German inflation highlights the difficulty of the ECB's last lap

German headline inflation remained stable in April despite the expected downward pressure from the timing of Easter, suggesting that inflation is indeed sticky

Shoppers in Berlin

According to the just-released flash estimate, the disinflationary trend in Germany has come to an end as energy and food prices offset the dampening effects of transportation and communication on inflation in April. Headline inflation came in at 2.2% year-on-year, unchanged from March and still below the 2.5% YoY recorded in February. The European inflation measure came in at 2.4% YoY from 2.3% in March, slightly higher than consensus expectations.

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

Inflation on the rise again

Judging from the available components, the increase in inflation was driven by energy and food prices. Core inflation seems to have come down somewhat but the expected reversed 'Easter bunny' effect hardly materialised. In fact, despite the early timing of Easter this year, prices for leisure, packaged holidays and hotels and restaurants did not fall in April.

Today's German inflation data not only illustrates the high impact oil and food prices are having on headline inflation but also stresses how sticky inflation remains.

This stickiness looks set to continue, and headline inflation in Germany could rebound to 3% next month. In fact, over the coming months, inflation will be determined by two opposing factors: the still delayed impact of monetary policy tightening and, at the same time, less favourable base effects, supply chain frictions as a result of the Middle East tensions as well as the cyclical improvement of the German economy. The stickiness of inflation is also reflected by companies' selling price expectations, which in manufacturing have stabilised slightly below historical averages and, in the services sector, clearly above. As a result, we continue seeing inflation hovering within the broader range of between 2% and 3% rather than continuing on a straight line to 2%.

New headaches for ECB

Today's increase in German headline inflation is a good reminder of how difficult the last mile of bringing inflation sustainably back to 2% will be for the European Central Bank. Still, given the ECB communication over the past few months, a rate cut at the June meeting still looks like a done deal. However, looking beyond June, the path for the Bank is anything but clear. The recent reacceleration of inflation in the US will have reignited inflation worries in the eurozone as well, at least with some ECB hawks. The recent increase in oil prices, as well as a weaker euro exchange rate, could easily push the ECB's own inflation projections for 2025 above 2% again, undermining the case for rate cuts beyond the June meeting.

In fact, right now, there's a risk the ECB could experience a "reverse Trichet moment". Back in 2008, the ECB hiked interest rates shortly before the US subprime crisis became a global financial crisis. A mistake. And in 2011, the ECB under president Jean-Claude Trichet, hiked interest rates, assuming the euro crisis was over. Also a mistake. Six months later, new ECB president Mario Draghi came into office and cut interest rates as the eurozone economy was stuck in recession. Any fears of a 'reverse Trichet moment' will not stop the ECB from cutting rates at the June meeting, but will not only play a role in the June communication but also in the months after. A longer substantial rate cut cycle will only materialise if inflation quickly returns to 2%. Any signs of reflation and also stronger economic activity will limit the ECB's room for manoeuvre.

In January, Bundesbank president Joachim Nagel said that the ECB had tamed the 'greedy beast' of inflation. To paraphrase this analogy, today's German inflation numbers could remind some ECB officials of a bad zombie movie, in which the 'beasts' always return several times before they are defeated for good.

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