

## German economy back in crisis mode as Ifo index drops to pandemic levels

A plunging Ifo index underlines the growing concerns among German companies about the adverse economic impact of the war in the Middle East



Germany's most prominent leading indicator fell to 84.4 in April from 86.3 in March, the lowest level since the pandemic

To quote Andreas Brehme, the all-too-early-departed scorer of Germany's winning goal in the 1990 World Cup final: "if you've got s\*\*\* on your boot, you've got s\*\*\* on your boot." A quote that applies to many situations in life, and certainly to the German economy right now.

At the end of 2025, the economy finally seemed to be escaping its endless stagnation, with growth returning in the fourth quarter, rising industrial orders, and the expectation of billions in defence and infrastructure investment. An upturn was within sight until, that is, the war in the Middle East started. The just-released Ifo index, Germany's most prominent leading indicator, took another plunge in April, to 84.4, from 86.3 in March, the lowest level since the pandemic.

### War in the Middle East, the energy price shock and possible supply chain frictions weigh on German economy

The war in the Middle East and soaring energy prices have again exposed the fact that Germany is

one of Europe's largest net importers of energy. Some 6% of its oil imports stem from countries in the Middle East. The so-called energy-intensive industries in Germany account for some 17% of industrial gross value added and employ just under one million people. With the war in the Middle East now gradually shifting from a pure energy price shock towards an energy supply and broader supply chain shock, the German economy is once again at the centre of an exogenous, global, disruption.

Admittedly, large corporates are likely still hedged against soaring oil prices, but SMEs are not, nor is there a hedge against deficits of physical oil. There is already anecdotal evidence of surging tarmac prices and coming supply frictions. As in 2022, this first inflation wave – from higher energy prices to knock-on effects on transportation and food, as well as products that need oil – is already in full swing. It is not only hitting consumers but also companies that, due to contractual obligations, are unable to immediately pass on higher costs. Also, remember that in 2022, several energy-intensive companies reduced or halted production as high energy prices made production uneconomical. Meanwhile, gas reserves are currently at their lowest level at this time of the year in five years, which could bring a cost-push for corporates and households next winter.

All of this said, even if sentiment is suffering enormous setbacks right now and fears of another year of stagnation have returned, it should be clear that the planned investments in defence and infrastructure are still on track and should support the economy this year and beyond. The fiscal impulse is real, it just needs time to reach the real economy.

## German government has to master two challenges at the same time

Talking about fiscal policy, the new energy price crisis has again laid bare cracks in the German government coalition and the difficulty in mastering two challenges at the same time: providing short-term relief from high energy prices and pressing ahead with longer-term structural reforms. Over the last few weeks, the policy debate in Berlin has heated up again. This has centred not only on the government's decision to temporarily cut fuel taxes and introduce a controversial €1,000 tax free bonus that employers may – but are not required to – pay their employees, but also on the broader question of structural reform.

With the government entering its second year in office, there have been a wide range of reform proposals but still very few actual decisions. The current focus is on healthcare and pension reform to bring public finances onto a more sustainable footing in light of Germany's demographic change. It seems that not a day goes by without some sort of proposal or idea. Which of these proposals, if any, will eventually be implemented is a completely different story. Some call this diversity of ideas and proposals part of a constructive debate in a healthy democracy, others simply call it chaos.

In any event, the war in the Middle East is a serious obstacle. Yet, it is no reason to bury the structural optimism that marked the start of the year. If the fiscal stimulus on infrastructure and defence is now finally combined with long-overdue reforms to open up fiscal space for further investment, along with targeted corporate tax relief and a clear strategy for affordable and more autonomous energy – in short, a real plan – then the economic upswing will only be delayed, not derailed. The federal government, however, should not take its inspiration from the philosopher Andreas Brehme. One of his other famous lines was that “making the impossible possible will be a thing of impossibility.”

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