



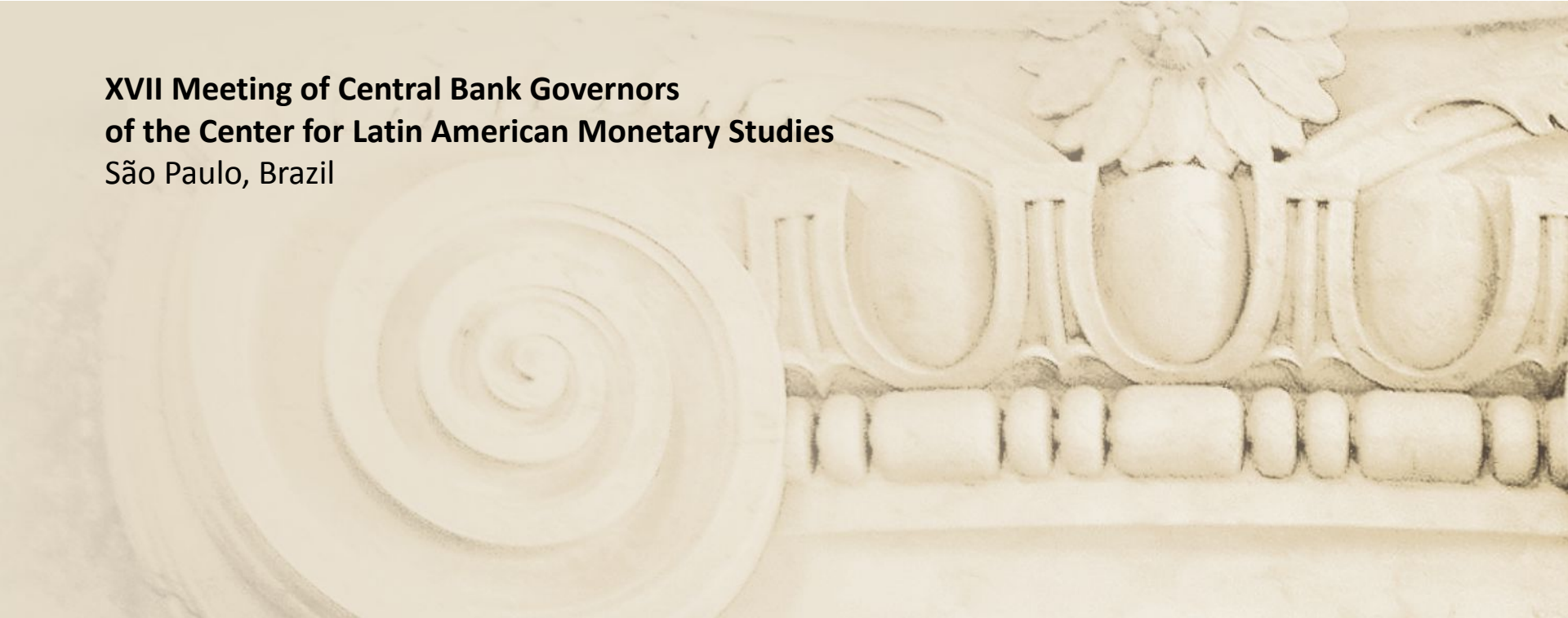
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# The European Paradox and the specificities of the challenges ahead

Carlos da Silva Costa • Governor

28 abril 2014

**XVII Meeting of Central Bank Governors  
of the Center for Latin American Monetary Studies  
São Paulo, Brazil**

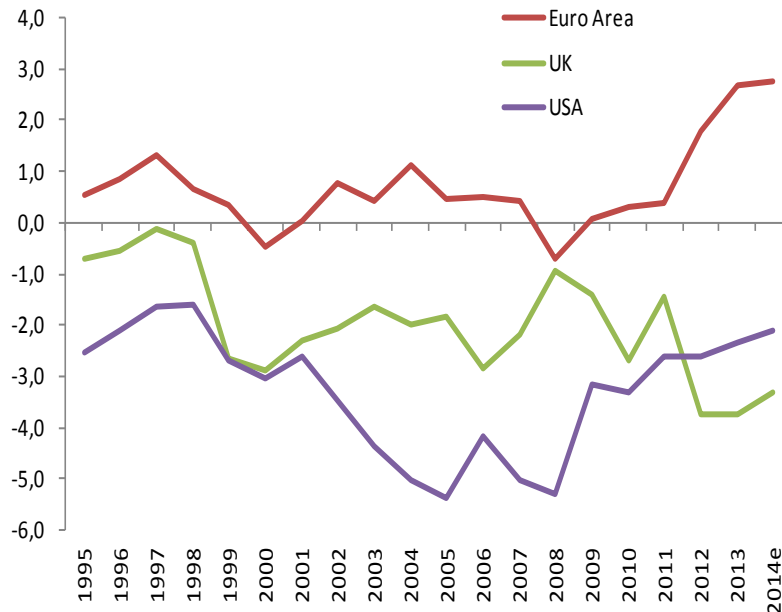




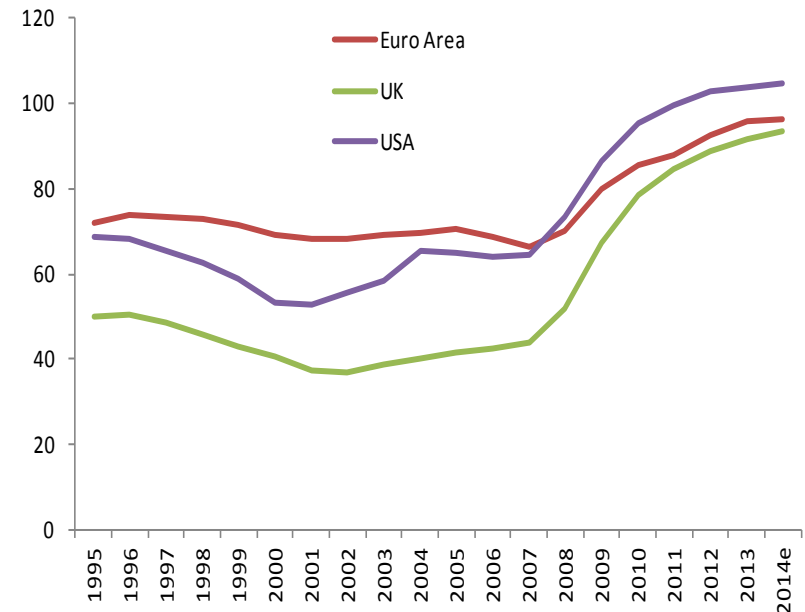
## Euro Area has:

- **Current account surplus**
- **Public debt ratio lower** than other advanced economies

### Current account balance (percent of GDP)



### Public debt (percent of GDP)

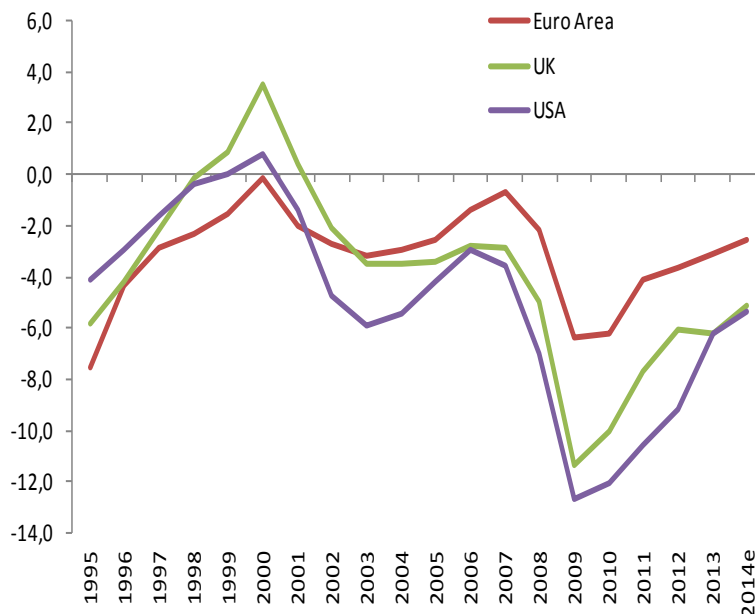




## Euro Area has:

- **Fiscal deficits lower** than other advanced economies
- **Low inflation** in line with other advanced economies

### Fiscal Balance (percent of GDP)



### Inflation (YoY, per cent)

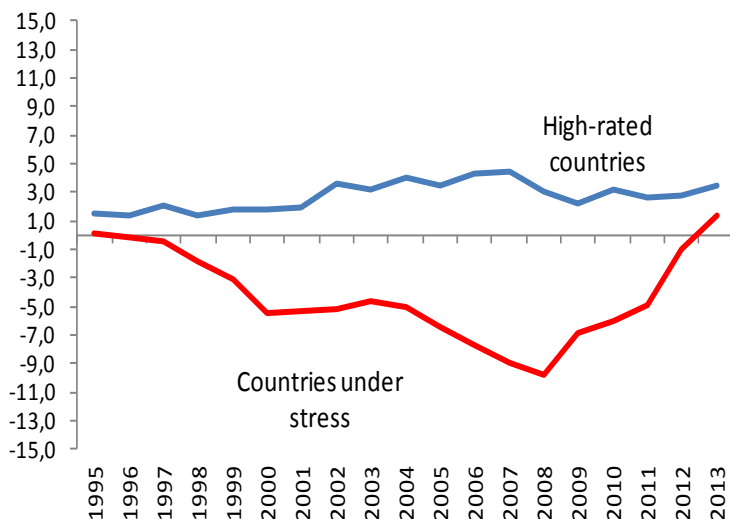




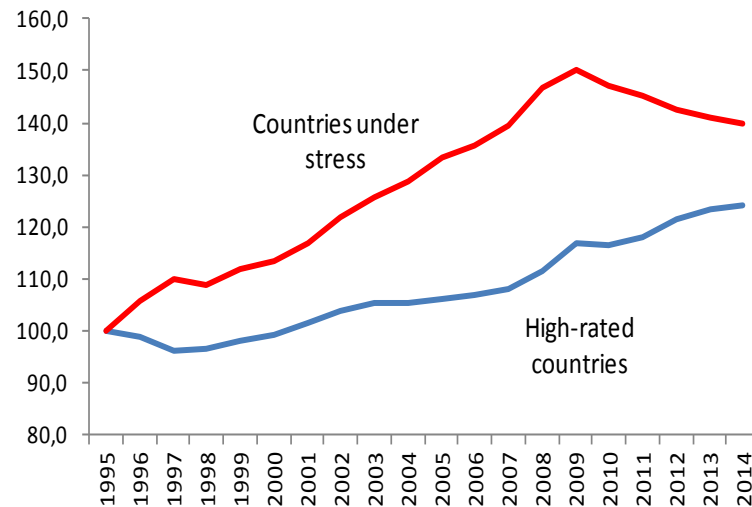
**But, large internal imbalances were built up in the years prior to the crisis:**

- **Countries under stress: accumulated significant external deficits and competitiveness losses**
- **High-rated countries: registered persistent current account surplus**

**Current account balance**  
(percent of GDP)



**Nominal Unit Labour Costs**  
(index, 1995=100)

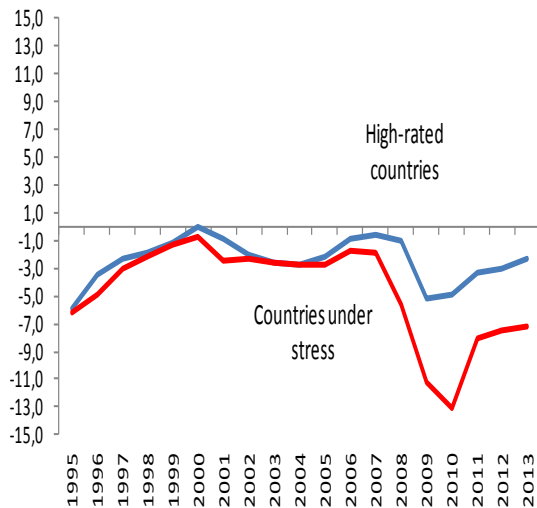


Note: High-rated countries include Belgium, Germany, France, Netherlands and Austria; Countries under stress include Greece, Ireland, Italy, Spain and Portugal.

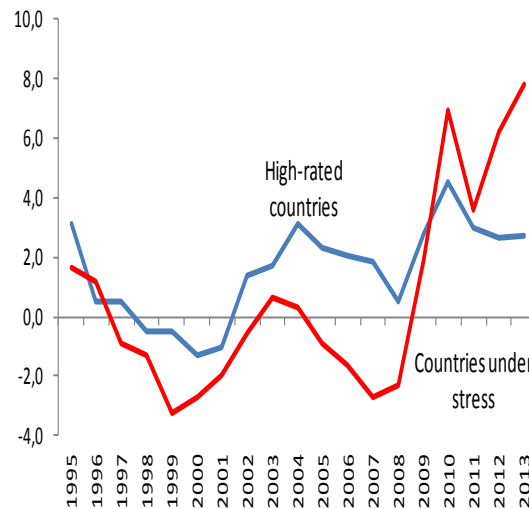


- Countries under stress: **budget deficits; significant accumulation of debt by the private sector**
- High-rated countries: **budget deficits (more moderate); the private sector maintained (in general) a net lending position**

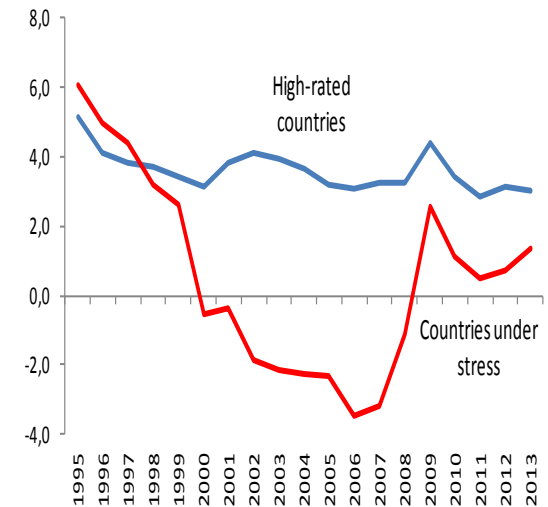
**Fiscal balance**  
(percent of GDP)



**Net lending (+) or net borrowing (-) by corporations**  
(percent of GDP)



**Net lending (+) or net borrowing (-) by households**  
(percent of GDP)

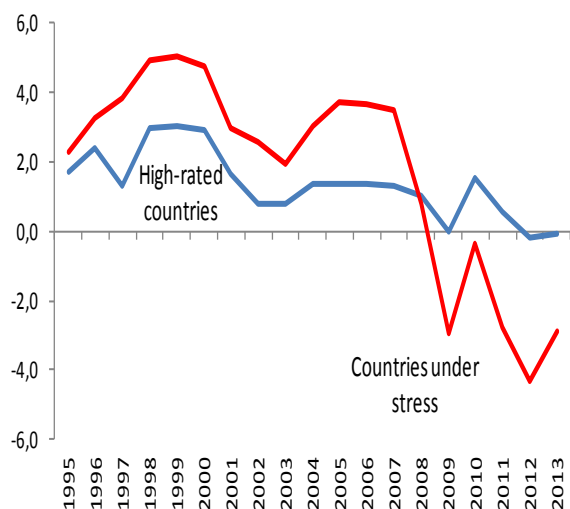


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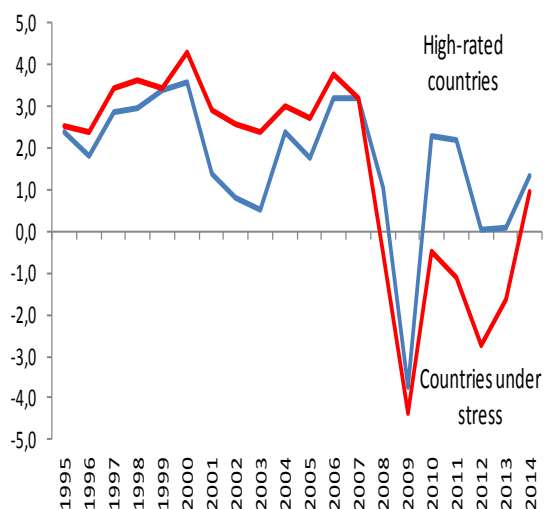


- Countries under stress: an **economic growth model** based on the dynamics of the **domestic demand**, which proved **unsustainable**
- High-rated countries: more **favourable growth performance**

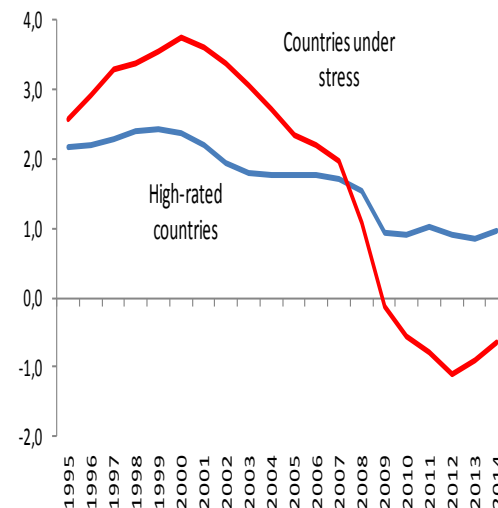
### Private consumption (YoY, per cent)



### Gross Domestic Product (YoY, per cent)



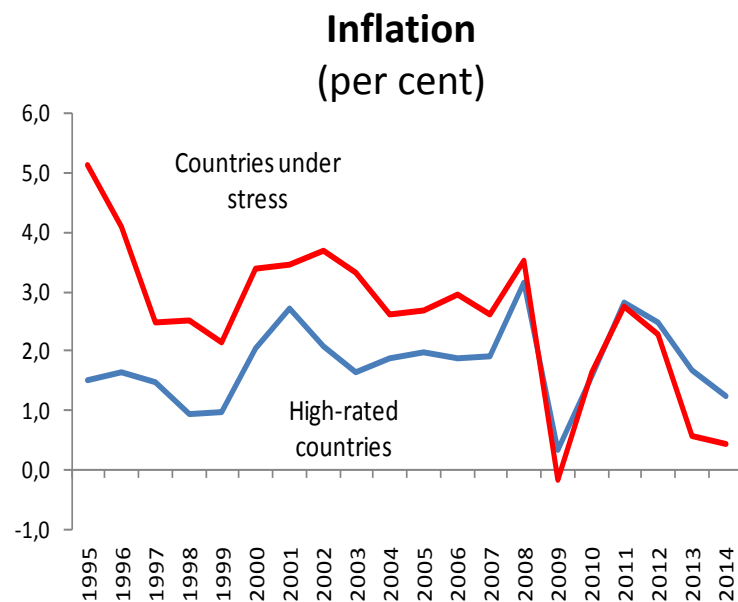
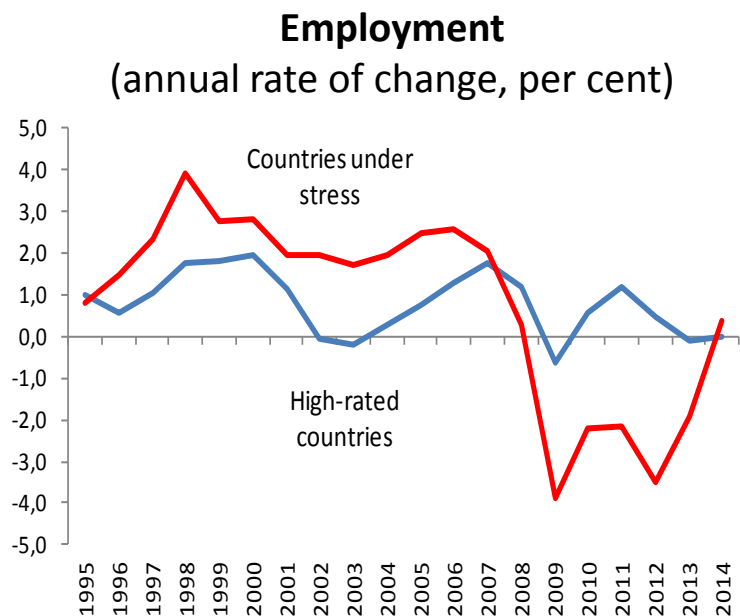
### Potential Output (per cent)



Note: High-rated countries include Belgium, Germany, France, Netherlands and Austria; Countries under stress include Greece, Ireland, Italy, Spain and Portugal.



- **Countries under stress: higher non-sustainable employment growth (e.g. construction and retail); higher inflation rates**
- **High-rated countries: moderate but more stable employment growth rates**



Note: High-rated countries include Belgium, Germany, France, Netherlands and Austria; Countries under stress include Greece, Ireland, Italy, Spain and Portugal.



## **Euro Area Member States with very different starting positions**

### **The two crises: financial crisis + debt crises affected differently the different Member States**

**The crisis revealed that the institutional framework of the euro area was not adequate to ensure macroeconomic and financial stability and to deal with the crisis**

#### **Fragmentation of the Monetary Union:**

- Stop of external finance to some sovereigns;
- “renationalization” of the banking system;
- Corporations and households of Member States face very different financing costs depending on their geographical location in spite of identical risk/return.

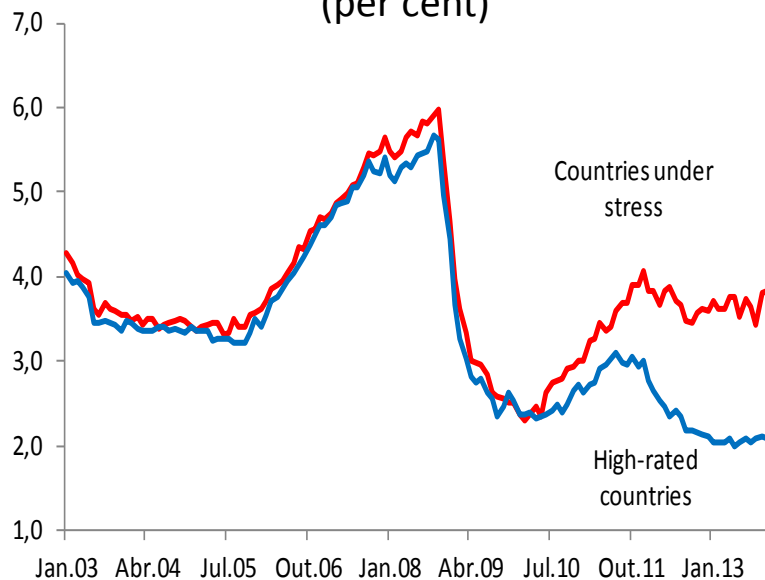




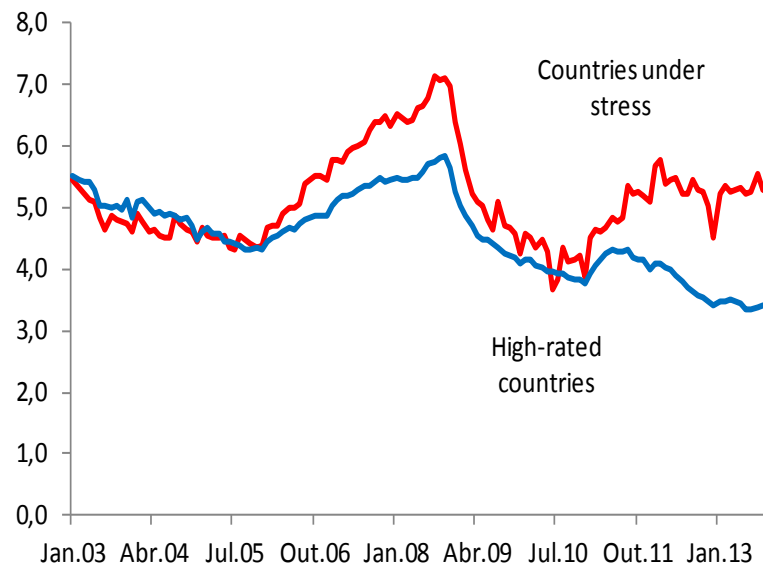
## Financial Fragmentation in the context of the crisis:

- **Non-financial corporations and households** in countries under stress face **higher financing costs**; negative implications for competitiveness of corporations of countries under stress

### Interest rates on new MFI loans to non financial corporations (per cent)



### Interest rates on MFI loans to households (per cent)



Note: High-rated countries include Belgium, Germany, France, Netherlands, Austria and Finland; Countries under stress include Greece, Ireland, Italy, Spain, Portugal and Cyprus.



## The European Response

### Immediate Response

- **Eurosystem** provided significant amounts of **liquidity to banks**
- **Official finance to sovereigns** were provided in the context of Adjustment Programmes
- **Firewalls** were created: **EFSF/ESM**

### Further response

- **Reinforced governance, surveillance and coordination framework:**
  - Reinforced **Stability and Growth Pact** ("Six-Pack")
  - Set up the "**European semester**" of integrated multilateral economic and budgetary surveillance
  - Introduce a new procedure for macroeconomic surveillance: **Macroeconomic Imbalance Procedure** ("Six-Pack" )
  - **Enhance economic surveillance, coordination, integration and convergence** amongst euro area Member States ("Two-Pack")
  - **Treaty for Stability, Coordination and Governance** further strengthens budgetary discipline and economic governance among these Member States (entered into force on 1 January 2013)
- **Reinforced financial integration: creation of the Banking Union**

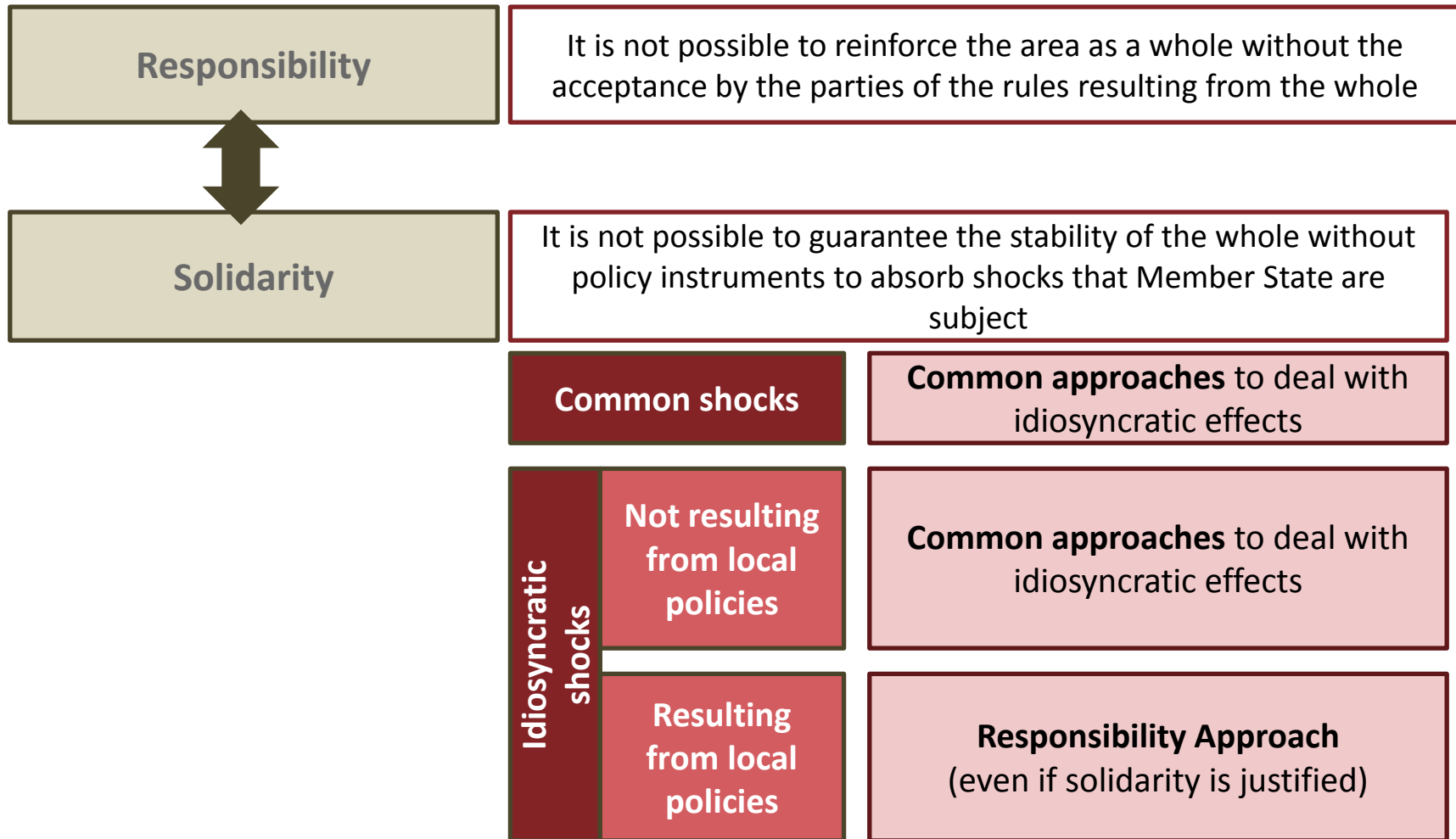


## Lessons to take:

1. **Unsustainable economic policies will pass wrong signals that will induce:**
  - Misallocation of capital and labour
  - Default of economic agents that followed the misleading policy signals
  - Sub-optimal economic growth (stop and go)
2. **The absence of an integrated economic and fiscal policy leads to:**
  - Financial fragmentation
  - Limited ability of common monetary policy to stimulate demand and investment
3. **A successful integration process calls for greater coordination of fiscal policy, economic policy and policy in general and new steps in fiscal and economic integration**
  - Need for institutional arrangements to deal with unsustainable and inconsistent policies followed by countries that are part of the integration process
  - Need for stronger mechanisms that reinforce policy coordination taking into account the imperative of the whole over its parts and the need for a sustainable equilibrium of each part
  - Need for new steps in fiscal and economic integration and in policy democratic legitimacy



## Challenges that need to be tackled ahead





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## The European Paradox and the specificities of the challenges ahead

**Thank you.**



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