The structure of Hungarian GDP growth is increasingly one-sided

The Statistical Office confirmed the quarterly decline in real GDP in the third quarter, with agriculture and industry the main drag. The impact of net exports turned negative. Improvement in business and consumer confidence is still needed for a sustainable recovery

Services stagnated, and agriculture and construction fell sharply in Hungary, leading to negative growth in the third quarter

-0.7% GDP growth in 3Q

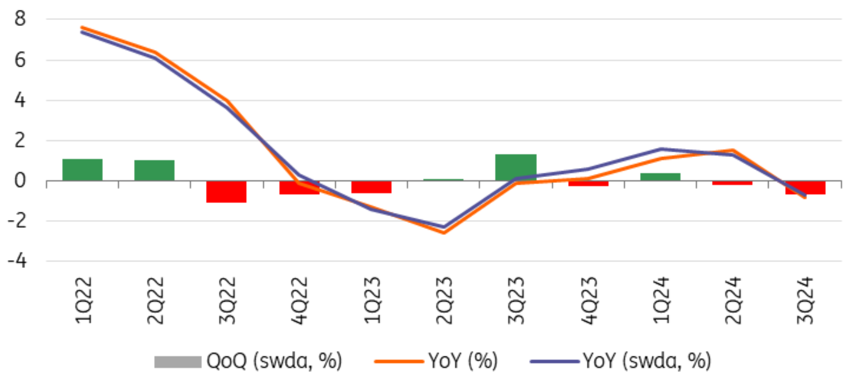
(QoQ, swda)

Two technical recessions in three years

The Hungarian Central Statistical Office (HCSO) did not make any significant changes to the GDP data for the third quarter of 2024. On a quarterly basis the Hungarian economy contracted by 0.7% in the July-September period. At the same time, the seasonally and calendar adjusted year-on-year index remained at -0.7%, as indicated in the first data release. The data thus confirmed that the Hungarian economy has slipped into a technical recession twice in the last three years.

Moreover, real GDP has contracted in six out of the last nine quarters.

Hungarian GDP growth



Source: HCSO, ING

And while the details helped us to better understand the overall picture of the third quarter, they also raised some new questions. We see some minor discrepancies between the expenditure and production side data, which may be due to poorer data quality and a less reliable seasonal adjustment of the time series in the 2020s than in the last two decades. Overall, while there are some positive signs, the picture is still rather bleak.

Services stagnate, agriculture and construction fall sharply

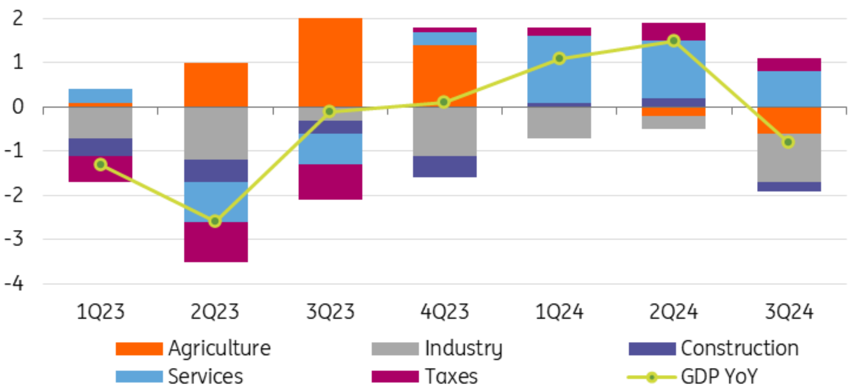
On the production side, as expected, the main drag on economic activity came from agriculture and construction. The volume of value added in the former sector fell by 4.5% and the latter by 4.2% on a quarterly basis. The performance of industry was also unsurprising given the weak high frequency production data, with growth of just 0.3% quarter-on-quarter recorded by the HCSO. However, the reason why the overall performance of the Hungarian economy in the third quarter was a very big negative surprise was the services sector. The volume of value added in services grew by only 0.1% on a quarterly basis. In other words, growth in the sector has essentially been on a decelerating trend in recent quarters.

Looking at the sub-sectors within services, it is worrying that consumption-related activities such as retail trade, accommodation and food service activities, and transportation and storage declined on a quarterly basis. The largest increases were recorded in information and communication and financial and insurance activities. The latter is likely to be driven by the pick-up in lending, although real estate in particular is not showing any growth, which certainly raises some questions.

Overall, the combination of rising real wages and improving purchasing power of households and the stalling of improvements in consumer and business confidence has led to a virtual stagnation in services, which has shown expansion in previous quarters. It is also interesting to note that, at the same time, the share of household expenditure on services rose significantly in nominal terms in the third quarter. Of course, this is also due to seasonal effects. On the other hand, the ratio has risen to a record high. In our view, the solution is inflation.

Inflation in services remains at a high level, so it is not surprising that summer leisure takes up an increasing share of household budgets in current prices. Meanwhile, the share of household spending on durable goods was only 5.4% in the third quarter of 2024. The last time the share was lower in the third quarter was in 2015. At the same time, it is also important to note that it is precisely for durable goods that the import share is the highest, so once again we have a rather difficult time to resolve the anomaly highlighted by the data on the expenditure side.

Contributions to GDP growth - production side (% YoY)



Source: HCSO, ING

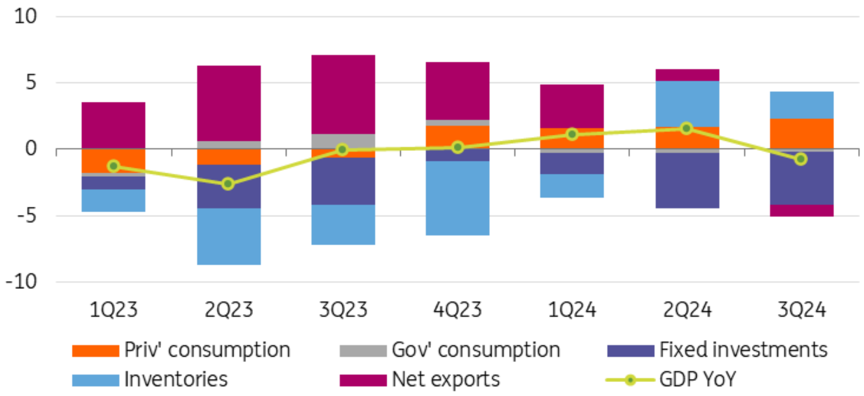
Looking at the classic year-on-year growth indicators, agriculture fell sharply in the third quarter from an extremely high base last year. Manufacturing is down by almost 6%, while construction output is down by almost 4%, not even close to the high base. Services showed a significant year-on-year increase, with both business-related public services and residential services showing positive changes on a year-on-year basis. In the third quarter, trade was one of the "ailing" segments, with a significant slowdown.

Net exports holding back GDP growth as imports rose

On the expenditure side, the real negative surprise came from the turnaround in net exports, with the change in the external balance of goods and services holding back GDP growth for the first time since the first quarter of 2022. Imports grew by almost 2% on a quarterly basis, while exports rose by only 0.3%. Of course, the latter is perhaps less surprising given the weak industrial performance. The rise in imports is likely to have come from two sources. Surprisingly, actual final consumption continued to show a reasonably strong quarter-on-quarter growth (1.1%), which may have boosted imports. However, it is likely that imports of semi-durable or fast-moving consumer goods, rather than big ticket items, picked up. Perhaps the weak agricultural sector could explain this phenomenon.

When it comes to investment activity, the situation remains poor. On a quarterly basis, the decline is 3.2%. All this despite the fact that the country is having large industrial projects (e.g. BMW, BYD, CATL) ongoing. Perhaps it was their import share that made the difference in the third quarter in net exports. Overall, however, the investment outlook is weak, as business confidence and sustained demand growth are still lacking. In their absence, a turnaround is unlikely in the near future. Inventories are likely to have risen slightly on a quarterly basis, which would also explain the pick-up in imports.

Contributions to GDP growth – expenditure side (% YoY)



Source: HCSO, ING

Speaking of inventories, if we look at the year-on-year development of inventories, the contribution is quite positive. It can hardly be explained by a buoyant industrial or retail performance. Rather, it can be explained by the large manufacturing projects under way. As long as these investments are not officially activated, they are likely to show up in inventories rather than in fixed investment. Nevertheless, inventories are still part of domestic demand, and here the year-on-year index still shows an anaemic 0.3% growth in the third quarter. The tight room for manoeuvre in the budget, the missing EU funds and the associated weakness in investment activity, low business confidence and uncertain growth prospects all play a role in the weakness in domestic demand. However, what remains as a domestic driver is giving more impetus to imports, and the lack of external demand is holding back export activity to a greater extent. As a result, net exports subtracted 0.9 percentage points from GDP growth in the third quarter, a large negative surprise.

We downgrade our GDP forecasts for 2024 and 2025

Looking ahead, it is certainly encouraging that consumption continues to grow at a good pace. However, the renewed decline in consumer confidence may indicate that this positive momentum could be broken. A turnaround in investment activity may still be some way off, given the slow recovery in order books, the still fragile fiscal situation and the deterioration in business confidence. New government programmes may bring some change to the overall picture, but in the absence of market-driven activity, this alone will not be sufficient to bring about a dramatic turnaround in investment.

Net exports are likely to remain a drag on GDP growth. We had expected this turnaround, but not so soon and not so sharply. The stronger-than-expected negative impact of weak external demand seems to have worked its way through to the underlying processes more quickly and to a greater extent. Meanwhile, the summer drought and autumn floods have significantly reduced average harvests, dampening not only this year's agricultural performance but also potential food exports.

The worsening crisis in the automotive sector does not bode well for Hungary either. All in all, in view of today's detailed data and in anticipation of a weaker German economy, we are revising down our previous forecast of 0.6% GDP growth to 0.5% this year, while in 2025 we expect the economy to expand by only around 2.0% as a base case, instead of our optimistic scenario of 2.9% (our previous forecast).

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