ING Monthly

June 2023

We're only human

Carsten Brzeski: We're only human

If anything can go wrong, it will… that's the definition of Murphy's Law. We always use our wealth of experience to come up with what we think's going to happen in the global economy but to err is human. So, what might we be getting wrong?

Always expect the unexpected; it's a guiding principle

My favourite home soccer club, Hertha Berlin, got relegated to the second division two weeks ago. They played a season to forget: too many goals conceded in overtime, questionable referee decisions and many missed opportunities to score. Everything that could possibly have gone wrong did just that. We call it Murphy's Law. And in the global economy, a lot has gone "wrong" over the last few years.

'Always expect the unexpected' has been a good guide to forecasting. And that's what we're trying to do in this edition of the ING Monthly.

Thinking in terms of scenarios rather than conviction calls has also been a good guide for our macro team. At the start of the summer, we tried to repackage our forecast updates with a sprinkle of creativity. Yes, asking an economist to become creative can sometimes be a bit of a stretch, but at least we tried. Instead of focusing on our base case scenarios, we brought Murphy in to take a look at what could go wrong in our well-considered forecasts.

We're getting creative

To be clear, we still expect a recession in the US over the coming quarters on the back of banking weakness, real estate and monetary policy tightening. In fact, we're sticking with our call of significant Fed rate cuts before the end of the year.

In the eurozone, the latest growth disappointments and weaker sentiment indicators have strengthened our longstanding call for subdued growth over the next two years. Rate cuts are not yet on the European Central Bank's mind, and we still see at least two additional rate hikes going into the summer. As both economic activity and inflation are coming down, any additional ECB rate rise comes at the risk of becoming a policy mistake, at least with hindsight.

Returning to Murphy, the question is, what could go wrong in our base case scenarios? What would need to happen for the Fed not to start cutting rates this year? Or in which economic world would the ECB continue hiking rates beyond the summer? And is there seriously a chance of a Goldilocks scenario, despite the current widespread pessimism? Join us and follow our economists' lines of thought as we get our creative juices flowing as much as we can as we really start challenging ourselves.

My home club, by the way, had been close to relegation for the last four years. Wrong financial decisions, wrong transfers and wrong strategic decisions. Getting relegated after such a long stretch of being wrong has no longer to do with Murphy but is rather a sign of incompetence. The latter clearly doesn't apply to our official forecasts.

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Key calls this month

- **US:** James Knightley looks at the risks to his US forecasts, which include uncertainty over inflation, the labour market, the health of banks and Supreme Court deliberations.
- **Eurozone:** Peter Vanden Houte discusses why he expects two more rate hikes from the European Central Bank, as core inflation is unlikely to come down much before the autumn, despite our downgraded growth outlook.
- **UK:** James Smith explains why he thinks the Bank of England will hike less than markets expect, and how inflation/wage growth needs to evolve for investors to be proved right.
- **Asia:** Rob Carnell looks at why we're forecasting a recovery later this year in the region, and why the risk is that this comes later and is weaker than we expect.
- **Energy:** Warren Patterson discusses how the oil market should tighten and drive prices higher. Risks on both the supply and demand side could challenge this view.
- **FX:** Chris Turner explains why the Fed easing cycle should kick off a multi-year dollar bear trend later this year. The biggest threat to this view comes from sticky US inflation keeping the US yield curve inverted and the dollar stronger for longer.
- **Market rates:** Padhraic Garvey outlines his forecast for market rates to fall, curves to steepen and US rates to converge on those in the eurozone. The biggest risk is sticky inflation and higher market rates, after which something breaks.

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	2.6	2.1	1.3	2	-1.5	-2.2	1.2	-1	1.4	2.5	2.2	0	2.3	2.4	2.2	2.0	2.2
CPI headline (% YoY)	8.0	8.6	8.3	7.1	8.0	5.8	4.2	3.5	2.8	4.1	2.2	2.1	1.8	1.9	2	2.2	2.4	2.3	2.3	2.3
Federal funds (%, eop)	0.50	1.75	3.25	4.50	4.50	5.00	5.25	5.25	4.25	4.25	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3-month interest rate (%, eop)	0.65	2.10	3.50	4.60	4.60	4.90	5.20	5.20	4.20	4.20	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
10-year interest rate (%, eop)	2.30	3.00	3.80	3.88	3.88	3.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.25	3.25	3.50	3.75	4.00	4.00	4.00
Fiscal balance (% of GDP)					-4.2					-6.0					-6.4					-5.6
Gross public debt / GDP					97.0					99.5					104.0					105.4
Eurozone																				
GDP (% QoQ, ann)	2.4	3.7	1.5	-0.2	3.5	-0.4	1.0	0.7	0.1	0.5	0.1	0.7	1.3	1.2	0.5	1.6	1.6	1.4	1.4	1.4
CPI headline (% YoY)	6.0	8.0	9.3	10.0	8.3	8.0	6.9	3.8	3.0	5.4	2.6	3.0	2.5	2.0	2.5	1.9	2.0	2.1	2.1	2.0
Refi minimum bid rate (%, eop)	0.00	0.00	1.25	2.50	2.50	3.50	4.00	4.25	4.25	4.25	4.25	3.75	3.50	3.25	3.25	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	3.00	3.60	3.80	3.70	3.70	3.60	3.30	3.10	2.90	2.90	2.70	2.75	2.80	2.80	2.80
10-year interest rate (%, eop)	0.60	1.40	2.10	2.56	2.56	2.30	2.50	2.30	2.20	2.20	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.40	2.50	2.50
Fiscal balance (% of GDP)					-4.1					-4.2					-3.3					-3.1
Gross public debt/GDP					97.3					95					93.4					93.6
Japan																				
GDP (% QoQ, ann)	-1.8	4.7	-1.1	0.1	1.0	1.6	1.6	1.2	0.8	1.1	0.8	0.8	1.2	1.2	1.0	1.2	1.2	1.2	1.2	1.2
CPI headline (% YoY)	0.9	2.4	2.9	3.8	2.5	3.6	2.9	2.4	1.7	2.6	1.7	1.8	1.8	1.8	1.8	1.7	1.6	1.4	1.3	1.5
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	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25
3-month interest rate (%, eop)	0.00	-0.03	-0.04	-0.02	-0.02	0.00	0.05	0.06	0.06	0.06	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.30	0.30
10-year interest rate (%, eop)	0.25	0.20	0.25	0.25	0.25	0.30	0.40	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.00	1.00	1.00
Fiscal balance (% of GDP)					-6.7					-9					-7					-5
Gross public debt/GDP					225.9					260.0					275.0					280.0
China																				
GDP (% YoY)	4.8	0.4	3.9	2.9	3.0	4.5	8.8	5.0	4.6	5.7	4.2	3.9	4.6	6.1	4.7	4.7	5.4	5.2	5.2	5.1
CPI headline (% YoY)	1.1	2.3	2.5	2.1	2.0	1.3	2.3	1.8	2.5	2.0	2.5	2.2	2.3	2.4	2.4	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	2.45	2.40	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	2.86	3.00	3.15	3.20	3.20	3.35	3.50	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)	2.0	0.2	-0.4	0.5	4.1	0.5	-0.4	1.1	0.8	0.3	1.3	1.1	1.3	1.3	1.1	1.6	1.6	1.6	1.6	1.5
CPI headline (% YoY)	6.2	9.2	10.0	10.8	9.0	10.2	8.2	6.2	4.1	7.2	3.3	1.9	2.1	1.7	2.2	1.7	1.4	1.8	2.1	1.7
BoE official bank rate (%, eop)	0.75	1.25	2.25	3.50	3.50	4.25	4.75	4.75	4.75	4.75	4.75	4.25	3.75	3.25	3.25	2.75	2.75	2.75	2.75	2.75
3-month interest rate (%, eop)	2.70	2.70	3.35	3.75	3.75	4.40	4.75	4.75	4.75	4.75	4.65	4.15	3.60	3.10	3.10	2.70	2.70	2.70	2.70	2.70
10-year interest rate (%, eop)	2.50	2.25	4.10	3.20	3.20	3.50	4.20	3.50	3.00	3.00	3.00	3.00	3.00	3.10	3.10	3.20	3.30	3.40	3.50	3.00
Fiscal balance (% of GDP)					4.0					5.0					3.0					2.5
Gross public debt/GDP					110.6					103.0					102.0					99.0
EUR/USD (eop)	1.11	1.05	0.97	1.02	1.02	1.08	1.10	1.15	1.20	1.2	1.2	1.17	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15
USD/JPY (eop)	122	132	145	138	138	133	132	125	120	120	118	115	115	115	115	115	115	115	115	115
USD/CNY (eop)	6.34	6.69	7.11	7.22	7.22	6.87	6.90	6.75	6.60	6.60	6.45	6.35	6.30	6.40	6.40	6.50	6.30	6.10	6.20	6.20
EUR/GBP (eop)	0.84	0.86	0.88	0.87	0.87	0.88	0.88	0.90	0.90	0.90	0.90	0.89	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88
ICE Brent -US$/bbl (average)	98	112	98	89	99	82	84	93	99	90	95	90	88	83	89	73	75	78	75	75
Dutch TTF - EUR/MWh (average)	101	101	205	124	133	53	35	32	50	43	60	52	45	50	52	60	50	40	50	50

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

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James Knightley: Risks skewed towards higher for longer US interest rates

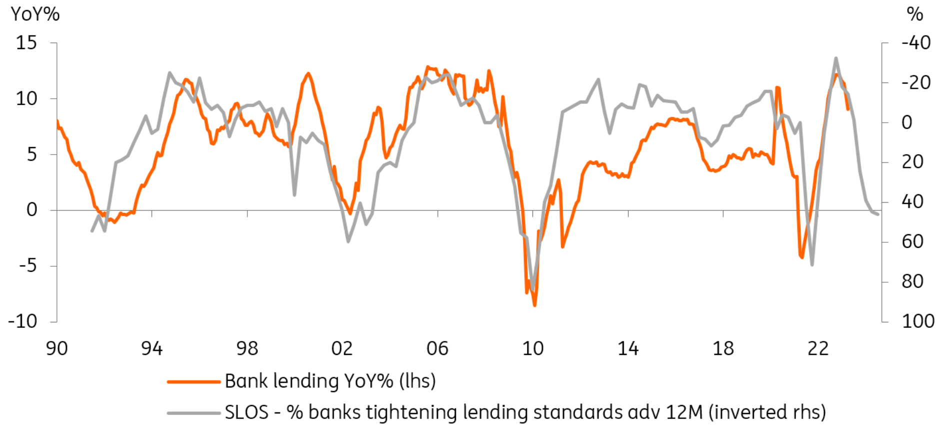
Uncertainty over inflation, the labour market, the health of banks and Supreme Court deliberations means our forecasts are subject to a lot of risks. With the Fed focused on inflation, interest rates could rise more than we expect, but economic threats may mean that the Fed ends up having to ease policy even more aggressively

Our US view

After the most rapid and aggressive tightening of monetary policy for more than 40 years, we expected financial and economic stresses to appear sooner rather than later. The small and regional banks are where this is most evident, but even before recent failures, banks were changing their attitudes and becoming more restrictive in terms of who they lend to, how much they lend and at what rate.

This combination of rapidly tightening lending conditions and significantly higher borrowing costs points to outstanding lending turning negative by the end of this year. For the US economy, where credit is such an important driver of economic activity, this outcome has in the past always meant recession. At the same time, corporate pricing plan intentions are softening and the high weighting of shelter and vehicles in the CPI basket means inflation should drop below 3% before year-end.

Tighter lending standards points to credit contraction and recession



Source: Macrobond, ING

Where we stand relative to the market

Compared with the consensus, we are forecasting a slightly more V-shaped profile for GDP growth of 1.2% for 2023, 0% for 2024 and 2.2% for 2025 – consensus is 1.1%, 0.8% and 2.0%, respectively. For inflation, we are broadly in line with the consensus for 2023 and 2025 at 4.1% and 2.3%, respectively, but for 2024 our more pessimistic growth view means we forecast inflation at 2% versus market expectations of 2.6%.

We are earlier and more aggressive in looking for Fed rate cuts, expecting a 50bp rate cut at both the November and December policy meetings with 3% rates by the end of the second quarter of 2024. The consensus is for no rate change this year before rates drop to 3.5% in 2024 and 2.75% in 2025. The market is, however, pricing modest interest rate cuts before the end of this year.

Where we could be wrong… inflation is stickier and the Fed tightens further

We see three key areas where our forecasts look vulnerable. First, we may be too optimistic that inflation falls rapidly. The unemployment rate is just 3.4% and labour market resilience could result in stickier wage pressures that keep service sector pricing more robust, especially if consumer spending remains firm. There are several hawks on the Federal Open Market Committee who want to see clear evidence that inflation is on a clear path to 2% before they are prepared to call time on hikes. If we see month-on-month inflation prints continuing to come in at 0.3% or 0.4%, rather than averaging 0.2%, and jobs numbers remain firm, we will probably see interest rates rise further with a Fed funds rate perhaps at 5.5% or even 5.75%.

Or we are too early in our downturn expectations

The second risk relates to the timing of events. Our long-held thesis is that the combination of higher borrowing costs and less credit availability weighs heavily on business and consumer spending in an environment where sentiment is already at recession levels.

Historically, credit growth lags movements in lending conditions by 12 months and unemployment responds similarly. Given lending conditions started tightening rapidly more than 12 months ago and interest rates have risen by 500bp since March 2022, our best guess has been that the economy will be showing the effects in the second half of this year.

However, strong household and corporate balance sheets may mitigate some of these effects and the downturn story could happen later than we are predicting. Therefore, Fed rate cuts may come later and possibly be less aggressive than we are predicting.

But things could get even worse

There are risks in the other direction though. We are hopeful we are almost through the debt ceiling crisis that has been unsettling for financial markets, but we can't rule out an intensification of stresses elsewhere. These could certainly resurface in the small and regional banks, most probably through their heavy exposure to the commercial real estate sector. Significant losses here could weaken balance sheets, resulting in a further tightening of lending conditions and a potential mini-credit crunch.

Also, we need to keep an eye on the Supreme Court deliberations regarding President Joe Biden’s $20,000 student debt forgiveness plan. Then there is the resumption of student loan repayments that were paused during the Covid-19 pandemic. As part of the debt ceiling deal between House Republicans and the president, it appears that interest will be charged again from September with repayments resuming from October. According to Federal Reserve data, $1.6tr is owed by more than 43 million Americans, so from the fourth quarter onward these households could end up needing to divert hundreds of dollars each month towards loan repayments. This has the potential to weigh very heavily on consumer spending.

A worst-case scenario of a return of banking strife and the resumption of student loan repayments amid a housing market downturn and weaker general activity would heighten the chances of a recession and an even swifter, sharper response from the Federal Reserve than we are forecasting.

Peter Vanden Houte: Eurozone growth is already dwindling

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On the back of a weak first-quarter performance for the eurozone economy, we have downgraded our growth outlook. That said, we now pencil in two more rate hikes, as core inflation is unlikely to come down much before autumn. We might be too pessimistic about growth, though an even worse scenario cannot be dismissed either

Eurozone view: weak growth with falling inflation

Eurozone growth disappointed in the first quarter. While falling energy prices and rising wages should support consumption, the soft Chinese reopening, tighter monetary conditions and looming US recession will weigh on growth and bring the economy close to a standstill by year-end. It is mainly services that are currently thriving. The manufacturing sector is struggling with excess inventories while construction is hampered by higher interest rates. It is therefore not surprising to see that services inflation remains quite sticky, while there are budding deflationary pressures in the goods industry. But the further weakening of growth over the course of the year should bring inflation down towards 3% by year-end. As the ECB wants to see a clear decline in core inflation before ending the tightening cycle, 25bp rate hikes seem likely in both June and July, with an additional one in September a genuine risk..

Eurozone data have been disappointing lately

Source: Refinitiv Datastream

Where we differ

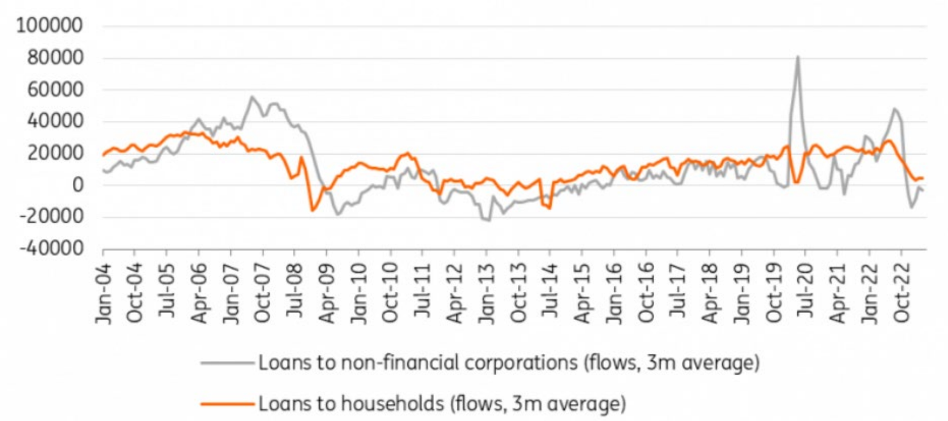
With our 0.5% GDP growth forecast for both 2023 and 2024, we are definitely below consensus (0.6% and 1.0% respectively) and far below official forecasts (for instance, the European Commission foresees 1.1% for 2023 and 1.6% for 2024, quite similar to what the ECB is pencilling in). With our 5.4% inflation forecast for 2023 and 2.5% for 2024, we are close to consensus, but below official estimates, especially for 2024. Market forwards indicate rates plateauing at a level around 50bp above today's level in the second half of the year, with a first rate cut in the second quarter of next year, exactly in line with our predictions.

Goldilocks after all?

We might be overly pessimistic about the growth outlook. With wages picking up and inflation coming down on the back of further falling energy prices, consumption growth could accelerate in 2024, certainly if you also pencil in a decline in the savings ratio. The weakness in manufacturing might also be short-lived: once the inventory overhang has been corrected and consumer demand for goods picks up again, manufacturing should become a driver of growth. If at the same time the US manages a soft landing and Chinese growth gathers momentum, net exports could also support the expansion.

Finally, with the European recovery plan gaining traction, public investment should add to growth. This would be a kind of goldilocks scenario, with growth accelerating and inflation falling in 2024.

Credit growth is stalling



Source: Refinitiv Datastream

A deeper downturn is still a genuine risk

On the other hand, it is certainly possible to come up with a stronger downturn scenario (bear in mind that we haven't pencilled in any negative growth quarters for the next two years). What we find a bit strange, is that in the official forecasts, it seems as if tighter monetary policy does have very little effect after all – even though the ECB's (admittedly somewhat discredited) models are forecasting a significative negative growth impact of monetary policy, both in 2023 and 2024. Also, in the past, it has been very hard for the eurozone to decouple from the US. Therefore, a US recession might hit the eurozone more than we currently anticipate.

On top of this, throw in the possibility of a credit crunch: falling house prices and an inverted yield curve will make banks a lot more cautious. So, even though we are already more bearish than the consensus, we cannot dismiss the possibility that growth turns out to be even weaker. Of course, that might allow the ECB to cut back rates a bit more strongly over the course of next year.

James Smith: Why we disagree with markets on the Bank of England

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Investors think Bank Rate could rise another 100 basis points following some shock inflation data. But there are also broader signs that wage and price pressures are slowly easing, which suggests one or perhaps two more rate hikes will prove sufficient

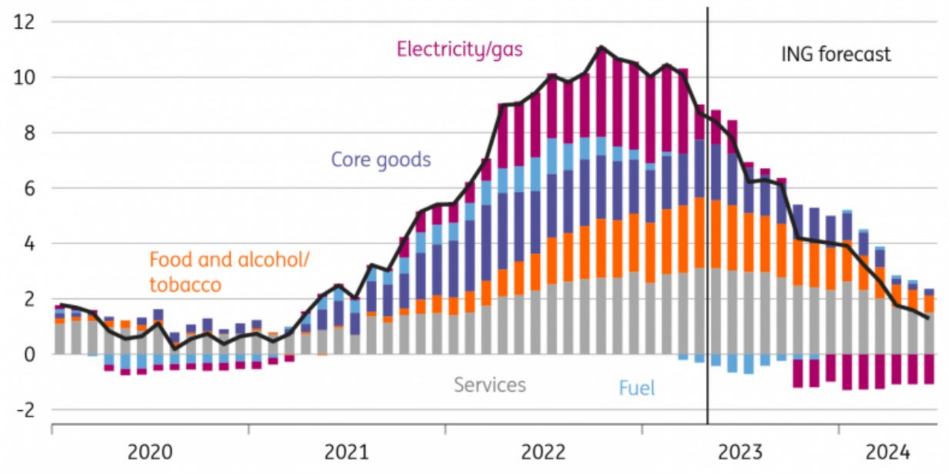
Market expectations for the Bank of England reminiscent of last year's crisis

UK investors would be forgiven for feeling a sense of déjà vu over recent days. An unexpectedly high inflation reading helped send market expectations for the Bank of England into territory last seen in October and November in the aftermath of the fateful 'mini budget'. That remains true whether you look at the peak rate being priced (5.5%) or the spread between expected policy rates in the US and UK in 6-12 months.

That equates to four more rate hikes, and incidentally, these are the same levels that prompted BoE policymakers to offer some rare pushback against market expectations at last November's meeting.

All of this seems excessive – and the BoE itself has repeatedly stated that much of the impact of past rate hikes is still to hit the economy. That being said, the Bank may be more reluctant than it was last November to push back against these lofty expectations. Given the tendency of recent inflation figures to come in hot, policymakers won't want to pre-commit. The current 'data-dependent' approach points to another hike in June – and perhaps one more in August.

Lower gas prices should see inflation fall to 4% area by year-end



Source: Macrobond, ING calculations

Dig deeper and inflation doesn't look as bad - but we could be wrong

It’s worth emphasising that beneath the surface of the recent shock CPI numbers, the story is not quite as bad as it looks. Recent strength is partly down to goods categories, like alcohol and vehicles, and these are trends that are unlikely to last. Services inflation, which is the Bank's main focus, would have been roughly in line with expectations had it not been for a highly unusual month-on-month spike in rents.

Broader measures of inflation, including the BoE’s survey of CFOs, point to lower inflation and wage expectations over the coming months. The latest jobs data points to cooling hiring demand and more muted pay pressure.

In short, we expect rates to peak below where markets expect and we think that rate cuts (when they eventually materialise in mid-2024) could be deeper too. Investors expect Bank Rate to settle around 4% in three years’ time, which seems high.

Where our view could start to fall apart is if services inflation fails to come down over the rest of this year. We think lower gas prices will alleviate a key source of price pressure, particularly in the hospitality sector, which has accounted for much of the rise in services inflation. There’s a clear risk that firms bank some of these lower costs to rebuild margins, and that’s essentially the view of the BoE hawks right now. In other words, what went up pretty quickly could be much slower to come down.

Worker shortages are also undoubtedly still a big issue for employers, and that looks like a structural rather than a cyclical challenge. We can’t rule out a rebound higher in wage growth. Though not our base case, in this scenario markets may well be right that interest rates end up rising above 5% and stay very restrictive for longer.

Rob Carnell: Asia rebound could be weaker and later

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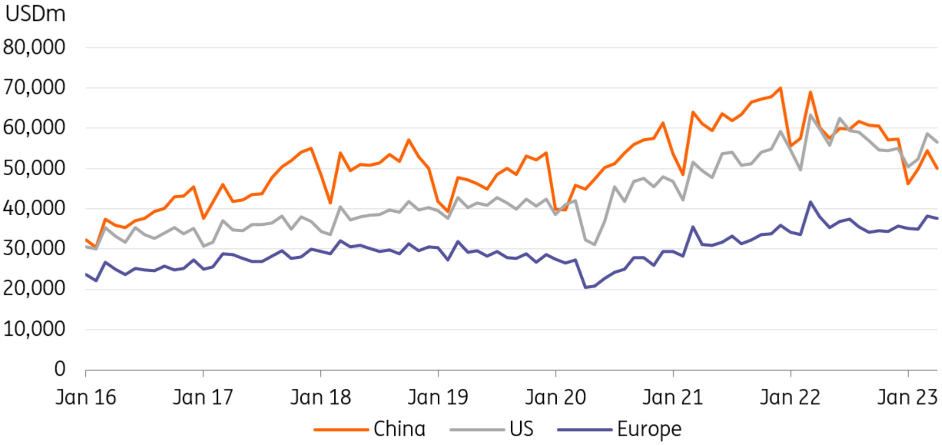
For most of the Asia region, we forecast 2023 as a year of slowdown but with a recovery picking up in the second half of the year. The risk is that this comes later and is much weaker than we anticipate

Guarded optimism

For Asia including China, 2023 was a year which mixed optimism with caution. On the one hand, we have economies belatedly opening up, such as China and Japan, which are reaping the benefits of greater mobility and economic interaction. On the other hand, for this very trade-focused region, the slowdowns happening in the US and Europe threaten to undermine the export contribution, which is important for jobs as well as GDP.

On top of that, the downturn in the semiconductor cycle, a hugely important factor for North Asia, but also of great importance across the region, is also worrying, though one that many analysts including ourselves have touted as troughing in the second half of the year.

Asia's exports to major trading partners
Korea, Taiwan, India, Indonesia, Japan, Malaysia, Philippines, Singapore, Thailand, Vietnam



Source: CEIC, ING

What's causing us to worry?

The risks to our cautious optimism about this year, and the better growth trajectory it implies for 2024, come from a variety of sources:

1) The US / European slowdown hasn't properly got going, could be harder and last longer than we expected. If we consider just the US, the main problem currently isn't economic weakness, it is that large parts of the economy seem to be holding up much better than many thought, prompting worries about Federal Reserve rates staying higher for longer. The chart above shows Asian exports to China falling much more rapidly than to either the US or Europe. But the second half of the year could be the glide path down to much weaker US activity, and also for the eurozone as the ECB tightens the monetary thumbscrews. For Asia, that suggests exports weakening right up to the year-end, and the subsequent forecast bounce is beginning to feel a bit like wishful thinking.

2) China's rebound is looking spotty: while this isn't necessarily bad news on a global scale, as it takes some pressure off commodity prices, and provides a more benign price backdrop as economies struggle with high inflation, it is certainly not helping the Asian export story. Although exports to the US and Europe are important, China's own consumption of finished goods these days makes it an important end-consumer of a lot of consumer and capital goods. A consumer/catering-focused rebound isn't doing a lot for the rest of Asia.

3) Looking at the geographical direction of Asia's export growth, the fact is that until very recently, exports from much of the region to the US and Europe were holding up fairly well. Exports to China were the standout weak spot. And with China, the single-largest export market for most of Asia, that isn't good news. The cause of this is not completely clear, but it looks tied to the semiconductor slump and is probably at least in part a reflection of tighter restrictions on exports of hi-tech capital equipment to China, and restrictions on imports of Chinese technology goods to the US and its allies. This regulatory pushback is gathering momentum, not easing back, with Japan now also limiting what it will export to China. Calling a trough in the semiconductor cycle in the second half of 2023 may be optimistic. Looking for a rebound in 2024 may also be unrealistic.

While it is still too early to start chopping our growth forecasts for the region, the risks are skewed to the downside, and to any eventual recovery and upturn taking place later, and possibly being slower than we have currently pencilled in.

Warren Patterson: China's economic recovery could push oil demand to record levels this year

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We expect the oil market to tighten as we move through the year, which should drive prices higher. However, there are some key risks on both the supply and demand side, which could challenge this view

Our oil call

The oil market is set to tighten significantly over the second half of 2023. Currently, we are forecasting that the global oil market will be in deficit by almost 2MMbbls/d over the latter part of this year. This deficit suggests that we should see prices moving higher over the remainder of the year. Our current ICE Brent forecast is US$96/bbl over the second half of the year.

Demand growth is an important factor contributing to the large deficit we forecast later in the year. We expect global oil demand to grow by 1.9MMbbls/d this year, which would take overall oil demand to record levels. This growth is predominantly driven by non-OECD countries and specifically China. As for OECD oil demand growth, we expect this will be close to flat year-on-year.

Supply dynamics also play an important role in our tighter outlook for the oil market. OPEC+ supply cuts run through until at least the end of the year, which should continue to take a significant amount of oil supply off the market. Furthermore, there is also the risk that we see further supply cuts coming through from the group, particularly if we see any further price weakness in the short term.

Where could we be wrong?

There are several factors which could prove to be an obstacle to our more constructive outlook for the oil market.

Firstly, when it comes to demand, more than 1MMbbls/d of the 1.9MMbbls/d of demand growth expected this year is set to come from China. The fact that such a large share of demand growth is expected to come from just one country is a risk. And clearly, in recent months there have been concerns over the strength in China's broader recovery. If Chinese oil demand disappoints, this could change the global balance significantly, with the market not as tight as expected. However, up until now, Chinese oil demand indicators have been looking fairly strong, with higher crude oil imports year-on-year and apparent record oil demand in recent months.

Another key downside risk related to demand is how severe a slowdown we'll see in the States. Our US economist expects the US economy to enter recession later this year, and clearly if this turns out to be severe, it would likely lead to some level of demand destruction, which once again would loosen up the oil balance. However, we are already taking a cautious view on US oil demand over the latter part of the year – we are assuming US oil demand will be flat year-on-year.

A final factor where we could be wrong is around OPEC+ supply and how compliant members are with their supply cuts through year-end. The group has made significant cuts since late last year and up until now compliance has been strong among most producers. We are assuming that compliance will remain very high through year-end. However, there is the risk that some producers grow tired of the supply cuts and start increasing output. We also cannot rule out the potential for disagreement between members. For example, there are questions in the market about whether Russia is really cutting by the 500Mbbl/d it had previously announced. Stronger seaborne crude oil exports suggest that we are not seeing these cuts. The risk around this is that it could lead to disagreements between members, which could ultimately lead to the end of the supply cut deal and a price war. This is what we saw between Saudi Arabia and Russia in early 2020.

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Chris Turner: Sticky US inflation is the biggest threat to our FX views

Our baseline FX view sees the Fed easing cycle kicking off a multi-year dollar bear trend later this year. That should be good news for global growth in that a weaker dollar can export lower US rates around the world. The biggest threat to this view comes from sticky US inflation keeping the US yield curve inverted and the dollar stronger for longer

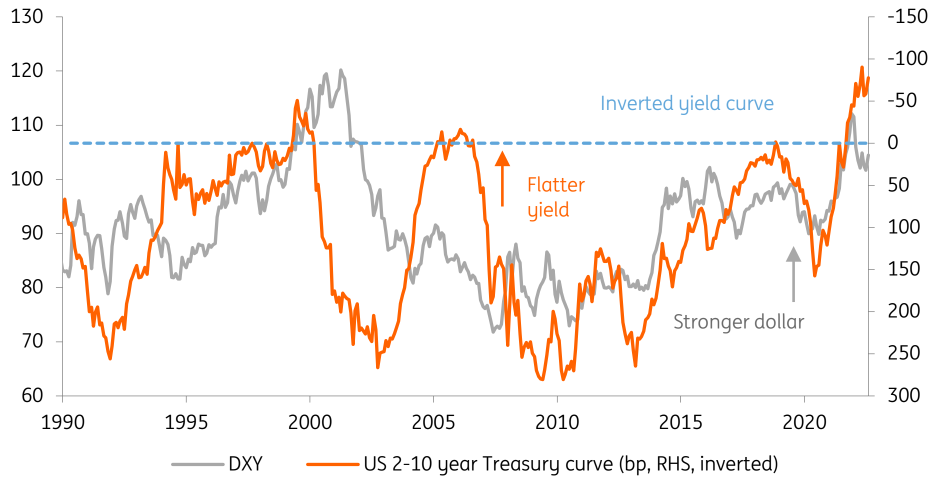
Being bearish on the dollar is our baseline view

Our baseline view in FX markets is that the dollar over the coming months will be entering a cyclical bear trend. This is premised on tighter US credit conditions adding to tighter monetary conditions and delivering the long-awaited US disinflation story. Should the Federal Reserve be in a position to cut rates sharply later this year, we are convinced that the dollar would trade lower. Under that scenario, we think EUR/USD should be somewhere in the 1.15+ area by year-end, while USD/JPY should be below 130.

Our cyclical call for a weaker dollar later this year should be roughly in sync with the next chapter of the US business cycle, where the bearish inversion of the US Treasury curve rotates into bullish steepening - all premised on the Fed being able to respond to the slowdown with rate cuts.

Equally, a weaker dollar should be a positive story for global growth. Many countries, especially emerging market countries, have had to support local currencies with higher rates. A turn in the broad dollar trend should give them some breathing room and perhaps attract to emerging markets the kind of positive portfolio inflows not seen since late 2020.

Cyclical dollar bear trend premised on a steepening of the US yield curve



Source: Refinitiv, ING

The alternative is a 1980s style dollar rally

As above, US disinflation is the vital cog in the wheel to a weaker dollar. Failure of US inflation to slow would keep Fed policy tight/tighter for longer - probably causing a deeper US slowdown if not a recession. Under such a scenario, the US yield curve would stay inverted for a lot longer, and 5-6% dollar interest rates would look even more attractive amid a global slowdown. Such a scenario would loosely resemble that of the early 1980s when Fed Chair Paul Volcker took the US economy into recession in order to get inflation under control. The hugely inverted US yield curve at that time sent the dollar through the roof and added to the US current account deficit. That dollar rally was only reversed in 1985 when the G5 nations agreed on the need for an orderly reversal of the dollar with the Plaza Accord.

Equally, the Fed keeping rates tight/tighter for longer would exacerbate the global slowdown and exacerbate the decline in pro-cyclical currencies such as the euro. In addition, many emerging market economies looking for breathing room with a weaker dollar would be frustrated. And presumably higher dollar rates would tip more EM sovereigns into default/debt restructuring. Instead of the virtuous cycle of a weaker dollar and lower global rates, the cycle could become a vicious one.

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Padhraic Garvey: Lower rates by the end of 2023, but there are risks

We previously forecast market rates to fall, curves to steepen and US rates to converge on eurozone ones. The biggest risk is sticky inflation, higher market rates, and then something breaks. That, in turn, requires lower rates than we had anticipated in the medium term. We also face budgetary, supply, and geopolitical risks and so much more

Our view sees market rates lower, steeper curves and US convergence to the eurozone

Our call for 2023 previously centred on the notion that the US 10yr Treasury yield would fall from 4% to 3%, and by the end of 2023, the curve would be in the middle of a pronounced re-steepening process. Eurozone yields would follow US yields lower, but not by as much. And with the European Central Bank keeping rates at their peak while the Fed commences cutting, eurozone rates would converge on US market rates, in fact trading through US market rates as the Fed's cuts begin to look quite at variance to an ECB still very much on hold as we approach the end of 2023.

We also laid out the notion that the US 10yr would, in effect, map out a range from 4% to 3% (maybe briefly below) and then back up toward 4% by 2024. The latter reflects the view that the Fed bottoming at slightly below 3% in 2024 should coincide with the 10yr yield being forced back up toward 4%, as in this way an upward sloping curve would evolve, as has been typical in previous cycles. The eurozone curve would echo many of these trends, just with a lag, just as the ECB tends to lag the Federal Reserve.

But, sticky inflation and persistent demand could push market rates

So what are the risks to this view? Well, one is inflation failing to calm. This would keep official rates both in the US and the eurozone higher than we anticipate and, by extension, would frustrate the likelihood for market rates to test lower by as much as we forecast. Rather than the US 10yr heading to 3%, it, in fact, breaks back above 4% and heads for 5%, or even higher. If this did happen, it would most likely come from the Fed forcing market rates up there through a combination of higher official rates and more aggressive quantitative tightening.

It would also elevate the risk that something breaks, as here the Fed would have failed on the soft approach and has little choice but to keep policy on a super-tightening trajectory. The consequence of this would, more than likely, be bigger cuts in the future after something has actually broken. This augurs for the delivery of wider credit spreads as default risks elevate too, and for higher volatility, as both rates and spreads are more prone to bigger and more erratic swings.

Lower market rates in 2024 than anticipated is the risk case outcome

The bigger the need for even higher rates now, the bigger the likely fall on the other side. So, rather than the Fed stopping at a little below 3% on the rate-cutting side, the Fed might be seen to go to 2% or even lower. A return to zero rates would be quite an extreme outcome, but not impossible. It depends on what's been broken along the way and how mendable it is. The two focus areas here would be on the banks and defaults (in both the personal and corporate sectors).

That brings us to another extreme outcome that is deviant from our view, one where the Fed is actually done now, and the macroeconomy really begins to creak in the quarters ahead. Agreement for spending reductions could add to this downward spiral, and if the international dimension echoed these themes, there is a scenario where US and eurozone market rates, in fact, shoot well below our predicted floors. This is a less likely scenario based on what we have seen so far in 2023. It is more likely to get to this low rates scenario if we go through a higher rates one first.

There are other things that could go awry.

A bigger banking stress story could have the effect where both the US and eurozone economies stall abruptly, manifesting in much lower market rates. Here the convergence process is accelerated, as this would most likely be a US issue, at least to begin with.

A worsening in the war in Ukraine, with spillover to Western Europe, is a route for elevated stress in Europe over the US. That will put downward pressure on market rates through flight to safety.

There is also a counteracting supply story where spending pressures in both the US and Europe puts upward pressure on market rates.

Clearly, there are significant pushes and pulls, but based on what we know, the biggest risk is for stickier inflation than we forecast, and for that to frustrate expectations for rate cuts and associated turn-of-cycle falls in market rates, dis-inversion and the re-steepening of curves.

GDP forecasts

Developed Markets (QoQ% annualised growth)							
	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F	2025F
US	2.0	-1.5	-2.2	-1.0	1.2	0.0	2.2
Japan	1.6	1.2	0.8	0.8	1.1	1.0	1.2
France	0.6	0.4	0.0	0.4	0.5	0.6	1.3
UK	-0.4	1.1	0.8	1.3	0.3	1.1	1.5
Italy	0.6	0.9	0.7	0.6	1.1	0.9	1.1
Canada	1.2	-0.8	-0.6	0.0	1.2	0.5	2.2
Australia	0.3	0.3	0.4	0.3	1.8	1.8	3.1
Eurozone	1.0	0.7	0.1	0.1	0.5	0.5	1.4
Austria	1.2	0.8	0.4	0.8	0.6	0.8	1.4
Spain	1.2	0.9	0.5	0.7	1.9	1.0	1.8
Netherlands	2.2	1.1	1.0	0.5	0.4	1.2	1.0
Greece	0.7	1.5	0.9	1.6	1.9	1.4	1.6
Portugal	2.0	1.1	0.6	0.7	2.7	1.1	1.8
Switzerland	0.8	0.4	0.4	0.8	0.6	0.8	1.4
Sweden	-1.4	-0.1	1.3	1.1	0.3	0.9	1.5
Norway[1]	0.6	1.4	1.6	1.8	1.5	1.6	1.8
Emerging Markets (YoY% growth)							
	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F	2025F
Bulgaria	1.6	1.7	1.7	2.4	1.7	3.1	3.5
Croatia	1.9	3.0	2.9	2.2	2.7	2.5	2.7
Hungary	-1.2	0.7	2.2	3.1	0.2	3.1	3.8
Romania	3.0	2.3	2.4	3.3	2.5	3.9	4.2
Turkey	4.0	1.4	0.1	2.1	2.0	3.5	4.0
Serbia	0.4	2.1	2.9	4.3	1.6	3.8	3.7
Russia	2.5	2.0	1.5	3.0	1.0	1.0	1.0
Kazakhstan	5.2	4.7	4.0	3.5	4.7	4.0	4.0
Azerbaijan	2.8	3.2	3.4	4.0	2.0	2.5	2.7
China	4.5	8.8	5.0	4.6	5.7	4.7	5.1
India	7.8	6.7	6.3	5.5	6	6.6	7.4
Indonesia	4.2	4.6	4.7	5.0	4.6	4.9	5.0
Korea	0.8	0.5	0.5	1.5	0.8	2.0	2.3
Philippines	5.0	4.8	4.5	5.3	5.2	5.5	6.0
Singapore	2.2	2.3	2.5	3.4	1.9	3.1	3.0

[1]Norway: Forecasts are mainland GDP

Source: ING estimates

CPI Forecasts (pa)

%YoY	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F	2025F
US	4.2	3.5	2.8	2.2	2.8	2	2.3
Japan	2.9	2.4	1.7	1.7	1.7	1.8	1.3
France	7.0	5.6	4.0	4.0	5.9	2.8	1.6
UK	8.2	6.2	4.1	3.3	4.1	1.7	2.1
Italy	7.7	5.7	2.8	3.3	6.5	2.4	1.9
Canada	3.5	3.5	3.2	2.6	3.8	2.1	2.0
Australia	0.3	0.3	0.4	0.3	1.8	1.8	3.1
Eurozone	6.9	3.8	3.0	2.6	3.0	2.0	2.1
Austria	7.9	4.9	3.8	3.0	6.8	2.4	2.0
Spain	3.6	3.1	2.9	3.1	3.7	2.6	2.1
Netherlands	6.0	2.6	1.2	2.8	4.1	1.8	1.4
Belgium							
Greece	3.8	2.8	3.1	2.7	4.0	2.3	1.9
Portugal	5.0	3.8	3.5	2.9	5.1	2.5	1.9
Switzerland	2.4	2.3	2.3	2.2	2.6	1.7	1.5
Sweden	7.0	5.0	2.9	2.0	5.4	2.0	1.8
Norway	5.8	4.5	3.9	3.7	5.2	3.6	2.5
Bulgaria	10.8	9.6	8.9	7.1	11.1	6.5	4.0
Croatia	7.8	5.7	4.4	4.0	7.4	4.3	3.0
Hungary	22.6	17.5	11.1	6.8	19.2	5.1	3.1
Romania	10.6	9.0	7.2	6.5	10.5	5.3	4.0
Turkey	42.3	41.8	46.2	41.1	45.8	33.4	17.7
Serbia	14.1	10.9	8.0	6.4	12.2	6.3	4.1
Russia	3.3	3.7	4.8	5.1	5.1	5.1	4.6
Kazakhstan	16.0	13.2	10.5	9.6	15.0	8.6	6.7
Azerbaijan	12.3	10.4	6.4	6.7	10.7	6.2	5.0
China	2.3	1.8	2.5	2.5	2.0	2.4	3.0
India	4.2	4.3	4.4	4.2	4.8	4.2	5.0
Indonesia	4.1	4.0	3.7	3.8	4.6	3.5	3.6
Korea	3.3	2.6	2.5	1.7	3.3	1.6	2.2
Philippines	5.5	4.9	3.8	4.1	5.6	3.9	3.5
Singapore	5.5	5.0	4.4	3.3	5.3	3.2	2.9

*Quarterly forecasts are quarterly average; yearly forecasts are average over the year, HICP for Eurozone economies

Source: ING estimates

Oil and natural gas price forecasts (avg)

	2Q23F	3Q23F	4Q23F	2022F	2023F	2024F	2025F
$/bbl							
Brent	84	93	99	95	90	89	75
EUR/MWh							
Dutch TTF	35	32	50	60	43	52	50

Source: ING estimates

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