



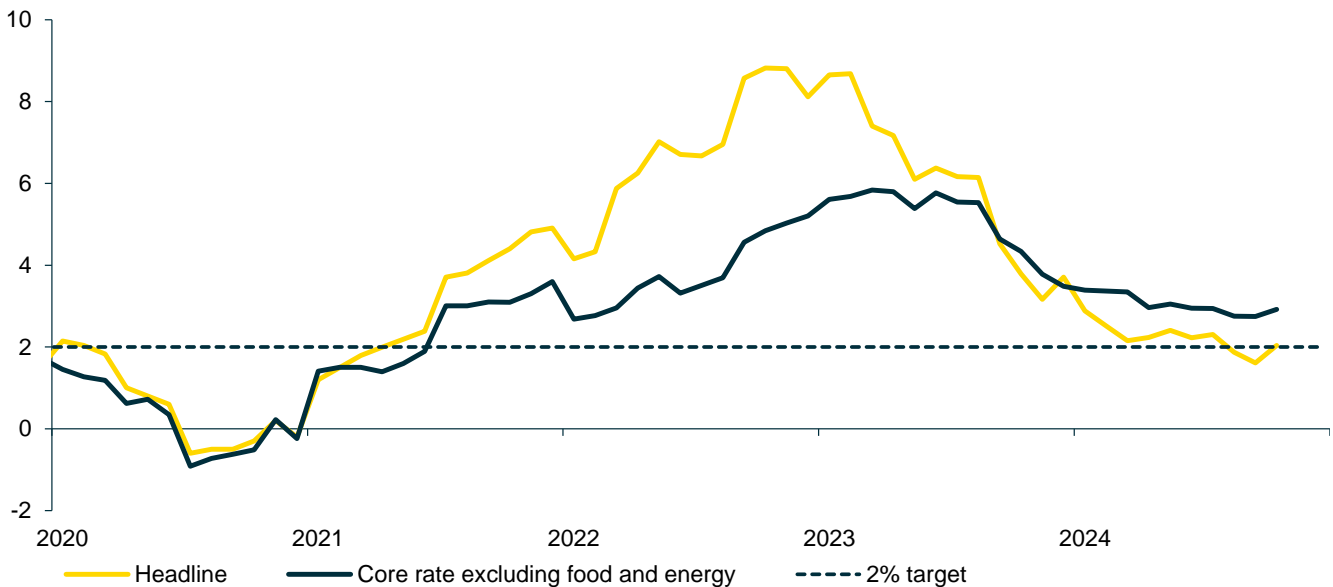
Germany: Underlying inflation stubbornly high

After two significant declines, German inflation rate rose again in October, from 1.6% to 2.0%. This is partly due to a higher year-on-year rates in the very volatile energy and food prices, but the core inflation rate has also increased. At 2.9%, it remains well above the ECB's target of 2%, and in view of the continued strong rise in labor costs, it is likely to fall only slowly in the coming months.

The fall of the German inflation rate below the 2% mark has proved to be only temporary. According to the preliminary estimate of the Federal Statistical Office, it rose again in October from 1.6% to 2.0% (Chart 1). One contributing factor was the rising year-on-year rates for energy and food prices. But even the core inflation rate, which excludes these two often highly volatile subcomponents, rose in October from 2.7% to 2.9% after having fallen slightly in the previous months.

Chart 1 - Headline inflation back at 2%, core rate still significantly higher

National CPI, change on year in percent



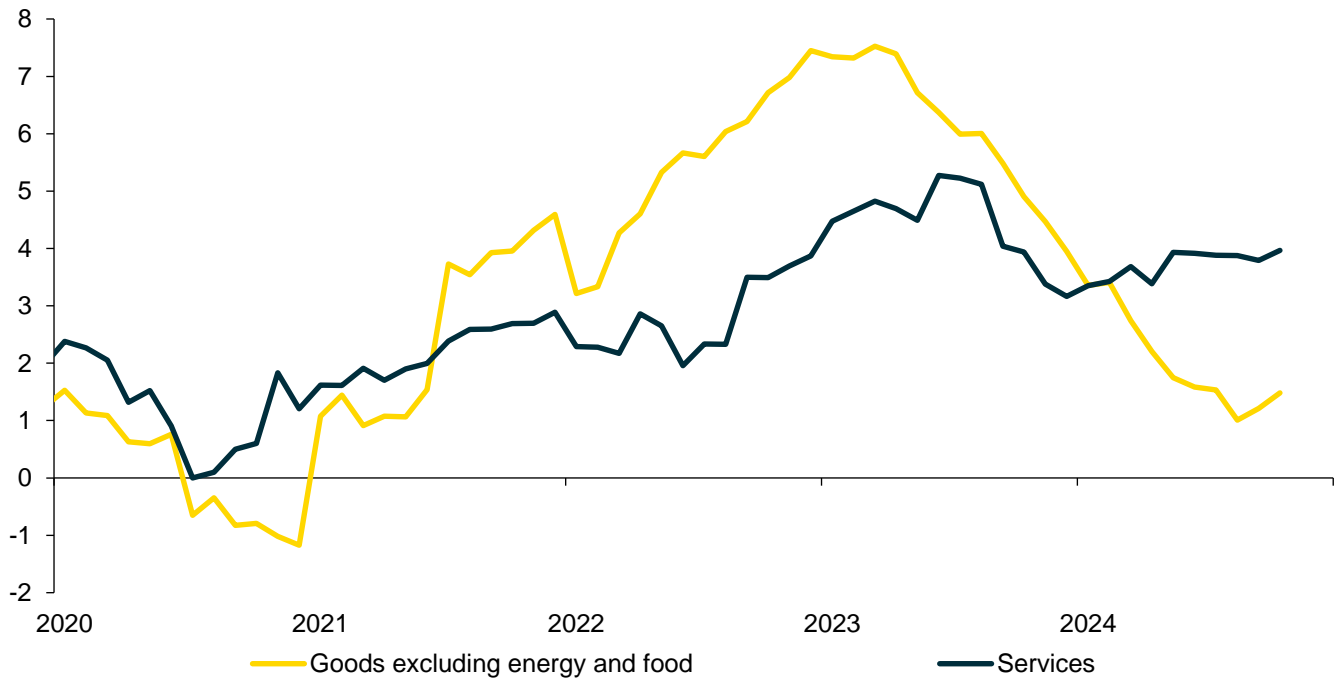
Source: destatis, Commerzbank Research



The high core inflation rate continues to primarily follow the ongoing strong rise in service prices (Chart 2). The year-on-year comparison here has been marginally below 4% since the spring; in October it increased slightly to 4.0%. The decisive factor for the sharp rise in service prices is likely to be the noticeable increase in wage costs. Since wages have risen significantly until recently, the only factor to slow prices is the weak economy, which will gradually push down the services inflation.

Chart 2 - Services inflation stable at an elevated level

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



Source: destatis, S&P Global, Commerzbank Research

The goods inflation (excluding energy and food) appears to be at least stabilizing. In October, it rose from 1.2% to 1.5%, the second increase in a row. The price trend at the preliminary stages also argues against a renewed significant decline, especially since higher wage costs tend to indicate rising prices here as well.

Thus, the core inflation rate is likely to fall only slowly in the coming months. The overall inflation rate is even likely to rise slightly in the coming months due to base effects in energy prices.



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