Three scenarios for energy, central banks, rates and FX markets

How a prolonged disruption to Middle East energy flows could affect inflation, interest rates and currencies

With the world in flux, certainty is a rare commodity

Three scenarios for energy prices

Scenario	Length of disruption (% disruption to Strait of Hormuz flows)						Oil supply lost (m barrels)	Brent forecast (USD/bbl)			Gas supply lost (bcm)	TTF forecast (EUR/MWh)		
	Mar	Apr	May	Jun	Jul	Aug		Q2	Q3	Q4		Q2	Q3	Q4
ING base 1	100	60	30	15	10	10	1138	96	93	88	28	55	45	45
Prolonged disruption 2	100	100	50	40	20	20	1754	110	102	100	38	74	60	60
Re-escalation 3	100	100	100	100	50	50	3635	135	150	120	58	90	75	80

Source: ING

Energy markets

Financial markets are taking a glass-half-full view on the Middle East crisis amid the ongoing ceasefire and reports of another round of negotiations between the US and Iran. But there are still plenty of ways this situation could play out.

In our refreshed base case, we're assuming that talks drag on, prompting renewed US pressure.

The American blockade of the Strait of Hormuz is a good example of this. But despite ongoing disruption, a deal is ultimately reached that enables more traffic to flow through the Strait as we head into summer. Our new forecasts are based on energy flows returning to 70% of normal through May and 90% by July. Remember that damage to energy infrastructure will hamper efforts to return fully to normal.

This scenario would see Brent Crude trading between US$90-100/bbl in the second and third quarters. TTF natural gas averages 55 EUR/MWh in the second quarter.

Alternatively, a scenario where prolonged disruption means flows return to only 60% of normal by the end of June, takes oil prices back above US$100/bbl and keeps them there for the remainder of 2026. Natural gas prices show further upside, too.

A more extreme situation, where talks collapse and a sustained military escalation ensues, keeps the Strait of Hormuz closed until the end of June, with only a steady recovery thereafter. Oil prices go as high as US$150/bbl in the third quarter.

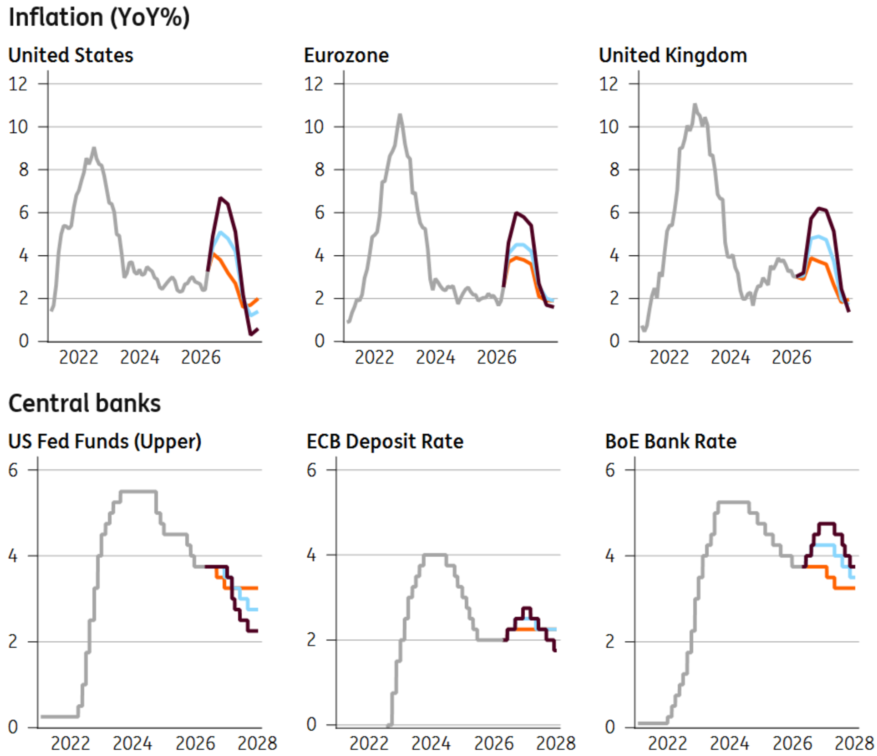
Central banks

Our new base case sees the European Central Bank hiking rates in June, though for now we think that's a one-off. While the threat of second-round effects on inflation is considerably less than in 2022, we think headline inflation at 4%, core inflation rising towards 3% and the optics of survey-based inflation expectations metrics surging, will tempt Frankfurt into some very limited tightening. The fact that we're assuming a material improvement in flows through the Strait of Hormuz by the time of the June meeting should prevent that from turning into a more aggressive tightening cycle.

That changes if the disruption lasts longer and prices spike higher. The supply chain impact will become more unpredictable and widespread. And as the central banks have highlighted, the secondary impact on inflation risks snowballing. Our most extreme scenario sees US, eurozone and UK inflation peaking at or above 6% this year. If that happens, we'd expect multiple ECB hikes, though we also think it would be swiftly reversed through 2027 as the inflation threat recedes.

In contrast, we don't expect rate hikes from the Fed in any of our scenarios, although an interest rate hike can't be ruled out if energy prices rise above our base case. This is a far narrower supply shock for the US than 2021/22 and there isn't the same demand impetus. Over the medium term, we think higher transport fuel prices are more likely to weaken growth and employment rather than lead to persistently higher inflation. So while our more adverse scenarios delay the timing of the next cut as the Fed weighs up the risk of second-round effects, ultimately we think the higher energy prices go, the deeper the rate cut cycle that eventually follows. As Middle East tensions subside and energy prices drop, we expect officials to increasingly focus on the jobs aspect of its dual mandate.

Three scenarios for central banks and inflation



Source: Macrobond, ING

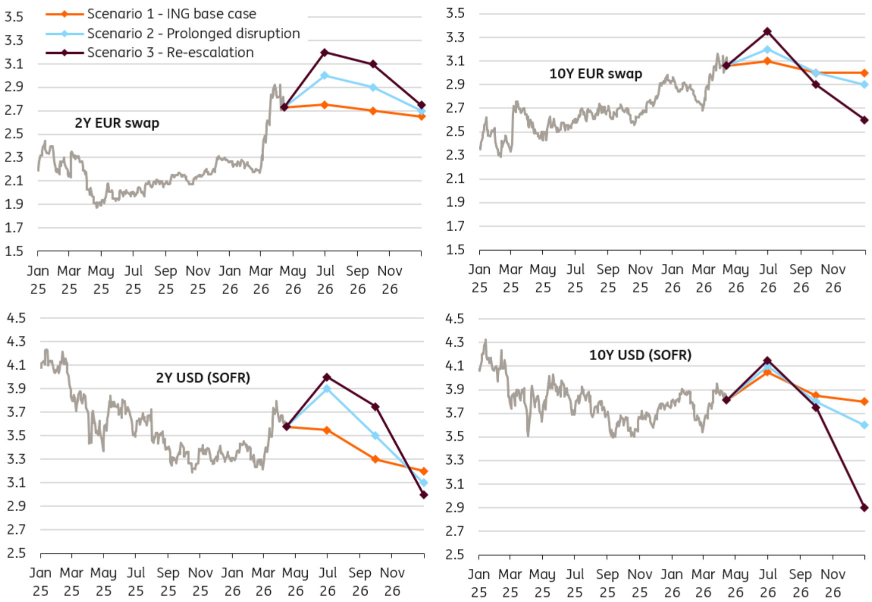
EUR and USD rates: Higher rates will struggle to hold over the medium-term

Euro rate markets are still positioned for more than two ECB hikes and seem willing to price in more if oil prices were to rise again. In the near term, that means markets could even get pushed towards four hikes, implying a 2Y swap rate moving well above 3%. For the higher oil price scenarios, we do, however, anticipate a sharp dovish shift as growth concerns start mounting towards the end of the year. That means markets would already start eyeing ECB cuts in 2027, pulling the 2Y rate even below current levels.

For 10Y euro rates, the initial reaction to higher oil prices will still be bearish, but the scope to go higher should be limited. Growth concerns on the back of tighter monetary policy and higher energy costs should start weighing on market sentiment. In effect, this starts pushing down longer-dated rates, also explaining the 2s10s curve inversion towards the end of 2026 in the worst outcome.

The outlook is similar for US rates, with the 2Y swap reaching 4% in the highest oil scenario. Also, 10Y rates can move materially higher in the near term, even in our baseline scenario, especially since market sentiment remains resilient. With inflation numbers coming in hot throughout 2026, that upward pressure on rates should hold. When markets turn more pessimistic on the growth outlook, however, the focus should shift from inflation to recession risks. In effect, this pushes down real rates, bringing 2Y and 10Y to levels below where we stand today.

Three scenarios for swap rates



Source: Macrobond, ING

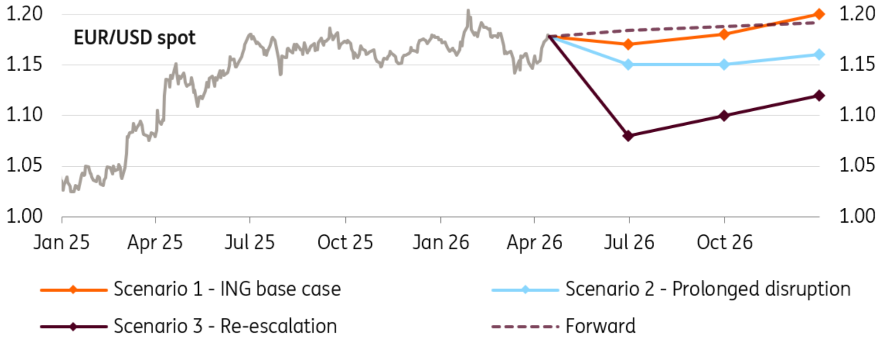
EUR/USD: Our baseline remains modestly bullish

Our baseline EUR/USD call for 3Q (1.18) and 4Q (1.20) remains unchanged from last month. While we now embed one ECB hike into our forecast, market pricing remains more hawkish (55bp) and we have revised our oil forecast higher. The backbone of our bearish USD view into year end remains our expectation of two Fed cuts, which should reopen USD hedging channels by easing front end rates.

If anything, risks sit on the upside relative to our 1.20 year end target, as the ECB might end up delivering two hikes after all and political uncertainty building into the November midterms could trigger more US specific dollar weakness. And if Republicans lose both houses of Congress, limits on Trump's ability to pursue new fiscal stimulus could reinforce structurally bearish views on the dollar.

In the shorter run, we see risks mildly tilted on the downside for EUR/USD, and we target 1.170 for the end of the second quarter. Markets have already leaned aggressively into the de escalation trade, while ECB expectations still look too hawkish. We expect no change at the 30 April meeting, followed by scope for dovish repricing.

Three scenarios for EUR/USD



Source: Refinitiv, ING

Return below 1.10 in EUR/USD in severe scenario

In our second scenario, we estimate that a moderate re escalation and longer oil supply disruptions will push EUR/USD back toward 1.15 for much of the remainder of the year. That level served as a key anchor in March, and under this scenario we would expect two ECB hikes and one Fed cut, broadly in line with current market pricing.

In the most severe scenario, the sensitivity of USD crosses to oil prices should rise sharply, relegating rate differentials to a secondary role. Average Brent prices in the US$135-150/bbl range would, in our view, be consistent with a move back below 1.10 in EUR/USD. That assumes an accompanying sharp deterioration in global risk sentiment, in a stagflationary environment where the Fed decides not to cut rates.

In numbers: Our three scenarios

	1 Base case			2 Prolonged disruption			3 Re-escalation		
	Q2	Q3	Q4	Q2	Q3	Q4	Q2	Q3	Q4
Brent Crude (USD/bbl)	96	93	88	110	102	100	135	150	120
Dutch TTF gas (EUR/MWh)	55	45	45	74	60	60	90	75	80
US Inflation (YoY%)	4.1	3.8	3.2	4.4	5.1	4.8	4.9	6.7	6.4
Eurozone Inflation (YoY%)	3.7	3.9	3.8	4.1	4.5	4.5	4.6	6.0	5.8
ECB Deposit Rate (%)	2.25	2.25	2.25	2.25	2.50	2.50	2.25	2.50	2.75
Fed Funds Rate (%)	3.75	3.50	3.25	3.75	3.75	3.50	3.75	3.75	3.75
2Y EUR swap rate (%)	2.75	2.70	2.65	3.00	2.90	2.70	3.20	3.10	2.75
10Y EUR swap rate (%)	3.10	3.00	3.00	3.20	3.00	2.90	3.35	2.90	2.60
2Y USD swap rate (%)	3.55	3.30	3.20	3.90	3.50	3.10	4.00	3.75	3.00
10Y USD swap rate (%)	4.05	3.85	3.80	4.10	3.80	3.60	4.15	3.75	2.90
EUR/USD	1.17	1.18	1.20	1.15	1.15	1.16	1.08	1.10	1.12

Source: ING

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