Dear Reader

Our current issue may be considered a thematic publication as the majority of the articles within explore the topic of monetary policy. Beyond the change of governorship at the National Bank of Hungary, the subject is also highly topical due to the fact that as a result of the international financial and economic crisis, the components of monetary policy have changed significantly, and dogmas considered set-in-stone until now have collapsed. For decades, it was a fundamental theory in economic and financial textbooks that the central bank may only be the bank of banks and cannot have any direct contact with enterprises. However, the Fed (the American central bank), upon seeing the damage caused by the crisis decided to do away with this doctrine and accepted corporate bonds as well during its crisis management. The principle of central bank independence also seemed inalterable (and perhaps also slightly over-mystified), but it was in the interest of supporting the ideas of the US government aimed at economic growth that the aforementioned Fed cut the interest rate in a country where the willingness to save dropped to a minimum. From a supervisory aspect, government securities have been considered risk-free in past decades – and now here we are, faced with a number of specific cases of state debts being downgraded, from Southern European countries all the way to what is considered the bastion of market capitalism, the United States.

It became clear during the years of crisis, that flexible inflation targeting has failed to create strong monetary frameworks, and that the supervisory and macro-economic aspects of monetary policy cannot be separated from one another. The harmonisation of monetary and fiscal policy became more important than previously thought, and it is also in evidence that asset prices cannot be ignored when measuring inflation. It is clear that the task of central banks – namely the protection of the external and internal value of money – is not an end in itself, but the instrument of the operation and development of the economy, which also ensures employment.

We may be right to respond to the above with the following answer: but this was exactly the task assigned by the public to central banks until now; why should it be necessary to emphasise it again separately? Could this mean that the assumed or actual needs of society as a whole are not represented emphatically enough in central bank policies? Is it plausible that the current central bank regulation applies different weights to the interests of certain social groups at the expense of others? If it is, how is this compatible with central bank independence? These are the important and topical issues that economist Pál Péter Kolozsi dissects in his article, which analyses and models the frameworks of the assertion of interests against central banks.

The study by *István Dedák* College Professor employs a new approach to the ideas regarding the current crisis and its management, as well as monetary policy,

describing crisis management as a balance sheet adjustment process. The roots of the current crisis are to be found in the over-indebtedness of certain players. This is true for the United States – where the value of debts did remain unchanged in the balance sheet of the private sector, asset prices, however, dropped, resulting in the disappearance of assets that secured the loans – just as it is for Hungary – where widespread foreign currency lending has placed the country in a difficult position. Adapting funds to this new and exaggerated indebtedness is bitter and painful, as someone's financial wealth is always another's debt and vice versa. In crisis management, the more daring overseas regions solved the problem by insolvent debtors losing their assets, and the financial investment institutions and insurance companies that went bankrupt being bailed out by the state through capital injections. All this, however, led to the further indebtedness of the state, i.e. the reduced debt of the private sector was replaced by state debt. If both the private sector and the state are indebted, financing must come from external sources and/or the monetary sector must ease up on its former stringency concerning money creation. Today, however, a policy of interest rate cuts is not sufficient for monetary crisis management; a situation like this calls for unorthodox solutions as well. It also speaks volumes that similarly to the Fed, the European Central Bank was also forced to introduce easing measures when purchasing the bonds of struggling sovereign debtors. How is it possible that this did not lead to significant inflation? This was resolved by the crisis itself, namely by the otherwise troublesome demand deficit. In connection with this, the study by István Dedák clearly points out the fact observed daily in Europe, namely that the policy of fiscal austerity measures does not solve our problems. The cutting of government spending spills over and fiscal multipliers drag the entire economy back with elemental force.

One of the most exciting pieces of our current issue is the SAO analysis that examines the relationship between Hungarian monetary and fiscal policy. The study's starting point is that the task of the State Audit Office, as laid down by law, is to provide opinions on the annual budget plan, and on a related note, in connection with supporting the work of the Fiscal Council, to examine the fulfilment of the constitutional debt rule. What this means is that the mapping and analysis of budgetary risks is inevitable. Within these risks, the study focuses on the fact that pursuant to legislation, every year the central budget must fill up the reserves of the National Bank of Hungary, and compensate for the central bank's losses. The analysis points out that in this respect, the central bank's foreign currency reserves are particularly important, because if interest revenues on these are lower than the interest on financing HUF funds, losses are generated which the budget has to reimburse. Now, the Hungarian central bank has amassed substantial foreign currency reserves over the past years, therefore, this risk is undoubtedly real. The authors also observe that the central bank tools employed in Hungary made it much too favourable for banks to put their excess liquidity in the central bank, therefore it was not in their interest to urge riskier lending activity or seek out opportunities of interbank lending. To put it bluntly: it seems one of the declared objectives of central bank policy was to calibrate a certain level of commercial bank profitability.

It is doubtful whether there would have been demand for loans in the recession period if they were slightly cheaper, but what is certain is that the above observation is in line with the conclusions of our study examining the assertion of interests by certain market players and groups.

The study comparing and juxtaposing the fiscal policies of Hungary and Singapore is informative, and at the same time it supports the search for the way out in Hungary. According to the authors *László György* and *József Veress* (both professors at the Budapest University of Technology), the seemingly far-away example shows how the positive effects of the inflow of foreign capital could have been achieved at costs much lower than those recorded in Hungary. Highly important are the very last lines of the article, which state that Singapore compensates for the appreciation effect of the inflow of capital with a conscious industrial policy that develops competitiveness. This is surely an area where Hungarian economic policy still has some things to do.

The article describing the circumstances of the loans Hungary has taken out from the International Monetary Fund (IMF) also presents many interesting observations and conclusions. Apart from presenting the various borrowings, the study by the Head of Department and University Professor at the St. Stephen University, *György Csáki* also shows that the IMF always makes its decisions on the basis of the *letters of intent* submitted, which means in the case of these loans, there are no agreements in the continental sense, signed by both parties. Not many are precisely familiar with this procedure, which was evident from the public debates on the 2008 borrowing and the analysis of this loan. It is, however, still clear that in spite of all assumed positive impacts, it would still be expedient to avoid using this as the last resort...

I hope you will benefit from the contents of this issue. Pleasant reading!

Katalin Botos
Member of editorial board