

## **The reduction of interest rates may start slowly**

**According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank it is almost sure that the 2007 portion of the convergence program will be implemented successfully. The rate of GDP growth will decelerate slightly. Following the peak of the first quarter, the rate of inflation is expected to fall in the course of the year in general and from autumn on in particular. The exchange rate of the Hungarian forint to the euro is likely to remain strong. Interest rates may start to decrease in the second quarter. Real earnings are predicted to drop by 3-3.5 per cent in 2007.**

In industry, export-oriented production growth that started last year continued with a 10 per cent rate. Due to the mild weather, energy production fell by 3.5 per cent. The output of building materials was up by 60 per cent. Nevertheless, this impressive growth did not affect construction, since its performance declined by 3 per cent in volume terms, although against a rather high base level recorded in January, 2006. Hungarian exports and imports surged by 20 per cent each in January, this is an extraordinary high growth rate. In the first month of the year, the rate of growth of exports did not exceed that of imports, as it was usual in the past few years. In the course of 2007, however, the rate of growth of exports is expected to be higher than that of imports since domestic demand is likely to grow slowly, and the deterioration of Hungary's terms of trade recorded in the previous years is expected to come to a halt. The rate of growth of retail trade slowed down, in January it was slightly higher than 1 per cent.

In January 2007, gross earnings grew by 7.7 per cent, net ones by 0.9 per cent compared to the same month of 2006. Real earnings decreased by 6.4 per cent. The growth rate of real earnings is rather high, the gap between gross and net earnings increased sharply. The difference between the competitive sphere and the public sector, too, is rather large. Gross earnings were up by 10.4 per cent, whereas net ones by only 5.6 per cent. Figures recorded in January reflect several temporary factors. In 2007, net earnings are projected to increase by about 3 per cent. The rate of inflation totalled 8.8 per cent this February, it might have peaked at this level in 2007. In the first two months of the year, the growth rate of prices of household energy and food represented double digit figures, whereas the prices of consumer durables declined.

According to the latest figures, external imbalances improved significantly in 2006, the improvement was more pronounced than expected earlier. The deficit was EUR0.8 million smaller than in 2005. Nevertheless, the inflow of foreign direct investments was lower, whereas the outflow higher than previously.

Speculation aiming at the abolition of the central parity and the intervention band (implying a switch to free floating) explains to a large extent the spectacular strengthening of the forint in March. Nevertheless, the contribution of the appreciation of the Slovak crown, the weakening of domestic political tensions, favourable domestic and regional macroeconomic reports and high interest rates on financial assets denominated in Hungarian forints was undeniable as well. In the first two months of 2007, the general government deficit was high, but lower than previous government forecasts. Actual figures allowed the lowering of the projection of the government by a symbolic 0.1 percentage point. GKI Co. expects the general government deficit to amount to about 6.5 per cent of GDP, this figure is lower than the projection of the government. The reference rate of the National Bank of Hungary may decrease in the second quarter, reaching 6-6.5 per cent at the end of the year.

**Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2007**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>January 2007</b>	<b>2007. (forecast)</b>
1. Volume of GDP (%)	105.2	104.2	103.9	-	103.0
2. Industrial production (constant prices %)	107.4	107.3	110.1	111.0	108
3. Investment in the national economy (constant prices %)	107.9	105.6	98,2	-	104
4. Construction (constant prices %)	106.8	116.6	98.4	97.1	104
5. Retail trade (volume index %)	105.8	105.8	104.4	101.2	101.5
6. Exports (current prices in euro %)	115.3	111.4	115.7	120.1	113
7. Imports (current prices in euro %)	113.2	108.3	113.4	120.8	110
8. Trade deficit (EUR bn)	3.9	2.9	2.1	0.2	1.0
9. Combined deficit of the current & capital accounts (EUR bn)	6.7	5.3	4,5	-	4.0
10. Average exchange rate of euro (in forints)	251.7	248.0	264.3	253.6*	252
11. Deficit of the general government (cash flow basis without local governments; HUF bn)	1284.1	984.4	2034	413*	1550
12. Index of average gross earnings	106.1	108.8	108.1	107.1	107
13. Consumer price index	106.8	103.6	103.9	108.3*	106.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	106.5	108.8*	104.5
15. Rate of unemployment (at the end of the period %)	6.3	7.3	7.5	7.4**	7.8

\* January-February 2007

\*\* December 2006-February 2007

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