German inflation still on disinflationary trajectory in June

That's how the European Central Bank likes it. German inflation came in at 2% year-on-year in June, right on target

The just-released flash estimate of German inflation for June shows that the disinflationary process continues in baby steps and is now spot on the ECB's target. Headline inflation, both according to the national and European measures, came in at 2.0% year-on-year in June, from 2.1% YoY in May. Core inflation also continued its gradual downward trend and came in at 2.7% YoY, from 2.8% in May. While the ECB discusses the outcomes of its assessment of the monetary policy strategy review and thinks that it is well-prepared for major inflation swings, the reality is that inflation in the eurozone is currently moving only in small increments.

Period of sub-2% inflation ahead

The available regional state data suggests that falling monthly prices for food and clothing, as well as lower heating oil and gasoline prices compared to last year, pushed down headline inflation. Meanwhile, prices for healthcare and transportation accelerated compared with last year. Services inflation remained broadly unchanged.

Looking ahead, at least in the nearer term, German inflation is likely to continue its downward trend, probably dropping below 2% over the coming months. This view is confirmed by recent selling-price expectations in both industry and services, which have dropped to the lowest levels in more than a year. Needless to say that a lot of the current inflation forecast depends on oil prices going forward. More structurally speaking, two opposing trends will shape the future path of underlying inflation. On the one hand, the cooling of the labour market should take away wage pressures and consequently inflationary pressures; on the other hand, the government's fiscal stimulus is likely to push up inflationary pressure towards the end of the year and beyond.

As a result, and based on current energy prices, we now expect German headline inflation to hover between 1.5% and 2% throughout the second half of the year.

ECB to cut in September if disinflationary trend continues

Today's German inflation reading should comfort the ECB in its view that the job to bring inflation back to target is mostly done. Remember that the ECB's forecasts presented at the June meeting, for the first time, brought forward the point at which inflation is expected to fall below 2%. For some time now, this moment has been consistently the third or fourth quarter of 2026. Now it is the third quarter of 2025 - one year earlier than previously expected. The German railways would pay a fortune for such a performance.

Despite the celebrations at the ECB, let's not forget that disinflation in the eurozone has been largely driven by external factors and lately, by President Trump. Falling oil prices and a stronger euro have been important drivers. Service inflation, however, remains elevated - at levels not seen since the mid-1990s before the pandemic - and is only expected to dip below 3% next year. This persistent pressure should temper any premature celebrations at the ECB.

Admittedly, this ongoing disinflationary process is highly dependent on oil prices, and the last two weeks showed how volatile these prices can be. For now, and in the absence of another tariff shock after the end of the 90-day pause in less than two weeks from now, we expect the ECB to pause at the next meeting in July and to keep the option open for another rate cut at the September meeting, if the disinflationary trend continues.

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