

HUNGARIAN EURO-ZONE ENTRY, AS EARLY OR AS LATE AS POSSIBLE?

Analysing the performance of the Hungarian economy we can say that the distances from reaching the Maastricht criteria are different, but the ongoing tendencies are positive. Latest by 2013 realistically all the criteria can be met. Concerning the policy related to Hungarian euro-zone entry both from the Hungarian and EU institutions sides there are possibilities for an as soon as possible and an as late as possible approach. The new government can decide the appropriate policy. The positive scenario (which is better for the economy): is a 2014 euro-zone entry with crucial reforms in the budgetary system, together with sizable tax reductions. The negative scenario is that there is no entry during the next political cycle for Hungary.

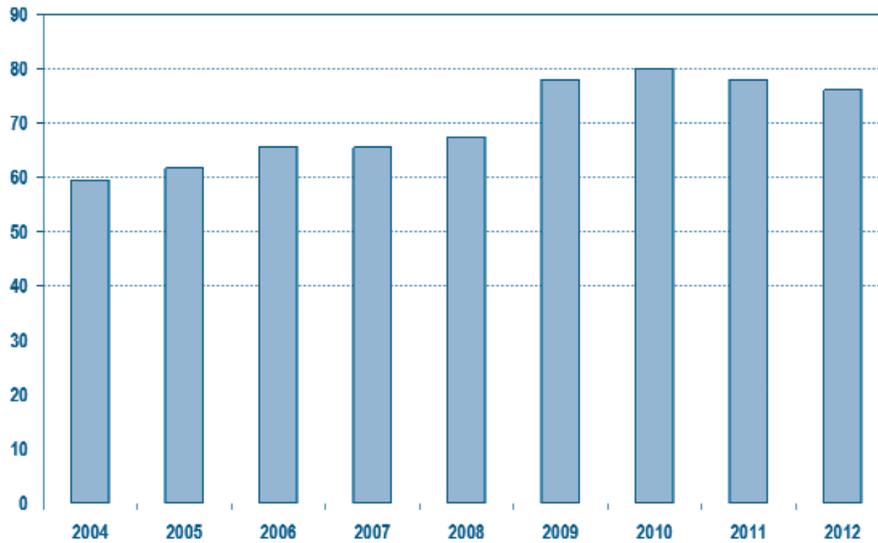
Analysing the performance of Hungary concerning the fulfilment of the Maastricht criteria we can say, that the picture is mixed. The distances from reaching the Maastricht criteria are different, but the ongoing tendencies are positive. Inflation and interest rates are approaching the criteria in coming years. Budget deficit was 3.9% of GDP last year, which is not too far from the 3% limit. The structural budget deficit is below 3% in 2009-2010, which is a good sign concerning the future fulfilment of the criteria.



Source: Eurostat, GKI forecast

Figure 1. Harmonised Hungarian consumer price index and the Maastricht inflation criterion, 2006–2010 (per cent)

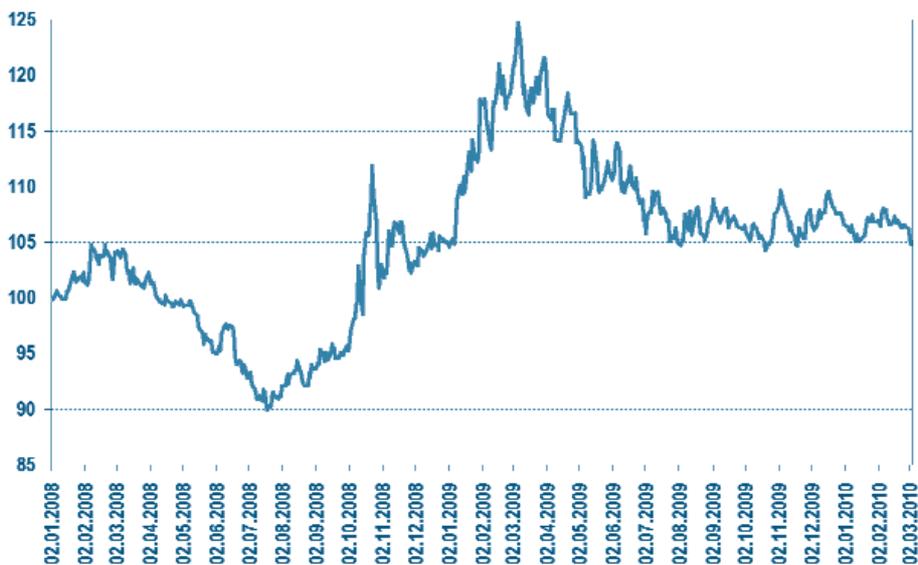
General government indebtedness is above 60%, nearly 80% of GDP in 2009. It will peak in 2010, and assuming 3% GDP growth from 2011, a declining tendency is expected. It means, that the modified indebtedness criterion can be met from 2013 (after 2 years of decline and the very likely continuation of such a tendency.)



Source: Ministry of Finance, GKI

Figure 2. Gross government debt in per cent of GDP, 2006–2012

Interestingly the forint/euro exchange rate is within a not existing $\pm 15\%$ band. But as the ERM-2 entry did not happen yet, there is no possibility legally to measure the fulfilment of the exchange rate criterion (to spend 2 years without depreciation within the band). It can be a major problem for the euro-zone entry, whenever the ERM-2 entry is delayed further.



Source: Ministry of Finance, GKI

Figure 3. Exchange rate fluctuations (HUF/EU)

From the Hungarian side there are two main policy alternatives concerning the euro-zone entry.

- a) The first possible policy is as soon as possible (according to the existing rules). Old arguments for entry are relevant even now (improves growth potential and competitiveness, leads to better fiscal discipline, and so on). The crisis experience demonstrates the stability advantage of euro.

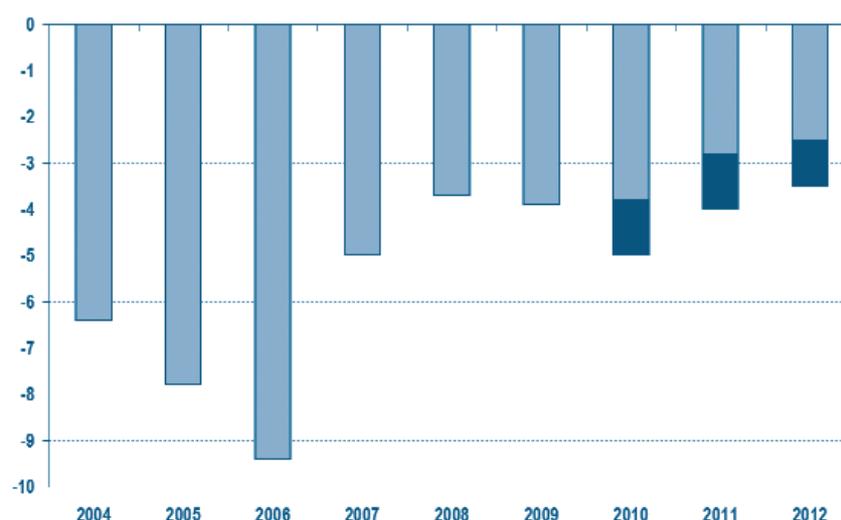
The budgetary criterion can be met by 2012, whenever the needed significant tax reductions will be partially financed by savings on the expenditure side of the budget, implementing deep changes, that is reforms in some fields. (Economic growth also can contribute to tax reductions, but it is not enough alone.) A reliable euro introduction program diminishes the interest rate expenditures of the budget soon and improves competitiveness as well. Such a euro policy can be even politically rational, as it follows the classical approach: the burden is at the beginning, and the fruits are coming at the end of the election cycle.

This means, that at Spring 2013 all the existing criterions can be fulfilled realistically (assuming the ERM-2 entry latest till early 2011) and the euro-zone entry can be implemented at January, 2014.

- b) The second possible policy is as late as possible. It can be followed only without formal declaration (no euro-zone entry target, or a very late target).

Such a policy seems to expand the scope of tax reductions and to help avoiding a part of painful reforms. But with such a policy the interest rates remain higher, the exchange rate weaker, which has effects, very negative on budget. The hoped extra tax reductions coming from such a policy choice can be rather small.

The EU excessive deficit procedure and the strength of the money market limit the budget deficit creation, even with such a policy the deficit should go below 4 % from 2011–12.



■ With consolidation expenditures in 2010 and following different policies in 2010–2012
Source: Ministry of Finance, GKI

Figure 4. General government balance in per cent of GDP, 2006–2012

From the European institutions they are also two possible policies towards zone expansion

- a) As soon as possible (even changing the rules, for example following the Breugel proposals*). There are good arguments supporting the idea. It might help the crisis management. As only 3 euro-zone countries are fulfilling now the budgetary criterion, it is fair to be flexible at new entries, but there is a need to be tougher towards zone members in the future. The potential new entrants do not make a big difference for the size of the zone's economy.

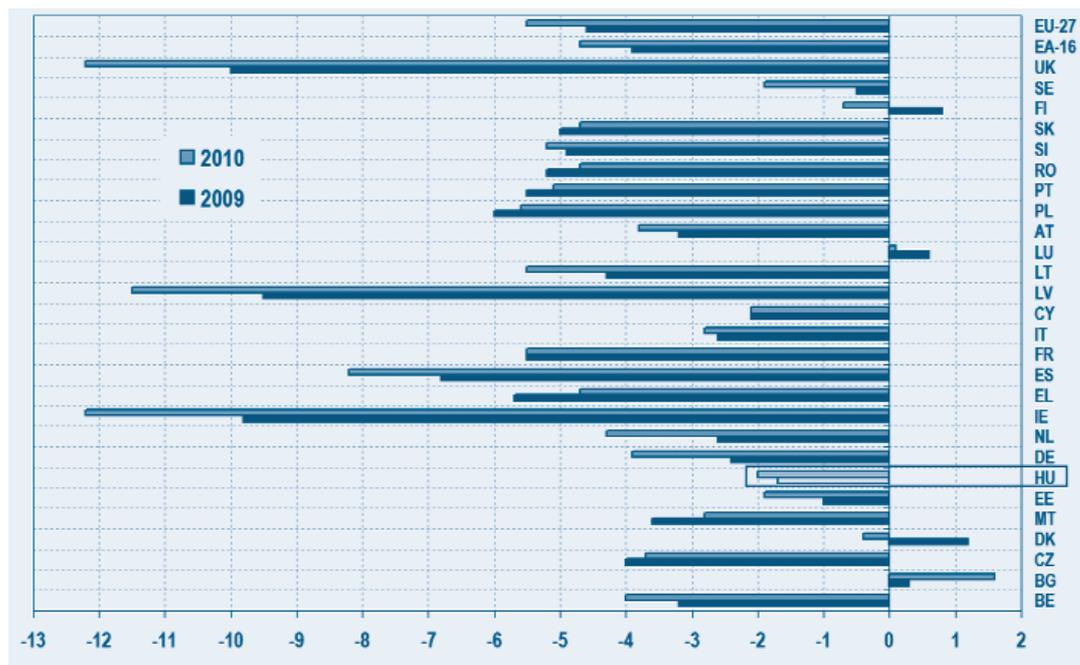


Figure 5. Structural balance 2009–2010 (percent of GDP)

- b) As late as possible. They are mainly hidden arguments supporting such a policy choice. The euro-zone and the ECB face enough problems with the existing members. The sustainability of the fulfilment of the criteria can always be questioned. In case of potential national crisis a non-euro-zone EU country can rely on IMF funds and on depreciation, which favours a delayed euro changeover. The possible outcome concerning Hungary is open. The new government can decide the appropriate policy. The realistic maximum from EU institutions is to accept new candidate countries to the zone, when all criteria are fulfilled. The positive scenario: is a 2014 euro-zone entry with crucial deep changes, that is reforms in the budgetary system, together with sizable tax reductions. The negative scenario is: an as late as possible policy, that is there is no entry during the next political cycle for Hungary. (It might even happen that the Hungarian government and the EU institutions silently agree in practice on such a ground.) Let me hope that the positive scenario will be followed, because it is better for the economy.

* To countries wishing to join the euro, a path to membership should be offered, with clear, economical-ly meaningful benchmarks, instead of atemporal, nowadays largely irrelevant criteria.'