Message in a bottle

It was vintage Lagarde this week as the ECB president poured old wine from a barely new bottle. This month's Fed meeting is unlikely to be sparkling; we preview it. China's growth story might give you a headache; watch the video. And along with Russia's big rate hike - don't mess with Elvira - we examine the global implications of Germany's elections. Prost!

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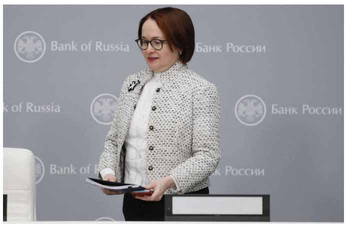

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Article | 22 July 2021

The ECB pours old wine from a barely new bottle

The ECB slightly changed its forward guidance as a result of the new strategy, becoming even more dovish. As a result, any tapering announcement in September looks highly unlikely

ECB president, Christine Lagarde

The announcement of the revised ECB strategy had increased expectations for today's meeting. Would the ECB really be serious about implementing the new strategy, which implied becoming more dovish, and how would the new 'crispier' communication that president Christine Lagarde promised just two weeks ago really look?

Let's start with communication. Here, the ECB clearly overpromised and underdelivered. Hardly anything changed, except for some restructuring of texts and adding some coloured headlines. The new bottles had a lot of scratches and dust at delivery.

The ECB did indeed make a shift towards more dovishness

As regards the implementation of the new strategy, the ECB did indeed make a shift towards more dovishness, putting more emphasis on the possibility of inflation overshooting and by tying the forward guidance on interest rates even closer to the inflation projections. With an inflation projection currently of 1.4% YoY for 2023 and the new forward guidance, interest rates will remain low for even longer.

The statement that rates will remain unchanged until the ECB "*sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon',* and it judges that '*realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term*" is very clear. Also, the ECB emphasised that it will accept "*a transitory period in which inflation is moderately above targe*t". Not very surprising; this decision was not taken unanimously.

Today's decision to stick to the front-loading of asset purchases in our view implies that there will either be significant tapering in the fourth quarter of the year or that the envelope could be increased, pushing an end of the Pandemic Purchase Programme (PEPP) beyond March 2022.

What's next for the ECB?

What does all of this old wine in new bottles really mean? In our view, it means that the new strategy indeed marks a shift towards more dovishness, potentially leading to a delayed and very soft tapering as well as a further delay of any rate hike. Not a real surprise but a confirmation that the hawks at the ECB are currently having a hard time.

An extension of PEPP, its emergency pandemic programme, beyond March 2022 looks increasingly likely. A significant reduction of monthly asset purchases before the end of this year looks increasingly unlikely, and any rotation out of PEPP into the old Asset Purchase Programme (APP) will hardly lead to an overall reduction of monthly purchases in 2022.

The hawks at the ECB are currently having a hard time

All of this is obviously built on a very benign, and in our view challengeable, take on inflation and pass-through from higher producer and commodity prices to consumer prices. We sometimes feel reminded of the football fans who see a clear negative trend in their favourite club's performance while the team manager is still blaming the referee, bad luck and the weather for a series of disappointing matches.

In any case, as long as the ECB sticks to this benign inflation view the only really important change that the ECB delivered today was that any change (to monetary policy) will come later than expected. Even in new but scratched bottles, the wine is still the same: low for even longer and QE for almost ever.

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Article | 23 July 2021

China | Video

Pang: A stark warning about China’s future growth

China's growth prospects are looking shaky and our Chief Economist for Greater China, Iris Pang, is worried. Here's why

A stark warning about China’s future growth

The prospects for growth in China have unexpectedly weakened. So says ING's Iris Pang in Hong Kong. She's concerned about a decline in investment in equipment linked to the global semiconductor chip shortage. But there's more to it than that. International politics are playing a big role as are internal reforms which are heightening credit risk. And, of course, no one is sure how the coronavirus pandemic will unfold in the coming year.

[Watch video](#)

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Article | 23 July 2021 United States

Tapering talk and policy normalisation: What to expect from the Fed

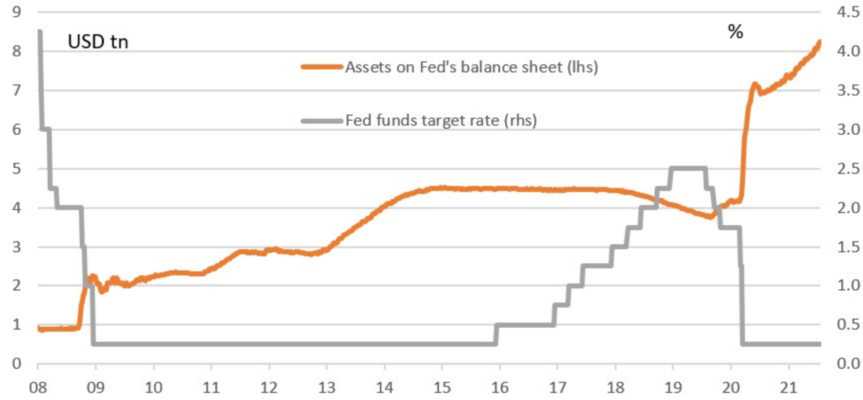
While no Federal Reserve policy changes are expected in July's meeting, we could hear more about the tapering discussions that started in June. The volume surrounding this issue is likely to be turned up at the August Jackson Hole conference with the risks remaining skewed towards earlier policy normalisation that the Fed is currently signalling

The Fed Chairman, Jerome Powell, stands before the Senate Committee on Banking earlier this month

Fed to bide its time

We are building up to the 28 July Federal Reserve meeting, but Chair Jerome Powell made it clear in his recent testimony to Congress that he continues to believe inflation pressures are largely transitory and there isn’t any pressing need to signal an imminent shift in policy. After all, employment levels remain more than 6 million lower than before the pandemic started while the latest Covid wave adds another level of uncertainty that can be used to justify inaction.

Federal Reserve balance sheet & Fed funds target rate



Source: Macrobond, ING

Remember too that the Fed's new monetary framework places a much greater emphasis on ensuring as many people in society feel the benefits of growth. This was accompanied by a move to an "average" inflation target of 2% and a clear signal that the economy will be allowed to run hotter than in previous cycles to ensure these targets are reached.

Given this backdrop we are not expecting any change to the Fed funds target rate range of 0-0.25%, nor do we expect the Fed to lower its monthly QE asset purchases, which are currently running at $120bn per month. Moreover, Chair Powell is likely to suggest that while discussion on tapering has started, there is still plenty of time before they need to reach a conclusion on what they will do.

The tide is changing

Nonetheless, there is a growing hawkishness creeping into the viewpoints expressed by other FOMC members given the strong economy and the fact that inflation is running at more than double its 2% target. For instance, St Louis Fed President James Bullard has historically been viewed on the more dovish end of the spectrum of FOMC members, yet in recent months he is arguably one of its most hawkish by making the case for an imminent taper.

> *We believe that inflation will be more persistent than the Fed is forecasting*

We believe that inflation will be more persistent than the Fed is forecasting with supply disruptions and labour shortages showing little sign of abating. In fact, we forecast that US headline inflation will stay above 4% until 1Q22 with core inflation unlikely to get below 3% until the summer of next year. We also expect the strong growth to story continue and with workers remaining in short supply, we see further wage pressure too.

We also have to consider financial market conditions. The fall in 10Y yields from 1.7% to 1.25% is a big additional monetary stimulus for the US economy and is only likely to add to the nervousness of the more hawkish members of the FOMC.

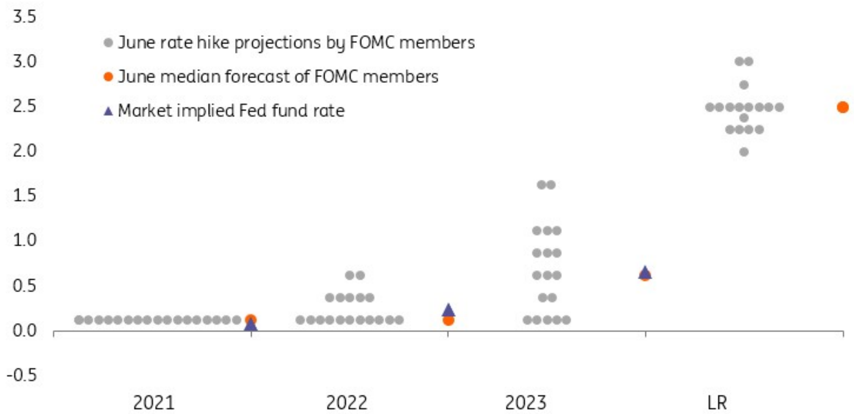
Taper talk is key

While the July FOMC meeting is likely to be a non-event in itself, we wouldn't be surprised to hear Jerome Powell talk a little bit more about the discussions surrounding the path of tapering. The upcoming Jackson Hole Federal Reserve Conference in late August, we suspect, will see Fed officials starting to lay the groundwork for a QE taper with this fleshed out in more detail at the September FOMC meeting before being formally announced in December. We predict a relatively swift reduction that sees QE purchases end in the second quarter of 2022.

Risks skewed towards earlier rate hikes

As for interest rates, the June FOMC meeting saw officials shifting their collective view to a 2023 start point for interest rate increases after having previously been adamant it would not happen before 2024. The Fed's own 'dot plot' chart of individual members' thoughts on the outlook for interest rates only requires two of the 11 members not favouring a 2022 rate hike to switch sides to bring the medium in favour of action next year. As we have seen, things can change very quickly at the Fed.

Fed dot plot - individual FOMC member interest rate expectations (%)



Source: Macrobond, ING

With the economy continuing to grow strongly, inflation well above target and the jobs market looking strained through a lack of suitable workers we wouldn't be surprised to see that happen at the September FOMC meeting. This would then tally with our own view that we will start to see policy tightening get underway in September 2022 with a follow-up interest rate rise in December 2022.

Implications for the dollar: We're bullish

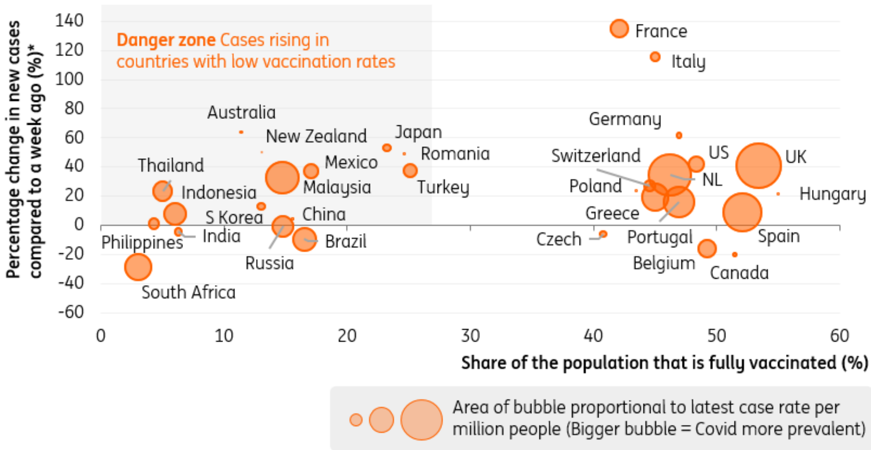
The dollar goes into the Wednesday FOMC meeting close to the highs of the year. Assuming that the Fed continues to dangle the carrot of a September tapering and the global growth environment remains mixed at best, we suspect the dollar can retain its gains, if not edge higher.

It has been a tough summer for those bearish on the dollar. The 2021 bearish dollar outlook had been based on two key tenets:

- a patient Fed keeping US real interest rates very negative and
- a continuing recovery in the global economy as scientists and policymakers increasingly overcame their battle with Covid-19.

Both of those positions have been tested this summer. Firstly the June 16th FOMC meeting suggested the Fed might not be as patient after all and could well be swinging to rate hikes in 2022. The second has been the pick-up in Covid-19 cases driven by the Delta variant. Its impact has not been evenly spread. Developed economies in the northern hemisphere, where vaccination rates are high, are trying to ride the latest wave out without resorting to lockdowns. Developed economies in the southern hemisphere and Emerging Markets, where vaccination rates are low, as you can see in the chart below, are more likely to return to lockdowns and be hit harder.

The vaccination divide



Source: Macrobond, Our World in Data, ING

The combination of a less dovish Fed and the Delta Variant has certainly hit portfolio flows to emerging markets, which have been negative in five out of the last six weeks. This has certainly provided support to the dollar. It is hard to see this trend turning in the immediate future.

And given that the US rates markets do not look heavily positioned for a hawkish Fed – 1m USD OIS rates priced three years forward have corrected 30bp lower from their highs in June – a Fed sounding like it is ready to start normalising should prove dollar supportive.

For EUR/USD, we had felt that it had a chance of tracing out a 1.17-1.23 range for the second half of this year. A more difficult global environment and a more dovish European Central Bank now means that 1.1700 floor will come under more pressure. A sustained break of 1.1700 would warn of 1.15 and even 1.13 in 3Q21.

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Article | 23 July 2021 Germany

The global implications of Germany’s September elections

Germany's September elections not only mark the end of the Merkel era but could also mark a structural change in Germany’s fiscal stance

Source: Shutterstock
Top candidates for the upcoming federal elections (L-R) Annalena Baerbock (Green Party), Olaf Scholz (SPD), Christian Lindner (FDP) pose in front of a picture of Armin Laschet (CDU) for photographers prior to a discussion board in Berlin, Germany

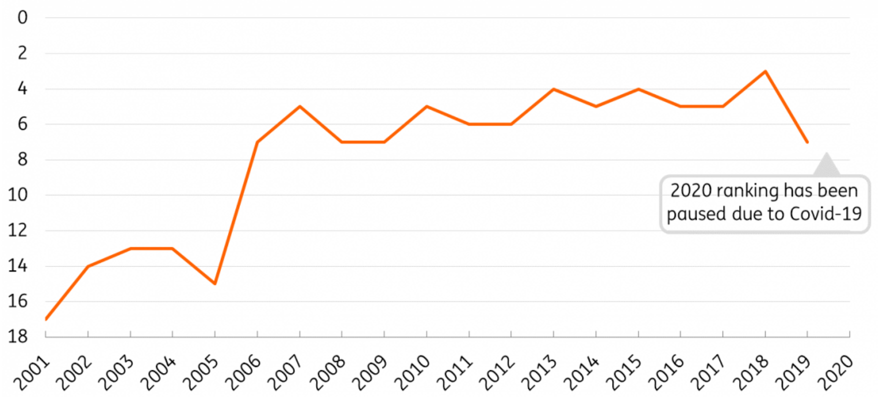
Since the 2017 elections, the German economy has gone through several ups and downs, while the structural economic problems have not changed. The 2017 elections took place against a backdrop of strong growth, low unemployment and the last phase of what many called the country’s second *Wirtschaftswunder* the so-called economic miracle.

> *The German economy had started to fall behind its eurozone peers*

Since then industry, in particular, has experienced what it means for a traditional stronghold to face structural changes. On a gradual decline since mid-2018 due to several one-off factors, as well as ongoing trade tensions, this was the first sector to suffer from the outbreak of Covid in Asia. It became an important growth driver during the second lockdown and is currently suffering from supply chain frictions.

More generally speaking, the German economy had started to fall behind its eurozone peers in 2018 and 2019 but thanks to significant fiscal stimulus since the start of the pandemic will be one of the first eurozone countries to have returned to its pre-crisis level. Were all the warnings about structural weakness exaggerated or have they simply been resolved?

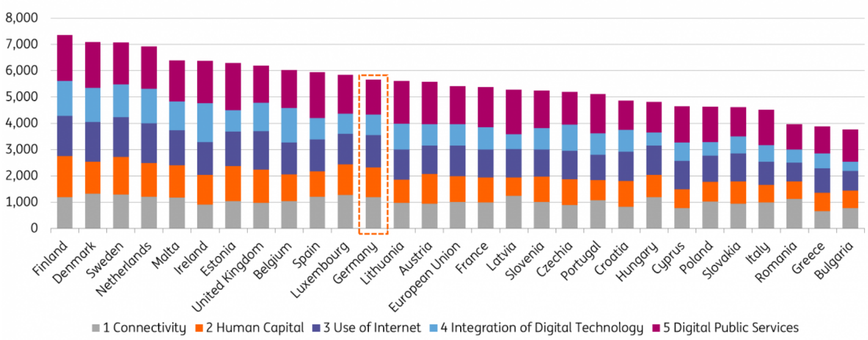
WEF Global Competitiveness Ranking



Source: World Economic Forum

The answer to that question is 'not really'. Looking at some structural indicators, the German economy has, at best, stood still over the last few years, if not lost further ground. Rankings on international competitiveness have seen the German economy dropping further between 2017 and 2019. The quality of traditional infrastructure has weakened. Investment growth had been much weaker than in the rest of the eurozone until the start of the crisis.

The Digital Economy and Society Index, 2020 Ranking



Source: European Commission

Internet access remains slow and expensive compared with many other countries. And the costs of the energy transition are still high. Due to the pandemic, not all of the structural economic indicators were updated in 2020 or 2021 but the overall picture of the available indicators hardly looks any different to how things were in 2017.

Economic policies according to the election manifestos

The pandemic has just been another reminder of Germany's lack of digitalisation. Whether it is the digital infrastructure, the educational system, e-government or digital services, there is clearly plenty of upside potential for the economy in the years ahead. The U-turn of the incumbent government on fiscal policy, already ahead of the pandemic but in full swing during the pandemic, has prepared the ground for a more general acceptance of public spending and investment. Therefore, it does not come as a surprise that all parties have presented many plans on how and where to invest in the coming years. Climate change, demographic change with its impact on pensions and health care, digitalisation, energy transition and the structural change from manufacturing to services, just to mention a few hot topics, are all in the proposals. The financing of all these ideas, however, is not always very clear.

The pandemic has just been another reminder of Germany's lack of digitalisation

What differentiates the four parties, with the highest likelihood to join the next government, is taxes. While the CDU/CSU and FDP advocate no tax increases but propose different forms of tax relief, the Greens and the SPD have proposed tax increases for the highest income bracket as well as the introduction of a wealth tax.

The discussion on the constitutional debt brake has somehow died down. CDU/CSU and FDP advocate a relatively swift return to fiscal policies in line with the debt brake, while the SDP remains silent on this issue and the Greens propose a reform. In our view, this discussion is mainly shadow boxing as it requires a two-thirds majority in parliament to change the constitutional debt brake. It looks very unlikely that any such majority could emerge after the elections. However, the CDU/CSU, Greens and also the SPD seem open to the idea of at least temporary workarounds, allowing for more investment and, in turn, higher debt in the coming years. This workaround could be a shadow household for investment in digitalisation, infrastructure or the fight against climate change.

All in all, there seems to be a broad consensus on the need for more investment and fiscal stimulus, obviously with widely differing views on the size and how to finance it. Regarding the eurozone level, however, views and proposals diverge much more. The Greens have the most 'federal' approach, while the CDU and FDP manifestos clearly put a brake on dreams of a fiscal union. Both parties would like to return to strict implementation of the fiscal rules. The CDU/CSU is keeping the door open to some changes in the fiscal rules but only if these changes lead to stricter rules.

The FDP is again advocating a mechanism for orderly sovereign default in the eurozone. While the SPD is keeping further reforms of the monetary union's institutional framework in the air, the Greens are more precise with their ideas of eurozone fiscal capacity and changes to the fiscal rules. This demarcation line is also visible on other European fiscal issues with the Greens and SPD advocating own resources for the EU from a digital or carbon border tax, while the FDP rules out such own resources and the CDU remains rather vague.

The manifesto options

Main (European) economic topics in election manifestos of the four parties realistically forming the next government, in whatever combination

	CDU	SPD	Greens	FDP
Corporate tax	• Reduce corporate tax to 25%		• Minimum tax rate of 25% in medium term	• Reduce corporate tax to 25%
Income tax/ introduction wealth tax	• No tax increases • Tax cuts only if public finances allow it	• Tax increases for highest income bracket • Introduction of wealth tax	• Tax increases for highest income bracket • Introduction of a wealth tax	• Reform of income taxes, lower tax burden, increase of top income bracket
Debt brake	• Return to debt brake but no clear timetable	• No mentioning of debt brake at all	• Reform of debt brake to allow for investments	• Return to debt brake asap
Fiscal rules/EMU	• Open to revision of Stability Pact Rules but only if it doesn't mean watering down. • Stricter implementation of the rules • Next Generation EU has to remain one-off	• Further develop the Stability and Growth Pact into a sustainability pact. Developing the EU into a genuine fiscal, economic and social union	• Develop the euro into a credible, international reserve currency so that Europe preserves and expands its sovereignty. • Morph ESM into European Monetary Fund • Reform of the SGP to prevent too much austerity, create space for investments, • European Monetary Fund • Eurozone fiscal capacity	• Quick return to strict implementation of current fiscal rules • ESM is to be transformed into a European Monetary Fund • Reforms of the Stability and Growth Pact to get tougher sanctions • Return to SGP rules, mechanism for orderly sovereign default
EU own resources	• Not clear	• ETS, Digital tax, carbon border tax	• Digital tax, carbon border tax	• No

The experience question

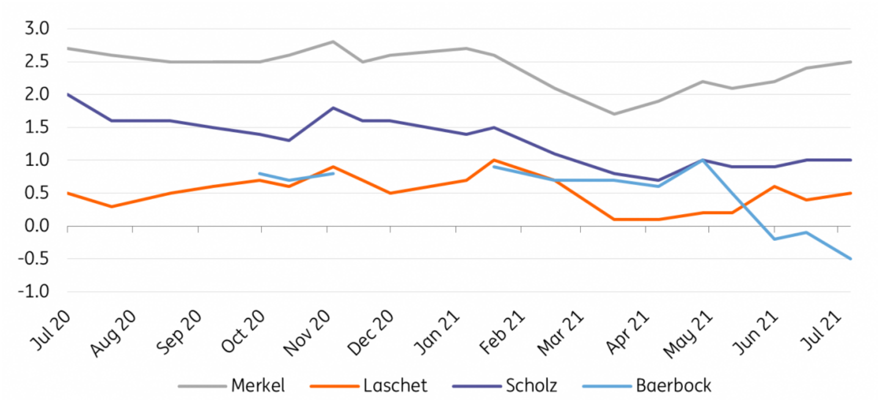
The September elections will be the first federal elections ever in which the incumbent chancellor will not run for another term in office. As a consequence, the so-called Amtsbonus, the advantage of having the incumbent chancellor on the ticket, will not apply. Except for the SPD candidate and current finance minister Olaf Scholz, none of the running candidates has any experience at the national executive level.

CDU candidate Armin Laschet is currently minister-president of North-Rhine Westphalia, while Green candidate Annalena Baerbock does not have any experience in the executive. She is currently a member of the German parliament and party co-leader of the Greens. This lack of experience and a lapse in judgement by some of the candidates - be it slightly blown-up resumes, plagiarism, inappropriate laughing in public or other communication missteps - have put the focus on personality over policy. Instead of winning the electorate's hearts, it currently looks as if the candidate who makes the least mistakes in the next two months will win the race.

However, don't forget that at the elections, German voters cannot directly vote for the next chancellor; they have to give their vote to a party. Here, local personalities and topics matter as well. Fun fact: the Chancellor doesn't have to be a person from the election list. In theory, anyone could be put forward to be elected as the next chancellor by the next parliament. As long as he or she gets a majority of the votes there.

How the politicians stack up

Evaluation of politicians according to sympathy and achievement (Mean values on a scale from -5 to +5)

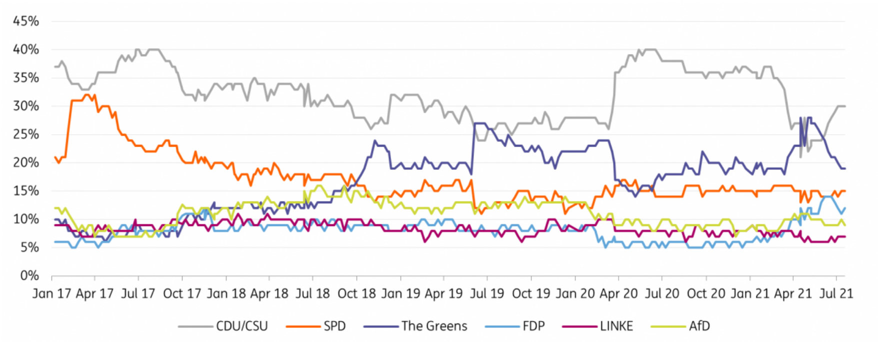


Source: Forschungsgruppe Wahlen: Politbarometer, July 2020 - July 2021

A more fickle electorate

Developments over recent months have shown that German politics, or at least voter support, has become more fluid. Larger swings in the polls have become normal. Look at the latest rise and fall of the Greens. Therefore, with some two months to go, no one should jump to early conclusions about the final outcome. Personal missteps by the leading candidates as well as unexpected events such as the recent floods in parts of Germany could easily be game-changers in the coming weeks.

If there were general elections next Sunday who would you vote for?



Source: Wahlrecht/Forsa

Generally speaking, unless the Greens stage another comeback due to the latest floods, with climate change taking centre stage again, the CDU/CDU will probably come in as the largest party. Anything north of 30% would be a success, anything below a disappointment. The Greens currently look like the clear number two, still hoping to close the margin with the CDU/CSU. FDP, AfD and SPD will fight to become the third-largest party, with all three ranging between 10% and 15% currently. The Left Party has lost some ground and stands around 7%. Next to these six parties, no new party is expected to make the 5% threshold. But we should watch out for the

European party Volt, which made some surprising gains in other European countries.

Change of times? Not really

Judging from the latest developments, we've expanded our base case scenario and see a CDU/Green and a CDU/FDP coalition as the most likely outcome (or possibly even another attempt to get the three parties into a coalition, as in 2017). In our view, any of these outcomes bodes well for more fiscal stimulus in Germany but don't expect any major changes regarding fiscal policy at the eurozone level.

Given the CDU's very explicit views, a coalition with the Greens is unlikely to advance ideas for making the European Recovery Fund more permanent and for closer fiscal integration. While in other countries, political divisions may centre around europhiles and eurosceptics, in Germany, it is only the level of eurozone integration that separates parties.

It currently looks as if the big German push for more eurozone fiscal stimulus will come with a "Germany first" investment agenda and some trickling through effects for the rest of the eurozone, rather than a "euro first" push. While this is bad news for euro federalists, it is good news for analysts and commentators, as the never-ending discussion on what should and will (or is politically acceptable to) happen is set to continue.

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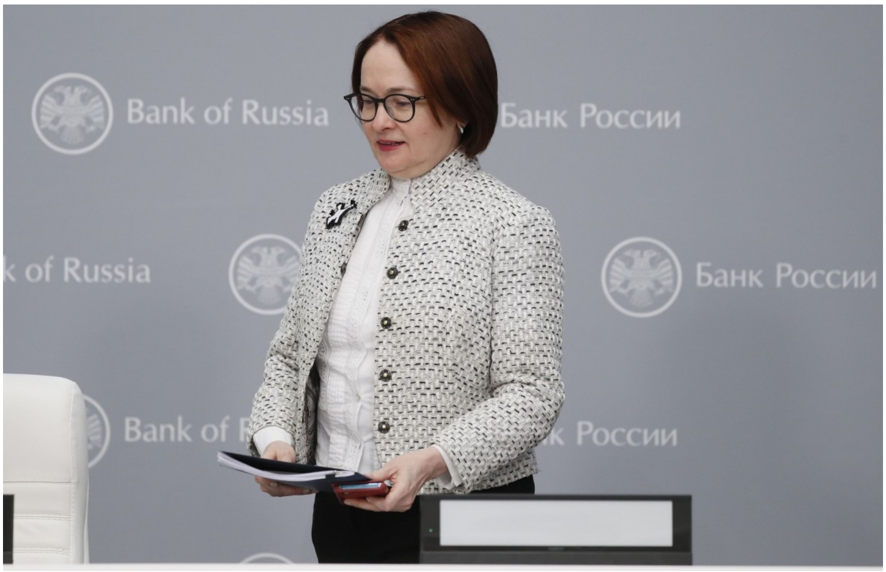
Russia aggressively hikes rates but the ceiling is in sight

A 100 basis point hike to 6.5% was slightly more aggressive than we expected and inflation is to blame. The Central Bank of Russia now doubts that CPI will return to 4% in 2022. The commentary suggests that further upside is limited, and we reiterate our expectations of a ceiling at 6.5 to 7.0%, with a 25 bp hike likely to follow in September



The Head of the Russian Central Bank, Elvira Nabiulina

6.50%

Russian key rate

a 100 basis point hike

Higher than expected

Hawkish bias confirmed

Russia's central bank has confirmed its hawkish bias. The key rate is up 100 basis points to 6.5%, which is in line with analyst consensus and slightly more aggressive than our 75 bp call.

The commentary suggests that inflationary concerns are to blame, forcing the more aggressive stance.

- The CBR has highlighted the continued growth in households' inflationary expectations and expressed doubts in the CPI's ability to return to the targeted 4.0% in 2H22, which is a deterioration compared to the previous decision.
- According to the CBR's updated medium-term macro forecast, the year-end CPI forecast for 2021 was increased from 4.7-5.2% to 5.7-6.2% (challenging our 5.7% view) and for 2022 it went up from 4.0-4.2% to 4.0-4.5%.
- Based on the CBR's updated key rate projections, the average key rate until the year-end is likely to stay between 6.5-7.1% (up from 4.8-5.4%), while expectations for 2022 increased from 5.3-6.3% to 6.0-7.0%.

Overall, the tone of the commentary remains hawkish, but became somewhat softer, reflecting a **smaller upside of the key rate from the current level**.

- The near-term guidance softened from "necessity of further increases in the key rate" to "will consider the necessity of further key rate increase at its upcoming meetings".
- In describing the balance of risks the pro-inflationary tilt remained, but became nuanced, as the CBR admitted that the risks from the food segment are somewhat lower, in line with our expectations.
- We also note that the upgrade in the 2021 GDP growth forecast from 3.0-4.0% to 4.0-4.5% is driven primarily by the upgrade in the external demand expectations rather than local momentum, suggesting lower inflationary risks coming from the demand side.

Upside to the key rate appears limited, unless new negative surprises follow

Based on the written commentary and ahead of the governor's press conference we believe that at least a 25 bp hike is more or less guaranteed for the second half of this year and, given the expected CPI profile, it is likely to come sooner rather than later - i.e. in September, as afterwards CPI inflation should stabilise and start to decelerate, everything being equal.

Further hikes are less certain at this point, suggesting that our view on the key rate ceiling in the 6.5-7.0% range still stands. We reiterate our take, that factors limiting the upside to inflation and the key rate should gain importance, as monetary supply growth has been decelerating since September last year. That should translate into monetary inflation with a 12-month lag, global food CPI should also stabilise, and the local growth story is facing obstacles in the form of higher pandemic risks.

Following today's hike, the real key rate, based on 12M expected CPI, is north of 2%, keeping Russia in the top 3 among its peers (after Turkey and Kazakhstan), which should be positive for portfolio inflows into Russian assets. This does not suggest immunity to external risk-off, but should assure more or less defensive market performance relative to peers. A real rate in excess of 2%, i.e. north of the neutral range, should also allow the CBR to refrain from a material increase in the key rate even in case of further moderate deterioration in inflationary expectations.

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Article | 16 July 2021

Automotive Sector Update: Recovery underway, stirred but undeterred

Global car sales showed a recovery in the first half of this year against a weak backdrop last year. We are reiterating our expectations of 7 to 9% growth in light vehicle sales in 2021. We believe that the continued headwinds from the chip supply shortages may slow and should not deter the recovery while electrified vehicle sales continue to expand

Source: Shutterstock

Sales growing, underpinned by consumer demand

With the first half of 2021 already behind us, we are providing an update for our passenger car sector outlook for the full year. In our Automotive Sector Outlook, published in January, we outlined expectations for global passenger car sales growth of 7% to 9% in 2021. At the mid-point of the year, we are inclined to maintain this range, in spite of the continued supply chain headwinds experienced by car manufacturers. While some statistics for the first six months are still being finalised, we believe that things are progressing broadly as we expected with the recovery in sales, underpinned by solid consumer demand in major geographies.

Specifically, according to the European Automobile Manufacturers' Association (ACEA), in January-June 2021, EU demand for new passenger cars increased by 25.2% year-on-year (YoY) to reach 5.4mn units in total. Given that last year's comparative base was significantly impacted by the emergence of the Covid-19 virus, EU car registrations this year showed a sharp year-on-year drop in January-February, followed by an even more optically pronounced recovery during March-May. This was followed by a solid rate of growth of 10.4% YoY in June, against a much higher prior-year comparative base. However, the ACEA notes that the first half registration numbers were still well below the 2019 pre-Covid levels, by as much as 1.5mn units (or 21.7%) for the comparable period.

S&P reiterated a positive outlook for global light vehicle sales in 2021, upgrading its forecasts for the year to 8-10%.

In terms of the global picture, we note that earlier in May, S&P also reiterated a positive outlook for global light vehicle sales in 2021, upgrading its forecasts for the year to 8-10%, from 7-9% previously, while also cutting the 2022 sales growth forecast to 3-5% from 7-9% previously. In absolute terms, S&P now expects global auto sales to amount to 83-85 million units this year, relative to 77mn in 2020. Across major geographies, in FY 2021, using a mid-point of the estimated range, the rating agency expects sales of 26.2mn vehicles in China (+6.9% YoY), 18.0mn units in Europe (+9.8% YoY), 16.6mn in the United States (+14.5% YoY) and 23.4mn in the Rest of the World (+6.8% YoY).

Global Light Vehicle Sales Forecast

	2020A Units (m)	2020A	2021E	2022E	2023E
		% change (YoY)			
US	14.5	-15	14 to 16	minus 1 to 0	minus 1 to 0
China	24.5	-4	5 to 9	2 to 4	2 to 4
Europe	16.4	-21	9 to 11	7 to 9	7 to 9
Rest of the World	21.9	-20	6 to 8	4 to 6	3 to 5
Global light vehicle sales	77.2	-15	8 to 10	3 to 5	3 to 5
Global light vehicle production	74.5	-16	12 to 14	6 to 8	1 to 2

Source: S&P Global Ratings

While we are encouraged by robust consumer demand fuelled by improved economic prospects, new vehicle inventories have not been replenished so far this year due to production volumes being held back somewhat by the well-publicised shortage of semiconductors for the use of passenger car manufacturers. These low inventories also resulted in the rapid rise in second-hand car prices.

Semiconductor shortages persist…

While we continue to believe that our base case scenario for the recovery of global passenger car sales this year should remain intact, we note that sourcing issues with the supply of semiconductors are proving to be a more lasting phenomenon than we, and industry participants, perhaps expected at the start of the year. As we have crossed the half-year mark, we feel that the visibility on the matter is still rather limited with new commentaries appearing almost daily and frequent updates provided on the sales and production impact. What can be noted is that the semiconductor shortages have already left a mark on the first half 2021 car manufacturer production and sales volumes and, also, the logistical issues are not likely to disappear completely in the short term as supply is still having trouble keeping up with demand.

...but won't derail the sector's recovery

At this point, we believe that the broad industry guidance is that shortages will continue to occur to some extent for the rest of this year and potentially into and even through 2022. In conjunction with its recent earnings, TSMC, the largest global chip manufacturer, commented that it expected supply tightness to last into 2022, but the company aims to increase its output of auto microchip units (MCU's) by close to 60% YoY this year, relieving some of the supply pressures starting this quarter. We also note that the impact of the chip shortages is uneven across car manufacturers and each of them is striving to manage the situation in their own way and, importantly, prioritising the production of higher-margin models to minimise the impact on profitability, which given the aforementioned robust consumer demand should be less impacted than production volumes.

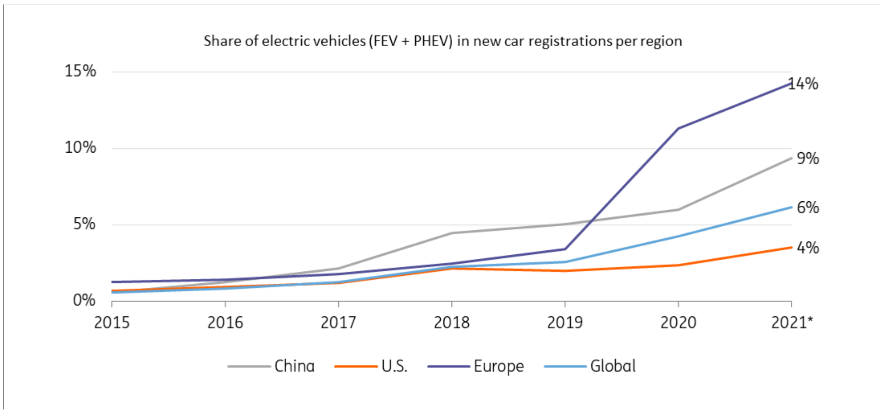
> *We may be on the cusp of semiconductor supply turning and things improving gradually.*

Therefore, to recap, we may be on the cusp of semiconductor supply turning and things improving gradually. While the worst may be behind us, it is unlikely that things will return completely to normal during the remainder of this year. On balance, we still expect a noticeable impact on production and sales volumes for the full year. In the end, it may be that forecasts made at the beginning of the year (such as a net production loss of up to 3mn units, which S&P predicted in February, may be on the low side but not as significantly off the mark as might have appeared based on the worst moments of the second quarter). We also note that the chip shortages were exacerbated in the first half of this year by some one-off factors, such as the fire at Renesas' Naka facility in March (the facility returned to normal production by the end of June) and by the inclement weather in the southwest of the US earlier in February.

Continued momentum for electric cars in 2021 and 2022

At the start of 2021, a mere 1% of the global rolling car fleet had a power plug (10 million units). This, however, is changing rapidly on the front side in new sales. The pandemic turned out to be an accelerator for the development and sales of electric vehicles (EVs). To support the car industry through the pandemic and simultaneously push a green recovery, EVs benefit from government support programmes and subsidies in various countries. BNEF expects the global share of EVs (full electric vehicles - FEV and plug-in hybrid electric vehicles - PHEV) in new sales to increase by 50%, from 4% to 6% in 2021, and rising further to 8% in 2022. Europe leads the world here, with EVs making up an expected 14% in new sales in 2021, followed by China (9%). Norway is at the forefront of the global shift, with EVs reaching a share of 82% in 1Q21.

Europe leads the EV-transition followed by China and the US

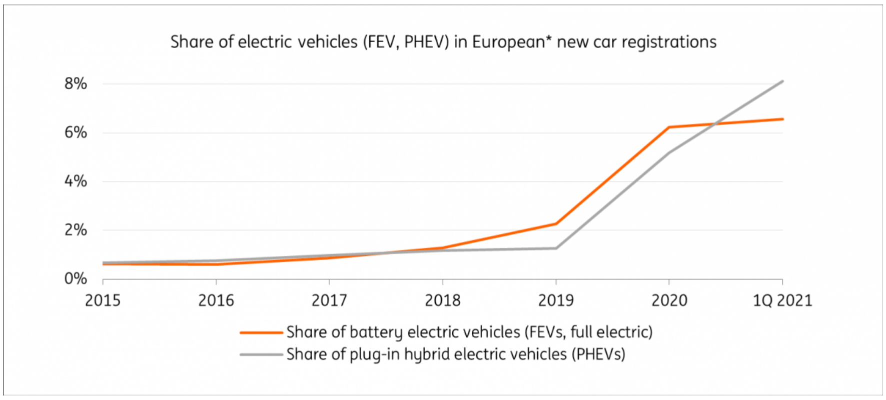


Source: BNEF, ING Research
*forecast

Mainstream car buyers look at PHEVs as an intermediate step

As the uptake of EVs reaches the car driving middle class, plug-in hybrids are providing an intermediate step for a large share of mainstream car buyers. These consumers prefer plug-in hybrids in order to stay flexible and also because there are more models to choose from. This is notably the case in Europe but globally PHEVs are also gaining traction. However, we believe this remains a temporary phenomenon. The share of PHEVs is expected to go down in a few years as FEVs continue to develop, prices reach parity and charging infrastructure is rolled out further.

European plug-hybrid car sales gain most traction in 2021



Source: ACEA, ING Research *EU + UK + EFTA

Manufacturers ramp up commitment to electrification

The shift to electric vehicles has a fundamental impact on car manufacturers. With a battery pack instead of an internal combustion engine (ICE), EVs are less complicated to construct. But designing new models, further development of (battery) technology, and digitalisation require massive investment in R&D and new production facilities, and organisations need to adapt drastically. Since regulators have embraced the future phase-out of the ICE car as part of their plans for the energy transition, and the transition is now beyond doubt, car manufacturers have adopted it as a central part of their strategy.

The EU 'Fit for 55'-plan to significantly raise the CO2-reduction targets for new cars to 60% in 2030 offers new guidance. And in the US, the Biden administration is also facilitating the uptake of EVs as part of his infrastructure bill. Car makers are now striving to show that they are acting ahead of the transition by raising EV targets for new sales. In the first half of 2021, several car groups made announcements, including General Motors (100% in 2035), VW (70% in 2030 in Europe), Volvo/Geely (100% in 2030) and Stellantis (70% in 2030 in Europe, including Opel: 100% in 2028 in Europe). Alongside these targets, several car makers have also mentioned multi-billion investment programmes to develop their electric portfolios. While plug-in hybrids are usually just existing models that have been electrified, full electric vehicles require a complete make-over and a new product range, like VW is creating with its ID line up. Manufacturers are seeking to find opportunities to scale up EV-production volumes to create an attractive profitable base out of this as soon as possible.

EVs require more chips but manufacturers still seem to prioritise them

Increasing production levels also require more supplies. Ongoing semiconductor shortages are a real risk for raising production levels of EVs. EVs need more and advanced chips (as well as batteries) and European manufacturers, in particular, are still largely dependent on deliveries from other parts of the world (predominantly Asia). Although manufacturers seem to prioritise production of EVs over other car types to meet emission targets and keep up with competitors, longer lead times may still limit the rise in registration numbers of new EVs this year.

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