JCR

ISSUER REPORT

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12038

Hungary

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Long-term Rating	BBB+
Outlook*	Stable
Short-term Rating	-

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

1. Overview

Hungary is one of the medium-sized economies in Central and Eastern Europe (CEE) with a nominal GDP of EUR113.7 billion and a population of 9.83 million in 2016. Since its economic transition in the early 1990s, the country had pushed economic reforms and proactively introduced foreign direct investments (FDI) well ahead of other CEE countries. It joined NATO in 1999 and was approved to accede 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. After the outbreak of the global financial crisis in 2008, the country was forced to receive IMF/EU financial assistance totaling EUR20 billion (18% of GDP in 2008) amid its ballooning external debt brought by chronic fiscal and current account deficits. Since taking office in May 2010, the Viktor Orban administration has been capitalizing on its strong political base to push ahead with an unconventional policy to pull out the country from the prolonged economic slump. The policy has proved effective in reviving the economy and solidifying its structure.

2. Socio-political condition and economy policy

Since the country's first free election was held in 1990, parliamentary democracy has been functioning as exemplified by a multi-party system and change of administration. In the process of its EU entry negotiation, 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 the spring of 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 election, the alliance retained its two-third majority, allowing Prime Minister Orban to remain in power. The next general election is scheduled for April 2018. Latest opinion polls indicate that the ruling parties keep a comfortable lead over other parties amid persistent voter support for its policies on economic revival and the immigration issue. It looks highly likely that the coalition will retain their majority in parliament.

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 stability of public finance. It has adopted some 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. The fund generated by the special tax and the transfer of private pension assets was mainly used for fiscal consolidation and other economic purposes. The rescue scheme for mortgage borrowers put a heavy burden on banks, but it contributed a great deal to resolving the longstanding issue. The government also enacted a new media law that regulates media activity and a new Central Bank Act that limits the independence of the central bank. The EU warned that both laws are incompatible with its legislation.

3. Economic base

Hungary has a relatively advanced and export-oriented economic structure centering on the automotive and chemical industries. Its per capita GDP (ppp) approximately US$27,000 in 2016, which is the highest among the sovereigns rated in the BBB 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. The outstanding balance of FDI at the end of 2016 was equivalent to approximately 90% of GDP. Along with this trend, the ratio of exports to nominal GDP has risen reaching 90% in 2017, the second highest after Slovakia among the CEE countries. Around 80% of exports were bound for the EU with Germany accounting for close to 30%. The country is deeply integrated into the EU's supply chain. After its accession to the EU, the country has been receiving a substantial amount of transfer from the EU funds. The government has been upgrading the country's social infrastructure by effectively using them. The country was entitled to receive EUR25 billion or 25% of GDP (in 2007) between 2007 and 2013 and EUR22 billion or 21% of GDP (in 2014) between 2014 and 2020.

4. Current economic condition

Annual real GDP growth rate exceeded 4% in the early 2000s but contracted to the annual average of -1% between 2008 and 2012 due mainly to the outbreak of the financial crisis. In addition to the setback of exports caused by weak global demand, consumer spending and investment plunged amid intensified reduction of swollen debts mainly owed by households and banks. The economy started recovering in late 2013 on expanded public investment prompted by a massive inflow of EU funds and a pickup of exports as well as the stimulus measures implemented by the government and the central bank. In 2014, the economy grew 4.2% on a recovery of consumer spending. While the economy slowed down in 2015 and 2016 on weaker public investment resulting from a reduced inflow of EU funds, it accelerated to 4.0% (preliminary data) in 2017, led by robust consumer spending and resumed inflow of new EU funds (2014-2020). Also supporting the strong recovery is the ongoing resolution of structural drawbacks such as a weak financial system, a low employment rate, and large government and external debts. Total compensation of employees has been fast growing on an increase of the minimum wage amid a tightening labor market marked by a record-low 4.2% jobless rate in 2017. Investments have continued to be made in expanding the capacity of the automobile-related industries, contributing to the growth of exports and the improvement of productivity. The consumer price inflation accelerated to 2.4% in 2017 from 0.4% in 2016 on a pickup of energy prices, but the major hike of the minimum wage had only a limited impact. JCR expects that the economy will slightly slow down on a lower inflow of EU funds but that it will continue to grow around 3% annually. Inflation will pick up moderately on solid domestic demand and wage increases.

5. Financial System

The country's financial system experienced significant deterioration in the aftermath of the financial crisis, but it has started recovering stability following implementation of remedial measures by the government and NBH. After the financial crisis, the swollen FX mortgage loans drastically deteriorated in credit quality. Banks tightened their lending to avoid further risk taking. This deterred economic recovery. Faced with the situation, the government converted most of those loans into the Hungarian forint in early 2015. It also set up an asset management company to purchase nonperforming commercial real estate loans held by banks. The central bank launched its Funding for Growth Scheme aimed to encourage banks to make more loans to SMEs in a bid to stimulate bank lending to the private sector. The banks were obliged to accept the conversion, lower the interest rates on loans and pay compensation to the borrowers. This forced the banks to set aside a significant amount of provisions, leaving them with the largest net loss on record in 2014. However, the transactions have helped them significantly ease their risks as the compensation was applied to reduce the principal owed by the borrowers and almost all their mortgage loans were converted into the local currency. The banks saw their performance recover in 2015 and were seen to have made substantial profits in 2017 mainly led by reversal of loan-loss provisions. They stay fully resilient to risks, with their nonperforming loan ratio cut to around 4% and capital ratio boosted to more than 20% at the end of September

2017. The outstanding balance of bank loans keeps growing despite the waning effect of the central bank's initiative aimed to encourage banks to make more loans.

6. External position

The country's external debt remains large as compared with those of other sovereign governments rated in the BBB range by JCR. However, it shrank close to 90% of GDP at the end of September 2017 from 148% at the end of 2009 mainly led by the banking sector. The ratio is now comparable to the level before the financial crisis in 2008-2009. The country also fully repaid IMF/EU loans at the beginning of 2016. The current account balance turned around into surplus in 2010. The surplus slightly narrowed in 2017 as imports grew on strong domestic demand, but it stayed close to 4% of GDP. Given the automotive industry's enlarging production capacity, the balance may remain in surplus barring deterioration of the EU economy. The country's external liquidity stays stable thanks to increased inflows of EU funds despite narrowed current account surpluses in 2017. Furthermore, the government, banks and households have been cutting back on their foreign currency-denominated debts and external debts. This should help reduce the country's vulnerability to external shocks.

7. Fiscal base

Capitalizing on its stable political base, the government has been implementing a series of fiscal consolidation packages aimed to cut its growing debt since the beginning of 2011. The government also set a constitutional cap on public debt with an aim to contain its fiscal debt. The general government fiscal deficit (ESA2010) has been kept below 3% of GDP since 2012. The ratio in 2017 was estimated at around 2%, slightly lower than the budget target. While election measures such as the reduction of social contribution by employers, corporate income tax cut (the lowest rate in the EU), and decreases in VAT on selected staple foods as well as increased public investment were adopted in 2017, the revenues surged on economic expansion and rising inflation. The government remains committed to contain its fiscal deficit below 3% of GDP from 2018 onward. Its 2018 budget plan envisages containing the fiscal deficit to 2.4% of GDP. It also retains reserves to provide for contingency. The general government debt (ESA2010) remains large, but its ratio to GDP was seen to have declined to around 72% at the end of 2017 from 80% at the end of 2011. Depending on the outcome of the negotiation between the government and Eurostat, the ratio will increased by 2 percentage points to around 74% due to inclusion of the debt owed by the state owned Hungarian Exim bank. The composition of the debt has also improved as the government ramped up implementation of its Self-Financing Program with a focus on funding in local currency on the domestic market, in particular households and banks. The ratios of the central government debt owed to nonresidents and foreign currency-denominated debt to the total at the end of 2017 were slashed to 37% and 22%, respectively, from 69% and 49% at the end of 2011.

8. Overall assessment and outlook

The ratings mainly reflect the country's relatively advanced and export-oriented economic structure, the progress on the structural reforms and significant reduction of vulnerability to external shocks. On the other hand, the ratings remain constrained by the large external and government debts, both of which have constantly been shrinking in GDP terms.

The rating outlook is stable. Thanks to the effective economic measures implemented by the government, the country is overcoming its structural problems including a week financial system, a low employment rate and large government and external debts. The economy is keeping its domestic demand-led expansion, supported by an enhanced utilization of EU funds and accommodative fiscal and monetary policies. The fiscal deficit has been kept subdued despite the general election scheduled for April 2018. The current economic policy may well be continued even after the election as the ruling coalition led by Fidesz-Hungarian Civic Union is highly likely to retain its majority in parliament. Barring marked changes in the external environments, JCR expects that Hungary will make further improvements on the government and external debts amid the continuing moderate economic expansion.

Further reduction of government debt and external debts in terms of GDP will be positive for the ratings. Meanwhile, the continued tightening of labor market is likely to have a negative impact on the ratings. If the government was unsuccessful to improve tightening labor market and the country's potential growth rate, the economy is likely to slow down. In the foreseeable future, however, public-sector employees and Hungarian residents in foreign countries may contribute to supplying additional labor force to the private sector.

The government also has been stepping up its efforts to enhance the country's potential economic growth rate in cooperation with private sector.

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Selected Economic and Fiscal indicators

		2013	2014	2015	2016	2017E
Nominal GDP	USD billion	135	140	123	126	139
Population	million	9.9	9.9	9.9	9.8	9.8
Per capita GDP(PPP)	USD	24,463	25,645	26,689	27,008	27,800
Real GDP growth rate	%	2.1	4.2	3.4	2.2	4.0
Consumer price inflation	%	1.7	-0.2	-0.1	0.4	2.4
Unemployment rate	%	10.2	7.7	6.8	5.1	4.2
General government revenues/GDP	%	46.6	46.8	48.2	44.8	44.3
General government expenditures/GDP	%	49.3	49.5	50.2	46.7	46.2
General government balance/GDP	%	-2.6	-2.7	-2.0	-1.9	-2.0
General government debts/GDP	%	76.0	75.2	74.7	73.9	72.0
Current account balance/GDP	%	3.8	1.5	3.5	6.1	3.8
External debts/GDP	%	117.8	114.7	107.1	96.2	86.1
External debts/Export G&S	%	137.5	130.9	118.7	107.4	96.2
International reserves/Monthly import G&S	Times	5.1	4.8	4.0	3.2	2.8
International reserves/Short-term external debts	Times	2.0	2.1	2.1	1.9	1.9

(Note) Figures for 2017 are estimation made by JCR
(Sources) Hungarian Statistical Office and National Bank of Hungary

Ratings

(millions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
Foreign currency long-term issuer rating	BBB+	Stable	-	-	-	-	2018.03.01
Local currency long-term issuer rating	A-	Stable	-	-	-	-	2018.03.01
Japanese Yen Bonds-Sixth Series (2018)	BBB+	-	30,000	0.37	2018.03.22	2021.03.22	2018.03.14

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

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

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