2020: muddling through (at best!)

December 2019

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thinkforward

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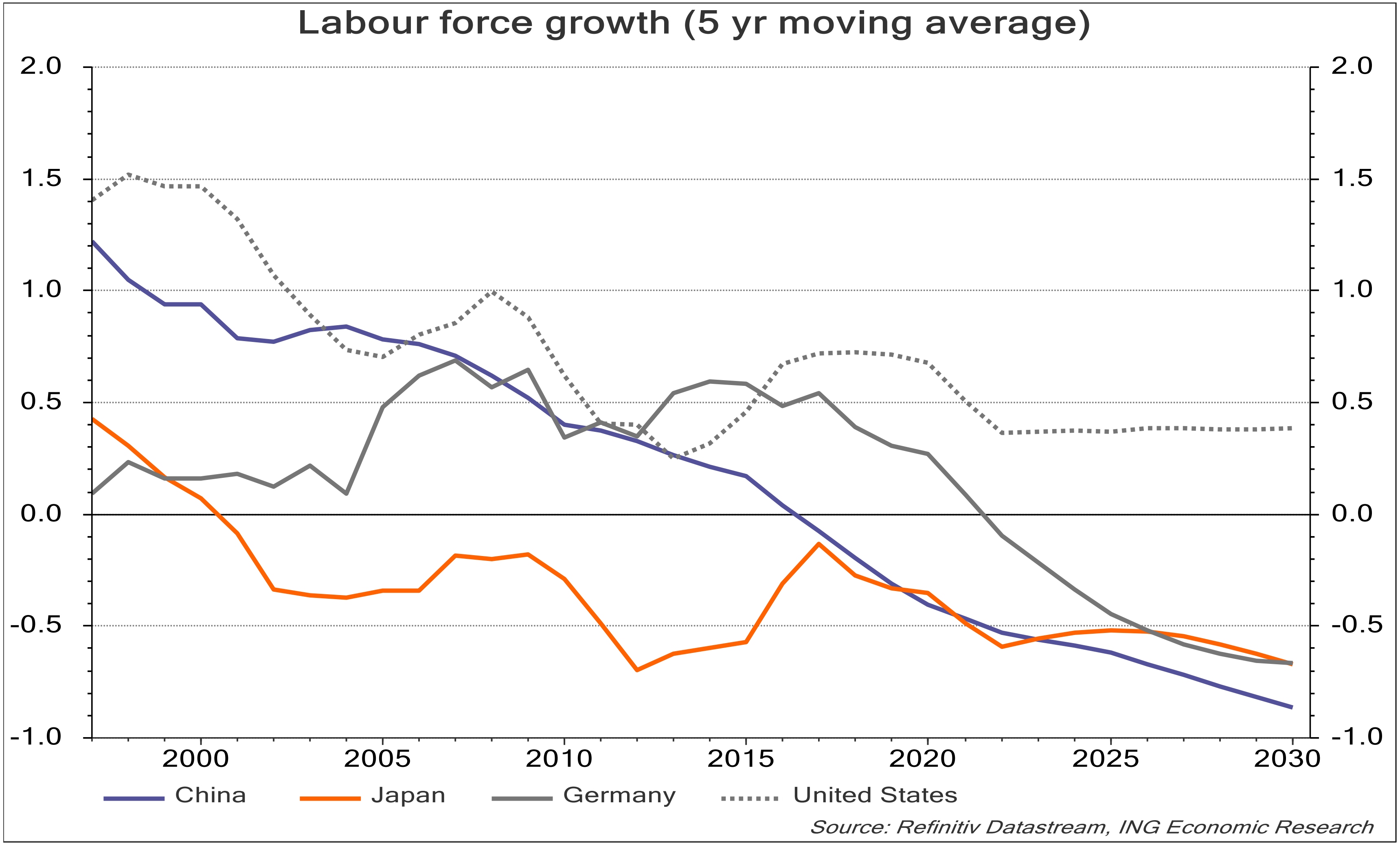
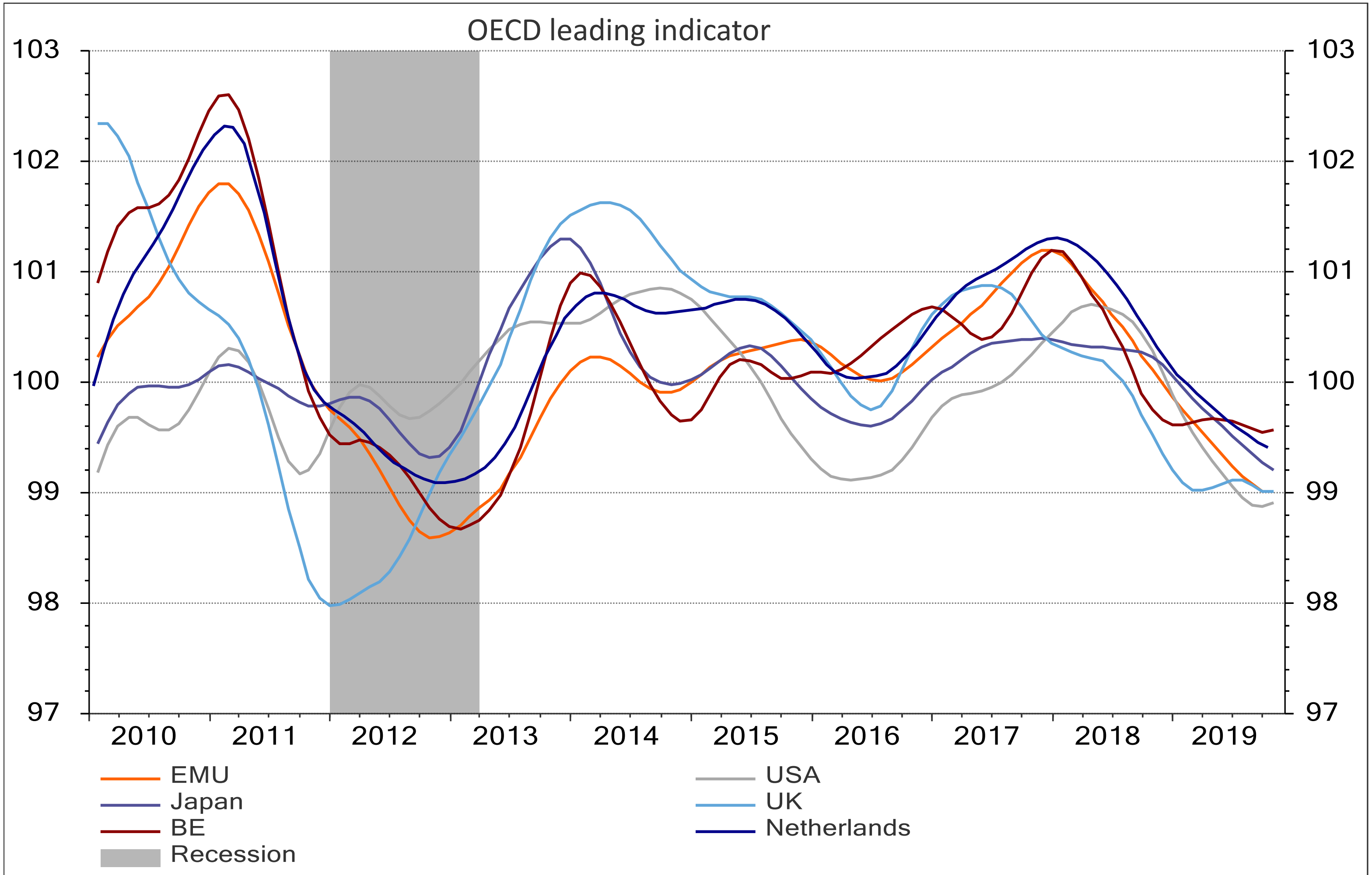
Labour force growth is pushing trend GDP growth down



Neutral interest rate has declined in the Eurozone

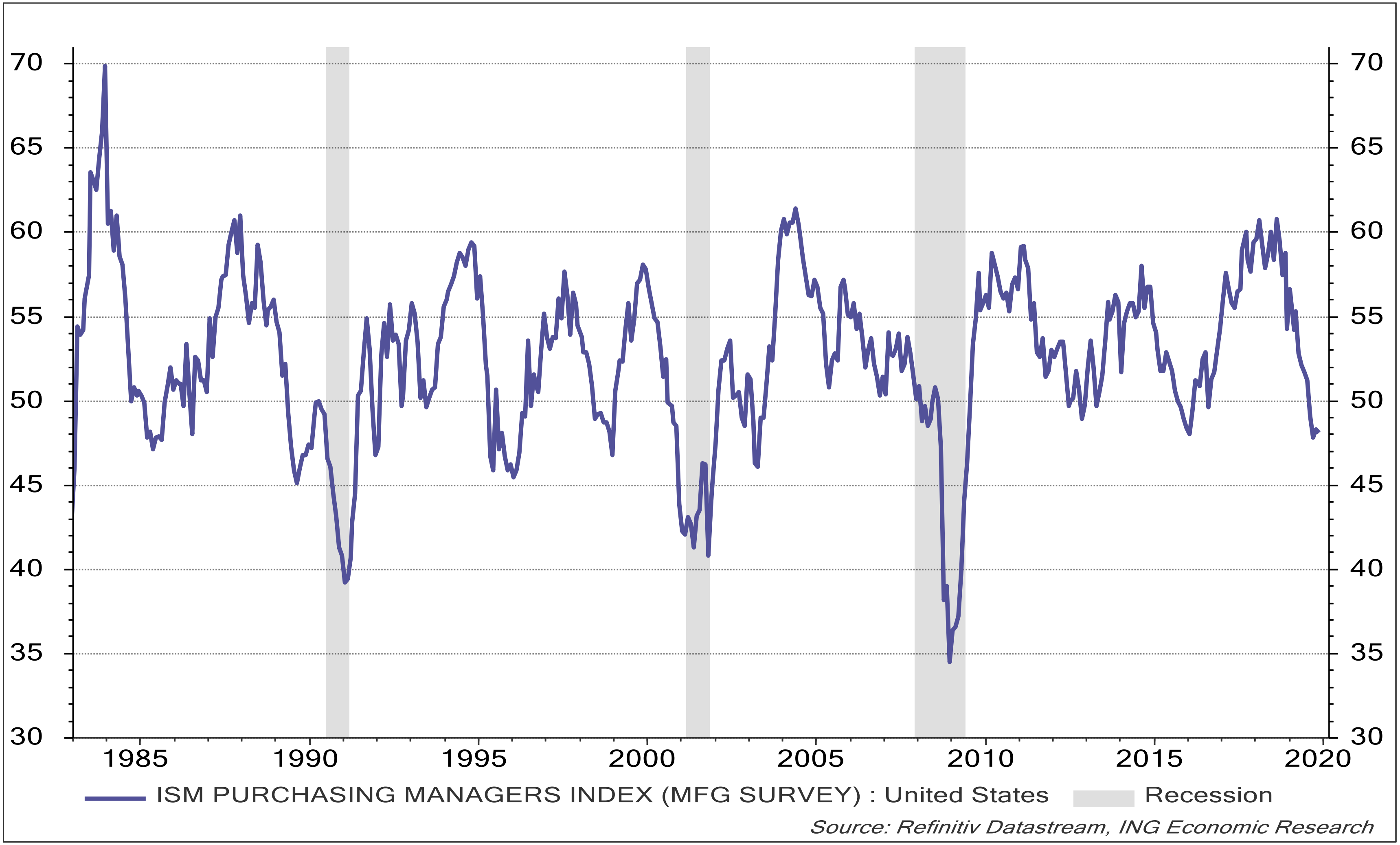
Nominal R* based on Laubach, Holston & Williams

Significant slowdown in OECD countries

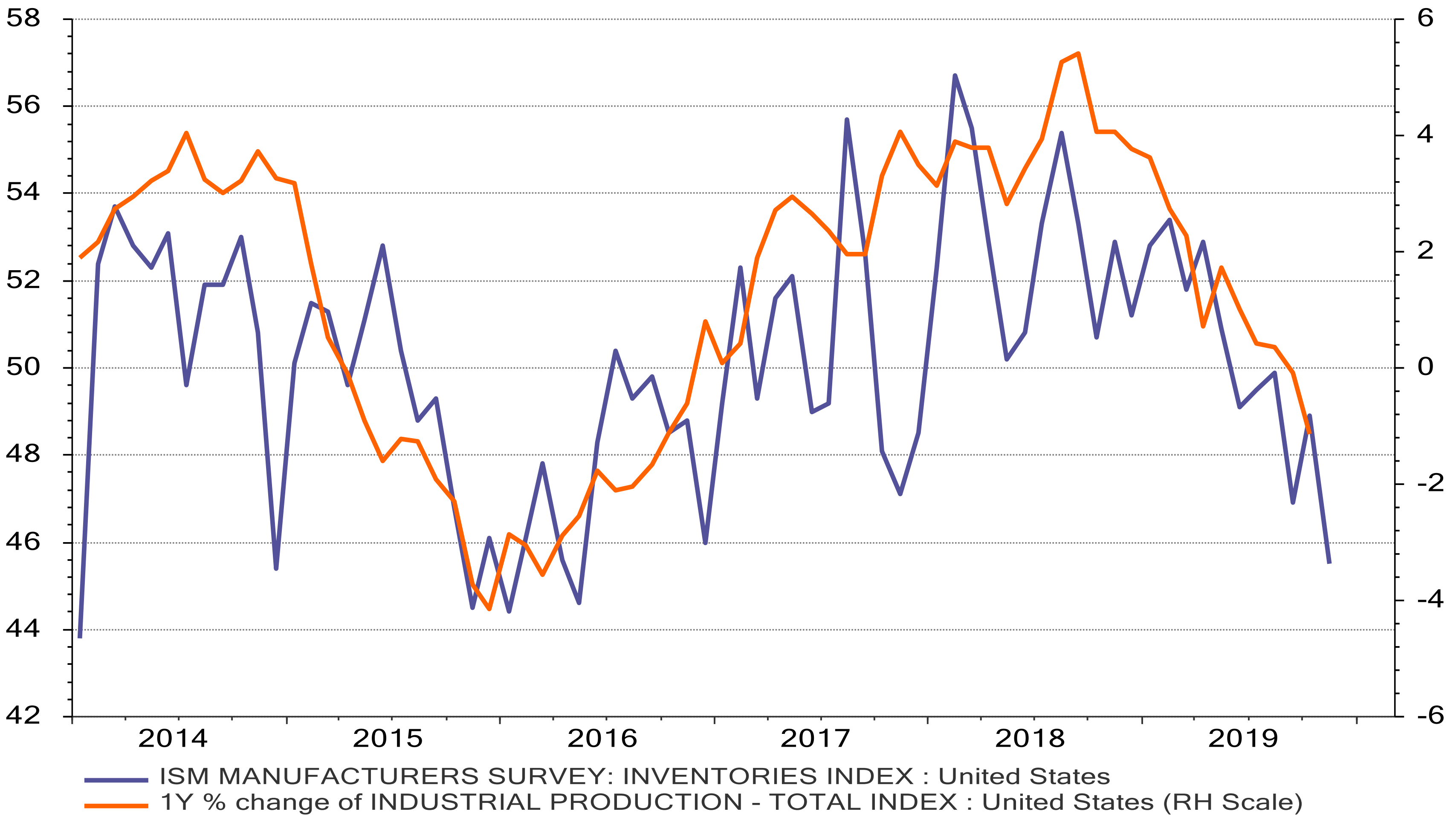


Source: Refinitiv Datastream, ING Economic Research

Mini-cycle in a slowing growth trend?

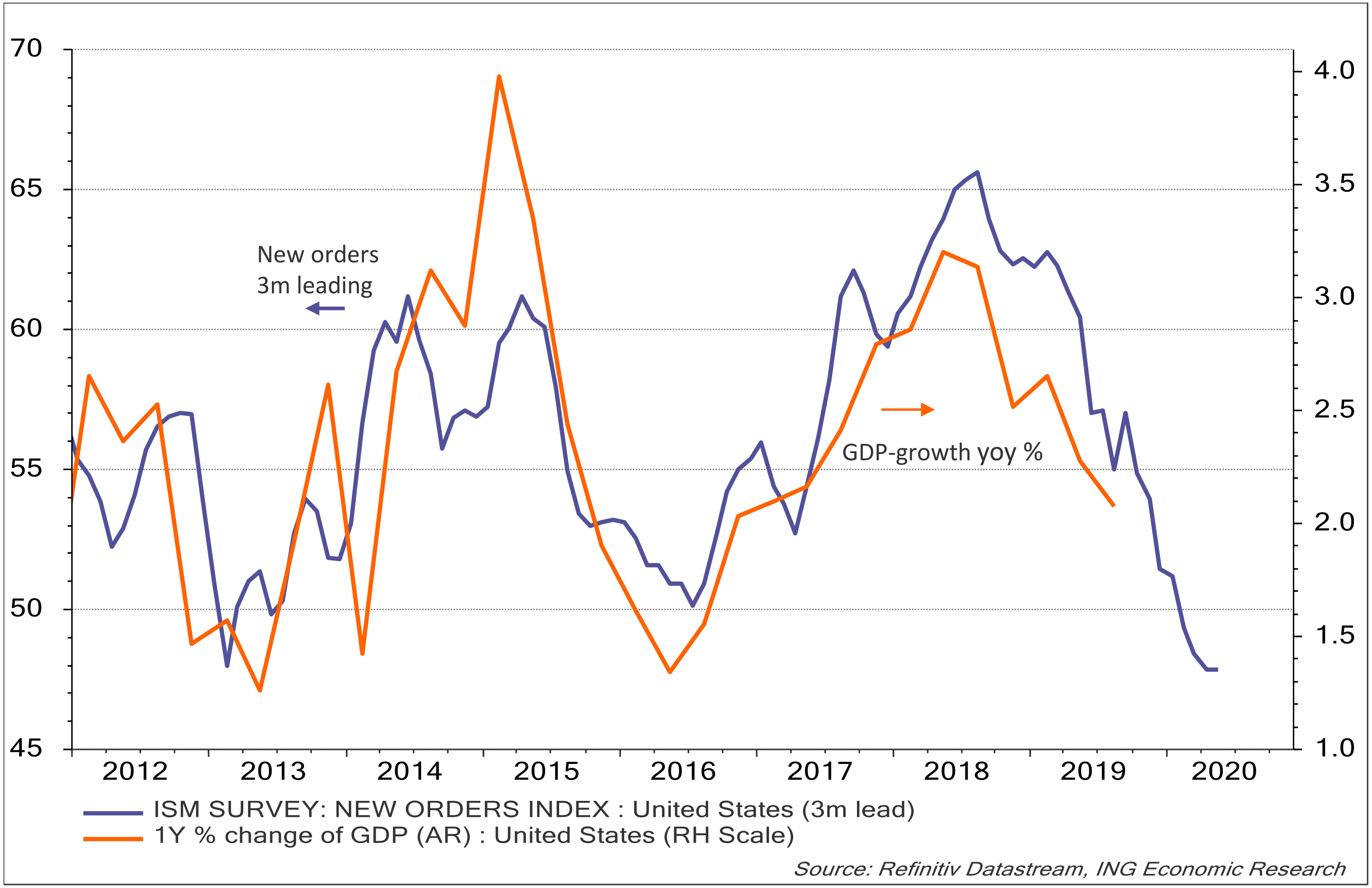


Inventory correction is not finished yet…

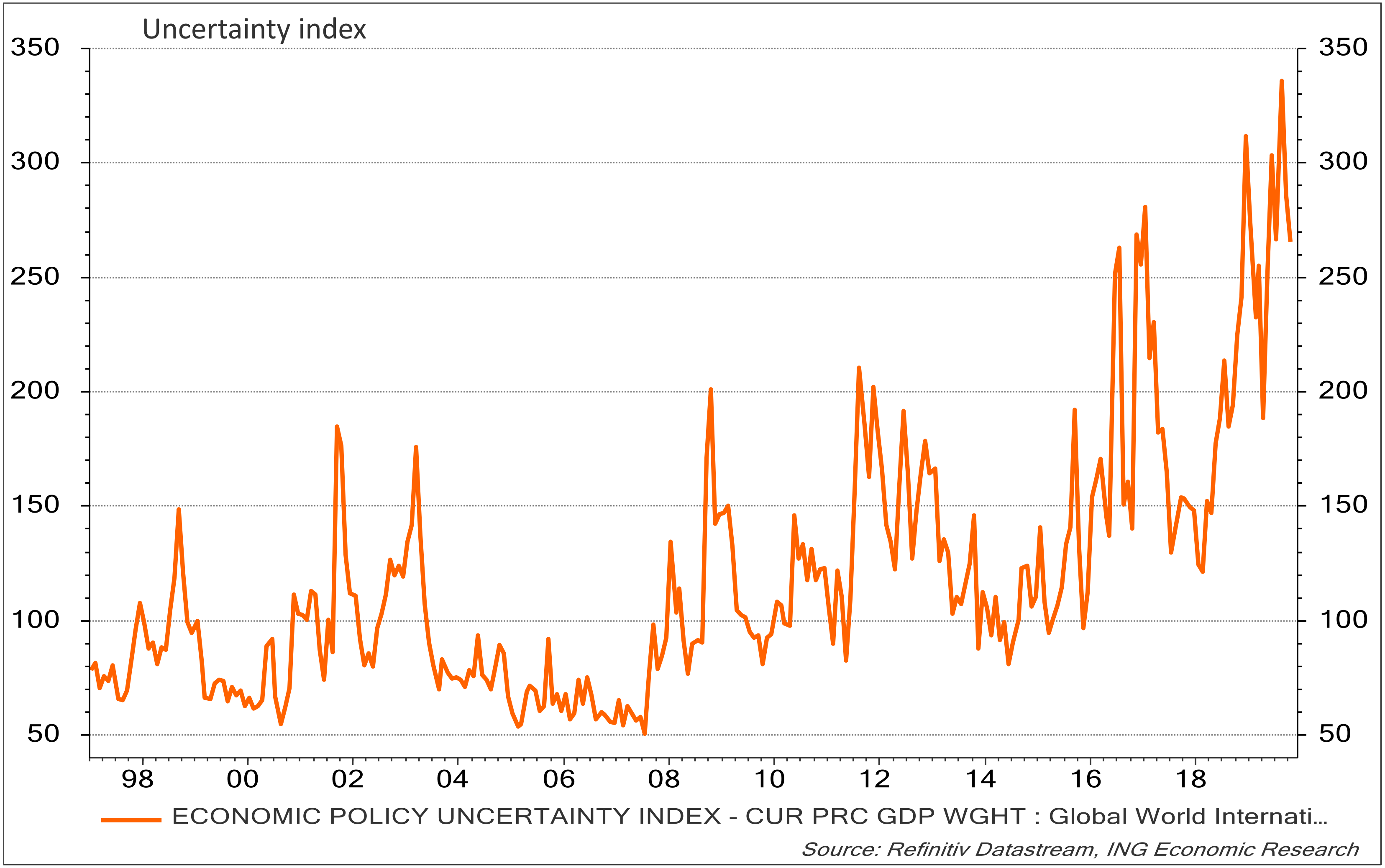


Source: Refinitiv Datastream, ING Economic Research

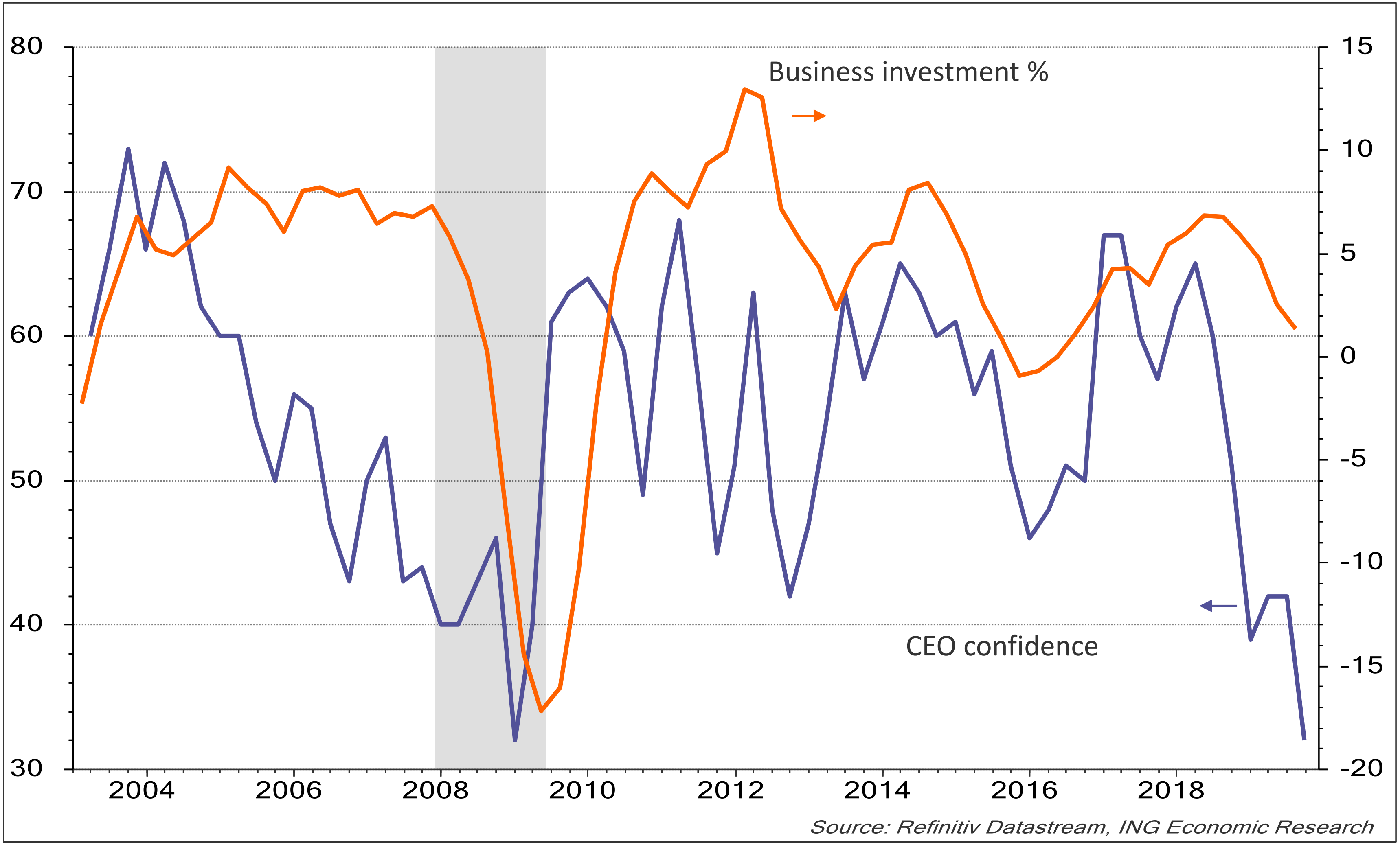
…and new orders are still weak



External environment remains uncertain…



…especially hurting business investment



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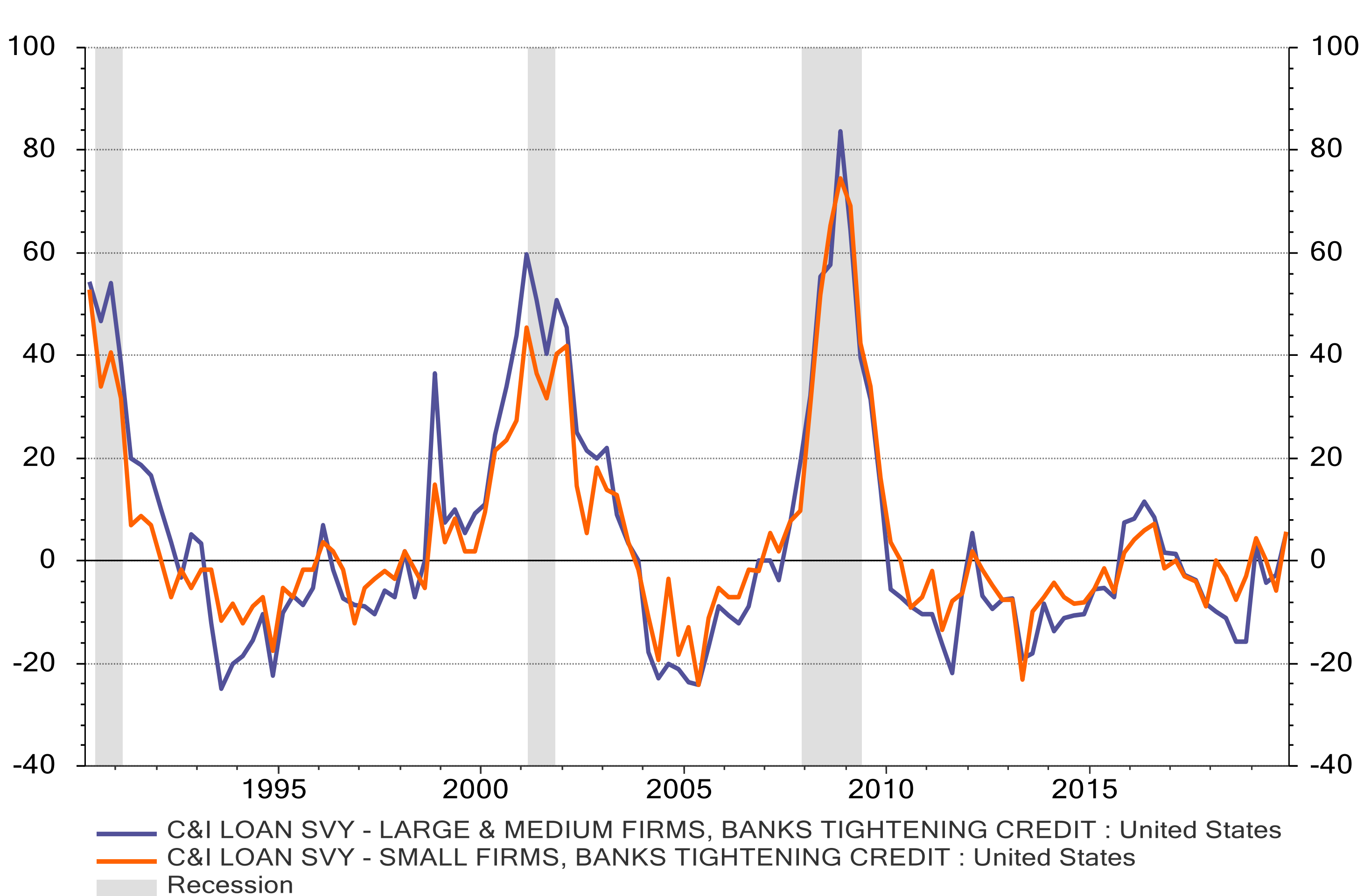
US bank credit remains relatively easy



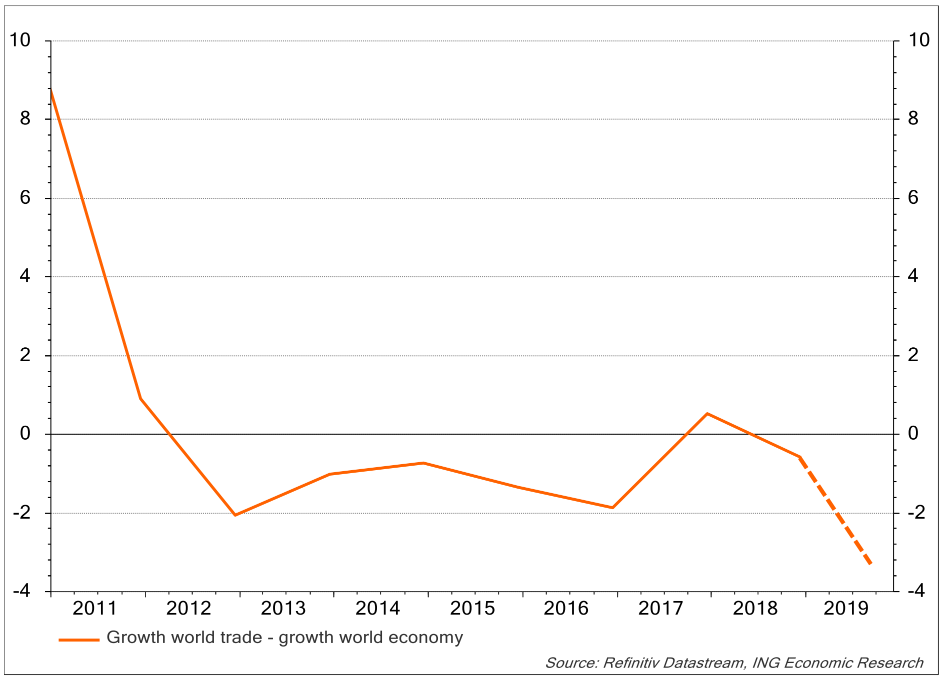
Source: Refinitiv Datastream, ING Economic Research

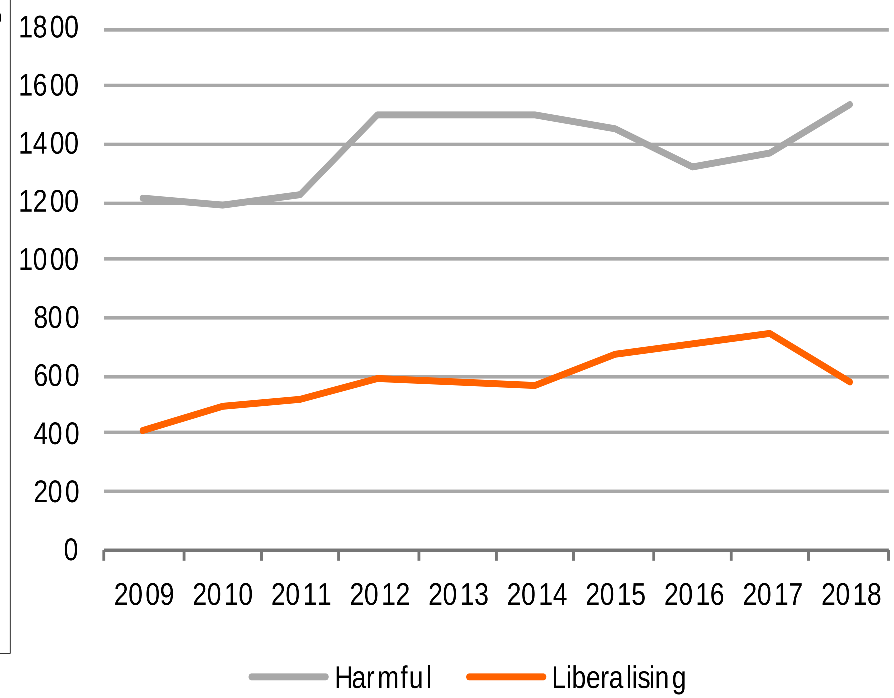
Trump cannot afford a recession during the election campaign…

…but deglobalisation will continue after the elections

World trade penetration is falling…

…and protectionist measure outnumber liberalising ones





Polarisation of political landscape is not conducive to more free trade

China: still not full steam ahead

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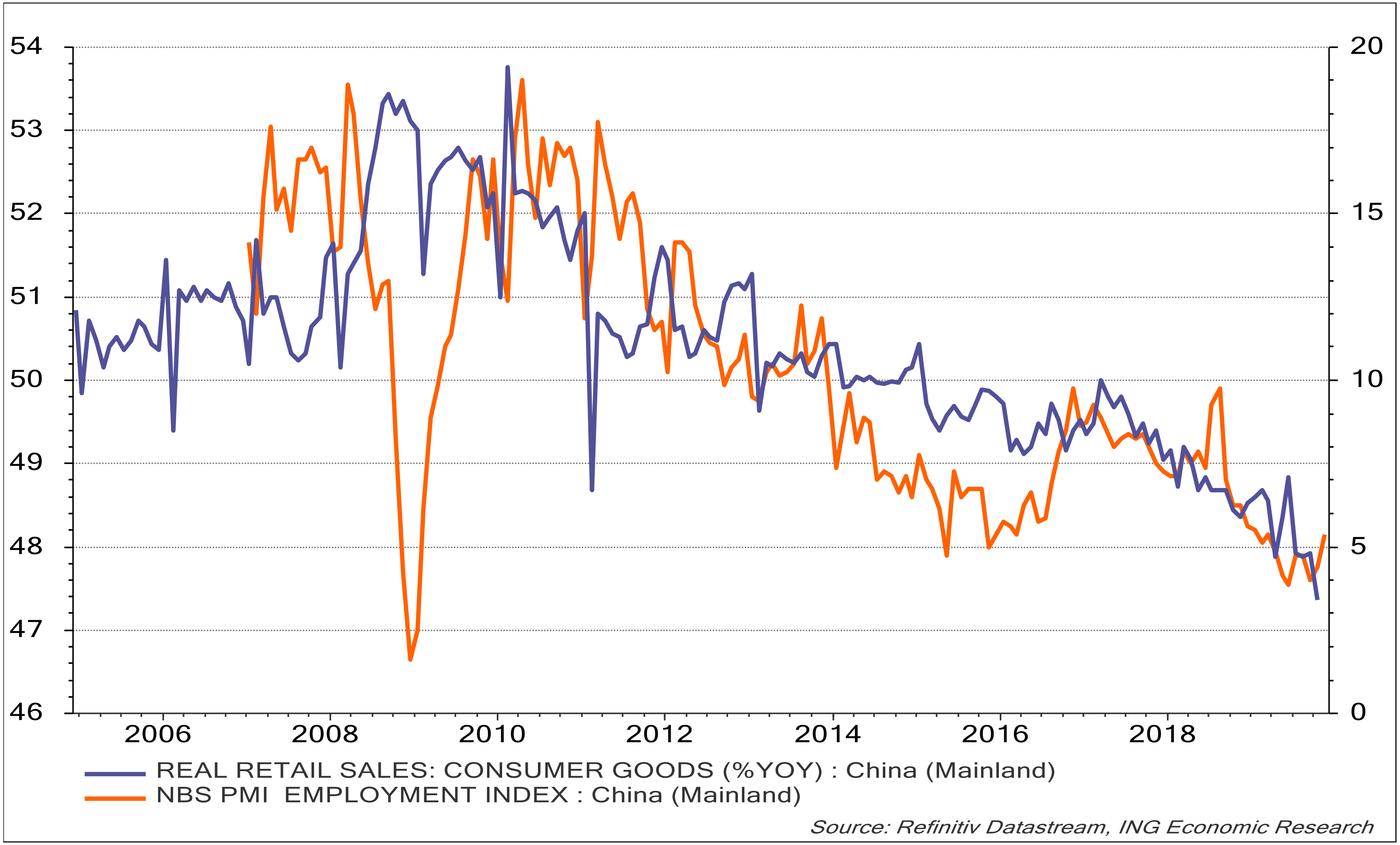
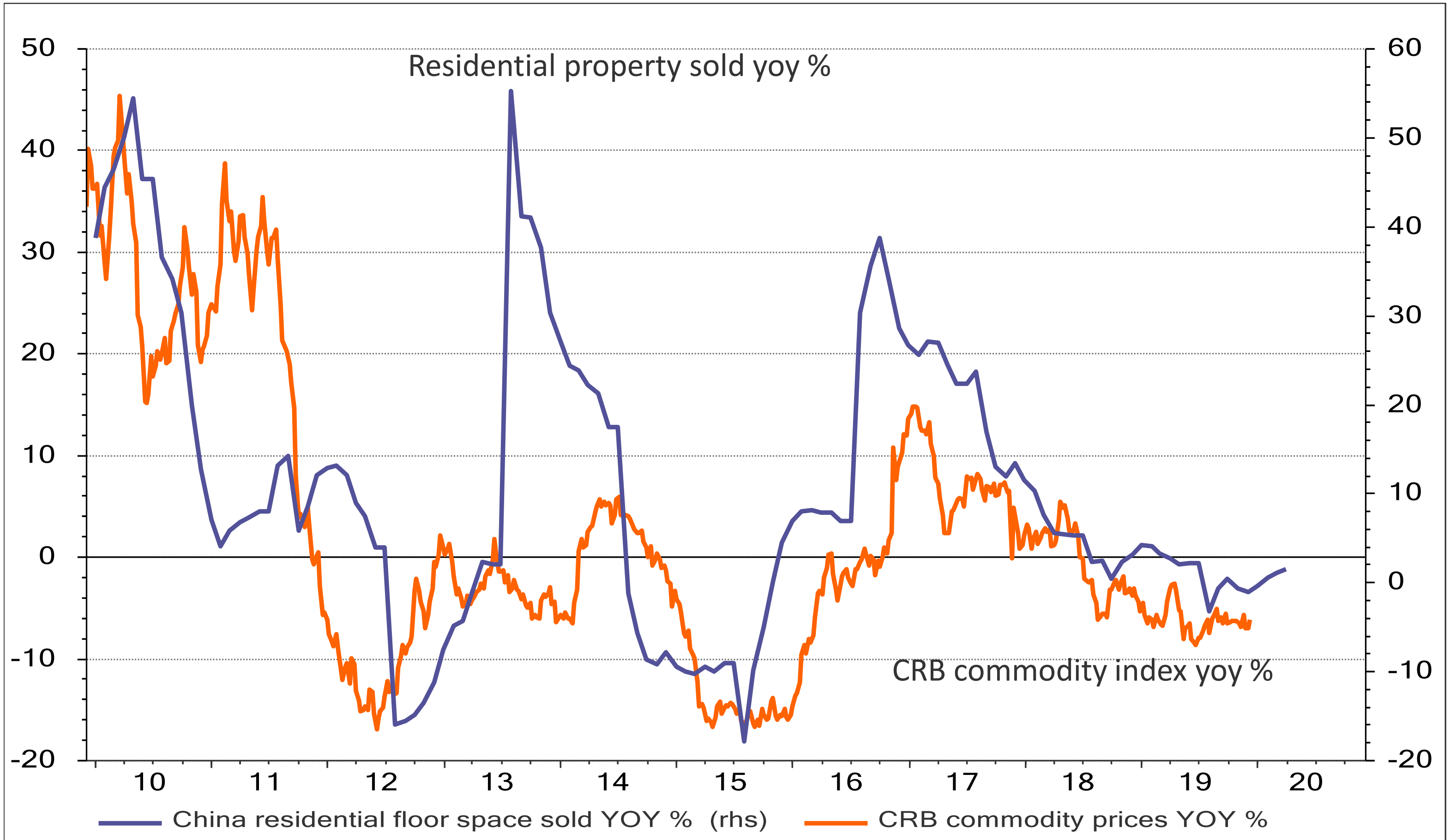
Weaker job market, weaker retail sales growth

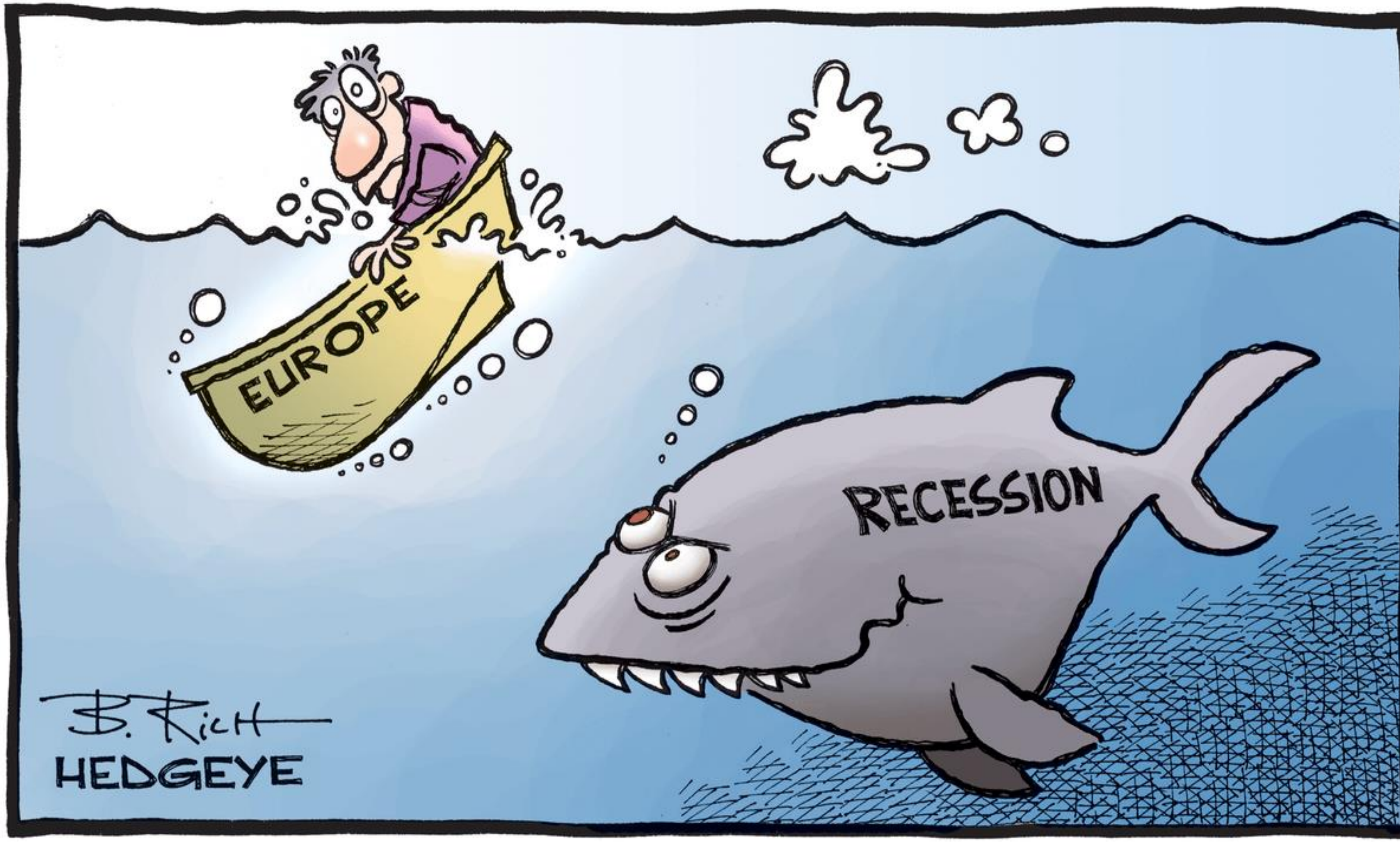


Commodity prices: no real boost from China

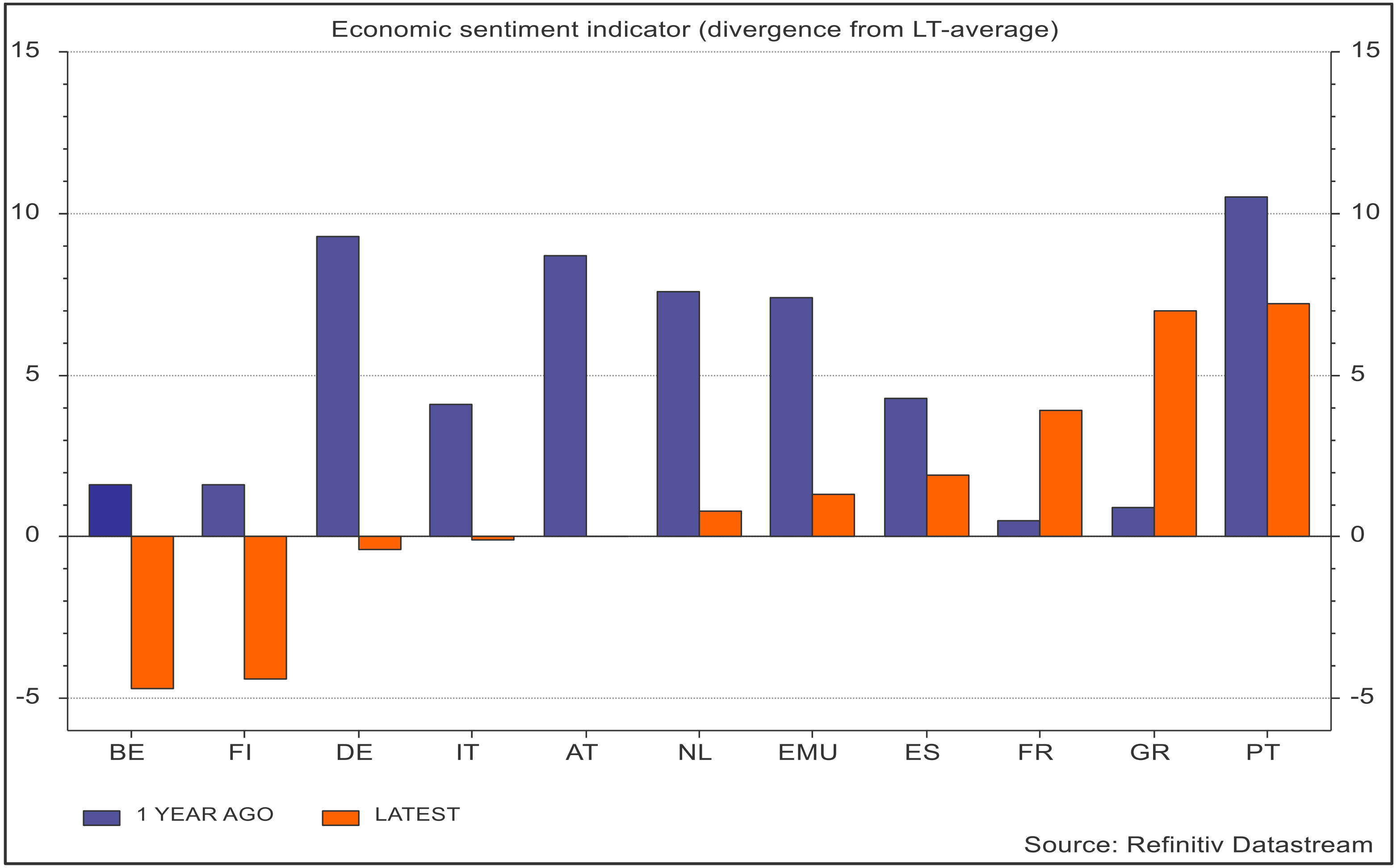


Source: Refinitiv Datastream, ING Economic Research

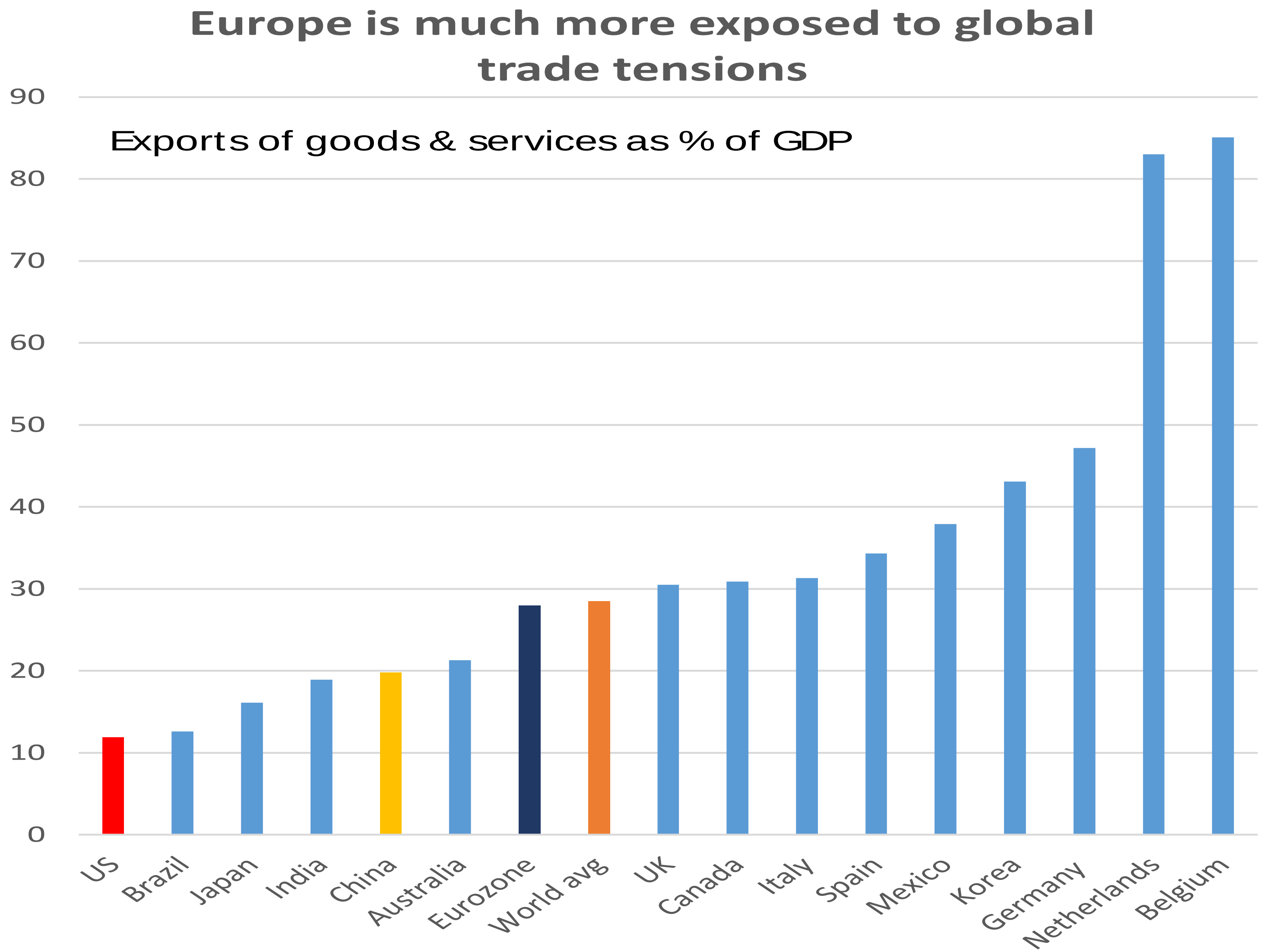
European growth has weakened



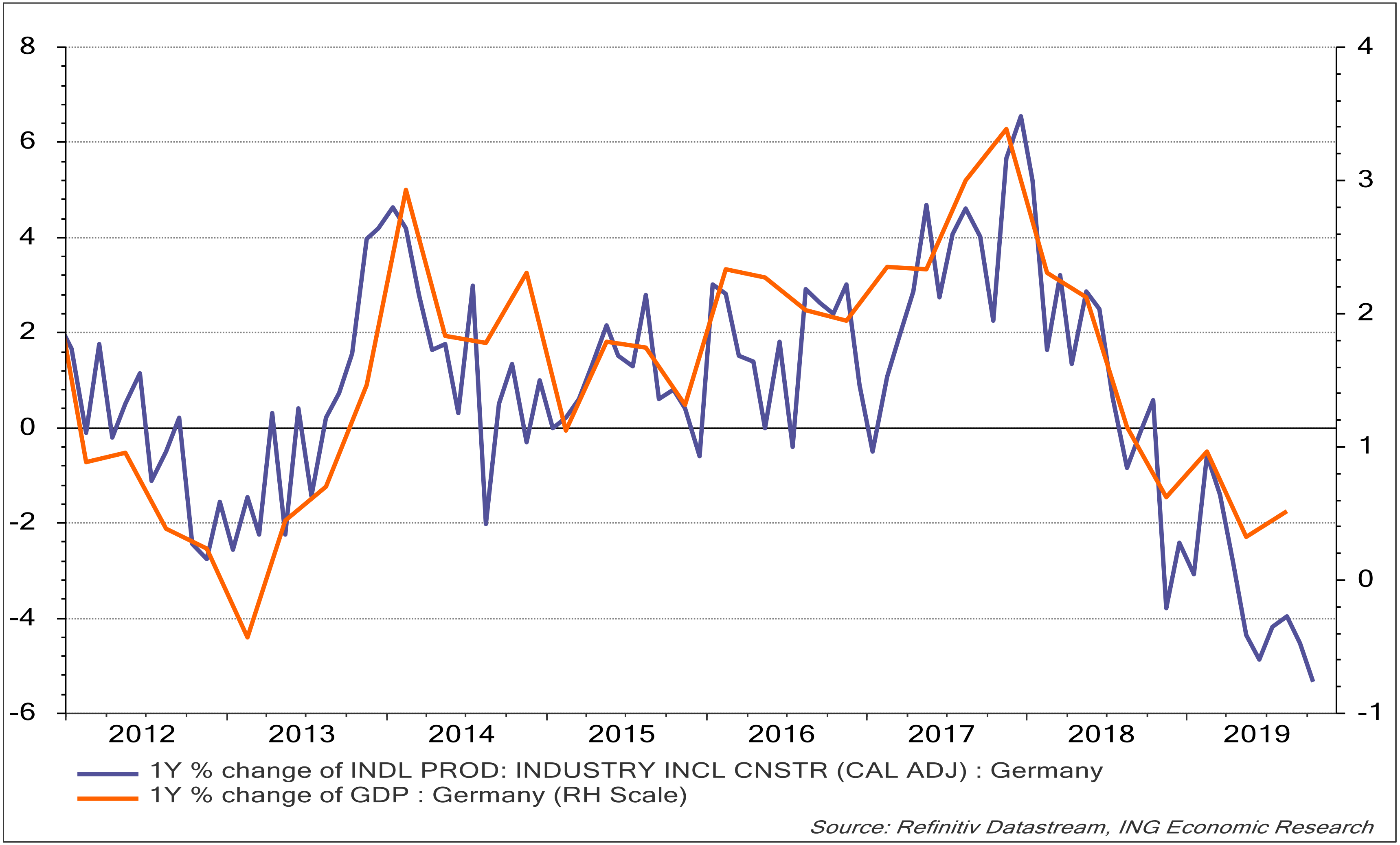
Economic sentiment fell back significantly in the Eurozone



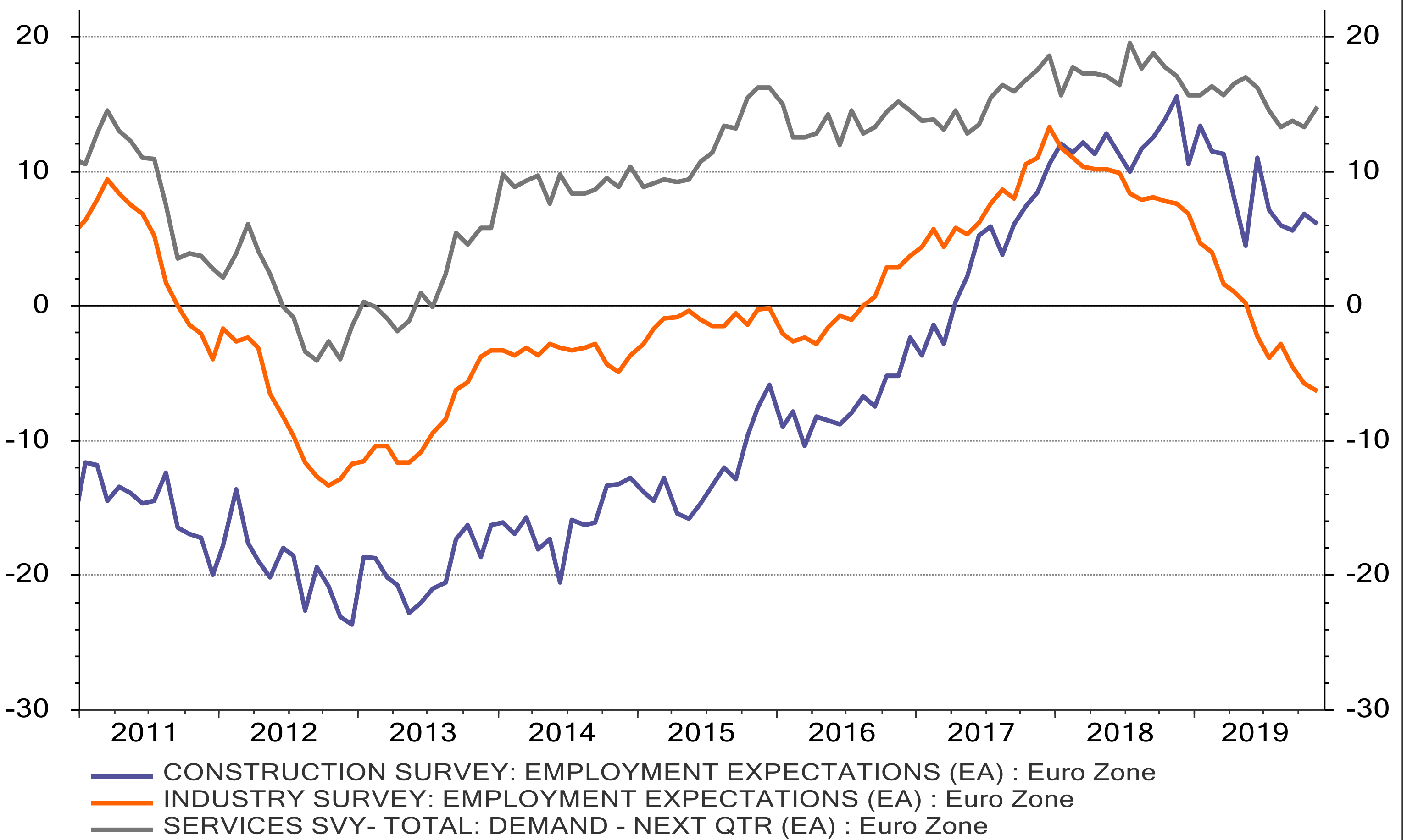
Europe more exposed to trade war



Weak Q4 to be expected, because of weak industry



Hiring intentions are moderating in the Eurozone



Source: Refinitiv Datastream, ING Economic Research

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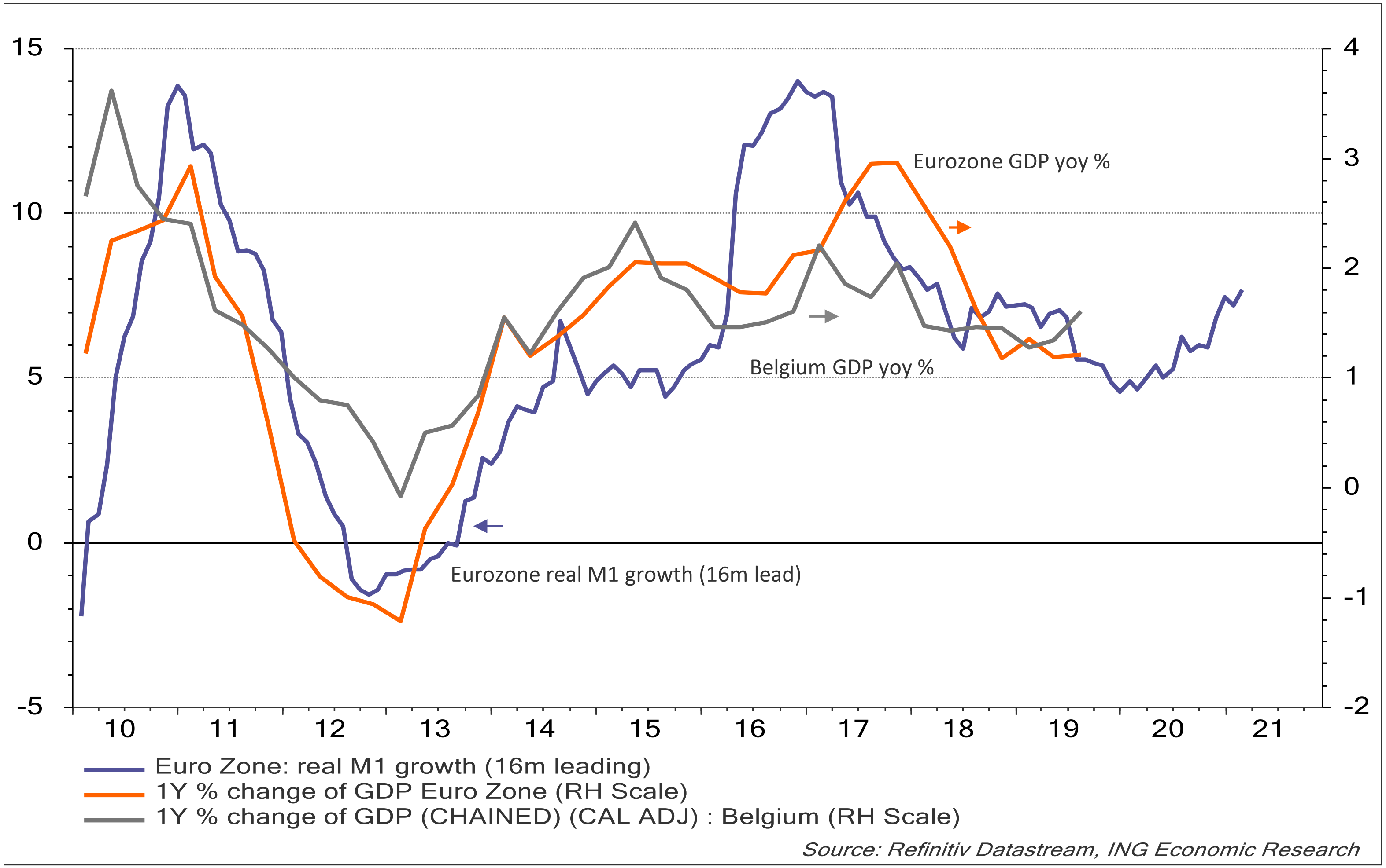
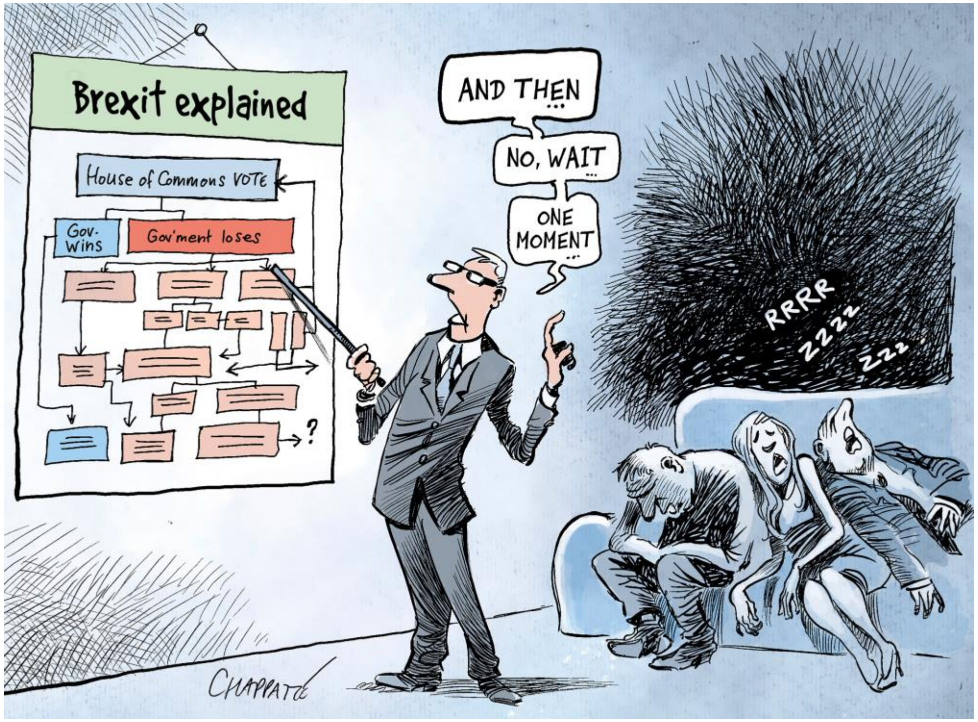
Leading indicators suggest some growth deceleration, but no recession (yet)



Trade war risk? Brexit? Italy?



UK: the biggest new risk: an abrupt end to the transition period

Without a swift agreement on the UK paying into the 2021+ EU budget, talk of the new 'no deal' will intensify

2020

12 December
Election date

January
New Parliament returns. If Conservative majority, deal likely to be ratified before 31 January deadline

Feb-June
Initial trade talks will quickly turn to money

30 June 2020
Deadline to extend transition period, set out within withdrawal agreement

Default: UK (ex NI) leaves single market and customs union

31 December 2020
Current end date of transition period

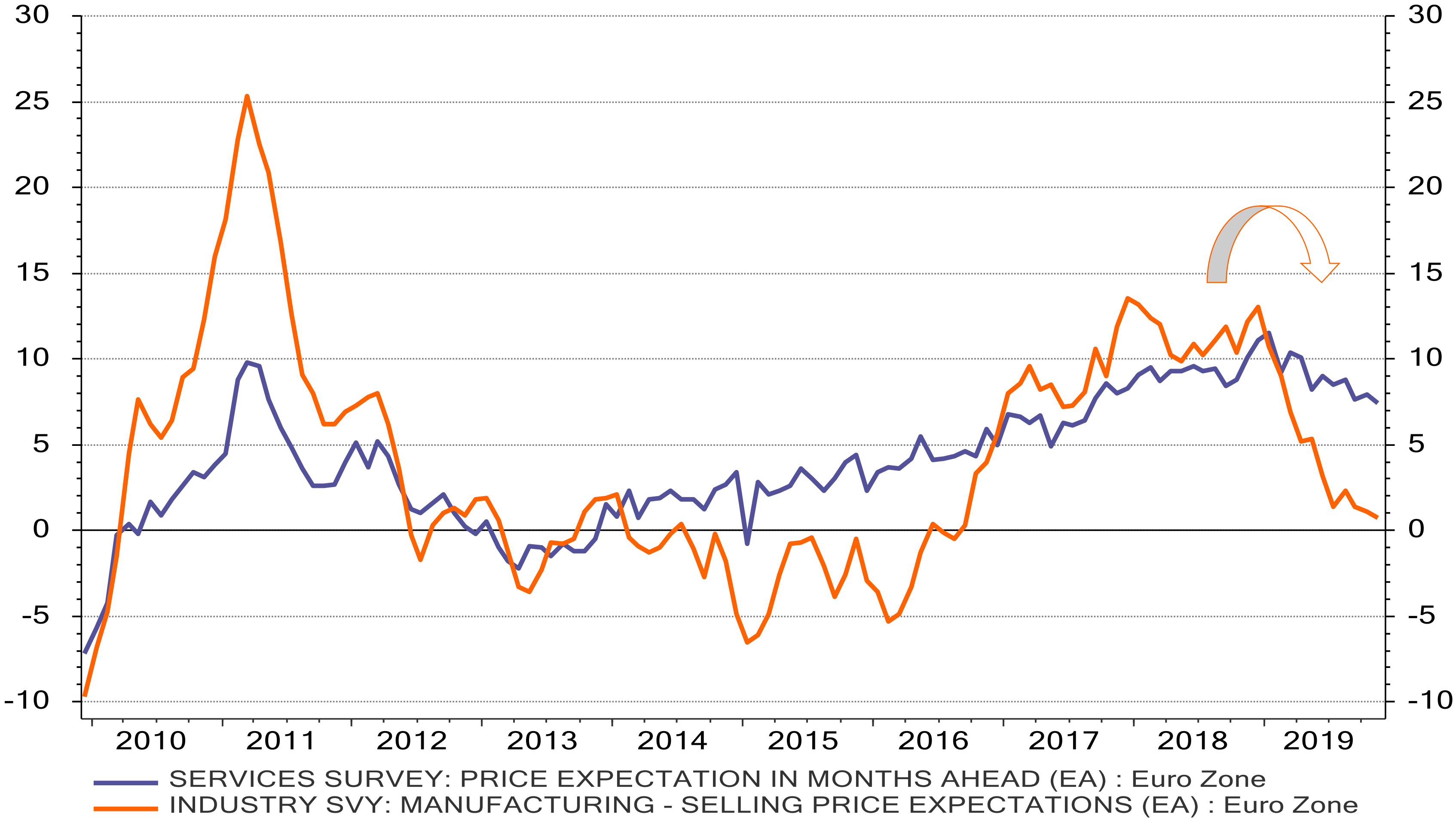
Things that need to happen to ensure smooth exit in December 2020

- Negotiate free-trade agreement with the European Union – Michel Barnier has estimated this could take two/three years or longer
- If the transition period is to be extended, negotiate the UK's contribution to the EU's next multi-annual. This could get messy – particularly given that the UK will have lost its right to a rebate
- Hire staff to operate new customs, regulatory checks at the UK entry points
- Build and implement new border checks/online technology to handle new paperwork/payments
- Implement new checks/controls on goods flowing between GB and Northern Ireland. Set criteria determining "at risk" goods

Growth outlook: still positive, but below consensus

	2018	2019	2020	Consensus 2020
USA	2.9	2.3	1.4	1.8
Eurozone	1.8	1.1	0.7	1.0
UK	1.3	1.4	1.0	1.1
Belgium	1.5	1.3	0.7	1.0
Japan	0.8	1.3	0.2	0.3
China	6.6	6.3	5.9	5.9

Pricing power is softening in the Eurozone => inflation to remain low



Source: Refinitiv Datastream, ING Economic Research

ECB maintains a low interest rate policy

“We expect interest rates to remain at their present or lower levels until we have seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within our projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

ECB inflation forecast remains low over the next 2 years

There is a higher probability that interest rates will be cut further than that they will be raised in the period 2020-2021!

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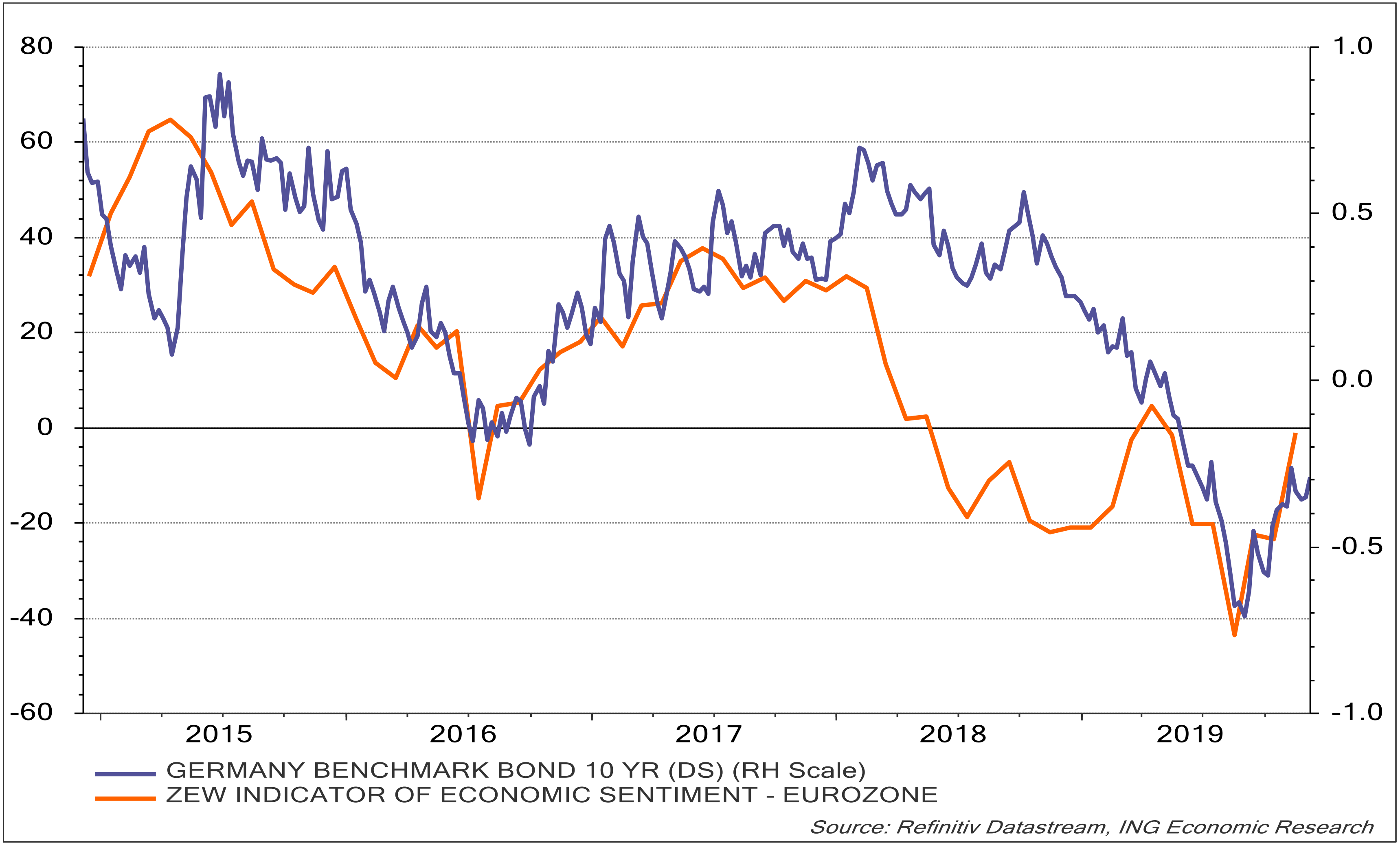
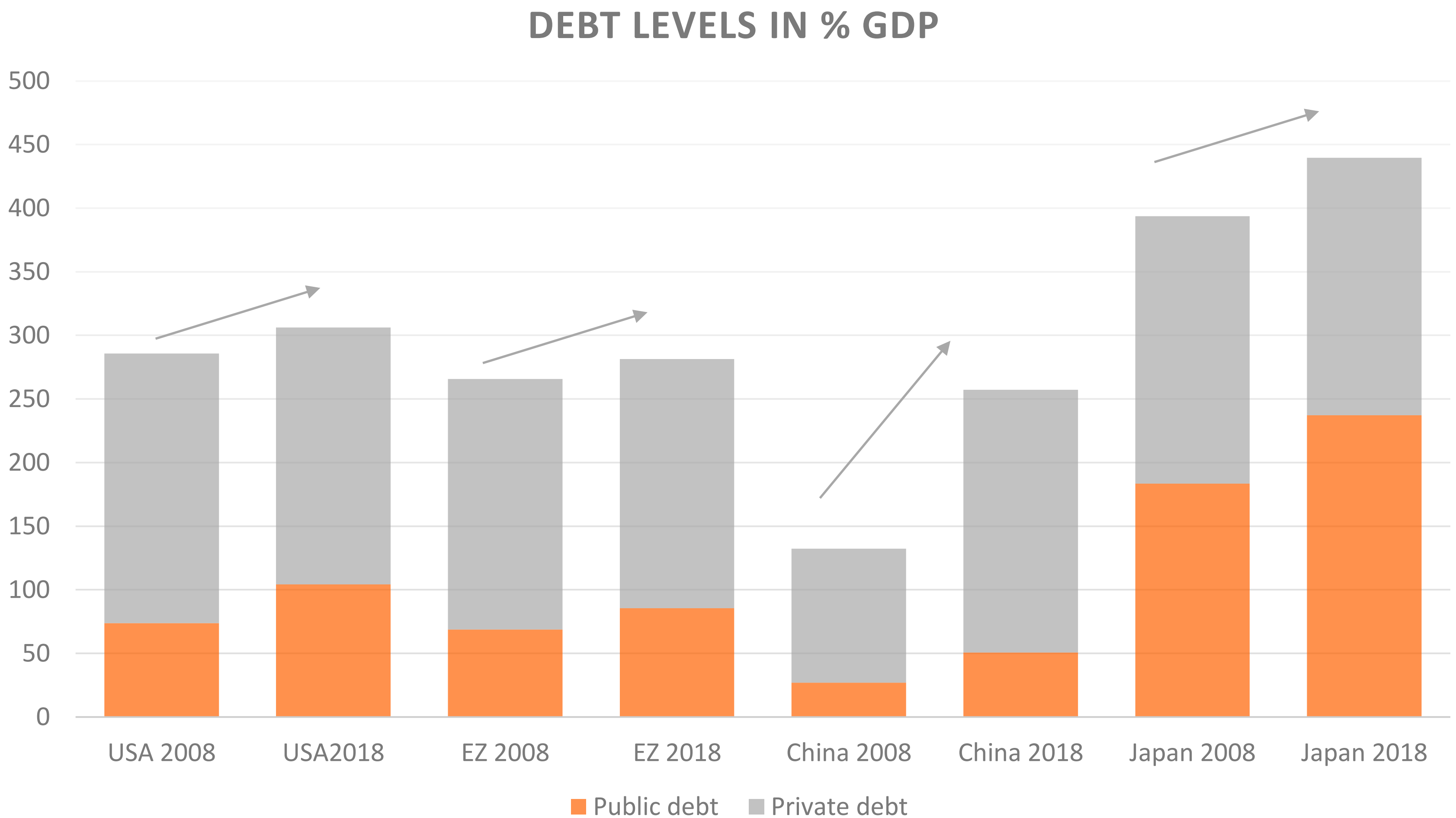
How long can the ECB continue to buy bonds? (probably until the end of 2021)

		PSPP holdings (est.)		PSPP space left	
					unchanged issuer limits
		(bn)	(% of stock)*	(bn)	(years)**
GE	Germany	434	26%	119	2.7y
NE	Netherlands	93	25%	30	3.1y
FI	Finland	29	25%	9	2.4y
AS	Austria	48	20%	31	6.5y
FR	France	348	18%	285	8.4y
BE	Belgium	59	17%	57	9.5y
IR	Ireland	27	23%	13	4.8y
PO	Portugal	34	26%	10	1.0y
SP	Spain	216	24%	89	4.5y
IT	Italy	314	19%	268	9.5y
SNAT	Supras	205	36%	81	4.5y

Expectations of recovery could push bond yields slightly higher in 2020

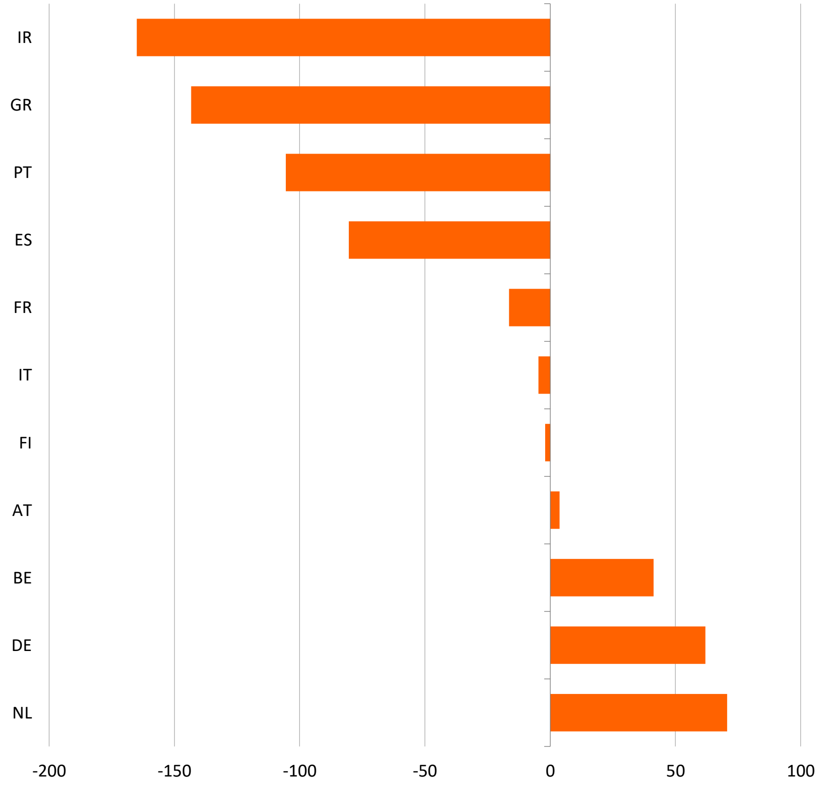


Debt levels are higher than at the start of the debt crisis, maintaining the need for low interest rates



Tensions within the ECB's Governing Council

Net external assets in % GDP



The ECB's strategic review: not a big impact

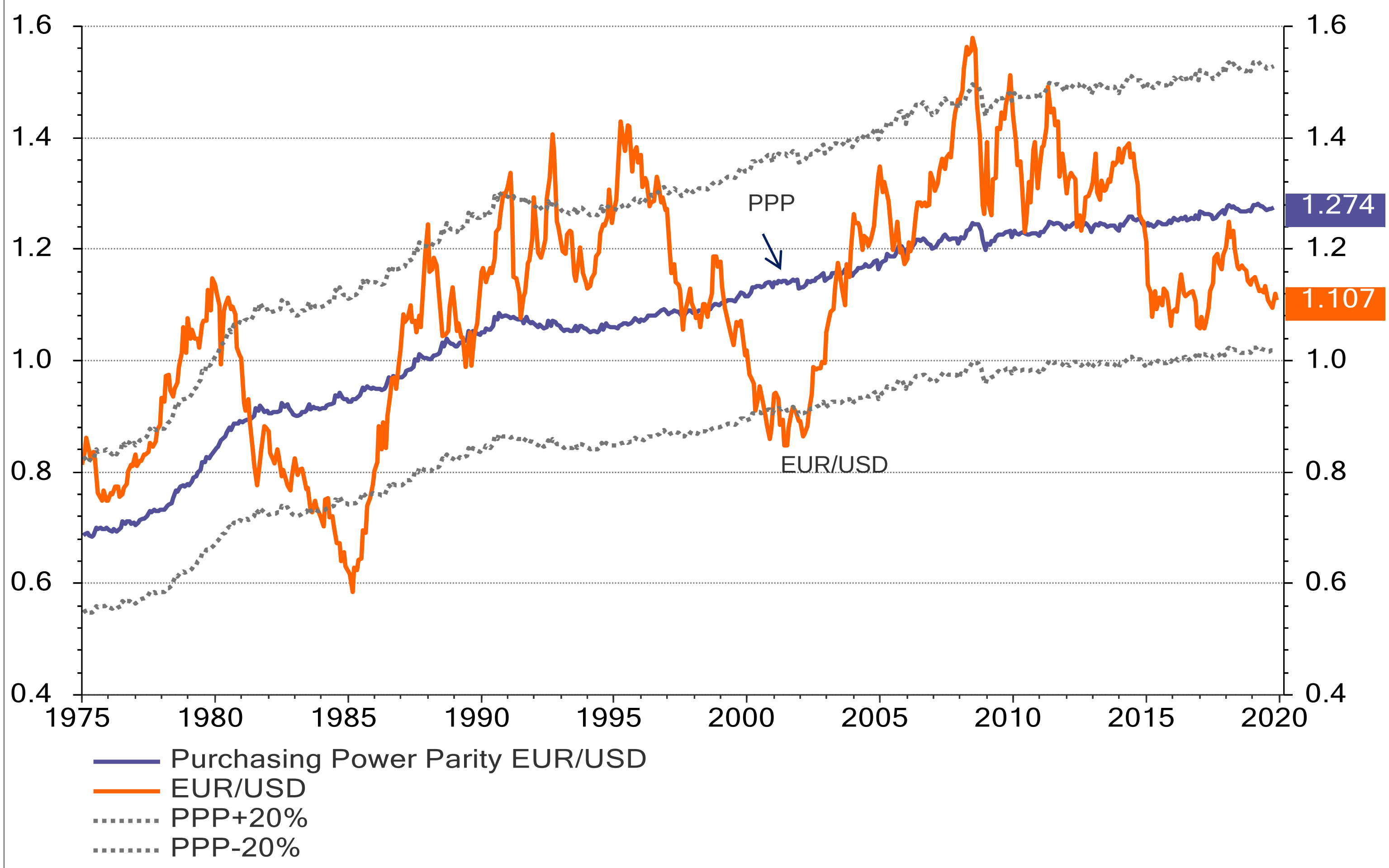
- **No big change to be expected in the definition of "price stability"**":
  - Certainly not a lower inflation target
  - Even an inflation range seems unlikely, as it would still introduce a downward bias, but potentially an inflation target "around 2.0%"

- **Voting with a mention of the name of the dissenters seems unlikely** as it would open the door for national pressure on the members of the Governing Council, although they are appointed in their personal capacity and not as representatives of their Member States

- **Some attention to climate change** (If inflation criterion is fulfilled, the **ECB has** a mandate to **support** the **general** economic policies in the Union with a view to contributing to the **general objectives** of the Union)
  - incorporation of climate change in the models
  - checking that banks take account of climate risks
  - ECB pension fund investments
  - Green emphasis in QE bond purchases
  - But <u>no</u> helicopter money to finance green investments!

Echange rates

EUR/USD and Purchasing Power Parity



Source: Refinitiv Datastream, ING Economic Research

Speculators are still short euro, long dollar

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Conclusions

- World economy cooling rapidly, though growth is likely to remain positive in 2020 (but <1% in most European countries). Subdued improvement likely in the course of 2020

- Trump will temper the trade war next year

- ECB will keep money market rates in negative territory at least until 2021, Fed will lower interest, but not much

- Bond yields could rise marginally over the next few years, but the interest rate level is bound to remain structurally low

- Limited downward dollar risk