

ING Monthly

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Central bankers left holding the baby



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When everything else fails, central bankers come to the rescue. That's how the story goes; they have a reputation for nursing sickly children back to health. Perhaps Lagarde, Powell and the rest of them need to start brushing up on their parenting skills when it comes to the ailing global economy

The only game in town

It seems to me that the global economy is mainly driven by politics these days. You've got escalating conflict in the Middle East and stalemate in Ukraine. And all that's playing into the economic ailments of falling competitiveness, faltering growth momentum and a fracturing political system. It's extraordinary, then, that when you check out the financial markets, monetary policy seems to be the only game in town.

We've been here before. I'm losing count of the number of times people look to central banks to react when global economies lose momentum. In 2015, the then-president of the European Central Bank, Mario Draghi, repeatedly emphasised that if you want growth, monetary policy isn't the only game in town. In the end, his brand of monetary policy, along with negative interest rates and asset purchases, might not have been the only game, but it was certainly the most impressive.

Right now, the US economy is losing traction. China's sliding into a European-style consumption slump. The eurozone is flirting with recession. So, the spotlight's back on central banks to come to the rescue once again. All the major ones are at important turning points. They're juggling the twin dilemmas of inflation versus decisive rate cuts. Is the former slain? Will the latter breathe life into the still-snarling dragon?

While the bankers mull over these shifts, so many governments seem reluctant to use structural reform and fiscal policy as their main tools in tackling seemingly moribund economies. Falling back on central banks is easy. Far harder is mapping the painful reforms and clear fiscal direction so desperately needed as government debt rises to horrifying levels.

Parting of the ways

As for that fiscal direction, the next few weeks will be crucial in both the US and the eurozone. The American presidential elections and subsequent policy announcements are likely to lead to still higher government debt. Neither Mr Trump nor Ms Harris is inclined to elaborate on their plans to address that. Goodness knows when this will actually become a structural problem, but you'll know it once you see it.

Here in Europe, memories appear to be short. The debt crisis was a little over a decade ago. Sure, some reforms seem to have made the fiscal rules more resilient, but somehow, history appears to be repeating itself, and it isn't pretty.

In the early 2000s, France and Germany breached the Stability Pact rules and avoided any consequences. Today, both countries have diverged greatly here. France, with a government debt ratio of more than 110% of GDP, an average annual fiscal deficit of more than 6% of GDP over the last four years, and government spending of close to 60% of GDP, wants to bring back its fiscal deficit to 3% of GDP by 2029. And that poses a severe first test case as to the implementation of the reformed fiscal rules.

Germany, meanwhile, with government debt of 60% of GDP, is sticking to its constitutional debt brake and is struggling to agree on any new investments. The eurozone is heading into unprecedented fiscal divergence.

Whatever it takes

So, we've seen this sort of economic divergence before, and it didn't end well. And you don't have to be a learned economist to know that such disparity will feed into greater anxieties and tensions. So, bring on the maestros! Bring on the central bankers, those modern financial market magicians! It's what the crowds are waiting for. Surely, they've got some tricks up their sleeves to magically support weakening economies; they've done it before.

Central banks are always the ones left holding the baby.

'Whatever it takes', right?

Watch: Monetary policy should not be the only game in town



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Our key calls this month:

- **United States:** After September's 50bp rate cut, the Federal Reserve is likely to move more cautiously from now on. Official data suggest strong growth and robust employment gains, but survey evidence indicates the situation isn't as rosy and caution is warranted. We still favour the soft landing scenario amid cooling inflation fears and the Fed cutting rates to 3.5%.
- **Eurozone:** The European economy is rapidly losing steam with growth likely coming to a standstill in the winter months. The good news is inflation figures are benign, allowing the European Central Bank to step up the easing pace. We expect cuts in October and then at every meeting until the deposit rate reaches 2%.
- **United Kingdom:** The Bank of England is trading more carefully for now, but we expect cuts to accelerate from November onwards. The 30 October budget could involve sweeping changes to fiscal rules that unlock a big boost to investment. That's a potential risk for markets, though investors seem relaxed.
- **China:** Sweeping fiscal and monetary policy announcements have been cheered by financial markets. These are a good step in the right direction, but the economic outcome still depends on the strength, speed, and effectiveness of upcoming fiscal policy support to build upon the initial momentum. We have revised up our 4Q and 2025 growth forecasts.
- **Central and Eastern Europe:** The increase in geopolitical risk is bringing unusual FX weakness to the CEE region, while the potential for higher oil prices is reintroducing inflation concerns. At the same time, the fiscal picture is raising eyebrows in some countries in the region, and any further central bank rate cuts remain conditional.
- **FX:** The dollar is on firmer footing compared to where it was a month ago. A more volatile geopolitical backdrop can keep it supported, though the Presidential election will become increasingly important. EUR/USD may struggle to bounce back above 1.10 into November 5th, with risks skewed to the 1.08 area as lower eurozone inflation prompts the ECB to cut rates in October.
- **Market rates:** A strong jobs report has taken 10-year US yields back to 4%, though any material move up is constrained by the recessionary risk ahead. A payrolls wobble could take it lower again, but in the medium/longer-term we still expect the 10-year to trend back towards 5%.

ING global forecasts

	2024					2025F					2026F				
	1Q24	2Q24	3Q24	4Q24F	2024F	1Q25F	2Q25F	3Q25F	4Q25F	2025F	1Q26F	2Q26F	3Q26F	4Q26F	2026F
United States															
GDP (% QoQ, ann)	1.6	3.0	2.7	1.8	2.7	0.5	0.5	1.5	2.3	1.4	2.2	2.1	2.0	2.0	2.0
CPI headline (% YoY, aop)	3.2	3.2	2.6	2.4	2.9	2.0	1.7	1.9	1.9	1.9	1.9	2.0	2.0	2.0	2.0
Federal funds (% eop)	5.50	5.50	5.00	4.50	4.50	4.00	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
3-month SOFR rate (% eop)	5.40	5.40	5.00	4.40	4.40	3.90	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
10-year interest rate (% eop)	4.25	4.40	3.80	3.70	3.70	3.90	4.00	4.25	4.75	4.75	5.00	5.00	5.00	5.00	5.00
Fiscal balance (% of GDP)					-6.8					-6.6					-6.2
Gross public debt / GDP					98.9					102.4					104.5
Eurozone															
GDP (% QoQ, ann)	1.3	1.2	0.4	-0.1	0.6	0.5	0.8	1.2	1.4	0.6	1.3	1.5	1.5	1.5	1.3
CPI headline (% YoY, aop)	2.6	2.5	2.2	1.9	2.3	2.0	1.9	2.0	1.9	2.0	2.2	2.2	2.2	2.2	2.2
ECB Deposit Rate (% eop)	4.00	3.75	3.50	3.00	3.00	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
3-month interest rate (% eop)	3.90	3.70	3.40	3.20	3.20	2.70	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10-year interest rate (% eop)	2.30	2.60	2.10	2.00	2.00	2.10	2.20	2.25	2.40	2.40	2.50	2.60	2.60	2.70	2.70
Fiscal balance (% of GDP)					-3.1					-2.8					-2.7
Gross public debt/GDP					89.1					89.5					89.7
Japan															
GDP (% QoQ, ann)	-2.4	2.9	0.8	3.2	-0.1	1.2	1.6	0.4	0.4	1.5	1.2	1.2	1.2	1.2	0.9
CPI headline (% YoY, aop)	2.5	2.7	2.7	2.5	2.6	2.2	1.8	1.7	1.7	1.8	1.7	1.7	1.8	1.8	1.8
Target rate	0.10	0.10	0.25	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00
3-month interest rate (% eop)	0.26	0.30	0.50	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25
10-year interest rate (% eop)	0.73	1.06	0.90	1.00	1.00	1.25	1.25	1.50	1.50	1.50	1.75	1.75	2.00	2.00	2.00
Fiscal balance (% of GDP)					-12					-12					-15
Gross public debt/GDP					280					290					300
China															
GDP (% YoY)	5.3	4.7	4.4	4.8	4.8	4.2	5.0	5.1	5.0	4.8	4.7	4.8	4.4	4.5	4.6
CPI headline (% YoY, aop)	0.0	0.3	0.6	1.4	0.6	1.2	1.3	1.3	1.5	1.3	1.7	1.5	1.6	1.6	1.6
7-day Reverse Repo Rate (% eop)	1.80	1.80	1.50	1.40	1.40	1.40	1.40	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
3M SHIBOR (% eop)	2.16	1.92	1.84	1.80	1.80	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.65	1.65	1.65
10-year T-bond yield (% eop)	2.30	2.21	2.20	2.10	2.10	2.10	2.15	2.20	2.25	2.25	2.30	2.30	2.35	2.35	2.35
Fiscal balance (% of GDP)					-5.0					-5.10					-5.2
Public debt (% of GDP), incl. local govt					121					130					140
United Kingdom															
GDP (% QoQ, ann)	2.8	1.8	1.2	1.2	1.0	1.3	1.2	0.9	0.9	1.2	1.0	1.0	1.0	1.0	1.0
CPI headline (% YoY, aop)	3.5	2.1	2.1	2.4	2.5	2.5	2.1	2.3	2.2	2.3	2.1	2.1	2.1	2.2	2.1
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	3.25	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	3.20	3.20	3.20	3.20
10-year interest rate (% eop)	3.95	4.20	4.00	3.60	3.60	3.60	3.70	3.70	3.80	3.80	3.80	3.85	3.90	4.00	4.00
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	1.12	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
USD/JPY (eop)	148	150	143	140	140	140	138	137	135	135	135	135	135	135	135
USD/CNY (eop)	7.22	7.26	7.00	7.10	7.10	7.05	7.00	6.95	6.95	6.95	6.95	6.95	6.90	6.90	6.90
EUR/GBP (eop)	0.86	0.87	0.84	0.85	0.85	0.86	0.86	0.86	0.86	0.86	0.86	0.86	0.86	0.86	0.86
ICE Brent - US\$/bbl (average)	82	85	79	79	81	74	72	73	69	72	67	69	73	70	70
Dutch TTF - EUR/MWh (average)	28	32	36	37	33	33	27	24	30	29	32	25	23	30	28

Source: ING forecasts

How things can go wrong - or right - for the global economy

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The global economic outlook hinges on whether we're heading for a US recession, whether China can escape the current cycle of falling property prices and weak sentiment, and whether we see a cooling in geopolitical tensions. Here are two alternative scenarios for the global economy



We're all hoping for a soft landing

The upside risk: Recession fears overblown

There are three obvious ways that our forecasts could be too pessimistic.

Firstly, the US economy continues to prove resilient despite the negative signals coming from some of the recent survey data. Healthy profit margins and corporate balance sheets allow the economy to shrug off the impact of past rate hikes. The unemployment rate falls back to or below 4%, undershooting the Federal Reserve's year-end forecast of 4.4%. Labour supply growth stalls as the recent surge in migration ebbs away, but layoffs stay contained. The addition of extended/expanded tax cuts, which are likely if Trump wins the Presidency and a clean sweep in Congress, would add to the stronger growth/higher inflation narrative. The end of election uncertainty may also provide a short-lived boost to investment, regardless of who wins.

Secondly, China manages to return to annual growth rates in excess of 5%. That may be down to more aggressive government stimulus, be it fiscal or monetary, or if we begin to see the housing market turning a corner. Past measures successfully restore confidence in the market, which in turn boosts consumer activity via the wealth effect and improved sentiment.

Finally, the tensions in the Middle East subside – or at least stabilise – and/or the war in Ukraine peacefully ends earlier than many expect.

The combination of stronger global demand, especially from China, as well as calmer geopolitics and the possible anticipation of Ukrainian reconstruction, would be a boost for European (particularly German) industry.

All of this means that central banks can become more relaxed about growth. While they would likely continue to cut rates, recognising that a more neutral setting is still

necessary, these cuts are likely to be slower than in our base case. The terminal rate also ends up higher than expected, as policymakers remain on their guard for the second-round effects of stronger growth on inflation. Depending on how far rates fall initially, that could even entail some very modest rate hikes in the second half of 2025. Either way, this scenario implies a terminal rate closer to 4% in the US and 3% in the eurozone.

The downside risk: Serious spike in oil prices causes widespread recession

The same three drivers that we've discussed above could just as easily become a source of downside risk, too.

Firstly, the recent US data turns out to have been massively overstating economic resilience. We already know that payrolls are set to be revised down, but so far only as far as March. More substantial revisions may eventually follow thereafter. This implies that the Sahm rule, which has been triggered by a half-a-percentage-point rise in the unemployment rate from its prior 12-month low, turns out to be a reliable recession signal after all.

Secondly, the risk is that the challenges in the Chinese property market continue to mount despite recent government stimulus. Sentiment remains weak. And local government finances, which were previously heavily reliant on land sales and real estate development, prove to be a major drag on economic activity.

But it's oil that is undoubtedly the biggest "known unknown" in our global macro forecast. The risk, as our commodities team has detailed, is that material escalation in the Middle East, prompted by a blockade in the Strait of Hormuz, doubles oil prices.

The impact on inflation would be substantial. Headline CPI in the US/eurozone would increase by 1.5-2.0ppt due to gasoline costs alone, and by greater still once the indirect impact on food and other goods prices is accounted for. Both the US and eurozone slip into recession.

Consumer spending turns weaker in the major economies, and the challenges the manufacturing industry is already experiencing become magnified. Greater use of tariffs, depending on the US election winner, would add to those issues.

Central banks face a dilemma – look through the rise in oil prices and support demand, or keep rates elevated in order to balance second-round effects. Experience from the past couple of years suggests policymakers might opt for the latter. Rates fall back to neutral more quickly but don't go materially "accommodative".

However, that stance could quickly change assuming the recession in major economies causes widespread layoffs and a further spike in US/European unemployment rates. Higher central bank rates would become increasingly untenable and that ultimately forces a second wave of rate cuts into more expansionary territory and central banks switch focus to generating a recovery.

An unexpected recession, coupled with initially elevated central bank rates, could imply even greater scrutiny of government finances. Rate cuts would still herald some relief for debt interest costs, but any positive impact that has on deficits is offset by lower revenues/higher social spending. Government bond yields trade with a greater fiscal risk premium, potentially implying wider spreads in Europe. That would add another layer of difficulty for the eurozone economy.

Central bank rate cuts: How fast and how far?

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Central banks are at a crossroads. Inflation is down and the growth outlook is increasingly uncertain. Can policymakers deliver a soft landing? And how far are rate cuts likely to go? Here's our latest thinking



Central banks are at a critical juncture, much like drivers navigating the confusing road networks in Brussels

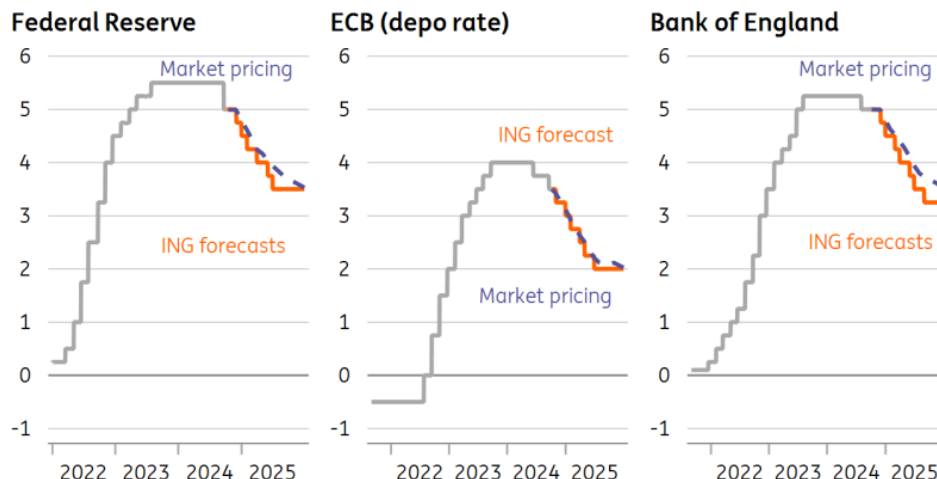
Central banks at a crossroads

Do you remember 2022? This was the year central banks in developed markets finally abandoned their 'inflation is transitory' narrative and started the fight to restore their reputation. They did this not only by gradually leaving behind ultra-loose monetary policy but by going all-in on rate hikes. For followers of eurozone monetary policy, [a speech by](#) European Central Bank Executive Board member Isabel Schnabel in Jackson Hole in the summer of 2022 was a pivotal moment: the optimal policy to counter inflation, she said, was a 'forceful response'.

More than two years later, major central banks appear to be at another critical juncture. It's not exactly a crossroads, but more like one of those confusing traffic situations in Belgium where you have only two choices: keep driving straight ahead or make a sudden U-turn. The question is, will central banks continue to squeeze out the last remnants of inflation, or will they abruptly abandon concerns about a second inflation wave and start supporting the cooling economy?

For the second time in little more than two years, central banks are at a turning point. The key issue now is whether this turning point will be abrupt or gradual. Financial markets have already found their answer to the question. They think that major central banks will cut rates aggressively over the coming months. Are they right? To get to the core of the matter, here are a few topics we need to discuss first...

How ING central bank forecasts compare to market pricing



Source: Macrobond, ING calculations

How have central banks’ reaction functions changed? Are central banks really focusing more on (the lack of) growth than on inflation?

For the Federal Reserve to cut interest rates by 50bp after the economy grew 3% in the second quarter, inflation is still above target, unemployment stands at just 4.2% with jobs still being added, and equity markets are at all-time highs, suggests that the Fed is behaving differently this cycle and is more forward-looking. The bank does not want to cause a recession if it can avoid doing so, and with inflation tracking towards target, policymakers appear to be of the view that they can move policy towards neutral quickly. It is possible that there is concern about data quality, particularly in light of the provisional benchmark revisions lower on jobs numbers. Given this situation, they are likely putting increasing focus on their own data gathering. The Federal Reserve’s Beige Book – and anecdotal survey of trusted contacts – suggests that 75% of the regional Fed Banks are seeing flat or negative growth right now. This is more aligned with the weakness seen in business surveys, such as those published by the ISM and the NFIB, than official data.

The Fed differs from other central banks in that it formally has a growth target proxy in the form of “maximising employment”. Remember, too, that Joe Biden added a third target of making the maximum number of people feel the benefits of growth. The central bank had signalled in late 2023 a growing confidence that inflation was on the path to 2% with the December forecast including three 25bp rate cuts, only for the inflation data to come in hot in the first few months of 2024, which forced the Fed to backtrack. This time around there is more conviction that inflation is on the glide path to 2% and with the jobs outlook looking weaker, the bank has pivoted to put more emphasis on this aspect of its mandate – hence Jerome Powell’s comments that “we don’t seek or welcome further cooling in labor market conditions” and that “The time has come for policy to adjust. The direction of travel is clear”.

In the eurozone, the European Central Bank appeared to be ahead of the Federal Reserve when it began cutting interest rates in June. However, the rate cuts in June and September were more about fine-tuning the level of monetary policy restrictiveness rather than addressing heightened growth concerns. This stance seems to have shifted now. With speculation about an October rate cut, the ECB is aligning with the Fed’s increased focus on the lack of growth.

So far, the Bank of England’s reaction function has less obviously changed. The hawks still talk about potential permanent shifts in price and wage-setting behaviour that make rate cuts look premature. And the notion of “inflation persistence” is still the key buzzword for the committee as a whole. The ongoing focus on inflation over growth

stems from service-sector price pressure that remains more troublesome than elsewhere, an economy that has outperformed over recent months, and a jobs market that is cooling but seemingly not falling apart.

Could rate cuts go faster than we thought?

The Fed also started the 2007 rate-cutting cycle with a 50bp cut, but outside of times of critical stress, this is unusual. Typically, the Fed favours 25bp increments and Jerome Powell stated on 30 September that "This is not a committee that feels like it's in a hurry to cut rates quickly", suggesting 25bp moves are the most likely course of action in November and December.

There is less empirical evidence for rate-cutting cycles in the eurozone. The few short episodes that we have seen, however, show that the ECB has actually more often cut rates by 50bp than people think, particularly in times of financial or economic stress and when interest rates were at relatively higher levels. At the current juncture, the ECB looks set to follow a very gradual rate-cutting path. Inflation looks sticky and the economy is resilient. If inflation turns out to be less sticky and the economy's resilience fades, rate cuts at a faster pace or with larger steps seem likely.

The Bank of England is in a similar situation, though markets are pricing some divergence between US and UK rate cuts. That's entirely consistent with history, where the BoE's reputation as a 'Fed satellite' is a bit of a myth. In this case, though, we think the BoE will end up accelerating rate cuts through the winter when services inflation looks more palatable and thus the UK won't look like an outlier.

In the end, all central banks currently emphasise their data dependence and do not want to send any signals of precommitment. However, the shift towards greater focus on growth over inflation, means that if activity and jobs data deteriorate more quickly and inflation remains benign or even falls back, larger rate cuts will be almost unavoidable.

Can central banks orchestrate a soft landing and what does history tell us?

Recent analytical work by the ECB shows that inflation driven by supply shocks is the largest challenge for central banks and the biggest risk for a hard landing. As the ECB's paper states: "Central banks have typically hiked aggressively in response to supply shocks. Rates were also cut earlier in the inflationary phases, and more quickly, possibly in response to a weakening growth outlook and declining inflation expectations. These past responses did not lead to soft landings in the past."

For the US, former Fed vice-chairman Alan Blinder analysed soft and hard landings [in the Journal of Economic Perspectives and](#) concluded that eight of the eleven monetary policy tightening periods since 1965 were followed by recessions. Admittedly, the last two after 2006 and 2019 were triggered by external events and not by monetary policy tightening. However, when looking closer at the episodes that Blinder identified as being followed by hard landings, it becomes clear that in some cases creating a recession was actually part of the plan.

At the current juncture, US data still points to a soft landing as activity data remains robust and employment levels are high. Business surveys and consumer confidence have softened, suggesting downside risks to future growth, but if monetary policy is loosened and a smooth US election allows political uncertainty to dissipate, this could be enough to generate a rebound in sentiment. Early action from the Federal Reserve under Alan Greenspan in the mid-1990s achieved such a feat, followed up with additional rate cuts in the late 1990s in response to the Russia crisis/LTCM failure, sandwiching a 25bp rate hike in 1997.

The major caveat with any historical comparisons is that fixed-rate borrowing has become much more prevalent over the past decade. Households and businesses took advantage of low rates to fix their costs for longer periods. That may partly explain why the US and eurozone economies haven't been seriously upended by aggressive rate hikes. But it also potentially means the Fed and ECB shouldn't expect to cut rates now and expect results as quickly as they might have done in decades gone by.

What do we think about terminal rates?

Markets have started to price in terminal rates for both the Fed and the ECB that are clearly below assumed neutral levels. We are a bit more cautious. Even if central banks in the shorter term are shifting their preferences and reaction functions, it is still hard to see inflation nicely settling down on target. The world has simply changed. Persistent supply-side constraints could easily bring back inflation as soon as demand in the economy picks up again; and the structural factors of 3D inflation – demographics, deglobalisation, and decarbonisation – continue to suggest a trend of higher inflation.

Recent experience has shown how those trends also mean that external shocks – be it from oil or natural gas prices – can more easily translate into persistent periods of inflation than in the post-financial crisis decade. Also, given that fiscal policy, (not only in the US) is very likely to remain (or turn) loose again, there is a strong argument that monetary policy needs to be tighter.

Our latest views on the major central banks

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The Federal Reserve is likely to pivot back to smaller 25bp rate cuts unless something changes in the economy. We also expect a 25bp ECB rate cut in October, although it's far less certain than financial markets currently think



Federal Reserve

After cutting rates by 50bp at the September FOMC, Fed Chair Jerome Powell suggested their baseline is 25bp increments from now on unless something changes. That said, the recent strong jobs report and better survey data have led some in the market to question whether the Fed needs to cut at all. We characterise the Fed's policy loosening as a risk mitigation move. Monetary policy has been restrictive for some time and now that inflation is looking better behaved it makes sense to lower borrowing costs to give the economy a little more breathing space.

The Fed is clearly trying to replicate the success of the 1995 loosening cycle, directed by Alan Greenspan, that achieved a soft landing and cooler inflation. After all, not all the data is pointing in the same direction, with the Fed's own Beige Book reporting that only three of the 12 Fed regional banks are reporting economic growth. In an environment where households are becoming more nervous about the threat of job losses, the Fed looks set to continue gradually moving policy towards a more neutral setting.

European Central Bank

We are far less certain than financial markets that the ECB will cut rates at its October meeting. The two main questions for the ECB will be how it interprets the distinction between data dependence and data point dependence and how it balances between actual data and forecast uncertainty. If the ECB decides to cut rates at the October meeting, this would mark an important change in its own reaction function. It would be a rate cut to bolster growth, while longer-term risks to inflation remain.

October or not, the change in the ECB's reaction function will come and with more growth disappointments in the offing, we expect the ECB to step up the pace and potentially size of rate cuts, bringing the policy rate to 2% before the summer of 2025.

Bank of England

Financial markets continue to think the Bank of England will cut more gradually than the Federal Reserve. UK services inflation remains stickier than elsewhere, while growth has been strong in the first half of the year. BoE hawks remain concerned that price/wage setting behaviour has changed for good. While it's unlikely that this is the majority view on the committee, the BoE as a whole remains comfortable with a gradual approach to cuts. But that could be about to change. Recent comments by Governor Andrew Bailey in a newspaper interview have opened the door to a dovish pivot. And surveys continue to point to more muted wage/price rises among corporates.

We think services inflation will end the year below 5% (currently 5.6%), and assuming the jobs market and activity data continue to cool, we suspect officials will put more emphasis on the risks to growth as time goes on. We expect an acceleration in rate cuts to enable 25bp moves at every meeting from November onwards until the Bank Rate reaches 3.25% next summer.

Bank of Japan

The Bank of Japan is expected to pause in October. The central bank is likely to be monitoring the impact of the two rate hikes earlier this year, as well as financial market reactions to Fed policy changes. The BoJ's policy normalisation will continue, but there is no need to rush. The recent LDP leadership election result is more or less neutral for the BoJ's policy, as the newly elected leader, Shigeru Ishiba, is in favour of normalising the BoJ's policy.

We expect the BoJ to resume its rate hikes in December if October inflation growth is solid and wage growth continues. However, given the BoJ's cautious response to the financial market and the US economy, the BoJ may be worried that a December rate hike could rattle the market again, given that market liquidity is typically thin in December, so it may play it safe and raise rates in January.

Middle East escalation pushes energy prices higher

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Oil and gas prices have moved higher following an Iranian missile attack on Israel. Markets are waiting to see how Israel responds. Escalation in the region is putting energy supply at greater risk



Bushehr nuclear power plant in Iran

The impact of losing Iranian oil supply

Oil prices briefly broke above US\$80/bbl as the market waits to see how Israel responds to Iran's latest missile attack. Clearly, growing tensions have seen the market price in a greater war risk premium. However, where prices go from here will depend on how Israel responds. A similar response to Iran's April attack would likely see the risk premium eventually start to erode, with fundamentals once again coming to the forefront. And with the global market set to be in surplus through 2025, this means that oil prices will likely weaken. We are forecasting that ICE Brent will average US\$72/bbl over 2025.

However, Israel may decide on a more aggressive response. There have been suggestions that Israel could target Iranian energy infrastructure. The key question would then be whether Israel hits downstream assets or mid/upstream assets. Hitting downstream oil assets, such as refiners, would likely increase oil supply for the global market as Iran would be unable to process this oil and so would have a larger exportable surplus. In theory, this should be bearish for prices. However, given it would be seen as an escalation, oil prices would still likely move higher, at least initially. A more serious impact for the global oil market would be if Israel targeted mid and upstream oil assets, which would affect Iran's ability to export crude oil. This would put as much as 1.7m b/d of supply at risk, which could see oil prices trading above US\$90/bbl in 2025.

This kind of response would only escalate the situation further and take the market a step closer to a more extreme scenario, which for now we still think is unlikely. There is the potential in a worst-case scenario that Iran attempts to disrupt Persian Gulf oil flows through the Strait of Hormuz. Almost a third of global oil flows through the Strait of Hormuz and any significant disruption to these flows could very well see oil trading to new record highs, exceeding the record price of almost US\$150/bbl in 2008. Unfortunately, given that the bulk of OPEC capacity sits in the Persian Gulf, this spare capacity would be of little help if Iran was successful in significantly disrupting oil flows through the strait.

Persian Gulf LNG flows disrupted under worst-case scenario

European natural gas prices have also rallied on the back of Middle East developments. TTF once again broke briefly above EUR40/MWh. While the European market is well

supplied with storage close to 95% full and likely to be close to 100% full ahead of the 2024/25 heating season, it is still vulnerable to supply disruptions.

We believe that European natural gas prices should fall through 2025. However, much will depend on how the weather develops over the winter. Europe has had two mild winters and we cannot assume a third. Even assuming a normal winter, as well as the loss of Russian pipeline flows through Ukraine from 1 January 2025 following the expiry of Gazprom's transit deal with Ukraine, we still expect Europe to exit the 2024/25 heating season with storage more than 40% full. The starting and ramping up of several US LNG export facilities should help to offset potential Russian supply losses via Ukraine.

However, a growing concern for gas markets related to Middle East escalation is the potential for disruption to Persian Gulf LNG supplies moving through the Strait of Hormuz. While it is an extreme scenario, the potential impact of these supplies being disrupted is significant. Qatar exports a little more than 100bcm of LNG annually and makes up around 20% of global LNG trade. Losing a large share of this trade would leave the global LNG market in deficit, pushing up prices. The ramping up of new LNG export capacity elsewhere will take time, so any potential disruptions to flows from the Persian Gulf would be difficult to offset through the 2024/25 winter.

US data contradictions make life tricky for the Fed

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After September's 50bp rate cut, the Federal Reserve is likely to move more cautiously from now on. Official data suggests strong growth and robust employment gains, but survey evidence indicates the situation isn't as rosy and caution is warranted. We still favour the soft landing scenario amid cooling inflation fears and the Fed cutting rates to 3.5%



We subscribe to the soft landing thesis in the US, but the impending election also poses risks - and the pressure for answers from the Fed could soon ramp up

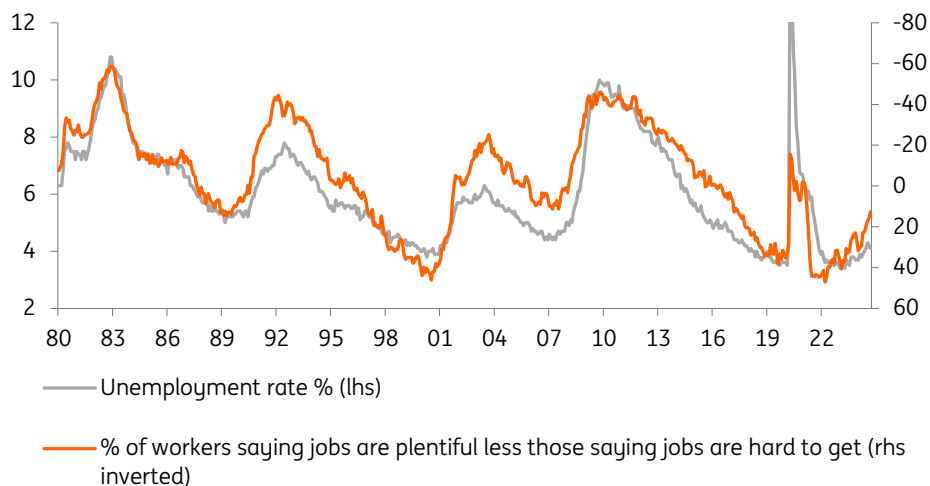
No regrets from the Fed

In the wake of the strong September jobs report, we have been asked on a number of occasions whether the Federal Reserve is regretting its decision to cut the Fed funds target rate by 50bp last month, especially when the economy is growing 3%, equity markets are at all-time highs and inflation remains above target. We don't think so. We characterise the 50bp cut as a risk mitigation move as policymakers seek to optimise the monetary policy stance for its differing policy goals. In this regard, better month-on-month inflation prints have given the Fed the confidence to start putting more emphasis on its other targets of maximum employment and making sure the majority of households feel the benefits of economic growth.

After all, not all of the data is so positive. It is difficult to square the robustness of the jobs report with survey evidence that painted a much bleaker picture of hiring intentions while the Fed's own Beige Book survey has suggested a clear cooling in the labour market this year. Perhaps more significantly, households are noticing that jobs are much harder to get - as reported by the Conference Board - and are changing their behaviour, with the proportion of workers quitting their jobs to move to a new employer collapsing over the past 12 months.

With full-time employment continuing to fall and with the knowledge that the Bureau for Labor Statistics has structurally overestimated job creation by a third over the past 18 months, we think the Fed will be wary of putting too much emphasis on those September jobs figures. Note too that the October jobs report will be published on 1 November, ahead of the next FOMC meeting and the election - and could influence the outcome of both.

Workers feel a shift in the jobs market before it shows up in the unemployment rate



Source: Macrobond, ING

Increasing consumer caution set to see rates heading towards neutral

Another issue for the Fed is the bifurcation of the consumer and the Fed's challenge of ensuring that the maximum number of people in America feel the benefits of economic growth. Higher-income households continue to spend strongly given inflation is an irritation rather than a constraint on purchasing power, surging equity and property prices have boosted wealth and ongoing high interest rates are generating significant income from money market funds. However, it is a very different story for middle and lower-income households. There, we are seeing more stress with rising loan delinquencies and falling savings highlighting the pain many are facing. If we overlay a growing sense of unease about job security, which could make consumers retrench, it again makes sense for the Fed to loosen monetary conditions gradually to try and offer some relief from the financial pressures in an environment where inflation is seen as less threatening.

We believe the Fed is looking to replicate the success of the 1995 loosening cycle directed by Alan Greenspan, which achieved a soft landing with inflation returning to target. The jobs report, firm consumer spending data and better ISM survey readings merely suggest that the Fed will switch back to 25bp incremental cuts in coming months rather than repeating September's 50bp move. We continue to look for the Fed funds rate to bottom at 3.25-3.5% by next summer.

Soft landing with election providing two-way risks

We subscribe to the soft landing thesis, but the impending election also poses risks to both the upside and the downside. A clean result with a smooth political transition to the new president will provide clarity and help support sentiment — and in a lower interest rate environment, it could improve economic prospects. If Donald Trump becomes president, lower taxes may support the growth story a little more than Kamala Harris's policies of higher taxes, with higher spending for specific groups. Trump's policy mix also increases inflation concerns given the threat of tariffs, so if he wins, the Fed may take the view that rates don't need to be cut as far as the 3% level the market is currently pricing. The Fed may feel that it has greater scope to cut rates if Harris wins, but it is likely to be marginal.

However, if this is an election and transition that sees significant tensions and a sense of unease among households and businesses that leads to weaker growth and rising unemployment, the pressure on the Fed to act more aggressively will be intense.

We've downgraded the eurozone's growth outlook again

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The European economy is rapidly losing steam, and growth will likely come to a standstill over the winter. The good news is that inflation is now more benign and that should allow the ECB to step up its pace of interest rate cuts



This tram, driven by the Belgian King, appears to be accelerating faster than the eurozone's economy

A hesitant consumer

It looks as if the eurozone is again headed for a winter slowdown. Both the PMI and the European Commission's sentiment indicator lost ground in September, meaning that the fourth quarter is starting on a weak footing. The hope for a revival of household consumption on the back of higher real wages should be tempered, as the savings ratio increased for the eighth consecutive quarter from April to June. It now stands at 15.66% of disposable income against a 25-year average of 13.45%.

This is not surprising given that unemployment expectations in the consumer survey climbed to their highest level since November 2022 last month. Add to that the current geopolitical tensions which could well be weighing on consumer confidence. It seems likely that household consumption is likely to contribute less to growth than international institutions expect.

Weak 2025 growth

At the same time, industry's inventory correction has not yet run its course. Those inventories are still considered to be on the high side, while new orders continue to disappoint. With capacity utilisation in industry having fallen to 77.7% in the third quarter, the outlook for business investment looks dire, even though interest rates are now coming down.

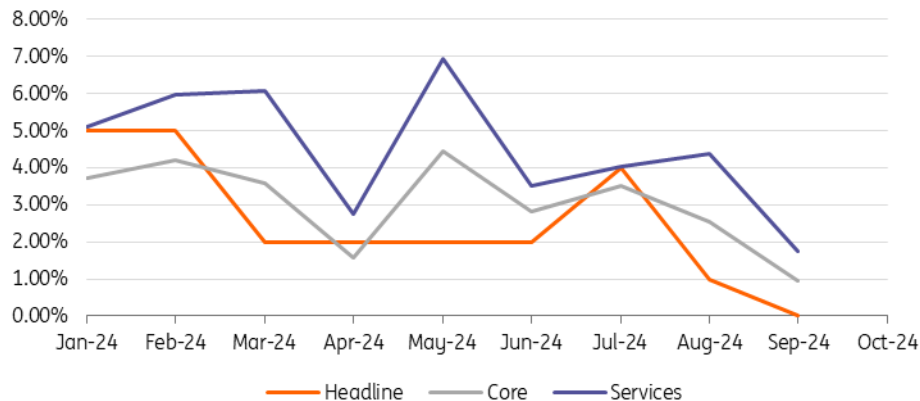
It's a similar story with construction. The PMI for the sector indicated a contraction in September for the 29th month in a row, with new orders continuing to fall steeply. The fact that eurozone house prices are now past their trough does offer a glimmer of hope, but usually, it takes a few quarters before improving real estate activity translates into higher construction activity.

We now believe that growth will come to a standstill in the fourth quarter and that a timid recovery is only expected from the second quarter of next year. By then, the

inventory correction will be completed and lower interest rates should be starting to work their magic. That actually means that we've had to downgrade 2025 GDP growth again, this time to 0.6%, the same as our growth estimate for 2024.

Inflation is coming down

Month-on-month consumer price % change annualised



Source : LSEG Datastream

Inflation now headed towards 2% in 2025

As for inflation, the September HICP was encouraging. The year-on-year figures are, of course, strongly affected by base effects, but when you annualise month-on-month changes, even services price inflation comes out below 2%. Admittedly, this is only one data point, but the price expectations component in the services sector also fell in September to the lowest level since June 2021, which seems to indicate that the underlying inflation trend is definitely down.

Higher energy prices on the back of the conflict in the Middle East could, of course, still push headline inflation higher, but we don't expect this to have a lasting effect. We have actually lowered our headline inflation forecast for 2025 to 2%.

ECB set to cut interest rates at every meeting

The European Central Bank has indicated that its monetary policy decisions will be data-dependent. And remember, the last meeting of each quarter is the most data-driven, not least because it provides an update on the staff forecast. Until now, we believed the ECB would only cut rates once every quarter in the second half of 2025. But now, with inflation seemingly under control and the economy increasingly showing signs of weakening, we think the Bank may well cut rates again at the October meeting. And then it should carry on cutting rates at every meeting until the deposit rate reaches 2%.

This terminal rate is also a downgrade from our previous 2.25% forecast, as we now think that the weaker economy and a somewhat tighter budgetary policy might justify a slightly easier monetary policy in 2025. The only caveat is that a further escalation of the conflict in the Middle East might keep energy prices and inflation higher for longer than we now expect, injecting more uncertainty regarding the pace of monetary easing.

Why the UK's Halloween budget isn't yet scaring investors

James Smith

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From creaking public services to ageing infrastructure, there are growing calls on the UK's public purse. Potential changes to the fiscal rules on 30 October will buy the Treasury time and space to lift investment. Major tax rises have been ruled out, but we doubt these can be avoided indefinitely



We're expecting more tricks than treats at 11 Downing Street in this year's Autumn Budget

Labour has little choice but to boost day-to-day spending

The Labour government has made no secret of the fact that it's not impressed with its economic inheritance. Some of this gloom is undoubtedly overstated; the UK economy grew by almost 1.5% over the first half of the year, after all. But that doesn't change the fact that there's next to no money available to play with in the existing budget.

Remember the UK's finances are guided by fiscal rules that are overseen by the Office for Budget Responsibility. And as of March, the Treasury only met those rules with a very modest "headroom" of just £9bn – less than half a percent of GDP.

Despite that, Labour has little choice but to increase day-to-day spending. Public services are creaking and spending plans dating back to 2021 were never properly adjusted for inflation. Roughly £20bn/year is needed to avoid unrealistically sharp real-terms cuts across several government departments.

Without revisiting major tax hikes, Labour will struggle to bridge the gap. The Treasury is looking at a swathe of changes to minor taxes and allowances, but these often raise negligible amounts of cash. A planned change to one of the fiscal rules, which will require the government to balance the current budget over five years, will increase the available headroom only fractionally.

Surprises are possible, but it seems we're likely to see only modest increases in tax that fund equally modest increases in day-to-day spending. But on investment, things look more interesting.

UK-German spreads have increased, though not because of budget concerns

Spread between UK and German 10-year government bonds (%)



Source: Macrobond

Increased public investment looks likely

Under existing plans, capital spending is set to fall from 2.5% of GDP last year to 1.7% in five years' time.

To turn that around, the Treasury is reportedly considering a further re-engineering of the fiscal rules that would potentially unlock in excess of £50bn/year by the end of the decade for investment, equivalent to 2% of GDP. Those are big numbers which, if realised, would presumably be financed by a significant increase in borrowing.

So far, investors don't appear particularly concerned. Yes, we've seen a spike in the UK-German bond spread. And the spread between UK gilts and the equivalent swap rate has widened out too. But the former is down to a global central bank repricing, and the latter is due to quantitative tightening. Fiscal concerns don't seem to be feeding into markets just yet.

That could of course change; France has shown that markets aren't immune to fiscal challenges. In the UK, memories of the 2022 budget debacle are still etched into the country's political memory. We therefore suspect the government will be reluctant to endorse a plan that dramatically increases borrowing.

The government might create the space for large investments, but that doesn't mean it has to use all or even most of it. And where it does, we suspect the Treasury will go to great lengths to demonstrate that it's selecting the investment projects with the biggest potential to boost economic activity.

None of this changes the fact that there will be ever-growing calls on the public purse over the coming years. Fiscal rule changes buy the government time – but we doubt tough decisions on tax rises can be avoided forever.

Three big questions on China's stimulus blitz

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We take a look at three questions after policymakers in China unleashed a coordinated monetary and fiscal stimulus push



China's ailing property sector is getting a boost from fresh stimulus measures

What's behind China's stimulus blitz?

Chinese policymakers have largely preferred piecemeal and targeted measures since exiting the pandemic era, as economists were divided between the risks of bubbles emerging and inflation risk versus the risks of an economic downturn. This debate clearly swung in the latter direction this year, as growth momentum waned and weak confidence became pervasive through much of the economy. While we've seen numerous policies targeting stabilisation this year, the moves starting in late September marked the most aggressive push yet.

We wrote in a note last month that there would be [increased short-term urgency](#) for rolling out stimulus after the weak data from the last few months prompted a call from President Xi to "strive to achieve the full-year economic and social development goals" last month. Policymakers quickly moved to answer this call, unleashing successive stimulus measures in the biggest post-pandemic policy blitz which triggered a furious market rally in Chinese equities.

What is included and what is still to come?

The first part of the [stimulus package was from the People's Bank of China](#), which not only provided a 20bp 7-day reverse repo rate cut (the biggest cut since 2020), 30bp MLF cut, and 50bp RRR cut, but also introduced new measures as well.

Property sector support included a long-rumoured 50bp cut to existing mortgage rates which provides a little relief to households, expanding funding a re-lending programme to banks from 60% of loan principal to 100% for lending to State-Owned Enterprises to acquire unsold properties, and cutting the required downpayment ratio for second home purchases from 25% to 15%.

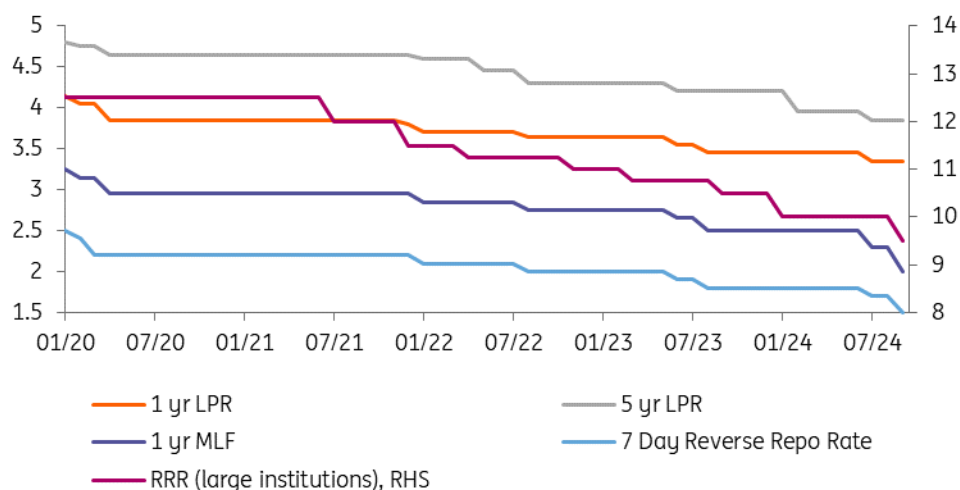
Additionally, a RMB 500bn swap facility was set up to provide liquidity support for stock purchases, which helped spark the equity market rally.

The second part has been what should be the start of a broader fiscal policy support rollout. The National Development and Reform Commission announced that RMB 100bn

of next year's budget would be brought forward to use in 4Q. We saw Shanghai announce a RMB 500mn consumption voucher programme, potentially setting an example for other cities to follow; a similar initiative in Hong Kong was quite effective in boosting consumption during the pandemic. Aside from this, there was also an announcement of a one-off cash handout to low-income households.

Moving forward, there has been extensive market discussion over plans for potentially trillions of RMB of special bond issuance to support further measures. We're expecting further fiscal stimulus to continue to roll out in the coming weeks. We also still see room for further monetary policy easing in the months ahead with both interest rate and RRR cuts still on the table before year end.

PBoC has made aggressive moves to shore up growth



Source: PBOC

Is this the big turning point markets have waited for?

We've seen a lot of hyperbole in the aftermath of the stimulus. Some in markets have cheered the moves as China's "whatever it takes" moment, referring back to [Mario Draghi's famous speech](#) back in 2012. It remains difficult to say for certain if this is the case – in our view, the policies announced represent a good step in the right direction, but the outcome still depends on the strength, speed, and effectiveness of upcoming fiscal policy support to build upon the initial momentum. At the other extreme, we've seen some rather fatalistic takes as well, especially in the aftermath of an NDRC press conference which fell short of many investors' expectations to build on the momentum.

Taking a step back from the short-term reactionism, it's important to note that the most recent measures appear to mark several shifts in policy stance. First, rather than slowly rolling out a series of piecemeal measures, bundling many moves concurrently has clearly had a better messaging effect. Second, the shift towards demand-side fiscal stimulus will certainly be cheered by economists, and consumption vouchers as well as cash handouts should be more effective than niche trade-in policies.

The stimulus comes too late to impact the third quarter numbers, which we expect to finish on the weak side. However, the measures, along with expected further fiscal policy support, have raised our expectations for 4Q and 2025 growth. After what will likely be a weaker-than-expected third quarter, it remains challenging to hit 5% growth for the year, but full-year growth falling a little short of that should still be sufficient to achieve the "around 5%" target. A downgrade of the third quarter and upgrade of fourth quarter growth leaves our 2024 4.8% annual growth forecast unchanged, but we are upgrading our 2025 forecast from 4.6% to 4.8%.

High stakes for Asia at the US elections

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Asian markets seem relatively relaxed ahead of the US elections on 6 November. But here are some reasons why they should be more anxious



The world will watch to see who emerges as the next American president and in Asia, the interest will be as great as anywhere.

Non-China Asia's gains could become next year's problems

While it may be a US election, the world will watch to see who emerges as the next American president on November 6. And in Asia, the interest will be as great as anywhere.

The Biden administration's approach to this region has differed from that of the Trump administration, yet Trump-era tariffs remain in place, with some additional tariffs recently introduced.

Asian economies, excluding China, have had to navigate the impact of a weaker Chinese economy on exports and growth, and these additional sanctions and tariffs won't have helped the region as a whole. But some economies will have picked up market share in areas where China has lost ground.

And depending on who wins the next election, this could cause problems...

Tariffs may be broader than they were in 2017

If we look back at trade data from 2017, when Donald Trump started his presidency, the US had an annual bilateral deficit with China of US\$336bn – more than 60% of the entire US trade deficit that year. The combination of trade wars, tariffs, and other sanctions plus reshoring and friend-shoring / de-risking and re-location by Chinese companies has shifted this balance.

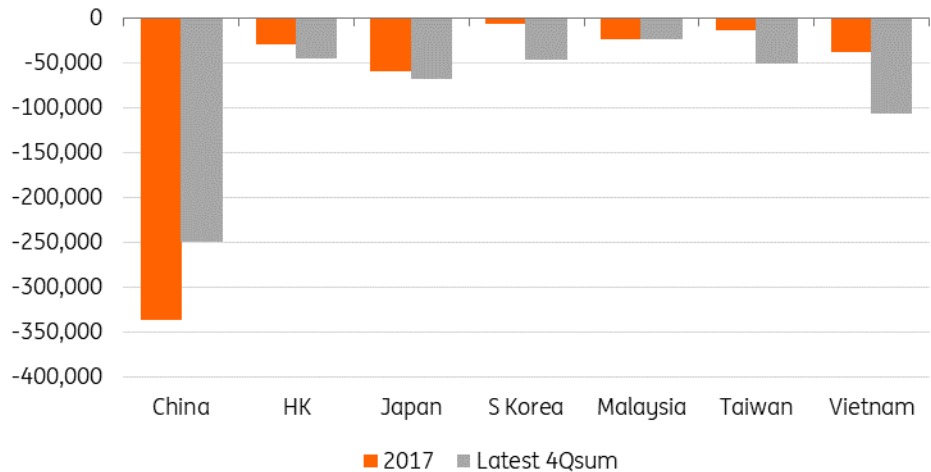
The bilateral deficit with China has fallen and the latest fourth-quarter sum is about \$87bn lower than it was for the whole of 2017. But the deficits with other Asian economies have risen by even more (about \$150bn is the latest fourth quarter sum compared to 2017).

It will not come as a surprise to learn that Vietnam, the poster child for the China-plus one story, has seen the biggest swing in the bilateral deficit with the US. But there have

also been gains for South Korea and Taiwan, and some of the SouthEast Asian economies.

This raises a question. If an incoming president wants to tackle trade imbalances, is the focus this time likely to be broader than just China? And if so, could there be a wider set of tariffs which will capture more of Asia directly than during 2017-21? It's worth considering.

US bilateral deficits with Asia (US\$m 4Q sum)



Source: CEIC

Asia dominates the US currency manipulator monitoring list

The timeline for any such action is highly contestable. The previous Trump administration took some time to build up to the full-scale trade wars with China, starting with some tariffs on fridges and solar panels before scaling things up over subsequent years. At that time, a split Congress meant that Trade policy was one of the few avenues available to Trump to enact policy, which may help explain why this became such a focus.

For non-China Asia, a similarly split Congress might be a more worrying outcome than a clean sweep for the Republican Party. The latter might suggest more of a domestic focus on policy, at least initially.

As well as tariffs, the tag of “currency manipulator” may be a first red flag for an Asian economy. In 2024, the US Treasury found that none of its major trading partners appeared to be manipulating their currency – a charge which could start the process of investigation and possible sanctions including tariffs. There are three criteria for meeting this list, none of which make a huge amount of sense, and in addition are open to change and interpretation, but large surpluses with the US are the main trigger point.

Asian economies dominate the current “monitoring list”, and alongside China is Japan (newly added), Vietnam, Taiwan, Malaysia and Singapore. So to conclude, Asian markets seem relatively calm at the moment. But with this election too close to call, a little more trepidation may be appropriate.

Geopolitics and inflation hinder prospects of further rate cuts in the CEE

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The increase in geopolitical risk is bringing unusual FX weakness to the CEE region, while the potential for higher oil prices is reintroducing inflation concerns. At the same time, the fiscal picture is raising eyebrows in some countries in the region, and any further central bank rate cuts remain conditional



A partially empty terrace restaurant at Krakow Market Square, 2024: Core CPI is stickier in Poland compared to its CEE peers

Poland: Outperformance despite eurozone stagnation

Economic recovery in Poland remains uneven. Data on first-quarter GDP disappointed, but second-quarter performance was stronger than expected. The external environment deteriorated between July and September. High-frequency data suggests that GDP growth in the third quarter probably slid back below 3%YoY again.

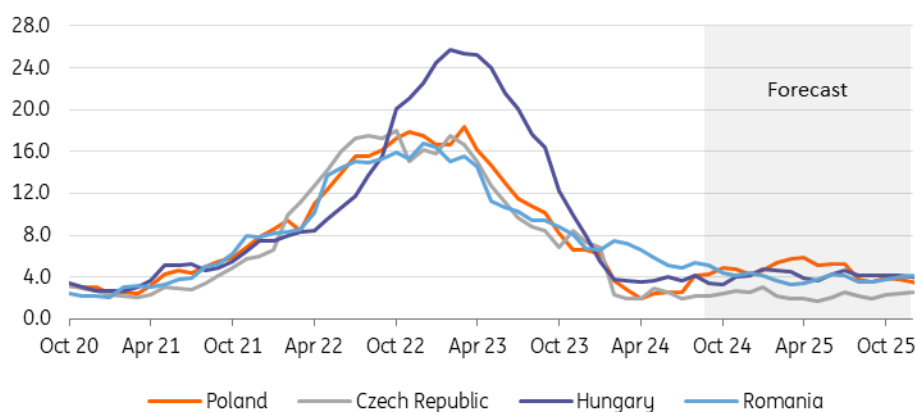
Economic growth continues to be primarily driven by consumption, thanks to improvements in real disposable income. However, manufacturing performance remains weak, and construction activity is sluggish. Fixed investment rebounded in the second quarter of 2024, growing by 2.7% year-on-year after a 1.8% decline in the first quarter. This strong performance is largely attributed to public defence spending, as investment in mid-size and large enterprises continued to decline. We stick to our forecast of 3% economic growth for 2024 and expect it to accelerate to 3.5% in 2025, driven by a rebound in fixed investment supported by EU funds.

After hitting a local low of 2.0% YoY in March, headline inflation rebounded and is now nearly double the National Bank of Poland (NBP) target of 2.5%, reaching 4.9% year-on-year in September. This increase was driven by the partial removal of measures that previously shielded households from high energy prices. Therefore, we are now seeing past inflation being reflected in the headline figures. With some protective measures still in place for the second half of 2024 (such as the electricity price cap and exemption from the capacity fee), we anticipate the CPI to peak around 6% year-on-year in March 2025.

Core CPI is stickier in Poland compared to its CEE peers, and the NBP is not following the global trend of monetary easing. Unless an increase in relative restrictiveness of monetary policy and actual widening of interest rate disparity leads to excessive firming of the PLN, the Polish MPC is likely to postpone rate cuts until spring 2025. We expect the first 25bp rate cut in the second quarter of next year and believe rates may go down by 100bp next year.

Despite the excessive deficit procedure imposed on Poland, the 2025 draft budget remains expansionary. Authorities now expect the fiscal imbalance in 2024 to be wider than previously projected, increasing from 5.1% to 5.7% of GDP. The planned structural adjustment is minimal, around 0.2% of GDP. The government appears to be delaying significant adjustments and avoiding austerity measures in 2025, likely due to the upcoming presidential elections. The pursuit of multiple fiscal goals, such as increased spending on the military, may prove unsustainable and require future re-evaluation. We see an adjustment in 2026, mainly based on the cyclical improvement of revenues.

Headline inflation forecast (%YoY)



Source: d

Czech Republic: Mounting challenges to global growth represent a risk

Economic recovery has gained attention now that inflation is largely under control. We anticipate continued expansion in the second half of the year, resulting in an overall economic growth of 1.1% for the year. Both household and government consumption are expected to significantly contribute to this rebound. Meanwhile, fixed investment will be a laggard due to the weak start to the year affected by the onset of the new EU funding period.

Net exports are about to boost overall performance, mainly on account of declining imports. Exports will grow only moderately this year as the leading European trading partners face challenges while the tepid foreign demand gives the Czech export engine a hard time. Industrial production has remained roughly flat since 2018, with the PMI survey pointing to lukewarm foreign demand as the main source of the trouble. Indeed, the German manufacturing output has been trending down for more than six consecutive years, with the recent news not indicating a turnaround any time soon.

Headline inflation is expected to increase to 3% in December, partially due to a low comparison base. A major electricity and natural gas distributor announced a reduction in end prices, which is expected to lower headline inflation by 0.2 percentage points early next year, helping it return to target. However, core inflation will likely remain elevated, driven by the stubborn price dynamic in the service sector and solid household spending. There is also a risk that the market and imputed rents will follow the renewed growth in property prices, potentially leading to upward repricing in January. Overall, we

see a twofold situation in consumer prices, with headline inflation close to the target over the next year, while core inflation is a drag to real income growth.

We expect the Czech National Bank to carry on with another soft cut in November to bring the policy rate to 4%. As for December, we see a pause as the most likely outcome, with the bank board waiting to see January's inflation data, which is prone to more pronounced moves than in other months. Whether to cut or not to cut at year's end will be a close call, as not much forward guidance was provided, except that the easing could be terminated at any time. The question is whether real interest rates below 1.5%, as measured by core inflation, are stringent enough to hold core inflation on a short leash, break the stubborn price growth in the service segment, and temper the accelerating credit growth.

Hungary: Looking for bright spots

We stand by [our previous statement](#) that the development of business and consumer confidence will influence economic activity going forward. However, we haven't seen any extreme changes and the incoming data and information tend to point to some downside risks for Hungary's economic performance.

The details of the disappointing second quarter GDP data highlighted some structural problems as well as some green shoots. Consumption is trending up, but investment activity (or rather the lack of it) is worrying. In general, we see GDP growth at 1.5% and 3.6% in 2024 and 2025 respectively. Focusing on the positives, the labour market has been the bright spot of the Hungarian economy, although labour hoarding and high wage growth pose both recessionary and inflationary risks. The coming quarters will decide which way we go, although the inflation outlook has improved significantly so far. We see inflation averaging 3.8% this year, with a slight acceleration to 4.0% in 2025. With this inflation, real wage growth continues to support the underlying growth outlook and provides the potential for a pick-up in domestic demand next year.

The country's external balances remain supportive of both real growth and financial market sentiment. Without such a positive base, the volatility of the HUF would have been even more pronounced during the recent geopolitically-driven FX market shock. Like its CEE peers, the forint has come under pressure in recent weeks amid the global news. However, a weaker HUF also means a more hawkish National Bank of Hungary (NBH), which should be a backstop for further weakness and time for a EUR/HUF fade. Our year-end forecast of 395 remains realistic. The significant reassessment of the key central bank's rate path also affects the NBH's room for manoeuvre, which is why we see only a 25bp rate cut, possibly in December. The political cycle and uncertainties related to a new central bank governor and a changing Monetary Council (the market is thinking of a dovish shift) could trigger a level shift in the currency pair with a new permanent range of 400-410 in 2025.

Romania: Fiscal splurge in full swing

Internal demand looks set to remain at healthy levels in the third and fourth quarters. Retail sales continued to grow strongly in August and, from September onwards, higher pensions will have boosted disposable income. Investments have also likely remained robust, driven by the ongoing large-scale infrastructure projects. That said, we expect net exports to continue to contribute negatively since the economy struggles to prevent the benefits of strong activity from dissipating externally through imports. Our forecast for 2024 GDP growth stands at 1.3%. One major risk ahead is the upcoming Eurostat-guided five-year revision of GDP due on 10 October, which can induce large base effects.

On the monetary policy front, the National Bank of Romania (NBR) left rates on hold at its October meeting, in line with our expectations. Policymakers highlighted the need for caution due to both internal and external risks. We don't exclude a 25bp rate cut in

November – but in the absence of a higher-than-expected decline in September’s inflation and a cooling of the upside risks stemming from the Middle East conflict in the meantime – no further cuts this year is our base case. For 2025, we foresee a total of 100bp of rate cuts, taking the key rate to 5.50%.

On the fiscal front, the budget deficit slipped visibly to 5.5% of GDP between January and September. At this stage, we expect the deficit to end 2024 at 8.0% and 2025 at 7.0%. The key factor to watch remains the outcome of the negotiations with the European Commission this autumn. A seven-year deficit adjustment plan is the most likely path. The only good news here is that the investment cycle looks set to continue.

Firmer dollar into US election cliffhanger

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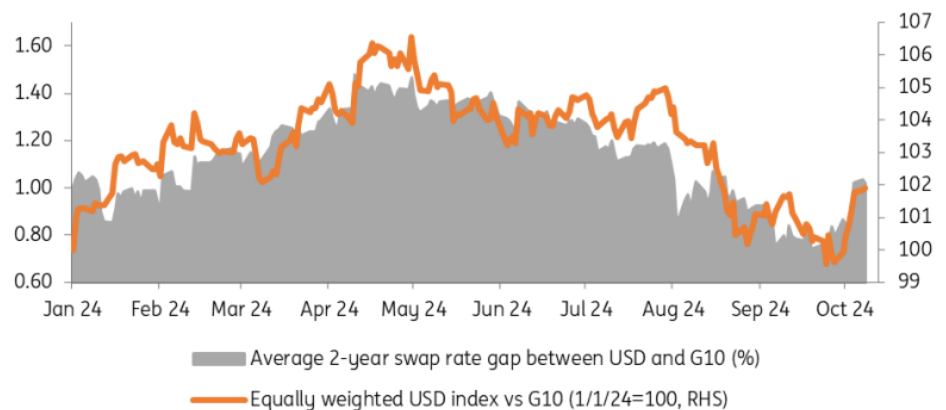
An improved rate advantage, Middle East tensions and potential defensive positioning ahead of the US election all suggest that the dollar can hang on to recent gains this month. Either way, after 5 November, the whole FX picture might change dramatically



The external environment might look favourable for the dollar right now, but we're aware that the entire FX landscape risks being entirely reshaped in less than a month's time

The dollar is now on a firmer footing compared to a month ago. As illustrated in the chart below, the average USD two-year swap rate differential against other G10 currencies has rebounded as the anticipated 50bp Federal Reserve cuts have been priced out, and markets have adopted a relatively more dovish stance on other central banks such as the European Central Bank. Looking ahead to the coming weeks, we find it challenging to identify a catalyst for a dollar decline unless US economic data significantly disappoints and revamps half-point Fed cut speculation.

Dollar rate advantage has rebounded



Source: ING, Refinitiv

The external environment is, incidentally, more favourable to the dollar. Tensions in the Middle East still have room to escalate, and Israel's potential targeting of Iranian energy facilities could lead to further surges in oil prices. Even if equities have shown resilience,

the new layer of uncertainty and volatility in geopolitics and commodities can keep the dollar supported.

That said, the entire FX landscape risks being entirely reshaped in one month's time by the US elections, which have so far been a "dormant" theme. We discuss different scenarios in detail in our [US election guide for the FX market](#). For now, we note that markets appear to be pricing in – even if not fully – a win for Kamala Harris. This means that:

- 1) We could see some pre-emptive USD buying into the election ahead of a tightly contested vote;
- 2) The FX reaction to a win for Donald Trump would likely be larger and asymmetrically more bullish for the dollar.

EUR/USD may struggle to bounce back above 1.10 into 5 November, with risks skewed to the 1.08 area as lower eurozone inflation should now prompt the ECB to cut rates in October. While the yen can outperform pro-cyclical currencies on US election volatility, USD/JPY could climb back above 150 in the near term due to higher USD rates and a delay in additional Bank of Japan tightening. The recent dovish tone from Bank of England Governor Andrew Bailey adds greater dovish flexibility to the GBP curve, and sterling could remain pressured below the 1.30 mark.

In the rest of the G10 space, we continue to expect some downward volatility in AUD and NZD, which are highly exposed to the Trump risk, while CAD could perform more strongly in the crosses. In Scandinavia, SEK should remain more resilient than NOK despite Riksbank cuts, while pockets of risk aversion can keep EUR/CHF capped.

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Think normal is boring? Think again

The Fed and ECB are gliding towards what we'd consider to be broadly normal rates. Sounds tranquil. But the deceleration and re-acceleration of these journeys is what impacts longer-dated market rates. In contrast to the smooth policy rate journey, longer tenor rates are susceptible to quite some extremes in the coming months, both high and low



The Fed and ECB are gliding towards what we'd consider to be broadly normal rates

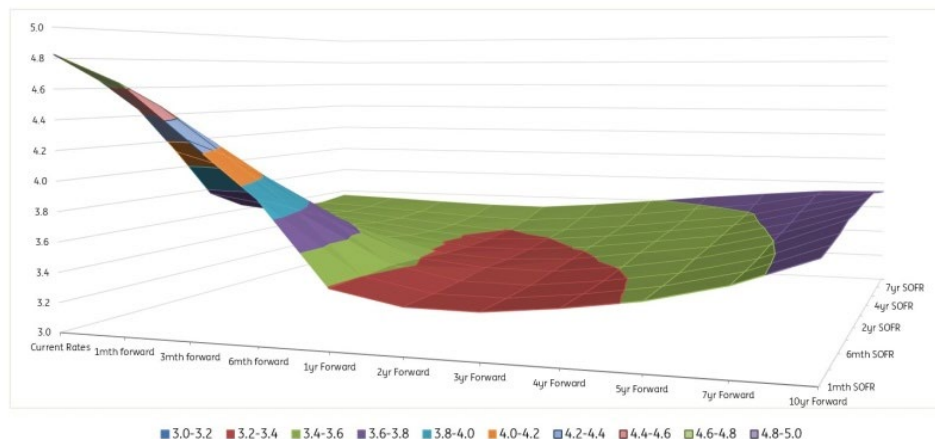
There may be glide paths mapped out, but they are very susceptible to resets

We're in a really interesting period right now. Once the Federal Reserve finally cut by 50bp a couple of weeks back, the rate-cutting cycle was confirmed as well and truly on. Then we've had nuances on both sides of the Atlantic, with a blowout payrolls report curbing the extent of cumulative cuts discounted. And from the eurozone, there's been a decent smattering of disinflation / German vulnerability commentary that has added to discounted rate-cutting needs there. It does appear that both the Fed and the European Central Bank are riding the wave, as opposed to being behind the curve. They have the flexibility to respond in kind to data variations. Neither is on a wholly pre-determined path. A key element is where they are going to end up. And then, of course, what that means for the shape of curves.

Indeed, as strategists, one thing we constantly keep an eye on is the end game. In other words, where rates end up after the rate-cutting cycle. This requires first identifying the likely bottom for policy rates. In the US, there had been a market tendency to view that bottom as mildly sub-3%. But since the recent firm payrolls report, that discounted bottom is now around 3.3%.

For the eurozone, the discounted low for the deposit rate is around 2%, with a marginal tendency to dip mildly below. These levels are not dramatically deviant from where we'd identify "normal" to be. Around 3% (or slightly over) is suitable for the US while around 2% is appropriate for the eurozone. The market discount is broadly on a glide path towards these types of levels, and that's important, as it means a return to normal.

Reality will be far more volatile than suggested here (same for eurozone)
SOFR curve and forward profile



Source: ING estimates, Macrobond

Expect far more variation in the journey for 10yr rates, partly reflecting glide path adjustments

Normal may appear boring, but it's not, as returning to normal on the front end requires more dramatic adjustment for longer tenors. Our 3% equilibrium anchor for the Fed funds rate maps out to a normal 10yr SOFR rate of around 4% (and a 10yr Treasury yield of 4.5%). To see how we get to this, see more [here](#). The current 10yr Treasury yield is around 4%. The normal is 4.5%. We could absolutely head straight to 4.5% unless that is frustrated by a material recession in the labour market. On the assumption that there is such a recession, there is a journey back down to the 3.5-3.75% area. See [here](#) for more on this. As the Fed continues its gradual adjustments to the funds rate, 10yr market rates are likely to experience big directional swings. But the end-game is a 100bp one-month to 10yr SOFR curve by this time next year.

For the eurozone, the directional dynamics are similar, just a tad less extreme. But still meaningfully impactful. As the ECB glides to the 2% area, bringing the front end with it, longer tenors are on a different type of journey. The 10yr Ester rate is now at 2.5%. With the deposit rate getting to the 2% area, the normal Ester rate would be in the 2.75-3% area, likely a bit flatter than the SOFR curve. But for simplicity, a 2-3% curve is the probable mythical equilibrium curve from 1mth Ester to 10yr Ester. That implies a 100bp gap between the SOFR curve and the Ester curve from one-month out to the 10yr, again purposely using round numbers. The journey for 10yr Ester is then 2.5%, back down to 2% (on a US employment report wobble, or something similar in the eurozone in the next few months) and then back up towards 3% (more likely in 2025).

What to watch here is the acceleration or deceleration in the glide path for the Fed and ECB. Recently, the Fed's path has slowed, which is why we've had a severe backup in long-tenor rates. If we get the employment report wobble feared, then the glide path can re-accelerate, likely bringing long rates down with it. If we never get the employment report wobble, then longer tenor rates have seen their lows and the 10yr yield is not going back below 4% (not our base view).

It's a similar situation for the ECB. Its glide path re-accelerated on rising macro angst (before the US payrolls report), bringing 10yr rates down with it. The prospect for an earlier ECB cut plus US robustness has since pulled the 10yr rate back up again. Watch this continue to play out like this in the months ahead.

GDP forecasts

Developed Markets (QoQ% annualised growth)									
	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
US	2.7	1.8	0.5	0.5	1.5	2.3	2.7	1.4	2.0
Japan	0.8	3.2	1.2	1.6	0.4	0.4	-0.1	1.5	0.9
Germany	-1.0	0.5	0.1	0.4	1.0	0.9	-0.1	0.2	1.5
France	1.6	-0.4	0.4	0.8	1.2	1.6	1.1	0.7	1.4
UK	1.2	1.2	1.3	1.2	0.9	0.9	1.0	1.2	1.0
Italy	1.4	1.0	0.4	0.8	1.7	1.1	0.7	0.9	1.0
Canada	0.8	0.8	1.0	1.5	2.2	2.2	0.9	1.3	2.2
Australia	0.8	0.8	1.6	2.0	2.4	2.8	1.0	1.6	2.6
Eurozone	0.4	-0.1	0.5	0.8	1.2	1.4	0.6	0.6	1.3
Austria	0.8	1.2	1.0	1.2	1.2	1.2	-0.4	0.9	1.3
Spain	2.2	1.8	2.0	2.0	2.4	2.4	2.8	2.1	2.2
Netherlands	0.4	0.5	1.3	1.7	1.5	1.4	0.3	1.5	1.6
Belgium	0.8	0.8	1.2	1.2	1.2	1.2	1.1	1.1	1.2
Greece	0.3	-0.3	1.4	3.2	3.2	2.2	2.1	1.7	2.0
Portugal	2.0	2.2	2.2	2.4	2.4	2.4	1.9	2.2	2.2
Switzerland	1.2	1.2	1.2	1.6	1.6	1.2	1.5	1.4	1.5
Sweden	-0.6	1.6	1.3	1.3	1.3	1.4	0.5	0.9	1.3
Norway	1.8	1.9	1.6	1.6	1.6	1.6	0.8	1.6	1.6
Emerging Markets (YoY% growth)									
	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
Bulgaria	2.3	2.6	2.9	3.1	3.2	3.2	2.3	3.1	3.2
Croatia	4.5	2.9	2.9	2.9	2.8	2.9	3.8	2.8	2.4
Czech Republic	1.4	1.7	1.8	2.0	2.2	2.4	1.0	2.1	2.4
Hungary	1.3	2.2	2.4	3.3	4.0	4.8	1.5	3.6	4.4
Poland	2.8	3.7	3.2	3.1	3.3	4.1	3.0	3.5	3.8
Romania	1.2	2.5	2.5	3.3	2.9	3.0	1.3	3.0	3.0
Turkey	2.3	0.5	0.3	3.0	3.6	4.5	2.5	3.0	4.0
Serbia	3.4	3.5	3.9	4.2	4.1	4.2	3.9	4.1	4.2
Azerbaijan	3.0	2.5	2.0	2.5	3.0	3.0	3.5	2.6	2.8
Kazakhstan	4.6	3.6	5.4	5.5	5.3	5.7	3.7	5.5	4.5
Russia	2.4	2.0	1.0	2.5	1.5	1.0	3.5	1.5	0.5
Ukraine	1.5	3.7	2.5	4.0	5.0	5.5	3.5	4.3	4.5
China	4.4	4.8	4.2	5.0	5.1	5.0	4.8	4.8	4.6
India	6.8	6.6	6.3	8.1	8.9	7.3	6.9	7.6	7.3
Indonesia	5.0	5.0	5.1	5.1	4.9	5.0	5.0	5.0	5.1
Korea	2.0	1.7	1.0	1.6	1.7	2.0	2.3	1.6	2.0
Philippines	5.3	5.2	5.5	6.6	6.3	6.0	5.6	6.1	6.0
Singapore	2.7	2.1	2.4	2.5	2.6	2.7	2.7	2.6	2.7
Taiwan	3.8	3.1	3.2	1.5	2.8	3.5	4.6	2.7	3.3

Norway: Forecasts are mainland GDP
 Source: ING estimates

CPI Forecasts (pa)

(%YoY)	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
US	2.6	2.4	2.0	1.7	1.9	1.9	2.9	1.9	2.0
Japan	2.7	2.5	2.2	1.8	1.7	1.7	2.6	1.8	1.8
Germany	2.1	2.3	2.3	2.1	2.3	2.4	2.4	2.3	2.2
France	2.1	2.6	2.6	1.8	1.8	0.9	2.6	1.8	2.0
UK	2.1	2.4	2.5	2.1	2.3	2.2	2.5	2.3	2.1
Italy	1.2	1.1	1.4	1.2	1.6	2.1	1.1	1.6	2.0
Canada	2.2	2.6	2.6	1.7	1.8	1.8	2.6	2.0	1.9
Australia	2.9	2.5	2.2	1.9	2.3	2.8	3.2	2.3	2.6
Eurozone	2.2	1.9	2.0	1.9	2.0	1.9	2.3	2.0	2.2
Austria	2.4	2.2	2.3	2.2	2.1	2.1	3.0	2.2	2.1
Spain	2.4	2.2	2.5	2.1	2.0	2.0	2.9	2.2	2.1
Netherlands	3.3	4.0	3.6	3.3	2.4	1.7	3.3	2.8	2.6
Belgium	3.5	2.4	2.1	1.9	2.0	2.1	3.0	2.1	2.1
Greece	3.0	2.9	2.7	2.4	1.7	1.9	2.9	2.2	2.0
Portugal	1.8	2.7	2.4	2.1	2.0	2.0	2.5	2.1	2.2
Switzerland	1.1	0.9	0.9	0.8	0.9	0.8	1.1	0.8	0.9
Sweden	2.1	0.8	1.1	1.7	1.8	1.8	1.7	1.7	2.0
Norway	2.8	1.8	1.9	1.9	1.5	2.1	3.0	2.1	2.2
Bulgaria	2.2	2.7	3.0	3.7	3.6	3.4	2.6	3.4	2.9
Croatia	2.1	2.8	3.0	3.0	2.6	2.5	3.0	2.8	2.7
Czech Republic	1.9	1.8	2.4	2.3	2.4	2.5	2.1	2.4	2.4
Hungary	3.8	5.0	4.9	4.7	4.5	3.8	4.1	4.5	3.3
Poland	4.5	4.6	5.7	5.3	3.8	3.8	3.6	4.6	3.0
Romania	4.9	4.2	3.4	4.0	3.6	4.1	5.4	3.8	4.0
Turkey	49.4	43.3	33.3	29.4	24.6	24.6	58.2	28.8	19.9
Serbia	4.3	4.2	4.4	4.2	3.7	3.4	4.6	3.9	3.4
Azerbaijan	3.3	4.4	5.3	5.6	3.8	3.6	2.3	4.6	4.5
Kazakhstan	8.5	8.5	8.3	8.2	7.4	6.7	8.7	7.7	6.3
Russia	8.9	7.5	6.7	6.2	5.8	5.4	8.0	6.0	4.9
Ukraine	8.0	8.0	9.5	7.0	6.5	6.0	6.8	7.3	5.0
China	0.6	1.4	1.2	1.3	1.3	1.5	0.6	1.3	1.6
India	4.1	4.3	5.2	5.1	3.6	4.6	4.6	4.6	4.7
Indonesia	2.0	2.2	2.1	2.0	2.1	2.2	2.1	2.1	2.2
Korea	2.2	2.1	1.6	1.7	1.7	1.6	2.5	2.1	1.9
Philippines	3.3	2.7	2.4	3.0	3.0	3.5	3.4	3.3	3.5
Singapore	2.7	2.4	2.7	2.5	2.3	2.3	2.7	2.5	2.4
Taiwan	2.2	1.7	1.6	1.5	1.4	1.5	2.1	1.5	1.5

*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)

	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	2024F	2025F	2026F
Brent (\$/bbl)	79	79	74	72	73	81	72	70
Dutch TTF (EUR/MWh)	36	37	33	27	24	33	29	28

Source: ING estimates

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