SMEs enter the new year with increased confidence

- **SMEs**: expectations clearly and current conditions slightly improved
- **Large companies**: substantial business climate recovery
- **Sales price expectations**: increased risk of deflation

Strong improvement to the business climate for SMEs at the end of the year

SMEs finish 2014 on a conciliatory note and show signs of optimism that the phase of weak economic growth will come to an end in 2015. The business climate has improved in December for the second month in a row after a continued downward trend from April to October. This improvement was seen in a rather significant increase of 2.8 points to 12.3 balance points, which is roughly one and a half times higher than a normal month-on-month change. The last time this sentiment indicator posted a slightly higher level was in July. Most of all, this increase was due to renewed confidence among businesses:

- Business expectations increased considerably in December by 4.5 points to 4.6 balance points, which demonstrates that more and more companies are anticipating a recovery in the first half of 2015.
- In contrast, business assessments have shown only moderate improvement (+1.0 points to 19.8 balance points). The figures for Q4 came in at 1.6 points under the previous
period. This confirms our forecast of continued weak growth in the last quarter of the
year.

Large companies: subdued optimism despite improvements in the business climate
Both climate components also improved for large companies; however, expectations for this
sector are more subdued than for SMEs. They are up 2.5 points to -0.9 balance points,
remaining below the zero line for the fourth month in a row. The zero line represents the
long-term average. Compared to small and medium-sized enterprises, this subdued
optimism may be due to the disproportionate focus on foreign trade among large companies.
Particularly in the international trade sector the recent events in Russia and Greece have
caused a sense of uncertainty and risk in the German economy, while domestic demand,
especially consumption, remains an anchor of stability there. At the same time, while the
assessments of large companies continue the upward trend that began three months ago
(+2.5 points to 14.4 balance points), large companies have ultimately also enjoyed a
recovery in their business climate (+2.5 points to 6.9 balance points).

More jobs but sales price expectations at a five-year low
The renewed confidence among companies is also reflected in their plans for expanding
employment. SMEs made an upward correction of a solid 2.4 points to 8.9 balance points,
which is equivalent to almost twice the average month-on-month change. In contrast, sales
price expectations continue to fall in the wake of declining oil prices, posting their lowest
levels in five years (SMEs: -0.8 points to -6.1 balance points; large companies: -4.0 points to
-8.2 balance points). Although this will help increase the real purchasing power of consumers
in the short term, it also increases a risk of deflation that could become a serious problem if it
were to take hold.

Despite improved sentiment: easy does it!
Without a doubt, the good sentiment at the dawn of the new year rings a positive note. We
do, however, recommend maintaining a down-to-earth approach. We disagree with the most
recently published economic forecasts that predict improvements to the economy. We also
expect that a drop in crude oil prices will provide consumers with more money to spend and
that the falling euro exchange rate will benefit exports. These developments should be a
source of economic growth in 2015. However, the unfavourable mixture of the crisis with
Russia, an extremely sluggish recovery in the euro zone and nervous financial markets has
considerable potential to cause disappointment and uncertainty if these were to escalate.
Companies may therefore wait to make decisions on investments until these uncertainties
subside. There is time: Interest rates shall remain low for a long time and capacity utilisation
even fell slightly in the last two quarters. We therefore stand by our forecast: Given that the
winter half year is expected to be rather weak, Germany will have average economic growth
of around just 1 % in 2015 (not calendar-adjusted), following growth of approximately 1.5 % in
2014.

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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 their economic situation, 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.