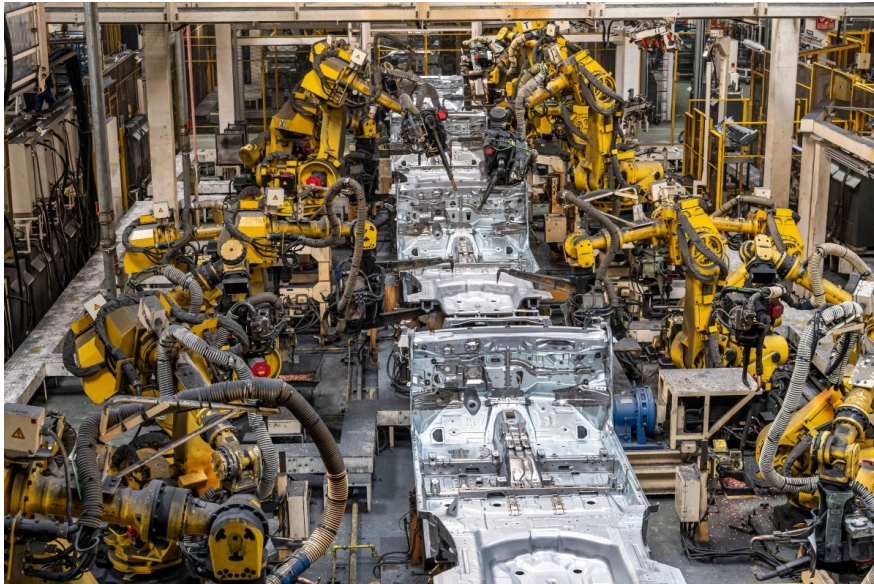


Hungary's industrial and retail sectors still a shadow of their former selves

Some downside surprise here, some upside surprise there, but the big picture remains unchanged. With domestic demand hit by the drop in purchasing power, both sectors are finding themselves between a rock and a hard place



The Hungarian Central Statistical Office (HCSO) has released June figures for the industrial and retail sectors. While we saw an upside surprise in industry and a downside surprise in retail sales in May, the June readings show exactly the opposite. Nonetheless, both sectors continue to struggle with weak domestic demand, thus we see these areas remaining a drag on GDP growth in the second quarter.

-6.1%

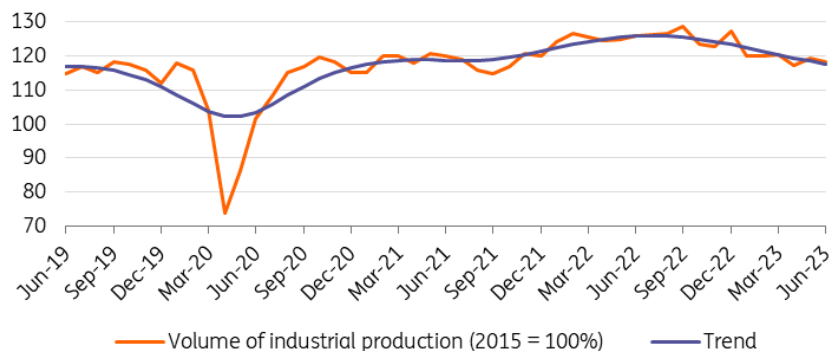
Industrial production (YoY, wda)

ING estimate: -9.1% / Previous: -4.5%

Worse than expected

Industrial production delivered a strong negative surprise in June compared to market consensus, though performed better than we expected. Output fell by 0.9% on a monthly basis (seasonally and working day adjusted). This translates into a year-on-year decline in industrial production of 6.1% (working day adjusted). The data suggests that the pick-up in industrial production seen in May was not sustained and that industrial production continues to follow a strong negative trend.

Volume of industrial production

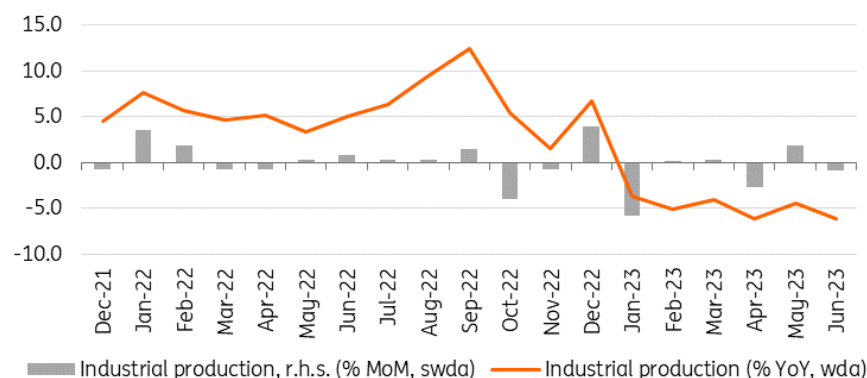


Source: HCSO, ING

Although detailed data has yet to be released, the HCSO reports that everything is unchanged. While most sub-sectors contributed to the decline in output, the exceptions remain electrical equipment (EV battery production) and motor vehicles. In essence, only the export-oriented sectors, including segments with some links to the automotive industry, are still able to partially offset the declines in other areas. At the same time, such a dichotomy still reflects the continuing contraction of domestic demand in the Hungarian economy, as sectors producing for the domestic market do not need to produce as much in the absence of demand.

The picture is, therefore, crystal clear: export sales are able to compensate to some extent for the very weak performance of companies producing for the domestic market. Looking ahead, this dichotomy is likely to persist, but the positive impact of exports may start to wane. New export orders are also becoming more subdued, at least according to surveys, and perceived demand from firms producing for the external market is also weakening. As the backlog of orders built up in recent years is worked through, this segment of industry may also begin to weaken. The weakening performance of the global manufacturing sector is a clear sign of falling demand for industrial goods, from which the Hungarian economy will not be able to escape.

Performance of Hungarian industry



Source: HCSO, ING

However, it is to be hoped that the moderation of inflation and the recovery of purchasing power in Hungary – possibly as soon as September – will provide some positive impetus to the domestic industrial sectors, which could offset the initial weakening of industrial exports.

For the year as a whole, however, we still expect total industrial production to turn negative, i.e. to fall short of the output levels of 2022. This also means that agriculture could remain the sole saviour of economic growth, as a better-than-expected retail sales figure does not mean that we are on the verge of a sustained turnaround.

-8.3%

Volume of retail sales (YoY, wda)

ING estimate: -9.7% / Previous: -12.3%

Better than expected

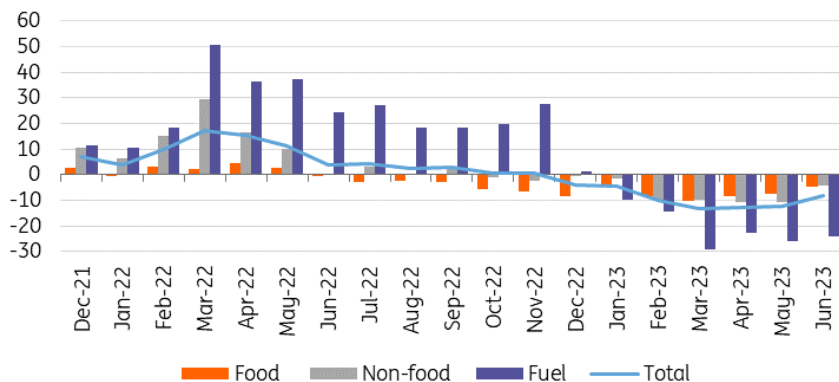
The performance of the retail trade sector in June was a rather strong positive surprise, offsetting the negative surprise in industry. Not only did the year-on-year index improve on the previous month, but retail sales volume also rose on a monthly basis. Compared with the previous month, sales volumes rose by 0.7%, while the year-on-year index improved to -8.3%. The 4ppt improvement reflects last year's low base as well.

A closer look reveals the source of the surprise. On the one hand, food retail sales rose again by 0.3% on a monthly basis, which is not exceptional, but it is certainly positive that the expansion has continued for three months now. On the other hand, the performance of non-food sales was exceptionally strong. The monthly increase of 2.5% is a clear outlier: the last time this segment recorded a higher monthly increase was in February 2022.

By sub-sectors, there were significant increases in sales of manufactured goods, furniture and electrical goods, but also a strong increase was registered in sales of second-hand goods. The biggest question is whether this is the start of a trend reversal or just a one-month blip. It's very difficult to say at this stage, but twice in the last three years we have seen a surprisingly strong

performance in non-food retailing in June. This suggests some sort of emerging seasonality. That all is not yet well with household purchasing power is shown by the continued decline in fuel sales, which fell by 1.1% on a monthly basis. However, it is important to note that fuel prices had already risen significantly in June, so the fall in sales volume here is less of a surprise.

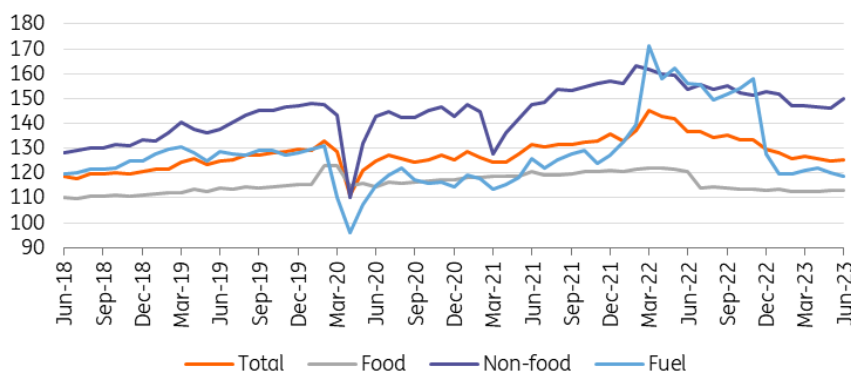
Breakdown of retail sales (% YoY, wda)



Source: HCSO, ING

On the positive side, however, retail sales excluding fuel rose on a monthly basis in June after eight months of decline. Looking ahead, we do not expect June's positive performance to be repeated in the short term. However, a slow, trend-like turnaround in retail sales could take hold as inflation moderates and purchasing power is expected to start rising again in September. However, this is unlikely to be enough to salvage the year as a whole, which means that we expect a significant decline in the full-year performance.

Retail sales volume in detail (2015 = 100%)



Source: HCSO, ING

With today's data, we now have an insight into the overall performance of two important sectors in the second quarter, namely retail trade and industry. In light of the data, it is now almost certain that these areas have made a significant negative contribution to the economy's performance on both an annual and quarterly basis. Indeed, the annualised indices suggest that the rate of contraction of GDP in the second quarter may have accelerated on an annual basis. We also do not expect any surprises in the construction sector in June that could reverse the negative trend

seen there.

On the other hand, the performance of agriculture could be very positive, partly because of the favourable weather so far and partly because of last year's extremely low base. According to the Ministry of Agriculture, the average yield of arable crops this year is 25-50% higher than last year. This should be enough to offset the weak performance of industry, retail sales and construction, and should allow the agricultural sector to pull the Hungarian economy out of technical recession in the second quarter, meaning that positive GDP growth could return on a quarterly basis.

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