

## Reasons to be cheerful, part 3

Our rates' team is relatively optimistic about 2021. As for FX, things should start to look a bit more normal as the dollar's pull fades. And with apologies to Elvis Costello, 'a bit of grin and bear it, a bit of come and share it'... what to expect from the ECB. Oh, we've also got Padhraic Garvey on our podcast

### In this bundle



FX

#### 2021 FX Outlook: Back on Track

2021 will be the year that FX markets get back on track, as the gravitational pull of the dollar fades. We forecast the dollar to broadly decline in 2021...

By Chris Turner and Francesco Pesole



#### Rates Outlook 2021: Money for nothing

Our outlook for rates in 2021 is relatively optimistic. That said, there are numerous drags that will contain those market rates. A large debt overhang is...

By Padhraic Garvey, CFA and Benjamin Schroeder



#### ECB: Preparing for December action

The minutes of the October ECB meeting display the central bank's concerns about the economic and inflation outlook but give very little away in...

By Carsten Brzeski



#### Listen: Don't worry about the debt, yet

UK Chancellor Rishi Sunak has laid the groundwork for tackling Britain's unprecedented surge in borrowing, which is set to hit a peacetime record of...

By Padhraic Garvey, CFA and Rebecca Byrne



## What weak bank lending and strong deposit inflows mean for the ECB

Bank lending growth dynamics continue to diverge between countries, while strong deposit inflows put increasing pressure on bank interest margins

By Suvi Platerink Kosonen



## Transport & Logistics

### The buses of the future: Another Covid-19 casualty

Electric buses are the future of public transport as many European countries decarbonise their economies. But the coronavirus crisis has dramatically...

By Rico Luman

# 2021 FX Outlook: Back on Track

2021 will be the year that FX markets get back on track, as the gravitational pull of the dollar fades. We forecast the dollar to broadly decline in 2021 - generally by 5-10% against most currencies



Source: Shutterstock

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Report | 19 November 2020

# Rates Outlook 2021: Money for nothing

Our outlook for rates in 2021 is relatively optimistic. That said, there are numerous drags that will contain those market rates. A large debt overhang is one. Pushing in the other direction is re-pricing from heavy supply and a potentially jumpy inflation dynamic



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Snap | 26 November 2020

## ECB: Preparing for December action

The minutes of the October ECB meeting display the central bank's concerns about the economic and inflation outlook but give very little away in terms of what it wants to do at the December meeting. We think an extension of favourable TLTROs, an increase in PEPP by up to 500bn euros and an emphasis on the role of the asset purchase programme will be on the cards



Source: Shutterstock

The minutes of the ECB's October meeting confirmed the central bank's alertness on the weakening economic outlook, the impact of the second lockdown and the potential downward revisions of the ECB's projections. The minutes echoed the official wording at the October press conference that the risks surrounding the growth outlook are "clearly tilted to the downside".

During the discussion, the ECB did not only touch upon the short-term outlook but also emphasised: "the possibility that the pandemic might have longer-lasting effects both on the demand side and on the supply side, reducing potential growth". Also, the ECB showed concerns that the crisis could have longer-term effects on balance sheets of firms, households, banks and governments. In the discussion on policy instruments, ECB members highlighted both the TLTROs and PEPP as the most effective policy instruments.

*The Austrian central bank governor Robert Holzmann today broke the alliance, stating that a lower deposit rate wouldn't have any effect on the real economy*

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With exactly two more weeks to go until the next ECB meeting, the unity in official comments has been impressive. After the October meeting and Christine Lagarde's de facto commitment to deliver new policy action, the only question has been 'what' and not 'if' the ECB is going to do. Today's minutes and official comments so far have hardly given away anything.

Having said that, the Austrian central bank governor Robert Holzmann today broke this alliance, stating that a lower deposit rate wouldn't have any effect on the real economy.

In our view, we think the ECB will mainly focus on TLTROs and the PEPP as screws to turn on 10 December.

Focusing on these two instruments would be a continuation of the crisis mode and will probably be the best way forward to receive support from the ECB hawks, who in turn want to prevent the crisis measures from becoming permanent.

In short, an extension of (even more) favourable TLTROs, an increase in the PEPP by up to 500bn euro to ensure quantitative easing purchases continue at least until the end of 2021 as well as emphasising the role of the Asset Purchase Programme (the 'old' QE programme) in sustainably pushing up inflation look like the most likely outcome of the December meeting.

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Podcast | 26 November 2020

## Listen: Don't worry about the debt, yet

UK Chancellor Rishi Sunak has laid the groundwork for tackling Britain's unprecedented surge in borrowing, which is set to hit a peacetime record of almost £400 billion this year. But is it too soon to be worrying about the spiralling debt load? In this podcast, ING's Padhraic Garvey shares his thoughts



In his one-year spending review, the UK Chancellor described record debt levels as "unsustainable", noting that Britain has a "responsibility" to address public finances once the economy recovers. In the meantime, he's frozen public sector pay and cut the foreign aid budget.

Concern about the mountain of debt that Covid-19 has left in its wake is not just confined to the UK. In the US, some Republicans are also urging fiscal restraint.

[In this podcast](#), ING's Senior Editor Rebecca Byrne asks Padhraic Garvey, ING's Regional Head of Research in the Americas, if it's wise to start thinking about fiscal consolidation, as the global economy remains firmly in the grip of the pandemic.

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Article | 26 November 2020

# What weak bank lending and strong deposit inflows mean for the ECB

Bank lending growth dynamics continue to diverge between countries, while strong deposit inflows put increasing pressure on bank interest margins



Source: Shutterstock

## Bank lending to business remains strong only in Italy

Today's October ECB monetary data shows that bank deposit inflows remain elevated, while net bank lending to businesses was weak in most countries. Lending to households has been holding up well this year, while business lending has understandably displayed large fluctuations. In fact, net bank lending to businesses has been around zero or even negative since the summer in most countries. France and Italy stand out though.

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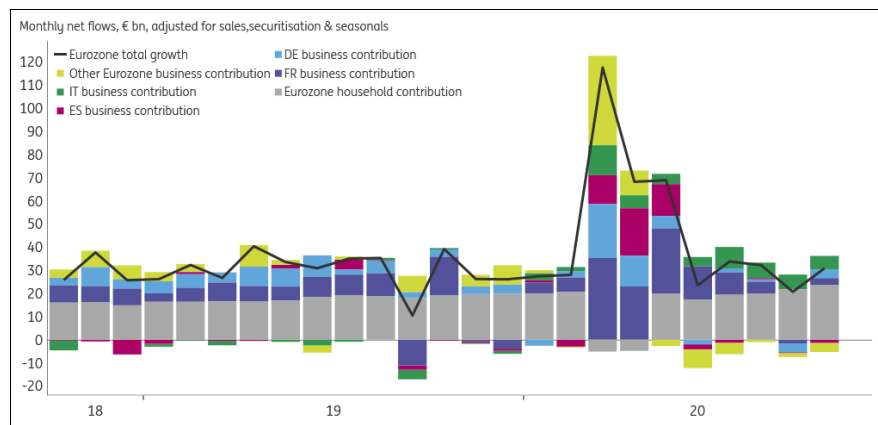
*In Italy, businesses continue to borrow heavily from banks*

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In France, net bank lending to business was very strong and remained so for longer than elsewhere, only dipping below zero in September and slightly recovering in October. In Italy, businesses have continued to borrow heavily from banks, with only a slight deceleration visible

over the past few months. It shows in the substantial contribution of Italian business lending to the eurozone total in the chart below.

## Eurozone bank lending to households and non-financial businesses



Source: ECB, Macrobond, ING

It is interesting to note that in the ECB Survey of Access to Finance of Enterprises, published this Tuesday, SMEs in Italy and the Netherlands were the least pessimistic about the expected availability of finance (see [our coverage](#)), likely for very different reasons.

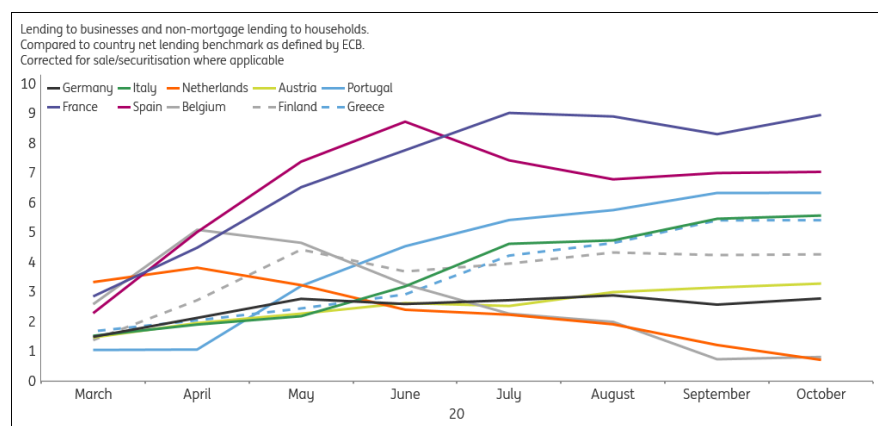
*SMEs in Italy and the Netherlands are least pessimistic, but for very different reasons*

Italian businesses appear confident that bank facilities remain available to them, and indeed lending data proves them right so far. The relative optimism of Dutch businesses on the other hand can be explained by the fact that, on average, they have much lower financing needs in the first place, no doubt helped by direct grants and tax credit extended by the government. Dutch government support is provided less via government guaranteed loans compared to some other countries. Consequently, business demand for bank lending has been low in the Netherlands, translating into net negative bank lending there.

## Most countries on track to meet TLTRO benchmark, but not all

Which brings us to the implications of today's figures for banks' prospects of attaining the TLTRO benchmark. In order to qualify for the most attractive TLTRO-III borrowing rate of -1% between June this year and next, banks would need to exceed their lending benchmark (0% in most cases) in the "special reference period", which is the 13-month period running until the end of March 2021. Banks in France, Spain and Italy are showing the strongest lending growth so far and are very well positioned to obtain the most attractive TLTRO-III lending rates. Net interest income of banks in these countries may get substantial support from the very attractive TLTRO lending rate. Realising the most attractive -1% TLTRO lending rate in Belgium and the Netherlands is becoming increasingly challenging.

## Cumulative TLTRO-eligible net lending growth since March '20, %



Apart from the “special reference period”, the ECB has also set a longer-running “second reference period”. The picture is little different there however, with the Netherlands now at the benchmark and trending down, while most other countries remain above. For Benelux banks, realising the -1% rate may prove difficult even though we note that bank-to-bank differences may be substantial. Apart from weak business lending demand, some Dutch banks are in the process of driving down parts of their lending books as part of larger strategic shifts reflected as downward pressure in loan books.

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*Meeting none of the TLTRO benchmarks would probably lead to prepaying of TLTRO funds*

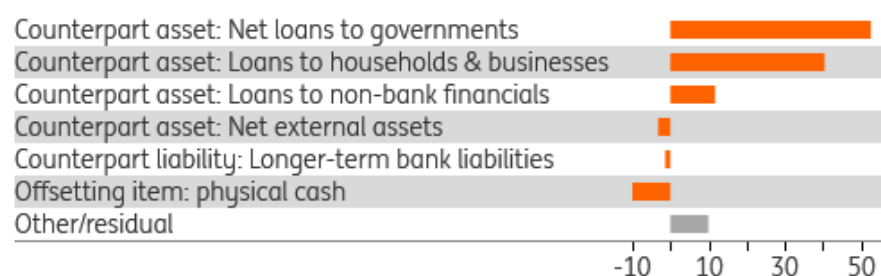
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Meeting none of the lending benchmarks means that a bank would, after the special interest rate period ends, face its TLTRO rate rising from -0.5% to 0%. In most countries this would mean, in our view, that that the bank in question will look into prepaying the funds early, i.e. for the first five tranches in September 2021.

## High deposit inflow causes another headache for banks

While bank lending has decelerated since the summer, the inflow of bank deposits has held up. This poses a problem for banks: with little bank lending volume generated, the excess deposit inflow will have to be “parked” at the ECB at a marginal -50bp in many cases. In fact, since March this year, for every additional euro parked at a bank, on average only 40 cents is lent to businesses and households.

## Counterpart items to bank deposit increase since March '20 (%)



Source: ECB, Macrobond, ING-calculations

Monetary geeks and accounting fans may wonder: how is this at all possible? How can deposit inflow remain high while net bank lending has come down? From a monetary perspective, aren't deposits in fact created by lending? Indeed most money is normally created by commercial banks' lending. However, the word "normal" ceased to apply to monetary dynamics some time ago. Since the ECB started quantitative easing, it opened a new channel of money creation. In fact 40% of the deposit inflows in the years 2015-2019 find their origin, not in commercial bank lending but in Eurosystem government bond buying. This ECB-government channel has become even more important since March this year.

# 53%

of the €995bn of new bank deposit inflows since March can be attributed to Eurosystem government bond buying

Eurozone governments have been borrowing heavily, issuing bonds that have by and large been bought (on the secondary market) by the Eurosystem. Governments have passed on the money thus created directly to businesses and households. As such, since March, 53% of the €995bn of new bank deposit inflows can be attributed to Eurosystem government bond buying. From a commercial bank perspective, these increased liabilities are not matched by asset generation (the bonds move onto the Eurosystem's balance sheet), and hence the funds end up at the Eurosystem, eating away at the banks' interest margin.

### Implications for the 10 December ECB meeting

Given the second lockdown, the ECB is [widely expected to provide additional monetary stimulus](#) at its forthcoming meeting. [Zooming in on the TLTRO-III](#), the ECB could look into extending the programme by providing additional tranches on top of the two that are still left in December 2020 and in March 2021. This would provide banks with additional cheap funding at longer maturities to make sure the ECB's monetary policy does not tighten prematurely. On top of that, the central bank could look at closing the gap between the end of the special interest rate period (June 2021) and the first prepayment date (September 2021), by lengthening the special interest rate period. This would ensure that TLTRO-III participation does not prove too punishing for banks that face a lack of lending demand in their geographic areas due a combination of relatively strong company fundamentals, design of government support frameworks and a longer-running deleveraging trend. A

change in the lending benchmark calculation could be another alternative to better accommodate such factors.

To ease some of the additional pressure from increasing deposits caused by the Pandemic Emergency Purchase Programme and Asset Purchase Programme (even more so if these programmes are expanded), the ECB could adapt the existing deposit tiering system, allowing a larger share of central bank deposits at 0% instead of at the deposit rate of -0.5%.

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# The buses of the future: Another Covid-19 casualty

Electric buses are the future of public transport as many European countries decarbonise their economies. But the coronavirus crisis has dramatically impacted passenger numbers and given all this uncertainty, uptake is slowing



An electric bus on the streets of Barcelona

## Investments are at stake

The Covid-19 pandemic has had a tremendous impact on European public bus transport. Passenger volumes dropped significantly and recovery to previous levels will take several years. As the crisis slashed ticket income and promises to change travelling behaviour, investments are at stake. This slows the transition to electric buses rather than speed it up.

In recent years, the electrification of public buses has been leading the way within heavy-duty vehicles. The EU's fleet of battery-electric buses started accelerating from 2018 and more than doubled to 3,500 in 2019, but growth remained limited to an extra 500 units to 4,000 in 2020 so far (of an estimated 190,000 in total).

This shows Covid-19 is already impacting the transition and there is little doubt that this trend will continue in 2021.



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## *A green recovery might need more government support*

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All this comes at a time when all things electric are becoming increasingly attractive. Several countries have already adopted minimum targets for 2025 and the transition becomes even more important with the focus on clean air and plans to raise the CO<sub>2</sub>-reduction target to 55% in 2030.

Both public transport authorities and operators have been challenged to find a route to fulfil that ambition and keep the transition going. However, with the current uncertainties about future ridership and income, a green recovery might need more government support, especially when private operators are responsible for investments in the fleet.

### 1 The characteristics of the public bus transport market

#### **Public transport is a mature market, but growing within urban areas**

The public bus market is mainly concentrated on shorter-distance public transport and more than 75% of this traffic happens in urban areas. The market is developed and has shown moderate growth in most Western European countries in recent years. Covid-19 now impacts the market dynamics significantly even while the ambition to reduce the footprint quickly grows. As the Netherlands is a front runner in the electrification of the public bus fleet, we take a look at the Dutch situation in more detail.

#### **Public and private interests meet in public transport, government influence differs**

Public transport is vital as a public service assuring connectivity for travellers and visitors. Consequently, it is a blended field where public and private interests meet. Under the [European PSO-regulation](#), the market for public transport has been opened via a system of concessions although in-house procurement is still possible.

Local governments still have a critical stake as a major funder. This means the supply of public transport is highly dependent on the fiscal budget and that gives authorities an influence in the energy transition.

### **Bus transportation volume is determined by multiple drivers**

- **Main short-term drivers**

#### **Employment growth leads to more travellers**

Commuters represent a significant part of travellers in public buses, mostly for distances between two and 30 km and more people commuting results in larger travel flows. Consequently, there's a positive relationship between travel volumes and economic growth.

- **Main structural drivers**

#### **Population growth: Developing urban areas stimulate traffic**

In the long run, passenger transport is directly linked to population growth and urbanisation. Demand for public bus transport increased with the ongoing growth of urban (city) areas and the need to manage the daily travel flows smoothly and efficiently. Due to Covid-19,



this has completely changed, at least in the short term.

**Economic development: More wealth, more car ownership**

Another influential factor is economic development. In countries with a lower per capita income, public bus transport tends to play a larger role. However, when it's affordable people more often will choose to drive their own car.

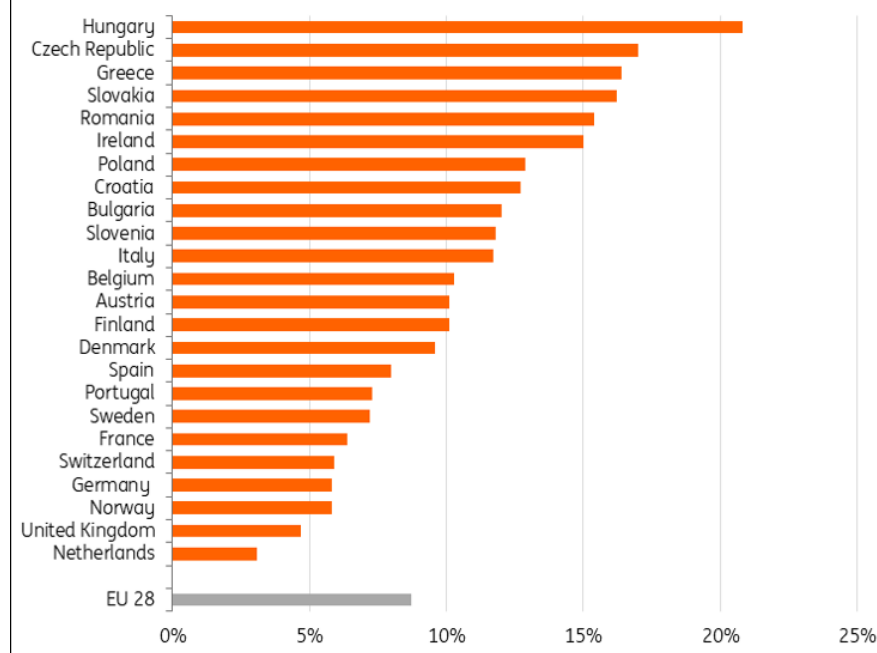
**Availability and ease of alternatives: Getting from A to B is the main objective**

The relative importance of bus transport also depends on the availability of alternatives and local circumstances and (cultural) preferences. In countries with intensive and widely spread train and metro networks in cities, the role of public buses will be smaller. And in the Netherlands, for instance, transport plays a smaller role than elsewhere due to the country's cycling tradition.

## The importance of bus transportation

### Bus transportation relatively important in Eastern and some Southern European countries

Share of bus transportation in the modal split of total passenger km's (2018)



Source: Eurostat, ING Research

## 2 The public transport sector and its green ambitions for the fleet

### Electric public buses are the future; new generation covers 90-95% of the lines

European countries are increasingly adopting the ambition to decarbonise the fleet, improve air quality and reduce emissions to zero.

To reach this goal, battery-electric buses (BEV) are most in focus. The latest models of electric

buses have a range of over 400km which covers probably 90-95% of urban area dominating European public bus connections. The purchasing price of battery-electric buses is still substantially higher than diesel buses (with € 400,000 – 500,000 against € 200,000 – 250,000) and charging infrastructure is required as well.

However, the operational cost of these buses is much lower as electricity is cheaper than diesel, less maintenance is required and the economic life will be longer. In combination with fast charging the new models, electric buses could already be competitively deployed (source: BNEF).

## Battery-electric buses leading the zero emission charge rather than hydrogen

The question is often raised as to whether hydrogen would be a viable option for public bus transportation.

Given the moderate weight of passenger transport buses, the loss of energy in production and the usage of hydrogen and the relatively high total cost of ownership of fuel cell buses, we expect the battery-electric buses to be dominant at least until 2030. Hydrogen might play a larger role in public transportation as well, but heavy users without alternatives, such as the chemical industry, are expected to benefit first when (green) hydrogen production goes up and prices drop.

As soon as green hydrogen is abundantly available the trade-off between electricity and hydrogen might change.

### 3 The size and composition of Europe's bus fleet

#### Share of public buses higher in North-West European countries

The total rolling stock of buses over 3.5 tonnes in the EU adds up to roughly 770,000 units (2018). An estimated 190,000 (app. 25%) of these vehicles are qualified as public transport buses. The remainder is other (privately deployed) buses and coaches.

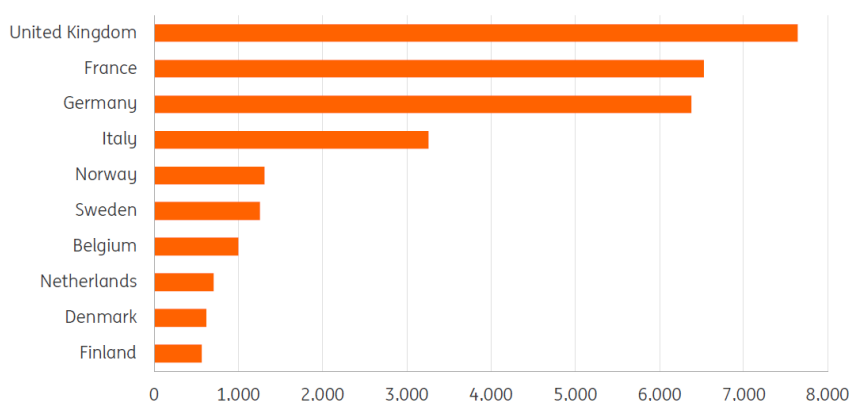
Southern and Eastern European countries such as Greece, Romania and Poland have relatively large but old fleets with a small fraction of public buses. In-service public use in Belgium, the Netherlands and Sweden has a respective share of 48%, 51% and over 70% of the fleet. In new registrations, the portion of public transport buses is relatively high as public buses are intensively used and regularly replaced in concession cycles.

The UK and France are the largest European markets for new buses.

## The European bus market

### France has the largest continental European bus market

Average number of new registered buses 2014-2019 (> 3,5 ton) per country



Source: ACEA, ING Economics Department

## 4 Where we stand on electrification

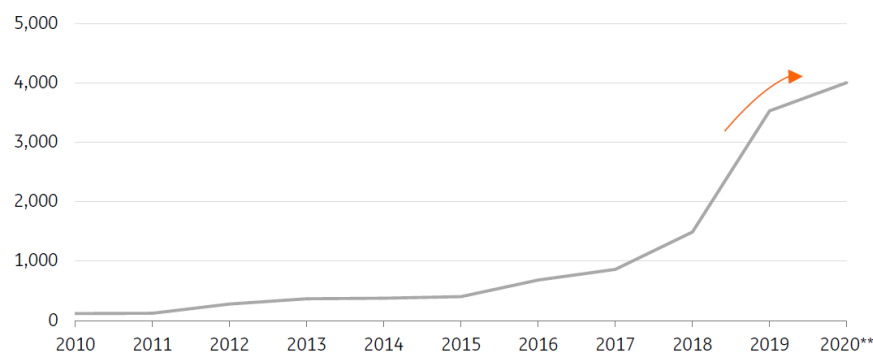
### Electrification of public buses was gaining traction before Covid-19

China is the world leader in the electrification of buses to improve air quality in cities, but in Europe, this process started just five years ago. Before the pandemic, in 2019, the inflow of battery-electric buses accelerated and the total fleet more than doubled from 1,500 to 3,500, but that growth slowed to 4,000 in November 2020.

### The Covid-19 effect on the electric bus fleet

#### The rising numbers of the battery electric buses in Europe slowed in 2020

Total electric bus (BEV) fleet in the EU\*, excluding trolley buses



Source: EAFO.EU

\*Excl. UK \*\*YTD 17/11/20

## The Netherlands leads the way in Europe

The Netherlands leads the way in the electrification of public buses following the ambition to meet the 100% zero-emission target for new registrations by 2025 and decarbonise the full fleet by 2030.

In 2019 more than 40% of total new registrations were electric buses and with deliveries of pre-Covid ordered buses in 2020, it will probably hit 50%. For public buses, this figure was only

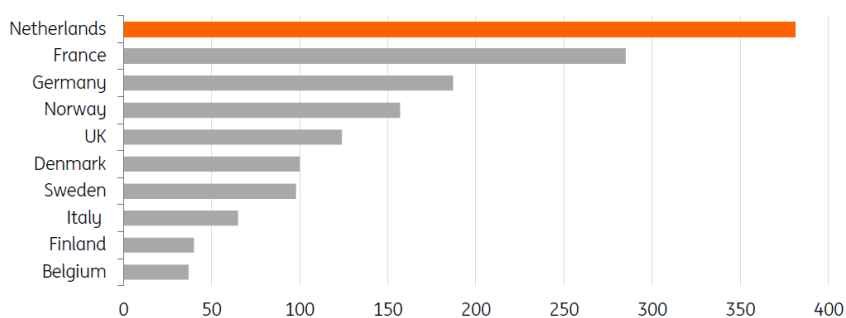
exceeded by Denmark in 2019 (by 60%) and other Scandinavian countries are also making good progress.

In terms of the total number of electric buses, countries like France, Germany and the UK will soon become the largest European markets.

## Electrification in Europe; the Dutch lead the way

### Netherlands leads the way in electrification...

Number of new registered electric buses (BEV) in 2019

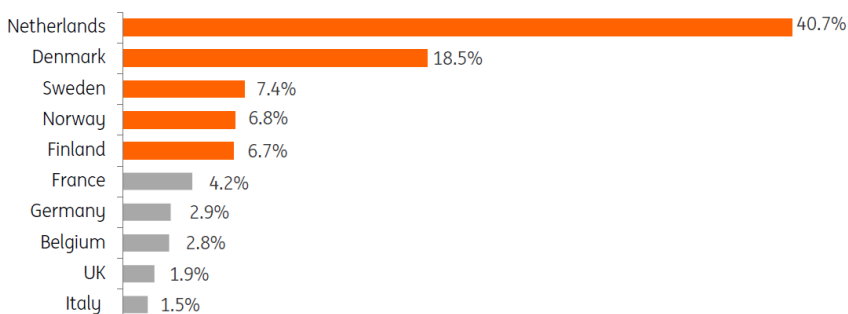


Source: ACEA, ING Economics Department

## And Nordic countries follow in new sales

### ...Nordic countries follow in shares of new sales

EV-shares in total new bus registrations in 2019

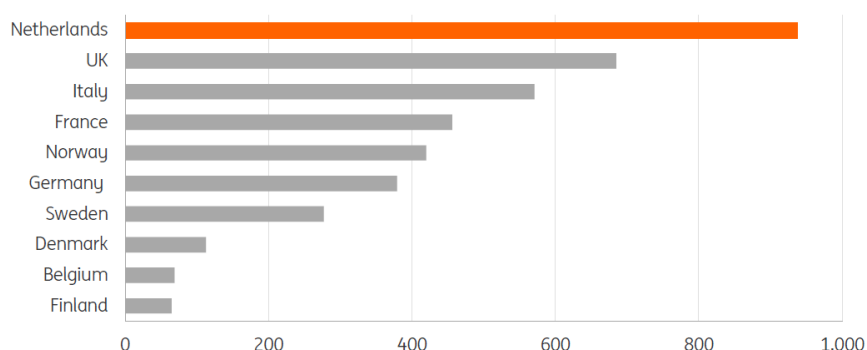


Source: ACEA, ING Economics Department

## Share of electric bus fleet

**Netherlands still have the largest electric bus fleet, major European countries follow**

Total number of battery electric buses (BEV) per country in 2020\*



Source: ACEA, ING Economics Department

\*YTD 22/11/20

## Trolleys still responsible for most of the electric fleet in Europe

Europe has a number of trolley cities, especially in Eastern Europe, but also in Switzerland and Italy. These buses are connected to the electricity grid and won't have to make a shift to zero-emission.

Often cities have a tradition of using trolleys, but nevertheless, to reduce costs, there might be cities which switch to battery-electric in the future. As of the first of January 2020, Europe still accounted for more than 5,000 of these buses (source: CROW-KpVV).

## 5 How Covid-19 has affected the public bus market?

### Passenger numbers dropped dramatically following lockdown measures and changing travel behaviour

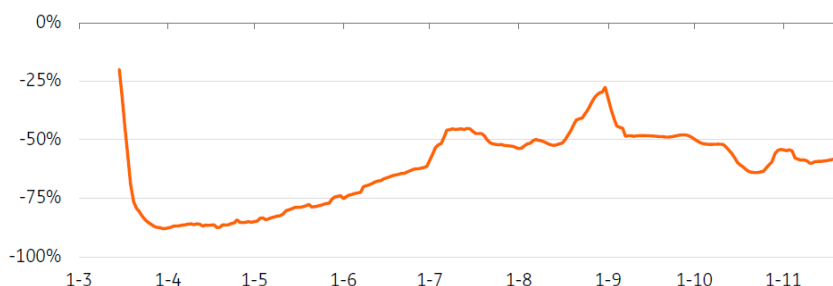
Public transport passenger volumes suffered heavily from Covid-19 and subsequent lockdown measures. As people were discouraged to travel and advised to work from home if possible, they experienced a steep fall across Europe. In the Netherlands, for instance, passenger numbers dropped initially to a fifth of the 2019 levels in the first lock-down phase.

In the UK bus passenger numbers [followed a similar pattern](#). Even in Sweden, which had a relatively mild lock-down, as well as Germany, [the impact was severe](#) with a drop of 40-50%. During the summer there was some revival, but halfway this stagnated and fell back again during the second wave in the autumn.

## Decline in passenger numbers

### Passenger volume stuck below half of normal towards 2021

Development of daily check-ins in public transport in the Netherlands in 2020 year on year



Source: Translink, OV-chipkaart, ING Economics Department

## Recovery of passenger volumes will take several years

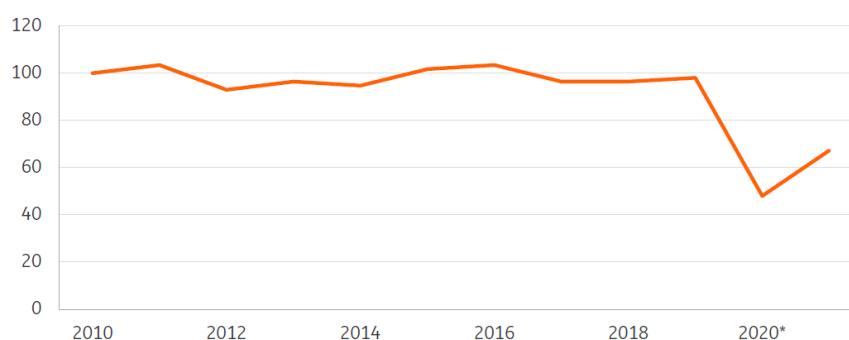
During the Covid-19 crisis, many commuters learned how to work from home and meet via video conferencing. People also chose to cycle and walk more and avoid public transport by using their own car. On the other hand, there might be some shift back to public transport if business lease options are reduced. This [reassessment of travelling](#) will also have its post-coronavirus effect on travel figures, although that effect will differ throughout Europe.

Once a vaccine will be widely available, travellers are expected to return in larger volumes. However pre-Covid numbers are expected to remain out of sight in 2021, which means recovery will take at least several years. It depends on the level of government funding if this will lead to smaller public transport bus fleets.

## A dramatic fall in kilometres travelled

### Public transport faces a mayor setback in the COVID-crisis

Index passenger km's by bus in the Netherlands and forecast (2010 = 100)



Source: CBS, KIM, \*ING Economics department

## Passenger volumes slash variable ticket income

The impact of Covid-19 on public transport operators (PTOs) is unprecedented. In the Netherlands, for example, roughly 35% of the income of PTOs consist of variable ticket income. Fixed costs are relatively high and mainly consist of wages and vehicle costs which makes the setback in volumes hurt even more.

As PTOs have had to cut costs, network frequencies (time schedules), notably in rush hours and at night, are expected to be downsized following lower travel numbers, occupation rates and income. Given the tiny margins in this market, the main question here is how much extra authorities want to spend on public transport to close the financial gap for operators.

## 6 The fate of the fleet after Covid-19

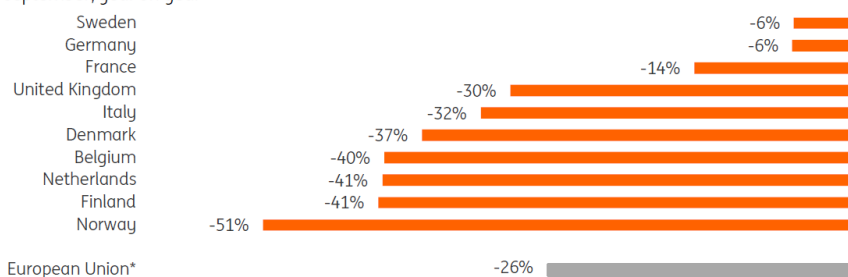
### A significant drop in total new bus registrations in 2020

The Covid-19 crisis is likely to generally lead to reduced investments in new buses. In the first nine months of 2020, registrations of total new buses had already dropped by more than 25% compared to last year. Germany, Sweden and France showed the smallest drop. Given planning limitations, that effect will no doubt be exacerbated in 2021.

## Development of total new registered buses

### Relatively small contractions of new registered buses in Sweden, Germany and France

Development of total new registered buses > 3,5 ton 2020 (including coaches) - up and including september, year on year



Source: ACEA, ING Economics Department

\*Excl. UK

## Uncertainty leads to postponement of investment and lower inflow of electric buses

Currently, there is much uncertainty about future passenger volumes and compensation for PTOs. This makes it difficult for PTOs to give their quotes on new concessions especially when new charging infrastructure is required. This is why various expiring concessions in 2021 and 2022 have been extended in the Netherlands and emergency concessions are implemented. In Denmark and Sweden running concessions have been extended as well.

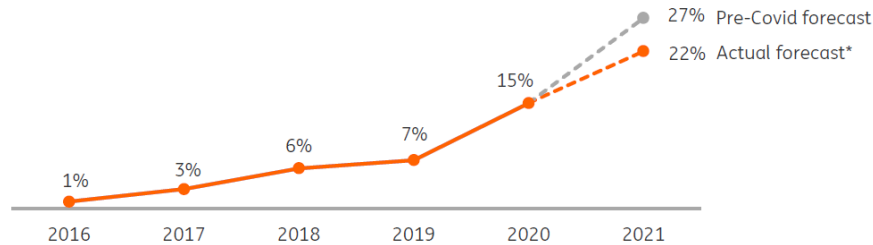
Consequently, the pace of transition to electric buses will continue to slow as the inflow of new buses will be delayed. This will especially be true for countries where private companies own most of the fleet. In countries where most of the fleet is directly owned by companies linked to public transport authorities (PTAs), such as Belgium and Germany, this is less of an issue, although investment might still have to be reconsidered.



## The slow-down in the Netherlands

### Covid delays the inflow of electric buses in The Netherlands

Share of zero emission public buses in the Netherlands per January 1st



Source: CBS, CROW-KpVV

\*raming ING Economisch Bureau o.b.v. CROW-KpVV

## Manufacturers of electric buses face challenges while expected demand is delayed

For manufacturers of electric buses like VDL and Ebusco, delayed investment in electric buses will create serious challenges as orders are postponed and might be bundled in the years after. As various European countries already adopted minimum targets for 2025 and the green vehicle directive comes into force, we expect there will be a catch up prior to that. This means manufacturers need to keep production capacity and the innovative nature of zero-emission buses going while, at least temporarily receiving few new orders. This could be challenging. As soon as the crisis ends, it might be hard again to fulfil the large numbers of new buses about to be ordered.

## Not all actors hit the brakes – some governments already act anti-cyclical

Not all parties in the public transport sector have faced a slow down following the Covid-19 crisis.

In the UK, the government announced an initiative for large investments in green buses in cities as part of a '[green recovery plan](#)'. In the Netherlands, on a local level, the Amsterdam region (VRA) announced extra investment programmes. Given the uncertainty and larger financial pressure on privatised PTO's a difference seem to appear between regions where PTOs are directly connected to PTAs and more market-driven regions.

To keep the green track on pace, more government action would seem to be required when private operators are responsible for investments in the fleet.

In a subsequent article, we will have a closer look at the transition targets, how much electric vehicles will enter the fleet and challenges faced to proceed with the transition.

For this report, we conducted a number of interviews with the following:

- Guy Hermans - Gerard van Kesteren (CROW-KpVV)
- Sanne van Breukelen (DOVA)

- Peter Bijvelds (Ebusco)
- Thomas Cuingnet – Bruno Lapeyrie – Julie Watremez (Keolis)
- Peter de Raadt (Transdev Netherlands)
- Aida Abdullah (UITP)
- Ard Romers – Jan van Meijl (VDL)

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