

# ING Monthly: The world waits for a climbdown

Military conflicts are highly unpredictable, making high-conviction forecasts almost impossible. That's why, rather than attempting to predict precise outcomes, we have provided detailed scenario analysis

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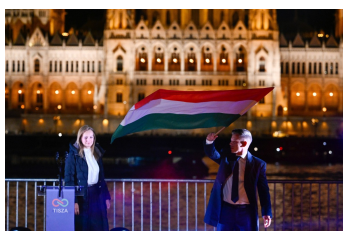
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## ING Monthly: The world waits for a climbdown

The six weeks of war in the Middle East have created a new stagflationary drag on the global economy

By Carsten Brzeski

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Article | 16 April 2026

## The world waits for a climbdown

The war in the Middle East is forcing us to play a game we can't just walk away from. The longer it goes on, the worse things will become for consumers and companies. And central banks are facing their worst challenges. Carsten Brzeski is trying to make sense of it all



President Donald Trump descending Marine One last week

### Our new base case scenario

It was 1983 when the movie *WarGames* taught a generation that the only winning move in a nuclear standoff is not to play. Forty-plus years later, economists find themselves in a similar bind, except we don't have the luxury of walking away from the board. Wars have become our subject matter, and the 2020s have been unforgiving.

War is not a game. Lucky as I am to have only experienced the Cold War as a child, it is still almost unimaginable that we economists now have to become experts on war, or at least on the economic impact of conflict. The biggest lesson I've learnt is that predicting how military conflicts develop is close to impossible. And that's why, instead of having strong conviction calls, the best thing we can offer is scenario analysis. We're trying to understand the mechanisms and transmission channels at play, not to pretend we know when or how the war in the Middle East or Ukraine will end.

In our new base-case scenario, we assume negotiations between Iran and the United States will drag on, prompting renewed tensions and even limited, calibrated military actions. It will take

another 2 to 4 weeks before a deal is reached, uncertainty begins to retreat, and the Strait of Hormuz reopens. But don't forget that once that does happen, it will take a while before traffic returns to pre-war levels; insurers and shipowners will be cautious, at first. In this scenario, we see oil prices gradually retreating to below 90 USD/b by the end of the year.

## The 2022 playbook, with one big difference

It is obvious that with every passing day of a de facto blockade of the Strait of Hormuz, the risk of knock-on effects for the global economy grows. Consumers around the world are already feeling the sting of higher energy prices. Companies will be next, facing either new supply chain constraints or energy costs too high to make production viable, or both at once. It's the 2022 playbook, but at the risk of sounding like a broken record, one big difference between then and now is that four years ago, the global economy was emerging from lockdown with healthy balance sheets and an almost unstoppable consumer appetite to go out and spend - the perfect breeding ground for fast-spreading inflation.

This time, the inflationary impact of an energy price crisis is likely to be more muted, as consumers will be far more reluctant to open their wallets. You can already see that reluctance in reported willingness-to-spend indicators, which are currently well below 2022 levels. At the same time, the hit to economic activity could be sharper than in 2022: Asia will be harder hit by potential energy supply constraints, and public finances on both sides of the Atlantic are more stretched, leaving less room for fiscal stimulus. Watch out for companies in the middle of supply chains: they may end up squeezed the hardest.

## One of the worst challenges for central banks

The six weeks of war in the Middle East have created a new stagflationary drag on the global economy. This wave will vary somewhat across regions and intensify the longer the conflict lasts, but it poses one of the worst challenges central banks can face. As in 2022, we will increasingly see the return of "team transitory" versus "team structural", the former arguing that monetary policy can do very little about a genuine supply-side shock, the latter pushing for pre-emptive rate hikes to prevent price-wage spirals from taking hold. Our view is that a transatlantic divide will open up again: a Fed joining "team transitory" and still cutting rates later this year, and an ECB half-heartedly siding with "team structural", at least one insurance hike, more symbolic than inflation-stopping. Don't forget that since 2022, the word "transitory" is as forbidden in Frankfurt as "Voldemort" is in the Harry Potter series.

But before Voldemort brings too much darkness, Europe has had some genuine good news. The election results in Hungary should end the country's role as the permanent - if occasionally necessary - thorn in the EU's side. Despite the daily struggles of both the German and French governments, Europe now has no excuse or scapegoat for failing to approve the agreed loans for Ukraine and push forward on the single market and common energy policy commitments made back in February.

I suspect this ING Monthly won't be the last one filed under "war and economics." There was a time when the biggest macro risk on an economist's desk was a central bank meeting. Those days feel like a different game entirely. And unlike Matthew Broderick, we can't just unplug the computer.

## □ Our key calls

- In our new base case, we're assuming energy flows gradually recover through the second quarter, though remain below pre-war levels until at least year-end. That sees oil prices averaging 96 USD/bbl through the second quarter.
- We now expect a single ECB rate hike in June. Headline inflation at 4%, core inflation above 3% and a surge in survey-based inflation expectations would make inaction increasingly difficult to justify.
- We still expect two rate cuts later this year. Moderating shelter inflation should mitigate the energy-driven rise in inflation, shifting the focus to weaker consumer spending.
- In China, the CNY has stood out as a surprise winner in the currency space, despite the focus on China's oil imports. We are adjusting our USD/CNY fluctuation band forecast to 6.70-7.05, down from 6.85-7.2, and risks are now broadly balanced to this forecast.
- We're sticking to our call for no Bank of England rate hikes. A weak jobs market and the fact that policy is still restrictive reduce the need for action.
- Developed Asia – Taiwan, Japan, Korea – are better positioned to weather this crisis, helped by stronger energy buffers. Developing Asia looks more exposed.
- CEE central banks remain cautious after the Middle East energy shock, but rate hikes are not imminent. We think Poland and the Czech Republic will stay on hold as inflation risks remain manageable, while Hungary turns more hawkish amid weaker growth and delayed easing.
- Our baseline EUR/USD call for 3Q (1.18) and 4Q (1.20) remains unchanged from last month. The backbone of our bearish USD view into year-end remains our expectation of two Fed cuts, which should reopen USD hedging channels by easing front-end rates.
- We think US 10-year yields will rise back towards 4.5% in the second quarter.



## What the Middle East war means for the global economy right now

The war in the Middle East is starting to have serious consequences for economies around the world. We're not yet predicting a recession, but it's going to hammer growth and increase inflation. Carsten Brzeski says accurately predicting what's going to happen next, however, is a fool's game

[Watch video](#)

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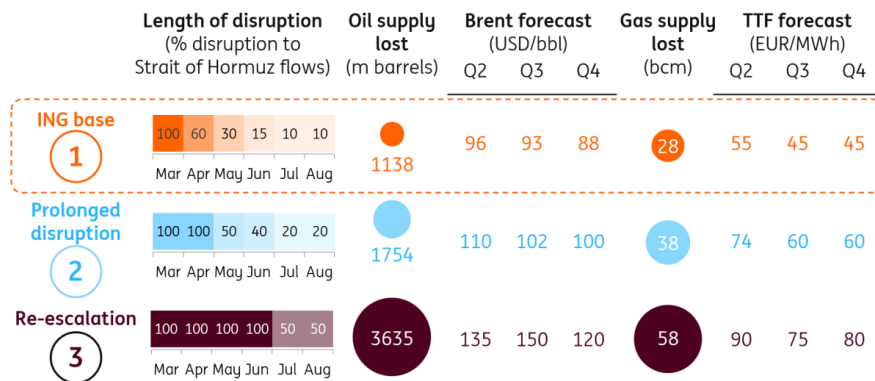
# Three scenarios for energy, central banks, rates and FX markets

How a prolonged disruption to Middle East energy flows could affect inflation, interest rates and currencies



With the world in flux, certainty is a rare commodity

## Three scenarios for energy prices



Source: ING

## Energy markets

Financial markets are taking a glass-half-full view on the Middle East crisis amid the ongoing ceasefire and reports of another round of negotiations between the US and Iran. But there are still plenty of ways this situation could play out.

In our refreshed base case, we're assuming that talks drag on, prompting renewed US pressure.

The American blockade of the Strait of Hormuz is a good example of this. But despite ongoing disruption, a deal is ultimately reached that enables more traffic to flow through the Strait as we head into summer. Our new forecasts are based on energy flows returning to 70% of normal through May and 90% by July. Remember that damage to energy infrastructure will hamper efforts to return fully to normal.

This scenario would see Brent Crude trading between US\$90-100/bbl in the second and third quarters. TTF natural gas averages 55 EUR/MWh in the second quarter.

Alternatively, a scenario where prolonged disruption means flows return to only 60% of normal by the end of June, takes oil prices back above US\$100/bbl and keeps them there for the remainder of 2026. Natural gas prices show further upside, too.

A more extreme situation, where talks collapse and a sustained military escalation ensues, keeps the Strait of Hormuz closed until the end of June, with only a steady recovery thereafter. Oil prices go as high as US\$150/bbl in the third quarter.

## Central banks

Our new base case sees the European Central Bank hiking rates in June, though for now we think that's a one-off. While the threat of second-round effects on inflation is considerably less than in 2022, we think headline inflation at 4%, core inflation rising towards 3% and the optics of survey-based inflation expectations metrics surging, will tempt Frankfurt into some very limited tightening. The fact that we're assuming a material improvement in flows through the Strait of Hormuz by the time of the June meeting should prevent that from turning into a more aggressive tightening cycle.

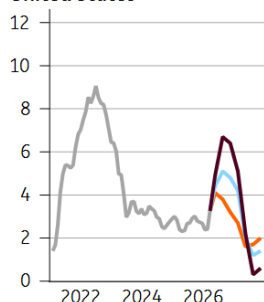
That changes if the disruption lasts longer and prices spike higher. The supply chain impact will become more unpredictable and widespread. And as the central banks have highlighted, the secondary impact on inflation risks snowballing. Our most extreme scenario sees US, eurozone and UK inflation peaking at or above 6% this year. If that happens, we'd expect multiple ECB hikes, though we also think it would be swiftly reversed through 2027 as the inflation threat recedes.

In contrast, we don't expect rate hikes from the Fed in any of our scenarios, although an interest rate hike can't be ruled out if energy prices rise above our base case. This is a far narrower supply shock for the US than 2021/22 and there isn't the same demand impetus. Over the medium term, we think higher transport fuel prices are more likely to weaken growth and employment rather than lead to persistently higher inflation. So while our more adverse scenarios delay the timing of the next cut as the Fed weighs up the risk of second-round effects, ultimately we think the higher energy prices go, the deeper the rate cut cycle that eventually follows. As Middle East tensions subside and energy prices drop, we expect officials to increasingly focus on the jobs aspect of its dual mandate.

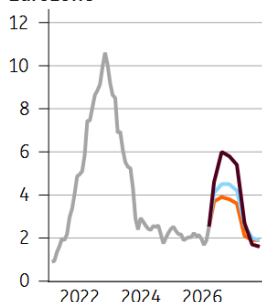
## Three scenarios for central banks and inflation

### Inflation (YoY%)

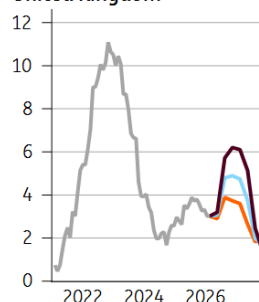
United States



Eurozone

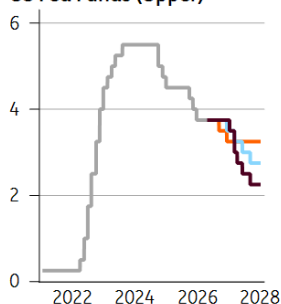


United Kingdom

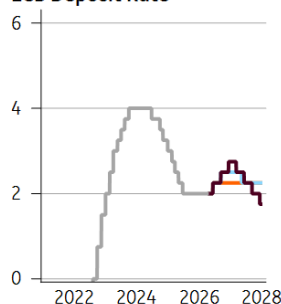


### Central banks

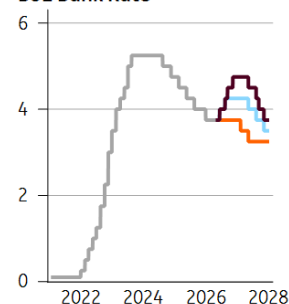
US Fed Funds (Upper)



ECB Deposit Rate



BoE Bank Rate



Source: Macrobond, ING

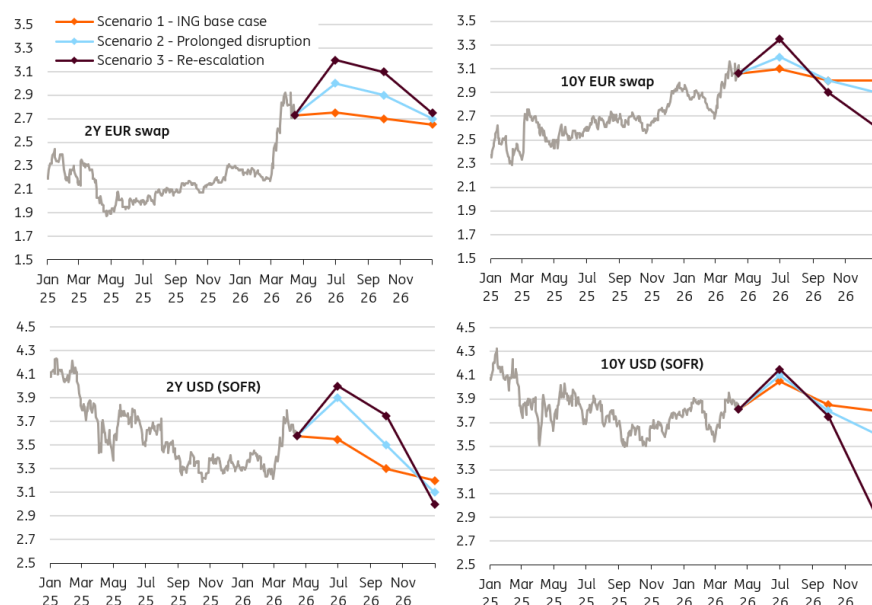
## EUR and USD rates: Higher rates will struggle to hold over the medium-term

Euro rate markets are still positioned for more than two ECB hikes and seem willing to price in more if oil prices were to rise again. In the near term, that means markets could even get pushed towards four hikes, implying a 2Y swap rate moving well above 3%. For the higher oil price scenarios, we do, however, anticipate a sharp dovish shift as growth concerns start mounting towards the end of the year. That means markets would already start eyeing ECB cuts in 2027, pulling the 2Y rate even below current levels.

For 10Y euro rates, the initial reaction to higher oil prices will still be bearish, but the scope to go higher should be limited. Growth concerns on the back of tighter monetary policy and higher energy costs should start weighing on market sentiment. In effect, this starts pushing down longer-dated rates, also explaining the 2s10s curve inversion towards the end of 2026 in the worst outcome.

The outlook is similar for US rates, with the 2Y swap reaching 4% in the highest oil scenario. Also, 10Y rates can move materially higher in the near term, even in our baseline scenario, especially since market sentiment remains resilient. With inflation numbers coming in hot throughout 2026, that upward pressure on rates should hold. When markets turn more pessimistic on the growth outlook, however, the focus should shift from inflation to recession risks. In effect, this pushes down real rates, bringing 2Y and 10Y to levels below where we stand today.

## Three scenarios for swap rates



Source: Macrobond, ING

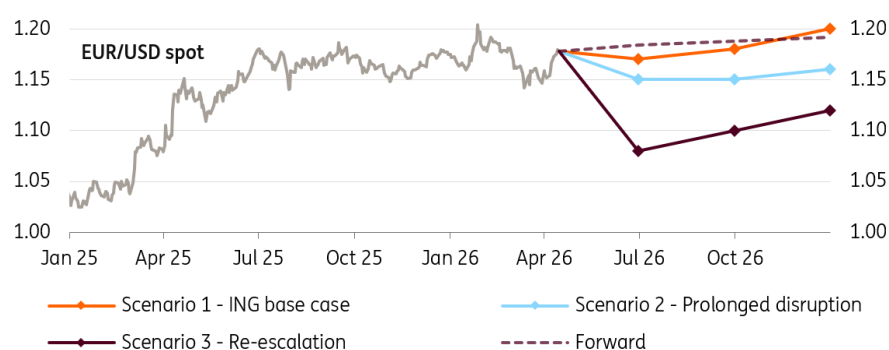
## EUR/USD: Our baseline remains modestly bullish

Our baseline EUR/USD call for 3Q (1.18) and 4Q (1.20) remains unchanged from last month. While we now embed one ECB hike into our forecast, market pricing remains more hawkish (55bp) and we have revised our oil forecast higher. The backbone of our bearish USD view into year-end remains our expectation of two Fed cuts, which should reopen USD hedging channels by easing front-end rates.

If anything, risks sit on the upside relative to our 1.20 year-end target, as the ECB might end up delivering two hikes after all and political uncertainty building into the November midterms could trigger more US-specific dollar weakness. And if Republicans lose both houses of Congress, limits on Trump’s ability to pursue new fiscal stimulus could reinforce structurally bearish views on the dollar.

In the shorter run, we see risks mildly tilted on the downside for EUR/USD, and we target 1.170 for the end of the second quarter. Markets have already leaned aggressively into the de-escalation trade, while ECB expectations still look too hawkish. We expect no change at the 30 April meeting, followed by scope for dovish repricing.

## Three scenarios for EUR/USD



Source: Refinitiv, ING

## Return below 1.10 in EUR/USD in severe scenario

In our second scenario, we estimate that a moderate re-escalation and longer oil supply disruptions will push EUR/USD back toward 1.15 for much of the remainder of the year. That level served as a key anchor in March, and under this scenario we would expect two ECB hikes and one Fed cut, broadly in line with current market pricing.

In the most severe scenario, the sensitivity of USD crosses to oil prices should rise sharply, relegating rate differentials to a secondary role. Average Brent prices in the US\$135-150/bbl range would, in our view, be consistent with a move back below 1.10 in EUR/USD. That assumes an accompanying sharp deterioration in global risk sentiment, in a stagflationary environment where the Fed decides not to cut rates.

## In numbers: Our three scenarios

	① Base case			② Prolonged disruption			③ Re-escalation		
	Q2	Q3	Q4	Q2	Q3	Q4	Q2	Q3	Q4
Brent Crude (USD/bbl)	96	93	88	110	102	100	135	150	120
Dutch TTF gas (EUR/MWh)	55	45	45	74	60	60	90	75	80
US Inflation (YoY%)	4.1	3.8	3.2	4.4	5.1	4.8	4.9	6.7	6.4
Eurozone Inflation (YoY%)	3.7	3.9	3.8	4.1	4.5	4.5	4.6	6.0	5.8
ECB Deposit Rate (%)	2.25	2.25	2.25	2.25	2.50	2.50	2.25	2.50	2.75
Fed Funds Rate (%)	3.75	3.50	3.25	3.75	3.75	3.50	3.75	3.75	3.75
2Y EUR swap rate (%)	2.75	2.70	2.65	3.00	2.90	2.70	3.20	3.10	2.75
10Y EUR swap rate (%)	3.10	3.00	3.00	3.20	3.00	2.90	3.35	2.90	2.60
2Y USD swap rate (%)	3.55	3.30	3.20	3.90	3.50	3.10	4.00	3.75	3.00
10Y USD swap rate (%)	4.05	3.85	3.80	4.10	3.80	3.60	4.15	3.75	2.90
EUR/USD	1.17	1.18	1.20	1.15	1.15	1.16	1.08	1.10	1.12

Source: ING

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# Energy market outlook hinges on the Middle East

The key factor for energy markets remains developments in the Middle East. The only way energy prices move lower is the resumption of flows through the Strait of Hormuz. In the absence of this, prices will only move higher



Dated Brent crude oil prices hit \$144.46 a barrel recently, an all-time high

## Oil futures don't fully reflect the scale of supply disruptions

Oil flows through the Strait of Hormuz remain largely cut off, which continues to tighten the oil market. However, despite this significant tightening, the futures market appears to be responding more to headlines over how the war may evolve, with hopes that we could see a resolution in the coming weeks. However, we just need to look at the physical market to get a better idea of the reality of the supply disruption. Dated Brent has traded as high as \$144/bbl recently and is trading at around a \$30/bbl premium to Brent futures. Clearly, the longer supply disruptions persist, the more likely we will see futures needing to catch up with the physical market.

We estimate that around 13m b/d of oil flows from the Persian Gulf are being disrupted due to the Strait of Hormuz blockade. This is after taking into account pipeline diversions, Iranian tankers still moving through the Strait (although this could change with the recent US blockade), as well as some other tankers transiting this key chokepoint. While releases of government stocks and the drawing down of floating storage have helped the market, the shortfall is still significant. Therefore,

there is a need for demand destruction. We are already seeing signs of this, particularly in parts of Asia, with several governments in the region announcing measures to reduce energy consumption. Clearly, the longer this persists, the more demand destruction we will need to see, and this will have to occur across other regions as well. To drive further demand destruction, we will need to see higher oil prices.

For now, our base case is that energy flows will start to make a gradual recovery through the second quarter. However, flows will remain below pre-war levels until at least year-end. This would see Brent averaging \$96/bbl over 2Q26 and \$89/bbl over the full year 2026. A more extreme scenario would be where Persian Gulf flows remain mostly cut off, while escalation sees extensive infrastructure damage, and risks to Red Sea oil flows also grow, which could see Brent trading over \$150/bbl.

## The LNG market continues to tighten

The global LNG market also continues to tighten with developments in the Persian Gulf, and the market is set to see supply disruptions persist for longer, even if we were to get a quick resumption of vessel movements through the Strait of Hormuz. Firstly, restarting Qatari LNG capacity will take some time, while 17% of Qatari LNG capacity will also be offline for the foreseeable future after an Iranian attack. As a result, we are seeing the Asian and European gas market increasingly pricing in a tighter market until 2027. A delay in the start of new Qatari capacity only adds to a tighter-than-expected outlook.

There is little in the way of supply alternatives for the market to offset the sizeable volumes we are seeing disrupted from the Persian Gulf. The ramp-up of new US LNG capacity is simply not enough. Therefore, demand destruction will be key to balancing the gas market. This will likely be evident in the power sector, where we expect the industry to lean more on coal, particularly in Asia. But even in Europe, it makes more sense to burn coal rather than gas, even when taking into consideration carbon prices.

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# Our latest views on the major central banks

Our take on what could be next for the Federal Reserve, the European Central Bank, the Bank of England and the Bank of Japan over the coming months



These are difficult times for global central banks

## Federal Reserve

The Fed currently views the oil price surge as a supply shock that it can't do much about. So far, market and consumer inflation expectations are within tolerable ranges, and there is a sense that inflation is more likely to be transitory this time around than in 2022.

While inflation is likely to test 4%, the Fed's dual mandate is also an important consideration. Having failed to create jobs in meaningful numbers over the past 18 months, when growth was strong, the risk is that we see weaker US jobs figures on the back of geopolitical, financial-market and economic angst.

Higher energy costs are likely to be demand destructive, given that household spending power is already under pressure and confidence is at such low levels. Weaker consumer spending growth will help keep a lid on core inflation pressures, and if we do see Middle East tensions ease and oil prices drop back in the second half of 2026, sub-2% inflation is achievable in 2027. This will give the Fed scope for rate cuts late this year.

## European Central Bank

The ECB's 'good place' is no more. Instead, the ECB is back in crisis mode, shifting its focus away from longer-term projections to actual developments, back to a "driving at sight" approach. Key variables to watch are actual inflation data, survey-based longer-term inflation expectations, and wage developments, all of which will be weighed against the risk of slowing economic activity and financial stability concerns.

We think the ECB – like us – is expecting an initial inflation wave, starting with gasoline prices, followed by knock-on effects on transportation costs, food prices and other industrial products. As long as this remains a single, time-limited wave, there is no need for ECB rate hikes.

That said, three potential pain points remain for the ECB: a psychological one, i.e., headline inflation above 4%, reviving uncomfortable memories of 2022; an analytical one, with core inflation above 3%, signalling broader price pressures; and a credibility one – a surge in survey-based inflation expectations, which would make inaction increasingly difficult to justify. The longer the blockade of the Strait of Hormuz lasts, the higher the likelihood that some of these pain points will be hit. This is why we now see the ECB announcing at least one insurance rate hike. Some would go as far as calling it a policy mistake.

## Bank of England

In contrast to the ECB, we're sticking with our call for no Bank of England rate hikes this year. While we don't rule anything out – particularly if natural gas prices were to spike materially – there are good reasons to think that the UK won't experience a long-lasting episode of inflation, akin to what it saw post-2022. The jobs market is weak, fiscal policy is tight, and unlike the ECB, interest rates are still in restrictive territory. Bank of England Governor Andrew Bailey has also taken the rare step of pushing back against market rate hike pricing. That hints at a pause in April, though despite a unanimous on-hold decision in March, we think the committee remains heavily divided. We expect at least one vote for a hike at this month's meeting.

## Bank of Japan

Recent Middle East developments pose downside risks to growth due to Japan's significant reliance on commodities from the region – yet recent data shows economic resilience. Companies are planning wage rises and expanded investment following strong profits, while real cash earnings gained in early 2026. Meanwhile, inflation expectations appeared to rise on the back of higher energy prices.

The Bank of Japan's March meeting minutes reveal a greater focus on inflation risk than on slower growth. The BoJ's new CPI metric, excluding institutional effects, remains above 2% (vs headline CPI well below 2% in February), reinforcing its view that underlying inflation remains firm. Additionally, revised potential GDP estimates showed that the economy exited its negative GDP gap a while ago, signalling growing demand-side pressure.

Considering these factors, our BoJ rate hike forecast now expects the first move in April rather than June, and a subsequent hike in October instead of January 2027. Governor Kazuo Ueda's recent dovish remarks dampened expectations for an April rate hike, but we believe he aimed to emphasise uncertainty rather than rule out the possibility of a hike. We expect firmer inflation and fiscal expansion to drive 10Y JGB yields to 3% by 2027.

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## 'Team Transitory' holds for now in the States

US inflation is rising, but without the scale of the 2021-22 supply shock or the demand impetus that drove persistent inflation then. If tensions ease and oil prices fall in the second half of 2026, rate cuts remain more likely than hikes



Fed Chair, Jay Powell, at last month's press conference

### Inflation expectations remain tolerable

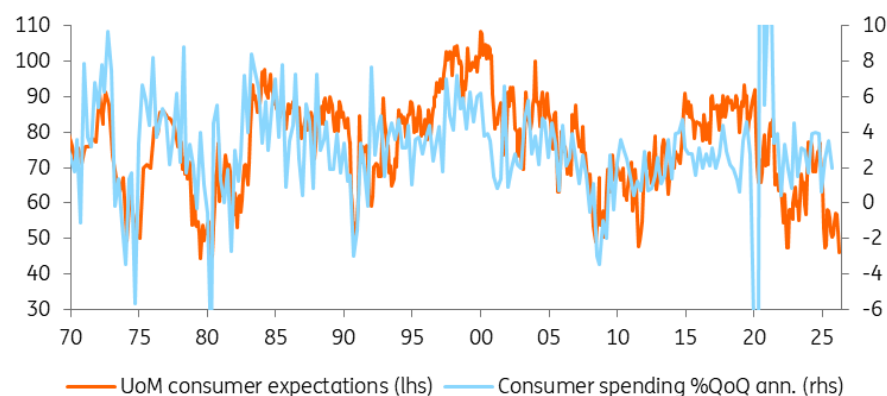
The Federal Reserve can't do anything to ease the energy supply shock. Instead, its role is to ensure that inflation expectations remain contained and, for now, that seems to be the case. Long-term consumer inflation expectations are tolerable, being a full percentage point below the 4.4% figure hit in the wake of the 'Liberation Day' tariffs 12 months ago. Meanwhile, break-even inflation rates on Treasury Inflation-Protected Securities have not shifted to a worrying degree – the 2Y implied rate is at 2.9%, 5Y at 2.7% and 10Y at 2.4%. In January, the averages were 2.5%, 2.4% and 2.3% respectively. As such, the central bank, households, and financial markets appear to believe that inflation is likely to be transitory.

While we expect US headline inflation to soon breach 4% on higher motor fuel and airline fare costs, we certainly don't think we are in for a repeat of 2022, when inflation got within touching distance of 10%, and the Fed had to hike the policy rate by 525bp. That is primarily because the supply shock is not as broad as the pandemic-related supply chain stresses in 2022, focused on

motor and aviation fuel. At the same time, we don't have the same sort of demand impetus that would risk a broader, more persistent inflation story.

US companies have not been able to pass on the \$25bn per month cost of tariffs to consumers in a meaningful way, with core goods consumer prices rising little more than 1% year-on-year. This gives us reason to doubt they will be able to pass on higher energy and distribution costs outside of airline fares. Furthermore, US natural gas prices have been falling, suggesting that developments in the Middle East will be less impactful on US utility costs than in Asia and Europe.

## Sentiment slump points to softer spending growth



Source: Macrobond, ING

## High energy costs likely to be demand destructive

In terms of activity, the differences with 2022 are even starker. The economy added 4.5 million jobs in 2022, wage growth averaged nearly 6%, savings had been built up during the pandemic, we had stimulus checks and significant pent-up demand as people sought a return to their pre-Covid lifestyles. Today, the jobs market has stalled, wage growth is closer to 3%, confidence is at record lows, savings have been depleted, and real household disposable income is flat-lining. Even the tax refund story, which we had hoped would provide a near-term boost to spending power, is looking less supportive than predicted. After disappointing January and February consumer spending data, surging energy costs will eat into household spending power and risk being demand destructive, hence our downward revision to 2026 GDP growth to 2.2% from 2.5%.

It isn't all bad news. Net trade is making a positive contribution to growth while pipeline indicators for business investment remain strong, especially for tech-related business capital expenditure. Government spending should also provide a significant boost to first-quarter GDP growth after the October shutdown weighed heavily on fourth-quarter 2025 economic activity.

## Dual mandate suggests rate cuts remain on the cards for late 2026

In terms of what this means for our call on Federal Reserve policy, we continue to believe interest rate cuts are more likely than hikes. With weaker consumer spending growth, core (excluding food and energy) price inflation is expected to be further dampened. In this regard, we need to remember the importance of shelter costs within the US inflation basket (35.5% weighting for headline and 44% for core), which we expect to moderate further.

The Federal Reserve's dual mandate of price stability and maximising employment is a key distinguishing feature of the US. Having failed to create jobs in meaningful numbers over the past 18 months, when growth was strong, the risk is that we see weaker US jobs figures on the back of geopolitical, financial-market and economic angst. Remember, too, that the Fed still views the current stance of monetary policy as being very modestly restrictive. With a new Fed governor taking office and key elections this year, the political pressure for action will intensify.

As such, if we do see Middle East tensions ease and oil prices drop back in the second half of this year, there is a strong chance of sub-2% inflation being achieved in 2027. So, while the Fed is likely to sound relatively hawkish in the near term, we continue to see scope for two 25bp rate cuts towards the end of the year.

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## ECB set to signal an 'insurance' rate hike

The stagflationary shock induced by the war in the Middle East will slow eurozone growth in the coming months, while inflation will climb towards 4%. Even though the ECB cannot do much to fight a supply shock, an 'insurance' rate hike has become likely to prevent a deterioration in inflation expectations



European Central Bank President Christine Lagarde last month

### Slower growth ahead

As the war in the Middle East lingers on and a quick normalisation of energy prices looks unlikely, the stagflationary impact of the crisis is likely to manifest itself in a more pronounced way in the coming months. Before the war, activity data already pointed to a subdued growth profile. Industrial production growth remained subdued in the first two months of the year and eurozone retail sales stagnated. In March, both business and consumer sentiment soured further.

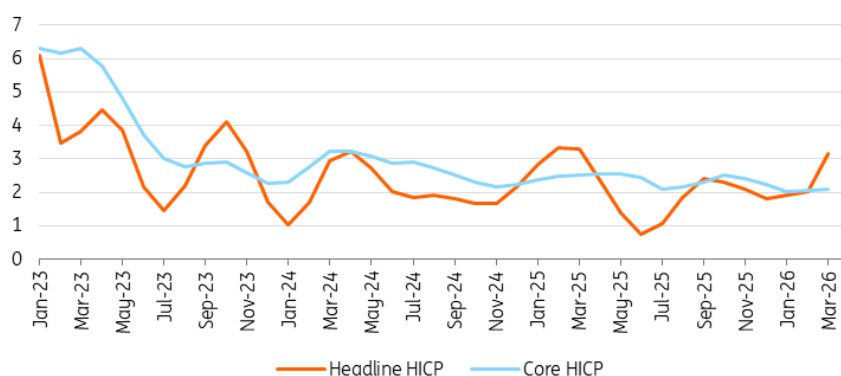
Leading indicators like new orders and hiring intentions in March's business sentiment indicators foreshadow slower growth in the months ahead. With unemployment expectations rising, we cannot count on a substantial decline in the savings ratio to boost household spending. And while countries like Spain, Italy and Germany have already announced some measures to counter the rise in energy prices, the total stimulus is likely to remain much lower than in 2022-23.

## Growth expectations downgraded again

In the ECB's March staff projections, several scenarios were explored, with the adverse and severe scenarios indicating GDP growth rates of 0.6% and 0.4%, respectively. We are leaning toward the adverse scenario, now forecasting 0.7% growth for 2026, down from 0.9%. Nevertheless, German fiscal stimulus hasn't vanished and, together with falling energy prices next year, should spark a renewed recovery in 2027. As a result, growth for 2027 is expected to reach 1.3%, slightly less than the prior estimate of 1.4%.

## Headline inflation rising, underlying inflation still under control

3M/3M annualised change HICP



Source: LSEG Datastream

## Inflation heading towards 4%

HICP inflation climbed to 2.5% in March from 1.9% in February, driven by higher energy costs. Core inflation is still under control for now, with the annualised three-month change in consumer prices excluding energy and food steady at 2%. Still, some secondary inflation effects are likely since businesses are signalling increased selling price expectations in surveys. We anticipate headline inflation rising towards 4% in the coming months, while core inflation is likely to hover between 2.5% and 3.0% in the second half of the year. This should produce an average headline inflation of 3.4% in 2026 and 2.4% in 2027.

## An insurance rate hike

Although the ECB currently has limited data to act upon, financial markets expect at least two rate hikes this year. We know that a supply shock is the hardest to tackle for a central bank. As a matter of fact, rate hikes will not boost the crude oil supply.

However, the ECB is unwilling to risk inflation expectations deteriorating as it did in 2022-23. Unlike that period, the deposit rate is now at 2%, compared to -0.5% at the start of 2022. This suggests that a modest rate hike would probably suffice as a signal. Call it an "insurance" rate hike. Could we see two rate increases? It's possible, but we continue to believe the ECB tightening will fall short of market expectations.

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# China's growth faces pressure from reflation and a narrowing trade surplus

China's economy appears to be absorbing the early impact of the Iran war, with inflation trending higher, strong export and import growth in the first quarter, and the CNY emerging as a surprising winner. That said, if the conflict drags on, boosting domestic demand will become increasingly important



Inflation is trending higher for shoppers like these in Beijing

## Iran war will give China's reflation story a nudge in the right direction

China's reflation story is picking up steam. After years of struggling with deflationary pressure, China's inflation looks like it'll be solidly in positive territory this year. PPI inflation returned to positive levels in March, the first time since 2022, while CPI inflation has stayed above 1% for two consecutive months. Upward price pressures will likely persist, as higher energy prices are already showing in the data.

The factors behind reflation are less encouraging; higher inflation stemming from energy and food prices isn't the typical, healthy demand-driven inflation that central bankers tend to look for. However, it could be the push in the right direction needed to restore inflation expectations and avoid a deflationary spiral. With FAI hitting a record low last year and retail sales sluggish, restoring

inflation expectations could encourage companies and households to open their wallets.

## Can the external demand story hold up another year?

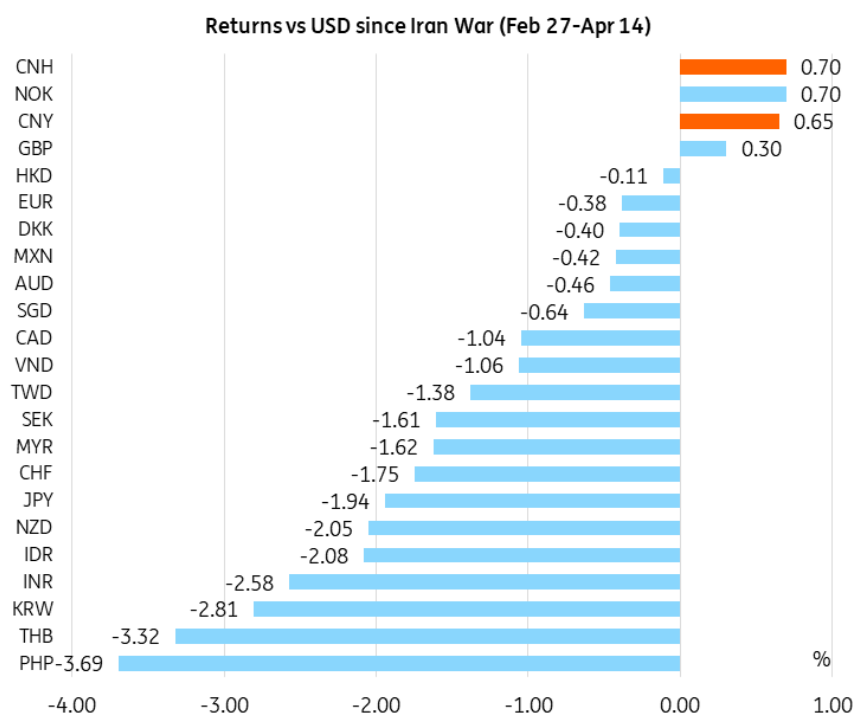
In the first quarter of the year, China's exports rose 14.7% YoY as strong demand from the rest of the world continued to offset the drag from the US.

However, the strong start to exports has been offset by an even sharper acceleration of imports, up 22.7% YoY in 1Q26. Higher tech product prices can be seen impacting both export and import growth. A stronger CNY may also be contributing to this.

In net, China's first quarter trade surplus of US\$264.3bn is down -2.5% YoY compared to 1Q25. A smaller trade surplus may be welcome news for China's trade partners seeking a more balanced trade relationship, but it will come at the cost of this year's growth, which already looks to face more pressure from higher energy prices and the general reflation trend.

If the external demand driver begins to weaken, we'll likely need to see stimulus ramp up to keep growth on track this year.

## CNY has outperformed since the start of the Iran war



Source: Bloomberg, ING

## CNY emerges as a surprising outperformer post-Iran war

With all the focus on the negative impact of the Iran War on China's oil imports, the CNY stood out as a surprise winner. Amid the broader strong USD environment, the currency was one of the top performers.

This came despite widening US-China yield spreads. The main factor in the near term is likely the People's Bank of China signalling tolerance for further appreciation after briefly pushing back on it

before the Iran war. Sentiment may also have been buoyed by renewed talk of a potential “petroyuan” emergence after reports that Iran wished to collect tolls on passage through the Strait of Hormuz in CNY.

In any case, bullish sentiment on the CNY continued to prevail. We are adjusting our USD/CNY fluctuation band forecast to 6.70-7.05, down from 6.85-7.2, and risks are now broadly balanced to this forecast.

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## We (still) don't expect the Bank of England to hike rates

We're sticking to our call for the Bank of England to keep rates on hold this year, in contrast to our forecast for an ECB rate hike in June. A weaker jobs market, tighter fiscal policy and a more restrictive starting point for interest rates set a higher bar for monetary tightening



Bank of England Governor Andrew Bailey

### No, the UK is not more vulnerable to the coming inflation shock

Financial markets are still applying the 2022 playbook to the Bank of England. The scale of repricing in interest rate expectations has been more dramatic than either the eurozone or the US. The implied UK rate one year from now has risen a full percentage point since the onset of war, and investors are still pricing close to two hikes by year-end.

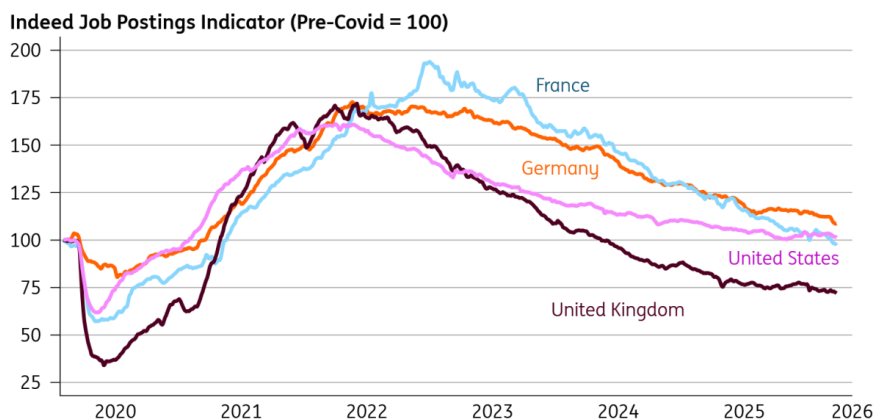
That seems to imply that the UK is facing a more severe inflation shock than elsewhere. We disagree. That may have been true in 2022. And Britain may be a major energy importer. But its dependency is on natural gas. And fortunately, this is not yet a natural gas crisis. Wholesale prices are still a fraction of where they traded in the fallout of the Ukraine invasion.

Based on ING's updated energy price forecasts, we think inflation is set to rise to 3% through May/June and bounce between 3.5-4% from July onwards. That's virtually identical to our new eurozone inflation predictions. And if anything, the UK may be less exposed to the second-round

inflationary effects that keep central bankers up at night.

The jobs market is weaker than in much of Europe, judging by vacancy data, thanks to the effects of last year's tax rises. Those increases had minimal impact on inflation but a notable impact on hiring. It's a reminder that firms have much less pricing power than they did in 2022. Likewise, workers don't have nearly as much power to demand higher pay. Wage growth has already fallen sharply in recent months. Unemployment is set to rise further.

## The UK jobs market looks weaker than in the eurozone



Source: Macrobond, ING

## We're still not convinced the Bank will hike rates

Fiscal policy is also getting tighter. The structural deficit is still set to fall this year thanks to the freeze in income tax brackets. That's in contrast to the post-pandemic period, but also Germany and its neighbouring economies, which are set to benefit from the wave of infrastructure spending coming online this year. Universal energy bill support looks unlikely.

The other major difference is that Bank of England interest rates are still widely seen as restrictive. The nominal neutral rate – a rate neither expansionary nor restrictive for the economy – is seen around 2.5-3%. Again, that's a difference with the ECB, where its 2% deposit rate is largely seen as neutral. The centre of gravity is still down, if anything; remember the Bank of England was on the verge of cutting rates further before the war began.

Finally, the Bank of England itself has begun to strike a different tone to its continental neighbours. Governor Bailey recently made a rare and not-so-subtle intervention on market pricing, saying investors were “getting ahead of themselves” in pricing hikes.

We took this to mean an April rate hike is highly unlikely. We're sticking with our call for the Bank to keep rates on hold this year. This marks a small divergence with the ECB, from which our team now expects a hike in June.

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# Energy shocks in Asia: diverging buffers, diverging growth

Asia's oil shock exposure is uneven. Developed Asia, supported by stronger buffers and policy space, will see growth ease marginally to 2.1% in 2026. Yet developing economies face a larger drag, with South Asia slowing to 5.4% from 6.2%, and India, the Philippines and Indonesia experiencing growth downgrades



People queue to refuel their vehicles in Jakarta, Indonesia.

## Asia and oil - uneven exposure to energy shocks

Asia accounts for the bulk of oil flows through the Strait of Hormuz, with China, India, and Japan among the largest recipients. But exposure to this supply shock is far from uniform, with wide differences in reserve buffers, policy capacity and the energy mix.

Japan and South Korea are backed by deep strategic reserves and fiscal space to stabilise domestic fuel prices. By contrast, India, the Philippines and Indonesia sit closer to the economic fault line, with thinner buffers and greater sensitivity to imported energy costs. This divergence is already visible in policy outcomes. Gasoline prices in the Philippines have surged by as much as 75%, while Thailand and Indonesia have kept increases modest, leaning on subsidies and price controls – though at a growing fiscal cost.

The energy mix matters, too. Economies with greater reliance on coal – most notably China and, to a lesser extent, India – have more room for substitution. China's coal-heavy power generation has helped dampen the macroeconomic impact of oil-related disruptions, limiting broader spillovers.

## Developed Asia is better positioned

Developed Asian economies – including Taiwan, Hong Kong, Korea, Japan and Australia – entered the year with firm momentum. Domestic demand has held up in Japan and Malaysia, supported by tight labour markets. In Australia, the lagged effects of central bank easing continue to underpin activity. Korea has benefited from fiscal support. Externally, the region remains well-positioned to capture upside from the AI-led tech cycle.

Stronger energy buffers reinforce this advantage. Japan, for example, held 228 days of oil reserves as of 7 April (including 143 days in public stockpiles). Reserve releases and gasoline price caps have limited pump-price increases to around 8%, a stark contrast to more exposed economies.

Against this backdrop, we are more constructive on developed Asia. We upgraded Taiwan's GDP growth forecast to 8.2% from 6.7%, reflecting stronger-than-expected tech and AI momentum.

Singapore also remains resilient. While oil supply risks persist, robust tech-driven external demand and recent fiscal measures – including a corporate income tax rebate and targeted transport support – should help cushion the impact on Singapore. We now forecast 3.3% year-on-year growth in 2026, only marginally below the previous 3.4%. This is still above trend. We revised down 2026 GDP growth forecasts for Japan and Korea marginally to 0.7% YoY and 2% YoY, respectively.

## Developing Asia faces a larger drag

Developing Asia is more exposed to the shock. Higher energy dependence, weaker macroeconomic buffers, and tighter policy constraints suggest a larger drag on growth. As a result, we have downgraded our GDP growth forecasts for the Philippines to 4.5% (from 5.2%), India to 6.5% (from 6.7%), and Indonesia to 4.8% (from 4.9%), as elevated energy costs weigh on domestic consumption, external balances, and fiscal space.

While the magnitude of these downgrades appears modest, it's important to note that growth expectations for these economies were already lower. Following the latest revisions, GDP growth in South Asia is now projected to slow to 5.4% in 2026 from 6.2% in 2025. Growth in developed Asia is expected to ease by only 0.1 percentage point to 2.1% in 2026, largely due to stronger momentum in Korea.

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## CEE: Rates on hold as oil shock clouds outlook but avoids panic

CEE central banks remain cautious after the Middle East energy shock, but rate hikes are not imminent. Poland and the Czech Republic stay on hold as inflation risks remain manageable, while Hungary turns more hawkish amid weaker growth and delayed easing



A new Prime Minister in Hungary won't change near-term economic woes

### Poland: NBP stays calm in the face of energy shock

Poland's central bank maintains a neutral rather than a hawkish stance in response to the Middle East energy shock. Not only did the National Bank of Poland cut interest rates by 25bp in March, after the Israeli/US attack on Iran, but it also delivered balanced communication following its April decision to hold rates flat. The NBP appears to share our view that this mainly constitutes a supply-side shock, while the 2019-23 CPI spike was a combination of supply and demand shocks with much more conducive conditions for inflation pass-through.

The NBP Governor stated that there is no risk of a significant increase in inflation from higher oil prices. Adam Glapiński noted that a supply-side shock raises inflation but may also dampen economic activity, thereby generating some disinflationary impulses. He also outlined a range of arguments indicating that Poland is not facing heightened inflation risks:

As a result, the central bank has shifted to a 'wait and see' approach. It is unlikely to resume rate

cuts in the near term, but it also does not view rate hikes as necessary at this stage.

We expect NBP interest rates to remain unchanged this year, as the inflation outlook has deteriorated and become more uncertain.

## **Czech Republic: Higher inflation and slower growth remain manageable**

Our perhaps optimistic scenario of the Middle Eastern conflict lasting roughly two months, with Brent Crude averaging above \$100/bbl until April and then gradually declining, remains a probable outcome. As the Czech economy entered the negative external supply shock in good shape, the anticipated upward effect on overall prices and downward effect on economic performance will still leave the economy insulated.

For sure, we expect noticeably higher inflation and slower economic expansion than before the attacks on Iran. Still, both variables would record a pace of around 2.2% this year, which would allow the Czech National Bank to do the right thing in this type of shock: wait with unchanged policy rates and see how all the forces come together.

Nevertheless, should the conflict drag on, with Brent above \$100/bbl until the end of the year, with repercussions for supply chains and global economic activity, we would enter a different world, where non-linearities and strong feedback loops kick in. In such a case, Czech real economic growth would ease to around 1.5% this year and the next, while headline inflation would average 2.8% this year and climb to above 3% on average the next year.

## **Hungary: A new government won't fix short-term economic woes**

The ousting of Viktor Orbán in Hungary has dominated news headlines, but a change in government won't necessarily have a significant short-term impact on the real economy. That's because its structure and, of course, geopolitics, are still mostly shaping the outlook for the rest of the year. Based on the hard data, Hungary's economy was pretty mixed in the first quarter of the year. We still expect Hungary to achieve meaningful growth this year, though we have had to lower our expectations once again.

Geopolitical risks continue to pose a serious threat to Hungary's growth prospects. We have reduced our 2026 growth forecast from 1.7% to 1.6%. Based on the latest data for February, it appears that the strong economic momentum observed earlier is fading. However, retail sales remain the sole driving force and the last hope for growth.

Inflation has continued to show a surprisingly positive picture, standing at only 1.8% year-on-year. This demonstrates resilience in the face of the initial energy price surge, but further inflationary pressures are on the way. Despite the low inflation rate, the National Bank of Hungary kept the base rate unchanged in March. However, the war in the Middle East has forced the bank to revise its macroeconomic projections and adopt a more hawkish stance. Forward guidance in the March press release indicates a hawkish bias, stating that maintaining price stability requires tight monetary conditions. We do not expect an interest rate cut in the coming months.

The ongoing war in the Middle East continues to put significant pressure on oil markets, particularly

given Hungary's status as a net energy importer. Persistently high oil prices are hindering the normalisation of inflation and inflation expectations, and making it more difficult to break out of economic stagnation.

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## CIS-4: new global scenarios further reshape the outlook

The upside to energy prices further reshapes our CIS-4 view. Exporters benefit more, gold provides Uzbekistan with a unique buffer, while importers face cost pressures. Meanwhile, FX stability is retained region-wide thanks to continued capital inflows amid a prudent monetary policy approach



Higher energy prices make Azerbaijan the biggest winner in the CIS-4

### Energy exporters benefit the most

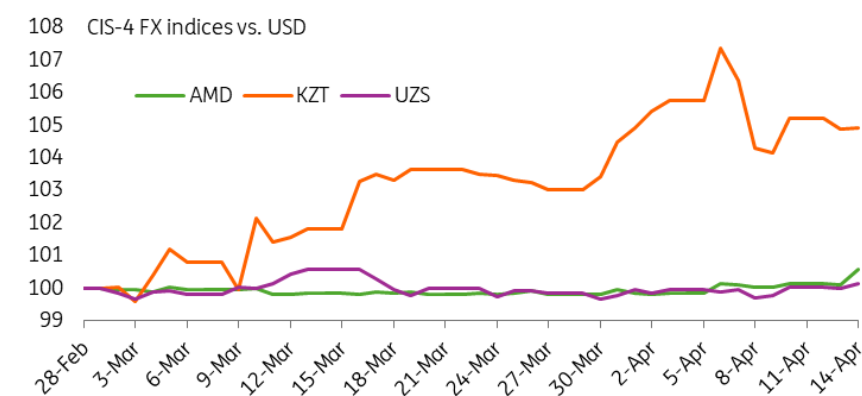
Another upward revision to global energy price assumptions calls for an adjustment of our CIS-4 outlook. The base case scenario for Brent is now \$89/bbl for 2026 and \$77/bbl for 2027, but the adverse scenarios assume \$121 and \$97, respectively.

Azerbaijan and Kazakhstan are the beneficiaries. Given our assessment of the [sensitivities](#), the new base case makes Azerbaijan the biggest winner, with its 2026 current account reaching 8-9% of GDP and budget surplus at 4.0-4.5%. Kazakhstan's financial gain could be limited by dividend outflows and lower investment income of the sovereign fund, but the current account deficit should nearly halve to 2.0-2.5% of GDP in 2026, while the consolidated budget should remain close to balance.

Commodity importers face a less favourable environment. Armenia's current account deficit should widen to around 9% of GDP in 2026, with the fiscal deficit remaining in the 3-4% GDP range.

That said, the adjustment costs have so far been absorbed without destabilising domestic markets. The Armenian dram has remained resilient since the outbreak of the Iran war, indicating that capital flows and remittances continue to provide an effective buffer.

## KZT has rallied on higher oil, but non-oil FX have remained resilient



Source: Refinitiv, national sources, ING

## Uzbekistan could withstand a return to gold prices of \$2.0-2.5ths/oz

Uzbekistan is a special case due to its exposure to gold. ING's base case for gold has so far remained unchanged, but in an adverse scenario, gold prices are vulnerable to downside risks. Uzbekistan has the capacity to mitigate gold price volatility through export volumes. The country exported around 85 tonnes of gold in 2025, but Uzbekistan has previously demonstrated the capacity to temporarily increase export volumes to around 120 tonnes per year, as seen in 2023.

This implies that even if the gold price were to average \$2,200/oz in 2026, roughly 35% below the 2025 average, Uzbekistan could still maintain annual gold export proceeds of around \$10bn by boosting volumes.

## Common risk of higher CPI calls for tighter monetary policy approach

Higher commodity prices reinforce inflation risks across the CIS-4, particularly through the food channel. Armenia is especially sensitive, with a 10% increase in global food prices (UN FAO) potentially adding up to two percentage points to CPI, though other CIS-4 are also sensitive at 0.8-1.5 ppt.

Given the limited nature of the food price increase, we have made only a modest c.0.5 ppt increase in our CPI forecasts for most of CIS-4, with the main effect delayed until 2027. However, the potential second-round effects still call for a more cautious approach from the central banks. All the CIS-4 central banks, including those in [Kazakhstan](#) and [Uzbekistan](#), tightened the wording of their monetary policy in March. We still do not expect any rate hikes in 2026-27, but the room for rate cuts in CIS has been reduced.

## Longer-term investment depends on domestic institutional framework

Looking beyond the commodity repricing, structural considerations remain decisive for the region's investment case. Domestic and foreign policy, the role of the state, sectoral diversification, and the institutional environment remain common challenges across the region. Country-specific macro themes also matter. Kazakhstan and Uzbekistan could support portfolio inflows through sustained fiscal discipline and firmer control over inflation; Azerbaijan would benefit from a more open capital account; and Armenia would gain from a more secure and predictable foreign policy position in the region.

Overall, it would be a stretch to view CIS financial assets as a direct alternative to developed markets currently experiencing pressure on their financial assets. However, tactically they can match the interests of investors seeking higher returns and domestic issuers – mainly sovereign and quasi-sovereign, as seen in [Uzbekistan](#) recently – looking to secure financing at attractive valuations.

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## Rates: Mapping the war to markets

We're in an uncomfortable spot. But it's tolerably better than a spiral out of control. Given what we know, rate markets are dealing with an upward shift in the starting points of curves and an increase in inflation expectations. Both of these maintain pressure for elevated bond yields. There is a tipping point, led by lower real yields. But not quite yet



Expect market yields to remain elevated

### The markets and the war and bond yields

To understand market thinking on the war, one must recognise that markets are cold-hearted. The fact that negotiations broke down last week is important, of course, but it's not the dominant factor for markets; wars between regional powers aren't actually that important to them. What matters is an improved medium-term capacity to get back to a normal flow of stuff generally. While remaining apolitical, the stalemate in the Strait of Hormuz is bizarrely a more market-friendly outcome given that, in theory, the ultimate aim is to reopen the Strait fully and unrestricted.

The impact reaction is more nuanced, as in fact the US intervention mutes flows, certainly from Iran. But the bigger and longer-term picture is more palatable. From a cold market mindset, even if Israel and Iran were to lob munitions at each other, markets wouldn't care that much. Markets will care if the US is in the game and ramping up risk. As it is, it seems the US prefers an off-ramp, as

long as it comes with the US taking control of enriched uranium and the Strait fully reopening. Things could change quickly in the coming days, but based on what we know, a landing has been found in an uncomfortable spot, in an area that averts a super-bad-case outcome.

Expect market yields to remain elevated, though. Oil prices may be off their highs, but nothing's been solved. Inflation breakevens *have* managed to ease lower in short tenors, reflecting that mild ratchet away from extremes. But longer-tenor yields have come off highs mostly from an easing in real yields. The market is beginning to think about a medium-term activity hit. That said, we continue to view the inflation spurt as the immediate issue that will keep long-term yields elevated.

## Setting the scene for medium-term rates

Translating this into a view on bond yields requires mapping out the considered neutral valuations, then assessing where we should be relative to them.

In the eurozone, the deposit rate at 2% is considered neutral. The 10yr, then, at 75bp above that, is where the conversation begins about where neutrality is. It's a more opaque conversation for longer tenors. But two key ingredients need to be added. First, the front end is trading in the 2.75% area, which presents us with an elevated base. Second, 1yr inflation breakevens are around 4%. Bottom line, it's fair to argue that the 10yr Euribor rate should have a 3% handle (which it does), and it risks edging higher still.

In the US, the funds rate is considered neutral in the range of 3% to 3.5%. It's currently at 3.64%, and markets expect it to hold there for the coming couple of quarters. That's the base from which the curve needs to be pitched. Front-end inflation breakevens are in the range 3% to 3.5%. Neutrality for the 10yr yield has a 4% handle. Currently, the 10yr real yield is at 1.8%. Lob the latest 2.7% core CPI number on top of that, and we hit 4.5%. Market breakevens in the 10yr area are lower, but printed PCE inflation metrics are higher. There is no perfect model here, but getting to 4.5% should not be a surprise outcome.

There is a tipping point where bond markets start to worry more about collapsing real yields and a recessionary tendency. That would be where the war re-intensifies, and would likely require some loss of control by the US. We don't assume that, so for now, the central impulse is coming from front and centre inflation worries. And for as long as rate hikes are *not* delivered, pressure for higher (consequently unprotected) long yields remains.

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Report | 16 April 2026

# ING Monthly: The world waits for a climbdown

The six weeks of war in the Middle East have created a new stagflationary drag on the global economy



President Donald Trump descending Marine One last week

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