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# German Ifo adds to recessionary evidence

A sharp fall in the July Ifo index adds to the long list of downside risks for the German economy

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More recessionary signals. Germany's most prominent leading indicator, the Ifo index, took a strong nosedive at the start of the third quarter. In July, the Ifo index fell sharply to 88.6, from 92.3 in June. Both the current assessment and expectations component dropped, with the expectations component experiencing the sharpest drop since March and the third largest drop since the pandemic started. Today's Ifo index illustrates that the list of downside risks for the German economy is getting longer and longer.

## Already in recession?

The latest hard macro data has confirmed our concern that the economy might already have contracted in the second quarter of the year. Admittedly, this is only data up to May but almost all of the data is down compared with the first quarter. If it weren't for still relatively strong business sentiment and a particularly solid current assessment, a contraction would have been the consensus view already. At face value, absolute levels of most leading indicators suggest that the German economy should have grown in the second quarter. However, supportive factors for the economy such as post-lockdown reopenings and filled order books have been losing momentum rapidly. Weaker global demand, supply chain frictions, and high inflation denting consumption are hitting the German economy. In fact, consumer confidence is already in clear recession territory and it looks as if the rest of the economy is quickly following suit. With this in mind, we expect a contraction of the German economy already in the second quarter. We will know more about it on Friday when the first estimate for 2Q GDP growth is released.

## Long list of downside risks

Needless to say that currently, there are more downside than upside risks to the outlook. The single largest risk is further disruption to Germany's energy consumption and a complete stop in the Russian gas supply. The reopening of the NordStream1 pipeline last week has already helped to fill up Germany's gas reserves, which currently stand at around 66%. To get through the winter without any Russian gas, the government intended to have reserves filled up to 90%. This target increasingly looks unachievable and explains why over the weekend, the first prominent Green politicians opened the door to an extension of the last three nuclear power plants, which are still scheduled to close down at the end of this year. A further escalation in the energy crisis will remain a key risk for the economy going into the winter.

Even if the current holiday mood wants to make us believe that all is well, the outlook for the German economy is anything but rosy. Currently, in the base case scenario with continuing supply chain frictions, uncertainty and high energy and commodity prices as a result of the ongoing war in Ukraine, the German economy will be pushed into a technical recession. To make matters worse, the current dry weather has reduced water levels in the main rivers close to their 2018 levels, when low water levels led to the disruption of supply chains. All of this makes for a perfect storm in the second half of the year.

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