ING Monthly

February 2023

This could well be a 'fool's spring'

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We should guard against the premature return of optimism even if things seem better than expected.

The first month of the new year brought a couple of positive surprises to the global economy. The less complicated-than-expected reopening of the Chinese economy, lower energy prices and a bout of optimism from soft indicators out of Europe didn't only fuel a stock market rally but also led to a wider upward revision of many growth forecasts. However, as much as in times of darkness, even a sunrise is mistaken for a sunset, first signs of optimism do not always point to an upcoming growth party. We have said it before, but better is not necessarily good enough.

Up to now, the sheer fact that the European economy has been holding up better than feared and could even have avoided a winter recession brings welcome relief. The same holds for the US economy, where it takes longer than initially expected before higher interest rates finally take their toll. Together with the reopening of China, the global economy is definitely in a better place than feared only a couple of months ago.

However, we don't think that this is yet the right time to become overly optimistic. In fact, the list of potential risks - but also very real drags - on many economies is still long. In this regard, particularly the idea that the latest improvements in soft European indicators could signal an upcoming rebound of the economy looks premature. Given that the European economy has now been lagging behind that of the US on so many aspects, be it inflation, monetary policy or growth, it is hard to see why the European economy would rebound when the US is staging a soft or hard landing. The latest soft indicators in Europe could have been like those rays of sunshine in January: temporary relief but too early to foretell spring weather.

The example of the US illustrates that textbook economics still works: excess demand fueled higher inflation, triggered a strong monetary policy reaction, and higher interest rates are now pushing the economy into recession. The first cracks in the labour market have become visible, and the housing market has started to come down. As inflation will retreat sharply, we still expect the Fed to cut rates in the second half of the year, even if a milder recession and somewhat higher core inflation could lead to second-guessing at the Fed.

The example of the US economy is also a good reminder for Europe. Here, headline inflation has also started to come down, but core inflation remains stubbornly high, partly driven by the ongoing pass-through of last year's higher energy prices but also partly driven by fiscal stimulus. The risk here is that what initially was a supply-driven inflation shock could become demand-driven inflation as a result of fiscal stimulus. In any case, the US example should tell the eurozone that higher interest rates do matter and can bring down economic activity: traditional economic wisdom. However, for a long while, the dampening impact of higher ECB interest rates on the eurozone economy seems to have been ignored by many experts and policymakers.

Finally, remember that decoupling between the US and the eurozone economy has never really existed. With a slowing economy, it looks almost impossible to see an outperforming eurozone economy when at the same time, the full impact of ECB rate hikes still needs to materialise, the region is still facing an energy crisis, and the war in Ukraine mercilessly continues to drag on.

The outlook for the global economy has improved, but better is still not good enough. The list of risks is long and the probably most underrated risk is central banks' action to defeat inflation. Nothing's wrong with that, but please remember that at least in the US, eight out of the last nine times the Fed embarked on a series of interest rate hikes to rein in inflation, a recession followed.

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Our main calls this month

- **United States:** Recession fears linger as softening activity spreads throughout the economy. There are also tentative signs that the labour market is cooling with increasing layoff announcements and slowing wage growth. Inflation pressures are subsiding and we expect one final 25bp Fed hike in March, with rate cuts from late third quarter.
- **Eurozone:** The significant fall in natural gas prices has probably sheltered the eurozone from a winter recession, though there are still some headwinds that will keep growth subdued in 2023. Sticky core inflation is likely to keep the European Central Bank in tightening mode. A 50bp hike in March looks like a done deal and a rate cut is unlikely before the end of 2024.
- **China:** China's economic recovery following its reopening could be unbalanced initially, as industrial production grows less fast than consumption. But a full recovery later in the year is likely.
- **Japan:** Spring wage negotiations will be key to deciding how quickly the new Bank of Japan Governor acts when he takes up the post in April. Following an initial policy review, we think the BoJ will lift the mid-point target for the 10Y government bond yield in early 2024, followed by a rate cut a few months later.
- **United Kingdom:** Lower gas prices should herald a fall in consumer energy bills by the summer. A recession is still the base case however, and we only expect one more rate hike of 25bp in March.
- **FX:** Assuming that inflation allows the Fed to cut rates as much as we believe, the dollar should remain under further pressure this year. Narrowing rate differentials at the short end of the curve should drive EUR/USD close to 1.15 in the second quarter. The Japanese yen should also benefit as the Bank of Japan softens the controls of its very dovish monetary policy.
- **Market rates:** We see potential for a c.25bp move to the upside from current 10-year bond yield levels, before commencing the final drop toward our target levels of 2% for the 10yr Bund and 3% for the US 10yr yield – though this could be a slow process. We also anticipate more convergence of eurozone to US rates, helped by the ECB hiking more than the Fed in 2023.

ING global forecasts

	2022					2023					2024					2025				
	1Q22	2Q22	3Q22	4Q22	FY	1Q23	2Q23	3Q23	4Q23	FY	1Q24	2Q24	3Q24	4Q24	FY	1Q25	2Q25	3Q25	4Q25	FY
United States																				
GDP (% QoQ, ann)	-1.6	-0.6	3.2	2.9	2.1	-1	-2.7	-1.1	1.1	0.1	2.7	2.6	2.3	2.2	1.5	2.0	2.0	2.0	2.0	2.0
CPI headline (% YoY)	8.0	8.6	8.3	7.1	8.0	5.5	3.5	2.6	2.2	3.4	1.7	1.7	1.8	2	1.8	2.0	2.2	2.2	2.0	2.1
Federal funds (%, eop)	0.50	1.75	3.25	4.50	4.50	5.00	5.00	4.50	4.00	4.00	3.50	3.00	2.50	2.50	2.50	2.50	2.75	3.00	3.00	3.00
3-month interest rate (%, eop)	0.65	2.1	3.5	4.6	4.6	4.9	4.75	4.3	3.75	3.75	3.25	2.75	2.4	2.45	2.45	2.5	2.7	2.9	2.9	2.9
10-year interest rate (%, eop)	2.30	3.00	3.80	3.88	3.88	3.75	3.25	3.25	3.00	3.00	3.00	3.25	3.25	3.50	3.50	3.50	3.75	3.75	4.00	4.00
Fiscal balance (% of GDP)					-4.2					-4.7					-3.9					-3.4
Gross public debt / GDP					99.9					100.9					101.3					100.6
Eurozone																				
GDP (% QoQ, ann)	2.4	3.4	1.2	0.5	3.5	-0.4	0.7	0.9	0.7	0.6	0.9	1.4	1.8	1.6	1.1	1.4	1.4	1.4	1.4	1.4
CPI headline (% YoY)	6.0	8.0	9.3	10.0	8.3	7.9	6.0	4.7	4.3	5.7	3.4	3.0	2.2	1.4	2.5	1.8	1.9	2.1	2.1	2.0
Refi minimum bid rate (%, eop)	0.00	0.00	1.25	2.50	2.50	3.50	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.50	3.50	3.00	3.00	3.00	3.00	3.00
3-month interest rate (%, eop)	-0.45	-0.35	1.17	2.13	2.13	3.20	3.30	3.30	3.30	3.30	3.40	3.40	3.30	3.10	3.10	2.70	2.75	2.80	2.85	2.85
10-year interest rate (%, eop)	0.60	1.40	2.10	2.56	2.56	2.10	2.00	1.90	1.90	1.90	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.40	2.50	2.50
Fiscal balance (% of GDP)					-4.6					-4.5					-3.5					-2.4
Gross public debt/GDP					99					96.4					94.5					94.4
Japan																				
GDP (% QoQ, ann)	-1.8	4.5	-0.8	2.4	1.2	0.8	0.8	0.8	0.8	1.1	1.2	1.2	1.2	1.2	1.1	1.2	1.2	1.2	1.2	1.2
CPI headline (% YoY)	0.9	2.4	2.9	3.8	2.5	4	3.3	2.7	1.7	2.9	1.4	1.7	2	2.3	1.9	2.3	2.2	2	1.9	2.1
Interest Rate on Excess Reserves (%)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.00	0.25	0.25	0.50	0.50	0.50
3-month interest rate (%, eop)	-0.10	-0.15	-0.25	-0.16	-0.16	-0.17	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.00	0.25	0.00	0.30	0.50	0.50	0.50	0.50
10-year interest rate (%, eop)	0.25	0.20	0.25	0.25	0.25	0.50	0.40	0.30	0.50	0.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25
Fiscal balance (% of GDP)					-7					-8					-7					-6
Gross public debt/GDP					270.0					275.0					275.0					270.0
China																				
GDP (% YoY)	4.8	0.4	3.9	2.9	3.0	4.5	5.2	5.7	4.5	5.0	5.5	5.3	5.0	5.5	5.3	4.7	5.4	5.2	5.2	5.1
CPI headline (% YoY)	1.1	2.3	2.5	2.1	2.0	2.3	2.5	2.0	2.0	2.2	2.2	2.2	2.3	2.5	2.3	2.5	2.8	3.1	3.4	3.0
PBOC 7-day reverse repo rate (% eop)	2.10	2.10	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.10	2.20	2.20	2.30	2.40	2.50	2.60	2.60
3M SHIBOR (% eop)	2.38	2.20	1.65	2.20	2.20	2.30	2.35	2.40	2.50	2.50	2.55	2.60	2.65	2.70	2.70	2.75	2.80	2.85	2.95	2.95
10-year T-bond yield (%, eop)	2.80	2.75	2.75	2.95	2.95	3.1	3.15	3.2	3.35	3.35	3.45	3.55	3.65	3.80	3.80	3.90	4.00	4.15	4.25	4.25
Fiscal balance (% of GDP)					-8.0					-8.0					-6					-4
Public debt (% of GDP), incl. local govt.					129.0					131.0					132.0					129.0
UK																				
GDP (% QoQ, ann)	2.5	0.2	-1.2	0.0	4.1	-0.8	-0.5	0.3	1.0	-0.3	1.2	1.2	1.4	1.4	1.0	1.7	1.7	1.7	1.7	1.5
CPI headline (% YoY)	6.2	9.2	10.0	10.8	9.0	9.9	7.3	5.8	3.7	6.7	3.3	1.2	1.2	1.1	1.7	1.0	1.7	1.8	2.1	1.6
BoE official bank rate (%, eop)	0.75	1.25	2.25	3.50	3.50	4.25	4.25	4.25	4.25	4.25	4.25	3.75	3.25	2.75	2.75	2.50	2.50	2.50	2.50	2.50
3-month interest rate (%, eop)	2.70	2.70	3.35	3.75	3.75	4.20	4.20	4.20	4.20	4.20	4.05	3.55	3.05	2.60	2.60	2.45	2.45	2.45	2.45	2.45
10-year interest rate (%, eop)	2.50	2.25	4.10	3.20	3.20	3.40	3.20	3.10	3.10	3.10	2.90	2.90	2.80	2.80	2.80	2.80	2.90	3.00	3.00	3.00
Fiscal balance (% of GDP)					4.0					5.2					3.0					2.5
Gross public debt/GDP					97.5					98.1					98.1					97.7
EUR/USD (eop)	1.11	1.05	0.97	1.02	1.02	1.08	1.15	1.12	1.12	1.12	1.15	1.18	1.18	1.15	1.15	1.15	1.15	1.15	1.15	1.10
USD/JPY (eop)	122	132	145	138	138	128	125	123	120	120	120	120	120	120	120	120	120	120	120	120
USD/CNY (eop)	6.34	6.69	7.11	7.22	7.22	6.8	6.77	6.75	6.72	6.72	6.75	6.80	6.90	7.00	7.00	7	6.95	7.10	7.00	7.12
EUR/GBP (eop)	0.84	0.86	0.88	0.87	0.87	0.89	0.89	0.89	0.9	0.9	0.90	0.90	0.89	0.88	0.88	0.88	0.88	0.88	0.88	0.88
ICE Brent -US$/bbl (average)	98	112	98	89	99	90	95	105	110	100	98	90	88	83	90	73	75	78	75	75

GDP forecasts are rounded to the nearest whole/half number, given the large magnitude and uncertainty surrounding our estimates

Source: ING forecasts

Quick-fire answers to your global economy questions

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Give us a minute, and our economists will give you some answers to the global economy's biggest questions, notably around energy and China's reopening. And take a look at our three scenarios for the world as February begins

Three scenarios for the global economy

ING Outlook: Our base case

Energy prices
Chinese LNG demand only partially recovers, allowing EU to increase LNG imports. Storage starts next winter more than 90% full. European gas prices (TTF) average EUR75-80/MWh in second half of the year.

China Reopening
Rebound in spending concentrated in the service sector, with a more gradual industrial recovery. Commodity prices rise but not rapidly enough to materially impact global inflation profiles.

Central banks
Federal Reserve hikes by 25bp in March but cuts rates by 100bp by year-end. ECB hikes by 50bp in March and 25bp in May – and signals no cuts in 2023.

Economics
Europe's recession is extremely mild, suggesting core inflation takes time to come down even if headline rates tumble on lower gas prices. The US experiences a downturn as higher interest rates and low business confidence begin to hit hiring activity.

Markets
Second half Fed rate cuts allow the dollar bear trend to continue and the euro to enjoy modest recovery.

Market rates are pulled lower from the US end, and ECB hikes ensure convergence versus eurozone rates.

2023 growth forecasts

0.1%	0.6%	5.0%
US	Eurozone	China

Markets: End-2023 forecasts

1.12	3.00%	110
EUR/USD	US 10-year	Oil (Brent)

Source: ING

Positive scenario

Energy prices
Chinese LNG demand little changed, allowing EU to absorb more of 2023's supply growth. Dutch TTF averages EUR 50-55/MWh in second half of the year.

China Reopening
"Goldilocks" scenario where activity recovery surpasses the pre-pandemic level, but without any resulting squeeze on commodity prices.

Central banks
Central banks become much more relaxed about inflation, enabling earlier rate cuts in Europe.

Economics
Europe avoids recession but inflation comes down quicker than expected anyway - lower energy prices feed through indirectly to services. Energy-independent US more similar to the base case (less sensitive to gas prices).

Markets
Not a big change from base case, EUR/USD probably does a little better given better global growth.

US rates see a bigger pull power, tightening spreads versus the eurozone more from the US side.

2023 growth forecasts

US	Eurozone	China
0.4%	1.3%	5.6%

Markets: End-2023 forecasts

EUR/USD	US 10-year	Oil (Brent)
1.15	2.50%	75

Source: ING

Negative scenario

Energy prices
Russian gas flows to Europe further reduced. Chinese LNG demand recovers faster than expected, meaning European gas prices need to rise to compete. Dutch TTF averages EUR135/MWh in second half of the year.

China Reopening
Industry recovers faster than expected, putting abrupt pressure on global energy and commodity prices. Impact on global inflation slightly mitigated by further improved supply chain reliability.

Central banks
Policy rates go another leg higher, and no major central bank cuts rates in 2023. But a deeper recession prompts widespread easing in 2024.

Economics
Core goods price inflation falls less rapidly. Higher gas prices push eurozone into recession, but government support and boost from Chinese demand provide a partial offset. US is more insulated, but higher rates prompt a deeper downturn.

Markets
Dollar rebounds as sticky inflation nixes Fed easing cycle and damages global growth prospects.

Market rates forced to reprice terminal central bank rates higher; abrupt unwind of current richness.

2023 growth forecasts

US	Eurozone	China
-0.3%	0.1%	4.8%

Markets: End-2023 forecasts

EUR/USD	US 10-year	Oil (Brent)
1.05	4.25%	122

Source: ING

How far could gas prices rise from here, and what would be the major cause?

We currently expect that European gas prices will average EUR 70/MWh over 2023, peaking in the fourth quarter with an average of EUR 80/MWh. However, clearly there are significant upside risks to this view. If remaining Russian gas flows to the EU were to come to a halt and if we were to see stronger than expected LNG demand from China this year, this would tighten up the European market significantly. Under this scenario, we would need to see stronger-than-expected demand destruction to keep the market in balance. As a result, prices would need to trade higher, potentially up towards EUR 150/MWh going into the '23/24 winter. The European Commission's price cap of EUR180/MWh for TTF should provide a ceiling to the market, at least for exchange prices within the EU.

Is Europe still heading for recession?

Lower energy prices and high levels of national gas reserves as a result of the warm weather and lower energy consumption have helped the eurozone economy to avoid an energy crisis this winter. Fiscal stimulus has also supported the economy and prevented the eurozone from falling into a severe recession. However, the eurozone economy is not out of the woods, yet. Industrial orders have weakened and once the post-pandemic boost is behind us, growth in the services sector could soften. With (core) inflation remaining stubbornly high and the full impact of ECB rate hikes still materialising (with activity in the construction sector particularly vulnerable), the eurozone is facing a longer quasi-stagnation. The worst-case scenario has been avoided for now but this doesn't automatically lead to a strong recovery.

If gas prices rise, have governments done enough to shield consumers/businesses in Europe?

It took a while but at the end of last year, fiscal support measures in most eurozone countries had reached levels seen during the pandemic. For the eurozone as a whole, the announced fiscal stimulus amounts to around 5% of GDP. The stimulus packages are largely aimed at supporting household purchasing power but also at keeping companies' energy costs at bay. However, if energy prices remain at current levels, the full amount reserved for energy price caps will not have to be used up. While these packages offer significant relief in the short run, they will not be able to shield consumers and businesses against structurally higher energy costs. Government expenditures in the eurozone already amount to around 50% of GDP and with the weighted eurozone government budget at 4.5% of GDP, any room to scale up deficit-financed stimulus, which is exclusively aimed at supporting consumption, looks limited.

Is the end of zero-Covid in China a gamechanger?

The surprise reopening of the Chinese economy will certainly boost demand, and we have revised up our GDP forecasts accordingly. What is still unclear is how much and when the reopening will boost domestic spending within China, especially on services. Household balances are swollen after prolonged inactivity, so some "revenge" spending seems plausible. How important these balance sheet effects are for spending within China is still being debated, with unemployment still high and wage growth still subdued.

Of greater global relevance will be how strongly industry recovers, as this will dictate the strength of the recovery in demand for commodities, including energy. Our current thinking is that manufacturing recovers more slowly than domestic spending on services, and this should not result in a substantial boost to global commodities prices, though some upward price pressure is probable. With the economy just emerging from the Lunar New Year, and data clarity very low right now, this "goldilocks" view is offered with fairly low conviction.

Is inflation really falling, and have markets been too quick to price in cuts?

Headline inflation rates across the developed world should fall this year as the sharp rises in food, fuel and goods prices of late 2021-mid 2022 are unlikely to be repeated. Admittedly, of these three categories, food prices have probably the biggest potential to rise again significantly this year.

With commodity prices - including food indices - having fallen in many cases, there is a case for a sharp reduction in goods-related inflation this year, and in some categories, outright price falls. This story is likely to be more aggressive in the US, where month-on-month increases in core CPI and PCE deflator readings have slowed from 0.5-0.6% in the middle of last year, to 0.2-0.3% more recently. That's still above the 0.17% MoM average required to take the year-on-year rate to 2%, but we're getting close. Rents are topping out, vehicle prices are falling and there is growing evidence that corporate pricing power is waning with businesses thinking more defensively as recession fears mount. We continue to forecast core inflation measures getting down to 2% by the end of 2023.

In Europe, the story is likely to be more gradual. Core inflation is yet to peak, and the lagged impact of higher energy prices is continuing to put pressure on services pricing.

The strong prevalence of collective bargaining in many European countries also suggests wage pressures will continue to feed through, too, and ongoing fiscal stimulus and government intervention could lengthen the inflationary pressure. The fear is that supply-side inflation could morph into demand-side inflation. The divergence between the EU and US in terms of inflation suggests that markets are right to be pricing rate cuts from the Federal Reserve later this year, while the easing priced in from the European Central Bank in 2024 looks premature.

Can the US economy avoid recession?

Possibly, but we need something to turn around quickly. We have a housing market correction coupled with six consecutive monthly falls in residential construction, three MoM drops in industrial production and two consecutive 1%+MoM falls in retail sales, which hint at a broadening slowdown. Meanwhile, the labour market is showing tentative signs of cooling after five consecutive months of decline in temporary help, which typically leads broader labour market trends. With CEO confidence at the lowest level since the Global Financial Crisis, implying a growing proportion of businesses adopting a more defensive stance, the risks are mounting that there will be a recession. However, strong household balance sheets and a robust-looking jobs market suggest it will be relatively short and shallow, assuming inflation falls as we expect and the Fed is able to offer stimulus later this year.

Can the recovery in risk assets continue?

It has been a strong start to the year for risk assets, underpinned by robust inflows. Equity markets are up as much as 9% in Europe and dedicated bond funds are up anywhere between 2-4%. But risk assets will struggle to post further near-term gains should our view for some tactical upward pressure on market rates bear fruit. It’s a non-consensus call though, and even if market rates were to fall it’s more likely that the market reads this as a measure of underlying angst, which can cause issues for risk assets, via an elevation in perceived default risk ahead. The strong rally in credit markets has lasted for over three months before which credit was pricing in a significant recession. The value that was evident then has evaporated. Nonetheless, with persistent inflows to the sector remaining a dominant theme, we remain constructive in the longer term and further returns in the sector will be a function of yield and carry, rather than spread tightening. In FX, growing headwinds to risk assets would provide some temporary support to the dollar and help cement a 1.05-1.10 EUR/USD trading range for the rest of the quarter. Later in the year, however, 1.15 levels are possible as the conviction builds over a Fed easing cycle.

February 2023 - Scenario forecasts

United States

Real GDP (QoQ ann%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	-1.0	-2.3	0.7	2.0	0.4	2.9	2.8	2.4	2.5	2.0
Base case	-1.0	-2.7	-1.1	1.1	0.1	2.7	2.6	2.3	2.2	1.5
Negative scenario	-1.0	-3.0	-2.3	-0.6	-0.3	0.7	1.9	2.0	2.2	0.3

Inflation (YoY%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	5.5	3.5	2.4	1.9	3.3	1.5	1.5	1.8	2.2	1.8
Base case	5.5	3.5	2.6	2.2	3.4	1.7	1.7	1.8	2.0	1.8
Negative scenario	5.5	4.3	3.6	3.0	4.1	2.7	2.0	1.6	1.4	2.0

Fed Funds Rate (%, eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	5.00	5.00	4.50	4.00	4.00	3.50	3.00	3.00	3.00	3.00
Base case	5.00	5.00	4.50	4.00	4.00	3.50	3.00	2.50	2.50	2.50
Negative scenario	5.00	5.25	5.25	5.25	5.25	4.25	3.25	2.25	2.00	2.00

Eurozone

Real GDP (QoQ ann%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	0.8	1.3	2.1	2.3	1.3	2.1	2.1	1.6	1.6	2.0
Base case	-0.4	0.7	0.9	0.7	0.6	0.9	1.4	1.8	1.6	1.1
Negative scenario	-1.1	0.0	0.2	-1.5	0.1	-1.3	0.4	1.1	2.0	-0.2

Inflation (YoY%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	7.8	5.8	3.7	3.0	5.1	2.7	2.3	2.0	1.8	2.2
Base case	7.9	6.0	4.7	4.3	5.7	3.4	3.0	2.2	1.4	2.5
Negative scenario	8.0	6.3	6.0	6.2	6.6	6.0	4.0	2.0	1.2	3.3

ECB Main Refi Rate (%, eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	3.50	3.75	3.75	3.75	3.75	3.75	3.50	3.25	3.00	3.00
Base case	3.50	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.50	3.50
Negative scenario	3.50	4.00	4.25	4.25	4.25	4.00	3.50	3.00	2.75	2.75

United Kingdom

Real GDP (QoQ ann%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	0.4	1.0	1.2	1.5	0.4	1.8	1.8	1.9	0.9	1.6
Base case	-0.8	-0.5	0.3	1.0	-0.3	1.2	1.2	1.4	1.4	1.0
Negative scenario	-2.2	-0.7	0.0	-0.6	-0.9	-0.8	0.4	0.9	1.4	-0.1

Inflation (YoY%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	9.9	6.5	4.2	2.2	5.7	1.6	1.3	2.0	1.8	1.7
Base case	9.9	7.3	5.8	3.7	6.7	3.3	1.2	1.2	1.1	1.7
Negative scenario	9.9	7.6	6.2	4.0	6.9	3.7	1.8	1.7	1.5	2.2

Bank Rate (%, eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	4.25	4.25	4.25	4.00	4.00	3.75	3.50	3.25	3.00	3.00
Base case	4.25	4.25	4.25	4.25	4.25	4.25	3.75	3.25	2.75	2.75
Negative scenario	4.50	4.75	4.75	4.75	4.75	4.25	3.25	2.75	2.25	2.00

China

Real GDP (YoY%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	4.7	5.5	5.9	6.3	5.6	5.7	5.5	6.1	5.6	5.7
Base case	4.5	5.2	5.7	4.5	5.0	5.5	5.3	5.0	5.5	5.3
Negative scenario	4.7	5.0	5.0	4.6	4.8	5.3	5.0	5.2	5.0	5.1

Inflation (YoY%)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	2.2	2.3	2	2	2.1	2.1	2.1	2.2	2.4	2.2
Base case	2.3	2.5	2	2	2.2	2.2	2.2	2.3	2.5	2.3
Negative scenario	2.3	2.6	2.5	2.3	2.4	2.4	2.5	2.5	2.7	2.5

7-day reverse repo (%, eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.10	2.20	2.20
Base case	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.10	2.20	2.20
Negative scenario	2.00	2.05	2.05	2.10	2.10	2.10	2.15	2.20	2.35	2.35

Energy

Brent crude (USD/bbl)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	80	80	78	75	78	75	78	76	72	75
Base case	90	95	105	110	100	98	90	88	83	90
Negative scenario	95	110	118	122	115	105	96	94	88	96

Dutch TTF (EUR/MWh)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	60	55	50	56	55	60	50	30	40	45
Base case	65	60	75	80	70	80	65	50	60	64
Negative scenario	70	90	120	150	108	155	100	85	95	109

Markets

EUR/USD (eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	1.08	1.15	1.12	1.15	1.12	1.15	1.15	1.15	1.15	1.15
Base case	1.08	1.15	1.12	1.12	1.12	1.15	1.18	1.18	1.15	1.15
Negative scenario	1.05	1.00	1.00	1.05	1.05	1.10	1.12	1.15	1.20	1.20

US 10Y (eop)	1Q23	2Q23	3Q23	4Q23	FY23	1Q24	2Q24	3Q24	4Q24	FY24
Positive scenario	3.75	3.00	2.50	2.50	2.75	3.25	3.5	3.75	3.75	3.75
Base case	3.75	3.25	3.25	3.00	3.00	3.00	3.25	3.25	3.50	3.50
Negative scenario	3.75	4.50	4.50	4.25	4.25	3.50	2.75	2.50	2.75	2.75

All forecasts are average of the period unless marked 'eop' (end of period)
Source: ING

Commodities: milder winter offers some comfort to energy markets

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A mild European winter has seen gas prices continue to collapse in January and Europe is likely to get through this winter in a comfortable state. However, there are still clear upside risks. Oil prices have been more rangebound, but we see prices moving higher later in the year as the market tightens

A mild winter has allowed Europe to build up its gas storage levels

Drastic change in the natural gas outlook

A late start to the 2022/23 heating season saw Europe building gas storage almost until mid-November. At a little more than 95% full, storage was essentially maxed out. This was far above the target of 80% by 1 November 2022 set by the European Commission. While there have been some cold spells in the current heating season, it has been largely mild, which has meant storage levels have held up well. In fact, there have been days this winter when storage has seen net increases. Storage at the moment is around 72% full, well above the five-year average of around 53% for this time of year.

Assuming Europe does not experience a prolonged cold spell in the current heating season, the region should exit the 2022/23 winter with storage above 50% full. This is significantly higher than the 26% seen at the end of the last heating season and above the five-year average of 34%.

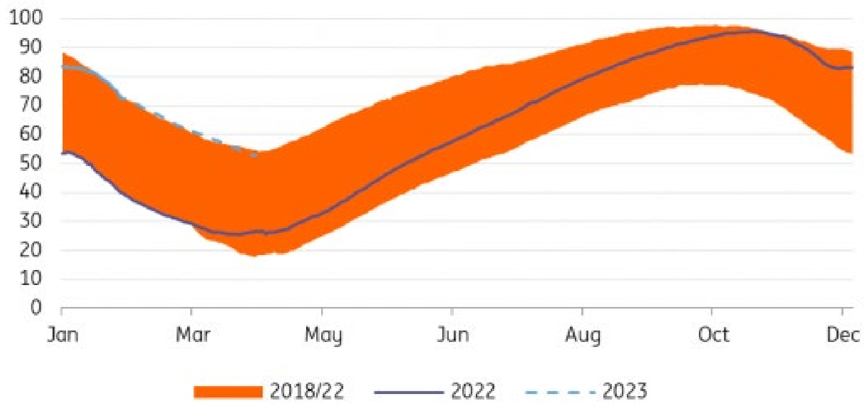
Ending this winter with very comfortable inventories makes the job of refilling storage over the injection season and hitting EU inventory targets of 90% by 1 November 2023 easier. Between 1 April and the end of October last year, the EU added in the region of 67 billion cubic metres (bcm) to storage. If we were to see similar storage levels at the start of the next heating season, the EU would only need to add around 43bcm of gas this year.

A more comfortable European balance suggests that prices do not need to trade as high as initially expected, although prices will still remain historically high in order to ensure adequate demand destruction and liquefied natural gas (LNG) supply. We expect TTF to average EUR70/MWh over 2023 with prices peaking over the fourth quarter of 2023 to average EUR80/MWh.

The assumption to these forecasts is that we do not see a further decline in remaining Russian pipeline flows to Europe, and that Europe sees a marginal increase in LNG imports in 2023 (this would mean not seeing a return to 2021 LNG import volumes for China) and that we see demand destruction in the region of 10% from April 2023 onwards. These factors should ensure that the EU hits its target of having storage at least 90% full by 1 November 2023.

Clearly, an upside risk to our view is if we see Russian flows fall further and/or stronger-than-expected Chinese LNG imports in 2023.

EU storage to exit this winter comfortably (% full)



Source: GIE, ENTSOG, Eurostat, ING Research

Oil market set to tighten

Oil prices have been trading in a largely rangebound manner so far this year, although there is still plenty of uncertainty over the demand outlook (which will really depend on how strong a recovery we see from China this year) and Russian oil supply.

Global oil demand is expected to grow in the region of 1.7MMbbls/d this year, which would take global oil demand above pre-Covid levels and to a record 101.3MMbbls/d. Around 50% of global demand growth is expected to come from China this year, following the reversal of its zero-Covid policy.

As for Russian supply, the EU ban on Russian seaborne crude oil imports came into force in December and whilst there was an initial drop in Russian seaborne export volumes, we have seen a recovery. On 5 February, the ban will include Russian refined products, which could prove more disruptive for oil markets, given the challenge of rerouting refined products that would have gone to the EU to other destinations. We expect that the Russian oil supply will fall in the region of 1.3MMbbls/d year-on-year in 2023 due to the EU ban on Russian crude and refined products. Clearly, the risk to this view is if Russia manages to find new homes for its refined products, much like it has done with increased crude oil flows to India and China.

The oil market is comfortably supplied over the first quarter of the year with Russian supply holding up better than expected, whilst a milder winter will also mean reduced fuel demand for heating purposes. This leaves the oil market in surplus over the first quarter, which suggests that the upside for prices is limited in the short term. However, in the medium to long term, the market is expected to tighten which should see prices moving higher from the second quarter onwards. We expect ICE Brent to average US$100/bbl over 2023, with the bulk of strength coming in the second half of the year, when we see prices averaging US$108/bbl.

Our view on the major central banks

The Fed and Bank of England are closing in on the end of their respective tightening cycles, while the ECB still has more work to do. Greater potential for an inflation pullback in the US suggests the Fed will be much earlier to cut rates than its European counterparts. Bank of Japan tightening is likely to be a gradual process

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ECB President, Christine Lagarde with Croatia's Economy Minister at the World Economic Forum last month

Federal Reserve

After the most aggressive series of policy rate increases seen in more than forty years, After the most aggressive series of policy rate increases seen in more than 40 years, unsurprisingly, the US economy is now experiencing slower growth. Markets are now pricing recession, but Federal Reserve officials are concerned that lower Treasury yields and a softer dollar have loosened financial conditions, thereby undermining the Fed's policy stance.

They continue to warn that "unacceptably high" inflation means the economy needs to experience a "sustained period of below trend growth" for them to be confident price pressures will fade. Hence the latest 25bp hike with a further 25bp expected in March.

However, job loss announcements are becoming more prevalent, and weakening price intentions, falling car prices and a clear topping out in housing rents offer encouragement that inflation will fall sharply. This should open the door to significant interest rate cuts from late in the third quarter of this year, with the Fed funds target rate potentially falling back to 2.5% next year.

European Central Bank

It took the ECB a while, but it seems to have got the hang of it: hiking interest rates. And as long as core inflation remains stubbornly high and core inflation forecasts remain above 2%, the ECB will continue hiking rates. The increasing probability that a recession will be avoided in the first half of the year also gives companies more pricing power, showing that selling price expectations remain elevated.

The celebrated fiscal stimulus, which has eased recession fears, is an additional concern for the ECB as it could transform a supply-side inflation issue into demand-side inflation. These are two factors that could extend inflationary pressures in the eurozone, albeit at a lower level than we see at the moment. As a consequence, we expect the ECB not only to continue hiking into late spring but also to keep interest rates high for longer than markets have currently pencilled in.

Bank of England

The Bank of England has given its strongest hint yet that the tightening cycle is nearing an end - and perhaps even that February's 50bp hike was the last. In practice we're probably not quite there yet. UK headline CPI may have peaked, but the same can't yet be said for wage growth or service-sector inflation. We therefore expect the BoE to pivot back to a 25bp rate hike in March but that's likely to be it.

However unlike the Fed, it's unlikely that the BoE will begin cutting rates later this year. The Bank's Chief Economist, Huw Pill, recently noted that the UK has the worst bits of the US inflation story (structural labour shortages) and the eurozone (energy crisis), arguing that core inflation could stay stickier as a result. That's a line we're likely to hear a lot of over the coming months and suggests a rate cut is unlikely for at least a year.

Bank of Japan

The Bank of Japan attracted the attention of market participants around the world after it surprised with an unexpected adjustment in the yield curve in December. Governor Kuroda reiterated at the January meeting that the economy still needs easy monetary policy, and the BoJ's sustainable inflation target of 2% has yet to be achieved.

We think that it is highly unlikely that Kuroda will make another move in March, just before his retirement in early April. Indeed, markets are paying more attention to who will be the next governor, hoping the new leader may change the BoJ's policy stance. We agree, but "Shunto", the Spring wage negotiations, is key to watch. If wage growth is not strong enough to offset recent inflation, it will take longer than expected to normalise policy.

We predict that the BoJ will keep its negative policy rate and yield curve control policy until the end of 2023 for now.

US: easing inflation fears boost hopes for a Fed rescue

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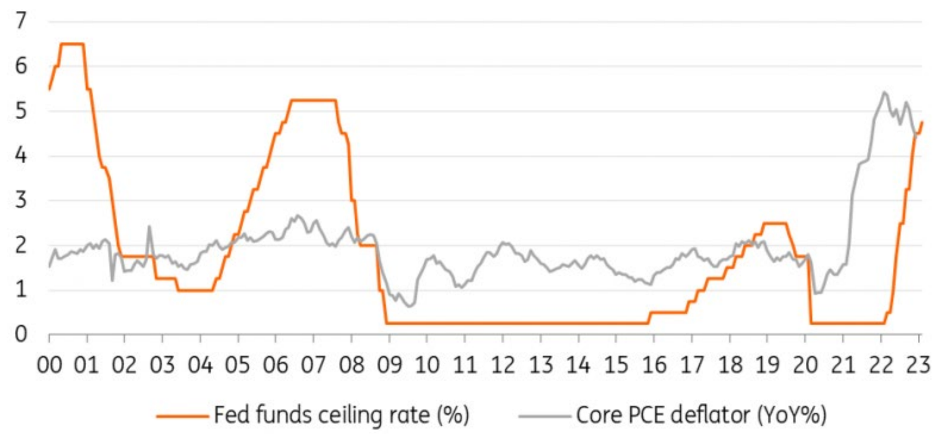
US recession fears linger on as softening activity spreads throughout the economy. There are also tentative signs that the labour market is cooling with increasing layoff announcements and slowing wage growth. Inflation pressures are subsiding and offer hope that the Fed will ride to the rescue with stimulus later this year

The Fed's Jerome Powell may well start stimulating the US economy later this year

Real interest rates turn positive as Fed hikes continue

Inflation caught the Federal Reserve off guard last year and it had to catch up aggressively, implementing the most substantive series of interest rate increases in more than 40 years. Despite that, it has taken a further 25bp hike this week to finally get positive real interest rates; both the ceiling and the lower band of the Fed funds target rate range are above core inflation for the first time since 2019.

US policy rates finally exceed inflation



Source: Macrobond, ING

This doesn't mark the end of policy tightening. Inflation remains well above the 2% target and unemployment is at very low levels leaving the Fed wary that any relaxation of policy could allow inflation to reignite, especially with China reopening and the European story looking more positive. Moreover, many officials are concerned that financial markets are getting ahead of themselves in pricing interest rate cuts later this year. Lower Treasury yields, a softer dollar and narrowing credit spreads could boost growth and undermine the central bank's attempts to control inflation.

We don't share those concerns to the same extent. Instead, we expect a final 25bp interest rate increase in March. With inflation set to continue slowing and the outlook for both growth and the labour market deteriorating, we think that will be the peak and rate cuts will indeed be the story of the second half of the year.

Weakness is spreading

The economy is certainly feeling the impact of the Federal Reserve's interest rate hikes and the knock-on effects for borrowing costs throughout the economy. The housing market has cooled rapidly in response to the surge in mortgage rates, with the number of transactions slowing sharply and residential investment contracting at an annualised 26.7% rate in the fourth quarter of 2022. In fact, we've had seven consecutive month-on-month falls in residential construction, three consecutive drops in industrial production plus 1%+ MoM falls in retail sales in both November and December.

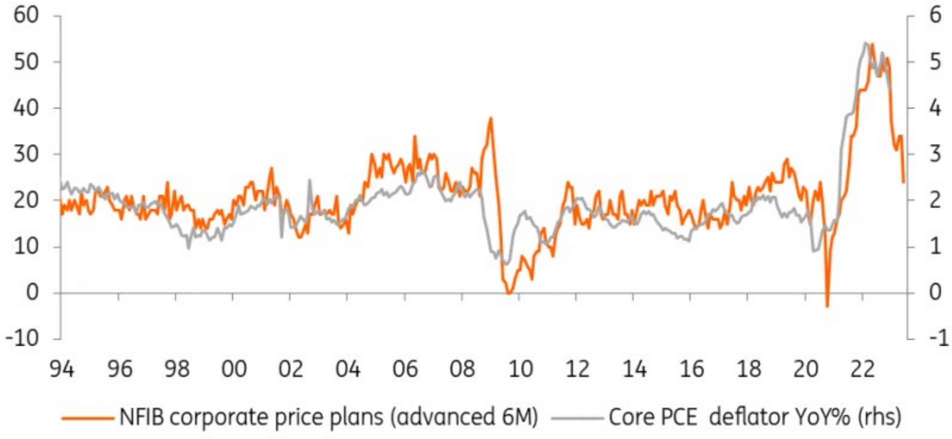
We need to see a turn quickly to prevent GDP from turning negative in the first half of this year, but with the ISM manufacturing and non-manufacturing surveys pointing to a flat to weaker trend, this is going to be difficult. Auto sales are looking OK, but we are concerned that the strong boost to growth from net trade and inventory building experienced in the fourth quarter of last year will not be repeated.

We see a strong chance, therefore, that first quarter GDP growth will be negative. Moreover, the Conference Board's measure of CEO confidence is now at the lowest level since the global financial crisis, which suggests that corporate America will turn increasingly defensive, implying a greater focus on cost control rather than a desire to expand businesses.

Inflation pressures are cooling, allowing Fed rate cuts from the third quarter

This isn't encouraging from a labour market perspective. Job loss announcements are becoming more prevalent, and there have been five consecutive monthly falls in the temporary help component; historically, that's a strong leading indicator ahead of broader shifts in employment. If America's boardrooms are as gloomy as surveys suggest, this does indeed indicate the threat of rising unemployment.

Fewer companies are looking to raise prices



Source: Macrobond, ING

Wage pressures also appear to be cooling, with the latest Employment Cost index posting the slowest increase in a year; both wages and salaries, along with benefits are seeing this trend. Corporate pricing power also appears to be softening, as you can see in the chart above. With fewer firms planning to raise prices, falling inflation looks to be a strong bet even before we consider slowing housing rents and falling car prices which together account for more than 40% of the basket of goods and services used to calculate the inflation rate.

A weak economy, a cooling jobs market and rapidly slowing inflation will, in our view, allow the Fed to cut rates from late in the third quarter. Remember that over the past 50 years, the average time elapsed between the last rate hike in a cycle and the first rate cuts has only been six months. We expect the fed funds ceiling to be cut to 4% by year-end.

The eurozone's been saved, in part, by the weather

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The significant fall in natural gas prices has probably sheltered the eurozone from a winter recession, though there are still some headwinds that will keep growth subdued in 2023. Sticky core inflation is likely to keep the European Central Bank in tightening mode in the first half of the year

Warmer weather in Europe has helped offset big energy price rises. Pictured: an art installation on the Champs-Élysées in Paris

Sentiment is improving

Looking at recent economic sentiment indicators and the stock market rally in Europe, it looks as if the projected winter recession is not happening after all. Eurozone GDP surprisingly grew by 0.1% in the fourth quarter of 2022. Meanwhile, the composite PMI has been creeping up since November to reach 50.2 in January, a level that can no longer be associated with an economic contraction. At the same time, consumer confidence rose for the fourth consecutive month after having reached a historic low in September.

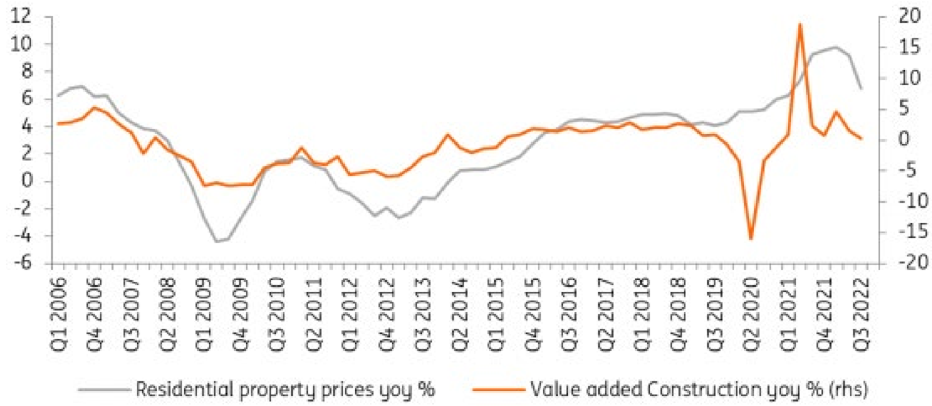
Much of the improvement in sentiment is, of course, attributable to the significant fall in natural gas prices. With inventories still close to record highs on the back of the relatively mild winter, natural gas prices have nose-dived and are back at pre-war levels. While we don't believe that they will remain so low, they probably won't return to the growth-choking levels that we saw in the autumn of 2022. Another tailwind is the opening up of the Chinese economy, which is likely to support eurozone exports in the coming quarters, although this might be partially compensated by a weaker US economy.

Not all headwinds have disappeared, however

So, no worries then? Not so fast. While consumption is less depressed, it is far from strong. Because of weak demand, there is an inventory overhang in many sectors that might weigh on production in the short run. The ongoing ECB tightening cycle is causing havoc on the real estate market, and construction is also likely to feel the pain. The signs are already apparent in the weak credit growth figures in December and the downbeat bank lending survey, while house prices have started to fall in a number of member states.

While the current growth deceleration might barely cause a weakening of the (tight) labour market, the corollary is that the subsequent upturn will not benefit from rapidly growing employment. We also think that fiscal policy will become tighter in the wake of the still-high budget deficits. The bottom line is that we are revising our growth forecast upwards to 0.6% for this year, but for 2024 we are sticking to the 1.1% growth projection.

Higher interest rates will weigh on the housing market and construction sector

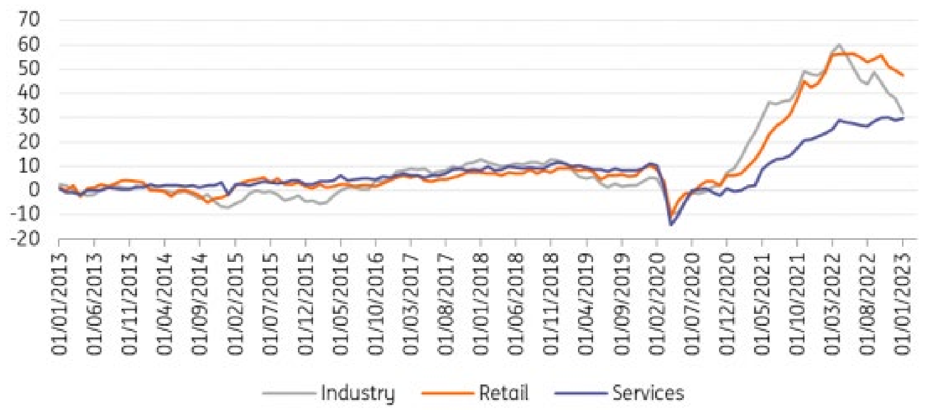


Source: Refinitiv Datastream

Inflation problems not over yet

HICP headline inflation fell in January to 8.5% on the back of the lower energy prices. However, core inflation remained stuck at 5.2%. Looking at the business surveys, intentions to raise prices in the coming months remain high. You might even say that less adverse economic circumstances contribute positively to businesses' pricing power, especially in the services sector. We now expect average headline inflation of 5.7% in 2023, while core inflation is projected to average 4.6% over the year. A return to the ECB's 2% inflation objective will probably have to wait until the fourth quarter of 2024.

Selling price expectations remain high



Source: Refinitiv Datastream

More monetary tightening to come

A 50 basis point rate hike both in February and March now looks like a done deal. The question is how much more tightening the ECB will add after that. While we anticipated a final 25bp rate hike in May, we must admit that the probability of an additional 25bp tightening is increasing by the day. At the same time the bank might also decide to increase the amount of maturing bonds that will no longer be reinvested in the second half of the year. As for a first rate cut, we probably will have to wait until the end of 2024 at the earliest.

China: rebound starts with consumption

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China's economic recovery following its reopening could be unbalanced initially, but a full recovery later in the year is likely

Wealthy Chinese households are resuming their pre-pandemic spending patterns

Recovery starts with consumption

According to data from the National Tax Administration, retail sales revenue this Chinese New Year holiday increased by 12.4% compared to the 2019 holiday. Most of the growth came from travel-related activities, such as sales by travel agencies. In addition, box office results were 14% more than the pre-pandemic levels of 2019. Hotel sales revenue increased by around 20% compared to 2022.

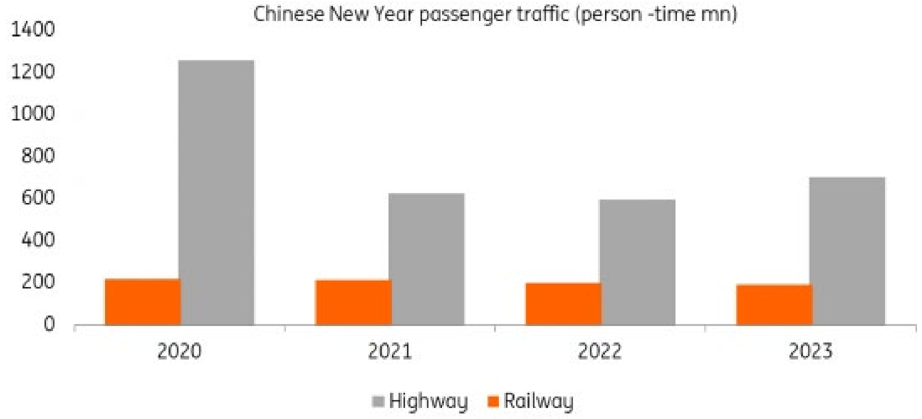
This data reflects the fact that Chinese consumers are generally engaging in travel close to home rather than taking long-distance trips within the country. Coupled with the queues of shoppers seen in front of luxury shops, the current recovery looks uneven.

The general consumer base, which is spending more money this holiday season than in 2022, remains cautious because they are even less certain about wage growth this year. This is even more pronounced in the manufacturing sector, due to weak external demand.

At the richer end of the household spectrum, wages and job security are less relevant. This group can resume their pre-pandemic spending patterns. Not only does this group tend to spend within China, but they are also the first to restart luxury shopping overseas.

For both groups, the strong spending growth in January was due to the lifting of Covid restrictions that coincided with the Chinese New Year holiday. This may not repeat in February, and we should expect more modest spending growth in that month, before it picks up again in March. That said, we expect consumption to fully recover to pre-pandemic levels in the second half of the year.

Chinese New Year passenger traffic via railway and highway



Source: CEIC, ING

Manufacturing may not be as good

Industrial production may not grow as fast as consumption because 1) the peak of export orders in China is usually for shipments between September and November. This means that most existing orders should already have been filled; 2) export markets in the US and Europe are entering a weak phase and there may be fewer orders for Easter than last year; and 3) orders for the summer holidays may not be booked until shortly before the holidays, as sellers in the US and Europe may need more time to gauge market demand.

In short, the risk to industrial production this year lies in external demand. We expect transport and logistics to run smoothly this year, and there should be no supply disruptions from this front.

There is another growing risk. The technology war between China and the US and its allies has been intensified by the possible ban on semiconductor equipment entering China and the ban on solar panel technology from China. This technology war could spread to a wider range of items and could pose a risk to some companies' access to essential components and products. While it is too early to call this a supply chain disruption, the risks are rising.

Real estate is no longer a systemic risk

With the People's Bank of China (PBoC), the central bank, providing liquidity to property developers, the likelihood of a crisis for indebted property developers has been significantly reduced and this is no longer a systemic risk. We expect the PBoC to widen access to financing for developers and the market should be able to price in the credit risk of different developers appropriately. Real estate construction activity should gradually resume this year.

Infrastructure construction activity should also make a comeback as local governments prioritise growth on their to-do lists. These infrastructure projects include soft infrastructure, which includes technology development, as well as hard infrastructure, which is more likely to be inter-provincial transport projects rather than local projects. These projects could be financed by local government financial instruments or by the People's Bank of China's refinancing programme.

In our view, the PBoC does not need to reduce interest rates or the reserve requirement ratio (RRR) further as the economy is already recovering well. Therefore, for most of the year, the PBoC can focus on re-lending schemes to provide additional liquidity to specific sectors, including technology, ESG and agriculture.

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The Bank of Japan faces tough choices ahead of policy normalisation

Market expectations for a policy change by the Bank of Japan will continue to grow, but it won't move as fast as many in the market might hope

Kuroda Haruhiko, Governor of the Bank of Japan, is getting ready to step down

Will a change in leadership lead to a change in policy?

The Bank of Japan's Governor, Haruhiko Kuroda, will step down on 8 April after serving ten years at the Japanese central bank. Kuroda is credited as being the main advocate of Japan's super-easy monetary policy stance. And his looming retirement means that market expectations are growing over whether the next governor will shift the BoJ's policy stance.

His successor nominee will be presented to Parliament on 10 February, but a couple of names are already circulating, notably those of the current deputy governor or his predecessor. Based on their past remarks, it's expected they would both reduce the extent of accommodation, although there is a 'hawk-dove' division as far as the policy spectrum's concerned. So, the pace and extent of any changes will surely vary, but even small modifications can shock the market, as was demonstrated after the December policy tweak.

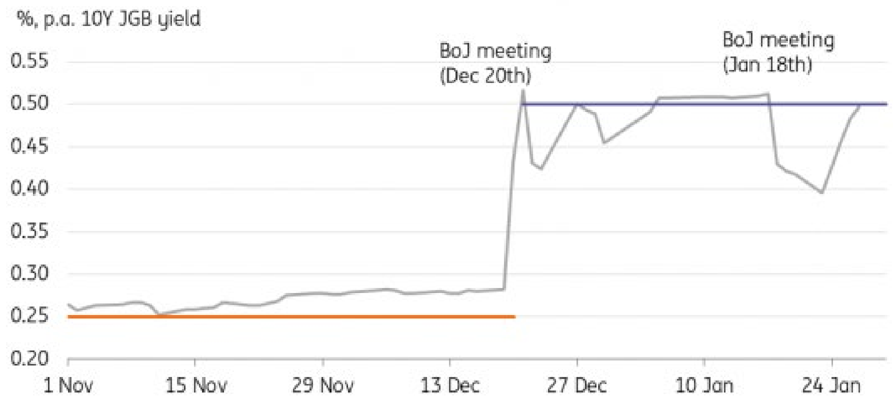
Consequently, a conservative policy transition is likely to be pursued. We also think that the next governor is likely to continue to focus on prices, as the current above-4% inflation rate is not considered sustainable and is expected to fall below 2% in the coming quarters. That's why we believe the spring wage negotiations, known as Shunto, are the key variable to watch.

Wage increases are essential to escape the vicious cycle of deflation

As we mentioned in our research note "Why is Japan's inflation so low?", there are structural problems which have led to Japanese consumers' wage and wealth growth stagnating. Core CPI inflation, excluding fresh food, is expected to exceed 4% in January. But this is driven mainly by supply-side pressures and will be transitory. Therefore, from the BoJ's perspective, there is still concern about deflation. This is why the spring salary negotiation is important. Without wage growth, it is going to be very difficult to achieve a sustainable inflation target of 2%.

The government has offered incentives to companies for wage increases, but in our view, wage growth will rise more slowly than the 3% sought by the BoJ. Base salaries may pick up, reflecting high inflation, but this may be largely offset by a reduction in bonuses and incentives as corporate earnings are likely to be squeezed. The latest labour market reports suggest that wage pressures remain relatively weak. However, if wages do rise by around 3%, then the pace of policy adjustment by the BoJ is expected to accelerate.

10-year JGB runs just below the BoJ's target band



Source: CEIC

BoJ watch

We think it will be difficult for Kuroda to try any policy changes at the March meeting just before he steps down. A lack of upward wage pressure, along with slowing inflation, may also prevent the new governor from taking immediate action in April. We think he will likely adjust its forward guidance and call for a policy review with the Ministry of Finance. This will give the BoJ more flexibility in policy-making.

As we argued in our outlook report, there could well be a re-examination of the inflation target – from the current "at the earliest possible time" to making the 2% target a "long-term goal". Thereafter, we think the BoJ will lift the mid-point target for the 10Y Japanese government bond from 0% to 0.25% in early 2024, followed by raising its short-term policy rate from -0.1% to 0.0% in the second quarter of 2024.

If wage growth is stronger than we expect and inflation stays above 2% until the third quarter of this year, then the timing could be brought forward to the end of this year.

UK: lower gas prices point to a more modest recession

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Lower gas prices should herald a fall in consumer energy bills by the summer. A recession is still the base case, but the reduced squeeze on household incomes suggests the peak-to-trough fall in GDP could now be less than 1%

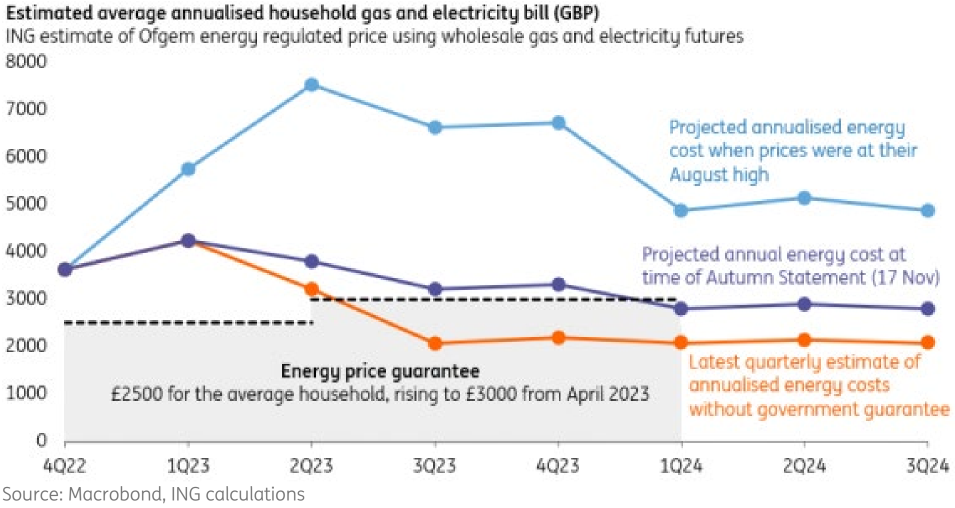
The British Prime Minister, Rishi Sunak, is facing major economic headwinds

Lower gas prices are good news for UK consumers

Lower gas prices are as much of a boon for the UK as they are for the rest of Europe. It's true that Britain has considerably less gas storage than its peers, making it more vulnerable on days of low temperatures and wind. But in general, lower prices point to lower consumer bills – and that means the hit to GDP this year is likely to be less than feared.

April's planned increase in unit prices can probably be cancelled, and in fact, the average annual household bill is likely to fall from £2,500 under the government guarantee, to £2,000 over the summer. Such a move would shave roughly 1 percentage point off headline inflation later this year and means it would end the year only modestly above the Bank of England's 2% target. Admittedly, business support is still set to become less generous, though with wholesale gas prices so much lower, this looks less consequential than it once did.

The average annual household energy bill should fall by the summer



Source: Macrobond, ING calculations

The UK doesn't look like it will be a notable outlier on GDP

With the hit to household incomes diminished, we now think the peak-to-trough fall in UK GDP is likely to be less than 1%. Most of the hit is likely to fall in the first quarter. But while this still places the UK towards the bottom of the pack on growth (again), we think it's an exaggeration to say it will be a notable outlier.

For instance, while higher mortgage rates are likely to weigh on 2023 growth, the UK doesn't look any more exposed than much of Europe to a house price correction. Unlike somewhere like Sweden, which has so far seen a 15% fall in house prices, the UK has a very low share of variable rate mortgages and ranks in the middle-of-the-pack on household indebtedness, as well as on increases in price-to-income ratios over recent years.

The situation is trickier for businesses, particularly smaller corporates where floating rate lending makes up 70% of outstanding debt. Survey data suggests that's a particular issue in consumer services and real estate. The latter, combined with weaker homebuyer demand, unsurprisingly points to a fall in construction this year.

For now, the Bank of England is more focused on persistently strong wage growth and service-sector inflation. While it looks like we're close to the top of this tightening cycle, we think the UK's somewhat unique combination of structural labour shortages and exposure to Europe's energy crisis points to somewhat sticky core inflation. That suggests the UK is likely to be slower than the US Federal Reserve to cut rates, and we don't expect policy easing before next Easter.

CEE: moment of truth for Central and Eastern Europe

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January and February will be a moment of truth for Central and Eastern Europe and confirmation that the region has its own inflation story, more persistent than the global narrative. The region's economic picture is generally better than expected, but this also means stronger inflationary pressures and a problem for central banks to cut rates soon

The Polish Prime Minister, Mateusz Morawiecki

Poland: Resilient economy but persistent core CPI remains a problem

The Polish economy proved to be relatively resilient to the shocks of war, energy and aggressive rate hikes, both at home and abroad last year. In 2023 we stick to our above-consensus GDP forecast of 1%. Lower gas prices and China reopening support the eurozone and our GDP expectations for Poland. Last year's fourth-quarter GDP backdrop was disinflationary, but the labour market was still tight. According to the National Bank of Poland Beige Book, the percentage of companies planning wage hikes grew to an all-time high of 62.3% due to a tight labour market and a countercyclical hike of the minimum wage by 19.1%.

We expect CPI to rise to 18.1% in January and peak at 20% YoY in February. In the following months, CPI should drop by half to about 10% in December 2023. But the problem is the persistence of core inflation. We are not expecting rate cuts in 2023 against quite aggressive market pricing. The government covered more than 50% of borrowing needs but given the strong sentiment in the Polish government bond (POLGBs) market, it plans for heavier supply in February.

Together with the approaching European Court of Justice ruling on 16 February, both of these factors call for tactical profit taking on the POLGBs market. The ruling of the ECJ is the second step in the Swiss franc mortgage saga. The ECJ is expected to judge whether banks can charge clients for the cost of capital, even when CHF mortgages are terminated. Should the ECJ ruling turn negative, local banks may be forced to significantly raise provisions, which should hinder their demand for POLGBs. This is an important systemic risk which needs to be tackled by policymakers. This uncertainty explains the underperformance of the zloty vs CEE FX recently and should also affect POLGBs.

Czech Republic: Recession confirmed

The flash GDP estimate confirmed the Czech economy entered recession in the second half of 2022. The Czech economy declined by -0.3% Quarter-on-Quarter, mainly due to a reduction in private spending. The good news is that the decline remained still relatively shallow compared to market expectations. The economic contraction has not been mirrored in a significant deterioration of the labour market yet. However, key local car producers have already announced they are planning to reduce their production markedly in the coming weeks due to problems with component supplies. Given the importance of the automotive sector to overall economic performance, it seems the pace of economic recovery will be postponed.

We expect inflation is likely to exceed 17% YoY in January, reflecting the increase in regulated prices and food prices. On the monetary policy side, there is no change in our view that the central bank will keep interest rates the same in February. Czech National Bank officials mostly assume that ongoing strong inflation is largely attributable to supply-side effects and should fade during the year, while the current level of rates at 7% is sufficient to tame domestic demand-pull inflationary pressures, together with a decline in consumer spending. Depending on inflation and the performance of the economy, we see the possibility of reopening the discussion on rate cuts in the middle of the year.

The Czech koruna strengthened further, which is mostly attributable to the decline in gas prices. Previous interventions by the CNB cooled market pressure on the koruna. We expect a soft correction of the currency to slightly weaker levels and volatility isn't expected to be too much of a problem.

Hungary: A glimpse of light at the end of the tunnel

This year could not have started better for a small open economy with a high dependency on energy imports like Hungary. After a rough year, the Hungarian economy is facing a non-negligible tailwind thanks to the improving external outlook on China's turnaround and the resilience of the eurozone. Internally, the biggest positive surprise is the local labour market, where companies are still trying to retain workers. However, the strength of the labour market is a double-edged sword. It leads us to revise this year's GDP growth up to 0.7% on average but poses a significant red flag from an inflationary perspective. Wage-push inflation is a real threat now. And though we see the headline inflation peaking somewhat below 26% in January-February, the deceleration will be slow and gradual.

This possible tenacity of price increases makes us forecast an 18.5% average inflation rate in 2023. Against this backdrop and seeing the outcome of the January rate-setting meeting, we think that the monetary policy will exercise more patience than other central banks. We see the National Bank of Hungary starting its policy pivot only during the second quarter, gradually reducing the rates of the temporary, targeted tools. Our tighter-for-longer call will be complemented by more conscious fiscal spending this year. Tight fiscal and monetary policy alongside an ongoing significant voluntary energy consumption reduction will help to reduce the current account deficit. We also expect tensions to ease between the European Commission and the government as the latter will meet more milestones, translating into the flow of more EU funds. Against this backdrop, it is easy to understand why we stick to our general bullish view regarding Hungarian assets.

Romania: Strong demand in the economy but also in markets

The high-frequency data available to date suggest a rather resilient GDP growth in the fourth quarter of 2022, consistent with our current estimate of around 1.0% quarterly advance. This would take the full 2022 GDP to +5.0%, arguably one of the best outcomes one could have hoped for. Much in line with external developments, there are early signs of an accelerated cooling in the economy in January, with the Economic Sentiment Index falling for the third consecutive month, particularly on the back of lower demand in the service sector.

On the monetary policy front, the National Bank of Romania is likely done with rate hikes for the rest of the year. While not yet clearly visible, a consolidation of the downward inflationary trend should be more obvious starting in March, when we expect the headline CPI to flirt with 14.0% (from the peak of 16.8% in November). As for actual market rates, they remain somewhat decoupled from the 7.00% policy rate, being heavily influenced by the liquidity conditions in the money market.

Speaking of liquidity, January has been an outstanding month for the Ministry of Finance, which managed to issue almost RON20bn in the local bond market, thus absorbing a large chunk of the surplus liquidity created in November-December. We still think that a return to a liquidity deficit situation is unlikely, but smaller surpluses (say below RON5bn monthly) could become more usual.

FX: timing the dollar decline

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The dollar is around 10% off the highs seen in late September, and understandably the view is that the dollar bull cycle – which started summer 2021 – is well and truly over. Consensus expects the dollar to weaken further this year, and we agree

Dollar bear trend could pick up speed in the second quarter

At the heart of the bearish dollar view is the call that the Fed will shift to a reflationary stance in the second half of 2023, US short-dated yields will fall and those yield differentials will move against the dollar. This story should be particularly acute for EUR/USD, where sticky core inflation in the eurozone means that the ECB will not be considering rate cuts until late 2024.

At the same time, lower natural gas prices have seen the eurozone terms of trade improve markedly and justify fundamentally higher levels of the euro. Assuming that the China reopening story continues to evolve positively, we think this confluence of factors can drive EUR/USD steadily higher throughout 2023. Most of the gains, however, may come in the second quarter, when US inflation is seen falling quite sharply.

Sustained EUR/USD gains beyond 1.15 may be harder to achieve in the second half – especially if US debt ceiling negotiations are pushed to the limit. Some would argue that the US debt ceiling is a bullish factor for the dollar – prompting a flight to quality. Yet the evidence from 2011 proves the contrary. Only were the US very close to an unthinkable sovereign debt default – i.e. extreme risk aversion – would the dollar derive any brief benefit.

USD/JPY should continue to fall throughout the year. Bank of Japan (BoJ) meetings will prove positive event risks for the yen as investors second-guess how quickly a new BoJ governing team will unwind the current very dovish settings. We target 120 here and the yen should outperform on the crosses whenever the benign investment conditions are challenged.

Sterling is trading on a slightly steadier footing as the UK government attempts to restore fiscal credibility. The marginally better global investment environment is also helping the risk-sensitive pound. Sterling may hold its gains through the first half of the year as the Bank of England (BoE) stays hawkish. But clearer signs of easing labour market and price pressures in 2H23 will see conviction build of a forthcoming BoE easing cycle. EUR/GBP may well be ending the year nearer 0.90/91. [Text]

Rates: reasons the upside can be tested

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Most macro indicators argue for more downward pressure on market rates. However, we think things are more nuanced than that. Belated ECB and Bank of Japan tightening, and remarkably low US market rates versus the Fed's ambitions, present reasons for market rates to back up a bit from here

Eurozone and Japanese rates primed to provide independent upside pressure

One key element ahead is the probability that the ECB will hike by more than the Fed does in 2023. This is a factor that can push global market rates higher, as it implies a narrowing in the spread between Treasury and Bund yields, driven by independent upward pressure on Bund yields. A second related element is the upward pressure being brought to bear on Japanese government bond (JGB) yields. The 50bp cap on the 10yr JGB yield is yet again being tested by the market. This is another independent pressure that will act to narrow spreads to Treasuries, adding an upside excuse for core global yields generally.

In the US, it's a story of a remarkably stretched full curve inversion

In the US, the spread between the 10yr yield and front-end rates is remarkably stretched, as can be gleaned from the deep inversion of the curve. While an inverted curve is perfectly normal as we approach the end of a rate hiking cycle, it's the degree of inversion that's startling. There are many ways to measure this. The graph below is one. It shows the 10yr yield currently at 1.7% below the 6mth Libor rate (we use the 6mth tenor to incorporate future hikes). This has never been so stretched (on data going back to the 1980s).

6mth Libor is a staggering 1.7% above the US 10yr

Basis points

Source: Macrobond, Federal Reserve, ING estimates

Never before (since the 1990s at least) has the 10yr been so rich at this stage of the cycle

There is another important element to consider – timing. It is not at all unusual for the 10yr to trade below money market rates as the Fed approaches the peak in the cycle. In fact, it's like that in practically every cycle. But the extreme, where the 10yr trades most through money market rates, tends to be just before the Fed is about to execute a first cut (having held rates at a peak for a number of months). Here, however, we have similar extremes while the Fed is still hiking. This is unprecedented.

To put some numbers on this, past cycles have typically seen the 10yr trade some 75bp below the Funds rate on the eve of a rate cut. The most extreme version was during the dot com bust when the 10yr was some 150bp through the Fed funds rate just before the first cut. Fast forward to today, and the 10yr yield is already 83bp below the Funds rate. If the 10yr yield remains here (at around 3.5%) that stretches to 108bp after the expected hike on 1 February, and if we get a March hike it stretches it further to 133bp. That's against a backdrop where the Fed is nowhere near an actual rate cut.

Bottom line, we identify the US 10yr as being exceptionally rich to the money market rates, and we see independent pressure for upside to market yields from the eurozone and Japan. That's an important counter to weak macro data that's been driving market yields lower since late 2022.

GDP forecasts

%YoY	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	2022F	2023F	2024F	2025F
World (USD)	1.5	1.6	1.5	1.5	1.2	2.5	1.5	2.3	2.5
US	1.0	1.1	0.6	-0.5	-0.9	2.1	0.1	1.5	2.0
Japan	1.3	1.5	0.8	1.2	0.8	1.3	1.1	1.1	1.2
Germany	1.2	0.0	-0.1	-0.2	0.3	1.8	-0.2	0.5	1.9
France	0.6	0.7	0.2	0.2	0.4	2.6	0.4	1.2	1.4
UK	0.4	-0.5	-0.6	-0.3	0.0	4.1	-0.3	1.0	1.5
Italy	1.6	1.3	0.4	0.3	0.7	3.9	0.7	1.4	1.2
Canada	2.4	1.6	0.3	-0.4	-0.2	3.5	0.3	1.7	2.2
Eurozone	1.9	1.2	0.5	0.4	0.5	3.5	0.6	1.1	1.4
Austria	2.7	0.5	-1.1	-1.0	-0.1	4.7	-0.4	1.1	1.5
Spain	2.7	2.9	0.7	0.7	0.5	5.5	1.2	1.1	2.0
Netherlands	3.2	2.3	0.4	0.8	0.6	4.5	1.0	1.4	1.7
Belgium	1.4	0.9	0.5	0.5	0.6	3.1	0.6	1.0	1.6
Ireland	15.7	8.9	7.2	5.3	2.4	12.6	5.9	3.0	2.5
Greece	2.0	-0.3	0.0	1.3	2.1	4.9	0.8	1.7	2.0
Portugal	3.1	0.7	0.7	0.6	0.5	6.7	0.6	1.1	1.9
Switzerland	0.7	0.4	0.5	0.6	0.9	2.0	0.6	1.2	1.4
Sweden	0.7	-0.2	-1.4	-1.8	-1.0	2.8	-1.1	1.0	1.5
Norway	2.2	2.2	0.9	0.3	0.1	3.8	0.9	1.4	2.0
Bulgaria	2.2	1.8	1.8	2.2	2.3	3.0	1.4	3.3	3.0
Croatia	4.2	1.5	0.4	1.8	2.6	6.4	1.6	2.9	2.5
Czech Republic	0.4	-1.3	-1.0	0.0	1.7	2.2	-0.2	2.5	2.5
Hungary	0.4	-0.4	-0.9	0.9	3.4	4.8	0.7	3.6	4.1
Poland	2.3	-2.0	1.2	1.0	3.4	4.9	1.0	2.5	3.5
Romania	5.2	3.7	2.8	2.0	2.0	5.1	2.5	3.7	3.5
Turkey	2.7	3.2	3.9	2.5	0.9	5.2	2.5	4.0	4.0
Serbia	-0.2	0.9	0.7	2.9	4.1	2.2	2.2	3.8	4.5
Russia	-4.8	-5.0	-2.5	-3.5	-4.0	-2.2	-3.8	-2.4	0.0
Kazakhstan	2.4	3.5	4.0	4.1	4.1	2.8	3.8	3.5	3.0
Azerbaijan	2.5	2.5	2.8	3.2	3.4	4.8	3.0	2.5	2.5
China	2.9	4.5	5.2	5.7	4.5	3.0	5.0	5.3	5.1
Indonesia	4.9	4.2	4.1	4.6	4.7	5.2	4.4	4.9	4.0
Korea	1.3	0.5	0.2	0.4	1.5	2.6	0.6	2.3	2.1
Philippines	7.2	4.9	5.1	5.0	4.9	7.6	5.0	5.5	6.0
Singapore	2.2	2.5	2.2	2.1	2.7	3.6	2.4	3.3	3.2
Taiwan	-0.9	-2.0	-1.0	2.5	3.0	2.5	0.6	4.3	4.6

Source: ING estimates

CPI Forecasts (pa)

%YoY	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	2022F	2023F	2024F	2025F
World (USD)	7.6	5.9	3.7	4.0	3.4	5.6	4.4	2.9	2.7
US	7.1	5.5	3.5	2.6	2.2	8.0	3.4	1.8	2.1
Japan	3.8	4.0	3.3	2.7	1.7	2.5	2.9	1.9	2.1
Germany	10.9	8.1	5.8	5.4	3.2	8.7	5.6	2.5	2.0
France	7.0	7.2	6.9	9.0	5.2	5.9	6.3	3.4	1.9
UK	10.8	9.9	7.3	5.8	3.7	9.0	6.7	1.7	1.6
Italy	12.5	10.1	7.9	5.6	2.2	8.7	6.4	2.1	2.0
Canada	6.7	4.8	2.3	1.9	1.9	6.7	2.7	1.7	2.2
Eurozone	10.0	7.9	6.0	4.7	4.3	8.3	5.7	2.5	2.0
Austria	11.1	8.6	6.6	4.9	3.2	8.6	5.8	2.1	2.0
Spain	6.6	5.3	4.3	3.5	2.9	8.4	4.0	2.3	2.1
Netherlands	13.0	7.2	6.8	3.5	2.2	11.6	4.8	3.1	1.2
Belgium	11.1	7.7	5.8	4.8	4.0	9.6	5.6	2.1	2.0
Ireland	8.8	7.5	6.0	4.2	2.7	8.1	5.2	1.8	2.2
Greece	8.6	6.8	3.8	2.8	3.6	9.3	4.3	2.0	2.1
Portugal	9.9	7.5	5.9	4.3	2.8	7.8	5.1	2.9	2.0
Switzerland	2.9	2.8	2.6	2.2	1.9	2.8	2.4	1.5	1.5
Sweden	9.7	8.3	5.6	3.6	1.5	8.2	4.0	1.9	2.0
Norway	6.6	6.1	4.3	2.9	2.3	5.8	3.9	3.0	2.5
Bulgaria	17.0	17.7	10.6	9.4	8.7	15.2	10.7	6.5	4.0
Croatia	13.3	11.7	7.5	5.5	4.0	10.7	7.2	4.0	3.0
Czech Republic	16.0	16.0	12.3	8.8	9.2	15.1	10.8	6.3	2.0
Hungary	22.7	25.1	22.4	16.3	10.3	14.5	18.5	5.1	3.2
Poland	17.3	18.3	13.6	12.2	10.1	14.4	13.8	7.7	5.0
Romania	16.6	14.9	10.9	10.0	7.7	10.8	5.1	4.0	3.0
Turkey	77.4	48.5	37.7	35.9	38.1	72.3	39.5	29.7	17.1
Serbia	15.1	14.4	11.9	8.8	5.9	11.9	10.2	5.8	4.0
Russia	11.9	3.5	3.4	4.6	5.3	13.7	5.2	5.2	5.5
Kazakhstan	20.3	17.0	12.8	9.1	7.7	14.6	13.4	7.5	6.8
Azerbaijan	14.3	12.3	10.2	6.7	4.8	13.6	9.7	5.0	4.6
China	1.8	2.3	2.5	2.0	2.0	1.9	2.2	2.3	3.0
Indonesia	5.4	4.5	4.3	4.0	3.7	4.2	4.0	3.5	3.5
Korea	5.2	4.8	3.6	2.9	2.9	5.1	3.6	2.0	2.1
Philippines	7.9	7.4	5.8	4.9	3.9	5.8	5.5	3.9	3.5
Singapore	6.5	5.8	5.6	5.2	4.6	6.1	5.3	3.0	3.0
Taiwan	2.6	1.5	1.0	1.5	1.9	3.0	1.5	2.2	2.8

Source: ING estimates

Oil Forecasts (avg)

$/bbl	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	2022F	2023F	2024F	2025F
Brent	89.0	90.0	95.0	105.0	110.0	99.0	100.0	90.0	75.0

Source: ING estimates

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