

Forint gains strength

According to the forecast made by GKI Economic Research Co. in cooperation with the Erste Bank the growth of the economy is slowing down, the inflation is accelerating but the balance of the economy is improving. The confidence of the investors and consequently the forint is gaining strength. Nevertheless, a marked improvement in the assessment of the performance of the Hungarian economy is expected only in the coming year.

This year the Hungarian GDP is expected to grow by 4%. Its growth rate was 4.7% in the first quarter, decreased to 3.7% in the third quarter and probably will be similar in the fourth quarter as well. The growth rate of the industry is stable at around 10%; the expansion of the exports is close to 14%, that of the domestic sales - 6%. The development of the production of electric machinery, instruments and vehicles is outstanding. The construction industry, the performance of which was extraordinary last year, lagged behind the last year's results in almost every month. In the year as a whole it will stagnate at best. Retail trade expands vigorously. The effects of the fiscal adjustment measures (e.g. the increase of VAT) were felt very little so far in September: the 4.5% growth was barely below the 5% average of the first 9 months of the year. In the remaining period of the year the expansion of the turnover will probably slow further. In September the growth rate of both the exports and imports perceivably moderated and were basically equal.

In September the gross and even more the net earnings grew slower than in the previous months. Net earnings were above the level of the previous year by 8% in the first nine months but by only 4% in September. The change is a result of the increase in social security contributions. In the first nine months of the year real earnings increased by 4.8% but in September they dropped by almost 2% compared with the corresponding period of the previous year. This was a result not only of the slowdown of the nominal wage increases but also of the accelerated inflation. Price increases were the slowest (2.3%) in March-April, after which they started to accelerate reaching 5.9% in September and 6.3% in October. The inflation will reach its peak in spring 2007 around 8% and will go down to around 4% by the end of the year.

In 2006 the general government spends 120 forints out of every 100 forints revenue. Some improvement has already started but even so the deficit in 2006 will be equal to 9.5% of GDP i.e. much more than the 7.5% in 2005 or 7.5-8% in the 2006 budget revised taking into account the methodological changes. The combined deficit of the current and capital accounts as well as the trade deficit will be approximately the same as in 2005.

At the beginning of 2006 the forint strengthened, the interest rates decreased. From the middle of the year though the forint weakened by 10% and interest rates increased substantially - due partially to global and regional developments, partially because of the lack of clarity around the economic policy changes. Since the beginning of October though the forint has been strengthening almost uninterruptedly - by around 6% to date. On the one hand, other currencies of the region have been strengthening; on the other hand, the skepticism concerning the convergence program has been moderating. Money markets accept the economic policy more and more creditworthy. Most probably the 8% base rate of the central bank will not increase further.

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

	2004.	2005.	2006. Jan-Sept.	2006. (forecast)
1. Volume of GDP (%)	105.2	104.2	104.1	104
2. Industrial production (constant prices, %)	107.4	107.3	110.1	110
3. Investment in the national economy (constant prices, %)	107.9	105.6	99.6	102
4. Construction (constant prices %)	106.8	116.6	97.9	100
5. Retail trade (volume index %)	105.8	105.8	105.0	104
6. Exports (current prices in euro %)	115.3	111.4	114.8	115
7. Imports (current prices in euro %)	113.2	108.3	113.0	113
8. Trade deficit (□ bn.)	3.9	2.8	1.8	2.5
9. Combined deficit of the current & capital accounts (□ bn.)	6.7	5.3	2.9*	5.3
10. Average exchange rate of euro (in forints)	251.7	248.0	265.7**	265
11. Deficit of the general government (cash flow basis without local governments; bn. forints)	1284.1	984.4	1510**	2000***
12. Index of average gross earnings	106.1	108.8	107.7	107.3
13. Consumer price index	106.8	103.6	103.4**	103.9
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	106.3**	106.5
15. Rate of unemployment (at the end of the period, %)	6.3	7.3	7.4****	7.5

* H1

** January-October 2006

*** Including the assumption of debt of the National Highway Co.

**** August-October 2006

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