

Easter bunny cannot stop German disinflation

Disinflationary trends broaden as headline inflation drops for the fourth month in a row



Even the Easter Bunny can't stop German disinflation. According to the just-released flash estimate, German inflation has dropped for the fourth consecutive month, with the March headline number coming in at 2.2% year-on-year from 2.5% YoY in February. The European inflation measure came in at 2.3% YoY from 2.7% in February, slightly lower than consensus expectations and the lowest level since June 2021.

Remember that the main differences between the national and the European inflation measures are differing weights for individual consumer goods as well as the fact that the national measure includes prices for gambling and owner-occupied housing.

Inflation could drop to 2% as soon as next month

To some extent, today's drop in headline inflation could mark the second leg of a longer disinflationary trend in Germany. The first leg was simply due to favourable energy and food base effects. The second leg could be a more general cooling off of inflationary pressures as a result of the European Central Bank's monetary policy tightening and hence weaker demand, as illustrated

by monthly price changes that remained slightly below historical averages for the month of March. Also, despite the early timing of Easter this year, prices for leisure, packaged holidays and hotels and restaurants rose less than expected month-on-month than expected. The Easter bunny effect, ie the base effect stemming from the timing of Easter, was hardly visible this year.

Looking ahead, headline inflation in Germany could drop to 2% as soon as next month, before rebounding somewhat in the months after. In general, inflation developments will be highly determined by weaker demand but also less favourable base effects, supply chain frictions as a result of the tensions in the Red Sea, as well as government interventions and austerity measures. Our view that inflation will hover within the broader range of between 2% and 3% rather than continuing on a straight line to 2% or less is confirmed by forward-looking indicators. Selling price expectations in manufacturing, for example, have returned to a six-month high and are only slightly below long-term averages. In the eurozone, selling-price expectations are even at a 10-month high. At the same time, however, selling price expectations in the services industry have come down since the start of the year but remain above historical averages.

What to expect from next week's ECB meeting

At first glance, today's German inflation data brings some relief for the ECB and could support calls for rate cuts as early as next week. With inflationary pressures fading away, why wait for a first rate cut until June? Well, the bottoming out of the eurozone economy, as illustrated by leading indicators as well as lending growth, undermines any calls for rate cuts to save the eurozone economy from falling further into stagnation. Also, still-elevated domestic and services inflation in the eurozone as a whole illustrates just how difficult the last mile will be for the ECB and argues against cutting rates too early. As a result, the ECB will want to wait to be entirely sure of the trend for both headline and underlying inflation. Here, wage developments remain key and as long as the economy doesn't fall off a cliff, the ECB will sit tight next week, waiting for more data and the June meeting.

The discussion at the coming ECB meetings will no longer be on 'whether' but rather on 'when' and 'how much' the ECB should cut interest rates. Remember that the ECB's staff projections in January had inflation returning to target in the second half of 2025, while growth would be slightly above potential both in 2025 and 2026. Given how the ECB's models work, the ECB would have to cut rates by some 100bp to get to these, what the ECB would call, favourable macro outcomes. Assuming a June rate cut is almost cast in stone, the ECB will be discussing the size and sequence of rate cuts. We think that as long as the eurozone economy is not in recession and risks to inflation and the inflation outlook remain to the upside (be it due to cyclical but also structural drivers), the ECB will opt for a "slow hand" policy of rate cuts by 25bp each every quarter. Any more aggressive rate cut scenario would smell like panic and require a more adverse growth outlook for the eurozone.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.