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Central Intelligence Agency

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Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

11 MAY 1983

HUNGARY's FINANCIAL PROSPECTS

The loans provided by the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) in 1982 stanched the hemorrhaging of Hungary's hard currency reserves and forestalled the need for a rescheduling. This help gave the regime time to take remedial action but did not correct fundamental weaknesses in Hungary's balance of payments. With a growing level of debt repayments through 1985 and only modest gains in Hungary's financial position expected this year, Budapest will remain on a financial tightrope. To restore its financial health, Hungary must:

- -- regain the confidence of Western bankers by achieving a sizable current account surplus in 1983;
- -- restructure its debt and build up reserves in order to reduce its vulnerability to the withdrawal of short-term credits; and
- -- implement reforms to improve efficiency and export competitiveness. [redacted] 25X1

This memorandum was prepared by [redacted] East European Division, Office of European Analysis. It was requested by Mr. William Milam, Director, Office of Monetary Affairs, US Department of State. Comments and questions are welcome and should be directed to [redacted] Chief, East European Division, Office of European Analysis [redacted] 25X1 25X1 25X1

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Hungary's Financial Goals for 1983

The IMF stabilization program approved last December projects that Hungary will rebuild its reserves by $500 million in 1983 with the help of a $600 million current account surplus and $366 million in IMF credits to offset a roughly $400 million decline in commercial debt. The Hungarians hope to move their current account into surplus from last year's $160 million deficit (see Table) by raising exports from $4.9 billion to $5.3 billion, holding imports at the 1982 level, and benefitting from a $400 million decline in net interest costs. Budapest has projected its medium and long-term borrowing requirements at $945 million, roughly equal to repayments on medium and long-term debt. In addition to IMF credits, the Hungarians plan to cover their needs by $250-300 million in trade credits, many of which would be government-backed; $60-70 million in drawings on World Bank development loans; and $200-260 million in untied commercial bank loans. Short-term commercial borrowings are projected to be $250 million higher than last year, but total short-term debt would fall slightly through repayment of the $300 million due to the BIS. Although the IMF credits carry a 6 year term, the Hungarians do not envision a significant lengthening of their debt's maturity structure because Western banks remain reluctant to extend medium-term credits. Nonetheless, the Hungarians hope to reduce their vulnerability to a quick reduction in short-

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term credit lines by use of more medium-term trade credits in place of borrowing Eurodollar deposits. 25X1

Adjustment Policies and Reform

The need to produce a current account surplus has forced Budapest to tighten its external adjustment policies. Beginning in 1979, Budapest shifted economic priorities from promotion of growth to gradual reduction in the country's current account deficit. The growth of demand was dampened mainly by sharp reductions in investment. Although increases in consumption slowed, the regime tried to maintain living standards. IMF statistics show that between 1979 and 1982 investment fell by more than 3 percent annually while consumption rose by 1.6 percent annually. The need to accelerate the adjustment process in 1983 has forced Budapest to place a greater burden on the consumer. Hungary's targets for 1983 envision a 3-4 percent decline in real domestic demand to be accomplished by a 1.5-2.0 percent reduction in consumption, a 6.5-7.5 percent fall in investment, and a 3.5-5.5 percent reduction in government outlays. The Hungarians hope to hold real GDP at the 1982 level by growth in net exports. 25X1

Hungarian economists have told the US Embassy in Budapest that the IMF would likely press harder for more structural reforms--probably a more comprehensive policy on wage differentiation--if Hungary requests a second standby program later this year. While the current program focuses on demand restraint policies to address the immediate balance of payments

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problem, a sustainable improvement will require more efforts to strengthen the efficiency and competitiveness of the Hungarian economy. The regime has already pushed ahead this year with additional reforms, which link wage incentives more closely with enterprise profitability, encourage the elimination of excess labor, and reduce subsidies to inefficient producers. 25X1

Prospects for 1983

Current Account The adjustment measures now being implemented should continue last year's improvement in the current account, but we doubt that Hungary will attain the projected $760 million gain. We estimate that the 1983 trade surplus will reach only $940 million--instead of the $1.1 billion target--and the current account surplus will reach only $400 million. The shortfall will result from poorer than expected growth in exports despite Budapest's commitment to gradual devaluations of the forint. Hungarian officials recently told the US Embassy in Budapest that growth in key West European markets is lagging behind their initial projections. Prospects for increased hard currency exports to developing countries and socialist countries (notably Yugoslavia and the USSR), which account for nearly half of Hungary's sales, are not encouraging either. Financial constraints are forcing the LDCs and Yugoslavia to curb imports; moreover, the Hungarians have been complaining in press articles about delayed payments from these countries. Because of shrinking hard currency earnings, the USSR may become less willing to buy Hungarian goods for hard currency and may insist instead on more hard good deliveries in ruble trade.[1] For these reasons, we estimate that Hungary's hard currency exports will grow by only 3 percent instead of the projected 7 percent increase. The Hungarians probably cannot cut imports further without disrupting industrial production and consumer supply. [redacted] 25X1

<u>Borrowing</u> Hungary is making progress toward covering its borrowing needs, but success is uncertain. In April, Budapest received a $200 million syndicated loan with 3-year maturity from Western commercial banks. The Hungarians appear to be in compliance with the IMF program targets, which will ensure continued drawdown of standby credits. [redacted] 25X1
[redacted] the Hungarians have stepped up use of 25X1
guaranteed trade credits, particularly from West Germany, France, and Japan, and have a substantial reserve of undrawn commitments. The US Embassy in Budapest reports that the World Bank will probably approve $200-250 million in project credits which the Hungarians may begin to draw by the fourth quarter of this year. [redacted] the Hungarians 25X1
have also been lining up short to medium-term trade financing

1 Although most of Hungary's trade with CEMA countries is conducted on a clearing account basis, approximately 15-20 percent of imports and exports involve hard currency transactions or exchanges of goods otherwise salable in Western markets (so-called hard goods). Most of this trade is with the USSR and, [redacted] mainly involves the exchange of 25X1
Hungarian grain, meat, and other agricultural products for Soviet oil outside planned soft currency deliveries. [redacted] 25X1
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[redacted] Budapest and the IMF 25X1
include these surpluses in Hungary's overall hard currency balance of payments. [redacted] 25X1

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from commercial banks, particularly in the form of bankers acceptances. [redacted] efforts to arrange over $500 million in medium-term loans apart from the IMF credits may be too ambitious in the current lending climate. Indeed the failure of attempts to expand the $200 million syndicated loan indicates many banks remain nervous about medium-term lending to Hungary. Furthermore, some bankers are concerned that Hungary is still losing short-term deposits. [redacted] 25X1

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<u>Reserves</u> The likely shortfall in the current account surplus and continuing uncertainties surrounding Hungary's borrowing prospects make a $500 million buildup of reserves appear unlikely. In early 1983, when efforts to complete the $200 million syndication were faring poorly, senior Hungarian bankers broached the possibility of extending the $300 million BIS loan to preclude a renewed drawdown of reserves. Completion of the syndication, however, made a rollover of the entire credit less necessary. Nonetheless, according to press reports, Hungary's low level of reserves induced Western central banks to grant a 2-month loan for $100 million to be used for repaying the BIS. The loan from the central banks is to be repaid out of IMF credits scheduled to be disbursed in June. Because of continuing liquidity problems, Budapest may need a second IMF standby program in late 1983 or early 1984 to obtain additional medium-term credits to reinforce its reserves. Indeed, the Hungarians indicated the possibility of another $500 million standby credit in documentation given to banks participating in last year's club loan. [redacted] 25X1

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Outlook Through 1985 Hungary must address its fundamental balance of payments problems more effectively because the country needs a growing hard currency trade surplus to cover rising debt service payments. According to IMF estimates, repayments on medium and long-term debt and gross interest payments will rise above $2 billion in both 1984 and 1985 compared with $1.7 billion this year. Hungary will also have to roll over at least $2 billion in short-term credits each year. Since banks will likely remain reluctant to extend new medium-term credits, the Hungarians will continue to face the problem of bunched up maturities for the next several years. 25X1

Structural reforms, while necessary, will not be sufficient to ensure improved balance of payments performance. Hungary also needs a continued fall in international interest rates and sustained growth in its major Western markets. But even projected current account surpluses will leave Hungary far short of covering its financing requirements over the next several years. Thus the Hungarians will remain dependent on large borrowings from Western banks to meet all their obligations. 25X1

HUNGARY: FINANCING REQUIREMENTS 1982-83

	1982	Hungarian Projection 1983	CIA Projection 1983
Financing Requirement	4,250	2,424	2,624
Current account balance	-160	600	400
Trade balance	777	1,142	940
Exports	4,885	5,252	5,050
Imports	4,108	4,110	4,110
Net interest	-951	-580	-580
Other	14	38	40
Repayments of medium and long-term debt	-878	-936	-936
Repayments of short-term debt	-2,849	-1,724	-1,724
Repayment of BIS credits	-210	-300	-300
Export credits, net	-153	-64	-64
Borrowing Sources	3,364	2,924	2,616
Medium and long-term credits	893	579	450
Short-term credits	1,724	1,979	1,800
IMF credits	237	366	366
BIS credits	510	-	-
Change in reserves	-886	+500	-8

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Distrubution List for Hungary's Financial Prospects

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1	C/EURA/EE	
1	DC/EURA/EE	
1	C/EURA/EE/CE	
1	C/EURA/EE/EW	
1	[redacted]	25X1
1	Mr. Wm. Malin	State
1	Mr. Tim Houser	State
1	Mr. John Davis	State
1	Mr. Steve Canner	Treasury

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