German inflation data suggests no relief in July

While the national inflation measure dropped for the second month in a row due to government relief measures, the European harmonised inflation measure shows that there is no inflation relief in sight

Inflationary pressure is far from over in Germany

German headline inflation dropped for the second month in a row in July. However, this is not yet the end of surging inflation rates. Rather, it's a good example that it is currently governments, not central banks, that can stop inflation. According to a first estimate based on the regional inflation data, German headline inflation came in at 7.5% year-on-year in July, down from 7.6% YoY in June. The HICP measure, however, increased to 8.5% YoY, from 8.2% in June. The main reason for these opposing trends is probably the different treatment in seasonal corrections and packaged holidays in both measures. The increase in HICP inflation is a warning sign for the European Central Bank. In any case, don't be mistaken, even the drop in the national measure is not the start of the end but rather just government-induced temporary relief.

Inflation to remain high for a while

Judging from the available regional inflation components, the drop in headline inflation is mainly the result of the government's energy relief package which became effective on 1 June. In fact, the tax rebate for gasoline as well as the €9 per month ticket to use regional public transportation clearly show up in lower motor fuel and transportation inflation. At the same time, however, food price inflation continued to pick up and the expected price mark-ups in the services sectors, such as hospitality and tourism, gained more momentum.

The energy relief package will end in August. This will also be the moment when the temporary relief to headline inflation ends. Even if pricing power in both industry and services seems to have peaked, we still expect the pass-through from higher costs to last at least over the summer months, if not longer. The risk of an end to Russian gas for Germany has already increased gas prices again in recent weeks and is likely to keep energy prices at highly elevated levels going into the winter season. This makes any significant retreat of headline inflation highly unlikely for 2022. It will take until 2023 before negative base effects send the headline rate towards 2% again.

For the ECB, today's drop in German headline inflation does not bring any relief. Not only because the harmonised inflation measure actually increased but also because German inflation data actually sends a different important message: it is currently not central banks but governments that can effectively bring down inflation. Still, even with this in mind and despite the looming recession, we expect the ECB to continue normalising monetary policy at the end of the summer with another 50bp hike before taking a long pause.

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