

## Deteriorating outlook for Europe

**The forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank shows that the Hungarian economy gets out of the growth hole in the second half of the year – despite the deteriorating European economic environment. Both the internal and external equilibrium improve significantly compared to the last year; inflation is slowly moderating.**

In Q2 2008 GDP decreased by 0.1% compared to the previous quarter in the EU, while it increased by 0.6% in Hungary. Thus, the growth of the Hungarian economy compared to the corresponding period of the previous year was somewhat faster, than the 1.7% average of the EU, although its growth continued to be much slower than that of the new member states. The stronger than expected slowdown of the European – especially German – economy and the deteriorating European business confidence limit the growth possibilities in Hungary. This is true even though the two most important engines of this year's development are the cessation of the decline in the public services and the spectacular development of the agriculture.

In June industrial production was less than a year earlier. Exports that produced a two digit growth in the first four months of the year basically stagnated in June. In the first five months the expansion of the Hungarian exports to the EU was less than 10%, but around 30% to non-EU countries. Growing share of exports goes to the dynamically developing new member states of the EU and domestic demand is slowly expanding – thus, the 5-6% industrial growth observed in the first half of the year hopefully will continue further. In the first half of the year the performance of the construction industry was by 10%, the retail trade turnover by 2% below the level of the corresponding period of the previous year. Nevertheless, the speed of the decline is slowing down. This year the number of people employed stagnated in the competitive sector and decreased in the public sector. As a result, unemployment is higher than a year ago but lower than at the beginning of this year. Due to the good agricultural production the economy is expected to grow by approximately 3%.

In July 2008 prices increased 0.1% compared with the previous month, while the twelve-month growth was 6.7%. As a result of the good harvest, decreasing agricultural producer prices, stabilizing oil prices and strong forint the inflation will slow down during the coming months of the year to around 5.5% in December. In the first half of the year real earnings increased 0.5%; they grew 1.5% in the competitive sector and decreased 1.5% in the public sector. During the year as a whole 2% real earning increase expected in the competitive sector and stagnation in the budgetary sector.

The forint strengthened abruptly in July and remained strong in August. The strengthening was caused by the high central bank base rate and high interest rates of the government papers; although the improving financial assessment of the region and the improving external and internal equilibrium also played a role. In the coming months some weakening of the forint is expected. There may be some uncertainty and even significant weakening if the minority government will have difficulty in preparing the 2009 budget. The adoption of the budget may bring strengthening again, while an eventual rejection may lead to further weakening. Assuming stable political conditions, the decreasing inflation and the strong forint may lead to gradual reduction of the central bank base rate starting from mid autumn.

**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-June 2008</b>	<b>2008 forecast</b>
1. Volume of GDP (%)	104.1	103.9	101.3	102.0*	103
2. Industrial production (constant prices. %)	107.3	110.1	108.1	105.6	106
3. Investment in the national economy (constant prices. %)	106.4	98.0	100.3	96.7	104
4. Construction (constant prices. %)	116.6	98.4	85.9	89.3	102
5. Retail trade (volume index. %)	105.8	104.4	97.0	97.8	100
6. Exports (current prices in euro %)	111.4	116.6	115.7	111.9	110
7. Imports (current prices in euro %)	108.3	113.9	111.9	110.0	109
8. Trade balance (billion euros)	-2.9	-2.0	-0.3	0.5	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	250.5**	245
11. Deficit of the general government (cash flow basis without local governments; billion forints)	984.4	2034	1291	581.3**	1000
12. Index of average gross earnings	108.8	108.1	108.2	108.2	108.5
13. Consumer price index	103.6	103.9	108.0	106.8**	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	106.7**	105.5
15. Rate of unemployment (at the end of the period %)	7.3	7.5	7.7	7.5***	7.5

\* Q1 2008

\*\* January-July 2008

\*\*\*May-July 2008

Sources of actual data: CSO. NBH. MoF