

Too early for optimism

As we look back on what the last month has brought for the global economy, it's becoming increasingly apparent that being right about a less promising outlook isn't necessarily a good thing



Carsten: Too early for optimism

With a less promising outlook on the horizon as we and many others had predicted, one major realisation has come to light for ING's Carsten Brzeski: being right isn't necessarily a good thing

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Cynics would say another month, another crisis. Tragic events in Israel amid the escalating conflict have once again shown us just how fragile the global economy currently is. They've also illustrated just how fragile geopolitics currently are, as well as how uncertain economic forecasts can be. This is a conflict with seemingly endless human tragedy, and it holds enormous potential to rock the global economy. As in the case of the ongoing war in Ukraine, the economic impact will not follow the traditional lines of trade flows, but rather via oil prices and ripples of increasing uncertainty. If the situation were to escalate further and if Iran becomes directly or indirectly involved, possible sanctions, further oil supply reductions or closure of the Strait of Hormuz could trigger a new surge in oil prices and consequently higher inflation. Recent demonstrations in the US and Europe – as well as individual terror attacks – could also bring the conflict to the Western world, weighing on economic sentiment at a time in which major economies are already weakening.

This brings me to the frustration of being right. Over the course of this year, we've rightly been challenged on our major calls of a slowing US economy and a eurozone economy being stuck in stagnation. Haven't both economies shown much stronger resilience than expected? In the case of the US, it has indeed. However, while we and many others might have been wrong on timing, the latest surge in bond yields and interest rates is very likely to push the US economy into a severe slowdown – only later than expected. In recent weeks, interest rates on credit cards surged to almost 30%, and mortgage and car loan interest rates jumped to 8%. It isn't unimaginable that the US economy could bow under this kind of interest rate pressure. We don't think it's a question of if, but when.

In Europe, stagnation has firmly become the new reality. The summer revival turned out to be weaker than hoped for and the latest sentiment indicators have dented any hopes of imminent improvement. Instead, new geopolitical uncertainties and the slowing of the US economy – together with the ongoing impact of ECB tightening so far – will once again test economic resilience over the winter months. It looks highly unlikely that the eurozone will be able to escape stagnation any time soon.

Major economies are now doing what they are supposed to do in the wake of aggressive monetary policy tightening: weakening. Some market participants may have simply forgotten that so far, the single most important driver of economic slowdown and recession since World War II has always been monetary policy tightening. With slowdowns on the rise, major central banks will eventually realise that their job of hiking rates is already done; but as long as headline inflation remains clearly above target, 'high for longer' will be the next stage of tightening. It could, however, very easily happen that this 'longer' period will be shorter than that of policy rate hikes. Interestingly, there seem to be first signs of central bankers preparing the ground for rate cuts even if inflation is not yet back on target. This would follow the principle of taking away some restrictiveness without moving again to accommodative monetary policies. We see actual and core headline inflation at around 3% as the magical level at which rate cuts could become a reality.

Kermit once sang that it's not easy being green. For us, with a less promising economic outlook on the horizon, it's not easy being right.

□ Our key calls this month

- **United States:** With Treasury yields up around 5% and the dollar holding firm, financial conditions have undoubtedly tightened, reducing the need for another Fed rate hike. Consumer borrowing costs are moving rapidly higher, savings are being exhausted, and real household disposable incomes are falling. That means the risks to growth in 2024 remain to the downside.
- **Eurozone:** Growth turned negative in the third quarter and the next two quarters don't look very promising either. With inflation declining, the case for an additional rate hike is disappearing. However we don't expect any rate cuts before the summer of 2024.
- **United Kingdom:** The BoE is keeping the door open to further hikes, but we think the tightening cycle has finished. Higher mortgage rates will act as a growing drag on UK activity. Rate cuts are likely to start from next summer.
- **China:** It's been an eventful month in China. The economy has firmed up further, the government has pledged to expand the central government deficit. We've revised up our 2023 GDP forecast to 5.4%.
- **Central and Eastern Europe:** The story in the CEE region is becoming increasingly diversified

due to varying economic outlooks, inflation profiles and reaction functions of central banks. We see more divergence looking forward than convergence, but some common themes remain that will temper the region's outlook in the year ahead.

- **Commodities:** Geopolitics will continue to dictate oil prices and the clear risk for the market is if an escalation in the Middle East leads to supply disruptions from some key producers in the region. We currently forecast ICE Brent to average \$90/bbl in 2024 and \$95/bbl in the second half of 2024.
- **FX:** November and December are normally soft months for the dollar. This year, however, the tailwind from strong US growth and hawkish Fed policy should keep the dollar bid through to year-end.
- **Market rates:** We're off recent highs for 10yr rates, but we think that the current momentum points to hitting those highs again, then likely breaking above. The Fed and the ECB may be done, but market rates are not. Despite geopolitics, market rates remain under upward pressure.

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