

Decreasing inflation

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, employment will be basically unchanged. Fiscal reform and adjustment are expected after the elections and this will make possible further reduction of interest rates.

Hungarian economy is growing by approximately 4.2% both in 2005 and 2006, no significant change is expected even in the growth rate of individual branches of the economy. The performance of the construction industry continues to be outstanding: its growth was 17% last year and an almost similar expansion is expected this year. The construction of buildings increased by 12.5%, while the civil engineering works - including the construction of motorways - increased by 21%. Industrial production increased by a similar rate as in 2004, but within this the exports slowed down a bit (from 15% to 11%), while the domestic sales, which decreased by 1% in 2004, increased by more than 4% in 2005. The fastest growth was seen in the production of building materials, telecommunication equipment and motor vehicles; while the output of the food and textile industries decreased. It is a positive development that the shoe industry - after several years of decline - resumed growth.

The growth was the fastest in Middle Transdanubia and Northern Hungary, while the strongest decline was seen in Southern Transdanubia. Last year both the exports and the imports increased slower than in 2004, but the growth rate of the exports moderated to lesser extent. Thus, the trade deficit decreased by more than □ 1 bn. This year the exports and the imports are expected to grow by almost identical rate.

Employment remained basically unchanged in 2005 - increased a little in the business sector and decreased in the public sector - and the unemployment increased by 1 percentage point. No significant change is expected in 2006. In January the inflation declined to below 3% - to a level not seen in the past three decades. In the coming months - as a result of the VAT reduction - inflation will gradually decrease below 2%. Nevertheless, in the third and fourth quarters of the year the prices of energy and certain central and local government services - reflecting the world market price movements - will grow. On the other hand, the prices of clothing and consumer durables will continue to decrease. Depending on the magnitude and timing of the fiscal reform and adjustment, the inflation in the year as a whole will be around 2-2.5% and about 3% at the end of the year.

Last year the real earnings increased by 6.3%, but this was partly due to the deferred payment of the 13th month salary in the public sector. In the business sector the real earnings increased by 4.5%, while in the public sector the growth was a little bit higher even without the 13th month salary. This year a similar increase is expected.

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

	2003.	2004.	2005.	2006.
1. Volume of GDP (%)	103.5	104.6	104.2*	104.2
2. Industrial production (constant prices %)	106.4	107.4	107.3	107.5
3. Investment in the national economy (constant prices %)	102.5	107.9	110*	110
4. Construction (constant prices %)	102.0	106.8	116.6	115
5. Retail trade (volume index %)	109.0	105.7	105.5*	104.5
6. Exports (current prices in euro %)	104.4	115.3	111.0	111
7. Imports (current prices in euro %)	105.9	113.2	107.8	111
8. Trade deficit (□ bn.)	4.2	3.9	2.8	3.1
9. Combined deficit of the current & capital accounts (□ bn.)	6.4	6.9	6.5*	7.0
10. Average exchange rate of euro (in forints)	253.5	251.7	248.0	248
11. Deficit of the general government (on cash flow basis without local governments; bn. forints)	1054	1284.1	984.4	1550
12. Index of average gross earnings	112.0	106.1	108.8	105
13. Consumer price index	104.7	106.8	103.6	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
15. Rate of unemployment (at the end of the period, %)	5.5	6.3	7.3	7.2

* GKI Co. estimate

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