

Covid-19: Europe to the rescue this weekend?

Expect marathon talks this weekend as European leaders discuss a €750 billion recovery aimed at digging the continent out of the economic impact of Covid-19. Here's what's at stake along with a selection of other market-moving stories from this week

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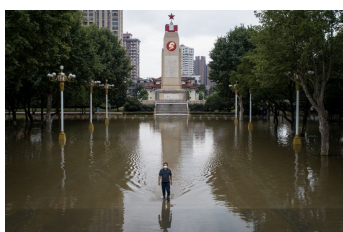


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Source: Shutterstock

Our base case: Some progress, but more time needed

As discussed in detail in our economics team's note: [“EU summit preview: Is the impossible within reach?”](#), several different scenarios appear on the cards ahead of the EU Summit starting tomorrow.

Pressures from the so-called “Frugal Four” (Austria, Denmark, Netherlands and Sweden) around the size of the fund, disbursement process, conditionality and the grants/loans mix appears to have taken the original Franco-German proposal off the table. Still, intense bilateral talks and the mediation efforts of German Chancellor Merkel have helped create some room for compromise.

Our economics team thinks that such compromise may consist in something close to a €600bn 50/50 loans/grants fund, with annual reviews to determine the loans/grants mix depending on compliance with some conditions.

Still, with many sticky points (and not only those raised by the “Frugal Four”) still to be addressed, we do not see an agreement being reached as the base case ahead of this EU summit. Instead, we

expect some progress towards a compromise being made, but some time for more negotiations is still required. This should allow a consolidation of the notion that the EU Recovery Fund will eventually come into existence – without having to be materially resized first. We therefore deem less likely that the negotiations will break up.

Four scenarios for FX and rates

The chart below shows four different outcomes of the EU Council meeting, ranked from most to least market-friendly. On the right-hand side are displayed our estimations for the levels of EUR, Bunds and BTPs as markets re-open on Monday. We discuss our views on FX and rates in detail in the sections below.

	Scenario	Description	Market impact (Mon 20 Jul levels)			
Most market-friendly	① Agreement found on grants	Merkel's mediation succeeds in bringing "frugal" members on board. Market reaction positive, but its magnitude will depend on how close the agreement is to the GE-FR proposal.	EUR/USD 1.1550/ 1.1600	EUR/CHF 1.0900/ 1.0950	10Y BTP-Bund 150bp	10Y Bund -0.35%
Market impact	② Compromise shaping up <small>ING base case</small>	The "Frugal Four" show openness to grants and Southern economies to some conditionality. More time is needed to iron out the details, but negotiations appear on the right path. A statement illustrating the principle agreement is released.	EUR/USD 1.1450/ 1.1500	EUR/CHF 1.0850/ 1.0900	10Y BTP-Bund 160bp	10Y Bund -0.45%
	③ Gridlock	Negotiations stall as members cannot agree on the size/grants/conditionality mix. Calls for more negotiations, but markets starting to doubt the feasibility of the Fund. No official Summit statement released.	EUR/USD 1.1300/ 1.1350	EUR/CHF 1.0700/ 1.0750	10Y BTP-Bund 175bp	10Y Bund -0.50%
Least market-friendly	④ Negotiations collapse	Irreconcilable divergences among member states generates hawkish comments and a break-up in negotiations. The Fund will have to be drastically revised or scrapped.	EUR/USD 1.1200/ 1.1250	EUR/CHF 1.0600/ 1.0650	10Y BTP-Bund 185bp	10Y Bund -0.55%

Source: ING

EUR: The bar for a surprise is not too high

EUR/USD is currently trading around the 1.14 level, not far from its 2020-highs. While the pair has been benefiting from hopes surrounding the EU Recovery Fund, its rally has largely been a function of a generalized USD weakness as risk sentiment has improved. In fact, we are of the view that the EUR is not pricing in a quick and seamless agreement on the Fund, nor that its final shape will be the one proposed by the European Commission (nor of the French-German proposal).

The resilience of EUR to a number of pessimistic comments – from the “Frugal Four” in the past couple of months and from Hungary (for instance) more recently – could be a case in point. While some optimism around the eventual realization of the Fund appears there, EUR seems to be fully pricing in the “bumps” of the negotiations.

In light of this, we expect that there is still room for the EUR to benefit from progress being made at the EU Summit this weekend, and the prospect of more negotiations should not scare EUR bulls. After all, the main factor driving EUR/USD higher in the coming months remains a weak-dollar environment. The simple notion that progress is being made on the EU Recovery Fund should be enough to maintain a benign environment for the common currency, which could unlock more upside in the pair.

Barring negative events hitting global sentiment next weekend, we could see EUR/USD push to the

upper-half of the 1.14/1.15 range on Monday if our base case (scenario 2 above) materialises. EUR/CHF could make a decisive leap into the 1.08 region, also helped by a shrinking BPT-Bund spread, as we discuss in the rates section below.

Rates: Cash is king

We view the EU Recovery Fund as acting on interest rates markets through two channels. The most straightforward one is the net monetary benefit (disbursement minus contribution, or net contribution) for each member state. In the absence of any certainty about either the size, allocation, timing, or nature (loans vs grants) of the disbursements, it is hard to reach a definitive conclusion.

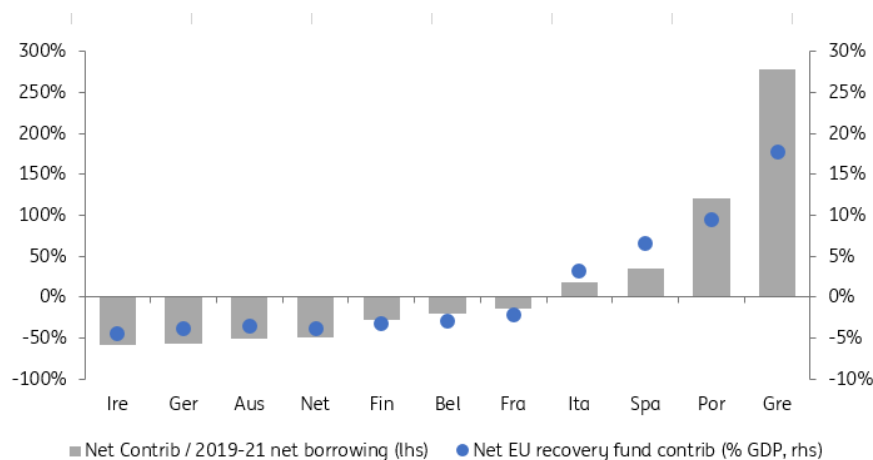
The European Commission’s proposal does offer an illustrative guide of the allocation key between member states however. Since the funds will in all likelihood be approved in the first three years of the Multiannual Financial Framework (MFF), we compared this net contribution to member states’ GDP and to their 2019-21 net borrowing.

There are a lot of caveats to this analysis. Firstly, we should stress here that the EC proposal is probably a best case scenario in terms of size. It is also likely that disbursements will be spread over the whole MFF, so 7 years, rather than just 3 years. Finally, the financial benefit of loans is mitigated by the fact that these need to be repaid out of a member state’s budget in subsequent years.

Greece and Portugal debt issuance could shrink

On both measures, the beneficiaries are the same: Greece (net benefit of 17.8% of GDP, and of 279% of 2019-21 net borrowing needs) and Portugal (9.5%, 121%) top the list. The upshot for both countries is that, taken as such, the EC proposal would cover a significant portion of their financing needs in the coming years. Depending on how the states choose to use the funds, for additional spending or as a replacement for market funding, this could imply a sharp drop in debt issuance for both sovereigns.

EU recovery fund net benefit vs GDP and vs net borrowing needs



Source: European Commission, ING

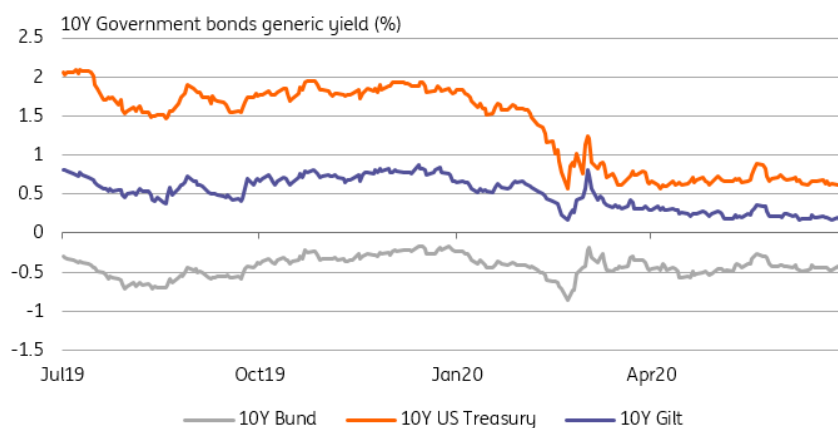
The second group of beneficiaries, Spain (6.6%, 36%) and Italy (3.2%, 18%) could also see a reduction of borrowing needs in financial markets. The magnitude and timing being uncertain, we expect their sovereign debt markets will find it hard to see this as a game-changer, however. This is particularly true as we are comparing the net benefit with deficits. In countries like Italy, gross borrowing needs, to refinance maturing debt, far exceeds deficits.

A symbolic gesture

The second way an agreement could impact the rates markets is as a signal that more financial integration in the Eurozone is back on the agenda. In three out of the four scenarios we identified above, the agreement of an EU Recovery Fund is a matter of when rather than if, so we see that signal as a high likelihood event.

As we have shown above, the EU Recovery Fund should only be a complete backstop for the finances of small peripheral economies. For larger ones, it is more of a token of good faith. It remains that an agreement would be a milestone in the long-term process of financial integration.

Eurozone breakup risk premium in Bund has already reduced



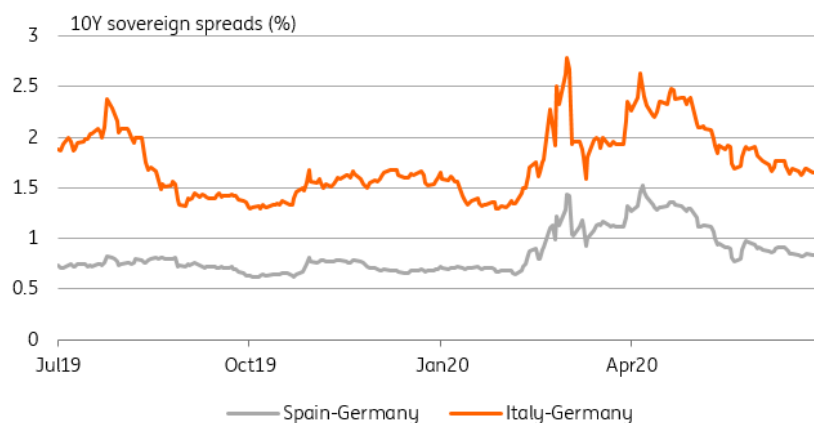
Source: Bloomberg, ING

In our view, some of the benefits of the EU Recovery Fund, namely a reduction in the Eurozone break-up risk, has already been priced in EUR rates markets. One prime example is the fact that Bund yields have failed to revisit their March lows despite the ECB adding to its QE programme in June. For comparison, US Treasury and Gilt yields have remained at or close to their all-time lows.

The upshot: tighter peripheral spreads

The case for a strong market reaction in peripheral debt is clearer to us. If heavy Italian or Spanish debt issuance will continue in the coming years, we think the combined impact of ECB purchases in the near term, and EU financial support in the medium term, amounts to a license for investors to buy peripheral bonds.

Room for tightening: Eurozone sovereign spreads



Source: Bloomberg, ING

In case of a swift agreement, we could see the 10Y Italy-German spread reaching our 150bp target this summer. In the event of a more protracted process, this target would likely only be reached towards the end of the year. In both cases, the carry benefit of peripheral debt, and lower prospective volatility thanks to the ECB intervention, make it a superior alternative to core bonds, in our view.

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EU summit preview: Is the impossible within reach?

EU leaders are edging closer to a deal on a recovery fund. A lot is still at stake at the coming EU summit, but a deal does seem to be within reach



Source: Shutterstock

The lines between European capitals are very busy these days. In the run up to the European Summit on Friday and Saturday, several bilateral meetings between the key players have received media attention. However, very little has actually been said after these meetings.

Angela Merkel seems highly determined to bring the European Recovery Fund to life

In our view, probably the most important news of recent days and meetings is that Angela Merkel seems highly determined to bring the European Recovery Fund to life. She leaves very little doubt that this time around she really wants to do serious business and put her (and Germany's) entire political weight behind it.

Admittedly, there are still many open issues and some observers have cast doubt about the feasibility of any deal at all. We remain more optimistic. European leaders have come already a long way on some very sensitive issues. The fact that there now is broad agreement about support for the worst-hit countries in the crisis and that there should be European borrowing from the market is already an enormous game-changer. It was only in October last year that plans for a eurozone budget had been negotiated down to a meagre €17 billion fund for competitiveness and convergence as part of the multiannual budget 2021-2027. This weekend, there is a fighting chance that an agreement will be reached on an EU recovery fund that holds many multiples of that.

Don't forget that European leaders never hammer out any single detail of a deal. For this weekend, a political agreement on the basic principles of a European Recovery Fund is still feasible, although the final stamp of approval may need another round of negotiating as it will involve lots of horse-trading, including the negotiations on the European budget. A deal now would be huge, but any sign of further progress on the remaining contested issues would also still be positive.

What are the make-it or break-it points on the table this weekend?

The European Commission plan for a €750bn recovery fund has been amended somewhat by the European Council, but overall the proposal that is now up for negotiation is roughly similar to the Commission plan. As is well-known at this point: the main opponents of the plan are Netherlands, Denmark, Sweden and Austria (Frugal Four) who are in general cautious on burden sharing. At the same time, remember that the initial French-German proposal foresaw a €500bn fund of grants only. Judging from the rounds of top-level tête-à-têtes this week, the main issues on the table now are size, conditionality, grants versus loans and control over disbursement.

- **Size:** the main opponents want the fund to be smaller than what is currently on the table. No amount was specified in the counter-proposal of the Frugal Four, but they do consider the €750bn amount unfounded. France and Germany had presented a 500bn euro fund, which would be exclusively grants. A possible compromise could be around €600bn with a mix of grants and loans.
- **Disbursement process:** According to the European Council's proposal, each disbursement should require a qualified majority vote. The European Commission had proposed a qualified majority vote to block disbursements, while the Frugal Four would like to see unanimity. Probably included in the ratio for unanimity is the proposal of national parliament approvals. However, this does not seem to stand a serious chance at the moment. It is hard to find middle ground here and this could be given to the Frugal Four as a sweetener.
- **Conditionality:** This may be the most difficult nut to crack at the moment, although there are several possible compromises with regards to conditionality. The current proposal of the council suggests an assessment of the plans according to consistency with the country-specific recommendations of the European semester, digital and green transition and economic potential and job creation. The opponents would like to see reform plans tied to the disbursement along the lines of the troika workings during the euro crisis. A possible compromise could be a model where the disbursement of the fund starts with grants to maintain the speed of disbursement and annual reviews would determine the mix between grants and loans based on reform conditions. Another possible compromise would be a model where disbursements from the fund start as loans but are turned into grants if conditions are met.

• **Grants versus loans:** This has been an ongoing discussion since the start. In the counter proposal by the Frugal Four, only loans were mentioned as the opposition to grants is large and Dutch PM Rutte has indicated that grants are a possibility under strict conditions. This is clearly a balance which provides wiggle room for a compromise. However, Angela Merkel this week said that a significant change would not make sense. In our view, this could be negotiated down to a fifty-fifty mix. At a size of €600bn, this would still allow for a sizable amount of grants.

	Size	Disbursement	Conditionality	Grants vs. Loans

Source: ING

What would constitute success at the summit?

The above does look like a lot of work is still to be done over the weekend with a lot of possible outcomes still imaginable. If an agreement on basic principles of a deal is found though, it is hard to imagine one that wouldn't be considered a historical success. It would mark a new step in terms of burden-sharing with the purest form of Eurobonds seen so far. Only if the size of the fund would be minimised this could be seen as disappointing, but would after some time still be perceived as a new step in terms of European integration.

Financial markets have responded positively in the run-up to a possible agreement

That would be received very positively by financial markets, which have already responded positively in the run-up to a possible agreement. In terms of real economic impact, the devil would be in the details, but the proposals floating now would generate significant stimulus in some of the countries most vulnerable to a longer economic slump.

If no deal is reached at the summit, this is not necessarily a disappointment. It is well possible that more negotiations are needed over the summer, so this does not necessarily mean that a deal is out of reach. Signs of concern would be a postponed decision to a new summit at a later date without a statement on progress. That would suggest that there is much more to be done, especially if no new date is immediately put forward. This lowers the chances of an ambitious result and could make deadlines for the multi-annual budget more challenging.

A possible compromise in our view could include a graduation of grants and loans, starting with grants in the first year and then have an annual review of and for the right balance between grants and loans. As stated above, any kind of political deal this weekend would be seen as a success. However, Angela Merkel's comments this week that settling for a deal could take until the end of

the summer was a clear warning against too much optimism.

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Snap | 16 July 2020

ECB: Summer break

The ECB meeting in short: No sudden end to the PEPP, its emergency purchase programme, and for the rest there was enough uncertainty to keep the window...



Christine Lagarde, pictured in June

Market participants and ECB watchers who had delayed the start of the summer break only not to miss out on today's ECB meeting will have regretted it. It will have been important for the Governing Council to take stock of recent macro developments and the impact of this year's monetary policy decisions but the information content for the outside world was – understandably – very limited.

The ECB acknowledges the rebound of the eurozone economy in May and June, with signs of a recovery in consumption and a rebound in industrial output. Almost needless to say that the ECB still sees as much uncertainty as all other forecasters; be it on the back of subdued labour market conditions, precautionary household savings, dampened investment, weak global growth and the risk of a second wave of lockdown measure. Therefore, there was no reason to change the monetary stance.

During the Q&A session of the press conference, the questions to ECB president Christine Lagarde mainly focused on two areas: the Pandemic Emergency Purchase Programme and the upcoming European Summit on the European Recovery Fund.

- As regards PEPP, Lagarde stressed the dual function of the programme. PEPP was constructed to address fragmentation in bond markets and to ease the overall stance of monetary policy. Flexibility was a crucial feature. This is why the ECB had frontloaded purchases first, slowed them down recently and will continue to do so. Temporary divergences from the capital key were allowed and according to Lagarde, the basic assumption was that the entire size and horizon (until mid-2021) will be used. It would need an unexpected positive surprise to stop the programme earlier.
- As regards fiscal policy and the European Recovery Fund, the introductory statement had reintroduced the need for structural reforms to flank any upcoming move there. While this sounded a little bit like covert support for the Frugal Four, Lagarde's comments during the Q&A session that a "large number of leaders is well aware of the importance of not wasting time" sounded already less understanding. In general, Lagarde hoped for a good and ambitious agreement.
- Last but not least, Lagarde stated that there hadn't been any discussion on changing the multiplier of the tiering facility again and that the strategy review would now start in September and is expected to yield results in the second half of 2021.

We stick to our view that the ECB will wait until the September meeting, if not the late October meeting, before deciding on any next steps. This is when after the initial V-shaped rebound of the eurozone economy, there will be a better picture of the actual recovery. Luckily there won't be any more ECB press conferences which have to bridge the void of not having to say anything.

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G10 FX Week Ahead: Merkel's put and EUR calls

The tone in FX markets will be a function of the outcome of the ongoing EU summit next week with the calendar otherwise looking very quiet. We're...



Source: Shutterstock

German Chancellor Angela Merkel (C) at the start of an EU summit at the European Council building in Brussels

USD: Quiet calendar, quiet dollar

	Spot	Week ahead bias	Range next week	1 month target
DXY	96.1000	Mildly Bearish 	94.9000 - 96.5000	95.0000

- As the US earnings season shifts from major banks to tech giants next week, equities continue to prove a quiet contained sensitivity to both the surge in US Covid-19 cases and geopolitical tensions. Gauging the magnitude of the economic recovery remains pivotal for market sentiment and the safe-haven dollar, but next week's quiet calendar may not offer much in this sense. Housing data will be the only focus in the US, with expectations around a solid rebound after the jump in mortgage applications. On the politics side, we may be seeing talks around a new fiscal package intensify.
- With the EU Summit's outcome likely setting the tone towards the start of the week and given our fairly optimistic view on some progress on the Recovery fund, we could see the USD still offered versus currencies sensitive to EU sentiment, although weak sentiment in Chinese equities may limit Asia FX gains.

EUR: Progress towards the EU recovery fund to benefit the euro

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1410	Bullish 	1.1330 - 1.1520	1.1300

- The outcome of the EU summit (starting today and finishing over the weekend) will be the key for EUR/USD and the wider G10 FX price action. As per EU Summit – Market preview, our base case is for some progress towards a compromise being made, but no final agreement reached just yet as time for more negotiations will still be required. But if negotiations were to appear to be on the right path (and the agreement being a question of when rather than if), this is likely to be positive for EUR, and EUR/USD is to head likely to move to the 1.1450/1.1500 level early next week.
- On the eurozone economic data front, the focus is on the July PMIs (Friday). Both manufacturing and services surveys are expected to rise, with the July PMI Service to move back in the expansionary territory (above 50) for the first time since the Covid-19 pandemic hit Europe. This could give some gentle upside to EUR/USD at the end of the week, though the crucial driver of the cross next week will be the outcome of / signals from the EU summit over the weekend.

JPY: Stuck in the range

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	107.10	Neutral	106.60 - 107.60	107.00

- The BoJ meeting this week left very little marks on the yen as the Bank kept all existing policy measures unchanged. USD/JPY appears stuck in a fairly tight range, failing to sustainably trade below 107.00 despite geopolitical tensions and the downturn in Chinese equities.
- Next week, the yen appears to be lacking clear catalysts for any idiosyncratic move. EUR/JPY may be the most interesting cross to watch, with the EU summit possibly pushing it above 123.00.

GBP: Lagging most of its European peers

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2547	Mildly Bullish 	1.2450 - 1.2710	1.2300

- If the EU summit provides a boost to risk sentiment over the weekend, we expect GBP to lag most of its European peers (with the exception of CHF) given its relatively lower beta to risk (and uneven one, with GBP more exposed to falling markets than rising markets) and the UK-EU trade negotiations overhang. Still, GBP/USD would likely tick higher mainly driven by the rise in the EUR/USD, with a limited potential for GBP/USD to outperform EUR/USD as GBP still faces the well-known headwinds (the future of the EU-UK relationship) which does not advocate a bullish GBP case for months to come.
- On the UK data front, the focus is on June retail sales and July PMIs (both on Friday). On the former, our economists look for a sharp rebound as the UK exited the lockdown measures, although under the surface there will be changes in the consumer spending behaviour (from sales in physical shops to online). On PMIs, the Services PMI may go back above the 50 level, but its explanatory power is limited as it only tells that more firms (understandably) report better conditions after the free fall earlier in the year. While both positive, this is unlikely to prompt meaningful GBP gains given the idiosyncratic issues sterling is facing (see above).

AUD: Eyes on RBA comments

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.6987	Neutral	0.6930 - 0.7040	0.6800

- Australia is facing the worst period of its battle against the pandemic, with the state of Victoria in full lockdown but still seeing big daily jumps in cases. The complacency of the Aussie dollar to this situation keeps highlighting some higher downside risks to the currency compared to NZD. Chinese equities dynamics may remain a key driver, given that AUD has the highest correlation with CNY in G10.
- Australia's central bank will release the minutes of the July policy meeting on Tuesday. What might be interesting to note is any currency-related comment, in what was an otherwise uneventful meeting. Some comments on AUD might also come from the speech by Governor Lowe after the release, as we see little probability of any change in rhetoric when it comes to the policy stance.

NZD: Less downside risk than AUD

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6548	Mildly Bullish 	0.6520 - 0.6610	0.6500

- A less worrying contagion picture in New Zealand, and NZD having already paid the price of its recent strength with some correction in the past few days, suggests NZD may outperform its procyclical peers next week.
- The calendar does not offer much of a catalyst for an idiosyncratic move, except for some trade data at the end of the week, which will leave NZD driven by global factors. But we see the diverging pandemic situations in Australia and New Zealand as likely warranting a move lower (to 1.0600) in AUD/NZD in the short term.

CAD: Still capped by US virus cases

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3580	Neutral	1.3500 - 1.3650	1.3500

- Tiff Macklem's first policy meeting as Governor did not yield any surprises on the policy side – as [we've discussed here](#). This has cemented our view that the central bank stance will hardly prove to be a key driver for CAD in the near future, where instead global risk sentiment, oil and US virus cases will remain centre stage for the loonie.
- On the latter, we suspect that increasingly worrying news on US virus cases can still put a lid on CAD due to Canada's high exposure to US lockdowns/slower economic recovery. We are, instead, less concerned from an oil perspective, as the cuts tapering by OPEC+ was already part of the plan and the oil market will remain in deficit in the second half of the year as demand recovers. Data-wise, we have retail sales and CPI in Canada next week, although both may have limited market implications.

CHF: More underperformance ahead

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.0752	Bullish ↗	1.0700 - 1.0900	1.0700

- With prospects of progress towards the EU recovery fund (and thus further compression of the eurozone risk premium) during the EU summit over the weekend, CHF has already started losing its safe-haven allure and EUR/CHF has moved meaningfully higher this week. A constructive outcome from the EU summit should keep the trend in place and lead to further EUR/CHF gains next week. We see EUR/CHF breaking above the 1.0800 resistance level and heading to 1.0850/1.0900 if there is a constructive outcome from the summit.
- It is a very quiet week on the Swiss data front, with July sight deposits out on Monday and June Money supply due on Tuesday are unlikely to affect the Swiss franc. The key to CHF price action will be the outcome of the EU summit.

SEK: Benefiting from the summit spill-over

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.3340	Bearish 	10.2570 - 10.4420	10.4000

- We look for EUR/SEK to break below the 10.30 level next week (which would be the strongest krona level since early 2019) in response to signs of progress towards the EU recovery fund. We continue to see SEK as well-positioned within the G10 FX space given the not so dovish Riksbank and the currency's vastly improved relative real rate position vs the state of affairs last year.
- As is the case for NOK, it is also a very quiet week on the Swedish data front. June unemployment due on Thursday and June PPI inflation due on Friday are likely to have a negligible impact on SEK.

NOK: The outperformer next week

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	10.6040	Bearish 	10.4300 - 10.7730	10.6000

- Both Scandinavian currencies should be the main beneficiaries from the progress on the EU recovery fund, given their higher beta and positive correlation with EUR/USD (which is expected to rise next week). NOK stands out given its high sensitivity to risk in the G10 FX space, with stable oil prices also supportive of the currency. EUR/NOK is likely to test the 10.50 level next week, with NOK/SEK expected to move back above 0.9800.
- It is a very quiet week on the Norwegian data front. Neither May unemployment rate nor 2Q industrial confidence, both out on Thursday should have any implications for the krone price action next week

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Two paths to a weaker dollar

A double-digit decline in the dollar would likely come for one of two reasons. In this video, ING's Global Head of Markets, Chris Turner, explains what they are, and whether he thinks that's likely to happen.

[Watch video](#)

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Why China's surprisingly strong economic growth isn't sustainable

China's GDP growth rebound in the second quarter exceeded our expectations by a considerable margin, but we think the rate of growth is...



Source: Shutterstock

Big questions on GDP growth with slow stimulus progress

China is recovering from the impact of Covid-19, but the detail suggests that GDP growth of 3.2% year-on-year in 2Q20 may not be sustainable despite improvements in foreign demand and infrastructure investments. However, we do now expect better growth numbers than our previous forecasts.

GDP growth of 3.2% YoY in 2Q20 looks very good after a 6.8% YoY contraction in 1Q20, and is a lot better than our expectation of -3.1% YoY. But we doubt that the main sources of growth were just inventories and net exports - which were lower because of slow import growth. We see this as unsustainable as we expect imports to grow faster in 3Q with improving domestic demand. We don't have the breakdown of GDP growth by components, so our guess is that some industrial production output that had not been used by infrastructure projects has been placed into the inventories category.

Industrial production grew 4.4% YoY in 2Q20, and most of the growth came from raw materials, technology components and energy production. Some will have gone to exports but we expect

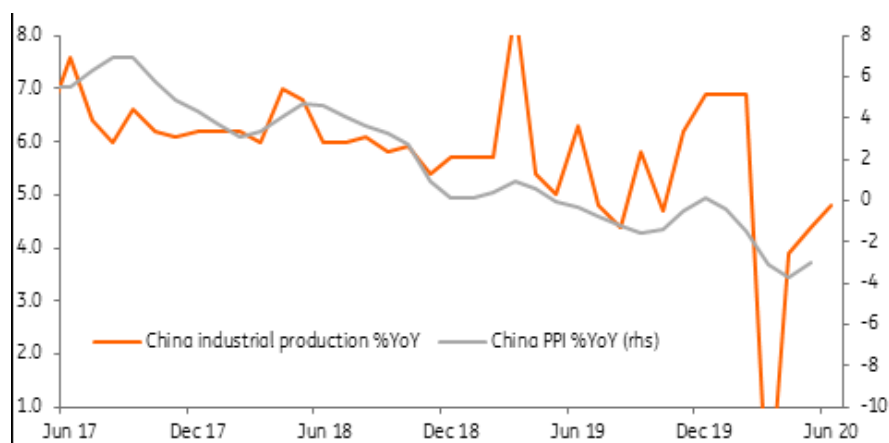
that some raw materials also went to inventories as infrastructure projects progressed slowly in 2Q20 in general. This would tie in with the negative year-on-year growth of the producer price index. If manufacturing was doing well in 2Q20, PPI should be rising.

Net export growth was faster at 8.8% YoY in 2Q20 due to the lower growth in exports and imports. Foreign demand seems to have rebounded as shown in the June data, and hopefully, this will form a recovery path for 2H20. This could help not only exporters but also manufacturers producing export goods, and therefore migrant workers' unemployment rate should come down. We previously estimated a 10% overall unemployment rate for April to May, including migrant workers, which has now come down to 8% in June due to more export orders for factories.

Retail sales contracted by 3.9% YoY in 2Q20. Consumption has not picked up on a yearly basis despite the relaxation of social distancing measures. This suggests consumers remain cautious and this continues to impact the hospitality sector. Spending on automobiles dropped on a yearly basis, which could be due to the one-off demand for cars (to avoid taking public transport) has been fulfilled following a pick-up in automobile sales for a few months at the peak of the Covid-19 outbreak.

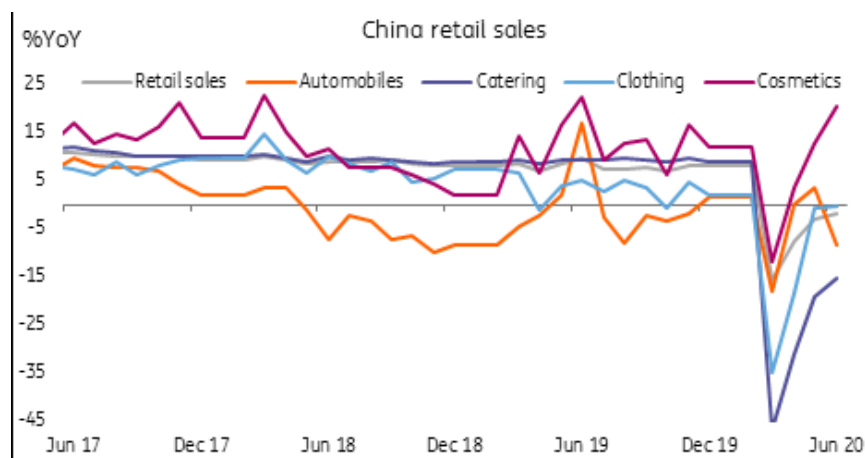
Fixed asset investments contracted by 3.1% YoY YTD in June, which was a smaller contraction than in May. The impact of fiscal and monetary stimulus on investments was small in 2Q20 due to the slow kick-off of transportation infrastructure projects but investment in R&D in advanced technology has started. The increased growth of investments from May to June could be due to more infrastructure projects being kicked off after the Two Session meetings held in May.

Chinese industrial production rebounds but PPI continues to be negative

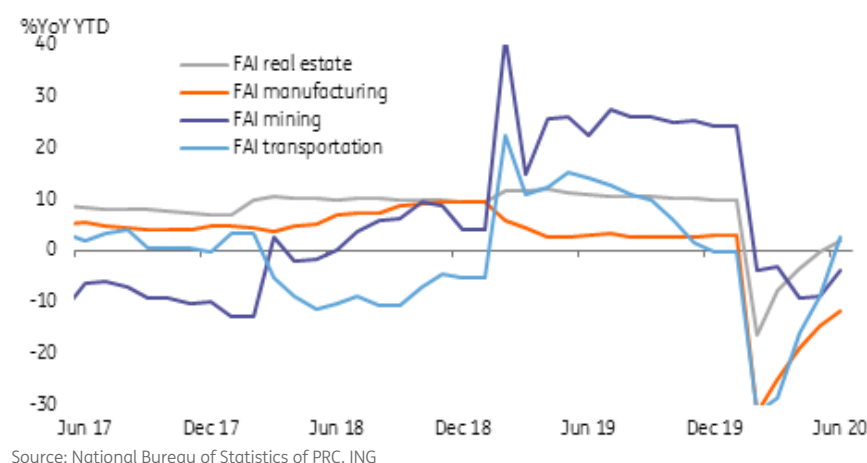


Source: National Bureau of Statistics of PRC, ING

Chinese retail sales were dismal but should improve with exports



Chinese infrastructure investment improved in June



The three main challenges ahead

Even though the economy is recovering, we see further challenges for China in the second half of 2020.

- The biggest risk we see is the technology war, not just with the US but also with the rest of the world. China has put a lot of money into R&D in advanced technology to achieve self-reliance on the most advanced semiconductor chips but it will take time to yield results.
- Following weeks of abnormally high rainfall, the most imminent risk domestically comes from the widespread floods, which are some of the worst seen in China for decades. The government has been able to reduce the death toll through early warnings to local communities. However, food prices increases as a result of the floods will not change the People's Bank of China's stance on monetary policy as this is a one-off event. The floods have been so widespread that infrastructure projects will be delayed as the majority of schemes are related to construction activities. As such, investments in July and even August will be affected by the floods.

- The possibility of another round of trade wars could be on the rise, with the US using Hong Kong to punish Mainland China. Though China continues to import agricultural products from the US we note that the growth of imports from Brazil was 34% MoM, higher than the 11% MoM imports from the US, which signals that China is continuing to diversify sources of agricultural imports in case political tension with the US increases.

GDP forecast for 2H20 revised upwards

We revise our GDP forecasts upwards to 0.5% YoY for 3Q20 and 5.0%YoY for 4Q20, from our previous forecasts of -0.5% YoY and +4.5% YoY, respectively. Our full year 2020 forecast is revised upwards to 0.48% due to:

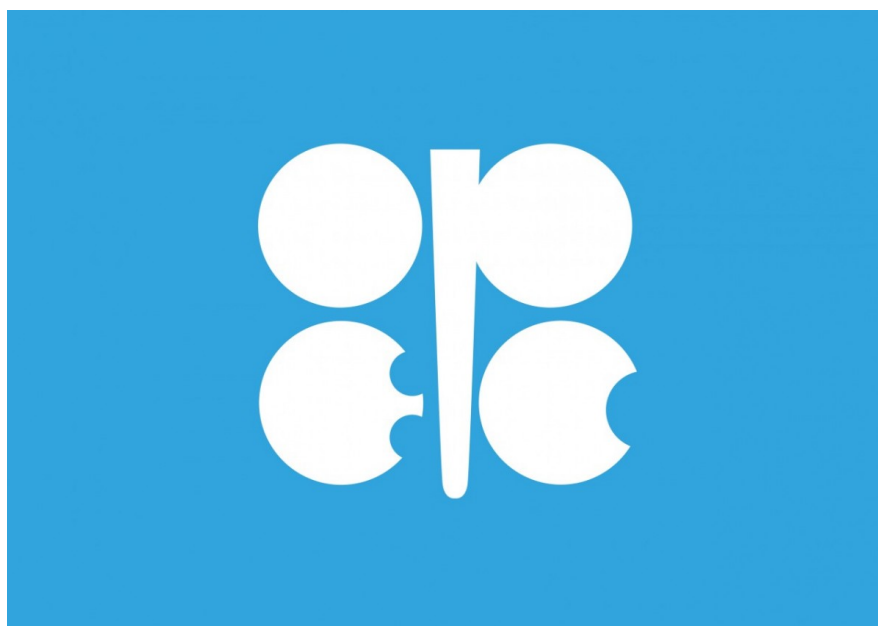
1. Better foreign demand from countries coming out of Covid-19 lockdowns
2. Faster implementation of infrastructure investment projects
3. Better job market situation in the manufacturing sector when foreign demand improves

Our forecasts rely on improvements in the major economies and if that doesn't happen then China's GDP growth will be undermined.

Article | 16 July 2020

OPEC+ cuts set to ease

The OPEC+ Joint Ministerial Monitoring Committee (JMMC) met yesterday, and as largely expected OPEC+ will start to ease production cuts from 1 August....



How much will production cuts be eased?

As largely expected by the market, OPEC+ will start to ease production cuts from 1 August, which will see group cuts falling from 9.6MMbbls/d to 7.7MMbbls/d. If you factor in compensatory cuts from a handful of producers who fell short of the deal over May and June, theoretically the easing will not be as significant. Getting laggards to hit 100% compliance is hard enough, but forcing them to compensate for prior poor performance sounds virtually impossible.

But just assuming that laggards do deliver and compensate in full for their shortfall so far, actual cuts would be in the region of 8.1-8.3MMbbls/d for August.

The Saudis also stated that their oil exports in August would not exceed July levels, with additional supply to be consumed in the domestic market, and this is something which is expected for a number of member countries.

What does it mean for the market?

The easing in supply cuts is no surprise to the market, which had already largely priced this in. The outcome of yesterday's meeting does not, therefore, change our view. While demand may be

taking longer than initially expected to recover, there is no doubt that we are still seeing a demand recovery and that this is a trend which is expected to continue in the months ahead. As a result, the global market should be able to easily absorb this additional supply from OPEC+.

We still expect that the global market will remain in deficit for the remainder of this year, and throughout 2021, which will allow it to continue drawing down hefty inventories. Therefore our outlook for the market remains intact. We continue to hold a more neutral view in the short term, with expectations that ICE Brent will average US\$40/bbl over 3Q20, then as we move into the latter part of the year, and the market eats further into the inventory overhang, we see prices averaging US\$50/bbl over 4Q20. Whilst for full-year 2021, with demand continuing to trend higher, and inventories lower, we expect ICE Brent to average US\$58/bbl over the year.

What are the risks?

There are a number of risks to our view, with demand remaining key. While we have seen a resurgence of Covid-19 cases in some areas recently, we have not seen full lockdowns returning yet. However, clearly, if the situation deteriorates further, and we see a return of similar lockdowns to those earlier in the year, this will weigh on demand, and as a result, alter our outlook for the oil market.

Another risk, although more to our medium to long term view on the market, is if we see a swift recovery in US output. At the moment, we believe prices are still not at levels which will see producers increase drilling activity, but this could change if prices continue to trend significantly higher for the remainder of the year.

Finally, the more constructive outlook we hold for the market over 2021 assumes that the OPEC+ deal continues as originally agreed. If OPEC+ decide to ease cuts by more than originally agreed for that period, or walk away from the deal altogether, this would be enough to push the market back into surplus.

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