



BANCO DE PORTUGAL  
EUROSYSTEM

# Reform and Prosperity in the Monetary Union

Carlos da Silva Costa • Governor

**New Narrative for Europe (and for the Monetary Union after the crisis)**  
**Lamfalussy Lecture series**  
Budapest, 2 February 2015





**I. Monetary Union and Economic Growth**

**II. Reforms at national level**

**III. Reform at European level**

**IV. Conclusions**



### Is there a trade-off between the Monetary Union and economic growth?

No. They are complementary. The sustainability of the Monetary Union depends:

At  
national  
level

On the need to implement sustainable economic policies

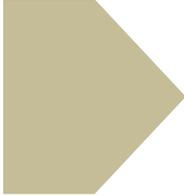
*But this is not enough...*

At  
European  
level

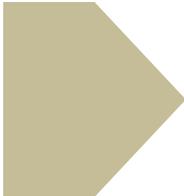
On the need to have policy instruments to absorb shocks that Member States are subject to



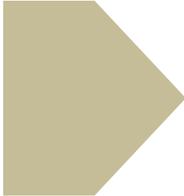
### Monetary Union & National Fiscal Policy



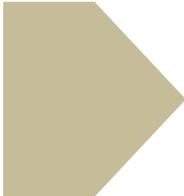
**Facilitates the implementation of a sustainable development strategy** – reduces the cost and the availability of credit and increases economic agents' confidence in nominal stability



**Intensifies and prolongs the imbalances created by unsustainable fiscal and economic policies** – private agents increase leverage, public debt constraint is eased, internal demand pressures lead to a deterioration of competitiveness (via increases in real wages above productivity)



**Exacerbates the conflict between sustainability of public finances and safeguarding financial stability** – monetisation of bank bail-outs impossible, financial repression cannot be used to help absorb public costs with the recapitalisation of the banking system



**Limits sovereign leeway to deal with idiosyncratic shocks and with asymmetric effects of common shocks**



### At national level:

#### Need for Economic Policy that compensates these effects:

- Rise in indebtedness of households and firms
- Private expenditure boom financed by credit
- Increase in relative price of non-tradables
- Increase in the share of the non-tradables sector
- Upward wage pressure
- Deterioration in competitiveness
- Deterioration in current account
- Accumulation of a substantial negative net foreign asset position



- 1 **Countercyclical Fiscal Policy**
- 2 **Macroprudential policy to manage the buildup of risks**
- 3 **Income policy that safeguards competitiveness**



## At European level:

- 1** Surveillance and monitoring of the sustainability of national policies (fiscal and income policies)
- 2** Financial support mechanisms to promote the return to a sustainable path of Member States with unsustainable situations. These mechanisms must be based on a commitment to an economic and fiscal adjustment path with financial assistance conditional on the adjustment progress
- 3** Risk sharing through integrated financial markets: Single Supervisory Mechanism, Single Resolution Framework (Single Resolution Mechanism and Single Resolution Fund) and Single Deposit Guarantee Scheme
- 4** Mechanisms to compensate the effects of idiosyncratic shocks and the asymmetric effects of common shocks



## MUTUAL TRUST

**Responsibility**



**Solidarity**

It is impossible to strengthen the area as a whole without the parties' acceptance of the rules resulting from the whole

It is impossible to ensure the stability of the whole without policy instruments to absorb shocks that Member States are subject to



**Sound Economic Policies**



**Cross-country Risk sharing**



**A Monetary Union with mechanisms that:**

- **support sustainability**
- **mitigate the inconsistency between the singleness of monetary policy and national budgetary sovereignty**
- **promote economic growth**

*But this is not enough to ensure that economic growth is optimal and sustainable*

**The sustainability of public finances is guaranteed but not a growth path consistent with the natural rate of unemployment**

**.....it can coexist with a suboptimal equilibrium!**



- **The nature of national economic policies and the coordination of these policies across the EU as a whole determines the sustainability of the development model** (growing imbalances in the labour market ultimately determine the sustainability of fiscal policy)
- We need an **integrator power over national economic policies that takes into account the path of potential output and employment in the area as a whole**. Direct and indirect instruments (via Member States) to manage aggregate demand, investment and potential output must be in place
- The sustainability of the Monetary Union **depends on the nature and integrative capacity of the mechanisms that ensure the integration of national policies**, which includes the economic integration stage and the corresponding institutional framework



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