

Germany: Inflation up but still no signs of overheating

A small uptick in German headline inflation in November is no sign of overheating but mainly the result of higher oil prices and another vacation period.



Based on the results of six regional states, German headline inflation rebounded somewhat in November, increasing to 1.7% YoY, from 1.8% YoY in October. Based on the harmonised European definition (HICP), and more relevant for ECB policymaking, headline inflation accelerated slightly faster to 1.8% YoY, from 1.5%. The monthly increase of 0.3% was the strongest November increase since 2007.

Higher inflation mainly result of oil prices and seasonal effects

Looking at the available components at the regional level shows that today's increase is mainly the result of higher oil prices. In fact, the so-called energy base effect has turned from being disinflationary into being inflationary. The fact that the heating oil component in some regional inflation statistics increased by 15% YoY in November clearly supports this view. Also, the special public holiday combined with school vacations in many states pushed up prices for package holidays and other recreational activities. At the same time, measures of core inflation remained stable.

Stable core inflation, however, masks two diverging trends in German prices. While prices for consumer goods have increased at an annual rate of above 2% for quite some time, the ongoing decline in communication costs and lower prices for services continues to keep core inflation at bay.

Three reasons why inflation is and should remain subdued

Looking ahead, the big question remains why an economy which has been growing at full speed for several years, with record high employment and capacity utilisation above historical averages is not printing higher inflation numbers? In our view, there are at least three reasons for subdued inflation rates, both for current and future developments: the output gap, digitalisation and globalisation.

1. Despite strong growth, the output gap is only mildly positive. In the past, the German economy needed much bigger positive output gaps before sustainably printing inflation rates above 2%. Following previous patterns, the German economy could probably continue for at least another year at the current growth rate before pushing inflation above 2%.
2. Digitalisation and the related increase in price transparency but also higher competition in the service sector seem to structurally put a lid on inflation.
3. Globalisation and automation are probably the main reasons why there is little upward pressure on wages and inflation. The fact that all wage settlements this year came in with agreed nominal wage increases of 2%-2 ½% indicates that the spur in wage increases the ECB has pencilled in is far from certain.

German inflation outlook: watch these oil prices

All of this means that headline inflation seems to be mainly driven by external factors. Domestic price pressure remains subdued. Higher oil prices could easily push German headline inflation again above 2% early next year but that an oil-driven inflation hike would really make the ECB re-assess its current policy stance is highly doubtful.

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>.