

## Hungary: Real chance of a rating upgrade

After strong second-quarter GDP data, Hungary may be set for more good news by the end of the week. S&P upgraded Hungary's credit outlook to 'positive' a year ago, will it finally raise its rating?



Source: Shutterstock

**BBB-** Sovereign debt rating of Hungary

Outlook: Positive

### The pros and cons

After an uneventful sovereign debt review by Moody's in June, S&P will deliver its verdict on Hungary's economy this coming Friday. The rating agency revised its outlook from 'stable' to 'positive' in August 2017 and given the favourable developments in the economy since then, we think Hungary has a realistic shot at an upgrade, from 'BBB-' to 'BBB', which would be the best rating since December 2010.

When considering an upgrade, debt agencies focus on some issues more than others. As Márton Nagy, Deputy Governor of the National Bank of Hungary, pointed out recently, S&P primarily

monitors the banking system, especially the proportion of non-performing loans (NPLs), both among households and corporates as well as the country's external indebtedness and vulnerability. This is in line with the latest S&P commentary released in February, regarding a possible Hungarian upgrade:

"We could raise the ratings in the next 12-18 months if recent improvements in the financial sector enhance the authorities' ability to influence domestic monetary conditions. This would be signalled, for example, by a stronger recovery of bank lending alongside continued economic growth, accompanied by contained fiscal deficits."

---

*We've seen further improvements in the banking sector, a clear pro*

---

Taking into consideration the changes since the last sovereign debt rating, we have seen further improvements in the banking sector. For example, households' NPL ratio dropped to 6.1% from 7.5% in 1Q18. In addition, upward risks stem from a robust 2Q GDP figure. According to S&P's last forecast, Hungarian GDP growth will reach 3.5% in 2018 overall. With the 1H18 economic activity at 4.5% on average, we see this as a strong argument favouring an upgrade. Moreover, it's not just about GDP itself, which came in better than expected. A stronger-than-expected reduction of the debt-to-GDP ratio, compared to S&P's base case, also helps.

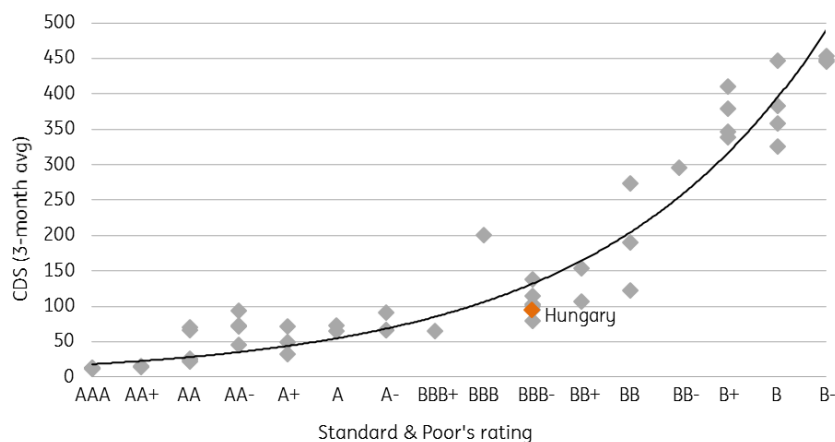
---

*The recent market turmoil and the dispute with the European Commission could be considered cons*

---

On the other hand, S&P could also find good excuses not to upgrade Hungary. First of all, the aforementioned 12-18 month period cited in February does not necessarily suggest an upgrade is imminent. Secondly, current geopolitical risks in Turkey and possible spillover effects to the whole emerging market space could give S&P pause. And finally, the rating agency could argue that the high cash-flow based deficit and high financing needs of the budget could derail the debt reduction plan if Hungary isn't able to resolve its issue with the European Commission over EU funds. Based on the latest news, it seems the dispute will be settled soon and at least HUF752 billion could be released from Brussels in 4Q18.

## Based on market-pricing, Hungary should have a better rating than 'BBB-'



Source: Bloomberg, ING

### The verdict

We see the pros outweighing the cons, so there is a real chance that S&P will be the first to upgrade Hungary to 'BBB', although a simple affirmation of the rating cannot be excluded. Given that Hungary has long since shed its 'junk' status (non-investment grade) and based on the CDS pricing, which shows investors are treating Hungary as a 'BBB'-country anyway, we don't expect any major move in the market in the aftermath of this decision.

### Author

**Peter Virovacz**

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10

Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).