

Germany: Inflation stuck in negative territory

Headline inflation remains stuck in negative territory, strengthening the threat of a deflationary spiral



Based on the inflation outcomes in several regional states, German inflation came in at -0.2% year-on-year in October, unchanged from in September. The harmonised index, relevant for ECB policymaking, dropped to -0.5% YoY, from -0.4% in September.

The negative base effect from low energy prices is keeping headline inflation low but there is more: the VAT cut of July is most visible in prices for food, clothing, other consumer goods and increasingly also for other leisure activities and packaged holidays. At the same time, the fact that the increase in hotel and restaurant prices is still very much in line with the trend seen prior to the VAT cut suggests that lower taxes are also used to support businesses and are not necessarily entirely passed on to consumers. For the time being for Germany, the conclusion is crystal clear, the current crisis is disinflationary.

Looking ahead, German headline inflation should first fall further before gradually rebounding next year; at least if the German government sticks to the plan of reversing the VAT reduction in January. This is a development that looks increasingly unlikely with the latest lockdown measures.

At the start of the crisis, there had been speculation about whether this current crisis would be an inflationary or deflationary event. For the time being for Germany, the conclusion is crystal clear: it is disinflationary. Since the VAT reduction, around 50% of the top 100 components of the inflation measure have recorded negative inflation rates. During the last fears of deflation in 2014 and 2015, this was never more than 30% – even if many drivers of negative inflation rates are one-offs and could be reversed next year. However, it would not be the first time that falling prices, driven by one-off factors, combined with economic uncertainty and increasing unemployment could develop into a deflationary spiral.

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