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# GERMAN INFLATION COMING IN HOT

## Berenberg Macro View

**Inflation surge.** German HICP inflation jumped to 8.7% yoy in May from 7.8% in April (see Chart), substantially above our own forecast of 8.2% and the 8.0% predicted by Reuters consensus. The HICP makes inflation rates comparable across EU countries. Measured by Germany's national CPI, inflation rose to 7.9% yoy in May from 7.4% in April, higher than the Reuters consensus of 7.6% but quite close to our own prediction of 7.8%. Energy prices remained the main contributor to headline inflation, rising 38.3% yoy in May after 35.3% in April. The pass-through of higher wholesale gas prices to consumers is still ongoing in Germany and motor fuel prices were also up in May. Food prices also surged further and were 11.1% higher in May than one year ago, up from the 8.6% yoy rate in April. This is most likely the result of trade-related disruptions from Putin's war – both Russia and Ukraine are major agricultural exporters. But price increases for services moderated to 2.9% yoy in May from 3.2% in April, even though the usually very stable rent component edged up further to 1.7% yoy in May from 1.6% in April.

Together with the increases of inflation in Spain (to 8.5% yoy in May from 8.3% in April) and Belgium (to 9.0% yoy in May from 8.3% in April), the German data suggest that Eurozone inflation for May (due tomorrow) will be markedly higher than April's 7.4% yoy rate.

**Inflation plateau?** Headline inflation could now be at or close to its peak in Germany. But it may take until Q4 before inflation starts to decline on a sustained basis. During summer upward and downward pressures on inflation may roughly balance each other out, with some month-to-month choppiness in the yoy rates. Factors contributing to higher inflation include:

- The ongoing pass-through of higher wholesale **gas prices** to consumers, which is taking longer in Germany than in other Eurozone countries. In part, this is because German utility companies seem to get a relatively large share of their gas via longer-term contracts which partially shield them from spot price surges. Furthermore, many German households do not need to immediately pay more, even if utility companies raise their prices. For instance, they may pay set monthly instalments to their landlords, with the instalments estimated in advance and any shortfall only settled a year or more later.
- **Food prices** are likely to increase somewhat further, as cost increases due to Putin's invasion of Ukraine continue to be passed on to consumers.

Factors that should have a moderating effect on inflation include:

- From June to August, the German government's **relief package**, which includes a reduction of fuel taxes and a steeply discounted public transport ticket, may temporarily reduce inflation by 0.4ppt yoy.
- From July onwards, the **special surcharge to support renewable energies** will be removed from electricity prices (the government will instead pay the renewable subsidies via the general budget). Utility companies are supposed to immediately pass on this cut to households, which may reduce inflation by 0.3ppt yoy.
- **Oil price** base effects will already have some downward impact in summer before picking up steam in October.

**Medium-term inflation outlook and ECB policy.** The fallout from Russia's attack on Ukraine and continuing supply shortages, further exacerbated by lockdowns in China, have pushed up inflation far beyond the ECB's 2% target. Base effects for energy prices and a gradual resolution of supply chain dislocations should lead to declining inflation rates starting in Q4 this year and continuing in H1 2023. By summer 2023 inflation rates may get close to 2% again. But beyond the short run, several factors are set to raise underlying trend inflation in the Eurozone for years to come, including expensive green transition policies, more expansionary fiscal policies, and falling participation rates due to the aging demographic. Following recent writings and speeches by members of its governing council, the ECB is now extremely likely to end its net asset purchases by the beginning of Q3 and to raise interest rates both in July and September, probably by 25bp each meeting. We then expect a further hike in December, followed by three more in 2023 and two in 2024. These moves will not do anything to the current inflation spike, but they can help to keep inflation expectations anchored. If expectations are de-anchored from the inflation target, a central banks job becomes much more difficult.

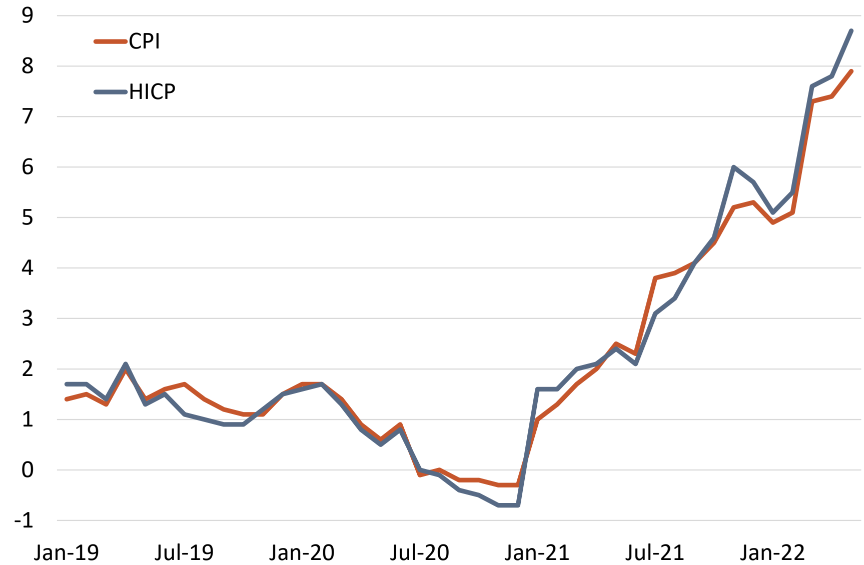
**German state-level data: key component details.** The preliminary data on the federal level do not include a detailed breakdown of price developments across sectors but some states already offer a deeper look. Data from North Rhine-Westphalia, where overall CPI inflation rose to 8.1% yoy in May from 7.7% in April, indicate some key contributors to May inflation:

- **Energy prices** remained the key driver of headline inflation, increasing again to 40.2% in May from 37.6% in April. Household energy was 40.1% more expensive than one year ago in May, up from 37.8% yoy in April. Household gas prices, up 38.9% yoy in May after 34.1% in April, were the main contributor, but prices for electricity, heating oil, and district heating also rose. Motor fuel prices increased 40.5% yoy in May after 37.4% in April.
- **Food prices** increased markedly – they were 12.7% higher than one year ago in May after 10.2% in April. Fats and oils had the most pronounced price surge, to 40.3% yoy in May from 27.7 % in April.
- The picture is mixed for the other components. After a strong Easter season, price increases for **package holidays** moderated to 5.2% yoy in May from 14.4% in April. But prices for **restaurant services** surged further, by 7.4% yoy in May after 6.3% in April – indicating that the post-Covid reopening bounce continued in May. Amid continuing supply shortages, prices for **consumer durables** also increased strongly, by 7.4% yoy in May after 6.8% in April.

**Inflation rises in Spain and Belgium.**

- HICP inflation in Spain rose to 8.5% yoy in May from 8.3% in April. Spanish inflation thus was slightly lower than our own forecast of 8.6% yoy, but higher than the 8.2% predicted by Reuters consensus. Inflation according to the Spanish national CPI measure rose to 8.7% yoy in May from 8.3% in April (Reuters consensus was 8.3%). The Spanish statistical office noted that prices for fuel, food and non-alcoholic beverages were the main contributors to the high inflation rates. However, core CPI inflation also advanced significantly, to 4.9% yoy in May from 4.4% in April.
- Belgian consumer price inflation surged to 9.0% yoy in May from 8.3% in April. Energy and food prices are major drivers of the headline rate, contributing 4.8ppt and 1.3ppt, respectively. But core inflation increased as well, to 4.4% yoy in May from 4.1% in April.
- Data for France, Italy, and other Eurozone countries, as well as for the currency area as a whole, will be released tomorrow.

**Chart: German inflation (in %) - national vs EU harmonised measure**




*Monthly data, year-over-year inflation, CPI: Consumer Price Index (national measure), HICP: Harmonised Index of Consumer Prices. Source: Destatis*

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