Economic Research

Economic Briefing

Ifo continues to creep upward

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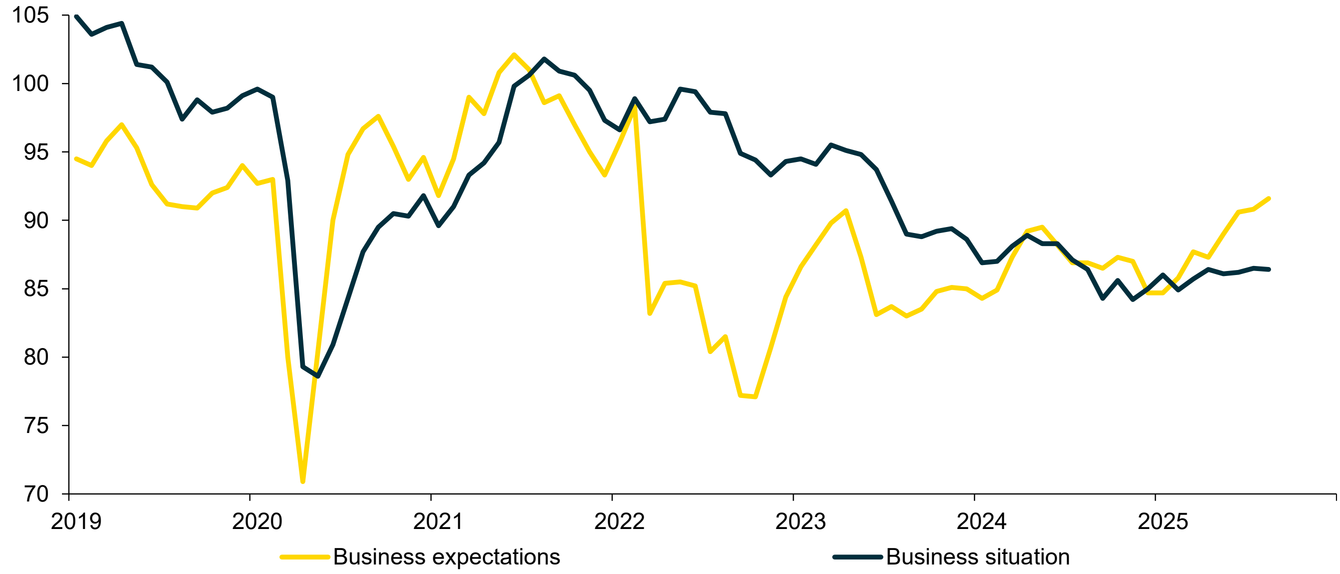
The Ifo business climate index rose from 88.6 to 89.0 points, marking the sixth consecutive increase. Business expectations improved, while the assessment of the current business situation remained virtually unchanged (poor). However, this result is somewhat puzzling given that the overall index rose slightly while sentiment in all sectors deteriorated slightly. Nevertheless, the improvement in the Ifo index, together with the rise in the purchasing managers' index, is fueling hopes that the economy will pick up in the coming months. However, the still relatively low level suggests that the upturn will be only modest.

Overall index improved, ...

As widely expected, the Ifo business climate improved again in August, although the increase was moderate at 89.0, up from 88.6 in July. As in previous months, it was primarily companies' business expectations that brightened. The corresponding sub-index is now as high as it was at the beginning of 2022 before Russia's invasion of Ukraine (Chart 1). By contrast, the assessment of the current business situation has actually deteriorated slightly, meaning that it has improved only marginally since its low point in fall 2024.

Chart 1 - Ifo: Companies anticipate a turnaround

Subcomponents of the Ifo business climate for Germany, 2015=100



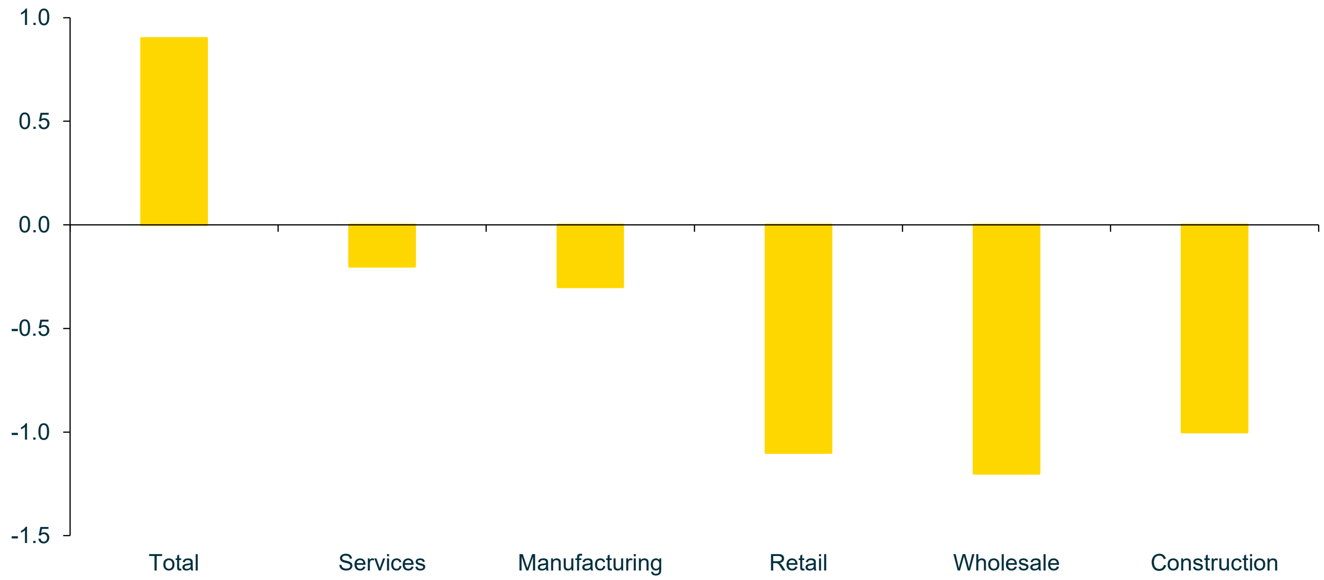
Source: Ifo, S&P Global, Commerzbank Research

... but sentiment worse across all sectors

However, the figures for the individual sectors cast doubt on the significance of the overall index. According to these figures, sentiment among companies in all five sectors covered has deteriorated (Chart 2). This is probably due to the fact that the overall index is calculated from the non-seasonally adjusted series for the sectors and then seasonally adjusted separately from them. As a result, the seasonally adjusted overall index does not necessarily correspond to the aggregate of the seasonally adjusted indices for the sectors. We assume that the (calmer) overall index reflects developments better than the more volatile indices for the individual sectors.

Chart 2 - Ifo for the whole economy higher, index for brnches lower

Ifo business climate, change in diffusion indizes from July to August, in points



Source: Ifo, S&P Global, Commerzbank Research

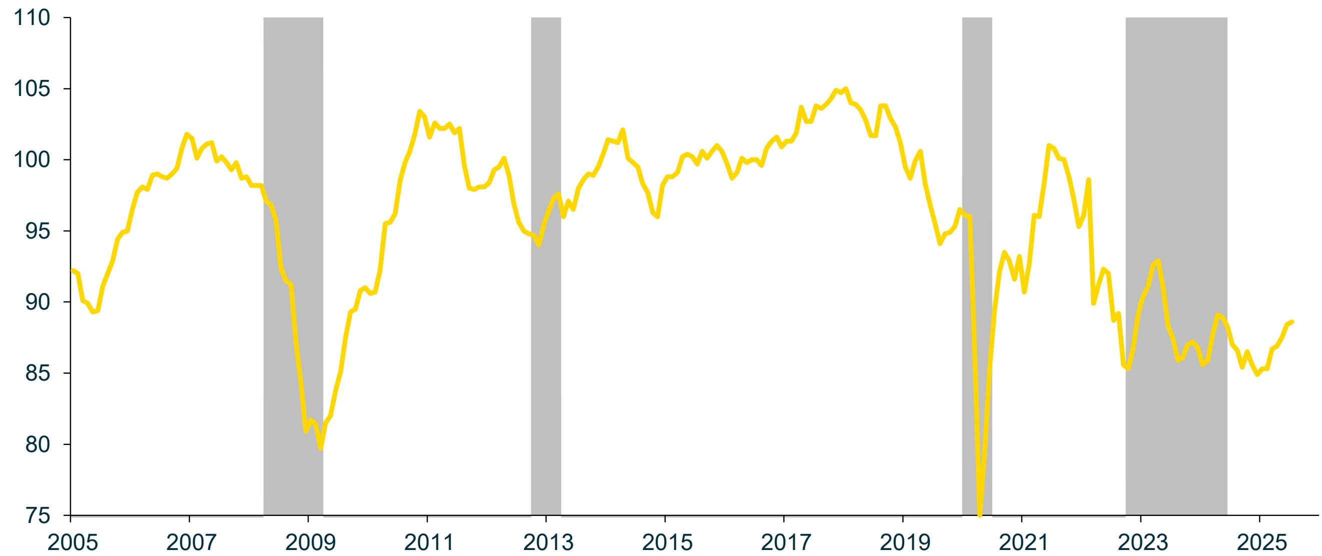
Does the old Ifo rule apply?

If the overall index does indeed prove to be the more meaningful indicator, then the sixth consecutive rise would undoubtedly fulfill the old Ifo rule for a lower turning point (three consecutive rises). However, even this rule can be wrong. For example, the Ifo rose six times in a row at the turn of 2022/23 without fulfilling the hopes it raised for an improved economy in Germany. Instead, the indicator turned downward again and the recession in Germany continued (Chart 3).

Back then, too, the rise in business sentiment was primarily based on improved expectations. However, there was one crucial difference compared to today: at that time, the growing optimism was based on falling energy prices, but many overlooked the fact that the monetary policy environment had deteriorated at the same time due to the ECB's massive interest rate hikes. This time around, the ECB's interest rate cuts, together with significantly more expansionary fiscal policy, should more than offset the negative effects of higher US tariffs. We therefore assume that the steady improvement in the Ifo index correctly signals an imminent upturn, especially as the combined purchasing managers' index has also improved recently. However, the very hesitant rise in the Ifo index suggests that this upturn is likely to be very modest.

Chart 3 - Ifo sometimes sending wrong signals

Ifo business climate for Germany, 2015=100; grey shaded areas mark recessions in the past



Source: Ifo, S&P Global, Commerzbank Research

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