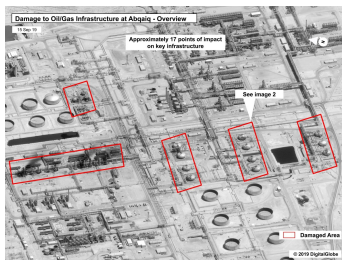


In case you missed it: A big week for oil

After oil saw its biggest spike in a decade, a flurry of central bank meetings followed. Most stayed on hold, but as expected the Fed cut rates. The one to really buck the trend was Norges Bank making it the lone G10 hawk. Fiscal stimulus chatter is beginning to grow and one of the thriftiest members of the EU is loosening its purse strings. Over to you Berlin...

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Pédro Sanchez, Spain's caretaker prime minister, had until 23 September to find a majority in parliament for his government. But last night it...



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BIS FX Survey: No sign of de-dollarization just yet

The BIS has just released its triennial survey of FX turnover. The stand-outs include: a) The dollar has consolidated its position as the world's...

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Dutch delivering on Draghi's demands?

ECB President Mario Draghi called upon governments with fiscal space, most notably Germany and the Netherlands, to fiscally "act in an effective and...

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Germany

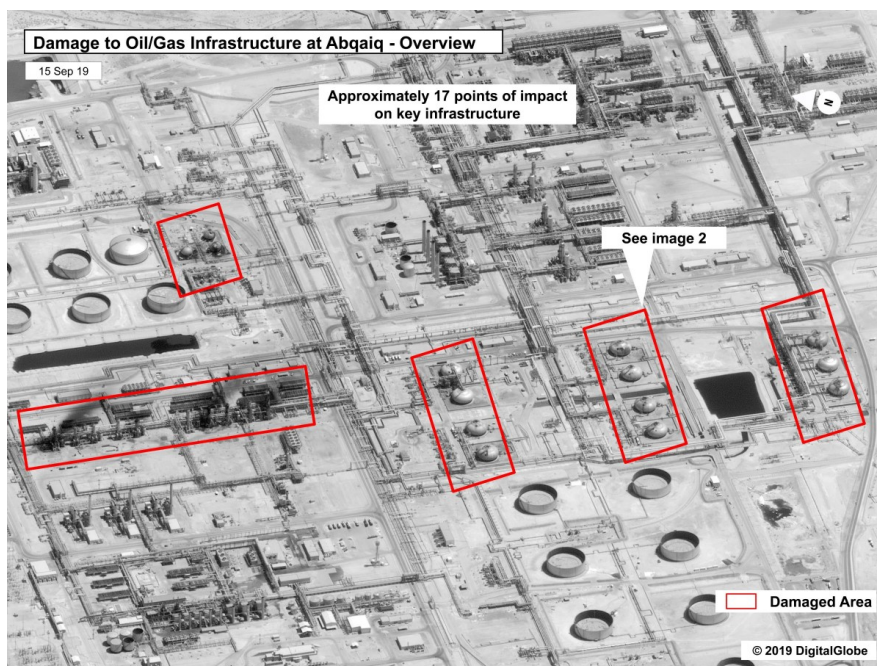
Germany: Green stimulus to the rescue?

This week will show whether Germany can actually do fiscal stimulus

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What events in Saudi Arabia mean for markets

Having been fixated by slowing demand this summer, financial markets now have to deal with the supply side – what does the attack on Saudi facilities mean for the global economy? Unless production is quickly restored, the disruption looks set to add to recessionary fears, keeping yield curves flat and, barring a dovish surprise from the Fed, the dollar bid



Source: Shutterstock

A satellite photo made available by the US Government and DigitalGlobe shows the Abqaiq oil field in eastern Saudi Arabia. According to Saudi state-owned oil company Aramco, two of its oil facilities in Saudi Arabia, Khurais and Abqaiq, were set on fire on 14 September following alleged drone attacks.

The Saudi outage: who is most exposed?

[As our commodities team have outlined](#), one of the most pressing issues from the Saudi Aramco facilities attack is how quickly Saudi production facilities can resume production.

A couple of metrics being discussed are: i) Saudi oil inventories are probably less than 26 days' worth of Saudi oil exports and ii) extra supply from OPEC + (perhaps worth 800-900 thousand

barrels per day (bpd) won't be anywhere near sufficient to compensate for the over 5m bpd Saudi outage. A prolonged outage would therefore likely see Brent crude trading well over \$70 and perhaps closer to \$80 if the outage extended over three to four weeks.

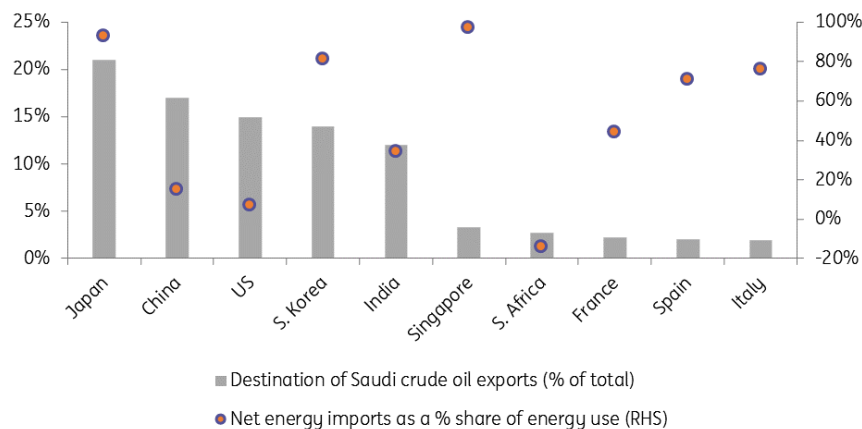
Countries like Japan, Korea and India - big buyers of Saudi oil are likely to be most affected and they have high energy dependency ratios

In terms of those countries most impacted by the loss of Saudi exports, the chart below shows the top ten destinations for Saudi crude oil. We've overlaid this chart with an energy dependency ratio – a ratio outlining what share of domestic energy use derives from net energy imports. This latter data series is a little out-dated (using 2015 data in many cases) and the US is far closer to energy independence than the 7% reading this chart suggests.

Most affected, it would seem, are countries like Japan, Korea and India - big buyers of Saudi oil plus high energy dependency ratios. However, the US is now close to energy independence and should be less affected. Again it would seem that Asia is most affected by this supply disruption, effectively compounding the challenges posed by the US-China trade war and the semi-conductor cycle.

[Can the market manage with this lost supply?](#)

Destination of Saudi crude exports



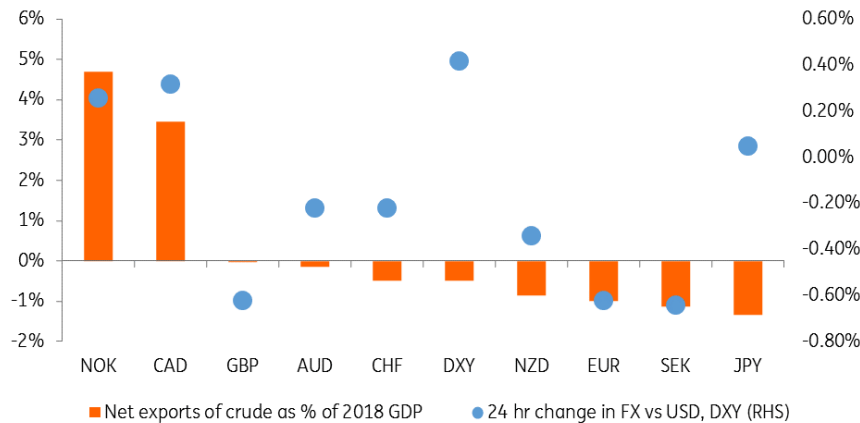
Source: World Bank (2015 data), ING

G10 FX markets react predictably

FX markets have reacted in predictable fashion. In the G10 space, the oil exporters of CAD and NOK have clearly out-performed in the first 24 hours of trading since the attack, plus some safe-haven demand for both the USD and the JPY. European activity currencies have once again under-performed, with the prospects of higher energy costs adding to the already weak outlook for industrial production. Unless the Fed turns exceptionally dovish, worried that an oil shock

undermines the key source of US growth – consumption – then it looks like the dollar can stay relatively bid and EUR/USD sinks into a 1.05-1.10 range into year-end.

Net crude export position drive early G10 FX trends



Source: Macrobond, Bloomberg

Emerging market FX: Crude rally may help RUB via macro-stability

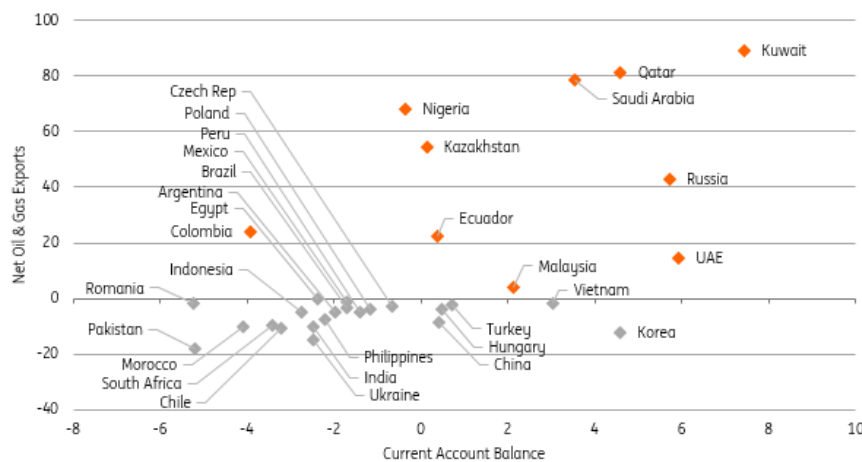
In the EMFX space, so far the Korean won has bucked the oil trend as outlined above, but the Indian rupee has understandably come under pressure, with higher energy costs adding to further concerns over India's twin deficits.

In Russia, there is a fiscal rule, which essentially forces the economy and markets to perform as if Urals is fixed at \$41.6/bbl+2% p.a, making RUB less of a commodity currency and more of an EM story

The rouble is performing well and our Russian Chief Economist believes the spike in oil may have a short-term positive impact on the RUB, but it's worth remembering that in Russia there is a fiscal rule, which essentially forces the economy and markets to perform as if Urals is fixed at \$41.6/bbl+2% p.a, making RUB less of a commodity currency and more of an EM story.

That said the higher oil price further improves the perception of Russia's macro stability, potentially supportive for portfolio inflows into the local state bonds (OFZ), but it's unclear how the general EM risk perception changes if Middle East tensions escalate. For now, we maintain our USD/RUB forecast of 63-67/\$ into year-end, while acknowledging some upside risks.

EMFX: Looking at the net energy versus current account balance trade-off



Source: IMF (Current account balances, 2019 WEO), UN Comtrade (net oil exports 2016)

How will the rates market react?

Fundamentally we would expect the impact of a sustained increase in oil prices to be negative for real growth, and so to tend to depress real rates in developed markets. The reality, as always, is more complicated and it is worth looking into the factors that would make the oil spike translate into a central bank reaction.

If we can generalise, most central banks would be inclined to 'look through' any temporary spike in inflation on account of the high volatility in energy price. As such, most of them make at least indirect reference to core inflation, typically stripped of its most volatile components such as food and energy. This is the reason why we think that on balance, central banks are more likely to respond to the potential growth (negative) shock than inflation (positive) shock.

We expect investors could view a prolonged increase in oil price as a threat to Fed easing. Indeed, this would make the risk of a less dovish tone at this week's Fed meeting more prevalent resulting in higher rates in the US compared to other currency zones and in a flattening of the USD curve

An exception to this rule of thumb is when central banks have a more explicit inflation mandate that could trigger them to 'disregard' a temporary growth shock if it does not bring about a reduction in inflation further down the line. There are a number of reasons why this could be the case, for instance depending on the persistence of the rise in price.

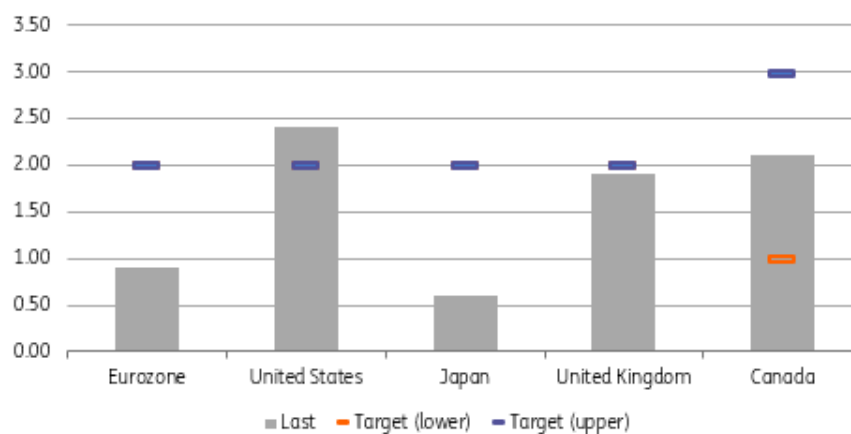
Another reason can be that the economy is operating close to full capacity and/or that inflation is already at or above target. In this instance, a further increase in oil price would risk a rise in inflation expectations beyond what a central bank is willing to countenance. Using this metric as

an indicator to compare various developed markets, it seems that the US is both the country where higher oil prices are likely to be reflected in headline inflation (since the US has one of the lowest tax wedges on gasoline), and where the central bank has the least room for manoeuvre when it comes to ignoring any spike.

Applying the above into the current economic context, growth expectations are already depressed in a number of developed economies and the focus has been squarely on how much accommodation can be delivered.

With this in mind, we expect investors could view a prolonged increase in oil price as a threat to Fed easing. Indeed, this would make the risk, [highlighted by our chief US economist](#), of a less dovish tone at this week's meeting more prevalent. This may result in higher rates in the US compared to other currency zones and in a flattening of the USD curve.

Core inflation versus CB targets in developed markets



Source: Bloomberg

A prolonged disruption to Saudi oil exports could add pressure to those countries already exposed to the manufacturing slow-down. Recessionary fears, flat yield curves and a strong dollar look set to remain in play.

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US: Fed underwhelms with another cut

The Federal Reserve has delivered another 25bp rate cut, but has provided a confused message of upwardly revising its GDP forecast despite being concerned about growth while ignoring the recent pick-up in inflation completely. Moreover, there is no consensus on additional rate cuts being needed



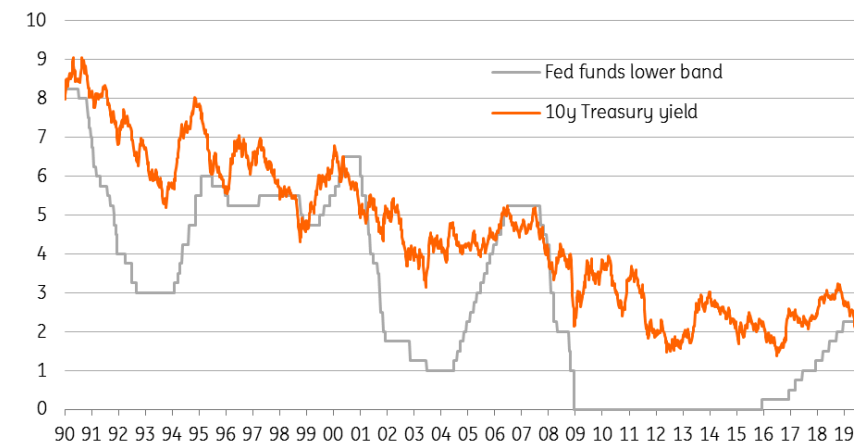
Source: Shutterstock

The Fed delivers, but the FOMC is split

The Federal Reserve has cut interest rates 25bp as widely expected to a range of 1.75-2%, but it certainly wasn't unanimous with both Esther George and Eric Rosengren, like in July, opposing the 25bp rate cut. On the other side James Bullard argued for a more aggressive response of a 50bp cut.

The accompanying press release was little changed from the one published in July with an upgraded assessment on household demand ("rising at a strong pace") offset by a more negative opinion on trade and investment (both have "weakened"). One remarkable aspect is the fact there was no acknowledgment of the recent sharp pick-up in core CPI or average hourly earnings – both of which are running at their fastest 3m annualised rates since before the financial crisis. Instead, the statement persists with the line "market based measures of inflation compensation remain low" while in the press conference Fed Chair Jerome Powell suggested inflation pressures "clearly" remain muted.

Fed funds target and 10Y Treasury yield



Source: Macrobond, ING

No consensus behind extra easing

We also got new forecasts and there was little change here either. In fact, we get a slight uptick in GDP growth for 2019 and 2021 (both by 0.1 percentage points) while inflation forecasts were left unchanged with both headline and core PCE at 2% in 2021. As we suspected, their median prediction shows they don't expect to cut rates again this year or next with the policy rate moving 25bp higher in 2021 before settling back at 2.5% over the longer term. In terms of the specific dots, just 7 officials expect one more 25bp rate cut this year with 8 officials expecting the policy rate to be in a 1.5-1.75% range in 2020.

This may be a little disappointing for those expecting a more dovish Fed outlook, but it won't matter much for markets, who continue to price another 75bp of Fed funds rate cuts from today's level. After all, the June median Fed forecast was for no rate changes in 2019 yet the Fed have delivered two 25bp cuts within three months of publishing that prediction.

But further easing will come...

We believe more Federal Reserve interest rate cuts are coming. This week's Chinese data only underlines our fears about global growth story while the latest round of ECB policy easing is unlikely to be the catalyst for a phoenix from the flames like recovery in Eurozone activity. Add in the rising geopolitical tension relating to Saudi Arabia and Iran, plus Brexit worries and a strong dollar (which is hurting US international competitiveness) and it is clear the US economy will continue to face major headwinds.

Trade tensions will also remain an issue. We doubt October's US-China trade talks will yield much. At best we may see discussions continue over coming months which means this threat to growth persists, even if it doesn't necessarily intensify.

For now, the consumer sector is performing well, but with payrolls growth showing signs of slowing and net trade and investment spending becoming drags on growth we worry about how long this can be sustained. To us, this justifies further "insurance" policy cuts. We expect another 25bp cut in December with another likely in 1Q20.

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China cuts rates via a new tool

China has cut the one-year loan prime rate, which we think was a result of the very weak August activity data, especially fixed asset investments and industrial production. Another cut is expected in October unless we see a very encouraging outcome from the trade talks, which is unlikely. We don't expect this cut to move the yuan



China cuts loan prime rate

The People's Bank of China cut the one-year loan prime rate (LPR) by five basis points to 4.2% while keeping the five-year LPR rate unchanged at 4.85%. The LPR is the new reference rate for banks and other financial assets, which can quote an interest rate linked to the LPR.

The last time the PBoC cut the one-year LPR was on 20 August, from 4.31% to 4.25%.

Here's how the interest rate works:

- the change in the LPR is an average of quotations from some banks;
- each rate change is a multiple of 5 bps;
- the LPR is linked to the medium lending facility (MLF) interest rate, i.e., $LPR = \pm MLF$;
- the MLF has not changed since 16 March 2018, when it rose 5 bps from 3.25% to 3.3%.

Why now?

We believe that the decision to cut the rate came from very weak August data released a few days

ago. Industrial production grew just 4.4% year-on-year, the lowest level since February 2002, while fixed asset investments grew 5.5%, down from 5.7% previously, even with support from infrastructure stimulus.

A 5 bps cut in the one-year LPR will guide interest rates lower in bank loans and other financial assets, including local government special bonds which are used to fund infrastructure projects. This means that production costs and investment costs will be lowered slightly.

As the trade war is expected to continue for some time, this rate cut is clearly necessary.

Impact on the economy

A 5 bps cut in the LPR alone won't be enough to soothe the market or counter weak growth right now. This cut, together with last month's move, will be too small (in total 10 bps) to have an obvious impact on economic growth. But we shouldn't forget that the PBoC also cut reserve requirement ratios on 16 September, and there will be more targeted RRR cuts on 15 October and 15 November. Together, these should be able to suppress overall interest costs in the economy.

We want to emphasise the benefits of fiscal stimulus and monetary easing working together. This PBoC rate cut, along with RRR cuts and the issuance of local government special bonds to finance infrastructure projects, should create synergies, which may be magnified in the fourth quarter.

We expect another cut in October unless September data is very encouraging, which we think is unlikely. With more rate cuts, the Chinese economy should grow at 6% in 2019.

"Rate cut doesn't necessarily mean a weaker yuan"

Impact on the yuan

A rate cut doesn't necessarily mean a weaker yuan. There is very little arbitrage opportunity given that China's capital account is not fully open. Put simply, the theory that lower interest rates weaken the currency doesn't apply in China.

USD/CNY peaked at 7.1054 on Thursday then closed at 7.0965. After the rate cut today, the USD/CNY moved to 7.0903. That is, the yuan actually strengthened rather than weakened.

We expect a weaker yuan if the trade talks go poorly. Our USD/CNY forecast is 7.20 by the end of 2019.

MLF and LPR



Source: ING, Bloomberg

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Caution grows at Bank of England as Brexit risks linger

The Bank of England's language looks increasingly cautious, emphasising that the prospect of fresh tightening looks more distant. That said, the fact that policymakers are still flagging the faint possibility of rate hikes hints that the BoE will remain reluctant to follow the Fed and ECB towards easing in the near future



Source: iStockphoto

The Bank of England has unanimously voted to keep rates on hold but as has been the case for the past couple of meetings, there is an increasing air of caution creeping into the narrative.

The thing that really stands out to us in this latest statement is that the Bank appears to be getting more wary about the outlook for wage growth. Don't forget that this has been a key pillar of the Bank's hawkish rationale over the past couple of years, and came amid increased skills shortages in the jobs market.

But while policymakers continue to emphasise that pay growth has strengthened, they note that the labour market "does not appear to be tightening further". Importantly, policymakers note that "political events" could lead to another prolonged period of "entrenched" uncertainty – and this, in turn, could hurt prospects for inflation.

At the very least, this just signals that Brexit will likely continue to dash any thoughts of policy tightening over coming months.

Admittedly, the perceived risk of 'no deal' appears to have decreased over the past couple of weeks following Parliament's legislative efforts to force a further delay to the Brexit process. However, the path for the UK's EU exit remains considerably uncertain. In our opinion, the chances of a deal being agreed, then approved by the UK Parliament during October, remain relatively low.

An election, coupled with an Article 50 extension, still looks likely. This means that the risk of 'no deal' could easily come back to the fore again, depending on who is in government after voters go to the polls.

In short, while the Bank still notes that rates may need to rise if Brexit goes smoothly, the risks surrounding Brexit, as well as global growth, mean this tightening is increasingly unlikely to materialise.

Having said that, the fact that the BoE is maintaining a tightening bias at all, does hint that policymakers are – and will likely remain – reluctant to follow the Federal Reserve and European Central Bank in the direction of policy easing in the near future.

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Swiss National Bank: More flexibility for more monetary easing

The Swiss National Bank has not changed its key rate, still at -0.75%, but it has changed its tiering system to allow more flexibility in monetary policy in the future



Unchanged rate

As expected, the SNB decided to keep its main policy rate unchanged at -0.75%. The European Central Bank's decision to reduce its deposit rate to -0.5% had no influence on the SNB rate, even though SNB officials have previously emphasised the importance of the interest rate differential between Switzerland and the eurozone. The SNB's interest rate differential with the ECB's deposit facility rate is now 25 basis points, which seems sufficient for the SNB at present, especially because the spread on the three-month horizon has not changed much so far. The SNB has also stated that it's always ready to intervene in the foreign exchange market when it is deemed necessary. Even with the recent appreciation in trade-weighted terms, the Swiss franc is still considered 'highly valued' by the SNB rather than 'overvalued'.

Revising forecasts downward

The SNB revised its inflation forecasts (conditional on an unchanged policy rate) sharply downward. The forecast for the current year has fallen slightly to 0.4% from 0.6% in June. For 2020, the SNB now expects an inflation rate of 0.2%, compared to 0.7% previously. For 2021, projected inflation now stands at 0.6% from 1.1% before. This is very low and can be seen as a sign that the SNB does not expect a return to normal monetary policy over the forecast horizon. This is a very clear

message: don't expect a positive policy rate in the coming years.

New monetary policy tool

The big surprise of the day came from the SNB's revision of its tiering system for sight deposits subject to negative rates. Since the introduction of negative interest rates in 2015, the SNB has exempted a portion of deposits from negative interest rates. Until today, the exemption threshold for resident banks was set at 20 times the minimum reserve requirements. This system has been revised. From November 1, the exemption threshold can vary every month and will depend on the evolution of banks' balance sheets over time. For the first period, which will begin on 1 November, the SNB decided to set the exempted amount at 25 times the minimum reserve requirements.

The SNB writes "the adjustment raises the exemption threshold for the banking system and reduces negative interest income for the SNB". According to our calculations, under the old system, about 50% of excess liquidity was exempted from negative rates. During the first period of the new system, about 64% of excess liquidity would be exempted (based on June data). This amounts to about CHF 60 billion more sight deposits exempted from negative rates, which means a gain of about CHF 445 million for resident banks.

This decision is justified by the fact that the low interest rate environment will probably continue for a longer period than previously anticipated. This probably means that the SNB expects this low interest rate period to be very long, and that it must therefore find ways to reduce the unwanted effects of negative interest rates on the domestic banking system. In this "lower for longer" context, the SNB wanted to give itself more flexibility by modifying the tiering system. This new system is now itself a monetary policy instrument, just like interventions in the foreign exchange market and policy rate.

What's next?

After today's rather dovish decisions, we expect rates to remain at their current low level for a long time. We do not expect a rate hike in the next few years.

For the time being, we do not expect a rate cut either, unless a negative shock should occur. We believe that the SNB will continue to intervene in the foreign exchange market when it is deemed necessary. It will also use the exemption threshold, now subject to possible revision every month, as a monetary policy tool to influence money market conditions.

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Norges Bank hikes rates but signals prolonged pause

With domestic oil-related activity increasing rapidly, the Norwegian central bank has gone against the tide and hiked rates to 1.5%. But amid lingering global trade, Brexit and geopolitical/energy uncertainty, the central bank's tightening cycle looks like it has run its course for now



The Norges Bank has cemented its position as the clear outlier in the global central banking arena, having decided to hike interest rates for the third time in 2019 at today's meeting.

This wasn't totally unexpected, as most analysts considered this would have been a close call. Oil investment/activity has been a key factor behind the central bank's hawkish stance over recent months. The recovery in global oil prices has seen both energy services, as well as investment in equipment, increase - especially given that break-even production costs are considered to be quite a bit below current market pricing for oil, according to the central bank.

Norges Bank's new rate path (which is little-changed versus the June edition) signals that this year's tightening cycle has

probably run its course for now

The fact that the krone has been much weaker than policymakers had anticipated also appeared to tip the balance in favour of earlier action. Going into the meeting, NOK was around 3% weaker on a trade-weighted basis than the central bank had assumed for the third-quarter.

Importantly though, Norges Bank's new rate path (which is little-changed versus the June edition) signals that this year's tightening cycle has probably run its course for now. The bank's press statement points to a number of uncertainties - Brexit, trade wars and geopolitical tensions in the Middle East - as reasons for caution.

1.5% Norway deposit rate
(25bp hike)

Higher than expected

We, therefore, suspect that interest rates will remain at 1.5% in Norway for the rest of this year. However, our base case assumes that some form of [trade truce is struck in the first half of 2020](#) between the US and China. If this comes to fruition, and the UK avoids a 'no-deal' Brexit, then we think there is a reasonable chance that the Norges Bank hikes rates again next year.

While a lot will depend on the timing of these political developments, for now, we're pencilling in another rate hike for the second quarter of 2020.

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Spain: New elections in November

Pédro Sanchez, Spain's caretaker prime minister, had until 23 September to find a majority in parliament for his government. But last night it became clear that his efforts have failed. Spain will now go back to the polls



Source: Shutterstock

Spain's caretaker Prime Minister Pedro Sánchez arrives at the Spanish parliament in Madrid.

New elections

Early this week, King Felipe VI met with the main party leaders to see if Sánchez would have enough support to form a government. Late yesterday evening, the king decided he has not. This implies that there will be new elections on 10 November, the fourth time in four years.

The key conclusion we can draw from opinion polls is that the political landscape hasn't changed much since the April elections. So based on these poll results, the formation of a government after the November 2019 elections will not be any easier.

The PSOE remains the largest party but still falls short of an absolute majority. Admittedly, the PSOE's support has increased slightly over the last couple of weeks which implies a gain of a few seats. In the April elections, the PSOE won 123 of the 350 seats in the Chamber of Deputies. On the right, we see a drop in support for Ciudadanos and a corresponding increase for the Partido Popular.

Impact on markets

It seems that financial markets are not really worried at this point about these recent events as the Spanish-German bond spread has barely moved.

Even though the political situation is difficult, the economic landscape seems to have improved over the last couple of months based on recent survey data. The ESI, the economic confidence indicator of the European commission, increased sharply in August. The PMI for the manufacturing sector also increased in August and this was the second increase in a row, even though it remains under the critical 50 level. The composite PMI, however, remains above 50.

With 2.2% growth in 2019, we expect Spain to remain one of the fastest growing economies in the eurozone (expected growth of 1.1% this year) and the political turmoil is unlikely to change that.

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BIS FX Survey: No sign of de-dollarization just yet

The BIS has just released its triennial survey of FX turnover. The stand-outs include: a) The dollar has consolidated its position as the world's most liquid currency, b) the march of the renminbi has slowed c) emerging market FX pairs have seen some of the biggest increases in volumes, while GBP turnover has held up despite Brexit



Source: Shutterstock

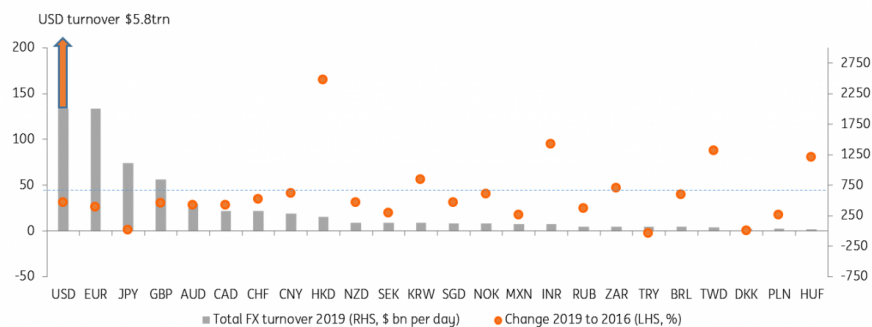
No signs of de-dollarization at a global level

The [latest triennial BIS FX turnover survey](#) was released last night and covers FX trading activity from April this year. There are no signs as yet that de-dollarization is taking hold on a global level. In other words, the dollar remains central to the world's exchange of trade and portfolio flows. The dollar retains its clear leadership status, still one side of 88% of all FX trades. Its nearest challenger remains the euro at 32%.

Despite fears that some of Washington's foreign policy could force trading partners away from using the dollar – especially the long reach of the US Treasury when it comes to sanctions – there are no signs that the dollar is losing its pre-eminent status on a global level. This bestows some benefits of seigniorage – or potentially lower borrowing costs as investors pay up for the privilege of investing in an asset backed by a liquid currency. [Though former Federal Reserve Chairman Ben](#)

[Bernanke does a good job](#) in a blog post of dismissing what seigniorage is really worth.

Dollar retains stand-out role as most liquid currency



Source: BIS, ING

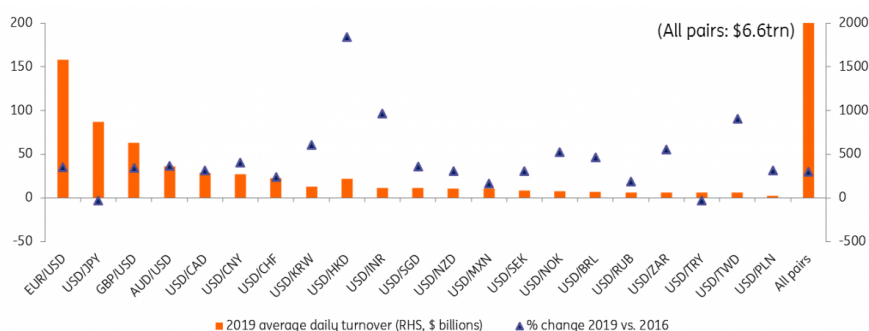
The march of the renminbi slows

Having joined the IMF's Special Drawing Right (SDR) in 2016, Chinese authorities might have hoped the renminbi would continue to climb up the rankings of the world's most traded currencies. CNY trading volumes have increased 40% since 2016, but the growth has not outstripped the aggregate trading volume increase sufficiently and the renminbi remains the eighth most liquid currency.

The difficulty in managing changes to the People's Bank of China fixing adjustment in summer 2016 and the authorities' reluctance to completely open the valves on the capital account (largely to prevent a disorderly renminbi decline) will no doubt have played a role here. Yet the PBOC's use of CNY swap lines to encourage trade in renminbi (over 30 countries now have CNY swap agreements with the PBOC) and China's increasing inclusion into benchmark equity and bond indices suggest that the renminbi will play an ever-large role in global FX markets.

That said, it is notable that the single biggest increase in trading volumes over the last three years has been the Hong Kong dollar (volumes up 165%) suggesting that renminbi volumes will increase when capital account restrictions are loosened further.

Big pick-up in USD/Asia FX pairs



Source: BIS, ING

Key changes in trading volumes

The other key story is the relative change in trading volumes. Only two dollar/FX pairs have seen a

decline in FX turnover since 2016 – these were USD/JPY and USD/TRY. The lack of volatility probably explains the former and domestic challenges through 2018/19 the latter. Despite the overall decline in the Japanese yen, the survey did pick out the big increase in JPY/TRY, JPY/BRL and JPY/ZAR cross trading – suggesting that Japanese retail margin trading of high yield FX is alive and well and partly explaining some of the big moves in the Turkish lira and South African rand seen in early Asian trading hours.

Currencies enjoying an above average (30%+) increase in turnover were the Indian rupee (INR), Taiwan dollar (TWD), Hungarian forint (HUF), Korean won (KRW), and South African rand (ZAR). Turnover in EUR/HUF doubled between 2016 and 2019 while EUR/PLN turnover was flat. We also note that GBP trading volumes increased largely in line with peers – suggesting no damage to liquidity from Brexit, whilst EUR/CHF turnover bounced back from the Swiss National Bank's floor exit debacle in 2015.

One final point, in terms of FX product lines, outright forwards (+43%) saw the biggest increase led by strong activity in KRW, INR and BRL non-deliverable forwards.

There are no signs of de-dollarization just yet, but the growth in HKD trading volumes suggests the renminbi's march to reserve status has just slowed rather than stalled.

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Dutch delivering on Draghi's demands?

ECB President Mario Draghi called upon governments with fiscal space, most notably Germany and the Netherlands, to fiscally “act in an effective and timely manner” and urged all eurozone members to “achieve a more growth-friendly composition of public finances”. Did the Dutch government deliver in its 2020 budget?



Source: Shutterstock

Disapproval toward Frankfurt's policies

During last week's Governing Council press conference, [Mario Draghi left the ECB with a big monetary bang](#). In the Netherlands, this was received as controversial. In anticipation of this big bang, the majority of the Dutch House of Representatives signalled its disapproval of further monetary stimulus, and even went so far as to send a formal letter to the ECB. Fearing the negative effect of an even lower interest rate on the coverage ratio of Dutch pension funds, it shared its concerns about the tiering of the deposit rates; providing comfort to banks without equally comforting funded pensions didn't seem right to Dutch parliamentarians.

All the same Draghi called for Dutch fiscal expansion

Additionally, the Dutch member on the Governing Council of the European Central Bank, Klaas Knot, [commented that “\[t\]his broad package of measures, in particular restarting the APP \(Asset Purchase Programme\), is disproportionate to the present economic conditions”](#). Knot also voiced concerns about the effectiveness of the measures. The ECB president nevertheless responded that

it is a good time for the Dutch government to activate a supposed 50 billion euros investment programme. Despite domestic annoyance towards further expansionary monetary policy, did the Dutch government deliver on Draghi's wishes in its 2020 budget?

No big bang for Draghi's goodbye

The Dutch government presented its budget for 2020 on 17 September and King Willem-Alexander delivered his thrones speech. While the thrones speech emphasised the EU as a cornerstone of Dutch foreign policy, the Dutch did not give Draghi a mind-blowing farewell present. The budget contained no concrete proposals for an investment fund and certainly no €50 billion (which would have been the equivalent of 6% of Dutch GDP) boost to investment.

A small farewell present nevertheless

What the new budget did bring was a small present in the shape of a mildly more expansionary fiscal stance. The medium-term coalition agreement already had expansionary aims. The previous forecasts had foreseen fiscal stimulus of 0.3% GDP, but with the new policy initiatives, the Dutch will be delivering even more in 2020. With the structural budget balance deteriorating from a positive 0.3% GDP in 2019 to -0.4% GDP in 2020, the fiscal discretionary fiscal expansion amounts to 0.7% GDP (€6 billion).

[Highlights from the 2017 Dutch coalition agreement](#)

More tax relief for households, less for corporates in 2020

Most of the fiscal expansion is due to the reduction in labour income taxation, aimed at boosting the purchasing power of households. This was already part of the medium-term plans for the year 2021, which the government is now carrying forward to 2020. Apart from the deterioration of the government budget balance, this will mainly be financed by higher energy taxes from businesses and a delay in the lowering of corporate tax rates. Where the government initially intended to lower total taxes on households by €1.5 billion in 2020 and by €1.9 billion for businesses, the new budget includes €4.4 billion of tax relief for households and only €0.2 billion relief for businesses.

The new budget for 2020 includes €4.4 billion of tax relief for households and only €0.2 billion relief for businesses.

Upset by the perceived "low" wage growth delivered by businesses so far, the government deliberately shifted some money from businesses to households and added relief to households on top. This is in line with the more critical attitude towards businesses of late. This, however, does not mean a serious deterioration of the business and investment climate of the Netherlands: corporate tax rate cuts, which were initially announced in the coalition agreement for 2020 will be still be delivered in 2021.

[Dutch Economy Chart Book, with graphs on Dutch public finances](#)

More humble investment fund on its way

Furthermore, Draghi's hopes for an investment fund were not entirely in vain. The budget memorandum promised to deliver a report to Parliament at the start of 2020 about the possibilities of such a fund, while Minister of Finance Wopke Hoekstra emphasised that the fund is not a matter of "yes or no" but rather of "how and when". The government referred to the low-interest rate and low productivity growth as reasons for a fund aimed at strengthening the growth potential of the Dutch economy in 20 to 30 years. However, it is unclear what the size of the investment fund would be. For now, the Minister of Finance is signalling that the fund could be worth "several tens of billions", not necessarily reaching the level of €50 billion as mentioned earlier. And the minister stressed that the funds wouldn't get all the money in one go, but rather gradually, when a flow of viable projects have been identified.

Signs of serious intentions

While we have to wait for the details of the fund, in the meantime the Minister of Economic Affairs & Climate will deliver a letter to parliament with a more general "agenda for growth" by the end of 2019, with options for policies (both financial and non-financial) that may boost potential growth, including options for boosting public as well as private investment. This shows that the intention to boost the country's growth potential are real and ideas for concrete investment projects may already be in the making.

One small step for Europe, one giant leap for the Netherlands

What does this all mean? The worsening of the structural budget balance next year and plans for a humble investment fund may seem like a small step, but it's a giant leap for the Dutch.

In order to provide the additional tax relief, the Dutch government had to violate its own long-standing national fiscal rules that dictate medium-term spending limits. Such violations are very uncommon. This comes on top of the fact that the current government had already started its reign with looser fiscal rules than its numerous austerity-minded predecessors, by excluding a number of cyclical components outside its medium-term spending ceiling that allows for more Keynesian automatic stabilisation.

We believe it's fair to say that the Netherlands is doing more of what Draghi and others like him are asking for. A well-designed investment fund would enhance prospects for the business climate in the Netherlands, which might be a reasonable attempt to combat low productivity growth observed across the OECD. And so it appears that the Netherlands remains an important European partner in the quest for economic growth.

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Germany: Green stimulus to the rescue?

This week will show whether Germany can actually do fiscal stimulus



Source: Shutterstock

Germany, Green vineyards above Stuttgart city

Over to you, Berlin. Next to the monetary stimulus 'big bang' and Mario Draghi's new 'as long as it takes' proclamation, this was the main message of last week's European Central Bank meeting. The call for fiscal stimulus has never been louder. And this week will show whether the eurozone country with the deepest pockets finally plans to empty them.

Black zero forever

Fiscal stimulus in Germany? No way. This has been a common reaction by many commentators and financial market participants over the last few years. The so-called debt-brake, an almost obsessive focus on fiscal surpluses, and frequent denial of the need for any public investment programme have led to many frustrations and disappointments. However, since the start of the year, the mood in Germany has gradually changed. It started with more conservative economists, who suggested changes to the constitutional debt brake to make room for investments, then reached mainstream media outlets and finally even politicians in Berlin have started to contemplate some fiscal stimulus (though no members of the government). The recent downswing of the economy has also clearly played an important role in this development.

Unfortunately, when German finance minister Olaf Scholz presented the federal budget last week, hopes for fiscal stimulus were indeed undermined once again. Remember that the federal budget is not the total budget used in fiscal surveillance under the Stability Pact. However, Scholz's budget

plans clearly lacked ambition. The government is sticking to its plan of a balanced budget until 2023. The so-called 'black zero' stands. Public investment is projected to increase by a meagre EUR0.9 billion next year and stay constant thereafter.

Green stimulus to the rescue

However, before giving up on the possibility of German fiscal stimulus, be aware that these budget plans completely exclude possible costs from the government's grand strategy to tackle climate change. This strategy is supposed to see the light on Friday, 20 September. According to a report in the German newspaper *"Welt am Sonntag"*, the government is looking for a EUR40bn package until 2023. This package could include higher subsidies for electric cars, subsidies for climate-friendly real estate renovations and investments in rail. Whether or not the package will also include a CO2 tax remains unclear.

Given comments over recent days, the financing of such a climate package could be done 'off-budget' or through some so-called Special Purpose Vehicles. Even the option of special green government bonds has been mentioned. The advantage of these financing methods is that they wouldn't collide with the constitutional debt brake and would 'only' be subject to European fiscal surveillance under the Stability Pact.

This is not the place to assess the German government's strategy to tackle climate change. Needless to say that any such strategy should be all-encompassing and preferably coordinated at the European level. However, just looking at it from a eurozone growth perspective, Friday 20 September could finally show that Germans can do fiscal stimulus. Green stimulus. It would not be enough to stop the current slide of the economy towards recessionary territory, but it could be an important cornerstone in Germany's recovery and its quest for a new economic model.

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