German businesses accentuate the positives

The ongoing improvement in business sentiment reflects the strong belief in the healing nature of fiscal stimulus

After last week's disappointing GDP numbers, today's Ifo index shows that German companies are still in a Bing Crosby and The Andrews Sisters mood, ac-cent-tchu-ating the positives.

Germany's most prominent leading indicator, the Ifo index, increased for the eighth consecutive month to 89.0 in August, from 88.6 in July. The Ifo index is now at its highest level in more than two years. While the current assessment component actually dropped to 86.4, from 86.5 in July, expectations increased to the highest level since the start of the Russian invasion of Ukraine.

It is still unclear where this optimism is coming from. Is it due to fiscal stimulus, a less benign take on US tariffs, or signs that the turning of the inventory cycle that we saw at the start of the year will pick up steam again? Possible, but definitely not a done deal.

All hopes on fiscal stimulus

Looking ahead, the German economy and industry will be particularly influenced by trade, the exchange rate, and fiscal stimulus. Following last week's disappointing GDP data, it is still unclear how much positive momentum remains in the German economy after the back-and-forth of US tariff frontloading and subsequent reversals. In fact, with the latest framework agreement between the US and the EU, German exports will again be impacted. US tariffs of 15% on most

European goods and uncertainty over whether (and when) the 27.5% tariffs on automotives will be brought back to 15% don't bode well for German exports.

While financial markets seem to have grown numb to tariff announcements, let's not forget that their adverse effects on economies will gradually unfold over time. The German Mittelstand could become a victim of US tariffs, as these hidden champions will have more trouble relocating production than big corporates. Add to that the stronger euro exchange rate – not only against the US dollar, but many other currencies – and it is hard to see how the export-dependent German economy will be able to get out of seemingly never-ending stagnation in the second half of the year.

All of this means that all hopes for a sustainable German recovery are on fiscal stimulus. In this regard, however, the current political debate in Germany on possible austerity measures could undermine the – at least psychological – impact of the announced fiscal stimulus for infrastructure and defence. As much as we subscribe to the need for sustainable public finances and structural reforms for the economy and the budget, it is a debate that would benefit from swift decisions. The longer a debate on potential austerity measures lasts, the higher the risk that households and companies will hold back spending and investment decisions – a risk factor that financial markets seem to have missed so far.

In short, today's Ifo index shows remarkable optimism of German businesses in the healing nature of fiscal stimulus for the economy. While we agree that eventually the government's spending plans for infrastructure and defence will lead to a surge in economic activity, there is still an increasing risk of underachieving. In any case, as much as we sympathise with accentuating the positives, we fear that it could take until the very special season of the year when they play even more popular Bing Crosby songs before the economy really enters a period of substantially stronger growth.

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