

Optimism returns to Germany as the Ifo jumps again

A third monthly increase in the Ifo index strengthens the view that the German economy has left its economic trough behind and should be able to enjoy some more cyclical improvement



Finally, Germany appears to be at a cyclical turning point. Its most prominent leading indicator, the Ifo index, has added to recent evidence of a bottoming out of the German economy. In April, the index increased for the third month in a row to 89.4, from 87.9 in March. Judging from previous experience, three consecutive increases tend to mark a turning point in the economy. Today's increase was driven by both the improved current assessment and expectations' components. The Ifo headline index is now back to levels last seen in the early summer of last year, illustrating the return of optimism.

Speed of cyclical improvement limited by structural challenges

The cycle has started to turn for the better. Today's Ifo index provides further evidence of a bottoming out of the German economy. Hard data for the first two months of the quarter already suggested it could have left recession behind earlier than expected. Strong activity in the construction sector on the back of mild winter weather and a technical rebound in trade and industrial production should have offset still weak private consumption. This cyclical upswing looks

set to continue in the second quarter.

However, let's not forget that several cyclical factors are still dragging down economic activity. Higher oil prices as a result of the military conflict between Iran and Israel, as well as the ongoing tensions in the Red Sea, are likely to weigh on industry and exports once again. Also, the increasing number of insolvencies and individual company announcements of upcoming job restructurings fuel 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 speed of any rebound this year.

All in all, today's Ifo index brings back more optimism for the German economy. The cyclical trough is behind us, but this doesn't necessarily mean that a strong recovery is imminent as structural weaknesses remain. A new risk of this cyclical improvement could be that it gives rise to policy complacency.

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