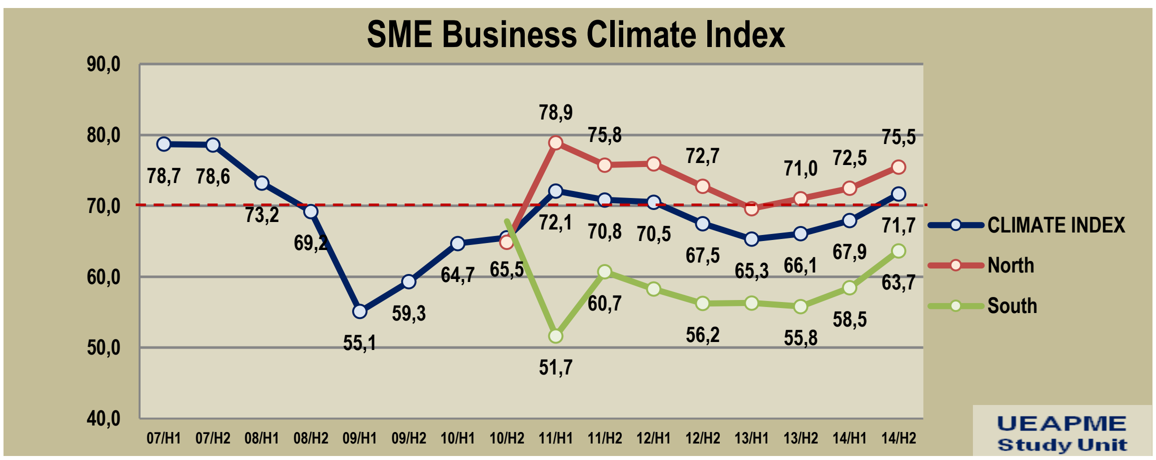
The EU Craft and SME Barometer 2014/H2

SME Climate Index up to 71.7: optimism that the worst is behind

Europe's Crafts and SMEs are growing again, but not enough to create more jobs

The **UEAPME SME Business Climate Index** (shown by the blue line in Chart 1) has climbed almost four (3.8) percentage points (pp) since last semester. This indicates that Crafts and SMEs in the European Union are, on average, seeing the beginnings of a recovery. As the graph indicates, this is the first time since 2012 that the index has risen above 70, which can be considered as the neutral level. Passing this point means that Crafts and SMEs in Europe have started to grow again and are more optimistic about the future than they were six months ago. However, most of the data was collected before the summer break and, therefore, does not fully include that latest political developments related to sanctions against Russia and the conflicts in the Middle East. This means that the more positive outlook is connected to some serious downward risks.

Chart 1 – Balance +/-



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).

A disaggregation (breakdown) between countries of the South and Periphery[1] and of the North and Centre[2] of the EU demonstrates that this positive change has occurred across the continent, not just in one region. The index for the South is up to 63.7 (+5.2, green line), and it is up to 75.5 for the North (+3.0, red line). Given these improvements, we can expect moderate growth in the North (as it is more than 5 points clear of the neutral 70 line), and we can expect the situation in the South/Periphery, generally, to become less negative. The index for the South/Periphery is still well below neutral 70 but moving closer to it. The gap between North and South is narrowing and, now at 11.8 percentage points, is at its lowest level in four years (Table 1, page 2).

[1] Croatia, Cyprus, Greece, Ireland, Italy, Malta, Portugal, Slovenia and Spain

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

Table 1: trend in the confidence gap between North and South of the EU 2011-2014

	North	South	Gap
11/H1	78. 9	51.7	27.2
11/H2	75.8	60.7	15.1
12/H1	75.9	58.3	17. 7
12H2	72.8	56.2	16.5
13H1	69.6	56.3	13.3
13H2	71.0	55.8	15.2
14H1	72.5	58. 5	14.0
14H2	75.5	63.7	11.8

Table 2: confidence gap between the Eurozone and the rest of the EU

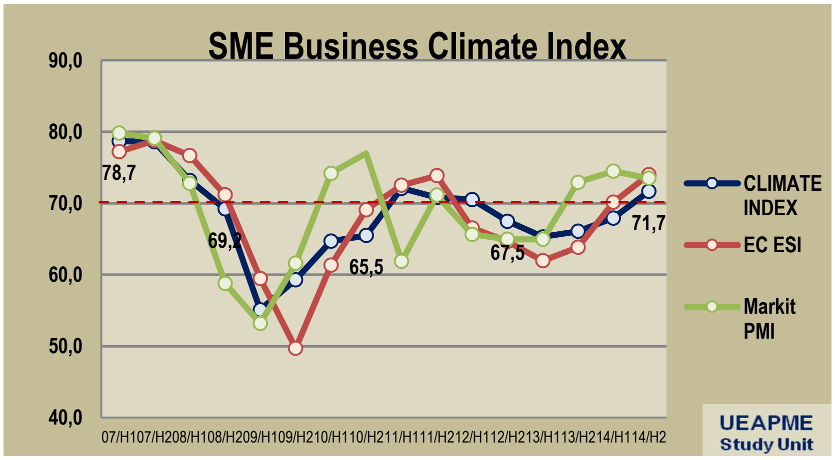
	Eurozone	EU Rest	Gap
13H1	64.1	67.9	3.8
13H2	68.3	68.8	0.5
14H1	67.0	69.8	2.8
14H2	71.8	72.9	1.1

After the original shock from the sovereign debt crisis in early 2011, the gap reached an extraordinary high level of 27.2 because in the first round the crisis only affected the more vulnerable countries in the south. After the first half of 2011, we are observing quite a stable gap between the two areas throughout the last business cycle, with gaps between 17.7 and 13.3 up until 14H1. However, recent progress in the South has closed the confidence gap even further to 11.8 in 14H2, suggesting that the engine of the South is at last picking up some steam while both regions of the continent see positive progress (even if the South is still 6.3 percentage points below the neutral 70 line).

The results comparing Eurozone and Non-Euro EU member countries (Table 2) show a narrowing gap for 14H2 after a 2.3 percentage point increase in 14H1. That the non-Euro area has higher confidence levels than the Eurozone countries is consistent with the 2014 Spring Forecast of the European Commission[3], which suggests that non-Euro area countries are doing slightly better than their counterparts. Perhaps, though, the single biggest takeaway is that both groups now possess confidence levels above 70—the first time this has occurred since at least 2011.

Chart 2 compares the UEAPME SME Business Climate Index (shown by the blue line) and two other well-known indicators: the European Commission's *Economic Sentiment Indicator (ESI)*[4] (red line) and the Markit *Purchasing Managers' Index (PMI)*[5] (green line).

Chart 2 – Balance +/-



Both the Markit PMI and EC ESI remain above the SME Climate Index, showing that small businesses are still lagging behind larger businesses in terms of growth. However, it is again important to note that all three indices are above the neutral stance for the first time since 2011.

[3] http://ec.europa.eu/economy_finance/eu/forecasts/2014_spring_forecast_en.htm

[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.

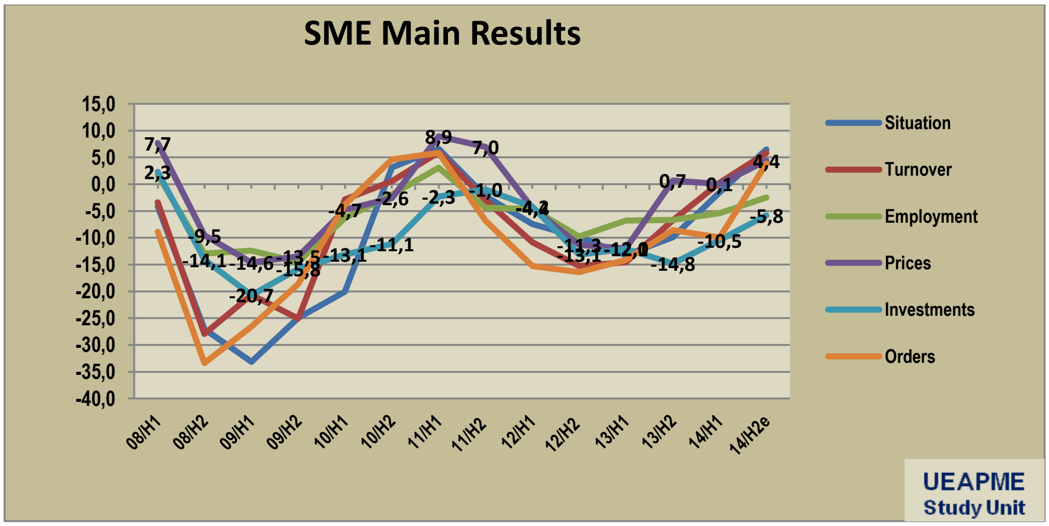
Main Result: First signs of growth for SMEs

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

First semester 2014 significantly better than last semester 2013

The results of the Barometer for the first semester 2014 (14/H1 in chart 3) illustrate the positive development the SME sector made over the last months. SMEs are showing improvements in coming out of the second recession experienced from late 2011 until approximately late 2013. While we see positive results for the overall situation, turnover and prices, the up-swing is still not strong enough to see increases in investment and employment. However, five of the six criteria either improved from 13/H2 to 14H1 or remained positive (these being overall situation, turnover, employment, prices and investments). Overall situation and turnover improved the most for SMEs, showing positive changes of 8.4 and 7.0 percentage points, respectively, while orders fared least well, shifting negatively by 1.4 percentage points.

Chart 3 – Balance +/-



Results for 2014/H1 better than expected 6 months ago

Expectations for 14/H1 were exceeded by realised outcomes in four of the six criteria given for SMEs. As one can see in Table 3 (page 4), which illustrates the differences between expectations and results for 14/H1, the four criteria that exceeded expectations (overall situation, turnover, employment and investment) did so by an average of 4.4 percentage points. Three things are particularly worth noting. The first is the degree to which the realised overall situation and turnover for 14/H1 exceeded expectations for 14/H1: 6.3 and 7.1 percentage points, respectively.

This is good news for the prospects of growth in the near future. The second interesting figure is how seriously the increase in prices was overestimated (by 8 percentage points). This indicates that even the increase in turnover has not led to the expected increase in sales prices, and it reflects the overall extremely low inflation rate in Europe. Thirdly, even the negative development for orders has not frustrated the high expectations as regards orders for the second half of 2014.

Table 3: difference between expectations and final results for 14H1 / expectations 14/H1

	Expectations 14H1e	Results 14H1	Δ (R-E)	Expectations 14H2e
Overall	-7.8	-1.5	6.3	6.5
Turnover	-6.8	0.3	7.1	5.8
Employment	-6.2	-5.4	0.8	-2.5
Prices	8.0	0.1	-7.9	4.4
Investments	-13.8	-10.5	3.3	-5.8
Orders	-7.2	-10.0	-2.7	3.9

Table 3, left, presents the differences between expectations for the first semester of 2014 and final results for the first semester of 2014. As mentioned earlier, the actual outcomes of the majority of indicators for 14/H1 were better than the results that SMEs originally expected. Overall situation (6.3), turnover (7.1), employment (0.8) and investments (3.3) were each better than expected. On the other hand, only prices (-7.9) and orders (-2.7) were lower than expected.

One final point worth noting concerning realised versus expected outcomes for 14/H1 is the fact that, unlike in 13/H2, actual investment was greater than expected investment. Looking at Table 4, one can see that actual investment was less than expected investment by 4.2 percentage points in 13/H2.

Table 4: expected vs. realised Investment

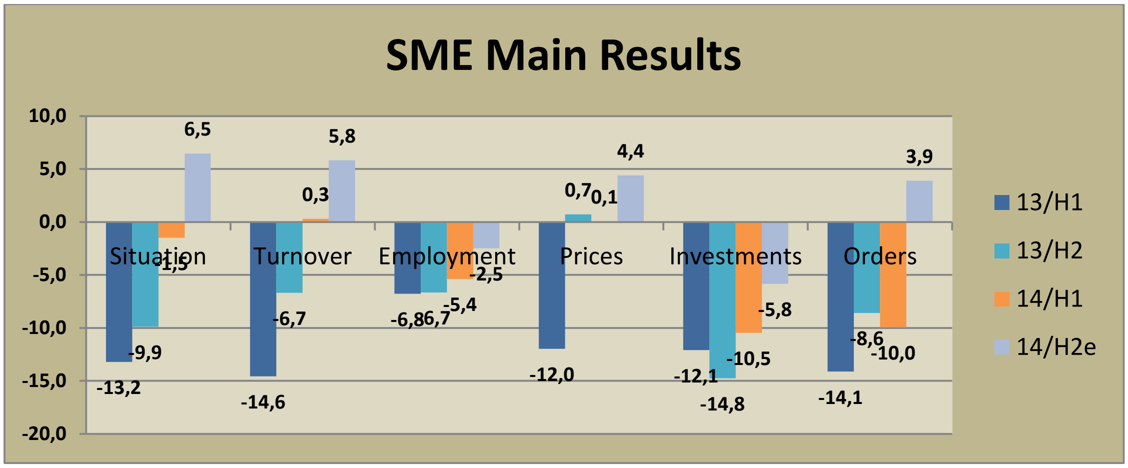
	Expected investments	Realised investments	Δ (R-E)
12/H2	-15.9	-13.1	+2.8
13/H1	-16.2	-12.1	+4.1
13/H2	-10.5	-14.8	-4.2
14/H1	-13.8	-10.5	+3.3

This was a cause for concern because actual investment is almost always higher than expected investment due to the fact that businesses cannot anticipate and thus plan to spend money on unforeseen

Expectations for second semester 2014 give further hopes

Given the way in which realised outcomes exceeded expectations for 14/H1, perhaps it is not surprising that expectations are also high for 14/H2. What may be surprising, though, is that SMEs expect every single criterion to improve from 14/H1 in the second semester of 2014. As seen in Chart 4, the criteria of SMEs are expected to begin returning to normal levels, with four of the six criteria (overall situation, turnover, prices and orders) expected to be positive. Specifically, expectations for the overall situation and turnover are quite positive (6.5 and 5.8, respectively), and prices and orders are also both expected to increase (4.4 and 3.9, respectively). Given how badly SMEs overestimated the rise in prices for 14/H1, this has now made expectations for price increases in 14/H2 much more realistic.

Chart 4 – Balance +/-

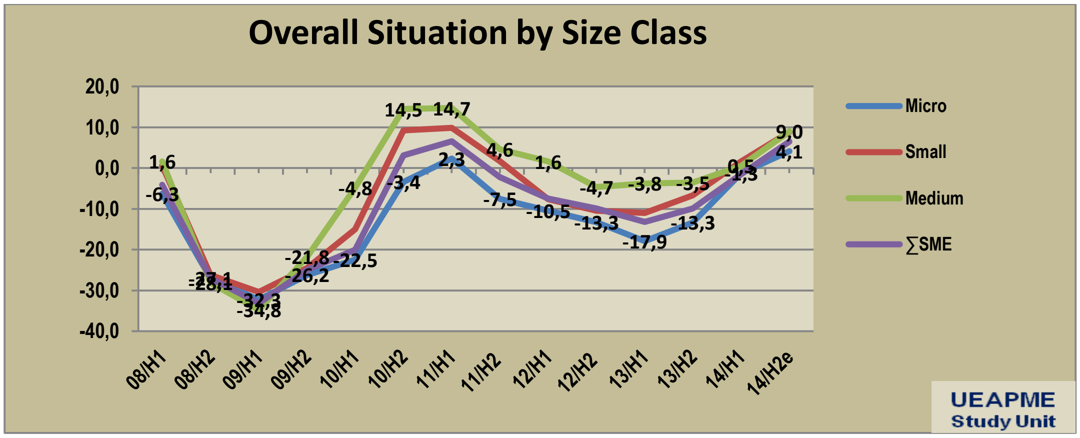


On the whole, these expectations indicate that SMEs believe the worst of the second recession is behind and that a period of growth is ahead. Even though investment and employment are still expected to be negative, it is anticipated that they will continue to move towards neutral or even positive levels as soon as the existing capacities are fully utilised. This means that investment and employment should be naturally pulled up as rates of turnover and orders increase further. The expectations for 14/H2 give a much more positive picture of the situation for SMEs than in past semesters, but some potential stumbling blocks to growth should be noted. Specifically, these are downward risks coming from the political sector, such as the situation with Russia and Ukraine as well as threats from militant groups such as IS. The second downward risk is the problems SMEs are facing if they have to finance investments, which will be the first step towards achieving sustainable growth and creating additional employment. However, if these risks are not realised, the given expectations indicate that SMEs will grow and start increasing employment.

Disparity between size-classes is narrowing, another sign for recovery

Chart 5, which illustrates the overall situation of SMEs by size, very clearly illustrates both the progress made by SMEs in 14/H1 and the high expectations set for 14/H2. Micro, small, and medium-sized enterprises are converging on similar overall situation levels, which is a sign for returning to normal. In fact, every single size class of SMEs had a better overall situation in 14/H1 than in 13/H2. Specifically, medium-sized businesses moved from a situation of -3.5 to a situation of 0.5, small-sized businesses moved from -6.8 to 1.7, and micro-sized businesses shifted more than ten points from -13.3 to -1.3. While overall situation levels now hover around zero, *every single SME size class* expects those levels to be positive in 14/H2 by some 4.1 to 9.0 percentage points. The differences between overall situation levels of different sized SME classes have also decreased. This is a positive sign given that disparities between different sized SMEs are normally signs of downturns or recessions, which worse results for medium-sized companies at the beginning and for micros rather at the end of an economic crisis.

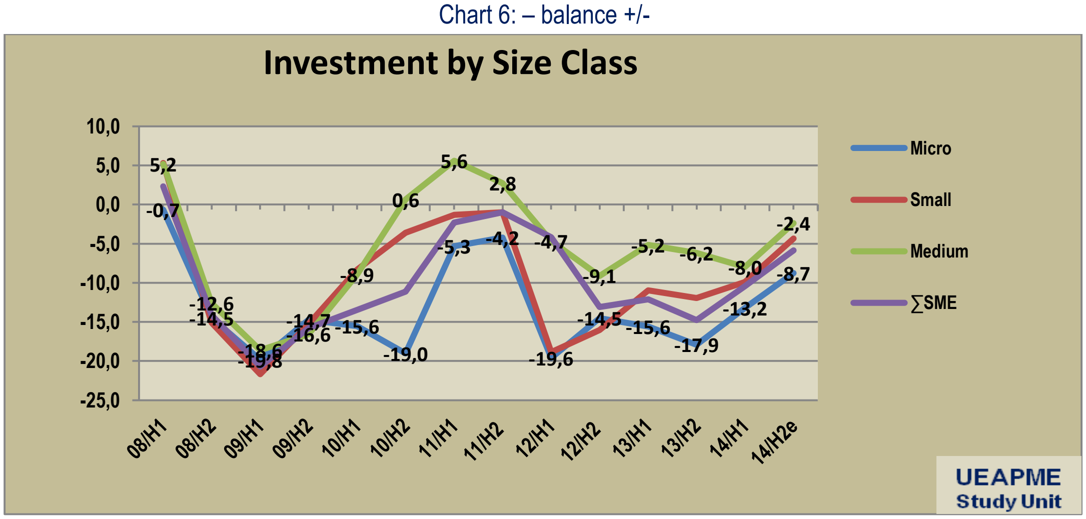
Chart 5 – balance +/-



It’s not just overall situation numbers that are returning to normal levels. Turnover and orders for SMEs of all sizes are expected to be positive in 14/H2, and there is also less disparity anticipated between the different size classes in 14/H2 than in the last four years. Also, prices are expected to be positive for 14/H2.

Despite these positive developments, both investments and employment are lagging behind the other criteria for SMEs. This indicates that they need time to catch up. There is still a clear disparity between the size-classes with medium-sized companies, which are farthest ahead, and micro enterprises, which have the weakest results. However, all figures are all still anticipated as being negative even though they are improvements from past semesters. Thus, more time is needed for increases in investments and employment in SMEs, which should be supported by increases in turnover, orders, and the overall situation.

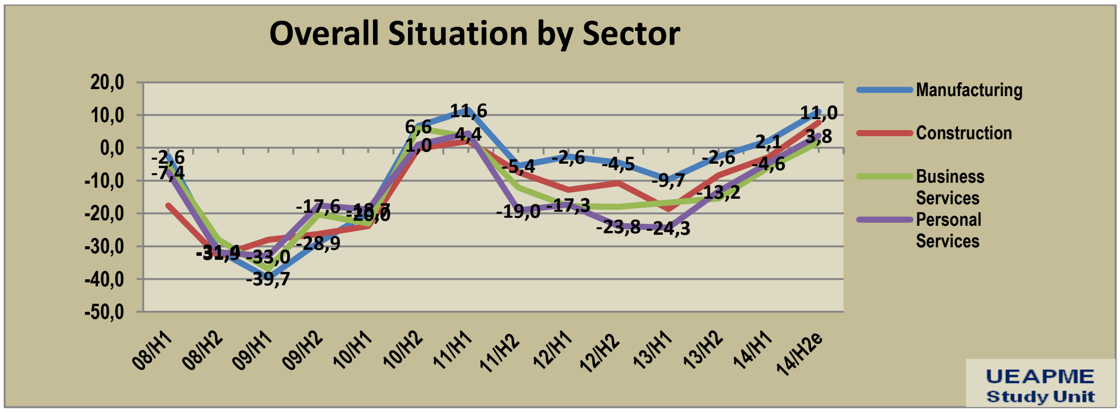
Chart 6: – balance +/-



Recovery has reached all sectors, with manufacturing in the lead

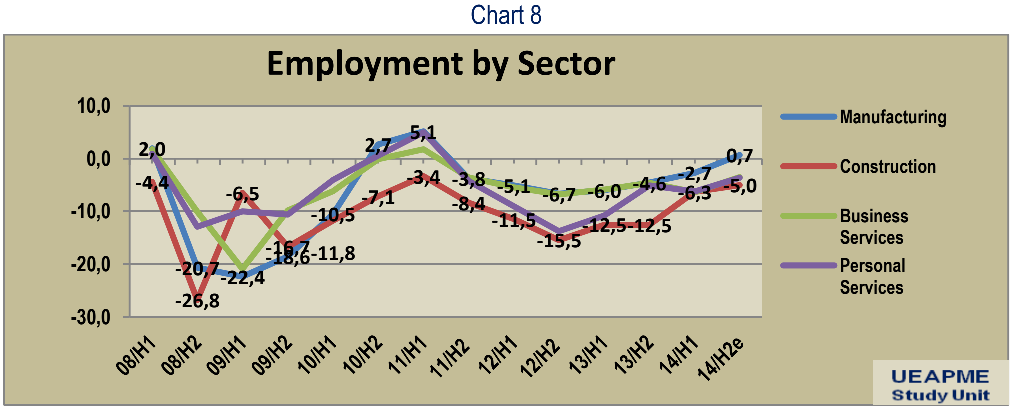
If there is one takeaway from the results given by SME sectors, it is this: much the same as SME size classes, every single SME sector of the economy saw its overall situation improve from 13/H2 to 14/H1 and expects a positive overall situation in 14/H2. Taking a closer look at Chart 7, which details the overall situation results for SMEs by sector, it becomes clear that these developments have been led by an export-driven manufacturing sector and resurgence in the construction sector.

Chart 7



Additionally, all sectors anticipate an increase in turnover, orders and prices in 14/H2, giving further weight to the argument that SMEs are beginning to climb out of the negative or neutral position they have been in for the last three years. However, like the size classes of SMEs, investment is expected to remain negative for all sectors even though it is expected to be better in 14/H2 than in 14/H1. The situation is similar for employment in the different sectors, which can be seen in Chart 8, below. Only the manufacturing industry appears to be back to stable employment, while the other three sectors lag behind. These two criteria will need more time to catch up with the turnover, orders, prices, and overall situations that have been improving for the various sectors. Interesting is the relative improvement of employment in the construction sector, where the balance, which remains negative, has closed the gap to the services sectors for the first time since 2009.

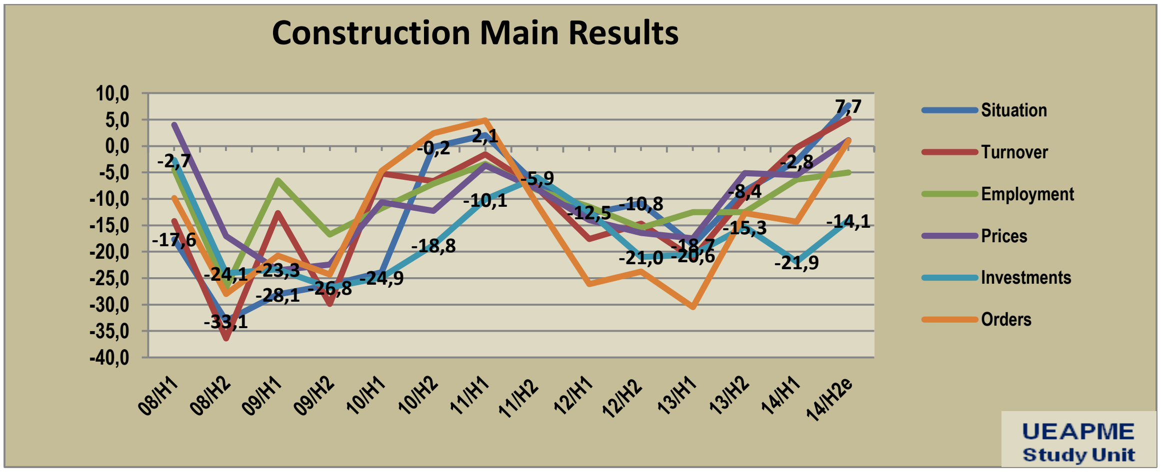
Chart 8



Surprising recovery in the construction sector

One sector that is worth examining in detail is construction. Originally hit hardest by the collapse of the housing bubble, construction has struggled to secure capital for investment and raise productivity because demand has been so low. In terms of investment, it is still significantly behind other sectors—by at least 11 percentage points, depending on the sector. And yet, in nearly every other indicator (situation, turnover, orders, prices, employment), construction is running roughly even with or ahead of business and personal services. Construction *outperforms* business services and personal services in overall situation (-2.8 versus -5.9 and -4.6) and turnover (-0.3 versus -3.9 and -3.5) for 14/H1, and it is expected that it will do the same in 14/H2. This is extremely interesting because, until now, construction has performed quite poorly. Chart 9, below, details the results for the construction sector.

Chart 9



As the chart indicates, the overall situation, turnover, orders and prices are expected to be positive in 14/H2, but investment and employment are expected to be negative in the same period.

There are a couple of factors likely driving the positive situation for construction. First of all is that, when the housing bubble crashed, many competitors were driven out of the market due to nearly complete lack of demand. This decreased the number of companies still building homes, office spaces, and the like. Next, as demand has slowly begun to increase again (found in housing booms in the UK, Germany, and Poland), the smaller number of construction companies still in the market creates a more advantageous situation. The expectations of the construction sector reveal that a positive mood has taken hold. This slowly increasing demand has led to rises in turnover and orders, but demand has not yet been raised enough to yield positive employment or investment. This means that companies are better able to utilise the existing capacities, but as one can see in Chart 9, there are still no intentions to raise investment and employment. Both are expected to be negative, with investment still well below the other criteria. However, as the overall situation stabilises and turnover improves, investment will be given the time it needs to catch-up, leading to higher employment in the construction sector.

Conclusions and recommendations

After a second recession, which has especially hit those companies depending on private consumption and investment (such as small construction companies and personal services providers), signs of stabilisation and even growth are materialising. This modest recovery is led by good performance in the export-driven manufacturing sector and resurgence in the construction sector. This resulted in a better than expected performance for SMEs in 14/H1 and even more hopeful expectations for 14/H2. However, there are also significant downward risks coming from the overall political situation and tight lending conditions, which may hold back necessary investments.

Given that there are positive trends in every single category of SME size and sector for the next semester, Europe can expect growth coming from SMEs in 14/H2 and into 15/H1. There are a few points of caution to be made: investments are still not expected to increase in 14/H2 and this will be a critical component for any long term recovery. The same goes for employment, which, with the exception of the manufacturing industry, is lagging behind other indicators. Nevertheless, the final takeaway should be that, barring some significant event, whether it be political or economic, SMEs are in a position to move from a period of stagnation to one of growth in the current and coming semesters.

It remains to be seen whether this trend will turn into a more robust recovery in the mid-term. This will mainly depend on the overall economic development, which is currently not very promising, and on the impact of political events on the economy in Europe. Secondly, a potential recovery will also be influenced by the policy response the EU and its Member States will give over the next months. Will the needed and promised structural reforms on product and labour markets be implemented, and will SMEs have access to finance, allowing them to accomplish their investments needed for growth?

Therefore, our overall policy recommendations, to ensure that the fragile recovery in the SME sector becomes sustainable and to create momentum for investment and job creation, are to create an attractive environment for private investment in Europe by improving competitiveness:

- Finalise the reforms of financial markets to regain trust in the sector and to allow financial service providers to serve the real economy.
- Implement the needed reforms on goods and services markets to create new market opportunities with positive impacts for investments, growth and job creation.
- Ensure the provision of skills and competences required by companies, and modernise the labour markets to provide small companies the needed flexibility.
- Provide SMEs with the needed support services for start-ups, innovation, internationalisation, and business transfers.
- Ensure the provision of energy and other resources at affordable prices.
- Improve the environment for businesses with better regulations and effective administrations.

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 May and September 2014, 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 expectation 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 first semester of 2014 (14/H1) as well as the expectations for the second half of 2014 (14/H2e).

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.

For further information on this document, please contact:

Gerhard Huemer, Director Study Unit

UEAPME

Rue Jacques de Lalaing, 4
B-1040 Brussels
Tel: +32 2 2307599
E-mail: g.huemer@ueapme.com

Nathan Thompson, Economist at the Study Unit

UEAPME

Rue Jacques de Lalaing, 4
B-1040 Brussels
Tel: +32 2 2307599
E-mail: study@ueapme.com

Results – European Crafts and SME Barometer – 2014/H2

UEAPME Study Unit

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

	All SMEs				Micro Enterprises				Small Enterprises				Medium-Sized Enterprises			
	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e
Situation	-13.2	-9.9	-1.5	6.5	-17.9	-13.3	-1.3	4.1	-11.0	-6.7	1.7	8.9	-3.8	-3.5	0.5	9.0
Turnover	-14.6	-6.7	0.3	5.8	-20.6	-10.5	-4.3	3.1	-15.5	-3.5	3.9	8.0	2.0	-0.1	4.9	10.8
Employment	-6.8	-6.7	-5.4	-2.5	-10.9	-8.2	-7.5	-4.9	-5.2	-5.9	-3.2	-2.4	1.3	-4.1	-2.6	-0.1
Prices	-12.0	0.7	0.1	4.4	-11.5	1.1	0.3	4.1	-13.0	0.9	-0.2	4.0	-9.6	-2.7	-2.9	2.4
Investments	-12.1	-14.8	-10.5	-5.8	-15.6	-17.9	-13.2	-8.7	-11.0	-12.0	-9.9	-4.4	-5.2	-6.2	-8.0	-2.4
Orders	-14.1	-8.6	-10.0	3.9	-11.7	-11.2	-13.4	1.4	-14.5	-5.8	-9.4	5.7	-3.4	-3.0	-8.1	7.3

	Manufacturing				Construction				Business Services				Personal Services			
	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e	13/H1	13H2	14H1	14H2/e
Situation	-9.7	-2.6	2.1	11.0	-18.7	-8.4	-2.8	7.7	-16.7	-15.4	-5.9	1.7	-24.3	-13.2	-4.6	3.8
Turnover	-11.5	-2.6	4.5	10.1	-21.2	-9.5	-0.3	5.2	-14.2	-8.2	-3.9	2.0	-24.8	-5.4	-3.5	4.3
Employment	-6.0	-4.6	-2.7	0.7	-12.5	-12.5	-6.3	-5.0	-5.9	-4.6	-6.4	-3.5	-10.8	-5.1	-6.3	-3.7
Prices	-7.0	2.5	2.2	5.5	-17.5	-5.1	-5.5	1.1	-13.6	-0.1	-0.4	2.0	-13.7	2.5	3.4	5.6
Investments	-9.6	-11.8	-8.2	-1.6	-20.6	-15.3	-21.9	-14.1	-12.8	-14.3	-7.2	-3.6	-12.9	-11.7	-5.8	-3.2
Orders	-8.9	-8.4	-7.0	9.9	-30.5	-12.7	-14.3	1.0	-9.3	-6.5	-10.7	1.5	-20.3	-5.9	-8.6	2.5

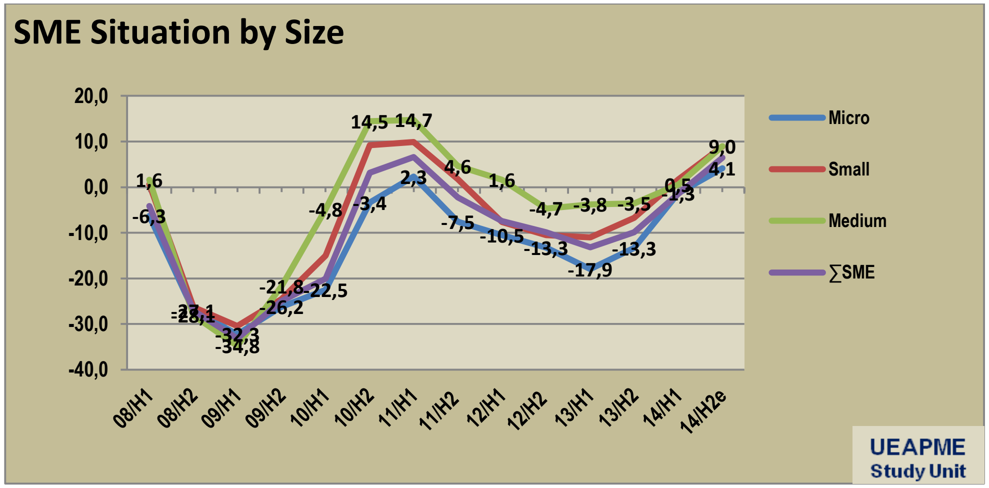
UEAPME Study Unit

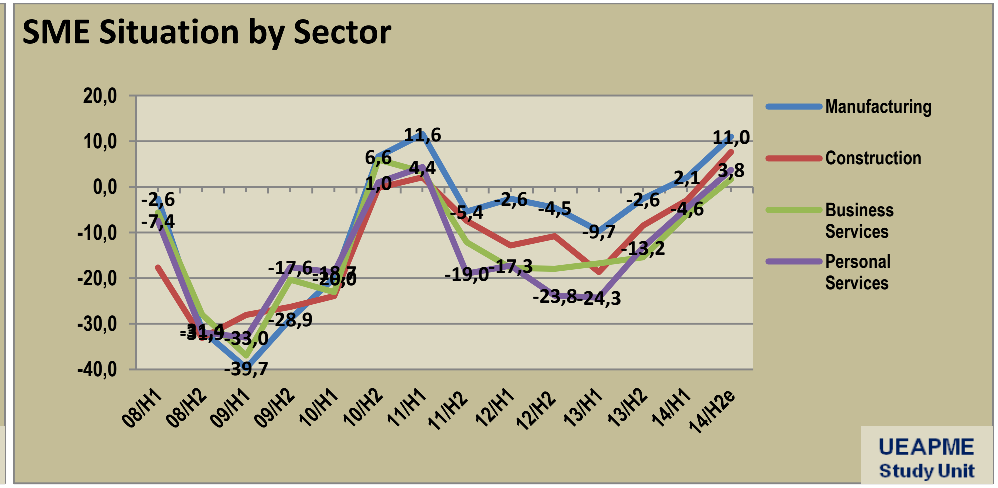
Difference between the realized balance and the expected balance

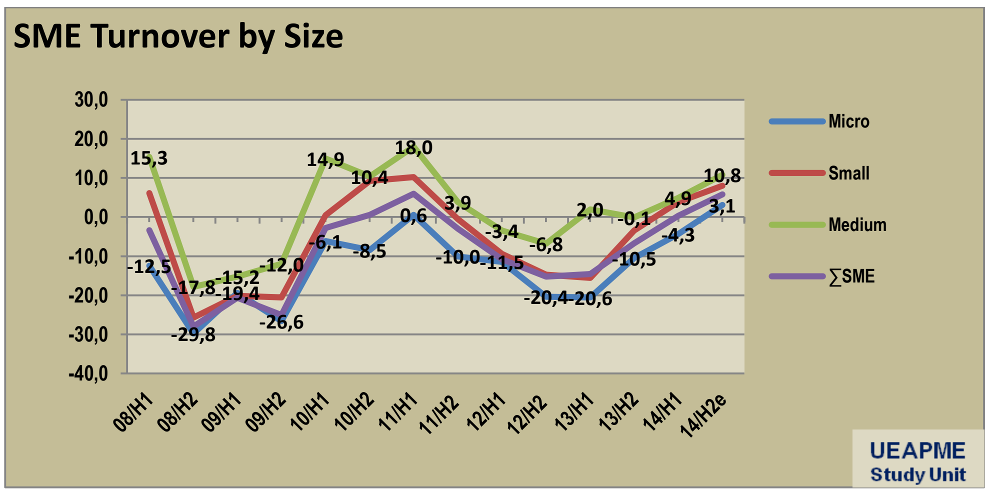
	All SMEs		Micro Enterprises		Small Enterprises		Medium-Sized Enterprises	
	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e
Situation	-7.3	6.3	-5.9	9.2	-6.5	7.6	-6.0	2.8
Turnover	-2.5	7.1	-0.7	2.9	1.1	9.1	-2.4	6.7
Employment	-2.1	0.8	3.2	-2.3	-1.4	3.2	-2.6	4.9
Prices	4.6	-7.9	-3.3	-8.1	6.4	-8.1	1.8	-7.6
Investments	-4.2	3.4	-3.0	2.2	-2.3	3.5	-1.2	1.5
Orders	-5.1	-2.7	-2.5	-5.8	-1.9	-3.3	-6.5	-5.4

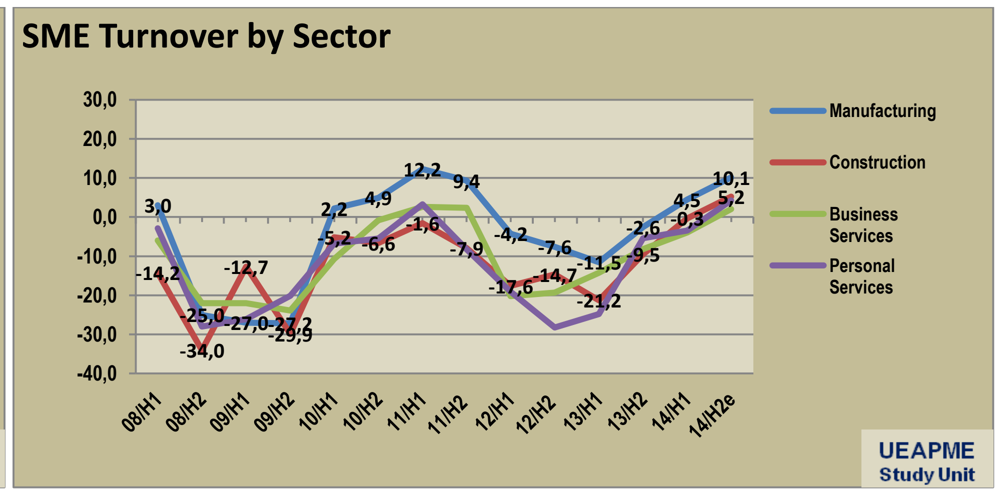
	Manufacturing		Construction		Business Services		Personal Services	
	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e	13H2-13H2e	14H1-14H1e
Situation	-3.2	1.0	-2.7	8.1	-6.2	5.6	1.3	5.2
Turnover	-4.4	6.4	1.3	13.4	2.9	1.5	8.0	2.4
Employment	-3.0	0.6	-3.4	5.8	-0.5	-0.4	5.8	-1.3
Prices	1.3	-9.2	4.0	-9.5	6.2	-7.9	6.0	-6.4
Investments	-6.8	3.8	1.0	-2.7	-0.6	4.6	1.8	5.0
Orders	-14.1	-2.1	-1.4	-0.7	0.9	-6.7	-0.6	-3.8

Results – European Crafts and SME Barometer – 2014/H2

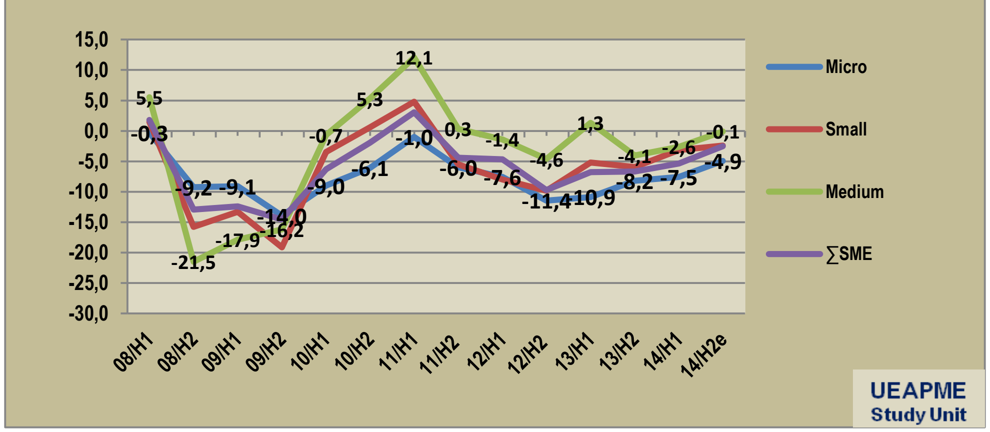




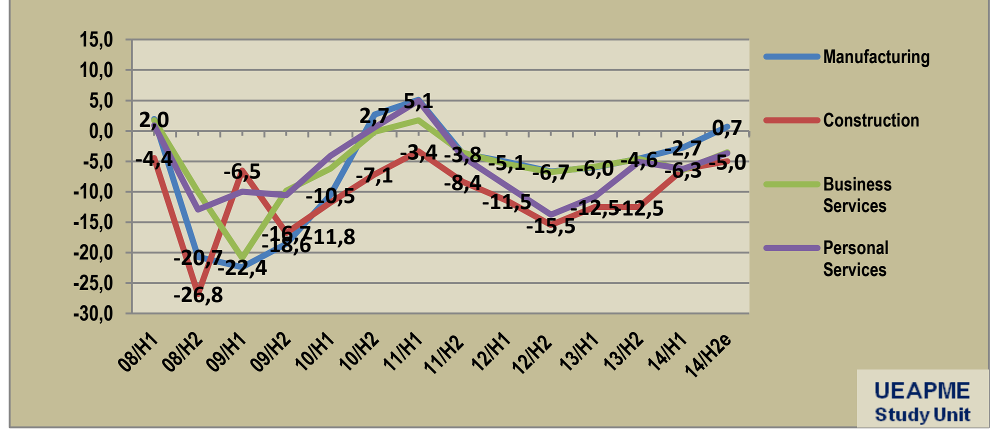




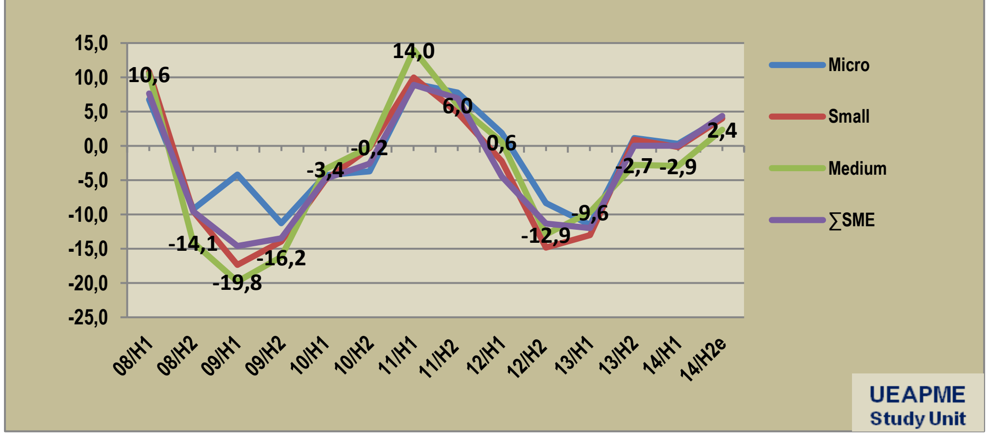
SME Employment by Size



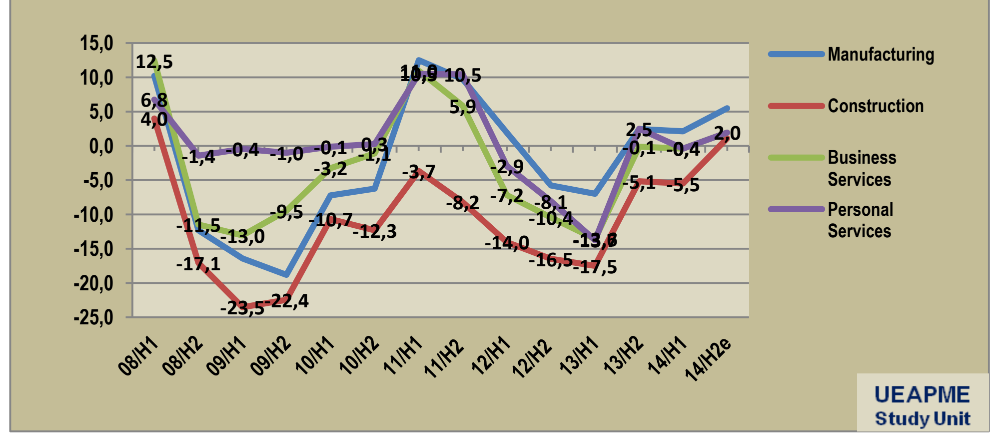
SME Employment by Sector



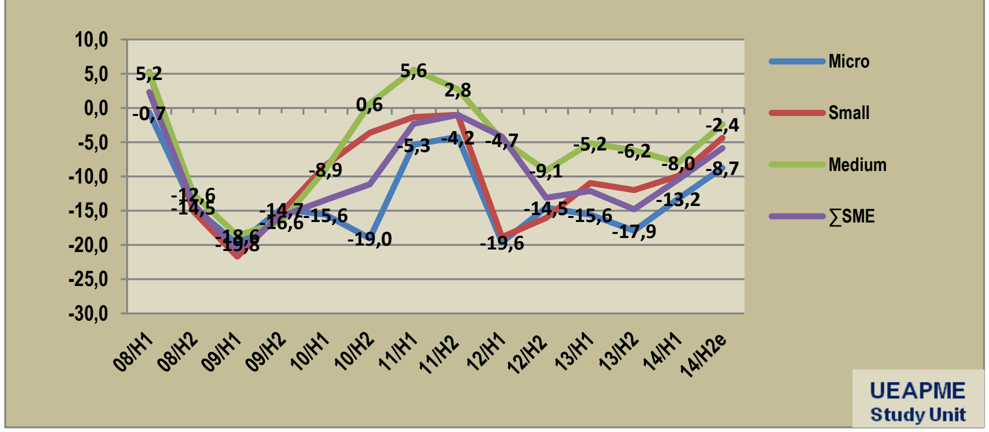
SME Prices by Size



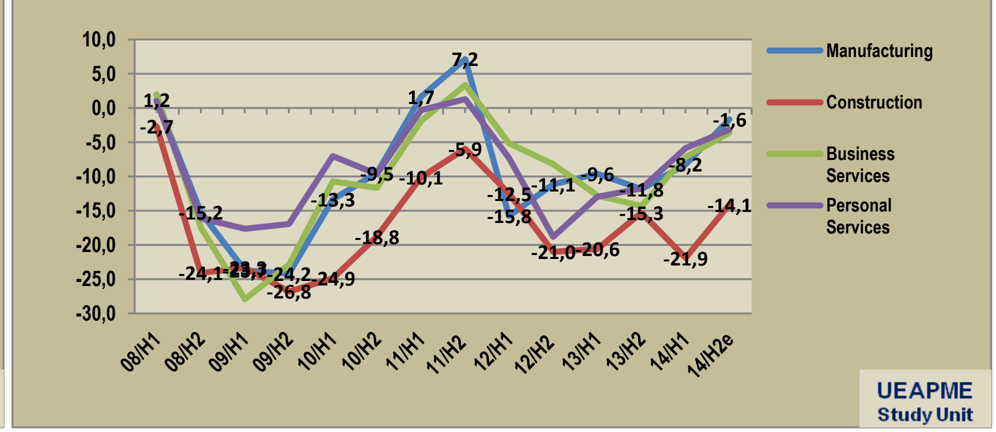
SME Prices by Size



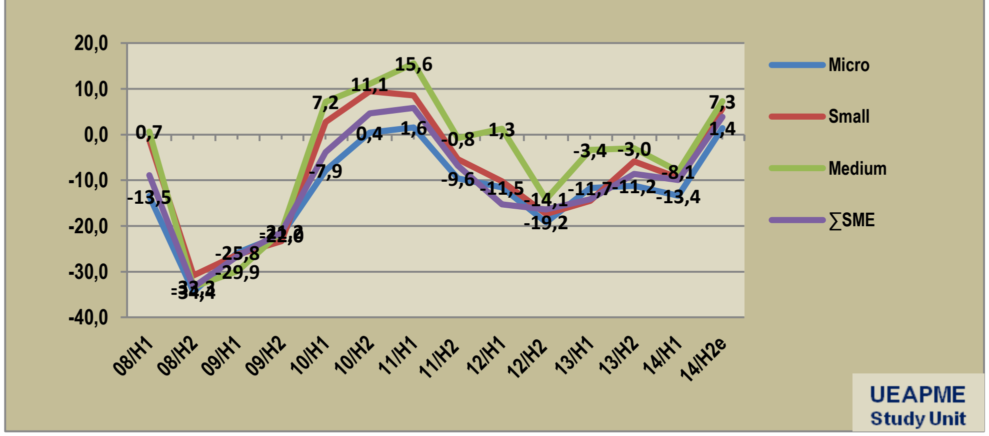
SME Investment by Size



SME Investment by Sector



SME Orders by Size



SME Orders by Sector