

Germany: No hangover as the Ifo bounces back

A surprisingly strong Ifo index suggests that the German economy is defying geopolitical and trade risks. The growth party is all set to continue



Source: Shutterstock

Germany's most prominent leading indicator just sent a strong sign of relief. After a long downward correction since the start of the year and a stabilisation during the early summer, the Ifo index staged an impressive comeback in August, increasing to 103.8, from 101.7 in July. Probably not only the warm summer weather but rather (temporary) relief of trade tensions and sound economic fundamentals have lightened up German business sentiment. In particular, the expectation component surged in August, to 101.2, from 98.2 in July. After last week's positive and encouraging 2Q GDP data, today's Ifo index strongly suggests that the growth party will continue. Looking ahead, the German economy should continue a multiple balancing act. Balancing between strong fundamentals and increased geopolitical risks, between the favourable effects of the ECB's loose monetary policy and the lack of new structural reforms, between solid domestic demand and trade tensions. Up to now, talks and fears of new crises, trade wars or a sudden end to a mature cycle have only been talks and threats. They have not left any significant marks on the German economy (yet).

Obviously, this could change in the coming months. Even though the EU seems to be off US radar screens at least for the time being, the series of German export partners being hurt by sanctions, tariffs or economic crises is getting longer. Just think of China, Russia, Turkey, Iran or potentially the UK. The strength of the German export sector has always been its diversity and the fact that it is not dependent on a single export partner. And while the weak euro should cushion any adverse effects stemming from tariffs or sanctions, the list of troubled countries should obviously not get too long. While risks from the external side are increasing, the domestic side of the German economy offers both challenges but also opportunities. Just think of an increasingly complicated political landscape, too few new investments and structural reforms and supply-side constraints in many sectors of the economy. Given that capacity utilisation has increased to the highest level since 2008 and companies have never before seen equipment as such a significant limiting factor to production as now, the German economy's current biggest problem is that it is bursting at the seams. Despite the recent upswing in investments, the economy clearly needs more investments, and fast. In this regards, the current political summer discussion with strong emphasis on pensions instead of future-oriented investments is not the most promising signal.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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