Germany: Retreat and relief

German headline inflation slows to the lowest level since February 2018 on the back of lower energy prices, and a further softening is in the offing. With consumer confidence close to all-time-highs, lower inflation makes consumers the best recession-fighting instrument that the German economy has

According to the just-released first estimate, German headline inflation came in at 1.4% year-on-year in January, from 1.7% YoY in December. HICP inflation came in unchanged at 1.7% YoY. Due to statistical revisions, the usual regional state data, which normally provides insights on individual inflation components, is not available today. With higher water levels in German rivers, low oil prices have finally reached the German economy.

Finally some good news

Earlier today, the German economy finally produced some encouraging macro data. Consumer confidence increased to a nine-month high, with the willingness to buy component improving to its highest level since April last year. At least for the time being, German consumers are defying the currently growing pessimism. Low inflation, higher wages and some tax relief since the start of the year have increased purchasing power. A strong consumer is clearly the best recession-fighting instrument for the German economy in the current times of extreme external uncertainties.

The only way is down, not up

Returning to inflation developments, in the preparation of the December ECB projections, the German Bundesbank sent in a headline inflation forecast of 1.4% YoY in Germany for 2019, with core inflation gradually increasing to 1.6%. A rather optimistic scenario in the current economic circumstances. In fact, if oil prices and the euro exchange rate were to remain at their current levels throughout the entire year, headline inflation is more likely to drop below 1% rather than getting anywhere close to the 2% mark. What's more, with increased economic uncertainty and companies' competitiveness under pressure, the ECB's forecast of gradually increasing core inflation is more wishful thinking than reality. Higher wages – current nominal wage growth is around 3% in Germany – are simply not passed on to consumer prices.

At least in the near term, the only way for headline inflation is down, not up. While this could lead to some headaches at the ECB, it is good news for the German economy. Together with the strong labour market and high consumer confidence, low inflation is a welcome shield against the current high wave of external uncertainties.

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