

What's happening in Australia and around the world?

In this bundle



Asia week ahead

Asia week ahead: Floodgates of central bank easing to open

The central banks of Australia, New Zealand, Malaysia, the Philippines, and Thailand are set to meet next week and most of them are expected to cut rates....



United States

Federal Reserve: Keeping the balance

While financial markets continue to price in rate cuts, the Federal Reserve is maintaining a cautiously upbeat tone that to us signals stable monetary...

By James Knightley



FX | China

Why sharp yuan appreciation or depreciation is unlikely in 2019

Since the central government described the Chinese yuan as a 'stable' currency, we have seen some structural changes in the movements of USD/CNY....

FX

In Charts: 5 reasons why we're still medium-term EUR/USD bulls

The recent fall below 1.12 has raised fears about another major leg lower in EUR/USD. We'd already penned a move to 1.10 in our profile for 2Q19 and...

By Chris Turner

Video

Watch: Some European regions may never recover

The financial crisis had a long-lasting and deep effect on economic activity and on employment in Europe, with some regions still struggling to see any...

By Bert Colijn



eZonomics

Breaking the money illusion

The cost of inflation is often misunderstood or ignored, with significant implications for consumer spending and economic behaviour on a wider scale



Commodities, Food & Agri

Food manufacturers turn to robots to meet consumer needs

The importance of technology for food manufacturers continues to grow, according to our report, 'Food tech: technology in the food industry'

By Thijs Geijer



Divided Europe: As some regions thrive, others may never recover

More than 10 years on from the financial crisis, regional labour markets across Europe continue to feel the impact. Will the next decade be any different?

By Bert Colijn

Asia week ahead: Floodgates of central bank easing to open

The central banks of Australia, New Zealand, Malaysia, the Philippines, and Thailand are set to meet next week and most of them are expected to cut rates. But the continued strength of the Chinese economy and a trade deal which might be just around the corner could change things quite a bit



Source: Shutterstock

Five central banks meet - and most may ease

The central banks of Australia, New Zealand, Malaysia, the Philippines, and Thailand are set to meet next week and we think the economic fundamentals of these countries argue for easing. Better now than later for some economies, here is why we think they should cut rates:

- **The Reserve Bank of Australia's** minutes from the policy meeting in April confirmed a shift in the policy stance from neutral to easing. Released subsequently, a sharp slowdown in consumer price inflation to 1.3% in 1Q19 [tipped us to forecast a rate cut in the current quarter](#). A cut just days ahead of the Federal elections scheduled on 18 May would still be a controversial decision for RBA policymakers, but any more signals of easing will be enough to strengthen the consensus for a cut at the June meeting.
- **The Reserve Bank of New Zealand** shares the same economic backdrop as its Australian counterpart and is expected to follow the same policy path. Inflation continues to grind lower with weak jobs growth possibly keeping it firmly on that path going forward, while the headwinds to growth remain strong.
- **The Bank Negara Malaysia** has [plenty of room to ease](#) at the next meeting. Inflation turned positive in March after two months of being negative, but it's still negligible (0.2%), and this strengthens the case for a central bank cut to shore up future growth.
- **The Bangko Sentral ng Pilipinas** can justify a policy easing on the grounds of [rapidly falling inflation](#). Philippine's central bank easing options include either a rate cut, the banks' reserve requirement rate (RRR) cut, or both. The April CPI numbers come a few days before the central bank meets on 9 May and will be a crucial input for policymakers, followed by 1Q19 GDP on the same data as the policy meeting. Our estimate has GDP growth slipping to a four-year low of 5.9% from 6.3% in 4Q18.
- **The Bank of Thailand's** meeting will be a non-event again. The central bank's sustained hawkish tone prevents us from expecting a rate cut this year, even as the argument for easing is just as strong as it is for its Asian peers with [growth starting to taper off](#) and inflation being no hurdle.

US and China closing on a trade deal

According to [media reports](#), one last round of negotiations between the US and China could pave the way for a deal (or no deal) as early as next week. Going by the increasingly positive rhetoric from US negotiators, and President Trump himself, a deal is more likely than not, even as the US maintains the threat of pulling out any time.

Anyway, a deal may lift a key overhang on global markets, but not necessarily on the global economy. Even if there is a deal, the complete roll-back of US tariffs on \$250bn of Chinese products will take a while or, it may not happen at all. Moreover, the US administration's trade war is no longer limited to China only as tensions with the other significant trading partners including the EU and Japan simmer in the background. Hence disruption to the real economy from the protectionist sentiment is likely to be an ongoing concern.

What's good for China is good for Asia

Good news for Asia is that the region's engine of growth – the Chinese economy – continues to steam up. Despite the trade dispute, China's exports growth has been positive, while most other economies in the region have been posting export declines this year.

China's April economic data flow starting next week will be closely watched for what it says about GDP growth in the current quarter. Released earlier this week, China's purchasing manager indexes (PMIs) for April remained in the expansion zone (above 50 reading), albeit with some moderation. However, falling export orders component of the manufacturing PMI suggests to us that the authorities should [maintain a stimulatory macroeconomic policy](#) setting for now.

Trade, inflation, and GDP releases from the rest of the region crowd the calendar. Indonesia's GDP growth in 1Q19 may have received some boost from election spending and just like Korea, the electronics-led slowdown has a firm grip on exports in Taiwan and the Philippines.

Asia Economic Calendar

Country	Time*	Data/event	ING	Survey	Prev.
Monday 6 May					
India	0600	Apr Nikkei Services PMI	-	-	52.0
Hong Kong	0130	Apr Nikkei PMI	-	-	48.0
Indonesia	-	1Q GDP (YoY%)	5.3	5.2	5.2
Tuesday 7 May					
China	-	Apr Forex Reserves (US\$bn)	3104.5	-	3098.8
Hong Kong	-	Apr Forex Reserves (US\$bn)	-	-	437.9
Korea	2300	Mar Current A/c Balance (US\$bn)	5.8	-	3.6
Malaysia	0800	Overnight Policy Rate	3.00	-	3.25
	0800	Apr Forex Reserves (US\$bn)	-	-	103.5
Philippines	0200	Apr CPI (YoY%)	2.9	-	3.3
	-	Apr Forex Reserves (US\$bn)	-	-	83613.2
Taiwan	0900	Apr CPI (YoY%)	0.6	-	0.6
	0900	Apr WPI (YoY%)	1.7	-	1.2
	0900	Apr Exports (YoY%)	-7.5	-	-4.4
	0900	Apr Imports (YoY%)	6.6	-	6.6
	0900	Apr Trade Balance (US\$bn)	3.1	-	6.6
Wednesday 8 May					
China	-	Apr Trade Balance (US\$bn)	32.7	-	32.7
	-	Apr Exports (YoY%)	14.9	-	14.2
	-	Apr Imports (YoY%)	13.5	-	-7.6
Philippines	0200	Mar Exports (YoY%)	1.1	-	-0.9
	0200	Mar Imports (YoY%)	5.3	-	2.6
	0200	Mar Trade Balance (US\$mn)	-2613.0	-	-2790.0
Thailand	0805	Benchmark Interest Rate	1.75	1.75	1.75
Thursday 9 May					
China	0230	Apr CPI (YoY%)	2.8	-	2.3
	0230	Apr PPI (YoY%)	0.6	-	0.4
Philippines	0300	1Q GDP (YoY%)	5.9	-	6.3
	0900	Overnight Borrowing Rate	4.5	4.5	4.75
Friday 10 May					
China	-	Apr Aggregate Finance (Yuan bn)	2104.5	-	2860.0
	-	Apr Financial Institution Loans (Yuan bn)	1900.0	-	1690.0
	-	Apr Money Supply (M2) (YoY%)	8.6	-	8.6
India	1300	Mar Industrial Production (YoY%)	1.8	-	0.1
Malaysia	0500	Mar Industrial Production (YoY%)	2.4	-	1.7
Singapore	0600	Mar Retail Sales Value (MoM, SA/YoY%)	-/-	-/-	-1.5/-10.0

Source: ING, Bloomberg, *GMT

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebvre
Economist
alissa.lefebvre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

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

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

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

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

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

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

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

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Federal Reserve: Keeping the balance

While financial markets continue to price in rate cuts, the Federal Reserve is maintaining a cautiously upbeat tone that to us signals stable monetary policy through 2019



Source: Federal Reserve

There were no real surprises from the Federal Reserve with the target range for the federal funds rate left at 2.25-2.5%. The vote was unanimous with the press release again emphasising the FOMC's willingness to be "patient" on policymaking despite President Trump's ongoing demands for an immediate rate cut.

The general tone was upbeat and it certainly didn't signal an inclination to cut policy interest rates anytime soon. Both the growth and the rate of jobs growth is described as "solid" – which is a slight upgrade on the March FOMC statement when they commented that the economy had "slowed from its solid rate". The Fed acknowledged that inflation is running below target, but mitigated this by stating inflation expectations "are little changed".

The Fed did announce a technical change to the interest rate paid on required and excess reserve balances, lowering it by 5 basis points to 2.35%. This is characterised as a way of helping to keep the effective fed funds rate within the target range since it has been pushing up towards the ceiling due to the Fed's balance sheet changes. It should not be construed in any way as a form of policy easing.

For now, though the market is of the mindset that inflation will remain low, growth will slow and the Fed will need to respond by cutting interest rates later this year.

In terms of our view on the outlook for monetary policy, GDP growth will certainly slow with an

inventory run down and a rebound in imports acting as a drag over the next couple of quarters. However, a robust jobs market and firm confidence readings can help partially offset the fading support from the fiscal stimulus. Improving financial conditions – lower borrowing costs, rising equities, a stable dollar – should also support growth. We still expect the economy to expand 2.5% this year.

As for inflation, we think the market is being a little too relaxed regarding the prospect of a pick-up. Rising labour costs in the form of both wages and other benefits could be passed onto consumers while higher energy price will feed through into other components. Gasoline prices have jumped 30% from \$2.23/gallon in mid-January to \$2.88 today and this will soon start to be felt in transport fares and distribution costs.

Given the decent growth story, the improvement in financial conditions and the prospect of rising inflation we see little reason for the Federal Reserve to cut interest rates.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Why sharp yuan appreciation or depreciation is unlikely in 2019

Since the central government described the Chinese yuan as a 'stable' currency, we have seen some structural changes in the movements of USD/CNY. This is why we're revising our forecasts of USD/CNY and USD/CNH



Source: Shutterstock

The 'two sessions' structurally changed yuan movements

After the 'two sessions' in March, the USD/CNY and USD/CNH have traded in narrow ranges as yuan stability is one of the big focuses of the Chinese government. And now, it is beginning to look clearer that yuan stability means the central bank manages the yuan movements in a narrow range.

Onshore yuan depreciated 0.2% against the dollar in March, and so far has dropped 0.3% in April (until 29/4/2019). These narrow range bounds are very different from the movements observed in the first two months of 2019 when the yuan appreciated 2.45% against the dollar.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and

1.16% year to date appreciation

It's important to note that not only has the range narrowed, but the direction has also changed from yuan appreciation to yuan depreciation.

We believe the change in direction, albeit small in substance, is a way for China to show that its yuan policy is independent from the influence of other countries. We think this is a snub to the Trump administration who said that the yuan cannot depreciate if there is a US-China trade deal.

Where is the yuan headed after a trade deal is finalised?

Even though we have few clues about when a trade deal between the US and China will be signed, we need to think about the path of the yuan when it eventually is. We think the narrow range bound may not change even after there is a deal.

China will probably want market stability at the beginning of the trade deal, and not add more uncertainty when both sides begin with the implementation. Moreover, we don't think the execution of the trade deal will be smooth, also noting that the US is pressurising its allies to refrain from using China's 5G equipment.

We don't think a sharp yuan appreciation or depreciation is likely for the political environment in 2019

We're ruling out a sharp yuan appreciation because we believe that will be interpreted as appeasing the US, which is probably politically incorrect from Beijing's point of view and we think a substantial yuan depreciation would only be possible if China wants to pick a fight with the US, at the cost of increasing market concern about capital flight from the country and this seems highly unlikely.

So, neither a sharp yuan appreciation nor depreciation is likely for the political environment in 2019.

Revising USD/CNY and USD/CNH forecasts

At the time of writing this article, USD/CNY spot was near 6.73 and has depreciated from 6.71 since the end of 1Q19.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and 1.16% year to date appreciation, respectively. Our previous forecasts for 2Q and 3Q were 6.85.

We maintain our 4Q19 forecast at 6.75, which suggests the yuan is going to appreciate by 2.62% in 2019.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

In Charts: 5 reasons why we're still medium-term EUR/USD bulls

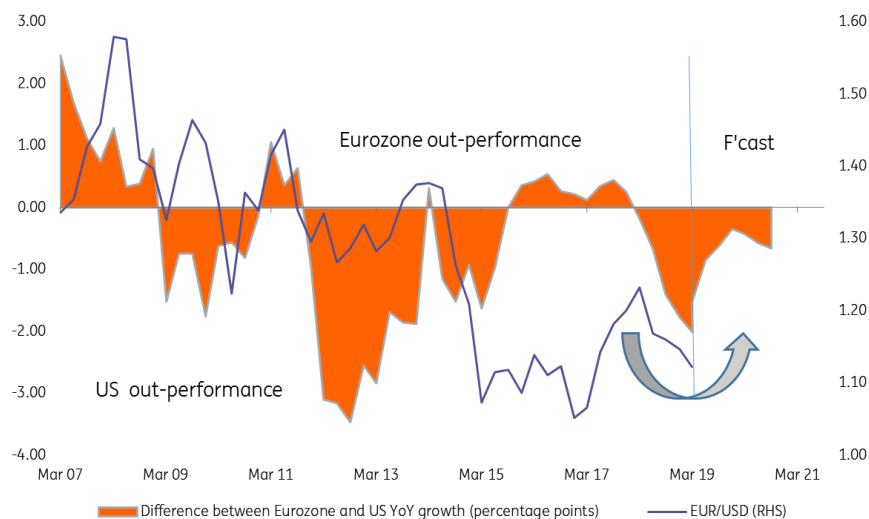
The recent fall below 1.12 has raised fears about another major leg lower in EUR/USD. We'd already penned a move to 1.10 in our profile for 2Q19 and we do acknowledge that the case for a rebound later this year has become a little harder. However, we think there are still 5 good reasons why EUR/USD will turn higher to 1.20 next year

ING's updated EUR/USD forecasts

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
EUR/USD	1.12	1.10	1.12	1.15	1.16	1.17	1.18	1.20	1.21	1.22	1.23	1.25
Prior*	1.12	1.10	1.12	1.18	1.20	1.22	1.23	1.25	1.26	1.27	1.28	1.30

Source: ING, *Prior forecasts as per Monthly Economic Update, 5th April 2019

Peak growth differential



Source: ING, Bloomberg

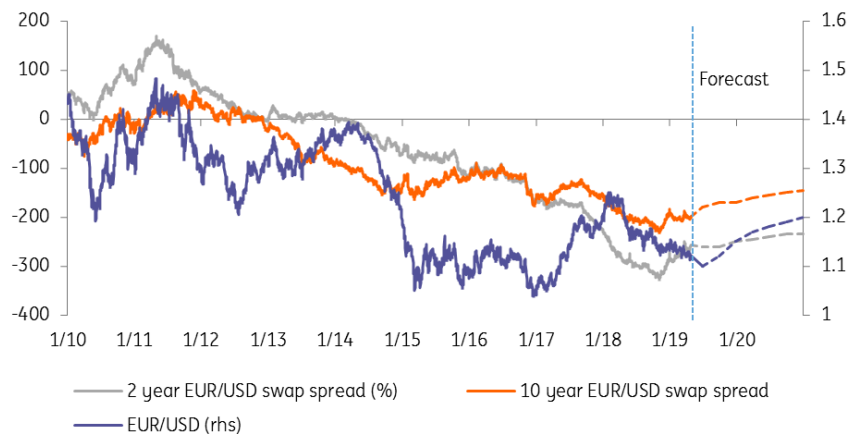
Peak Economic Divergence

Looking at year-on-year growth rates, 1Q19 saw the US outperform the Eurozone by 2%. That outperformance was driven by the contribution of inventories and trade, the positive effects of which should fade through 2019. From 3.2% YoY in 1Q19, our US team expect the growth rate to

slow below 2% into early 2020.

While nowhere near the 2.5% levels seen in 2017, our Eurozone team see growth staying in the 1.1-1.5% YoY area over the next 6-8 quarters. The narrative of US macro outperformance should therefore fade. This should have important implications for international equity flows and EUR/USD, where overweight US, underweight Europe positions were a core theme through 2018.

Peak interest rate differentials



Source: Bloomberg, ING

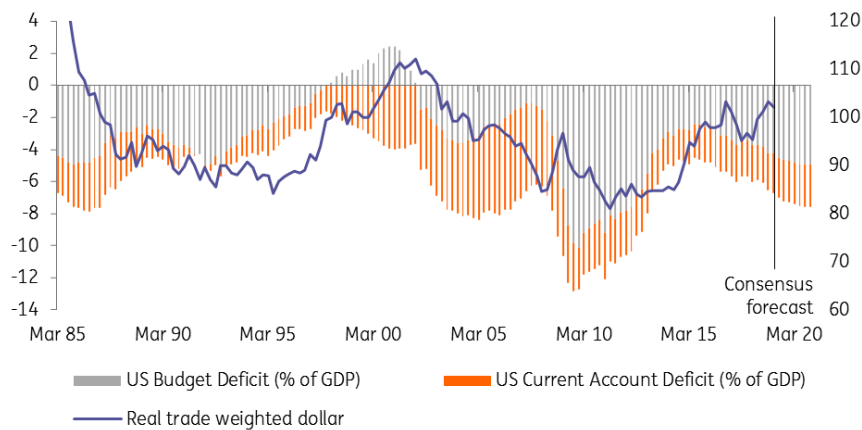
Peak Interest Rate differentials

Rate differentials have not had much say in determining EUR/USD pricing over recent months – a prime example being the dollar holding up very well despite the collapse in US interest rates in December). Unless the European Central Bank cuts the -0.40% deposit rate (not our call), it is hard to see Eurozone market interest rates going much lower.

The change in rate differentials should therefore largely be a US story. Our macro and rates strategy team expect US market interest rates (both at the short and long end of the curve) to continue to drift lower over coming quarters as the US business cycle matures – for reference June 2019 will mark the tenth year of the US expansion.

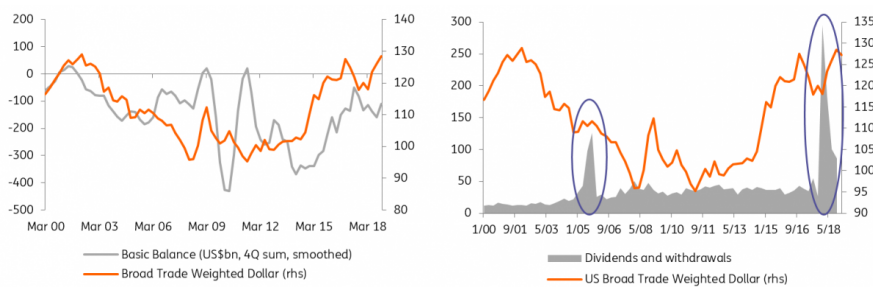
We happen to think that [interest rates at the short end of the curve are really important for FX markets right now](#). These have created exceptionally high USD hedging costs (now 3% for EUR and JPY-based investors) and these rates may only start to ease when it becomes clear the Fed is ready to ease – thus this may not be a story until 2020. Nonetheless, we don't expect rate spreads to move any wider and the multi-quarter direction of travel should be narrower.

US twin deficits still need funding.....



Source: Bloomberg, ING

... and the repatriation effects of overseas income look set to fade



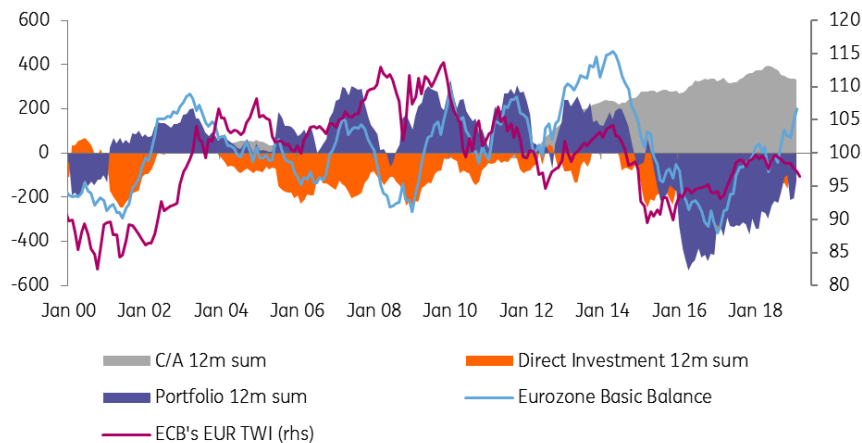
Source: Bloomberg, ING/US BEA, Bloomberg

US deficits still need funding...

It's certainly a medium-term issue, but there's no getting away from the overhang that US twin deficits have edged wider and are expected to deteriorate further over coming years. Consensus expects the US budget deficit to push close to 5% of GDP into 2020, with the current account deficit heading towards 3%.

Superior growth and interest rates have allowed the US to fund those deficits. As above, that US macro superiority looks set to dwindle. Additionally, the US received temporary funding of its current account deficit last year from the 2017 Tax Cut and Jobs Act. This prompted US companies to pay US\$500bn more in dividends than a year earlier – ie, repatriating funds from overseas to distribute as dividends in the US. Data from the Bureau of Economic Analysis (BEA) shows that this dividend activity peaked in 1Q18 and was tailing off by the final quarter of 2018. We doubt this factor will help the US Balance of Payments any more.

Eurozone Balance of Payments



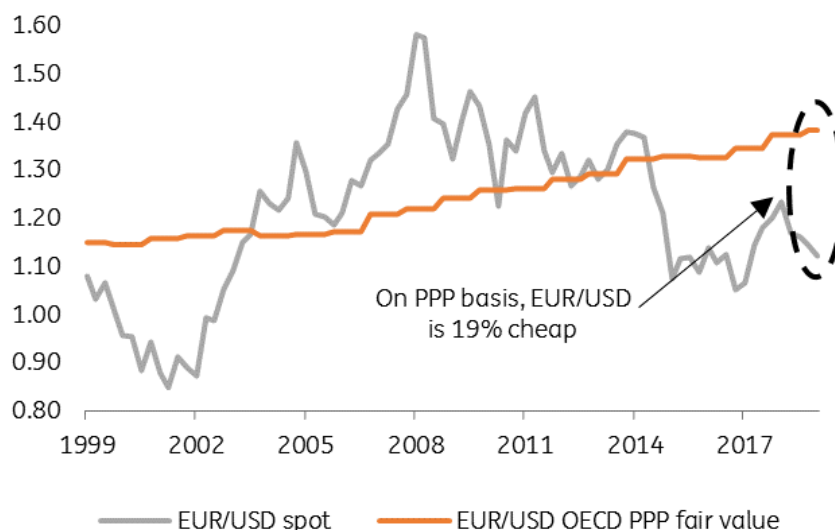
Source: Bloomberg, ING

Eurozone Balance of Payments actually look constructive

The EUR has failed to derive much benefit at all from its near 3% current account surplus, largely because rock-bottom Eurozone interest rates have encouraged high FX hedge ratios on Euro area investments.

But quietly, behind the scenes, the Eurozone BoP position has been improving markedly. The ECB's crowding out (into foreign bond markets) of European investors has slowed dramatically, meaning that the Basic Balance (Current Account + Direct Investment + Portfolio Flows) is now more Euro supportive. This is a compelling story for Euro bulls, but needs a catalyst from either a re-rating of Europe, or (more likely) a US slowdown.

EUR/USD looks cheap on a long-term basis



Source: Bloomberg, ING

Author

Chris Turner

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

chris.turner@ing.com

Watch: Some European regions may never recover

The financial crisis had a long-lasting and deep effect on economic activity and on employment in Europe, with some regions still struggling to see any improvement ten years on. ING's Bert Colijn explains whether these areas face another lost decade of employment growth. Our full report is here



Divided Europe: Why some regions will never recover

[Watch video](#)

Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Breaking the money illusion

The cost of inflation is often misunderstood or ignored, with significant implications for consumer spending and economic behaviour on a wider scale



In the three months to February, the average weekly earnings of UK employees (including bonuses) increased by 3.5%, according to the latest [report](#) from the Office for National Statistics. This may sound good, but when the figures are adjusted for inflation, the percentage drops to just 1.6%, giving consumers considerably less purchasing power than the headline figure might suggest.

Changes in 'real' terms, which account for the impact of inflation, are key to understanding the true value of money. Yet [research has shown](#) that many people think only in 'nominal' terms, with little consideration for what the face value of money is really worth and can actually buy. Indeed, experiments have demonstrated that people often choose a higher nominal pay hike over a lower real hike, even though the real increase would make them better off.

This so-called '[money illusion](#)' - a term popularised by the economist John Maynard Keynes - can have significant implications for consumer spending and economic behaviour on a wider scale. It can also affect the way we think about the value of money in the future, including our pension plans and returns on investments.

Looking at real returns

Since the global financial crisis, inflation fell sharply as the economic slump and rising unemployment meant shops and business could not raise prices. At the same time, central banks cut interest rates close to zero to stimulate the economy.

As banks follow the central bank when setting their own interest rates, savers received virtually no interest on their accounts. UK inflation has since risen- at 1.9% in March- while rates have remained below 1% for a decade, meaning that anyone relying on their savings for income has become worse off.

This analysis applies to investments such as bonds, shares, property and gold, all of which will have a return measured in nominal terms and one measured in real terms.

Fixed income assets such as government bonds (gilts) pay the same level of interest whether inflation is rising or falling. If inflation rises, the value of both the interest payments and of the money invested in the bond will fall in real terms.

The impact of inflation on stock prices is a little more complicated. Inflation reduces the net present value of a company's expected cash flows, suggesting that stock prices should fall as a result. At the same time, however, rising prices suggest that those future cash flows will be higher because companies are able to make bigger profits. In theory, these two forces should cancel each other out. In practice, markets often recoil at signs of inflation for fear the economy is overheating and interest rates will go up.

Economic reality

Accounting for inflation is also important when analysing economic growth. Statisticians calculate the total value of the output of an economy every year. In 2018, the nominal size of the UK economy was £2.12 trillion, up by 3.4% on the £2.05 trillion for 2017. However, growth in real terms was just 1.4% [in 2018](#) (£2.01 trillion to £2.03 trillion).

The concept isn't just important economically. It can also be a political issue, with governments choosing to focus on the measure that best suits them. When a country is in the grip of inflation, its growth rate can look huge in nominal terms though this figure is largely meaningless to consumers who may be struggling to buy basic goods.

Another danger comes from underreporting inflation, which makes the headline figure of growth in real terms look higher than it actually is. For example, [Argentina](#) was forced to revise the way it produced inflation figures after it was exposed for underreporting soaring inflation over the previous decade to make growth figures look better.

In the run-up to the 2015 presidential election, the government's statistics office reported inflation at 15% compared to estimates from private economists at 27.9%, one of the highest rates in the world. [Critics](#) said the government was trying to mask Argentina's major economic problem for political reasons. Consumers at the time said the official inflation figures did not jibe with the price rises they were experiencing personally. There was also [evidence](#) that investors were moving money abroad to stop their money from being eaten up by inflation.

The bottom line is that being able to look through the nominal figures and focus on what is

left after inflation will leave investors, employees and shoppers better able to understand what is happening to the value of their money.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

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

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com

Food manufacturers turn to robots to meet consumer needs

The importance of technology for food manufacturers continues to grow, according to our report, 'Food tech: technology in the food industry'

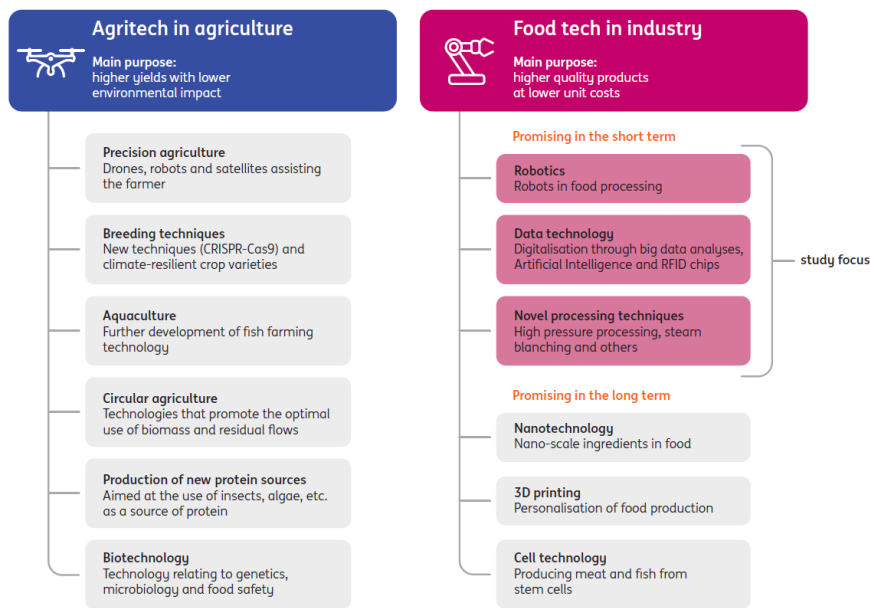


Source: iStock

Promising technologies for the food industry

Growing demands from customers, consumers and society raise the bar for food manufacturers and are having an impact on the uptake of technologies within the food industry. Retailers require larger volumes of food at low prices while pressures from consumers and society call for more measures to be taken for health and sustainability purposes. These demands are driving the need for the implementation of new technologies, such as robotisation and digitalisation, to help food producers increase productivity and improve production standards. Besides these key technologies, food manufacturers are also closely involved with the development of new technologies in agriculture as these help them to secure a high-quality and reliable supply of 'raw materials'.

Promising technologies within food & agriculture



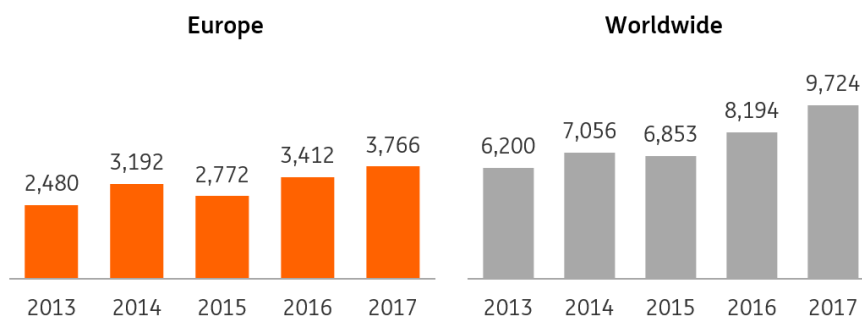
Source: ING

Robotics is becoming more commonplace

Robots are increasingly used within food production since innovations in image recognition technology and gripper technology have enabled robots to see and feel. This allows them to handle delicate and diverse food products and function in challenging environments, including heat, moisture and cold. At the same time, less human interference also reduces the risk of contamination, helping producers comply with strict food safety requirements. In Europe, robot sales to the food industry increased with 50% over the last five years.

Robot sales to the food industry are increasing

New robots sold to the food and beverage industry, per year



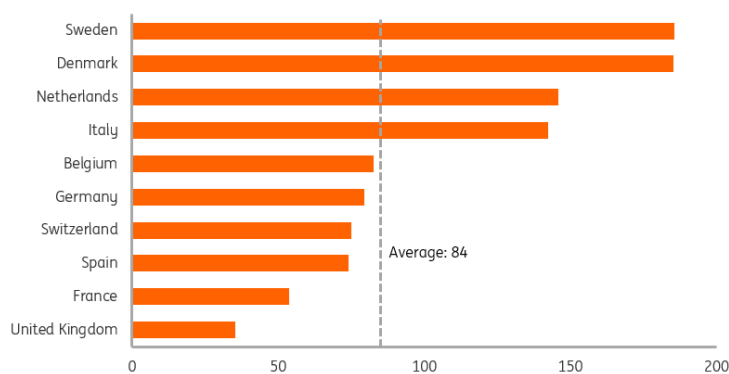
Source: International Federation of robotics (IFR)

High labour costs are a driver for robotisation in Europe

European food manufacturers account for almost half of the current worldwide robot stock in the food industry. The level of robotisation in the industry varies significantly between countries. Robot density, the number of robots per 10,000 employees, is especially high in Sweden and Denmark. These countries have relatively high labour costs, just like runner-ups including The Netherlands and Italy, increasing the need to automate manual labour.

Nordic countries have highest robot density in food & beverage industry

Robot stock in food & beverage industry per 10.000 employees



Source: International Federation of Robotics, Eurostat, calculations ING Economics Department

Food supply chain is getting digital

Besides the growing deployment of robots, food manufacturers increasingly turn to data technology. Applications in food production range from Artificial Intelligence software that improves the capacity use of production lines to digital field logs that help predict supply from farms and lead to a better match between supply and demand. The digitalisation of food supply chains is also used to create transparency from farm to fork, enabling consumers to trace the origin of an increasing number of food and beverage items in their shopping baskets.

Tech investment and human capital investment: Two sides of the same coin

For all opportunities robotisation and digitalisation bring to the food industry, increasing the complexity of production processes will also have its impact on the labour market. Labour productivity is set to increase further as employees will have more sophisticated machines and data tools at their disposal. Some jobs will disappear, others will change and new jobs will be created. As the skillset of employees within the food industry changes, investment in technology should go hand in hand with investment in human capital.

Author

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

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Divided Europe: As some regions thrive, others may never recover

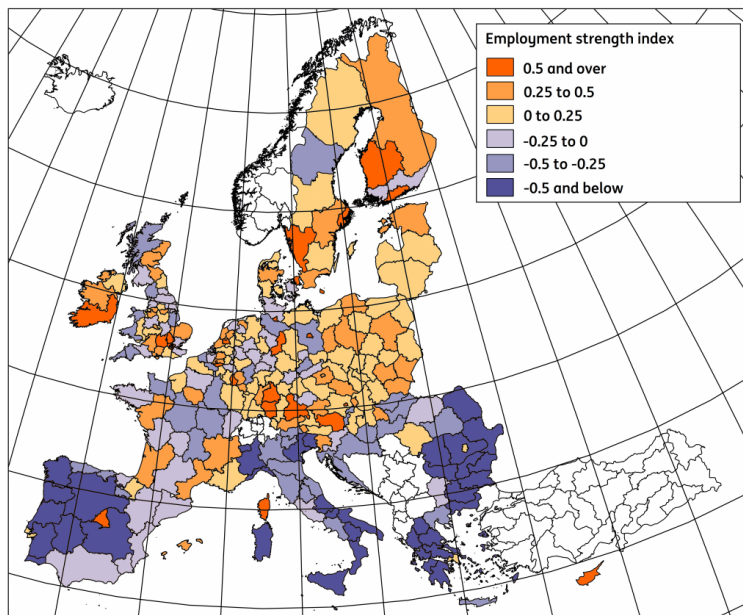
More than 10 years on from the financial crisis, regional labour markets across Europe continue to feel the impact. Will the next decade be any different?



Deep impact

In September 2008, the bankruptcy of Lehman Brothers marked the low point of the financial crisis. Ten years on, the European economy has recovered, but the scars of the crisis are still visible at a regional level. While employment – measured as employed persons – for the European Union is now 2% above the 2008 peak, this is not the case for many local economies. The crisis has had a long-lasting and deep effect on economic activity and on employment, and many regions have only recently begun to recover. The chart below highlights this stark regional divide.

The Employment Strength Index



Source: ING research

Another lost decade

Some regions have not even shown signs of bottoming out, with employment still in decline. Take the German regions Sachsen-Anhalt and Thüringen, for example, which have seen employment decline steadily over the past decade despite the German Wirtschaftswunder. The strong growth in German employment has not lifted the tide in these regions, indicating the persistence of regional differences. In Italy, strong growth in the northern regions and around Rome masks dismal job creation since the start of the crisis in the southern regions. This begs the question, what differentiates the winners from the losers and will the next decade be any different?

We find that:

Deep scars caused by the crisis are still impacting regional labour markets across Europe. Many regions are still recovering, with the unemployment rate still above the natural rate, according to our estimates.

Structural strength or weakness seems to be driven in part by the region's digital infrastructure, the vulnerability to globalisation, the innovative capacity of the region and the residents' level of education.

A large divide between urbanised and younger regions and rural and ageing regions, with the latter in general performing much more poorly. This confirms the view of a split in society between areas that are vulnerable to population outflow and ones with prolonged high structural unemployment and those which are more vibrant and generally profit from large societal trends.

When looking at the current state of those structural drivers, the strongest regions are large

metropolitan centers, which seem set up for continued strength in the years ahead.

We also find that there are several regions across Europe – mainly in the southern outer ring of the European Union – which are likely to remain weak in the years to come. As such, investment in infrastructure and intellectual capacity in these regions will be key. Structural improvements at the national level will also be needed, with a large concentration of the weakest regions in a few, mainly Southern European countries. Without this, these areas could face another lost decade of employment growth.

More redistribution at the European level seems unlikely given the political environment at the moment. With stagnation a possibility for many regions, the appetite for the populist vote, from an economic perspective, at least, could increase.

[Read our report in full here.](#)

Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

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