

Despite the recent ECB rise, Irish interest rates are still too low and most mortgages are far too large, warns Alan Ahearn, a former economic advisor at the US Federal Reserve, writes Peter Cluskey

**T'S NOT** for nothing that economics is known as "the dismal science". So it will come as little surprise that former adviser to the Federal Reserve Dr Alan Ahearn's analysis of Ireland's apparently endless property boom is likely to be dismissed out of hand by the vast majority of homeowners.

Because when Alan Ahearn casts his economist's eye over the Irish property landscape, he sees two big looming problems. The first is that interest rates, even with June's quarter of a per cent increase, are too low. And the second is that the loan-to-value ratio for a large proportion of mortgages is unacceptably high... In other words, mortgages of 100 per cent and more are, sooner or later, a recipe for disaster.

But if you're just these years into a monstrously large 20-year mortgage and are planning to buy a nice rentable flat apartment in Bulgaria with your SSA payout, that's not the type of analysis that sits comfortably with your wealthy financial commitments, is it?

On the other hand, Alan Ahearn knows a thing or two about economics – and about international housing markets. During seven years as an advisor to iconic former chairman, Alan Greenspan, at the US Federal Reserve in Washington, he co-authored, amongst many other things, a study which identified – believe or not – an extraordinary 44 instances of house price boom-and-bust in industrialised countries since 1970.

Ahearn returned to Ireland with his family last July to become Vice-Dean of Research at the J E Cairnes Graduate School of Business and Public Policy at NUI Galway. He's also a Research Fellow at Birrget, the Brussels-based economics think tank. And on a personal level, he's become a student of how Ireland has changed during the past 10 to 15 years.

"When I left Ireland in 1993, just before the economy began to improve, things were pretty bad. But when I came back last year I saw the prosperity right away – brand new expensive cars, people more brightly dressed, more confident and a lot busier. When I leave for work at 7 o'clock in the morning, the roads are already packed.

"But at the same time there are quality of life issues. Both parents in a family tend to have to work to support an increased standard of living. I sometimes wonder if that type of pressure is forcing people to do things they otherwise might not want to do – like leaving very small children in a crèche all day. I have to think twice about issues like that..."

What's also new, of course, is the interminable discussion in pubs, restaurants and around the dinner table about how long the economy can continue to grow and how long house prices can continue to climb – and what the consequences will be when the downturn comes.

"What interests me is that while the authorities, such as the Central Bank, are expressing concern about house prices, there doesn't appear to be very much determination to actually do much about them.

"Perhaps it's because nobody can call it for certain with

regards to house prices. Nobody can say definitively that there's a bubble and we need to stop prices rising straight away. And when it comes down to it, it's that lack of certainty that makes policy makers say: 'Let it go. We'll see what happens...'

But what should those policy-makers be doing? "There are things they can do and things they can't. In the past they would have increased interest rates, which are far too low in Ireland. And if we weren't in the euro, that increase would have strengthened our exchange rate and cooled things down. But those tools aren't available now.

So what tools are we left with? What we should be seeing are moves to restrict the loan-to-value ratios for mortgages, for instance. That would be a good start. Giving people 100 per cent mortgages is a move in completely the wrong direction. It's brought in people on the margin and in the event of a downturn they're going to be very exposed.

"Perhaps there's an argument for loosening restrictions on planning permission, and ensuring there's an adequate housing supply that will stop prices rising – although that would involve an environmental trade-off."

Fiscal policy is also crucial. "The obvious thing is not to add fuel to the fire by running an expansionist fiscal policy. We have a more or less balanced budget at the moment, but I'd sleep a bit easier if we had a budget surplus because it would allow us some room to manoeuvre if there's a downturn. It would allow us, for example, to give some fiscal stimulus through tax cuts or spending increases."

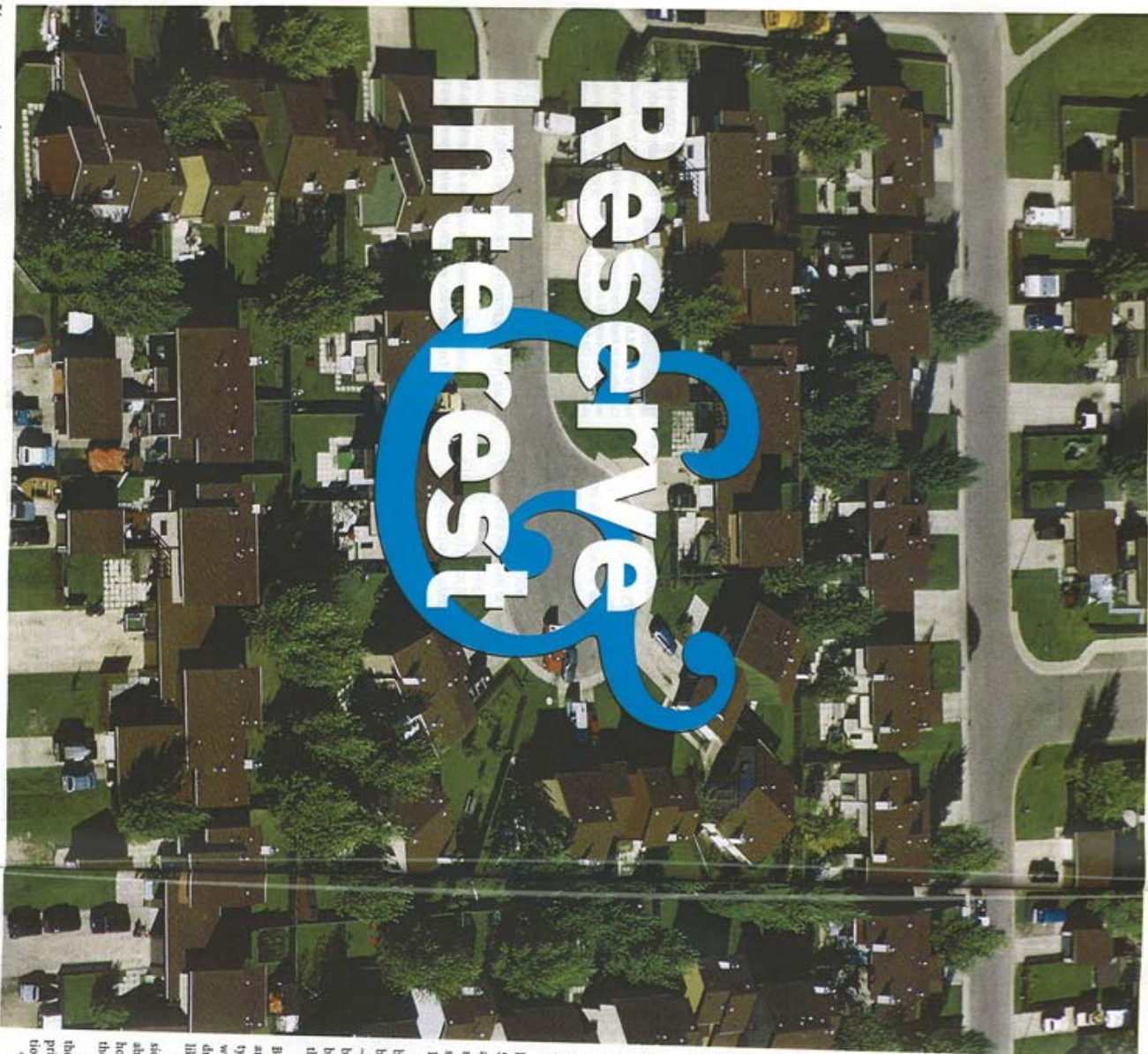
It's all a matter of economic prudence, he maintains. "Look at Norway. It has a fiscal surplus of around 15 per cent of GDP. A lot of that is oil-driven, but the point is that while the economic sun is shining, they're squirreling something away.

Okay, it's not as if we're running a deficit here in Ireland. We're not doing anything crazy. But I have the feeling we should be saving something for a rainy day."

The problem is that economics is by no means an exact science. Nobody really knows the answers to questions like: How long can Ireland's extraordinary economic boom go on? How long can house prices continue to rise, after shooting up 200 per cent in the past decade?

"Economic analysis is by its nature backward-looking," muses Ahearn. "We predict using historical experience. And, in doing that, what we're saying is that the future is going to look something like the past. So if we can learn from the past, we'll be better prepared to handle the future. But that model ignores big structural changes. And when you have big structural changes, as we've had and are continuing to have here in Ireland, historical relationships shift – and the past is no longer a reliable predictor of the future. That's the problem."

# Reserve Interest



## INFORMATION

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