ING Monthly

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Reasons to be cheerful, Part 3

Jerome Powell, Chairman of the US Federal Reserve

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Reasons to be cheerful, Part 3

The weather may be grim, much of the international news is grimmer still. But whisper it! We are daring to believe that there's some economic optimism, finally, in the air

Some of you may remember the Ian Dury classic Reasons to be Cheerful, Part 3 from the 70s. He lists a few small things that made him smile. And, for the first time in a long time, we're tapping our feet to a slightly different beat. For quite some time, we've been warning about premature optimism. While we're still not exactly jumping up and down with unabated glee, we are revising our US growth forecasts upwards. We're also seeing tentative signs of a bottoming out of the eurozone economy. And seeing as beggars can't be choosers, we're holding on to those very tentative signs of hope.

So, to Part One: The US economy has simply not stopped surprising us with its unexpected resilience. It still looks like a small economic miracle - or conundrum - that the surge of the entire spectrum of lending interest rates has hardly affected the real economy, at least not yet. We're throwing the recession towel in the ring and believe that the US consumer will currently rather tap his or her savings than reducing spending.

In Part Two, the more structural shift of investments also seems to be supporting the US economy. It appears to be the result of the Inflation Reduction Act and the AI hype creating a goldrush with apparently almost everyone buying several shovels. Instead of recession fears, the term 'Goldilocks' has appeared more often in recent weeks.

To be clear, there are still enough risks out there. Just think of the delayed impact of monetary policy tightening and potential financial stability woes as currently illustrated by recent renewed fears in smaller US banks.

The eurozone is still stuck in stagnation and, as so often in the recent past with geopolitical conflicts, it is Europe that economically seems to be hit the most by the current military conflict in the Red Sea. Up to now, the impact on both inflation and growth will be tangible but small. However, further supply chain disruptions cannot be excluded.

So, reasons to be cheerful, Part 3: the increase in German industrial orders at the end of last year, as well as the plateauing of inventories, point to a bottoming out of the German industrial weakness. That's good news for the eurozone as well. It's not yet good enough to revise our growth profile upwards, but at least it's an encouraging sign that some sort of gradual improvement could start kicking in from the second quarter.

Has spring come early? With more optimism regarding the growth outlook, we're becoming even more confident in our central bank calls of a first rate cut by the US Federal Reserve in May and by the European Central Bank in June. As long as both economies can avoid an unexpected sudden halt, inflation's not back to target and the risk of second round effects on wages isn't averted, major central banks will be more cautious starting a rate cut cycle than financial markets have still priced in.

Sometimes it is the small things that give hope and pleasure. There are still too many risks out there, economic and geopolitical, to become overly enthusiastic but after months of downward revisions, let's cherish the moment: some tentative optimism is back.

Watch: Reasons to be cheerful on the global economy

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Our key calls this month:

United States: Strong GDP and jobs growth shows that the US economy continues to shrug off high borrowing costs and tight credit conditions, largely through robust government spending and consumers running down their savings. These factors will be less supportive in 2024 and inflation is on the path to 2%, so the Federal Reserve has the room to cut interest rates sharply. We still expect the Fed to start cutting rates in May.

Eurozone: The eurozone escaped a technical recession and a number of indicators suggest the economy is now bottoming out. While the recovery is likely to be weak, it is still too soon to give the all-clear on inflation. The European Central Bank is expected to cut rates from June onwards, but more cautiously than the market is currently anticipating. Up until now, the ECB's aggressive hiking cycle has been taken well by southern countries of the eurozone. But rapidly declining borrowing indicates that this is set to turn.

United Kingdom: A less dramatic mortgage squeeze and the likelihood of tax cuts means we should expect modest growth in the UK this year. Inflation is set to fall below 2% in April, while nominal earnings growth is set to slow much less rapidly. Admittedly, we shouldn't get too overexcited about the outlook. The jobs market is cooling, though for now not rapidly, while savings in real terms are below the pre-Covid trend. Still, we think we should expect modest growth this year, and the chances of a near-term recession (i.e. not just a technical one) have faded.

China: Despite reaching its growth target for 2023, sentiment remains downbeat heading into the Lunar New Year. And that's raising expectations for more policy support. In terms of economic targets, we feel it is unlikely we will see major movements in targets and we expect a growth target of "around 5%" for 2024. The fiscal deficit to GDP target is worth watching as a potential signal for stronger fiscal policy support this year. We expect this target to be lifted from 3% to 3.5% of GDP in 2024, though an unchanged target does not preclude the government from more stimulus as it may use special bonds to finance necessary projects.

Central and Eastern Europe (CEE): While inflation in the region has made great progress, it's still not enough for central banks. But cutting rates is complicated, and the picture is not entirely clear. Economies should begin to recover, although the external picture is not entirely supportive. In Poland, investors are betting on the MPC resuming the easing cycle alongside the new projections. Recent MPC comments indicate the easing is unlikely to happen quite so soon. For the February meeting in the Czech Republic, we expect the cutting pace to accelerate to 50bp thanks to the CNB's new forecast, which should confirm our positive view on inflation.

Rates: The brief banking panic is behind us – at least until we get the next one. In front of us is a Fed on a holding pattern, and a May cut is now being questioned. As the Fed strip nudges higher, so too does the US 10yr yield. The 4.25% to 4.5% area is one where it will dawn on the market that it's gone too far. But for now, there is little to object to having that test. Eurozone rates reflect a lot of the same pushes and pulls. The nuance is that eurozone rates are already quite low.

FX: It has been a relatively quiet start to the year in FX markets. Doubts about the timing and speed of central banking easing cycles have contributed to lower levels of volatility and a search for yield. Assuming the Fed is preparing to cut rates in May/June, the bullish steepening of the US curve should be positive for most activity currencies – including the euro. We still forecast EUR/USD ending the second quarter somewhere near 1.10 and ending the year at 1.15. The year-end consensus forecast for EUR/USD is 1.12.

ING global forecasts

	2023					2024					2025				
	1Q23	2Q23F	3Q23F	4Q23F	2023F	1Q24F	2Q24F	3Q24F	4Q24F	2024F	1Q25F	2Q25F	3Q25F	4Q25F	2025F
United States															
GDP (% QoQ, ann)	2.2	2.1	4.9	3.3	2.5	1.9	0.7	-0.7	0.8	1.9	1.5	1.8	2.3	2.5	1.3
CPI headline (% YoY)	5.8	4.1	3.6	3.2	4.2	2.9	2.6	2.0	1.8	2.4	1.7	1.9	2.1	2.3	2.0
Federal funds (%, eop)	5.00	5.25	5.50	5.50	5.50	5.50	5.00	4.50	4.00	4.00	3.50	3.00	3.00	3.00	3.00
3-month interest rate (%, eop)	4.90	5.20	5.40	5.40	5.40	5.40	4.90	4.40	3.90	3.90	3.50	3.00	3.00	3.00	3.00
10-year interest rate (%, eop)	3.50	3.80	4.25	3.90	3.90	4.00	3.50	3.50	3.50	3.50	3.75	4.00	4.00	4.00	4.00
Fiscal balance (% of GDP)					-6.1					-6.1					-5.8
Gross public debt / GDP					98.4					100.4					103.0
Eurozone															
GDP (% QoQ, ann)	0.4	0.5	-0.5	0.1	0.5	0.3	0.5	1.2	1.1	0.4	1.6	1.6	1.4	1.4	1.4
CPI headline (% YoY)	8.0	6.2	4.9	2.7	5.5	2.8	2.8	2.4	2.1	2.5	2.0	2.1	2.1	2.2	2.2
Refi minimum bid rate (%, eop)	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	3.75	3.75	3.50	3.25	3.00	3.00	3.00
3-month interest rate (%, eop)	3.00	3.60	3.95	3.95	3.95	3.90	3.65	3.40	3.10	3.10	2.90	2.75	2.50	2.60	2.60
10-year interest rate (%, eop)	2.30	2.40	2.80	2.00	2.50	2.20	2.10	2.10	2.30	2.30	2.30	2.40	2.50	2.50	2.50
Fiscal balance (% of GDP)					-3.1					-2.8					-2.6
Gross public debt/GDP					91.2					89.3					89.2
Japan															
GDP (% QoQ, ann)	5	3.6	-2.9	1.2	2.0	1.6	2.4	2.4	1.2	1.3	1.2	1.2	0.8	0.8	1.4
CPI headline (% YoY)	3.6	3.4	3.1	2.9	3.3	2.3	2.2	1.8	1.4	2.0	1.9	1.6	1.5	1.3	1.5
Interest rate on excess reserves (%)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25
3-month interest rate (%, eop)	0.00	0.05	0.08	0.08	0.08	0.08	0.15	0.15	0.20	0.20	0.30	0.30	0.40	0.40	0.40
10-year interest rate (%, eop)	0.35	0.40	0.70	0.60	0.60	0.70	0.80	1.25	1.00	1.00	1.00	1.00	1.25	1.25	1.25
Fiscal balance (% of GDP)					-8.0					-12.0					-12.0
Gross public debt/GDP					265.0					280.0					290.0
China															
GDP (% YoY)	4.5	6.3	4.9	5.2	5.2	4	5.5	4.8	4.9	4.8	4.8	4.3	4.1	4.20	4.3
CPI headline (% YoY)	1.3	0.1	-0.1	-0.3	0.2	0.3	0.4	0.9	1.9	0.9	2.1	2.3	2.0	1.6	2.0
PBOC 7-day reverse repo rate (% eop)	3.65	3.55	3.45	3.45	3.45	3.35	3.35	3.25	3.15	3.15	3.05	3.05	3.05	3.05	3.05
3M SHIBOR (% eop)	2.45	2.17	2.30	2.60	2.60	2.60	2.50	2.50	2.40	2.40	2.40	2.40	2.45	2.45	2.45
10-year T-bond yield (%, eop)	2.86	2.65	2.50	2.60	2.60	2.50	2.40	2.40	2.60	2.60	2.70	2.70	2.80	3.00	3.00
Fiscal balance (% of GDP)					-6.0					-5.0					-4.0
Public debt (% of GDP), incl. local govt.					131					132					129
UK															
GDP (% QoQ, ann)	1.3	0.8	-0.1	-0.3	0.5	0.4	0.8	1.2	1.2	0.5	1.3	1.3	1.3	1.3	1.3
CPI headline (% YoY)	10.2	8.4	6.7	4.2	7.4	3.8	1.7	1.7	2.0	2.3	1.7	1.9	2.1	2.1	1.9
BoE official bank rate (%, eop)	4.25	5.00	5.25	5.25	5.25	5.25	5.25	4.75	4.25	4.25	3.75	3.25	3.25	3.25	3.25
3-month interest rate (%, eop)	4.40	5.40	5.40	5.30	5.25	5.25	5.05	4.55	4.15	4.15	3.60	3.20	3.20	3.20	3.20
10-year interest rate (%, eop)	3.50	4.45	4.45	3.50	3.50	3.80	3.65	3.55	3.65	3.65	3.65	3.75	3.90	4.00	4.00
Fiscal balance (% of GDP)					4.1					2.9					2.4
Gross public debt/GDP					96.3					96.3					95.6
EUR/USD (eop)	1.08	1.08	1.06	1.10	1.10	1.08	1.10	1.12	1.15	1.15	1.15	1.14	1.13	1.12	1.12
USD/JPY (eop)	133	145	149	141	141	140	135	130	130	130	125	125	125	125	125
USD/CNY (eop)	6.87	7.24	7.30	7.15	7.10	7.20	7.14	7.05	7.00	7.00	6.90	6.85	6.80	6.80	6.80
EUR/GBP (eop)	0.88	0.87	0.87	0.87	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
ICE Brent -US$/bbl (average)	82	78	86	83	82	82	80	82	84	82	84	80	80	77	80
Dutch TTF - EUR/MWh (average)	53	35	34	43	41	29	25	25	35	29	35	27	24	30	29

Source: ING forecasts

Our main calls for the global economy

All of latest from our team on what could be on the cards for various economic outlooks and developments in markets across the globe

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We're daring to believe that there's some economic optimism, finally, in the air

United States

Strong GDP and jobs growth shows that the US economy continues to shrug off high borrowing costs and tight credit conditions, largely through robust government spending and consumers running down their savings. These factors will be less supportive in 2024 and inflation is on the path to 2%, so the Federal Reserve has the room to cut interest rates sharply. We still expect the Fed to start cutting rates in May.

James Knightley

Eurozone

The eurozone escaped a technical recession and a number of indicators suggest the economy is now bottoming out. While the recovery is likely to be weak, it is still too soon to give the all-clear on inflation. The European Central Bank is expected to cut rates from June onwards, but more cautiously than the market is currently anticipating. Up until now, the ECB's aggressive hiking cycle has been taken well by southern countries of the eurozone. But rapidly declining borrowing indicates that this is set to turn.

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United Kingdom

A less dramatic mortgage squeeze and the likelihood of tax cuts means we should expect modest growth in the UK this year. Inflation is set to fall below 2% in April, while nominal earnings growth is set to slow much less rapidly. Admittedly, we shouldn't get too overexcited about the outlook. The jobs market is cooling, though for now not rapidly, while savings in real terms are below the pre-Covid trend. Still, we think we should expect modest growth this year, and the chances of a near-term recession (i.e. not just a technical one) have faded.

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China

Despite reaching its growth target for 2023, sentiment remains downbeat heading into the Lunar New Year. And that's raising expectations for more policy support. In terms of economic targets, we feel it is unlikely we will see major movements in targets and we expect a growth target of “around 5%” for 2024. The fiscal deficit to GDP target is worth watching as a potential signal for stronger fiscal policy support this year. We expect this target to be lifted from 3% to 3.5% of GDP in 2024, though an unchanged target does not preclude the government from more stimulus as it may use special bonds to finance necessary projects.

Lynn Song

Rest of Asia

While China may be struggling, we believe there are more positive signs emerging throughout the rest of Asia. We see some glimmers of stronger export and production activity together with a more benign inflation backdrop and recovering domestic demand.

Robert Carnell

Central and Eastern Europe (CEE)

While inflation in the region has made great progress, it's still not enough for central banks. But cutting rates is complicated, and the picture is not entirely clear. Economies should begin to recover, although the external picture is not entirely supportive. In Poland, investors are betting on the MPC resuming the easing cycle alongside the new projections. Recent MPC comments indicate the easing is unlikely to happen quite so soon. For the February meeting in the Czech Republic, we expect the cutting pace to accelerate to 50bp thanks to the CNB's new forecast, which should confirm our positive view on inflation.

Frantisek Taborsky

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Padhraic Garvey

FX

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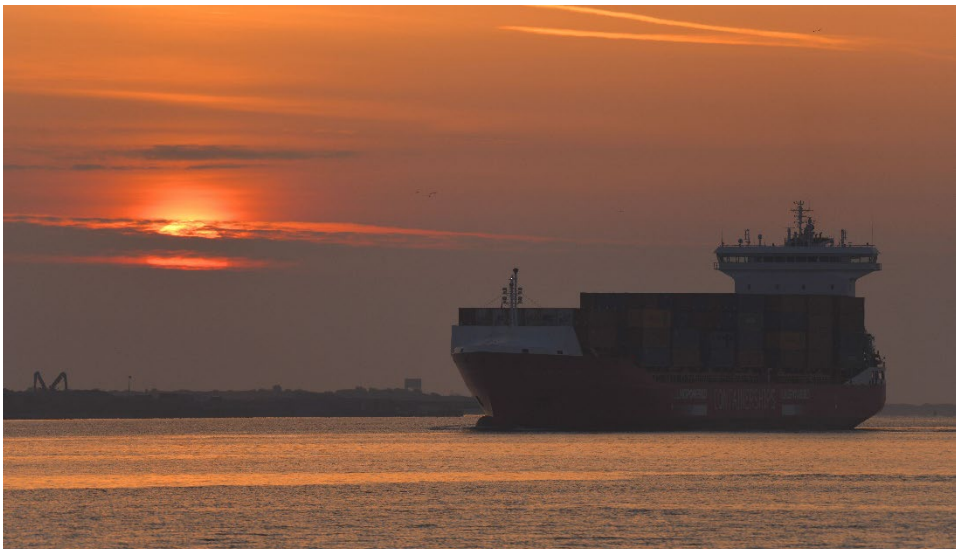
Red Sea crisis shouldn't spur inflation but the spillover to tankers is risky

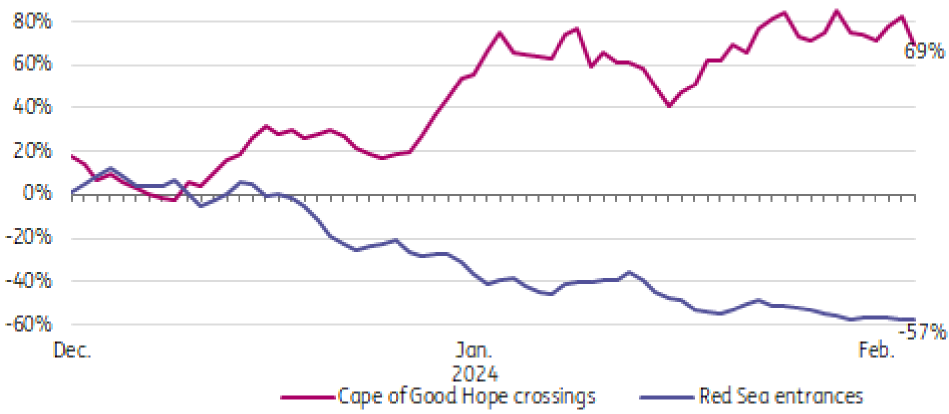
The Red Sea shipping crisis has dragged on for two months, and a full resumption of transits is not in sight. This is rattling supply chains, leading to delays and higher costs, but it won't derail global trade and the inflationary impact of higher container rates remains limited. The more critical tanker markets are now involved though and this adds to risks



We don't expect a far-reaching spillover effect to hit end-products or inflation for the time being

Number of vessels entering the Red Sea is still declining while Cape roundings have gone up

Number of vessels crossing Bab el Mandeb strait (Red Sea entrance) and passing Cape of Good Hope per day (rolling seven-day average)



Source: IMF Port Watch, ING Research

1 What is the current situation in the Red Sea and what about supply chains and trade?

More than 55% of vessels are avoiding the Red Sea, including an increased number of tankers

The Suez Canal route isn't blocked, as some think, but avoidance of the Red Sea still increased through January, despite efforts by the US-led Operation Prosperity Guardian. At the start of February, the weekly number of ships crossing the Bab el Mandeb strait dropped to 220, 55% lower than last year. This means that around 290 vessels have been re-routed around the Cape of Good Hope, carrying almost two-thirds of the shipped cargo. Over the course of January and following announcements from BP and Shell, the number of re-rerouted tankers mounted and increased by a similar amount.

Re-routing container trade is becoming the new normal and has been priced in

The risks are unlikely to disappear soon amid ongoing incidents, the war in Gaza and associated tensions in the Middle East. Several container liners have now included the Cape routing in their (next) sailing schemes, which suggests that this will be the new normal for now. The initial shock of re-routing was disruptive, but as things settle, the available overcapacity will be able to absorb the extra required vessels. And the still limited congestion indicates that it won't get much worse than this. Container spot rates, including surcharges, per twenty-foot equivalent unit from Shanghai to Rotterdam are still more than 3.5 times higher in early February compared to two months earlier but have stopped rising in recent weeks. After the Chinese New Year break (10-17 February) supply chains can start to recalibrate and rebalance in accordance with the new reality, although container rates will remain elevated for however long the re-routing lasts.

Production interruptions at manufacturers short lived – trade delayed than derailed

The re-routing, which started to gain traction before Christmas, has led to some quiet weeks at European ports at the start of the year. Tesla interrupted production at its German site for two weeks from the end of January and other automotive companies including Volvo, Suzuki and Michelin also ceased production at European locations for a short period due to shortages. According to the Kiel Trade Indicator, global trade fell by 1.3% month-on-month in December 2023 and the Red Sea delays are likely to weigh on the first quarter of the year as well, resulting in a minor negative impact on GDP. However, we do not expect current events to weigh heavily on global trade numbers this year. We feel comfortable sticking to our current goods trade forecast of 2.5% in 2024.

2 What is the impact on commodity markets?

Tankers increasingly re-routed – which leads to even longer miles and capacity depletion

In terms of commodity flows, oil markets appear most affected. Large volumes of both crude oil and refined product move through the Red Sea. EIA numbers show that around 9m bbl/d of oil and products moved through the region in the first half of last year. Tanker volumes have fallen significantly as attacks have escalated. According to IMF PortWatch, average daily tanker transit at the Bab el-Mandeb Strait was down around 48% year-on-year and the figure has fallen even further at the start of February. Northbound tanker flows towards Europe are most affected, which are now instead taking the longer route around the Cape of Good Hope. As for southbound cargoes, which move towards Asia, these flows have been less affected. However, following the recent attack on a tanker carrying Russian naphtha, there certainly is the potential for more southbound tankers to divert. Previously it was thought that Russian volumes would be able to move through the Red Sea largely unaffected. In addition, the impact is significant for oil product flows, with tonne-miles increasing most significantly for product tankers over the last two years. This also led to new highs in tanker earnings.

The ICE gasoil crack has strengthened from a little over US$22/bbl in early January to more than US$30/bbl by the end of January, suggesting tightness in middle distillates in the ARA region. Arrivals of middle distillates in Europe from Asia and the Middle East were down around 15% MoM in January, according to Refinitiv data. Jet fuel cracks in Europe have seen similar strength.

Nevertheless, we continue to hold our view that ICE Brent will average US$82/bbl over 2024, with a key assumption that the disruptions do not engulf larger parts of the Middle East.

3 What is the impact on inflation?

Higher shipping costs do have a transmission impact, but won't turn the course of inflation

A far-reaching spillover effect to end-products and inflation is unlikely at the current stage. In contrast to the sharp increase in global goods demand triggered by the pandemic, demand is now sluggish, meaning that there are limited price pressures. The situation in the Middle East could still escalate further and also the spillover to tanker and oil markets poses an upside risk to our outlook, but inflation levels should not reach those of the previous year. During the pandemic, the long-lasting supply chain disruptions added up to 2.5 percentage points to US personal consumption expenditure price inflation. However, supply chains are now far less disrupted and average shipping rates (including term contracts) are not anywhere near the peaks we saw then. With international shipping costs accounting for 3% of manufacturing's final costs and less than 1% of input prices, according to European Central Bank research, any transmission to inflation is likely to be limited to a fraction of this.

Our view on central banks

Our view on what could be next for major central banks across the globe

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ECB President, Christine Lagarde addresses a press conference following the meeting of the ECB Governing Council

Federal Reserve: First rate cuts expected in May

The Federal Reserve has formally removed its tightening bias, but strong data on jobs and growth has meant that officials have firmly pushed back against talk of an imminent interest rate cut. We continue to see some downside risks for growth in the coming quarters as the legacy of tight monetary policy and credit conditions weighs on activity and Covid-era accrued household savings provide less support for spending. Inflation pressures are subsiding, with the core personal consumer expenditure deflator heading towards 2%, while the employment cost index offered more evidence that inflation pressures emanating from the jobs market are fading fast.

Fed Chair Jerome Powell acknowledged that monetary policy is well into “restrictive territory” and it will be “appropriate to dial back” on that at some point this year. We expect that May will be the start point, by which time we think ongoing subdued core inflation measures will give the central bank the confidence to cut rates, with the policy rate getting down to 4% by the end of this year and 3% by mid-2025. This will merely get us close to neutral territory – the Fed’s view is that 2.5% is likely the long-term average. If the economy does enter a more troubled period, such as through banking stresses, there is scope for much deeper cuts than we are forecasting.

James Knightley

European Central Bank: ECB won't be fooled by lower headline inflation

Since the European Central Bank's December meeting, financial markets have been speculating on a first rate cut already in April. The drop in January eurozone inflation fuelled this speculation, but we doubt that the ECB will be fooled by this drop in headline inflation. The monthly increase and still high underlying inflationary pressure clearly argue against premature rate cuts.

Instead, we continue to expect the ECB to start cutting rates in June. Why? First of all, as long as the eurozone remains in de facto stagnation mode and doesn't slide into a more severe recession, and as long as the ECB continues to predict a return to potential growth rates one or two quarters later, there is no reason for the central bank to react to more sluggish growth with imminent rate cuts. Secondly, the job of bringing inflation back to target is not done yet. Finally, most ECB officials don't get tired of emphasising the role of wage developments for future rate decisions. Even if the relationship between wages and inflation is not straightforward or mechanic, the ECB simply needs more data to make up its mind. This data will only be available at the June meeting, strengthening our call for a first rate cut at that point.

Carsten Brzeski

Bank of England: 100bp of BoE rate cuts this year

The Bank of England has so far shown itself to be more reluctant than others to endorse the idea of rate cuts this year. But even if the BoE is slightly later to the cutting game than the likes of the Fed and ECB, we think the difference will be measured in weeks, not months. And the cutting cycle that ensues thereafter will, if anything, be more aggressive than the likes of the ECB.

The reason for expecting a slightly later start date to rate cuts is two-fold. Firstly, the key metrics that the Bank of England is using as a guide for policy – services inflation and private-sector wage growth – are likely to remain sticky through the first quarter, before falling more noticeably in the second. In other words, the committee won't have quite enough information to be comfortable with cutting rates by the time of the May meeting.

Secondly, there are widespread expectations that the Chancellor will use the March budget to implement material tax cuts. If that's the case, then the committee will be minded to offset the impact on demand with slightly tighter monetary policy. That is likely to manifest itself in a slightly later starting point.

But ultimately, we've long argued that the UK isn't an outlier on inflation and that the higher headline/core rates in Britain are more down to lags than anything else. We think services inflation will be back below 5% over the summer (from 6.4% now), while the more reliable data we have on the jobs market suggests hiring demand is continue to cool. That suggests wage growth should continue to gradually ease back too. We expect 100bp of BoE rate cuts this year.

James Smith

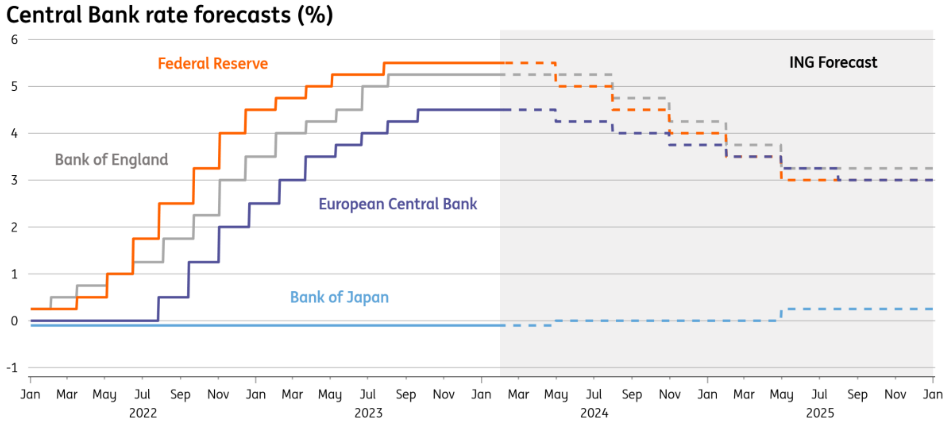
Bank of Japan: No major policy changes at the March meeting

The Bank of Japan has already been in deep discussion over the timing of an exit from negative interest rates, according to the December policy meeting minutes. The initial outcome of wage negotiations on 15 March (just a few days before the 18-19 March meeting) should be key in determining the timing of policy move, but some members noted the result itself shouldn't necessarily trigger a rate hike. Tokyo CPI inflation, a leading indicator for nationwide CPI trend, slowed faster than expected to 1.8% year-on-year in January. The impact of recent earthquakes will also begin to appear in data from February, so the Bank of Japan won't make any major policy changes at its March meeting.

The inflation path will be quite choppy up until April, exacerbated by the government's energy subsidy programmes. Inflation for the recent three months has stayed on the decline, but is expected to pick up again in February. April CPI is a key piece of data for judging the true inflation trend, but by the time the 25-26 April meeting is held, the nationwide CPI report won't be available. The BoJ also wants to confirm if wage growth could lead to sustained inflationary pressure, particularly in service prices, and will wait for a couple more months until June. The central bank will take orderly steps, including forward guidance being revised, before any action is taken. We expect to see a revision at the April meeting.

Min Joo Kang

Central Bank rate forecasts (%)



Source: ING

US recession risks recede, but growth fears linger

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Strong GDP and jobs growth shows that the US economy continues to shrug off high borrowing costs and tight credit conditions, largely through robust government spending and consumers running down their savings. These factors will be less supportive in 2024 and inflation is on the path to 2%, so the Federal Reserve has the room to cut interest rates sharply

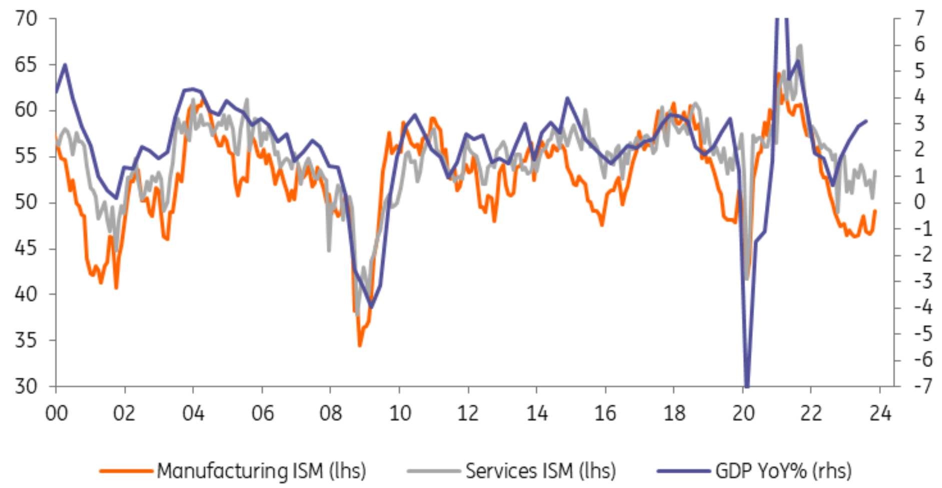
Sunset over the US Capitol in Washington, D.C.

Fed remains wary about easing policy too soon

After the Federal Reserve's dovish shift at the December FOMC meeting, where it signalled it was anticipating cutting the Fed funds target rate by 75bp in 2024, markets pushed on aggressively. Subdued inflation prints led the market to go so far as to price nearly 175bp of rate cuts starting at the March FOMC meeting. However, fourth quarter GDP and January payrolls subsequently beat all expectations and Fed officials have since moved to downplay the prospect of any imminent easing. While employment and inflation goals are "moving into better balance", Fed Chair Jerome Powell suggested that the central bank won't cut until the it has "gained greater confidence that inflation is moving sustainable toward 2 percent".

We think that inflation story will look increasingly benign over the next few months, but we suspect that the Fed recognises its credibility was damaged by its "inflation is transitory" assertion in 2021 only to have to rapidly reverse course with significant rate hikes through 2022 and 2023. The last thing the Fed wants to do is get it wrong again at a key turning point, loosen too soon, too quickly and reignite inflation pressures. We don't think that will happen, but so long as the official activity numbers continue to come in hot, the Fed won't feel comfortable easing policy.

ISM indices are tracking weaker than official GDP growth



Source: Macrobond, ING

But growth momentum is moderating

In this regard, the disconnect between strong official data and weaker business surveys remains a key topic of debate. The chart above shows that the widely watched ISM indices – which have been published for decades – are at levels historically consistent with GDP growth of around 1% year-on-year and not the 3.1% recorded in the fourth quarter. Likewise, hiring surveys paint a more downbeat picture than official payrolls data, while the Conference Board's leading index remains at levels historically consistent with a recession.

We maintain the view that high borrowing costs and tight credit conditions will increasingly weigh on activity and Covid-era accrued household savings provide less support for consumer spending. This will gradually result in the official data cooling and the Fed becoming more comfortable with interest rate cuts, but this is more likely to be a second quarter into the third story given seemingly decent consumer spending momentum in the early first quarter.

Inflation to allow the Fed move back towards neutral policy rates

Moreover, two of the Fed's favoured economic indicators are making clear positive progress in indicating inflation will sustainably move back to the 2% target. The core personal consumer expenditure deflator, which is the central bank's inflation measure of choice, is now consistently tracking a month-on-month rate below 0.2%. Meanwhile the employment cost index, the broadest measure of labour costs, is slowing and the decline in the proportion of workers quitting jobs to move to another suggests a less frenetic jobs market, which will help cool wage pressures.

By May, we think ongoing subdued core inflation measures and cooler growth and jobs numbers will give the Fed the confidence to start cutting the policy rate, getting down to 4% by the end of this year and 3% by mid-2025. This will merely get us close to neutral territory – the Fed's view is that 2.5% is likely the long-term average. If the economy does enter a more troubled period, i.e., through financial stress related to commercial real estate or consumer loan losses, this forces the Fed to move into 'stimulative' territory, there is scope for much deeper interest cuts than we are forecasting.

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Soft start to China's new year raises hopes for policy support

Sentiment about China's economy remains downbeat heading into the Lunar New Year. And that's raising expectations for more policy support despite the country reaching its 2023 growth targets

Welcoming in the Year of the Dragon in Suqian, Jiangsu province, China

Mission accomplished for 2023, but there are no guarantees for this year

Data over the past month confirmed that the Chinese economy grew by 5.2% YoY, exceeding the 5% growth target set at last year's Two Sessions. Despite this, property sector struggles continue to weigh on sentiment. Market focus remains on negative headlines such as Evergrande's liquidation court order. However, there are still some positive signs, with several cities releasing the long-awaited real estate project "whitelists", which highlight high-quality projects for which banks can provide financing support.

Early indications are that while the economy has stabilised in recent months, momentum remains soft right now. Our first look at China's 2024 activity data was the January manufacturing PMI, which came in at 49.2, slightly below expectations. At least it was trending in the right direction with a smaller contraction than December. The Chinese manufacturing sector remains under pressure amid a weak domestic recovery and poor external demand. The manufacturing PMI has been under 50 for nine of the past ten months.

With a less favourable base effect, repeating 5% growth in 2024 will be more challenging.

Policy direction remained supportive to start the year

Growth stabilisation has been the key theme for policymakers in the last few months, and we saw many piecemeal supportive policies released on a provincial and national level. Some of the highlights include discussions of a market stabilisation fund and the continued rollout of property market policies such as city-level project whitelists.

While the People's Bank of China refrained from cutting rates in January, it did announce a 50 bp Reserve Requirement Ratio cut to take effect from 5 February. It was the largest since 2021 and provides, in theory, up to RMB 1tn of liquidity to markets. The PBOC also broadened access to commercial loans for property developers by allowing bank loans pledged against developers' commercial properties to be used to repay other loans and bonds until the end of the year. It also cut the refinancing and rediscount rates for rural and micro-loans by 0.25 ppt to 1.75%.

Two Sessions will set China's official annual growth targets

	2019	2020	2021	2022	2023	2024F
GDP (%YoY)	6-6.5	Not set due to Covid-19	Above 6	c.5.5	c.5	c.5
Inflation (%YoY)	c.3	c.3.5	c.3	c.3	c.3	c.3
New urban employment	Above 11m	c.9m	c.11m	c.11m	c.12m	c.12m
Urban unemployment rate (%)	c.5.5 (survey), under 4.5 (registered)	c.6 (survey), 5.5 (registered)	c.5.5	c.5.5	c.5.5	c.5.5
Fiscal deficit (% of GDP)	2.8	Above 3.6	c.3.2	c.2.8	3.0	c.3.5
Special government bond issuance (RMBtn)	2.15	3.75	3.65	3.65	3.8	4.0

Source: Chinese government website, ING

Markets await the Two Sessions to set the tone for 2024

Soon after the Lunar New Year, the Chinese government will hold its annual Two Sessions, which refer to the plenary sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC). They're typically the most important policy meetings of the year and will start on March 4-5.

There is a higher-than-usual level of uncertainty this year, as the Third Plenary Session was postponed; it's traditionally a fourth-quarter meeting where the economy is the main focus and various reforms and new measures are announced. So, the upcoming meetings will be highly scrutinised for any new policy signals.

In terms of economic targets, we feel it is unlikely we will see major movements in targets. Premier Li Qiang's comments at Davos and the provincial level 2024 GDP targets indicate that the country-level GDP target will likely be "around 5%" again in 2024. The fiscal deficit to GDP target is worth watching as a potential signal for stronger fiscal policy support this year. We expect this target to be lifted from 3% to 3.5% of GDP in 2024, though an unchanged target does not preclude the government from more stimulus as it may use special bonds to finance necessary projects.

Asia-Pacific is not just China

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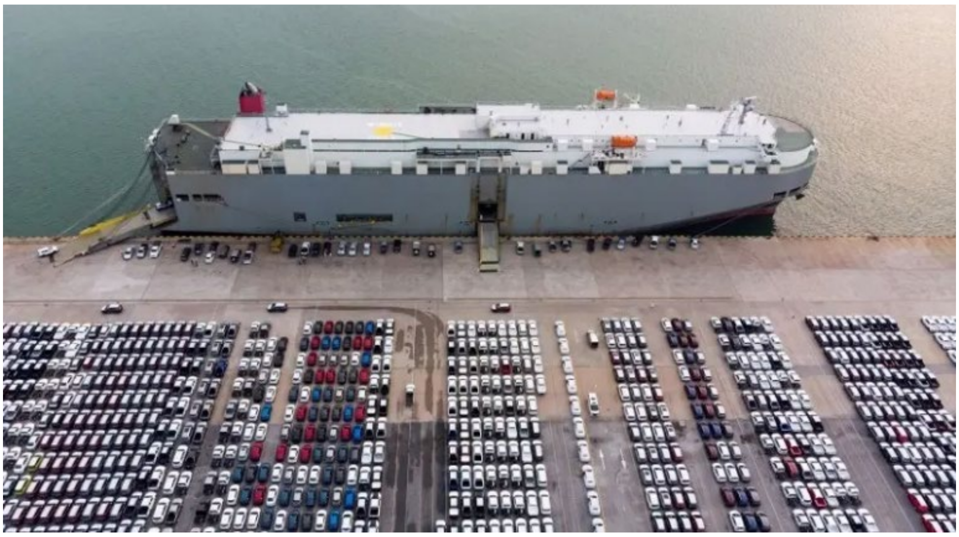
While the China macro story of ongoing transition is a headwind to the rest of Asia, there is more to the region's economic health than this. We see some glimmers of stronger export and production activity together with a more benign inflation backdrop and recovering domestic demand



Aerial view of a roll on/roll off ship, used for imports and exports of wheeled cargo across the globe

Exports are looking better

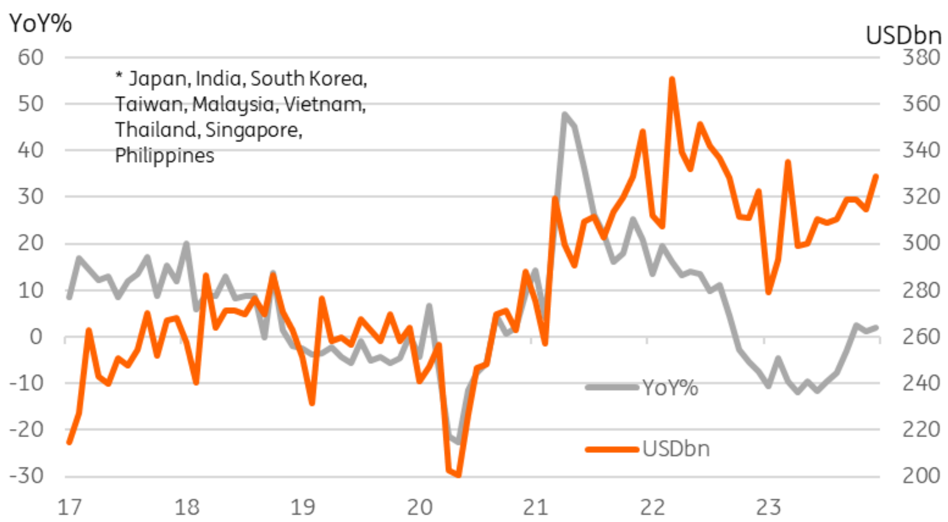
Most Asian economies are very open to trade, and so a global slowdown ought to be bad news. Since Mainland China is typically the single biggest trade partner for Asian economies (India being an exception, which is one of the reasons why it outperformed the region as a whole in 2023), this ought to add a further dampener to export and consequently growth outlooks.

The reality of the situation though is that after a very weak 2022 and 2023, the export figures are beginning to turn higher.

In the chart that follows, we show aggregate exports for non-China Asia in terms of the year-on-year growth rate. But because there has been so much volatility in recent years which can dominate such growth figures, we also show this in USD terms, which helps to put the numbers into a better perspective.

The year-on-year figures have improved and are hovering around zero after registering declines in all of 2023. But as the USD series shows, there has been some solid improvement. The trough in exports has evidently now passed, and while this looks more like a grind higher rather than a solid bounce, the direction is helpful.

Asian exports



Source: CEIC, ING

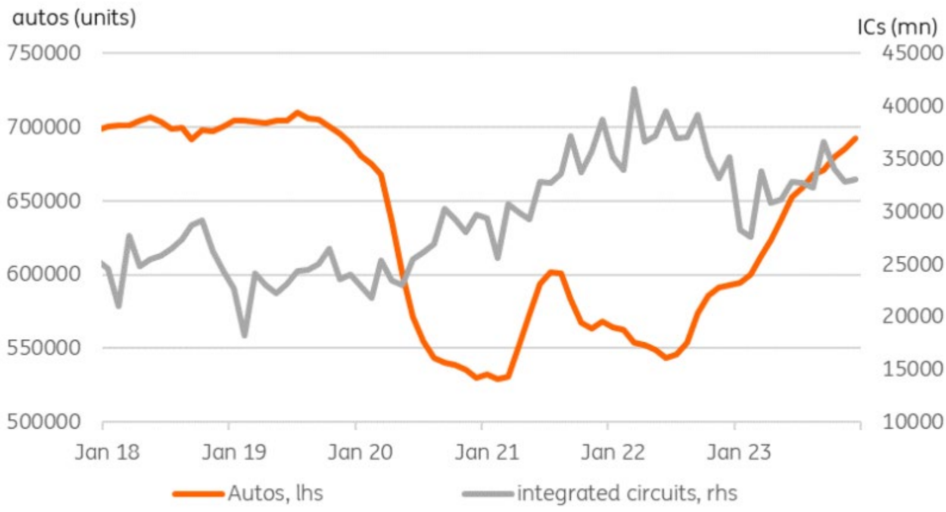
Chips and autos help progress along

Broken down by major export end destinations, it shows that imports to both the US and China are doing better. The same cannot be said for Europe. And this broadly fits our picture of the health of the rest of the world (see our other notes).

Underlying this improvement in the export performance for much of the region are two particular sectors which seem to be outperforming. The first of these is the semiconductor industry. This is particularly clear at the high end of the market and less pronounced for what we might term 'legacy' chips. As a result, the export growth rates for both South Korea and Taiwan are running much stronger than for the region as a whole, with Japan also seeing some outperformance. Notwithstanding the particular health of the industry leaders in this sector, a return to positive semiconductor demand should bode well for both exports and production figures across most of the region.

The other sector that is helping this regional improvement is autos. Whether this is still a pent-up replacement cycle following the pandemic or a feature of the growing demand for electric vehicles is not clear. It is also possible that this is also providing some support for the semiconductor industry, considering how full modern cars are of semiconductors these days. Again, South Korea and Japan benefit particularly from this, but so do other auto manufacturing sites such as Thailand.

Exports of autos* and integrated circuits**



*Autos: Korea, Japan, Thailand **ICs: JPN. MAL, KOR, TAI, THA
Source: CEIC, ING

We are not complacent about the Red Sea risks

This export recovery is not without any risks, though. The Red Sea conflict is causing the shipping costs for the region to rise significantly. The Financial Times recently published an article about why it's OK to be complacent about the Red Sea conflict. We don't agree. At least not for Asia. The costs for re-routing container ships from Asia around the Cape of Good Hope rather than taking the shorter route through the Red Sea will add 10-14 days to the transit time of ships from Asia to Europe. And this is estimated to cost the shipping lines 20-25% more. For those wishing to charter a container from Shanghai to Rotterdam, the cost has risen three to four times from its 2023 lows. Other sea routes are also showing much higher container day rates as ships stay at sea longer and their availability diminishes. This may make some exports unprofitable and squeeze the margins of others, as well as likely pushing up the end costs for importers and consumers in the destination countries.

Moreover, this is still very early days. The increase may currently look small compared to the supply chain disruptions of the pandemic, but this is not to say that the current situation is where it ends. It may be, in which case the situation is likely to be manageable. But the situation is extremely fluid, so taking the current backdrop as an accurate indication of where this ends up seems ill-conceived.

Better inflation data – this is helping growth too

One final positive feature of the region is the much more benign inflation backdrop. There is perhaps no better example of this in the Asia-Pacific region than Australia, where consumer price inflation has fallen from a high of 8.4% in December last year, to just 3.4% in December 2023. This is just 0.4 percentage points above the top of the Reserve Bank of Australia's target rate for inflation. This certainly helps the growth outlook as real wage growth is now improving again. And where available, we can see the positive impact of this in an upturn in service sector PMIs.

That said, base effects have been doing a lot of the work in bringing inflation rates down. And we may well see some upward drift again in inflation over the first half of 2024, which is likely to prevent any of the central banks in the region from moving ahead of any potential Fed cuts.

The eurozone economy is bottoming out

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The eurozone escaped a technical recession and a number of indicators suggest the economy is now bottoming out. While the recovery is likely to be weak, it is still too soon to give the all-clear on inflation. The ECB is expected to cut rates from June onwards, but more cautiously than the market is currently anticipating

The Belfry of Bruges, Belgium

More subdued recovery, more stubborn inflation

The two questions stirring debate regarding the eurozone outlook are whether the economy has now seen the worst of it, and how rapidly inflation will return to the 2% target. Most international institutions are convinced that growth will be stronger than in 2023, while the markets are betting that inflation will subside rapidly and will allow the European Central Bank (ECB) to cut interest rates significantly throughout the year. While we agree with the direction for both growth (up) and inflation and rates (down), we believe that the economic recovery will be more subdued, while inflation (although declining) is unlikely to trigger aggressive monetary easing.

Near term stagnation

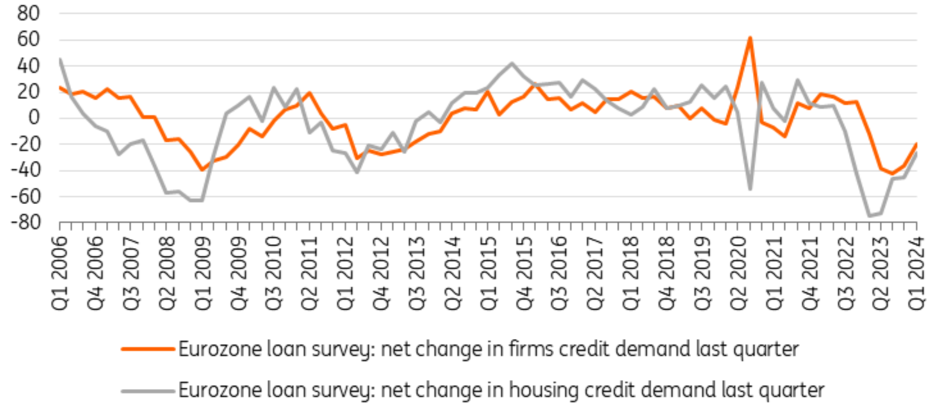
After a contraction in the third quarter, eurozone GDP stagnated in the fourth quarter, narrowly avoiding a technical recession. The first indicators for January are mixed. The composite PMI indicator rose in January, but remained below the 50 boom-or-bust level. The economic sentiment indicator from the European Commission saw a significant progression in December, but was unable to continue its ascent in January. And in Germany, where the more restrictive budget is not helping to get the economy out of the doldrums, the important Ifo indicator fell to the lowest level since the pandemic. No surprise that the eurocoin indicator, a monthly gauge of GDP growth, declined to -0.56% last month. January's sentiment data might have been negatively affected by the spreading unrest in the Middle East and incidents in the Red Sea.

Poor carry-over effect

While first quarter GDP growth is probably going to hover around 0%, we still believe that a gradual recovery is going to set in from the second quarter onwards. Despite geopolitical events, energy prices remain at relatively low levels. The mild winter has kept a lid on gas prices. At the same time, eurozone unemployment stood at the historical low level of 6.4% in December. The decline in mortgage rates might bring back some life in residential construction, while the inventory correction in manufacturing will likely have run its course by the summer. In the Bank Lending Survey the downtrend in credit demand seems to be reversing.

The bottom line is that even though the expansion will gradually gain momentum over the course of the year, the poor carry-over effect is likely to limit GDP growth to only 0.4% this year after last year's 0.5%. In 2025, we see a pick-up to 1.4%.

Downtrend in credit demand is coming to an end

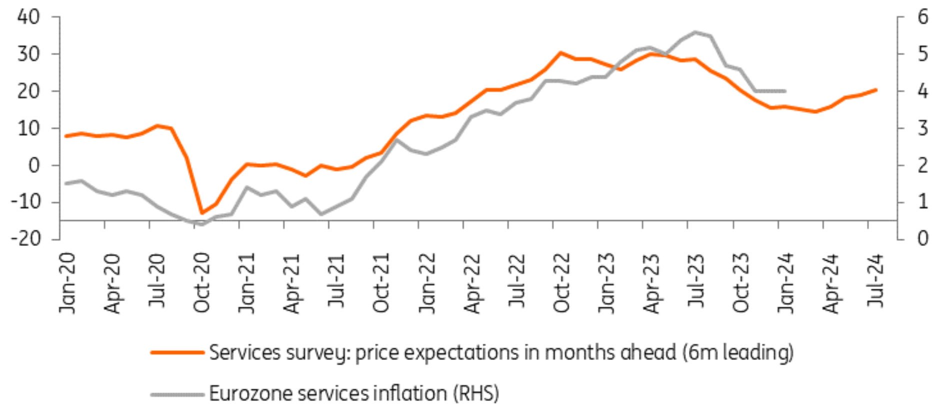


Source: LSEG Datastream

The inflation battle is not yet won

Headline inflation fell back to 2.8% in January, from 2.9% in December. The good news is that at the current level of energy prices there is not much of a hump to be expected in the second quarter. However, the decline in core inflation, now at 3.3%, is likely too slow for the ECB. Services inflation remains stuck at 4% and with higher wages, the risk is that the disinflation trend slows. Let's not forget that in both the PMI survey and the European Commission's economic sentiment survey, selling price expectations have now already been rising for several months in a row (for services, even five consecutive months), reversing a downtrend that started in the middle of 2022. We still think that the inflation trend remains downwards, with average headline inflation for 2024 likely to come in at 2.5%. For core inflation, we still expect at 2.7% on average this year.

Services inflation remains sticky



Source: LSEG Datastream

A cautious ECB

With the relatively tight labour market, the risk is that wage growth remains too high for comfort. And that this is not absorbed in profit margins if the economy emerges from its soft patch. We therefore remain convinced that the ECB is going to tread carefully. ECB

President Christine Lagarde clearly stated that the disinflation process would have to advance further for the central bank to be sure that it is sustainable. This led her to conclude that a rate cut before summer remains unlikely. We think June is still likely for a first 25bp rate cut. But thereafter, the ECB is likely to reduce interest rates only gradually. While the market already anticipates short rates at 2.5% by the end of this year, we only see that level in the second quarter of 2025.

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Pain from ECB hikes is set to shift south

The impact of the ECB's aggressive hiking cycle has been taken well by southern countries within the eurozone, but rapidly declining borrowing indicates that this is set to turn. We expect the impact of ECB tightening to have a larger impact on southern than northern eurozone countries in 2024

View of the ECB Tower in Frankfurt am Main, Germany

In 2023, southern eurozone countries defied the impact of monetary policy tightening

While expectations initially were that southern European countries would face significant problems if the European Central Bank (ECB) raised rates aggressively, this has not materialised so far. In fact, it rather seems to be the other way around – several indicators point to a stronger transmission of tighter monetary policy on northern and not southern European countries.

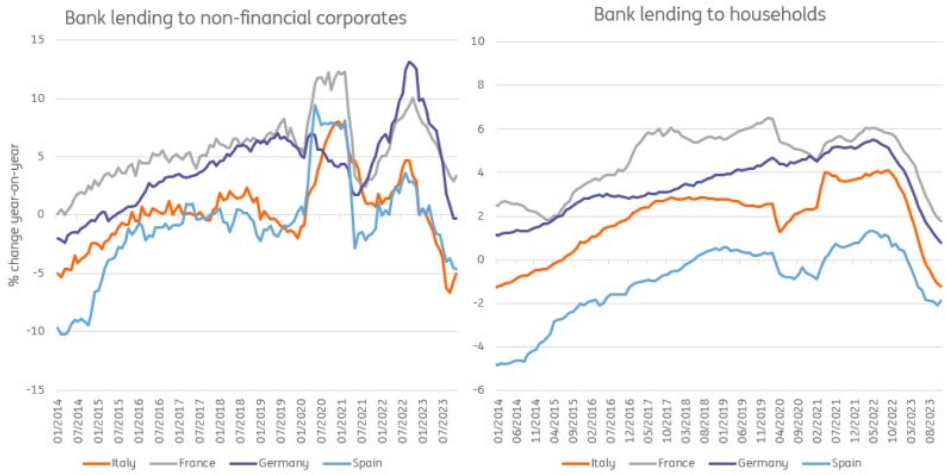
Take the stock market for example, where performances in northern European main indices have been weaker than in southern Europe. Also, price developments in the housing market point to a larger impact in northern Europe. Germany, the Netherlands and France have seen house prices fall below their recent highs, while Italy, Spain, Portugal and Greece still experience increasing house prices looking at latest available data. Turning to investments, the surge seen in southern European countries is remarkable. Admittedly, there is more to investments than only interest rates; think of the impact of the Recovery and Resilience Fund and some of the delayed impact of low interest rates, as well as the search for yield and successful structural reforms.

Differences in transmission are starting to show

The pain of monetary tightening is likely to be felt more in 2024 than 2023 due to the long and variable lags of monetary policy transmission. It just takes a while before the impact of tightening really impacts the economy. There is increasing evidence that the transmission of monetary policy in 2024 will be less favourable for southern European economies.

Take the most recent lending data. Lending volumes are currently falling in most southern European economies. In Italy, it's looking really rather serious as the 6% year-on-year fall of borrowing by non-financial corporates is worse than during the Global Financial and euro crises. Spain, Portugal and Italy see declining borrowing volumes for both households and corporates, while northern European economies are still seeing year-on-year growth in borrowing.

Bank lending is diverging quickly, likely resulting in weaker investment in the periphery

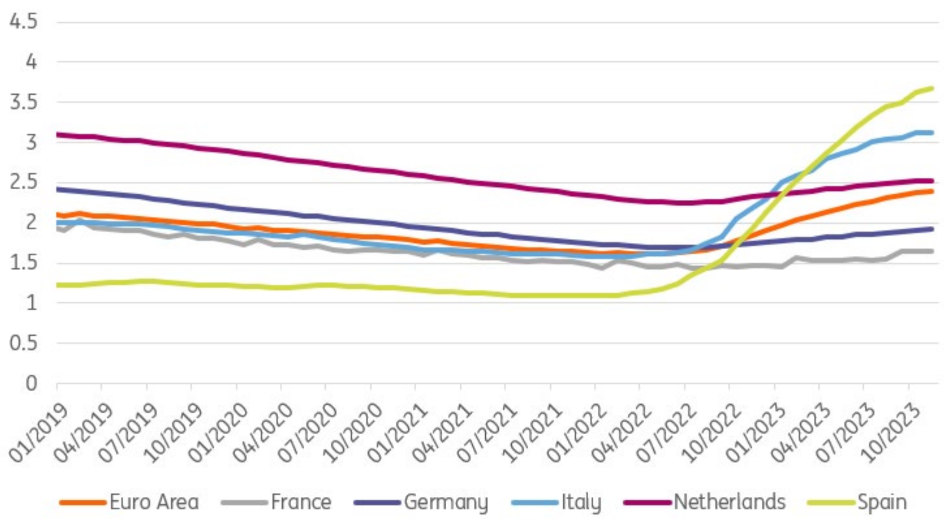


Source: ECB, ING Research

But the impact of higher interest rates is not only seen in new loans and new investments. It also impacts the economy through increasing interest rate payments. Average mortgage rates have gone up more in southern Europe as variable interest rates on mortgages are more common. The impact of higher mortgage burdens could play out through adjustments in the housing market and weakened consumption, as they reduce opportunity for disposable spending elsewhere. And there is another transmission channel through which higher mortgage rates will affect economies: redemptions on mortgage loans have increased markedly in Italy and Spain since higher rates have kicked in. This essentially means that higher rates have kicked off a process of household deleveraging in the south, which will weigh on consumption and economic activity.

Average mortgage rates have risen far faster in southern eurozone markets

Average household mortgage rate, all maturities, outstanding



Source: ECB

When looking at net interest rate payments for corporates, we see that German and Dutch companies have barely seen any impact so far. This could also be because they hold more cash reserves, which have started to generate positive interest flows. In Spain, Italy and France, net interest payments have risen to the highest level in more than seven years.

For governments, interest rate payments are also starting to increase, but again much more in the south than the north. While most countries have lengthened the average maturity on their debt, higher rates are starting to result in higher interest payments. We note that the increase has been fastest in Italy, where net interest rate payments have returned to 2015 levels. Overall, expect the gap to widen as more debt gets rolled over. This will cause discussions about austerity to become more pressing. Then again, at this point it is clearly Germany that leads the way in terms of belt tightening, so we don't see austerity efforts moving along the traditional north-south lines in 2024.

This year, the impact of tightening on the periphery looks worse than for the north

Even if ECB rates have peaked, and we might even see rate cuts later this year, 2024 will still be one where the full impact of monetary policy tightening of the last 18 months will unfold. While southern eurozone countries surprisingly seemed to defy the adverse impact of monetary policy tightening last year, we fear we'll not see something similar in 2024.

UK economic outlook brightens on anticipated rate cuts

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A less dramatic mortgage squeeze and the likelihood of tax cuts means we should expect modest growth in the UK this year

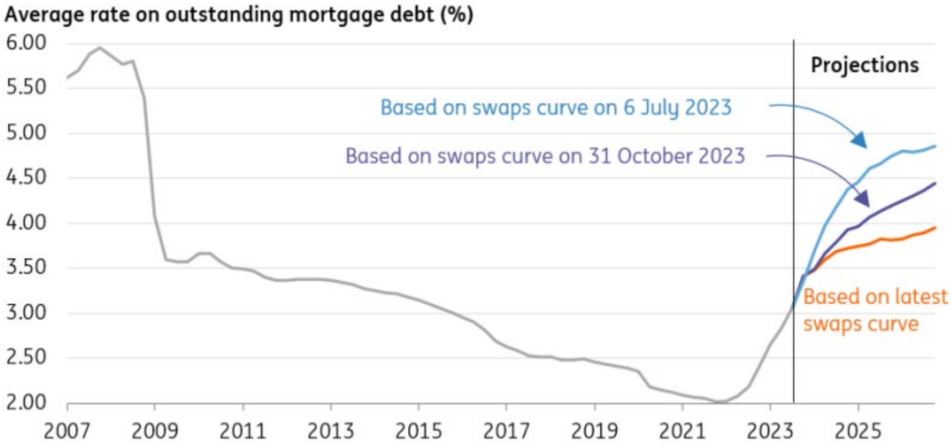
Westminster Bridge in London, UK

The mortgage squeeze is looking less aggressive

The UK economic outlook has started the year on a brighter footing. Green shoots are appearing in some of the sentiment indicators; most notable is the services purchasing manager's index (PMI), which has edged further into growth territory. That's at odds with the wider eurozone, where the sector is still – at least judging by this survey – in modest contraction. After a year of stagnation – and perhaps even a very modest technical recession in the second half – we're expecting modest and incremental positive quarterly growth through this year.

Much of this is down to the collapse in market rates. While that's a boon for all economies, there are two ways in which this has a more direct feedthrough in the UK than some of its neighbours. Twenty percent of mortgage holders will refinance this year, a higher proportion than in the likes of France and Germany, where longer-term fixes are more common. That means the average rate on outstanding lending will continue to rise this year. But the anticipation of rate cuts means this squeeze is much less aggressive than it had looked just a few months ago.

The average rate on outstanding mortgages won't rise much further this year



Tax cuts are likely in March

Another direct impact of lower market rates is that it directly translates into extra "headroom" for the Chancellor. This is money that the Treasury can spend now (or cut in taxes) and still meet the fiscal rule of cutting debt as a percentage of GDP in five years' time. Based just on the change in rate expectations, this extra headroom is likely to amount to roughly £12bn (in addition to £13bn left over in November). All in all, that leaves almost a percentage point of tax cuts that could be available, which would boost GDP by perhaps 0.2-0.4ppts this year, depending on the scope of what is announced.

At the same time, real wage growth is likely to be positive throughout this year. Inflation is set to fall below 2% in April, while nominal earnings growth is set to slow much less rapidly. Admittedly, we shouldn't get too overexcited about the outlook. The jobs market is cooling, though for now not rapidly, while savings in real-terms are below the pre-Covid trend. Still, we think we should expect modest growth this year, and the chances of a near-term recession (i.e. not just a technical one) have faded.

Inflation nears target but central banks remain unsatisfied

While inflation in the region has made great progress, it's still not enough for central banks. But cutting rates is complicated, and the picture is not entirely clear. Economies should begin to recover, although the external picture is not entirely supportive

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Early morning sunrise in Warsaw, Poland

Poland: Gearing up for recovery

According to the flash estimate, Poland's economy grew by 0.2% in 2023, following a GDP expansion of 5.3% in 2022. The recovery started in mid-2023 but then lost steam in the fourth quarter due to weaker consumption and sluggish production and exports. The data suggests that GDP grew by only 1% year-on-year in the fourth quarter vs 0.5% YoY in the third quarter of 2023. We estimate that household consumption was stagnant, while fixed investment continued its solid growth. We still expect that sound real income growth coupled with the marked improvement in consumer sentiment should translate into increased consumer outlays, but we are still not expecting a repeat of the consumption boom that we have seen in the last few years. Against the backdrop of weak external demand, we count on domestic consumption to be the main driver of economic growth in 2024. Investment continues to maintain a solid pace.

The Statistics Office revised December CPI inflation to 6.2% YoY from an earlier estimate of 6.1% YoY. CPI may fall close to the 2.5% YoY National Bank of Poland (NBP) target in the first quarter. The short-term inflation outlook looks favourable, with the headline CPI in the first quarter expected to be within the range of acceptable fluctuations around the NBP target (2.5%, +/- one percentage point). This is due to a combination of factors. Firstly, there is the high reference base from last year when, among other things, the basic VAT rates on electricity, gas, heat and fuels were restored following a temporary lowering. Secondly, the government has extended the freeze on household energy prices (electricity, gas, heating) until the end of June 2024 and zero VAT on food until the end of March this year.

The Monetary Policy Council's (MPC) reaction function has changed since the October elections from ultra dovish to neutral. The reasons mentioned by the NBP were the temporary nature of the CPI decline in the first quarter and the inflation outlook for higher CPI in the second half of the year. NBP Governor Adam Glapiński assessed that the 'inflation overhang' due to continued interventions in energy prices and lower VAT on food is around five percentage points. Full withdrawal of anti-inflation measures would immediately boost annual CPI by that amount. Therefore, in our view, the MPC will leave interest rates unchanged at least until May (the main rate at 5.75%), and will assess potential actions in the second half of 2024 after reviewing the next macroeconomic projection.

We expect the zloty to extend gains in 2024, with target levels around EUR/PLN 4.20-25. The market is still pricing aggressive NBP rate cuts – which we think are unlikely to materialise. On top of that, we expect gradual inflows of foreign capital – both private capital, i.e., the foreign share in Polish government bonds (POLGB), which is still half as high as in other CEE countries, and public funds (EU). Poland should also maintain a current account surplus. However, the conflict in Ukraine remains the key risk for the zloty and the uncertain MPC reaction function is the main worry for inflows into POLGBs.

The recent series of successful POLGB auctions and higher coverage of the record 2024 borrowing needs finally started to translate into the secondary market developments. 10-year bonds are still attractive, so we may soon see higher inflows from abroad. The late first quarter still remains a major risk. Investors are betting on the MPC resuming the easing cycle alongside the new projections. Recent MPC comments indicate the easing is unlikely to happen quite so soon. This should lift the interest rate swaps and POLGB curves.

Czech Republic: Time for the central bank to pick up the pace

The economy grew by 0.2% quarter-on-quarter in the fourth quarter of last year, the highest figure since mid-2022 – but clearly not something to celebrate. The main driver is still foreign demand, while domestic demand is recovering only very slowly, if at all. This year we expect a 1.4% recovery on average but still the weakest growth in the CEE region. More success is seen on the inflation and fiscal policy side. Headline and core inflation are still surprising to the downside with 6.9% and 3.6% respectively in December. The significant base effect will come into play in January, which we believe will lead to headline inflation of 2.7% year-on-year. The risks here are significant due to the strong seasonality in January in the Czech Republic, but the headline rate will very likely be by far the lowest in the CEE region.

The budget ended last year slightly better than the Ministry of Finance projected and the January numbers confirm that fiscal policy consolidation is in process. We expect the deficit to be slightly lower than planned this year as well. We therefore forecast a decline from 3.5% of GDP to 2.5% this year. The Czech National Bank cut rates for the first time by 25bp to 6.75% last December. We expect the central bank to continue cutting rates throughout this year. For the February meeting, we expect the cutting pace to accelerate to 50bp thanks to the CNB's new forecast, which should confirm our positive view on inflation.

After two years, the Czech koruna approached 25.00 EUR/CZK, mainly due to the market's growing bets on central bank rate cuts. We expect a peak in EUR/CZK in February and then the koruna should start appreciating again. The economy should recover later this year and FX should be supported by the current account surplus, which is already showing a strong recovery. We therefore expect 24.50 EUR/CZK by mid-year.

Romania: Not ready to cut rates yet

Economic growth is likely to accelerate in 2024 as private consumption is making a comeback, likely overtaking investments as the growth driver. That’s likely to put an end to the current account deficit correction witnessed in 2023, though we are not projecting a re-widening of the gap either. The sustainability of the current account deficit remains highly dependent on EU funds absorption, given that foreign direct investments only cover about a third of the deficit.

With the real wage growth getting close to double-digit territory, the inflation profile could prove stickier, especially in the services sector. After closing the year below expectations at 6.6%, we expect a relatively minor bump in January inflation, which should get back above 7.0%. Afterwards, a gradual descent to our estimated 4.7% by year-end should follow, though core inflation is likely to stick visibly higher than the headline for the entire year.

From a monetary policy perspective, we continue to expect that the National Bank of Romania (NBR) will officially begin its rate cutting cycle in May 2024, though April looks equally likely. We have a long-standing forecast for the key rate to reach 5.50% by the end of the year and, while we maintain this view, we also acknowledge that risks for a somewhat shorter cutting cycle have increased lately. One reason for this is the excess liquidity in the interbank market which reached a significant RON 44bn in December 2023, acting as a strong incentive for local banks to come up with lower rates for new loans and deposits. In our view, such levels of liquidity cannot go away anytime soon, and we might as well face a new permanent reality of the Romanian banking sector being structurally over-liquid. The lower the market pricing is, the less need for the NBR to cut rates. Stopping with the key rate around 6.00% in 2024 might therefore make sense as well.

Hungary: Flip the switch

At the end of 2023, we were bullish on Hungary. We saw a partial agreement between Budapest and Brussels, and we were hopeful that this would start to address the confidence issues. The National Bank of Hungary's (NBH) steady, cautious easing and rapid disinflation looked like an amazing combination for HUF carry. However, the recent shift in the tone of monetary policy and the increased unpredictability of economic policy have combined to produce a negative outcome; markets are no longer cheered up by the positive real interest rate environment. Add in pro-growth fiscal policy (at least pro-growth relative to the circumstances) and some red flags from the major rating agencies, and you have a challenging market environment. The icing on the proverbial cake is the geopolitical and political risks with the Red Sea conflict, the sovereignty bill, and Sweden's NATO access saga.

So, we flip the switch: optimism off. We now see EUR/HUF reaching 390 in the first quarter and 395 in the second. As there are also some positive factors (with some caveats), these can maintain some kind of balance and keep the forint in a relatively narrow range and away from breaking through 400 again. While disinflation is welcome, it will put all kinds of pressure on the central bank. Moreover, we see reflation in the second half of the year, with inflation coming back close to 6%. While we now see a lower mid-cycle terminal rate, we still believe in the need for positive real interest rates.

We therefore call for further easing in 75bp steps until a 50bp finishing touch in June, and then we see a lengthy pause at 6.50%. The slowly but surely inverting structure of economic activity does not bode well for the HUF either. With export activity seemingly struggling recently and domestic demand finding some footing – helped by the return of positive real wage growth and some economic policy measures to support investment activity – the favourable developments in external balances could reverse, reducing support for the local currency.

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FX markets remain in a holding pattern

FX markets are becalmed as investors continue to fine tune the starting dates for 2024 easing cycles. The dollar's high yield is keeping it attractive, especially given simmering geopolitical risks. We expect this trading environment to continue for some time and only expect a broad, bearish dollar trend to emerge through the second quarter

The presumption is that a potential Trump administration will be good for the dollar and bad for the likes of the peso and the Chinese renminbi, but a lot of this still hangs in the balance for the time being

It has been a relatively quiet start to the year in FX markets. Doubts about the timing and speed of central banking easing cycles have contributed to lower levels of volatility and a search for yield. Step forward the dollar with one of the highest yields in the G10 FX space and the added benefit of liquidity – useful should geopolitical or US regional banking stress escalate.

We continue to expect this range-bound environment to give way to a broader dollar decline during the second quarter. We had a sneak preview of this environment in the last two months of 2023. Assuming the Federal Reserve is preparing to cut rates in May/June, the bullish steepening of the US curve should be positive for most activity currencies – including the euro. We still forecast EUR/USD ending the second quarter somewhere near 1.10 and ending the year at 1.15. The year-end consensus forecast for EUR/USD is 1.12.

Before then, subdued volatility in the FX market favours the carry trade. Yen-funded strategies remain popular and target currencies in the emerging world are those of the Mexican peso and the Turkish lira.

Talk of the peso focuses the attention on the US election and the potential return of a Trump administration. We can certainly see investors pricing more volatility into FX markets after November. The presumption is that a Trump administration will be good for the dollar and bad for the likes of the peso and the Chinese renminbi. We would only caution that November is still over six months away, and the make-up of Congress – and the ability to deliver large fiscal stimulus – will also have a large say in whether any Trump administration does prove dollar-positive.

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Rates: Tactical upside to yields

The brief banking panic is behind us – at least until we get the next one. In front of us is a Fed in a holding pattern, and a May cut is now being questioned. As the Fed strip nudges higher, so too does the US 10yr yield. The 4.25% to 4.5% area is one where it will dawn on the market that it's gone too far. But for now, there is little to object to having that test

Federal Reserve headquarters in Washington, D.C.

US remains pivotal, tactical upside to yields with Fed on holding pattern

The local high for 2024 for the 10yr Treasury yield was just short of 4.2%. It feels right to be back up here, threatening to take out that high and making a path to the 4.25% area. The area between 4.25% and 4.5% is one where it will begin to feel like things have gone a bit too far, and one big catalyst can see us crashing back below 4%. We are just not at that tipping point yet.

The New York Community Bank fall is behind us now, and the big falls in the Regional Bank Index have stalled. Until we get some clear sight of material follow-through angst in this space, we move to a point where we effectively ignore the risks, just like we ignore major geopolitical calamity risks (until they hit us, that is). It leaves us with two items ringing in the ears. First, the payrolls report confirmed maintenance of a strong labour market. Second, a Federal Reserve cut in March is now a no go. These are factors forcing yields higher.

In fact, the next question is whether the Fed can cut in May – that's now a toss up from the market's perspective. The unwind of the May rate cuts discount and the upward drift in the Fed funds strip correlates with the ratchet higher in the 10yr Treasury yield. That can continue at least until something happens to negate it.

Structural dis-inversion still on the cards, to be led by the front end

On the curve, we'd expect it to dis-invert before an actual cut. Once we are a couple of months ahead of an actual cut and it's been effectively endorsed by the market discount and minimal Fed objection, then the 2yr yield will have space to gap lower by 50-100bp. That should be more than the 10yr can do, wiping out the 30bp inversion on the 2/10yr segment. From there, the 2/10yr segment begins a journey toward 100bp. The biggest part of that move will come from the front end to begin with.

Eurozone rates to echo the US, but are already quite rich versus future policy rates

Eurozone rates reflect a lot of the same pushes and pulls. The nuance is that eurozone rates are already quite low. For example, 5yr to 10yr Euribor rates are in the 2.6% area, and similar ESTER rates in the 2.4% to 2.5% area. The interest rate strip curves that discount the future for key front-end rates don't push much below these levels, if at all in the coming few years. That suggests that eurozone rates can echo moves in US rates, and in net terms we should see a structural convergence of US to eurozone rates once we get beyond the current tactical upside test to yields in general.

GDP forecasts

Developed Markets (QoQ% annualised growth)	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
US	3.3	1.9	0.7	-0.7	0.8	2.5	1.9	1.3
Japan	1.2	1.6	2.4	2.4	1.2	2.0	1.3	1.4
Germany	-1.3	-0.7	0.7	1.1	1.1	-0.3	-0.2	1.2
France	-0.1	0.0	0.8	1.4	1.2	0.9	0.5	1.3
UK	-0.3	0.4	0.8	1.2	1.2	0.5	0.5	1.3
Italy	-0.2	0.2	0.9	1.4	1.5	0.7	0.4	1.0
Canada	1.1	0.4	-0.5	-1.0	1.2	1.1	0.1	1.4
Australia	1.2	1.6	1.2	2.0	2.4	2.0	1.5	2.5
Eurozone	0.1	0.3	0.5	1.2	1.1	0.5	0.4	1.4
Austria	0.8	0.6	0.8	1.4	1.6	-0.7	0.0	1.5
Spain	2.5	1.4	1.6	1.8	2.2	2.5	1.8	2.2
Netherlands	0.7	1.3	0.6	1.7	1.8	0.1	0.7	1.7
Belgium	0.8	0.0	0.8	1.2	1.2	1.4	0.8	1.4
Greece	0.2	0.5	1.9	2.5	2.3	2.0	1.3	2.0
Portugal	3.4	1.2	1.8	2.0	2.2	2.3	1.6	2.2
Switzerland	0.0	0.8	0.8	1.2	1.2	0.7	0.7	1.4
Sweden	2.1	-0.6	0.7	1.3	1.6	-0.2	0.3	1.5
Norway	1.8	1.2	1.4	1.8	1.8	1.1	1.3	1.8

Emerging Markets (YoY% growth)	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
Bulgaria	1.8	2.3	2.7	3.0	3.4	1.8	2.9	3.3
Croatia	3.2	2.9	2.2	2.6	2.7	2.7	2.6	2.7
Czech Republic	-0.2	0.4	1.0	1.8	2.4	-0.4	1.4	2.2
Hungary	1.5	2.4	3.5	3.4	2.8	-0.6	3.0	3.6
Poland	1.0	2.1	3.2	3.3	3.3	0.2	3.0	3.5
Romania	2.2	3.5	2.6	2.5	2.8	1.7	2.8	3.0
Turkey	3.9	4.6	2.4	1.6	1.9	4.5	2.5	3.5
Serbia	3.4	3.7	2.9	2.2	2.4	2.4	2.8	3.4
Azerbaijan	0.0	4.0	2.5	2.0	1.5	0.6	2.5	2.7
Kazakhstan	4.5	3.5	3.0	4.5	5.0	4.7	4.0	5.0
Russia	4.5	3.0	1.5	-0.5	0.0	3.3	1.0	0.5
Ukraine	4.0	3.5	3.5	3.2	3.7	4.5	3.5	5.0
China	5.2	4.0	5.5	4.8	4.9	5.2	4.8	4.3
India	7.2	3.3	8.2	7.8	7.5	7.2	6.8	7.5
Indonesia	4.9	5.0	5.4	5.2	4.5	5.0	5.2	5.0
Korea	2.2	2.3	2.0	1.6	1.5	1.4	1.8	1.7
Philippines	5.9	4.5	4.2	4.9	4.5	5.3	4.5	5.0
Singapore	2.8	2.0	2.3	2.2	2.1	1.0	2.2	2.5
Taiwan	5.1	4.8	3.6	2.5	1.7	1.4	3.0	2.5

[1]Norway: Forecasts are mainland GDP
Source: ING estimates

CPI Forecasts (pa)

%YoY	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
US	3.2	2.9	2.6	2.0	1.8	4.2	2.4	2.0
Japan	2.9	2.3	2.2	1.8	1.4	3.3	2.0	1.5
Germany	3.0	2.8	2.8	2.6	2.8	6.0	2.8	2.1
France	4.2	3.7	3.3	3.2	2.2	5.7	3.1	1.9
UK	4.2	3.8	1.7	1.7	2.0	7.4	2.3	1.9
Italy	1.0	1.9	2.1	2.1	2.7	6.0	2.2	2.0
Canada	3.2	2.9	2.0	1.5	1.9	3.8	2.1	2.1
Australia	4.1	3.8	3.8	3.4	3.5	5.6	3.6	2.9
Eurozone	2.7	2.8	2.8	2.4	2.1	5.5	2.5	2.2
Austria	5.2	3.5	3.0	2.9	2.3	7.8	2.9	2.1
Spain	3.3	3.0	3.1	2.9	3.0	3.6	3.0	2.3
Netherlands	0.5	1.8	1.0	0.8	1.1	4.1	1.2	2.2
Belgium	0.8	3.6	3.4	3.3	2.6	4.0	3.2	2.1
Greece	3.2	2.7	2.3	1.9	2.3	4.1	2.3	2.0
Portugal	1.7	2.1	2.4	2.6	2.5	4.4	2.4	2.1
Switzerland	1.6	2.0	2.0	2.0	1.9	2.1	2.0	1.8
Norway	4.5	4.3	2.9	3.2	2.8	5.5	3.0	2.5
Bulgaria	5.3	3.7	3.6	3.4	4.0	9.6	3.7	4.1
Croatia	5.0	4.0	2.9	1.6	2.2	8.0	2.7	2.6
Czech Republic	7.2	2.6	2.6	2.4	2.6	10.8	2.6	2.0
Hungary	7.8	3.8	4.2	4.5	5.5	17.6	4.5	4.2
Poland	6.5	3.2	3.8	5.3	5.6	11.4	4.5	4.3
Romania	7.2	7.1	5.9	5.1	4.8	10.5	5.7	4.1
Turkey	64.8	66.8	70.3	45.1	41.6	53.9	55.9	25.8
Serbia	8.0	6.2	5.0	4.6	4.5	12.5	5.1	4.8
Azerbaijan	2.8	6.0	1.9	4.3	6.0	8.9	4.5	5.6
Kazakhstan	10.4	9.7	9.1	8.6	8.0	14.8	8.8	7.1
Russia	7.2	7.6	7.6	6.5	5.3	5.9	6.8	4.3
Ukraine	5.5	6.0	8.0	9.5	9.0	11.7	8.1	7.3
China	-0.3	0.3	0.4	0.9	1.9	0.2	0.9	2.0
India	5.4	5.4	5.4	4.5	4.9	5.5	5.0	4.8
Indonesia	3.5	3.4	3.7	3.6	3.3	4.0	3.5	3.6
Korea	3.4	2.7	2.7	2.4	2.3	3.6	2.5	2.0
Philippines	5.5	4.5	3.8	4.4	3.4	6.1	4.2	3.5
Singapore	3.3	4.3	4.0	3.5	3.0	4.8	3.2	2.8
Taiwan	2.9	2.1	2.0	1.7	1.5	2.5	1.9	1.8

*Quarterly forecasts are quarterly average; yearly forecasts are average over the year. HICP for European Union economies

Source: ING estimates

Oil and natural gas price forecasts (avg)

	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
$/bbl							
Brent	82.00	80.00	82.00	84.00	82.00	82.00	80.00
EUR/MWh							
Dutch TTF	29.00	25.00	25.00	35.00	41.00	29.00	29.00

Source: ING estimates

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