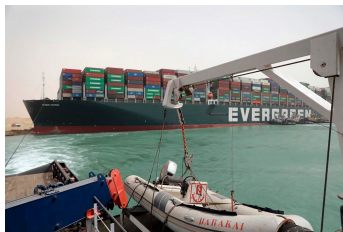


Night boat to Cairo

Here comes the boat, only half afloat... the Madness track sums up the crisis in the Suez which is already pushing up oil prices and strangling supply chains. The Fed didn't move either this week but Americans are spending again. Our podcast looks at Europe's third wave woes which could explain the growth in ready-mixed beverages. We'll drink to that

In this bundle



The blocked Suez Canal is another setback for supply chains

The Suez Canal has been blocked by a large container ship, but last year's drop in world trade volumes is still the bigger problem for supply chains



United States

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By James Knightley



FX | United States

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By James Knightley, Padhraic Garvey, CFA and Chris Turner



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Rising infections, fresh lockdowns and a sluggish pace of vaccination are threatening Europe's economic recovery. In this podcast, ING's Carsten...

By Carsten Brzeski and Rebecca Byrne



Energy | Sustainability | The Netherlands

Dutch election result could boost energy transition

Ruling liberal parties VVD and D66 are big winners in the Dutch election. This may have important consequences for climate and energy policies going...

By Gerben Hieminga



Commodities, Food & Agri | Manufacturing, Construction and Retail

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The 'ready-to drink' market has seen significant growth over the last few years driven by consumer demand for more convenience and healthier...



FX

Taking a peek at Yellen's foreign FX agenda

With the Treasury FX Report due mid-April, dealing with current (Switzerland and Vietnam) and future (Asian countries are at risk) FX manipulators will be...

By Francesco Pesole

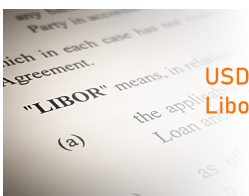


United States

US: Freezing February will give way to March madness

Virtually all February data has disappointed as winter storms and cold conditions took their toll on supply chains and kept people inside. Today's...

By James Knightley



Keeping SOFR pure and simple

The purest form of risk free rate is an overnight one. And to keep it simple, any future rate should be computed as a sequence of realised daily rates....

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Snap | 24 March 2021

The blocked Suez Canal is another setback for supply chains

The Suez Canal has been blocked by a large container ship, but last year's drop in world trade volumes is still the bigger problem for supply chains



With supply chains already under pressure, a large container ship has now literally blocked one of world trade's major routes.

Shipping capacity between Europe and Asia was already squeezed during the Covid-19 crisis, with high rates of ship cancellations as the pandemic began and shortages of containers and slower handling speeds continuing to affect world trade volumes.

The immediate impact of delays in the Suez Canal will centre on European – Asian trade

The immediate impact of delays in the canal will centre on European – Asian trade, adding delays to already disrupted supply chains affecting oil and refined products' supplies. But the route is significant to world trade as a whole, with around 10% of world trade by tonnage and 9% of the

world's seaborne oil (equivalent to 5.5 million barrels of oil per day) passing through the Suez Canal over the course of a year.

As delays extend, shipping liners may opt to re-route vessels via the Cape of Good Hope, increasing transit times by a third but avoiding the uncertainty of how long the problem will take to resolve and for backlogs to pass through the canal.

As the Suez Canal Authority works to free the canal, traffic is building up, and missing inputs will disrupt supply chains. But delays measured in days are normal in container shipping (depending on the route), and in the current context of much more acute capacity pressures at some ports, this setback on its own will not do much to trade volumes or cause much further harm to supply chains.

The ongoing effects of shipping liners' route choices, including container shortages and limits on port handling speeds, are likely to be more visible in production and trade data in the months ahead.

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The US spending surge is underway

Household spending fell back in February after January's stimulus-led surge. But March and April are set to rebound on yet more stimulus and a broader re-opening so we are pencilling in 9% annualised consumer spending growth in the first quarter and 15% in the second



Shoppers in New York

Stimulus payments creates a strong platform for growth

To get any meaning out of the February personal income and spending report we need to look at it in combination with January data. The \$600 stimulus payment in early January, together with ongoing support from extended and uprated unemployment benefits, lifted incomes by 10.1% MoM. Put another way, as the chart below shows, household incomes were \$2.5tn higher on an annualised basis versus February last year. An astonishing figure, that has given Americans the cash flow to not only spend more, as seen with the upwardly revised 3%MoM real spending growth figure for January but to also pay down credit card balances and to save more.

There is an incredibly strong platform for consumer spending growth

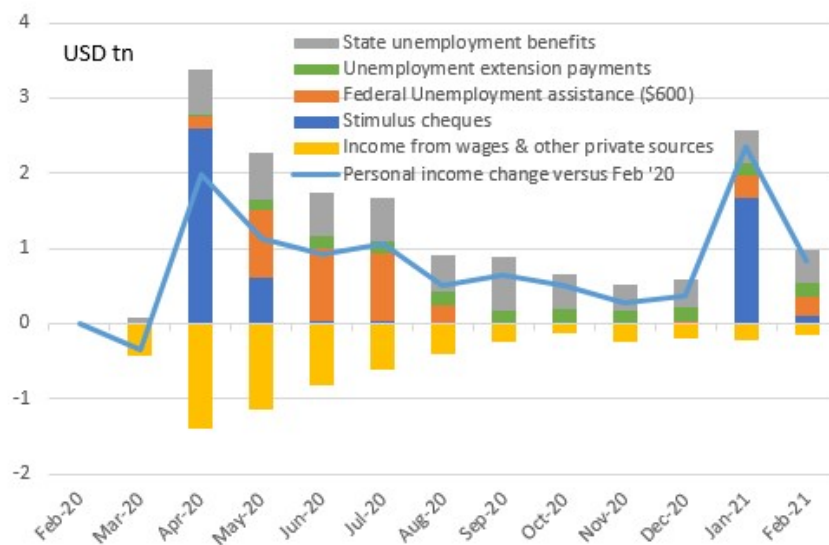
The Federal Reserve's flow of funds data shows that cash, checking and savings deposits have

increased by \$3tn since 3Q19. That means as the re-opening gathers momentum there is an incredibly strong platform for consumer spending growth.

The fact that there wasn't a stimulus payment in February accounts for all of the 7.1% January to February drop in incomes, but again it is important to point out that income levels this February are still \$1tn annualised higher than they were last February. With another \$1,400 stimulus payment having hit bank accounts in March – nearly \$400bn has been paid out by the government – we must be looking for a huge surge in March and April income data.

Incomes have soared through the pandemic

Contributions to the change in household incomes versus Feb 2020 (USDtn)



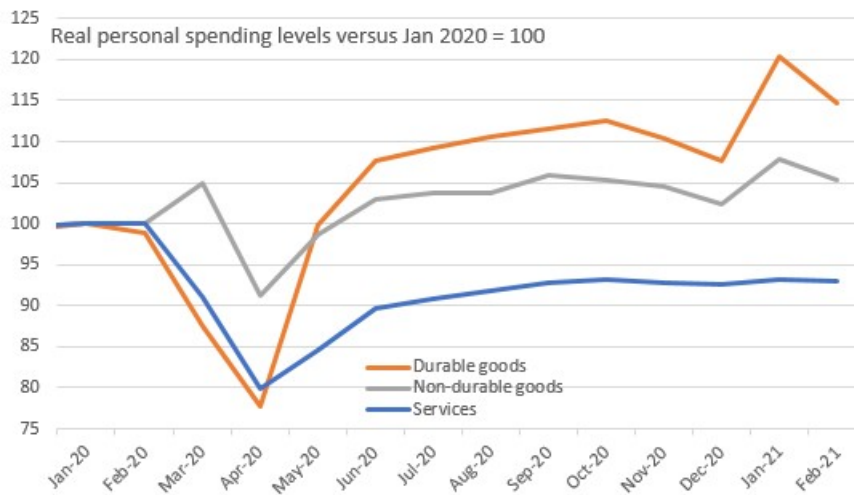
Source: Macrobond, ING

Spending is surging and will accelerate

February spending fell 1.2%MoM after that 3% January jump. People may well be getting tired of buying physical things as this is all that we have been able to do over the past year. Bad weather in February could also have influenced the data. However, March and April are likely to post incredibly strong spending figures.

With more and more of the economy re-opening there are more options to spend money. Services, such as restaurants, hotels and travel, are set to benefit hugely based on the daily data we see from TSA airport security check numbers, OpenTable dining data and hotel reservations. Putting it all together we are pencilling in 9% annualised consumer spending growth in Q1 and possibly 15% growth in Q2. The US economy is roaring back.

Services lag goods spending, but that will soon change



Source: Macrobond, ING

Soft inflation, but that will change too

The Fed's favoured measure of inflation – the core personal consumer expenditure deflator – actually dipped to 1.4%YoY from 1.5%. However, it is the April and May numbers that are going to show the big increases as price levels in a vibrant reopened, supply-constrained economy contrast starkly with those of one in lockdown last year. The Fed will continue to push their very dovish view for the next few months, but we suspect that will be increasingly difficult to reconcile with the data flow we expect to see through 2021.

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US: Fed holds, but optimism is creeping in

The Federal Reserve has left monetary policy unchanged and continues to signal the first rate rise won't happen until 2024. However, the forecasts point to a more positive outlook while we believe that there is a better growth and employment story that will lead to an earlier QE taper and a summer 2023 rate hike



Source: Shutterstock
Federal Reserve

Stable rates, stable QE

No surprises from the Federal Reserve as they unanimously leave monetary policy unchanged. The Fed funds target range remains 0-0.25% and their quantitative easing program is untouched. The statement reiterates that the \$120bn of monthly asset purchases split \$80bn for Treasuries and \$40bn for MBS will continue “until substantial further progress has been made toward the committee’s maximum employment and price-stability goals.”

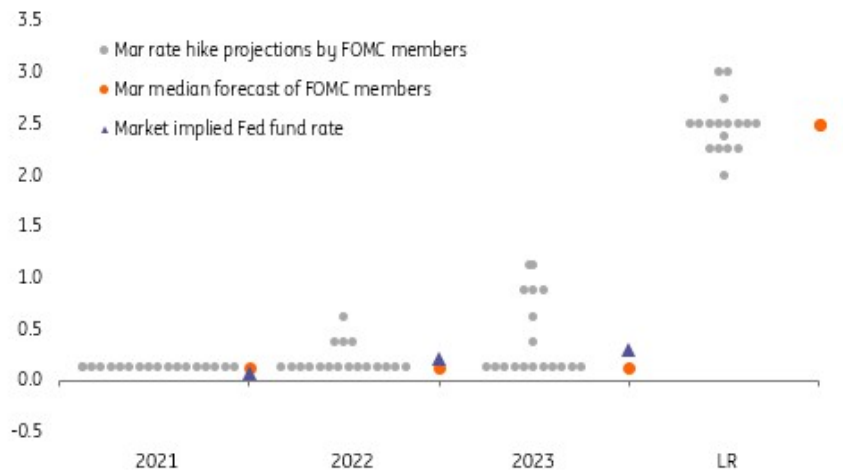
The descriptive element of the statement is little changed from the one released in January other than to acknowledge economic indicators have “turned up recently, although the sectors most adversely affected by the pandemic remain weak”.

It isn't exactly effusive stuff, but their accompanying forecasts suggest much more optimism versus December and in the accompanying press conference Fed Chair Jerome Powell at least acknowledges that the situation is improving. Nonetheless he also argues that the economy is a

long way from being healed.

By implication, withdrawing the stimulus too early outweighs the risks from withdrawing it later and “no-one should be complacent”. The message remains the Fed is going to do all it can to make sure the recovery happens and it feels it can remain patient before removing stimulus.

Fed dot plot of individual members forecasts for Fed funds target rate



Source: Federal Reserve, ING

Dot plots still favouring a 2024 rate hike

The Fed have published new forecasts and have raised their 2021 growth forecast (it is YoY% change between 4Q21 and 4Q20) from 4.2% to 6.5% and lowered their 4Q21 unemployment forecast to 4.5% from 5.0%. They also raised their inflation forecasts with the core PCE deflator expected to end the year at 2.2% rather than 1.8% and come in at 2% in 2022 and 2.1% in 2023.

Despite this the all-important dot plot shows modest changes, but the median forecast remains for no rate rise before 2024. There has been some movement though with 7 FOMC members out of 18 now predicting a rate rise by end-2023, up from 5 out of 17 three months ago. We also now have 4 members going for a rate rise in 2022 versus 1 in December. Once again no-one predicts a rate rise this year while the long-run target for the Fed funds rate remains 2.5%.

This isn't a surprise. Bringing forward the median forecast for the first-rate hike into 2023 wouldn't have fitted Fed Chair Jerome Powell's narrative. Signaling an earlier move would have given more ammunition for the bond market to push yields significantly higher just when Powell has been indicating his concern that “disorderly conditions in markets or a persistent tightening in financial conditions that threatens the achievement of our goals”.

Federal reserve economic forecasts versus December 2020

	2021	2022	2023	Longer run
Change in real GDP (Mar Fed forecast)	6.5	3.3	2.2	1.8
Previous Fed projection (Dec)	4.2	3.2	2.4	1.8
Unemployment rate (Mar Fed forecast)	4.5	3.9	3.5	4
Previous Fed projection (Dec)	5	4.2	3.7	4.1
Core PCE inflation (Mar Fed forecast)	2.2	2.0	2.1	-
Previous Fed projection (Dec)	1.8	1.9	2.0	-
Federal funds rate (Mar Fed forecast)	0.1	0.1	0.1	2.5
Previous Fed projection (Dec)	0.1	0.1	0.1	2.5

Source: Federal Reserve, ING

What is "substantial further progress"?

The over-riding message remains there will be no change in the Fed's stance until "substantial further progress" has been made. This rather vague statement gives the Fed plenty of flexibility on when and how to respond to ongoing improvements in the economy. Nonetheless, we are getting a few more clues about what it might constitute.

The Fed has signaled it feels there is significant slack in the economy and it is hard to argue with that given there are nearly 9.5mn fewer jobs than just 12 months ago. Indeed, there is a clear sense that the unemployment rate doesn't give a true reflection of the state of joblessness. After all, the labour force participation rate – the proportion of people of working age that are actually engaged with the labour market – fell from 63.4% in January 2020 to 60.2% last May and has only recovered to 61.4% now.

We therefore argue that looking at employment as a proportion of working age population is a better measure right now. While it has improved to 57.6% from a low of 51.3%, it remains lower than the worst reading during the Global Financial Crisis and is on a par with the early 1980s recession when female worker participation was lower than it is today. We suspect the Fed would like to see this ratio get back closer to 60% before declaring "substantial further progress" has been made.

Nonetheless, with the vaccination program going well and the US on track for a broad re-opening in the second quarter, job opportunities will become more abundant. There is no reason why a 60% employment ratio cannot be achieved this year.

Employment as a proportion of working age population



Source: Macrobond, ING

A slow twist and a 2023 hike

Given this backdrop we suspect we could see a more meaningful change in the Fed's language at the June FOMC meeting when they will again provide a new set of economic forecasts. At that point we do expect a majority of Fed officials to signal they expect a 2023 rate hike, which could open the door for a tapering of their asset purchases by December.

Such discussions would likely add to the upside pressure on Treasury yields and could generate another "taper tantrum", but the economy should be in a much stronger position to weather it by then.

The latest Bloomberg survey of analysts show 49%, like us, think the taper will start at or before the December FOMC meeting with 51% thinking it will be 2022. 69% think the taper will be sharp with monthly asset purchases being cut to zero within a year while 44% think there will be a shift in the distribution of the purchases to target long-term security purchases.

We suspect the taper could last a little longer – perhaps up to 18 months. We also see a stronger chance of a "twist" operation that involves weighting more of the remaining purchases towards the long end of the curve than the consensus does.

Such action may help mitigate against a sharp steepening of the yield curve, but the Fed could feel the need to announce even greater flexibility, i.e., not sticking rigidly to a monthly target for asset purchases and instead focus on a range for asset purchases by a certain date. They would be signaling they are prepared to halt the taper and actually increase purchases on a temporary basis, depending on market circumstances. This could reduce the likelihood of a major sell-off in Treasuries and help dampen volatility.

While there is still a long way to go and a lot could change, our central case remains a first hike in summer 2023 with the Fed funds rate peaking out in the 2-2.5% range in 2025.

Treasury market implication

The overall tone from the Fed leaves the back end of the curve absolutely unprotected. The impact

effect on both ends of the curve has been jumpy, but the net effect so far is a mild push lower in short yields and a net upward tendency in long yields. This remains a very accommodative Fed, meaning low carry costs for longs and no real barrier to a test higher in the 10yr yield in the coming weeks.

The subsequent pull lower in market rates seen likely reflected the nuance that Chair Powell choose to attach to the 2023 dots, where he emphasized that more members were looking for a first hike on 2023 than before - the median has not moved, but the composition of it has; he made a point of emphasizing this, which was instructive. This provides some semblance of back end protection at least for the back end to cling to.

There is little doubt that the Fed chatted on the front end. With SOFR peppering the 1bp area, it is certainly worthy of attention. The Fed has most control over the front end of the curve, and while SOFR is not an explicit policy rate, it is still clearly a very important rate ahead as we morph from Libor to it. Although the Fed did not choose to hike the rate on excess reserves at this meeting, it is one option that they continue to have at their disposal should they desire to frame the front end differently. For now the IOER rate remains at 10bp, with the effective funds rate at 7bp (within the zero to 25bp corridor). SOFR at just 1bp looks off though; a liquidity mop and/or a collateral add is required.

Just because the Fed choose not to make any formal announcements on the supplementary reserve ratio, does not mean it was not discussed. In fact, it likely was, and most probably at length. We should get an announcement at some point in the next week or so. Soundings from some US banks in recent weeks suggested that the Fed was looking at re-including Treasuries and commercial bank deposits at the Fed back into the calculation of the ratio. But an extension on the same terms remains most likely, perhaps with a target re-inclusion of one or both at some point in the future.

FX market greets FOMC with a sigh of relief

FX markets have welcomed the largely unchanged FOMC statement and the set of economic projections which sees some orderly US expansion without premature tightening of Fed policy. Only time will tell whether this was the Fed's best avenue to prevent a further disorderly sell-off in the bond market, but for the time being those currencies exposed to the recovery have rallied and the dollar has weakened.

There has been a lot more discussion recently about the dollar's 'smile' curve. To the extreme left of the smile, the dollar does well in a severe risk-off market and flight to quality (like last March). To the extreme right of the smile curve the dollar does well in the later stages of a US economic cycle and where we shift to see bearish flattening of the US curve as the Fed tightens policy (as opposed to bearish steepening witnessed today). And somewhere in between those extremes the dollar softens as the Rest of the World is allowed to breathe and activity currencies perform well.

Today's FOMC delays fears that the Fed is shuffling closer to the extreme right of that smile curve and is happy to remain in a reflationary setting, supporting equities, commodities. That is our preferred stance this year and why we're bearish on the dollar.

Assuming that we do not see another major leg higher in US Treasury yields (a quick move in the 10 year to 2.00% would certainly do a lot of damage) expect commodity FX and selected EM currencies to push ahead against the dollar. We say selected EM currencies since there are

important central bank rate meetings due over the next three days in Brazil, Turkey and Russia, where important tightening of policy needs to be seen to address macro-political challenges in each.

We are bullish EUR/USD, but have to acknowledge the delay in Europe's vaccination programme as a threat to our summer forecast of 1.25. In short, the EUR looks very unlikely to lead the charge against a weaker dollar.

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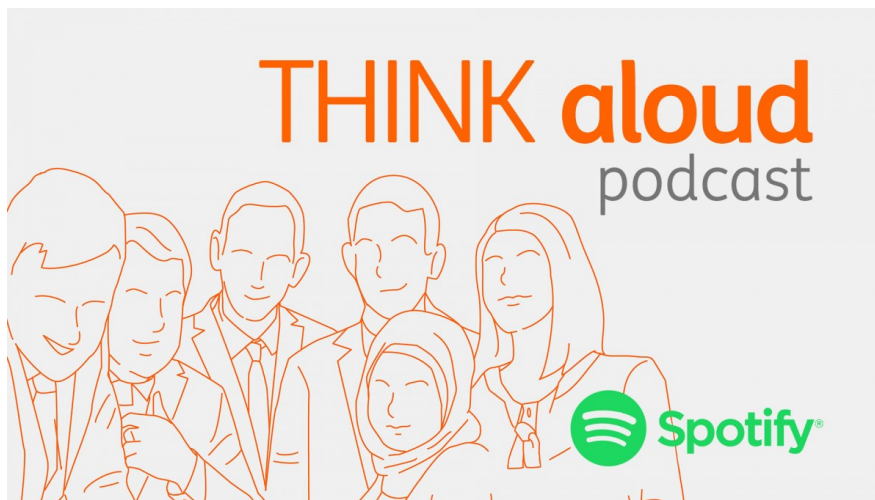
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Podcast | 25 March 2021

Listen: Europe's third wave woes

Rising infections, fresh lockdowns and a sluggish pace of vaccination are threatening Europe's economic recovery. In this podcast, ING's Carsten Brzeski looks at the possible short- and long-term damage from the third wave



The European Commission is calling for tougher controls on vaccine exports following criticism of the bloc's handling of the vaccine rollout. The vaccination programme has been hindered by a slower authorisation process, delayed deliveries and suspensions over fears of possible side effects. Meanwhile, infection rates are surging in some countries, with France, Germany, Italy and Poland recently forced to tighten or extend lockdown measures. [In this podcast](#), ING's Global Head of Macro Carsten Brzeski looks at the EU's management of the crisis and the possible impact on the region's economy.

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Dutch election result could boost energy transition

Ruling liberal parties VVD and D66 are big winners in the Dutch election. This may have important consequences for climate and energy policies going forward. D66 is now the second largest party. It is expected to seek a higher 2030 carbon emissions reduction target, pushing for more offshore wind, hydrogen and national carbon pricing



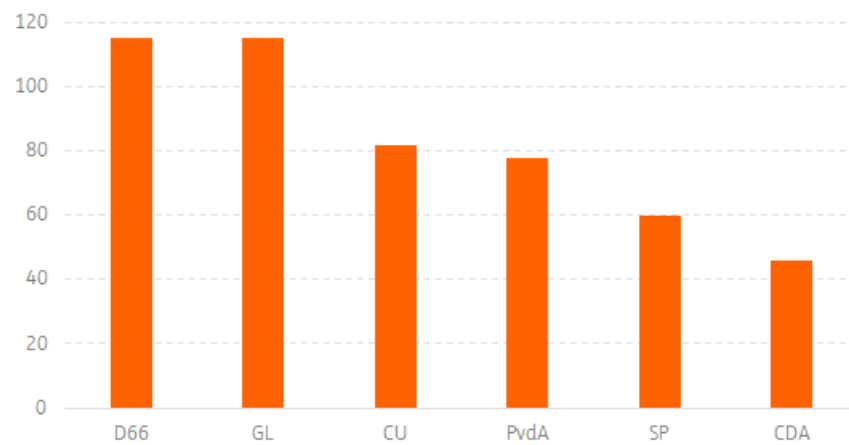
Source: ING

D66 is expected to bring climate change and energy transition to the negotiating table

With all votes counted, VVD remains the largest party, but D66 is now the [second largest party](#). This is likely to speed up energy transition plans in the Netherlands as the election manifesto of D66, together with the green progressive left party GroenLinks (GL), proposes higher levels of investment in this area than other parties, according to an assessment by the Dutch Environmental Planning Agency.

D66 and GL invest most in the energy transition

Cumulative investments in liveability* for 2021-2030 period, in 2020 euros



The VVD had not assessed its election program by PBL.

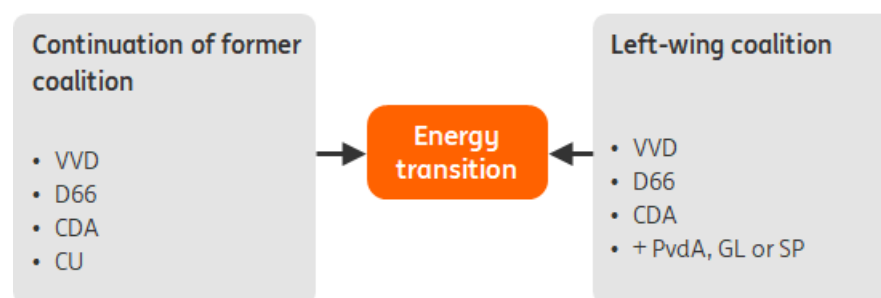
*Predominantly carbon reduction and energy transition investments, but it also includes road infrastructure. Numbers exclude investments in Dutch power grids.

Source: ING Research.

We explore the likely consequences for major climate and [energy transition](#) policies with a more left-wing coalition at the helm. In doing so, we focus on the general policy direction, rather than the specifics of the many parties that could form a coalition.

An energy transition perspective on a new coalition

Possible coalition parties from a continuation and left-wing perspective



Source: ING Research

2030 climate goal is likely to be raised

The Dutch Climate Agreement currently opts for an emission reduction [target of 4.9%](#). This target is expected to be raised to at least 55% to bring it in line with the recently increased EU-target. The election programmes of VVD, CDA and CU do not signal any plans to go beyond 55%, as this would cause serious carbon leakage within the EU-ETS system. This stands in sharp contrast to the EU-

orientated D66 and the more left-wing parties like PvdA, SP and GL, which point to higher reduction targets of close to 60%. These parties seem to value a rapid greening of the Dutch economy over carbon leakage that would limit the effectiveness of stricter national climate policies.

National policies on top of the European carbon trading scheme

Views on policy instruments differ, too. VVD has a stronger focus on European policies such as limiting free allowances within EU-ETS and extending the ETS-system towards other sectors such as transportation and the built environment. While D66 and many left-wing parties support these measures, they also stress the importance of additional national policies. D66, for example, wants to add 10 euros to the EU carbon price for large Dutch manufacturers this year, and the amount increases towards 2030. Under a left-wing coalition, climate and energy policies are likely to have a stronger national focus. The proposition for an [EU carbon border tax](#) can be found in the election programmes of both the former coalition (VVD and D66) and more left-wing parties such as PvdA.

Renewables, renewables, renewables

The Dutch Climate Agreement is already ambitious on solar and wind energy. New heavy weight D66 is likely to set the bar even higher. In its election programme, the party aims for the tendering of an astonishing 60 GW of offshore wind in the next 10 years to be operational before 2040, the equivalent of circa 6,000 wind turbines. That stands in sharp contrast to the current offshore capacity of 2.5 GW and the 2030 target of 11.5 GW in the Climate Agreement. It is likely that this ambition will come down in a coalition with CDA and CU, which have strong support in the fishing industry. Alternatively, an agreement may be struck to allow fishermen to fish between the windmills using new techniques.

All parties prefer offshore wind over onshore wind, and rooftop solar over large solar farms. Large scale solar farms on agricultural land, and on inland waters (floating solar) will be a discussion point, even among left-wing parties. D66 is not against these projects but other parties (GL, CDA and PvdA) want to preserve the landscape as much as possible, for example by obliging real estate owners to install solar panels on their rooftops (GL).

Biomass can set talks on fire

Views on the use of biomass differ widely. CDA is the only party that wants to continue to invest in biomass from sustainable sources. That is not surprising as CDA has strong support among farmers who are active in energy production from biomass. However, the party probably needs to compromise as both VVD and D66 want to stop subsidies for new biomass projects. Biomass could be a lightning rod for disagreement when left-wing parties enter coalition talks. Most of them explicitly mention the phasing out of existing biomass support schemes. This is also linked to the parties' positions on coal-fired power plants in which most of the biomass is co-fired. Currently, the four remaining coal-fired power plants need to close before 2030. Left-wing parties want to close them sooner, whereas VVD, CDA and CU stick to the current policy in their election manifestos.

Expect investment in hydrogen...

Hydrogen is the one thing that all the major parties agree on as being a building block of the Dutch energy transition. They all want to create a hydrogen hub in the Netherlands to support the energy transition in manufacturing, the power sector, the built environment and transportation, both domestically and internationally. Views differ on the electricity source for the production of

hydrogen. According to VVD, D66 and CDA, nuclear power could play a role in the future production of hydrogen, while this is a no go for CU and the left-wing parties.

...and carbon capture and storage

There seems to be more support for Carbon and Capture Storage (CCS) compared to the last formation in 2017. VVD, D66 and CDA view it as a necessity to reach the emission reduction targets and climate goals, especially in manufacturing. Left-wing parties have shown strong opposition in the past, but now they, too, view it as a necessary though temporary technology. This is further supported by a common understanding that the Netherlands has the knowledge and infrastructure to excel in CCS.

Expect renewed interest in nuclear energy, but no major investment decisions

Nuclear power is a controversial topic in the Netherlands. The VVD put the topic on the political agenda in the run up to the elections as it views nuclear power as a necessity to reach the climate goals. The Christian Democrats (CDA) do, too. However, the CU and all left-wing parties are against it. In light of this, the view of 'new heavy weight' D66 could be crucial, although the party seems to be ambivalent towards nuclear power. On the one hand, D66 allows market players to apply for permits to build nuclear power plants. On the other, they have no interest in subsidising nuclear power, which is a prerequisite for market participants to be able to build a viable business case and apply for a permit.

These differences might be bridged early on in the debate as many steps are still required before an investment decision can be made. Think of research and political debate on possible locations, whether it is wise to build nuclear power plants near the coastline in times of climate change and rising sea levels, the viability of the business case, how to finance multi-billion investments and how to organise local support. Such research and debate is likely to outlive the lifespan of the new coalition.

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‘Ready-to-drink’ market growth puts pressure on aluminium cans

The 'ready-to drink' market has seen significant growth over the last few years driven by consumer demand for more convenience and healthier alternatives. But, the increased consumption of canned beverages has led to aluminium can shortages, as recognition grows that the metal is infinitely more recyclable and sustainable in comparison to PET plastic



Source: Shutterstock

Variety of energy drinks, soda, soft drinks, fruit juice, non-carbonated, in bottles and cans in a supermarket

It's comforting to see there are some winners during these unprecedented times.

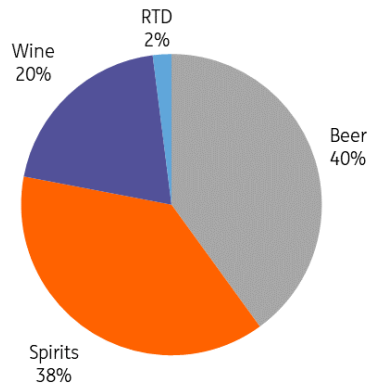
The ready-to-drink segment is the only category in the alcoholic beverage market that saw growth in 2020. In our view, this is partially due to Covid-19 but not entirely. Between 2014-2019, the global Total Beverage Alcohol (TBA) grew at a compound average growth rate of 5%, while the ready-to-drink segment grew at a rate of 8% over the same period.

Even before the pandemic, we think there were three main drivers. Convenience, on-the-go consumption and health & well-being. The single-serve nature of ready-to-drink beverages also

raises the question about their impact on the environment.

The figure below shows the market is still very small with only 2% of the total value.

Global Total Beverage Alcohol (2019)



Source: IWSR, ING Research

1 Consumers want convenience

The single-serve packaging that is ready for consumption on purchase answers this question due to the versatile nature of ready-to-drink beverages.

Consumers love the convenience of having what they want, when they want it, without any compromise

For example, a pre-mixed, canned cocktail can be quickly and easily served without the hassle of a pantry with numerous ingredients. A ready-to-drink option also makes it easier to meet different flavour preferences. In other words, consumers prefer the convenience of having what they want, when they want it, without compromise.

We also see how the ready-to-drink market functions as a snack or a meal replacement for consumers on the go too.

2 Functional ready-to-drink beverages rising in popularity

Health & well-being is the second main driver behind the growth of the ready-to-drink market.

This trend was already gathering pace even before the pandemic, but in our view has accelerated, as consumers become ever more conscious of the benefits of a healthier lifestyle.

Functional ready-to-drink beverages are an alternative to carbonated soft drinks, with lower sugar content, natural flavours and ingredients to enhance performance, and so on. This is valid for both alcoholic and non-alcoholic drinks. Although alcohol consumption is hardly 'healthy', consumers looking for healthier alternatives to cut down alcohol and sugar intake can have some indulgence and a healthy lifestyle simultaneously.

3 Market expected to grow by 41%

Lastly, we believe the shift from at-home consumption to out-of-home consumption has only been temporarily reversed due to Covid-19 lockdown measures. And as we have seen, the ready-to-drink market was the only category to experience growth during 2020, and more growth is very likely.

According to the drinks industry analytics group IWSR, between 2019- 2024, the market is expected to grow by 41%.

More canned beverages mean more aluminium consumption

Another side to the ready-to-drink market is that more canned beverages mean more aluminium consumption.

Even before the pandemic, there was plenty of tightness in the aluminium can market due to the strong demand growth, and Covid-19 has exacerbated the market imbalance, particularly from North America.

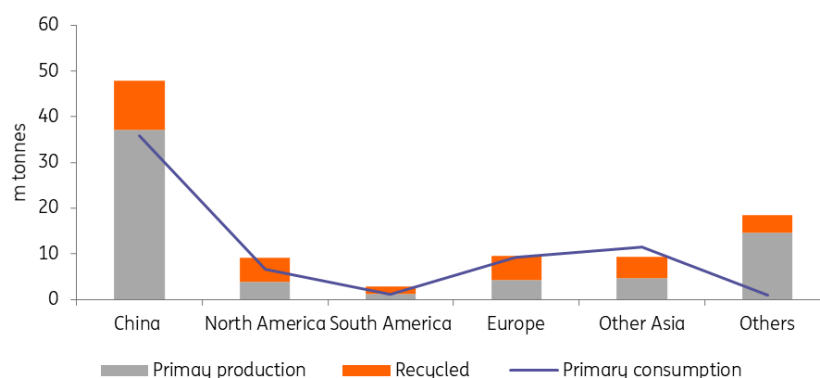
There has been a structural shift in beverage packaging materials due to the growing recognition that aluminium is infinitely recyclable

There are two primary drivers behind the strong aluminium can demand. Firstly, demand from the global beverage industry has seen strong growth even before the pandemic. Secondly, there has been a structural shift in beverage packaging materials due to the growing recognition that aluminium is infinitely recyclable and a more sustainable packaging alternative compared to glass and PET plastic.

One scenario is that the shortage in the aluminium can market may morph into a more secular one if beverage makers stepped up to slash their carbon footprints, as they face rising environmental, social and governance pressure. As such, they may seek to boost their use of either recycled aluminium or virgin aluminium but with a low carbon identity.

The trend in sourcing aluminium with lower carbon footprints is not unique to the packaging industry. Other industries, such as the consumer goods and transportation industry, face similar ESG pressure.

Aluminium supply breakdown versus consumption from major regions (2018)



Source: International Aluminium Institute, ING Research

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Taking a peek at Yellen's foreign FX agenda

With the Treasury FX Report due mid-April, dealing with current (Switzerland and Vietnam) and future (Asian countries are at risk) FX manipulators will be a key challenge for Secretary Yellen. In the longer-run, a revision of the criteria and the consequences attached to the manipulation tag may be needed to successfully discourage FX interventions



Read our latest article on this subject: [FX intervention: A monetary, macro-prudential or mercantilist policy?](#)

The Treasury FX report is due mid-April, and it will likely contain more than one hint on the direction of travel for the US trade policy under the Biden administration. Over the past two years, the Report had seen a strong political connotation as former President Trump used some countries' currency practices (above all, China) as a basis for implementing his aggressive trade agenda.

While the new administration took early steps to distance themselves from a number of policies of

the Trump-era, a continuation of the strict stance on foreign currency mis-practices with specific focus on China is widely expected.

The Treasury is responsible for the US foreign policy when it comes to currency practices, and Secretary Janet Yellen made clear in her confirmation speech that she intends to hold a tough line on currency manipulation and that she stands ready to “take on China’s abusive, unfair and illegal practices”. In this article we look at how the next Treasury FX Reports may look like to fit the new US trade agenda.

The starting point: addressing current manipulation tags

The FX report aims at identifying those countries that engage in FX interventions to gain a trade advantage to the US. Three criteria must be simultaneously met to be labelled a currency manipulator and the Treasury must engage in one year of bilateral talks with the country named a manipulator to encourage more fair and transparent FX practices. Eventually, penalties or tariffs can be imposed.

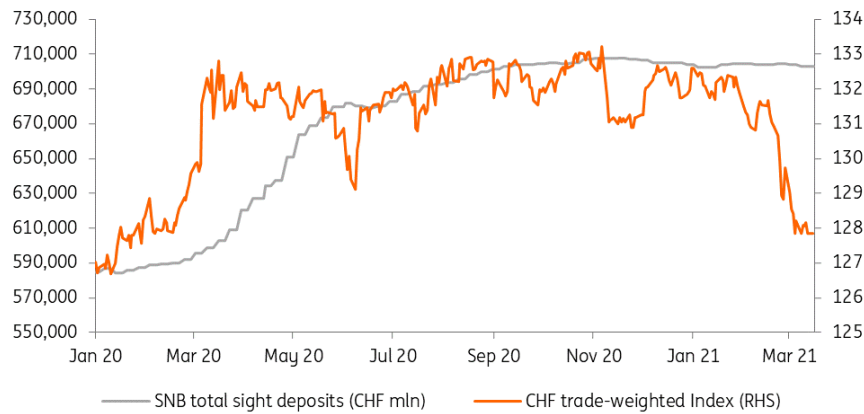
Criteria	Benchmark	Threshold
Significant Bilateral Trade Surplus with the United States	Goods Surplus with the United States	\$20 billion
Material Current Account Surplus	Current Account Balance	2% of GDP
Persistent One-Sided Intervention in Foreign Exchange Markets	Net FX Purchases	2% of GDP
	Persistence of Net FX Purchases (months)	6 of 12 months

Source: US Treasury, ING

The three criteria (shown in the picture above) have some quantitative thresholds that must be met. Those thresholds were lowered during Trump’s presidency, making it more likely for a country to exceed them.

Since the introduction of the report in 1988 and before the change in the criteria under Trump, only three countries had been labelled as currency manipulators (Japan in 1988, Taiwan in 1988 and 1992 and China from 1992 to 1994). In August 2019, at the peak of the US-China tension, China was named a manipulator despite meeting only one of the three criteria. The tag was then removed in January 2020, ahead of the Phase-one trade deal. In the very last report under Secretary Steve Mnuchin in December 2020, [Vietnam and Switzerland received the manipulator tag](#). Dealing with the existing “manipulators” will be the first challenge for Secretary Yellen.

Switzerland’s central bank (the SNB) was firm in affirming the US Treasury tag would not change the wide use of FX intervention as part of their policy mix after receiving the manipulation tag. Latest data on sight deposits (chart below) suggest that the SNB FX interventions have been more contained in line with easing buying pressure on the safe-haven CHF as the global recovery gathered pace (CHF is down 4.7% YTD vs USD).

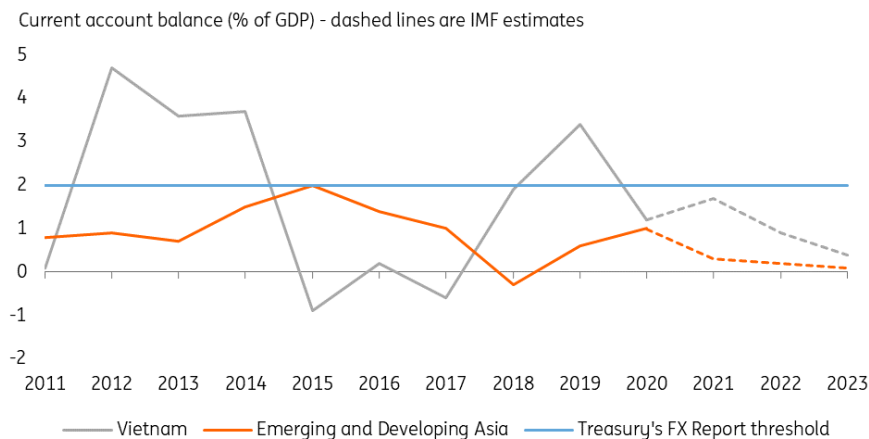


Source: Refinitiv, BIS, ING

Switzerland has not been a key target in the recent US trade policy, despite the country having a sizeable goods trade surplus with the US (\$56.7bn in 2020), which are mostly pharmaceutical products. If anything, a tough stance on Switzerland's FX interventions may be a way to discourage similar practices among other developed countries.

The Treasury approach on Vietnam may, instead, provide a hint of what will be the stance on the macro Asian region. Arguably, Vietnam has been the example of widespread currency practices among export-oriented Asian countries that have an interest in keeping appreciating pressures on their domestic currencies contained.

After receiving the tag, the Vietnamese central bank took steps to reduce their FX interventions, by announcing in February that the operations in the FX market would be cut from a daily to a weekly frequency, with the aim of allowing the dong to float more freely. The current account surplus is also estimated to shrink below the 2% threshold in the coming years according to the latest IMF estimates (chart below).



Source: IMF, ING

Asia set to remain the key focus

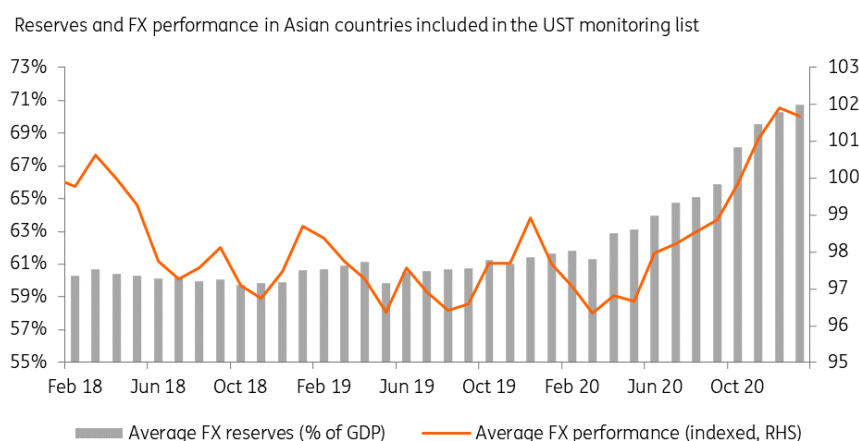
Relationships with China have moved back to centre stage this week after the US, EU, Canada and UK imposed sanctions on four Chinese nationals and one entity over alleged human right abuses.

As markets may start to look beyond the pandemic period in the coming months, Sino-American relations may re-emerge as a key topic.

While China may well continue to be the main concern for the Treasury, the FX Report will most likely retain a big deal of focus on the Asian region as a whole. Eight of the ten countries included in the monitoring list (for those countries that only meet two of the three criteria) in the December 2020 report were Asian countries: China, Japan, Korea, Singapore, Malaysia, Taiwan, Thailand, India.

With the global recovery gathering pace and the relatively good contagion situation in most of Asia, there is surely room for more inflows into Asian assets later in the year and we could see Asia FX find fresh support along with a generalized dollar weakness. The stance of the Treasury on FX interventions – and its ability to send a firm message to local central banks and government on this matter – will likely be a factor to consider to estimate the size of any new Asia FX rallies.

As shown in the chart below, the average of FX reserves (as % of GDP) rose drastically in 2020. That appears not only related to the initial pandemic shock, as it actually increased in pace in late 2020 when global financial conditions materially improved and – incidentally – saw an outperformance of the Asian EM bloc in the FX space. This tends to signal rising currency interventions by those country over the past year.



Source: Macrobond, Refinitiv, ING

Taiwan is one country that had already attracted some of the attention of the Treasury for FX mis practices, and we estimated that the country met all three criteria to be labelled a manipulator back in the summer of 2020. The Treasury only put Taiwan in the monitoring list in December, but the country has actually ramped up its FX interventions of late. Last week, the Taiwanese central bank Governor even acknowledged that Taiwan may be labelled a currency manipulator by the UST, but minimized the risk for the economy from receiving such a tag.

A new approach?

Taiwan's CB relaxed comments on the risk of being labelled a manipulator are likely emblematic of the fact that the FX Report and the manipulation tag itself have not fully served the purpose of discouraging FX interventions in targeted countries.

Indeed, the FX Report is only one instrument to achieve the goal of more market-based FX regimes,

but the new administration might start to see the need for a revision of how the Report is built and what consequences the manipulation tag has.

First, the criteria-based system does restrict the ability of the Treasury to mark a country a manipulator – barring impromptu measures like the China labelling in 2019 that were not unusual under President Trump. The three criteria have the same weighting, so that a country that has explicitly intervened to stop its currency appreciation may be spared the manipulator tag thanks to having a current account balance below 2% (that was the case of China, for example) or a goods surplus with the US below the \$20bn threshold. Making the FX intervention criteria more relevant for the final decision could provide more flexibility to name countries FX manipulators based on those countries' specific circumstances.

Second – and possibly more important – the Treasury might consider implementing tougher (and quicker) measures to those countries that are labelled FX manipulators. The relaxed stance of Taiwan despite the material risk of receiving the manipulation tag was likely emblematic in this sense. The lack of immediate consequences for the domestic economy – considering the US Treasury would first have to go through one year of negotiations with the local authorities – may have a role in pushing countries to accept the manipulation tag with the prospect of postponing any changes in the currency practices to when the risk of sanctions or tariffs become more tangible.

Should Secretary Yellen decide to make the FX Report a more central tool in her announced fight against FX mis-practices, we may see some changes in the next four years on these two critical points.

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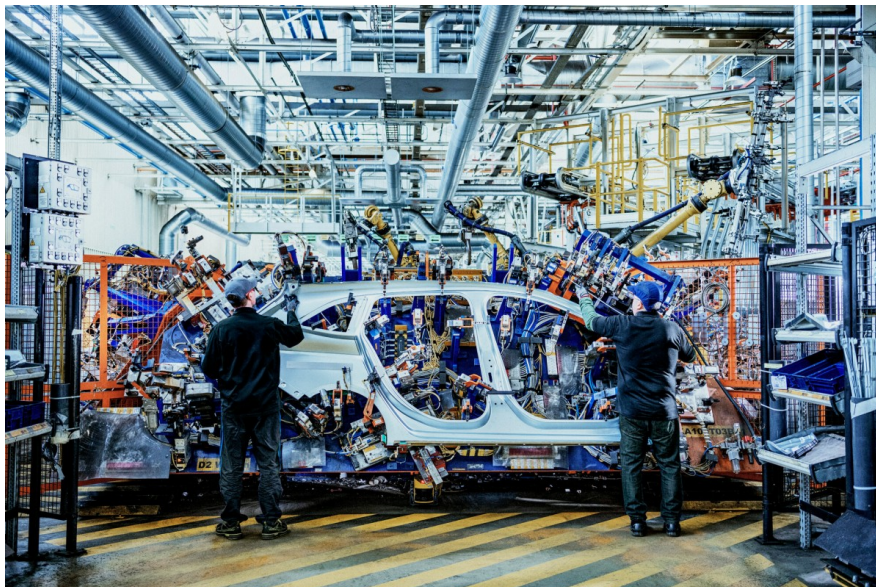
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US: Freezing February will give way to March madness

Virtually all February data has disappointed as winter storms and cold conditions took their toll on supply chains and kept people inside. Today's durable goods report was no different, but the data will all bounce strongly for March given massive fiscal stimulus and record low customer inventories



Source: Getty Images

Bad weather and supply chain issues weigh temporarily on orders

Like most other February data, the durable goods orders report has undershot expectations by falling 1.1% month-on-month rather than rise 0.5% as consensus forecast. The core non-defense capital goods orders ex aircraft, which has a strong lead quality for determining where business capex is heading, fell 0.8% versus the 0.5% gain anticipated. While not great, we see nothing to worry about.

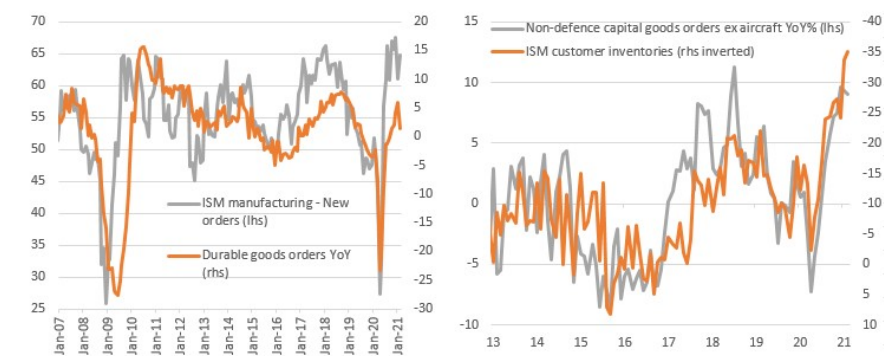
Bad weather is likely to have been a key factor here with all sectors witnessing declines aside from electrical equipment (+0.2% MoM). If you were experiencing slower production due to storm disruption you obviously need to order less for the next month. ISM orders figures remain very firm so March should rebound strongly on more seasonal weather patterns.

However, there are other issues such as the global semi-conductor shortage, which is impacting vehicle production around the world given they are in anything from brake sensors to satellite navigation to parking assistance systems. If you can't get enough semi-conductors then you order less of everything else as well, be it steel or tyres – note that vehicle and parts orders fell 8.7% MoM. Assuming this can be resolved soon, orders should also bounce back.

Business surveys point to a strong March rebound

The February ISM report suggest manufacturers remain optimistic and they are seeing strong order flow. Indeed, as the chart below shows ISM new orders are at levels historically consistent with 15% year-on-year growth in durable goods orders. Furthermore, record low inventory levels as reported by the ISM, combined with the prospect of a broadly re-opened, stimulus primed economy in the second quarter, suggest domestic orders will continue to grow strongly this year.

Strong order books and low customer inventories suggest strong growth ahead



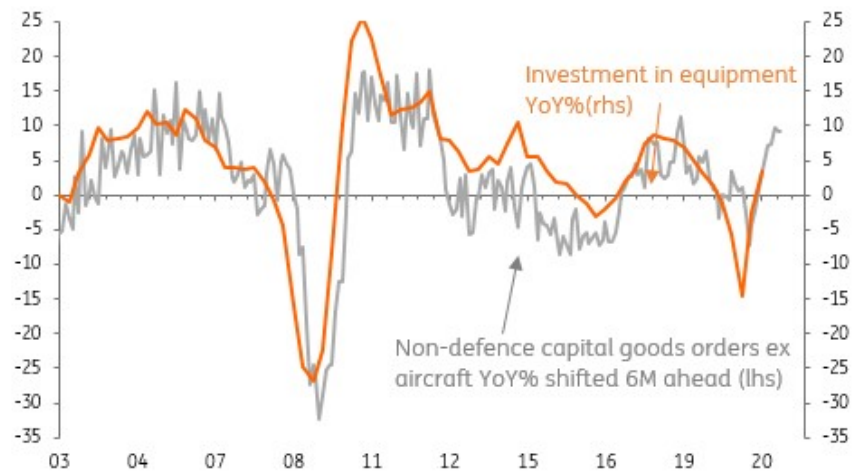
Source: Macrobond, ING

The investment outlook is strengthening

Export orders will continue to underperform given new lockdowns in Europe, but assuming we see an easing of restrictions in response to lower hospitalisations and rising vaccination rates we should see improvement in the second half of the year. All of this bodes well for capital expenditure as the chart below shows.

Consequently, while the February figures have disappointed there is nothing to be too concerned by. Consumer spending is expected to rebound strongly in March and April on the latest stimulus payments, manufacturing will roar back given the strong order books and low inventory levels while employment should continue to recover as the economy re-opens and job opportunities improve.

Investment spending to accelerate



Source: Macrobond, ING

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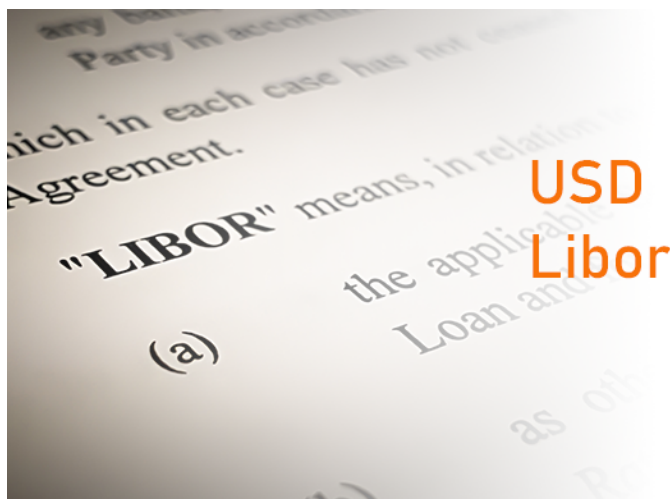
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Keeping SOFR pure and simple

The purest form of risk free rate is an overnight one. And to keep it simple, any future rate should be computed as a sequence of realised daily rates. The alternative, is to guess where the rate will be, in say 3 months; which in effect is a term rate. Such US terms rates are still coming. But with a significant delay, causing quite some angst in certain quarters



The ARRC decides to abandon the push for SOFR term rates - big decision!

The Alternative Reference Rates Committee (ARRC) in the US has significantly softened its target to make term Secured Overnight Financing Rates (SOFR) available.

There had been an implicit expectation for the term rate to become available at some point in 3Q21. Now, the ARRC is suggesting that it might not come in 2021 at all.

What are term rates? In the US the 3mth rate is the benchmark, and a 3mth term rate would be a prediction for the path of overnight SOFR for the 3mths ahead, rather than waiting for 3mths and then see where that compounded in arrears rate will be.

For some players, they ideally need to have term rates as they need to use that to discount future obligation now (just as they do currently with Libor). For most, it matters less, as the in-arrears methodology is generally workable.

Why does this matter? A sizeable rump of players are massively disappointed on this delay, and are left with key decisions to make on what to do, as the push remains to switch all new business to SOFR by end-2021.

This is a massive setback for a small but a not insignificant rump of players that have been expecting SOFR term rates; typically borrowers in the trade finance and working capital space, to manage their liquidity well.

In the UK, where Sonia terms rates are available, the take-up is running in the area of just under 10% of volumes. While that implies over 90% of new volumes will be in Sonia in arrears, that still leaves a sizeable sub-section that would be un-catered for if we extend these proportions to the US.

So why has the ARRC taken this stance, and does it matter? It does and it doesn't

The logic for the ARRC's reluctance to accelerate efforts to get a SOFR term rate is centered on two points. First, development of a term rate was always contingent on having suitable volumes built in SOFR futures and derivatives, and the ARRC has concluded that such volumes are not in evidence as of yet. And there is an implied presumption that such volumes may not build adequately and in a timely manner in the coming months. Second, and related to this, the ARRC is keen not to fall short of suitable volumes, to avoid legitimacy pitfalls that Libor fell into.

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To this end, the ARRC is urging participants to push ahead without a term rate. There is an underlying pressure for market participants to look for alternatives to SOFR term rates, and for any future term rates that might eventually come to be used in limited cases. This stance has been supported by various Fed studies that show a minimal basis between SOFR in arrears versus SOFR in advance for shorter tenors (e.g. 1mth). However, SOFR in advance is not the best predictor of SOFR in arrears for longer tenors (e.g. 6mths).

For most players in both loans and derivatives markets, the lack of a term rate is not debilitating. The swap derivatives market was always and will continue to be based off a SOFR in arrears structure.

Partly in consequence, the loans market will have a very similar structure, where the preference is to have so-called "Daily simple" as a reference, where the SOFR rate is applied on a daily basis. In arrears and daily simple are similar. Both are in arrears rates, the only material difference being an

implied averaging rather than a compounding computation in the classic in arrears computation.

Who is affected, and what can they now do? Use something else most likely

But what about players that had been holding out for SOFR term rates?

The implied suggestion from the ARRC is to use something else. There are Federal Reserve published SOFR indices that could be employed. Not ideal for longer tenors in trade finance (say out to 12 months), but at least a usable reference. As an aside, a similar implied solution is suggested by the Swiss authorities, which have stated for some time that they will not have a term rate available, ever.

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While this is not a debilitating development per se, it is quite unwelcome in the arena of supply chain financing. Either these players will need to significantly change the way they operate, or to use what they would describe as a sub-optimal solution rate (even "in advance" rates are technically calculated from historical rates). While this is a minor aspect of the market, unease here does not help against a backdrop where there is an ongoing push from the official sector to switch to SOFR-linked business this year.

The counter argument is this news removes a waiting game that had been ongoing.

The ARRC has now clearly advised those waiting for term SOFR to proceed without it, for 2021 at the very least. While disappointing for players that were waiting for SOFR term rates, the urgency now is transformed to moving on, and employing whatever alternatives are available.

The frustration is that this news, if it was coming, did not come earlier, so that such players could have readied themselves earlier too.

In fact, there is merit in such frustration. The fact that the ARRC had sent out requests for proposal for parties to come back with suitable term SOFR compilations had led most to believe that a term rate would be available. Furthermore, those that require such rates up front as a discounting mechanism had allowed themselves to believe that they could rely on this. That is no longer the case.

This obstacle can create opportunity. It will have to, as the clock is still ticking. Legacy USD Libor has a delay to mid-2023, but all new Libor business (including USD) must still come to a conclusion by end-2021.

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