KfW-ifo SME Barometer: June 2014

Economic uncertainty on the rise

- **SMEs: business climate deteriorates for third time running**
- **Large enterprises: current situation better, but expectations considerably worse**
- **Only retail trade retains positive trend in sentiment**

The economic activity continues to rise but at a noticeably slower rate than in the first quarter of 2014. In June the SME business climate declined a further 1.8 points, the third consecutive monthly drop. At 17.7 balance points, sentiment is nevertheless still above average, indicating a normalisation of speed, not a stalling of the economic engine. Both of the climate components declined compared to the previous month.

- The assessments of the situation fell 2.7 points, down to 25.6 balance points. Despite the worsening in comparison to May, companies still rated their current business activities as better than at the start of the year.
- Expectations deteriorated moderately by 1.0 points to 9.6 balance points. SMEs did not consider a quick return to very strong growth rates to be realistic. We share that view.
Large enterprises sceptical that the very good business situation will persist

In contrast, the large enterprises painted a differentiated climate picture. The development of the two climate components was not uniform. On the one hand they rated their current business activities as noticeably better than in May (+2.0 points to 25.5 balance points, together with the March figure a two-year high) and were able to catch up with the SMEs for the first time since April 2012. On the other hand, their expectations worsened by 1.7 times the average monthly change, hitting a ten-month low (-5.7 points to 7.1 balance points). As a consequence, the business climate of large enterprises was down on the previous month in June (-1.9 points to 16.4 balance points). Clearly, export-oriented companies fear that the nascent, cautious recovery of the global economy could be seriously hampered by geopolitical tensions in Ukraine and now even more so by those in Iraq. Added to this is the fact that the stabilisation process in Europe is still on very shaky ground, and the allocation of costs for the energy turnaround is still being debated with the European Commission.

Domestic sectors remain very satisfied, geopolitical risks unsettle industry

The concerns surrounding Germany’s cyclical risks in foreign trade can also be seen by glancing at the sector indicators; the trends are particularly accentuated in the three-monthly changes. The sentiment in the globally active industry is declining noticeably in both enterprise class sizes. The climate in the wholesale industry as the intermediary between foreign trade and the domestic economy remains fairly stable, at least for the large enterprises of the sector. Only the retail trade climate is consistently in the black in both size segments compared to the first quarter. This fits in with the revival of private consumption as a new driver of growth, spurred on by rising employment and considerably higher real wages. In the first quarter of 2014, allowing for inflation, wages rose by 1.3% compared to the same quarter of the previous year, the sharpest increase in almost three years. The construction sector is an exception in the domestic economy. The climate in the construction industry worsened considerably in the quarterly comparison. But we only regard this as an one-off effect relating to the weather due to the very mild winter masking the solid trend. As in other domestic sectors, the mood there also continues to be good.

Nevertheless: economic growth of two percent possible in Germany in 2014

The June results of the KfW-ifo SME Barometer support our picture of the economy, into which we have already factored a weakening of quarterly growth rates from 0.8% in the first quarter to between 0.3% and 0.5% during the rest of the year. Thanks to the excellent start to the year, real growth of 2.0% can be expected for 2014 as a whole. However, next year it may well prove difficult to maintain the momentum. Aside from the geopolitical risks, the main threat to the economy still lies in Europe. Even minor shocks could disrupt the fragile recovery in the euro area and disappoint expectations. The priority must be to eliminate the latent risk of deflation quickly.

Author: Dr Klaus Borger, +49 (0) 69 7431-2455, klaus.borger@kfw.de
Press: Christine Volk, +49 (0) 69 7431-3867, christine.volk@kfw.de
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.