

Germany: Headline inflation backtracks, core remains low

Strong consumer confidence and low core inflation are both comfort and concern for the ECB, but the outlook for Germany still remains solid



The morning after the national soccer trauma started with good news. German consumer confidence remained unchanged and close to its all-time high, suggesting that a possible trade war, higher oil price or political uncertainty in Europe and Germany cannot dent the Germans' positive shopping mood. At the same time, inflationary pressures receded somewhat.

Based on the results of several regional states, German headline inflation dropped marginally to 2.1% year on year in June, from 2.2% YoY in May, both in the national and European measure of consumer price inflation. Where available, regional core inflation measures dropped in June, indicating that underlying inflationary pressures in the German economy remain low.

Looking ahead, the outlook for the German economy still looks solid. But with regards to inflation, new temporary disinflationary

forces have emerged after yesterday. Expect large discounts and price reductions on all World Cup and national team merchandising in the coming days

Headline inflation, however, is still heavily affected by seasonal effects. The sharp surge in oil prices with public holidays and long weekends are currently the main drivers of headline inflation. 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.

Today's German data should be both comforting and worrying for the ECB. Comforting as the stabilisation of consumer confidence at a high level should support the ECB's view of a continued recovery. But worrying, because despite the tight labour market, a lack of qualified workers and recent wage increases, underlying inflation remains low and is not (yet) accelerating. The latter being a clear prerequisite for the ECB to actually engage in the anticipated end of QE by the end of 2018.

Looking ahead, the outlook for the German economy still looks solid. The two biggest risks are clearly a possible negative sentiment loop on the back of the ongoing trade war talks (even though the hard economic impact so far is close to zero) and further domestic political turmoil.

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