

Germany

IFO survey shows first improvement in business outlook for four months

- IFO survey Business Climate rises for second month in a row
- Future expectations pick up for first time in four months
- IFO points to second quarter GDP rise

Further signs of the German economy regaining momentum were provided by the IFO survey's headline index rising for a second successive month in June. The improvement comes soon after Markit's flash PMI likewise signaled a second consecutive upturn in the rate of growth.

The IFO's main Business Climate rose from 105.7 in May to 105.9 in June, rising further from April's recent low to reach a three-month high. The index is a simple average of two sub-indices, one of which measures current business conditions and one looking at companies' future expectations. It is the latter which, counter-intuitively, has historically had a closer relationship with official economic growth data, acting as a coincident indicator of GDP. It is therefore reassuring to have seen this future expectations index rise for the first time in four months in June.

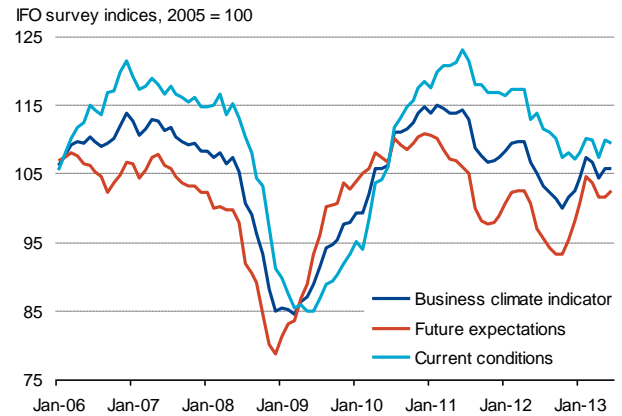
The recent upturns in both the PMI and IFO surveys have failed to regain the ground seen earlier in the year, but crucially both are well above the lows seen last autumn; lows which were soon followed by a steep 0.7% GDP contraction in the fourth quarter.

Divergent GDP signals from the surveys

The implications for GDP in the second quarter vary, with the IFO sending a firmer growth signal than the PMI. The former is broadly consistent with GDP rising by almost 0.5% in the three months to June whereas the PMI points to a roughly flat picture.

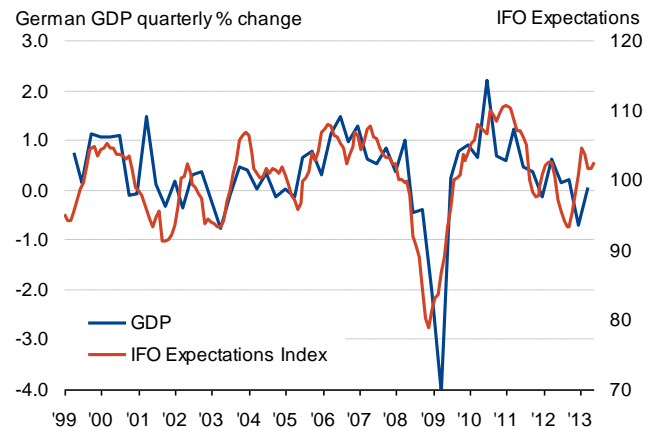
The divergence between the two surveys in terms of the IFO survey's more elevated level in recent months could possibly be attributable to it being a subjective sentiment-based survey, and business optimism may have improved alongside equity market gains this year. Although the Dax 30 has fallen in recent weeks, the

IFO survey indicators

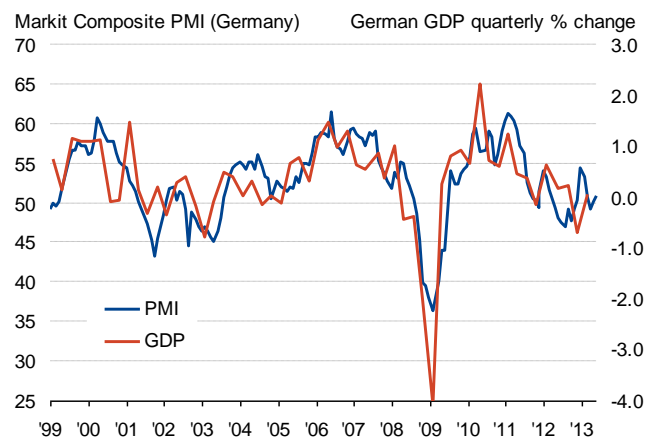


Source: IFO via Ecowin.

IFO survey and GDP



Markit German PMI and GDP



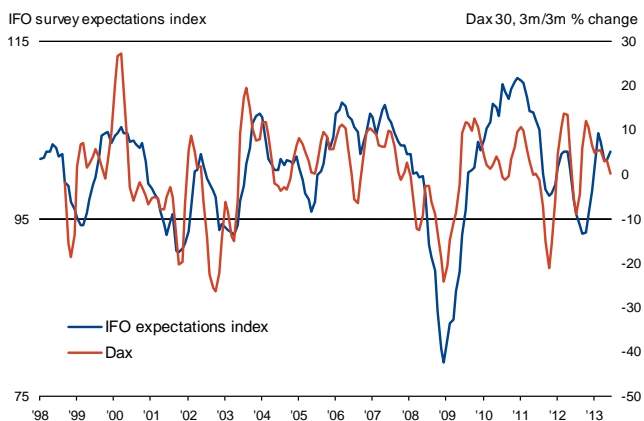
benchmark index remains close to a five-year high. The all-sector PMI, on the other hand, is based on a straightforward comparison of hard data relating to how output has changed from month to month, and is therefore less influenced by sentiment.

The concern is that, if equity markets continue to weaken, it would be unusual for the IFO index to not also deteriorate alongside a protracted drop in asset prices in the near future (see chart).

IFO also noted that the rise in future optimism was driven largely by exporters, suggesting any weakening of the US or Chinese economies would also have a big impact on the outlook.

The upshot is that Germany has at least flat-lined in the second quarter, and GDP may have risen slightly again after the modest 0.1% gain seen in the first three months of the year. But equity markets, overseas demand and any escalation of the eurozone crisis all pose downside risks to a fragile-looking German economy. A return to sustainable, robust growth still seems some way off.

IFO survey and equity markets



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