Germany: Easing inflation hysteria

A drop in German headline inflation in January suggests that even the ECB’s expectation of higher inflation is currently more wish than reality

Source: istock

1.6% January headline inflation

YoY

Based on results from six regional states, German headline inflation slowed to 1.6% YoY in January, from 1.7% YoY in December. According to the harmonised European definition (HICP), the measure more relevant for ECB policy making, headline inflation even dropped to 1.4% YoY, from 1.6% in December. While many financial market participants have recently been speculating about a return of inflation in the Eurozone, this German data suggests the opposite.

In fact, today's inflation data show two interesting things: (1) the appreciation of the euro has offset stronger oil prices; (2) underlying inflationary pressure in the Eurozone's largest economy remains low. While oil prices have increased by more than 16% over the last twelve months, the stronger euro seems to have offset the inflationary impact. Denominated in euro, oil prices only increased by less than 5% over the same period. What is more, looking at the available components at the regional level shows underlying inflationary pressures remain low. Measures of core inflation slightly dropped. Low core inflation rates, however, mask two diverging trends in German prices. While prices for consumer goods have increased at an annual rate of above 2% for quite some time, the ongoing decline in communication costs and lower prices for services continued to put downward pressure on core inflation.

Looking ahead, even with stable oil prices and an unchanged exchange rate, base effects should push German headline inflation up to, or even above, 2% in the first half of the year. However, there are still hardly any signs that underlying inflation could accelerate and ongoing structural factors such as increased competition in the service sector and price transparency on the back of digitalization or automation and globalization provide substantial arguments that this will change any time soon. In this regard, the ongoing wage negotiations in the industrial sector, or better the outcome of these negotiations, will be an important signal for the future path of inflation.

> Today's German inflation numbers should ease the recent excitement in markets about a possible inflation surge and changes to the ECB's monetary policy stance. For the time being, the ECB's own assessment and confidence that inflation will substantially pick up remains more wish than reality.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

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