

## In case you missed it: A flurry of central bank meetings

Most central banks with meetings this week chose to keep rates on hold this and the ECB President Draghi put on a brave face on the outlook and the autopilot path, but make sense of all central banker's next moves with our exhaustive guide. Plus, the US reaches new heights and another political impasse on the hands of the EU - and no it isn't Brexit

### In this bundle



Norway | Sweden...

#### **Our October guide to global central banks**

Everything you need to know about central bank policy around the world

By Carsten Brzeski, Charlotte de Montpellier and 3 others



United States

#### **US growth keeps booming as consumers splash the cash**

Another decent growth number will be welcome news for President Trump, but for markets, the bigger question is where the economy goes next. We see no...

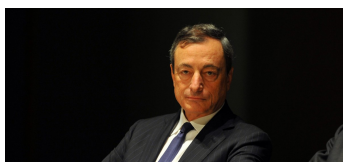
By James Smith



FX

#### **G10 FX Week Ahead: Looking pretty bleak**

The US economy looks to be hitting new heights, while Europe remains once again plagued by politics. Throw into the mix the strongest US wage growth...



### ECB: Not sexy but highly effective

The ECB remains determined to continue its chosen path to bring net QE to an end in December

By Carsten Brzeski

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### Canada

#### Bank of Canada hikes and hawkish tone suggests more to come

The central bank of Canada raised rates by 25bp today, but the question now is what will their 2019 tightening path look like?

Downside risks linger, but...

By James Knightley

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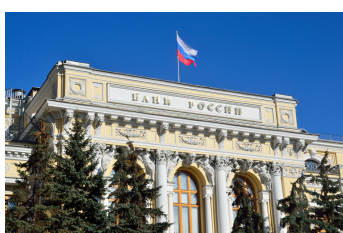
### Turkey

#### No surprises from the central bank of Turkey

Turkey's central bank kept the policy rate unchanged at 24% while pointing out the upside risks to the inflation outlook, ongoing strength in external...

By Muhammet Mercan

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### FX | Russia

#### Bank of Russia confirms it's in 'standby' mode

Bank of Russia fully confirmed our expectations by keeping the key rate at 7.5% and maintaining a cautious tone. The upcoming decisions are likely to be...

By Dmitry Dolgin

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### Norway

#### Norges Bank stays on track for a Q1 hike next year

No change from the Norwegian central bank; gradual tightening path confirmed

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### Sweden

#### Riksbank still in wait-and-see mode

No change from the Riksbank leaves the timing of the first interest rate increase uncertain. We continue to see a February hike as somewhat more likely...

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## Switzerland

### **The EU and Switzerland: Another arduous negotiation not going to plan**

The EU and Switzerland have been trying to negotiate a new framework agreement for the last four years, but the complex negotiations haven't been...

By Charlotte de Montpellier

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## Malaysia

### **Malaysia 2019 Budget Preview – A derailed fiscal consolidation**

Sweeping policy changes under the Malaysian government's drive to improve people's standard of living and drive out political corruption have...

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# Our October guide to global central banks

Everything you need to know about central bank policy around the world



Source: Federal Reserve, Bank of England, Shutterstock

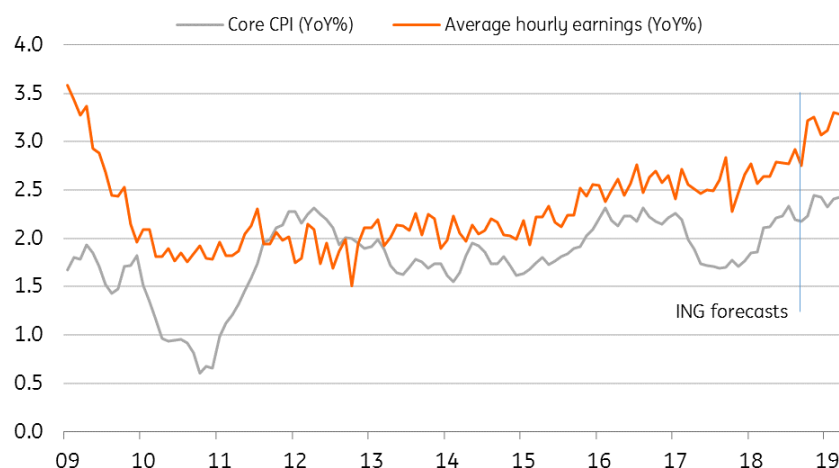
## Federal Reserve: Look for slightly more modest rate rises in 2019

While the Federal Reserve no longer views monetary policy as “accommodative” it certainly can’t be described as “restrictive”. Growth is strong, the unemployment rate is at a 50-year low and inflation is at or above the Fed’s 2% target on all the key measures. The ongoing support from massive tax cuts and mounting evidence of rising wage pressures suggest there is little reason to expect any meaningful slowdown in economic growth in the near term.

As such, the Fed suggests that the most likely course of action is a further rate hike in December taking it to a total of four 25bp interest rate rises in 2018. President Trump may not like it, but the Federal Reserve will continue to assert its independence and make policy fit the economic circumstances.

Economic activity will likely moderate in 2019 as the fiscal stimulus fades and the lagged effects of a strengthening dollar and higher interest rates dampen growth. There are also risks for growth in the form of trade protectionism and emerging market struggles, while the recent equity market wobble highlights an additional potential threat. As such, we look for a more modest set of interest rate rises in 2019 – we forecast three hikes that will be spread out over the first three quarters of 2019.

## Wages and inflation on the rise



Source: Macrobond and ING

## ECB: Still on track to end QE

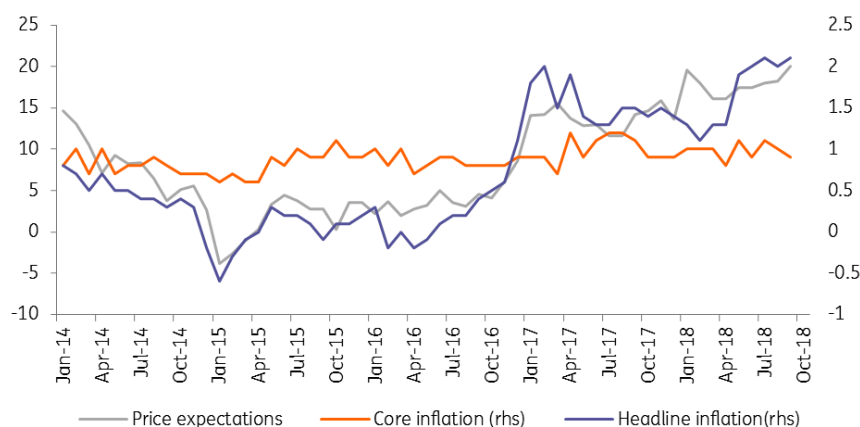
Downside risks to the economic outlook have increased and the inflation outlook remains mixed. Headline inflation has been hovering around 2% in recent months, mainly due to higher energy prices. But core inflation is still not picking up as the ECB hopes and expects.

But while recent developments have been anything but encouraging, the downside risks are simply too minor and too premature for the ECB to alter its chosen path. In our view, it would definitely need a severe growth accident, an escalation of the Italian crisis or trade tensions with tangible consequences on financial markets before the ECB would change its course.

At the October meeting, we expect a slightly more dovish stance from the ECB and President Draghi, though still signalling a determination to end QE in December.

Looking beyond the end of QE, the ECB could show more flexibility and willingness to react to slowing growth or the absence of an acceleration in core inflation either by postponing the first rate hike far beyond the summer of 2019 and/or by using the reinvestment period to strengthen forward-guidance.

## Rising Eurozone inflation mainly an energy story



Source: Reuters Datastream

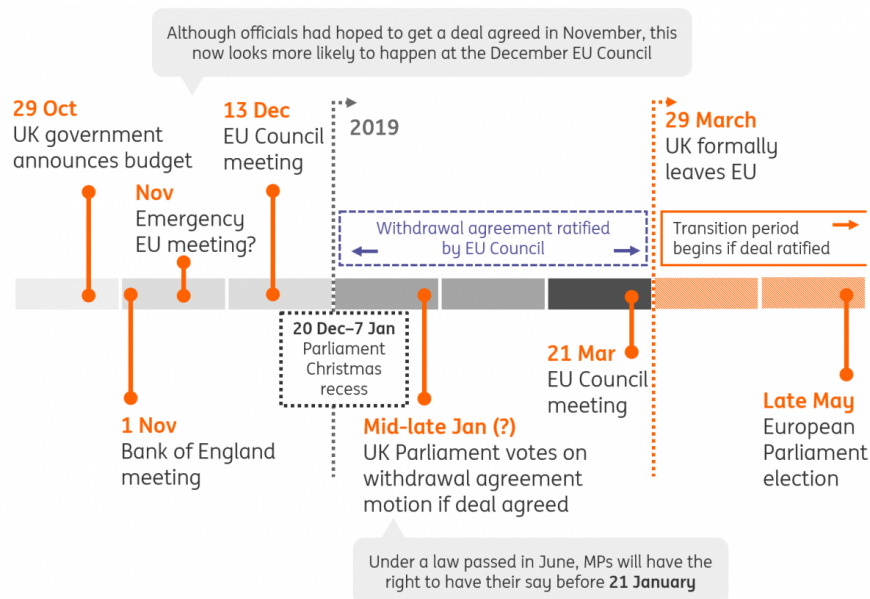
## Bank of England: 'No deal' risk means no hike before Brexit in March 2019

In any other situation, we suspect the Bank of England would be looking to increase interest rates pretty soon. Wage growth - something which has been at the heart of the Bank's rate hike rationale - has been surprisingly strong over the past few months. Pay is now rising at the fastest rate in almost a decade, as businesses find it harder to retain/attract certain skills. Economic activity has also had a better summer generally, helped along by the sunny weather.

But despite all this, Brexit remains policymakers' number one consideration. While we do expect the UK and EU to agree a deal, this may not happen until December's European Council, which in turn means it may not be until January that Parliament has its all-important vote. The implication is that we may not know if 'no deal' has been avoided for at least a couple more months, and in the meantime we think growth momentum could slow as [businesses and consumers grow more cautious](#).

If a majority of MPs approve the agreement in the Parliamentary vote (despite all the current bluster), then the UK will leave the EU on time in March and the transition phase will commence. This somewhat smoother outcome would keep the door open to a May rate hike. However if MPs reject the deal, or introduce tricky amendments that force Theresa May back to the negotiating table, that date could well get pushed back, even if 'no deal' is averted at the last minute.

## Key dates in the Brexit process



Source: ING

## Bank of Japan: 'Good enough' inflation could see further stealth tightening

The Bank of Japan releases its semi-annual report shortly, which could set the tone for the monetary policy meeting later this month. BoJ Governor, Haruhiko Kuroda, has been dropping hints about changes to BoJ policy. Kuroda has been sounding more positive about inflation, with core (ex-fresh food) inflation now at 1.0%. The elusive 2% level may still be the official target, but there is a sense that a more pragmatic "good enough" rate of about 1% could pave the way for the BoJ to start tweaking its policy stance.

Of course, this core measure does not exclude the most powerful driver of inflation in Japan right now, and that is energy. Strip this out too, and inflation is barely positive. But let's not let facts spoil an otherwise good story.

Japanese government bond (JGB) yields, which are officially targeted at "about zero" have been higher than that for some time now, rising to about 0.1% in August, and are now more than half way towards 0.2%. With Kuroda hinting that the 10Y JGB yield is the place to look for clues about a change in BoJ stance, it is worth asking: has this already taken place? And if so, is there more to come?

We think yes. The Japanese macro story is better than for some time, with corporate profit strength buoying a robust labour market, low unemployment and rising wages. Consumer spending is good, and the indicators are also positive for business investment. These domestic successes are making up for a weaker export picture. Taken together, they provide a backdrop that could see further stealth tightening by the BoJ.



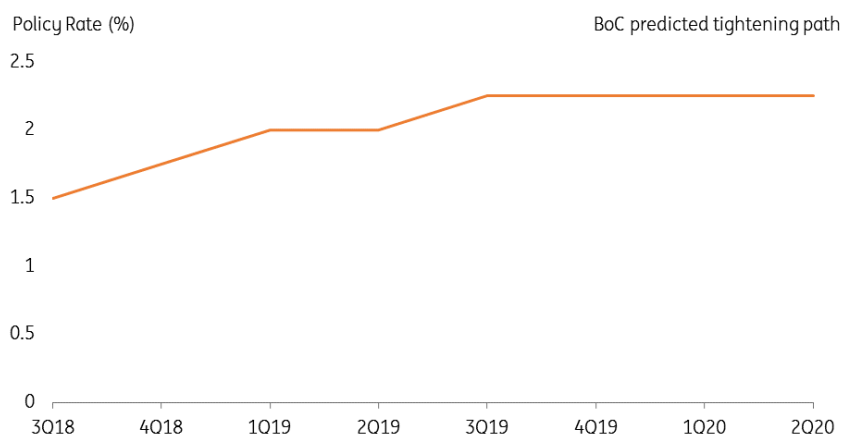
## Bank of Canada: Reduced trade uncertainty gives green light to October hike

The BoC makes its next [policy decision](#) on the 24 October and policymakers have signalled a hike this year is likely. Given their preference to change policy at meetings where a new forecast and quarterly monetary policy report are available, October seems the most likely hike opportunity and it is unsurprising that markets have more-or-less fully priced this in.

The key factor holding back the BoC earlier in the year was the uncertainty surrounding the renegotiation of Nafta and the risk it posed to Canada's most important trading relationship. This issue has been largely resolved, following the agreement of the new United-States-Mexico-Canada-Agreement (USMCA) in late September.

Admittedly the recent slowdown in wage growth and the surprisingly weak September inflation print raises some questions around the Bank's tightening plan. However, the key variable for the BoC is core inflation, which remains reasonably solid. This, coupled with the removal of the tariff threat on the back of USMCA, puts the BoC on track for an October rate hike and two more in 2019.

### We expect a hike in both 1Q and 3Q 2019



Source: Macrobond

## Reserve Bank of Australia: No rush to tighten despite weaker AUD

There hasn't been much to say about the RBA for some time, at least since August 2016, when it last changed policy rates and this doesn't look set to change any time soon.

Despite the weaker AUD, the RBA seems happy to let the currency keep sliding. As Deputy Governor, Guy Debelle said recently, the Fed's actions were helpful in pushing down the AUD, and in helping the economy to achieve its inflation target. So if the AUD falls further, this is one central bank that would not be responding with tighter policy. Debelle was also dismissive about the decline in Australian house prices. However, given outright price declines in some regions, and a very high stock of household debt, the resilience of the Australian consumer cannot be taken for granted, even with the labour market looking tight.



Indeed, as markets in Australia have already responded to global conditions with higher interest rates, and these have been passed on by some banks in higher lending rates, the RBA is today even less likely than it was to hike rates a few months ago.

## Reserve Bank of New Zealand: Could the Governor's dovish tone begin to change?

Back in August, RBNZ Governor, Adrian Orr, said that “remarkably low” inflation was giving the central bank headroom to keep rates at their low level “through 2019 and 2020, longer than we projected in our May statement”. Since then, all items CPI inflation has risen to 1.9%, pushed up by higher energy prices and a 0.9%QoQ rise in 3Q18. There is now a very good chance that inflation will increase through the RBNZ’s 2.0% inflation target next quarter. Indeed, even if the QoQ CPI index is unchanged, headline inflation is likely to exceed 2.0% given a 0.2%QoQ decline in the price level in 4Q17.

The weaker NZD may also be helping the inflation outlook recover, with 2Q18 import prices hovering around 1.8%, up from 0.0% in the first quarter, and likely to show further imported price increases in the quarter ahead.

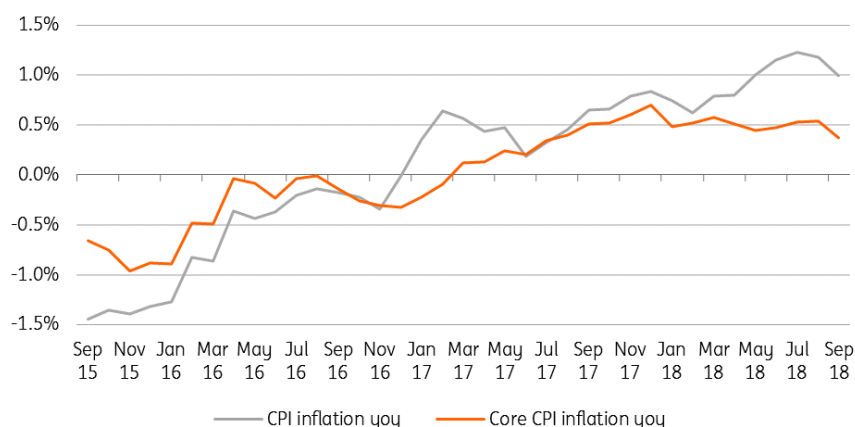
With the economy looking in decent shape, apart from a rising current account deficit (GDP growth was running at 2.8%YoY in 2Q18, and the unemployment rate is only 4.5% and is trending lower), it would not be surprising if Governor Orr’s dovish tone begins to change, or starts to be questioned by markets. This apparent divergence in the fortunes of New Zealand compared to its larger neighbour across the Tasman Sea could be reflected in the AUD/NZD exchange rate – currently about 1.0860.

## Swiss National Bank: Extremely cautious

The Swiss National Bank is maintaining an ultra-loose monetary policy. At its September meeting, the SNB left its main policy rates unchanged in negative territory. The SNB still believes the Swiss Franc is “highly valued”. It insisted on the recent appreciation of the Swiss Franc and believes that the situation on the foreign exchange market is still fragile. Indeed, the worries in emerging countries, the discussions on the Italian budget and the uncertainties surrounding Brexit pushed the Swiss Franc, a currency considered a safe-haven, to appreciate strongly against the euro.

At its September meeting, the SNB has revised downwards its inflation forecast for 2019 and 2020, signalling a dovish stance. This probably means that monetary policy will remain very accommodative in the coming years and much longer than previously expected. We don’t expect any rate hike before the ECB starts raising its own rates. Given that the ECB is not expecting to hike before the end of the summer of 2019, we think the SNB will not hike interest rates before December 2019. And given the global risk environment looks increasingly fragile, it looks increasingly possible that the first rate increase will be postponed into 2020.

## Swiss inflation remains subdued



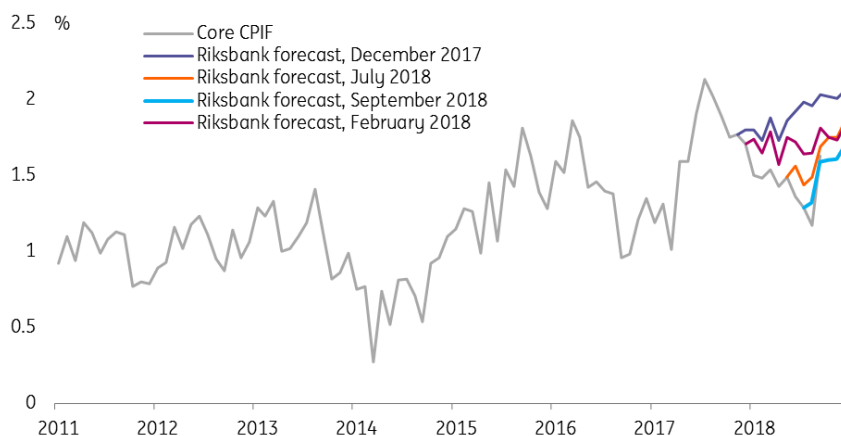
Source: Macrobond

## Riksbank: In a holding pattern for another few months

The Riksbank's September meeting was a pivotal one, with policymakers providing firm guidance that they intend to hike rates in either December or February. Having committed so clearly to a hike, it is unlikely that they will back down now. The [October meeting](#) is likely to prove less interesting, with policymakers reiterating their previous stance and aiming to keep their options open ahead of the key decision in December.

Underlying inflation picked up in September, meeting the Riksbank's core inflation forecast for only the second time this year. This will provide further support for the more hawkish members of the Riksbank board who want to raise rates sooner rather than later (two deputy governors, Ohlsson and Floden, are likely to vote for a hike in December). Set against that, it is becoming increasingly clear that the Swedish economy is slowing, with the housing slowdown hitting construction and household consumption. That, along with the continued fragile global risk environment, will in our view be enough to keep the cautious Riksbank majority from hiking until early next year.

## Core inflation finally hits Riksbank forecast



Source: Riksbank and Macrobond

## Norges Bank: One hike done, and more to come

In September, Norges Bank raised rates to 0.75%, the first hike in seven years. But relatively dovish rhetoric and a downward revision to the interest rate forecast meant that, despite the hike, the Norwegian central bank actually shifted towards a more cautious stance. Having achieved lift-off in September, the Norwegian central bank will not be shifting its policy stance much at the [October meeting](#). With two rate hikes expected for 2019, we continue to see risks as somewhat skewed towards the upside for Norwegian rates, but the bar for a more hawkish stance is fairly high.

The September decision showed the NB is reluctant to increase rates any faster than two hikes per year indicated in the current forecast. The key reason behind this caution is the high degree of indebtedness among Norwegian households related to the rapid house price increases over recent years. So despite a solid economy, rising oil prices and upside surprises to inflation, it is unlikely the NB will revisit its stance until at least December. We think it would take fairly material upside to the NB's forecasts in order to shift the policy stance in the near term and put a third hike in 2019 back on the table.

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# US growth keeps booming as consumers splash the cash

Another decent growth number will be welcome news for President Trump, but for markets, the bigger question is where the economy goes next. We see no...



Source: Shutterstock

At 3.5%, the latest US quarterly growth figure will be welcome news for President Trump, who appears keen to play up his administration's economic credentials to rally the Republican vote ahead of a challenging mid-term election in a couple of weeks' time.

Unsurprisingly, it was another exceptionally strong quarter for the US consumer, where the combination of tax cuts, rising wages and a tight jobs market saw spending contribute 2.7% to the overall economic growth figure. Admittedly, the latest quarterly accounts were also given a sizable boost by inventories, which helped offset a particularly sharp correction in net exports.

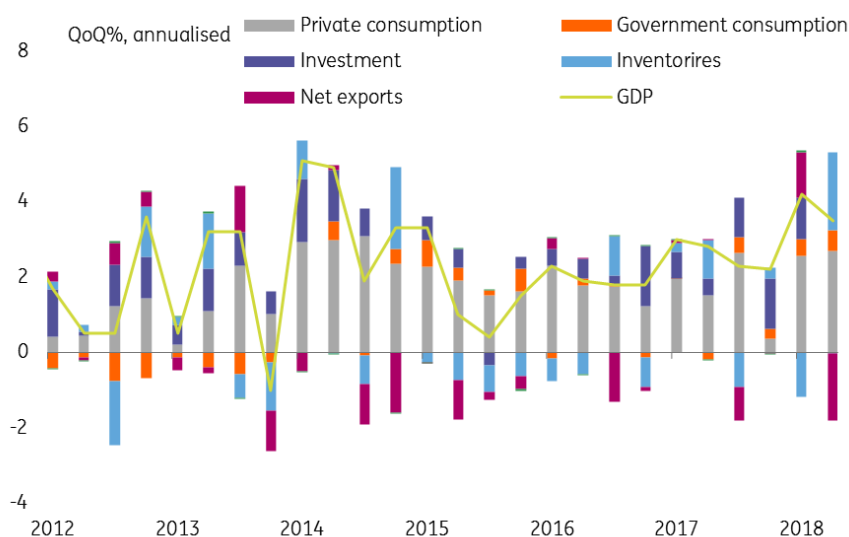
**-1.8%** Contribution of net trade to overall 3Q GDP

But the big question for markets, particularly in light of the recent stock market movements, is whether this is 'as good as it gets' for US growth. Well, at this stage we don't see any real reason to expect growth to fall sharply, particularly given that the fourth quarter is likely to be boosted by rebuilding and clean-up efforts following the recent hurricanes in the south-east.

That said, there is a risk that, as we move into 2019, growth begins to ease. Tighter financial conditions – driven by higher interest rates and the stronger dollar – may start to bite, while persistent trade uncertainties and fading fiscal tailwinds may also begin to restrain activity more noticeably. However, the strong underpinnings of the tight jobs market and the resulting positive impact on wage growth are likely to stay with us into next year, and we still expect a decent 2.4% growth reading for 2019.

With that in mind, we expect the Federal Reserve to push ahead with its tightening cycle, hiking in December and three more times in 2019.

## Contributions to US GDP growth



Source: Macrobond

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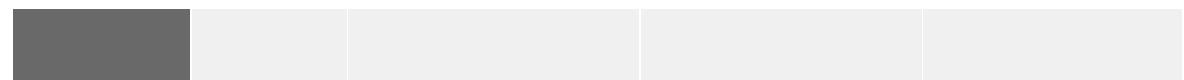
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## G10 FX Week Ahead: Looking pretty bleak

The US economy looks to be hitting new heights, while Europe remains once again plagued by politics. Throw into the mix the strongest US wage growth...



Source: Shutterstock



## EUR: Strong US, weak Europe theme to continue

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1340	Mildly Bearish 	1.1300 - 1.1450	1.1400

- Following a strong US GDP print, the US data focus in the week ahead shifts to the October jobs report. Our economists expect a strong employment rebound after a weather-depressed September reading caused by Hurricane Florence - and they had even hoped for an even stronger outcome than our 200,000 forecast for payrolls, but note that Hurricane Michael hit Florida the week of October payrolls data collection. In terms of wages, we think the annual rate will move up to 3.2%, which would make the fastest rate of pay growth since April 2009, while the unemployment rate could drop to the lowest since December 1969. While markets are broadly expecting this - any strong US inflationary signs could give US Treasury yields another boost and see global risky assets take a hit. The USD would likely remain bid in this scenario.
- We expect the EUR to stay under pressure as we struggle to see the Italian government backing down on the budget impasse (despite all of Mario Draghi's best efforts to inject a bit of calm into the situation). Italy's position seems unmoved with both deputy prime ministers Salvini and Di Maio stressing their reluctance to change the current budget draft. While forward-looking indicators have been more tepid, the only potential support for the EUR could come from stronger GDP and inflation data in the week ahead. At the time of writing, we haven't seen yet the key decision by S&P on the Italian debt rating outlook - so we can expect some reaction to this when markets open on Monday. Our Rates team say that if S&P mimics Moody's decision from last week and delivers a rating downgrade spreads could struggle to fall (much) below 300bp - and in fact widen substantially. If, however, S&P just switches the outlook to 'negative' - which we definitely don't rule out - the 10Y BTP-Bund spread could fall back to 250bp, especially if Rome and Brussels try to find some sort of compromise. The latter benign scenario could see a partial relief rally in the EUR - although upside may be limited to around 1.15 as there's still a long way to go before the Italian budget deadlock is resolved.



## JPY: More stealth BoJ tightening to come

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	112.10	Mildly Bearish 	111.10 - 112.90	112.00

- The key Japanese event in the week ahead will be the all-important October BoJ meeting (Wed). Our economists note that BoJ Governor, Haruhiko Kuroda, has been dropping hints about changes to BoJ policy. Kuroda has been sounding more positive about inflation, with core (ex-fresh food) inflation now at 1.0%. The elusive 2% level may still be the official target, but there is a sense that a more pragmatic 'good enough' rate of about 1% could pave the way for the BoJ to start tweaking its policy stance. We think that we may see more stealth tightening steps to come this week - and this could be mildly supportive for the yen.
- With global markets still looking fairly fragile, the combination of a hawkish BoJ and sell-off in risky assets could be quite supportive for the yen. While USD/JPY could drift lower here towards 111.00-111.50 - we suspect that it'll be other JPY crosses where we'll see the greater price action (eg, EUR/JPY and AUD/JPY). The week ahead also sees Sep jobless rate (Mon) and Sep industrial production data (Tue).

## GBP: Budget, Bank of England and Brexit... it could be messy

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.2780	Neutral	1.2660 - 1.2950	1.3000

- It's a big week of event risks for GBP - with the Nov Bank of England meeting (Thu) and Chancellor's Autumn budget (Mon) on the agenda. But make no mistake, they'll be no hiding from Brexit - and we suspect the UK's future relationship with the EU will be firmly in the spotlight at both events. Our economists note that given all the near-term unknowns of Brexit, UK Chancellor Philip Hammond appears keen to avoid making any dramatic changes as part of next week's Autumn Budget. But that could prove tricky, following the government's recent commitments to boost spending on health, as well as to bring the long-running austerity programme to an end from 2019. If Hammond wants to stick to his fiscal goals, which include bringing debt down as a percentage of GDP by the end of the current Parliament, he knows he will need to find extra sources of funding to help square the circle.
- In terms of the Bank of England meeting, we're likely to see a unanimous vote to keep policy unchanged next week, and we don't expect a rate hike before May 2019 at the earliest. But having stayed relatively quiet on Brexit risks at recent meetings, probably the most interesting question for markets next week will be whether Governor Carney voices greater concern about the short-term outlook. In the absence of Brexit, we think the Bank would be eyeing up another rate hike in the next 3-6 months. GBP/USD trading 2 big figures below the 'neutral' sentiment level of 1.30 presents a good opportunity to buy GBP again - if one believes that Brexit will, in fact, be alright on the night.

## AUD: Getting ready for a figure of 0.6-something

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7030	Mildly Bearish ↘	0.6900 - 0.7100	0.6900

- As [ING's Rob Carnell notes](#), we should get ready for an AUD figure of 0.6-something. [Our forecasts reflect this](#) - and we've pencilled in a potential trough point for the pair around 0.68-0.69 over the next few months. It's more a reflection that we think more things are likely to go wrong (US-China trade war, geopolitical uncertainties, global stock market correction) - rather than right over the next few months. Indeed, Rob notes that the AUD's weakness is more than just a China story - it's been all about the slowdown in global activity in 2018 (one that FX markets were not positioned for) that's weighed on the archetypal activity currency that is the Aussie dollar.
- The RBA is quite happy with a weaker AUD - and despite some likely good inflation data next week (3Q CPI due Wed), we doubt that investors will have any solid reasons to chase the currency higher. Our team feel that any Australian CPI uptick next week will be transitory - with higher oil prices the main reason for stronger inflationary pressures. In fact, we don't think underlying price pressures (wage growth) will pick up anytime soon - and that will keep the RBA hawks in check for a while longer. We could see a test of the 0.70 level over the coming week - and if we do go down and under here, look for 0.6930/40 as the next key support test.

## NZD: Sliding lower as global optimism fizzles out

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6470	Mildly Bearish ↘	0.6400 - 0.6580	0.6400

- It's another quiet week in the New Zealand calendar - although it's probably worth keeping an eye on Oct business confidence data (Wed). The kiwi could be quite sensitive to this release - not least given that rising speculation of an RBNZ rate cut in recent months has been largely due to waning business confidence.
- With NZD/USD having broken the 0.65 level, and very few positive catalysts on the horizon, there's a risk that we could see a decline to 0.61-0.62 (2015 lows) on the back of rising US Treasury yields in the coming months. For now, we think NZD/USD will spend most of its time below 0.65 in 4Q18 - with investors retaining a sell on rallies bias.

## CAD: Bank of Canada hikes, loonie depreciates

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3145	Neutral	1.3050 - 1.3230	1.3000

- It may have been a slightly more hawkish tone struck by the BoC at the October meeting than what many on the Street had expected ([see our reaction here](#)) - but as we pointed out, a lot of good monetary policy news is priced into the loonie. So it's no surprise to us to see USD/CAD trading back above 1.30 this week - although the bigger marginal drivers for CAD weakness have been lower oil and general global risk aversion.
- As for the week ahead, the focus will be on Aug GDP (Wed) and the Oct Canadian jobs report (Fri). Our economists forecast no change from July in the August growth figure; but at an estimated 2.4% YoY, the growth story is still upbeat as Canada continues to reap benefits from the strong foreign demand. We see the unemployment rate stable at 5.9%. Possible upward pressure should be noticeable in the full-time employment figures. Firms hinted recently in the Bank of Canada's 3Q Business Outlook survey that hiring plans will be extended. But the typical post-summer dip we see in participation rate could put a ceiling on the availability of labour, slightly dampening employment figures. Solid Canadian data may help to keep a lid on USD/CAD below 1.32 - we would look to fade any move above as it would appear out of sync with relative US/Canadian fundamentals.

## CHF: Italy and Brexit remain the two big elephants in the room

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1370	Mildly Bearish 	1.1280 - 1.1450	1.1200

- We think EUR/CHF could drift lower for at least two European political reasons: (1) it's hard to argue that the stand-off between the Italian government and Brussels will be resolved anytime soon and (2) it's highly unlikely that a solution to the Brexit negotiations will be found as early as next week - and instead, increasing uncertainty surrounding a 'no deal' could bring about a string of further negative headlines.
- On the other hand, despite a fairly muted week on the Swiss macro side, we see some upside risk on EUR/CHF to partly offset a more bearish outlook stemming from potential negative headlines on complicated negotiations between Switzerland and the EU for the market equivalence of Swiss stock exchange. As our economist Charlotte de Montpellier suggests, the chances of reaching an agreement is at stake and the Swiss financial system could run into difficulty should an agreement not be reached early next year. Messy European politics usually means a lower EUR/CHF - but with Switzerland caught up in the mess, stability around 1.13-1.14 looks the most likely outcome.

## SEK: Taking its cue from global risk

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.4010	Mildly Bullish ↗	10.3300 - 10.5000	10.7000

- The high-beta krona has weakened as global equity markets have fallen sharply. We expect this correlation to continue to drive EUR/SEK over the coming week, especially in a relatively data-light week ahead. Further risk-off moves in equities could easily push EUR/SEK towards the 10.50 level. While this week's Riksbank meeting proved a non-event, the minutes of the October meeting published on Friday may provide some support for the krona if there are indications that the expected rate hike could come as soon as December. Set against that, we expect another weak PMI reading (on Thursday) could weigh on SEK.
- Meanwhile, the post-election political stalemate continues with no end in sight; barring a surprise development over the weekend, PM Lovfen's mandate to propose a government will expire unsuccessfully on Monday. We don't see a solution on the horizon, but new elections (which would likely see the re-introduction of a small political risk premium in SEK) are also not likely to be called for some time yet.

## NOK: Struggling a little as oil price declines

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5160	Neutral	9.4160 - 9.5760	9.5000

- Like SEK, NOK has moved closely with global equity markets over the past week, and this is likely to remain the case over coming days as well. And with Brent oil falling into the mid-70s, the krone has lost a key supportive factor. This, combined with a continued gradualist stance from Norges Bank, means we see another move towards the key support level at 9.40 as unlikely in the near term.
- The key data to watch over the coming week is the PMI survey on Thursday, which we expect will show the Norwegian economy is holding up somewhat better than peers in Sweden and the Eurozone (where near-term indicators have turned down over recent months). The relative resilience of the domestic economy means we remain constructive on NOK compared to other high-beta currencies such as SEK, AUD, NZD.

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Article | 25 October 2018

## ECB: Not sexy but highly effective

The ECB remains determined to continue its chosen path to bring net QE to an end in December



Source: Shutterstock

### No change today

No changes from the ECB and President Mario Draghi. As expected the European Central Bank sticks to its autopilot to bring net QE purchases to an end in December. It didn't deviate from its earlier language and looks highly determined to continue with its strategy, chosen in June.

### What Draghi said

Some noteworthy comments by ECB president Mario Draghi during the press conference:

- **risks to the growth outlook are balanced.** With the latest stock market correction and dropping confidence indicators, some market participants had been speculating on some changes in the ECB's assessment. Wrongly so. Draghi gave a good overview of the ECB's take on the Eurozone economy. According to Draghi, the ECB acknowledged a somewhat weaker momentum in the Eurozone but still positive output gaps, positive domestic demand and pro-cyclical fiscal policies plus several country-specific temporary factors. Draghi, in our view, rightly so reiterated that the Eurozone was currently experiencing a weaker momentum but not a downturn.
- **the expected pick-up in core inflation.** Draghi stressed increasing negotiated wages in several countries, an expanding but tightening labour market and high capacity utilization rates were at the basis of the ECB's expectation of a gradual increase in underlying inflation.
- **Italy is a fiscal issue.** Obviously, Draghi was asked about Italy. Also, obviously, Draghi did not come up with any surprising comments. According to him, Italy was mainly a fiscal issue, the European Commission not the ECB was the Guardian of the Treaty and higher interest rates reduce the room to expand the budget.

## The year ahead

All of these comments demonstrate that the ECB remains highly determined to bring net asset purchases to an end at the December meeting. It would require a severe downturn of the economy, not only weaker momentum, in the coming six weeks for the ECB to alter its course.

Looking beyond December, however, weaker growth and the lack of higher underlying inflation could in our view still lead to currently unexpected changes in the ECB's monetary policy. Just think of the length of QE reinvestments, new TLTROs (already mentioned by two ECB members today) and forward guidance on interest rates. With every new disappointing data releases, the probability increases that the ECB will fine-tune the non-QE tools. At the same time, chances that Draghi could deliver at least one rate hike before leaving office decrease. But this will be 2019's story.

For this year, the autopilot should remain the main story. The ECB's autopilot to bring net QE purchases to an end. Not very exciting for markets and ECB watchers but highly effective.

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## Bank of Canada hikes and hawkish tone suggests more to come

The central bank of Canada raised rates by 25bp today, but the question now is what will their 2019 tightening path look like? Downside risks linger, but...



Source: Bank of Canada

As widely expected, the Bank of Canada hiked the policy rate by 25 basis points bringing it to 1.75%. Although we expected to see a more dovish tone given the poor September CPI print of 2.2% year on year -considerably undershooting the 2.6% YoY consensus, the BoC remained upbeat with the view that the limited spare capacity in the economy will continue to put pressure on prices. This is why it looks set to continue on its tightening path.

Core inflation is the key variable for policy decisions, and despite the slight dip in September, the three main measures still averaged the BoC's 2% target. As long as core data floats around this level, we expect further tightening in 2019. We predict two hikes in 1Q19 and 3Q19, taking the policy rate towards the lower end of the BoC's estimate of the nominal neutral rate (2.5%-3.5%, based on at-target inflation).

If lingering downside risks subside, then a third hike next year isn't entirely out of question, particularly, if we see a pick-up in wage pressures on the back of labour shortages, as was hinted at in the latest [BoC Business Outlook Survey](#).

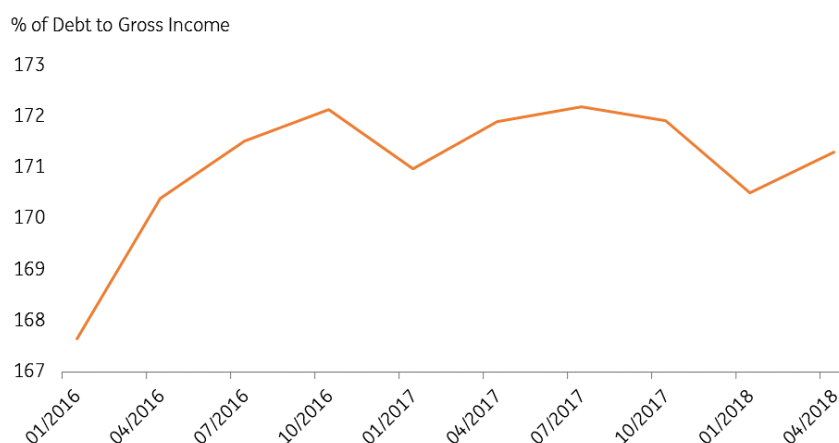


## Divergence between BoC's and the Fed's path

This is slightly slower than the Fed's predicted tightening path, where we see four more hikes from now until the end of 2019. But considering the Canadian economy hasn't received the huge fiscal boost the US has, along with potential downside risks associated with weaker wage growth, slowing house prices and the persistently large household/debt ratio, a slight divergence between the two central banks isn't a surprise.

Going into next year, any escalation in these downside risks could see the central bank having to rethink their tightening path, although today's hawkish statement makes this look less likely.

## Canada's household debt is a potential risk to the economy



Source: Macrobond

### We stick with our base case

Given the Bank of Canada still expects inflation to be at, or above, its target, and the growth outlook is still looking reasonable, we stick with our base case of two rate hikes in 2019.

### Author

**James Knightley**

Chief International Economist, US

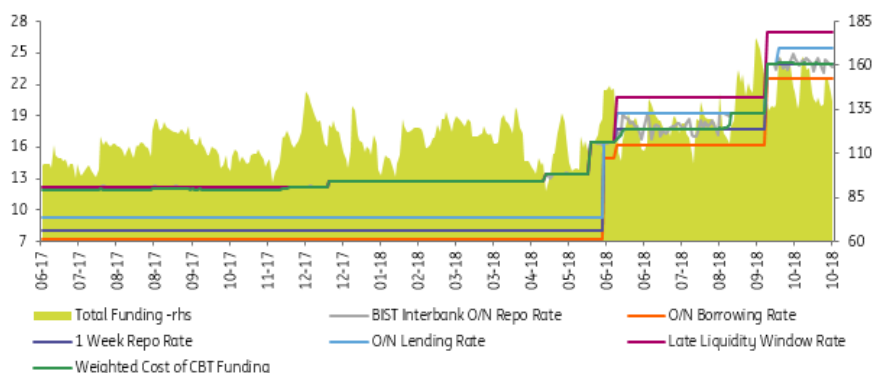
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# No surprises from the central bank of Turkey

Turkey's central bank kept the policy rate unchanged at 24% while pointing out the upside risks to the inflation outlook, ongoing strength in external...



## Key central bank of Turkey rates (%)



Source: CBT, ING Bank

## Policy rate flat at 24%

At today's meeting, the central bank of Turkey kept the policy rate unchanged at 24%, in line with the Bloomberg median consensus and our call. This is following the sharp adjustment last month

and with the recent lira strength on the back of Pastor Brunson’s release and subsequent signals from the US on lifting some sanctions.

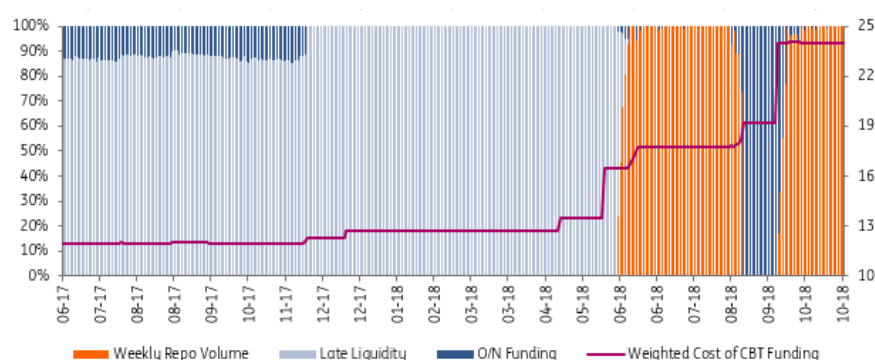
Markets first reacted negatively, and the lira moved to above 5.70 against the dollar, though later recovered towards 5.62s.

As we wrote before the meeting, the current recovery process of the lira could reduce some repercussions that we have witnessed since the beginning of this year including the declining FX pass through on inflation, given the high correlation between the lira's performance and core inflation. Secondly, the improving financial stability with a better operating environment for Turkish corporates that have a substantial short FX position.

That would be a relief factor for the central bank along with improvements in the geopolitical picture that will likely support the capital flow outlook, despite continuing fundamental macroeconomic challenges, such as inflationary pressures.

## Funding composition and cost of funding

(5d-MA, %)



Source: CBT, ING Bank

## Minor changes in the statement

In the statement, the central bank's growth assessment was broadly unchanged, pointing to the “slowdown in economic activity continues”, with an addition in the October statement that it is “partly due to tighter financial conditions”.

But, most importantly, the Bank remained vocal about price stability risks by, once again, reiterating price increases showing “generalised patterns across sub-sectors, reflecting the movements in exchange rates”. They also acknowledged upside risks in the inflation outlook despite “weaker domestic demand conditions will partially mitigate the deterioration”.

Accordingly, it maintained a hawkish bias, keeping the main policy guidance in the statement unchanged. So, while highlighting the determination to tighten further, if needed, the bank will continue to monitor the lagged impact of recent monetary policy decisions and the contribution of fiscal policy to rebalancing process in addition to inflation expectations, pricing behaviour and other factors affecting inflation.

Despite the deteriorating inflation outlook with a surge in forward-looking expectations and

fall in the ex-post real rate to the negative territory again, the central bank remained quiet.

This is probably because of rapid improvement in financial stability risks, the ongoing impact of recent financial volatility on the growth outlook, and expectations about the impact of the 10% price cut campaign on the inflation trend.

## Author

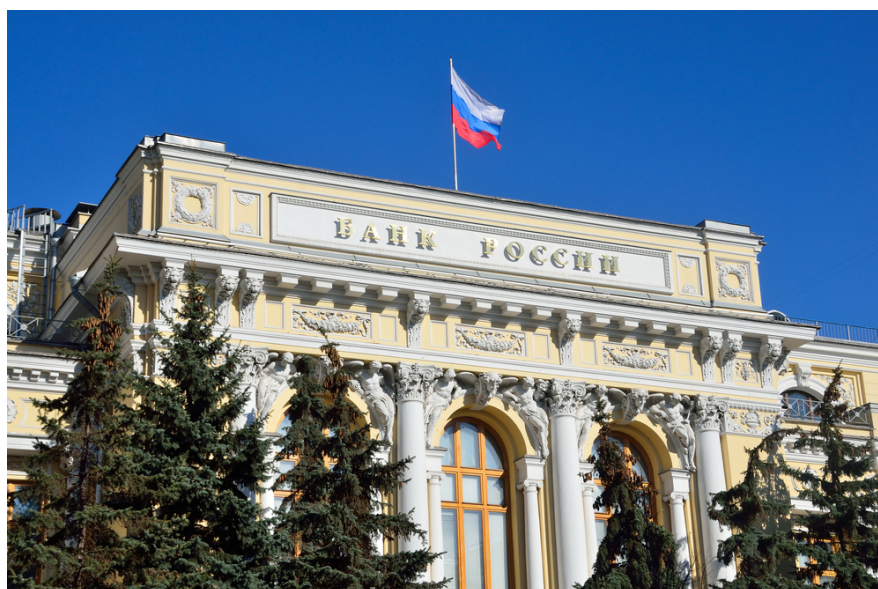
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# Bank of Russia confirms it's in 'standby' mode

Bank of Russia fully confirmed our expectations by keeping the key rate at 7.5% and maintaining a cautious tone. The upcoming decisions are likely to be...



Central Bank of Russia, Moscow

# 7.5%

Russia key rate

Rhetoric unchanged

As expected

## CBR decision and reasoning in line with expectations

The Bank of Russia's decision to keep the key rate unchanged at 7.5% was in line with the consensus and our expectations. The reasoning behind the decision also doesn't surprise:

- CPI is on track to accelerate from the current 3.5% year-on-year toward 3.8-4.2% YoY by year-end 2018 and 5.0-5.5% by year-end 2019 as a result of rouble depreciation pass-through and the upcoming VAT hike
- Households' 12-month expectations somewhat improved in October (i.e. remaining near

- 10%, though no specific figure was provided)
- GDP growth expectations from 2018-19F remain unchanged at around 1.5-1.7%
  - Financial markets have calmed since the September decision to put FX purchases on hold and raise the key rate by 25 basis points

Russia's central bank to wait and see till December

## Upcoming decisions likely to be between 'hold' and 'hike'

There was also no change in the assessment of the inflationary risks, which is also in line with our expectations. That highlights the uncertainties faced by the monetary authorities in the near- to mid-term. For now, we expect the key rate will remain unchanged until the end of next year under the assumption that the CPI will stay within the central bank (CBR) guidelines (including a temporary spike to 5.5-6.0% YoY in 1H18). At the same time, we acknowledge that the risks to our view on the CPI and key rate are tilted upwards.

- The most obvious risk is external, which was directly mentioned in the CBR communique - including continued capital outflows from emerging markets and Russia-specific foreign policy risks. Remember that since April there were some RUB550 billion capital outflows from the state bond market (OFZ) and RUB8/USD depreciation - mostly on the back of global emerging market outflows. Still, non-residents hold around RUB1.8 trillion of OFZ, and we doubt that further tightening in sanctions has already been priced in.
- The less obvious risk - the one CBR didn't mention - is the growing uncertainty regarding the local gasoline price growth. After a stable May-September, gasoline prices are back to 0.1% week-on-week growth since October. According to the media, the upcoming increase in excise tax and the overall tax changes in the oil industry may trigger an increase in the local gasoline prices by around 10%. The direct impact of such a spike on the CPI could be 0.4 percentage points (based on the gasoline's weight in the CPI basket). However, the secondary effects could amplify the potential deterioration in the inflationary trend. For now, it remains unclear whether the government will prevent this growth via budgetary or other means.

Our base-case scenario is unchanged 7.5% key rate in the upcoming meetings, but the risks to this view are tilted upwards.

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# Norges Bank stays on track for a Q1 hike next year

No change from the Norwegian central bank; gradual tightening path confirmed



Having raised the policy rate in September, little was expected from the Norges Bank today. And as usual, the central executive board delivered on expectations. Today's statement indicates an unchanged policy stance, repeating the guidance that the next hike will most likely come in the first quarter of 2019, which we interpret as the March meeting, given the NB's preference to move policy at meetings where they have new forecasts and a press conference.

The key assessment from policy statement indicates that:

"The Executive Board's assessment of the outlook and balance of risks imply a gradual increase in the key policy rate. Economic growth has been a little lower and inflation somewhat higher than projected, but the outlook and the balance of risks do not appear to have changed substantially since the September Report."

With little news in today's communication, the krone and short-term rates are largely unchanged.

So long as the Norwegian economy stays on track, and the rest of the world doesn't fall off a cliff, we expect the NB will follow through on the Q1 hike.



The key question remains what could cause them to shift from the current plan to raise rates on average twice per year. We continue to see the risks as skewed towards the upside, with the possibility of two hikes in the second half of 2019 in addition to the Q1 hike. But the recent sharp drop in the oil price and indications that the Eurozone and Sweden (key trading partners for Norway) are slowing down have reduced the chance of a more aggressive tightening path.

## Riksbank still in wait-and-see mode

No change from the Riksbank leaves the timing of the first interest rate increase uncertain. We continue to see a February hike as somewhat more likely...



The Riksbank left both the policy rate and the forecast for interest rates unchanged today. The policy statement is also broadly similar to September, indicating that the policy rate “will be raised by 0.25 percentage points either in December or February”. Two monetary policy committee members are now voting for an immediate rate hike (Martin Floden joining Henry Ohlsson in the hawkish dissenter’s camp).

The forecasts for GDP have been revised down following the statistics office’s major revision to the Q2 GDP figure, and now indicates somewhat weaker momentum in the Swedish economy. Unemployment has also been revised up following weaker employment growth figures.

Set against that, the inflation forecast is largely unchanged, and the statement is somewhat more optimistic that underlying price pressure is consistent with inflation remaining around the 2% target.

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*In our view, a December or February hike looks like a genuine 50-50 decision at this point and probably comes down to the*

## *data between now and the December meeting*

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In effect, the economic situation has reversed from the first half of this year, when GDP growth was very strong, but inflation looked anaemic. Now, price pressure look reasonably solid, at least in the near term, but growth is clearly slowing down. Similarly, global risks have shifted towards the downside and increasingly look like a factor that could nudge the inherently cautious Riksbank governors towards (an even more) gradual tightening path.

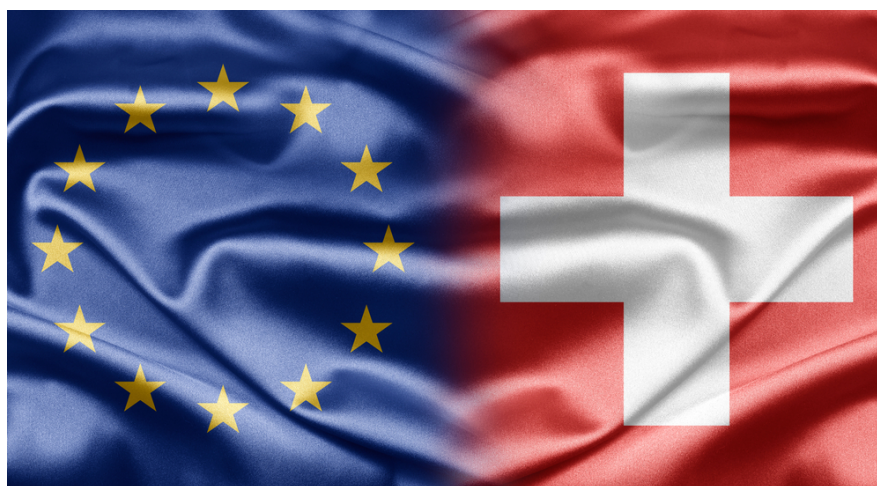
The fact that there is no indication that a December hike has become more likely, which to some extent had been expected after the strong September inflation reading, means today's stance is very marginally more dovish than anticipated. As a result, the krona has weakened slightly, and near-term forward rates have shifted down a touch.

In our view, a December or February hike looks like a genuine 50-50 decision at this point and probably comes down to the data between now and the December meeting.

We still see the Riksbank's forecast for GDP as somewhat on the optimistic side. Combined with further turbulence on global markets, this suggests to us that the cautious majority on the Riksbank board are likely to push the first rate hike into February, but it is a close call.

## The EU and Switzerland: Another arduous negotiation not going to plan

The EU and Switzerland have been trying to negotiate a new framework agreement for the last four years, but the complex negotiations haven't been...



Source: ING  
Switzerland and the EU

### An opportunity to replace 120 agreements

The EU and Switzerland are currently negotiating a framework agreement to formalise their relations and replace 120 different treaties that exist at the moment. The Brexit negotiations have pushed the European Commission to increase pressure on Switzerland to sign an agreement and want the framework to be more restrictive than it is now so that Switzerland-EU relations aren't seen as an example for countries looking to leave (or leaving) the EU.

Currently, Switzerland has access to the European common market by allowing the free movement of persons. It can enter into its own trade agreements, as it did a year ago by negotiating a free trade agreement with China. In practice, it is estimated that more than 33% of current Swiss legislation comes from European law, but there is no agreement currently obliging Switzerland to transpose European rules into its law.

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*The negotiations have been going on for four years, but haven't been moving very fast*

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A framework agreement would make the process more automatic by forcing Swiss rules to automatically change to align with European ones in areas such as legal development, supervision, interpretation and dispute settlement. In addition, an arbitration panel would settle disputes between the EU and Switzerland and the European Court of Justice would have a crucial role to play.

The negotiations have been going on for four years, but haven't been moving very fast. To make the Swiss to negotiate more quickly, the EU has put forth certain arguments on the table that can hardly be ignored by Switzerland.

In December 2017, the EU decided to link the progress of the negotiations with the recognition of the Swiss stock markets rules that allow cross-border trading, but that recognition had only been extended for a year until the end of 2018. Therefore, it needs to be renewed again and the EU has already announced that it will only do so if it considers that progress in negotiations has been sufficient.

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*The EU will only renew the agreement to recognise Swiss bourse trading rules if it deems sufficient progress has been made on the negotiations*

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This implies that in December 2018, without sufficient progress in the negotiations, European's access to the Swiss stock exchange and securities listed in Switzerland could be threatened. Without equivalence, Switzerland will probably apply the same measure to the EU and no longer recognise European stock exchanges. No need to say that this threat is extremely strong for a global stock market such as Switzerland. Without this access, the Swiss financial system would be in great difficulty, and the consequences for the Swiss economy would be significant.

[Read our Swiss Quarterly update here: The sun is shining but clouds loom](#)

## Negotiations at a standstill

However, it seems that negotiations are at an impasse and the chances of an agreement before the end of the year are minimal. 15 October was the negotiation deadline set by the European Commission, but no significant progress has been seen yet.

Disagreements over the free movement of people is a major problem, including the so-called "accompanying measures" issue. These measures force foreign employers who send workers to Switzerland to meet minimum wage and labour conditions. It severely limits social dumping and pushes wages upwards, leading to the current situation of high wages in Switzerland. However, the EU considers these measures penalise foreign companies and are discriminatory and would like them abolished. A framework agreement without modification of these accompanying measures would hardly be acceptable for the EU, but the Swiss unions oppose this relaxation of national regulation protecting wages.

Recently, the Austrian Economy Minister Margarete Schramboeck, whose country holds the rotating presidency of the EU until the end of the year downplayed the chances of an agreement

and said she believe we shouldn't expect them to reach an agreement before the end of 2018.

## A loss of stock exchange equivalence?

It seems apparent that an agreement won't be reached until January 2019 as the EU is reluctant to appear too flexible with Switzerland out of fear of giving ammunition to British negotiators discussing Brexit.

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*Despite these circumstances, we don't expect a loss of market equivalence for the Swiss stock market or unprecedented financial shock*

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We think despite the difficulties mentioned above, the EU is likely to grant a new provisional equivalence of one year in January, to avoid any interruption of financial transactions. The EU is likely to rely on the fact that the negotiations have nevertheless progressed during 2018, despite the lingering blockages.

We think the EU will probably reach an agreement with Switzerland by May 2019, before the European elections which lead to a renewal of the parliament. After May, it will take time for the new parliament to form itself, further complicating the discussions. It is worth remembering that after that Switzerland will be having their elections in October 2019 and negotiations could become even more complicated as the eurosceptic Swiss party UDC intends to make the fight against the framework agreement its electoral battle-horse to gain, even more, seats in parliament.

Even if uncertainty continues to prevail over the outcome of the negotiations, it seems that it doesn't really affect businesses and hasn't had any impact on economic activity for the time being. Firms don't really seem to be worried for now, and we don't expect a discernible impact on GDP.

Nevertheless, if stock exchange equivalence is not granted again in January, then the economic consequences could be significant - a risk that must be considered.

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# Malaysia 2019 Budget Preview – A derailed fiscal consolidation

Sweeping policy changes under the Malaysian government's drive to improve people's standard of living and drive out political corruption have...



Malaysian Prime Minister, Mahathir Mohamad

## Long-term inclusive growth, sustained development

The Mid-term Review of the 11th Malaysia Plan 2016-2020 (11MP) unveiled by Prime Minister Mahathir earlier this month (18 October) sets a clear tone for the upcoming Federal Budget for 2019 – a derailed fiscal consolidation. The first budget of the Pakatan Harapan [Alliance of Hope] coalition government will be presented to the parliament by Finance Minister Lim Guan Eng on Friday next week, 2 November.

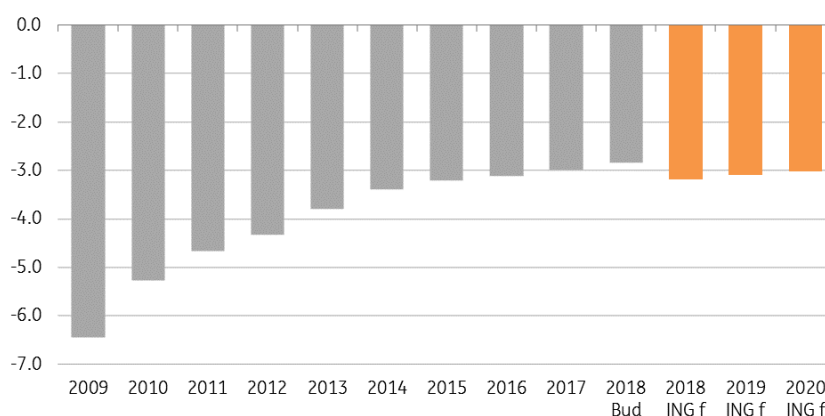
As per the 11MP review, the fiscal policy by the new administration will be driven by objectives of an 'inclusive growth and sustained development'. As tighter fiscal stance and risk from global trade tension slam the breaks on the economy, the government has downgraded GDP growth target for the remaining plan period, 2018-2020, by half a percentage point, from 5-6% in the original plan to 4.5-5.5%. The target for inflation is also revised slightly from 2.5-3% to 2-3%. And, contrary to the earlier target of a balanced budget by 2020, the fiscal deficit is now projected at 3% of GDP over



the plan period.

Notwithstanding its drive to rein in high public debt the focus remains on continued fiscal consolidation. Yet the year 2018 will see the trend of steadily falling fiscal deficit underway since 2009 coming to an end; the deficit hit a record 6.7% of GDP in 2009 and has more than halved to 3% by 2007 (see below). The initial budget for 2018 under the previous administration had projected a further fall in the deficit to 2.8% this year. That's not going to materialise.

## A decade-long fiscal consolidation coming to end - fiscal deficit (% of GDP)



Source: CEIC, ING

## Sweeping policy changes – elimination of GST and more

The economic policies took a significant turn, either for good or bad, after Dr Mahathir's coalition took over the helm in May this year. Keeping with its election agenda of boosting people's standard of living and cleaning the corrupt political machinery, the new administration launched sweeping policy changes. The most prominent among these are elimination of Goods and Services Tax (GST), replacement of GST with SST (Sales and Services Tax), and suspension of mega investment projects undertaken by the previous government in collaboration with foreign governments (China, Singapore, etc.). These policies certainly will have an adverse bearing on the fiscal situation in the current year and beyond.

The Finance Minister, Lim Guan Eng, is on record as saying that it would be "foolish" for the current government, which took power in May, to abide by "unrealistic" fiscal targets set by the previous administration. The policy shift makes the target of limiting the deficit at 3% a challenging task for the government as heightened global economic risks – the trade war, geopolitics, and emerging market routs – will undermine Malaysia's economic performance. As can be conjectured from the 11MP ditching of the balanced budget target, and holding a 3% line on the deficit over the remaining plan period, the fiscal deficit will have surged past the 3% mark in the current financial year itself and will likely prevail above that level in the medium-term.

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*Limiting the deficit at 3% will be challenging*

---

A strong run for the economy in 2017, with close to 6% of GDP growth, and through the first quarter of this year and a boost to petroleum revenue from higher oil price might have supported total government revenue in the current year. Indeed, the 10% year-on-year revenue growth in the first half of 2018 compares with 0.8% growth in the same period last year. The growth of operating government spending also accelerated to 6% from 1.5% over the same period, though it was offset by slower development spending to -0.7% from 1.9%. This left the fiscal deficit at 4.5% of GDP in the first half of the year, not unusual for the period yet raising the risk of an overshoot in the full-year deficit.

However, the real hit to the budget will have started after the removal of the GST in June, while the overall economic performance also started to weaken from the second quarter of the year - a double whammy to government revenue. The launch of the SST in September will make up for some of the GST revenue loss, but not all.

On the spending side, PM Mahathir has assured steady operating expenditure in a drive to fulfil election promises. The suspension of public investment projects will have kept development expenditure well under MYR 46bn planned in the original budget, of which only less than half was incurred in the first half of the year. While the revenue loss from consumer tax reforms will far outweigh saving on development spending, weak investment will further compound GDP growth slowdown and pressure the deficit in relation to GDP higher.

With this backdrop, we anticipate fiscal deficit in the current year rising to 3.2% of GDP from 3.0% in 2017.

## What's in store from the 2019 Budget?

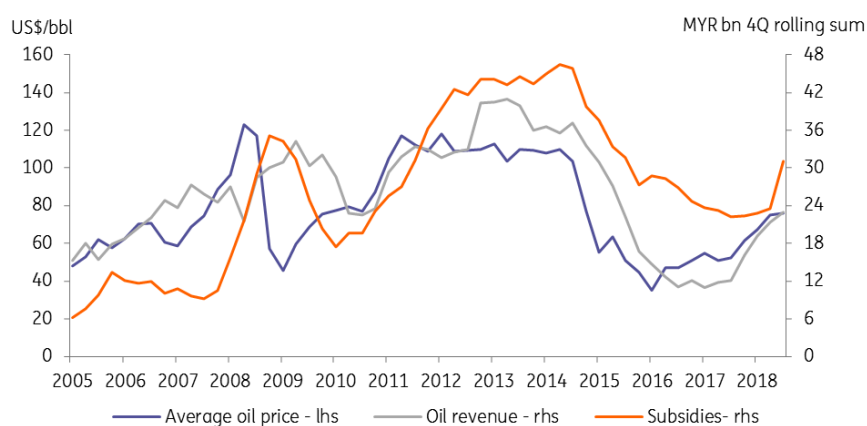
The forthcoming budget will set the course for the fiscal policy in the coming years. And, in all likelihood, it will be a tightening rather than easing. Here are some of the revenue and spending side factors deserving attention in the 2019 budget formulation:

- The tighter fiscal policy stance combined with sustained external risk suggests Malaysia's GDP growth will remain under pressure in 2019, more likely staying close to the low end of 4.5-5.5% target.
- Slower GDP growth will be associated with a continued slowdown in government revenue in 2019, while the MYR 23bn revenue gap left consumer tax reforms – MYR 44bn loss from the elimination of the GST as against MYR 21bn revenue from SST – will need to be plugged. However, the loss to the government is gain to the people. And the increase in household disposable income will sustain private consumption as a strong driver of GDP growth in the next year.
- Just a few weeks ago PM Mahathir signalled introduction of new taxes as well as the sale of assets to boost the revenue and curb the debt. However, media reports suggest some of the widely talked new taxes -- capital gains and inheritance taxes, as well as an extension of SST net to online business (digital tax) – might not be part of the 2019 budget. Indeed, they will need a thorough public consultation before implementation.
- Higher oil price will be the key positive for the economy and the public finances. It will not only soften the impact of the global trade war on Malaysian exports but also will increase the petroleum revenue to the government (see below). But a high oil price also means higher government expenditure on fuel subsidies to the public. The reports of \$70 per barrel oil price assumption for the 2019 Budget may be an understatement in view of the current

level of about \$80 per barrel, and the likelihood of geopolitics keeping it on the upward pressure in 2019.

- While the plan to significantly cut down on public debt, estimated over MYR 1 trillion (80% of GDP), over next two years faces headwinds from slower revenue growth, the cancellation costs of some of the infrastructure projects undertaken with other countries could blunt the debt reduction efforts. Moreover, the drive to cut down on development spending also bodes ill for the overall economic outlook.

## Higher oil price raise government revenue but also lift spending on subsidies



Source: Bloomberg, CEIC, ING

## Still, a healthy policy balance overall

We think the pressure to bring public finances back on track to consolidation without hampering economic prospects, especially in an environment of elevated external economics risks, will be a challenging task for policymakers in the near-term. We expect the budget deficit to remain elevated above 3% in coming years, with our forecast of 3.1% of GDP for 2019 and 3% for 2020.

### *Hopes are also pinned on higher oil prices*

The downside risk to our deficit forecast stems from a significant reduction in development spending, though that also means a greater downside GDP growth risk. The hopes also are pinned on higher oil price providing positive terms of trade shock to Malaysia's net oil exporting economy, while the economy continues to be largely driven by domestic demand that will get further support from consumer-friendly tax reforms as well current low level of inflation. We maintain our 4.5% GDP growth forecast for this year and revise the forecast for the next year slightly downward to 4.6% from 4.8%.

We believe the lower inflation allows for some policy balance, by letting the central bank (Bank Negara Malaysia) to maintain an accommodative monetary policy stance as the government has now embarked on a fiscal tightening to rein in the large public debt burden. We expect inflation to

average around 1% this year and to come in at the low end of the 2-3% official medium-term target in 2019.

The MYR has weakened to almost a year-low level against the USD of 4.18 on growing fiscal jitters ahead of the 2019 budget presentation next week. However, with sufficiently positive real interest rates the MYR should retain its year-to-date Asian outperformer position over the rest of the year. We consider our end-2018 USD/MYR forecast of 4.20 subject to upside risk, while we expect the pair to hover around that level through most of 2019.

## Malaysia - Key economic forecasts

Malaysia	2015	2016	2017	2018F	2019F	2020F
Real GDP (% YoY)	5.1	4.2	5.9	4.5	4.6	5.0
CPI (% YoY)	2.1	2.1	3.8	1.0	2.0	1.9
Fiscal deficit (% of GDP)	-3.2	-3.1	-3.0	-3.2	-3.1	-3.0
Current account (% of GDP)	3.0	2.4	3.0	2.1	1.8	1.6
BNM o/n policy rate (% eop)	3.25	3.00	3.00	3.25	3.25	3.50
3M interbank rate (% eop)	3.84	3.41	3.44	3.70	3.80	3.90
10Y govt. bond yield (% eop)	4.19	4.23	3.91	4.30	4.30	4.00
MYR per USD (eop)	4.29	4.49	4.05	4.20	4.18	4.05

Sources: CEIC, Bloomberg, ING forecasts

Source: Bloomberg, CEIC, ING

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