FRANKFURT—Germany’s central bank is willing to back an array of stimulus measures by the European Central Bank next month if needed to fight unacceptably low inflation, underscoring the Bundesbank’s shift away from its reputation in recent years as the euro zone’s policy rebel.

The Bundesbank is open to supporting aggressive—and in some cases, for the ECB, unprecedented—steps including negative rates on bank deposits, long-term loans to
banks at capped interest rates and purchases of packaged bank loans, a person familiar with the matter told The Wall Street Journal.


The euro fell sharply on the news of the Bundesbank's stance, which lends support to mounting expectations in financial markets that the ECB will act decisively, and with unity, on interest-rate cuts and other measures when it next meets June 5.

Projections by ECB staff on inflation for 2016, which central-bank officials will have in hand when they meet, will be central to the Bundesbank's decision on additional stimulus moves, the person said. But the German central bank's readiness to act marks the clearest sign yet that the Bundesbank—in recent years defined by its conservative opposition to the ECB's emergency measures to combat the euro-zone debt crisis—is fully engaged in fighting too-low inflation in the euro zone and open to using monetary-policy tools.

Germany's central bank is willing to back an array of stimulus measures from the European Central Bank if needed to keep inflation from staying too low. Michael Casey joins MoneyBeat. Photo: Bundesbank.de.

The Bundesbank's position also signals a return to the fold for its president, Jens Weidmann, whose three-year tenure heading Germany's revered central bank has often been characterized by his fierce opposition to the ECB's main anticrisis policy: an open-ended bond-purchase plan launched in 2012 to stabilize bond yields of stressed euro-zone members. The conservative German central bank regards the program, though never tapped, as a dangerous mix of monetary and fiscal policies.

Though the Bundesbank has been inching away from its opposition role and toward greater backing of ECB policies for nearly a year, the revelation of its low-inflation stance now serves a number of strategic issues for the central bank.

Tactically, a more flexible approach could benefit the Bundesbank by making its views more relevant in financial markets after finding itself largely isolated in its objection to previous efforts to ease market fears of a euro breakup. That, in turn, could strengthen its hand when it opposes such measures as large-scale asset purchases.
"They realize that they have a much stronger position if they come up with a list of proposals for what the ECB can do," said Carsten Brzeski, economist at ING Bank. "It's a more productive approach than the always-saying-no approach."

The Bundesbank's backing could provide critical support for ECB President Mario Draghi when the bank meets next month to weigh interest-rate cuts and other stimulus measures. Mr. Draghi put financial markets on notice last week that additional measures were possible in June amid weak annual inflation which, at 0.7% in the euro zone, is far below the ECB's target of just under 2%. Germany's inflation rate is slightly higher than the euro-zone average.

Central banks—particularly the inflation-wary Bundesbank—typically strive for low growth in prices, which keeps borrowing costs down and provides a stable backdrop for households and businesses to spend. But when inflation is too weak, debts become harder to service, and consumers may put off purchases in the hope that prices will fall. ECB officials have also made clear they are concerned about the high value of the euro, which weakens inflation.

Germany can withstand the effects of a strong euro better than many of its European peers, given its competitiveness strengths and export prowess. But it is vulnerable, too, particularly if key export markets such as China and other emerging economies slow. While its healthy labor markets have sheltered Germany from the low-inflation problems that others in Europe confront, its relatively high wages could come back to haunt Germany if Spain and others close the efficiency gap.

Though the Bundesbank has just one vote in the ECB's 24-member governing council, and policy decisions are made by the majority, the German central bank's backing is important to how policy is viewed publicly in Europe's strongest economy.

The Bundesbank's shift toward more support of ECB policies began gaining notice nearly a year ago, when Mr. Weidmann signed on to the bank's commitment to keeping interest rates at current or lower levels for an "extended period." Such forward guidance has been used by the Federal Reserve and Bank of England to firm up expectations for low interest rates in financial markets. But it was new for the ECB, which long refused to commit beforehand on rates.

Although Mr. Weidmann opposed the ECB's last rate cut in November—he preferred to wait for more data on inflation—he defended Mr. Draghi against criticism in Germany that the ECB was punishing German savers with its low-rate policies.

Earlier this year, the Bundesbank said it supported suspending weekly bank-funding drains under a previous bond-purchase plan. This would add extra cash to the banking system and stabilize money markets, though the ECB hasn't ended the drains, or sterilizations, yet. Mr. Weidmann also backed the ECB's unanimous pledge in April to use unconventional tools if needed to prevent a protracted period of low inflation.

But the Bundesbank's backing of new measures has limits. It remains resistant to large-scale purchases of public and private debt, known as quantitative easing, the person familiar with the situation said. The German central bank has discussed this option internally but has concluded that with government and corporate bond yields already quite low in Europe, the purchases wouldn't do much good and could instead create financial-stability risks.
But the Bundesbank is open to a significant package of measures, the person said, including reductions in the ECB’s lending and deposit rates; extension of unlimited loans to commercial banks—known as fixed-rate, full-allotment loans—from mid-2015 until mid-2016; offering new long-term loans to banks at a fixed rate to further beef up the ECB’s forward guidance; and some purchases of asset-backed securities.

But even without the large-scale asset purchases, the Bundesbank’s list would pack a punch. No central bank as large as the ECB has experimented with a negative deposit rate—the ECB’s rate is currently zero—which would effectively penalize banks for parking surplus funds at the ECB. The euro would likely cheapen as international investors cast a more wary eye on euro-denominated assets.

Meanwhile, extending the ECB’s provision of unlimited loans to banks well into 2016 would further cement the notion that the ECB will be far behind other major central banks, such as the Federal Reserve and Bank of England, when it comes to eventually raising interest rates.

The Bundesbank is also open to extending additional long-term loans to banks at a capped rate, meaning banks could tap the ECB for funds without worrying about future interest-rate increases, the person said. Another option, the person said, would be to better target ECB loans to the private sector.

But the steps the Bundesbank is willing to take aren’t a done deal, and depend critically on the ECB’s coming forecasts for inflation through 2016. The central bank currently forecasts inflation to average 1% this year, 1.3% next year and 1.5% in 2016. ECB staff economists expect that, by the end of 2016, inflation will be around 1.7%.

The Bundesbank expects forecasts for this year to be lowered. If the ECB keeps its 2016 projections unchanged, Germany’s central bank would be reluctant to support new stimulus measures, the person said. The number of steps on stimulus it would back depends on how far the 2016 inflation projections undershoot current estimates, the person said.

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