

Economic Briefing

25 October 2021

Ifo - Stagflation in the fourth quarter

The fourth consecutive decline in the Ifo business climate (97.7 after 98.9 in Sept) is a warning signal. Companies expect that politicians will react to the sharp rise in Corona infections with new restrictions. Moreover, the new Corona wave may lead to factory closures, especially in Asia, which will exacerbate supply shortages globally. The German economy is unlikely to grow much in the fourth quarter. Stagflation is on the horizon for this quarter at least.

The Ifo Business Climate for the German economy fell again in October, from 98.9 to 97.7; it was slightly below expectations (consensus: 97.9; Commerzbank: 98.0). As in previous months, the decline was mainly due to gloomy expectations for the coming six months (95.4 after 97.4 in September). By contrast, companies downgraded the current business situation comparatively little (100.1 after 100.4).

With the exception of construction, business expectations fell in all sectors (see chart). The companies' concerns are justified for two reasons:

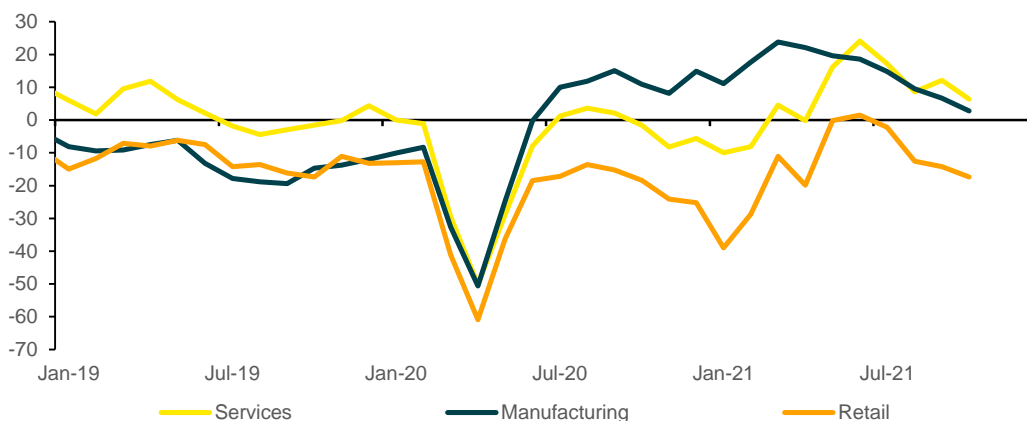
- **New Corona wave:** The new Corona wave has started. The 7-day incidence is already at 110 and rising steeply. It is only a matter of time before politicians react to this with more restrictions. We had already assumed a transition to a so-called G2 rule, so that the quarter of adult Germans who are not yet vaccinated would de facto be excluded from many contact-intensive services. In addition, the range of affected businesses could be extended to include the retail sector, as in mid-December 2020. Restrictions on vaccinated persons are also conceivable if infections spread so quickly that the stability of the health system is at risk.
- **Supply bottlenecks:** Already in September, 77.4% of industrial companies had complained about production hindrances due to supply bottlenecks. This share is likely to have risen again in October. As the global Corona wave is frequently leading to factory and port closures, especially in Asia, there is no end in sight to the supply bottlenecks.

Hardly any growth in the fourth quarter

In the third quarter, German GDP is estimated to have grown strongly by 2% compared to the second quarter because of the easing of Corona restrictions in the spring. But because of the new Corona wave, the shortage of materials and because the catch-up process in the services sector has now largely been completed after the easing in the spring, growth in the German economy is likely to slow massively in the fourth quarter. We expect only a meager plus (0.2%) compared to the third quarter. At the same time, inflation is likely to pick up further. Stagflation is on the horizon for the fourth quarter at least.

Firms are afraid of 4th corona wave and material shortage

Ifo business expectations, diffusion index



Source: Global Insight, Commerzbank Research

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