

## Germany: Relief but not a rebound in the Ifo

The Ifo index stabilises after last month's first increase in a year, bringing some relief to Germany's economic toxic mix



First signs of a bottom? The just-released Ifo index gives hope that the German economy is somewhere close to that bottom. After an almost free-fall since the summer of 2018 and 13 drops in 16 months, Germany's leading indicator stabilised in October and remained at 94.6. While the current assessment component dropped to 97.8 from 98.5, the expectations component halted its recent fall and increased to 91.5 from 90.8. The latter signals that the freefall of the economy could have come to a (temporary) halt.

### German economy remains caught in toxic mix

Despite today's Ifo news, the German economy remains caught in the toxic mix of external uncertainties, the global manufacturing slowdown and homemade structural weaknesses. In fact, even though the jury is still out, it looks increasingly hard for the German economy to avoid a technical recession; that would require a strong rebound in economic activity in September.

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## *The service sector seems to have lost its immunity against the manufacturing slowdown*

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What is worrisome currently is the fact that the service sector seems to have lost its immunity against the manufacturing slowdown. Yesterday's PMI services dropped to the lowest level in more than three years, adding to the risk of a negative sentiment loop, while earlier today, German consumer confidence added to recent pessimism as well. The GfK index for November is indicating a consumer climate value of 9.6 points, down 0.2 points from October, falling to its lowest level since November 2016.

Looking ahead, high inventories and thin order books do not bode well for the manufacturing sector in the months ahead. While a likely Brexit extension and positive headlines from trade could bring some short term relief, the experience of recent years suggests we need to be extremely cautious. Some relief can easily be followed by new disappointments. Or to stick to a horror narrative: the monster very often returns before disappearing for good.

## **Fiscal stimulus to the rescue? Watch the labour market**

Simply betting on the external environment to improve, therefore, looks like a dangerous strategy. Even though any recession will not even remotely feel like that of 2008/2009, a scenario of the German economy flirting with stagnation for the years to come is not very attractive either. Consequently, calls for German stimulus will not hush any time soon. In this regards, it is noteworthy that the German government's official narrative has changed once again. It is now twofold: the first narrative stresses that the public and often local administrations are unable to implement public investment decisions taken at the federal level. The second narrative stresses that the government stands ready to act if the economy really needs it. But not now.

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## *Calls for German stimulus will not hush any time soon*

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As for the first, it is true that there is a public administration bottleneck because of austerity measures in the past decade. However, no one would stop federal and local authorities from investing in e-government, hiring more staff or lowering administrative burdens. Also, public investment is now at the eurozone average but would need to exceed it for many years to come in order to close the gap of the last decade.

As for the second, German politics is very regionally-focused. This means that MPs and the government hardly ever act forward-looking but rather backward-looking once an economic development has hit their own constituencies. Also, the fiscal surplus has become politicised. For the CDU, it is one of the last conservative election promise they can stick to. For the SPD, attacking the fiscal surplus fetish before the leadership elections in December would also put pressure on the coalition. All of this means that due to mainly political reasons, there will only be significant fiscal stimulus once the labour market turns.

## Relief but not a rebound

Relief, unfortunately, is not the same as a rebound. However, after endless disappointing macro data out of Germany, today's Ifo reading gives hope that at least a bottoming out could be in sight. Still, the risk of a long flirt with stagnation remains high and with it the risk of a Japanification of the German economy. A bittersweet victory against a real recession, as such a stagnation would give the comfort of avoiding a severe crisis, while at the same time reducing the urgency to add.

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