KfW-ifo SME Barometer: May 2014

General sentiment: slower pace ahead

- Current situation and expectations for SMEs both fall
- Deterioration in business climate for large enterprises too
- Sales price expectations alarmingly weak

Tangible cool-down in business climate in May

The upswing is not over, but it is losing momentum: after the dream start to 2014 with quarterly growth of 0.8% – supported strongly by the good weather conditions – the German economy drops back to its normal pace again in the second quarter. The downturn in sentiment at an elevated level as indicated by companies in May fits in nicely with this scenario: the SME business climate indicator lost 2.4 points and is now sitting at 19.6 points, returning to roughly the same position as last December. Both of the climate components declined compared to the previous month:

- The assessments of the current business situation noticeably deteriorated compared to the two-and-a-half-year high in April (-2.6 points to 28.4 balance points). Nevertheless, companies are still more than satisfied with current business trends, as demonstrated by the high indicator reading.
• Expectations worsened, falling 2.3 points to 10.6 balance points. The more cautious outlook on the future is understandable given the numerous risks – the crisis in Ukraine, muted growth in emerging markets and the risk of deflation in the euro area.

**Gloomier assessment widespread**

Large enterprises have practically the same view of their economic situation in May as SMEs: despite the gloomier assessment, their views of current business are still very positive (-1.6 points to 23.6 balance points), while they are less optimistic about the future (-2.1 points to 12.9 balance points). All told, the business climate of large enterprises dropped 1.9 points to 18.4 balance points after climbing to a three-year high in the previous month. The deterioration in the climate is widespread, embracing almost every economic sector and size of business. The only exceptions are the large retailers, where sentiment improved marginally compared to April (+0.5 points to 11.9 balance points). Nevertheless, the business climate readings in all segments are still clearly higher than the historical averages which indicate normal economic activity. This sends a clear signal that the upswing is continuing – albeit more slowly. The employment expectations at companies in both size categories also point in the same direction. These are softening again at an above-average level, and therefore demonstrate continued, though somewhat less dynamic, growth in employment.

**Sales price expectations alarmingly weak**

By contrast, sales price expectations are alarmingly weak (SMEs: -1.1 points to -2.0 balance points; large enterprises: -1.8 points to -2.6 balance points). In spite of the improved economic activity compared to the last two years, they fell even further in May below the long-term average – indicated by the zero line. Prices have trended below this benchmark since mid-2012. Despite the now above-average capacity utilization, the pan-European pressure on prices is obviously increasingly making itself felt in Germany too, as demonstrated by the extremely subdued consumer price inflation rate for May (+0.9 % compared to previous year; four-year low).

**Chance of two-percent economic growth in Germany**

All told, we feel the May results of the KfW-ifo SME Barometer confirm our economic forecast: after the brilliant start to the year, economic growth is likely to hover around the trend rate again in the second quarter and beyond, which means quarterly rates of between 0.3 and 0.5 %. Under the given overall circumstances we can be satisfied with this. Working-day adjusted, real growth will likely increase in 2014 to 2.0 %. This would be the first notable growth in German GDP for three years, before falling slightly in 2015 (+1.6%). The greatest downside risk is still possible setbacks in Europe. Even small shocks could disrupt the fragile recovery in the euro area and disappoint expectations. In particular, a continued rise in the euro exchange rate would be difficult for the European export economy to cope with. This is why the ECB ought to adopt a resolute position in combating the deflation risks that are now conspicuous even in Germany.

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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 well-known ifo business climate index for which about 7,000 enterprises from trade and industry (manufacturing, construction, wholesale and retail trades) from western and eastern Germany are polled every month on current and future business, including around 5,600 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 limits have to be drawn more narrowly for retail trade (maximum annual turnover of EUR 12.5 million) and the construction industry (up to 200 employees). 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 are also expressed as balance figures. All time series are seasonally and mean adjusted. The zero line therefore marks the long-term ‘cycle-neutral' average. Indicators above (or below) zero point to an above average or favourable (below average or negative) business situation.