

German inflation drops in October

German inflation continues to drop, and the trend of disinflation looks set to continue at least until year-end



German headline inflation continues to drop. According to the just released flash estimate, October headline inflation came in at 3.8% year-on-year, from 4.5% YoY in September. The harmonised European inflation measure for Germany plunged to 3.0% YoY from 4.3% in September. This discrepancy between the national and the European measures can mainly be explained by base effects and different measures of packaged holidays. Disinflation in Germany is still mainly a base effects story, even if some sectors have started to show actual price drops.

More disinflation to come

Some of the earlier statistical noise that surrounded inflation data this year has finally disappeared. What we are now noticing are base effects, mainly in energy and food price inflation, but also monthly price drops in some sectors. Some regional states saw food prices dropping again, a trend which started in spring this year. At the same time, prices for services – particularly for hospitality services and tourism – reflect the expected reaction after the summer holiday period and fading demand. In fact, for the first time in a long while, monthly price developments were more favourable than their historical average.

Looking ahead, base effects should continue to drive inflation down further over the coming months. Actual price drops, however, have not gained momentum or really spread across the

entire economy. This could soon change with the economy stagnating and a further weakening of demand. The price drops in tourism and hospitality services could be a leading indicator for a broader trend that the time for bargain hunters has come. At the same time, the recent rollercoaster ride of oil prices was a strong reminder of how fragile the base case of further abating inflationary pressures is. For now, we continue to see German inflation falling to around 3% by the end of the year.

Admittedly, the risks to this outlook are obvious and clearly to the upside. Let's also not forget that inflation will be higher over the coming years than it was pre-pandemic. Demographics, derisking and decarbonisation all argue in favour of upward pressure on price levels. At some point in time, the European Central Bank (ECB) might regret that it redefined its inflation target at 2.0% and not "at around 2%".

Speaking of the ECB, today's German inflation data strengthens the case for staying put. The clear change in tone at last week's ECB meeting has confirmed our view that what started as a pause last week will soon become the official peak in rate hikes. It was not only the ECB's more cautious take on the eurozone's growth outlook but also a more benign take on how to react to higher oil prices which signalled that the ECB has de facto entered the next phase of its current hiking cycle: staying high for longer.

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