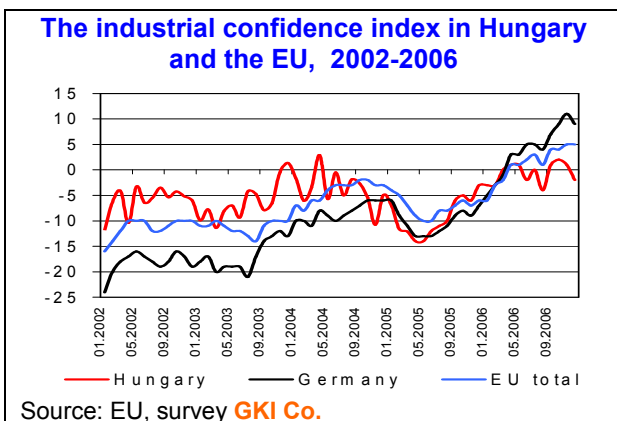
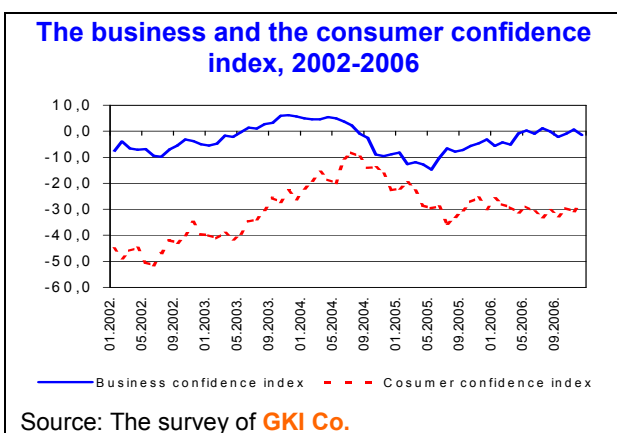


Monthly Flash Report for Top Executives (January, 2007)

In the EU, the rate of GDP growth is expected to decelerate from 2.8 per cent in 2006 to 2.4 per cent in 2007 and 2008 each. The projected growth rates will be still rather favourable. The European industrial confidence index came to a halt last December, whereas both its Hungarian and German counterpart deteriorated.



In December, **domestic business expectations** became slightly negative, although they improved somewhat in services. The evaluation of Hungary's situation deteriorated in construction and trade, whereas it improved in industry and remained unchanged in services. Following the peak recorded last April and the fall from May to July, **consumer expectations** have stagnated and they are slowly deteriorating.



With the slight weakening of the business cycle in Europe, a modest decrease is likely in the rate of growth of **industry** in 2007 and 2008. Economic growth will remain export oriented, domestic sales meant for further processing will be drawn by exports. The contraction of the purchasing power of households will restrain imports.

The volume of **construction in October 2006** exceeded the level of the previous year again. Nevertheless, in the first ten months of the year, its performance was down by 1 per cent compared to the same period of 2005. The stock of orders has been lower for four months than last year, in October it was 15 per cent below the level of the same month of 2005. In the course of 2006, stagnation is most probable. In 2007, with the sharp increase in the inflow of EU funds (including those accrued from last year), some recovery is projected but the construction of new homes will certainly decline further. In 2008, the inflow of EU transfers in under the new budgetary period will give additional impetus to infrastructural investments.

Trends in the real economy, 2005-2008 (volume, the same period of the previous year=100)

	2005	2006	2007	2008
Industrial production	107,3	110	108	108
Construction	116,6	100	104	110
Exports	110,8	115	112	111
Imports	105,3	111	109	110
Retail trade turnover	105,6	104	101	101,5

Source: HCSO, 2006-2008: projection of GKI Co.

The growth rate of **retail trade turnover** began to decelerate in the second half of 2006. As a consequence of the fall in real earnings, a more modest growth is expected in 2007 and 2008 than previously.

Foreign trade is set to remain robust, exports are projected to expand at a higher rate than imports in 2007, since restrained household consumption and weak investments will most probably result in the deceleration of import growth. In 2008, the rate of growth of exports and imports are predicted to be more or less the same. That will be the result of an investment boom generated to a large extent by the inflow of EU transfers. Following a 2-3 per cent deterioration in 2006, Hungary's **terms of trade** will not change significantly in 2007 and 2008 (the annual average price of imported crude oil is forecast to decrease this year, whereas that of natural gas is likely to be up).

In 2006, **unemployment** set to grow. In 2007, this trend will be reinforced by the reduction of staff in the public sector, since the competitive sector will be able to

absorb only a certain part of the work force dismissed in the public sphere. Nevertheless, slow improvement may take place in 2008.

Labour market trends, 2005-2008 (per cent)

	2005	2006	2007	2008
Rate of unemployment (4th quarter)	7,3	7,5	8,0	7,6
Gross earning (competitive sphere)*	106,9	107,8	107	107
Gross earning* (Public sector)	112,8	106,6	102	102
Real earning*	106,3	103,5	96,5	100

*The same period of the previous year = 100;

Source: HCSO 2006-2008: projection of **GKI Co.**

In the first ten months of 2006, **real earnings** grew by 4.3 per cent. However, with the increase of social security contributions and the rate of inflation they fell by almost 0.5 per cent in October mainly because of the low figures of the public sphere. In the average of 2006, the rate of increase of real wages are expected to total 3.5 per cent. In 2007, gross wages will grow at the same rate as in 2006 in the competitive sphere, but because of the higher tax burden and the acceleration of inflation it will result in a slight drop in real wages. In the public sector gross wages will not grow at all, net earnings are likely to decrease in nominal terms. In 2008, the growth rate of wages will be similar, but with declining inflation, this will lead to a slight (1 per cent) increase of real earnings in the competitive sector.

Financial indicators, 2004-2008

	2004	2005	2006	2007	2008
Consumer price index (annual average)	106,8	103,6	103,9	105,8	103,8
The reference rate of the central bank* (per cent)	9,5	6,0	8,0	6,0	4,5
Lending rate for the corporate sector (less than one year, in per cent)*	11,5	7,5	6,7	5,7	4,6
1 year reference yield (per cent)*	8,6	6,4	8,0	6,0	4,4
Foreign trade deficit (EUR billion)	3,8	2,8	2,5	1,4	0,7
General government deficit (GFS HUF billion)	1317	984,4	2000	1450	1200

* End of period

Source: HCSO NBH; 2006-2008: projection of **GKI Co.**

Households' **propensity to save** is increasing from mid-2006. Because of the growing fear from unemployment and the increase in living costs, **households' propensity to borrow will diminish**. Household consumption is expected to remain unchanged, investments tend to increase in 2007.

By the end of 2006, the consumer price index is expected to total **6.5 per cent**. **The annual average rate of inflation** is likely to reach **3.9 per cent**. In 2007, the price index tends to accelerate first, in some months it may reach even 8 per cent, but at the end of the year it will drop to close to 4 per cent and in 2008 further quick decline is predicted. This is the consequence of the fading-off of one-off official measures.

The **general government deficit** is expected to reach 9.5 per cent of GDP in 2006 (ESA, without corrections of contributions to private pension funds). As a result of the impact of the austerity measures and the fallout of some one-off items in expenditures, the deficit relative to GDP is projected to decline spectacularly to 6 per cent in 2007, and 4.3 in 2008 if the reforms will be accomplished in 2007.

The **exchange rate** of the forint to the euro appreciated by about 9 per cent in the previous quarter. First, the concerns over the accomplishment of the convergence program diminished, a tight budget was approved of for 2007, second, several other currencies in the region are strengthening. Nevertheless, early January a slight depreciation took place in the region.

The Monetary Council left the reference rate of the central bank on hold (at 8.5 per cent), economic trends do not justify further increase in 2007. In case of prolonged favourable conditions, even accelerating inflation will not trigger a rise in the reference rate of the National Bank of Hungary. In the second half of the year, a rapid reduction of the reference rate is most probable. In 2006, the annual average exchange rate of the domestic currency to the euro was HUF264, this may drop to HUF250 in 2007 and this value is expected to hold in 2008.

Summary figures, 2005-2008

	2005	2006	2007	2008
GDP (previous year = 100)	104,2	104,1	103,0	103,7
Investments (previous year = 100)	105,6	102,0	104,0	110
Consumption (previous year = 100)	103,8	101,5	100,5	101,5
External financing need (EUR billion)	-5,7	-5,3	-4,6	-4,2
Foreign direct investments in Hungary (EUR billion)	5,1	4,0	4,0	4,5

Source: HCSO, NBH 2006-2008: projection of **GKI Co.**