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THINK Economic and Financial Analysis

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An inconvenient truth for central banks

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An inconvenient truth for central banks

The recent surge in long-term interest rates in both the US and the eurozone illustrates an inconvenient truth for central bankers: as soon as financial markets start believing that rate cuts aren't coming anytime soon, market movements could push economies and policy rates in very unpleasant directions.

Longer-term interest rates are key now

It takes a while before higher policy interest rates find their way into the real economy. Some central bankers have openly discussed that this time around, the transmission of monetary policy is faster and stronger than in the past. This, however, does not diminish the evidence that longer-term interest rates have an even stronger impact on the economy than policy interest rates. According to standard models, at least in the eurozone, an increase in longer-term interest rates has a four times stronger impact on growth than a similar-sized policy rate hike.

Therefore, looking at interest rate movements in both the US and the eurozone explains why the negative impact of central banks' actions has so far been limited. In the eurozone, 450bp ECB rate hikes only pushed up 10-year German bund yields by 150bp, at least until the September ECB meeting. In the US, the Fed hiked interest rates by 525bp, pushing up 10-year US bond yields by 250bp, again until the Fed's September meeting.

Over the last two weeks, bond yields in the eurozone and the US surged by some 50bp. If standard econometric models are still of any guidance, the recent surge in bond yields alone should already have the same impact on economic activity as half of the policy rate hikes so far.

There are several reasons for the latest surge in bond yields. Just think of the recent increase in oil prices and fears that inflation might be stickier than hoped. But think also of renewed debt sustainability issues in both the US and the eurozone. Finally, the enormous efforts by central bankers to convey the message that rates will be high for a long while and a potentially earlier unwinding of the ECB's asset purchases have also played a role.

At first glance, central bankers should be happy looking at their screens as far as market interest rates are concerned. Financial markets are finally waking up to the scenario of 'higher for longer'.

In our base case scenario, it is still a 'high' and not 'higher' for longer, as we expect at least the Fed and the European Central Bank to have already reached peak policy rates. However, just judging from official comments, the risk of further additional rate hikes remains high. Admittedly, this is not the forward-looking type of central banking that students are taught at university.

Looking more closely, however, central bankers should be more concerned that financial markets are finally getting familiar with the 'high for longer' scenario. The increase in longer-term interest rates has the potential to push both the US and the eurozone economies not only into recession but also to break something somewhere. The irony of such a scenario would be that the more financial markets believe in 'high for longer', the higher the chances are that central banks will actually cut rates.

It's a very inconvenient truth for central bankers.

Our key calls this month:

- **Oil:** The market saw significant strength over the third quarter, with the market set to remain in a deep deficit until the end of the year. This tightness suggests we could see more upside, but we believe any move above $100/bbl will be short-lived
- **United States:** The US economy has performed strongly, with the Federal Reserve and financial markets both re-evaluating the likely path for interest rates. But sharply higher borrowing costs will increase financial stresses in the economy and mean recession fears will linger. A possible government shutdown in November adds an extra reason for the Fed to proceed cautiously later this year. Expect the first Fed cuts in the spring.
- **Eurozone:** While a full-blown recession might still be averted, 2024 growth is likely to be lower than this year. Inflation is declining slowly, but with the European Central Bank taking no risks, a first rate cut is unlikely before the third quarter of 2024.
- **China:** While China's economy is still struggling, it is at least not getting incrementally worse and there are some pockets of improvement. The government remains focused on targeted market support rather than a one-size-fits-all fiscal boost.
- **United Kingdom:** Investors have significantly reappraised the Bank of England outlook over recent weeks, and we think rate hikes have now finished. Rate cuts are likely to be a story for next summer.
- **Central and Eastern Europe:** Inflation continues to fall rapidly in the CEE region, while economic numbers are surprising on the negative side. At the same time, we see signs of a turnaround in the third quarter in some countries. Monetary policy is moving toward rate cuts, while fiscal policy tries in vain to tighten.
- **FX:** Resilient US growth, a hawkish Federal Reserve, and misfiring overseas economies are driving the dollar higher for a third straight month. We are deferring our call for a dollar sell-off this year, but three-quarters of negative US growth and 200bp of Fed easing should finally deliver a dollar reversal.
- **Market rates:** The US 10-year has got 5% on its mind, while the 10-year Bund yield is knocking on the door of 3%, and can stretch towards 3.25%. The 10-year Euribor rate at around 3.5% still maps a negative real yield when measured against the latest inflation print. Enough there for market rates to continue to test higher.

Watch: The 'inconvenient truth' for central banks

Are central bankers bluffing when they say interest rates could go higher still? The markets seem to think so. And if that's the case, there could be some nasty surprises around the corner.

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ING global forecasts

	2023					2024					2025				
	1Q23	2Q23	3Q23	4Q23	FY	1Q24	2Q24	3Q24	4Q24	FY	1Q25	2Q25	3Q25	4Q25	FY
United States															
GDP (% QoQ, ann)	2.2	2.1	3.7	1.6	2.2	-0.9	-2.5	-0.2	1.3	0.2	1.6	1.9	2.2	2.1	1.2
CPI headline (% YoY)	5.8	4.1	3.5	3.7	4.3	3.2	2.9	2.4	1.7	2.6	1.9	2.0	2.2	2.3	2.1
Federal funds (%, eop)	5.00	5.25	5.50	5.50	5.50	5.25	4.50	4.00	3.50	3.50	3.00	3.00	3.00	3.00	3.00
3-month interest rate (%, eop)	4.90	5.20	5.40	5.40	5.40	5.20	4.40	3.90	3.40	3.40	3.00	3.00	3.00	3.00	3.00
10-year interest rate (%, eop)	3.50	3.80	4.60	4.70	4.70	4.25	3.50	3.00	3.25	3.25	3.25	3.50	3.75	3.75	3.75
Fiscal balance (% of GDP)					-6.1					-6.3					-5.7
Gross public debt / GDP					97.2					100.8					103.1
Eurozone															
GDP (% QoQ, ann)	0.2	0.5	0.2	-0.1	0.5	0.1	0.6	1.2	1.1	0.4	1.4	1.5	1.3	1.3	1.3
CPI headline (% YoY)	8.0	6.9	5.0	3.7	5.9	3.4	3.3	3.0	2.4	3.0	1.9	2.0	2.1	2.1	2.0
Refi minimum bid rate (%, eop)	3.50	4.00	4.50	4.50	4.50	4.50	4.50	4.25	3.75	3.75	3.50	3.25	3.25	3.25	3.25
3-month interest rate (%, eop)	3.00	3.60	4.00	4.00	4.00	3.90	3.90	3.75	3.25	3.25	3.00	2.90	2.90	2.90	2.90
10-year interest rate (%, eop)	2.30	2.40	2.80	2.70	2.70	2.70	2.60	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.00
Fiscal balance (% of GDP)					-3.9					-2.9					-2.6
Gross public debt/GDP					91.8					90					89.7
Japan															
GDP (% QoQ, ann)	3.2	4.8	0.4	0.8	2.0	0.4	1.2	1.2	1.2	1.0	1.2	1.2	1.2	1.2	1.2
CPI headline (% YoY)	3.6	3.3	3.2	2.7	3.2	2.6	2.4	2.2	2.0	2.3	1.9	1.7	1.4	1.3	1.6
Interest rate on excess reserves (%)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25
3-month interest rate (%, eop)	0.00	0.05	0.08	0.08	0.08	0.10	0.10	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.30
10-year interest rate (%, eop)	0.35	0.40	0.70	0.80	0.80	0.80	0.80	0.90	0.90	0.90	1.00	1.00	1.00	1.00	1.00
Fiscal balance (% of GDP)					-8					-7					-5
Gross public debt/GDP					260.0					275.0					280.0
China															
GDP (% YoY)	4.5	6.3	4.1	3.1	4.5	4.2	4.2	5.1	6.1	4.2	5.8	5	4.1	5.20	5.2
CPI headline (% YoY)	1.3	0.1	0.0	0.7	0.5	0.8	1.4	1.5	1.5	1.3	1.6	1.7	1.8	1.9	1.8
PBOC 7-day reverse repo rate (% eop)	2.00	1.90	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.90	2.00	2.00	2.00	2.00
3M SHIBOR (% eop)	2.45	2.17	2.30	2.10	2.10	2.10	2.10	2.15	2.20	2.25	2.25	2.25	2.30	2.30	2.30
10-year T-bond yield (%, eop)	2.86	2.65	2.50	2.40	2.40	2.40	2.40	2.65	2.80	2.80	3.00	3.00	3.00	3.00	3.00
Fiscal balance (% of GDP)					-8.0					-6					-4
Public debt (% of GDP), incl. local govt.					131					132					129
UK															
GDP (% QoQ, ann)	1.3	0.8	-0.9	0.5	0.5	0.3	0.4	1.0	1.1	0.4	1.3	1.3	1.3	1.3	1.2
CPI headline (% YoY)	10.2	8.4	6.7	4.8	7.5	3.8	2.1	2.2	1.7	2.5	1.9	1.6	1.7	1.9	1.8
BoE official bank rate (%, eop)	4.25	5.00	5.25	5.25	5.25	5.25	5.25	4.75	4.25	4.25	3.75	3.25	3.25	3.25	3.25
3-month interest rate (%, eop)	4.40	5.40	5.40	5.25	5.25	5.25	5.05	4.65	4.15	4.15	3.60	3.20	3.20	3.20	3.20
10-year interest rate (%, eop)	3.50	4.45	4.50	4.45	4.45	4.25	3.75	3.50	3.70	3.70	3.70	4.00	4.15	4.15	4.15
Fiscal balance (% of GDP)					5.0					3.0					2.5
Gross public debt/GDP					103.0					102.0					99.0
EUR/USD (eop)	1.08	1.08	1.06	1.06	1.06	1.08	1.12	1.15	1.16	1.16	1.15	1.14	1.13	1.12	1.15
USD/JPY (eop)	133	145	149	148	148	140	135	130	125	125	125	125	125	125	125
USD/CNY (eop)	6.87	7.24	7.30	7.30	7.30	7.25	7.10	7.00	6.80	6.80	6.60	6.60	6.60	6.60	6.60
EUR/GBP (eop)	0.88	0.87	0.87	0.87	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
ICE Brent -US$/bbl (average)	82	78	86	92	85	85	87	93	96	90	84	80	80	77	80
Dutch TTF - EUR/MWh (average)	53	35	34	50	43	55	44	40	45	46	50	40	30	40	40

Source: ING forecasts

Key risks to the global outlook

Chinese real estate concerns, a ramping up of the ECB's quantitative tightening, and fresh instability in US commercial property and regional banks all pose risks to our current base case

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Ongoing concerns about China's property market are a potential curveball for the global economy

Risk of a China systemic banking crisis stemming from the property development company problems

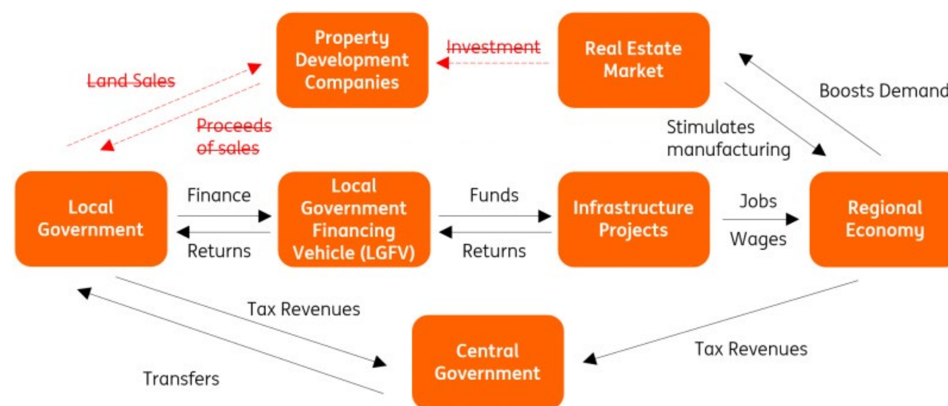
A lack of transparency and a convoluted financing system have raised fears that the problems of China's property development companies and the spillover to local government financing vehicles (LGFVs) could result in banking failures. We think the risk of a systemic crisis is low.

LGFVs developed out of the limitations of tax revenue raising for local governments and have been a way for local governments to boost expenditure on infrastructure and invigorate the local economy.

Local governments are usually the sole or dominant shareholders of the LGFV, which issues debt that may be bought by banks and other financial institutions to pay for these projects – say, social housing or roads and bridges. The returns on these infrastructure projects are frequently insufficient to meet the debt service costs and repayment of loans, and so local government land sales to property development companies have traditionally made up the shortfall.

This process has led to a substantial build-up of LGFV debt and, in turn, bank exposure to such debt. The scale of LGFV debt is now about CNY 55 trillion, according to PIMCO estimates. Banks are on the hook for about 60% of that, which accounts for about 15% of total loans. Smaller regional banks are the most exposed.

Property market issues have reduced ability of local governments to sell land and fund LGFVs



Source: ING

Clearly, the problems of the property sector cut this financing loop, raising the risk of LGFV default. However, while individual defaults cannot be ruled out – and some have already occurred – we consider the risks of a systemic banking crisis to be low. The central government and the People's Bank of China (PBoC) are both committed to preventing a systemic crisis. The playbook for local governments that have run into difficulties with LGFV debt so far is debt restructuring. This will of course squeeze the returns that banks expected on their exposure to this sector and lower their profitability. As a result, some banks may need to raise capital to make up for any losses.

Meanwhile, the government is keeping the property development sector on life support through targeted assistance measures. These are being implemented alongside considerable supply-side improvements in order to help the functioning of the real estate market more generally and allow local governments to issue other 'special' bonds to pay outstanding liabilities more cheaply than LGFV debt. Consequently, while the real estate market is hardly thriving, massive failure has largely been avoided. Companies like Evergrande are being quietly absorbed or broken up rather than being allowed to fail spectacularly with the ensuing collateral damage that this would imply.

As a result, financing difficulties are likely to be spread out over multiple years – this limits the risk of a systemic crisis but suggests that an extended period of adjustment and possibly constrained credit extension as well as weaker economic growth looks likely.

ECB quantitative tightening risks brining back debt sustainability concerns

There seems to be a growing view within the European Central Bank (ECB) that in order to get inflation further under control, policy rate hikes might not be sufficient. In fact, the risk of worsening the current stagnation in the eurozone with additional rate hikes is high. In times of inverted yield curves, the ECB's focus is likely to shift to non-interest rate tools again. Based on official comments since the September ECB meeting, an earlier end to reinvestments under the Pandemic Emergency Purchase Programme (PEPP) than the current "end of 2024" has become more likely.

The risk associated with an earlier end of the PEPP reinvestments is an unwarranted widening of spreads, particularly during a time when fiscal policies in the eurozone will turn more restrictive and the entire fiscal framework – the Stability and Growth Pact – is still subject to revisions. Consequently, an earlier unwinding of PEPP would return financial markets' focus back to debt sustainability issues in the eurozone. The monetary union is clearly more solid and better prepared than in 2010 to weather a new sovereign debt crisis. However, as long as inflation remains above target, the ECB will not be able to perform the role of unconditional lender of last resort. Instead of whatever it takes,

the ECB will only be able to offer its Transmission Protection Instrument. No single crisis ever repeats identically, but an earlier unwinding of the PEPP reinvestments clearly bears the potential to bring back debt sustainability tensions.

US commercial real estate remains a financial stability and economic risk

The plethora of risks to the US economy is highlighted by the wide range of views on where the Fed funds policy rate will end in 2024. On the positive side, we find that the Federal Reserve and a handful of other banks see little scope for any monetary policy easing in 2024. A tight labour market and a US consumer that has, so far, shown little inclination to slow the pace of spending could keep inflation higher for longer, especially if unions continue to extract inflation-busting wage agreements. This sets a benchmark for broader pay deals.

On the other end of the spectrum, there are several prominent banks that see interest rates being slashed through the coming year. Here, the sense is that, after the most rapid and aggressive series of interest rate increases for forty years and banks rapidly tightening their lending standards, something will eventually “break”. We are seeing delinquencies on credit cards and auto loans picking up rapidly, but most concerns centre on the commercial real estate sector. With around $1.8 trillion of commercial real estate debt needing to be re-financed over the next 18 months at a time when office occupancy and business travel remain down from pre-pandemic levels, there is a sense that owners could increasingly hand the keys over to the banks. Refurbishment and higher borrowing costs may mean that it simply isn’t worth holding onto the property, and with valuations coming under significant downward pressure, this could impact the balance sheet of banks.

Given that small and regional banks which account for around 70% of lending to CRE still remain stressed, such a situation could see confidence deteriorate with more deposit flight, thus creating instability in the financial system. Lending conditions would tighten across the economy, threatening to choke off credit flow to broad swathes of the economy. The Fed would inevitably respond with interest rate cuts likely being rapidly priced in by financial markets.

Oil prices to remain well supported

The oil market saw significant strength over the third quarter, with the market set to remain in a deep deficit until the end of the year. This tightness suggests we could see more upside, but we believe any move above $100/bbl will be short-lived

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Global oil prices continue to be well-supported

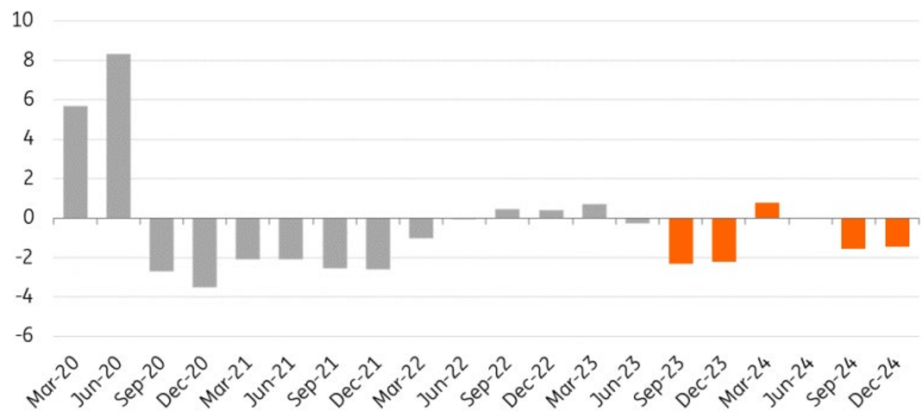
Deep deficit for the remainder of the year

ICE Brent has had its best quarterly performance since the first quarter of 2022, up more than 31% over the third quarter of this year. This is on the back of a deficit environment, which is expected to remain until the end of this year. Following Saudi Arabia and Russia extending voluntary supply cuts through year-end, our balance shows that the oil market will see a deficit of more than 2MMbbls/d in the final quarter of 2023.

A tight market for the rest of the year suggests that prices should remain well-supported for the remainder of 2023. Our forecast for Brent remains unchanged and we expect it to average US$92/bbl over the fourth quarter of the year.

We do expect some of this tightness to ease in in the early part of next year, with the market returning to a small surplus over the first quarter of 2024. This is driven by Saudi Arabia's voluntary additional cuts coming to an end, along with the seasonally weaker demand that we usually see over the first quarter. The looser balance early next year suggests we could see a pullback in prices towards the end of 2023 and moving into 2024. However, we believe any pullback will be relatively short-lived as the market starts to tighten once again from the second quarter, and with growing deficits over the second half of next year. Our 2024 Brent forecast remains unchanged at US$90/bbl.

Global oil balance remains tight (MMbbls/d)



Source: ING Research, IEA, EIA, OPEC

$100 oil likely not sustainable

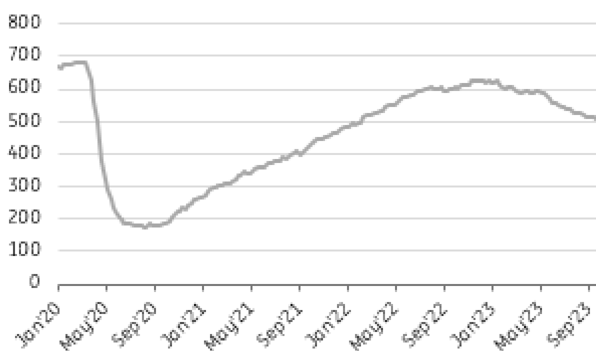
In addition, OPEC+ will likely come under increased political pressure to bring more supply back into the market if prices move much higher. There are elections in two key oil-consuming nations next year – the US and India – and these governments will likely want to minimise any potential inflationary pressures. However, there is no guarantee that OPEC+ or the Saudis will listen to any calls to increase supply. It will become increasingly difficult for OPEC+ to state that they aim for stability in markets when there is a large deficit, prices are moving towards $100/bbl, and the group is holding a sizeable amount of supply from the market.

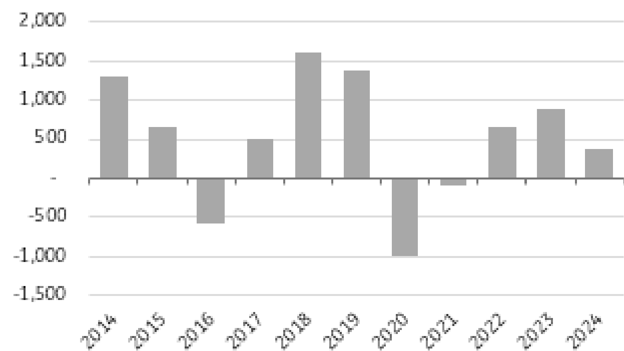
OPEC+ has a strong grip on the market

It has become very apparent that OPEC+ has full control over the oil market. It has taken a while, but the group has managed to push prices higher. Limited non-OPEC+ supply growth – specifically from the US – has given OPEC+ the confidence to cut supply and push prices higher without the risk of losing a significant amount of market share.

In order for OPEC+'s grip to loosen, we would likely have to see a resurgence in US oil supply growth. This is unlikely to be anytime soon, with US drilling activity having slowed significantly this year. The number of active oil rigs has fallen by 119 so far this year to 502, the lowest level since February last year. While US crude supply is set to hit record levels in 2024, the growth rates are expected to be very modest. If oil prices remain elevated, there is always the potential that US industry will start to relax the capital discipline it has shown in recent years – which would eventually translate into increased activity. However, up until now, we've seen few signs of this.

Modest US supply growth gives OPEC+ growing control of the market





Source: EIA, Baker Hughes, ING Research

Surging oil prices: a new concern for central banks

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Life for central banks has become even more complicated as surging oil prices add to the trilemma of how to balance slowing economies, the delayed impact of the rate hikes so far and still too-high inflation

Oil prices are currently up by more than 25% this quarter

Surging oil prices have become the new concern for central banks, aggravating the current trilemma: how to balance slowing economies, still too-high inflation and the delayed impact of unprecedented rate hikes. Interestingly, the answer to this conundrum differs between major central banks.

Looking ahead, the recent surge in oil prices will make things even more complicated as it will both worsen the economic slowdown but also push up inflation (or at least reduce the disinflationary trend). Balancing growth and inflation will become even harder, and future interest rate decisions will not only be determined by these two variables but also by central banks' credibility.

In this regard, central banks most concerned about their credibility and the longer-term impact on inflation expectations could end up continuing to hike interest rates.

Oil price rally likely to continue, but it's not sustainable in the longer run

Oil prices are currently up by more than 25% this quarter and even briefly reached $95/bbl. Our commodities analyst Warren Patterson expects oil prices to break above $100/bbl in the near term as supply cuts by OPEC+ countries more than offset weaker demand due to the global economy's slowdown.

However, he doesn't see oil prices remaining above $100/bbl for long as weaker demand and political pressure to increase supply should help to bring oil prices back to levels slightly above $90/bbl.

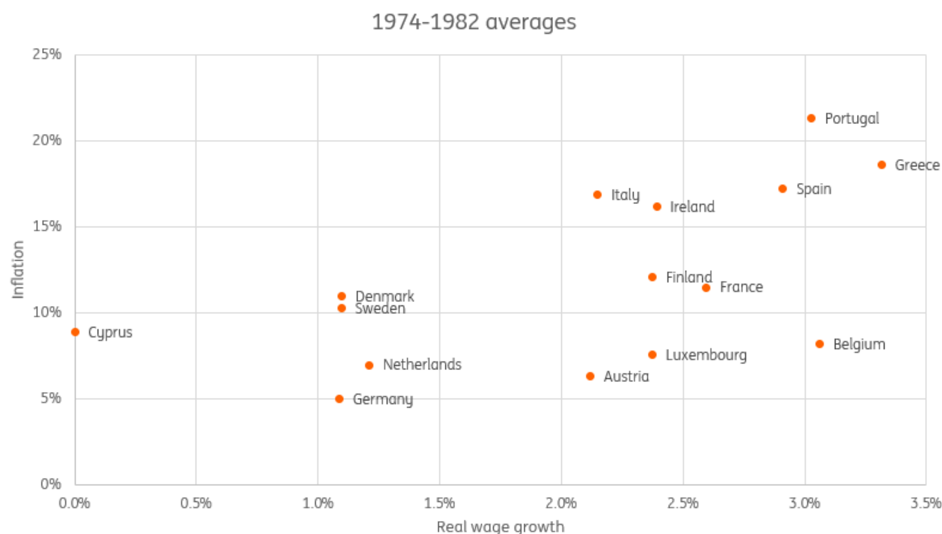
In our September Monthly update, we argued that the current inflation situation is not the same as the 1970s and that a second inflation wave looked highly unlikely. However, we also admitted that in the late 1970s, the second energy crisis was the main driver for the second inflation wave in many countries.

In the eurozone, there were three peak periods for inflation in the 1970s. The first was in 1974, when headline inflation was close to 14%; the second in 1977 with headline inflation above 10%, and then again in late 1979 and early 1980 with headline inflation back at double-digit levels. Back then, real wage growth remained positive even during the spikes of the oil crises, which allowed inflation to remain above 7% for more than a decade (1972-84). Indeed, the countries that experienced higher real wage growth for the period also experienced the highest inflation over this period (see chart below).

The current surge in inflation is different in that real wage growth turned negative quickly, which has slowed consumer demand drastically. This makes the chances of a prolonged second spike in inflation much smaller. With inflation currently trending down and wage growth stabilising above 4%, real wage growth is set to turn positive again soon, but we wouldn't expect it to erase the losses from the past two years.

At the same time, it is important to note that government support and employment growth have limited disposable income losses quite substantially.

In the 70s, countries with higher real wage growth also experienced higher inflation



Inflation is measured as the average annual growth in the national CPI and real wage growth as average annual growth in real compensation per employee, with private consumption as deflator.
Source: European Commission AMECO

How do current oil prices change our inflation forecast?

While this won't be a replay of the 1970s, expectations of further disinflation will be impacted by higher oil prices. This could result in a slower decline of inflation to 2%. Given that our expectations for oil prices do include a drop in the first half of 2024 again, the effect on our own forecast is rather moderate. Plus, a smaller decline in energy prices has materialised this year compared to expectations (which impacts next year's base effects).

The estimates below give a sense of how inflation could vary under alternative scenarios for oil, but also natural gas. Assuming oil prices stay at $95/bbl for all of 2024, however, the eurozone headline figure would rise by 0.3ppt next year, with a peak of the energy price contribution of 1ppt in the second quarter. At the same time, higher oil prices would probably further dent consumer confidence and spending, thereby contributing to the current disinflationary trend due to weaker demand.

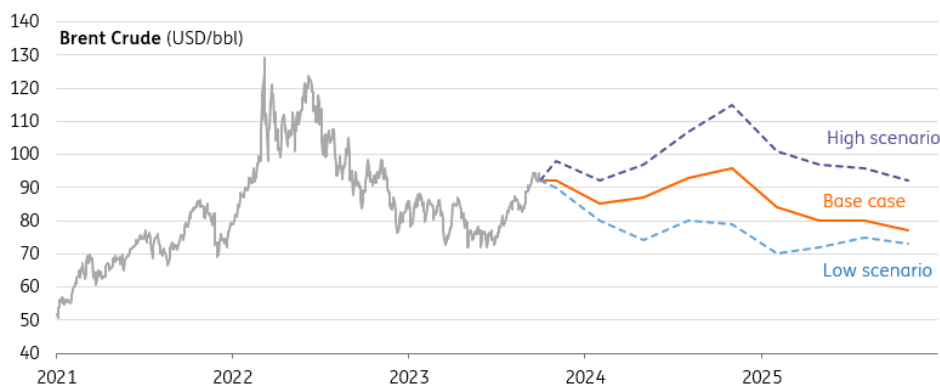
It's a similar story in the UK, though even in a higher oil/gas price scenario, the contribution from energy is still likely to be negative in the first half. The impact of lower natural gas prices comes through with more of a lag, and will offset the impact of higher petrol prices. The impact of rapidly slowing food price inflation also means that headline

CPI still falls back through 2024 even with a 'high' energy price scenario, though it would mean that inflation would be unlikely to hit 2% until 2025 when we've assumed oil/gas prices start to come lower again.

In the US, state and federal taxes account for less than 15% of the pump price of gasoline versus 50%+ in Europe so this means the effect of oil price moves on retail prices and household spending power are much more apparent, amplified by the higher driver miles covered in the US. Air passenger travel is also higher in the US while long-distance logistics distribution lines also mean the impact from energy price changes comes through more quickly than elsewhere. Consequently, price changes are felt in headline inflation rapidly, but given the impact on spending power, it can help to have a weak inverse relationship with core inflation over the longer term. Nevertheless, we have to remember that while energy has a high weighting within the CPI basket, it is dwarfed by housing components which will continue to exert the main directional pull on inflation overall. Given rapidly slowing rents this should continue to mean inflation slows over the next 12 months.

It's worth saying that these don't fully incorporate potential second-round effects like we saw last year. Instead, they simply assume that any new oil price shock will ultimately be more deflationary than inflationary. Still, if labour markets remain as tight as they are currently and economies bounce back a bit in early 2024, there is a risk that higher energy input costs would also put core inflation further above 2%.

Scenarios for oil

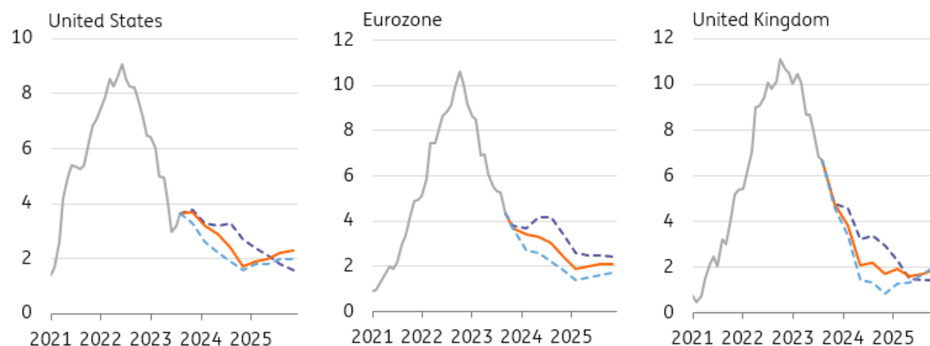


Source: Macrobond, ING calculations

Scenarios for natural gas

Source: Macrobond, ING calculations

Impact of scenarios on headline inflation (YoY%)



Source: Macrobond, ING calculations

What this means for central banks

Prior to the pandemic, most central banks would probably have looked past surging oil prices. Some even considered rising oil prices to eventually be deflationary, undermining purchasing power and industrial competitiveness. However, we are no longer in the pre-pandemic era, but the era of stickier-than-expected inflation. The ECB has emphasised in recent months that doing too little is more costly than doing too much in terms of rates.

For the ECB, the recent staff projections were based on the technical assumption of an average oil price of $82/bbl in 2024. If oil prices were to average $95/bbl next year, this would probably push up the ECB's inflation forecasts to 3.3% for 2024 (from 3.2%) and more importantly to 2.4% in 2025 (from 2.1%). As a result, the return to 2% would be delayed to 2026.

The delayed return to 2% would not be the only reason for the ECB to consider further rate hikes. Even though the ECB would still acknowledge the deflationary nature of a new oil price shock, the risk that this new oil price shock could lead to a de-anchoring of inflation expectations will definitely add to the ECB's concerns, making not only an additional rate hike more likely, but also that they stay higher for longer.

For the Federal Reserve, the favoured inflation measure has long been the core personal consumer expenditure deflator, which of course strips out energy. However, the focus has increasingly been on areas that they feel are more influenced by labour market strength and where inflation could be stickier. This has led to a growing awareness of the so-called super core services - services ex housing & energy. Energy prices in themselves are unlikely to warrant a change in Fed policy, but if they risk making inflation stickier elsewhere via second-round effects they will be prepared to act. Set against this, the squeeze on household spending power is likely to be swifter and greater than elsewhere which has the potential to dampen price pressures over the medium to longer term.

The Bank of England will be acutely aware that the key reason we have high service inflation right now is that we had sky-high energy prices in 2022. On paper, higher energy prices today might give policymakers pause for thought, though we doubt the moves we've seen so far will be enough to meaningfully shift the dial on the inflation outlook for 2024 and 2025. That suggests the Bank is unlikely to hike again in November solely because of higher energy prices, and we'd still expect rate cuts next year - albeit the risk is they come later rather than earlier.

What's next for the US after the summer spending splurge

James Knightley
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The US economy has performed strongly with the Federal Reserve and financial markets both re-evaluating the likely path for interest rates. But the Beyoncé and Taylor Swift stimulus has ended and households are facing more challenges. Sharply higher borrowing costs will increase financial stresses in the economy and mean recession fears will linger

Recent tours by Taylor Swift, pictured, and Beyoncé have given the US economy a helping hand as Americans spent big

Robust consumer spending means 4% GDP growth is possible

The US economy has had a stellar summer, with third-quarter GDP growth set to come in close to 4% annualised. Robust consumer spending has been the main driver, with households keen to maintain their lifestyles by tapping savings and borrowing on credit cards while inflation continues to eat into spending power. Leisure, tourism and travel have performed particularly strongly, with air passenger numbers hitting record highs, cinema attendance climbing and record-breaking concert tours by Taylor Swift and Beyoncé benefiting hotels, restaurants and bars wherever they performed.

Residential construction has done better than expected, too, with a lack of existing homes for sale boosting prices and making home building more profitable. Non-residential construction also continues to benefit from government initiatives, including the Inflation Reduction Act and the CHIPS Act that promote investment in energy infrastructure and semi-conductor production facilities.

Higher for longer Fed messaging drives borrowing costs up sharply

This means the US jobs market has remained hot with the Federal Reserve wary that unless the economy cools sufficiently, inflation may not slow sustainably to the 2% target, despite recent favourable data. At the September FOMC meeting, the Federal Reserve left the door open to a further rate rise while signalling it saw less chance of interest rate cuts next year. The market has also been reconsidering the prospect of policy easing and, in combination with lingering concerns over the scale of US government borrowing needs over coming years, we have seen Treasury yields climb. Longer-dated yields are at their highest level since 2007; we expect the 10-year to soon hit 5%.

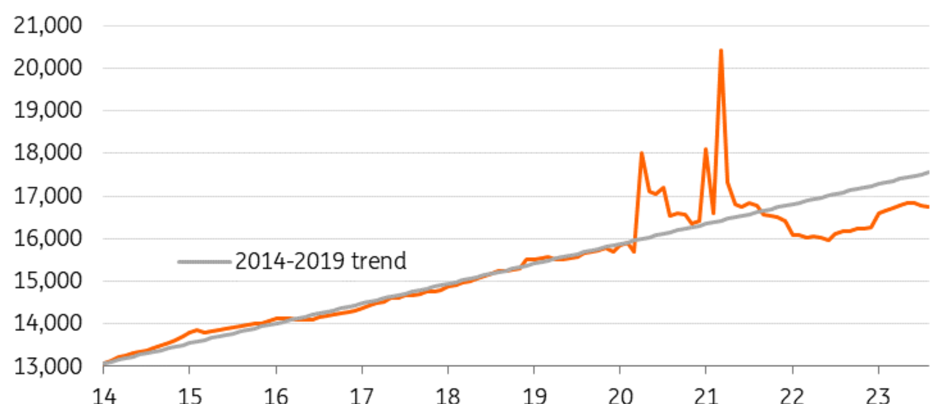
This is pushing borrowing costs higher throughout the economy, with the pace of increase reigniting talk of potential financial stress emerging at some point. We already know that credit card and auto loan delinquencies are rising quickly while mortgage rates, which are fast approaching 8%, are prompting a downturn in prospective home buyer traffic. Car loan rates are climbing and even good quality corporate names are not immune from the rise in borrowing costs, leading to some market concern about the impact on investment plans and long-term corporate profit growth. Commercial real estate remains the big worry though given weak valuations, subdued office usage and the prospect of significant refinancing needs over the next 18 months.

Household headwinds set to blow much harder as Taylor Swift moves on

The challenges facing the economy and the household sector, in particular, will intensify in the current quarter now that Beyoncé's tour has concluded and Taylor Swift has moved on to stimulating Latin America's economies. The Federal Reserve's own Beige Book warned that the summer spending splurge was mostly considered "the last stage of pent-up demand... from the pandemic era". It also noted that there were reports that "consumers may have exhausted their savings and are relying more on borrowing to support spending". There have been significant revisions to personal income and spending numbers and our calculations suggest that there is a larger savings war chest left than we had previously thought. Nonetheless, we would certainly agree that for many lower-income households, the cash savings accrued during the pandemic via reduced spending and higher incomes have been run down to zero.

These data revisions also showed a concerning trend for real household disposable income (RHDI). While incomes spiked during the pandemic, they have dropped back and have effectively flatlined over the past two years. Furthermore, they are over $800bn below where the pre-pandemic trend of growth suggests that we should be. In fact, RHDI has fallen for the past three months, which raises real concerns about how long consumer spending can remain so strong. If we don't have meaningful income growth, savings are depleted and credit is much harder to come by, the economy more broadly will struggle given consumer spending accounts for nearly 70% of economic activity. And this is before we consider the additional financial pressures from the restart of student loan repayments.

US Real Household Disposable Income ($bn) relative to the 2014-19 trend



Source: Macrobond, ING

Inflation will offer the Fed the flexibility to respond with rate cuts

Auto strikes will also provide a headwind for the economy, hitting suppliers and logistic companies, with some temporary lay-offs already announced while a government shutdown may only have been temporarily delayed by the recent stop-gap deal.

There has at least been good news on inflation with three consecutive 0.1% or 0.2% month-on-month prints for the Fed's favoured measure – the core personal consumer expenditure deflator. Slowing housing costs will increasingly depress this core inflation measure although recent rises in food and energy costs will mean headline inflation rates will be slower to fall.

Given the backdrop of inflation looking less threatening and the economic outlook looking increasingly challenging, we continue to doubt that the Fed will carry through with another interest rate increase. The spike in Treasury yields is doing the heavy lifting, but if they continue to move higher at the current pace it risks triggering economic pain that could quickly snowball. As a result, we continue to see the risks skewed towards more aggressive policy easing than the market is pricing for next year with rate cuts potentially starting in the spring.

What central banks are set to do next

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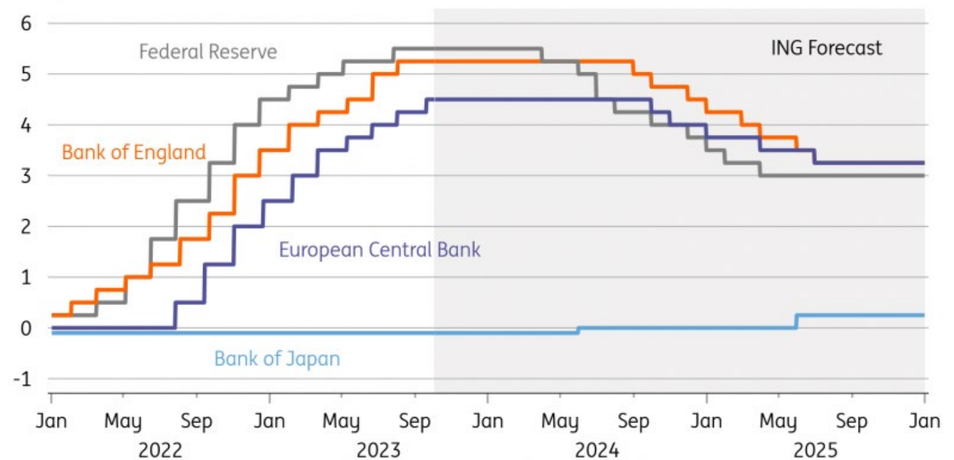
Central bank rates are reaching their peak globally, and we're already starting to see rate cuts in certain regions. Here's what our team expects from policymakers across the world over the next few months. For more forecasts, find the full report here

G7 finance ministers and central bank governors at the 49th annual G7 summit in Niigata, Japan

Major central bank forecasts



Source: Macrobond, ING

Federal Reserve

Our call: No further rate hikes with cuts starting from Spring 2024

Rationale: The Federal Reserve continues to signal the potential for a further rate hike this year, given that inflation remains above target, the jobs market is tight and activity has proven to be surprisingly resilient. Nonetheless, challenges will continue to mount, with real household disposable income slowing to a crawl just as student loan repayments are restarting, credit availability is drying up and pandemic-era accrued savings are being exhausted for many households. Encouragingly, key inflation

measures are looking more benign, with the core personal consumer expenditure deflator posting three consecutive 0.2% or below month-on-month prints. Assuming this continues, the Fed will have the flexibility to respond to the slowdown in the economy we expect to see in 2024.

Risk to our call: A tight labour market and a US consumer that continues to spend could keep inflation higher for longer, especially if unions extract inflation-busting wage agreements that set a benchmark for broader pay deals. The Fed would have little hesitation in hiking further in this scenario. Alternatively, if financial distress re-emerges in the banking sector – most likely via the commercial real estate market – this will tighten lending conditions markedly and could prompt the Fed to cut interest rates more aggressively.

James Knightley

European Central Bank

Our call: No further rate hikes and the first rate cut in summer 2024

Rationale: Official European Central Bank (ECB) comments since the September meeting and rate hike suggest that the ECB is not done yet with its hiking cycle. However, we expect the eurozone economy to weaken further and faster than the ECB currently expects. Combined with more disinflation until the end of the year, there will be very few arguments in favour of further rate hikes at the late October and early December meetings. Once the Fed starts cutting rates, and assuming eurozone inflation remains around 3% next year, the ECB will be in a position to alter its monetary policy stance to one which is less restrictive but not yet accommodative.

Risk to our call: A more resilient eurozone economy coupled with the impact of the recent oil price surge could easily push the ECB to opt for at least one more hike before year-end. The ECB is clearly also concerned with its own inflation-fighting credibility and the fear of a de-anchoring of inflation expectations. The ECB's very own dismal track record in predicting inflation could tilt the balance towards more hikes.

Carsten Brzeski

Bank of England

Our call: No more rate hikes and the first rate cuts from summer 2024

Rationale: The Bank of England (BoE) held rates steady at its September meeting, and there's not a huge amount of data set to be released between now and the next decision in November which is likely to alter that calculation. Barring a big spike in services inflation or wage growth, we think the tightening cycle has finished. The BoE has been very clear that it is prioritising keeping rates higher for longer over hiking more aggressively in the short term. Still, with unemployment rising, it's only a matter of time before wage growth starts coming down, though progress is likely to be gradual. Come next summer, the average rate on outstanding mortgage debt is likely to have gone from 3% now to over 4%, even without any more hikes. That suggests a gradual rate-cutting cycle can start from the middle of next year, taking rates to something closer to neutral.

Risk to our call: Large upside surprises to services inflation or wage growth unlocks another rate hike in November.

James Smith

Bank of Japan

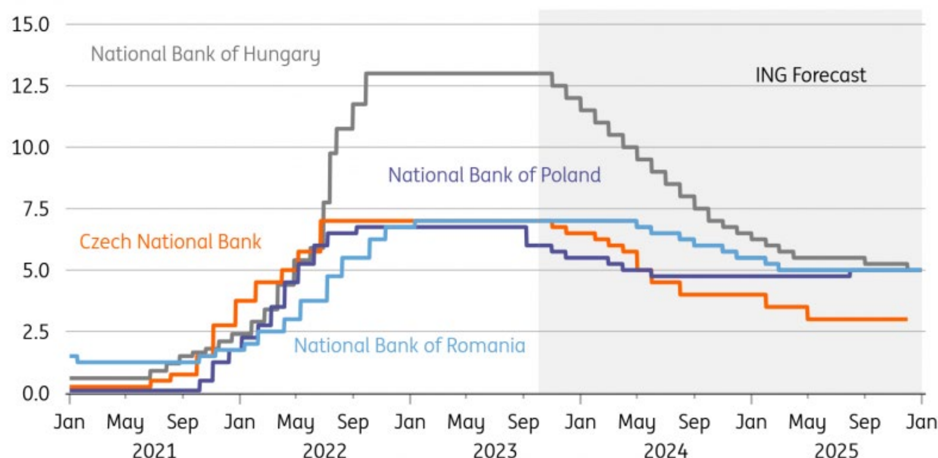
Our call: Another tweak to the Yield Curve Control (YCC) policy but no change in the policy rate until the second quarter of 2024

Rationale: Recent data has shown inflation is proving to be more stable and sticky than expected. There are signs that some of it reflects demand pressure, with private service prices rising notably in recent months, helped by rising tourism. An additional nudge from monetary policy would also provide some support for the JPY, which has been under pressure given the higher for longer market view of the Fed. A change to policy interest rates will not happen earlier than we are forecasting because the Bank of Japan (BoJ) will need to see the outcome of the Spring Wage settlement in order to be convinced that the economy can withstand interest rate normalisation.

Risk to our call: Despite evidence to the contrary on inflation and wages, the BoJ seems extremely nervous about departing from its current approach and may stick with it for longer.

Min Joo Kang

CEE central bank forecasts



Source: Macrobond, ING

National Bank of Hungary

Our call: Cautious easing with two 25bp cuts over the next couple of months

Rationale: According to our forecast, September headline inflation could be around 12.4%, clearly closing the door to a 75bp or a 100bp easing should the National Bank of Hungary (NBH) see a positive real interest rate (ex-post) after its October decision. What could also be a factor here is the EUR/HUF level and volatility. A lower-than-expected CPI print might reignite some dovish expectations, and as the NBH reaction function contains market stability, such a move in FX might call for a more hawkish stance. Against this backdrop, we stand pat with our call for a non-consensus 25bp (or perhaps 50bp) rate cut in October and November.

Risk to our call: The EU deal happening earlier than anticipated and lower September inflation will strengthen the HUF, allowing for a larger rate cut.

Peter Virovacz

Czech National Bank

Our call: First rate cut in November

Rationale: Inflation surprises to the downside, and thanks to base effects and seasonality, the headline rate will be close to the 2% target next January. The Czech National Bank (CNB) staff forecast has been indicating the need to cut rates for some time.

Risk to our call: Weaker FX or an upside surprise in inflation may be a reason to delay the first rate cut until the first quarter of next year.

Frantisek Taborsky

National Bank of Poland

Our call: The National Bank of Poland (NBP) has cut rates by 25bp at its October meeting, and the main policy rate is set to decline to 5.5% at the end of 2023. By the end of 2024, the NBP reference rate may decline to 4.75%

Rationale: Following a surprise 75bp rate cut in September, the Monetary Policy Committee switched to a more cautious approach in order to avoid further downward pressure on the PLN. We expect another 25bp cut in November. In 2024, we see room for an additional 75bp worth of policy easing as inflation is projected to continue moderating in the first half of the year.

Risk to our call: The CPI decline in September (to 8.2% year-on-year) was deeper than the NBP expected and may trigger more bold action from policymakers. If accompanied by ultra-dovish rhetoric from the governor then it may cause PLN weakness to resume, worsening the inflationary outlook – and that could require rate hikes in the second half of next year.

Rafal Benecki

National Bank of Romania

Our call: The key rate will remain at 7% until the first half of 2024 and reach 5.5% by the end of 2024

Rationale: Following a slight derailing of the disinflation path in August, significantly higher oil prices, and the likely upside pressures stemming from a higher fiscal burden in 2024, the first National Bank of Romania (NBR) rate cut now looks more likely to occur in the second quarter of next year rather than the first. That being said, with downside pressures on growth also likely to remain strong, we still expect 150bp worth of rate cuts by the end of 2024.

Risk to our call: Downside risks stem from a sharper-than-expected downturn in the German and eurozone economies – Romania's key trading partners – as well as from higher-than-expected oil supply levels from OPEC. Upside risks stem from wage growth remaining at very high levels, amplifying the stickiness of core inflation, as well as from oil prices remaining very elevated.

Valentin Tataru

Stefan Posea

The labour market conundrum keeps the eurozone economy just about afloat

Peter Vanden Houte
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Eurozone growth continues to soften, with negative growth in the fourth quarter now a growing risk. While a full-blown recession might still be averted, 2024 growth is likely to be lower than this year. Inflation is declining slowly, but with the European Central Bank taking no risks, a first rate cut is unlikely before the third quarter of 2024

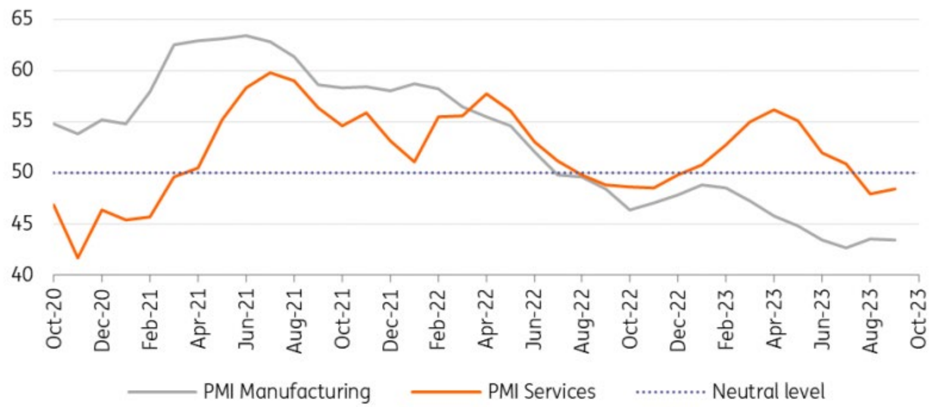
The eurozone economy is just about keeping its head above water. Pictured: Belgian artistic swimmers, Renaud Barral and Lisa Ingenito

Softening orders

The latest economic data continues to confirm our scenario of a weakening growth environment in the eurozone, though the slowdown is no longer intensifying, as most indicators have stabilised around subdued levels. The PMI composite indicator is in contraction territory and the €-coin indicator, a proxy for the underlying growth pace, stood at -0.18% in September. However, we doubt that third-quarter growth was negative. Europe saw a very strong tourism season and not all services indicators are at recessionary levels (yet).

That said, there doesn't seem to be an upturn in the offing. Inventory levels remain quite high and according to the PMI survey, orders in both manufacturing and services have softened further to levels not seen since the pandemic. This doesn't bode well for the fourth quarter and that's the reason why we now pencil in a very small negative figure for fourth-quarter GDP growth.

Sentiment indicators continue to be weak



Source: LSEG Datastream

The labour market conundrum

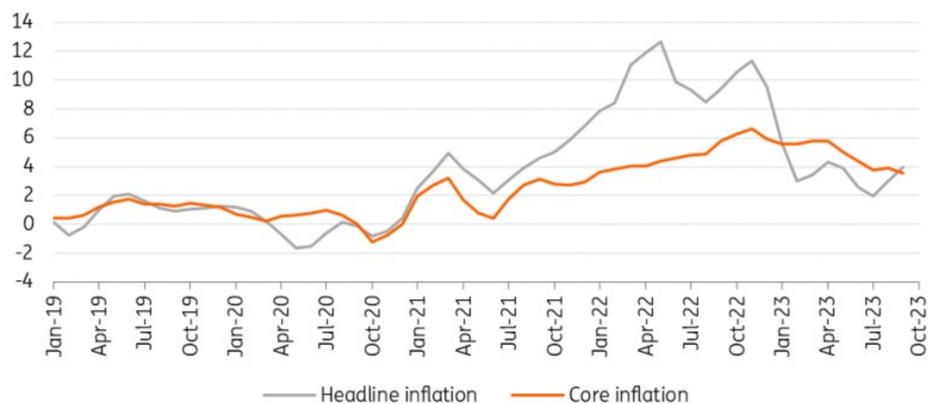
The question is what happens afterwards. Most international institutions see a stronger growth rate in 2024 than in 2023. The current cycle has indeed some special features, one of them being the demographically induced labour scarcity. Because of that we are now experiencing the rare combination of weak business sentiment and declining unemployment (the eurozone unemployment rate was at a record low in August). The fact that the labour market is holding up well and that real wages are now rising is certainly a factor that supports consumption and for the time being prevents the current downturn from morphing into a full-blown recession.

Slower growth in 2024

However, concluding from this that growth can only accelerate is perhaps a bit premature. Let's not forget that monetary policy works with a lag. And we have reasons to believe that the lag might be a bit longer than in the past, as the long period of low and even negative interest rates has probably allowed companies and governments to lengthen the duration of their debt. That said, credit growth was close to a standstill on a year-on-year basis in August and this trend is unlikely to reverse anytime soon. On top of that, there is still no agreement on a revamped Stability and Growth Pact, meaning that member states must abide by the old rules and present significantly more restrictive budgets this month. Several member states are at risk of the excessive deficit budget procedure, probably leading to some spread widening. Putting it all together, we only see some genuine improvement in the growth outlook from the second half of 2024 onwards. But we forecast this will result in a mere 0.4% GDP growth for the whole of 2024 after 0.5% this year.

Inflation trend

3m-on-3m annualised consumer price change



Source: LSEG Datastream

Inflation only slowly declining

Both headline and core inflation fell in September to 4.3% and 4.5%, respectively, and that was better than expected. However, one must bear in mind that base effects play a very important role in the recent decline. That's why we like to look at the 3-month on 3-month annualised rate of inflation, showing the headline rate at 4.0% and core at 3.6%. Although softening, the trend is thus still clearly above 2%. On top of that, the recent oil price increase is likely to keep headline inflation higher in the first half of 2024. We are now anticipating 5.9% headline inflation for this year and 3.0% for 2024.

The ECB increased its main interest rates again in September, bringing the interest rate on the deposit facility to 4%, a 450 basis point increase in just 14 months. The monetary policy statement suggested that the top might have been reached, though rates will have to be kept high for a sufficiently long duration to bring inflation back to target. That is the reason why we shifted our expectation for a first rate cut to the third quarter of 2024. The ECB is also considering ending the reinvestment of the Pandemic Emergency Purchase Programme holdings early to diminish the amount of excess liquidity. An announcement to do so could fall in the first quarter of next year. All of this limits the potential for a substantial bond rally.

China dodging the doom loop

While China's economy is still struggling, it is at least not getting incrementally worse and there are some pockets of improvement

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It looks like the economy is forming a trough in some areas

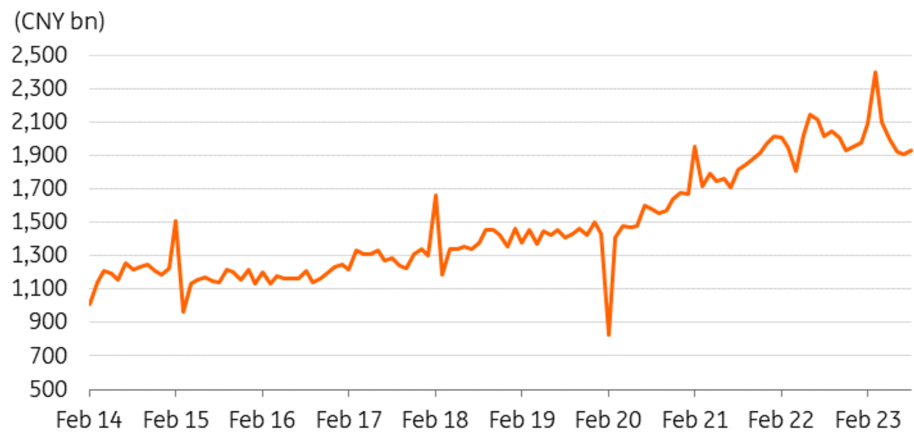
The last month has delivered a lot of data. And while there is a lot more to say about the condition of the economy, the principal fact seems to be that conditions are not getting incrementally worse. That is important. China is not currently spiralling into a doom-loop. Growth is returning, slowly, and not uniformly. But where there is growth, there is hope.

Let's deal with the positives first, because there are still plenty of negatives: New CNY loans picked up in September, and aggregate financing volumes were also higher. Further lending will be helped by the 25bp reduction in banks' reserve requirements.

PBoC holding the line on the CNY

We did not, however, see any further reductions in any of the policy interest rates, mainly due to the People's Bank of China's ongoing struggle to keep USD/CNY from depreciating above 7.30. And while the USD remains strong, conventional rate cuts seem to be off the agenda. The PBoC seems to be playing a holding game, waiting and hoping for some turn in the USD. And while it waits, it uses its daily reference point fixing to keep pushing the CNY lower (stronger) and allowing short-term funding rates to rise to make it more expensive to borrow in CNY and sell to buy foreign exchange. For the time being, the policy seems to be working. Occasional verbal warnings to the banks not to sell CNY also help.

China Exports (CNY, seasonally adjusted)



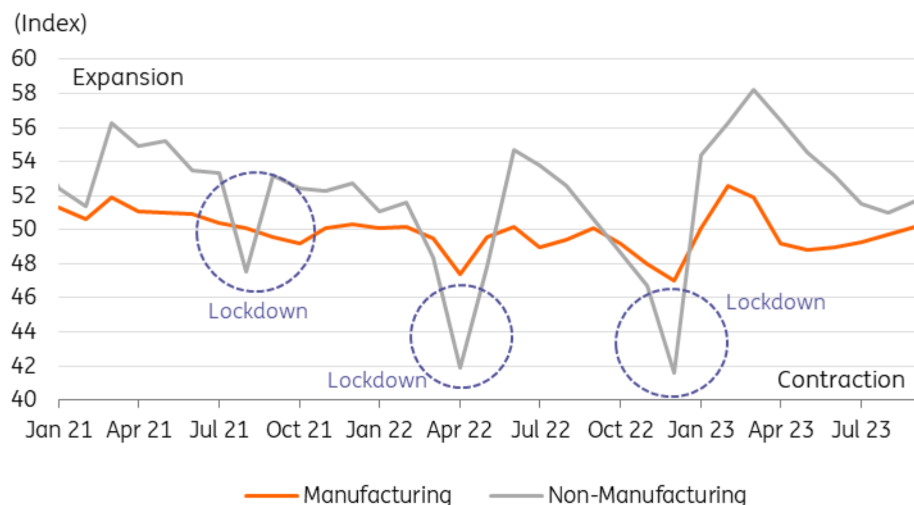
Source: CEIC, ING

Year-on-year export declines shrinking

Exports continue to decline in year-on-year terms, but the rates of decline are decreasing. Looked at in CNY terms, and adjusted for seasonality, exports, like some other parts of the economy, seem to be troughing.

This troughing can be seen in plenty of other data too. The monthly data deluge showed manufacturing and industrial production figures edging up slightly in year-on-year terms. Not by very much, but the direction is the important thing right now. Recent PMI data has also edged out of the contraction zone, though for the non-manufacturing sector, buoyant expectations are doing a lot of the heavy lifting, and it remains to be seen whether there is more to this than wishful thinking. The same can be said of retail sales, which have recovered slightly after undershooting their historical trend on the downside in recent months. As for the inflation rate, we challenged the "deflation" label provided a couple of months ago as being inaccurate, as well as likely temporary. Inflation has indeed edged back above the zero line, although only just. This is also mainly due to the expiry of base effects from falling food prices, though there is no getting around the fact that weak demand is the main reason why inflation is as low as it is in the first place.

China PMI headlines (>50 = expansion)



Source: CEIC, ING

Government sticking to its supply-side approach

What hasn't changed particularly is the government's approach to the economy. This is not to say that they are doing nothing. They are. But they still seem to favour targeted market support through multiple supply-side policies, rather than a single one-size-fits-all fiscal boost. We don't think that will change. Dealing with the economy's excessive leverage has been an ongoing goal and one that now seems to have been raised above other targets. You can question the timing of this, but this has been a longstanding weakness of the economy, and it feels like some short-term growth will have to be sacrificed to enable a brighter longer-term outlook.

The real estate sector of the economy continues to struggle. Renewed concerns over the fate of China Evergrande have surfaced following the detention of its chairman. And there are still questions looming over the economy's largest developer, Country Garden, which faces $14.9bn in further maturing debt next year, amid plunging unit sales, even as it has so far managed to avoid any default.

While the real estate sector continues to flounder, this will keep dragging on manufacturing, and labour demand, and in turn, on job availability and wages. The authorities in China will be hoping that this year's Golden Week Holiday, which is happening currently, encourages some more spending. But it seems optimistic to think that this will substantially offset weakness in other parts of the economy or dramatically change the overall trend.

Markets are right to rethink the Bank of England as rates reach a peak

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Investors have significantly reappraised the Bank of England outlook over recent weeks, and we think rate hikes have now finished. Rate cuts are likely to be a story for next summer

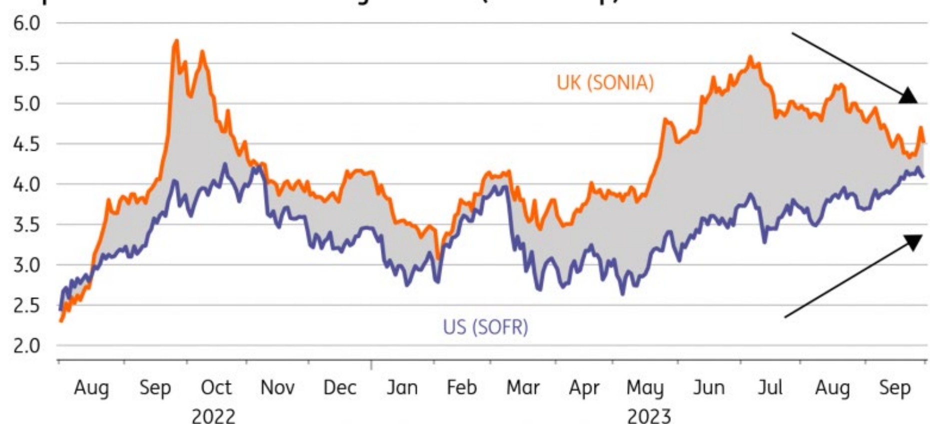
Bank of England governor Andrew Bailey says there's 'no room for complacency'.

Investors have revised down UK rate expectations over recent weeks

Against a backdrop of rising US market rates, it's all the more eye-catching that UK rate expectations continued to fall back through September. The differential between US and UK rates has narrowed considerably as a result, and if we look at where investors expect rates to be in two years' time, the Bank of England is expected to have rates only fractionally above the Federal Reserve. Contrast that with July, where at one point markets were pricing UK rates two full percentage points higher than across the Atlantic in mid-2025.

It's a big move, and it is at least partly a recognition that the UK's inflation problem isn't considerably worse than elsewhere – a narrative that had become fashionable earlier in the summer. The most recent inflation figures came in well below expectations, and even if some of that was noise, it's a reminder that disinflation is coming to Britain just as it has in Europe and the US.

UK rate expectations have fallen even as they've risen in the US



Source: Macrobond

We think hikes have finished and cuts can begin next summer

Markets are also responding to the Bank of England itself, which, having paused rate hikes in September, has effectively called the top in this tightening cycle. Barring a big data surprise between now and the November meeting, we think the Bank's August rate hike was the last.

That turns the focus to rate cuts, and the Bank is at pains to tell us that these are a long way off. We agree, up to a point. Services inflation – a key metric for the Bank – is likely to end the year below 6% from 6.8% now and continue falling thereafter as lower gas and electric prices work through with a lag. Wage growth is likely to do the same, though in both cases the decline will be gradual. Economic inactivity (people neither employed nor actively seeking a job) is on the rise again, and the employment rate is still a percentage point lower than pre-Covid. Worker shortages aren't going to go away entirely.

That said, the jobs market is now clearly beginning to cool. The ratio of job vacancies to unemployed workers is falling quickly, both because of a fall in openings but also a noticeable rise in joblessness. The BoE is also acutely aware that much of the impact of past rate hikes is yet to hit. The average rate on outstanding mortgages has risen from 2% to 3% and will be above 4% probably by the spring of next year. That's why the Bank is keen to keep rates high for a long period, but we think by next summer the case for maintaining rates at 5% or above will have faded. Assuming the Fed has started cutting rates by that point, we've pencilled in the first cut in August 2024.

Central bank hesitations

Inflation continues to fall rapidly in the CEE region, while economic numbers are surprising on the negative side. At the same time, we see signs of a turnaround in the third quarter in some countries. Monetary policy is moving toward rate cuts, while fiscal policy tries in vain to tighten

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Adam Glapiński, President of the National Bank of Poland

Poland: The economy is bottoming

The third quarter of this year was likely a turning point for the Polish economy. The August set of monthly data presents a gradual improvement in construction and retail sales, while industrial activity remained subdued due to poor performance in manufacturing. We're revising up our third-quarter GDP estimate from -0.2 to 0% year-on-year and expect over 2% GDP growth in the third quarter of this year. Overall in 2023, economic growth is seen at a mere 0.4%. This should improve to 2.5% in 2024, thanks to a rebound in household consumption and a smaller drag from destocking.

CPI inflation for September decreased to 8.2% YoY from 10.1% YoY in August, below the latest projections from the National Bank of Poland (NBP) and the governor's expectations presented during the September press conference. Around half of the decline comes from one-offs i.e., sharply falling gasoline prices driving a drop in the market despite rising crude oil prices and PLN depreciation, the introduction of partially free medicine, cheaper tickets and the extension of frozen electricity prices.

On top of that, food prices decreased for the fourth month in a row. Disinflation is expected to continue until mid-2024 but at a slower rate. After that point, we expect inflation to stabilise at around 5-6% YoY, with the NBP's target not yet sight over the medium term. Rising oil prices, monetary loosening, a weaker PLN and fiscal expansion will make it difficult to bring CPI to the central bank's target in 2024-25.

The NBP surprised markets with a bold 75bp rate cut in September, which triggered PLN weakening. In September, the bank switched to a 25bp cut. Both we and the market currently expect the easing cycle to be continued this year, albeit with smaller steps, to prevent further PLN weakening. We project another 25bp cut in November. In 2024, we see room for 75bp of policy easing, with rates reaching 4.75% by the end of the year.

We also see further PLN weakening by the end of the year, reaching around 4.72. The NBP's dovish bias remains in contrast to key central banks in the region and also encourages said weakening. Fundamentally, we expect Poland's current account improvement to slow, given soft economic prospects in the euro area. Moreover, opinion polls signal a rather uncertain political landscape following the general elections in October and a few scenarios which make access to RFF money uncertain. Long-end Polish government bonds remain at risk. The Ministry of Finance has already announced a relatively heavy issuance in the fourth quarter of this year (PLN9-20 billion). Bank Gospodarstwa Krajowego (BGK) will place bonds as well. Given the very limited interest of foreign investors in local debt, asset swap widening is very likely. Aggressive NBP policy easing and further fiscal pledges suggest that bringing CPI to the target is likely to take years. As such, local bond and swap curves are likely to steepen.

Czech Republic: CNB ready to start cutting cycle

The Czech economy is still teetering on the edge of recession and even the third quarter figures do not show much sign of recovery. It seems that we will have to wait a little longer and the next steps will depend on the shape of neighbouring Germany, to which the economy is strongly linked. Inflation fell again to 8.5% YoY in August more or less as expected. More interestingly, core inflation is falling faster than expected, with the latest number at 6.0% YoY.

Looking ahead, we expect headline inflation to fall to 7.4% in September – although due to base effects caused by government measures from last year, it will once again jump into the 8-9% range in the fourth quarter. Still, for similar reasons and the re-pricing in energy, we expect January inflation to reach the 2-3% band, close to the central bank's target.

The government has approved a state budget for next year of CZK252bn, slightly more than initially expected but still within plans to consolidate public finances. The Chamber of Deputies is debating the consolidation package in its third reading and opposition blocking can be expected. However, we expect approval in the coming weeks. This year's state budget figures also show positive surprises. The public deficit should end at 3.2% this year and we expect 2.2% of GDP for next year.

The Czech National Bank confirmed in September its readiness to start discussing rate cuts and every other meeting is live. We expect the first rate cut in November with the central bank's new forecast. However, if inflation surprises to the upside or a weaker CZK in the interim, the cut may be delayed until the first quarter of next year.

Hungary: Risks are accumulating

While high-frequency indicators show some improvement in Hungary's economic momentum, we can't say that the outlook is clearly brightening. The European Commission has asked nine questions to obtain more clarity on the implementation of judicial reforms. This stops the 90-day chess clock, which will start ticking again once Hungary answers, with only three weeks left. Now we see that the latest delay in the ongoing rule of law talks is only a minor one. We've already approached the issue from a technical perspective, but there is also an undeniable political side to it. As we see risks beginning to build around our base case, we have also put together a more pessimistic alternative scenario for 2024-25.

Returning to the short-term outlook, we see the technical recession ending in the third quarter of this year, but a full-year recession is likely to be unavoidable (-0.5% in 2023). Moreover, the outlook for next year is increasingly uncertain. Not are only internal (e.g., budgetary) risks mounting, but external ones too. The trade balance has improved markedly over the past six months, but the recent rally in energy prices could limit the upside. The labour market remains resilient, which bodes well for wage growth

momentum. At the same time, this poses an upside risk to our 5.1% inflation outlook for 2024. Especially if the 10-15% raise in the minimum wage materialises next year.

This could throw a spanner in the works of the ongoing disinflation, which is mainly driven by large base effects for the rest of the year. Looking ahead to next year, we see several trigger points for reflation. That's why we see an extremely cautious and circumspect monetary policy going forward, aiming at a positive real interest rate environment (ex-post) as soon as possible. We maintain our view that the central bank will only cut policy rates by 25bp in October. While acknowledging the risks of a 50bp cut, we believe that the EUR/HUF level and volatility could lead the Monetary Council to opt for a less dovish easing, thus providing renewed support to the HUF.

Romania: Fiscal adjustments set to reduce the deficit but weigh on the private sector

A second GDP reading confirmed the weaker-than-expected second quarter growth, which led to an average growth of 1.7% over the first half of 2023, down from 5.7% in the same period in 2022. Fixed investment stemming from EU-funded public infrastructure projects managed to keep the economy afloat, overtaking private consumption and accounting for the lion’s share of growth contribution. Weaker public and private spending – as well as exports – took their toll on output. Our latest growth forecasts are 1.5% in 2023 and 2.8% in 2024.

From a monetary policy perspective, we think a first rate cut from the National Bank of Romania is now more likely to happen in the second quarter of 2024, rather than in the first quarter. This could likely happen due to a slight derailing of the disinflation path in August this year, significantly higher oil prices in the second half of 2023 and the likely upside pressures stemming from a higher fiscal burden in 2024. On one hand, higher wages and further EU-funded investment activity will support activity. On the other hand, a gloomy outlook for the German economy and our view that the eurozone will stagnate next year (and not accelerate slightly like the consensus believes) will weigh on Romania’s external sector.

The government has recently assumed responsibility for the fiscal package, with the large bulk of the changes being enforced as of 1 January 2024. Meanwhile, the measures which should have been enforced from 1 October 2023 – concerning the removal of fiscal facilities for the IT, construction and food industries – are currently postponed as two opposition parties challenged the package at the Constitutional Court. While it is uncertain how long this will extend the implementation of the package, anything between one and two weeks could be a starting point. Nevertheless, the fiscal burden on the private sector will increase and cost-push shocks are now a key upside risk to our 2024 inflation forecast. While the intra-year profile could edge slightly higher next year, we still hold on to our 4.0% inflation forecast for the end of 2024.

More help for Dutch consumers after longer-lasting technical recession

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The Netherlands, which is already in a technical recession, is set to record yet another quarter of contraction in the third quarter. New proposals by parliament to support the purchasing power of low-to-middle-income households may provide a small boost via more consumption

The Dutch economy has ben struggling. Pictured: shoppers in Amsterdam

Hard indicators point to yet another contractionary quarter

Looking at the hard data, July was a bad month for GDP. Domestic consumption of households, goods exports and investment, in particular, fell in constant prices, while imports expanded. Manufacturing production contracted in July, while mining & quarrying (i.e. gas production) and construction expanded. Retail sales and car registrations fell in July-August. Furthermore, surveyed non-financial businesses became more pessimistic about sales/production in August and even more so in September. One of the few positives for service exports is the rise in the number of overnight stays of foreign visitors. All in all, we are projecting another mild GDP contraction for the third quarter.

Improvement expected for the fourth quarter

There are signs, however, that the Dutch economy will perform a bit better in the fourth quarter than in the preceding three months, even though the fourth quarter looks worse than the third for the rest of the eurozone. The Economic Sentiment Indicator for the Netherlands moved up slightly for two months in a row in August and September. This was mostly thanks to the large service sector. Underlying indicators for expected demand and production improved for industry, retail and commercial services in September.

Consumers have generally remained quite downbeat in recent months. However, one positive sign for consumption going forward is that house prices have stopped declining, with a significant increase recorded in August following two months of stagnation. Furthermore, wage increases will more clearly outpace inflation in the fourth quarter and beyond. This, combined with an expanding public sector and a little export growth, will need to offset a forecast decline in investment.

Expectations improved despite more backward-looking pessimism
Indicator for (expectations of) development of activity* of non-financial businesses

*Judgement about production/orders/demand, value added weighted seasonally adjusted balance of % positive and negative responses, normalised with long term average = 0 and scaled to 1 standard deviation
Source: European Commission via Macrobond, calculations ING Research

Changes in government spending might provide a small boost via higher consumption in 2024

Meanwhile, more growth can be expected from consumption in 2024 than assumed previously, as parliament has proposed amendments to the government budget worth 0.4% of GDP. These measures, such as the freezing of fuel excise taxes, higher minimum wage and higher statutory pensions, should support low (middle) incomes. The policy changes come on top of the 0.2% of GDP package of purchasing power measures which has already been proposed by the government.

The government advised against many of the proposals from parliament because these are often untargeted and in many cases, against the government's own fiscal rules (e.g. additional expenditures have to be financed by cuts in other expenditures). The government has also indicated that the accompanying proposed revenue measures are not as easy to implement (as of 1 January 2024) or as big as portrayed, which means that some changes will have to be made. This week, the debate continues.

Assuming that at least some measures will be adopted, we have raised the profile of the consumption of households a bit. This is because we expect some redistribution from firms, the wealthy and higher incomes (with a low marginal propensity to spend) to low (middle) incomes (with a high propensity). The expected effect on the budget balance is negligible, as we expect only funded measures to be adopted. Still, this should allow for positive GDP growth in 2024 (0.7%).

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FX: Strong dollar remains the only game in town

Resilient US growth, a hawkish Federal Reserve, and misfiring overseas economies are driving the dollar higher for a third straight month. We are deferring our call for a dollar sell-off this year, but ING's 2024 house forecast of three-quarters of negative US growth and 200bp of Fed easing should finally deliver a dollar reversal

The dollar looks set to hold its gains into the end of the year

The dollar has rallied about 2% since the last FOMC meeting in September, when the Fed cut in half its forecast for 2024 easing. Higher rates across the US curve since then have clearly helped the dollar. Our calculations suggest that the US 10-year Treasury yield at 5.00% would be consistent with EUR/USD trading at 1.02 given their recent relationship.

Even though November and December are seasonally weak months for the dollar, it is hard to call a turn in the dollar trend before year-end. US data is showing no signs of turning just yet and indeed large data revisions suggest the US consumer may have larger spending power than previously thought. For that reason, it seems hard for the market to completely price out the risk of one last Fed hike before year-end. This should keep short-dated US yields anchored above 5% and prevent the dollar from falling too far during any corrections.

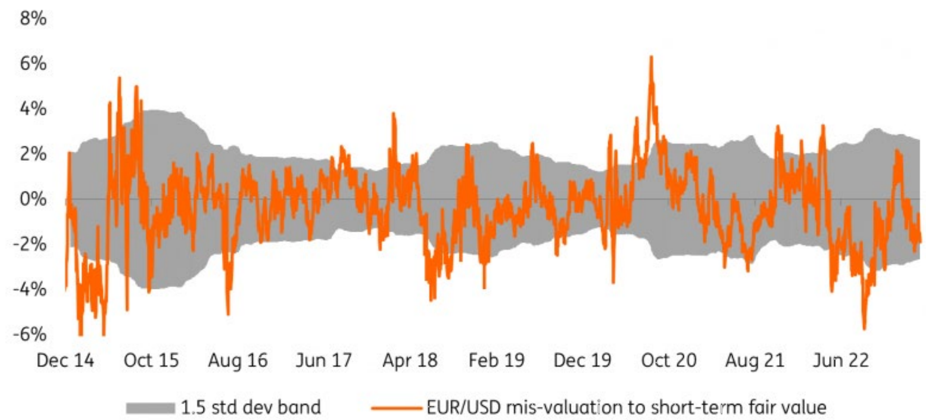
Looking into 2024, our call for US economic and rate convergence with stagnant growth elsewhere in the world should mean the dollar turns lower. Our calculations point to EUR/USD still heading up towards the 1.18 area in the second half of 2024 based solely on our house calls for the Fed and European Central Bank policy trajectories. Yet as we have seen repeatedly, policy rate differentials are not the sole driver of EUR/USD.

Currently, we estimate that EUR/USD contains a 2% risk premium – a risk premium that can extend to 6% during times of extreme stress in the eurozone. A low growth environment in the eurozone and political uncertainty over the re-introduction of the Stability and Growth Pact will keep that risk premium in the euro and means that EUR/USD ends this year near 1.06 and that its best levels of 2024 may be closer to 1.15 rather than 1.18.

There is also the extreme precedent of 2001 when EUR/USD failed to rally despite a 500bp Fed easing cycle. We doubt eurozone asset markets are as unattractive now as they were back then – but the situation bears watching.

Elsewhere, policymakers in China and Japan will continue to support their currencies and be praying for a market-led turn in the dollar. Incidentally, the strongest G10 currency this year remains the Swiss franc, as the Swiss National Bank has been busy selling from its plentiful FX reserves to drive the franc stronger for monetary purposes.

EUR/USD currently contains a 2% risk premium



Source: ING

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Rates: The pull of Treasuries, and 4% inflation

There's a lot going on out there that can drive market rates. We home in on two factors. One is ongoing macro resilience in the US. The other is question marks around inflation at 4% in both the US and the eurozone, and its potential stickiness. There is enough there to tempt market rates higher still, at least until something actually breaks

Traders have the US 10-year at 5% on their minds

In the US, the lure of 5% for 10-year Treasuries remains convincing

The US 10-year has managed to touch 4.8%, a new cycle high. That's now split down the middle between inflation expectations and the real rate, both at about 2.35%. Inflation expectations, in fact, peaked out at a little over 3% in April 2022, about a year and a half ago. That peak in inflation expectations chimed with the start of the Federal Reserve's rate hiking process. Things are in a better place now.

The offsetting rise has been in real rates. April 2022 saw the 10-year real rate flip from deep negative territory to moderately positive. This was an important breakout moment, as negative real rates had suggested underlying macro angst, even as inflation expectations had clearly broken higher. Now the 10-year real rate is knocking on the door of 2.5%. It will likely get there, as the 10-year nominal yield approaches 5%. And that remains our baseline view.

The drivers here centre on macro resilience. But this is interesting, as the US economy is hardly roaring ahead right now. It's just chugging along, refusing to go into a recession, or even a growth recession (sub-trend growth). For example, the replacement rate in the labour market is around 150k, and the payroll reports have been hovering just above this. There is a vulnerability to that, but it also just keeps trucking along. Nothing stellar. But the persistence of it is what's got the market's attention.

This has put a floor under US market rates at 4.25% (the funds rate bottom currently discounted). A 75bp term premium on top of that gels perfectly with the typical evolution of a 75bp curve at the bottom of the rates cycle historically. That's the rationale for a 5% outcome for the 10-year. We head there until or unless something finally breaks down.

In the eurozone, there is also 4% inflation to tackle - mapping negative real yields

Eurozone market rates are being dragged higher by US Treasury yields. This is not unusual. Typically, the direction for market rates comes from Treasuries. It's not that long since the 5-year ESTR to SOFR spread narrowed to around 40bp (in fact briefly slightly below). That was in May this year. Now that spread is at 125bp. The journey from 40bp to 125bp was led by US market rates deciding to go ahead and rise. The Silicon Valley Bank demise occurred in March, and the economy had taken that and a few other hits, but was chugging along again regardless. Europe had seen the demise of Credit Swisse, and war angst lingered. Activity was, and has been, patchy. But the US at least continued to motor along.

But there is another important dimension to this. Even though inflation has fallen dramatically through 2023, in both the eurozone and the US, it could be argued that that was the easy lift (from double-digits to 4%). The heavy lift is getting that down to 2%. While the European Central Bank clearly takes that responsibility seriously, it does not mean it will happen, at least not easily. This is the other theme the market has latched on to. It's one that makes it tough to deliver meaningful or timely rate cuts. So even though eurozone market rates are indeed being dragged higher by US ones, there is also an ongoing realisation that inflation at 4% remains well above the 10-year ESTR rate at 3.25%.

Bottom line, the US 10-year has got 5% on its mind. The US 10-year real rate is homing in on 2.5% already. The 10-year Bund yield is knocking on the door of 3%, and can stretch towards 3.25%. The 10-year Euribor rate at around 3.5% still maps a negative real yield when measured against the latest inflation print. Enough there for market rates to continue to test higher.

GDP forecasts

Developed Markets (QoQ% annualised growth)							
	3Q23F	4Q23F	1Q24F	2Q24F	2023F	2024F	2025F
US	3.7	1.6	-0.9	-2.5	2.2	0.2	1.2
Japan	0.4	0.8	0.4	1.2	2.0	1.0	1.2
Germany	-0.6	-0.2	-0.4	0.2	-0.3	0.0	1.4
France	2.2	0.2	0.0	0.4	0.8	0.6	1.3
UK	-0.9	0.5	0.3	0.4	0.5	0.4	1.2
Italy	1.2	1.0	0.8	0.8	1.0	0.8	1.0
Canada	1.4	1.3	-0.5	-0.5	1.3	0.3	1.8
Australia	1.6	1.2	1.2	2.4	1.9	1.6	2.9
Eurozone	0.2	-0.1	0.1	0.6	0.5	0.4	1.3
Austria	0.8	0.4	0.8	0.8	0.1	0.5	1.5
Spain	1.3	0.9	1.2	1.4	2.5	1.4	2.0
Netherlands	-1.1	1.1	0.9	0.2	0.2	0.7	1.6
Belgium	0.4	0.4	0.4	0.8	0.9	0.6	1.4
Greece	1.1	3.0	0.6	1.5	1.7	1.5	1.7
Portugal	1.0	0.8	1.0	1.4	2.3	1.1	2.1
Switzerland	0.4	0.0	0.8	0.8	0.7	0.6	1.4
Sweden	0.7	-1.4	0.4	0.9	-0.4	0.1	1.3
Norway	2.1	0.8	1.5	1.5	1.4	1.4	1.7

Emerging Markets (YoY% growth)							
	3Q23F	4Q23F	1Q24F	2Q24F	2023F	2024F	2025F
Bulgaria	1.6	1.7	1.7	2.4	1.7	3.1	3.5
Croatia	1.9	3.0	2.9	2.2	2.7	2.5	2.7
Czech Republic	0.2	1.1	2.0	2.2	0.0	2.2	2.2
Hungary	-0.2	1.7	2.8	4.2	-0.5	3.4	3.8
Poland	0.0	2.4	2.1	3.5	0.4	2.5	3.5
Romania	3.0	2.3	2.4	3.3	2.5	3.7	3.5
Turkey	3.3	3.0	2.5	2.0	3.5	2.5	3.5
Serbia	1.7	2.1	2.9	4.3	2.0	3.8	3.7
Azerbaijan	1.7	2.0	4.0	2.5	1.2	2.5	2.7
Kazakhstan	5.0	4.7	4.2	4.0	5.0	4.5	4.0
Russia	5.3	3.5	3.0	0.5	3.0	1.0	1.0
Ukraine	3.5	3.5	-	-	5.9	5.5	-
China	4.1	3.1	4.2	4.2	4.5	4.2	5.2
India	7.8	7.2	6.8	3.4	6.9	6.6	7.5
Indonesia	5.3	5.2	5.5	5.1	5.2	5.0	5.1
Korea	0.9	0.8	1.4	1.5	1.0	1.9	2.4
Philippines	4.5	4.1	4.0	5.0	4.8	4.7	5.5
Singapore	0.9	2.0	3.0	2.8	1.0	2.8	3.0
Taiwan	2.0	3.6	3.9	3.2	0.9	2.9	2.6

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

CPI Forecasts (pa)

%YoY	3Q23F	4Q23F	1Q24F	2Q24F	2023F	2024F	2025F
US	3.5	3.7	3.2	2.9	4.3	2.6	2.1
Japan	3.2	2.7	2.6	2.4	3.2	2.3	1.6
Germany	5.8	3.7	3.3	3.1	6.0	3.0	2.1
France	6.1	4.0	3.6	2.5	5.5	2.7	2.1
UK	6.7	4.8	3.8	2.1	7.5	2.5	1.8
Italy	7.8	5.8	2.5	2.5	6.4	2.1	2.1
Canada	3.8	4.2	3.9	2.8	4.2	2.6	2.0
Australia	5.3	4.9	4.4	4.1	5.8	3.6	2.7
Eurozone	5.0	3.7	3.4	3.3	5.9	3.0	2.0
Austria	6.8	3.8	3.0	2.6	7.5	2.4	2.0
Spain	2.8	3.6	3.8	3.1	3.6	3.1	2.3
Netherlands	3.1	2.2	3.5	3.0	4.6	2.6	1.7
Belgium	3.2	3.2	4.0	3.7	4.7	3.5	2.1
Greece	3.8	3.1	3.2	2.7	4.1	2.3	2.0
Portugal	3.5	2.9	2.5	2.2	4.8	2.4	2.2
Switzerland	1.6	1.8	2.0	2.0	2.2	2.0	1.8
Sweden	5.5	3.4	2.4	2.1	5.7	2.0	2
Norway	4.7	3.5	3.1	1.7	5.3	2.4	2.5
Bulgaria	10.8	9.6	8.9	7.1	9.9	4.6	4.9
Croatia	7.8	5.7	4.4	4.0	7.4	4.3	3.0
Czech Republic	8.3	8.4	2.6	2.4	11.0	2.4	2.0
Hungary	15.5	9.2	5.5	5.4	18.0	5.1	3.4
Poland	9.7	6.7	5.1	4.5	11.6	5.0	5.4
Romania	10.6	9.0	7.2	6.5	10.5	5.2	4.1
Turkey	61.7	69.6	68.8	71.9	54.9	56.7	26.2
Serbia	14.1	10.9	8.0	6.4	12.6	5.3	5.5
Azerbaijan	7.6	3.6	6.6	3.3	9.2	5.6	5.6
Kazakhstan	13.2	10.6	9.5	8.9	14.9	8.6	6.9
Russia	5.1	6.8	7.0	6.9	5.8	6.2	4.5
Ukraine	15.5	15.0	15.0	-	16.7	12.6	-
China	0.1	0.0	0.8	0.9	0.5	1.3	1.8
India	6.6	4.7	5	4.9	5.5	4.7	4.8
Indonesia	3.5	3.3	3.7	3.4	4.0	3.5	3.6
Korea	3.2	3.8	2.8	2.1	3.7	2.3	2.1
Philippines	5.2	4.3	3.3	3.4	6.0	3.6	3.5
Singapore	4.3	3.9	3.4	3.3	4.9	3.2	2.7
Taiwan	2.0	1.9	1.6	1.5	2.1	1.5	1.8

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

Source: ING estimates

Oil and natural gas price forecasts (avg)

	3Q23F	4Q23F	1Q24F	2023F	2024F	2025F
Brent ($/bbl)	**86.00**	**92.00**	**85.00**	**85.00**	**90.00**	**80.00**
Dutch TTF (EUR/MWh)	34.00	50.00	55.00	43.00	46.00	40.00
Metals forecast						
Copper	8,401	8,300	8,400	8,530	8,475	8,700
Aluminium	2204	2,250	2,250	2,294	2,288	2,350
Nickel	20,624	19,500	20,000	22,177	20,063	22,625
Zinc	2,447	2,550	2,550	2,659	2,575	2,625
Lead	2,158	2,150	2,200	2,136	2,175	2,125
Gold	1,927	1,900	1,950	1,924	2,050	2,100
Silver	23.6	22	22.5	23	23	23.5
Iron Ore	108	100	100	108	100	90

Source: ING estimates

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