

## Central bankers left holding the baby

When everything else fails, central bankers come to the rescue. That's how the story goes; they have a reputation for nursing sickly children back to health. Perhaps Lagarde, Powell and the rest of them need to start brushing up on their parenting skills when it comes to the ailing global economy



### Watch: Monetary policy should not be the only game in town

ING's Global Head of Macroeconomics, Carsten Brzeski, offers his take on the global economy and suggests that too much trust is being placed in central banks' abilities to fix the worsening economic situation.

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### The only game in town

It seems to me that the global economy is mainly driven by politics these days. You've got escalating conflict in the Middle East and stalemate in Ukraine. And all that's playing into the economic ailments of falling competitiveness, faltering growth momentum and a fracturing political system. It's extraordinary, then, that when you check out the financial markets, monetary

policy seems to be the only game in town.

We've been here before. I'm losing count of the number of times people look to central banks to react when global economies lose momentum. In 2015, the then-president of the European Central Bank, Mario Draghi, repeatedly emphasised that if you want growth, monetary policy isn't the only game in town. In the end, his brand of monetary policy, along with negative interest rates and asset purchases, might not have been the only game, but it was certainly the most impressive.

Right now, the US economy is losing traction. China's sliding into a European-style consumption slump. The eurozone is flirting with recession. So, the spotlight's back on central banks to come to the rescue once again. All the major ones are at important turning points. They're juggling the twin dilemmas of inflation versus decisive rate cuts. Is the former slain? Will the latter breathe life into the still-snarling dragon?

While the bankers mull over these shifts, so many governments seem reluctant to use structural reform and fiscal policy as their main tools in tackling seemingly moribund economies. Falling back on central banks is easy. Far harder is mapping the painful reforms and clear fiscal direction so desperately needed as government debt rises to horrifying levels.

## Parting of the ways

As for that fiscal direction, the next few weeks will be crucial in both the US and the eurozone. The American presidential elections and subsequent policy announcements are likely to lead to still higher government debt. Neither Mr Trump nor Ms Harris is inclined to elaborate on their plans to address that. Goodness knows when this will actually become a structural problem, but you'll know it once you see it.

Here in Europe, memories appear to be short. The debt crisis was a little over a decade ago. Sure, some reforms seem to have made the fiscal rules more resilient, but somehow, history appears to be repeating itself, and it isn't pretty.

In the early 2000s, France and Germany breached the Stability Pact rules and avoided any consequences. Today, both countries have diverged greatly here. France, with a government debt ratio of more than 110% of GDP, an average annual fiscal deficit of more than 6% of GDP over the last four years, and government spending of close to 60% of GDP, wants to bring back its fiscal deficit to 3% of GDP by 2029. And that poses a severe first test case as to the implementation of the reformed fiscal rules.

Germany, meanwhile, with government debt of 60% of GDP, is sticking to its constitutional debt brake and is struggling to agree on any new investments. The eurozone is heading into unprecedented fiscal divergence.

## Whatever it takes

So, we've seen this sort of economic divergence before, and it didn't end well. And you don't have to be a learned economist to know that such disparity will feed into greater anxieties and tensions. So, bring on the maestros! Bring on the central bankers, those modern financial market magicians! It's what the crowds are waiting for. Surely, they've got some tricks up their sleeves to magically support weakening economies; they've done it before.

Central banks are always the ones left holding the baby.

'Whatever it takes', right?

## Our key calls this month

**United States:** After September's 50bp rate cut, the Federal Reserve is likely to move more cautiously from now on. Official data suggest strong growth and robust employment gains, but survey evidence indicates the situation isn't as rosy and caution is warranted. We still favour the soft landing scenario amid cooling inflation fears and the Fed cutting rates to 3.5%.

**Eurozone:** The European economy is rapidly losing steam with growth likely coming to a standstill in the winter months. The good news is inflation figures are benign, allowing the European Central Bank to step up the easing pace. We expect cuts in October and then at every meeting until the deposit rate reaches 2%.

**United Kingdom:** The Bank of England is treading more carefully for now, but we expect cuts to accelerate from November onwards. The 30 October budget could involve sweeping changes to fiscal rules that unlock a big boost to investment. That's a potential risk for markets, though investors seem relaxed.

**China:** Sweeping fiscal and monetary policy announcements have been cheered by financial markets. These are a good step in the right direction, but the economic outcome still depends on the strength, speed, and effectiveness of upcoming fiscal policy support to build upon the initial momentum. We have revised up our 4Q and 2025 growth forecasts.

**Central and Eastern Europe:** The increase in geopolitical risk is bringing unusual FX weakness to the CEE region, while the potential for higher oil prices is reintroducing inflation concerns. At the same time, the fiscal picture is raising eyebrows in some countries in the region, and any further central bank rate cuts remain conditional.

**FX:** The dollar is on firmer footing compared to where it was a month ago. A more volatile geopolitical backdrop can keep it supported, though the Presidential election will become increasingly important. EUR/USD may struggle to bounce back above 1.10 into November 5th, with risks skewed to the 1.08 area as lower eurozone inflation prompts the ECB to cut rates in October.

**Market rates:** A strong jobs report has taken 10-year US yields back to 4%, though any material move up is constrained by the recessionary risk ahead. A payrolls wobble could take it lower again, but in the medium/longer-term we still expect the 10-year to trend back towards 5%.

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