German Ifo surprises in April

German businesses seem to have become more optimistic again. To us, however, this new wave of optimism feels premature

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Is this new optimism or just a false feeling of new normality? In any case, Germany's most prominent leading indicator, the Ifo index, just increased to 91.8 in April, from 90.8 in March. Both the current assessment and the expectations component increased. However, we warn against this early optimism, as the war in Ukraine will leave much more structural marks on the German economy than Covid.

Leaving the war behind? We think it's too early

Soft indicators paint a very mixed picture of how the war in Ukraine, high energy and commodity prices as well as continuing and new supply chain frictions are affecting the German economy. Against this background, today's rebound of the Ifo index comes as a surprise. Current assessment components had already been holding up well and now expectations have also started to rebound. If these current assessments are any reliable guidance, they could – combined with solid hard data for the first two months of the year – point to the fact that the German economy avoided another contraction in the first quarter. We will know more on Friday when the first estimate of 1Q GDP will be released.

Despite the optimism today's Ifo index seems to reflect, we remain very cautious. Supply chains are still disrupted due to the Shanghai lockdown and the war in Ukraine. Some might be disrupted for good. Elevated uncertainty and fear will weigh on both supply and demand in the coming months. Real disposable incomes of households will suffer, and companies will have increasing difficulties dealing with the costs of higher energy and commodity prices, putting corporate profit margins under pressure.

Even worse, with high energy and commodity prices for a protracted period, possibly even energy supply interruptions, an acceleration of deglobalisation, a possible new cold war, and an export-orientated economy highly dependent on energy, then of course imports will suffer. Government support schemes will dampen the adverse impact of the war but will not be able to avoid stagflation. As much as we welcome optimism, something doesn't feel right about today's Ifo index.

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