



The US inflation problem and its consequences

Due to the increased US inflation risks, we revised our forecast for the fed funds target rate at our monthly forecast meeting. We now expect only three rate cuts, the first one in December. In contrast, we continue to expect the ECB to deliver four rate cuts from June. Due to the significant change in interest rate differentials, we now expect the EUR-USD exchange rate to fall towards parity. We also have raised our forecasts for German government bond yields.

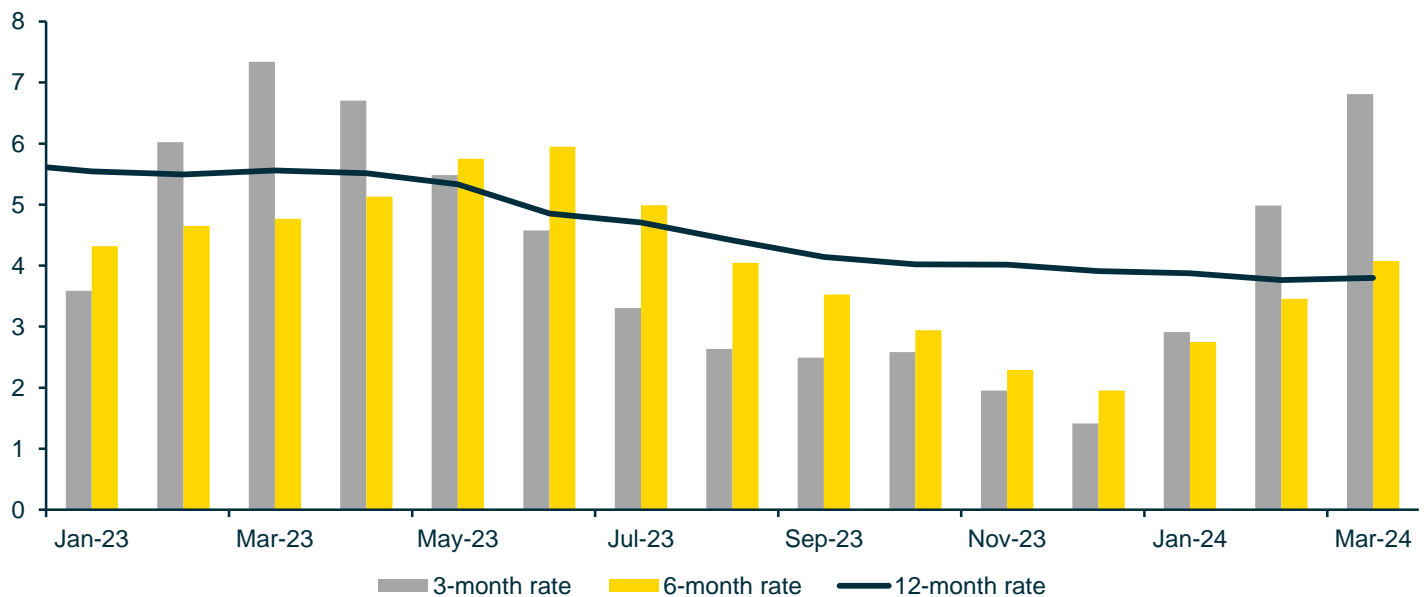
Dr. Jörg Krämer
Bernd Weidensteiner

Why US consumer prices have recently risen unexpectedly sharply

At our monthly forecast meeting, the focus was on US inflation. This was mainly due to the inflation data for March, which was published last week. According to the data, US consumer prices excluding energy and food ("core rate") rose unexpectedly sharply by 0.4% compared to February. Over the last three months, prices have risen by a strong 6.8% on an annualized basis (Chart 1). The central bank's 2% target is receding into the distance after inflation fell significantly in the second half of last year and many observers – not us – had proclaimed victory over inflation.

Chart 1 - US inflation is on the rise again

Consumer prices excl. food/energy, annual rate of change and annualized 3 and 6-month changes, in %



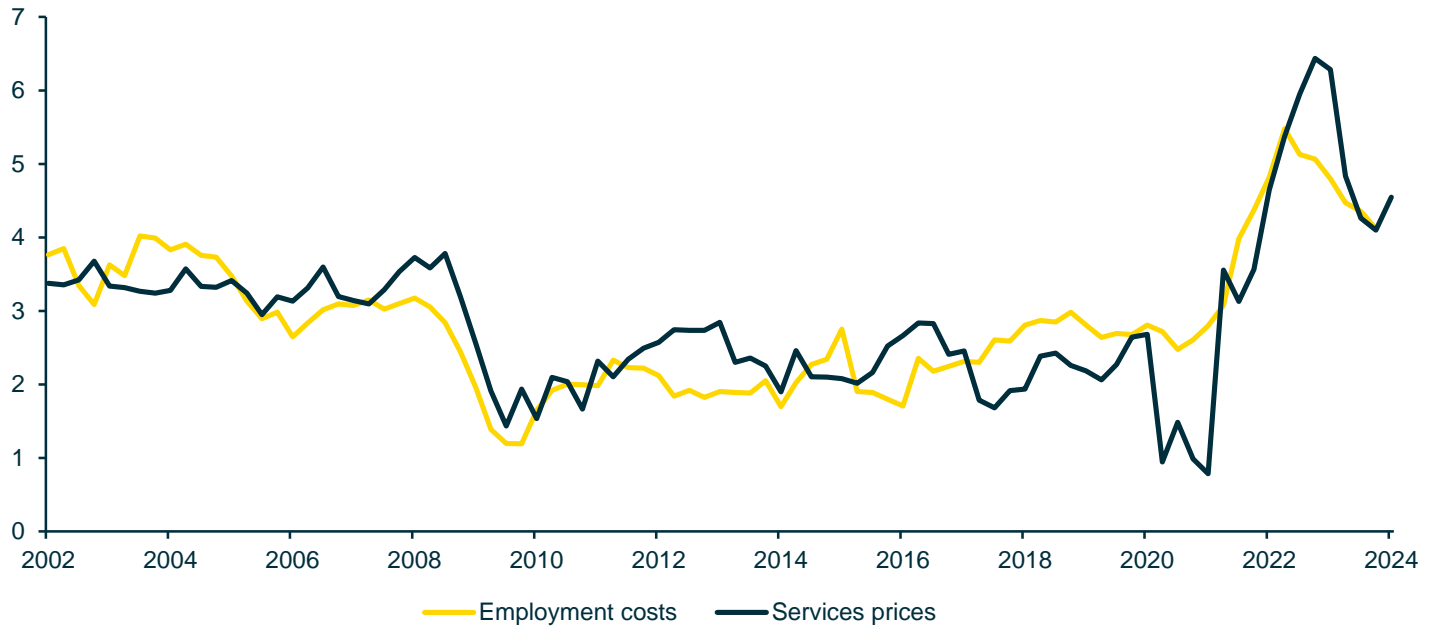
Source: S&P Global Insight, Commerzbank Research

The renewed rise in US inflation is not due to goods. Despite the recent rise in gasoline prices, goods are hardly any more expensive than a year ago. In contrast, the price increase for mostly labor-intensive services (excluding housing) has accelerated in recent months by around one percentage point year-on-year to 4.8% (Chart 2). This category accounts for around a third of the overall core rate.



Chart 2 - Inflation in labor-intensive services is rising again

Employment cost index for private business, prices for services excl. shelter/energy ("super core"), annual rates of change in %



Source: S&P Global, Commerzbank Research

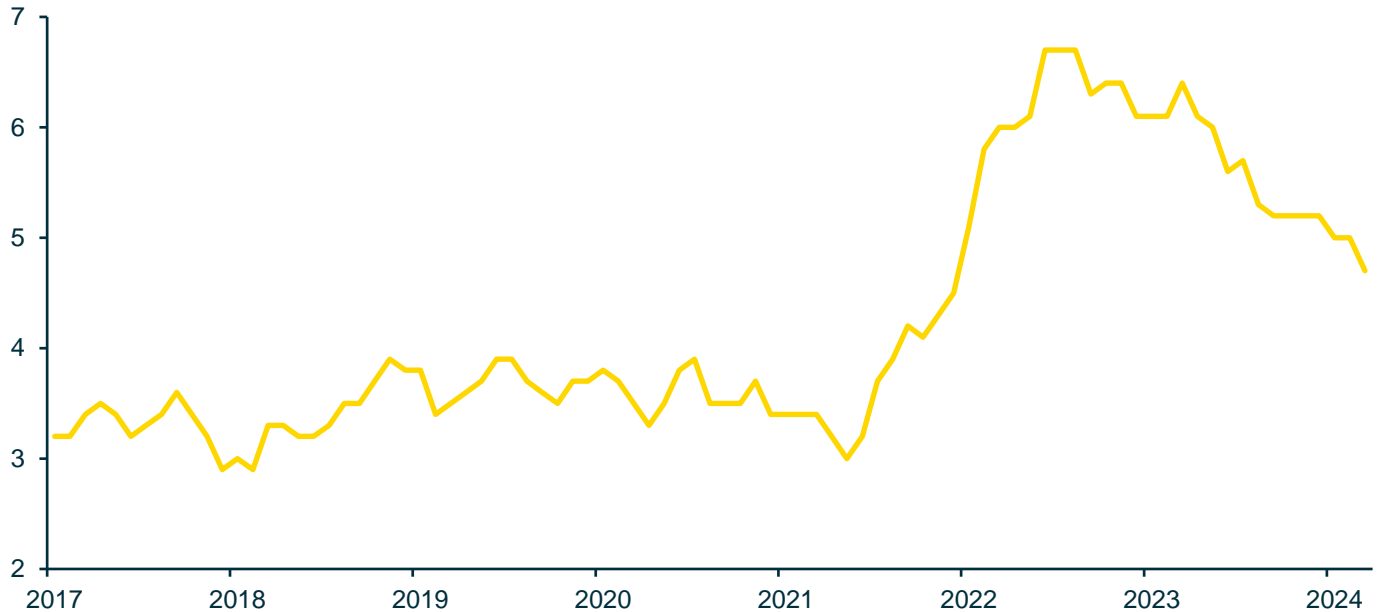
But wage increases are past their peak, ...

However, wage growth, which is important for service inflation, is already slowing. According to calculations by the Atlanta Fed, the median wage (a statistically better measure than average hourly earnings published as part of the employment report) was only 4.7% higher in March than a year earlier (Chart 3). Wages measured in this way have therefore not risen more strongly than service prices (excluding housing) over the past twelve months. This means that wages are unlikely to push up service inflation for much longer. In the medium term, price pressure in services should even fall if wage growth continues to weaken.



Chart 3 - Wage increases are slowing

Median wages, annual rate of change in %



Source: Atlanta Fed, Commerzbank Research

... which has to do with high immigration

At first glance, the slowdown in wage growth does not match the extraordinarily robust employment trend. A good 250 thousand new jobs were created on a monthly average in 2023. Conventional estimates assume that the US labor market needs around 100 thousand new jobs per month to put the growing population to work. Job creation that significantly exceeds this threshold for an extended period of time would drain the pool of available workers and lead to an overheating labor market.

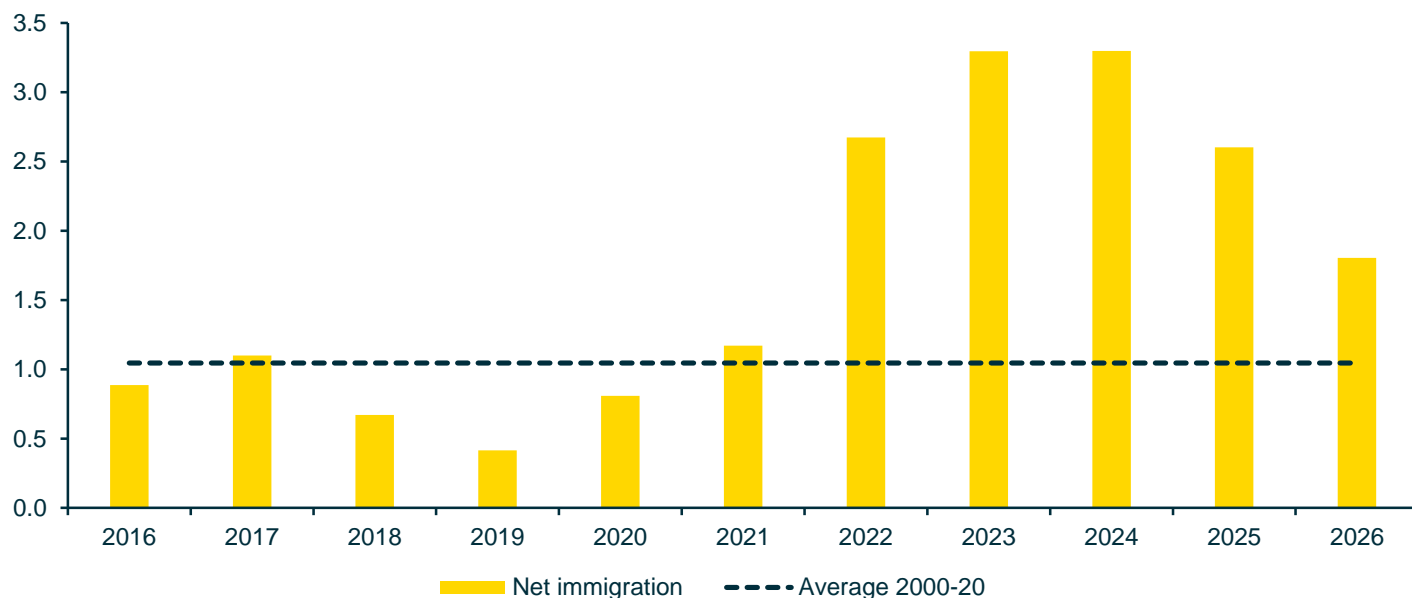
However, these calculations do not take into account the enormously high level of immigration since the end of coronavirus, which has significantly exceeded all previous forecasts. An annual average of 3 million people entered the country in 2022 and 2023 - three times as many as before coronavirus. Immigration is also expected to be well above average in 2024 and 2025. The Congressional Budget Office had to drastically increase its population projections within a year.

According to a **calculation by Brookings**, employment can now rise by around 200 thousand per month due to faster population growth without the unemployment rate falling. Increased immigration is likely to explain to a large extent why the recent high growth in employment has not led to an overheating of the labor market.



Chart 4 - Massive immigration increases labor supply

Net immigration, actual data and CBO projections, in million persons



Source: CBO, Commerzbank Research

We raised the inflation forecast for 2024, but left the 2025 outlook unchanged

Due to the high inflation at the beginning of 2024, we have revised our inflation forecast based on the consumer price index for 2024 upwards by half a percentage point to 3.5%. For 2025, however, we were able to confirm our previous forecast of 3.0%. We therefore remain significantly more cautious than the majority of economists (consensus 2025: 2.2%). This also applies to the deflator for consumer spending (Commerzbank forecast 2025: 2.5%), to which the Fed's 2% target refers. The inflation problem will not simply disappear into thin air.

Fed: We now expect three instead of five rate cuts

Due to the recent unexpectedly high inflation data, it will take longer before the Fed is confident enough that inflation will move sustainably towards 2%. We now assume that the Fed will not make its first cut of 25 basis points until December. It will not want to take such a decision immediately before the presidential election.

In 2025, it will probably make two more cuts and then continue straight ahead. These three cuts in total should not be seen as the start of a classic interest rate reduction process. Rather, it is only a gradual adjustment of monetary policy. The Fed is lowering the degree of policy restriction somewhat so as not to slow down the economy too much.

ECB to decouple from the Fed, ...

On the other hand, we have not changed our forecast for the ECB's key interest rates. After President Christine Lagarde effectively announced a rate cut for June at last week's press conference, we are of course sticking to this long-held forecast. This means that the ECB will initiate the interest rate turnaround almost six months before the Fed, although it started the rate hike cycle a quarter of a year later than the Fed in July 2022. We are also sticking to our forecast that the ECB will cut its deposit rate four times by 25 basis points each time and then leave it at 3.0% from the first quarter of 2025.

... also because ECB sees inflation differently

The fact that the ECB is lowering its interest rates earlier and more sharply than the Federal Reserve is initially due to its view of inflation. It is true that consumer prices excluding energy and food have risen somewhat more sharply than is compatible with the 2% target in the eurozone since the beginning of the year. However, the ECB interprets this primarily as a normal fluctuation in the inflation process and continues to assume that inflationary pressure will gradually ease. It also justifies this with a recent decline in wage pressure with the new wage agreements.



The second argument for the ECB decoupling from the Fed is certainly economic growth. While economists have massively raised their US growth forecast for 2024 from 1.3% to 2.2% on average since the start of the year due to the absence of a recession, they have slightly lowered their forecast for the eurozone.

Significantly lower forecast for EUR-USD ...

The EUR-USD exchange rate fell following the publication of the surprisingly strong US inflation data for March last week. The ECB's decoupling from the Fed increases the euro's expected interest rate disadvantage and argues for a further depreciation of the euro. We now expect the euro to end the year just above parity (1.04; previously: 1.10). We are deliberately not going below parity because the euro is already very cheap in terms of purchasing power parity.

... and modestly higher expectations for Bund yields

As the US Federal Reserve is lowering interest rates less than previously expected, we have raised our forecasts for bond yields slightly. However, the profile remains similar. Only when it becomes clearer towards the end of the year that the ECB is unlikely to find a sustainable solution to the inflation problem are bond yields likely to start rising again on a more sustained basis (see forecast table at the end of the document).

**Research contacts** (E-Mail: firstname.surname@commerzbank.com)**Chief Economist**Dr Jörg Krämer
+49 69 136 23650**Economic Research**Dr Jörg Krämer (Head)
+49 69 136 23650Dr Ralph Solveen (Deputy Head; Germany)
+49 69 9353 45622Dr Christoph Balz (USA, Fed)
+49 69 9353 45592Dr Vincent Stamer (Euro area, World trade)
+49 69 935345800Dr Marco Wagner (ECB, Germany, Italy)
+49 69 9353 45623Bernd Weidensteiner (USA, Fed)
+49 69 9353 45625Christoph Weil (Euro area, France,
Switzerland)
+49 69 9353 45589Tung On Tommy Wu (China)
+65 6311 0166**Interest Rate & Credit Research**Christoph Rieger (Head)
+49 69 9353 45600Michael Leister (Head Rates)
+49 69 9353 45610Rainer Guntermann
+49 69 9353 45629Hauke Siemßen
+49 69 9353 45619Ted Packmohr
(Head Covered Bonds and Financials)
+49 69 9353 45635Marco Stoeckle
(Head Corporate Credit)
+49 69 9353 45620**FX & Commodities Research**Ulrich Leuchtmann (Head)
+49 69 9353 45700Antje Praefcke (FX)
+49 69 9353 45615Tatha Ghose (FX)
+44 20 7475 8399Charlie Lay (FX)
+65 63 110111Michael Pfister (FX)
+49 69 9353 45614Thu-Lan Nguyen (FX, Commodities)
+49 69 9353 45617Carsten Fritsch (Commodities)
+49 69 9353 45647Barbara Lambrecht (Commodities)
+49 69 9353 45611Tung On Tommy Wu (China)
+65 6311 0166**Other publications** (examples)

Economic Research:	Economic Briefing (up-to-date comment on main indicators and events) Economic Insight (detailed analysis of selected topics) Economic and Market Monitor (chart book presenting our monthly global view)
Commodity Research:	Commodity Update (comment and news on commodities markets, two times per week) Commodity Spotlight (detailed analysis and forecasts of commodities markets)
Interest Rate & Credit Research:	Ahead of the Curve (flagship publication with analysis and trading strategy for global bond markets) European Sunrise (daily comment and trading strategy for euro area bond markets) Rates Radar (ad-hoc topics and trading ideas for bond markets) Covered Bonds Weekly (weekly analysis of the covered bonds markets)
FX Strategy:	Daily Currency Briefing (daily comment and forecasts for FX markets) FX Hot Spots (ad hoc analysis of FX market topics)

To receive these publications, please ask your Commerzbank contact.



Analysts

Dr. Jörg Krämer
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

Bernd Weidensteiner
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

In accordance with ESMA MAR requirements this report was completed 19/4/2024 07:19 CEST and disseminated 19/4/2024 07:19 CEST.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal view about the subject securities and issuers; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: <https://commerzbank.bluematrix.com/sellside/Disclosures.action>*

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.



Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: To the extent this report is distributed to U.S. investors, it is restricted from being sent to U.S. retail investors. Commerz Markets LLC ("CMLLC") is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. For securities purposes, Commerzbank AG provides this report as a third-party report, therefore the involved research analysts may not be registered with FINRA and the reports are not subject to the full provisions of FINRA Rule 2242. Any securities transactions by US investors resulting from this report must be effected with CMLLC. CMLLC is a member of FINRA and SIPC. Banking and swap services in the U.S. will be provided by Commerzbank AG in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. Commerzbank AG is not a member of SIPC and is a provisionally registered swap dealer with the CFTC.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a "financial advisory service" within the meaning of the Financial Advisers Act, Chapter 110 of Singapore ("FAA") and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order O4/1313.



Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People's Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for eligible entities in the PRC. No-one else may rely on any information contained within this document. The products and services in this document only apply to entities in the PRC where such products and services are permitted to be provided by PRC laws and regulations. For any person who receives this document, the information in this document shall neither be regarded as promotion or solicitation of the business nor accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication, and the recipient is advised to seek independent advice from its own professional advisers about the information contained herein and shall understand and abide by PRC laws and regulations while conducting any related transactions.

© Commerzbank AG 2024. All rights reserved. Version 24.02

Commerzbank Offices

Frankfurt

Commerzbank AG
DLZ - Gebäude 2,
Händlerhaus
Mainzer Landstraße 153
60327 Frankfurt
Tel: + 49 69 136 21200

London

Commerzbank AG
PO BOX 52715
30 Gresham Street
London, EC2P 2XY
Tel: + 44 207 623 8000

New York

Commerz Markets LLC
225 Liberty Street, 32nd
floor,
New York,
NY 10281-1050
Tel: + 1 212 703 4000

Singapore

Commerzbank AG
128 Beach Road
#17-01 Guoco Midtown
Singapore 189773
Tel: +65 631 10000