

German inflation set to drop to lowest level since start of Ukraine war

The disinflationary trend is finally gaining momentum in Germany and it's about more than just the base



Source: Shutterstock

Available regional data suggests that German headline inflation came in at the lowest level since the start of the war in Ukraine. The official data will be published at 2pm CET and it currently looks as if headline inflation in September came in at around 4.5% year-on-year, from 6.1% YoY in August.

Disinflation...finally

Inflation data in Germany and many other European countries continues to be surrounded by more statistical noise than usual, making it harder for the European Central Bank to take this data at face value. Government intervention and interference, whether temporary or permanent or occurring this year or last, will continue to blur the picture.

In the case of Germany, headline inflation over the summer months had been affected by several

base effects: while lower energy prices exerted downward pressure on inflation, the end of last summer's temporary government energy relief measures and cheap public transportation added upward pressure. These reversed base effects are now the main driver of the sharp drop in German headline inflation. Monthly price changes, however, paint a more complicated picture of German inflation dynamics. After five consecutive drops, food prices increased again month-on-month in most regional states. At the same time, dropping prices for services, particularly for hospitality services and tourism, reflect the expected reaction after the summer holiday period and fading demand.

Looking ahead, base effects should continue to drive inflation, not prices, down further over the coming months. The recent surge in oil prices as well as the monthly increase in food prices, however, suggest that the disinflationary trend could be less accentuated than previously thought. 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: just think of the recent surge in oil prices and the renewed increase in monthly food prices, as well as sticky core inflation, wage pressures and government measures to support the demand side of the economy. We also stick to the 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.

However, be cautious when hearing comments that inflation will never come down. These comments might come from the same sources that only a few years ago argued that inflation would never surge again. This does not mean that the loss in purchasing power as a result of the last inflationary years will be reversed any time soon. It just means that headline inflation can come down faster than currently anticipated.

For the ECB, a pause in October looks like a done deal but might not yet be the end

At face value, today's macro data in the eurozone has made the call for a pause at the European Central Bank's October meeting even stronger. Confidence continues to weaken and inflation has come down, even though it is still nowhere near levels that would bring relief or comfort to the central bank.

However, a pause in October will not necessarily mark the end of the current hiking cycle. In fact, the recent surge in oil prices will aggravate the ECB's current trilemma: how to balance slowing economies, still too-high inflation and the delayed impact of unprecedented rate hikes. Against this background, the initial calls that the last ECB rate hike was probably the final one, were obviously a bit premature. Given the ECB's concern about its inflation-fighting credibility, the fear of a de-anchoring of inflation expectations and the ECB's very own dismal track record in predicting inflation, the risk of further rate hikes remains high.

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 www.ing.com.