German inflation up again in August

The effect of the government's energy relief package was already waning ahead of the measures expiring tomorrow. Headline inflation increased in August on the back of higher gas and food prices as well as higher prices in the hospitality sector

Inflation in Germany is decelerating

On the penultimate day of the government's energy relief support package, figures show headline inflation increased again, pushing inflation to 7.9% year-on-year in August, from 7.5% in July. The HICP measure increased to 8.8% YoY in August, from 8.5% in July. The fact that monthly inflation (0.3% month-on-month) is far above the historical average for August also illustrates that inflation is running red hot in Germany.

Next stop for inflation could be 10%

Judging from the available regional inflation components, the downward push from the government's energy relief package and slightly lower oil prices was more than offset by higher gas and electricity prices, higher food prices and higher prices for leisure and packaged holidays.

While the government is discussing a new energy relief package, the current one with gasoline rebates and cheap public transportation will come to an end tomorrow. Looking ahead, and awaiting any new government decisions, the status quo is that headline inflation will increase further. Even if pricing power in both industry and services seems to have peaked, we still expect the pass-through from higher costs to last for a few more months. The sharp rise in wholesale gas prices will be passed through to customers over the next few months and the announced gas levy will increase prices and push inflation higher. This is why we expect German inflation to get close to 10% by year-end. However, with faltering demand as consumers will increasingly be unable and unwilling to pay high prices, as well as negative energy base effects, headline inflation should start to come down over the course of 2023 and could even touch 2% by the end of 2023; as outrageous as such a call currently looks.

It is very clear that hardly any current central banker has seen inflation rates as high as they are now in his or her professional life. This is why for the ECB, today's increase in German headline inflation will further heat up the internal debate on what to do next. Judging from recent speeches, the ECB is willing to follow in the Fed's footsteps and leave traditional monetary policy thinking behind. Instead of aiming at longer-term inflation developments and expectations, it is actual headline inflation which apparently must be brought down. Definitely not an easy task with inflation that is mainly driven by supply-side frictions. The ECB is under enormous pressure to act, and we expect the central bank to hike by another 50bp next week. Even with a looming recession, it currently looks as if the ECB is willing to hike even further.

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