

German Ifo improves but those recession fears haven't gone away

More sentiment improvement in Germany as the Ifo index increased once again in February. However, the second monthly drop in the current assessment component shows that recession risk in the first quarter is still real



German Economy
Minister Robert Habeck

91.1 German Ifo index
90.2 in January

The inflow of optimistic data continues. After the PMI and the ZEW, it is now the latest Ifo index reading which points to an improving outlook for the German economy. In February, it came in at 91.1, from 90.2 in January, and is back at levels last seen in the summer. It was the fifth consecutive monthly increase. Lower wholesale gas prices and the reopening of the Chinese economy have boosted economic confidence. However, all that glitters is not gold. The current assessment component dropped for the second month in a row and remains weak. It is

expectations which surged and they have now improved for the fifth month in a row.

Resilience thanks to the weather and fiscal stimulus

The German economy has been more resilient despite a long series of crises in 2022, which threatened to push it into a deep recession. The reason for this resilience is not so much the structure of the economy but the mild weather and a simple policy recipe that the German government has successfully used and perfected over the past 15 years but regularly criticises others when they try it: fiscal stimulus.

Contrary to popular belief and what German governments have often preached to other European governments, the government prefers outright fiscal stimulus in times of crisis. This was the case during the financial crisis, the Covid-19 pandemic and now as a response to the war and the energy crisis. During the pandemic and last year's crisis, German governments perfected the use of big ballpark figures, hoping that eventually, not all the money will have to be used. During the pandemic, outright fiscal stimulus amounted to more than 10% of GDP. Last year, after some months of hesitation, the government decided on several stimulus and price cap packages, amounting to around 8% of GDP.

Better is not yet good enough

Today's Ifo index reading is good news and fits into a picture of gradually improving confidence. At the same time, however, there is no reason to start partying. The second consecutive drop in current assessments suggests that the economy could see another quarter of economic contraction. Also, we should not forget that since last summer, there has been some kind of disconnect between hard and soft data. Remember that despite the sharp drop in confidence indicators, the German economy actually grew in the third quarter, and even the small contraction in the fourth should have been much stronger judging from soft indicators. Looking ahead, the question is whether the recent improvement in leading indicators will really translate into positive hard data or whether we could not first see a reversal of last year's disconnect, i.e. improving soft data but disappointing hard data.

We fear we're in the middle of a structural transition

More generally speaking, the latest improvement in soft data suggests that the German and eurozone economies are in the middle of a typical cyclical recovery, while we fear that we are actually in the middle of a structural transition. If we are right, any rebound this year will be softer and more short-lived than many expect and subdued growth rather than a strong rebound remains the base case. Or in other words: not falling off the cliff is one thing; staging a strong rebound, however, is a different matter. In Germany, industrial orders have weakened since the start of 2022, consumer confidence, despite some recent improvements, is still close to historic lows, the loss of purchasing power will continue in 2023 and the full impact of monetary policy tightening still has to unfold. The Chinese reopening and lower wholesale gas prices are clearly mitigating effects but they're probably not offsetting factors.

All in all, today's Ifo index suggests that the worst for the German economy should be behind us. However, numbers don't take away the risk of yet another contraction in the first quarter and,

thus, a technical recession. The German economy is still miles away from staging a strong rebound.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.