

## German inflation retreats in January but not enough for real relief

Headline inflation came down in January but not as much as expected as the disappearing base effects from the VAT reversal are still more than offset by high energy prices



Shoppers in Bremen, Germany

German headline inflation retreated less than expected at the start of the year. According to a first estimate based on the regional inflation data, German headline inflation came in at 4.9% Year-on-Year in January, from 5.3% YoY in December. HICP inflation stood at 5.1% YoY, from 5.7% YoY in December.

### Inflation will first broaden before significantly dropping

With today's inflation data, one of the so-called one-off effects from 2021 has disappeared. The base effects from the VAT reversal no longer show in Year-on-Year inflation rates. However, the picture that remains is still one of elevated inflation rates.

In fact, today's German inflation data has something for everyone, both 'team transitory' and 'team permanent'. While core inflation measures seem to have come down somewhat, everything related to energy prices still shows almost unchanged inflation rates. It seems as if the disappearance of the VAT reversal base effect has simply been replaced by higher energy prices

and pass-throughs from those. Remarkably, prices for packaged holidays and leisure were also up significantly. That's a sign that price markups are here to stay for a while.

---

*It's hard to see inflation coming down significantly any time soon*

---

Looking ahead, even with the end to the base effect from the VAT reversal, the pass-through from higher energy and producer prices is far from over. Higher gas prices have been passed on to most German households from 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. Chances are strong that average inflation over the entire year will be higher this year than in 2021. Even with headline inflation falling back to around 2% at the end of the year, we currently expect inflation to average 3.5% over the entire year.

## Implications for the ECB

For the European Central Bank, today's German headline inflation data will most likely lead to yet another upward revision of its inflation projections. Still, we see the ECB in no position to consider hiking interest rates any time soon. The drivers behind high inflation and higher inflation projections are still mainly driven by supply-side constraints and not by demand. In other words, tightening monetary policy would do little to ship containers faster from Asia to Europe or reduce energy prices. Consequently, the ECB needs to make a fine distinction between a falling necessity to continue stimulating the economy and actually bringing higher inflation down.

At its upcoming meeting on Thursday, the ECB will have to confirm its new hawkishness without sounding too hawkish. If market expectations surge too quickly, higher interest rates could undermine the economic recovery. On the other hand, too much dovishness could damage the ECB's credibility as an inflation fighter. This is why the ECB needs to avoid rushing from inflation patience to inflation panic. How could they do it? Confirm the December decisions, keep the door open for faster asset purchase reductions and stress the sequencing of policy rate hikes only after asset purchasing ends.

### Author

#### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto: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](http://www.ing.com).