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March 6, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Hungary - Staff Report for the 1984 Article IV Consultation

The attached supplement to the staff report for the 1984 Article IV consultation with Hungary has been prepared on the basis of additional information. A revised draft decision appears on page 4.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion on Friday, March 8, 1985, they should contact Mr. Somogyi, ext. 7188.

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INTERNATIONAL MONETARY FUND

HUNGARY

Staff Report for the 1984 Article IV Consultation-- Supplementary Information and Revised Proposed Decision

Prepared by the European Department

(In consultation with other departments)

Approved by Brian Rose and Eduard Brau

March 5, 1985

Since the staff report for the 1984 Article IV consultation with Hungary (SM/85/10) was issued, the following additional information has become available:

1. Performance criteria

Data reported by the Hungarian authorities show that the performance criteria for the end of 1984 were met, with the exception of a marginal overrun on net domestic assets of the National Bank (Table 1).

2. Balance of payments

The surplus of the current account in convertible currencies reached US$330 million in 1984 (Table 2), moderately less than the earlier estimate of US$349 million reported in SM/85/10. While the surplus on merchandise trade was in line with the previous estimate, net receipts from travel were lower and net payments of investment income higher than estimated earlier. On trade account, the growth in the volume of exports was somewhat stronger than foreseen in SM/85/10 and the nonruble terms of trade developed somewhat less adversely (deteriorating by 2.2 percent, as opposed to 2.8 percent for the year as a whole); the volume of imports, however, also increased more rapidly than estimated earlier.

The deficit of the current account in nonconvertible currencies (Table 3) fell more than estimated earlier, to US$59 million instead of US$125 million, due to a more favorable outturn on the services account and a somewhat lower deficit on trade settled in rubles.

The external liquidity position of Hungary at the end of 1984 was in line with expectations, with gross international reserves in convertible currencies at US$2.2 billion (with gold valued at SDR 35 per ounce) or US$2.6 billion (with gold valued according to the national practice at US$226 per ounce). At the latter level, the reserves were equivalent to 8.2 months of convertible currency imports. During the last quarter of 1984 the net inflow of capital was higher than estimated in SM/85/10.

Medium- and long-term borrowing was substantially larger than foreseen, and for the year as a whole net medium- and long-term liabilities increased by US$963 million, against US$503 million estimated in SM/85/10. Against this, the repayment of short-term liabilities and the extension by Hungary of medium-term and short-term commercial credits were also larger than estimated earlier. As a result, at the end of 1984 nonreserve assets in convertible currencies were higher than anticipated and gross convertible currency debt amounted to US$8.9 billion compared with the estimate of US$8.5 billion reported in SM/85/10. At the same time, the maturity structure of debt improved more than expected, with short-term debt in convertible currencies falling to US$1.4 billion.

3. National accounts

Partially revised national accounts data indicate an increase in real GDP of 3 percent in 1984 (against 2.3 percent reported in SM/85/10), with higher levels of both private consumption and fixed investment, but also a somewhat better outturn of the real foreign balance on goods and services. Nominal household incomes grew somewhat faster than estimated earlier (by 9 percent, compared with 8.7 percent), while the consumer price index rose slightly less rapidly (8.3 percent versus 8.5 percent). However, the savings of households appear to have been somewhat stronger and the reported increase in real private consumption of about 1 percent is only marginally higher than foreseen. Investment outlays of the socialist sector, at Ft 185.7 billion, moderately exceeded estimates in SM/85/10.

4. Money and credit

Net bank credit to the State budget and credit extensions by the State Development Bank were both within the performance criteria limits set for end-December, and despite a significant overrun on credits to households, gross credit extensions were in line with program forecasts at the end of 1984. However, higher than expected net disbursements from reserve and other funds contributed to a higher level of net domestic credit of the banking system than targeted in the program (Table 4). With the net external liabilities of the banking system roughly in line with program projections, this overrun was reflected at end-year in faster monetary growth. Broad money, which had been below program projections earlier in the year, grew by 5.8 percent in the year to December compared with a program projection of 3.7 percent and an increase in nominal GDP of around 8 3/4 percent. This overshoot was accounted for by additional money holdings of households; enterprise broad money was only slightly above program in December.

5. Economic policy measures

The body of legislation on the structural reform measures outlined in the staff report concerning the management of enterprises and steps to liberalize the price and wage system, to restructure the tax system, and to decentralize the banking sector and improve financial intermediation took effect at the beginning of 1985.

In conjunction with cuts in subsidies, procurement prices for farm products and some consumer prices were raised at the beginning of January and a major package of consumer price increases was introduced on January 21, 1985. The latter measures mainly affected the prices of food, household energy, postage, local transportation, books, and cultural services. They are estimated to raise the consumer price index by about 3 percentage points in 1985. Together with the carry-over effect of consumer price increases in 1984 of 0.5 percentage points and projected increases of market prices accounting for 3.5 percentage points, they are expected to lead to the planned increase of consumer prices by 7 percent in 1985. Compensatory increases in social benefits have been introduced for recipients of low pensions and families entitled to child allowances. The latter improvements are part of the 9.1 percent increase in overall social benefits foreseen in the plan for 1985. In an effort to moderate the fast rise of incomes from private sector activities, the rates of the company tax were increased with effect from January 1, 1985.

6. Exchange and trade arrangements

The authorities confirmed that the six import quotas still in force in the latter part of 1984 were abolished as of January 1, 1985, thereby removing all import restrictions introduced in September 1982. The authorities have also informed the staff that the bilateral payments agreement with Finland was terminated as of February 1, 1985. In the light of this latter development a change is proposed in the draft decision (see over).

The following revised draft decision is proposed for adoption by the Executive Board.

1. The Fund takes this decision relating to Hungary's exchange measures subject to Article VIII, sections 2 and 3, and in concluding the 1984 Article XIV consultation with Hungary, in the light of the 1984 Article IV consultation with Hungary conducted under Decision No. 5394-(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 and a multiple currency practice in accordance with 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 notes with satisfaction the announced termination of the bilateral payments arrangement with a Fund member. The Fund also welcomes the change in the method of setting the exchange rate of the forint against convertible currencies, which eliminates a practice that has given rise to broken cross rates in the past.

Table 1. Hungary: Quantitative Performance Criteria under 1984 Stand-By Arrangement

	Actual December 31, 1983	Actual March 31, 1984	Limit March 31, 1984	Actual June 30, 1984	Limit June 30, 1984	Actual September 30, 1984	Limit September 30, 1984	Actual December 31, 1984	Limit December 31, 1984
				(In billions of forint)					
Net domestic assets of National Bank of Hungary	261.7	261.4	262.0	262.4	262.5	264.0	264.0	260.1	260.0
Net bank credit to the State, under the understanding that no borrowing from the State Insurance Company will occur in 1984	28.9	22.5	22.5	19.8	19.8	15.8	16.4	10.9	11.0
Credit granted by State Development Bank	148.0	149.9	150.0	153.3	154.5	157.2	157.2	162.5	164.0
				(In millions of U.S. dollars)					
Net foreign liabilities in convertible currencies of specialized financial institutions	1,088	1,122	1,130	1,047	1,085	1,054.9	1,055	1,054	1,055
New long-term foreign debt in convertible currencies by nonbank borrowers	1.4	--	26.3	--	...	--	...	--	25.0
Total short-term debt in convertible currencies	2,123	1,680	1,350 1/	1,389	1,500	1,445.5	1,550	1,422.3	1,600

Sources: EBS/83/268 (12/16/83); Letter of Intent of May 18, 1984, and data provided by Hungarian authorities.

1/ Limit waived by Executive Board on May 14, 1984 (EBS/84/109, 5/9/84).

Table 2. Hungary: Balance of Payments in Convertible Currencies

(In millions of U.S. dollars)

	1982	1983	1984 Revised Program	1984 Outturn
Exports	4,876	4,847	4,994	4,965
Imports	-4,110	-3,970	-3,916	-3,729
Trade balance	766	877	1,078	1,236
Freight and insurance (net)	-220	-175	-193	-154
Travel (net)	176	165	180	163
Investment income (net)	-976	-662	-671	-744
Government expenditure (net)	-45	-39	-47	-37
Other current receipts (net)	146	77	-12	-197
Unrequited transfers (net)	61	54	65	63
Current balance	-92	297	400	330
Medium- and long-term capital				
Assets 1/	-192	-65	-100	-124
Liabilities	174	60	-309	963
Inflows	(1,068)	(1,276)	(1,226)	(...)
Outflows	(-894)	(-1,216)	(-1,535)	(...)
Short-term capital				
Assets 1/	-161	-239	-80	-307
Liabilities 2/	-883	393	-487	-557
Overall balance	-1,154	446	-576	305
Monetary movements				
Monetary gold (increase -)	383	-368	49	-167
Foreign exchange (increase -)	536	-430	77	-573
Use of Fund resources 3/	235	352	450	435
Memorandum item:				
Gross international reserves in convertible curencies (end-year) 4/	1,112	1,573	...	2,161

Source: National Bank of Hungary.

1/ Nonreserve assets; mostly export financing.
2/ Includes errors and omissions.
3/ Includes drawing of SDR 72 million under CFF in December 1982.
4/ Gold valued at SDR 35 per ounce.

Table 3. Hungary: Balance of Payments in Nonconvertible Currencies

(In millions of U.S. dollars)

	1982	1983	1984 Revised Program	1984 Outturn
Exports	4,207	4,031	4,216	3,871
Imports	-4,465	-4,482	-4,342	-4,293
Trade balance	-258	-451	-126	-422
Freight and insurance (net)	-91	-71	-101	-65
Travel (net)	81	95	104	103
Investment income (net)	14	-4	20	-16
Government expenditure (net)	3	7	2	5
Other current receipts (net)	28	161	88	333
Unrequited transfers (net)	2	3	2	3
Current balance	-221	-261	-51	-59
Medium- and long-term capital				
Assets 1/	12	-15	-9	...
Liabilities	87	94	25	...
Inflows	(133)	(133)	(...)	(...)
Outflows	(-46)	(-39)	(...)	(...)
Short-term capital				
Assets 1/	128	-27	--	...
Liabilities 2/	32	190	35	...
Overall balance	38	-19	--	-27

Source: National Bank of Hungary.

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

Table 4. Hungary: Selected Monetary and Credit Developments

	In Billions of Forint				Percentage Change Over 12 Months		
	December 1982	December 1983	Program December 1984	Outturn December 1984	December 1983	Program December 1984	Outturn December 1984
National Bank of Hungary							
Net domestic assets	251.3	261.7	260.0	260.1	4.1	-0.6	-0.6
Net foreign liabilities in convertible currencies 1/	164.0	163.8	153.6	151.3	-0.1	-6.2	-7.6
Currency in circulation	87.3	97.9	106.4	108.8	12.1	8.7	11.1
Banking System							
Net foreign assets 2/	-275.7	-276.0	-266.9	-264.8	-0.1	-3.3	-4.1
Convertible currencies	-269.2	-262.6	-250.8	-249.0	...	...	...
Nonconvertible currencies	-6.5	-13.4	-16.1	-15.8	...	...	...
Net domestic credit	663.3	681.2	687.1	693.2	2.7	0.9	1.8
Claims on budget	29.3	28.9	11.0	10.9	...	...	...
Claims on enterprises	534.1	551.0	579.5	576.6	3.2	5.2	4.6
Claims on households	133.6	154.3	175.9	179.4	15.5	14.0	16.5
Less: reserve funds, other items, etc.	-33.7	-53.0	-79.3	-73.7	...	...	...
Broad money (M2)	387.6	405.2	420.2	428.7	4.5	3.7	5.8
Money	183.0	190.2	202.8	201.0	3.9	6.6	5.7
Quasi-money	204.6	215.0	217.4	227.7	5.1	1.1	5.9

	1982	1983	Program 1984	Estimate 1984
Income velocity of M2 3/	2.25	2.26	2.29	2.33
M2 held by households	3.43	3.25	3.15	3.20
M2 held by enterprises	6.58	7.43	8.36	8.61

Sources: National Bank of Hungary; and staff estimates.

1/ Valued at constant (June 1982) exchange rates.
2/ Valued at program exchange rates.
3/ GDP divided by average of end-quarter stock of M2.