

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

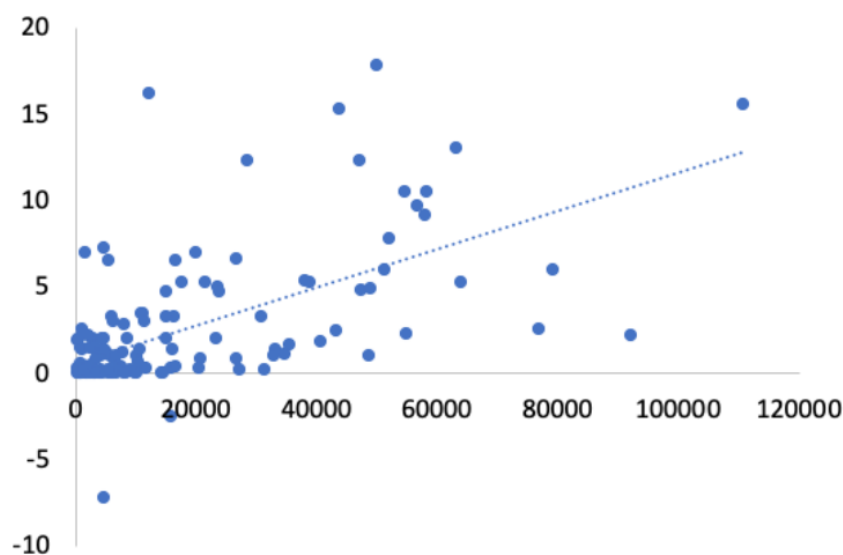
The COVID-19 outbreak emerged in Wuhan, China in December of 2019 and still persists globally. In addition to human suffering and loss of lives, the outbreak has generated a major global economic downturn. The world's largest economies (the G7 and China) are among those that have been most affected by 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 disproportionately 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.

The full original article first appeared on VoxEU [here](#). The article is based on a research paper first published [here](#).

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz
Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebvre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

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

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

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

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

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

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

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

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

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

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

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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](#).

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte

Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee
kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant

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

Sander Burgers

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

Lynn Song

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

Michiel Tukker

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

Michal Rubaszek

Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea

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

Marine Leleux

Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research
coco.zhang@ing.com

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

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

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

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

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

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

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

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

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

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

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

Edse Dantuma

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

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

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

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

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

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

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

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

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

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

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.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research
coco.zhang@ing.com

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

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

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

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

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

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

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

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

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

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

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

Edse Dantuma

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

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

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

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

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

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

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

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

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

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

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 contentious. 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.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist
alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte

Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee
kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant

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

Sander Burgers

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

Lynn Song

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

Michiel Tukker

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

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

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

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

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

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist
raoul.leering@ing.com

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

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

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