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.

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.