

German recovery gains momentum, but tariffs could spoil the party

A strong Ifo index reading in February illustrates what a decent cyclical upswing could look like – if it wasn't for the latest tariff woes



German Chancellor
Friedrich Merz

Is this finally the long-awaited cyclical upswing? Germany's leading indicator, the Ifo index, surged to 88.6 in February, from 87.6 in January. This is the highest level since last summer. Both the current assessment and expectations improved in tandem.

While January's Ifo index was likely still somewhat distorted by the Greenland conflict, today's reading comes before German businesses have had a chance to factor in the latest [tariff uncertainty](#).

In the midst of a cyclical upswing, were it not for the new uncertainty

We have written extensively about ketchup bottles and popcorn in relation to the upcoming cyclical upswing in German manufacturing. In fact, today's Ifo index confirms that we are in the middle of it. It is a cyclical upswing on the back of fiscal spending on defence and infrastructure, and it is a cyclical upswing that is currently illustrated by improving order books and dropping inventories.

With the rapid expansion of defence production capacity, there is a good chance that a large part of defence spending will remain within the domestic economy and not leak to other countries. We see a clearly higher multiplier for defence investments than anticipated a year ago. Last but not least, even though corporates never tire of complaining about elevated energy costs, the government's decision to bring those costs down to one-third of their current levels should bring further relief, if implemented.

However, Germany wouldn't be Germany these days if there weren't a catch to the tentative good news. Renewed tariff uncertainty – now carrying a greater risk of escalating into a full blown trade war than last year – alongside a stronger euro and the recent winter weather, once again forms a long list of potential downside risks. And we are not even mentioning the risk of policy complacency and reluctance or incapability to decide on more structural reforms.

All in all, today's Ifo index paints a picture of what a nice and decent cyclical upswing could look like. Unfortunately, economic narratives from Germany have hardly been fairy tales recently.

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