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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 the medium-sized economy in Central and Eastern Europe (CEE) with a nominal GDP exceeding USD 160 billion and a population of about 9.8 million in 2019. 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. Since taking office in May 2010, the Viktor Orban administration has been capitalizing on its strong political base to push ahead with unconventional policies to pull out the country from the prolonged economic slump after the global financial crisis. The policies have proved effective in overcoming the country's longstanding structural problems, reviving the economy and solidifying its economic base.

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 and the April 2018 elections, the alliance retained its two-third majority, allowing Prime Minister Orban to remain in power.

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 measures. The rescue scheme for FX 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 limited the independence of the central bank. The EU warned that both laws are incompatible with its legislation. The dispute between the EU and the Hungarian government continues over the asylum policy and judicial reforms. Nonetheless, the country had already established high-level political, social and economic systems in the EU accession process. Unless the issues will lead to substantial reduction of allocation of the EU fund between 2021 and 2027, their impact is likely to be limited.

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) has already reached around USD 30,000 in 2018, which belongs to the highest group 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. Nowadays around 90% of exports were bound for the European countries with Germany accounting for close to 30%. The country is deeply integrated into the supply chain of European countries, in particularly Germany.

In view of reviving from the prolonged economic slump after the financial crisis, the Orban administration has almost put an end to the country's structural problems such as a week financial system, a low employment rate and large government and external debts, the economy has been expanding mainly led by domestic and external demand. Significant improvement of the country financial system has provided banks with more capacity to lend loans to private sector. A surge in employment rate has supplied more employment in the economy. The government debt in compared with GDP fell to the levels before the financial crisis and its structure also improved with the shares of Foreign exchange denominated and nonresident holding being declined. The administration has also promoted to increase foreign direct investment. As of end 2019, the outstanding balance of FDI (IIP) was estimated at around 80% of GDP. 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. The economy is changing to more export and investment oriented as the shares of exports and investment in real GDP surged to around 110% and 28% at the end of 2019. According to financial account in Hungary, net financial worth of households continues growing amid decreasing net external debt. Global automotive manufacturers and parts companies mainly from Germany have set up their facilities in Hungary. Auto industry has become one of major industries and generates approximately 30% of the country's total industrial output and 20% of exports. It is said that the efficiency of the country's automotive OEM facilities is higher than those in other countries outside Germany. The country is also becoming one of the largest battery producing countries to meet growing demand of electric vehicles in European countries. These measures and efforts were proved to be effective to strengthen the country's economic base.

4. Current economic condition

The economy stagnated between 2008 and 2012 due mainly to outbreak of the financial crisis, but 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 economic 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 4.3% in 2017, led by robust consumer spending and increased investment resulted from resumed inflow of new EU funds (2014-2020).

The economic growth rate reached around 5% in 2018 and 2019 mainly driven by the robust domestic demand and solid export amid slowdown of European economy. The growth rate in 2019 was the second highest after Ireland among EU member countries. Increased employment, a hike of the minimum wage and tax cuts contributed to expanding consumer spending. Investment continued a strong growth thanks to private investment, public investment related to EU funds (allocated between 2014 and 2020) and housing investment on the subsidy scheme pushed by the government. The labor market is tightening marked by a record-low 3.4% unemployment rate in 2019 amid the continued rise in employment rate. Consumer price inflation rose to 3.4% in 2019 reflecting a steep increase of wages resulting from a labor shortage and a hike of the minimum wage, but has been partially curbed by higher productivity. The economy will slightly decelerate on a slower European economy, a labor shortage and normalization of monetary policies. However, an annual growth rate of around 3-4% will be sustained over the coming years on expanded production capacity resulting mainly from increased investment in automotive segments. JCR will monitor how EU funds will be allocated to member countries under the 2021-2027 budgets.

5. Financial System

The country's financial system has shown marked improvement after implementation of a rescue scheme for FX mortgage borrowers in 2014. The earnings performance of the banks were initially forced to register a huge loss due to higher provisioning, but continues to improving after the introduction of rescue scheme. The outstanding balance of bank loans remains low at around 50% of GDP, but lending to nonfinancial cooperation and households has been growing in 2017 and showed two digit growth rate in 2018 and 2019 thanks to lower interest rates and the incentive measures adopted by the government and the central bank. Banks were estimated to have made another record profit in 2019 on increased operating income and reduced loan-loss provisions. While securing solid net interest income on the growing lending to private sector amid lower interest rate environment, banks boosted its operating income on the robust non interest income mainly led by commission. Operating expenses and loan loss provision were contained. Banks stay fully resilient to risks, with their nonperforming loan ratio cut to below 5% and capital ratio boosted to around 18% at the end of 2019. House prices are rising in urban areas, but JCR views that this is not an immediate concern because household debts still stay low in GDP terms with the LTV ratio kept at low levels.

6. External position

The country's gross external debt and net external liabilities (IIP) remain large as compared with those of other sovereign governments rated in the A range by JCR. However, they were estimated to shrink to below 80% and 50% of GDP at the end of 2019. The current account balance had posted surpluses since 2010 on increased exports driven by higher production capacity especially in the automotive industry. However, it turned around into marginal deficits below 1% of GDP both in 2018 and 2019 reflecting increased imports driven by strong domestic demand. Given the automotive industry's enlarging production capacity, the balance may return to surplus with slowdown of domestic demand. As for external liquidity, the country stays as net lender position thanks to increased inflows of EU funds despite marginal current account deficit in 2019.

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 (ESA 2010) has been kept below 3% of GDP since 2012. The ratio in 2019 was estimated at around 2%, almost on par with the budget target. The good performance came from continuing spending curbs and increased VAT and personal income tax revenues brought by the economic expansion. The government is committed to reducing its fiscal deficit in GDP terms from 2020 onward. Its 2020 budget plan envisages cutting the ratio to 1% and sets aside reserves equivalent to 1% of GDP to provide for contingency. The ratio of the general government debt (ESA 2010) to GDP was estimated to have fallen below 70% at the end of 2019 for the first time since 2007. The ratio is likely to fall to the average for sovereigns rated in the A range by JCR within a few years. The debt composition is improving as the government ramps up funding in local currency on the domestic market centering on households and banks under its Self-Financing Program. The ratios of the government debt owed to nonresidents and foreign currency-denominated debt to the total slashed to 34% and 17%, respectively, at the end of 2019 from 66% and 40% at the end of 2012.

8. Overall assessment and outlook

JCR upgraded Hungary's ratings in this year's annual rating review. The upgrading mainly reflects the country's strengthened economic base resulting from the effective economic policies taken by the government and the central bank, improved public finance brought by a stabilizing revenue base, and shrinking government and external debts in terms of GDP. The economy is growing at a relatively high annual pace of around 5% on solid domestic demand, but may return to a more stable growth rate of around 3-4%. Growing consumer price inflation remains contained to some extent, with the impact of rising wages partly offset by improving productivity. The ratios of government and external debts in GDP terms remain high, but are likely to keep shrinking amid stable economic expansion.

Further reduction of government debt and external debts in terms of GDP will be positive for the ratings. Meanwhile, deterioration of external environment mainly EU economies, failure to ease increasing shortage of labor and substantial reduction of allocation of EU fund as a sanction by the EU are likely to have a negative impact on the ratings, because these will be considerable downward pressure on the economy and public finance.

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Selected Economic and Fiscal indicators

		2015	2016	2017	2018	2019F
Nominal GDP	USD billion	124.5	127.5	141.6	157.9	163.6
Population	million	9.9	9.8	9.8	9.8	9.8
Per capita GDP(PPP)	USD	26,668	27,171	29,159	31,081	32,500
Real GDP growth rate	%	3.8	2.2	4.3	5.1	4.9
Consumer price inflation	%	-0.1	0.4	2.4	2.8	3.4
Unemployment rate	%	6.8	5.1	4.2	3.7	3.4
General government revenues/GDP	%	48.7	45.4	44.6	44.4	44.6
General government expenditures/GDP	%	50.6	47.2	47	46.7	46.6
General government balance/GDP	%	-2.0	-1.8	-2.4	-2.3	-2.0
General government debts/GDP	%	76.2	75.5	72.9	70.2	66.4
Current account balance/GDP	%	2.4	4.5	2.3	-0.5	-0.6
External debts/GDP	%	106.3	96.3	84.1	80.1	74.7
External debts/Export Goods & Service	%	120.8	110.4	96.5	94.4	90.3
International reserves/Monthly import Goods &Service	Times	4.1	3.2	2.8	3.1	3.0
International reserves/Short-term external debts	Times	2.1	1.8	2.0	2.1	1.7

(Note) Figures for 2019 are JCR projection
(Sources) Hungarian Statistical Office, National Bank of Hungary, and EIU

Ratings

(millions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
Local currency long-term issuer rating	A	Stable	-	-	-	-	2020.02.21
Foreign currency long-term issuer rating	A-	Stable	-	-	-	-	2020.02.21
Japanese Yen Bonds-Sixth Series (2018)	A-	-	30,000	0.37	2018.03.22	2021.03.22	2020.02.21

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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