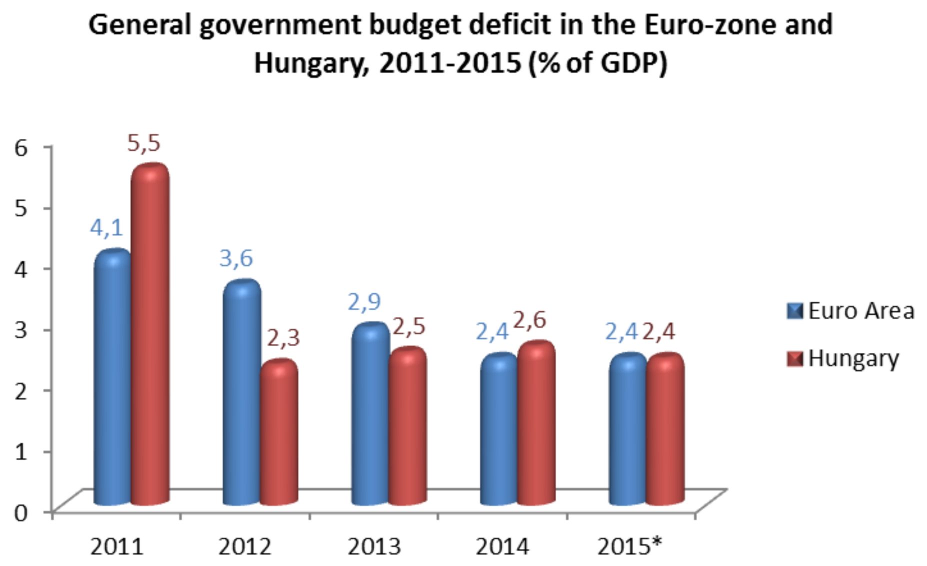
Hungary meets almost every Maastricht convergence criterion

In the first half of 2015, several studies evaluated the economic fundamentals of Central and Eastern European countries from the aspect of the introduction of the common currency. One of the main conclusions was that Hungary showed significant progress compared to the situation some years ago. The country already meets three out of the altogether five so-called Maastricht criteria. In case of the fourth criterion -- although the general government debt-to-GDP ratio is still higher than 60 percent -- a steady positive trend has been in place and the level of state debt is already below the EU average. The fifth requirement of staying in the ERM II exchange rate mechanism for at least two years prior to joining the bloc is a technical criterion.

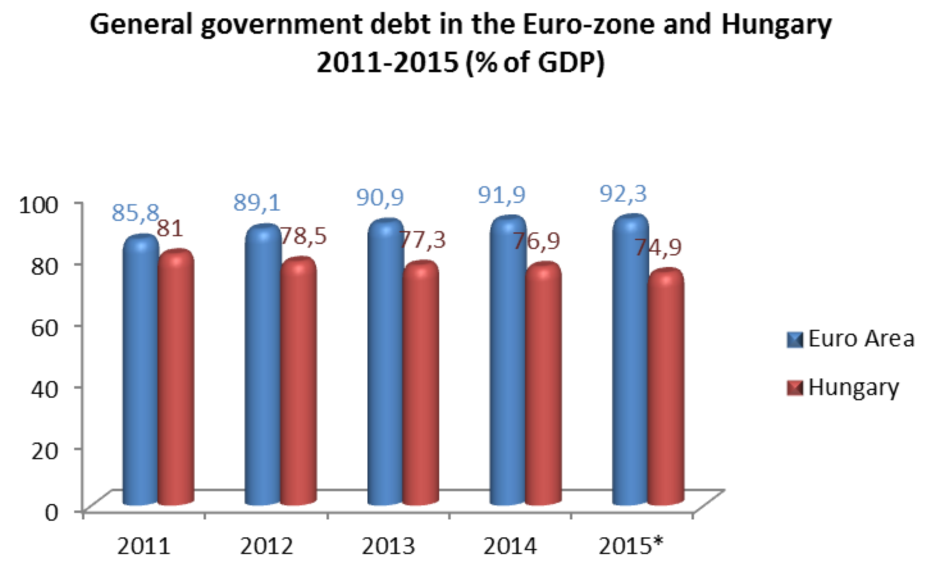
The five Maastricht criteria – the preconditions for introducing the common European currency – demand a stable macro-economic basis from aspiring candidate countries and the meeting of these requirements is not only vital for adopting the common currency but also for serving the interest of member states.

The **first criterion** is a pillar of fiscal prudence; it defines a fiscal deficit ceiling for member states. Member states that are under the Excessive Deficit Procedure are not allowed to apply for membership of the common currency bloc. Hungary had been under the procedure between 2004 and 2013, but since then the country has not been subject to the EDP. Hungary has consistently met the so-called "fiscal criterion" (below 3 percent fiscal deficit) for the third consecutive year.



Source: Eurostat

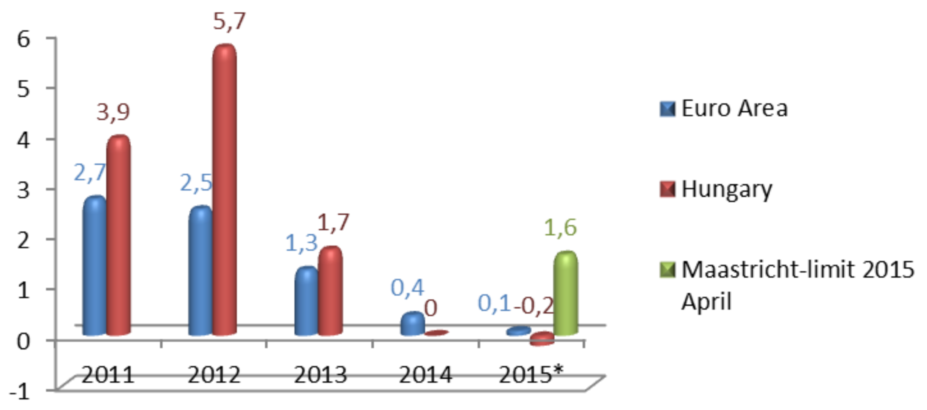
The **second criterion** sets a general government debt limit. This is the only precondition Hungary cannot at present fulfil, as the country's level of state debt is above the 60 percent mark. However, the level of debt has been declining for the fourth year and it is some 20 percent below the average of the Euro-zone. All things considered (and provided every other criterion is met) Hungary would have every right to aspire for the introduction of the common currency.



Source: Eurostat

The **third criterion** safeguards inflation and currency stability. Hungary has also met this criterion for the third year running and the inflation rate this year is far below the level set by the Maastricht criterion. As the below chart shows this macro-variable in Hungary has moved fully in line with that of the Euro-zone.

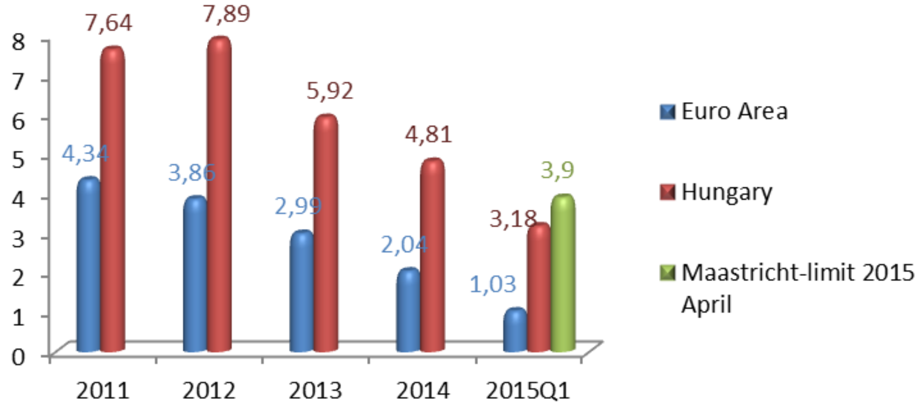
Inflation rates in the Euro-zone and Hungary; Maastricht limit in April 2015 (%)



Source: Eurostat, National Bank of Hungary (MNB)

The **fourth criterion** demands interest rate convergence. Over the past four years, the interest rate payable on long-dated Hungarian government debt (which also reflect risk premia) and average real interest rates within the economy have fallen by more than half and thus this level is currently more than half a percent below the Maastricht ceiling of April 2015. Accordingly, this precondition cannot be a stumbling block for Hungary to join the European common currency area as a stable and competitive member.

Long-term interest rates in the Euro-zone and Hungary;
Maastricht-limit in April 2015 (%)



Source: Eurostat, National Bank of Hungary (MNB)

The **fifth criterion** prescribes a two-year period of ERM II membership prior to the introduction of the Euro. Technically this means that a national currency is pegged to the Euro exchange rate and the exchange rate must move within a band of +/-15 percent in a stable manner, without central bank intervention.

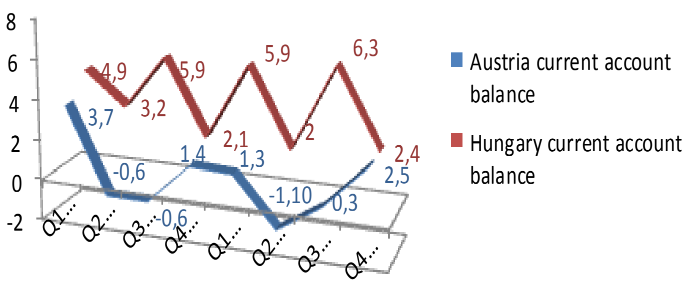
Fulfilment of convergence criteria by other EU countries

Some countries of the region awaiting (and required to obtain) Euro-zone membership show a similar level of preparedness: in light of 2014 data Poland meets three out of the five requirements (fiscal deficit still above 3 percent and ERM II membership is not granted); the Czech Republic meets four criteria (except for ERM membership); Romania also mastered three points (the inflation rate is still above the required level, ERM membership is not granted); Croatia fulfils two of the criteria (concerning the inflation rate and the long-term interest rate level).

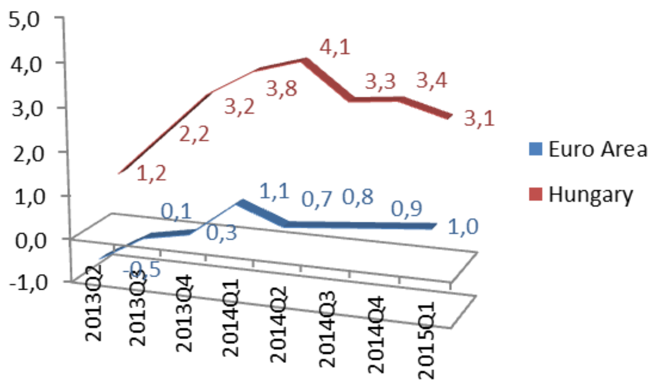
The best way to assess economic development and competiveness is through GDP growth figures and current account balance data from recent years. Examining GDP growth data from the past eight quarters provides a clear picture of the Hungarian economy's convergence path.

In case Hungary's current account surplus – as one of the most telling indicators of a country's competitiveness – is compared to Austria's, as the country with one of the Euro-zone's most competitive economies and with one of the highest per capita GDP -- in light of the latest statistics Hungary not only meets the preconditions for adopting the Euro, but it could certainly become a stable and competitive member of Europe's elite club in a long term.

Current account deficit/surplus in Austria and Hungary (% of GDP y/y)



GDP growth in the euro zone and Hungary (% GDP y/y)



Source: Eurostat

Joining the ERM mechanism and the Euro-zone is a matter of political decision. While Hungary definitely meets objective criteria already, the pros and cons for adopting the Euro are roughly balanced and the issue deserves to be debated only when membership advantages clearly outweigh disadvantages.