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## **The Deficit May Be Even Lower Than Planned**

**The forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank shows substantial improvement in the internal and external equilibrium this year with real wages in the business sector already climbing while inflation and interest rates remain high.**

The general government deficit for the first five months of the year was not even 40% of the annual target, which is substantially lower than usual. Despite rising energy prices, which worsen the terms of trade, the trade balance had a surplus of 330 million euros in the first four months, which is unprecedented since the beginning of the economic transition. At the same time, inflation is declining very slowly from the extremely high level reached last year. Prices rose by 6.9% on average over the first five months; the index was down to 6.6% at the end of April, only to rise to 7% in May. In the wake of the worldwide rise of prices, almost every country in the region (with the exception of Slovakia and Poland) has inflation matching or exceeding Hungary's.

This year's general government deficit will likely be smaller than that approved in the budget act (3.8% instead of 4%). As a result, Hungary will be close to ending the so-called excessive deficit procedure as soon as this year (with retirement fund adjustment, the deficit would have to be at 3.6%.) It may even meet this Maastricht criterion!! Even so, Hungary will likely have the highest general government deficit in the EU. More than 40% in the improvement stems from the rise in taxes and contributions, 20% each are due to cuts in wages and expenses, respectively, and 15% is due to restraining investment expenditures.

The country's external equilibrium will continue to improve. In the first quarter the combined deficit of the current account and the capital account dropped by a spectacular 0.6 billion euros (as a result of rising EU transfers), and the inflow of FDI increased by another 0.6 billion euros. The external financing requirement for the entire year will decrease to 3.5 billion euros, or 3.2% of the GDP (from 4% last year).

The main driver of inflation in 2008 is no longer the adjustment but the rise in global energy, raw material and food prices. The annual average inflation will drop to 6.5%, with the end-of-year price index at 5.5%. As in other parts of the world, the Hungarian inflationary (disinflationary) trajectory has also shifted upward.

Since the necessary negative effects of the structural adjustment primarily impacted the economy last year, when global growth is slowing and inflation is rising this year, events in Hungary are reversed: development is accelerating from last year's extremely low level and the rate of price increases is declining from last year's extremely high level.

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

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>January- April, 2008</b>	<b>2008 Forecast</b>
1. Volume of GDP (%)	104.1	103.9	101.3	101.7*	103.0
2. Industrial production (constant prices, %)	107.3	110.1	108.1	108.1	106
3. Investment in the national economy (constant prices, %)	106.4	98.0	100.3	95.2*	104
4. Construction (constant prices, %)	116.6	98.4	85.9	86.5	102
5. Retail trade (volume index, %)	105.8	104.4	97.0	97.4	101.0
6. Exports (current prices in euro %)	111.4	116.6	115.7	115.2	110
7. Imports (current prices in euro %)	108.3	113.9	111.9	112.1	109
8. Trade balance (billion euros)	-2.9	-2.0	-0.3	0.3	0
9. Combined balance of the current & capital accounts (billion euros)	-5.3	-5.2	-4.0	-0.4	-3.5
10. Average exchange rate of euro (in forints)	248.0	264.3	251.3	255.9**	250
11. Deficit of the general government (cash flow basis without local governments; billion forints)	984.4	2034	1291	424.8**	1030
12. Index of average gross earnings	108.8	108.1	108.2	107.5	108.5
13. Consumer price index	103.6	103.9	108.0	106.9**	106.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.3	106.5	107.4	107.0**	105.5
15. Rate of unemployment (at the end of the period %)	7.3	7.5	7.7	7.7***	7.5

\* January-April 2008

\*\* January-May

\*\*\* March-May

Sources of actual data: CSO, NBH, MoF