Hungary: Moody's might surprise

Hungary is facing a review of its sovereign debt rating on 1 June. The outcome is like flipping a coin, but we think Moody's could upgrade its outlook

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Baa3 Moody's credit rating for Hungary

Outlook: Stable

Moody's will review the Hungarian sovereign debt rating on 1 June. Unlike the previous review, this one might surprise. Moody's has remained the only major rating agency with a stable outlook. Both S&P and Fitch have a positive outlook.

Considering the chance of a possible outlook upgrade, we see several arguments, both for and against. As Moody's highlighted in its previous review in November 2017, upward pressure on Hungary's rating could stem from:

1

Faster than expected improvement in the country's economic metrics

The Hungarian Ministry of Finance (formerly Ministry for National Economy) predicted GDP growth of 4.1% year-on-year in 2017, which was roughly in line with the actual 4% growth. Meanwhile, Moody's expected growth of 3.5% and 3.1% YoY in 2017 and 2018, respectively. As the 2018 GDP forecast is subject to upside risks (4.4% GDP growth in 1Q), we see this factor as supportive to an outlook upgrade.

2 Faster than expected improvement in the country's fiscal metrics and public debt

The accrual-based deficit was below the Maastricht criteria in 2017 and will probably be below this in 2018 as well, so we don't see it as a game changer in the rating decision. When it comes to the debt, however, the Ministry of Finance has changed its debt-to-GDP forecast such that it is now calculating a 0.4ppt decrease between 2017 and 2018. This stands in contrast to the 1.5ppt debt reduction forecast by the previous convergence programme. In our view, this change is mainly due to the bigger-than-expected gap between the disbursements of EU projects and the money transferred by Brussels. Nevertheless, the Finance Ministry's state secretary in charge of the budget Péter Benő Banai pointed out that the "government is expecting a slight decrease in debt-to-GDP by the end of the year". Finance Minister Mihály Varga has also warned that "Hungary needs deficit cuts in response to market risk". In light of these events, it is possible Moody's maintains a stable outlook.

3 Structural reforms to boost potential growth

Moody's highlighted in a piece after the election: "Though we expect broad fiscal policy continuity under the government, the credit implications of the result will only become clear as the government's policy agenda emerges". So far, we have only witnessed verbal actions and guidelines about the new agenda. According to the government, it will focus on the improvement of demography and competitiveness. We don't know whether it is enough for an upgrade or Moody's wants to see a more specific action plan with concrete measures.

There are two more important factors which could influence the rating decision. Moody's positive evaluation of the Hungarian banking system suggests the ratings agency could upgrade the country's overall outlook. On the other hand, recent turmoil and turbulence (Hungarian forint weakness and increase in both the short and the long end of the Hungarian yield curve combined with a steepening) rather support the case for no action by Moody's.

Conclusion: It's a draw

A positive outlook upgrade on the Hungarian sovereign debt rating would not be a huge surprise, although it is very likely that Moody's will wait and see until the next scheduled review on 23 November.

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