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12038
Hungary

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Long-term Rating	A-
Outlook*	Stable
Short-term Rating	-

*Long-term Rating refers to Foreign Currency Long-term Issuer Rating in principle.

1. Overview

Hungary is a medium-sized economy in Central and Eastern Europe (CEE) with a nominal GDP of approximately USD 156 billion and a population of about 9.8 million in 2020. Since its economic transition in the early 1990s, the country has pushed economic reforms and proactively introduced foreign direct investment (FDI) well ahead of other CEE countries. It joined NATO in 1999 and acceded to the EU in 2004. As Hungary strengthened its ties with other European countries through international trade and finance, its economic structure has grown increasingly export-oriented. Since taking office in May 2010, the Viktor Orban administration has been capitalizing on its strong political base to push ahead with policies initially deemed to be unconventional to pull out the country from a prolonged economic slump after the global financial crisis. These policies have proved effective in overcoming the country's longstanding structural problems, reviving the economy and solidifying its economic and fiscal bases. The country has experienced several COVID-19 pandemic since the spring of 2020, and has introduced large-scale economic measures to mitigate a steep economic contraction and support an early economic recovery.

2. Socio-political condition and economy policy

In the process of its EU entry negotiations, Hungary had to make a major review of its political, economic and fiscal systems. New systems in conformity with the EU standards have been put in place to ensure political and social stability. In the general election held in April 2010, the alliance of conservative right-wing Fidesz-Hungarian Civic Union and the Christian Democratic People's Party won a two-third majority. Prime Minister Orban formed his second administration following the first one in 1998. In the April 2014 and April 2018 elections, the alliance retained its two-third majority, allowing Prime Minister Orban to remain in power. A general election is scheduled for April 2022, and despite the moves of the opposition alliance, the Orban administration is likely to be re-elected mainly because it has so far been praised for its prompt response to the pandemic.

The Orban administration has been promoting a policy that puts greater emphasis on the role of government. On the political front, it has swiftly enacted a new constitution, cut the number of parliamentary seats and changed the election system. On the economic and fiscal fronts, it has pressed ahead with broad-ranging reforms on the labor market, pension system, public finance and financial system with an aim to revive the economy and regain the stability of public finance. It has adopted some so-called unconventional policies including introduction of a special tax targeted at specific industries, transfer of private pension assets to the government sector and a rescue scheme for foreign currency-denominated (FX) mortgage borrowers, initially drawing criticisms from international investors and the media. Funds generated by the special tax and the transfer of private pension assets were mainly used for fiscal consolidation and other economic measures. The rescue scheme for FX mortgage borrowers put a heavy burden on banks, but it contributed a great deal to resolving their longstanding issue. On the other hand, it has introduced a new media law that restricts media activities, its own refugee policy, and more recently, discriminatory policies against the LGBT. These have been criticized by the EU for violating EU law. In December 2020, the EU adopted compliance with the "rule of law" as a condition for disbursing the 2021-2027 EU fund and Recovery Fund. However, the European Court of Justice will decide whether or not the "rule of law" is being threatened. Given the high level of public support for EU and the importance of EU funds for further economic development, the administration is expected to find a way out after the general election. The country had already established high-level political, social and economic systems in the EU accession process and the inflow of foreign direct investment continues growing in volume. JCR holds that an impact of this issue will be limited unless it leads to a substantial reduction of EU fund disbursements.

3. Economic base

Hungary has a relatively advanced and export-oriented economic structure centering on the automotive and chemical industries. Its per capita GDP (in ppp terms) exceeded USD 33,000 in 2020, which is higher among the sovereigns rated in the A range by JCR. Since the early 1990s, the country has proactively introduced FDI mainly from other European countries and deepened its economic relationship with those countries through international trade and finance. Around 90% of exports were bound for the European countries with Germany accounting for nearly 30%. The country is deeply integrated into the supply chain of European countries, in particular Germany.

In terms of energy sources, the country is highly dependent on imports, with fossil fuels accounting for about 70% of consumption, renewable energy for over 10%, and nuclear power for more than 15%. Four nuclear power plants are currently in operation, and two new plants are scheduled to be operational by the end of 2030. In 2018, the government formulated The Second National Climate Change Strategy and is working on measures to combat climate change. The goal is to reduce greenhouse gas emissions by 40% from 1990 levels by 2030, increase the share of renewable energy in final consumption to minimum 21%, and become carbon neutral by 2050. At present, greenhouse gas emissions reduction are progressing as planned.

With a view to ensuring an economic revival after the financial crisis, the Orban administration has made utmost efforts to put an end to the country's structural problems such as a weak financial system, a low employment rate and large government and external debts. The country's financial system has markedly improved as a result of the implementation of a rescue scheme to help households convert their foreign currency mortgage loans to forint-denominated ones. The government's employment promotion measures have been successful in substantially raising the employment rate, with the unemployment rate falling to a record low in 2019. Prior to the pandemic, both the government debt and the external debt at the end of 2019 in GDP terms had fallen to the levels significantly lower than before the financial crisis. The government's debt structure also improved as liabilities denominated in foreign currency and those held by nonresidents declined in volume. The administration has also promoted introduction of FDI to automobile and other industries. The outstanding balance of FDI (IIP) at the end of 2020 reached around 80% of GDP. After its accession to the EU, Hungary has been receiving a substantial amount of transfers from the EU funds. The government has been upgrading the country's social infrastructure by effectively using them. Hungary received EUR25 billion (25% of nominal GDP in 2007) between 2007 and 2013 and more than EUR22 billion (21% of nominal GDP in 2014) between 2014 and 2020. The country's economic structure is now highly dependent on exports and investment, with exports by automobile and other manufacturing industries accounting for 90% of real GDP in 2020 and investment for 26%. Global automakers and parts manufacturers mainly from Germany have set up their facilities in Hungary. The automotive industry has become one of major industries accounting for close to 30% of the country's total industrial output and 20% of exports. Hungary is also becoming one of the biggest battery producers amid the growing demand for electric vehicles in European countries.

4. Current economic condition

Prior to the pandemic, the annual economic growth rates for the period from 2017 to 2019 had averaged 4.8%, driven by domestic demand, one of the highest in the EU, and the unemployment rate had fallen to a record low while prices had risen only moderately. The current account balance had been either in surplus or marginal deficit, and both the external debt and net external debt (IIP), while still high relative to GDP, had significantly shrunk, helping to strengthen the economic foundation. When the pandemic began in the spring of 2020, the government declared a state of emergency at an early stage and enforced movement restrictions. In the April-June quarter of 2020, the economy contracted a sharp 13.0% from a year earlier. The pandemic resurged after that, but the effects of massive economic measures and resumption of economic activities eased its impact, with the economic contraction in the entire 2020 abated to 4.7%. The economic measures by the government and the central bank, equivalent to about 30% of GDP, were one of the largest in the EU. About half of them was fiscal spending such as maintenance and creation of employment, financial support for households and pensioners, and investment promotion, the remainder being financial support.

Although the pandemic surged again in 2021, the economy was seen to have grown by around 6% as a whole thanks to the effect of the economic measures and accelerated resumption of economic activities. As the government consumption underpinned the economy, both investment and exports have been expanding since the end of 2020 with consumer spending recovering since the April-June quarter of 2021. Yet production and exports mainly in the automotive industry were adversely affected by supply constraints in the July-September quarter of the year although the production gradually resumed later. The size of real GDP in the April-June quarter of 2021 recovered to the level before the pandemic. JCR holds that the economy will grow by around 4% in 2022 and by around 3-4% in the medium term, given the country's economic foundation that has been strengthened so far, the continued effect of the economic package and a large inflow of money from the EU funds and its recovery fund.

5. Financial System

Hungary’s financial system has been kept stable, with banks staying fully resilient to risks. The outstanding balance of bank loans stood low at around 60% of GDP at the end of 2020, but the lending to nonfinancial companies and households has been growing since 2017 thanks to lower interest rates and the incentive measures adopted by the government and the central bank. The bank lending kept a double-digit growth in 2020 on the financial support measures aimed to mitigate the impact of the pandemic. Banks reported a lower profit in 2020 as their higher operating income was offset by increased loan-loss provisions. While securing solid net interest income on the growth of lending despite the lower interest rate environment, they boosted their operating income on increased non-interest income centering on commissions. They contained their operating expenses, but loan-loss provisions surged in volume to cover risk assets. Their nonperforming loan (NPL) ratio fell from 3.4% at the end of June 2021 to 3.0% at the end of September 2021 and their capital adequacy ratio stayed high at 19.1% at the end of June 2021.

To mitigate the impact of the pandemic, the government has implemented financial support measures such as a debt repayment moratorium and loan guarantees, and the central bank has carried out monetary easing, asset purchase programs and liquidity support measures for banks. The government enforced the moratorium for households and nonfinancial corporate borrowers in March 2020 and extended a portion of it for vulnerable sectors by the end of June 2022 for those borrowers who are still suffering from the impact of the pandemic. Banks have already built up their loan-loss provisions to cover high-risk loans. In the first nine months of 2021, their pre-tax profit doubled from the year earlier as operating income continued expanding while provisioning for loan losses was cut significantly. Their NPL ratio declined further to 3.4% at the end of September 2021, with their capital adequacy ratio kept high at 18.1%. After the expiry of the moratorium, banks may require an additional buildup of provisions. However, JCR believes that they will be fully able to absorb them with their pre-provision profits.

6. Resilience to external shocks

The country’s gross external debt and net external liabilities (IIP) remain large as compared with those of other sovereigns rated in the A range by JCR. However, they were cut to around 80% and below 50% of GDP, respectively, at the end of 2020, which were significantly lower than their 2009 peaks. The current account balance had been in surplus since 2010 on increased exports stemming from enhanced production capacities especially in the automotive industry. However, it slipped into a modest deficit in 2019 and 2020. Increased imports driven by strong domestic demand caused a larger trade balance deficit in 2019. In 2020, the service balance involving tourism ended up with a reduced surplus due to the movement restrictions forced by the pandemic. Nonetheless, Hungary continued to enjoy a net capital influx thanks to continuing inflows of EU funds. The modest current account deficit continued in the January-September period of 2021 despite the recovery of imports and exports since the end of 2020. The foreign currency reserves (excluding gold, reserve position in the IMF and SDRs) remained high level of EUR 30.8 billion at the end of 2021 amid continued net inflows of foreign direct investment. The balance of gross external debt and net external liabilities at the end of September 2021 increased from a year earlier, standing at closer 90% and just below 50% of GDP, respectively. Given the automotive industry's enlarging production capacity, JCR expects that exports will expand and the current account balance will return to surplus once the impact of the pandemic recedes.

7. Fiscal base

The general government fiscal deficit (ESA 2010) had been constantly kept below 3% of GDP from 2012 to 2019 in line with the reduction of the government debt-GDP ratio. The debt structure also improved as the government ramped up funding in local currency from households and banks, sharply reducing the ratios of debt owed to nonresidents and foreign currency-denominated debt to the total. The government had initially planned to cut its fiscal deficit in GDP terms from 2020 onward. However, the deficit in the year widened to 8.0% due to the massive economic package aimed to mitigate the impact of the pandemic and a slower growth of tax revenues caused by the economic contraction. The total package provided by the government and NBH was worth about 30% of GDP, of which around a half was fiscal expenditures. The general government debt rose sharply to 80.1% of GDP at the end of 2020 from 65.5% a year earlier. The government was forced to apply the exemption clause in the law that obliges it to reduce the debt in budget formulation.

The budget deficit was estimated to have narrowed slightly to around 7% of GDP in 2021 due to the reduction of the economic stimulus measures and increased tax revenues brought by the economic recovery, with the government debt seen to have been cut to less than 80% of GDP. The government plans to continue fiscal consolidation and curb its debt from 2022 onward. The country's law obliges the government to cut the debt ratio in budget compilation when it exceeded 50% of GDP. Given the government's strong commitment backed by the legal obligation and its track records, JCR holds that fiscal consolidation will continue to make headway after the general election in April 2022 onward. There has been no major change in the government debt structure, but the average debt maturity has exceeded six years partly due to the issuance of long-term foreign currency-denominated bonds. In 2020, based on its green bond framework, the government issued its first green bonds in euros and yen. It was the first such bond in yen by a foreign government. In 2021, the government issued long-term US dollar and euro bonds and green RMB bonds.

8. Overall assessment and outlook

The ratings are mainly supported by the country's developed and export-oriented economic structure, strengthened economic and fiscal base brought by appropriate economic policies and stable banking system. On the other hand, they remain constrained by its relatively large external and government debts in GDP terms. The rating outlook of the rating is Stable. Large-scale economic measures have been implemented in order to mitigate the impact of the pandemic. As a result, although the public finance deteriorated significantly, real GDP and employment recovered to pre-pandemic levels in the first half of 2021. While the future outlook remains uncertain due to supply constraints and a possible resurgence of the pandemic, both economic and fiscal bases are becoming more resistant to shocks. The current government is highly likely to be re-elected in the general election in April 2022, and as the economy continues to recover, the government will continue to promote fiscal consolidation.

Promotion of an early sustainable economic recovery through measures to ensure living with COVID-19 and a continued reduction of the government and external debts in GDP terms would be positive factors for the ratings. On the other hand, the ratings will come under downward pressure if a prolonged pandemic, a substantial reduction of EU fund allocations resulting from sanctions, and emergence of geopolitical risks have material impacts on the economy and public finance.

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Selected Economic and Fiscal indicators

		2016	2017	2018	2019	2020
Nominal GDP	USD billion	128.7	143.2	160.6	163.5	155.8
Population	million	9.8	9.8	9.8	9.8	9.8
Per capita GDP(PPP)	USD	27,948	29,501	31,863	33,962	33,253
Real GDP growth rate	%	2.2	4.3	5.4	4.6	-4.7
Consumer price inflation	%	0.4	2.4	2.8	3.4	3.3
Unemployment rate	%	5.1	4.2	3.7	3.5	4.3
General government revenues/GDP	%	45.0	44.3	44.0	43.6	43.6
General government expenditures/GDP	%	46.8	46.7	46.1	45.7	51.6
General government balance/GDP	%	-1.8	-2.5	-2.1	-2.1	-8.0
General government debts/GDP	%	74.9	72.2	69.1	65.5	80.1
Current account balance/GDP	%	4.5	2.0	0.2	-0.7	-1.6
External debts/GDP	%	95.4	83.1	79.1	72.4	80.0
External debts/Export Goods & Service	%	110.4	96.7	94.5	88.6	100.7
International reserves/Monthly import Goods &Service	Times	3.2	2.7	2.9	2.7	3.6
International reserves/Short-term external debts	Times	1.8	1.9	2.1	2.1	1.9

(Sources) Hungarian Statistical Office, National Bank of Hungary, and Eurostat

Ratings

	Rating	Outlook*	Amount (millions)	Currency	Rate (%)	Issue Date	Maturity Date	Release
Foreign Currency Long-term Issuer Rating	A-	Stable	-	-	-	-	-	2022.01.31
Local Currency Long-term Issuer Rating	A	Stable	-	-	-	-	-	2022.01.31
Japanese Yen Bonds-Seventh Series(2020)	A-	-	22,700	JPY	0.52	2020.09.18	2023.09.15	2022.01.31
Japanese Yen Bonds-Eighth Series(2020)	A-	-	20,000	JPY	0.74	2020.09.18	2025.09.18	2022.01.31
Japanese Yen Bonds-First Series(2020)(Green Bonds)	A-	-	15,500	JPY	1.03	2020.09.18	2027.09.17	2022.01.31
Japanese Yen Bonds-Second Series(2020)(Green Bonds)	A-	-	4,500	JPY	1.29	2020.09.18	2030.09.18	2022.01.31

History of Long-term Issuer Rating (Foreign Currency Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer
1996.08.02	BBB+	-	Hungary
1999.11.25	A-	-	Hungary
2003.05.16	A	Stable	Hungary
2006.10.04	A-	Stable	Hungary
2008.10.21	#A-	Negative	Hungary
2008.12.18	BBB+	Negative	Hungary
2010.03.05	BBB+	Stable	Hungary
2011.03.31	BBB+	Negative	Hungary
2012.04.03	BBB	Negative	Hungary
2014.03.18	BBB	Stable	Hungary
2016.02.17	BBB	Positive	Hungary
2017.02.21	BBB+	Stable	Hungary
2019.03.27	BBB+	Positive	Hungary
2020.02.21	A-	Stable	Hungary

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor.

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