

## Germany: First green shoots

Spotting turning points in the economy remains a very difficult task. Today's ZEW index adds to tentative evidence that a gradual rebound of the German economy is in the making



The ZEW index, which measures investors' confidence, increased for the sixth consecutive month, to 3.1 in April, from -3.6 in March, entering the positive territory for the first time since March 2018.

However, the current assessment component continued the trend of the last few months and recorded its seventh straight drop. German stock market's gains of more than 5% during the previous four weeks, a weakening of the trade-weighted exchange rate by more than 2.5% since last summer as well as positive macro news from China have boosted financial analysts' optimism on the German economy.

All backed by the Fed's and ECB's u-turns towards an easing bias.

### German economy still in mystery land

The German economy remains a mystery. Driven by a series of one-off factors, the German industry was all of a sudden in a free fall in the second half of last year. A free fall, which had not been predicted by any leading indicator. While the current situation in the industry is not as disastrous as some data points suggest, as order books are still filled, the risk of a negative

sentiment loop or a cycle of fear has clearly increased.

At the same time, however, the domestic part of the economy has remained stubbornly strong. The decoupling of the services and manufacturing sectors illustrates the current dichotomy of the German economy. The latter reflecting the global slowdown as well as increased global uncertainty, while the former reflects the sound domestic fundamentals of the German economy. In fact, this decoupling is not a new phenomenon, it already started in 2015. Since then, the manufacturing sector has gone through a full cycle, while the service sector remained constantly stable. Another interesting aspect of the current downswing of the German economy is the fact that downturns normally follow on prior excesses. The German economy, however, did not show any excesses that would require a cleansing correction. Consequently, the economy is currently witnessing the slowdown which basically came from nowhere.

## ZEW index points to tentative optimism

Looking ahead, the main question is whether the significant slowdown could disappear almost as quickly as it came. The reversal of last year's one-off factors, some encouraging recent evidence from global activity as well as continued solid domestic fundamentals have again brightened the outlook for the German economy.

The main question, however, remains if it happens, when will the rebound happen? Not an easy question to answer. The first quarter might come in better than many expect. Judging from all available data so far, retail sales, car sales, employment, exports and construction were all stronger than in 4Q18. While Ifo and PMI have a much better track record in nowcasting German growth, the ZEW index is the only indicator which – unfortunately not always – signals turning points in the economy before they actually happen. Even though the ZEW index offers little clue about the actual strength of any downturn or rebound, six consecutive increases send a strong signal.

A strong ZEW index alone will not solve the current mystery of what the real strength of the German economy actually is. In our view, however, it is another welcome green shoot. After a long series of downward revisions of German growth prospects, it could be time for first (tentative) upward revisions.

### Author

#### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

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