

Inflation in Hungary

Inflation is one of the major problems to solve in the Hungarian economy

Inflation for an individual means the rise of costs of living, and something against one can not defend himself. Pensioners are the most touched by inflation, as their rents are not indexed to the inflation.

But the governments not only have to cope with such social problems, but they have to fulfil macroeconomic aims as well. They want to achieve economic growth, but in the case of Hungary the high and capricious inflation causes uncertainty, that is why there is a low level of investments.

The aim would be to decrease this inflation so that it would be a one-figure number, which would mean a natural rate of inflation.

Inflation in Hungary has 3 stages in the 1990-1997 period, which reflect the different stages of economic policy.

These are:

1. 1990-1991
2. 1992-1994
3. 1995-1997

Let us see now how it looks on this diagram (Diagram included in Appendix)

1. 1990-1991: in this period the inflation of CPI and PPI grew rapidly and it reached its highest point in September 1991. Inflation was 38,6% by then.
2. After September 1991 there was a year of dezinflation, then one year of stable of stable inflation growth, after which the inflation grew rapidly again in 1994. The main characteristics of this period was that the CPI was mostly 10% bigger than the PPI inflation.
3. In the beginning of the 3rd period the inflation accelerated, it nearly reached its 1991 September level, then it was followed by stable dezinflation. The inflation of CPI was very similar to the inflation of PPI

So let us see the three periods one by one:

1. 1990-1991

In 1990-1991 the main goal of economic policy was to avoid an external debt crisis in Hungary

It was threatening to happen because of 3 reasons:

- (a) the liquidation of CMEA/COMECON
- (b) followed by rapid growth of oil prices
- (c) the collapse of Eastern European Trade

The stabilisation policy contained the clamp down of budgetary and monetary policy and two serious devaluations of the Forint.

The implements of the monetary policy were the adjusting of the inland credits, and decreasing the real credits for the industrial sector, although the demand for money has grown since 1989.

The strict monetary policy meant decreasing the state subsidies and increasing the prices of centrally controlled goods e.g. the price of energy.

These all caused the increase and acceleration of inflation and the narrowing of the domestic demand. There was also inflow of foreign capital into the country, with the help of these the official reserves were filled, and rate of exchange became stable.

On the other hand the GDP, investments, domestic consumption has decreased and unemployment increased rapidly.

2. In the first part of this period (until July 1993) the economic policy's two main goal were to decrease inflation and to restart the economic growth.

The decrease of output has stopped by this time, the GDP stagnated and although there was dezinflation (inflation decreased to its half) the inflation proved to be very stubborn.

The recession continued because of the decrease in the agricultural output and the 1992 very strict bankruptcy law. The law really helped the change in the structure of companies, but the output of those companies, which were unable to pay has fallen, which meant less revenue from taxes to the budget.

The export volume has decreased as well, because of very weak external demand, and because of losing competitiveness.

Success was achieved in order to encourage output and to decrease inflation, but on the other hand, the budget deficit has grown because of growing expenditures and declining revenues.

In the second part of the period there was a very big deficit in the budget and the balance of payments. The government decided to restrict the budgetary policy more, which meant the increase of consumption taxes, the monetary policy became stricter as well, the interest rates began to grow from September.

But these steps proved to be too late, and the deficit continued to grow, although year 1993 was the first when GDP began to grow.

1994 was an election year and there were only small corrections made.

The real wages increased which increased the domestic demand, which again caused the GDP to grow. The investments have increased due to government guarantees, not due to the good economic performance of the country. The inflation continued to grow because of the ever-increasing deficit. Altogether we can state that the macroeconomic equilibrium was broken down.

3. 1995-1996

1995 was the year of inevitable stabilisation. A package of orders was introduced: increase taxes, temporary extra customs duty, the decrease of the number of civil servants, moderation of state subsidies and transfers, and the holding back of real wages and pensions. This caused of course a decline in budget deficit.

Altogether the net effect of this package was the decrease of domestic demand which caused to aggregate output to decelerate (even though there was vivid growth in exports) The balance of payments has improved as well. This was partly due to the inflow of long term capital to the country. The inflation has risen temporarily but afterwards there was a stable dezinflation.

1996 the strictness of the budgetary policy remained, and the real wages continued to drop. Till March 1996 the dezinflation was slow and accelerated afterwards. The investments in the Jan.-Sept. period declined, but in October they began to rise again.

GDP has risen only by one %, but all other macroeconomic indicators have shown that the economic growth became vivid, and this tendency remained in 1997, which is supported by the growth of real wages and the strong export performance.