

## Germany: Still free fallin'

More bad news out of Germany. Another horrible Ifo reading weakens hopes for a rebound of the economy from its own strength



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The just-released most prominent leading indicator, the Ifo index, instead suggests the risk of a negative sentiment loop is larger than ever. In August, the Ifo index dropped for the eleventh time in the last twelve months since August last year. At 94.3, from 95.8 in July, the Ifo index stands at its lowest level since late-2012. One year ago, the Ifo index stood at 104.2, close to an all-time high. In August, both the current assessment and expectation components dropped significantly. The expectation component dropped to the lowest level since June 2009.

In particular, the German manufacturing sector still seems to be in free fall. At least in the short run, there is very little hope for a rebound. High inventories and smaller order books do not bode well for industrial activity in the coming months. It would take some relief from the ongoing trade conflicts and a general sentiment improvement to boost industrial activity at least towards the end of the year. At the same time, the manufacturing downturn and never-ending external woes have started to bruise the domestic economy. So far, it is only tentative signs like companies' profit warnings, a small increase in short-time work schemes and weaker consumer confidence, but these tentative signs could easily mutate into severe problems.

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## *The free fall of the German economy continues*

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Against the background of the economy's contraction in 2Q and the industrial slowdown, calls for some government action are getting louder by the day. As for so many things in Germany (and often also in Europe), however, the issue of whether or not the government should agree on fiscal stimulus is not answered overnight. It is a gradual process. To gauge the likelihood and the size of any German stimulus, the domestic economy will be the indicator to watch. The more and harder the domestic economy will be hit by the current slowdown, the higher the likelihood of a significant fiscal package. Currently, there are in our view plenty of arguments in favour of a two-pillared fiscal stimulus, consisting of (i) short-term stimulus to break-through the current negative sentiment loop and (ii) longer-term investment measures to finally clear the backlogs regarding infrastructure, digitalisation and education. However, such a big stimulus package does not seem to be on the cards yet. Instead, we expect the German government to decide on a small investment package, possibly outside the budget, to tackle climate change in September and to agree on stopping the solidarity tax (i.e. a de facto relief on the income tax). However, of any such package, headlines will probably be bigger than its actual size.

The free fall of the German economy continues. Today's Ifo index marks another low-point and can be described with one simple word: "horrible". Within one year, the German economy has made a complete turnaround, unfortunately not for the better but for the worse.

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