

Costly promises

According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, the growth of the Hungarian economy in 2006 will be somewhat faster than in 2005. Inflation will slow down in the first half of the year but will accelerate a little in the second half. Real earnings will grow fast. Fiscal reform and adjustment are expected after the establishment of the new government that will stabilize the forint and make possible further reduction of interest rates.

Parallel to the improvement of the business climate in Europe the growth of the Hungarian economy will accelerate a little. The January data show extraordinarily fast, two-digit growth in the industry and construction, 20% in foreign trade. Although the low Q1 2005 low basis plays certain role in this, nevertheless, the start of the year is promising. Industrial exports increased by 20%, domestic sales of industry by 8%, mainly due to the expansion of the production of motor vehicles, machinery and instruments. The production of shoes grows very fast - although its weight is already rather limited. Construction industry is expanding mainly as a result of the motorway constructions; in January the book of orders of the sector increased considerably. The growth of the retail trade turnover accelerated; especially that of the cars and motor fuels.

Inflation is slowing down; it may decelerate to 1.5% by the end of the second quarter. In February the price level of food and services increased faster than the average (compared to the corresponding period of the preceding year). At the same time the price level of clothing, consumer durables and electric energy decreased. Gross wages are increasing very fast; real earnings in January were 4.8% higher than a year ago. Unemployment increased and reached 7.8%. This is equal to the average of the old EU member states but much lower than the level of most of the new members.

The general government deficit is high but is in accordance with the expectations. In the pre-election period we see a fierce competition of promises aimed at winning the support of various groups of the society. If all these promises will be kept, the deficit will grow further. Certain sobering is probable after the formation of the new government and we expect that around mid 2006 the government will launch institutional reforms and implement fiscal adjustment measures amounting to 1-1.5% of GDP this year. This will lead to certain acceleration of the inflation in the second quarter, but without these measures there is no way to calm the market and have the convergence program accepted by the EU. On the medium term the reform measures are more important but their financial results will be seen in 2006 only to a very limited extent.

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

	2004.	2005.	2006. January	2006. (forecast)
1. Volume of GDP (%)	104.6	104.1	-	104.4
2. Industrial production (constant prices %)	107.4	107.3	113.7	107.5
3. Investment in the national economy (constant prices %)	107.9	106.4	-	108
4. Construction (constant prices %)	106.8	116.6	114.1	112
5. Retail trade (volume index %)	105.8	105.8	106.7	104.5
6. Exports (current prices in euro %)	115.3	111.0	119.4	111
7. Imports (current prices in euro %)	113.2	107.8	120.8	111
8. Trade deficit (□ bn.)	3.9	2.8	0.2	3.1
9. Combined deficit of the current & capital accounts (□ bn.)	6.7	5.7	-	6.5
10. Average exchange rate of euro (in forints)	251.7	248.0	253.7*	253
11. Deficit of the general government (cash flow basis without local governments; bn. forints)	1284.1	984.4	435.5*	1750
12. Index of average gross earnings	106.1	108.8	106.1	105
13. Consumer price index	106.8	103.6	102.6*	102.3
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	102.5*	103.5
15. Rate of unemployment (at the end of the period, %)	6.3	7.3	7.8**	7.2

* January-February

** December 2005-February 2006

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