Republic of Hungary And National Bank of Hungary 'BBB-' Ratings Remain On Watch Negative

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Standard & Poor's Ratings Services today maintained its CreditWatch on the 'BBB-/A-3' foreign- and local-currency sovereign credit ratings on the Republic of Hungary. The ratings were initially placed on CreditWatch with negative implications on Nov. 11, 2011.

The 'BBB-' long-term rating on the National Bank of Hungary will also remain on CreditWatch with negative implications for the same period.

The CreditWatch status reflects our view of the likelihood of a downgrade if economic growth prospects and fiscal and external performance are impaired by weaker predictability and credibility of Hungary's policy framework. However, the terms of an IMF/EU program, particularly one including a financing package, may head off those policy consequences.

Our view of Hungary's policy framework is informed, in part, by official actions that we believe have diminished the independence of Hungary's oversight institutions, and complicated the operating environment for investors. Moreover, in our opinion, the downside risks to Hungary's creditworthiness are also increasing as the global and domestic economic environments weaken.

In particular, the imposition of temporary tax hikes on various services--including telecoms, energy, and the financial and retail sectors--is likely in our view to discourage investment and job creation in the short term. Such tax hikes could constrain growth prospects at a time when risks to the open Hungarian economy are rising due to the uncertain outlook for the global economy. We also believe that the recent move to facilitate households' prepayments of foreign-currency-denominated mortgages at concessional exchange rates could further reduce the supply of credit to Hungary's economy.

In our view, both policymaking and creditworthiness could be bolstered from participation in a multilateral program. On Nov. 19, 2011, the Hungarian government formally approached the IMF and the EU regarding a new financing arrangement; the previous joint program had expired in October 2010 without another program being agreed. The government has indicated that any assistance it may receive will be treated as precautionary, meaning that it does not intend to draw on approved funds. Discussions on a new program are expected to commence shortly and the Hungarian government envisions that an agreement could be in place by February 2012.

Resolution of the CreditWatch is likely before the end of February 2012, once we have more information about Hungary's policy framework and the likelihood of an IMF/EU agreement being reached.

We believe that, as with the previous program, an IMF/EU agreement could improve the predictability and quality of Hungary's policymaking. In our view, it could also help to improve Hungary's access to, and reduce funding costs in, the capital markets. In our opinion, the likelihood of a new IMF/EU agreement could swing on amendments by the Hungarian government to aspects of policy measures such as the tax increases described above. In our view, negotiations with the IMF and EU could particularly focus on measures Hungary would be required to take to achieve fiscal targets, although we believe that Hungary is committed to meeting those targets.

We believe that without an EU/IMF program, Hungary is likely to face higher and more-volatile funding costs. This could lead in our view to negative balance sheet effects that could increase private and public sector debt and weigh on economic performance, with negative implications for Hungary's debt dynamics.

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