

Germany: Surging inflation further complicates ECB's job

In the shade of Italian excitement, a whole series of German macro data passed by almost unnoticed this morning. The main message: a recovery is in the making but one-off effects have not yet disappeared



Retail sales rise

The morning started with encouraging signals from retail sales. The first hard data for the second quarter recorded an increase of 2.3% month-on-month in April, from -0.4% MoM in March. This was the first increase in monthly retail sales since November last year, boding well for a re-acceleration of the German economy in the second quarter. The fact that German unemployment fell to a new record low of 5.2% in May also shows that the domestic momentum in the economy remains strong. Admittedly, the labour market has always been a lagging, rather than a leading, indicator for economic activity. In times of external uncertainty, however, the strong labour market will definitely be a cushion to any potential weakening of trade.

Headline inflation at 15-month high

The most imminent threat to domestic activity could be the recent surge in oil prices. Today's inflation data are already providing some flavour as to how higher oil prices could dent purchasing

power. Based on the results of several regional states, German headline inflation surged to 2.2% year-on-year in May, from 1.6% YoY in April, the highest level since February 2017. According to the harmonised European definition (HICP), the measure more relevant for ECB policy-making, headline inflation was even stronger and also stands at 2.2% YoY, from 1.4% in April.

Easter Bunny effect

While the Easter Bunny effect has finally been left behind, German inflation is still heavily affected by seasonal factors. The sharp surge in oil prices, in combination with several public holidays and long weekends, pushed up energy prices, leisure costs and food prices. Under the surface of (too) many one-off factors, German inflation data still tells a two-sided story: while prices for consumer goods have gradually accelerated in recent months, inflation on services has slowed down and has even been negative for a couple of months for communication and clothing. Where available, core inflation measures at the state level actually dropped in May.

What it means for the ECB

Despite today's increase in headline inflation, the underlying trend still points to a rather benign picture for inflationary pressures. For the ECB, however, today's inflation data from Germany gives a taste of the increased complications on the road to taper. The still-undecided debate on whether the Eurozone economy is in a soft patch or at the start of a protracted downswing, the surge in oil prices and latest political developments in Italy have clearly complicated the ECB's life. It increasingly looks as if the big question for the ECB is not when to stop QE but rather when to signal an extension of QE. With the latest market turmoil and political tensions in Italy, giving some certainty in times of uncertainty could be the ECB's preferred policy choice. This would be an announcement or at least a very clear hint at QE extension at the June meeting.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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