Economic Research

Economic Briefing

Germany – Services inflation slowing down

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Dr. Ralph Solveen [AC]

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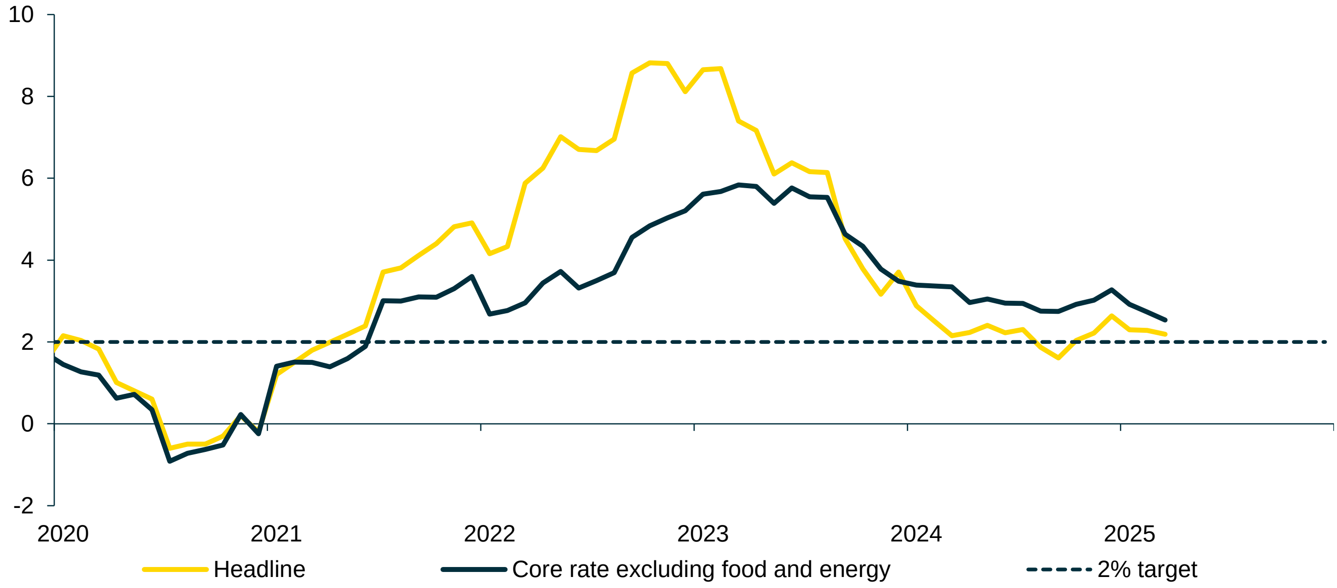
The German inflation rate continued its downward trend in March, falling from 2.3% to 2.2%. In contrast to the past, this was not primarily due to the price development of energy and food. Rather, the core inflation rate, excluding these two often highly volatile subcomponents, fell from 2.7% to 2.5%. It is apparent that companies in the service sector in particular are finding it increasingly difficult to pass on higher labor costs to their customers in light of the weak economy.

Inflation rate only marginally above ECB target

As widely expected, the German inflation rate fell further in March and, at 2.2%, is now close to the ECB's inflation target. Lower energy prices and higher food prices have largely offset each other. Rather, excluding these two subcomponents, core inflation has fallen from 2.7% to 2.5%. This is its lowest level since mid-2021 (Chart 1).

Chart 1 - Core inflation rate on the lowest level since almost 4 years

National CPI, change on year in percent



Source: Destatis, Commerzbank Research

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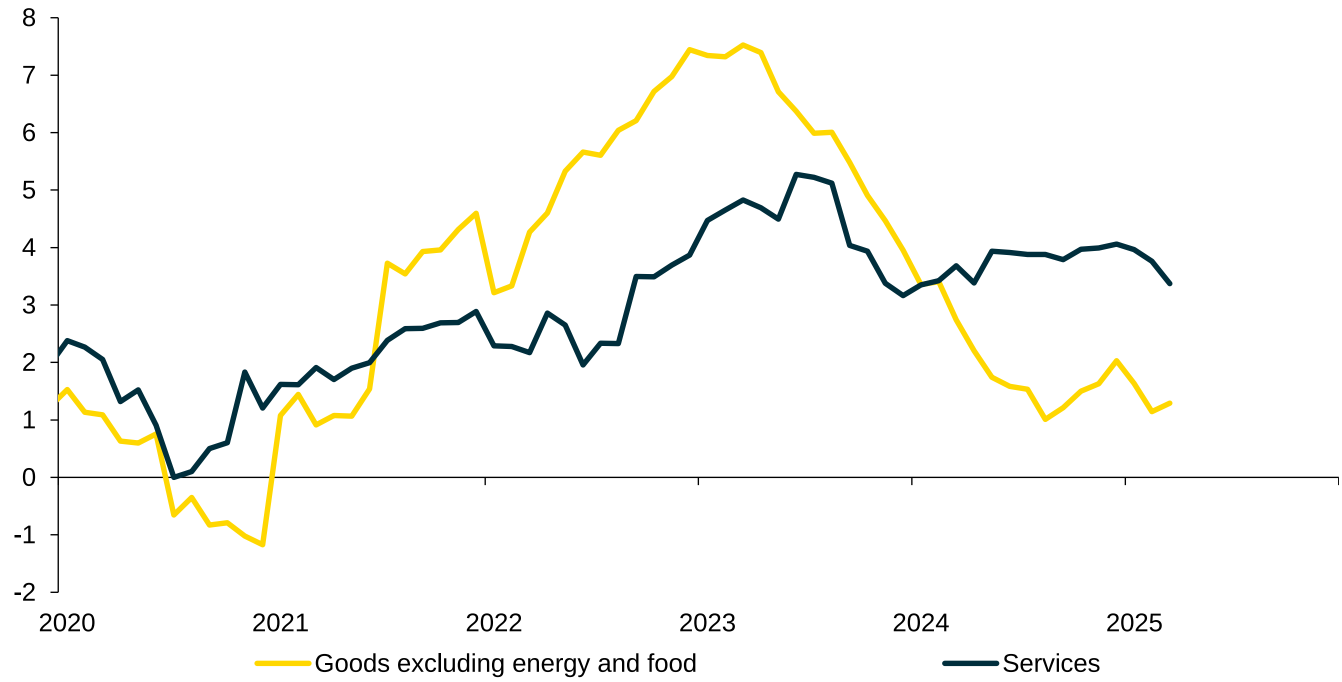
Services prices are rising much more slowly

A glance at the two subgroups of the core inflation rate shows that goods inflation was actually slightly higher in March than in February (1.0% after 0.9% in February). The main reason for the decline in the core rate was therefore a weaker service inflation. In March, prices for services were only 3.4% higher than a year earlier, whereas this year-on-year rate had been fairly stable at around 4% for much of the previous year (Chart 2). However, this is hardly attributable to the development of wages, which continued to increase significantly over the course of last year. Rather, it seems that companies are finding it increasingly difficult to pass these higher costs on to their customers in light of the persistently weak economy.

Chart 2 - Service inflation slowing down

Sub-groups of German CPI, change on year in percent



Source: Destatis, S&P Global, Commerzbank Research

Inflation is no obstacle for further interest rate cuts

In the euro area, the inflation rate is also likely to have fallen further in March and, at an expected 2.2%, is now only just above the ECB target. At its meeting in mid-April, the doves on the ECB Governing Council will use this as an argument to cut the key interest rate again by 25 basis points. Another step is likely to follow after the June meeting, before the ECB will probably switch to a “wait-and-see” mode.

Analysts

Dr. Ralph Solveen AC
Senior Economist
+49 69 9353 45622
ralph.solveen@commerzbank.com

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Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000