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ECONOMIC COMMITTEE

ECONOMIC SITUATION IN HUNGARY IN 1976:  
SUMMARY REPORT

Note by the Chairman

At its meeting on 23rd September, 1976, the Committee examined Working Paper AC/127-WP/482 and suggested a number of changes to this document. The attached revised version attempts to meet the wishes of the Committee.

(Signed) J. BILLY

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This document includes: 1 Annex

N A T O C O N F I D E N T I A L

ECONOMIC SITUATION IN HUNGARY IN 1976:  
SUMMARY REPORT

I. THE 1971-1975 PLAN

A. General Assessment

Hungary is the smallest of the East European countries with a population of 10.5 million in 1975. It has limited natural resources and is dependent upon growth in its agricultural, industrial and foreign trade sectors\*. In the last Plan period, Net Material Product and industrial growth were slightly ahead of Plan targets; despite the labour shortage and difficulties experienced in the export trade, the main objectives of the Plan were achieved. The agricultural situation in Hungary is better than in most of the other COMECON countries and there were no real supply gaps, as output for the full five years was 18% larger than in the previous five years and exceeded the Plan (15-16%).

2. There were, however, a number of weaknesses in Plan implementation, especially deficiencies in the building industry and failure to meet demand for consumer goods. The economy is suffering from a severe labour shortage despite some further re-deployment and improvements in productivity. Adverse conditions in world markets during 1974 and 1975 - especially Western inflation/recession and changes in pricing procedures within CEMA placed, by the end of the Plan period, serious strains on the Hungarian economy. The country's hard currency indebtedness is high (1975: over \$2 billion) and unless the growing trade deficit with the West is reversed and Hungarian terms of trade improve, there is no short term solution in sight for this problem.

3. Although the Hungarian Authorities, like elsewhere in Eastern Europe, are determined to maintain stable prices in the consumer sector, they have been forced to impose in 1976 a series of extensive consumer price increases, including sugar by 50% and building materials by 22%, to prevent excessive demand with ensuing supply shortages.

B. Sectoral Analysis

4. Net Material Product(1) in 1975 was 5% higher than in 1974; over the period of the Fourth Five-Year Plan its average annual growth was 6.2%, ahead of the target (5.4-5.7%).

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\* In 1974, foreign trade accounted for 45.7% of Hungarian GNP. (GNP estimated according to Western concept by United States Authorities).

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5. Capital investment: in 1975 investments were reported at 141-142 billion forints, 14% more than in 1974. Planned investment target of 7.1% growth a year, in volume, was exceeded, the actual percentage being 8.6%. This was the third highest growth in Eastern Europe after Poland and Romania.

6. In 1975 the value of unfinished construction projects stood at 117,000 million forints compared with the 1970 figure of 70,000 million, itself more than double the figure for 1965. Several reasons have been cited for the growing amounts of capital tied up in unfinished projects the greater freedom to invest given initially to enterprises under the NEM, the poor performance of the building industry, inadequate technical preparation and the increased cost of both raw material imports (especially from the USSR) and Western technology.

7. Manpower: The population has been increasing at a rate of less than 1% a year since the mid-1950s and the labour shortage is acute and worsening. At the end of 1975 the labour force totalled some 5.1 million, over 48% of the total population, having increased by only 92,000 (2.2%) between 1971-1975(2).

8. Industry: Between 1971-1975 total output increased by 37% (6.5% a year), slightly more than planned (5.7-6.0%), and industry's contribution to national income produced rose from 42.6% in 1970 to 44.9% in 1975. The labour productivity growth rate in industry of 6.2% a year was well beyond the Plan figures of 4.1-4.7%. The engineering and chemical industries grew most rapidly and exceeded the planned objectives. The electronics industry has expanded rapidly in recent years and specializes in the manufacture of communications equipment. A recent survey shows that 36% of COMECON co-operative agreements with the West involved some aspects of the Hungarian electronic industry(3). On the other hand, the building industry achieved only half its planned increase.

9. During the last few years the rising cost of imported raw materials and demand has forced the government to lay great emphasis on the importance of the domestic production of fuel and power. Coal output in 1975 dropped to 24.9 million tons (1965: over 37 million tons) while net imports reached around 1.4 million tons and coal represented 38% of primary energy consumption, a decrease of 14 percentage points over 1970. Domestic crude oil production is limited to 2 million tons per year, in 1975 some 8.5 million tons of oil had to be imported, mainly from the USSR at a price of 37 roubles a ton, thus increasing the deterioration of Hungary's

position with the Soviet Union by an estimated 140 million transferable roubles or 5.5 billion forints(4). In 1975 Hungary produced 5,175 million cubic metres of natural gas and imported only 806 million cubic metres, of which 600 million were from the USSR. Last year 24 billion kWh of electricity were generated while imports totalled 4.2 billion kWh, all of which came from the USSR.

10. Agriculture: Gross agricultural production increased by 18% in 1971-1975 compared with the Plan target of 15-16%. Hungary maintained self-sufficiency in basic foods and had an increasing agricultural surplus for export. The public sector which accounts for 93% of agricultural land produced two-thirds of the value of total output, while the small private farms produced the remaining third on 7% only of the agricultural land. Because of a decline in livestock numbers held by the private sector, cheese and butter had to be imported and, recently, difficulties have been experienced with meat supplies. The Authorities have now come out visibly in favour of the numerous private plots in order to encourage an increase in vegetable production and livestock breeding(5).

11. Despite fairly good Plan results there is a general feeling that agriculture is sluggish because of several factors: the decreasing number of co-operative farms (1,400 in 1975 but 4,000 in 1968), the disparate acreage for most farms and the low quality of farm management; the decline in livestock inventory (cattle, poultry, swine, sheep) partially because of the EEC embargo on meat imports; the need further to mechanize agriculture; inadequate infrastructure and inadequately planned new projects (e.g. the sugar beet project of 1973)(6).

12. The standard of living has risen slowly but surely between 1971-1975 with total real income per head rising by 4.6% a year. Over the period, consumption also rose by 28% (about 5% a year) (Table 1) with the proportion accounted for by food, clothing and "luxury items" (mainly high priced Western goods imported for psychological impact) falling, while there was an increase in the share of consumer durables which are more readily available than in most other COMECON countries. Although the volume of retail trade is said to have increased by 35% at constant prices, the level of savings bank deposits rose by 93% suggesting both repressed purchasing power in the hands of the population and savings for a car or an apartment(7).

13. The consumer price index is reported to have risen by almost 15% between 1970-1975, while producer price level in industry went up by 22%. This partly reflects price rises which averaged about 47% for imports, this had an impact on production costs, and 22% for exports - which also exerted some pressure on domestic prices. However the internal price rises were limited by State subsidies and by regulations forcing enterprises to absorb some of the increases.

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14. Foreign Trade: The importance of external trade to the Hungarian economy has grown in recent years with 1970-1975 trade turnover increasing in dollar terms by 177%, from \$4.8 billion to \$13.3 billion. The bulk of this trade (68.7%) was with other Communist countries (Table 3). Hungary has been encountering substantial problems in this sector, especially in 1974 and 1975. Revised pricing procedures within CEMA under which prices of raw materials initially increased much faster than those of manufactured goods, have seriously affected the economy and increased Hungary's dependence towards the USSR, its main trading partner. On the other hand, imports from the West, mainly machinery and manufactured goods, and from the LDC's, have risen much faster than exports; this has resulted in large convertible currency deficits in 1974 and 1975, respectively \$582 million and \$550 million.

15. In 1975 Hungary had a negative balance of trade of some \$1.1 billion (\$322 million with the Communist countries and \$778 million with the non-Communist countries), and was in deficit with virtually each of its major trading partners; this was partly due to the deterioration of its terms of trade with the COMECON area by almost 9% (over 1974) and by 7% with the industrial West(8); these, however, have improved somewhat in 1976.

16. In 1975 imports amounted to \$7.2 billion. Purchases from Communist countries at \$4.75 billion had risen 188% over the figure recorded for 1970; these countries supplied the bulk of the fuels, raw materials, spare parts, machinery and vehicles purchased abroad by Hungary(9). The growth of imports from the non-Communist countries was also remarkable: 190% between 1970 and 1975 when imports amounted to \$2.48 billion and consisted mainly of machinery, equipments, raw materials for the food industry, live animals and food products.

17. The bulk (72%) of Hungarian exports goes to Communist countries. Sales to the latter reached \$4.4 billion in 1975, 186% more than in 1970, and included a very substantial share of Hungarian exports of machinery and other capital goods, industrial consumer goods and raw materials. Deliveries to the non-Communist countries, at \$1.7 billion only, grew by 122% between 1970 and 1975.

18. In order to reduce convertible currency expenditure on Western technology and know-how and to find guaranteed markets for the resultant products Hungary has, as of May 1975, established 63 joint Hungarian-foreign enterprises operating world-wide, including 46 in Europe(10), but this will alleviate Hungary's balance of payment only in the medium and long term. In the short term, however, it needs to borrow to finance her purchases in convertible currency. It was among the first Soviet bloc countries to enter the Eurocurrency market where it raised some \$1 billion in loans and bond issues. It has also received government guaranteed credits. Overall indebtedness, as of December 1975, is estimated at over \$2 billion.

II. THE 1976-1980 PLAN

C. General Assessment

19. The tone of the new Hungarian Five-Year Plan 1976-1980 is cautious. Its targets are roughly similar to or slightly below those for 1971-1975, which were about average within East Europe and which were generally achieved. However this does not mean that the new targets will be fulfilled easily for Hungary faces a number of problems. The trade deficit is growing, the terms of trade remain unfavourable and Hungary may be over-estimating its capacity to export to the West during 1976-1980, particularly if the latter experiences new economic difficulties.

20. The new Plan hits the consumer by reducing the rate of growth of real wages compared with 1971-1975, in an effort to release more resources for investment and export. Hungary is having to divert a growing volume of production to pay for the increasingly expensive energy and raw materials imported from the USSR and from other sources. Further domestic price rises are likely in response to the higher cost of imports.

21. The hoped for rate of economic growth is also threatened by the labour shortage and because the Plan provides for only a relatively small increase in investment which, in the past, has often been badly controlled. There is no evidence to suggest that the NEM is likely to be overturned, although progress towards greater decentralisation is likely to remain difficult, and the tendency to deal with pressing problems such as inflation and shortage of manpower by decisions at the centre will continue.

D. Sectoral Analysis

22. National Income: The new Five-Year Plan (1976-1980) expects National Income to grow by 30-32% overall (5.5% a year) based on higher labour productivity. There may, however, be some allowance in this income projection for expected inflation as a result of rising import prices and domestic wage pressures (Table 1).

23. Investment: The Plan officially provides for a 25-26% increase in investments for the period 1976-1980. However the overall amount to be invested is put at 870,000 million forints, which is 52% more than the investment for 1971-1975, the latter figure may possibly represent the growth rate in current prices and suggests an anticipated inflation rate of some 4.7% a year during the period.

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24. There is little specific information on how the money will be spent. 340-350,000 million forints (39.4% of the total) is to be allocated to industrial projects, mainly in the raw material, heavy industries and energy sectors, especially petrochemical plants and systems (e.g. Orenburg gas pipeline, Adria oil pipeline). In other areas the emphasis will be on the modernization of existing plant.

25. Other investment allocations include 105-107,000 million forints (12.3% of the total) each for agriculture and for transport and communications, 43-45,000 million (5.2%) for roads, and 33-34,000 million (3.9%) for internal trade, two-thirds of it for the development of trade in consumer goods, the provision of better shipping and catering facilities, and only 2.3% (20,000 million forints) given to the construction sector.

26. Manpower: In 1976-1980 the total labour force is expected to increase by only 60,000 (1.2%), with 120-130,000 expected to leave agriculture for work in other sectors, mainly in the retail trade, health and cultural services. The shortage of labour plus the tendency towards underemployment has led to a 1975-1976 ban on further recruitment and replacement of administrative personnel in government offices and most factories. All the growth in the industrial sector during the Five-Year Plan is to be allieved by increasing labour productivity.

27. Industry: Under the new Plan average overall growth in industrial output is to be 6% a year, slightly less than during the preceding five year period. The highest growth rates are again expected to be in the engineering and chemical sectors. The general industrial strategy will be strongly influenced by the need to redress the foreign trade balance. There are plans to improve the quality of goods produced, to modernise equipment and to suppress uneconomic production. Despite efforts to increase domestic production, the share of imports in primary energy consumption is to rise from 47% in 1975 to 59% in 1980.

28. Agriculture: Investment in agriculture in 1976-1980 (105-107 million forints) is to be slightly below the figure for 1971-1975 with a higher share allocated for machinery (instead of new construction projects), conservation, irrigation and cultivation of existing land. The planned increase in fertilizer application is to rise only 10% to 290-300 kg per hectare in 1980.

29. The 1976-1980 Plan requires that total agricultural production should grow by 3.2-3.4% a year for an overall 16-18% rise in output. This extra production is to be achieved mainly by improving crop yields. The Plan aims for a grain harvest of

about 14 million tons by 1980, 3 million tons more than the estimated domestic requirement in that year. The output of meat (live weight) is to increase by 12-13%, milk by 15-16% and eggs by 11-15%. In view of the decline in capital investments and in the agricultural labour force, labour productivity will have to continue to rise and the farming of the private plots be encouraged if planned targets are to be met.

30. Consumer and Prices: During 1976-1980 personal consumption is forecast to rise by 21-23%, less than was achieved during the last Five-Year Plan (28%). This decrease over 1971-1975 reflects the fact that per capita real income is to increase only 18-20%, a drop of 5-7 percentage points over the 1971-1975 period. The Plan also calls for the quality of the nation's diet to be improved. Although more consumer goods will be available it is unlikely that these will be sufficient to meet demand. The Plan makes it clear that neither producers nor consumers can be protected from long term changes in world prices. Although in some areas enterprises will be allowed to pass on higher costs to consumers, further disparities are likely to emerge between producer and consumer prices. A severe belt-tightening for the population at large is suggested in the 1976-1980 goals. The 1976 Plan calls for an average consumer price increase of some 4.5%; recent price rises include building materials (22%), furniture (3.4%), paper and oil products (10-15%), sugar (50%) and meat (30%). Overall, even the modest improvement in the standard of living planned for 1976-1980 seems likely to come under considerable pressure.

31. Foreign Trade: The Fifth Five-Year Plan lays great stress on the need to expand exports and restrict imports, but is devoid of data on foreign trade growth. Earlier guidelines suggest that COMECON countries will continue to be Hungary's main trading partner: exports are forecast to grow by 43-45% in 1976-1980 and imports by 32-35%. The position of the USSR as the first trading partner of Hungary (36.7% of 1975 total turnover) has been enhanced by the improvement of Soviet terms of trade with Hungary over the last couple of years. Recent long term trade agreements between the two countries suggest that Budapest will become increasingly dependent upon trade with the Soviet Union. Over the Plan period overall turnover may increase by 58% and additional exports to the USSR will consist of raw materials and foodstuff exported in the past to the West(11).

32. Total trade with the West is planned to rise faster than with the Socialist countries (50% against 40%), exports are planned to increase by 60-65% and imports by 36-40% only. Hungary's plan is to increase substantially its sales of manufactured goods to the West. This is an ambitious goal which

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depends in large measure on events beyond its control. Accelerated economic recovery and lowered inflation in the West and relative stability in raw material prices give at present a favourable short term outlook. However, the long term success of the Hungarian export drive to the West depends on two developments which are by no means assured: continued Western prosperity and growth and Hungary's ability to make machinery and equipments which are competitive in Western markets.

NOTES

- (1) The best available Western estimate based on purchasing power equivalent to the US dollar, suggests that in 1974 Hungary's GNP (at factor cost) was equivalent to about \$21 billion, the smallest after Bulgaria among the countries of the Warsaw Pact. Per capita GNP in Hungary (from the same calculation) was just over \$2,000.
- (2) RFER (Hungary), 2nd June, 1976, p. 6. For a fuller view of the Hungarian labour force see Joint Economic Committee (ed.), Reorientation and Commercial Relations of the Economies of Eastern Europe (Washington 1974), p. 443 ff.
- (3) Notes et Etudes Documentaires, 11 mai 1976, p. 82 (based on an examination of 207 contracts).
- (4) AC/127-WP/468, p. 25
- (5) "Private Plots back in Favour", Financial Times, 1st August, 1976.
- (6) AC/127-WP/466
- (7) AC/127-WP/466
- (8) Notes et Etudes Documentaires, 11 mai 1976, p. 73 and p. 79.
- (9) AC/127-WP/465, Table 10.
- (10) RFER, 27th May, 1975
- (11) US Department of State, Hungary's Foreign Trade and Development Strategy, 13th July, 1976, Report No. 515.

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TABLE 1

Principal Targets of the Five-Year  
Plans 1971-1975 and 1976-1980

|                                    | 1971-75% growth<br>over 1970 |             | 1976-80% growth<br>over 1975 |
|------------------------------------|------------------------------|-------------|------------------------------|
|                                    | Target                       | Performance | Target                       |
| National Income                    | 30-32                        | 35          | 30-32                        |
| Industrial Output                  | 32-34                        | 37          | 34                           |
| Building Industry<br>Output        | 41-43                        | 28          | 31-34                        |
| Agricultural Output*               | 15-16                        | 18          | 16-18                        |
| Consumption                        | 29-30                        | 28          | 23-25                        |
| Per capita real<br>income          | 25-27                        | 25          | 18-20                        |
| Real wages per<br>worker           | 16-18                        | 18          | 14-16                        |
| Consumer price level               |                              | 15.8        |                              |
| Producer price<br>level (industry) |                              | 22          |                              |
| Retail trade<br>(constant prices)  |                              | 35          | 28-30                        |
| Investment<br>(constant prices)    | 41                           | 51          | 25-26(1)                     |
| Exports<br>(constant prices)       |                              | 57          | 53-55                        |
| Imports<br>(constant prices)       |                              | 42          | 36-38                        |

\* Figures compare the full five years referred to in the column heading with the previous five years

- (1) Investment for period 1976-80 put at 870,000 million forints is officially claimed to increase by 25-26 per cent. Arithmetically the increase is 52% and may possibly represent the growth rate in current prices during the period.

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TABLE 2  
COMMODITY TRADE BY GROUPS OF COUNTRIES, 1975

(million US \$)

|  | Fuels,<br>Electric<br>energy | Raw materials,<br>Semi-finished<br>products,<br>Spare parts | Machinery,<br>Transport<br>Equipment,<br>Other capital<br>Goods | Industrial<br>Consumer<br>Goods | Raw materials<br>for Food<br>Industry,<br>Live Animals,<br>Food Products | Total         |
|--|------------------------------|---|---|---------------------------------|--|---------------|
| <u>IMPORTS</u>                                       |                              |   |   | 621                             |  |               |
| <u>All countries</u><br>(percentage share)           | 855<br>(11.8)                | 3055<br>(42.2)  | 1584<br>(21.9)  | 621<br>(8.6)                    | 626<br>(8.7)   | 7231<br>(100) |
| of which<br><u>Communist countries</u><br>% of total | 707<br>82.7                  | 2053<br>67.2  | 1231<br>77.7  | 513<br>82.6                     | 246<br>39.3  | 4750<br>65.6  |
| <u>EXPORTS</u>                                       |                              |   |   |                                 |  |               |
| <u>All countries</u><br>(percentage share)           | 106<br>(1.7)                 | 1563<br>(25.5)  | 1888<br>(30.8)  | 1189<br>(19.4)                  | 1385<br>(22.6)   | 6131<br>(100) |
| of which<br><u>Communist countries</u><br>% of total | 23<br>21.7                   | 978<br>62.6   | 1678<br>88.9  | 867<br>72.9                     | 882<br>63.7  | 4428<br>72.1  |

TABLE 3

Hungarian Foreign Trade by Groups of Countries

(million US \$)

|                                | 1970   | 1974   | 1975   | Percentage<br>(increase)<br>1975/74 | Change<br>1975/70 |
|--------------------------------|--------|--------|--------|-------------------------------------|-------------------|
| <u>All Countries</u>           |        |        |        |                                     |                   |
| Turnover                       | 4821   | 10703  | 13362  | 24.8                                | 177.2             |
| Exports                        | 2316   | 5728   | 6131   | 19.6                                | 164.7             |
| Imports                        | 2505   | 5575   | 7231   | 29.7                                | 188.7             |
| Balance                        | -189   | -447   | -1100  |                                     |                   |
| <u>Communist Countries</u>     |        |        |        |                                     |                   |
| Turnover                       | 3199   | 6626   | 9187   | 38.7                                | 187.2             |
| (Percentage share)             | (66.4) | (61.9) | (68.7) |                                     |                   |
| Exports                        | 1550   | 3441   | 4428   | 28.7                                | 185.7             |
| (Percentage share)             | (66.9) | (67.1) | (72.2) |                                     |                   |
| Imports                        | 1649   | 3185   | 4750   | 49.1                                | 188.1             |
| (Percentage share)             | (65.8) | (57.1) | (65.7) |                                     |                   |
| Balance                        | -99    | +256   | -322   |                                     |                   |
| <u>Non-Communist Countries</u> |        |        |        |                                     |                   |
| Turnover                       | 1622   | 4077   | 4184   | 2.6                                 | 158.0             |
| Exports                        | 766    | 1687   | 1703   | 0.9                                 | 122.3             |
| Imports                        | 856    | 2390   | 2481   | 3.8                                 | 190.0             |
| Balance                        | -90    | -703   | -778   |                                     |                   |

Source: Statisztikai Havi Közlemenyek No. 1, 1976

TABLE 4

Index of Gross Production of State Industry  
(Constant Prices - Previous Year = 100)

| Sector                               | 1971  | 1972  | 1973  | 1974  | 1975  | % Increase<br>1975 over<br>1970 |
|--------------------------------------|-------|-------|-------|-------|-------|---------------------------------|
| <u>Heavy Industry:</u><br>Total      | 107.5 | 104.9 | 107.6 | 109.8 | 106.6 | 142                             |
| of which:                            |       |       |       |       |       |                                 |
| Mining                               | 100.1 | 98.4  | 103.0 | 80.7  | 103.6 | 104.7                           |
| Elec. energy                         | 107.6 | 107.2 | 109.1 | 108.6 | 103.1 | 143.6                           |
| Metallurgy                           | 106.7 | 101.6 | 108.2 | 109.1 | 98.9  | 126.6                           |
| Engineering<br>total                 | 107.6 | 105.3 | 106.2 | 111.9 | 109.8 | 148.4                           |
| including:                           |       |       |       |       |       |                                 |
| vehicle prod.                        | 106.9 | 109.2 | 107.7 | 115.3 | 110.9 | 160.7                           |
| elec. machines<br>& appliances       | 109.3 | 113.1 | 105.3 | 110.7 | 107.4 | 154.8                           |
| telecommuni-<br>cations<br>equipment | 110.6 | 110.1 | 108.9 | 120.0 | 116.4 | 186.2                           |
| Building mater-<br>ials industry     | 103.0 | 103.2 | 107.0 | 107.2 | 105.0 | 127.9                           |
| Chemical<br>industry                 | 112.6 | 110.9 | 110.6 | 110.1 | 108.4 | 165.0                           |
| <u>Light Industry:</u><br>Total      | 103.0 | 105.7 | 110.8 | 106.5 | 102.7 | 132.9                           |
| of which:                            |       |       |       |       |       |                                 |
| Wood processing                      | 105.1 | 105.1 | 111.4 | 113.7 | 108.7 | 152.1                           |
| Paper                                | 107.3 | 108.0 | 110.8 | 104.9 | 105.5 | 142.1                           |
| Printing                             | 110.7 | 104.7 | 103.2 | 114.5 | 107.8 | 147.6                           |
| Textiles                             | 102.1 | 106.1 | 109.4 | 104.7 | 100.0 | 124.1                           |
| Leather, fur &<br>shoe industry      | 103.4 | 103.9 | 111.9 | 104.5 | 103.4 | 130.0                           |
| Clothing ind.                        | 102.9 | 104.4 | 115.6 | 104.9 | 98.3  | 128.0                           |
| Handicrafts &<br>home-crafts         | 105.9 | 110.9 | 111.9 | 106.1 | 106.6 | 148.6                           |
| Food processing                      | 106.8 | 105.2 | 103.4 | 106.4 | 102.2 | 126.3                           |
| State industry<br>total              | 106.7 | 105.4 | 106.9 | 108.4 | 104.9 | 136.7                           |

Source: Statisztikai Havi Közlemények, 2-3/76