German business confidence rose to the highest level in 16 months in August, beating forecasts and indicating that the recovery in Europe’s largest economy is gathering pace. A measure of construction activity fell.

The Ifo business climate index, based on a survey of 7,000 executives, climbed to 107.5 from 106.2 in July, the Munich-based institute said today. That’s the highest since April 2012. Economists predicted an increase to 107, according to the median of 42 forecasts in a Bloomberg News survey.

German gross domestic product expanded 0.7 percent in the second quarter, rebounding from a colder-than-usual winter that curbed output and helping the 17-nation euro area emerge from its longest-ever recession. The nation’s growth was led by private consumption and included the first increase in plant and machinery investment since 2011, signaling the recovery may be sustained.

“The latest business sentiment readings confirm our view that the German economy will be able to maintain a somewhat more moderate but still robust momentum in the second half of 2013, following the exceptional rebound in the spring,” said Alexander Koch, an economist at UniCredit Group in Munich. “Domestic demand should remain a major growth pillar, currently adding to an overall broad-based recovery path.”

The euro fell after the report. The currency was at $1.334, down 0.2 percent, at 11:19 a.m. in Frankfurt, Germany’s benchmark DAX (DAX) stock index dropped 1.5 percent to 8,311.44.

Construction Decline

Companies’ assessment of the current situation climbed to 112 in August from 110.1, while a gauge of expectations rose to 103.3 from 102.4. An assessment of construction activity slid to minus 4.2 from minus 1.5 the prior month and a measure of retailing dropped to 2.6 from 3, signaling a potential slowdown.

“The fall in the construction index seems to confirm that the second quarter’s sharp rise in activity was a temporary bounceback from bad weather in the first quarter,” said Jennifer McKeown, an economist at Capital Economics in London. “The fall in the retail index is a reminder not to put too much faith in German consumers. Nonetheless, it seems that a moderate recovery is finally underway.”

The Bundesbank predicts German GDP will expand 0.3 percent this year and 1.5 percent in 2014. An index measuring German manufacturing rose to the highest level in more than two years in August, beating economists’ forecasts. The euro area’s economy grew 0.3 percent last quarter, snapping six quarters of contraction.

Company Forecasts

Some companies are still cutting costs amid lower demand from Europe. Salzgitter AG (SZG), Germany’s second-largest steelmaker, forecast a 2013 pretax loss on Aug. 5 and announced plans on Aug. 14 to shed more than 1,500 jobs.

At the same time, Hamburger Hafen & Logistik AG, the handler of about 80 percent of containers at Hamburg’s port, raised its 2013 volume forecast on Aug. 14 on growth in Asian and Baltic Sea traffic.

Rising business confidence may help Chancellor Angela Merkel, who seeks a third term as German leader in a Sept. 22 election on the strength of shielding her country from the worst effects of the euro area’s debt crisis.

Merkel’s Christian Democratic-led bloc has 40 percent support, according to a weekly Emnid poll for Bild newspaper on Aug. 25. The opposition Social Democrats are at 25 percent and Merkel’s Free Democratic Party coalition partner is at 5 percent.

ECB Outlook
European Central Bank President Mario Draghi said this month that he expects a gradual recovery for the euro area in the second half of the year and that the risks surrounding the outlook are still “on the downside.” The ECB cut its benchmark rate to a record low of 0.5 percent in May and Draghi this month repeated a July pledge to keep rates at current levels or lower for an extended period.

The ECB predicts the euro area, Germany’s biggest export market, will shrink 0.6 percent this year before growing 1.1 percent in 2014. The Frankfurt-based central bank will publish new projections on Sept. 5.

Consumer confidence in the U.S., the world’s biggest economy, may have declined for a second month in August, according to a Bloomberg survey before a report today. The Conference Board’s confidence index probably fell to 79 from 80.3 in August, the survey shows.

China’s industrial-profit growth rebounded in July, adding to signs that the world’s second-biggest economy is stabilizing after a two-quarter slowdown and an interbank lending squeeze. Net income rose 12 percent from a year earlier after gaining 6.3 percent in June, the statistics bureau said in Beijing today.

“The German economy looks set to register healthy growth during the second half of the year, even though it will probably not be able to continue at the extraordinary pace seen in the second quarter,” said Joerg Kraemer, chief economist at Commerzbank AG in Frankfurt.

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