Germany: This is what a lockdown looks like

A dreadful Ifo index reading is another data point on the road to what will be the worst economic performance in a long time

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Another day with 'historic lows' and 'worst drops ever'. Germany's most important leading indicator just dropped to a new all-time low. The Ifo index fell to 74.3 in April, from 85.9 in March. This drop was even worse than the previous worst monthly drop in March. While the current assessment component remained slightly above historic lows, the expectations component saw its lowest reading ever, suggesting that German businesses do not expect a quick turnaround.

Needless to say that this is another dreadful data point. More will follow. It will take a while to fully grasp the magnitude of the Covid-19 crisis. If history offers any guidance, and taking past correlations between the Ifo index and GDP growth into account, today's Ifo reading points to a contraction of the economy as in the first quarter of 2009. Back then, the economy shrank by almost 5% quarter-on-quarter. At the same time, given that this is a completely unprecedented situation, the question is how credible any past links between soft and hard indicators are.

As dreadful as today's Ifo numbers are, the bigger concern for any growth forecasts is the fact that the easing of the lockdown measures takes somewhat longer and is more gradual than initially expected. As of Monday, many stores have reopened, under strict conditions, and schools will very gradually reopen in the coming days and weeks. While some sectors, for example the chemical industry, were able to continue production throughout the lockdown period, other sectors like the automotive industry have only recently restarted production. To be very clear, this is far from being a return to normalcy, with hotels and restaurants still being closed and public events prohibited until the end of August.

It will take several more months and many data points before we will have a better grip on the full magnitude of the crisis, the permanent damage to the economy as well as the pace of the recovery. One glimmer of hope for the German economy is that the government has shown a swift and strong policy response to cushion the crisis, putting more than 30% of GDP on the table. Yesterday morning, the government decided on another €10 billion stimulus package, including an extension of short-time work schemes, unemployment benefits, tax relief for small companies and a VAT reduction for restaurants. The crisis has clearly led to a U-turn in the government's approach to fiscal policy, at least in its own country. The old motto for fiscal stimulus 'less is more' has become 'big is beautiful'. Against this background, it is only a matter of time before additional stimulus measures will be announced.

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