German Ifo index surprises in October

The Ifo index increased in October on the back of improving expectations, while the current assessment worsened once again

Germany's most prominent leading indicator fell to 86.4 in March from 88.4 in February

Hope dies last; it's always darkest before the dawn. As it's currently difficult to find economic reasons for the rebound in German business sentiment, it must be slogans of perseverance like these that led to a slight increase in the Ifo index. Germany's most prominent leading indicator increased to 88.4 in October, from 87.7 in September, but remains below this year's high in August. While the current assessment dropped for the third month in a row, expectations improved significantly to the highest level in more than three years.

Risk of yet another year of stagnation still alive

Despite today's Ifo index increase, the risk of yet another year of stagnation is still alive and kicking. After the excitement and enthusiasm sparked by Germany's fiscal policy U-turn and its decision to invest significantly in infrastructure and defence this spring, the summer brought a rude awakening. The mood in Germany soured and optimism ground to a halt – and not just because of US tariffs or a stronger euro, both of which complicate matters for the export industry. Today's Ifo index reading (as well as last week's PMIs) provides some hope of a possible rebound, although it wouldn't be the first time that a temporary rebound in leading indicators eventually ends up disappearing into thin air.

In fact, German policymakers are apparently just now waking up to the painful reality that readers of our research have heard endlessly over the last five years. A reality in which Germany has lost international competitiveness as a result of long-term underinvestment, a portion of naivety and arrogance, and China's rise from export destination to system rival. Current fears of production stops in the German (automotive) industry as a result of Chinese export controls on microchips are one of too many reminders that German industry is no longer dictating the rules of the game, and instead, merely lies at the receiving end.

Another reason for the worsening mood in Germany is domestic politics. The hope that a new government and fiscal stimulus would finally lift the economy out of its prolonged stagnation seems to have faded. Why? The discussion around possible austerity measures undermines the psychological impact of the announced fiscal stimulus. The government's decision to shift previously planned investments from the annual budget to special investment funds has also brought a whiff of creative accounting in German fiscal policy. These developments not only revive unpleasant memories of coalition infighting from the previous government but also risk dampening household and corporate spending and investment decisions.

All hopes are still on fiscal stimulus

Let's be clear: the scale of Germany's announced fiscal stimulus – €500bn for infrastructure and a 'whatever it takes' stance on defence – remains significant. This money will eventually reach the economy. However, recent fiscal manoeuvres have increased the risk that the stimulus will be less impactful and slower to materialise than initially hoped. Add to this the well-known supply-side constraints, from a shortage of skilled labour and high material costs to bureaucratic hurdles, and it seems likely that infrastructure investments will boost the economy more in 2027 than in 2026. Defence spending, on the other hand, could still deliver a positive growth surprise.

Still in search of structural reforms boosting competitiveness and growth

Beyond the diluted impact of fiscal stimulus, the government is also struggling to agree on the far-reaching reforms needed to structurally enhance Germany's competitiveness. Chancellor Friedrich Merz has promised a 'Fall of Reforms'. So far, the government has not only failed to deliver but also appears stuck in a macroeconomic model rooted in the 20th century, lacking a clear plan to propel the German economy into the 21st century.

That said, autumn isn't over yet, and recent weeks have seen new initiatives aimed at reducing bureaucracy and boosting digitalisation. And yes, it takes time for investments and reforms to translate into growth. But given the disappointments of recent weeks, the need for a traditional short-term stimulus – or at least a stabilisation package – is still there.

This is not a turning point

On Thursday, the first estimate of German third-quarter growth will provide a better impression of the current state of the economy. After the contraction in the second quarter, chances of a rebound are lower than the chances of yet another contraction and, in turn, a technical recession. Today's Ifo index suggests that German businesses still bank on the fiscal stimulus to save the economy, even if the economy is heading for a third consecutive year of stagnation.

With all the headwinds from trade, the exchange rate and geopolitics, it is hard to believe that today's Ifo index marks a turning point.

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