COMMERZBANK

Economic Research

Economic Briefing

Update Quant Inflation Model – Inflation falls more slowly

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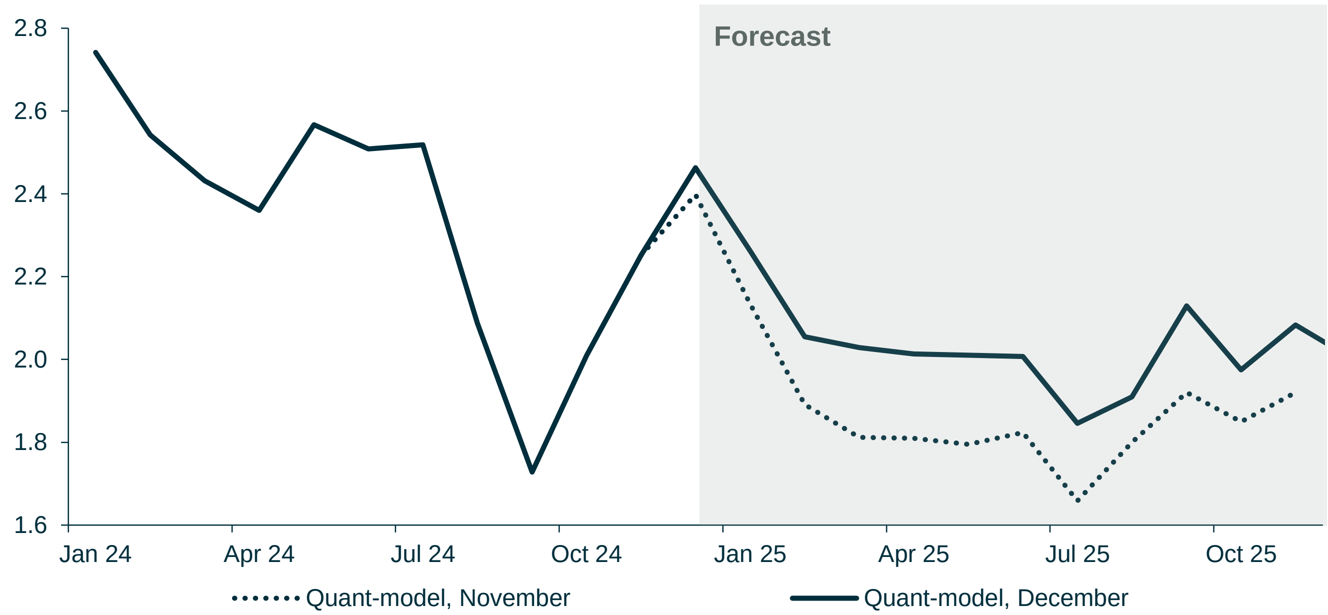
Our machine-learning based Quant-model predicts higher inflation in the euro area for the first half of next year than it did a month ago. Due to persistent wage pressure, the easing of service prices is likely to be delayed. The weak euro exchange rate is also making imported goods from abroad more expensive. We also expect price-driving effects beyond the scope of the Quant-model.

The Quant-model expects higher inflation

Our Quant-model based on machine learning (see **here**) expects the euro area inflation rate to be 0.2 percentage points higher on average in the first half of next year than it did last month (Chart 1). This is shown by updated calculations based on data available up to mid-December. This is already the second upward revision of the forecasting model in a row. Nevertheless, the model still expects inflation to fall noticeably next year – to around 2.0% by June. According to the model, the ECB target of 2.0% will not be undershot in the coming months.

Important disclosure and analyst certification (AC) at end of document

Chart 1 - The Quant-model sees a more moderate inflation reduction
Consumer price index in the euro area, year-on-year rate in %, as of December 2024
Commerzbank quant-forecasts



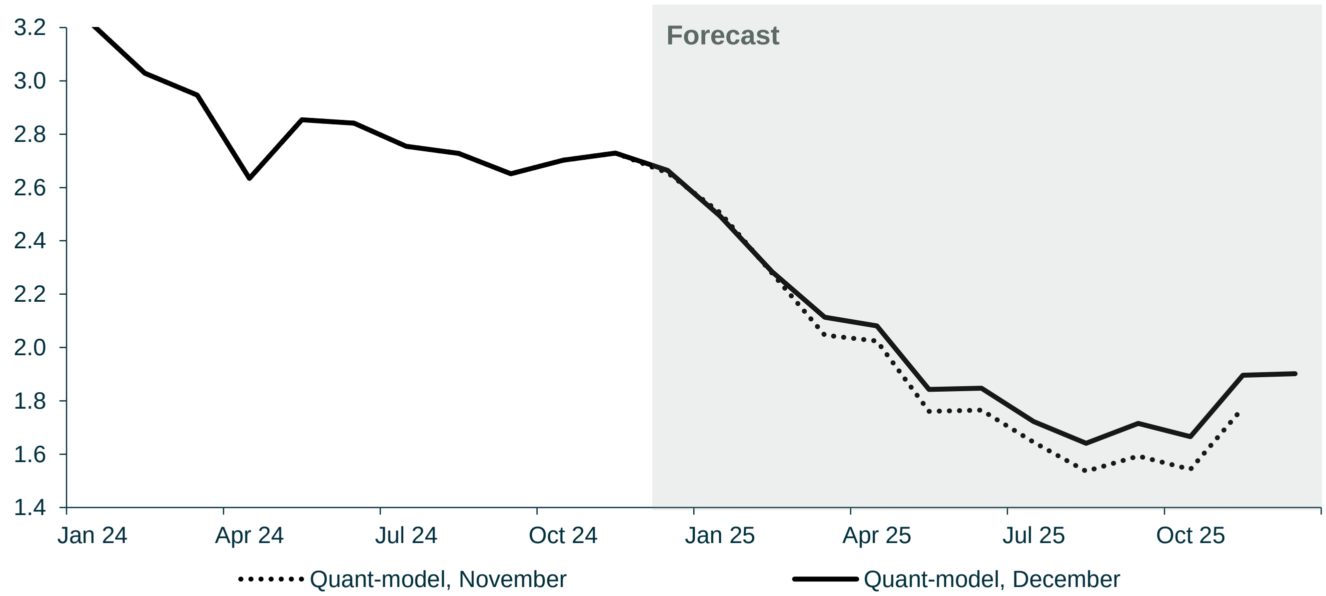
Source: Eurostat, Commerzbank-Research

Wage trends are supporting core inflation

The Quant-model for inflation excluding the volatile prices of energy, food, alcohol and tobacco (core rate) still expects core inflation to fall noticeably next year. However, this is also due to the fact that strong price increases in spring 2024 will no longer be included in the year-on-year comparison and the core rate will therefore fall in the spring 2025 (base effect). The Quant-model has also revised its forecasts for the core rate upwards – by around 0.1 percentage points (Chart 2). The calculations here are reacting to wages that are still rising sharply and to the information provided by purchasing managers in December, who are observing higher input prices for services.

Chart 2 - The Quant-model still expects the core rate to fall

Consumer price index in the euro area excluding energy, food, beverages and tobacco, year-on-year rate in %, Commerzbank quant-forecasts as of December 2024



Source: Eurostat, Commerzbank Research

Deep Dive: Upside risk in goods inflation

Goods inflation has been hovering around the zero-mark in the month-on-month comparison for several months. For the coming months, the Random Forest models (the basis of our quant model) also assume only a slight increase in goods prices excluding energy. However, we observe an upside risk to goods prices stemming from foreign trade (see Random Forest model based on 'external' indicators - Chart 3). In particular, international transportion costs were significantly higher this year than in 2023 and are now being reflected, with a time lag, in goods prices in the euro area. Exchange rates are also likely to make goods prices in the euro area more expensive. The euro has weakened by around 3% against major partner currencies since October, making imports more expensive.

Insurance premiums push up inflation in January

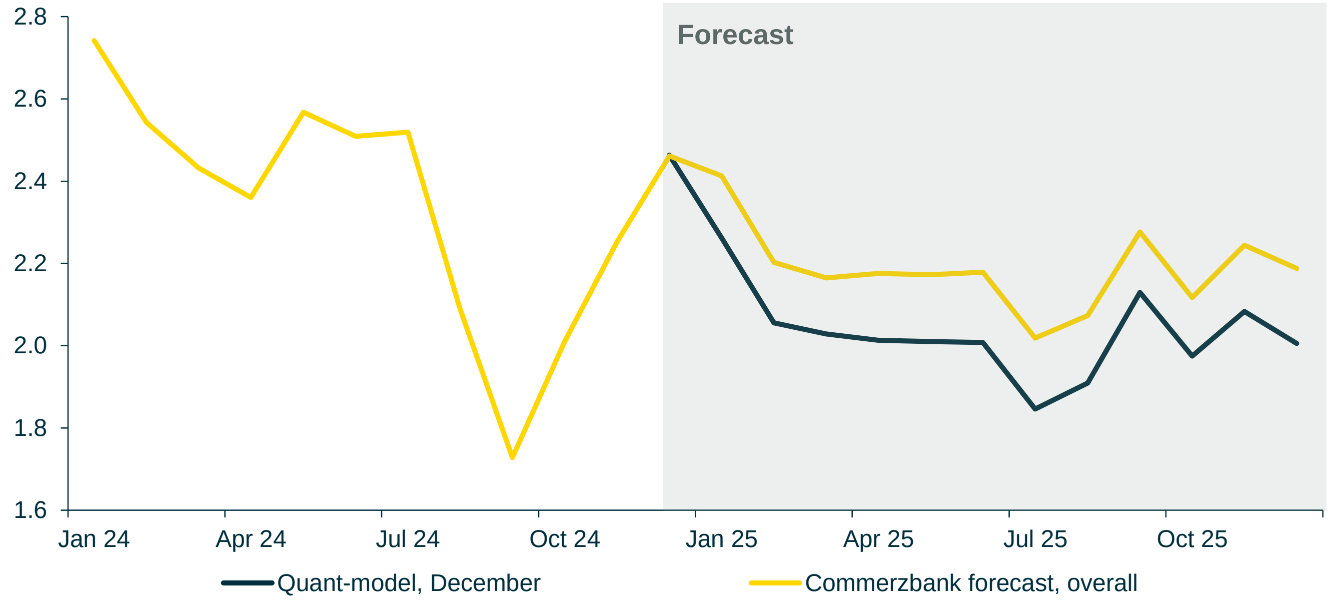
We always assess the results of the purely data-driven model from an economic perspective and supplement them if necessary. At present, the model is likely to significantly underestimate the inflation risks:

Firstly, public and private health insurance companies in Germany, France and Spain, among other countries, have announced higher contributions for 2025. In Spain, a taxation for private health insurance will also increase from January. Secondly, the CO2-price will rise again in January 2025 from 45 to 55 Euros per ton of CO2, thereby increasing the price of a liter of petrol by three cents, for example. The energy component of inflation alone is likely to rise by almost one percentage point as a result. Currently, no forecasts for insurance premiums or the CO2 price are included in the Quant-model.

All in all, we therefore expect slightly higher inflation than the Quant-model for 2025, namely at 2.1% (Chart 4). This also applies to core inflation (Commerzbank forecast: 2.3%).

Chart 3 - We expect a somewhat higher inflation than the Quant-model

Consumer price index in the euro area, year-on-year rate in %, past and future Commerzbank forecasts



Source: Eurostat, Commerzbank forecasts

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