SPEECH

Learning from Lisbon: recovery and resilience in Europe

Speech by Christine Lagarde, President of the ECB, on the occasion of the 175th anniversary of Banco de Portugal in Lisbon

Lisbon, 3 November 2021

Introduction

I am delighted to be here in Lisbon to celebrate the 175th anniversary of the Banco de Portugal, an institution that can be proud of its contribution to Portuguese history.

And it is a history that is fused with Europe. Lisbon was home to the peaceful Carnation Revolution of 1974, which ushered in democracy and marked a crucial step towards Portugal's membership of the European Community. Not long after, the city gave its name to one of the most important treaties to have shaped the European Union – the Treaty of Lisbon.

But Portugal's past is also rich with lessons for Europe today. One of the defining events for Portugal was the Lisbon earthquake of 1755, which struck the city in the early hours of a November morning.

The earthquake was first and foremost a human tragedy. The number of deaths in the city was estimated at between 20,000 and 30,000.[1] The catastrophe sparked a great debate about the causes of such destruction, attracting the finest minds of the era, such as Voltaire and Kant, and marking a seminal moment in the European Enlightenment.

The earthquake was also an enormous economic shock, costing between 32% and 48% of Portuguese GDP.[2] Yet the Portuguese leaders of that time managed to turn a terrible disaster into a starting point for transformation. They acted immediately and forcefully in the direct aftermath of the earthquake, providing life-saving assistance to the city's population and focusing on recovering from the natural disaster. This prevented an even greater catastrophe.

Perhaps most crucially, the earthquake provided the government with a now-or-never moment for a far-reaching reform of the economy.[3] Portugal launched a series of measures, including industrial development policies, that would go on to revitalise the country in the latter half of the eighteenth century.

There are some clear parallels between that episode and the situation in Europe today as we recover from the coronavirus (COVID-19) pandemic.

We have also faced a human tragedy, with over 800,000 people in the EU losing their lives.[4]

We have reacted decisively to prevent even worse outcomes: policies have worked together in an unprecedented way to preserve jobs and stave off bankruptcies.

And now we have a chance to transform the economy, accelerating the necessary green and digital transitions and protecting ourselves in a fast-changing world.

In this process, we have drawn – and must still draw – on the strengths that characterised Portugal's response to the unexpected disaster of the Lisbon earthquake: **resolve**, **recovery**, and **resilience**.

Resolve and recovery

Following the outbreak of the pandemic, the euro area experienced a highly unusual recession.

We saw an extraordinary contraction in economic activity with euro area real GDP's steepest fall on record.[5] Portugal's economy was hit even harder.[6] Lockdowns and physical distancing measures delivered a particularly hard blow to the services sector, which is the most labour-intensive part of the economy. This threatened jobs and incomes on a previously unforeseen scale.

But the historic magnitude of the pandemic crisis was matched by the **resolve of Europe's policy response** to overcome it. Faced with an unprecedented threat to citizens' welfare, we saw an unprecedented degree of alignment between monetary policy, fiscal policy and regulatory policy – and unprecedented cooperation between European countries.

In particular, national and European policies worked together to protect jobs by financing wide-ranging job retention schemes. More than one-quarter of the labour force in Portugal benefited from temporary state support during the most acute phase of the crisis in 2020.[7] This was aided by close to €6 billion in loans under the EU's SURE instrument.[8]

This decisive joint intervention meant that, despite the scale of the contraction, the unemployment rate increased only marginally – by less than half a percentage point between 2019 and 2020 – in Portugal and the euro area as a whole.[9] For comparison, after the great financial crisis, the unemployment rate rose by well over 4 percentage points in both.

The ECB also played its role. Our pandemic emergency purchase programme (PEPP) ensured that financing conditions for all sectors of the economy remained favourable, even during the darkest moments of the crisis. Coupled with measures taken by ECB Banking Supervision, our policy response is estimated to have saved more than one million jobs.[10]

The overall European policy mix proved crucial in bridging the crisis while vaccination campaigns got underway. Today over three-quarters of adults in Europe are fully vaccinated.[11] Portugal has the highest rate of fully vaccinated people in the world, according to one measure.[12]

As a result of Europe's resolve, we have created the **conditions for a sustained recovery**.

We expect to see euro area GDP back at its pre-pandemic level before the end of this year, while Portugal's GDP should reach that level by mid-2022.[13] After the great financial crisis, it took the euro area seven years to get back to its pre-crisis level and Portugal a decade. However, growth momentum is moderating somewhat owing to the effects of supply bottlenecks and the rise in energy prices.

Market interest rates have risen over the past weeks, mainly as a result of greater market uncertainty about the inflation outlook, spillovers from abroad to policy rate expectations in the euro area, and some questions about the calibration of asset purchases in a post-pandemic world.

In our forward guidance on interest rates, we have clearly articulated the three conditions that need to be satisfied before rates will start to rise. Despite the current inflation surge, the outlook for inflation over the medium term remains subdued, and thus these three conditions are very unlikely to be satisfied next year.

Regarding asset purchases, for the time being, we continue to use the PEPP to safeguard favourable financing conditions and ensure that borrowing costs for all sectors of the economy do not unduly tighten. An undue tightening of financing conditions is not desirable at a time when purchasing power is already being squeezed by higher energy and fuel bills, and it would represent an unwarranted headwind for the recovery.

As for the calibration of bond purchases in a post-pandemic world, we will announce our intentions in December. Even after the expected end of the pandemic emergency, it will be still important that monetary policy – including the appropriate calibration of asset purchases – supports the recovery and the sustainable return of inflation to our target of 2%.

European resilience in an uncertain world

With the recovery underway, now is the time for Europe to focus on **building more resilience**.

The pandemic has created both internal and external challenges for Europe.

Internally, it has irreversibly sped up the green and digital transitions. Nine out of ten Europeans now want the EU to become climate-neutral by 2050.[14] And the pandemic has accelerated the digitalisation of products and services in Europe by seven years, according to one estimate.[15]

This is a positive development, but it could create difficulties if the transition is not managed well. Specifically, if we move too slowly, there is a risk that the green transition may cause more volatility in energy prices. The digital transition could also increase inequality between those with high levels of digital skills and those without.

Externally, the pandemic has shown us how vulnerable we are to disruptions that threaten the global trading order – and this is particularly true for Europe, with our deep integration into the global economy.

Indeed, today's supply chain disruptions may only be a dress rehearsal for some of the difficulties we will face when natural disasters become more frequent, or if international relations become more fraught and supply chains start to be influenced by geopolitical biases.

So how can we strengthen our resilience along these two dimensions?

On the internal front, we need to step up our investment in the sectors of the future. And we have an ideal tool for the job: the €750 billion Next Generation EU (NGEU) fund. It gives us a mechanism to stay focused on future-oriented investment even when national fiscal policies become less expansionary after the pandemic. And it helps reduce the green and digital divide within Europe, which is crucial for ensuring that future growth is equitable.

There are major opportunities here for Portugal. Over the last 15 years, the carbon intensity of Portugal's economy was over one-fifth above the EU average.[16] The European Commission's most recent Digital Economy and Society Index placed Portugal 18th out of 27 in terms of digital performance.[17]

But now Portugal, one of the first to submit proposals for NGEU funds, is set to receive €16.6 billion in grants and loans, a sizeable majority of which will support green and digital initiatives.[18] This should reinforce the positive trends that are already underway: for example, energy sector carbon emissions have halved since 2005.[19]

To make the most of this opportunity, all economies need to be able to adapt to changes faster. As demand moves towards the sectors of the future, supply needs to be able to adjust with it.

This is an important reason why NGEU is linked to reform plans that allow the economy to make the most of the European investment push. In this area, Europe can in fact learn from Portugal's experience. The country suffered very badly during the sovereign debt crisis, but it managed to implement difficult labour market reforms as part of an economic adjustment programme. These reforms ultimately increased the labour market's ability to adjust to changes.[20]

On the external front, we need to be ready for a more uncertain world. As I have recently argued, this means using Europe's economic weight to support reciprocated trade openness globally, while strengthening its own domestic demand to insure against a more volatile global economy.[21]

Europe's goal of "open strategic autonomy" helps reduce vulnerabilities while continuing to support open trade. That goal can include pursuing supply chain diversification for those inputs that have strategic implications for the European economy. For example, 93% of the EU's supply of magnesium, a crucial resource for the automotive and construction industries, comes from China alone.[22]

As a result, regionalisation will likely become more important for Europe, a trend that was already clear before the pandemic. Export integration within the euro area consistently outpaced export integration with the rest of the world in the decade following the great financial crisis.[23] In fact, by 2019 over 70% of the euro area's contribution to global value chains was regional.[24]

This is a trend that Portugal is well placed to benefit from. Its gains in competitiveness during the last crisis helped the country enjoy strong export growth in the years leading up to the pandemic.[25] In recent years, Portugal has formed stronger trade ties with the euro area as well. By July 2021, roughly 65% of Portugal goods exports went to the euro area, compared with under 60% back in 2014.

Conclusion

Let me conclude.

For Europe to master today's challenges, we must demonstrate a drive and capacity for reform. That requires courage. We should follow in the footsteps of the people of Portugal all those generations ago.

The pandemic, like the Lisbon earthquake, was a human tragedy and an unexpected economic shock. But through its resolve, Europe has achieved a strong economic recovery. Let us now work on building a more resilient future.

And as we look to that future, I am reminded of the Portuguese poet Fernando Pessoa, who once wrote, "Trago comigo as feridas de todas as batalhas que evitei" – "I bear the wounds of all the battles I've avoided."

If Europe does not seize the unique opportunity presented by the pandemic and push ahead with the transformation of the economy, we will all be the worse for it in the long run.

But we can take courage from the example set by our forebears. If Portugal could achieve such a fundamental revitalisation of its economy in the eighteenth century, so too can Europe in the twenty-first century.

Europe should embrace this lesson from Lisbon.

1. Pereira, A.S. (2009), "The Opportunity of Disaster: The Economic Impact of the 1755 Lisbon Earthquake", *The Journal of Economic History*, Vol. 69, No 2, June.

2. ibid.

3. ibid.

4. Figure as at 2 November 2021. See Ritchie, H., Mathieu, E., Rodés-Guirao, L., Appel, C., Giattino, C., Ortiz-Ospina, E., Hasell, J., Macdonald, B., Beltekian, D. and Roser, M. (2021), "Coronavirus Pandemic (COVID-19)".

5. Eurostat (2021), data can be found here.

6. Eurostat (2021), data can be found here.

7. European Commission (2021), "Post-Programme Surveillance Report – Portugal, Spring 2021", June.

8. European Commission (2021), "The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE)".

9. It should be noted, however, that the unemployment rate alone does not summarise labour market dynamics. Both the number of people in the labour force and the hours worked in the economy remain below their pre-pandemic levels. See Eurostat (2021), data can be found here.

10. Lagarde, C. (2020), "Monetary policy in a pandemic emergency", speech at the ECB Forum on Central Banking, 11 November; see also Altavilla, C., Barbiero, F., Boucinha, M. and Burlon, L. (2020), "The great lockdown: pandemic response policies and bank lending conditions", *Working Paper Series*, No 2465, ECB, Frankfurt am Main, September.

11. Figure as at 2 November 2021, with reference to the European Economic Area. See European Centre for Disease Prevention and Control (2021), data can be found here.

12. Ranking as at 2 November 2021. Reference specific to “Share of people fully vaccinated against COVID-19”, with “Share of people only partly vaccinated against COVID-19” omitted. See Ritchie, H., Mathieu, E., Rodés-Guirao, L., Appel, C., Giattino, C., Ortiz-Ospina, E., Hasell, J., Macdonald, B., Beltekian, D. and Roser, M. (2020), “Coronavirus Pandemic (COVID-19)”.
13. European Commission (2021), “European Economic Forecast, Summer 2021”, *European Economy Institutional Papers*, No 156, July.
14. European Commission (2021), “Eurobarometer Survey: Europeans consider climate change to be the most serious problem facing the world”, 5 July.
15. McKinsey (2020), “How COVID-19 has pushed companies over the technology tipping point—and transformed business forever”, 5 October.
16. European Parliamentary Research Service (2021), “Climate action in Portugal”, September.
17. The ranking here omits the United Kingdom, which was included in the 2020 analysis. See European Commission (2020), “The Digital Economy and Society Index. European Analysis 2020”.
18. European Commission (2021), “Factsheet: Portugal’s recovery and resilience plan”.
19. European Parliamentary Research Service (2021), “Climate action in Portugal”, September.
20. European Commission (2016), “Ex Post Evaluation of the Economic Adjustment Programme, Portugal, 2011-2014”, *European Economy Institutional Papers*, No 40, November.
21. Lagarde, C. (2021), “Globalisation after the pandemic”, 2021 Per Jacobsson lecture at the IMF Annual Meetings, 16 October.
22. European Commission (2020), “Study on the EU’s list of Critical Raw Materials – Final Report”, September.
23. See Box 1 in Work stream on globalisation (2021), “The implications of globalisation for the ECB monetary policy strategy”, *Occasional Paper Series*, No 263, ECB, Frankfurt am Main, September.
24. Cigna, S., Gunnella, V. and Quaglietti, L. (forthcoming), “Global Value Chains: Measurement, Trends and Drivers”, *Occasional Paper Series*, ECB, Frankfurt am Main.
25. OECD (2019), “OECD Economic Surveys: Portugal”, February.

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