

Interest rate cut from May

According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank the relatively favorable growth rate of the first months will continue during the rest of the year. Inflation will not accelerate further, moreover, it is expected to decline from September. Real earnings dropped by 7% at the beginning of the year, but the annual average decrease will be less than 5%.

Industrial production will continue to grow by an approximately 10% annual average. In the first two months industrial exports increased by almost 20%, while domestic sales grew minimally. The production of construction materials, vehicles, electric machines and instruments expanded spectacularly, while the food industry stagnated. In February the construction industry increased its output by almost 10% - which means a growth rate not seen since 2005. This was due to a low base and favorable weather. Retail trade continued to grow, albeit slowly. Foreign trade is soaring: in the first two months of the year exports increased by more than 20%, surpassing the growth rate of the imports by 2 percentage points.

In February the growth rate of the gross wages in the business sector slowed down by 2.5% compared to the January figure. Nevertheless, even this is the upper limit of the 5.5-8% band agreed upon in the National Interest Reconciliation Council. In some sectors notorious of "wages without taxation" (e.g. construction industry) the increase was especially strong. The wages in the lower brackets increased almost two times faster than the salaries of white-collar employees. All this indicates along with wage-inflation certain whitening process. As a combined result of previous year's salary increases, growing minimal wage level and wage freezing measures, the gross earnings in the public sector increased by 4% in the first two months of the year. In the second half of the year there will be a 4% wage increase as an advance payment against the 13th month salary due in January 2008. According to the calculations of the Central Statistical Office there is a 6 percentage points difference between the growth rates of the net and gross earnings due to the increase of wage-related fees, the solidarity tax and the annulment of total tax exemption of the minimal wage. Thus, at an 8.2% inflation real earnings declined by 7.2%. During the year as a whole an approximately 5% decline is expected in the real wages due to moderating inflation and increase in the net wages. Thus, for the time being there is no inflationary pressure from the demand side.

In the first two months of the year the number of people employed in the business sector increased by 1.5%, while in the public sector it declined by 3.5%. The unemployment rate did not change in the first quarter. This is due in part to the really growing job opportunities and favorable weather conditions, but in part to the spreading of the legal employment.

The confidence in the Hungarian economy is growing, the fiscal developments are somewhat better than expected. The cooperation between the government and the central bank has been improving. The forint is steadily strong and - although the inflation is still high - the price increases will slow down significantly from the autumn. All these factors create already now conditions for gradual reduction of interest rates. By the end of the year a 6-6.5% central bank interest rate is probable, while the forint might somewhat weaken amidst certain fluctuations.

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

| | 2004 | 2005 | 2006 | January- February 2007 | 2007 (forecast) |
|--|-------------|-------------|-------------|-----------------------------------|----------------------------|
| 1. Volume of GDP (%) | 105,2 | 104,2 | 103,9 | - | 103,0 |
| 2. Industrial production (constant prices %) | 107,4 | 107,3 | 110,1 | 110,8 | 109 |
| 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 | 102,9 | 103 |
| 5. Retail trade (volume index %) | 105,8 | 105,8 | 104,4 | 100,6 | 101,5 |
| 6. Exports (current prices in euro %) | 115,3 | 111,4 | 116,6 | 121,6 | 118 |
| 7. Imports (current prices in euro %) | 113,2 | 108,3 | 113,9 | 119,5 | 115 |
| 8. Trade deficit (EUR bn) | 3,9 | 2,9 | 2,0 | 0,3 | 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 | 252,3* | 252 |
| 11. Deficit of the general government (cash flow basis without local governments; HUF bn) | 1284,1 | 984,4 | 2034 | 762,4* | 1550 |
| 12. Index of average gross earnings | 106,1 | 108,8 | 108,1 | 106,5 | 107 |
| 13. Consumer price index | 106,8 | 103,6 | 103,9 | 108,5* | 107 |
| 14. Consumer price index at the end of the period (corresponding month of the previous year=100) | 105,5 | 103,3 | 106,5 | 109,0* | 104,8 |
| 15. Rate of unemployment (at the end of the period %) | 6,3 | 7,3 | 7,5 | 7,5* | 7,8 |

* January-March 2007

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