

THE PORTUGUESE DISINFLATION PROCESS: ANALYSIS OF SOME COSTS AND BENEFITS

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Abstract

The present study main goal consists in analysing the Portuguese economic policy of disinflation through a nominal stabilization policy of the Portuguese Escudo. We study the pegging of the Portuguese Escudo (PTE) to the Deutsch Mark (DM) taking for granted the anti-inflation reputation of the *Bundesbank* and the role played by the Deutsch Mark in the stability process of the foreign exchange and of the European price level.

Besides the group of domestic macroeconomics variables, we included also in our analysis variables that represent the Portuguese foreign context, such as the Consumer Price Index, the Nominal Interest Rate and the Gross Domestic Product (GDP) of Germany. The methodology used to study the Portuguese disinflation process consisted in obtaining co-integrating relations using the Johansen's methodology, in the construction of a Near-VAR model and in the accomplishment of a shocks simulation analysis.

The acceptance of the German monetary policy and the pegging of the Escudo to the Deutsch Mark allowed the Portuguese economy to successfully achieve the primary goal of price stability. However, despite the credibility and stability gains obtained, the adoption of a disinflation policy drove to a real appreciation of the Escudo.

This study tries to clarify the influence that an appreciation of the real exchange rate can have on GDP and the price level. We can not deny that Portugal made enormous progresses in its process of European integration, being able to integrate the group of EMU member-states. Nevertheless it is also possible to identify as a cost associated with the disinflation process the decrease of the Portuguese competitiveness. This reflects itself in the practice of low wages, limiting in this way output growth.

We find that the knowledge of the benefits of disinflation as well as of the cost as far as output is concerned of these policies is therefore of primary importance.

JEL Classification: C32, C51, E42, E58, F31, F33.

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