JCR
ISSUER REPORT
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12038
Hungary

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Long-term Rating	BBB+
Outlook*	Positive
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 exceeding USD 155 billion and a population of about 9.8 million in 2018. 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 and government debts brought by chronic current account and fiscal 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 overcoming the country's longstanding structural problems, reviving the economy and solidifying its economic 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 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 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

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ongoing 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 the EU fund, 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) estimated to have reached around USD 30,000 in 2018, 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 (IIP) at the end of 2018 was around 80% of GDP. Along with this trend, the ratio of exports to nominal GDP has risen close to 90% in 2018, the second highest after Slovakia among the CEE countries. 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 and is becoming more susceptible to economic condition of those countries. 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 average 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 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 4.1% in 2017 and 4.9% (preliminary) in 2018, led by robust consumer spending and increased investment resulted from resumed inflow of new EU funds (2014-2020) amid economic slowdown of European economy in 2018. Increased employment, a hike of the minimum wage and tax cuts contributed to expanding consumer spending. Investment continued a double-digit growth thanks to the effect of projects related to EU funds (allocated between 2014 and 2020) and housing subsidy scheme pushed by the government. Household and corporate debts remained subdued. The labor market is tightening marked by a record-low 3.7% unemployment rate in 2018. The core CPI inflation has been rising to around 3.0%, but inflation has been contained to some extent by higher productivity. 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 considerably. JCR expects that the economy will slightly decelerate on a slower European economy, labor shortages in some sectors and normalization of monetary policies, but it will sustain an annual growth rate of around 3% over the coming years.

5. Financial System

The country's financial system continues improving. The outstanding balance of bank loans remains low at around 50% of GDP, but keeps growing mainly led by nonfinancial corporation. Banks maintained substantial profits in 2018 despite moderate decline of pretax profits from a year earlier. 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 increased somewhat, but loan loss provision fell sharply. They stay fully resilient to risks, with their nonperforming loan ratio cut to around 2% and capital ratio boosted to nearly 20% at the end of 2018. EU-wide Stress test conducted by European Banking Authority disclosed the results in November 2018. The country's largest bank, OTP was a sole bank to participate the exercise in Hungary. The results showed the bank will be able to retain solid capitalization to adverse shocks.

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 to 81.2% of GDP at the end of 2018 from 148% at the end of 2009 mainly led by the banking sector. The ratio now returned to the level before the financial crisis in 2008-2009. The current account balance turned around into surplus in 2010. The surplus narrowed in 2018 as imports grew on strong domestic demand, but it stayed in a surplus equivalent to 0.5% of GDP. Given the automotive industry's enlarging production capacity including electric vehicles and electric motors, 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 2018. 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 (ESA 2010) has been kept below 3% of GDP since 2012. The ratio in 2018 declined to around 2.2% (preliminary), slightly lower than the budget target. Budget expenditures were increased moderately before the general election in 2018, but they were more than offset by increased VAT and personal income tax revenues brought by the economic expansion. The government remains committed to contain its fiscal deficit below 3% of GDP from 2019 onward. Its 2019 budget plan envisages cutting the ratio to 1.8% and set aside reserves to provide for contingency. The ratio of the general government debt (ESA 2010) to GDP stayed still large at 70.8% (preliminary) at the end of 2018, but had been continuously declining from 80% at the end of 2011. 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 centering on households and banks. Its resilience to external shocks kept improving, with the ratios of the government debt owed to nonresidents and foreign currency-denominated debt to the total slashed to 36% and 20%, respectively, at the end of 2018 from 66% and 40% at the end of 2012.

8. Overall assessment and outlook

The ratings mainly stem from the country's developed and export-oriented economic structure, the advanced stage of structural reforms and a significant reduction of vulnerability to external shocks. On the other hand, the ratings remain constrained by the large external and government debts, though they have been constantly shrinking in terms of GDP. The economic measures implemented by the government and the central bank have been proving effective in overcoming the country's structural problems such as a week financial system, a low employment rate and large government and external debts. Inflation remains contained as a sharp rise of wages resulting from tightening labor market and increase in minimum wage has been partly offset by improved productivity. Public finance continues improving on increased tax revenues on robust economic expansion led by the domestic demand. The external debt also continues shrinking on a consistent current account surplus. The current slowdown of European economy, a tightening labor market and normalization of monetary policy weigh on the future growth rate, but the economy is likely to return to more stable growth rate around 3% in the years ahead. In these environments, JCR expects that the government and external debts will continue shrinking. All these things considered, JCR decided to change the rating outlook to Positive.

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 tightening of labor market and substantial reduction of allocation of EU fund are likely to have a negative impact on the ratings, because these will be considerable downward pressure on the economy.

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Selected Economic and Fiscal indicators

		2014	2015	2016	2017	2018
Nominal GDP	USD billion	140.1	123.0	126.0	139.8	155.7
Population	million	9.9	9.9	9.8	9.8	9.8
Per capita GDP(PPP)	USD	25,518	26,189	26,741	28,215	30,150
Real GDP growth rate	%	4.2	3.5	2.3	4.1	4.9
Consumer price inflation	%	-0.2	-0.1	0.4	2.4	2.8
Unemployment rate	%	7.7	6.8	5.1	4.2	3.7
General government revenues/GDP	%	46.9	48.2	45.1	44.7	44.2
General government expenditures/GDP	%	49.5	50.1	46.8	46.9	46.5
General government balance/GDP	%	-2.6	-1.9	-1.6	-2.2	-2.2
General government debts/GDP	%	76.7	76.7	76.0	73.4	70.8
Current account balance/GDP	%	1.5	2.8	6.2	2.8	0.5
External debts/GDP	%	114.7	107.6	97.4	85.1	81.2
External debts/Export G&S	%	130.9	120.9	108.5	96.5	93.1
International reserves/Monthly import G&S	Times	4.8	4.1	3.2	2.8	3.0
International reserves/Short-term external debts	Times	2.1	2.1	1.8	2.0	2.2

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

Ratings

(millions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
Foreign currency long-term issuer rating	BBB+	Positive	-	-	-	-	2019.03.27
Local currency long-term issuer rating	A-	Positive	-	-	-	-	2019.03.27
Japanese Yen Bonds-Sixth Series (2018)	BBB+	-	30,000	0.37	2018.03.22	2021.03.22	2019.03.27

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

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

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