Germany: Paving the path for a recovery

With the fourth consecutive increase, the latest ZEW index paints a good picture of the path of recovery. After a sharp rebound, some flattening out should follow

Source: Shutterstock

A handwritten 'r'

After a real V-shaped move in March and April, the ZEW index, which measures financial analysts' assessment and expectations of economic and financial developments, returned to normal monthly changes and has taken the pattern of our current favourite: a handwritten 'r'.

In June, the ZEW index increased to 63.4, from 51.0 in May, the fourth consecutive increase. At the same time, the current assessment component increased for the first time during the crisis to -81.3, from -93.5 in May. The further improvement in expectations probably reflects the lifting of lockdown measures as well as central bank and government actions.

Could the ZEW index be right?

Given that traditionally, the ZEW index has a better track record in predicting turning points in the economy, rather than predicting exact outcomes for GDP growth, it is interesting to look at the difference between current assessment and expectations. This difference is currently larger than was seen in 2008 and has stabilised in May and June, suggesting investors' increasing optimism that the worst might be behind us.

Indeed, we would agree that the worst could be over. The dreadful macro data should have marked the trough of the crisis. More real-time data, such as Google mobility data, shows that activity already accelerated by mid-May. While (social and economic) activity slowed down to 60% of its January level during the peak of the lockdown, it has now returned to almost 90%. The truck toll mileage index has already returned to some 95% of its pre-crisis level. Combined with the huge fiscal support by the German government, the rebound of the economy should continue well into the second half of the year.

Needless to say, the structural challenges the German economy was already facing prior to Covid-19 have not suddenly disappeared. The latest fiscal stimulus package will tackle some of these weaknesses, but it will take some time. Therefore, any initial sharp rebound will be followed by a flattening out.

It could very well be that this time around, and different from past experiences, the ZEW index could gain a better track record in predicting short-term movements in the economy.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de