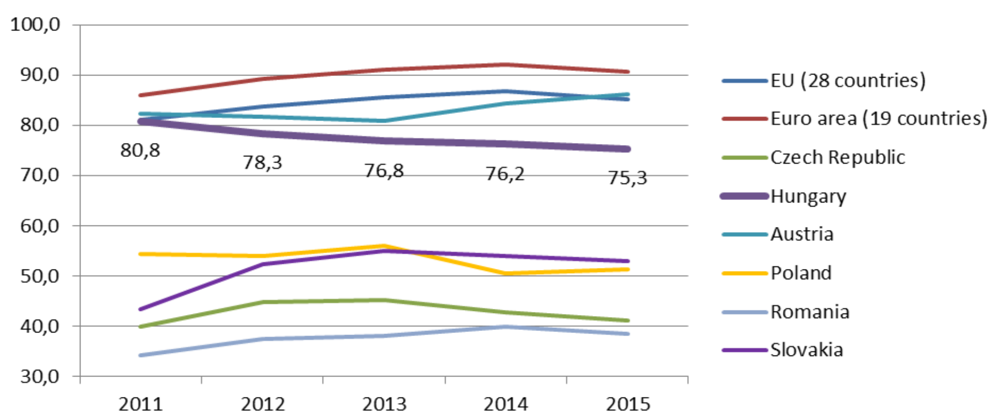
MINISTRY
FOR NATIONAL ECONOMY

Hungary back in investment-grade category

Following an upgrade by Fitch Ratings in May 2016 and by Standard&Poor's in September 2016, Moody's Investors Service also revised upward Hungary's state debt status on 4 November 2016. Thus, after five years in "junk" category, Hungary has been elevated to investment grade by all the three leading international credit rating agencies. Moody's revised the former Ba1 rating to Baa3, with stable outlook. In light of data released in recent months, analysts had anticipated and welcomed this positive decision, and their expectations are also upbeat concerning the future.

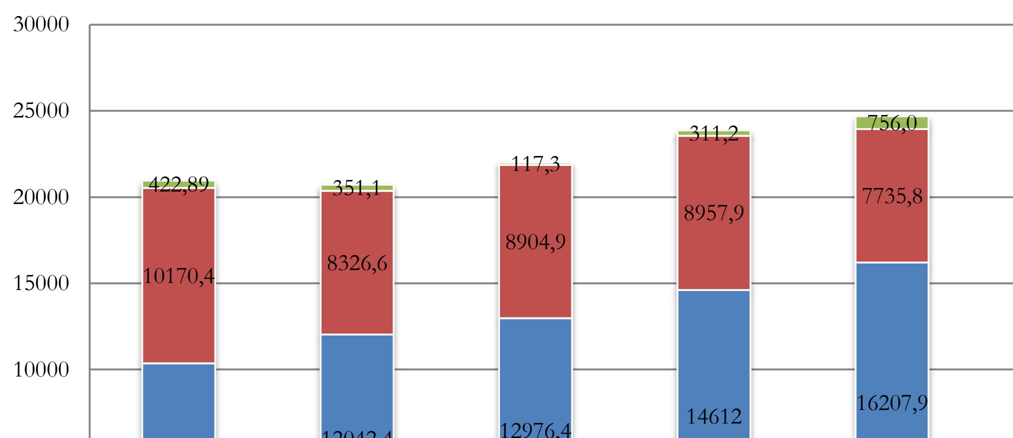
Hungary's upgrade mainly reflects stable public finances and an upward real economic growth path. One of the major achievements was the realization of the objectives laid down in Hungary's Convergence Programme: the general government debt-to-GDP ratio has been declining and the share of forex debt within the total debt volume has been reduced significantly. Structural measures comprise the second group of positive factors, which are expected to massively contribute to the 2-2.5 percent annual economic growth rates anticipated in coming years. The third determinant was the impressive improvement in Hungary's exposure to external, global shocks. As a result of these factors, the risks and costs of the financing of public administration and debt have become lower, while the economy is expected to remain sound.

Fig. 1.: General government gross deb-to-GDP ratio



Source: Eurostat

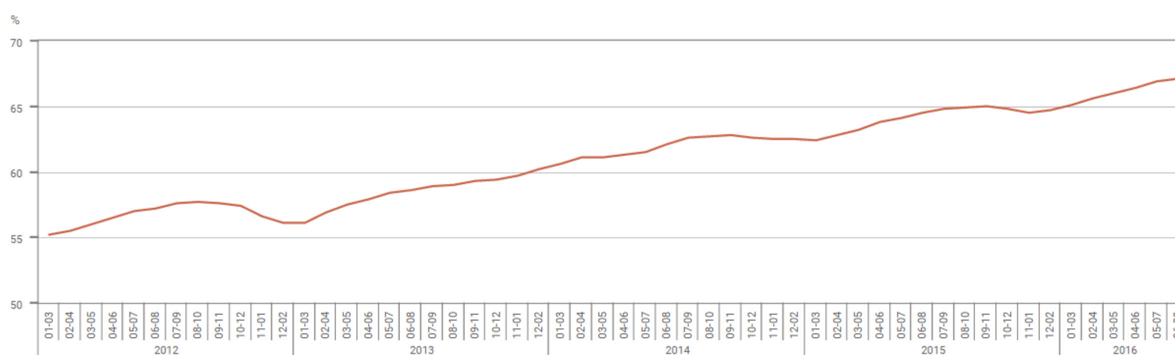
Fig. 2.:Volume of forint and forex debt within total general government debt (bn HUF)



Source: Hungarian Government Debt Management Agency (ÁKK)

Moody's analysts are predicting that **Hungary's general government debt-to-GDP ratio is set to decline from a peak of 81 percent in 2011 to 72 percent next year**. This ratio has been on a descending path since 2011 (fig.1.). In addition, as **the share of forex debt has also been falling** within the total volume of debt (fig.2.), Hungary is in a more favourable position than the majority of countries with the same (Baa) ranking.

Fig. 3.: Employment *(in the age group 15-64 years; 3-month moving average)*



Source: Hungarian Central Statistical Office (KSH)

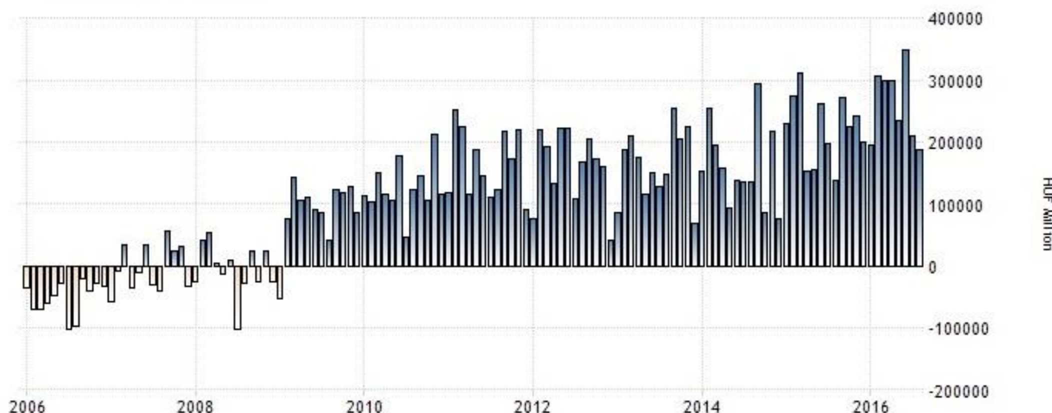
The credit rating agency is optimistic with regard to the performance of the Hungarian economy in coming years. Hungary's economic growth may gain additional impetus in the next five years from EU funds, as these are the equivalent of 3 percent of the country's GDP, one of the highest figures in the region. In their rationale, the agency highlighted among the Government's

economic measures the positive impact of public work programmes on the labour market. **The employment rate of those aged 15-64 years rose to 67.1 percent in Q3 2016,** from 55 percent at the beginning of 2012. Thus, Hungary has reached the average of developed countries (fig.3.).

Moody's third major argument for the upgrade was the fact that Hungary's exposure to external risks has been significantly reduced. **Hungary does not need external financing and the country's trade balance has not slipped into the red since 2009**: actually, the sector has been posting ever larger surpluses (fig.4.).

The credit rating agency is predicting further improvement in the country's resilience for the next years, as current account surpluses are to offset the country's potentially negative or deteriorating international investment status in the future.

Fig. 4.: Hungary's balance of trade



Source: www.tradingeconomics.com and KSH

Moody's also recommended the introduction of further economic policy measures in the field of investment and the potential to attract capital. Hungary is lagging behind regional peers on the World Economic Forum Global Competitiveness Index: this implies that institutional reforms and a purposeful economic development policy are required to boost economic efficiency. Moody's is expecting the bank tax, levied on credit institutions, to be lowered and measures potentially reducing bank profitability to be avoided -- in accordance with the Memorandum of Understanding concluded with the European Bank for Reconstruction and Development. This will improve investor sentiment.

Analysts believe that a further upgrade could be warranted by continuing economic expansion, improving indicators concerning public finances and a faster-than-anticipated fall in the state debt ratio.

The Hungarian Government could increase the odds for an upgrade, Moody's suggests, by implementing pro-investment structural reforms. The country may risk a downgrade in case – due to some Government measures – the descending state debt path is reversed and a weakening growth outlook darkens the debt outlook.