

## Financial market confidence may start strengthening in the autumn

**According to the forecast made by GKI Economic Research Co. in cooperation with Erste Bank, investor confidence will improve gradually in the wake of the adoption of the fiscal adjustment laws in July, the clarification of the reform measures, the presentation of the convergence program to the EU at the end of August and the improvement of the fiscal data in the autumn. Nevertheless, radical improvement in the assessment of the state of the Hungarian economy will not take place before next year, as a result of the several-month-long spectacular decline in the fiscal deficit. All this will be reflected in the strengthening of the forint as well. The expansion of the economy will not yet slow down this year, but inflation will accelerate temporarily.**

In April industrial production slowed down a little, the output of the construction industry declined and retail trade turnover accelerated. Foreign trade growth slowed down as well, but the expansion of exports was once again faster than that of imports. Annual growth is expected to be faster than last year. The effect of the fiscal adjustment will be felt from the autumn; it will slow down the growth of the economy to 3.5% next year.

Confidence in the fiscal policy, which had been continuously declining for several years, declined further in June. The main reason is that the deficit of the general government is expected to remain very high - around 8% - even after the adjustment. In addition to that, the increasing interest rates in the foreign markets and PR problems also contributed to the spectacular weakening of the forint. Nevertheless, it is certain that the general government deficit will not be higher than the latest projection by the government.

After the fast decline in the first months of the year, inflation will be around 2.5% in the summer, then it will be increasing rapidly in the autumn reaching 5% by December. The forint probably will not weaken further. Moreover, in the wake of growing confidence of the international financial community the forint probably will slowly strengthen in the autumn. Nevertheless, the situation in the financial market is still uncertain, a further base rate increase is possible - especially if it will occur with other currencies as well.

During the first four months of the year, gross earnings were 7.5% higher than a year earlier. In the business sector the increase was 8.6%, although the agreement in the National Reconciliation Council was only 4-6% for 2006. The salary increase in the public sector was 6.1%. The minimum wage increased by 10%. In the first four months real earnings were 5.7% higher than a year earlier; the increase in the business sector was 6.5%, in the public sector 4.9%. For the year as a whole - despite the fiscal adjustment - a 3-3.5% average real earning increase is expected. Nevertheless, the 5% growth in the first half of the year will slow down to 1-2% in the second half. This will happen due partly to an increase of wage related contributions, and partly to accelerating inflation. Following an almost two-year-long continuous increase, unemployment has been decreasing since March.

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

	2004.	2005.	2006. Jan.- April	2006. (forecast)
1. Volume of GDP (%)	105.2	104.1	104.6*	104.4
2. Industrial production (constant prices %)	107.4	107.3	109.9	110
3. Investment in the national economy (constant prices %)	107.9	106.4	109.7*	108
4. Construction (constant prices %)	106.8	116.6	103.7	108
5. Retail trade (volume index %)	105.8	105.8	105.6	104.5
6. Exports (current prices in euro %)	115.3	111.4	115.5	114
7. Imports (current prices in euro %)	113.2	108.3	114.1	114
8. Trade deficit (□ bn.)	3.9	2.8	0.8	3.1
9. Combined deficit of the current & capital accounts (□ bn.)	6.7	5.7	-	6.1
10. Average exchange rate of euro (in forints)	251.7	248.0	258.2**	265
11. Deficit of the general government (cash flow basis without local governments; bn. forints)	1284.1	984.4	981**	1750
12. Index of average gross earnings	106.1	108.8	107.5	106.3
13. Consumer price index	106.8	103.6	102.5**	103.3
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	102.8**	105
15. Rate of unemployment (at the end of the period, %)	6.3	7.3	7.3***	7.5

\* January-March

\*\* January-May

\*\*\*March-May

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