

# 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



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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.

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