THINK Economic and Financial Analysis

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I wanna dance with somebody

Might the ECB be left dancing in the dark should it start a rate-cutting cycle long before anything the US does? It's a possibility and not necessarily a bad thing

Everyone's talking about divergence

Do you remember that viral video 'Leadership Lessons from Dancing Guy" from years ago? Watch it here if you like. It shows a solitary guy who starts busting some moves at a festival. Slowly but surely, he's joined by more until everyone on the hill is on their feet. I thought about it again recently when pondering the lessons for global central banks. Could the ECB really be that dude... the first adopter who eventually starts an entire movement? I am, of course, talking about interest rate cuts.

The answer to that is, of course, yes. The European Central Bank is a fully independent institution, and there's no secret agreement between central bankers about who'll be first on the dance floor. And, let's face it, Europe's got its elections before the US chooses between Trump and Biden. And right now, the Eurovision Song Contest is in full s(w)ing... and the US doesn't have that at all, for good or ill.

That said, reality has been somewhat different over the past 25 years. Since the start of the European Monetary Union, ECB monetary policy has broadly followed that of the Fed, albeit with different time lags and with the exception of the years following the euro crisis. On the rare occasions it hasn't, it's later been seen as a misstep. Think of the rate cuts in 1999, when the Fed had already started hiking. Or the even more infamous rate hike in 2008 to prevent feared second-round effects from higher German wages; the Fed was already fighting the financial crisis with aggressive rate cuts. And then there was 2011, when the ECB under president Jean-Claude Trichet, hiked rates, assuming the euro crisis was over, while the Fed kept theirs at record lows to support the economy.

Six months later, the new ECB president, Mario Draghi, had to undo it all and started cutting as the eurozone economy was mired in recession.

Dancing in the dark

Sure, the eurozone has been hit much harder by supply chain frictions, the war in Ukraine, and an energy crisis in recent years, and it has seen less fiscal stimulus than the US. While the American economy has enjoyed strong growth, here in the eurozone, we've been flirting with stagnation and even recession. This is the growth story. And the inflation story's not so different.

Energy prices and transportation costs have come down, while both the US and the eurozone are experiencing strong labour markets and worker shortages. It is exactly these strong markets which seem to be fuelling the risk of reflation. In fact, let's not forget that traditionally, there has always been a trigger for starting a central bank's cutting cycle: a recession and/or a severe crisis.

That has yet to happen in both the US and the eurozone. The Fed started hiking rates in March 2022, with the ECB following in July the same year. The last Fed hike was in July last year, and the ECB stopped in September.

So when the ECB almost certainly cuts rates in June, with the Fed most likely waiting until September, it'd be the first time since the start of the monetary union that the ECB would be in the lead. There's nothing wrong with that, of course. But given that US inflation has also led eurozone inflation over the past few years, the Europeans would be well-advised not to categorically reject tentative signs of reflation across the pond. It's not about copying the US but rather understanding the inflation mechanisms over there, even those they've developed quite similarly over the past few years.

There's a high risk this similarity is not yet over. In the video I mentioned at the start, the clue is that the dancing guy needs a first follower to create a movement. It's never about the first mover... it's always about the first follower. The ECB will be hoping that its first dance partner will indeed be the Fed as inflation turns out to be less sticky than currently feared. If not, the risk is high the ECB will be all alone, dancing in the dark.

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Watch: Why Europe's dancing to a different tune

ING's Carsten Brzeski on the two key words dominating the global economic discussion: optimism and divergence

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Our key calls this month:

United States: We continue to forecast three 25bp Fed rate cuts this year, starting in September. We also expect inflation to post more encouraging readings as cooler economic activity and subdued labour cost growth help dampen price pressures.

Eurozone: Despite first signs of possible reflation in the eurozone, a rate cut at the ECB's June meeting still looks like a done deal. But the path beyond is anything but clear. Any signs of reflation and also stronger economic activity will limit the ECB's room for manoeuvre. This is why we expect the ECB to cut rates this year by no more than 75bp.

UK: We have revised up our growth forecasts as positive real wage growth and an easing mortgage squeeze lifts momentum. We expect the first Bank of England rate cut in August, with three cuts this year.

China: The first quarter was better than expected, but China's economic recovery remains uneven. Due to policy rollout and base effects, second quarter GDP should remain relatively strong at 5.3% YoY before moderating in the second half of the year.

FX: We think we may well have seen the dollar's pre-election peak and the dollar will again be sensitive to any decline in US activity and particularly US price data. At the same time, better-than-expected eurozone activity data and some calming in Middle East tensions mean that EUR/USD is seen as less of a one-way bet on the downside.

ING global forecasts

	2024					2025					2026
	1Q24F	2Q24F	3Q24F	4Q24F	2024F	1Q25F	2Q25F	3Q25F	4Q25F	2025F	2026F
United States											
GDP (% QoQ, ann)	1.6	2.8	0.3	0.6	2.4	1.3	1.8	2.2	2.5	1.4	2.1
CPI headline (% YoY)	3.2	3.5	3.0	2.7	3.1	2.3	1.8	1.9	2.1	2.0	2.0
Federal funds (%, eop)	5.50	5.50	5.25	4.75	4.75	4.25	4.00	4.00	4.00	4.00	4.00
3-month SOFR rate (%, eop)	5.40	5.40	5.20	4.70	4.70	4.20	4.00	4.00	4.00	4.00	4.00
10-year interest rate (%, eop)	4.25	4.75	4.25	4.00	4.00	4.00	4.25	4.50	4.50	4.50	5.00
Fiscal balance (% of GDP)					-6.0					-5.8	-5.4
Gross public debt / GDP					99.4					101.8	103.1
Eurozone											
GDP (% QoQ, ann)	1.3	1.1	1.4	1.4	0.7	1.4	1.4	1.3	1.3	1.4	1.3
CPI headline (% YoY)	2.6	2.5	2.3	2.4	2.5	2.1	2.1	2.1	2.2	2.1	2.2
ECB Deposit Rate (%, eop)	4.00	3.75	3.50	3.25	3.25	3.00	2.75	2.50	2.50	2.50	2.50
3-month interest rate (%, eop)	3.90	3.70	3.40	3.20	3.20	2.90	2.75	2.50	2.50	2.50	2.50
10-year interest rate (%, eop)	2.30	2.40	2.30	2.30	2.30	2.30	2.40	2.50	2.60	2.60	2.80
Fiscal balance (% of GDP)					-2.7					-2.5	-2.3
Gross public debt/GDP					89.2					89	88.5
Japan											
GDP (% QoQ, ann)	-0.8	4.0	4.0	2.0	1.1	0.4	0.4	0.4	0.4	1.4	1.1
CPI headline (% YoY)	2.5	2.3	2.1	1.8	2.2	2.1	2.1	1.8	1.7	1.9	1.8
Target rate (Upper Bound)	0.10	0.10	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
3-month interest rate (%, eop)	0.25	0.35	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25
10-year interest rate (%, eop)	0.74	0.90	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75	2.00
Fiscal balance (% of GDP)					-12.0					-12.0	-15.0
Gross public debt/GDP					280.0					290.0	300.0
China											
GDP (% YoY)	5.3	5.3	4.5	5.0	5.0	4.0	5.0	4.8	4.40	4.5	4.7
CPI headline (% YoY)	0.0	0.3	0.9	2.1	0.8	1.2	2.2	2.2	2.4	2.0	1.8
1 Year Loan Prime Rate (% eop)	3.45	3.45	3.35	3.25	3.25	3.15	3.15	3.05	3.05	3.05	3.05
3M SHIBOR (% eop)	2.16	2.12	2.10	2.00	2.00	1.95	1.95	1.90	1.90	1.90	1.85
10-year T-bond yield (%, eop)	2.30	2.35	2.40	2.40	2.40	2.45	2.50	2.45	2.45	2.45	2.50
Fiscal balance (% of GDP)					-5.0					-5.0	-4.8
Public debt (% of GDP), incl. local govt					121					131	138
UK											
GDP (% QoQ, ann)	1.5	1.1	1.2	1.2	0.5	1.3	1.3	1.3	1.3	1.3	1.4
CPI headline (% YoY)	3.5	1.8	1.8	1.9	2.3	1.9	1.7	2.0	2.0	1.9	2.2
BoE official bank rate (%, eop)	5.25	5.25	5.00	4.50	4.50	4.00	3.50	3.25	3.25	3.25	3.25
3-month interest rate (%, eop)	5.25	5.05	4.80	4.30	4.30	3.80	3.30	3.20	3.20	3.20	3.20
10-year interest rate (%, eop)	3.95	4.20	3.80	3.50	3.50	3.50	3.50	3.60	3.60	3.60	3.60
Fiscal balance (% of GDP)					3.0					2.7	2.5
Public sector net debt (FY, %)					100.1					100	99.8
EUR/USD (eop)	1.08	1.08	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
USD/JPY (eop)	148	150	145	140	140	140	140	140	142	142	145
USD/CNY (eop)	7.22	7.25	7.18	7.12	7.12	7.05	7.00	6.95	6.90	6.90	6.85
EUR/GBP (eop)	0.86	0.87	0.87	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88
ICE Brent -US$/bbl (average)	82	87	88	85	85	84	80	80	77	80	75
Dutch TTF - EUR/MWh (average)	28	25	25	35	28	35	27	24	30	29	28

Source: ING forecasts

Our answers to your global economy questions

What would it take for the Fed not to cut this year? And can Europe really diverge from the US on interest rates? Our economists offer their answers

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Varying rate expectations: The ECB's Christine Lagarde and the Fed's Jay Powell

What would it take for the Fed not to cut at all this year?

Having signalled the potential for three interest rate cuts this year as recently as March, officials have moved to downplay the possibility of imminent policy easing. Three consecutive 0.4% month-on-month core inflation prints, ongoing strong consumer spending numbers and a tight jobs market have given officials little option but to suggest that interest rates could stay higher for longer to ensure inflation returns to target.

We believe talk of a second wave of high inflation is misplaced. To generate a renewed, sustained acceleration we would need to see the re-emergence of wage pressures – which put up business costs that are then passed onto the consumer. However, the plunging quits rate and declining hiring intentions surveys suggest a cooling is more likely. Moreover, the Atlanta Fed's wage tracker is returning to pre-pandemic rates as is Indeed's own data on salaries of new job postings on its widely used job listing website. That said, if we are wrong and we do see business surveys rebound, hiring intentions pick up and unemployment start to move lower again, then fears of a protracted period of sticky inflation would keep the Fed policy rate elevated.

Another assumption has been that housing rents slow in line with market measures of private sector rents. Should we see a re-acceleration in rents this would be a major problem for the Fed given it is by far the largest component within CPI index.

Furthermore, if inflation does stay sticky for a few more months and we see growing momentum behind President Trump's re-election campaign this could make the Fed wary of easing at all this year. Proposals for tax cuts that shore up domestic demand, immigration controls (which limit labour supply and potentially boost wage pressures over the medium term) and tariff hikes that may add to inflation pressures, could result in expectations of potential interest rate increases in 2025.

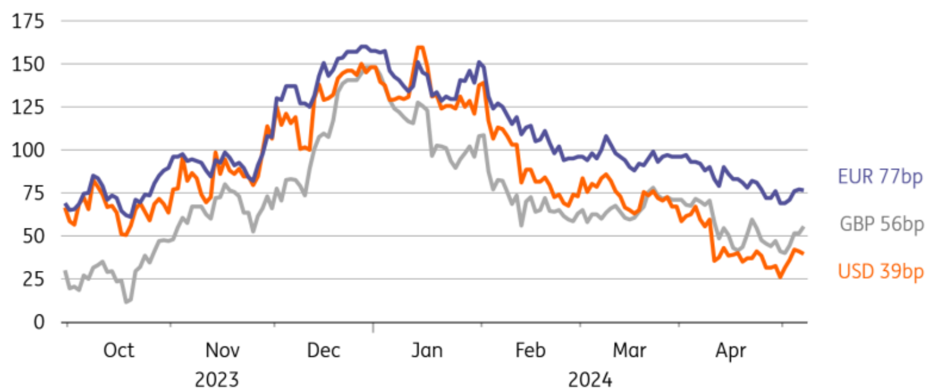
Can central banks in Europe really diverge from the Fed?

A year or two ago, central banks across Europe were chasing US rates higher as inflation data proved ever more shocking. Now, the situation is more nuanced. The likes of Switzerland and Sweden have now cut rates despite the Fed turning more hawkish, and the Bank of England and European Central Bank are signalling they can still cut rates this side of summer. With inflation closer to target – and also proving a bit more predictable – central banks in Europe seem more comfortable with diverging from the Fed. They also seem less acutely concerned about the risk of currency weakness.

However, we think this divergence has its limits. Already at the ECB, we detect a change in mood amongst some officials, where there are fears that recent US inflation stickiness could be mirrored in Europe later this year. The risk of a "reverse Trichet moment" – a reference to the two infamous 2011 rate hikes that were quickly reversed – whereby the ECB is forced to curtail a fledgling easing cycle appears to be worrying some of the hawks.

The first ECB and - to a lesser extent - BoE rate cut seems relatively baked in by the summer. But a scenario where the Fed only cuts once – or not at all – this year would, we think, inevitably see the likes of the ECB and Bank of England scale back their easing ambitions later this year. This is partly why central banks in Europe are signalling they aren't inclined to cut at every consecutive meeting.

2024 rate cuts priced into financial markets (basis points)
December 2024 OIS relative to policy rate



Source: Refinitiv, ING

What would higher oil prices mean for central bank rate cuts?

While we only expect moderate strength in oil prices from current levels, several scenarios could see prices trading significantly higher. A key upside risk to the oil market would be if OPEC+ overtightened the oil market during the second half of the year. Currently, we expect the market to be in small surplus over the latter part of the year, requiring only a partial rollover of current supply cuts, but if members rollover the full 2.2m b/d of cuts for the remainder of the year, it leaves the potential for Brent to trade towards mid- $90/bbl, assuming oil demand does not disappoint. An even more bullish scenario is if tensions in the Middle East reignite again, leading to actual oil supply disruptions. While significant spare OPEC production capacity would be able to cushion the market in the event of most supply disruptions, an extreme scenario where it would not help, is if oil flows from the Persian Gulf (through the Strait of Hormuz) were disrupted. This could put as much as 20m b/d of oil supply at risk, which if lost, could push oil prices well above $150/bbl and towards $200/bbl.

When oil prices surged after the pandemic, and latterly with the war in Ukraine, the direct impact on gasoline added roughly 1.5 percentage points to US headline inflation. The impact was a little lower in Europe, given that tax makes up a greater share of the

consumer price, and the weight in the inflation basket is lower than in the US too. Back then, in year-on-year terms, oil prices were increasing by 100% at times. That suggests to get a similar shock this time around we'd need to see oil prices up around $150/bbl. Still, with the "last mile" proving a headache for central bankers, especially in the US, more modest increases in oil prices could still be a headache – and remember those impacts cited earlier don't include so-called second-round effects (eg transportation costs) on other goods.

Earlier this year, the ECB tried to play down the impact of potentially higher oil prices on its monetary policy by stressing that the impact on inflation could differ and would also depend on the strength of the economy. Still, according to standard models, a 10% increase in oil prices would potentially push up inflation by 0.1 to 0.2 percentage points over the next two years. An oil price spike could therefore limit the ECB's room for rate cuts in 2025, unless of course higher oil prices were to also hit the fragile eurozone recovery.

Similar to the eurozone, significantly higher energy prices would be a constraint on US economic activity as this erodes household spending power and there is a more direct transmission into the retail price of gasoline due to lower taxes versus Europe. The US is a net energy producer, so this will provide some mitigation for economic activity, but given consumer spending is 70% of the economy the overall effect will be a drag on growth. The inflation impact comes via direct fuel prices as well as transportation and logistics pricing. How the Fed responds is a little more complex than in Europe given the Fed's dual mandate of 2% inflation and maximum employment – which could be impacted by the damage to growth from higher energy costs. On balance, it would likely make the Fed more wary of implementing significant interest rate cuts.

What could force central banks to cut rates more rapidly than currently expected?

In the past, rate cutting cycles by major central banks were normally triggered by either a recession and/or a severe (financial) crisis. Think of the financial crisis, the euro crisis or the pandemic; just to look at the last 15 years. While a recession in the US, despite the current resilience, cannot be excluded, the ECB would probably react to a new escalation of the war in Ukraine with more aggressive rate cuts. Also, as discussed in the last Monthly Update, the US presidential elections could bring new economic policies in the US, which eventually would harm the eurozone economy, and would eventually force the ECB to cut rates more aggressively.

In the case of the US, the Federal Reserve has more flexibility to respond to economic stress given its dual mandate. Therefore we don't necessarily need to have inflation especially close to target for the Fed to take action if it believes there are brewing problems in the labour market that will eventually provide downside risk for inflation.

The case in point is the weakness in labour hiring surveys. The ISM employment components are at levels historically consistent with payrolls falling by more than 100,000 per month. The NIFB survey is at levels historically consistent with private payrolls growth of 0-50,000 by the summer, while the plunge in the quits rate, indicating workers are increasingly nervous about job security, is at levels historically consistent with the unemployment rate rising to 5%. Should these occur we strongly suspect the Fed will be inclined to signal a series of interest rate cuts are on the way.

If this is then compounded by re-emerging issues in the small banking sector of the US, resulting from the realisation of loan losses relating to commercial real estate and consumer loans, then the Fed may also feel the need to step in pre-emptively to mitigate any stress in the financial system. Such stress would inevitable tighten credit

conditions in the economy and the Fed may feel the need to offer support via policy rate cuts.

Then there is inflation itself. Insurance and medical premiums plus sticky rents are the main causes of the firmer-than-expected 0.4% core CPI prints through the first three months of the year. This was also the situation last year until core inflation cooled in subsequent months. This has given rise to talk of “residual seasonality” – essentially seasonal adjustment factors have not fully adjusted for when premiums for insurance are adjusted each year. Given the 20%+ increase in some insurance costs, this is a potentially meaningful situation. Residual seasonality is a debated topic and there are no guarantees, but if we do indeed see a repeat of 2023 this would give the Fed more room to ease monetary policy in the latter part of the year.

Middle East tensions ease for energy as Russian sanctions hit metals

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Commodity prices increased throughout April due to geopolitical tensions for energy and sanction concerns for metals. Oil's future price largely depends on OPEC+ output policy. We expect natural gas and most metal prices to trend lower in the medium term

A worker at the Neft Daslari oil rig in Azerbaijan

The prospects for oil

Given geopolitical developments over the month, energy markets saw increased volatility throughout April. Retaliatory attacks by both Iran and Israel against one another raised fears of an escalation in tensions in the Middle East and the potential impact on oil supplies. However, those tensions appear to have eased even quicker than they escalated, leading to the risk premium in the oil market being fully eroded. A significant amount of spare OPEC capacity would have also helped ease concerns over potential supply disruptions due to any escalation.

The oil market remains tight this quarter. Our balance sheet shows the market to be in deficit by around 1m b/d in the second quarter of the year before returning to a small surplus in the second half of 2024. However, this surplus could disappear quickly if OPEC+ members decide to roll over their additional voluntary cuts of 2.2m b/d. This would be enough to leave the market in deficit for the remainder of 2024, which would prompt us to revise up our current Brent forecast of US$87/bbl for the second half of the year. The more recent price weakness in oil increases the likelihood of a rollover of cuts in some shape or form, possibly a partial rollover rather than a full one. However, US elections at the end of the year could also possibly influence the choice OPEC+ members make.

We should get clarity on OPEC+ output policy early next month with the next Joint Ministerial Monitoring Committee meeting scheduled for 1 June. While the committee will not decide on output policy, it will likely recommend what members should do.

Supply risks could hit natural gas later in the year

European natural gas prices witnessed renewed strength and volatility through April and early May. A late cold spell across large parts of Europe increased heating demand last month, while Norwegian outages led to reduced flows into Europe. As a result, European storage has been steady for several weeks at around 62% full. In fact, there were several days in April when there were withdrawals from storage. As a result, storage started April at record levels for this time of year but ended the month broadly in line with 2020 levels, which are still very comfortable.

We hold onto our view that gas prices will trend lower through the injection season and expect TTF to average EUR25/MWh over the summer months.

Supply risks are expected to build towards the end of the year when Gazprom's transit deal with Ukraine expires. Ukraine has made it clear it has no intention of renewing the agreement. This puts roughly 15bcm of annual gas supply at risk, equivalent to around 5% of total EU imports. While prices are likely to react to such a development, we believe it will be manageable for Europe with further LNG supply ramping up over the second half of 2024.

Russian sanctions push base metals higher

Base metal prices have experienced strength and increased volatility over the last month. A key catalyst for the move higher was the LME banning the delivery of new Russian-origin metal into its warehouses following sanctions imposed by the US and UK governments for Russia's invasion of Ukraine. This move predominantly has implications for aluminium, nickel, and copper.

While the move does not significantly change supply fundamentals, it has led to uncertainty and volatility in the near term, prompting us to revise higher our second-quarter forecasts. However, we believe prices for aluminium and nickel risk a pullback once the market adapts to the new changes and realises the sanctions do not change the overall supply picture.

For nickel, we expect the global primary nickel market to remain in surplus for a third consecutive year in 2024, which should cap prices. For aluminium, higher prices and falling production costs could incentivise European smelters to restart idled capacity later this year, putting downward pressure on prices.

Copper prices have stood out over the last month, with LME copper breaking above $10,000/t for the first time in two years. Concerns over tightness in global mine supply and stronger demand from the green energy sector have boosted prices.

However, short-term indicators suggest that copper prices are due a downward correction. In China, copper inventories are at seasonally elevated levels, while import premiums for refined copper have fallen to zero, reflecting sluggish demand. In addition, while spot treatment charges have weakened significantly, there are no signs yet of Chinese smelters cutting operating rates.

External developments, specifically monetary policy, will also be important for metals' price direction. If US Fed rate cut expectations continue to be pushed back (like we have seen for much of the year), it should provide some further headwinds to metal prices.

Our latest views on the major central banks

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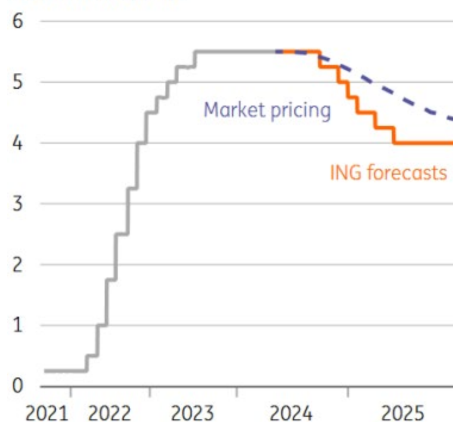
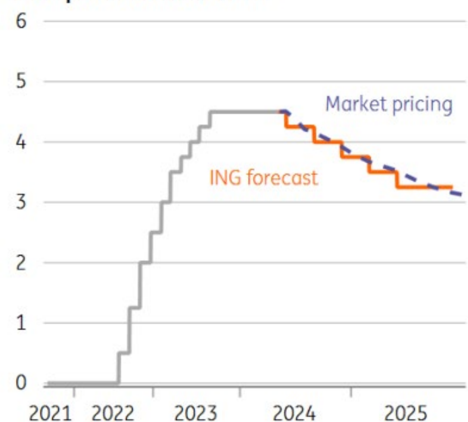
Despite recent setbacks, we continue to expect three rate cuts from the US this year, starting in September. An ECB rate cut in June looks like a done deal

Fed Chair Jerome Powell suggested their monetary policy stance was in "in a good place", but it is obvious that officials are concerned about the recent lack of progress on inflation

How our central bank views compare to market pricing





Federal Reserve

At the May FOMC meeting, Fed Chair Jerome Powell suggested their monetary policy stance was in "in a good place", but it is obvious that officials are concerned about the recent lack of progress on inflation. Rate hikes remain unlikely, but the Fed is prepared to leave interest rates at current levels until that progress is achieved or the jobs market clearly weakens.

Ahead of that meeting markets were only pricing around 28bp of rate cuts for this year, having fully discounted over 150bp in January. But some cautious comments on the prospects for the labour market from Chair Powell and the subsequent softer than anticipated April jobs report has seen the pricing move back towards 50bp of cuts.

We continue to forecast three 25bp moves for the year, starting in September. Business surveys suggest caution on the outlook for the economy is warranted while employment surveys point to a pronounced slowing in hiring in coming months. We also expect inflation to post more encouraging readings as cooler economic activity and subdued labour cost growth help dampen price pressures. However, to deliver a cut we would likely need to see at least three 0.2% MoM core inflation prints by September, some signs of cooling consumer spending and the unemployment rate trending upwards to perhaps 4.2% or higher.

European Central Bank

Despite first signs of a possible reflation in the eurozone, a rate cut at the ECB's June meeting still looks like a done deal. The fact that some ECB members already wanted to cut at the April meeting as well as the communication by almost all ECB speakers since the April meeting make it almost impossible for the ECB not to cut. However, looking beyond June, the path for the Bank is anything but clear. The risk of reflation has clearly increased. Not only has US inflation been a good leading indicator for eurozone inflation over the last two years and is currently on an upward trend again, but there are also other factors closer to home pointing to new inflationary risks. The cyclical rebound in economic activity as well as higher oil prices and a weaker euro exchange rate could easily push the ECB's own inflation projections for 2025 above 2% again. A longer substantial rate cut cycle will only materialise if inflation quickly returns to 2%. Any signs of reflation and also stronger economic activity will limit the ECB's room for manoeuvre. This is why we expect the ECB to cut rates this year by not more than 75bp.

Bank of England

The Bank of England's May meeting left little doubt that the committee is edging closer to its first rate cut, though it's keeping its options open. A June rate cut is a possibility, though there's two inflation reports due before then and we think April's release risks being punchy. This is the time of the year where annual index-linked or contractual price increases kick-in and last year this saw a big and unexpected surge in services inflation. There's a risk something similar happens this year, albeit on a smaller scale. If we're right, then we think the committee will lean towards waiting until August before cutting rates, at which point another inflation print will be available. Either way, we think the BoE cuts rates before the Federal Reserve, and we expect three rate cuts in total this year.

Bank of Japan

This month's key data, including 1Q24 GDP, earnings, and inflation prints are expected to support the BoJ's dovish stance. GDP is expected to contract 0.2% QoQ sa as a result of the safety scandal-related halt in car production in January and February, overshadowing the improvement in private consumption. Inflation is expected to fall sharply to below 2% in April due to various government programmes, while FY24 Shunto results have not yet been reflected in the earnings data yet. We continue to believe that the data will turn supportive of an additional hike of 15bp in July, but if the GDP contraction is deeper than expected and real wage growth remains negative by June, then the timing of the hike should be pushed back by a few months.

What you need to know about June's European elections

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The outcome of the European elections could delay future decision-making but will not derail the European economy

Which way now? A boy considers some election posters on a street in Rome

With less than one month to go, the European elections are in full swing. Coverage of, and attention to these elections has clearly increased over the last couple of decades. Nevertheless, the actual turnout - despite some increase over the last few years – still significantly lags behind voter turnout at national elections. In 2019, the last time these polls were run, only slightly more than 50% of the electorate came to the ballot box.

This year, the elections will take place from 6-9 June. At the next European Summit at the end of that month, national heads of state are likely to select a candidate for the European Commission presidency. The formal election of the next Commission president will likely happen in the mid-September session of the European Parliament.

This short article is not the place to underline the importance of Europe and the impact of Europe on businesses and people every day. But it is the place to briefly answer the three most important questions regarding the economic implications. In contrast to the US presidential elections, the economic impact of European elections will be more gradual. Even if their powers have increased over recent years, neither the European Commission nor the European Parliament has the same discretionary power as the US president.

The potential impact of an expected shift to the political right in Europe

In recent national elections, several European countries have already seen a shift towards the political right. According to the polls, the European elections could see further gains for populist parties, partly as European elections are often seen as a good occasion for protest votes but partly also as a simple result of national trends. However, a recent drop in the polls for the German AfD party indicates how fragile and volatile support for anti-European parties can be.

As symbolic as any gains for anti-European parties would be, there wouldn't be any imminent direct implications on the economy. First of all, populist and anti-European parties have, up to now, not been able to work together in the European Parliament. The character, membership and number of groups can change and have changed over the years. For anti-European and populist parties to block some of the EU's procedures (e.g. the rule of law mechanism) they would need to act as a unified block and achieve more than one-third of the seats in the next Parliament. They could then influence the shape of new legislation if the other mainstream parties were divided. Currently, an still unlikely scenario. In fact, even after the elections, the more disruptive potential of populist parties will be much higher via the Council (and national governments) than via the European Parliament.

Still, decision-making could become more complex in a more fragmented European Parliament, particularly as the EP and the Council jointly adopt most EU laws. As a result, the impact of any gains by anti-European parties will not derail the European economy, but it will further complicate new investment initiatives or cross-border reforms and endeavours.

What to expect from the next European Commission

Remember that even if the largest political group in the European Parliament has a good chance to propose the President of the next European Commission, it is government leaders who make the final decision. Currently, polls suggest a second Ursula von der Leyen Commission to be the most likely outcome, but von der Leyen herself experienced in 2019 how a 'dark horse' can suddenly become president. A second term is by no means a given, and that's perhaps underlined by recent rumours that the former ECB Chief Mario Draghi could be put forward by Emmanuel Macron as president of the EC.

As for the so-called strategic agenda of the next European Commission, it looks for now that these issues will top the list:

- strategic autonomy, competitiveness and defence,
- further EU enlargement, and
- implementing rather than enhancing the Green Deal.

The European Commission has exclusive competencies in policy areas such as trade agreements, competition rules within the single market, and the customs union. The Commission's role in trade agreements could particularly gain more importance after the US presidential elections.

The recently agreed revised fiscal rules have opened the door to more flexibility and tailor-made approaches, giving the European Commission more power vis-à-vis the member states. The timing of the European elections has already delayed measures to control fiscal deficits that are too high. The European Commission will only publish its assessment of the latest fiscal plans after the elections.

We expect the EC to launch so-called Excessive Deficit Procedures for several countries, including France, Italy and Spain. The political process, however, will clearly last into the autumn. As a result, fiscal policy in the eurozone as a whole is likely to become more restrictive in 2025.

Getting some answers from the US consumer puzzle

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The US growth story remains driven by consumer resilience. High income households are in a great financial position, but those on lower incomes are feeling intensifying stress. How these competing stories play out will be key to the growth outlook for the rest of the year and the prospect of Federal Reserve interest rate cuts

How long can the spending strength of the top 20% of Americans offset everyone else?

It's all about the high-earning consumer

The remarkable resilience of the US economy to high interest rates and tight credit conditions has to be admired. But now we're starting to see signs of softening. Business surveys have weakened notably, consumer confidence is moderating, and first-quarter GDP growth was weaker than expected, although that was mainly due to a negative contribution from inventories and net trade.

Nonetheless, inflation continues to run too hot. With three consecutive 0.4% month-on-month core CPI prints from the start of the year, the Fed is in no mood to cut interest rates imminently. The reason for the strength of the US economy remains the consumer, who accounts for 70% of GDP. The top 20% of households by income spend roughly the same dollar amount as the bottom 60%. By definition, those at the top have good incomes and probably own their own home, either outright or with a low fixed-rate mortgage. They have exposure to rising property and stock prices and have their savings in money market funds making 4-5%, so high interest rates actually benefit these households.

The question hanging in the air is how long the spending strength of the top 20% can continue to offset intensifying stresses for everyone else.

Savings are being sharply depleted

There are four ways to finance consumer spending: through income, savings (either saving less each month or running down the stock of savings), borrowing or selling assets. Real household disposable income is flat-lining and hasn't been the prime driver of consumer strength for well over a year; wage growth has slowed and inflation is eating into spending power. Instead, it is households in aggregate which have fully run down the excess savings built up during the pandemic which are keeping the momentum going.

The San Francisco Fed estimates that during Covid, excess savings maxed out at $2.1tn in August 2021. They now stand at a negative $72bn. We know wealthier households have continued to build savings, so this suggests that lower-income households have not only exhausted those pandemic-era savings but are likely eating into pre-existing savings, too.

Credit card spending isn't particularly sustainable

That leaves credit as the primary source for many households to be able to increase spending. But with credit card borrowing costs at all time highs and car loans at 20+ year highs, this is hardly sustainable. Indeed, delinquency rates on consumer loans are rising sharply, and Philly Fed data suggests more than 10% of households are only making the minimum payment on their credit cards as of the last quarter of last year.

If business surveys, such as the ISM employment series and the NFIB hiring intentions survey, are correct and job losses become a reality, it is difficult to see consumers as the driving force of economic growth in the second half of 2024 as they have been over the past few years. Intensifying weakness in lower-income household spending power runs the risk of offsetting what we see in those higher-income brackets.

Such an outcome will help dampen inflation pressures and, if we see the unemployment rate start to rise, both the Fed's and the market appetite for interest rate cuts will intensify. We continue to look for three interest rate cuts this year, starting at the September FOMC meeting.

A moderate recovery is already underway in the eurozone

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Eurozone first-quarter growth was surprisingly strong, but the initial data for the second quarter is mixed. The upturn has certainly started, but its pace is likely to be moderate. Inflation is still comfortable enough for the European Central Bank to begin cutting rates in June

There's not long to wait for the Paris Olympics and the ECB's first rate cut

Surprisingly strong first quarter

After two quarters of negative growth, eurozone GDP increased by a stronger-than-expected 0.3% in the first quarter. The question is, where do we go from here? The first indicators for the second quarter are a mixed bag. The European Commission's Economic Sentiment Indicator was disappointing in April, with moderate service sector activity and weakening manufacturing output. The PMI, while increasing in April, still showed industry in contraction territory. It seems that the inventory correction has yet to run its course, but we expect that excessive inventories will have been reduced sufficiently in the second half of the year to allow for more production growth.

The eurozone unemployment rate remained at a historic low of 6.5% in March for the fifth consecutive month. That said, labour market tightness seems to be easing somewhat. The European Commission's labour hoarding indicator fell in April and is now clearly below last year's level. Job vacancies, though still high, are coming down and the Employment Expectation Index is now also in a downward trend.

All those indicators are still above historical levels, and adverse demographics likely preclude any significant uptick in unemployment. Rising real wages should continue supporting consumption over the coming quarters.

Cometh the taxman

While there are sufficient reasons to expect growth to continue, we don't anticipate much of an acceleration. The US economy is likely to soften over the coming quarters, which might negatively affect European exports. And in June, the European Commission will finally publish its assessments of EU member states' public finances. That will force several of them to conduct much tighter fiscal policy in 2025, likely tempering the pace of the recovery.

In that regard, we expect quarterly growth to hover around 0.3% non-annualised over the next six quarters. With the stronger-than-expected first quarter generating a positive base effect for 2024, we revised our growth estimate for this year upwards to 0.7%. For 2025, we maintain our 1.4% forecast.

Inflation in a bumpy downtrend

The April figures confirmed that month-on-month inflation dynamics are softening. And so important for the European Central Bank, wage developments are seeming to moderate. The Indeed wage tracker stood at 3.3% year-on-year in March, down from 4% in January and 4.9% a year ago. While this is not a perfect reflection of the dynamics in negotiated wages, it indeed seems to indicate that wage inflation is coming down. That said, the fading out of energy support measures and base effects is a recipe for inflation volatility in the coming quarters. We now expect 2.5% inflation this year and 2.1% for 2025.

In recent comments, some members of the ECB's governing council indicated that barring any unforeseen surprises, a June rate cut was a *"fait accompli"*. The question is pretty much what happens after June. A continuing modest recovery has taken away the need for aggressive easing. And we cannot exclude that the labour market tightens again later this year, reversing the downward trend in wage growth. And that will be enough for the ECB to tread carefully in its rate normalisation process.

For now, we maintain our call of three rate cuts this year, but there is a risk that we'll see only two of them.

UK growth is rebounding, but the big risk is the jobs market

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We've revised up our UK growth forecasts as economic momentum returns. That's being driven by positive real wage growth and a less aggressive mortgage squeeze. But there are risks, not least from the jobs market which continues to cool

The UK economy, like these London marathon runners, is picking up speed

The UK growth outlook is brighter

The UK's economic outlook is undoubtedly brighter than just a few months ago.

We're yet to get first-quarter growth figures at the time of writing, but judging by January and February's GDP data, it looks like we've seen a decent rebound in activity. Some of that is thanks to a surprising - perhaps too surprising - collapse in December retail sales, which fully recovered in January. However, the latest purchasing managers indices, which are now well above the breakeven 50 level, suggest some of this momentum is genuine.

Looking at fundamentals, that makes some sense. Like much of Europe, the UK is effectively enjoying a positive growth shock from lower natural gas prices. Headline inflation will be below the Bank of England's 2% target from May and is likely to stay there for most of this year, at a time when nominal wage growth is up at 6% and coming down much more glacially. Retail sales are, accordingly, recording positive year-on-year growth for the first time in a while, albeit fractionally.

We also think the two-thirds of the mortgage squeeze is behind us. We judge that by looking at the average rate paid on outstanding housing debt, which has risen from 2% to roughly 3.5%. As more homeowners refinance off pandemic-era low rates, we estimate that that average will increase to 4%, but not until the end of 2025. Admittedly, the boost to savings income will also fall accordingly as we edge closer to Bank of England rate cuts, but this disproportionately affects higher earners who are less likely to change spending habits as a result.

Growth is back into positive territory, but there are risks

We've revised up our growth forecasts accordingly, but we think there are three main uncertainties.

The first has to do with the data itself. We mentioned the volatility in the GDP numbers, but a quick glance at the PMIs suggests there is some 'residual seasonality' – that is, a seasonal pattern that's not being fully adjusted for by the adjustment algorithms. In both 2022 and 2023, we saw a similar winter rise followed by a drop over summer, which could be a legacy of lockdown timing. Other surveys have improved less noticeably than the PMIs.

Secondly, there's the level of savings. Judging by the national accounts, the savings ratio has risen sequentially recently. But if we look at savings in actual bank accounts and adjust for inflation, they are barely above pre-pandemic levels. It's an open question as to how far savings can boost growth this year, but we're a bit cautious.

Finally, there's the jobs market. The vacancy-to-unemployment ratio is back to pre-Covid levels, but redundancy levels have been contained so far. We'd expect a further gradual cooling of the jobs market, but there's a clear risk that we're seeing the early signs of past rate hikes translating into a more noticeable hit to jobs.

China's economic recovery continues, but the job's not done yet

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First quarter GDP growth beat forecasts at 5.3% year-on-year, surpassing the 5% growth target. But China's economic recovery remains uneven

China is on track to meet its 5% growth target

The story behind the data

Most market participants revised their GDP forecasts for China higher following stronger-than-expected official data for the first two months of the year. But much to the surprise of many, first quarter GDP beat the vast majority of these forecasts, at 5.3% year-on-year.

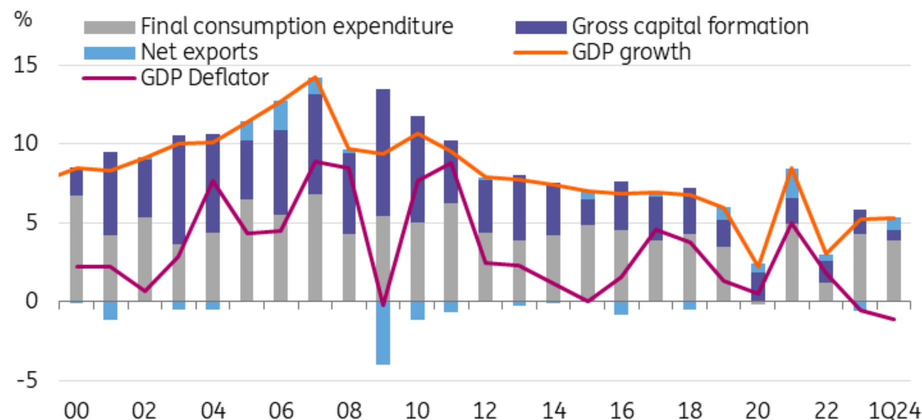
There was some scepticism around this data: March monthly data largely weakened, and it did not seem likely the activity data on hand could translate into such a strong GDP reading.

We believe the higher figures are down to a few surprises. First, the GDP deflator came in at the most negative level since 1999, contributing 1.1 percentage points to real GDP growth in the first quarter, double the value from the fourth quarter of 2023. In all likelihood, as inflation begins to move higher, the deflator will not add as much to growth in subsequent quarters.

Second, net exports contributed 0.77ppt, despite customs data showing only a modest increase in the trade surplus in the first quarter of 2024 versus the same period last year.

Nonetheless, the first quarter GDP release increases the odds that the full-year growth target of 5% will be met, but the job is not done yet.

First quarter GDP was boosted by deflator and net exports



Source: CEIC, ING

Policy stance remains supportive after Politburo meeting

Despite the headline number looking comparatively rosy, other data shows that the recovery remains uneven.

First, investment has come in stronger than expected so far this year, but this strength has been heavily driven by the public sector. The first quarter investment data paints a stark contrast; while state-owned enterprise (SOE) investment was 7.8% year-on-year, private sector investment grew a tepid 0.5% YoY.

Second, consumption has moderated, with retail sales down to 4.7% YoY in the first quarter from 7.2% in 2023. Confidence indicators have bottomed out but remain well below historical averages.

Third, while there is growing optimism domestically that we could see a bottoming out of property prices in tier one and two cities some time this year, in terms of the impact on economic growth, the property sector will continue to be a drag through 2024 as investment and new property starts remain well in contraction territory.

As such, most economists (including us) are continuing to advocate for policy support to continue. The April Politburo meeting indicated that this will be the case. The top-level meeting featured comments to maintain fiscal spending and to step up the use of special bonds, as well as flexibly use interest rate and reserve requirement ratio tools to lower funding costs.

In the near term, efforts will likely be focused on infrastructure investment, bolstering consumption via a “trade-in” programme, and continued support of the property sector. Continued policy rollout will increase the odds of reaching the 5% growth target this year.

Forecast revisions

As a result of the better-than-expected first-quarter GDP reading, we’ve revised our 2024 GDP forecast higher to 5.0% YoY. Due to policy rollout and the base effect, second quarter GDP should remain relatively strong at 5.3% YoY before moderating in the second half of the year.

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India continues to power ahead

India's economy grew 7.7%, faster than any other major economy last year and it's now the fifth largest in the world. The forecast for 2024 is for another year of 7%+ growth. We agree

India's Finance Minister Nirmala Sitharaman before the country's budget speech earlier this year

What's going well for India

One of the perennial problems for most emerging economies is that fast growth often degenerates into an inflation or balance of payments crisis. India has avoided this so far. Inflation has not exceeded the Reserve Bank of India's 6% upper inflation target since August last year, when a seasonal food spike led to a temporary surge. This will probably happen again at some point, though the occasional temporary lapse does not invalidate the fact that, for the most part, inflation has been well-behaved.

At 6.5%, the RBI's policy rates are some of the highest in the region. The RBI has run a fairly conservative monetary policy regime and is reaping the rewards. GDP growth also owes far less to unproductive household spending and far more to productive capital expenditure. This conclusion is supported by the current account data, where the deficit narrowed at the end of 2023 to only a little over 1% of nominal GDP. No sign of runaway spending here.

India's external balance has been supported by a number of factors. The Indian external deficit is often a victim of energy-cost shocks but, import costs have been tempered by greater imports of cheap Russian crude oil. This has probably gone as far as it can realistically go for now, and we don't expect any further incremental boost from this.

On the export side – increasingly – exports of transport, machinery and electronics are picking up the pace, while agriculture is flatlining as constraints on exports of staples such as rice and sugar have led to more stable domestic supply and have also helped tip the balance towards a more sustainable inflation environment. Evidence of the growing role of manufacturing is also visible in the GDP figures, where, on a gross value-added basis, industry has been contributing a greater proportion to total output than previously. All of this is evidence of travel up the value-added curve. Also by region, India now exports more to non-China and non-Japan Asia than it does to the US, reflecting in part the growing relevance in the region of SE Asia as a new engine for growth.

The exchange rate is also helping

The stable USD/INR exchange rate will also have helped encourage foreign direct investment and potential output at a time when much of the developed world is rethinking its relationship with China and looking for alternative locations within Asia to base production. Along with Vietnam, India has been one of the key beneficiaries of this re-division of the investment cake, even if flows more recently have softened everywhere.

The stability of the INR, which has been managed very tightly since October 2023, may reflect official concerns about fast money inflows following the decision to include Indian Government bonds in the JP Morgan global bond index this June. Recently, the INR has shown a little more volatility, but it remains one of the most stable currencies in the Asia-Pacific region. This stability has been achieved without burning through the RBI's FX reserves, which remain very comfortable at more than 11 months of import supply.

Some of the credit for strong and sustainable growth should go to fiscal policy too. The government has managed to reliably hit its deficit reduction targets since the pandemic, helped by more efficient tax revenue collection as payments have become increasingly digitised. Despite bringing the deficit down and stabilising the debt ratio, the government has still found room for substantial capital expenditure on productivity-enhancing infrastructure.

Areas of concern

The one area where we have some concerns is household credit growth, which is centred on housing loans, personal loans, and credit cards. This is very high and growing faster as the Unified Payments Interface (UPI) now offers credit options to customers. Although inflation and external balance data don't suggest anything to worry about, this looks to us to be an area that needs very close watching. And if anything does go wrong in the coming years, this looks like a possible source of risk.

CEE Inflation set to rebound with cautious economic recoveries

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Inflation in the region has reached this year's lows and we are likely to see a rebound in some countries. Here, the challenge will be to distinguish between one-off effects and persistent inflationary pressures. It is clear that the battle with inflation is not over, which will complicate further rate cuts in the region

Poland: Weaker start into 2024, but expected CPI rebound to keep rates unchanged

The beginning of 2024 surprised to the downside and weak industrial output and construction data has prompted us to revise our first quarter economic growth forecast down from 2.1% year-on-year to 1.5%. With construction output down by some 8% YoY in the first quarter, we may even see a decline in fixed investment in annual terms. At the same time, we still believe in a consumption-led recovery and 3% GDP growth in 2024. Even though corporate profits narrowed (less robust mixed income), lower inflation and buoyant wage growth should allow for solid private consumption growth despite a higher propensity to save.

CPI inflation increased to 2.4% YoY in April on the back of the return of VAT on food and is expected to continue trending upwards as the disinflationary impact of the high reference base stemming from the earlier energy shock fades away. The partial withdrawal of the energy shield could lead to exceptional uncertainty in inflation in the second half of 2024 as the scale of the potential jump in electricity and gas prices is difficult to estimate. At the same time, core inflation is projected to remain persistently elevated amid a tight labour market and double-digit wage growth that is keeping services inflation high.

In the face of the upward trend in headline inflation, high core inflation and uncertainty surrounding the inflation outlook (partial withdrawal of energy shields), the National Bank of Poland (NBP) is expected to maintain a cautious approach and stick to a hawkish policy bias. We still believe the Monetary Policy Council will keep policy rates unchanged by the end of 2024 and start to discuss potential cuts later this year. In 2025 we forecast 75-100bp cuts in NBP rates.

Czech Republic: A cyclical upswing driven by household spending keeps the central bank on alert

The Czech economy continued its expansion at the beginning of this year, with growth of 0.5% quarter-on-quarter being a positive surprise. At the same time, real GDP has not yet risen above the pre-pandemic level. High inflation in recent years has put household budgets under significant pressure, with real wages falling a cumulative 18% from their 2021 peak. The recent return of consumer inflation to the Czech National Bank's (CNB) 2% target will ultimately be reflected in a return of real wage dynamics to positive territory, boosting households' appetite for spending.

The continuous improvement in consumer confidence since the beginning of the year suggests that economic activity is finally rebounding from two years of stagnation. However, this cyclical upturn will continue to be constrained by medium-term structural weaknesses such as high levels of regulation, insufficient support for innovation, and increasing Chinese competition in the auto industry. The Czech economy is thus likely to expand by 1.2% this year, with real growth accelerating to 2.2% next year.

Headline inflation had been tamed, but price growth in the service sector has remained strong, even amid a lacklustre economic performance. At the same time, labour market conditions are still tight despite some easing recently. Overall, wage-driven inflationary pressures could accumulate over the medium term, with the unemployment rate expected to hover only around 3% and nominal wage growth continuing at around 7% YoY. Therefore, we expect renewed strength in domestic demand to keep inflation in the upper tier of the CNB's tolerance band. The Board will likely be cautious about further cuts in the key interest rate. In our view, monetary policy will remain restrictive as the policy rate is expected to gradually fall to 4% by year-end.

The Ministry of Finance assumes the public deficit will fall to 2.1% of GDP this year as part of a consolidation package. As a consequence, government consumption is about to hamper economic growth this year, while the impact is expected to be neutral next year.

Hungary: An uncertain recovery

The Hungarian economy has started to emerge from stagnation, according to preliminary GDP data for the first quarter. However, high-frequency data still paints a rather mixed picture, so we haven't seen a general upswing yet, just some green shoots here and there. The very tight labour market has eased recently, so we expect the pace of wage growth to moderate gradually in the second half of this year. While this is good news from an inflation point of view (lack of wage-push inflation), a pick-up in domestic demand may be more challenging. The large trade surplus comes as declining export activity meets subdued import needs. The former is due to constrained external demand and the latter is due to lower energy costs and weak domestic activity. Coming back to price pressures, disinflation is about to end, with services and fuel inflation heating up. Base effects will take over and push inflation towards 5.5-6.0% by the end of the year. Given all the risks (inflation and money market), the central bank slowed the pace of easing in April and delivered a hawkish message. As a result, we are raising our mid-cycle terminal rate to 7.00%.

The government has officially raised the ESA-based deficit target for 2024 to 4.5% of GDP. However, we still see a risk of around 0.5-1.0ppt even for the updated target. We see pro-inflationary risks if the fiscal adjustment is implemented in the second half of the year. S&P also expects these measures to be carried out after the local and EU elections and in anticipation of this, affirmed Hungary's 'BBB-' rating with a stable outlook. However, we are concerned about the risk of a downgrade by Fitch given its latest comments. As a result, the forint is entering a complicated period with fiscal risks and a further narrowing of the interest rate differential. We expect EUR/HUF to return to

the 395-400 range. The IRS curve should invert again. Hungarian government bonds continue to benefit from strong auction demand, but fiscal risk and a rebound in inflation may keep yields higher for longer.

Romania: Strong consumer activity and early fiscal slippage complicate the easing cycle ahead

After slowing in 2023 to 2.1%, economic growth in Romania is set to pick up this year on the back of stronger momentum in private consumption. Early signs are already pointing in that direction. In January-February, retail sales were very strong and wage growth remained comfortably in double digits. Fixed investment growth, the key component which kept the economy afloat last year, is set to remain high but slow nevertheless, partly due to some delays in project execution and EU financing absorption. On exports, the recent improvement in German activity only make the outlook slightly less cloudy. Overall, we expect growth to accelerate to 2.8% in 2024.

On the monetary policy front, we think that the National Bank of Romania is preparing the ground for a cautious easing cycle ahead. Our call for a first rate cut of 25bp at the May meeting is still in place, although the most recent communication from the Bank made the situation less certain. We now expect a total of only 50bp of rate cuts by the year-end, with a terminal rate of 6.5%, driven by the fiscal slippage, high wage growth and stronger-than-expected private consumption early in the year.

On the fiscal front, the budget deficit slipped visibly to 2.06% of GDP in the first quarter (2024 official target: 5.0% of GDP). At this stage, we pushed up our 2024 deficit forecast from 5.5% to 6.0%, with upside risks still in play. The key factors to watch ahead are the outcome of the negotiations with the European Commission (EC) in June and the growing debates on whether military spending should be exempt from the metrics. Getting to -3.0% of GDP looks out of sight until 2027-2028 at the earliest.

FX: Tokyo struggles to turn the tide

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FX volatility is coming lower as the Fed holds out hope of rate cuts and Japanese authorities intervene to support the yen

Japanese authorities entered FX markets to stabilise USD/JPY

After a spike last month, FX volatility is drifting lower again. Two factors are driving this move: the less hawkish outlook on Federal Reserve policy and Japanese authorities entering FX markets to stabilise USD/JPY.

On the former, last month's theme of 'divergence' did not last long. Jerome Powell's dovish FOMC press conference was enough to thwart those positioning for unchanged Fed rates this year. We think we may well have seen the dollar's pre-election peak and the dollar will again be sensitive to any decline in US activity and particularly US price data. At the same time, better-than-expected eurozone activity data and some calming in Middle East tensions mean that EUR/USD is seen as less of a one-way bet on the downside.

We have several measures pointing to EUR/USD medium-term fair value around the 1.08 area and we doubt EUR/USD will stray too far from this level over the next month.

FX stability has also been found from Japanese authorities likely supplying $50bn of dollars in FX intervention. Again, Tokyo will be trying to make USD/JPY less of a one-way bet and will be buying some time before – Tokyo hopes – softer Fed policy drags the dollar broadly lower through the second half of the year. For the time being, however, we would not be surprised to see more FX intervention in the 155-160 range this month.

Elsewhere in the G10 space, we think sterling is on the verge of independent weakness. The jury is out on whether sterling, with its high rates, should be traded more like a Fed/dollar story than an ECB/euro story. At some point over the next couple of months, we think the Bank of England will make it clear that it does have room to cut rates and sterling will fall. We can see EUR/GBP climbing to the 0.87 area later this quarter.

In the emerging market space, we are seeing pockets of appetite for high-yielding currencies such as the Mexican peso and other commodity-backed currencies in Latam and Africa. A little more stability in the G10 FX space should help these trends and also encourage the renewal of monetary easing cycles in emerging markets.

Rates: ECB to lead the Fed – what then?

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It's May. In June, the European Central Bank is set to cut by 25bp. In September, we think the Fed will cut. The period in between and up till June should see wider Treasury/Bund spreads and a relative steepening in the eurozone curve

The European Central Bank beating the Federal Reserve to the first cut is remarkable in itself, as the mantra over recent decades has been for the Fed to make the first moves, paving the way for the ECB (and indeed, many other central banks). It has copper-fastened the dominant market narrative of US rates being a directional lead indicator for eurozone rates. And given the near certainty of this, real-time correlation has been high. That correlation remains high.

The gap between US and euro rates is wide at both ends. It's likely to get wider

Right now, we have the US 10-year Treasury yield in the 4.5% area. That compares with a German 10-year yield of 2.5%, so effectively a 200bp gap between the two. That's high. The average in the past three decades has been 70bp. But these are unusual circumstances, and if indeed the ECB kicks off a rate-cutting cycle ahead of the Fed, that should echo right out the curve, widening the 10-year spread further. The absolute high was 260bp in 2018. We think the spread can head in that direction and that the 200bp to 250bp range is one we should be looking at.

We should see something similar play out in the 2-year area. Here, the spread is 190bp. That has averaged 50bp but has also seen an ultimate high of 335bp back in 2018, when the ECB was holding in negative rates territory while the Fed was getting some rate hiking done. That was quite some spread, and getting back there would likely require the ECB to keep cutting, and for the Fed not to cut in 2024 at all. That's a combination that we think is unlikely, but at the same time not inconceivable. We'd class it as a path of least resistance to pursue until disproven.

US inflation is a vital driver. It needs to tame, else spreads just keep widening

The key driver here is US inflation. For the first quarter, US prices rose by 1%. Annualise that and you get to 4% inflation, which is too high. If that trend continues, the market will price out Fed rate cuts for 2024, and the aforementioned spreads (eurozone into US) can really soar. But if, as we think, US inflation slows, then the widening in spreads can be muted.

The problem is that the market discount for April inflation is already shaping up to be broadly in line with 4% inflation. So it may not be till the May readings that we see some calming. This leaves us with at least a four-week window ahead where the wider spread trend continues.

The outcomes are a relative euro steepener and even better carry on swaps

A few things flow from this. First, market rates should be pulled lower in the coming three to six months (as they typically fall when the Fed cuts). Second, for now there is more steepening (dis-inversion) potential on the eurozone curve. And third, both 2-year and 10-year spreads between US and eurozone rates have the capacity to widen.

The bottom line is that it widens the carry advantage on paying lower euro rates and receiving US rates, a play that both asset managers (for higher yield) and liability managers (lower interest rate costs) can employ.

GDP forecasts

Developed Markets (QoQ% annualised growth)	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
US	1.6	2.8	0.3	0.6	1.3	2.4	1.4
Japan	-0.8	4.0	4.0	2.0	0.4	1.1	1.4
Germany	0.9	0.3	1.1	0.9	1.1	0.3	1.0
France	0.9	0.6	1.1	1.3	1.6	0.8	1.3
UK	1.5	1.1	1.2	1.2	1.3	0.5	1.3
Italy	1.2	0.6	0.7	1.0	1.0	0.8	1.1
Canada	0.8	0.8	0.4	1.2	1.5	1.0	1.5
Australia	0.4	0.4	1.2	1.6	2.0	1.0	2.0
Eurozone	1.3	1.1	1.4	1.4	1.4	0.7	1.4
Austria	0.9	0.8	1.4	1.6	1.6	0.2	1.5
Spain	2.9	1.6	1.8	2.2	2.2	2.1	2.2
Netherlands	1.2	1.6	1.2	1.4	1.0	0.7	1.3
Belgium	1.2	0.8	1.2	1.2	1.6	1.2	1.4
Greece	1.4	1.7	2.5	2.2	1.0	1.5	2.0
Portugal	3.2	1.8	2.0	2.2	2.4	1.5	2.2
Switzerland	0.8	0.8	1.2	1.2	1.2	0.9	1.3
Sweden	-0.2	0.5	0.7	1.4	1.5	-0.1	1.3
Norway	1.3	1.5	1.9	1.9	2.0	1.2	1.9

Emerging Markets (YoY% growth)	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Bulgaria	2.3	2.7	3.0	3.5	3.3	2.9	3.3
Croatia	4.1	3.3	3.3	2.4	2.6	3.3	2.7
Czech Republic	0.4	0.6	1.9	2.0	2.0	1.2	2.2
Hungary	1.7	2.3	2.2	3.1	3.2	2.2	3.8
Poland	2.1	3.0	3.1	3.9	3.2	3.0	3.5
Romania	2.8	2.3	2.2	3.5	3.0	2.8	3.0
Turkey	4.8	3.1	2.2	1.7	1.9	2.9	3.5
Serbia	4.4	3.4	2.8	2.7	3.0	3.5	3.5
Azerbaijan	4.0	2.5	2.0	1.5	2.5	2.5	2.7
Kazakhstan	4.5	3.8	5.0	4.5	5.5	4.5	5.0
Russia	4.0	2.0	1.0	1.5	1.0	2.5	1.0
Ukraine	3.5	3.5	3.2	3.7	-	3.5	5.0
China	5.3	5.3	4.5	5.0	4.0	5.0	4.5
India	5.8	7.8	7.8	6.8	6.2	7.0	7.2
Indonesia	5.1	5.0	5.2	5.0	5.2	5.1	5.1
Korea	3.4	2.7	2.3	2.0	1.1	2.5	1.7
Philippines	5.9	6.4	4.7	4.5	4.7	5.5	5.4
Singapore	2.7	2.2	2.3	2.1	2.6	2.2	2.5
Taiwan	6.5	3.3	2.6	2.3	2.5	3.1	2.7

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

CPI Forecasts (pa)

%YoY	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
US	3.2	3.5	3.0	2.7	2.3	3.1	2.0
Japan	2.5	2.3	2.1	1.8	2.1	2.2	1.9
Germany	2.5	2.7	2.5	2.9	2.8	2.7	2.4
France	2.8	3.0	2.8	2.5	2.4	2.8	2.0
UK	3.5	1.8	1.8	1.9	1.9	2.3	1.9
Italy	1	1.1	1.4	1.9	2.1	1.4	1.8
Canada	2.9	2.6	2.0	2.4	2.5	2.5	2.0
Australia	3.6	3.7	3.5	3.4	3.1	3.5	2.9
Eurozone	2.6	2.5	2.3	2.4	2.1	2.5	2.1
Austria	4.3	3.1	2.9	2.3	2.1	3.1	2.1
Spain	3.1	3.4	3.3	3.0	2.5	3.2	2.2
Netherlands	3.0	2.4	1.9	2.3	2.1	2.4	2.5
Belgium	2.7	3.2	3.4	2.6	2.1	3.0	2.1
Greece	3.2	2.9	2.4	2.4	2.3	2.7	1.9
Portugal	2.2	2.5	2.6	2.5	2.4	2.5	2.1
Switzerland	1.2	1.0	1.2	1.1	1.1	1.1	1.1
Sweden	2.7	2.7	2.7	2.1	1.7	2.5	2.1
Norway	4.4	3.4	2.9	3.6	3.0	3.6	3.0
Bulgaria	3.4	3.1	2.9	3.5	4.1	3.2	4.1
Croatia	4.1	3.0	1.8	2.4	2.7	2.7	2.6
Czech Republic	2.1	2.4	2.0	1.9	2.2	2.1	2.3
Hungary	3.7	4.4	4.6	5.5	5.3	4.5	4.2
Poland	2.8	3.0	4.9	5.2	6.2	4.0	4.5
Romania	7.1	6.0	5.3	4.8	4.1	5.8	4.1
Turkey	66.8	71.0	45.1	42.2	32.8	56.3	29.8
Serbia	5.7	4.5	4.1	4.0	4.2	4.5	4.3
Azerbaijan	1.3	0.1	1.3	2.6	3.5	1.6	3.8
Kazakhstan	9.3	8.9	8.6	8.4	8.1	8.8	7.6
Russia	7.6	7.9	7.1	5.7	4.9	7.1	4.7
Ukraine	4.1	6.0	8.0	9.5	-	8.1	7.3
China	0.0	0.3	0.9	2.1	1.2	0.8	2.0
India	5.0	4.8	5.1	4.4	5.3	4.5	4.7
Indonesia	2.8	3.4	3.0	3.2	3.0	3.2	3.1
Korea	3.0	2.9	2.3	2.5	2.2	2.7	1.9
Philippines	3.3	4.2	3.6	3.2	3.8	3.6	3.5
Singapore	3.0	3.5	3.2	3.0	2.8	3.3	2.8
Taiwan	2.3	2.1	1.9	1.4	1.3	1.9	1.4

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

Source: ING estimates

Oil and natural gas price forecasts (avg)

	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F	2026F
$/bbl							
Brent	87.00	88.00	85.00	84.00	85.00	80.00	75.00
EUR/MWh							
Dutch TTF	25.00	25.00	35.00	35.00	28.00	29.00	28.00

Source: ING estimates

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