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GERMAN IFO SLIPS ON TRADE TENSIONS

Berenberg Macro Flash

German Ifo, March

	Business climate	Expectations	Current assessment
Actual:	**114.7**	**104.4**	**125.9**
Previous:	115.4	105.4	126.4
Consensus:	114.6	104.4	125.6
Berenberg:	114.8	104.5	125.9

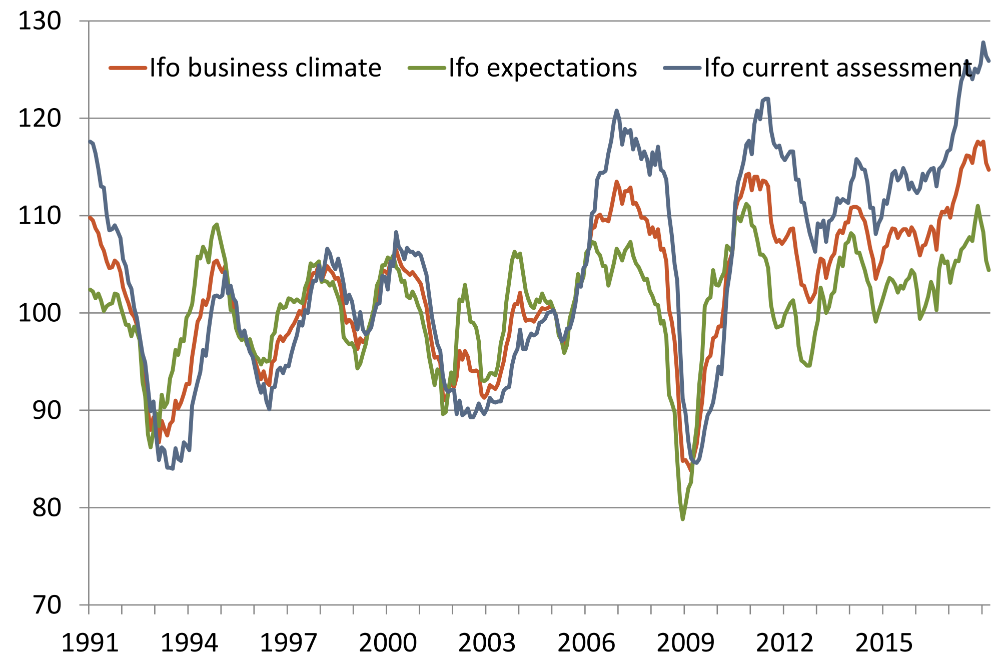
German business confidence slips further on trade tensions: Few major advanced economies rely on international trade as much as Germany's. Thus, trade tensions and fears of a protectionist wave that have surfaced over the last couple of weeks were set to leave a mark on business confidence in the Eurozone's biggest economy. Germany's broadest gauge of confidence among exporting manufacturers, the Ifo survey, dropped in March for the second month in a row. That a new government was formed in Germany, reducing political uncertainty, could not offset the headwinds from the threat of trade wars. For the time being we probably do not need to worry about the only small correction in confidence. Sentiment had reached multi-decade highs at the turn of the year before falling off a bit recently. The fall in the soft data brings it in line with the hard data and the current level suggests a healthy pace of expansion in 2018.

Industry and economy still in very good shape: The business climate indicator fell from 115.4 in February to 114.7 in March, broadly in line with expectations (114.6) (see chart 1). Firms' assessment of the current situation dropped from 126.4 to 125.9, while the expectations suffered a bigger hit (104.4 after 105.4). While expectations are below the 2017 average (107.0) for the second month in a row, they remain well above the long-term average of 100.7. The current assessment remains close to the pan-German high it reached in January (127.8). The Ifo business cycle clock, which combines expectations and the current business situation on two separate axes, suggests that the economy is still in healthy expansion territory (see chart 2). Even though the strongest growth rates are probably behind us, German industry has rarely been in a better shape. Capacity utilisation is at the highest level since 2008 and order books are full. Combined with the strong labour market and a small fiscal stimulus this year, we expect the German economy to maintain its 2017 real GDP growth rate of 2.5% in 2018

Risks to the outlook are balanced: When the fears of protectionist measures turned into concrete announcements a month ago we changed the risks to our outlook from tilted to the upside to balanced. We did not change our actual forecasts. Protectionist risks mitigate the upside risks suggested by the survey data. Despite the recent softening in the soft data, it is still suggesting the German economy can manage real GDP growth 0.7% qoq in Q1 – which is still above the Q4 growth rate (0.6%) and our own estimate for GDP growth in Q1 of 0.5%. Due to severe weather conditions in February we expect a slightly slower rate of expansion in Q1, but a correction in Q2 (0.7%).

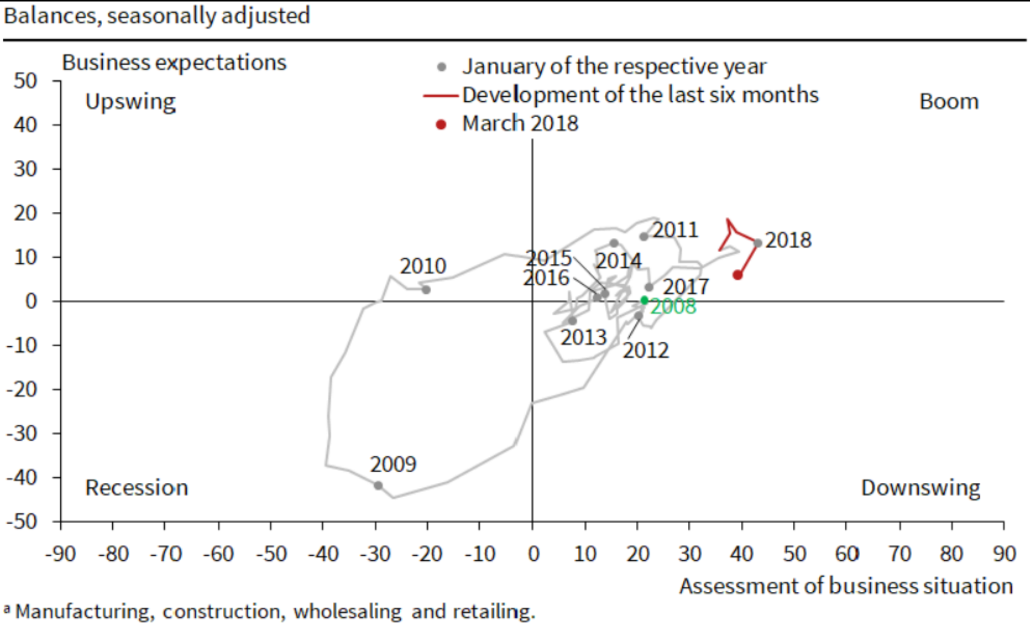
The real risk of a trade war has increased, but remains low: For now, the tariffs announced by the US administration do not pose an immediate economic threat to the global economy. They remain very limited in size and scope. We expect the checks and balances in the US to reign in Trump's most damaging instincts on trade. Still, we need to watch two risks which relate to the second-round effects: First, the confined measures could lead to an escalating spiral of protectionism. Already, the EU and other countries have stressed that they would answer with retaliation if Trump where to push his tariffs through. Second, the saber-rattling could weigh on business and household confidence to such an extent that capital formation and housing investment could take a hit. At a stage of the cycle where investment growth is a key contributor to the above-trend growth, a slowdown in capital expenditure would hurt the current expansion. But, in that case, central banks would likely step in and act as a buffer. In the Eurozone, the ECB would normalise its monetary stance probably (even) slower than.

Chart 1: : Ifo business climate, current assessment and expectations



Source: Ifo

Chart 2: Ifo business cycle clock



Source: Ifo

German Ifo

	MAR	FEB	JAN	DEC	NOV	OCT
Business climate	114.7	115.4	117.6	117.3	117.6	116.9
Expectations	104.4	105.4	108.3	109.5	111.0	109.3
Current assessment	125.9	126.4	127.8	125.6	124.7	125.1

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