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## MACRO NEWS

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Florian Hense, Economist | Florian.hense@berenberg.com | +44 20 3207 7859

### GERMAN IFO: SERIOUS TRADE RISKS AMID DOMESTIC STRENGTH

#### Berenberg Macro Flash

##### German Ifo, July

	Business climate	Expectations	Current assessment
<b>Actual:</b>	<b>101.7</b>	<b>98.2</b>	<b>105.3</b>
Previous:	101.8	98.5	105.2
Consensus:	101.5	98.3	104.9
Berenberg:	101.6	98.6	104.9

**Not too bad yet:** Although German business confidence softened for the seventh out of eight months in July according to the Ifo institute, it did so only marginally. The headline climate gauge fell from 101.8 in June to 101.7 in July, the lowest level since March 2017 (see chart 1). Expectations softened for the eighth consecutive month while the assessment of current conditions held stable. Weaker sentiment among manufacturers offset more confident service providers. While trade tensions continue to cast dark shadows over the German economy, the domestic economy remains resilient, at least so far.

**Expectations drive climate lower:** The drop in the headline climate index was driven by weaker optimism about the future (98.2 in July after 98.5 in June) after remaining fairly stable in June. For the first time since February 2016, business expectations fell below their post-2005 average of 98.3. Yesterday's Purchasing Managers' Index (PMI) suggested that orders do not keep track with output and last month's Economic Sentiment Index pointed to a lower capacity utilisation in Q2 2018 after strong gains over the last two years. While this does not bode well for the second half of this year, there was also something positive to take away from the Ifo surveys. Current assessment ticked up marginally from 105.2 in June to 105.3 in July. This could suggest that businesses are starting to get used to the trade threat as they realise that new business keeps coming in at a healthy, albeit slower pace. The current assessment is well above its long-term average of 96.6. The Ifo business cycle clock, which combines expectations and the current business situation on two separate axes, suggests Germany's business environment remains fairly positive and we are still in healthy expansion territory (see chart 2). This confirms the message from the ECB's money and credit statistics for June: Strong net bank flows to (non-financial) businesses pushed Germany's annual growth rate of bank loans to a buoyant 6% in June (after already strong 5.5% in May), the highest since early 2009. Although loan growth in the Eurozone as a whole lags behind that of Germany, the advance in the Eurozone's rate from 3.7% in May to 4.1% in June reported today also points to positive momentum in the overall Eurozone economy.

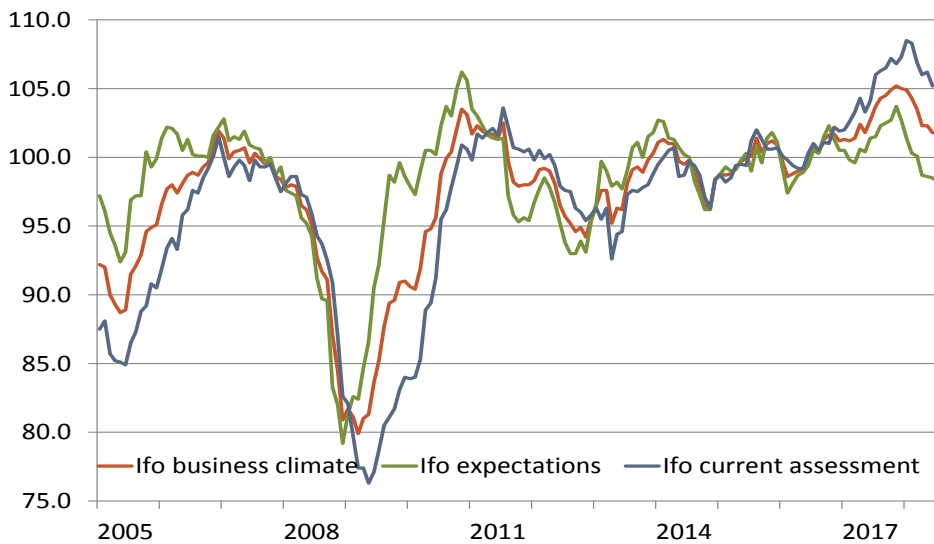
**Manufacturing suffers from trade tensions, services draw strength from domestic economy:** On a sector basis, the Ifo survey painted a different picture than yesterday's German PMI which suggested Germany's economy had regained some momentum thanks to a surprising rebound in manufacturing. The results of the Ifo survey were more in line with our general view (see chart 3). While confidence among export-oriented manufacturers cooled for the sixth consecutive month, sentiment in the service sector held firm, confirming that domestically-focused businesses draw strength from healthy gains in employment, disposable income and consumption. Business sentiment in construction hit a new record, registering its biggest increase to date. According to the Ifo's press release "construction is booming". Meanwhile, confidence among businesses in retail and wholesale trade followed that of manufacturers lower. The question going forward is to what extent continued headwinds for Germany's exporting manufacturers will weigh also on service providers at home over time.



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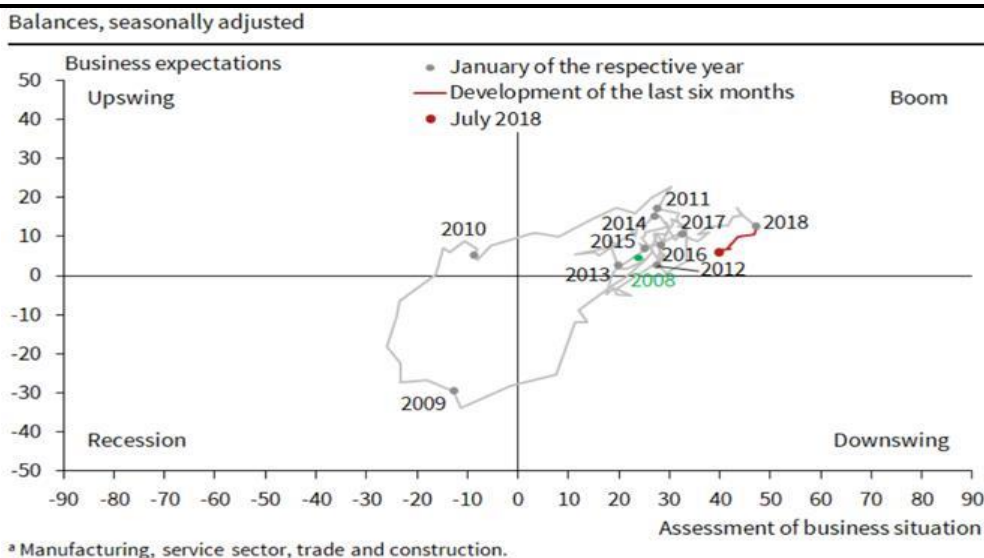
**The outlook for the German economy crucially rests on what happens to trade:** German growth has already slowed down under the impact of escalating trade tensions that threaten business models and supply chains of German exporters. Higher oil prices weighing on private consumption have added to the Damocles sword of protectionism. European Commission President Jean-Claude Juncker's meeting with US President Donald Trump will probably not yield much today – a kick-off of more serious and detailed negotiations would already be a positive result. We still expect Trump to refrain from implementing car tariffs. If so, German confidence can rebound and German growth can re-accelerate to annualised rates around 2% from Q4 2018 onwards.

Chart 1: Ifo business climate, current assessment and expectations



Source: Ifo

Chart 2: Ifo business cycle clock

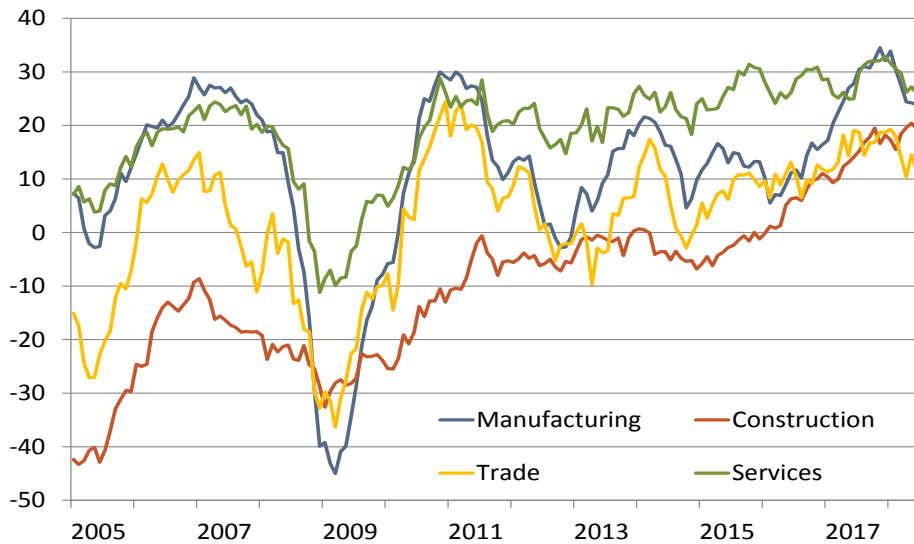


Source: Ifo



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Chart 3: Ifo business climate by sector



Source: Ifo

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Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7859  
[www.berenberg.com](http://www.berenberg.com)  
[florian.hense@berenberg.com](mailto:florian.hense@berenberg.com)