New Horizons Hub: Negative interest rates for the post-crisis recovery?

While the coronavirus crisis poses a huge challenge to the well-established global economic order, Kenneth Rogoff argues that deep negative interest rates would be a huge boon to emerging markets too. We pick up on these in our top selection of this week's stories from our trusted third-party providers and ING experts

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VoxEU: Economic policy responses to a pandemic: Developing the COVID-19 Economic Stimulus Index

Governments around the world adopted different measures in fighting the Covid-19 pandemic. The economic stimulus is more pronounced in richer countries and where the median age is higher and the number of hospital beds per capita is lower, write Ceyhun Elgin, Gokce Basbug, Abdullah Yalaman for VoxEU

Countries adopted different policy measures

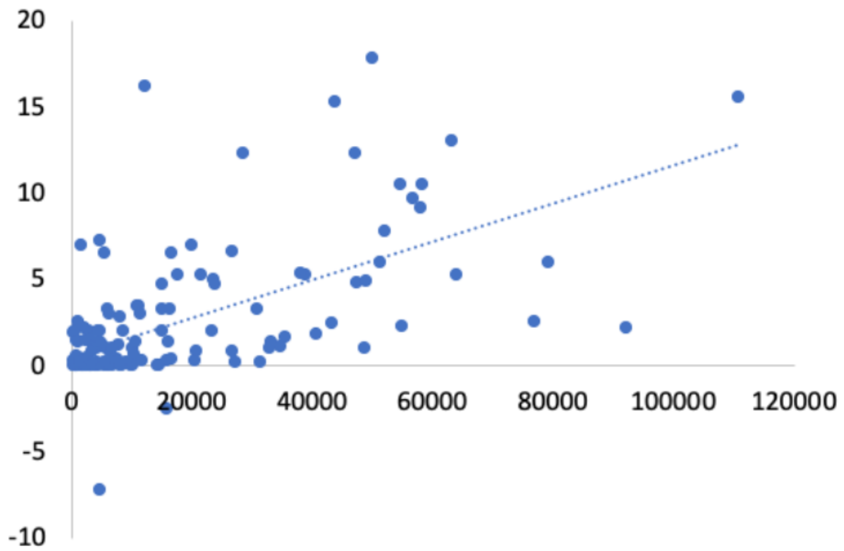
The COVID-19 outbreak emerged in Wuhan, China in December of 2019 and still persists globally. In addition to human suffering and loss of lives, the outbreak has generated a major global economic downturn. The world's largest economies (the G7 and China) are among those that have been most affected by the pandemic (Baldwin and Weder DiMauro 2020). To mitigate the negative effects of public health controls on the economy and to sustain public welfare, governments have adopted economic packages including fiscal, monetary, and financial policy measures (Gourinchas 2020). These economic measures targeting households, firms, health systems and banks vary across countries in breadth and scope (Weder di Mauro 2020).

A key quote:

We find that in countries where the median age is higher (which is highly relevant in the case of the COVID-19, as it disproportionally affects older patients), the number of hospital beds per-capita is lower and GDP per-capita is higher, the stimulus is more pronounced.

Fiscal stimulus (% of GDP) and GDP per capita

Figure 2 Fiscal stimulus (% of GDP) and GDP per capita



Source: Source: Ceyhun Elgin et al (2020)

Authors' note: Our dataset will be regularly updated every week. The latest version is available at www.ceyhunelgin.com.

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Opinion | 12 May 2020

VoxEU: Lockdowns boost support for incumbents, trust in government

Major crises can act as catalysts – either destabilising or strengthening the political regimes that oversee them, depending on how citizens view their government's performance, writes André Blais, Damien Bol, Marco Giani, Peter John Loewen for VoxEU

Introduction

The 2020 Covid-19 pandemic has created a difficult trade-off for policymakers (Boeri et al. 2020). On the one hand is the need to impose strict social containment, also known as lockdown, to slow the spread of the virus and protect populations at risk while helping hospitals with limited intensive care units to cope with the number of infected patients – a policy objective that is often labelled 'flattening the curve' (Anderson et al. 2020). On the other hand, lockdowns have important negative consequences. First, they drastically reduce the civil liberties of citizens who see their right to travel freely limited to a minimum. Second, lockdowns will have dramatic consequences for the economy, in the short-term and the long-term. Evidence shows that experts and citizens alike share concerns about the human and economic costs of lockdowns (Baldwin and di Mauro 2020, Fetzer et al. 2020).

This policy trade-off has placed the state under a spotlight. Governments need to make hard decisions that can further destabilise or reinforce their authority. In times of crisis – after a natural disaster, for instance – a government's policy response can rally citizens around the flag and fortify their support for institutions (e.g. Bechtel and Hainmueller 2011, Healy and Malhorta 2009). Or, such crises can shift citizens' views of these institutions, even leading to a regime change (e.g. Acemoglu and Robinson 2001, Aidt and Leon 2016). In a new paper, we document how Covid-19 lockdowns have affected citizens' trust in their incumbents and institutions in the context of democratic Western Europe (Blais et al 2020). We find that the lockdowns have increased support for the democratic status quo: citizens report being more likely to vote for the incumbent, trusting in the government, and satisfaction with democracy.

A key quote from the article

Our findings bring good news for democracy, or at least for status quo democratic institutions. An argument could be made that dictatorships are better equipped to make the tough and drastic decisions required in a pandemic crisis, while democratically elected governments would be too prudent to adopt the necessary stringent measures. Instead, most democratic governments have enacted stringent confinement measures and been rewarded with increased support. Perhaps most importantly, lockdowns have produced higher satisfaction with the way democracy works. Apparently, most citizens understand that strict social confinement is necessary. They appreciate seeing their fears taken into account by their elected governments and even prioritised over economic interests. Even in this populist age, traditional political institutions enjoy some support.

The full original article first appeared on VoxEU here.

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Kenneth Rogoff: The case for deeply negative interest rates

Only monetary policy addresses credit throughout the economy. Until inflation and real interest rates rise from the grave, only a policy of effective deep negative interest rates, backed up by measures to prevent cash hoarding by financial firms, can do the job, writes Kenneth Rogoff for Project Syndicate

Kenneth Rogoff

Negative interest rates no longer a taboo

For those who viewed negative interest rates as a bridge too far for central banks, it might be time to think again. Right now, in the United States, the Federal Reserve – supported both implicitly and explicitly by the Treasury – is on track to backstop virtually every private, state, and city credit in the economy. Many other governments have felt compelled to take similar steps. A once-in-a-century (we hope) crisis calls for massive government intervention, but does that have to mean dispensing with market-based allocation mechanisms?

Blanket debt guarantees are a great device if one believes that recent market stress was just a short-term liquidity crunch, soon to be alleviated by a strong sustained post-COVID-19 recovery. But what if the rapid recovery fails to materialize? What if, as one suspects, it takes years for the US and global economy to claw back to 2019 levels? If so, there is little hope that all businesses will remain viable, or that every state and local government will remain solvent.

Negative rates would operate similarly to normal monetary policy, boosting aggregate demand and raising employment

A better bet is that nothing will be the same. Wealth will be destroyed on a catastrophic scale, and policymakers will need to find a way to ensure that, at least in some cases, creditors take part of the hit, a process that will play out over years of negotiation and litigation. For bankruptcy lawyers and lobbyists, it will be a bonanza, part of which will come from pressing taxpayers to honour bailout guarantees. Such a scenario would be an unholy mess.

Now, imagine that, rather than shoring up markets solely via guarantees, the Fed could push most short-term interest rates across the economy to near or below zero. Europe and Japan already have tiptoed into negative rate territory. Suppose central banks pushed back against today's flight into government debt by going further, cutting short-term policy rates to, say, -3% or lower.

For starters, just like cuts in the good old days of positive interest rates, negative rates would lift many firms, states, and cities from default. If done correctly – and recent empirical evidence increasingly supports this – negative rates would operate similarly to normal monetary policy, boosting aggregate demand and raising employment. So, before carrying out debt-restructuring surgery on everything, wouldn't it better to try a dose of normal monetary stimulus?

Cash hoarding remains a key issue

A number of important steps are required to make deep negative rates feasible and effective. The most important, which no central bank (including the ECB) has yet taken, is to preclude large-scale hoarding of cash by financial firms, pension funds, and insurance companies. Various combinations of regulation, a time-varying fee for large-scale re-deposits of cash at the central bank, and phasing out large-denomination banknotes should do the trick.

It is not rocket science (or should I say virology?). With large-scale cash hoarding taken off the table, the issue of pass-through of negative rates to bank depositors – the most sensible concern – would be eliminated. Even without preventing wholesale hoarding (which is risky and expensive), European banks have increasingly been able to pass on negative rates to large depositors. And governments would not be giving up much by shielding small depositors entirely from negative interest rates. Again, given adequate time and planning, doing this is straightforward.

Most objections are either fuzzy-headed or easily addressed

Negative interest rates have elicited a blizzard of objections. Most, however, are either fuzzy-headed or easily addressed, as I discuss in my 2016 book on the past, present, and future of currency, as well as in related writings. There, I also explain why one should not think of "alternative monetary instruments" such as quantitative easing and helicopter money as forms of fiscal policy. While a fiscal response is necessary, monetary policy is also very much needed. Only monetary policy addresses credit throughout the economy. Until inflation and real interest rates rise from the grave, only a policy of effective deep negative interest rates can do the job.

Negative rates could help emerging markets too

A policy of deeply negative rates in the advanced economies would also be a huge boon to emerging and developing economies, which are being slammed by falling commodity prices, fleeing capital, high debt, and weak exchange rates, not to mention the early stages of the pandemic. Even with negative rates, many countries would still need a debt moratorium. But a weaker dollar, stronger global growth, and a reduction in capital flight would help, especially when it comes to the larger emerging markets.

Tragically, when the Federal Reserve conducted its 2019 review of policy instruments, discussion of how to implement deep negative rates was effectively taken off the table, forcing the Fed's hand in the pandemic. Influential bank lobbyists hate negative rates, even though they need not undermine bank profits if done correctly. The economics profession, mesmerized by interesting counterintuitive results that arise in economies where there really is a zero bound on interest rates, must share some of the blame.

Emergency implementation of deeply negative interest rates would not solve all of today's problems. But adopting such a policy would be a start. If, as seems increasingly likely, equilibrium real interest rates are set to be lower than ever over the next few years, it is time for central banks and governments to give the idea a long, hard, and urgent look.

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Prompting sustainable action may depend on asking the right question

Most of us agree that more needs to be done to protect the environment. New technologies are being continually developed to make our lifestyles and our homes more sustainable. But if push came to shove, would you pay to install solar panels? Ian Bright, Jessica Exton and Jay Shamji help explain how your answer would probably depend on how you were asked

The way a message is framed can influence how it is perceived. Tailoring a message to appeal to our nature or to emphasise one aspect of an argument over others, are examples of how framing can be applied to influence responses. For example, beef advertised as 95% lean mince, instead of 5% fat will appear more attractive.

The effects of framing when communicating to people about sustainability are particularly interesting. If a simple change of wording prompts more people to make their homes more sustainable, which would subsequently impact long-term energy consumption and deliver a variety of benefits, for example, people would want to know about it.

Solar tools

Solar panels available to households have the potential to significantly reduce the environmental impact homes have. Deloitte analysis suggests that if solar panels were placed on every suitable roof surface in the Netherlands, half of the country's electricity demand could be generated by the sun.

The cost savings solar panels provide are making them increasingly popular. In the year leading up to July 2019, solar power use in the UK almost doubled. US 'fact tank', Pew Research Centre, further found that more than two in five US homeowners have given serious thought to installing solar panels. Additionally, the sustainable impact of solar panels is being recognised in sunny California, where a new set of environmental standards will require most new homes built after 2020 to include solar panels.

Wording matters

Despite significantly reducing household energy bills, the initial high cost of installing solar panels will deter some prospective users. This type of challenge is consistent across many environmental decisions, with many sustainable products incurring a large initial outlay as well as a long payback period. Whether an offer to install solar panels focuses on the immediate impact or the longer-term returns will likely influence responses.

To test this, a single question about attitudes to installing solar panels was asked to all 13,000 European respondents involved in 2019's Homes and Mortgages ING International Survey. In each of the 13 countries, respondents were split into two equal groups. Each were given estimates of average energy bills for households in their country and the average cost of installing solar panels. Half were asked how much money they would need to save each year to install solar panels. The other half were asked how many years of savings they would need to justify the initial instalment costs. The questions were asked in a way that the savings each year and number of years to pay off could be compared directly.

When asked the question in different ways, Europeans on average gave different answers. A third of people (32%) said investing in solar panels wasn't worth the highest return option we provided, when the return was expressed as a monetary saving. But a much larger group (47%) said this investment wasn't worth it when they considered the number of years it would take to recoup the initial cost. People were more likely to invest in solar panels when they considered how much could be saved each year, compared to how many years of saving it would take to recoup the initial costs.

The questions

Q: What annual saving on your energy bills would make this investment worth it?

A: On average, 32% said they would need to save more than 70% of their energy bill each year (equivalent to less than 15 years repayment time) to make the investment worth it.

Respondents selected a percentage of their annual energy bill that would need to be saved between 70% (which would take approx. 15 years to repay) and 20% (which would take approx. 43 years to repay) or said 'I would need to save more than this each year'.

Q: How quickly would you need to make the total cost of solar panels bank, to make this investment worth it?

A: On average, 47% said they would need to recoup costs in less than 15 years (equivalent to more than 70% annual energy bill saving) to make the investment worth it.

Respondents selected a number of years on a range between 43 years (approx. equivalent to saving 20% of each annual energy bill) and 15 years (approx. equivalent to saving 70% of each annual energy bill) or said 'I would need to recoup my costs faster than this'.

The findings

Almost half (47%) of Europeans said that a repayment period of 15 years was too long. They did not feel that it was worth installing solar panels if it would take this long to make a full return on their investment.

Comparatively, only a third (32%) of Europeans gave the equivalent response, saying that 15 years was too long to make up their investment, when we framed this return as an annual saving on their energy bill. This was the equivalent of wanting to save more than 70% of each annual energy bill.

Driving framing

With this single question, we can't know what assumptions and calculations respondents may have made when deciding if the investment was worth it for them. Therefore, while we can see differences in the answers, we can't say exactly why they have occurred. We can however, hypothesise.

It may be that respondents who were shown the question that phrased returns on their solar panel investment in terms of annual energy savings were focusing on short-term gains. Each year they would incur a saving on their annual energy bill that would continue into the foreseeable future. This would happen immediately after installation. While this saving would be used to account for the high initial installation cost, the fact that energy bills would be reduced may have felt like a win, and therefore considered attractive.

Respondents who were shown the question that phrased returns in terms of how many years it would take to repay their investment, were however led to focus on something very different. Rather than an immediate saving, they considered the total repayment period. This may have made this option less attractive. Respondents would have had to work out the immediate financial benefits themselves as these weren't made obvious.

Time vs Money

Another reason for the different responses may be that one group viewed costs in terms of money, the other in terms of time.

'Time is money'. It's a common saying that suggests interchangeability. We *spend* money on activities, we *spend* time on others. In some cases, we can think of periods of time as 'worth' a certain amount of money. One can be translated to the other.

But research suggests that it's normal to think about time and money differently, even if with a quick calculation we can translate one into another. And not everyone will make this translation the same way. There are many factors that impact how we think about translating the value of time into a monetary amount. While each of us has an identical number of hours in a day, admittedly with different amounts of 'free' time, not everyone has the same amount of money. While we might be able to go out and earn more money, there is arguably no way to go out and simply find more time.

One way to try and quantify the value of an hour may be to assess how much someone else is willing to pay for it, i.e. one's hourly earnings. But this will vary across individuals. The 19th century American writer and philosopher, Henry David Thoreau said: "The cost of a thing is the amount of life which is to be exchanged for it". This is also something unique to each person.

People also tend to approach decisions that involve time differently to those that involve money. For example, they can apply heuristics to simplify the process of estimating time to one that requires little cognitive analysis. Heuristics are "strategies of simplifying judgments that allow individuals to make decisions under suboptimal circumstances" and may lead to responses based on a gut reaction rather than a reasoned and calculated assessment. We are more likely to apply heuristics when thinking in terms of time, rather than money.

Context specific

These questions were asked in the context of a broader survey about the environmental impact of spending and consumption. Given this, it's worth noting that a desire to be seen as socially responsible may have influenced responses. Some may have said they would have invested in solar panels in either the monetary or time state to appear more contientious. The differences between how the questions were phrased are however interesting.

Previous research suggests that opinions and cognitive processes can be shaped, to some extent, by the wording of a question. Even if the values in a question are equivalent to one another, or lead to the same results. In this scenario, both groups had equivalent options to choose from, yet when we asked whether people would invest in solar panels with a return on investment described as an annual percentage of their energy bill saved, they were more likely to make the investment than when the return on investment was described in terms of the length of time it would take.

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