Philip R Lane: Q&A with Fortune

Q&A with Mr Philip R Lane, Member of the Executive Board of the European Central Bank, and Fortune, conducted by Ms Maithreyi Seetharaman at Fortune Global Forum, Paris, 18 November 2019.

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The following is a transcript of an on stage question and answer.

This is almost a time of new beginnings in Europe in many, many ways – especially as of 1 November – but it's new beginnings for you as well. It's been six months since you joined the ECB as its Chief Economist, and a big role change going from the Governor of the Central Bank of Ireland to now looking at the eurozone as a whole. Here's a curiosity question: the ECB had a retreat just a few days ago and it was in a very grand palace – probably grander than this – to build fences, get to know each other. What's the new leadership of the European Central Bank looking like, with fresh blood like yours and Ms Lagarde's?

I think the way to think about it is, the Governing Council meets all the time. The people in the Governing Council actually meet each other even more frequently through the IMF, ECOFIN, the Bank for International Settlements. But what is true is that the Governing Council has the six of us in Frankfurt and then the 19 Governors. When we spend time together in meetings, we're busy. We have decisions to take, so what is true is that these years have been quite busy. In the four years I've been in the Governing Council, there's not been the opportunity to have that kind of retreat. I'm sure every organisation here, you have these every so often, especially when there's a new leadership. Let me emphasise: this year it's not just the fact we've a new President or that I've arrived. Of the 25 members of the Governing Council, I think by the end of the year a majority will be new. And at the Executive Board there'll be two new appointments, we think, starting in January, with Fabio Panetta and Isabel Schnabel.

So it is a time for a new team and it's important, especially when we have so many medium-term challenges as well as the short-term day-to-day, meeting-by-meeting decisions, there are a lot of medium-term challenges over the next eight years for all of us. So it's good to have that kind of retreat and that time to have some informal discussion.

I know a lot of people are curious about how maybe the structure and the operational side of decision-making at the European Central Bank could potentially change. I know there are a lot of voices – especially amongst the fresh blood that is coming in – of wanting it to look a little bit more like the Fed or like the Bank of England. Do you see that kind of openness coming into play when decision-making is made going forward? Do you see that playing a role in the way Europe looks at the European Central Bank?

There's a lot in that question. Let me differentiate between the formalities of decision-making, where the tradition – I think it's a very strong tradition – is, where we can, to make decisions by consensus. And actually, most of the time monetary policy is not that divisive. Most of the time I think we can achieve that. But what is true is, when you have different voices, new voices, how do you have a debate that adds light as opposed to noise? Because it's not a good idea to have – in any system – signals which are hard to interpret. It's very important for monetary policy that there's a clear narrative, there's a clear understanding of what we're up to. And so I do think, collectively, it's fine to elaborate where you have a different point of view. But we also have to emphasise that we also make decisions. So we've got a decision, and I think it's important to say the most important element of that decision was achieved by consensus.

The most important element of the decision in September was: we need to add extra

accommodation in our monetary policy, that inflation is too low and we need to demonstrate our commitment to having inflation move back towards its target sooner rather than later. After that, the details of which instruments we use, of course, with 25 members and…

You can't really have consensus.

… many choices, there is going to be a range of views, but all of that is secondary to the fact that there was consensus that a monetary easing of some type was needed.

Well, let's talk a little bit about where there is no consensus and there is no clarity – which would be Brexit – and that would be quite an interesting conversation to have. We've been talking about Brexit, the impact on the sterling. What is the position when it comes to the European Central Bank as we edge closer and closer to the UK elections, with not that much clarity still in place of whether we do a no deal, whether we get some sort of a deal that Mr Johnson's kind of agreed to? What are the red flags for Ireland and for the eurozone at this point and what needs to happen for those red flags to become yellow or green?

Let me emphasise, from the euro area perspective, that in terms of planning we plan for all scenarios. As of now, because there is a draft deal, the worst-case scenario of a disorderly Brexit is less likely. But even if it did come back on the table, the ECB and the Bank of England have worked very closely together in the last two years. It's not like this is a surprise; Brexit has been announced openly.

Ad nauseam.

Exactly, so it would be unforgiveable for the central banks not to be ready as far as we can be ready. So that kind of risk of discontinuities, something not working overnight – that is handled. But from the economic point of view, the big issues are going to be, what does this mean for future output, future trade – for the UK, most importantly. Remember, this is a disruption primarily for the UK. Of course, as a close neighbour, it's important for the euro area, but percentage-wise less; the UK is 13%, some number like that, of EU GDP. So something that's a big deal for the UK is a big deal for the rest of the euro area, but proportionally less.

Are you worried about Ireland at all and this back and forth which seems to have…

Of course, we are. The Irish economy is going to be the most affected, but this is the context of an Irish economy that is growing quite quickly, of an Irish economy which now has trade and investment links with the world – as you know – most famously with the US economy. One of the big pieces of news from the draft deal was the fact that there is now a sustainable approach, I think, to handling Northern Ireland in terms of the economics of reconciling no border on the island of Ireland, while maintaining the integrity of the EU single market.

I wanted to open this up to everyone in the audience because it's rare to get an opportunity to speak to him directly, so Philip is here. If you have a question, please raise your hand. We'll get the mics to you. Do let me know. Otherwise, I have plenty of questions to go on with. We'll come back at some point to check in and see if the folks here do want to ask you a question. But it brings back a question of the number of risks. I know that there are risks within Europe of banks and banking profitability. There are trade wars. Brexit is one of those risks. When you look at the eurozone overall, if this was a pyramid, what are you going to put at the top of your worry list for 2020 and the next decade that is to come?

There are a lot of medium-term challenges. There's a medium-term challenge for the world economy; as a very important part of the world economy – most importantly, China – is

undergoing its own transition, undergoing a transition towards being focused on the domestic economy, focused on boosting consumption and services, then that transition has a mirror image. Because, of course, Europe benefited so much for many years from being able to be the supplier of capital goods, the supplier of so much to the Chinese economy. That's an obvious structural transformation.

Another one is the climate change agenda: how is the world going to move along in terms of the carbon transition? Then also, and connected to those points: in terms of the mix of activity in the European economy, one thing the ECB has been highlighting is that, essentially, at this point after a very difficult period of rebuilding public finances, in terms of the support that could be provided by fiscal policy to a more balanced European economy, that this requires a big conversation among fiscal policymakers and, by extension, among the electorates about the role of fiscal policy in the European economy.

It has been said quite a bit by a number of central bank governors and within the ECB, there's a limitation to what monetary policy can accomplish when you have slowing growth. What would you say are those limitations? Because at some point, QE has to end. Is there a plan for that? That's not going to go on indefinitely, is it?

Let me rephrase that. Underneath everything, so whether it's about very low interest rates, about low inflation, underneath everything is: how quickly is the European economy going to grow? Indeed, how quickly is the world economy going to grow? For that —many people here I'm sure have studied economics to some degree — monetary policy does not have long-run effects. And unless those long-run challenges about raising the growth rate, better policies about innovation, education, making sure there's enough fiscal support for the level of aggregate demand are met …— monetary policy can take care of the cycle to an extent. But that cycle is around the trend, and the trend depends on these wider policies.

For us, what we say is: if fiscal policy and structural policies delivered a faster growth rate for the economy then the monetary policy challenge would be a lot less. But I think also we would be emphatic that our monetary policies will accommodate for as long as necessary. But we think the recovery would be quicker if these other policies kicked in more strongly.

If they don't kick in strongly, what tools are left in the chest?

Let me emphasise that what tools we pick out of the toolbox will depend on the particular circumstances we face. What we do emphasise is that our assessment is that it is not the case that we are at some kind of limit. In fact, the concept of monetary policy hitting an absolute limit – I think there's a lot of nuance to that. But let me emphasise; we don't think we're at the limit as of yet. We do think the bigger focus should be, rather than on the distance of the central banking world to the limits, on the role that other policies can contribute to make this limit question less relevant, less interesting, because the economy will be growing more quickly.

You touched on something that I think resonates with everyone in this room, which is climate change. That is becoming part of the banking stress test here in Europe. When do you see climate issues being part of monetary policy for the European Central Bank? The remit is quite narrow at this point. What will it take, when do you see the time frame of it becoming part of that?

Lane: Let me answer that on different levels. First of all, it's already part of monetary policy. When I'm trying to forecast the European economy for the next two years, the future of the car industry is a central issue. And, of course, the future of the car industry is deeply interconnected to where we're going to be in terms of regulatory policy, carbon taxation, the preferences of consumers – many factors which are centrally driven by the carbon transition already are central to monetary policy. I think that's only going in one direction. It's very difficult to overstate, in the

last two years, the speed at which the world's central banks, both as monetary policymakers and as regulators, have invested in dealing with the carbon transition.

The implications for monetary policy are quite straightforward. At one level, there are many opportunities. In fact, I was in various meetings in the last few weeks where the dominant driver of investment for many firms right now is adapting their firm to deal with the climate challenge. So at one level, it's a driver of investment. At another level, uncertainty about: how quickly will carbon prices go up? What exactly will be the nature of regulatory restrictions to encourage the transition? That uncertainty is not helpful, so the more there are clear, comprehensive and vigorous climate change policies, I think the better for the transition.

Does anyone have a question for Philip? We do have one at the front. Please wait for the mic to come to you. Just your name and the company you represent, and a very quick question, please.

Audience member: I wanted to ask a similar question to the question that's already been asked about interest rates. You will be aware, of course, that with the lowering of interest rates into negative interest rates it's a real squeeze on interest rate margins for banks, to the point that many euro banks and non-euro banks are charging customers to be able to hold their deposits in euros. Banks are being charged to hold liquidity at the ECB. Now, I was also trained as an economist and in my lifetime, that was a very unusual experience to have to pay someone to hold money with them. I do not know if there is a nice way of asking, but I'd be really interested to know where you see the trend going over the next 12, 18 months. I actually think it's unsustainable at its current trend.

I think it's a fascinating question, which is very important that we put into context, so when we set monetary policy it's for the whole economy. Now, banks are a central part of the transmission channel so we absolutely do care about how banks are adjusting to this. But let's start at the most basic issue. Underneath our interest rate policy decision is, again, many people here will be familiar with the concept of the real interest rate, the inflation-adjusted rate, which is determined by the intersection of savings and investment. When you think at a global perspective or a European perspective, the driver of why interest rates are so low is a mix of low investment activity and a high preference for savings because of demographics – and also, by the way, risk aversion. There is also a high preference of finding so-called "safe assets".

And so the challenge for us is: many estimates of this real interest rate are close to zero or negative, either globally or for the European economy. Essentially, what that means is, if we raised rates above the level consistent with that real rate, that would be contractionary for the European economy. So we have this paradox of: it's unprecedented, but it's also the case – and the inflation numbers tell you – it's not particularly a super loose policy. If it was super loose inflation would be higher. And this is the big question for the financial sector.

The first point I would make is, our forecasts do say there will be recovery. We do say, even though inflation is around 1 now, we assess by 2021 it'll be 1.5 which would be closer towards the target. The money markets do anticipate there will be some reversal in the interest rate path, so I think that's a good baseline. On the other hand, I do think everyone here involved in the financial sector – and more generally those involved in government policy for pensions, insurance – have to recognise, how do we live in a world where sometimes it's going to be the case the policy rate we set will go negative?

I think there is an adaptation of expectations. We are seeing, it's very interesting in the banking world, right now about a quarter of European deposits to corporates are being charged at a negative rate. What's interesting, we see, is, those corporates who were charged a negative rate, rather than suffer that, they're doing more capex. Our transmission is supported, so it's a nuanced view. As you know, we brought in tiering to compensate banks who are sitting on a lot of

excess liquidity.

In terms of transmission, we also think up to now banks have benefited from a better macro picture, which means volumes are up even though margins are down. Also, credit risk is down, so there's been less provisioning, less concern about credit risk. That isn't to say those forces will be forever, so we absolutely accept this is something we'll look at all the time. It's an ongoing question.

I cannot think of a better question to end that interview on, and a better answer to give us a snapshot of what's happening in Europe. Philip, thank you so much.