

# In Case You Missed It: The unreliable boyfriend returns

Governor Mark Carney throws a Bank of England May hike into question and the Swiss franc is safe no more. Plus, we try to get into the heads of global central bankers, figure out what the flattening yield curve means for the US economy, preview an ECB meeting that nobody really needs and revise our oil price forecast

## In this bundle



### Where next for central banks?

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

By James Knightley, Carsten Brzeski and 2 others



### United Kingdom

#### Four things that matter for the Bank of England as Carney goes cautious

A May rate hike still looks more likely than an August move, but Mark Carney's cautious comments sent a clear warning to those anticipating two or...

By James Smith



### United States

#### US: Are we heading to recession?

The US yield curve keeps getting flatter with growing concern it could turn negative. Such a development preceeded all nine recessions since 1955. How...

By James Knightley



FX | Switzerland

### EUR/CHF at 1.20: Thank Trump

This week EUR/CHF traded at 1.20 – the level of the currency floor which the Swiss National Bank (SNB) abandoned so suddenly in January 2015. We...

By Chris Turner

---



### ECB preview: A general repetition no one really needs

Thursday's ECB meeting will again be one of those most of their officials would rather skip if they could. It should only serve as the prelude to the...

By Carsten Brzeski

---



### Shrinking oil inventories mean higher prices

ICE Brent broke back above US\$70/bbl last week due to geopolitical risks along with some fundamentally bullish developments in the market. We are finding...

By Warren Patterson

---

---

Article | 20 April 2018

# Where next for central banks?

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



Source: Federal Reserve, Bank of England, Shutterstock

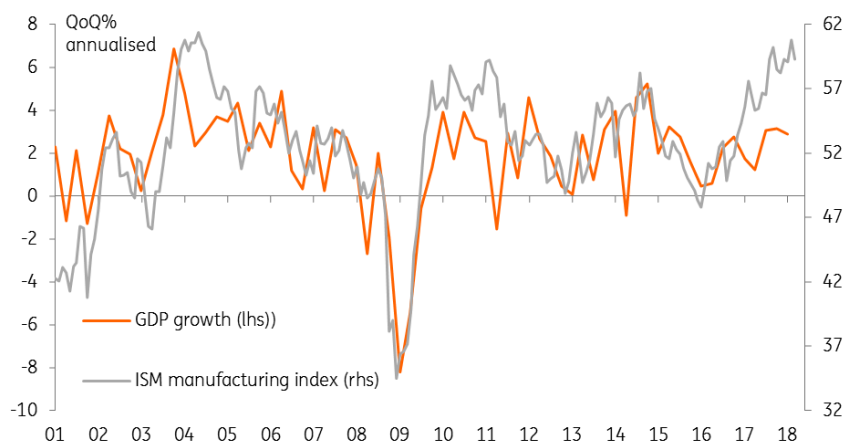
## Federal Reserve: Tightening on track

There has been a slight sense of loss of momentum in 1Q18, partly weather-related and partly sentiment driven due to protectionist concerns, but on balance we remain upbeat on the US economy's prospects. Domestic demand is strong, supported by a firm jobs market, rising house prices and an expansionary fiscal policy driven primarily by significant tax cuts. At the same time, the US dollar's depreciation means exporters are in a competitive position to benefit from the upturn in the global economy.

Meanwhile, consumer price inflation is broadly in line with the Federal Reserve's 2% target. Given the tight labour market, we find it easy to envisage wage growth rising towards 3.5%YoY later this year. With energy prices and import prices picking up again there is the possibility headline CPI rises towards 3%.

In this environment of robust growth and rising inflation, we forecast the Fed raising rates three more times this year with a further two, possibly three likely for 2019, especially if President Trump makes progress on his infrastructure spending plan. This would take the Fed funds rate up to around 3%.

## Surveys suggest US GDP is understated



Source: Macrobond

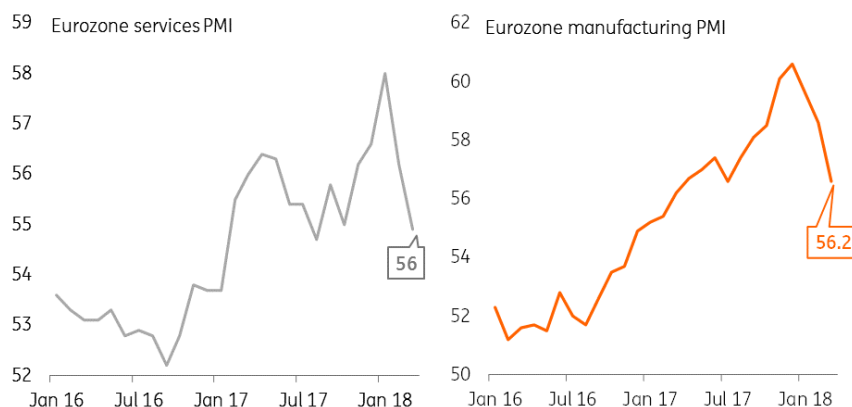
## European Central Bank: Questions about quantitative easing

Behind the scenes, next week's European Central Bank meeting should be much more exciting than what ECB president Draghi will present during the press conference. While trade tensions and the soft patch in the economy should lead to a somewhat more cautious tone, the ECB will wait until the next round of staff projections in June to get a better grip on inflation developments.

The only thing that Draghi could give away on Thursday would be a confirmation of his previous statement that there would be no abrupt ending to QE in September. A clear sign QE will be extended once again.

Looking beyond next week's meeting, lack of inflationary pressure combined with some weakening of the cycle should keep the debate on the end of QE lively. In fact, the central question is if there will be an extension of QE by three or six months and will it be an extension with an open or a definite end.

## Eurozone data dips in the first quarter



Source: Macrobond

## Bank of England: Cautious Carney casts serious doubt over May hike

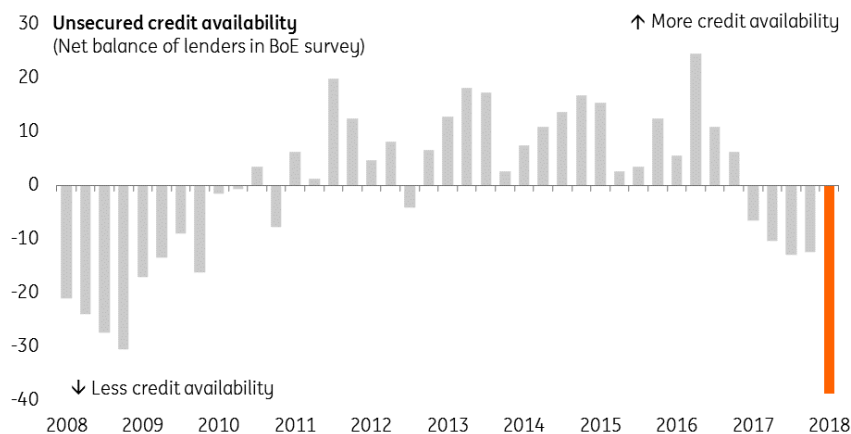
Cautious comments from Bank of England Governor Mark Carney mean a May rate hike now looks like much more of a 50:50 call.

However, the surprisingly strong wage growth numbers over recent months, coupled with the post-Brexit transition period agreement had led markets to near-enough price in a rate rise at the next meeting. And given the hawkish comments from the Bank so far this year it seemed as if the Bank was trying to boost expectations ahead of a May move. “Earlier”, “somewhat greater” and “ongoing” are all words that have been used to describe the nature of future tightening.

But since then, it has become clear the retail sector has had a dreadful quarter – perhaps the worst since the crisis. Some of this is weather-related, and that’s also seen manufacturing and other service-sector output dip. But much of this is down to ongoing consumer caution. Real incomes, while no longer falling, remain under pressure. And with consumer credit availability dropping “significantly” according to the BoE, we see few catalysts for a recovery in spending in the short-term.

That said, we still think a near-term hike is likely as Carney’s comments might simply be a case of buying some extra time to see how things play out between now and August. But with growth fragile, core inflation imminently set to return to target and Brexit talks likely to be bumpy, thoughts of multiple rate hikes this year look premature.

## UK consumer credit availability drops off cliff in first quarter



Source: Bank of England

## Bank of Japan: Held back by inflation

Following some possibly loose-lipped comments by the Bank of Japan's Governor, Haruhiko Kuroda, to the effect that the BoJ's qualitative and quantitative easing programme (QQE) could come to an end by mid-2019, there has been little to suggest that this is indeed on the cards. Indeed, a recent back-slip by inflation makes the BoJ's task look as insurmountable as ever. Kuroda's comments were most likely aimed to chime with the BoJ's projection of inflation rising to 2% over this same time frame, though this has never looked particularly realistic, and markets may have overanalysed these remarks.

However, things may not be as stagnant as they seem. The Japanese economy remains in good shape, with profitability strong in the manufacturing sector, and resilience to further yen strength good. But this good news does not spill over into the political sphere, and some analysts are speculating that PM Abe's days as Japan's political leader are numbered, following the scandal over land sales to nationalist schools with links to the PM's wife.

If Abe does stand down later this year, the Abenomics policy approach would probably continue in overall substance and direction, but not perhaps with as much zeal as previously. This may even entail an acknowledgement that 2% inflation is not attainable and that some elements of monetary stimulus could be pulled back.

## **People's Bank of China: Interest rate liberalisation meets financial deleveraging**

New central bank governor Yi Gang has emphasised that interest rate liberalisation could be sped up. In particular, the central bank would like banks or other financial institutions to link market rates when they quote lending rates so that lending rates are market-based. For example, linking SHIBOR for short-term rates and CGB yields for long-term rates. Currently, lending rates are linked to the one-year benchmark lending rate, which the central bank is trying to phase out.

Moreover, the central bank also wants deposit rates to be market driven. Liberalising deposit rates is related to both interest rate liberalisation and financial deleveraging. If deposit rates are more competitive, there would be less demand for wealth management products, which would result in fewer shadow banking products.

We expect the People's Bank of China to follow the Fed's remaining three rate hikes but at five basis points each to reflect the already tightened liquidity situation in China. Following the Fed's rate hike path will keep the interest rate spread between China and US steady, and therefore avoid capital outflows.

## **Reserve Bank of Australia: Labour market could stretch rate hike forecasts**

Recent labour market data out of Australia has been somewhat disappointing, and if this is reflected in quarterly wages data, then even our expectation that the Reserve Bank of Australia will eventually hike rates by 25bp in 4Q18 looks a bit stretched. The next meeting is on 1 May, and really, the RBA is under no obligation to offer guidance in any direction, with markets not looking for any action. The Monetary Policy statement out on 4 May will likewise be equally uncommunicative.

In the background though, the housing market continues to lose steam gradually, with recent house price figures somewhat stronger than anticipated, though still with an overall downward trend. The RBA's inactivity, coupled with the Australian Prudential Regulatory Authority's (APRA) consistent but gradual tightening of lending regulations, seems to be delivering a somewhat improbable but welcome soft-landing in this sector.

With so much Australian household net worth tied up in property, and the gross liabilities being overwhelmingly in property too, this is a very favourable outcome and one that neither the RBA nor APRA will want to mess up with precipitous action.

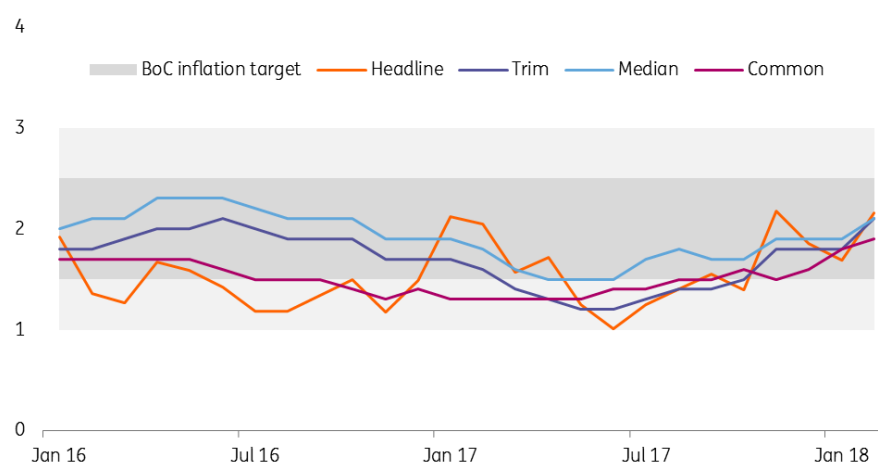
## Bank of Canada: Hiking to resume once NAFTA uncertainty clears

The Bank of Canada kept rates on hold again in their April meeting, which was the most likely scenario given trade uncertainties relating to NAFTA and US-tariffs. However as NAFTA uncertainty clears (talks of a deal being reached by early May), we expect the Bank to recommence their hiking schedule with two moves, starting in July.

The Canadian economy is still growing healthily, albeit at a slower pace than in 2017, and this is expected to continue throughout 2018. Additionally, there has been a slight fall in the worryingly high debt to income ratio, which the Bank will continue to watch closely among other measures as they monitor the economy's sensitivity to changes in interest rates.

Price and wage pressures have also been building, climbing above the Bank's 2% target. This is likely to challenge the Bank's recent dovish 'wait-and-see' approach and is a pivotal reason as to why we think the Bank will start hiking soon after a NAFTA deal is signed.

### Build-up of Canadian inflation



## Reserve Bank of New Zealand: On hold for foreseeable future

On 26 March this year, the Reserve Bank of New Zealand (RBNZ) decided to add maximum sustainable employment alongside price stability. The current unemployment rate is only 4.5%, but it has historically troughed lower (December 2007 saw it hit 3.3%). Moreover, at the current unemployment rate, inflation has not been accelerating, but decelerating, suggesting maximum employment remains elusive and that the RBNZ can sit with the policy rate at 1.75% for the foreseeable future.

Our house forecasts, like the RBA, have a 4Q18 rate hike pencilled in. But this is a low conviction holding-pattern forecast, and even if the unemployment rate keeps falling while inflation moves away from, not towards 2.0% (now 1.1%), this forecast remains at risk of being pushed back into 2019.

## Authors

### **James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

### **Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

### **Robert Carnell**

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

### **James Smith**

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)



## Four things that matter for the Bank of England as Carney goes cautious

A May rate hike still looks more likely than an August move, but Mark Carney's cautious comments sent a clear warning to those anticipating two or...



Source: Bank of England

### The 'unreliable boyfriend' is back, or so it seems

Having more-or-less fully priced in a May rate hike, markets have received quite a shock following comments from Bank of England (BoE) Governor Mark Carney that appear to cast doubt over a move at the next meeting. This is all the more surprising given BoE rhetoric so far this year, most of which had suggested policymakers were looking to guide markets towards a May rate rise, following better wage numbers and recent Brexit progress.

So what do we make of all of this? Well for now, we still narrowly think the Bank will hike rates next month, although this has become much more of a 50:50 call. Amidst bad weather, consumer caution and a sharper-than-expected fall in core inflation, it's entirely possible that policymakers may be looking to buy some time to see how things play out, before considering a rate rise at August's meeting.

But either way, Carney's comments will send a clear message to markets. The debate on where policy should go next is still far from clear-cut, and this means that any thoughts of two-or-more rate hikes this year still look premature.

Here are four things that will be feeding into the Bank's thought process.

## ↑ Wage growth and global growth remain (largely) on track

An expectation that wage growth would soar in 2018 was one of the key reasons for hiking rates back in November. Bank agents had indicated that firms expected the best year since the crisis for pay settlements. Since then, we suspect even the more hawkish committee members will have been surprised by just how quickly wage momentum has picked up over recent months. Of course, it's still early days, and the pace of increases has slowed a little in the latest couple of readings, although we suspect not nearly enough to cause concern amongst policymakers.

Global growth – another key plank in the November rate hike decision – has also held up reasonably well. Admittedly, the Eurozone has shown some signs of fatigue since the start of the year, but with order books still fairly full and a variety of temporary factors holding back growth, our team is still upbeat on prospects for the next few months.

This all means a UK rate hike in the near-term still looks like a reasonable bet.

## ↑ Seize the day! The rate hike window may not stay open for ever

If the build-up to the December and March EU leader's meetings is any guide, the months leading up to the October summit could see negotiations get increasingly noisy as we head through the year. For this reason, we've long warned that the rate hike window may well close as we head into the autumn. Unless the Bank has, in fact, become suddenly more concerned about the economic outlook, we would be surprised if policymakers didn't look to capitalise while they can – particularly with markets relatively on-board with the idea of a hike over the next few months.

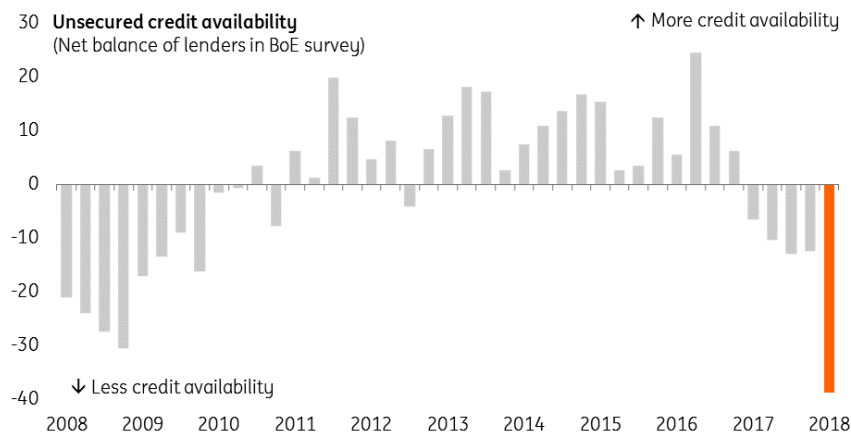
## ↓ A dreadful quarter for retail means the Bank has to tread carefully

The latest dip in retail sales rounded off what has been a dreadful quarter for spending, ranking as one of the worst since the financial crisis. Some of this was certainly down to snowy weather, and this has also seen other manufacturing and service sector activity drop off in March. But much of it also has to do with ongoing consumer caution.

It is certainly true that the household squeeze is no longer at its worst – inflation is easing, whilst wage growth is finally showing signs of life. But real incomes don't look set to rise materially any time soon either – and it's not clear that savings or credit will come to the rescue. Consumers had already been diving into savings as the wage squeeze started to bite, and credit availability has plunged since the start of the year according to a Bank of England survey. With confidence near multi-year lows (particularly stark when compared to Europe or the US, where shoppers are the happiest they've been in well over a decade), the retail sector is not out of the woods just yet.

With retailers' margins also being squeezed by higher minimum wage costs, as well as increased business rates, the Bank will have to tread carefully when raising rates – particularly as many firms have built up debt in the post-crisis years.

## Unsecured credit availability has reduced significantly according to the BoE



## ↓ Core inflation is now near-enough back to target

Inflation has fallen noticeably faster than the Bank of England was forecasting back in February. Part of this can admittedly be chalked down to the fact that the early easter didn't boost prices as much as thought. But it's also clear that the effect of the pound's post-Brexit plunge is fading rapidly. Prices have now more or less adjusted to the new value of the pound, and that's seeing the cost of currency-sensitive goods starting to fall. This is only set to continue, and we expect to see core inflation back at target at some point over the next three-four months.

This is another reason why we think the Bank may only hike rates once this year - although as we said above, policymakers have been increasingly taking their cue from wage growth as a guide of underlying inflationary pressures.

### Author

#### James Smith

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

## US: Are we heading to recession?

The US yield curve keeps getting flatter with growing concern it could turn negative. Such a development preceeded all nine recessions since 1955. How...

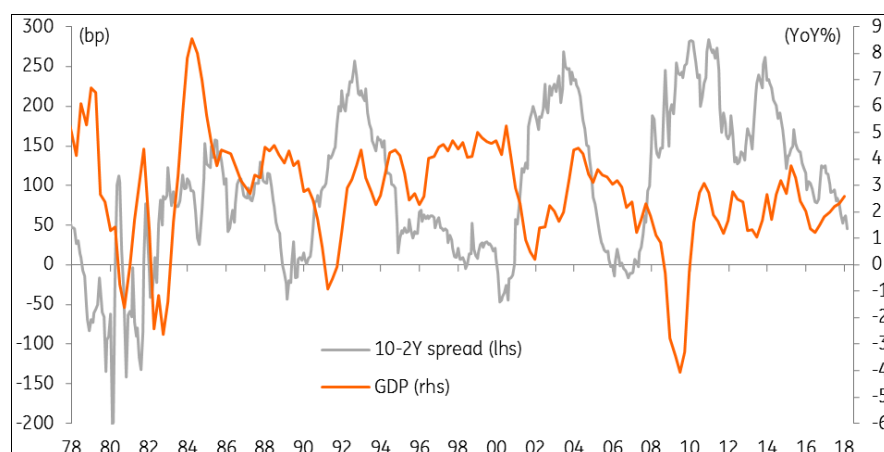


Source: Shutterstock

### Yield curves and the economic cycle

The US yield curve is currently the flattest it has been for a decade. With the Fed looking set to hike rates another three times this year a growing number of voices are warning we could soon see the yield curve actually invert, meaning it is cheaper for the government to borrow over ten years than it is over 2 years. This is a huge story. When the yield curve has inverted previously it's been an early warning signal of impending doom - the US has typically fallen into recession within 2 years.

## The US yield curve and GDP growth



Source: Macrobond

That said, it is important to remember that this is a guide, not a rule. In 1998 when we saw a very temporary shallow inversion following the Asia/Russia/LTCM crises, a swift Fed response meant the economy powered on and the yield curve quickly normalised with a positive slope.

Nonetheless, even in a relatively benign situation such as then, an inverted yield curve would signal bond market nervousness that could trigger a broader switch towards safe-havens and provide some respite for the beleaguered dollar.

### Why invert?

Yield curves typically steepen ahead of a central bank tightening cycle as the market anticipates higher interest rates and then flatten as the central bank actually raises short-term rates. This is the process we are seeing right now. But if it continues and the curve inverts, history would suggest there are two main scenarios that we face:

1. The concerning one: The market believes the Federal Reserve is making a policy mistake by raising short-term interest rates too aggressively. This prompts an economic downturn that requires corrective action later on and is bad news for risk assets.
2. The more benign one (ie, 1998): The economy and inflation pressures aren't as strong as the Fed believes and we will see those anticipated Fed rate hikes priced out, lowering shorter dated yields, which prompts a re-steepening the yield curve. This is less damaging for risk assets.

### The Fed divided

Over the past couple of days we have heard several Fed officials offering their perspective. As you would expect, there are a range of views.

St. Louis Fed President James Bullard (a noted dove) suggests we could see a negative yield curve within the next six months if the Fed pushes ahead too aggressively with rate hikes. He advocates a "wait and see" approach to monetary policy, believing that there is little inflation threat in the economy. It's important to remember he doesn't get to vote on Fed decisions this year.

San Francisco Fed President (from June NY Fed president) John Williams admits that an inverted yield curve has in the past been a “powerful signal of recessions”, but he doesn't “see the signs yet of an inverted yield curve”. He believes that there is more of an inflation threat than Bullard, which will mean longer dated bond yields will move higher, but that the curve will continue to flatten – “it's totally normal” in his view.

Fed Governor Quarles agreed yesterday, saying “I'm not viewing the current flattening of the yield curve as a particular signal towards pending recession”. Like Williams, he believes the longer end of the bond market is lagging behind and will respond.

## **Inversion avoided... for now**

We have more sympathy with the views of Williams and Quarles than we do for Bullard's at this stage. We remain upbeat on the US economic prospects. Domestic demand is strong, supported by strong jobs market, rising house prices and an expansionary fiscal policy driven primarily by significant tax cuts. At the same time the US dollar's depreciation means that exporters are in a competitive position to benefit from the upturn in the global economy. If in addition President Trump can make progress on infrastructure investment this could help extend the US economic cycle.

Meanwhile, consumer price inflation is broadly in line with the Fed's 2% target. Given the tight labour market, we find it quite easy to envisage wage growth rising above 3.5% YoY later this year. With energy prices and import prices picking up again there is the possibility headline CPI rises towards 3%.

In this environment of robust growth and rising inflation we forecast the Fed raising rates three more times this year with a further two, possibly three likely for 2019. This would take the Fed funds rate up to around 3%.

We also see upward pressure on longer dated yields. For reasons already stated, we think that the bond market is under-pricing the threat of higher US inflation - consensus estimates suggest inflation will be benignly rise fractionally above 2% before settling at that level for the next few years.

Then there is the Federal deficit, which is set to hit \$1 trillion dollars next year or 5% of GDP. This requires a massive increase in government debt issuance, much of which is likely to be in the form of longer dated treasuries, at a time when the Federal Reserve is running down its vast balance sheet. This change in the supply/demand mix could provide upside impetus for longer dated bond yields.

As such we see 10Y yields rising towards 3.5% and a Fed funds terminal rate of around 3.25-3.50%. But the Fed does not get anywhere near that this year. Hence the probability of inversion is low for 2018.

### **But we acknowledge the risks**

The US economy is undoubtedly late cycle – we are in the midst of the second longest US economic expansion since the end of World War Two and debt levels are clearly on the rise. Consequently the response to higher interest rates is somewhat uncertain, but this is one of the reasons why the Fed continues to emphasise its “gradual” approach to policy tightening.

Add in the fear of an escalation of protectionist policies that could de-rail the positive global and US growth story and we acknowledge there is some justification for bond market nervousness that could lead to an inversion.

That said, it is important to remember that a negative yield curve doesn't mean recession is inevitable. Obviously, the US will eventually experience recession again, but for the next couple of years we remain upbeat with the global growths story while a competitive dollar and ongoing fiscal stimulus and infrastructure spending can help prolong the economic cycle.

## Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## EUR/CHF at 1.20: Thank Trump

This week EUR/CHF traded at 1.20 – the level of the currency floor which the Swiss National Bank (SNB) abandoned so suddenly in January 2015. We...



### EUR/CHF back at 1.20



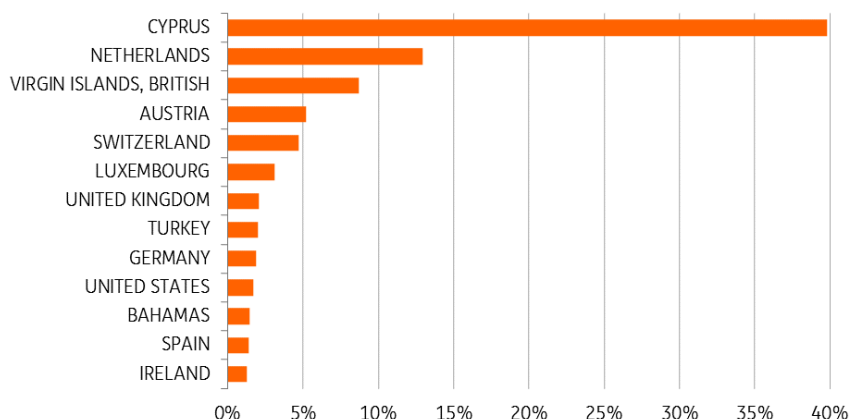
### Back where it belongs

It's taken a while – just over three years in fact – but EUR/CHF has finally made it back to the 1.20 level. 1.20 was the SNB's currency floor up until January 2015, at which point the prospect of ECB



quantitative easing and further EUR weakness prompted the SNB to wave the white flag. We think three factors have been driving EUR/CHF strength over recent weeks.

## Russia's overseas assets by geography



### 1 Russian sanctions

On April 6th, the US Treasury expanded its list of Russian sanctions to a further seven oligarchs and 12 companies they control. There were some high profile names on the list, including the owner of the major aluminium smelter, Rusal.

What's the connection to the Swiss franc? Well one of the sanctioned oligarch's companies, Renova Group, had a controlling stake in the Swiss-listed Sulzer AG, causing Sulzer's assets to be blocked by the US Treasury. This week Sulzer has undertaken a hurried share buy-back to reduce Renova's stake in the company to 49% from 63%. The transaction was worth CHF546 million according to Sulzer's website and may have weighed on the CHF if the market felt Swiss assets were being divested.

The performance of the CHF also reflects Switzerland's reasonably large role in Russia's stock of overseas FDI. However, by far the largest concentration of Russia's overseas assets sits in Cyprus. Russian residents had US\$181bn of equity and debt assets listed out of Cyprus as of last September and amongst other things, fresh US sanctions have prompted a sharp sell-off in Cypriot government debt over recent weeks.

Unpicking the network of Russian residents' international holdings and their response to sanctions is a near impossible task, but this may prove a soft negative backdrop to the CHF over coming months.

### 2 'Vollgeld' follies?

Another factor impacting the CHF may be the increasing focus on a June 10th referendum in Switzerland on the issue of sovereign money or 'vollgeld'. Viraj Patel [highlighted this on Wednesday](#). This could be turning into a Brexit-style vote for the Swiss electorate, where a populist backlash against the banks wants the Swiss National Bank to be solely in charge of creating CHF liquidity and not the banks.

Authorities have come out firmly against such a notion, but as we discovered with Brexit, populist

stories cannot easily be dismissed when it comes to national votes on complex subjects. The shadow of this referendum may well hang over the CHF into the June 10th referendum.

### 3 Dodging the currency manipulator bullet

One final point to mention. With President Trump happy to shower policy prescriptions around the globe, there was always a chance that the semi-annual FX report from the US Treasury released mid-April could have been far more critical of the SNB's FX intervention to buy EUR/CHF as part of its current monetary policy toolkit. The report, in fact, wasn't that critical of the SNB, although it did suggest the SNB should consider off-loading some of the near CHF800bn in FX reserve assets acquired since the financial crisis.

### Stay on target: 1.25

These three factors have probably been behind April's weakness in the CHF. But in terms of the bigger picture we continue to expect that the reversal of ECB QE policy – including the return over coming years of portfolio flows driven outside of the Eurozone by the QE policy – will continue to drive EUR/CHF towards our six to 12-month target of 1.25

#### Author

##### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

---

Article | 22 April 2018

## ECB preview: A general repetition no one really needs

Thursday's ECB meeting will again be one of those most of their officials would rather skip if they could. It should only serve as the prelude to the...



Source: Shutterstock

When the ECB gets together this week, the Eurozone's central bankers will look at an economy which is currently showing signs of a slowdown and very little evidence that the latest inflation projections are more than just wishful thinking. In fact, the first two months of the year were two months to forget. While the weakening of several confidence indicators could still be filed away as a leveling off from record-high levels, the slide in hard data is more worrisome. It would already need very strong March readings to avoid a disappointing first quarter

---

*The first two months of the year were two months to forget*

---

Still, despite this short-term weakening, it is far too early for the ECB to sound the alarm bells. The optimistic tone of recent months should continue albeit with somewhat more emphasis on downside risks and uncertainty.

As for inflation, there is very little evidence that the ongoing divide between wish and reality will change any time soon. While the ECB remains confident that inflation should pick up, hard data are telling a different story. March inflation only accelerated due to seasonal effects and core inflation remained unchanged at extremely low levels. Also, there seems to be very little price pressure in the production pipeline as producer price inflation has come down significantly from its early 2017 highs. If it was not for traditional cyclical and survey indicators, which still point to an acceleration in headline inflation, there would be very few arguments supporting the ECB's own projections of headline inflation at 1.7% in 2020.

## Lots of noise but very few new hard facts

In short, except a lot of noise stemming from the brewing trade conflict, military action in Syria and fading euro-phoria on the back of growing German opposition against Macron's Eurozone reform plans, the only "hard" changes since the last ECB meeting are currently benefiting the doves. But what does this mean for the future path of the ECB's monetary policy?

First of all, the ECB will have to find a consensus view on its own narrative. Remember that the ECB has always tied its QE programme to the "sustained adjustment in the path of inflation consistent with its inflation aim". This means that even though QE was started to tackle a deflationary threat, the sheer disappearance of such a threat should not be sufficient to stop QE. Instead, the ECB's wording has always made QE a "revamp-inflation" rather than a "fight-deflation" tool.

## Looking beyond next week's meeting

With all that in mind, there are (at least) three scenarios for the ECB's next plausible step.

### 1. An abrupt end to QE in September

This scenario would follow the initial logic of QE as a deflation-fighting tool. With the ongoing recovery, closing output gaps and headline inflation at least above 1%, no single European central banker can still seriously talk about deflation. Hence, an end to QE would be the logical consequence. This scenario, however, would not only contradict Mario Draghi's own words that he did not expect an abrupt end of QE, but it would also bring forward expectations about a first rate hike. This would be to an even earlier date than the mid-2019 recently advocated by Weidmann and other hawks. Therefore, this scenario is extremely unlikely, though not completely impossible.

### 2. Another open-ended extension

This scenario currently seems to be the mainstream ECB call. It reflects the view that there seems to be a broad consensus within the ECB that QE should be ended but that diverging views only exist on the timing and details of this end. Another "lower for longer", reducing the monthly QE purchases from currently €30bn to €15bn at least until the end of the year would be an almost organic next step in the ECB's gradual end to QE. It would also leave the door open to another extension beyond 2018 in case of an unexpected slowdown of the Eurozone economy or new downward revisions of the inflation forecasts. At the same time, however, it could be too much for the ECB hawks who are clearly advocating a clear end date for QE.

### 3. Much lower for much longer, but with an end date

Another possible compromise between hawks and doves could be a so-called "much lower for much longer", ie, an extension of QE for another six months but then at a very low level of about

€5bn. This extension could then be combined with an end date. This scenario would become more likely in case the soft patch of the first two months of the year was to continue and if the June staff projections for inflation up to 2020 remain unchanged or are even revised downwards.

## We expect another extension of QE, at least until December and possibly even beyond

Needless to say that there are more than only these three scenarios possible. In particular, combinations of scenarios 2 and 3 give multiple additional options. What counts most is obviously a definite end date to QE and how much in advance such an end date will be communicated. The end date is crucial. As soon as the ECB has communicated an end date for QE, the focus will immediately shift on sequencing. Sequencing will then be the ECB's main tool to steer market expectations and rates.

---

### *The end data is crucial*

---

Will it be six months between the end of QE and the first rate hike or could it be more (or even less)? Currently, the ECB seems to be happy with market expectations that sequencing means six months. Another topic in the beyond-QE era will be the reinvestments of maturing assets held by the ECB. When would the ECB stop the reinvestments? At the moment of a first rate hike or later? Given that the ECB has been mirroring and following the Fed's QE experience substantially, a continuation of the reinvestments looks likely. In the US, the Fed's reinvestment programme went on for another three years after the official end of QE.

Our base case scenario remains another extension of QE at least until December. We even consider the possibility of a "much lower for much longer" scenario, which would push the end of QE into 2019 and the first rate hike into the second half of 2019. To see this happen, the current soft patch of the economy would have to be longer-lasting than expected and the inflation outlook at the June meeting should – due to structural factors – remain benign.

All of this means that this week's meeting will be a general repetition or just the prelude to the big June meeting. Given the nitty-gritty discussions and controversies on the timing and details of tapering, it will be a general repetition the ECB would probably prefer to perform behind closed doors, as currently, silence is clearly more golden than any words.

### Author

**Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

Article | 17 April 2018

# Shrinking oil inventories mean higher prices

ICE Brent broke back above US\$70/bbl last week due to geopolitical risks along with some fundamentally bullish developments in the market. We are finding...



Source: Shutterstock

Previous	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
ICE Brent (US\$/bbl)	67	60	57	57	50	52	55	55	50	55	60	55
NYMEX WTI (US\$/bbl)	63	58	55	55	49	51	54	54	49	54	59	54
New	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
ICE Brent (US\$/bbl)	67	69	66	64	60	62	65	65	60	65	70	65
NYMEX WTI (US\$/bbl)	63	65	62	60	56	58	61	61	57	62	67	62

## Geopolitical risk in the Middle East

*“Russia vows to shoot down any and all missiles fired at Syria. Get ready Russia, because they will be coming, nice and new and “smart!” You shouldn’t be partners with a Gas Killing Animal who kills his people and enjoys it!”*

Those were the words that Trump wrote on Twitter, following allegations that Syria used chemical weapons on its citizens. This was followed by US, UK and French airstrikes on suspected facilities in Syria over the weekend. However, the short duration of the campaign and little retaliation from Russia as of yet, have reduced concerns over the conflict potentially spilling over to the oil market.

## US\$80/bbl Saudi target and OPEC cuts

There have been media reports that Saudi Arabia is targeting an oil price of US\$80/bbl ahead of the IPO of Saudi Aramco, which now looks more likely to be a 2019 event. The market, particularly the record spec long, has taken comfort in these reports, as it suggests that the Saudis along with other OPEC members should remain committed to the production cut deal.

If the Saudis are targeting a price of US\$80/bbl, it will make one producer very happy- the US. If current prices are a no-brainer for the US industry to increase drilling activity, anything between US\$70-80/bbl on WTI should see US producers throw everything they have into expanding production.

OPEC compliance to the production cut deal remains high. In March, compliance amongst OPEC was 160%, which has taken average compliance since the deal started to 109%. However let's not forget OPEC has been given a helping hand by the continued slide in Venezuelan production, which has fallen by almost 500Mbbbls/d over the last year, to a little over 1.5MMbbbls/d. If declines continue at the same rate, we could see production slump to just 1.22MMbbbls/d by the end of this year. This will clearly help OPEC in achieving its goal of bringing inventories back to "normal".

The IEA's latest oil market report suggests that OECD inventories could already be at the five-year average. By the end of February, the IEA estimates that stocks were 30MMbbbls above the five-year average. A tightening in the global oil market is evident when looking at the deepening backwardation in the front month spread in ICE Brent, with it trading at over US\$0.60/bbl currently, up from US\$0.23/bbl in mid-March.

Given the fate of Venezuela, continued strong compliance from other OPEC members, and robust demand growth we now expect that the global oil market will be in deficit for the remainder of the year, which supports our relatively more constructive view.

## OPEC compliance with production cuts- Venezuela leads the way

Country	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Average
Algeria	98%	98%	98%	98%	98%	58%	58%	58%	98%	138%	158%	98%	78%	98%	178%	101%
Angola	104%	78%	155%	117%	155%	104%	91%	117%	142%	53%	181%	155%	168%	194%	232%	136%
Ecuador	69%	50%	69%	69%	69%	69%	69%	69%	31%	69%	108%	108%	108%	108%	108%	78%
Gabon	78%	244%	244%	22%	22%	22%	22%	22%	-89%	133%	22%	22%	22%	22%	133%	63%
Iraq	34%	58%	62%	72%	67%	39%	29%	34%	43%	100%	81%	62%	62%	62%	62%	58%
Kuwait	98%	98%	102%	105%	98%	98%	105%	98%	90%	67%	105%	113%	98%	105%	105%	99%
Qatar	110%	93%	127%	110%	93%	93%	127%	127%	127%	260%	160%	127%	160%	93%	127%	129%
Saudi Arabia	136%	124%	124%	122%	126%	106%	106%	112%	112%	110%	118%	122%	110%	137%	139%	121%
UAE	45%	45%	71%	81%	110%	81%	74%	67%	60%	74%	96%	88%	117%	153%	110%	85%
Venezuela	39%	39%	71%	92%	92%	102%	102%	102%	102%	218%	218%	386%	418%	481%	586%	203%
Total	93%	90%	102%	102%	107%	88%	85%	89%	90%	109%	121%	128%	128%	148%	160%	109%

## The US goes drilling

In a market that is looking more constructive, one of the downside risks remains the US. The number of active oil rigs in the US increased to 815 last week, which is the highest level seen since March 2015, and an increase of 68 since the start of the year. Given current prices, we would expect rig activity to pick up moving forward.

Looking at oil output, unsurprisingly it is a similar story. US production hit a high of 10.53MMbbbls/d over the last week, increasing from 9.49MMbbbls/d in the first week of 2018. The EIA in its Short Term Energy Outlook estimates that crude oil production will average 10.7MMbbbls/d over 2018 and 11.4MMbbbls/d in 2019. While the administration has left its 2018 forecast largely unchanged, it has

increased its 2019 forecast by 100Mbbbls/d from last month.

The increase in output has been driven by the Permian region, where the EIA expects output to hit 3.18MMbbbls/d in May, up from 2.38MMbbbls/d in May last year. The growth in output is weighing on certain spreads, with the WTI Midland/Cushing spread having traded to a US\$6/bbl discount, with takeaway capacity unable to keep up with production growth in the region. Although more recently the spread has traded back towards a US\$3.50/bbl discount, with news that Enterprise will add 35Mbbbls/d to its Midland to Sealy crude oil pipeline over May, which would take total capacity of the pipeline to 575Mbbbls/d.

Meanwhile in the longer term, there are some projects which are set to increase takeaway capacity from the Permian region over 2019. Magellan is looking to add 40Mbbbls/d of capacity, whilst the EPIC pipeline, which is set to start up by mid-2019, will have a capacity of 440Mbbbls/d.

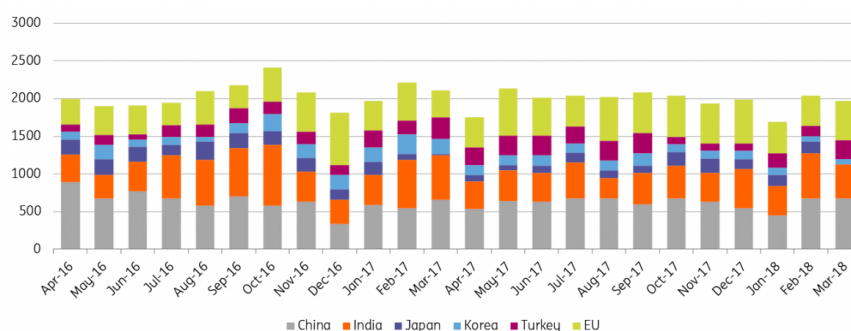
## Looming Iranian sanctions

The 18th May is expected to be the day when Trump will decide whether he will certify the Iranian nuclear deal. All signs suggest that he won't, and instead will reinstate sanctions on the country. This does mean the potential for a loss in Iranian oil supply. A large part of the recent move higher we believe is the market pricing in the risk of sanctions.

If Trump follows the Obama administration, the reduction in supply should only be seen in November onwards, with the market given 180 days to settle outstanding contracts. The next question will then be who will actually reduce their Iranian oil purchases.

Currently, China and India are the largest buyers of Iranian crude, making up around 60% of demand, we believe that these two nations will continue to purchase Iranian oil. Other significant markets are Turkey, Japan, South Korea, and the EU. We believe that the supply which is most at risk is that going to the EU. If this is the case we could see up to around 500Mbbbls/d of supply lost to the world market. But as mentioned this could start to be felt only from November onwards. However, there is no certainty that Trump would follow what was done in the past when it comes to implementing these sanctions.

## Iranian crude oil export destinations (Mbbbls/d)



Source: Bloomberg, ING Research

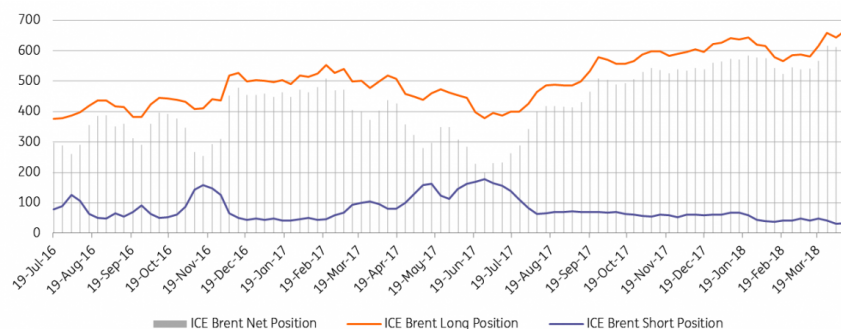
## Speculators at the limit?

Speculators continue to appear comfortable buying the market, with the managed money net long position standing at a record 632,454 lots, up from 523,295 lots in February. The net position



makes up 20% of total market open interest, whilst for every spec short there are a little over 20 spec longs. This also suggests that speculators are overextended, and consensus risk is significant. Speculators are pricing in plenty of supply risk around Iran and sanctions, so if Trump does surprise the market and certify the nuclear deal, expect a sizeable amount of spec liquidation.

## Speculators hold a record long in ICE Brent (000 lots)



Source: Bloomberg, ING Research

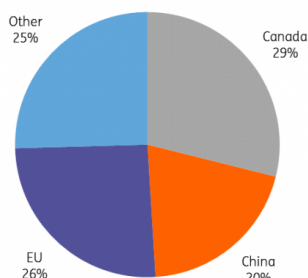
## The trade war risk

There does appear to be somewhat of a softening in stance in the trade war between the US and China, this does help alleviate concerns over global economic growth, and the potential this can have on oil demand growth moving forward. However, we would point out that negotiations between China and the US are ongoing, and with plenty of uncertainty around planned tariffs, expect to see increased volatility not just in oil, but markets in general.

If we do see tensions escalate between the two countries once again, there is the risk that China takes action against flows of US crude oil into the country. This would be a blow for the US, given that over 2017, China took 20% of US crude oil exports. Any action like this would most likely mean further widening in the Brent-WTI spread, which is already trading at close to US\$5.25/bbl.

Still, China appears to be keen to resolve trade issues and we do not see tariffs on US crude oil as a significant risk for the market, at least for now.

## 2017 US crude oil export destinations



Source: EIA, ING Research

## Author

### Warren Patterson

Head of Commodities Strategy

[Warren.Patterson@asia.ing.com](mailto:Warren.Patterson@asia.ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.