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Ifo index gives cold shower to optimists

A stagnating Ifo index in May suggests that the bottoming out of the German economy is not yet being followed by a strong recovery



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The Ifo index, Germany's most prominent leading indicator, just illustrated that the cyclical bottoming out will not automatically be followed by a strong recovery. After three consecutive increases, the Ifo index remained unchanged at 89.3 in May. While the expectations component improved again, the current assessment component dropped.

Judging from previous experience, three consecutive increases tend to mark a turning point in the economy and we have seen these increases between February and April. Today's Ifo index reading is a good reminder that the growth prospects after the turning point remain muted.

Cyclical bottoming out not yet followed by strong recovery

Looking ahead, and despite today's cold shower, the German economy should gain more momentum. Strong wage growth should fuel a cautious recovery in private consumption and even the inventory cycle should gradually start to turn positive. However, this cyclical improvement does not mean everything is suddenly hunky-dory again in Germany. There are still several cyclical factors potentially dragging down economic activity. Higher oil prices as a result of the ongoing military conflicts in the Middle East could easily weigh on industry and exports once again.

Also, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are fuelling the risk of a weakening labour market this year.

Finally, besides the potential cyclical headwinds, Germany's well-known structural weaknesses will not disappear overnight and will limit the pace of any rebound.

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