ING Monthly

September 2024

Summer's feel-good factor didn't last long

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Summer's feel-good factor didn't last long

While you might still be energised by your vacation, the Olympics and even the very short-lived summer market turmoil, the global economy is returning back to form. While August's recession fears were overdone, the outlook has weakened. And cyclical and structural factors are dominating the race

It's getting chilly

Oh, to be back in August when the biggest worry was whether Simone Biles would take a tumble or I had to choose the pool or the beach for a cooling dip. And now I have to pour cold water on hopes of a global sustained economic recovery.

In the US, we're finally seeing what every textbook economic model tells us would happen after a sharp tightening of monetary policy: the economy cools off as a result of higher interest rates. Admittedly, it took longer than we and many others expected, but recent developments clearly point to an American soft landing. In China, structural factors are still mainly holding back growth. Whether it is the ongoing correction of the labour market or increased protectionism in many developed economies, the Chinese economy is losing rather than gaining momentum after a positive start to the year.

And then there is Europe, where so often the worst of both worlds come together: cyclical and structural headwinds. Here, confidence indicators are starting to point south again, with the exception of an Olympic boost to services in France. Europe is not in recession, but it is in a low-growth environment. And, given weaknesses elsewhere, it's hard to see how Europe can rebound in the coming months. Here, too, we need to prepare for a soft landing... and we haven't been flying as high as the US.

Numerous reality checks

We're also facing a political reality check and something similar around the future of AI. Are election results really as adverse for economies as some feared, or is there too much panic and exaggeration? So far, the jury is still out. The new European Commission still has to start up after the June elections. France is still looking for a new government, and the German chancellor Olaf Scholz suffered severe defeats in two regional state elections. It's too early to assess the economic impact of all of this, but we're not exactly on fertile ground. And the same politicians seem to be outpaced by big tech as far as regulating artificial intelligence is concerned.

At least inflation's come down to somewhere between 2 and 3%. But service inflation and wage growth are the two biggest worries for central banks, and that explains why none of the major ones has yet to engage in a full rate cut cycle.

The ageing process

So, we're set to get those rate cuts in the US and the eurozone in the coming few weeks. And it begs the question of whether the Fed and the European Central Bank are behind the curve. And I'm tempted to answer: does it really matter? Any hesitation is not just due to that inflation stickiness but also the very human reaction of having missed inflation targets for several years in a row; I'm not surprised they're treading carefully.

And we think that caution will persist. The Fed will kick things off, and we're predicting three cuts before the end of the year, possibly starting with a 50bp reduction later this month. The ECB will be more hesitant.

In the world of sports, there is a saying that nothing ages faster than yesterday's success. And how we wish that the optimism surrounding the global economy at the start of the year hadn't withered quite so quickly. Let's hope we don't have to wait another four years before we see Olympian-style growth returning.

Watch: Summer's feel-good factor didn't last long

As the nights start to draw in across Europe, we're becoming more gloomy about the world's economic prospects. And ING's Carsten Brzeski is looking very carefully at how global central banks are going to respond. Interest rate cuts are coming.

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ING global forecasts

	2024					2025					2026				
	1Q24F	2Q24F	3Q24F	4Q24F	2024F	1Q25F	2Q25F	3Q25F	4Q25F	2025F	1Q26F	2Q26F	3Q26F	4Q26F	2026F
United States															
GDP (% QoQ, ann)	1.4	3.0	2.4	0.8	2.5	0.7	1.0	1.8	2.3	1.4	2.2	2.1	2.0	2.0	2.1
CPI headline (% YoY)	3.2	3.2	2.6	2.5	2.9	2.0	1.8	2.0	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	3.50	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	1.1	0.8	0.7	0.7	0.8	1.2	1.4	0.9	1.3	1.3	1.3	1.3	1.3
CPI headline (% YoY)	2.6	2.5	2.5	2.5	2.5	2.3	2.2	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
ECB Deposit Rate (%, eop)	4.00	3.75	3.50	3.25	3.25	2.75	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
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	2.20	2.20	2.30	2.40	2.45	2.60	2.60	2.60	2.65	2.70	2.75	2.75
Fiscal balance (% of GDP)					-3.1					-2.7					-2.6
Gross public debt/GDP					89.5					89.5					89.4
Japan															
GDP (% QoQ, ann)	-2.3	3.1	3.2	3.2	0.3	0.0	0.4	0.4	0.4	1.4	1.2	1.2	1.2	1.2	0.9
CPI headline (% YoY)	2.5	2.7	2.4	1.8	2.3	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	0.75	0.75	1.00	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	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
10-year interest rate (%, eop)	0.73	1.06	1.10	1.25	1.25	1.50	1.50	1.75	1.75	1.75	2.00	2.00	2.00	2.00	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	4.7	4.5	4.7	4.8	4.1	4.7	4.7	4.80	4.6	4.7	4.8	4.4	4.50	4.6
CPI headline (% YoY)	0.0	0.3	0.6	1.6	0.6	0.9	1.5	1.9	2.2	1.6	2.8	1.7	1.2	0.9	1.6
7-day Reverse Repo Rate (% eop)	1.80	1.80	1.70	1.60	1.60	1.50	1.50	1.40	1.40	1.40	1.40	1.40	1.30	1.30	1.30
3M SHIBOR (% eop)	2.16	1.92	1.85	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	2.15	2.05	2.05	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					-5.0					-4.8
Public debt (% of GDP), incl. local govt					121					131					138
UK															
GDP (% QoQ, ann)	2.9	2.3	1.2	1.4	1.1	1.3	1.2	0.9	0.9	1.3	1.0	1.0	1.0	1.0	1.1
CPI headline (% YoY)	3.5	2.1	2.2	2.8	2.7	2.7	2.2	2.4	2.0	2.4	2.1	2.2	2.2	2.2	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	3.25	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	3.70	3.60	3.40	3.50	3.60	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					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**	**7.12**	**7.10**	**7.10**	**7.10**	**7.10**	**7.05**	**7.00**	**7.00**	**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**	**82**	**80**	**82**	**78**	**77**	**79**	**75**	**77**	**72**	**74**	**78**	**75**	**75**
Dutch TTF - EUR/MWh (average)	**28**	**32**	**35**	**37**	**33**	**33**	**27**	**24**	**30**	**29**	**32**	**25**	**23**	**30**	**28**

Source: ING forecasts

At a glance: The world right now

Recession risks, rate cut bets, carry trade unwinds. This summer had it all. Here's our look at where the world is as we head into Autumn

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The yen carry trade has largely been unwound

July was dominated by the, at times, disorderly unwind of the yen carry trade. At the heart of the story was extreme, one-way positioning in the yen, a hawkish Bank of Japan and some softer US data. The surge in volatility on the back of this undoubtedly added to the broad risk reduction seen into early August, which included a sharp correction in US tech stocks. The 12% peak-to-trough adjustment in USD/JPY now leaves speculative positioning in the yen near flat.

The US jobs market isn't looking too healthy

A particularly weak July jobs report was enough to spark widespread fears about an imminent US recession. The unemployment rate has risen from 3.4% to 4.3% in little over a year, which is above the 4% rate the Fed predicted for the end of the year. This has in turn triggered the Sahm rule, a momentum measure of changes in the unemployment rate that has historically been consistent with recession.

On top of that, the Bureau of Labor Statistics has adjusted its figures, removing a third of the jobs previously believed to have been added in the 12 months leading up to March 2024. This revision, stemming from incorrect assumptions about job creation in small businesses, raises serious questions about whether the slowdown in job creation since April has been worse than reported. We think the unemployment rate will be closer to 5% than 4% at the end of this year.

The Fed has opened the door to big rate cuts

Fed chair Jerome Powell used his speech at the Jackson Hole symposium to tell us that the “time has come” to cut interest rates. He also said he didn’t welcome further weakness in the jobs market and did little to dispel lingering expectations of a 50 basis point cut at the September meeting.

A 25bp move on 18 September is slightly favoured by markets right now, but if we get a sub-100k on payrolls and the unemployment rate ticks up to 4.4% or even 4.5%, then 50bp looks likely.

An Olympics boost is masking sluggish economic growth in the eurozone

The combined impact of the Paris Olympics, and a strong tourist season in Spain/Italy, has helped lift service-sector sentiment in the eurozone. But it would be premature to label this as the start of an acceleration of growth. Manufacturing remains weak and is likely to stay that way while US growth is slowing and domestic demand in China remains under pressure.

Consumers are enjoying positive real wage growth, but increasing wariness about job security might simply push up the savings ratio rather than spending. We expect the eurozone economy to continue to grow, but at a slower pace.

The ECB is treading more cautiously than the Fed

The ECB is finally rallying around a September rate cut but appears more cautious than the Federal Reserve in endorsing further easing. Headline wage growth is slowing, but partly due to base effects from last year's inflation compensation schemes.

Big union demands in Germany are also a reminder that the direction for pay remains an uncertainty for the ECB. We therefore expect gradual cuts in September and December, but a weaker growth outlook suggests the ECB can step up the pace thereafter.

The Bank of England is moving slowly – for now

Not for the first time in recent years, investors are thinking that the Bank of England will take a more hawkish path than the Federal Reserve. That follows very strong growth in the first half of the year, ongoing stickiness in services inflation, and a more hawkish tone from BoE officials. That means August's BoE rate cut is unlikely to be followed by another later this month. We expect the next cut in November, but like the ECB we think the pace of cuts will accelerate as it becomes clearer that inflation "persistence" is reducing.

Momentum in China's economy has continued to slow

After a surprisingly strong performance in the first half of the year, China's manufacturing sector seems to be slowing down. This is partly due to a significant decline in auto production, which risks turning this sector from a supportive tailwind into a challenging headwind for the broader economy in the near future.

Meanwhile, a negative wealth effect and low wage growth continue to suppress consumption. This will make it challenging for China to hit its 5% growth target this year. We will need to see continued policy rollout to reverse the momentum, particularly as base effects turn less supportive for growth in the second half of the year.

Central banks to step up the pace of rate cuts later this year

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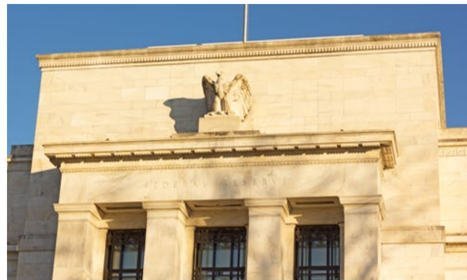
The Federal Reserve is poised to cut rates at every meeting this year and larger 50 basis point moves look plausible. The ECB and Bank of England are moving more slowly for now, but by the start of 2025 we think both will have stepped up the pace of easing



Federal Reserve

At the recent Jackson Hole conference, Fed chair Jerome Powell made it clear that the Federal Reserve would cut interest rates on 18 September, stating that "the time has come for policy to adjust. The direction of travel is clear". Our previous forecast update round coincided with the market volatility at the beginning of August and we changed our three 25bp rate cut call for this year to one whereby the Fed could cut by 50bp in September before reverting to 25bp moves in November and December with the policy rate reaching 3.5% by summer 2025.

A 25bp move on 18 September is slightly favoured by markets right now, but if we get a sub-100k on payrolls and the unemployment rate ticks up to 4.4%, or even 4.5%, then 50bp looks likely given Powell's comment that "we don't seek or welcome further cooling in labour market conditions". Even if they move by 25bp, there is still the possibility of a 50bp cut at some point with softening business surveys and hiring indicators suggesting the Fed will manoeuvre policy to a more neutral level relatively swiftly, in line with a cooling economy where inflation is on the path to 2%.

European Central Bank

With the latest inflation data out of the eurozone, a rate cut at the ECB's September meeting has almost become a done deal. As current headline inflation is closing in on 2% and longer-term inflation forecasts remain stable at around 2%, the ECB will see enough reason to reduce the level of monetary policy restrictiveness further. However, still high wage growth and too high selling price expectations suggest that the fight against inflation is not entirely over yet. This will make further rate cut decisions beyond the September meeting initially more complicated and controversial than currently priced in by financial markets.

Still, we expect the ECB to eventually show a stronger reaction to the weakening economic prospects of the eurozone, stepping up rate cut efforts in 2025. As a result, we

see the ECB cutting rates by 25bp in September and December and another 100bp in the first half of next year.

Bank of England

The BoE cut rates for the first time at the August meeting but made it abundantly clear that it didn't want investors to run away with the idea that this will be an aggressive easing cycle. Policymakers are divided, but there's a general sense that services inflation is too high and wage growth has been consistently higher than expected. That's led some of the more hawkish members of the committee to conclude that it could still be more difficult to get inflation consistently back to target.

That means a September rate cut looks unlikely. But by November, we think the committee will have become more relaxed about the inflation backdrop and cracks in the jobs market may have started to show more clearly too. We therefore expect a cut in November and think a December move is more likely than not. We anticipate that rates will fall to 3.25% by next summer, which is a steeper move than markets expect.

Bank of Japan

The BoJ is set for a pause in September after a 15bp hike in July. Another hike in the fourth quarter remains likely, although the timing Is uncertain. Following market jitters in early August, the BoJ’s policy stance is likely to have become more risk-adverse. Governor Kazuo Ueda signalled that the BoJ would not be in a hurry to take further policy action, as it examines the impact of financial market moves on inflation.

The sharp depreciation of the JPY should ease the BoJ’s concerns about rising import prices. The policy uncertainty caused by the recent announcement of Prime Minister Fumio Kishida’s resignation also won't be welcomed by the BoJ. Meanwhile, household spending and wage growth should improve, showing that the economy is moving in line with the BoJ’s projection. Core inflation is likely to ease due to the re-starting of the utility subsidies for the summer months. We therefore see a slightly higher chance of a December hike than an October move for now.

Oil demand worries and natural gas supply risks

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Demand concerns and prospects for a supply surplus in 2025 have weighed on oil prices; we've revised lower our Brent forecast for the rest of the year. European natural gas prices remain elevated on the back of supply risks

The European natural gas market is nervous about ongoing maintenance in Norway

Demand fears weigh on oil

Oil prices saw a fair amount of volatility in August. In fact, implied volatility in ICE Brent hit a year-to-date high during the month. Several supply risks have arisen, providing a short-term boost to prices. However, this has been short-lived, with demand concerns continuing to weigh on sentiment.

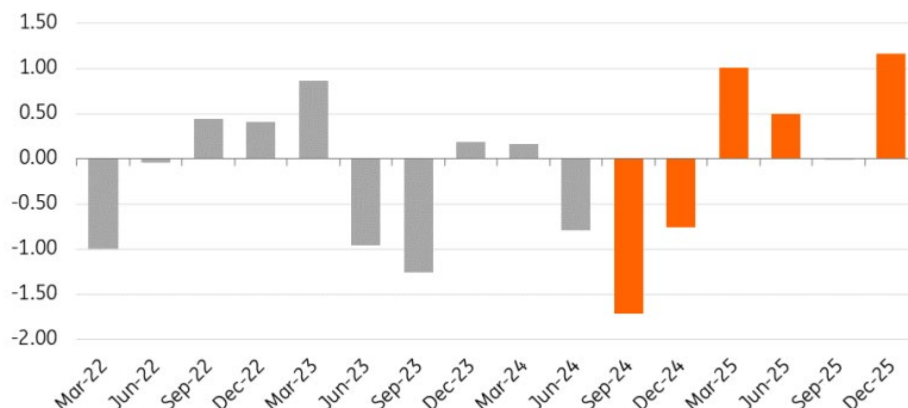
Demand concerns are centred around China, where cumulative imports over the first seven months of the year are down 2.1% year-on-year, while apparent domestic consumption has fallen YoY for the last four months. Given that China is expected to make up a significant portion of global oil demand growth, weaker domestic demand has had an impact on oil prices. However, global oil demand is still expected to grow in the region of 1m b/d in 2024 and by a similar amount in 2025.

A key uncertainty for the market is OPEC+ policy. OPEC+ members are scheduled to start unwinding their additional voluntary cuts from October 2024 until the end of September 2025. The process should see the group bringing more than 2m b/d of oil back onto the market. However, the group stated from the beginning that plans to bring this supply back can be paused or reversed depending on market conditions. Demand concerns and the fact that Brent is trading below US$80/bbl could delay plans to increase supply. However, much will also depend on how the situation in Libya evolves. A dispute between the Western and Eastern governments in Libya has seen the eastern government shutting down oil fields, putting 1.2m b/d of oil supply at risk. If this dispute lingers, it could provide OPEC+ members the opportunity to increase their supply without actually seeing a net increase in global oil supply.

Weaker Chinese demand has led us to revise our Brent forecast lower for the remainder of the year. We now expect ICE Brent to average US$80/bbl in the fourth quarter of this year, down from our previous forecast of US$84/bbl. In addition, our balance is showing a slightly larger surplus in 2025, which has led us to cut our 2025 Brent forecast from an

average of US$79/bbl to US$77/bbl. Our balance sheet assumes that OPEC+ will stick to its plan to unwind additional voluntary supply cuts.

Global oil market to return to surplus in 2025 (m b/d)



Source: ING Research, IEA, EIA, OPEC

Supply risks propping up European natural gas

The European natural gas market was well supported in August. TTF traded above €40/MWh on several occasions during the month. The strength in the market is due to increased speculative activity caused by growing supply risks, rather than fundamentals becoming increasingly bullish. Speculators built their net long in TTF to a record high in August.

There are several supply risks facing the market. This includes concern that remaining Russian pipeline flows via Ukraine could be disrupted due to recent developments between the two countries. Ukrainian attacks in the Kursk region of Russia, specifically near the Sudzha entry point, where Russian pipeline gas enters Ukraine before making its way to the EU, threaten around 40mcm/day of supply to Europe, equivalent to almost 15bcm of natural gas annually. However, for now, these flows remain uninterrupted.

Russian pipeline gas via Ukraine is still set to stop at the end of this year. Ukraine has made it very clear that it has no intention to extend the transit deal with Russia, which expires on 31 December 2024. The EU and Ukraine are looking at alternatives, including a possible gas swap with Azerbaijan. No renewal in the transit deal should be largely priced into the market, given that Ukraine has made its position clear over the past year. However, there is still the potential for a knee-jerk reaction in prices, particularly if the 2024/25 winter is colder than usual.

The market is also nervous about ongoing maintenance in Norway. This maintenance has led to a drastic reduction in Norwegian gas flows to Europe. While this maintenance is scheduled, and not a surprise to the market, there is concern over the potential for an overrun in work, which could leave the market tighter than expected going into the next heating season.

Supply risks and healthy speculative appetite in the gas market have forced us to revise our forecasts for the remainder of 2024. We expect TTF to average €37/MWh in the fourth quarter of 2024, up from €35/MWh previously. Although, this suggests that we still see prices trading down from current levels. Storage is more than 92% full and hit the European Commission's target two months early. We expect storage will be close to 100% full by the start of the 2024/25 heating season.

In addition, further LNG capacity is expected to ramp up later this year and in 2025, leaving the global LNG market more comfortable next year. As a result, we continue to expect TTF to average €29/MWh in 2025.

US job jitters prompts the Fed into action

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Having signalled little prospect of meaningful interest rate cuts as recently as June, the Federal Reserve is now primed to cut rates on 18 September. Inflation fears have receded and it is the rapidly cooling jobs market that is firmly in focus

Now slowly marching to a rate cut beat, the Fed's Jerome Powell

Markets are pricing 100bp of rate cuts this year – we agree

The combination of a surprise Bank of Japan rate hike, a dovish pivot by the Fed and the subsequent soft jobs report sent financial markets into a tailspin last month. Fears that a huge unwinding of the yen carry trade could unleash a torrent of broader market dislocation saw financial markets price in the very real risk of an inter-meeting Federal Reserve interest rate cut.

Subsequent soothing words from officials and an improvement in the US data have calmed the situation, yet we are left in a position where the market is now fully discounting 100bp of rate cuts from the Fed this year, with the policy rate heading to 3% next year. This is significantly more than the Fed was signalling would be likely in its June forecast, where a single 25bp cut was indicated for this year, with the target rate reaching a mere 4.25% next year.

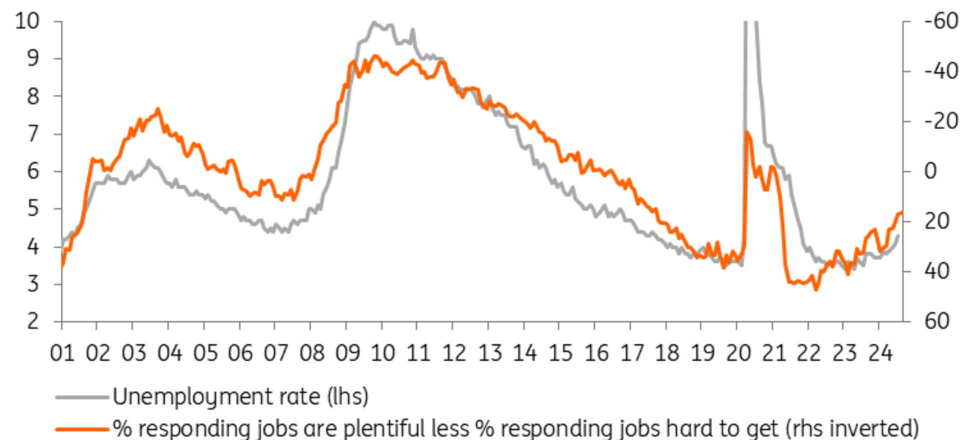
A cooling jobs market is now the primary focus

The Fed has had to play catch up to recent events, and it recognises that if it is going to achieve its aim of a "soft landing", it is going to need to adjust policy more quickly than thought. Thankfully, inflation is playing ball. We have now had three consecutive months where both measures of core inflation (core CPI and core personal consumer expenditure deflator) have come in at or below the 0.17% month-on-month run rate consistent with 2% annual inflation.

This means the Fed can put more focus on its second target of maximum employment. Here, things are looking more worrisome. The unemployment rate has risen from 3.4% to 4.3%, which is above the 4% rate the Fed predicted for the end of the year. This has, in turn, triggered the Sahm rule, a momentum measure of changes in the unemployment rate that has historically been consistent with recession.

On top of that, the Bureau for Labour Statistics has revised away a third of the jobs that had been thought added in the 12 months to March 2024. With the BLS having made incorrect assumptions about job creation in small businesses, this raises serious questions about whether the apparent slowing in job creation since April has been worse than reported.

Unemployment is rising and households sense jobs are harder to come by



Source: Macrobond, ING

The Fed recognises it needs to move policy to a more neutral level

Even before the recent spike in volatility, the July FOMC meeting minutes *suggested "the vast majority of members"* thought it would be *"likely appropriate"* to cut the Fed funds target rate on 18 September while *"several"* officials had seen a plausible case for a cut at the July meeting. Fed Chair Jerome Powell made it clear where he stood at the recent Jackson Hole conference – *"the time has come for policy to adjust. The direction of travel is clear."*

A 25bp move on 18 September is slightly favoured by markets right now. Still, if we get a sub-100k on payrolls and the unemployment rate ticks up to 4.4% or even 4.5%, then 50bp looks likely, given Powell's comment that *"we don't seek or welcome further cooling in labour market conditions"*. Even if they just move by 25bp, there is still the possibility of a 50bp at some point, with softening business surveys and hiring indicators suggesting that the Fed should manoeuvre policy from "restrictive territory" to a more neutral level relatively swiftly.

How quickly and how fast will be determined by the rate of deterioration in the jobs market. So far, the rise in the unemployment rate has been caused by labour supply growth outpacing labour demand. However, full-time employment has fallen in year-on-year terms for six consecutive months, and as the chart above shows, households are noticing the slowdown. There is a clear perception that jobs are becoming much harder to get, and a period of belt-tightening from consumers may be required. This runs the risk that a "soft landing" scenario could quickly turn into something much weaker that necessitates a more aggressive response from officials.

The eurozone recovery is stuck in first gear

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Eurozone GDP growth is unlikely to accelerate in the coming quarters; indeed, quite the contrary. With inflation now in a downward trend, the ECB can continue its gradual easing process, though it might have to step up the pace in the first half of 2025

These are difficult times for France's Emmanuel Macron and Germany's Olaf Scholz

No Olympic medal for industry

After an OK-ish second quarter, where GDP growth came in at 0.3% quarter-on-quarter, data for the third is mixed at best. Judging by sentiment indicators, the Olympic Games had a small positive effect in France in August. This, together with a strong tourism season in Spain and Italy, lifted services sentiment in the whole of the eurozone.

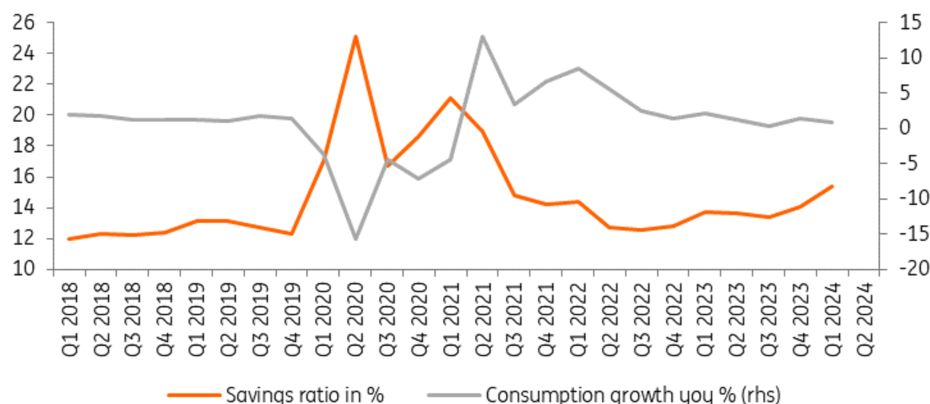
However, it would be premature to label this as the start of a growth pace acceleration. The manufacturing sector remains in the doldrums, with the inventory correction proceeding at a snail's pace, and the order books assessment remains at a depressed level. The German Ifo indicator declined for the third month in a row in August. The fact that even Volkswagen is now considering closing factories in Germany is testimony to the continuing industry rout.

Winter weakness seems likely

We are sceptical that the eurozone economy will accelerate in the second half. We're forecasting a deceleration in US growth, and domestic demand in China remains under pressure, so European exports are unlikely to be a strong growth driver. Low capacity utilisation in industry and weak credit demand are not heralding a strong pick-up in business investment either.

While households are now enjoying real wage growth, labour market expectations in the consumer survey have been softening since April. This might result in a higher savings ratio than an acceleration of consumption expenditure. All of this leads us to believe that the eurozone economy will continue to grow but at a slower pace. That doesn't take away the hopes for an acceleration from the second half of 2025 onwards. But on the back of weak winter quarters, it seems wise to downgrade next year's GDP growth to 0.9%, after 0.7% this year.

A rising savings rate is constraining consumption growth



Source: LSEG Datastream

Core inflation is coming down

HICP inflation fell to 2.2% in August, with core inflation declining to 2.8%. That said, services price inflation reaccelerated to 4.2%. This is likely to be a temporary effect, also due to the Olympics. Indeed, looking at the selling price expectations in the services sector, which has been a reliable leading indicator, services price inflation is likely to fall below 3.5% by the first quarter of next year.

While wage growth remains quite high, especially in Germany, the European Central Bank thinks this is temporary because of one-off payments. Wage growth is expected to fall back to 2.5% in the course of 2025. The bottom line is that inflationary pressures are softening, though headline inflation might still show some volatility over the coming quarters.

ECB stepping up easing pace in next year

On the one hand, the ECB seems to have gained confidence in its forecasts of gradual disinflation. But on the other, there is still the fear that easing monetary policy too rapidly might push inflation expectations up again. As Isabel Schnabel recently stated: *"Central banks must not abandon disinflationary policies too early".* So, we still expect the ECB to tread cautiously in the short run.

We maintain our forecasts of 25bp rate cuts both in September and December. On the back of the weaker growth outlook, we now believe that the ECB will step up the pace of easing thereafter, cutting rates by 50bp in both the first and the second quarters of 2025. Once the “neutral” level of 2.25% has been reached, the deposit rate is expected to remain at that level for quite some time.

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Bank of England set for several rate cuts despite current caution

Sticky services inflation and a more hawkish tone from the Bank of England means investors are starting to price a less aggressive easing cycle in the UK relative to the US. We doubt that divergence will last long

Andrew Bailey, governor of the Bank of England

Investors are starting to consider BoE divergence from the Fed

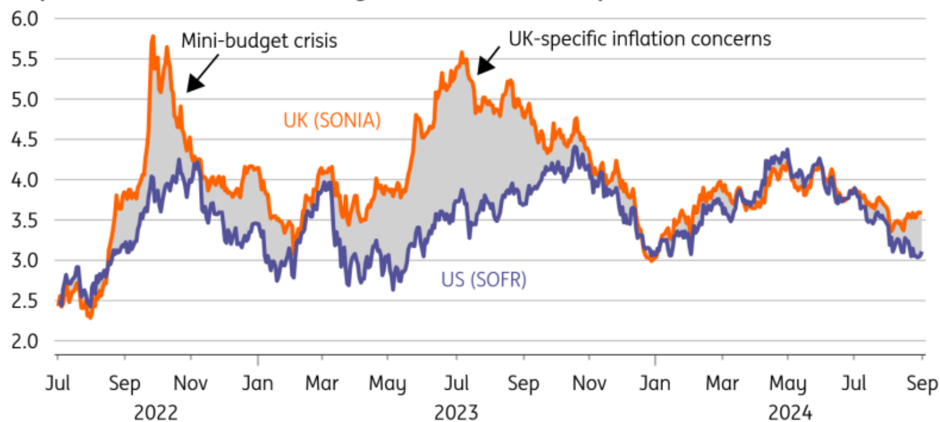
Not for the first time in recent years, investors are thinking the Bank of England will take a more hawkish path than the Federal Reserve. Markets expect UK rates to end up 50 basis points above the US in two years' time. They also think the BoE will opt for fewer rate cuts in total this year.

In part, this is because the signals emerging from the Bank of England and the Federal Reserve have been quite different in recent weeks. Where the Fed's Jerome Powell has emphatically endorsed a September rate cut with little hint of gradualism, BoE governor Andrew Bailey is toeing a much more cautious line.

The idea of Bank of England divergence is also not unprecedented. The Fed completed an entire hiking and cutting cycle between 2016 and 2019, where the BoE kept rates largely unchanged. It was a similar story in the early 2000s.

This time, investors are looking at elevated levels of UK services inflation and wage growth, and are concluding that this will limit the scope of rate cuts in Britain. Officials are also questioning whether it'll take more pain for the UK jobs market to lower inflation, or worse, if price and wage setting behaviour has permanently changed, making it much harder to get inflation consistently back to target.

Markets think UK rates will fall less far than the US



Source: Macrobond

We expect BoE rate cuts to accelerate in the fourth quarter

We suspect both concerns are overblown. The fact is, the jobs market has cooled significantly over the past couple of years. True, much of this is down to higher worker supply than a rise in layoffs, but that still implies downward pressure on wage growth.

Meanwhile, the BoE's survey of chief financial officers suggests firms are raising wages less aggressively than they were six to 12 months ago. There are signs that firms are raising prices less regularly too, a hint that pricing behaviour hasn't permanently shifted in the way that some of the BoE hawks have feared.

The Bank is unlikely to cut rates for a second time at its September meeting, but from November we suspect the pace of cuts will accelerate. We therefore don't think the Bank's cutting cycle will look materially different to that of the Fed. We reckon the Bank Rate will fall to 3.25% by next summer, which is further than markets currently expect.

That's despite the UK economy delivering a remarkable performance through the first half of this year. GDP has grown by 1.5% since last December, which has eclipsed most of its European neighbours. Unsurprisingly some of this can be traced back to the recent improvement in real wage growth, though other recent trends are harder to explain.

Like the Bank of England, we suspect the economy will return to more "normal" growth rates of 0.3-0.4% through the second half of this year. As a result, the recent strength is unlikely to make too much difference to the Bank's strategy on rate cuts.

China will struggle to hit its 5% growth target this year

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Momentum in the Chinese economy has softened in the past few months as pessimism becomes increasingly entrenched. That suggests further supportive policy measures are needed

President Xi Jinping meeting members of China's Olympic delegation

Industrial activity is moderating after a strong first half

China's manufacturing provided a pleasant surprise in the first half of the year as a mild recovery of export demand along with domestic technology self-sufficiency and hi-tech drives supported industrial activity.

However, recent developments indicate this engine of growth slowed in the second half of the year. Recent manufacturing PMI data has been sluggish, remaining in contraction for four consecutive months. Additionally, after driving growth in the last few years, auto production dropped sharply in the last few months, falling below headline industrial production growth in July for the first time since 2022.

Overcapacity in the auto industry could be concerning as domestic sales slow and tariffs come into play in Europe and North America. There is a real risk that the auto sector could swing from a growth tailwind to a headwind before long.

Weak sentiment continues to drag on investment and consumption

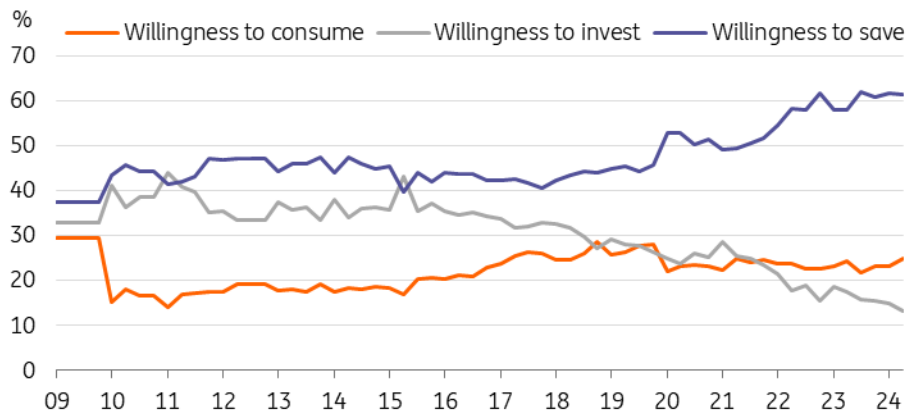
Despite the general acceleration of a supportive policy rollout, the piecemeal nature of most of these measures has yet to stabilise sentiment. Weak confidence is now the biggest overhang on the Chinese economy. And we believe the clearest effects of this can be seen in two categories.

The first is private sector investment, where growth has continuously decelerated this year and is now stagnant at 0.0% YoY through the first seven months of the year.

The second is household consumption, where retail sales of 3.5% YoY, year-to-date, mark the lowest level on record, excluding the pandemic-impacted years. A negative wealth effect and low wage growth continue to suppress consumption.

A PBOC quarterly survey has shown that the willingness to save is at near record highs while the propensity to invest has dropped to an all-time low.

Households' willingness to save near record highs amid weak sentiment



Source: PBOC, CEIC, ING

Rebound of the yuan will give policymakers more room to ease

So, all that is creating a significant challenge for China to successfully hit its 5% growth target this year. We will need to see continued policy rollout to reverse the momentum, particularly as base effects turn less supportive for growth in the second half of the year.

Fortunately, dovish developments abroad could allow for more aggressive easing. Amid China's monetary policy reform, policymakers finally delivered rate cuts in July. We expect to see an additional cut by the end of the year, and the odds are rising we'll see still more. The main impediment to earlier easing was a focus on currency stability.

We've also seen more fiscal side measures be deployed, with discussions that local governments would be allowed to issue special bonds to use for property stabilisation measures. High-level meetings indicate that measures to support consumption "through multiple channels" could also be on the way.

The road to hitting 5% growth looks increasingly challenging with every passing month. Piecemeal measures have had some success on a smaller scale but have yet to result in a broader turnaround. With policymakers indicating no "drastic" measures coming, we'll have to see if rate cuts and increased fiscal support will be enough to restore growth dynamism.

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Our Asian central bank barometer

We enjoyed James Smith's recent Central Bank Top Trumps note so much that this month, we decided to create a similar analysis for Asian central banks. However, our backdrop is quite different to his. We have a diverse mix of central banks, with some hikers, some cutters, and everything in between

Real policy rates is the central metric

Unlike my colleague James Smith's developed market Top Trumps, our analysis of Asian central banks lacks many of the metrics he uses. For instance, we don't have reliable measures of the unemployment rate or comparable mortgage yields. What we do have are local concerns about currency strength and stability. In short, our central bank barometer will look different to his.

Our principal benchmark for Asian regional central banks is where policy rates are relative to inflation. Call this the "real policy rate". In simple terms, it says whether policy rates are restrictive (much higher than inflation), neutral (about the same) or accommodative (lower than inflation).

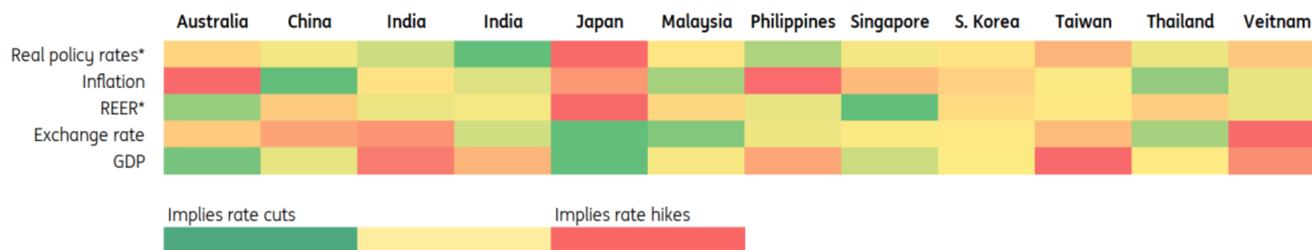
In the wake of the Covid-19 pandemic, soaring inflation rates initially kept most policy rates from reaching restrictive levels. As inflation has receded, much like the ebbing tide, many of these rates have now shifted to the restrictive side of neutral. Central banks with the highest rates are likely to make the most significant adjustments. For instance, the Philippines has already begun cutting rates ahead of the US Federal Reserve.

We'd also highlight India's Reserve Bank, where 6.5% policy rates and an inflation rate below 4% call for imminent rate cuts. We expect to see that soon. Indonesia has a policy rate of 6.25% and is therefore in a very similar position, with well-contained inflation making for a very high real policy rate. China too looks as if it needs to ease more on this basis, in line with our house forecasts.

At the other end of the spectrum, Japan's policy rates remain well down on inflation, so as we have noted before, we expect the Bank of Japan's (BoJ's) policy normalisation to continue, and further hikes from the Bank of Japan, perhaps as soon as October.

Central Bank barometer

Better than flipping a coin, worse than country-specific analysis



Source: ING, CEIC

Deviation from inflation is an obvious addition

We also consider the simple deviation of inflation from central bank targets. These targets vary considerably from 2% for most of the more developed economies in the region to a top end of 4.5% for Vietnam, and central rates of 4% for India.

Australia is the main standout here, where inflation of 3.5% is a full percentage point above the central target of the RBA – one of the reasons we recently felt hikes were a possibility. That changed when core rates started to decline. But it suggests Australia is not completely out of the woods yet.

Real effective exchange rates and currency weakness

A deviation from our developed market colleagues' approach is our Real Effective Exchange Rate (REER) measure, which is a benchmark for FX valuation. Here we measure how much weaker the currency is in real inflation-adjusted terms measured against its major trading partners. Unfortunately, this is rather dominated by the recent swings in the Japanese yen, which also dominates the other FX term, which measures how weak each currency has been in the last three months – where a (negative) green indicates currency strength that suggests trimming rates support.

Stripping Japan out, the Malaysian ringgit, Thai baht and Chinese yuan look weak on a REER basis, while the Singapore dollar looks strong (not surprising as that is how the Monetary Authority of Singapore manages inflation). Based on recent currency performance, this largely gets flipped on its head, as these (not CNY) are also the currencies that have tended to appreciate the most in the last few months.

GDP growth relative to trend

Our final criteria looks at GDP growth relative to recent trends. India and Taiwan look as if their growth is strong enough to weather higher, not lower, rates, while Australia and Japan look as if recent weakness would be more in keeping with lower rates. In the case of Japan, the car safety scandal accounts for a lot of this recent weakness and should dissipate over the coming quarters.

When viewed as a whole, the most striking story is Japan's situation, which is fairly understandable. Beyond that, the pattern is quite varied. South Korea appears to be a potential candidate for easing, but financial stability issues, which aren't included in this comparison, complicate the picture.

Stick to the day job

We'll keep an eye on these indicators – real policy rates are probably the main yardstick we will keep watching. But in the end, for APAC, we think we'll stick to single economy analysis. This region is way too disparate for this sort of approach to provide a reliable guide to policy.

Recovery in peril for CEE region

Economic recovery in the CEE region is below expectations but the disinflationary process has come to an end and inflation is higher in some places. The central banks' cutting cycle is thus entering a fine-tuning phase

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Poland's second-quarter GDP reading came in higher than expected

Poland: Governor pivots towards easing but reasons to be cautious

Economic recovery is continuing in Poland thanks to robust private and public consumption. The second-quarter GDP reading came in higher than expected and seasonally adjusted data suggests that the recovery is gaining momentum, despite economic stagnation in its main trading partner Germany.

At the same time, the headline reading reached a bottom in March and will near 4.7% year-on-year at the end of 2024, while core inflation remains elevated. The National Bank of Poland (NBP) President Adam Glapiński stated in July that rates could remain unchanged until 2026, but other MPC members are less hawkish and are leaning towards monetary easing in 2025. In August, Glapiński pivoted by saying that rate cuts could indeed start next year.

Government officials said they would continue to protect households from high electricity prices in 2025 as well, so the inflation path is unlikely to be as high as in the July NBP projection. That, along with the prevailing majority within the Council for policy easing in 2025, probably led to an amendment of the NBP governor policy bias. Still, there are arguments for remaining cautious in any imminent decision to cut rates, including economic recovery, elevated inflation and loose fiscal policy.

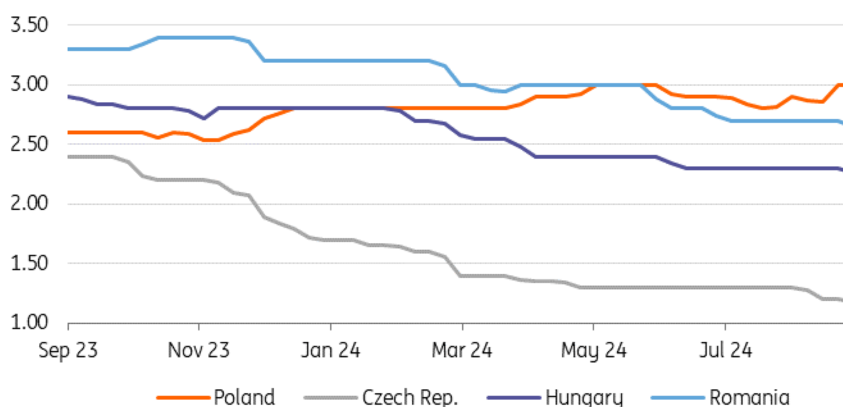
The 2025 draft budget bill envisages a record-high cash basis state budget deficit and borrowing needs, but it's important to note that spending includes financial support for the Polish Development Fund (PFR) and state-owned BGK bank to allow them to redeem state-guaranteed bonds issued during the pandemic. This transaction is neutral for the general government deficit and debt and should be deducted from 2025 net borrowing needs.

Expenditures by PFR and BGK were reported in the previous year and the state-guaranteed debt was replaced by state treasury debt. The MinFin funding plan assumes record-high borrowing needs but bond supply is split among different instruments, EU

funding and has an elevated cash buffer. So funding needs in 2025 are manageable but the economy needs credible fiscal adjustments in the coming years.

The government has revised the 2024 general government deficit to 5.7% of GDP, up from the previous estimate of 5.1%, which effectively presents a higher fiscal expansion than expected for 2024. For 2025, the headline deficit is also higher than planned a few months ago, but in terms of the structural deficit corrected for (imported) defence spending, 2025 presents a kind of fiscal tightening versus an expansionary 2024. Glapinski should therefore not use fiscal expansion as an argument against easing. We expect NBP rates to remain unchanged in 2024 and the first cut to be delivered in the second quarter of next year. In 2025, we foresee a policy easing of 100bp.

Consensus forecasts for 2024 GDP growth (%)



Source: Reuters, ING

Czech Republic: Inflation to stay close to target amid lukewarm recovery

Given the continued weakness in industry, nominal wage growth is expected to soften in the second half of the year, and so are real wages, with inflation remaining close to target. Manufacturers face tepid demand from abroad which is set to erode their willingness to support further lofty wage increases. The confidence of Czech consumers is set to drop, while household consumption expenditure decelerated noticeably in the second quarter. We expect the elevated uncertainty and less buoyant wage increases to restrain consumer spending in the months ahead. That said, the annual real GDP growth is set to quicken in the two following quarters due to the low comparison base of the previous year.

Pricing in industry is about to remain on the soft side as anaemic demand exerts pressure on boosting cost competitiveness, representing a risk to future employment gains. That said, the labour market remains tight, with firms seeing incentives to keep or hire skilled employees in case Europe's economic performance picks up. The deteriorating mood in the service sector is worrisome, as this was the segment where the economy performed well until now. Overall, we expect the economy to expand by 1% this year, which is well below its potential.

Such a gradual rebound will keep headline inflation close to the Czech National Bank target, or even below, in the coming months. A gradually strengthening koruna fosters this expectation via subdued import prices. All this implies a restrictive monetary policy stance, with real interest rates exceeding 2% over the coming months. We foresee the Bank Board going ahead with two more soft rate cuts during the two consecutive meetings this year, followed by a break at 4% toward the year-end. One should bear in mind that policymakers have not appeared concerned about sub-target inflation for some time.

Hungary: Improved growth is contingent on confidence

There was some fragile optimism on our part at the beginning of this summer, but it has since faded. Or at least it has become highly dependent on an improvement in business and consumer confidence, which is still weak. With the latest incoming data painting a rather cloudy picture in the short term, we maintain our pessimistic growth outlook for 2024. We see only 1.5% GDP growth this year, as both consumption and investment have failed to provide the expected boost to economic activity. However, some more positive underlying factors balance the overall long-term picture and lead us to believe that 2024 will be a slow healing process, while 2025 will be a year of healthy and solid GDP growth (averaging 3.6%).

The resilience of the labour market is remarkable and, while the jury is still out, if the global inventory cycle does indeed turn soon and consumers and businesses feel confident enough to start spending again, labour hoarding will provide a stable springboard to quickly meet the needs of rising external and domestic demand. The only caveat could be the renewed pricing power of companies as demand picks up. This, together with rising labour costs due to labour shortages and the rising or non-easing tax burden resulting from the government's recent fiscal measures, could pose a pro-inflationary risk.

However, even if we do not expect a significant demand-driven price shock, we expect above-average repricing and base effects to lead to an average inflation rate of 4.5% in 2025, compared with 4.0% in 2024. Against this backdrop, the National Bank of Hungary could remain careful, patient and stability-oriented in the short term, and we see only two more 25bp rate cuts to 6.25% over the rest of the year. This approach could keep EUR/HUF in a narrow range of 390-400 in 2024. The political cycle and uncertainties stemming from a new central bank governor and a changing Monetary Council could trigger a level shift in the currency pair with a new range of 400-410 in 2025.

Romania: Weaker-than-expected growth clouds the robust internal demand picture

Private consumption is set to re-emerge as the key growth driver this year. Over the first half of the year, retail sales grew by a solid 7.0% in annual terms. With public wages and pensions on the rise this year, momentum should remain strong. That said, growth over the second quarter surprised negatively, coming in at 0.8% year-on-year following a downwardly revised first quarter. Data on 6 September should bring more clarity and we expect to learn that net exports were the main culprit. Our forecast is under review until then and, in the meantime, we have revised our 2024 GDP growth projection from 2.8% to 2.0%.

On the monetary policy front, at this stage, we hold on to our call of no further rate cuts this year, although we acknowledge that risks have increased due to the recently released weak GDP growth numbers. On another note, it's worth mentioning that the political arena is set to decide this month on the composition of the new National Bank of Romania board. All in all, we expect a cautious and gradual easing cycle ahead, with the key rate at 6.50% by year-end and 5.75% by the end of 2025.

On the fiscal front, the budget deficit slipped visibly to 4.06% of GDP between January and July. At this stage, we expect the deficit to end the year at 7.0% of GDP, with balanced risks. The key factor to watch ahead is the outcome of the negotiations with the European Commission (EC) this autumn. A seven-year deficit adjustment plan is the most likely to be agreed with the EC, with lower corrections until 2027 in order to sustain the investment momentum.

How the US election will impact deficits, debt, and the yield curve

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Government borrowing and the national debt are barely getting a mention in the US election campaign, yet a failure to change trajectory risks further debt downgrades, more market volatility and higher borrowing costs

Trump vs Harris. Whoever wins the election will have to get to grips with the national debt issue

This year's election is set against a backdrop where the government is borrowing the equivalent of 6% of GDP and the national debt totals $35tr.This poor fiscal position risks being exacerbated by structural factors, such as an ageing population, and cyclical factors, such as cooling economic growth. Failure to get to grips with the issue runs the risk of more debt downgrades, more market volatility, higher borrowing costs and slower potential economic growth.

Long-term challenges of the US budget

Huge fiscal expenditure during the pandemic under both the Trump and Biden presidencies has been the major factor responsible for the deterioration in government finances. That has abated, but even if the candidates were seriously motivated to shrink the deficit, there are major structural issues that make it difficult to get a real grip on expenditures.

Mandatory spending, or spending mandated by existing laws, represents nearly two-thirds of expenditure. It is predominantly healthcare and social security spending, largely determined by the number of recipients and has been growing by 0.1-0.2pps as a share of GDP per year historically, driven by demographic trends. In the past, the growing mandatory outlays were offset by shrinking discretionary spending (voted on in the annual appropriations process). However, this component, of which defence constitutes half, is already close to historical lows in real terms, suggesting limited scope to generate significant spending cuts. The third and smallest component of government spending is interest expense. Having spiked by 0.5pps in 2023 due to higher interest rates, this reached 2.4% of GDP last year.

Given these constraints, the non-partisan Congressional Budget Office's June projections suggest an average annual deficit of 6.3% of GDP between 2024-34 with public debt projected to increase from 99% to 122% of GDP. The assumptions included Trump's 2017 Tax Cuts and Jobs Act (TCJA) expiring and a solid economy maintaining an average growth rate of 1.8%YoY, employment rising nine million over the period and incomes growing solidly. A more detailed analysis of the budget trends can be found here.

Trump versus Harris: fiscal decisions

In terms of direct fiscal decisions, a Harris administration is expected to let Trump's TCJA income tax cuts expire. There would be additional tax increases for businesses (7pp hike of the corporate tax rate), and wealthy individuals, but this would be more than offset by tax credits for families and lower-income households plus subsidies for first-time home buyers. Spending activities will be focused on improving access and lowering costs related to healthcare, childcare, housing and education.

This policy mix could amount to a higher deficit to the tune of $1-1.5tr over a decade relative to the CBO baseline, but it would be even larger if the additional tax hikes don't get passed by Congress.

A Trump administration will focus on a "second phase" of tax cuts in addition to an extension of the 2017 TCJA. This will involve sizeable tax cuts for corporates paid for by spending cuts/efficiency savings and tariffs placed on imported goods. The second major Trump initiative is the imposition of 10% tariffs on all goods imports with 60% levies on Chinese-made products together with a four-year plan for phasing out Chinese imports of electronics, steel, and pharmaceuticals.

Extending the 2017 tax cuts ($4tr alone), plus additional tax cuts offset by revenues raised from tariffs are, we believe, set to result in deficits increasing by perhaps $5.5tr relative to the CBO's baseline – nearly triple that of Harris' proposals.

Economic Impact

We sense that Trump's policy proposals could help to support domestic demand via lower taxes, but there are upside risks for inflation relative to Harris' proposals. Tariffs and trade barriers will push up business costs, while intensified immigration controls may limit labour supply growth. This environment is likely to mean monetary policy needs to be kept tighter than would otherwise be under Harris, where tax hikes could weigh on activity. Our longer-term projections with a more inflationary environment under a Trump presidency could lead to a 50-75bp higher neutral Fed funds rate (3.25-3.5% versus the Fed's 2.8% assumption) over the long run. Under Harris, it may remain closer to 3%.

The CBO analysis suggests that the variation in the interest rate environment has potentially the biggest impact on the budget deficit scenarios. Each 10bp of deviation from the baseline results in around 0.1pps of GDP p.a. increase in the expected fiscal deficit over a 10-year period, due to higher expenses on debt servicing.

Under both presidential candidates, the deficit will remain uncomfortably wide, with debt levels continuing to rise rapidly. However, the combination of direct decisions on tax policy and the macro conditions plus higher borrowing costs suggests that a Trump administration could lead to up to 1.2-1.3% GDP wider annual deficits starting in 2027 compared to a Harris administration. We have a stronger GDP growth profile with Trump in our long-term growth forecasts, which helps improve the appearance of the fiscal ratios, but even so, we are likely to see the deficit average nearly 7% of GDP under Trump while vs. slightly below 6% under Harris.

Implications for US Treasuries and markets

The US Treasury market is currently not particularly bothered by the extra issuance supply resulting from the higher deficit.

There are three reasons for this. Firstly, we're on the eve of a Fed rate-cutting process and this is dominating market direction with markets expecting 200bp+ of Fed rate cuts over the next 18 months.

Second, the Treasury has managed to curb the effect of the extra issuance by morphing the more significant increases towards shorter maturities.

Third, there is a risk-on market theme out there with equities at record highs, implying the market believes there is little to worry about.

Going forward, a lack of market concern about the size of the deficit can easily pivot to it being top of the list of worries. The transmission mechanism here is a few poor bond auctions that become a trend, requiring the build of a material new issue concession that gets built into structurally higher absolute yields. That could happen slowly, or it could be more abrupt. Our base is for a slow creep. But it's an impactful one. We see the 10-year yield heading for 5% as a base case in 2026.

In fact, a 5% 10-year yield call is a conservative one all things considered. It's just a 150bp curve to a Fed funds rate that's been cut to 3.5%. While the fiscal deficit difference between the two candidates favours a Harris policy mix (lower than a Trump deficit), it's not big enough to be materially impactful. We have a baseline view for a 5% 10-year yield and a 150bp curve from the funds rate out, which we feel is fair given the size of the deficit, and broadly agnostic to the election outcome. If it's a Trump administration, yields are likely to be higher and the curve steeper, but probably on a delta of no more than 50bp for the 10-year yield and the curve.

Market pressure to eventually refocus politicians' minds

In the current environment, where markets are calm, politicians see little threat from the current trajectory of the US's fiscal position. But that will quickly change if ratings agencies and markets start to see it as an issue.

If markets become dysfunctional, it will force governments to take more rapid and painful action. That may not happen in the next four years – but as a minimum, the higher, steeper yield curve we expect will put up costs for households and businesses and prove a headwind for the economy more broadly.

FX: November will be a game-changer

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US elections in November will be a game-changer for FX markets. We continue to flat-line our EUR/USD forecasts after November until the US political situation is much clearer. In the meantime, we take a slightly bearish view of the dollar before the Fed's first cut in September

Donald Trump will face Kamala Harris in the US elections on 5 November

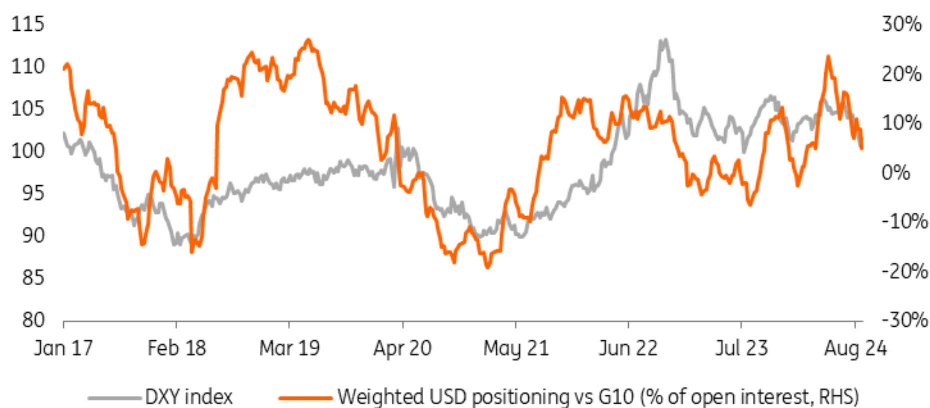
It's been both a yen and a dollar story

Those lucky enough to have had a long summer holiday will be coming back to find the dollar just over 4% off its highs seen in early July. That move can be attributed to developments coming out of both Japan and the US. On the former, the disorderly unwind of the yen carry trade - and its fall-out on global risk assets - briefly had the market pricing an emergency Fed rate cut in early August. And the speed of that USD/JPY adjustment owed a lot to extreme short yen positioning, a more hawkish Bank of Japan, and a more aggressive BoJ FX intervention policy.

Since then, asset markets have settled, and we have started to see a more orderly, broad-based dollar decline. Perhaps that has been most evident in the recovery in Asian currencies, which have enjoyed their first meaningful rally since last November. As James Knightley discusses, the Fed's confidence in the disinflation process and concern over the jobs market have been a big driver in this dollar decline.

These forces have seen speculators pare back their net long dollar positions, as you can see in the chart below. This community now awaits the 'next big thing'.

Speculators have cut long dollar positions back to flat



Source: ING, CFTC

The next big thing

That next big thing is undoubtedly the US presidential election in November. Given the power invested in the executive branch and what it can mean for trade and foreign policy, the outcome will determine whether global trade has to suffer a repeat of the 2018/19 experience. Equally, were the Republicans to win both branches of Congress, the dollar would be buoyed by loose fiscal/relatively tighter monetary settings.

If the Democrats win out, market expectations of status quo politics would see investors focus on the Fed easing cycle, and the dollar would probably weaken. We discuss all this in our US Presidential Election: Three Scenarios for Markets article published last month. We'll await the election results before taking a medium-term view on the dollar.

Before then, we have a slight bias that the dollar stays soft. The start of Fed easing cycles and bullish steepening of the US yield curve is normally a bearish time for the greenback. Assuming US activity, especially employment data, continues to soften, we would expect the dollar to be heading into the November elections on the weak side.

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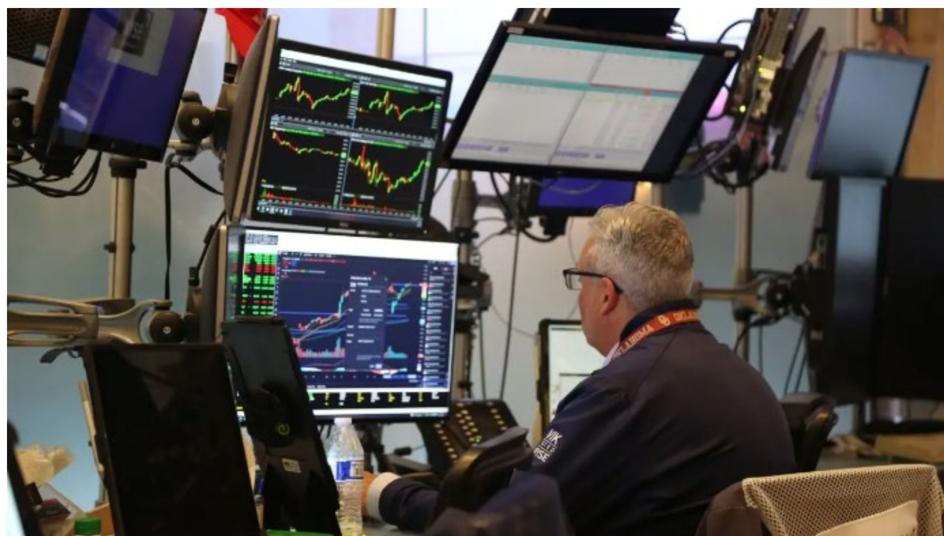
Cutting fever is containing long rates, for now

We think the rate-cutting process can coax longer tenor rates lower some more. But there is a limit, and we're close to it. The bigger movement on a three to nine-month outlook is, in fact, higher for longer tenor rates and a steeper curve versus the forward discount



Long-tenor rates can still fall further, but the bigger move will ultimately be to the upside

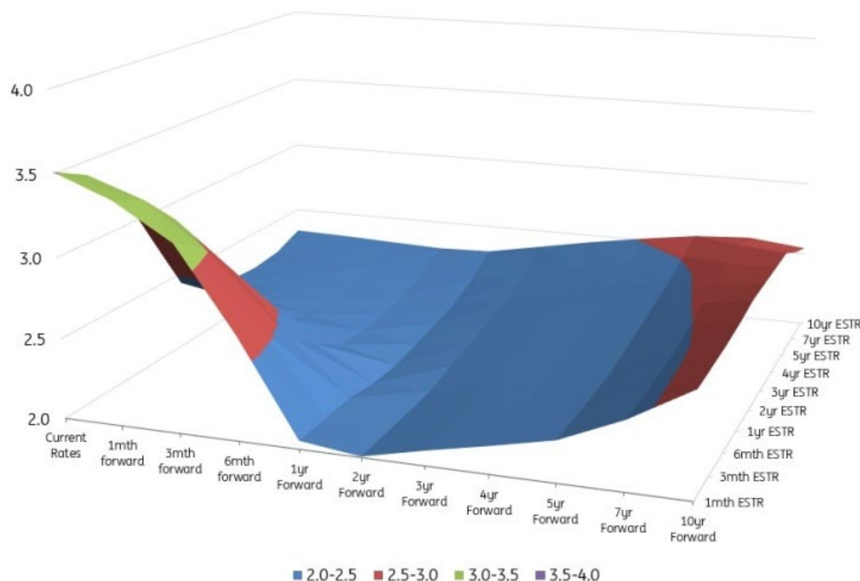
US 10-year SOFR to touch 3% but then backs up to 4% plus

We recently sent out a note on US rates. It's here. In it, we identified the 3% area as neutral for the Fed funds rate. We back this up from previous analysis from the noughties. And that's here. During that decade, US inflation averaged c.2%-2.5%, a rate the Federal Reserve finds acceptable. And over the same time period, the funds rate averaged 3%. The same exercise based on the noughties finds the average 10-year Treasury yield was 4.5%. That translates to around 4% for the 10-year SOFR, and a fair value 100bp curve between the funds rate and the 10-year SOFR.

Based on that, we can see that the current funds rate is high – it's well above the neutrality area of around 3%. The Fed is about to cut, with 3% the ultimate target. But what about the 10-year SOFR rate? It's at 3.4%. That's some 60bp below its neutral area of around 4%. There is no great mystery as to why it's below 4%. The Fed is about to embark on a significant rate-cutting exercise, and history shows that the 10-year rate tends to fall in anticipation - and on delivery of cuts. Hence, 10-year SOFR should still have some room to move lower.

That rate could get down to 3%, a 40bp fall from here. That's the one to three-month target. But getting to 3% would also be an extreme valuation to the downside. We find a 100bp curve from the funds rate to the 10-year yield to be a fair value one. If the funds rate gets pitched at 3%, then 4% is the level we should be thinking about for 10-year SOFR. That's the target on a three- to nine-month view.

The forward profile for ESTR rates shows a structural 2-2.5% tendency from six months out



Source: ING estimates, Macrobond

Eurozone 10-year Euribor to approach 2%, but then backs up towards 3%

Now, what does all of this mean for eurozone rates? In fact, it is something very similar, just with fewer extremes. The forward profile for ESTR is, in fact, very similar to that for SOFR. The entire ESTR curve gets dumped down to the 2% to 2.5% area in the six-month forward space and stays there right out to the four-year forward space. We'd overlay this by asserting that there is a greater probability for the 10-year ESTR rate to claw its way back up towards 3%, especially with 10-year SOFR hitting 4%.

The big adjustment on the ESTR curve in the coming six to twelve months is down on the front end to the 2% area (or slightly above), from 3.5% for one-month ESTR. Out the curve, five-year ESTR also falls to slightly above 2% in the six-month forward space, while 10-year ESTR essentially holds at 2.3%. That results in only a moderately upward-sloping curve in the six to twelve-month forward space. We're OK with this on a one to three-month outlook. But on a three to twelve-month outlook, we'd expect longer rates to be higher. Euribor, of course, trends with ESTR, with a steady c.10bp spread.

If you're interested in an update on the global spreads environment for all tenors - it's here. We expect most spreads to narrow as the Federal Reserve cuts by more than most central banks in the months and quarters ahead.

GDP forecasts

Developed Markets (QoQ% annualised growth)										
	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
US	3.0	2.4	0.8	0.7	1.0	1.8	2.3	2.5	1.4	2.1
Japan	3.1	3.2	3.2	0.0	0.4	0.4	0.4	0.3	1.4	0.9
Germany	-0.3	1.0	-0.1	0.1	0.6	1.2	1.2	0.1	0.5	1.2
France	0.6	1.6	-0.4	0.4	0.8	1.2	1.6	1.1	0.7	1.4
UK	2.3	1.2	1.4	1.3	1.2	0.9	0.9	1.1	1.3	1.1
Italy	1.2	0.6	1.2	0.8	0.7	1.7	1.5	0.9	1.1	1.0
Canada	1.6	0.8	0.8	1.0	1.5	2.2	2.2	0.9	1.3	2.2
Australia	0	0.8	0.8	1.6	2.0	2.4	2.8	0.7	1.5	2.6
Eurozone	1.2	1.1	0.8	0.7	0.8	1.2	1.4	0.7	0.9	1.3
Austria	0.0	1.0	1.2	1.0	1.2	1.2	1.2	0.0	1.1	1.3
Spain	3.2	1.8	1.2	1.2	2.0	2.4	2.4	2.7	1.8	2.2
Netherlands	4.1	0.4	0.5	1.3	1.7	1.5	1.4	0.3	1.5	1.6
Belgium	0.8	0.8	0.8	1.2	1.2	1.2	1.2	1.1	1.1	1.2
Greece	0.8	2.1	1.0	1.1	3.0	2.2	1.6	1.7	1.7	1.9
Portugal	0.5	2.0	2.2	2.2	2.4	2.4	2.4	1.8	2.2	2.1
Switzerland	2.8	1.2	1.2	1.2	1.6	1.6	1.2	1.5	1.4	1.5
Sweden	-2.7	2.6	1.1	1.3	1.3	1.3	1.4	0.5	1.2	1.5
Norway	0.2	1.5	1.9	1.9	2.0	2.0	2.0	1.2	1.9	2.0
Emerging Markets (YoY% growth)										
	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
Bulgaria	1.9	2.1	2.5	2.8	3.1	3.2	3.2	2.1	3.1	3.2
Croatia	3.3	4.6	2.9	2.9	2.5	2.7	2.9	3.7	2.8	2.4
Czech Republic	0.6	1.4	1.7	1.8	2.0	2.2	2.4	1.0	2.1	2.4
Hungary	1.5	1.3	2.2	2.4	3.3	4.0	4.8	1.5	3.6	4.4
Poland	3.2	3.1	3.7	3.2	3.4	3.6	3.8	3.0	3.5	3.8
Romania	0.8	2.8	3.3	2.5	2.9	3.0	3.2	2.0	3.0	3.0
Turkey	2.5	2.1	0.6	0.3	2.9	3.8	4.4	2.5	3.0	4.0
Serbia	4.0	3.3	3.6	3.9	4.2	4.2	4.2	3.9	4.1	4.2
Azerbaijan	4.6	3.0	2.5	2.0	2.5	3.0	3.0	3.5	2.6	2.8
Kazakhstan	2.7	4.6	3.6	5.4	5.5	5.3	5.7	3.7	5.5	4.5
Russia	4.0	1.2	1.5	1.0	2.5	1.5	1.0	3.0	1.5	0.5
Ukraine	3.5	1.5	3.7	2.5	4.0	5.0	5.5	3.5	4.3	4.5
China	4.7	4.7	5.0	4.3	5.0	4.9	4.7	4.9	4.6	4.8
India	6.7	6.8	6.6	6.3	8.1	8.9	7.3	6.9	7.6	7.3
Indonesia	5.0	5.0	5.0	5.1	5.1	4.9	5.0	5.0	5.0	5.1
Korea	2.3	2.0	1.7	1.0	1.6	1.7	2.0	2.3	1.6	2.0
Philippines	6.5	5.0	4.4	4.7	5.7	5.8	6.0	5.3	5.6	6.0
Singapore	3	2.7	2.1	2.4	2.5	2.6	2.7	2.7	2.6	2.7
Taiwan	5.1	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)	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2024F	2025F	2026F
US	3.2	2.6	2.5	2.0	1.8	2.0	1.9	2.9	1.9	2.0
Japan	2.7	2.4	1.8	2.2	1.8	1.7	1.7	2.3	1.8	1.8
Germany	2.6	2.4	2.8	2.7	2.4	2.4	2.4	2.6	2.4	2.2
France	2.5	2.5	2.5	2.5	2.6	2.4	1.9	2.6	2.4	2.0
UK	2.1	2.2	2.8	2.7	2.2	2.4	2.0	2.7	2.4	2.2
Italy	0.9	1.2	1.7	2.0	1.7	1.7	1.9	1.2	1.8	2.0
Canada	2.7	2.2	2.6	2.6	1.7	1.8	1.8	2.6	2.0	1.9
Australia	3.8	3.6	3.5	3.3	2.9	2.6	2.8	3.6	2.9	2.6
Eurozone	2.5	2.5	2.5	2.3	2.2	2.1	2.2	2.5	2.2	2.2
Austria	3.3	2.8	2.5	2.3	2.2	2.1	2.1	3.2	2.2	2.1
Spain	3.4	2.9	3.0	2.5	2.1	2.0	2.0	3.1	2.2	2.1
Netherlands	2.9	3.3	4.0	3.6	3.3	2.5	1.8	3.3	2.8	2.6
Belgium	3.5	3.5	2.4	2.1	1.9	2.0	2.1	3.0	2.1	2.1
Greece	2.7	2.2	2.2	2.3	2.0	2.0	2.2	2.6	2.1	2.0
Portugal	2.7	2.5	2.5	2.4	2.1	2.0	2.0	2.5	2.1	2.1
Switzerland	1.4	1.2	1.1	1.1	1.1	1.2	1.2	1.2	1.1	1.3
Sweden	2	2.1	0.8	1.1	1.7	1.8	1.8	1.7	1.7	2.0
Norway	3.2	3.2	2.8	2.4	2.3	2.1	2.1	3.5	2.2	2.5
Bulgaria	2.4	2.2	2.8	3.1	3.8	3.6	3.4	2.7	3.5	2.9
Croatia	3.2	2.2	2.7	2.9	2.9	2.6	2.5	3.0	2.8	2.7
Czech Republic	2.5	1.9	1.8	2.4	2.3	2.4	2.5	2.1	2.4	2.4
Hungary	3.8	3.8	5.0	4.9	4.7	4.5	3.8	4.1	4.5	3.3
Poland	2.5	4.4	4.6	5.7	5.3	3.8	3.8	3.6	4.6	3.0
Romania	5.3	4.9	4.3	3.5	4.1	3.9	4.1	5.4	3.8	4.0
Turkey	71.6	47.9	41.8	31.6	27.3	23.2	23.0	57.6	27.0	18.9
Serbia	4.4	4.3	4.2	4.4	4.2	3.7	3.4	4.7	3.9	3.4
Azerbaijan	0.3	3.2	4.5	5.5	5.9	4.0	3.6	2.2	4.7	4.5
Kazakhstan	8.5	8.4	8.2	7.8	7.8	7.2	6.7	8.6	7.4	6.6
Russia	8.2	8.8	7.4	6.6	6.1	5.4	5.2	8.0	5.8	5.0
Ukraine	5.3	8.0	8.0	9.5	7.0	6.5	6.0	6.8	7.3	5.0
China	0.3	0.6	1.6	0.9	1.5	1.9	2.2	0.6	1.6	1.6
India	4.9	4.5	4.9	5.9	5.8	3.9	4.6	4.9	5.0	4.7
Indonesia	1.9	2.1	2.2	2.1	2.0	2.1	2.2	2.1	2.1	2.2
Korea	2.7	2.2	2.1	1.6	1.7	1.7	1.6	2.5	2.1	1.9
Philippines	3.8	3.5	3.2	2.9	3.5	3.3	3.5	3.4	3.3	3.5
Singapore	2.7	2.7	2.4	2.7	2.5	2.3	2.3	2.7	2.5	2.4
Taiwan	2.2	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)**	82.00	80.00	78.00	77.00	79.00	82.00	77.00	75.00
Dutch TTF **(EUR/MWh)**	35.00	37.00	33.00	27.00	24.00	33.00	29.00	28.00

Source: ING estimates

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