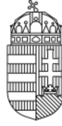


MINISTRY
FOR NATIONAL ECONOMY

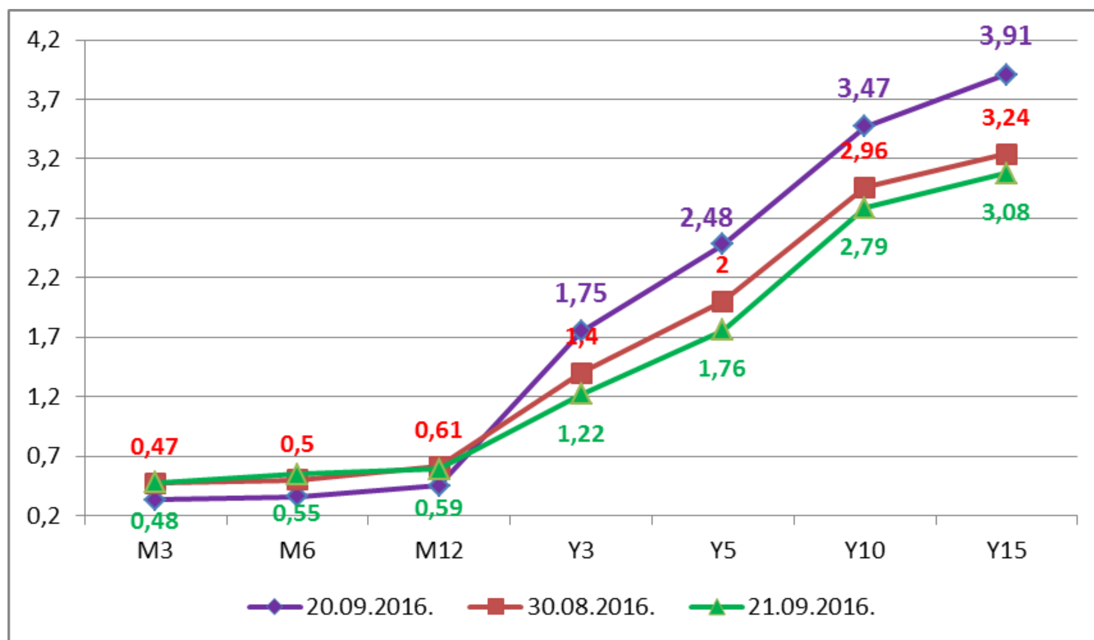
Another major credit rating agency upgraded Hungary's state debt

Following a similar move by Fitch Ratings in May 2016, Standard & Poor's has also restored Hungary's investment grade status. S&P's has raised the country's credit rating from the former BB+ with stable outlook to BBB- again with stable outlook. As analysts had expected no change in the rating, this step has taken markets by surprise and triggered some large movements.

As an article by the Hungarian online financial journal, Portfolio.hu, points out, the improving outlook of the state budget, external exposure and economic growth had been the main factors behind the positive decision. Besides acknowledging encouraging data, the rating agency finds that the National Bank of Hungary (MNB) is set to shift to a less active monetary policy. The fact that Hungary has not registered a current account balance deficit ever since 2009, and in 2015 the country posted a positive balance of 8 percent of GDP is also highlighted by the agency. As a positive factor, S&P's mentions the declining share of forex liabilities within total state debt, and the lower share of non-domestic investors among holders of Hungarian government securities. This trend is mitigating Hungary's vulnerability to external shocks, analysts stress.

S&P is also expecting the introduction of further stimulus measures by the Government and the MNB until 2019. They predict that higher fiscal revenues, stemming from lower interest payments and rising tax receipts, are more likely to be spent on boosting expenditures and cutting taxes than on reducing the fiscal deficit. However, the Government has been strongly committed to maintaining a low fiscal deficit, therefore, this year's deficit figure of some 2 percent of GDP is to remain the same in coming years. A larger-than-expected economic stimulus programme, on the other hand, may jeopardize this fiscal prognosis.

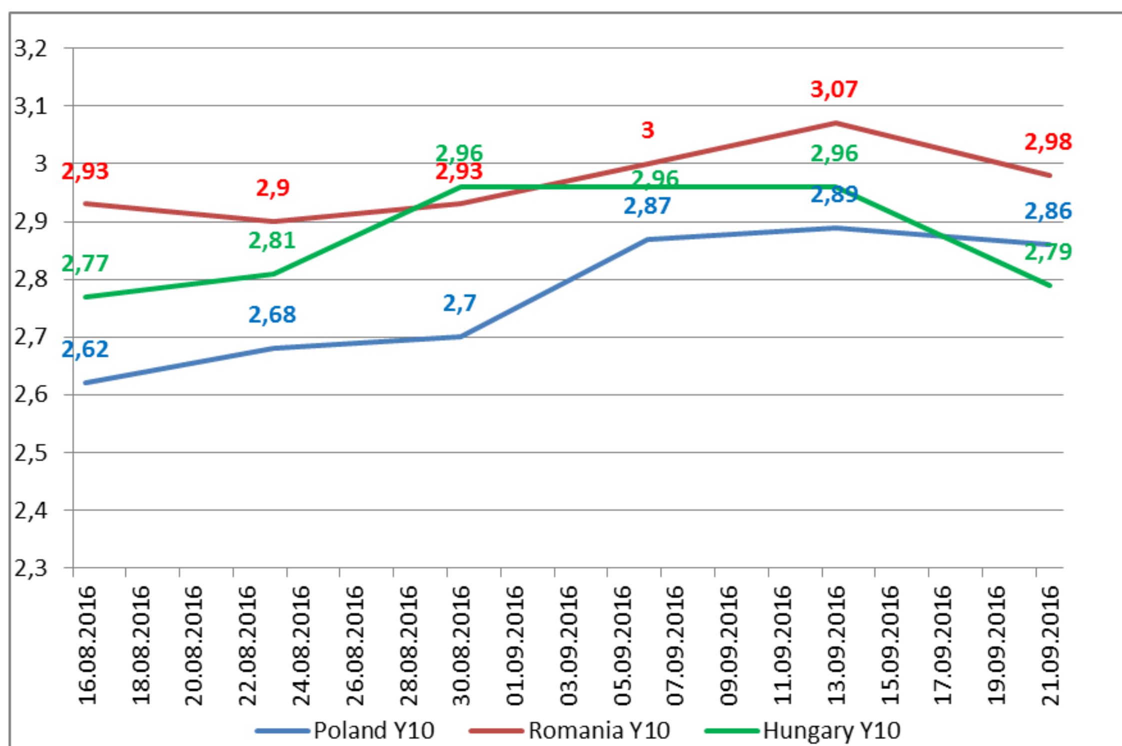
Fig 1: Yield curves of benchmark Hungarian government securities (percent)



Source: Reuters

On the Hungarian government securities market, S&P's decision has accelerated a long-running trend of falling yields: **the yield curve has already flattened in recent weeks, and this has resulted in a more favourable structure in the financing of government debt.** Yields have fallen most markedly regarding bonds with long maturities. As figure 1 shows, **the yield on a key benchmark, the 10-year government bond, edged down from 2.96 percent to 2.79 percent, by 16 basis points, over the past three weeks, while it dropped by 68 basis points year-on-year.** The improvement in debt ratings is expected to generate rising demand for certain Hungarian assets, and thus the costs of the financing of state debt may decline, the forint may strengthen and stock prices may rise. JPMorgan said the rating upgrade could bring flows of USD 1-1.5bn to the bond market.

Fig 2: Yields on 10-year government bonds of Poland, Romania and Hungary (percent)

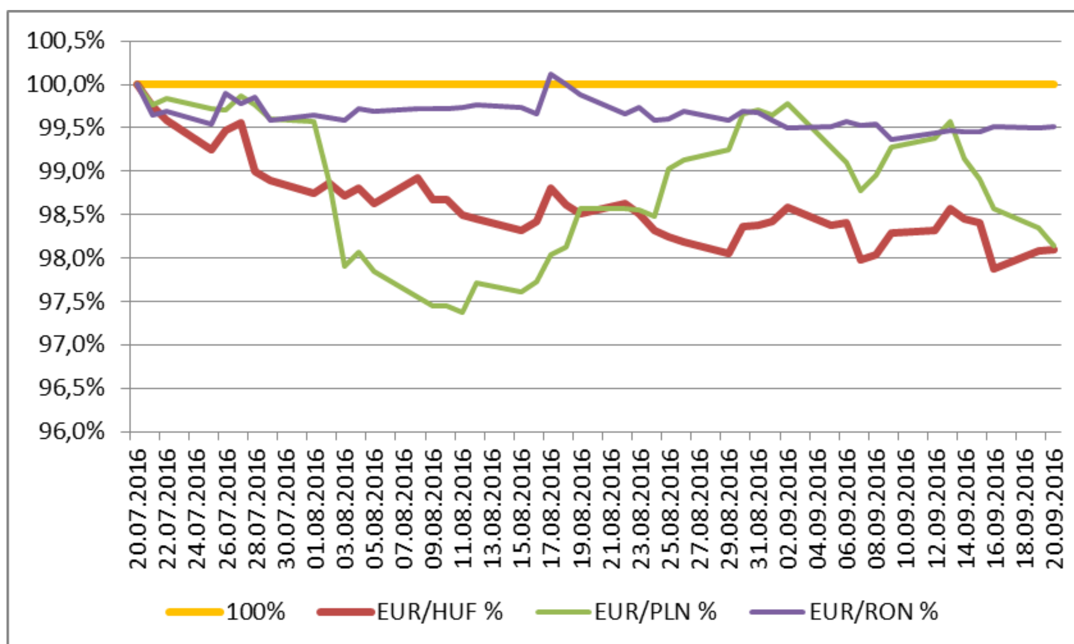


Source: Reuters, Investing.com

In figure 2, yields on the 10-year government bonds of Poland and Romania, the countries that have currencies other than the EUR among our neighbours, had been similar to Hungary's. **In the last couple of days, Hungary's yield on this benchmark has fallen even below those of Poland and Romania.** While the yield on the 10-year bond of Poland displays a rising trend, financing conditions for Hungary's government debt have been improving steadily. Provided the country is not affected by some unforeseeable external shock, improving debt ratings are expected to bring yields further down.

Fig 3: Change in Euro exchange rates of regional currencies (percent),

20.07.2016=100 percent



Source: Reuters

Figure 3 shows changes in the exchange rates of Hungarian, Polish and Romanian national currencies in comparison to the level seen two months ago. **In this period, the forint and zloty have both gained 2 percent against the euro**, but the Hungarian currency's relative volatility was well below that of the Polish one. The currency of Romania was even more stable, without any large swing. **S&P's decision is expected to underpin the forint's steady performance, and in case the country regains its investment-grade status at all the three major rating agencies, processes on the financial markets are anticipated to improve further.**

As the S&P's report emphasises, a larger-than-expected fall in the country's government debt-to-GDP ratio and subsequently lower interest payments would be the factors that could result in a further upgrade. On the other hand, the slackening of fiscal rigour, a potential reversal in the government debt trend or the arising of major external risks might lead to a downgrade. Among other risk factors, the credit rating agency mentions deteriorating transparency, especially if it carries some financing risks.