A good start for Hungary's economy, which might mean nothing now

Based on January economic activity data, the Hungarian economy was doing well. However, since the outbreak of war in Ukraine, that's all water under the bridge now

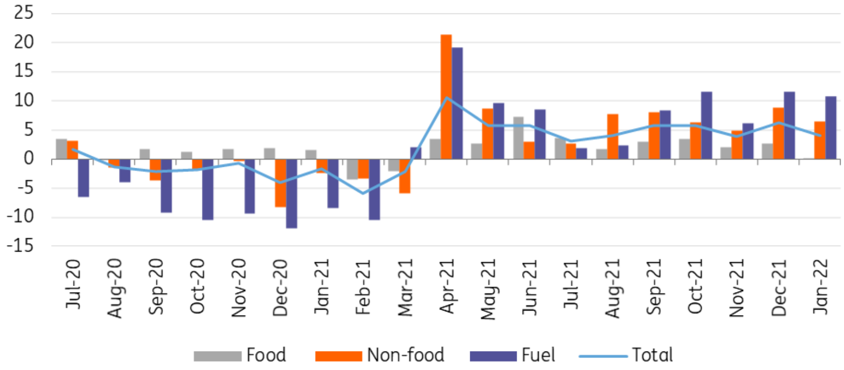
Some Hungarian households have started accumulating durable foods to help Ukrainian refugees arriving into Hungary

The Hungarian Central Statistical Office has released its latest set of data about retail sales (3 March) and industry (4 March). The big picture painted by these figures was really promising, but that was before the Russia-Ukraine war began. Let's first go through what happened in January, then we must talk about the harsh reality of the present situation.

January was a bit mixed but rather strong

The growth rate of retail trade slowed somewhat in January, as the volume of turnover increased by 4.1% year-on-year, adjusted for the calendar effect. At first glance it looks good, but as soon as we make a comparison to the final month of 2021, retail sales volume shows a 0.1% month-on-month decline, based on seasonally adjusted data. The last time retail sales posted a monthly decline was in July last year.

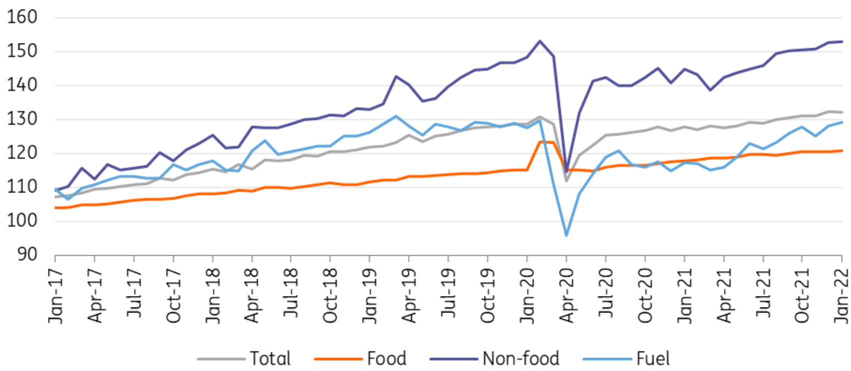
Breakdown of retail sales (% year-on-year, working day adjusted)



Source: HCSO, ING

In terms of the detail, the moderated January retail performance can be attributed to both weaker-than-usual food and non-food sales. In both these areas, there was essentially a stagnation in sales volume on a monthly basis. The growth of turnover among food retailers was practically zero on a yearly basis too. When it comes to the non-food retail sector, the 6.4% year-on-year growth is a result of last year's low base. One interesting detail regarding the non-food sector: the volume of sales in second-hand goods stores jumped 33% on a yearly basis. This could easily be the first sign of changing consumer behaviour induced by the unusually high inflation.

Retail sales volume in detail (2015 = 100%)



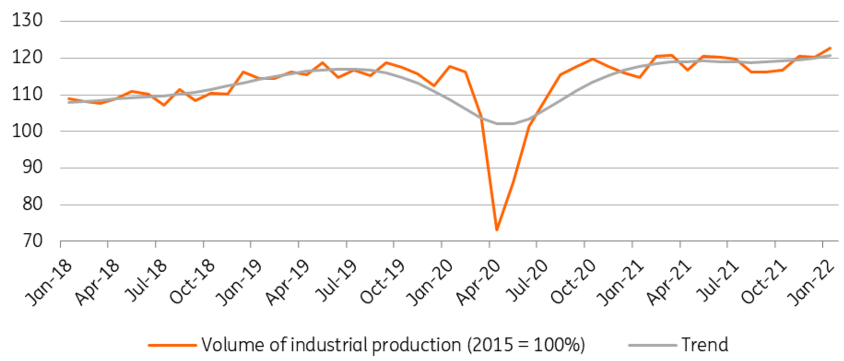
Source: HCSO, ING

The turnover at fuel retailers grew dynamically on both a monthly and annual basis, presumably due to the fact that the retail fuel price was fixed by the government. Thus consumers did not hold back their demand as they would otherwise have done without the price cap. Without the cap in place, fuel prices would have risen significantly (by 10-15%).

Perhaps the somewhat weaker January figure may also be a result of consumers temporarily curbing their spending in anticipation of government benefits in February (13-month pension, personal income tax refund for families etc.) which is likely to have funded major spending, potentially resulting in a significant jump in retail sales in February.

Now moving onto industry. 2022 saw a really strong start. The sector's growth in January exceeded expectations. Production jumped by 1.9% on a monthly basis, translating into an 8.9% year-on-year growth, according to unadjusted data. This also means that industry has managed to break through the “glass ceiling” as, since October 2020, the level of production (considering the 2015 average is 100%) has not been able to substantially rise above 120%.

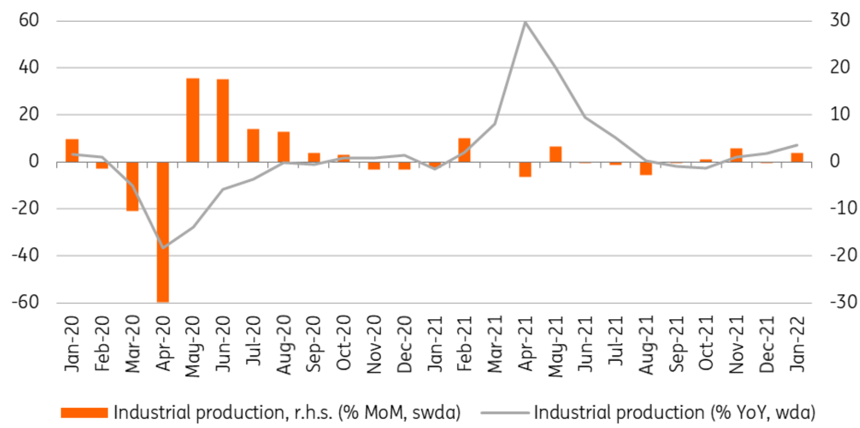
Volume of industrial production (2015 = 100%)



Source: HCSO, ING

When we first wrote about the “glass ceiling” we indicated that while the automotive and electronics industries have been struggling with supply problems, we can’t expect an upward trend in production levels. Our conjecture seems to have been confirmed as car production played a huge role in the good performance seen in January. Although the Statistical Office has not yet provided detailed data, it emphasised in its brief comment that vehicle production had risen again after a six-month decline.

Performance of Hungarian industry



Source: HCSO, ING

In contrast, the production of the second most important industrial sector in Hungary – electronics – practically stagnated. This means that there was potential in the Hungarian manufacturing industry but production was limited by shortages.

All in all, based solely on January's performance, the outlook for industry (and for the whole Hungarian economy) looked quite bright. However, the war has shattered our rosy picture.

Short-term outlook in the shadow of the war

When it comes to retail sales, the current war and humanitarian catastrophe at our Eastern border may have, in our view, some positive implications on retail sales and consumption. Some Hungarian households have started accumulating durable foods, for example, in anticipation of a worsening situation. In the meantime, many (including the government) have been buying aid packages (food, drink, blankets, beds, toiletries etc.) to help refugees arriving in Hungary. This is likely to strengthen the February/March retail data. Moreover, the more than 100,000 (and counting) Ukrainian refugees will add an extra boost to consumer spending as long as they remain in Hungary. Therefore, we expect retail sales to have a strong first quarter (albeit for a sad reason), but the longer-term outlook for the economy is increasingly uncertain.

One of the main reasons for this uncertainty is related to industry. The strong performance seen in January will now become unsustainable because of the war. With the closure of Ukrainian manufacturing plants, car manufacturers (and probably others as well) across Europe are once again facing a shortage of parts. More and more car factories are signalling that they are running out of inventories of parts and there is no replacement. In addition, a significant proportion of commodity imports related to car manufacturing is tied to Russia. This means mainly aluminium, nickel and palladium shortages. This will bring down industrial production capacities across Europe even further.

The key question for the coming months will be whether there will be a similar level of industrial shutdown as seen at the height of the coronavirus crisis. The main difference is that at that time, the recovery potential was relatively high, as factories were able to return to production pretty quickly once the first really tough lockdown measures were lifted. There were enough spare parts, labour and capital to restart production.

But now a significant part of the labour force has left Ukraine, a country also deeply integrated into global value chains. The war destroys capital as well and there is no material to start production. In this regard, the possibility of a swift recovery is questionable and rather doubtful. Companies that are able to set up the supply of parts may take even longer. So, industry's performance this year is unpredictable, and we are clearly facing another difficult year.

Author

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