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Germany: Optimism increases

The latest Ifo reading suggests that German businesses believe the rebound is strengthening

From rearview mirror to GPS. After this morning's GDP data for the second quarter gave a final glance at the depth of the crisis in the second quarter, the just-released Ifo index gives some guidance on the short-term outlook for the economy. Germany's most prominent leading indicator increased for the fifth consecutive months to 92.6 in August, from 90.4 in July. German businesses have started to believe in the rebound as both the expectations and current assessment component increased. While the current assessment component is still clearly below its pre-crisis level, the expectations component stands at its highest level since November 2018.

An interesting aspect of this crisis is the productivity boost for more real-time and experimental data. Many of these are leading the traditional leading indicators and were relatively reliable in predicting the extent of the slump and now the upswing. Whether they also provide reliable information for nowcasting when the main focus returns to decimal places remains to be seen. If they do, market participants will pay much less attention to the traditional indicators.

The German economy has managed the first stages of the crisis relatively well. The lockdown was eventually milder than in many other countries. Lockdown measures were lifted earlier than in most countries and consequently the rebound could be stronger than in most other countries. However, it remains important to make a strong distinction between rebound and recovery. While the rebound looks strong, as illustrated by the latest update of the Bundesbank's activity tracker, the shape of the recovery is much more uncertain, particularly to the extent that the amount of permanent damage is still hard to gauge. At some point in time, the government will have to balance between cyclical relief and potential longer-term costs of delaying structural change. Today, the government will discuss a possible extension of the short-term work schemes from 12 to 24 months. It will, in our view, not be the last discussion about possible extensions to crisis measures. Just think of the VAT reduction, which is supposed to expire at year-end, or the suspension of the obligation to file for insolvency in time (currently until end September). It is hard to see that the government would want to enter an election year with an increase in the VAT and a surge in unemployment and insolvencies.

For now, today's Ifo index keeps the hopes for a V-shaped rebound alive. However, the fact that a rebound is not necessarily the same as a recovery will be the main theme of the coming months.

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