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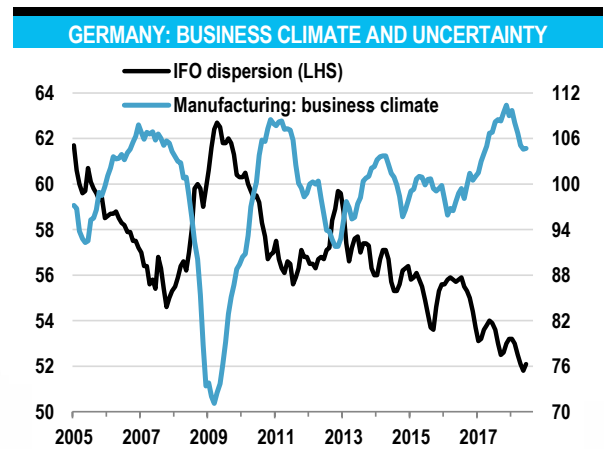
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Germany: still relaxed about softer sentiment

■ German business climate indicators have eased since the start of the year, a movement which is broad-based ■ Very recently, some indicators have stabilised ■ Corporate uncertainty, as measured by the dispersion of the assessments of the economic outlook, has not increased yet despite concern about a trade war ■ However, dispersion tends to lag the overall evolution of the business climate so this indicator will need to be monitored closely in the coming months

In line with softer sentiment data in the eurozone, data for Germany have also weakened since the end of 2017, albeit from a very high level. The Markit manufacturing PMI has declined from a peak of 63.3 in December 2017 to 55.9 in June. The services PMI dropped to 52.1 in May from 57.3 in January. The IFO business climate index eased from a historical high of 105.2 in November last year to 101.8 in June. The European Commission economic sentiment index for Germany fell from 116.0 in January to 111.9 in June, an evolution which was broad-based (industry, services, consumer sentiment, retail trade) although the climate remained stable in the construction sector.

The current readings of the sentiment indicators still correspond to above potential GDP growth. Moreover, the business expectations component of the IFO index has stabilised and the services PMI has rebounded to 53.9 in June. This, in conjunction with strong fundamentals (income growth, earnings growth, capacity utilisation, low interest rates, etc), may explain why the dispersion of the assessments by individual companies of their business outlook continues to be very low. This measure, which is calculated by the IFO institute in Munich, can be considered as an indicator of corporate uncertainty considering its high correlation with other, more traditional uncertainty measures. As shown by the chart, dispersion evolves countercyclically and the improvement in the business climate since the start of 2013 has seen a trend decline of dispersion and uncertainty. The observation that the recent softening of business sentiment has not caused an increase in dispersion should be welcomed in view of the threat of a trade war between the US and Europe which could hit Germany particularly hard, in particular if US tariffs on cars imported from Europe would be increased significantly. That does not mean that the threat has no impact. Looking into the IFO surveys in greater detail, one observes that export expectations have dropped a lot as of late in a number of sectors (chemicals, capital goods, consumer goods, machinery, automobiles, textiles) whereas they have hardly moved in others. The absence of an increase of dispersion does not justify complacency however because dispersion tends to lag the evolution of the business climate, as illustrated in 2007-2009 and 2011-2012. Moreover, empirical research shows that uncertainty shocks have a delayed yet considerable impact on the manufacturing and construction sectors so the dispersion indicator will need to be monitored closely in the months to come.



Source: IFO, BNP Paribas.

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