

## Rate cuts will continue

**According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank inflation has passed its peak and the time of rate cuts have arrived - although not with new steps in each month. Real earnings dropped by 6.8% in the first five months and will decline by 4.5% in the year as a whole, while in the last quarter they will be on the same level as in the corresponding period of the previous year.**

The growth of the economy will slow down compared to the last year's rate, but will be much higher than originally planned. In May the speed of the growth in the industry and foreign trade moderated, but increased in the construction industry. In the first five months of the year the exports of the industry expanded by 15%, its domestic sales stagnated. Within this the sales of durable and non-durable goods decreased by 4-6%. The expansion of the construction activity is due exclusively to the construction of buildings. The retail trade turnover lags behind the last years performance.

The acceleration of inflation was only transitory; it has already passed the peak and starting from September - when the last year's huge price increases enter the basis - it will decline fast. In the first five months the price of household energy increased strongly: by more than 30% and the increase of food prices was above the average as well. At the same time the price of consumer durables - partly due to the strong forint - decreased. The annual average consumer price increase expected to be around 7%, the year-end inflation 4.5-5%

In the January-May period the gross nominal wages increased faster than planned: by 7.4%. In the business sector the wages increased by more than 10% - i.e. faster than the upper limit of the agreement reached in the National Interest Reconciliation Council - although this is partly due to the whitening of the employment. Pay rises in the public sector are below 3%. In the autumn there will be a slowdown in the private sector, because the wage increase generated by the whitening of the employment started already last year. Public sector wages will be increasing by some 8% in the second half of the year (at the expense of the half of the 13th month wages). Although the difference between the pace of the gross and net wage increases will be shrinking during the year, the expected decline of the real wages will be stronger than originally planned. Beginning from September, real wages will no longer be below the level of the corresponding period of 2006.

Unemployment decreased during the first months of this year but by the end of the year it will be somewhat higher - partly because of seasonal factors, partly because of the expected lay-offs of teachers.

In June the central bank started to reduce its base rate, which had been 8% since October 2006, but there was no further cut in July. During the year there will be at least one percentage point rate cut - following the drop in the inflation. Thus, by the end of the year the base rate may be around 6.5%. The forint is strong, the annual average exchange rate will be around 250 forints/euro.

The development of the balance of the economy is favorable. The deficit of the general government measured by the EU methodology will be 6.2% of GDP, which is still very high, but less than planned in the convergence program. For the time being the trade deficit is half of the 2006 figure and this tendency is expected to continue during the rest of the year. The deficit of the current and capital accounts is improving. In the first quarter of the year the FDI inflow was lower than in the previous year, while the export of capital increased. Nevertheless, during the year as a whole the import of capital will grow.

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

	<b>2004.</b>	<b>2005.</b>	<b>2006.</b>	<b>2007. January-May</b>	<b>2007. (forecast)</b>
1. Volume of GDP (%)	104,8	104,1	103,9	102,7*	103,2
2. Industrial production (constant prices, %)	107,4	107,3	110,1	108,0	109
3. Investment in the national economy (constant prices, %)	107,6	105,3	97,9	97,7*	104
4. Construction (constant prices, %)	106,8	116,6	98,4	101,9	103
5. Retail trade (volume index, %)	105,8	105,8	104,4	99,1	100,5
6. Exports (current prices in euro, %)	115,3	111,4	116,6	116,8	118
7. Imports (current prices in euro, %)	113,2	108,3	113,9	114,2	115
8. Trade deficit (□ bn)	3,9	2,9	2,0	0,5	1,0
9. Combined deficit of the current & capital accounts (□ bn)	6,7	5,3	4,5	1,0*	3,0
10. Average exchange rate of euro (in forints)	251,7	248,0	264,3	250,3**	250
11. Deficit of the general government (cash flow basis without local governments; billion forints)	1284,1	984,4	2034	1004**	1550
12. Index of average gross earnings	106,1	108,8	108,1	107,4	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	108,6**	104,8
15. Rate of unemployment (at the end of the period %)	6,3	7,3	7,5	7,0***	7,8

\* Q1 2007.

\*\* H1 2007.

\*\*\* Q2 2007

Source of actual data: CSO, NBH, MoF