

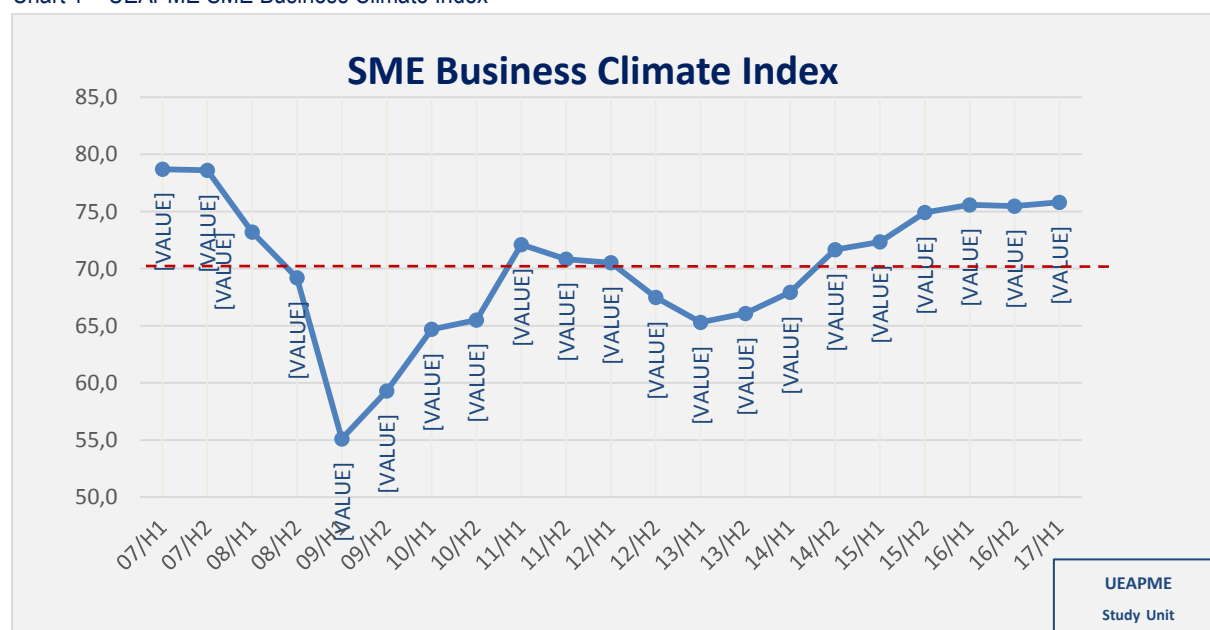
The EU Craft and SME Barometer 2017/H1

SME Climate Index up to 75.8, but new forms of imbalances

SMEs expect a slowdown in domestic demand

The **UEAPME SME Business Climate Index**, shown in Chart 1, increased by 0.3 points compared to last semester, reaching 75.8 percentage points. The index, which consists of the shares of the European Crafts and Small and Medium Enterprises reporting stable and positive business situation and expectations, has maintained its level above the neutral level (i.e. 70 points) for the sixth consecutive semester, exhibiting a small but steady growth. This result confirms that SME recovery continues, resisting the recently observed economic and political changes.

Chart 1 – UEAPME SME Business Climate Index



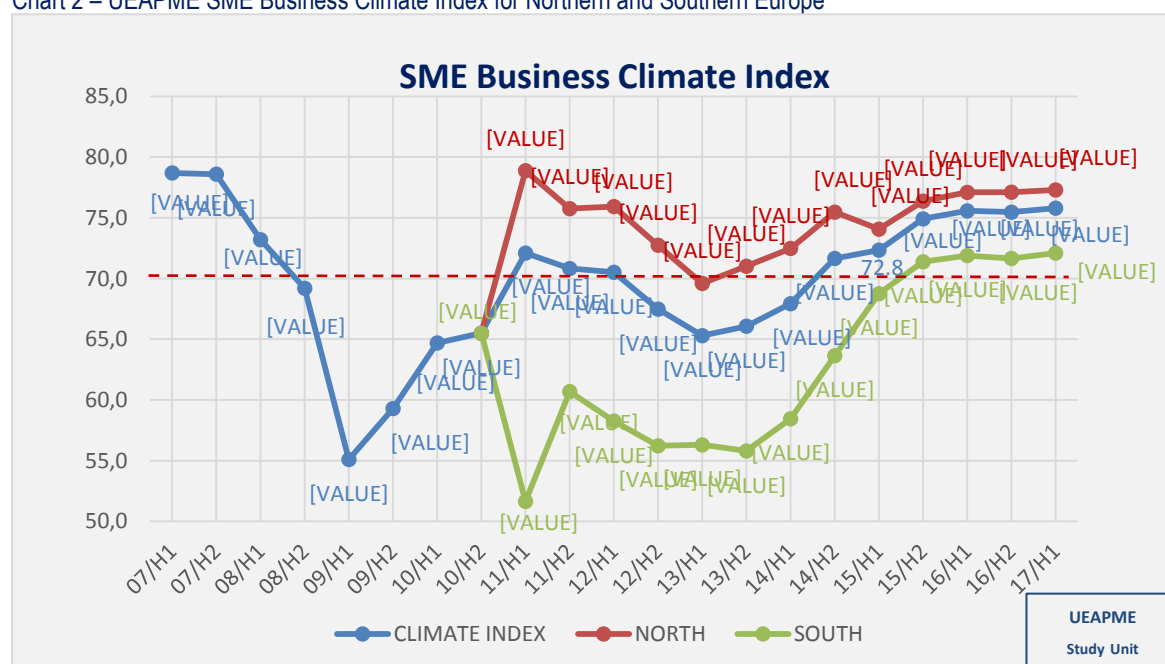
The index is calculated as an average of companies that have reported positive or stable business situations and expect a positive or stable development for the next period. Therefore, the index can range from 100 (all positive or neutral) to 0 (all negative).

Regarding the situation in the North and Centre¹ and in the South and Periphery² (Chart 2), the last figures confirm that the situation is quite similar and stable for both areas. In the north, the Climate index has reached 77.3 percentage points (i.e., +0.2 compared to last semester), whereas in the south it has increased by 0.4 points, recording 72.1 points. As already noted in our last publication, the similar trends of the Northern and Southern Europe are quite encouraging, and point toward a homogeneous European growth path.

¹ Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Latvia, Lithuania, Luxembourg, Netherlands, Poland, Romania, Slovakia, Sweden and UK

² Croatia, Cyprus, Greece, Ireland, Italy, Malta, Portugal, Slovenia and Spain.

Chart 2 – UEAPME SME Business Climate Index for Northern and Southern Europe



That said, two points are worth making. Firstly, a gap between the north and the south persists, showing the heterogeneity of the EU economies and the need for coordinated policies at EU level to foster convergence. Also, it must be said that, while the between-group growth path may have stabilised, within-group differences are sharpening, possibly driven by the spreading effects of Brexit. Our last Climate Index, in fact, already depicted a negative impact of the Brexit on UK SMEs as well as on those economies strongly depending on the UK one (i.e. Denmark and Ireland). Chart 3 confirms the negative tendency for the UK-DK-IE group.

Chart 3 – UEAPME SME Business Climate Index for Euro, Non-Euro countries and the DK-IE-UK group

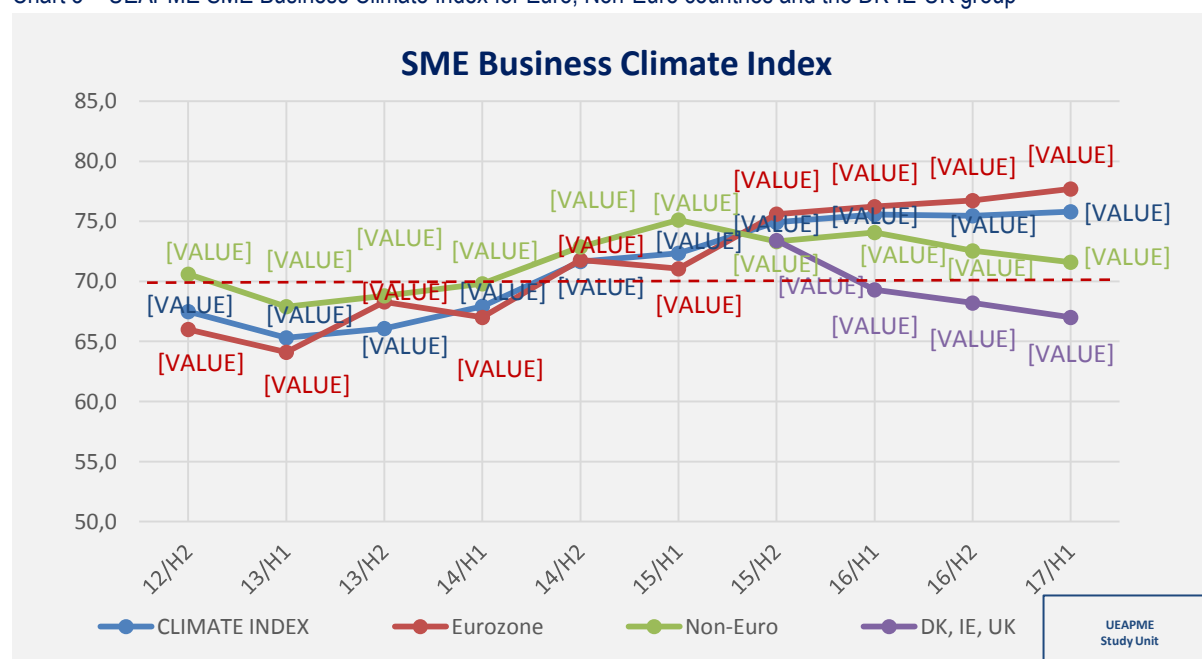
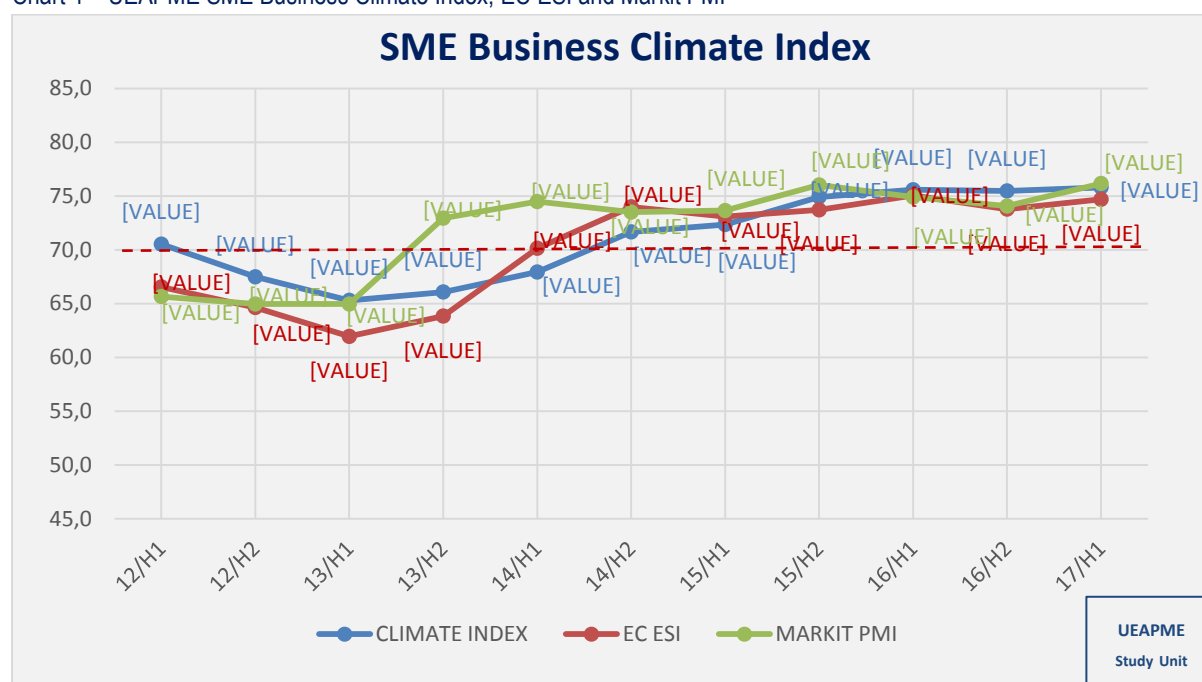


Chart 3, however, also shows a negative trend for those countries out of the Eurozone, perhaps implying that Brexit effects have spread, particularly affecting those countries not under the umbrella of the single currency. On the other hand, the general positive tendency for the south is being held back by the negative Italian trend³. Therefore, while increasing on average, European SMEs' situation presents remarkable within-group divergences. Such findings suggest that a north-south comparison may not be enough to fully grasp heterogeneity and imbalances of the EU economies and the need for coordinated policy at EU level.

Chart 4 compares the UEAPME SME Business Climate Index (blue line), the European Commission's *Economic Sentiment Indicator* (EC ESI - red line)⁴ and the *Purchasing Managers' Index* (Markit PMI – green line)⁵.

Chart 4 – UEAPME SME Business Climate Index, EC ESI and Markit PMI



The Markit PMI records 76.2 points exceeding both the Climate Index (75.8) and the EC ESI (74.7). Interestingly, as opposed to the previous semester, both indicators show a slightly steeper increase compared to the Climate Index. This may be due to the greater exposure of large enterprises to global events and external demand. Therefore, an increase in the ESI and PMI indexes may reflect an increase in the level of external and extra-European demand.

On the other hand, SMEs mainly depend on internal demand and are less involved in the current geopolitical issues. Thus, a lower growth of the Climate Index points to a possible fading out of the internal demand as driver for growth, as also hinted by the last *Winter Economic Forecast* of the Commission.

³ Italy is the only southern country presenting a negative change in the Climate Index.

⁴ The EC's ESI measures five confidence indicators linked to different sectors: Industrial Confidence Indicator; Services Confidence Indicator; Consumer Confidence Indicator; Construction Confidence Indicator and Retail Trade Confidence Indicator. The average of last six months ESI values has been re-scaled to make it comparable with the UEAPME SME Business Climate Index, with 70 as the long-term average/neutral value. http://ec.europa.eu/economy_finance/db_indicators/surveys/index_en.htm

⁵ The Markit Composite PMI measures new orders of large firms in manufacturing and services. The average of last six months PMI values has been re-scaled to make it comparable with the UEAPME SME Business Climate Index, with 70 as the long-term average/neutral value.

Main Results: European SMEs are stable, but domestic demand is expected to fade-out

The EU Craft and SME Barometer presents the balance between positive and negative judgements from SMEs for different business aspects, size classes and sectors⁶.

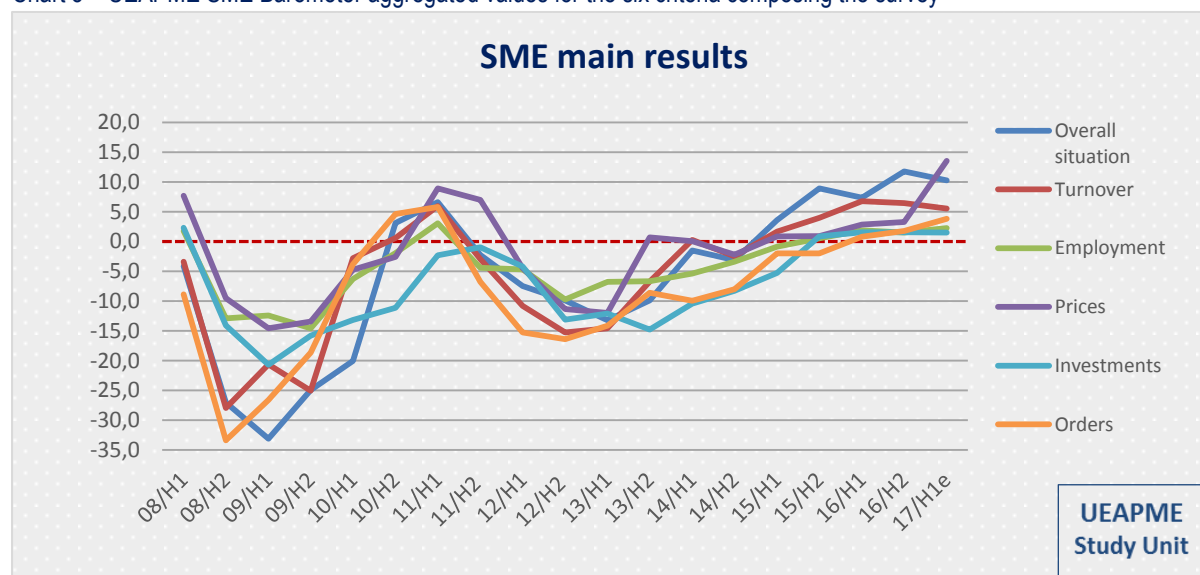
Results for 2016/H1: all criteria are in the positive sphere, but first signs of a domestic demand slowdown

The results of the Barometer for the second semester 2016 are positive for all criteria albeit presenting a slowdown compared to the past semester.

As shown in the Chart 5, in 16/H2 the overall situation has considerably increased by 4.4 pts from last semester, recording 11.8 points. Interestingly – as in 16/H1 – such a figure seems to be at odds with the values observed for the remaining criteria. This may be indicating that, overall, SMEs are still experiencing the positive effects of the past growth.

Turnover is slightly decreasing (-0.4 pts) registering 6.4 points. However, on a one-year lag, it confirms its positive tendency increasing by +4.7 pts. With a -0.4 points change, employment follows the trend and records 1.5 points. The brake on both turnover and employment has ultimately affected investments, which remain unchanged at 1.6 points.

Chart 5 – UEAPME SME Barometer aggregated values for the six criteria composing the survey



Prices confirm their positive tendency reaching 3.3 points (+0.5 compared to 16/H1). Similarly, Orders present an increased figure stepping up from 0.8 in 2016/H1 to 1.8 in 2016/H2.

The above-presented results may seem to be conflicting with the positive change in Climate Index. In this respect however, two points should be considered. Firstly, the Climate Index is usually highly correlated with the figure for the overall situation, which – as seen above – has increased compared to

⁶ More on the methodology can be found on page 11.

16/H1. Also, it is worth noticing that the results from 2016/H2 contain much more neutral answers than in the past. This means that, while the sum of positive and neutral answers used for the Climate Index may be increasing, the higher number of neutral answers confirms the rather static economic scenario shown by the Barometer.

Growth dynamic behind expectations

The figures presented in the table below show that such a static scenario was however unexpected. Having a look at the difference between the expectations and the real results in 16/H2 (Table 1), it is straightforward to see that the majority of the criteria has been overestimated. In particular, as opposed to the past semester, the results for turnover and employment were behind expectations by 3.6 and 3.4 points. Despite these negative developments, the results for the overall situation were 1.3 ppts higher than expected. As already noted, this may be due to the enduring effects of the past growth. On the other side, the difference between observed and predicted prices – albeit negative – is smaller than usual (16/H1 recorded a -7.3 ppts change). This may have boosted the expected profitability thereby softening the negative impact of the reduction in turnover.

Table 1 – Difference between expectations (e) and final results for 16/H2 and expectations for 17/H1

	Expectations 16/H2e	Results 16/H2	Δ (R-E) 16/H2	Expectations 17/H1e
Overall	10.4	11.8	1.3	10.3
Turnover	10.0	6.4	-3.6	5.6
Employment	4.9	1.5	-3.4	2.3
Prices	8.1	3.3	-4.8	13.5
Investments	1.4	1.6	0.2	1.5
Orders	7.4	1.8	-5.6	3.8

Table 2 – Turnover by sector

Turnover			
	16H1	16H2	Δ 16/H2- 16/H1
Manufacturing	8.6	8.7	0.1
Construction	3.5	-0.7	-4.2
Business Services	5.2	6.8	1.5
Personal Services	6.3	6.6	0.3

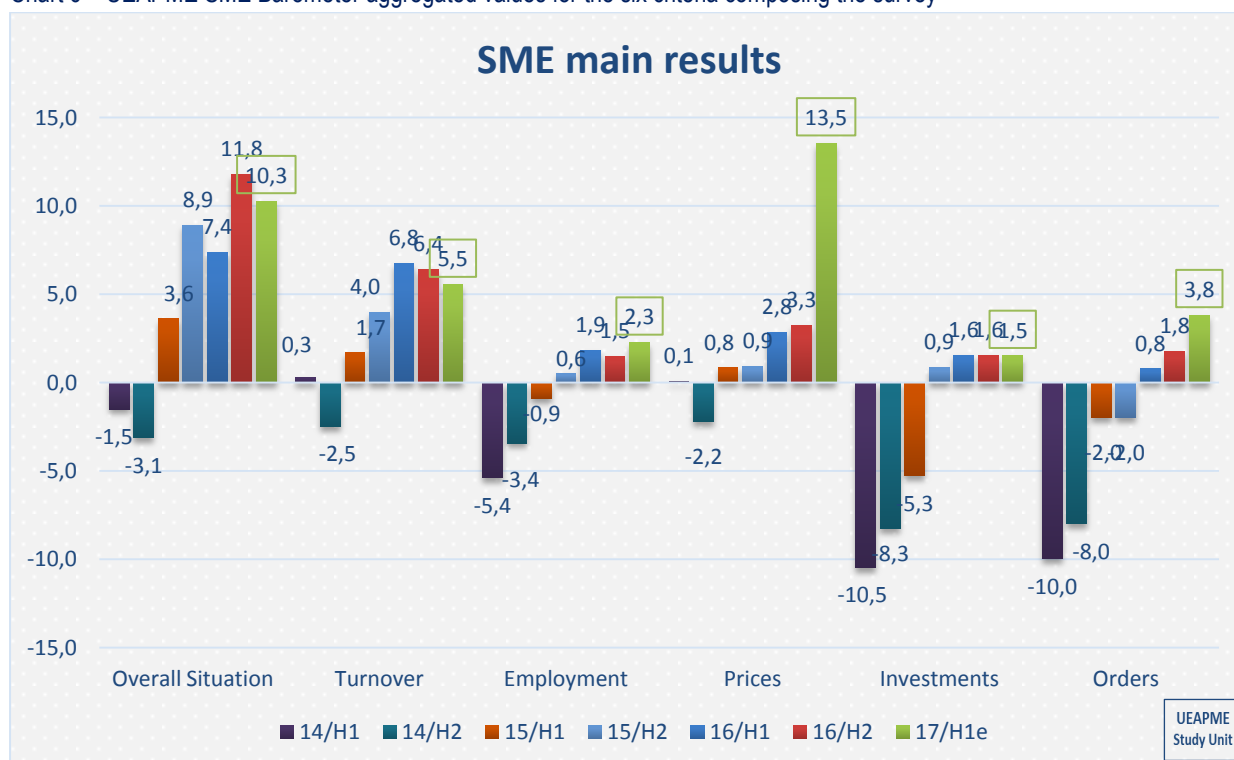
Moreover, looking at the figures for turnover by sector, it is clear that – aside from construction – all the remaining sectors show an increase, however small, between 16/H1 and 16/H2. Therefore, despite less than expected, the majority of sectors witnessed a raise in turnover, which may have led SMEs to positively judge the overall situation. On the other hand, as it will be argued in the next paragraphs, the negative change in turnover recorded by the construction sector may be due to an inflation-driven slowdown in domestic demand.

Expectations for the current semester confirm a domestic demand slowdown

Expectations for the incoming semester (17/H1e) for all six indicators are shown in Chart 6.

The ‘*Winter Forecast*’, recently published by the European Commission predicts stable medium-term growth for Europe, accompanied – in the short run – by an inflation-driven slowdown in domestic demand. The graph below nicely pairs with such a prediction. Prices are expected to rise by 10.2 points. Such inflationary pressure may have led SMEs to expect a slowdown on the internal demand side, thereby causing expected decreases in overall situation (-1.5 points), turnover (-0.8 points) and investment (-0.2 points). Employment, on the other hand, is expected to step up to 2.3 points (i.e., +0.8). These seemingly conflicting findings may be explained by the higher rigidity of the SMEs’ labour market. SMEs (and more specifically micro enterprises), due to their small size, have less room for manoeuvre in terms of labour force compared to large firms. Thus, they tend to retain work force in periods of downturn to not risk to loose qualification. Additionally, it is worth noting that the expected change in the level of employment went from +3 points in 16/H2 to +0.8 points in 17/H1. This may suggest that, while still positive, the expected change in employment might have been held back by the expected demand slowdown. The same logic may well apply to expected orders: in fact, they went from an expected +6.6 points change last semester to an expected +2 for the current semester.

Chart 6 – UEAPME SME Barometer aggregated values for the six criteria composing the survey



That said, two further considerations are worth making. Firstly, while the above chart depicts a small expected slowdown, all figures remain significantly positive. Also, as noted above, the results for this semester contains a vast majority of neutral answers, which – far from being negative – means that many SMEs are quite confident that the positive economic scenario witnessed in the past semesters will continue in the future.

Domestic demand slowdown affects construction and personal services

As it was outlined above, inflationary expectations may – via a temporary reduction in domestic demand level – drive expected confidence and turnover down. This because, differently from large enterprises, SMEs have a core exposure to internal demand, being therefore particularly affected by any evolution on this side. Chart 7 depicts the trends in overall situation for the four different sectors considered in the Barometer, namely: Manufacturing, Construction, Business Services and Personal Services. As anticipated, while increasing in 16/H2, overall situation is expected to drop in winter. The chart also shows that expectations are especially negative for the construction and personal services sector. This confirms the idea that such a decrease may hinge on an expected brake on domestic demand. Differently from manufacturing and business services in fact, construction and personal services are particularly dependent on domestic demand, as – by their very nature – they cannot be delocalised and offer very locally targeted services.

Chart 7 – Overall Situation by sector

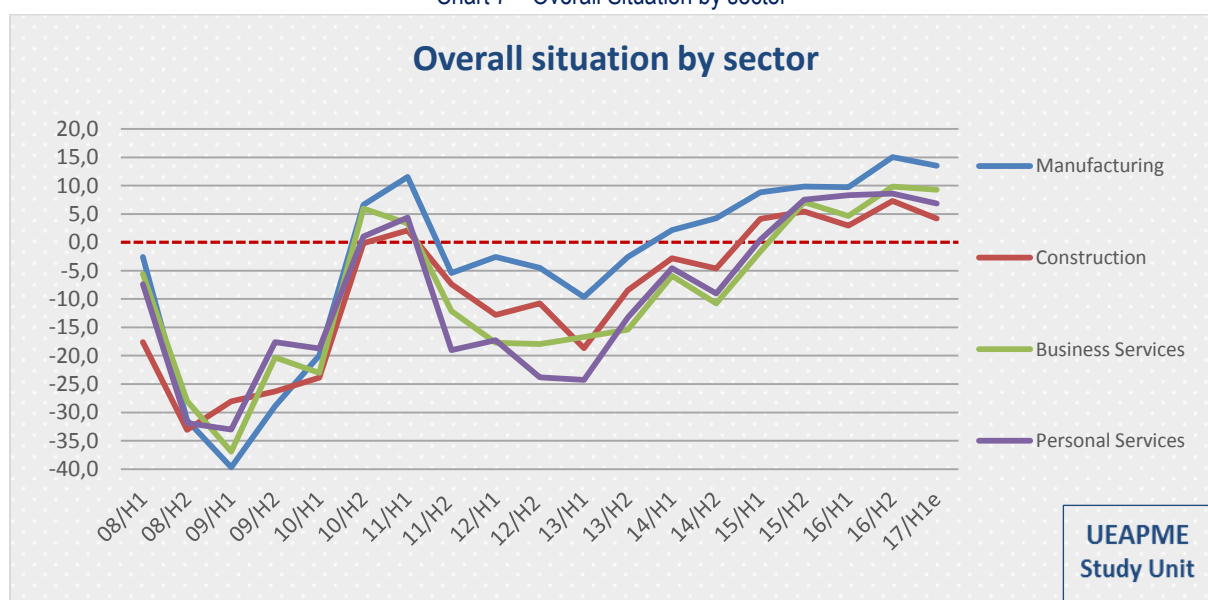


Chart 8 – Turnover by sector

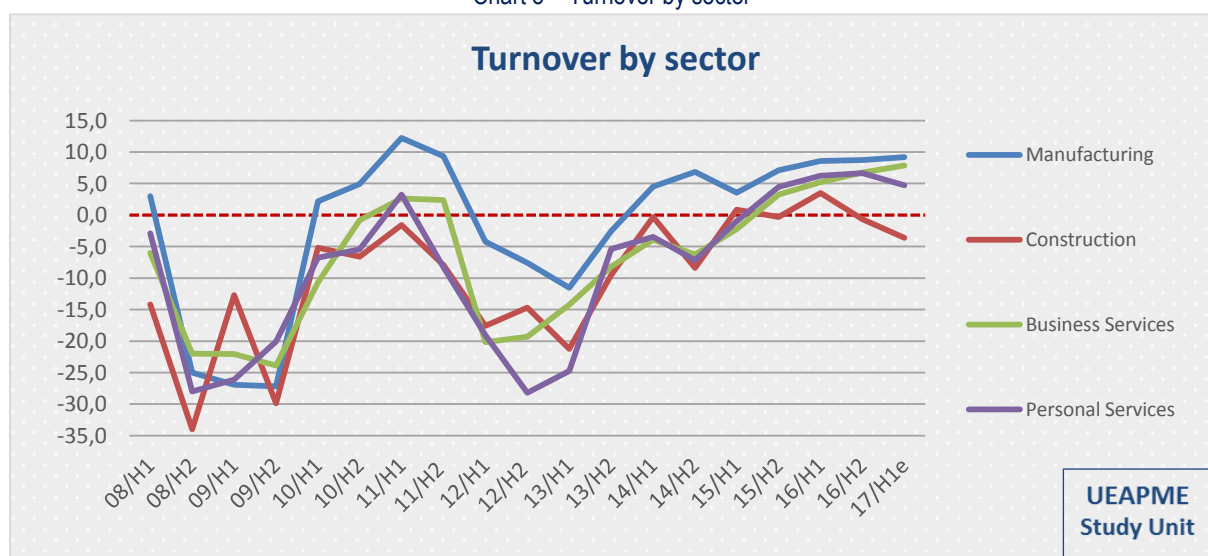


Chart 8 supports the proposed interpretation. Turnover, in fact, is expected to decrease both for construction (-2.9) and personal services (-1.9), whereas it is roughly stable (or slightly increasing) for manufacturing (+0.5) and business services (+1.1). Turning to results for last semester, it must be said that, aside from construction, all sectors record a slight increase compared to last semester. This may suggest that the contraction on domestic demand has, so far, only reached the construction sector, which, in turn, may have served as a negative signal influencing expectations for the other sectors. Furthermore, it is important to stress that the construction sector presents strong imbalances between countries. Specifically, Poland and Italy lead the negative trend with a marked decrease while Germany counterbalances with a much more stable situation. This further reiterates the key importance of coordinated policies at EU level.

Employment and Investments show stronger resistance to the economic conjuncture

Charts 9 and 10 present the evolution of employment and investments across sectors. As noted before, domestic demand shocks might asymmetrically hit the different sectors. In principle, however, both employment and investments should – for different reasons – be less responsive to the economic conjuncture. Employment, as mentioned, is relatively more inelastic due to the rigidity of the labour market. Remarkably, while this feature may be detrimental during economic growth periods and in a long-term perspective, it may as well be advantageous during temporary economic downturn as it preserves jobs and ultimately limits the negative effects of the slowdown. Looking at the graph below, it seems that – although construction and personal services have been especially hit in 16/H2 – figures are more homogeneous. Moreover, the personal services sector is expected to catch up with manufacturing and business services. As for construction, after the drop witnessed in 16/H2, employment expectations remain roughly constant for the current semester. The different behaviour – in expected values – for construction and personal services may be partially explained by seasonality which may be particularly beneficial for the personal services sector. Nonetheless, many different elements are at play in the labour market. Therefore, it would be incautious to provide any more detailed interpretation given the limited amount of data available.

Chart 9 – Employment by sector

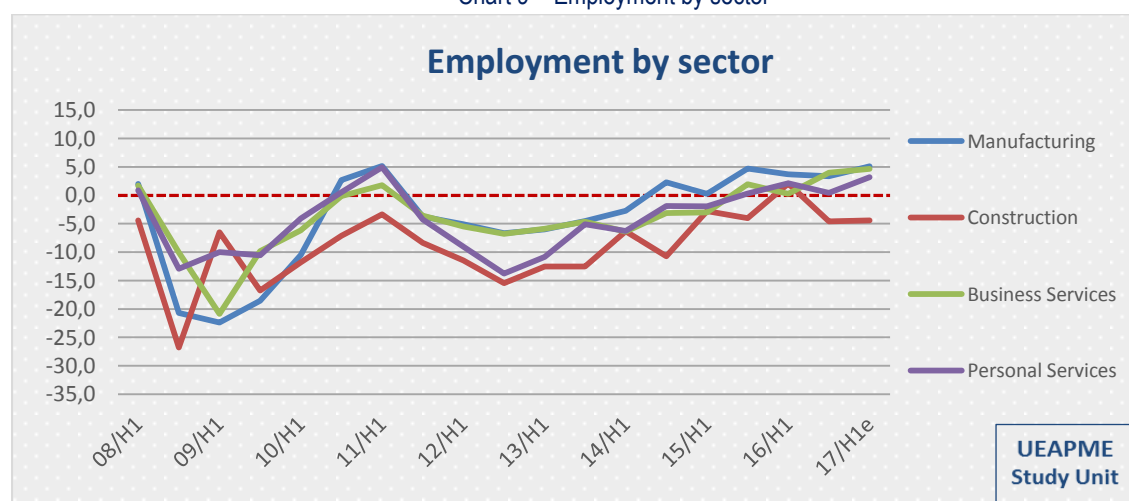
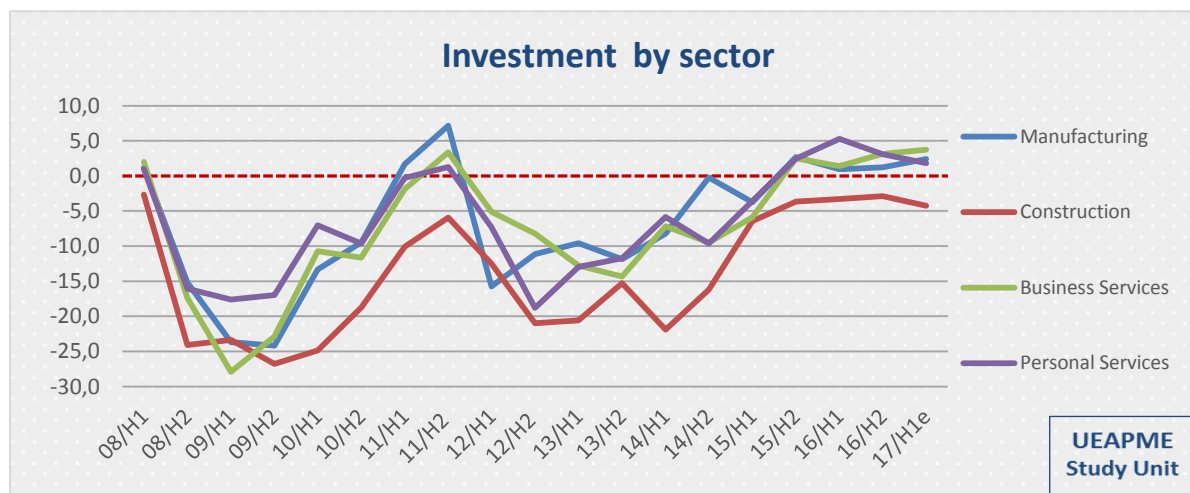


Chart 9 – Investment by sector

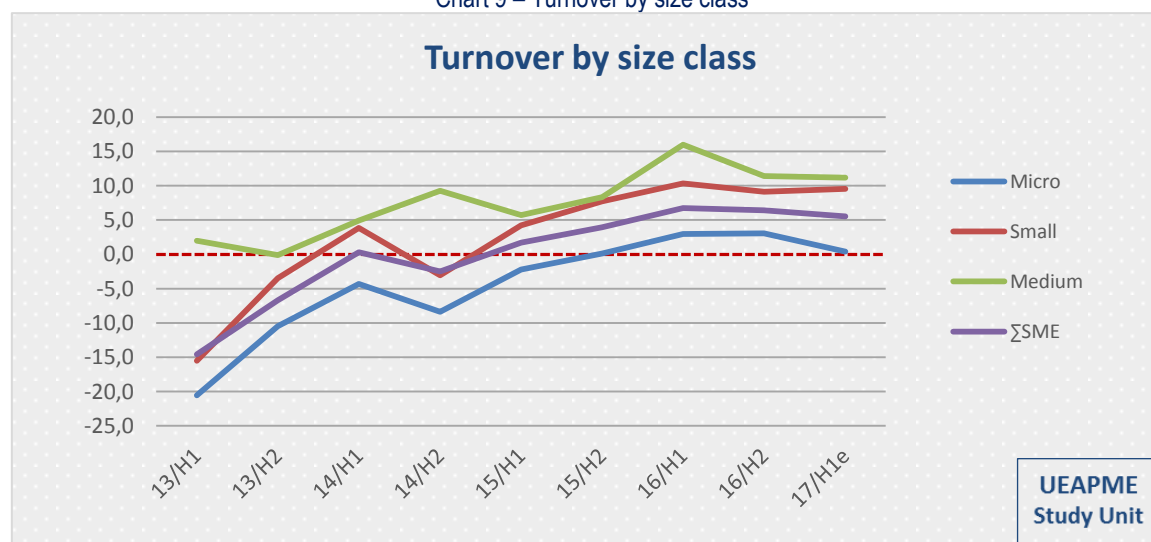


Investments, on the other hand, normally present a smaller short-term variability due to the fact that they are usually long-term projects based on previous results. That said, looking at the graph, a negative trend for the construction and personal services sectors can be identified. This further reinforces the idea that an expected domestic demand slowdown may hide behind the observed negative expectations.

Micro enterprises bear the burden of the downturn in construction

Chart 10 provides a general overview of the turnover by size class. While at the top, medium enterprises recorded a descending trend in turnover during the last semester. This may be the effect of the recently observed economic and political events, especially Brexit and the sanctions against Russia. On the other hand, micro enterprises seem to bear the burden of the downturn in the construction and personal services sectors which drives turnover expectations down.

Chart 9 – Turnover by size class



Conclusions and recommendations

The economic situation in Europe has improved over the last few years. Such upward trend may be now held back by a potentially incoming slowdown on domestic demand. Although positive overall, in fact, the indicators studied in the Barometer exhibit a slight downward trend, especially for those sectors highly dependent on domestic demand.

The Climate Index, witnessing a slight increase, demonstrates that recovery continues, resisting the recently observed geopolitical changes. On the other hand, its lower growth compared to the ESI and PMI index reinforces the idea that a domestic demand may be slightly fading out.

At the EU political level, a sharpening divergence between Euro and Non-Euro countries suggests that a north-south comparison may not be enough to fully grasp the heterogeneity of the EU economies and the need for coordinated policy at EU level. On the other hand, southern Europe clearly demonstrates that Member States which have implemented structural reforms at the product and the labour markets are performing better than those still postponing the needed reforms.

Although the economic situation recorded for the past semester is overall stable, the potential slowdown on domestic demand should not be underestimated. The decrease witnessed in the construction sector seems to show the importance of the role played by internal demand and by interest rate set by the European Central Bank. Now it is important to strengthen private investments by appropriate policy measures.

So far, the European Union and Member States have introduced several reforms. At EU level, the Union is promoting an economic strategy⁷ based on fiscal responsibility, investment and structural reforms as clearly stated and implemented during the European Semester⁸ procedures. However, this policy strategy will only deliver positive results if national governments are implementing the jointly agreed social and economic reforms in order to strengthen the recovery and foster growth and job creation.

To sustain the economic recovery and to tackle the issues limiting investments in and growth of EU firms some useful recommendations might be:

- Implement labour market reforms to boost the employment thanks to more flexible labour market systems;
- Ensure the availability of skilled and qualified workforce;
- Ensure a better access to finance for SMEs to increase their investments, by prolonging and extending the SME finance window of the European Funds for Strategic Investments;
- Reduce the level of uncertainty about the key political topics, such as the refugee crisis and the Brexit negotiations;
- Invest in digital skills and infrastructure to enhance the level of innovation among SMEs;
- Ensure that all groups of a society have the chance to participate and profit from welfare gains reached by the internal market and due to globalisation.

⁷ http://ec.europa.eu/economy_finance/structural_reforms/index_en.htm

⁸ http://ec.europa.eu/economy_finance/economic_governance/index_en.htm

UEAPME EU Craft and SME Barometer: Methodology

The **EU Craft and SME Barometer** is built on the results of surveys conducted by UEAPME Member Organisations two to four times a year in different regions all over Europe. The survey is based on about **120.000 questionnaires, with 30.000 answers** received. The data for this survey were collected between January 2017 and February 2017, which gives quite a recent picture of the development and expectations of SME owners all over Europe.

At the European level, we are able to provide **data for size classes** (micro, small and medium-sized enterprises) and for **four economic sectors** (manufacturing, construction, business and personal services), which may show different developments over business cycles and may react differently to external effects.

For each of these groups the Barometer provides **balanced figures** on the following categories: **overall situation, turnover, employment, prices, investment and orders**, where balanced means the difference between businesses that answered the questions about their expectations in these six categories in a positive or negative manner (balance = positive answers - negative answers). In order to get European figures from different national surveys, national results have been weighed with employment figures.

This Barometer presents the results (experiences) for the second semester of 2016 (16/H2) as well as the expectations for the first half of 2017 (17/H1e).

UEAPME publishes its **EU Craft and SME Barometer twice a year**, ahead of the European Summit in spring and autumn. The publication also includes the **European SME Business Climate Index** (see first pages), which is calculated using the average of the current situation and the expectations for the next period, as a result of the sum of positive and neutral answers as regards the overall situation for the business.

Finally, UEAPME will only present European figures and will not disclose country specific data. This is due to the facts that, for all Member States, we do have not data significant enough from a statistical perspective and furthermore, that the presentation of national data from SME surveys is a prerogative of our national organisations that are collecting them.

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Results – European Crafts and SME Barometer – 16/H2

Table 3 – UEAPME Study Unit

Balance between positive and negative answers, weighted by number of employees

	All SMEs				Micro Enterprises				Small Enterprises				Medium Enterprises			
	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e
Situation	7.4	10.4	11.8	10.3	3.6	7.2	6.6	5.0	10.3	13.2	16.3	14.5	15.2	15.5	16.5	15.5
Turnover	6.8	10.0	6.4	5.6	3.0	6.5	3.1	0.4	10.3	13.8	9.1	9.6	16.0	17.5	11.4	11.2
Employment	1.9	4.9	1.5	2.3	-0.4	3.2	-1.2	1.1	5.7	6.4	3.5	3.4	9.1	7.4	6.9	3.8
Prices	2.8	8.1	3.3	13.5	2.2	7.1	3.2	12.6	4.7	9.3	4.5	14.0	2.6	7.1	1.6	12.0
Investments	1.6	1.4	1.6	1.5	-0.8	-0.4	-0.9	-0.6	3.7	3.2	4.3	2.2	8.6	5.4	4.7	5.4
Orders	0.8	7.4	1.8	3.8	-2.0	4.6	-1.4	0.1	4.8	10.0	6.7	7.2	2.7	11.7	2.0	8.1

	Manufacturing				Construction				Business Services				Personal Services			
	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e	16H1	16H2e	16H2	17H1e
Situation	9.7	12.2	15.0	13.5	3.0	8.8	7.3	4.2	4.6	6.3	9.9	9.3	8.3	7.6	8.6	6.9
Turnover	8.6	15.9	8.7	9.2	3.5	3.9	-0.7	-3.6	5.2	7.7	6.8	7.9	6.3	9.4	6.6	4.7
Employment	3.7	7.4	3.3	5.1	2.1	1.3	-4.6	-4.4	0.2	5.7	4.0	4.6	2.1	5.8	0.4	3.2
Prices	3.2	10.1	3.6	15.1	-0.2	4.3	0.0	10.6	3.7	7.7	5.0	13.9	5.8	9.7	5.6	16.0
Investments	0.9	2.7	1.2	2.4	-3.3	-3.2	-2.9	-4.3	1.4	2.3	3.1	3.7	5.3	3.8	3.1	1.8
Orders	1.7	11.9	5.0	6.9	-3.1	2.5	-5.4	-3.3	1.4	4.9	4.5	5.7	2.2	7.2	2.6	3.3

Table 4 – UEAPME Study Unit

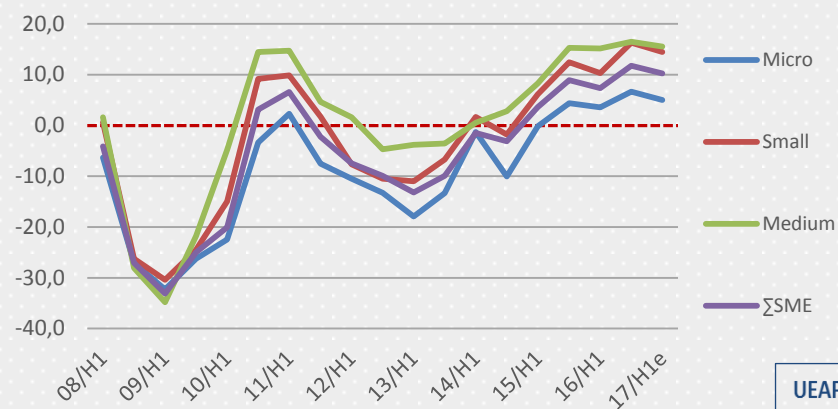
Difference between the realised balance and the expected balance

	All SMEs		Micro Enterprises		Small Enterprises		Medium Enterprises	
	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e
Situation	-1.2	1.3	-1.3	-0.5	-0.7	3.1	-0.1	1.0
Turnover	2.7	-3.6	1.4	-3.4	5.0	-4.6	6.2	-6.1
Employment	0.8	-3.4	-0.1	-4.4	5.1	-2.8	5.1	-0.5
Prices	-7.3	-4.8	-7.8	-3.9	-4.1	-4.8	-7.9	-5.5
Investments	1.5	0.1	0.5	-0.5	3.9	1.1	3.3	-0.7
Orders	-2.2	-5.6	-3.1	-6.0	1.6	-3.3	-5.0	-9.7

	Manufacturing		Construction		Business Services		Personal Services	
	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e	16H1-16H1e	16H2-16H2e
Situation	-2.2	2.8	-1.7	-1.6	-2.8	3.5	0.1	0.9
Turnover	0.4	-7.2	5.6	-4.6	0.0	-1.0	-5.8	-2.8
Employment	-0.3	-4.0	5.3	-5.9	-2.1	-1.7	0.4	-5.3
Prices	-7.9	-6.5	-6.5	-4.3	-7.8	-2.7	-6.4	-4.1
Investments	-1.3	-1.4	2.0	0.3	0.2	0.8	2.9	-0.7
Orders	-5.4	-6.9	-1.5	-7.9	-1.6	-0.5	-2.1	-4.6

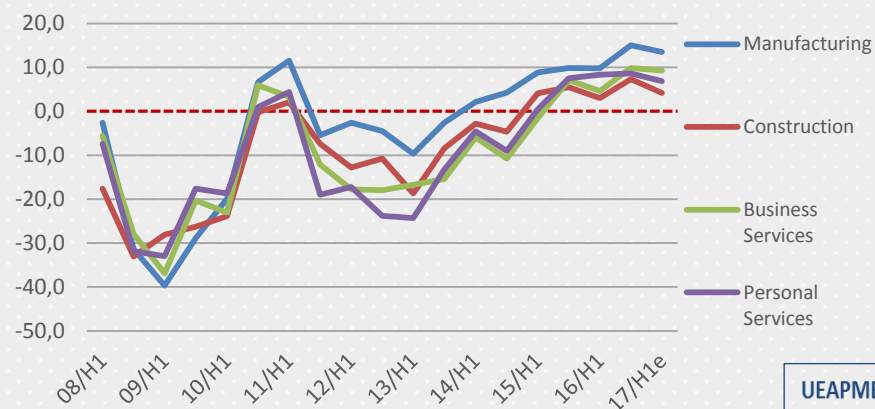
Results – European Crafts and SME Barometer – 16/H2

Overall situation by size class



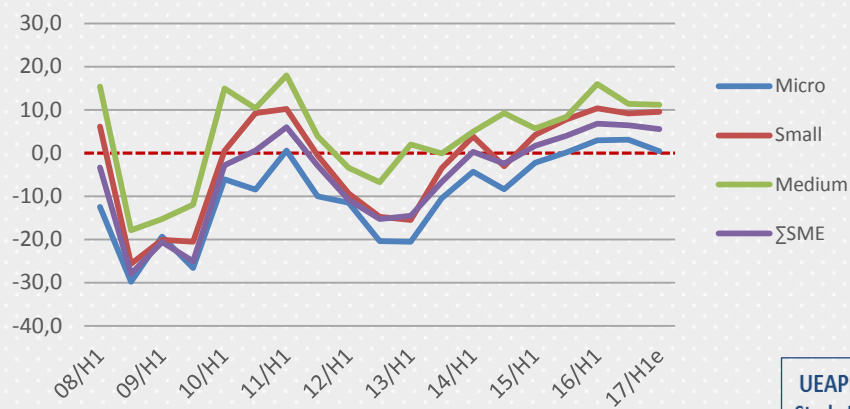
UEAPME
Study Unit

Overall situation by sector



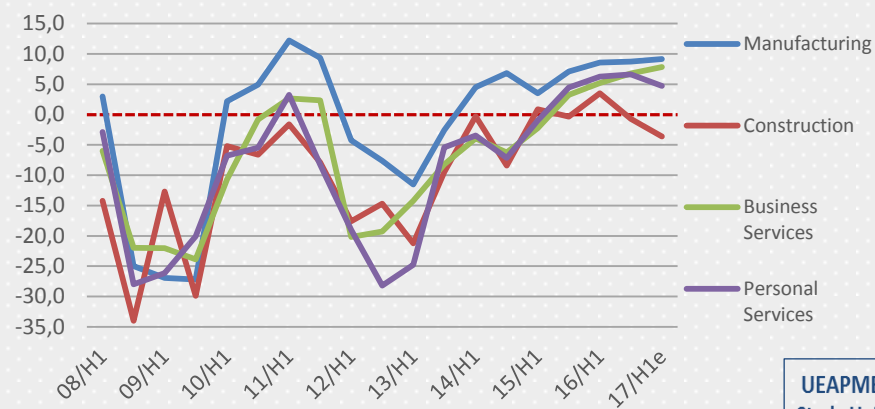
UEAPME
Study Unit

Turnover by size class



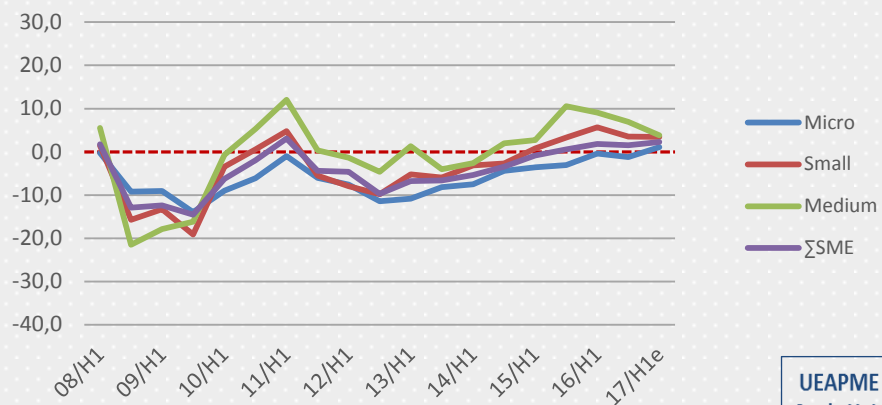
UEAPME
Study Unit

Turnover by sector

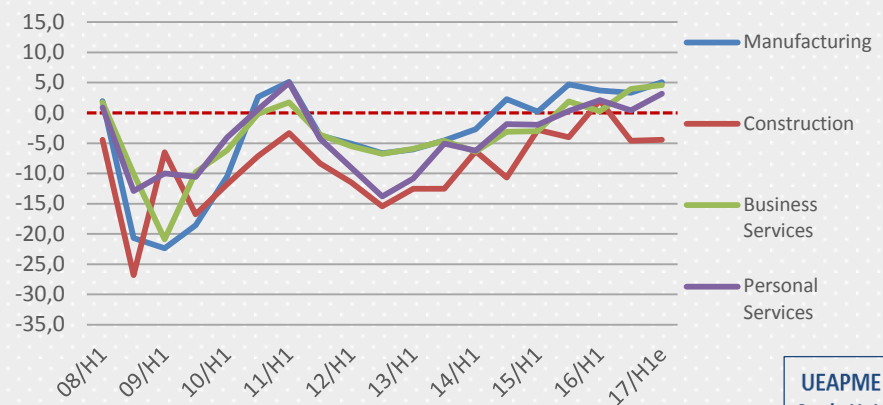


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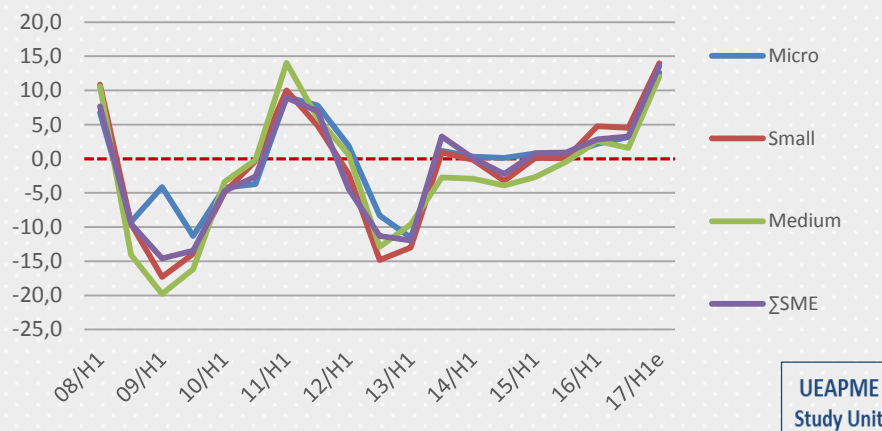
Employment by size class



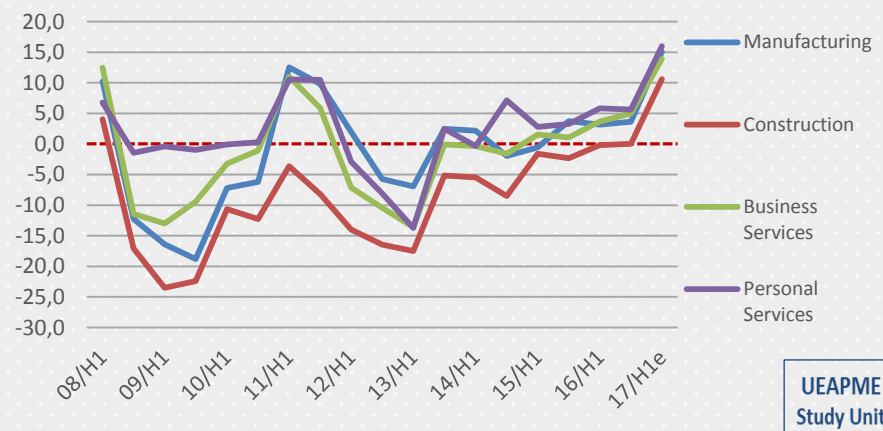
Employment by sector



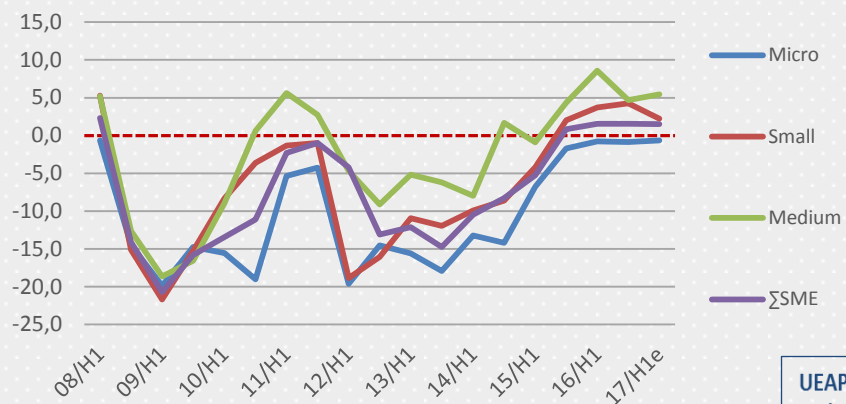
Prices by size class



Prices by sector

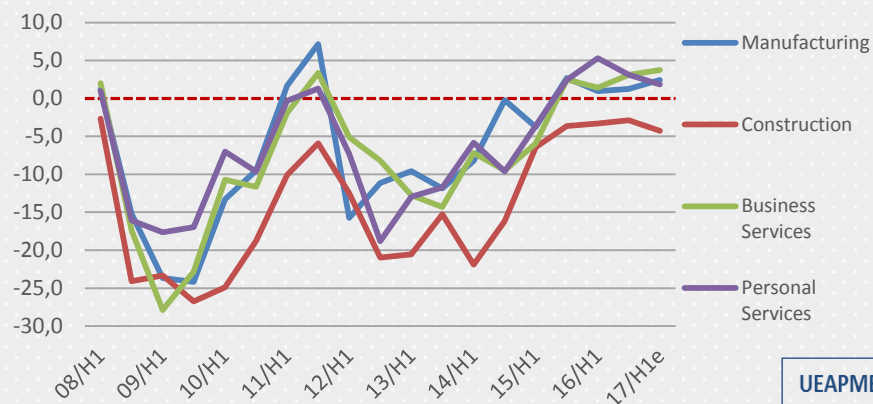


Investment by size class



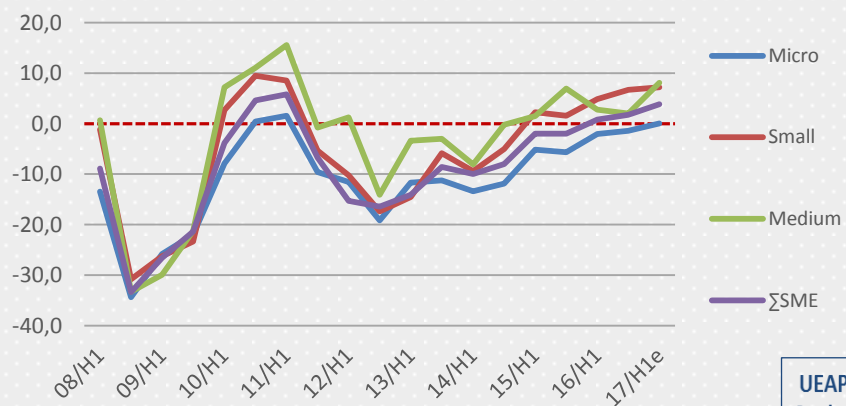
UEAPME
Study Unit

Investment by sector



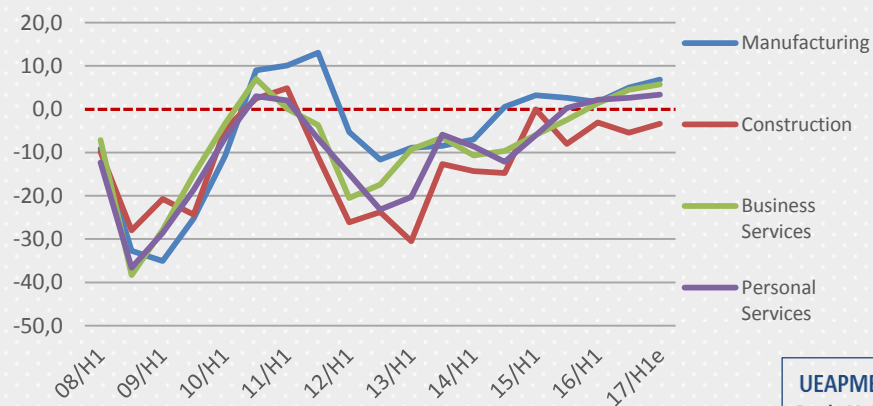
UEAPME
Study Unit

Orders by size class



UEAPME
Study Unit

Orders by sector



UEAPME
Study Unit