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## GERMAN INFLATION DEFLATES – GOOD NEWS FOR THE ECB

### Berenberg Macro View

**The worst is over.** German inflation dropped sharply in May and looks set to decline further. Germany's EU-harmonised HICP inflation rate fell much more than predicted to 6.3% yoy in May from 7.6% in April (see Chart), below Reuters consensus (6.8%) and our own expectations (6.7%). Together with a significant drop in French inflation to 6.0% yoy in May from 6.9% in April and the recent downturn in economic indicators, this makes it even more likely than before that the ECB will not raise rates again after the summer break. We expect the ECB to stop at a 3.75% deposit rate after two more hikes of 25bp each in June and July.

Encouragingly for the ECB, the decline in German consumer price inflation is increasingly broad-based. The overall national CPI inflation measure rose 6.1% yoy in May, down from 7.2% in April. Energy prices, helped by base effects from last year's run-up in prices, lead the decline – they rose by only 2.6% yoy in May after 6.8% in April. Prices also slowed significantly for food (to 14.9% yoy in May from 17.2% in April) and other goods (to 6.6% from 7.3% per our estimate). Even services prices rose less quickly than before, at 4.5% yoy in May after 4.7% in April, but this was likely mainly due to a one-off effect from the introduction of the subsidised €49 “Germany ticket” for public transportation. The traditionally very stable rent component rose 2.0% yoy in May, the same as in April. This implies that services excluding rents were 5.8% more expensive in May than one year ago, down from 6.0% in April. As the value chain from imported cost shocks to final consumer prices is longer for many services than for goods, it took more time for services prices to surge in response to higher costs for basic inputs – and now it is also taking longer for them to abate.

Consumer price inflation is set to decrease further in the quarters ahead on the back of receding cost pressures that have already been visible for some time in early stages of the pricing chain. German import prices (also published today) decreased 7.0% yoy in April after a 3.8% decline in March – by more than Reuters consensus had predicted (-5.8%) and far below the +32.7% yoy peak rate in August 2022. Base effects due to higher prices in spring 2022 after the Russian invasion of Ukraine helped. Energy prices were 31.8% lower than one year earlier. But even excluding energy, German imports were 0.6% cheaper than in April 2022.

While inflation is definitely moving in the right direction, it is still much higher than would be consistent with the ECB's inflation target. We thus expect the ECB to still go ahead with two more rate hikes by 25bp each in June and July before staying put.

**German state level details: note a public transport one-off.** The preliminary data on the federal level do not include a detailed breakdown of price developments for product groups but some states already offer a deeper look. Data from **North Rhine-Westphalia (NRW)**, where overall CPI inflation fell to 5.7% yoy in May from a revised 6.7% yoy in April, indicate some key contributors to May inflation (see Table).

- **Energy** prices continued to lead the disinflation trend – they were up just 0.8% yoy in May, down from the 4.7% rate in April. Both motor fuels and heating oil were cheaper than in May 2022. While other components of household energy remained more expensive than one year ago, their yoy rates of increase declined compared to April.
- The price pressure within **food** and **non-alcoholic beverages** abated further, too.
- Prices for many **other goods** also decelerated markedly, including for clothing and footwear as well as furniture, lights, appliances and other household equipment.
- **Services** prices rose less quickly as well. After the introduction of a subsidised “Germany ticket” prices for combined passenger transport services plunged 28.5% yoy in May after a 3.7% rise in



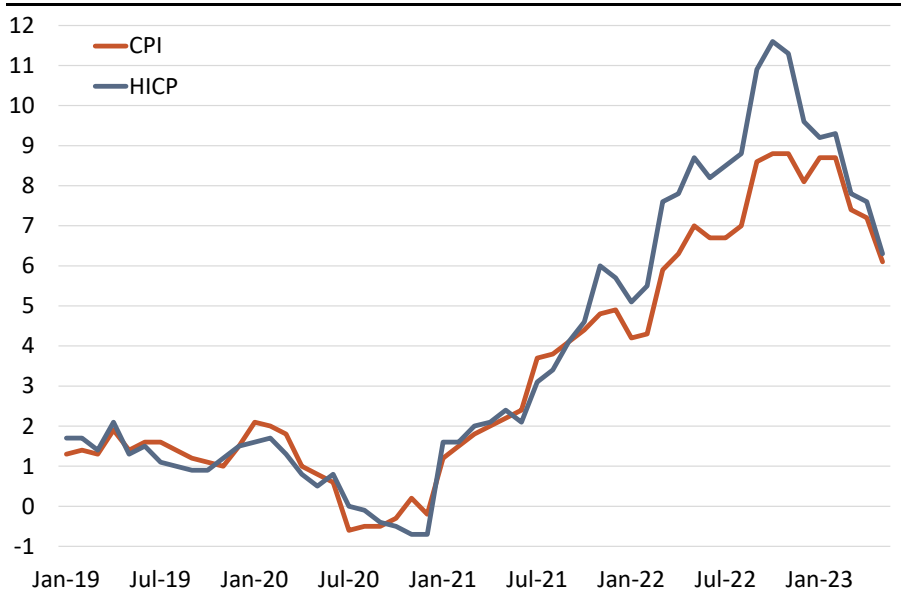
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April – by itself, this shaved about 0.2ppt off of headline inflation. But prices for tourism-related services (package holidays and accommodation services) rose markedly further, likely reflecting persistent strong demand for travel since the end of Covid restrictions.

**Eurozone inflation set to fall in May.** A number of other Eurozone countries also released May inflation figures this week ahead of the Eurozone aggregate due tomorrow. We expect inflation to decelerate to 6.4% yoy in May from 7.0% in April. However, the data from the individual countries so far imply a good chance that the decline will be even steeper.

- In **France**, inflation fell to 6.0% yoy in May after 6.9% in April on the HICP measure, coming in below Reuters consensus (6.4%) and our own expectations (6.6%). The national CPI inflation rate similarly decreased to 5.1% yoy from 5.9%. The good news came from all major categories, but was strongest in energy (2% yoy in May after 6.8% in April), followed by food (14.1% after 15.0%), manufactured products (4.1% after 4.6%) and services (3.0% after 3.2%).
- Inflation in **Italy** declined less than expected. The HICP was 8.1% yoy higher in May, down from 8.7% in April but above Reuters consensus (7.5%) and our own expectations (8.0%). The disinflation was concentrated in energy and food prices – core inflation only edged down to 6.1% yoy in May from 6.2% in April.
- **Spanish** inflation decelerated more than expected. The HICP rose 2.9% yoy in May, below April's 3.8% rate and the 3.4% both Reuters consensus and we had expected. The national headline CPI slowed to 3.2% yoy in May from 4.1% in April, helped by base effects in energy – but core inflation also receded to 6.1% from 6.6%.
- Headline CPI inflation in **Belgium** declined to 5.2% yoy in May from 5.6% in April – but core inflation moved up to 8.7% from 8.3%, likely reflecting significant pressures to index-linked wages in Belgium.
- For **Portugal** headline HICP inflation dropped to 5.4% yoy in May from 6.9% and CPI inflation fell to 4% from 5.7%. A temporary VAT exemption for some essential food items (in force from 18 April to 31 October) helped. But core CPI inflation also slowed markedly to 5.5% yoy in May from 6.6% in April.

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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**Table: Notable price changes in NRW (% yoy) and component weights (%)**

	May	April	Weight
Headline	5.7	6.7	100.0
Ex energy and food	5.0	5.5	82.1
Goods	7.4	9.1	49.7
Services	3.9	4.2	50.3
Services excluding net housing rents	5.3	5.8	33.1
Energy	0.8	4.7	7.4
Food	15.4	17.6	10.5
Electricity	6.6	8.6	2.5
Household gas	39.1	43.8	1.1
Heating oil	-4.5	3.5	0.4
District heating	2.1	2.9	0.3
Motor fuel	-14.9	-10.0	3.0
Non-alcoholic drinks	11.0	14.7	1.4
Clothing and footwear	4.2	4.7	4.2
Furniture, lights, appliances, etc.	6.5	8.0	6.8
Combined passenger transport services	-28.5	3.7	0.7
Package holidays	13.6	10.4	1.3
Accommodation services	9.5	9.0	1.0

Consumer price index (national definition). Source: *it.nrw*, Destatis



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