

## Germany: Ifo surprisingly stable, but don't get too excited

A surprise increase in the February Ifo together with last week's positive PMI reading should normally be encouraging for the growth prospects of the German economy but we think the risk is things will first get worse before they can get any better



Source: istock

Germany's most prominent leading indicator just surprised with a better-than-expected reading in February, increasing to 96.1, from 96.0 in January.

However, given that in the past, the Ifo index has more often reacted with a lag of one or two months to adverse global events, today's reading should be taken with a pinch of salt. Also, don't forget that the Ifo index had dropped surprisingly in January. Today's reading is still lower than the December reading. A bit striking is the fact that the expectations component increased, while the current assessment component dropped.

## Signs of bottoming out but expect more delays

We would warn against reading too much into single indicators. Being an open economy, Germany is clearly bouncing between many external developments. While some relief from trade argued in favour of a bottoming out of the economy, structural challenges, as well as the impact from coronavirus, are throwing another spanner in the works.

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The manufacturing sector remains Germany's Achilles' heel. While there were tentative signals of a bottoming out at the turn of the year with inventories dropping from high levels, the economic impact from the coronavirus will delay any such bottoming out. In fact, it increasingly looks as if things in the manufacturing sector will first get worse before getting better.

Accounting for roughly 6% of total German exports, weaker Chinese demand will leave its marks on the economy and could accentuate troubles in the automotive industry. However, disruptions to the supply chain could have an even more adverse effect on the German economy. Some 10% of intermediate goods originate in China, mainly for the automotive and pharmaceutical industry. The longer the supply chain disruptions last, the more German companies might try to look for alternatives, which eventually could – at least temporarily – push up prices.

Finally, Chinese tourists have become an important driver of consumption in Germany, accounting for almost half of annual duty-free sales. Often Chinese tourists visit Germany as part of a business trip, making chances of a rebound later this year less likely. Needless to say that recent news about the virus spreading to the Northern part of Italy, the country's industrial backbone, could have additional disruptive effects on the German economy.

### Disadvantage of being an open economy

Last week's PMI readings had given some hope for an improvement, however, the increase in manufacturing PMI was mainly driven by longer delivery times. In normal times, a good leading indicator for future activity but these days rather an indication of supply chain disruptions and consequently less positive.

Today's Ifo reading would in normal times be evidence of at least a bottoming out of the economy. However, these are no normal times. In our view, it is simply too early to gauge the exact impact on the economy, both for companies and analysts.

One thing, however, is clear: as an open economy, Germany is again at the centre of yet another adverse global event.

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