

## German inflation rebounds in December

Inflation rebounded in December, strengthening the case for the European Central Bank to wait a little longer before discussing rate cuts



### Temporary end to disinflation

According to the just-released flash estimate, German inflation ended a five-month period of dropping inflation rates in December as headline inflation came in at 3.7% year-on-year, from 3.2% YoY in November. The European inflation measure came in at 3.8% YoY from 2.3% in November. 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.

### Base effects pushed up inflation in December

Most of 2023 saw a disinflationary process that made the entire 'team transitory' smile. At the start of 2023, headline inflation stood still at 8.7% YoY. Interestingly, the disinflationary process in both Germany and the entire eurozone has mainly been the result of favourable base effects, a normalisation of supply chains and lower energy prices. Turning back to Germany, price cuts in leisure, entertainment and hospitality services as well as discounts in food prices added to falling headline inflation in the second half of 2023.

In December, the rebound in headline inflation was mainly the result of a reversal of base effects in energy prices and the introduction of energy price caps in December last year. Compared with November, only prices for heating oil and alcohol actually dropped, while food prices increased for the second month in a row.

## Two opposing trends will shape the 2024 inflation picture

Looking ahead, inflation developments in the coming months will be determined by two opposing trends: more disinflation and potentially even deflation as a result of weaker demand but also new inflationary pressures due to government intervention.

While the downward trend in headline inflation throughout 2023 was mainly the result of base effects, the next stage of disinflation will be driven by the ECB's monetary policy tightening. The weakening of demand as a result of higher interest rates should lead to actual price drops in the coming months. This is already reflected in selling price expectations which have started to come down significantly in the services sector, following the earlier trend in manufacturing. However, on the other hand, the German government's measures to close the 2024 funding gap in the budget will insert new upward pressure on inflation. The return of the limited VAT of 7% to the normal 19% for restaurant services was already decided before the government had a funding gap in its 2024 budget. But the increase in CO2 emission pricing, the introduction of a plastic tax, a flight tax and the end of energy price caps are new inflationary drivers in 2024. As a result, we expect German inflation to hover around 3% YoY in 2024, with risks clearly tilted to the upside.

## Reacceleration of inflation should push ECB rate cut expectations further out

For the ECB, this reacceleration of inflation strengthens the stance of keeping a very steady hand and not rushing into any rate cut decisions. We stick to our call of a first ECB rate cut in June. As much as today's rebound in inflation and potentially more inflationary pressure in the coming months is bad news for consumers, it should be enough to finally push out market expectations about the timing of the first ECB rate cut.

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