Margit Rácz

Thoughts on the crisis based on the situation that has evolved in the European Union

The financial crisis that erupted in the autumn of 2008 and evolved into a global financial crisis at a terrific speed has transformed into a global real economic crisis at a similar pace. The whole of 2009 will surely be a year of crisis. The only question is whether the crisis will reach its lowest point this year, and recovery will start in 2010, or the global economy will be dominated by crisis events for two or three years. The answer to this question cannot be found yet with sufficient probability. Mainly because this crisis cannot be compared to the periods of recession that have been cyclically recurrent since World War II. This time recession in the real economy was triggered by the crisis of the financial sector. A crisis with such a background has been unprecedented in the past 50 years.

Therefore, the number one question is when and how a financial sector capable of prudent lending and built on mutual trust among the banks can be re-created. The second question is what risk factors are implied in the crisis of the real sector – which has evolved due to the lack of loans – for the economy as a whole, and how this will affect the financial sector itself.

Since in 2009 we are only at the beginning of an unprecedented crisis process, these questions cannot be answered with a single or unanimous answer. This would require brave speculations. However, it is inappropriate to outline such speculations in the spring of 2009, since such efforts are significantly affected by the economic views of the expert who predicts the scenario. It can already be seen that some of the liberal economists claim that this crisis is nothing out of the ordinary. At the same time, the opponents of liberal economics, which is marked with the name of Friedman, claim – with some adherence to the Keynesian philosophy – that this is the model crisis of the free market in the extreme sense of the word. Such preconceptions can be overcome only if conclusions can be drawn subsequently, on the basis of facts.

At any rate, the fact that the governments have given and promised banks and companies rescue packages of several hundreds of billion dollars and euros within national jurisdictions, points to the fact that in such a situation only Keynes' recipes can be taken out of the bottom of the drawers. No other recipes have been prepared to date. The initiation of huge infrastructural investments by the governments from state resources also reveals methods based on an economic policy that emphasises the state's role in crisis mitigation. What has triggered the revival of this method of company rescue, which has not been applied for a long time now and has been declared unsuccessful based on the experiences?!

In my opinion there is one reason: mass-scale bank bankruptcies have become imminent.

Primarily, because a bank with a century-old history went out of business in Wall Street. The banking sector has a prominent role in any market economy. With a bit of exaggeration it can even be said that the bank is the "eye" of the economy. Therefore, in the complex and developing market economies the necessary balance is eventually guarded by the banking system. Therefore, if the banking system becomes unable to maintain its normal functions, the market economy is also unable to function. And at the beginning of 2009 it cannot be stated that the entire banking system has surely been cleaned of bad debts.

In connection with the crisis itself it causes a rather big problem that acceptable information is available neither about its course, nor its ending date. Therefore, the short- and medium-term forecasts should be reviewed with a strong critical stance. At any rate, it can already be seen that crisis management is carried out at member-state level, and many conferences are held in parallel, yet with rather modest results so far.

A FEW STATISTICS ON AND ANALYSIS OF THE CRISIS THAT BROKE OUT IN THE AUTUMN OF 2008

The crisis process prompted the European Commission to give an overview on the last two quarters of 2008 in an interim report in mid January 2009, and provide a forecast for the period until the end of 2010. Normally, the Commission issues such forecasts in February. Early publication was motivated by the fact that the macroeconomic figures of the EU in the last two quarters of 2008 were completely different from the former forecasts.

Therefore, it can first of all be noted that a financial crisis of this magnitude and the subsequent downturn of the real economy had not been anticipated. Nonetheless, really substantial changes cannot usually be foreseen. This crisis was already "up in the air", however neither its timing, nor its magnitude could be predicted. *(See Table 1)*

In connection with the forecasts contained in Table 1 it is reasonable to point out that since they were made at the beginning of the year, they may reflect more treasury optimism than sense of reality. It is especially worth comparing the growth data of the EU and US. Growth figures are identical in the 2006–2008 period. This is significantly due to the dynamic growth in member states outside the eurozone and in the CEE region, since the US economy usually grows more rapidly than the economy of the EU. Naturally, only in periods of economic boom. There is one figure in the five-year time series which shows discrepancy, and this is year 2009. According to the forecast of the Commission, the decline in GDP will be significantly greater in the EU than in the US. This difference is similar even if the figure for the US is compared with that pertaining to the eurozone. This is something new compared to former crises. The US usually suffered greater setbacks in the GDP than the EU, however it could overcome the crises more rapidly. This truth seems to fall short in this crisis according to the forecast of the Commission! Maybe it is too early to draw any conclusions from this, yet it gives rise to the slightly sarcastic statement according to which recession comes (as usual) from the US. Insofar this is again the case. But since the non-traditional cause of this recession also stems from the US economy, the crisis will presumably take another course, and the US may eventually be hit harder.

It can also be quite clearly observed from the figures that heterogeneity is rather large-scale within the EU-27 on the basis of these five growth parameters. It cannot even be said that the level of development plays a determining role, i.e. less developed member states develop at a faster pace. Nor can it be said that in this period of good economic performance the development of the most developed EU mem-

Table 1

THE GDP IN THE EU MEMBER STATES AND IN THE US IN THE 2006-2010 PERIOD

(as a percentage of each preceding year)

	2006	2007	2008 *	2009F	2010F **
Belgium	3.0	2.8	1.3	–1.9	0.3
Germany	3.0	2.5	1.3	–2.3	0.7
Ireland	5.7	6.0	–2.0	–5.0	0.0
Greece	4.5	4.0	2.9	0.2	0.7
Spain	3.9	3.7	1.2	–2.0	–0.2
France	2.2	2.2	0.7	–1.8	0.4
Italy	1.8	1.5	–0.6	–2.0	0.3
Cyprus	4.1	4.4	3.6	1.1	2.0
Luxemburg	6.4	5.2	1.0	–0.9	1.4
Malta	3.2	3.9	2.1	0.7	1.3
The Netherlands	3.4	3.5	1.9	–2.0	0.2
Austria	3.4	3.1	1.7	–1.2	0.6
Portugal	1.4	1.9	0.2	–1.6	–0.2
Slovenia	5.9	6.8	4.0	0.6	2.3
Slovakia	8.5	10.4	7.1	7.7	3.1
Finland	4.9	4.5	1.5	–1.2	1.2
Eurozone	**2.9**	**2.7**	**0.9**	**–1.9**	**0.4**
Bulgaria	6.3	6.2	6.4	1.8	2.5
Czech Republic	6.8	6.0	4.2	1.7	2.3
Denmark	3.3	1.6	–0.6	–0.1	0.6
Estonia	10.4	6.3	–2.4	–4.7	1.2
Lithuania	12.2	10.3	–2.3	–6.9	–2.4
Latvia	7.8	8.9	3.4	–4.0	–2.6
Hungary	4.1	1.1	0.9	–1.6	1.0
Poland	6.2	6.7	5.0	2.0	2.4
Romania	7.9	6.2	7.8	1.8	2.5
Sweden	4.2	2.5	0.5	–1.4	1.2
Great Britain	2.8	3.0	0.7	–2.8	0.2
EU	**3.1**	**2.9**	**1.0**	**–1.8**	**0.5**
US	**3.1**	**2.9**	**1.0**	**–1.0**	**0.5**

* estimate
** EC's note: unchanged policies scenario

Source: European Commission, Interim Forecast for the 2009–2010 period, Brussels, 19 January 2009

ber states was the most balanced of all. Growth heterogeneity was typical in years of good economic performance, and remains in place in the crisis period, too.

Of course, during the crisis one will be able to analyse the signs of development heterogeneity with sufficient precision only on the basis of actual figures. However, it is already worth pointing out that within the EU-27 the Hungarian GDP can hardly be compared to the GDP of other countries: growth in Hungary has slowed down since 2006, that is the implementation of the stringent convergence programme, which can be explained with internal causes. Therefore, since the beginning of the crisis, recession has hit Hungary harder than the other countries.

Yet, it is worth observing the countries of the mega-enlargement of 2004 not only because it will be five years in May 2009 that we joined the EU, but also because the analyst institutions of the world also compare the economic performance of the countries of the mega-enlargement within their respective region.

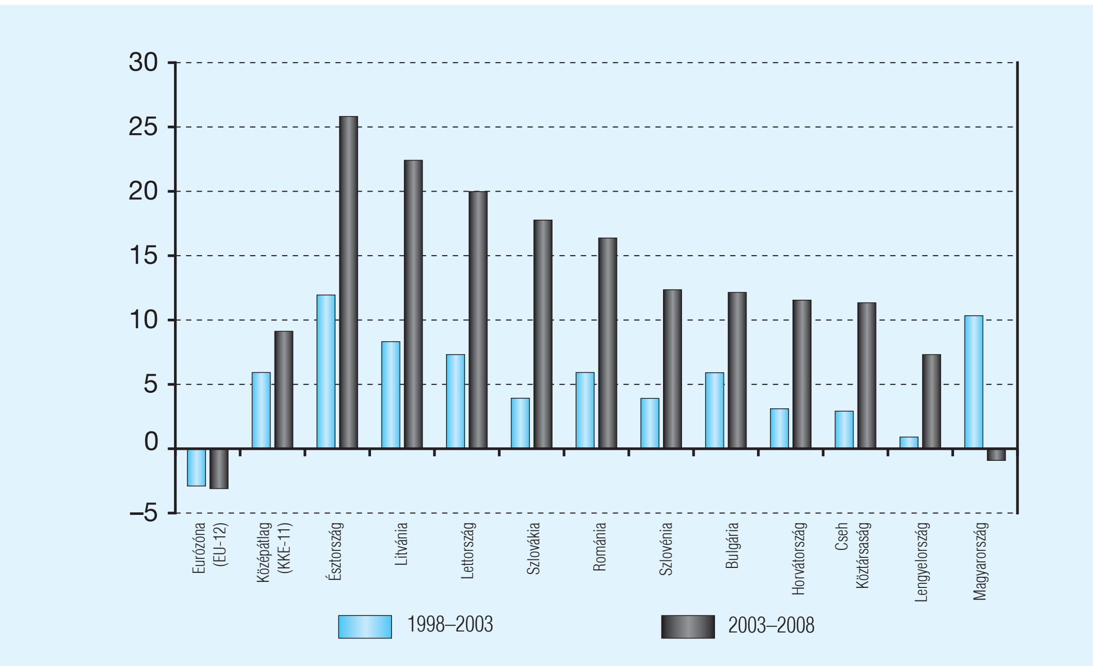
An analysis by Deutsche Bank contains an interesting opinion on which Central and Eastern European countries converge and which do not on the basis of their growth indicators. *(See Chart 1)*

Based on the figures, CEE countries have achieved significant results in convergence in terms of per-capita GDP, since compared to the EU-27, all of the presented countries have managed to attain spectacular results. Naturally, the starting level matters a lot for each country. The presented figures are more characteristic of the speed of convergence than of the attained level. From this aspect Hungary shows an alarming trend, since it has a negative indicator for the 2003–2008 period compared to the average of the EU-27, which draws attention to the fact that convergence has come to a halt in Hungary, what's more, the country has slumped into slight recession. This is why it can be laid down that the development trend in Hungary – at least in the past five years – has been unparalleled in the entire region. In other words: from among the *11 countries analysed, Hungary was the only country that could not capitalise on the global economic boom, which evolved in this period.* This is in part due to this fact that the global economic crisis, which

Chart 1

WHICH COUNTRIES CONVERGE AND WHICH DO NOT IN THE CEE REGION?

(calculated at per capita GDP, purchasing power parity, in comparison to the EU-27, average change, %)



Eurozone (EU-12) = average of the eurozone, calculating with 12 members before the enlargement, Mittelwert CE-11 = the average value of the next 11 CEE countries: Estonia, Latvia, Lithuania, Slovakia, Romania, Slovenia, Bulgaria, Croatia, Czech Republic, Poland, Hungary

Source: Gunter Deuber, Ein Osteuropa gibt es nicht mehr, Deutsche Bank Research, 12 January 2009

Table 2

THE GDP IN THE EU MEMBER STATES AND IN THE US IN THE 2007–2010 PERIOD

(as a percentage of each preceding year)

	2007	2008P	2009P	2010P
Belgium	2.6	1.3	-2.3	0.7
Germany	2.6	1.3	–2.5	1.1
Ireland	6.0	–2.0	–3.5	–0.8
Greece	4.0	3.2	–0.8	0.0
Spain	3.7	1.3	–2.6	–1.0
France	2.1	0.8	–2.3	0.9
Italy	1.4	–0.4	–2.3	1.0
The Netherlands	3.5	2.0	–1.7	0.8
Austria	3.0	1.6	–2.8	0.6
Portugal	1.9	0.5	–2.0	0.3
Finland	4.4	2.0	–1.0	0.9
Eurozone	**2.6**	**0.9**	**–2.5**	**1.0**
Czech Republic	6.5	3.1	–1.0	1.6
Denmark	1.6	–0.8	–2.3	–0.5
Hungary	1.3	0.9	–3.7	1.0
Poland	6.6	4.5	0.4	2.0
Romania	6.0	8.0	1.6	3.1
Sweden	2.7	0.5	–1.0	1.0
Great Britain	3.0	0.8	–2.5	0.6
US	**2.0**	**1.2**	**–2.0**	**1.6**

Source: Deutsche Bank, Ausblick: Globale Trends, 2009. 1.

erupted in the autumn of 2008, has affected Hungary differently and more severely than the other countries of the region.

It is worth reviewing another forecast that starts out of the crisis processes. This forecast was prepared by the experts of Deutsche Bank, the biggest German bank, in the last days of 2008. *(See Table 2)*

The forecast of Deutsche Bank significantly differs from the forecast published by the European Commission a few weeks later. According to banking experts, the GDP decline in 2009 will be greater in many countries than foreseen in the document of the Commission. It is worth mentioning Hungary separately, where the decline will be the largest in 2009 within the countries presented (–3.7 per cent). According to the forecast of Deutsche Bank, the drop in 2009 will be smaller than anticipated by the Commission in Ireland, the Netherlands, Sweden and Great Britain. In all other cases the setback will be greater in 2009 according to the bank. However, Deutsche Bank's forecast is in general more optimistic for 2010. This means that in the opinion of the bank's experts 2010 will show the signs of more definite recovery in terms of GDP growth than according to the document prepared by the Commission.

The difference between the presented forecasts is a good reflection of the uncertainty that has become dominant in connection with this crisis. As far as 2009 is concerned, the only thing that can be surely stated is that considerable decline can be expected across the EU. But there will be significant differences between the countries. It can be well seen *that the large, developed and older EU member states will face a serious recession, which will considerably limit the export possibilities of several EU member states.* From this aspect strong interdependency has developed within the EU-27. Mutual trade may slacken as a result of the crisis, which may affect unfavourably the further liberalisation of the single internal market.

EXPECTED CHANGES IN THE CURRENT PUBLIC FINANCE DEFICIT AND INFLATION IN THE EU MEMBER STATES

During the process of creation of the common currency and in the first ten years of its existence rigorous rules were adopted to ensure compliance with the requirement of stable public finances, and preferably with the requirement of small-scale rise in consumer prices. The Maastricht convergence criteria themselves prescribed stringent financial stability rules as a precondition for EMU-membership. However, within the eurozone, the fiscal criteria stipulated by the Stability and Growth Pact were even more stringent, especially in the case of current deficit, since non-compliance with the criterion on the current deficit may entail the imposition of a fine. Nonetheless, it is worth noting here that several countries have repeatedly violated the requirement, according to which the current deficit shall not exceed 3 per cent of the GDP, and no fine has been paid to date. Instead, the SGP itself has been revised.

However, the crisis that erupted in 2008 poses such a challenge to the enforceability of the rule pertaining to the size of the current deficit which has been unprecedented in the past ten years. Therefore, we have no experience about the mass-scale violation of the regulation and the concomitant obligations. It cannot be known to what extent the standpoint, according to which the extraordinary situation requires extraordinary measures, would be appropriate to ensure the legal tolerability of the massive ignorance of the rules.

The only possibility available to us now is the review some of the forecasts pertaining to the current deficit, similarly to those on the expected GDP growth. *(See Table 3)*

While according to the GDP forecasts decline will be typical in 2009, and 2010 may see the beginning of growth, albeit at a slow pace, figures pertaining to the current public finance deficit show a different picture. *In general, the GDP proportionate deficit will be greater in 2010 than in 2009.* This may be attributed to the fact that *changes in the current deficit follow the drop in GDP growth with some delay.* At any rate, a dramatic situation will evolve according to the stringent SGP rules, especially if the payment of fines would be taken seriously.

Maybe this is the only field in which the development of the Hungarian economy shows a positive tendency, a better one than several member states in the region. This is a significant issue since the current crisis projects the long-term scarcity of international financial resources. Therefore, Hungary will belong to those EU member states in which the financing of the current deficit would gradually become less burdensome as time goes by.

In relation to the public finance deficit it can most probably be assumed that in 2009 there would be several member states, including EMU countries, in which the current public finance deficit will considerably exceed the 3 per cent limit. *Joaquin Almunia,* the EU's Commissioner for Economic and Monetary Affairs, has recently warned that the governments of the member states should watch their current deficits in 2009, since it seems that several countries are unable to meet the deficit target undertaken in the convergence and stability programs. It is worth noting that Ireland, Spain, or France, for instance, may also face an excessive deficit pro-

Table 3

THE PUBLIC FINANCE DEFICIT IN THE EU MEMBER STATES IN THE 2004–2010 PERIOD

(as a percentage of the GDP)

	2004	2005	2006	2007	2008F	2009F	2010F*
Belgium	–0.2	–2.6	0.3	–0.3	–0.9	–3.0	–4.3
Germany	–3.8	–3.3	–1.5	–0.2	–0.1	–2.9	–4.2
Ireland	1.4	1.7	3.0	0.2	–6.3	–11.0	–13.0
Greece	–7.5	–5.1	–2.8	–3.5	–3.4	–3.7	–4.2
Spain	–0.3	1.0	2.0	2.2	–3.4	–6.2	–5.7
France	–3.6	–2.9	–2.4	–2.7	–3.2	–5.4	–5.0
Italy	–3.5	–4.3	–3.4	–1.6	–2.8	–3.8	–3.7
Cyprus	–4.1	–2.4	–1.2	3.4	1.0	–0.6	–1.0
Luxemburg	–1.2	–0.1	1.3	3.2	3.0	0.4	–1.4
Malta	–4.7	–2.8	–2.3	–1.8	–3.5	–2.6	–2.5
The Netherlands	–1.7	–0.3	0.6	0.3	1.1	–1.4	–2.7
Austria	–4.4	–1.5	–1.5	–0.4	–0.6	–3.0	–3.6
Portugal	–3.4	–6.1	–3.9	–2.6	–2.2	–4.6	–4.4
Slovenia	–2.2	–1.4	–1.2	0.5	–0.9	3.2	2.8
Slovakia	–2.3	–2.8	–3.5	–1.9	–2.2	–2.8	–3.6
Finland	2.4	2.9	4.1	5.3	4.5	2.0	0.5
Eurozone	**–2.9**	**–2.5**	**–1.3**	**–0.6**	**–1.7**	**–4.0**	**–4.4**
Bulgaria	1.6	1.9	3.0	1.1	3.2	2.0	2.0
Czech Republic	–3.0	–3.6	–2.7	–1.0	–1.2	–2.5	–2.3
Denmark	2.0	5.2	4.2	4.5	3.1	–0.3	–1.5
Estonia	1.7	1.5	5.9	2.7	–2.0	–3.2	–3.2
Lithuania	–1.0	–0.4	–0.2	0.1	–3.5	–6.3	–7.4
Latvia	–1.5	–0.5	–0.4	–1.2	–2.9	–3.0	–3.4
Hungary	–6.4	–7.8	–9.3	–5.0	–3.3	–2.8	–3.0
Poland	–5.7	–4.3	–3.8	–2.0	–2.5	–3.6	–3.5
Romania	–1.2	–1.2	–2.2	–2.5	–5.2	–7.5	–7.9
Sweden	0.8	2.4	2.3	3.6	2.3	–1.3	–1.4
Great Britain	–3.7	–3.4	–2.7	–2.7	–4.6	–8.8	–9.6
EU	**–2.9**	**–2.4**	**–1.4**	**–0.9**	**–2.0**	**–4.4**	**–4.8**

* EC's note: unchanged policies scenario

Source: European Commission, Interim Forecast for the 2009–2010 period, Brussels, 19 January 2009

cedure. In the past ten years Ireland and Spain have been almost famous for the fact that while they were often unable to meet the inflation criterion, they could comply with the current deficit criterion in an exemplary manner. It is worth mentioning France, since due to its bargaining strength in the ECOFIN Council, it could formerly attain – naturally, together with Germany – that the fine payable for excessive deficit should not be enforced in the period in which the deficit is exceeded.

In relation to all this it can also be observed that there will be increasing speculation according to which this rapid deficit growth may eventually lead to the collapse of the eurozone. Even if this speculation does not lead to the collapse of the eurozone, it will presumably halt, at least temporarily, the dominance of the euro on the world market. Of course, it must not be forgotten that the economic indicators of the US will not be rosy either. (According to some forecasts, the current public finance deficit of the US will equal 13.5per cent of the GDP.)[1] During the eight years marked with the name of George W. Bush, both the current payment and the public finance deficit significantly grew in the US.

In relation to the current balance of payments, the eurozone has tendentially performed better than the US. This tendency continues, but a significant drop in deficit is expected to occur in the US. *(See Table 4)*

The EU member states presented above show a rather heterogeneous picture in terms of the current balance of payments. However, one fact can be observed in the forecasts: the current payment deficit is decreasing in all countries in this four-year period, independent of the initial size of the deficit, at least according to bank experts. In any case, it is probable that in the next few years we will not see an abundance of liquidity similar to that experienced in the past 15 years. This may trigger changes in the current balance of payments.

In addition to the forecast stipulated in the report of the EU Commission, it is again worth presenting the relevant figures contained in the above cited publication of Deutsche Bank on the expected changes in the current public finance deficit, since the bank's figures and forecasts are not necessarily identical with those of the EU Commission. *(See Table 5)*

The forecast for the entire eurozone is definitely more pessimistic than the forecast of the Commission. The difference is distinct espe-

Table 4

THE CURRENT BALANCE OF PAYMENTS IN THE EU MEMBER STATES AND IN THE US IN THE 2007–2010 PERIOD

(as a percentage of the GDP)

	2007	2008F	2009F	2010F
Belgium	2.4	0.5	0.0	–0.5
Germany	7.5	6.2	4.5	5.2
Ireland	–5.5	–4.5	–3.5	–2.0
Greece	–14.0	–14.2	–10.0	–8.0
Spain	–10.1	–10.4	–8.5	–7.5
France	–1.2	–1.7	–2.0	–1.8
Italy	–1.7	–2.0	–1.5	–1.5
The Netherlands	9.8	7.0	7.0	6.0
Austria	3.3	3.0	1.5	0.0
Portugal	–10.0	–11.0	–9.0	–8.0
Finland	5.3	5.5	4.5	4.0
Eurozone	**0.4**	**–0.3**	**–0.4**	**–0.2**
Czech Republic	–2.5	–3.0	–0.5	–0.4
Denmark	1.2	1.0	0.5	1.0
Hungary	–6.5	–6.3	–0.9	–1.4
Poland	–4.7	–4.9	–2.1	–2.9
Sweden	8.4	4.5	4.0	3.5
Great Britain	–3.8	–1.6	–1.1	–2.6
US	**–5.3**	**–4.7**	**–3.5**	**–3.0**

Source: Deutsche Bank, Ausblick, Globale Trends, 2009. 1.

Table 5

THE CURRENT PUBLIC FINANCE DEFICITS IN THE EU MEMBER STATES AND IN THE US IN THE 2007–2010 PERIOD

(as a percentage of the GDP)

	2007	2008F	2009F	2010F
Belgium	-0.3	-0.6	-4.7	-5.8
Germany	–0.1	–0.1	–3.3	–4.9
Ireland	0.2	–5.8	–5.8	–5.6
Greece	–3.5	–3.6	–5.5	–6.0
Spain	2.2	–0.7	–4.7	–5.9
France	–2.5	–3.3	–4.5	–4.3
Italy	–1.6	–2.8	–4.9	–5.3
The Netherlands	0.3	0.8	–2.0	–3.0
Austria	–0.4	–1.2	–4.1	–5.2
Portugal	–2.6	–2.8	–5.4	–6.4
Finland	5.3	4.3	1.4	0.2
Eurozone	**–0.6**	**–1.5**	**–4.3**	**–5.3**
Czech Republic	–1.0	–1.2	–2.5	–3.4
Denmark	4.5	2.5	0.0	–0.5
Hungary	–6.0	–3.2	–2.8	–1.8
Poland	–2.0	–2.3	–2.9	–2.6
Sweden	3.6	2.0	0.0	–1.0
Great Britain	–2.5	–5.3	–8.0	–6.8
US	**–**	**–3.2**	**–8.2**	**–3.4**

Source: Deutsche Bank, Ausblick, Globale Trends, 2009. 1.

cially in the comparison of the figures predicted for 2009 and 2010. According to the forecast of Deutsche Bank, the growth in public finance deficit occurs later than the decline in the GDP. It is especially worrisome that according the experts of the bank, the deficit will be the greatest in 2010 in the entire period under investigation. This means that one must count with a protracted "offence". Several experts have aired their views about the crisis on behalf of the Commission, too, and it has been reiterated that "extraordinary events require extraordinary measures". Of course, this does not show what exactly these extraordinary measures are, and the violation of which rules and how long can be tolerated in the light of these measures. All this clearly indicates that the EU faces a short-term period that will raise serious challenges for all institutions of the Community, at least in relation to the fiscal rules.

For the stability of the euro such convergence criteria were established that assumed direct correlation between the fiscal discipline and the stability of the common currency. The criteria emphasised the approach according to which no inflationary pressure can be exerted on the common currency through lax fiscal policy. During the past ten years several experts have reiterated that since the public finance deficit cannot be financed by starting the banknote press, but only from resources actually borrowed from the money market, the public finance deficit has a much more moderate impact on inflation.[2]

However, this chain of thoughts had no impact whatsoever on the convergence criteria themselves. Of course, in the past ten years no crisis situation similar to the current one has occurred. Within the eurozone, such a significant, mass-scale deficit growth was not an issue. Consequently, it cannot even be presumed whether the review of the criteria will be rejected or not.

After many reverses, the euro itself was introduced to provide protection against the crisis phenomena of the international money market. The introduction of the euro was also determined on the basis of the experience that the national currencies of the EU member states had to face such a speculative wave in the early 1990s that the finance ministers and central bank presidents of the member states could hardly tackle. The current crisis also proves that speculation against the euro is much smaller than against the national currencies of the EU member states.

This may even result in the rise in the member states' commitment for the euro.[3] What is more, it could even encourage more consistent compliance with the convergence criteria. Since the smaller the external financing needs of public finances or the current balance of payments, the smaller the impacts of an external financial crisis are. Therefore, financial stability represents value in any case. But if rescue packages financed from the state budget must be used for the mitigation of the crisis in the real economy, financial discipline may temporarily be put on the back burner. Forecasts about the current deficit are clear indications about this. The source of financing this increasing deficit will become a serious question only in the near future, and not in the present. No problem will occur if the GDP starts to grow quite dynamically in 2010. But what happens if one can only wait for this to happen even after 2010?!

Is it conceivable that the Stability and Growth Pact will be suspended in the eurozone?! What could be achieved with the excessive deficit procedures launched against most member states of the eurozone pursuant to the SGP, once deficits double the allowed deficit have evolved in some of these countries?!

At any rate, it is a serious issue within the EU: what to do with the rules in case of a prolonged global crisis? The SGP itself provides some room for manoeuvre in case the GDP significantly declines in two successive quarters. But the relevant provision does not stipulate that deficits increasing for several years could be tolerated. Therefore, such an absurd situation can be made legally acceptable by creating other possibilities. It is still impossible to predict which method could be used for this purpose.

The figures in Table 5 also show that the GDP-relative current deficit in a few non EMU EU member states will be much more favourable than in several EMU countries. I am not talking only about Denmark and Sweden, the countries that are usually known for their high stability, but also about Poland, Hungary and the Czech Republic. The figures for Hungary and Poland are better than those for the Czech Republic in that the rate of the deficit will decrease from 2009 to 2010. Here it is worth noting again that based on the current deficit forecasts, the worst year will be 2010, and not 2009.

The long-term drop in the global energy and raw material prices will presumably result in a smaller-scale rise in consumer prices than forecasted earlier, not only in the eurozone, but also in the other EU member states. In an economic situation when wages do not increase, and what is more, many people lose their jobs, low consumer price growth may play a significant role in the acceptance of the evolving situation. Of course, it is not guaranteed that the global market price of energy resources will remain low for a longer period of time. Short-term economic growth outlooks are bleak, which makes it probable that energy resources will also enjoy low demand. This presumes that the relatively low prices will remain in place, at least in 2009.

The highest oil price (USD 146 per barrel) was experienced in mid 2007, after which the price began to continuously decline, altogether by over 70 per cent, down to HUF 40 per barrel. Food prices have decreased by nearly 30 per cent following the peak in the middle of 2008. The question is whether the trend will turn around, and if yes, when this will happen? At any rate, this is a favourable piece of news for all consumers, and definitely gleeful for the inflation target of the eurozone. It may be presumed that in the short run we do not need to count with major price hikes. Even if the oil price itself goes up, it will not exceed USD 50. It is worth studying a figure on changes in oil prices. *(See Chart 2)*

Naturally, the acceptance of the euro strongly depends on its value stability. And this can first of all be characterised in the expected changes in consumer prices. *(See Table 6)*

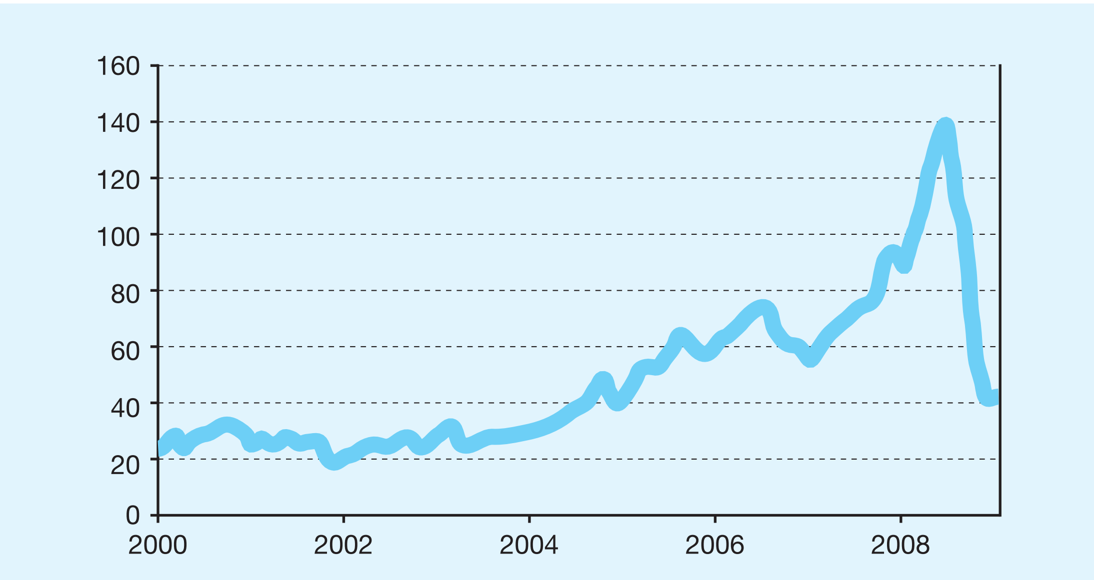
These data quite clearly show that this crisis cannot be described as stagflation, at least not until 2010, since while the GDP has significantly declined, the growth in consumer prices has remained moderate. Of course, it must be emphasised in the case of any forecast that early-year data can considerably change throughout the given year.

The inflation figures for Hungary are the highest among the EU member states presented, at least for 2007 and 2008. According to the forecast, Hungary is one of those few countries in which the inflation is expected to be higher in 2010 than in 2009. (Such countries include Greece and Poland, too.) However, in the case of Hungary the expected inflation deserves special attention. In the optimum case the Hungarian currency should be taken into the common exchange rate mechanism in 2010. This is not possible

Chart 2

CHANGES IN GLOBAL OIL PRICES

(USD/barrel of Brent oil)



Source: Deutsche Bank Research, Aktuelle Themen, 2009, 438.

Table 6

THE INFLATION RATE IN THE EU MEMBER STATES AND IN THE US IN THE 2007–2010 PERIOD

(as a percentage of each preceding year)

	2007	2008F	2009F	2010F
Belgium	1.8	4.5	1.2	1.5
Germany	2.3	2.8	0.9	0.8
Ireland	2.9	3.1	1.5	1.5
Greece	3.0	4.3	2.7	3.1
Spain	2.8	4.2	1.3	1.5
France	1.6	3.3	1.0	1.4
Italy	2.0	3.5	1.5	1.6
The Netherlands	1.6	2.2	1.6	1.7
Austria	2.2	3.2	1.2	1.4
Portugal	2.4	2.8	1.5	1.7
Finland	1.6	3.9	1.4	1.6
Eurozone	**2.1**	**3.3**	**1.2**	**1.4**
Czech Republic	2.8	6.4	1.2	1.7
Denmark	1.7	3.5	2.2	1.6
Hungary	8.0	6.1	1.9	2.7
Poland	2.5	4.2	1.8	2.5
Sweden	2.2	3.7	2.2	1.5
Great Britain	2.3	3.6	1.1	1.5
US	**2.9**	**4.0**	**-0.4**	**1.5**

Source: Deutsche Bank, Ausblick, Globale Trends, 2009. 1. (12 December 2008)

unless the current volatility of the exchange rate of the Hungarian currency is eliminated. Assuming that this will happen already during this year, changes in consumer prices will also play an important role. Since an inflation that would lead to real devaluation would be detrimental.

The lesson that can be drawn especially from the current crisis is that *effective protection against external speculation is provided only by Hungary's inclusion in the eurozone.* Since the current deficit will most probably be acceptable, not the least because of the control mechanism of the IMF's stand-by loan, it would be unfortunate if Hungary could not meet the inflation requirement. From this aspect all tax changes that are accompanied by a growth in VAT carry risks.

A FEW THOUGHTS ON THE FORMER METHODS OF CRISIS MANAGEMENT

In the period that has elapsed since the beginning of 2009 there has been no positive indication of the fact that the completion of the consolidation of the bank system would be drawing near, and that the normal lending practice would soon resume. As long as this does not happen, no one can say that the market economy is back to normal. Recession itself cannot be regarded a unique economic situation, *however the uniqueness of the current decline is that the bank system is out of order.*

Consequently, *the state becomes responsible not only for saving the banks, but also – for the lack of bank loans – for keeping other industries alive from tax revenues. However, the latter* *raises serious concerns.* On one hand, who can ensure that only those worthy in terms of competitiveness will be included in the group of beneficiaries of the rescue package? On the other hand, it is not sure at all that one can settle for the permanent, individual support of companies in the single internal market of the EU.

When this intention of the member states became apparent, the Commission put forward a proposal according to which the support should not exceed EUR 500,000 per company. This amount has been exceeded in some of the assistance schemes distributed recently. It is the auto industry that needs – at an almost extreme rate – the financial life-belt of the state.[4]

Aid incompatible with the rules of the single internal market triggers various problems. One of the most serious problems is that in several EU member states aid from the national budget is given only to domestic production. This means that the supported company is not allowed to outsource manufacturing, not even within the internal market. "Marek Topolánek, the prime minister of the Czech Republic, the current holder of the EU Presidency, declared that on 1 March the heads of the EU-27 would discuss the effects of the protectionist measures introduced under the banner of crisis management, and an extraordinary summit would be held in May too on employment. The 1 March meeting was initiated after French president Nicolas Sarkozy urged for the repatriation of French car factories operating in the Czech Republic."[5]

The free movement of capital is one of the four freedoms that are fundamental for the operation of the single internal market. Therefore, questioning the free movement of capital within the internal market of the EU due to some cost advantage is absurd from several aspects. On one hand, all consumers would lose out on this, since products themselves would become more expensive. On the other hand, such precedents would occur that would eventually make the single internal market unfeasible.

This example also points out that it is extremely counterproductive to use national crisis management plans with the single market and common currency in place. Unfortunately, the member states could not leave this method of crisis management behind despite the plenty of conferences organised. Although this means "throwing out the baby with the bath water".

This "inclination" to support, which devours large sums of money, has another depressing effect, i.e. the growth in the funding needs of the state. And in parallel with this growth, the convergence requirement on the current deficit of public finances is permanently violated.

As a consequence, it has been expressed several times that several EMU member countries could consider withdrawal from the eurozone. As for me, I don't think that this move would be beneficial for anybody in the EU-27. Already such publicity is detrimental. A "normal" solution arising from the existence of the EU could be, for example, if the EU closed ranks in order to satisfy this funding need in the most cost-effective manner. And this in turn would strengthen the internal cohesion of the EU.

One of the major experiences of the crisis of the international money market is that although the practice of prudent lending was abandoned in the US banking world, illiquid securities emerged in such quantities in the banks of the eurozone that it has led to a similar crisis in this area, too. Therefore, *in the optimum case the regulation of the international money market should be reconsidered, and such standard rules should be developed that could be adopted both in the US and the eurozone.*

When the establishment of the single money and capital market was formulated as a goal following the creation of the eurozone, a mixed committee was set up from the competent leaders of the EU Commission and the eurozone, as well as the chief financial officials of the US in order to share the regulatory experiences of the US money and capital markets, and to adopt some of these regulations when formulating the rules of the eurozone. During this process prudent operation could not be questioned at all.

After the eruption of the crisis the question is: to what extent can the self-regulatory mechanisms of the market be changed in order to forestall the future occurrences of such crises? It is assumed that the European practice would call for other rules than the US practice, since loans equalling 120% of the value of the objects, naturally by the acquisition of the mortgage, eventually led to a crisis that can be safely regarded as the model crisis of the given market model. And the model crisis suggests that purely market regulations may not provide sufficient guarantee for the prevention of bad loans.

In order to enable the EU to have an effective say in this international regulation, first of all internal unity must be achieved, on the basis of which the EU can represent a powerful standpoint. The current methods of crisis management and the inherent risks that are already apparent do not point toward this direction. It is only cold comfort that the US could not come up with a circumspect, successful and exemplary method of crisis management either.

In February 2009 it is still too early to make many or at least sure conclusions on the basis of the past events. However, threats – that are worth being considered, too – are taking shape in a more coherent manner. It would be too bad if the regulatory system of the single market and the common currency was questioned to an extent that would lead to a severe integration crisis. To prevent this from happening, *fewer state-level, and more community-level methods of crisis management should need to be proposed.*

Notes

[1] Deutsche Bank, Ausblick, Konjunktur & Märkte, 6 February 2009

[2] Bofinger, Peter (2004): Politikkoordinierung nützt Europas Zukunft. (2004) Wege aus der Krise. Nomos Verlagsgesellschaft, Baden-Baden, p. 256

[3] It may come closer in time that the United Kingdom, which has suffered great losses in this financial crisis, will decide to enter the eurozone.

[4] In Germany, for instance, car-owners are eligible for an incentive of EUR 2,500 if they turn in vehicles over 10 years old and switch to new models. This type of incentive has proved to be highly successful. As a result, car manufacturers could get rid of a lot of vehicles in stock. This measure was designed to support people with limited incomes.

[5] Source: The news item of Reuters news agency is quoted by Világgazdaság, 12 February, 2008, p. 5

Literature

Blanchard, O. (2009): Lessons of the global crisis for macroeconomic policy, *Washington, IMF, p. 17*

Bofinger, P. (2009): Erst verstaatlichen, dann sanieren, *Frankfurter Allgemeine Zeitung, 30 January, p. 13*

Bofinger, P. (2004): Politikkoordinierung nützt Europas Zukunft, Wege aus der Krise, *Baden-Baden, Nomos Verlagsgesellschaft, 2004,. p. 256*

Deuber, G. (2009): Ein Osteuropa gibt es nicht mehr, *Deutsche Bank Research, 12 January*

GLASSNER, V, – GALGÓCZI, B. (2009): Plant-level responses to the economic crisis in Europe, *[s. l.], [s. n.], p. 51*

MATTHES, J. (2009): Die Rolle des Staates in einer neuen Weltwirtschaftsordnung, Eine ordnungspolitische Rückbesinnung, *Köln, Institut der Deutschen Wirtschaft Köln, p. 44 (IW-Positionen, Beiträge zur Ordnungspolitik/Institut der deutschen Wirtschaft, p. 38)*

MEYER, H. (2009): Großbritannien zwischen globaler Wirtschaftskrise und New Labou, *Berlin, Friedrich Ebert Stiftung, p. 12*

RAUNIG, B.- SCHEICHER, M. (2009): Are banks different? Evidence from the CDS market, *Wien, Österreichische Nationalbank, [3], 39, [3] p. (Working paper/Oesterreichische Nationalbank; 152)*

SCHNEIDER, M. – RAGACS, CHR. (2009): Why did we fail to predict GDP during the last cycle? A breakdown of forecast errors for Austria, *Wien, Österreichische Nationalbank, p. 13*

TILFORD, S. – WHYTE, PH. (2009): How to emerge from the wreckage, *London, Centre for European Reform, p. 111*

WOLF, M. (2009): Fixing global finance, How to curb financial crises in the 21st century, *Martin Wolf, New Haven, London, Yale University Press, XV, p. 230*

Better Regulation: Grundmerkmale moderner Regulierungspolitik im internationalen Vergleich, Zukunft: Beiträge eine gestaltungsfähige Politik, 1/2009, *Gütersloh: Bertelsmann Stiftung, 2009,* (Zukunft regieren: Beiträge für eine gestaltungsfähige Politik, *Bertelsmann Stfitung, 2009/1) p. 84*

Deutsche Bank Research, *Aktuelle Themen, 2009. 438. (16 January 2009)*

Deutsche Bank (2009): Ausblick, *Globale Trends, 1. (12 December 2008)*

Interim forecasts for the 2009-2010 period. *Brussels, EU Commission, 19 January 2009 = www.europa.eu.int (IP/09/67)*

Several issues of Világgazdaság, Bruxinfo and Frankfurter Allgemeine Zeitung

Single Market News, 2008. p. 52

The size of the fiscal expansion (2009): An analysis for the largest countries, *Washington, IMF, p. 9*

The state of public finances (2009): Outlook and medium-term policies after the 2008 Crisis, *Washington, IMF, p. 51*