

# German inflation unchanged at 2% in July

Headline inflation remained unchanged at 2% year-on-year. Looking ahead, German and eurozone inflation are likely to fulfil the ECB's old target of 'below but close to 2%'



The just-released flash estimate of German inflation for July shows that the disinflationary process continues in baby steps. Headline inflation, according to the national measure, remained unchanged at 2% year-on-year, while the European measure dropped to 1.8% YoY, from 2.0% YoY in June. Core inflation remained unchanged at 2.7% YoY.

## German inflation to remain 'below but close to 2%'

The available regional state data confirms that Germany, along with the broader eurozone economy, is currently experiencing a process of disinflation, not deflation, as actually only monthly prices for clothing and heating oil fell. Almost all other categories saw prices increasing, albeit often at a slower pace than last month.

Looking ahead, at least in the nearer term, German inflation is likely to fulfil the ECB's old definition of price stability and should remain 'below but close to 2%'. Favourable energy base effects are petering out, while core inflation should be coming down somewhat. It remains to be seen how

European and US companies will react to US tariffs. While one scenario could see prices falling in the eurozone due to overcapacities and weaker sales in the US, globally operating companies might try to actually increase prices in Europe in order to offset profit squeezing in the US. A rather domestic theme will be the cooling of the German labour market, which should take away wage pressures and consequently inflationary pressures. On the other hand, the government's fiscal stimulus is likely to push up inflationary pressure towards the end of the year and beyond.

The latest trade developments and the avoidance of a full-blown trade conflict have alleviated pressure on the ECB to continue cutting rates to support eurozone growth. Add to this the latest weakening of the euro as well as meagre but positive GDP growth in the second quarter and the bar for yet another rate cut this year has clearly risen. Still, at least for the next few weeks, we will stick to our call of one final rate cut at the September meeting. Why? First of all, a deal is only a deal once it's signed on paper. This particularly applies to trade negotiations these days and it wouldn't be the first time that some last-minute announcements or disruptions occur. There is also our view that both actual inflation and hard macro data could come in weaker than softer data over the coming weeks, fueling the inflation undershooting narrative. Finally, and the strongest argument, is the fact that the ECB's June projections actually included a terminal rate of 1.75%. Not delivering on these market prices would mechanically push down the ECB's own inflation and growth projections.

Admittedly, with recent developments, the degree of conviction for our own call has also come down. In fact, if the easing of trade tensions lifts uncertainty and increases resilience of the eurozone economy, the debate at the ECB could quickly shift; from whether or not more rate cuts are needed to when to hike rates to tackle inflationary pressures stemming from fiscal stimulus.

## Author

### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

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