

Germany: Inflation - still an Easter hangover

The sharp drop in German headline inflation will further support the ECB's current easing bias.



According to the just-released first estimate based on the results of several regional states, German headline inflation came in at 1.3% year-on-year in May, from 2.1% in April, and the lowest level since April last year. The national inflation measure dropped to 1.4% YoY, from 2.0% in April.

The main inflation drivers were lower food prices, continued price drops in communication and services and lower prices for leisure and package holidays. The latter shows once again the ever-returning impact of the Easter Bunny on German headline inflation, an up and down hopping which this year distorts inflation for three months. As expenditures for leisure and packaged holidays are also included in core inflation measures, available regional core inflation proxies point to a significant drop in core inflation. This is true not only in Germany (probably from 2% YoY to around 1.5% YoY), but also in the entire Eurozone.

Leaving the Easter Bunny fluctuation aside, today's inflation data show that core inflation in the Eurozone is still moving sideways and actually has been doing so since 2015. The ECB's hope that headline inflation would move towards the ECB's medium-term aim is increasingly being derailed

rather than delayed. In fact, if it were not for oil prices, the last years of monetary stimulus have avoided a further drop in underlying inflation but have not succeeded in bringing inflation close to target. The German experience also casts doubts about the ECB's view that the pass-through of higher wages on inflation is still intact. In fact, the German experience shows that even though the transmission from a tighter labour market to stronger wage growth has, since 2016, finally matched previous periods, the transmission from higher wage growth to faster inflation still barely exists. Margin squeezing to maintain (international) market shares, more price transparency due to digitalization and more competition and mobility in the service industry (also due to digitalization) could be the main drivers eventually debunking the textbook relationship between wage growth and higher inflation.

More arguments for the ECB's easing bias

All of this means that the ECB will stick to its current easing bias. Clearly, low inflation also gives rise to discussion on whether the definition of price stability is still up-to-date and whether unconventional measures are still needed in a low inflation situation without deflationary risks. However, in the current set-up and at least until the change of guard in November, the ECB will do whatever it takes to bring (medium-term) inflation back to target. As a consequence, even though it's not our base case, additional easing measures over the summer should not be ruled out.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.