In case you missed it: Crunch time

The global landscape is looking murky. Further trade tensions this week prompted yet another downgrade to our Chinese yuan forecast, EU leaders are in "extend and pretend" mode and could Brexit lead to another 'Minsky Moment'? Plus, we look at four scenarios that could drive the EUR/USD in the coming year

In this bundle

FX

G10 Week Ahead: It ain't looking pretty

The landscape for FX markets is set to remain murky this summer with four key themes dominating - trade wars, European politics, how the Fed, the ECB - as...

By Chris Turner

United States

US inflation starting to climb

The 'Big 4' inflation measures that the Federal Reserve follows are all at or above the 2% target. With the economy set to grow by around 4% in...

By James Knightley

Sweden

Riksbank preview: Still waiting for Godot

We expect the Swedish central bank to keep the monetary policy stance unchanged at its July meeting. That may provide some short-term support for the...

ING International Survey | Mobile banking

Cracking the code on cryptocurrency

The ING International Survey Mobile Banking 2018 asked nearly 15,000 people across Europe, the USA and Australia what they think of the cryptocurrency...

Article | 29 June 2018 China

Why we're revising our yuan forecast down again

We are revising our USD/CNY forecast to 7.0 by the end of 2018. But there's no panic in the market and we don't expect a repeat of August 2015

Policies could attract foreign investments, reduce outflow worries

Our previous argument for a slight yuan depreciation was based on the concern that a weaker yuan could lead to massive capital outflows, which would then push the yuan down even further, resulting in a vicious cycle.

But new policies to open up the market for foreign investments reduce the risk of outflows. These policies could also help to offset any outflows that do occur as a result of the weaker yuan.

New policies cover a whole range of sectors including agriculture, rare earth, automobiles, shipbuilding, aviation, railway, shipping services, surveying and financial services. The scope is not only larger than expected, it targets sectors affected by tariffs. Foreign companies facing tariff risks could move production to China to avoid tariff hurdles.

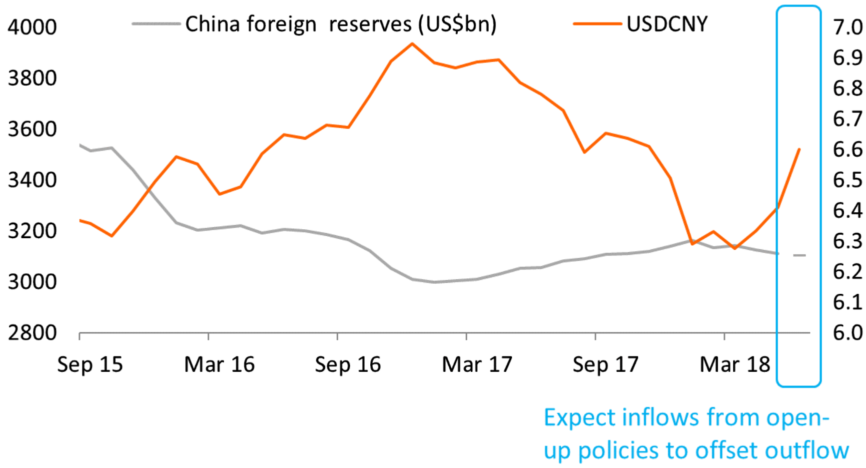
These measures, together with potential inflows from more A-share inclusion into MSCI and China Depository Receipts (CDR) in 2H18, have led us to reassess our outlook for capital outflows. We were overly pessimistic.

Limiting offshore dollar bond issuance signals further yuan weakening

It is reported in the media that China is going to restrict offshore dollar bond issuance to no less than 365 days. The objective is to reduce repayment risks as the yuan weakens against the dollar over 12 months' time.

We see this as a signal that the central government is increasingly prepared for a weaker yuan.

Foreign reserves may fall only mildly even as yuan depreciation speeds up



Source: ING, Bloomberg

Reintroducing counter-cyclical factor only if market panics

The central bank may reintroduce the counter-cyclical factor in the currency's fixing formula only if onshore and offshore yuan intraday activities signal panic in the market. The counter-cyclical factor would limit the volatility of the yuan at the start of the day. After the reintroduction of the counter-cyclical factor, intervention via the derivative market or the spot market would be likely to avoid further yuan depreciation.

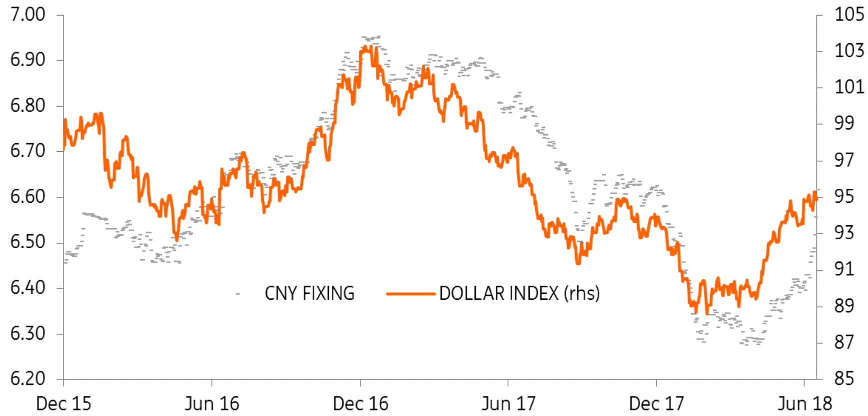
The yuan is the only a shield in a trade war

Yuan depreciation can't be described as a weapon in a US-led trade war, even if the currency were to fall by more than 7% per year.

Tariffs of 10% to 25% on $450 billion of Chinese goods have a larger impact than just the tariff amount itself. They would reduce trade flows overall. Exporters wouldn't just see a 'mere' 10% to 25% reduction in profit margins, they could miss an entire export order.

A weaker currency would, at most, be a shield, safeguarding wider damage from a trade war and the hurdles faced by Chinese companies' operating in US.

Yuan fixing and dollar index



Source: ING, Bloomberg

Forecasting USD/CNY at 7.0

We are revising our USD/CNY forecast from 6.60 to 7.0 by the end of 2018, which is near a historical high since reform. The central bank's attempt to liberalise the yuan on 11 August 2015 drove USD/CNY to 6.9649 in 4Q 2016.

We think that this time USD/CNY at 7.0 won't create panic:

- 11 August 2015 was a crisis caused by the central bank. Today's depreciation is market-driven, reflecting the risks of a trade war. This implies that the central bank is allowing market forces to dictate the speed of the depreciation when there is room to do so.
- Since the escalation of a trade war and announced investment hurdles, China has allowed the yuan to weaken against the dollar, even when the dollar index itself has weakened. This confirms our view that yuan weakness reflects trade war risks.
- We hesitate to predict that the USD/CNY will surpass 7.0 because that could lead to market panic.

Article | 29 June 2018

Eurozone: And it does move

In another nightlong meeting, European leaders agreed on an initial deal to shake up immigration rules. The meeting was clearly too energy-consuming to...

When European leaders negotiate for an entire night and present their results just before sunrise, you know that negotiations were tough but that something substantial was concluded. It was clear that these negotiations had to deliver some results. Going home empty-handed would not have been an option for Italian prime minister Giuseppe Conte and could have marked the last European Summit ever for German Chancellor Angela Merkel. Consequently, European leaders agreed on some interesting measures to tackle the flow of migrants into the European Union and to shake up existing rules.

Saving Merkel

European leaders agreed to step up border security, set up holding centres to handle asylum seekers (on a voluntary basis) but also to set up centres in Africa to stop migrant smugglers, and to speed up the process of determining whether people have the right to asylum and expelling those who don't. Leaders also agreed to overhaul the rules for distributing migrants. The current Dublin agreement should be changed and improved in the next six months under the Austrian EU presidency.

Even though this outcome still leaves room for interpretation, it's a major step towards change. It also allows Italy's Conte to return to Rome and present his first success on the European stage. Probably even more important, the agreement will make it extremely hard for the Bavarian CSU to continue its kamikaze strategy in Berlin. Merkel delivers what she promised: (first steps towards) a European solution for the migrant crisis combined with stricter border control and a general shift towards a stricter stance on refugees. It's hard to believe that the CSU will want to go down in the history books as the regicide. This is especially true in a situation where, according to the latest opinion polls, there is broad support in the German population for Merkel as chancellor. The CSU will meet on Sunday to discuss the latest developments and to decide whether the minister of interior affairs, Horst Seehofer, will proceed with his intention to stop asylum seekers, registered already in other EU countries, at the German border.

Little progress on eurozone reforms

Initially, this week's summit of European leaders was supposed to deliver big breakthroughs for further eurozone reforms. With political developments in Germany, it had become obvious that eurozone reforms would be pushed onto the backburner, with migrants being the most prominent issue.

The outcome of the talks on eurozone reforms, however, suggests that the nightlong negotiations on migrants were clearly too energy-consuming for European leaders to engage in longer discussions on reforms within the bloc. Instead, leaders only delivered the bare minimum: an agreement on using the European Stability Mechanism as a financial backstop for bank resolutions. The firepower of the Single Resolution Fund will be doubled by this move. For the rest, leaders didn't break the deadlock, which was already present after the last meeting of eurozone finance ministers. There was no agreement on anything else. All other decisions were postponed to (at least) the December summit. Extend and pretend….

The Eurocratic language in the official statement highlights this “extend and pretend” strategy. Phrases like “work should start on a roadmap for beginning political negotiations on the European Deposit Insurance Scheme” or “agree on a term sheet for the further development of the ESM by December 2018” or “Eurogroup will further discuss all the items” simply show that there is hardly any agreement on anything.

There was no mention of a eurozone budget or budget line within the EU's budget. No mention of a stronger ESM. To be honest, given that European leaders clearly had other things on their minds, this is not necessarily bad news. Given that Eurogroup president Mario Centeno had laid out a broad range of topics, mainly reflected in the Franco-German Merseburg position, the next few months and subsequent Eurogroup meetings will show whether any breakthrough can be achieved. Nevertheless, today's disappointing outcome does not bode well for these future talks. It also shows that European leaders currently don't consider eurozone reform to be a topic which wins elections or votes. Simply too technical. Too long-term. Potentially too costly. Perhaps someone should warn them that by delaying, they risk another nightlong European summit, this time on how to rescue the eurozone. And that would definitely be costlier.

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Article | 29 June 2018 **FX**

EUR/USD: What's next for euro-dollar?

Here are four potential EUR/USD paths as we try to cut through the global markets' gloom. Click here to download our fuller PDF report

Our scenario analysis: Click on the image to enlarge

The landscape for global markets is pretty murky but here are four potential EUR/USD paths

Four themes for EUR/USD over the next 12 months

Scenario (progressively more bearish for EUR/USD)	Trade wars & protectionism	Political climate in Europe	Relative ECB-Fed policy outlook	Relative EZ-US growth outlook	EUR/USD outlook (End of period forecast) 4Q18	2Q19	4Q19
1 **Euro's Elysian Rally** Reduction in external risks invigorates solid Eurozone cyclical economic forces	**Tariff ceasefire** White House takes a step back from its protectionist bias	**'Merkron' revival** Fresh reform drive in Europe & stable Italian government	**Hawkish ECB** Early summer 2019 ECB hike risks; Fed hiking cycle priced	**Rotation into EZ** Overseas investors see value in Europe as growth recovers	1.28	1.35	1.40
2 **Steady Euro Rebound** (ING house view) Euro sees right through Trump's tariff bluffs & re-couples with solid economy	**Dangling threats** Risk of auto tariffs & investment curbs but no escalation	**Political stability** Merkel resolves CSU issues; Italy also given concessions	**Slow and steady** ECB still ends QE in 2018 and short-end EUR rates rise	**Stable outlook** Eurozone equity outflows abate as activity stabilises	1.23	1.30	1.35
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4 **Negative EU Shocks** Euro dumped as Trump targets EU car sector while EZ politics is in disarray	**US protects cars** US puts tariffs on car imports but no RoW retaliation	**A lost EU cause** Merkel leaves, EU left leaderless; Italy issues mini-BoTs	**Hawkish Fed** Upside risks to USD rates; ECB hike bets pushed out to 2020	**'Sell Eurozone'** Eurozone equities sold (local risks); US assets outperform	1.05	1.05	1.10

Source: ING estimates

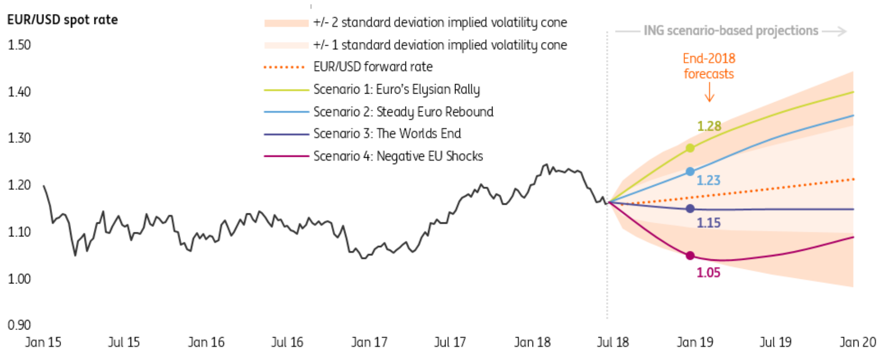
EUR/USD has confounded consensus expectations this year, hit by both intermittent episodes of

USD strength and EUR weakness. Of the many factors that will drive EUR/USD over the next 12-18 months, four stand out:

1. Trade wars
2. European politics
3. The relative ECB/Fed policy outlook
4. The relative EZ-US growth (and equity) prospects.

This is taken from our more comprehensive report, which you can download here

EUR/USD decline since mid-April has been in large part driven by a rising risk premium



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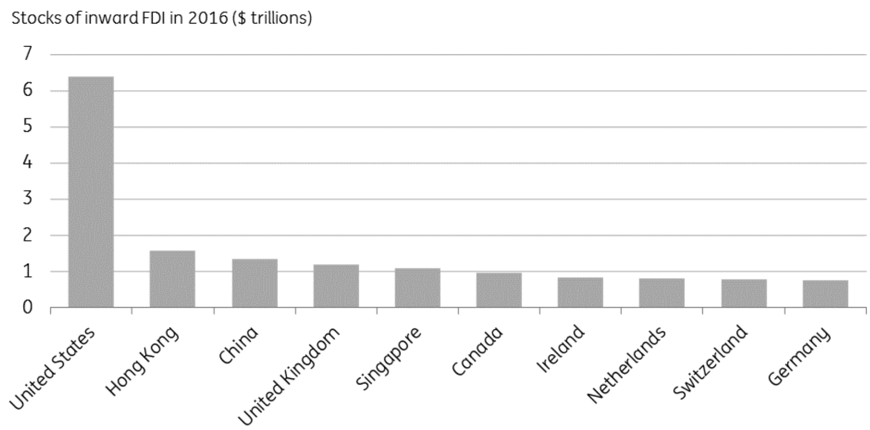
Article | 29 June 2018 United Kingdom

Turning tide? The Brexit threat to UK foreign direct investment

Businesses urgently need clarity, and a change of tack, from the UK government as they decide on current and future investments in the UK

The Brexit threat

In 2016, the UK had accumulated the fourth largest stock of inward foreign direct investment (FDI) in the world, and the largest among EU countries (Chart 1). Several factors have contributed to the UK's success in attracting investment, including the size and relative wealth of its domestic market, a flexible and skilled workforce, relatively low taxation, supportive government policies, and an entrepreneurial culture.



Source: UNCTAD

The finance, insurance and manufacturing industries have the largest stocks of foreign direct investment in the UK, and EU membership is of obvious importance to these industries. Firms located in London are able to benefit from networks of complementary functions situated in the City while exporting financial services across the EU thanks to 'passporting' rights. In manufacturing, frictionless trade underpins complex supply chains that allow firms to specialise. With each representing more than a quarter of the foreign-held UK assets, a significant amount of the UK capital stock is vulnerable to a deal which causes manufacturers and financial services to pack their bags.

The negotiations between the EU and UK have offered firms and investors little reassurance that these benefits will be preserved in the future relationship. Over the last week, there have been appeals to the UK government to urgently provide more clarity. Appeals from firms with complex supply chains, such as Airbus, BMW and Jaguar Landrover, have made it clear that their investments in the UK – and hundreds of thousands of jobs – are potentially under threat from the lack of progress in the negotiations.

Crunch point

A post-Brexit UK, we believe, belongs in the EU customs union and VAT area, and adheres to single market regulation for industrial goods. There is no doubt that this will be challenging to negotiate. However, it's the most realistic way of avoiding a hard border between Ireland and Northern Ireland, or in the Irish Sea. There are other benefits for both sides: the UK could keep its manufacturing industry, and both parties could avoid higher costs of trade in goods (in which the EU has a surplus).

Until now, the UK government has favoured leaving the customs union and the single market, and using technological solutions to minimise the resulting trade frictions. However, even a few minutes' delay to lorries' transit would see the roads to Dover and other ports, on both sides of the English Channel, blocked with queues. There is also the question of when the blow will fall, due to the need to develop and test the technology. Estimates of the time needed suggest at least five years would be needed, making the 20-month transition period inadequate, another source of uncertainty for firms.

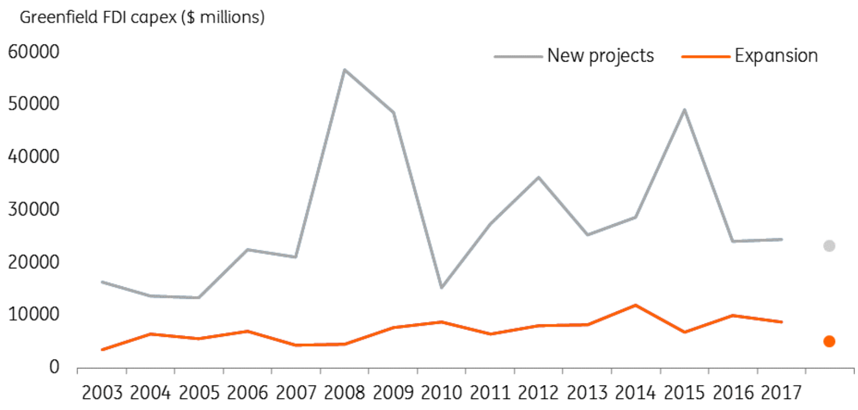
A post-Brexit UK could do little to counter the downsides for UK manufacturing from a rise in trade frictions (less regulation, for example, would be a barrier to trade with the EU and other countries, too). The threat of no deal is still hanging over the negotiations, and could yet happen if the UK government cannot find a position to unify it. Manufacturers have seemingly reached a crunch point in their decisions. Their plea to government is not just to avoid a no deal outcome, but to change course in the negotiations.

While forcing the government's hand in this way may bring some relief for UK manufacturing, it will do nothing for the City. As an issue belonging to the future relationship between the EU and UK, trade in financial services has not yet been dealt with in detail by the negotiators. A temporary permissions regime should come into play in the event of no deal. However, firms are eyeing the prospect of greater trade frictions and – unlike with manufacturing – the lack of a compelling incentive for the EU to minimise these in the negotiations. The direction of travel for new investment, and for future jobs, is toward Frankfurt and Paris.

Odds and indicators

With betting odds suggesting "no deal" is a 50:50 call, the need to manage supply chains differently and make preparations for disruption is showing up in rental yields on storage units, which are at levels more often associated with prime real estate. Uncertainty about the UK's future relationship with the EU has already affected business investment within the UK, causing it to drag on growth. But foreign direct investment appears to have held up so far.

As the Bank of England noted on Wednesday in its Financial Stability Report, in 2016-17 there were substantial inward flows of direct investment (as well as other types of investment) into the UK, supported by the risk appetite in global markets. The latest data show a net inflow of direct investment in 1Q 2018 after outflows had consistently exceeded inflows in 2017 (causing the four-quarter sum of net FDI to turn negative in Chart 3). UK greenfield projects have continued to attract FDI. The total value of capital expenditure normally fluctuates from year to year, and during 2016-17 it has been in line with the post-crisis average, though lower than in recent years. Investment in the first half of 2018 points to some slowing in expenditure on project expansions (Chart 2).



Source: fDi Markets, ING calculations

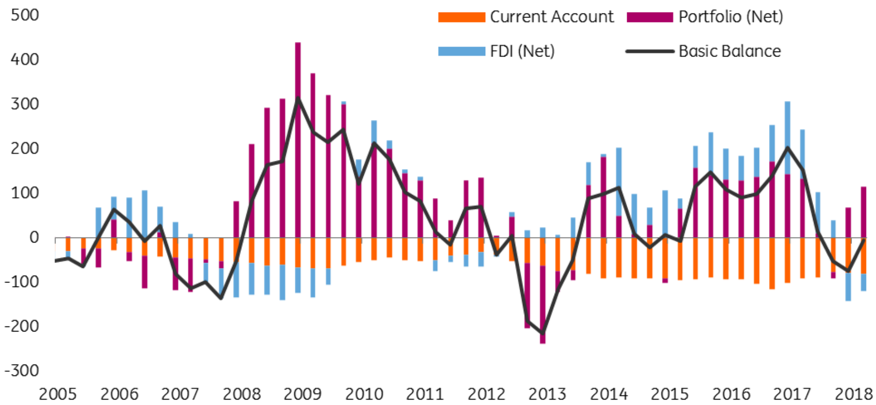
Bank Rate and Sterling

At the moment financial markets are pricing in a 60% chance of an August interest rate rise from the Bank of England and this is our call too, but we see little to justify further significant policy tightening. The UK growth story is subdued and inflation could slow more quickly than the BoE anticipates given the peak of the inflationary impulse from sterling's Brexit-related plunge has passed, and pay pressures remain muted.

However, should a future UK-EU trade deal generate significant trade frictions the risks to interest rates will be increasingly skewed to the downside. If FDI starts to leave the UK then jobs will be lost and unemployment will climb. The long-anticipated pick-up in wages won't happen and there will be a shortfall in tax receipts, pushing up government borrowing levels. In such a negative scenario we could, in fact, see the Bank reverse its course on interest rate moves, compounding the downside risks for sterling.

The post-Brexit outlook for UK FDI is pivotal for sterling – especially if one views the pound's external dynamics through the prism of the UK's basic balance. We've previously noted that evidence of a broad 'sell UK assets' theme in global markets has been limited since the Brexit referendum – and in the absence of a material breakdown in UK talks with the EU, we expect this to remain the case.

UK basic balance (£ billions, 4Q sum)



Source: ONS

But a 'Minsky Moment' for UK assets is a tail risk for GBP. In particular, if the prospects of a no deal Brexit resurface, then one could see both portfolio and FDI flows reversing – which would see all three factors in the basic balance pointing downwards (Chart 3). Sterling's sharp post-Brexit decline implies that financial markets have partly adjusted to such a scenario, but we could well see sustained pressure on the currency over a period of time. Put alternatively, sterling is cheap – but cheap for good reason, and unfavourable external dynamics will keep the pound structurally weaker for longer.

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Source: ING estimates

EUR: All over the shop right now

	Spot	Week ahead bias	Range next week	1 month target
EUR/USD	1.1700	Neutral	1.1510 - 1.1780	1.1700

- EUR/USD is tentatively holding psychological support at 1.15, brought back from the brink by speculation that the EU summit can produce a migration deal to appease Merkel’s coalition partners and the new Italian government. At the time of writing encouraging signs are emerging, and the EUR could derive if a little more support if the Christian Social Union party do indeed step back from an open confrontation with the German Christian Democrats. A quiet week for Eurozone data could help EUR consolidation.
- However, EUR/USD will have to face another onslaught of dollar positive macro news. ISM business confidence surveys look set to stay near cycle highs, and Friday’s US jobs release could see the unemployment rate at a new cycle low and wages staying firm near 2.8% year on year. Signs that the US economy is so far immune to Trump’s protectionism warns that the EUR/USD downside certainly remains vulnerable.

JPY: Notable shift in sentiment

	Spot	Week ahead bias	Range next week	1 month target
USD/JPY	110.60	Neutral	109.50 - 111.10	110.00

- There's been a noticeable change in USD/JPY sentiment, where it looks like the Japanese yen is getting caught up in the Asian FX sell-off. Depending on where People's Bank of China (PBoC) fix USD/CNY in the week ahead and whether it starts to build the notion of a managed devaluation in Asian currencies, USD/JPY could be pressing some significant resistance just above the 111.00 area.
- A break-out is certainly a risk, especially were US jobs data to see US yields spike higher and emphasise the diverging nature of the US macro/policy differential with the rest of the world. The ability of US equities to hold up in the face of protectionism is going to be key going forward. USD/JPY traded steadily higher during the Asian crisis until US equities were finally caught in the cross-fire.

GBP: Caught in a positive BoE and negative Brexit trap

	Spot	Week ahead bias	Range next week	1 month target
GBP/USD	1.3160	Neutral	1.3050 - 1.3300	1.3300

- GBP remains caught between a bullish Bank of England and a bearish Brexit trap - with the latter currently winning out as the UK government still tries to formulate its Brexit strategy. Trying to second-guess is proving to be futile - and we've outlined various potential sterling paths here: GBP: Theresa May's Impossible Brexit Trinity. The currency is looking quite vulnerable around some key levels - in particular, EUR/GBP posting a topside breakout after a trading a narrow range could see a follow-through to 0.90 if the Brexit newsflow turn sour for the pound.
- But aside from Brexit, the short-term forces for GBP have been pretty constructive; the Bank of England looks increasingly ready to hike rates in August should (a) domestic data hold up and (b) Brexit negotiations don't unravel such that the odds of a cliff-edge exit from the EU are high. On the former, the positive revision to 1Q UK GDP was a welcome relief - and given that relative growth differentials have been driving currencies in 2018, this story is mildly positive for GBP, but the outlook is still fragile. However, there will be a keen focus on UK PMI readings in the week ahead starting with manufacturing on Monday. Governor Carney will also be speaking on Thursday. Our base case remains that GBP/USD holds 1.30 - and that the direction of travel is towards 1.40.

AUD: Could the RBA turn dovish like the RBNZ this week?

	Spot	Week ahead bias	Range next week	1 month target
AUD/USD	0.7380	Neutral	0.7250 - 0.7460	0.7200

- The Reserve Bank of Australia are meeting next week on Tuesday and may get that extra bit of attention after both the Reserve Bank of New Zealand - and arguably the Bank of Canada - took a dovish turn over the past week. The escalating trade war between the US and China doesn't bode well for an Australian economy that is still somewhat synchronised to economic and trade developments in Asia. Moreover, AUD's high-beta nature means that it is vulnerable to any sharp sell-off in the stock markets.
- Away from the RBA, the week ahead sees PMI, trade and retail sales data, all due on Wednesday - although domestic data likely to play second-fiddle in the current environment. AUD/USD looks to be in a bearish channel since the start of the year; a breach of the 0.7300 level could open the floodgates towards 0.70.

NZD: Taken out by fragile global markets and a dovish central bank

	Spot	Week ahead bias	Range next week	1 month target
NZD/USD	0.6750	Neutral	0.6700 - 0.6900	0.6900

- NZD/USD fell to a two-year low after the RBNZ's latest statement was judged to have had a dovish spin to it. The central bank noted that there was 'marginally more spare capacity in the economy than anticipated' after the latest weak NZ GDP readings - which suggests that policy could remain steady for the foreseeable future. Indeed, the RBNZ's prior mantra that a 'rate cut is equally as likely as a hike' lends itself to a pretty flat NZD OIS curve.
- However, given that there's now little room for markets to further re-price the RBNZ story, the kiwi will be a function of external global market dynamics. It's likely now that NZD/USD consolidates below 0.70 for the summer until trade war risks abate.

CAD: Poloz gets cryptic over a July rate hike

	Spot	Week ahead bias	Range next week	1 month target
USD/CAD	1.3240	Neutral	1.3120 - 1.3300	1.3000

- While Bank of Canada's Governor Poloz noted the 'big picture' economic outlook warranted further policy tightening this week, he pretty much left markets guessing whether the Bank would raise rates at their next scheduled meeting on 11 July. Judging by the sharp swings in USD/CAD, investors weren't overly convinced that there was a clear hawkish message from the BoC chief - although the CAD has since drifted higher, with the probability of a July hike now at 70%.
- Before the July BoC meeting, the week ahead sees the latest Canadian jobs report, trade balance figures and Ivey PMI reading, all due on Friday. While the jobs figures have been inconsistent of late, Canadian wage growth has been on a tear (the latest reading at 3.9% YoY outstripping the US average hourly earnings equivalent). Should this remain elevated, then we'd expect a July rate hike to be a pretty close call - but going right down to the wire depending on how US trade policy and markets evolve over the coming weeks.

SEK: Negative view remains intact

	Spot	Week ahead bias	Range next week	1 month target
EUR/SEK	10.4550	Mildly Bullish	10.3560 - 10.5480	10.5000

- The Riksbank policy meeting on Tuesday is likely to be a non-event. Having revised its rate forecast downwards in April, and with the outlook broadly unchanged there is little reason for the Swedish central bank to change its stance at this point. SEK may get some modest support as unchanged forecast will still point to a hike in 4Q18 – which we see as unlikely, but such support should be very short-lived.
- With the Riksbank to eventually by and large mirroring the ECB (hence a hike this year is unlikely) and the external environment being negative for SEK (which is a low liquidity currency of an open economy that is vulnerable to trade wars), we retain our highly non-consensus bullish EUR/SEK view, targeting 10.50 in coming weeks and 11.00 by the year-end.

CHF: Trading a tight range

	Spot	Week ahead bias	Range next week	1 month target
EUR/CHF	1.1600	Neutral	1.1500 - 1.1600	1.1600

- EUR/CHF has found some support under 1.1500, and we suspect the Swiss National Bank may be taking an interest here. CHF sight deposits are on the rise suggesting that FX intervention is on-going. Should European politics experience some warm after-glow after the EU summit, EUR/CHF could be carried towards the 1.16 area – given this year's strong correlation with European politics.
- Locally the focus will be on Swiss PMI and then the June inflation data on Thursday. The latter is now expected to creep up towards the 1.1% YoY area. However, in the June policy update, the SNB revised the near term inflation profile higher on oil but cut the 2020 inflation outlook based on activity. Thus the market should be prepared for higher inflation over coming months.

NOK: More outperformance vs SEK

	Spot	Week ahead bias	Range next week	1 month target
EUR/NOK	9.5150	Mildly Bullish	9.4440 - 9.5810	9.4000

- Like most other higher beta commodity currencies NOK has been feeling the heat of the escalating trade wars, with EUR/NOK breaking above the 9.5000 level (after briefly trading through the 9.40 level in the prior weeks).
- On the data front, we look for Norway's June manufacturing PMI due Monday to modestly increase. Coupled with oil prices remaining at elevated levels, this should provide some modest upside to NOK and partly (yet not fully) ease the effect of the external environment. In the relative value space, we continue to prefer NOK to SEK and look for the cross to persistently move above the NOK/SEK 1.1000 level in coming months.

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The 'Big 4' inflation measures that the Federal Reserve follows are all at or above the 2% target. With the economy set to grow by around 4% in...

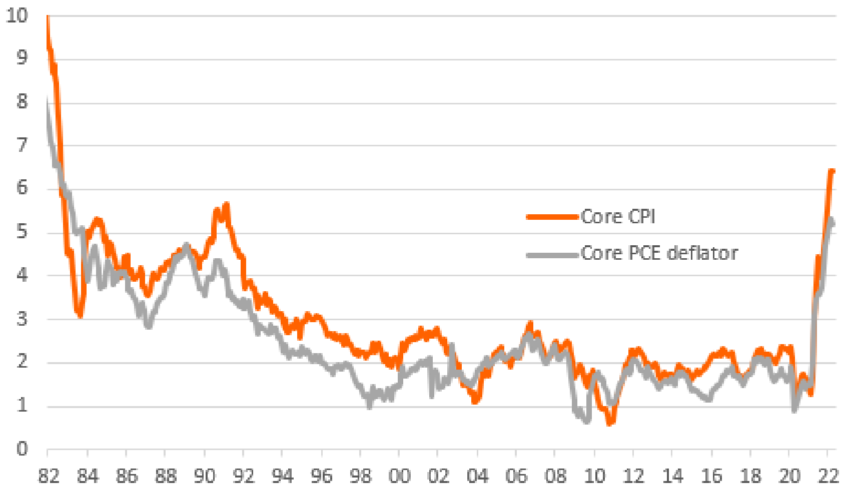
Source: iStockphoto

Today's release of the core personal consumer expenditure deflator shows the headline rate of inflation rising from 2% to 2.3% year on year while the core rate, which excludes the volatile food and energy components, rose to 2% from 1.8%. Both were above what the market was expecting (2% and 1.9% respectively) with both also showing the fastest rates of inflation for over six years.

This suggests that the next FOMC announcement (1 August) will need to see a more robust acknowledgement of the inflation pressures in the US economy. We expect all inflation measures to remain under upward pressure over the summer - particularly with oil prices on the rise again - with the more widely followed CPI measure likely to hit 3% in the next two to three months. Momentum is certainly to the upside given the strength of the economy and the tightness of a labour market that has the lowest rate of unemployment for 50 years.

Meanwhile, the Atlanta Federal Reserve Bank's Nowcast model, based on the recent data flow, currently suggests that real GDP growth could come in at around 4.5% for 2Q18. However, today's report showed real consumer spending for May was weaker than hoped at 0% versus the 0.2% month on month consensus. As such, we think 4.5% is a stretch, but something close to 4% looks possible. With inflation rising at such a rate, nominal GDP growth will be in excess of 6%, suggesting to us that the market remains too cautious on the outlook for Federal Reserve interest rate hikes.

US inflation measures all on the rise (YoY%)



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Sweden

Riksbank preview: Still waiting for Godot

We expect the Swedish central bank to keep the monetary policy stance unchanged at its July meeting. That may provide some short-term support for the...

The outlook for the Riksbank remains broadly similar to the last meeting in April. We expect only limited changes to its economic forecasts, and the interest rate path to be left unchanged (indicating the first hike at the end of 2018).

The Riksbank has a well-known dovish bias and has delivered a de facto softer policy stance at each of its past three meetings. So even an unchanged stance at this meeting, reiterating its forecast that interest rates will rise by the end of the year, might provide some short-term support for the krona and short rates.

In the longer term, our view remains that weak domestic inflation pressure and the very gradual tightening of ECB policy means the Swedish central bank is unlikely to deliver its first rate hike until mid-2019. We believe the Riksbank's policy stance will start to shift slowly in that direction as the year goes on.

Below is a more detailed analysis of the key factors driving the Riksbank's policy.

Inflation: Headline strength masks underlying weakness

In April, the Riksbank put significant emphasis on core inflation (which remains subdued at around 1.5%) as opposed to the headline inflation measure (which is at the 2% target). The message was that the Riksbank would look through temporary effects on the inflation rate and focus on the underlying trend.

That divergence between core and headline inflation continued in April and May and will increase further over the summer. Higher energy prices will push up the headline figure above 2% while base effects (related to last year's change to the measurement of airfares) hold back core inflation around current levels or even lower. Service price inflation, the best gauge of domestic inflation, has fallen materially over the past few months and looks likely to remain moderate.

We expect only minor changes to the Riksbank's inflation outlook. Headline inflation will likely be revised up in the near term to reflect higher energy prices and a weaker krona, while core may be revised down a little, yet again. But we will have to wait until autumn for clarity on the inflation outlook.

Growth: Still solid but risks are increasing

First quarter GDP came in pretty strong at 0.7% quarter on quarter, but near-term indicators suggest momentum is slowing down. The second quarter is likely to see slightly slower growth at 0.5%QoQ, and momentum could slow down further during the second half of the year.

> *Our view remains that the majority of Riksbank MPC members are reluctant to raise rates much before the ECB does. At most, we see a 10bps hike in December or February 2019 as plausible, bringing the Riksbank's policy rate in line with the ECB's - 40bps deposit rate*

Two key factors drag on Swedish growth: the slowing housing market and the 'soft patch' in European growth seen in the first half of 2018. Other central banks, e.g. the ECB and the Bank of England have expressed confidence that fundamentals remain solid and global growth momentum will pick up again. The Riksbank will probably make a similar assessment of the global outlook and argue that it has already factored in a slower domestic housing market and therefore not changing its forecast significantly.

But the risks to their forecast are clearly to the downside. A global slowdown would be particularly problematic for Sweden in the current situation where domestic demand is already slowing down.

Also, tensions around US trade policy have escalated and pose a major risk to Sweden's export-dependent economy. Sweden is particularly exposed to the US' threat to impose tariffs on car imports. Trade with the US accounts for about 2% of Swedish GDP (of which around a fifth is car exports). Indirect links via the auto parts supply chains into Europe are also at risk.

Housing: Not out of the woods yet

Swedish house prices have stabilised over the spring, but the troubles in the housing market are far from over just yet. The supply of unsold homes is at record highs, with lots of newly built-apartments coming onto to the market. To clear the overhang of unsold properties, we suspect further price falls, perhaps 5-10%, may be necessary this autumn.

This week, the Swedish premium property developer Axxonen filed for bankruptcy, becoming the first corporate victim of the housing slowdown - and it won't be surprising if it were the first of many. Several developers have scaled back construction plans over the past months. While lower construction is factored into the Riksbank's forecast, it is always hard to judge how bad things can get. The housing market remains the key domestic risk in Sweden, and the Riksbank is unlikely to raise rates until it can be sure the situation has stabilised.

Exchange rate: Better too weak than too strong

The krona exchange rate steadied over the past couple of months after the rapid depreciation from February to April. But it remains around 2% weaker than factored into the Riksbank's April forecast, and 4% below the expected average for Q3. This will mechanically push up on the inflation and GDP forecasts and at the margin supports a somewhat more hawkish stance.

But we don't think the Riksbank particularly minds a weak krona. Policy-makers have long fought to keep the exchange rate from appreciating too rapidly and will continue to prefer currency weakness to strength.

ECB: Later hikes from Frankfurt means later hikes in Stockholm

Finally, the ECB's policy announcement at its June meeting is arguably the most significant news for the Riksbank since its last meeting. The firm guidance that the ECB does not intend to raise interest rates "through summer 2019" gives the Riksbank more clarity on a key determinant for its policy stance.

Our view remains that the majority of Riksbank monetary policy committee members are reluctant to raise rates much before the ECB does. As Governor Ingves pointed out in the minutes of the April meeting, the current Riksbank stance "is very much due to the highly expansionary monetary policy conducted in the euro area in recent years. In this respect, the Riksbank is in approximately the same situation as the central banks in Denmark and Switzerland."

Given that neither the Danish nor the Swiss central bank are expected to raise interest rates until after the ECB does, this is a fairly clear signal that the Riksbank is unlikely to raise rates this year and will wait until nearer the time the ECB is likely to raise rates. While the Riksbank is less constrained by the ECB than the DNB or SNB, it is still difficult to see them raising rates more than nine months ahead of the first date (September 2019) that the ECB might move. A more likely scenario is that the Riksbank waits until July or even September 2019.

At most, we see a 10bps hike in December or February 2019 as plausible, bringing the Riksbank's policy rate in line with the ECB's - 40bps deposit rate.

Cracking the code on cryptocurrency

The ING International Survey Mobile Banking 2018 asked nearly 15,000 people across Europe, the USA and Australia what they think of the cryptocurrency...

Source: Shutterstock