

## Hungary: Will Moody's follow the others?

Both S&P and Fitch upgraded Hungary's sovereign debt rating in February, though they both previously held positive outlooks on the country. We don't expect a rating change from Moody's but we think there's a good chance the outlook will be upgraded from 'stable' to 'positive'



Source: Shutterstock

# Baa3

Sovereign debt rating (Moody's)

Outlook: Stable

### The background

Both S&P and Fitch have recently upgraded Hungary's sovereign debt rating to 'BBB', and today Moody's will deliver its verdict. The rating agency upgraded Hungary to 'Baa3' from 'junk' in November 2016 and since then, neither the rating nor the outlook has changed. However, the macroeconomic and financial environment has improved significantly, prompting the other two rating agencies to upgrade their ratings, so there are reasons to be cautiously optimistic about the forthcoming rating action.

## Arguments for

According to Moody's, there are many factors which could lead to an upgrade in the outlook or even the rating. These include:

1. Higher-than-expected economic growth and strong fundamentals. GDP grew by 4.9% year-on-year in 2018, exceeding Moody's expectations of 4.3% YoY despite a deterioration in the external environment.
2. The government's continuous commitment to keeping the deficit low and reducing the debt-to-GDP ratio. The public debt/GDP ratio has been constantly shrinking and is expected to decline to 69% in 2019 from 70.8% in 2018. Last year's figure came in better than expected and the final deficit figure was lower than planned in 2018.

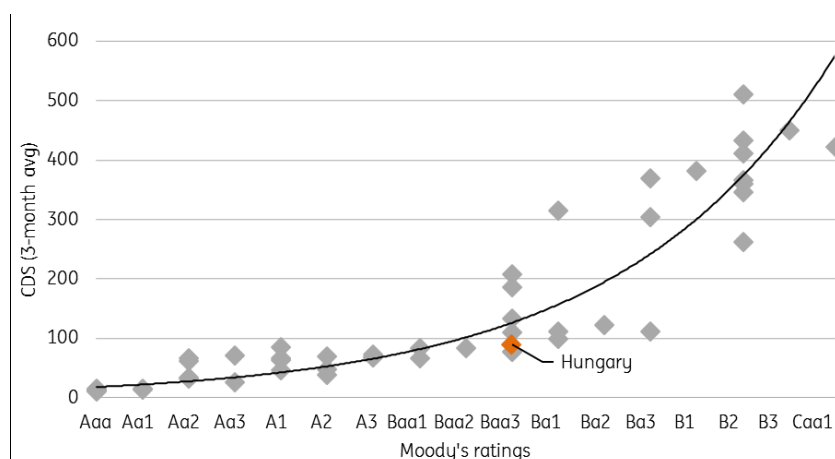
Since Moody's previous comments on the macroeconomic outlook, potential negative risks about the economic and budgetary performance should have decreased.

## Arguments against

There are still some concerns which might prevent Moody's from making changes even to its outlook. In its last report, the agency highlighted that Hungary is highly exposed to external shocks and a deterioration in the global economic outlook, and with narrow fiscal and monetary space, any downturn would have a strong, negative impact on the economy. While we agree with this view to some extent, we have doubts about the inability of economic policies to react accordingly and see more room for manoeuvre both from a fiscal and a monetary policy point of view.

Concerns about the independence of the central bank, as well as conflict with the EU, remain an issue. The European Parliament's recommendation to start a procedure against Hungary under [Article 7](#) of the EU treaties was mentioned [in the last Moody's report](#), however, there has been no movement on this so far, adding to the uncertainty. In addition, despite a decline in public indebtedness, this is still much higher than the 'Baa2' median, arguing against any type of rating change.

## Based on market pricing, Hungary should have a better rating than 'Baa3'



Source: Bloomberg, ING

## Our expectation

We see a good chance that Moody's changes its outlook to 'positive' from 'stable' as positive developments outweigh the negative, in our view. This would not signal a strong pre-commitment to raising the actual rating and would still buy at least one more year for Moody's to assess the situation. In theory, there's a chance of a rating upgrade, but we see this as highly unlikely, taking into consideration the still high public debt and Moody's issues with the institutional frameworks. A simple affirmation (or even skipping the review) can't be excluded either. In any event, based on CDS pricing which shows that investors are treating Hungary as a 'Baa1'-country anyway, we don't expect any major market move in the aftermath of this decision.

### Review calendar for Hungary in 2019

| Fitch Ratings | Moody's    | S&P         |
|---------------|------------|-------------|
| 22 February   | 03 May     | 15 February |
| 16 August     | 25 October | 16 August   |

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