

## German Ifo index increases in May

German business sentiment improved in May as companies seem to ignore the potentially adverse impact from US tariffs



German businesses remain cautiously optimistic. After the back-and-forth on US tariffs, German businesses seem to be focusing on the bright side of what could happen under the new German government, rather than fearing the downsides from ongoing uncertainty and trade tensions. This is, at least, the message that the just-released Ifo index seems to convey. Germany's most prominent leading indicator improved again and came in at 87.3 in May, from 86.9 in April. While the current assessment component weakened to 86.1, from 86.4 in April, expectations improved significantly to 88.9, from 87.4, the highest in a year.

### Between nearer term risks and longer term opportunities

Taking a step back from high frequency data (and noise), the German economy remains in the middle of two seismic activities: a new government, which seems to lack strong ambition for structural reforms but will have access to unprecedented fiscal space for infrastructure and defence investments, and fundamental shifts in trade and geopolitics, including US tariffs. We think that, at least in the shorter run, the negatives will outweigh the positives. Not that we enjoy negative news but we're currently witnessing several official forecasts for German growth this year converging with our long-held view of yet another year of stagnation. Yesterday's forecasts from the Germany council of economic advisors was just another example.

Still, not everything is bad. The German economy actually grew in the first quarter, probably as a result of export frontloading, and industrial data pointed to some cyclical rebound at least before 'Liberation Day'. The tariff extravaganza since the beginning of April, however, will leave clear marks on the German economy. There is the direct impact, as even with the current 90-days-pause, tariffs are still higher than at the start of the year, but also the indirect impact via confidence and still high uncertainty. In the longer term, the announced fiscal stimulus will boost growth in Germany. Implemented in the right way, investment in infrastructure should lead to a cyclical upswing, at least. The caveat, however, remains that the fiscal measures alone – impressive as they might be – will do very little to improve the economy's competitiveness. Modern infrastructure is essential for one of the world's largest economies, but it doesn't inherently drive innovation, sector transformation, or new growth opportunities. In this regard, we still expect tensions within the government about potential expenditure cuts and some structural reforms as the intended additional spending plans, other than infrastructure and defence, are hard to reconcile with the European fiscal rules.

The frustrating observation, however, is that the analysis of a stagnating economy with the need for investment and structural change is not new. While the discussion has been going on for years now, actual action to change the situation has been limited. In fact, due to the tensions within the last government, the elections and the new government just off the starting blocks, another year of economic policy standstill has passed. Last week, Chancellor Friedrich Merz announced that Germans should feel some positive changes by this summer. We agree that a quick implementation of policy and quick results will be needed but remain sceptical that the summer will bring significant change given the long implementation lags of public investment. Rather than seeing tangible improvements, Germans may find themselves noticing little more than old fax machines still lingering on the streets of Berlin. Public investment and structural changes simply take time.

All in all, today's Ifo index comes as a positive surprise. Still, we caution against overly hasty optimism. There are currently more unknowns than knowns for the German economy, and we continue to expect another year of stagnation – which would mark the first time ever for Germany to go through three consecutive years without growth.

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