

## German Ifo index brings year-end optimism

Germany's most prominent leading indicator, the Ifo index, staged a strong rebound, increasing to 88.6 in December, from 86.4 in November. The index is now back at a level last seen during the summer. Both the current assessment and the expectations components improved in December



Shoppers in Lubeck, Germany

### New optimism still lacks solid fundamentals

At the end of what has once again been a challenging year for the German economy, hope has returned: hope that the economy might even avoid a winter recession or at least hope that it will only be a mild one. Indeed, implemented and announced government fiscal stimulus packages and the lockdown-related backlogs have prevented the economy from falling off a cliff. At the same time, however, the cold winter spell of the last days has shown how quickly filled national gas reserves and gas consumption reductions can disappear again. In the week ending 11 December, for example, gas consumption was only some 5% below the historical average, far away from the 20% reduction that is needed to get safely, and without energy supply disruptions, through the winter.

Looking ahead, the fact that the economy has avoided the worst does not automatically mean

that the only way is up from here. On the contrary, the downsides still outweigh the upsides: new orders have dropped since February and inventories have started to increase again, a combination that never bodes well for future industrial production. Despite some relief in global supply chain frictions, early leading indicators from Taiwan and Korea point to a weakening of global trade in the winter. The next chapter of the pandemic in China will also weigh on trade and supply chains again. Finally, high energy prices are only gradually being passed through to consumers, a trend which will continue throughout 2023, therefore gradually weighing on private consumption.

Looking beyond the short term, the next question will be whether the economy can actually avoid a double dip in the winter of 2023/24. Currently, many official forecasts expect the German economy to return to average quarterly growth rates by mid-2023. We are more cautious and think that the series of structural changes and adjustments will keep the recovery subdued, with a high risk of a double dip.

For now, the winter of 2023/24 is still far away. Today's Ifo index gives a strange feeling of hope and comfort at a time when none of the crisis drivers and fear factors have really disappeared. So the question is whether the risks and fears were overdone previously or whether we have all just got used to these risks and fears, which subjectively make these drivers look less risky. With just a few more days to go before Christmas, we wish that the current optimism is ultimately justified. However, it would not be the first time that in the midst of a structural crisis, early optimism proved to be premature.

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