Banking on Prudence

By Simon Carswell

Trinity Economics Professor Philip Lane reflects on life after academia, the economic risks facing Ireland and four post-crisis years at the helm of the Central Bank before his move to become Chief Economist at the European Central Bank in Frankfurt.

There is a painting of a west of Ireland landscape by famed artist Paul Henry hanging in the office of Central Bank Governor Philip Lane. It sets the pale blue and grey colour scheme throughout the bank's interior on Dublin's north quays.

This should not be interpreted as a sign that everything emanating from Lane's office sets tone and policy too among the 2,000 staff working up and down the eight-storey building on North Wall Quay.

Looking back on his four years leading the Central Bank before he becomes the European Central Bank's Chief Economist in Frankfurt, Lane prefers to see one of the most powerful roles in Irish public life as similar to the position he previously held as a Professor of Economics at Trinity: as a collaboration.

Like his time at Trinity, Lane sees colleagues at the Central Bank as collaborators and the bank as a "knowledge institution". The main difference between them is scale: where he worked with up to six people in academia, specialising in international macroeconomics, he works with dozens across the bank.

"My life is not that far different to my Trinity life because in the end, it's trying to understand what's going on in the economy, trying to use economic analysis to make sense of the world," he says.

Lane buys into the simple theory of British economist John Maynard Keynes on the relevance of academic research: in the end, "we are all the slaves of some defunct economist" and that "ideas do matter".

In central banking, the week-to-week, month-to-month decision-making and access to information – be it the detail of every mortgage loan or, from this summer, every major commercial loan across the EU – makes the role more immediate and "invigorating" with "a more direct type of engagement with the world".

Lane is excited about the collaborators he will work closely with in his next role at the European Central Bank (ECB) and the "intellectual firepower" that will surround him in Frankfurt, which he describes as "extremely impressive".

A month before taking up the influential new role in Europe in June 2019, Lane reflects on the completion of another tumultuous phase of change at the economic watchdog that has to supervise not just the behaviour of banks and financial institutions, but monitor the wider economy for signs of risks and overheating. New Zealand Treasury Head Gabriel Makhlouf takes over as the 12th Governor of the Central Bank in September.

To say the job, in the wake of one of the world's worst financial crises, came with pressure is a massive understatement. Lane succeeded another Trinity academic, Patrick Honohan, in 2015, breaking decisively the tradition of picking a senior civil servant to run the bank. Honohan took charge at the height of the crisis, taking over as the property and banking sector crashed. Lane has had to maintain a careful watch.

While the recovery in the economy is apparent – however uneven it may be geographically across the country – Lane does not believe the light over the Irish economic system is flashing red or green, but amber. There are still "corrective measures" required to protect against risks in the system, he says.

"To some people, what we see now is that the economy has recovered, the crisis was horrible, but let's make sure it never happens again, and let's assume it'll never happen again. And if you assume it will never happen again, you will complain about high mortgage rates, because you think why would we still be in high rates, even though the crisis is over, even though a lot of reform has happened," he says.

"The amber light view of the world is: yes, we have gone through a lot, we're not in a red zone, but no analyst, no bank anywhere, when they look at the Irish market is going to forget the crisis."

Lane is not fearful of another property crash. Housing prices are "still far below peak," he says, and the effects of loan-to-income restrictions "seem to be kicking in". The banks are less exposed to the sector than during the Celtic Tiger era, as much of the commercial property development is funded by the international sector. If a downturn came, the banking system would be much more able to absorb "that reversal".

"The first order of business is to say: if such a reversal happens, let's try and build a lot of buffers, so it doesn't lead to that kind of amplified crisis," he says.

This is where Lane's "macro-prudential toolkit" comes into play. It is one of his legacies he is most proud of from his time at the Central Bank. Interest-rate setting and other monetary policies moved to the European centre in Frankfurt, depriving national central banks of a powerful tool to act quickly, but Lane believes preemptive measures can still be taken at a national level to ward off an acute crisis.

These are restrictions applied to the supply of credit, forcing the Irish banks to set aside more capital in the good times so they are ready for the bad.

"That was the big motivation for why I wanted to take on this job. I am convinced that national central banks are more important than ever for these reasons," says Lane.

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Philip Lane,
Outgoing Governor
of the Central Bank

About Philip Lane

Philip Lane started at Trinity in 1987. He was a Scholar in Economic and Social Studies and was the top-ranked Economics student when he graduated with first-class honours and a gold medal in 1991. He received his Ph.D. at Harvard University in 1995 and then became Assistant Professor of Economics and International Affairs at Columbia University from 1995 to 1997. He returned to Trinity in 1997 where he ran the Department of Economics. He was Professor of Macroeconomics and Director of the Institute for International Integration Studies. He remains affiliated with Trinity as Whately Professor of Political Economy and has been on leave from this position while Governor of the Central Bank and Chief Economist at the European Central Bank.

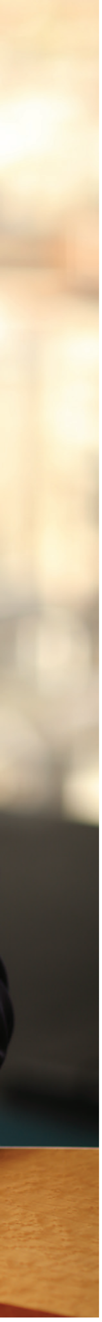

Photo: Courtesy of the Central Bank

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There is another tool Lane wants in the kit. He believes banks should hold extra capital to protect against systemic risks facing the economy. Surprisingly, those risks do not relate to Brexit. The UK's departure from the EU will, "wherever it ends up," be an economic negative, he says, but Ireland's open economy means populism and anti-globalisation pose bigger challenges for the future of the multinational sector that Ireland relies so heavily on.

"Trade, tax and those other things – they're actually bigger issues. They are less visible. They are a little bit more abstract but the Irish economy is much more dependent on the future of the multinational sector than it is on the range of possibilities of Brexit," he says.

Although Lane has sat on the ECB governing council as Central Bank Governor, his new role on the executive board puts him in a powerful agenda-setting role on the eve of change at the institution. Italian Mario Draghi retires as ECB President in October 2019 at the end of an eight-year term. France's Christine Lagarde, International Monetary Fund boss, has been nominated as the next President so, with Lagarde coming from another big country, will Lane be in a critical role coming from one of the smaller states?

"That really is not the way it works," says Lane. He points out that even the physical layout of their meeting room, with seating arranged in alphabetical order by first names, stresses the importance of hearing all opinions equally.

"It is an effective reminder that you are there as individuals. It is not acceptable even to phrase any kind of argument in that kind of national perspective," he says.

Lane says that by training and inclination he tends to come up with "synthetic positions" to challenge two different extremes in opinion where a solution is "much more likely to be somewhere in between".

"Economists are accused of having two hands," he said, referring to their oft-ridiculed 'on the one hand and on the other' equivocation. "I think that's a positive, not a negative".

Despite the requirement to shed his green jersey in Frankfurt, Lane still sees the ECB as an "Irish institution" and a "shared institution" because the country has chosen to share monetary policy with 18 other countries and Ireland is a part of that.

"There are about 100 Irish staff there. We make a lot of contributions to how this works, and that is a very important part of being committed to the EU," he says.

ABOUT THE AUTHOR

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Lane's Biggest Challenge as Central Bank Governor: The Tracker Scandal

The banking crisis may be in the rear-view mirror, but the behaviour of the banks is not.

Lane's term at the Central Bank was dominated by the tracker mortgage scandal, where banks deprived customers of the chance to stay on or move back to a low-cost interest rate that tracked the ECB rate. He was criticised for not moving fast enough and forcing banks to recognise the problem and fix it earlier. At last count, almost 40,000 customers were affected and the public heard horror stories of people losing homes in a scandal that is set to cost the banks more than €1 billion and millions of euro more in fines.

Lane admits in hindsight that the banks could have moved more quickly and that they should not have made people who lost so much money wait as long as they did.

"The best way for this to run was the banks move quickly on a voluntary basis. The fact that we had to intervene more aggressively was regrettable, but it had to be done and we did it," he says.

The outcome has "shown the power of the Central Bank" and that it is willing to stand up for consumers, he says.