

# 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.

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