In case you missed it: Trump 2.0

As the world adjusts to the new reality of a split Congress, the Fed sticks to its script and seems to be on track for a December hike. However, it doesn't seem to be business as usual for oil markets, as Brent continues to fall as Washington allies pump up supply. Elsewhere, UK GDP was propped up by the bout of good sunny weather but Germany hasn't been so lucky

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Snap | 8 November 2018 United States

Federal Reserve: On track for a December hike

No change from the Fed today but policymakers remain on track to deliver further gradual rate hikes. A December hike looks pretty much baked in at this point, and three further hikes in 2019 still seem like the most likely outcome

Source: Shutterstock

Fed Chair, Jerome Powell

Today's policy statement from the FOMC is largely similar to the September statement. The Fed upgraded its assessment of business fixed investment to say it has "grown strongly", reflecting the latest data for 3Q, but otherwise left its language unchanged. This suggests policymakers remain content with the way the economy is evolving, and will stick to their current policy stance of "gradual increases" in the policy rate.

Near-term momentum in the US economy remains strong, with 3Q GDP coming in at 3.5% QoQ annualised in the advance reading. The labour market is going from strength to strength, with the highest wage growth since 2009 and the lowest unemployment rate since the dotcom bubble. Inflation remains around the 2% target on all the key measures the Fed looks at. The recent volatility in equity markets looks unlikely to derail the Fed's plans – after all, the more severe volatility episode back in February didn't affect the March hike, and equity markets appear to have regained their poise, at least for now.

All this suggests further interest rate rises are on the way. We expect another 25 basis point hike in December, and three more in 2019, in line with the Fed's 'dot plot'. Recent speeches by Fed governors, including newly appointed vice-chair Richard Clarida, suggests the FOMC remains in an optimistic mood.

That said, the outlook for 2019 is in our view turning a bit cloudier. The economy faces more headwinds as the support from this year's massive fiscal stimulus gradually fades and borrowing costs rise. The stronger dollar and softer growth in the rest of the world, particularly emerging markets, will also act as a brake on US growth. In addition, there is the drag from trade tensions that will impact supply chains and put up the cost of doing business. This may dampen inflation pressures in the medium term. Set against that, there are upside risks if these external tensions ease, or if President Trump and the newly elected Democratic majority in Congress can agree on a major infrastructure spending package next year.

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Article | 7 November 2018 United States

US midterms: a case of the blues...

The US midterms threw up some surprises, but we have a split Congress. President Trump's legislative agenda risks being constrained as a result, which will make it harder to generate a platform that will stand him in good stead for a defence of his presidency in 2020

US President Donald Trump

A blue wave... In the House...

Few pundits thought the Republicans had much of a chance of holding onto the House of Representatives in the build-up to the election. After all incumbent Presidents typically see their party lose seats (only three out of the last 21 midterm elections have seen gains) and according to data compiled by Gallup, President Trump was the least popular president at this stage in a presidency since Harry Truman in 1950. At the same time, the Democrats were ahead in generic polling by around 7-8 percentage points and managed to raise more money in key battleground constituencies while the Republicans also experienced a relatively large number of high profile retirees, including House speaker, Paul Ryan. As such the question on most people's lips was how big the "blue wave" would be.

The Democrats are projected to make a net gain of 34 seats, according to FiveThirtyEight, which is more than the 23 they need to win control of the House.

However, it was a different story in the Senate with the Republicans actually gaining seats to leave them with an enlarged majority - it could be as many as five extra Senate seats. So, while not a great night for the Republicans, they can take solace in the fact that they prevented a Democrat sweep that could have completely blocked both the President's legislative agenda and any appointments to federal courts, new cabinet members and the Federal Reserve.

The Democrats could also have used the additional political momentum of winning the Senate to really step up the threat of impeachment proceedings against the President. By not succeeding here, the mathematics make getting a successful impeachment look a remote possibility, barring overwhelming and incontrovertible evidence of malfeasance.

Trump tapered

Even so, life is going to get far tougher for President Trump. The split Congress (Democrat House and Republican Senate) means that there is more likely to be gridlock, which will significantly curtail his legislative agenda. Bi-partisan action may be possible in areas such as infrastructure spending, but for the most part divisions between and within the parties mean that progress will be difficult. For example, President Trump's proposal on additional income tax cuts has received a major blow because of the election result.

Faced with this, the President is likely to focus his attention on areas where his executive powers give him more leeway to set the agenda, such as trade policy. This suggests that he is likely to continue pushing hard on China to make concessions that will contribute to getting the bilateral trade deficit lower and do more to protect US intellectual property rights. However, China's response so far (the massive fiscal stimulus announced last week points to China digging in for a long attritional battle) leaves us sensing that tensions will likely escalate further in the near term, with tariffs being increased and broadened next year.

This in itself may well get backing from Democrats, but they are likely to be more resistant to starting a trade war with traditional allies such as the European Union or pulling out of the World Trade Organisation. Instead, we may get more discussion about working together with Europe in order to stand a better chance of getting movement from China on trade.

There is, of course, the remote possibility that President Trump and the Democrats choose to bury the hatchet and work together - both President Trump and current Democrat House minority leader (likely next House Speaker) Nancy Pelosi have called for bi-partisanship in the wake of the results. This could unleash additional fiscal spending, particularly on infrastructure, while allowing potentially for more tax cuts as long as they are targeted at lower income households. This would be a positive for growth, but given the hostile and polarised nature of Washington politics right now this would be an uneasy truce.

What now for fiscal policy?

Historically we have typically seen federal budget deficits get larger during Republican presidencies and get smaller under Democrat presidents. This trend has continued under President Trump. The Congressional Budget Office estimates that the US Federal deficit will widen out to 4.6% of GDP next year at a time when the economy is booming and the unemployment rate is at 50-year lows. The massive fiscal stimulus introduced by the President this year is leaving a hole in the government's finances and there are legitimate questions starting to be asked about longer-term fiscal sustainability. After all, if the US was to experience an economic shock with lower growth or even a recession, the deficit could quickly balloon back towards the 7-9% of GDP deficits experienced in the aftermath of the global financial crisis.

However, the fact that the Democrats control the House means that there is a reduced prospect of additional fiscal expansionary policy initiatives. In turn, this may help to ease the debt sustainability fears, but they won't subside completely. There will be a bigger threat of potentially disruptive government shutdowns given differences of opinion on government funding. In addition, President Trump's criticism of the Federal Reserve's interest rate increases will continue, but that will continue to be shrugged off by policymakers.

Impeachment looking less likely

This was a topic never far away from political commentators in the build-up to the vote. The most plausible scenario would be if special counsel Robert Mueller found direct and incontrovertible evidence of Russian interference in the 2016 election. Of course, now that the Democrats have control of the House they can launch Congressional investigations with subpoena power, which could heighten talk of possible impeachment proceedings - we are also likely to see renewed demands for the President to release his tax returns. To start impeachment proceedings against the President would require a simple majority in the Democrat-led House, but it requires a super majority of 67 Senators, where the Republicans now hold a larger majority.

As such, based on the numbers as they currently stand this would need around 20 Republican Senators to cross the floor and vote with the Democrats. This seems unlikely, especially if they believe President Trump can pardon himself - as he has stated. Given this situation, the Democrats may be reluctant to act quickly and even if they do pull the trigger there is a strong likelihood Donald Trump would be found not guilty.

Market reaction

Market reaction has been fairly muted. US stocks opened about 1% higher, continuing a recent rally, while bond yields also rose and the dollar was slightly lower. Had the Republicans retained control of both the House and Senate then we would have expected a bigger bounce in US equities, Treasury yields, and the dollar. This would have been on the basis of a greater prospect of additional fiscal stimulus with the Federal Reserve responding to the stronger growth and inflation environment by raising interest rates more aggressively. There would have also been more worries about US fiscal sustainability.

However, the results mean that we wouldn't be surprised to see a slight drift in the opposite direction given the expectation of more limited room for manoeuvre on fiscal policy. That said, President Trump will not be scaling back his protectionist policies anytime soon and there is a chance of bi-partisanship on some pro-growth strategies such as infrastructure. Moreover, the growth stories outside of the US aren't looking particularly robust right now so it is hard to see a dramatic rotation into overseas asset markets on the back of these results.

President Trump feeling blue

While not a great outcome for President Trump, it could have been worse. He clearly had plans to press on with infrastructure spending and further tax reform in the second half of his presidential term and while the policies are not dead, they are likely going to be curtailed or heavily revised by a Democrat-controlled House. Bi-partisanship will be required for progress to be made and for President Trump to generate a strong platform to defend his Presidency in 2020.

However, the US economy will face an increasing number of challenges over the next couple of years as support fades from the fiscal stimulus and weaker global growth (contributed to by President Trump's trade protectionism), a stronger dollar and higher interest rates provide increasing headwinds. A weaker economy and potentially falling asset prices and household wealth would compound the problems for President Trump.

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Article | 8 November 2018

Crude oil: Sanctions and waivers come

Despite the sanctions, the market has come under pressure, with Brent falling as much as 16% from its recent peak. We think the market is oversold, and expect to see an upward correction in the near term. However, as we move into 2019, we believe downward pressure will re-emerge once again

Source: iStock

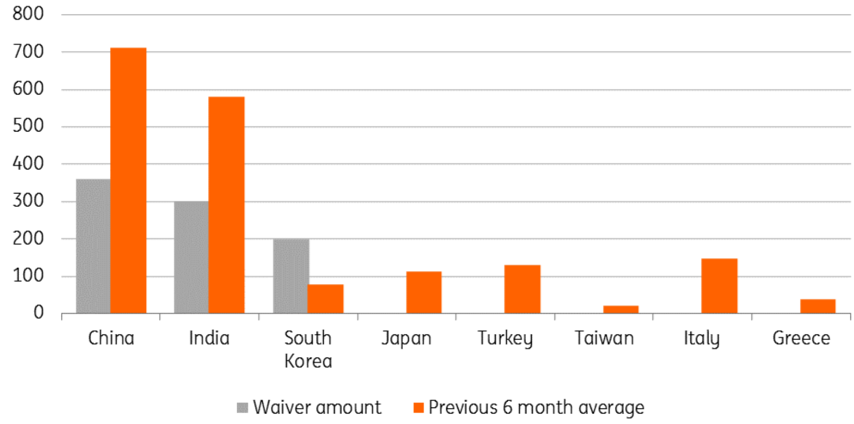
You get a waiver! And you too

US sanctions against Iran came into effect on the 5th November, yet offered little in the way of support to the market, with participants having had plenty of time to price in the impact already. However, the markets were focused on the countries who would receive waivers, and what volume was covered over the 180 day waiver period.

With the exception of Italy and Greece, there were no real surprises. China, India, Japan, South Korea, Taiwan and Turkey are the remaining countries who managed to secure waivers for the next 180 days. In October, these eight importers made up for around 75% of total Iranian exports.

However what the market is really interested in, is the volume these waivers allow each country to import. Media reports suggest China secured waivers for 360Mbbls/d, while India is allowed to import 300Mbbls/d and South Korea a total volume of 200Mbbls/d. As for the other countries, there is little clarity on volumes yet.

Sanction waivers vs. average Iranian oil imports (Mbbls/d)



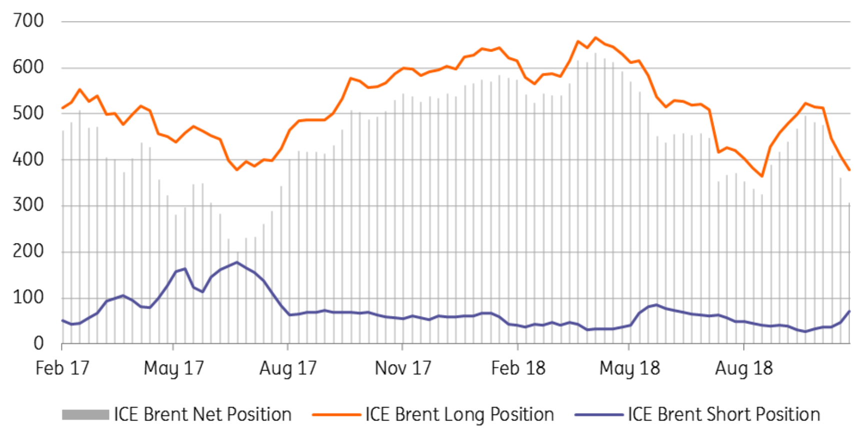
Source: Bloomberg, ING research

Speculators run for the door

In recent weeks, speculators have significantly reduced their net long position in Brent, by liquidating about 200k lots of their net longs since early October. Growing supply, broader macro concerns, and the shrinking backwardation have all clearly contributed to this move. However, this does leave speculators with quite a bit of room to increase their long positioning moving forward. The long/short ratio also suggests that speculators are currently holding a rather neutral position, with the ratio currently standing at around 5, as opposed to over 20 earlier in the year.

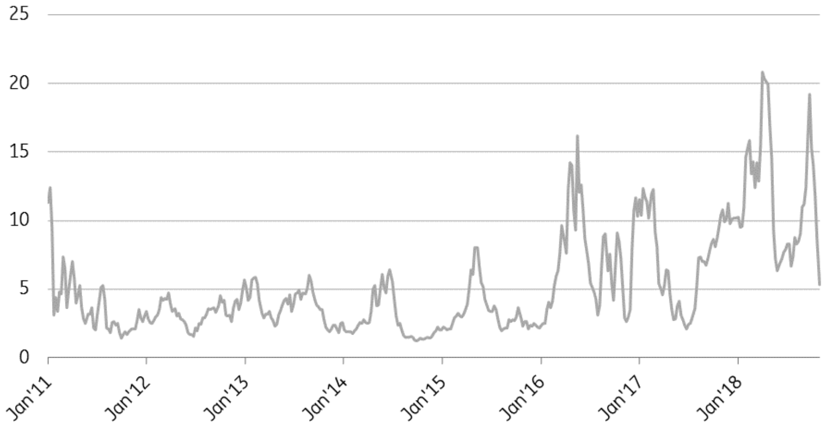
However, to see speculator longs enter the market once again, we would need an appropriate catalyst. At the moment, the most obvious catalyst is noise around OPEC and Russia discussing potential cuts in 2019.

ICE Brent managed money position (000 lots)



Source: ICE, Bloomberg, ING Research

ICE Brent managed money long/short ratio



Source: Bloomberg, ING Research

Will OPEC+ cut production once again?

Concerns over whether OPEC nations would be able to make up for Iranian shortfalls have clearly eased, evident by the pressure we have seen on Brent since early October. While October secondary output numbers are yet to be released by OPEC, Bloomberg estimates show that the group's output increased by 430Mbbls/d over October to reach 33.33MMbbls/d - the highest level seen since November 2016. If OPEC reports a similar number, this would mean that output has increased by 1.2MMbbls/d since May. No surprise that Saudi Arabia made up the bulk of this increase, with output increasing by close to 700Mbbls/d since May.

Russia has also done a good job ramping up its output, with production averaging a record 11.41MMbbls/d over October, up 40Mbbls/d MoM, and significantly higher than the 10.97MMbbls/d produced back in May.

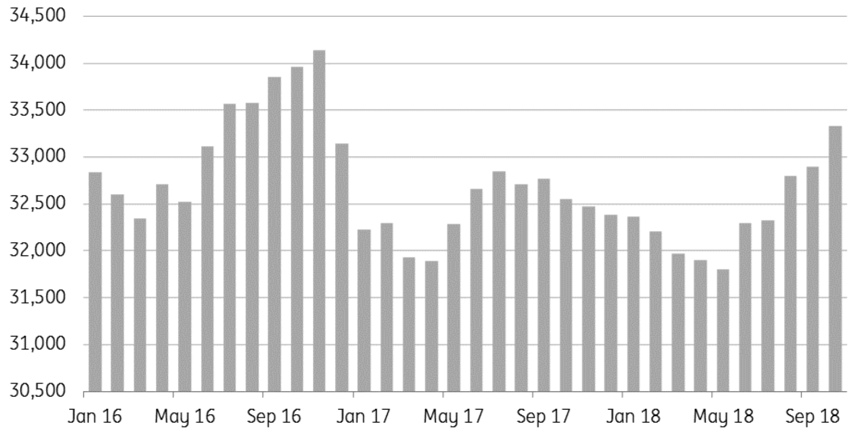
> *The pace of increases from OPEC+ has clearly surprised the market, and in fact, this has seen a significant narrowing in the global deficit that was expected over the last quarter of 2018*

Price weakness has raised the prospect of OPEC+ reversing their recent policy of producing as much as they can, to one where they show more restraint. Already this week there has been increased noise that OPEC and Russia could look to potential production cuts over 2019. This weekend will see OPEC members meeting in Abu Dhabi for a Joint Ministerial Monitoring Committee (JMMC) meeting, where the possibility of cuts or at least limiting output increases will be on the agenda.

If any cuts are to be introduced, we believe that they will be much more limited in scope. Our balance sheet shows that the global market will be in surplus over the first half of 2018, and so if OPEC was to intervene, there is the possibility that they try to limit any cuts/freezes to a six month period.

Further cuts from OPEC+ would likely draw criticism from key consumers. However, the US may not show as much concern this time around, given that the mid-term elections are now behind us. However key emerging market consumers are likely to continue to show their discontent at potentially higher oil prices, coupled with a stronger USD. India stands out as a prime example, with the rupee depreciating around 15% year to date. Meanwhile, the country has general elections over 2019.

OPEC production continues to grow (Mbbls/d)



Source: OPEC, Bloomberg, ING Research

US going full throttle

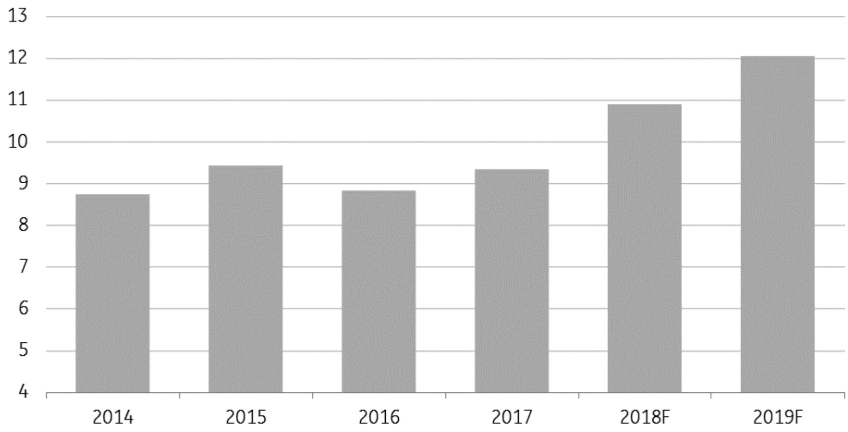
Recent developments in the US market have certainly not helped the oil market. We have seen consistent builds in US crude oil inventories, in fact over the last seven weeks, US crude oil inventories have increased by a rather impressive 37.65MMbbls, which has taken US crude oil inventories back above the five-year average, and also weighed heavily on WTI spreads, with the front end of the curve in contango. We don't think these builds will persist for much longer, as refiners will be returning from the maintenance season in the coming weeks. As we see a pick up in run rates, this should start to offer some support to the market we believe.

> *The other pressure point for the US remains production, which continues to grow at quite an amazing pace*

Monthly production data from the EIA shows that over August, US crude oil output averaged 11.35MMbbls/d, much larger than the 10.98MMbbls/d suggested by weekly production estimates. In fact, over August, the US was the largest crude oil producer in the world, with its output surpassing Russia.

The supply pressure does not stop there, in the EIAs latest Short-Term Energy Outlook, they revised higher their 2018 US oil production forecast from 10.7MMbbls/d to 10.9MMbbls/d, which would be a 1.5MMbbls/d increase from 2017 levels. Meanwhile, the EIA also took the opportunity to revise higher their 2019 production forecast from 11.8MMbbls/d to 12.1MMbbls/d. Although pipeline constraints may be an obstacle in achieving this number, with significant pipeline capacity out of the Permian only expected to come online over the 2H19.

US crude oil production (MMbbls/d)



Source: EIA, ING Research

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Snap | 9 November 2018 United Kingdom

UK economic momentum fading despite solid third quarter

The UK economy shifted up a gear over the summer, but with the sunny weather now behind us and Brexit uncertainty very much in front, we suspect the momentum will fade over the winter. Expect something closer to 0.3% QoQ growth in the fourth quarter

Source: Shutterstock

At 0.6%, the latest UK growth for the third quarter indicates the economy moved up a gear over the summer. The underlying details show much of this was driven by consumption, helped along considerably by persistently warm weather. There was also some better news for investment; it fell in the first two quarters of the year but grew by 0.8% in the third.

Exports have also rebounded strongly – although importantly a fair chunk of this is likely to be down to the erratic 'non-monetary gold' component. This is a quirk of the national accounts related to non-residents buying/selling gold and will have been cancelled out by an equal and opposite entry in the investment (valuables) category, so is altogether neutral for growth. Once that is stripped out, we suspect the trade story is much less exciting.

With that aside, overall there's little doubt the economy had a better run over the summer. But now that the sunnier weather is behind us, we think this stronger momentum will begin to fade. There has already been some evidence of this in the latest PMIs, which indicate Brexit uncertainty may be beginning to weigh more heavily on activity.

0.3% ING's 4Q UK GDP forecast

While there have been positive signals that a Brexit deal may be nearing its conclusion, the challenge of getting it approved by Parliament looks as tough as ever. We still think there is a clear risk that we won't know for sure that 'no deal' has been avoided until next year. In the meantime, a greater number of firms are likely to enact contingency plans, and at the very least, this is likely to see investment and hiring slow further.

So we think the economy has a challenging few months ahead of it, and we expect to see fourth-quarter growth to slow to around 0.3%. Despite the Bank of England's cautiously optimistic stance/forecasts, we don't expect policymakers to hike rates again before May 2019 at the earliest.

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Germany: More disappointments

September trade data adds to recent evidence of the worst quarterly performance for the German economy since 2015

Source: Shutterstock

A combination of slowing world trade and temporary factors like the new emissions norms for autos hit the German export sector over the summer months. In September, exports dropped by 0.8% month-on-month from a slightly upwardly revised 0.1% in August. German exports have now dropped in four out of the last six months. At the same time, imports decreased by 0.4% MoM, which narrowed the trade balance to €17.6 billion from €18.2 billion.

Today's trade data ends a disappointing week for German industry. Available monthly data suggests that the economy had its worst quarterly performance in 3Q since the beginning of 2015. The first GDP estimate will be released next week on Wednesday.

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Article | 5 November 2018 United States

US Housing: As good as it gets?

Despite a red-hot economy, the US housing market looks decidedly lukewarm. Unless construction picks up, slowing residential investment will start to drag on GDP growth

Source: Shutterstock

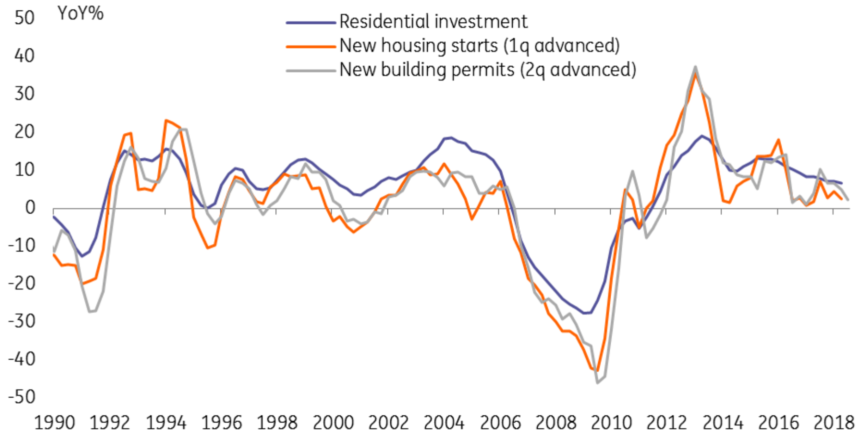
The market has stalled since the start of the summer

Sales of existing homes have fallen to 5.15m (annualised) in September, the lowest level for two years, down from an average of around 5.5m at the start of the year. New home sales have also been falling, with only 515,000 new homes sold in September, compared to 650,000 on average in Q1. Having said that, pending home sales in September increased slightly, suggesting sales may pick up a little in Q4.

> *Housing looks to be turning into a headwind for the US economy, with flat or slowing construction spending over the next year or so increasingly likely*

New construction looks similarly lacklustre, with new starts stalling around 1.3m annualised since 4Q17. June and July were particularly weak for housing starts, which may be partly related to the extremely hot weather – 2018 saw the hottest summer since the 1970s. But new building permits (which are less affected by weather effects) have also flatlined in 2018, indicating construction is unlikely to pick up soon.

Residential investment slowing as pace of new starts and permits growth slows



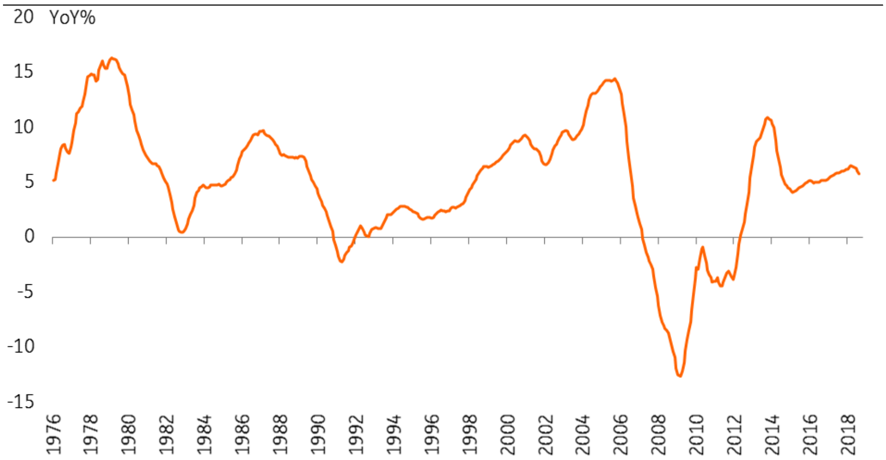
Source: Macrobond and ING calculations

Affordability is worsening

Average house prices are still rising at a healthy clip (5.8% year on year according to the S&P Case-Shiller index). But the pace of price increases has fallen back somewhat this year, and that may well continue into 2019. The slowdown widespread: 15 of the 20 cities covered by the S&P index saw slower price growth in the latest data from August.

Affordability constraints are clearly starting to bite. Potential homebuyers now face materially higher interest rates – effective mortgage rates on a standard 30-year mortgage have risen above 5%, and are up by around 100bps in 2018, roughly half of which is due to the rise in long-term Treasury yields and the other half to a higher spread between Treasury yields and mortgage rates. Also, tax changes have reduced the incentives for homeownership, and increased the cost considerably for some (those owning or buying high-value homes in states with high property taxes).

US national house price index



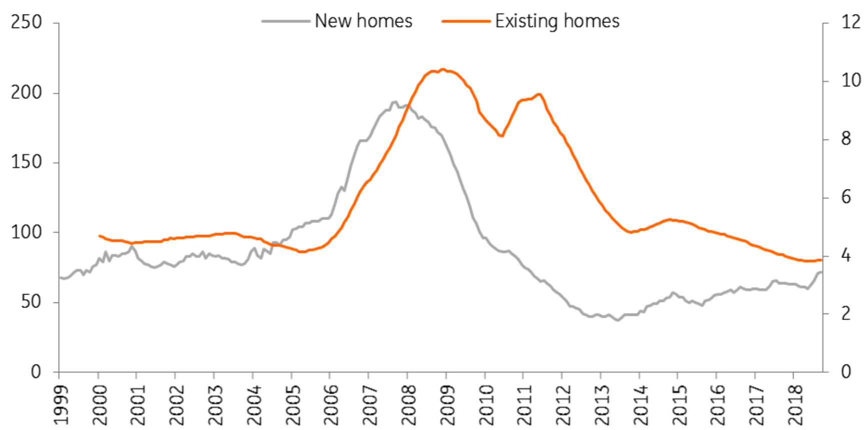
Source: Macrobond

And inventory has started to increase

Another indication the market is less buoyant is the increase in inventory (existing homes available for sale), which has ticked up to 4.4 months' worth of sales – inventory is highly seasonal, but inventory over the past three months was higher than at the same time last year. While these are still historically low levels of inventory, it is significant that the downtrend over the past few years has been broken.

At the same time, inventory of new homes has risen more markedly and is nearing the pre-crisis average. There is anecdotal evidence that some locations may be facing significant oversupply, especially of relatively expensive newly built apartments. We think it is plausible that American cities which have seen the most dramatic rise in prices and construction over recent years (the likes of NYC, Boston, Denver, Seattle, and San Francisco) could experience a price correction. This would be similar to what has already happened in large cities in Canada, Australia, Sweden and Norway, where house price inflation and construction has been very fast in recent years and oversupply, and stretched valuations are now putting downward pressure on prices and sales.

Supply of available for sale homes



Source: Macrobond

What does it mean for the wider economy?

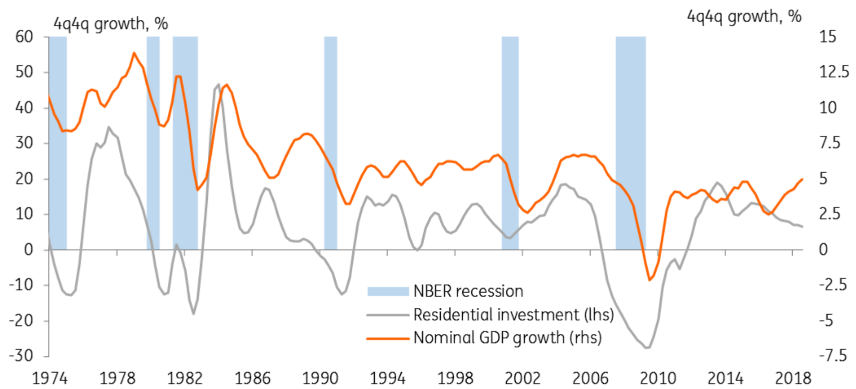
Now, none of these data points by themselves suggest a sudden slowdown is imminent. But taken together they do paint a picture of a slowing housing market that may have reached the limit for the current expansion or, at best, could see sales and construction inch up a little more over the next few quarters. But the best part of the housing expansion looks to be behind us, and even our relatively conservative assessment earlier this year now looks to have been too optimistic.

This is important because historically housing has been a key driver of the economic cycle. The most obvious example, of course, is the housing market meltdown ahead of the Great Recession in 2007-09. But residential investment has been a decent predictor for an economic slowdown for much of the post-war period.

The current situation, where GDP growth has accelerated over the past year or even as residential investment has been slowing down, is pretty unusual. One reason for the divergence is probably the tax bill passed late last year, which has boosted the overall economy but arguably was a net negative for the housing market. We'd expect this divergence to close gradually, with GDP growth slowing somewhat over coming quarters.

The bottom line is that housing looks to be turning into a headwind for the US economy, with flat or slowing construction spending over the next year or so increasingly likely. This is consistent with our expectation that the pace of US growth will moderate in 2019.

Growth in residential investment and GDP has diverged



Source: Macrobond and ING calculations

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Poland: MPC unmoved by risk of target overshooting in 2019

The new projection shows CPI temporarily breaking the upper bound of the central bank's target in 2019. We expect the Monetary Policy Council to be more adaptive down the road. We still see flat rates till the end of 2020 due to downside risk to GDP growth

Source: Shutterstock

The National Bank of Poland (NBP) press conference on the inflation outlook is for the baseline scenario of the new CPI projection to temporarily break the upper bound of the NBP target in 2019 (CPI above 3.5% YoY). The annual average CPI forecast for 2019 was revised from 2.7% YoY to 3.25% on the assumption of a strong rise in wholesale energy prices. The forecast for 2020 remained nearly unchanged (at 2.9% YoY).

NBP governor Adam Glapinski reiterated that despite the risk of overshooting the target, rates should remain flat in 2019. Furthermore, he stated that without any new demand-side shocks in his opinion stable policy in 2020 is the most probable scenario. Glapinski assumes that direct drivers of inflation (cost of CO_2 emission, coal prices) remain outside of the Monetary Policy Council's (MPC) control and the potential for second-round effects or indirect spill-overs is limited. Secondly, the NBP governor stated that the projection baseline scenario should be treated as a worst-case option due to conservative (high) assumptions. He added that the MPC needs to balance between the risk of a CPI increase caused by supply factors and the risk of slowing economic activity.

Centrist MPC members present at the conference have not directly challenged the governor's view. J.Osiatyński highlighted the supply-side nature of the inflation shock and stated that demand-driven pressure should weaken with stagnating wage growth. R.Sura was more dovish than Osiatyski and said that nothing has changed but added that the Council needs to be more cautious as changes in the labour market (potential outflow of Ukrainian workers) may increase prices.

In our opinion, the MPC seems to be less confident about the future rate path and should present a more adaptive or backwards-looking approach. Importantly, Governor Glapinski highlighted during the second part of the press conference that flat rates until 2019 is his opinion and could not be representative for the entire Committee. The market, as well as the MPC, should be much more sensitive to the upcoming figures, which should present what is the actual rise of electricity prices and how this affects headline and core CPI as well as how much external economies are slowing. We expect macroeconomic activity indicators (production, retail sales) and CPI in 1Q and 2Q of 2019 to have a much greater market impact on the policy stance than presently.

Before the NBP presented its projections, our CPI forecast were above the market consensus. We still expect flat rates as we are quite bearish on global and Eurozone growth and its impact on Poland. We reiterate our forecast assuming no change in policy until the end of 2020. A potential slowdown of the Polish economy in 2019 and 2020 should persuade the MPC to look through temporary a CPI spike in 2019.

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