Germany: Weaker inflation supports case for ECB action

Low August inflation in Germany bolsters the case for a new round of monetary easing at the ECB's September meeting

German headline inflation came in at 1.0% year-on-year in August, from 1.1% in July. That's according to the just-released first estimate, based on the results of several regional states. The national inflation measure dropped to 1.4% YoY, from 1.7% in July. This year's strong discrepancy between the national and the European measure of German inflation is mainly caused by methodological changes to the measurement of package holidays in the European measure and changes to the weights of different components in the national measure.

Looking at the available components in several regional states, there were opposing trends in price developments. While prices for heating oil have started to drop compared with last year, reflecting lower global prices, those for electricity and gas are still up. At the same time, prices for food have started to accelerate, probably early signs of the dry and warm summer, while costs for communication and durable goods continue to fall. Overall, these diverging trends seem to offset each other, keeping core inflation measures broadly unchanged.

Looking ahead, lower oil prices will keep German headline inflation hovering around 1% in the coming months. While this is good news for consumers, who as Mario Draghi once said can "buy more stuff", the low inflation combined with the prospects of an at best stagnating economy bolsters the case for new monetary stimulus from the ECB in two weeks from today. In fact, we think that the ECB doesn't want to wait until the Eurozone economy is again caught in a possible deflationary spiral but will want to set another (maybe final) preemptive strike. In our view, the ECB will present a new stimulus package consisting of a 20bp cut in the deposit rate, a tiering system, a restart of QE with 30bn euro per month as well as a repricing of the TLTROs.

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