Snap | 30 May 2022

German inflation climbs to 8.7% in May

German inflation continues to accelerate, keeping alive the European Central Bank's discussion on a possible 50bp rate hike in July

Record-high inflation in Germany has had an impact on consumers' budgeting and financial planning

German headline inflation surged once again as the war in Ukraine pushed up energy and commodity prices, and inflationary pressure broadens. According to a first estimate based on the regional inflation data, German headline inflation came in at 7.9% year-on-year in May, up from 7.4% YoY in April. The HICP measure came in at 8.7% YoY, from 7.8% in April. Unless there is a sharp downward correction of energy prices in the months ahead, German headline inflation will continue to increase and only start to level off in late summer.

Still more inflation in the pipeline

We've stopped digging out illustrations of the times when inflation in Germany was at comparable levels. Let's put it like this: most citizens and policymakers have hardly ever seen these kinds of inflation rates in their professional lives.

Sure, the surge in headline inflation is still dominantly driven by energy and commodity prices. However, looking at available regional data, the pass-through of these higher prices to the broader economy is in full swing. In some regional states, food inflation was already at double-digit levels and prices for leisure activities, hospitality, and more general services have been accelerating in recent months. The inflation rate for these items is far above the European Central Bank's 2% target. In fact, in April only 17 out of the 94 main components of the German inflation basket had inflation rates of 2% or less. The only significant U-turn in the upward inflation trend was in packaged holidays. However, this was rather driven by the so-called Easter Bunny effect (the timing of the Easter break) and not so much by disinflationary trends. Consequently, any drop in core inflation on the back of lower packaged holidays inflation will be temporary.

Looking ahead, the fact that monthly price increases are still far above their historic average (0.9% month-on-month in May compared with 0.2% in a 'normal' May) illustrates the high inflationary pipeline pressure. As much as we would like to see a levelling off in inflation rates, with the war in Ukraine and continued tension and upward pressure on energy, commodity and food prices, headline inflation in Germany will accelerate further in the coming months.

We think that the pass-through to all kinds of sectors is still in full swing. Add to this the additional price mark-ups in the hospitality, culture and leisure sectors after the end of lockdowns and it is hard to see inflation coming down significantly any time soon. Against the backdrop of recent geopolitical events, we now expect German inflation to average at more than 8% this year with a chance that monthly inflation rates will enter double-digit territory in the summer.

ECB 50bp rate hike not off the table

The ECB has clearly passed the stage of discussing whether and even when policy rates should be increased. The only discussion seems to be on whether the ECB should start with a 25bp rate hike in July or 50bp. In this regard, it is quite remarkable that both ECB president Christine Lagarde and ECB chief economist Philip Lane have tried to take back control of this particular discussion. In an interview released this morning, Philip Lane definitely broke with the previous ECB communication strategy to never pre-commit. Instead, he spelled out the roadmap for normalising monetary policy, de facto announcing an the end of net asset purchases in early July, a 25bp rate hike at the ECB meeting of 21 July and another 25bp rate hike at the September meeting. There is nothing wrong with the content of his remarks as it is exactly what we have already been expecting the ECB to do. However, a de facto pre-announcement almost two months ahead of the 21 July meeting is remarkable, to say the least.

In any case, as today's German inflation numbers mark an upside surprise for many, the debate on the magnitude of the first hike, be it 25bp vs 50bp, is not entirely off the table. If core inflation in the eurozone continues accelerating in May and June, Lane and Lagarde could still regret their new pre-commitment.

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