Hungary
Rating Report

SCOPE BBB STABLE OUTLOOK

Credit strengths

- Strong record of robust growth performance, backed by high investment
- Resilient external position and favourable debt profile amid external shocks

Credit challenges

- High public debt stock with significant refinancing needs
- Deterioration in governance indicators in recent years

Rating rationale:

Strong record of robust growth dynamics: The Hungarian economy has a strong record of robust growth supported by large foreign investments and significant EU funding – creating high value-added jobs and supporting economic development.

Weakening growth outlook due to external risks: Hungary counts among the most exposed countries to the fallout from the Ukraine conflict, in view of its high reliance on Russian fossil fuel imports amplified by an economic structure dominated by energy-intensive businesses with complex value chains. Further inflationary pressures amid weakened policy predictability and currency weakness are weighing on the country's growth prospects.

Resilient external position and favourable public debt profile: Hungary benefits from good reserve adequacy, a moderate proportion of foreign currency-denominated central government debt and a high share of fixed-rate debt. Hungary has good access to foreign and domestic financing, including through a sizeable domestic retail programme. The country's external liabilities mostly consist of direct investment, supporting Hungary's resilience to external shocks.

Rating challenges include: i) an elevated debt burden with high refinancing needs and growing interest payments; and ii) recent deteriorations captured in governance metrics and political headwinds with the EU, which have led to delays to the disbursement of EU funds from the Recovery and Resilience Facility.

Hungary's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	bbb-	HUF [+0]	0	BBB
Public Finance Risk		20%	a+		0	
External Economic Risk		10%	ccc		0	
Financial Stability Risk		10%	aa		0	
ESG Risk	Environmental Factors	5%	aaa		0	
	Social Factors	7.5%	bb+		0	
	Governance Factors	12.5%	bb		-1/3	
Indicative outcome		**bbb**			**0**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers

- Improvement of medium-term growth prospects supported by improving external metrics
- Significant public debt reduction due to improvement in public finances

Negative rating-change drivers

- Growth prospects weaken and/or external metrics weaken more-than-expected
- Protracted fiscal deterioration weakens debt sustainability

Ratings and Outlook

Foreign currency

Long-term issuer rating	BBB/Stable
Senior unsecured debt	BBB/Stable
Short-term issuer rating	S-2/Stable

Local currency

Long-term issuer rating	BBB/Stable
Senior unsecured debt	BBB/Stable
Short-term issuer rating	S-2/Stable

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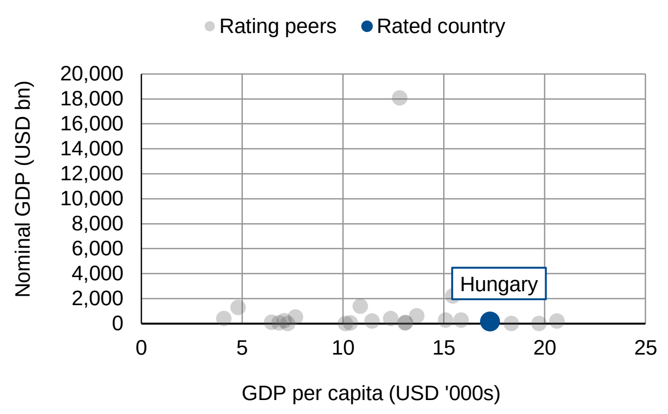
Domestic Economic Risks

- **Growth outlook:** The Hungarian economy demonstrated resilience in the previous year, achieving a robust GDP growth of 4.6%. However, the economic outlook for 2023 indicates a temporary slowdown, with GDP growth projected at 0.1%. This deceleration can be largely attributed to the surge in inflation rates, which has weighed on Hungary's economic activity. The country has experienced a technical recession for three consecutive quarters, spanning from the third quarter of 2022 to the first quarter of 2023. Looking ahead to 2024, our forecast suggests a GDP growth rate of 2.5%, signifying a moderate economic expansion. One trend observed since 2020 is the significant inflow of large-scale investments, particularly in the automotive industry. This sector plays a pivotal role in Hungary's industrial landscape, contributing substantially to export earnings and employment.
- **Inflation and monetary policy:** After reaching its highest point at 25.7% in January 2023, inflation has been on a gradual decline, reaching 20.1% by June. In 2023, we project average inflation to be 17.5%. The government has implemented various measures to reduce inflation to single digits by the year-end. In May, the Hungarian National Bank reduced the one-day deposit rate by 100bps to 17%. Subsequently, during the months of June and July, there was an additional reduction to 16% and 15%, respectively, signifying a partial normalisation of rates. The goal is to align the one-day deposit rate with the 13% base rate by the September meeting. Following this, monthly 50bp reductions are expected, reaching 11.5% by the end of 2023. However, rate cuts may be paused if there is a significant weakening of the forint.
- **Labour markets:** Hungary's unemployment rate remains favourable compared to other EU countries, standing at 3.8% in June. The number of employed individuals reached a historic peak in June, with labour market activity on the rise since mid-2020. The demand for labour in various sectors, particularly manufacturing and trade is expected to increase further as economic performance improves in the second half of the year. The 16% increase in the minimum wage and 14% increase in the guaranteed minimum wage, along with other factors like labour market tightness, have contributed to wage dynamics.

Overview of Scope's qualitative assessments for Hungary's *Domestic Economic Risks*

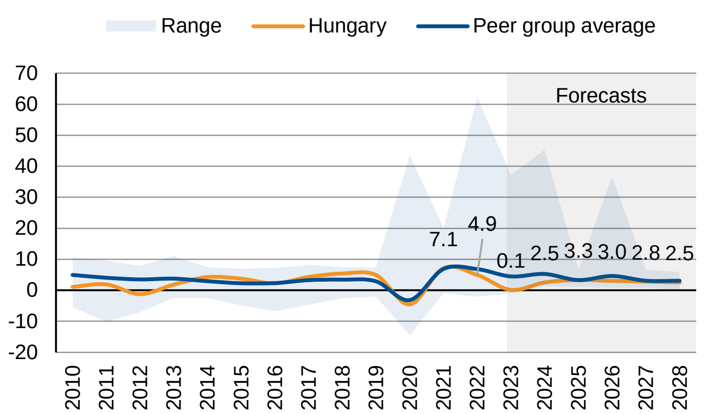
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Growth potential of the economy	Neutral	0	Robust growth dynamics supported by high investments; low savings
	Monetary policy framework	Neutral	0	Credible central bank; previous discrepancies in the policy mix have limited effectiveness of monetary policy
	Macro-economic stability and sustainability	Neutral	0	High reliance on external markets amplified by an economic structure dominated by energy-intensive businesses with complex value chains; large-scale foreign direct investments in key industries support recovery

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

Public Finance Risks

- **Fiscal outlook:** In 2022, Hungary experienced a budget deficit of -6.2% of GDP, primarily driven by significant pre-election fiscal spending. Additionally, 1.2% of GDP was attributed to extraordinary gas purchases. Hungary's commitment to reducing the public deficit ratio reflects a prudent fiscal policy framework aimed at ensuring fiscal sustainability. The recent declines in the public deficit and debt ratios indicate a positive trend, highlighting the government's efforts to control expenditures. We anticipate a reduction in the deficit to 4.2% of GDP this year and further down to 3.4% of GDP in 2024. The Hungarian government's ambitious targets of 3.9% for 2023, 2.9% for 2024, and 1.9% for 2025 underscore substantial fiscal consolidation efforts over this period.

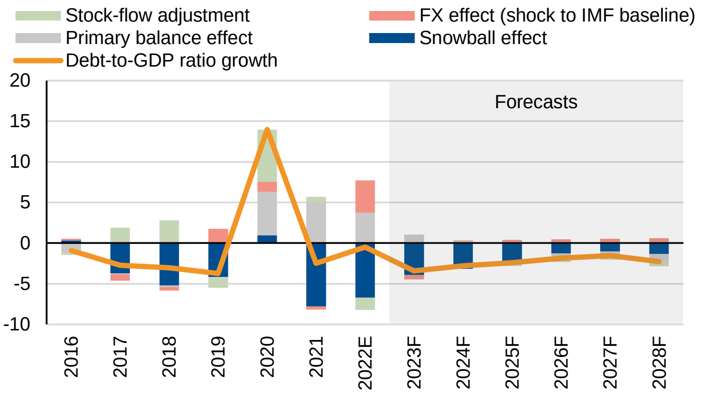
- **Debt trajectory:** By the end of 2022, the public debt ratio to GDP had decreased from 76.6% to 73.3%. We expect the government debt-to-GDP ratio to gradually decrease to 71.0% this year and further to 62.0% in 2028. This trajectory is driven by expectations of robust nominal growth offsetting the impact of growing interest payments and persistent primary deficits. The uncertainty around the release of EU funds adds significant downside risk to the debt outlook, however, through increased financing costs and weakened growth prospects.

- **Debt profile and market access:** The debt profile is favourable, including an adequate average maturity of 6.1 years as of June 30, 2023, a high share of fixed-rate debt (69.8%), and a moderate proportion of foreign currency-denominated central government debt (25.3% of the total). Hungary benefits from good access to foreign and domestic financing, including through a sizeable domestic retail programme. The debt market in Hungary maintains a stable investor base, with non-resident holdings accounting for a portion of 24.9%. The domestic investor base is further reinforced by a significant share of retail debt, where households own 19.5% of securities within the total debt. Hungary has made substantial progress in fulfilling its 2023 financing plan, with 64% completed as of June 30, 2023. All dollar bond issuances and 74% of annual FX issuances specified in the 2023 financing plan have been completed.

Overview of Scope's qualitative assessments for Hungary's *Public Finance Risks*

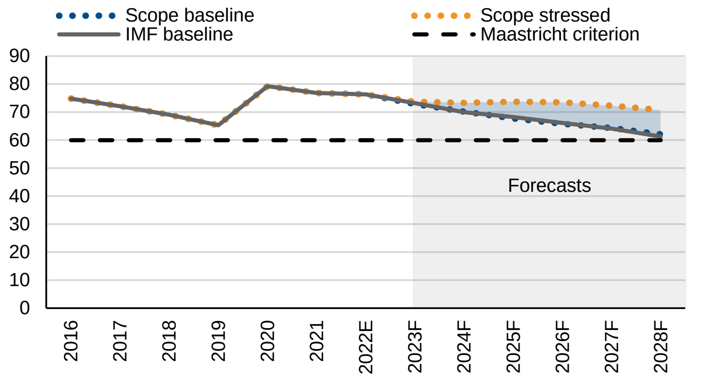
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Fiscal policy framework	Neutral	0	Good record of primary surpluses; limited fiscal space
	Debt sustainability	Neutral	0	Elevated debt burden and growing interest payments; long-term debt trajectory supported by robust nominal growth prospects
	Debt profile and market access	Neutral	0	Resilient debt profile and solid domestic investor base

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

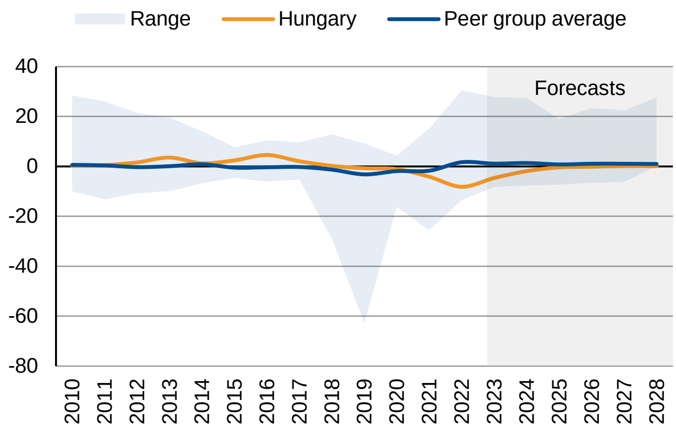
External Economic Risks

- **Current account:** Hungary's experience with a high current account deficit of -8.1% of GDP in 2022 underscores the country's sensitivity to external energy price shocks. However, there has been a marked improvement in Q1 2023, with the current account deficit reducing to 2.0% of GDP, driven by declining energy prices and the readiness of new export capacities. The trade balance for the period January to May 2023 (EUR 2.5 bn surplus, compared to a deficit of EUR -2.0bn in the same period last year) should bolster economic growth based on export performance.
- **External position:** Gross external debt is comparatively elevated, at about 85% of GDP, though associated risks are partially offset by a favourable composition. External liabilities mostly consist of direct investment and equity rather than debt-creating flows, while the shares of short-term liabilities and banking sector external debt are low. The NIIP is negative but moderate in size, having improved from around -90% of GDP in 2013 to -52% in 2022.
- **Resilience to shocks:** Hungary's dependence on Russian energy imports has been reduced through the diversification of gas imports and the rapid increase in domestic solar power plant capacity, which has doubled in size in the first six months of 2023. As of 21st July, Hungarian gas storages are at 74%, with the stored amount covering nearly half of the country's total yearly gas consumption. Moreover, the Hungarian government's measures, such as limiting subsidized household energy prices and incentivizing energy savings, have led to a significant decrease in energy consumption. However, further steps are needed to achieve full energy diversification, particularly in gas and oil, which will require international cooperation and investments. International reserves provide a comfortable cushion against shocks. Hungary’s FX reserves to short-term debt ratio has been above 1.0x since 2012. Nevertheless, further uncertainty around EU funds inflows amid heightened borrowing needs could create pressure on the country’s external financing.

Overview of Scope’s qualitative assessments for Hungary’s *External Economic Risks*

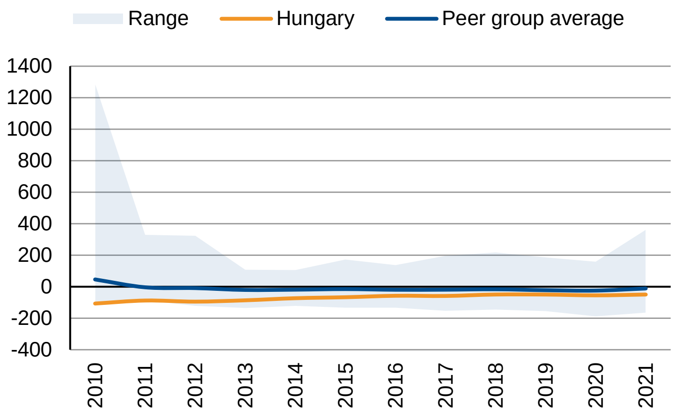
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Neutral	0	Pre-pandemic track record of stable current account receipts with a manufacturing sector highly integrated in global supply chains
	External debt structure	Strong	+1/3	External liabilities mostly consist of direct investment and equity rather than debt-creating flows
	Resilience to short-term external shocks	Weak	-1/3	High refinancing needs; reliance on external demand and foreign capital

Current-account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

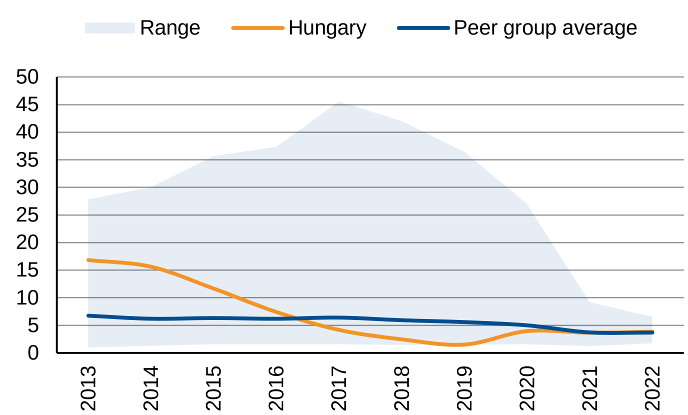
Financial Stability Risks

- **Banking sector:** The Hungarian banking system demonstrates resilience through a stable and well-balanced funding structure. Although the liquidity coverage ratio (LCR) decreased from an average of 183% in September 2022 to 174% in March 2023, it comfortably exceeds the regulatory expectation of 100%. This decrease in LCR is influenced by interest rates on central bank instruments and a reallocation of retail bank deposits to other assets, while still maintaining steady liquidity reserves. The decline in retail deposits does not present funding risks for banks, as reflected in the low loan-to-deposit ratio of 81% in March 2023. Additionally, banks are compliant with the EU-wide net stable funding ratio (NSFR) requirement of 100%, ensuring long-term stable funding. The NSFR's average level was around 139% at the systemic level in March 2023.
- **Private debt:** The Hungarian banking sector experienced notable growth in its corporate loan portfolio in 2022. The moderation in growth during Q1 2023 indicates a balanced expansion, aligned with the country's economic performance. The use of foreign currency loans by companies with natural collateral suggests a strategic approach to managing borrowing risks.
- **Financial imbalances:** The rise in lending rates has been managed through subsidised loans, maintaining favourable borrowing conditions. Additionally, government loan programs have played a crucial role in supporting corporate lending. However, household loan growth decelerated during this period, highlighting a potential shift in consumer borrowing behaviour.

Overview of Scope's qualitative assessments for Hungary's *Financial Stability Risks*

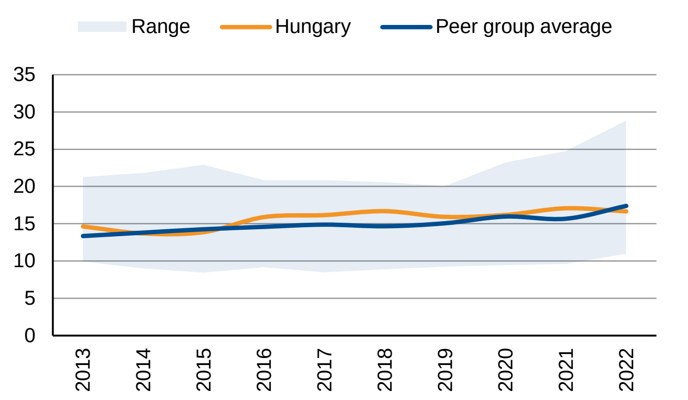
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Banking sector performance	Neutral	0	High capitalisation and liquidity levels; resilient profitability
	Banking sector oversight	Neutral	0	Effective supervisory control; timely and comprehensive regulatory measures
	Financial imbalances	Neutral	0	Macroprudential measures underpin financial stability

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

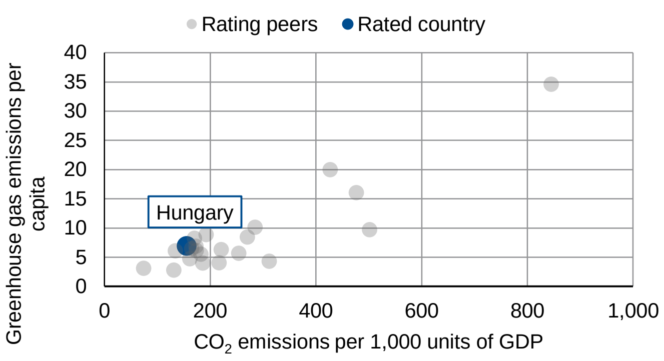
ESG Risks

- **Environment:** Energy consumption in Hungary is above the EU average, largely due to high per-capita consumption. The transformation of the country's coal region, which produced 8.5% of electricity in 2022, and Hungary's energy-intensive industries represent transition risks. Electricity consumption is expected to increase over the next decade, in parallel with the electrification of the economy. Hungary faces several environmental challenges, including weak water quality and air pollution, reflected by persistent breaches of water and air quality standards and weak energy efficiency in the residential sector.
- **Social:** Despite structural improvements in the labour market over recent years, persistent employment gaps remain, which remain wide in an EU comparison. Income inequality is comparatively elevated and inequalities in access to public services remain high. Housing also remains inadequate for much of the population. The shortage of affordable rental housing hinders social mobility. Educational outcomes are below the EU average with large differences in certain areas.
- **Governance:** Worsening governance metrics are compounded by the public sector's growing market predominance in various economic sectors. In our view, the government's frequent application of regulatory and budgetary changes limit Hungary's policy predictability and budgetary flexibility. Hungary has made significant efforts in addressing the vulnerabilities identified by the European Commission, particularly in judicial independence. The legislative package required for compliance with the EU Charter of Fundamental Rights was submitted to and adopted by the Hungarian parliament in May 2023, entering into force in June. The way in which the EU applies its conditionality mechanism to Hungary will define their relations over the coming years.

Overview of Scope's qualitative assessments for Hungary's *ESG Risks*

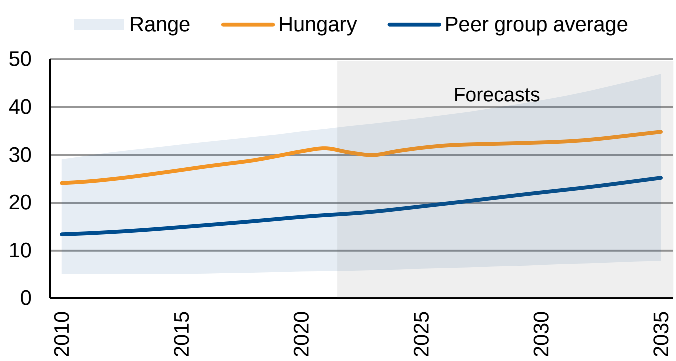
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Environmental factors	Neutral	0	Low vulnerability to transition risks and natural disasters risk; elevated reliance on fossil fuel imports
	Social factors	Neutral	0	Significant employment gaps and high regional inequalities, mirroring those observed among peers
	Governance factors	Weak	-1/3	Ongoing institutional challenges and tensions with the EU; polarised political environment

Emissions per GDP and per capita, $mtCO_2e$



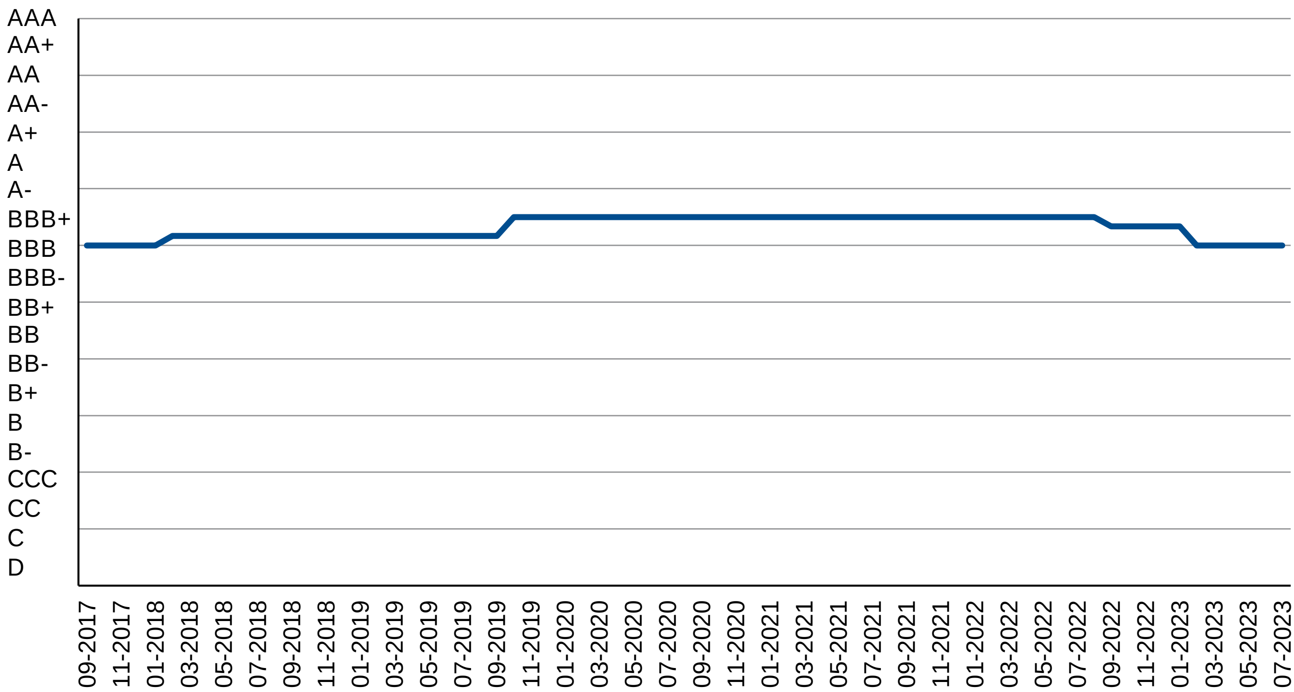
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Bulgaria
China
Greece
Romania

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022
Domestic Economic	GDP per capita, USD '000s	IMF	16.4	16.8	16.1	18.7	17.3
	Nominal GDP, USD bn	IMF	160.6	164.0	157.2	181.8	168.3
	Real growth, %	IMF	5.4	4.9	-4.5	7.1	4.9
	CPI inflation, %	IMF	2.8	3.4	3.3	5.1	14.5
	Unemployment rate, %	WB	3.7	3.4	4.3	4.1	3.4
Public Finance	Public debt, % of GDP	IMF	69.1	65.3	79.3	76.8	76.4
	Interest payment, % of revenue	IMF	5.1	4.9	5.0	5.1	5.4
	Primary balance, % of GDP	IMF	0.2	0.1	-5.4	-5.1	-3.7
External Economic	Current account balance, % of GDP	IMF	0.2	-0.8	-1.1	-4.2	-8.1
	Total reserves, months of imports	IMF	2.5	2.5	3.6	3.0	2.6
	NIIP, % of GDP	IMF	-48.7	-49.0	-53.9	-48.9	-52.0
Financial Stability	NPL ratio, % of total loans	IMF	2.5	1.5	4.0	3.7	3.9
	Tier 1 ratio, % of risk-weighted assets	IMF	15.8	15.9	15.1	17.0	17.2
	Credit to private sector, % of GDP	WB	32.4	33.4	37.9	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	166.9	160.1	162.6	155.8	-
	Income share of bottom 50%, %	WID	22.0	22.0	22.0	22.0	-
	Labour-force participation rate, %	WB	71.9	72.6	72.8	76.1	-
	Old-age dependency ratio, %	UN	28.9	29.8	30.8	31.4	30.5
	Composite governance indicators*	WB	0.5	0.5	0.5	0.5	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging market economy
5y USD CDS spread (bps) as of 30 June 2023	160

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