# Darkening skies over Germany

With six drops in the last seven months, today's weaker Ifo index adds to concerns about the growth outlook for the German economy

**101.8** German Ifo index, June

Down from 102.3 in May

It was only a short breather. After the stabilisation in May, Germany's most prominent sentiment indicator took another hit in June on the back of increased trade tensions and domestic political turbulence. The Ifo index dropped to 101.8, from 102.3 in May. While the expectations component remained unchanged, the current assessment component dropped to 105.1, from 106.1 in May. The jury on the real state of the German economy is still out. The combination of strong fundamentals, a stuttering start in the first months of the year and a series of soft indicators has clearly increased uncertainty. Temporary soft patch, transition to a slower growth path or even the start of the end of the long and impressive growth performance, which started in 2009, are three possible scenarios for the German economy in the coming months.

In our view, the most likely scenario is still a rebound towards a slower growth path on the back of the strong labour market, low interest rates, low inflation and a weak euro. At the same time, however, the number of dark clouds in the German economic sky has clearly increased. Currently, the most threatening factors are gradually escalating trade tensions, higher oil prices and, very recently, turbulences in domestic politics. Even though trade is often cited as the number one risk to the German economy, we tend to see domestic politics as a much bigger risk. Sure, Germany would suffer from a fully-fledged trade war but such a scenario is still far out. 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 affect demand; particularly as long as the euro remains weak.

Domestic politics, however, currently are a bigger risk. The next two weeks could dramatically change the political landscape in Germany and in a worst case scenario even lead to a fall of the government and new elections. For the economy, this would mean further delays of the urgently needed investments, new structural reforms and strengthening of the monetary union. Six drops and one stagnation in the last seven months or in other (soccer) words: six losses and one draw. This is clearly not a promising trend. However, as seen last Saturday in the World Cup match between Germany and Sweden, never count out Germany. Hope dies last, even if it takes until the very last second.

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