

The assessment of the Hungarian economy has deteriorated.

According to the forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank the internal and external balance of the economy will improve further considerably in 2008. Although in the first quarter the growth will be very modest, the Hungarian economy will bottom out from the last year's "hole" by the end of 2008. However, the inflation will abate significantly not sooner than around the end of the year. If by that time the global economy will stabilize, the interest rates will decrease and the forint will strengthen.

In the spring of 2008 the state of the world economy became critical, owing to the high and still growing food-, raw material-, and energy prices, the weakening dollar, the danger (or fact) of recession in the American economy and turbulence in the international money and capital markets. The portfolio crisis developed into credit- and liquidity crisis leading to continuous uncertainty and plunge in the money and capital markets.

All these facts – combined with the overheated domestic political fight – make the implementation of the convergence program difficult. In the first quarter of 2008 the exchange rate of the forint stabilized at a level 4% lower than before, while other currencies of the region strengthened. The exchange rate of the forint may strengthen durably in the second half of 2008 unless new international shocks occur. The annual average exchange rate of the forint is expected to be somewhat weaker than last year: around 257 forints/euro. Between August 2007 and now the interest rate premium of the 10 year government paper increased from 200 basis points to 380 basis points, while for the rest of the Visegrad countries the increase – from a much lower point – was only approximately 50 bps. In other words, the assessment of the Hungarian economy deteriorated in the past half year. The further improving internal and external equilibrium, the decreasing inflation, the not-too-fast wage outflow, the codification of new fiscal rules – that will help to tighten the conditions for the planning of the general government – may create the conditions for the reduction of the interest rates from the second half of the year. Before that, however, a temporary interest rate increase is probable. The central bank base rate may be 7-7.5% around the end of the year. This would be the same as last year, while the inflation is expected to be 2.5% lower by the end of the year.

In 2008 the annual average inflation will slow down to 6-6.5%. Nevertheless, the price increase of food and household energy will be well above 10% (following the global market price movements the price of the natural gas for the households may go up even by 30%, that of the electric energy by 10% and that of the district heating by 10-15% in the second half of the year). Inflation will slow down from the 7.4% at the end of 2007 to approx. 5% by the end of 2008. The increase in the gross wages of the business sector will be 8%, which is somewhat above the upper limit of the 5-7.5% band recommended by the National Council for the Reconciliation of Interests, while the increase in the public sector will be 7%. Almost 1 percentage point difference is expected between the growth rates of the gross and net wages. Thus, in 2008 at approx. 6.2% inflation, real earnings will grow by 0.5-1%. Real value of pensions will increase by 1%. Employment will moderately expand in the business sector and shrink in the public sector. The rate of unemployment that increased around the end of 2007 will decrease a little by the end of the year: to 7.5%.

In 2008 the growth rate of the economy will lag far behind the growth rate of the new EU member states. On top of that, no acceleration will be felt in the first quarter of the year. Given the seasonality of the agricultural production the compensation for the last year's decline will take place only from the summer months. In 2007 the drop in the performance of the public services and retail trade became pronounced only after the first quarter, thus the basis at the beginning of the year is still relatively high. The effect of EU transfers that will help to revitalize the construction industry will be felt only around the beginning of the summer. Given the gloomy European economic outlook – despite the favorable January data – only a 5-6% growth is expected in the industry like in the last months of 2007. The outlook continues to be favorable in the majority of the business services. In 2008 the total GDP will grow by 2.5-3%, while the performance of the sectors other than the agriculture and public services will increase by 3.3%. As in the slowdown of 2007, in the acceleration of 2008 the effect of one-off factors will be significant.

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

	2005	2006	2007	January 2008	2008 forecast
1. Volume of GDP (%)	104.1	103.9	101.3	-	102.7
2. Industrial production (constant prices, %)	107.3	110.1	108.1	106.6	106
3. Investment in the national economy (constant prices, %)	106.4	98.0	100.3	-	104
4. Construction (constant prices, %)	116.6	98.4	85.9	72.6	102
5. Retail trade (volume index, %)	105.8	104.4	97.0	97.0	101.0
6. Exports (current prices in euro %)	111.4	116.6	115.7	116.4	110
7. Imports (current prices in euro %)	108.3	113.9	111.9	112.9	109
8. Trade deficit (billion euros)	-2.9	-2.0	-0.3	-0.1	0
9. Combined deficit of the current & capital accounts (billion euros)	5.3	5.2	3.9*	-	3.5
10. Average exchange rate of euro (in forints)	248.0	264.3	251.3	259.0**	257
11. Deficit of the general government (cash flow basis without local governments; billion forints)	984.4	2034	1291	182.1**	1050
12. Index of average gross earnings	108.8	108.1	108.2	98.5	107.7
13. Consumer price index	103.6	103.9	108.0	107.0**	106.2
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.3	106.5	107.4	106.9**	105
15. Rate of unemployment (at the end of the period %)	7.3	7.5	7.7	8.1***	7.5

* GKI Co. estimate

** January-February

*** November 2007 – January 2008

Sources of actual data: CSO, NBH, MoF