	-14.2	-21.3	-19.9	-17.8	-23.9	-6.1	-5.7	-1.7
Wholesale trade	SME	-12.0	-28.2	-25.8	-28.9	-24.9	-29.7	-35.1	-5.4	-23.1	-2.3
	LSE	-19.9	-34.2	-33.0	-35.3	-29.0	-36.6	-38.0	-1.4	-18.1	-0.4
Services	SME	-8.5	-11.5	-12.7	-8.9	-10.3	-12.0	-14.8	-2.8	-6.3	-1.3
	LSE	-21.4	-30.6	-29.0	-26.2	-26.4	-29.0	-29.4	-0.4	-8.0	0.3
Germany	SME	-10.5	-18.1	-19.0	-16.7	-16.0	-19.1	-22.1	-3.0	-11.6	-1.1
	LSE	-15.7	-28.4	-26.1	-26.4	-24.7	-27.3	-26.3	1.0	-10.6	0.9
Current situation	SME	0.6	-10.3	-14.0	-11.4	-12.8	-13.6	-16.3	-2.7	-16.9	-2.3
	LSE	-7.2	-21.9	-18.5	-22.8	-20.2	-24.2	-24.0	0.2	-16.8	-1.7
Expectations	SME	-20.6	-25.4	-23.9	-21.8	-19.2	-24.4	-27.7	-3.3	-7.1	-0.1
	LSE	-23.4	-34.4	-33.1	-30.0	-29.0	-30.4	-28.7	1.7	-5.3	3.1
Employment expectations	SME	6.2	-4.0	-5.7	-4.9	-4.1	-3.7	-4.8	-1.1	-11.0	0.7
	LSE	4.2	-3.8	-6.2	-9.9	-11.3	-9.0	-9.8	-0.8	-14.0	-3.4
Sales price expectations	SME	20.9	-0.4	0.7	1.7	4.5	7.2	4.9	-2.3	-16.0	4.9
	LSE	23.2	-1.0	-0.7	-1.0	-1.9	0.6	2.1	1.5	-21.1	1.2
Export expectations of manufacturing	SME	-9.2	-18.2	-20.5	-18.3	-15.3	-18.8	-19.2	-0.4	-10.0	1.2
	LSE	0.0	-10.5	-17.1	-11.7	-12.8	-14.5	-18.0	-3.5	-18.0	-2.0

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 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.