

# German GDP

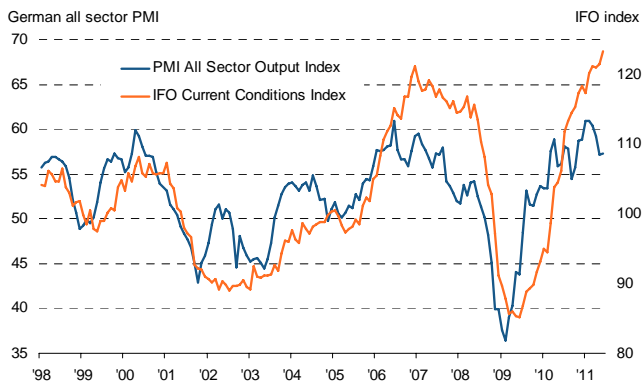
## PMI™ points to Q2 GDP slowdown, but IFO survey gives mixed signals

The IFO and Markit PMI™ surveys of German business conditions have diverged again in June, with the former suggesting current business conditions have reached a new peak while the latter suggests that economic growth slowed in the second quarter. However, the IFO's forward-looking expectations index also signals a slowdown, though still fails to match the PMI in terms of its accuracy in anticipating changes in gross domestic product, most likely due to differences in survey methodology.

### Surveys diverge

The IFO survey's index of current business conditions hit a record high in June (the survey started in 1991). The improvement contrasted with Markit's all-sector flash PMI, which ticked up slightly on May but remained well below the recent peak seen in January.

### IFO and PMI – current conditions



Sources: Markit, IFO

While the IFO survey suggests that economic growth should have accelerated in Q2, from an already booming 1.5% quarterly growth rate in Q1, the PMI suggests that growth probably slowed to around 1.0%. Historical comparisons indicate that the PMI has a closer correlation with economic growth, as measured by gross domestic product (GDP). In particular, the PMI proved a more accurate indicator of the recovery from the recession in the second half of 2009, and also anticipated the easing of GDP growth in mid-2010 and the subsequent re-acceleration. The IFO survey's current conditions index, by contrast, has simply

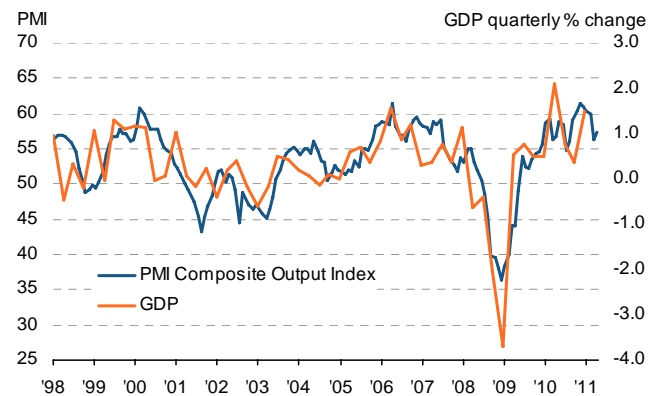
signalled a more or less constant acceleration of growth since early-2009.

### GDP growth slowed in the second quarter

Oddly, the IFO survey's index of future expectations is a more reliable contemporaneous indicator of current GDP than the IFO's index of current business conditions. However, even this index failed to anticipate the short-lived faltering of GDP growth in the second half of last year. The PMI has therefore acted as a better forward indicator of GDP growth than both measures from the IFO survey in recent years, although since 1999 the PMI and IFO expectations indices exhibit almost identical correlations of approximately 70%.

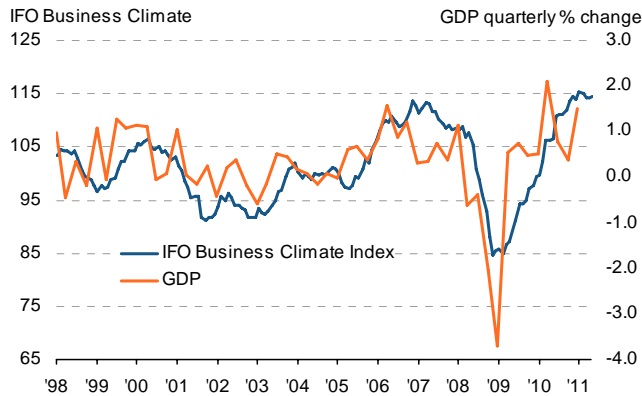
However, perhaps most importantly, like the PMI the IFO's expectations index is currently signalling an easing in the rate of quarterly GDP growth to somewhere in the region of 1.0% in Q2.

### PMI and GDP



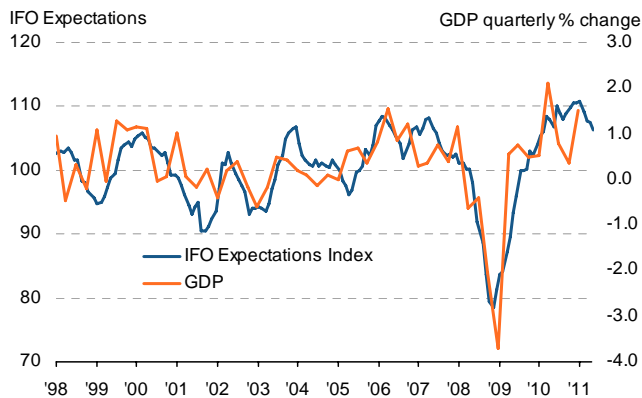
Sources: Markit, FSO.

### IFO current conditions and GDP

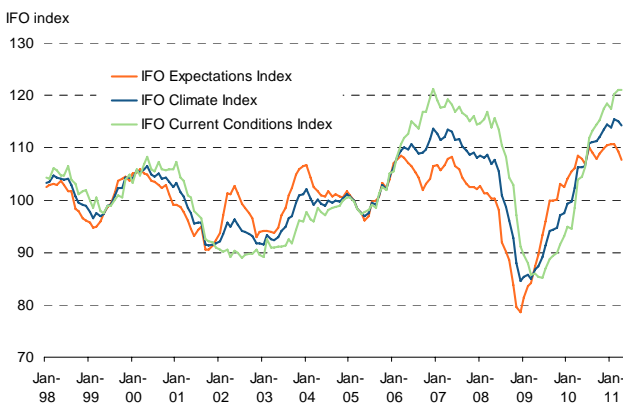


Sources: IFO, FSO.

### IFO future expectations and GDP



### IFO indices



Sources: IFO, Ecwin.

### Differences in survey methodology

There are several valid reasons that explain why the PMI is a better leading indicator of growth than even the IFO's expectations index, and why the IFO's current conditions index fails to track economic growth as well as the other measures:

- IFO collects data earlier in the month than Markit collects PMI data. The IFO data collection period for the June survey, for example, started in late May

(and at the time of writing the institute had already started collecting July data). The PMI data collection period for June, in contrast, is from 13 June to 27 June. The PMI survey therefore relates more to the whole of the current month than the IFO survey, for which some questionnaires may have even been received in the prior month

- The IFO survey asks firms to characterise their situation as "good", "satisfactory" or "poor", and their business expectations for the next six months as "more favourable", "unchanged" or "more unfavourable". These are clearly subjective measures and contrast with the more objective measures seen in the PMI survey, where respondents are asked to report on the actual change in output from one month compared to the prior month.
- Not only is the PMI survey tracking more objective "hard data" than the IFO, but the measurement of the *change* in variables such as orders and output, rather than measuring the overall situation (or level) means that the PMI can pick up turning points with greater accuracy. For example, a company may be struggling to deal with a high backlog of orders and therefore report to the IFO survey that its situation is "good". However, that same firm may not have received any **new** orders for several months and would have been reporting a deterioration when completing the PMI questionnaire over this period. It is perhaps for this same reason that the IFO's survey of expectations has the better relationship with the PMI (and GDP) than the current conditions index, as this question allows survey respondents to take into consideration the inflows of new business.

### Further information

Markit's [commentary notes](#) and [press releases](#) can be accessed online, as can a diary of [forthcoming Markit release dates](#).

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