

Good MornING Asia - 2 March 2018

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War

The biggest threat to global growth is a trade war

At the beginning of each year, economists are often asked to list the biggest threats to their forecasts. This year was no different to most, and though my prognosis was generally favourable, my biggest risk was trade - namely, that US President Trump would unleash a trade war. Other analysts have been scrutinising speeches from the Federal Reserve about rate policy, still others, analysing the slope of the yield curve to gauge recession risk. In my opinion, these are all second order to a global ramping up of tariffs on trade.

Trade is just about the only thing economists are agreed on - more is better. You might ask, better for whom? That would be a fair criticism of recent trade deals, gains from which seem to have accrued to a narrow and already privileged group. But even if such criticisms have merit, it doesn't mean that less trade is good - for anyone. If it were, then we imagine the Dow Jones would be up 400 points today, not down 400 points on the back of Trump's announcement of "severe tariffs" on steel and aluminium. Even the USD seems to be in agreement, giving back some of the gains against the EUR of the last few days, though that may reflect the sharp drop in bond yields and slight flattening of the curve.

If Trump does indeed announce tariffs of 25% on imported steel and 10% on imported aluminium,

then retaliation seems inevitable. And though we may worry about China's reaction (so far they have been very patient), Canada and Europe seem particularly vexed - not unreasonably given that national security will probably be used as the excuse for tariffs. Korea and Japan are also big steel exporters to the US, and Australia a big exporter of the raw materials that third parties (mainly China) use to make steel. If these US "allies" take the lead with retaliatory tariffs, it will open the door for China to respond too.

Korean production - difficult to disentangle

Korean production for January came in stronger than the consensus view, recording a 4.6%YoY gain (consensus 1.7%, ING f 4.4%). But we aren't sure whether to be happy or concerned. The data are in all likelihood affected heavily by the Chinese New Year distortions- as all data in this region are at this time of the year. The stronger year-on-year increase seems to have been boosted by downward revisions to historical data, whilst the January month on month gain missed slightly on the downside and was subsumed by a bigger downward revision to the prior month's gain, leaving production in the December-to-January period essentially unchanged.

We certainly need to see more data to work out exactly what the production momentum is for Korea. Yesterday's trade data were encouraging, so for now, we prefer to err on the optimistic side, though not so much that we can envisage any BoK action until much later this year.

Italian elections -just when you thought European politics looked safe

Europe managed to dodge a number of political bullets last year - the Dutch elections passed uneventfully, France did not vote for extremism, and Germany's election, though inconclusive, at least did not usher in a far-right party. With the exception of Germany's CDU/SPD negotiations, which are still an interesting backstory, the main event risk for Europe this year is the Italian elections this weekend. Having sounded highly Eurosceptic at times, the popular five-star movement has been sounding a little more mainstream recently. But polls suggest that we may come in on Monday morning to another German-style inconclusive poll. Protracted negotiations will then follow and quite possibly, new elections later on. This probably isn't a substantial negative to the EUR. Time and again, European countries have proved that they operate quite well without a government (Netherlands, Belgium...).

May scrambles for unity on Brexit - tough ask

With a wide spectrum of views to appease, today's speech by UK PM Theresa May will attempt to please everyone, and in the process, will probably please no-one. The current state of affairs is that the EU has put forward a framework which crosses many of the UK's red lines for Brexit, whilst May has put forward a plan which can fairly be described as "cherry picking", and therefore unacceptable to the EU.

This doesn't mean that the UK is hurtling towards crashing out of the EU without a deal, This is a negotiation, and it would be odd if the opening offers were acceptable to either party. But the gulf seems as wide as ever, and the clock is ticking. Not surprisingly, GBP looks a little vulnerable right now.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Asia week ahead: Spotlight on China

China's Two Sessions will inform on the macro policy directive for 2018. Philippines inflation and a Malaysian central bank policy meeting are also highlights



China aims for qualitative growth

An annual rite of spring, China's Two Sessions -- the Chinese People's Political Consultative Conference (CPPCC) and the National People's Congress (NPC) -- will be held on 3rd and 5th of March. Unlike last year's GDP target of "around 6.5% growth for 2017", Premier Li's annual report to the NPC may not include a GDP growth target. Instead, the report is likely to focus on achieving qualitative growth through macro-prudential measures, corporate and financial sector reforms, greater technological advances in manufacturing and related investments, tighter environmental protection measures, rural developments, and Belt and Road projects.

The Two Sessions may also discuss taxation reform, especially central and local government splits of tax revenue. Although this may not yield a concrete result, we anticipate higher budget spending in 2018 directed toward President Xi's objective of narrowing the urban-rural divide. As such, a higher budget deficit than the government's 3% of GDP line in the sand in recent years shouldn't come as a complete surprise. We also expect the authorities to announce a new central bank (PBoC) governor as Mr. Zhou is moving to another role. The new governor will be someone

who shares Xi's gradual reform approach on interest rate and exchange rate liberalisation.

China's National Statistics Office releases economic data for February, including foreign reserves, trade, and consumer and producer price inflation. The combined January-February activity growth will be a good guide to GDP growth in the current quarter.

Philippines central bank calms markets before CPI data

Consumer price inflation for February will be closely watched in the Philippines. The release of January CPI data showing a bigger-than-expected spike to 4% year-on-year from 3.3% in the previous month unsettled the markets a month ago. The central bank (BSP) forecasts February inflation in a 4-4.8% range but it has attempted to calm the markets this time by signalling steady monetary policy in the near-term. We do not rule out a pre-emptive rate hike as early as March to stabilise inflation expectations.

4-4.8%

BSP's inflation forecast for February

Year-on-year

Malaysian central bank keeps policy on hold

Malaysia's central bank (BNM) holds its monetary policy meeting on 7-Mar. BNM raised its policy rate by 25 basis points at the last meeting on 25-Jan, describing the move as a normalisation, not tightening, of monetary policy. Steady strong growth and slowing inflation support a baseline of a gradual policy normalisation. We do not expect a move at the forthcoming meeting, but retain our call of a 25bp hike in the third quarter of 2018.

3.25%

BNM policy rate

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Friday 2 March					
Singapore	1300	Feb PMI	-	53.1	53.1
Thailand	0330	Feb CPI (YoY%)	0.8	0.7	0.68
	0330	Feb Core-CPI (YoY%)	0.6	0.6	0.58
South Korea	0030	Feb Nikkei Manufacturing PMI	50.3	-	50.7
Saturday 3 March					
China	-	China's National Legislative Meetings Begin			
Monday 5 March					
China	-	China's National People's Congress Begins in Beijing			
India	0500	Feb Nikkei Services PMI	-	-	51.7
Malaysia	0400	Jan Trade balance (RM bn)	4.19	-	7.25
	0400	Jan Imports (YoY%)	18	-	7.85
	0400	Jan Exports (YoY%)	16	-	4.66
Taiwan	0800	Jan Industrial production (YoY%)	3	5	1.2
	0800	Feb Forex Reserves (US\$bn)	454.5	-	455.7
South Korea	2300	Feb CPI (MoM/YoY%)	0.5/1.2	-/-	0.4/1
Tuesday 6 March					
Philippines	0100	Feb CPI (YoY%)	4.2	-	4
Wednesday 7 March					
China	-	Feb Forex Reserves (US\$bn)	3182	-	3161.46
Malaysia	0700	Overnight Policy Rate	3.25	-	3.25
	0700	Feb 28 Forex reserves- Month end (US\$bn)	-	-	103.6
Philippines	-	Feb Forex reserves (US\$bn)	80.8	-	81.224
Taiwan	0800	Feb CPI (YoY%)	3.5	-	0.88
	0800	Feb WPI (YoY%)	-1	-	-0.74
	0800	Feb Trade balance (US\$bn)	4.42	-	2.42
	0800	Feb Exports (YoY%)	9.8	-	15.3
	0800	Feb Imports (YoY%)	6	-	23.3
Thursday 8 March					
China	-	Feb Trade Balance (US\$bn)	8.4	-	20.349
	-	Feb Imports (YoY%)	9.6	-	36.8
	-	Feb Exports (YoY%)	26.7	-	11.1
Friday 9 March					
China	0130	Feb PPI (YoY%)	4.1	-	4.3
	0130	Feb CPI (YoY%)	2	-	1.5
Philippines	0100	Jan Trade balance (US\$mn)	-3000	-	-4017
	0100	Jan Imports (YoY%)	14.7	-	17.6
	0100	Jan Exports (YoY%)	11.5	-	-4.9

Source: ING, Bloomberg

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Indonesia: Slower inflation bolsters steady policy rate view

Softer headline and core inflation in February at 3.18% and 2.58%, respectively, will keep the central bank on a steady policy rate path in 2018. But concerns about a weak currency remain



Source: Shutterstock

3.18%

February headline inflation

Moderate inflation path in 2018

Lower than expected

Bank Indonesia is likely to remain on hold in 2018 with moderate inflation.

Headline and core inflation slowed to 3.18% and 2.58% from January's 3.25% and 2.69%, respectively. Base effects have been positive which would likely extend to most of this year. However, price pressures could partially offset the base effects. The Indonesian rupiah's weakness in February of almost 2% YoY is likely to work through the economy. Budgetary pressures may require further tweaks in subsidised energy prices even as coming elections require stable energy

prices. This year's budget assumes oil prices of around \$48/bl and an IDR at IDR13500. We have revised our 2018 average inflation forecast to 3.4% from 3.5% previously. With inflation forecast within BI's target range of 2.5% to 3.5%, we expect BI to be on hold for 2018. The risk to these expectations is a significant adjustment in administered or subsidised prices and a significantly weaker IDR.

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

Philippines: No change in policy rate despite forecast of higher February inflation

The central bank (BSP) forecasts February inflation of between 4% and 4.8%. BSP insists that there is no need to change policy settings



4% to
4.8%

BSP February inflation
forecast

Unlikely to shift bias to tightening

BSP still sees no need to tighten policy soon

Inflation is expected to be higher than January's 4% rate. BSP forecasts the February inflation rate at 4% to 4.8%. We are optimistic and expect the February inflation rate at 4.2% on the view that the government had moved to address some supply issues. Despite higher inflation expectations not only for February but also for the near term, BSP reiterates a steady policy rate environment.

BSP's senior officials insist that there is no point in tightening since BSP expects inflation to trend to within the target range over the policy horizon. The steady bias was obvious at the last policy rate meeting. BSP kept policy rates steady at the 8 February meeting even as it raised the average inflation forecast to 4.3% in 2018. BSP expects the 2019 inflation average to return to the target range of 2% to 4%. BSP's 2019 average inflation forecast is 3.5%. We argued recently that the likelihood of steady policy rates this year increased considering that the policy lag is 12-18 months. This implies that there is no need to tighten since inflation is expected to return to within the target range over the policy horizon (by March 2019). Nevertheless, we still believe that a more forceful reassurance (via a rate hike as early as the March meeting) is needed to stabilise inflation expectations. We expect an inflation average of 3.9% in 2019 from 3.6% previously.

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

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