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 exceeding USD 163 billion and a population of about 9.8 million in 2019. Since its economic transition in the early 1990s, the country has pushed economic reforms and proactively introduced foreign direct investments (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.

2. Socio-political condition and economy policy

Since the country's first free election held in 1990, parliamentary democracy has been functioning as exemplified by a multi-party system and frequent change of administration. 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. His administration has been praised for its prompt response to the COVID-19 pandemic, and currently maintains a high approval rating.

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 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. 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 their 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, and adopted its own asylum policies. The EU warned or ruled that these policies are incompatible with its legislation. 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, but its specific operation has not been determined yet. Nonetheless, the country had already established high-level political, social and economic systems in the EU accession process. Economic impact of this issue is likely to 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) has already reached around USD 34,000 in 2019, 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. 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.

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 record low. Both the government debt and the external debt in GDP terms fell 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 foreign direct investment to automobile and other industries. The outstanding balance of FDI (IIP) at the end of 2019 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 92% of real GDP in 2019 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. Its automotive OEM facilities are said to boast one of the highest production efficiencies outside Germany. Hungary is also becoming one of the biggest battery producers amid the growing demand for electric vehicles in European countries.

4. Current economic condition

Hungary's annual real GDP growth rates averaged 4.8% between 2017 and 2019 led mainly by domestic demand, which was relatively high among the EU member countries. The economy kept growing at a high rate in 2019 although the growth rate itself decelerated to 4.6% from 5.4% in 2018 on slower domestic demand. Increased employment, a hike of the minimum wage and tax cuts contributed to expanding consumer spending. Investment continued a strong growth led by private investment, public investment related to EU funds (allocated between 2014 and 2020) and housing investment prompted by a government subsidy scheme. The labor market is tightening as the country attained a full employment in 2019, with the unemployment rate falling to record 3.4% amid a moderately rising inflation.

Following the COVID-19 pandemic in the spring of 2020, the government declared a state of emergency at an early stage and enforced movement restrictions. The state of emergency was lifted in June along with relaxation of the movement restrictions. In the April-June quarter of 2020, the economy contracted 13.6% year-on-year due to the impact of the movement restrictions. After that, a second wave of the pandemic began in late August, but it has almost been contained at the moment. The economy has kept recovering from the sharp fall in the April-June quarter on resumption of economic activity and the implementation of the government's large-scale economic package. Its real GDP shrank 5.5% in the January-September period, which was moderate as compared to the entire EU's 7.0% setback. Given the impact of the second wave, the economy is estimated to have contracted around 6% in 2020 as a whole. JCR expects that the growth rate will recover to around 4% in 2021 and remain in the 3-4% range in the medium term backed by a large inflow of money from the EU fund and its recovery fund as well as the country's strengthened economic base and the effect of the massive economic package.

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 2019, but the lending to nonfinancial companies and households began growing in 2017, registering a double-digit growth rate since 2019 thanks to lower interest rates and the incentive measures adopted by the government and the central bank. Banks reported a record-high profit in 2019 on increased operating income and reduced loan-loss provisions. While securing solid net interest income on the growth of lending despite the lower interest rate environment, banks boosted their operating income on increased non-interest income centering on commissions. They contained their operating expenses and loan-loss provisions at low levels. Their nonperforming loan (NPL) ratio fell to 4.1% (3.5% for private-sector loans overdue for 90 days or more) and their capital adequacy ratio stayed high at 18.4% at the end of 2019.

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, extending it until the end of June 2021. Banks have significantly built up their loan-loss provisions to cover high-risk loans, and have been able to absorb them with pre-provision profits. Their NPL ratio declined further to 3.8% at the end of September 2020, with their capital adequacy ratio kept high at 17.9%. After the expiry of the moratorium, their NPL ratio may go up, requiring an additional buildup of provisions. However, JCR believes that the banks will be able to absorb them with their pre-provision profits.

6. External position

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 below 80% and 50% of GDP, respectively, at the end of 2019, 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 equivalent to 0.2% of GDP in 2019 on increased imports driven by strong domestic demand. But Hungary remained a net lender thanks to continuing inflows of EU funds. Both imports and exports largely declined in 2020, but the current account balance ended with a modest surplus in the January-September period of the year. The foreign currency reserves increased significantly to EUR 32.2 billion until September 2020 amid continued net inflows of foreign direct investment. The balance of gross external debt and net external liabilities at the end of September 2019 decreased from a year earlier. However, gross external debt was estimated to exceed 80% of GDP, due to the sharp contraction of the GDP. Net external liabilities narrowed further in terms of GDP. 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 since 2012 and the ratio in 2019 ended at 2.1%, 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 general government debt (ESA2010) at the end of 2019 stood at 65% of GDP, substantially down from the peak-time 80% in 2011. The debt structure also improved as the government ramped up funding in local currency on the domestic market with a focus on households and banks. The ratios of the government debt owed to nonresidents and foreign currency-denominated debt to the total decreased sharply. Average debt maturities were extended. The government had initially planned to cut its fiscal deficit in GDP terms from 2020 onward. However, the deficit in the year is seen to have widened to around 8% 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 downturn. The total package provided by the government and NBH is worth about 30% of GDP, of which more than a half is financial assistance. To minimize its fiscal impact, the government made budgetary rearrangement, withdrawal of the fiscal reserves and increases in taxes. The general government debt is seen to have risen again to around 80% of GDP at the end of 2020 due to the widening of the fiscal deficit and the sharp contraction of GDP. There has been no major change in the government debt structure, but the average debt maturity has exceeded five years 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 bond in euros and yen. It was the first such bond in yen by a foreign government.

The government plans to promote fiscal consolidation and curb its debt from 2021 onward. In the 2021 budget, the fiscal deficit was initially set at 2.9% of GDP, but it was revised to 6.5% due to additional economic measures necessitated by a second wave of the pandemic and a downward revision of the economic outlook. The ratio of general government debt to GDP is planned to be reduced from the level at the end of 2021. The country's law obliges the government to cut the ratio under its budget when it exceeded 50% of GDP. Given the government's strong commitment backed by legal obligations and its track records, JCR holds that fiscal consolidation will make headway from 2021 onward.

8. Overall assessment and outlook

The ratings are mainly supported by the country’s developed and export-oriented economic structure, strengthened economic base brought by appropriate economic policies, stable banking system and improved public finance. On the other hand, they remain constrained by its relatively large external and government debts in GDP terms. The country’s economy and public finance have deteriorated significantly in 2020 due to the impact of the pandemic and the resultant introduction of a massive economic package. However, the country has become more resilient to shocks as its economic and fiscal bases have been reinforced by the appropriate policies taken in the past. Therefore, JCR holds that an economic recovery and fiscal consolidation will make progress once the impact of the pandemic recedes.

Attainment of herd immunity through vaccination, an early economic recovery and a sustained reduction of the government and external debts in GDP terms will be positive factors for the ratings. In contrast, the ratings will come under downward pressure if the pandemic persists and the government debt further expands in GDP terms due to an additional large-scale economic package.

12038　Hungary

●Selected Economic and Fiscal indicators

		2015	2016	2017	2018	2019
Nominal GDP	USD billion	125.0	128.5	143.0	160.4	163.5
Population	million	9.9	9.8	9.8	9.8	9.8
Per capita GDP(PPP)	USD	26,785	27,909	29,832	32,086	34,503
Real GDP growth rate	%	3.8	2.1	4.3	5.4	4.6
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	%	48.4	45.0	44.1	43.8	43.5
General government expenditures/GDP	%	50.4	46.8	46.5	45.9	45.6
General government balance/GDP	%	-2.0	-1.8	-2.4	-2.1	-2.1
General government debts/GDP	%	75.8	74.9	72.2	69.1	65.4
Current account balance/GDP	%	2.3	4.5	2.0	0.3	-0.2
External debts/GDP	%	105.9	95.5	83.2	79.4	72.4
External debts/Export Goods & Service	%	120.8	110.4	96.8	94.7	88.1
International reserves/Monthly import Goods &Service	Times	4.1	3.2	2.8	3.0	3.0
International reserves/Short-term external debts	Times	2.1	1.8	2.0	2.1	2.2

(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	-	-	-	-	-	2021.02.03
Local Currency Long-term Issuer Rating	A	Stable	-	-	-	-	-	2021.02.03
Japanese Yen Bonds-Sixth Series(2018)	A-	-	30,000	JPY	0.37	2018.03.22	2021.03.22	2021.02.03
Japanese Yen Bonds-Seventh Series(2020)	A-	-	22,700	JPY	0.52	2020.09.18	2023.09.15	2021.02.03
Japanese Yen Bonds-Eighth Series(2020)	A-	-	20,000	JPY	0.74	2020.09.18	2025.09.18	2021.02.03
Japanese Yen Bonds-First Series(2020)(Green Bonds)	A-	-	15,500	JPY	1.03	2020.09.18	2027.09.17	2021.02.03
Japanese Yen Bonds-Second Series(2020)(Green Bonds)	A-	-	4,500	JPY	1.29	2020.09.18	2030.09.18	2021.02.03

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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