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# Hungary

## November 2019

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| SOVEREIGN RATING | Initial rating | Review |
|---|---|---|
| Date of Rating Committee: | 21.05.2019 | 14.11.2019 |
| Date of rating publication: | 24.05.2019 | 15.11.2019 |
| Long-term rating: | BBB+ (ns) | BBB+ (ns) |
| Outlook: | Stable | Stable |
| Short-term rating: | A-2 (ns) | A-2 (ns) |

● (ns) – not solicited rating

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**"BCRA - CREDIT RATING AGENCY" AD rates Hungary with unsolicited sovereign long-term rating BBB+ (ns) and short-term rating A-2 (ns) with stable outlook.**

**BCRA's officially adopted Sovereign Rating Methodology has been applied (https://www.bcra-bg.com/files/Sovereign_Methodology_2019_en.pdf ).**

The report has been prepared and the rating – assigned, based on public information, made available by the Hungarian National Bank, the Hungarian Central Statistical Office, the Ministry of Finance, the Government Debt Management Agency, the World Bank, the International Monetary Fund, the European Commission, BCRA's database etc. BCRA uses sources of information, which it considers reliable, however it cannot guarantee the accuracy, adequacy and completeness of the information used.

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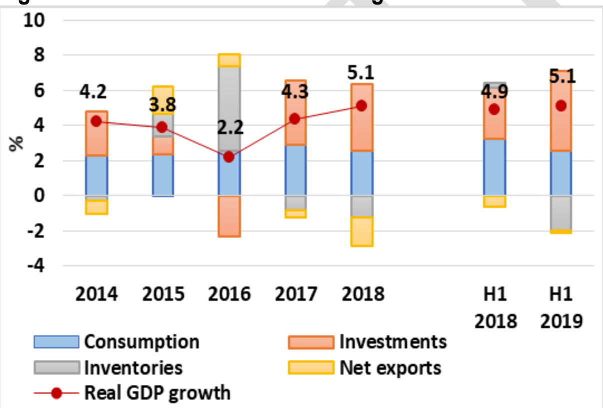
## Overview

National-conservative party Fidesz (Hungarian Civic Union), led by Viktor Orbán, has dominated Hungarian **politics** since 2010. Fidesz has the support of the small KDNP (Christian Democratic People's Party) as a coalition partner. In 2019, Orbán serves as a Prime minister for the fourth (and third in a row) time for the 2018-2022 mandate. Ruling coalition got election majority at both 2019 votes - for EP in May and for local authorities in October, even though the opposition won in some major cities including Budapest.

Relationships between Hungarian Prime Minister and Brussels remain strained. In relation to Hungarian restrictive migrant policy, Prime Minister Viktor Orbán has led eastern European opposition to EU quotas that aim to distribute asylum seekers around the bloc since 2015. In September 2018, The European Parliament voted to trigger Article 7 disciplinary procedures against Hungary for under-mining democratic rules including criminalization of assistance to asylum seekers. In September 2019, the preliminary hearing into the allegations was held as the first step the in the EU's rule of law mechanism. However, the suspension of Hungary's voting rights requires a unanimous vote from the European Council — a move that is likely to be blocked by Poland.

**Figure 1: Contributions to real GDP growth: 2014 - H1 2019**

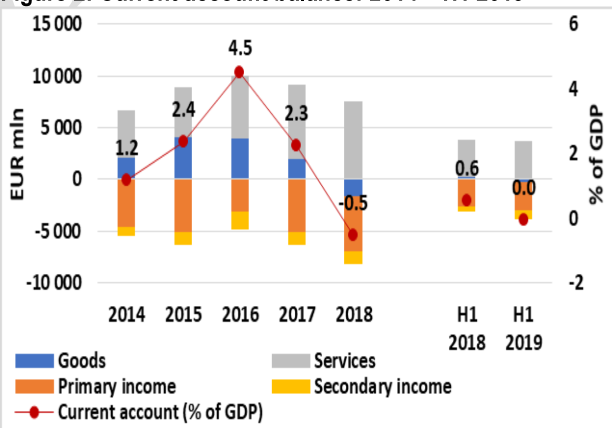



Source: HCSO

Following the strong expansion in 2018, the Hungarian **economy** grew by 5.1% in the first half of 2019 - being among the best performers in the EU. Domestic demand was the growth driver on the expenditure side of GDP, while net exports had a negative contribution. The upswing in consumption continued, albeit at a somehow slower pace. Supported by rapid wage increase and employment gains, the household consumption annually picked up by 4.8% in the first half of 2019 (5% in H1 2018). Concurrently, the favourable financing environment, as well as EU funding, bolster investment activity in the country. As a result, fixed investment growth further accelerated to 20.6% y-o-y (14.3% in H1 2018), providing the largest positive contribution to the economic expansion in the first half of 2019. Both exports and imports decelerated, however, imports grew at a higher rate (5.5%) than exports (5%), thus, net exports dragged down the GDP growth.

On the production side, **gross value added** (GVA) picked up by 5.2% y-o-y in H1 2019, supported by favourable developments in almost all economic activities. Services expanded by 4% in total with the strongest contribution of trade services. Industry rebounded as the industrial production rose by 5% in real terms, mainly backed by the strong performance of the automotive sector. Output volume growth of the construction sector significantly accelerated to 34.4%. On the other hand, the contribution of agricultural sector was slightly negative.

**Figure 2: Current account balance: 2014 – H1 2019**




Source: MNB

In 2018, the **current account** balance turned negative (-0.5% of GDP) for a first time since 2009 as the pickup in the domestic demand contributed to a rapid growth of imports. However, the deficit was more than fully financed by a strong FDI inflow in the amount of 5.3% of GDP. The negative current account balance accumulated in the first half of 2019 amounted to EUR 65 mln, compared to a surplus of EUR 728 mln recorded in the same prior-year period. The deterioration once again was related mainly to the trade balance, which posted a

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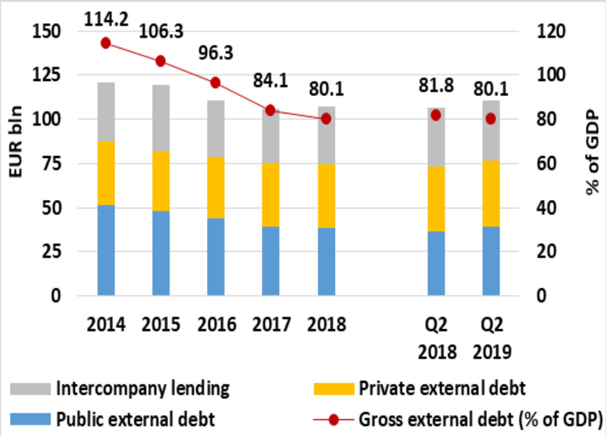
deficit of EUR 306 mln. Also, the primary income deficit and the secondary income deficit increased, while only the higher surplus on net services trade somehow limited the overall contraction.

**Figure 3: Gross external debt: 2014 – Q2 2019**




Source: MNB

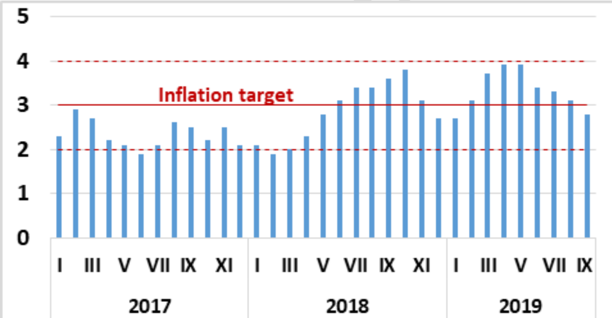
Due to the persistently favourable net lending position, country's external vulnerabilities have been strongly reduced over the past few years. Hungary's **gross external debt** (excluding SPEs) declined to 80.1% of GDP in Q2 2019, whereas Intercompany lending accounted for almost one-third (31%) of total external debt liabilities. The maturity profile also has improved, with the share of short-term external debt dropping to 11.4%. In parallel, the adequacy of **international reserves** increased, as their coverage of short-term debt reached 213.6% in June 2019.

In line with both the expansion in external assets and the decrease in debt liabilities, **net external debt** fell to 8.8% of GDP at the end of June 2019, while country's net international investment position improved to -52.9% of GDP.

The real sector expansion has transmitted into economic activity benefits - both record low unemployment and high employment resulted in activity rate of 62.9% in Q2 2019 (0.5pp. higher than in Q2 2018). **Unemployment rate** in Hungary shrank to barely 3.3% as of Q2 2019 (3.6% a year earlier), a fifth of which, however, comes from the lowest age group (15-24 y.o.).

Labour incomes continued to grow robustly over the first half of 2019 - by 10.6% in nominal terms (11.3% for 2018). The steeper hikes have been visible since the adoption of the six-year wage agreement complemented by overall tightening of the market and well-performing economy. Analogously, national income measured by **GDP per capita** pertained its positive dynamics. According to Eurostat data, Hungarian GDP per capita in euro (market prices) reached EUR 3 650 or 46.0% of the EU average in the Q2 2019.

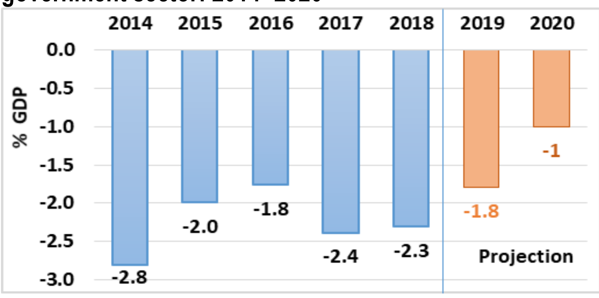
**Figure 4: Annual CPI inflation: 2017 – IX 2019**




Source: HCSO

Consumer prices annually increased by 3.3% on average in January–September 2019, driven by food and services price dynamics. After peaking to 3.9% in May 2019, annual **inflation** has eased to 2.8% in September 2019, but is expected to rise again towards year-end due to base effects in fuel prices. Afterwards, inflation is likely to stabilise at the inflation target level of 3%.

**Figure 5: Actual and projected ESA balance of the general government sector: 2014 -2020**




Source: Eurostat; Ministry of Finance

Rising budget revenues, driven by solid economic performance, have underpinned the stability of **public finances**, which provided room for a fiscal relaxation. Several tax cuts were implemented in the last two years, but their fiscal impact was largely offset by the increase in tax base derived from the dynamic rise of earnings and the expansion of consumption. Regarding the spending programs, key elements in 2017-2018 were the implementation of large-scale investment projects, the career path models in the public sector, as well

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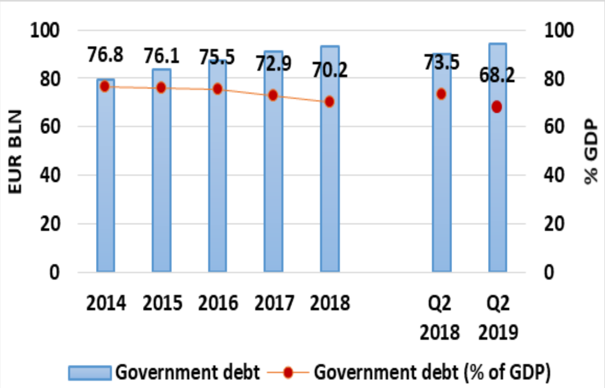
as the additional budgetary costs of the housing support scheme. At the same time, lower interest and social expenditures provided a substantial deficit-moderating effect.

The budget bill for 2019 targets a general government deficit in the amount of 1.8% of GDP, which would represent a 0.5 pp. decrease compared to the deficit recorded in 2018. The government plans a further tightening of the fiscal stance in the next year with a projected budget deficit of only 1% of GDP. The medium-term fiscal targets would primarily be implemented by cutting expenditures, while the announced tax cuts would be compensated by broadening in the tax base and improving collection.

**Figure 6: General government gross debt: 2014 – Q2 2019**

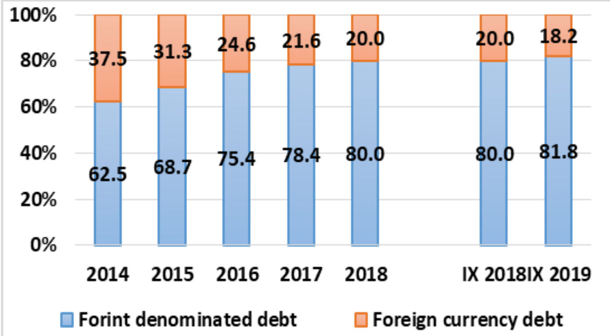



Source: Eurostat

At the end of June 2019, the general government gross debt amounted to EUR 94 071 mln or 68.2% of GDP. Compared to the end of 2018, debt level increased by EUR 759 mln in nominal terms, while its proportion in country's GDP decreased by 2 pp., thanks to the higher economic growth. Although on a sustained downward trajectory, **government debt**-to-GDP ratio still represents a source of vulnerability, as it exceeds the 60% threshold set by the Maastricht Treaty and is substantially higher than the values observed in regional peers.

However, the risks are partly mitigated by the continued improvement in the debt structure. In line with the negative net FX issuance, the share of foreign currency debt in central government debt further decreased from 20% at the end of 2018 to 18.2% in September 2019, contributing to a decrease in the external vulnerability of the economy.

**Figure 7: Currency structure of CG debt: 2014 – IX 2019**




Source: Government Debt Management Agency

The 10-year Hungarian government bond yield declined from round 10% at the end of 2011 to a historical low of 1.83% in August 2019. Similarly, the primary market and auction yields largely followed the secondary market trends.

After some troublesome periods, Hungarian **banking system** get back on track (2016-2018). The volatilities in size of assets and profitability are currently reduced along with an increase in attracted deposits and accelerating credit growth in the last three years. These trends have been generally preserved over the first half of 2019 with Hungarian forint being the preferred currency by the non-financial sector (NFS).

Dynamic increment in granted loans to NFS remained, boosted by the low interest rates, large investment projects as well as government-supported special credit schemes. Regarding trends in lending MNB stated that overheating could not be detected. Concurrently, NPL ratio has been on a steady downward path with continuous decrease in non-performing amounts. From previously high proportion of credit, the NPLs shrank two-fold for the last three years reaching to 5.4% in 2018 and 4.9% as of end-June 2019.

Banks remained profitable on average in H1 2019 albeit at lower rates on an annual basis, and the main prudential indicators concerning solvency and liquidity of the system have been broadly adequate. Banking sector has been still consolidating with prevalent domestic ownership.

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**Outlook:**

The **stable** outlook of the Sovereign Rating of Hungary reflects the BCRA's opinion that risks are broadly balanced. Hungary's credit rating is supported by its robust economic growth and strong reduction in external vulnerabilities. On the other hand, some institutional shortcomings and the still elevated public debt level represent key credit rating constraints.

**Positive** pressures on the Sovereign Rating and/or the Outlook would be considered:

- Stronger fiscal results, lowering the public debt burden at a faster pace;
- Sustained external debt reduction;
- Faster income convergence with EU averages;

**Negative** pressures on the Sovereign Rating and/or the Outlook may arise in case of:

- Fiscal consolidation reversal;
- Escalating conflicts with the EU institutions;
- Strong capital outflows related to sudden shift in investors' sentiments;

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## Regulatory announcements

### Rating initiative

*This is an unsolicited sovereign rating. Neither the rated entity, nor a related third party has participated in the credit rating process. BCRA did not have access to the accounts, management and other relevant internal documents for the rated entity or a related third party.*

Please, visit www.bcra-bg.com to review BCRA's full policy on unsolicited credit/sovereign ratings.

### Clarifying Notes:

There may be some differences in the stated values and changes in the analysed indicators due to the conversion of those values in another currency (namely in EUR). The used exchange rate is the publically announced by the Hungarian National Bank as the average value for the corresponding period (i.e. yearly, quarterly and monthly). There may also be some differences stemming from using average values for the period rather than end-period values. The cited growth rates in the current report are based on changes in national currency, with the exception of data recorded in EUR (i.e. Balance of payments, External debt, Net international investment position). The data on which the current report is based includes the public data available until November 2019.

### Summary of the minutes of the Rating Committee:

On the 14st of November 2019, Rating Committee of BCRA – CREDIT RATING AGECY (BCRA) had a session, on which the **Report regarding the affirmation of an unsolicited initial sovereign rating of Hungary** was discussed.

The members of the Rating Committee discussed the grades of numerous credit rating factors included in the **Rating Model** and analysed in the **Credit Rating Report** according to the **Sovereign Rating Methodology**.

The members of the Committee reviewed the key political events and macroeconomic developments in the country. The economic growth remained high and supported by robust consumption and investment as well as by buoyant labour market, which was positively assessed. Dynamics of external sector indicators as well as fiscal performance and budget execution as of mid-2019 were viewed.

The sovereign rating and the related outlook have been determined based on the above discussion.

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# Tables:

| Country | Development classification |
|---|---|
| Hungary | Emerging and Developing Europe (IMF classification) |

| MAIN MACROECONOMIC INDICATORS | | | | | | | |
|---|---|---|---|---|---|---|---|
| | H1 2019 | H1 2018 | 2018 | 2017 | 2016 | 2015 | 2014 |
| Gross domestic product (EUR mln) | 67 624 | 62 893 | 133 791 | 125 595 | 115 252 | 112 247 | 105 923 |
| Final consumption | 47 163 | 44 723 | 91 513 | 87 744 | 80 601 | 77 126 | 74 373 |
| Gross capital formation | 17 026 | 14 283 | 36 425 | 28 697 | 24 569 | 26 155 | 24 828 |
| Net exports of goods and services | 3 435 | 3 887 | 5 852 | 9 154 | 10 082 | 8 966 | 6 722 |
| Exports of goods and services | 59 434 | 56 764 | 113 640 | 109 447 | 100 444 | 98 754 | 92 596 |
| Imports of goods and services | 55 998 | 52 877 | 107 788 | 100 293 | 90 362 | 89 788 | 85 874 |
| Real GDP growth (% change) | 5.1 | 4.9 | 5.1 | 4.3 | 2.2 | 3.8 | 4.2 |
| GDP per capita[1] (EUR) | 6 920 | 6 430 | 13 690 | 12 830 | 11 740 | 11 400 | 10 730 |
| Unemployment rate[2], (%) | 3.4 | 3.7 | 3.7 | 4.2 | 5.1 | 6.8 | 7.7 |
| Average net monthly earnings | 746 | 687 | 688 | 639 | 562 | 524 | 504 |
| CPI - annual average (% change) | 3.5 | 2.3 | 2.8 | 2.4 | 0.4 | -0.1 | -0.2 |
| HUF/EUR, annual average | 320.5 | 314.0 | 318.9 | 309.2 | 311.5 | 309.9 | 308.7 |
| HUF/USD, annual average | 283.7 | 259.5 | 270.3 | 274.3 | 281.4 | 279.5 | 232.5 |
| EXTERNAL SECTOR[3] | | | | | | | |
| EUR mln | H1 2019 | H1 2018 | 2018 | 2017 | 2016 | 2015 | 2014 |
| Current account | -65 | 728 | -717 | 2 830 | 5 209 | 2 648 | 1 260 |
| Goods | -306 | 253 | -1 654 | 1 909 | 3 958 | 4 052 | 2 125 |
| Services | 3 739 | 3 625 | 7 525 | 7 244 | 6 126 | 4 907 | 4 587 |
| Primary income | -2 726 | -2 589 | -5 293 | -5 131 | -3 131 | -5 131 | -4 625 |
| Secondary income | -773 | -560 | -1 295 | -1 192 | -1 744 | -1 180 | -827 |
| Capital account | 1 791 | 1 486 | 3 459 | 1 075 | -21 | 5 160 | 3 908 |
| Gross external debt | 110 907 | 106 395 | 107 218 | 105 583 | 110 940 | 119 339 | 120 968 |
| Net external debt | 12 175 | 13 397 | 11 804 | 16 372 | 26 886 | 22 002 | 46 927 |
| International reserves | 27 065 | 24 061 | 27 403 | 23 368 | 24 384 | 30 322 | 34 578 |
| International investment position | -73 235 | -69 617 | -74 077 | -76 675 | -79 411 | -74 980 | -83 885 |
| % of GDP[4] | | | | | | | |
| Current account | 0.0 | 0.6 | -0.5 | 2.3 | 4.5 | 2.4 | 1.2 |
| Goods | -0.2 | 0.2 | -1.2 | 1.5 | 3.4 | 3.6 | 2.0 |
| Services | 2.7 | 2.8 | 5.6 | 5.8 | 5.3 | 4.4 | 4.3 |
| Primary income | -2.0 | -2.0 | -4.0 | -4.1 | -2.7 | -4.6 | -4.4 |
| Secondary income | -0.6 | -0.4 | -1.0 | -0.9 | -1.5 | -1.1 | -0.8 |
| Capital account | 1.3 | 1.1 | 2.6 | 0.9 | 0.0 | 4.6 | 3.7 |
| Gross external debt | 80.1 | 81.8 | 80.1 | 84.1 | 96.3 | 106.3 | 114.2 |
| Net external debt | 8.8 | 10.3 | 8.8 | 13.0 | 23.3 | 19.6 | 44.3 |
| International reserves | 19.6 | 18.5 | 20.5 | 18.6 | 21.2 | 27.0 | 32.6 |
| International investment position | -52.9 | -53.5 | -55.4 | -61.0 | -68.9 | -66.8 | -79.2 |

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| PUBLIC FINANCE[5] | | | | | | | |
|---|---|---|---|---|---|---|---|
| EUR mln | H1 2019 | H1 2018 | 2018 | 2017 | 2016 | 2015 | 2014 |
| General government revenues | 30 705 | 28 563 | 59 352 | 56 008 | 52 360 | 54 603 | 50 312 |
| General government expenditures | 29 788 | 29 310 | 62 415 | 58 999 | 54 394 | 56 814 | 53 229 |
| Interest expenditures | 1 627 | 1 569 | 3 199 | 3 365 | 3 590 | 3 880 | 4 211 |
| Budget balance | 917 | -747 | -3 062 | -2 991 | -2 033 | -2 211 | -2 917 |
| Primary budget balance | 2 544 | 822 | 137 | 374 | 1 556 | 1 669 | 1 294 |
| General government gross debt | 94 071 | 90 250 | 93 312 | 91 204 | 87 441 | 83 815 | 79 565 |
| % of GDP | | | | | | | |
| General government revenues | 22.2 | 22.0 | 44.7 | 44.7 | 45.4 | 49.2 | 48.5 |
| General government expenditures | 21.5 | 22.5 | 47.0 | 47.1 | 47.1 | 51.1 | 51.3 |
| Interest expenditures | 1.2 | 1.2 | 2.4 | 2.7 | 3.1 | 3.5 | 4.1 |
| Budget balance | 0.7 | -0.6 | -2.3 | -2.4 | -1.8 | -2.0 | -2.8 |
| Primary budget balance | 1.8 | 0.6 | 0.1 | 0.3 | 1.3 | 1.5 | 1.2 |
| General government gross debt | 68.2 | 73.5 | 70.2 | 72.9 | 75.5 | 76.1 | 76.8 |

| BANKING SYSTEM[6] | | | | | | |
|---|---|---|---|---|---|---|
| EUR million | Q2 2019 | Q2 2018 | 2018 | 2017 | 2016 | 2015 |
| Total assets | 137 052 | 126 264 | 130 988 | 125 529 | 114 923 | 108 819 |
| Deposits (total economy) | 108 884 | 101 694 | 104 954 | 100 973 | 92 359 | 86 999 |
| Loans (total economy) | 84 996 | 75 339 | 79 124 | 74 670 | 71 095 | 70 184 |
| % | | | | | | |
| Non-performing loans ratio | 4.9 | 6.6 | 5.4 | 7.5 | 10.7 | 14.6 |
| NPL coverage ratio | 62.9 | 62.6 | 62.3 | 60.5 | 59.2 | 54.3 |
| Return on assets (ROA) | 1.5 | 1.6 | 1.5 | 1.5 | 1.2 | 0.0 |
| Return on equity (ROE) | 12.7 | 14.4 | 13.4 | 13.2 | 10.6 | 0.9 |
| Capital adequacy ratio | 18.4 | 18.0 | 19.1 | 19.2 | 19.3 | 18.2 |
| Liquidity coverage ratio (LCR) | 176.8 | 190.8 | 186.8 | 192.2 | 216.6 | 223.4 |

1) Eurostat data;
2) Labour Force Survey data for population aged 15- 74;
3) MNB data, excluding SPEs;
4) Ratios for H1 2018 and H1 2019 are calculated using GDP data for the 4 preceding quarters;
5) Eurostat data based on ESA methodology;
6) Data from MNB - Prudential data of credit institutions

*Sources: Hungarian National Bank, Hungarian Central Statistical Office, Ministry of Finance, Government Debt Management Agency, World Bank, Eurostat, International Monetary Fund*