Germany: Headline inflation retreats...

...but not as much as it should have, given the almost unprecedented divergence between crude oil and gasoline prices in most parts of Germany

Finally dropping again

According to the just released first estimate, German inflation came in at 2.3% year-on-year in November, from 2.5% YoY in October, based on the results of seven states. HICP inflation came in slightly lower at 2.2% YoY, from 2.4% YoY.

Despite the sharp drop in crude oil prices, German headline inflation is still stubbornly high and has been above the ECB's level of price stability for seven months in a row. This, however, is not a sign of underlying inflation picking up. To the contrary, some regional measures of core inflation actually dropped.

Lower oil prices, higher gasoline prices

With the latest sharp drop in oil prices, German inflation should have declined much more. However, Germany is currently experiencing an almost unprecedented divergence of crude oil prices and gasoline and heating oil prices. While crude oil prices denominated in euros have dropped by more than 20% since the summer, gasoline prices in Germany have increased by some 5%. In fact, crude oil prices have more or less returned to their November 2017 levels, while at the same time gasoline prices in Germany are up by around 15%. The reason for this abnormality is the dry summer and low water levels in many German rivers, leading to logistical problems. As a result, the base effect from energy prices has not disappeared.

With today's inflation data, 2018 will have the highest annual inflation since 2012. Looking ahead, however, once lower oil prices finally reach German households, headline inflation should fall back under the 2%-mark in the first months of 2019.

What it means for the ECB

With crumbling and more uncertain growth prospects and very little underlying inflationary pressure in the entire eurozone, the ECB will be happy that the December meeting is not too far away and that it can bring net QE purchases to an end before discussions about an extension could flare up again. At least one unconventional measure should be shelved now. Against the background of recent developments and a more cautious Fed, however, the ECB will, for the time being, try to tackle any growth slowdown as well as stubbornly low core inflation with forward-guidance on rates and the length of the reinvestment programme. If things really get nasty, next year's discussions on the timing of the first rate hike could easily morph into discussions on whether the second unconventional measure (negative deposit rates) should be shelved or whether to hike rates at all.

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