Germany: Higher inflation - delayed, derailed or simply debunked?

German headline inflation drops to its lowest level since April 2018 and undermines the ECB's hope for structurally higher inflation.

According to the just-released first estimate based on the results of several regional states, German headline inflation came in at 1.5% year-on-year in March, from 1.7% in February, the lowest level since April 2018. The national inflation measure dropped to 1.3% YoY, from 1.5% in February.

The Easter Bunny strikes again

The main inflation drivers were lower food prices, continued price drops in communication and lower prices for leisure and package holidays. The latter shows once again the ever-returning impact of the Easter Bunny on German headline inflation. This year, however, it was only a small Easter Bunny effect as only one half of last year's Easter break fell in March.

The Easter Bunny aside, available inflation details illustrate that the drop in global oil prices since late-September has not fully reached German consumers. While global oil prices dropped below their February 2018 levels in February this year and are currently some 6% higher than their March 2018 levels (in EUR), prices for heating oil were still up by some 15% YoY in most German states in

March.

Between delayed, derailed and debunked

Yesterday, ECB president Mario Draghi said that the increase in Eurozone headline inflation towards the ECB's medium-term aim had been "delayed rather than derailed". Eventually, however, the ECB still believes in higher inflation on the back of stronger wages. Unfortunately, the German experience casts doubts about the ECB's view that the pass-through of higher wages on inflation has only been delayed and not derailed. In fact, the German experience shows that even though the transmission from a tighter labour market to stronger wage growth has, since 2016, finally matched previous periods, the transmission from higher wage growth to faster inflation still barely exists. Margin squeezing to maintain (international) market shares, more price transparency due to digitalization and more competition and mobility in the service industry (also due to digitalization) could be the main drivers eventually debunking the textbook relationship between wage growth and higher inflation.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de