



COMMERZBANK

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German inflation rate significantly lower again in January

The German inflation rate fell significantly again in January from 3.7% to 2.9%. The main reason for this was the development of energy prices, where a distorting base effect disappeared. In addition, the numerous government measures that came into effect at the turn of the year had a much smaller effect than we had assumed. The core inflation rate fell only slightly from 3.5% to 3.4%, with the inflation rate for services showing signs of stabilizing.

The German inflation rate fell significantly again from 3.7% to 2.9% at the beginning of the year. This was primarily due to the fact that the inflation rate in December was distorted upwards by a base effect in energy prices, which has now disappeared. By contrast, the core rate excluding energy and food prices fell only slightly from 3.5% to 3.4%.

With this significant decline, the inflation rate was much lower than we had expected. Apparently, the numerous government measures that came into effect at the turn of the year (including higher VAT on food in restaurants, higher CO2 prices and the end of the price brakes on electricity and gas) caused the consumer price index to rise less sharply than we had previously assumed. For example, gas prices have fallen significantly in some states despite the end of the price brakes.

The underlying price increase is more important anyway, as it is likely to have an influence on when and how quickly the ECB will cut interest rates. A look at the details shows that the slight decline in the core inflation rate is solely due to a lower increase in goods prices (excluding energy and food). Here, the inflation rate fell significantly from 4% to 2.3% (Chart 1), which once again confirms that companies have now largely passed on their significantly increased costs for primary products and raw materials over the past two years to their customers. On the other hand, the inflation rate for services has risen again slightly following a decline in recent months. This can probably be explained primarily by the VAT effect on restaurants and a stronger increase in the (always very volatile) prices for package tours. But even without these effects, there are signs that the inflation rate is stabilizing at a still high level.

We assume that the current sharp rise in wages will continue to push up prices for services and thus ensure that underlying inflation stabilizes above the ECB's target of 2%. Although this will not prevent the ECB from cutting interest rates – we expect the first

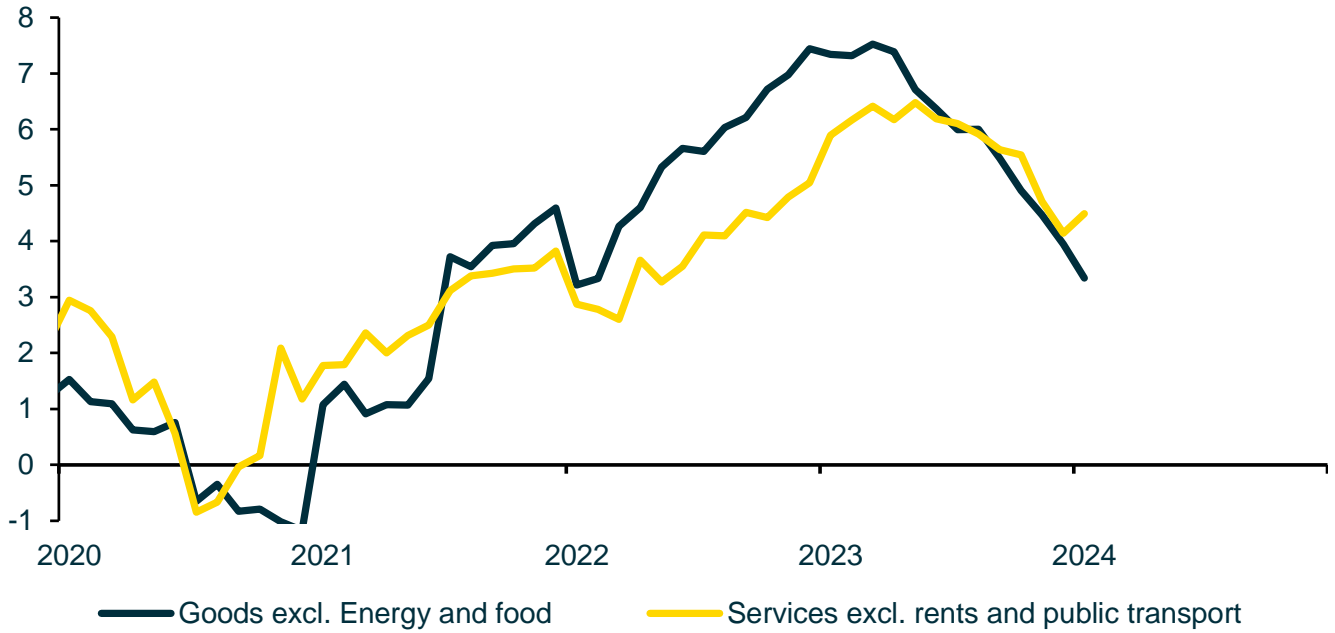
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move to be made in June - it will probably cause it to ease monetary policy more slowly than the market currently expects.

Chart 1 - Is service inflation set to stabilize?

Sub-groups of CPI, change on year in percent; October figures partly estimated based on figures for German states



Source: destatis, Commerzbank Research



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