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CI-CPRI

Portugal in the EU: the Perspective of Convergence

<u>Tese de Mestrado</u>

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5.1.2 Criteria of Monetary Stability

About the long-term interest rates we know that lower the risk-premium smaller the difference between the interest rates and better the integration conditions. This was also to verify the anti-inflationary credibility of the country in question.

Knowing that inflation is a general and permanent augmentation of the prices of goods and/or productive factors, inflation rates must be controlled because if they're too high investment drops, also for different expectations of the agents that rather invest today than tomorrow, speculation increases, there's a depreciation of the country's coin contributing to a lower purchase power, unemployment rates augment and the general conditions of life become worse.

Criterion 3: Long-term Interest Rates (income of 10 years state obligations, secondary market) must not exceed in more than 2% the average interest rate verified in the three state-members with better performance on prices stabilization.

Square 3: Long-term Interest Rates

	1993	1994	1995	1996	1997
Austria	6,7	7,0	7,1	6,3	5,7
Belgium	7,2	7,8	7,5	6,5	5,8
Denmark	7,3	7,8	8,3	7,2	6,3
Finland	8,8	9,0	8,8	7,1	6,0
France	6,8	7,2	7,5	6,3	5,6
Germany	6,5	6,9	6,8	6,2	5,6
Greece	23,3	20,8	17,1	14,4	9,9
Ireland	7,7	7,9	8,3	7,3	6,3
Italy	11,2	10,5	12,2	9,4	6,9
Luxembourg	6,8	7,2	7,2	6,3	5,6
Netherlands	6,4	6,9	6,9	6,2	5,6
Portugal	11,2	10,5	11,5	8,6	6,4
Spain	10,2	10	11,3	8,7	6,4
Sweden	8,5	9,7	10,2	8,0	6,6
UK	7,5	8,2	8,3	7,9	7,1
	EU12			EU15	
Average	9,3	9,3	8,8	7,5	6,3

Eurostat annual 98/99

This is a more evident criterion of nominal convergence since most of values are situated in the home of 5,6 and 6,4 in 1997, except for Italy, UK and Sweden, a bit above and the eternal Greece way divergent with 9,9. In the period of 1993/ 95 values were far more divergent among themselves as well as higher.

The convergence seems considerably remarkable when Italy, Portugal, Spain and Greece had very high interest rates in 1993, imposing to themselves determined efforts to not be left behind.

Criterion 4: Inflation rates

The harmonized price indexes of consumption were introduced as a criterion in 1997, founded over the domestic index prices. This paper also presents here other price indexes, the ones present in the EUROSTAT annual seen as relevant in the context of this criterion, about the fluctuation of the purchasing power of the ECU, to help the analyse.

Square 4: Harmonized price indexes of consumption

	1996	1997
Austria	100,0	101,2
Benelux	100,0	101,5
Denmark	100,0	101,9
Finland	100,0	101,2
France	100,0	101,3
Germany	100,0	101,5
Greece	100,0	105,4
Ireland	100,0	101,2
Italy	100,0	101,9
Netherlands	100,0	101,9
Portugal	100,0	101,9
Spain	100,0	101,9
Sweden	100,0	101,9
UK	100,0	101,8
EU15	100,0	101,7

Eurostat annual 98/99

Square 5: Harmonized price indexes of consumption, corrected of the exchange rate of the ECU (1996=100) - Fluctuation of the purchase power of the ECU.

	1995	1996	1997
Austria	100,2	100,0	98,3
Benelux	100,2	100,0	98,4
Denmark	98,4	100,0	100,3
Finland	101,0	100,0	100,3
France	97,5	100,0	99,4
Germany	98,4	100,0	100,3
Greece	93,5	100,0	104,1
Ireland	95,2	100,0	107,4
Italy	88,5	100,1	103,4
Netherlands	100,5	100,0	98,6
Portugal	97,0	100,0	100,5
Spain	95,3	100,0	98,7
Sweden	90,7	100,0	100,2
UK	95,7	100,0	119,7
EU15	96,6	100,0	102,9

Eurostat annual 98/99

From the first square its clear that from 1996/97 only Greece diverged from the other countries with a growth of 5,4% when all the others grown between 1 and 2%.

The fluctuation of the purchase power of the coin ECU ends being a more interesting indicator for being more complete. From these harmonized indexes its possible to realize that Portugal is around the average of the EU15 in 1995 and 1996, and under the average in the following year, which should be remarked (100,5 against 102,9), but the general idea from the group of countries is much less homogenous. For instance, the United Kingdom balances from 95,7 to 119,7. Ireland goes from 95,7 to 107,4. Better performances belong to Austria, Benelux, France, Netherlands and Spain whose prices diminish (the purchasing power augments).

The first indicator shows clear nominal convergence. The second contradicts a bit that conclusion.

5.1.3 Criteria of Exchange Stability

Exchange stability was indispensable to achieve the correct environment for the birth of the Euro. With stable inflation there was no more need for exchange policies and a unique coin had all the conditions to increase trade inside the community because of higher transparency on prices leading to a bigger competition among firms and some decreasing prices, and the elimination of a volatile exchange diminishing transference costs. In the monetary market investment would increase and could also affect the labour market with gradual increasing wages, needing for that structural changes, needing for that a higher real converge after the nominal achievements.

Criterion 5: for **exchange stability** the domestic money should be inside the fluctuation margins of the European Monetary System (ESM) for two years without depreciations of their own initiative towards other state-members.

Square 6: Bilateral fluctuations (Max and min) of the money, ones in term of the others inside the EMS

		1993		1994		1995		1996		1997	
Country	Coin	Max	min	Max	min	Max	min	Max	min	Max	min
Austria	Schilling	*	*	*	*	5,04	1,04	2,11	-3,58	-2,55	-5,35
Benelux	bel/ lux fr.	1,54	-3,33	3,55	-1,16	5,10	1,26	2,44	-3,45	-2,59	-5,44
Denmark	Dan crown	-0,08	-4,21	0,48	-2,64	1,44	-2,60	0,66	-3,85	-2,35	-5,14
Finland	fin. mark	*	*	*	*	*	*	1,18	-1,86	0,01	-3,91
France	French fr	0,21	-2,24	0,52	-2,09	1,66	-3,21	0,31	-4,11	-2,65	-5,77
Germany	germ. mark	4,00	-0,52	3,22	-0,86	5,08	1,01	2,1	-3,56	-2,52	-5,33
Greece	Drachma	*	*	*	*	0,00	0,00	0,00	0,00	0,00	0,00
Ireland	Irish lira	2,54	-1,11	4,12	0,04	3,71	-4,63	4,11	-2,99	5,77	2,73
Italy	Italian lira	*	*	*	*	*	*	0	-2,87	-1,61	-5,27
Nether.	Florin	4,21	-0,05	3,77	-0,30	5,48	1,55	2,70	-3,18	-2,49	-5,29
Portugal	Escudo	4,02	-4,13	-0,44	-3,42	1,25	-0,9	1,1	-1,79	-0,77	-4,28
Spain	Peseta	3,63	-4,26	-1,01	-4,12	2,56	-5,48	2,99	-2,71	-1,56	-4,48
Sweden	sw crown	*	*	*	*	*	*	*	*	*	*
UK	sterling lira	*	*	*	*	*	*	*	*	*	*

Eurostat annual 98/99

The countries of the EMS didn't fluctuated each domestic money outside the margins of the European Monetary System (ESM) for the two promised years, nor imposed depreciations of their own initiative towards the other members, showing for that nominal convergence.

Portugal shows an especial effort on this sense, because the numbers testify that diminished tendency to change the nominal exchange rate and because the depreciation of the Portuguese coin had for many times been one of the preferred (and efficient) government policies to gain export-competition outside the domestic market.

5.1.4 In the H Hour the Reality of the State-Members of the Euro Area

After realizing the tendencies is time to see the final results in the beginning of the year of 1998 for the countries that actually would be part of the EURO area after 1999.

Square 7: In the H hour the reality of the state-members of the Euro area

Inflation rates		Balance of public administrations (%GDP)		Brut Debt (%GDP)	
Belgium	0,9	Ireland	0,4	Luxembourg	5,3
Austria	1	Luxembourg	0,1	Finland	55,8
Ireland	1	Finland	-0,9	France	58
France	1,3	Netherlands	-2	Germany	61,3
Germany	1,4	Belgium	-2,1	**Portugal**	**61,9**
Luxembourg	1,5	**Portugal**	**-2,5**	Austria	66,5
Finland	1,6	Spain	-2,6	Ireland	67
Italy	1,8	Germany	-2,7	Spain	68,3
Spain	1,9	Austria	-2,7	Netherlands	72,7
Portugal	**2,1**	Italy	-2,7	Italy	121,6
Netherlands	2,2	France	-3	Belgium	123

Journal Expresso, 28 FEB 1998, "Portuguese revenge", LT

From this square where the Portuguese performance is situated according to its merit it's possible to realize that the worse previsions were not valuable and that Portugal did accomplish the criteria; and didn't occupy the last place in neither of them. These results also reflect a curious nominal converge, especially in the first two criteria (inflation and deficit/GDP), because the dept/GDP still shows unless three countries a bit away from the others (not mentioning away from the limit of 60%).

5.2 Real Convergence

Real Convergence takes time and considerable effort from the part of all the state-members. Is traduced by structural changes, stronger economic growth, better living standards and general development of the economy. Real convergence represents macroeconomic stabilization and a group of permanent effects leading to higher domestic flexibility, also to be able to face the possible asymmetric shocks.