Germany: Bad, worse, Ifo

Germans are losing their optimism. The drop in the Ifo index increases the risk of a negative sentiment loop

The German economy should be careful it doesn't hit a 'bonk', a condition of sudden fatigue often used in cycling

Still no silver linings for the German economy. The just-released most prominent leading indicator, the Ifo index, instead suggests the risk of a negative sentiment loop is larger than ever. In July, the Ifo index dropped for the tenth time in the last eleven months since August last year. At 95.7, from 97.5 in June, the Ifo index stands at its lowest level since late-2012. Both the current assessment and expectation components dropped significantly.

External woes start harming the domestic economy

The German economy increasingly looks like a racing cyclist who has been on solo breakaways from the Eurozone peloton for a long while but is now running out of energy. The industry has been in a constant downswing since last summer. First the slowdown was mainly the result of one-off factors but by now has become rather structural. Even worse, there are tentative signs that the industrial downswing has started to leave some marks on the domestic economy, which up to now had been very resistant to external weaknesses. Order books have shrunk to levels at which companies are reducing production capacities, as illustrated by the increase in (partly subsidised) shorter working hours scheme but also by companies' profit warnings and announcements of lay-offs.

Currently, the increase in short-time work schemes is still only a fraction of the increases seen during the 2009 recession. Currently, some 50 000 employees are running under the shorter working hours scheme. In 2009, it was more than 1.5 million. However, the domestic protection shield against external uncertainties and risks is clearly crumbling. To make things worse, the current heatwave and the third consecutive dry summer is very likely to slow down growth in the second half of the year (again). The water levels in the Rhine have started to fall in a similar magnitude to last summer. The economic harm last year was only done when water levels dropped further during the very dry autumn season. Therefore, it is too early to panic. However, if water levels were to drop further, leading to a repetition of the 2018 events, the entire economy would suffer. Last year, the low water levels reduced quarterly GDP growth by a total of 0.3 pp in the second half of the year.

The most dangerous crossroads since 2009

All in all, the German economy is currently at a dangerous crossroads. The powerful recession insurance, domestic demand, is crumbling. Against the background of constantly weakening sentiment, it is doubtful whether domestic demand could rebound without external support, i.e. fiscal stimulus or trade relief. Getting back to that racing cyclist, the German economy needs to watch out that it does not suffer from a typical bonk, collapsing in a leading position and then finishing the race at the end of the peloton. Every cyclist knows that constant – legal – stimulus is the best prevention against a bonk.

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