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EXIT STATEGIES FROM THE CRISIS ON THE EXAMPLE OF THE BALTIC STATES

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Abstract: *The aim of this paper is to analyze the macroeconomic policy of the Baltic states in response to the financial crisis of the years 2007–2010. The considerations are based on the thesis that the general direction of the macroeconomic policy chosen by the analyzed countries is correct. The consistent maintaining of a fixed exchange rate during the crisis aroused much controversy and was criticized in the literature. In the study, particular attention was paid to the issues of exchange rate, which has constituted the key element of the policy, both in the initial period of transformation, as well as in the times of recession. The first part of the study concentrates on the specificities of small open economies of the Baltic countries and on the determinants of their monetary and exchange rate policy. Subsequently, the economic situation of the Baltic republics in the face of the crisis was characterized, indicating the main factors increasing their vulnerability to economic shocks. The next subject of the analysis was the macroeconomic policies in response to the deep recession. The considerations were intended to assess the validity of maintaining a fixed exchange rate policy as a core element of an anti-crisis strategy. The methods used in solving the scientific problem were the critical literature studies and the analysis of macroeconomic indicators.*

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INTRODUCTION

After two decades of the economic and political transformation the Baltic states have met their primary geopolitical goal and became members of the European Union in 2004. Although the EU membership obligates to strive for adoption of a common currency, the desire to achieve this objective among the new Member States is not widespread. Lithuania, Latvia and Estonia are an exception compared to other countries of the region, as they have consistently linked their currencies to the euro. Estonia became a member of the euro area in 2011.

The Baltic republics had been registering impressive economic growth, which in the face of the global crisis quickly turned into a very deep recession. The Baltic countries have taken a strong action to devalue (only by internal means) their currencies, because they have not changed their basic direction of the macroeconomic policy, which was to maintain a fixed exchange rate against the euro.

The paper will discuss the macroeconomic situation in the Baltic states in response to the financial crisis. Particular attention was paid to the issues of exchange rate, which constituted a key element of macroeconomic policy, both in the initial period of transition, as well as in the times of recession. In the first part, the study takes a closer look at the specificities of small open economies of the Baltic countries, then the determinants of their monetary and exchange rate policies are more closely analyzed . Subsequently, the study characterizes the economic situation of the Baltic States in the face of the crisis and indicates the main factors increasing the vulnerability to crises. Finally the macroeconomic policies have been examined. The considerations were intended to assess the validity of maintaining a fixed exchange rate policy as a core element of an anti-crisis strategy. The methods used in solving the scientific problem were the critical literature studies and the analysis of macroeconomic indicators.

THE SPECIFICITY OF THE BALTIC COUNTRIES AND THE DETERMINANTS OF THEIR MACROECONOMIC POLICY

The Baltic republics have carried out strong and consistent reforms from the very beginning of the transformation process. One of the central axes of their program was the adoption of the currency board regime (Lithuania, Estonia) or the hard peg regime, which operates in a similar way (Latvia). This macroeconomic policy has several advantages; it works in small and open economies, which, after all, the Baltic countries constitute; allows a quick reduction of inflation (at least in the initial period of transformation), supports the development of trade and gives a clear signal to financial markets about the plans of rapid entry in the euro zone. The Baltic republics have been praised by the international organizations like the IMF for this consistent policy. The currency board required that Estonian and Lithuanian money in circulation was entirely covered by foreign exchange reserves. Similarly, in Latvia the money in circulation was totally covered by the holding of international reserves.

The Latvian lat has been linked to the euro since 2005, and is allowed to float within a range of +/- 1% with respect to a the central rate. The Lithuanian lit has been in a currency board system since 2002. What is worth mentioning, the rate of the Estonian crown to the euro has not changed since the birth of the common currency. Maintaining a stable exchange rate requires the central bank to hold an appropriate level of reserves to be able, if necessary, to make interventions in the foreign exchange market. Such intervention purchases of domestic currency, worth about 1.2 billion euros, were made by the Latvian central bank in autumn 2008.

The main disadvantage of fixing the exchange rate is the lack of absorption of macroeconomic shocks by exchange rate accommodations, which is why flexibility of the real sector of the economy is strongly desirable. If necessary, it could assume the burden of adjustment (e.g. a reduction in prices and wages, changes in the employment structure). Such risks arose in connection with the shock caused by the Russian crisis, which was an interesting test of the sensitivity of the Baltic economies to the turmoil in the macroeconomic environment and a trial for the adopted monetary policy. A deep fall in GDP gives the decision makers an incentive to devaluate, in order to enhance the competitiveness of domestic goods and to ease the shock. All three republics registered a deep decline of GDP in 1999. Fortunately, the trade ties with Russia no longer had the same importance. While in 1991 Russia's share in Estonia's exports amounted to as much as 95%, in 1998 it was barely 13%. For Lithuania, weakly linked by trade with the U.S. and with litas based on the dollar, the Russian crisis has brought the problems associated with the depreciation of the euro.

According to Frankel's trilemma, a country has the ability to accomplish only two out of three policy objectives – financial integration, exchange rate stability and monetary autonomy. The Baltic states, which tied their currencies to the euro, deliberately limited the autonomy of monetary policy, which had an important consequence – it gave the important monetary issues the protection from current political designs, especially the attempts to use them for an active policy of demand stimulation and to finance the budget deficit.[1]

[1] With an increasing international mobility of capital the degree of monetary policy autonomy decreases, even in the countries with a floating exchange rate system. The central

Such a regime helps to build a greater degree of central bank independence and to establish better practices in the area of fiscal policy (Feldmann 2008, pp. 243–246). In all three republics, the public finances showed relative signs of sustainability – in comparison with other countries in the region. This "culture of stability" is also associated with the capital constraints of small economies, which have to reach for foreign savings. The classification to the so-called emerging countries, often quite superficial, hampers and raise the costs of external financing. To ensure the market participants the access to international financial resources (especially in the initial phase of the transition), the republics had to convince the markets of their credibility by low budget deficits and reasonable public debts. Estonia in 2002–2007 showed even a budget surplus, which in Europe is without precedent. It is worth to stress the role of the historical background for the ongoing business processes. The Baltic republics entered the process of transformation from the "clean slate" in terms of foreign debt, while Poland and Hungary inherited a great debt ballast from the previous system, in which restructuring required a considerable effort.

After accession to the European Union, the Baltic States have consistently sought to join the euro zone, but were not able to meet all the convergence criteria, particularly concerning inflation. The case of rejection of the application of Lithuania in 2006 due to exceeding the reference value of inflation by 0.07 percentage points was very characteristic. The decision of the European Commission and Eurostat caused frustration in Vilnius and brought a wave of criticism. In Estonia the inflation rate exceeded the reference value in the period 2004–2010, then, due to the crisis, deflation appeared, which has enabled Estonia to meet the inflation criterion. Latvia was no exception and since accession it has not managed to fulfill the criteria (European Commission 2008).

THE ECONOMIC SITUATION IN THE BALTIC COUNTRIES ON THE THRESHOLD OF THE CRISIS

The Baltic republics after 2000 belonged to the countries with the fastest economic growth, not only in Europe but worldwide. The rate of economic growth in 2004–2006 averaged 7.5% and even at the beginning of 2007 there were no visible signs of slowing down. The first country which recorded a growth slowdown (by 2.5 pp.) was Estonia in the second quarter of 2007. At the same time, Lithuania and Latvia were still maintaining the highest

banks are anxious that an active manipulating in the interest rate would trigger serious fluctuations of the exchange rate.

growth rate in the region. The general weakening of growth in these countries were recorded in the fourth quarter of 2007.

Table 1. Annual and quarterly GDP growth rates of the Baltic countries in 2001-2010 (in %)

Country	**2001-05**	**2006**	**2007**	**2008**	**08Q2**	**08Q3**	**08Q4**	**2009**	**10Q1**	**10Q2**	**10Q3**
Lithuania	7,8	7,8	9,8	2,9	4,7	2,1	-1,1	-14,7	-2,7	-0,3	0,8
Latvia	8,2	12,2	10,0	-4,2	-2,9	-5,6	-10,4	-18,0	-5,1	-2,6	2,5
Estonia	7,9	10,0	6,9	-5,1	-1,1	-3,5	-9,7	-13,9	-2,0	3,1	5,0
Euro Area	1,5	3,0	2,9	0,4	1,5	0,6	-1,3	-4,1	0,6	2,0	1,9

Source: European Central Bank (2011).

The Baltic republics were attractive to foreign investors due to the successful transition towards a market economy, low production costs, geographical proximity and access to the European common market. The inflow of capital supported the building of the production potential of economies, and helped to finance the current account deficit. The Baltic countries have taken out a large scale foreign loans and deposits, which resulted in a strong accumulation of foreign debt.

In the years immediately preceding the crisis there was a huge liquidity on the international market associated with long-term expansionary monetary policy of the U.S. Federal Reserve. Other central banks, including the ECB, have also conducted “mild” policy in the pre-crisis period. In 2005–2008 the money supply measured by M2 aggregate, grew by an average of 9.5% per annum (Åslund 2010, p. 53). Maintaining the inflation close to the target of 2% masked this policy, which manifested in a growing bubble in the real estate market in the Euro zone countries – especially in Spain and Ireland. If the international markets are saturated with a large supply of liquidity which reduces the overall level of market interest rates, the demand for risky assets with a higher expected rate of return expands. Consequently, the speculative demand for the currency with relatively higher interest grows, and so does the demand for stocks, bonds and real estate (Slawinski, 2007). The Baltic countries were no exception, because the decomposition of growth shows that the largest growth contribution gave domestic demand. Domestic demand, including consumption, was financed mainly by loans, and the dynamics of credit at the beginning of 2006 was about 70% (Lithuania, Estonia). The credit growth was largely channeled to the real estate market, resulting in a bubble. Consequently, in Latvia during the decade, housing prices have increased tenfold, and the inflationary impulse moved to the rest of the economy. In 2007 the bubble burst and prices of apartments and houses fell by over 50%. An important factor in credit growth was negative real interest rates. In 2007, the inflation rate was 5.8% in Lithuania, 10.1% in Latvia and 6.7% in Estonia, while the harmonized long-term interest rates in the mid of the year were ca. 4.4%, 5.6% and 5.4%, respectively. Similar conclusions about negative interest rates can be inferred from the analysis of the rates on the interbank market.

Importantly, the capital funding real estate market came from the Scandinavian capital groups, mainly from Sweden. Swedish banks had loaned an amount equivalent to roughly 21 percent of its gross domestic product to the Baltic countries (as of June 2008, BIS 2011). Such a large commitment of the capital explains why the Swedes opted for financial assistance to the Baltic countries on the EU forum so much. In Latvia and Estonia, over 80% of loans were granted in foreign currency. Fixed exchange rate system eliminated currency risk for borrowers.

At the end of 2007 in Latvia, the foreign debt, mainly generated by the private sector, amounted to more than 125% of GDP. In Lithuania and Estonia, 71.8% and 109.6%, respectively.

The Baltic countries showed a high level of external imbalances. Transition countries usually record a deficit on current account, but generally not so great. Latvia's current account balance in 2007 was -23.3% of GDP, of Estonian and Lithuania's -16.0% and -13.0% GDP respectively (International Monetary Fund, 2008). This situation was partly caused by the real appreciation of currencies resulting from a higher inflation than in the euro-zone countries – the most important trading partners – accompanied by rigid nominal rates. In addition to the appreciation of real effective exchange rate, there was another factor which weakened the competitiveness of the countries – the growth of unit labour costs. Labour productivity did not grow as fast as nominal wages. Even in 2008, wage growth remained at a high level – in Estonia on average 16.5% in the first three quarters (y/y), in Lithuania 13.0%, while in Latvia 12.1% in the fourth quarter (as much as 30% in 2007) (Narodowy Bank Polski 2009).

To sum up, the main endogenous factors which increased vulnerability of the Baltic economies to the crisis were large external imbalances, the dependence on external financing, a high debt in foreign currencies, the excess of the real estate market. Moreover, strong wage growth and high inflation, attributed to the increase of unit labor costs and a real appreciation of exchange rate, which in turn weakened the international competitiveness. Finally, the system of fixed exchange rate must be pointed out, which did not allow to depreciate and to ease the shock driven by the downturn in major trading partners. It can therefore be assumed that in a situation of increased risk aversion among investors in international markets in the face of the financial crisis, the Baltic countries seemed to be a "natural" candidate for a strong collapse.

An attempt to define, on a theoretical basis, a closed set of indicators which may predict an outbreak of the crisis (regardless of its type) seems to be doomed to failure, but the analysis of historical financial crises can identify risk factors for their occurrence. The most important variables include growth in lending to the private sector, the current account deficit, real appreciation of domestic currency, a mismatch in the exchange rate regime of stable exchange rates (IMF 1998). Public finances play a significant role in various types of crises (Reinhard, Rogoff 2010), but in the case of countries studied, it was just a strong point.

At this point the question arises whether such a deep correction is justified? Did the Baltic States "deserve" the crisis? Although the global economic crisis had its roots in the U.S., and the investors from the Baltic countries were not contaminated with bad assets, it seems that the macroeconomic situation did not go in the right direction, and sooner or later the problems would have occurred. The question of the trigger causing the crisis is of secondary importance. For Baltic countries one can use an argument put forward to describe the situation in Poland – it is good that the crisis did not come two years later, because the scale of imbalances, the debt burden and the overheating of the economy would have reached much more dangerous proportions.

MACROECONOMIC POLICY IN THE FACE OF THE CRISIS

Since the fourth quarter of 2007, GDP growth fell in all the Baltic states, and then turned into a deep recession (Table 1). This phenomenon was accompanied by a number of other trends. The structure of economic growth has changed. While earlier the growth was based mainly on domestic demand (consumption and investment), and the contribution of net exports was negative, these proportions have reversed. The decomposition of GDP growth showed a breakdown of consumption and investment. The decrease in imports was even deeper than in exports, so the current account balance improved gradually in the course of 2008.

The deepening crisis has left a strong imprint on the labor market. After a long-term fall the unemployment rate increased sharply. According to the ECB data, the average annual unemployment rate in 2008 amounted to 5.9%

(Lithuania), 7.5% (Latvia) and 5.6% (Estonia), and in 2009 already 13.7%, 17.1% and 13.8% respectively.

A strong increase in market interest rates, despite a reduction in inflation since mid-2008 was a characteristic of CEE countries. This meant a rise in real interest rates. Strengthening of the euro resulted in nominal and real appreciation of currencies of the Baltic countries towards the number of trading partners, which worsened the competitiveness of goods.

In all the analyzed countries a very deep (deeper than in other new member states) drop in lending action was observed, which continued even in 2010. These negative growth rates came from both sides of the market – on the supply side banks continued to deleverage, while the demand for credit among enterprises and – to a lesser extent – among households continued to stagnate (World Bank 2010).

A very visible consequence of the crisis was the deterioration of public finances in all Baltic countries. As mentioned above, compared to other EU countries, public finances were relatively healthy. Estonia has not even issued a 10-year government bonds. The decrease in the budget revenue was mainly due to the slowdown and a bad labor market situation. Following this, there was a rapid increase in spreads of treasury bonds and CDS.

Table 2. The balance of public finance and public debt in the period 2006-2011 (in % of GDP)

Country	**2006**	**2007**	**2008**	**2009**	**2010***	**2011***	**2006**	**2007**	**2008**	**2009**	**2010***	**2011***
Lithuania	-0,4	-1,0	-3,3	-9,2	-8,4	-7,0	18,0	16,9	15,6	29,5	37,4	42,8
Latvia	-0,5	-0,3	-4,2	-10,2	-7,7	-7,9	10,7	9,0	19,7	36,7	45,7	51,9
Estonia	2,4	2,5	-2,8	-1,7	-1,0	-1,9	4,4	3,7	4,6	7,2	8,0	9,5
Euro Area	-1,4	-0,7	-2,0	-6,3	..	..	68,4	66,1	69,8	79,2	..	..

Source: European Central Bank (2011); European Commission (2010a), (2010b).

The Baltic states were forced to take a number of difficult decisions in macroeconomic policy. In each of them, special attention was focused on fiscal policy and exchange rate. In order to rescue the situation, the countries had to implement a package of measures to improve the budget balance (Table 3). Strengthening the revenue side was to be achieved by increases in direct and indirect taxes. Severe restrictions on expenditure side have been made – wages in the public sector were frozen or even cut. In each country, it was necessary to review the budget during the year 2009, because the assumptions used in their construction were too optimistic.

Lithuania's direction chosen in 2009 was especially painful if compared to the 2008 election year, when budgetary constraints – in line with the political cycle – were relatively soft. Since the beginning of the crisis, nominal wages in the economy has fallen by about 10% (European Commission 2010b). The Lithuanian authorities are also planning to adopt a comprehensive package of measures to support the business sector by reducing administrative burdens, facilitating access to finance and facilitate exports and investment. In the opinion of the EU, scheduled for 2009–2011 restrictive fiscal policy stance is the appropriate response of Lithuania to the macroeconomic situation and the budgetary authority (The Council Of The European Union 2009).

The public finances of Estonia, compared to Latvian and Lithuanian ones, seems to be relatively sound owing to the buffer of previously accumulated surpluses. The relatively low budget deficits will translate into an increase in public debt to 9.5% of GDP at the end of 2011. In Latvia, this increase is more dramatic – at the end of 2011, the debt will reach almost 52%, and at the end of 2012 nearly 57% of GDP. In Lithuania, 43% and 48% of GDP respectively. The explosion of debt entails a rise in operating costs – the interest payments of both countries will exceed 2% of their GDP (European Commission 2010a).

Table 3. Government measures in 2009 and 2010 budgets

Country	**Pension freeze**		**Freeze or cut o wages in public sector**		**New revenue measures**						**Budget revision 2009**
					VAT		**Direct Tax**		**Others**		
	1	2	1	2	1	2	1	2	1	2	
Lithuania		•	•	•	•		•		•	•	•
Latvia	•	•	•	•	•		•	•	•	•	•
Estonia			•	•	•		•		•	•	•

Notes: 1 – year 2009, 2 – year 2010.

Source: own presentation based on The World Bank (2009).

The most drastic measures have been implemented in Latvia; they cover even the freezing of pensions. The condition for granting financial assistance to this country of 7.5 billion (mainly by the IMF and the EU) was "... a strong commitment from the Latvian authorities to implement an ambitious fiscal, financial system and structural reform programme to facilitate the necessary external and internal adjustments, to stabilize the economy and to restore economic policy credibility” (European Commission 2009).

Another problem turned out to be the exchange rate policy issues. The Baltic countries have consistently maintained the previously set parities against the euro. For Estonia, this strategy resulted in a measurable effect, which was the entrance to the euro area on 1 January 2011, the recession was used to meet the inflation criterion, which in normal circumstances would be difficult to achieve. The entrance to the zone constitutes a kind of proof of political maturity, the crowning achievement of many years of exchange rate policy and a clear signal to potential foreign investors. In the case of Lithuania and Latvia to maintain parity on the one hand meant the costs associated with real appreciation, a deepening recession and, on the other hand, it gave hope for a quick entry into the euro zone. The dilemma was much bigger than in Estonia. The recession was deeper in Latvia, but the country received IMF assistance, which imposed tough program. Adoption of external constraints implied by a reputable institution in return for financial support is easier to explain to the public. Lithuania has not requested assistance from the Fund, and consequently had to impose the same restriction by itself.

Opinions about the need to change exchange rate policy by Latvia have appeared in the literature for a long time. Many prominent economists, including P. Krugman, N. Roubini and K. Rogoff, expressed the view that the devaluation of the Latvian lat is necessary and is only a matter of time. The situation of Latvia was compared to the Argentinian crisis, because of certain similarities: incomplete currency boards systems, which led to overdevaluation because of excessive inflation and large current account deficits (Åslund 2010). However, there are a number of differences which have cast doubt on the analogy between the case of Latvia and Argentina, without going into details – mainly Latvia’s (and other Baltic countries) greater fiscal discipline.

According to T. Becker (2009), Latvia should have freed the lat long before the crisis, in a favorable international environment, which would have minimized the problem of excess of credit markets and borrowing in foreign currencies. According to the same author, there are three ways out of the misalignment of the exchange rate. First of all the devaluation and the adoption of the euro; second solution is leaving the central rate at its current level, but extend the fluctuation band and, thirdly, to remain at the current parity, which is, in his view, the least preferred solution. Similar scenarios for Latvia were taken into account in the work of the IMF, but can be extended also to other Baltic states, particularly Lithuania.

The IMF is of the view that the first cited option – „Accelerated adoption of the euro at a depreciated exchange rate would deliver most of the benefits of widening the bands, but with fewer drawbacks. Unlike all other options for changing the exchange rate, the new (euro-entry) parity would not be subject to speculation. By providing a stable nominal anchor and removing currency risk, euroization would boost confidence and be associated with less of an output decline than other options.” The EU authorities have strongly rejected this possibility because the convergence criteria are not met European Commision 2008). Unilateral euroization, theoretically possibile, was not taken into account.

The biggest advantage of widening the fluctuation band would be a faster way out of the recession owing to the fact that it would improve competitiveness and return of the current account into balance. The negative effect of the depreciation, however, would be increasing private sector net foreign currency exposure by 11% of GDP and worsening of external debt to GDP.

Letter of intent from 18th December 2008 addressed by the Latvian authorities to the IMF, expressed the view that the basic objective which is the early entry into the euro zone can best be achieved by maintaining the current exchange rate peg and recognize that this calls for extraordinarily strong domestic policies supported by broad political and social consensus.

In the literature the view was that a country with the currency board system should have prepared an exit strategy from the system. „The best exit strategy is the adoption of the anchor currency as sole national legal tender” (Gurtner 2004, p. 681). Latvia's government strategy to adopt the euro in 2014 finally ends speculation problem associated with the exchange rate. The decided declaration has helped to anchor the expectations of the market participants and build credibility.

CONCLUSIONS

By refusing to devalue its currency, and thus remain at the current parity, the Baltic countries had to carry out painful internal devaluation requiring adjustments on the supply side of the economy. The program included the mentioned cuts in fiscal policy, hampering domestic demand, adjustment of domestic prices and wages. Given that, compared with its trading partners with inflation close to zero, the Baltic countries would have to enter a dangerous deflation. In fact, according to the Commission, in 2009, wages in Latvia fell by almost 12%, while in 2010 – by about 4%. Back in 2007 they grew by 35%! (European Commission 2010b). Similar trends have occurred in Lithuania, and – to a lesser extent – in Estonia. The general price level (HICP) fell in Latvia from 15.3% in 2008 to just 3.3% a year later, while in 2010 there was -1.2% deflation. In Lithuania, the price reaction was more lenient and it was 11.1%, 4.2 and 1.2%, Estonia 10.6%, 0.2 and 2.7% (European Central Bank 2011).

The implemented policies led to a strong improvement in current account balances, primarily through a decline in imports, and helped to minimize inflation. Signals of recovery emerged in mid-2010, and in the third quarter the growth in all the Baltic countries (Table 1) was much faster than expected. Indeed, most macroeconomic indicators (investment, consumption) remains at a much lower level than at the best time before the crisis, but there are signs of recovery.

The crisis has shown that to maintain a stable exchange rate the Baltic states are ready to tighten fiscal policy and to make substantial sacrifices, despite the fact that, among the general public, the support for the euro fluctuated in 2010 around 40% and the number of opponents increased (Eurobarometer 2010). Fortunately, no serious social reactions and anti-capitalist protests occurred. This attitude contrasts sharply with a lower tendency to self-denial and conservancy of decision-makers in the Fifteen, for example in Greece.

The Baltic countries exhibited the "culture of stability" of public finance and the coordinated action by governments and central banks in a model fashion. This has brought good propaganda effects. Estonia's adoption of the euro area was not only evidence of the health of the Estonian economy to foreign investors, but also an inherent component of the image of the euro area, torn by the Greek crisis.

The crisis showed that it is worth caring about public finances and taking into account the possibility of a downturn. Not even with the perspective of a euro adoption, meeting the convergence criteria makes sense. Low levels of structural deficit and debt give a safety buffer and room for maneuver in fiscal policy, as demonstrated by an example of the Baltic countries, especially Estonia. It can be assumed that when the situation improves, the debt resulting from the crisis in these countries will be subsequently reduced. The Baltic countries are likely to emerge from the crisis leaner and more efficient, as confirmed by the accelerated growth in industrial production in Estonia by about 21% in 2010 compared to the previous year (Statistics Estonia 2010). The GDP grew quarter by quarter in the second half of 2010 in all three countries. In the fourth quarter of 2010 by remarkably 6,8% in Estonia and by considerably 4,6% in Lithuania and 3,6% in Latvia.

The crisis has proved that even the countries widely regarded as resistant to shocks and leading responsible policy (Estonia) cannot protect themselves against serious turmoil and, paradoxically, stronger currencies of the countries with solid "foundations" (like Polish zloty) may be subject to greater depreciation pressure than currencies with weaker macroeconomic background (like Hungarian forint). Not all investors are engaged in in-depth analysis which would allow to distinguish the economies better prepared for the crisis from the economies more vulnerable to shocks. The conclusions is that in case of serious turmoil in the world markets the transition economies could benefit from the credibility of being in the common currency zone.

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