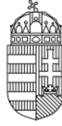


MINISTRY
FOR NATIONAL ECONOMY

Favourable macro-economic data prompt Fitch to upgrade Hungary's government debt

Fitch Ratings, one of the "big three" credit rating agencies, has restored the investment-grade rating of Hungarian government bonds. The key determinant behind the agency's decision was Hungary's current account surplus, but other factors, such as the forint conversion of forex loans, the self-financing programme of the National Bank of Hungary (MNB), the steady flow of EU funding as well as the diminishing stock of banks' external debt also played a major role in the positive decision and in reducing the exposure of the country and the financial sector to external risks. The upgrade also proves that the Government-led economic restructuring since 2010 has been a success: the economy has recently seen modest but steady growth.

Fitch Ratings published its latest rating report for Hungary on 19 May 2016, in which the country's rating of "BB+" was revised to "BBB minus with stable outlook". Among positive factors that had motivated the new debt rating, the agency listed current account surpluses, the forint conversion of forex loans and the self-financing programme of Hungary's central bank. In addition, Fitch highlighted the fact that Hungary's data on net external debt show a declining trend, and the indicator fell from 73 percent in 2012 to 48 percent by Q3 2015. Domestic resources (those by banks and households) have been representing an ever higher share in debt financing, and fiscal processes have also been improving, as the budget deficit could be kept below 3 percent of GDP in recent years. Fitch Ratings predict a fiscal deficit of 2 percent for this year and 2.5 percent for next.

For the majority of analysts, the upgrade did not come as a surprise. They had long expected it, thanks partly to the prior decision one year ago that had signalled a probable upgrade. The performance of the Hungarian economy in recent years had also foretold a positive decision, especially given the fact that country risk indicators, such as Credit Default Swaps and government bond yields, had been on the level of countries in investment-grade category.

The upgrade is anticipated to have several positive effects on the Hungarian economy: bond yields are likely to fall, the re-financing of maturing debt becomes cheaper and the accelerating flow of FDI may fuel turnover on the stock market.

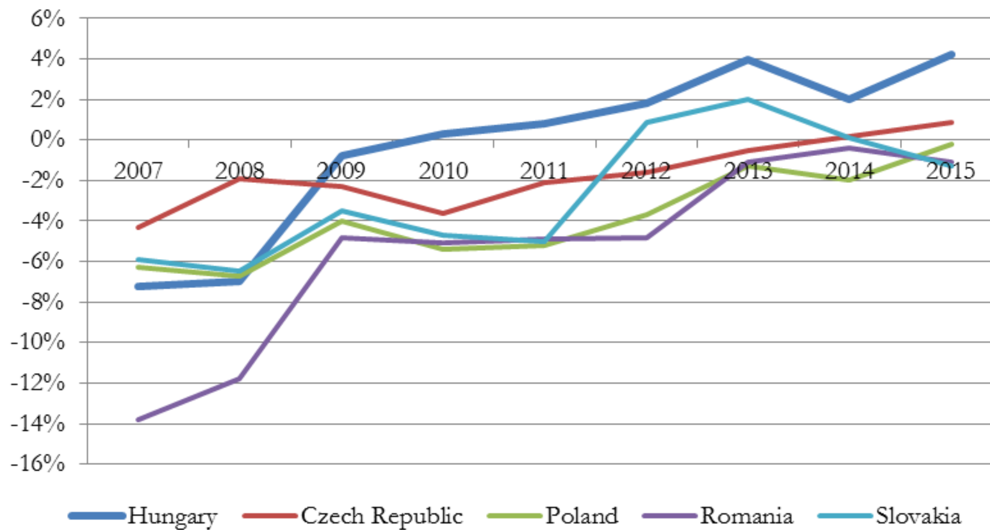
A major issue analysed by the report was fiscal loosening, regarding which Fitch was highly upbeat -- although in their opinion Hungary will be incapable of reducing the structural deficit to 1.5 percent of GDP, one of the commitments Hungary had assumed within the EU, by 2019 -- despite the fact that the Government will use rising tax revenues to boost economic growth and cut taxes.

Favourable macro-economic data

The MNB's semi-annual Financial Stability Report confirms that Hungary's growth path is sound and steady, and it is less and less exposed to external risks. Last year, the economy posted growth of 2.9 percent, and growth components have been balanced. Analysts are prognosticating that the economy is set to expand by 2.8 percent this year and 3.0 percent next year.

Hungary's external balance indicators improved further in 2015. As data of the below chart show, last year the annualized surplus of the current account exceeded 4 percent of GDP, and Hungary's current account has been posting the largest surpluses since 2009. As a result of rising EU transfers, the capital account surplus has almost reached 5 percent of GDP. The recent external financing capacity figure of more than 9 percent is outstanding even from a regional perspective. Thanks to soaring exports stemming from industrial demand and subsequent output growth, the current account has been in the green since 2010. However, for 2015, analysts are expecting a lower surplus, due to rising imports driven by domestic demand growth.

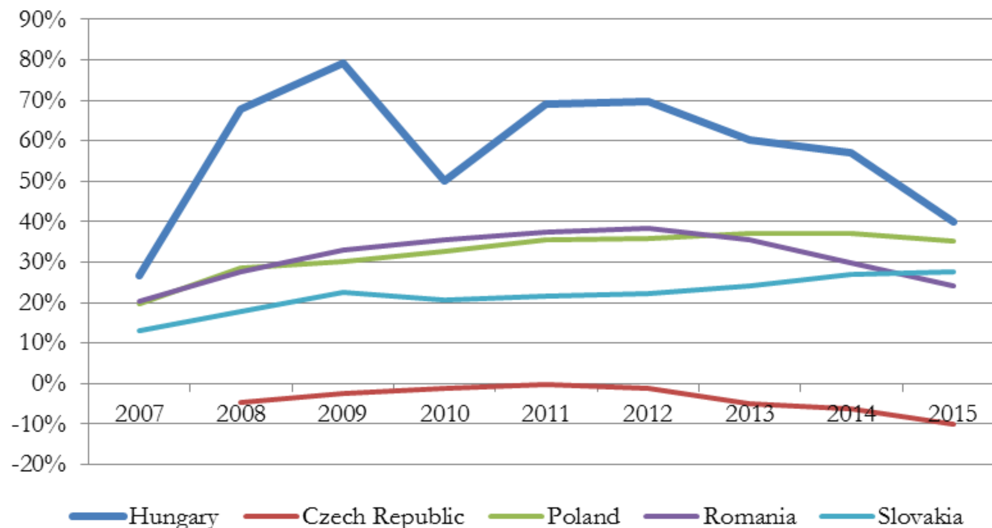
Current account of V4 countries and Romania, % of GDP (2007-2015)



Source: Eurostat

The drop in the liabilities of domestic banks and enterprises vis-á-vis foreign entities as well as the lower net amount of external debt have been instrumental in reducing the vulnerability of the Hungarian economy to external shocks. The rising stock of forint-denominated government securities has increasingly improved conditions for the servicing of government debt and, accordingly, alleviated the country's external exposure. Hungary's net external government debt-to-GDP ratio has been edging down in recent years (since 2012). The latest data show that this indicator is close to the regional average (see below chart). This is mainly attributable to the diminishing volume of debt held by non-residents, but nominal GDP growth has also been a contributing factor. This has led to a debt structure that increasingly resembles that of regional countries.

Net external debt of V4 countries and Romania, % of GDP (2007-2015)



Source: Eurostat

Household consumption has soared last year, driven primarily by dynamic real wage growth, but favourable job growth and low inflation have also contributed to the increase. Public consumption has also added to overall consumption growth, through in-kind benefits and EU funding. Net exports have also fuelled growth, as a result – among others – of lower oil prices. In the opinion of analysts, household consumption and net exports will continue to be pivotal in GDP growth; nonetheless, these factors are seen to have a limited impact this year.

Data regarding the MNB self-financing programme launched in 2014, which was also mentioned as a pro-upgrade argument, have been similarly encouraging. Since the onset, the stock of government securities held by banks has risen to HUF 2 396bn. This has boosted liquidity within the entire banking sector.

Future expectations

Based on favourable external environment and growing domestic demand, the credit rating agency predicts GDP growth of 2.1 percent for 2015 and 2.5 percent for 2017. Consumption growth is seen to be underpinned by further improvement in the unemployment rate, benign inflation and the increasing value of households' wealth.

Fitch also lists factors which it believes will determine a future rating decision. These include a further drop in external debt (resulting from current account surpluses), the reduction of the government debt-to-GDP ratio in a sustainable manner and the acceleration of economic growth due to an improved business environment. On the other hand, the agency also mentions negative factors, for example the potential increase of the government debt-to-GDP ratio, deteriorating economic policy conditions and their ripple effects.

Hungary requires at least one more upgrade by another one of the “big three” to see more institutional investors on the Hungarian government bond market and thus the improvement of debt servicing conditions. Following this step by Fitch, however, the country stands a good chance that either Moody’s or Standard&Poor’s will step forward with a positive decision.