German December numbers mark worst inflation year since 1993

Headline inflation increased once again, ending the year at 5.3% year-on-year. While the December number should mark the peak of the inflation surge, inflationary pressure will first broaden before it finally abates towards the end of the year

The year 2021 ended with another inflation shocker as German headline inflation came in at 5.3% YoY from 5.2% YoY in November, the highest level since June 1992. HICP inflation came down somewhat at 5.7% YoY, from 6.0% in November. The all-time high of German inflation since reunification dates back to the summer of 1992, at 6.2%. For the entire year 2021, inflation came in at 3.1%, the highest since 1993. All these numbers are obviously a first estimate based on the inflation outcomes of several regional states.

Inflation should first broaden before coming down towards end of the year

By now, the main drivers of surging headline inflation in Germany are well known: it is base effects from the VAT reversal, which also shows up in subcomponents such as prices for clothing and leisure, higher energy costs and price mark-ups post-lockdown in the leisure and hospitality services. However, high inflation is no longer only concentrated in a few sectors or a few goods. Almost half of the 92 largest components of the inflation basket currently have an inflation rate of 4% or more. A year ago, this was less than 10%.

Looking ahead, the base effect from the VAT reversal will disappear which alone should bring headline inflation down by more than 1 percentage point. However, at the same time, the pass-through from higher energy and producer prices is far from over. Higher gas prices have been passed on to most German households with the start of the new year. Based on personal anecdotal evidence, all kinds of administrative prices and even TV broadcasting prices have gone up. Add to this additional price-markups in the hospitality, culture and leisure sectors once the current round of restrictions is over and it is hard to see inflation coming down significantly any time soon. It will take until late summer to see inflation slowing down to any significant degree, when lockdown-related price markups are over and negative energy price base effects kick in.

The year 2021 brought Germany the worst inflation surge since the early 1990s. Today's inflation numbers should, in our view, mark the peak of the inflation surge. However, inflation is unlikely to come down in a straight line from here. Instead, inflationary pressures will first broaden further across sectors and goods before abating towards the end of the year.

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