

Germany: Confidence setback

First scratches to the strong German economy as the Ifo drops to its lowest level since September 2017



Source: istock

115.4 The Ifo index
February

Market turmoil hits confidence...

Germany's most prominent leading indicator, the Ifo index, took a big hit in February, illustrating that the latest market turmoil, the political impasse in Berlin and new fears of a protectionist wave coming from the US as well as the US tax changes are leaving the first marks on business optimism. In February, the Ifo index stood at 115.4, from 117.6 in January. The expectation component dropped particularly sharply, while the current assessment component is still close to its all-time high.

But the economy is still in good shape

Despite today's disappointing Ifo reading, the German economy is still in good shape. It looks like an already mature cycle is getting longer and longer. At least in the first months of the year, the economy should maintain its strong momentum. Over the last year, confidence in the manufacturing sector has surged and finally caught up with already high confidence in the service sector. Order books are still richly filled and the domestic momentum remains strong.

The big question for 2018

In our view, the German economy still has some upward potential and is not on the verge of overheating, as the output gap is positive but not extraordinarily high, capacity utilisation is above its historical average but still lower than in 2007 and investments have only started to increase this year. The big question over the course of 2018 will be whether less monetary policy accommodation – on the back of a stronger euro and higher long-term interest rates – can be offset by the recent upswing in the Eurozone economy and the general strength of the global economy.

Another risk for the economy could come from a possible protectionist wave starting in the US. While German exports have proven to be very resilient to all kind of shocks, weaker trade with the US – on the back of tariffs – and the UK – on the back of Brexit and a weaker sterling – could leave some marks on the German economy.

All in all, today's Ifo drop is no reason to worry, yet. Rather, it provides evidence that even in Germany, the sky can be the limit.

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