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THE OPPORTUNITY FOR THE EURO'S INTRODUCTION IN ROMANIA AND HUNGARY

After 2004, more than half of the 13 countries that joined the EU, 7 have already joined the eurozone, too, while 6 countries, including Romania and Hungary, the subject of our research have not yet to join. Moreover, apart from some press releases it does not even seem when Prague, Warsaw, Zagreb and Sofia beside Budapest and Bucharest enter the ERM-II system, which is considered the euro hall. Therefore, in our paper, we examine the trade and economic indicators for the two chosen countries that are not included in the Maastricht Convergence Criteria, at the same time we do not think it is possible to set aside them if we want to use the European single currency in the future in a sustainable way. We present our work as a thought-provoking, and we would like to contribute with our analysis to the possible biggest domestic macroeconomic changes in the next decade. In our view, only the smallest challenge is the introduction of the euro from the perspective of the real economy. Greater efforts will be made by sustainable economic development in the euro area.

1. ECONOMIC OVERVIEW OF ROMANIA

The economic growth of Romania have shown a growing tendency in the last years, consequently it reached a 4,9 % GDP growth in 2016. Although this performance is far below the pre-crisis levels, it is remarkable from the countries in the region. Expansion is due to expansionary fiscal policy, low unemployment, and an upswing in domestic demand. The unemployment rate, which is also moderate at international level, continued to decline in post-crisis years, reaching 5,9% in 2016, which strengthens internal consumption growth. The household consumption is supported by the fiscal incentives, namely the wage growth (12,8% annual growth), and VAT-reduction (the average VAT rate declined from 24% to 20%) in addition to positive labor market trends. The investment demand shows a growing tendency due to the favorable macroeconomic environment, while the level of public investment is low, due to the very small use of EU funds [European Commission, 2017b].

Despite the positive labor market trends and the dynamic economic growth, the extremely high poverty rate is a serious problem. According to the World Bank' data, the rate of people with extreme poverty dropped from 11% to 6,6% in the total population over the last four years, while the financial deprivation in the periphery is still high. [World Bank, 2017]. The inequality of the incomes are growing constantly, which problem is sensible mostly between the bigger cities and the countryside. The effect of the tax system, to reduce the social differences is extremely low [European Commission, 2017b].

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The economic growth is supported on by the growing export. The reason for this is the emergence of European market outlets, the boost of the export to the non-European partners and the low world market trend of oil prices. Romania's most important foreign trade partner is still the European Union, the economic merger has strengthened in the last 10 years since the accession. Romania exports more than 70% of its export articles to the EU. It means in the same time, that likewise the surrounding countries, it is exposed to the fluctuations in foreign trade trends [Eurostat, 2017b]. The machinery and transport equipment reckon among the most important export articles. However, despite the well-performing exports, the external trade balance remains weak, largely contributed to the strengthening of imports as a result of internal consumption [European Commission, 2017b].

Romania's stable banksystem have strengthened the international investor's trust, but it is important to note that mostly foreign banks are the dominant on the market. The capital adequacy of the banksystem is sufficient, the profitability is strengthened, as the non-performing loans had decreased in balance sheets, and the loan-to-deposit ratio has been improving since the crisis and reached 87% in 2016 [European Commission, 2017b].

2. ECONOMIC OVERVIEW OF HUNGARY

The Hungarian economy has been characterised by stable growth over the last few years, resulting a 2,2% expansion in 2016, but the pace of the growth is still below pre-crisis levels [MNB, 2017c]. Growth was mainly driven by the recovery of domestic demand and the strong export performance. The rising consumption of household sector is driven by real wage-growth, low inflation and positive labor market trends. The unemployment has eased to a record low level after the crisis, therefore the unemployment rate was at 5,1% in 2016 to which an increasing activity rate was associated. Economic growth, however, curtailed by the decline in public investment due to the temporary reduced use of public investment. The level of the private sector's investment is still low, which can be originate in the banksector cautious lending willingness. [European Commission, 2017a].

As a small open economy, Hungary's export performance greatly contributes to the dynamic growth. The primary market outlets are the member states of the European Union. The external trade of Budapest is with 80% of the above mentioned countries [Eurostat, 2017a]. In case of the export articles, the products of vehicles dominate. The import shows also an increasing trend, which is supported primarily by the rise of domestic demand., however, the external trade balance remains sufficient. In addition to the prosperous trade flows, it is important to mention the increase in unit labor costs, which, in addition to improving higher real wages and moderate productivity, has a negative impact on the competitiveness of the country in the long run [European Commission, 2017a].

The banksector has stabilized after the crisis, the sector's capitalisation is eligible, its shock resistivity is strong. The loan-deposit ratio in the previous year reached the 81%, the profitability's tendency have improved due to the favorable macroeconomic environment and the tax cuts affecting the sector. Despite the prosperous expectations, banks' lending willingness remains low, especially in the corporate sector. The MNB have launched plenty of lending revival program, mainly for the SME-sector, which have stimulated the economy. After the forintization, the balance of credit institutions has been cleaned and asset quality improved, but the rate of non-performing loans continues to be significant, which also contributes to the moderate lending willingness. [European Commission, 2017a].

3. FULFILL THE MAASTRICHT CRITERIA

The Maastricht criteria and their fulfillment are the cornerstones of European Monetary Cooperation and the mandatory, but not automatically gaining of the eurozone membership. This applies to all Member States, even for countries with opt-out status, such as Denmark³ and the United Kingdom⁴.

The 5+1 Maastricht Criteria, also known as the Convergence Criteria, which must be met by the accessing countries, as the following:

1. The rate of financial deterioration, i.e. the inflation rate, should not exceed the average of the three lowest inflation rates of the Member States by more than 1,5 percentage points. This, of course, also applies to Member States with deflationary values, that is to say not only the accelerating inflation rate should be taken into account for the national bank of that country, but also for a possible reduction in the price level.
2. The ratio of the annual general government deficit must not exceed 3% of the GDP at the end of the preceding fiscal year.
3. The ratio of gross government debt must not exceed 60% of the GDP at the end of the preceding fiscal year. However, at this criterion, it is important to note that most Member States, typically older Member States, have failed to meet the low government debt ratios required. Among the older Members States, Austria, Belgium, the United Kingdom, Finland, France, Greece, the Netherland, Ireland, Germany, Italy and Spain have failed to meet this criteria in 2016. The euro-using Luxembourg and Denmark and Sweden, which did not the use the euro, could only keep the 60% criteria. For this reason, an easing has been introduced earlier, which means that it is not necessary to lower the value of the 60% government debt to GDP, but it is important that the government debt should fall year by year and approach the target.
4. Long-term interest rates shall be no more than 2 percentage points higher, than the average of the 3 EU member states with the lowest HICP inflation.
5. It is important and also the criteria that, for the two years prior to the actual euro zone accession, the national currency should participate in the European Exchange Rate Mechanism (ERM) so that the national currency can not be devalued over that period compared to the euro. It is responsible not only for the national bank of that country but also for the European Central Bank to assist in the event of a crisis or pressures on currency.
6. Although it is not common to mention it, an important criteria is that monetary policy must be independent of fiscal policy. This is the basis for the European single currency system and its use, which is based on the model of the German monetary system. That is, the national bank can not finance government spending. This is a good example for Sweden, where the criteria is directly ignored, but de jure facing the country, in its constitution stated that the Swedish National Bank is not independent of fiscal policy, so Stockholm can not introduce the euro [ECB, 2016].

Let us now look at how Romania and Hungary are fulfilling the Maastricht Criteria.

³ Denmark does not have to introduce the European single currency, only if the Danish government decides so, and the Danish public opinion decide and support it with a referendum.

⁴ The United Kingdom's opt-out position- apart from the outcome of the Brexit-negotiations- is weaker than the Danish position. London will have to introduce the euro once, the government decides on this date. In case the Brexit-negotiations end the secession, this position will naturally cease for London.

3.1. FULFILL THE MAASTRICHT CRITERIA IN ROMANIA

Although Romania is among the less developed ones from the newly acceded countries, it can be said that if we look only at the convergence criteria for accession of the monetary union, Bucharest could soon join ERM II. However, long-term sustainability of this performance is already questionable, joining the euro zone not only creates stable monetary conditions but also the long-term sustainability of real economic indicators that can not be directly reflected in the Maastricht Criteria. It can fundamentally influence the criteria are necessary for the euro zone's membership would be positive for Romania (and all other Member States).

In case of Romania, the biggest challenge was caused by the national currency's, the RON's deterioration. After the failure of the Ceausescu-dictatorship, primarily because of the shortage of the supply, the deterioration's value was the highest in Central-Europe. The currency's impairment loss exceeds annually 200% in 1992-1993 [Paun – Topan, 2013]. The Romanian National Bank reached an one-digit deterioration in 2005. The decisive factor in this was the fact that Romania and Bulgaria signed accession application to the EU in Luxembourg in 25 April, 2005. This way Bucharest have joined not only to the most developed economic integration community of the world, but in the long run, glut is also provided to the country. The full membership secures a stable background to the goods-cash balance. Inflation has reached the lowest value since the change of regime and in the negative range in 2015, so the National Bank of Romania (NBR) remained below the 2,5% inflation target. The inflation have shown a downward trend over the past 10 years due to, among other things, VAT-reduction, the low worldprice of the oil and the moderate inflation environmet in the Eurozone, NBR has been able to carry out monetary loosening in several quarters between 2013 and 2015 [NBR, 2016].

In 2016 we were talking about deflation when (-1.1)% was the change in the value of money, which means that the value of the price level [Eurostat, 2018b]. In the first 11 months of 2017 the inflation was below 1% in Romania, thus due to the EU membership and the associated balance of money and goods, Bucharest meets the inflection criterias.

Due to EU criteria, fiscal stability was achieved in the years following the crisis. But this performance is largely dependent on world economic trends. Compared to the eurozone's indicator used as reference, it can be said that as soon as a recession starts, the Romanian budget deficit is over the eurozone average, which means that the economic downturn is likely to deteriorate rapidly and dramatically in the recession period. This is because the economy does not have internal reserves that could be activated during the deconstruction period. There is a lack of internal diversified production capacity that would be able to provide the state with a sufficient tax revenue [Tradingeconomics, 2018b].

In addition, since 2014, it has decided to reduce the Romanian government's deficit, including the social security contribution and the VAT rate (the overall VAT rate has fallen from 24% to 20%), and a widening of public sector wages, totaling 2,5% resulting in a percentage deficit at the end of 2016 [European Commission, 2017b]. The 2,9% deficit target set by the government for 2018 [NBR, 2016] is unlikely to be met under the current procyclical fiscal policy, and endangers the low level of government debt to GDP ratio. If fiscal loosening continues, there is a risk that the country will again be subject to an excessive deficit procedure, which, according to the European Commission's decision, will be abolished in Romania in 2013. [Tradingeconomics, 2018c].

The issue of national debt is very favorable for Romania. In 2016, the value of GDP was 37,6%, which, in addition, is steadily increasing, although not at a rapid pace but decreasing, while financing is stable. The structure of sovereign debt in the long run jeopardizes sustainable

financing, with the ratio of external debt to nearly 50%, a significant part of which is listed in euros. The reason for increased external funding is partly Romania's EU membership, as the country has gained access to international capital markets. Short-term debt elements pose additional risks, but government aspirations to extend maturities will reduce market concerns [NBR, 2016].

Unless an irresponsible, far beyond the country's power of spending (without investment loans) or a new world economic crisis, as it happened in 2008-2009, the criterion of gross debt seems to be fulfilled in the long run.

Where, however, the obligation assumed is not fulfilled, is the long-term interest rate. Its value exceeds the average of the three lowest inflation-rate Member States in the euro area by 3 or more points year by year, indicating that investor confidence is not strong enough for a eurozone membership. At the level of political instability, the investor atmosphere is worsening. Despite the serious government, the composition of the semi-annual Prime Minister's personality and cabinet does not really reinforce trust in the rest of the world.

3.2. FULFILL THE MAASTRICHT CRITERIA IN HUNGARY

Although Hungary is richer than Romania, it does not automatically mean that it will introduce the euro first as its Eastern neighbour. Moreover, in examining the macroeconomic environment - and in this section it should be emphasized that this applies only to the four criteria - we will find something that is more favorable to Bucharest.

The budget deficit is also the central element of the Maastricht criteria in our country. The responsible fiscal management brings with it the declining interest rate and the decline in inflation. Not to mention the fact that the aggregate value of the deficit prevails in the public debt. That is, with tight fiscal policy, government debt can be kept in line.

Interestingly, Hungary has been in the opposite direction from this point of view comparing to the other Member States. In the first decade of 2000s, a huge deficit worldwide was accumulated year after year in the period of a major prosperity in the world economy. Since then, every year since 2012, a 3% budget deficit with the required GDP has been maintained, which is unprecedented in post-communist fiscal policy in Hungary. This was achieved even when the economic recession was still in the EU, meaning that Budapest could keep the budget deficit below 3% in the hope of membership of the euro area and after the introduction. In order to support this, the introduction of electronic cash registers and the Electronic Traffic Control System (EKÁER) was a major step in the revenue side, with the aim of making the taxpaying transparent and thus the bleaching of the economy. The planned fiscal easing, i.e. tax cuts in 2018 (VAT, TAO and bank tax cuts), will lead to a further increase in the budget deficit (MNB, 2017c). Any fiscal expansion would also endanger the stable financing path of sovereign debt.

Of the newly acceded countries, the highest public debt to GDP ratio is Hungary. One of the reasons for this is the legacy of socialism, as a result of which Hungary as the most depleted state has come to the threshold of the change of regime. The debt ratio of more than 85% of GDP reached its lowest level of 51,4% in 2001 and, thanks to irresponsible farming, grew by over 79% in 2010. The Constitution of Hungary, effective from April 25, 2011, also states in Article 36 (4) - (5) that the government debt rate must be continuously reduced until it reaches 50% of the Hungarian gross domestic product.

The most important fact while reviewing the issue of sustainability is that the vulnerability of the country has been further reduced by the reduction of external debt, which by the end of 2016 reached 42% (MNB, 2017c), thanks to the central bank's self-financing program. Sustainable

repayment is facilitated by a favorable change in the maturity structure. Stable financing capacity was also reflected in the risk rating of the country, which contributed to the reduction of interest burdens [European Commission, 2017a].

To sum up, therefore, the value of government debt relative to GDP is improved, which thus complies with euro area standards both in theory and in practice. The past seven years have shown that this is done in a sustainable manner by the country.

Inflation has been moderate in recent years, reaching 0,4% in 2016, with loose monetary policy. According to the forecast of the National Bank of Hungary, if the current expectations are met, inflation reaches the 3% target set by the central bank in the first half of 2019, with an internal fiscal policy much stricter than before. If the world market price of raw materials, especially the oil, does not increase drastically, and manages the labor market reserves so that inflation is not expected to increase in the short term and the inflation rate is not high in the wake of rising wages, then this indicator will also be able to reach Hungary within the given limits.

If, however, the world market trend and the wage surge would accelerate the pace of financial deterioration, the planned VAT cuts and the moderate expectations of the private sector can help to mitigate inflation [MNB, 2017c]. So there is still a tool for Hungarian fiscal policy to be able to keep this Maastricht criterion.

In 2017, the Hungarian long-term interest rate went average by 1,87 percentage points from the average interest rate of the three lowest inflation-rate member states [Eurostat, 2018b]. On this basis, the criterion of interest is also formally fulfilled for Hungary, i.e. for the past 1 year Hungary would be able to introduce the euro. At the same time, we see a risk that the real Hungarian value close to the 2 percentage point difference lies in the fact that in 2015 and 2016 the difference was higher than the reference value and therefore we consider it advisable not to draw far-reaching conclusions. We are making efforts to ensure that Hungary can produce this favorable result in the medium term and thus deliver sustainable Maastricht criteria for the introduction and use of the euro.

It is worth comparing the four Maastricht criteria examined with the average euro area average and their reference values. The charts thus illustrate the approach of the two countries to the main indicators of the currency area.



Source: Eurostat, 2018d

