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October 6, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Hungary - Exchange Arrangements

Attached for the information of the Executive Directors is a paper on a recent change in the exchange arrangements of Hungary.

Mr. Hole (ext. 8811) is available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

HUNGARY

Exchange Arrangements

(In consultation with the Legal Department)

Approved by L. A. Whittome and J. T. Boorman

October 6, 1986

In a recent communication from the Alternate Executive Director representing Hungary (EBD/86/257, 9/26/86), the Fund was informed that effective September 23, 1986 the forint was depreciated by 8 percent against the basket of currencies to which it is pegged for purposes of determining exchange rates against convertible currencies. In terms of the U.S. dollar, the exchange rate was devalued by 9.2 percent.

Previously in 1986, the forint was depreciated in terms of its basket by 3 percent on February 28 and by 1 percent on June 3. According to staff estimates, in the twelve months to July 1986 the forint depreciated by 7.0 percent in trade weighted nominal effective terms and by 9.7 percent in real effective terms, developments which reflect in part the comparatively high weight assigned to the U.S. dollar in Hungary's exchange rate basket.

The devaluations in 1986 are consistent with the authorities' intention to seek to maintain the competitiveness of the Hungarian economy through periodic adjustments of the exchange rate with respect to the basket. The authorities expect that the recent decision will contribute to improving the current account balance in convertible currencies by strengthening export performance and weakening the demand for imports. In the view of the staff, the recent decision represents a move in the right direction in the light of the deterioration of the terms of trade experienced so far this year. However, to hold, if not reverse, the progressive weakening in the current account balance in convertible currencies witnessed so far in 1986, adequate flanking policies and the advancing of the process of structural reforms will be essential. In the first half of the year, a current account deficit of US\$845 million was recorded, about double the amount of the corresponding period of 1985 and a significant shortfall from the surplus of some US\$100 million initially targeted for 1986 as a whole.

Article IV consultation discussions with the Hungarian authorities are scheduled for October 8-22, 1986 and an assessment of exchange rate policy will be covered in the Staff Report for the 1986 Article IV consultation.