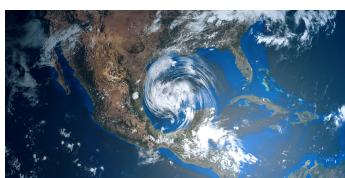


## Good MornING Asia - 2 September 2019

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### In this bundle



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#### India

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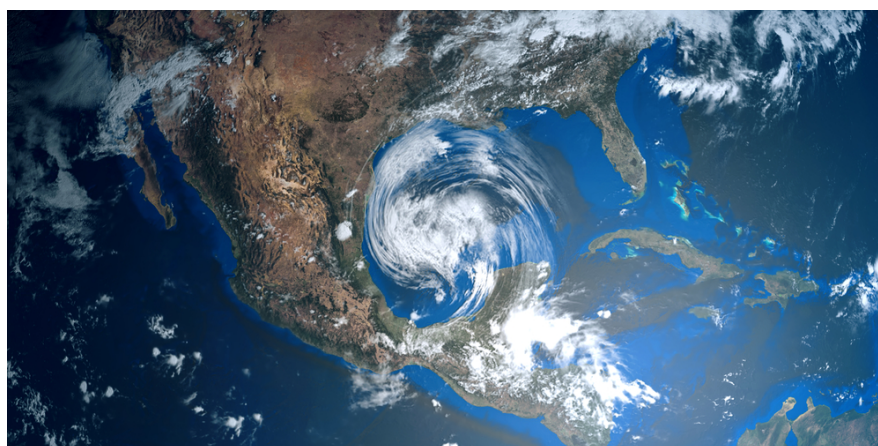
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Opinion | 2 September 2019

# Storm chasing - what does Dorian mean for markets?

Ignoring the ongoing trade war saga, Brexit debacle and the weekend's clashes in HK SAR, today I turn my focus to the natural world, and what it can mean for financial markets.



Source: Shutterstock

## Nervous traveller

Just five days before I board a plane for the US, I'm anxiously watching news about Hurricane Dorian, currently battering the Bahamas. This category 5 hurricane, with its estimated 180mph winds, could affect much of the Eastern Seaboard. I'm expecting a bumpy flight, even on Friday. One of the features of this hurricane is that it is very slow-moving. That enables it to straddle land and sea for longer, doing a lot more damage than it might do otherwise if it quickly moved inland and lost its power source of warm seas.

The Hurricane will inevitably be totted up by the bean-counters at some stage. Wikipedia very helpfully has a list of the most costly Atlantic Hurricane's, with Hurricane Katrina in top place (\$125bn), along with a more recent Hurricane Harvey (2017 and only a category 4 Hurricane - also \$125bn, though I have to say I don't remember that one). Investopedia has a similar list, though the numbers differ. The orders of magnitude are roughly the same though - in excess of a hundred billion dollars.

## The Three R's

What if any economic consequences does this have? The answer to this is tricky, and not at all intuitive. Hurricanes are hugely disruptive whilst they endure, and for some time after, given the

damage to infrastructure and dislocation of workforce who flee to safer areas. But in the months that follow, the received wisdom is that the three R's of repair, replacement and rebuilding, can provide a boost to activity and GDP growth that can outweigh the initial disruption.

[This report by the New York Fed is interesting though](#), as it cites longer-term negative consequences of such disasters, which it shows can last decades after an event such as Katrina.

But the traditional theory of such events runs along lines like this: If an economy's capital stock is its balance sheet, then a Hurricane causes a big loss, but its GDP is more like its profit and loss, and that can take a boost. In any event, the net effect on financial markets is not clear.

## Financial Market response

[I found this quite interesting study by Cambridge University online this morning](#) in a quick search. It is probably worth a longer read. That said, it concentrates more on the sort of "Super-catastrophe" scenarios that this hurricane hopefully won't be.

Most of the studies I found online this morning in a five-minute search tended to focus on the stock market, which typically responds negatively to the cash-flow disruption of such events. Commodity markets often are positively affected - supply channels, especially of oil from the Mexican Gulf can lead to shortages and price spikes. But the bond market, which is rarely if ever mentioned, will in my opinion, most likely rally (the Cambridge paper talks about rating downgrades, but it is looking at entirely a different league of disaster).

As for the currency, Fed and short term rates...using Katrina as a benchmark, the Fed tends not to react to events like this, at least not through monetary policy, though it does provide liquidity assistance to regional banks affected by the disaster.

Back in 2005, the Fed was in hiking mode and had already hiked rates twice that year, hiking on a quarterly schedule to coincide with its press briefing meetings. Katrina formed on August 23 and dissipated by August 31, the Fed hiked rates again in September at their next meeting, though there was a longer than usual pause before their next hike in January the following year. There is some evidence that the USD lost some ground in the period during the hurricane and immediately afterward, though it rapidly made it back.

This may not be an appropriate yardstick for a Fed in easing mode, though. I imagine that markets will view this as an excuse to take an already dovish Fed over the line at this month's meeting.

## Day ahead:

After that refreshing break from commenting on the trade war, Brexit or the HK SAR unrest, what does today bring?

Well before we look at that, let's start with a quick look at events breaking late last week and over the weekend: Starting with India's GDP. [Check out Think for a more considered piece by Prakash](#). But the short story here is that the 5.0%YoY release was substantially at the low end of expectations and very disappointing given the degree of stimulus the economy has already had. We have a further 50bp of easing penciled in for the RBU for the rest of the year. We should maybe ink it in now.

Also, (from Iris Pang) "As the new US tariffs kick in (came in yesterday on September 1), we expect

that China's Caixin manufacturing PMI will stay below 50 for another month in September even though there will be more infrastructure projects in place. The official manufacturing PMI fell to 49.5 in August from 49.7 a month earlier, showing that contraction in manufacturing activities continued. The details showed that both export orders and domestic orders continued to stay below 50. The sub-index of production was 51.9, which is likely the result of infrastructure projects entering their production phase.

This should continue to give some support to the overall manufacturing PMI in the coming months. But we have to keep in mind that this growth came from fiscal stimulus. It is not the result of regular manufacturing activity, which will be hit by another wave of tariffs starting from 1st September".

Today sees plenty more PMIs across the region, most of which look to dip a little further into the red, though there is an increase in the Korean PMI, possibly reflecting what we believe might be an emerging trough in the semiconductor industry. Though this economy still has substantial problems.

Thai CPI today is of no particular market interest, as they don't really have any inflation. Indonesian inflation is more relevant given the recent swing of Governor Warjiyo from talking the dovish talk to walking the dovish walk with their recent rate cut (August 22 25bp cut of 7-Day reverse repo rate to 5.5%).

## Author

### Robert Carnell

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

## ASEAN Morning Bytes

Risk sentiment will likely fade quickly with the US and China starting the implementation of their new round of tariffs over the weekend.



### EM Space: : Traders to seek safety with trade war escalating

- **General Asia:** Risk-taking will likely take a backseat on Monday with investors focusing on the escalating US-China trade war while investors will get a further glimpse of China manufacturing through the Caixin PMI likely showing contraction as the ill effects of the trade tension continue to weigh on activity.
- **Philippines:** The Bangko Sentral ng Pilipinas (BSP) expects the August inflation between 1.3-2.1%, down from 2.4% in July. The lower oil, rice and electricity prices, and continued favourable base effect pushes headline inflation below the BSP's 2-4% inflation target. Slowing inflation and lackluster growth in 1H opens the door for further BSP easing with Governor Diokno pledging another 25 bps rate cut before year-end.
- **Thailand:** August CPI is due with consensus looking for a slowdown in the headline inflation to 0.6% YoY from 1.0% in July and little-changed core inflation at 0.4%. Falling transport component inflation continues to offset the firmer food component. We don't see inflation drifting away from the low end of the BoT's 1-4% policy target this year and, with weak growth, the BoT continue to cut rates.
- **Indonesia:** August CPI is due today with consensus pointing to a slight acceleration on prices to 3.51%, right at the midpoint of the 2.5-4.5% target. Bank Indonesia (BI) Governor Warjiyo forecasts it to settle at 3.47%, right at market expectations as temporary factors have caused prices of select food items to rise. Meanwhile, the Governor expects 3Q GDP to

improve slightly from the reading in 2Q (5.05%) as the central bank is cutting policy rates to bolster momentum.

## What to look out for: Asian manufacturing and US jobs

- China Caixin PMI manufacturing (2 September)
- India PMI manufacturing (2 September)
- Indonesia inflation (2 September)
- Taiwan PMI manufacturing (2 September)
- Thailand inflation (2 September)
- South Korea PMI manufacturing (2 September)
- Singapore PMI manufacturing (3 September)
- South Korea inflation and 2Q GDP (3 September)
- US ISM PMI manufacturing (3 September)
- China Caixin PMI services (4 September)
- Fed Rosengren and Williams speech (4 September)
- India PMI services (4 September)
- Malaysia trade (4 September)
- US trade (4 September)
- Philippines inflation (5 September)
- India current account (5 September)
- US durable goods (5 September)
- Fed Bowman, Kashkari, Evans and Bullard (5 September)
- Hong Kong GIR (6 September)
- Malaysia GIR (6 September)
- Taiwan inflation (6 September)
- US NFP (6 September)

### Author

#### Nicholas Mapa

Senior Economist, Philippines

[nicholas.antonio.mapa@asia.ing.com](mailto:nicholas.antonio.mapa@asia.ing.com)

## India: Where has all that stimulus gone?

A 6-year low of 5% GDP growth in 1Q FY2020 provides more reasons for the government and central bank to remain in policy-easing mode over the rest of the year.



Source: Shutterstock

**5%** GDP growth in 1Q FY2020

Worse than expected

### 6-year low GDP growth...

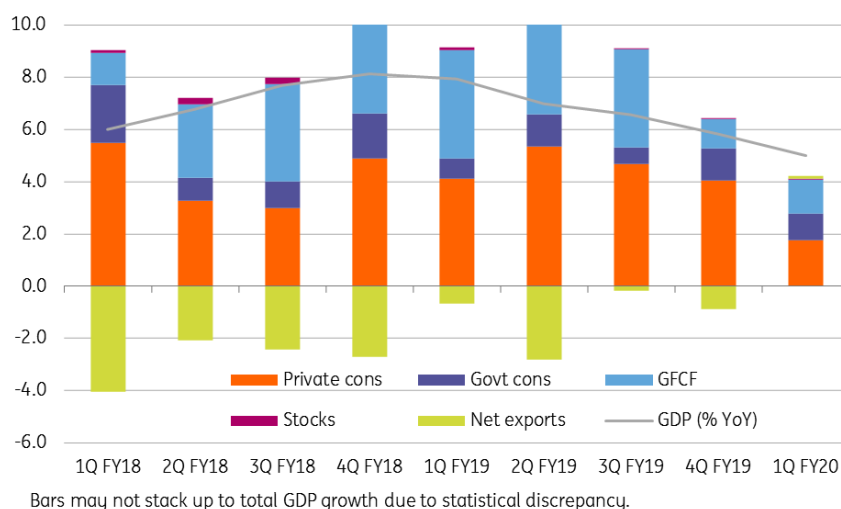
Contrary to the consensus of just a tick-down in growth, GDP in the first quarter of FY2020 (started in April this year) posted a sharp slowdown to 5% year-on-year from 5.8% in the previous quarter. The consensus median was 5.7% growth as against 5.8% in the previous quarter. We were more optimistic with our 6.0% forecast, which rested on the massive stimulus the authorities, both the government and the central bank, unleashed earlier this year in the election drive to boost growth.

Among the spending components, private consumption stood out to be the main source of GDP slowdown. 3.1% consumption growth more than halved from 7.2% in the previous quarter, implying a 2.3 percentage point hit to GDP growth. There was also a sharp slowdown in government consumption (to 8.8% from 13.1%), which is at odds with fiscal stimulus. Growth of

fixed capital formation improved slightly (to 4.0% from 3.6%), thanks to the aggressive policy rate cuts by the Reserve Bank of India (RBI).

Firmer exports were reflected in an improved net trade contribution to GDP growth (albeit zero overall), though these failed to sustain manufacturing as a source of GDP growth from the industry side, while services growth also slowed in the last quarter.

## Weak private consumption dents growth



Source: CEIC, ING

## ... paves way for more stimulus

Data suggests that all the stimulus that has gone into the economy this year -- as part of a surge in the election spending as well the RBI taking advantage of low inflation by slashing policy rates -- has failed to boost growth. The latest data also reflects significant policy lags (pointed out by an RBI policymaker in the latest policy minutes) with less than 40% of the rate cuts so far being transmitted to the banking system. The 110 basis point RBI policy rate cut this year was by far the most aggressive easing by any central bank in the world this year.

The question is: should the RBI pause easing and allow the rate cuts implemented time to filter down into the economy? We think so, though we are sceptical that they will actually do so now that growth has dipped well below the RBI's 6.9% growth forecast for the full FY2020 (revised recently from 7.0%).

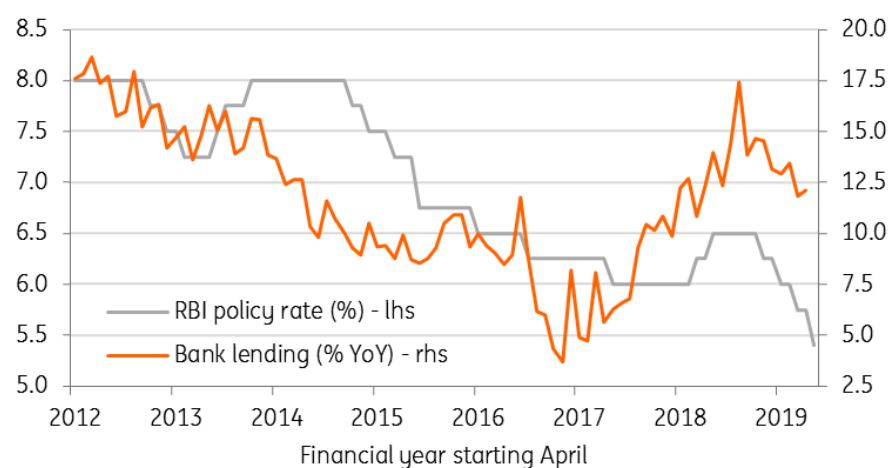
We retain our forecast of an additional 50bp of rate cuts over the rest of the year, taking the repo rate to 4.90%, the lowest in a decade and just shy of the 4.75% record low reached during the 2009 global financial crisis.

Furthermore, taking advantage of a \$24 billion windfall received from the RBI this year, the government unveiled additional stimulus just prior to the GDP release. We don't see it stepping off the stimulus pedal just yet.

However, we continue to caution about the inflationary implication of such massive policy accommodation. We retain our view of inflation accelerating above the RBI's 4% policy target by the end of the year. So continued easing now may lead to considerable policy awkwardness later.



## Monetary easing failing to stimulate bank lending



Source: Bloomberg, CEIC, ING

### Author

#### Alissa Lefebre

Economist

[alissa.lefebvre@ing.com](mailto:alissa.lefebvre@ing.com)

#### Deepali Bhargava

Regional Head of Research, Asia-Pacific

[Deepali.Bhargava@ing.com](mailto:Deepali.Bhargava@ing.com)

#### Ruben Dewitte

Economist

+32495364780

[ruben.dewitte@ing.com](mailto:ruben.dewitte@ing.com)

#### Kinga Havasi

Economic research trainee

[kinga.havasi@ing.com](mailto:kinga.havasi@ing.com)

#### Marten van Garderen

Consumer Economist, Netherlands

[marten.van.garderen@ing.com](mailto:marten.van.garderen@ing.com)

#### David Havrlant

Chief Economist, Czech Republic

420 770 321 486

[david.havrlant@ing.com](mailto:david.havrlant@ing.com)

#### Sander Burgers

Senior Economist, Dutch Housing

[sander.burgers@ing.com](mailto:sander.burgers@ing.com)

**Lynn Song**

Chief Economist, Greater China

[lynn.song@asia.ing.com](mailto:lynn.song@asia.ing.com)

**Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

**Michal Rubaszek**

Senior Economist, Poland

[michal.rubaszek@ing.pl](mailto:michal.rubaszek@ing.pl)

**This is a test author**

**Stefan Posea**

Economist, Romania

[tiberiu-stefan.posea@ing.com](mailto:tiberiu-stefan.posea@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Jesse Norcross**

Senior Sector Strategist, Real Estate

[jesse.norcross@ing.com](mailto:jesse.norcross@ing.com)

**Teise Stellema**

Research Assistant, Energy Transition

[teise.stellema@ing.com](mailto:teise.stellema@ing.com)

**Diederik Stadig**

Sector Economist, TMT & Healthcare

[diederik.stadig@ing.com](mailto:diederik.stadig@ing.com)

**Diogo Gouveia**

Sector Economist

[diogo.duarte.vieira.de.gouveia@ing.com](mailto:diogo.duarte.vieira.de.gouveia@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Ewa Manthey**

Commodities Strategist

[ewa.manthey@ing.com](mailto:ewa.manthey@ing.com)

**ING Analysts**

**James Wilson**

EM Sovereign Strategist

[James.wilson@ing.com](mailto:James.wilson@ing.com)

**Sophie Smith**

Digital Editor

[sophie.smith@ing.com](mailto:sophie.smith@ing.com)

**Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

**Adam Antoniak**

Senior Economist, Poland

[adam.antoniak@ing.pl](mailto:adam.antoniak@ing.pl)

**Min Joo Kang**

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

**Coco Zhang**

ESG Research

[coco.zhang@ing.com](mailto:coco.zhang@ing.com)

**Jan Frederik Slijkerman**

Senior Sector Strategist, TMT

[jan.frederik.slijkerman@ing.com](mailto:jan.frederik.slijkerman@ing.com)

**Katinka Jongkind**

Senior Economist, Services and Leisure

[Katinka.Jongkind@ing.com](mailto:Katinka.Jongkind@ing.com)

**Marina Le Blanc**

Sector Strategist, Financials

[Marina.Le.Blanc@ing.com](mailto:Marina.Le.Blanc@ing.com)

**Samuel Abettan**

Junior Economist

[samuel.abettan@ing.com](mailto:samuel.abettan@ing.com)

**Franziska Biehl**

Economist, Germany

[Franziska.Marie.Biehl@ing.de](mailto:Franziska.Marie.Biehl@ing.de)

**Rebecca Byrne**

Senior Editor and Supervisory Analyst

[rebecca.byrne@ing.com](mailto:rebecca.byrne@ing.com)

**Mirjam Bani**

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

[mirjam.bani@ing.com](mailto:mirjam.bani@ing.com)

**Timothy Rahill**

Credit Strategist

[timothy.rahill@ing.com](mailto:timothy.rahill@ing.com)

**Leszek Kasek**

Senior Economist, Poland

[leszek.kasek@ing.pl](mailto:leszek.kasek@ing.pl)

**Oleksiy Soroka, CFA**

Senior High Yield Credit Strategist

[oleksiy.soroka@ing.com](mailto:oleksiy.soroka@ing.com)

**Antoine Bouvet**

Head of European Rates Strategy

[antoine.bouvet@ing.com](mailto:antoine.bouvet@ing.com)

**Jeroen van den Broek**

Global Head of Sector Research

[jeroen.van.den.broek@ing.com](mailto:jeroen.van.den.broek@ing.com)

**Edse Dantuma**

Senior Sector Economist, Industry and Healthcare

[edse.dantuma@ing.com](mailto:edse.dantuma@ing.com)

**Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

**Rico Luman**

Senior Sector Economist, Transport and Logistics

[Rico.Luman@ing.com](mailto:Rico.Luman@ing.com)

**Jurjen Witteveen**

Sector Economist

[jurjen.witteveen@ing.com](mailto:jurjen.witteveen@ing.com)

**Dmitry Dolgin**

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

**Nicholas Mapa**

Senior Economist, Philippines

[nicholas.antonio.mapa@asia.ing.com](mailto:nicholas.antonio.mapa@asia.ing.com)

**Egor Fedorov**

Senior Credit Analyst  
[egor.fedorov@ing.com](mailto:egor.fedorov@ing.com)

**Sebastian Franke**

Consumer Economist  
[sebastian.franke@ing.de](mailto:sebastian.franke@ing.de)

**Gerben Hieminga**

Senior Sector Economist, Energy  
[gerben.hieminga@ing.com](mailto:gerben.hieminga@ing.com)

**Nadège Tillier**

Head of Corporates Sector Strategy  
[nadege.tillier@ing.com](mailto:nadege.tillier@ing.com)

**Charlotte de Montpellier**

Senior Economist, France and Switzerland  
[charlotte.de.montpellier@ing.com](mailto:charlotte.de.montpellier@ing.com)

**Laura Straeter**

Behavioural Scientist  
+31(0)611172684  
[laura.Straeter@ing.com](mailto:laura.Straeter@ing.com)

**Valentin Tataru**

Chief Economist, Romania  
[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

**James Smith**

Developed Markets Economist, UK  
[james.smith@ing.com](mailto:james.smith@ing.com)

**Suvi Platerink Kosonen**

Senior Sector Strategist, Financials  
[suvi.platerink-kosonen@ing.com](mailto:suvi.platerink-kosonen@ing.com)

**Thijs Geijer**

Senior Sector Economist, Food & Agri  
[thijs.geijer@ing.com](mailto:thijs.geijer@ing.com)

**Maurice van Sante**

Senior Economist Construction & Team Lead Sectors  
[maurice.van.sante@ing.com](mailto:maurice.van.sante@ing.com)

**Marcel Klok**

Senior Economist, Netherlands  
[marcel.klok@ing.com](mailto:marcel.klok@ing.com)

**Piotr Poplawski**

Senior Economist, Poland

[piotr.poplawski@ing.pl](mailto:piotr.poplawski@ing.pl)

**Paolo Pizzoli**

Senior Economist, Italy, Greece

[paolo.pizzoli@ing.com](mailto:paolo.pizzoli@ing.com)

**Marieke Blom**

Chief Economist and Global Head of Research

[marieke.blom@ing.com](mailto:marieke.blom@ing.com)

**Raoul Leering**

Senior Macro Economist

[raoul.leering@ing.com](mailto:raoul.leering@ing.com)

**Maarten Leen**

Head of Global IFRS9 ME Scenarios

[maarten.leen@ing.com](mailto:maarten.leen@ing.com)

**Maureen Schuller**

Head of Financials Sector Strategy

[Maureen.Schuller@ing.com](mailto:Maureen.Schuller@ing.com)

**Warren Patterson**

Head of Commodities Strategy

[Warren.Patterson@asia.ing.com](mailto:Warren.Patterson@asia.ing.com)

**Rafal Benecki**

Chief Economist, Poland

[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

**Philippe Ledent**

Senior Economist, Belgium, Luxembourg

[philippe.ledent@ing.com](mailto:philippe.ledent@ing.com)

**Peter Virovacz**

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

**Inga Fechner**

Senior Economist, Germany, Global Trade

[inga.fechner@ing.de](mailto:inga.fechner@ing.de)

**Dimitry Fleming**

Senior Data Analyst, Netherlands

[Dimitry.Fleming@ing.com](mailto:Dimitry.Fleming@ing.com)

**Ciprian Dascalu**

Chief Economist, Romania

+40 31 406 8990

[ciprian.dascalu@ing.com](mailto:ciprian.dascalu@ing.com)

**Muhammet Mercan**

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

**Iris Pang**

Chief Economist, Greater China

[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

**Sophie Freeman**

Writer, Group Research

+44 20 7767 6209

[Sophie.Freeman@uk.ing.com](mailto:Sophie.Freeman@uk.ing.com)

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto: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](mailto:martin.van.vliet@ing.com)

**Robert Carnell**

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

**Karol Pogorzelski**

Senior Economist, Poland

[Karol.Pogorzelski@ing.pl](mailto:Karol.Pogorzelski@ing.pl)

**Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

**Viraj Patel**

Foreign Exchange Strategist  
+44 20 7767 6405  
[viraj.patel@ing.com](mailto:viraj.patel@ing.com)

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

**Bert Colijn**  
Chief Economist, Netherlands  
[bert.colijn@ing.com](mailto:bert.colijn@ing.com)

**Peter Vanden Houte**  
Chief Economist, Belgium, Luxembourg, Eurozone  
[peter.vandenhoute@ing.com](mailto:peter.vandenhoute@ing.com)

**Benjamin Schroeder**  
Senior Rates Strategist  
[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

**Chris Turner**  
Global Head of Markets and Regional Head of Research for UK & CEE  
[chris.turner@ing.com](mailto:chris.turner@ing.com)

**Gustavo Rangel**  
Chief Economist, LATAM  
+1 646 424 6464  
[gustavo.rangel@ing.com](mailto:gustavo.rangel@ing.com)

**Carlo Cocuzzo**  
Economist, Digital Finance  
+44 20 7767 5306  
[carlo.cocuzzo@ing.com](mailto:carlo.cocuzzo@ing.com)



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