

ING Monthly: A perfect summer storm for financial markets

Like the rest of you, we had hoped to be relaxing somewhere in the mountains, lakes and beaches or gorging on the Olympics. Instead, the financial market turmoil at the start of August begs explanations, assessments and, in a phrase beloved of central bankers, some forward guidance



Sheltering from storms in New York's Times Square

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The summer storm is a reality check

The market turmoil at the start of August came like a summer thunderstorm: not entirely unusual, but still a surprise when you get soaked. So, just what triggered the market sell-off? As so often is the case, there is not one single explanation for market movements but a series of explanations. Many can be labelled as a reality check.

The reality check for everything related to technology and AI had already started somewhat

earlier. Some earnings disappointed and illustrated that there are limits to fantasies regarding future returns and that not everything that has 'AI' on it immediately brings big bucks. Another came from US weaker-than-expected labour market data last Friday, which brought back the R-word to financial markets: recession. The announcement that Warren Buffet sold some big positions also triggered some concerns among market participants; *what does he know that we don't?*

Finally, as the interest rate differential between Japan and the US and also the eurozone is gradually narrowing, some closed carry-trade positions and fueled a sell-off in Japanese stocks. To be clear, Japanese macro fundamentals have not changed in recent weeks. Add to that the omnipresent geopolitical risks, now in the form of new tensions between Iran and Israel, and we had the perfect storm for financial markets.

Our global growth forecasts haven't changed

It would be foolish to claim that we know where markets will be going over the coming weeks. However, what we do know is that we're not changing our macro picture despite recent developments. Remember that we've not exactly been known as outgoing macro optimists in recent years. A soft landing in the US had always been in the cards, and it is the long-lasting resilience of the US economy that surprised us rather than the current cooling.

There is still some room for positive surprises

In the eurozone, the latest drop in confidence indicators shows that the recovery the ECB and other institutions had been expecting will take longer to unfold, if ever. There is still some room for positive surprises if consumers finally start to open their wallets or if the inventory cycle really starts to turn. However, don't fall into the usual European trap of thinking that the continent can escape a slowdown or recession in the US.

While the market turmoil so far has not really altered our growth forecasts, it is a reason to change our Fed call. Over the past week, we've seen substantial changes to market Fed rates. It already started to prepare the ground for a September cut at its July meeting, but the new recession fears and market turmoil saw markets swing from expecting 65bp of cuts for the rest of this year to virtually having it all priced in to happen by the next meeting date.

Calm has since been restored by soothing words from the Fed and a stronger ISM services index, but there is certainly an argument that the Fed is "behind the curve" and needs to accelerate rate cuts to avoid a recession.

The Fed is set to cut and cut again

As recently as June, the Fed was forecasting fourth-quarter GDP growth of 2.1% YoY and unemployment ending the year at 4%, with perhaps only one rate cut needed. That looked optimistic even then, but with business surveys softening, hiring rapidly cooling, inflation tracking towards 2%, and unemployment blowing past their projections, the Fed certainly can argue that it should move sooner than previously thought.

At one point, the market was looking at the possibility of an inter-meeting rate cut, but unless there is financial system stress, we don't see the need for impending action, and the Fed can indeed wait and watch the data flow before deciding what to do at the September FOMC meeting. Carry trades are being unwound and equities have been hit hard but are still up year-to-date. The Fed will be strongly opposed to being seen to be bailing out risk-takers if there isn't a pressing economic or financial system need.

A Fed rate of 3.5% by next summer

We have long been on the more dovish end of forecasters, expecting the Fed to cut rates more quickly and aggressively than the market. Our most recent change in the spring was to scale back our view to a mere 75bp of cuts in the second half of the year, which appears to have been the wrong thing to do. Instead, we see the Fed acquiescing to some of the market worries and implementing at least one, perhaps two 50bp moves to get them on track to moving policy to a more neutral footing quickly.

We are leaning toward a 50bp in September, followed by a series of 25bp moves that would get us back to a Fed funds rate of around 3.5% by next summer.

With this update, we hope to return to those beaches, mountains, and lakes. However, markets and the economy never take a vacation. So be assured that we are continuing to follow all developments closely, wherever we are, and will keep you informed as usual.

Our latest key forecasts

	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
Real GDP growth (QoQ annualised %)									
United States	1.7	0.8	0.9	1.7	2.2	2.4	2.5	1.5	2.1
Eurozone	1.0	1.0	1.3	1.4	1.3	1.3	0.7	1.2	1.2
Inflation (CPI, YoY%)									
United States	2.7	2.6	2.1	1.9	2.0	1.9	2.9	2.0	2.0
Eurozone	2.5	2.5	2.3	2.2	2.1	2.2	2.5	2.2	2.2
Policy rates (%)									
US (upper bound)	5.00	4.50	4.00	3.50	3.50	3.50			
Eurozone (deposit rate)	3.50	3.25	3.00	2.75	2.50	2.50			
10-year government bond yields (% end of period)									
United States	3.80	3.70	3.90	4.00	4.25	4.75			
Germany	2.20	2.20	2.30	2.35	2.40	2.55			
FX (end of period)									
EUR/USD	1.12	1.10	1.10	1.10	1.10	1.10			
USD/JPY	143	140	140	138	137	135			

Source: ING

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