

## Less certain economic outlook – improving equilibrium

**According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank the economic growth will accelerate and the inflation will slow down in 2008, although to lesser extent than forecasted earlier. Internal and external equilibrium will continue improving, real earnings will increase – although minimally.**

Because of the deteriorating European business environment the industrial production in Hungary will grow somewhat slower than in 2007: by about 7.5%. Nevertheless, the industrial exports remain the main driving force of the economic development. At the same time the acceleration of the growth in 2008 is to some extent automatic correction of the precipitous decline of the agricultural production that took place in 2007. After a 10-15% decline in 2007 the contribution of the agriculture to the GDP in 2008 is expected to grow by 10% – presuming average weather conditions. After the significant decline in 2007 the output of the construction industry will expand vigorously in 2008. The fast growth will continue in several business services. There will be some expansion in the trade sector. The contribution of the public services to the GDP will continue to shrink, but to lesser extent than in 2007.

Exports will grow dynamically, but slower than in 2007. Along with the deceleration of the industrial exports the agricultural exports will slow down as well (at least in euro-terms) as a result of the last year's poor crop. On the other hand, the growth of imports can even accelerate getting as far as the growth rate of the exports. This will happen due to deterioration of the terms of trade, to the expected expansion of investments and to the slow increase of consumption. The trade deficit will stagnate at a low level. The foreign trade of services will expand, its surplus will grow moderately. Increasing deficit is expected in the balance of incomes. Thus, the deficit of the current account will remain basically unchanged around 5 billion euros. In 2008 Hungary starts using those EU funds that has been at the disposal of the country since 2007, while disbursements of funds from earlier period will take place as well. As a result, the external financing requirements of the national economy will decrease to 3.2 billion euros, i.e. to about 3% of GDP.

In the last months of 2007 inflation accelerated, mainly as a result of fast growing global energy, raw material and food prices exacerbated by the poor domestic crop. This year these tendencies continue to influence the price formation, except the one-off price increasing effect of the fiscal consolidation measures. Food prices will grow by approximately 10% (but by the end of the year they may slow down to around 5% because of the high price level in December 2007). The price of household energy will increase by more than 8%. The price level of consumer durables will decrease and the price of clothing will increase only minimally. Fuel prices will increase moderately from the already high 2007 level. The price of services will grow a bit slower than the wages, but faster than the average inflation. Thus, inflation will decrease very slowly from the 7.4% at the end of 2007: it will be around 6% at mid-year and around 4% at the end of the year resulting in a 5.7% annual average. The annual average euro/forint exchange rate will remain around the last year's 252 forints – the weakening of the forint observed in January was probably a transitory phenomenon.

The growth of incomes will somewhat slow down in nominal terms, the whitening of the economy continues. Gross earnings will grow by 8% in the competitive sector and by 7% in the public sector. Thus, real wages in the national economy will grow by approximately 0.5-1%, but within this the growth will be minimal in the public sector and more than 1% in the competitive sector. The unemployment that – for seasonal reasons – increased at the end of 2007 is expected to decrease in 2008. The employment in the competitive sector, which deteriorated since summer 2007 will start to improve slowly and moderately.

**Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2008**

|  | <b>2005</b> | <b>2006</b> | <b>Jan.-Nov.<br/>2007</b> | <b>2007<br/>estimate</b> | <b>2008<br/>forecast</b> |
|--|-------------|-------------|---------------------------|--------------------------|--------------------------|
| 1. Volume of GDP (%)   | 104.1       | 103.9       | 101.6*                    | 101.5                    | 103.2                    |
| 2. Industrial production (constant prices, %)  | 107.3       | 110.1       | 108.2                     | 108.2                    | 107.5                    |
| 3. Investment in the national economy (constant prices, %)   | 105.3       | 97.9        | 99.2*                     | 100                      | 106                      |
| 4. Construction (constant prices, %)   | 116.6       | 98.4        | 87.2*                     | 87                       | 108                      |
| 5. Retail trade (volume index, %)  | 105.8       | 104.4       | 97.1                      | 97                       | 101.5                    |
| 6. Exports (current prices in euro %)  | 111.4       | 116.6       | 116.5                     | 116                      | 113                      |
| 7. Imports (current prices in euro %)  | 108.3       | 113.9       | 112.3                     | 112                      | 113                      |
| 8. Trade deficit (billion euros)   | 2.9         | 2.0         | 0.3                       | 0.3                      | 0.3                      |
| 9. Combined deficit of the current & capital accounts (billion euros)                              | 5.3         | 5.2         | 3.3**                     | 4.1                      | 3.2                      |
| 10. Average exchange rate of euro (in forints)   | 248.0       | 264.3       | 251.3**                   | 251.3**                  | 252                      |
| 11. Deficit of the general government (cash flow basis without local governments; billion forints) | 984.4       | 2034        | 1291**                    | 1291**                   | 1100                     |
| 12. Index of average gross earnings  | 108.8       | 108.1       | 108.3                     | 108.5                    | 107.5                    |
| 13. Consumer price index   | 103.6       | 103.9       | 108.0**                   | 108.0**                  | 105.7                    |
| 14. Consumer price index at the end of the period (corresponding month of the previous year=100)   | 103.3       | 106.5       | 107.4**                   | 107.4                    | 104                      |
| 15. Rate of unemployment (at the end of the period %)  | 7.3         | 7.5         | 7.7***                    | 7.7***                   | 7.4                      |

\* Q1-3 2007

\*\* Actual annual data

\*\*\* Q4 2007 (actual)

Sources of actual data: CSO, NBH, MoF