

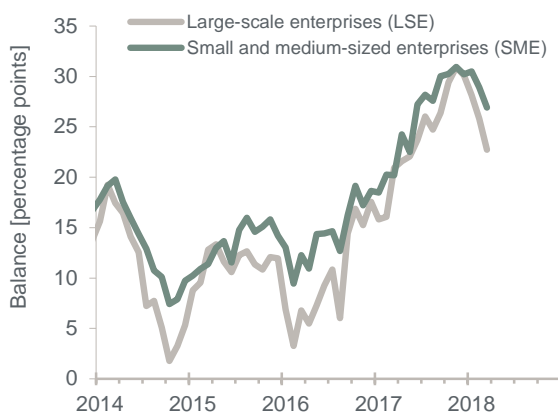
## »» Dark clouds on the horizon

5 April 2018

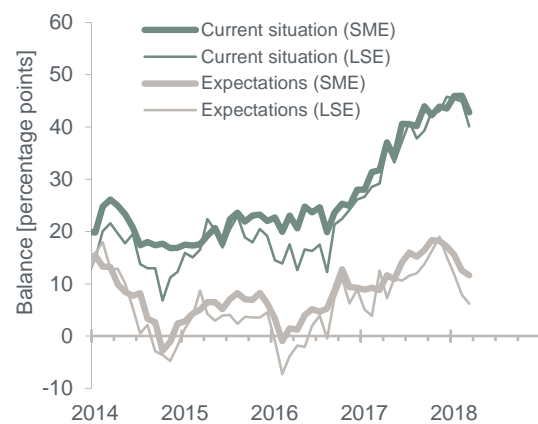
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- SME business climate has clouded over further
- Situation assessments have declined more strongly than expectations
- Sentiment has cooled even more strongly among large enterprises
- Upswing continues but is losing momentum

### KfW-ifo business climate



### KfW-ifo climate components



Source: KfW Research, ifo Institute

### SME business confidence has fallen again

The growing threat of a protectionist spiral triggered by the US is weighing on sentiment. Good news, such as the successful formation of a German government at long last after a prolonged exploratory phase and agreement on an orderly transitional phase after Brexit, is not enough to allay concerns. The SME business climate dropped 2.0 points to 26.9 balance points in March. After the second consecutive decline, the key indicator of the KfW-ifo SME Barometer remains on a high level but is now clearly below its record of last November (31.0 balance points). Both components are down:

- Expectations continued on the downward trend that began five months ago, falling by 1.0 points in March. The majority of companies expecting their business to improve in the next half year dropped further to now just 11.6 balance points.
- Situation assessments fell to 42.8 points at the same time. Irrespective of the clear 3.2-point drop from the previous month's all-time high, SMEs still regard their situation as extremely positive from a historic perspective.

### Business climate among large enterprises on the decline

Confidence among large enterprises has dropped off more strongly than among SMEs for several months now, including in March. Their business climate has fallen by 3.1 points to 22.7 balance points. As with SMEs, they have mainly corrected their assessment of the current business situation downward, albeit from a very high level (-4.8 points to 40.1 balance points). By comparison, the renewed decline in expectations has been less pronounced, dropping 1.7 points to 6.2 balance points. However, large enterprises' optimism has been significantly more subdued than among SMEs already since the beginning of the year.

### The spectre of protectionism

This can probably be explained by the growing fear of a global trade war, especially since the US has for the first time announced specific punitive tariffs on steel and aluminium. Large export-oriented firms would be most severely affected by growing protectionism. Even with a temporary exemption for steel and aluminium exports from the EU, the additional punitive tariffs recently announced for China are further increasing the risk of an escalating trade conflict. Measures such as high US tariffs on automobile imports, which would also hit Germany very hard, are conceivable against this background.

### **Construction sector bucks the downward trend**

It is therefore not surprising that, in a sectoral view, manufacturers and wholesalers lost confidence in March across a broad front, as these are the sectors where international linkages are particularly close. This contrasts with the positive development in SME construction firms, where confidence rose by a strong 4.9 points to near-record 38.5 balance points. Among the large construction firms, confidence remained nearly unchanged on the previous month, at 39.9 balance points (-0.5 points on February). Construction activity remains vigorous and is one of the pillars of the upturn.

### **Puzzling collapse of retail confidence**

A mysterious development, however, has been the very sharp decline in confidence in the retail sector which has gripped both SME retailers (down 7.2 points to 18.3 balance points) and large retailers (down 6.4 points to 5.5 balance points). Continuing employment growth – demonstrated not least by the relevant indicators of the KfW-ifo SME Barometer – and rising real wages provide the fundamental prerequisites for a continued buoyant consumption trend in any case. The consumption barometer of the German Retail Federation, which has risen continuously since the temporary decline in January, points in the same direction. We therefore believe that the most recent deterioration in retail business confidence is an outlier (presumably attributable to inaccuracies in the seasonal adjustment procedure in combination with the changing timing of the Easter holidays) which will soon be corrected.

### **Upturn will continue at a slower pace**

The March findings of the KfW-ifo SME Barometer are above all one thing: an expression of the growing uncertainty in the face of a US administration that is increasingly beginning to underpin its already familiar protectionist rhetoric with concrete measures. Nevertheless, it is prudent to stay level-headed and resist any temptation, neither in Europe nor in China, to adopt hasty countermeasures. The actions announced by the US until now apply only to a very small portion of global trade and their consequences – seen in isolation – would be extremely limited, especially for Germany. The great danger is, above all, that they could set in motion a protectionist spiral at the end of which all trading partners would lose. Given its enormous current-account surplus, Germany would be particularly vulnerable. But that would not happen automatically, especially if the EU stands together and responds in a constructive manner. We therefore remain optimistic for now: Germany's growth will slow but remain healthy for a foreseeable period of time. Specifically, we predict GDP growth of 2.5% this year and 1.9% next year. In the present environment, however, downward risks are mounting, especially if growing concerns over the introduction of new trade barriers have a heavier impact on companies' investment confidence in the future. ■

# KfW Research

## KfW-ifo SME Barometer: March 2018

### Annex: SME business cycle in figures

#### KfW-ifo SME Barometer

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Mar/17	Oct/17	Nov/17	Dec/17	Jan/18	Feb/18	Mar/18			
<b>Business climate</b>											
Manufacturing	SME	17.6	28.8	30.2	29.6	29.9	27.4	25.0	-2.4	7.4	-2.1
	LSE	23.5	32.4	34.7	31.9	30.5	27.8	25.8	-2.0	2.3	-5.0
Construction	SME	29.2	40.1	36.5	36.8	36.8	33.6	38.5	4.9	9.3	-1.5
	LSE	37.1	45.5	41.2	44.1	42.8	40.4	39.9	-0.5	2.8	-2.5
Retail trade	SME	18.5	25.7	24.8	23.4	25.1	25.5	18.3	-7.2	-0.2	-1.7
	LSE	5.3	15.5	12.1	16.9	11.0	11.9	5.5	-6.4	0.2	-5.4
Wholesale trade	SME	22.3	27.9	29.6	28.9	27.3	30.5	25.9	-4.6	3.6	-0.9
	LSE	20.7	26.6	30.7	31.9	29.8	27.1	21.7	-5.4	1.0	-3.5
<b>All economic sectors</b>	<b>SME</b>	<b>20.2</b>	<b>30.2</b>	<b>31.0</b>	<b>30.2</b>	<b>30.5</b>	<b>28.9</b>	<b>26.9</b>	<b>-2.0</b>	<b>6.7</b>	<b>-1.7</b>
	<b>LSE</b>	<b>20.9</b>	<b>29.4</b>	<b>30.9</b>	<b>30.1</b>	<b>28.2</b>	<b>25.8</b>	<b>22.7</b>	<b>-3.1</b>	<b>1.8</b>	<b>-4.6</b>
Current situation	SME	31.7	42.3	43.9	43.6	45.9	46.0	42.8	-3.2	11.1	1.7
	LSE	29.2	43.0	43.0	45.8	45.4	44.9	40.1	-4.8	10.9	-0.5
Expectations	SME	8.8	18.4	18.3	17.1	15.6	12.6	11.6	-1.0	2.8	-4.7
	LSE	12.6	16.3	19.0	15.1	11.8	7.9	6.2	-1.7	-6.4	-8.2
West Germany	SME	21.0	31.5	32.3	31.4	31.5	30.1	27.8	-2.3	6.8	-1.9
	LSE	21.4	29.7	31.3	30.6	28.3	26.2	22.7	-3.5	1.3	-4.8
East Germany	SME	15.7	22.4	22.3	23.0	24.0	21.3	21.8	0.5	6.1	-0.2
	LSE	10.4	23.1	20.4	19.3	24.4	17.6	23.0	5.4	12.6	0.7
<b>Employment expectations</b>	SME	13.2	18.8	21.1	21.5	20.7	18.7	18.6	-0.1	5.4	-1.1
	LSE	13.9	22.3	22.6	25.9	25.0	22.8	21.2	-1.6	7.3	-0.6
<b>Sales price expectations</b>	SME	9.7	11.0	12.9	15.4	13.9	13.0	11.9	-1.1	2.2	-0.2
	LSE	6.3	4.4	3.8	8.4	5.3	4.0	2.0	-2.0	-4.3	-1.7

Source: KfW Research, ifo Institute

Explanations and abbreviations:

\*Seasonally and mean adjusted (long-term mean since January 1991 = 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

### 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 building 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.