Hungary: Growth data shows a torn economy

Hungary's Statistical Office has made a big change to the GDP growth profile, pencilling in a 1.4% quarter-on-quarter figure in the last three months of 2020, but tough times are ahead

Masked travellers at a station in Budapest

1.4%

4Q20 GDP growth (QoQ)

First estimate 1.1%

Better than expected

The surprise comes from construction

The 2020 GDP profile was changed significantly by the Hungarian Central Statistical Office (HCSO), adjusting the record high quarter-on-quarter growth figure in the third quarter lower (11%), while moving the fourth quarter figure higher to 1.4%. The latter also means that the year-on-year profile improved a tad to -3.6% in 4Q20. With all the changes, the Hungarian economy went through a 5% recession in 2020, much better than we thought even a month ago.

Construction and investment activity were the heroes

The strong QoQ growth in the last quarter of 2020 was more than surprising. Now we know the details behind this surprise. On the production side, construction was the green shoot. The value-added of the sector increased by 12.9% QoQ, in contrast with high-frequency production data, which suggested a stagnation as the best case. The 2.9% QoQ growth in the agriculture sector hardly changes the big picture, while the 0.9% QoQ rise in the value-added of industry was in line with expectations. The only sector not able to produce a positive outcome was services. However, it only showed a 0.1% QoQ decrease, a practically negligible negative performance, outperforming every expectation amidst containment measures during the second wave of Covid-19.

On the final use side, the quarter-on-quarter growth profile mimics the above-mentioned story. The real hero is investment activity, where the HCSO registered a 4.4% QoQ growth, causing an upside surprise. Government consumption rose by 3.6% on a quarterly basis, another higher-than-expected performance. On top of that, final consumption of household increased by 1.3% QoQ, in contrast with the disappointing retail sales figures during the fourth quarter.

The Hungarian economy is torn, badly

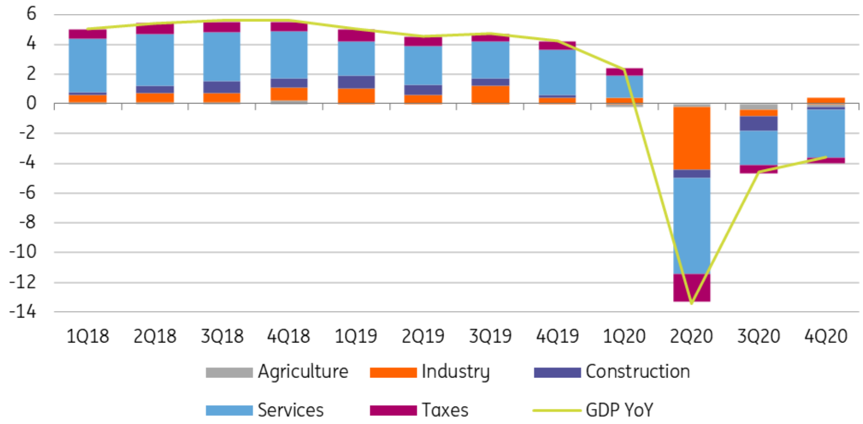
These growth profile numbers provide us with two lessons. First, high-frequency production and sales data and even big data (like Google mobility) are unable to proxy the performances of the different sectors based on national accounts. Secondly, the Hungarian economy is torn and torn badly, with some sectors skyrocketing while others facing an uphill battle.

A skeleton of a torn economy

This thesis rather shows up in the year-on-year performances. While the value-added of services is down by 5.7% YoY, the aggregate figure masks the enormous differences between the subsectors. Accommodation and food service activities (the most hit sector by containment measures) were down by 51.1% YoY in 4Q20. Transportation and storage nosedived by 20% YoY, while arts, entertainment and other services plunged by 8.7% YoY. All these sectors are affected by Covid-19 and its economic implications.

In contrast, the information, communication sector was up by 6.3% on the year, thanks to the forced digitalisation and automation even in areas where we didn't think that the working-from-home concept was feasible. Financial and insurance activities also showed a 3.3% YoY growth as households and corporates need loans to survive the lows or bracing for the worst to come with insurance policies. In the secondary sector, manufacturing was up by 2.4% YoY, mainly due to the improvement in global trade activity. Construction is still down by 3.9% compared to the same period of the previous year, but this sector has got a lot of support from the government (housing schemes, EU projects) and from the central bank (cheap loans, low-interest rate environment), so retail, public and corporate investments are in good shape.

Contributions to GDP growth – production side (% YoY)



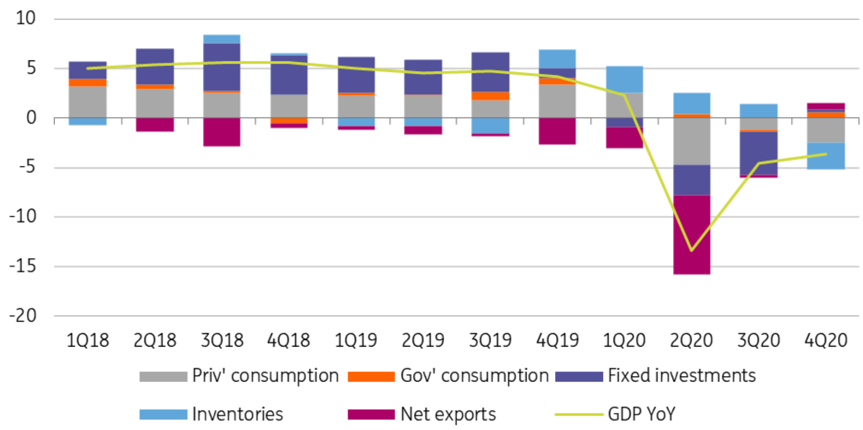
Source: HCSO, ING

Challenges on the expenditure side

When it comes to the expenditure side, we saw similar challenges. Households' actual final consumption was down by 4.2% YoY, which is worse than the third-quarter figure. The second wave and the late start of vaccination increased precautionary savings. In the meantime, the government pushed the economy as hard as it can, having a 6.2% YoY growth in government consumption, despite the high base last year.

We all remember the December 2020 monthly deficit figure. It seems it had an impact on GDP after all. In the middle of the crisis, corporates rolled back investment activity, but by the fourth quarter, that's disappeared. Gross fixed capital formation was higher by 1.2% YoY in 4Q20, although sell from inventories depleted GDP growth. With weak consumption but rising investment activity, the domestic demand was still negative. On the other hand, resilient manufacturing propelled export activity, so net export contributed to the GDP growth in a positive manner.

Contributions to GDP growth – expenditure side (% YoY)



Source: HCSO, ING

Near-term outlook is challenging

Today's upwardly revised fourth-quarter data also means that the carry-over effect in 2021 may be slightly stronger than previously calculated. If Hungarian real GDP stagnates during this year, only due to the strong 4Q20 performance, the economy will grow 2.2% on average. On top of that, we see significant growth potential in the economy this year. So, the growth impulse during the year will be positive and probably reach a record high. Some of the fourth-quarter data, mainly the construction/investment combo also suggests more dynamic underlying growth this year. We expect a 5.4% YoY GDP growth in 2021, as our base case. Against this backdrop, by the end of this year, we see the Hungarian economy will be able to overcome the drop caused by the coronavirus-crisis, at least on the aggregate level. For some sectors (e.g. accommodation, food services, arts, entertainment) the recovery will be much longer and more difficult than the aggregate GDP forecast shows.

> *Supply chain disruptions, labour market woes and the third wave of Covid are the key challenges ahead*

The 2021 outlook also highly depends on economic performance during the first quarter. As we now see, this first quarter may still hold negative surprises. First, there are the production shortages caused by supply chain disruptions that could slow industry's performance. Besides this, the labour market effects of the second Covid-19 wave will be more pronounced in the first quarter of this year, as indicated by rising unemployment in January. This is accompanied by a more moderate wage outflow due to the delay in the agreement and the magnitude of change of the minimum wage for this year.

The proverbial icing on the cake is the third wave of coronavirus and the possibility of a further tightening of the containment measures. All things considered, we could end up with a drop in real GDP in 1Q21, which would mean rather a slightly above 4% GDP growth. But if the economy shows the same resilience (or even more) during the first quarter, we can end up with a 5-6% economic activity in 2021.

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.