

Germany: Dented optimism

A sharp fall in Ifo expectations illustrates how the current lockdown has almost entirely sapped the summer optimism



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When looking at the latest Ifo index, remember that a large part of economic activity is about psychology.

Germany's most prominent leading indicator is losing ground and just recorded the worst monthly drop since April 2013 (excluding this year's Covid-19-related swings).

In November, the Ifo index came in at 90.7, from 92.5 in October - the second consecutive decline. While the current assessment component remained relatively stable at 90.0, from 90.4 in October, the expectations component recorded its largest drop since August 2011 (again excluding this year's Covid-19 swings). In fact, within two months' time, German businesses seem to have lost most of their summer optimism.

Things will get worse before they get better

So the economy is losing momentum and Germany is in the middle of a second lockdown, but will the economy also drop into the contractionary territory?

In our view, a double-dip looks inevitable. Admittedly, the second lockdown will not have the same

negative impact on the economy as the first. However, the new lockdown measures are hitting sectors which had already been suffering from the first lockdown, accounting for roughly 10% of total German employment. Also, don't underestimate the psychological impact, which is likely to turn involuntary savings into precautionary savings, and an increased risk of companies going out of business.

The only hope for the economy to avoid a contraction comes from a surprisingly strong manufacturing and export sector. However, as yesterday's PMIs suggested, the manufacturing sector is also losing momentum and with most other eurozone countries in (partial) lockdown, as well as the currently discussed option in Germany to close factories for the last two weeks of the year, it will be very hard for the manufacturing sector to prevent the total economy from falling into contraction.

Today's Ifo index illustrates how the latest lockdown measures in Germany, but also across Europe, have dented the summer optimism. The only upside is that more news about a vaccine and a timetable to roll it out should soon help to bring back this optimism.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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