

Reform and equilibrium

According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, the growth of the Hungarian economy accelerates a bit in 2006, parallel with the improvement of the European business climate. As a result of the planned fiscal adjustment measures of the new government the deficit of the general government will not grow further, the inflation will bottom out at the end of the first half of the year and will accelerate temporarily. The growth of real earnings will slow down. The increasing confidence of the investors will lead to strengthening of the forint in the second half of the year; interest rates are expected to decrease from the end of summer.

In the first quarter of the year the Hungarian economy expanded by 4.5%, i.e. by more than 2 percentage points faster than the EU average. The fastest growth (13%) was seen in the industrial production. Domestic sales of industry continued to increase fast (7.5%), but the driving force was the 18% expansion of the exports. In both directions the engineering industry played the most important role, but the chemical industry and - after a several year's decline - the food industry increased the output palpably as well. The construction industry - after a halt in February - soared again in March. Retail trade turnover was higher than in the first quarter of 2005, in spite of the fact that Easter was in April this year. Foreign trade turnover accelerated further, but the dynamism of the imports was stronger than that of the exports. This is due to high energy prices, weaker forint and the purchase of fighter planes paid for in March.

In the first three months of the year gross earnings were 7.3% higher than a year ago. The increase in the competitive sector was 9.1%, although the agreement in the National Reconciliation Council was 4-5% increase in 2006. The increase in the public sector was 5%. The minimal wage increased by almost 10%. In the first three months of the year real earnings were by 5.7% higher than a year ago - by 6.5% in the private and by 4% in the public sector. In the year as a whole the expected increase of the average real earnings is 4% - despite of the fiscal adjustment. After an almost uninterrupted two-year-long increase, the unemployment started to decline in March. This is mainly due to drainage or flood related public works. Nevertheless, unemployment is still higher than a year ago.

The cash-flow deficit of the general government in the first four months of the year was close to 60% of the amount planned for the whole year. As a result of the adjustment measures the deficit will not grow further from the autumn months. The inflation declined by 1 percentage point from December to 2.3% in March and April. By the end of the first half of the year inflation is expected to decrease to 2%, but in the second half it will increase again due to fiscal adjustment measures (e.g. retail price increase of the natural gas, rise of the 15% VAT rate to 20%) and by the end of the year inflation will be more than 3.5%. Nevertheless - as a result of the growing confidence of the international financial community - probably the forint will strengthen and the central bank base rate will decrease.

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

	2004.	2005.	2006. Jan.- March	2006. (forecast)
1. Volume of GDP (%)	105.2	104.1	104.5	104.4
2. Industrial production (constant prices %)	107.4	107.3	112.9	110
3. Investment in the national economy (constant prices %)	107.9	106.4	109.7	108
4. Construction (constant prices %)	106.8	116.6	107.9	108
5. Retail trade (volume index %)	105.8	105.8	105.4	104.5
6. Exports (current prices in euro %)	115.3	111.4	118.5	114
7. Imports (current prices in euro %)	113.2	108.3	119.1	114
8. Trade deficit (□ bn.)	3.9	2.8	0.7	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	257.1*	253
11. Deficit of the general government (cash flow basis without local governments; bn. forints)	1284.1	984.4	904*	1750
12. Index of average gross earnings	106.1	108.8	107.3	106.3
13. Consumer price index	106.8	103.6	102.5*	102.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	102.3*	103.9
15. Rate of unemployment (at the end of the period, %)	6.3	7.3	7.5**	7.5

* January-April

** February-April

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