

Germany – Does service inflation ease?

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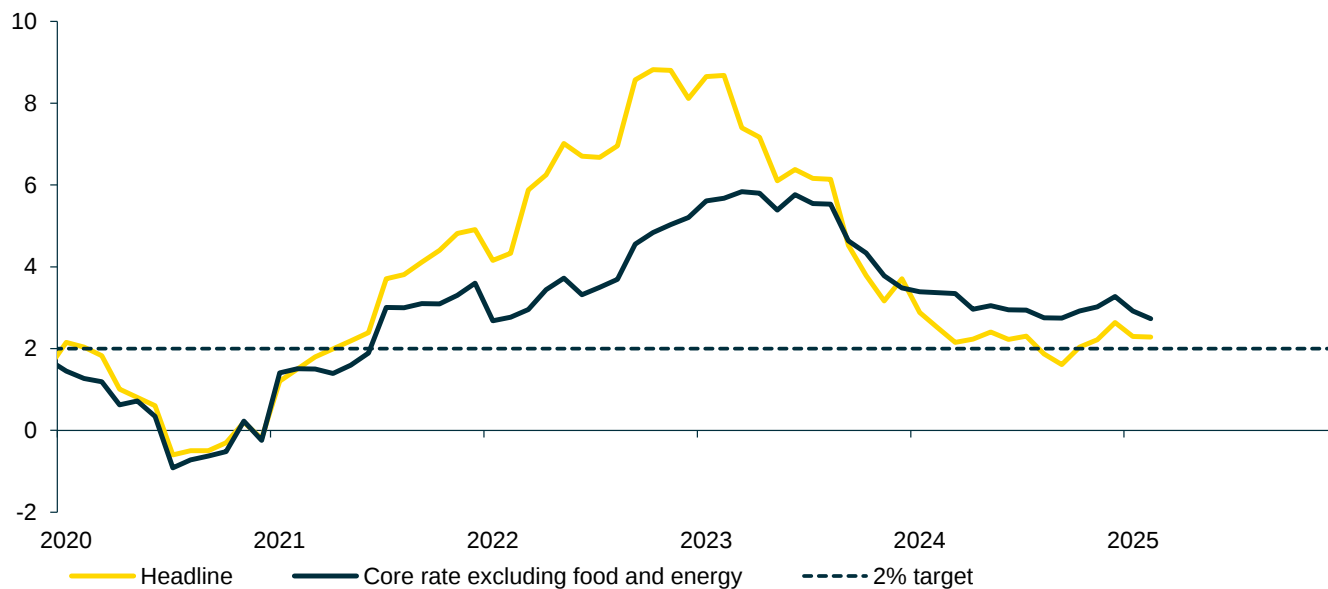
The German inflation rate in February was 2.3%, the same as in the previous month and in line with expectations. However, the core inflation rate fell from 2.9% to 2.6%, partly because service prices rose more slowly. Companies are obviously finding it more difficult to pass on the continued sharp rise in wage costs to their customers. As a result, core inflation is likely to continue easing slowly in the coming months, although it is unlikely to fall below 2%. For the eurozone, the national results available to date suggest that the inflation rate has fallen from 2.5% to 2.3%, bringing it back closer to the ECB's target of 2%.

According to the first estimate by the Federal Statistical Office, consumer prices in February were on average 2.3% higher than a year earlier, meaning that the inflation rate was just as high as in January. The figures were largely in line with expectations. However, the overall rate conceals two opposing changes. On the one hand, food prices rose significantly more than in January compared to the previous year, which exerted upwards pressure on the inflation rate. On the other hand, however, the core inflation rate excluding food and energy prices fell from 2.9% to 2.6% (Chart 1).



Chart 1 - Headline inflation close to 2%, core rate still significantly higher

National CPI, change on year in percent



Source: Destatis, Commerzbank Research

Service prices rise somewhat more slowly

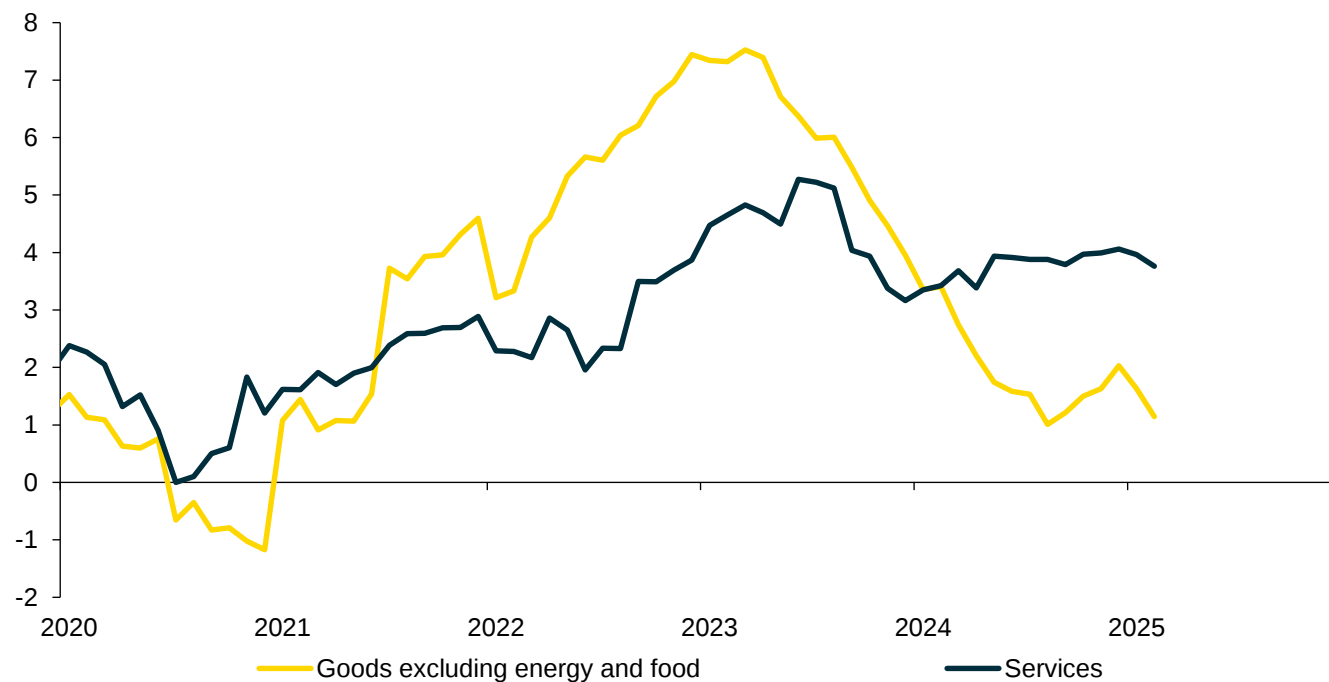
If the core inflation rate is broken down into the development of services and goods prices (also excluding energy and food prices), it can be seen that prices in both areas have risen less compared to the previous year (Chart 2). Of particular interest here is the fall in the rate of inflation for services to 3.8%, having previously been stuck at a high level of around 4% for some time. The rise in wage costs, which had pushed up prices for labor-intensive services in particular, has barely slowed down to date. However, companies appear to be finding it more difficult to pass on their higher costs to their customers in view of the weak economy. This trend is likely to continue in the coming months as the economy remains very subdued. However, as the rate of inflation for goods is unlikely to fall any further due to rising import prices, the core inflation rate will probably decline only slowly in the coming months. We believe



it is unlikely to fall below 2%, as wage costs will continue to rise significantly and a number of other factors, such as unfavorable demographics and the increasing protectionism driven by the US president's policies, point to a stronger rise in prices.

Chart 2 - Less inflation for goods and services

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



Source: Destatis, S&P Global, Commerzbank Research

Eurozone inflation rate likely to fall to 2.2%

Based on the national results available to date for consumer price inflation in February, the inflation rate in the eurozone is likely to have fallen from 2.5% to 2.3%, slightly below expectations. The core inflation rate is likely to be around 2.4%, after 2.7% in January. This would bring both rates gradually closer to the ECB's 2% target.



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