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GERMAN IFO: FROM STRENGTH TO STRENGTH

Berenberg Macro Flash

German Ifo, July

	Business climate	Expectations	Current assessment
Actual:	116.0	107.3	125.4
Previous:	115.2	106.8	124.2
Consensus:	114.9	106.5	123.8
Berenberg:	114.9	106.5	123.8

No cooling, the sun is shining as strong as ever: The German Ifo survey did not halt its ascent in July, as we and others had expected, and other recent soft data had suggested. Instead, the business climate among German businesses improved in July to a fresh post-unification high for the third month in a row. Both the assessment of the current situation and expectations rose further. The reading contradicts yesterday's PMI and last week's ZEW surveys which suggested that Germany may be losing a little momentum in the third quarter. There is a chance that economic growth in Q3 beats our forecast for a less exuberant pace of 0.4% qoq in Q3, after 0.6% in Q1 and (likely) Q2.

The Ifo does it yet again: Business climate improved from 115.2 in June to 116.0 in July, the highest level ever recorded since the start of the pan-German series in 1991. Both firms' expectations and their assessment of the current situation increased (from 106.8 to 107.8 and from 124.2 to 125.4, respectively) (see chart 1). The Ifo's two main components have trended up since the start of the year. The averages for both expectations and the assessment of the current situation so far this year are well above their averages of the previous year (105.5 and 121.4 versus 102.6 and 114.3 in 2016). The Ifo business cycle clock, which combines expectations and the current business situation on two separate axes, suggests that the pan-German economy has never been deeper in the boom sphere (see chart 2).

Broad-based gains across sectors: On a sector basis, sentiment among **manufacturers** continued its strong gains since the beginning of the year (the diffusion index reached 29.5 after 26.2 in June) and reached a new post-unification high. As current demand advanced to a new record and capacity utilisation rose significantly, manufacturers plan to ramp up production. Driven by healthy demand for German products across the globe, manufacturing remains a main engine of economic growth. Industrial production excluding construction rose by 1.4% mom in May and by 1.8% taken April and May together compared to the first quarter. The recently stronger Euro (more than 4% versus the USD over the past month) may cost some competitiveness in export markets, but the message of the Ifo seems to be that this effect could be offset by the firmer global recovery raising demand for German products further. Sentiment among **construction** firms also rose, from 12.6 to 14.2, improving the record level it had reached in May further. Construction output was already at a high level in April and May, with the average of the two months 3.3% up compared to Q1. The show seems to go on. Sentiment in **wholesaling** edged higher on the back of far better business expectations. The **retail** sector suffered a setback to the assessment of the current and future situation – both components, however, remain at high levels. Consumers are confident. The GfK consumer climate and income expectations are at a very high level. Together with the favourable labour market and pick-up in retail sales (the average of April and May was 0.9% up compared to Q1), private consumption should have held up during Q2, and should continue to do so in Q3, despite a less subdued rate of inflation compared to



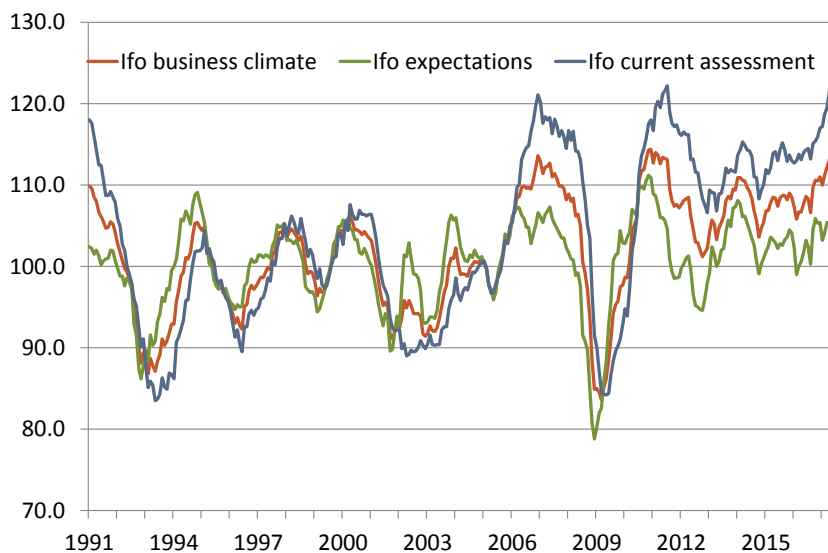
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2016. The Ifo surveys cover 40% of the German economy – manufacturing, construction, wholesale and retail trade. The remaining 60% are services (excluding wholesale and retail trade).

Mixed soft data suggest plateau of sentiment and activity: The Ifo survey is the most representative gauge of the German economy. Unlike the ZEW it captures the perceptions of businesses, rather than finance professionals – who may have lowered their expectations in response to a drop of the DAX by more than 3% over the the last month. Yesterday’s flash PMI composite, however, also pointed to a slowdown of the German economy – for the second month in a row. The Ifo and the PMI often deviate in short-term fluctuations, but trends are very similar. Taken together the July round of soft data so far suggests we are reaching somewhat of a peak in sentiment and activity.

Outlook positive, chance that GDP growth holds up its exuberant pace in Q3: Surveys have exaggerated the underlying strength of the economy in the first half of this year. For that reason, we believe GDP growth remained at a strong rate of 0.6% qoq rather than accelerating further in Q2. A first estimate will be published on 15 August. In line with more sustainable levels of sentiment, capacity constraints in some sectors of the industry and the recently stronger euro limiting the upside potential of exports slightly, we expect some slowdown to 0.4% qoq in Q3. As the encouraging gain in Ifo business expectations shows, the risks to our calls are clearly tilted to the upside (see chart 3). The German economy may, in fact, continue to expand with robust momentum in the second quarter of 2017.

Chart 1: Ifo business climate, current assessment and expectations



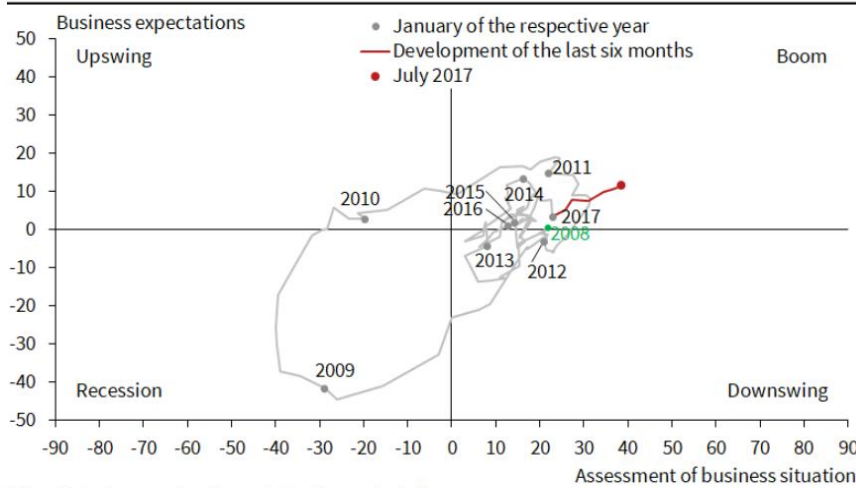
Source: Ifo



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Chart 2: Ifo business cycle clock

Balances, seasonally adjusted

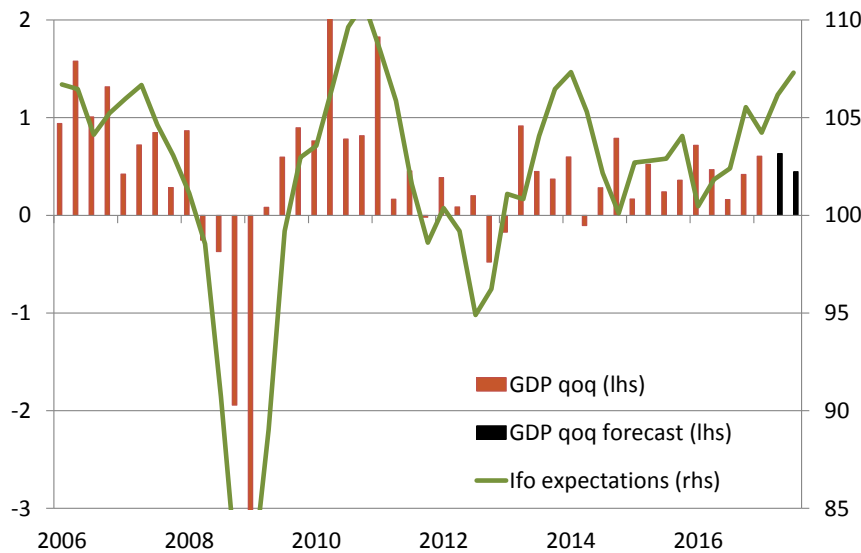


* Manufacturing, construction, wholesaling and retailing.
Source: Ifo Business Survey, July 2017.

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Source: Ifo

Chart 3: German GDP qoq (in %) versus Ifo business expectations



Quarterly average for Ifo, July as a proxy for Q3. Source: Destatis, Ifo, Berenberg calculations

German Ifo

	JUL	JUN	MAY	APR	MAR	FEB
Business climate	116.0	115.2	114.6	113.1	112.2	111.2
Expectations	107.3	106.8	106.5	105.2	105.4	104.1
Current assessment	125.4	124.2	123.3	121.1	119.5	118.7



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