

Green light to further rate cuts

According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank the growth of the economy continued to be very slow in the third quarter of the year. In July the export driven industry expanded its production very fast, while the output of the construction industry and domestic trade continued to decline. The increasing world prices of crude oil and agricultural products make curbing inflation very difficult.

The rate of economic growth drastically slowed down in the Q2: it was only 1.2% and probably there was no change in the growth rate during the summer months. The unfavorable weather conditions caused significant reduction in the agricultural production. This year the production of cereals was 9% less than last year. Even stronger reduction is likely in the corn production. Nevertheless, the position of the producers is not bad due to the increase in the agricultural prices. In the construction industry there was an upsurge in the government investments during the last year's pre-election period, followed by a decline, which probably bottomed out in July 2007 when the output was 14% less than a year earlier. Compared to the corresponding period of the previous year retail trade increased minimally in the first quarter, decreased by 3% in the second quarter and by 4.2% in July. The most dynamic sector of the economy is the industry, although its fast growth is exclusively due to the exports. In July the exports of the industry was 25% higher than a year ago, while domestic sales increased only by 2%. The car industry increased its sales in both the domestic and export markets. The level of investments stagnated in the first half of 2007, but in the manufacturing industry it increased by one third.

Inflation has passed its peak and started to strongly decrease from September. At the same time the agricultural prices hinder this process due to the bad weather and subsequent low production, to the use of agricultural products for energy generation, as well as the increase of global demand because of the growing consumption in Asia. Thus, it is expected that the annual average inflation will be 7.5% and the year-end inflation around 5.5%.

In July the gross nominal earnings were 10% higher than a year ago. In the public sector the salary increase was 9% due to the fact that the agencies started to disburse half of the 13th month salaries already in June. On the other hand, there was some slowdown in the business sector. Nevertheless, until now the wage increase in the competitive sector was more than 10% - i.e. more than the higher limit of the agreement in the National Council for the Reconciliation of Interests. This is partly due to the new impetus of the "whitening" of employment and wages, that started in September 2006. Consequently, while in the coming months the salary increase in the public sector will be faster than in the first half of the year, it will be slower in the business sector. During the year as a whole the expected decrease of the real wages is 4% and if we count with the effect of whitening it might be around 6%. This year unemployment is lower than it was last year, but by the end of the year it may reach again last year's level due partly to seasonal effects, partly to measures - like termination of employment among teachers.

The central bank base rate had been 8% since October 2006. Its reduction started in June but was continued only at the end of September. Since the inflation is slowing down, the dollar interest rates are decreasing, the forint is strong and the domestic demand is weak - further reduction of the base rate is expected from the present 7.5% to 7% or even less by the end of the year. The forint weakened in August, then strengthened in September. The annual average forint/euro exchange rate probably will be around 250 - the same as the average of the first eight months. The deficit of the general government will be around 6% of GDP according to the EU methodology. This is still too high, but lower than what was envisaged in the convergence program.

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

	2004	2005	2006	January-July 2007	2007 (forecast)
1. Volume of GDP (%)	104.8	104.1	103.9	101.9*	102.2
2. Industrial production (constant prices. %)	107.4	107.3	110.1	108.9	109
3. Investment in the national economy (constant prices. %)	107.6	105.3	97.9	101.4*	102
4. Construction (constant prices. %)	106.8	116.6	98.4	94.2	98
5. Retail trade (volume index. %)	105.8	105.8	104.4	98.0	99
6. Exports (current prices in euro. %)	115.3	111.4	116.6	117.9	118
7. Imports (current prices in euro. %)	113.2	108.3	113.9	114.3	115
8. Trade deficit (□ bn)	3.9	2.9	2.0	0.6	1.0
9. Combined deficit of the current & capital accounts (□ bn)	6.7	5.3	5.2	2.8*	4.5
10. Average exchange rate of euro (in forints)	251.7	248.0	264.3	250.8**	250
11. Deficit of the general government (cash flow basis without local governments; billion forints)	1284.1	984.4	2034	982.3**	1450
12. Index of average gross earnings	106.1	108.8	108.1	108.2	108.5
13. Consumer price index	106.8	103.6	103.9	108.5**	107.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	106.5	108.3**	105.5
15. Rate of unemployment (at the end of the period %)	6.3	7.3	7.5	7.2***	7.5

* H1 2007

** January-August 2007

*** June-August 2007

Sources of actual data: CSO, NBH, MoF