

Decreasing deficit, slow growth, high inflation

According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank this year the internal and external equilibrium of the Hungarian economy is improving faster than expected but its growth is sharply slowing down and inflation remains high.

In September the output in most of the sectors of the economy was below the earlier levels. The growth of the industry was slower than in any of the previous months, the output of the construction industry fell by a quarter, the decline in retail trade turnover became more pronounced. The expansion of the exports slowed down as well. In January-September 2007 the exports of the industry increased by 17%; its domestic sales by 1.3%. Especially fast growth is seen in the in the exports of electric machinery, instruments and motor vehicles. In the food industry total output declined, but exports expanded. While the output of the construction industry contracted 10%, interestingly the number of houses put into use increased 10%. In the retail trade the turnover of food product decreased by 1%, that of other product by 4%, while there was an even stronger decline in September: 3% and 5.5% respectively. In the Q3 the GDP increased only 1%. This was due mainly to the shrinking public services and the dramatic decline of agricultural production caused by unfavorable weather conditions. Most probably the latter contributed to the decrease in the domestic freight transport in the Q3. The volume of investments has shrunk as well.

This year the deficit of the general government will be reduced to 6% of GDP. Half of the roughly 3 percentage points improvement will be result of increased revenues, the other half comes from reduction of expenditures: from curtailed central and local government investment as well as shrinking public service outlays. External balance is significantly improving as well. The trade deficit in the Q1-Q3 period shrunk to 0.4 billion euro from the 2 billion in the corresponding period of the previous year. During the year as a whole there will be significant surplus in the combined balance of foreign trade of goods and services. On the other hand, the deficit in the flow of incomes is widening due mainly to the growing profits on foreign capital invested in Hungary, partly to interest expenditures. Since within the capital account the EU transfers barely grow from the last year's level, the external financing requirements of the Hungarian economy will reach 4.5 billion euros, i.e. 4.4% of GDP.

Inflation sharply accelerated starting from summer 2006. Its peak in spring 2007 was higher and its slowdown from summer 2007 was more moderate than forecasted earlier. This is because of the high world market crude prices and the high prices of agricultural products. In October the rate of inflation even accelerated further and no change is expected before the end of the year - mainly because of the fast increasing fuel prices. An annual average 7.9% inflation is expected this year. Gross annual average wage will increase by approximately 8.5%, within this by about 9.5% in the business sector and 6.3% in the public sector (due to the salary increase in the second half of the year, which is a kind of advance payment of the 13th month salary). The growth of the net wages is lagging far behind the gross wages. Thus, real wages statistically will decrease 4.5%, but if we take into account the whitening effect (i.e. the initial reduction of the tax evasion) the decrease will be around 6% both in the private and public sectors. The real value of pensions will remain unchanged (but calculated with the pensioners price index, it will decrease by 2%). The consumption of households will shrank by 2%, but within this the purchased consumption will decrease only a little. The annual average exchange rate of the euro will be around 251-252 forints. The process of interest rate reduction has been halted; its continuation depends on global developments.

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

	2004	2005	2006	January-September 2007	2007 (forecast)
1. Volume of GDP (%)	104.8	104.1	103.9	101.6	101.7
2. Industrial production (constant prices, %)	107.4	107.3	110.1	108.6	108.5
3. Investment in the national economy (constant prices, %)	107.6	105.3	97.9	99.2	100
4. Construction (constant prices, %)	106.8	116.6	98.4	89.8	92
5. Retail trade (volume index, %)	105.8	105.8	104.4	97.5	98
6. Exports (current prices in euro %)	115.3	111.4	116.6	117.6	118
7. Imports (current prices in euro %)	113.2	108.3	113.9	113.2	115
8. Trade deficit (billion euros)	3.9	2.9	2.0	0.4	0.6
9. Combined deficit of the current & capital accounts (billion euros)	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**	252
11. Deficit of the general government (cash flow basis without local governments; billion forints)	1284.1	984.4	2034	1196.9**	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	108.1**	107.9
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.5	103.3	106.5	106.7**	106.9
15. Rate of unemployment (at the end of the period %)	6.3	7.3	7.5	7.3***	7.5

* H1 2007

** Jan.-Oct. 2007

*** Aug.-Oct. 2007

Sources of actual data: CSO, NBH, MoF