Hungary: A two-in-one rating preview, again

Both Fitch and S&P are having the opportunity to review Hungary's sovereign debt rating on 12 February. We hardly see any of the agencies pulling the trigger, as the underlying processes both in the economy and in public financing are hard to identify

Hungary's parliament building in Budapest

Introduction

Hungary's sovereign debt rating was affirmed by Fitch Ratings in August 2020, while S&P lowered the rating outlook to stable from positive in April 2020. The country's rating has remained in the 'BBB' category, two notches above non-investment grade. The outlook is stable in both cases, referring to the balanced positive and negative macro risks.

Pros and cons

In its latest report Fitch Ratings highlighted that the economic impact of the coronavirus crisis will sharply worsen fiscal metrics, but it expects an improvement beyond 2020. Fitch sees the Hungarian economy growing almost 5% in 2021, followed by a roughly 7% GDP growth in 2022, the strongest in the region. To see a positive rating action, the previous review underscored two fields that need to be improved post-pandemic. In public finances the debt-to-GDP level needs to be lowered and in macro a more predictable economic policy, an improved business environment with stronger medium-term growth prospects are needed without the emergence of imbalances like a large current account deficit or prolonged high inflation.

As for S&P, it's economic outlook for Hungary is similarly positive than Fitch Ratings', stating that the Hungarian economy is expected to reach pre-pandemic real GDP levels by early 2022, sooner than most other CEE economies. However, Hungary needs to outperform this high expectation to trigger a positive rating action by S&P. Another upside scenario exists with a faster-than-expected consolidation in public finances, for example through recurrent government surpluses.

> *Both Fitch and S&P see Hungary growing faster than regional peers but weakening public finances is an issue*

When it comes to the possibility of a negative rating action, both credit rating agencies emphasized that permanently weakening public finances and adverse debt dynamics can trigger such a move. Besides the worsening of fiscal metrics, the failure to manage an economic recovery (S&P) and the weakening of the institutional framework (Fitch) are also posing downside risks to the rating.

To make an educated guess regarding the possible outcomes, it's worth taking a look at the fiscal and macro outlook. The government plans only a moderate debt reduction in the coming years, despite suffering a significant increase in debt levels. In only one year, a decade of debt reduction was nullified. However, based on the latest official projection from the Ministry of Finance, the debt-to-GDP level will remain above 80% in 2021 and remains above 70% through 2024. Government plans to revert to the 3% deficit-to-GDP ratio are only in 2023. This speed will hardly trigger a positive action but should be enough to avoid a negative one.

Regarding the economic outlook, we see 4.3% GDP growth in 2021 with a 5% rise next year. However, this baseline is surrounded by positive risks, as in our optimistic scenario we see 6% GDP growth on average in 2021-2022. This also means elevated upside risks to the inflation outlook, meaning a prolonged high inflation. As the stronger rebound could stem from a better-than-expected increase in domestic demand (with high import ratio), this could lead to a sharper deterioration in the current account metrics.

The verdict

All things considered, it's still hard to separate the discretional changes from the underlying trend in fiscal and macro as we are still in recovery mode constrained by widespread restrictions. Moreover, we didn't see a one-sided story when it comes to the rating agencies upside or downside scenarios. Against this backdrop, we see only a theoretical chance for positive outlook changes based on the relative optimistic economic assessment from both agencies. We attach the highest probability to a review-and-affirm scenario in both cases, as it gives some leeway to see the how things are shaping up after the re-opening.

Rating agency	First review	Second review
Fitch Ratings	12 February 2021	30 July 2021
Standard and Poor's	12 February 2021	13 August 2021
Moody's	26 March 2021	24 September 2021

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

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