

## Against the wind

**The forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank shows that the external conditions of the economic development have been considerably deteriorating, the domestic political situation is uncertain, while the economic situation – first of all the fiscal and external balance – is modestly improving.**

The energy, raw material and agricultural price shock impacting the global economy became less powerful by the fall of 2008 as a result of the slowing expansion of the world economy and the favorable agricultural production, yet the level of prices is permanently high. At the same time, the financial crisis that started in the American mortgage market is deeper, more extensive and longer lasting than previously believed. The steps taken by governments and central banks will probably be sufficient to stop the panic, but the resulting large-scale extra expenditure will have to be reflected in the tax programs and inflation rates of the coming years. All these are threatening the EU with recession, clearly deteriorating the opportunities for economic development in Hungary.

In the first nine months of 2008 general government deficit accounted for 2.7% of GDP, 70.8% of the annual target (compared with 88.2% last year). At 3.8% of GDP, the deficit target, which has been reduced by the government during the course of the year, is realistic, with the possibility of an even lower rate. The trade surplus seen in the first half of the year will likely vanish by the end of the year, due to the deteriorating global business climate, as well as the increasing domestic investment and consumer demand. The net external financing requirement will drop to 4.9 billion euros (4.4% of GDP).

Owing to the performance of agriculture, as well as some low year-on-year base figures in a number of sectors that have stabilized following a decline in 2007, GDP is expected to grow 3.5% over the second half of the year, and 2.7% for the year as a whole. The growth rate of industrial exports, which had been the engine of growth over the prior period, has been plummeting since May. While the volume of exports increased by over 12% on average in the first four months, the growth slowed down to as low as 0.8% in the following three months. After bottoming out in the summer, exports are expected to edge up, partly due to the lower base figures. The favorable agricultural yields will have a positive effect on the food industry. The construction sector will be gathering pace in the second half of the year, primarily owing to the low base figures. Nevertheless, the annual figure will likely show a decline of approximately 2%. On the other hand, agriculture is soaring, the GDP contribution of the agricultural sector is increasing 25% in 2008 as a whole. Retail sales are expected to edge up modestly in line with the increase in real earnings, but the annual rate will only reflect a positive stagnation. Consumption will be up approximately 1% in the year as a whole. Investments stagnate. Developments funded by EU transfers are not yet sufficient to buoy up the investment market this year.

Inflation is decreasing slowly in 2008 (6.5% in August). However, the price index is expected to fall at a relatively rapid rate in the last few months of the year, primarily due to the fact that the year-on-year comparative figures will include last year's elevated food prices. The year-end inflation rate is forecast around 5.5%, while the annual average rate is expected to be 6.5%. The monetary policy is not likely to reduce the benchmark interest rate in the fall of 2008. Nevertheless, provided that the budget is approved (or at least domestic developments point into this direction), the slowing rate of inflation will motivate the onset of cautious interest rate cuts by the end of the year.

The unemployment rate is expected around 7.6% at year-end and the annual average number of people employed will fall 1% short of last year's figure. In the first half of the year real earnings increased by 0.5%. Real earnings are expected to rise about 1% in the year as a whole, with a 1.7% increase in the private sector and stagnation in the public sector.

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

	<b>2006</b>	<b>2007</b>	<b>January-July 2008</b>	<b>2008 forecast</b>
1. Volume of GDP (%)	104.1	101.1	101.9*	102.7
2. Industrial production (constant prices %)	110.1	108.1	103.6**	104.5
3. Investment in the national economy (constant prices %)	93.8	101.5	96.7*	100
4. Construction (constant prices %)	98.4	85.9	89.1	98
5. Retail trade (volume index %)	104.4	97.0	98.2	100
6. Exports (current prices in euro %)	116.6	115.7	110.9**	110
7. Imports (current prices in euro %)	113.9	111.9	109.8**	109
8. Trade balance (bn. euros)	-2.0	-0.3	0.0	0
9. Combined balance of the current & capital accounts (bn. euros)	-6.2	-5.4	-2.6*	-4.9
10. Average exchange rate of euro (forints)	264.3	251.3	249.3***	245
11. Deficit of the general government (cash flow basis, without local governments; bn. forints)	2034	1291	731.0***	1000
12. Index of average gross earnings	108.1	108.2	108.1	108.5
13. Consumer price index	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)	106.5	107.4	106.5**	105.5
15. Rate of unemployment (at the end of the period, %)	7.5	7.7	7.5****	7.5

\* January-June 2008.

\*\* January-August 2008.

\*\*\* Januar-September 2008.

\*\*\*\* June-August 2008.

Sources of actual data: CSO. NBH. MoF