

Interest-rate differentials, speculative capital flows and exchange-rate volatility

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Interest rates on the Hungarian forint are higher than interest rates in the Euro area or other countries in the region. Interest-rate decisions are based on assessing several factors in monetary policy. This paper evaluates the effects of a sizable interest-rate differential between Hungary and the Euro area on the exchange rate and on its volatility. There is a difference in the effects of the interest-rate differential on the exchange rate in the short run and in the long run, but a higher interest-rate differential tends to increase exchange-rate volatility on both horizons. There is a triangular relation between interest-rate differential, speculative capital flows, and exchange-rate volatility. Any angle in this triangular relation points to the importance of the financial-stability consideration in forming monetary policy.

Budget adjustment and growth in the European Union—lessons for Hungary

Dóra Györffy

The study examines, in relation to Hungary's difficulties with budgetary consolidation, how far it is possible under outside pressure to carry out lasting correction or catching up. There are good chances of answering this through correction and growth experiences of old EU member-states, whose performances differed, though the outside compulsion was the same. The author finds the successful countries were those where internal commitment based on social consensus behind budget equilibrium emerged irrespective of euro accession. Such countries managed to retain expenditure-side consolidation through several governments, while countries simply aspiring to join the euro zone relied mainly on income-enhancement measures. The difference in adjustment strategies meant that economies in the first group attained lasting consolidation reflected in their growth performance.

Savings and external financing in the American economy. The background to the credit-market crisis (1997–2007)

István Magas

Rather than dealing with the immediate policy steps to dampen the crisis, this paper attempts to reveal the worsening savings/consumption pattern of the US economy over the last ten years. Based on the closed logic of open-economy GDP-accounting, it argues that the current crisis is deeply rooted in shrinking public and private savings trends discernible as early as 1997. The current mortgage-market crisis and deep fall in new

residential housing are products of a distorted financial environment that encourages over-borrowing and over-consumption. Expansion of the credit cycle through successive financial innovations has increased, not decreased output volatility. But the main foreign lenders to the US—Japan, China and Germany—have managed to offset their losses on US securities by buying into US companies. Large US firms have also benefited from rapid dollar depreciation as USD-denominated yields on their foreign assets experienced strong run-ups. The weak dollar has also helped American firms with large assets on foreign markets. So there were strong benefits for the US, not just on the goods-export side, but on the asset side, an aspect rarely emphasized.

Is there a thermodynamic constraint on economic activity?

Gábor Bartus

Many people have enquired, since environmental problems came to the fore, why economics does not deal with estimation of the optimal scale of the economy, though the limits to the Earth's material resources mean the size of its economy cannot increase indefinitely. The ecological school of economics have sought a requisite scientific basis for such measurement in the second law of thermodynamics (the entropy law). The study concludes first that economics takes cognizance of many scientific constraints during its investigations—though these conclusions are not emphatic—and secondly that the desirable aggregate measures of economic activity (if there should exist such an optimum, which is not dealt with here) can certainly not be proved through the second law of thermodynamics.