ING-DiBa positions

Saving in a low interest rate environment

December 2016

„Interest rates are very low at the moment but it still makes sense to save and set money aside for major purchases and retirement. We support our customers with flexible savings products and cost-effective ways to invest in stocks and bonds."

Nick Jue
Chief Executive Officer

Will ING-DiBa introduce negative interest rates?
For savings customers using our Extra-Konto – ING-DiBa's overnight deposit account and core savings product – we offer an interest rate which is generally above the market average. Should market rates continue falling, the bank could still reduce the interest rate paid on savings deposits. That means there is currently no intention to introduce a negative interest rate for ING-DiBa's private customers.

What are our aims?

- **Enable our customers to manage their own personal financial planning –** we help them with straightforward products and clear information.
- **Offer our customers fair, market-oriented investment conditions –** and pass on lower interest rates to the lending side as well.
- **Help our customers to build up their retirement assets in simple and cost-effective ways –** with both one-off investments and savings plans.

The low interest rate phase: causes and effects

For several years now, the European Central Bank (ECB) has been pursuing an expansionary monetary policy with the aim of stimulating the European economy. As a result, interest rates have fallen to a historically low level. Many experts expect this situation to continue.

There are various consequences for consumers:
Many banks are offering virtually no interest on savings deposits. The same applies to investments in ten-year German government bonds. Better returns are only available from riskier investments. Long-term low-interest rates are also a major problem for retirement savers. Many savings plans are based on long-term capital generation and the compound interest effect. The lower investment yields reduce the final capital of these plans – and leave savers with a smaller nest egg. This affects not only private savings plans, but also occupational pensions. The negative consequences of low interest are somewhat alleviated by the fact that consumer prices are barely rising: the inflation rate is below 1%.

Borrowers can benefit from the low interest rates: there are already fixed-rate ten-year mortgages available with an effective annual interest rate of well below 2%. And the rates for normal consumer loans have never been lower.

The low interest rate environment also has wide-ranging consequences for banks:
Banks have two main sources of income: interest income and service fees such as account charges. Interest income is the difference between the interest earned by the bank in the lending business and the interest paid by the bank to its savings customers. The low interest phase has put the margin between investment rates and lending rates under severe pressure. Many institutions have suffered lower earnings. The effect can be offset by an expansion of the lending business but, since almost all banks want the same thing, the market is highly competitive. Furthermore, the demand for credit is limited; large companies often have enough own resources for investment.

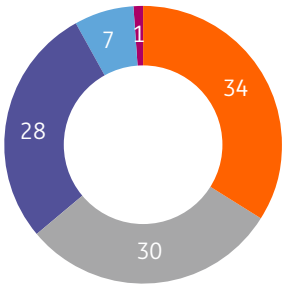
Traditionally, funds that the banks cannot place in the lending business are invested partly as liquidity reserves at the central bank. But whereas that used to earn interest it now costs money: the ECB currently charges banks a negative interest rate of 0.4% p.a. for deposits. Many banks are currently seeking a way out of this income problem by raising or introducing account management fees.

In our opinion, this approach will not result in a permanent stabilisation of bank sector earnings. What we need, in this increasingly digitised world, is a significant increase in the efficiency of the banking business. This includes, in particular, a reduction in costs. ING-DiBa has already applied this approach successfully in recent years.

Negative interest rates – How would customers react?

Will we see a large-scale implementation of negative interest on bank deposits in 2017? Almost 60% of the 3,600 bank customers canvassed by the Centre for European Economic Research (ZEW) on behalf of ING-DiBa believe this to be possible. This expectation and the sustained low interest rate phase already have their consequences: 40% of the interviewees have changed their behaviour and now save less or not at all. This is problematic, especially for people with a relatively low income and low financial wealth. If negative interest rates are actually implemented, large market changes will quickly follow: 95% of savers say they would change their overnight deposit account or seek better profit opportunities in longer-term or higher-risk investments.

How likely is it that banks will introduce a negative interest rate on current accounts and savings accounts over the next 12 months?



- very likely
- probable
- not probable
- very unlikely
- no answer

Total answers: 3,575

What is the "real interest rate"?

What savers really earn from their interest yield incomes depends to a large extent on the rate of inflation. For example, if a savings account offers a yearly interest of 4% and inflation during this period is 3%, the real interest rate is 1%. This value expresses the real increase in purchasing power achieved by the saver. In the past, there have been periods when the real interest rate was negative, because the inflation rate was higher than the interest rates on savings. The fact that the interest rates were then significantly higher than today, does not change anything.

Financial planning in a low interest rate phase: what can consumers do?

1. Build up an emergency reserve

A car breakdown or a defective fridge should not cause a financial squeeze. Every household should set up a rapidly available reserve for emergencies. As a rule of thumb, it should be at least two or three net salaries.

2. Pay off debt before you invest

If there are outstanding loans, savers should check whether they can pay them off early with available capital. This not only reduces existing debts: if the credit rate is higher than the investment rate, repayment also results in a better return.

3. Save for planed expenses

Normally, when it comes to large acquisitions like buying a house, part of the purchase price has to be saved up beforehand. In this case, the shorter the accumulation period available, the less susceptible to fluctuations the selected savings system should be.

4. Build up an additional pension provision

There are additional ways to secure one's retirement, in addition to the statutory pension system: with tax concessions, such as occupational retirement plans and the Riester pension scheme, or on a purely private basis. It often makes sense to mix different forms of savings and investment. The low interest rates make investing in securities of different risk classes increasingly important. And owning debt-free property is for many an important element in their old-age provision.

Tip: Independent advice on appropriate individual investment and pension strategies is available from consumer organisations (verbraucherzentrale.de).

With more than eight million customers, ING-DiBa is Germany's third-largest retail bank. Its core retail banking services are savings, securities, mortgage lending, consumer credit and current accounts. The bank is accessible to its customers every day, around the clock. ING Wholesale Banking takes care of corporate clients, including large, internationally operating companies, the public sector, banks, insurance companies and other institutional investors. More than 3,700 employees work for ING-DiBa at its offices in Frankfurt (headquarters), Hanover, Nuremberg and Vienna.

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ING-DiBa AG **Public Affairs**
Theodor-Heuss-Allee 2
D-60486 Frankfurt am Main
positionen@ing-diba.de

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