All Signal, No Noise

MARKET ANALYSIS

German Inflation and Reweighting: Key Uncertainties

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The German final CPI print for January will be released tomorrow at 0700 GMT / 0800 CET. Consensus expects the harmonised inflation print to be confirmed at +0.5% m/m and +9.2% y/y, implying a 0.4pp deceleration on the annualised headline print. Markets are pricing in 49bp for the March ECB meeting (where the ECB has already strongly signalled a 50bp hike) and then pricing in a further 36bp of hikes in May and a terminal rate around 3.75% in the summer. Any large revisions to tomorrow's data are likely to have a larger impact on May and terminal rate pricing than on March pricing.

- **Recap:** The flash January HICP data released on 9 February saw a downside surprise on HICP, yet this remained higher than the likely estimate implemented by Eurostat in their earlier January eurozone aggregate flash release. Based on MNI calculations, the flash HICP German number all else equal would be consistent with around a 0.2ppt revision higher to the final Eurozone HICP print on 23 February (0.1-0.4ppt range).
- The German Federal Statistics Office (Destatis) is due to release revisions tomorrow: *"The final results for January 2023 and all results recalculated from January 2020 onwards using the new 2020 base year will be published by the Federal Statistical Office on 22 February 2023. Comprehensive supplementary information on the revision will also be released"*.
- CPI rose by +1.0% m/m in the January flash, resulting in a +8.7% y/y print. Yet it is unclear as to whether the annualised January flash data constitutes a deceleration or acceleration on December. Tomorrow's release will provide additional information on how core, energy and food inflation moved in January.

Interpretation of the January data:

- A rise in comparison to December would largely indicate the inflationary offset of the December government energy bill payment, yet this may be outweighed by energy price caps effective in January.
- Alongside clarification on Destatis' treatment of back-paid government energy support, reweightings of the consumer basket contribution will likely be substantial. Federal states' contributions to the national print will also be reweighted and published in tomorrow's release, with state data to be released throughout the morning.
- Destatis will hold a press conference addressing the revisions at 0900 GMT / 1000 CET.

Uncertainty 1 - New Weights: As of January 2023, Destatis will use new weights to calculate CPI. It's reweighted based on 2022 spending patterns, implying that energy will be more heavily weighted.

- A more heavily weighted energy component expected due to the 2020-rebasing will ensure that whichever way the aggregate effect swings, the repercussions will be greater for the headline inflation print.
- The 2022 recovery in tourism may see the weight of package holidays increased, which would produce more volatility in the year-on-year CPI rates between seasons.
- Larger weights for transport have been seen in France and Spain. However, they are less of a certainty for Germany , due to a stark reduction in consumer spending on transport in the summer months, underpinned by the Summer 9-euro public transportation ticket.
- If Germany follows the trend of eurozone countries' new basket weighting schemes, we're likely to see services and transport take a larger share of the headline index in 2023.
- Spain, but reduced weights for food and clothing. The effect of clothing will be based on whether retailers attempted to salvage profit margins or move merchandise in sales.
- France also increased weights and services (notably catering and accommodation), reducing weights for manufactured products, whilst Italy increased weights most notably for energy and services subcomponents.

Uncertainty 2 – Energy Subsidies Implications: How Destatis treats the energy bill rebates remains uncertain, after the government paid December bills, potentially implying a much higher y/y print in January then December.

- If Destatis were to smooth the gas price caps over Jan/Feb, and make an assumption of the delayed December energy bill payment for consumers without direct gas from supplier to be averaged at 1/12 per month, this could underpin the German HICP disappoint in the flash data. If not and the full effect of the rebound from the December energy bill payment would likely see CPI closer to consensus with an upward revision to EZ HICP.
- A degree of government support (gas price caps) will be effectively backdated and not paid until March. It is unclear whether Destatis will include this subsidy in the January print. If this were to see a sharp decline on energy bills through the energy price brake for existing customers on older energy contracts, the downwards effect on headline CPI would be more pronounced. Whilst those on newer contracts will see their energy costs increase to the price break level.

According to Destatis:

- **Measures not affecting CPI:** The September 300 euro energy bonus was distributed as a fixed amount with no direct reference to goods/services consumption.
- **Measures affecting CPI:**
    - Temporary fuel tax reduction (Tankrabatt): This dampened CPI from June-August 2022, the exact degree of price reduction for consumers cannot be determined due to the opaque pricing by gas stations.
    - 9-Euro Transport Ticket: This dampened passenger transport services from June-August 2022, and CPI.
    - VAT reduction on gas and heating: from Oct 2022 to March 2024. This will reduce CPI, however, due to late legal implementation has only included from November 2022 CPI.
    - December one-off payment for gas and heating: If customers have a direct contract with supplier – no December payment collected and direct effect on CPI (affecting around half of consumers). If consumers pay yearly utility bill, due with next bill and not taken into account in CPI.
    - As such the December -39.1% m/m fall in gas prices, -12.9% m/m fall in energy and -12.1% m/m fall in heating oil are likely to be reversed in January.
    - Gas, heat and electricity price brake: Price caps have been introduced as of Jan 2023 for electricity, gas and heat as of March 2023. These effectively impact CPI from as early as Jan 2023 for electricity. For gas, costs over the caps will be retroactively reimbursed for January/February in March due delays in legalities.