

## German disinflationary trend pauses for the summer

German inflation increased in June to 6.4% year-on-year, from 6.1% YoY in May. But what looks like an end to the disinflationary trend of the last few months is only a temporary break. Disinflation should gain more momentum after the summer



With lower-than-expected energy prices and dropping food prices, German inflation could come down faster than the ECB expects

According to the just-released first estimate, German headline inflation increased in June, coming in at 6.4% year-on-year (from 6.1% YoY in May). The harmonised European measure showed German headline inflation at 6.8% YoY, from 6.3% in May. This marks an end to the disinflationary trend seen over the last six months. However, a closer look at the data suggests that the disinflationary trend will gain new and even stronger momentum after the summer.

### Disinflationary trend has paused, not stopped

Inflation data in Germany and many other European countries this year will be surrounded by more statistical noise than usual, making it harder for the European Central Bank to take this data at face value. Government intervention and interference, whether temporary or permanent or occurring this year or last, will continue to blur the picture.

Today's inflation data show that headline inflation is and will be affected by several base effects: while lower energy prices insert downward pressure on inflation, the end of last summer's temporary government energy relief measures has inserted upward pressure. Looking at monthly price changes actually paints a promising picture of German inflation dynamics. For the third month in a row, food prices have dropped month-on-month. Prices for clothing have dropped for the first time since January; a tentative sign of weaker demand and price discounts.

With still lower-than-expected energy prices, dropping food prices and fading pipeline price pressures in both services and manufacturing, German (and eurozone) inflation could come down faster than the ECB expects, at least after the summer. In fact, there is the risk that another chapter will be added to the misconceptions of inflation dynamics: after 'inflation is dead' and 'inflation is transitory', we could now have 'inflation will never come down'.

Don't get us wrong, we still believe that, structurally, inflation will be higher over the coming years than pre-pandemic. Demographics, derisking and decarbonisation all argue in favour of upward pressure on price levels. However, be cautious when hearing comments that inflation will never come down. These comments might come from the same sources that only a few years ago argued that inflation would never surge again. This does not mean that the loss in purchasing power as a result of the last inflationary years will be reversed any time soon. It only means that headline inflation can come down faster than currently anticipated.

We see German headline inflation falling to around 3% towards the end of the year. Admittedly, the risks to this outlook are obvious: sticky core inflation, wage pressure and government measures to support the demand side of the economy.

## ECB will continue to hike

ECB President Christine Lagarde made it clear at this week's ECB forum in Sintra that the job is not done, yet.

We, however, still think that the ECB is too optimistic about the eurozone's growth outlook. Historic evidence suggests that core inflation normally lags headline inflation while services inflation lags that of goods. These are two strong arguments for a further slowing of core inflation in the second half of the year and reasons to start doubting the need for further rate hikes.

But, the ECB simply cannot afford to be wrong about inflation (again). The Bank wants and has to be sure that it has slayed the inflation dragon before considering a policy change. This is why it is putting more emphasis on actual inflation developments, and why it will rely less on forecasts than in the past. As a consequence, the ECB will not change its tightening stance until core inflation shows clear signs of a turning point and will continue hiking until then.

If we are right and the economy remains weak, the disinflationary process gains momentum and core inflation starts to drop after the summer, the ECB's hiking cycle should end with the September meeting.

## Author

### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto: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 <http://www.ing.com>.