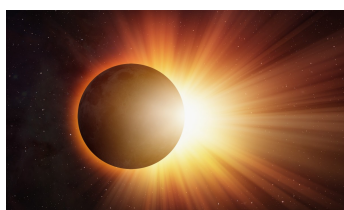


Global Macro Outlook 2021: The darkness before the dawn

In this bundle



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Once winter has passed, the CEE region should brace itself for a meaningful economic rebound from 2Q21 onwards but the prospects of a reflation narrative...



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Brazil in 2021: The focus is on fiscal policy

Brazil's forceful policy reaction to the pandemic was crucial to mitigate its economic impact but it requires some correction in 2021. As it stands,...



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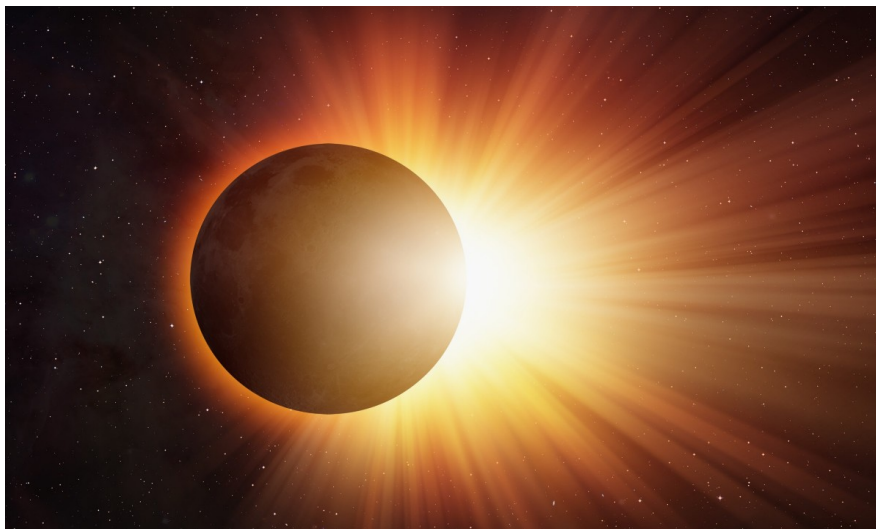
Philippines in 2021: The economy continues to lose steam

Philippine GDP growth contracted 10% in the first three quarters of the year and there's little hope of a big turnaround in 2021

Report | 17 November 2020

Global Macro Outlook 2021: The darkness before the dawn

What a year! As this wild and turbulent year draws to a close, we look back on how Covid-19 has sent the global economy into the worst slump in a century and focus on what to expect beyond lockdowns, the virus and the vaccine in 2021



Source: Shutterstock

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

The US in 2021: The Biden bounce

The US economy faces major near-term challenges, but longer-term we think the market is too cautious on its prospects. A vaccine, a major fiscal stimulus, ongoing Federal Reserve support and a more internationalist approach with allies and trade partners can lay the foundations for a vigorous recovery from 2Q21



James Knightley: The US in 2021

[Watch video](#)

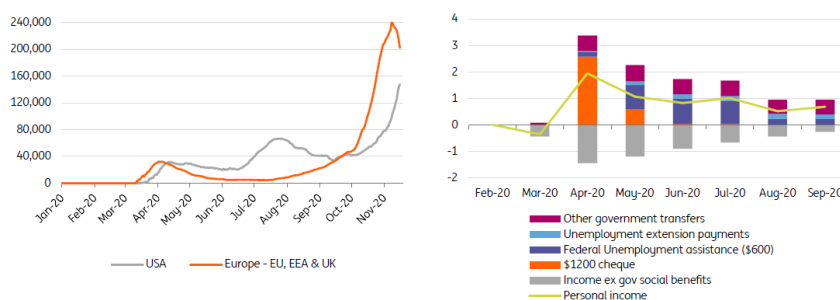
Back in the red

Recent newsflow on the efficacy of Covid vaccines has undoubtedly come as welcome news, but we know that an inoculation programme remains several months away. With the number of cases rising rapidly and healthcare systems facing increasing challenges there is the very real prospect of more individual states having to reintroduce containment measures.

As in Europe, we suspect that manufacturing, construction and most retail will remain open, but restrictions on other sectors will still come at a huge economic cost with millions of jobs potentially at risk. Adding to the problems, this comes at a time when millions of households are already experiencing cuts to their incomes as state unemployment benefits expire and Federal government support becomes more limited. The key question is how will politicians respond?

Given Donald Trump's legal challenges to the election and claims of fraud, we sense that political animosity could delay or limit a government response, potentially deepening an economic crisis. The Federal Reserve may feel the need to respond, with more stimulus to try and shore up confidence. Either way, we fear the December-January period will be tough on both a human and an economic level with a probable negative GDP print for the first quarter.

US Covid cases following Europe's surge while incomes are being squeezed



Source: Macrobond, ING

But the turn is coming

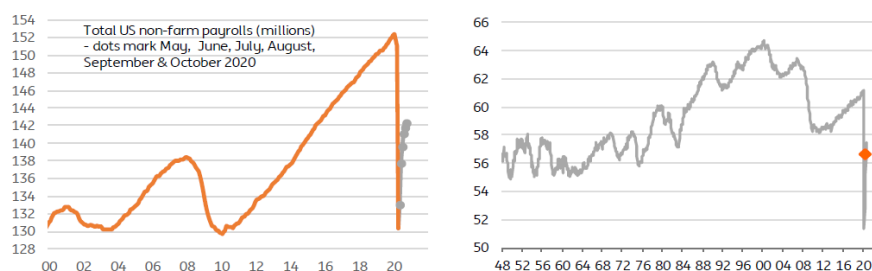
However, as a vaccine programme starts to be rolled out – we assume it starts fairly early in the year following regulatory approval – this can give a huge lift to both consumer and business sentiment. The prospect of a return to normality, with people willing and able to get a flight, go to the cinema and meet with friends in a bar, could propel growth massively. As we have repeatedly noted, it is higher income households that have been holding back the recovery in consumer spending since they spend so much more of their income on experiences - something they haven't been able to do due to Covid restrictions.

Assuming a smooth transition to a Joe Biden presidency, the rebound could be further fuelled by a substantial fiscal stimulus. The 5 January runoff for the two Senate seats in Georgia will determine how ambitious he can be. The Democrats would need to defeat both incumbent Republican Senators to regain control and this looks challenging. Even if they don't pull it off, we still assume a package of around \$1 trillion is possible, equivalent to just under 5% of GDP.

This would be focused initially on low income households and hard-pressed state and local governments, but is also likely to leave a large chunk of money for investment projects. The \$2 trillion proposed for Green Energy projects is on the table, but that runs the risk of being curtailed or delayed because of the challenges of getting it through the Senate. Tax hikes are also on the agenda, but we suspect they will be delayed until 2022/23 as next year is all about growth and recouping the 10 million jobs that are still to be regained.

With the Federal Reserve set to leave monetary policy ultra-loose for the next couple of years and Biden likely reverting to a more predictable, multilateral approach to international relations this can give businesses the confidence to put money to work through investment and hiring workers.

Jobs market remains much weaker than February



Source: Macrobond, ING

Could it be too good

One increasingly plausible scenario is that inflation expectations start to rise and the yield curve steepens more sharply as market pricing for Federal Reserve interest rate increases are brought forward.

After all, the pandemic has caused major structural changes to parts of the economy and there is the possibility that robust demand, coupled with supply constraints, leads to rising inflation numbers. For example many entertainment venues, bars and restaurants have gone out of businesses while airlines, car hire firms and hotel chains have cut back dramatically on capacity. A global recovery may put upward pressure on fuel prices, adding to the sense that inflation will move higher.

Of course, we continue to argue that the US is largely a service sector economy and weak wage growth in an environment of high unemployment will act as an offset. Nonetheless, we wouldn't be surprised to hear the Fed gradually shift its language to indicate that it may not be as late as 2024 before they consider raising interest rates.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Eurozone in 2021: Digital, fiscal and monetary changes

A double-dip in the eurozone has become almost inevitable. But despite all the government support to soften the blow to the economy, the structural face of the crisis will emerge next year. We think there is more in the offing for the eurozone in 2021, and here is what you should watch out for



Carsten Brzeski on 2021

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Key Themes in 2021

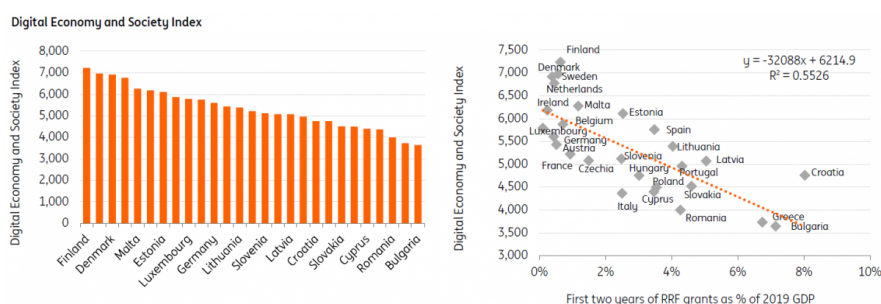
1. Digitalisation is key to a sustained recovery and investments in the digital economy could be the 2021 game-changer for more convergence in the eurozone.
2. With the need for more growth-oriented public investments, a discussion around more fundamental reform of the fiscal rules for the bloc.
3. Expect the ECB to follow in the footsteps of the Fed and apply the principle of symmetry to its inflation target.

□ Digitalisation is key to a sustained recovery

During the peak of the first wave, we looked at the [vulnerability of eurozone countries](#) to a prolonged Covid-19 slump, which showed that the old eurozone periphery has a larger chance of a weak recovery than core or northern economies. Looking beyond the pace of the immediate recovery, sustainable growth seems to be more dependent on digitalisation due to the crisis. This means that countries that have an edge in terms of digitalisation are even more likely to have a stronger structural growth path.

[Why Eurozone's periphery is in peril](#)

The digital economy is weaker in the eurozone's periphery, but EU funds could help



Source: Eurostat, European Commission and ING calculations

Among the countries that do best according to the Eurostat's Digital Economy and Society Index are Finland, Netherlands and Ireland. Greece, Italy and Portugal are among the weakest. Sound familiar? This means that digital infrastructure, connectivity, integration of digital technology, etc. could be as decisive for eurozone divergence and convergence as fiscal and monetary policies.

There is one upside for 2021 though, which is that the Recovery and Resilience Fund has an investment in digitalisation as a requirement for disbursement of the grants. Investments in the digital economy could be the 2021 game-changer for more convergence in the eurozone.

□ Fiscal rules to change once again?

One remarkable game-changer of the crisis has been the U-turn of fiscal policy.

Between 2008 and 2012, the preferred policy prescription to tackle the crisis was structural reforms and austerity, but from the start of this crisis, eurozone governments have opened their pockets big time and the second lockdown should trigger additional stimulus.

Add to that the likely losses on governments' guaranteed loans, it becomes clear that budget deficits will still be above 6% of GDP in 2021 after close to a 10% deficit this year. At the same time, the debt level in the eurozone will rise above 106% of GDP, more than 20 percentage points higher than in 2019.

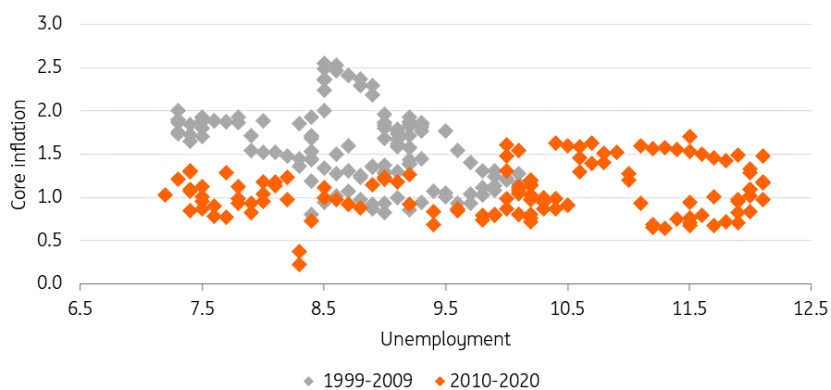
And there is more. Thanks to the so-called 'escape clause', the fiscal rules of the Stability and Growth pact have been put aside at least until 2021. In our view, this temporary waiver could once again open the door for a more fundamental discussion about the fiscal rules in the eurozone. This discussion is even older than the monetary union itself and there have been many attempts and actual changes to the rules. However, with the need for more growth-oriented public investments and the seeds for a eurozone budget now planted in the form of the European Recovery fund, 2021 could bring a more fundamental reform of the fiscal rules.

□ 2021 – The year the Phillips curve finally died in the eurozone

While currently, it is still all hands on deck for the ECB to support the eurozone economy and bring inflation expectations and projections finally back to target, the second half of the year could see an unexpected twist. At the end of the ongoing strategy review, we expect the ECB to follow in the footsteps of the Fed and apply the principle of symmetry to its inflation target, without going all the way and deciding on an average inflation target.

We expect the ECB to announce a new definition of its 'below but close to 2%' to 'around 2%', however, the question will be whether this 2% target will be credible as structural forces continue to weigh on inflation. As such the link between unemployment and the inflation rate - the so-called Phillips curve, has flattened.

Is the Phillips curve dead?



Source: Eurostat

The Covid-19 induced acceleration of digitisation, which is putting pressure on employment in some sectors, will only reinforce this trend. If the ECB sticks to the 2% target and makes it even more symmetric, this would suggest an ultra-accommodative monetary policy for even longer than the current 'very long'.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

China in 2021: Quantifying quality growth

In its fourteenth five year plan, China has outlined a vision for achieving high-quality growth. Here's what it means in practice



Iris Pang: China in 2021

[Watch video](#)

To be an advanced economy means a lot for China

We've already written extensively about China's 2021 goals [here](#). The vision for 2035 provides a little more quantification. China wants an "advanced economy" in fifteen years' time. There is no specific definition of this. But we can make some estimates.

Using the latest World Bank data. China's GDP per capita is US\$10.6 thousand. That compares to US\$18 thousand for Greece. The UK, France and Japan are all about \$39 thousand. While Germany is US\$45 thousand, and the US is US\$63 thousand. That shows where China stands relative to most advanced/developed economies.

From this standpoint, China's objective in terms of GDP per capita would be to at least double within the next 15 years. And that is an aggressive target.

To realize this vision, China must pursue two main strategies

1. Become self-reliant in technology;
2. Export green products, such as vehicles, renewable energy technologies and so on, areas

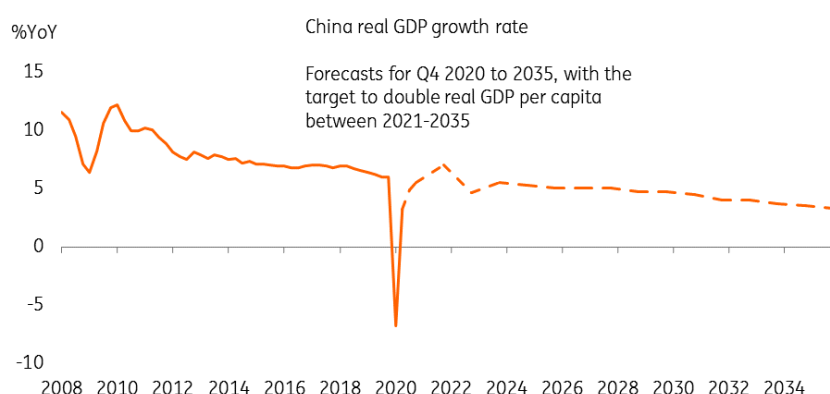
where it's starting to have a technological advantage.

Achieving these objectives would help China sustain continuous income growth, as well as speeding up the engine of "domestic circulation", creating more jobs from domestic consumption of goods and services.

While this may sound simple, it will be quite a challenge. China has relied on exports of technology for more than ten years. Although these were predominantly basic products using elementary technological inputs, they provided more than a third of China's export value. This has been changed by the technology war. China has responded by promoting a new export area, "green" exports. As more countries set Environment and Social Governance (ESG) targets, they need renewable energy, waste management, and water management systems, which China has been developing and can now export, and which will face far less resistance from other economies.

Our simple growth projection for the next 15 years is as follows: There will be faster growth in the first five years, but then slow gradually in the remaining years up to 2035. This projection assumes a roughly stable population. Promoting higher child-birth has been successful in some areas in China. But this policy also faces an ageing population, and won't make much difference to the labour force over this timescale. Our projected real GDP growth rate is 4.5% on average for 2021-2035.

Growth in 2021 should be much stronger than this at around 7%.



Source: CEIC, ING

Projection of GDP according to the 2035 envision to become an advanced economy by 2035.

Technology war is still the number one risk in 2021

The biggest risk factor in 2021 is still the technology war, which we have incorporated into our forecast. This is not just confined to the US and China. Many more economies could become reluctant to use Chinese-made technology because of security concerns.

Interest and exchange rate reform is both risk and opportunity

We don't expect any significant changes in monetary policy in 2021. The People's Bank of China (PBoC) will take advantage of the stable interest rate environment, to promote market-based interest rate instruments on loan products to pave the way for further interest rate liberalisation.

The PBoC will do the same for exchange rate liberalisation. The recent fading out of the counter-

cyclical factor in daily USDCNY fixing is a step in this direction. USDCNY and USDCNH will be more sensitive to intraday market information. And the CNY trend will also be more market-driven. We expect USDCNY to reach 6.30 by end of 2021.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Asia in 2021: Ascendant

Fiscal and monetary policymakers have ripped up the rule book in Asia this year to battle the pandemic, but the strength of the recovery in 2021 will depend on how much Asian central banks push the boundaries in terms of unorthodox monetary policies, the nature of fiscal support rather than just the amount and the momentum for the semiconductor industry



Rob Carnell: Asia in 2021

[Watch video](#)

Three main themes for Asia in 2021

Three issues most likely to dominate the outlook for Asia in 2021, excluding China are:

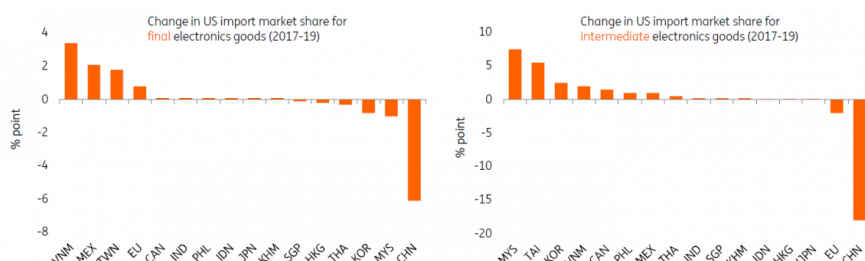
1. The development of the semiconductor cycle
2. The effectiveness of Covid-19 support measures
3. Central banks drift towards unorthodox monetary policies

1 Semiconductor upcycle

Recent export and industrial production releases around the region have shown recovery from the depths of the pandemic. But the recovery has been uneven. Most industries are still struggling. The big exception to this is semiconductors and select electronic components.

This is of especial importance to the region’s semiconductor giants - South Korea and Taiwan. But there are few countries in Asia that are not tightly linked into the semi-conductors cycle. Increasingly Vietnam, Thailand and Malaysia have been taking market share from China in this sector, attracting new inward foreign direct investment as well as some relocations from China. Indonesia and India are the two least affected economies and will likely miss out on any upturn.

Gains of electronics market share from China



Source: ITC, MAS - Market share gains

While the momentum for the semiconductor industry is currently strong, this is a notoriously fickle sector, prone to overinvestment and excess capacity, price plunges as well as gains. With relations between the US and China over technology hanging in the balance, backing a continued technology upswing is not without risks.

On the other hand, China’s push towards “new infra” and roll out of 5G could well provide a multi-year push for the sector, which would provide all of Asia with a considerable boost.

2 Effectiveness of fiscal support

The outlook for 2021 will be heavily tempered by how the pandemic evolves, possibility of a vaccine and potential return to more normal work and leisure practices.

But the difference between solid recoveries for some, and tepid and erratic recoveries for others, might be the scale and effectiveness of fiscal support measures put in place in 2020. All countries in Asia have provided considerable fiscal support measures, though there has been a considerable exaggeration of the scale of support in many instances, making a reliable comparison impossible.

What 2021 will show, is the effectiveness of these efforts in three important areas:

1. Protecting the business sector, and maintaining the productive capacity of the economy
2. Providing the same support/insurance, for the labour force
3. Longer-term reform measures undertaken in some economies

While there is probably some overlap between the amounts set aside for fiscal spending and the strength of the recovery in 2021, the nature of that spending may well prove as important as the amounts.

3 Unorthodox central bank policies in Asia

As well as ripping up the rule books on fiscal policy during the crisis, monetary policy has also come under assault from central banks running out of traditional support tools.

The assumption has always been that emerging market economies would not be “allowed” negative real interest rates, and if so then certainly not quantitative easing and definitely not direct deficit financing.

But while fiscal policy easing has been less constrained during the pandemic, emerging market economies have still had to pay heed to the mood of rating agencies, and that has meant preserving some vestige of fiscal respectability, some have been pushed towards more monetary easing.

Asian central banks' conventional and unconventional policy easing during Covid-19 crisis

Economies	Conventional			Unconventional					
	Rate Cuts	Near-zero/-ve rates	CRR/SLR * cuts	Govt. bonds	Corp bonds	Comm paper	ABS **	Yield Control	Advances to govt.
Australia	√	√/X	X	√/X	X	X	√/X	√/X	X
China	√	X	√	X	X	X	X	X	X
India	√	X	√	√/X	√/X	√	X	√	√
Indonesia	√	X	√	√	X	X	X	X	√
Japan	X	√/√	X	√	√	√	X	√	X
Korea	√	√/X	X	√	√/X	√/X	X	X	X
Malaysia	√	X	√	√	X	X	X	X	√
New Zealand	√	√/X	X	√	X	X	X	√	X
Philippines	√	X	√	√	X	X	X	√	√
Taiwan	√	X	√	X	X	X	X	X	X
Thailand ***	√	√/X	X	X	√	X	X	X	X

* Cash Reserve Ratio/Statutory Liquidity Ratio

** Asset-backed securities

*** The Bank of Thailand has set up the Corporate Bond Stabilization Fund (BSF) to provide liquidity support and stabilize the corporate bond market as well as maintain overall financial stability.

Source: Newswires, ING

With negative real rates seemingly posing few problems, some governments have been emboldened to supplement their fiscal constraints with more imaginative monetary support – namely thinly-veiled direct deficit financing, or quasi-quantitative easing.

[A number of economies have dabbled in this area, including South Korea, with their “Korean style” QE, and the Philippines, with some outright bond purchases in secondary markets.](#) But perhaps most blatantly of all, Indonesia's central bank, is engaged in small-scale (currently) direct primary market financing “burden-sharing”, and the independence of the Bank is also being watered down.

[Read more about the depth of Asia's unconventional central bank easing](#)

Asia Pacific – unorthodox policy by country

	Philippine central bank	Indonesia central bank	Reserve Bank of India	Bank of Korea
What has happened?	BSP unloaded a hefty monetary response with a flurry of conventional easing - 175bp of rate cuts and 200bp reduction in reserve requirements. As a result, PHP 1.9 trillion was released into the system.	BI has carried out its fair share of conventional easing, with rates slashed by 100 bp and reserve requirements reduced for both dollar and specific IDR-denominated accounts in first-quarter. But Indonesia is constrained by a vulnerable currency- the rupiah.	India's central bank action has been a mix of both conventional and unconventional measures. The RBI cut policy interest rates by a total of 115 bp and banks' cash reserve ratio by 100bp from March to May.	The Bank of Korea leapt in to help with a quick 50bp rate cut in March followed by another 25bp of easing in May. This is still where policy rates stand today, at 0.50% - still above zero, and indicating some slight additional room for further orthodox easing should it be required.
Quantitative Easing	FULL - The central bank has bought up government securities with no volume limits or target tenors. To date, we estimate, it has bought up roughly PHP 1.1 trillion worth of bonds & given the heft of their holdings relative to the outstanding total (20%).	FULL - At the onset of the pandemic, BI received provisional authority to expand its scope to purchases of long-term securities in the primary market via "perpu" or presidential declaration to assist the govt. manage the impact of Covid. Currently, BI's monetary operations have totalled roughly IDR 658 trillion, worth roughly 4.2% of GDP.	LITE - When hefty rate cuts failed to revive growth and CPI started to rise towards the year-end, the RBI resorted to buying long tenor govt bonds and selling short ones to drive market yields lower. Given the long-term nature of this operation (1 to 3-years), assets created remain on the RBI's balance sheet until the maturity of TLTRO. As of August, the outstanding balance on this account was INR 2.5 trillion (1.2% of GDP).	LITE - The Bank has been keen to enter the unorthodox club with talk of "Korean-style QE". At its 9 April meeting, it announced the adoption of an unlimited liquidity support facility. This was to use a weekly repo purchase facility to supply an "unlimited" amount of liquidity at set interest rates for a period of 3 months. The new measures were also linked to the implementation of the government's financial support package.
Deficit financing	LITE - The Bank's charter allows short-term cash advances to the govt, capped at PHP 810 bn. Given the cash crunch faced by authorities in October, the Bank agreed to purchase PHP 540 bn worth of 3-month paper directly from the government. As time goes by, it looks like BSP may be willing to move on to full-on deficit financing .	FULL - Indonesia's central bank has also recently entered into a "burden-sharing" agreement with the govt, as the Bank carries out full deficit financing. Despite subsequent pronouncements highlighting the independence of BI, investors remain wary of future burden-sharing agreements in the coming months with BI tagged as standby financier of the deficit.	LITE - Under Governor Das, the RBI has been generous in helping the govt to fund a wide budget deficit. The main channel here is the RBI's dividend payment and transfer of excess reserves to the government. The Bank also boosted its Ways and Means Advance limits for central and state governments. This isn't a source of deficit financing per se - just a mean to tide over short-term (usually up to 3 months) mismatch of government's receipts and spending.	
Where do we go from here?	Despite, pledging the use of unconventional policies was "time-bound" and will be phased out, authorities have secured legislation to extend and upsize the budget for cash advances, setting the precedent for more cash advances between monetary and fiscal authorities.	The Bank appears ready to resort to unconventional measures to support the govt's recovery efforts. Bank officials have repeatedly declared independence from fiscal authorities but we expect the Bank to carry out more deficit financing activities in 2021 and also use QE measures to ensure adequate liquidity in the system.	The RBI balance sheet doesn't provide sufficient grounds for thinking about outright QE or deficit monetisation. Total assets/GDP ratio of 27% is small compared to many developed market central banks pursuing full QE. We look for signs of significant balance sheet expansion to indicate policy has switched from its current lite measures to full QE or deficit financing.	Despite the Governor raising the possibility of purchasing corporate bonds or commercial paper as an expansion of this exercise, the Korean-style QE program concluded at the end of July, having supplied around KRW19tr. With market rates having stabilised, the liquidity benefits of this program are not required. Nor does the Governor seem keen to embark on mainstream QE.

Source: ING

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Deputy Global Head of Editorial and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporate Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

UK in 2021: Another year of tough decisions

The end of the post-Brexit transition period poses a fresh challenge for the economic recovery, although we're unlikely to see a Covid-style GDP collapse. Instead, the timing and way in which government support for jobs and businesses is unwound could have a bigger bearing on how far the UK economy recovers through 2021



James Smith: The UK and Brexit in 2021

[Watch video](#)

Three main themes for 2021

1. Brexit to add pressure to the jobs market, but it's unlikely to trigger a Covid-style GDP collapse in early-2021. We expect GDP to rise by roughly 4.5% in 2021, but this is mainly a reflection of the sharper and more-prolonged lockdown in 1H20.
2. Unemployment set to rise further, potentially to high-single-digits if government support schemes are unwound before social distancing rules are meaningfully eased.
3. Bank of England to steer clear of negative rates, although it's a close call.

2020 has been a comparatively bad year for the UK economy. Not only are Covid-19 mortality

figures worse than many other developed economies, but the longer lockdown has also resulted in a slower recovery. And while subsequently reversed, the initial decision to end wage support earlier than many other European governments means unemployment is likely to have risen further over the course of the year.

Prospects for a vaccine and mass-testing means that, on paper, 2021 should be a better year for the UK economy. But given the risks surrounding Brexit, and the uncertainty of how government support will be unwound means the economy is unlikely to return to pre-virus levels next year.

1 Brexit to add unemployment pressure, but not like Covid-19

At the time of writing, we still don't know whether the UK and EU will be able to sign-off a free-trade agreement before the end of 2020. But what we do know is that, compared to the current position of single market and customs union membership, all roads lead to a sharp change in trade-terms at the start of 2021.

With Covid-19 restrictions likely to remain relatively tight both in the UK and across the channel in January, the timing arguably couldn't be worse. England will still be emerging from lockdown, which we expect to hit UK-wide GDP by 6-7% in November.

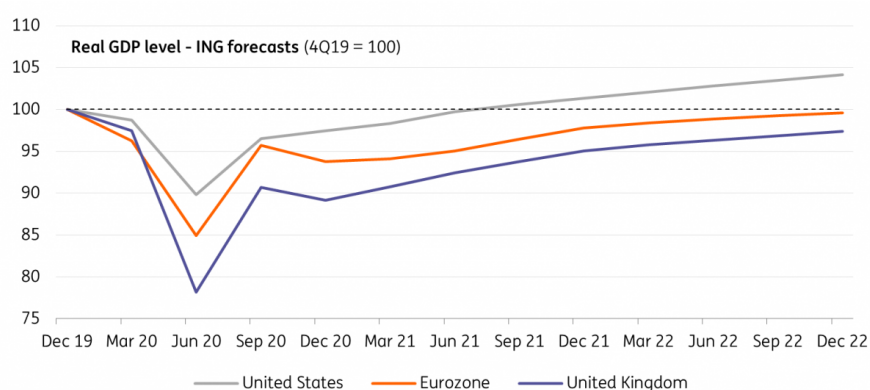
The hope is that assuming there is a deal, both sides will be able to agree on some sideline measures to help reduce the scale of the early disruption - mitigations to ease the congestion at ports from day one, alongside EU decisions on financial services equivalence and data-adequacy, among other things.

All roads lead to a sharp change in trade-terms at the start of 2021

Even so, some initial disruption is to be expected, but importantly this is unlikely to trigger a Covid-19 style GDP hit early next year. In fact, barring another lockdown later in the winter, the first quarter will almost certainly record a positive growth figure, reflecting the technical bounce-back from the current shutdowns.

Instead, the impact may show through more clearly in the jobs market. The costs of new customs processes will put pressure on industries so far unscathed by the pandemic (eg agriculture). For other sectors, those already hit-hard by Covid-19 (eg carmakers), the new cost burden is likely to compound the damage already done by the pandemic.

UK still set to underperform Europe and US



Source: ING

2 Unwinding government support could bring new challenges

An equally, if not more important, question for 2021 is how the government will extricate itself from the unprecedented support it has offered the economy through 2020.

Take the furlough scheme, which helps to pay workers 80% of their normal salaries. The policy, which was originally set to be replaced by a less generous scheme from the start of November, has been extended to March given the return to lockdown. That will undoubtedly help limit the rise in unemployment, although admittedly the policy announcement will have come a little too late to save some jobs.

Further extensions to this policy are possible, but at some point in 2021, the government faces the tough decision over how and when to unwind this, and other similar crisis policies. At stake are potentially around 1.7 million jobs (roughly 6% of employees) - the number of people we estimate were still 'fully furloughed' in October before the latest restrictions came in. Many of these jobs will be in sectors that were never allowed to fully reopen after the first lockdown.

If social distancing rules are still a heavy feature when the furlough scheme is scaled back, then potentially we could still see the unemployment rate rise into the high single digits at some point in 2021, as redundancies build in sectors that are still heavily constrained by Covid-19 rules.

3 Negative rates still far from guaranteed

Elsewhere, the Bank of England also faces a tough decision in 2021, when the debate on negative interest rates is likely to come to a head.

We think policymakers will more likely avoid rate cuts if they can next year, focussing instead on quantitative easing, but it's a close call. You can read more about this debate in our 2021 outlook for central banks.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Rates in 2021: Far from risk free

This is it! The final year for Libor, at least for the US, the UK and some others. Euribor continues, but the rest need to get ready for 'risk-free' rates. The transition will be helped by flat central bank rates, but expect volatility in longer dates. The bias will be steeper and higher for market rates, assuming the Covid-19 threat diminishes



Padhraic Garvey: Rates in 2021

[Watch video](#)

A yield of at least 1% on the US 10yr should be a structural thing for 2021

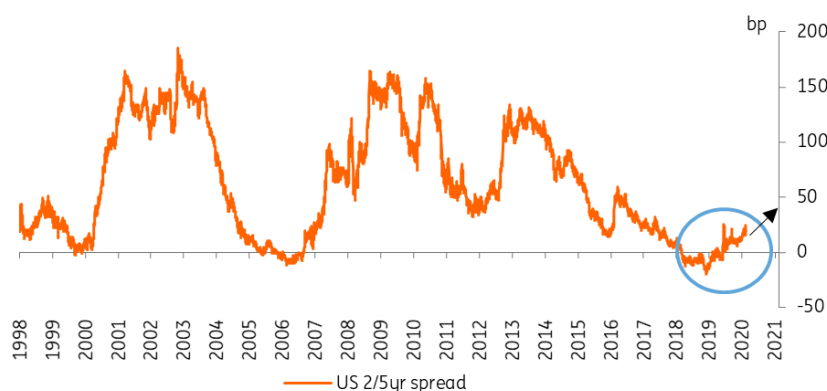
The recent vaccine moment vindicates a move of the US 10yr to 1%, where it has a so-called 1-handle. It's a key level, as it brings us back to the notion of describing yield in percentage rates rather than in basis points. It is also foreign territory to the 10yr German rate at -50bp. Deviating from that is something to be strived towards. While negative rates have served the purpose of providing ultra-low financing conditions, they are also not a desired outcome.

We see 2021 as a year in which the spread between the German and the US 10yr widens back towards 175bp. And this is important for eurozone yields, as higher US yields can help to pull eurozone ones up too; which is a good thing as higher yields usually mean better things in terms of

underlying macro circumstances. We don't see this as being a consequence of more supply. That might come. But for now the dominant pull on market yields is a reflationary 2021.

We'll see this in the shape of the curve too; it should steepen. Watch the US curve here more than the eurozone one, as the latter has a strange front end that can go as deeply negative as it likes it seems, bringing long end rates with it. The US curve is more anchored at zero. When it stretches steeper, it means something. Our target is for it to be in the 100-125bp range as a theme for 2021, with the 10yr trading between 1% to 1.25%. The German 10yr likely stays in -50bp territory, but at least is shown the way by the US, especially if the US manages a break above 1.25%.

A picture of reflation, a mini reflation so far, but better than the deflation discounted in mid-2019



Source: Macrobond

Why is Libor so low and where is it heading to in 2021

Libor will live out its final days in market centres through 2021, but it is strutting through 2020 with quite a bit of attitude. One of the issues with Libor is the implied bank risk that it contains, which proved exceptionally volatile during crises (most notably through the great financial one). But as we head towards the end of the year, Libor is on the floor. USD Libor at 20bp is some 5bp below the Fed funds ceiling. There's not much-implied bank credit risk there.

The likelihood in 2021 is that this changes. We think that USD Libor should be some 10bp higher than it is currently, and we'd assert similar for Ibors in most other centres. For example, remarkably, 3mth Euribor is currently flat to the ultra-safe ECB's deposit rate. While this can be rationalised on account of advantageous bank funding conditions, it still looks anomalous.

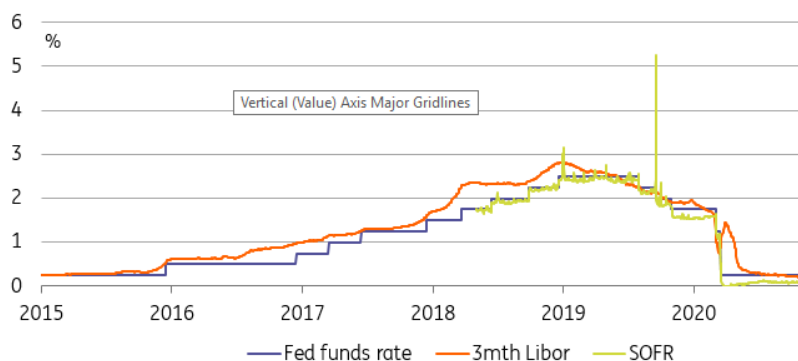
So while central banks may not do an awful lot in 2021 in terms of policy changes, we would expect to see lbor rates drift higher from current levels. An ancillary rationale here centres on the likelihood that risk attributed to banks and the system ratchet higher again, especially as default risk gets re-elevated. The end of Covid-19 is clearly positive, but it also means the Band-Aids come off, in many cases, leaving ghastly unhealed wounds that will result in numerous uncomfortable shutdown stories, even as economies begin to structurally rebound.

Why risk free rates are the future, and what to expect in 2021

Actually, there is no such thing as a risk-free rate. All rates have risk. The transition here is from Libor, which contains a bank credit risk, to overnight rates that minimise both credit and

counterparty risk. The transition must happen in 2021, as there (likely) will be no, for example, USD Libor in 2022. Initial resistance to change has morphed to inertia, as players await first movers. And there has not been huge movement so far, to say the least. One Federal Reserve spokesperson likened the process to herding cats; very apt.

Down in the dumps, but at least steady for transition



Source: Macrobond

Still today the vast majority of derivatives trades are set with reference to Libor, and not to the new replacement 'risk-free' rates. Many are awaiting a build-up in volumes before switching. We expect to see a material build in such volumes through 2Q 2021, and we view it as being a simultaneous process, as volume in all product builds at the same time. This is vital. Such a build in volumes would allow for derivatives referencing risk-free rates to begin to dominate Libor. While not a flick of a switch, we do feel that transition to the use of the new rates can be swift, happening over a matter of weeks.

That, in turn, would facilitate the mapping out of term rates in the USD risk-free rate in particular e.g. a 3mth rates rate in advance (and not in arrears). A decent rump of players in the loans market globally is calling for this as a must-have. We expect term rates to be in place by early 3Q 2021, and this is a critical call for a smooth transition. The other issue is how to deal with the legacy Libor product and especially loans. Here, bi-lateral conversations will have to be had, effectively on suitable spreads that translate from Libor to risk-free rates. There are traded market spreads that can help as a reference, but they move. Not easy. Also not easy as Libor is so low now that the market spread is below average, which makes the discussion that bit more complicated.

And we have not even touched on different methodologies to be used in derivative versus loans. It's really very messy; get ready for it as best you can.

Author

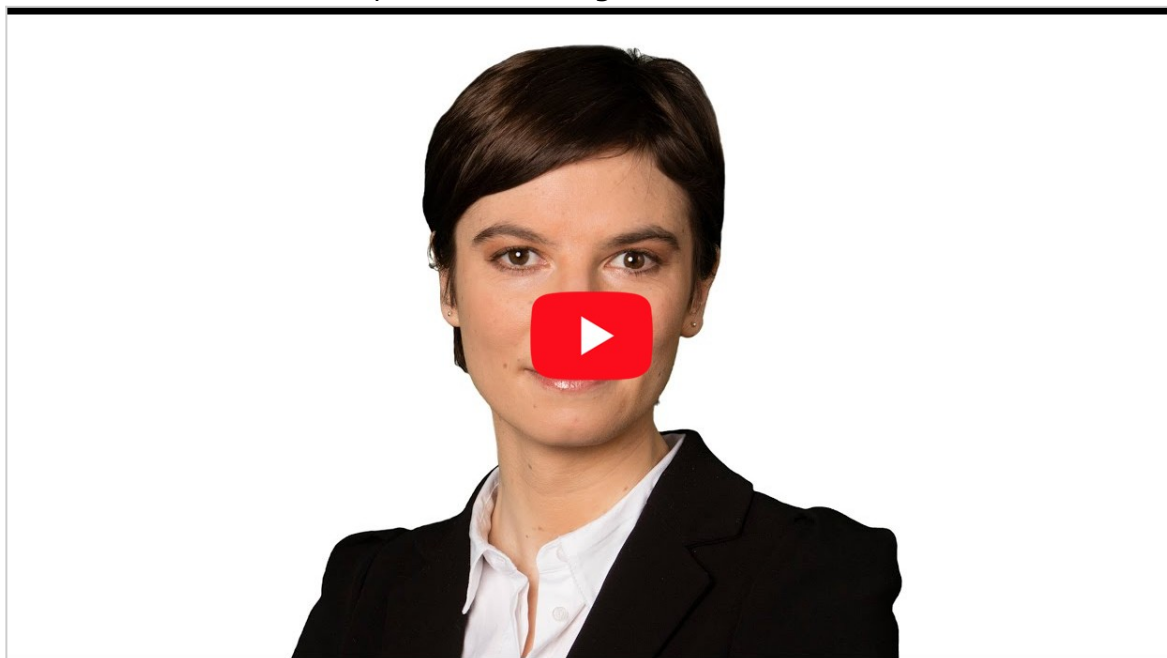
Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

International trade in 2021: Plenty of challenges, but recovery in sight

World trade will not be far from news headlines in 2021, and despite the new leadership both in the US and soon at the World Trade Organisation, this is no guarantee of international co-operation. But at least it offers some hope for thawing of trade tensions



Joanna Konings: Trade in 2021

[Watch video](#)

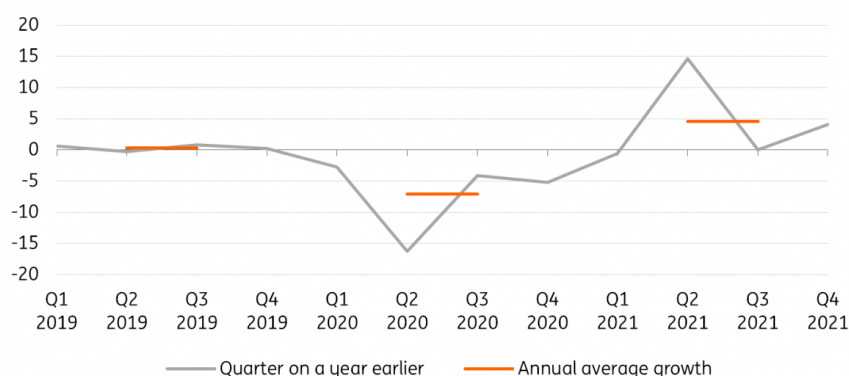
With a vaccine, trade will rebound but second round effects will drag into 2021

Progress towards a vaccine is a key step towards restoring consumer and investment confidence over the course of 2021, helping trade volumes recover to their pre-pandemic levels from the 16% collapse in 2Q20. But some Covid-related disruptions to transport capacity will take time to unwind, and cause a persistent drag even as demand recovers.

Even though trade will respond quickly as demand recovers, it may take until 2022 to reach pre-pandemic volumes again.

As Covid restrictions ease, trade bounces back

We forecast a 7% fall in goods trade volumes in 2020 followed by growth of around 5% in 2021, to reach pre-pandemic levels in early 2022.



Source: UNCTAD, ING

As the recovery progresses, government support packages which have been essential for consumers and businesses alike pose a downside risk to trade volumes, as subsidies create an uneven playing field for exporting firms. If government support is unwound, the dampening effect on trade volumes should be limited.

The costs of diversifying supply and holding larger inventories will limit any grand migration of supply chains in 2021

However, much of the support provided has no formal end-date, and could therefore have unintended [effects](#) on trade's recovery.

Policy responses to the vulnerabilities revealed by Covid-19 may result in countries stockpiling certain goods and even trying to incentivise re-shoring. But supply chain disruptions from lockdown in China proved to be a smaller problem than collapsing demand in export markets, especially thanks to China's swift reopening. For many firms, increasing supply chain resilience is easier said than done. The costs of diversifying supply and holding larger inventories will limit any grand migration of supply chains in 2021.

Trade war act II will be milder

US trade policy under President-elect Joe Biden looks likely to continue to put pressure on US-China trade relations while de-escalating other disputes.

The tariffs on US-China trade flows are likely to remain in place, though talks may resume. As part of a Biden campaign pledge to "work with our closest allies" on trade, US tariffs on steel and aluminium may be reduced, and the threat of US tariffs on EU cars forgotten.

Alongside continued strained trade relations with the US, and now also Australia, China faces the

threat of continued restrictions on its investment abroad. In response, it may redouble its efforts to lower trade costs and build export markets closer to home through its Belt and Road connectivity projects and develop its high-tech manufacturing capacity as part of its 'Made in China 2025' strategy, reducing imports in the process.

Challenges right from the start, with high stakes

Thanks to Brexit, we are almost guaranteed to start the new year talking about trade disruption. Even if a trade deal is signed, cancelling the prospective tariff increases on goods between the two countries, new customs checks on the origin of goods and safety standards will delay cargo travelling from the UK to the EU from 1 January 2021.

By early 2021, the new director-general of the WTO should have been appointed, just in time for the world trade system to play its part in the distribution of Covid-19 vaccines. Countries have signed up to the principle of fair allocation, but making this work will be key to a global recovery in 2021, and prospects for multilateral co-operation thereafter. The stakes couldn't be higher.

Being 'under new management' is no guarantee of international co-operation on a vaccine

The incoming WTO director-general has other daunting issues to address too. Various disputes caused by the trade war are working their way through the WTO's courts, including the US steel and aluminium tariffs, which require the WTO's appellate body to get back on its feet. There is also a dispute with China about the use of state subsidies, where the US has been joined by the EU and Japan in voicing concerns. Progress on these difficult issues is required to avoid future trade wars.

Cautious optimism on global trade seems warranted

Trade will not be far away from the headlines in 2021, and being 'under new management' is no guarantee of international co-operation on a vaccine, or resolving the issues that led to the trade war. World trade will continue to bear the scars of the tit-for-tat trade war, and the effects of subsidies introduced during the pandemic risk dampening the recovery.

But in spite of the challenges and risks, cautious optimism for 2021 is warranted as economies are set to recover and trade policy may be done through talks, rather than tariffs.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

What Brexit and Biden will mean for the world in 2021

Two big themes in 2020 were Brexit and Joe Biden's election win. We map out their broader implications for economic and foreign policy in 2021



Source: Shutterstock

President-elect Biden: Ushering in a warmer period of US-EU relations

The US President-elect Joe Biden's domestic ambitions for a redistributive fiscal mix of higher taxes on corporates and the wealthy while offering more support for people on the lower end of the income spectrum will depend critically on whether the Democrats regain control of the Senate on 5 January. Assuming the Republicans hold, there will be an inevitable watering down of aspirations, but we still think a substantial fiscal stimulus, of the order of \$1 trillion is likely.

While we may not see much improvement in US-China tensions, there is clearly an opportunity for the US and European relations to be rebuilt

When coupled with the introduction of a vaccine, which can allow a full reopening of the economy, we suspect the US will grow very rapidly with full-year growth forecast at 3.6% despite a negative

first quarter. This will help to fuel global optimism while also sucking in imports and supporting activity elsewhere.

The contrast between Joe Biden and Donald Trump with regards to international relations couldn't be starker. While we may not see much improvement in US-China tensions – see the section in our global outlook on the tech war – there is clearly an opportunity for the US and European relations to be rebuilt. Biden is likely to revert to a more rules-based multilateral approach, which should at the minimum give greater predictability of policy than experienced under Donald Trump.

We would expect a return to the World Health Organization together with a re-engagement with the World Trade Organization and NATO. His advocacy of Green energy also suggests a strengthening of the partnership on dealing with climate change. With international relations on a more stable footing, we may also start to see an unwinding of tariffs with Europe and Canada that can give businesses greater clarity and the confidence to implement investment plans that may have been put on hold.

Brexit - a new, less uncertain chapter for the UK on the world stage?

When it comes to Brexit and the UK's role on the global stage, 2021 could go one of two ways.

If a deal is agreed with the EU, then this should put UK-European relations on a more stable footing. While a basic free-trade agreement will inevitably need to be built upon, a deal would presumably usher in a more constructive relationship on other issues, at a time when the US is looking to rebuild its ties with the EU.

If the UK and EU fail to agree to a deal by the end of the year, the UK is likely to find itself more isolated geopolitically with both Europe and the US

By putting an end to the recent chapter of Brexit noise and also some of the uncertainty facing Northern Ireland, the Johnson administration also stands a better chance of resetting relations with the new Biden team. The President-elect's stance on issues such as climate change and geopolitics (e.g. the Iran deal) is arguably more aligned with Prime Minister Boris Johnson's than that of President Trump.

However, things could look pretty different if the UK and EU fail to agree to a deal by the end of the year. While some of the above may still be true, the UK is likely to find itself more isolated geopolitically with both Europe and the US.

Ultimately, Britain will need a trade deal with its closest partner, and therefore at some point, both sides will need to return to the negotiating table - where presumably many of the same issues, chiefly on state aid, will resurface. This, combined with the Scottish independence story coming to the fore in 2021 under a no-deal scenario, means the cloud of uncertainty that has hovered over the UK economic outlook relative to Europe and the US since 2016, may well linger for another few years to come.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

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Key political events in 2021

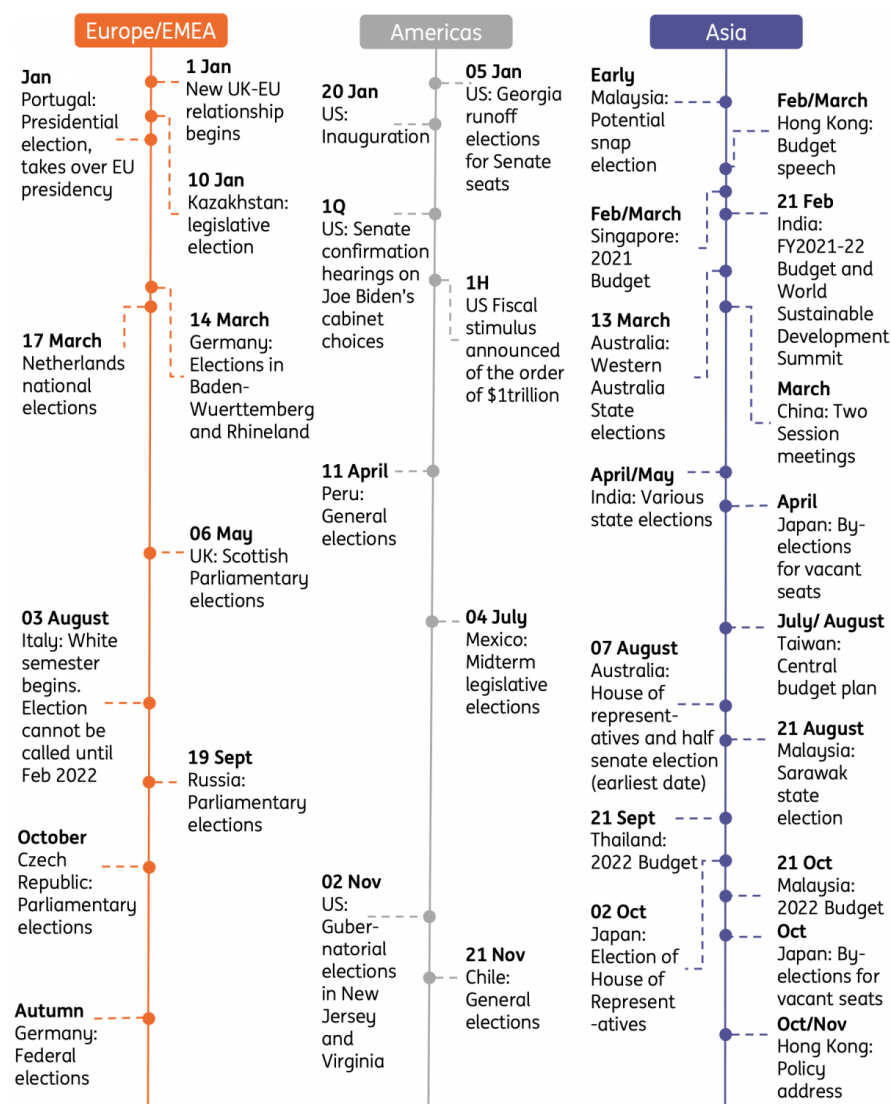
In the next twelve months, from Peru to India, the Netherlands to Australia, many elections and political events have the potential to shape the economic outlook



Source: Shutterstock

Chinese President Xi Jinping (C-L), German Chancellor Angela Merkel (C) and Russian President Vladimir Putin (C-R) pose for the official family picture during a cultural event at the Osaka Geihinkan during the G20 summit in Osaka, Japan

The key events we'll be watching in 2021



Source: ING

✓ United States: The early-2021 race for the Senate

The US political calendar in 2021 will kick off with the run-off elections for Georgia's two Senate seats.

No candidate got the required 50% of the popular vote in the presidential elections so it will be a straight race between the Democrat and Republican candidates in the absence of any other contenders. This will be critical for how aggressive Joe Biden can go with his legislative agenda. Should the Democrats win both seats, this will leave a 50-50 tie in the Senate, with Vice President Kamala Harris given the deciding vote on any piece of legislation that is split down party lines. This would facilitate a more ambitious policy change on tax, regulation and spending as there would be less need for watering down a piece of legislation to get Republicans onside. Nonetheless, filibuster rules, which require 60 votes to close a debate and move to a vote, will remain difficult to overcome.

The US political calendar in 2021 will kick off with the run-off elections for Georgia's two Senate seats

On balance, it will be tough for the Democrats to win both, but tens of millions of dollars will be spent to try and convince the electorate in Georgia given the critical role these two votes play. We suspect that negotiations over a new fiscal stimulus will remain tricky and it will end up coming in closer to \$1 trillion rather than \$3 trillion in size. Nonetheless, with the very real prospect of a vaccine that can lift sentiment and lead to a broader reopening of the economy, this should still provide a strong platform for growth in 2021/22.

 **Europe: Rumbling core**

It is often said that political and sometimes even existential tensions for the eurozone come from the periphery. In this regard, 2021 could be a good year for the monetary union as no elections are scheduled in southern European countries, though one can never entirely rule out Italian elections. On a more serious note, however, next year's political calendar will put the theory to test that it is not the periphery but rather the core countries in which anti-European parties could eventually bring the eurozone closer to the brink.

Both the Dutch and German elections have the potential to become historic events

It is hard to see that differing views on Europe will decide the elections in either Germany or the Netherlands. Instead, the management of the pandemic will probably be high on the agenda alongside other important topics. Nevertheless, watch out for right-wing populist parties in both countries. The more votes they garner, the more problematic it will be to form new governments.

In any case, both the Dutch and German elections could become historic events. Another term in office for Dutch Prime Minister Mark Rutte could make him the longest-serving government leader in Europe, at least if Angela Merkel indeed decides not to run in the autumn elections. The end of Merkel's term in office could create a (short-lived) vacuum in European politics as currently none of her potential successors looks set – at least not immediately – to fill her shoes.

 **UK: Brexit noise to give way to Scottish uncertainty**

Those hoping that Brexit will disappear off the news agenda forever from 2021 may be a little disappointed. Even if a deal is agreed, it will inevitably be a basic one. A free-trade agreement will avoid tariffs, but may not prove to be a particularly sustainable trading platform in the long-term. That's even more true if both sides begin trading on World Trade Organization terms from January – a deal will still inevitably be needed further down the line.

The rollercoaster ride of Brexit is likely to give way to more focus on the push for Scottish independence

That said, the rollercoaster ride of Brexit is likely to give way to more focus on the push for Scottish independence. The prospects of a relatively arms-length deal with the EU (Scotland did not vote for Brexit overall), combined with the unfavourable public perception of the handling of Covid-19 by the UK government, has seen support for independence climb through 2020.

Of course, the government in London needs to give its approval for another referendum akin to the one in 2014, something the current Conservative administration is very reluctant to do. But the pressure will inevitably grow through 2021, particularly in light of Scottish parliamentary elections in May that are predicted to heavily favour the Scottish National Party. Another referendum is probably a few years off, but there is nevertheless a creeping sense that a second vote may be more a question of 'when' rather than 'if'.

✓ Asia: Japanese, Indian and (possibly) Malaysian elections the focus

On paper, 2021 promises to be a relatively quiet period for Asia, with possible snap elections resulting from the perennially weak government in Malaysia the likely highlight on the calendar.

Japanese elections for the House of Representatives are unlikely to be very eventful, rubber-stamping Prime Minister Yoshihide Suga's hold on power. Otherwise, a string of local and regional elections fill the political calendar. Some of these, for example, state elections in India, may provide an indication of potential future upsets in general elections.

More likely, it will be unscheduled events that attract the most attention, with growing unrest in Thailand likely to generate some political backlash as protesters push for government change and reform of the monarchy.

✓ Latam: Peru, Chile and Mexico to stage key elections

Latin America's political calendar will be dominated by general elections in Peru and Chile, along with mid-term elections in Mexico.

Peru and Chile have already been facing tremendous political tumult for the last few years and, even though elections typically generate uncertainty, there's some hope that, in these two cases, elections could pave the way for less political friction.

Latin America's political calendar will be dominated by general elections in Peru and Chile, along with mid-term elections in Mexico

In Peru, the April election of a president with a working legislative majority appears essential to end years of political dysfunction that has resulted in a very unstable presidential mandate, including three presidents in less than the five-year typical mandate. In Chile, social unrest provides fertile ground for political instability that could also calm down following the election of a constitutional convention to rewrite the country's constitution, taking place in April, and general elections in November.

Overall, while uncertainty is likely to remain elevated, the political calendar could also serve to reset political expectations and create a more harmonious political environment in the Andes. In Mexico, the focus will be on mid-term elections in July, with Congressional races helping determine President Lopez Obrador's ability to hold on to the large majority he currently enjoys. AMLO remains popular, but the deep recession and Mexico's questionable handling of the pandemic may reduce MORENA's ability to keep its current share of seats in the Lower House.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Article | 17 November 2020

Global central banks in 2021

Global central banks have had a busy 2020, but their job is far from over. What tools do policymakers have left to deploy and what should we expect from monetary policy in 2021?



Source: Shutterstock

The outlook for central banks in 2021

European Central Bank

Ending the year with a bang. After Christine Lagarde's comments in October, the question is no longer if but what the ECB will announce at its December meeting. We expect an increase in QE by some EUR500n, an inclusion of so-called Fallen Angels in corporate bond purchases and even more favourable liquidity for the banks. In 2021, all focus should be on the strategy review and the 'greening' of the ECB, that is, at least as long as the economy enters the expected recovery.

Federal Reserve

The Federal Reserve's dot plot suggests little chance of an interest rate rise before end 2023. We are cautious on the near-term macro outlook as surging Covid case numbers prompt fears of renewed containment measures. However, a vaccine roll-out looks possible in a few months and there is the prospect of a significant reflationary fiscal stimulus under President Biden. This could generate a rethink on economic prospects with rate hike expectations likely creeping forward.

Bank of Japan

With no prospects of a change in Governor at the BoJ, we see little prospect of any new thinking in terms of policy. Asset purchases will fluctuate to keep JGB yields at about 0%, and the policy rate will remain -0.1%.

Bank of England

Negative rates aren't our base case, but definitely shouldn't be ruled out if the outlook deteriorates further. That said, it's clear the BoE thinks QE is a more useful tool, and we suspect any foray into negative rates would be both time- and depth-limited.

China (PBoC)

Stable Covid-19 means the need for monetary easing has reduced. We expect no change in policy interest rates or the RRR from now to the end of 2021. Instead, the central bank has put more focus on interest rate and exchange rate liberalization.

Bank of Canada

The BoC has signaled rates are on hold until the 2% inflation target is "sustainably achieved", which on their current forecasts won't happen until 2023. As with the Fed we see the potential for market expectations to edge towards an earlier move.

Reserve Bank of Australia

With the cash rate target and 3Y yield target both reduced to 0.1%, along with the adoption of numerical quantitative easing, the RBA has almost nowhere further to do with policy as it still rules out negative interest rates.

Reserve Bank of New Zealand

The RBNZ opted to keep some policy leeway in reserve and not follow the RBA's recent rate cutting. Instead, it has opted to pursue a more direct path to stimulus through a funding for lending program. Conventional rate cuts and negative rates remain an option though.

Riksbank

Further stimulus can't be ruled out for 2021. This would most likely involve a further QE extension, allowing purchases to continue into 2H21. The Riksbank has hinted it could return to negative rates, but this seems unlikely.

Norges Bank

With rates already at zero, further stimulus is unlikely - neither negative rates nor QE are viable. Instead, expect continued signals of a 2022 rate hike, which would re-cement Norges Bank's position as a hawkish outlier.

Source: ING

Federal Reserve

Financial markets have performed strongly since it became clear that Joe Biden will be the next President of the United States while positive newsflow on a Covid-19 vaccine has provided further fuel for the rally in risk assets. However, we are becoming more concerned about the near-term story with unemployment benefit income being tapered for millions of households at a time when Covid-19 cases are rising rapidly. Vaccines could take several more months to roll out so we have to acknowledge the possibility for the return of pandemic containment measures in the US, similar to what Europe is currently experiencing, in an effort to limit the strains on the healthcare sector.

We remain very upbeat on the prospects for 2021 and 2022, which could help pull interest rate hike expectations forward from 2024

Legal challenges surrounding the election could intensify already high levels of political animosity, which may hamper the ability or limit the desire for politicians to agree to a swift package of measures that could support the economy during this period. This could make the Federal Reserve feel compelled to step up via asset purchases and/or liquidity injections to calm nerves and ensure smooth market functioning if we are correct and the economy enters a more troubled period.

Nonetheless, there is scope for a significant fiscal package in excess of \$1trn next year (equivalent to around 5% of GDP). This stimulus, when combined with a long-anticipated Covid-19 vaccine, can really lift the economy and drive growth. We consequently remain very upbeat on the prospects for 2021 and 2022, which could help pull interest rate hike expectations forward from the 2024

dateline currently implied by the Fed dot-pot.

Depending on how robust the recovery is, we could see Fed asset purchases slow or even stop during 2021.

European Central Bank

After Christine Lagarde's comments at the October meeting, the only question is not if but what the ECB will announce at its December meeting.

Even recent news on a vaccine will not prevent a downward revision of the ECB's growth and inflation outlook. As a consequence, we expect the ECB to announce an increase in its quantitative easing programme by around €500bn, the inclusion of the so-called 'fallen angels' into corporate bonds purchases and even more favourable liquidity for banks.

In our view, the ECB will want to keep maximum flexibility and therefore change its definition of price stability from 'below, but close to, 2%' to 'around 2%'.

With the economy, hopefully, entering a sustainable recovery in 2021, the ECB's focus will be on the strategy review. We expect the ECB to follow the Fed in putting more emphasis on the symmetry of its inflation target, without going all the way towards an average inflation target.

In our view, the ECB will want to keep maximum flexibility and will therefore change its definition of price stability from 'below, but close to, 2%' to 'around 2%'.

Bank of England

The Bank of England has extended its quantitative easing programme to allow it to continue asset purchases throughout 2021, but the combination of the new UK-EU trading relationship and the risks surrounding Covid-19 suggest more stimulus may be needed. But will this involve negative rates? We think the jury is still out.

We think the BoE will steer away from negative rates, barring a significant deterioration in the outlook

Policymakers are currently collecting evidence from banks on the impact sub-zero rates may have on profitability, although we doubt this will ultimately be enough to block the policy. The central bank has already hinted it may follow the ECB's lead with a tiered system of implementing negative rates.

Instead, the decision will hinge on MPC consensus on whether the policy would be of much use - and so far that's not been the case. Our own feeling is that lower rates are unlikely to add a great deal of impetus to the recovery. We, therefore, think the BoE will steer away from negative rates,

barring a significant deterioration in the outlook.

Instead, QE is likely to remain the tool of choice.

Bank of Japan

It has been many years since we have pretended that the Bank of Japan had anything relevant or interesting still to come in terms of monetary policy, and that remains the case.

Policy rates are at -0.1% and are unlikely to be cut again, and certainly aren't going up for years to come. Likewise, we don't see any merit in the central bank pushing bond yields substantially below zero – the current target. Indeed, their most recent policy push seems more concerned with shoring up the banking sector, something that has arguably been talked about, though not necessarily undertaken on a large scale, since the 1990s when the controversial “Convoy system” was implemented.

It has been many years since we have pretended that the Bank of Japan had anything interesting to come in terms of monetary policy

Returning to this theme won't necessarily bring an end to Japan's slow growth, low inflation or sluggish lending. But if turning deposits into profitable assets remains next to impossible in Japan, cutting fixed costs and overheads through mergers and acquisitions still seems a worthwhile endeavour, even if only to deliver a bit more support and stability to the banking sector.

People's Bank of China

The People's Bank of China has stopped cutting the loan prime rate since May 2020 and hasn't slashed the reserve requirement ratio since February.

Economic recovery from fewer Covid-19 cases has been the main reason behind the neutral stance. We expect no change in monetary policy until the end of 2021, instead the core focus of the central bank will be interest rate and exchange rate liberalisation.

We have seen more advocacy from the central bank governor urging banks to apply the policy rate and link it to pricing financial products. The central bank has also started to phase out the use of counter-cyclical factors in the USD/CNY daily fixing formula, which means the exchange rate is likely to be increasingly driven by the market.

Bank of Canada

The Bank of Canada, like the Federal Reserve, has effectively signalled a shift to average inflation targeting.

We don't envisage any major changes to the central bank's policy

mix in 2021 although market interest rate hike expectations could start inching up earlier

Their forward guidance now states that policy won't be normalised until the 2% inflation target is "sustainably achieved", which under their current forecasts is not expected to happen until 2023.

The central bank has also recalibrated its asset purchases so they are focused at the long end of the curve in the hope that a flatter, lower yield curve will deliver the conditions that give the most benefit to households and corporates. We don't envisage any major changes to this policy mix in 2021 although as with the Fed, market interest rate hike expectations could start inching up earlier.

Reserve Bank of New Zealand

At its last meeting (10 Nov) the RBNZ left open the possibility of a single further conventional rate cut. In leaving cash rates at 0.25% at its latest meeting, the RBNZ noted "better than expected" economic activity. But at the same time, they kept their options open in terms of further easing of policy rates, including, controversially, negative rates.

In the meantime, the RBNZ, which already owns about 37% of the outstanding stock of government debt after only six months, is supplementing its QE programme with a NZD100bn funding-for-lending scheme. Against the backdrop of a red-hot housing market, even if the labour market remains soft, further rate cuts by any channel may prove awkward. And in all likelihood, the RBNZ is out of substantive further easing measures. In our view, all of this discussion about alternative policies is simply part of an elaborate attempt to manipulate market expectations. But even if we are right and there is no further easing, we don't anticipate any tightening in 2021.

Reserve Bank of Australia

At its most recent rate meeting, the Reserve Bank of Australia cut the official cash rate and 3-year yield target to just 0.1% from 0.25% and implemented a (numerical) quantitative easing policy (yield curve control is already a form of QE). This new scheme was for bonds at a 5-10Y tenor.

With the Australian economy picking up after its lockdowns came to an end, it is not entirely clear why the central bank decided the economy needed this extra, and arguably very marginal, additional easing. The latest policy announcements had a very limited and temporary effect on both the Australian dollar and Australian bond yields.

Unlike the RBNZ, the Australian central bank Governor Philip Lowe remains unequivocal in his opposition to negative rates. So even more than the RBNZ, the RBA looks to have hit rock bottom for cash rates, and in all probability, for all other substantive incremental easing measures, though that may not stop them from implementing some additional "cosmetic" measures during 2021.

Riksbank

While Sweden continues to take a more liberal approach to Covid-19 restrictions relative to its European neighbours, the virus nevertheless poses risks for the domestic economy.

The first wave of the pandemic showed us that individuals are likely to 'act with their feet' by

taking a more cautious approach to going out and about. That said, there are potentially some brighter spots, too. Manufacturing looks set to be less affected by lockdowns globally than in the first half of 2020 - good news for Sweden's production-heavy economy.

More stimulus can't be ruled out, but we'd continue to expect this to take the form of quantitative easing over a return to negative rates. The Riksbank currently plans to complete its balance sheet expansion by the middle of 2021, something that could be feasibly extended. But having hiked the repo rate out of negative territory at the end of 2019, and opting against returning below zero during the peak of the pandemic, we suspect the bar is high for a rate cut in 2021.

Norges Bank

2021 has the potential to be a pretty unexciting year for Norwegian monetary policy. That's not because the economy doesn't face challenges - the country has imposed new restrictions on socialisation that will undoubtedly halt the recovery and risk a further rise in unemployment.

The interesting question, therefore, is whether the Bank will be one of the first to hike interest rates after the pandemic

Instead, a lack of action from the Norges Bank in 2021 reflects an absence of realistic options to add further stimulus. Negative rates are not seen as a viable option, while logistical constraints mean quantitative easing is unlikely.

The more interesting question, therefore, is whether the Bank will be one of the first to hike interest rates after the pandemic. Clearly, this is unlikely next year, but policymakers are officially projecting the first increase could come in the second half of 2022. While that may seem ambitious given the signals being offered by other central banks, it's worth remembering that Norges Bank was a key hawkish outlier through 2019 where it hiked rates three times against a more dovish global backdrop.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

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How to deal with soaring debt levels

Fiscal deficits have surged to unprecedented levels and government debt in the eurozone is expected to reach the highest level since 2014. While in the short-run, there is definitely no alternative to huge fiscal stimulus, the question of how to deal with elevated debt levels will soon bring back heated discussions



Eurozone sovereign debt

The ongoing pandemic has led countries around the world to take exceptional economic and financial measures. In the eurozone, national measures were followed by pan-European action.

As a result, debt ratios have surged. During the previous financial and sovereign debt crisis, debt ratios in the eurozone rose from 65.9% of GDP in 2007 to around 93% of GDP five years later. By the end of 2019, the ratio had only come down to 87% of GDP, indicating how difficult it is to return government debt to any pre-crisis level.

Right now, we expect government debt in the eurozone to increase by some 15% of GDP to more than 100% GDP in 2020. Italy, Spain and Greece should see the strongest increases, with debt-to-GDP ratios surging by more than 25%.

As we expect many eurozone governments to provide more stimulus and possibly even write off some of the guaranteed loans to tackle the second wave of the pandemic, debt ratios are likely to

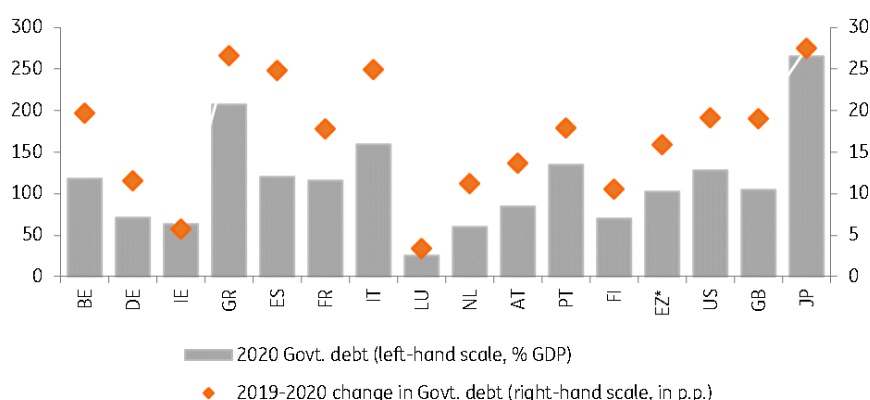
rise further. As a consequence, discussions on how to eventually reduce debt levels could return quickly.

We expect government debt in the eurozone to increase by some 15% of GDP to more than 100% GDP in 2020.

Based on our calculations, even with a return to the fiscal balances and nominal growth of 2018 and 2019, it would take until 2029 for the eurozone to return to pre-crisis debt levels. Luxembourg and Ireland could already be back to their 2019 debt levels by the end of 2021 while Germany could reach its pre-crisis debt level by 2023. However, it would take countries with high pre-crisis debt levels, such as Greece, Spain or France until 2030, 2031 and 2032, respectively. Italy - the country with the second-highest pre-crisis debt level - would take until 2060 to be able to reach a debt-to-GDP ratio of 134.4%.

If governments continue their current accommodative fiscal policies – again all else being equal – nominal growth would have to jump to 14.1% of GDP from 2021 to 2025 to return debt levels to their 2019 level. For example, if Germany were to continue with current fiscal policies, the country would need a nominal yearly GDP growth of nearly 18% to get back to pre-crisis levels by 2025.

2020 government debt per GDP ratios



Source: European Commission, ING estimates

An argument often heard is that very low-interest rates enable governments to have higher debt. If we follow this line of thought, it is also argued that the ECB will actually have a hard time increasing interest rates again as this would put an unbearable burden on public finances. To test this argument, we investigate how an increase in bond yields by 200 basis points would affect public finances.

The eurozone debt ratio, on average, would only return to its pre-crisis level by 2040 at the earliest

A 200bp increase would mean that the average debt ratio in the eurozone would not return to its pre-crisis level until 2040, at the earliest.

Assuming nominal GDP growth and a primary balance at the average 2018 / 2019 level, countries with high pre-crisis debt levels such as Italy, Greece, Spain and France, could have significant difficulties in lowering their debt burden at all. By 2030, Italy and Greece's debt levels would have increased further and reached 188.5% and 222.8% of GDP, respectively. Spain and France would stand at 115.7% and 120.2% of GDP.

In contrast, if bond yields fell by 100bps, we would see eurozone debt levels returning to their pre-crisis stage by 2025.

Even though there is no alternative to extensive fiscal stimulus to tackle the economic fallout from the crisis, accelerating government debt could return quicker to the European agenda than many might think. Low interest rates are almost an inevitable prerequisite to keeping government debt in check.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Article | 17 November 2020

Central and Eastern Europe in 2021: Bracing for the post winter rebound

Once winter has passed, the CEE region should brace itself for a meaningful economic rebound from 2Q21 onwards but the prospects of a reflation narrative are limited as deflation has never been an issue. We expect some central banks to ease but this is unlikely to derail the rebound in local FX which should experience a benign and less volatile year in 2021



Source: Shutterstock

Three main themes for CEE in 2021

1. After the cold winter months, the region should brace itself for a meaningful economic rebound from 2Q21 onwards
2. The wider reflation narrative is, in isolation, less relevant for CEE as low inflation has never been an issue
3. Local central banks may ease more, but this won't derail a rebound in local FX. We prefer the Czech koruna and Turkish lira

1 Second dip now, but a strong recovery from 2Q21 onwards

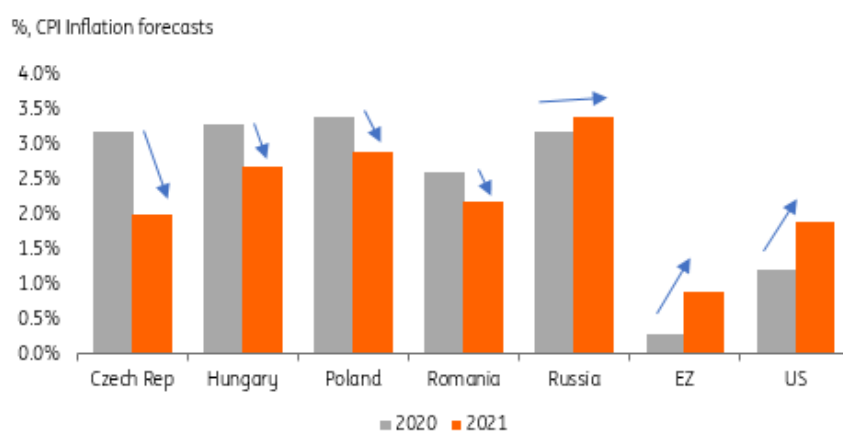
The double-dip recession the region will experience is now certain as the second wave of the pandemic and related restrictions in Europe weigh both on domestic demand as well as

exports. All CEE countries will experience negative quarter-on-quarter growth and shallow activity in the first quarter of 2021.

The rebound is expected to come in the second quarter next year once we pass the tough winter months and that should be in line with the expected recovery path of the eurozone economy. With the prospects of a successful vaccine in place, this (a) reduces downside risks to the growth outlook for the second half of next year (i.e, a low probability of the winter lockdown in late 2021); (b) the brighter outlook for global trade should benefit open CEE economies.

Moreover, new EU funds should provide further cushion to the regional growth outlook, though the front-loaded investments within the seven-year EU budget are more likely to materialise in 2022 rather than next year.

Differing EMEA inflation dynamics to Eurozone and the US



Source: ING

2 External, internal reflation theme narrative

In isolation, the prospects of the reflation narrative are limited in Eastern Europe, with the local inflation dynamics being vastly different from developed Europe.

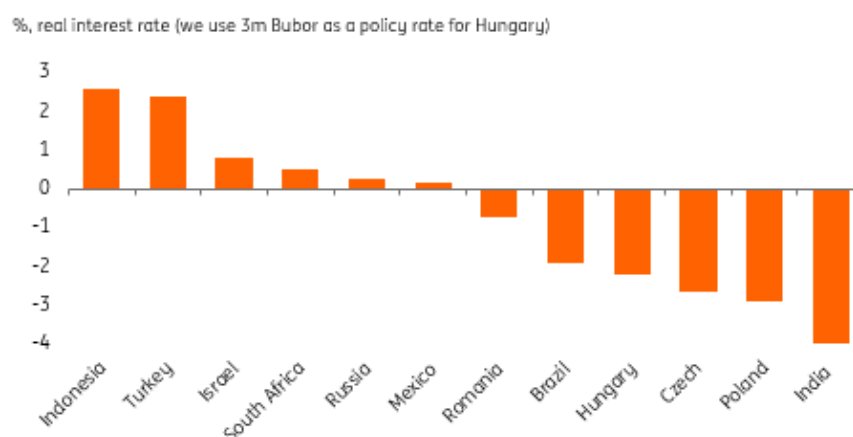
As the chart above shows, inflation should on average be lower in the region in 2021, not higher. The deflation threat isn't really present here this year given the cushion the tight labour market provided to domestic prices. All CEE countries started the year with above-target inflation and now we see a normalisation towards the target, which is also likely to continue next year (mainly in Q1) as the Covid-19 related one-offs and the labour market shortage ease.

Any reflation theme for the CEE region next year will be more about the pick-up in local economic growth

From this perspective, any reflation theme for the region next year will be more about the pick-up in local economic growth rather than domestic price pressures, as these will decelerate rather than accelerate compared with 2020. That increase in local growth should reduce the easing bias of some local banks despite above-target CPI and higher long-end core rates, which reflects the re-

rating of the economic outlook and inflation expectations in the developed world.

Preference for higher real rates



Source: ING, Bloomberg

3 Modest easing ahead, but EMEA FX should do well nonetheless

Despite the brighter outlook for 2021 and limited deflation risks, the near-term bias remains towards more easing among regional central banks, albeit for different reasons.

In Hungary, the central bank is likely to reverse its 15 basis points FX stabilising hike in September. In Poland, the Bank may cut reference rate by 10bp (and/or explore other measures) should the currency continue appreciating, while in Russia the benign inflation outlook points to more rate cuts.

In contrast to this year, EMEA FX should experience a more benign and less volatile year in 2021

For the easing prone Poland and Hungarian central bank, in particular, the bar is high for a move towards less accommodative policy in 2021, pointing to steeper local curves. However, the Czech central bank should be the outlier in the region, with a non-negligible probability of the Bank delivering a hike at the end of 2021, suggesting higher front-end CZK rates vs PLN.

In contrast to this year, EMEA FX should experience a more benign and less volatile year in 2021. The more supportive global backdrop (due to more predictable US international relations policy and the Covid-19 vaccine), the sharp pick up in CEE growth from 2Q21 onwards and gradually rising EUR/USD should be beneficial for CEE FX.

We heavily favour CZK to PLN and HUF, given the inherent dovish bias of Poland and Hungarian central banks versus the Czech national bank. The benign global environment and lower volatility should favour carry. Within the high yielding EMEA space, TRY outlook for upcoming months looks the most attractive as the central bank is likely to deliver meaningful tightening, in turn cementing

its superior carry and real rate position within the emerging market space.

This should also further compress some of the still profound risk premia and help the lira.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@ing.com

Michiel Tukker
Senior UK & Eurozone Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Senior Economist, Healthcare & Technology
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill

Credit Strategist
timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland
leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com

Brazil in 2021: The focus is on fiscal policy

Brazil's forceful policy reaction to the pandemic was crucial to mitigate its economic impact but it requires some correction in 2021. As it stands, the fiscal tightening dictated by current law would pave the way for a credit-fuelled virtuous cycle and higher growth. Another round of fiscal stimulus would, however, create a vicious cycle



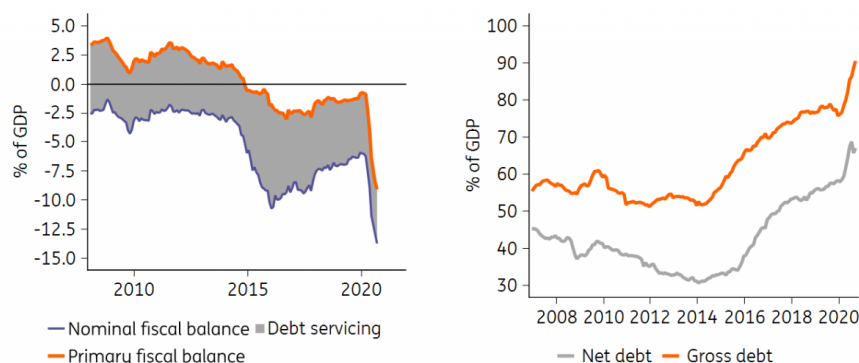
Binding fiscal constraints imply binary 2021 outcomes

Brazil's economic policy response to the pandemic was unusually aggressive by emerging market standards. The monetary easing was perhaps the most forceful in EM when you consider the current level of the policy rate of 2%, relative to the ten-year historical average of 10%. The persistent FX sell-off has been the primary side-effect of that easing, which is, arguably a minor concern in the current low-inflation environment.

Much more consequential has been the fiscal stimulus enacted, especially the household income transfers to help offset wage income lost to Covid-19 movement restrictions.

The combined effect of the larger spending and the recession-related drop in tax collection should result in a major fiscal deterioration in 2020, as you can see in the chart below. And 2021 is likely to be a crucial year for Brazil to reveal its commitment, or not, to a sustainable fiscal trajectory.

Fiscal deficit surged to record-highs, provoking a sharp rise in public debt



Source: Macrobond, ING

With the household income transfers set to end in December and government spending already set to reach the legal limit stipulated in the “fiscal spending ceiling” in 2021, temptation to change the law to accommodate greater spending has increased, resulting in frequent efforts to weaken the fiscal framework.

Those efforts have, so far, encountered severe resistance and we expect them to continue to fail. But uncertainty regarding that outcome would keep risk premium levels elevated and limit prospects for the economic recovery.

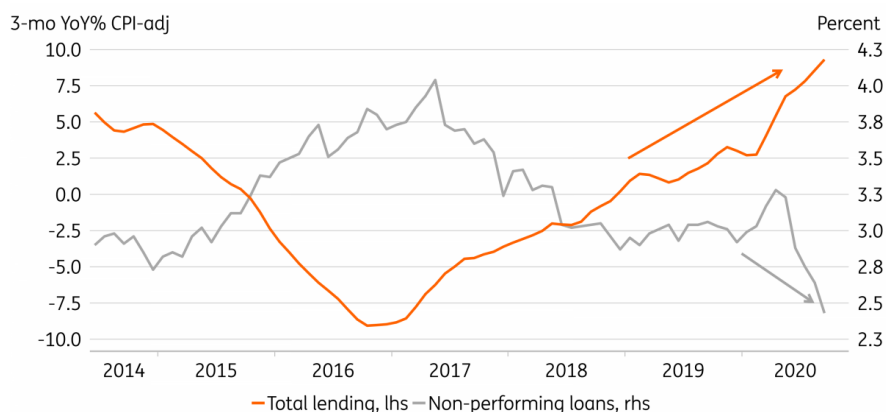
Continued monetary stimulus depends on fiscal consolidation

As it stands, the current fiscal framework, centred on the “fiscal spending ceiling” mandate, which has frozen government spending in inflation-adjusted terms, would ensure a gradual improvement in Brazil’s fiscal trajectory.

Our base-case scenario is that this fiscal framework will remain unaltered in the foreseeable future, as advocated by the Finance Ministry. This scenario should not be taken for granted, but we believe there’s enough opposition within Congress, regulators, and the press, along with disciplinary market forces, to prevent the creation of a constitutional majority in Congress to change the law.

A corollary of our fiscal assumption is that fiscal policy will turn contractionary in coming years, paving the way for a prolonged period of expansionary monetary policy. And this monetary stimulus, amid favourable prospects for a credit-fuelled economic recovery, is the main reason to be optimistic about Brazil’s growth prospects.

Bank lending continues to rise, amid record-low delinquency

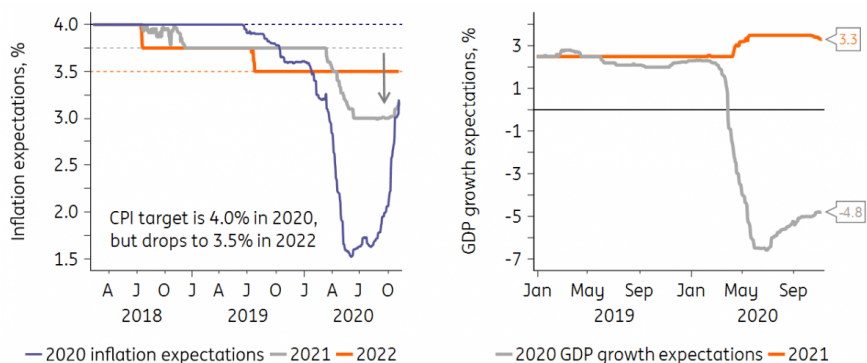


Source: Macrobond, ING

As seen in the chart above, bank lending has surged, despite the pandemic, and the outlook remains favourable, especially in the housing and construction sectors, which should benefit from record-low rates and new financing options.

There are two other growth-enhancing drivers we would highlight. The first is the expected progress in pro-growth legislation such as the approval of the new regulatory framework for natural gas and private sector investment in water/sanitation services. The second is the more competitive FX rate, which should help local producers so long as the inflation outlook remains anchored, as we expect.

Inflation expectations should remain anchored but we see upside risk to GDP growth



Source: Macrobond, ING

Despite uncertainties, our 2021 outlook is rather benign

Overall, we expect the government and Congress to remain committed to the current fiscal framework. This suggests that inflation expectations should remain fully-anchored and the central bank should be able to keep the policy rate unchanged at 2% throughout 2021, providing upside risk to GDP growth expectations.

Inflation risks have risen, amid fast-rising food prices and global supply disruptions, but high

unemployment and spare capacity suggest that price pressures are likely to be temporary.

We currently expect Brazil's GDP to contract by 4.3% in 2020, among the best results in LATAM, and to grow by 3.9% in 2021. Our bias is for a better-than-expected 2021.

The Brazilian real's underperformance since mid-2019 was largely driven by the country's deep interest rate reduction and given that we don't expect any rate hikes in 2021, the BRL should remain poorly supported by the monetary policy stance.

We expect an appreciation bias for the BRL to gradually emerge throughout 2021 however, as external accounts continue to improve and fiscal risks abate, helped by the recovery and falling debt servicing costs.

An alternative scenario in which Congress abandons the current fiscal framework and opts for fiscal stimulus would, meanwhile, create a vicious cycle. It would exacerbate fiscal risks, elevate risk premium levels and, eventually, stimulate the dollarisation of local portfolios, forcing the central bank to tighten monetary policy, resulting in further deterioration in the fiscal outlook.

Author

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Philippines in 2021: The economy continues to lose steam

Philippine GDP growth contracted 10% in the first three quarters of the year and there's little hope of a big turnaround in 2021



Authorities forecast a quick recovery in 2021 but trends suggest otherwise

The Philippine economy is mired in a recession with year-to-date GDP at -10% as elevated Covid-19 infections force an ongoing 9-month-long partial lockdown in the capital and surrounding provinces.

Authorities have acknowledged that growth will contract sharply on a year-on-year basis in 2020 but continue to bet on a quick recovery in 2021 (6.5 to 7.5%) and 2022 (6.0%) touting the economy's "solid fundamentals".

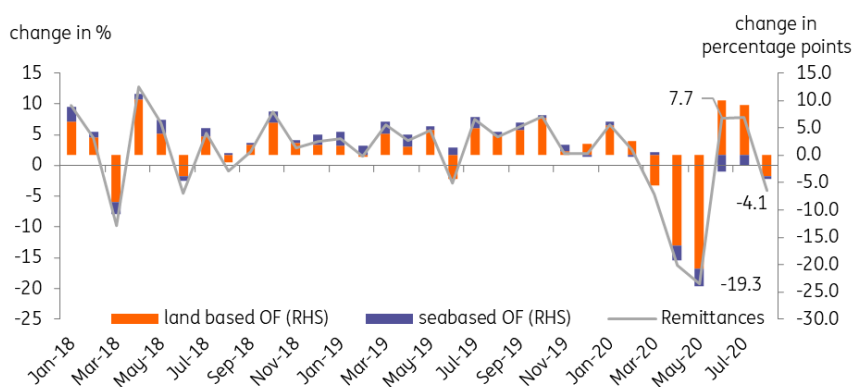
ING maintains that growth will likely enter a lower trajectory as current trends point to a very different scenario heading into 2021 with the Philippine economy missing contributions from every sector of the economy. Worrisome trends for consumption, capital formation and government spending will not likely reverse quickly even as lockdown restrictions are relaxed.

Consumption lacking the remittance punch

Household consumption delivers the bulk of Philippine economic output and we expect this sector to struggle given elevated unemployment, virus concerns and fading remittance flows. Overseas Filipino (OFs) remittances augment domestic incomes with households receiving Php59,295 annually, roughly 19% of the average income in the Philippines. Land-based remittances will likely slide as global lockdowns are reinstated while a downturn in maritime traffic should impact remittances sent by seafarers. Authorities estimate that up to 300,000 Filipinos will be repatriated due to the pandemic, depleting the stock of 2.2 million Filipino contract workers based abroad.

We forecast a 5-10% drop in remittances this year given renewed lockdowns and negative prospects for maritime traffic. This will translate to a drop of up to \$3.1 bn in 2020 and 2021 with consumption missing the integral boost from these inflows.

Philippine remittances per source



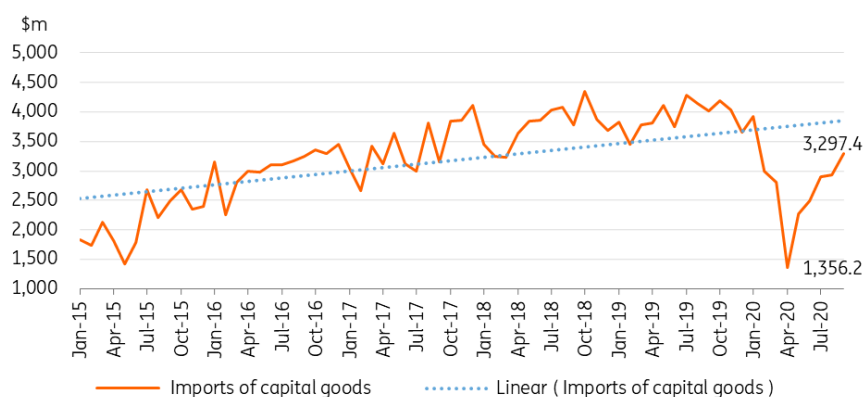
Source: Bangko Sentral ng Pilipinas

Investment momentum stalls, potential output fades

Prior to the pandemic, capital formation was increasing thanks to a construction boom coupled with the administration’s hallmark infrastructure programme but the current trends point to stalling momentum for this sector.

Capital imports fell sharply in April and have recovered somewhat but remain below the 5-year average of \$3.5 bn per month. We expect the recent downturn in capital goods to weigh on potential output as corporates are likely to put off large scale investments given the recession to protect cash and weather the downturn. Meanwhile, we also expect households to defer investment plans given the challenging job market, reflected in a steep fall in road vehicle sales, which are down 44.6% for the year.

Philippine imports of capital goods

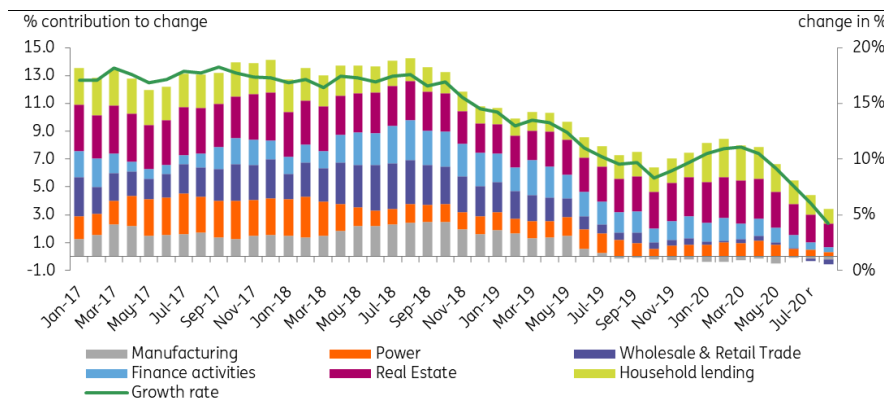


Source: Philippine Statistics Authority

Bank lending grinding lower

Meanwhile, declining investment momentum is mirrored in trends for commercial bank lending, which has now been decelerating for five months through August. Loan disbursements to retail trade and manufacturing have turned negative with manufacturing activity now in contraction (October PMI: 48.5) while retail trade plunged as vacancies in mall space hit 14%, the highest level reported since the Asian financial crisis. Prospects for a pickup in lending to real estate are not particularly upbeat with office space vacancy rising to 8.3% as Chinese offshore gaming operators close shop.

Philippine bank lending per sector



Source: Bangko Sentral ng Pilipinas

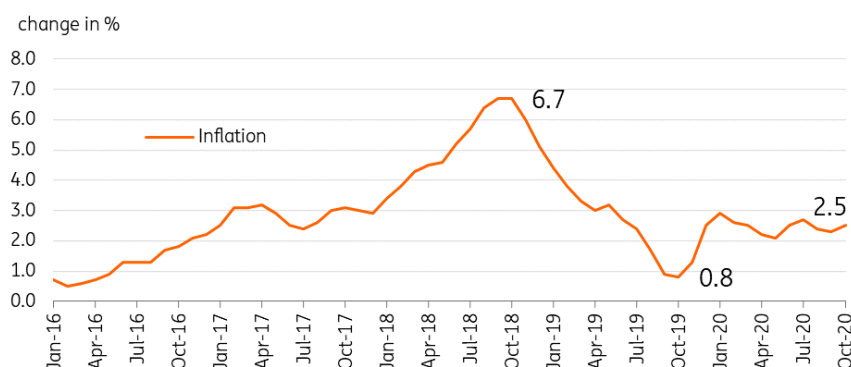
BSP unconventional moves and low inflation

The response of the central bank, the BSP, to the pandemic has been aggressive, resorting to both conventional and unconventional measures, such as quantitative easing and de facto debt monetisation. The net effect of BSP's unconventional moves was a surge in excess liquidity, now at Php1.4 trillion, roughly 7.2% of GDP and 8.9% of money supply, resulting in a flatter and lower yield curve. Inflation (2.5%) is not expected to accelerate in the next few months given depressed demand conditions and a stronger currency.

Inflation is expected to be benign through to 2022 and BSP is not expected to exit from

unconventional policies soon, so we expect the yield curve to remain flat with rates suppressed unless government borrowing picks up substantially next year.

Philippine inflation



Source: Philippine Statistics Authority

Fiscal response has been modest at best

Trends in government spending also point to a downward trajectory for growth. The fiscal response, however, has been modest with authorities recently passing additional Covid-19 funding worth Php140 bn, to bring the total Covid-19 response spending to roughly Php590 bn or 2.7% of GDP. After seeing an initial surge in spending, we've noted a sharp slowdown with September expenditures falling 15.5% as authorities clamped down on efforts to manage the budget deficit. Government officials have repeatedly turned down calls for additional fiscal packages in 2021 and it appears that the economy will not be able to count on government spending to help offset the slowing growth momentum.

Recession to continue into 2021 as trends point to weakness across key sectors

The Philippines is poised to remain in recession for a couple of more quarters with trends pointing to sustained weakness across key sectors. Government officials remain confident of a quick turnaround, but signs of soft consumption, decelerating investment and lacklustre government spending all suggest otherwise. Unless we see a reversal in these trends we believe that the Philippine economy is on pace to enter a lower growth trajectory, failing to return to the pre-pandemic growth average of 6%.

Author

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

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