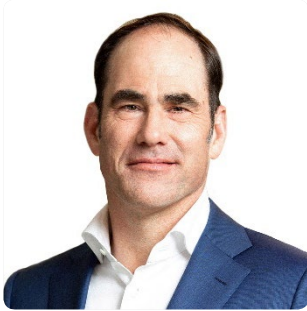


## ING Monthly

September 2025

# Europe's summer of disillusionment





## Europe's summer of disillusionment

**Summer romances are often fleeting – filled with warmth and excitement, only to end abruptly, leaving behind little more than fond memories. That's how this economic summer felt: it began with optimism around trade deals and progress in Ukraine, but quickly unravelled. Trade uncertainty is back, the war drags on with rising casualties, and Europe is once again grappling with a political crisis.**

This summer once again revealed the tectonic shifts in geopolitics. The US-EU trade deal exposed Europe's vulnerabilities and dependencies, showing that the EU is, sadly, more of a deal-taker than a deal-maker. Add to that the Trump-Putin meeting in Alaska and the Shanghai Cooperation Organisation summit, and the shifting geopolitical landscape is hard to ignore.

Surprisingly, these shifts haven't yet left visible marks on the global economy. But, as with many structural changes, the impact often takes time to surface. Just because we don't see the cracks now doesn't mean they aren't forming. This is especially true for tariffs. Companies – both American and foreign – can only absorb higher costs for so long. Eventually, those costs will be passed on to consumers or lead to reduced production. In Europe, this is reportedly already happening.

Amid all this, Europe continues to struggle to find its place. The optics aren't great. Some have even dubbed the past few weeks "Europe's summer of humiliation." When it comes to trade, I'm inclined to agree. But in other areas, Europe has tried to step up. Most notably, defence spending has increased significantly, and coordination among European leaders on Ukraine has improved. Still, with growing austerity pressures, it's fair to ask how long some countries will maintain their defence commitments.

As we mark the first anniversary of the famous Draghi report, Europe's core weakness is once again laid bare: it's not the analysis or awareness that's lacking, but the willingness – and ability – to implement meaningful change. Yes, there have been attempts to cut red tape and launch new initiatives, with flashy names like the "Competitiveness Compass" and the "Clean Industrial Deal." But beyond German fiscal stimulus and defence efforts, little of substance has changed. Most of Draghi's recommendations have been watered down, slimmed down, or – predictably – run into resistance at the member state level.

The current political crisis in France, while still a domestic affair, won't do much to boost Europhoria. And with France facing serious public finance issues and struggling to agree on austerity or reforms, can anyone really imagine Germany signing off on Eurobonds? I certainly can't.

My relationship with Europe has lasted far longer than one summer, but it's frustrating to see it unable – or unwilling – to rise to the occasion. The German government seems stuck in a 20th-century economic model, and many others across Europe appear blind to the geopolitical shifts and their economic consequences. It's as if Europe is clinging to a too-comfortable present.

Or, as Jean-Claude Juncker once said: "All government leaders know what to do. They just don't know how to get re-elected if they do it." Need I say more?

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**Watch:** Carston on Europe's summer of disillusionment



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## Our key calls this month

- **Energy:** Strong OPEC+ supply growth and more modest demand growth will leave the oil market in large surplus in 2026, which should see ICE Brent trade sustainably below \$60/bbl next year. The potential for further sanctions and secondary tariffs is a risk to this view.
- **United States:** The rapid cooling in the jobs market heightens the downside risks for US economic activity in the coming quarters. Inflation is becoming less of an issue with slowing housing costs, falling energy prices and weak wage growth mitigating the impact of tariffs on goods prices. We continue to expect 25bp interest rate cuts at each of the next five Federal Reserve policy meetings, especially with the FOMC membership set to increasingly lean dovish.
- **Eurozone:** Eurozone growth remains stable, with sentiment holding up but no acceleration expected. US tariffs and French political turmoil may dampen the outlook. A gradual recovery is still forecast for 2026, supported by German fiscal expansion, though risks persist. Inflation rose slightly in August but should fall below 2% short-term. A final ECB rate cut now seems unlikely unless recovery stalls or French instability worsens.
- **United Kingdom:** We still expect a rate cut in November, though the hawkish August decision weakened our conviction. Four of the nine committee members opposed a cut, and officials signalled that the easing cycle may be nearing its end. Inflation, especially food, remains a concern, but services inflation could undershoot forecasts. The jobs market is a downside risk. Data will determine if the next cut comes in November or later, but we expect rates to approach 3% by mid-2026.
- **China:** After a strong first half of the year, July's sharper-than-expected slowdown signals deeper economic cooling. Domestic confidence remains subdued, weighing on consumption and investment. Property prices continue to fall across cities. While anti-involution remains a long-term goal, the slowdown may prompt a shift back to stimulus ahead of key policy meetings to support growth.
- **Japan:** The economy grew more than expected earlier in the year, but exports and construction are set to slow. Private consumption should remain steady due to wage gains and fiscal support. Inflation is expected to ease mainly due to energy subsidy programmes. Markets will watch the LDP leadership race closely, while the Bank of Japan is likely to keep rates unchanged in September as it reviews the US-Japan trade deal and political developments.
- **FX:** Volatility in FX markets continued to grind lower this summer, despite August's USD-negative surprises (payroll revisions, Powell's dovish pivot, Trump's attempted firing of the FOMC's Lisa Cook). EUR/USD stalled near 1.16-1.17, capped by dollar resilience and French political noise. US data, Fed policy, and Ukraine developments remain key September drivers. Risks still tilt upward for EUR/USD.
- **Rates:** In August, global yield curves steepened as long-term yields rose. US 30Y yields climbed while 2Y fell on rate cut expectations. Germany saw 2Y yields rise slightly, anchored by ECB cut forecasts. 10Y yields are expected to rise further, with more upside in the US than Germany.

**ING global forecasts**

	2024					2025					2026					2027
	1Q24	2Q24	3Q24	4Q24	2024	1Q25	2Q25F	3Q25F	4Q25F	2025F	1Q26F	2Q26F	3Q26F	4Q26F	2026F	2027F
<b>United States</b>																
GDP (% QoQ, ann)	1.6	3.0	3.1	2.5	2.8	-0.5	3.3	1.5	1.0	1.8	1.1	1.9	2.1	2.3	1.6	2.2
CPI headline (% YoY, avg)	3.2	3.2	2.7	2.7	3.0	2.7	2.5	2.9	3.3	2.8	3.0	3.0	2.7	2.1	2.7	2.0
Federal funds (% eop)	5.50	5.50	5.00	4.50	4.50	4.50	4.50	4.25	3.75	3.75	3.50	3.25	3.25	3.25	3.25	3.25
3-month SOFR rate (% eop)	5.40	5.40	5.00	4.40	4.40	4.50	4.40	4.20	3.70	3.70	3.50	3.30	3.30	3.30	3.30	3.30
10-year interest rate (% eop)	4.25	4.40	3.80	4.60	4.60	4.25	4.25	4.00	4.25	4.25	4.50	4.50	4.25	4.25	4.25	4.25
Fiscal balance (% of GDP)					-6.9					-6.9					-6.7	-6.1
Gross public debt / GDP					99.6					101.8					104.3	106.2
<b>Eurozone</b>																
GDP (% QoQ, ann)	1.5	0.9	1.6	1.2	0.9	2.3	0.5	0.7	0.6	1.3	1.2	1.5	1.9	2.0	1.2	1.6
CPI headline (% YoY, avg)	2.6	2.5	2.2	2.3	2.4	2.3	2.0	2.1	1.8	2.1	1.8	1.9	2.0	2.1	2.0	2.3
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	2.25
3-month interest rate (% eop)	3.90	3.70	3.25	2.85	2.85	2.40	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.10	2.10	2.40
10-year interest rate (% eop)	2.30	2.60	2.10	2.36	2.36	2.80	2.60	2.70	2.80	2.80	2.80	2.90	3.00	3.00	3.00	3.20
Fiscal balance (% of GDP)					-3.4					-3.4					-3.5	-3.2
Gross public debt/GDP					91.1					90.8					92.1	92.2
<b>Japan</b>																
GDP (% QoQ, ann)	-0.9	1.9	2.3	2.1	0.1	0.3	2.2	-1.2	0.4	1.1	1.2	0.8	1.2	1.2	0.7	0.9
CPI headline (% YoY, avg)	2.5	2.7	2.8	2.9	2.7	3.8	3.4	2.9	2.5	3.1	1.6	1.7	1.8	1.7	1.7	2.1
Target rate (% eop)	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.50
3-month interest rate (% eop)	0.26	0.30	0.43	0.62	0.62	0.82	0.77	0.80	1.00	1.00	1.00	1.00	1.20	1.20	1.20	1.70
10-year interest rate (% eop)	0.73	1.06	0.86	1.10	1.10	1.50	1.44	1.60	1.65	1.65	1.70	1.75	1.80	1.80	1.80	2.50
Fiscal balance (% of GDP)					-7.0					-7.0					-6.0	-4.0
Gross public debt/GDP					236					235					235	232
<b>China</b>																
GDP (% YoY)	5.3	4.7	4.6	5.4	5.0	5.4	5.2	4.6	4.3	4.9	4.5	4.5	4.5	4.4	4.5	4.4
CPI headline (% YoY, avg)	0.0	0.3	0.5	0.2	0.2	-0.1	0.0	-0.2	-0.1	-0.1	0.6	0.3	1.0	2.3	1.1	1.6
7-day Reverse Repo Rate (% eop)	1.80	1.80	1.50	1.50	1.50	1.50	1.40	1.40	1.30	1.30	1.30	1.30	1.20	1.20	1.20	1.20
3M SHIBOR (% eop)	2.16	1.92	1.84	1.85	1.85	1.91	1.63	1.55	1.50	1.50	1.50	1.50	1.45	1.45	1.45	1.45
10-year T-bond yield (% eop)	2.30	2.21	2.20	2.00	2.00	1.82	1.65	1.75	1.80	1.80	1.80	1.80	1.85	1.90	1.90	2.00
Fiscal balance (% of GDP)					-5.0					-5.50					-5.3	-5.3
Public debt (% of GDP), incl, local govt					121					135					145	-
<b>United Kingdom</b>																
GDP (% QoQ, ann)	3.7	1.8	0.0	0.4	1.1	3.0	1.4	0.9	0.6	1.3	1.2	1.1	1.1	1.1	1.0	1.0
CPI headline (% YoY, avg)	3.5	2.1	2.0	2.5	2.5	2.8	3.5	3.9	3.6	3.5	3.2	2.6	2.7	2.8	2.8	2.4
BoE official bank rate (% eop)	5.25	5.25	5.00	4.75	4.75	4.50	4.25	4.00	3.75	3.75	3.50	3.25	3.25	3.25	3.25	3.25
3-month interest rate (% eop)	5.25	5.05	4.80	4.55	4.55	4.45	4.20	3.95	3.70	3.70	3.45	3.20	3.20	3.20	3.20	3.20
10-year interest rate (% eop)	3.95	4.20	4.00	4.25	4.25	4.68	4.55	4.60	4.50	4.50	4.40	4.40	4.30	4.30	4.30	4.30
Fiscal balance (% of GDP)					4.3					4.0					3.6	3.1
Public sector net debt (FY, %)					95.2					95.4					96.1	96.4
<b>EUR/USD (eop)</b>	<b>1.08</b>	<b>1.08</b>	<b>1.12</b>	<b>1.05</b>	<b>1.05</b>	1.08	1.18	1.17	1.20	1.20	1.20	1.20	1.21	1.22	1.22	1.25
<b>USD/JPY (eop)</b>	<b>151</b>	<b>160</b>	<b>143</b>	<b>155</b>	<b>155</b>	150	145	145	140	140	138	137	136	135	135	132
<b>USD/CNY (eop)</b>	<b>7.22</b>	<b>7.26</b>	<b>7.01</b>	<b>7.25</b>	<b>7.25</b>	7.26	7.16	7.15	7.10	7.10	7.10	7.05	7.05	7.00	7.00	6.80
<b>EUR/GBP (eop)</b>	<b>0.86</b>	<b>0.87</b>	<b>0.84</b>	<b>0.83</b>	<b>0.83</b>	0.84	0.86	0.87	0.87	0.88	0.88	0.88	0.89	0.90	0.90	0.90
<b>ICE Brent - US\$/bbl (average)</b>	82	85	79	74	80	75	67	67	62	68	58	56	58	54	57	62
<b>Dutch TTF - EUR/MWh (average)</b>	28	32	36	43	35	47	36	33	37	38	37	30	30	34	33	26

Source: ING forecasts

# Trade update: a risk of higher, not lower, tariffs

## Carsten Brzeski

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**Calm and more stability on trade were short-lived. Uncertainty is back as major trade agreements are more fluid than US trading partners had hoped**



We see the tariff level of close to 20% remaining in effect for Trump's entire term in office

Trade never sleeps. While agreements between the US and some trading partners at the start of August gave hope for calm and more policy certainty, recent developments have shown that this hope was very short-lived. Fears of extreme developments might be gone, but the risk of further trade and tariff escalation remains real.

Many of the trade deals struck in recent months remain non-binding, symbolic, or logistically and politically not feasible. Just think of the promises made by, for example, the EU and Japan to significantly increase corporate investments in the US. Consequently, the collapse or unilateral revision of any of these agreements could easily trigger further escalation. So far, most US trading partners have held off on retaliation, but further escalation would likely trigger tariff responses.

For businesses, the uncertainty is paralyzing. The lack of clarity around tariff policy discourages long-term investment and complicates supply chain planning. Even if some tariffs are eventually rolled back, the broader message is clear: trade policy will remain a volatile and politically charged arena for the foreseeable future.

Another factor bringing back uncertainty is of a legal nature. Recently, the legal foundation of some US tariffs has come under intense scrutiny. A 7-4 ruling by the US Court of Appeals for the Federal Circuit declared the administration's use of the International Emergency Economic Powers Act (IEEPA) to impose tariffs illegal. While the decision allows tariffs to remain in place until 14 October to permit a potential Supreme Court appeal, it casts serious doubt on the long-term viability of the current tariff regime.

Should the Supreme Court uphold the ruling, the administration will be forced to pivot to alternative legal mechanisms. These include Section 122 of the Trade Act of 1974, which allows for temporary tariffs of up to 15% (renewable by Congress), and Section 338,

which permits tariffs of up to 50% or outright import bans. These fallback options are more procedurally constrained and less flexible than IEEPA, potentially limiting the administration's ability to respond swiftly to trade developments.

All in all, we stick to our previous base case scenario, anticipating that average US tariff rates will remain elevated at close to 20%. Contrary to our previous belief, we no longer see the US government backtracking on tariffs in 2026 and beyond. The benefits of tariffs for the US budget are simply too attractive. This is why we see the tariff level of close to 20% remaining in effect for US President Donald Trump's entire term in office. If anything, there is a risk of higher, not lower tariffs.

# OPEC+ continues with supply hikes

Despite expectations of a large surplus in 2026, OPEC+ has continued to ramp up supply, which should put downward pressure on oil prices in the months ahead

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The fundamental outlook for oil prices remains firmly bearish

## OPEC+ surprises with another supply hike

Supply risks in the oil market grew in August due to US secondary tariffs on India for its purchases of Russian crude oil. This development left plenty of uncertainty about what Indian refiners would do with their procurement of Russian oil. India has increased the volume of Russian oil it has bought since the Russia-Ukraine war, buying in the region of 1.6m b/d.

Some Indian refiners paused their purchases of Russian oil following the US's announcement of secondary tariffs on India, and ship tracking data confirms that volumes of Russian seaborne exports have dropped in recent weeks. However, more recently, we have seen Indian buying interest for Russian oil resume again. This is crucial for the market outlook. Obviously, if Indian refiners start to shun Russian oil, and Russia struggles to find alternative buyers, it would likely lead to a reduction in Russian oil supply, leaving the global market more undersupplied than anticipated.

However, the fundamental outlook for oil prices remains firmly bearish. The market is set to move into a large surplus from the fourth quarter of this year and in 2026, which should weigh on prices. We continue to believe that ICE Brent will average US\$57/bbl in 2026. Modest demand growth, along with OPEC+ supply hikes, has been key to the expected surplus. OPEC+ has fully unwound 2.2m b/d of supply cuts within a period of six months, bringing this supply onto the market a full 12 months ahead of schedule. Furthermore, OPEC+ has started unwinding its next tranche of 1.65m b/d of supply cuts, with the group set to increase supply in October by 137k b/d. This move by OPEC+ only cements the more bearish outlook we have towards the oil market.

## Rangebound European gas

European natural gas prices have been relatively rangebound over the last month, while speculators have been reducing their positioning in TTF. This is despite maintenance in Norway, which has reduced Norwegian gas flows to Europe.

Weaker Asian LNG demand continues to cap prices, with Chinese LNG demand particularly weak, driven by stronger pipeline flows and also weaker domestic demand.

However, we still expect natural gas prices to remain relatively well supported for the remainder of this year. It is looking increasingly unlikely that the EU will hit its 90% storage target, although admittedly, there is more flexibility now when it comes to these storage targets.

Furthermore, European gas prices will need to remain relatively well supported to ensure that we see stronger LNG flows into Europe as we head into the 2025/26 winter.

We expect TTF to remain above EUR30/MWh in the near term, however, prices will come under growing pressure as global LNG supply ramps up. But we will likely have to wait until 2027 before LNG supply additions weigh heavily on prices.

# Our view on the major central banks

Our take on what could be next for the Federal Reserve, the European Central Bank, the Bank of England and the Bank of Japan over the coming months

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Consumers' concerns over job security and squeezed spending power are likely to limit GDP growth to average 1.5% for coming quarters

## Federal Reserve

The balance of risks surrounding the Fed's dual mandate of price stability and maximum employment is swinging towards one whereby the jobs market is the bigger concern. This gives us greater conviction in our call of 25bp rate cuts at the September, October and December FOMC meetings with a further 50bp of policy easing in early 2026.

Consumers are worried about job security and squeezed spending power due to tariff-induced price hikes and this is likely to limit GDP growth to average 1.5% for coming quarters. Goods prices are set to rise, but we are in a very different situation to 2021/22 when the Covid-related supply side shock was amplified by a tripling of oil prices, surging housing costs and a red-hot jobs market. These three factors are set to dampen inflation this time around, giving a more dovish-leaning Federal Reserve the room to offer meaningful support to the economy.

## European Central Bank

With a still relatively resilient eurozone economy and inflation not yet showing any signs of undershooting, the ECB looks set to keep interest rates on hold this autumn. At a deposit rate of 2%, the ECB seems to feel comfortable in what President Christine Lagarde has frequently called a 'good place'. However, there are still convincing arguments for a more dovish ECB, such as the stronger euro exchange rate, potentially more aggressive rate cuts in the US, the delayed impact of US tariffs on the eurozone economy and the political crisis in France. Just to mention a few.

The extensive list of potential downside risks to both inflation and growth reinforces our view that discussions within the ECB are likely more contentious than markets are currently pricing in. If just any of these downside risks materialise, the ECB could still decide to cut interest rates one more time, even though this does not seem to be the current majority view in Frankfurt.

### **Bank of England**

We still expect a rate cut in November, though a hawkish August BoE decision has weakened our conviction. Not only did four out of the nine-strong committee vote against a cut at that meeting, but officials hinted we're getting closer to the end of the easing cycle. Inflation is a key concern, particularly food. But we see scope for services inflation to undershoot the Bank's forecasts. The jobs market – which received surprisingly little attention at the August meeting – is also a downside risk.

The data will decide whether the next cut comes in November or next year, but either way, we think rates will get much closer to 3% by the middle of next year.

### **Bank of Japan**

The recent resignation announcement by Prime Minister Shigeru Ishiba has increased political uncertainty, which may complicate the BoJ's upcoming rate decision. The OIS currently indicates a 47% probability of a rate hike by year-end, down from 70% last week. The result of the LDP leadership contest, expected in early October, could have implications for macroeconomic policy; if a far-right candidate wins, it may raise fiscal sustainability concerns, weaken the yen and Japanese government bonds, and lead to looser monetary policy. But macro-economic conditions still support the BoJ's policy normalisation.

In the first half of 2025, the Japanese economy grew more than expected despite US tariff challenges. Private spending was supported by firm wage growth and underlying inflation continued to build. Looking ahead, lower energy and food prices could increase consumer purchasing power, while fiscal stimulus may further boost consumption. While political uncertainty introduces a major risk, our view for an October rate hike remains unchanged for now.

# France's fiscal outlook deteriorates, but a full-blown crisis remains unlikely

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**It will be a challenge to form a new government following the resignation of Prime Minister François Bayrou. There is more uncertainty in France as public finances worsen. We think a full-blown crisis can be averted**



Prime Minister François Bayrou lost the confidence of Parliament and resigned

## **Forming a new government will be very difficult**

On Monday 8 September, Prime Minister François Bayrou lost the confidence of Parliament and subsequently resigned. The next day, President Macron appointed Sébastien Lecornu, a close associate from the centre-right, as the new prime minister. Lecornu now faces the daunting task of forming a government and presenting a 2026 budget in a deeply fragmented parliament.

To avoid a vote of no confidence, he must secure tacit support from either the left or the far-right, a scenario unlikely unless the budget proposal undergoes significant revisions.

As a result, we anticipate protracted negotiations. If these talks succeed, it will likely be at the cost of a less stringent fiscal path, effectively slowing budgetary consolidation. However, there remains a strong possibility that Lecornu will fail to build a viable coalition, which would increase the probability of new parliamentary elections. In our view, the likelihood of Macron resigning is very low at this stage.

## **Weak growth will only exacerbate the problem**

The fall of the government and the low probability of a swift resolution to the political crisis have added a new layer of uncertainty to an already weak economy. Indeed, France's GDP growth in early 2025 appeared resilient, but underlying fragilities persist. The modest expansion was driven almost entirely by inventory accumulation, masking stagnation in private consumption and contractions in investment and net exports.

While industrial production showed a slight uptick, overall momentum remains weak. Labour market conditions are deteriorating, and household confidence is fragile. Political instability further clouds the outlook, making a recovery in the second half increasingly unlikely, especially as the higher risk premium on French bonds is likely to weigh on interest-sensitive sectors like construction and real estate.

On average, GDP growth could reach just 0.6% in 2025, down from 1.1% in 2024. With a weak starting point for 2026, growth is expected to remain below potential, continuing to weigh on public finances.

### **The public finance situation is serious**

According to the Ministry of Finance, public spending is projected to increase by €51.1bn in 2026 without corrective measures, resulting in a budget deficit of 6.1% of GDP, which significantly exceeds the 4.6% target submitted to the European Commission. With little prospect of resolving the current political crisis and even less likelihood of rapidly securing an agreement on the 2026 budget, the fiscal outlook is poised to deteriorate further.

Without a shift in policy, public debt is projected to climb from 113% of GDP in 2024 to 125.3% by 2029. France's fiscal challenge is largely structural, driven by demographic trends and weak potential GDP growth.

### **The existence of TPI should help**

The political crisis has already caused government bond (OAT) spreads to widen, though not to levels seen during the sovereign debt crisis. Importantly, the European Central Bank (ECB) retains significant firepower to limit excessive widening of eurozone government bond spreads, and markets are well aware of this.

In theory, the ECB could activate the Transmission Protection Instrument (TPI) if elevated interest rates on OATs begin to impair monetary policy transmission. While the TPI requires compliance with EU fiscal rules, which France currently does not meet, the ECB has stated that these criteria are "inputs into its decision-making and may be dynamically adjusted".

It is unlikely that France would receive a free pass upfront, but the ECB would likely trigger TPI if spillover risks threaten financial stability. As such, the mere existence of the tool may be sufficient to prevent spreads from spiralling upwards, avoiding a full-blown crisis.

# The eurozone remains mired in sluggish growth

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Recent sentiment data suggests continuing growth in the third quarter, but with difficult budget consolidations in the spotlight, growth is likely to remain subdued. Inflation is still expected to fall below 2% before year-end. As the ECB is likely to see this as a temporary undershoot, it is bound to keep interest rates stable over the next year



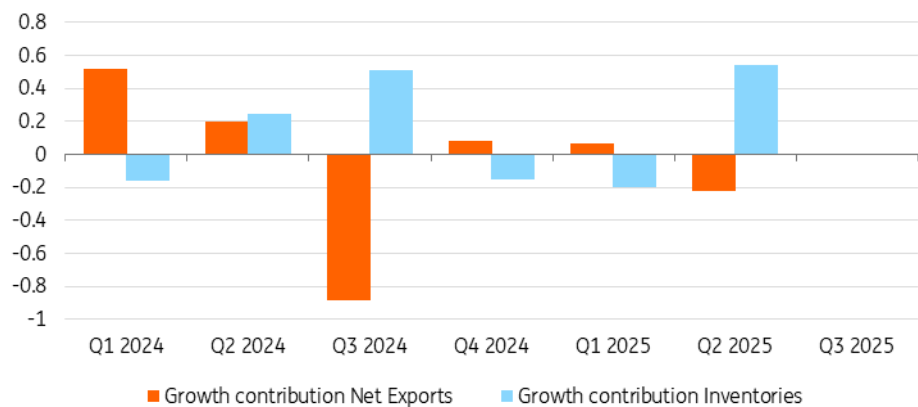
Sluggish growth and a brief inflation dip in the eurozone seem unlikely to justify further ECB rate cuts

## Subdued growth continues

Following a strong first quarter of the year, partially driven by a temporary surge in exports to the US, the eurozone maintained positive momentum in the second quarter, even with net exports detracting 0.2 percentage points from quarterly GDP growth. While this headline figure appears encouraging, a closer look reveals underlying fragility: inventory accumulation contributed 0.5 percentage points, underscoring weak domestic demand. Consumption edged up by just 0.1%, and investment contracted sharply by 1.8%.

Sentiment indicators for the third quarter suggest continued growth, albeit without signs of acceleration. The European Commission's August survey revealed a deterioration in export order books, although the overall level of orders improved. Unemployment remains at a historic low, yet consumer confidence is subdued. Households anticipate a worsening of their financial situation over the next year, and the 0.5% drop in retail sales in July reflects ongoing consumer caution.

### Inventories were an important growth driver in the second quarter



Source: LSEG Datastream

### Trade deal remains a headwind

The recent trade agreement with the US presents a mixed picture. On the one hand, newly imposed tariffs are expected to dampen exports, subtracting an estimated 0.25 percentage points from growth over the next 12 to 24 months. On the other hand, the deal provides companies with greater clarity, potentially unlocking investment decisions. That said, this positive effect should not be overstated, as the US administration continues to revise its interpretation of tariff rules constantly, with more product categories now subject to the 50% tariff bracket.

### Fiscal policy hardly a boost

Fiscal policy will play a divergent role across member states. In France, fiscal restraint will be necessary to contain budget deficits, likely weighing on consumption. Conversely, Germany is set to implement more stimulative policies in 2026, which may offset tightening elsewhere. However, we do not expect a broadly expansionary fiscal stance across the eurozone, as governments are already retreating from previous commitments to significantly boost defence spending.

Overall, we forecast eurozone GDP growth of 1.3% in 2025, largely attributable to the strong first quarter. Growth is expected to gradually pick up in 2026, resulting in a full-year expansion of 1.2%.

### ECB has reached the end of the easing cycle

The latest inflation developments were disappointing, as the August HICP headline inflation rose to 2.1%, while core inflation held steady at 2.3%. That said, lower energy prices are expected to exert downward pressure on headline inflation, likely pushing it below 2% from Q4 2025 to mid-2026. Nevertheless, the ECB is likely to view this as a temporary undershoot. Longer-term inflation risks remain tilted to the upside, especially as supply constraints may re-emerge in the coming years.

As a result, we expect the ECB to maintain its key interest rate at 2% over the coming year. A faltering recovery or a broader financial crisis – potentially triggered by political instability in France – could still prompt rate cuts, but this is not our base case.

# Job worries push the US Fed into action

**James Knightley**

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**Trade swings are masking a cooling of US economic growth, but nothing can disguise the obvious weakening of the jobs market. There is a growing confidence that tariffs will not boost inflation more permanently, so the Fed appears ready to embark on a series of interest rate cuts that will swiftly move monetary policy to a neutral setting**



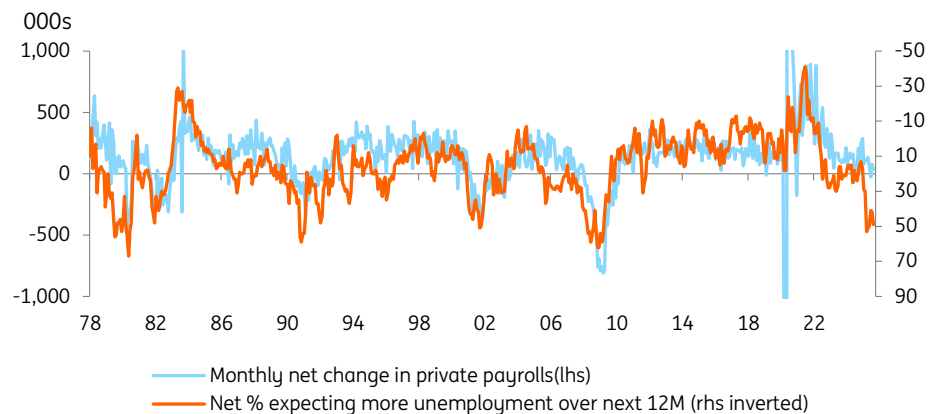
The Fed appears ready to embark on a series of interest rate cuts that will swiftly move monetary policy to a neutral setting

## **Job weakness becoming the priority**

Second-quarter GDP growth was revised up to 3.3%, but given the trade volatility brought about by President Trump's tariff policy, we should take an average of the first two quarters, which means annualised growth of around 1.5% for the first half of the year. The second half is likely to expand at a similar rate. There appears to be a modest consumer revival in the third quarter, offset by weaker construction and investment and a drag from trade. In the fourth quarter, we suspect growing fears about the jobs market and the squeeze on disposable incomes from tariff-induced price hikes mean consumer spending growth slows again.

Weakness in the jobs market is becoming more apparent after yet another disappointing payrolls figure for August and a rise in the unemployment rate to 4.3%. It remains a story of slowing hiring with limited evidence of firings right now, but the deterioration in sentiment towards the jobs market among workers is very concerning. The fear of losing one's job has only been greater on four occasions in the past 50 years.

### Households fear that unemployment could climb



Source: Macrobond, ING

### Inflation fears start to ease

As for inflation, we continue to expect tariffs to lift prices for goods, but the impact on overall CPI shouldn't be overplayed. Admittedly, it is a big supply shock, but three factors that amplified and extended the post-Covid inflation surge to above 9% in 2022 are absent this time around.

First, oil prices tripled between 2021-22, but they are falling today. Second, house prices rising 50% and a doubling of mortgage rates contributed to CPI measures of rent rising 8% year-on-year nationally by 2023. Today, house prices have fallen for four consecutive months and are set to fall further, with rents already cooling. Third, the weakening jobs market means wage growth is slowing towards 3% rather than rising towards 6% as in 2022. Remember too that the core goods (ex food and energy) – where tariffs have most influence – are only around 19% of the CPI basket by weight. By way of contrast, housing is 33%.

So with growth remaining below trend, the jobs market clearly cooling and tariffs set to mean a one-off step change in some goods prices rather than something more permanent on inflation, the Federal Reserve has scope to restart moving policy from 'restrictive' territory to closer to neutral. We continue to forecast three 25bp rate cuts this year with a further 50bp of cuts across the two early 2026 meetings. The recent data flow has prompted markets to move in line with our view.

### The housing market needs to be watched closely

For next year, the balance of risks, we suspect, is skewed toward the Fed moving policy below neutral, i.e. the Fed cutting interest rates more than we are forecasting rather than implementing fewer cuts. This is largely because the housing market is looking increasingly vulnerable to a potential correction.

Demand remains weak due to a lack of affordability, but the limited housing supply has kept prices supported. That situation is changing with the number of homes for sale rising consistently over the past year. Factors that are prompting this include employers being less willing to accommodate remote working, family circumstances changing, plus higher property taxes and adjustable mortgage rate resets, meaning an increasing number of people are struggling financially.

The result is that the demand-supply rebalance has prompted four consecutive monthly price falls already, with the prospect that more are on their way, especially if the jobs market cools further. Property is the largest reserve of wealth for most Americans, and any erosion of that will intensify consumer angst.

# The pivotal Lisa Cook case: a tipping point?

## Padhraic Garvey

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**The Lisa Cook affair is a pivotal test case of the Trump administration's capacity to fire Fed governors, practically at will. We could see more of this, and if pushed too far, it risks Fed credibility. We'd look to longer tenor bonds to react the most should the Fed be seen to be over-cutting for political reasons**



The Fed's Lisa Cook

## **Good news for Lisa Cook as a court rules in her favour – but this is far from over**

A few weeks ago, President Trump attempted to fire Federal Reserve Governor Lisa Cook for "cause". The identified "cause" was the alleged falsification of mortgage documents prior to her taking up the role of governor. There has been a court hearing on the matter, and we've just had the outcome, which is a positive one for Cook. Essentially, the court ruled that "cause" should reflect something done while actually in office, followed by the assertion that a firing based on "unsubstantiated and vague allegations" would "endanger the stability of our financial system". Cook keeps her job and gets to vote at the upcoming FOMC meeting.

But this is not over. The Justice Department is likely to appeal on the theory that even if Cooks' alleged falsification of documents is viewed as minor under some interpretations, it may still be sufficient grounds for removal. In the extreme, this could go all the way to the Supreme Court. And if it did, that court has tended to swing right. Either way, this whole affair does smack of a political agenda to make changes at the Fed by the Trump administration.

A burning question is why the markets have not reacted more negatively? After all, this does smack of political interference. Part of the explanation could lie in the perception that the allegations - while unproven - retain a degree of plausibility in the eyes of investors, at least until definitively dismissed. Some investors may also trust the courts to uphold due process, reinforcing faith in institutional safeguards.

However, if Chair Jerome Powell were to get involved as an obstacle, say, for attempting to protect Cook, and were fired on that basis, that would be a whole different story. Take us there, and the market would react more dramatically. In the end, any extreme action taken to undermine Fed independence would be viewed with much suspicion by longer-dated bonds.

The front end does not care about longer-term risks, as it is slavish to where the funds rate goes. By definition, it cannot think beyond two years. But the back end is a deeper thinker, and can worry about second- and third-round effects, and especially on medium-term risks potentially being taken on inflation should the interference with the Fed be seen to be swinging policy too dovish.

This has the potential to get very messy, and could finally tip the back end over the edge – an edge it has thus far resisted crossing, even under significant fiscal pressure. How messy? It's tough to say, but we'd more than likely comfortably take out the previous 10yr and 30yr yield highs seen in this cycle.

### **Upcoming rate cuts have little to do with the Lisa Cook case, but beyond that this theme is potentially extremely relevant**

In the wake of the latest round of weak jobs data and a downbeat assessment on the economy from the Federal Reserve's own Beige Book report, the market is now convinced the Fed will soon resume cutting interest rates. While this is mostly aside from the Lisa Cook saga, the market's hunger for cuts has been further fuelled by the prospect that the Fed is set to lean more dovishly in the months ahead as Donald Trump seeks to appoint new members who are more aligned with his thinking that interest rates need to be much lower than they are currently.

The anticipated changes in personnel at the Fed mean there is a perception in the market that the "new" Fed could be seen to be more willing to put the political goals of the president ahead of economic stability, similar to when Richard Nixon pressured Arthur Burns into cutting interest rates ahead of the 1972 election. In combination with a lifting of wage and price controls, this contributed to a spiralling of inflation in subsequent years.

Nonetheless, it is important to point out that no potential Fed candidate has endorsed the president's call for 200-300bp of immediate interest rate cuts.

Stephen Miran is set to be in position for the 17 September FOMC meeting, temporarily filling the governor role vacated by Adriana Kugler after she decided to step down early. Miran has somewhat controversially refused to resign from his current role as chair of the President's Council of Economic Advisors. Instead, he is taking a temporary period of unpaid leave, raising questions about how independent he can be, given that he will be returning to work for the president in early 2026.

It will then be up to President Trump to name a permanent successor to Kugler, and with the future of Lisa Cook in doubt, plus Jerome Powell's term as Fed Chair ending in May 2026, the composition of the FOMC will soon look very different to how it started 2025. Nonetheless, we must remember the FOMC is a committee made up of 12 voting members, and while any new members joining in the coming months may be in favour of lower interest rates right now, given the current economic conditions, there is no guarantee that will be the case if the economic situation changes.

Financial markets will also provide a stiff test for new officials. In the UK, the reason that the then newly elected Labour government gave the Bank of England independence in 1997 was to give the new political administration more economic credibility. It was believed that an independent central bank gives financial markets greater confidence that inflation would be more stable at lower levels, and this reduced term premium, which helped deliver lower market interest rates and stronger economic growth than would have been otherwise achieved. If global markets started to question the credibility of US economic policy, this could risk higher borrowing costs and slower growth, which would not be in the president's best interests as we head towards the mid-term elections.

# Softer China data could restore urgency for stimulus rollout

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**While anti-involution remains a long-term priority, an economic slowdown may necessitate a short-term focus to swing back to stimulus ahead of key policy meetings**



Extreme weather has been blamed for China's economic slowdown in July

## Weak July economic activity data shows slowing domestic momentum

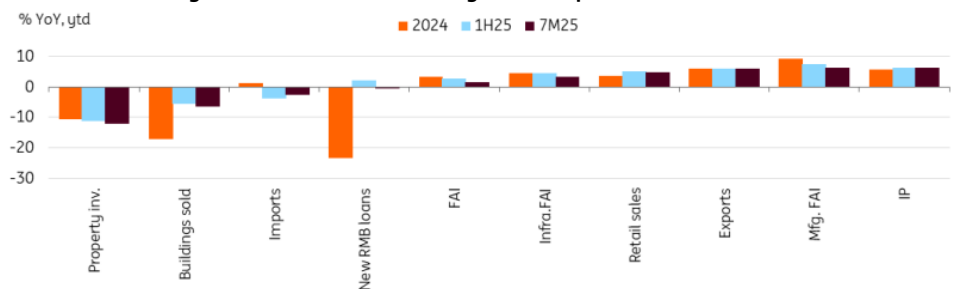
After a stronger-than-expected first half of 2025, we had been expecting a cooling of the economy in the second half of the year; however the moderation of growth in July was more than anticipated.

While exports continued to surprise on the upside in July amid a surprisingly resilient external demand environment, overall, other economic activity data were down across the board, with retail sales, fixed asset investment, and value added of industry growth all reaching the lowest levels of the year. Domestic confidence has remained soft, and this is being translated into softer consumption and investment activity.

Furthermore, China's 70-city property price index showed that prices continued to decline, with widespread weakness on a city level.

Extreme weather has been blamed for the slowdown in July, and as such, some rebound is expected in August, but data has been slowing for several months regardless and could once again present a case for more policy support.

## Domestic activity indicators slowed in July while exports accelerated



Source: CEIC, ING

### **Immediate priorities could shift from anti-involution to stimulus**

Much attention has been placed on the anti-involution theme in the past few months. This concept advocates reducing the amount of unhealthy, excessive competition in the economy, a move that is undoubtedly essential for the long-term well-being of both the economy and society. However, the poor July data also shows that the risks to the short-term outlook may mean that anti-involution measures will be gradual, as measures to crack down on excess capacity and price competition would likely come with immediate costs.

We expect renewed urgency on policy support to close out the year, especially if August data continues to disappoint. This may have already started, with policymakers unveiling a programme to help subsidise 1% of consumption loan interest in an effort to further support consumption. The recent acceleration of property price declines should also be sounding some warnings, and we also saw that Shanghai further eased home-buying rules in late August.

### **All eyes on Fourth Plenum and 15th five-year plan**

The Fourth Plenum will be held in October, at which time the Five-Year Plan will be discussed in detail, before being put up for approval at next year's Two Sessions.

China's five-year plans tend to set the big picture strategy for the upcoming five years, and as such, it will be important to see where the main focuses are and if there are any shifts in policy direction or priorities. China's longer-term goal is to become a moderately developed economy and achieve socialist modernisation by 2035, and the next five years are vital to keep this goal on track.

# India's GDP faces large tariff hit

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Steep US tariffs pose a clear downside risk to India's growth. Recent tax rate cuts may partially offset the impact, but a lack of meaningful export diversification suggests the drag on growth will be significant. Deflationary effects could push already low CPI inflation down further, bringing forward rate cuts. This sets a supportive backdrop for bonds



New Delhi, India

In Asia, the big story has been India, with US President Trump's steep 50% tariffs on Indian imports officially taking effect – a move that includes a 25% penalty on India for its continued oil imports from Russia. At a broad level, the macro impact looks relatively manageable. India exported about US\$87bn worth of goods to the US in FY2025 – that's less than 2% of its GDP. Once you factor in tariff-free categories like pharma and electronics, and adjust for domestic value added, the actual GDP exposure to these tariffs drops to around 1.2-1.3%. IMF estimates suggest that over the long run, a 1% increase in India's international export prices could lead to a drop in export volume growth – around 0.9% across all industries, and about 1.1% for manufacturing. Assuming a full tariff pass-through and no trade diversion, the direct hit to output would then be 0.6-0.7% of GDP.

However, the impact would be much larger given the second-round effect on employment and consumption. Labour-intensive sectors like textiles, leather, and jewellery face the highest downside risk – not just in terms of exports, but also employment. These industries operate on thin margins and are highly price-sensitive, making them especially vulnerable to tariff shocks. Plus, since they rely more on low-skilled labour, they're easily substitutable by countries like Vietnam and Bangladesh, which offer similar products at competitive prices.

Can Asia fill the export gap? We doubt it. India's shrinking regional trade tells a different story. What's most striking about India's trade direction is that its trade with the rest of Asia has been going down steadily over the past few years.

One of the recent measures that could partially offset the tariff impact has been cuts to GST (Goods and Services Tax) rates for some commodity groups. Taxes on essential items – including food products, basic household goods, consumer electronics, and small motor vehicles – have been significantly reduced, while life-saving drugs and health and life insurance have been made entirely tax-free. These reforms are designed to directly

boost consumption, especially among middle- and lower-income households. Importantly, these changes are projected to lift consumption by 0.1-0.2% of GDP – providing a timely boost to economic growth.

The downside risks to growth create more room to ease monetary policy. The export losses from high US tariffs and GST cuts would reinforce the disinflationary trend. We estimate that a full pass-through of GST rate cuts to the consumer could lower CPI inflation by 1 percentage point or by 50bp in a more conservative scenario. This strengthens our case for another 50bp Repo rate cut by the Reserve Bank of India (RBI) over the next six months, with rising risks of the RBI front-loading cuts in the fourth quarter.

Active RBI intervention is expected to cap USD/INR around 89.0 in the near term. However, the risk of further weakness persists if India fails to negotiate tariff levels lower. A prolonged export slowdown could structurally weaken India's current account balance, adding sustained pressure on the currency.

# Further Bank of England rate cuts hang in the balance

**James Smith**

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**We still narrowly favour another rate cut in November, though it wouldn't take much to push the next move back into 2026**



Bank of England Governor Andrew Bailey

## **A November cut hangs in the balance**

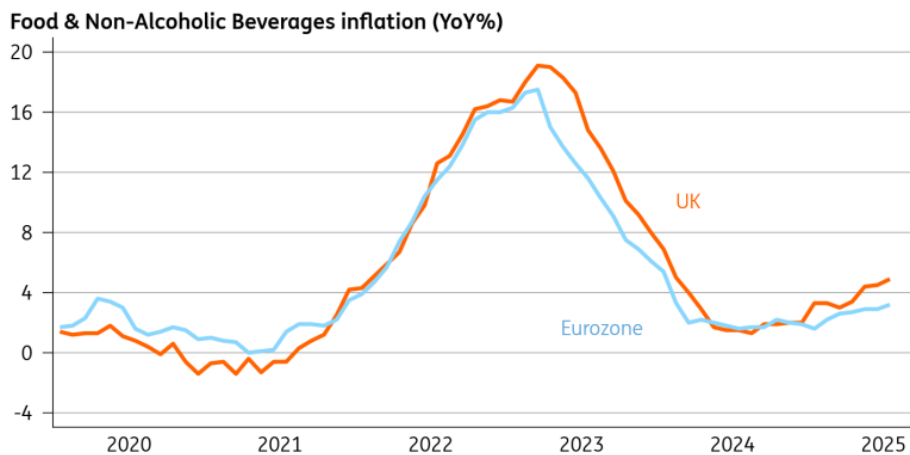
A hawkish Bank of England decision in August has cast serious doubt on our call for another rate cut in November. Officials did lower rates over the summer, but the committee is heavily divided on the way forward. And the statement raised the possibility that the Bank is nearing the endgame on rate cuts.

Financial markets are pricing a November cut at just 20% probability, though there's a lot of key data to come before then. We think at least some of the following need to happen to keep a cut in play:

First, inflation needs to show further progress, and on headline CPI at least, that is unlikely before November. Food inflation is set to rise above 5% and this is a key preoccupation of rate setters, owing to its formative role in setting household inflation expectations. But the news isn't all bad. The Bank ultimately cares most about service sector inflation, and we think there is scope for this to modestly undershoot the BoE's forecasts before November. Rapidly slowing rental growth is a key driver.

Second, signs of further stress in the jobs market would clearly be a game-changer for the BoE's thinking. Employment has fallen in eight of the last nine months, but the Bank is surprisingly relaxed about this. Perhaps that's because the majority of the weakness is concentrated in hospitality, a sector acutely exposed to April's payroll tax and minimum wage hike. Or because the surveys are looking a little brighter. Our base case is that we'll see a further gradual cooling in the jobs market, which on its own is unlikely to move the dial too much on a November cut.

### Food inflation is becoming a problem



Source: Macrobond, ING

### Wage growth is set to fall later this year

But coupled with lower private sector wage growth, which is likely to be closer to 3.5% than its current 5% level by year-end, the case for further easing would become more compelling. Officials have long been irked by the fact that wage growth has consistently come in above its forecasts.

Finally, the Autumn Budget is likely to be net-dovish for the Bank of England. Significant tax hikes are likely to dominate, in sharp contrast to last year's budget, where the increase in employer National Insurance was dwarfed by significant spending increases. However, given the budget won't happen before November's meeting, this is unlikely to factor into the Bank's thinking until much later this year or early next.

In short, there's just about enough here to keep the promise of another 2025 cut alive. Remember, too, that the Bank's own forecasts, which foresee inflation returning to target over two years, are premised on two more cuts. But it also wouldn't take much to push us towards a different BoE call. If the next set of inflation data is particularly hot, we'd be tempted to push back our call for the next cut into 2026.

## CEE: A land without rate cuts

Poland leads the region with 3.4% GDP growth and CPI near target, but the central bank remains cautious due to the loose fiscal stance. The Czech economy is expanding steadily, with rate hikes possible in 2026. Hungary's inflation remains high, delaying easing. Romania stagnates, with inflation set to peak near 10%, and rate cuts likely from mid-2026

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### Poland: CPI down, GDP up

Economic growth accelerated to 3.4% year-on-year in the second quarter from 3.2% YoY in the first. On the supply side, GDP expansion was driven by services, while on the expenditure side, data showed that households' consumption propelled economic growth. Due to buoyant services sectors, the Polish economy is growing faster than its CEE peers, despite facing similar headwinds in industry. In the second half of the year, GDP growth should accelerate to nearly 4% YoY, and we still expect 3.5% GDP growth in 2025, clearly above the pace seen in other countries in the region. Investment activity remains subdued, but is expected to bounce back as the Recovery and Resilience Facility and Cohesion Funds from the EU begin to flow more widely into the economy.

The 2026 draft budget reflects deteriorating fiscal conditions in 2025, with the general government deficit projected at 6.9% of GDP, up from the previously expected 6.3%. The 2026 fiscal plan offers limited consolidation, and policy remains expansionary – potentially discouraging the National Bank of Poland (NBP) from further monetary easing. Poland's new President, Karol Nawrocki, says he will veto tax increases and social spending cuts, which suggests that Poland is unlikely to tackle its excessive deficit targets by 2028. This could increase pressure from rating agencies and investors amid rising public debt and the absence of a meaningful fiscal adjustment.

August CPI inflation decreased to 2.8% YoY from 3.1% YoY in July and is close to the central bank's target of 2.5% (+/- 1 percentage point). Core inflation, which excludes food and energy prices, is also on a downward trend. According to current estimates, it probably moderated to 3.1% YoY from the 3.3% YoY reported in July. With inflation close to the NBP target and securely within the range of acceptable deviations from the target, the Monetary Policy Council cut rates by 25bp to 4.75% on 3 September, but took a more cautious policy stance with respect to further policy easing amid highly expansionary fiscal policy. In October, policymakers may pause and return to the debate

on rate cuts in November, when the new NBP staff economic projections become available. Real rates are relatively high, though, and policymakers have room for further policy easing, and in 2026 as well.

### **Czech Republic: Stable rates do the job for the expanding economy**

Czech annual inflation eased in August primarily due to a continued slowdown in food price dynamics. The reading also showed that price growth in the services sector remains unshattered, hovering around 5% since 2024. We see this as a structural issue that could start to embed into inflation expectations, especially after such a protracted period. With both nominal and real wage growth exceeding expectations in the second quarter, households will have sufficient resources to continue spending as the year progresses. We see the economy gradually entering a fully-fledged growth setup, with the labour market flipping into a retightening mode in the coming quarters. This would mean upward pressure on wages throughout the upcoming year, with wage growth representing a candidate for upward surprises compared to general expectations. In such a situation, we see rate stability as an optimal response for the time being.

That said, there are inflationary risks when looking ahead, primarily driven by several factors: persistent overheating in the housing market, which could push up rents and core inflation; a genuine economic rebound in Germany spurred by fiscal stimulus; nominal wage growth potentially exceeding 7%, leading to renewed inflation in the services sector; a significant CPI impact from ETS2, including pronounced secondary effects and front-loading into 2026.

With the economy expanding swiftly and the labour force once again becoming a scarce resource, an additional combination of the risks mentioned above would likely result in a renewed hiking cycle around mid-2026. Indeed, the current rate of 3.5% is generally considered only slightly restrictive in terms of domestic demand, while further strengthening of the koruna will provide some relief via cheaper imports.

### **Hungary: Our case for a more hawkish monetary policy outlook is growing**

The breakdown of Hungary's weak second-quarter GDP growth highlights that household consumption is currently the main driver of the economy. However, despite low unemployment and robust real wage growth, consumer spending remains solid but not exceptional. In contrast, investment continues to decline. The underlying issue? A lack of confidence. Households are concerned that prolonged stagnation over the past three years could jeopardise job security, while inflation remains elevated. Unlike expectations, high inflation in Hungary hasn't spurred spending – it has encouraged saving, as households are still recovering from recent economic shocks that depleted their financial reserves.

A lack of strong domestic demand, coupled with weak external demand, is making businesses less confident. Add to this geopolitical uncertainty, global and local economic policy uncertainty, and rising labour costs, and you have the perfect storm for investment delays.

Meanwhile, inflation has continued to surprise on the upside, suggesting entrenched price pressures that won't ease soon. Unsurprisingly, the National Bank of Hungary is sticking to its hawkish playbook, emphasising that anchoring inflation expectations is essential. To achieve this, a cautious, patient monetary policy is needed, which prioritises the stability of the Hungarian forint too, according to the Monetary Council.

However, it is not just the central bank. The Ministry of National Economy is sending out the same messages, which makes us increasingly doubtful about our monetary policy baseline, which assumes that the base rate will remain unchanged in 2025, but expects a significant easing cycle in 2026. If we see further upside surprises in inflation in the

coming months – despite the strong forint – and if there are some hawkish surprises globally, we will need to flip the switch.

If policymakers are serious about the forint, this could lead to a complete overhaul of our monetary policy and FX market outlook. Our alternative scenario, which is becoming increasingly likely, is that the base rate will remain at 6.50% in 2026, with the forint hovering in the 380-400 range to the euro. Investors' long HUF bias could be supported by a credible fiscal policy that uses all the room given by investors and rating agencies, but no more. In this regard, we estimate this year's fiscal deficit to be 4.6% of GDP, and next year's to be 4.5%. The additional financing required could be covered by EU SAFE funds, and we can envisage some adjustments to the retail bond market too.

### **Romania: Growth stalls amid fiscal and inflationary pressures**

On the growth front, the situation is yet to improve at this stage. Detailed GDP figures for the second quarter reaffirm that Romania's economy is essentially flatlining. Year-on-year growth stood at just 0.3%, matching the weak pace of the first quarter and leaving first-half 2025 growth at a mere 0.3%. The slowdown in consumption is becoming more visible, but at the same time, it also helps to partly offset the large trade imbalances.

In the near term, public investment financed by EU funds should become the economy's primary engine, which should sustain activity in the construction sector and help prevent a deeper downturn. On the fiscal front, the deficit is expected to remain elevated this year, likely above 7.5%, and only diminish more substantially next year when the recently adopted measures will bring the desired impact.

Looking at inflation, we think that the recently implemented VAT and excise duty hikes will push up price pressures close to 10% in the coming months, before base effects kick in around next summer and bring inflation closer to the 4-5% area by the end of 2026. Given the pressures on growth and the likely temporary nature of this inflationary episode, we don't see any rate hikes from the National Bank of Romania, and our current base case is for a rate cut in May 2026 and further support to the economy from there onwards.

## CIS-4: fundamentals and sentiment remain largely positive

### Dmitry Dolgin

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CIS-4 economies remain resilient amid global headwinds. Armenia and Azerbaijan benefit from expected easing in regional foreign policy risks, while Kazakhstan and Uzbekistan enjoy above-expected growth in activity. Monetary policy easing is paused everywhere except Azerbaijan, as inflation risks persist



Azerbaijani President Ilham Aliyev, left, and Armenia's Nikol Pashinyan sign peace agreement in front of US President Donald Trump

### Armenia: peace process remains key

Armenia's economy is normalising after the 2023-24 surge, with first half 2025 GDP growth at 5.6% year-on-year. However, growth is gradually decelerating despite robust lending and a widening fiscal deficit (4.0% of GDP as of mid-2025), highlighting underlying fragility. The central bank has held the policy rate at 6.75% since February as CPI remains above the 3% target and is trending higher, even with a strong dram.

The peace declaration with Azerbaijan could become a major positive for sentiment, but its economic impact depends on implementation. Optimism around the peace process may unlock investment inflows and support the dram, but fundamentals point to vulnerability: the 12-month rolling trade deficit is around 15% of GDP as of mid-year, while net remittances have dropped below 5% of GDP.

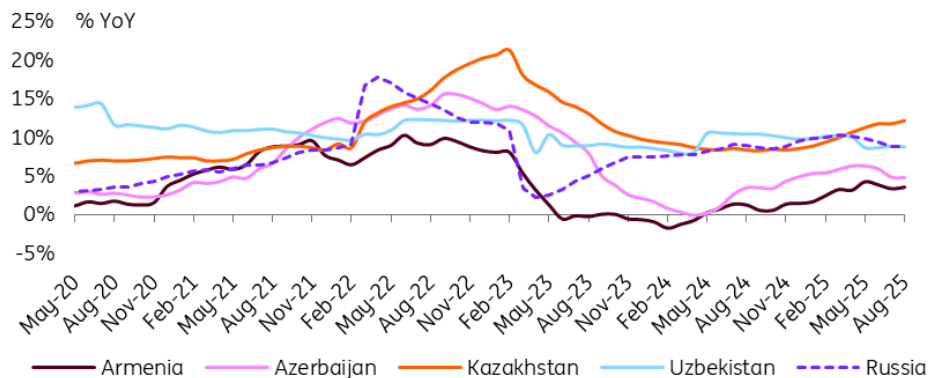
### Azerbaijan: focus on a shrinking trade balance

Azerbaijan's economy is under pressure in 2025, with GDP dropping by 2.3% in July after showing a modest 1.5% YoY increase between January and June, as momentum weakens after a strong 2024 despite a supportive fiscal and credit stance. The budget surplus narrowed to 2.6% of GDP, while retail lending remains high. The central bank cut its policy rate to 7.00% in July and maintained it in September, focusing recent communication on FX market flows.

The manat remains pegged at 1.70/USD and is expected to hold throughout 2025. Moody's upgraded Azerbaijan to investment grade in July, citing improved buffers and normalised Armenian relations. However, the shrinking trade surplus (\$1.8bn vs \$5.5bn in 2024) is a key risk if oil prices remain weak.

**CPI risks persist in the region, especially in Kazakhstan**

CPI growth by country (% YoY)



Source: CEIC, national sources, media, ING

**Kazakhstan: activity and inflation are looking up**

Kazakhstan’s economy is outperforming, with GDP growth accelerating to 6.2% YoY in the first half of 2025, led by construction and domestic trade. However, inflation is rising sharply, reaching 12.2% YoY in August from 8.6% at the end of 2024. The central bank kept the base rate at 16.5% in August but signalled a higher likelihood of a rate hike due to persistent demand-driven pressures, recent tenge weakness, higher tariffs, and a planned VAT hike in 2026. Fiscal consolidation credibility remains a key watch factor.

The tenge has stabilised after summer weakness, with expected government FX sales in September providing near-term support. Still, a widening current account deficit (\$2.8bn in the second quarter) and increased net capital outflows pose medium-term risks.

**Uzbekistan: keeps benefitting from global uncertainties**

Uzbekistan remains the region’s growth leader, with GDP growth rising to 7.5% YoY in the second quarter, driven by robust domestic demand and strong exports. However, it is uncertain if this momentum will persist in the second half of the year. Inflation stayed elevated at 8.8% YoY in August but appears manageable for now, helped by recent gold-driven appreciation of the soum and ongoing fiscal consolidation efforts.

The central bank has held the refinancing rate at 14.00% since March. Upcoming policy decisions will weigh on whether to hold versus cut rates, with much depending on how quickly inflation trends toward the long-term 5% target – a goal that still looks distant given current dynamics and persistent price pressures.

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# FX: Pressure builds on the dollar

**'Treading water' is probably the best term to describe dollar price action this summer. However, that soon may be replaced with 'that sinking feeling' as the restart of the Fed easing cycle triggers another wave of dollar hedging activity**



The Fed story looks set to drag the dollar lower into year-end. Pictured: Chair Jerome Powell

## The Fed should be a dominant factor

Somewhat surprisingly, the dollar has not sold off much further this summer. In fact, it has not gone far at all. But don't confuse some temporary stability with emerging strength. Certainly, the Fed story looks set to drag the dollar lower into year-end.

The question, however, will be: what kind of dollar decline will we see? Will it be a benign decline that keeps risk assets bid as the Fed credibly cuts rates back to neutral (3.00/3.25%) while avoiding a recession? Or will it be a more precarious descent driven by increased political pressure on the Fed as the White House seeks to secure 'a majority' on the board of what should be an independent Federal Reserve? We expect the former, while being alert to the latter.

Either way, we expect to hear a lot more about the potential for negative US real rates into year-end as the Fed shifts policy back to neutral and potentially even into accommodative territory.

And the big rallies in gold and digital assets serve as a reminder that the dollar will be vulnerable to a pick-up in inflation at a time when the Fed's inflation-fighting powers are being questioned. We suspect we might hear as much about 'negative real rates' over the coming months as we have heard about 'fiscal dominance' this summer – the latter being the threat that the Fed will have to cut rates to service increasingly shorter durations of US government debt.

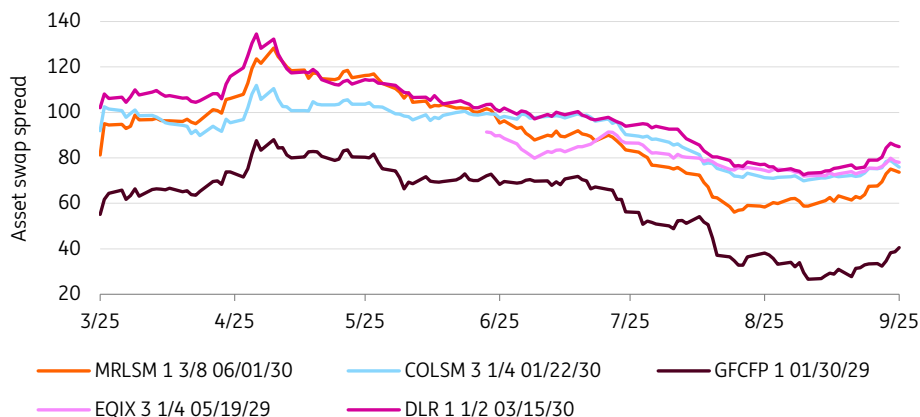
## 1.20 remains the EUR/USD target

Lower US rates will make it cheaper to hedge dollar assets. From around 2.2% per annum today, it looks like three-month dollar hedging costs for a euro area investor will drop to around the 1.00% area over the next six to nine months. That is generally consistent with a higher EUR/USD and returns to that theme which hit the dollar in the

second quarter – namely, investors in US assets raising hedge ratios without necessarily selling the underlying asset.

The fact that the European Central Bank has likely finished easing now supports the above theme, and we expect EUR/USD to gain upside momentum in the November/December window – seasonally a weak period for the dollar.

**Dollar hedging costs look set to cheapen**



Source: Refinitiv, ING

We also remain bearish on USD/JPY, but will take close note of the direction of Japanese government policy. A more fiscally expansionist prime minister who leans on the Bank of Japan to go slow with policy normalisation could delay our forecast drop for USD/JPY to 140. However, the upside for USD/JPY should be relatively limited. The pair trades well above where short-term interest rate differentials suggest it should be trading. And we suspect both Tokyo and Washington will not want it to trade too much over 150, which would be at odds with Washington’s plan for a smaller Japanese trade surplus.

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# A US rate cut vs a French affair

A lot is going on. In the eurozone, it's all about spreads, particularly French ones. It comes against an underpinning of mild upward pressure on longer core rates, but without much conviction, partly because there is rate-cut fever at play in the US. We could see long US rates dip down into the cut period and subsequently back up again as inflation bites back



## We expect the US 10yr to have a go at gapping lower, but should rebound in subsequent months

The US 10yr yield, now in the 4.1% area, fell to 3.6% when the Federal Reserve commenced its rate-cutting cycle a year ago. Back then, the Fed cut by 50bp as a start and subsequently delivered a further two consecutive 25bp cuts. That 100bp rate-cutting cycle coincided with a remarkable rise in the 10yr yield, from 3.6% all the way up to 4.8%. During the pause phase since then, the 10yr yield has managed to trade around the middle of that range (the 4.25% area, give or take 20bp). It's now shaping up to make a break below 4%, and if it's going to do that, it's most likely in the next week or two. The bond market has rate cutting as a driver, and the first cut of any cycle is always a big event for bonds, typically right out the curve.

That said, we doubt that longer tenor bond yields can simply sail structurally lower from here. One constraint is the inflation readings in the coming months, which are very liable to show an accelerated tariff impact. We anticipate that US inflation, currently at around 3%, rises to the 3.5% area in the third quarter and into the fourth quarter. The 10yr SOFR rate is currently at 3.55% and is liable to find some discomfort should inflation hit that level, resulting in an implied 0% 10yr real rate. While it's true that tariffs are more likely to drive up prices than cause structural inflation, this assumption still needs to be proven.

Also, note that the market is anticipating that the funds rate will fall to the 3% area (maybe a tad below). That sets something of a floor for 10yr SOFR, and really it should not get anywhere near that floor. Right now, there is a degree of rate-cut fever at play that is liable to sustain downward pressure on longer-tenor yields. But we see a limit to that, especially given the inflation dynamic expected in the immediate few months. So a reversal higher is likely, similar to last time. See more [here](#). At the extreme, we can see the 10yr yield bottom ahead at 3.75% before reverting up towards 4.5% over the next few months. SOFR will do similar.

**Eurozone rates are proving resilient, although spreads are showing more movement. Still eyeing upside (for both)**

The eurozone rates story is all about spreads right now, as the French 10yr now sits broadly flat to Italy, and quietly the German yield curve has separated itself from the rest as its debt dynamics revert to its typical solid footing (as has the Dutch curve, and debt dynamics). At the same time, even the German curve continues to sit above the ultra-risk free curve in the guise of Ester (reflecting the German deficit prognosis). We maintain the view that eurozone rates are more prone to edge higher from here than lower, at least on a multi-month view.

The prognosis of elevated fiscal deficits is an important element across the eurozone, and the need (and indeed, promise) for more spending on defence pushes in the same direction. The German 10yr is now at 2.65%. We maintain a multi-month tendency for that to edge in the direction of 3%, reflecting some of these issues. But also reflecting the fact that the eurozone is no Switzerland, in fact thankfully (from a rates perspective), as negative rates or the threat thereof is not where we want to be heading to.

We view the eurozone core rates space as spanning 2% on the front end (Ester / Euribor) to 3% on the 10yr (Germany / Euribor), and above that for longer tenors. Factors that can push the German 10yr yield lower in the more immediate future are twofold, 1. Fallout of any gap lower in the 10yr Treasury yield, and 2. Residual flight to safety should the French story get nasty (probably won't, but needs to be watched).

**GDP forecasts**

Developed markets, QoQ% annualised (avg)										
	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F	4Q26F	2025F	2026F	2027F
US	3.3	1.5	1.0	1.1	1.9	2.1	2.3	1.8	1.6	2.2
Japan	2.2	-1.2	0.4	1.2	0.8	1.2	1.2	1.1	0.7	0.9
Germany	-1.1	0.0	0.6	1.0	1.4	1.6	1.9	0.2	0.9	1.9
France	-0.2	0.4	0.8	0.8	1.2	1.2	1.2	0.4	0.8	0.0
UK	1.4	0.9	0.6	1.2	1.1	1.1	1.1	1.3	1.0	1.0
Italy	-0.3	0.3	0.6	0.8	0.8	1.3	0.9	0.5	0.7	0.9
Canada	-1.6	0.0	-0.8	0.4	1.8	2.3	2.5	1.0	0.6	2.2
Australia	1.6	1.8	1.8	2.1	2.2	2.3	2.4	1.6	2.3	2.5
Eurozone	0.5	0.7	0.6	1.2	1.5	1.9	2.0	1.3	1.2	1.6
Austria	1.2	0.6	1.2	1.4	1.4	1.6	2.0	0.3	1.3	1.8
Spain	3.0	2.5	2.5	2.2	1.8	2.0	2.0	2.7	2.2	2.2
Netherlands	0.4	0.3	0.7	1.5	1.5	1.7	2.0	1.4	1.2	1.8
Belgium	0.7	0.8	0.8	1.2	0.8	1.2	1.6	1.0	1.0	1.4
Greece	2.3	2.0	2.6	0.2	2.4	2.4	2.3	1.9	1.7	2.1
Portugal	2.3	2.2	2.2	2.0	2.0	2.5	2.5	1.7	2.2	2.2
Switzerland	-0.4	0.0	0.8	1.2	1.6	2.0	1.6	1.1	1.1	-
Sweden	0.0	0.8	0.8	1.1	1.4	1.4	1.4	0.6	1.1	1.4

Emerging Markets, (YoY% growth)										
	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F	4Q26F	2025F	2026F	2027F
Bulgaria	2.4	2.3	2.4	2.4	2.3	2.4	2.3	2.8	2.3	2.5
Croatia	2.4	2.8	2.1	2.1	1.8	2.4	2.8	3.0	2.2	1.7
Czech Republic	2.3	2.3	2.6	2.7	2.8	2.3	2.3	2.5	2.6	2.6
Hungary	1.6	2.5	2.4	2.5	2.6	1.6	2.5	0.7	2.5	2.8
Poland	3.6	3.9	3.0	3.0	3.6	3.6	3.9	3.5	3.4	3.0
Romania	0.0	0.6	0.0	1.7	2.8	0.0	0.6	0.3	1.4	2.8
Turkey	3.2	3.3	3.5	4.3	4.6	3.2	3.3	3.3	4.0	4.5
Serbia	3.4	4.5	4.4	4.1	3.8	3.4	4.5	3.0	4.2	3.8
Azerbaijan	4.5	3.5	3.0	2.5	1.0	4.5	3.5	2.3	2.5	2.0
Kazakhstan	3.5	4.0	3.5	4.5	5.0	3.5	4.0	5.2	4.3	4.0
Russia	0.8	1.0	1.0	0.5	-0.5	0.8	1.0	1.2	0.5	0.8
Ukraine	4.5	4.6	4.3	4.0	4.0	4.5	4.6	3.3	4.3	-
China	4.3	4.5	4.5	4.5	4.4	4.3	4.5	4.9	4.5	4.4
India	6.2	6.0	6.2	6.4	6.4	6.2	6.0	7.0	6.3	6.5
Indonesia	4.7	4.8	4.9	5.0	5.0	4.7	4.8	4.8	4.9	5.0
Korea	2.3	2.7	2.2	1.3	1.1	2.3	2.7	1.2	1.8	1.7
Philippines	5.3	5.7	5.7	5.9	5.9	5.3	5.7	5.5	5.8	6.0
Singapore	0.0	1.0	1.5	2.0	2.0	0.0	1.0	2.3	1.6	1.8
Taiwan	3.9	3.8	0.5	2.3	3.7	3.9	3.8	5.7	2.6	2.9

Norway: Forecasts are mainland GDP  
 Source: ING estimates

**CPI Forecasts (pa)**

YoY% (avg)	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F	4Q26F	2025F	2026F	2027F
US	2.5	2.9	3.3	3.0	3.0	2.7	2.1	2.8	2.7	2.0
Japan	3.4	2.9	2.5	1.6	1.7	1.8	1.7	3.1	1.7	2.1
Germany	2.1	2.1	2.0	1.9	2.2	2.3	2.4	2.2	2.2	2.2
France	1.0	1.4	1.7	1.7	1.5	1.6	2.0	1.3	1.7	0.0
UK	3.5	3.9	3.6	3.2	2.6	2.7	2.8	3.5	2.8	2.4
Italy	1.8	1.7	1.7	1.7	1.8	2.1	2.1	1.8	1.9	2.1
Canada	1.8	2.2	2.7	2.5	1.9	1.6	1.6	2.2	1.9	1.9
Australia	2.0	2.4	2.8	2.8	2.7	2.5	2.4	2.4	2.6	2.8
Eurozone	2.0	2.1	1.8	1.8	1.9	2.0	2.1	2.1	2.0	2.3
Austria	3.2	3.5	2.6	2.1	2.1	2.2	2.2	3.2	2.2	2.1
Spain	2.2	2.7	2.4	2.2	2.2	2.3	2.4	2.5	2.2	2.2
Netherlands	3.3	2.5	2.2	2.0	2.0	2.0	2.1	2.8	2.0	2.6
Belgium	2.4	1.9	2.0	1.6	1.9	2.3	2.1	2.4	2.0	2.2
Greece	3.2	3.9	3.6	3.5	3.1	2.3	2.2	3.4	2.8	2.2
Portugal	2.0	2.3	2.0	2.1	2.2	2.2	2.3	2.0	2.2	2.0
Switzerland	-0.1	0.1	0.5	0.6	0.6	0.7	0.8	0.2	0.7	-
Sweden	2.3	2.8	2.6	1.6	2.0	2.0	1.9	2.5	2.0	2.0
Bulgaria	3.9	5.6	5.7	3.6	4.3	2.8	2.9	4.8	3.4	3.7
Croatia	3.4	4.3	4.0	3.6	4.4	3.7	4.0	3.8	4.0	4.5
Czech Republic	2.4	2.6	2.8	2.5	2.6	2.3	2.4	2.6	2.5	2.7
Hungary	4.4	4.3	4.6	3.4	4.3	4.5	4.5	4.6	4.2	3.7
Poland	4.1	3.0	2.7	2.5	2.7	2.3	2.5	3.7	2.5	2.3
Romania	5.3	9.2	9.7	9.1	9.4	5.1	4.5	7.3	7.0	4.4
Turkey	35.0	31.4	30.0	25.9	22.8	21.0	19.7	34.4	22.8	17.4
Serbia	3.9	4.0	3.6	3.6	3.9	3.5	3.6	4.1	3.6	3.9
Azerbaijan	6.2	4.9	5.2	5.0	5.3	5.3	5.7	5.5	5.3	8.9
Kazakhstan	11.3	12.2	13.0	14.8	13.8	12.3	11.0	11.5	12.9	6.7
Russia	9.8	8.4	7.1	5.9	5.4	5.2	5.0	8.9	5.4	4.6
Ukraine	14.0	12.0	8.4	7.0	6.7	6.5	6.3	12.0	6.6	-
China	0.0	-0.2	-0.1	0.6	0.3	1.0	2.3	-0.1	1.1	1.6
India	2.7	1.8	2.5	4.2	4.5	4.7	4.4	2.7	4.5	5.0
Indonesia	1.8	2.2	2.5	2.3	2.3	2.5	2.5	1.8	2.4	2.5
Korea	2.1	1.9	2.2	1.7	1.8	2.0	1.9	2.1	1.8	1.9
Philippines	1.4	1.5	2.0	2.5	3.0	3.5	3.0	1.8	3.0	3.0
Singapore	0.8	0.6	0.6	1.0	1.2	1.3	1.5	0.8	1.3	2.0
Taiwan	1.8	1.5	1.4	1.0	1.4	1.4	1.5	1.7	1.3	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 forecasts (avg)**

	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F	4Q26F	2025F	2026F	2027F
Brent (\$/bbl)	67	62	58	56	58	54	68	57	62
Dutch TTF (EUR/MWh)	33	37	37	30	30	34	38	33	26

Source: ING estimates

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