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December 16, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Hungarian People's Republic - Staff Report for the 1983 Article IV Consultation and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Hungary and its request for a stand-by arrangement equivalent to SDR 425 million. Draft decisions appear on pages 24 and 25.

This subject has been tentatively scheduled for discussion on Friday, January 13, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mrs. Junz, ext. 72967 or Ms. Salop, ext. 74897.

Att: (1)

INTERNATIONAL MONETARY FUND

HUNGARIAN PEOPLE'S REPUBLIC

Staff Report for the 1983 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the European Department and the Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by L. A. Whittome and Subimal Mookerjee

December 15, 1983

I. Introduction

Discussions for the 1983 Article IV consultation with Hungary and for a request by Hungary for a new stand-by arrangement with the Fund were conducted in Budapest during October 11-November 1 and November 27-December 3, 1983. 1/ The Hungarian representatives included senior officials of the National Bank of Hungary, the Ministries of Finance and Foreign Trade, and the National Planning Office. Members of the mission also met with the Deputy Chairman of the Council of Ministers, Mr. Marjai, the Minister of Finance, Mr. Hetenyi, the President of the National Bank of Hungary, Mr. Timar, the First Deputy President of the National Bank, Mr. Fekete, and the Deputy Chairman of the National Planning Office, Mr. Pulai. Mr. de Groote, Executive Director for Hungary, was present for part of the discussions.

Hungary continues to avail itself of the transitional arrangements under the provisions of Article XIV.

The proposed quota of SDR 530.7 million under the Eighth General Review was approved by the Presidential Council of the Hungarian People's Republic on October 28, 1981.

A 13-month stand-by arrangement for Hungary in an amount equivalent to SDR 475 million (126.7 percent of the present quota of SDR 375 million) was approved by the Executive Board on December 8, 1982 (EBS/82/206, 11/10/82). The midterm review was completed at EBM/83/91 (6/24/83) on the basis of EBS/83/110 (5/27/83). Hungary has thus far made four purchases, totaling SDR 391.8 million, under the arrangement. The fifth and last purchase--for which the performance criteria have been met--becomes

1/ The staff teams were headed by Mrs. Junz (EUR) and included, for varying periods of time, Messrs. Hole (EUR) and Belanger (ETR), Ms. Salop, Messrs. Somogyi and Stanyer (all EUR) and Mr. Nivollet (FAD, EP), with Miss Pike (EUR) as secretary during the first visit and Miss Stuart (EXR) as secretary during the second visit.

available after December 14, 1983. As of November 30, 1983, the outstanding use of Fund credit by Hungary amounted to 123.7 percent of the present quota (87.4 percent of the new quota); excluding a purchase under the compensatory financing facility, holdings amounted to 104.5 percent of quota (73.8 percent of the new quota).

In the attached communication to the Managing Director, Hungary requests a new 12-month stand-by arrangement in an amount equivalent to SDR 425 million (80 percent of the new quota). Financing of the proposed stand-by would be SDR 212.5 million from ordinary resources and SDR 212.5 million from borrowed resources. Purchases would be available in four installments, with the first, of SDR 127.5 million immediately following approval of the arrangement; the second, of SDR 99.2 million, not before May 15, 1984; the third, of SDR 99.2 million, not before August 15, 1984; and the fourth, of SDR 99.1 million, not before November 15, 1984. Of the total amount, 53.3 percent would be purchased before the review scheduled for June 1984. The resulting Fund holdings of forint are shown in the table attached to Appendix III. A waiver of the limitation in Article V, Section 3(b)(iii), of the Articles of Agreement would be required.

In the IBRD, Hungary has been judged to qualify for medium-term project loans. In June 1983, the Bank approved loans of US$109.0 million for an Industrial Energy Diversification and Conservation Project and of US$130.4 million for a Grain Storage and Agricultural Mechanization Development Project. Additional foreign exchange for the projects is being made available through three cofinancing loans involving direct IBRD participation: two Japanese yen loans totaling the equivalent of about US$70 million, and a Eurodollar loan of US$200 million. Total disbursements by the IBRD in connection with these projects are tentatively estimated to amount to about US$16 million in 1983 and US$60 million in 1984. Negotiations are in an early stage on a third project for promoting exports to the convertible currency area.

II. Recent Economic Developments

1. Overview

Hungarian economic policy over the past several years has been directed in the first instance toward correcting a substantial external disequilibrium that stemmed from both the overoptimism generated by the economic buoyancy of the early 1970s and the large-scale weakening of the terms of trade following 1973-74. A corollary to the overexpansion of that period was a rapid accumulation of foreign debt, the use of which, once economic circumstances altered, was no longer able to earn the rates of return needed for debt service. Against this background, and in the face of a heavy schedule of maturing medium- and long-term debt in 1982-85, as well as a need to roll over large amounts of short-term debt, the principal objective of recent policy has been to bring about a large and sustainable improvement in the current account in convertible currencies. The stabilization program adopted to this end in 1982 was targeted to bring about a shift from a deficit of US$727 million in 1981 to a surplus of US$600 million in 1983. Subsequently, at the midterm review, the 1983 forecast was scaled back to a surplus of US$500 million, largely in the light of weaker-than-anticipated prices in external markets. Together with purchases from the Fund, a strengthening of the current account by this amount was still expected to permit a reduction of borrowing from market sources and some rebuilding of external reserves. Thereby, it was hoped to reduce the vulnerability of the balance of payments to adverse shifts in market sentiment and to position the economy better to meet continued heavy debt servicing obligations in 1984-85.

In order to achieve the external target, the program foresaw a reduction of real domestic demand by somewhat more than 1 percent in 1982 and by 3-4 percent in 1983. This was to be achieved primarily through a sharp tightening of financial and incomes policies, an improvement in incentives to save, and a more active exchange rate policy. While these various measures were taking effect, temporary recourse was made in the latter part of 1982 to import restrictions, but it was envisaged that these would be removed in the course of 1983.

In the event, the authorities' efforts to implement this program have met with only partial success. Although the current account deficit in convertible currencies in 1982 was reduced to US$60 million, or by about US$100 million more than targeted, domestic demand was more buoyant than planned, due to an overshooting of gross investment and private consumption. The latter development stemmed essentially from a stronger-than-expected increase in income from private sector activities, following their liberalization at the beginning of the year. 1/ As such, it went hand in hand with a larger-than-projected increase in output which, together with exceptionally good crops and savings in intermediate inputs, left room for an improvement in the real foreign balance of fully 3 percent of the previous year's GDP, as planned.

1/ In 1982, private sector activity accounted for rather more than 10 percent of GDP.

In 1983, the current account has improved further, but by significantly less than targeted, notwithstanding the maintenance of the import restrictions introduced in 1982. For the year as a whole, a surplus of some US$300 million is now projected, which would bring the improvement in the current account from 1981 to more than US$1 billion, or the equivalent of some 5 percent of projected GDP in 1983. The shortfall from target has had its origin largely in a somewhat larger deterioration in the terms of trade and sharply lower prices for both exports and imports than had been anticipated, 1/ and in the impact on agricultural exports of drought. While domestic absorption has been considerably stronger than planned, there appears to have been little spillover into trade in convertible currencies, with an overrun on consumption more or less matched by the higher supplies provided in part by the private sector, and an investment overrun accommodated by a rundown in machinery stocks, larger-than-planned imports from the nonconvertible currency area, and additional construction services.

Through end-September 1983 all performance criteria under the stand-by arrangement were observed (Table 1). However, mirroring the smaller-than-programmed improvement in the external current account and bigger-than-programmed holdings of currency, the limits on net domestic assets of the National Bank have come under increasing pressure since mid-1983, and it is now thought unlikely that the end-December ceiling can be met.

2. Domestic economy

The original program for 1983 aimed at reducing real domestic demand by 3-4 percent, this objective being consistent with a current account surplus in convertible currencies of US$600 million, a small decline in real GDP, and a moderate deterioration in the terms of trade. The greater buoyancy of demand and supply registered in 1982, however, spilled over into 1983 with domestic absorption and production running well in excess of program targets during the first part of the year. This occurred at a time when, with prices in export markets falling below expectations, an increasing share of domestic supply needed to be directed to achieving the external adjustment target. Thus, various supplementary policy measures designed to realign domestic demand with program targets were introduced as the year progressed. The first policy package, in the early months of 1983, focused on investment and included a partial freezing of state and enterprise investment funds, a tightening of credit, and an acceleration of credit repayment schedules; it is estimated to have immobilized investable resources equivalent to about 1/2 percent of projected domestic demand. Around midyear, in the framework of the midterm review, a second package was put in place designed to withdraw purchasing power equivalent to some 3/4 percent of domestic demand. It was aimed largely at restraining the growth of consumption and included a reduction of consumer price subsidies, increases in administered prices, a virtual

1/ Since the trade balance is in surplus, proportionally lower import and export prices result in a smaller surplus, even without a change in the terms of trade.

freezing of wages in the government sector, and a depreciation of the forint. Steps were also taken to contain investment expenditures by higher interest rates, a confiscation of working capital funds from inefficient enterprises, the freezing of additional enterprise investment funds, and increases in average effective tax rates on construction and investment. More recently, in September, the prices of certain foods were increased by 10-23 percent, raising the consumer price index by about 1/2 percent at an annual rate.

Despite these various steps, domestic absorption has continued to run ahead of program. For the year as a whole, final expenditure is now projected to decline by only 1/2 percent in volume terms, rather than by 3 percent as programmed at midyear (Tables 3 and 4). Compared with 1982, real personal consumption is forecast to remain roughly unchanged, instead of falling by 2 percent, due largely--as in 1982--to unexpectedly strong growth of incomes in the private sector (Table 5). Private sales of farm products and the activities of the new economic partnerships have increased particularly rapidly. At the same time, the rise in consumer prices, and thus the absorption of household purchasing power, has been less than projected (an estimated 7 3/4 percent, against 8-9 percent), primarily because of weaker-than-anticipated foreign prices.

Fixed investment outlays have also been noticeably stronger than programmed, declining by an estimated 2 percent in volume terms rather than by about 7 percent as planned. In the state sector, in part because of unanticipated deliveries of capital goods from the CMEA area, work on large projects financed by credits from the State Development Bank (SDB) has surpassed earlier projections. Capital outlays on infrastructural projects by local authorities have likewise run ahead of plan, financed primarily by larger-than-programmed contributions from enterprises and the population. In addition, enterprise investment has been unexpectedly buoyant, reflecting better profits than expected, a larger-than-planned drawdown of reserve and development funds, and a more moderate rise in inventories than projected.

Current estimates suggest that the overrun in real final expenditures in 1983 is likely to total 2 1/2 percentage points, with the resources being provided by the following deviations from program targets: smaller stockbuilding of 1/2 percentage point; larger GDP of somewhat more than 1 percentage point; and smaller net exports of somewhat less than 1 percentage point. However, if the estimated effects of the drought of 1983, which depressed GDP, stockbuilding, and exports, are excluded, a somewhat different accounting of the accommodation of the 2 1/2 percentage point overrun on domestic absorption emerges: viz., larger internally generated supplies of about 2 percentage points of GDP and larger net imports--mostly machinery from the CMEA area--of somewhat under 1/2 percentage point. Although a rundown of certain stocks appears to have accommodated a significant part of the overrun of investment demand, this was broadly offset by an accumulation of stocks of unfinished goods. The maintenance of tightened import restrictions prevented the domestic demand overrun from resulting in an even larger shortfall from target of the convertible current account.

3. External developments and policy

Although the overrun of domestic demand was largely prevented from spilling over into the trade balance in convertible currencies, the improving export performance was not matched by an improvement of cash receipts because of a continuous weakening of export prices and involuntary extensions of export credit to countries in payments difficulties. Excluding rising re-exports of energy products, the volume of exports settled in currencies other than rubles is estimated to have increased by 4.4 percent in 1983, following an increase of more than 7 percent in 1982. 1/ This growth is expected to be achieved even though the forecast for exports of grains and vegetable oils has been reduced following the drought, and reflects further market penetration, especially in the Middle East. But with prices falling by 10 percent in 1983, following a decline of 7.6 percent in 1982, total export receipts in convertible currencies in 1983 are estimated to be US$100 million below their 1982 levels. Excluding imports for re-export, 2/ the volume of imports settled in currencies other than rubles is estimated to have fallen by about 2 percent in 1983, following a decline of 5 percent in 1982. With import prices falling by 8 percent, the trade balance improved in 1983 by a little over US$100 million (Table 7), about US$180 million less than programmed at the time of the midyear review and about US$260 million below the original target. Of the former shortfall about US$100 million is explained by the effects of the drought on exports and about US$70 million by the worse-than-expected development of trade prices.

Developments in 1983 on current services and transfers have been broadly in line with earlier expectations; the deficit is now estimated to be US$577 million, compared with US$829 million in 1982 and US$1,172 million in 1981. As the level of foreign debt has fallen and the maturity structure improved, interest payments have been reduced, helped by improved access to more favorable sources of financing and lower interest rates. However, the trend growth in the surplus on travel account appears to have been arrested in 1983, largely because of reduced tourist arrivals from Yugoslavia.

The improvement on current account has brought a significant improvement in the attitude in financial markets toward Hungary. During the first six months of 1983, there still was a net outflow of about US$0.5 billion, marking the reversal of capital inflows that had helped bolster the reserve position in late 1982, and the continuation into early 1983--albeit on a lesser scale than in 1982--of withdrawals of maturing deposits by some banks (Table 6). Since then, the availability of both short- and long-term capital has improved significantly, with

1/ Staff estimates. Since published trade statistics include re-exports and associated imports, the behavior of the volume and value indices may be significantly distorted at times of sharp fluctuations in the value of re-export trade. This has been the case since the last quarter of 1982 for trade in energy products settled in currencies other than rubles, exports and imports of which increased to more than US$200 million per quarter from US$70-80 million previously.

2/ Staff estimates.

short-term liabilities in convertible currencies falling by only US$100 million between March and September, despite repayments to the BIS of US$300 million. For 1983 as a whole, the balance of long-term financial flows has been revised from a forecast outflow of US$0.4 billion to a surplus of US$28 million, due in particular to the recent signing of loan agreements amounting to US$270 million for cofinancing of IBRD projects. As a result, the overall balance of payments deficit in 1983, at an estimated US$0.2 billion, will be US$1 billion below the 1982 level.

Reflecting the above developments and purchases of some US$265 million from the Fund, gross international reserves in convertible currencies, which fell from US$1,112 million at the end of December 1982 to US$638 million in March 1983, recovered to US$745 million at end-September 1983 (Table 9). Concurrently, external debt in convertible currencies (including liabilities to the Fund) was reduced from US$7.7 billion at the end of 1982 to US$7.4 billion at end-September 1983 (Table 10)--most of the reduction reflecting the appreciation of the U.S. dollar relative to the other currencies in which the debt is denominated.

In contrast to the balance of payments in convertible currencies, a larger deficit is expected in 1983 in the current account in nonconvertible currencies (Table 8). In part, this deviation is attributable to larger-than-planned imports of capital equipment from the CMEA area in conjunction with the PAKS nuclear power project. It is now estimated that the volume of imports settled in rubles will rise by 0.3 percent in 1983, compared with the decline of 2 percent expected earlier, while the volume of exports is now expected to increase by 6.4 percent, compared with the previous target of 6.2 percent. The terms of trade for ruble transactions worsened further in 1983 by 2.7 percent, as prices for intra-CMEA trade in petroleum and raw materials continued to catch up with developments in world markets. The larger external current deficit was financed by the accumulation of short-term liabilities.

4. Money and credit

Monetary and credit developments in 1983 partially reflect the shortfalls from the current accounts programmed vis-à-vis the convertible and nonconvertible areas, with overall net foreign liabilities (NFL) of the banking system now expected to be 4 percent more than programmed (Table 13). For transactions in convertible currencies, NFL are above target by somewhat more than half the corresponding current account shortfall; the remaining portion is accounted for by lower net foreign assets of the nonbanking sector, partly owing to smaller-than-forecast export credit extensions. Of the current account shortfalls financed through the banking system, roughly half is due to higher-than-forecast credit to enterprises and half to drawdowns of enterprise deposits in reserve and development funds.

While credit to enterprises expanded by somewhat more than programmed--4.0 percent rather than 2.6 percent--the overrun appears to have had little direct causative influence on the shortfall on current account in convertible currencies, which, for the most part, was due to smaller-than-programmed export receipts. The overrun on credit to enterprises comprised excesses on working capital (Ft 2.0 billion) and loans extended by the State Development Bank (Ft 4.5 billion). At least half of the latter was to finance the aforementioned advance equipment deliveries from the CMEA area. Since the shortfall on current account in nonconvertible currencies has been due to higher imports, it appears reasonable to infer that the overrun in NFL prompted by the credit overrun was mostly vis-à-vis the nonconvertible area, with the overrun in NFL in convertible currencies financed by the drawdown of enterprise deposits accompanying the shortfall in export receipts.

While enterprise deposits at end-year are now expected to be Ft 7.9 billion below the program forecast, enterprise liquid deposits are expected to be Ft 2.4 billion above program. The two developments were to some extent related, with the relatively strong increase in liquid deposits deriving primarily from a run-down of inventories of machinery wholesalers in response--in the context of the import restrictions--to the investment overrun financed by greater use of enterprise reserve funds.

The resulting unexpectedly high liquidity of the banking system's domestic liabilities is reflected in deviations from program targets for velocity of currency, narrow money, and quasi-money, with the velocities of currency and narrow money below target by 2.6 percent and 2.1 percent, respectively, and the velocity of quasi-money above target by 2.1 percent (Table 14). These variations from targets have been mutually offsetting and, overall, the program target for broad money is expected to be realized.

With respect to currency, stronger-than-expected holdings in the enterprise sector, which have been due primarily to the more buoyant-than-expected developments in the free economy, have been augmented by larger-than-programmed holdings of vault cash by the branches of the National Savings Bank (NSB) in response to the growth both of housing loans in rural areas (where disbursements are typically in cash) and of household demand deposits. Notwithstanding these developments, net domestic assets of the National Bank of Hungary (NBH) were held within the program ceilings at end-June and end-September (Table 15). By end-December, however, the continuing overrun on currency is expected to be accompanied by an overrun on net foreign liabilities, reflecting the shortfall on current account, and it is considered unlikely that the program ceiling can be held to.

5. Public finance

Since the midterm review, the state budget has improved more rapidly than anticipated by the authorities. The budget deficit is now forecast to be Ft 2.6 billion (Table 16) compared with the target of Ft 6.0 billion set at the time of the review and Ft 8.0-9.0 billion set in November 1982. On present estimates, the reduction in the deficit between 1982 and 1983 would total Ft 9.6 billion (1 percent of GDP), with revenues rising by 11.0 percent and expenditures by 8.8 percent compared with programmed increases of 7.6 percent and 6.1 percent, respectively. The bulk of the above-program growth in the scale of government transactions is associated with a newly created State Lending Fund, which in 1983 is fully funded by budgetary receipts of IBRD credits and confiscated enterprise deposits and which, though included in the budget as an expenditure item, is kept on deposit at the NBH (see Section III, 2.b. below). In addition, the overall size of the budget has been boosted by pari passu increases in expenditures and revenues of the so-called budgetary institutions (hospitals, schools, etc.). Otherwise, budgetary expenditures are below and revenues above their respective program targets by small amounts.

Aside from the contributions to the State Lending Fund and spending by the budgetary institutions, expenditures included in the state budget are now forecast to be Ft 2.8 billion less than assumed in the program. Overruns on investment and subsidies totaling Ft 6.2 billion have been more than covered by smaller-than-programmed "other expenditures" and the utilization of the budgetary "reserve" (which, until it is spent, is carried in the budget as unallocated "other" expenditures). The overrun on investment has occurred despite the authorities' undertaking in May to freeze the budget's investment reserve; for the most part it represents larger advances to local councils for their program of purchasing and renovating houses for subsequent resale to the population. On subsidies (Table 17), deviations from program targets for consumer and producer subsidies more or less offset each other. However, modernization grants--which are primarily subsidies on exports to the CMEA area--have exceeded expectations, notwithstanding a large budgeted increase, and "other subsidies" have also run ahead of plan due to drought-related payments to agricultural entities and higher-than-forecast subsidies to local councils in connection with their rental-housing renovation program.

Abstracting from confiscated enterprise development and working capital funds--which, while anticipated at midyear, were not included at that time as a budgetary source--and receipts of the budgetary institutions, revenues of the state budget are now projected to total Ft 1.7 billion more than previously expected. For the most part this reflects higher-than-anticipated revenues deriving from the increases in the rates of taxation on investment and new construction implemented at midyear, although wage and social security tax receipts are also likely to be larger than expected in part because of higher payments of social insurance premia in the private sector.

6. Exchange and trade system

Effective September 1, 1982, several measures were introduced to restrict imports (Table 12). Imports of specified primary products were made subject to quantitative restrictions, while imports of component parts became subject to a 20 percent surcharge. Imports subject to these restrictions had amounted to US$1.5 billion in 1981, equivalent to

30 percent of total imports settled in currencies other than the ruble. Valued at 1981 prices, quotas announced for 1982 were set about US$60 million below 1981 imports. In addition, all import licenses were made subject to discretionary individual approval.

While the authorities had intended to eliminate these restrictions in 1983, unfavorable developments on the capital account in early 1983 and uncertain prospects for the remainder of the year concerning both capital inflows and foreign prices resulted in a postponement of their removal. Nevertheless, the quota and import licensing restrictions were eased partially as of January 1, 1983: viz., the proportion of imports subject to quotas in 1983 was reduced by about 20 percent compared with 1982, and importers handling large and frequent transactions were exempted from the discretionary individual licensing requirement, subject to prespecified quarterly limits in relation to 1981 imports. This simplification did not apply to imports of capital goods, for which licenses remained subject to individual approval.

Company-specific reference limits for 1983, below which individual licenses are automatically granted, range from 80 percent to 120 percent of 1981 imports (in forint), averaging 98.3 percent for all qualifying importers. Imports outside the reference limit system remain subject to individual approval. It is expected that such imports in 1983 will amount to 95 percent (in forint) of similar imports in 1981.

The import license is subject to Fund jurisdiction as a joint exchange and trade license. Also, the quotas on imports of certain raw materials, being implemented through the licensing system, are considered part of the licensing system. While Hungary avails itself of the transitional arrangements of Article XIV, the tightening of the import licensing system, and the imposition of certain import quotas since September 1982 amount to an intensification of an exchange restriction. These measures are thus subject to Fund approval under Article VIII, Sections 2 and 3.

Hungary's exchange and trade system involves a number of other exchange restrictions, some of which do or may give rise to multiple currency practices. In particular, broken cross rates may result from current practices in setting the exchange rate of the forint against convertible currencies. In addition, a multiple currency practice results from the significant difference between the implied and the explicit exchange rates between the forint and the national currencies of some other CMEA countries which are also Fund members. Hungary maintains bilateral payments agreements with 12 Fund members and a number of non-Fund members. 1/ It also maintains some other discriminatory restrictions against both Fund and non-Fund members. These restrictions and multiple

1/ In accord with Brazil, the bilateral agreement between Hungary and Brazil is being cancelled. In accordance with the terms of the agreement, the cancellation becomes effective in June 1984, that is, six months after the announcement of the partners' intention to terminate the agreement.

currency practices in their current form are treated as transitional arrangements under the provisions of Article XIV, and do not require Executive Board approval.

III. Principal Objectives for the Period Ahead

1. External setting and targets

The key objective of economic policy remains the maintenance of external solvency. Accordingly, and taking into account the large increase in debt service payments falling due in the next few years, the authorities envisage a further strengthening of the external current account in convertible currencies.

Over the medium term, it is expected that the current account surplus in convertible currencies can be increased gradually from US$0.3 billion in 1983 to US$0.7 billion in 1987-88 (Table 11). This projection assumes an annual rate of increase of non-oil imports by Hungary's trading partners of 4 percent, the maintenance of recently gained market shares, and annual increases in both export and import prices of 6 percent. Projected increases in imports are estimated to be consistent with annual rates of growth of GDP of 2-3 percent over the period 1985-88. Such an external performance would make it possible to increase reserves and reduce external debt in convertible currencies (including liabilities to the Fund) by about US$1.1 billion from the end of 1983 until the end of 1988. Thus, the ratio of debt service payments to exports of goods and services settled in convertible currencies, which is expected to increase from 33 percent in 1982 to nearly 40 percent in 1984, would subsequently decline gradually to less than 30 percent.

For 1984 the authorities have adopted a target of US$400 million for the current surplus in convertible currencies, with most of the US$100 million improvement over 1983 to result from an increase in the trade surplus. The larger trade surplus is expected to be achieved despite a projected further worsening of the terms of trade by 1.4 percent and a strong increase in imports as the restrictions imposed in September 1982 are gradually lifted. The liberalization of imports is estimated to result in increases in the volume of nonruble imports of 3.3 percent in 1984 and 5.1 percent in 1985--compared to unchanged real GDP in the former year and a 2 percent growth in the latter--thus adding US$110 million to import payments in 1984 and an additional US$190 million in 1985. Accordingly, a strong performance of exports will again be required. Projections for 1984 anticipate a growth in the volume of nonruble exports of 5.7 percent, implying a further small gain in market shares.

The deficit on current services and transfers is expected to be slightly smaller in 1984, contributing about one fourth of the projected improvement of the current balance. Key factors underlying the projected improvement of the balance on services are lower interest payments on external debt and a larger surplus on other current receipts, in particular fees and transit trade.

The larger current account surplus and purchases from the Fund under the proposed stand-by arrangement are expected to permit an increase in reserves in convertible currencies from US$1.3 billion 1/ at the end of 1983 to US$1.5 billion at the end of 1984, equivalent to 4.8 months of projected 1984 imports settled in convertible currencies. Such holdings of reserves would still be equivalent to only 60-70 percent of holdings in 1980-81 and be equal only to the amount of outstanding short-term debt. For added security, the authorities intend to seek additional credit lines from commercial banks for reserve contingencies.

Taking into account the large increase--to US$1.5 billion--in amortization payments in 1984 and the availability of capital from official and market sources now anticipated, it is projected that net repayments of medium- and long-term debt (excluding liabilities to the Fund) will amount to US$0.4 billion in 1984. To the extent that larger gross inflows can be raised, as was the case in 1983, the reserve position can be bolstered further.

Concurrent with the projected strengthening of the balance of payments in convertible currencies, a sharp reduction of the current account deficit in nonconvertible currencies--by US$270 million--is also programmed. During the late 1970s and early 1980s, the availability of foreign financing for the rising price of energy in intra-CMEA trade made it possible for Hungary to run sizable current account deficits in nonconvertible currencies. However, that financing is no longer available to such a degree, and the current deficit in nonconvertible currencies will have to be substantially reduced. The projected narrowing in 1984 is expected to be achieved despite a further worsening of the terms of trade as energy prices are raised further, and reflects a 7.6 percent programmed increase in the volume of exports to the ruble area.

2. Policies and prospects for 1984

The authorities recognize that for the current account surplus in convertible currencies to increase on the scale set out above, domestic demand will need to be reduced by a larger amount than in 1983. The economy now has a much smaller cushion of usable inventories to draw upon, and a further projected decline in the terms of trade is projected. In addition, the gradual elimination during 1984 of the import restrictions introduced in the latter part of 1982 will raise the ratio of convertible imports to aggregate expenditure. Finally, the planned reduction in the current account deficit with the nonconvertible area will absorb additional domestic resources.

All told, the balance of payments target for 1984 is thought by the authorities to be consistent with an improvement in the real foreign balance on a national accounts basis of much the same order as that realized in 1983, namely, the equivalent of some 2 percent of GDP. This is seen as requiring a reduction in the volume of domestic demand of some 2 percent and in final expenditure of close to 2 1/2 percent (on

1/ Gold valued at US$226 per ounce.

the assumption of some modest replenishment of the inventories run down in 1983). The Government's macroeconomic plan for 1984, in turn, looks for private consumption and public consumption to be reduced by about 1/2 and 1 1/2 percent, respectively, in real terms, and for gross fixed investment to be cut back by more than 8 percent.

In order to realize its demand management objectives, the Government intends to bring about a small reduction in real household incomes through wage and price policy measures, to increase incentives to save, to tighten credit policy significantly, and to improve the position of the state budget. In addition, significant structural reform measures will be implemented in 1984, aimed in the short run at maximizing output on the basis of the current composition of resources and, in the medium term, at increasing the efficiency of production and the intersectoral allocation of resources.

a. Incomes and prices

Wage regulations are to be set for 1984 which, after allowing for greater wage differentiation and a stronger increase on average in sectors subject to freer wage formation, will contain the growth of total nominal wage incomes to no more than 5 1/2 percent. Together with an increase in social benefits of up to 10 1/2 percent--broadly matching the projected rise in consumer prices plus the increase in the number of benefit recipients and higher pension entitlements of currently retiring persons--and in other incomes of an estimated 8 percent, this will hold the growth of disposable income of households to just below 8 percent.

Against this, it is planned that the consumer price index should rise by up to 9 percent. This is to result primarily from a reduction in consumer and producer price subsidies of Ft 20 billion from the 1983 level, which is expected to add 4.5-5 percentage points to the consumer price index. The balance of the increase reflects the carry-over effect of price adjustments in 1983, the impact on domestic prices of the expected movement of foreign prices in 1984, and additional steps to liberalize the system of producer and consumer price determination. Three quarters of the subsidy cuts will be implemented in January-February 1984, and decisions on the remainder will be taken within the first half of the year.

All told, real household disposable income is thereby programmed to decline by about 1 percent. With the household savings ratio expected to remain approximately constant, this would secure the targeted reduction in consumers' expenditure in the program period. In order to prevent a major reduction in the savings rate, the authorities will introduce incentives to long-term savings, including a 2 percentage point rise in the interest rate on household time deposits.

b. Money and credit

The authorities are aware that any overshooting of their domestic targets in 1984 is likely to be transmitted directly to the external sector. Therefore, they have taken measures and set credit targets designed to prevent an overrun on fixed investment. In 1983, the principal sources of financing for the overrun on investment were above-target credits extended by the SDB and drawdowns of enterprise development and reserve funds. To guard against a repetition of the former, the authorities have put a ceiling on SDB credit. To contain enterprise liquidity, a large part--some Ft 21 billion--of enterprise contributions to development funds in 1984 will be confiscated and the assets presently set aside in compulsory reserve funds will be neutralized. About two thirds of the latter funds--some Ft 26 billion--will be frozen, while Ft 13 billion will be converted into bonds which--at least for 1984--the NBH is committed not to buy back. Thus, an enterprise can liquidate its holdings of these bonds only if another enterprise is willing to purchase them. These withdrawals of enterprise resources follow confiscations in 1983 of Ft 7-9 billion in development funds, Ft 19 billion in reserve funds, and Ft 1-2 billion in working capital funds.

Despite strict regulations that govern the use of enterprise reserve funds, leakages into investment have been rising. At the same time, reserve funds have come to be seen by the authorities as a buffer against government policies, rather than the prudential shield against market and real shocks for which they were created. Against this background, and in anticipation of the large increase in 1984 in enterprise labor costs accompanying increase in the social security tax rate and decrease in consumer subsidies, the authorities consider it timely to release enterprises from their obligation to place a portion of after-tax earnings into reserve funds. In 1984 such contributions will still be obligatory on the basis of profits earned in 1983 and for replenishing drawings made in 1983 and previous years, but starting with profits earned in 1984, compulsory contributions will no longer be required.

In late 1983, the authorities created a State Lending Fund, financed by part of the confiscated development funds and by budgetary contributions. The resources of this fund are not meant to be spent as such, but rather to be a source of bank credit. In 1984, the authorities estimate that the lending fund will draw on budgetary revenues of Ft 14.8 billion, of which Ft 9.0 billion is the budget's share of the development funds to be confiscated in that year. The remaining Ft 12.0 billion expected to be confiscated from enterprise development funds is to form an "Intervention Fund" for recycling back to enterprises in extreme financial difficulty; the authorities estimate that Ft 4.0 billion will be paid out of this fund in 1984.

The magnitude of these various items--the confiscated reserve funds, the outstanding stock of reserve fund bonds, and the state lending and intervention funds--are clearly large and, in the staff's view, highly uncertain. For this reason and continued uncertainties concerning other deposits, credit policy in 1984 is to focus on net domestic credit of the banking system rather than gross domestic credit, with the preceding items--and "other items, net"--netted out of the totals. Thus, if during the course of the year these funds are smaller than programmed, then the gross credit target will be scaled back pari passu with the shortfall.

Over the year as a whole, net domestic credit of the banking system is targeted to rise by 2.1 percent, consistently with a current account surplus in convertible currencies of US$400 million and an increase in broad money of 4.4 percent (with a rise in velocity of 2.3 percent). Based on the official projections of the development of the various funds mentioned above, the implied growth in gross domestic credit would be 4.7 percent. However, in view on the previous record of enterprise compliance with the confiscation of such funds, the staff expects these banking system liabilities to evolve more slowly, producing a rise in gross credit of 3.4 percent. In line with this overall monetary framework--and in addition to the ceilings for March 31, 1984 that are proposed as performance criteria in section IV below--an indicative limit has been set under the program which provides for virtually no change in net domestic assets of the National Bank over the twelve months to end-1984.

c. Budget policy

The budget's position is to strengthen further in 1984, to a surplus of at least Ft 12.0 billion (1.3 percent of GDP). The improvement is concentrated in two major areas: subsidy cuts, and a 10 percentage point increase in the social security tax. The net impact of these policy changes on the budget will be moderated by sharply increased payments for social security. While some of the confiscated enterprise development funds will accrue to the budget, the projected amount falls short of the forecast contribution of the budget to the State Lending Fund (Table 16).

The authorities intend to reduce outlays for consumer and producer subsidies by Ft 20 billion (more than 20 percent) from their 1983 level. To date, they have already decided decreases of Ft 14.2 billion (Table 17) in consumer subsidies to take effect early in 1984--mostly for food and energy--and it is their intention to take the remaining steps at midyear. It is expected that the budget surplus, on Fund definitions, will increase above Ft 12.0 billion by the full amount of these subsequent cuts.

The authorities have dual goals in raising the social security tax rate--viz., to reduce substantially the operating deficit of the social security fund, which is expected to exceed Ft 20 billion in 1983, and to raise the cost of labor in order to induce its more rational utilization. It is not expected that the social security fund's deficit will be eliminated in 1984, since although revenues from wage taxes and social security contributions are forecast to grow by Ft 30 billion, larger expenditures are officially forecast to absorb about half this amount. The projected surge in nominal outlays results from demographic changes and higher prices. While the real value of pension benefits received by most individuals has been declining somewhat with the inflation of recent years, in per capita terms real pensions have been rising in line with the changing earnings history of the average pensioner.

d. External policy

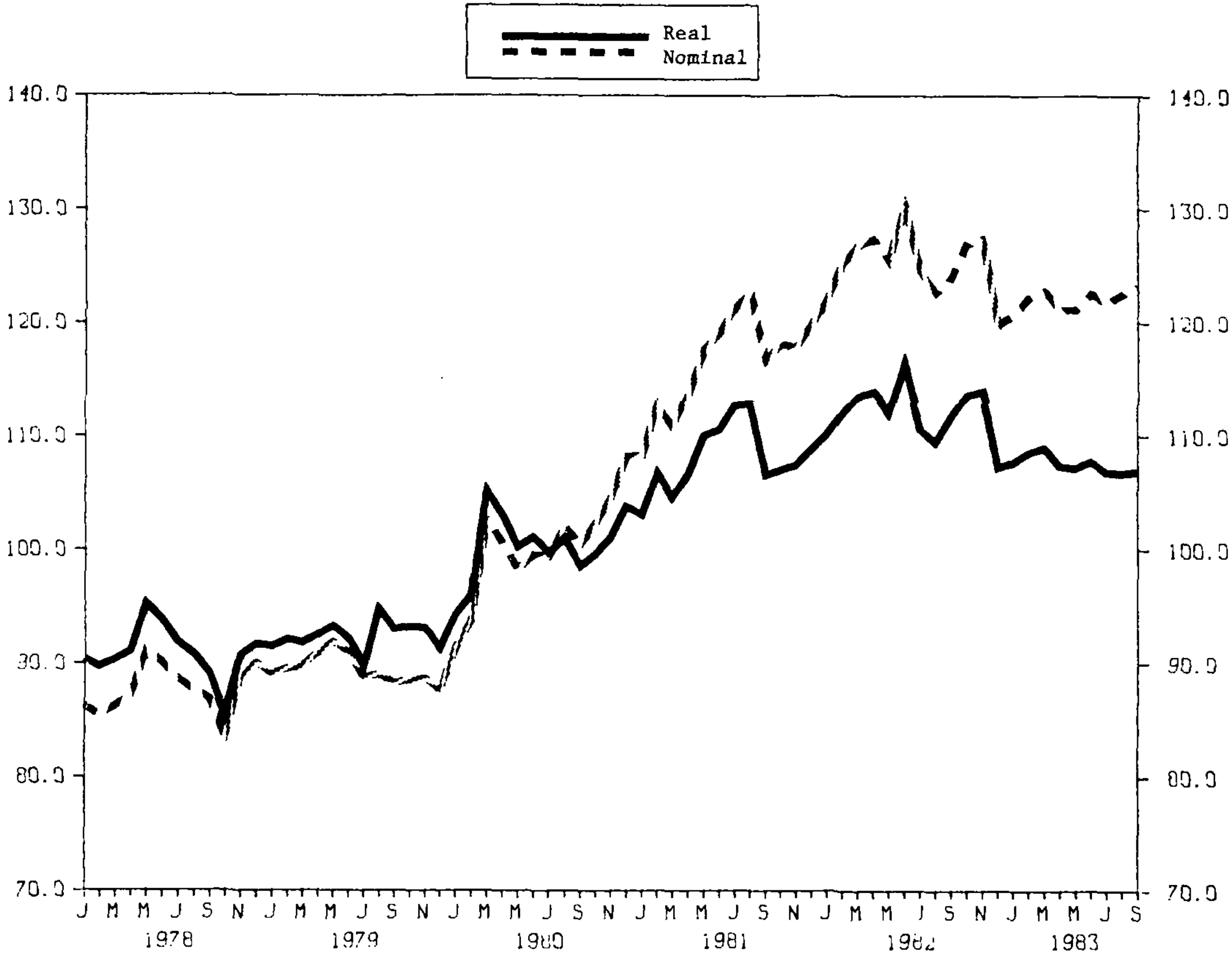
A key concern underlying exchange rate policy in recent years has been the maintenance of adequate levels of profit in the production of exportables. Thus, during the second half of 1982, the forint was depreciated by some 11 percent against the basket of convertible currencies to which it is pegged. Further depreciations, totaling 7 percent, were made during the first nine months of 1983. Accordingly, the real effective exchange rate for the forint depreciated by 8 percent between June 1982 and September 1983 (Chart). The authorities have indicated that they will continue a policy of timely exchange rate adjustments to ensure adequate profitability for exports and import substitutes.

Efforts to expand exports in recent years have also included increased authorizations for domestic producers to export directly rather than through foreign trading enterprises. This policy is to be continued in 1984-85, with foreign trading rights for exports and imports granted liberally upon proof of the ability of the enterprise to deal in foreign markets, and competition among foreign trading organizations being promoted by the elimination of administrative restraints on these activities.

Consistent with the intention of the authorities to remove the import restrictions introduced in September 1982 as early as possible, steps are being taken to ease them from January 1, 1984. About one quarter of the imports of raw materials now subject to quota limits will be freed from such restrictions at that time, while reference limits applied to large and frequent importers for the first half of 1983 will be raised by 15 percent, allowing thereby an increase in the volume of imports of about 5 percent relative to the first half of 1982. Similar increases will apply for the informal targets for imports effected outside the reference limit system, which are subject to individual discretionary approval. Reference limits have been set for the first six months of 1984 rather than quarterly, as was the practice in 1983. Further steps to be taken during the second half of 1984 to eliminate the remaining quotas on imports of raw materials, remove the surcharge on imports of component parts, and re-establish the automatic licensing system in force before September 1982 will be agreed at the midterm review.

The objective of the authorities as regards external debt policy is to continue improving the maturity structure of the debt. While a decline in outstanding medium- and long-term debt from market sources is projected, reflecting the bunching of maturities falling due, only a small increase in total short-term borrowing is envisaged. Most of the new borrowing is expected to be contracted by the National Bank and the Foreign Trade Bank. Consistent with the ceilings on net domestic assets and on the net foreign liabilities of the specialized banks, gross borrowing in excess of current envisaged amounts would result in greater accumulation of foreign assets. Except for foreign borrowing by the Government on the basis of intergovernmental agreements, all foreign borrowing requires the approval of the National Bank.

HUNGARY
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



e. Structural reform

In the framework of a more concerted effort toward structural reform, initial steps will be undertaken in 1984 aimed at a more rational allocation of resources and at strengthening the ability of the economy to adjust to changes in domestic and external markets.

The rationality of relative prices will be enhanced by the planned cuts in producer and consumer price subsidies and by making more flexible the rules of price formation for selected enterprises--accounting for about one quarter of the output of the manufacturing sector. For enterprises in this sector that operate under adequate competitive conditions, most administrative constraints on prices will be lifted, permitting them to be set freely, subject only to the condition of not exceeding import prices. For certain other enterprises, the price formation rule linking profit margins on domestic sales to those on foreign sales will be eliminated.

To encourage a more efficient use of labor by enterprises and greater labor mobility, the relative cost of labor will be raised and the scope for wage differentiation widened. Labor costs will rise not only as a result of the increase in employers' contributions to social security, but also through wage increases in conjunction with the scheduled curtailment of consumer price subsidies. Labor hoarding will be further discouraged and wage differentiation enhanced by an increase (from 30 percent to 60 percent) in the proportion of savings from reductions in staff that can be used to raise the wage rates of employees free of tax. Furthermore, the progressivity of the tax on wage increases will in some instances be reduced and the spread between the upper and lower limits of wage rates will be widened, particularly for employees working under hardship conditions, highly trained personnel, and managers.

In order to make relative prices more rational and enterprise profitability a more meaningful indicator of efficiency, adjustments are also to be made in the fiscal system. In addition to the cuts in subsidies, the rates of consumer turnover taxes will be streamlined and the number of depreciation rates greatly reduced. The upper limits of depreciation allowances for certain capital goods will be raised to reflect more closely the actual costs and economic life of the assets. A first step toward a uniform system of personal income taxation will also be taken with the institution of a single progressive tax on incomes earned in the private sector outside agriculture.

Further steps will be taken in 1984 to improve financial intermediation and the responsiveness of the economy to financial incentives. The authorities will continue to encourage both the placement of municipal bonds with individuals and the issuance of enterprise bonds. At the same time, the supply of tradable financial instruments will be expanded through the introduction of commercial bills for enterprises, discountable at the National Bank at a rate dictated by credit policy requirements. Beginning in 1984, the Bank will set a central bank rate as a precursor of an eventual bona fide discount rate and will start adjusting interest rates on deposits in line with changes in market conditions. In addition, the development of independent banking institutions will be promoted and first steps taken toward the eventual separation of the commercial banking and central banking functions of the National Bank.

IV. Performance Criteria for Proposed Stand-By Arrangement

The following performance criteria, the quantified components of which are set out in Table 2, are applicable for the proposed stand-by arrangement:

(1) a limit on the net domestic assets of the National Bank of Hungary on March 31, 1984;

(2) a limit on net credit from the banking system to the state budget on March 31, 1984;

(3) a limit on credit extended by the State Development Bank on March 31, 1984;

(4) a limit on net foreign liabilities in convertible currencies of the specialized financial institutions on March 31, 1984;

(5) a limit on the contracting of new foreign debt in convertible currencies by the nonbanking sector on March 31, 1984;

(6) a limit on total short-term debt in convertible currencies on March 31, 1984;

(7) the customary provisions regarding the exchange and trade system; and

(8) a review by June 30, 1984 to reach understandings on policies and performance criteria for the period June 30-December 31, 1984, including a review of exchange rate policy, of progress in eliminating the import restrictions introduced in late 1982, and of the implementation of structural policies.

Indicative limits for December 1984 and, on a selected basis, for June and September 1984 are shown in Tables 2, 13, and 15.

V. Staff Appraisal

The Hungarian authorities, in the attached letter of intent, are requesting a stand-by arrangement in the amount of SDR 425 million in support of a one-year stabilization program. The program is primarily one of demand management, bolstered by a number of structural reform measures. The authorities hope to be able to put together by mid-1984 a comprehensive program of structural reform, with specific measures to be taken beyond 1984; if so, they would be inclined to seek replacement of the arrangement now being requested by an 18-month arrangement that would continue until end-1985.

While there has been considerable slippage in performance under the current program--with an expected improvement of only US$360 million on current account in convertible currencies rather than the US$660 million improvement expected initially and the US$560 million improvement expected at the time of the midyear review, significant adjustment has taken place. Even with the shortfall, the transfer of resources to the external sector in 1983 amounted to the equivalent of nearly 2 percent of GDP, bringing the cumulative improvement since 1981 to close to 5 percent of GDP.

The expected shortfall in the convertible currency current account surplus in 1983 from that envisaged at midyear is largely explained by a loss of about US$100 million in exportables because of the drought and a worse-than-expected development of foreign prices, costing the external balance about US$70 million. The spillover into net imports in convertible currencies of domestic demand in excess of the program targets established at midyear has been small compared with the magnitudes of the overruns on consumption and fixed investment. This is because domestic supplies have proved relatively elastic and the maintenance of import restrictions has prevented demand from being reflected in a larger current deficit in convertible currencies, resulting instead in a drawdown of stocks of investment goods and a diversion of demand to the nonconvertible currency area.

To a large extent, the demand overruns were associated with the authorities' attempts to free up the economy, and illustrate the difficulties in moving from a centralized system of micro-controls to a decentralized system of macro-controls. Thus, the consumption overruns were primarily due to the private economy, and the overrun on enterprise investment was financed by enterprises' own funds. The authorities were rightly concerned with these overruns and during the course of the year took various additional measures without which the shortfall from the original targets would have been greater. Thus, monetary and fiscal policies were strengthened, wages were virtually frozen in the government sector, administered prices were increased, and the forint devalued. There was, unfortunately, an inability to contain credit expansion, in particular by the State Development Bank, and it is now expected that the overall credit target for the end of the year will be exceeded. The staff supports the proposal to put greater restraint on the SDB in 1984.

As to the authorities' policy intentions for the period ahead, three points are worth noting. First, the program is designed to rely on a simultaneous rise in export volumes and containment of imports to effect the current account improvement, and the plan is to replenish convertible currency reserves by at least US$250 million. Since the reserves would still remain well below the levels of end-1980 and end-1981 and be about equal only to outstanding short-term liabilities, the authorities also intend to seek commercial bank credit lines for reserve contingencies. If Hungary is successful in securing gross borrowings in financial markets of more than the US$1.1 billion presently projected, further increases in reserves will be possible. Second, the underlying adjustment path is reasonable and sustainable with the current account projected to rise from a surplus of US$300 million in 1983 to US$400 million in 1984 and US$700 million in 1988. Third, the authorities are continuing to move forward with measures of structural reform aimed at augmenting the efficiency and supply response of the economy.

The external target set by the authorities for 1984 implies a further shift of resources to the convertible currency area equal to 1/2 percent of GDP. Given the intention to remove gradually during the course of the year the import restrictions that were imposed in 1982 and retained in 1983 and the large improvement that is projected in the current balance in nonconvertible currencies, attainment of this target will require that domestic absorption be limited more strictly than it was in 1983. Given also that the targeted shift of resources is being sought at a time when Hungary's competitors in international markets are also attempting to expand their markets, the efforts to free domestic resources for exports and import substitution ought, in the staff's view, to err on the side of overfulfillment. However, the policies decided upon appear to strike only balance, with domestic absorption programmed to fall by 2 percent in real terms.

Moreover, as public and private consumption are to decline only moderately, by 1/2 and 1 1/2 percent respectively, the main burden of adjustment, for the fifth consecutive year, falls on gross fixed investment, which is to be cut back by more than 8 percent. The authorities are cognizant of the continued imbalance in such an adjustment pattern and the consequences for future growth that is entailed therein. Nevertheless, since the level of investment is still not unreasonable--25 percent of GDP, down from an unsustainable 30-35 percent in the mid-1970s--this cost can be borne until the external balance appears more secure. The longer-run consequences of reliance on cutbacks in investment could be lessened by ensuring that scarce capital resources are not squandered on loss-making enterprises with little or no prospect of longer-run viability, or on projects with below-average expected rates of return. While efforts to deal with this problem have been long-standing, so far they have tended to founder in the absence of financial responsibility at the enterprise level.

The authorities have designed their financial program for 1984 mindful of the 1983 overruns on enterprise and state investment and the sources of financing thereof. Thus, investable funds of enterprises are to be sequestered and either frozen or brought directly under government control in extrabudgetary funds. To reduce the risk that unanticipated leakages from these funds would increase enterprise liquidity and permit the financing of above-programmed amounts of enterprise investment, the authorities' internal target for domestic credit has been set on a net basis, with gross credit to be cut back pari passu with any such leakages. Furthermore, as a major source of financing of the overruns on state investment in 1983 has been the virtually untrammeled activity of the State Development Bank, the Government from 1984 forward will put a ceiling on the Bank's outstanding credits and this ceiling will const - itute a performance criterion within the Fund program. With the planned increase in net domestic credit in line with the domestic absorption targets, and the safeguards adopted with respect to the activities of the State Development Bank and the liquidity of enterprises, investment expenditure should be under much better control in 1982.

While recognizing the need for stringent demand management efforts in 1984, the Hungarian authorities are quite aware that to consolidate the tangible results achieved so far toward attaining external balance, they cannot rely exclusively on demand restraint. Rather, if the gains of the past two years are not to erode, demand management must be coupled with measures designed to increase supply. In the recent period, the authorities' efforts to make the economy more adaptable and responsive to market forces have been severely circumscribed by tight external constraints. In addition, there are limits to the pace at which wages and prices can be freed from the regulations that currently prevent an efficient allocation of resources, partly because of the social and economic consequences of the inflationary impulses that would be so generated.

The latter constraint is particularly severe in a country whose population has experienced hyperinflation twice--with the last one the worst in recorded history--in recent memory. Since savings instruments for households still are confined to savings deposits and recently introduced municipal bonds, income bulges can be largely absorbed only by price erosion or taxation, if demand-management needs so require. While steps are being taken to introduce a unified personal income tax system, the time horizon for full implementation, of necessity, is long, and in the meantime, the authorities remain diffident about moving broadly to free wages and prices. Caught between the self-imposed constraint of keeping the rate of inflation below the two-digit level and the priority given to encouraging the growth of the private sector and small business activity, the authorities have decided to restrain the growth of wage incomes to around 4 percentage points below the projected rate of increase of 9 percent for the consumer price index. This policy, however, is at some odds with the goal of achieving greater wage differentiation and a generally higher cost of labor relative to capital. Because there is some limit to restraint of industrial wages as compared with labor income generated elsewhere in the economy, demand-management efforts to reduce consumption in this way are also limited. This, as noted above, forced the Government to put the burden of demand restraint on the most dynamic part of the enterprise sector.

The authorities are seeking to move as fast as possible under these circumstances to improve the responsiveness of the economy to market stimuli and to improve the efficiency of resource use. However, time is needed to fashion a coherent program of structural reform since the elements are mutually interdependent. Thus, the freeing of wages and prices must be supported by financial autonomy of enterprises, which, in turn, presupposes the existence of an efficiently working financial intermediation system. Furthermore, the move from a system of direct controls over enterprises to increased reliance on indirect macroeconomic control mechanisms depends upon appropriate tax and monetary instruments being available and properly utilized. None of the supporting institutional changes should be fashioned in haste. However, the authorities have been refining their structural reform concepts for some time and now feel that by midyear 1984 they will have in hand a fully articulated program covering the 18 months to the end of 1985.

In these endeavors, the staff would urge the authorities to move with considered speed, and not to lose their momentum by deliberating too long. Consolidation of the adjustment gains crucially depends upon the structural changes, now being mapped out, being implemented effectively. It would seem that already in 1984 forward moves beyond those set out in the attached letter of intent should be possible. This appears particularly true for wage differentiation, market-determined formation of prices--not only for large exporters but also for other producers not in a monopolistic position such as those faced with competition from imports--and financial intermediation. In the latter respect an early move by the National Bank of Hungary to unify its criteria for evaluating applications for investment credits across the various sectors of the economy would constitute a significant and necessary step toward the decentralization of the banking system.

The staff welcomes the first steps taken by the authorities as part of the program adopted for 1984 to introduce some of the much-needed structural reforms, in particular, the steps taken to raise the cost of labor, to increase the scope for wage differentiation and freer pricing, to reduce producer and consumer subsidies, and to end the compulsory reserve fund. The staff also welcomes the measures taken by the authorities to remove in part the restrictions of September 1982 and the intention of the authorities to remove the remaining restrictions during the second half of 1984. Provided that the steps taken in 1984 are supported fully by strict adherence to the demand management policies adopted by the authorities and are followed without undue delay, as is intended, by the implementation of the wider and farther-reaching measures of structural reform outlined earlier, the staff considers that a strong and enduring improvement of the balance of payments can be achieved.

In sum, the Hungarian authorities have made progress in their adjustment effort in 1983, while the program that they have adopted for 1984 is designed to carry this important effort forward, with stronger demand management and with greater emphasis than was possible previously on measures to improve supply. Hungary's balance of payments need, meanwhile, will remain large in 1984 in relation to its quota, taking into account the need both to rebuild reserves and to finance larger imports as restrictions are relaxed. In light of these considerations, the staff supports the program of the authorities and believes that the amount of assistance requested is appropriate.

If all purchases under the proposed arrangement are made, the outstanding use of Fund credit by Hungary--excluding an existing purchase under the compensatory financing facility--will amount to 169.6 percent of the new quota, thus allowing for possible further Fund financing under present access limits.

It is recommended that the next Article IV consultation with Hungary be held on the standard 12-month cycle.

VI. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1983 Consultation

1. The Fund takes this decision relating to Hungary's exchange measures subject to Article VIII, sections 2 and 3, and in concluding the 1983 Article XIV consultation with Hungary, in the light of the 1983 Article IV consultation with Hungary conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Hungary maintains restrictions on payments and transfers for current international transactions as described in EBS/83/268, 12/16/83). With respect to the tighter import licensing and import quotas introduced in September 1982, the Fund urges their elimination at an early date. In the meantime, in the circumstances of Hungary, the Fund grants approval of these restrictions until June 30, 1984, or the completion of the review under the stand-by arrangement, whichever is earlier. For those restrictions maintained under Article XIV, the Fund encourages Hungary to pursue policies that would permit their elimination. In particular, the Fund encourages Hungary to take early steps to eliminate its bilateral payments agreements with Fund members. In this respect, the Fund welcomes the intention of the Hungarian authorities to terminate the bilateral agreement with Brazil.

Stand-By Arrangement

1. The Government of Hungary has requested a stand-by arrangement for a period of 12 months in an amount equivalent to SDR 425 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/268.

3. The Fund waives the limitation in Article V, Section 3(b)(iii), of the Articles.

Hungary--Stand-by Arrangement

Annexed hereto is a letter dated December 2, 1983 from the Deputy Chairman of the Council of Ministers of the Hungarian People's Republic and the Governor for the Fund of the Hungarian People's Republic, requesting a stand-by arrangement and setting forth (a) the objectives and policies that the authorities of Hungary intend to pursue for the period of the stand-by arrangement; (b) understandings of the Hungarian People's Republic with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of the Hungarian People's Republic will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of 12 months from January .., 1984, Hungary will have the right to make purchases from the Fund in an amount equivalent to SDR 425.0 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 127.50 million until May 15, 1984, the equivalent of SDR 226.67 million until August 15, 1984, and the equivalent of SDR 325.84 million until November 15, 1984.

b. None of these limits shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Hungary's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1; provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Hungary will not make purchases under this arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

a. during any period in which the data at the end of the preceding period indicate that:

(1) the limit on net domestic assets of the National Bank of Hungary specified in paragraph III.1.a. of the annexed letter; or

(2) the limit on the net credit from the banking system to the state budget specified in paragraph III.1.b. of the annexed letter; or

(3) the limit on the credit granted by the State Development Bank specified in paragraph III.1.c. of the annexed letter; or

(4) the limit on net foreign liabilities in convertible currencies of the specialized financial institutions specified in paragraph III.1.d. of the annexed letter; or

(5) the limit on the contracting of new foreign debt in convertible currencies specified in paragraph III.1.e. of the annexed letter; or

(6) the limit on outstanding short-term foreign debt in convertible currencies specified in paragraph III.1.f. of the annexed letter,

is not observed; or

b. during the period after June 29, 1984 until the policies of the program have been reviewed and suitable performance criteria have been established in consultation with the Fund as contemplated by paragraph III.1.h. of the annexed letter, or, after such performance criteria have been established, while they are not being observed; or

c. during the entire period of this stand-by arrangement if Hungary:

(1) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(2) introduces or modifies multiple currency practices; or

(3) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(4) imposes or intensifies import restrictions for balance of payments reasons.

When Hungary is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Hungary and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Hungary's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility; or (b) a decision of the Executive Board to suspend transactions, either generally or in order

to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Hungary. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Hungary and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Hungary, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the fifteenth day or the last day of the month, or the next business day if the selected day is not a business day. Hungary will consult the Fund on the timing of purchases involving borrowed resources.

8. Hungary shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. a. Hungary shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Hungary's balance of payments and reserve position improves.

b. Any reductions in Hungary's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

c. The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the sixth day or the twenty-second day of the month, or the next business day, if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement, Hungary shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Hungary or of representatives of Hungary to the Fund. Hungary shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Hungary in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph III.3. of the annexed letter, Hungary will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing

Director requests consultation because any of the criteria in paragraph 4 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Hungary has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Hungary's balance of payments policies.

Deputy Chairman of the Council of Ministers
of the Hungarian People's Republic

Budapest, 2nd December, 1983

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. de Larosière,

Since 1968, Hungarian economic policy has sought to achieve its objectives by increasingly linking national economic planning with the active role of a regulated market. In making use of the instruments of market regulation, the Hungarian economy has considerably improved its capability to adjust, and has become more closely interlinked with world markets. However, since the events of 1973-74, flexible adjustment to changing external and internal conditions has become even more important. Thus, the economic policy pursued since 1979, which aimed at improving the external balance, necessitates further continuous significant steps toward enlarging the role of market forces, improving entrepreneurial attitudes in enterprises, and expanding the role of the instruments of macro-control. Speeding up the development of this economic management system is an integral component in the consolidation of the results of the equilibrium-oriented economic policy, and, therefore, a priority of Hungarian policy. But, the success of this policy depends crucially upon a relatively stable external financial environment as the structural measures, that will improve the responsiveness of the Hungarian economy to changes in that environment, are introduced.

I.

1. Since 1979, the basic objective of Hungary's economic policy has been to achieve a substantial and enduring improvement in its external current account in convertible currencies. Policies to this end relied heavily on restraint of the growth of domestic incomes and investment and were marked with success through 1980. However, in 1981, largely in response to a worsening of world economic conditions, the improvement in the Hungarian external balance began to reverse. Heavy losses of reserves in the first quarter of 1982 necessitated a further tightening of financial policies and an acceleration of the implementation of the adjustment program that has been supported by the present 13-month stand-by arrangement with the Fund since December 1982.

2. Between 1981 and 1983, the principal objective of economic policy has been to bring about sustained improvement in the current account balance in convertible currencies, to eliminate the deficit and to achieve a surplus. The efforts made toward this end have met with considerable success. The current account deficit in convertible

currencies was reduced from US$730 million in 1981 to US$60 million in 1982. In 1983, the current account moved into surplus (some US$300 million on present estimates), but by a lesser amount than originally programmed (a surplus of US$600 million). Nevertheless, the cumulative improvement in the external current balance in convertible currencies since 1981 is now estimated to amount to US$1,030 million, equivalent to some 5 percent of projected GDP in 1983.

3. The shortfall from the balance of payments target in 1983 has had its origins in both external and domestic factors. First, exports were affected adversely by the drought and by significantly weaker external market conditions than had been expected. Second, domestic absorption while falling, is larger than programmed. For the year as a whole, total domestic demand is now projected to fall, in real terms, by roughly half (1.5 percent) of the programmed fall. Both investment and personal consumption have been more buoyant than planned. Gross investment outlays are now forecast to fall by 4.5-5 percent, instead of by about 7 percent as foreseen in the program. The volume of state investments will surpass earlier projections largely because of unanticipated advance deliveries of imported components. Enterprise investment decreased less than planned, partly because of the development of profits and a smaller-than-planned commitment of enterprise resources to reserve funds. Largely as a result of a strong rise in incomes earned in the new forms of small ventures, personal consumption will increase fractionally rather than falling by 2 percent. At the same time, domestic absorption was favorably affected by the fact that stockbuilding is significantly less than programmed.

4. The overshooting of the program's domestic demand objectives has occured despite a two-step intensification of the stabilization efforts, first in early 1983 and then around midyear. The additional measures included a decrease of the target rate of credit expansion, increases of interest rates on credits, additional taxation of enterprises, a confiscation of part of enterprises' investable resources, a virtual wage freeze in the government sector, higher-than-planned increases in administered prices, and devaluations of the forint. These measures, coupled with a much lower state deficit than budgeted, were not able to rein in credit expansion sufficiently to prevent it from exceeding the program targets set for the end of 1983; this reflects in part a stronger-than-planned increase of credits extended by the State Development Bank.

5. In 1983 external demand and prices for Hungarian export products proved weaker than expected. In addition, because of the severe drought, crop results in 1983 fell behind target, pushing down exports in the latter part of the year. All told, in 1983, export receipts in convertible currencies are projected to fall, in terms of U.S. dollars, by 2 percent, although there has been a gain in market shares. Imports also will be lower than expected, partly because of lower prices and partly because the precarious liquidity situation dictated the retention of the import restrictions introduced in 1982. The deficit on services and transfers will decline as anticipated.

6. During the first half of 1983 external capital transactions reflected the continuing pressure in financial markets. But during the past months, the current account moved solidly into surplus, confidence on the part of foreign lenders has improved and significant inflows have ensued. In all, the net capital outflow in convertible currencies is expected to amount to about US$500 million in 1983 (against US$1.1 billion in 1982), leaving gross reserves essentially unchanged at US$1.1 billion, after allowing for purchases from the Fund. The balance of payments in nonconvertible currencies will perform essentially as anticipated in 1983, although a somewhat larger deficit is anticipated for the year as a whole, primarily as a result of higher deliveries of capital equipment.

7. Strengthening the external liquidity position will continue to be the basic priority of economic policy, reflecting Hungary's commitment to meet its international payments obligations and its intention to return the economy as soon as possible to a balanced growth path, largely by improving the economy's capability to adapt flexibly to a changing environment. Repayments of principal on external debt are scheduled to rise (by US$0.4 billion) to US$1.5 billion in 1984, and further to US$1.7 billion in 1985. Taking into consideration the relatively low level of foreign exchange reserves and the need to guard against a worsening of financial market sentiment, it is imperative that we achieve a larger current account surplus in both years than will be recorded in 1983, thereby further reducing our external debt. Consistent with this, we will aim for a current account surplus in convertible currencies in 1984 of US$400 million.

8. Attainment of this objective will require further strengthening of our adjustment efforts, the more so in as much as (i) in 1984 exports of agricultural products as a result of the 1983 drought, will be some US$150 million lower than would otherwise be possible; (ii) our terms of trade vis-à-vis the convertible currency area are expected to deteriorate further, while the markets in that area will at best be only moderately more favorable than in 1983; and (iii) we shall remove the import restrictions introduced in 1982, as detailed in para 10. Against this background a further reduction in domestic demand is unavoidable. Indeed, real domestic demand will need to fall by about 2 percent for our targets to be met, as production is expected to grow only moderately, the ratio of imports to aggregate expenditure is expected to rise as a consequence of the gradual elimination of import restrictions, and the terms of trade should worsen by about 2 percent. In order to achieve our objective, we will take several income and price measures, the balance of which will serve to reduce domestic purchasing power. These measures will be flanked by a tight credit policy, an increase in the incentives to save and continued improvement of the balance of the state budget. The policy measures will be supported by far-reaching steps to improve the structure of the economy. The totality of the policy measures aims at maximizing output on the basis of the current structure of resources in the short run, and at increasing the efficiency of the economic mechanism and the allocation of resources in the medium run. In support of this program of economic stabilization and the structural reform process, the Hungarian People's Republic is requesting from the IMF a new

stand-by arrangement over a period of 12 months totaling SDR 425 million. During 1984, the Government intends to specify further measures of structural reform, along the general lines set out in Section II of this document, to be introduced beyond 1984. At that time (by mid-1984), the Government intends to seek a cancellation of the arrangement now being requested and its replacement by a new arrangement, for a period of 18 months, in support of a fully articulated medium-term adjustment program.

9. The required restraint of domestic demand in 1984 will be achieved through the following measures:

a. Incomes and price policy

Wage regulations in 1984--taking into account the higher-than-average wage increase that will stem from a more differentiated wage policy in the competitive sectors of the economy--aim at a growth of nominal wage incomes in the socialist sector of about 5-5.5 percent. This implies growth of personal disposable incomes of about 8 percent. As the consumer price level is planned to rise by up to 9 percent, real household disposable income will decline by about 1 percent. The increase in the consumer price level will result from central price increases arising from a reduction of subsidies and from an increase in the turnover tax, the carry-over effects of price adjustments in 1983 and the impact of market price movements. Consumer and producer price subsidies will be cut in 1984 compared to 1983, by a net amount of Ft 20 billion. Three fourths of this cut will be realized in January-February 1984; decisions regarding the implementation of the remainder will be taken no later than June 1984.

b. Budget policy

The state budget will contribute to the required restraint of demand in 1984. This reflects a budgeted increase in revenues of Ft 26 billion, largely as a result of a 10 percentage point increase in social security taxes. This rise in revenues is in part offset by an estimated increase in expenditures of Ft 11 billion as the Ft 20 billion cut in outlays for subsidies is outpaced by increases in social security and other expenditures. Direct budgetary support for investment in 1984 will remain at about its 1983 level. The resulting cash position of the budget will allow a reduction in the net credit balance of the state vis-à-vis the banking system of Ft 12 billion between end-1983 and end-1984--a shift equivalent to about 1 1/4 percent of projected GDP in 1984.

c. Credit policy

Credit policy for 1984 has been designed to prevent a recurrence of the overshooting of the targets for investment in the socialist sector. The external constraints virtually preclude the start of new projects (except those directed to export promotion and energy saving). By necessity, therefore, financial resources that could be converted into new investments are being withdrawn from enterprises. These withdrawals, partly from compulsory reserve funds and partly from development funds, are expected to amount to Ft 47 billion. An additional Ft 13 billion of linkages back to gross domestic credit of these collections, we have decided to set our domestic credit target for 1984 on a net basis, so that leakages from these withdrawals will be reflected in commensurate decreases in our gross credit extensions. The net domestic credit target for the end of 1984 is set at Ft 685 billion, 1 percent above its estimated level at the end of 1983. This reflects the decline of net foreign liabilities of the banking system associated with the US$400 million current account surplus in convertible currencies to be realized in 1984 and an increase in the velocity of broad money of about 3 percent.

To encourage the development of a commercial bill market, the National Bank of Hungary will be allowed to exceed the ceiling on net domestic credit pari passu with its discounting of enterprise bills by up to Ft 2 billion. In view of the overrun of credit extensions by the State Development Bank in 1983, we are limiting the possibility of the Bank to extend credit to Ft 163.7 billion by the end of 1984, equivalent to an increase of 10.2 percent from end-1983. In addition, net credit to the state budget will fall by at least Ft 12 billion. In conjunction with the development of a competitive banking system. The Government will contemplate using a portion of the variously frozen funds now under government jurisdiction for purposes of increasing the capital of the National Bank of Hungary and capitalizing possible new banking entities.

d. Interest rate policy

Interest rates on credits to enterprises are substantially positive in real terms and will remain so. From January 1984, the existing system of preferential interest rates and rebates is to be replaced--where appropriate--with tax allowances. In order to improve incentives for personal savings, rates on households time deposits, which for the most part are now significantly negative in real terms, will be augmented from March 1, 1984 on average by 2 percentage points, thereby helping to guard against an increase in personal consumption through a reduction in the savings rate. Besides the increase of interest rates, other incentives to longer-term savings also will be elaborated. For example, subscribers to the recent bond issue by the postal authorities will receive preference for installation of telephone service.

10. Trade policy

The tight external conditions in 1983 and the greater-than-expected difficulties faced by exports have not permitted the lifting of the import restrictions imposed in late 1982. Our unequivocal intention is, however, to eliminate these restrictions during 1984. To this end, from January 1, 1984, 5 out of 12 existing quotas applying to imports of raw materials will be eliminated and the affected products will be free of restrictions. This represents one quarter of the trade value under quotas. In addition, in the first half of 1984, reference limits for large and frequent importers will be raised by 15 percent compared to the limits applied in the first half of 1983. The reference limits will be set for the first six months of 1984, rather than quarterly, as in 1983. Similar principles will be applied in the case of imports falling under individual licensing.

Further steps to be taken during the second half of 1984 to eliminate the remaining quotas on imports of raw materials, remove the surcharge on imports of component parts, and re-establish the automatic licensing system in force before September 1982 will be agreed with the Fund at the time of the midterm review.

11. Exchange rate policy

Active use will be made of exchange rate policy in support of the external adjustment objective. The achievement of the external target in 1984 will require that the profitability of exporting enterprises be maintained relative to that of enterprises supplying the domestic market and that the profitability of import-substituting enterprises remain adequate. While it is difficult at this time to assess precisely the effects on the profitability of export- and import-substituting activities of the progressive removal of restraints on domestic price formation, we shall continue to pursue an exchange rate policy, which by timely exchange rate changes will ensure the competitiveness and profitability of such activities.

12. Reserve management and external debt policy

We shall expand our relationship with the international commercial banking community so as to provide a secondary line of defense for our reserve position. We also intend to continue our efforts to improve the maturity structure of our external debt, building on the progress achieved in 1983 in reversing the shortening of maturities experienced in 1982.

II.

To consolidate the tangible results achieved so far, in the effort to attain external balance, the demand management efforts of the past several years must not only be continued, but they must be coupled with measures to improve performance and thus increase supply. The concentration of the adjustment program of the past couple of years has been necessarily on demand management policies with large short-term effects. This has been at odds with the medium-term goals of balanced growth, since the burden of adjustment has to a decisive extent been borne by the profitable enterprises. Such a division of the burden of adjustment cannot continue, since it puts the largest sacrifices on the most vital part of the economy. Reform measures aiming at strengthening the overall ability of the economy to adjust are not only a prerequisite for achieving balance between demand and supply, but they are also the means of achieving that balance at higher levels of growth. Accordingly, we have developed a broad outline for the acceleration of our program of structural change, part of which will be implemented in 1984.

Our intention in further developing the economic management system is to move toward realistic pricing of the factors of production, to strengthen internal market conditions through a reduction of monopoly power, to free imports, and to eliminate constraints still exisitng on enterprises entering different lines of trade and production, and to provide an efficient financial intermediation system. All in all, our aim is to improve the capability of the economy to adjust flexibly to changing external and internal conditions. For this purpose we will move in the following areas: we will gradually spread (a) the free formation of prices (except in those areas where monopolistic positions or social objectives dictate otherwise) and (b) the formation of wages regulated only by economic conditions, and we intend to increase (c) mobility in the labor market, (d) the autonomy of enterprises, so that they will respond more rationally to changes in market conditions and be responsible for their production and financial decisions, and (e) our efforts to liberalize imports further in support of our objective to promote domestic competition. Measures to this end will be supported by a reform of the tax, budgetary, and financial systems, with the goal of strengthening their influence as instruments of macroeconomic policy. Accordingly, financial intermediation will run through an increasingly independent banking system and the role of the budget will diminish in this respect. In addition, budgetary accounting procedures will be changed so as to reflect a greater transparency. As the decision-making power of enterprises increases at the micro-level, the tax and monetary control system at the macro-level will need to be strengthened. For taxes, this means moving toward taxing final expenditures and the development of a unified personal income tax system. The monetary control system will be strengthened through the separation of the commercial and central banking functions of the National Bank of Hungary, through the development of new financial instruments, of an active financial market, and of a credit mechanism appropriate for macro-guidance by the central bank.

1. Price policy

From January 1984, we will introduce significant changes in the pricing system that currently applies to the competitive sector. Where domestic supply and demand conditions ensure adequate market competition, industrial enterprises gradually will be given the right to form their prices without the constraints of linkage to export prices with the import price as an upper limit. This system will apply at first particularly to large exporters. For those enterprises, for which domestic demand and supply conditions will not allow at this time the free formation of prices, but for which changes in export prices are relevant indicators, the provision linking domestic profit margins to those obtained in exports will be lifted; in such cases, the increase in producer prices will be limited only by changes in export prices. All in all, these changes in the pricing system are expected to apply to some 60-100 enterprises accounting for about one quarter of the turnover of the manufacturing sector.

Subsequently, we will move further to eliminate constraints on free enterprise price formation and the system will be enlarged as much as market conditions and the reduction of monopolistic practices allow. In the sphere of free prices, administrative calculation rules will be eliminated for most enterprises. The scope of free price formation will be further increased, both for producer and consumer prices, including services, as price subsidies from the budget will be cut to about one third of their 1983 levels, with only those remaining for which maintenance is justified by long-term social policy requirements.

2. Wage policy and labor management

In order to strengthen wage differentiation, to increase the relatively low cost of labor, and to move it to higher productivity activities, the system of wage regulation needs to be further developed and simplified. Accordingly, the cost of labor will be raised at the beginning of 1984, through an increase of 10 percentage points of employer contributions to the social security system, and through the increase of nominal wages in conjunction with the reduction of consumer price subsidies.

We will raise, subject to conditions, the rate of savings in wage costs, stemming from reductions in staff, that can be used to raise wages from 30 to 60 percent. Furthermore, during 1984, the progressivity of the tax scale of wage increases will be reduced for those significant exporters, for whom domestic market conditions are balanced. With the later introductions of a uniform tax on the wage bill, which will include all forms of remuneration of labor, the steepness of the taxes on wage increases will be further reduced and eventually eliminated.

Beginning in January 1984, the system of wage brackets for various jobs and the job classification schedule will be improved. The upper limit of the brackets will be increased by 25 percent on average and the lower bracket by 10 percent. For employees working under hardship conditions, for highly trained personnel, and for managers bracket increases will exceed the average.

3. Financial policies

The freer price and trading system must be supported by adequate fiscal and credit policies. This will require improved mechanisms for a more effective demand management through budget and credit policy.

a. Fiscal policy

The role of the budget in direct resource allocation will be reduced. However, measures instituted in other areas in 1984--such as the reduction in consumer and producer price subsidies and the increase in the wage tax paid by the enterprises--will produce a transfer of financial resources to the budget. It creates the opportunity to speed the needed structural changes in the fiscal and monetary system. In addition, the budgetary accounting system will be modernized in order to increase the transparency of budgetary flows.

The tax system will be simplified, starting in 1984, and finally will be replaced by a larger tax on final expenditures and a unified personal income tax. First steps toward unifying the present system of personal income taxation will become effective January 1984.

The character of recent taxation of the financial resources of enterprises will be altered so as to eliminate its ad hoc nature and, if demand management purposes so require, to tax enterprises on expenditures, such as investment outlays or inventory accumulation rather than on financial resources. Enterprise taxation will be rationalized starting in 1984 and the level of such taxation reduced starting in 1985.

The numerous rates of consumer turnover taxation will be reduced during 1984. The effect of this simplification will be a slight increase in the average rate of turnover taxes. If, by the middle of 1984, the attainment of the price and demand management goals seem to be endangered, certain turnover taxes will be raised.

In January 1984 the number of separate depreciation rates will be greatly reduced and upper limits of some depreciation allowances will be raised, taking into account the actual cost and economic life of fixed assets. Subsequently, a system of accelerated depreciation allowances will be introduced with a view toward its eventual use as an instrument of demand management. The taxation of depreciation allowances will be gradually phased out and replaced by an investment tax, the level of which would be set and varied according to macroeconomic conditions. The compulsory formation of reserve funds will be eliminated in 1984 and replaced by a voluntary system. The accumulation of such reserves will be taxed only when used for investment or profit-sharing purposes.

b. Financial and credit policies

If incentives to save and deploy savings at their highest marginal rate of return are to be major objectives, a well-functioning intermediation mechanism is required. The macro-control of financial flows by the central bank requires responsiveness of enterprises and private savers to financial incentives.

(i) In 1984, the availability of tradable financial instruments will be expanded by promoting issuing of commercial bills by enterprises. The National Bank of Hungary will stand ready to repurchase such bills at a discount dictated by the requirements of credit policy.

(ii) The issue of bonds by municipalities for sale to individuals, as well as issues of bonds by enterprises, will continue to be encouraged.

(iii) In order to strengthen the ability of the National Bank of Hungary to control credit at the macro-level, the Bank will begin in 1984 to set a central bank rate, with a view to converting it into a bona fide discount rate as the banking system develops and rediscounting becomes a reality. Interest rates on deposits increasingly will be varied in conformance with changes in market conditions, such variation to begin in 1984.

(iv) The ability of existing financial institutions, such as the National Savings Bank and savings cooperatives, to enter into full-scale banking activities will be strengthened and the ability of new entities of this sort to establish themselves will be widened.

(v) Steps will be taken to decentralize the commecial functions of the National Bank of Hungary by granting the varoius credit divisions greater autonomy in the fields of both deposit and credit business. This measure will be in the direction of the total separation of the commercial banking and central banking functions of the NBH, to be realized within a reasonable period of time.

(vi) As the wage and price system comes to reflect actual cost and demand and supply conditions in the economy more appropriately, the market-clearing price of credit will tend toward equality across branches reflecting the economy's marginal rate of return. Accordingly, the expected profitability criterion for projects qualifying for NBH investment credits will no longer be based on an average rate for each sector of the economy, but will only vary with the projects' assessed risks.

5. Decision-making process of enterprises

For a more efficient operation of the market, the institutional system has to be modified so as to allow for greater autonomy in enterprise decision making and greater managerial initiative.

(i) In 1984, the release of resources from enterprises operating either with losses or with low efficiency will be speeded. The steps for dealing with losses set out in the decree of 1981 will be speeded up. Budget subsidies and preferences extended to loss-making enterprises must be a rare exception and must be temporary, decided upon by the Ministry of Finance in coordination with the National Bank of Hungary.

(ii) In order to strengthen competition in the domestic market, decentralization of large organizations being in monopolistic position will continue in 1984 and thereafter. In particular, producers will be given foreign trading rights both for direct exports and imports upon proof of the ability to deal in foreign markets. In addition, competition among foreign trade organizations will be encouraged. Regional and profile restrictions on activities will be eased.

(iii) The competence of entities currently exercising ownership rights over enterprises will be limited in most instances to supervising the legality of enterprise operations. In line with this, the legal status of enterprises needs to be modified to provide safeguards for the autonomy of management.

III.

1. In support of its program the Hungarian People's Republic is requesting from the IMF a stand-by arrangement totaling SDR 425 million.

The execution of the program will be subject to the following performance criteria:

a. Net domestic assets of the National Bank of Hungary will not exceed Ft 262.0 billion on March 31, 1984.

b. Net credit to the state budget from the banking system will not exceed Ft 22.5 billion on March 31, 1984.

c. Credit extended by the State Development Bank will not exceed Ft 150.0 billion on March 31, 1984.

d. Net foreign liabilities in convertible currencies of the specialized financial institutions will not exceed US$1,130 million on March 31, 1984.

e. In the six months ending March 31, 1984, the contracting of new foreign debt in convertible currencies with an original maturity of more than one year and up to and including 12 years by borrowers other than those listed under a. and d. above, will be limited to the equivalent of US$25 million.

f. Total outstanding debt in convertible currencies of an original maturity of up to and including one year will not exceed the equivalent of US$1,350 million on March 31, 1984.

g. During the period of the stand-by arrangement, the Government of the Hungarian People's Republic will not introduce any multiple currency practices; impose any new or intensify any existing restrictions on payments and transfers for current international transactions; enter into any bilateral payments agreements with Fund members; or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

h. A review of policies under the stand-by arrangement will be held no later than the end of June 1984. At that time the Government of the Hungarian People's Republic intends to consult and reach understandings with the Fund on (a) ceilings for June 30, 1984, September 30, 1984, and December 31, 1984 on net domestic assets of the National Bank of Hungary, net credit to the state budget, credit extended by the State Development Bank, net foreign liabilities of the specialized financial institutions, the contracting of new long-term foreign debt by nonbank borrowers, and the level of outstanding short-term foreign debt; and (b) other economic policy targets and instruments of the program.

2. The indicative ceilings for December 31, 1984 are Ft 256.2 billion for net domestic assets of the National Bank of Hungary; Ft 19.1 billion for net credit to the state budget from the banking system; Ft 163.7 billion for credit extended by the State Development Bank; US$1,085 million for net foreign liabilities in convertible currencies of the specialized financial institutions; and US$1,600 million for total short-term debt in convertible currencies.

3. The Government of the Hungarian People's Republic believes that the policies set forth above are adequate to meet the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Hungary will consult with the Fund on the adoption of any such measures in accordance with the policies of the Fund on such consultations. In addition to the review which is to be completed by end-June 1984, we would welcome periodic discussions with the Fund staff to consider jointly, on an ongoing basis, the measures taken in implementing the stabilization and structural policies.

Sincerely,

József Marjai
Deputy Chairman of the Council of Ministers,
Chairman of the Economic Committee of the Government

János Fekete
Governor for the Fund on behalf of the Hungarian People's Republic

Hungary--Summary of Program for 1984 Under Stand-By Arrangement

1. Assumptions

a. Real GDP growth: nil. Consumer prices: up 9 percent.

b. Growth of markets in the convertible currency area: 4 percent. Terms of trade deterioration: 1.4 percent (trade in convertible currencies expressed in terms of the U.S. dollar) and 2.7 percent (trade in nonconvertible currencies). Interest rate on foreign debt: 9.9 percent. Current account deficit in nonconvertible currencies: US$50 million.

c. Ratio of GDP to money plus quasi-money: 2.25 (2.20 in 1983).

2. Targets

Current account surplus in convertible currencies: US$400 million or 1.9 percent of GDP. Overall balance of payments deficit (in convertible currencies): US$194 million.

3. Principal elements

a. Demand management: domestic demand down 2 percent. Socialist sector real average earnings: down 2-2.5 percent. Households' real disposable income: down about 1 percent. Public consumption: to decline 1.6 percent. Schemes to stimulate long-term savings. Confiscation of investable resources of enterprises.

b. Budget: a budget surplus, on the Fund staff's definition, of at least Ft 12 billion (1.3 percent of GNP).

c. Money and credit: broad money to grow by 4.4 percent and domestic credit by 4.9 percent from end-1983 to end-1984. Limits on net domestic assets of the National Bank of Hungary, on bank credit to the State, and on new credit granted by the State Development Bank. From early 1984, interest rate paid on household time deposits to be raised 2 percentage points.

d. Reform measures:

(1) Prices and wages: regulations affecting price formation to be liberalized. Distortions in relative prices to be reduced by cuts in consumer and producer price subsidies. Ceilings on wage brackets to be raised and the progressivity of the tax on wage increases reduced.

(2) Fiscal system: system of turnover taxes to be streamlined. Uniform income tax to be introduced on incomes earned in private sector outside farming.

(3) Enterprise sector: compulsory reserve funds to be abolished. The system of multiple depreciation allowances to be simplified.

(4) Financial intermediation: the National Bank of Hungary to encourage enterprises to issue commercial bills, by offering rediscount facilities. Enterprises and municipalities to continue to issue bonds. As first steps toward developing an independent banking system, the National Savings Bank to extend its banking activities and the commercial banking departments of the NBH to become more decentralized.

e. Exchange and trade system: active use of exchange rate policy for balance of payments adjustment. Import restrictions introduced in September 1982 to be eliminated in 1984.

Fund Relations with Hungary

Date of membership:	May 6, 1982
Quota:	SDR 375 million. Proposed quota under Eighth General Review of SDR 530.7 million was approved by the Presidential Council of the Hungarian People's Republic on October 28, 1983.
Fund holdings of forint: (as of November 30, 1983)	SDR 838.8 million (223.7 per cent of quota), which includes SDR 72.0 million (19.2 per cent of quota) under compensatory financing and SDR 183.9 million (49.0 per cent of quota) under enlarged access.
SDR holdings:	SDR 5.0 million (as of Nov. 30, 1983)
Exchange system:	The exchange rate of Hungary's currency, the forint, vis-à-vis the currencies of countries other than members of the Council of Mutual Economic Assistance, the People's Socialist Republic of Albania, and the Democratic People's Republic of Korea is linked to a weighted basket of nine currencies. As of November 29, 1983, the representative rate was Ft 44.8280 per U.S. dollar.
Article IV consultation:	Discussions were held in Budapest May 18-June 11, 1982. The staff report (SM/82/176, 8/25/82) was discussed by the Executive Board on December 8, 1982.

Hungary: IMF Position September 1983 to December 1984

(In millions of SDRs)

	Actual	Projected	Proposed			
	Sept. 30, 1983	3 months to Dec. 31, 1983	1 month to Jan. 31, 1984	4 months to May 31, 1984	3 months to Aug. 31, 1984	3 months to Nov. 30, 1984
Purchases	83	83	128	99	99	99
Stand-by arrangement	83	83	128	99	99	99
Ordinary resources	38	38	64	50	50	50
Borrowed resources	45	45	64	50	50	50
Repurchases	--	--	--	--	--	--
Stand-by arrangement	--	--	--	--	--	--
CFF	--	--	--	--	--	--
Net purchases	83	83	128	99	99	99
Fund holdings 1/						
Total (cumulative)	839	922	1,050	1,149	1,248	1,347
Holding in percent of quota	223.7	245.9	197.8	216.5	235.1	253.8
(Excluding CFF)	(204.5)	(226.7)	(184.2)	(202.9)	(221.6)	(240.3)

Sources: IMF, Treasurer's Department and staff projections.

1/ At end of period. Holdings in percent of quota based on total holdings to two decimal places in relation to Hungary's quota of SDR 375 million through Dec. 31, 1983 and in relation to Hungary's new quota of SDR 530.7 million thereafter.

Hungary: Selected Economic and Financial Indicators, 1982-84

	1982	Estimate 1983	Program 1984
	(Annual percentage changes, unless otherwise specified)		
National income and prices			
GDP at constant prices	2.8	0.9	--
GDP deflator	5.7	4.9	6.6
Consumer prices	6.9	7.7	9.0
External sector (on the basis of U.S. dollars) 1/			
Exports, f.o.b.	-0.7	-6.2	8.4
Imports, c.i.f.	-11.8	-9.7	7.8
Export volume	7.2	4.4	5.7
Import volume	-5.5	-1.8	3.3
Terms of trade (deterioration -)	-1.1	-2.3	-1.4
Nominal effective exchange rate (depreciation -)	7.4	-2.3	...
Real effective exchange rate (depreciation -)	3.7	-4.2	-0.5
Government budget			
Revenue, excluding grants	2.8	11.0	4.5
Total expenditures	3.3	8.8	1.7
Money and credit			
Domestic credit	6.1	6.2	4.9
Government	52.6	6.1	-38.6
Enterprise and households, etc. 2/	4.7	6.2	6.8
Money and quasi-money	6.2	5.1	4.4
Velocity (GDP relative to M1) 3/	4.6	4.6	4.6
Interest rate (annual rate, one-year savings deposit)	5.0	5.0	7.0
Domestic credit as a share of M2 4/	11.0	11.1	8.9
	(In percent of GDP)		
Overall public sector balance 5/	-1.6	-0.4	1.3
Central Government budget balance	-1.4	-0.3	1.3
Domestic bank financing	1.4	0.2	-1.3
Gross domestic investment 6/	28.5	26.5	24.9
Gross domestic savings	29.3	28.6	28.1
External current account balance, including grants 1/	-0.3	1.5	1.9
External debt 1/	34.9	34.7	30.5
Inclusive of use of Fund credit	36.0	37.6	35.3
Debt service ratio (in percent of exports of goods and nonfactor services) 1/	32.7	35.1	40.1
Interest payments (in percent of exports of goods and nonfactor services) 1/	15.3	13.6	13.2
	(In millions of SDRs, unless otherwise specified)		
Overall balance of payments 7/	-961	-122	-183
Gross official reserves (months of imports) 8/	3.6	3.9	4.8
External payments arrears	--	--	--

Sources: Central Statistical Office, Statistical Yearbook; data provided by the Hungarian authorities; and staff estimates.

1/ Nonruble transactions for trade and convertible currencies for current account debt, debt service payments, and reserves. Trade figures adjusted for increased re-exports since September 1982 (staff estimates).

2/ Including real estate investments.

3/ End-year stock figures.

4/ Percentage contribution to M2 growth.

5/ Includes State budget and local authorities' net borrowing from National Savings Bank.

6/ Including stockbuilding.

7/ In convertible currency.

8/ Gold is valued at the price of US$226 per ounce.

Table 1. Hungary: Quantitative Performance Criteria Under Previous Stand-by Arrangement

	Limits (Dec. 31, 1982)	Actual (Dec. 31, 1982)	Limits (Mar. 31, 1983)	Actual (Mar. 31, 1983)	Limits (June 30, 1983)	Actual (June 30, 1983)	Limits (Sept. 30, 1983)	Actual (Sept. 30, 1983)	Limits (Dec. 31, 1983)
					(In billions of forint)				
Net domestic assets of National Bank of Hungary	261.5	251.3	255.0	254.6	256.9	256.5	252.6	252.5	251.0
Net bank credit to the State	32.5	29.3	28.0	23.9	28.4	28.3	33.1	30.6	34.5
					(In millions of U.S. dollars)				
Net foreign liabilities in convertible currencies of the specialized financial institutions	1,230	1,228	1,310	1,205	1,175	1,154	1,175	1,148	1,175
New foreign debt in convertible currencies by nonbank borrowers	...	0.2	50	0.2	...	1.2	...	1.3	50.2

Sources: EBS/82/206 (11/10/83); Letter of Intent of May 9, 1983; and data provided by the Hungarian authorities.

Table 2. Hungary: Quantitative Performance Criteria

	Previous Program		Proposed Program	
	Actual	Limits	Limits	Indicative limits
	Sept. 30	Dec. 31	March 31	Dec. 31
	1983		1984	
	(In billions of forint)			
Net domestic assets of National Bank of Hungary	252.5	251.0	262.0	(256.2)
Net bank credit to the State	30.6	34.5	22.5	(19.1)
New credit granted by the State Development Bank		...	150.0	(163.7)
	(In millions of U.S. dollars)			
Net foreign liabilities in convertible currencies of the specialized financial institutions	1,148	1,175	1,130	(1,085)
New long-term foreign debt in convertible currencies by nonbank borrowers	1.3	50.2	26.3	(...)
Total short-term debt in convertible currencies	1,282	...	1,350	(1,600)

Sources: EBS/82/206 (11/10/82); Letter of Intent of May 9, 1983; and data provided by the Hungarian authorities.

Table 3. Hungary: Macroeconomic Variables

	Program 1983 1/	Preliminary estimates 1983 1/	Proposed program 1984
	(Percentage changes in volumes)		
Consumer expenditure	-2.0	0.3	-0.5
Government current expenditure	-0.7	-1.1	-1.6
Gross fixed investment	-6.7	-2.0	-8.4
Final domestic demand	-3.1	-0.5	-2.7
Stockbuilding 2/	-0.4	-0.9	0.5
Domestic demand	-3.5	-1.4	-2.1
Exports of goods and services	6.0	5.3	6.2
Imports of goods and services	-1.5	-0.2	1.4
Foreign balance 2/	3.0	2.2	2.1
GDP	-0.4	0.9	--
	(In millions of U.S. dollars)		
Current account balance in convertible currencies	500	305	400
	(In billions of forint)		
Budget balance	-6.0	-2.6	12.0
Domestic credit, end of period	734.5	740.2	776.4
Of which:			
Net credit to state budget	34.5	31.1	19.1

Sources: EBS/83/110 (5/27/83); data provided by the Hungarian authorities; and staff estimates.

1/ Percentage changes in program are based on preliminary data for 1982 underlying the projections of the midterm review of the stand-by arrangement; percentage changes of preliminary staff estimates are based on final outturn for 1982.
2/ In percent of GDP of previous year.

Table 4. Hungary: Gross Domestic Product

(In billions of forint, deflators 1981 = 100)

	1982			1983 1/			1984 2/		
	At 1981 prices	At current prices	Deflators	At 1981 prices	At current prices	Deflators	At 1981 prices	At current prices	Deflators
Consumer expenditure	485.8	515.1	106.0	487.0	552.3	113.4	484.6	596.0	123.0
Percentage change	1.3	7.8	6.5	0.3	7.2	7.0	-0.5	7.9	8.5
Government current expenditure	80.4	84.2	104.7	79.5	88.2	110.9	78.2	91.1	116.6
Percentage change	1.0	6.5	5.5	-1.1	4.8	6.0	-1.6	3.3	5.9
Gross fixed investment	203.4	213.9	105.2	199.3	222.0	111.4	182.5	217.0	118.9
Percentage change	-1.6	3.5	5.2	-2.0	3.8	5.9	-8.4	-2.3	6.7
Final domestic demand	769.6	813.2	105.7	765.8	862.5	112.6	745.3	904.1	121.3
Percentage change	0.5	6.5	6.0	-0.5	6.1	6.6	-2.7	4.8	7.9
Stockbuilding	10.3	27.9	...	3.5	16.0	...	7.5	20.9	...
Percentage contribution to GDP growth	-0.6	0.4	...	-0.9	-1.4	...	0.5	0.6	...
Domestic demand	779.9	841.1	107.9	769.3	878.5	114.2	752.8	925.0	122.9
Percentage change	-0.1	6.7	6.8	-1.4	4.5	5.8	-2.1	5.3	7.6
Exports of goods and services	319.1	321.8	100.9	336.1	356.3	106.0	357.1	394.7	110.5
Percentage change	3.5	4.6	0.9	5.3	10.7	5.0	6.2	10.8	4.2
Imports of goods and services	304.5	315.0	103.5	303.9	338.3	111.3	308.3	363.7	118.0
Percentage change	-3.8	-0.4	3.5	-0.2	7.4	7.5	1.4	7.5	6.0
Foreign balance	14.6	6.8	...	32.2	18.0	...	45.8	31.0	...
Percentage contribution to GDP growth	3.0	1.8	...	2.2	1.3	...	2.1	1.5	...
GDP	794.5	847.9	106.7	801.5	896.5	111.9	801.6	956.0	119.1
Percentage change	2.8	8.7	5.7	0.9	5.7	4.9	--	6.6	6.6

Sources: Data provided by Hungarian authorities; and staff estimates.

1/ Preliminary staff estimates.
2/ Staff projections.

Table 5. Hungary: Household Income, Consumption, and Saving

(In billions of forint and percentage changes)

	1982	1983 1/	1984 2/
Wages, excluding agricultural cooperatives	259.3	270.2	285.0
Percentage change	5.9	4.2	5.5
Earnings in agricultural cooperatives	42.3	46.1	49.8
Percentage change	12.8	9.0	8.0
Labor income from private activities	40.4	47.5	51.8
Percentage change	9.8	17.6	9.0
Labor income in kind	36.1	37.5	41.9
Percentage change	3.7	3.9	11.7
Total labor income, gross	378.1	401.3	428.5
Percentage change	6.8	6.1	6.8
Less: taxes, etc.	21.0	24.3	27.1
Percentage change	14.1	15.7	11.5
Total labor income, net	357.1	377.0	401.4
Percentage change	6.4	5.6	6.5
Social benefits	178.2	194.3	214.6
Percentage change	10.0	9.0	10.4
Other income, net	9.2	12.0	11.8
Disposable income	544.5	583.3	628.0
Percentage change	7.8	7.1	7.7
Less: consumer expenditure	515.1	552.3	596.0
Savings	29.3	31.0	32.0
Percent of disposable income	5.4	5.3	5.1

Sources: Data provided by the Hungarian authorities; and staff estimates.

1/ Preliminary staff estimates.
2/ Projections.

Table 6. Hungary: Balance of Payments in Convertible Currencies, 1983-84

(In millions of U.S. dollars)

	1st qtr. 1983	2nd qtr. 1983	3rd qtr. 1983	4th qtr. 1983	Total 1983	1st qtr. 1984	2nd qtr. 1984	3rd qtr. 1984	4th qtr. 1984	Total 1984
Exports	1,161	1,209	1,101	1,298	4,769	993	1,116	1,180	1,440	4,729
Imports	-1,012	-954	-889	-1,032	-3,887	-818	-927	-960	-1,068	-3,773
Trade balance	149	255	212	266	882	175	189	220	372	956
Freight and insurance	-45	-54	-37	-40	-176	-43	-44	-52	-54	-193
Travel	21	32	53	47	153	23	35	55	50	163
Investment income	-174	-165	-145	-155	-639	-159	-159	-159	-159	-636
Government expenditure	-11	-11	-8	-12	-42	-12	-12	-13	-13	-50
Other current receipts	25	46	-12	16	75	25	25	25	25	100
Unrequited transfers	11	15	11	15	52	15	15	15	15	60
Current balance	-24	118	74	137	305	24	49	91	236	400
Medium- and long-term capital										
Assets 1/	-7	-192	13	107	-79	-10	-22	-33	-35	-100
Liabilities	-65	304	-113	-98	28	-370	-172	98	25	-419
Inflows	(136)	(529)	(157)	(419)	(1,241)	(140)	(150)	(380)	(430)	(1,100)
Outflows	(-201)	(-225)	(-270)	(-517)	(-1,213)	(-510)	(-322)	(-282)	(-405)	(-1,519)
Short-term capital										
Assets 1/	-17	21	-53	-127	-176	-15	35	-25	-95	-100
Liabilities 2/	-300	-280	67	255	-258	-200	-5	10	220	25
Overall balance	-413	-29	-12	274	-180	-571	-115	141	351	-194
Monetary movements										
Monetary gold (increase -)	-164	125	-154	-197	-390	...	...	...	...	...
Foreign exchange (increase -)	488	-185	79	-166	216	436	10	-246	-456	-256
Use of Fund resources	89	89	87	89	354	135	105	105	105	450

Sources: National Bank of Hungary; and staff estimates.

1/ Nonreserve assets; mostly export financing.
2/ Includes errors and omissions.

Table 7. Hungary: Balance of Payments in Convertible Currencies, 1981-84

(In millions of U.S. dollars)

	1981	1982	1983 Program 1/	1983 Revised projection	1984
Exports	4,877	4,876	4,920	4,769	4,729
Imports	-4,432	-4,110	-3,858	-3,887	-3,773
Trade balance	445	766	1,062	882	956
Freight and insurance (net)	-216	-220	-205	-176	-193
Travel (net)	133	176	206	153	163
Investment income (net)	-1,100	-976	-669	-639	-636
Government expenditure (net)	-47	-45	-47	-42	-50
Other current receipts (net)	11	175	105	75	100
Unrequited transfers (net)	47	61	48	52	60
Current balance	-727	-63	500	305	400
Medium- and long-term capital					
Assets 2/	-104	-192	-97	-79	-100
Liabilities	617	260	-392	28	-419
Inflows	(1,443)	(1,154)	(613)	(1,241)	(1,100)
Outflows	(-826)	(-894)	(-1,005)	(-1,213)	(-1,519)
Short-term capital					
Assets 2/	31	-161	-185	-176	-100
Liabilities 3/	-348	-998	-347	-258	25
Overall balance	-531	-1,154	-521	-180	-194
Monetary movements					
Monetary gold (increase -)	177	383	-164	-390	...
Foreign exchange (increase -)	354	536	319	216	-256
Use of Fund resources 4/	--	235	366	354	450
Memorandum items:					
Nonruble trade volume 5/ (percentage change)					
Exports	1.7	7.2	7.8	4.4	5.7
Imports	3.6	-5.5	-1.9	-1.8	3.3

Sources: National Bank of Hungary; and staff estimates.

1/ Includes revisions made at the time of the midterm review.
2/ Nonreserve assets; mostly export financing.
3/ Includes errors and omissions.
4/ Includes drawing of SDR 72 million under the CFF in December 1982.
5/ Adjusted for increased re-exports since September 1982 (staff estimates).

Table 8. Hungary: Balance of Payments in Nonconvertible Currencies, 1981-84

(In millions of U.S. dollars)

	1981	1982	1983 Program 1/	1983 Revised projection	1984
Exports	4,017	4,207	4,321	4,464	4,216
Imports	-4,423	-4,465	-4,528	-4,835	-4,342
Trade balance	-406	-258	-207	-371	-126
Freight and insurance (net)	-110	-91	-121	-122	-101
Travel (net)	117	81	72	90	104
Investment income (net)	-20	14	-11	-11	-20
Government expenditure (net)	3	3	5	5	2
Other current receipts (net)	245	28	86	86	88
Unrequited transfers (net)	2	2	3	3	2
Current balance	-169	-221	-173	-320	-51
Medium- and long-term capital					
Assets 2/	-26	12	5	5	-9
Liabilities	502	87	108	107	25
Inflows	(582)	(133)	(221)	(226)	(...)
Outflows	(-80)	(-46)	(-113)	(-119)	(...)
Short-term capital					
Assets 2/	-118	128)	60)	208)	35
Liabilities 3/	-274	32)	)	)	
Overall balance	-85	38	--	--	--
Memorandum items:					
Ruble trade volume (percentage change)					
Exports	3.9	3.3	6.2	6.4	7.6
Imports	-3.4	2.8	-2.0	0.3	-0.5

Source: National Bank of Hungary.

1/ Includes revisions made at the time of the midterm review.
2/ Nonreserve assets; mostly export financing.
3/ Includes errors and omissions.

Table 9. Hungary: International Reserves and Other Foreign Assets, 1980-83

(In millions of U.S. dollars)

	1980	1981	1982	Mar. 1983	June 1983	Sept. 1983
International reserves						
Convertible currencies						
Gold 1/	92	69	25	38	26	40
Foreign exchange	1,978	1,624	1,087	600	784	705
Official reserves	(1,853)	(1,482)	(771)	(331)	(555)	(542)
Other readily marketable assets 2/	(125)	(142)	(316)	(269)	(229)	(163)
Total	2,070	1,693	1,112	638	810	745
Nonconvertible currencies	113	28	66	84	117	105
Total	2,183	1,721	1,178	722	927	850
Other foreign assets						
Convertible currencies	1,256	1,219	1,539	1,561	1,635	1,687
Short term 3/	(685)	(595)	(773)	(788)	(725)	(786)
Long term	(571)	(624)	(766)	(773)	(910)	(901)
Nonconvertible currencies	413	510	318	327	311	305
Short term	(139)	(238)	(89)	(101)	(94)	(93)
Long term	(274)	(272)	(229)	(226)	(217)	(212)
Total	1,669	1,729	1,857	1,888	1,946	1,992
Total international reserves and other foreign assets	3,852	3,450	3,035	2,610	2,873	2,842

Source: National Bank of Hungary.

1/ Valued at SDR 35 per ounce. Gold was valued at US$42.22 per ounce prior to 1978, US$126 per ounce in 1978, and is valued at US$226 per ounce thereafter in official reserve statistics.

2/ Excluded from the official Hungarian definition of reserves.

3/ Includes working balances of the specialized banks and claims of enterprises in the form of export bills and suppliers' credits. Prime export bills are discountable at the National Bank, with recourse. The National Bank regards this facility as a means of providing domestic liquidity to the enterprises and normally holds the bills to maturity rather than rediscount them on foreign markets.

Table 10. Hungary: Foreign Debt, 1980-83

(In millions of U.S. dollars; end of period)

	1980	1981	1982	Mar. 1983	June 1983	Sept. 1983
Total foreign debt	10,314	10,026	8,989	8,864	9,002	8,944
In convertible currencies	9,090	8,699	7,715	7,329	7,397	7,367
By original maturity:						
Short term	3,347	2,849	1,764	1,410	1,221	1,282
Long term	5,743	5,850	5,951	5,919	6,176	6,085
By type:						
Financial loans 1/	8,616	8,050	6,653	6,146	6,150	5,964
Trade-related credits 2/	293	402	661	797	888	1,032
Intergovernmental credit	6	6	5	4	4	4
Other 3/	175	241	396	382	355	367
In nonconvertible currencies	1,224	1,327	1,274	1,535	1,605	1,577
By original maturity:						
Short term	558	243	249	525	608	624
Long term	666	1,084	1,025	1,010	997	953
By type:						
Financial loans	532	260	225	503	585	599
Trade-related credits	23	15	39	38	35	33
Intergovernmental credit	635	1,038	974	959	951	910
Other	34	14	36	35	34	35

Source: National Bank of Hungary.

1/ Syndicated loans, bonds and notes, bank-to-bank credit and deposits, and balances of nonresident banks. Includes Fund credit.
2/ Including bankers' acceptances.
3/ Mainly downpayment for Hungarian exports; and import documents in the process of settlement.

Table 11. Hungary: Medium-Term Debt Analysis in Convertible Currencies, 1982-88

(In millions of U.S. dollars)

	1982	1983	1984	1985	1986	1987	1988
Debt service payments							
Payments on existing debt 1/							
Interest 2/	1,016	753	600	450	320	260	210
Amortization	894	1,213	1,481	1,342	1,152	709	412
Of which: IMF	(--)	(--)	(--)	(--)	(139)	(166)	(52)
Payments on new borrowings							
Interest	--	17	150	270	360	410	430
Amortization 3/	--	--	38	238	428	837	1,107
Of which: IMF	(--)	(--)	(--)	(--)	(5)	(122)	(225)
Total	1,910	1,983	2,269	2,300	2,260	2,216	2,159
Total debt service payments/ exports of goods and services	32.7	35.1	40.1	37.3	33.5	30.0	26.7
Balance of payments							
Exports of goods and services	5,844	5,656	5,665	6,169	6,743	7,378	8,095
Imports of goods and services	-5,907	-5,351	-5,265	-5,719	-6,193	-6,748	-7,390
Of which:							
Interest payments	(-894)	(-770)	(-750)	(-720)	(-700)	(-670)	(-640)
Current account	-63	305	400	450	550	630	705
Capital account	-1,091	-485	-594	-535	-396	-223	-212
Of which: Gross borrowing	(1,154)	(1,241)	(1,100)	(1,200)	(1,200)	(1,200)	(1,200)
IMF (net)	235	354	450	--	-144	-288	-277
Gross reserves (months of imports)	3.6	3.9	4.8	4.0	3.7	3.6	3.6
Memorandum items:							
Debt outstanding (end-period)	7,714	7,553	7,609	7,289	6,979	6,713	6,484
Of which: IMF	(237)	(583)	(1,033)	(1,033)	(889)	(601)	(324)

Sources: National Bank of Hungary; and staff estimates.

1/ Debt outstanding at end-June 1983.
2/ Includes interest on short-term debt. Assumed interest rate: 10.4 percent in the second half of 1983 and 9.9 percent afterward.
3/ Average maturity six years, including one-year grace period.

Table 12. Hungary: Import Restrictions Introduced September 1982

	Imports 1981	Imports 1982	Quota 1/	Imports 1981	Imports 1982	Quota 2/
	Volume (tons)			Value (millions of forint)		
Imports subject to quotas						
1982 quotas						
Iron ore	339,600	228,000	290,000	623.8	...	...
Asbestos, long fibred	2,627	4,500	4,500	78.0	...	...
Caustic soda, solid	4,443	7,000	5,000	54.0	...	...
Organic chemical basic material	...	...	...	1,654.5	1,594.0	1,680.0
Aliphatic ketones, aldehydes acids	...	...	...	1,091.8	944.0	1,050.0
Aniline colors, auxiliary chemical materials for the textile, leather and fur industries	...	...	...	1,719.2	1,608.0	2,000.0
Natural rubber	14,238	12,000	13,000	715.3	...	...
PVC	9,397	8,000	8,000	321.4	...	...
Plastic basic materials 3/	...	...	...	*2,587.0*	*2,611.0*	*2,300.0*
Zinc oxide, titanium dioxide and litophone	18,163	17,000	13,000	640.9	...	...
Cellulose based silk	6,845	6,000	6,700	1,023.0	...	...
Fibrous semifinished product for the paper industry	92,619	93,000	95,000	1,631.4	...	...
Paper and cardboard	88,939	96,000	95,000	2,239.0	...	...
Raw cotton	25,167	14,000	16,700	1,722.0	...	...
Rawhide	24,565	28,000	25,000	1,369.9	...	...
Protein fodder of the vegetable oil industry/soya meal	597,913	565,000	600,000	6,871.9	...	...
Husked rice	19,223	13,000	11,000	342.5	...	...
Total	...	...	...	24,685.6	...	...
1983 quotas						
Office equipment requisites	...	...	...	200.0	150.0	120.0
Aniline colors, auxiliary chemical materials for the textile, leather and fur industries	...	...	...	1,719.0	1,603.8	2,000.0
Motor vehicle tires (thousand units)	263	174	75	392.0	...	...
PVC powder and hard granules	9,400	8,000	8,000	321.0	...	...
Polystyrene and styrene capoliners	16,500	18,000	16,000	686.0	...	...
Fertilizers--nitrogene	--	9,000	12,000	--	...	...
phosphore	88,300	138,000	140,000	1,716.0	...	...
calcium	6,800	6,000	8,000	...	...	...
Plant protection chemicals	...	...	...	2,100.0	2,213.0	2,500.0
Paper and cardboard	88,939	74,100	98,000	2,232.0	...	...
Protein fodder of animal and vegetable origin	644,500	239,000	670,000	7,737.0	...	...
Fodder concentrate	6,200	7,000	5,000	156.0	...	...
Animal feed phosphate	72,400	73,000	75,000	901.0	...	...
Chemicals for feed	...	...	...	1,300.0	1,392.8	1,500.0
Total	...	...	...	19,460.0	...	...
Imports subject to surcharge	...	...	...	26,729.0	25,700.0	...

Source: Data provided by the Hungarian authorities.

1/ If quota specified in volume.
2/ If quota specified in value.
3/ Except PE, PP, PS, PTFE, PVC, and moulding powders.

Table 13. Hungary: Consolidated Monetary Survey

(In billions of forint, end of period)

	1980	1981	1982	1983 I	1983 II	1983 III	1983 Program forecast IV	1983 Revised forecast	1984 Program forecasts I	1984 Program forecasts II	1984 Program forecasts III	1984 Program forecasts IV
Domestic credit	603.5	657.0	697.0	708.4	715.8	729.7	736.3 1/	740.2	748.3	757.6	769.2	776.4
Claims on state budget (net) 2/	10.3	19.2	29.3	23.9	28.3	30.6	34.5	31.1	22.5	24.4	23.9	19.1
Claims on enterprises, etc. 3/	486.0	517.9	534.1	548.3	547.0	548.8	549.8 1/	555.5	569.2	571.7	572.5	580.7
Claims on households	107.2	119.9	133.6	136.2	140.5	150.3	152.0	153.6	156.6	161.6	172.8	176.6
Money	155.3	167.0	183.0	166.9	170.1	175.6	190.0	195.6	184.5	187.7	190.7	206.9
Currency in circulation	72.8	81.3	87.3	87.6	95.6	94.2	94.6	97.2	101.3	102.7	101.2	106.0
Demand deposits of households	4.5	5.8	8.2	8.4	9.3	10.1	10.1	10.6	10.8	11.3	12.0	12.4
Current accounts of enterprises	67.4	69.4	76.6	60.2	56.9	60.3	73.9	76.3	61.5	65.1	67.0	76.9
Unfinished settlements	10.6	10.5	10.9	10.7	8.3	11.0	11.4	11.4	10.9	8.6	10.5	11.6
Quasi-money	186.8	198.1	204.6	212.2	215.1	212.9	216.2	211.7	215.5	218.3	216.3	218.4
Households	136.6	147.9	159.4	165.8	167.5	168.9	171.2	172.9	178.2	180.0	180.3	186.3
Enterprises	50.2	50.2	45.2	46.3	47.6	44.0	45.0	38.8	37.3	38.3	36.0	32.1
Savings bonds	4.2	6.4	8.2	9.0	9.3	9.6	10.3	10.3	11.2	11.4	11.8	12.3
Enterprise reserve funds 4/	38.3	40.0	55.2	35.1	35.5	33.8	42.0	37.9	39.1	39.1	39.1	39.1
State lending and intervention funds	--	--	--	3.1	3.1	4.6	9.0	10.8	20.8	22.8	25.8	33.6
Net foreign liabilities 5/	209.9	224.1	240.9	258.9	266.3	277.2	258.8	269.4	270.6	269.7	273.6	259.7
Other items (net) (by difference) 4/5/	9.0	21.4	5.1	23.3	16.4	16.0	10.0 1/	4.5	6.6	8.6	11.9	6.4

Sources: National Bank of Hungary and staff estimates.

1/ The program allowed for IBRD-related credits up to Ft 2 billion to be supplementary to the credit targets. The Ft 1.8 billion included in the "revised forecast" has been incorporated into the "program forecasts" for domestic credit, credit to enterprises, and other items net.

2/ Claims of the National Bank of Hungary and the Central Exchange and Credit Bank.

3/ Includes real estate investment and a small and relatively stable amount of credit extended by the Foreign Trade Bank, in addition to the claims of the National Bank of Hungary (direct claims plus refinancing credits extended to the State Development Bank).

4/ Figures for 1983 reflect transfers of Ft 19.1 billion of enterprise reserve funds to the National Bank in connection with the settlement of currency valuation changes. Figures for 1984 comprise reserve fund bonds and confiscated and frozen reserve funds.

Table 14. Hungary: Income Velocity of Money 1/

	Currency	Money	Broad Money 2/
1977	11.44	4.96	2.26
1978	11.00	5.03	2.24
1979	11.13	4.91	2.28
1980	9.71	4.55	2.10
1981	9.58	4.66	2.16
1982	9.71 3/	4.63	2.19
1983 Program forecast	9.47	4.72	2.20
Revised forecast	9.22	4.58	2.20
1984 Program forecast	9.02	4.62	2.25

Sources: National Bank of Hungary; and staff estimates.

1/ Defined as the ratio of nominal GDP to money, using end-year money stocks.
2/ Excludes savings bonds.
3/ The increase reflects a smaller-than-usual end-year prepayment of wages and larger-than-usual end-year consumer spending associated with the more-than-seasonal increases in imports of consumer goods.

Table 15. Hungary: Net Domestic Assets of the National Bank

(In billions of forint; end of period)

	Q4 1981	Q4 1982	1983 Q2 Program	1983 Q2 Actual	1983 Q3 Program	1983 Q3 Actual	1983 Q4 Program	1983 Q4 Projected	1984 Q1 Projected	1984 Q2 Projected	1984 Q3 Projected	1984 Q4 Projected
Net foreign liabilities in convertible currencies 1/	166.5	164.0	163.3	160.9	159.6	158.3	156.4	158.7	160.7	157.2	157.0	150.2
Currency in circulation	81.3	87.3	93.6	95.6	93.0	94.2	94.6	97.3	101.3	102.7	101.2	106.0
Net domestic assets (I + II)	247.8	251.3	256.9	256.5	252.6	252.5	251.0	256.0	262.0	259.9	258.2	256.2
Assets	490.6	509.1	522.2	517.0	524.0	517.5	525.2	530.7	535.8	540.8	541.7	543.7
Net credit to the state budget	19.2	22.1	21.2	21.1	20.7	23.4	22.1	21.7	13.1	15.0	14.5	8.7
Investment credits	122.7	120.6	113.9	113.5	115.7	114.2	120.0	121.0	114.6	117.3	119.0	123.0
Working capital credits	170.6	179.4	200.4	198.4	199.2	194.7	188.0	190.0	209.5	207.7	205.3	203.0
Refinancing credits, etc.	178.1	187.0	186.7	184.0	188.4	185.2	195.1	198.0	198.6	200.8	202.9	209.0
Liabilities	242.8	257.8	265.3	260.5	271.4	265.0	274.2	274.7	273.8	280.9	283.5	287.5
Enterprise reserve funds 2/3/	40.0	48.0	29.7	28.3	27.3	26.6	29.6	28.5	29.7	29.7	29.7	28.7
State lending and intervention funds	--	--	5.9	3.1	7.6	4.6	9.0	10.8	20.8	22.8	25.8	33.6
Other funds of enterprises	119.6	121.8	100.3	104.5	106.1	104.3	118.9	115.1	98.8	103.4	103.0	109.0
Deposits by other financial institutions 4/	66.1	73.0	73.9	72.8	72.3	72.5	73.7	68.5	72.9	72.0	67.0	67.0
Net foreign liabilities in nonconvertible currencies	4.8	2.9	16.3	15.7	17.1	16.1	5.9	9.5	9.5	12.0	17.6	9.5
Unclassified liabilities (net) 1/3/	12.3	12.1	39.2	36.1	41.0	40.9	37.1	42.3	42.1	41.0	40.4	39.7
Memorandum items:												
Net foreign liabilities of specialized banks in convertible currency 1/	50.6	43.9	42.0	49.2	41.5	41.0	41.9	40.7	40.1	40.1	38.6	38.0
CECB claims on state budget	--	7.2	7.2	7.2	12.4	7.2	12.4	9.4	9.4	9.4	9.4	10.4
National Savings Bank												
Credit to households	119.9	133.6	140.3	140.5	148.8	150.3	152.0	153.6	156.6	161.6	172.8	176.6
Deposits of households	160.1	175.8	183.6	186.1	183.7	188.6	191.6	193.8	200.2	202.7	204.1	211.0

Sources: National Bank of Hungary; and staff estimates.

1/ Figures for 1982, 1983, and 1984 are based on the exchange rates prevailing at the end of June 1982.
2/ Beginning June 1982, data relate to the funds redeposited by the CECB and exclude the amount of enterprise reserve funds on-lent to the state budget by the CECB (see memorandum item).
3/ Figures for 1983 reflect transfers of Ft 19.1 billion of enterprise reserve funds to the National Bank in connection with the settlement of currency valuation changes. Figures for 1984 comprise reserve fund bonds and confiscated and frozen reserve funds.
4/ Excluding enterprise reserve funds redeposited by the CECB.

Table 16. Hungary: The State Budget

(In billions of forint)

	1981	1982	1983 Program Forecast EBS/83/110	1983 Estimated Outcome	1984 Program Forecast
Expenditures					
Investment	59.7	53.3	55.0	57.2	56.1
Price subsidies	144.5	146.5	155.6 1/	159.6	141.9
Social security	90.4	98.5	106.9	107.0	119.6
Health, defense, other	187.5	199.7	211.1	207.2	218.8
Contributions to state lending fund	--	--	--	10.8	14.8
Total expenditure	482.1	498.0	528.6 1/	541.8	551.2
Revenue					
Wage tax and social security contributions	63.7	75.3	84.4	86.4	116.4
Profit taxes	121.1	112.5	129.9	129.5	132.5
Production and capital tax	21.7	25.8	29.7 1/	30.4	28.2
Indirect taxes	176.4	191.5	208.4 1/	203.0	194.8
Other revenues	89.7	80.7	70.2	89.9	91.3
Of which:					
Confiscated working capital	(--)	(--)	(--)	(1.4)	(--)
Confiscated development funds	(--)	(--)	(--)	(8.5)	(9.0)
IBRD credits	(--)	(--)	(0.9)	(0.9)	(1.7)
Total revenues	472.6	485.8	522.6 1/	539.2	563.2
Budget balance	-9.5	-12.2	-6.0	-2.6	+12.0

Sources: Ministry of Finance; and staff estimates.

1/ The changes from the corresponding entries in Table 8, EBS/83/110 (5/27/83), reflect reclassifications of certain expenditures and revenues in the Hungarian budget.

Table 17. Hungary: Budgetary Expenditures on Subsidies

	1981	1982	1983: Program forecast EBS/83/110	1983: Estimated outcome	1984: Unchanged policies	1984: Program forecast
Consumer price subsidies	62.1	64.2	63.3 1/	65.4	70.9	51.2
Producer subsidies 2/	27.1	27.3	30.6 1/	28.2	32.8	29.2
Subtotal	(89.2)	(91.5)	(93.9) 1/	(93.6)	(103.7)	(80.4)
Modernization grants	25.4	26.7	32.8 1/	36.5	38.6	36.8
Tax rebates to exporters	16.5	14.4	13.9	12.0	12.5	8.5
Import subsidies	2.4	0.9	2.5	0.9	1.3	0.7
Other	11.0	13.0	12.3	16.6	18.6	15.5
Total	144.5	146.5	155.6 1/	159.6	174.7	141.9

Sources: Ministry of Finance; and staff estimates.

1/ The changes from the corresponding entries in Table 9, EBS/83/110 (5/27/83), reflect reclassification of certain expenditures and revenues in the Hungarian budget.
2/ Including subsidies to agricultural enterprises.