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## GERMAN UPSWING GAINS MOMENTUM AS IFO IMPROVES FURTHER

### Berenberg Macro Flash

#### German Ifo, October

	Business climate	Current situation	Expectations
<b>Actual:</b>	<b>110.5</b>	<b>115.0</b>	<b>106.1</b>
Previous:	109.5	114.7	104.5
Consensus:	109.6	114.7	104.5
Berenberg:	109.5	114.7	104.5

Shrugging off earlier concerns about emerging markets and Brexit, Germany's economic upturn looks set to gain momentum in coming months. Led by a further surge in expectations, Ifo business climate rose in October to its best level in more than two years. This confirms the recent run of other positive survey data. After a post-Brexit blip in August in the Ifo data and a strong recovery in September, the further gain in October signals some upside risk to our call for German GDP growth of 0.32% qoq for the fourth quarter.

The headline number of the Ifo business climate advanced to 110.5 in October, its highest level since April 2014, after 109.5 in September. While the assessment of current conditions edged up only slightly, from a very positive 114.7 to 115.0, the forward looking but more volatile expectations improved strongly from 104.5 to a two-year record of 106.1.

**Manufacturing and construction stronger, trade sends mixed signals:** In manufacturing the business climate rose thanks to a far better outlook for the months to come. The assessment of the current situation also improved. Demand for capital goods seemed particularly strong. The rate of capacity utilisation rose by 0.9ppt to 85.7% versus last quarter, heralding somewhat stronger business investment to come. Construction continued its record-breaking run due to stronger expectations. Although business confidence fell among wholesaling companies, it remains significantly above its long-term average even in this sector. The climate among retailers remained almost unchanged, with expectations brightening further amid a slightly less optimistic assessment of the current situation.

**Sentiment of service providers slightly softer, but still at very high level:** A separate Ifo survey for services, which is not included in the headline Ifo numbers, receded marginally to 32.1 after 32.3 in September as the assessment of the current situation turned a bit softer. After strong gains in sentiment in the service sector throughout 2016 and a significant surge in September, we see this as no more than a slight correction. The overall climate among service providers remains elevated at the second highest value this year. Expectations for the next six months actually improved. Unlike the Ifo gauge for the German manufacturing, construction and trade or the German PMI services, the Ifo survey for the service sector had shown no dip after the Brexit vote (see chart 1).

**Upside risk to our GDP Q4 call:** The headline reading of the German PMI yesterday pointed to stronger GDP growth at the start of the final quarter of the year. The current assessment component of the German ZEW survey provided a similar signal. Looking ahead, political risks such as the US elections (unlikely to be a major upset) or the Italian referendum (uncertain outlook) could potentially affect the German economy, especially its export-oriented manufacturing sector. But for the time being – now that the immediate shock of the Brexit vote has been digested – we see no compelling reason for business confidence to deteriorate



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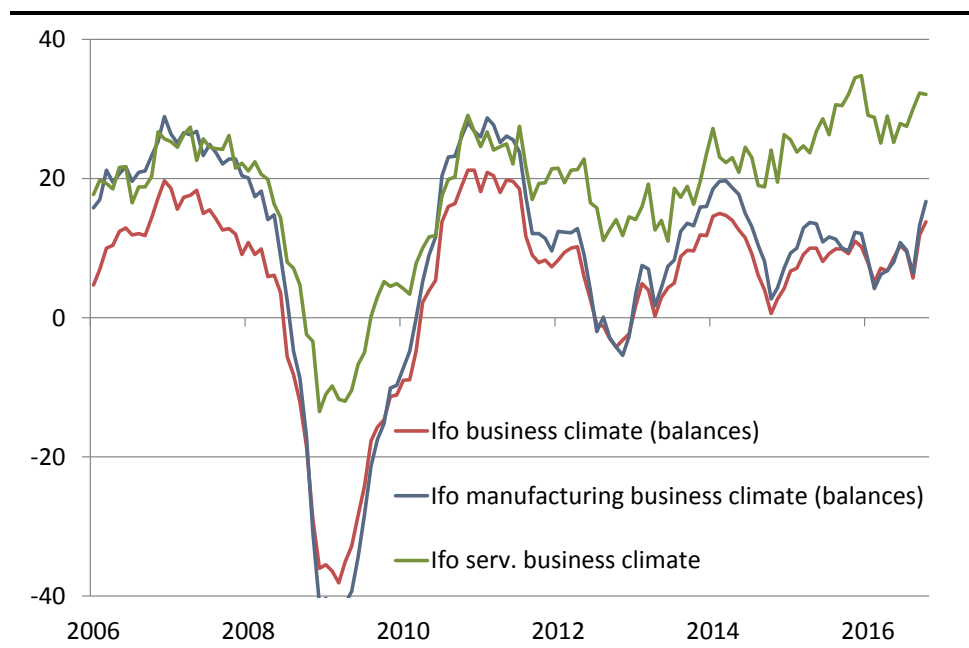
significantly in the near future. In fact, the Ifo expectations and underlying data of the PMI suggest the performance of the German economy is set to remain strong into next year. The 6-month forward-looking gauge of the ZEW also signalled solid growth. The brighter sentiment suggests that economic growth will be slightly stronger in Q4 after a Q3 that may have been marginally affected by the initial bout of uncertainty in the wake of the Brexit vote. We look for an 0.32% qoq gain for German GDP in Q4 after a likely 0.3% qoq in Q3. The risks to our forecasts are clearly tilted to the upside (see chart 2).

**ECB's doves have edge over hawks – the case for extending beyond March:** If the run of hard and soft data for the Eurozone continues to be good, the more hawkish members of the ECB's Governing Council may use the data to argue against any additional monetary stimulus in December. However, the main policy goal of the ECB is to meet the inflation target of 'below, but close to, 2% over the medium term'. Although yesterday's PMI survey point to some increase in inflation to come, we are yet to see whether core inflation will indeed move up significantly from its current rate of 0.85% yoy. We expect the doves on the ECB council to prevail with their call to announce in December that the ECB will extend its asset purchases of €80 billion per month by three or – more likely – by six months beyond March 2017.

### German Ifo

	OCT	SEP	AUG	JUL	JUN	MAY
Business climate	110.5	109.5	106.3	108.3	108.7	107.8
Current situation	115.0	114.7	112.9	114.8	114.7	114.3
Expectations	106.1	104.5	100.1	102.1	103.0	101.7

**Chart 1: German Ifo by sector**

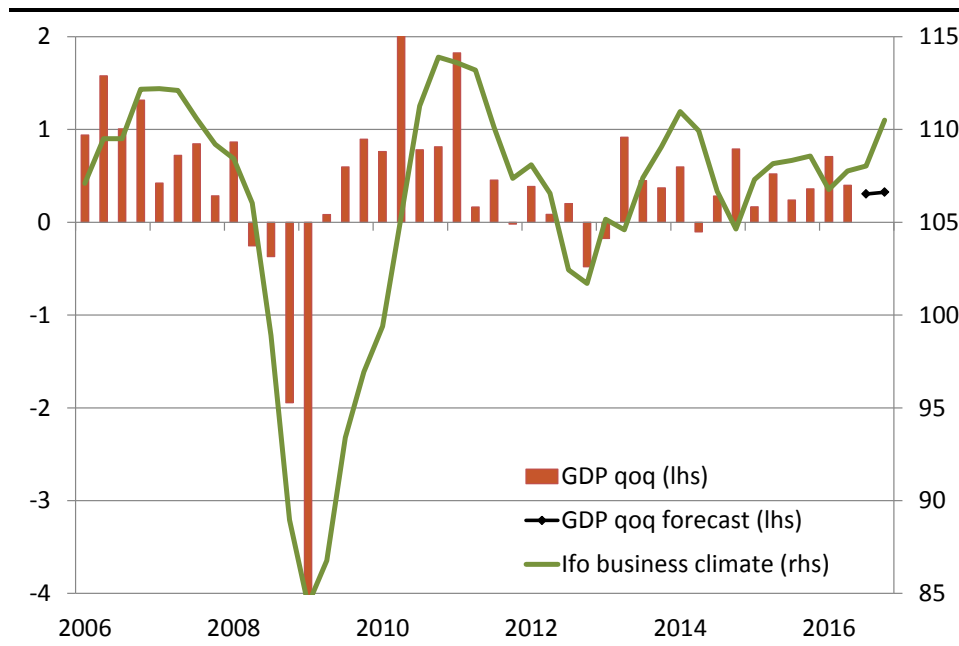


Net balances for industry (headline), manufacturing and services. Source: Ifo.



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**Chart 2: German Ifo (quarterly average) vs. GDP growth qoq (in %)**



*Ifo's quarterly average for Q4 based on October only. Source: Ifo.*

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