

# Quick-fire answers to your global economy questions

Give us a minute, and our economists will give you some answers to the global economy's biggest questions, notably around energy and China's reopening. And take a look at our three scenarios for the world as February begins



## Three scenarios for the global economy

**ING Outlook: Our base case**

**Energy prices**

Chinese LNG demand only partially recovers, allowing EU to increase LNG imports. Storage starts next winter more than 90% full. European gas prices (TTF) average EUR75-80/MWh in second half of the year.

**Economics**

Europe's recession is extremely mild, suggesting core inflation takes time to come down even if headline rates tumble on lower gas prices. The US experiences a downturn as higher interest rates and low business confidence begin to hit hiring activity.

**China Reopening**

Rebound in spending concentrated in the service sector, with a more gradual industrial recovery. Commodity prices rise but not rapidly enough to materially impact global inflation profiles.

**Markets**

Second half Fed rate cuts allow the dollar bear trend to continue and the euro to enjoy modest recovery.

Market rates are pulled lower from the US end, and ECB hikes ensure convergence versus eurozone rates.

**Central banks**

Federal Reserve hikes by 25bp in March but cuts rates by 100bp by year-end. ECB hikes by 50bp in March and 25bp in May – and signals no cuts in 2023.

2023 growth forecasts

<b>0.1%</b>	<b>0.6%</b>	<b>5.0%</b>
US	Eurozone	China

Markets: End-2023 forecasts

<b>1.12</b>	<b>3.00%</b>	<b>110</b>
EUR/USD	US 10-year	Oil (Brent)

Source: ING

**Positive scenario**

<p><b>Energy prices</b> Chinese LNG demand little changed, allowing EU to absorb more of 2023's supply growth. Dutch TTF averages EUR 50-55/MWh in second half of the year.</p>	<p><b>China Reopening</b> "Goldilocks" scenario where activity recovery surpasses the pre-pandemic level, but without any resulting squeeze on commodity prices.</p>	<p><b>Central banks</b> Central banks become much more relaxed about inflation, enabling earlier rate cuts in Europe.</p>												
<p><b>Economics</b> Europe avoids recession but inflation comes down quicker than expected anyway - lower energy prices feed through indirectly to services. Energy-independent US more similar to the base case (less sensitive to gas prices).</p>	<p><b>Markets</b> Not a big change from base case, EUR/USD probably does a little better given better global growth.  US rates see a bigger pull power, tightening spreads versus the eurozone more from the US side.</p>	<p>2023 growth forecasts</p> <table border="0"> <tr> <td>0.4%</td> <td>1.3%</td> <td>5.6%</td> </tr> <tr> <td>US</td> <td>Eurozone</td> <td>China</td> </tr> </table> <p>Markets: End-2023 forecasts</p> <table border="0"> <tr> <td>1.15</td> <td>2.50%</td> <td>75</td> </tr> <tr> <td>EUR/USD</td> <td>US 10-year</td> <td>Oil (Brent)</td> </tr> </table>	0.4%	1.3%	5.6%	US	Eurozone	China	1.15	2.50%	75	EUR/USD	US 10-year	Oil (Brent)
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Source: ING

**Negative scenario**

<p><b>Energy prices</b> Russian gas flows to Europe further reduced. Chinese LNG demand recovers faster than expected, meaning European gas prices need to rise to compete. Dutch TTF averages EUR135/MWh in second half of the year.</p>	<p><b>China Reopening</b> Industry recovers faster than expected, putting abrupt pressure on global energy and commodity prices. Impact on global inflation slightly mitigated by further improved supply chain reliability.</p>	<p><b>Central banks</b> Policy rates go another leg higher, and no major central bank cuts rates in 2023. But a deeper recession prompts widespread easing in 2024.</p>												
<p><b>Economics</b> Core goods price inflation falls less rapidly. Higher gas prices push eurozone into recession, but government support and boost from Chinese demand provide a partial offset. US is more insulated, but higher rates prompt a deeper downturn.</p>	<p><b>Markets</b> Dollar rebounds as sticky inflation nixes Fed easing cycle and damages global growth prospects.  Market rates forced to reprice terminal central bank rates higher; abrupt unwind of current richness.</p>	<p>2023 growth forecasts</p> <table border="0"> <tr> <td>-0.3%</td> <td>0.1%</td> <td>4.8%</td> </tr> <tr> <td>US</td> <td>Eurozone</td> <td>China</td> </tr> </table> <p>Markets: End-2023 forecasts</p> <table border="0"> <tr> <td>1.05</td> <td>4.25%</td> <td>122</td> </tr> <tr> <td>EUR/USD</td> <td>US 10-year</td> <td>Oil (Brent)</td> </tr> </table>	-0.3%	0.1%	4.8%	US	Eurozone	China	1.05	4.25%	122	EUR/USD	US 10-year	Oil (Brent)
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Source: ING

## ? How far could gas prices rise from here, and what would be the major cause?

We currently expect that European gas prices will average EUR 70/MWh over 2023, peaking in the fourth quarter with an average of EUR 80/MWh. However, clearly there are significant upside risks to this view. If remaining Russian gas flows to the EU were to come to a halt and if we were to see stronger than expected LNG demand from China this year, this would tighten up the European market significantly. Under this scenario, we would need to see stronger-than-expected demand destruction to keep the market in balance. As a result, prices would need to trade higher, potentially up towards EUR 150/MWh going into the '23/24 winter. The European Commission's price cap of EUR180/MWh for TTF should provide a ceiling to the market, at least for exchange prices within the EU.

## ? Is Europe still heading for recession?

Lower energy prices and high levels of national gas reserves as a result of the warm weather and lower energy consumption have helped the eurozone economy to avoid an energy crisis this winter. Fiscal stimulus has also supported the economy and prevented the eurozone from falling into a severe recession. However, the eurozone economy is not out of the woods yet. Industrial orders have weakened and once the post-pandemic boost is behind us, growth in the services sector could soften. With (core) inflation remaining stubbornly high and the full impact of ECB rate hikes still materialising (with activity in the construction sector particularly vulnerable), the eurozone is facing a longer quasi-stagnation. The worst-case scenario has been avoided for now but this doesn't automatically lead to a strong recovery.

## ? If gas prices rise, have governments done enough to shield consumers/businesses in Europe?

It took a while but at the end of last year, fiscal support measures in most eurozone countries had reached levels seen during the pandemic. For the eurozone as a whole, the announced fiscal stimulus amounts to around 5% of GDP. The stimulus packages are largely aimed at supporting household purchasing power but also at keeping companies' energy costs at bay. However, if energy prices remain at current levels, the full amount reserved for energy price caps will not have to be used up. While these packages offer significant relief in the short run, they will not be able to shield consumers and businesses against structurally higher energy costs. Government expenditures in the eurozone already amount to around 50% of GDP and with the weighted eurozone government budget at 4.5% of GDP, any room to scale up deficit-financed stimulus, which is exclusively aimed at supporting consumption, looks limited.

## ? Is the end of zero-Covid in China a gamechanger?

The surprise reopening of the Chinese economy will certainly boost demand, and we have revised up our GDP forecasts accordingly. What is still unclear is how much and when the reopening will boost domestic spending within China, especially on services. Household balances are swollen after prolonged inactivity, so some "revenge" spending seems plausible. How important these balance sheet effects are for spending within China is still being debated, with unemployment still high and wage growth still subdued.

Of greater global relevance will be how strongly industry recovers, as this will dictate the strength of the recovery in demand for commodities, including energy. Our current thinking is that manufacturing recovers more slowly than domestic spending on services, and this should not result in a substantial boost to global commodities prices, though some upward price pressure is probable. With the economy just emerging from the Lunar New Year, and data clarity very low right now, this "goldilocks" view is offered with fairly low conviction.

## ? Is inflation really falling, and have markets been too quick to price in cuts?

Headline inflation rates across the developed world should fall this year as the sharp rises in food, fuel and goods prices of late 2021-mid 2022 are unlikely to be repeated. Admittedly, of these three categories, food prices have probably the biggest potential to rise again significantly this year.

With commodity prices – including food indices – having fallen in many cases, there is a case for a sharp reduction in goods-related inflation this year, and in some categories, outright price falls. This story is likely to be more aggressive in the US, where month-on-month increases in core CPI and PCE deflator readings have slowed from 0.5-0.6% in the middle of last year, to 0.2-0.3% more recently. That's still above the 0.17% MoM average required to take the year-on-year rate to 2%, but we're getting close. Rents are topping out, vehicle prices are falling and there is growing evidence that corporate pricing power is waning with businesses thinking more defensively as recession fears mount. We continue to forecast core inflation measures getting down to 2% by the end of 2023.

In Europe, the story is likely to be more gradual. Core inflation is yet to peak, and the lagged impact of higher energy prices is continuing to put pressure on services pricing. The strong

prevalence of collective bargaining in many European countries also suggests wage pressures will continue to feed through, too, and ongoing fiscal stimulus and government intervention could lengthen the inflationary pressure. The fear is that supply-side inflation could morph into demand-side inflation. The divergence between the EU and the US in terms of inflation suggests that markets are right to be pricing rate cuts from the Federal Reserve later this year, while the easing priced in from the ECB in 2024 looks premature.

## ? Can the US economy avoid recession?

Possibly, but we need something to turn around quickly. We have a housing market correction coupled with six consecutive monthly falls in residential construction, three month-on-month drops in industrial production and two consecutive 1%+MoM falls in retail sales, which hint at a broadening slowdown. Meanwhile, the labour market is showing tentative signs of cooling after five consecutive months of decline in temporary help, which typically leads to broader labour market trends. With CEO confidence at the lowest level since the global financial crisis, implying a growing proportion of businesses adopting a more defensive stance, the risks are mounting that there will be a recession. However, strong household balance sheets and a robust-looking jobs market suggest it will be relatively short and shallow, assuming inflation falls as we expect and the Fed is able to offer stimulus later this year.

## ? Can the recovery in risk assets continue?

It has been a strong start to the year for risk assets, underpinned by robust inflows. Equity markets are up as much as 9% in Europe and dedicated bond funds are up anywhere between 2-4%. But risk assets will struggle to post further near-term gains should our view for some tactical upward pressure on market rates bear fruit. It's a non-consensus call though, and even if market rates were to fall it's more likely that the market reads this as a measure of underlying angst, which can cause issues for risk assets, via an elevation in perceived default risk ahead. The strong rally in credit markets has lasted for over three months before which credit was pricing in a significant recession. The value that was evident then has evaporated. Nonetheless, with persistent inflows to the sector remaining a dominant theme, we remain constructive in the longer term and further returns in the sector will be a function of yield and carry, rather than spread tightening. In FX, growing headwinds to risk assets would provide some temporary support to the dollar and help cement a 1.05-1.10 EUR/USD trading range for the rest of the quarter. Later in the year, however, 1.15 levels are possible as the conviction builds over a Fed easing cycle.

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