



1055 Budapest, Honvéd utca 13-15.  
Tel: (1) 374-2736  
Fax: (1) 374-2912  
E-mail: kozgazdasagi@gkm.gov.hu

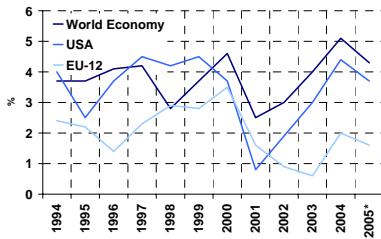
## OVERVIEW

### of the current situation and future prospects of the Hungarian economy

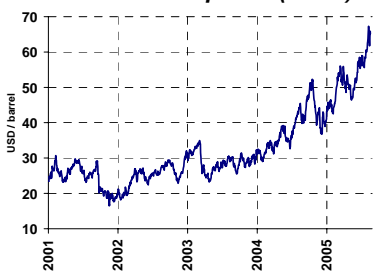
(updated: 30 August 2005)

#### International environment

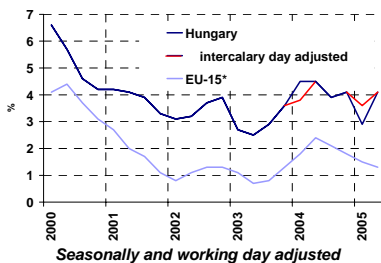
World economic growth



Crude oil prices (Brent)



Economic growth of Hungary  
and the EU-15

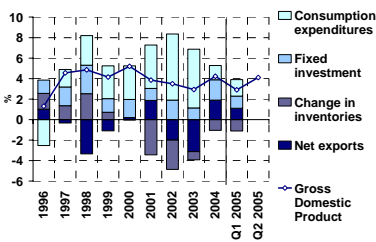


- Last year the world economy accomplished the best growth rate in 15 years, and growth in all global economic centres accelerated considerably. Although the growth of the world economy is expected to show a slight slowdown in 2005, forecasts predict that it will still continue to expand faster than the average of the past 10 years.
- In the USA economic growth accelerated to over 4% in 2004, although the boom has passed its peak during the year. This year the American growth dynamics also slightly decelerated (the rate of growth in the first half of 2005 did not reach 3.5%), nevertheless, the USA remains one of the most important driving forces of the world economy, albeit long-term prospects continue to be shaded by the lack of internal and external economic equilibrium.
- Having hit the bottom in 2003, last year the economy of the EU finally gained momentum. The German economy started to show signs of healthy growth as well, which had a particularly favourable effect on Hungarian exports. However, the European growth rate is still lagging far behind US or Asian levels, moreover, in the second half of 2004 it slowed down again (particularly Germany). Growth rate in Europe is expected to be lower this year (below 2%) than in 2004; in the second quarter it was 1.3%.
- The upward trend in oil prices experienced in recent years continued, and oil prices in the global market climbed steeply in most of 2004. Following a temporary decrease at the end of last year, the price of a barrel of Brent crude oil exceeded again USD 50 this year. The above 60 dollar price level that came along with the end of summer is certainly restraining the growth of world economy. The negative effects related to high oil prices could be even more accentuated in Europe, as the US dollar – contrary to the earlier trend – has marked considerable gains against the euro since the beginning of the year. (It is also true, however, that the depreciation of the euro may positively affect European recovery.)

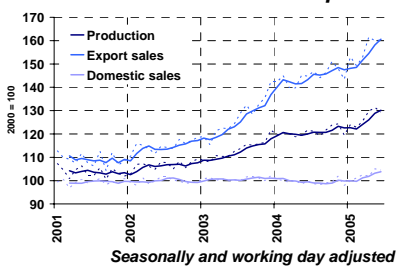
#### Economic growth

- Simultaneously with the accelerating growth of the world economy, the Hungarian economy also grew more dynamically in 2004: the gross domestic product grew by 4.2% in annual terms, although the growth rate slowed down somewhat in the second half year. In line with the European downswing, domestic growth decelerated in the first quarter of this year (2.9%; or 3.6% intercalary day adjusted), however in the second quarter GDP grew again at a pace of above 4%. Reflecting less favourable global environment, Hungarian economy is expected to grow at a bit lower pace in annual terms, though growth rate – supposing an upturn of the Western-European economies during the course of the year – may reach 3,5 to 4%.
- The growth rate exceeding 4% was coupled with a favourable structure, as in 2004 the main driving force of growth dynamics was the robust expansion of investment (7.8% in annual terms). Investment grew substantially both in terms of buildings (8.8%) and equipment (7.1%) last year, and investment in manufacturing (accounting for 25% of total investment) showed a particularly high growth at 15.3%. In the first half of 2005 investments' growth reached 8.3%, however, it was mainly due to the 13.2% expansion of construction investments (which includes infrastructure development), meanwhile investments dynamics in manufacturing slowed to a modest 5.6%. In annual terms investments are likely to grow by 5 to 7%.

### GDP growth and main components



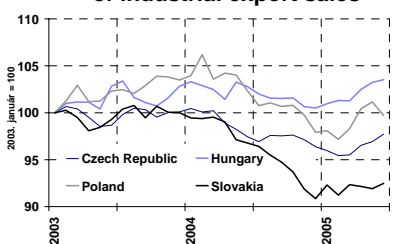
### Industrial output



- The expansion of consumption slowed down significantly in 2004, attributable partly to the fact that wage increases slowed down and partly to fiscal constraints. This represents a welcome change from the growth structure of the previous years, clearly dominated by consumption. **Household consumption grew by 3.5** last year (as opposed to the 8.1% growth of 2003), while government consumption actually fell by 2.1%. **The growth of consumption remained restrained in the first quarter of this year:** consumption of the households expanded by 2.2%, while that of the government grew by only 0.4%, compared to the same quarter of the previous year.
- Based on the national accounts statistics, **exports rapidly speeded in 2004** (by 14.9% annually), and though imports gained pace at a similar extent, altogether **the change in net export position contributed positively to economic growth**. Although in the first quarter of 2005 export dynamics decelerated to 6.2%, attributable to the parallel slowdown of imports the net export position further improved, thus contributing 1.1 percentage points to the change of real GDP.
- Industrial output gained further momentum** in 2004: although the growth was somewhat less dynamic in the second half of the year, the volume of **gross output grew by 8.3% last year** (in comparison with the 6.4% rate measured 2003). Exports constituted the exclusive source of industrial growth last year, too: while **export sales grew by 15.7%** (despite some loss of momentum in the second half of the year), domestic sales were sluggish – similar to the previous year. After the moderate growth in the first quarter of this year (only 1.7%), due to the gaining momentum of exports, **industrial performance improved again markedly in the second quarter** (output growth approached 10% in April to June), nevertheless **in 2005 as a whole industrial growth is expected to be less vigorous** (around 6 to 8%) than last year.
- In addition to a rise in industrial production, GDP growth in 2004 was also boosted by an **exceptional expansion of agricultural output** (36.3%) and the **growth of construction that was faster** than in 2003. The excellent performance of the agriculture sector cannot be easily repeated this year (compared to the high base of a year earlier the sector's output contracted in the first quarter), however, the 13.8% increase of **construction** in the first half of 2005 definitely **shows further acceleration**. At the same time, however, **growth in the service sector clearly slowed down (2.5%) in 2004**, thanks to a more restrained consumption demand, however, it picked up again **in the first quarter** of this year, **reaching a level (3.6%) over GDP growth rate**.

## Competitiveness

### Real effective exchange rate based on price indices of industrial export sales

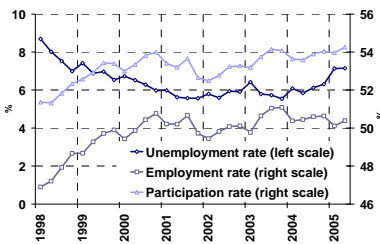


Note: Adjusted by the price indices of industrial domestic sales of EU-25. Values below 100 represent appreciation.

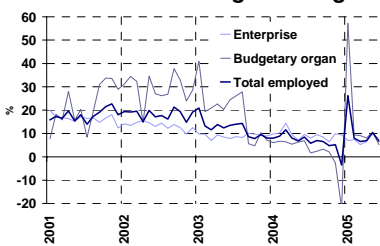
- Though last year's productivity growth (11.2%), calculated from industrial gross output, exceeded the increase in gross wages of the sector, **industrial unit labour cost expressed in euros rose by 2.7 in 2004**, due to the difference in the dynamics of value added and output and a slight appreciation of the forint. (Among the Visegrad Countries the Czech Republic realized a minimal improvement, in Poland ULC decreased substantially, while Slovakia had to face considerable rise in industrial labour costs.) **In the first half** of this year **unit labour cost** (expressed in euro) **rose slightly** (mainly due to the relatively strong forint), **however the deterioration of cost based competitiveness in the other three V4 countries was more serious**.
- Hungary's **industrial price based competitiveness somewhat improved last year**, because sale prices in the EU-25 internal market increased to a higher degree than export prices of Hungarian industrial products. In the **first half of 2005** the exchange rate effect (the forint appreciated by 3,5% compared to the same period of the previous year) and the 0.7% rise of industrial export prices was offset by the 5% rise of European industrial domestic sales prices. Since the beginning of 2004 – on the contrary to other currencies of the region – **the real exchange rate of the forint has fluctuated within a narrow band and has appreciated negligibly**, while, exporters of the neighbouring countries had to face substantial deterioration of price based competitiveness.

## Labour market

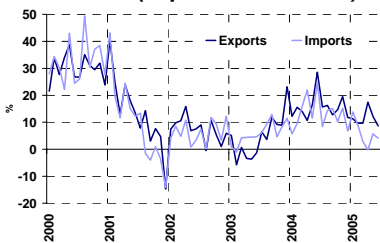
Labour market indicators



Dynamics of gross average earnings



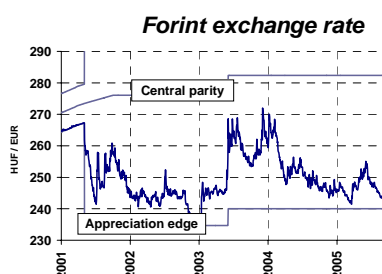
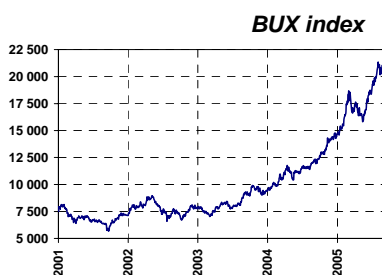
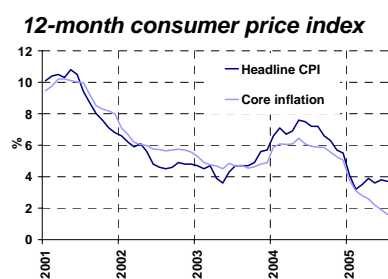
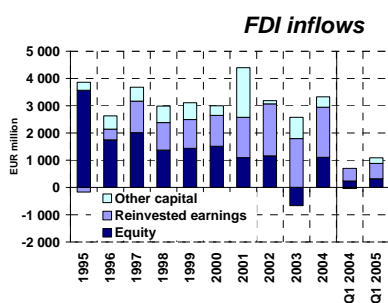
Change in export and import values (expressed in euros)



- Unemployment rate averaged 6.1% last year**, representing a 0.2 percentage point increase relative to the previous year, and it **climbed further up in the first half** of this year (above 7%). The rise of the number of unemployed can mainly be explained by **the return of the earlier economically inactive** to the labour market – which should be considered a welcome move with regard to the strikingly low activity rate in international comparison – meanwhile **the number (and the rate) of the employed remained practically at last year's levels**. Though due to seasonal effects the unemployment rate might ease the next months, in terms of annual average a significant rise is to be expected. At the same time, however, **Hungary's unemployment rate can still be considered low by international standards**: it was 8.7% in the expanded European Union in July 2005, and is in the two-digit range in most of the surrounding countries.
- Favourable changes took place in respect of the number of employees in the private and public sectors**: in 2004 the number of employees working for businesses employing more than 5 grew considerably (1.5% or near 30,000 persons), while the number of employees in the public sector dropped (by 1.3% or 11,000 persons). In the first half of this year, however, **the number of employees only stagnated** (in the last four months even contracted). The number of **private sector employees was 0.3% higher in the first half** than a year before, as compared to a **1.3% decrease in the public sector**.
- In 2004 growth in average earnings slowed down considerably**, principally due to the Government's strict incomes policy. **Gross average earnings were 6.1% higher than a year before**; within this, earnings grew by 9.3% in the private sector, and by only 0.7% in the public sector (mainly due to one-off effects). Based on the wage agreements concluded between interest representing bodies, **gross earnings in 2005 are expected to grow by about 7% in both the private and the public sectors** (this latter will move upward significantly due to the shift of 13<sup>th</sup> month's salaries from December to January). Taking into account the diminishing inflation rates and the favourable changes in personal income tax, **net real earnings may grow by more than 4% this year**. In the first half of this year the **gross nominal wage growth reached 7.3% in the private sector and 18% in the public sector**, while adjusted for the distorting effects of the changes mentioned above (the payment of the 13<sup>th</sup> month's salaries), the growth rate was 7.8% in the latter sector.

## Equilibrium

- Foreign trade continued to grow dynamically in 2004: the value of exports and imports (calculated in euros) increased by 15.7% and 13.4%**, respectively, compared to the previous year. The foreign trade balance also showed significant improvement in: the deficit stayed below EUR 3.9 billion, some EUR 300 million less than in 2003. This **strong impetus of exports continued this year**, too: in the first six months exports expressed in euros grew by 11.4%, while imports dynamics slowed to 5.4%. The deceleration of imports is due to the high basis of March-May 2004 (in relation with EU-accession), and although the remarkable improvement in the balance of the first six months (over EUR 1.1 billion) cannot be projected to the rest of the year, marked additional improvement appeared in the first half even on top of the base effect. Thus, we expect the foreign trade deficit to improve this year.
- The deficit of the current account reached EUR 7,118 million (8.8% of the GDP) in 2004**, a figure EUR 754 million higher than in 2003, and the EUR 1,497 million 2005 first quarter deficit is also larger than that of the same period of the previous year. The deficit increased largely **due to the deterioration of the balance of incomes and current payments**, while the balance of goods clearly showed improvement, and with regards to the balance of services only a slight deterioration can be observed. **As for 2005 the current account deficit to GDP ratio is expected to somewhat moderate**, and tak-



ing into account the increasing surplus of the capital account, the external borrowing requirement may decrease even more significantly.

- **FDI into Hungary amounted to EUR 3,323 million in 2004**, which is approximately EUR 1.4 billion more than a year earlier. The rising tendency seems to persist this year as well: **in the first quarter the value of total FDI inflow accounted for EUR 1,091 million**, which exceeds that of the same period of 2004 by EUR 430 million. **According to our expectations, the annual inflow of FDI (in the form of equity capital and reinvested earnings) may be around EUR 3.5-4 billion**, in 2005. Hungarian capital exports in 2004 were more modest (EUR 427 million) relative to the previous year and reached EUR 377 million in this year's first quarter. Taking into account the regional acquisition plans of some large corporations, **capital exports in 2005 are likely to substantially exceed that of 2004.**
- **In 2004 the budget deficit** (when taking into account the adjustment related to the mandatory private pension scheme) **decreased to 4.5% of the GDP on an accruals basis**, which meets the target figures of the Ministry of Finance (adjusted upwards during the year). The deficit decreased considerably compared to 2003, by almost 2 percentage points relative to the GDP, and this year it **will drop to 3.6% of the GDP according to the Budgetary Act.**
- In 2004 **the average annual inflation rate rose to 6.8%** from the 4.7% measured in the previous year, mainly due to the changes in VAT and excise duties. However, the rate of inflation clearly slowed down in the second half of the year: **the 12-month consumer price index**, having peaked in May 2004 at 7.6%, gradually decreased from the summer months onwards and **dropped to 5.5% in December.** As the price boosting effect of the changes introduced in taxation in early 2004 had been absorbed, **consumer price index averaged below 4% in the first half of 2005** (inflation was at 3.7% in July). Thus, it is most likely that the inflation will stay within the target range of the central bank set for December 2005 (4%  $\pm$ 1%) and the **annual average inflation rate is likely to also stay below 4%.**

## Financial markets

- The rally of the Hungarian stock market that started in mid-2003 evolved even more in 2004. As a result, **stock prices at the Budapest Stock Exchange rose by over 40% in one year.** Besides the almost unbroken upward trend, **the stock market also experienced a buoyant turnover** (in the last quarter of 2004 the average daily trading on the spot market was HUF 12 billion). **The Stock Exchange has not lost momentum yet in 2005**, and despite a strong correction in mid-March, the BUX index hit record highs in August (over 21,000 points) again, thus it has risen by close to 45% as compared to the beginning of the year, while the turnover also remained substantial.
- After some hectic movements earlier, in 2004 there was a gradual **consolidation on the government bonds and forint market.** Yields started to decline from the high levels attained at the end of 2003, prompting **the central bank to reduce its base rate gradually:** between March 2004 and August 2005 the central bank cut its base rate on fifteen occasions by a total of 625 basis points, reducing it to 6.25%. After some instability at the beginning of 2004, **the forint grew consistently stronger throughout last year.** This trend continued this year, and the forint temporarily approached the appreciation edge march; in the summer months the exchange rate has stayed mostly within the **243-254 forint/euro band.**

Contact: László Turóczy  
([turoczy.laszlo@gkm.gov.hu](mailto:turoczy.laszlo@gkm.gov.hu))



1055 Budapest, Honvéd utca 13-15.  
Tel: (1) 374-2736  
Fax: (1) 374-2912  
E-mail: kozgazdasagi@gkm.gov.hu

# OVERVIEW

## of basic macroeconomic indicators

(updated: 30 August 2005)

### Basic macroeconomic indicators (2001 to 2004)

Indicator		2002	2003	2004	2005
Gross domestic product <sup>(1)</sup>	(previous year = 100)	103.5	102.9	104.2	103.5 <sup>(H1, preliminary)</sup>
Households' consumption <sup>(1)</sup>	(previous year = 100)	109.4	107.2	102.5	102,2 <sup>(Q1)</sup>
Gross fixed capital formation <sup>(1)</sup>	(previous year = 100)	109.3	102.5	108.3	106,8 <sup>(Q1)</sup>
Industrial output <sup>(1)</sup>	(previous year = 100)	102.6	106.4	108.3	105.9 <sup>(Jan-June)</sup>
Construction output <sup>(1)</sup>	(previous year = 100)	120.1	100.7	106.8	113.8 <sup>(Jan-June)</sup>
Retail sales <sup>(1)</sup>	(previous year = 100)	110.7	108.4	105.6	103.1 <sup>(Jan-June.)</sup>
Unemployment rate <sup>(2)</sup>	(per cent)	5.8	5.9	6.1	7.1 <sup>(May-July)</sup>
Gross nominal earnings	(previous year = 100)	118.3	112.0	106.1	110.9 <sup>(Jan-June)</sup>
Net real earnings	(previous year = 100)	112.3	109.2	99.0	107.5 <sup>(Jan-June)</sup>
Balance of external trade <sup>(3)</sup>	(EUR million)	- 3 424	- 4 167	- 3 879	- 1 180 <sup>(Jan-June, preliminary)</sup>
Export of goods <sup>(1)</sup>	(previous year = 100)	105.9	109.1	117.0	110.4 <sup>(Jan-May)</sup>
Imports of goods <sup>(1)</sup>	(previous year = 100)	105.1	110.1	114.0	103.0 <sup>(Jan-May)</sup>
Current account balance	(EUR million)	- 4 929	- 6 364	- 7 118	-1 497 <sup>(Q1)</sup>
as % of GDP	(per cent)	- 7.2	- 8.8	- 8.8	
Foreign direct investment <sup>(4)</sup>	(EUR million)	3 185	1 909	3 323	1 091 <sup>(Q1)</sup>
Net foreign debt <sup>(5)</sup>	((EUR billion)	16.2	21.3	25.4	
as % of GDP	(per cent)	23.5	29.1	31.7	
General government balance <sup>(6)</sup>	(HUF billion)	- 1 569	- 1 063	- 1 284	- 936 <sup>(Jan.-July)</sup>
as % of GDP <sup>(7)</sup>	(per cent)	- 8.5	- 6.2	- 4.5	
Inflation <sup>(8)</sup>	(per cent)	5.3	4.7	6.8	3.7 <sup>(July)</sup>
BUX index <sup>(9)</sup>	(point)	7 798	9 380	17 137	21 654 <sup>(30 August)</sup>
Central bank base rate <sup>(9)</sup>	(per cent)	8.50	12.50	9.50	6.25 <sup>(30 August)</sup>
10-year reference yield <sup>(9)</sup>	(per cent)	6.46	7.95	7.05	5.64 <sup>(30 August)</sup>
Forint exchange rate <sup>(10)</sup>	(HUF/EUR)	242.97	253.51	251.68	244.90 <sup>(30 August)</sup>

### Forecasts for 2005 (latest publicly available)

Indicator		Kopint	GKI	Reuters	MNB	Ministry of Finance
Gross domestic product <sup>(1)</sup>	(previous year = 100)	103.6	103.5	103.5	103.6	103.5-104.0
Gross fixed capital formation <sup>(1)</sup>	(previous year = 100)	107.0	106.0	..	105.4	105-107.0
Industrial output <sup>(1)</sup>	(previous year = 100)	106.5	105.0 <sup>(11)</sup>	106.0	..	106-108.0
Unemployment rate <sup>(2)</sup>	(per cent)	7.2	6.8 <sup>(9)</sup>	..	..	6.1-6.3
Current account balance	(EUR billion)	- 6.6	- 6.5 <sup>(12)</sup>	- 7.2	- 6.7	-7.2 - (-7.5)
General government balance <sup>(7)</sup>	(per cent of GDP)	- 4.5 <sup>(13)</sup>	- 4.0 <sup>(13)</sup>	- 5.1 <sup>(13)</sup>	- 3.5 - (-4.9)	- 3.6
Inflation <sup>(8)</sup>	(previous year = 100)	103.5	103.8	103.9	103.6	103.5-104.0
Forint exchange rate <sup>(10)</sup>	(HUF/EUR)	..	247.00	250 <sup>(9)</sup>	..	..

Sources:  
KSH, MNB, Ministry of Finance,  
BSE, ÁKK Rt., Kopint-Datorg Rt.,  
GKI Rt., Reuters

Notes: (1) volume index; (2) labour market survey, annual average; (3) balance of external trade; (4) equity and re-invested earnings; (5) including other capital (inter-company loans), end of year; (6) cash basis, excluding local government; (7) accrual basis (ESA 95), adjusted for the effect of the mandatory private pension scheme; (8) consumer price index, annual average; (9) end of year; (10) annual average; (11) national accounts basis; (12) balance of the current account and the capital account; (13) not adjusted for the effect of the mandatory private pension scheme.