



Have the markets got it wrong on US growth?

Our answers to this month's big questions



Our top six themes this month

Global Economics
and Strategy Team

January 2017



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Financial and Economic Analysis

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Markets have priced in US reflation:
Why it's not that simple...

#2

Surprise! Are you ready for a Fed
hike in March?

#3

Brexit: What you need to know
right now

#4

Could France and the Netherlands
really have an EU vote too?

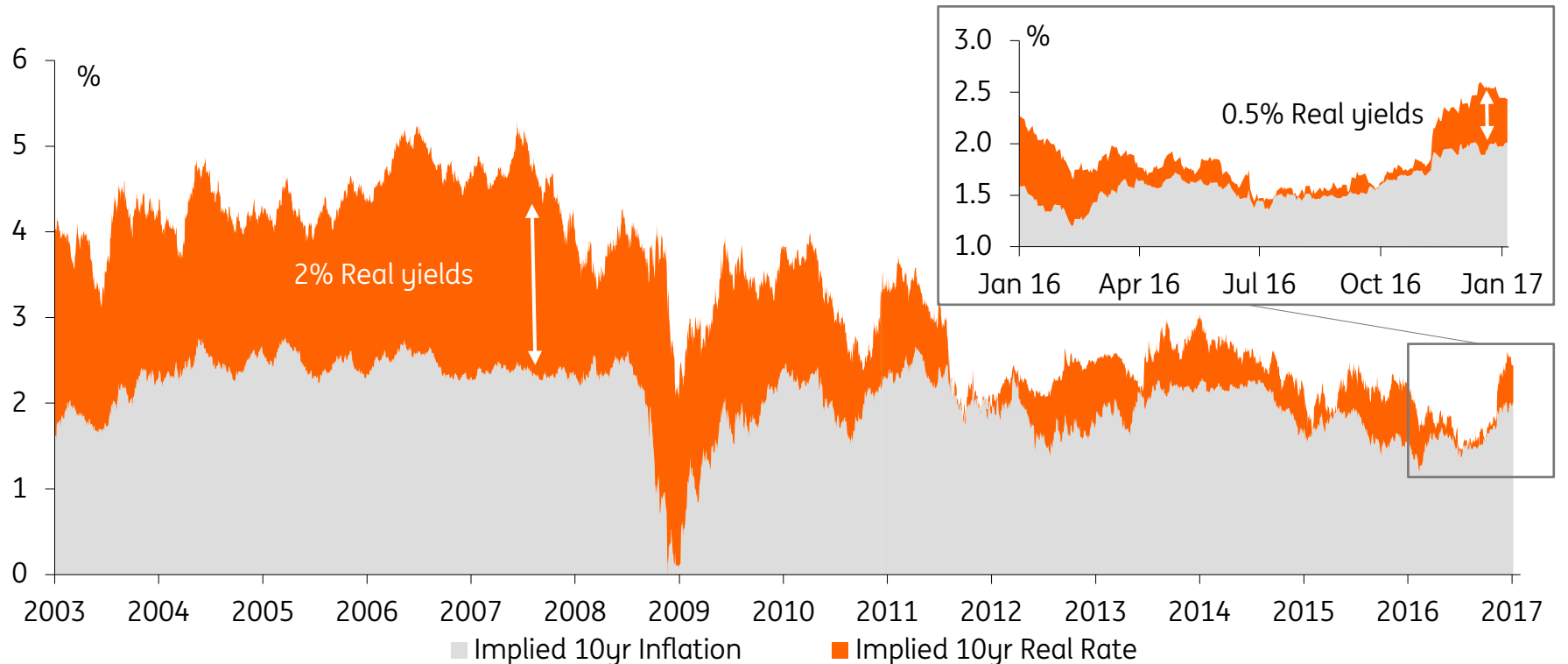
#5

Why you shouldn't get carried
away by oil's rally

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How can the euro cope with the
dollar's relentless rise?

Markets are once again pricing in higher US growth



- The 10 year real rate is now back around 0.5%, having been virtually zero through the middle of 2016.
- That's come as markets have reevaluated growth prospects under President Trump
- The risk to this comes from 'Trump-unknowns' and to a greater extent, uncertain European politics.
- In a worse risk case scenario, we could see a sub-2% 10yr yield.

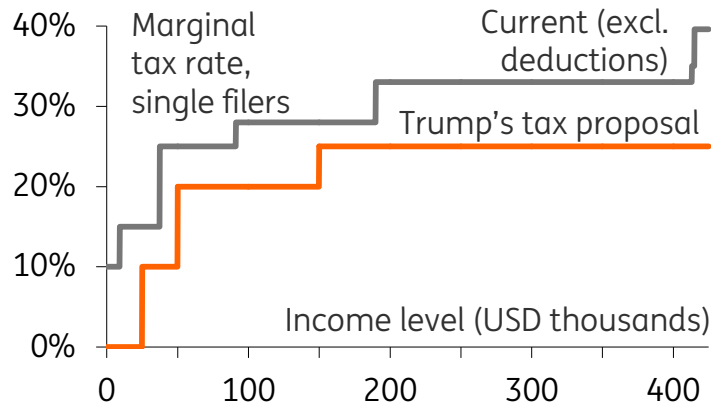
Markets have priced in US reflation. But it's not that simple...



Trump's wish list (Presidential budget)

Submits to Congress by 6 February

- ✓ Household tax cuts (flatter/lower?)
- ✓ Corporation tax cut (35% → 15%?)
- ✓ Temporary "tax amnesty" for overseas retained earnings
- ✓ Infrastructure spending

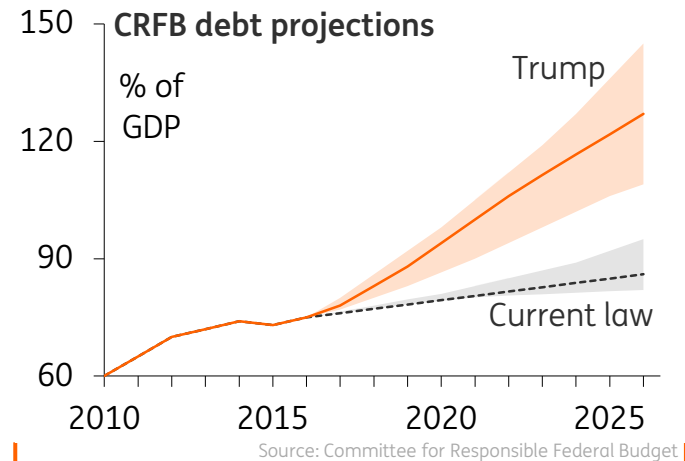


Source: Tax Foundation, Donald Trump

Debt ceiling deadline

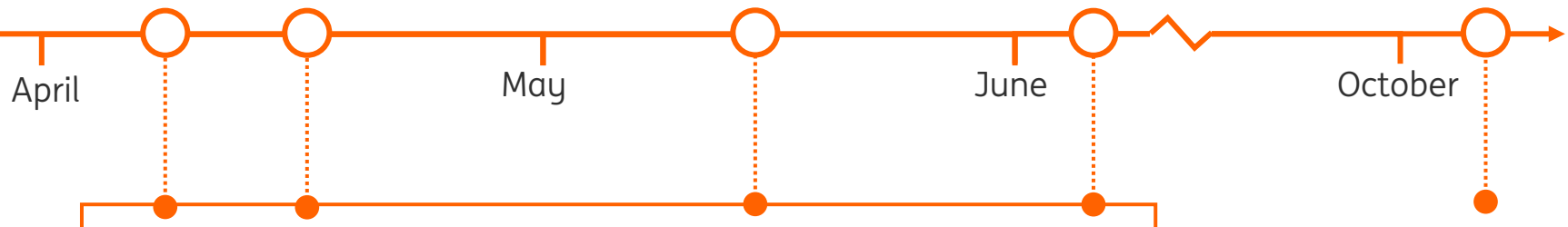
Suspension ends on March 16

Congress will likely pass a continuing resolution until budget has passed



Source: Committee for Responsible Federal Budget

Markets have priced in US reflation. But it's not that simple...



Budget Process

Deadline: April 1

House + Senate Budget Sub-committees hears draft and House draws up **resolution** on budget

Deadline: April 15

Budget resolution considered in House + Senate
This sets revenue, spending and other budget targets. Also includes **reconciliation instructions** to committees

After May 15

Appropriations subcommittees in House + Senate report **appropriation bills**, which authorise the government to spend money on non-mandatory programmes.

June 1 – June 30

House + Senate complete all action on appropriation bills, before budget passed to President for signature

Fiscal year begins

October 1

Trump either signs or vetoes budget before October.

President's budget is separate from the budget process.

That means Congress can (theoretically) ignore Trump's wishes. In reality they won't do that, but they could meaningfully water down Trump's fiscal ambitions.

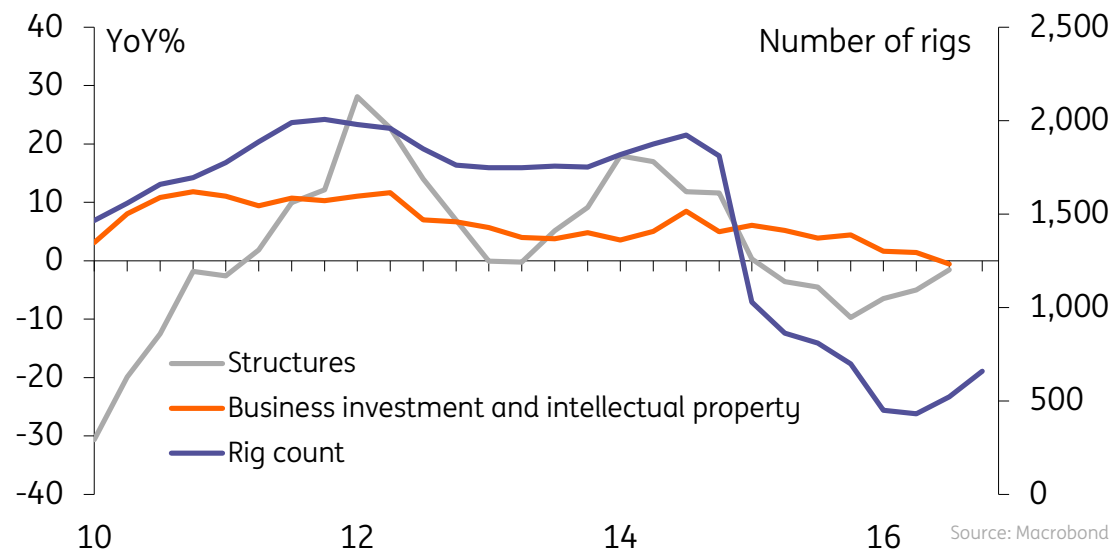
Why we're above consensus on 2017 US growth

Watch out for the return of investment

It is almost certain that Congress will allow for a more expansionary budget. But we think they will be more open to tax cuts than fiscal spending, and even then may water down Trump's proposals and phase them in over time.

That means this story is more important for growth in 2018 than 2017. **But even without fiscal tailwinds, we expect strong growth this year as business investment makes a return.**

Rising rig count will lift US structures investment



2.8%
Our 2017 US
growth forecast

Why the Fed could hike again as early as March

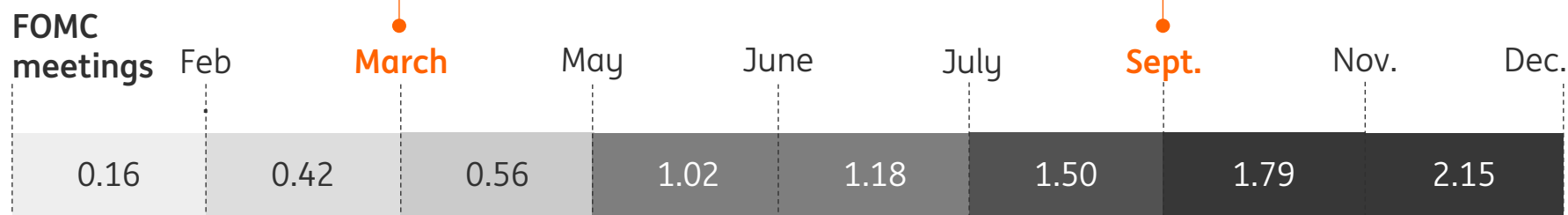
Given concerns about the excessively low neutral rate, the **Fed's three- hike signal looks ambitious.**

But the US economy is strong enough for two rate hikes. We expect 2.8% growth this year, which along with rising inflation and a strong labour market should give the Fed confidence to act.

This could encourage the Fed to frontload its hikes before focussing on the balance sheet later in the year. We look for a hike in March, but that depends on any spill-over from a packed European political calendar.

2 hikes
ING forecast

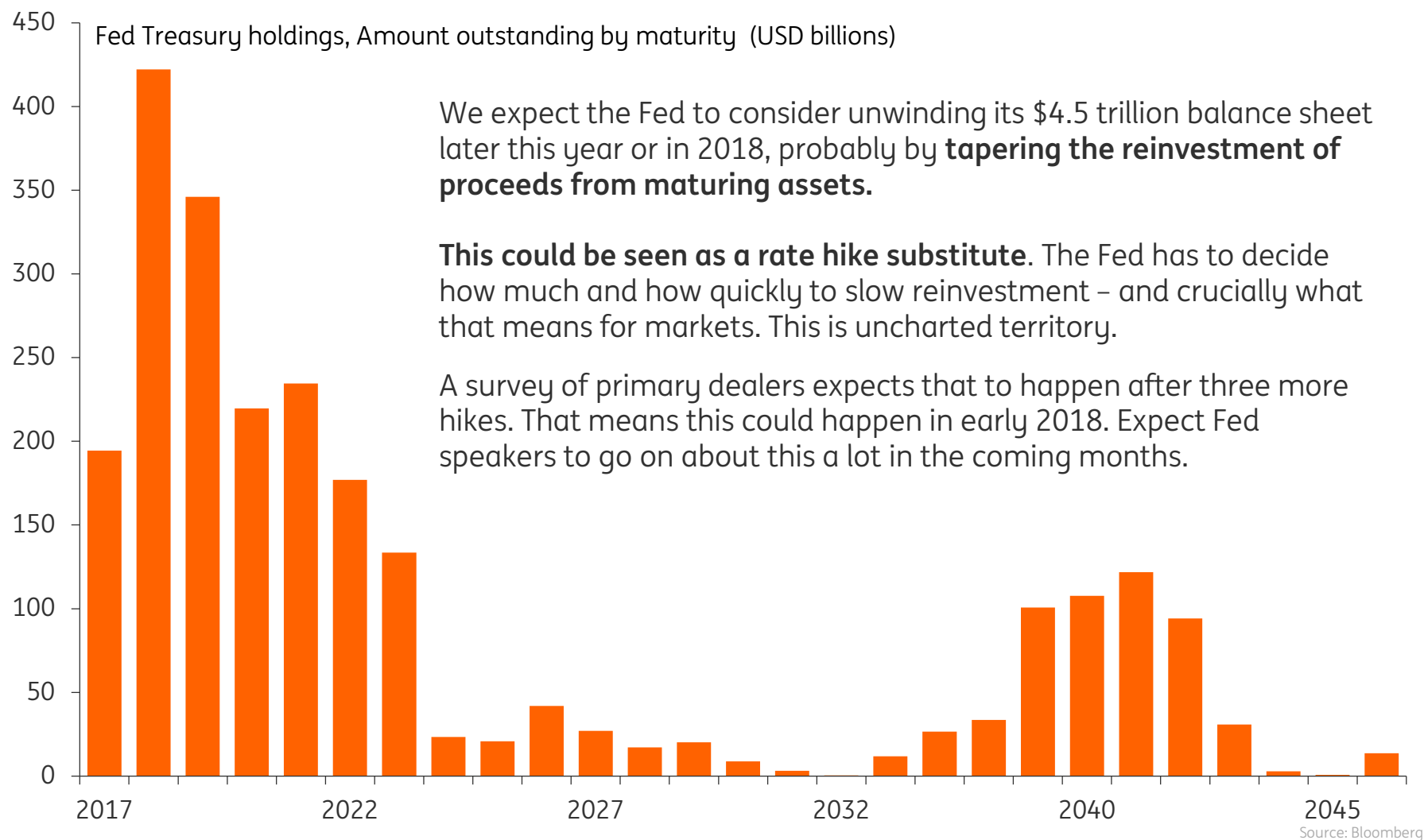
ING US rate hike forecasts



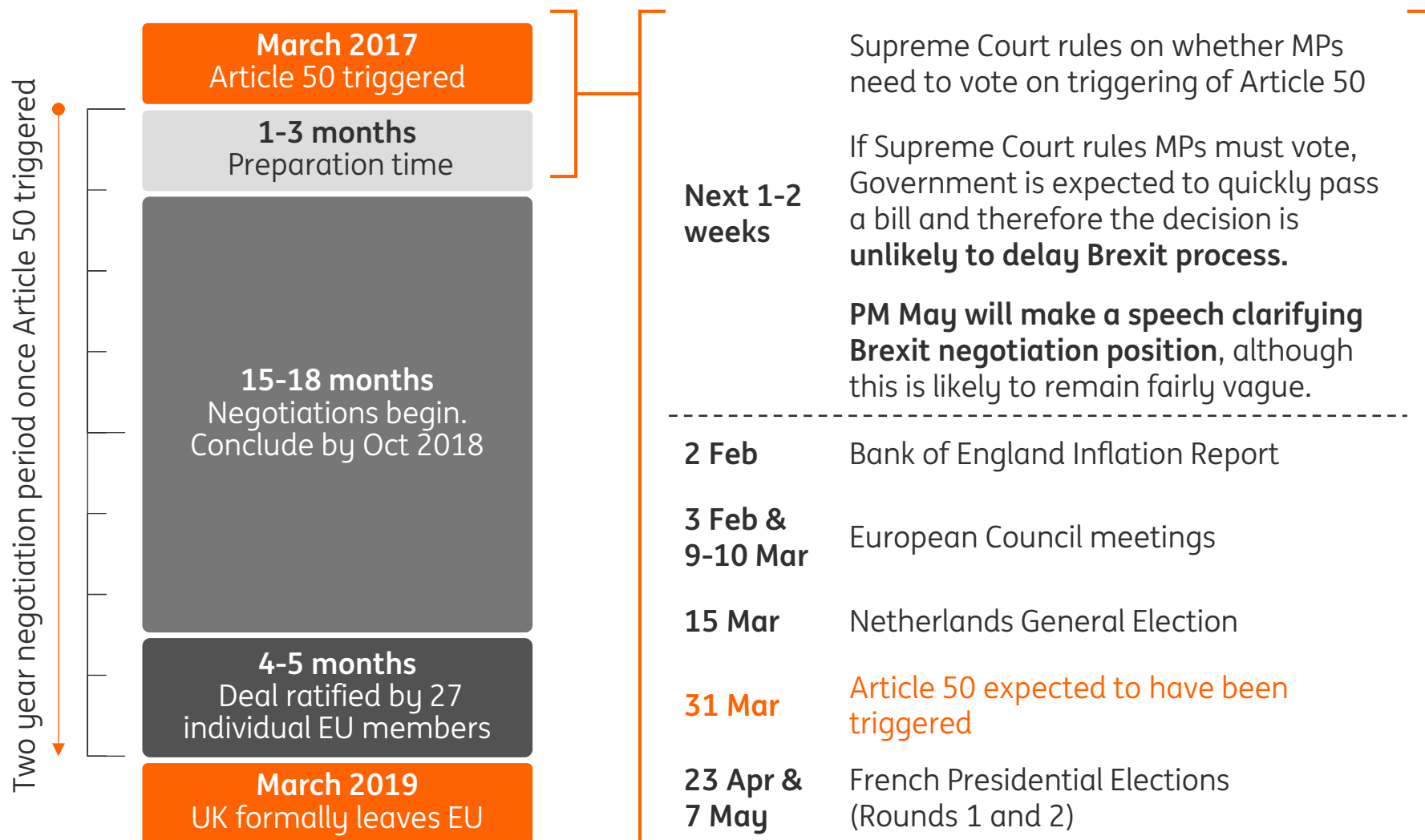
Shading reflects **number of hikes** priced in the USD OIS curve (as of 11 Jan)

Source: Bloomberg

How and when will the Fed start unwinding its balance sheet?



Brexit Timeline: What to expect before and after Article 50



Nexit, Frexit? Look at the polls for the Netherlands and France

Key European election calendar:

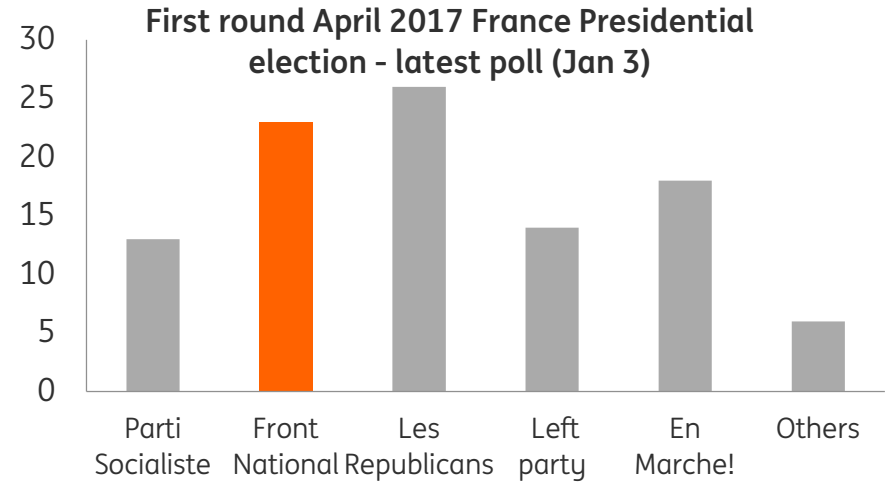
15 March **Netherlands**
General election

23 April **France**
Presidential election (Round 1)

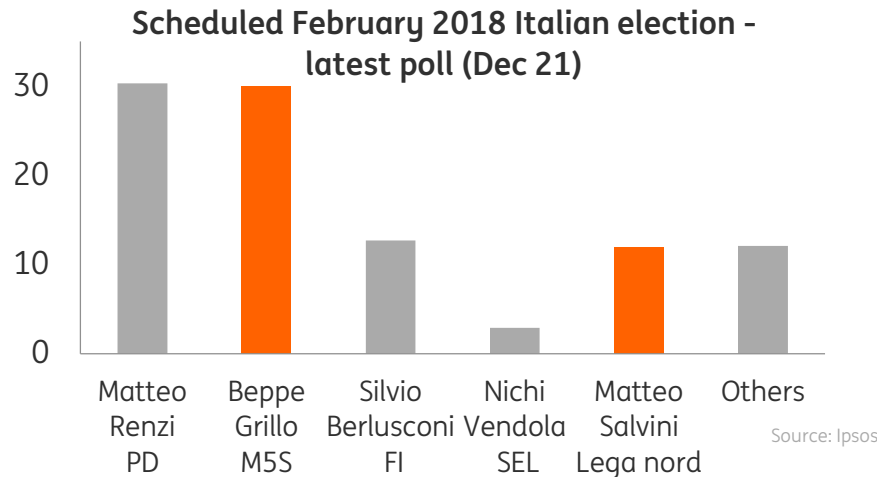
7 May **France**
Presidential election (Round 2)

June? **Italy?**
Elections possible later this year

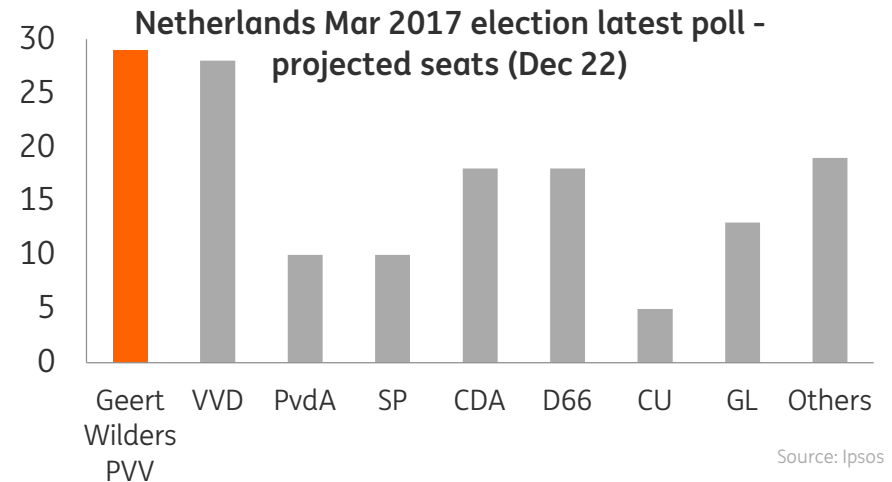
3Q17 **Germany**
Federal election



Source: Elabe



Source: Ipsos



Source: Ipsos

A French EU referendum? Why it's not so simple

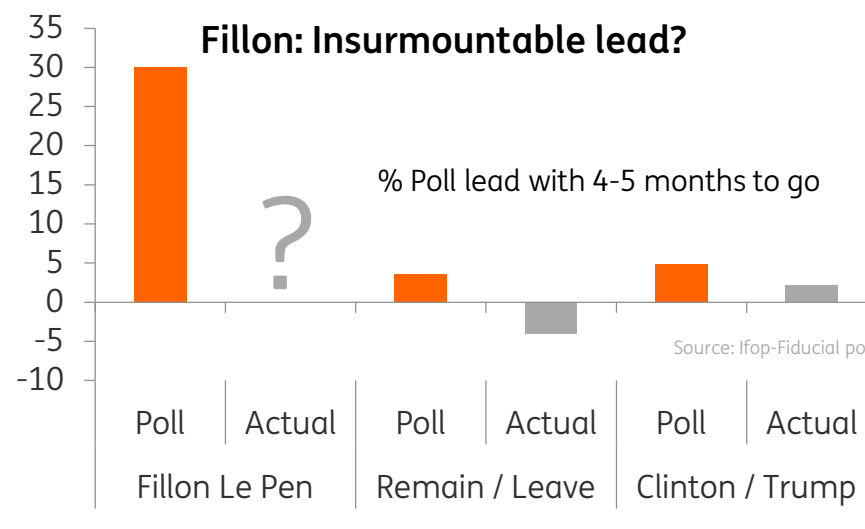
If Le Pen wins, can she call a referendum?

Current polls suggest Fillon is poised to win comfortably the French Presidency. But if Le Pen does win, she's promised to call an EU vote.

The **ability to call a referendum** on new laws or constitutional change, which would be required, **relies on majority support from Parliament.** **Le Pen is not expected to have enough seats**, which means that she would be relying on the support of other political parties.

So, **the only real possibility of a referendum is if the Prime Minister** (not from Le Pen's FN party) **comes under political pressure** to call one (as Cameron did at the 2015 UK election).

It's worth noting that surveys suggest that **less than a third of French people think France would be better off outside the EU** (see chart on next slide)



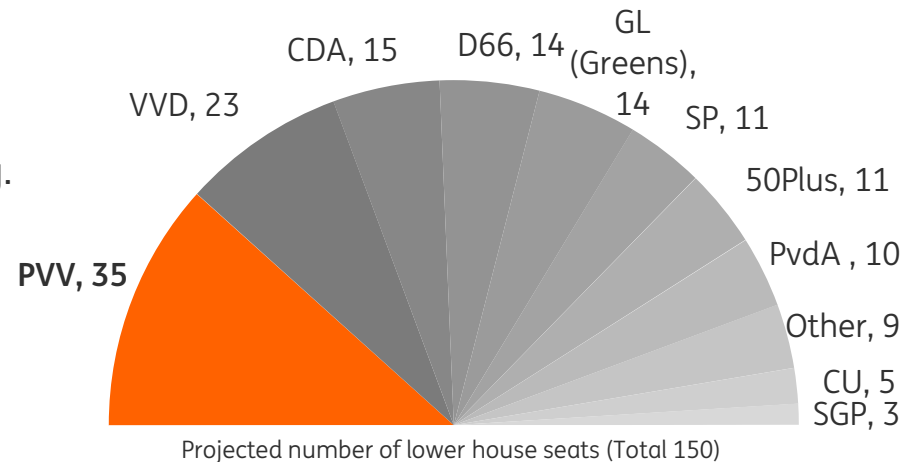
It's not so straightforward in the Netherlands either...

Dutch politics are particularly fragmented

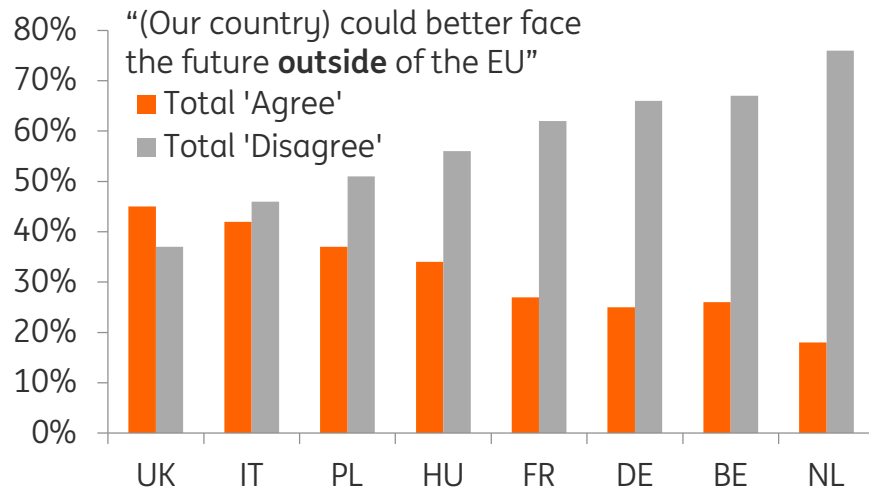
Geert Wilders is leading the polls, but several parties are expected to get more than 10 seats. Most have ruled out forming a coalition with Wilders' PVV party.

Only the ruling VVD have not fully written off the idea, although recent comments suggest joining forces would only occur under a VVD-led coalition.

The most likely outcome is a coalition of 4 or 5 centre-right and centre-left parties.



Source: Peil.nl poll, 8 Jan



Source: Eurobarometer

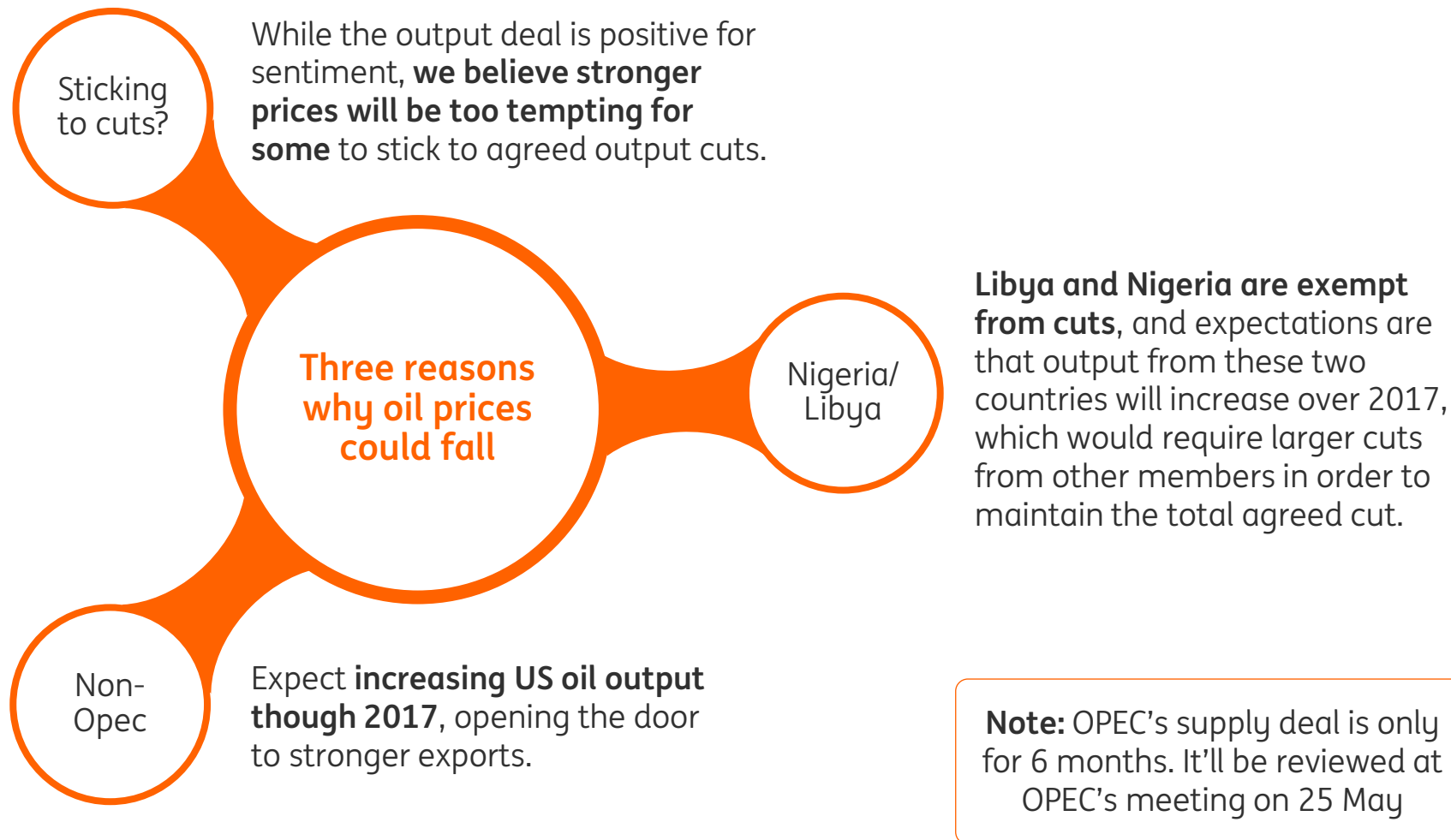
The risk of a Nexit seems very remote

Legally, referendums in the Netherlands are only advisory and can cover only recently-adopted laws.

That means there's currently no legal possibility of a Nexit vote. A majority in both the lower and upper houses would be required to change legislation to allow an EU vote.

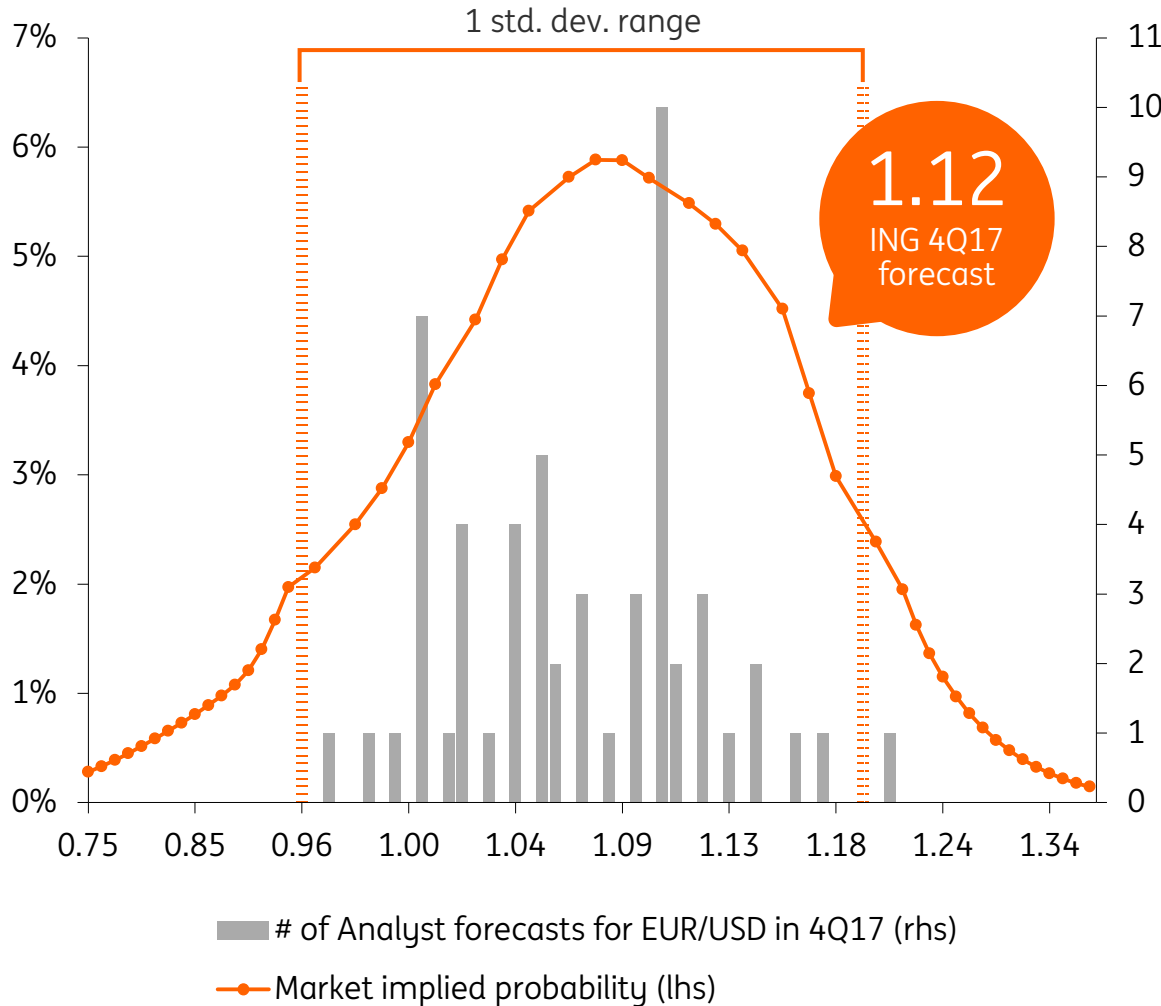
All the main political parties don't support a referendum. **Surveys suggest most of the population is in favour of staying in the EU/Euro.**

Why oil prices could fall back to \$45 by the end of 2017



Where next for EUR/USD?

Expect EUR/USD to flirt with parity in 1Q17, but break above 1.10 towards the end of 2017



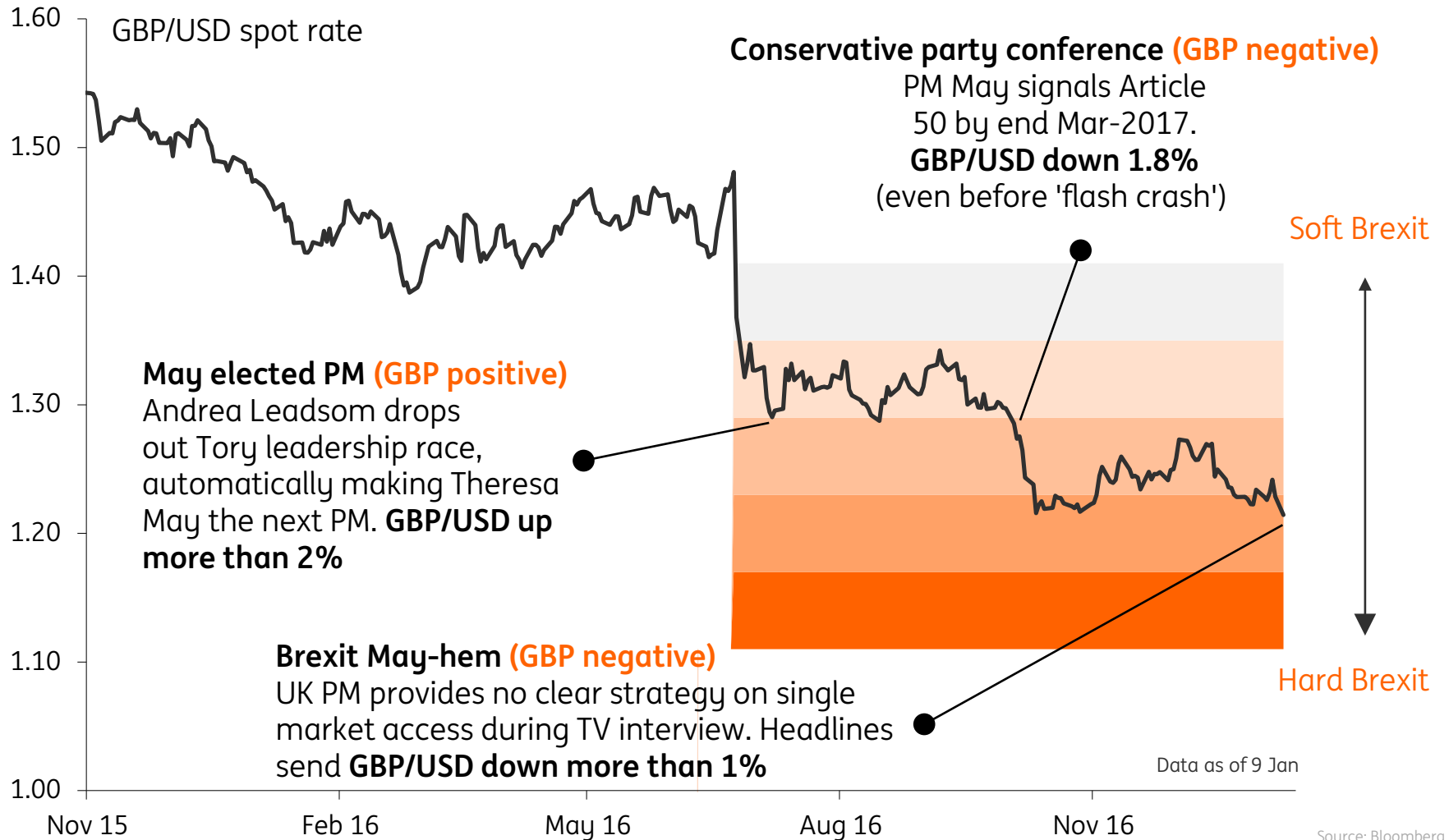
Source: Bloomberg

Expect EUR/USD to flirt with parity as US yields rise further when Trump unveils his fiscal wish list in a few weeks. That'll be compounded by European political risks.

But expect this to gradually reverse if markets moderate US reflation expectations, the ECB's QE policy comes under pressure and Eurozone political risk fades.

We forecast 1.12 by year-end – that's towards the upper end of analyst expectations

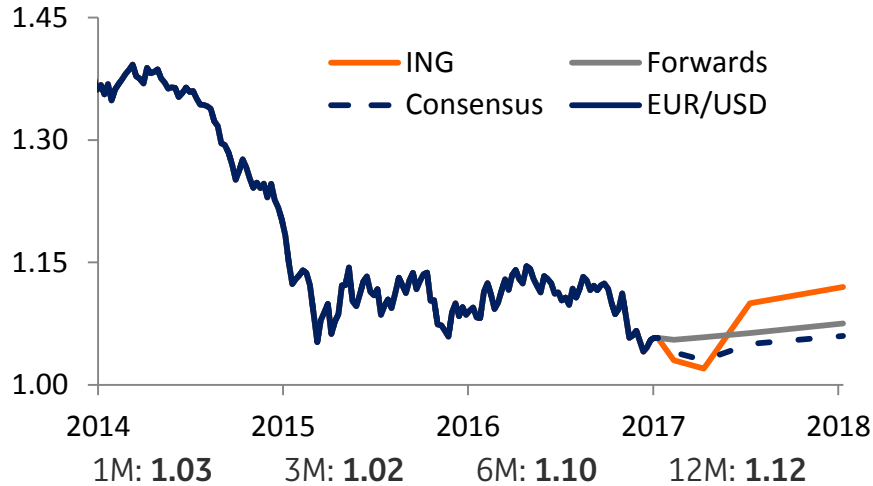
GBP: Are markets losing faith in Britain's Brexit 'vision'?



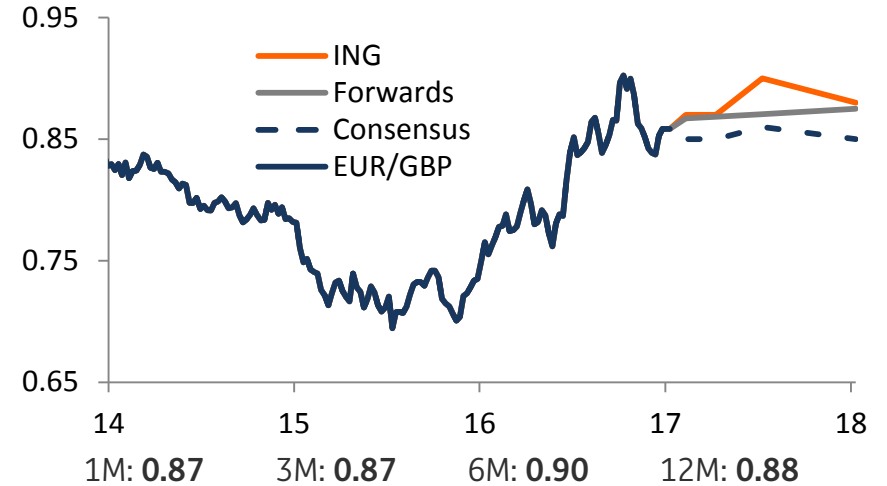
Our global forecasts

All data sourced from Bloomberg/ING forecasts

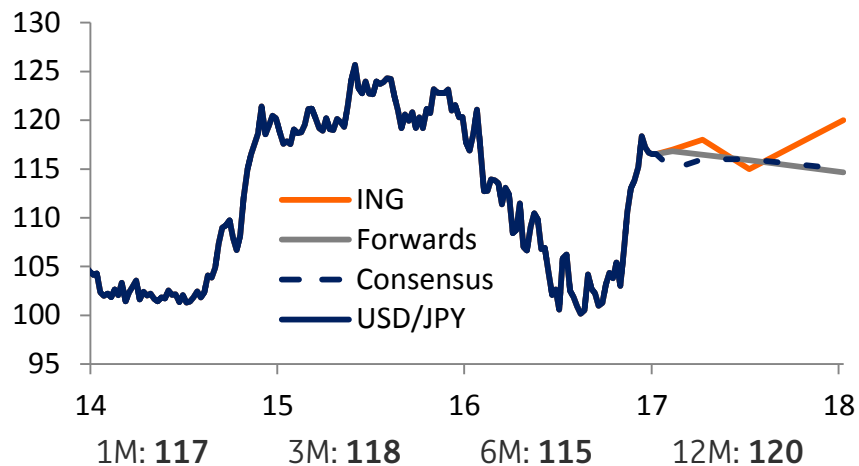
EUR/USD



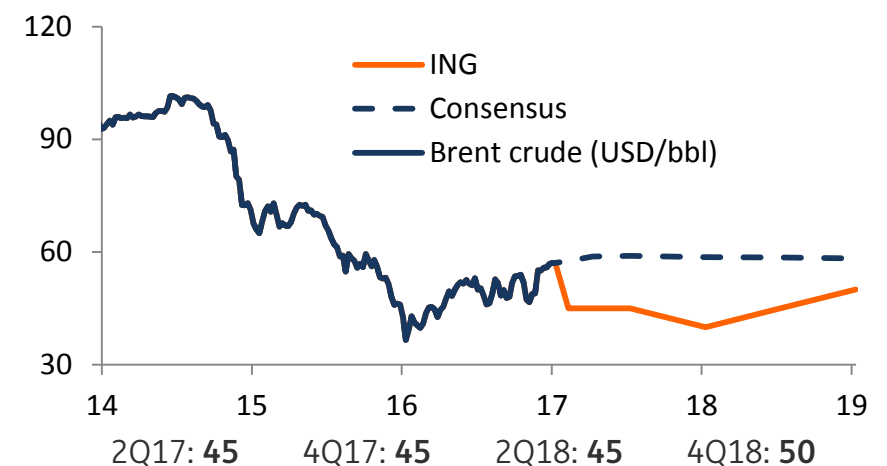
EUR/GBP



USD/JPY



Oil (Brent Crude)



Our global forecasts

	2016F					2017F				
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY
United States										
GDP (% QoQ, ann)	0.8	1.4	3.5	2.0	1.6	3.0	2.7	3.4	3.6	2.8
CPI headline (% YoY)	1.1	1.1	1.1	1.7	1.3	2.3	2.3	2.6	2.7	2.5
Federal funds (% eop, lower bound)	0.25	0.25	0.25	0.50		0.75	0.75	1.00	1.00	
3-month interest rate (% eop)	0.62	0.65	0.83	1.01		1.21	1.20	1.36	1.38	
Eurozone										
GDP (% QoQ, ann)	2.1	1.2	1.1	1.5	1.6	1.5	1.5	1.8	1.8	1.5
CPI headline (% YoY)	0.0	0.0	0.3	0.7	0.3	1.3	1.0	1.1	1.1	1.1
Refi minimum bid rate (% eop)	0.05	0.00	0.00	0.00		0.00	0.00	0.00	0.00	
3-month interest rate (% eop)	-0.22	-0.26	-0.30	-0.31		-0.31	-0.32	-0.32	-0.32	
Japan										
GDP (% QoQ, ann)	2.1	0.7	2.2	0.8	0.6	0.7	0.5	0.7	0.9	0.7
CPI headline (% YoY)	0.1	-0.4	-0.3	0.0		0.3	0.5	0.8	0.9	
Excess reserve rate (%)	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	-0.1	-0.1	
3-month interest rate (% eop)	0.09	0.06	0.04	0.02		0.05	0.05	0.05	0.05	
China										
GDP (% YoY)	6.7	6.7	6.7	6.6	6.7	6.6	6.5	6.4	6.4	6.5
CPI headline (% YoY)	2.1	2.1	1.7	1.8	1.9	2.0	2.0	2.0	2.0	2.0
PBOC 1yr deposit rate (% eop)	1.50	1.50	1.50	1.50		1.50	1.50	1.50	1.50	
PBOC 1yr best lending rate (% eop)	4.35	4.35	4.35	4.35		4.35	4.35	4.35	4.35	
7-day repo rate (% eop)	2.90	2.71	2.60	2.75		2.75	2.75	2.75	2.75	
UK										
GDP (% QoQ, ann)	1.4	2.6	2.3	2.0	2.0	1.0	-0.1	0.2	1.2	1.1
CPI headline (% YoY)	0.3	0.4	0.7	1.2	0.6	2.3	2.9	3.0	3.1	2.8
BoE official bank rate (% eop)	0.50	0.50	0.25	0.25		0.25	0.10	0.10	0.10	
BoE Quantitative Easing (£bn)	375	375	435	435		435	435	435	435	
3-month interest rate (% eop)	0.60	0.60	0.30	0.40		0.40	0.25	0.25	0.25	

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