German inflation is good news for ECB hawks

German inflation accelerated in November and will strengthen opposition against a 50bp rate cut

The just-released flash estimate of German inflation in November wraps up a good day for the ECB hawks. With headline inflation accelerating and economic sentiment stabilising, opposition against a 50bp rate cut at the December meeting will grow stronger.

German headline inflation came in at 2.2% year-on-year, up from 2.0% YoY in October. Back in September, headline inflation was still at 1.6% YoY, The European inflation measure came in at 2.4% YoY, unchanged from October.

German inflation to move within the 2% to 2.5% range

Today's rebound in German inflation was mainly the result of less favourable energy base effects, while at the same the timing of school vacation during the Fall season inserted downward pressure on headline inflation.

Looking ahead, the stickiness of inflation at slightly too high a level still looks set to continue as favourable energy base effects will continue petering out while wages are increasing. However, with the current turning of the labour market, wage growth should come down more significantly than previously thought, leading to more disinflationary pressures next year. As a result, we continue to expect inflation to remain within the broad range of between 2% and 2.5% in 2025.

Opposition for a 50bp rate cut in December growing

With today's surprise (meagre) improvement in eurozone sentiment and now German inflation, some ECB members might start doubting both the October rate cut decision and the opening to even larger rate cuts at the December meeting.

What remains is the genuine idea of almost all ECB officials that the rate-cutting cycle will continue. The only question is for how long and how far. Yesterday's remarks by Isabel Schnabel clearly stressed the hawkish case, which is one of a very gradual process of cutting rates. However, even more important than the debate about 50bp or 25bp at the December meeting is the question of how far the ECB will eventually go with rate cuts. Here, Schnabel tried to mark her preferred terminal rate of between 2% and 3%, while Philip Lane's comments earlier on suggested that the ECB could clearly go below any neutral interest rate level next year.

In any case, having been slow to address rising inflation and arguably late in stopping rate hikes last year, the ECB now appears determined to get ahead of the curve and return interest rates to neutral as quickly as possible. For the doves, this is a no-brainer, and for the hawks, the argument might be that getting rates back to neutral quickly could be enough to avoid another episode of unconventional monetary policy with quantitative easing and negative interest rates further down the line. Today's macro data releases in the eurozone, however, should encourage the ECB hawks to object to a 50bp rate cut in December and the case for a 25bp rate cut is growing.

In fact, a 50bp rate cut decision would be a security move to preempt any potential risks for the eurozone economy coming from the next US administration's potential economic policy choices. A 25bp rate cut decision would rather follow the cautious meeting-by-meeting approach, though running the risk of not yet getting ahead of the curve. We will wait for tomorrow's eurozone inflation numbers to finally make up our minds.

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