

Reform and equilibrium

According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, in the first months of 2006 the Hungarian economy followed the same course, which had been characteristic since spring 2005. Thus, parallel to the European recovery the economic growth accelerates somewhat. Inflation has been abating - due mainly to the reduction of the VAT. At the beginning of the year employment declined somewhat and unemployment increased further. The deficit of the general government increased, the trade deficit - after the last year's strong improvement - stagnates. The forint weakened in the spring months due to a number of reasons, like the increasing dollar and euro interest rates, the high Hungarian fiscal deficit, the flood of pre-election promises and the uncertainty around the expected economic policy of the new government. If the new government abides by its post-election commitment to follow an economic policy focused on deficit reduction and a series of reforms, the forint will strengthen and the interest rates will decrease during the rest of the year.

In the first two months of the year industrial production increased very fast, construction industry somewhat slower than earlier (12.6% and 5.4% respectively, compared with the corresponding period of the previous year). In both cases the different basis of the first quarter of the previous year played certain role. The expansion of retail trade accelerated; in contrast with the past the demand for food products increased faster than the average (although the price index of this group of goods was the highest at the beginning of the year). Foreign trade accelerated further, exports grew a little faster than imports (17.9% vs. 17.4% measured in euro). Terms of trade strongly deteriorated in January because the price level of energy carriers measured in forints increased heavily in one year (that of the natural gas by 61%). In spite of this fact, the trade deficit of the first two months is roughly equal to the last year's figure.

In the first two months of the year gross earnings were 7.2% higher than a year earlier. The growth in the business sector was 9.1% while the parties in the National Interest Reconciliation Council had agreed on a 4-5% annual increase in 2006. Minimal wage increased by almost 10%. In the first two months real earnings increased by 5.6% - in the business sector by 6.7%, in the public sector by 4%. Unemployment increased from the 7.1% a year ago, to 7.7% now. The cash-flow deficit of the general government in the first quarter was more than half of the amount planned for the whole year. In March inflation was 2.3%, i.e. 1 percentage point lower than in December. By the end of the first half of the year inflation is expected to decline below 2%, although in the second half it will grow again because of the fiscal adjustment program (e.g. if the 15% VAT rate will be increased to 20%) and by the end of the year it may reach 3.5%. In spite of this fact the increasing confidence of the international financial community will probably lead to the strengthening of the forint and decreasing of the Central Bank base rate.

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

	2004.	2005.	2006. Jan.- Febr.	2006. (forecast)
1. Volume of GDP (%)	104.6	104.1	-	104.4
2. Industrial production (constant prices %)	107.4	107.3	112.6	108.5
3. Investment in the national economy (constant prices %)	107.9	106.4	-	108
4. Construction (constant prices %)	106.8	116.6	105.4	110
5. Retail trade (volume index %)	105.8	105.8	106.3	104.5
6. Exports (current prices in euro %)	115.3	111.0	117.9	111
7. Imports (current prices in euro %)	113.2	107.8	117.4	111
8. Trade deficit (□ bn.)	3.9	2.8	0.4	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	254.4*	253
11. Deficit of the general government (cash flow basis without local governments; bn. forints)	1284.1	984.4	790*	1750
12. Index of average gross earnings	106.1	108.8	107.2	106
13. Consumer price index	106.8	103.6	102.5*	102.3
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	102.3*	103.5
15. Rate of unemployment (at the end of the period, %)	6.3	7.3	7.7*	7.5

* January-March

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