

Some relief in German inflation

German inflation came down somewhat in November, on the back of energy base effects. However, the ongoing pass-through of high wholesale gas prices as well as additional pipeline pressure still make likely another rebound before reaching the final inflation peak.



Inflation in Germany is decelerating

A very small breather for German inflation. Headline inflation came in at 10% year-on-year in November, from 10.4% in October. The monthly drop in consumer prices (by 0.5%) was the largest since early 2020. The HICP measure also fell, to 11.3% YoY, from 11.6% YoY in October.

Peak still not reached

Available regional data suggest that the drop in headline inflation was mainly driven by energy base effects and a drop in prices for leisure and entertainment after the Fall vacation period. Food price inflation still increased.

Looking ahead, the November inflation number might not yet be the peak of German inflation. We rather expect headline inflation to rebound in December, before finally reaching a more structural peak in the first quarter. Most importantly, the pass-through of higher wholesale gas prices is still in full swing. Many households will see the first price increase only as of 1 January. Also, even though corporate selling price expectations have started to come down somewhat in the last two months, there is still a lot of inflationary pressure in the pipeline. Don't forget that during previous

episodes of supply-side driven inflation shocks, headline inflation started to come down as the pure result of base effects, while core inflation continued to go up for a while. Needless to say that any forecast for headline inflation is still hugely affected by developments in energy and commodity markets.

According to the German Bundesbank, the recently-announced gas price cap could bring down headline inflation by one percentage point next year. However, the price cap will only become effective in March next year and it is questionable whether the suggested retrospective implementation for January and February will show in the official inflation statistics. In any case, the agreed compensation of one month energy downpayment for December will not have any impact on headline inflation. In general, this is an important distinction to be made: government support schemes that come as compensation for households and companies to offset higher energy costs do not bring down headline inflation but cushion the negative price impact in the short run, while also prolonging inflationary pressure. Direct price caps can immediately bring down headline inflation but open the door for limitless government support measures.

All in all, we remain cautious and don't call today's numbers the peak in German inflation, yet. The pass-through of wholesale gas prices as well as still high selling price expectations suggest that there could first be a rebound before the final peak will really be reached. For the ECB, however, today's German inflation number as well as the sharp drop in Spanish inflation could be reason enough to go for a 50bp rate hike and not another jumbo rate hike by 75bp at the December meeting. Even though, ECB Executive Board member Isabel Schnabel last week said that there was only limited room to slow down the pace of rate hikes. The fact that the rate hikes up to now still need to fully reach the real economy, the uncertainty surrounding the looming recession and the upcoming further shrinking of the ECB's balance sheet all argue in favour of slowing down the rate hike cycle and to eventually shift from policy rates to the size of the balance sheet as the ECB's main instrument to fight inflation.

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