

German inflation drops further in November

The disinflation trend in Germany has gained more momentum in November and brings the European Central Bank's target closer in sight



Some very late satisfaction for 'team transitory' as German inflation continued its disinflationary trend in November. According to the flash estimate, headline inflation came in at 3.2% year-on-year, from 3.8% YoY in October. The European inflation measure came in at 2.3% YoY, from 3.0% in October.

Disinflationary process to enter second stage

A year ago, inflation was still at double-digit levels. And while falling inflation is not the same as actually falling prices, the disinflationary process is remarkable. In November, as much as in previous months, the main drivers behind falling inflation rates were favourable base effects across almost all sectors of the economy as well as actually falling energy prices and price cuts in leisure, entertainment and hospitality services. The only worrisome development was the monthly increase in food prices.

Looking ahead, the disinflationary process should continue. In fact, this year's drop in headline

inflation has mainly been 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. As a result, German headline inflation should drop further in December and settle down in the 2% to 3% range in 2024.

Admittedly, the risks to this inflation forecast are obvious; it is not only energy prices but also the recent fiscal woes in Germany, which could push inflation up again. In particular, the fiscal woes could lead to upward pressure on prices. A reversal of the lowered VAT rate for restaurants, from 7% back to 19%, was already announced, pushing up headline inflation by some 0.1 percentage points. Further tax increases or increases in administered prices could follow, in order to close the government's funding gap. Also, we never tire of repeating our long-held view 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.

How the ECB's last mile could become a walk in the park

As disinflation is not only a German phenomenon but widely spread across the entire eurozone, the ECB runs the risk of underestimating the disinflationary momentum as much as it underestimated the inflationary momentum two years ago. With a weakening economic outlook and disinflation, rate hikes should be off the table at the December meeting. Given that the full impact of the tightening so far will still unfold in the coming months, the risk is even high that the ECB has already tightened too much. For now, and definitely for the December meeting, the ECB will still try to avoid mentioning or even, to use Christine Lagarde's words, 'pronounce' rate cuts. Instead, the ECB will try to influence market expectations by warning about the 'difficult last mile'. However, the ECB has not yet answered the question of where this last mile is leading, which is actual inflation rates consistently at 2.0% or inflation expectations and inflation forecasts at around 2%. While we agree that the former won't be easy, the latter could almost become a walk in the park.

Author

Carsten Brzeski

Global Head of Macro

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>.