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Soaring costs and shortages push German industry to the brink

By Anna Cooban and Inke Kappeler, CNN Business

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01:21 - Source: CNNBusiness

3 reasons why Deutsche Bank is forecasting a recession

Correction: An earlier version of this article incorrectly stated which EU countries had already been cut off from Russian gas supplies.

London/Berlin (CNN Business) — Siempelkamp Giesserei has seen its fair share of crises in its 99 years. But pandemic shutdowns, supply chain disruptions and soaring energy prices have thrown the Düsseldorf metals factory into uncharted territory.

"There has never been anything like this before," Georg Geier, the company's managing director, told CNN Business.

The major difference between past and present? Customer demand is high, but Siempelkamp either can't find, or can't afford, the supplies of the iron, nickel and energy it needs.

It is a similar story at many of Germany's manufacturing businesses, which contribute almost a fifth of its GDP, according to the World Bank. Industry behemoths like Volkswagen (VLKAF) and Siemens (SIEGY) are grappling with supply chain bottlenecks too, but it is Germany's roughly 200,000 small and medium-sized manufacturers who are less able to withstand the shock.

These companies are a vital part of the "Mittelstand," the 2.6 million small- and medium-sized enterprises that account for more than half of German economic output and nearly two-thirds of the country's jobs. Many are family-owned and deeply integrated into rural communities.

Sascha Schuermann/Getty Images

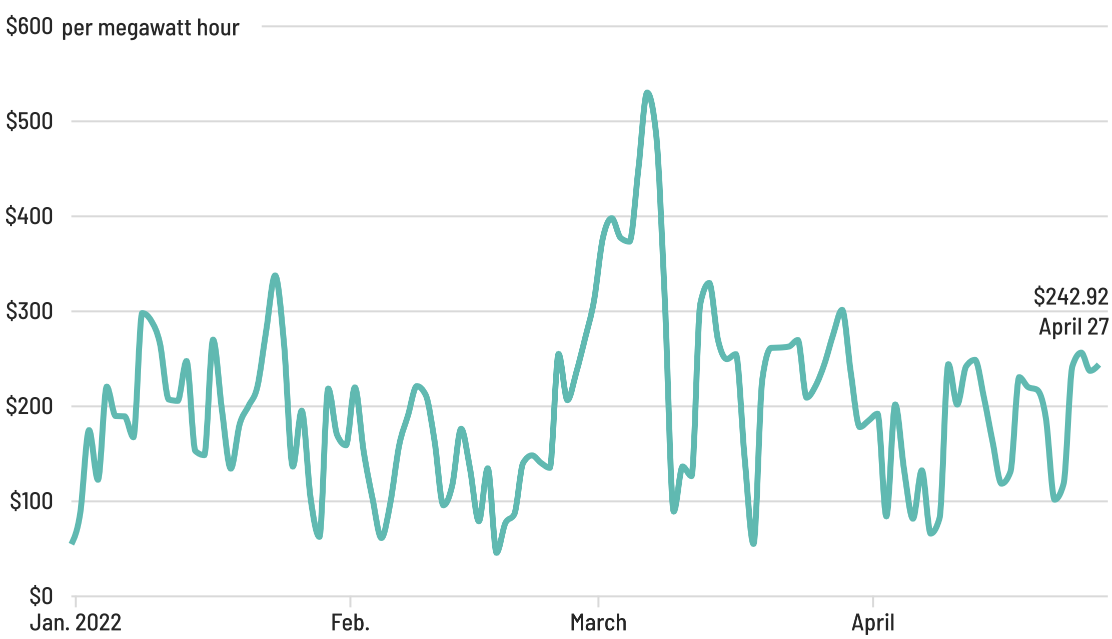
A worker pours molten iron into a mould at the Siempelkamp Giesserei foundry on April 21, 2022 in Krefeld, Germany.

The Siempelkamp foundry burns enough energy each year to power a town of 20,000 people. For years, the company paid between €40 ($43) and €50 ($53) per megawatt hour of electricity. But its bills shot up around September and "exploded" to all-time highs after Russia invaded Ukraine, Geier said. Average prices in March were around €250 ($267) per megawatt hour.

"We're made aware [of our energy costs] nearly each and every day," Geier said. "When we get up until we get out."

Electricity prices rise in Germany

Electricity prices in Germany spiked in March following Russia's invasion of Ukraine.



Note: Data as of April 27, 2022, at 3:30 p.m. ET

Source: Refinitiv
Graphic: Tal Yellin, CNN

The war has stoked global inflation, which had begun to accelerate last year as economies reopened from pandemic lockdowns, causing a surge in demand for energy and goods. Now, Western sanctions on Russia's coal and oil exports — and efforts by the European Union to slash consumption of its natural gas — have pushed prices up again. Sanctions on Russia, a major metals exporter, have further scrambled supply chains.

Europe's biggest economy is particularly vulnerable. According to the International Energy Agency, Germany relied on Russia for about 46% of its natural gas consumption in 2020. That number is likely to have fallen since the war started, but any sudden interruption in imports from Russia would be "catastrophic" for manufacturers like Siempelkamp, Geier said.

Spiraling prices

So far, Siempelkamp has not cut production, but is passing on eye-watering cost increases to its customers, such as the copper and cement producers that use its grinding mills, and electric car makers that use its machines. In turn, it expects its clients to pass costs to consumers.

Germany's annual producer price inflation — that's the price of goods leaving factories — topped 30% in March, the highest level in 73 years.

Prices at the factory gate are feeding into consumer price inflation, which hit a 41-year high of 7.3% last month. In both cases, surging energy prices were the biggest contributor. There was no relief in April, with consumer prices rising by 7.4% over the same month last year, according to a preliminary estimate.

In Berlin, an ice cream maker is also feeling the strain.

Florida Eis is partly insulated from high prices — it has switched much of the energy it uses for production and delivery to renewable sources — but its suppliers are not. The company now is paying between 30% and 40% more for its milk.

Its owner Olaf Höhn shudders at the thought of the loss of Russian gas.

"The sugar industry needs an enormous amount of energy. If they do not have gas any more, there would not be raw sugar any more," Höhn said. "We cannot buy raw sugar on the world market due to EU regulations."

"We would have tremendous cutbacks up to a complete standstill," he added.

Paul Zinken/picture alliance/Getty Images

Ice cream boxes are pictured on a conveyor belt of ice cream manufacturer Florida Eis in Berlin, Germany, in July 2015.

Rocketing prices have rattled a country that has long prided itself on its stable economy, and that still carries a deep-rooted fear of the kind of hyperinflation of the 1920s and 1930s that is widely thought to have helped the Nazi party rise to power.

Siempelkamp Managing Director Dirk Howe wonders how long this can all last.

"We are in a kind of spiral right now," he told CNN Business.

Germany's appetite for relatively cheap and reliable Russian energy was long a competitive advantage, and helped it weather past economic crises, said Tamas Vonyo, an associate professor of economic history at Bocconi University.

That advantage has now become a liability.

EU leaders have pledged to reduce consumption of Russian gas by 66% before the end of this year, and to break the bloc's dependence on Russian oil and gas by 2027. Germany's economic ministry said last month that it had already slashed Russia's share of total gas imports from 55% to 40%.

But a sudden stop would be disastrous. After Putin threatened to turn off the taps if countries did not pay in rubles, the German government initiated the first of a three-stage emergency plan that could lead to gas rationing. Households and hospitals would take priority over many manufacturers.

Krisztian Bocsi/Bloomberg/Getty Images

Fuel prices on a sign at a Total gas station in Berlin, Germany, on Tuesday, March 15, 2022.

Russian energy giant Gazprom cut off gas supplies to Poland and Bulgaria on Wednesday because they had not made payments in rubles. Many fear Germany could be next.

An abrupt break would slice almost 2% off German GDP in 2022, according to the country's central bank. An analysis by five of the country's top economic institutes this month also said that a sudden embargo would result in 550,000 job losses across 2022 and 2023.

"Natural gas probably will remain expensive after an embargo or supply cut for quite a significant time," Sebastian Dullien, research director at the Macroeconomic Policy Institute, told CNN Business.

He warned of “structural damage” to Germany’s economy if Russia cuts off its gas — damage that will be more difficult to recover from than the 2008 financial crisis. That could create a recession at least as deep and potentially much longer lasting than a decade ago.

‘Stagflation’ fears

Inflation is only part of the story.

Germany’s economy may already be heading into a recession. The German Council of Economic Experts, a government advisory group, last month cut its forecast for GDP growth in 2022 from 4.6% to 1.8%, citing inflation and the war in Ukraine.

Sven Hoppe/picture alliance/Getty Images

A woman walks through a supermarket with her shopping cart on March 31, 2022, in Neubiberg, Bavaria.

Manufacturing output contracted this month, falling to its lowest level since June 2020, according to survey data from S&P Global, and slumping confidence could spell a protracted downturn.

“The risk [of a recession], I would say, is more than 50% at the moment,” Dullien said.

Germany, and indeed much of Europe, is now staring at stagflation — that nightmare combination of high inflation and weak economic growth.

‘We have to cope’

Companies and countries are grappling with shortages of staple foods and raw materials. For example, rocketing energy prices have contributed to a drop in zinc production, a metal used to protect steel, while Russia’s invasion of Ukraine has put the global supply of wheat at risk. Together, both countries account for about 30% of global wheat trade.

Germany’s association for small and medium-sized businesses, said some of its members were already cutting back production due to shortages.

“[Production cuts are] not the result of a lack of electricity, or high electricity prices, but [because] they don’t have materials to produce the goods,” Hans-Jürgen Völz, the association’s chief economist, told CNN Business.

“For instance, aluminum, steel and everything [else] that is in short supply right now all over the world because of sanctions against Russia.”

The war in Ukraine has sparked fears of a fall in raw material exports from the region. Nickel prices, a metal used in electric vehicle batteries, soared to an all-time high in early March, doubling to $100,000 per metric ton, and triggering the London Metal Exchange to suspend trading.

That’s bad news for Germany’s auto industry, which is still battling a shortage of semiconductor chips.

Delays at China’s Shanghai Port — one of the world’s busiest — due to a strict coronavirus lockdown in the city have also snarled global supply chains in recent weeks. The bottlenecks could not have come at a worse time for Germany’s importers.

Höhn, at Florida Eis, considers himself an optimist, but even he can’t ignore the “dark clouds” gathering over the German economy.

“We have to cope,” he said.