

Weak German Ifo reading reminds us that stagflation is the base case

A weak Ifo reading in June should remind everyone that the German economy is feeling the full economic impact of the war in Ukraine, broader supply chain frictions, and higher inflation



Consumer confidence in Germany is already in clear recession territory

Short-lived optimism

After two months of improving business sentiment, Germany's most prominent leading indicator, the Ifo index, just delivered a reality check and dented any premature optimism. The Ifo index dropped to 92.3 in June, from 93.0 in May. In March, the Ifo stood at 90.8. Both the current assessment and the expectations component weakened in June, with expectations almost back down to the March levels. The reasons for dampened optimism are clear: the war in Ukraine, lockdowns in China and the consequent supply chain frictions, higher costs and prices, and weakening demand. It is actually not the first time German business sentiment seems to have had a delayed reaction to global events.

Stagflation remains our base case scenario for the German economy

Yesterday, the German PMI fell for the fourth consecutive month, to the lowest level since the

fourth wave of the Covid-19 pandemic. The PMI details showed another sharp inventory build-up and a cooling in the services sector, a combination that definitely doesn't bode well for future economic activity.

In fact, 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. Supply chains continue to be disrupted due to the Shanghai lockdown and the war in Ukraine. Some might be disrupted for good. Elevated uncertainty and fear will weigh on both supply and demand in the coming months. Real disposable incomes of households will suffer, and companies will have increasing difficulties dealing with the costs of higher energy and commodity prices, putting corporate profit margins under pressure. Not a happy-go-lucky story.

The German economy will definitely not plunge as it did during the 2020 lockdowns. However, consumer confidence is already in clear recession territory and today's Ifo reading, as well as yesterday's PMI reading, both suggest that the manufacturing sector is quickly following suit. Stagflation for the rest of the year remains our base case scenario for the German economy, and an outright recession is our risk scenario.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.