The ECB's wage mirage

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The members of the ECB Governing Council are confident that inflation will soon return to the 2% target on a sustainable basis. A key argument for them is the prospect of a significant easing of wage pressure. In fact, there are arguments for a lower rise in wages. However, it is questionable whether the rate of wage growth in the second half of the year will fall as sharply as the ECB's Wage Tracker indicates. On the contrary, it is likely to underestimate wage growth in the second half of the year due to the way it is constructed.

ECB well on the way to further interest rate cuts, ...

The ECB's next interest rate decision is due in the coming week; the central bankers are confident that the inflation rate will return to the target of 2% in the foreseeable future. At the press conference following the monetary policy meeting in December, President Lagarde referred to indicators showing that wage growth will gradually fall to a rate that is compatible with the inflation target of 2% over the course of 2025. It is therefore to be expected that the central bankers will cut interest rates not only in the coming week, but also at subsequent meetings. As a result, the ECB's deposit rate is likely to arrive at 2% by the middle of the year, 100 basis points lower than at present.

... also because its Wage Tracker signals much lower wage pressure

From the ECB's perspective, an important indicator of the impending lower wage growth is the experimental Wage Tracker, which ECB Chief Economist Lane presented for the first time just over two years ago and which the ECB intends to publish on the ECB data portal after every monetary policy meeting from now on. According to this indicator, wages should continue to rise strongly in the first half of this year, but wage growth should slow noticeably in the second half of the year, especially if special payments such as inflation compensation, bonuses or retroactively paid wages are taken into account (title chart).[1]

There are some arguments that wage growth is slowing down, ...

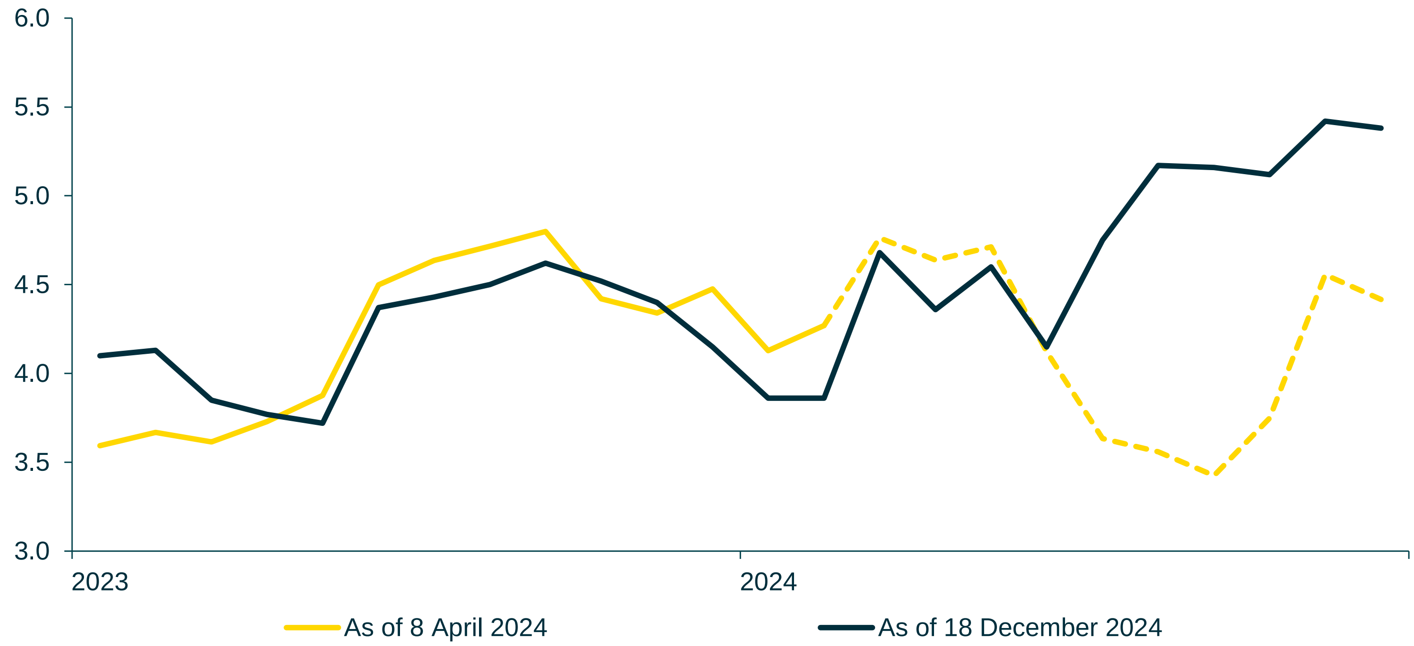
In fact, there are some arguments that wage pressure will ease over the course of this year. The unions' negotiating power has deteriorated due to the economic downturn, which has been ongoing for some time. In addition, the argument of “inflation compensation” is no longer as convincing as it was one or two years ago due to the now significantly lower inflation rate.

... but really that strong?

However, it is questionable whether wage growth will weaken as much as the ECB's forward-looking wage trackers indicate. After all, the forward-looking ECB Wage Tracker also indicated a significant slowdown in wage pressure at the beginning of 2024 for the latter part of the year (Chart 1). In fact, wage pressure even increased at that time, meaning that wages ultimately rose by more than one percentage point more on average in the second half of 2024 than the wage tracker had indicated at the start of the year.

Chart 1 - ECB Wage Tracker massively underestimated the view ahead in 2024

Experimental ECB Wage Tracker (incl. one-off payments): as of the monetary policy meeting on April 8, 2024 and as of the last monetary policy meeting on December 18, 2024, in percent compared to the previous year



Source: ECB, Commerzbank Research

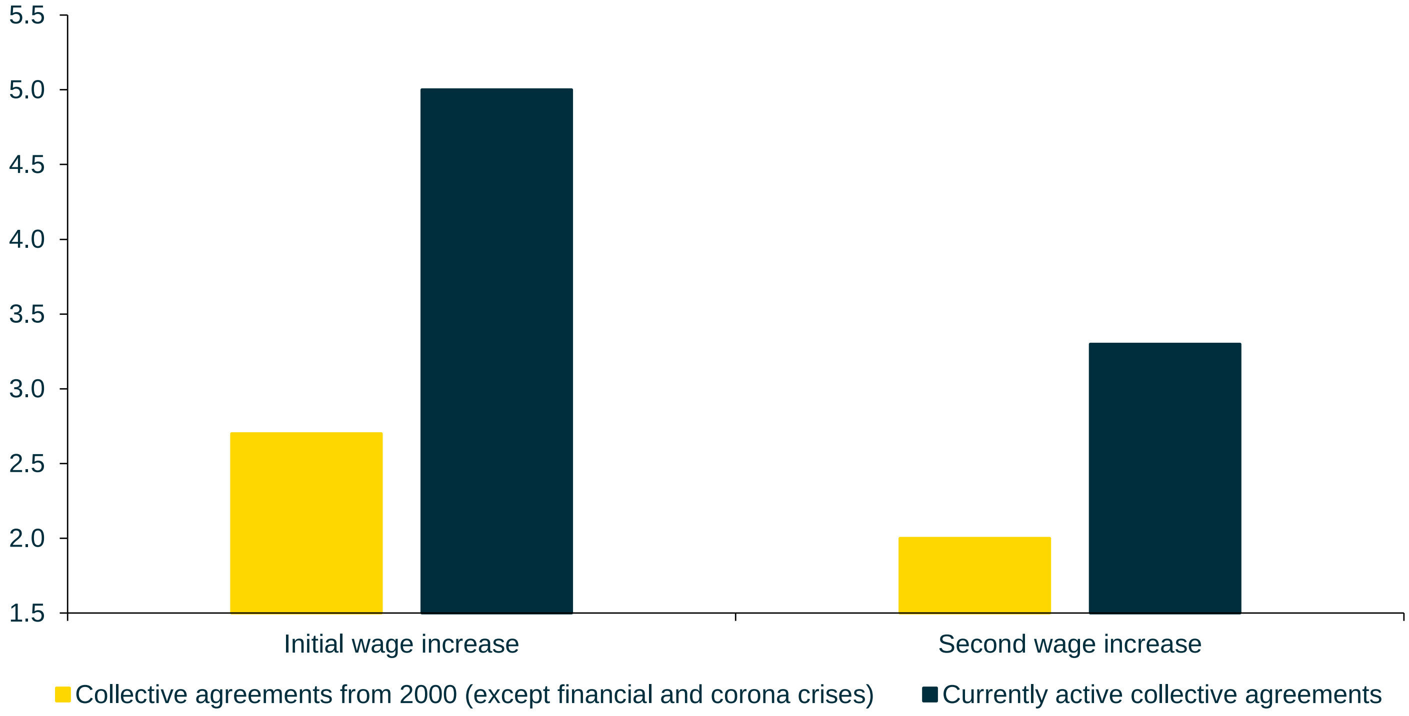
Forward view is distorted downwards by structural effect

This underestimation of wage growth could be due to the construction of the indicator. The ECB statisticians only use the currently active collective wage agreements when looking ahead. From the month in which an agreement ends, wage developments in the relevant sector are no longer taken into account. This means that the forward-looking wage tracker is based on fewer agreements the further into the future you look.

This not only narrows the statistical basis of the indicator. There is also another effect. In Germany in particular, many collective agreements have a term of two years or more. However, wages are usually increased more in the first year than in the second. For the currently active collective wage agreements (excluding one-off payments) for the largest German sectors, the median of the first wage increase is more than one and a half percentage points higher than the second step (Chart 2). This pattern was also observed in the past: For collective agreements since 2000 – excluding those around the financial crisis and corona crisis – the median of the first wage increase was 0.7 percentage points higher than for the second increase.

Chart 2 - Second wage increase within a collective agreement typically smaller

Collective agreements for the largest sectors in Germany: median of the first and second wage increase within the same collective agreement, in percent compared to the previous year

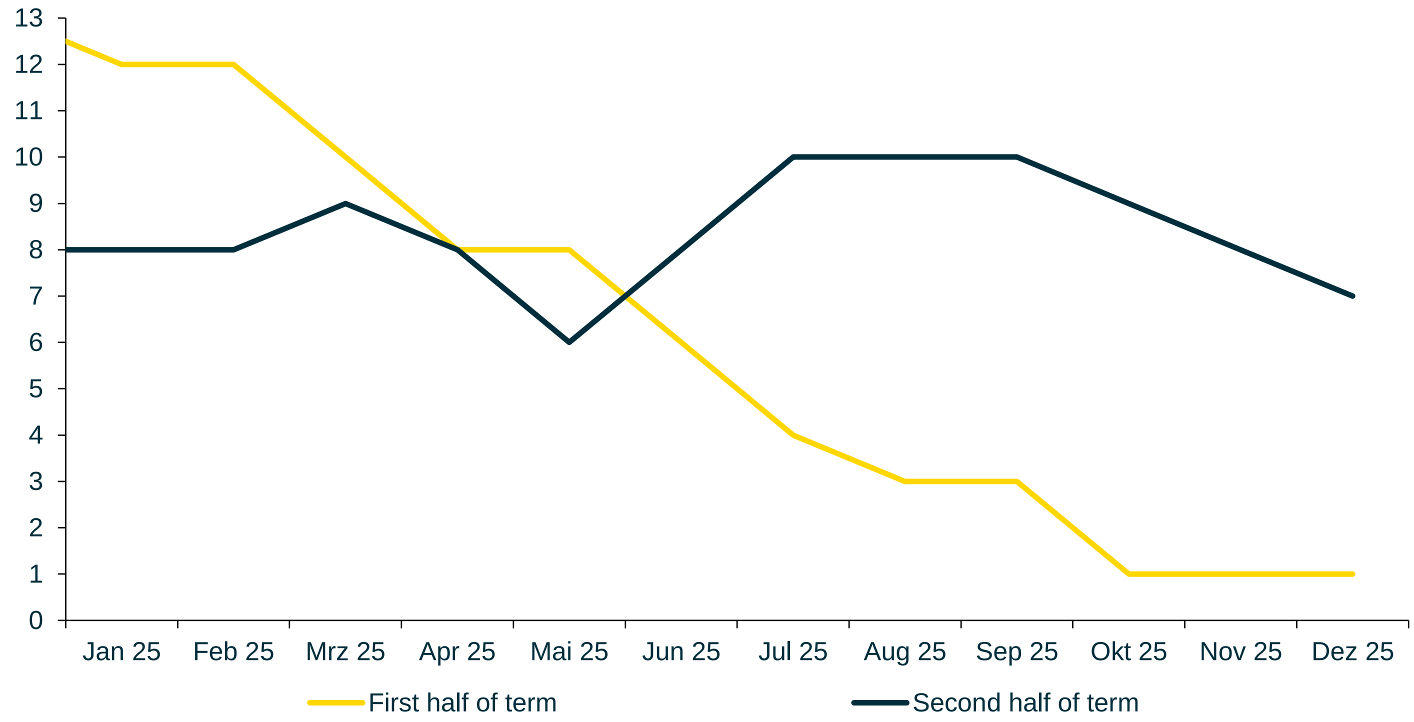


Source: WSI, Commerzbank Research

The further the ECB's Wage Tracker looks into the future, the more collective agreements are in the second half of their term, in which wages rise more slowly. Chart 3 shows this effect for Germany.

Chart 3 - Germany 2025: Diminishing number of collective agreements in their first half of term

Collective wage agreements in the largest sectors in Germany: number of agreements in their first half of term and second half of term

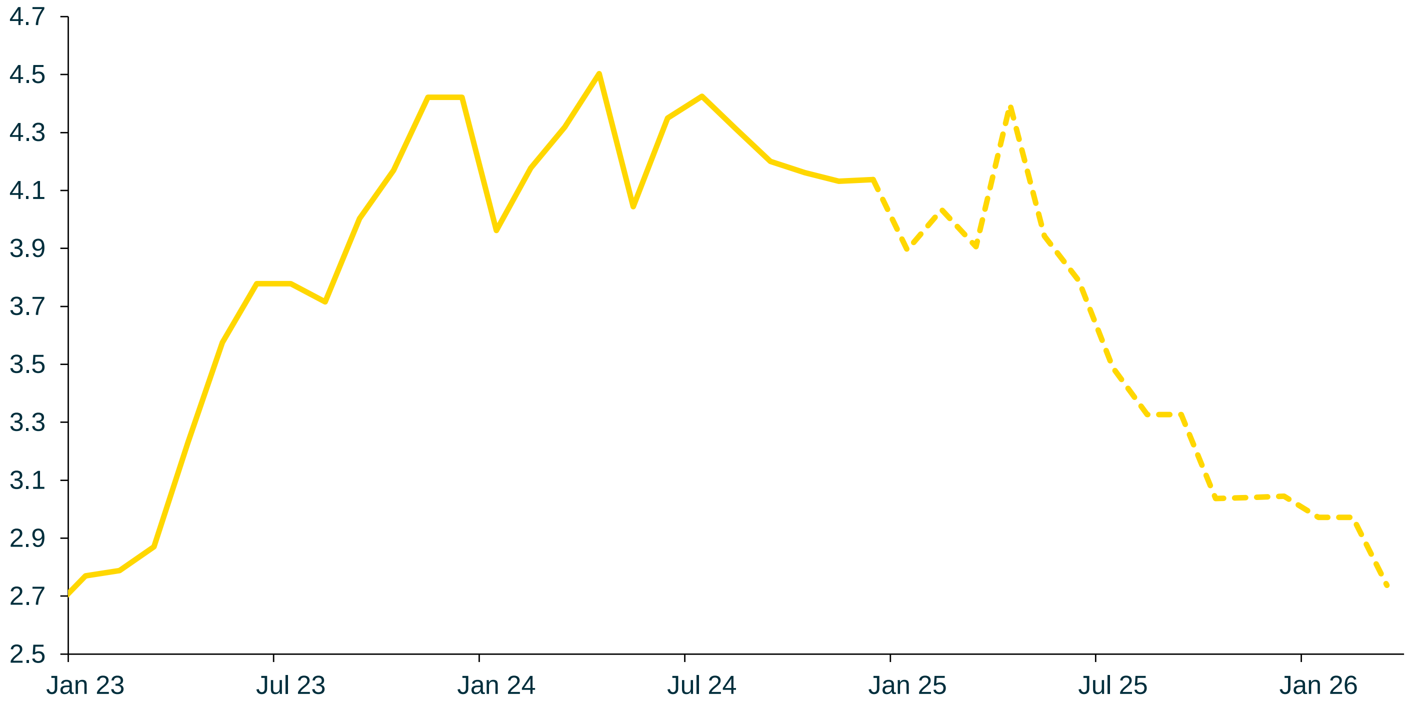


Source: WSI, Commerzbank Research

This is the main reason why the "Germany Wage Tracker" - whcih we calculated on the basis of data from the Düsseldorf Institute of Economics and Social Sciences (WSI) - signals a significant decline in wage growth from over 4% to almost 2.5% in the coming months (Chart 4). This pattern can be seen in the collective wage agreements for the wholesale and retail sectors, for example, which provided for a wage increase of around 5% for around 1 million employees from May 2024, but only around 2% from June 2025.

Chart 4 - “Germany Wage Tracker” points clearly downwards

Collective agreements (excluding one-off payments) in the largest sectors in Germany: Forward-looking Wage Tracker only takes into account existing collective agreements from 2025, percentage change on the year



Source: WSI, Commerzbank Research

ECB too optimistic about wage growth?

We also assume that wages will not rise as sharply as recently over the course of this year. However, wage growth will slow down less than the ECB Wage Tracker is currently signaling. The inflation problem has not yet been solved. In the end, inflation is likely to settle above the ECB's target of 2%, especially as structural factors such as deglobalization, demographics and decarbonization also point to higher inflation.

[1] The ECB Wage Tracker is based on data on collective wage agreements from the seven euro countries Germany, France, Greece, Italy, Austria, the Netherlands and Italy. One version of the Wage Tracker includes one-off payments such as inflation adjustments, bonuses or retroactively paid wages. In the version without special payments, the Wage Tracker reflects the scope of structural (or permanent) collectively agreed wage increases. For the projection from 2025 onwards, the pay scale conditions of the current contracts are used. (back to the text)

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