

German optimism falls back to earth as Ifo tumbles

Even without ground control calling, German optimism has been brought down by a mix of US tariffs, a stronger euro and the political inability to combine fiscal stimulus with growth-enhancing reforms



After a long series of partially inexplicable rising optimism, the Ifo index – Germany's most prominent leading indicator – dropped sharply in September. The index came in at 87.7, down from 88.9 in August. Both the current assessment and expectations components decreased.

Over the summer, the mood in Germany changed for the worse. Optimism has been grounded, and this is not only due to US tariffs and a stronger euro – two factors that will further complicate the picture for the export industry. It also has to do with domestic politics. Gone seems to be the hope that the new government and fiscal stimulus would finally lift the economy out of its endless stagnation.

Set for another year of stagnation as hopes for reforms fade

Looking ahead, we remain cautious about the near-term outlook for the German economy. The turning of the inventory cycle that we identified as a driver of growth and optimism at the start of the year turned out to be mainly exclusively a result of US front-loading, at least for now. Also, the

stronger euro exchange rate and US tariffs are headwinds for the export industry, whose full impact always takes a while to unfold. This is why all hopes for a sustainable German recovery are still on fiscal stimulus.

Here, however, the current political debate in Germany on possible austerity measures could undermine the – at least psychological – impact of the announced fiscal stimulus for infrastructure and defence. And there is more: as the government shifted previously planned investments from the annual budget to the special investment funds, the shady flavour of creative accounting has entered German fiscal policies. Two developments that, for Germans, not only bring back unpleasant memories of the in-coalition fights of the former government but also bear the risk that households and companies will hold back spending and investment decisions.

Don't get us wrong: the size of the announced German fiscal stimulus, with €500bn for infrastructure investments and a 'whatever it takes' stance on defence investments, remains significant. At some point in time, this money will reach the economy. However, the risk has now risen that, next to fiscal stimulus, there will be very few reforms and measures to structurally boost German competitiveness. Chancellor Friedrich Merz has promised a 'Fall of reforms'. Up until now, the government has not only been stuck for an answer, but it also seems to be stuck in the macroeconomic business model of the 20th century, lacking a plan on how to bring the German economy into the 21st century.

All in all, today's Ifo index serves as a painful reminder of how high hopes can quickly evaporate into thin air. The optimism of the first months of the year has swiftly been brought back down to earth. This does not automatically mean that hopes for a recovery should be given up entirely – but it does mean that the economy is set for yet another year in stagnation. It now really needs a 'Fall of reforms' to make sure that three years of stagnation are not followed by a fourth.

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