

## THE PORTUGUESE DISINFLATION PROCESS: ANALYSIS OF SOME COSTS AND BENEFITS

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This study aims to analyse 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) knowing the reputation of the *Bundesbank* for its anti-inflationary *record* and the role played by the Deutsch mark in the stability processes of foreign exchange and European price levels. The study was based on the attainment of co-integrating relations using Johansen's methodology, the construction of a Near-VAR model and the establishment of a simulation analysis. The acceptance of German monetary policy and the pegging of the escudo to the Deutsch mark allowed the Portuguese economy to achieve its primary goal of price stability. However, despite the credibility and stability gains obtained, the adoption of a disinflation policy led 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 price levels. It cannot be denied that Portugal has made great progress in its European integration, successfully integrating into the group of EMU member-states. However we can point to a decrease in Portuguese competitiveness as the price paid for the disinflation process. This reflects itself in lower wages, which in turn limit output growth. We find that it is of primary importance to realise both the benefits of disinflation, and the costs of the policies in terms of output.

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