

ECB doves bolstered by German disinflation

Headline inflation in Germany dropped again in September, giving ECB doves additional reasons to consider reintroducing the rate cut option at the October meeting



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The just-released flash estimate of German inflation in September has everything the ECB needs to continue cutting rates at the September meeting. Coming in at 1.6% year-on-year, from 1.9% YoY in August, German headline inflation is now at the lowest level since January 2021. The European inflation measure came in at 1.8% YoY, from 2.0% in August.

Disinflation is getting broader

At first glance, today's drop in headline inflation is once again the result of favourable energy price base effects. And, indeed, gasoline prices in September were some 15% lower than a year ago, and electricity prices some 25%. At second glance, however, components of some of the regional state inflation data point to a tentative broadening of disinflation. While leisure costs showed the typical post-summer-break monthly drop, prices for education, communication and even services fell in September compared with August.

Looking ahead, today's inflation reading likely marks the end of the disinflationary trend driven mainly by base effects this year. Forward-looking indicators suggest that inflation will remain relatively stable in the coming months, with a slight uptick in headline inflation towards the end of the year. Selling price expectations in both industry and services have remained relatively stable, or "sticky," over the past year – slightly above historical averages for services and slightly below for industry. The ongoing challenges in German industry might prompt unions to reconsider their wage demands in ongoing negotiations, potentially prioritising job security over significant wage increases. As a result, the anticipated wage pressure may be less pronounced than previously expected.

Nevertheless, even if inflation seems to settle down around 2%, there are at least three reasons to not give the all-clear yet: many consumers have yet to recover the losses in real purchasing power from recent years; persistent supply-side constraints could easily bring back inflation as soon as demand in the economy picks up again; and, finally, the structural factors of 3D inflation – demographics, deglobalisation, and decarbonisation – continue to suggest a trend of higher inflation.

Rate cut option back on the table at ECB's October meeting

For the European Central Bank (ECB), today's German inflation data is another strong argument to bring a rate cut at the October meeting back on the table. The recent series of disappointing economic sentiment indicators and lower-than-expected inflation data have provided new strong arguments for ECB doves. Remember that after the September meeting and the rate cut announcement, all ECB members seemed very happy to take it easy and to wait until the December meeting to make any next rate cut decision. With a lot of uncertainty regarding inflation and growth, waiting for the next round of staff projections seemed the best thing to do. However, recent data releases have clearly increased the risk of a rather significant downward revision of the ECB's inflation and growth forecasts in December.

For the October meeting, the main question for the ECB will be how it interprets the distinction between data dependence and data point dependence. If all of recent data is regarded as one big data point, there is no reason to cut at the October meeting. If it is regarded as one big series of disinflationary data, it is. In any case, against the background of the latest data, the main challenge for the ECB will no longer be whether or not to cut rates again in December, but rather whether to cut by 50bp in December or 25bp in October.

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