BANCO DE PORTUGAL
EUROSISTEMA

Time for Reform

1. I would like to start by extend a greeting to the distinguished members of the panel and thank the Economic Chamber of Greece, namely its President, Konstantinos Kollias, and Deputy Governor Iannis Mourmouras, for their kind invitation to be part of this magnificent Conference. It is a great pleasure to be in the mythical and unique city of Athens and to be able to address such an illustrious audience, sharing with you a few thoughts on the experience of the countries that have implemented adjustment programmes.

The timing of this conference could not have been more appropriate against the background of the conclusion of the third adjustment programme for Greece and the ongoing debate on the future of the European Union, in particular concerning the reform of the Economic and Monetary Union.

Obviously, the experience gained from the adjustment programmes does not concern *only* the Member States that have implemented it. In a union with the level of integration of the European Union and, even more, when we speak of the Eurozone, a severe crisis in one Member State poses a risk to the other Members and, also for that, should be a common concern. The soundness of the whole is dependent on the soundness of each Member State.

Furthermore, as Professor Joseph Weiller rightly said, the European Union was created to be a "community of destiny". If this is forgotten, its problems will only tend to worsen.

2. Following the global financial crisis, from 2010 to 2013, Greece, Ireland, Portugal and Cyprus were subject to adjustment programmes. Spain also benefit, in 2012, from considerable financial support to its banking sector.

All of these programmes have long since been concluded and the third Greek programme is well on its way. However, they gave rise to consequences so intense in the economic, social, financial and political domains and in the mutual trust among Member States that their effects have not yet dissipated.

In the spring of 2011, Portugal lost access to the markets at sustainable interest rates and had to request external assistance. Consecutive years of economic stagnation or low growth, a severe imbalance in public finances, a high external deficit, a banking system with imbalances, all amplified by the effects of the international financial crisis, made this scenario unavoidable.

The Economic and Financial Assistance Programme to Portugal was implemented from 17 May 2011 to 30 June 2014. A post-programme surveillance phase is currently in place.

The purpose of my presentation is not to conduct a detailed analysis of the programme. There is considerable institutional and academic literature on the subject and the opinions and assessments are widely different.

It is a fact that from 2011 to 2013 Portugal experienced an economic recession without precedent in its recent history. The unemployment rate grew abruptly, reaching 16.2% in 2013, with severe social consequences.

However, at the end of the programme, Portugal regained access to the markets. The financing rates of the Republic fell significantly and the confidence of economic agents was gradually restored. We all know that the non-standard monetary policy measures, introduced courageously by the European Central Bank, were decisive to this. But there were also other very important factors both at Portuguese and European level.

Growth returned, still very timidly, from 2014 onwards. But in 2017, domestic product grew by 2.7% in real terms, the highest rate since 2000. The main sectors of activity made a positive contribution to this momentum, with manufacturing recording its largest growth since 2010.

Exports and investment were the drivers of the Portuguese economy's acceleration in 2017, which will be important for correcting some of the structural problems.

These results must be seen in the context of the euro area's positive business cycle and more contingent factors such as a very dynamic tourism sector.

The good performance of Portuguese exports was chiefly due to external demand for Portuguese goods and services, in particular from euro area partners. However, Portuguese exports also increased their share in external markets.

The construction sector was one of the major drivers of an increase in investment, boosted by a rise in demand by non-residents and the strong growth of tourism and related real estate activities.

In this environment, the unemployment rate started to follow a clear downward trend, reaching 8.9% in 2017, and according to the latest data in 2018, at less than 8%. Employment rose by 3.3%, which was the highest annual growth since Portugal's participation in the euro, especially in the youngest and oldest age groups.

The public accounts have been showing fairly positive developments, in line with the consolidation targets agreed at European level.

In terms of the external accounts, the current and capital account surplus was 1.4% of GDP in 2017, similar to the surplus recorded since 2014.

In parallel, a set of policies designed to eliminate some measures applied under the adjustment programme were put in place from 2016. The purpose of these policies was to improve the social environment and contribute to better living conditions for some of the lower income segments of the population, but also to certain parts of the middle class.

The Portuguese banking sector also strengthened its position. It is today more stable and capitalised, with higher profitability levels, undergoing restructuring to face the various challenges from regulation to the rise of the digital economy. The resolution measure applied in August 2014 to Banco Espírito Santo – at that date the third largest bank in the Portuguese financial system – was completed in October 2017 with the sale of the resulting bridge bank. The NPL portfolio has been considerably reduced, although it still remains high.

3. To strengthen and sustain these positive economic developments, past mistakes must not be repeated at national and European level.

And it is crucial that *growth is also inclusive*, not only in individual Member States but in the European Union as a whole. Adjustment programmes did not include explicit social objectives nor monitoring requirements on the social impact. However, they could have and should have done so.

Article 3, number 1, of the Treaty on the European Union states that, together with the advancement of peace and its values, the Union's aim is to promote the well-being of its peoples. Likewise, number 3 establishes that the Union "shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress" stating also that the Union promotes "economic, social and territorial cohesion, and solidarity among Member States."

The Union's policies should be globally consistent, given that the rules established by the Treaties are all equally binding.

4. In the beginning of January 2019 we will celebrate the 20th anniversary of the European Monetary Union although euro banknotes and coins only began to circulate in 2002. Portugal was among its eleven founding Member States. For millions of young European citizens the euro is the only national currency they know.

It is common knowledge that the establishment of the Economic and Monetary Union was the most far-reaching political step in the history of European integration. Likewise, we have always known that the architecture set up in Maastricht was incomplete and risk-inducing, particularly due to the absence of mechanisms to cope with asymmetric shocks. Its architects implicitly admitted that the missing components would sooner or later be added, as a result of the integrationist momentum. However, History has repeatedly proven that determinism can be a mistake...

Up until the onset of the financial crisis, we lived under a kind of 'spell'. In many countries, the decrease in interest rates boosted indebtedness, while there were illusory improvements in living conditions. Neither the economic agents nor the authorities managed to clearly perceive that the monetary union would necessarily entail a new economic regime: the centralisation of monetary and foreign exchange policies warranted a completely different policy mix. Fiscal and income policies acquired greater importance, but, in fact, fiscal policy was also subject to heavy constraints.

When the international financial crisis broke out, it progressed rapidly, quickly exposing and enhancing the accumulated imbalances within the Union.

The response to the crisis focused on strengthening the coordination between fiscal policies, the development of new financing mechanisms, and the establishment of the banking union and, of course, non-standard monetary policy measures. This was far from insignificant, but, in some cases, it was perhaps a little late. In many ways, we were entering a new territory as it was with the implementation of adjustment programmes, which pose unique challenges in countries within a monetary union.

We need to drive the Economic and Monetary Union reform forward. Part of this reform merely consists in finalising the previous cycle of reforms by completing the banking union with the implementation of its third pillar and by endowing the Single Resolution Fund with the adequate financial resources to fully accomplish its mission. No debate is more sterile than the one on whether to reduce or to share risks. In truth, we must do both. And, in some ways, we have been doing just that.

As many contend, it is human nature to only make important decisions when faced with necessity, during critical situations. Let us hope that it is possible to dispel that perception, by taking full advantage of the existing proposals and ongoing debate – which should be open and inclusive – to adopt the necessary measures to improve the working of the European Union and, in particular, the Economic and Monetary Union. In fact, we should avoid to do so under pressure from a new crisis.

Only the future will show if we are able and willing to make the necessary decisions so that the European Union will be the "community of destiny" as Joseph Weiller put so well, and as its founders intended.

Thank you for your kind attention.

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