

In case you missed it: Worse and worse

Mario Draghi has set the scene for a big bang in September, consumers are rescuing the US economy and risks to EUR/USD have skewed towards 1.10 rather than 1.15 over the summer. Looking ahead, the Bank of England meets next week, but we're not really expecting any meaningful action. The Fed meeting, on the other hand, should be a completely different story

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The US Fed's expected to prolong the party with a cut this week

The US economy is experiencing its longest expansion on record, but weaker external demand and trade tensions are risks to the outlook. A benign inflation backdrop allows the Federal Reserve room to offer support and cut rates by 25bp next week

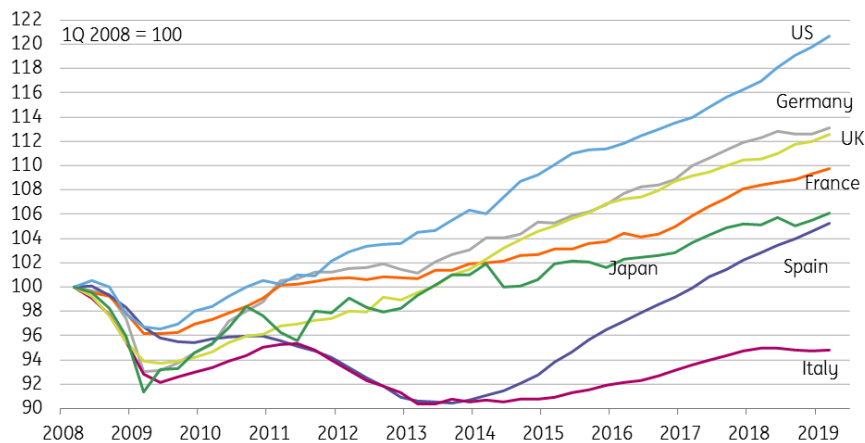


Fed Chairman, Jerome Powell (centre) with the Bank of England's Mark Carney and David Malpass (right), President of the World Bank Group

Slowdown signals

The US economy has performed solidly since the end of the financial crisis thanks to aggressive stimulus from a number of sources. The combination of a swift recapitalisation of the banking sector, interest rate cuts and quantitative easing allowed borrowing costs to fall sharply and credit to remain available. This helped to support asset prices while plunging interest rates also contributed to a weaker, more competitive dollar exchange rate. More recently, the US has experienced President Trump's tax cuts, which have helped drive the US economy to new highs. In fact, the current expansion is the longest since the National Bureau for Economic Research's data records began back in [1854](#), with the US clearly outperforming key trade partners as you can see in the chart below.

Level of real economic output versus 2008



Source: Macrobond, ING

However, a weaker global growth backdrop, as underlined by recent eurozone figures, and heightened trade tensions have started to weigh on US activity. Inventory and trade numbers have obviously been impacted, but as Fed Chair Jerome Powell noted in recent testimony, "growth in business investment seems to have slowed notably" as well.

President Trump, a vocal critic of the Federal Reserve, has demanded aggressive policy stimulus to support the US economy, but with the US consumer sector continuing to perform strongly, thanks to low unemployment and the combination of rising wages and asset prices, the Fed has been reluctant.

Prevention versus cure

That situation is now changing. After having raised interest rates in December, the language of officials has shifted significantly with Jerome Powell stating that "uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the US economic outlook". For now, there is a tentative truce with US-China trade talks resuming. Unfortunately, the two sides remain a long way apart on key issues so we can't rule out the possibility that talks break up acrimoniously once again. Another round of tariff hikes would lead to a renewed bout of pessimism and contribute to more pronounced economic weakness by disrupting supply chains, putting up costs and hurting profit margins.

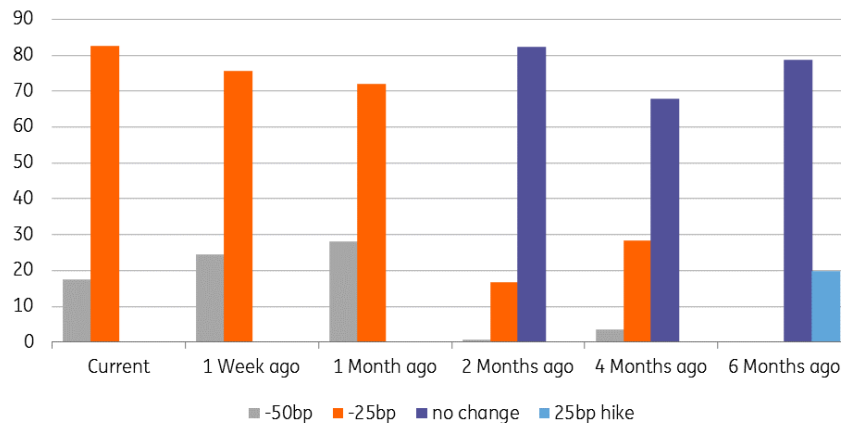
Such an environment would be negative for equity markets and make US businesses more reluctant to invest and hire new workers. Therefore it was interesting to hear Jerome Powell say in his latest testimony that "many FOMC participants saw that the case for a somewhat more accommodative monetary policy had strengthened". He too appears to be backing the case by arguing "an ounce of prevention is worth more than a pound of cure". This is a clear signal the Federal Reserve is set to ease monetary policy by cutting interest rates next week.

25bp or 50bp?

Several analysts have made the case for the Fed going early and aggressively to head off the risks to US growth with a 50bp move on 31 July. However, recent firm data has put pay to that view with the implied probability of such action drifting lower over the past couple of weeks. St Louis Fed

President James Bullard, who is perceived to be one of the most dovish members of the FOMC having voted for a rate cut in June, has also downplayed that prospect. He said last Friday that “I’d like to go 25bp at the upcoming meeting”. Moreover, we have to remember that at the June FOMC meeting, the median forecast of FOMC members had no rate cuts for this year and only one for next. The newsflow hasn’t deteriorated over the intervening period, so based on this we expect just a precautionary 25bp rate cut next Wednesday.

Implied probability of different scenarios for July 31st FOMC meeting



Source: Bloomberg, ING

Insurance action

Our view is that we are seeing merely some insurance policy easing, similar to the Fed’s response to the 1995-96 and 1998 slowdown fears, is given credence by the Fed’s assurance that “our baseline outlook is for economic growth to remain solid, labour markets to stay strong and inflation to move back up overtime” to 2%. Indeed, the recent improvement in manufacturing surveys coupled with the very strong numbers coming from the household sector suggests economic fundamentals are broadly in decent shape.

We don't believe the Fed is seriously contemplating the 100bp of rate cuts that markets are currently expecting by the end of 2020

At this stage, we don't believe the Fed is seriously contemplating the 100bp of rate cuts that markets are currently expecting by the end of 2020. We would argue there isn't a great deal domestic interest rate cuts can do to mitigate against external threats, such as trade wars and weaker European growth, other than perhaps limit the upside for the US dollar. After all, mortgage rates have already fallen 100bp since November and debt servicing costs are historically at very low levels while external trade only accounts for around 10% of US economic activity versus more than 20% in China and 30% in Europe.

It's all in President Trump's hands

But also like 1995-96 and 1998, we suspect the Fed will not implement just one cut. Instead, they will likely follow up with a further 25bp interest rate cut in September. After that, it is down to the big unknown of what happens with trade policy, and that is something that is very firmly in President Trump's hands.

Should tensions escalate, markets sell-off and economic weakness spreads then the Federal Reserve will respond with more stimulus given the benign inflation backdrop. However, our trade team takes the view that the fear of economic weakness for both sides will lead to China and the US finalising a deal later this year, even if it doesn't necessarily achieve all of President Trump's initial demands. After all, President Trump wants to go into next year's election with the economy in the best shape possible. A positive boost to sentiment from a trade deal would help his re-election chances and would clearly reduce the need for any additional Fed policy easing.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Brexit and the next 100 days in five charts

New UK prime minister Boris Johnson will face the same hurdles as Theresa May, and crafting a new Brexit deal will be tricky. The new leader may be open to 'no deal', but Parliament will do all it can to stop it. We think a general election is increasingly likely - maybe even inevitable - and the pound is likely to come under further pressure



Source: Shutterstock

In a nutshell: PM Johnson to face the same hurdles as PM May

With 100 days to go until Brexit, the UK finally has a new prime minister - former foreign secretary Boris Johnson.

Fears are growing that the UK could leave the EU without a deal on 31 October, but at least in the first instance, one of the PM's first acts will be to return to Brussels and seek a reworked deal. But with neither side willing to compromise on the Irish backstop - the mechanism designed to avoid a return to a hard border between Ireland and Northern Ireland - negotiations are unlikely to bear fruit.

This sets the stage for an almighty battle in October as Parliament tries to stop 'no deal'

from happening - and a no-confidence vote in the government is likely to happen in the run-up to the Brexit deadline. A general election is getting more likely - perhaps even inevitable. Recent polling suggests that an election might not actually be a bad thing for Mr Johnson - but given that an election would almost certainly require another Article 50 extension, his party's renewed popularity could falter by the time the vote occurs.

All of this uncertainty makes for a tricky few months for the economy, and this has sparked talk of a UK rate cut later this year. Markets see a 50% chance of easing in 2019, although we're yet to be convinced. Even so, the risks for the pound are intensifying - we could see [EUR/GBP hit 0.92 over the summer](#).

Our updated Brexit scenarios

	ING probability	How scenario could materialise	Article 50 extension?	Market reaction
Parliament forces a general election	40%	Parliament stops 'no deal' by passing no confidence motion. General election takes place as early as December	✓ At least 3 months	EUR/GBP: 0.95 GBP/USD: 1.18
Revamped deal	25%	To avoid election at all costs, pro-Brexit MPs reluctantly back tweaked deal given there's a Brexiteer in place for next stage of trade talks	✓ Possibly (for legislation)	EUR/GBP: 0.85 GBP/USD: 1.34
Second referendum	10%	Parliament may struggle to force a 'People's vote'. But can't fully rule out PM triggering one as "least worst" option versus an election	✓ At least 6 months	EUR/GBP: 0.82 GBP/USD: 1.40
No deal	20%	If EU rejects further A50 extension, or a new leader pushes for a hard Brexit, Parliament may lack the legislative tools to stop it	✗	EUR/GBP: 1.00 GBP/USD: 1.10
Revoke Article 50	5%	Parliament may prefer this over a 'no deal' exit, but like a 2 nd ref, MPs could lack a legislative tool to force the new PM's hand.	✗	EUR/GBP: 0.78 GBP/USD: 1.47

We also wouldn't rule out Mr Johnson asking for a further extension simply to buy more time to break the deadlock - although his recent comments suggest he is highly averse to doing so

Source: ING

Finding a tweaked deal that both the EU and Parliament can agree to will be challenging

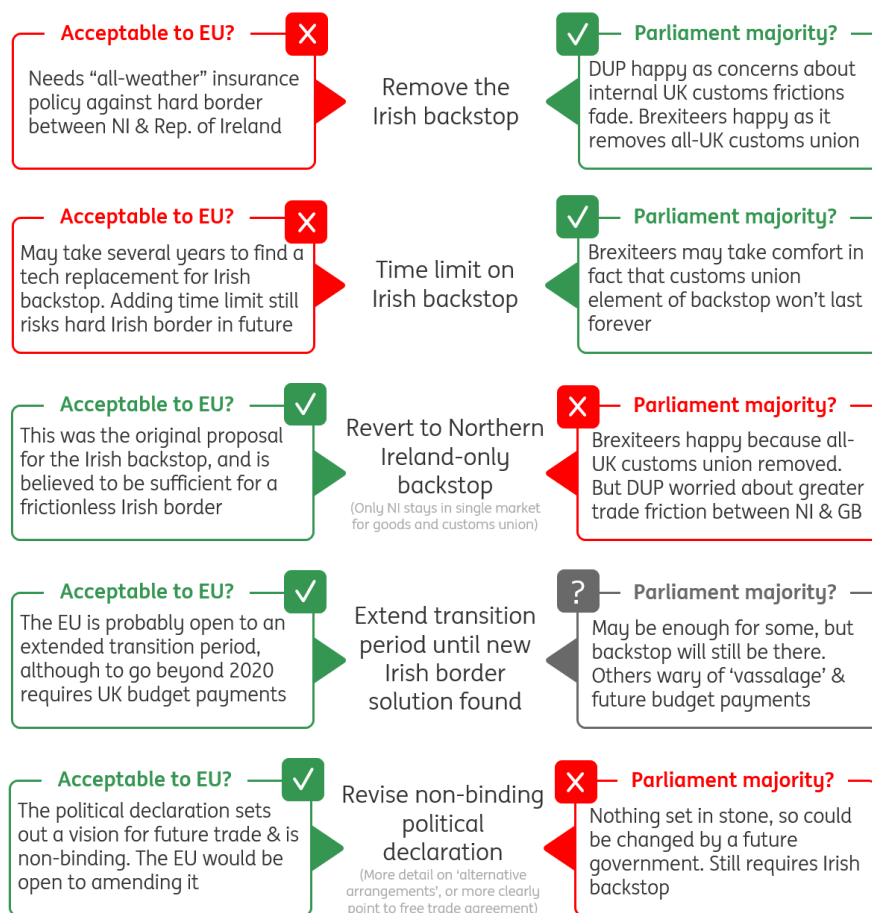
Despite all the 'no deal' rhetoric, we assume the new prime minister will initially head to Brussels in September to attempt a renegotiation of PM May's existing deal. But seeking a meaningful change to the agreement from the EU - and then getting enough MPs to support it - will be seriously challenging.

Brussels has ruled out removing, or time-limiting, the contentious Irish backstop - something which Mr Johnson has repeatedly said is a red-line in talks. So what could the new prime minister do? The chart below shows how most proposals would be unacceptable to either the UK or the EU, although one particular idea looks interesting.

One way the new PM might be able to command a majority is if he can convince sceptical MPs that the Irish backstop will never come into effect - and the most obvious way of doing that is to ask for a long transition period with the EU. In theory, that could allow time to find a different - perhaps technological - solution to preventing a hard border on the island of Ireland.

In reality, it could be several years before such technology becomes available (if it becomes available at all), but in principle the EU would probably be open to a more prolonged transition period. The current deal leaves the door open to a transition until the end of 2022, assuming both sides agree.

What are Mr Johnson's options for a revised deal?



Source: ING

If a deal is to get a majority in Parliament, the devil might not be in the detail after all

So is the 'long transition deal' a strategy that could work for Mr Johnson? We see three reasons why it probably won't.

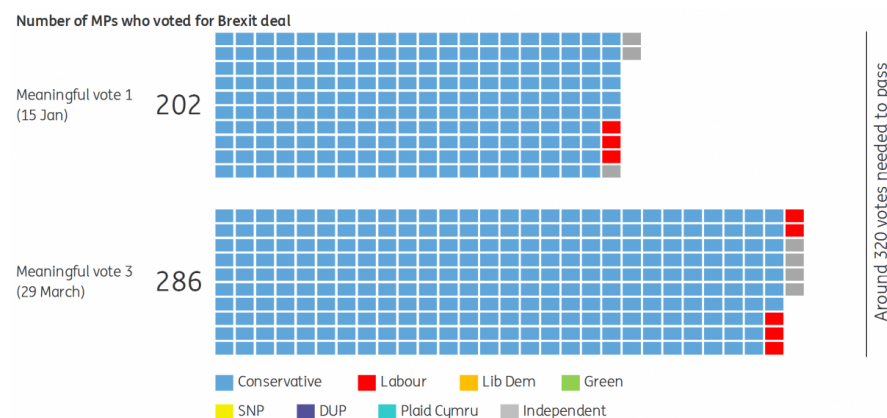
1. While it is probably the PM's best chance of demonstrating the Irish backstop will not be needed, the backstop will nevertheless remain a part of the deal. And as long as the backstop stays, leaving open the possibility of regulatory diverge between Northern Ireland and the British mainland at some point in the future, the Democratic Unionist Party (DUP) are unlikely to back the agreement.
2. Secondly, an extended transition period will require fresh budget commitments for the next EU multiannual financial framework (MFF), which begins at the start of 2021. The idea of paying more money, rather than less, to the EU is unlikely to go down well with the domestic UK audience.

- Thirdly, for many pro-Brexit MPs, an extended transition period would present too much 'vassalage' – staying within the single market but without a say in the rules.

All of that means it's hard to see pro-Brexit Conservative/DUP lawmakers backing such a deal. But as always, the politics matters. If MPs don't back a revised deal, opposition lawmakers may well succeed in forcing an election to avert 'no deal'. Some Brexiteers may conclude that it's safer to 'swallow' a lightly-amended deal, and take the fight to the next stage of talks where the ultimate trading relationship will be agreed than it is to fight an election and risk losing control of Brexit altogether.

Unlikely as that may sound, something similar actually happened back in March, when a number of pro-Brexit Conservatives voted for the deal in the third meaningful vote, on the basis that Mrs May had committed to resigning her post if the agreement passed. The chart below shows that 81 additional Conservative MPs – including Mr Johnson himself - voted for the deal third-time around at the end of March, than in the initial vote in mid-January.

A number of Brexiteers voted for Mrs May's deal on the third vote



The election numbers look good for Mr Johnson - but can they last?

Our base case is that new negotiations will not prove successful, and this could set up an almighty battle in October as Parliament races to try and prevent the new government pursuing a 'no deal' exit. While a 'no deal' is possible (we see a 20% chance at the moment), all of this is more likely to culminate in a no-confidence vote in the government. One way or another, a late 2019 election is getting increasingly likely.

Predicting the outcome of an election is very challenging. But as the polls stand, things are looking good for Mr Johnson. His repeated commitment to get the UK out of the EU one way or another has resonated with many voters.

A recent [YouGov](#) survey found that around 51% of Conservative voters at the 2017 election (64% if you exclude those that aren't sure/wouldn't vote etc.) would vote for Mr Johnson's party at an election, assuming Brexit is done by then. While that is still a sharp fall compared to the last

election, polls suggest Labour would fare worse. Less than half of 2017 Labour voters said they would vote for the party again in a post-Brexit election.

A failure to live up to the promise of achieving Brexit by October would undoubtedly dent Conservative support

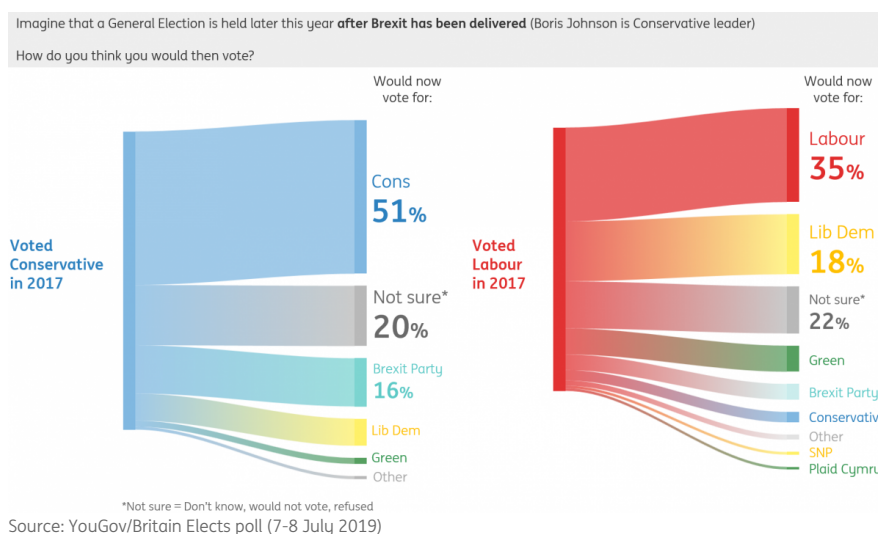
Translating all of this back into the UK's first-past-the-post electoral system is not straightforward, but in theory a Conservative share of the vote of around 30% could translate into a decent result for Mr Johnson. Some commentators have gone as far as to suggest he himself could trigger an election to run on a 'no deal' ticket to 'cash in' this advantage.

We think that's unlikely – not least given the lessons of the 2017 election where Mrs May's polling (which was significantly stronger than Mr Johnson's is now) failed to translate into a Conservative majority when the public had their say.

But the bigger issue for the new government is that an election – however it comes about – would almost certainly require a further article 50 extension. A failure to live up to the promise of achieving Brexit by October would undoubtedly dent Conservative support. And while the new PM may make a 'no deal' Brexit a formal campaign pledge – potentially shoring up support in key Leave-supporting areas – [polling from Hanbury/Politico](#) suggests this could alienate the more centrist Conservative voters in swing seats in areas such as London and Scotland.

It's also worth noting that, while the main opposition Labour Party may not do so well either, the party arguably has a wider pool of potential coalition/confidence and supply partners than the Conservatives. This means a Labour-led coalition is not an inconceivable outcome of a 2019 election, should the Conservatives fail to gain (or come close to) a majority.

Polls suggest a more divided Labour Party than Conservatives at an election



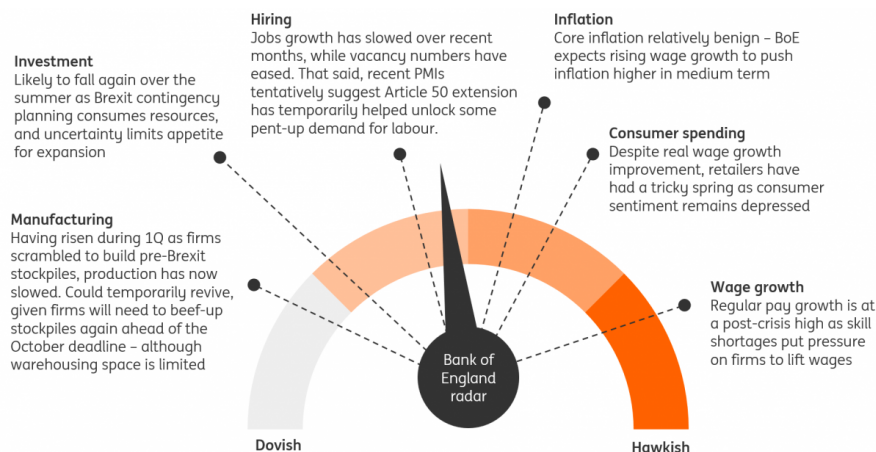
Uncertainty to take its toll on growth, although rate cuts not yet on the horizon

All of this uncertainty will continue to take its toll on growth. The prospect of further declines in investment, coupled with the recent lacklustre retail spending numbers, suggests underlying quarterly growth (once volatile production/inventory numbers are stripped out) will remain capped at around 0.2/0.3% for much of the rest of the year. Benign inflation projections and the prospects of monetary easing abroad have sparked talk of a UK rate cut - markets are pricing a 50% chance of one happening by the end of 2019.

At this stage, we aren't convinced. Wage growth has reached another post-crisis high, and this has been a key hawkish factor for policymakers over the past couple of years. A lot will depend on Brexit of course, but if an election takes place, or Article 50 is extended to allow more time to break the deadlock, we expect rates to remain on hold for the time being.

However, a further deterioration in UK growth, a significant escalation of global trade tensions, or a 'no deal' Brexit in October, could be catalyst for fresh easing from the BoE.

BoE radar: Investment set to remain a drag on economic activity



Source: ING

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

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US: Appetite to spend fuels 2Q GDP growth

Surging consumer and government spending offsets temporary weakness elsewhere, suggesting limited need for major Fed stimulus



2.1%

2Q GDP growth

down from 3.1% but better than consensus

Households and government underpin growth

GDP growth slowed in 2Q19 to 2.1% annualised from the 3.1% rate seen in 1Q19, but it was at least above the 1.8% consensus estimate. Moreover, the underlying story is better than the headline suggests given the huge swings in the inventory and the net trade components. Strip this out and we find real final sales to domestic purchasers grew an impressive 3.5%, which hardly suggests a desperate need for aggressive monetary policy stimulus.

Ever since President Trump kicked off the tariff war at the beginning of 2018 trade and inventories have been flying all over the place. US firms have been sucking in imports to avoid anticipated tariff hikes and then cut them as inventories became maxed out. In the second quarter net trade subtracted 0.65 percentage points from headline GDP after having contributed +0.73 percentage

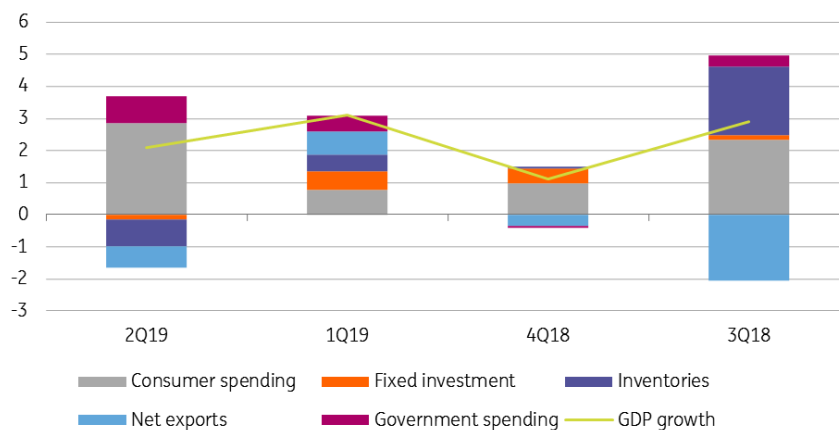
points in 1Q. Much of this was also due to weakness in headline exports, which underlines the legitimate concerns about global demand.

Likewise, inventories were liquidated in 2Q, subtracting 0.86 percentage points from growth after having been built up strongly for three consecutive quarters. This inventory run down can be attributed to the surge in consumer demand, which grew 4.3% annualised in 2Q. A strong jobs market, rising wages and asset prices and falling gasoline prices mean households had the confidence and the cashflow to spend.

Government consumption also surged – up 5% annualised. This reflects the rebound in spending after the late 2018/Jan 2019 government shutdown, which had depressed government spending over the previous two quarters.

Rounding out the report, fixed investment was weaker, falling 0.8%. Residential investment was down for the sixth straight quarter while non-residential was down after two consecutive 4%+ quarterly readings. However, we see some signs for optimism on this key component.

Contributions to annualised GDP growth (%)



Source: Bloomberg, ING

Outlook remains positive

Firstly, the fact that inventories have been run down so aggressively means we won't see a repeat in 3Q, thereby providing a strong platform for future growth. At the same time the household sector is fundamentally in strong shape while recent improvements in the housing market (rising sales and mortgage applications for home purchases in response to plunging mortgage rates) suggest residential investment may finally make a positive contribution.

The latest durable goods orders numbers, meanwhile, point to an improvement in 3Q non-residential fixed investment. As such something close to 2-2.5% growth looks achievable in 3Q19, particularly if US-China trade talks make progress – or we at least don't see an escalation of tensions.

Our call: Just two Fed rate cuts...

Given that the volatility in trade and inventories had such a huge impact on both 1Q and 2Q19 GDP growth, we think it's better to look at the two quarters together. This gives an average rate of 2.6%,

which is clearly very respectable. 3Q19 GDP growth also looks encouraging with recent data showing that the consumer sector is clearly in a good place while even manufacturing is showing renewed signs of life.

Nonetheless, the run rate for growth is slower than the 3% seen in much of 2018 and there is the threat that trade uncertainty will continue to act as a brake on activity. To combat this risk, we expect the Federal Reserve to pull the trigger on a precautionary 25bp rate cut next Wednesday with a further 25bp move likely in September.

The market continues to look for four rate cuts in total by the end of 2020, but we believe the catalyst for such action would have to be a significant ratcheting up in trade tensions. The key question is whether President Trump wants to go down this route. We assume he wants to go into next year's election with the economy in the best shape possible. A positive boost to sentiment from a trade deal would help his re-election chances and would clearly reduce the need for any additional Fed policy easing.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Snap | 25 July 2019

ECB: Preparing the big September bang - part II

During the press conference, Mario Draghi added some flavour to the announced language changes. Not everyone at the ECB seems to be ready for a big September package yet, but this should not stop the ECB from acting



ECB President, Mario Draghi, at Thursday's news conference

As if it weren't hot enough already in the eurozone, expectations about today's ECB meeting also raised the temperature levels. The ECB refrained from cutting rates or announcing new monetary stimulus but it is clearly preparing markets for a rate cut and probably even more at the September meeting. When there is no new action, it is words which count. In this regard, the ECB changed its language on four crucial issues:

1. **In its forward guidance**, the ECB included that interest rates will no longer not only remain at present levels but now also at "or lower" levels, sending a clear hint at a future rate cut.
2. **As for the willingness to act**, the ECB added new language, repeating Draghi's Sintra words that the ECB will act if the medium-term inflation outlook continues to fall short of its aim. The ECB stands ready to adjust all instruments.
3. **The relevant committees**. In the past, tasking the relevant committees has been a

codeword for upcoming ECB action. Consequently, using the magic words that the “Governing Council has tasked the relevant Eurosystem Committees with examining options, including ways to reinforce its forward guidance on policy rates, mitigating measures, such as the design of a tiered system for reserve remuneration, and options for the size and composition of potential new net asset purchases” is a clear language.

4. **Symmetry.** Last but not least, the ECB for the first time explicitly pointed to the symmetry of its inflation target. Apparently, there had also been a discussion on possible changes to the inflation objective. During the press conference, Draghi stressed that the ECB was not accepting the current low inflation levels.

What Draghi said during the press conference

During the press conference, ECB president Mario Draghi gave some insights into the discussion and the reasons for the ECB’s dovishness. In short, the ECB has become less optimistic about the eurozone’s growth and inflation outlook, having doubts about a rebound of the economy in the second half of the year as well as a pick-up of inflation and inflation expectations. Draghi tried not to be too pessimistic, pointing to some signs of strength, but the words that the outlook for the eurozone was getting “worse and worse” was probably the best and shortest illustration of the ECB’s concerns.

Judging from Draghi’s comments, it also looks as if not all ECB members are yet up for new policy action. According to Draghi, views were converging on the macro economic assessment but there was no unanimity on what to do in September. There were different views on the nuances of the possible policy options. This was why the relevant committees had been tasked.

What will come next?

With the latest disappointing macro data and tentative signs of a weakening of the domestic economy, it will be hard for the ECB not to act in September. At his Sintra speech, Draghi said that the ECB would act if there were no improvement. Today, the macro outlook was getting “worse and worse”.

In our view, it is hard to see how the ECB could once again step up its dovishness by words, rather than action. Admittedly, it does not yet look as if there is a consensus view of what to do at the ECB. However, in our view, the likelihood of a package of several measures at the September meeting, rather than a series of smaller measures, has clearly increased. Think of a 20bp cut of the deposit rate, a tiering system, a lowering of the TLTRO pricing and a restart of QE by 20-30bn euro per month.

One day before the 7th anniversary of his “whatever it takes” speech, Draghi today has clearly prepared the grounds for another (and his personal last) “whatever it takes” in September.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

China changing how it eases

The Chinese central bank has injected liquidity using its medium-term lending facility (MLF) and targeted medium-term lending facility (TMLF), eschewing cuts in its required reserve ratio (RRR) for now. Does this mean the central bank has started its easing cycle?

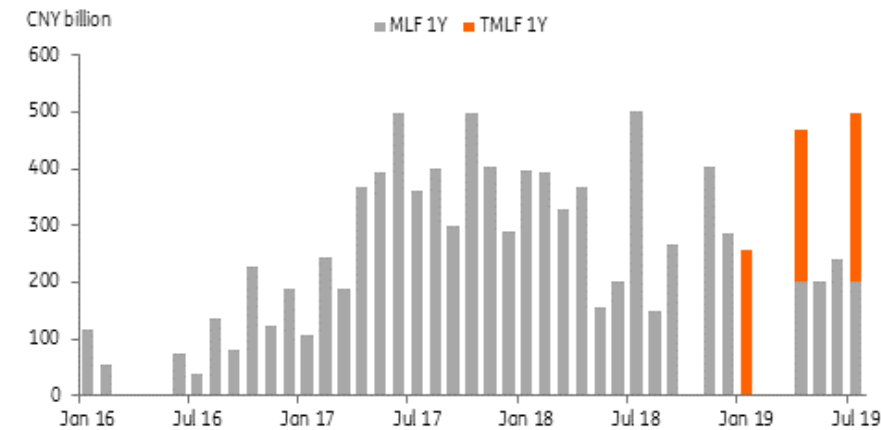


Source: Shutterstock

PBoC's MLF and TMLF liquidity injection is merely liquidity replenishment

The People's Bank of China added liquidity today using unconventional tools. Its medium term lending facility provided CNY200 billion while its targeted medium term lending facility added CNY297.7 billion, both for one year at interest rates of 3.3% and 3.15%, respectively. TMLF funding can be rolled over twice and so is viewed as a three year liquidity injection with an annual interest rate of 3.15%.

Still, these combined liquidity injections only offset part of the liquidity that matured today. The net result is still an absorption of CNY164.3 billion.



Source: ING, Bloomberg

Still an easing signal

We consider this liquidity management exercise to be the start of the easing cycle:

1. The newly added liquidity is cheaper in terms of interest costs. Borrowing via MLF and TMLF for one-year at 3.3% and 3.15%, respectively, is cheaper than interbank borrowing at 3.1% for three months.
2. The injection via MLF and TMLF, though, was a net absorption of liquidity, and saw the three-month interbank interest rate move lower, from 3.4% on Monday to 3.1% today.
3. The use of MLF and TMLF replaces regular open market operations - the duration of the liquidity injection is longer and therefore liquidity in the market should be more stable.

When will the PBoC cut the RRR? Or will it cut at all?

Regular liquidity injections into the system via MLF and TMLF once a quarter are unlikely to be sufficient to suppress the upward pressure on interest rates due to funding demand for infrastructure investment projects.

We have yet to see any RRR cut from the PBoC. But the central bank can't wait much longer if it wants to support the economy, which is being squeezed further by the trade and technology war.

While China has signalled it may be prepared to import US agricultural products again, we still haven't seen concrete action here. And even if there is action, concessions made from the US are likely to be limited. As long as Huawei remains on the US's "entity list", China will continue to set a strong tone in the negotiations. This means the trade truce will likely continue without material improvement.

The Chinese economy will need more liquidity and lower interest rates in 2H19 to support investment in infrastructure projects.

We expect two 0.5 percentage point RRR cuts together with 5bp cuts in the benchmark rate in 3Q and 4Q, respectively. The benchmark rate cuts will send a signal to the market that the PBoC is easing, and could help the market to form self-fulfilling easing expectations, which should push down interest rates further.

It's possible that the PBoC won't cut the RRR as this could result in a large and rigid change in the

system's liquidity, which would be very difficult to reverse. More frequent MLF and TMLF injections could replace RRR cuts instead. But equally, RRR cuts would send a strong message to the market that the central bank is serious about easing. The choice will really depend on the pace of growth in 2H19.

USD/CNY won't cross 7

The path of USD/CNY will depend on which liquidity tools are used by the PBoC.

1. If there is no RRR cut in 2H19 but more frequent MLF and TMLF operations, the market may not be too alarmed that the PBoC is in fact easing. The USD/CNY will be fairly stable and range bound around 6.90.
2. If the central bank cuts the RRR twice in 2H19, as we expect, the market will receive a strong easing signal from the central bank. This will put downward pressure on USD/CNY. But let's not forget that the USD/CNY is not a market driven exchange rate. And, as we have argued, the PBoC has set an invisible line at 7.0 (once in 2016 and once in 2018) because the central bank can't afford the asset market uncertainty that would likely accompany USD/CNY crossing this key level. So USD/CNY could weaken to 6.95 but is unlikely to touch 7.0.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

EUR: The signalled September ECB easing to keep the euro under pressure

Despite the euro's 'buy the rumour sell the fact'-like rebound, we see downside to the euro over coming months. We expect the ECB to announce a packaged deal of easing in September (a 20bp cut and QE among other things). This should keep EUR/USD risks skewed to 1.10 rather than 1.15



Detailed easing to come in September

Buy the rumour sell the fact. This summarises today's euro reaction to the ECB meeting. While the perceived lack of details from President Draghi on the upcoming and signalled easing (no hint at the size of the rate cut or assets under consideration for QE) reduced some pressure on the euro, we still see more ECB generated EUR downside ahead. This is because the interest rate cuts (that may be non-negligible) and QE are coming.

Deeper rates cuts and re-start of QE

- On the rates front, the fact that committees have been tasked to study "mitigating measures, such as the design of a tiered system for reserve remuneration" means there is scope for large cuts given the likely introduction of the tiering system. This gives the ECB some room for deeper rate cuts and in excess of the 18bp priced in by the market for this

year. We expect a full 20bp cut to be delivered in the September ECB meeting (vs 12bp priced in). See [ECB Review](#) for details for what we expect.

- On the QE front, the fact that committees have been tasked to look at “options for the size and composition of potential new net asset purchases” suggests that the new round of QE will be also announced in September. Our economists are looking for around EUR 20bn-30bn per month)

Risks to EUR/USD still skewed to the 1.1000 level

All this means that while the market might have been disappointed by the lack of details today (though in our view the press release got as dovish as it could get without actually implementing a monetary easing), this won't be the case in September as a set of specific unconventional measures will likely be announced and the ECB is expected to deliver a larger cut vs market expectations.

Unless the Fed embarks on more pronounced easing vs what is priced in for this year (more than two and half 25bp cuts vs our call for two 25bp cuts) it is hard to see EUR/USD embarking on a persistent and meaningful uptrend. In our view, risk to EUR/USD has re skewed towards 1.10 rather than 1.15 over the course of summer.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Turkish Central Bank front-loads with big rate cut

Turkey's central bank cuts its policy rate by 425bp to 19.75%. It clearly feels more confident about the strength of the ongoing disinflation trend and front-loaded the easing cycle amid an improvement in the political and geopolitical backdrop



The Turkish Central Bank in Ankara

-425bp CBT policy rate change
To 19.75%

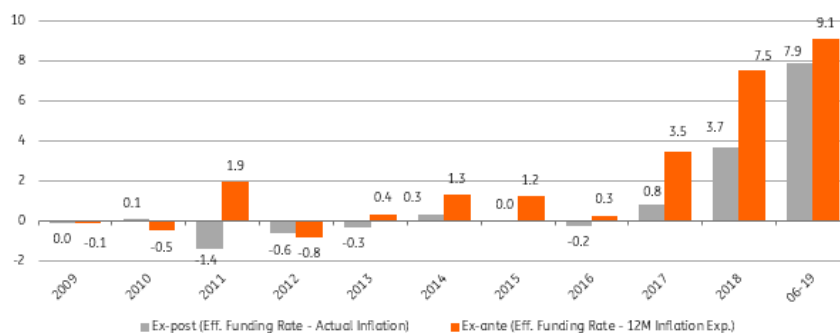
Higher than expected

The Central Bank of Turkey (CBT) announces a deeper than expected policy easing by cutting the policy rate (1-week repo rate) by 425bp to 19.75% vs market consensus of 250bp (and our call of 200bp) at its July rate-setting meeting. With the decision, the ex-post real policy rate that had been low or sometimes even negative since the global crisis dropped sharply to 400bp from more than 800bp before vs the average ex-post policy rate for EM peers around 300-400bp.

Ahead of the MPC, there were two relevant questions, namely the extent of easing in July and guidance for the policy implementation in the period ahead. As already signalled by new Governor Murat Uysal in an interview last week, the CBT utilised “room for manoeuvre in monetary policy” and came up with a frontloaded 425bp easing by “considering all the factors affecting inflation outlook”.

In its much longer MPC statement comparing the previous months, the CBT elaborates on the recently released data and provides expectations for the near term. On the inflation front, it acknowledges the ongoing downtrend on the back of “a deceleration in unprocessed food and energy prices”, along with a contribution from “domestic demand and the tight monetary policy”. The bank will announce its inflation report next week, but in the statement, it gives evidence for the inflation forecast, stating that “inflation is likely to materialise slightly below the projections of the April Inflation Report by the end of the year”.

Central Bank Funding



Source: CBT, ING

As for monetary policy, the CBT reiterates its key sentence in a different form, that “keeping the disinflation process on track with the targeted path requires the continuation of a cautious monetary stance”, given the close relation between disinflation and “achieving lower sovereign risk, lower long-term interest rates, and stronger economic recovery”. So as to keep inflation on the downward path, the bank vows that “the extent of the monetary tightness will be determined by considering the indicators of the underlying inflation trend”.

In this month's statement, the CBT mentions not only its price stability objective but also its financial stability objective, likely a signal that it will continue to watch the dollarisation that has been more visible this year along with exchange rate developments.

The rest of the statement makes these points:

1. The CBT envisages a relatively better growth outlook, noting a moderate recovery in economic activity with increasing competitiveness while the current account balance is expected to maintain the narrowing trend. The bank also sees a continuation of the recovery process with the support of disinflation and an improvement in financial conditions.
2. It states the increasingly supportive stance of global central banks. Despite a better global backdrop for emerging market assets, the bank recognises the likely risks on capital flow outlook from higher protectionism and global economic policy uncertainties.

Overall, given the surprisingly positive inflation releases, the CBT felt more confident about the strength of the ongoing disinflation trend and frontloaded the easing cycle given the improvement in the political and geopolitical backdrop. For the rest of 2019, the base effects will facilitate a rapid decline in inflation until November and we will likely see an increase in the last two months. Given the emphasis on the disinflation process and a cautious monetary stance, the CBT will likely come up with measured moves in the upcoming MPCs as the real policy rate now is less divergent from that of other EM counterparts in line with the Governor's objective of "a reasonable rate of real return".

Author

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

South Korean economy dodges recession

The Bank of Korea's policy interest rate cut a week ago is a step in the right direction as the central bank's 2.2% GDP growth forecast for the year remains subject to asymmetric downside risk



2.1% 2Q19 GDP growth

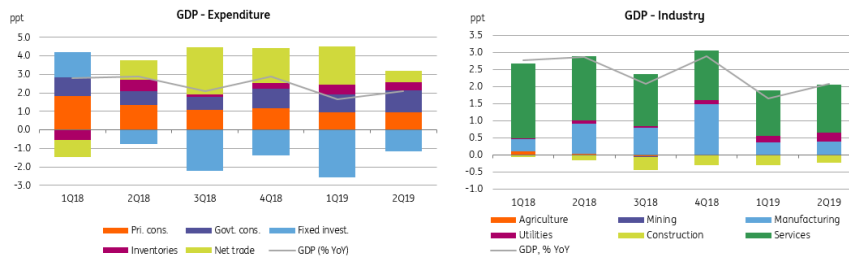
Better than expected

Growth picks up in 2Q19

South Korea's second quarter GDP grew by 2.1% from a year ago and by 1.1% (seasonally adjusted) from the preceding quarter. Growth was not only firmer than the Bloomberg consensus estimates of 1.9% year-on-year and 0.9% quarter-on-quarter, but also marked an acceleration from the 1.7% YoY and -0.4% QoQ SA rates recorded in 1Q19. More importantly, the economy avoided a recession with QoQ growth back in positive territory.

Private and public consumption persisted as the key expenditure-side drivers of GDP growth. The contribution of private consumption to GDP growth rose to 1.0 percentage point (ppt) from 0.9ppt in 1Q and that of government consumption was up to 1.2ppt from 1.0ppt. Investments remained a drag albeit smaller than in 1Q (-1.2ppt vs. -2.6ppt in 1Q). And all this more than offset a significant narrowing in the net trade contribution. On the industry-side, services retained their spot as the main driver of GDP growth, while an improvement in manufacturing and utilities also helped.

What's behind firmer GDP growth in the last quarter?



Source: Bloomberg, CEIC, ING

Note: Bars may not stack up to total GDP growth due to statistical discrepancy.

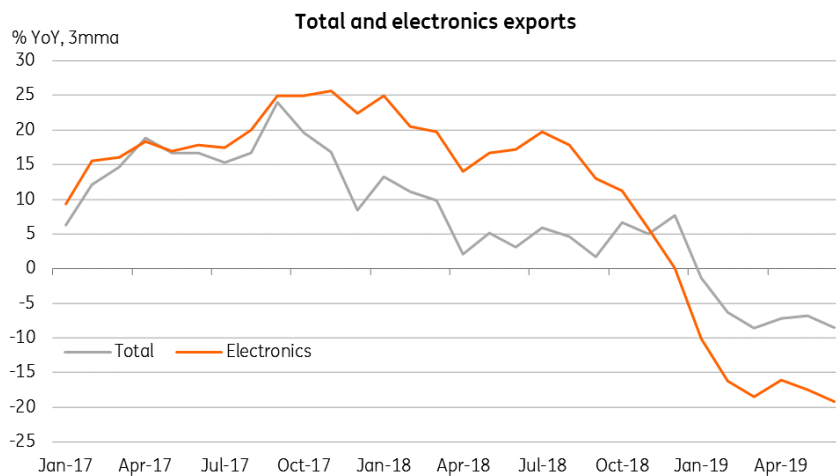
Economy dodges a recession

While YoY growth of 2.1% matched our forecast exactly, we overestimated the QoQ weakness in forecasting no growth for the period. With a 0.4% QoQ 1Q19 contraction and further weakness displayed by activity data in 2Q19, we feared the economy could have fallen into a technical recession. Even the tiniest negative reading (rounding up to our forecast of zero growth) would have resulted in a technical recession defined as two straight quarters of negative QoQ growth.

This would not have been too surprising given that the economy is heavily reliant on exports, which have been beaten up by the US-China trade and tech wars as well as a global tech slump. Electronics exports, a bellwether for the economy which account for a third of total exports, have suffered from a contraction of as much as 20% YoY in recent months, and within that, semiconductors have fared even worse, with a more than 30% fall.

Could it be that the wonky seasonal adjustment for QoQ growth helped the economy to avert a recession?

Electronics dampening export performance



Source: Bloomberg, CEIC, ING

Outlook isn't promising though

Even if the economy has averted a recession for now, the outlook for the rest of the year remains clouded by a worsening external environment, including an ongoing trade spat with Japan.

Just a week ago, the Bank of Korea (BoK) scaled back its growth forecast for 2019 to 2.2% from 2.5%. Average 1.9% GDP growth in the first half of the year precisely matched the BoK's revised forecast for the period. But its 2.4% growth view for the second half of the year appears optimistic. Aside from some favourable base effects (growth slowed sharply in 3Q18), there's no reason for year-on-year growth to recover in the second half. That, too, assumes that things don't become any worse than they currently are, which is a risky proposition absent any let-up in the export slump.

More easier policy is the order of the day

Better late than never, the BoK's 25 basis point policy interest rate cut no more than a week ago was a step in the right direction. However, [as we argued at the time](#), this was a mere reversal of the tightening late last year, not a stimulus in any real sense.

The key questions that today's data pose are whether the BoK will be complacent after an acceleration in GDP growth and stay on hold for the rest of the year, or, will it see through the GDP figure that's masking underlying weakness in the trade and electronics sectors, and ease policy further with more rate cuts?

Judging from the shift in global central bank policies, increased policy support for growth is the order of the day. We expect the BoK to go with the flow and ease again by 25bp in the final quarter of the year as its 2.2% full year GDP forecast looks increasingly unattainable. ING's forecast for Korea's full-year 2019 GDP growth is 1.4% (consensus 2.0%).

[Korea: Central bank starts easing cycle with 25bp rate cut](#)

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering

Senior Macro Economist
raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Watch: Boris, Brexit, the Bank and Britain's pound

Boris Johnson is to be the UK's next Prime Minister. With 100 days to go before Britain is due to leave the European Union, ING's James Smith looks at the prospects for a no-deal Brexit, the pound and rate changes at the Bank of England



Boris, Brexit, the Bank and Britain's pound

[Watch video](#)

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Report | 19 July 2019

Global debt flows: De-risking in Govies seen, but still long duration

We face into the 31 July FOMC meeting (and the ECB) with a market-place that is quite long duration. It is also long risk generally as evidenced from inflows built into long end governments, investment grade and high yield corporates and emerging markets.



Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

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