

High General Government Deficit

According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, the Hungarian economy is developing more dynamically following the slowdown in the first quarter. Despite the uncertainty regarding the calculation of the general government deficit and the continuous interest rate cuts, the forint remains strong. Real wages are growing rapidly. External equilibrium is improving significantly.

The GDP of the eurozone will rise by 1.6% this year; that of the Hungarian economy will be up 3.9%, chiefly because the trade balance is improving more dynamically than expected. Industrial, agricultural and public employment is declining while business services and construction will gain jobs resulting in an unchanged total. Annual average unemployment will be 7%, which is higher than in previous years. Gross wages increased particularly strongly at the beginning of the year and in the public sector as annual bonuses were paid in January. We expect a 9% expansion for the year (7-8% in the business sector and 10-11% in the public sector). Since net wages are rising faster than that, real wages will grow 6% (there was a small decline last year; the average annual increase in 2004-2005 will be slightly more than 2.5%). The net monetary savings rate will rise appreciably, to nearly 4% of GDP, as the expansion in the outstanding debt of households slows down (but the savings rate is still low). Compared with the 2004 peak, housing construction will barely decrease. Household consumption will rise by some 3.3%. Investments will expand by a dynamic 8%, approximately.

Following the temporary surge caused by a tax increase, inflation declined rapidly in the spring, expected to be between 3.5-4% by the end of the year. Inflation is expected to average 3.8%. The most spectacular price increase took place in fuels, but it was still below-average in a multi-year perspective. Owing to the country's improving international reputation, the inflow of capital and the large-scale euro-denominated borrowing of the various economic sectors, the forint continues to be strong. The base interest rate was 6.0% at the end of September. The end-of-year level is likely to be 5.75%.

General government deficit measured according to the EU methodology will be around 6% of GDP, up from 5.4% in 2004. The size of the shortfall will be greatly influenced by the timing of the Budapest Airport transaction.

The foreign trade deficit will drop from nearly 4 billion euros last year to 3 billion as exports are expanding faster than imports. There will be a serious deficit in income transfers (in proportion to the foreign capital invested here). The combined deficit of the current account and the capital account was 2.9 billion euros in the first half, 0.7 billion euros less than last year, and the full-year figure will also be below the 2004 level. Still, net external debt will increase.

Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2005

	2003	2004	Jan-July 2005	2005 (forecast)
1. Volume of GDP (%)	102.9	104.2	103.5*	103.9
2. Industrial production (constant prices %)	106.4	108.3	105.9	106.5
3. Investment in the national economy (constant prices %)	102.5	107.9	108.3*	108
4. Construction (constant prices %)	102.0	106.8	114.6	111
5. Retail trade (volume index %)	109.0	105.7	104.9	104.5
6. Exports (current prices in euro %)	104.4	115.3	109.3	112
7. Imports (current prices in euro %)	105.9	113.2	104.5	109
8. Trade deficit (□ bn.)	4.2	3.9	1.5	3.0
9. Combined deficit of the current & capital accounts (□ bn.)	6.4	6.9	2.9*	6.5
10. Average exchange rate of euro (in forints)	253.5	251.9	246.8**	247
11. Deficit of the general government (on cash flow basis without local governments; billion forints)	1054	1284.1	996.4**	1100-1400
12. Index of average gross earnings	112.0	106.1	110.4	109
13. Consumer price index	104.7	106.8	103.7**	103.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.7	105.5	103.6**	103.9
15. Rate of unemployment (at the end of the period, %)	5.5	6.3	7.2***	7.0

* First half

** January-August

*** June-August

Sources of actual data: Central Statistical Office. National Bank of Hungary. Ministry of Finance