KfW-ifo SME Barometer: February 2014

Business climate: more realism, less optimism

- **SME business climate positive, driven by dramatic improvement in assessments of the current situation**
- **Business expectations among SMEs fall to four-month low**
- **Sentiment among large enterprises continues to improve**

Current business situation for SMEs shows significant improvement

The upturn is picking up speed. SMEs reported a significant improvement in their current business situation in February: the current situation indicator rose more than twice as much as usual by 5.3 points to 28.6 balance points, a 23-month high. However, the business climate indicator registered a more modest rise (up 1.2 points to 21.8 balance points), as business expectations fell to a four-month low (down 3.0 points to 14.7 balance points). We see no cause for serious concern:

- The decline in expectations does not yet mean an end to the positive trend. The indicator is still a clear 5.0 points above its outcome of October last year, the level before the three most recent – in some cases very sharp – improvements in expectations.
- Expectations have been cut after eight months of consecutive rises – a total gain of 14.5 points – which was not entirely matched by improvements in assessments of the current
situation (up 5.4 points). In light of this, a consolidation was overdue to bring expectations more into line with reality.

**Good reasons for cautious optimism**

There are also good economic reasons not to allow expectations to spiral: global economic indicators from both China and the USA have been rather disappointing recently and turbulence on emerging financial markets could in the worst case have the effect of hampering the global recovery if further large amounts of capital are withdrawn. The conflict in Ukraine has added another risk factor to the mix. Nevertheless, the possibility of a euro zone setback remains the primary economic risk. It is worth noting that sentiment among industrial SMEs with a strong international focus has remained largely unchanged (up 0.2 points to 19.1 balance points), while the business climate in the retail segment surged to a 22-month high in February (up 6.6 points to 22.9 balance points). The latter points to buoyant demand in Germany and confirms our view that the surprisingly weak consumer spending in the final quarter of last year was merely temporary.

**Large corporations unconcerned by risks so far**

Large corporations also reported a marked improvement in current business in February, up 4.1 points to 21.7 balance points. They are less worried about potential risks than SMEs. Optimism even advanced slightly month-on-month, with expectations gaining 0.4 points to 18.9 balance points after an already sharp rise in the expectation indicator in January. However, assessments of the current situation are still lower than among SMEs, leaving large corporations more scope for advances – particularly if the global economy registers an at least moderate recovery, as generally expected. Overall, the business climate rose more strongly for large corporations – up 2.3 points to 20.6 balance points – than among their SME counterparts.

**2014 to see dynamic first half, followed by more moderate growth**

The best news from the KfW-ifo SME Barometer in February is that a clear improvement in the actual situation is finally bolstering the business climate. Even the less optimistic forecasts can be seen in a positive light: more cautious optimism limits the scope for disappointment, particularly in light of serious risks such as the current geopolitical tensions surrounding Ukraine. Forecasts are healthier, which should not be mistaken for a shift towards pessimism. Expectations remain positive, which demonstrates that – after two slow years – companies are now assuming that there will be a recovery. This is also reflected in the recent trend in SMEs' recruitment plans, which are at a two-year high. Business sentiment appears to support our economic projection: a strong economy in the first half of 2014, with quarterly GDP growth slowing somewhat from the summer. That will be sufficient to achieve real
growth of 2.0% in 2014. We then anticipate growth of 1.6% – adjusted for calendar effects – in 2015.

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