

The only way is up, baby

We've been broken down. To the lowest turn. Bein' on the bottom line. Sure ain't no fun... prophetic lines from Yazz in 1988. More than thirty years later, the only way is up, not least for inflation in the States. And probably the pound. Certainly for electric car sales. Here's our roundup of ING's top economic stories this week... for you and me now

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Our Chief FX Strategist, Petr Krpata on why we expect the British pound to keep on rising

Knightley: Price pressure in the USA

ING's James Knightley on why inflation could soon become an ingrained problem for the American economy



Price pressure in the USA

US inflation is on the rise and could potentially spark pressure on the American economy that we haven't seen in a generation. That's certainly the view of the former Treasury Secretary, Larry Summers and it's put President Biden and the current Treasury Secretary, Janet Yellen firmly on the back foot, according to ING's James Knightley in New York. James says we could even see inflation testing 4% in the coming few months not least because of the promised coronavirus stimulus measures and Biden's Build Back Better programme that could pump trillions into the economy.

[Watch video](#)

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FX intervention: A monetary, macro-prudential or mercantilist policy?

On a day in which the Bank of Israel announces a staggering \$6.8bn of FX intervention in January alone, we review some of the factors driving this activity and look at how the theme of FX intervention will develop through the year. We suspect the new US Administration will have little tolerance for those they believe are preventing an orderly \$ adjustment



Source: Shutterstock

2021's early movers

In [our prior article](#) on this subject, we highlighted how Sweden, Chile and Israel had all pre-announced FX reserve building programmes for this year.

In fact, [Israel has today announced](#) that in January alone it spent \$6.8bn of its \$30bn full-year programme. We have also seen the Reserve Bank of India Governor Shaktikanta Das outline that emerging nations, in order to mitigate global spillovers, 'have no recourse but to build their own FX reserve buffers'.

This broader concern of FX reserve adequacy firmly sits in the macro-prudential bucket of reasons to increase FX reserves – similar to the rationale that Chile announced in early January. But when it comes to FX reserve building, which countries can really justify reserve adequacy considerations and when does it cross into a more mercantilist measure to protect local exporters? In fact, Israel even admitted that FX intervention was partially designed to protect exporters and prevent import substitution.

Below, we look at a couple of FX reserve adequacy metrics to identify which emerging countries have the most – and least – justification for an FX intervention programme.

[FX Intervention: Back in fashion](#)

Emerging market FX reserve adequacy: Does India have a case?

For emerging market economies, FX reserves play an essential role in sovereign credit metrics as their currencies do not benefit from reserve currency status and many public and private creditors tend to borrow in foreign currencies, primarily the US dollar and euro.

Thus, adequate FX reserves are key to ensuring financial stability (notably the ability to ease pressure on the exchange rate in times of shocks) and provide confidence in a country's ability to repay FX-denominated debt. Notably in early 2020 when the pandemic triggered a broad-based currency depreciation in emerging markets, we have seen many central banks stepping in to support their currencies, resulting in a drop in FX reserves. Nonetheless, most central banks have since been able to rebuild FX reserves in a prudent manner and thus for most countries, FX reserves have increased in 2020 (by an aggregated +4.4% for the 22 emerging market economies we have included here).

Two commonly-used metrics to compare FX reserves are three-months' worth of import cover while the second is the percentage cover of external financing needs

Below, we look at two commonly-used metrics to compare FX reserves (based on IMF figures on total reserves excluding gold for December 2020) and note a stark divergence across emerging markets economies.

The first is the adequacy metric of three-months' worth of import cover while the second is the percentage cover of external financing needs. On the latter, a 100% coverage of short term external debt and the current account deficit is commonly seen as an important metric.

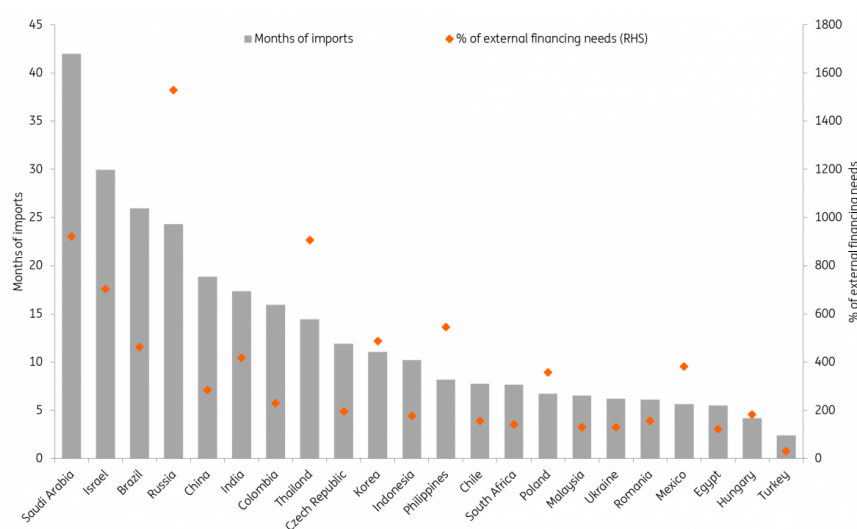
Among the countries mentioned above that have pre-announced a boost to their FX reserves, we find that India and Israel are among the countries with arguably the amplest FX reserves, thus any claims (e.g. India) to build reserves for macro-prudential measures may come under scrutiny from Washington. Others in that category include Brazil, China, Russia, Saudi Arabia and Thailand.

India and Israel are among the countries with arguably the most plentiful FX reserves

In contrast, we believe there is a need for Turkey to rebuild FX reserves (which have fallen by 46% over 2020 and only cover c.30% of external financing needs over the next year). Egypt and Ukraine, both frontier markets, have committed to gradually rebuild their FX reserves under their ongoing IMF programmes. Meanwhile, Hungary and Romania have relatively low reserves but benefit from their close ties to Eurozone countries (reflected also by the repo lines with the ECB). In the case of Chile, some prudence is also warranted given the drop in FX reserves last year and political uncertainty ahead of the constitutional convention and general elections.

Positively, we see a window of opportunity to improve external resilience through higher FX reserves, thanks to our view of a broad-based weaker dollar in 2021.

EM FX reserve adequacy: Import cover and short term external financing needs



Source: IMF (IFS, DOTS, WEO), World Bank (QEDS), ING

Whisper it, what about reserve adequacy in the G10?

Away from the heavily interventionist Switzerland, already named a currency manipulator, what are the chances of other developed market central banks concluding that their FX reserves are too small and starting FX intervention programmes – useful if they would like to slow local currency gains through this early part of the recovery cycle?

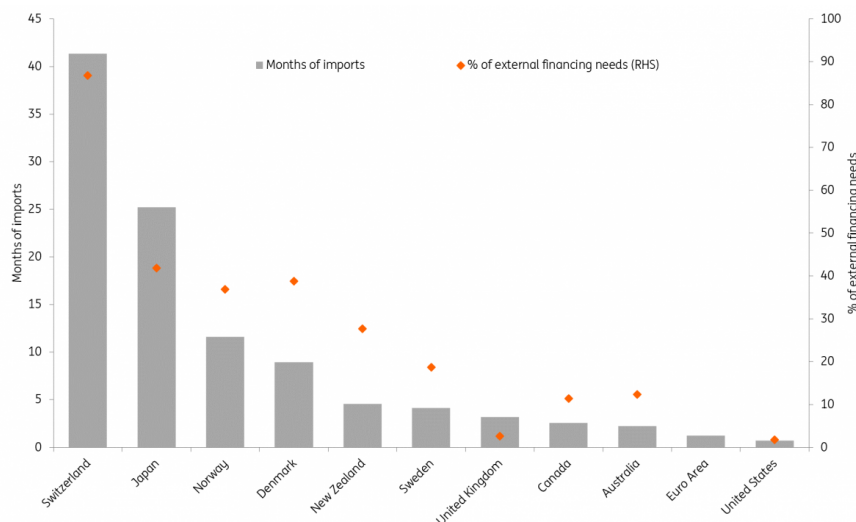
Second-tier reserve currencies, such as those issued by Australia, New Zealand and Canada would find it a tough sell marketing the view that they needed higher FX reserve levels for macro-prudential measures

We would say that those second-tier reserve currencies, such as those issued by Australia, New Zealand and Canada would find it a tough sell marketing the view that they needed higher FX reserve levels for macro-prudential measures. These countries have some of the highest sovereign

ratings in the world. And, for example, tight security relationships probably mean that these countries would be quickly 'persuaded' by the US that trying to fight this broad dollar adjustment was not in their interest.

The chart is also a reminder that the US and the Eurozone have tiny FX reserves – a reflection of the 'exorbitant privilege' of issuing the world's top two reserve currencies. It would be a huge step for either side to undertake a reserve-building programme – although there was talk of US Treasury FX intervention when the dollar was very strong in 2018/19.

DM FX reserve adequacy: Low for a reason



Source: IMF (IFS, DOTS, WEO), World Bank (QEDS), ING

Reserve building as an extension of monetary policy

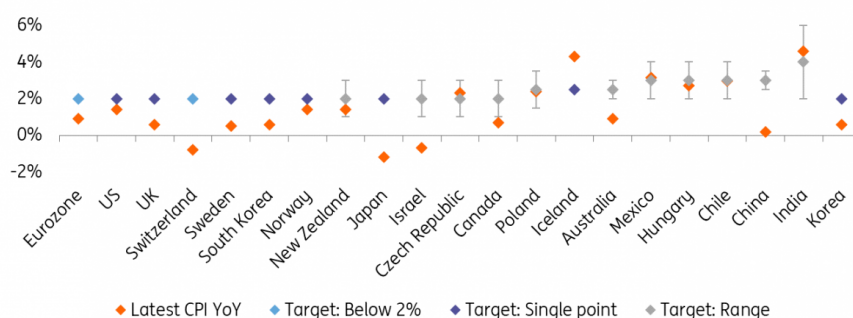
Massive FX intervention by both Switzerland and Israel falls under their auspices of monetary policy – both long sufferers of deflation.

As we highlight below, that line of justification will not be open to all. For example, India would struggle to market FX intervention from a monetary policy angle, where inflation is already above target.

This topic is also relevant for the ECB, where EUR/USD strength was seen adding to the Eurozone's travails with low inflation. Indeed, the idea has recently been floated that the ECB could cut the depo rate if EUR/USD were to rise too quickly. But the idea of the ECB building FX reserves to slow the EUR/USD advance looks far-fetched - especially in a year when Washington will be very sensitive to trading partners taking advantage of US fiscal stimulus and consumption with under-valued currencies.

Also in this section, one could assess the activity of Polish authorities, intervening to buy EUR/PLN in December in spite of Polish inflation broadly being in line with the target. Incidentally, the IMF has just said that Poland needs to explain what it is trying to achieve with its FX intervention - many think Polish intervention at year-end was actually designed to increase the value of Poland's FX reserves for budgetary purposes.

Inflation versus target: Which countries can justify intervention on monetary grounds?



Source: ING, Refinitiv

Washington watches

We are bearish on the dollar this year and think that Washington will be very active in its surveillance of FX policies undertaken by its trading partners.

A lot of the US legislation written behind the US Treasury's currency manipulation report was done so exactly for a year like this – a year in which the dollar is undergoing an orderly, market-led decline and trading partners, through FX intervention, maybe looking to interfere with that adjustment.

We are bearish on the dollar this year and think that Washington will be very active in its surveillance of FX policies undertaken by its trading partners.

That is why we think USD/Asia FX intervention over recent months looks to be more characterised by 'smoothing' or 'liquidity adding' rather than trying to defend any line in the sand.

And we're interested in how developments proceed with Switzerland. The Swiss wholeheartedly reject accusations of 'currency manipulation', but let's see how negotiations proceed between the two. We suspect the Swiss will be hoping that a pick-up in the world economy can unwind some of the market's pre-cautionary CHF longs bought during the height of the trade war – meaning that little Swiss central bank FX intervention will be required after all.

Overall, however, we suspect the political environment means that reserve managers will only be able to slow, not reverse local currency appreciation against the dollar this year.

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Euroflation: the EUR reflation trade and its market implications

EUR interest rates and, more noticeably, inflation swaps have been rising in tandem with their USD counterparts. The move rests on shaky fundamental ground but could run ahead with US markets poised to drag the rest of the world out of its gloom. We look at the curve and consider broader market implications.



The Eurozone reflation trade: hard to justify with fundamentals

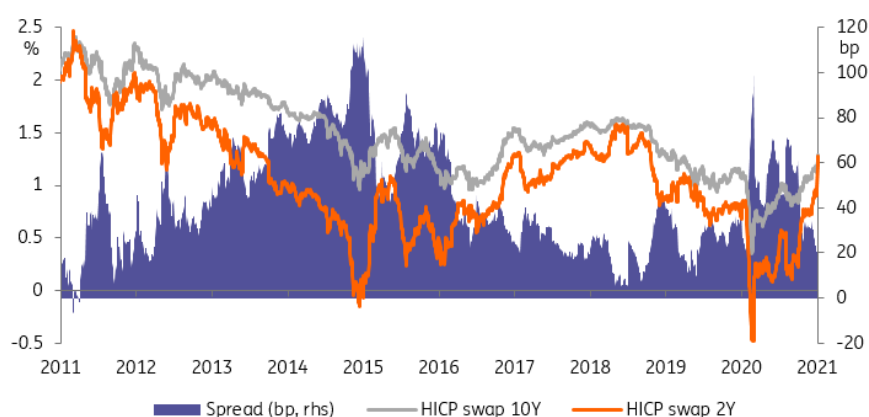
The 'made in the Eurozone' reflation trend shares many of the characteristics seen in other developed markets, chiefly in the US. If correlation between global markets is not a new phenomenon, the rationale in the Eurozone is harder to make sense of. [We wrote in our 2021 outlook](#) that the divergence between USD and EUR rates markets would be one of the key themes of the year. This has largely proved true for nominal rates...but inflation expectations have been rising apace on both side of the Atlantic.

inflation expectations have been rising apace on both side of the Atlantic

The Eurozone economy remains dogged by harsher lockdown policies than in the US, a slower vaccine rollout and, most importantly, more limited hopes of fiscal stimulus. As such, the Eurozone reaching 'escape velocity', the point where growth is sufficient for stimulus to be withdrawn, is but a distant prospect.

To be sure, some global developments could prove this analysis wrong. For instance, goods inflation, a more global phenomenon than service inflation, could pick-up as the global economy recovers. Rising commodity prices are also finding their way in prices. It is likely that these effect would prove transient however. Longer-lasting inflation would have to rely on higher wages. By and large, the rise in Eurozone inflation that our economics team expects this year should not last, and [medium term price pressure remains weak](#).

EUR inflation swaps have risen much faster at the short-end



Source: Refinitiv, ING

Reflation and the curve: steeper nominals ahead

If there is a place where a temporary rise in inflation is justified, it is to be found at the short-end of inflation swaps. And indeed, the rise in 2Y inflation swaps has outpaced 10Y. This has only occurred twice in the past ten years. Once in 2011, and once in 2018. In both instances, market concerns about the risk of premature ECB tightening grew quickly.

This time could be different. Inflation swaps anticipating inflation of 1.32% over the next two years are hardly cause for concern at the ECB. Neither is 1.27% average inflation, also implied by swaps, over the next 10 years. Nevertheless, inflation expectations are an important input in interest rates, and interest rates are an input in all other markets.

Inflation of 1.32% over the next two years is hardly cause for concern

One important fact about long-term (10years) inflation expectations as implied by swaps is that they have been on a clear downtrend since the great financial crisis. It is all well and good to aim for expectations rising back to the levels prevailing in the previous cycle, around 1.5% in 2018, but when it comes to breaking higher, the burden of proof lies with those calling for a change in long-

term inflation dynamics.

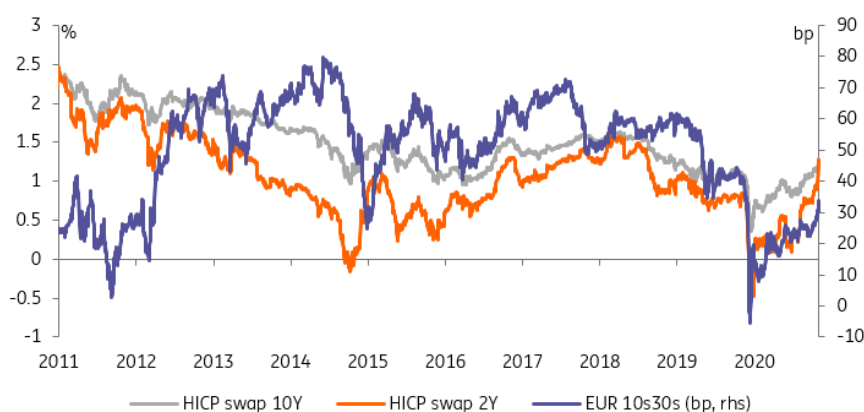
60bp

EUR 10s30s nominal slope

would be consistent with 10Y inflation swaps at 1.5%

Interestingly, past relationships between long-term inflation and the slope of the EUR nominal interest rate curve suggests EUR 10s30s (to take that example) should lie somewhere around 45bp, from 35bp currently. 10 year inflation swaps at 1.5% would be consistent with 10s30s at 60bp. In short, even as the inflation swap slope is inverting 2s10s, the nominal rates slope steepening appears to have only begun.

Rising inflation expectations imply a steeper curve is necessary

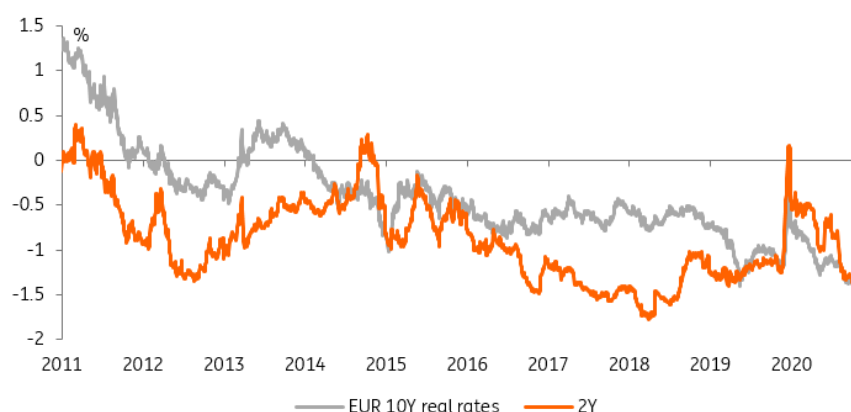


Source: Refinitiv, ING

Real rates at record lows: a few more weeks of goldilocks

As we hinted above, the implications of higher inflation, higher nominal rates, and of a steeper curve do not stop at interest rates markets. We let individual strategy teams detail the implications for their respective markets but one general point is that there is a solid theoretical basis to believe that real rates, the difference between nominal rates and inflation expectations, matter for risk appetite in financial markets.

Real rates are at record lows at both ends of the curve



Source: Refinitiv, ING

By that measure, with both 2Y and 10Y real rates at record lows, one could conclude that financial conditions are exceptionally accommodative. Interestingly, the ECB is in the midst of a debate on what the definition of favourable financing conditions should be. ECB president Christine Lagarde has hinted that the answer, when it eventually arrives, will rely on a broader set of indicators than just interest rates. It is clear to us however, that low interest rates, tight credit spreads, and buoyant stock markets put in the context of rising inflation expectations indicate a degree of disconnect.

Higher rates now, sowing the seeds of lower rates by year-end

Barring a hawkish ECB communication accident (or one from the Fed) we see this state of play extending for a few more weeks to a few more months. It should turn when one of two things happen. Either economic hopes are proved correct by data later this year, or they aren't. In the former case, the debate about withdrawing monetary accommodation will heat up, and nominal rates will catch up higher to inflation swaps. In the second scenario, inflation swaps will converge lower towards nominal rates in pricing dim economic prospects.

We continue to doubt 10Y nominal EUR swaps will end the year above 0%

Either way, higher real rates will usher a more challenging period for risk appetite, one that would see nominal rates drop or remain low, by virtue of safe asset demand for government bonds. In that respect, the higher the spike in real rates in the first half of 2021, the lower nominal rates will be pulled by the end of the year. We continue to doubt 10Y nominal EUR swaps will end the year above 0%, but they may well test that level in the coming months.

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BNLX+ Financials: Fasten your seatbelts



Source: Shutterstock

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Netherlands General Election: What to watch

The Netherlands goes to the ballot box on 17 March 2021, for regular elections for the House of Representatives. In this report, we look at what the polls are showing and the possible implications for economic policies.



Fall of government implies switch to caretaking mode just a bit earlier

On 15 January 2021, the Dutch government stepped down because of the so-called “day-care allowance affair”, in which the government unjustly treated thousands of households as fraudulent. The government is currently continuing as a caretaking government, as expected anyway in light of the regular elections, only just a bit earlier than anticipated.

In this publication, we discuss what to expect from this election – taking recent polls as a given – and outline the positions of the political parties most relevant for the next coalition on economic topics that are of most importance to an audience outside the Netherlands for the next four-year term.

Political landscape remains scattered

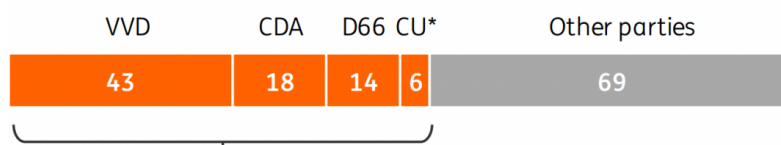
The leading [Dutch Polling Indicator](#) suggests no dramatic change in Dutch politics. Based on this composite of various polls, the Dutch political landscape is likely to remain scattered, with 14 parties polling for at least one seat in the lower house and six parties with a medium number of seats.

Much support for VVD and its current coalition

Prime Minister Mark Rutte's VVD remains the party with by far the most support of the electorate, polling between 41 and 45 of a total 150 seats. It might actually grow substantially compared to its current 32 seats. This combined with a small loss of support for coalition partners D66 and CDA and a minor gain for ChristenUnie provides ample room for the current government to win another term.

Substantial majority support for current coalition

Estimated polled number of seats for the House of Representative**



Current coalition partners: 81 of 150 seats - 76 required for absolute majority (between 76 and seats 86 at 95% confidence level)

Source: Peilingwijzer of 28 January 2021, *CU=ChristenUnie, **Estimates based on polls of I&O Research, Ipsos/EenVandaag and Kantar, taking into account variance and so called "house effects"

Change of leadership could have effect close to the elections

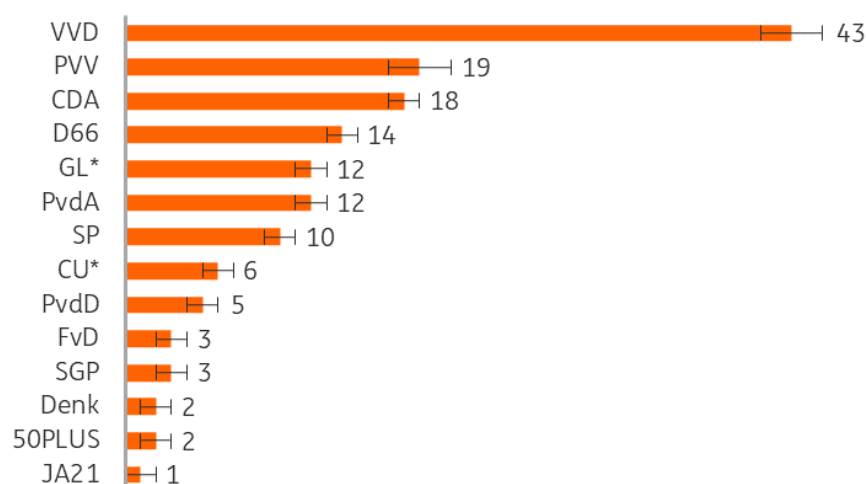
Since CDA, D66 and PvdA all recently chose new political leaders with no experience in election debates, large last minute swings in polls cannot be excluded. While the ruling government just fell due to the so-called "day-care allowance affair", it continues as a caretaker government and the polls show no significant shift in support for coalition parties as a consequence so far.

VVD could form centre-right or centre-left coalition

As it stands, it could be expected that the VVD will take the new initiative to form a new coalition government with at least three parties. Besides the current centre-right VVD-CDA-D66-ChristenUnie coalition, a similar VVD-CDA-D66 coalition and centre-left government of VVD-CDA-GroenLinks-PvdA are among the most evident options. The current lack of a Senate majority for all these options is not likely to be seen as an insurmountable hurdle.

VVD by far the party with most support in the polls

Estimated polled number of seats for the House of Representative**, point estimates with 5% error margins



Source: Peilingwijzer of 28 January 2021, *CU=ChristeneUnie, GL=GroenLinks, **Estimates based on polls of I&O Research, Ipsos/EenVandaag and Kantar, taking into account variance and so called "house effects"

VVD by far the party with most support in the polls

No huge policy shifts expected, but austerity less likely

A government of such traditional parties would not imply a huge regime change. Nevertheless, the Dutch mood specifically regarding quick domestic austerity seems to have changed compare to the previous crisis period: a focus on long-run sustainability seems more likely than a push for short-term debt reduction. Meanwhile, there is also a lot of support for more public investment.

Definitely no break with Europe, but no unconditional solidarity

With regards to European fiscal policies, the next government is expected to remain in favour of conditionality and sanction capabilities in return for solidarity. Opinions about the necessity to change the European Stability and Growth Pact differ among the coalition candidates. The election manifestos of the parties that are most likely to join the government suggest that radical steps away from European projects such as leaving the European Monetary Union or the European Union seem very unlikely.

For more in-depth analysis, please download the report.

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Electric car sales gain traction at start of transitional decade

Electric car sales surged last year and will do so again in 2021, with Europe at the forefront of the transition



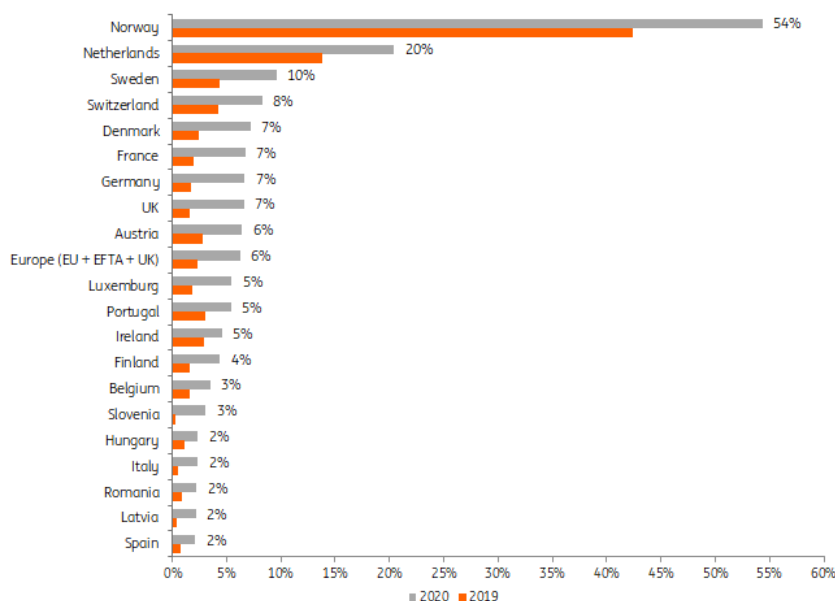
Electric car sales accelerate as pandemic hits the European market

In a dramatic year for the European car market where new car registrations dropped 24%, the total number of new battery electric vehicles (BEV) hitting the road more than doubled. The largest European car markets in Germany, the UK and France showed a significant increase. In these three countries, the share of BEVs in new car sales jumped from 2% in 2019 to 7% in 2020. The European BEV-share closed the year at 6%, against 2% in 2019, which puts Europe at the worldwide forefront of the transition to electric vehicles (global share 2020: 3%). All European countries experienced an increase in BEV sales, but large differences appear across the continent. Norway leads the transition with its share of new car sales last year at 54%, followed by The Netherlands (20%) and Sweden (10%).

<https://think.ing.com/articles/automotive-sector-outlook-recovering-after-traumatic-2020/>

Norway leads the electrification of new car sales in Europe, biggest markets Germany, France and the UK caught up in 2020

European top 20 full electric vehicles (BEV) in % of new car registrations



Source: ACEA, ING Economics Department

Uptake of electric vehicles to continue in 2021

We believe the rise of the BEV will continue in 2021. Worldwide sales could soar 50% again this year, according to BNEF. From a demand perspective, the costs of ownership and the range available are getting more attractive to drivers, with new affordable models entering the market. On top of that, fiscal stimulus packages (or exemptions) are still applicable. But perhaps most important, on the supply side, car manufacturers need to comply with an average footprint of 95 grams of CO2 per kilometer for newly built cars this year, which will have to be reduced by another 15% by 2025. Several European countries have adopted targets to reach 100% zero emissions for new car sales between 2025-2035. Car makers like General Motors have announced a full phase out of the internal combustion engine in the near future.

<https://think.ing.com/reports/break-it-or-make-it-long-term-impact-of-tech-and-policy-on-energy-transition/>

Hybrids (PHEVs) experience a temporary surge in the slipstream

Sales of plug-in hybrid vehicles (PHEV) also jumped from 1% to 5% of European new registrations. Nordic countries are in the lead here as well (Sweden: 23%, Norway: 20% and Finland: 14%). This actually reflects a revival of hybrids following the trend of making traditional models ready for short electric rides. Before the first attractive BEVs entered the market, hybrid cars (including PHEVs) were becoming increasingly popular. Fully electric vehicles mostly require a complete redesign of car models, like VW's ID.3. From this perspective, the current rise of the PHEV can be seen as a precursor to further proliferation of BEVs.

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Listen: Inflation Blues

It gave B.B. King the blues. And Larry Summers is getting worried about it, too. Inflation in the US is set to rise in the coming months, fuelled by an economic reawakening and massive fiscal stimulus. Will the Federal Reserve be forced to respond? In this podcast, ING's James Knightley takes a look



The White House has defended its \$1.9 trillion Covid relief plan following criticism that the package is too big and risks fuelling inflation.

In a [Washington Post op-ed](#), Larry Summers, Treasury Secretary under Bill Clinton and a former economic adviser to President Obama, argued that the Biden Administration's fiscal stimulus risks setting off "inflationary pressures of a kind we have not seen in a generation, with consequences for the value of the dollar and financial stability."

Treasury Secretary Janet Yellen says while accelerating inflation is a risk, it's one worth taking given the scale of the economic damage. And Federal Reserve Chairman Jerome Powell seems to agree, arguing that upward price pressures [will be "neither large nor sustained."](#)

[In this podcast](#), ING's Chief International Economist James Knightley tells Senior Editor Rebecca Byrne where he thinks inflation is heading in 2021 and beyond.

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Krpata on the pound: Why we've upgraded our sterling forecasts

Our Chief FX Strategist, Petr Krpata on why we expect the British pound to keep on rising



Why we've upgraded our sterling forecasts

We have upgraded our sterling forecast and expect EUR/GBP to reach the 0.85 level this year and 0.82 in 2022. With the risk of a no-deal Brexit out of the way, the pound is now free to reap the benefits of a faster vaccination rollout in the UK versus the eurozone. As for sterling against the dollar, its gains should be even more pronounced as the pair will also benefit from the rising euro/dollar this year and cable should be moving towards the 1.50 level in 2021.

[Watch video](#)

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