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GERMANY

German optimism returns

The second consecutive increase in the Ifo index suggests that optimism in German businesses is gradually returning

Hope is back. Germany's most prominent leading indicator, the Ifo index, increased to 85.6 in June, from 84.9 in May. Interestingly, not only expectations but also the current assessment component improved in June. However, before getting overly enthusiastic, even with today's increase the Ifo index still remains below its pre-war level.

While some football pundits might credit the German national team's World Cup performance for this shift in general sentiment, the talks between Iran and the US on reopening the Strait of Hormuz are probably the real driver behind the renewed optimism.

Somehow, the German – and indeed the wider European – economy remains in a kind of twilight zone. Hard data will continue to show the fallout from the war in the Middle East and soaring energy prices, while soft data such as this morning's Ifo index, points to a return of optimism.

As for the hard data, there is a high risk that the German economy slipped into contraction in the second quarter. This is not only a result of high energy costs but also because of disappointing reform efforts by the government. As bleak as this might sound, the upside is that both headwinds could soon fade. A reopening of the Strait of Hormuz will not change the structural energy price challenges facing German industry but it should ease some of the downward pressure on private consumption. At the same time, and this is even more remarkable, it looks as if the German government is finally stepping up its reform efforts. The proposed pension reform won't solve the country's competitiveness problem but would help address the impact of demographic change on the public finances. It would also send a clear signal that the government is willing and able to implement overdue reforms. Sometimes, wins secured by an unexpected last-minute goal do more than unleash a wave of enthusiasm; they can also provide a powerful boost for what comes next.

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