Global Monthly

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Five themes to watch over the summer

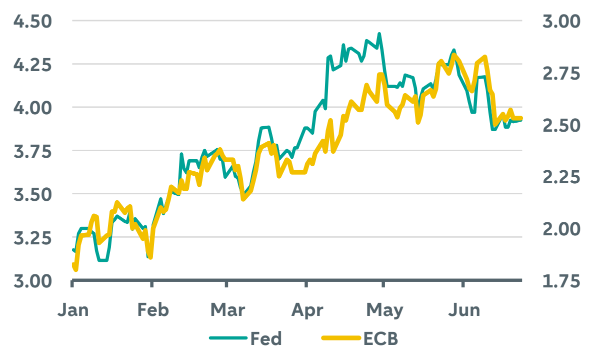
- As we approach the summer holiday period, we preview five major themes to watch
- We start with the repricing of central bank rate cuts, which we think has further to run. This will likely be helped along by our second theme – the US economic slowdown
- We also preview upcoming elections, explore the drivers of the recent rise in shipping freight tariffs, and finally, we flag the potential for eurozone services activity to see a boost from summer cultural events
- As is customary in summer, we will take a break in July, resuming publication in late August
- Regional updates: The ECB is waiting to gain further confidence in the eurozone inflation outlook, while in the Netherlands, tax cuts and rising real incomes are expected to support consumption
- In the US, disinflation and a weaker labour market are strengthening the case for rate cuts
- Proposed EU tariffs on China's EV exports could yet be watered down

Global View: From *soft landings* to *Swiftonomics*, there is enough to keep an eye on

We saw a further convergence in transatlantic growth trends over the past month, although admittedly, this was driven by slowing growth in the US rather than stronger growth in the eurozone. Indeed, last week's flash PMIs for June underlined the fact that the eurozone recovery remains fragile. Coming alongside the resumption in the disinflationary trend in the US, weaker macro data triggered trend change in market pricing for central bank rate cuts. For most of this year, markets have moved to price out rate cuts by central banks. Over the past month, that finally showed the first signs of reversing. For the Fed, markets now expect almost six rate cuts by end-2025; this time last month, they expected only four. This is still significantly short of our own expectation for nine rate cuts by end 2025. As markets gain increasing confidence in the inflation outlook, and as evidence builds that the US economy is slowing to a below trend underlying pace, we expect this repricing to continue. Meanwhile, supporting the transatlantic growth convergence will be the services recovery in the eurozone, which is benefiting from real income growth, falling rates and record tourism inflows, as well as some major cultural events that will offer support over the summer months. All of this takes place against an explosive political backdrop, with the French election paving the way for a potential showdown with financial markets and/or European institutions, while the US election campaign – and trade wars – simmer in the background. In short, there is enough to keep an eye on over the coming summer break[1]. In this month's *Global View*, we preview five major themes to watch.

Market pricing of rate cuts has further to run

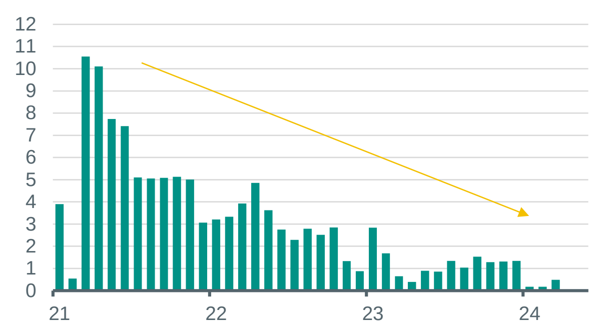
Market-implied policy rates by end 2025 for Fed (lhs) and ECB (rhs)



Source: Bloomberg, ABN AMRO Group Economics

US consumption: Softly landing?

US real retail sales, % above/below pre-pandemic trend



Source: LSEG, ABN AMRO Group Economics

[1] As is customary over the summer, we will take a break in July, resuming publication in late August.

1. Does the repricing of central bank rate cuts have further to run?

Yes.

2024 was supposed to be the summer of rate cuts. Of the major central banks in our coverage, so far the ECB is the only one to have followed through, with Fed rate cuts delayed by the unexpected rebound in US inflation earlier this year[2]. As we had previously flagged, US inflation is now finally springing some downside surprises, and combined with the broader cooling in US data, this supports our view that the Fed will follow the ECB in embarking on its own rate cut cycle in September. We expect inflation in the US to continue to come in on the more benign side over the coming months, and the BLS is likely to report that it will make significant downward revisions to payrolls growth data in August. However, the inflation scare of early this year means that the Fed is likely to tread more carefully initially, cutting rates only once per quarter rather than at every policy meeting. While we concur with financial markets that the Fed will cut cautiously this year, we continue to think markets are under-pricing rate cuts for next year. As things stand, markets currently only price four more rate cuts next year, while we expect seven cuts, with the upper bound of the fed funds expected to fall to 3.25% by end-2025. The summer data flow could trigger a further repricing in that direction.

For the ECB, following what practically amounted to a hawkish first rate cut in June, we expect a resumption of cuts in September. At the June press conference, Lagarde offered the hint that more guidance from the ECB would be forthcoming 'much later in summer'. We think this is a reference to the timing of the ECB's negotiated wage data for Q2, which comes out late July. This data point has long become a key focus for Governing Council members in judging the risks to the medium term inflation outlook. The ECB's forward-looking tracker suggests this measure of wage growth is likely to move sideways over the coming half year or so. As such, provided this data does not show a meaningful acceleration in wage growth, we think the ECB will be comfortable enough to forge ahead with another rate cut. Supporting this view is that disinflation in the eurozone – unlike in the US – has stayed broadly on track, while last week's PMIs suggest the recovery that started in Q1 seems to have lost some momentum. Similar to the Fed, we continue to think markets are significantly under-pricing the scope for ECB rate cuts next year.

2. Could the US slowdown get out of hand?

Most likely not.

Macro data in the US has taken a notable turn southward recently, with Bloomberg's data surprise index falling to a new post-pandemic low last week. Indeed, outside the pandemic, the index has not been this low since 2016. At the same time, as our US economist has explained, even the seemingly unstoppable jobs data might be on the verge of a significant downward revision. What is going on, and could this be the start of a more meaningful downturn in the US?

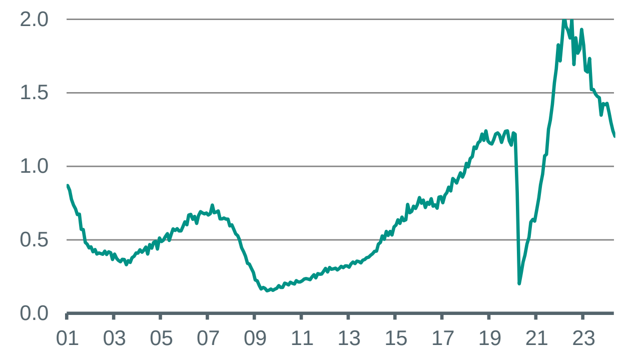
US macro data has been surprising to the downside

Bloomberg Data Surprise Index (US growth indicators)

Source: Bloomberg, ABN AMRO Group Economics

Labour market has reached an important milestone

US unemployed to job vacancy ratio



Source: LSEG, ABN AMRO Group Economics

Broadly, we think the data reflects a necessary coming back down to earth for the US economy, following a prolonged period of exceptional strength, and the turn in the data is consistent with our forecast for somewhat below-trend underlying growth in the coming quarters. Consumption has normalised now that consumers have exhausted their excess savings, and supply-demand imbalances in the labour market have resolved, thanks to tight monetary policy dampening demand, and the post-pandemic surge in immigration. At the same time, the economy is likely to find a floor, thanks to: 1) strong balance sheets (household debt is still very low, despite pockets of financial stress), and 2) accommodative financial conditions (strong equity markets and low corporate bond spreads, despite high rates).

[2] For the Bank of England, we have long been of the view that rate cuts would start in August and proceed at a slower pace than the Fed and ECB, given that inflation is likely to prove stickier in the UK than in the US and the eurozone

With that said, we have now reached some important milestones – particularly in the labour market – where arguably the Fed will want to be more mindful of the downside risks. The unemployment rate has risen 0.6pp from its January 2023 low of 3.4%, to 4% as of May, following a record period below 4%. Meanwhile the job vacancy to unemployed ratio has fallen sharply recently, reaching the symbolic pre-pandemic level of 1.2 in April. This still points to a strong labour market, but you would not want to see the pace of this decline persisting for much longer. All in all, the turn in the data supports our expectation for the Fed to start cutting rates sooner (September) rather than later.

3. Elections: Is the political lurch rightward unstoppable?

It looks that way, with the notable exception of the UK.

It is certainly shaping up to be a politically eventful summer. Following the earthquake of French president Macron's unexpectedly big loss at the European Parliament election, looms the potentially even bigger aftershock of a new far right (or far left) government in France. The first round of voting in France's snap legislative is now just days away on 30 June, and opinion polls continue to suggest Le Pen's far right RN party is in the lead. However, the two stage process of the election (with a runoff scheduled a week later on 7 July) makes the ultimate outcome still highly uncertain. Our base case sees a minority right-wing government taking office in a *cohabitation* with Macron, and we think the constraints of financial markets, a lack of an absolute majority, and European institutions will ultimately contain the fiscally ambitious (to put it mildly) policy proposals. However, the election is likely to be a bumpy ride for financial markets, and it is highly uncertain to what degree the incoming government will seek to test markets and European institutions in its attempt to fulfil promises to voters. In a worst case scenario, we could end up with a UK/Liz Truss-style bout of market turmoil. See our election preview for more.

If this were not exciting enough, in the middle of the two French election rounds is the UK's own general election, sandwiched in between on 4 July. The outcome in the UK looks much more certain and if anything quite boring, policy-wise: a moderate, market-friendly centre-left Labour government is likely to win by a landslide, following 14 years of Conservative rule under a progressively more right-wing direction. Given the UK's lack of fiscal space, and with near-zero political appetite to make meaningful changes to Brexit policy, we see no immediate implications for UK growth, inflation, or interest rates (see Key Views for our UK macro/BoE base case). Where the election may prove more interesting is what happens to the right of the political spectrum in the election aftermath. The Conservative party is expected to suffer a historic defeat, and opinion polls show the far right, populist Reform party significantly eating into its vote share. The UK's first past the post electoral system means that Reform is unlikely to gain many seats, but the final outcome of the election could have significant ramifications for the future of the Conservative party.

Finally, although the US presidential election does not take place for another four months, the campaign is heating up, with the first TV debate between president Biden and former president Trump taking place this week (27 June), and the second debate happening on 10 September. So far, the polls continue to paint a neck-and-neck contest, but with Trump currently enjoying a marginal lead in key swing states. We will have much more to say on the implications of the US presidential election over the coming months, but we continue to think a potential re-election of Trump poses the biggest risk to the economic outlook, given his proposals for massive, large-scale import tariffs.

4. Will trade wars or the Houthis scupper the nascent manufacturing recovery?

No, but developments are worth keeping an eye on.

Another notable – and rather more unwelcome – recent development has been the sharp rebound in shipping freight tariffs. Tariffs spiked at the beginning of the year, after attacks by the Houthis on vessels passing through the Red Sea led to a large-scale rerouting around the longer Cape of Good Hope route. Initially, the container shipping industry appeared to have absorbed this change relatively smoothly, helped by record capacity additions. As a result, prices gradually declined from January to late April. Then, tariffs mysteriously and spontaneously began rebounding, with even shipping experts struggling to point to one particular driver. According to Drewry, the rise is being driven by a combination of factors: 1. A temporary lull in capacity additions (significant new capacity is due in the second half of 2024), 2. Somewhat stronger demand, 3. Some bringing forward of shipments due to worries about delays, 4. Port congestion in parts of Asia. There should be some easing of these pressures in the near-term, particularly as much greater capacity additions are expected[3]. As we explained in our January Global Monthly, even sustained higher shipping freight tariffs are unlikely by themselves to move the needle on inflation, given the tiny contribution shipping costs make to the final cost of a good (around 1% on average), and given that the post-pandemic falls in shipping costs had likely yet to be fully passed on (tariffs are still less than half the pre-pandemic peak). As such, even with ships

[3] 1mn teu of new container capacity has been added so far this year, fulfilling the extra demand associated with longer shipping routes, but another 2mn is expected to be added by the end of 2024 and this should lead to a net expansion in capacity rather than only making up for the shipping diversion. This is explained here.

continuing to avoid the Red Sea, we do not view the latest shipping tariff rises as a major risk to either the inflation nor the growth outlook, particularly as capacity additions mean that this rise is unlikely to be sustained.

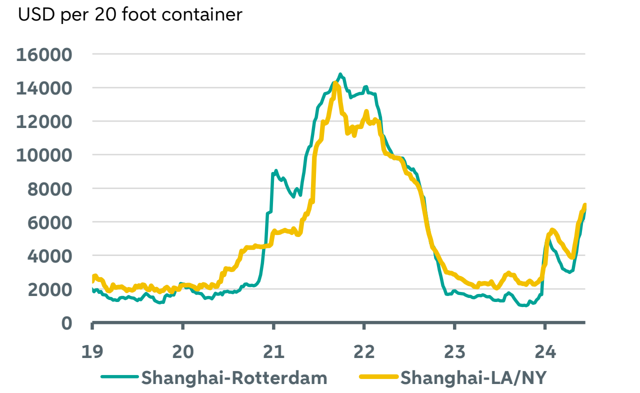
Perhaps a more important development to watch is the latest trade spat between the EU and China over EVs (see China), although here too, we have seen some encouraging signs that the economic fallout will be limited. In particular, German Economy minister and vice-chancellor Robert Habeck's visit to China has yielded an agreement from Beijing to open talks on the matter. While the Commission's proposed tariffs on EVs are likely to be implemented in some form, the spat looks unlikely to escalate into a large scale confrontation. A much bigger risk on the trade tariff front looms from a potential Trump re-election, though that would be something to worry about in 2025.

5. What do Taylor Swift, football, and the PMIs have in common?

They all suggest that services activity in the eurozone could do rather well over the summer.

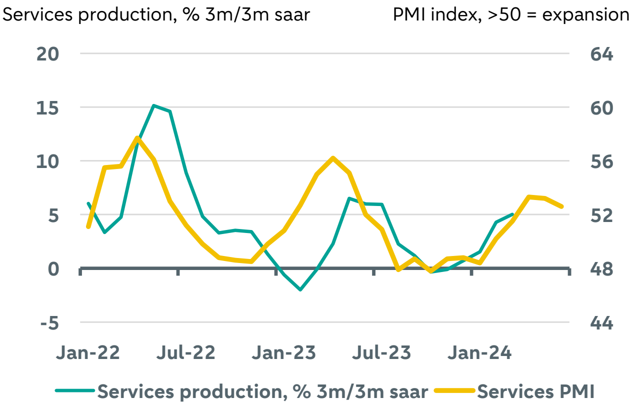
A clear bright spot in the eurozone economy over the past few months has been the services sector. Record-breaking visitor arrivals have been a particular support for activity in southern Europe, but across the eurozone, services activity has grown strongly in 2024 so far. Eurostat data shows services activity grew 5% over Q1 on an annualised basis, while the services PMI suggests that this strong pace of growth carried over into Q2, and probably will continue in Q3.

Shipping freight tariffs are surging again



Source: Bloomberg, LSEG, ABN AMRO Group Economics

Eurozone services activity is picking up



Source: Bloomberg, LSEG, ABN AMRO Group Economics

Aside from rising real incomes, and the gradual fall in interest rates expected over the next few months, another positive driver of services activity is the number of major sporting and cultural events in the eurozone this summer. The European football Championship has already kicked off in Germany, and over the coming weeks an Ifo institute analysis suggests that extra visitor spending on hospitality could add 0.1pp to GDP growth in Germany in Q3. GDP in France could see an even bigger boost from the Paris Olympics – following a similar methodology to Ifo's analysis for Germany, we estimate it could add 0.2pp to French Q3 output. While suggesting some near-term upside risks to growth forecasts, it should be noted that these boosts to activity are very much one-offs, and will therefore probably be subject to payback in Q4 as the effects unwind.

Finally, we must not ignore the Taylor Swift effect – if not on activity then perhaps on inflation. After Beyonce concerts famously boosted Swedish inflation last year via a jump in hotel rates, Swift's concerts apparently had a similar upward impact on Sweden's inflation rate for May. According to analytics firm Lighthouse, hotel rates are expected to jump on average 44% in periods when Swift performs. It should be noted that such events by themselves are far less likely to boost overall eurozone inflation given that the eurozone is many multiples the size of Sweden. However, they could impact the inflation rates of individual countries, and coming alongside the major sporting events happening over the same period (Swift's concerts take place across Europe between May and August), there could well be some modest upside risk to services inflation forecasts over the summer period. But, as with the boost to activity, any temporary effects will surely see payback later in the year.

In conclusion, the main impact of these big summer events will likely be to inject unwelcome volatility to the data rather than provide any meaningful economic signal.

Eurozone: ECB in wait-and-see mode until late summer

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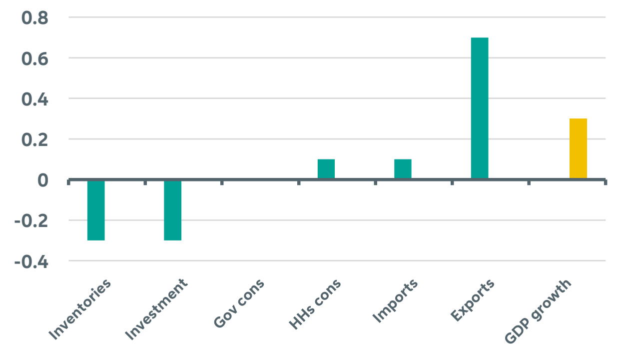
- Growth remains positive in Q2 as the outlook improves further, but remains below the trend rate
- Core inflation rose in May due to strong services inflation; leading indicators suggest further disinflation
- The ECB is in wait-and-see mode until after July, after which we expect an extensive rate cut cycle

In June the details of Q1 growth (+0.3%) were published. Growth was driven by private consumption and net trade. Destocking, due to weakness in manufacturing, lead to a negative contribution from inventories and high interest rates lead to a contraction in investment. Overall, the economy is slowly regaining its footing with growth momentum remaining positive approaching the second half of 2024. Growth is expected to remain positive in Q2 but to edge down compared to the surprising high Q1 figure, as some one-offs – such as strong construction activity and tourism spending which pushed up Q1 growth – fall away. We have penciled in 0.2% of qoq growth in Q2. The picture however remains broadly the same: economic activity is expanding in services, helped by real wage increase and low unemployment, and is bottoming out in manufacturing on the back of increasing trade volumes and a further easing of the energy crisis.

Still, while growth this year will pick up compared to 2023, it is expected to remain below trend for a few reasons. First, past headwinds such as the energy crisis have eased but have not fully resolved yet. Second, monetary policy is still restrictive. A non-negligible share of firms has yet to refinance loans against higher interest rates, which will continue to weigh on activity. Third, for the economy to pick-up steam, a stronger recovery in demand is needed. German factory orders for instance are stabilizing according to April figures, but for manufacturing to expand, factory orders have to pick up considerably. The same holds for consumer demand. Wage growth contributed to consumption growth in the first quarter (+0.2% qoq), but the recovery in real incomes is uneven across countries (see graph), and a significant impulse to demand has yet to materialize. A final reason is geopolitical uncertainty. Recently, trade tensions increased as the Commission proposed to raise tariffs on Chinese EVs, with China possibly retaliating via specific product groups. So far, the developments are in line with expectations and the growth effect is likely to be limited in 2024, but the increase in uncertainty is weighing on the outlook.

First quarter growth driven by consumption and net

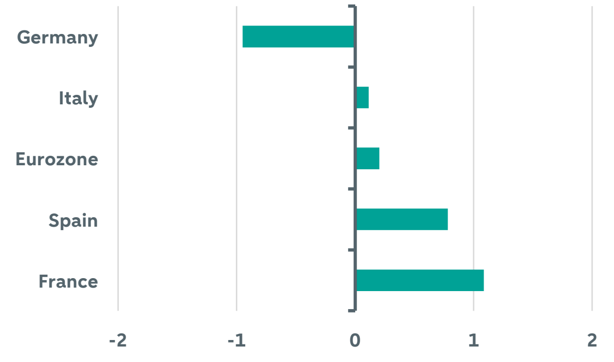
%, quarter-on-quarter



Source: LSEG, ABN AMRO Group Economics

Real wages catch up in 2025, but country differences

%, real wage developments 2021-2025 (incl. EC forecasts)



Source: LSEG, AMECO, ABN AMRO Group Economics

Eurozone inflation in May surprised to the upside, driven by services. Indeed, a rise in services inflation was anticipated due to upward base effects from a public transport policy measures in Germany last year, but the increase also reflected the pass through of wages to services prices. This is especially the case in contact-intensive sectors where margins are low and the pass-through is quick. This drove core inflation to 2.9% yoy, up from 2.7% in April. Headline inflation was in line with expectations at 2.6%. Leading indicators, such as the monthly Indeed wage tracker suggest wage growth will continue normalizing over the coming year. As such, while core inflation is likely to stay somewhat elevated in the near term, this lagging aftershock of the energy crisis is unlikely to derail ECB rate cuts. Indeed, at the June meeting the ECB lowered its key policy rates by 25bp. At the press conference Lagarde hinted that a signal on a future move would come only after July. We think the ECB will want to wait for the Q2 negotiated wages data in August before cutting further, and as such, we no longer expect a rate cut in July. Starting at the September meeting, we still expect an extensive rate cut cycle, however, with 25bp cuts at consecutive meetings throughout 2024-25.

The Netherlands: Households supported by purchasing power recovery

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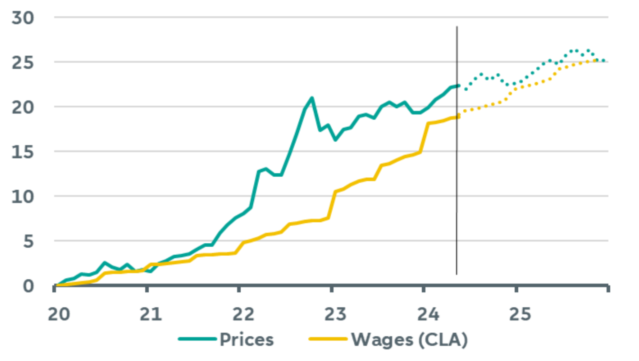
- Despite the Q1 contraction[4], growth is expected to pick up and to average 0.5% in 2024
- Government spending and household consumption will be the drivers of this gradual growth
- The stimulus measures in the newly announced coalition agreement are reason for us to slightly increase our growth estimate for 2025 from 1.2% to 1.3%
- Inflation (HICP) will continue to gradually come down, averaging 2.5% in 2024 and 2.1% in 2025

The second quarter is almost nearing its end, and so far the incoming data has confirmed our view that households and the government will drive economic growth in 2024. Since the last quarter of 2023 private consumption has been picking up, and we expect this trend to continue through 2024. Households are benefiting from three factors that are positive for purchasing power. Firstly, inflation is expected to fall further, although the 2% mark will remain out of sight for some time (see below). Secondly, the combination of lower inflation and strong wage growth is driving a recovery in purchasing power: the that opened up between wage and price levels since the pandemic and the energy crisis has now fallen to 3.5pp in May 2024, down from the peak in October 2022 when the difference was 13.8pp. As we expect wage growth to exceed inflation going forward, wage growth will have caught up with prices towards the end of 2025. Third, the caretaker government is also supporting real incomes in 2024, for instance through higher rental allowances and tax cuts for middle-income households. Lower income households in particular are benefitting from such redistributive policies. All in all, we expect household consumption to grow by 2.2% y/y in 2024 and to drive overall GDP growth.

The outlook for investment is weak in the short term. Because of the weak external environment, high interest rates, and low capacity utilization rates, there is little impetus to expand production capacity. We do see some investment growth in order to replace the existing capital stock. The tight labour market and shortages of skilled personnel is also weighing on both public and private investment. As a result, demand for credit is weak in the short term, as shown by survey results from the ECB's Bank Lending Survey. Investment growth will improve when the expected easing of financial conditions happens and exports pick up, especially for sectors which operate internationally and are more rate-sensitive.

Wage level continues to catch up with price level

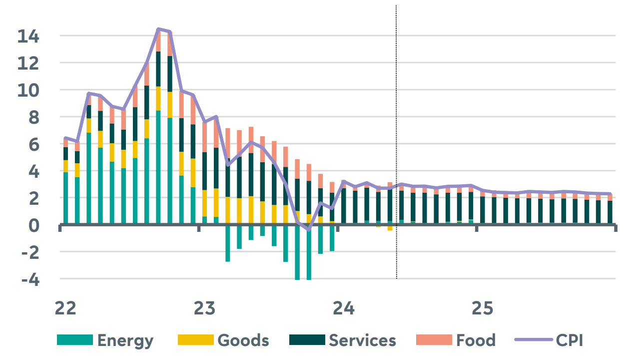
% difference from January 2020



Source: LSEG, ABN AMRO Group Economics

Inflation is expected to fall only gradually

% y/y, contributions in pp



Source: CBS, ABN AMRO Group Economics

In 2024, the downward path in inflation has continued, although disinflation is slowing. Energy prices are playing a smaller role. Instead, labour-intensive services are making their mark on inflation. Although the risk of a wage-price spiral is limited, the current elevated wage growth is causing inflation to stay above the ECB's target of 2% for the time being. Wage growth has peaked, which is why we expect services inflation to ease slowly over the coming quarters. Given the volatility in the global economy in recent years, the risks to our inflation forecasts are primarily to the upside. The main upside risks come from the geopolitical situation, for example escalation of the conflict in the Middle East and possibly contagion effects to energy markets. The coalition agreement will also have a small upward effect on inflation in 2025, as product-related taxes increase. All in all, we expect inflation to average 2.5% in 2024 and 2.1% in 2025.

[4] On Monday the second calculation of Q1 GDP showed a q/q contraction of 0.5% instead of 0.1% (read here). The backward looking adjustment will negatively impact our forecasts, it however does not change our view on the Dutch economy going forward. We are still reviewing our forecasts.

US: The tide is turning

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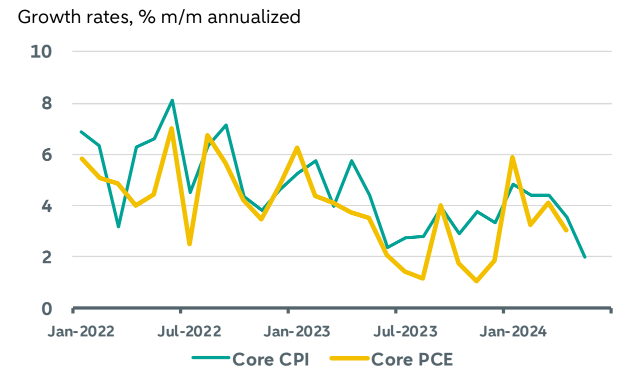
- The US disinflationary process has resumed with a bang
- There are increasing signs of weakness in the labor market…
- … raising the likelihood of a Fed rate cut in September

Core CPI inflation came in at 0.2% m/m in May, offering a pleasant surprise after a hot first quarter. The figure annualized to less than 2.0% for the first time since March 2021, and led to a drop of y/y inflation to 3.4% from 3.6% in April. The downward surprise was driven by price decreases in transportations services, particularly airfares and car insurance premia. Housing inflation on the other hand, remained at high levels at 0.4% m/m, and we expect it to remain elevated for most of the year. Fundamental inflationary pressures in the housing market remain benign, and as such it is a matter of time for post-pandemic price increases to fully pass-through, giving the Fed little reason for concern. The surprise in CPI inflation, and the low core PPI figures (0.0% m/m) released this month, bode well for the PCE inflation releases later this week.

This month's FOMC meeting fell on the same day as the CPI release, which meant that the June projections and dot plot did not fully reflect the latest reading. The dot plot showed a roughly equal split between one or two rate cuts before the end of the year, down from three in the March dot plot. Chair Powell offered a balanced performance, largely aimed at tempering the market reaction to inflation figures, playing down the importance of a single number. This was similar to how – going the other way – he played down the negative impact of inflation figures in the May press conference. Powell reiterated that, 'if the labor market were to weaken unexpectedly, or inflation decrease more rapidly, the committee stands ready to respond.'

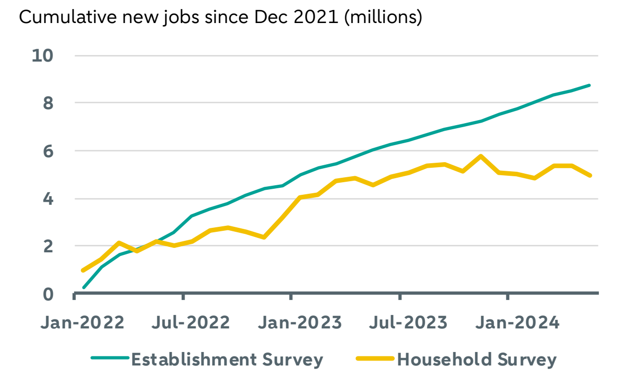
What is the case for either surprisingly benign inflation, or a surprisingly weak labor market? In their baseline projections, the median FOMC member puts inflation at 2.8% at the end of the year, the path pushed horizontally by base effects stemming from low inflation in the second half of 2023. Powell acknowledged this to be a 'conservative' forecast. We expect 0.2% m/m inflation readings to continue, putting core PCE inflation at 2.6% y/y by year end, a position which Powell referred to as 'a good place to be' in the June press conference.

The disinflationary process has resumed



Source: LSEG, ABN AMRO Group Economics

Labor data is diverging



Source: LSEG, ABN AMRO Group Economics

The median FOMC member projected a similarly flat trajectory for unemployment, forecasting 4.0% at the end of the year, its current level. Data on the labor market has been difficult to make sense of, with an increasing divergence between different metrics. In particular, employment based on the establishment and household survey has diverged considerably in recent years. We expect the majority of the ultimate reconciliation of the two to come from a downward revision in non-farm payrolls, and estimate that the monthly pace of job creation this year has been closer to 90k than the current BLS estimate of 247k (link). Crucially, a BLS note outlining the magnitude of such revisions for 2023 data is scheduled to be released in August, before the September FOMC meeting. This, combined with the recent rise in the unemployment rate, will likely drive a downward adjustment to the Fed's assessment of the labor market. Alongside benign inflation trends at that point, we expect this to trigger an easing cycle.

China: Between Beijing, Brussels and Berlin

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- China's exports benefit from recovery in global trade, but overcapacity contributes to trade spats
- Following Brussels' decision to raise tariffs on Chinese EVs, Beijing started a probe on European pork
- Meanwhile, Berlin acts to soften tariffs; we do not expect escalation to a broad EU-China trade war

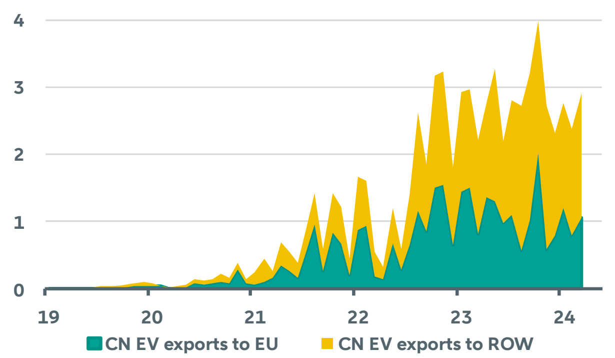
Recent macro data confirm that drags from the property sector remain, despite the rolling-out of further measures to stabilise the sector. Growth is supported by a stronger momentum in exports. Still, risks on the external front are rising, as China's overcapacity contributes to trade spats, with the US/Europe (and others) trying to protect strategic industries.

May macro data are a mixed bag, confirm ongoing drags from property

The macro data for May showed a mixed picture, but confirmed that China's recovery is still uneven, with domestic demand hampered by the property sector downturn. Earlier this month, the divergence between China's two PMI surveys returned. Whereas the official manufacturing PMI dropped back below the neutral 50 mark separating expansion from contraction, Caixin's equivalent rose further – to equal a two-year high of 51.7. Meanwhile, export growth accelerated – helped by a recovery in global trade and industry – but import growth slowed on sluggish domestic demand. True, retail sales picked up in May (both in annual and monthly terms), but they were boosted by a long holiday, and remain well below their pre-pandemic trend, as highlighted in previous publications. Following a surge in April, industrial production cooled somewhat. Fixed investment also slowed further, still being dragged down by property investment. Despite the recent introduction of a new approach to break the negative feedback loop in real estate (see our May Monthly here), property sector data do not show signs of improvement yet. Overall lending growth slowed to a 25-year low of 9.3% yoy, although this still fits within Beijing's approach to ensure lending growth is being capped by nominal GDP growth. All in all, we expect sequential GDP growth to slow in Q2-24, following an above-trend pace of 1.6% qoq in Q1, but annual growth to accelerate to ±5.5% yoy helped by base effects from last year.

Chinese EV exports to Europe have risen rapidly

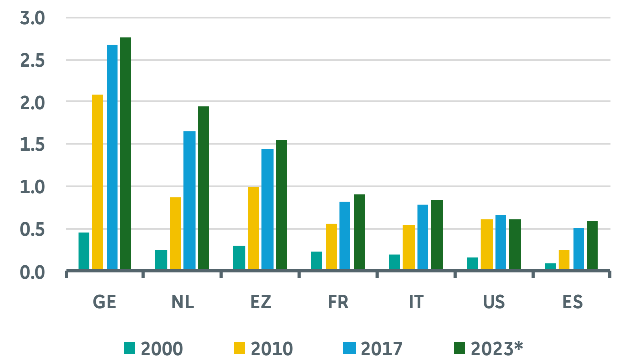
Chinese EV exports, monthly, USD bn



Source: ABN AMRO Group Economics, ITC

Germany more dependent on exports to China

Exports to China, % GDP (*EZ: 2022)



Source: ABN AMRO Group Economics, Bloomberg, LSEG, IMF

Brussels proposes higher tariffs on Chinese EVs; Germany tries to water them down

Earlier this month, the European Commission announced it will impose additional import tariffs on Chinese electric vehicles (EVs) per early July, raising them by 17-38% on top of the current 10%. This would be applicable to all EVs produced in China, both Chinese and foreign brands. This follows an investigation launched in September 2023, after a surge in Chinese EV exports to Europe in recent years (see chart, and earlier coverage in our 2024 Outlook and April 2024 Monthly). Although Brussels has started investigations into some other Chinese sectors as well, our base case assumes European authorities to maintain a balanced approach while protecting their (emerging) tech industries, also taking into account the risk of Chinese retaliation. Noteworthy is that Germany has started a campaign to water down the tariffs. The largest EU economy – with a relatively high export exposure on China in GDP terms, see chart – fears Chinese retaliation to hit its own (car) industry. Beijing seems to have taken these German actions into account, and has agreed to start talks on the issue. While aviation, agriculture, and cars with large engines were allegedly on the shortlist for retaliation a while ago, China has now communicated to start a probe on European pork imports. Potential higher Chinese tariffs on European pork would not hurt Germany, but Spain in particular. China has used this playbook before, as it has targeted the agricultural sector in previous trade spats with the US and Australia. China's probe will take six months, with Beijing likely hoping that Europe's farmers lobby would push other EU members to join Germany.

Key views on a page

Growth indicators are showing signs of a pickup in the eurozone and China, while the US economy is gradually cooling. Big picture, the global economy is slowly converging towards a more trend-like pace of growth, and this remains our base case for the second half of 2024. Global trade and industry are slowly recovering, but a sharp rebound is unlikely while rates remain restrictive, and possible new trade tariffs pose an additional risk. Inflation has fallen significantly, and progress towards the 2% target has resumed in the US following the hiccup in early 2024. The impact of the conflict in the Middle East has receded and the inflation impact of the rise in shipping tariffs is likely to be minimal. The ECB has started lowering interest rates, and we expect falling inflation and a softening labour market to enable the Fed to do the same in September. Still, rates will stay high for some time yet, and this will keep a lid on the recovery.

Macro	Central Banks & Markets
Eurozone – Growth is expected to remain positive in Q2 but edge lower compared to the strong Q1 reading. We have penciled in 0.2% of qoq growth in Q2. Overall, the eurozone economy is slowly regaining its footing, economic activity is expanding in the services sector while manufacturing continues to bottom out. Growth is expected to remain below the trend rate over 2024. In May, core inflation surprised to the upside due to strong services inflation, in part driven by the pass-through of wages. Leading indicators however suggest disinflation will broadly continue in the coming months.	**ECB** – The ECB started its rate cut cycle with a 25bp rate cut at the June meeting, in a widely telegraphed move. In the policy statement the ECB refrained from pre-committing to a particular rate path. In the press conference however Lagarde hinted that a signal on a future move would come only after the July meeting. May's inflation data support this wait-and-see approach. As a result, we no longer expect a follow up rate cut in July. Starting at the September meeting, our base case still foresees an extensive rate cut cycle with 25bp cuts at consecutive meetings.
The Netherlands – Despite the contraction in Q1, GDP growth is expected to pick up and to average 0.5% in 2024. Government spending and household consumption are the drivers of this gradual growth. The stimulus measures in the newly announced coalition agreement led us to slightly raise our growth forecast for 2025 from 1.2% to 1.3%. Inflation is continuing its downward trend. However, the price trend of components with a large wage element – such as labour-intensive services – is slowing the path downward. Inflation is expected to average 2.5% in 2024 and 2.1% in 2025.	**Fed** – We expect rate cuts to start in September, with additional rate cuts once every quarter until March 2025. Afterwards, we expect consecutive rate cuts at each meeting. The Fed will remain attentive to upside risks to inflation and downside risks to the labor market. Monetary policy is expected to remain restrictive throughout 2024 and into 2025. We expect the upper bound of the fed funds rate to reach 5.00% by end-2024, and 3.25% by end-2025.
UK – The election is expected to have no implications for growth and inflation, despite the expected change of government. This is due to the lack of fiscal space and the limited appetite to re-open Brexit policy. The economy is recovering from a prolonged period of stagnation on the back of high rates. Disinflation is continuing, but services inflation is stubbornly high, due to wage growth that is still well above levels consistent with 2% inflation. The return to 2% inflation will take longer than in other advanced economies, due to historically higher inflation expectations in the UK.	**Bank of England** – The MPC has kept Bank Rate at 5.25% since last August. Incoming data suggests stubbornly high underlying inflationary pressure, but Governor Bailey's dovish bias continues to support our expectation for rate cuts to start this coming August. With that said, sticky wage growth – which poses upside risks to medium-term inflation – is likely to keep rate cuts at a more gradual pace than for the ECB and Fed, even into next year. We expect only two rate cuts (total 50bp) in 2024, and four rate cuts (total 100bp) in 2025, with Bank Rate falling to 3.5% by end-2025.
US – Following a surprisingly low growth reading in Q1 of 2024 on the back of higher imports, we expect a reversal with above trend growth for Q2. Still, weak bank lending and pockets of financial stress among households are likely to contribute to a slowdown in growth in the second half of the year, before returning to trend next year. The disinflationary process has resumed in recent months, and we expect it to continue in the remainder of the year, with the 2% y/y target in sight in the course of 2025.	**Bond yields** – The French snap election created high uncertainty and volatility in the European debt market, leading to a sell-off in OATs that also spilled over to other EGBs. Once the political outcome is known and investors get a better insight into the economic policy and approach to the EU of the new government, we expect country spreads to tighten (with OATs still underperforming). Regarding outright yields, levels came down following recent macro data in the US and in EZ indicating weaker economic activity. Markets repriced the terminal rate lower in response for both the Fed and the ECB.
China – Recent macro data confirm that drags from the property sector remain, despite the rolling-out of further measures to stabilise the sector. Growth is supported by stronger momentum in exports, but external risks are rising, as China's overcapacity contributes to trade spats. Following an investigation launched in September 2023, Brussels announced it would raise import tariffs on EVs made in China. We still expect European authorities to maintain a balanced approach, also taking into account the risk of Chinese retaliation. Meanwhile, Germany is trying to water down these tariffs.	**FX** – EUR/USD has been rangebound. EUR weakness from current levels will materialize in the coming months as long as rate cut expectations for the ECB run ahead of rate cut expectations of the Fed. As soon as the Fed begins its easing cycle and markets start to anticipate a larger number of rate cuts in 2025, the dollar will probably decline. Our forecasts for Q2 and Q3 are 1.05 and for year-end 1.07. Our forecast for end 2025 stands at 1.10.

Main economic & financial market forecasts

	GDP (				Inflation				Policy rate			
	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
Eurozone	3.5	0.5	0.7	1.6	8.4	5.5	2.4	2.0	2.00	4.00	3.00	1.50
Netherlands	4.3	0.1	0.5	1.3	11.6	4.1	2.5	2.1				
UK	4.3	0.1	0.6	1.1	9.1	7.4	2.9	3.1	3.50	5.25	4.75	3.50
US	1.9	2.5	2.5	2.0	6.5	3.8	2.6	2.1	4.50	5.50	5.00	3.25
China	3.0	5.2	5.1	4.5	1.9	0.2	0.8	1.8	3.65	3.45	3.25	3.25

Note: Annual average for GDP and inflation, end of period for the policy rate

	2023	24/06/2024	Q3 24	2024	2025	Energy	2023	24/06/2024	Q3 24	2024	2025
US Treasury	3.88	4.24	4.05	3.75	3.25						
German Bund	2.02	2.42	2.20	1.90	1.75	Brent - USD/bbl*	77.04	86.01	85	90	80-85
EUR/USD	1.10	1.07	1.05	1.07	1.10	WTI - USD/bbl*	71.65	81.63	80	85	75-80
USD/CNY	7.14	7.26	7.15	7.10	6.80	TTF Gas - EUR/MWh*	35.25	37.33	35	40	35-40
GBP/USD	1.2731	1.27	1.27	1.27	1.32						

* Brent, WTI: active month contract; TTF: next calender year

	2023				2024				2025			
GDP (qoq)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	0.1	0.1	0.0	-0.1	0.3	0.2	0.2	0.4	0.4	0.5	0.5	0.5
Netherlands	-0.4	-0.4	-0.3	0.3	-0.1	0.5	0.3	0.4	0.3	0.3	0.3	0.4
US (saar)	2.2	2.1	4.9	3.4	1.3	2.5	1.5	1.5	2.0	2.0	2.5	2.5
UK	0.2	0.0	-0.1	-0.3	0.6	0.1	0.2	0.3	0.3	0.3	0.3	0.4
China (yoy)	4.5	6.3	4.9	5.2	5.3	5.6	4.9	4.8	4.4	4.6	4.6	4.6
Inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	8.0	6.2	4.9	2.7	2.6	2.5	2.1	2.2	2.1	2.0	2.0	2.0
Netherlands	7.2	6.3	2.7	0.4	3.0	2.5	2.4	2.3	2.2	2.1	2.1	2.1
US (PCE)	5.0	3.9	3.3	2.8	2.5	2.7	2.4	2.6	2.2	2.1	2.0	2.0
UK	10.2	8.4	6.7	4.2	3.5	2.2	2.7	3.1	3.3	3.2	3.0	2.8
China	1.3	0.1	-0.1	-0.3	0.0	0.4	1.2	2.0	2.1	1.9	1.7	1.6
Unemployment	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	6.6	6.5	6.6	6.5	6.5	6.4	6.5	6.6	6.7	6.8	6.8	6.7
Netherlands	3.5	3.5	3.6	3.6	3.6	3.8	3.9	4.0	4.0	4.0	4.0	4.0
US	3.5	3.6	3.7	3.8	3.8	3.9	4.2	4.2	4.3	4.2	4.1	4.0
Policy rate	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	3.00	3.50	4.00	4.00	4.00	3.75	3.50	3.00	2.50	2.00	1.50	1.50
US	5.00	5.25	5.50	5.50	5.50	5.50	5.25	5.00	4.75	4.25	3.75	3.25
UK	4.25	5.00	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50
China	3.65	3.55	3.45	3.45	3.45	3.45	3.35	3.25	3.25	3.25	3.25	3.25

Source: LSEG, Bloomberg, ABN AMRO Group Economics

(saar = season adjusted annual rate)

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