

Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859**GERMAN IFO SIGNALS DENT TO GROWTH IN Q3**

Berenberg Macro Flash

German Ifo, August

	Business climate	Current situation	Expectations
Actual:	106.2	112.8	100.1
Previous:	108.3	114.8	102.1
Consensus:	108.5	114.9	102.4
Berenberg:	108.5	114.9	102.3

After a strong first half of the year, the German economy will probably lose some momentum in this and the next quarter.

The business climate fell to 106.2 in August after 108.3 in July and well below consensus of 108.5. The assessment of the current situation and expectations worsened by similar amounts. Expectations, the more forward-looking but noisy of the two components dropped to 100.1 after a revised 102.1 in July. The gauge for the current situation softened by 2-points to 112.8, compared to a revised 114.8 in July. These are the softest readings since early 2016 (current assessment in January: 112.6; expectations in February: 99.0).

German Ifo

	AUG	JUL	JUN	MAY	APR	MAR
Business climate	106.2	108.3	108.7	107.8	106.7	106.8
Current situation	112.8	114.8	114.6	114.2	113.3	113.8
Expectations	100.1	102.1	103.1	101.7	100.5	100.2

Manufacturing and trade weaker: Manufacturing expectations fell below its long-term average as order books turned weaker. Exporters may see less demand from the UK and elsewhere. Gauges for wholesale and retail trade softened even more than manufacturing. These readings may be affected by unusual weather resulting in lower demand for seasonal clothing and possibly by shifts in the timing of holidays. Construction remained unchanged at record levels. These readings suggest that GDP in Q3 may have to wait for a recovery in business investment, after drags by capital spending to growth in Q2. Net exports, given the weaker order books, may contribute less to growth than in Q2.

Services hold firm: We need to put the decline in Ifo business climate into perspective, though. The unexpectedly soft August result is still above the 105.9 trough of February in the wake of the China and emerging market crisis. As it turned out, the German economy was expanding solidly at the time. In addition, today's separate Ifo survey on confidence in the services sector registered a further modest increase in August to 29.5 from 27.7 in July, reaching its highest level since December 2015. Private consumption should contribute to growth given the strong underlying fundamentals (rising real wages, record low unemployment etc.).

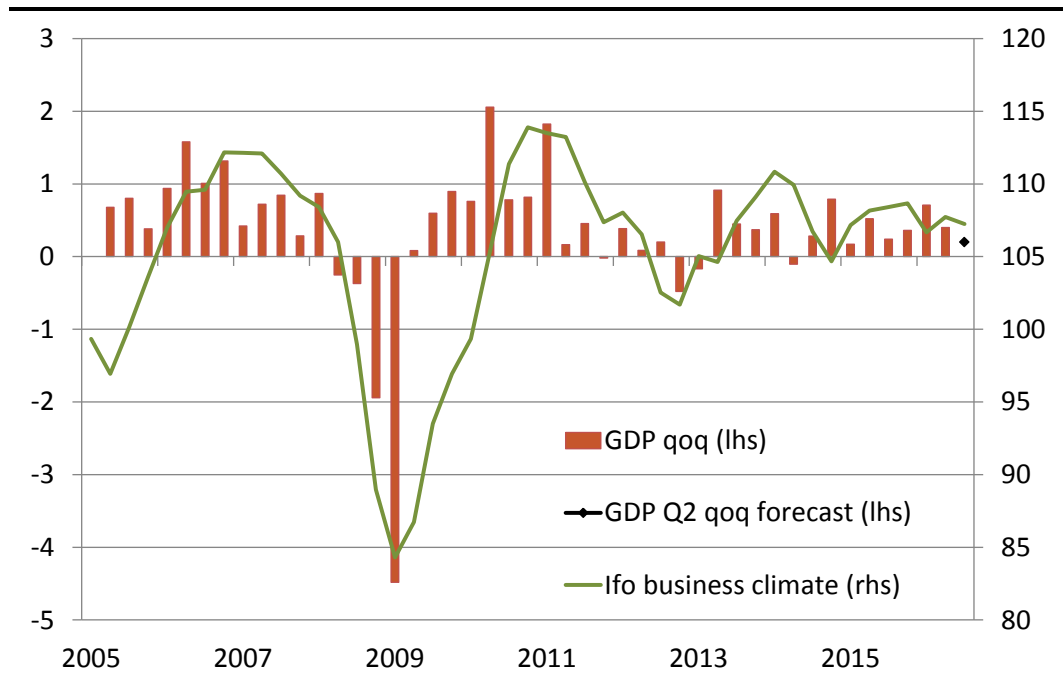
Growth below trend in Q3, but still solid for 2016: Today's reading of the Ifo current assessment confirms the weaker take from the other major business survey in Germany, the composite German PMI earlier this week. The Ifo's average for July and August is slightly below the average for Q2. Ifo's expectations suggest that Brexit-related and other risks remain. This is in line with our call that, after growth of 0.7% and 0.4%



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qoq in Q1 and Q2, German GDP growth will slow down to 0.25%, which is below the trend of 0.4% (see chart). Germany is, however, still set to have a solid 2016. The country's fundamentals are strong. Even if GDP were to stagnate for the rest of the year, which the business surveys suggest is not happening, at least for Q3, the economy would expand by 1.5% this year. With 0.25% qoq growth in Q3 and Q4, average annual growth for 2016 would still come in at 1.7%.

German Ifo vs. GDP growth qoq (Ifo's 2016 Q3: average of July and August)



Source: Ifo.

Mixed signals from France, positive surprise in Spain: Business confidence in France also fell from 102 in July to 101 in August. The main sectors, manufacturing and services, sent mixed signals. The manufacturing sector suffered from weaker order books, lower price expectations and a softer outlook for own company production. The service sector on the other hand held firm at 101. This divergence between manufacturing and services was in line with the French PMIs at the beginning of the week which showed services rebounding while manufacturing was subdued. For Spain, the second reading of GDP surprised on the upside, as the economy grew by 0.8% qoq, above the 0.7% the flash estimate suggested. Spanish GDP was driven by business investment, private consumption and net exports. That capital spending rose (+2.0%) by even more than construction (+1.1) is promising. On a sector level, both services (especially wholesale and retail trade) and industrial production improved with the latter benefitting likely from an improved external environment.



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