

German economy sees further loss of momentum

Germany's Ifo index dropped for a fourth month in a row in October. The risk of the economy stagnating in the fourth quarter is high



There is very little light in the just-released Ifo index. In fact, Germany's most prominent leading indicator dropped in October for the fourth month in a row, coming in at 97.7. The growth enthusiasm of the summer months has completely gone up in smoke. The last time the Ifo index dropped for four consecutive months was in the summer of 2019. Both the current assessment and the expectations component weakened, suggesting that there is very little hope for a quick turnaround from the current loss of momentum in the German economy.

Economy increasingly unlikely to return to pre-crisis level this year

The German economy continues to suffer from ongoing supply chain frictions, higher inflation in general, and higher energy and commodity prices in particular. Supply chain frictions were already being felt in the second quarter as industrial production shrank, weighing on the overall positive post-lockdown rebound, and they have continued to subdue manufacturing activity in the third quarter. A clear risk for the German economy would be a clear scaling down of new orders as a

result of shortages. Last week's PMIs suggested that demand from the automotive industry has indeed started to drop.

Higher commodity prices are not only adding to companies' costs, they will also dent private consumption. The only upside to this rather negative outlook is that fundamentally, the ingredients for a solid recovery are still there: be it richly-filled order books and low inventories in the manufacturing sector or a strong labour market and excess savings for consumers.

It is hard to predict when the supply chain frictions will be over. In fact, it could take until next summer before all the disruptions have been resolved and supply chains are back to normal. The same holds for energy prices. Here, we currently expect some relief after the winter. All of this means that there is not only an increasing risk that the German economy could come to a complete standstill in the final quarter of the year, there is also the clear risk that the economy will not reach pre-crisis levels this year.

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