THINK Economic and Financial Analysis

ING Monthly

January 2024

Daring to question the markets' rate expectations

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Daring to question the markets' rate expectations

Call us daredevils, but we think the markets may have got it wrong as far as interest rate expectations are concerned

Call us daredevils...

The new year started with the global economy's same old problems: high geopolitical uncertainty, the still-unfolding impact of aggressive monetary tightening, fiscal policy in many jurisdictions gradually becoming more restrictive, and a long list of structural transitions. We're still waiting for any kind of landing for the US economy, just like last year. And we're still watching out for any significant improvement in China and the eurozone. And despite the disinflationary sprint in the second half of 2023, worries are increasing that the inflation genie has still not completely been put back into its bottle.

And there's something else that hasn't changed since December: financial markets are already pricing in aggressive rate cuts by major central banks by the spring despite central banks doing all they can to curb at least the timing of rate cut expectations. In fact, I can barely recall another time when financial market expectations and economists' forecasts of central banks' next steps have been so out of sync.

Of course, we all know the market is always right and that, at all times, it has all the information it can possibly want and need. So, should we really question markets' rate cut pricing?

I think we should. Call us crazy daredevils, but we are going to challenge current market pricing as we think those central banks will start cutting rates later and more gradually than many expect.

Central bankers are only human...

Why? First of all, the irony of market pricing right now is that it makes the need for actual policy rate cuts less urgent. Financing conditions have eased in both the US and the eurozone since early December, doing the work actual rate cuts should do: supporting growth but also pushing up inflation risks. Consequently, the more aggressive the market prices future rate cuts, the less needed those cuts will be.

Secondly, the very tentative signs of the US economy coming into land, along with the 'at-least-things-are-not-getting-any-worse-in-the-eurozone' scenario, give very little reason for emergency rate cuts. In other words, to get both the Federal Reserve and the European Central Bank to start cutting in the spring, we would have to see a severe economic accident or collapse of the economy, and that's not in our scenarios, nor is it a part of central bank thinking.

Thirdly, there is the inflation story. 2023 was all about base effects and disinflation. 2024 will first have to prove whether it will be the year of more disinflationary momentum or possibly even deflationary pressures or whether we could see some kind of inflation reacceleration. Wage pressure or fiscal policies, as well as new supply chain frictions - for example as a result of the Suez Canal disruptions - are not so unlikely risk factors.

This brings me to the fourth argument, why central bankers will be more hesitant to start cutting rates than markets are currently expecting. It's the Arthur Burns argument. No central banker wants to be another Arthur Burns, the Fed chairman in the 1970s who is often said to have cut interest rates prematurely, preparing the ground for a second inflation leg. Or, to put it differently, central bankers missed the inflation upswing; they now want to be fully sure of the inflation downswing and will, therefore, by definition be staying well behind the curve.

Maybe this is what entirely rational markets are currently underestimating: central bankers are only human.

Watch: The market's bet against central banks might be misguided

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ING global forecasts

	2023					2024					2025				
	1Q23	2Q23F	3Q23F	4Q23F	2023F	1Q24F	2Q24F	3Q24F	4Q24F	2024F	1Q25F	2Q25F	3Q25F	4Q25F	2025F
United States															
GDP (% QoQ, ann)	2.2	2.1	4.9	2.5	2.5	0.9	-1.7	-1.6	1.2	1.0	1.5	2.0	2.4	2.6	1.1
CPI headline (% YoY)	5.8	4.1	3.6	3.2	4.1	2.8	2.5	1.9	1.7	2.2	1.7	1.9	2.1	2.3	2.0
Federal funds (%, eop)	5.00	5.25	5.50	5.50	5.50	5.50	5.00	4.50	4.00	4.00	3.50	3.00	3.00	3.00	3.00
3-month interest rate (%, eop)	4.90	5.20	5.40	5.40	5.40	5.40	4.90	4.40	3.90	3.90	3.50	3.00	3.00	3.00	3.00
10-year interest rate (%, eop)	3.50	3.80	4.25	3.90	3.90	4.00	3.50	3.50	3.50	3.50	3.75	4.00	4.00	4.00	4.00
Fiscal balance (% of GDP)					-6.1					-6.3					-5.9
Gross public debt / GDP					97.1					100.6					103.6
Eurozone															
GDP (% QoQ, ann)	0.2	0.6	-0.4	-0.2	0.5	0.3	0.6	1.2	1.1	0.4	1.6	1.6	1.4	1.4	1.4
CPI headline (% YoY)	8.0	6.2	4.9	2.7	5.5	3.1	3.0	2.8	2.2	2.8	1.9	2.0	2.1	2.1	2.0
Refi minimum bid rate (%, eop)	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	3.75	3.75	3.50	3.25	3.00	3.00	3.00
3-month interest rate (%, eop)	3.00	3.60	3.95	3.95	3.95	3.90	3.65	3.40	3.15	3.15	2.90	2.70	2.60	2.60	2.60
10-year interest rate (%, eop)	2.30	2.40	2.80	2.00	2.50	2.20	2.10	2.10	2.30	2.30	2.30	2.30	2.40	2.50	2.50
Fiscal balance (% of GDP)					-3.2					-3					-2.8
Gross public debt/GDP					90.8					88.9					88.9
Japan															
GDP (% QoQ, ann)	5	3.6	-2.9	1.2	2.0	1.2	3.2	1.6	1.2	1.3	1.2	1.2	0.8	0.8	1.3
CPI headline (% YoY)	3.6	3.4	3.1	3.0	3.3	2.8	3.0	2.7	2.1	2.7	2.1	1.5	1.3	1.2	1.5
Interest rate on excess reserves (%)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25
3-month interest rate (%, eop)	0.00	0.05	0.08	0.08	0.08	0.08	0.10	0.10	0.20	0.20	0.30	0.30	0.40	0.40	0.40
10-year interest rate (%, eop)	0.35	0.40	0.70	0.60	0.60	0.60	0.80	0.80	1.00	1.00	1.00	1.00	1.20	1.20	1.20
Fiscal balance (% of GDP)					-8.0					-10.0					-10.0
Gross public debt/GDP					265.0					280.0					285.0
China															
GDP (% YoY)	4.6	6.3	4.9	5.8	5.4	4.2	4.2	5.1	6.1	5.0	5.8	5.0	4.1	5.20	5.0
CPI headline (% YoY)	1.3	0.1	-0.1	-0.5	0.2	-0.9	-0.4	-0.2	0.9	-0.2	1.6	1.7	1.8	1.9	1.8
PBOC 7-day reverse repo rate (% eop)	2.00	1.90	1.80	1.80	1.80	1.80	1.70	1.70	1.60	1.60	1.60	1.70	1.70	1.70	1.70
3M SHIBOR (% eop)	2.45	2.17	2.30	2.60	2.60	2.60	2.50	2.50	2.40	2.40	2.40	2.40	2.45	2.45	2.45
10-year T-bond yield (%, eop)	2.86	2.65	2.50	2.60	2.60	2.50	2.40	2.40	2.60	2.60	2.70	2.70	2.80	3.00	3.00
Fiscal balance (% of GDP)					-8.0					-6.0					-4.0
Public debt (% of GDP), incl. local govt.					131					132					129
UK															
GDP (% QoQ, ann)	1.3	0.8	-0.1	0.1	0.5	0.4	0.8	1.0	1.2	0.5	1.3	1.3	1.3	1.3	1.2
CPI headline (% YoY)	10.2	8.4	6.7	4.1	7.4	3.6	1.7	1.8	2.1	2.3	1.9	1.8	2.0	2.0	1.9
BoE official bank rate (%, eop)	4.25	5.00	5.25	5.25	5.25	5.25	5.25	4.75	4.25	4.25	3.75	3.25	3.25	3.25	3.25
3-month interest rate (%, eop)	4.40	5.40	5.40	5.30	5.25	5.25	5.05	4.55	4.15	4.15	3.60	3.20	3.20	3.20	3.20
10-year interest rate (%, eop)	3.50	4.45	4.45	3.50	3.50	3.80	3.65	3.55	3.65	3.65	3.65	3.75	3.90	4.00	4.00
Fiscal balance (% of GDP)					4.1					2.9					2.4
Gross public debt/GDP					96.3					96.3					95.6
EUR/USD (eop)	1.08	1.08	1.06	1.10	1.10	1.08	1.10	1.12	1.15	1.15	1.15	1.14	1.13	1.12	1.12
USD/JPY (eop)	133	145	149	141	141	140	135	130	130	130	125	125	125	125	125
USD/CNY (eop)	6.87	7.24	7.30	7.15	7.15	7.15	7.05	7.00	6.90	6.90	6.80	6.75	6.80	6.80	6.80
EUR/GBP (eop)	0.88	0.87	0.87	0.87	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
ICE Brent -US$/bbl (average)	82	78	86	83	82	82	80	82	84	82	84	80	80	77	80
Dutch TTF - EUR/MWh (average)	53	35	34	43	41	38	32	30	40	35	40	30	28	35	33

Source: ING forecasts

The world right now

From rate cuts to fresh signs of economic recovery, here's everything we're expecting over the coming months in the US, the UK, Asia and Central and Eastern Europe

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United States

We continue to see some downside risks for growth in the coming quarters relative to the consensus as the legacy of tight monetary policy and credit conditions weigh on activity and Covid-era accrued household savings provide less support. Inflation pressures are subsiding, and the December FOMC meeting showed that Federal Reserve officials have become more inclined to cut interest rates in 2024. They are indicating three 25bp rate cuts this year – but this has effectively given markets the green light to push on more aggressively. Six 25bp moves are being now priced in line with our own forecasts.

Nonetheless, the economy is still growing, the labour market is tight, and inflation for now remains well above 2%. The plunge in Treasury yields has also loosened financial conditions to some extent. Consequently, there isn't immediate pressure for a rate cut and we believe the Fed will choose to wait until May to make the first move. The major risk that we're most concerned about is rising loan losses on unsecured consumer credit and commercial real estate, which could create some financial system stress. This would add to downside risks for growth and could prompt a more aggressive response from the Federal Reserve.

James Knightley

Eurozone

The shallow recession in the eurozone is coming to an end. The eurocoin-indicator – a proxy of underlying GDP growth – saw a strong improvement in December, though still slightly negative (-0.22). The European Commission economic sentiment indicator also ended the year on a stronger note. Growth is likely to pick up gradually in the first half of the year.

That said, on the back of the weakness seen in Germany, we only expect 0.4% GDP growth for the whole of the year, after 0.5% in 2023. Inflation rose to 2.9% in December due to energy related base effects, while core inflation fell to 3.4%. The annualised three-month on three-month change shows both headline and core inflation now below 2%. This is encouraging, but it would be premature to declare victory in the fight against inflation. Indeed, selling price expectations increased across the board in December, while several tax decisions in Germany are also likely to have an upward impact on inflation. The European Central Bank is therefore likely to remain in wait-and-see mode for some time to come. We continue to see a first rate cut in June, with the ECB most likely proceeding more cautiously than the market is now pencilling in.

Peter Vanden Houte

United Kingdom

The UK economy may have entered a fractional technical recession in the latter half of 2023, but things are slowly looking up. Remember that, unlike much of Europe, the majority of UK mortgages are fixed for five years or less, meaning roughly 20% of borrowers refinance this year. But tumbling market rates mean the average rate paid on outstanding debt will rise from 3.2% to just 3.6% by year-end. Falling rates will also gift the government with an additional £12bn or so in “headroom” money that can be spent while still achieving the main fiscal targets. That will almost certainly get spent in the March budget on tax cuts, which will provide a modest (0.2-0.3% of GDP) boost. Meanwhile, inflation is set to fall to 1.6% in May, with services inflation also coming noticeably lower by summer. Prospects of a fiscal boost could tempt the Bank of England to hold fire on rate cuts a little longer than markets expect. We’re pencilling in the first cut for August, with 100bp of easing this year.

James Smith

China

China’s economic recovery remains fragile. Retail sales and the service sector are keeping things moving in a modestly positive direction. But anything related to the real estate sector is struggling, and this is having collateral effects on industry, which has relied on a thriving real estate market to generate demand. Government measures for providing support continue to be unfurled. The debt overhang from real estate is also weighing on the usual channels for local government revenue generation and spending, and infrastructure spending is failing to pick up the slack.

Unofficial reports have suggested that residential property prices have fallen far more than official data suggests. If there is any substance to this, it will make a recovery far more difficult. Monetary policy support is hamstrung while the CNY remains fragile. FDI data suggests that capital is now leaving China, and unless the USD weakens, rates will likely stay unchanged. Inflation is not currently an issue in China. Recent negative inflation figures are mainly a reflection of historical food price spikes and recent energy price declines and nothing more serious – but inflation is very low and does need watching.

Robert Carnell

Rest of Asia

Asia’s economies currently show weak manufacturing but stronger service sectors. Of the 12 Asian economies we routinely track, the manufacturing purchasing manager indices (PMIs) of only five are positive, with an unweighted average PMI of less than 50 – consistent with a slight contraction in activity. Weak overseas demand and softer exports are part of the story. There are some more positive developments in the semiconductor space, but these are concentrated in high-end chips made by Korea and Taiwan, not the legacy chips produced elsewhere in Asia.

The auto sector is also showing more signs of growth than other sectors, and this is helping the big auto exporters such as Japan and South Korea. Services are showing more resilience, helped by falling inflation and a resumption of tourist travel – although this has not yet recovered to pre-Covid levels, with Chinese tourism only recovering slowly. Apart from Japan, where we expect a cosmetic increase in policy rates in June, rates are likely to be trimmed later this year in most economies. Most Asian central banks will probably wait for the US Fed to move before they start to cut.

Robert Carnell

Central and Eastern Europe (CEE)

Given the Czech National Bank's first rate cut in late December, we can say that the CEE region is fully engaged in a rate-cutting cycle, with only the National Bank of Romania waiting on the sidelines. While we expect an economic recovery across the board in the region this year, the end of last year did not support this much. Monthly numbers surprised negatively, or at best are mixed. Risks coming from abroad for this year suggest a complicated recovery.

However, in January and February the focus will shift to inflation numbers, where we expect the last big drop in most of the region. This will be the main driver for the cutting cycle this year. The easiest picture seems to be in Hungary, where the play is between 75bp and 100bp steps for the next meetings. In the Czech Republic, the gameplan for now seems to be 25bp in February and 50bp in March. In Poland, the first live meeting after the break won't be until March – but in any case, we see room for rate cuts as limited after the delivery of 100bp in late 2023. Romania remains last on the starting line, and given the pick-up in inflation at the start of the year, we expect the cutting cycle to start here in the second quarter.

Frantisek Taborsky

FX, Rates and Commodities at a glance

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As we head into a year set to be characterised by lower market rates, a weaker US dollar, and the potential for ongoing geopolitical tensions to persist, our team outlines their top calls for markets over the coming months

FX

The mood in the FX market can best be described as mixed. The dollar is recovering some of its late 2023 losses as the scale of the expected Federal Reserve's easing cycle is pared back. The consensus view, however, remains that 2024 will be the year of a weaker dollar. As always, timing is everything.

Our preference is that the next major leg of the dollar decline probably comes through late in the second quarter as the Fed launches into its easing cycle. Rate spreads should eventually prove positive for EUR/USD – especially as European Central Bank (ECB) easing expectations seem far too aggressive – but again, it should be in the second half that the currency pair embarks on its rally to 1.15. Until then, we expect choppy conditions for the major currencies and also expect investors to continue their search for yield. Perhaps it is no surprise that some of the strongest currencies so far this year have been the Hungarian forint, the Mexican peso and the Indian rupee – all of which are the highest yielding currencies in their respective trading blocs.

Chris Turner

Rates

We continue to expect market rates to get lower in 2024, but let's take this one step at a time. Evidence is mounting for a step higher in market rates first. The eurozone economy remains one characterised by 3% inflation, and US labour market angst remains low.

In a way, rate markets have jumped the gun. Markets are just not yet seeing enough from the macro data to validate the dramatic fall in market rates seen at the tail end of 2023. The 10yr Treasury yield is now just around 4%, while the 10yr term premium is back in negative territory at around -20bp. Similar holds true for the 10yr Bund yield. A negative term premium means that the level of rates is being dominated by the future path of short-term rates. There is no compensation for taking on duration. This isn't to say that 10yr rates cannot fall – they can, of course. They can overshoot to the downside, and they will. For now, a drift higher in rates is right before we get to a proper rate cutting environment.

Padhraic Garvey

Commodities

Despite tensions in the Middle East and additional voluntary OPEC+ cuts, ICE Brent settled a little more than 10% lower in 2023 – its first annual decline since 2020. The oil balance is looking increasingly more comfortable for 2024 with a small surplus over the first half of the year, before returning to deficit over the second half. Non-OPEC+ supply growth has been stronger than expected, which has helped loosen the market. However, if current additional voluntary cuts from OPEC+ are rolled over into the next quarter, this will reduce the scale of surplus and provide some support to prices. Furthermore, tensions in the Middle East have been growing recently. While this is currently not leading to any supply disruptions, there are clear risks that escalation could potentially start to have a direct impact on the oil supply.

The European gas market is also looking increasingly comfortable, with gas storage more than 86% full at the end of December, above the 83% seen at the same stage last year. Gas demand remains under pressure, which has ensured comfortable storage. In the absence of any supply shocks or demand spikes, our balance sheet suggests that Europe will now likely exit the 2023/24 heating season with storage more than 50% full, which would mean that significant upside in gas prices is unlikely.

Warren Patterson

GDP forecasts

Developed Markets (QoQ% annualised growth)	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
US	2.5	0.9	-1.7	-1.6	1.2	2.5	1.0	1.1
Japan	1.2	1.2	3.2	1.6	1.2	2.0	1.3	1.3
Germany	-1.3	-0.7	0.7	1.1	1.1	-0.2	-0.2	1.2
France	-0.4	0.2	0.8	1.6	1.2	0.8	0.5	1.2
UK	0.1	0.4	0.8	1.0	1.2	0.5	0.5	1.2
Italy	-0.2	0.2	0.9	1.4	1.5	0.7	0.4	1.0
Canada	0.8	0.4	-0.5	-1.0	1.2	1.1	0.1	1.4
Australia	1.2	1.2	1.2	2.0	2.4	2.0	1.4	2.5
Eurozone	-0.2	0.3	0.6	1.2	1.1	0.5	0.4	1.4
Austria	0.0	0.6	0.8	1.4	1.6	-0.7	0.0	1.5
Spain	0.6	1.1	1.5	1.8	2.2	2.3	1.3	2.2
Netherlands	0.7	1.3	0.6	1.7	1.8	0.1	0.7	1.7
Belgium	0.8	0.0	0.8	1.2	1.2	1.4	0.8	1.4
Greece	0.2	0.5	1.9	2.5	2.3	2.0	1.3	2.0
Portugal	-0.2	0.8	1.7	2.0	2.2	2.1	0.8	2.2
Switzerland	0.0	0.8	0.8	1.2	1.2	0.7	0.7	1.4
Sweden	2.1	-0.6	0.7	1.3	1.6	-0.2	0.3	1.5
Norway	1.8	1.2	1.4	1.8	1.8	1.1	1.3	1.8

Emerging Markets (YoY% growth)	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
Bulgaria	1.8	2.3	2.7	3.0	3.4	1.8	2.9	3.3
Croatia	3.2	3.0	2.2	2.6	2.8	2.6	2.6	2.7
Czech Republic	-0.6	0.4	1.0	1.8	2.4	-0.4	1.4	2.2
Hungary	1.5	2.4	3.5	3.4	2.8	-0.6	3.0	3.6
Poland	1.5	2.2	3.2	3.3	3.3	0.3	3.0	3.5
Romania	2.2	3.5	2.6	2.5	2.8	1.7	2.8	3.0
Turkey	3.5	4.7	2.8	1.7	1.5	4.3	2.5	3.5
Serbia	3.4	3.7	2.9	2.2	2.4	2.4	2.8	3.4
Azerbaijan	0.0	4.0	2.5	2.0	1.5	0.6	2.5	2.7
Kazakhstan	4.5	3.5	3.0	4.5	5.0	4.7	4.0	5.0
Russia	4.5	3.0	1.5	-0.5	0.0	3.3	1.0	0.5
Ukraine	4.0	3.5	3.5	3.2	3.7	4.5	3.5	5.0
China	5.8	4.2	4.2	5.1	6.1	5.4	5.0	5.0
India	7.2	3.3	8.2	7.8	7.5	7.2	6.8	7.5
Indonesia	4.9	5.0	5.4	5.2	4.5	5.0	5.2	5.0
Korea	1.9	1.8	1.6	1.5	1.8	1.3	1.7	2.0
Philippines	5.9	4.5	4.2	4.9	4.5	5.3	4.5	5.0
Singapore	2.8	2.0	2.3	2.2	2.1	1.0	2.2	2.5
Taiwan	3.6	4.5	3.4	2.3	2.0	1.0	3.0	2.5

[1]Norway: Forecasts are mainland GDP

Source: ING estimates

CPI Forecasts (pa)

%YoY	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
US	2.8	2.5	1.9	1.7	4.1	2.2	2.0
Japan	2.8	3.0	2.7	2.1	3.3	2.7	1.5
Germany	3.2	3.1	2.8	2.5	6.1	3.0	2.1
France	4.0	3.3	3.2	2.2	5.7	3.2	1.9
UK	3.6	1.7	1.8	2.1	7.4	2.3	1.9
Italy	1.9	2.1	2.1	2.7	6.0	2.2	2.0
Canada	2.7	1.8	1.3	1.7	3.8	1.9	2.1
Australia	4.0	4.1	3.6	3.3	5.7	3.8	2.9
Eurozone	3.1	3.0	2.8	2.2	5.5	2.8	2.0
Austria	3.3	2.7	2.4	2.1	7.8	2.6	2.1
Spain	3.1	3.1	2.9	3.0	3.6	3.0	2.3
Netherlands	1.5	1.1	0.8	1.1	4.1	1.1	2.1
Belgium	3.6	3.4	3.3	2.6	4.0	3.2	2.1
Greece	2.7	2.3	1.9	2.3	4.1	2.3	2.0
Portugal	2.0	2.4	2.6	2.5	4.4	2.4	2.1
Switzerland	2.0	2.0	2.0	1.9	2.1	2.0	1.8
Norway	4.3	2.9	3.2	2.8	5.5	3.0	2.5
Bulgaria	3.9	3.8	3.6	4.2	9.7	3.9	4.2
Croatia	4.2	3.1	1.9	2.4	8.1	2.9	2.7
Czech Republic	2.6	2.6	2.4	2.6	10.8	2.6	2.0
Hungary	3.8	4.2	4.5	5.5	17.6	4.5	4.2
Poland	3.9	4.5	6.0	6.4	11.6	5.2	4.6
Romania	7.2	6.0	5.2	4.8	10.5	5.8	4.3
Turkey	67.3	71.7	45.9	41.8	53.9	56.6	25.4
Serbia	6.4	5.2	4.8	4.6	12.5	5.2	4.8
Azerbaijan	6.0	1.9	4.3	6.0	8.9	4.5	5.6
Kazakhstan	9.7	9.1	8.6	8.0	14.8	8.8	7.1
Russia	7.6	7.6	6.5	5.3	5.9	6.8	4.3
Ukraine	6.0	8.0	9.5	9.0	11.7	8.1	7.3
China	-0.9	-0.4	-0.2	0.9	0.2	-0.2	1.8
India	5.2	5.2	4.3	4.7	5.6	4.9	4.8
Indonesia	3.4	3.7	3.6	3.3	4.0	3.5	3.6
Korea	2.5	2.3	1.9	1.8	3.6	2.2	2.0
Philippines	4.5	3.8	4.4	3.4	6.1	4.2	3.5
Singapore	4.3	4.0	3.5	3.0	4.8	3.2	2.8
Taiwan	1.8	1.6	1.5	1.4	2.3	1.6	1.8

*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)

	1Q24F	2Q24F	3Q24F	4Q24F	2023F	2024F	2025F
$/bbl							
Brent	82.00	80.00	82.00	84.00	82.00	82.00	80.00
EUR/MWh							
Dutch TTF	38.00	32.00	30.00	40.00	41.00	35.00	33.00

Source: ING estimates

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