

German inflation highest since 1992

Germany's inflation acceleration continues and will put more pressure on the European Central Bank's December debate on how to proceed with its asset purchases next year



German consumers are facing higher prices which will put pressure on the ECB

Based on inflation outcomes of several regional states, German inflation in September came in at 4.1% year-on-year, from 3.9% in August. The harmonised index relevant for the ECB jumped to 4.1%, from 3.4% in August.

The surge in headline inflation was driven by the full base effects from a VAT reversal, which also shows in subcomponents such as prices for clothing and leisure, higher energy prices and price mark-ups post-lockdown in the leisure and hospitality services. Higher producer prices on the back of supply chain disruptions, higher commodity prices and the gradual reopening of the economy are still being felt and will continue to impact consumer prices. Together with the reversal of the German VAT rate, headline inflation could even get close to 5% towards the end of the year.

Looking further ahead, some one-off factors should disappear at the start of next year but the recent surge in energy prices, as well as continued supply chain frictions and post-lockdown price mark-ups, are likely to keep German inflation above 2% throughout most of 2022.

December debate at ECB on next steps for asset purchases is likely to be heated

The last time German inflation stood above 4% was in June 1992. Needless to say that the world back then looked very different. It was a year after the East-German mark disappeared into the D-mark, Germany lost the final of the European football championship against Denmark and Helmut Kohl was still chancellor.

Coming back to today's inflation, the recent surge will do very little to bridge the gap between the two inflation camps: one arguing that inflation drivers are transitory and that base effects will disappear or even reverse next year and the other seeing a broad risk of accelerating inflation. We remain somewhere in the middle. While structural factors like labour market slack or digitalisation indeed argue in favour of a more benign approach to inflation, we are seeing the most fertile breeding ground for second-round effects in a long while.

We wouldn't be surprised to see the ECB reducing its asset purchases in 2022 to a larger extent

In fact, we do see two kinds of second-round effects materialising. The first is the pass-through from higher producer prices to consumers. In the past, producers absorbed higher costs by profit margin squeezing. This time around, they seem to be willing to pass on higher costs to consumers as illustrated by the fact that selling price expectations in both the manufacturing and services sector are currently at record highs. The second pass-through channel will be wages. The narrative that German wage settlements were well-behaved this year belongs to history. Latest announcements show that unions are going into upcoming negotiations with demands linked to current inflation numbers, not to inflation expectations.

Admittedly, monetary policy can hardly bring down inflation driven mainly by one-off factors. However, constantly higher inflation rates and a high risk that the ECB has actually entered a period in which its longer-term inflation forecasts frequently turn out to be too low, compared with too high in the years prior to the pandemic will put more pressure on how much monetary accommodation the eurozone economy really needs. We would no longer be surprised to see the ECB reducing its asset purchases in 2022 to a larger extent than thought after the August meeting.

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 www.ing.com.