

Two halves of the game in 2006

According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, the growth of the Hungarian economy in 2006 will resemble the growth in 2005: inflation will continue to decline, real earnings will grow fast. Fiscal adjustment is expected following the formation of the new government and this will make possible further reduction of interest rates.

Both the European business environment and the domestic business and household expectations have been improving since early summer. Hungarian GDP is growing by approximately 4.2% both in 2005 and 2006. The pace of economic growth continues to be faster than the EU average by an ample 2 percentage point, but among the Central European countries Hungary has left behind probably only Poland.

The economic policy probably will be different in the first and second period of 2006. No significant change is expected before the general elections - and very little before the local elections in the autumn. But the new government, which will be formed early summer, will probably center its policy - after some eight years hiatus - on real general modernization of the state apparatus, on reducing the gap between Hungary and the old member states of the EU, improvement of the equilibrium, introduction of the euro in 2010 and improvement of the international opinion on Hungary. It will, on the one hand, adopt immediate adjustment measures, which will influence already the 2006 fiscal balance, and, on the other hand, will start real preparation of the 2007-2008 reforms. In this case the central bank may reduce the base rate even below 5% without weakening the forint.

As a result of the VAT reduction the inflation may decrease below 2% in spring 2006. Nevertheless - due to world market price changes - the price of certain energy carriers and central/local government service charges probably will increase in the third and fourth quarters. At the same time the decreasing tendency of the prices in the markets of clothing and consumer durables will continue. In the year as a whole a 2-2.5%, at the end of the year a 3% inflation is expected - depending on the implementation, measure and timing of the fiscal adjustment.

In 2006 in the business sector the annual average gross earnings are expected to grow by 5.5% - i.e. somewhat higher than the 4-5% agreed upon in the National Conciliatory Board - partly because of the almost 10% rise of the minimal wages. In the public sector the gross earnings will increase slower: probably by 4.5%. Net earnings will increase by 1 percentage point faster than the gross earnings in 2006 as well. As a result the real earnings in the national economy will grow by at least 4%.

Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2005-2006

	2003	2004	Jan-Nov. 2005	2005 (estimate)	2006
1. Volume of GDP (%)	103,5	104,6	104,1*	104,2	104,2
2. Industrial production (constant prices %)	106,4	108,3	107,3	107	107
3. Investment in the national economy (constant prices %)	102,5	107,9	108,5*	110	110
4. Construction (constant prices %)	102,0	106,8	117,0	117	115
5. Retail trade (volume index %)	109,0	105,7	105,6	105,5	104,5
6. Exports (current prices in euro %)	104,4	115,3	110,9	111	111
7. Imports (current prices in euro %)	105,9	113,2	107,5	108	112
8. Trade deficit (□ bn.)	4,2	3,9	2,6	3,0	3,5
9. Combined deficit of the current & capital accounts (□ bn.)	6,4	6,9	4,6*	6,5	7,0
10. Average exchange rate of euro (in forints)	253,5	251,7	247,6	248,0 (actual)	250
11. Deficit of the general government (on cash flow basis without local governments; bn. forints)	1054	1284,1	1197	984,4 (actual)	1550
12. Index of average gross earnings	112,0	106,1	109,1	109	105
13. Consumer price index	104,7	106,8	103,6	103,6 (actual)	102,3
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105,7	105,5	103,3	103,3 (actual)	103
15. Rate of unemployment (at the end of the period, %)	5,5	6,3	7,2**	7,2	7,2

* Q1-Q3

** September-November

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