

Monthly projection of interest rates, exchange rates and inflation (January 2007)

1. Assumptions for economic trends in the following period:

- The rate of GDP growth is likely to decelerate from 4.1 per cent in 2006 to 3 per cent in 2007 in Hungary and from 2.6 per cent to 2.4 per cent in the eurozone.
- The price of Brent totalled USD65.4 per barrel in 2006. In January it decreased, at present Brent is traded at a price below USD55 per barrel. In 2007, GKI Co. assumes that the price of Brent will average about USD61/bl.
- At its last meeting of 12 December 2006, the Fed left its reference rate again on hold (at 5.25 per cent). In the US money markets, short- and long-term yields increased by 10-20 basis points within one month, this may indicate the renewed strengthening of expectations concerning the rise of the federal funds rate. In spite of this, GKI Co. does not expect the Fed to increase its reference rate any more in 2007. Amidst favourable conditions, the Fed may even reduce its official rate.
- At its meeting of 11 January 2007, the ECB, too, left its reference rate on hold (at 3.5 per cent). In Europe, short-term interbank interest rates dropped slightly, whereas long-term ones grew by 10 basis points. In the eurozone, the upward interest rate cycle came to an end, too, by the end of 2007, a slight reduction may take place.
- In the international money and capital markets the US dollar strengthened by 2-3 per cent against the euro. The euro/dollar exchange rate is predicted to average USD1.3 in 2007.
- The exchange rate of the forint to the euro was at around HUF253 this January. In 2007, the EUR/HUF exchange rate is expected to remain in the HUF250-HUF255 range.
- In January 2007, the Monetary Council left the base rate unchanged again. The members identified only the wage dynamics of the competitive sphere as an upward risk. Nevertheless, they underlined the fact that it is important to fend off the spill-over effects of one-off price increases through expectations.
- In 2006, the external financing need did not reach EUR5.3 billion which was the figure in 2005, and in 2007 it is expected to go back to EUR4.6 billion, thereby accounting for 4.6 per cent of GDP.
- In 2006, the general government deficit measured by cash flows totalled HUF2033.8 billion. According to the methodology of

Eurostat, general government deficit is likely to reach **9.5 per cent of GDP**. The exact value depends on the size of one-off items the government intends to include in the budget of 2006. In 2007, as a result of the adjustment as well as the exclusion of one-off expenditure items, the general government deficit is predicted to fall to **6 per cent of GDP**.

2. Domestic producer prices in manufacturing

The domestic price index of manufacturing equalled to 5.9 per cent. In 2007, with the decline of oil prices, the domestic producer price index is expected to increase at a slower rate, by about 4.5 per cent.

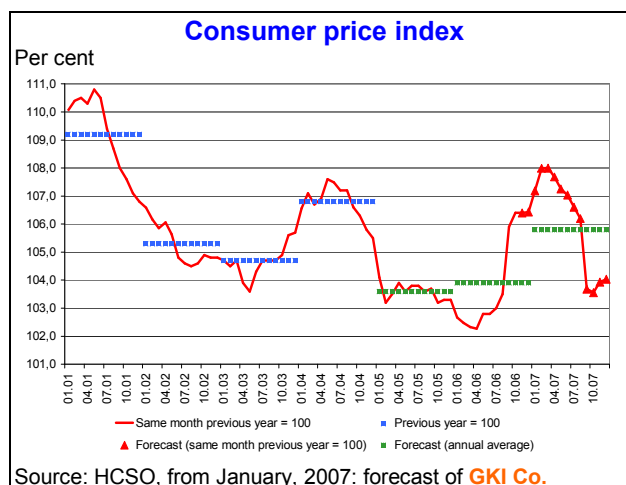
Domestic producer prices in manufacturing (Per cent)

Period	Average period price index	End of period price index, the same month of previous year = 100
2006. I-XII.	105,7	105,5
2007. I.	105,2	105,2
2007. I-VI.	104,9	104,5
2007. I-XII.	104,6	103,4

Source: HCSO, from December, 2006: forecast of GKI Co.

3. Consumer price index

Consumer prices rose by 3.9 per cent in 2006 year-on-year, whereas the month-on-month price index was 6.5 per cent in December.



In 2007 government decisions (such as the transformation of the gas price subsidisation system, etc.) temporarily accelerated consumer price inflation that is projected to peak in spring 2007 at about 8 per cent, in the last quarter it will fall rapidly.

Desinflation will be reinforced by the strengthening of the forint, the declining crude oil price and the fading away of the effects of energy price and tax rises introduced in August and September 2006.

Consumer price index (per cent)

Period	Average period price index	End of period price index, the same month of previous year = 100
2006. I-XII.	103,6	103,3
2007. I.	103,9	106,5
2007. I-VI.	107,0	107,0
2007. I-XII.	106,0	104,0

Source: HCSO, from January 2007: forecast of **GKI Co.**

The rate of inflation is likely to **average 6 per cent in 2007**, but in December 2007 it will go back to 4 per cent m-o-m.

The consumer price index according to product groups (Per cent, previous period = 100)

	Actual			Forecast of GKI Co.
	2004	2005	2006	2007
Consumer price index	106,8	103,6	103,9	106,0
Out of this:				
Food	106,7	102,5	107,7	107,8
Alcoholic beverages, tobacco	111,4	103,3	104,3	106,9
Clothing	103,6	100,2	99,3	103,4
Consumer durables	99,4	97,7	96,0	99,0
Household energy	114,3	106,2	106,4	124,0
Other goods, gasoline	103,9	104,5	102,7	100,3
Services	107,6	105,5	104,1	105,2

Source: HCSO, 2007.: forecast of **GKI Co.**

4. The exchange rate

The exchange rate of the euro and the US dollar

Period	The average exchange rate in the period indicated	
	EUR	USD
Jan.-Dec. 2005.(actual)	248,1	199,7
Jan.-Dec. 2006.(actual)	264,3	210,4
January 2007	253,0	198,0
January-December 2007	250,0	195,0

Source: NBH, from January 2007: forecast of **GKI Co.**

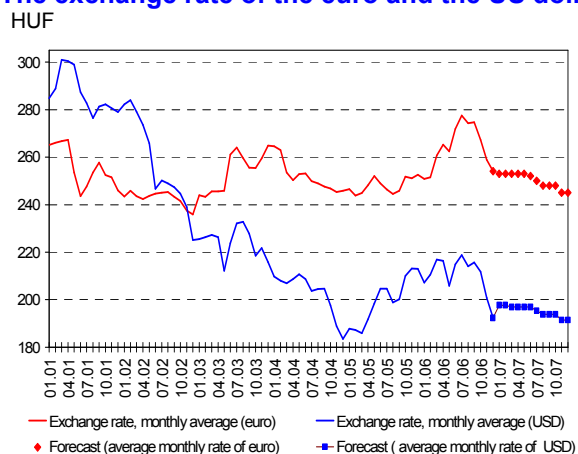
With weakening doubts concerning the implementation of the convergence programme, the exchange rate of the forint to the euro

strengthened to the level registered in the spring of 2006 from early October to late December 2006.

In the past month, the exchange rate of the forint stagnated and so did other regional currencies.

If the Parliament approves of the legal rules on reforms submitted by the government with the original contents in 2007, investors' confidence is expected to remain stable, and the forint may strengthen further.

The exchange rate of the euro and the US dollar



Source: NBH, from January, 2007: forecast of **GKI Co.**

5. Interest rates

The 1 year **reference yields** grew by almost 25 bp. in the past month. The yields of longer maturity were up by 30-40 bp.

According to **GKI Co.**, the further lifting of the reference rate of the NBH is not justified for inflationary reasons. The forint is strong, the jump in inflation is temporary, it is not necessary to react to it by raising the base rate. Nevertheless, the base rate did not follow the temporary fall of the inflation rate either. In 2007, with the favourable general government figures and the approval of reform measures, the strengthening of the forint and the improving inflationary perspectives make the gradual reduction of the NBH reference rate possible or even unavoidable. By the end of the year, the reference rate of the NBH is predicted to sink to 6 per cent.

Interest rate forecast (interest rates at the end of the month)

At the end of the period	NBH reference rate	1 year reference yield	10 year reference yield	Fed reference rate	ECB reference rate	SNB reference rate
December 2006	8,0	8,0	6,7	5,25	3,5	2,0
January 2007	8,0	7,9	6,9	5,25	3,5	2,0
December 2007	6,0	5,8	5,5	4,75	3,25	1,5

Source: NBH, GDMA. From January 2007: forecast of **GKI Co.**