

German industry continues to suffer under supply chain frictions

Instead of the hoped-for rebound, disappointing industrial production in August suggests that the traditional growth engine of the German economy will again be a drag on growth in the third quarter.



Industrial production took a hit in August, dropping by 4% month-on-month, illustrating that supply chain frictions have become a bigger threat to German industry than the pandemic.

On the year, industrial production was only up by 1.7%, from 6% in July. With the August drop, German industrial production has dropped in six out of the first eight months of this year. It would require a rebound of around 8% MoM in September to bring third quarter industrial production above its second quarter level. As this looks very unlikely, German industry seems set for another quarter of shrinking activity, weighing on the entire economy.

It's all about supply chain frictions

German industry is facing a challenging and complex environment. When lockdown restrictions were lifted around the world, supply chain frictions overshadowed any rebound effect and sent industrial production into negative territory. With today's data, industrial production is very likely to be a drag on growth in the third quarter again.

Looking ahead, despite yesterday's sharp drop, order books are still richly filled and inventories remain low. Under normal circumstances this should be a safe bet for industrial production to surge. However, there currently are no normal circumstances for industry as supply chain frictions have become an enormous obstacle. In the European Commission's survey on limits to production, 'equipment' is at an all-time-high. At the same time, the lack of skilled workers has become as pressing as in 2018, when the German industry was close to overheating.

The fact that, despite filled order books and low inventories, German industry has been a drag and not a driver of economic growth shows the downside of international production processes. Supply chain frictions have completely undermined strong fundamentals. At some point in time the high backlog will have to be reduced and should lead to a surge in industrial activity again. It currently looks as if this moment will come rather later than sooner.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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