

Germany: Huge sigh of relief

An unchanged Ifo index finally brings some good news to the Eurozone



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Ifo keeps hopes alive

How times can change. After weeks and months of disappointing data, not only from Germany but the entire Eurozone, an unchanged Ifo index is good news. After five consecutive drops, Germany's most prominent leading indicator, the Ifo index, remained unchanged in May, after an upward revision of the April data, keeping the hopes of an economic rebound alive. While the current assessment component increased to 106.0, from 105.8, the expectation component dropped once again (to 98.5, from 98.7), illustrating increased worries from ongoing trade tensions.

The Ifo index had been on a worrying downward slide for five months in a row. Last time the Ifo index experienced such a downward correction was in 2014. Obviously, such a trend raises doubts about the strength of the recovery and opens the stage for advocates of an end to Germany's long and impressive growth performance, which started in 2009. And, indeed, dark clouds in the German economic sky have clearly increased. Just think of higher oil prices, Italian politics and the ever-accelerating trade tensions. Add to this the political reluctance to speed up new structural reforms and, both public and private, investments and it becomes obvious that the German growth story is running on its last leg. Need more evidence? In the latest international competitiveness ranking, Germany dropped from rank 13 to rank 15. In 2014, Germany was still ranking number six.

Start of rebound or a brief stopover?

The swan song on strong German growth has been sung several times over the last few years. Always too early. Nevertheless, this does not take away that the economy has been caught between two stools for a long while. A long cycle on the base of strong domestic fundamentals but also artificially extended by low interest rates and a weak euro goes hand-in-hand with too few investments and a lack of new structural reforms. Over recent years, strong fundamentals and the ECB's steroids have almost always had the upper hand. It is hard to tell when the strong domestic momentum will fade away and when the lack of reform and investment starts to hit in. When the one-off factors of the first quarter have fully disappeared, growth should rebound anyway, only on the back of strong fundamentals. Nevertheless, the economy is also already experiencing supply-side constraints. Supply-side factors are increasingly hampering Germany's growth prospects. Both equipment and labour are currently at their highest levels ever as limiting factors to production. Against this background, more investment seems to be the best and easiest way forward. It would increase production capacity and could lift the current speed limits.

After weeks and months of disappointing data from Germany and the entire Eurozone, today's Ifo reading brings some relief. However, the fact that no change is already good news also shows how sharp expectations for the entire Eurozone have been revised downwards recently. Let's hope that today's Ifo index is the start of another rebalancing of expectations and reality. The rollercoaster ride between eu(ro)phoria and fears of a new euro crisis needs some middle ground. The next weeks will tell whether today's Ifo was a huge sigh of relief and the start of a new rebound or simply a brief stopover on a longer downward slide.

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