German Ifo index plunges in July

A sharp plunge in July marks the third monthly drop in the Ifo index in a row, completely reversing the optimistic trend at the start of the year. The German economy is back as the eurozone's growth problem child

What a difference two months can make. In May, in the run-up to the European Football Championships hosted in Germany, many headlines, comments and articles wondered whether such an event could be a kick-start for the national football team and the economy and bring back stellar performances for both. Two months later, the verdict is clear. The national football team, admittedly due to some bad luck or holy hands, exited the Euros after the quarter-finals, and the economy is back to where it was half a year ago: the eurozone's growth problem child.

Ifo index plunges to 87.0 in July

The latest batch of German confidence indicators still points to a very anaemic recovery of the German economy after the cyclical bottoming out at the start of the year. While consumer confidence improved somewhat, yesterday's PMI, as well as the just-released Ifo index, disappointed. Germany's most prominent leading indicator, the Ifo, plunged to 87.0 in July, from 88.6 in June. After three consecutive increases at the start of the year, the index has now fallen three months in a row. While one is none, three is clearly a trend.

It's all being driven by a worsening of the current assessment component and an even worse plunge in expectations. A weaker global economic outlook, policy uncertainty in both France and Germany as well as the potential implications of the US presidential elections for Europe seem to be weighing on business sentiment.

German economy remains stuck in stagnation

The German economy started the year with optimism. First-quarter GDP growth surprised to the upside, and confidence indicators improved, giving rise to hopes that the pessimism of the last few years was left behind and that the discussion on whether or not Germany was Europe's sick man could be shelved again. Truth, however, also is that GDP growth in the first quarter was driven by the mild winter weather and a downward revision of fourth quarter GDP. Hence, it was not what we would call a sustainable and healthy growth story.

At the same time, improving sentiment indicators were a result of a better outlook for the global economy and slowing inflation. Right now, we're not really seeing an improvement globally. Instead, the US economy has started to cool off and the Chinese economy, too, has lost some momentum. New trade tensions are also weighing on the outlook for an export-oriented economy like Germany's.

Disappointing hard data for May suggests that the German economy could again have reached a standstill in the second quarter, and latest sentiment indicators do not bode well for the third. Weak industrial orders, high inventory levels and precautionary savings are still weighing on the economy. On top of that, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are still hanging like the Sword of Damocles over the labour market this year.

But there is still hope

Still, despite a weak start to the second half of the year, don't rule out potential positive surprises. In fact, extremely weak May data could have been exaggerated due to many public holidays and long weekends. Plus, it only needs a small improvement in industrial order books to get industrial production growing again, admittedly from low levels. The highest increase in real wages in more than a decade should also eventually loosen even German consumers' traditionally very tight wallets.

Finally, despite ongoing political tensions, the government recently announced a new growth initiative to tackle the economy's well-known structural weaknesses. Unfortunately, the initiative is rather rich in words and intentions than in money and will, therefore, not bring imminent relief, but it could contribute to a very gradual improvement.

The German economy remains stuck in stagnation, and the latest disappointing sentiment indicators illustrate that the combination of cyclical and structural headwinds cannot easily be overcome. Nevertheless, a rebound in the second half of the year is still possible, even though it is highly unlikely that it will be a strong one.

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