Hungary: Coming out of the thick of the forest

The Statistical Office confirmed quarterly GDP growth of 0.9% in the third quarter of 2023. Hungary has emerged from a technical recession, but there is still a long way to go to return to full health

A good starting point

In line with expectations, the Hungarian Central Statistical Office (HCSO) did not change the third-quarter GDP figure released in advance. On a year-on-year basis, the volume of gross domestic product contracted by 0.4%, while on a quarterly basis, the economy's performance improved by 0.9%. The quarter-on-quarter increase also means that the Hungarian economy has left the technical recession behind. However, it is too early to say that all is well. The recovery has started, but in many areas, it will take several quarters before we can claim that the recovery is complete.

Hungarian GDP growth

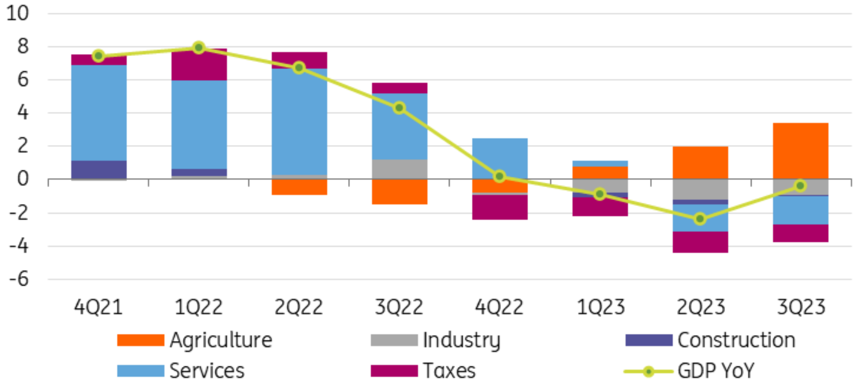
Source: HCSO, ING

The Academy Award for Best Makeup goes to... Agriculture

Let's start our deep dive with the production side, where the performance of agriculture raised some eyebrows. However, we can't say that the strong performance of this small sector was a big surprise. Agricultural value added surged 88.2% year-on-year in the third quarter. This is partly the result of strong quarterly growth, but also due to the base effect. Last year was purgatory for the sector, including the impact of the war, the related energy crisis and adverse weather conditions. That's why we were already expecting such a huge improvement for the year, based on the latest harvest results and a much more favourable weather situation.

In other sectors, we saw a sea of negative figures when it came to year-on-year performance. Although industrial production and construction grew on a quarterly basis (0.6% and 2.7% QoQ respectively), as we'd expected from the high-frequency production data, it wasn't strong enough to pull these sectors out of recession. Again, there are some problems to be aware of. In industry, sectors serving domestic demand are in free fall, while export generators are still doing well (mainly car and battery manufacturers). In the construction sector, the strong performance in the third quarter is more related to a one-off event: the completion of construction works related to the 2023 World Athletics Championships in Budapest. Against this backdrop, we see a fragmented economic structure. In line with this, the domestic demand-driven services sector contracted by 0.9% quarter-on-quarter, leaving services value added down by 3.1% year-on-year. This is worse than in the second quarter.

Contributions to GDP growth – production side (% YoY)



Source: HCSO, ING

Overall, although there are some green shoots here and there, the improvement in GDP growth is not necessarily sustainable. With agriculture contributing 3.4ppt to the year-on-year economic activity, this is an Oscar-winning performance in the makeup category, as other sectors, excluding agriculture, together subtracted 3.8ppt from the headline growth figure.

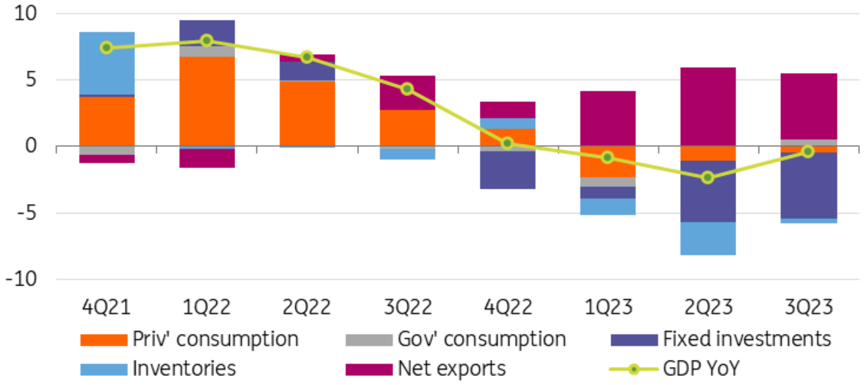
Household consumption remains a puzzle

On the expenditure side, it remains rather difficult to explain what is happening with consumption. We saw a significant quarter-on-quarter increase of 1.5% in household final consumption expenditure. As a result, the year-on-year index improved as well. The dynamism of consumption as measured by this national account-based statistic runs counter to all other indicators of consumption trends. Retail sales fell by 0.3% on a quarterly basis during the third quarter. VAT receipts do not reflect such an increase in consumption as well. According to detailed government accounts, VAT receipts fell by 1.0% in the third quarter compared with the second. All in all, the puzzle of the year still seems to be unsolved.

It is also somewhat surprising that the volume of social benefits in kind from the government and government consumption increased by 1.0 and 1.2% QoQ, respectively. A plausible explanation for this increase in actual final consumption could be that it was mainly driven by the consumption of imported goods, with the services sector declining on a quarter-on-quarter basis and import volumes stagnating on a quarterly basis. However, the increase in consumption-related imports was probably offset by the dampening effect of investment- related imports. Indeed, investment activity in Hungary continues to show an extraordinary contraction due to postponed public investment, a high interest rate environment and the weaker financial situation of households. The volume of gross fixed capital formation was almost 15% lower than a year ago in 3Q.

Against this backdrop, it hardly comes as a surprise that in line with a surprisingly resilient export performance in manufacturing and with weak domestic demand, exports are outperforming imports. Moreover, it seems that tourism (probably boosted by the 2023 AWC) made its way to GDP as well, as exports of services were almost 2% higher than a year ago, thanks to a 5.3% QoQ increase in the third quarter.

Contributions to GDP growth – expenditure side (% YoY)



Source: HCSO, ING

The 5.0ppt positive contribution of net exports to growth indicates that, alongside a sharp fall in domestic demand, the strong performance of export sectors is propping up the Hungarian economy, which is still struggling in almost all other areas.

Strong year ahead to build on weak 2023

Despite positive real wage growth in the last quarter, consumer confidence is at a 10-year low and a large part of the population has depleted its savings and accumulated personal loans. As a result, we do not expect any major structural change in the Hungarian economy in the final quarter of the year. The tight fiscal situation and the lack of EU funds do not bode well for a rapid recovery of investment momentum. The positive real interest rate environment is also cooling down private and corporate investment. Clouds are also gathering over exports, given global industrial trends. Our latest forecast is for GDP to contract by 0.6% this year, but the positive carry-over effect could be quite strong given the expected c.1% quarter-on-quarter growth in the final quarter. As a result, economic growth is expected to be around 3% in 2024, whereas the carry-over effect will be responsible for around 40-50% of the full-year GDP growth, in our view.

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