German Ifo index improves again in January

Germany's most prominent indicator has improved for the fourth month in a row, but the renewed optimism is still based on very fragile fundamentals

The outlook for the German economy still isn't clear. Pictured: skyscrapers in Frankfurt's business district

90.2 German Ifo index

88.6 in December

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 January, the Ifo index came in at 90.2, from 88.6 in December, and is back at levels last seen in the summer. While the drop in the current assessment component illustrates that the economy is definitely not out of the woods yet, expectations continued to improve. Lower wholesale gas prices and the reopening of the Chinese economy have boosted economic confidence. However, the fact that the German economy seems to have avoided the worst doesn't automatically mean the outlook is rosy.

More reslient than feared

Hope has clearly returned to the German economy. The warmer winter weather, along with implemented and announced government fiscal stimulus packages, have prevented the economy from falling off a cliff.

In fact, 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 rather a simple policy recipe that the German government has successfully used over the last 15 years and perfected recently: fiscal stimulus.

Contrary to common belief and what German governments have often preached to other European governments: in times of crisis, the government prefers outright fiscal stimulus. This was the case during the financial crisis, during the Covid-19 pandemic and now as a response to the war and the energy crisis. What German governments perfected during the pandemic and last year's crisis is 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 a total of some 8% of GDP. The announcement effect and the actual money saved the economy from falling into recession, at least for now.

Better is not good

Not falling off the cliff is one thing, staging a strong rebound, however, is a different matter. And there are very few signs pointing to a healthy recovery of the German economy any time soon. First of all, we shouldn't forget that fiscal stimulus over the last three years stabilised but did not really boost the economy. Industrial production is still some 5% below what it was before Covid, and GDP only returned to its pre-pandemic level in the third quarter of 2022. Industrial orders have also weakened since the start of 2022, consumer confidence, despite some recent improvements, is still close to historic lows, and the loss of purchasing power will continue in 2023.

Finally, like every eurozone economy, the German economy still has to digest the full impact of the ECB rate hikes. Demand for mortgages has already started to drop and, as in previous hiking cycles, it didn't take long before the demand for business loans also started to drop. In short, the German economy will still be highly affected by last year's crises throughout 2023.

Germany's economic outlook looks complicated, to say the least

Germany's economic outlook for this year looks complicated, to say the least, with an unprecedentedly high number of uncertainties and developments in opposing directions. And there is more. Let's not forget that the German economy is still facing a series of structural challenges which are likely to weigh on growth this year and beyond: energy supply in the winter of 2023/24 and the broader energy transition towards renewables, changing global trade with more geopolitical risks and changes to supply chains, high investment needs for digitalisation and infrastructure, and an increasing lack of skilled workers. This long list embodies both risks and opportunities. If historical lessons from previous structural transitions are of any guidance, even if managed in the most optimal way, it will take a few years before the economy can actually thrive again.

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