

Good MornING Asia - 12 June 2020

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Markets catch a bad case of reality

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By Robert Carnell



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Source: Shutterstock

Plausible direction, but will it last or get worse?

Recent experience suggests that it would be wrong to get too smug about a stock market decline of this size, which finally seems to reflect some of the growing weight of bad news in the global economy. Critics are quick to criticize the US Federal Reserve. Although in their defence, they have not done anything wrong except to point out what we already knew - that the US/global economy was in a bad place and that there would be no quick bounce even with recent more optimistic signs from the US labour market, auto and housing markets. There is no point in shooting the messenger. US policy rates are already at virtually zero, backed up with QE. What more could the equity bulls really expect? What more would yield curve control have delivered? Probably very little is the answer that springs to my mind. And the same goes for negative rates (despite what Kenneth Rogoff writes).

The other factor mentioned in the ex-post rationalization of why stocks fell so much in one day was the virus. We have been tracking this closely since I first starting writing about it on around 23 Jan this year. And yes, some of the data from the states do look bad and suggest a second wave following premature re-opening. This was evident more than a week ago. We have been noting it in these notes from time to time.

We hear from various politicians overnight that the US will not shut down again. Maybe not. But the Mayor of Houston, one of the more affected areas in the resurgence of infections in Texas, is reported to be considering issuing stay home notices again. So some more surgically applied shut-downs can't be ruled out in infection hotspots. That isn't to say these will be adhered to.

But really, stocks probably fell so much simply because they had gone up too much. The simplest explanations are often the best. Some investor fingers will have been burned. But others will see this as a buying opportunity. After today's adjustment, there is no telling which way markets will go.

In the meantime, in our part of the world here in Asia, the currencies that saw the fastest month-to-date increases, the IDR and KRW, are top of our list for seeing selling pressure today. The AUD and NZD have already tumbled sharply. They will not be alone.

Other G-7 news

It's pretty quiet across the G-7 today, though we read that UK Cabinet Office Minister, Michael Gove, will formally rule out an extension of the EU transition period today. The transition period is due to end at the end of this year, and the UK had until the end of this month to ask for an extension. The move comes against rumours that the EU may be softening its stance on some of the UK's red lines, including fishing and state aid. The UK for its part seems to be firming up the only card it has in its hand, namely the threat of hard Brexit. Rising hard Brexit fears won't be good news for either the EUR or GBP, though probably worse for the GBP.

The only US release today of any note is the University of Michigan consumer sentiment index. Buried within the detail of this survey are some interesting indices looking at households expectations for losing their job over the coming 12 months, and house and auto buying intentions. These will be interesting given the recent resilience shown by these sectors. But probably not market moving.

And In Asia...

It is also pretty quiet in Asia today. Prakash Sakpal has picked up on some looming releases from India, writing, "May CPI inflation and April industrial production (IP) releases today should reinforce the ugly state of the Indian economy. A 60% YoY plunge in exports and 38% fall in key infrastructure industries' output in April tells you what to expect from the IP data (ING forecast is -33% YoY). Inflation should stay close to the last published reading of 5.8% in March (there was no April data due to the lockdown and we aren't sure if we will get one for May either). The continuing rapid rise of Covid-19 infections in India suggests the economy is poised to be much worse before it shows any signs of improvement. And that won't be anytime soon. India is now the fourth worst-affected country in the world. We now see a steeper 2.1% GDP fall in FY2020, revised down from -1.2% a month ago".

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

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Asia week ahead: Central banks up for more rate cuts

Three Asian central banks will decide policies next week - Japan, Taiwan, and Indonesia. Two are expected to cut policy rates further and one will stay on hold. No point in guessing that the Bank of Japan meeting will pass as a non-event



Source: Shutterstock

4.25%

Bank Indonesia policy rate

After 25bp cut next week

Central bank policy

Central banks in Japan, Taiwan, and Indonesia hold their monetary policy meetings.

Having pledged an unlimited purchase of government bonds since March, yields close to zero, and the main policy rate negative, Japan's central bank monetary easing has run out of steam. Nobody expects them to do anything next week. Yet, keeping with his usual dovish rhetoric, Governor Haruhiko Kuroda today committed all necessary steps to support cash-strapped business and protect jobs. But, he also regarded easing so far as “sufficient and appropriate”. Does this still leave any interest in the BoJ meeting?

The most important thing now is to provide necessary financing to firms through the banking system, and to make financial markets stable.- BoJ Governor Kuroda

The Central Bank of China, Taiwan's central bank, is expected to continue with its piecemeal policy easing and cut the interest rates by another 12.5 basis points to 1.0%, an all-time low. This is just a second rate cut in this easing cycle as the economy is almost unscathed by the Covid-19 pandemic and we see this as the end of the easing cycle.

And one of Asia's aggressive easer since mid-2019, Bank Indonesia, will be back in action next week, delivering another 25bp policy rate cut to 4.25%. Indonesia's GDP growth has slowed sharply and inflation has been subdued, warranting more policy accommodation. Moreover, the usual headwind for BI easing, the weak currency, has been absent; the Indonesian rupiah has been an emerging market outperformer since April. If continued, these trends will open doors for more BI rate cuts ahead.

Busy data calendar

The next batch of China's activity data for May arrives next week. This includes key indicators such as industrial production, retail sales, and fixed-asset investment. The consensus estimates point to an improvement in these indicators, albeit smaller declines in retail sales and investment.

The key question of the week is whether Singapore's non-oil domestic exports continue to buck the weak exports trend.

The calendar is also heavy on the external trade figures for May coming from India, Indonesia, Japan and Singapore. The export weakness is seen accelerating in most Asian economies. But, Singapore's non-oil domestic exports (NODX) have been in the limelight recently for bucking the weak trend on the back of surging pharmaceutical demand in this global pandemic. Whether that continued in May needs to be seen. The consensus suggests another month of positive NODX growth. But we are sceptical and look for a 6% YoY fall.

And the May jobs report in Australia and New Zealand's first-quarter GDP report will make into the headlines.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Monday 15 June					
China	0230	May New home prices (YoY%)	5.4	-	5.2
	0300	May Industrial Production (YoY%)	4.2	5	3.9
	0300	May Retail Sales (YoY%)	-6	-2	-7.5
	0300	May Fixed asset investment (YTD, YoY%)	-9.5	-6	-10.3
India	0730	May WPI (YoY%)	-1	-1.1	1
		- May Trade deficit (US\$bn)	-6.4	-7.048	-6.76
		- May Exports (YoY%)	-73	-	-60.28
		- May Imports (YoY%)	-69	-	-58.65
Indonesia	0500	May Trade balance (US\$mn)	-419	-	-344.7
	0500	May Exports (YoY%)	-19.3	-	-7.02
	0500	May Imports (YoY%)	-26.9	-	-18.58
Wednesday 17 June					
Singapore	0130	May Non-oil domestic exports	-9.0/-6.1	-/-	-5.8/9.7
Thursday 18 June					
Indonesia	0820	BI policy decision (7-day reverse repo, %)	4.25	-	4.5
Taiwan		- Benchmark Interest Rate	1.000	-	1.125

Source: ING, Bloomberg, *GMT

Author

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@asia.ing.com

Michiel Tukker

Senior European 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

Sector Economist, TMT & Healthcare

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@asia.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
Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor 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

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

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 Corporates 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

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

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@asia.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 Fehner

Senior Economist, Germany, 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

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.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

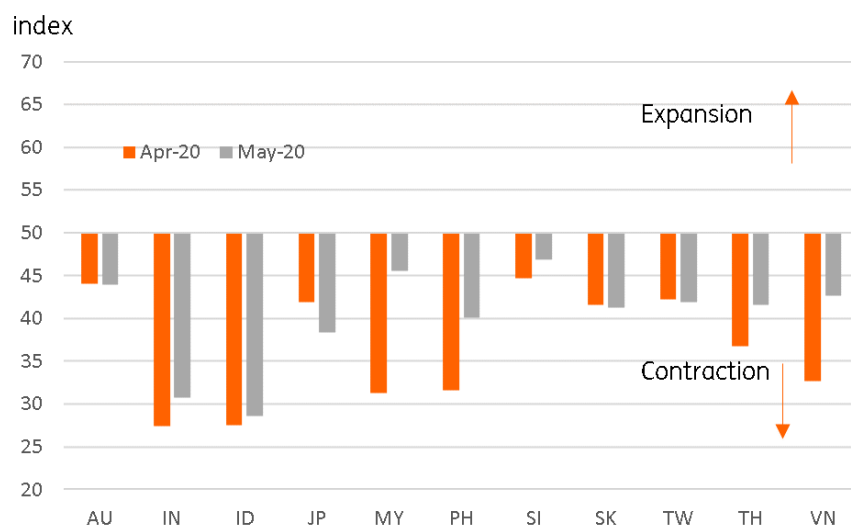
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Asia Ex-China - still slowing

The release of May Purchasing managers indices provides a helpful snapshot of where Asian economies stand following the sharp declines in April, which marked the first full month for many of these economies under movement controls, and in some cases, picked up on the early stages of re-opening



Asia Ex-China Purchasing Manager Indices



Source: Bloomberg, ING
Mfg PMIs

The fiscal packages keep on coming

There is still a tendency for governments across the region to allow fiscal policy to take the strain off the economy. Scope to do this rests on a number of factors – how fiscally secure an economy is, how much of a ratings buffer exists to burn in letting the deficit widen, and whether this is accompanied by a current account deficit too, in which case, the currency may come under pressure.

Japan can hardly be described as a paragon of fiscal virtue, with a debt-to-GDP ratio that will exceed 220% this year. But as a case in point, they recently announced a second supplementary budget to help lift the economy totalling a quite incredible 40% of GDP.

Like some other economies in the region (Malaysia for example, with its claimed 20% boost to the economy), Japan's headlines haven't attracted a great deal of market attention from cynical investors used to government smoke and mirror tactics (double-counting, soft loans, accrued spending etc). Indeed, it is unclear who the intended audience is for these announcements, as the general public must also be totally aware of the game being played. But there is also some genuine stimulus underlying all the fluff. Not enough, in our opinion, to make us want to revise any of our growth forecasts higher. But enough to improve the prospects for recovery post-Covid19 lockdowns.

Still, as first-mover China is showing clearly, while the end of lockdowns is a necessary condition for recovery, it doesn't guarantee much strength, especially for the more export focussed economies.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

China: Mixed messages from the central bank

The People's Bank of China has sent mixed messages about its monetary stance. Here's what we expect for June



Source: Shutterstock

Is the PBoC reluctant to ease?

Before the Two Sessions- China's most important political event of the year - the PBoC removed from its monetary policy report language which described its stance as prudent. The market (myself included) assumed that this meant the central bank would take a more aggressive easing stance to address the economic damage from Covid-19.

However, the PBoC has shown by its actions that this assumption was quite wrong.

1. The central bank did not cut the Loan Prime Rate in May.
2. The size of the innovative re-lending programme announced after the Two Sessions is too small, at a maximum creating CNY 1 trillion loans for SMEs between March and December 2020. By way of comparison, April's one-month new yuan loans came to more than CNY1.6 trillion. That's why we think this programme is too small. Moreover, if exporters and manufacturers do not see an end to the fall in export orders, this re-lending programme will not prevent them from shutting down, and certainly won't encourage them to think about hiring more factory workers.
3. Although the maturing MLF could be rolled over on 15 June, there has been a net absorption

of CNY270 billion liquidity in open market operations between 1-9 June. This is particularly eye-catching because June marks the end of the half year when liquidity has traditionally been very tight. The PBoC seems to be confident that liquidity will be ample at the end of the half year period. As such, we no longer call for a targeted RRR cut or RRR cut of 0.5-1.0 percentage point in June.

In short, the central bank has been reluctant to pump extra liquidity into the financial system, with more focus on SME loan availability.

Still expect one rate cut but the chances are falling

Despite the seemingly tight stance shown by the PBoC, we still expect a rate cut in June of over 50%. We expect one rate cut on the 7D reverse repo, the 1Y Medium Lending Facility and 1Y Loan Prime Rate by 10-20 basis points.

That is because the economy is in poor shape amid weak global demand and the manufacturing sector is trying to turn to the domestic market as external demand falls. A lower interest rate will help corporates to lower their interest costs, as prices of products are more likely to fall than rise in a weak economy.

Though we still expect a rate cut in June, we have to admit that the chance is falling as the PBoC may want to save ammunition for the future if tensions between China and the US increase. The PBoC does not want the policy interest rate to reach a level which is too low and could potentially lead to a liquidity trap in China.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Malaysia's April manufacturing plunges 32%

As Malaysia's industrial production tumbles by 32% in April, the case for more rate cuts seems to be getting stronger and stronger. We expect another 100bp rate cut by the end of 3Q



-32% April industrial production growth
Year-on-year

Worse than expected

Exports dent manufacturing

Malaysia's industrial production tumbled 32% in April from a year ago, surpassing consensus centred around a -15.4% year on year and our estimate of -25%.

A sharp plunge in exports, by 24% in April, explains the weakness. These are the worse readings for exports and manufacturing since the 2009 global financial crisis.

But it wasn't just exports weakness that dragged manufacturing down. The Covid-19 movement restrictions also depressed domestic demand. Manufacturing sales - a proxy for retail sales, also

posted a 33% YoY fall in April as employment and wages fell.

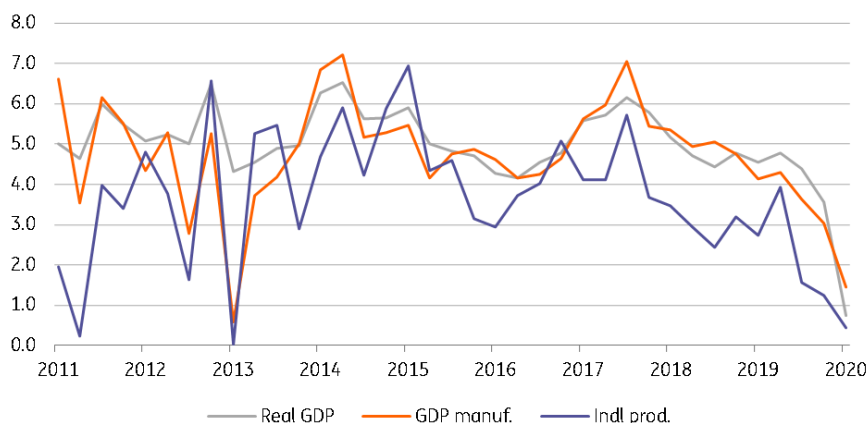
Today's data is a harbinger for poor GDP data

Industrial production growth closely tracks manufacturing GDP growth, which in turn drives total GDP growth. Undoubtedly, today's data is a harbinger for a sharp GDP fall in the current quarter, thanks to the Covid-19 movement control measures that spanned almost the entire quarter. We recently cut our 2Q20 GDP growth forecast to -8.3% YoY from -6.6%, and the full-year 2020 forecast to -3.9% from -2.9%.

The case for further monetary policy easing by the central bank in this cycle is just getting stronger. The central bank has cut its policy rate by a total of 100 basis points so far this year and we anticipate an additional 100bp cut by end-3Q20, taking it to an all-time low of 1%.

The next scheduled meeting is on 7 July.

Manufacturing and GDP growth (% year-on-year)



Source: CEIC, ING
Quarterly data.

Author

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@asia.ing.com

Michiel Tukker

Senior European 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

Sector Economist, TMT & Healthcare
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@asia.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

Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor 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

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

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 Corporates 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

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

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@asia.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, Germany, 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

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.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**Disclaimer**

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