

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.

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