## IX. Exchange Arrangements and Capital Account Liberalization[119]

230. This chapter outlines the exchange arrangements of Hungary, the treatment of current international payments and receipts, and the present structure of capital controls. A more detailed description can be found in the IMF publication *Annual Report on Exchange Arrangements and Exchange Restrictions.*

231. The currency of Hungary is the Hungarian forint. Since March 13, 1995 a crawling peg exchange rate regime has been in place. From January 1, 1999 the central parity is fixed against a basket composed of the euro—formerly the deutsche mark—with a 70 percent weight, and the U.S. dollar with a 30 percent weight. A fluctuation band of 2.25 percent on either side of the central parity has been maintained since December 23, 1994. The monthly rate of devaluation is preannounced by the National Bank of Hungary (NBH), and was set as follows:

| Monthly Rate of Crawl (Percent) | Date of Introduction |
|---|---|
| 1.9 | March 13, 1995 |
| 1.3 | July 1, 1995 |
| 1.2 | January 1, 1996 |
| 1.1 | April 1, 1997 |
| 1.0 | August 15, 1997 |
| 0.9 | January 1, 1998 |
| 0.8 | June 15, 1998 |
| 0.7 | October 1, 1998 |
| 0.6 | January 1, 1999 |

232. The NBH is vested with authority to enforce foreign exchange regulations under the Act on Foreign Exchange of 1995. In accordance with UN Resolution No. 661 and Executive Board decision No.144–(52/51), Hungary maintains payments restrictions against Iraq.

233. Hungary accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement with effect from January 1, 1996. Hungary's exchange system is free of restrictions on payments and transfers for current international transactions. The limit on purchases of foreign exchange for tourism was abolished on January 1, 1997. Purchases for import payments only require a declaration regarding the use of the foreign exchange.

234. Export proceeds and current transfers in convertible currencies must be immediately repatriated to Hungary and surrendered by deposit in a foreign exchange account at a

[119] Prepared by Craig Beaumont.

domestic bank. Foreign exchange receipts not resulting from an international transaction must be immediately converted into domestic currency. Current transfers to resident natural persons are exempted from the surrender requirement.

235. Hungary maintains capital controls, with restrictions primarily on short-term capital flows, so as to contain potential speculative pressures on the forint, and reduce the risk that capital inflows might stimulate an unsustainable current account deficit. To enforce these capital controls, Hungarian residents must obtain permission to hold foreign exchange accounts abroad. The following outlines the key restrictions on capital flows by asset type:

i. Debt securities: residents may freely transact in bonds with original maturity greater than one year issued by OECD governments or OECD-based enterprises, but transactions must be made through a resident brokerage company. Nonresidents may freely transact in Hungarian bonds of original maturity greater than one year. For other transactions foreign exchange authorization is required.

ii. Money market instruments, open-end funds, and derivatives: transactions between residents and nonresidents require foreign exchange authorization. However, as an exception, foreign investors have been allowed to trade on the Budapest stock exchange in futures contracts for the stock exchange index (BUX) or the shares of individual companies.

iii. Credit operations: credits from residents to nonresidents require foreign exchange authorization, except credits between close relatives, or long-term credits from a resident to a nonresident enterprise in which they have greater than 10 percent participation, in which case the credit is treated as outward FDI—see below. Residents must obtain authorization to receive credits from nonresidents, except for medium- and long-term loans to enterprises.

iv. Equity securities: transactions in shares of OECD-based enterprises are free of controls, but residents must use a resident brokerage company. For other transactions foreign exchange authorization is required.

v. Direct investment: outward FDI (acquisition of holdings in nonresident companies of greater than 10 percent) is free of controls. Inward FDI is also free of exchange controls.

236. Specific provisions apply to certain institutions:

i. From January 1, 1997 banks were permitted without prior approval to make short-term foreign exchange denominated loans to nonresidents, or to purchase foreign short-term securities, but the total of loans and security holdings may not exceed 50 percent of total liabilities in foreign exchange. Medium- and long-term loans to nonresidents still require foreign exchange authorization. Banks must report all foreign borrowing to the NBH.

ii. Insurance companies are governed by the Law on Insurance Companies and Insurance Activities 1995 and regulated by the independent Insurance Authority. Payments for insurance services, which are current transactions, are free from exchange restrictions; however, nonresident insurance companies cannot operate cross-border. Resident insurance companies face restrictions on portfolio composition, including a ban on foreign investment.

iii. Private pension funds participating in the compulsory second pillar are subject to legislated portfolio restrictions, which initially limit foreign investments to 10 percent of funds, rising to 30 percent by 2002. For the pension funds in the voluntary third pillar, the limit on foreign investment is fixed at 20 percent of funds.

237. Hungary has been liberalizing its capital controls over time, consistent with the commitments it made when joining the OECD in December 1995 to come into compliance with the OECD Code of Liberalization of Capital Movements. Though there is no specific date for compliance to be achieved, the Hungarian authorities consider that full capital account liberalization might be achieved within two or three years, with short-term capital movements likely liberalized last. The final step in liberalization would also include ending the obligations to repatriate foreign exchange earnings, as this would *de facto* give residents the right to open accounts abroad. This movement towards capital account liberalization is also consistent with adoption of the EU *acquis communautaire*, which includes the freedom of intra-EU capital flows. However, countries seeking EU accession have previously obtained transitory periods in the case of short-term capital flows.

238. A number of measures liberalizing capital transactions came into effect on in January 1, 1998. The requirement that resident transactions in foreign securities be restricted to companies with an investment grade rating was removed. Nonresident companies from within the OECD, and with an investment grade credit rating, may issue Forint-denominated bonds carrying a maturity of more than one year. Restrictions on direct investments in branches of foreign companies were eliminated, as was the requirement for foreign exchange authorization for outward FDI to non-OECD countries. Residents were also permitted to acquire or build real estate abroad without foreign exchange authorization, though transactions must be reported within eight days.