

Germany: More optimism

Optimism is back as the Ifo index continues to surge on the back of significantly improved expectations.



Cars on a German Autobahn

After rain comes sun. Germany's most prominent leading indicator has just staged another strong comeback. The Ifo index increased to 86.2 in June, from 79.5 in May. Remember that back in April, the Ifo index had dropped close to all-time lows. Particularly expectations surged, while the current assessment component was still muted. Expectations increased to 91.4, from 80.1 in May, and have almost returned to their February level. At 81.3, from 78.9 in May, the current assessment component is still far below levels seen at the start of the year, when it was close to 100.

Confidence indicators have to be taken with a pinch of salt

The problem with soft indicators these days is that they give a good impression of the relative change but should be taken with a huge pinch of salt when it comes to their predictive power of actual GDP growth outcomes. In the past, leading indicators like PMIs, the European Commission business sentiment or the Ifo index, gave good proxies for actual and near-term economic growth. At the current juncture, absolute levels of these confidence indicators tell us very little about expected GDP growth or, better, contraction. When the Ifo index, for example, reached record lows in 2009, the German economy shrank by 4.7% QoQ. Even though the Ifo index has moved away from these lows in the last two months, the German economy will have contracted by some 7% QoQ in the second quarter.

It's a 'v'...at least for now

Still, today's Ifo index echoes more real-time signals that economic and social activity has started to pick up significantly since the first lifting of the lockdown measures in late April. Some sectors have seen activity returning to up to 90% of January/February levels. However, it is currently still impossible to measure the more permanent damage the crisis has caused and what its impact will be on future growth. Reviving economic activity and returning optimism are highly welcome but are definitely no reason for complacency. The fact that capacity utilization in industry has dropped to its lowest level since 2009 as well as that access to finance is a much bigger impediment to production than during the financial crisis illustrate the depth of the crisis.

Looking ahead, higher unemployment, insolvencies and weak external demand are likely to put a cap on the pace of the recovery once the technical v-shaped rebound is behind us. In this regards, the government's latest fiscal stimulus should help, not only to support domestic demand but also to accelerate the necessary structural change of the economy. In the shorter run, the main risk for the German economy seems to be a second virus wave, together with the prospects of a second lockdown. Recent developments, including a virus outbreak in a giant abattoir with more than 1,500 positively tested workers, have already given some flavor of such a second wave. The wider region of the slaughterhouse's location has gone into lockdown (again).

In short, today's Ifo index adds to the optimism that at least the first phase after the lockdowns will be v-shaped. Not a real surprise but still good to see it actually happening. What comes after the 'v', however, is much more uncertain.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial

Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.