

## German inflation stable in February

February inflation data shows very few to no signs of any disinflationary process outside of energy and commodity prices



Inflationary pressure is far from over in Germany

February's headline inflation came in at 8.7% year-on-year, unchanged from January. The HICP measure came in at 9.3% YoY, from 9.2% in January. The sharp monthly increase by 1% month-on-month shows that the inflationary pressure is far from over. The discrepancy between the national and European measures can be explained by a rebasing of the national time series and changes in the weights.

### No start of disinflationary trend, yet

Available regional components suggest that core inflation has remained broadly unchanged. While food price inflation increased, energy price inflation continued to come down. At the same time, service price inflation remained high and increased in, for example, packaged holidays and leisure activities. Last month, only very few services had inflation rates of below 2%. Among these were services like insurance or communication but also paramedic services. Overall, there are few to no signs of any disinflationary process outside of energy and commodity prices.

Inflation data in Germany and many other European countries this year will be surrounded by more statistical noise than usual, making it harder for the European Central Bank to take this data at face value. Government intervention and interference, this year and/or last year, sometimes temporarily, sometimes more permanently, will often blur the picture. In Germany, for example,

the Bundesbank estimated that energy price caps and cheap public transportation tickets will lower average German inflation by 1.5 percentage points this year. The energy price cap will come into effect as of 1 March but will be paid retroactively. And there is more. Negative base effects from last year's energy relief package for the summer months should automatically push up headline inflation between June and August.

Looking ahead and beyond the statistical noise, the German and European inflation outlook is highly affected by two opposing drivers. Lower-than-expected energy prices due to the warm winter weather could, if they remain at current levels, push down headline inflation faster than recent forecasts suggest. On the other hand, there is still significant pipeline pressure stemming from energy and commodity inflation pass-through. In Germany, selling price expectations, the best proxy for the pass-through of higher energy and commodity prices in recent years, have dropped significantly since last summer and currently stand at levels last seen in the spring of 2020. At the same time, however, selling price expectations in services remain close to historic highs. Combined with expected nominal wage growth of more than 5% year-on-year this year, this means that core inflation will remain stubbornly high.

## ECB will continue to hike

The downside of government support schemes and the fact that the eurozone has avoided falling into a severe recession is that what started as supply-driven inflation could morph into demand-driven inflation. And not only in Germany. This is probably a bigger concern for the ECB than just one month of increasing headline inflation.

As long as core inflation remains stubbornly high in the eurozone, the ECB will continue hiking rates and will not consider future rate cuts. A 50bp rate hike at the March meeting has been pre-announced and looks like a done deal. Beyond the March meeting, the ECB seems to be entering a new game in which further rate hikes will not necessarily get the same support within the governing council, as hiking deep into restrictive territory increases the risk of adverse effects on the economy. The main question beyond the March meeting will be whether the ECB will wait to see the impact of its tightening on the economy or whether it will continue hiking until core inflation starts to substantially come down. We currently expect a compromise: two additional rate hikes by 25bp each in May and June, before pausing the hiking cycle and entering a longer wait-and-see period. Financial markets, which only a couple of weeks ago were still betting on rate cuts at the turn of the year, have now once again turned around and are expecting the ECB to hike by a total of 150bp over the next few months. Not impossible, but clearly a recipe for more bad macro news in 2024.

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