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**FOR  
AGENDA**

EBS/82/206  
Supplement 1

CONFIDENTIAL

December 6, 1982

To: Members of the Executive Board  
From: The Secretary  
Subject: Hungarian People's Republic - Request for Stand-By Arrangement

The attached supplement to the paper on the request by the Hungarian People's Republic for a stand-by arrangement (EBS/82/206, 11/10/82) has been prepared on the basis of additional information.

Att: (1)



INTERNATIONAL MONETARY FUND

HUNGARIAN PEOPLE'S REPUBLIC

Request for Stand-By Arrangement--Supplementary Information

Prepared by the European Department

Approved by L. A. Whittome

December 3, 1982

1. Recent economic developments

Data available through October 1982 suggest that, despite bumper crops for several agricultural commodities, economic activity in Hungary is slowing down rapidly. Restraint on domestic demand seems to be the main cause of this development. Compared with the same period in 1981, the volume of agricultural products sold in the first ten months of 1982 was almost 6 per cent larger, but output of socialist industry was less than 1 per cent higher. Fixed investment outlays in the socialist sector showed no increase in current prices from last year, as state investments declined by a further 3 per cent. Cash incomes of the population recorded a modest 0.5 per cent increase in real terms as the rise in consumer prices accelerated to 6.7 per cent while that of nominal incomes was the same as in 1981. The stagnation of real purchasing power was reflected in a marked deceleration in the volume of retail sales to only 0.7 per cent, by comparison with an increase of more than 3 per cent in 1981.

Balance of payments developments were generally in line with the projections in EBS/82/206 (11/10/82). For the first ten months of 1982, the current account deficit with the convertible currency area was reduced to US\$284 million, and it seems likely that for the year as a whole it will be below US\$100 million. Travel receipts have increased more rapidly than anticipated while the growth of both imports and exports has been lower than projected. Prices remain depressed for a number of products sold abroad: through October 1982, unit values for nonruble exports recorded a decline of 2.4 per cent, by comparison with the same period in 1981, while the volume exported rose by 5.4 per cent. The volume of imports from the nonruble area was 6 per cent below the corresponding period of 1981, largely due to the restraint on domestic demand--although the import restrictions introduced in September 1982 probably also played a small part. Notwithstanding the progressive reduction of arrears and some short-term capital outflows, official reserves recovered to US\$803 million at the end of October, reflecting both the improved current account situation and a loan from the BIS in the third quarter (Table 1).

Budget results for the first ten months of 1982 indicate that the deficit for the year as a whole could be below the range indicated in Table 3 of EBS/82/206. Although receipts from profit taxes and tariffs

Table 1. Hungary: International Reserves and Other Foreign Assets, 1981-1982

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

	1981	1982			
		March	June	September	October
International reserves					
Gold <u>1/</u>	69	18	22	27	34
Foreign exchange					
Convertible currencies	1,624	455	588	718	751
Official reserves	(1,486)	(249)	(421)	(451)	(507)
Other readily market- able assets <u>2/</u>	(142)	(206)	(177)	(267)	(244)
Nonconvertible currencies	<u>28</u>	<u>6</u>	<u>128</u>	<u>22</u>	<u>18</u>
Total	1,721	479	738	767	803
Other foreign assets					
Convertible currencies	1,220	1,334	1,283	1,412	1,435
Short-term assets <u>3/</u>	(596)	(633)	(565)	(640)	(659)
Long-term assets	(624)	(701)	(718)	(772)	(776)
Nonconvertible currencies	510	460	346	279	288
Short-term	(238)	(193)	(81)	(46)	(55)
Long-term	(272)	(267)	(265)	(233)	(233)
Total	<u>1,730</u>	<u>1,794</u>	<u>1,629</u>	<u>1,691</u>	<u>1,723</u>
Total international reserves and other foreign assets	3,451	2,273	2,367	2,458	2,526

Source: National Bank of Hungary.

1/ Valued at SDR 35 per ounce.

2/ Excluded from the official Hungarian definition of reserves.

3/ This item includes some working balances of the specialized banks but comprises mainly the 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.

were below those foreseen in the approved 1982 budget, total expenditures are now projected to be more than Ft 10 billion (2.3 per cent) below the amount approved.

Money and credit developments through October 1982 did not differ markedly from those projected in Tables 4 and 5 of EBS/82/206, although currency in circulation is somewhat higher than expected, and the net foreign liabilities of the National Bank of Hungary increased as a result of the repayment of arrears. The Hungarian authorities viewed this development as temporary.

## 2. Measures of economic policy

Since September 1982 the authorities have taken several decisions aimed at containing domestic absorption in line with the adjustment program underlying the stand-by arrangement. In order to ensure a marked slowdown in the growth of nominal household incomes, the legislative proposal on the reform of the wage system, which is to take effect in 1983, was modified so as to limit the rise in nominal wages to 3.5 per cent. Pension contributions of individuals have been raised so as to absorb an estimated half a percentage point of the rise in nominal wages. Furthermore, the population will have to pay higher fees for certain public services, and the traditional partial compensation payments for administrative consumer price increases to low income families will be curtailed. The growth of real disposable income will also be affected by the 3 per cent devaluation of the forint on December 1, 1982 and a 20 per cent increase in gasoline prices to take effect in December 1982.

New decisions have been adopted to limit the financial resources of enterprises available for investment and wage payments. About 4-6 per cent of the development funds of enterprises, stemming from retained earnings and part of depreciation allowances, will be taxed away, and the estimated proceeds of Ft 3-5 billion will be frozen in a special account with the National Bank of Hungary. In order to discourage excessive stockbuilding by unprofitable firms, a new decision enables the authorities to withdraw up to 10 per cent of any company's own working capital. Part of the funds obtained may be reallocated to other enterprises with a justified need for working capital. In early 1983, the authorities will review ongoing investment projects with a view to reducing outstanding credit commitments and to reallocating part of the resources to priority projects that would contribute to a better external balance.

In addition to the budgetary effects of the decisions mentioned above, new measures will be incorporated in the state budget for 1983 to reduce the deficit, in addition to the decision already taken of raising the social security tax paid by enterprises. Tighter constraints will be imposed on public sector wages and on other current expenditures. The authorities have also prepared contingency measures, mainly price increases, should balance of payments developments deviate from those in the program.

In the latter part of 1982, the authorities have taken new initiatives to stimulate the structural adjustment of industry. In order to improve the efficiency of enterprises, their autonomy will be expanded. Certain important prerogatives of supervisory government bodies will be delegated to management councils and supervisory boards within firms. The appointment of managers will be subject to competition, the extension of their contracts will depend on their performance, and their authority to manage their business independently will be strengthened. New guidelines have been adopted to enhance the mobility of labor from ailing enterprises. According to decisions to be incorporated in the official plan document for 1983, failure of a weak enterprise to improve its efficiency will trigger an automatic sequence of adjustment measures, including obligations to change the structure of production, to improve management, and to release manpower. Credit availability for these companies will be restricted. Other measures are aimed at improving the allocation of capital. Firms will be allowed to issue bonds through financial institutions; the latitude of financial institutions to participate in the capital of companies will be widened; and rules are being elaborated to permit some mobility of investment funds among enterprises.