

In case you missed it: The land of lower rates

A precautionary Fed rate cut seems to be a done deal, despite today's encouraging jobs report, but we'll be looking for what the Fed Chair has to say when he testifies to Congress next week. In Europe, a change of guard to Lagarde, Italy dodges disciplinary action and alarm bells ring in Germany as the fear factor returns. It's all there in our monthly update!

In this bundle



July Economic Update: The Art of the Deal

Politics is increasingly driving economics, with escalating US-China trade tensions and subsequent ceasefire being a case in point. We believe a trade...



US June jobs boom

A really encouraging jobs report that suggests the broad economy is shrugging off the US-China trade uncertainty. While the Federal Reserve is gearing up...

By James Knightley



Germany: Order book deflation continues

The great order deflation continues and wraps up a week to forget for the German economy.

By Carsten Brzeski



OPEC+ cuts extended

This has certainly been one of the less exciting OPEC+ meetings, with President Putin spoiling the surprise on the side-lines of the G-20 summit. The...

By Warren Patterson



Europe: Breakthrough with many surprises

The outgoing president of the European Council, Donald Tusk, just announced a breakthrough in the seemingly endless negotiations between European leaders...

By Carsten Brzeski



Canada

Five reasons to stay long CAD

The Canadian dollar's rally may feel the kickback from re-escalating trade tensions, but the long-term outlook is still positive. We see high...

By Francesco Pesole



Italy

Italy: The EU Commission chose not to ask for an EDP against Italy, for the time being

The 2019 budget re-assessment and the related decree were deemed enough by the EU Commission not to pull the trigger now. However, the ghost of an EDP...

By Paolo Pizzoli

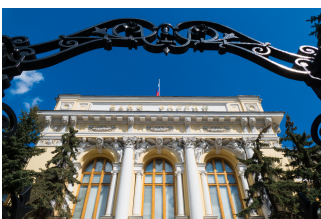


Sweden

Riksbank hints at 2019 hike, defying ECB dovishness

The ongoing weakness in the Swedish krona means the Riksbank appears to be taking a more relaxed stance towards prospective ECB easing than in years gone...

By James Smith



Russia

After the rally: Domestic factors to play a greater role in RUB pricing

We're upgrading our 3Q19 USD/RUB forecasts from 65-67 to 63-65, to account for the RUB2 rally which took place in mid-June on global risk-on, but in...

By Dmitry Dolgin



India

India's FY2020 budget targets lower deficit, really

Finance minister Nirmala Sitharaman may have scored some points for fiscal consolidation with a lower deficit target of 3.3% of GDP. Whether her maiden...

Report | 5 July 2019

July Economic Update: The Art of the Deal

Politics is increasingly driving economics, with escalating US-China trade tensions and subsequent ceasefire being a case in point. We believe a trade deal will finally be signed later this year, but not before the Federal Reserve and European Central Bank have come to the economy's aid with monetary easing.



Source: Shutterstock

President Donald Trump shakes hands with Chinese President Xi Jinping during a meeting on the sidelines of the G-20 summit in Osaka, Japan

July Economic Update: The Art of the Deal

Politics is increasingly driving economics, with escalating US-China trade tensions and subsequent ceasefire being a case in point. We doubt the truce will hold for long and Europe could yet get dragged into the conflict over the next few months. We believe a trade deal will finally be signed later this year, but not before the Federal Reserve has come to the economy's aid with interest rate cuts. The ECB is expected to offer stimulus of its own, and the nomination of Christine Lagarde as the bank's new president has added to this dovish view. Moreover, the political dealmaking in Europe, now under new leadership, looks set to be ramped up as Brexit looms large.

Despite the easing of trade tensions, the Federal Reserve is clearly indicating it is prepared to offer early support to the US economy. Activity data is showing signs of softening, inflation is benign and markets are keen for action. As such, we expect precautionary 25 basis point rate cuts in both July and September.

The market continues to look for more - a third move in 4Q19 with an additional fourth cut in 1Q20. We remain more cautious given our belief that President Trump wants to be re-elected and will therefore be prepared to sign a trade deal, probably in 4Q, that doesn't necessarily meet all of his initial demands. We assume Trump will want the optimal conditions of rising equity markets and decent economic activity going into the campaign proper, and a trade deal together with lower interest rates can deliver that.

Meanwhile, bond markets are enjoying the art of the steal. On one side of the balance sheet, core issuers are obligated to return less money than they have been lent right out to 10 years. On the other side, investors have eyed the 10yr US at 2% and concluded that that is a steal when compared with other (negative yielding) risk-free rates. Absolute yield levels are discounting all kinds of awful scenarios ahead, partly reflective of a perennial disinflation tendency, but also heavily influenced by a remarkable excess of demand over supply (which the ECB will likely augment).

The eurozone economy is still desperately seeking guidance and support. Confidence indicators have started to deteriorate again, and a rate cut is now a question of 'when' rather than 'if'. It's a close call, but barring a further deterioration in the data before the July meeting, we think the ECB is more likely to wait until September when it will have a new set of staff projections.

Concerns are growing that a new UK prime minister could pursue a 'no deal' Brexit, although we still think parliament would force a general election if there were no alternative way to stop it. All of this uncertainty is continuing to weigh on growth and a Bank of England rate hike this year looks unlikely.

Even after the China-US sideline meeting at the G20 in late June, it is still too early to say that the two sides are close to reaching an agreement. Technology is the big issue, but it seems to us little can be done. China needs more infrastructure investment, both for stimulus purposes and for achieving technology independence. The central bank needs to support these projects by adding more liquidity to the market. USD/CNY has been more affected by a weak dollar than the outcome of the G20.

The eight year dollar bull run is showing signs of fatigue – but is not giving up without a fight. We suspect that an escalation in trade tensions will prove the catalyst for a fresh bout of dollar losses – especially in USD/JPY.

ING global forecasts

	2018					2019F					2020F					2021F				
	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY
United States																				
GDP (% QoQ, ann)	2.2	4.2	3.4	2.2	2.9	3.1	1.8	1.6	1.8	2.5	1.6	1.9	1.9	2.0	1.8	2.0	2.1	2.0	1.9	1.8
CPI headline (% YoY)	2.7	2.7	2.6	2.2	2.4	1.6	2.0	1.9	2.1	1.8	2.5	2.1	2.2	2.2	2.2	2.1	2.0	1.9	1.8	2.0
Federal funds (% eop) ¹	1.50	1.75	2.00	2.25	2.25	2.25	2.25	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
3-month interest rate (% eop)	2.30	2.35	2.45	2.65	2.65	2.60	2.45	1.95	1.95	1.95	2.00	2.05	2.05	2.05	2.05	2.05	2.05	2.05	2.05	2.05
10-year interest rate (% eop)	3.00	3.00	3.00	2.80	2.80	2.30	2.00	1.80	1.70	1.70	1.90	2.00	2.10	2.10	2.10	2.10	2.10	2.10	2.10	2.10
Fiscal balance (% of GDP)					-4.0					-4.6										-4.7
Fiscal thrust (% of GDP)					1.1					1.1										0.3
Debt held by public (% of GDP)					76.7					78.9										83.8
Eurozone																				
GDP (% QoQ, ann)	2.8	1.6	0.5	1.0	1.9	1.6	0.6	0.8	1.1	1.0	0.9	1.4	1.2	1.1	1.1	1.1	0.9	0.5	0.8	0.9
CPI headline (% YoY)	1.3	1.7	2.0	2.0	1.8	1.4	1.3	1.0	1.1	1.2	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Refi minimum bid rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (% eop)	-0.33	-0.33	-0.33	-0.33	-0.33	-0.32	-0.32	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
10-year interest rate (% eop)	0.50	0.30	0.40	0.24	0.24	-0.07	-0.30	-0.30	-0.10	-0.10	-0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Fiscal balance (% of GDP)					-0.5					-0.8										-0.7
Fiscal thrust (% of GDP)					-0.2					-0.1										-0.1
Gross public debt/GDP (%)					87.8					86.8					85.7					84.4
Japan																				
GDP (% QoQ, ann)	-0.3	2.2	-2.5	1.6	0.8	2.2	1.4	0.7	0.5	1.1	0.5	0.6	0.8	0.8	0.7	0.8	0.8	0.8	0.8	0.8
CPI headline (% YoY)	1.3	0.6	1.1	0.9	0.9	1.0	1.1	1.2	1.0	1.1	0.8	0.6	0.8	1.0	0.8	0.8	0.6	0.8	1.0	1.0
Excess reserve rate (%)	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
3-month interest rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15	-0.15
10-year interest rate (% eop)	0.05	0.05	0.10	0.10	0.10	0.00	-0.10	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20
Fiscal balance (% of GDP)					-3.0					-2.8										-2.2
Gross public debt/GDP (%)					235.0					233.0										232.0
China																				
GDP (% YoY)	6.8	6.7	6.5	6.3	6.6	6.4	6.2	6.3	6.3	6.3	6.3	6.2	6.2	6.2	6.2	6.2	6.3	6.3	6.4	6.3
CPI headline (% YoY)	2.2	1.8	2.3	2.5	2.2	1.8	2.5	2.6	2.6	2.4	2.6	2.6	2.5	2.4	2.5	2.5	2.5	2.5	2.5	2.5
PBOC 7-day reverse repo rate (% eop)	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.50	2.45	2.45	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
10-year T-bond yield (% eop)	3.75	3.50	3.65	3.30	3.30	3.05	3.20	3.00	2.95	2.95	2.95	2.90	2.90	2.85	2.85	2.85	2.90	2.95	3.00	3.00
Fiscal balance (% of GDP)					-2.6					-4.5										-4.0
Public debt, inc local govt (% GDP)					88.0					102.0										103
UK																				
GDP (% QoQ, ann)	0.2	1.6	2.8	0.9	1.4	2.0	0.1	1.1	1.7	1.4	1.5	1.6	1.2	1.1	1.4	1.7	1.3	0.8	0.5	1.3
CPI headline (% YoY)	2.7	2.4	2.5	2.3	2.5	1.9	2.0	1.8	1.9	1.9	2.3	2.1	2.1	2.0	2.1	1.9	1.9	1.9	2.0	2.0
BoE official bank rate (% eop)	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.00	1.00
BoE Quantitative Easing (Ebn)	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445	445
3-month interest rate (% eop)	0.60	0.80	0.80	0.80	0.80	0.85	0.85	0.85	0.85	0.85	1.05	1.10	1.30	1.35	1.35	1.35	1.35	1.35	0.95	0.95
10-year interest rate (% eop)	1.45	1.48	1.57	1.30	1.30	1.00	0.80	0.70	0.80	0.80	1.00	1.20	1.20	1.20	1.20	1.20	1.10	1.00	1.00	1.00
Fiscal balance (% of GDP)					-1.4					-1.4										-1.0
Gross public debt/GDP (%)					86.9					85.7										83.6
EUR/USD (eop)																				
EUR/USD (eop)	1.20	1.17	1.15	1.12		1.12	1.12	1.12	1.15		1.16	1.17	1.18	1.20		1.21	1.22	1.23	1.25	
USD/JPY (eop)	107	110	114	113		112	108	105	103		102	100	100	100		98.0	95.0	93.0	90.0	
USD/CNY (eop)	6.28	6.67	6.87	6.88		6.74	6.90	6.95	6.90		6.90	6.85	6.80	6.75		6.75	6.70	6.75	6.70	
EUR/GBP (eop)	0.88	0.88	0.89	0.90		0.85	0.90	0.92	0.92		0.90	0.88	0.85	0.85		0.85	0.85	0.85	0.85	
Brent Crude (US\$/bbl, avg)																				
Brent Crude (US\$/bbl, avg)	67	75	76	69	72	64	68	69	73	69	70	74	76	74	74	72	77	77	74	75

¹Lower level of 25bp range; 3-month interest rate forecast based on interbank rates

Source: ING

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Article | 5 July 2019

US June jobs boom

A really encouraging jobs report that suggests the broad economy is shrugging off the US-China trade uncertainty. While the Federal Reserve is gearing up for precautionary interest rate cuts, we think the market is expecting too much



Source: Shutterstock

224k

Number of US jobs added in June

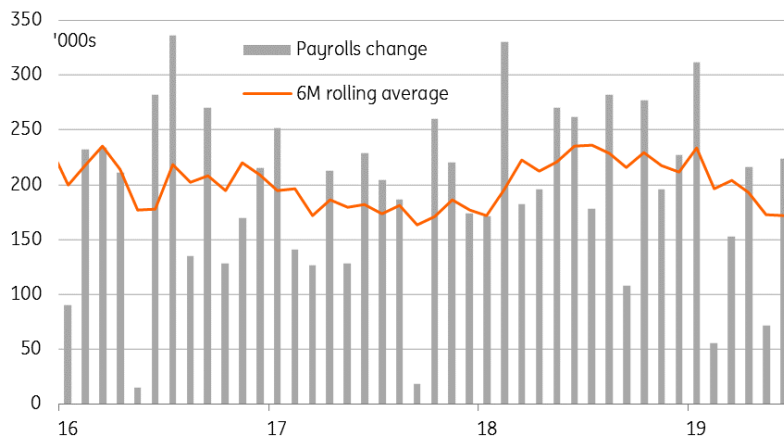
(Consensus was 160k)

Labour demand remains strong

It is a really strong US payrolls figure for June with 224,000 jobs created versus the 160,000 consensus. In fact, 224,000 is higher than all of the 75 economist estimates provided to Bloomberg! The previous two months of data saw a net downward revision of 11,000, but nothing can take away from the fact this is a surprisingly strong outcome.

Manufacturing payrolls rose 17,000 despite the struggles in the sector relating to an inventory overhang and uncertainty on the trade front. Private payrolls in total rose 191,000 versus the 150,000 expected. Service sector employment rose 154,000 led by business services and education & health, with government employment up 33,000.

Payrolls growth is resilient



Source: Bloomberg, ING

But wages and unemployment miss expectations

The unemployment rate moved up to 3.7% from 3.6% (it went to 3.67% from 3.62% for those who are sticklers for accuracy), but this reflects a rise in the participation rate – disaffected former workers being attracted back into the labour force, which should be seen as an encouraging story.

There was some softness on the wage front though. Average hourly earnings rose just 0.2% month-on-month versus 0.3% expected and our own forecast of 0.4%. Annual wage growth remains at 3.1%, which is a little disappointing given the tightness of the jobs market. However, it is well ahead of all the key inflation measures so real household disposable income growth is in great shape, which bodes well for consumer spending in the months ahead.

Payrolls growth will slow, wages can catch up

Taking it all together it is an encouraging report that suggests the broad economy is currently shrugging off the US-China trade uncertainty. We do expect employment growth to slow, but this will be more down to a lack of workers with the right skills to fill vacancies rather than any meaningful downturn in demand – remember the US is in its longest expansion period since 1854 and unemployment remains close to a 50-year low so the pool from which to find new workers is pretty small. However, there should be positive implications for wages as firms seek to recruit and retain staff. The resilience of the US jobs market is a key reason why we believe risks are skewed towards more modest Fed policy loosening relative to market expectations.

What it means for the Federal Reserve

Federal Reserve Chair Jerome Powell testifies to Congress next week and looks set to validate market expectations of precautionary interest rate cuts to head off the threat of a downturn. He may repeat yet again his view that “an ounce of prevention is worth more than a pound of cure”. We look for the Fed to go with a July interest rate cut of 25 basis points followed by a 25bp move in September.

The market is looking for more – pricing in three rate cuts this year with a further 25bp cut in early 2020. However, President Trump will be well aware that pushing too hard for too long on trade risks a weaker economy and plunging asset markets, which would undoubtedly hurt his re-election

chances. As such, we would expect him to strike a deal around the turn of the year, claiming the wave of market euphoria a trade deal would generate, coupled with an environment of lower interest rates, as a personal victory that supports his case for the presidency.

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Snap | 5 July 2019

Germany: Order book deflation continues

The great order deflation continues and wraps up a week to forget for the German economy.



The great order book deflation continues. Devastating new orders data just undermined any hopes for an industrial rebound. We are starting to lose our optimism. Instead, the order book deflation just reached a new standard. In May, new industrial orders dropped by a painful 2.2% MoM, from a slightly upwardly-revised 0.4% MoM increase in April. After two positive months and hopes for a bottoming out, the downward slide is back again. On the year, new orders were down by 8.6%; the worst YoY drop since 2009. In particular, foreign orders dropped sharply: -5.7% MoM from non-Eurozone countries and -1.7% MoM from Eurozone countries, reflecting continued global uncertainties. After four disappointing months, domestic orders increased by 0.7% MoM. Still, domestic orders have been an even bigger disappointment than foreign orders this year, having dropped by an average of 1.5% MoM since the beginning of the year.

Today's sharp drop in new orders clearly undermines the tentative signs of a rebound or at least a bottoming out at the end of the first quarter. In fact, the great order book deflation continues. The last two times order books shrank with a similar magnitude was in 2011/12 and 2008/9. While the former fall ended mildly with a decent rebound, the latter continued and we all know how it ended. Back to the current situation, a strong inventory build-up in the automotive industry also does not bode well for the coming months and brings back the not so distant memories of last Fall. Combined with the weakest June performance of the labour market since 2002 and disappointing retail sales, today's new orders wrap up a week to forget for the German economy. The fear factor is back.

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Article | 2 July 2019

OPEC+ cuts extended

This has certainly been one of the less exciting OPEC+ meetings, with President Putin spoiling the surprise on the side-lines of the G-20 summit. The commitment of OPEC+ to bring the market back to balance by extending cuts should be viewed as constructive, and we continue to hold the view of higher prices from here for the remainder of the year



Source: Shutterstock

What was agreed?

It seems to have been an easy decision for OPEC+, extending production cuts of 1.2MMbbls/d by 9 months, which would take the current deal through until the end of 1Q20. The length of the cuts was one surprise for the market, with the general consensus in the lead up to the meeting that cuts would be extended through until the year-end. However, given that the next OPEC+ meeting will be in December, the group will have the chance to review the deal and make any necessary changes.

As we saw with the deal over the first half of the year, it is likely that Saudi Arabia will continue to carry the bulk of cuts. The Kingdom over-complied with the deal over 1H19, with production averaging around 9.88MMbbls/d compared to their quota level of around 10.3MMbbls/d. Looking ahead, there are suggestions that the Saudis will continue to cut more than needed, with reports that they would produce on average a little less than 10MMbbls/d for the remainder of the year.

The Saudis are also keen to adjust the target of where they want to see global inventories. In the past the aim of OPEC was to bring oil inventories back in line with the 5-year average, however, the Saudis appear as though they want to go even further by bringing inventories back to the 2010-14 average. This, however, does not seem to be a view which is shared by other members, with them more reluctant to commit to such an aggressive target.

Why is OPEC+ cutting into 2020?

There are a number of reasons why OPEC+ have extended the deal into 2020, firstly Q1 is seasonally the low point in demand, and so there is the possibility of further stock builds if members were to increase output.

Secondly, there is growing consensus that the global balance looks more than comfortable next year, with the IEA in their first forecast for 2020 estimating that non-OPEC supply will grow by 2.3MMbbls/d, while demand is forecast to grow by 1.4MMbbls/d over the year. However, we do believe that the IEA may be a bit optimistic about their supply growth numbers for 2020.

Then on the demand side, there is still plenty of uncertainty. Demand growth forecasts for 2019 have been revised lower a number of times already this year, with the IEA initially forecasting that demand would grow by 1.4MMbbls/d this year, and now their latest expectation is 1.2MMbbls/d. However, a key determinant behind demand growth is going to be how trade talks between China and the US play out. Whilst the conclusion from the G-20 summit was fairly constructive, with both sides set to resume talks, we are still some distance away from a deal. Therefore the longer uncertainty around trade persists, the more concern we are likely to see around oil demand growth.

Prolonged cuts...yet market sells off

The market certainly has not reacted in the manner that OPEC+ members would have liked, with the market already giving back all of Monday's gains and more. We believe a key reason behind this weakness is continued demand worries, whilst the market is also likely concerned about why OPEC+ are needing to extend cuts into 2020 - slowing demand growth, along with expectations of robust non-OPEC supply growth. Then there is also the issue of how sustainable these cuts will be in the longer term, given that US producers will be more than happy to fill the void left by OPEC+ cuts.

Saying this, we continue to hold a constructive view of the oil market for the remainder of this year. We are forecasting that prices will firm from current levels, with ICE Brent averaging US\$69/bbl over Q3 and US\$73/bbl over Q4. We should see a seasonal pick-up in demand over Q3, and this combined with continued cuts from OPEC+ and further declines from exempt Venezuela and Iran should see a tightening in the global oil balance. Furthermore, lingering tensions in the Middle East should continue to offer some support to the market.

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Snap | 2 July 2019

Europe: Breakthrough with many surprises

The outgoing president of the European Council, Donald Tusk, just announced a breakthrough in the seemingly endless negotiations between European leaders on how to fill the European top jobs. Europe never fails to surprise



Source: Shutterstock

Christine Lagarde, Charles Michel, Ursula von der Leyen

The heat was more than only on. Too many deadlocks, too many national interests and the first session of the European Parliament coming up, with a vote on the next president of European Parliament. Now, there finally is a breakthrough. European government leaders just agreed on the following nominations:

- Christine Lagarde (France) as president of the European Central Bank
- Ursula von der Leyen (Germany) as next president of the European Commission
- Charles Michel (Belgium) as president of the European Council
- Josep Borrell (Spain) as high representative for foreign policy

The European Parliament has to agree to the nomination of Von der Leyen but does not have a veto on the nomination for the ECB. The other two nominations are exclusively decided by governments.

Biggest surprise: Lagarde at the ECB

For financial markets, the nomination of Christine Lagarde as the successor to Mario Draghi is of most importance. It is also a surprise. Lagarde, who currently heads the IMF has always ruled out any ambitions for European top jobs and only today popped up as a frontrunner for the ECB job. Lagarde will be the first woman ever at the top of the ECB and also the first ECB president without active central bank experience.

The initial criticism is obvious: no central bank experience, not the top-notch economics education, another former (some might argue even current) politician at the head of the ECB. However, let's not forget the old saying "the King is dead, long live the King". Jean-Claude Trichet was different from his predecessor Wim Duisenberg as Mario Draghi is different from Jean-Claude Trichet. Therefore, here is a first brief assessment of what Lagarde's nomination as next ECB president could mean for the ECB and monetary policy in the eurozone.

- Hawk or dove? Actually, impossible to tell as Lagarde so far has not caught any attention with outspoken views on monetary policy.
- Mario Draghi has always given the impression that he could be called in the middle of the night and still would know all components of the last PMI readings by heart. The smartest kid in class with a close ear and eye to financial markets. Christine Lagarde would probably be more of a moderator than an intellectual mastermind on monetary policy. In times when some ECB members have criticised too much inner circle decision-making, it would be a change.
- Yes, the ECB has a strong and highly qualified staff, but the question is whether the monetary policy brain drain with the departures of Peter Praet, Vitor Constancio and Mario Draghi will be equally replaced or whether Philip Lane might soon be the last pragmatic monetary economist standing in the ECB's Executive Board. Related to this, the question is whether Lagarde at the helm of the ECB could lead to a subtle shift in the balance of power, away from the Executive Board and towards national central bank governors.

With Christine Lagarde, the ECB will get another excellent communicator. What kind of monetary policies Lagarde really stands for, no one can currently tell. In our view, a continuation of a pragmatic monetary policy stance as well as a confirmation of "whatever-it-takes" looks likely. Whether or not the ECB under Lagarde will also be willing to go as boldly as Draghi to where no European central bank has gone before will depend on the new balance of power between Executive Board and national governors.

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Five reasons to stay long CAD

The Canadian dollar's rally may feel the kickback from re-escalating trade tensions, but the long-term outlook is still positive. We see high potential for the Loonie to keep outperforming its G10 peers in the coming quarters



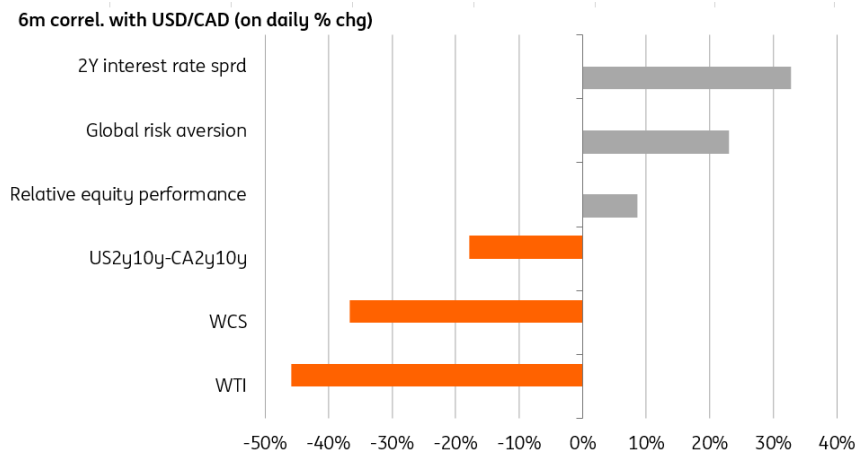
Source: Shutterstock

A great first half for the loonie

At the time of writing, CAD is the best-performing currency in the G10 space since the start of the year (+4.09% vs USD to be precise).

We've [recently revised our USD/CAD](#) forecast profile lower and now expect 1.30 by the end of the year. Looking at the past six months, USD/CAD has been highly correlated with three market factors: crude oil prices, interest rate spreads and market risk sentiment. The shape of the yield curve and relative equities performance tend to show a less relevant correlation.

[Read our latest issue of FX Talking: The beginning of the end of the dollar's rally](#)



Source: Bloomberg, ING

In the current market environment, the largest risk to an open economy like Canada and its currency are the ongoing trade tensions. The recently-agreed trade truce and the restart of negotiations for a deal between the US and China will probably keep market risk sentiment supported for some time. Although looking ahead, our trade team is reluctant to [exclude a re-escalation of trade tensions](#), and we don't exclude the US imposing fresh tariffs on Chinese exports as early as in 3Q.

Some market attention will also be on the Canadian federal elections scheduled for October. The latest vote projections suggest the incumbent Liberal party is bound to face a defeat by Andrew Sheer's Conservative party, but for the time being, we don't see a high market-moving potential to the elections.

We think there are at least five reasons which suggest positives will more than offset most trade-related downside risks and keep the Canadian dollar on an appreciating path.

1 Oil prices are likely to stay supported

Our commodities team expects the ongoing OPEC meeting – and the OPEC+ meeting tomorrow – to deliberate [further supply tightening in the crude market](#).

Latest media reports indicate that members should all be in agreement to extend the current deal for 1.2MMbbls/d of output cuts. This would come as a positive at a time when oil prices have already found some support from US-Iran tensions and we expect WTI keep to edge above 60 \$/bbl.

Nonetheless, the outlook for the regional benchmark Western Canada Select is slightly gloomier after reports that the Canadian state of Alberta is planning to increase its production limits. While this may translate into a partial re-widening of the Western Texas Intermediate and Western Canadian Select (WTI-WCS) spread, the very low correlation of the spread with USD/CAD performance tends to suggest the impact on the currency pair may be quite limited.

2 Inflation is strong, economy is set for a rebound

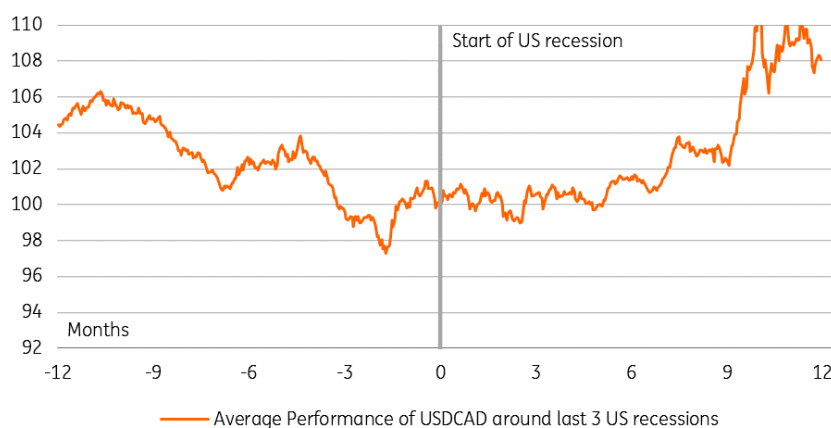
We believe a number of indicators likely back the constructive economic view expressed by the Bank of Canada in its latest statement.

- Inflation in Canada is strong. The core measure has touched 2.3% in May - a 10-year high. The headline print also surprised to the upside at 2.4%. Both measures currently fall in the upper half of the BoC inflation-target band. Looking ahead, our economists expect inflation to stay broadly in line with the 2% median target at least until the end of 2020.
- The labour market looks healthy: unemployment rate (5.8% in March) is close to historical lows, the participation rate has rebounded from late 2018 lows and wage growth (2.55% in May) has been quite robust.
- Q1 subdued GDP numbers have been negatively affected by a widening trade deficit. A recovery in the deficit has already started to benefit GDP monthly reads (April YoY read at 1.5%), suggesting that the Canadian economy likely bottomed out in Q1. We currently forecast 1.5% growth in 3Q19 and 1.7% both in 4Q19 and 1Q20.
- A further boost to exports will likely come from the ratification of the USMCA trade deal, which seems to be close to being passed by the US Congress as Democrats' oppositions have fanned.

3 The Fed will blink first, the BoC may not blink at all

The strong fundamentals listed above have been indeed acknowledged by Canada's central bank in its latest statement, as they reiterated an "accommodative" policy stance.

Accordingly, our economics team expects the BoC to keep rates on hold throughout 2019 and 2020. This is in contrast with markets expectations for some monetary easing ahead, with the OIS curve currently showing -25bp priced in by 2Q20. On the other side of the border, the Federal Reserve is facing increasing pressure to cut interest rates and our economists expect two rate cuts by the end of the year. Such policy divergence is likely to keep the US-Canada interest rate differential under pressure.



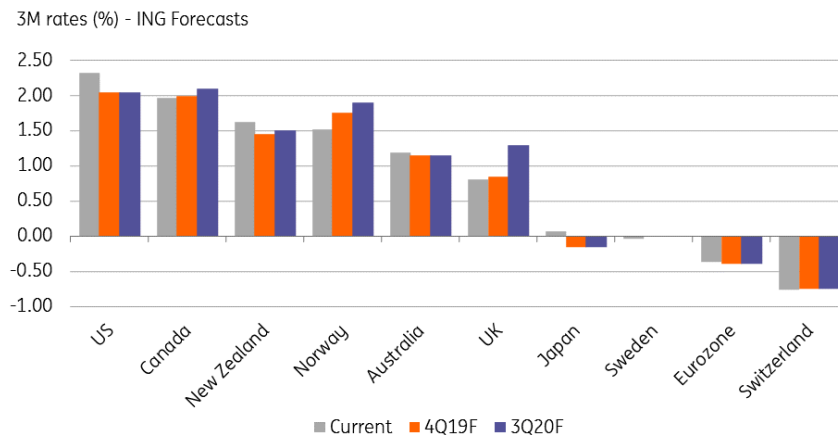
Source: Bloomberg, ING

4 CAD has been historically strong before a US recession

From a different perspective, historical evidence from the three most recent US recessions suggests that the CAD has been amongst the best performers in the G10 space as USD weakened whilst

approaching a US recession.

Looking ahead, investors may see in the loonie an interesting substitute to the US dollar to enter carry trades as the dollar rate advantage staggers. Indeed, CAD is currently the second-highest yielding currency (short-term rates) in the G10 space. According to our economists' forecasts, Canada will have the highest 3-month yields in 3Q20. This would keep CAD supported as investors may rush to enter carry trade positions in the coming quarters before unwinding them as increased risk of a global economic downturn threatens their profitability.



Source: Bloomberg, ING

5 CAD can still benefit from short positioning

Despite the recent bullish mood on the CAD, Commodity Futures Trading Commission (CFTC) data shows that combined net speculative position on the loonie is still in short territory (-9% of open interest). This tends to suggest that there is still some room for position-squaring-related downside risk in USD/CAD, especially when considering that positioning on USD is, on the opposite, still extensively long.

We see high potential for CAD to keep outperforming its G10 peers in the coming quarters. Nonetheless, the fall in USD/CAD may be contained around the 1.31-1.32 level until trade-tension-related downside risks dissipate. In the longer run we stick to our forecasts for 1.30 in 4Q19, 1.28 in 1Q20 and 1.26 in 2Q20.

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Italy: The EU Commission chose not to ask for an EDP against Italy, for the time being

The 2019 budget re-assessment and the related decree were deemed enough by the EU Commission not to pull the trigger now. However, the ghost of an EDP against Italy could be re-awakened in the autumn should the 2020 budget draft point to deliberate deviations from the Stability Pact path



Source: Shutterstock

The EU Commission decided earlier today not to ask the Ecofin to open an excessive deficit procedure (EDP) against Italy. The move, which had been anticipated by government bond markets over the last few sessions, came after the Italian government accepted to provide formal evidence and to secure a commitment to improvements in 2019 Italian state accounts.

Reassessment of 2019 budgetary developments was temporarily deemed enough not to act now

The Italian government's fiscal update, disclosed late on Monday, had provided fresh evidence that a combination of factors was bringing about a €7.6bn reduction in the 2019 budget deficit with

respect to the target set in the DEF document. According to the Italian government, these would result from higher tax revenues, extraordinary dividend payouts from CDP and the Bank of Italy and, crucially, from smaller costs due to a lower-than-expected take-up of the flagship “citizenship income” and “level 100” schemes. The latter savings were locked on Monday via a government decree, which will impose realized savings to be channelled for deficit reduction. According to the Italian Ministry of Finance, this should allow Italy to target a nominal deficit of 2.1% of GDP and to obtain a structural adjustment fully compensating the 0.3% deviation recorded in 2018 and that for 2019. The third condition reportedly requested by the EU, ie, obtaining detailed assurances on the 2020 draft budget, was not formally met. During the negotiations, in a letter to the Commission, the Italian government simply committed to meet the stability pact requirements for 2020.

EDP issue could be resurrected when the 2020 budget will be drafted

As made clear by Commissioner Moscovici, the EU Commission will monitor the implementation of the measures in the second half of the year and will stand ready to ensure that the 2020 draft budget to be presented this autumn will be compliant with the Stability Pact. As things stand, crafting a fiscally sound 2020 budget will prove challenging. Both Salvini and Di Maio have recently re-affirmed their determination to sterilize the budgeted VAT increase (worth €23.3bn) and Salvini has insisted on the need for tax cuts of at least €10bn, to be implemented by extending (at least partially) the flat tax to personal taxation. As so far the indications of the relevant funding have been vague at best, the risk that the threat of a procedure could be resurrected during the autumn budget season remains high. Furthermore, debt reductions initiatives budgeted for 2019, worth on paper some €18bn (or 1% of GDP) have so far failed to materialize.

Risk of September snap election now reduced, but tensions between Salvini and Di Maio might persist

The Commission decision provides an ex-post justification to the recent rally of Italian government bonds, which brought the spread of 10y BTP versus Bunds down to 200bp. At the same time, at least in principle, it deprives Salvini of a political handle to pull the plug from the government and call for snap elections in September. After today's decision, Europe cannot be fingered as the nasty guy imposing overburdening austerity on Italy, at least for now. A government crisis might still materialize should tensions between Salvini and Di Maio on key economic themes increase further along the pro-business/anti-business line. To check the ground, Salvini might very soon start forcing PM Conte's hand in setting the government agenda, possibly starting from the regional independence divisive issue.

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Riksbank hints at 2019 hike, defying ECB dovishness

The ongoing weakness in the Swedish krona means the Riksbank appears to be taking a more relaxed stance towards prospective ECB easing than in years gone by. Policymakers are hinting that a rate hike could come later this year, although we still have our doubts



A modestly hawkish outcome from the July Riksbank meeting

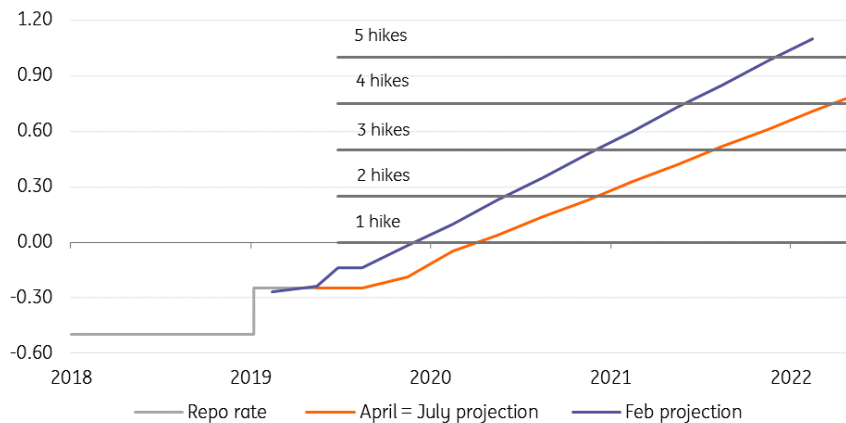
The Riksbank has opted to keep the repo rate on hold at -0.25% at its July meeting, but as ever the focus is on what policymakers have to say about the future path for rates. In what is probably a modestly hawkish move for markets, the Riksbank (RB) has kept its interest rate projection unchanged from April.

While it's true the domestic fundamentals haven't really shifted – for instance inflation has come in pretty much exactly in line with the RB's forecast – the major change is that global central bank expectations have completely collapsed since the last meeting just over two months ago. All else being equal, we'd have expected that to have modestly lowered the rate path. But following an in-depth look at krona fair value, the central bank is now forecasting a weaker currency over the forecast period and this appears to be the offsetting factor for lower overseas rate expectations.

All of this goes to show that the Riksbank is relatively unfazed by the prospect of a dovish ECB. While policymakers have often closely mirrored eurozone policy in the past, the fact that the krona

has got steadily weaker over recent months has seen the RB take a more relaxed stance towards potential currency strength at recent meetings.

The Riksbank has kept its interest rate projection unchanged from April



Source: Riksbank, ING

Domestic and global risks suggest rates likely to remain on hold for the time being

But while we don't expect the Riksbank to follow the ECB into policy easing any time soon, we aren't convinced the Riksbank will increase interest rates either – or at least, not as soon as the central bank's guidance suggests.

While policymakers left global growth forecasts more or less unchanged, this is premised on the “information now available”, hinting that they are quite aware that an escalation in trade tensions may yet throw a spanner in the works.

We also think there are risks to the domestic outlook. The Riksbank is projecting a pick up in wage growth next year, but a slight dip in inflation expectations among labour organisations suggests that the risks surrounding next spring's wage negotiations are biased towards a more lacklustre pay settlement.

All in all, we expect the Riksbank to keep rates on hold for the foreseeable future.

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After the rally: Domestic factors to play a greater role in RUB pricing

We're upgrading our 3Q19 USD/RUB forecasts from 65-67 to 63-65, to account for the RUB2 rally which took place in mid-June on global risk-on, but in the near-term, we remain cautious due to the balance of payments seasonality. Local risks beyond 2019 include uncertainties regarding investing part of National Wealth Fund locally



Source: Shutterstock

231 bn

Minfin's FX purchases for July in roubles

Down from RUB 310 bn in June

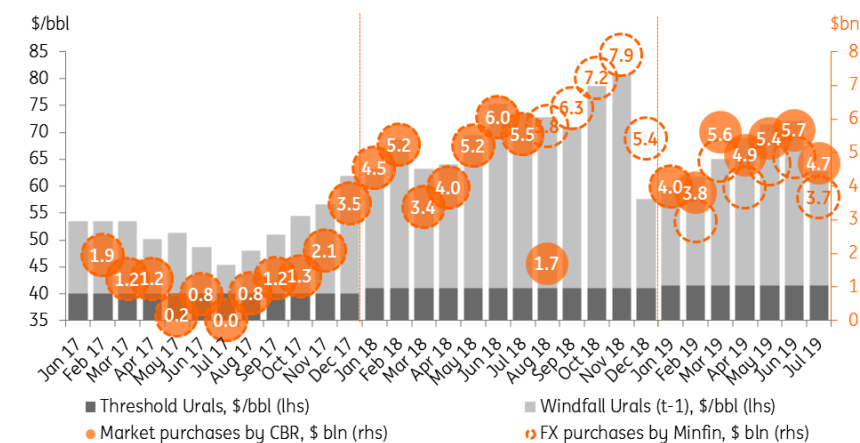
As expected

The Russian finance ministry announced it will spend RUB 231 billion (an equivalent of USD 3.7 billion) for FX purchases between 5 July and 6 August, as per the budget rule.

The amount includes the RUB 257 billion in extra fuel revenues of the budget expected in July and the RUB 26 billion downward revision in the extra fuel revenues for June.

Combine this with the August-December 2018 backlog, when the central bank put market purchases on hold, the total amount of FX purchased on the market will be \$4.7 billion in July, down from the \$5.7 billion seen in June. The decline in the FX purchases was expected and primarily reflects the nearly \$10/bbl drop in the average monthly Urals crude oil price in June.

Monthly FX purchases by Russian Finance Ministry/Central Bank



Source: Bank of Russia, Finance Ministry, ING

The ministry of finance's FX purchases now should serve as a reminder to market participants of local RUB drivers following the global emerging market repricing that took place after the Federal Reserve's softening of communication. The externally-driven RUB appreciation to USD in the second half of June was around 2%, in line with that of RUB's emerging market peers. This calls for an adjustment of our near-term USD/RUB projections by RUB 2 - to 63-65 for 3Q19 and to 64 by the end of the year.

As can be seen, this doesn't cancel out some expected weakness in the coming months due to the seasonality of the balance of payments.

- We expect the Minfin/central bank FX purchases of around \$15 billion in 3Q19 to sterilise around 75-100% of the \$15-20 bln current account surplus, which in turn might be pressured by the summer holidays and ongoing dividend season (we expect custodians to purchase around \$9 bln in favour of non-resident shareholders of the largest Russian dividend payers).
- In the meantime, the private sector seems to keep a high preference for the accumulation of international assets amid weak local capex growth. According to available data, net private capital outflow reached around \$5 billion per month in April-May and may continue to do so. CBR is due to publish 2Q19 balance of payment data on July 8.
- The only support factor to RUB (and the channel of transmission of global risk-on/off to Russia) seems to be the inflow of foreign portfolio investments into the local state bonds (OFZ) of around \$3-3.5 bln per month in April-May, which may have continued in June. However, the ability to maintain such strong inflows is now under question, as
 - foreign holders have restored their OFZ holdings close to historical high of \$41 billion
 - Minfin has fulfilled around two thirds of the annual placement plan in 1H19 and is planning to reduce primary supply to around \$1.5-2.0 bln per month

We keep our 2020 expectations of further RUB depreciation to 68/USD given the persistent

weakness in the capital account (accumulation of the international assets by corporates and the population) and the uncertainties related to the proposed investing part of the National Wealth Fund locally after 2019 (details on the proposal are outlined [in our earlier note](#)).

For now, we don't subscribe to the view expressed by some market participants, that the investment of NWF locally would necessarily result in return of some of the earlier accumulated FX back to the market, i.e. that the CBR will lower the FX purchases on the market. Unless officially refuted by the CBR and Minfin, we do not exclude a scenario, under which the FX purchases on the market will remain unchanged in line with the budget rule, while the conversion of FX into RUB for the purposes of investments would be done through internal transaction between Minfin and CBR with unchanged CBR international assets and increased supply of roubles on the money market.

Here's why we think there are no direct requirements for the central bank to adjust its current FX purchasing practice:

- The accumulation of FX under the budget rule is logically and legally separated from decisions as to where and how to invest the accumulated funds, ie, investing part of NWF locally does not reduce the amount of FX needed to be purchased by Minfin throughout the year
- The budget rule specifies only the actions of Minfin, not the CBR – i.e. it does not matter for Minfin whether the FX is purchased directly from CBR or on the market
It is up to CBR to decide whether it wants to mirror the FX accumulation on the market (as confirmed by last year's decision to postpone purchases of some \$30 bln until 2019-2022)
- CBR Governor Nabiullina indicated during the press conference that even though the CBR reserves have reached the comfortable \$500 bln level, the CBR intends to keep accumulating FX reserves in line with the budget rule
- Regarding the CBR's approach to FX purchases, we should mind the 2018 situation when in the two-way flows to NWF, the CBR only respond to the accumulation part
i.e. budget-rule mandated accumulation of NWF by RUB4.2 trillion was accompanied by the market purchases, while the simultaneous NWF spending of RUB1.1 trillion to finance the deficit of the State Pension Fund was not accompanied by any selling of the FX by the CBR on the market.

[Read why weak Russian activity is starting to impact budget policy](#)

Overall, we believe it's too soon to make conclusions on the volumes and mechanics of the National Wealth Fund investments, as the discussion is clearly still in the early stages.

However, the uncertainties related to the potential changes in the approach to the management of the state savings justify cautiousness regarding the long-term RUB trends.

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India's FY2020 budget targets lower deficit, really

Finance minister Nirmala Sitharaman may have scored some points for fiscal consolidation with a lower deficit target of 3.3% of GDP. Whether her maiden budget revives the economy to 7% of GDP growth in the current financial year remains to be seen



Source: Shutterstock

3.3% FY2020 fiscal deficit target

Lower than expected

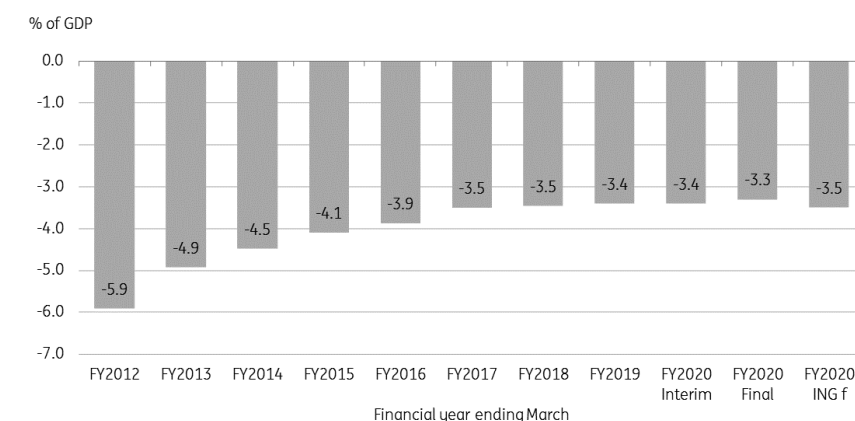
The final Budget for FY2020

To the surprise of many, new Finance Minister Nirmala Sitharaman's maiden budget for FY2020 (ending on 31 March 2020) aims for a lower fiscal deficit equivalent to 3.3% of GDP from 3.4% in

the interim budget. With persistent downside growth risk likely depressing government revenue and an infrastructure investment drive entailing more spending, the risk to the deficit target will be tilted on the upside.

We continue to expect another overshoot; we forecast the fiscal deficit at 3.5% of GDP in the current financial year, which rests on our view of much slower, 6.6% GDP growth than the government's 7% projection.

Derailed fiscal consolidation



A \$5 trillion economy in five years

Besides its prevailing “Make in India” theme, the government is aiming to make India a \$5 trillion economy by 2024, a near-doubling from \$2.7 trillion currently. This seems to be a feasible goal on the assumption of steady GDP growth of about 7% and inflation of 4% annually.

However, the long-term potential of 7-8% growth hinges on rapid infrastructure development. On the face of it, the budget appears to be heavy on words and light on concrete action on this front, while the long-term nature of infrastructure projects also makes them prone to frequent alterations, cost overruns, and uncertainty. Moreover, boosting infrastructure investment spending in the future could be a difficult proposition if countered by the drive to improve public finances and cut down the deficit, which will be an ongoing necessity to build global investor confidence, as the government eyes the international debt market for deficit financing (see below).

Among other things, the measures to attract more foreign investment (both direct and portfolio), public-private partnership (PPP) in infrastructure projects, and reduction of corporate taxes are some of the better initiatives.

Tapping international market for funds

In an initiative aimed at broadening the debt market, the government plans to turn to the international market to meet its funding needs. Given the low level of external debt, running around 20% of GDP, the move to broaden deficit financing to overseas debt markets may not be an issue.

The success, however, depends on the kind of investor response the government receives on this front. Considering the significant growth potential of the Indian economy ahead, this could be

positive, once the cyclical slowdown currently underway has passed. Moreover, investors will also be looking at the government's record of fiscal management. Weak growth feeding into the risk of sustained deficit overruns won't go down positively in the international market as this also adds to the risk of a sovereign rating downgrade - a risk that hasn't even been discounted currently with a persistent twin-deficit (fiscal and current account deficit).

For now though, this move should ease some of the supply overhangs on the domestic bond market, and thus reduce upward pressure on yields. Meanwhile, the government has maintained its INR 7.1 trillion local borrowing target for this year.

Budget in figures

Financial year ending March 31 INR bn	FY2016 Actual	FY2017 Actual	FY2018 Actual	FY2019 Actual	FY2020 Interim	FY2020 Final
1. Revenue receipts (% YoY)	11950.3	13759.6	14304.0	15631.7	19776.9	19627.6
	8.5	15.1	4.0	9.3	26.5	25.6
2. Tax revenue (Net to Centre)	9437.7	11013.7	12424.9	13169.5	17050.5	16495.8
3. Non-tax revenue	2512.6	2745.8	1879.2	2462.2	2726.5	3131.8
4. Capital receipts a/ (% YoY)	5957.6	6033.1	7114.2	7482.5	8065.1	8235.9
5. Recovery of loans	208.4	177.7	203.1	178.4	125.1	148.3
6. Other Receipts	421.3	477.4	1000.5	850.5	900.0	1050.0
7. Borrowing and other liabilities b/	5327.8	5378.0	5910.6	6453.7	7040.0	7037.6
8. Total Receipts (1+4)	17907.8	19792.7	21418.2	23114.2	27842.0	27863.5
9. Total expenditure (10+13) (% YoY)	17907.8	19792.7	21418.2	23114.2	27842.0	27863.5
	7.6	10.5	8.2	7.9	20.5	20.5
10. On revenue account; of which	15377.6	16929.9	18793.5	20084.6	24479.1	24477.8
11. Interest payments	4416.6	4807.1	5289.5	5826.8	6650.6	6604.7
12. Grants in aid for creation of capital assets	1317.5	1657.3	1953.5	2003.0	2007.4	2073.3
13. On capital account	2530.2	2862.8	2624.8	3029.6	3362.9	3385.7
14. Revenue deficit (1-10) % of GDP	-3427.4	-3170.3	-4489.4	-4452.9	-4702.1	-4850.2
	-2.5	-2.1	-2.6	-2.3	-2.3	-2.3
15. Effective revenue deficit (14-12) % of GDP	-2109.8	-1513.0	-2535.9	-2449.9	-2694.7	-2776.9
16. Fiscal deficit [9-(1+5+6)] % of GDP	-5327.8	-5378.0	-5910.6	-6453.7	-7040.0	-7037.6
	-3.9	-3.5	-3.5	-3.4	-3.4	-3.3
17. Primary deficit (16-11) % of GDP	-911.2	-570.8	-621.1	-626.9	-389.4	-432.9
	-0.7	-0.4	-0.4	-0.3	-0.2	-0.2

a/ Excluding receipts under Market Stabilisation Scheme

b/ Includes drawdown of Cash Balance

Source: Government Budget

Source: Govt. of India

Some of the budget initiatives

- Virtuous investment cycle with heavy infrastructure investment in national and state highways and inland waterways to facilitate the growth of internal trade. Boosting investment in suburban railroads with PPP initiatives.
- Boosting rural infrastructure with easier availability of electricity and water to farmers. Zero-budget farming (no credit, no chemical fertilizer) farming to double farmers' income.
- More support to MSMEs (micro, small, and medium enterprises) with easier credit availability. Pension plans for small businesses.
- Measures to attract foreign direct investment (FDI). Opening of aviation, insurance and media sectors to foreign investors. Labour market reforms enabling easier access for foreigners.
- Simplifying KYC (know your customer) guidelines for foreign portfolio investors (FPI) and allowing 'AA' rated bonds as investment collateral.
- INR 700 billion recapitalisation for state-owned banks. More powers to the Reserve Bank of India to regulate the non-bank financial sector, including housing finance companies.

- Increase in public stockholding limit for companies up to 35% from 25%. Rise in the target of public sector asset sales by 17% to INR 1.05 trillion in FY2020 from the interim budget. Proposed reduction in government shareholding in state-owned companies below 51%.
- Reduction of the corporate tax rate for turnover of up to INR 4 billion to 25% from 30%. Electronics assessment of personal income tax and surcharges of up to 7% for high-income earners.
- Hike in customs duty on gold and precious items and excise duty on petrol and diesel. Discouragement of cash economy with 2% tax deduction at source on over INR 10 million cash withdrawal per year.
- Tapping international market for sovereign borrowing. No change to the INR 7.1 trillion gross (4.73 trillion net) domestic borrowing target for FY2020.

India: Key economic indicators and ING forecasts

India (FY ending March)	FY2016	FY2017	FY2018	FY2019	FY2020 f	FY2021 f
Real GDP (% YoY)	8.0	8.2	7.2	6.8	6.6	7.0
CPI (% YoY)	4.9	4.5	3.6	3.4	4.5	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.4	-3.5	-3.5
Public debt (% of GDP)	69.9	69.0	69.8	72.5	73.0	71.0
Current account (% of GDP)	-1.1	-0.6	-1.8	-2.1	-2.5	-2.4
FX reserves (mth of imports)	10.2	10.6	10.2	8.7	7.8	7.2
External debt (% of GDP)	182.1	168.2	171.3	165.3	174.2	178.0
RBI repo rate (% eop)	6.75	6.25	6.00	6.25	5.75	5.75
3M T-bill rate (% eop)	7.27	5.82	6.09	6.14	6.20	6.50
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.35	7.40	7.65
INR per USD (eop)	66.33	64.84	65.18	69.16	69.80	68.80

Sources: Bloomberg, CEIC, ING forecasts

Source: Bloomberg, CEIC, ING

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