

German inflation continues to surge making things even more complicated for the ECB

With headline inflation on the rise, the ECB's attempt to avoid the taper conversation will become more and more complicated. However, we think German headline inflation could eventually range between 3% and 4% in the second half of this year



Source: Shutterstock

Headline inflation is accelerating like the temperature outside

Based on inflation outcomes of several regional states, German inflation in May came in at 2.5% year-on-year, from 2.0% in April. The harmonised index relevant for European Central Bank policymaking increased to 2.4%, from 2.1% in April - the highest level since November 2018.

This acceleration in German inflation is mainly due to higher energy prices but don't forget that all the lockdowns still distort these numbers and imputed prices as many goods and services are simply unavailable.

All inflation drivers in full swing

Today's May inflation data shows that the entire range of potential inflation drivers is currently in full swing.

Higher producer prices on the back of supply chain disruptions, higher commodity prices and the gradual reopening of the economy are all leaving their marks on consumer prices. According to data from regional states, prices for household goods, services and leisure activities were the main drivers of headline inflation.

We think German headline inflation could eventually range between 3% and 4% in the second half of this year

The fact that headline inflation has now surged from -0.7% YoY in December last year to 2.4% in May will cause concern for many Germans, and the bad news is - there is more to come. With supply chain disruptions, like higher container prices, delivery problems with semiconductors and elevated commodity prices, producer prices are set to increase further, possibly putting more pressure on consumer prices.

Add to this some post-lockdown reflation in a few sectors, which will gain momentum soon, and the reversal of the German VAT rate and German (and eurozone) inflation, the only way is up. In our view, German headline inflation could eventually range between 3% and 4% in the second half of this year.

How long can the ECB really avoid the taper conversation?

Like the US, every single data point shows accelerating inflation in the eurozone, which raises questions about the *raison d'être* for ultra-loose monetary policy.

Despite higher inflation, accelerating vaccination roll-out and the strong economic rebound, the ECB looks set to stick to its current stance. Last week, ECB Executive Board member Isabel Schnabel, who seems to be giving most informative speeches and interviews for those looking for the ECB's reaction function, set the scene by warning against "a premature withdrawal of either fiscal or monetary support".

This is just another reminder that the rise of inflation won't be over any time soon. For the ECB, this means that it will be increasingly difficult to avoid the taper talk. The avoidance strategy might work next week but not for much longer.

Consequently, when the ECB meets again next week, the main focus will be on avoiding any tapering talk.

Why? Even if economic developments, in our view, clearly justify at least having a first discussion, the sheer mention of such a discussion could push up bond yields further and consequently undermine the economic recovery before it has actually started. The fact that several more dovish statements were made by ECB officials recently underlines this view. However, the ECB will not be able to avoid the tapering discussion for long.

This discussion will gain momentum over and after the summer, and we expect the ECB to engage in its own twist eventually: gradually ending asset purchases under the PEPP while increasing them under the old Asset Purchase Programme.

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 <http://www.ing.com>.