Hungary’s corporate credit outlook is negative for 2024

Inflation, high interest rates, demand shocks and political risk strain balance sheets across sectors

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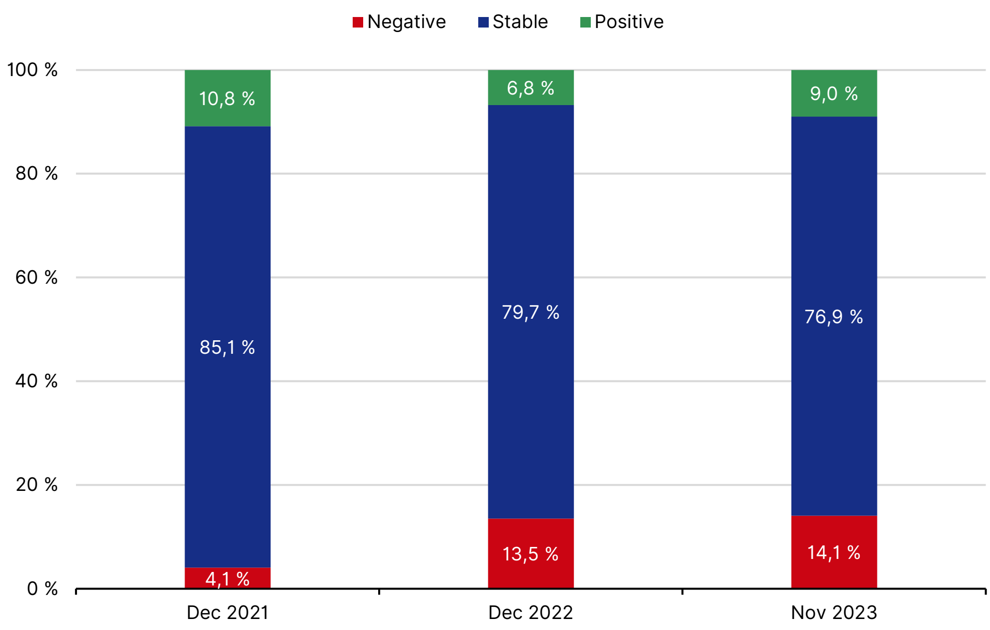
Hungarian companies have proved their resilience in a difficult operating environment of high interest rates, falling growth and stubborn inflation in the past year. Government support for some sectors has helped offset immediate challenges to corporate creditworthiness. However, the number of negative credit outlooks has increased.

We see six pressing issues for Hungarian firms, even though their intensity varies from sector to sector: demand shocks, labour shortages and rising wages, missing EU funds, volatile prices in an inflationary environment and high interest rates militating against new investments.

Figure 1: Outlook distribution of issuer ratings in Hungary



Source: Scope

Macroeconomic backdrop remains difficult in 2024

High inflation, decreasing purchase power weighs on economic activity

Corporate sector faces strong economic headwinds

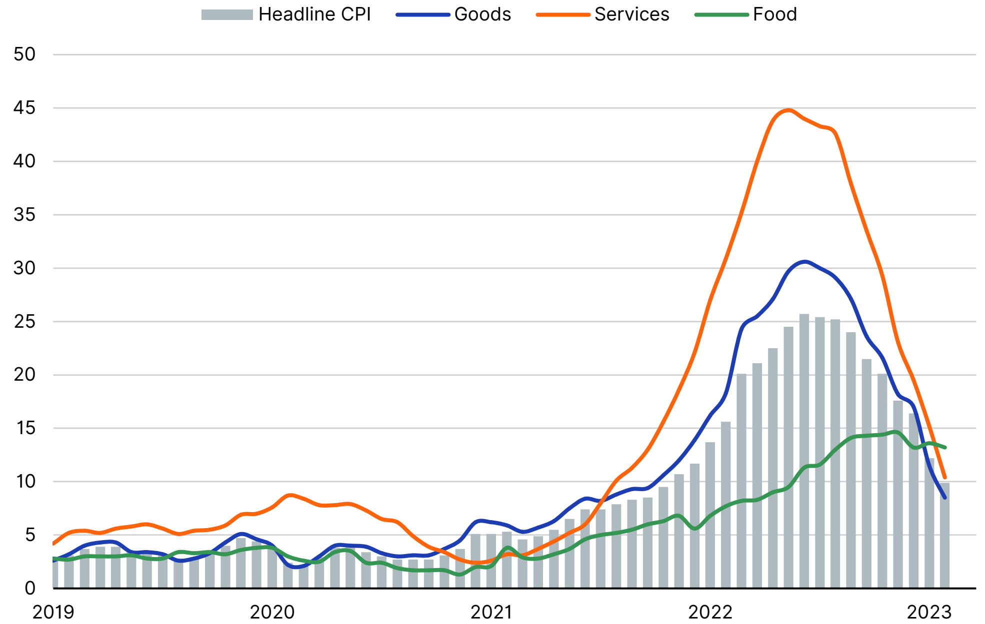
The macroeconomic environment has not been favourable for corporates as Hungary faces one of the highest inflation rates in the EU. Surging inflation has forced the Hungarian central bank (MNB) to raise interest rates to levels unaffordable to most corporates and households. While employment has remained high, steeply rising wages did not fully compensate for higher prices, thus reducing the purchasing power of households.

Weak demand plus rising costs have squeezed corporate margins. At the same time, high interest rates have held back the investment necessary to restore profitability and overcome labour shortages, such as in automation and robotisation.

Inflation remains stubbornly high

While inflation has receded in 2023 and the MNB was among the first central banks to cut policy rates, core inflation remains well above target and policy normalisation will take time.

Figure 2: Inflation in Hungary 2021-23



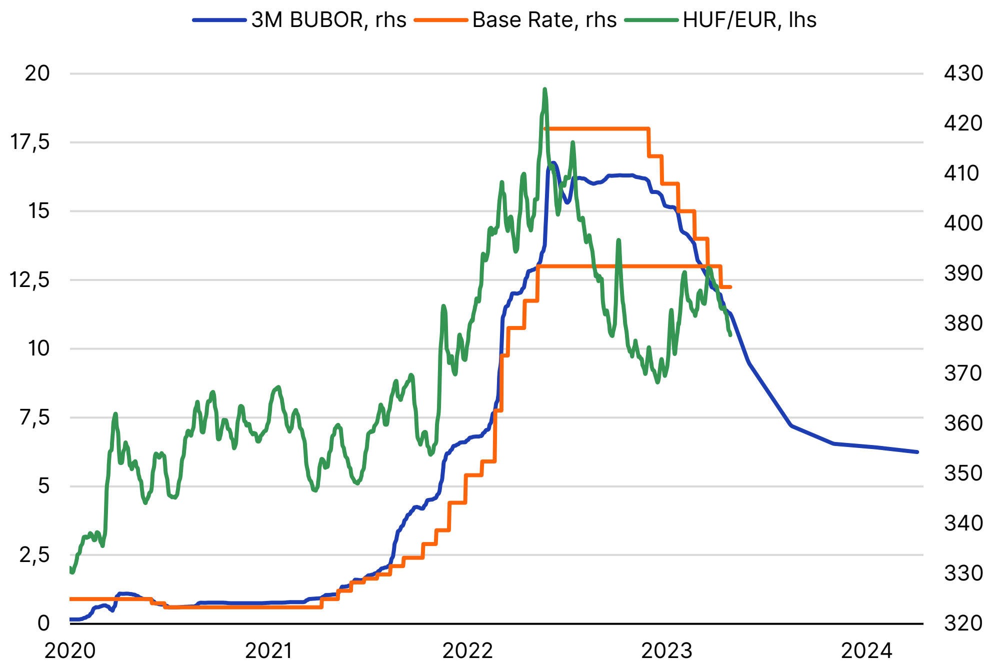
Source: Eurostat

Currency risk hanging over corporate decision-making

Based on current policy guidance, base interest rates in Hungarian Forint (BUBOR) are set to decrease in 2024 but they will remain above 6% by year-end, which means a fast rebound of economic activity is unlikely next year. Lower interest rates are subject to stable energy prices and the need to maintain a stable exchange rate in order not to induce renewed inflation.

Currency risk remains significant in 2024. The central bank is likely to continue lowering the base rate while a significant portion of EU funds, typically converted to Hungarian forint, may not be unblocked. Should the forint weaken, exporters could initially benefit, though rising inflation is likely to erase those gains quickly and force interest rates higher again.

Figure 3: Interest rates expected to fall significantly in 2024



Source: MNB, Bloomberg, Macrobond

Risks to 2024 growth outlook

We expect that domestic demand will remain weak in 2024 due to households' and businesses' diminishing purchasing power and high interest rates which are likely to hold back consumption and investment.

Weak domestic demand weighs down on corporate performance

Recent large foreign investments will produce returns from 2025 at the earliest, while governmental infrastructure spending is unlikely to recover before Brussels and Budapest end their dispute over civil rights and the rule of law which has blocked Hungary's significant share of EU funds.

On the positive side, lower energy prices in 2023 compared with last year, and growth in exports have improved the current account, thus taking some pressure off the currency. Energy prices may remain volatile in 2024 and possibly higher than in 2023 amid continued geopolitical uncertainty, including the violent escalation in the conflict between Israel and Hamas in Gaza.

Scope currently forecasts Hungary's 2024 GDP growth at 2.5%, assuming an agreement for the release of EU funds – compared with official forecasts of between 2.8% (EU Commission) and 3.1% (IMF) – improved from 0.1% this year but below 4.6% in 2022.

GDP growth may rebound – but modestly – in 2024

Governance concerns pose risk to economic outlook

The unresolved dispute with the EU limits the government's room for fiscal manoeuvre and delays corporate investment. The European Commission froze EUR 7.5bn in regular EU payouts and EUR 5.8bn in pandemic recovery grants. The two funds are equivalent to 7.9% of GDP over the next couple of years.

Unresolving rule-of-low dispute with EU clouds investment plans

Unlike most other EU countries, Hungary remains exposed to Russian energy imports. Around 60% of mineral fuels in Hungary are imported from Russia compared with the EU average of less than 20% in 2022. Russia's Rosatom is also building Hungary's Paks II. nuclear power plant. While the rest of the EU has been reducing its economic ties to Russia, change in Hungary is unlikely due to its particularly close geographic and economic links to the country.

Nationalist industrial policy boosts local players

Hungary's government has used state funds to repurchase firms or aid local buyers with funding and guarantees to buy out foreign owners and to renew government infrastructure.

For example, in telecommunications, 4iG PLC bought UK-based operator Vodafone PLC's local operations. Opus Global PLC bought assets from Germany power utility E.ON SE. The local firms have bolstered their domestic market positions. This type of activity coupled with unpredictable taxation, including with several high, often partially retroactive levies, are denting investor confidence in Hungary.

Scope rates Hungary sovereign debt at BBB/Stable

Scope downgraded the sovereign rating of Hungary to BBB/Stable from BBB+/Negative in February 2023.

Foreign investment remains a driver of manufacturing activity

Healthy foreign investment in auto sector

Hungary has long enjoyed strong linkages to German car manufacturers such as Audi AG and Mercedes-Benz AG which have had plants in Hungary for many years. In addition, BMW AG is setting up new production facilities in the city of Debrecen while Chinese investments of up to EUR 11bn are planned for electric-vehicle and battery production. Chinese car and bus manufacturers are likely to follow.

The biggest bottleneck is labour and mass housing in a concentrated area, considering Hungary's low unemployment (4% in September 2023). In Debrecen, where EV output is one of the highest in the EU, 25-30,000 new jobs are being created over the next two years in a city with only 200,000 inhabitants.

Government plays central role in debt capital markets

State intervention has bolstered liquidity for SMEs

Hungarian companies have retained access to debt capital markets despite very high interest rates due to state-subsidised lending programmes such as EUR 4.2bn financing at yearly fixed interest rates of 5-6%, denominated in forint and euro, through the Baross Gábor Reindustrialisation Programme. The programme was intended mainly to cover increased working capital needs and capital expenditure. This helped Hungary avoid a corporate liquidity crunch and improved liquidity for many firms.

Central bank has diminished room for manoeuvre

However, there are no significant subsidised lending programmes available for large corporates because the central bank needs to maintain tight financial conditions to combat inflation and with its reported losses its room to manoeuvre became limited. Small and medium-sized enterprises (SMEs) that can still access the Széchenyi Kártya programme consisting of subsidised interest rate financing facilities, albeit in small amounts.

Table 1: Main factors driving changes in corporate credit ratings in Hungary

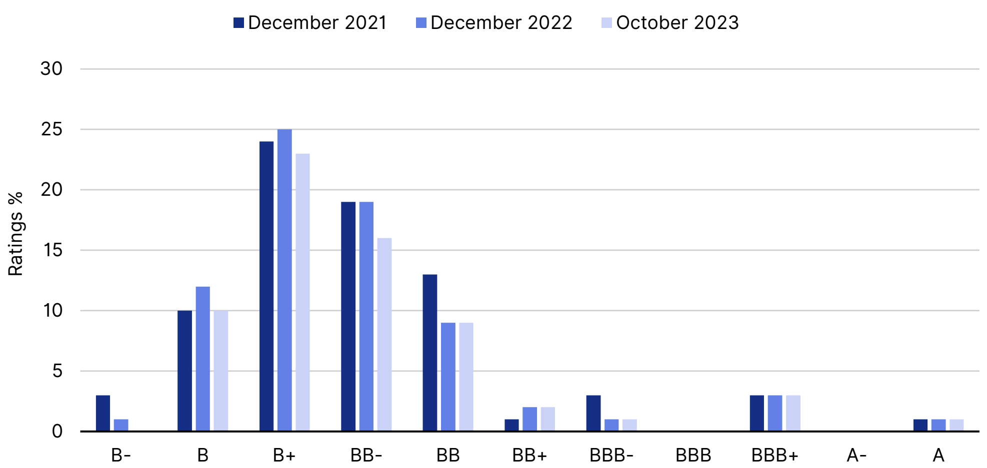
	Credit positive	Credit negative
High interest rates	• High deposit rate with positive effect on Scope-adjusted EBITDA / interest cover • Postponed CAPEX results in better financial metrics on short-term	• Credit negative until at least end of 2024 for new financing need and variable rate debt • Postponed investments hinder competitiveness, which is below EU average • Low demand from retail (consumption, housing) • High FX risk during decrease of base rate
High inflation	• Rising EBITDA and stable long-term debt can result in improving Scope-adjusted debt/EBITDA	• Decreasing purchasing power lowers and alters consumer demand • Double-digit inflation can stretch liquidity and result in inadequate liquidity
Dispute with EU		• Reduced government-backed infrastructure projects • Increasing sovereign risk
Government interventionism	• High investment subsidies • Limited funding available at reasonable interest rates of 5-6% yearly	• Unpredictable policy making dents investor confidence • High, ad hoc sector taxes
Strong foreign direct investment but tight labour market		• Exacerbates labour, housing shortages; offshoring to Asia is complex, time-consuming alternative • Steeply increasing labour costs

Scope's corporate ratings in Hungary

Scope Ratings rates 79 corporate issuers in Hungary mostly in the BB and B categories. In the tough operating environment in January through October 2023, 10 issuers were upgraded compared with five downgrades, though two issuers are under review for possible downgrade.

Scope covers 79 Hungarian companies

Figure 4: Rating distribution of Scope's Hungarian corporate issuer ratings



Source: Scope

Interest rates hedged at the right time for 10 years

One reason for the ratings stability despite high interest rates is that Scope rates issuers with fixed-rate debt related to the Bond for Growth programme of the central bank. These companies are less exposed to high interest rates. Other companies turned to cheaper euro-denominated borrowings or shorter tenors, pointing to potentially more risky financing structures if rates remain high and the forint depreciates, unless hedged by matching foreign currency revenues.

The positive rating actions in 2023 reflect the strong performance of vertically integrated consumer products companies or specialised retail, such as auto parts, which typically benefit during a recession. Industry consolidation and reduced capex also resulted in better-than-expected credit metrics – including higher EBITDA and stable debt – among utilities, telecom operators and holding companies.

The negative rating actions in 2023 reflect various reasons from increasing costs, decreasing demand, slow production ramp up of new production lines and governance issues.

Number of negative outlooks on the rise

Rising count of negative credit rating outlooks

While there is no deterioration in the average credit quality of our rating corporate portfolio in Hungary, there are signs of deteriorating metrics which we capture in the issuers' credit ratings.

We assigned six negative outlooks, half of which related to the construction sector and home builders, driven by the lower demand for investments from the government partially due to the blocking of EU funds in the dispute over the rule of law. The remainder were related to shrinking consumer demand as inflation has eroded households' purchasing power.

Four issuers have bonds in grace period at end-October

We note that four Hungarian bonds issued by companies we rate are in grace period at 31 October 2023 as their rating fell below B+. This may trigger debt acceleration that can have default implications.

Sector breakdown of ratings

Our Hungarian corporate ratings portfolio is diverse. The largest segments are B2B and B2C services, construction, consumer products, real estate and retail, making 60% of the issuer ratings.

Table 2: Sector breakdown of Hungarian corporate ratings by Scope at 31 October 2023

	Issuer Ratings	% of total
Business Services	15	19%
Construction	11	14%
Consumer Products	11	14%
Real Estate	11	14%
Retail	9	11%
Chemicals	4	5%
Utilities	4	5%
Agribusiness	2	3%
Asset Management	2	3%
Capital Goods	2	3%
Metals & Mining	2	3%
Others	6	8%
Total	**79**	

Source: Scope

Selected sector outlooks: construction, retailing face mixed prospects

Real Estate and Construction

Negative overall outlook for real estate, construction

The credit outlook for real estate developers is negative, particularly those with stretched liquidity, low pre-sale rates, unbalanced development pipelines and a high share of speculative projects.

For homebuilders, we see no significant turnaround in the short-term. The market is reliant mostly on cash buyers amid high mortgage rates and tighter credit requirements – in H1 2023, the number of approved housing loans fell 55% YoY. Centrally located, high-quality and energy efficient projects show good pre-sale levels.

Government subsidies have had little impact in supporting the housing market. Most grants are allocated to the secondary home market and the construction of individual homes. Transaction volume seems to have stabilised/bottomed in H1 2023 after declines last year. The pronounced decline in the number of apartments sold has not been matched by a drop in prices.

Industrial real estate, construction demand remains buoyant

For commercial real estate, financing remains constrained and highly dependent on the level of pre-commitment and conservative loan-to-cost/loan-to-value ratios requirements. The state-driven industrialisation programme could lead to new projects, but many existing ones are on hold and development volumes have fallen sharply subsequently, especially in the office segment.

Sentiment is better for industrial properties, as occupiers' demand for high-quality and energy-efficient assets remains strong. As such, the commercial development pipeline in Hungary is predominantly skewed toward the industry, though most projects are led by owner-occupiers rather than developers.

Order backlogs continue to remain low as public infrastructure investment has fallen due to the unresolved dispute with the EU and tighter financing conditions. Buoyant foreign investment is one favourable trend, focused in the auto sector, though projects are often too large for Hungarian construction companies: only a handful of rated entities are involved. We expect the backlogs of domestic construction companies to improve at the earliest in mid-2024.

Retail – Wholesale and Consumer Products

Tax, regulation crimps profitability in retail sector

The retail sector has been adversely affected by the windfall tax of around 4% based on revenues in addition to tighter food-price regulation. Profits have shrunk significantly. Some food retailers reported more losses in H1 2023 having fallen into the red in 2022.

Still, the performance of Hungarian companies in the sector is uneven as consumers have adapted to the more difficult economic climate of rising prices and lower disposable incomes. Supermarkets offering cheaper own-label products have benefited from greater bargain hunting. Auto parts suppliers have benefited from people delaying new car purchases, preferring to keep older vehicles on the road for longer. In contrast, retailers selling discretionary items have recorded sharp falls in demand.

Cooling inflation offers sector some relief

One factor helping offset falling profitability and diminished financial liquidity, features of Hungarian corporate performance in 2022 and early 2023, is the decline in input prices in recent months, compensating in part for reduced volumes and boosting liquidity.

Appendix I: Publicly rated corporates in Hungary by Scope

1 4iG Nyrt.
2 Abroncs Kereskedőház Kft.
3 Alfa Equity Holding Kft.
4 ALTEO Energiaszolgáltató Nyrt.
5 Appeninn Holding Nyrt.
6 Aranynektár Kft.
7 AutoWallis Nyrt.
8 AXIÁL Kft.
9 B+N Referencia Zrt.
10 Baromfi-Coop Kft.
11 BAYER Construct Zrt.
12 Biggeorge Property Zrt.
13 Bonafarm Zrt.
14 CLA Pig Kft.
15 Communication Technologies Kft.
16 CORDIA International Zrt.
17 Daniella Kft.
18 Duna Aszfalt Zrt.
19 Duna House Holding Nyrt.
20 DVM Group Kft.
21 ÉLTEX Kereskedelmi és Fuvarozó Kft.
22 ENSI Kft.
23 Envien Magyarország Kft.
24 ÉPKAR Zrt.
25 FORRÁS Vagyonkezelési és Befektetési Nyrt.
26 FUTUREAL Development Holding Ingatlanforgalmazó Kft.
27 Global Refuse Holding Zrt.
28 GOPD Nyrt.
29 Greenergy Holding Vagyonkezelő Zrt.
30 GTC Real Estate Development Hungary Zrt.
31 GVC George's Venture Capital Zrt.
32 HELL ENERGY Magyarország Kft.
33 Hunland Trade Kft
34 INFOGROUP Holding Kft
35 Inotal Zrt.
36 ITK Holding Zrt.
37 KÉSZ Holding Zrt.
38 KOMETA 99 Zrt.
39 Kopaszi Gát Zrt.
40 Lexholding Zrt.

41 LP Portfolio Kft.
42 Magyar Telekom Nyrt.
43 Market Építő Zrt.
44 Marso Kft.
45 Masterplast Nyrt.
46 Mercedes-Benz Manufacturing Hungary Kft.
47 MET Hungary Solar Park Kft.
48 Metál Hungária Holding Zrt.
49 MetMax Europe Zrt.
50 MOBILBOX Konténer Kereskedelmi Kft.
51 MOL Magyar Olaj- és Gázipari Nyrt.*, MOL Group Finance Zrt. *
52 Naturtex Kft.
53 Nestlé Hungária Kft. *
54 NITROGÉNMŰVEK Vegyipari Zrt.
55 OPUS Global Nyrt.
56 OPUS TIGÁZ Zrt.
57 Otthon Centrum Holding Kft.
58 Pannonia Bio Zrt.
59 OTP Bank Nyrt.
60 Pannon-Work Zrt.
61 Pick Szeged Zrt.
62 Progress Étteremhálózat Kft.
63 Reneszánsz Kőfaragó Zrt.
64 Richter Gedeon Nyrt.
65 Stavmat Építőanyag Kereskedelmi Zrt.
66 Sun Group Kft.
67 SunDell Estate Nyrt.
68 Szabó Fogaskerékgyártó Kft.
69 Szinorg Universal Zrt.
70 Textúra Zrt.
71 TRANS-SPED Logisztikai Szolgáltató Központ Kft.
72 Tranzit-Food Kft.
73 Unix Autó Kft.
74 Vajda-Papír Kft.
75 Vasútvill Kft.
76 Vöröskő Kft.
77 Wellis Magyarország Zrt.
78 Wingholding Zrt.
79 ZALACO Sütőipari Zrt.

Note: * Subscription ratings available on Scope's digital platform ScopeOne

Related Research

Hungary sovereign rating (4 August 2023)
Hungary - corporate credit outlook for 2023 (14 November 2022)
Hungary's temporary taxes take on permanent look, weighing down on investment, credit outlook (13 June 2023)

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