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# **Central Europe and the financial and economic crisis: can the introduction of the euro offer an easy way-out?**

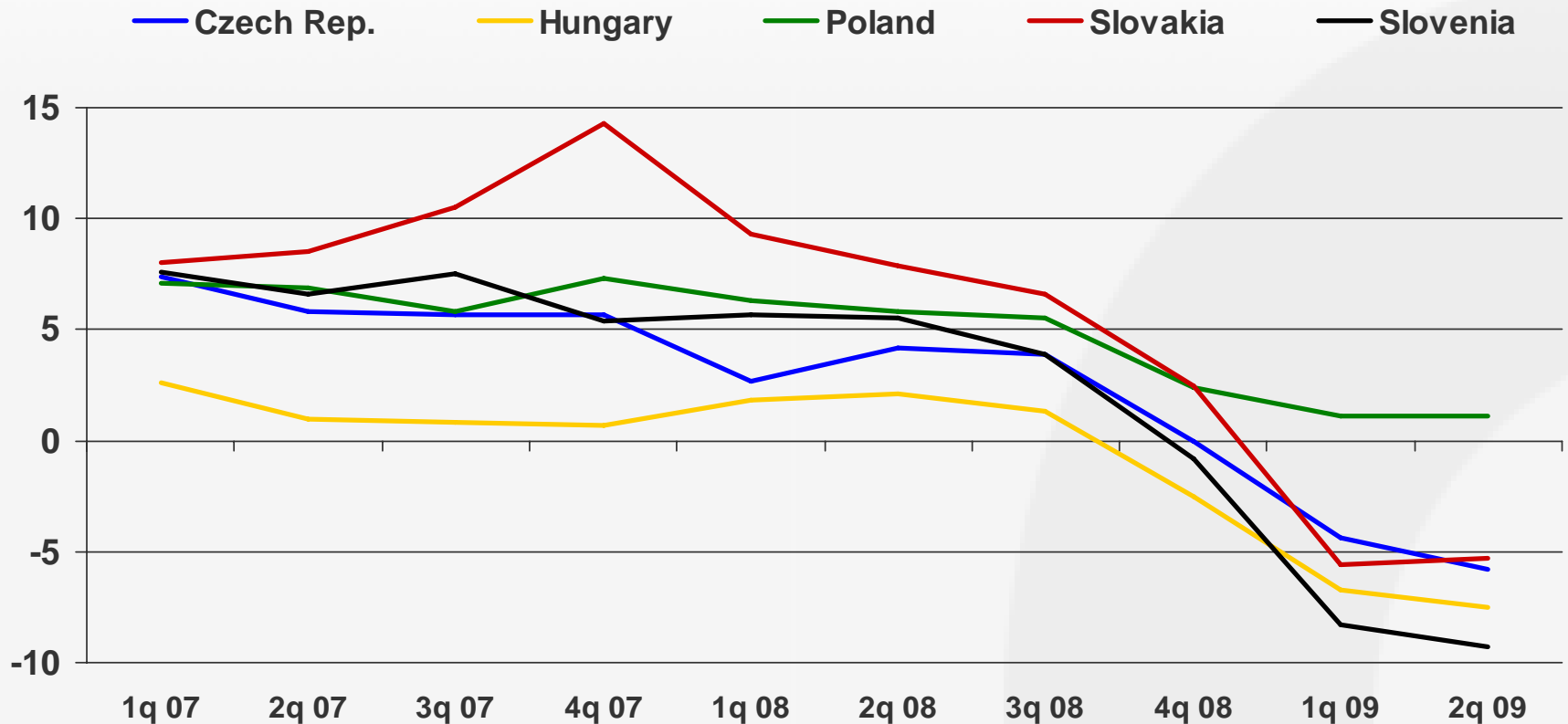
*November 2009*

# The structure of the presentation:

- **Features of the crisis in Central Europe**
- **The outlook**
- **A special case: Hungary**
- **Dilemmas of euro adoption**

# GDP, 2007-2009

Quarters, real change, compared to the previous year, in %



# The extent of the growth reversal

Change in quarterly GDP growth rates between 2Q 2008  
and 2Q 2009

Lithuania	-25.4
Romania	-18.0
Latvia	-16.8
Estonia	-14.9
Slovenia	-14.8
Slovakia	-13.2
Bulgaria	-12.0
Czech Republic	-10.0
Hungary	-9.6
Poland	-4.7

Source: Eurostat.

# The extent of the growth reversal

Change in quarterly GDP growth rates between 2Q 2008  
and 2Q 2009

Slovenia	-14.8
Slovakia	-13.2
Czech Republic	-10.0
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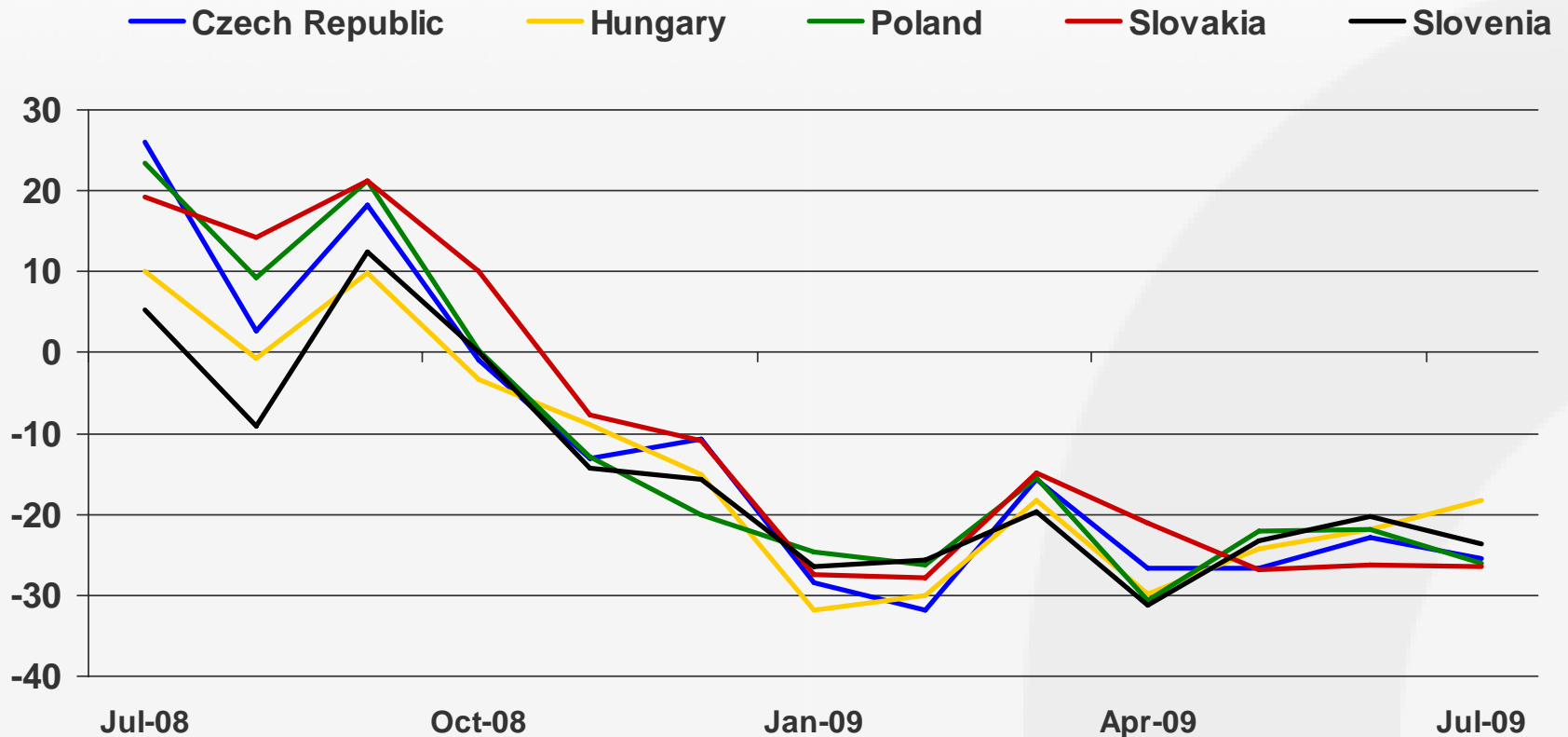
# Gross industrial production

real change in % against preceding year (based on NACE Rev. 2)

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Czech Republic	1.8	5.1	-7.3	4.4	-9.7	-17.8	-11.8	-22.0	-23.0	-12.2	-21.2	-21.3	-11.8	-18.2
Hungary	0.8	1.2	-5.0	1.3	-5.5	-10.6	-19.2	-22.5	-28.9	-15.5	-27.0	-22.1	-18.8	.
Poland	6.5	4.9	-4.4	5.5	-2.0	-10.7	-5.6	-15.3	-14.6	-1.9	-12.2	-5.2	-4.4	-4.5
Slovakia	8.5	12.9	-0.8	1.0	-4.0	-14.8	-19.1	-26.3	-25.2	-14.7	-24.1	-23.9	-17.6	.
Slovenia	6.8	2.0	-2.0	9.3	0.5	-11.8	-13.2	-21.7	-22.0	-18.0	-30.1	-22.2	-22.0	-20.1

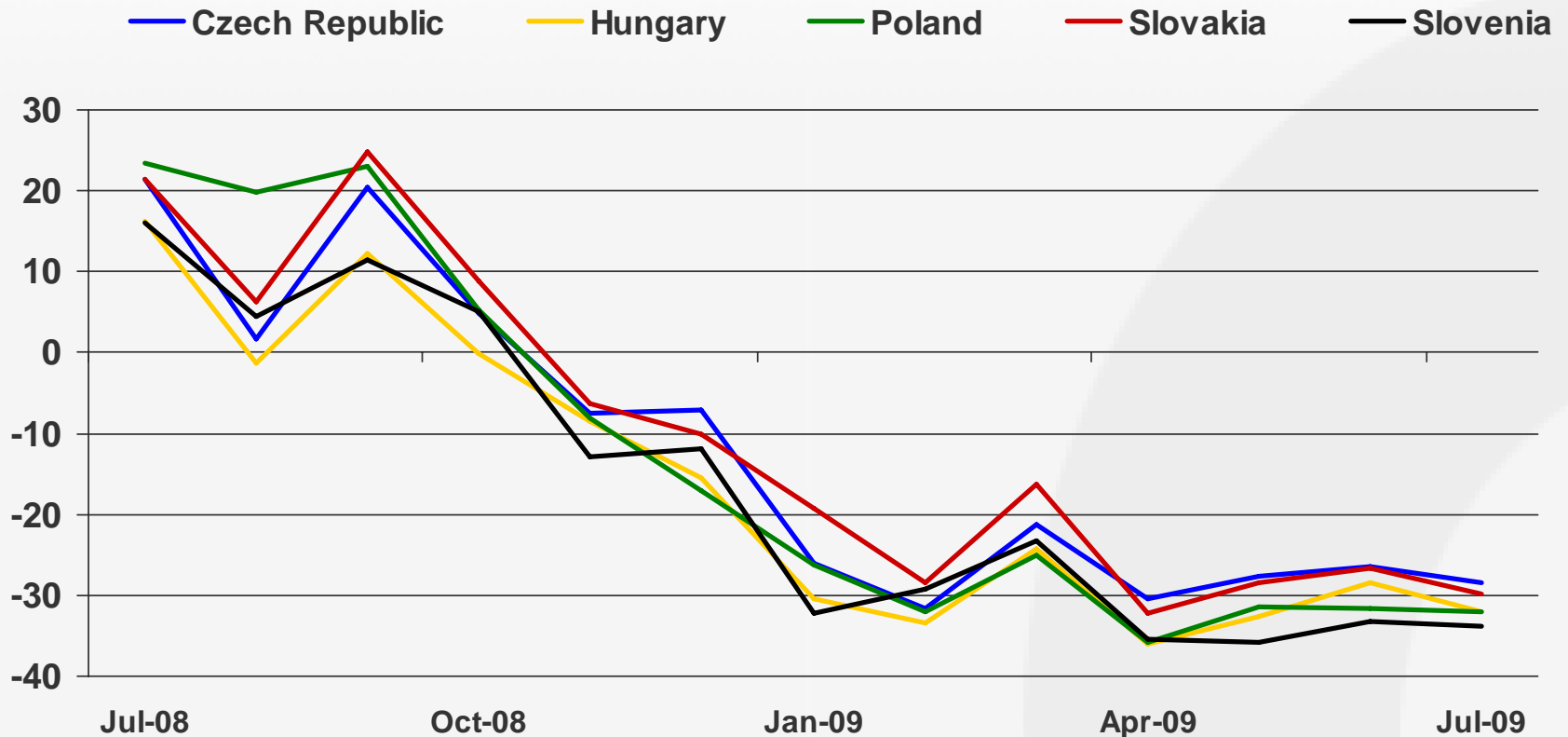
# Exports of goods (fob)

Change compared to the previous year, in % (Euro-Basis)



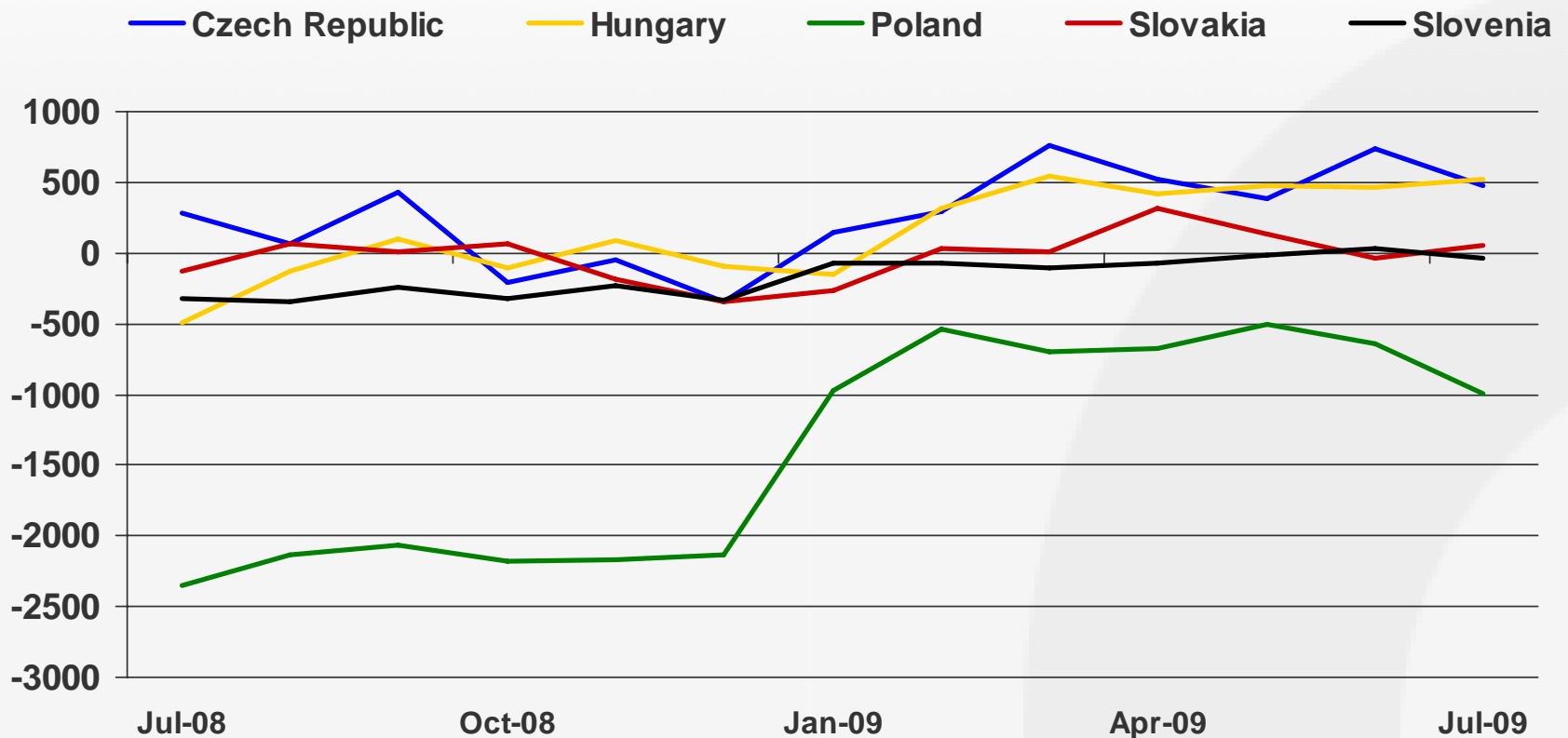
# Imports of goods

Change compared to the previous year, in % (Euro-Basis)



# Balance of trade

## EUR Mio.



# Unemployment rate in %

## LFS definition, annual averages

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009 2Q</b>	<b>2009 2010 2011 Forecast</b>		
Czech Republic	7.1	5.3	4.4	6.1	7.0	8.0	8.0
Hungary	7.5	7.4	7.8	9.6	10.5	10.5	10.0
Poland	13.8	9.6	7.1	.	9.0	10.0	9.0
Slovakia	13.4	11.1	9.5	10.9	12.0	13.0	13.0
Slovenia	6.0	4.8	4.4	5.5	6.5	7.0	7.0

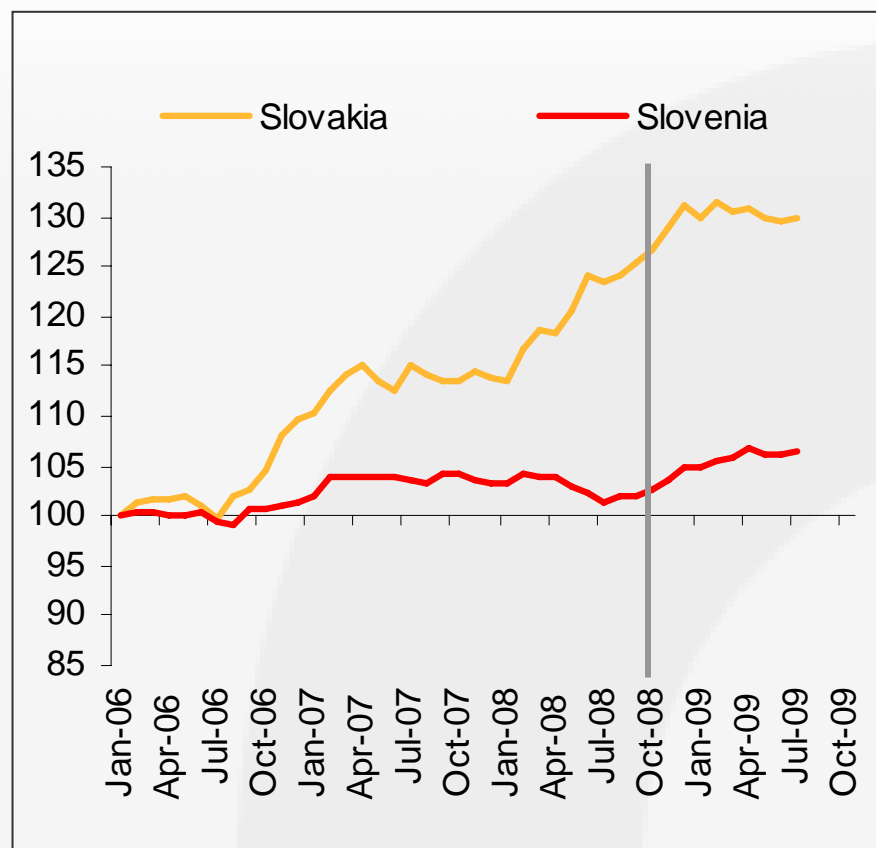
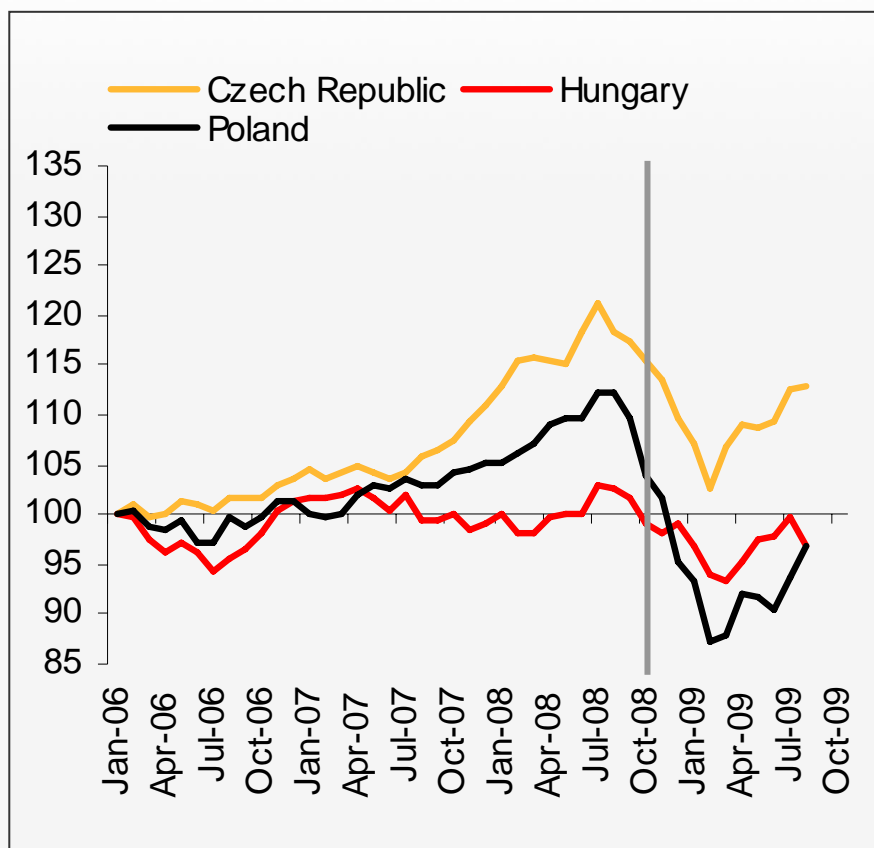
# Outlook 2009-2011

## What will determine the recovery?

- Exports of goods and services
- Imports of capital
- Domestic demand, fiscal policy
- Stability of the financial institutions

# Real Exchange rates\*, 2006-2009

EUR/national currency unit, PPI-deflated, Jan. 2006 = 100



\* Values over 100 indicate appreciation relativ to January 2006.

Source: wiiw Monthly Database incorporating national statistics, Eurostat.

# Imports of capital

- Foreign Direct Investments (FDI)
- Credits, Bonds
- Portfolio Investments
- International Organisations (IMF, EU, Worldbank, etc.)
- EU transfers

# Current account balances

in % of the GDP

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
			<b>2Q</b>	<b>Forecast</b>		
Czech Republic	-3.2	-3.1	-0.4	-1.1	-1.4	-2.0
Hungary	-6.4	-8.7	0.6	-1.9	-2.0	-2.3
Poland	-4.7	-5.4	-0.7	-1.3	-2.2	-2.9
Slovakia	-5.7	-6.6	-3.1	-3.9	-4.7	-5.3
Slovenia	-4.8	-6.2	0.3	-0.3	-0.8	-1.3

# Fiscal policy

- Anti-cyclical fiscal policy in Slovenia and the Czech Republic,
- Pro-cyclical fiscal policy in Hungary
  - Dependence on international financial investors
  - Reconstruction of credibility is priority
  - IMF Stand-by agreement is binding

# Fiscal balances (general government)

in % of the GDP

	2007	2008	2009	2010	2011
			Forecast		
Czech Republic	-0.6	-1.4	-5.0	-6.0	-5.0
Hungary	-4.9	-3.4	-3.9	-5.0	-3.5
Poland	-1.9	-3.9	-3.4	-6.1	-4.0
Slovakia	-1.9	-2.2	-6.0	-5.0	-3.0
Slovenia	0.5	-0.9	-5.5	-6.0	-4.5

# Public debt

## in % of the GDP

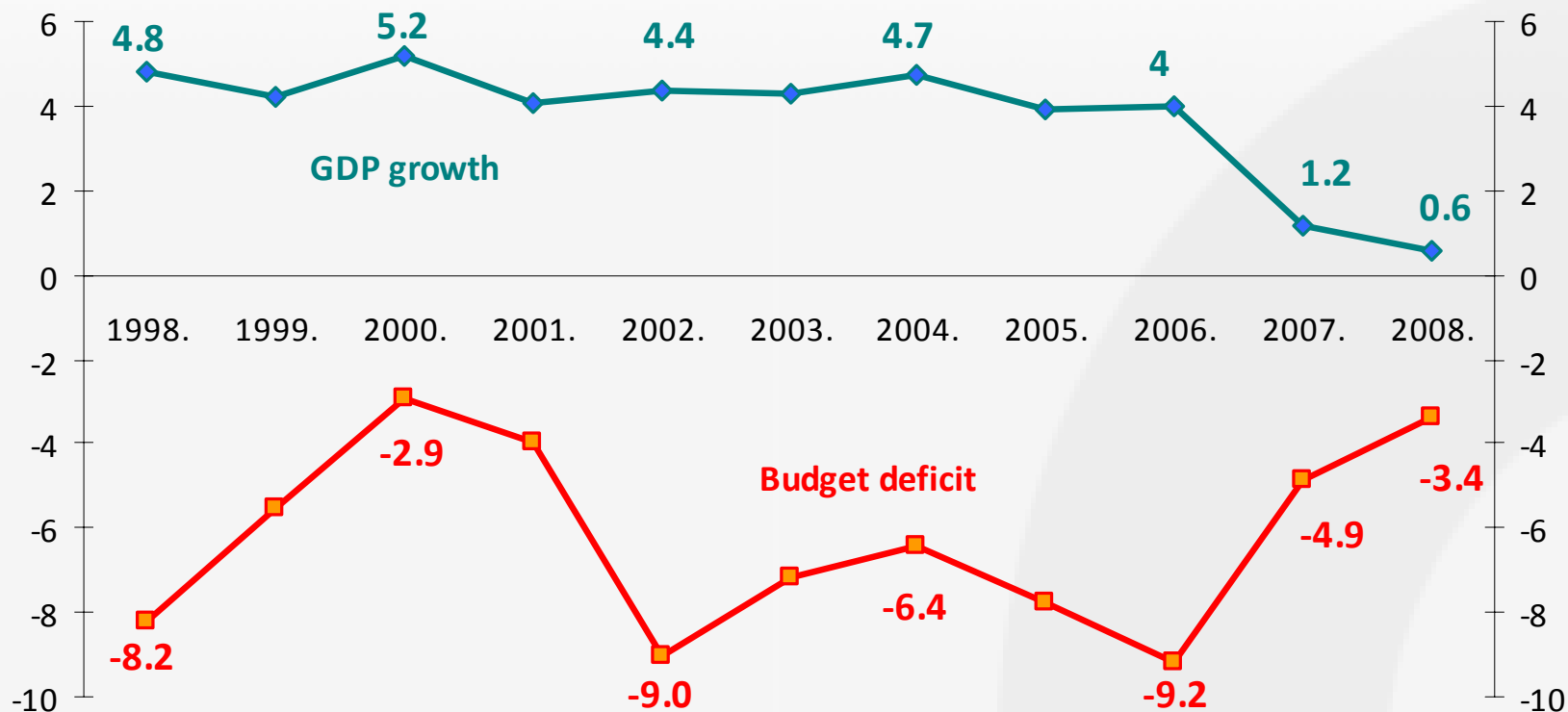
	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Czech Republic	29.8	29.6	28.9	29.8
Hungary	61.7	65.6	65.8	73.0
Poland	47.1	47.7	44.9	44.8
Slovakia	34.2	30.4	29.4	27.6
Slovenia	27.0	26.7	23.4	22.8

# GDP

real change compared to the previous year, in %

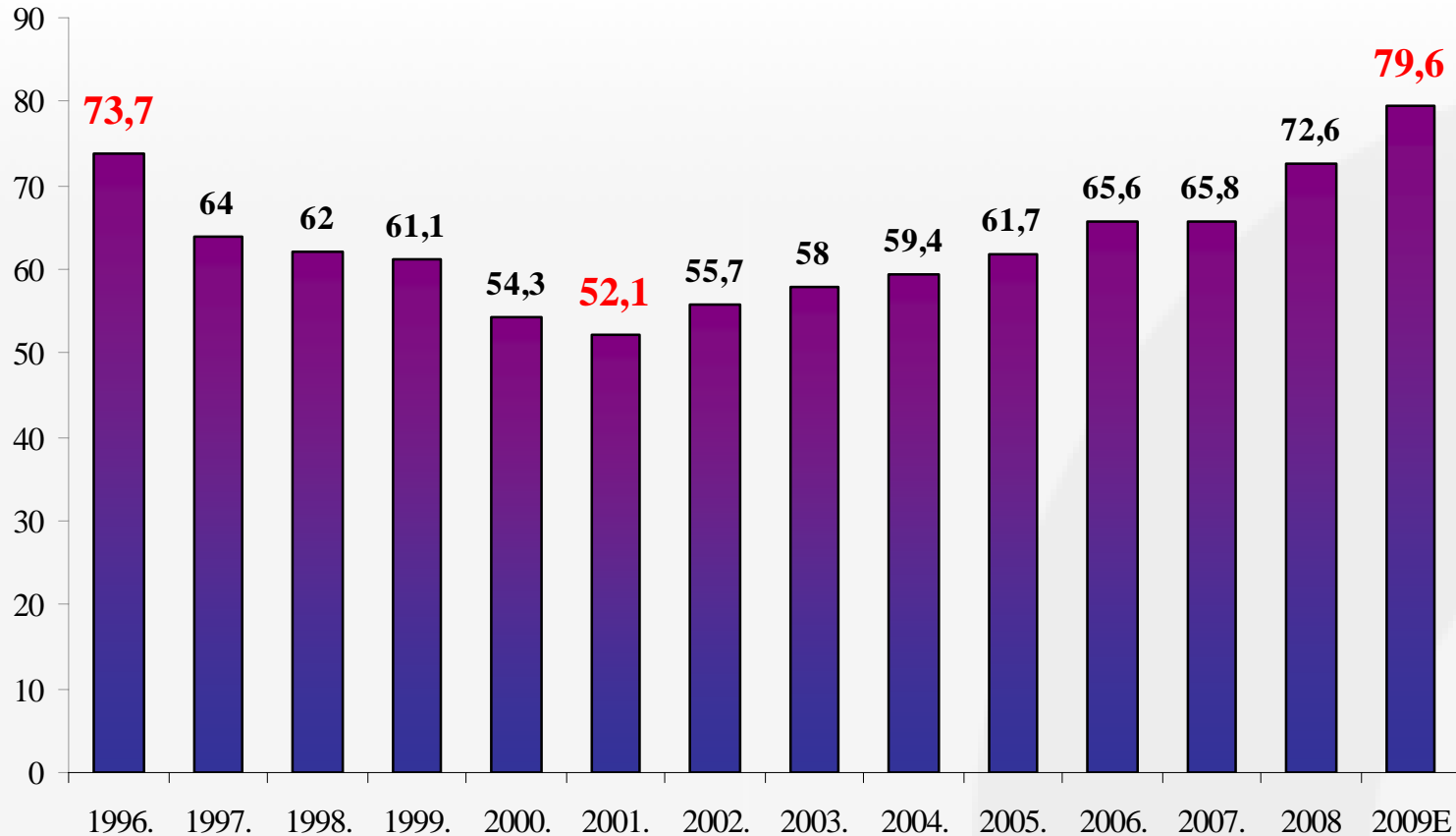
	2008	2009	2010	2011
	<b>Outlook</b>			
Czech Republic	3.0	-3.5	0.5	3
Hungary	0.6	-6.5	0	3
Poland	5.0	0.8	1.5	3
Slovakia	6.4	-5	0	1
Slovenia	3.5	-7.5	1	3

# GDP growth and budget deficit in Hungary, 1998-2008



# Hungary: public debt in 1996-2009

in % of GDP



# Euro adoption: willingness and ability

Snapshot about Central Europe before the crisis:

- Czech Republic: able but not willing
- Hungary: willing but not able
- Poland: unwilling and unable (???)

# Ability: the Maastricht criteria and the crisis (1)

- Inflation: „best performers“ Ireland (0.0%), Portugal (0.1%), Luxembourg (0.6%)? While ECB target is 2%
- General government deficit: is -3% (of GDP) the proper answer to the challenge imposed by the crisis?
- In the longer run: higher budget deficit coupled with higher growth should not be a problem
- Public debt – no problem except for Hungary
- Long term interest rate – no problem except for Hungary

# Ability: the Maastricht criteria and the crisis (2)

- Exchange rate: flexibility has been rewarded in the crisis
- Painful adjustment if the exchange rate is fixed: wage cuts to increase competitiveness
- How to find the optimal conversion rate? The warning case of Slovakia

# Euro adoption: if yes, when?

(1)

- Czech Republic: Ministry of Finance and National Bank proposed in joint document *not to set* a target date for the CZ.R. and not to enter ERM II in 2009
- Hungary: improving indicators (except for public debt), euro adoption is important psychological anchor, but elections in early 2010, decision on target date remains to the new government
- Poland: political clashes around the euro adoption, new strategy to be announced soon

# Euro adoption: if yes, when? (2)

Reuters August 2009 poll on likely year of euro adoption

- Czech Republic: 2014
- Hungary: 2014
- Poland: 2013

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- Estonia 2013; Latvia, Lithuania 2014; Bulgaria, Romania 2015

# Conclusions

- Can the euro adoption offer an easy way-out from the crisis?
- The Central European countries are less closer to the euro than before the crisis – but that is good so
- There will be no „euro adoption light“
- Exchange rate flexibility remains an asset
- Improving global environment and improving competitiveness are the key points of recovery