German Ifo index surprises in April

A strong belief in resilience or simply ignorance of the tariff extravaganza of the last few weeks? Whatever it is, German businesses look rather unimpressed by recent trade tensions - at least for now

Today's Ifo index comes as a positive surprise, but we'd caution against too premature optimism

Are German businesses just more relaxed than financial markets, or more naive? This is the question that arises after today's Ifo index – Germany's most prominent leading indicator – improved against all odds. In April, the index came in at 86.9, from 86.7 in March.

No impact from the tariff extravaganza of the last weeks at all? Not entirely; the small improvement was driven by a strong increase in the current assessment component, while business expectations dropped to 87.4, from 87.7 in March. But even this drop was mild given the considerable impact US tariffs could potentially have on the German economy. Before hastily jumping to conclusions about whether German businesses see a more resilient economy than financial markets, we would like to remind you that the Ifo index has a long track record in reacting with some delay to political events.

Taking a step back from today's Ifo index, the German economy remains in the middle of two seismic activities: an incoming government, which seems to lack high ambitions for structural reforms but will have access to an unprecedented fiscal space for infrastructure and defence investments, and US tariffs as well as fundamental shifts in trade and geopolitics. We think that at least in the shorter run, the negatives will outweigh the positives. We're also currently witnessing several official forecasts for German growth this year converging with our long-held view of yet another year of stagnation.

Bottoming out is not yet followed by rebound

Combining the latest confidence indicators with available hard data suggests that the German economy has bottomed out in the first quarter of the year, but the first round of tariffs and the related direct and indirect impact will delay even a gradual rebound at least towards the second half of the year. In the longer term, the announced fiscal stimulus will definitely boost growth in Germany. Implemented in the right way, investment in infrastructure should lead to a cyclical upswing, at least. The caveat, however, remains that the fiscal measures alone – impressive as they might be – will do very little to improve the economy's competitiveness. Modern infrastructure is essential for one of the world's largest economies, but it doesn't inherently drive innovation, sector transformation, or new growth opportunities.

At the same time, the exact timing remains unclear as there is no plan yet on when or how much to spend of the newly created fiscal space. The already growing tensions within the incoming new government on annual budgets and spending plans other than infrastructure and defence could undermine or limit the positive impact from Germany's fiscal u-turn.

And there is more to watch in the long run. Just think of the fast-evolving (and still controversial) negotiations and talks to end the war in Ukraine, which could have a full range of possible implications for Europe and Germany, but also the more structural shifts in the global economy if US trade policies don't change. In the latter, changes to the (trade) relationship with China could have significant longer-term implications for the German economy.

All in all, today's Ifo index comes as a positive surprise. Still, we caution against too premature optimism. There are currently more unknowns than knowns for the German economy, and we continue to expect another year of stagnation – which would mark the first time ever for Germany to go through three consecutive years without growth.

Author

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