German Ifo index plunges in June

The Ifo index has dropped or more accurately, collapsed, for the second month in a row, suggesting that the rebound of the German economy has ended before it ever really began

In June, Germany's most prominent leading indicator, the Ifo index, dropped for the second consecutive month, after a six-month expansion, coming in at 88.5 from 91.7 in May. The weaker-than-hoped-for Chinese reopening, a looming US recession and ongoing monetary policy tightening seem to be weighing on German company sentiment. Also, the growing feeling that Germany is in for a longer period of subdued growth seems to have reached German business. Both the current assessment and the expectations component fell. Expectations are now as low as at the end of last year.

Uncomfortable reality check

We still don't know what the best title for the current German economic situation should be: 'The Great Decoupling' or 'The rebound that never came' are clear favourites after today's Ifo index release. Since last year, soft or leading indicators have become rather more 'soft' than 'leading'. Remember that the Ifo index had been on an upward trend since last autumn, while the economy actually shrank by 0.5% quarter-on-quarter in the fourth quarter of 2022 and 0.3% in the first quarter of 2023. An unprecedented war, energy crisis and fiscal stimulus have clearly weakened the relationship between soft and hard data - be it the 50 threshold of PMIs or the trend in other previously reliable indicators like the Ifo index or the European Commission's economic sentiment index. At the current juncture, all traditional leading indicators have to be taken with a large pinch of salt.

Back to the German economy. What is clear is that the optimism at the start of the year seems to have given way to more of a sense of reality. A drop in purchasing power, thinned-out industrial order books, as well as the impact of the most aggressive monetary policy tightening in decades, and the expected slowdown of the US economy all argue in favour of weak economic activity. On top of these cyclical factors, the ongoing war in Ukraine, demographic changes, and the current energy transition will structurally weigh on the German economy in the coming years. However, all is not bleak. The stuttering Chinese rebound could easily bring some temporary positive surprises as well. Also, the drop in headline inflation and the actual fall in energy and food prices combined with higher wages should support private consumption in the second half of the year.

Today's disappointing Ifo index reading suggests that the hoped-for rebound of the German economy is nothing more than hope. Optimism is fading and the economy faces new growth concerns. We are not saying that the economy will be stuck in recession for the next couple of years, but with several short and long-term challenges, growth will remain subdued at best.

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