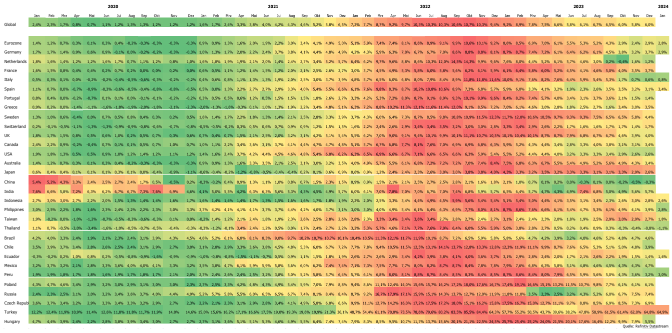
9 February 2024

Inflation: the tough beast tamed?

Since the financial and economic crisis of 2008/2009, inflation rates in many countries have been very low - in the view of many central banks, even too low at less than two percent. However, the tide turned with the outbreak of the coronavirus pandemic: supply chain problems led to a supply-side shortage of many goods, while generous fiscal support measures for companies and private households led to a significant increase in demand. Prices reacted to this in the way you learn in the first semester of economics: they rose, and not just a little. At the end of 2020, the inflation rate in the OECD countries was just over one percent, a year later it was already at six percent. The Russian attack on Ukraine in February 2022 then caused energy and food prices to rise rapidly, triggering a second wave of inflation. As a result, the OECD inflation rate peaked at well over ten percent in the fall of 2022, leading to an intense debate about whether inflation was here to stay.

Since then, however, inflationary pressure has eased considerably. Fortunately, this development is not limited to a few countries, but is a global phenomenon that can be observed in most industrialized countries as well as in almost all emerging markets. This development is illustrated by the following inflation heat map, which shows the inflation trend in 32 countries as of January 2020. Green fields stand for comparatively low inflation rates, red fields for high inflation rates. With a few exceptions (China and India in 2020, Turkey in 2023), the inflation and color gradient is very homogeneous. This means that the inflation rates between the various countries and regions are very similar.



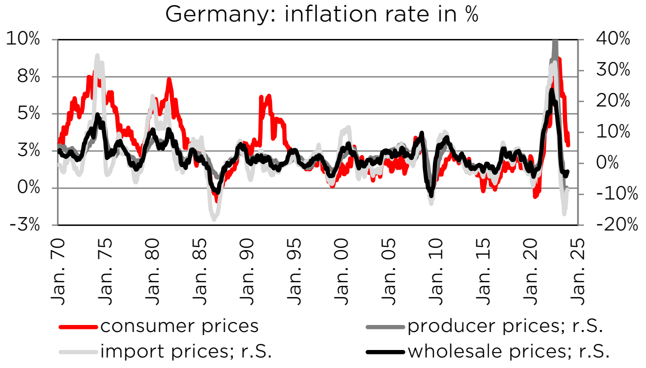
Inflation rate in the Eurozone falls to two percent, first interest rate cut in June

Of course, we are paying particular attention to inflation trends in the Eurozone. Since prices peaked in October 2022, the inflation rate has fallen from 10.6 percent to 2.8 percent in January 2024. This means that the European Central Bank's inflation target ("price stability is ensured at an inflation rate of two percent in the medium term") has not yet been fully achieved. After all, six of the 20 euro countries have an inflation rate based on the harmonized consumer price index of 2.0 percent or less. The biggest price driver in the Eurozone is still food prices, which rose by 5.7 percent year-on-year in January, followed by prices for services, which were 4.0 percent higher than in the previous year. Prices for goods and energy rose much less sharply, with rates of change of 2.0 percent and -6.3 percent, respectively.

As the inflation rate has fallen significantly and the ECB's inflation target is not far away, the central bank has not raised its key interest rates since September 2023. Since then, the deposit rate has stood at 4.0 percent and the main refinancing rate at 4.5 percent. In order for the ECB to cut interest rates by June at the latest, as the majority of capital market participants expect, the inflation rate must fall further towards two percent by then. We are optimistic that this will be achieved. The inflation rate could already take a significant step downwards in February. A year ago, food and services rose disproportionately, but this year we expect prices to develop more moderately, meaning that the overall inflation rate could fall to 2.3 percent in February. This alone could argue in favor of an interest rate cut by the ECB in April. However, as the core inflation rate in February and March is likely to be closer to three than two percent, the central bankers will probably not be brave enough to decide to cut interest rates.

Momentum of wage increases weakens

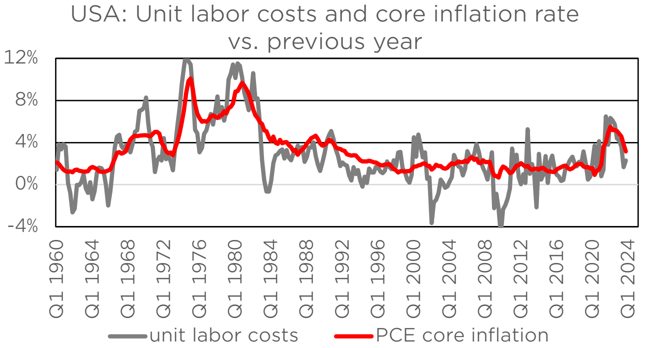
A stronger decline in the core inflation rate is possible in April and especially in the summer months, meaning that June is most likely to be the first month of interest rate cuts. From August onwards, the inflation rate could even temporarily fall below the two percent mark, meaning that we expect at least four interest rate cuts totaling 100 basis points by the end of the year. We consider the probability of a wage-price spiral, which could lead to a permanently higher inflation rate, especially for services, to be rather low. According to our calculations, the momentum of wage increases already peaked in the summer of last year and we expect the trend towards slightly weaker wage increases to continue in 2024. This should tend to have a more favorable impact on general price trends than many economists expect. We are therefore forecasting an average inflation rate of 2.2 percent for the Eurozone this year, while the figure for Germany is likely to be slightly higher at 2.4 percent due to the somewhat less favorable starting point. However, in Germany too, the disinflationary developments in the preliminary stages of consumer prices (producer, wholesale and import prices are all currently showing a negative rate of change compared to the previous year) and the close correlation of international consumer prices mentioned above suggest that the inflation rate is likely to reach the two percent mark over the course of the year.



source: Refinitiv Datastream

USA: Robust labor market could lead to prolonged price pressure, but...

In the US, the labor market continues to run smoothly: at 3.7 percent, the unemployment rate is close to a record low, and the rise in hourly wages has recently accelerated again somewhat from 4.3 percent to 4.5 percent, after slowing almost continuously from almost six percent in the spring. As in Germany, however, we believe that the risk of a wage-price spiral in the USA is low. On the one hand, wage growth is likely to slow somewhat in the coming months and, on the other, the US economy has recorded surprisingly high productivity growth over the past three quarters. The flip side of the coin is moderately rising unit labor costs, which in the second half of 2023 were only two percent above the previous year's level. Whether this favorable development already has something to do with the increasing use of AI cannot be answered at present. However, it is striking that many technology companies have decided to cut jobs despite booming business. This trend is also likely to be observed in other sectors over the course of the year, meaning that the labor market will cool down somewhat, but without this leading to a recession. For the capital markets, these are favorable conditions for share and bond prices to continue to rise.



source: Refinitiv Datastream

Carsten Klude

Market data

Stock marktes	As of 09.02.2024 08:22	Change versus 02.02.2024 -1 week	08.01.2024 -1 month	08.11.2023 -3 months	08.02.2023 -1 year	29.12.2023 YTD
Dow Jones	38726	0,2%	2,8%	13,5%	14,1%	2,8%
S&P 500	5015	1,1%	5,3%	14,4%	21,8%	5,1%
Nasdaq	15794	1,1%	6,4%	15,7%	32,6%	5,2%
DAX	16964	0,3%	1,5%	11,4%	10,1%	1,3%
MDAX	25786	0,5%	-2,0%	1,6%	-11,7%	-5,0%
TecDAX	3403	2,4%	4,1%	13,7%	3,2%	2,0%
EuroStoxx 50	4711	1,2%	5,0%	12,7%	11,9%	4,2%
Stoxx 50	4221	0,3%	2,9%	8,7%	8,6%	3,1%
SMI (Swiss Market Index)	11139	-0,9%	-0,8%	5,1%	-1,2%	0,0%
Nikkei 225	36897	2,0%	10,5%	14,7%	33,7%	10,3%
Brasilien BOVESPA	128217	0,8%	-3,2%	7,6%	16,6%	-4,4%
Russland RTS	1119	0,1%	2,7%	0,5%	13,9%	3,3%
Indien BSE 30	71502	-0,8%	0,2%	10,0%	17,9%	-1,0%
China CSI 300	3365	5,8%	2,4%	-6,8%	-17,4%	-1,9%
MSCI Welt	3266	0,6%	3,6%	13,1%	16,6%	3,1%
MSCI Emerging Markets	998	0,9%	0,1%	4,1%	-2,3%	-2,6%
Bond markets						
Bund-Future	133,62	-131	-243	289	-240	-360
Bobl-Future	117,06	-80	-151	40	6	-222
Schatz-Future	105,61	-28	-61	47	-5	-94
3 Monats Euribor	3,90	-1	-1	-1	129	1
3M Euribor Future, Dec 2024	2,74	11	25	-34	-3	44
3 Monats $ Libor	5,58	2	-1	-5	72	-2
Fed Funds Future, Dec 2024	4,26	8	23	-29	88	42
10 year US Treasuries	4,16	13	15	-36	52	29
10 year Bunds	2,37	17	25	-21	4	37
10 year JGB	0,73	6	12	-12	24	10
10 year Swiss Government	0,96	11	13	-15	-43	26
US Treas 10Y Performance	589,36	-1,1%	-0,9%	3,7%	-0,9%	-1,9%
Bund 10Y Performance	552,84	-1,0%	-1,5%	2,8%	2,9%	-2,2%
REX Performance Index	442,84	-0,5%	-0,3%	1,3%	2,2%	-1,1%
IBOXX AA, €	3,37	12	10	-44	-1	30
IBOXX BBB, €	4,00	12	2	-63	-20	24
ML US High Yield	7,96	0	-12	-99	-23	16
Commodities						
MG Base Metal Index	374,65	-2,0%	-1,1%	-1,6%	-13,7%	-4,2%
Crude oil Brent	81,50	5,1%	7,6%	2,4%	-4,3%	4,9%
Gold	2033,59	-0,1%	-0,1%	3,8%	8,4%	-1,5%
Silver	22,52	-0,7%	-2,9%	-1,1%	1,0%	-7,1%
Aluminium	2191,95	-0,2%	0,2%	-2,5%	-10,2%	-6,5%
Copper	8085,02	-3,5%	-3,1%	0,3%	-8,8%	-4,5%
Iron ore	129,07	0,3%	-8,4%	1,4%	4,8%	-5,4%
Freight rates Baltic Dry Index	1473	4,7%	-27,2%	-3,7%	144,3%	-29,7%
Currencies						
EUR/ USD	1,0775	-1,0%	-1,6%	1,0%	0,4%	-2,5%
EUR/ GBP	0,8531	0,0%	-0,9%	-2,1%	-3,9%	-1,6%
EUR/ JPY	160,83	0,8%	1,7%	-0,1%	14,2%	2,9%
EUR/ CHF	0,9420	1,1%	1,2%	-1,9%	-4,7%	1,7%
USD/ CNY	7,1928	-0,1%	0,5%	-1,2%	5,9%	1,3%
USD/ JPY	149,32	0,6%	3,5%	-1,1%	13,7%	5,9%
USD/ GBP	0,79	0,3%	1,0%	-2,7%	-4,3%	1,0%

Source: Refinitiv Datastream

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