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**IFO: GERMANY ENJOYS ITS GOLDEN DECADE**

## Berenberg Macro Flash

**German Ifo, October**

	Business climate	Expectations	Current assessment
<b>Actual:</b>	<b>116.7</b>	<b>109.1</b>	<b>124.8</b>
Previous:	115.3	107.5	123.7
Consensus:	115.1	107.4	123.5
Berenberg:	115.0	107.2	123.4

**Upside risks to our Q4 call, strong pace likely to hold up for longer:** Election? What election? The business climate among German businesses improved in October to a fresh post-unification high. This compares to our and the market's expectations that the German Ifo survey would rather normalise further from its high in July. Our view so far has been that GDP growth peaked in H1 and is turning slightly more moderate throughout H2, from an annualised rate of 2.7% to 2.2%. We maintain that view. Yesterday's PMI suggested that Germany may be losing a little momentum in the fourth quarter. Today's Ifo reading, however, suggests that the moderation is taking place later or at a slower pace. For that reason, there is a chance that economic growth in Q4 beats our forecast for a less exuberant pace of 0.5% qoq, after 0.7% in Q1, 0.6% in Q2 and (likely) 0.6% in Q3.

**From strength to strength, to strength – fresh post-unification high:** Business climate improved from 115.3 in September to 116.7 in October. Both firms' assessment of the current situation and their expectations increased (from 107.5 to 109.1 and from 123.7 to 124.8, respectively) (see chart 1). The Ifo's two main components had trended up from the start of the year until July before heading slightly downwards in August and September. 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 (106.3 and 122.4 versus 102.6 and 114.3 in 2016, respectively). The Ifo business cycle clock, which combines expectations and the current business situation on two separate axes, suggests that the pan-German economy is enjoying the greatest boom since 1991 (see chart 2).

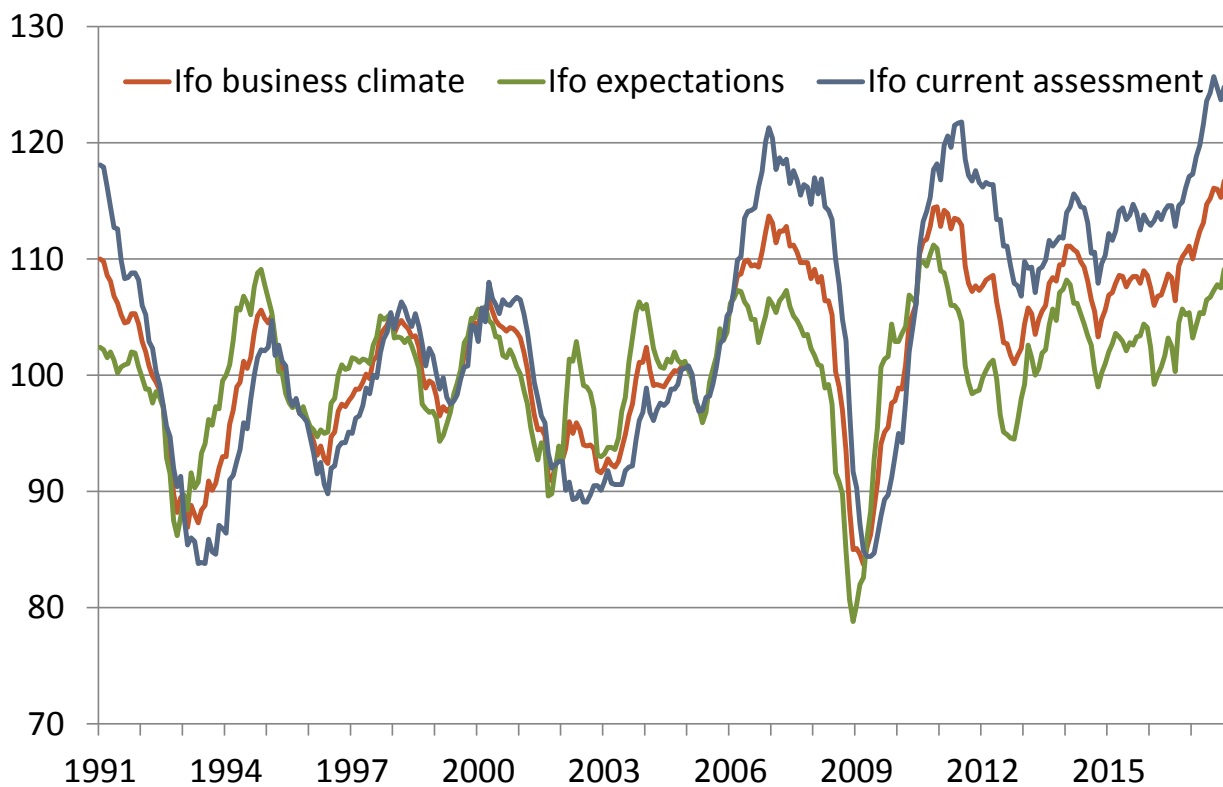
**Broad-based gains across sectors show German industry unfazed by election and euro strength:** On a sector basis, sentiment among **manufacturers** rebounded (the diffusion index reached 30.9 after 28.0 in September) and reached its highest level to date since the introduction of the pan-German series in 1991. Capital goods producers, especially mechanical engineering firms were the main drivers. With current demand advancing to a new record and capacity utilisation rising by 0.4% to 87.1% (long-term average: 83.7%), manufacturers plan to ramp up production. Driven by healthy demand across the globe, manufacturing remains a major engine of economic growth. This year's appreciation in the euro (c12% ytd versus the USD) may cost some competitiveness in export markets, but the message of the Ifo seems to be that this effect is rather minor and for now is offset by the firmer global recovery. Sentiment among **construction** firms also rose, from 18.5 to 19.9, improving the record level it had reached in May. Even though firms scaled back their assessment of the current situation, expectations in the construction sector seems to know just one direction in Germany: up. **Wholesaling** was the only sector that edged lower, but this follows after strong gains in H1. Sentiment in the **retail** sector jumped higher thanks to both better assessments of the current and future situation, and plans to increase prices. That retailers plan to increase prices suggests that they have enough pricing power to pass along higher input costs – further signs that price pressures



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are building in the Eurozone's largest economy. The message is clear; Retailers face consumers who are confident. The GfK consumer climate and income expectations are close to record-high levels. Together with the favourable labour market, private consumption should have held up during Q3, and should continue to do so in Q4, despite a less subdued rate of inflation compared to 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).

**Chart 1: Ifo business climate, current assessment and expectations**



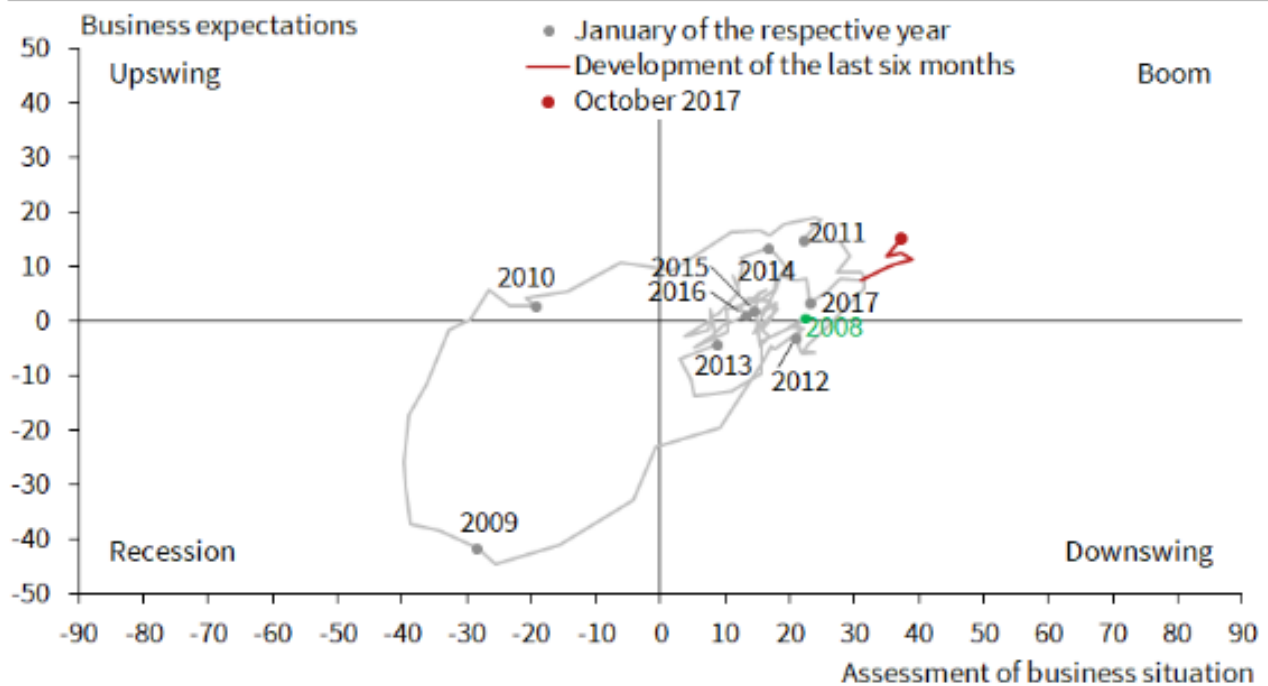
Source: Ifo



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Chart 2: Ifo business cycle clock

### Balances, seasonally adjusted



<sup>a</sup> Manufacturing, construction, wholesaling and retailing.

Source: Ifo

### German Ifo

	OCT	SEP	AUG	JUL	JUN	MAY
Business climate	116.7	115.3	116.0	116.1	115.2	114.7
Expectations	109.1	107.5	107.8	107.3	106.7	106.5
Current assessment	124.8	123.7	124.7	125.7	124.3	123.6

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