German Ifo tanks in March

The war in Ukraine has now affected German economic data. Expectations dropped to the lowest level since the start of the pandemic as German businesses seem to be realising that the war is more of a game-changer for the German economy than Covid has ever been

Germany's most prominent leading indicator, the Ifo index, just tanked to the lowest level since January 2021. While the Purchasing Manager Index yesterday still presented a rather optimistic picture, the Ifo index seems to better reflect the economic implications of the war in Ukraine. The headline reading came in at 90.8 in March, from 98.5 in February. The current assessment mirrored the PMIs, staying relatively solid at 97.0, from 98.6 in February. However, the expectations component saw an even sharper decline than at the start of the pandemic in March 2020, dropping to 85.1, from 99.2 in February.

No more economic rebound but stagflation is the new base case

With the war in Ukraine, the world has dramatically changed. The outlook for the German economy has also dramatically changed. While a month ago, economic prospects for Germany looked bright and a strong rebound was in the making, stagflation has now become the most likely scenario. Higher energy and commodity prices than at the start of the year and probably for a long while, new supply chain disruptions on top of the old ones with a high risk that these supply chains will be disrupted for good, and high uncertainty and fear will weigh on both supply and demand in the coming months.

Even worse, the risk is high that the economic implications of the war are much more of a structural game-changer for the European and particularly the German economy than the pandemic has ever been. With high energy and commodity prices for a protracted period, possibly even energy supply interruptions, and an acceleration of deglobalisation, possibly Cold War 2.0, an export-oriented economy highly dependent on energy imports will suffer. Government support schemes like the ones announced yesterday will dampen the adverse impact of the war but will not be able to avoid stagflation. The only silver lining here is that these squeezes to the economy and the entire economic model will accelerate the green transition and energy independence even more, requiring fiscal stimulus and private investment and eventually leading to a boost in structural international competitiveness.

More precisely for the German economy, the risk of another contraction in the first quarter of the year and hence a technical recession is high. For the entire year, we have revised downwards our growth forecast to 1.6%, which would delay the return of the economy to pre-pandemic levels to the end of this year.

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