

Interest rate cut in June

According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank internal and external financial balances are substantially improving, although this is accompanied by unavoidably deteriorating indicators of growth, inflation and unemployment. The reforms are still fragmented, they are met with resistance and burdened with political and technical errors.

Economic growth is unabated in the EU and especially robust in Germany. This fact and the fast expansion of domestic consumption is leading to spectacular acceleration of growth in the Central European countries. Because of the unavoidable fiscal adjustment Hungary can not participate in this development, although the competitive branches of the economy are successful in using the export opportunities.

The rate of economic growth will slow down compared to the last year, nevertheless, it will be much faster than planned. Industrial production will grow by approximately 9%. In contrast to the last year's decrease the output of the construction industry will increase by a modest 3%. Certain business services (domestic tourism, highway transit transport, business consultancy) will expand fast, but public services will stagnate or decrease. GDP will grow by 3.2%.

Exports will expand by 18%, imports by 15%; the trade deficit will shrink from the last year's □ 2 bn. to □ 1 bn. in 2007. As a result the total foreign trade of the Hungarian economy (including the services) will be fully balanced. The deficit of the current account will be around □ 4.5 bn. - due mainly to the large profit taking of the foreign owned firms. Since the net EU transfers - owing to the delayed disbursements - will be around □ 1.5 bn. the external financing requirement will drop to three billion euros, below 3% of GDP.

The inflation rise was only temporary; it started to abate moderately as of April and will drop markedly from September onward. The average rate of inflation will be 8.3% in the first eight months of the year but only 4.8% in the last four months. The gross nominal increase of earnings will be 7.5%, i.e. larger than planned, but the inflation will be higher than planned as well: around 7%. Private sector wages are rising by approximately 8.5%, i.e. faster than the upper limit of the agreement reached in the National Interest Reconciliation Council, and public sector wages are increasing by some 6%, with an approximately 8% wage hike in the second half of the year. The difference between gross and net wages - which was 6.2% in the first quarter - will be diminishing throughout the year, nevertheless, real wages will drop somewhat faster than projected, by approximately 4.5%. The decrease in real wages will be significantly less prevalent in the public sector and more pronounced in the private sector. Beginning in September, real wages will no longer be below the level of the corresponding period of 2006. The stricter control of labor relations, the introduction of wage-related contributions based on the double of the minimal wage and the measure connecting health care services with actual payment of health care contributions led to the start of a modest but definite "whitening" of the economy.

In May the central bank did not cut the base rate, referring to the fast outflow of wages, but it is highly probable that this step will be taken in June. By the end of the year a 6-6.5% base rate is expected. The forint will remain strong, because the still high interest rate will attract the investors. The annual average exchange rate is expected around 250 forints/euro.

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

	2004	2005	2006	January- March 2007	2007 (forecast)
1. Volume of GDP (%)	105,2	104,2	103,9	-	103,2
2. Industrial production (constant prices %)	107,4	107,3	110,1	108,8	109
3. Investment in the national economy (constant prices %)	107,9	105,6	98,2	100,8	104
4. Construction (constant prices %)	106,8	116,6	98,4	103,3	103
5. Retail trade (volume index %)	105,8	105,8	104,4	100,3	100,5
6. Exports (current prices in euro %)	115,3	111,4	116,6	118,2	118
7. Imports (current prices in euro %)	113,2	108,3	113,9	114,7	115
8. Trade deficit (□ bn)	3,9	2,9	2,0	0,3	1,0
9. Combined deficit of the current & capital accounts (□ bn)	6,7	5,3	4,5	-	3,0
10. Average exchange rate of euro (in forints)	251,7	248,0	264,3	250,7*	250
11. Deficit of the general government (cash flow basis without local governments; billion forints)	1284,1	984,4	2034	745,4*	1550
12. Index of average gross earnings	106,1	108,8	108,1	107,1	107,5
13. Consumer price index	106,8	103,6	103,9	108,6*	107
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*	104,8
15. Rate of unemployment (at the end of the period %)	6,3	7,3	7,5	7,5**	7,8

* January-April 2007

** February-April 2007.

Source of actual data: CSO, NBH, MoF