Hungary: S&P not ready to pull trigger on credit rating

Standard and Poor's affirmed Hungary's 'BBB-' rating and the outlook remains positive. It's not a huge surprise though we were optimistic about an upgrade

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The decision

Standard and Poor's (S&P) affirmed Hungary's sovereign debt rating at 'BBB-' and confirmed its positive outlook. As we noted in our S&P preview, we felt there was enough evidence to support an upgrade but we didn't rule out a simple affirmation of the credit rating either.

S&P could have cited a string of obvious excuses for keeping its rating on hold including geopolitical risks, emerging market turmoil and fiscal issues. The fact it didn't mention these could be considered a good sign. However, the agency clearly highlighted its dissatisfaction with net general government debt over the past 12 months. The rationale for its decision to keep the rating on hold was that the "**relatively weak checks and balances between government branches, moderate wealth levels, and high public debt are key constraints**".

The government has made only modest progress in reducing net general government debt to GDP

The agency also issued a new warning about monetary policy. It noted that Hungary's economy has already seen some signs of overheating and economic policy has not reacted accordingly, which "**could weaken Hungary's external competitiveness and balance of payments performance**". This seems like a shot at the National Bank of Hungary's prolonged loose monetary policy. The rating agency also worries about the lack of structural reforms, which is keeping potential growth around 2-2.5%. This low rate reflects "**poor demographics exacerbated by net emigration (...), a large public sector, a challenging business environment, low productivity and a chronic skill shortage**".

The silver lining

Despite strong demand-driven growth, Hungary's external position continues to be in surplus, with substantial net foreign direct investment. "**Hungary's strong external profile, its resilient export-driven economy, low private sector debt levels, and the flexible exchange rate regime support the sovereign rating,**" according to S&P. "**The outlook remains positive, reflecting strong growth and external performance and the improved health of the financial sector**."

The outlook remains positive with a chance for an upgrade within 12 months

S&P emphasised that it could raise its rating in the next 12 months if economic performance remains strong and the banking sector strengthens. Maintaining the current account surplus, keeping the fiscal deficit contained and faster income convergence with EU averages could also drive an upgrade. We think there could be other positive developments, too, given that the government appears ready to tackle demographic issues and low productivity and is planning to downsize the public sector.

What's next?

Hungary has missed out on its best chance for an upgrade this year. Next in line is Fitch Ratings on 31 August, but this review comes less than six months after the agency reiterated its positive outlook. Moody's will review its rating on 23 November when we can expect an upgrade to the outlook, at best.

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