

## Germany: A drop in business confidence that almost feels like an increase

Ifo index still points to solid growth but trade war fears continue to weigh on expectations



The search for the trough continues. After six drops in the last seven months, German business sentiment recorded another small decrease in July. The divergence between an improving current assessment and weakening expectations suggests that at least up to now, trade fears are only fears and not a drag on growth (yet). Germany's most prominent sentiment indicator, the Ifo index, dropped to 101.7 in July, from 101.8 in June. While domestic political turbulence has been resolved for the time being, trade tensions led to a drop in expectations. The Ifo's expectations component fell to 98.2, from 98.5 in June. At the same time, however, the current assessment component increased to 105.3 from 105.2.

Trade tensions are dominating headlines again today as another round of talks between the EU and the US kick off in Washington. In an export-oriented economy- in which the US is still the largest export destination- the prospects of more complicated trade are raising concern. For now, the German economy clearly shows sign of fear but does not feel it. In fact, the fear factor is much bigger than the actual hard impact. Why? Currently, actual tariffs on aluminium and steel will

definitely not hurt the economy. And given traditional price insensitivity of German goods, even significant US import tariffs on cars might not significantly affect demand; particularly as long as the euro remains weak. Sure, all kind of simulations show that the German economy would, not surprisingly, be hit by a fully-fledged trade war, somewhere in the range of 0.1 and 0.4% of GDP. However, it is still in the German economy's hand to reduce such a negative impact by increasing domestic investment and strengthening ties with other trade partners.

All in all, today's Ifo index illustrates that the German economy continues its balancing act between solid economic fundamentals and fears about the possible impact from a potential trade war. The jury is still out as to which of these two factors will prevail in the coming months. While we still place our bets on solid economic fundamentals, the risk of a negative sentiment loop can clearly not be ignored. Even though in our view, fear has never been a good guide.

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