

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

SM/86/176

CONTAINS CONFIDENTIAL
INFORMATION

July 17, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Staff Report for the 1986 Midyear Consultation
Under Enhanced Surveillance

Attached for consideration by the Executive Directors is the staff report for the 1986 midyear consultation under enhanced surveillance with Yugoslavia, which is tentatively scheduled for discussion on Friday, August 2, 1986.

Mr. Szapary (ext. 8866) or Ms. Happe (ext. 8864) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Staff Report for the 1986 Mid-Year Consultation
Under Enhanced Surveillance

Prepared by the Staff Representatives for the
1986 Enhanced Surveillance with Yugoslavia

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

July 16, 1986

I. Introduction

A staff mission visited Belgrade from June 11 to June 20, 1986 to conduct discussions for the first mid-year review under enhanced surveillance. The staff representatives were G. Szapary (head), N. Happe, A. Leipold, P. Fontana (all EUR), E. Zervoudakis (ETR), M. Farsad (IBRD), and V. Harvey (secretary, ETR). Mr. J. J. Polak, Executive Director for Yugoslavia, was in Belgrade during the first days of the mission's stay. The Yugoslav delegation was led by Mr. Stanojevic, Deputy Governor of the National Bank of Yugoslavia (NBY). Members of the mission also met with Mr. Rikanovic, Secretary for Finance, and Mr. Vlatkovic, Governor (NBY).

The Yugoslav authorities requested enhanced surveillance in connection with refinancing agreements with both commercial banks and official creditors. Enhanced surveillance for Yugoslavia, which is to run from May 16, 1986 through 1991, was approved by the Executive Board on March 12, 1986 (EBS/86/38, 2/19/86 and Sup. 1, 3/7/86). The enhanced surveillance procedures which apply to the rescheduling agreement with official creditors were discussed further at the Executive Board Meeting on May 12, 1986 (EBS/86/96 and SUR/86/40, 5/12/86). Enhanced surveillance procedures will include two reports from the Fund per year. Copies of the staff reports, which will discuss developments within the framework of quantified annual economic programs, will be provided by the Yugoslav authorities to creditor banks and to the Chairman of the Paris Club.

The staff discussions for the 1985 Article IV consultations and a review under the stand-by arrangement were held in December 1985 and January 1986 and the staff report (EBS/86/38 and Sup. 1) was considered by the Executive Board on March 12, 1986. On May 15, 1986, Yugoslavia completed its most recent stand-by arrangement with the Fund which was approved by the Executive Board on April 29, 1985 for an amount

equivalent to SDR 300 million, or 49 percent of quota (Annex I). The full amount of the stand-by arrangement was purchased. Developments against the targets under the stand-by arrangement are reviewed in Section III and the 1986 Quantified Program under enhanced monitoring is discussed in Section IV.

World Bank loans disbursed and outstanding to Yugoslavia amounted to US\$2,160 million at end-1985, including a structural adjustment loan (SAL) of \$275 million approved in June 1983 (Annex II). The Bank is in the process of discussing a second SAL with Yugoslavia but the negotiations have been protracted.

II. Background

Faced with the necessity of servicing a large foreign debt, Yugoslavia has, for several years now, pursued adjustment policies aimed at strengthening the country's external position. ^{1/} In many respects, the achievements of the adjustment effort have been impressive: the balance of payments has improved sufficiently to allow Yugoslavia to make some net repayment of external debt in convertible currencies while also allowing a gradual easing of the severe import constraint that had characterized the initial period of adjustment. The authorities have moved in many areas toward strengthening the operations of the market, most notably by relaxing price controls and by following a more realistic exchange rate policy. At the same time, measures have begun to be taken to improve financial discipline in the enterprise sector, to strengthen monetary and credit control, and more generally to enhance the responsiveness of the economy.

The external adjustment achieved has not been without sacrifice in terms of growth. The turnaround in the total external current account from a deficit of 1 percent of GSP in 1982 to a surplus of 2 percent of GSP in 1985 was accompanied by a sharp slowing of economic growth, with real GSP rising by only about 1 percent over the entire period 1983-85 and domestic absorption contracting each year (Table 1). ^{2/} A large

^{1/} For a detailed discussion of the extent and pattern of adjustment in Yugoslavia over the past three years see EBS/86/38 (2/18/86).

^{2/} The coverage of gross social product (GSP) is somewhat narrower than that of GDP since the former excludes certain services. GDP is estimated by the OECD to have been about 8 percent higher than GSP in 1983. There are large discrepancies between GSP data calculated from the production and from the demand side. The authorities have greater confidence in the GSP data from the production side. Most of the discrepancies seem to stem from weaknesses in the data on stockbuilding, but there are doubts also about the evolution of the other components of domestic demand. On balance, it appears fairly certain that final domestic demand declined over the period 1983-85, but probably by a lesser amount than indicated by the available GSP data. Appendix Tables 1 and 2 set out, respectively, the official GSP data and the GSP data based on the staff's revised estimates of stockbuilding.

Table 1. Yugoslavia: Selected Economic and Financial Indicators, 1982-86

	1982	1983	1984	1985		1986
				Original Stand-by Program	Prelim.	Staff fore- cast <u>1/</u>
(Annual percentage changes, unless otherwise specified)						
National income, prices, and costs:						
GSP at constant prices (ave. est. <u>2/</u>)	1/2	-2 1/2	2 1/2	2 1/2	i	2
Final domestic demand	-2	-4 1/2	-3	1 1/2	-2 1/2	3 1/2
GSP deflator	32	40	51 3/4	55	80 3/4	90
Industrial producer prices <u>3/</u>	24 1/2	55	53	50	81 1/2	100
Retail prices <u>3/</u>	31	58 1/2	52 1/2	50	79 1/2	100
External sector (convertible currency area)						
Export volume	-7	12	14	8	4	--
Import volume	-12 1/2	-12	-3	6 1/2	7 1/2	4 1/2
Terms of trade (deterioration -)	6	1	-8 1/2	-2 1/2	-3 1/2	6
Nominal effective exchange rate (depreciation -) <u>4/</u>	-30	-46 1/2	-33 1/2	...	-43 1/2	...
Real effective exchange rate (depreciation -) <u>4/</u>	-15	-25 1/2	1	--	--	...
Federal government						
Total revenue	21	31 1/2	49	56	76	90
Total expenditure	17 1/2	32 1/2	49 1/2	56	79	88
Money and credit						
Net domestic assets <u>3/</u> <u>5/</u>	17	10 3/4	17 1/2	15	15 3/4	23 1/4 <u>6/</u>
Broad money (M2) <u>3/</u> <u>7/</u>	32	37 1/2	48 1/2	44 1/2	60 1/2	63 <u>6/</u>
Velocity (GSP relative to M2) <u>8/</u>	-6	9	5	7	13 1/2	4 1/2 <u>6/</u>
Interest rate (annual rate, one year savings deposit)	13	18	59 <u>9/</u>	<u>10/</u>	64 <u>11/</u>	56 <u>12/</u>
(In percent of GSP)						
Consolidated public sector expenditure	34	33 1/2	32	31 1/2	31	31
Gross fixed investment	29	25 1/2	24 1/2	23 1/2	22	22
Broad money (M2); end of period <u>7/</u>	74 1/4	75	71	60	62 1/2	57 1/2 <u>6/</u>
Convertible current account balance	-3	1/2	2	2	1	2
Global current account balance	-1	1/2	1	...	2	2
External convertible currency debt; end of period	31 1/2	42 3/4	45	46 1/2	46 1/2	39 1/2
(Other ratios and data)						
External debt service ratio, convertible currencies, in percent of exports of goods and services (remittances net) <u>13/</u>	35	40	43	42	44	43
Of which:						
Interest payments, in percent of exports	18	15 1/2	15 1/2	15 1/2	16	13 1/2
Gross external reserves (weeks of convertible merchandise imports)	9 1/2	11	14 1/2	15	15	14 1/2
Overall balance of payments with convertible currency area (in millions of U.S. dollars)	-1,575	-465	524	285	274	463

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Staff forecast except as noted on money and credit.

2/ Weighted average of demand-side (1/4) and production-side (3/4) data on GSP based on staff estimates of stockbuilding.

3/ Twelve-monthly change to end of period.

4/ End of year over end of preceding year; Yugoslav official currency basket.

5/ Stand-by definition excluding valuation changes and public sector deposits.

6/ Official forecast.

7/ Including valuation changes and public sector deposits.

8/ Calculated using end of year level of M2 and industrial producer prices plus real GSP growth.

9/ Raised to 59 percent on January 1, 1985.

10/ Three-month rate to be adjusted at least quarterly to 1 percentage point above inflation rate.

11/ Effective November 20, 1985.

12/ Effective July 1, 1986.

13/ Including amounts refinanced.

part of the reduction in domestic absorption fell on investment, which had risen excessively in earlier years. Real consumption also declined, with the brunt of adjustment being carried by personal incomes in the socialized sector. Since these incomes fell much more than private consumption, however, other household incomes probably rose significantly.

Despite the external adjustment achieved so far, Yugoslavia continues to face a serious adjustment problem. The external debt service ratio in convertible currencies, including amounts refinanced, is currently about 43 percent relative to exports of goods and services plus net workers' remittances. ^{1/} The authorities recognize that such a high debt service ratio is unsustainable over the medium term. Their objective is to reduce it to a level that would allow Yugoslavia to resume normal relations with the international financial community. Staff projections indicate that in order to reduce the debt service ratio to about 25 percent by 1991--which is broadly in line with the target of the Yugoslav authorities--Yugoslavia needs to ensure a satisfactory growth of exports and to maintain a significant external current account surplus in convertible currencies. ^{2/} If achievement of this external target is to be accompanied by a reasonable degree of economic growth, considerable efforts will be required to raise domestic savings and to improve the allocation of resources and increase the efficiency of their use.

Although progress has been made toward increasing the role of market forces, the Yugoslav economy remains characterized by structural rigidities and allocative inefficiencies. The structural rigidities, which appear to be very significant in Yugoslavia, include most notably the inadequate mobility of labor and capital, as well as of goods. For a long time, price controls and an unrealistic exchange rate policy impeded the efficient use of resources. With the moves toward liberalization of prices and the adoption of a more realistic exchange rate in recent years, some major obstacles to a better allocation of resources have been removed. However, the allocative system has remained seriously impaired by an inadequate costing of capital and by a financial system that has accommodated enterprise inefficiency through money creation. Domestic demand has exceeded the available supply of resources and there has been unsatisfied import demand, leading to the rationing of imports on the basis of a complex foreign exchange allocation system, with its associated inefficiencies. One major

^{1/} Excluding amounts refinanced, the current debt service ratio is about 30 percent.

^{2/} Medium-term balance of payments scenarios are discussed in Annex III.

manifestation of these imbalances has been the high and rising rate of inflation which has become a primary source of concern for policy-makers in Yugoslavia.

The discussions with the authorities centered on a review of recent developments and on an assessment of their Quantified Economic Program for 1986 under the procedures for enhanced surveillance.

III. Recent Developments 1/

1985 was characterized by a decline in economic growth, a further acceleration of inflation, and a smaller external current account surplus in convertible currencies. A most significant development since mid-1985 has been a surge in real wages. The consequent increase in domestic demand has elicited some supply response but it has also sparked a quickening of inflation and contributed to strong import demand, prompting the authorities to tighten foreign exchange allocation.

1. Growth and the labor market

Real GSP increased by 1 percent in 1985, compared with 2 1/2 percent in 1984 and an original target of the same magnitude under the 1985/86 stand-by arrangement. In part, the slowdown in output growth was due to a drought which caused a 6 percent fall in value added in agriculture (Appendix Table 3). Although private consumption was stagnant for the year as a whole, there was a substantial pickup during the second half of the year as a result of the increase in real personal incomes. The rapid response of private consumption to the increase in real wages is probably a reflection of the high marginal propensity to consume, given inadequate savings incentives and the fact that a relatively large share of household incomes serves to cover essential needs. 2/ Gross fixed investment continued its downward trend, falling by 8 percent in real terms, despite some revival in the latter part of

1/ This section reviews developments in 1985 and the first quarter of 1986 and compares the outcome to the main targets of the 1985/86 stand-by arrangement (Table 2). Further details on the performance under the stand-by arrangement are available in EBS/86/38, 2/19/86.

2/ According to official data, household real disposable income rose by 9 1/2 percent in 1985, which would imply a sharp increase in the savings ratio. However, these data include interest income as well as the revaluation of deposits in foreign exchange accounts, which have been the fastest growing components of disposable income in recent years. In a high inflation environment, such accounting overestimates the growth of real income since valuation changes and the largest portion of interest earnings are simply used to maintain the value of wealth. Adjusting for these effects, staff calculations show a decline in the savings ratio in 1985.

Table 2. Yugoslavia: Quantitative Performance Criteria,
Under the 1985/86 Stand-by Arrangement

	Credit Ceiling			
	Net domestic assets of the banking system		Net asset position of the public sector with the banking system	
	Limit	Actual	Floor	Actual
		(In billions of dinars)		
1985				
January-June 1/	6,381	6,352	...	...
June 2/	6,464	6,463	113	201
July-September 1/	6,607	6,495	...	...
September 2/	6,648	6,462	113	298
October-December 1/	6,917	6,728	...	...
December 2/3/	7,130	7,128	113	265
1986				
January-March 1/ 3/	9,975	9,970	...	...
March 2/	10,050	10,047	260	408
	External reserves of the banking system			
	Floor		Actual	
	(In millions of U.S. dollars)			
1985				
June		2,000		2,057
September		2,300		2,311
December		2,350		2,365
1986				
March		1,850		1,896
	Disbursements on external loans			
	Limit			Actual
	(In millions of U.S. dollars)			
With original maturity of more than one year (gross inflow)				
January-December 1985		3,200		3,171
January 1-May 15, 1986		1,600		1,020 4/
With original maturity of up to and including one year (net inflow)				
January-December 1985		100		-36
January 1-May 15		10		-54 4/
	Public sector expenditure			
	Limit 5/			Actual
	(Percentage change from year earlier)			
1985				
January-June		62.2		58.9
January-September		68.6		65.3
January-December		70.4		75.7 6/
January 1985-March 1986		72.5		83.6 6/
	Real effective exchange rate			
	Limit 7/			Actual
	(December 1984 = 100)			
1985				
June		100		100.0
September		100		100.6
December		100		100.4
1986				
March		100		100.0
	Interest rates on three-month deposits			
	Minimum 8/			Actual
	(Percent per annum)			
1985				
May 20		67		67
July 1		70		70
October		61		61
1986				
January 1		6/ 9/		61
February 1		68		68
April 1		73		73

Sources: EBS/85/243, 10/31/85; and data provided by the Yugoslav authorities.

1/ Average of end-month data.

2/ End-month data.

3/ The actual December 1985 NDA level, unadjusted for valuation changes in 1985, for purposes of comparison with the 1986 NDA projections was Din 9,940 billion.

4/ Data show actual disbursements through May 31 rather than May 15.

5/ For each period, the maximum percentage growth of public sector expenditure is set equal to the year-on-year increase in the retail price index over the same length of time but with three months' lag.

6/ A waiver was granted subsequently.

7/ With margin of error of 1.0 percentage point.

8/ One percentage point above the annualized inflation rate, measured on the basis of three months' actual, and two months' projected, price changes.

9/ Price projections were not formally agreed.

the year. Preliminary data suggest that most of the decline occurred in housing, although investment in other sectors was also weak. To some extent, this may be related to the adoption in 1984 of the law imposing stricter working capital requirements on enterprises undertaking new investment projects. The constraint on the availability of imported equipment also appears to have played a role. The net foreign balance made a positive contribution to growth for the fifth consecutive year, but this contribution declined substantially from 3.2 percentage points in 1984 to 1.8 percentage points in 1985 as the growth of exports slowed while that of imports accelerated (Chart 1).

During the first quarter of 1986, the rate of growth in real GSP increased to 4 percent (over the first quarter of 1985, Table 3). The main impetus to growth came from private consumption which rose by 5.5 percent in the wake of the surge in real wages. The strong domestic demand was partly satisfied by an acceleration of imports. As a result, the contribution to growth of the net foreign balance turned negative, as the volume of imports grew almost twice as fast as the volume of exports. In response to the growth of demand, industrial production increased by 5 1/2 percent during the first five months of 1986 and there are indications that stocks were drawn down significantly.

Employment grew by about 2 1/2 percent in 1985, accelerating toward the end of the year as production strengthened (Appendix Tables 4 and 5). Nevertheless, the number of registered unemployed rose by almost 7 percent as the labor force expanded under the influence of demographic factors, further migration from rural to urban areas, and continued net immigration. Unemployment reached over a million (10 percent of the labor force), with a growing proportion comprising first time job-seekers with a higher education. During the first quarter of 1986, the growth of employment accelerated somewhat but the number of unemployed continued to edge upward.

2. Incomes and prices

Real wages, as measured by real incomes per employee in the socialized sector, marked a reversal in 1985 of the continuous fall observed over the preceding five years (Chart 2 and Appendix Table 6). Although real wages continued to decline in the first half of the year, they rebounded strongly in the second half and were, by the first quarter of 1986, almost 13 percent above their level of the first quarter of 1985. These wage increases far exceeded the increase in labor productivity, thereby running counter to the federal guideline of linking real wage growth to productivity gains.

To a degree, this wage push was the result of social and political pressures following several years of consecutive declines in real wages in the socialized sector. In this regard, the authorities pointed out that even after the recent increase, real wages remained well below their level of 1979. The rise in wages was also motivated in part by

Table 3. Yugoslavia: Quantitative Targets of the 1986 Economic Program 1/

	1986									
	1st quarter		2nd quarter		3rd quarter		4th quarter		year	
	Orig.	Actual	Orig.	Rev.	Orig.	Rev.	Orig.	Rev.	Orig.	Rev.
National accounts										
Real gross social product (GSP)	2.6	4.0	2.9	3.3	2.9	2.0	3.3	3.2	3.0	3.0
Of which:										
Private consumption	3.2	5.5	2.4	2.5	1.1	--	1.8	1.2	2.0	2.0
Public consumption	1.9	1.9	2.2	1.9	1.5	1.9	1.7	1.8	1.8	1.9
Gross fixed investment	3.3	3.8	3.2	2.9	3.0	2.9	3.3	2.7	3.2	3.0
Output, employment and productivity										
Socialized productive sector <u>2/</u>										
Output	2.3	4.3	2.4	3.3	2.4	1.0	2.6	2.3	2.5	2.5
Employment	1.9	3.0	2.1	3.0	2.1	1.8	2.0	1.8	2.0	2.5
Labor productivity	0.4	1.3	0.3	0.3	0.3	-0.8	0.6	0.5	0.5	--
Industry										
Output	2.5	6.9	3.0	3.0	3.1	2.0	3.4	1.6	3.0	3.0
Employment	2.2	3.5	2.5	3.5	2.3	2.7	1.9	2.2	2.2	3.0
Labor productivity	0.3	3.4	0.5	-0.5	0.8	-0.7	1.5	-0.6	0.8	--
Agriculture output	3.8	1.0	5.0	2.0	10.2	10.0	8.0	9.6	8.0	8.0
Prices and incomes										
Cost of living index	70.2	79.4	62.7	87.3	...	87.1	...	67.3	...	80.3
Nominal personal income per employee	72.6	102.1	62.9	99.0	...	87.2	...	58.7	...	82.4
Real personal income per employee	1.4	12.6	0.1	6.4	0.7	0.1	1.7	-5.0	0.5	1.9

Source: Data provided by the Yugoslav authorities.

1/ Official projections.2/ Output is equal to GSP excluding that part produced by the private sector.

Table 3. (concluded). Yugoslavia: Quantitative Targets of the 1986 Economic Program 1/

	1986									
	1st quarter		2nd quarter		3rd quarter		4th quarter		Year	
	Orig.	Actual	Orig.	Rev.	Orig.	Rev.	Orig.	Rev.	Orig.	Rev.
Federal budget expenditure	199	190	243	...	298	...	364	...	1,103	...
Money and credit 3/										
Including valuation changes										
Net foreign liabilities	3,806	3,766	4,305	5,024	4,464	4,924	4,725	5,294	4/	4/
M2	7,315	7,605	7,864	8,942	8,617	9,566	9,903	11,289	4/	4/
NDA	11,121	11,371	12,169	13,966	13,081	14,490	14,628	16,583	4/	4/
Domestic credit	7,584	7,474	8,239	8,661	8,893	9,315	9,881	10,624	4/	4/
Dinar credit	(4,533)	(4,636)	(4,898)	(5,093)	(5,248)	(5,747)	(5,905)	(6,622)	4/	4/
Foreign currency credits	(3,051)	(2,838)	(3,341)	(3,568)	(3,645)	(3,568)	(3,976)	(4,002)	4/	4/
Other items, net	3,537	3,897	3,930	5,305	4,188	5,175	4,747	5,959	4/	4/
Excluding valuation changes										
Net foreign liabilities	3,479	3,420	3,570	3,506	3,405	3,406	3,316	3,301	4/	4/
M2	7,016	7,193	7,273	7,596	7,728	8,220	8,664	9,450	4/	4/
NDA	10,495	10,613	10,843	11,102	11,133	11,626	11,980	12,751	4/	4/
Domestic credit	7,295	7,184	7,668	7,692	8,028	8,346	8,695	9,241	4/	4/
Dinar credit	(4,533)	(4,636)	(4,898)	(5,093)	(5,248)	(5,747)	(5,905)	(6,622)	4/	4/
Foreign currency credits	(2,762)	(2,548)	(2,770)	(2,599)	(2,780)	(2,599)	(2,790)	(2,619)	4/	4/
Other items, net	3,200	3,429	3,175	3,410	3,105	3,280	3,785	3,510	4/	4/
Balance of payments										
(convertible currencies)										
Merchandise exports, f.o.b.	1,435	1,515	1,930	1,740	1,750	1,865	2,015	2,380	7,130	7,500
Merchandise imports, c.i.f.	1,800	2,065	2,200	2,050	2,050	2,235	2,700	2,900	8,750	9,250
Trade balance (deficit -)	-365	-550	-270	-310	-300	-370	-685	-520	-1,620	-1,750
Workers' remittances, net	370	382	400	530	600	480	350	343	1,720	1,735
Tourism earnings, net	75	75	170	195	547	620	268	263	1,060	1,270
Interest payments, net (-)	-420	-540	-415	-355	-410	-275	-335	-315	-1,580	-1,485
Other services, net	255	226	273	300	295	265	397	486	1,220	1,277
Current account (deficit -)	-85	-407	158	360	732	720	-5	257	800	930
Change in international reserves, net	-515	-469	138	110	530	600	-103	-31	50	200

(In millions of U.S. dollars)

Source: Data provided by the Yugoslav authorities.

1/ Official projections.

3/ Monetary data shown here differ from those in the stand-by program, in that they include public sector deposits.

4/ Same as end of fourth quarter.

anticipation of a tightening of incomes policy. This anticipation seems to have been due, inter alia, to progress toward the final translation into law of the federation-wide social compact, signed in December 1984, on the distribution of income in the enterprise sector. 1/ The social compact aims at putting on a sounder basis the criteria for determining the distribution of net income between investment, reserves, and payments to employees; it is also intended to strengthen the link between labor productivity and income per worker. The authorities expect the lengthy procedure for the implementation of the social compact to be completed in 1986. 2/

Inflation accelerated from slightly over 52 percent in 1984 (December-to-December) to about 80 percent in 1985 as measured by either the industrial producer price index (IPPI) or the retail price index (RPI). This compares with an original target of 50 percent and a revised target of about 75 percent under the stand-by arrangement. During the 12 months ended in May 1986, the increase in the RPI accelerated to 84 percent; the increase in the IPPI slowed to 73 percent, although on a month-to-month basis the IPPI continued to rise at an annual rate of slightly over 80 percent (Chart 3 and Appendix Table 7). In early 1985, a substantial price increase occurred following the major liberalization of prices in January. After a tapering off during the summer months, the pace of inflation quickened again in the fall with the sharp rise in wages. The relatively more rapid increase in the RPI than in the IPPI during the first five months of 1986 was due in part to a decision to allow an increase in trade margins. In addition, the prices of some industrial oil products were reduced following the decline in oil import prices, while the prices of petroleum products used mainly by consumers were not lowered. The authorities said that the funds made available by the incomplete pass-through of the fall in world oil prices would be mainly used to finance customs duty drawbacks for exports, and oil and gas exploration.

3. Finances of the enterprise sector and fiscal developments

After improving in 1984, the financial position of the enterprise sector deteriorated in 1985 (Chart 4 and Appendix Table 9). Losses rose by about 2 percentage points of after-tax income and the number of loss-making enterprises increased by about 8 percent. The authorities estimate that approximately one third of the losses in 1985 reflected the introduction of more realistic accounting rules which had the effect of reducing recorded net income. A fairly limited number of

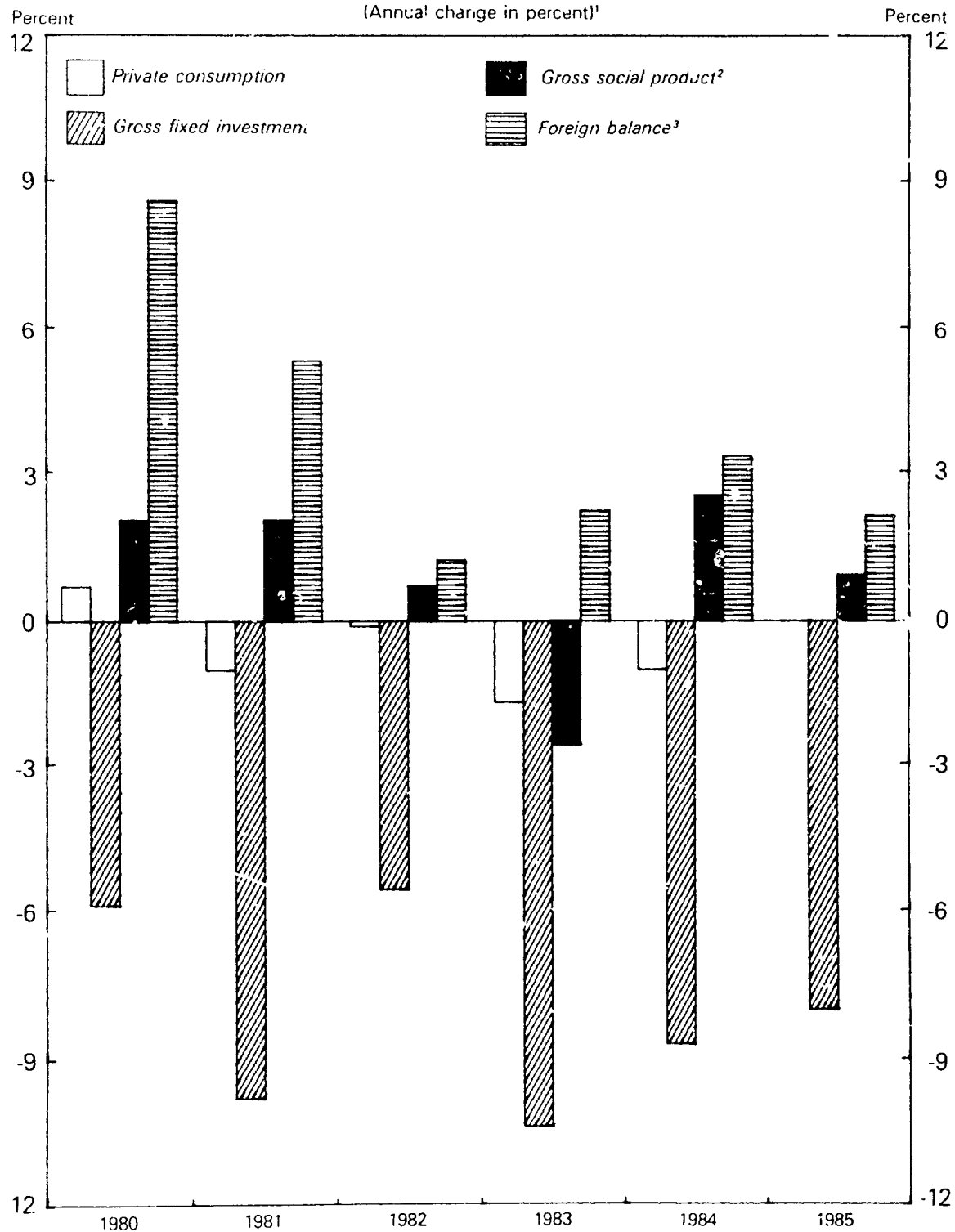
1/ A social compact, which does not have the full force of law until translated into specific by-laws and regulations, is an accord signed by government authorities (sociopolitical communities) as well as by representatives of organizations of associated labor (enterprises) and/or other organizations.

2/ For further details see SM/85/108, 4/15/85, pp. 22-23; and SM/86/39, 2/27/86, pp. 25-26.

CHART 1

YUGOSLAVIA

GROSS SOCIAL PRODUCT



Sources: Data provided by the Yugoslav authorities, and staff estimates

¹ In constant prices.

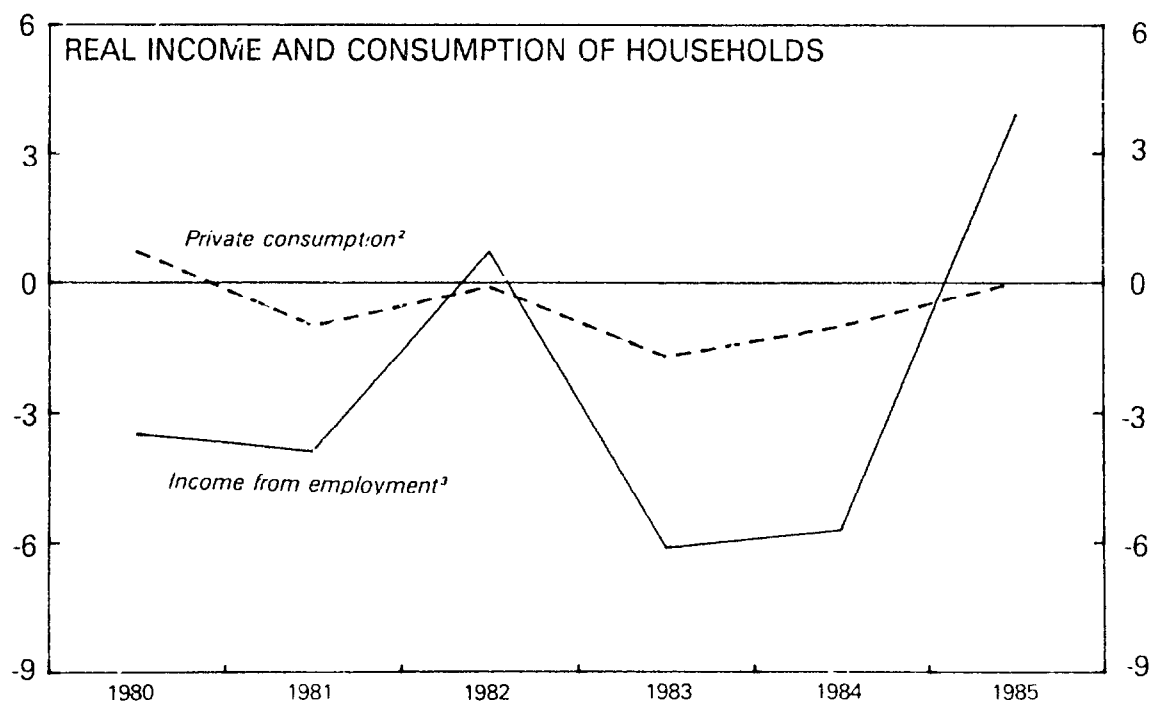
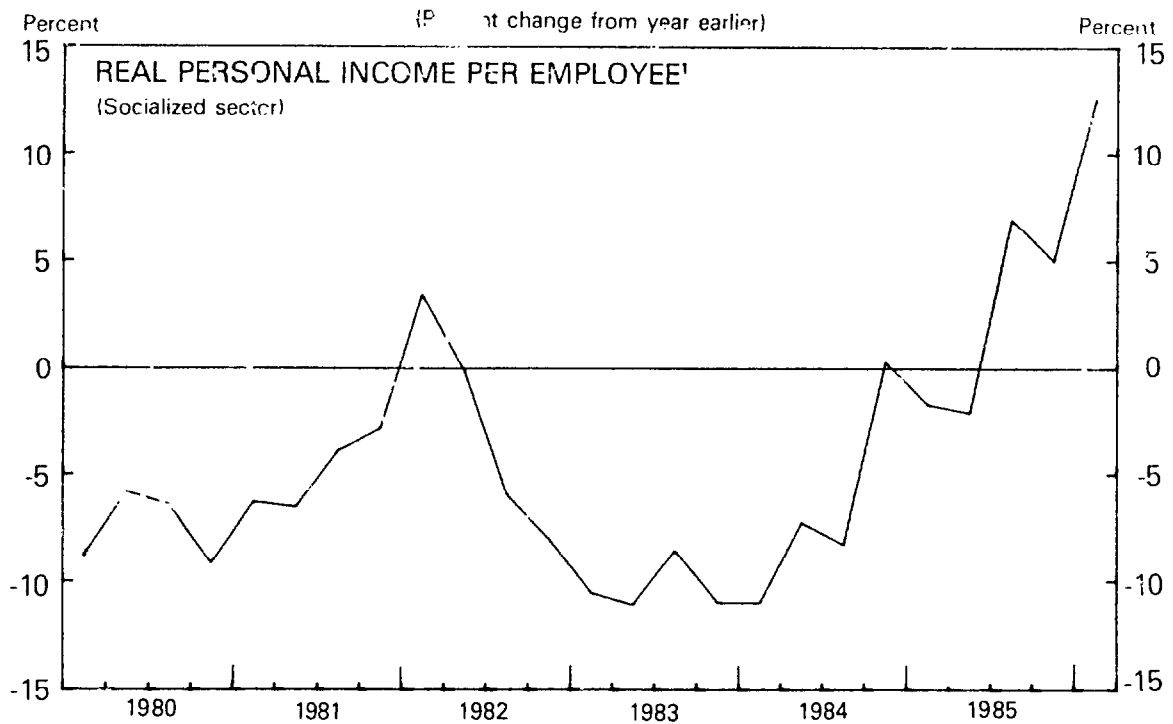
² Weighted average of demand and production estimates of GSP in constant prices.

³ Change in percent of preceding year's GSP

CHAPTER 2

YUGOSLAVIA

REAL PERSONAL INCOME AND CONSUMPTION



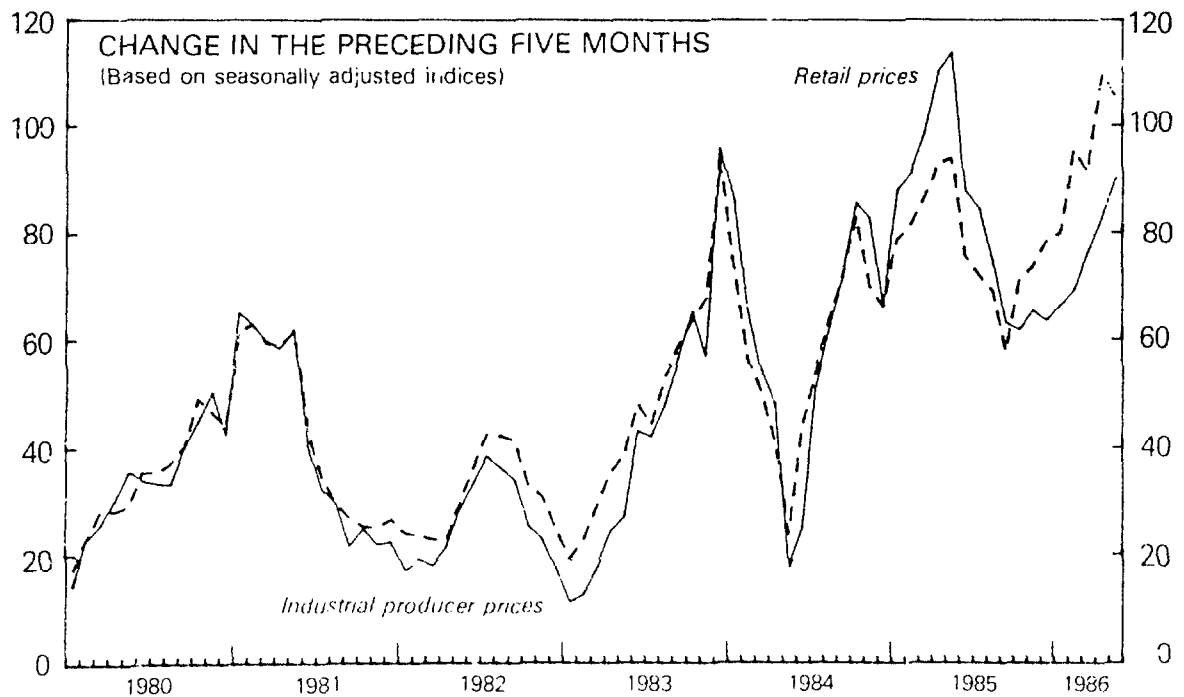
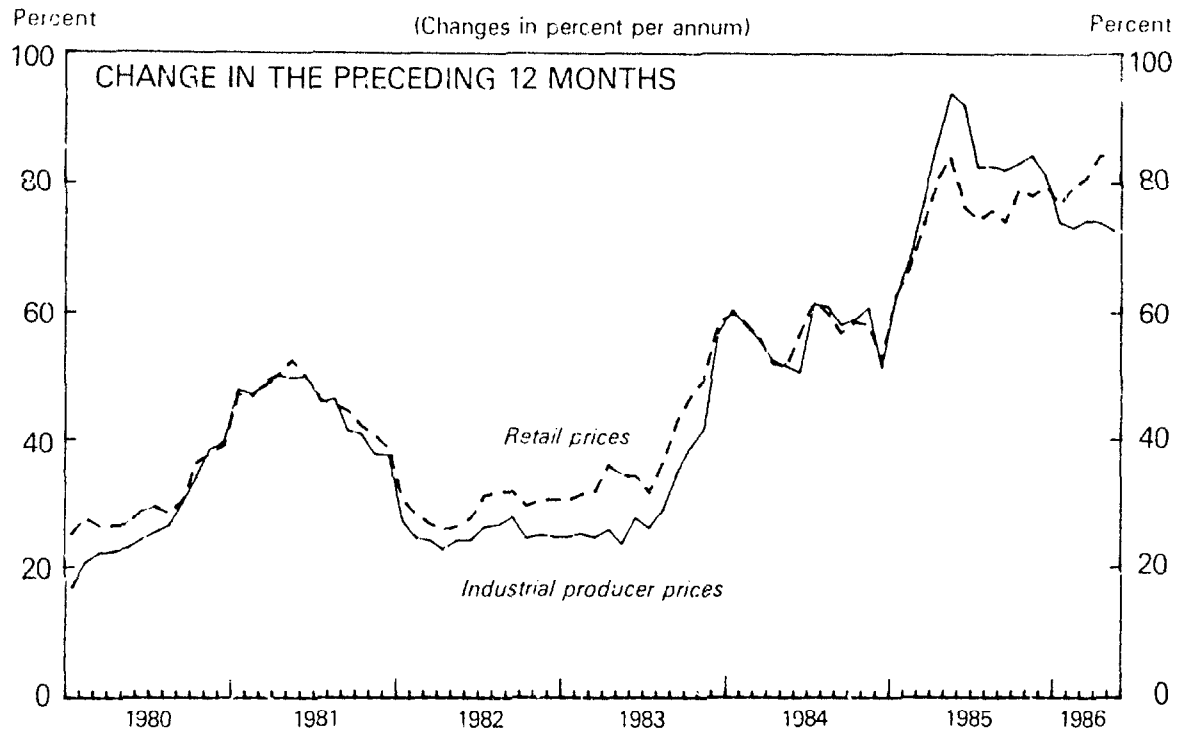
Source: Federal Statistical Office, *Indeksi*; and data provided by the Yugoslav authorities

¹ Net personal income per employee deflated by cost of living index

² On gross social product basis.

³ Gross payment of income from employment in the socialized sector deflated by the cost of living index

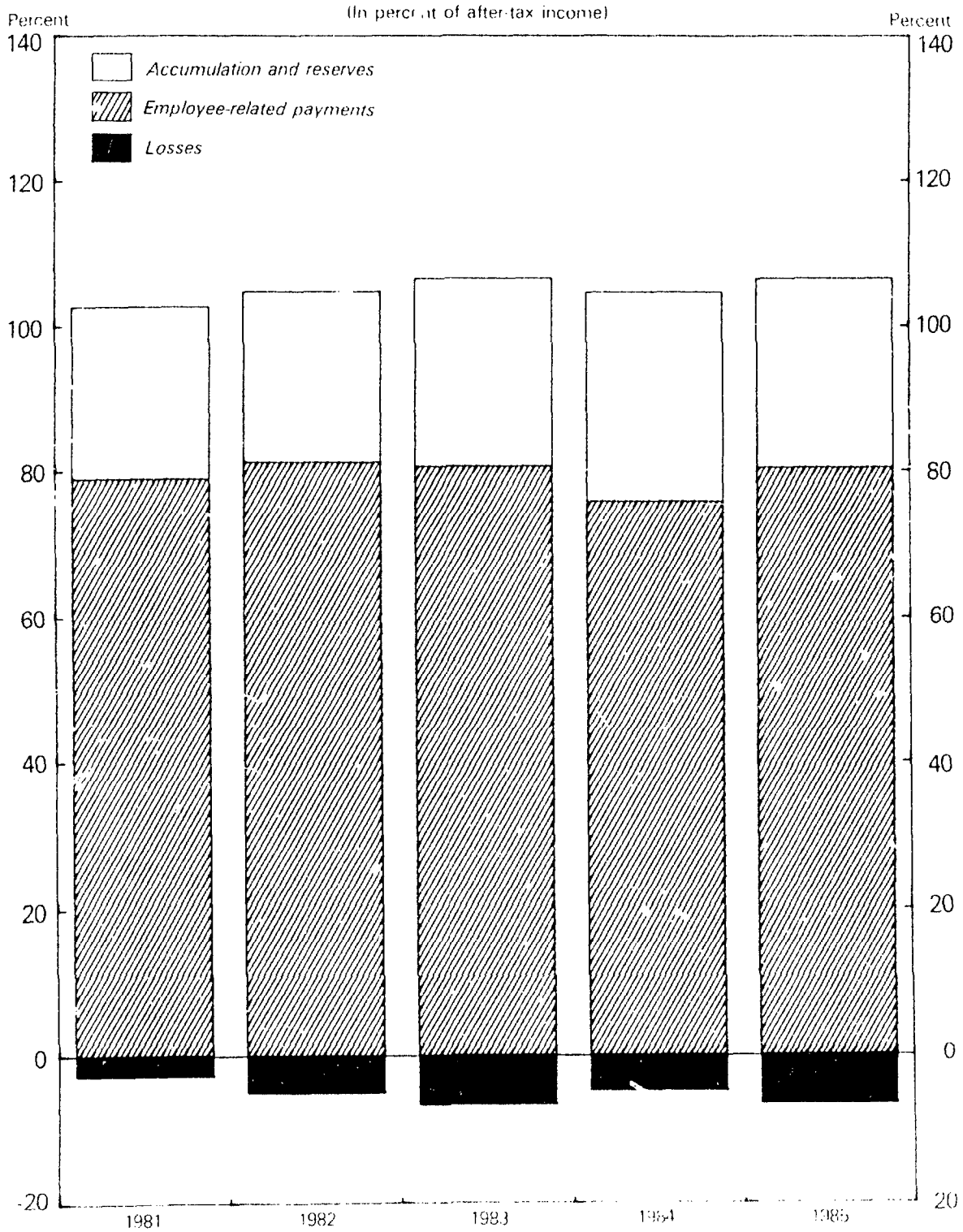
CHART 3
YUGOSLAVIA
PRICE DEVELOPMENTS



Source: IMF *International Financial Statistics* and data provided by the Yugoslav authorities

CHART 4

YUGOSLAVIA DISTRIBUTION OF AFTER-TAX ENTERPRISE INCOME



enterprises--mostly subject to price controls--account for about 80 percent of total losses. These enterprises are mainly in the field of electricity generation, railway transportation, fertilizer production, food processing (particularly sugar refining), and construction.

Fiscal policy in recent years has aimed at releasing resources from the government to the rest of the economy and this trend continued in 1985. The ratio of consolidated public expenditure to GSP was reduced to 31 percent (compared to 32 percent in 1984 and 43 percent in 1978, Chart 5 and Appendix Table 10). This was achieved despite a faster rise in revenues and consequently expenditures in the second half of 1985 than indicated in the Annual Resolution (yearly plan). ^{1/} To remain within the target of the Resolution, a so-called intervention law was passed in October 1985. This law stipulated that excess revenues of public sector entities ("narrow definition", Appendix Table 11) should be placed in blocked accounts until the beginning of 1986, when they would be released to create room for a reduction in tax and contribution rates. In the event, the authorities of the republics and provinces were reluctant to reduce taxes and the funds released from blocked accounts, together with an increase in revenue, led to a 17 percent growth in real expenditures in the first quarter of 1986 by comparison with a year earlier. The higher expenditure took mainly the form of increased personal incomes and a catch-up of expenditures on education, cultural, and health services from previously depressed levels.

4. Monetary developments and policies

Continuing the accelerating trend over the past five years, broad money (M2) expanded by 61 percent in 1985 and at a slightly faster rate during the 12 months ended in April 1986 (Appendix Table 12). As in the past few years, a major source of money growth has been the revaluation of foreign currency deposits in line with the continuous depreciation of the dinar. The higher than expected valuation changes of foreign currency deposits were also the main reasons for the more rapid growth of M2 than both the initial (45 percent) and revised (54 percent) targets under the stand-by arrangement. ^{2/}

Efforts to strengthen financial discipline have been frustrated by the fact that most real interest rates have remained at sharply negative levels. On the deposit side, even though the stated policy aim was to have positive real interest rates and the authorities set interest rates on deposits at 1 percentage point and 3 percentage points above the inflation rate for three-month and 12-month deposits, respectively, real

^{1/} Public sector revenues are earmarked and public sector entities are in essence assumed to spend what they take in as revenues. The control of expenditures thus passes through the control of revenues.

^{2/} The NDA ceilings under the stand-by arrangement were observed, however, as these ceilings were defined as excluding valuation changes.

interest rates on these deposits were positive only for very short periods of time as they were quickly eroded by accelerating inflation until the time came for the next adjustment in nominal rates (Chart 6 and Appendix Table 13). 1/ In addition, due to the lack of an adequate range of short-term deposits earning inflation-related interest rates, enterprises have been unable to get a remunerative return on their temporarily idle funds. 2/ The low deposit rates have discouraged savings in bank financial assets which has led to a continuous increase in the velocity of M2. However, while dinar-denominated broad money has steadily declined in real terms, foreign currency deposits, which are the only financial assets in Yugoslavia that have secured a positive real return, have tended to rise or at least remain stable in real terms (Chart 7). 3/ As a result, there was a continuous shift from dinar to foreign currency-denominated deposits, and the share of the latter rose from 32 percent of M2 at end-1982 to 44 percent at end-1985.

On the lending side, real interest rates have been vastly negative in recent years and the margin has widened. During the first quarter of 1986, for instance, less than 3 percent of new credits carried a positive real rate of interest. The weighted average of lending rates on new credit was 59 percent for short-term and 53 percent for long-term credit, as compared to an inflation rate ranging between 74 and 85 percent, depending on which price index is used. 4/ Negative real rates of such magnitude have created a strong incentive to borrow, keeping the demand for bank credit excessively high and encouraging a misallocation of resources. Furthermore, a considerable and growing portion of credit in the economy has been channeled outside the banking system, largely in the form of interenterprise credit. The use of interenterprise credit has been encouraged in Yugoslavia both by the low level of interest rates on enterprise deposits and by an accommodating financial policy which has not provided adequate penalties for making bad loans. With sharply negative real lending rates and increasing financial disintermediation, the task of imposing financial restraint has fallen on a rationing of the quantity of credit by the National Bank of Yugoslavia which has come under intense pressure to satisfy a growing demand for credit. As a result, total credit in the economy, both inside and outside the banking system, has been ample enough to allow

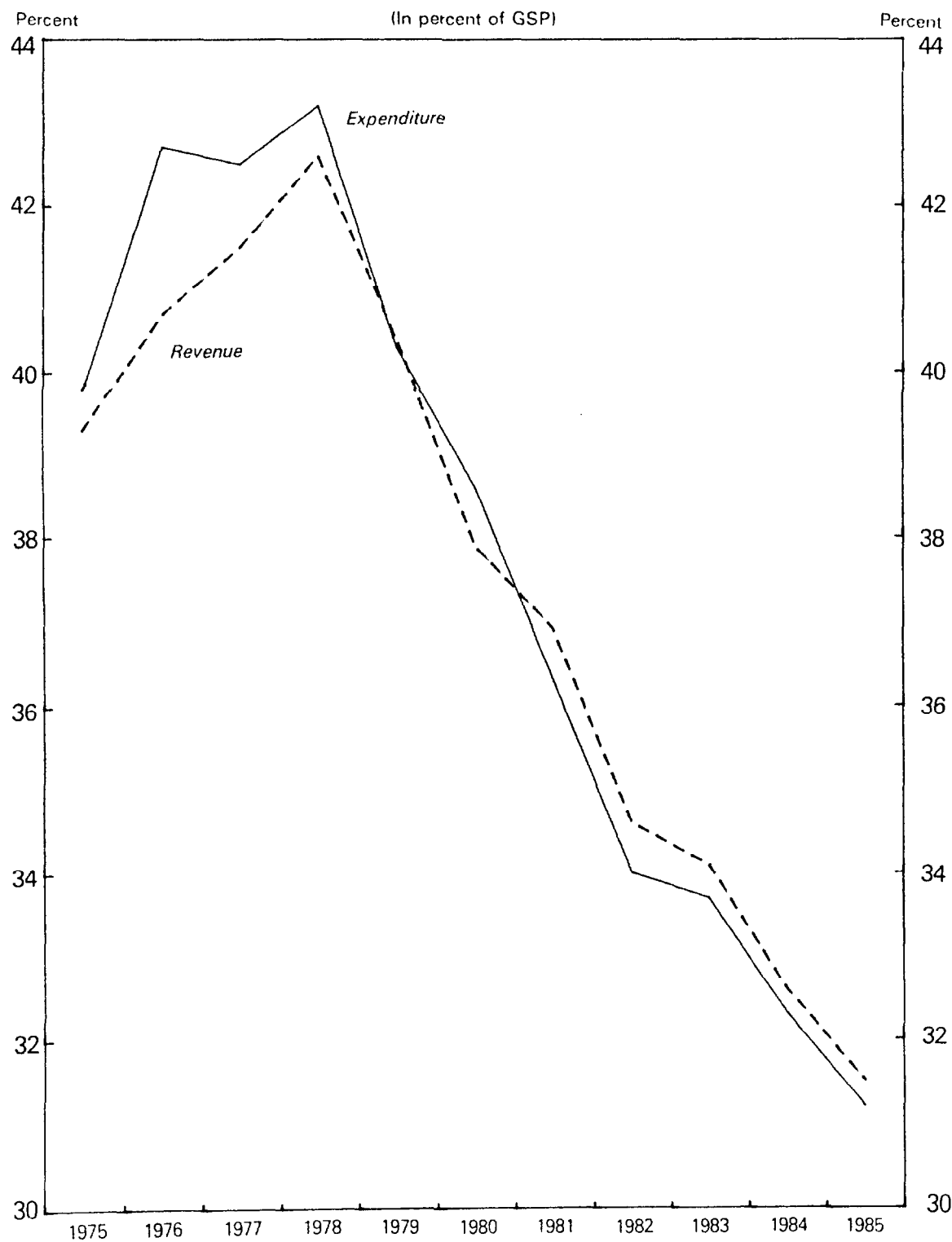
1/ Interest rates for these deposits were adjusted quarterly on the basis of a formula incorporating the latest three months' actual and two months' prospective price increases.

2/ Enterprise deposits of less than three-month maturity earn only 4 percent annual interest.

3/ The decline since the end of 1985 reflects the restrictions imposed on foreign currency holdings under the new foreign exchange law.

4/ On April 1, 1986, the selective lending rates of the NBY were increased from a range of 53-55 percent to 71 percent. The authorities said that the impact of this increase on the banks' lending rates was not yet known. In any case, the impact was short-lived since the NBY's lending rates were sharply reduced effective July 1 (see Section IV).

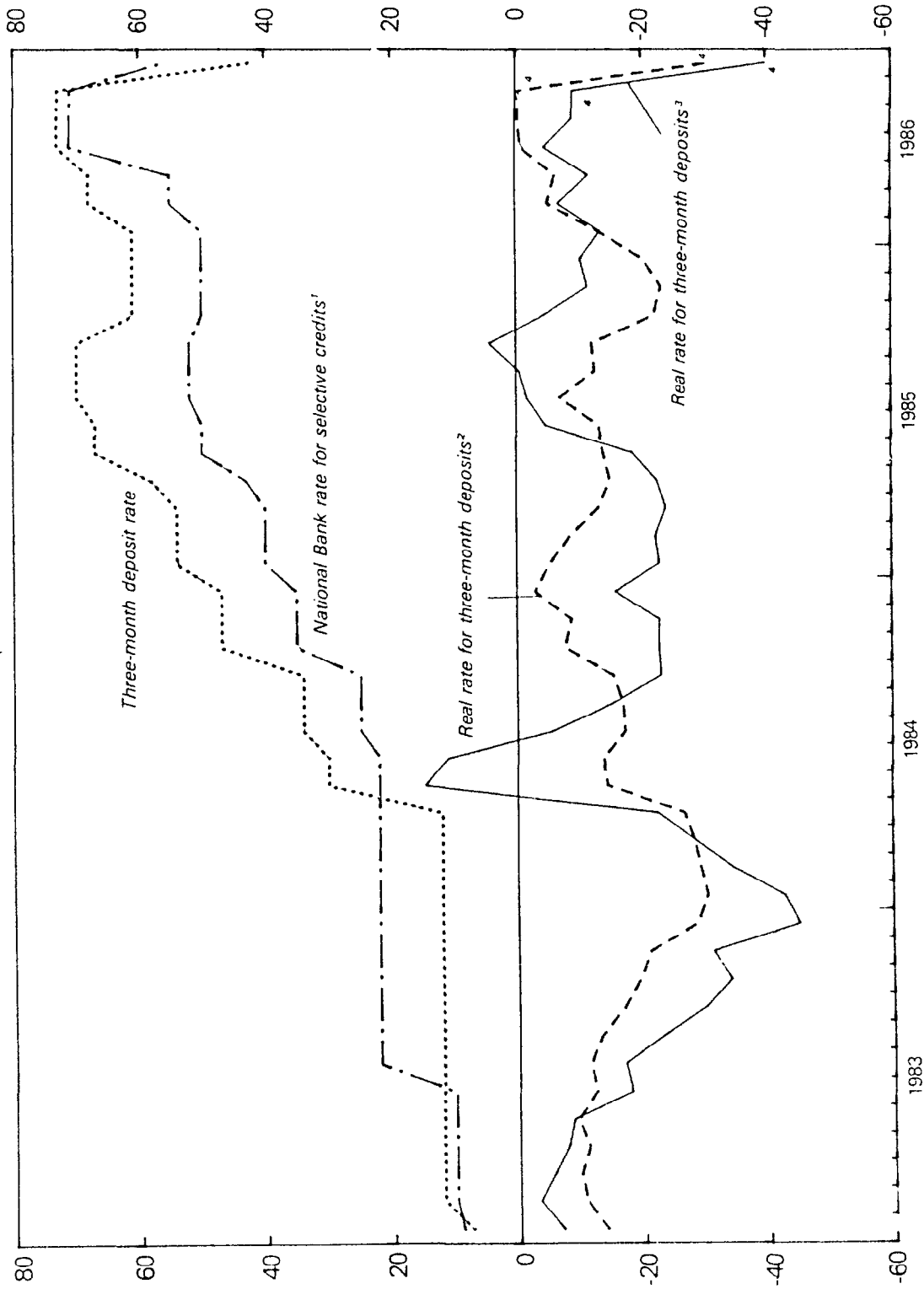
CHART 5
YUGOSLAVIA
CONSOLIDATED PUBLIC SECTOR REVENUE AND EXPENDITURE¹



Source: Data provided by the Yugoslav authorities.

¹ Includes budgets, funds and communities of interest at all levels of government, excludes the Federal Fund for the Development of Underdeveloped Regions, net of transfers among public sector entities.

CHART 6
YUGOSLAVIA
INTEREST RATES
(Percent per annum)



Source: Yugoslav authorities and IMF staff calculations.
 1 Highest rate applicable on NBY selective credits.
 2 Three-month deposit rate deflated by the change in the industrial producer price index over the past twelve months.
 3 Three-month deposit rate deflated by the change in the industrial producer price index over the past five months.
 4 By 1986 only.

CHART 7
YUGOSLAVIA
REAL LEVELS OF MONETARY AGGREGATES¹



Source: Data provided by the Yugoslav authorities.

¹ Nominal levels of monetary aggregates deflated by cost of living index (1984=100).

enterprises to pay out personal incomes that have been excessive in relation to the level of demand compatible with the external and domestic supply constraints.

5. Balance of payments developments 1/

The external current account surplus in convertible currencies amounted to US\$344 million in 1985 (about 1 percent of GSP), compared with US\$779 million in 1984 and a rather ambitious original official target of US\$880 million for 1985. The less favorable external performance in convertible currencies reflected both an export shortfall due in part to harsh weather conditions in early 1985 and a surge in imports in the last quarter of the year in anticipation of the implementation of the new foreign exchange regime. Exports to the convertible area rose in volume terms by 4 percent, only slightly above export market growth, following two years of substantial gains in market shares. The global current account, on the other hand, showed a sharp improvement, with the surplus increasing to US\$833 million (2 percent of GSP) in 1985, due mainly to lower oil imports from the clearing account area following large bulk purchases in the previous year and sharply higher ship deliveries to the Soviet Union.

There was a net repayment of external debt in convertible currencies of about US\$100 million in 1985. Due to the depreciation of the dollar, however, Yugoslavia's external debt in convertible currencies rose by about 6 percent to US\$19.1 billion (46 1/2 percent of GSP). Despite the smaller than expected current account surplus in convertible currencies, external reserves rose by over US\$200 million, owing to the positive valuation impact on reserves of the depreciation of the dollar.

In line with the usual seasonal pattern, the current account in convertible currencies registered a deficit of US\$324 million during the first four months of 1986, somewhat less than in the corresponding period of 1985. Exports in convertible currencies rose by 19 percent in dollar terms over the same period a year earlier, owing to an estimated 12 percent rise in unit values (due largely to the depreciation of the dollar) and a 7 percent growth in volume. However, if account is taken of the abnormally low level of exports in early 1985, there was an underlying stagnation, or possibly a decline, in the volume of exports to the convertible currency area in the first four months of 1986.

The invisibles account was favorably affected by the depreciation of the dollar, since a much higher percentage of service receipts than of payments is denominated in other currencies. 2/ The improvement by

1/ Appendix Tables 14-19.

2/ Remittances and tourism receipts largely originate from Western European countries and are denominated in their currencies; on the other hand, interest payments are largely fixed in terms of U.S. dollars.

about US\$200 million in the first four months of 1986 stemmed mainly from increases in the net inflow of remittances and tourism receipts in dollar terms; in terms of the currencies of denomination, net inflows of remittances are estimated to have declined by about 10 percent and tourism receipts to have shown only a small increase.

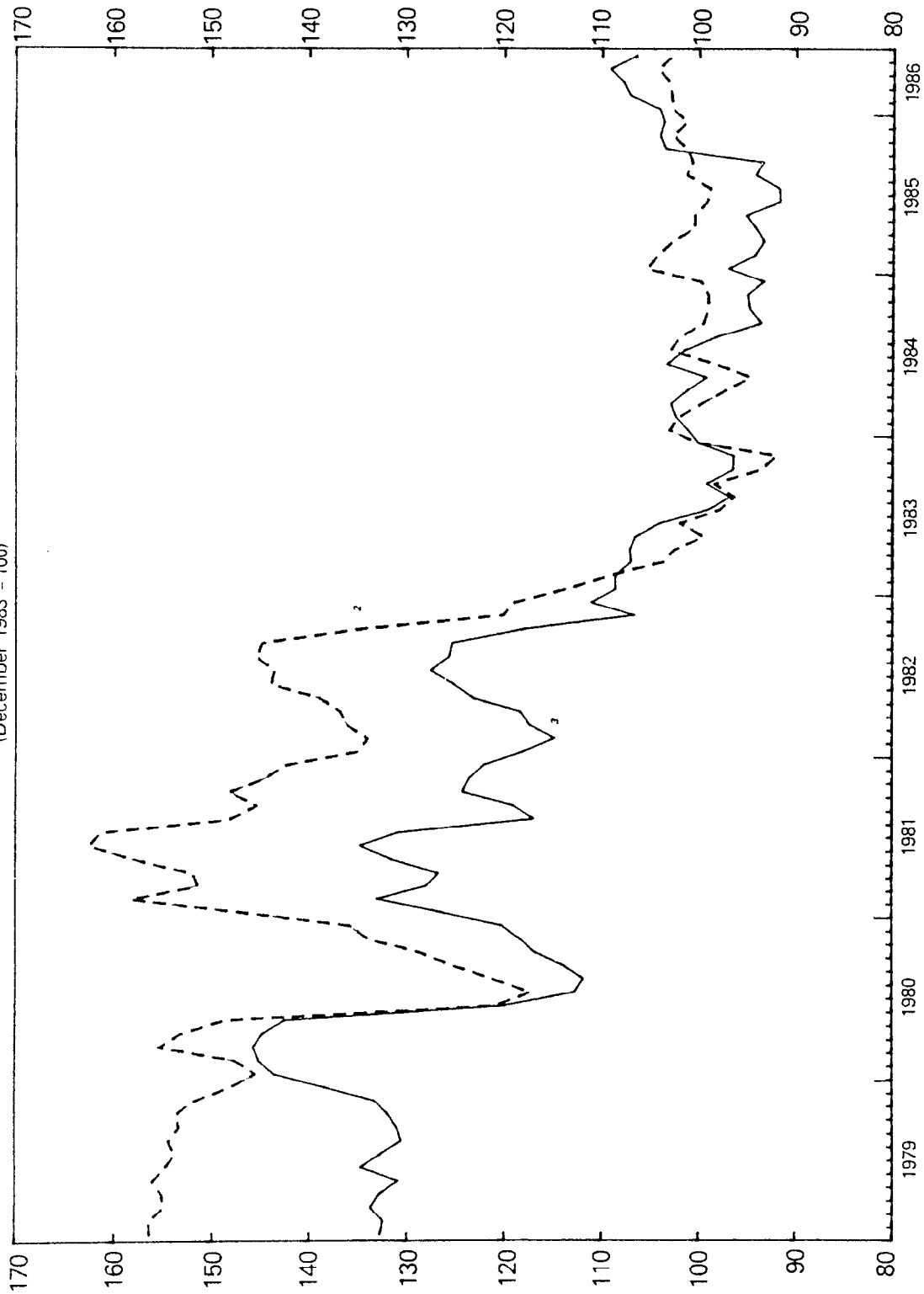
There was a large net repayment of medium- and long-term debt amounting to almost US\$500 million in convertible currencies during the first four months of 1986. This resulted from advance repayments under the refinancing agreement with commercial banks, and a relatively low rate of utilization of foreign credits due mainly to the introduction of new exchange and trade regulations. There was also a very large positive errors and omissions item of almost US\$900 million, whose origin is not entirely clear. A certain portion of it (about US\$120 million) can be explained as the counterpart of the valuation effect on reserves of the dollar depreciation. The remainder was attributed by the authorities to a change in accounting procedures, which induced exporting enterprises to accelerate the surrender of foreign exchange to the banking system by reducing the level of their outstanding export bills. 1/

6. Exchange and trade policies

Since late 1982, the authorities have pursued a flexible exchange rate policy which was instrumental in improving the country's external position. Following a real effective depreciation by 26 percent during 1983, the real value of the dinar against the currencies of its major trading partners has been maintained (with some minor temporary deviations) at its December 1983 level through a continuous slide of the nominal rate (Chart 8). However, the dinar has recently appreciated substantially in real terms against the currencies of countries at a comparable state of development that compete with Yugoslavia in major markets, as these currencies have tended to follow the U.S. dollar in its downward trend since March 1985.

1/ In particular, a change in accounting rules that became effective at the beginning of 1986 provided that enterprises could count receipts from exports as income (and hence available for distribution as wages) only after the foreign exchange receipts have been surrendered to the banking system and not upon the shipment of exports as allowed previously. This reportedly induced enterprises to accelerate the surrender of foreign exchange to the banks. As a result, outstanding export bills, which were estimated at US\$1.5 billion at end-1985, were sharply reduced in early 1986. The Yugoslav representatives said that, due to a change in accounting practices after the implementation of the new foreign exchange system, they could not provide data on the amount of export bills outstanding and cash export receipts in 1986.

CHART 8
YUGOSLAVIA
REAL EFFECTIVE EXCHANGE RATE INDICES¹
(December 1983 = 100)



Source: IMF, *International Financial Statistics* and data provided by the National Bank of Yugoslavia.

¹ Increase means appreciation.

² Nominal effective exchange rate based on a currency basket of Yugoslavia's main trading partners adjusted for relative producer prices.

³ Export competitor weighted nominal effective exchange rate index adjusted for relative consumer prices based on a currency basket of 10 non-OEC countries competing with Yugoslavia in major markets.

A policy change which also had an effect analogous to an appreciation of the exchange rate was the introduction on January 1, 1986, of a new exchange and trade system. ^{1/} The new system provides that all foreign exchange be surrendered to the banking system at the official exchange rate. Access to foreign exchange for the payment of foreign debt obligations is not subject to any restrictions, while access to foreign exchange to pay for imports is restricted according to various categories. Exporters continue to benefit from preferential treatment over other enterprises in the determination of import rights, but net exporters no longer enjoy the foreign exchange premia from the sale to other enterprises of foreign exchange not used for their own account, as was possible under the previous system. The new system also adversely affects net importing enterprises that previously could buy foreign exchange from other enterprises. To alleviate this latter difficulty, the authorities plan to allocate foreign exchange made available through official foreign borrowing (e.g., from multilateral development institutions) to enterprises that would not otherwise qualify for import rights under the new system.

Owing to a shortage of foreign exchange, the authorities had to invoke Article 110 of the new foreign exchange law as of January 1, 1986. This Article, which had been intended as a transitory emergency measure, has remained in effect since that time; consequently, authorized banks have been required to submit daily to the NBY their intended payments in foreign exchange according to eight categories of priority, e.g., external debt service, imports of inputs by net exporters, priority federal needs, energy imports, etc. Based on information on the total availability of foreign reserves, the Federal Executive Council then decides on the categories of payments that can be made on a country-wide basis. One of the main objectives of the new foreign exchange allocation system is to ensure a more efficient transfer of reserves from surplus to deficit banks and regions. So far, interbank foreign exchange transactions have been quite limited, implying a failure of the system to generate an adequate transfer of reserves.

The continuous resort to Article 110 was attributed by the authorities to the strong import demand and three exceptional factors. First, because of seasonal factors, foreign exchange receipts were significantly lower than payments in the early part of the year. Second, commercial banks have been reluctant to utilize short-term foreign credits because in accordance with new regulations, they cannot pass on to borrowing enterprises the costs resulting from exchange and interest rate changes. A change in the relevant by-laws is being considered to deal with this latter difficulty. Third, there has been low utilization of available medium- and long-term foreign credits by

^{1/} For a detailed description of the new exchange and trade system, see Appendix II of SM/86/39 (2/27/86).

enterprises because of new strict conditions applying to such borrowing. A rationalization of borrowing regulations is planned to alleviate this problem.

7. External debt management

Yugoslavia recently concluded debt refinancing arrangements with commercial and official creditors. On December 18, 1985 an agreement was signed with Yugoslavia's major commercial bank creditors on the refinancing of 100 percent of the principal falling due during 1985-88 ^{1/} in respect of medium- and long-term debt contracted before January 17, 1983. The agreement went into effect on March 25, 1986. On April 17, 1986 an agreement was reached with official creditors within the framework of the Paris Club concerning medium- and long-term debt contracted before December 2, 1982 and falling due during May 16, 1986-December 31, 1988. ^{2/} In particular, it was agreed (i) to refinance 85 percent of the principal falling due between May 16, 1986 and May 15, 1987 with a grace period of four years and a maturity period of eight and one-half years; (ii) to refinance with similar repayment terms a smaller percentage of principal falling due between May 16, 1987 and March 31, 1988, the precise percentage to be decided at a subsequent meeting; and (iii) concerning amounts falling due in the last three quarters of 1988, participating official creditors expressed their willingness to remain involved in the process of medium-term adjustment provided that various conditions are met, including continuation of an appropriate relationship of Yugoslavia with the Fund (EBS/86/96, 4/25/86). The bilateral agreements for the first stage are to be concluded by end-February 1987.

IV. Stance of Policies and the 1986 Quantified Economic Program

The main objectives of the Government which took office in mid-May 1986 are to revive economic growth, to bring inflation under control, and to continue the process of external adjustment in order to reduce the external debt service burden. The Government recently announced a series of measures and other measures are still under preparation and will be announced later. The main macroeconomic targets of the authorities for 1986 are to increase the rate of economic growth to 3 percent, to reduce the rate of inflation to 65 percent by the end of the year, and to realize a current account surplus in convertible currencies of about US\$900 million. The staff supports these objectives but its view is that while some of the measures announced go in the right direction, others are likely to exacerbate the country's economic difficulties, casting most serious doubts on the achievability of the authorities' targets.

^{1/} Estimated at US\$1.8 billion.

^{2/} Principal falling due during this period is estimated at US\$1.1 billion.

The main quantitative quarterly projections of the authorities are presented in Table 3 and the policies underlying these projections are discussed in the following sections.

1. External policies

Developments during the first four months of 1986 diverged from the quarterly path under the Quantified Program mainly in that the current account deficit in convertible currencies was higher than earlier forecast. This reflected essentially higher than projected volume growth of imports and lower volume growth of exports. ^{1/} Nevertheless, developments in external reserves were broadly in line with the target as the emergence of a large positive errors and omissions item offset both the higher current account deficit and the lower foreign borrowings (see Section III above).

In view of the successful renegotiation of long-term oil import contracts and actual developments so far in the year, the authorities now project for 1986 a current account surplus in convertible currencies of US\$930 million (2 percent of GSP), compared with an earlier forecast of US\$800 million. Savings from lower oil prices are now estimated at US\$300-400 million in convertible currencies, as compared with about US\$120 million assumed in the earlier projections. Furthermore, the Yugoslav authorities expect that they will not borrow from commercial markets as much as had been envisaged earlier, implying a reduction in foreign indebtedness by about US\$700 million. The build-up of reserves is now forecast at US\$200 million compared to an earlier projection of US\$50 million. The strengthening of the foreign reserve target in dollar terms takes into account the need to preserve the real value of reserves in view of the depreciation of the dollar. Underlying these official forecasts are increases in the volumes of exports and imports of 7 percent and 6 percent, respectively.

Vis-à-vis clearing account partners, Yugoslavia is benefiting from a more substantial improvement in its terms of trade since most of the country's energy imports come from this area. For 1986, the saving due to the decline in the prices of oil and natural gas is estimated at US\$700-800 million. According to an agreement reached with these countries, Yugoslavia will maintain its exports to that area at their 1985 levels and imports from these countries are expected to rise by 10 percent. Even taking into account a higher volume of energy imports projected for 1986, ^{2/} this implies a considerable increase in the volume of non-energy imports from clearing account countries. The authorities said that the room for higher imports will be used to import consumer durables in short supply in Yugoslavia and certain industrial

^{1/} In dollar terms, both imports and exports were higher than projected due to the depreciation of the dollar.

^{2/} Following bulk purchases of oil in 1984, oil imports were unusually low in 1985.

raw materials, such as wool and cotton, which would allow higher textile production for both exports and domestic consumption. With these expected developments, the global external current account surplus is projected to remain at about 2 percent of GSP.

The staff cautioned that the higher surplus now foreseen in convertible currencies would be achievable only through import strictures if the weakening trend of exports observed so far in 1986 continued. 1/ Yugoslav exporters had lost competitiveness as a result of the abolition of the foreign exchange premia under the new exchange system and the appreciation of the dinar in real terms against the currencies of certain major competitors. The volume growth of exports forecast by the authorities was thus unlikely to be achieved, although in dollar terms the official projections for exports did not seem unreasonable as the increase in export unit value was likely to be higher than assumed in those projections.

The authorities agreed that there was a need to strengthen competitiveness. Consequently they accelerated the depreciation of the dinar in late June, resulting in a real depreciation of the dinar by about 8 percent. The authorities stated that following this accelerated slide, the new level of the real effective exchange rate would be maintained by continuously adjusting the exchange rate as before to make up for inflation differentials. This exchange rate policy would be supplemented by other measures, such as the provision of preferential credit to exporters and relief of exporting enterprises from fiscal levies and contributions. Noting that the surge in domestic consumption of exportables had contributed to the weakening of exports, the authorities felt that the measures to curb personal incomes that they had recently announced (see below) would also increase export supplies.

The Yugoslav representatives also mentioned a number of other planned measures to promote exports and tourism. These included the lifting of export bans on certain agricultural products, credit sanctions against enterprises whose exports are returned because of poor quality, and the opening of duty free shops along the Adriatic coast and major highways. They said that the impact of Chernobyl on Yugoslavia's agricultural exports was still unclear, but it was likely that there would be losses. On the other hand, they were confident that the impact on tourism would be minimal, as they noted that there had been no significant increase in cancellations following the nuclear accident. They also stressed that Yugoslavia's adjustment process would be facilitated by greater access to international markets.

1/ Export data for May which became available after the discussions show a further weakening of export performance.

2. Fiscal policy

The execution of the federal budget during the first five months of 1986 was in line with the targets of the Quantitative Program. The authorities have not yet revised their projections for 1986 although the budget will in all likelihood require a revision because of the higher rate of inflation. 1/ The Yugoslav representatives reaffirmed their commitment to avoid any real increase in expenditure and to maintain the federal budget in overall balance. They said that priority would be given to moderating expenditures but they did not rule out the possibility of increasing certain tax rates because federal revenue had tended to lag behind inflation as receipts from the turnover tax had been adversely affected by a shift in the pattern of consumption toward basic goods. Regarding the public sector including local authorities and other public entities, the authorities stated that the Federal Assembly had recommended measures to republics and provinces that should bring the growth of revenue in line with the objective of no growth in expenditure in real terms for 1986 as a whole. Implementation of these measures was being monitored and should they prove inadequate, the Government would, as in October 1985, introduce an intervention law to freeze excess revenues.

Progress toward tax reform and harmonization, as embodied in two social compacts signed in early 1985, has remained slow. The main objectives of the envisaged reforms are to reduce the tax burden of the enterprise sector; increase the share of direct taxes relative to indirect taxes; place greater emphasis on taxing enterprises and households in accordance with their ability to pay; facilitate the coordination of tax policy; and harmonize tax rates, deductions, exemptions, etc., across the various republics and provinces. 2/ Despite the slow progress, the authorities said that they remained committed to the tax reform. Measures to hasten its implementation had recently been discussed with the republics and provinces.

3. Monetary policy

The Yugoslav representatives characterized the stance of monetary policy to be followed in the second half of 1986 as being moderately and selectively restrictive, compared to what they felt was a highly restrictive policy over the previous year. In line with the provision in the Annual Resolution that the monetary program be revised whenever actual developments in the major nominal aggregates differ from projections by more than 5 percentage points, the quarterly monetary targets for 1986 have been revised from the second quarter onward. Growth in M2 for the 12 months ending in December has been revised upward from the previous 45 percent to 63 percent, roughly the same rate

1/ The authorities normally revise the Federal budget only later in the year.

2/ For further details, see SM/86/39 (2/27/86), pp. 35-36.

of growth as the officially projected inflation rate of 65 percent (December-to-December). According to this monetary program, the growth of domestic credit is to accelerate from an annual rate of 40 percent in the first four months of 1986 1/ to an annual rate of 52 percent for the remainder of the year. Credit policy will be selective to allow relatively faster growth in credit to priority sectors, e.g., export, agriculture, and energy, which will be allowed to expand at the same rate as inflation. Non-priority credit will be allowed to increase by 10-15 percent less than the rate of inflation.

Reflecting their feeling that high nominal interest rates are a source of cost-push inflation and a major impediment to investment and growth, the authorities announced a sharp reduction in interest rates effective July 1, 1986. The selective lending rate of the NBY was reduced from 71 percent to 56 percent, the three-month deposit rate from 73 percent to 42 percent, and the one-year deposit rate from 76 percent to 56 percent. The authorities stated that the Government was still adhering to the principle of positive real rates but that henceforth this would be measured on the basis of a formula that took into account the rate of inflation during the past three months and the officially targeted inflation rate during the four months ahead. Since the official target envisaged a sharp reduction in inflation in the months to come, the formula yielded a lowering of nominal interest rates. Furthermore, the key interest rate in the system was changed from the three-month deposit rate to the one-year deposit rate, and the former was reduced to a lower level than the rate yielded by the new formula. 2/

The staff considered that the authorities' monetary policies were inconsistent with the targeted reduction in the rate of inflation. First, the monetary program assumed an increase in velocity of M2 of only about 4 percent, compared to an average increase of 9 percent per year in the last three years. With the sharp lowering of interest rates, the increase in velocity was likely to accelerate (in 1985, velocity rose by about 13 percent). Second, since inflation was underestimated, the valuation adjustment to foreign currency deposits

1/ After making allowance for a change in the accounting of certain foreign exchange denominated credits.

2/ The authorities indicated that the monthly inflation rates used in the formula were as follows (based on IPPI):

<u>Actual:</u>	March	6.3	<u>Projected:</u>	June	3.5
	April	4.9		July	2.8
	May	4.5		August	2.2
				September	1.5

These projected price increases, if extended to the end of the year, would yield a lower inflation than the authorities' target of 65 percent for the 12 months ending in December 1986.

and hence the growth of M2 were also underestimated. The staff estimated that on the basis of the authorities' policies, the rate of inflation could approach 100 percent by end-1986 unless of course price controls were strengthened (see below). Moreover, the vastly negative real interest rates resulting from the recent cuts in nominal rates would further exacerbate the misallocation of resources and would accelerate the shift from domestic currency to foreign currency holdings. Since for residents the interest on foreign currency deposits were credited in dinars, the lowering of dinar deposit rates would also reduce the attractiveness of holding foreign currency deposits in Yugoslavia rather than abroad. 1/

The staff also expressed regret that the authorities had not yet arranged to pay inflation-related interest rates on a range of short-term bank deposits available to enterprises. The Yugoslav representatives said that steps were being taken to implement such a measure. However, the fact that the authorities now use the one-year deposit rate as the guide for interest rates, rather than the three-month rate as was the case previously, appears to deemphasize the importance attached to attractive rates of return on shorter-term deposits. On the other hand, new legislation restricts the guaranteeing of promissory notes to commercial banks only (i.e., excluding internal banks under the direct control of enterprises), a step that should help bring interenterprise credit under control.

The authorities said that after three or four months they would assess the success of their policies in reducing inflation and if necessary interest rates would be adjusted in line with actual inflation. One possible method of securing positive real interest rates under consideration was the indexation of the principal of all loans and deposits to the price level so that the nominal interest rates would become in effect real interest rates. The staff commented that an advantage of this method as compared to an outright increase in nominal interest rates was that it would put a lesser burden on the cash flow of enterprises by evening out over time the repayment of principal in real terms. This could make the introduction of positive real interest rates throughout the economy more acceptable.

4. Incomes policy and financial discipline

The big increase in real wages since mid-1985 has made it necessary for the authorities to revise their projections of personal income growth for 1986. They now forecast that these incomes will rise by 2 percent in real terms in 1986. Since real personal incomes are already 4 percent above their average 1985 level, the official target

1/ Effective July 1, 1986, the interest rates on foreign currency deposits are related to the interest rates prevailing in the domestic financial markets of the currencies in question plus a margin of 2 percentage points.

implies a cut in real wages during the remainder of 1986. The authorities said that they did not intend to implement a full-scale wage freeze. Instead they planned to introduce strict measures aimed at limiting the growth of nominal increases so that, with inflation, real incomes will be brought back to within the target growth. The specifics of these measures were not yet available at the time of the staff's discussion, but the authorities subsequently informed the staff that a law was passed reducing the scope for enterprises to pay out personal incomes. The objective of this measure is to induce enterprises to harmonize their internal regulations with the provisions of the social compact regulating the distribution of enterprise income. Penalties are foreseen for noncomplying firms. Referring to recent experience, the staff expressed doubts whether wage moderation could be effectively implemented through rules and regulations alone, and suggested that such regulations should be supplemented by an appropriately tight credit policy to prevent enterprises from granting excessive wage awards.

A reduction of the scope of loss-making and illiquid enterprises to absorb financial and real resources has been one of the authorities' policy aims. Several measures have been taken in this area in the recent past and the authorities referred to a number of favorable developments. There had been a shift away from coverage of losses by non-reimbursable funds (i.e., a "socialization" of losses) to coverage through rehabilitation credits (Appendix Table 9), a method implying stricter economic criteria. Furthermore, there had been an increase in liquidations and mergers, reducing the number of enterprises by some 2 percent, which was indicative of an ongoing process of rationalization and restructuring. The staff noted that while the above developments appeared to be in the right direction, their significance was difficult to gauge in light of the recent boom in wages and the large increase in enterprise losses in 1985, which the authorities forecast to rise further in 1986.

5. Pricing policies

The Yugoslav representatives indicated that they did not intend to reimpose general price controls, and they referred to some further liberalization measures introduced in early 1986. ^{1/} Nevertheless, they

^{1/} In January, a new category of price approval was established called the "system of price formation". Its purpose is to provide a mechanism whereby controlled prices can be adjusted automatically when costs rise, without requiring government approval for each increase. For the time being only coffee is on the list, but the authorities are planning to shift to the new system other items which are now under direct government control. Effective April 3, 1986, a number of new items were placed on the uncontrolled list, bringing the total number of goods on this list to 42.5 percent of the industrial producer price index, compared with 28.4 percent previously (Appendix Table 8). Finally, the authorities also modified the system for determining the prices for railway transportation, PTT services, electricity and coal so as to reflect costs more closely.

believed that there was a need to break the psychology of inflation and to that end the Government has recently taken measures to strengthen the controls over prices. Products on which price increases previously required 30 days advance notification (covering about 38 percent of the industrial producer price index) now require a prenotification period of 120 days, although this period may be reduced to 60 days in special cases. In addition, certain enterprises which had increased their prices after March 1, 1986, are required to roll back these prices to their end-February 1986 level. Products affected by this measure represent about 4 percent of the producer price index. Other measures, as yet unspecified, will be taken to eliminate price disparities across the country, particularly for energy and agricultural products.

It is difficult to interpret the importance of these measures as their impact will depend largely on their implementation. Since the underlying policies are likely to add to inflationary pressures, it is doubtful that the intensified price controls could provide more than an ephemeral respite from inflation. On the contrary, unless other policies are changed, the strengthening of price controls is likely to lead to distortions and more speculative price hikes in the future.

6. Growth and investment prospects

The authorities continue to project a rate of economic growth of about 3 percent for 1986. They believe that with the new measures, the growth of exports will pick up while domestic consumption demand will slow. The staff projects a growth rate of about 2 percent, with higher private consumption growth being offset by lower investment and a less favorable development in the foreign balance. The staff feels that the official investment growth target is unlikely to be met since investment in equipment will continue to be constrained by the availability of imports. Due to the weak export performance in the first part of 1986, the contribution to growth of the net foreign balance is likely to be negative rather than positive as forecast by the authorities.

The Government has recently undertaken measures to encourage the development of the small-scale economy both in the social and private sectors. One such measure was the decision to allow the number of employees in private ventures to increase from five to ten per owner and co-owner. A further measure envisaged is the simplification and standardization of documents required for setting up a small-scale enterprise. The Government also plans to take steps toward promoting foreign investment in joint ventures. The authorities hope that these steps to encourage the small-scale economy and joint ventures will help increase investment and employment in Yugoslavia.

V. Staff Appraisal

Yugoslavia has achieved considerable external adjustment over the past three years by adopting a series of policies aimed at improving the allocation of resources. Crucial in this regard have been an active exchange rate policy, a liberalization of prices, and measures to strengthen financial discipline. External adjustment has, however, been accompanied by protracted sluggishness of growth and high inflation, which are essentially the manifestation of continued structural rigidities and obstacles to the efficient allocation of resources that inhibit the supply responsiveness of the economy. The major structural rigidities are to be found in the fragmentation of the markets for capital, labor, goods, and foreign exchange. Some of these rigidities involve sensitive social issues and will no doubt take time to come to grips with. However, there are obstacles to the efficient allocation of resources that should be dealt with without delay to ensure that in the future the required external adjustment can be realized at the same time as a reasonable rate of economic growth.

The staff supports the Government's objectives of continuing the process of external adjustment while aiming at reviving growth and bringing inflation under control. Some of the measures announced recently by the Yugoslav authorities go in the right direction, but in the staff's view other measures run clearly counter to these objectives. As regards the authorities' main macroeconomic targets, the staff thinks that economic growth is likely to fall short of the official forecast of 3 percent largely because of a deterioration in the contribution to growth of the net foreign balance. In view of the slowing of exports, the external current account surplus in convertible currencies projected by the authorities for 1986 would be attainable only with tighter import strictures. Inflationary pressures, rather than abating, are likely to intensify substantially.

The most unfortunate measure is the considerable reduction in nominal interest rates effected on July 1, 1986 which has made most interest rates markedly more negative in real terms. This measure goes against the policy objective described earlier by the authorities and will have detrimental effects in several respects. It further encourages the misallocation of resources by rewarding investment in speculative inventories and by its influence on investment decisions with respect to the degree of capital/labor intensity of projects. At the same time, it provides an incentive to increase the indebtedness of enterprises, at a time when the objective should be to reduce the high debt/net worth ratio of the enterprise sector with a view to regaining greater flexibility in the conduct of interest rate policy. It will also reinforce the flight from domestic money and increase the preference for goods and other real assets, thus adding to inflationary pressure. Finally, it will give a renewed impetus to the shift toward foreign currency deposits held at home or abroad, particularly given the recent accelerated depreciation of the exchange rate.

In the staff's view, any viable anti-inflation plan must include the introduction of significantly positive real interest rates throughout the economy. This is not only necessary to promote savings and a better allocation of resources but also to discourage the shift away from dinar deposits and toward foreign currency deposits so that the effectiveness of monetary policy as a mechanism of anti-inflationary policy can be strengthened. With positive real interest rates, inter-enterprise credit would be considerably curtailed which would also strengthen the effectiveness of monetary policy and improve credit allocation. Because it is difficult to gauge inflation expectations in a high inflation environment, the margin of nominal interest rates above the actual rate of inflation would have to be large enough to ensure that real interest rates are perceived as being positive. In this regard, the indexation of principal under consideration by the authorities could provide the means of obtaining the political support for securing positive real interest rates throughout the economy.

There appears to be no economic justification for the surge in real personal incomes far in excess of productivity gains that has taken place since mid-1985. This wage push has increased the unsatisfied demand for imports and has added significantly to inflationary pressures. The staff supports the Government's objective to curb personal incomes in the second half of 1986. In light of recent experience, there is a legitimate question whether measures regulating the distribution of enterprise income alone can be effective in curbing the growth of personal incomes. It seems essential that these regulations be supported by an appropriately tight credit policy that would discourage enterprises from paying excessive wages.

The authorities took some further steps toward price liberalization in early 1986 but have recently announced measures that strengthen price controls again. It is too early to assess the degree of tightening implied by these measures because much will depend on the way they are implemented. Since underlying policies are likely to increase rather than reduce inflationary pressures, the temptation to rely increasingly on price control measures will be great. These temptations should be resisted. Increased price controls would only lead to distortions and speculation, and in the end to higher inflation as economic agents realize that in the absence of supportive policies price controls cannot be effective in the long run. In the process, the credibility of the policies would be undermined by the return to the on again/off again policy of the past.

The authorities' have been quite successful in recent years at reducing the share of public expenditures in GSP in order to release resources to the rest of the economy. The staff now sees difficulties lying ahead, because the scope for further expenditure cuts has narrowed, and because pressures to catch up on social expenditures and for subsidies to support priority sectors are mounting. The staff would encourage the authorities to resist these pressures, not the least because an acceleration of public spending would jeopardize the planned

tax reform. Progress in the area of taxation, particularly in implementing the plans to levy a progressive tax on the unified income of individuals from all sources, will be essential to reduce the tax burden on enterprises and establish greater equality of treatment.

The new foreign exchange law adopted in early 1986 has increased the reliance on administrative controls and introduced new rigidities into the allocation of foreign exchange. One of the principal objectives of the new system was to ensure an adequate transfer of resources from surplus to deficit regions but it seems that this objective is not being achieved. There is a serious danger that the new system, rather than alleviating will in fact reinforce the tendency of freezing current import and output patterns by rendering new entries into the production cycle more difficult.

In view of the slowing of export volume growth and the loss of external competitiveness following the introduction of the new foreign exchange law, the staff supports the accelerated depreciation of the dinar implemented in late June 1986. It is important that this lower level of the real exchange rate for the dinar be safeguarded by maintaining the policy of a continuous depreciation of the dinar to offset inflation differentials. In addition, exchange rate policy should be kept under close review and strengthened as needed to ensure satisfactory export growth. Exchange rate policy must of course be supported by appropriate financial restraint and an interest rate policy that would provide adequate incentives for holding dinar-denominated financial assets.

The staff welcomes the measures introduced or contemplated to encourage the development of the small-scale economy in the private sector since there is significant employment creation potential in this area. In addition, further development of the small-scale economy would enhance competition and exert a moderating impact on prices. The encouragement of foreign investment in joint ventures should also be given high priority by guaranteeing, inter alia, the remittance of profits. Such investment has the advantage of being a nondebt-creating form of foreign savings inflow which is often accompanied by the transfer of know-how and technology.

The authorities have stated that if the recently announced measures prove ineffective in reducing inflation and reviving growth, they would initiate new measures in about three to four months. The staff understands that the new Government should feel a sense of urgency in bringing inflation under control and that it should take new initiatives toward this end, but it seriously doubts whether the measures so far taken will achieve these objectives. The staff views the sharp reduction in nominal interest rates and the authorities' monetary program as counterproductive for bringing inflation under control; these measures are likely to spark a new inflationary spurt and will fail to generate a sustainable increase in output and employment. The move

toward greater administrative interference with price formation will not help to curb inflation in the long run and might not even provide a temporary respite given the other policies.

The recent measures constitute a clear move away from the use of market signals and discipline, and this raises doubts about the Government's commitment to the strengthening of market forces. Rather than turning back on the policy orientations adopted over the last three years, the authorities should build on them and show consistency in the application of policies to ensure their credibility both at home and abroad. Above all, the authorities should tackle, and tackle urgently, the weaknesses inherent in the fragmentation of the markets for capital, labor, goods and foreign exchange. Until these basic weaknesses are overcome, the economy cannot be expected to meet the goals that have been set. The task at hand is difficult, but the recent improvement in the external environment provides an opportunity for the authorities to pursue their adjustment effort with less sacrifice than would be the case otherwise. The point of the authorities is well taken that Yugoslavia's adjustment efforts would be facilitated by increased access to markets abroad.

Consistent with the timing indicated by Executive Directors in concluding the most recent Article IV consultation with Yugoslavia, it is expected that the next consultation will be conducted in early 1987.

Yugoslavia - Fund Relations

June 30, 1986

I. Membership status

- (a) Yugoslavia is an original member of the Fund.
- (b) Status - Article XIV.

A. Financial RelationsII. General Department

- (a) Quota: SDR 613 million.
- (b) Total Fund holdings of dinars: SDR 2,488.24 million, or 405.91 percent of quota.
- (c) Fund credit: SDR 1,875.23 million, or 305.91 percent of quota, of which: credit tranche: SDR 365.21 million; SFF: SDR 1,175.02 million; and EAR: SDR 335.00 million (59.57 percent, 191.68 percent, and 54.65 percent, respectively, of quota).
- (d) Reserve tranche position: none.
- (e) Current Operational Budget (maximum use of currency): none.
- (f) Lending to the Fund: none.

III. Stand-by arrangements and special facilities

- (a) Latest stand-by arrangement: approved on April 29, 1985 and expired on May 15, 1986; in an amount of SDR 300 million (49 percent of quota). The full amount was purchased.
- (b) In May 1979 Yugoslavia was granted a stand-by arrangement covering the first credit tranche, i.e., SDR 69.25 million, which was used in full.

On June 6, 1980 the Executive Board approved a stand-by arrangement effective through December 31, 1981 for an amount of SDR 339.325 million (122.5 percent of the quota then in effect) of which SDR 200 million was purchased. This arrangement was replaced by a three-year stand-by arrangement approved by the Executive Board on January 30, 1981 for an amount of SDR 1,662 million (400 percent of the quota then in effect). Yugoslavia purchased the full amount available under this arrangement.

On April 18, 1984, the Executive Board approved a 1-year stand-by arrangement for an amount of SDR 370 million (60 percent of quota), which was used in full.

(c) Special facilities: none in the past three years.

IV. SDR Department

(a) Net cumulative allocation: SDR 155.16 million.

(b) Holdings: SDR 1.20 million, or 0.77 percent of net cumulative allocations.

(c) Current designation plan: not included.

V. Administered Accounts

(a) Trust Fund loans: none.

(b) SFF Subsidy Account: none.

VI. Overdue obligations to the Fund

None.

B. Nonfinancial Relations

VII. Exchange rate arrangement

The currency of Yugoslavia is the Yugoslav dinar. The authorities do not maintain the exchange rate of the dinar within announced margins; all transactions, with the exception of those effected under the procedures set forth for certain countries with which Yugoslavia has bilateral payments arrangements, take place at an exchange rate adjusted from time to time by the authorities. The middle rate for the U.S. dollar in the foreign exchange market in Belgrade on June 30, 1986 was Din 419.44 per U.S. dollar. Rates are quoted for certain other currencies.

Yugoslavia maintains a restriction under Article VIII on the availability of foreign exchange for travel. This restriction has been approved by the Fund's Executive Board until the completion of the next Article IV consultation, or April 30, 1987, whichever is earlier. There also existed an exchange restriction giving rise to external payments arrears for which the Fund granted approval until March 25, 1986.

VIII. Last consultation, stand-by review and
approval of enhanced surveillance

The staff report for the 1985 Article XIV consultation and review under the stand-by arrangement (EBS/86/38, 2/19/86 and Sup. 1, 3/7/86) were considered by the Executive Board at EBM/86/45, 3/12/86. The Executive Board approved the decision set forth in EBS/86/38, Sup. 1 relating to the mid-term review of the stand-by arrangement, and Yugoslavia's request for enhanced surveillance for the period May 16, 1986 through 1991. The Executive Board's decision on the 1985 consultation with Yugoslavia, adopted on March 12, 1986, was as follows:

1. The Fund takes this decision in relation to Yugoslavia's exchange measures subject to Article VIII, Sections 2 (a) in concluding the 1985 Article XIV consultation with Yugoslavia and in the light of the 1985 Article IV consultation with Yugoslavia conducted under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).
2. As described in EBS/86/38, 2/19/86 and Sup. 1, 3/7/86 the restrictions on the making of payments and transfers for current international transactions are maintained by Yugoslavia in accordance with Article XIV except that the restrictions evidenced by the limitations on the availability of foreign exchange for travel and external payments arrears are subject to approval under Article VIII. In the circumstances of Yugoslavia, the Fund grants approval of the restriction on availability of foreign exchange for travel until the completion of the next Article IV consultation or April 30, 1987, whichever is earlier, and of the restriction evidenced by external payments arrears until March 25, 1986.

Table 1. Yugoslavia: Fund Position During Period of Arrangement

	Outstanding at the beginning of arrangement May 15, 1985 <u>1/</u>	1985			1986
		May 16- June 30	July 1- Sept. 30	Oct. 1- Dec. 31	Jan. 1- May 15
<hr/>					
		<u>(In millions of SDRs)</u>			
Transactions under tranche policies (net) <u>2/</u>	--	-50.21	-4.72	-23.45	30.99
Purchases		30.00	67.50	67.50	135.00
Ordinary resources	--	15.00	33.75	33.75	67.50
Enlarged access resources		15.00	33.75	33.75	67.50
Repurchases	--	-80.21	-72.22	-90.95	-104.01
Ordinary resources	--	-47.42	-40.86	-40.85	-38.02
Enlarged access resources		-32.79	-31.36	-50.10	-65.99
Total Fund credit out- standing (end of period) <u>2/</u>	<u>1,997.09</u>	<u>1,946.88</u>	<u>1,942.16</u>	<u>1,918.71</u>	<u>1,949.70</u>
<hr/>					
		<u>(As percent of quota)</u>			
Total Fund credit out- standing (end of period) <u>2/</u>	<u>325.8</u>	<u>317.6</u>	<u>316.8</u>	<u>313.0</u>	<u>318.1</u>

Source: International Monetary Fund.

1/ Including last purchase of SDR 90 million under the 1984 stand-by arrangement, effected May 15, 1985.2/ All ordinary and borrowed resources.

Table 1. Yugoslavia: Fund Position During Period of Arrangement

	Outstanding at the beginning of arrangement May 15, 1985 <u>1/</u>	1985			1986
		May 16- June 30	July 1- Sept. 30	Oct. 1- Dec. 31	Jan. 1- May 15
<hr/> (In millions of SDRs)					
Transactions under tranche policies (net) <u>2/</u>	--	-50.21	-4.72	-23.45	30.99
Purchases		30.00	67.50	67.50	135.00
Ordinary resources	--	15.00	33.75	33.75	67.50
Enlarged access resources		15.00	33.75	33.75	67.50
Repurchases	--	-80.21	-72.22	-90.95	-104.01
Ordinary resources	--	-47.42	-40.86	-40.85	-38.02
Enlarged access resources		-32.79	-31.36	-50.10	-65.99
Total Fund credit out- standing (end of period) <u>2/</u>	<u>1,997.09</u>	<u>1,946.88</u>	<u>1,942.16</u>	<u>1,918.71</u>	<u>1,949.70</u>
<hr/> (As percent of quota)					
Total Fund credit out- standing (end of period) <u>2/</u>	<u>325.8</u>	<u>317.6</u>	<u>316.8</u>	<u>313.0</u>	<u>318.1</u>

Source: International Monetary Fund.

^{1/} Including last purchase of SDR 90 million under the 1984 stand-by arrangement, effected May 15, 1985.

^{2/} All ordinary and borrowed resources.

Financial Relations with the World Bank
(In millions of U.S. dollars; as of May 31, 1986)

I. Structural Adjustment Loan

Amount approved	
Appraised	February 28-March 18, 1983
Board approval	June 28, 1983
Actual loan closing date	June 30, 1985
A. First tranche \$175.0 million	
Disbursed through December 31, 1983	31.0
Disbursed January 1 - December 31, 1984	144.0
Subtotal	175.0
B. Second tranche \$100.0 million	
Released	August 23, 1984
Disbursed August 23 - December 31, 1984	57.0
Disbursed January 1 - June 30, 1985	43.0
Subtotal	100.0
Total disbursed	275.0

II. IBRD gross commitments (loans approved by the Board)

FY 1984 (July 1, 1983 - June 30, 1984)	
Middle Neretva Hydro Supplemental Loan	61.0
Sixth Railway Project	110.0
Third Power Transmission Project	120.0 ^{1/}
Seventh Industrial Credit Project Loan (2)	70.0
Fertilizer Sector Loan	90.0 ^{2/}
Total	451.0
FY 1985 (July 1, 1984 - June 30, 1985)	
Montenegro Regional Development Project	40.0
Visegrad Hydropower Project	125.0
Bosnia Forestry Project	35.0 ^{2/}
Petroleum Sector Project Loans (3)	92.5 ^{3/}
Total	302.5
FY 1986 (July 1, 1985-June 30, 1986)	
Highway sector loan	121.5 ^{2/}

III. Disbursements (other than SAL)

January 1 - December 31, 1983	260.7
January 1 - December 31, 1984	204.5
January 1 - December 31, 1985	251.9
January 1 - May 31, 1986	89.1

IV. Position of the World Bank (including SAL)

Total amount disbursed and outstanding	2,170.6
Total amount undisbursed loans	742.5 ^{4/}
Total	2,913.1

Source: IBRD.

^{1/} This loan was subsequently reduced at the time of loan effectiveness to \$115.05 million.

^{2/} Not yet signed.

^{3/} Signed but two of the loans are not yet effective

^{4/} Does not include loans not yet effective.

Medium-Term Scenarios for External Debt
and the Balance of Payments

The Yugoslav authorities remain committed to a substantial reduction of external debt in convertible currencies and a corresponding decline in the debt service ratio over the medium term. To ascertain the implications of such a policy for the balance of payments and growth, a simple computational model has been used to simulate various scenarios. The calculations should be regarded as illustrative since they depend crucially on assumptions that are inevitably somewhat arbitrary.

The three scenarios presented here have a number of assumptions in common. Export and import prices and interest rates (in terms of U.S. dollars) are consistent with those assumed for the Fund's most recent World Economic Outlook exercise. Export prices are assumed to rise by about 6 percent in 1987 and 5 percent per year over the period 1988-91, while import prices are projected to rise by 3.8 percent in 1987 and 4.8 percent per year in subsequent years. As regards interest payments, the average interest rate on the total debt in convertible currencies is projected to decline from 9.7 percent in 1985 to 9.1 percent in 1986 and 8.9 percent in 1991, as a result of a decline in the six-month LIBOR from 8.7 percent in 1985 to 7.5 percent in 1986 and beyond; reflecting the impact of refinancing operations, the proportion of the total debt subject to floating interest rates is estimated to have increased to 70 percent. The model also contains specific assumptions as regards borrowing from international agencies, suppliers' credits, export financing (about US\$250 million a year during the entire period), and reserve accumulation (the gross reserves of the banking system are assumed to rise by US\$200 million in 1987 and US\$300 million in subsequent years so as to remain equivalent to somewhat above three months of imports). In addition, debt service payments on new debt are based on the assumptions that suppliers' credits carry a maturity of five years with a one-year grace period, and that new money on commercial banking terms has a maturity of seven years with a four-year grace period. Gross foreign borrowing for 1986-88 includes refinancing of principal repayments to governments and commercial banks (in relation to debt contracted before 1983) in accordance with recent agreements; in addition, it is assumed that 80 percent of principal repayments to governments falling due during May 16, 1987-December 31, 1988 will be refinanced on terms similar to those of the 1986 refinancing agreement. Short-term debt of the banking system is assumed to remain constant at its end-1985 level throughout the entire projection period.

Scenario 1 contains a balance of payments and external debt scenario that envisages, in line with the Yugoslav authorities' objectives, a decline in the debt service ratio from 44 percent in 1985 to about 25 percent in 1991 and a reduction in total external debt by 10 percent in nominal terms (or from 47 percent of GSP in 1985 to 24 percent of GSP in 1991). Over the 1987-91 period, the current

- 35 -

account surplus is projected to average 1.3 percent of GSP, compared with 0.8 percent in 1985 and 2.0 percent in 1986. Exports are assumed to rise in volume terms in line with growth in export markets. Under these assumptions, imports would be permitted to grow by over 5 percent a year in volume terms allowing for a moderate growth of GSP.

Scenario 2 is based on an alternative policy path that assumes higher exports and imports and no net repayment of debt during the projection period. There would still be a large reduction in the debt-service ratio to about 25 percent, as the improved domestic supply conditions would permit a somewhat higher export volume growth. Imports would rise on the average by 6.5 percent in volume terms thereby permitting a more satisfactory growth for GSP than under the previous scenario. For purposes of comparison, Scenario 3 assumes that domestic policies fail to contain internal demand and protect external competitiveness, so that the volume of convertible exports remains stagnant during the entire period; as in Scenario 2, external debt is assumed to remain constant in nominal terms during the projection period. Under such circumstances, imports will rise in volume terms by less than 2 percent on average during the projection period thereby preventing a satisfactory growth performance and fostering domestic inflationary pressures. Furthermore, the debt-service ratio will remain at the relatively high level of 32 percent in 1991.

Table 1. Yugoslavia: Medium-Term External Debt and Payments Scenarios, 1986-91

(In millions of U.S. dollars)

	1985	1986	1987	1988	1989	1990	1991
<u>Scenario 1</u>							
Current account balance	344	930	800	800	800	800	800
Gross medium- and long-term borrowing	2,932	2,880	2,856	2,867	2,635	3,163	3,069
Of which: Additional borrowing on commercial terms	--	300	393	718	1,228	1,631	1,431
Amortization of medium- and long-term debt outstanding at end-1985	2,929	3,352	2,720	2,311	1,824	1,840	1,467
Amortization of new borrowing	--	--	79	267	526	1,264	1,773
Interest payments	1,828	1,720	1,660	1,610	1,590	1,560	1,540
Total debt outstanding at year-end <u>1/</u>	19,070	18,441	18,098	17,848	17,598	17,348	17,098
Debt service ratio (percent of foreign exchange earnings) <u>1/</u>	44.2	42.5	35.5	31.6	27.6	28.3	25.4
Ratio of total debt to GSP <u>1/</u>	46.5	39.4	35.6	32.3	29.3	26.6	24.1
Export volume growth (annual percentage change)	4.1	--	1.9	4.9	4.9	4.9	4.9
Import volume growth (annual percentage change)	7.6	4.3	7.4	5.3	5.3	5.0	5.0
<u>Scenario 2</u>							
Current account balance	344	930	700	500	300	300	300
Gross medium- and long-term borrowing	2,932	2,880	2,956	3,167	3,135	3,663	3,597
Of which: Additional borrowing on commercial terms	--	300	493	1,018	1,728	2,131	1,959
Amortization of medium- and long-term debt outstanding at end-1985	2,929	3,352	2,720	2,311	1,824	1,840	1,467
Amortization of new borrowing	--	--	79	267	526	1,264	1,773
Interest payments	1,828	1,720	1,670	1,630	1,650	1,670	1,680
Total debt outstanding at year-end <u>1/</u>	19,070	18,441	18,198	18,248	18,498	18,748	18,998
Debt service ratio (percent of foreign exchange earnings) <u>1/</u>	44.2	42.5	35.6	31.6	27.7	28.5	25.9
Ratio of total debt to GSP <u>1/</u>	46.5	39.4	35.7	32.6	30.2	28.2	26.1
Export volume growth (annual percentage change)	4.1	--	1.9	5.4	5.4	5.4	5.4
Import volume growth (annual percentage change)	7.6	4.3	8.3	7.5	6.9	4.8	5.0
<u>Scenario 3</u>							
Current account balance	344	930	700	500	300	300	300
Gross medium- and long-term borrowing	2,932	2,880	2,956	3,167	3,135	3,663	3,597
Of which: Additional borrowing on commercial terms	--	300	493	1,018	1,728	2,131	1,959
Amortization of medium- and long-term debt outstanding at end-1985	2,929	3,352	2,720	2,311	1,824	1,840	1,467
Amortization of new borrowing	--	--	79	267	526	1,264	1,773
Interest payments	1,828	1,720	1,670	1,630	1,650	1,670	1,680
Total debt outstanding at year-end <u>1/</u>	19,070	18,441	18,198	18,248	18,498	18,748	18,998
Debt service ratio (percent of foreign exchange earnings) <u>1/</u>	44.2	42.5	36.2	33.6	30.8	33.3	31.7
Ratio of total debt to GSP <u>1/</u>	46.5	39.4	35.9	33.6	31.8	30.4	29.1
Export volume growth (annual percentage change)	4.1	--	--	--	--	--	--
Import volume growth (annual percentage change)	7.6	4.3	6.3	2.0	1.6	-0.7	-0.5
<u>Memorandum items</u>							
Repurchases from the IMF	317	418	457	539	535	308	107
Charges payable to IMF	211	196	167	199	85	46	25
Amortization payments on debt contracted before 1983							
Governments <u>2/</u>	596	577	456	390	328	273	138
Banks <u>3/</u>	1,364	1,041	898	509	258	75	59
Amortization payments refinanced	1,900	1,542	1,286	841	--	--	--

Source: Data provided by the Yugoslav authorities; and Fund staff estimates.

1/ Including IMF.2/ Debt contracted before December 2, 1982.3/ Debt contracted before January 17, 1983.

Table 2. Yugoslavia: Gross Social Product Based on New Estimates of Stockbuilding 1/ 2/

	1985		1985					1986	
	In bil- lions of dinars	Percent of total	1981	1982	1983	1984	1985	1986	
			(In 1983 prices; percent change)					Staff Forecast	
Private consumption	5,586.6	50.4	-1.0	-0.1	-1.7	-1.0	--	4.0	
Public consumption 3/	941.3	8.5	-5.4	0.6	-1.1	1.6	0.3	2.0	
Gross fixed investment	2,420.9	21.9	-9.8	-5.6	-10.4	-8.7	-8.0	2.5	
Final domestic demand	8,948.8	80.8	-4.5	-1.8	-4.4	-3.0	-2.3	3.4	
Stockbuilding 4/	405.2	3.7	3.1	1.6	-4.5	3.0	2.0	0.6	
Total domestic demand	9,354.0	84.5	-1.4	-0.1	-9.1	0.3	0.1	4.0	
Exports of goods, nonfactor services	3,849.9	34.8	-0.4	-11.2	1.4	10.1	8.2	-1.2	
Of which: Goods	(2,879.2)	(26.0)	(4.2)	(-14.9)	(8.0)	(12.9)	(7.6)	(-2.0)	
Nonfactor services	(970.7)	(8.8)	(-10.5)	(-1.7)	(-13.0)	(2.4)	(10.0)	(1.0)	
Imports of goods, nonfactor services	3,620.5	32.7	-12.3	-13.5	-5.5	-0.4	2.3	3.5	
Of which: Goods	(3,313.2)	(29.9)	(-12.3)	(-14.0)	(-4.1)	(-2.0)	(2.5)	(4.3)	
Nonfactor services	(307.3)	(2.8)	(-12.3)	(-8.8)	(-18.2)	(17.6)	(0.5)	(-4.5)	
Foreign balance 4/	229.4	2.1	5.3	1.2	2.2	3.3	2.1	-1.5	
GSP, demand-side estimate	9,583.4	86.5	4.4	1.2	-6.9	4.2	-2.4	2.0	
Statistical discrepancy 4/	1,986.9	17.9	-1.9	-0.4	3.7	-1.2	1.2	--	
GSP, production estimate	11,570.3	104.5	1.3	0.6	-1.3	2.0	0.5	2.0	
GSP (weighted average) 2/	11,073.6	100.0	2.0	0.7	-2.6	2.5	0.9	2.0	

Sources: Federal Statistical Office, Indeksi; Social Accounting Service, Statisticki Bilten; data provided by the Yugoslav authorities; and staff calculations.

1/ Stockbuilding calculated on basis of enterprise statistics and published price indices; see SM/86/39, pp. 121-124, for explanation.

2/ GSP estimated by staff as 25 percent of demand-side estimate of GSP plus 75 percent of production-side estimate of GSP.

3/ Material expenditures only.

4/ Changes in percent of preceding year's GSP at constant prices.

Table 3. Yugoslavia: Gross Social Product by Sector

	1985 (est.)		1981	1982	1983	1984	1985 Est.	1986 Plan
	In billions of dinars	Percent of total							(In 1985 prices; percent change)
Manufacturing and mining	5,268.5	45.4	4.3	-0.1	0.8	5.2	2.7	3.0
Of which:								
Energy	(653.3)	(5.6)	(1.8)	(2.5)	(4.2)	(5.2)	(4.5)	(7.1)
Basic metals	(374.1)	(3.2)	(6.0)	(-1.6)	(5.3)	(6.7)	(3.6)	(4.7)
Equipment and consumer durables	(1,659.6)	(14.4)	(4.3)	(-0.1)	(-1.4)	(6.2)	(3.7)	(3.3)
Nonmetallic minerals, construction materials	(426.7)	(3.7)	(5.3)	(1.1)	(-1.7)	(6.5)	(-0.2)	(1.7)
Chemicals	(732.3)	(6.3)	(8.7)	(-0.8)	(3.0)	(3.7)	(2.5)	(4.0)
Other	(1,422.5)	(12.3)	(3.5)	(-0.8)	(0.4)	(4.1)	(1.0)	(2.5)
Agriculture, forestry, fishing	1,370.8	11.8	2.9	7.3	-1.1	2.2	-6.2	7.4
Trade and catering	2,403.9	20.8	-2.0	0.9	-1.7	-2.0	1.2	1.4
Construction	817.0	7.1	-4.9	-7.5	-13.1	-4.2	-7.0	-0.4
Transportation and communications	810.7	7.0	1.3	-2.9	1.3	4.6	1.0	4.8
Crafts and other	899.4	7.8	2.5	3.6	-0.2	-1.9	3.7	2.1
Total GSP, production estimate	<u>11,570.3</u>	<u>100.0</u>	<u>1.3</u>	<u>0.5</u>	<u>-1.1</u>	<u>1.9</u>	<u>0.5</u>	<u>3.0</u>
Of which:								
Socialized sector	10,422.9	90.1	1.2	--	-1.2	2.1	1.2	2.5
Private sector	1,147.4	9.9	2.4	5.1	-0.7	-0.2	-5.6	7.5

Source: Data provided by the Yugoslav authorities.

Table 4. Yugoslavia: Output, Employment, and Productivity by Sector 1/

(Annual percentage change)

	Percent of GSP in 1982	1976-79			1979-82			1983			1984			1985		
		Out- put	Em- ploy- ment	Produc- tivity	Out- put	Em- ploy- ment	Produc- tivity	Out- put	Em- ploy- ment	Produc- tivity	Out- put	Em- ploy- ment	Produc- tivity	Out- put	Em- ploy- ment	Produc- tivity
Industry,																
including mining 3/	40.0	8.8	3.9	4.7	2.8	3.2	-0.5	0.8	2.6	-1.8	5.6	2.8	2.7	2.7	3.4	-1.0
Energy (01-05)	4.8	7.3	2.4	4.8	3.8	3.1	0.7	4.6	3.5	0.6	6.7	4.1	2.6	2.8	3.6	-0.8
Basic metals (06-10)	2.7	6.2	3.4	2.7	1.6	3.1	-1.5	4.4	3.6	0.8	7.0	3.6	3.3	3.3	5.2	-2.2
Minerals, building materials (11,12,20,21)	2.9	9.2	4.0	5.1	2.5	2.8	-0.3	-0.1	0.9	-1.0	6.9	--	6.9	2.7	2.0	0.7
Metal products, machinery (13-17)	11.2	10.9	5.3	5.3	2.8	3.7	-0.9	-0.6	2.2	-2.8	5.0	2.0	3.0	4.1	2.4	1.7
Chemicals, paper (18,19,24)	4.5	12.6	4.5	7.8	4.0	4.4	-0.3	-0.6	3.3	-3.7	6.8	2.7	4.0	2.1	2.1	--
Wood products (22,23)	2.5	8.1	3.4	4.6	0.9	2.7	-1.7	-0.4	1.1	-1.5	5.2	1.9	3.3	-2.6	1.3	-3.8
Textiles, leather products (25-29)	6.1	5.9	2.7	3.1	2.9	3.1	-0.2	1.2	3.2	-2.0	6.4	5.3	1.0	4.5	6.5	-1.9
Food, beverages (30-33)	4.6	8.1	3.8	4.1	2.3	2.4	-0.1	1.1	3.3	-2.2	7.5	2.3	5.1	-2.9	3.1	-5.8
Printing; other (34,35)	0.8	7.3	3.4	3.7	1.5	2.5	-1.0	-2.0	2.4	-4.3	3.1	1.2	1.9	6.0	2.8	3.1
Agriculture and fishing	14.5	1.7	1.6	0.1	3.4	3.7	-0.3	-0.8	3.8	-4.5	2.0	3.9	-1.8	-9.0	2.4	-11.0
Forestry, water supply	1.2	3.8	--	3.8	2.4	1.7	0.7	-3.6	2.4	-5.8	0.4	1.1	-0.7	2.1	2.1	--
Construction	9.5	10.0	6.6	3.2	-4.1	0.7	-4.7	-13.1	-1.9	-11.4	-10.0	-1.2	-9.0	-1.4	-0.5	-1.0
Transportation	8.1	6.8	2.8	3.9	0.8	2.4	-1.6	1.3	1.4	-0.1	5.0	2.2	2.7	3.1	2.3	0.8
Trade	17.0	8.1	4.1	3.8	-0.2	2.8	-3.0	-2.2	2.3	-4.4	-2.0	1.6	-3.5	3.0	1.7	1.3
Catering, tourism	2.8	6.3	5.7	0.6	1.8	4.3	-2.4	2.0	2.5	-0.6	4.0	4.3	-0.3	5.0	2.5	2.4
Other	6.9	7.3	...	...	2.7	...	...	-0.1	...	...	3.9	...	...	3.5	2.7	0.8
Total 4/	100.0	7.3	4.5	2.7	1.4	2.8	-1.4	-1.3	1.9	-3.2	2.1	2.1	--	1.0	2.5	-1.5

Sources: Federal Statistical Office, Statistical Yearbook, and Index; and data provided by the Yugoslav authorities.

1/ Output through 1984 measured by production data on gross social product (in 1972 prices), except that industrial output changes in 1985 are based on industrial production index; employment measured in man-years on basis of end-March and end-September data.

2/ Changes in 1985 based on socialized sector only.

3/ Numbers in parentheses are industrial branch codes.

4/ Employment encompasses economic sector, i.e., covers a limited number of services excluded from gross social product.

Table 5. Yugoslavia: Labor Force, Employment, and Unemployment

	1982	1983	1984	1985	1983	1984	1985
	(In thousands)				(Percent change)		
Employment in socialized sector ^{2/}							
Economic activities	4,955	5,052	5,163	5,294	2.0	2.2	2.5
Industry, including mining	(2,313)	(2,374)	(2,445)	(2,529)	(2.6)	(3.0)	(3.4)
Agriculture and fishing	(210)	(218)	(227)	(231)	(3.7)	(3.9)	(1.8)
Forestry, water supply	(83)	(85)	(86)	(87)	(1.6)	(0.9)	(1.2)
Construction	(612)	(599)	(592)	(583)	(-2.0)	(-1.3)	(-1.5)
Transportation	(415)	(422)	(430)	(440)	(1.6)	(2.0)	(2.3)
Trade	(607)	(621)	(631)	(641)	(2.2)	(1.6)	(1.6)
Catering, tourism	(215)	(220)	(228)	(234)	(2.4)	(3.5)	(2.6)
Arts and crafts	(177)	(181)	(183)	(185)	(2.7)	(0.6)	(1.1)
Public utilities, housing	(115)	(119)	(121)	(125)	(3.3)	(1.9)	(3.3)
Financial and other services	(209)	(216)	(224)	(242)	(3.1)	(3.8)	(8.0)
Noneconomic activities	1,024	1,045	1,062	1,084	1.9	1.7	2.1
Education and culture	(416)	(422)	(425)	(429)	(1.3)	(0.7)	(0.9)
Health and social services	(339)	(350)	(361)	(376)	(3.4)	(3.2)	(4.2)
Government sector	(268)	(270)	(273)	(276)	(0.8)	(1.2)	(1.1)
Total socialized sector	5,980	6,097	6,225	6,378	2.0	2.1	2.2
Employees in private							
nonagricultural sector	124	126	131	137	1.6	4.0	4.6
Self-employed (nonagricultural)	311	339	372	419	9.0	9.7	12.6
Active agricultural population	2,595	2,503	2,410	2,310	-3.5	-3.7	-4.1
Workers temporarily employed abroad	760	740	730	710	-2.6	-1.4	-2.7
Registered unemployment	862	910	975	1,040	5.6	7.1	6.7
Less: double-counting (-) ^{3/}	-658	-636	-651	-626	...	...	...
Economically active population							
(mid-year estimate)	9,974	10,079	10,180	10,368	1.1	1.0	1.7
Memorandum items:							
Registered unemployed							
(In percent of total							
labor force ^{4/})	(8.6)	(9.0)	(9.6)	(10.0)	...	...	...
(In percent of socialized							
sector labor force ^{5/})	(12.6)	(13.0)	(13.5)	(14.0)	...	...	...
Unfilled vacancies (average)	71	73	78	84	2.4	6.0	7.7

Sources: Federal Statistical Office, Indeks and Statistical Yearbook; Federal Bureau for Employment, Zaposlijavnost; data provided by the Yugoslav authorities; and staff estimates.

^{1/} Change from corresponding period of preceding year.

^{2/} Annual data are averages of end-March and end-September figures for socialized sector employment.

^{3/} Registered unemployment comprises those seeking a job in the socialized sector and includes some who are working outside the socialized sector. Also, the "active agricultural population" includes those who are temporarily working abroad or are employed in the socialized agricultural sector.

^{4/} Defined as the economically active population.

^{5/} Socialized sector employment plus registered unemployment.

Table 6. Yugoslavia: Nominal and Real Net Personal Income
Per Worker in the Socialized Sector

	Net Personal Income Per Worker				Cost of Living		Real Net Personal Income Per Worker			
	Socialized sector		Of which: Economic sector		1981=100	1981=100	Socialized sector		Of which: Economic sector	
	Dinars per month	Percent change 1/	Dinars per month	Percent change 1/			1981=100	Percent change 1/	1981=100	Percent change 1/
1980	7,368	20.5	7,167	20.9	71.0	105.5	105.5	-7.6	104.4	-7.3
1981	9,846	33.6	9,675	35.0	100.0	100.0	100.0	-5.2	100.0	-4.2
1982	12,542	27.4	12,329	27.4	131.7	96.7	96.7	-3.3	96.8	-3.2
1983	15,858	26.4	15,638	26.8	185.6	86.8	86.8	-10.3	87.1	-10.0
1984	22,810	43.8	22,500	43.9	284.3	81.5	81.5	-6.1	81.8	-6.1
1985	40,661	78.3	40,025	77.9	493.3	83.7	83.7	2.7	83.9	2.6
1981 December	11,590	34.0	11,277	35.4	112.1	105.0	105.0	-2.0	104.0	-1.0
1982 December	14,284	23.2	13,900	23.3	149.1	97.3	97.3	-7.3	96.4	-7.3
1983 December	19,463	36.3	18,900	36.0	238.7	82.8	82.8	-14.9	81.9	-15.1
1984 December	29,241	50.2	28,455	50.6	348.4	85.2	85.2	2.9	84.4	3.1
1985 December	57,628	97.1	55,846	96.3	645.2	90.7	90.7	6.5	89.5	6.0
1985										
1st qtr.	30,537	59.9	30,153	59.7	402.2	77.1	77.1	-1.7	77.5	-1.8
2nd qtr.	35,693	69.7	35,147	69.5	459.8	78.8	78.8	-2.1	79.0	-2.2
3rd qtr.	42,235	83.2	41,781	83.0	505.8	84.8	84.8	6.9	85.4	6.8
4th qtr.	53,735	92.4	52,557	91.7	617.7	88.4	88.4	5.0	87.9	4.5
1986										
1st qtr.	61,725	102.1	60,743	101.4	721.9	86.8	86.8	12.6	87.0	12.2

Sources: Federal Statistical Office, Indeks; and data provided by the Yugoslav authorities.
1/ Change from corresponding period of preceding year.

Table 7. Yugoslavia: Domestic Price Developments

	Weights in 1984 ^{1/}	1982	1983	1984	1985	1982		1983		1984		1985		1986	
						Dec.		Dec.		Dec.		Mar.	June	Sept.	Dec. May
In percent		Percentage change from one year earlier													
Industrial producer prices	100.0	25.0	32.0	56.8	81.5	24.7	55.0	52.9	76.9	91.9	82.0	81.3	74.4	73.0	
Investment goods	8.6	15.8	22.1	42.2	79.4	17.9	29.9	55.0	77.4	89.0	77.4	79.3	75.5	87.1	
Intermediate goods	55.6	27.1	33.9	61.8	86.6	26.2	61.4	55.0	80.9	101.9	88.2	82.6	74.8	64.4	
Consumer goods	35.8	24.8	31.7	52.5	73.4	24.6	52.2	48.9	70.8	76.5	72.1	79.7	72.6	84.9	
Retail prices	100.0	29.5	39.1	56.7	75.7	30.7	58.4	52.4	73.4	76.3	73.9	79.5	80.8	84.0	
Of which:															
Agricultural products	5.3	43.8	44.1	40.0	66.9	44.7	54.0	31.1	56.1	51.3	73.3	88.9	76.7	90.0	
Manufactures	74.9	28.6	39.3	61.8	75.6	30.0	59.9	57.2	76.0	78.4	72.0	75.6	79.1	81.3	
Services	7.8	20.3	29.7	42.7	80.7	19.7	50.0	44.4	73.8	88.8	81.2	80.7	80.9	85.8	
Cost of living	100.0	31.7	40.9	53.2	73.5	32.7	60.1	46.1	68.8	68.6	72.8	85.2	81.7	85.6	
Of which:															
Food	46.2	38.8	44.9	47.2	70.1	40.1	63.2	33.3	59.8	57.9	71.6	95.2	81.0	92.0	
Clothing	12.9	35.2	40.6	65.8	71.4	36.1	51.7	76.8	83.3	73.0	69.1	61.6	69.6	77.4	
Rent	2.3	24.0	34.4	38.3	73.7	18.1	45.6	45.6	61.0	87.7	72.1	74.6	83.9	72.7	
GSP deflator	...	31.9	39.8	51.7	80.8										

Sources: Federal Statistical Office, Indeks; data provided by the Yugoslav authorities; and staff estimates.

^{1/} Weights for retail price index are for 1985.

Table 8. Yugoslavia: Price Regimes in 1985 and 1986
 (Percentage weights in industrial producer price index)

	1985			1986	
	Jan.-Apr.	May-Sept.	Oct.-Dec.	Jan. 3- Apr. 3	from Apr. 3
Prices established by decision of Federal Executive Council	16.9	16.9	16.9	14.7	14.7
Prices subject to approval of Federal Bureau of Prices (FBP)	--	2.5	5.2	12.4	4.1
Buyers given advance notice of price increases	48.0	48.0	47.0	--	--
Of which: Notice sent also to FBP	(--)	(--)	(30.0)	--	--
Prices to be based on self-management agreement	--	6.4	--	--	--
New system of price formation	--	--	--	0.9	0.7
Price changes subject to 30 day advance notification to FBP	--	--	--	43.6	38.0
Free formation of prices; no advance notice required	<u>35.1</u>	<u>26.2</u>	<u>30.9</u>	<u>28.4</u>	<u>42.5</u>
Total	100.0	100.0	100.0	100.0	100.0

Source: Information provided by the Yugoslav authorities.

Table 9. Yugoslavia: Coverage of Enterprise Losses 1/

(In billions of dinars)

	1982	1983	1984	1985	1986 <u>2/</u>
Total uncovered losses	<u>28.6</u>	<u>47.7</u>	<u>87.1</u>	<u>99.8</u>	<u>242.9</u>
Loss covered by nonreimbursable funds	<u>3.3</u>	<u>6.7</u>	<u>22.8</u>	<u>9.6</u>	<u>2.2</u>
BOALs linked by self-management agreement and other BOALs	1.5	1.5	6.1	3.4	1.1
Joint reserve funds	0.8	0.3	1.4	0.5	0.1
Sociopolitical communities and other users of social resources	0.7	4.6	14.6	4.5	1.0
Claims written off	0.3	0.3	0.7	1.2	--
Loss covered through rehabilitation credits	<u>19.3</u>	<u>27.9</u>	<u>52.3</u>	<u>73.9</u>	<u>17.7</u>
BOALs linked by self-management agreement and other BOALs	2.6	5.6	11.0	30.9	12.1
Joint reserve funds	11.4	12.9	25.1	12.6	1.4
Banks	4.2	6.6	12.9	23.7	4.1
Sociopolitical communities and other users of social resources	1.1	2.8	3.3	6.7	0.1
Loss still uncovered at end of the year	<u>6.0</u>	<u>13.1</u>	<u>12.0</u>	<u>16.2</u>	<u>223.0</u> <u>3/</u>

Source: Data provided by the Yugoslav authorities.

1/ Financing of losses in calendar year following year in which losses are made (e.g., the figure for 1985, Din 99.8 billion, represents mainly 1984 losses not covered when the accounts for 1984 were submitted in early 1985; it also includes a minor amount of losses from 1983 and earlier that remained uncovered at end-1984).

2/ Financing of 1985 losses as at March 31, 1986.

3/ 1985 losses still uncovered at end-March 1986.

Table 10. Yugoslavia: Consolidated Revenue and Expenditure of the Public Sector 1/

(In billions of dinars)

	1981	1982	1983	1984	1985
Revenue					
Direct taxes <u>2/</u>	457.0	575.7	729.9	1,054.6	2,003.9
Indirect taxes <u>3/</u>	272.9	326.5	455.7	668.7	1,106.0
Other taxes and nontax revenue	<u>67.9</u>	<u>90.6</u>	<u>147.7</u>	<u>257.8</u>	<u>377.9</u>
Total revenue	797.8	992.8	1,333.3	1,981.1	3,487.8
(Percent change)	(35.8)	(24.4)	(34.3)	(48.6)	(76.0)
(Percent of GSP)	(36.9)	(34.6)	(34.1)	(32.6)	(31.5)
Expenditure					
National defense and administration	190.8	238.3	309.1	461.4	862.6
Education	110.8	132.6	168.1	238.6	451.4
Social security and welfare	286.6	380.8	522.2	745.3	1,363.5
Interventions in the economy	66.0	84.0	145.5	262.2	385.4
Other expenditures <u>4/</u>	<u>130.0</u>	<u>139.5</u>	<u>174.5</u>	<u>254.9</u>	<u>387.0</u>
Total expenditure	784.3	975.2	1,319.4	1,962.4	3,449.9
(Percent change)	(31.1)	(24.3)	(35.3)	(48.7)	(75.8)
(Percent of GSP)	(36.3)	(34.0)	(33.7)	(32.3)	(31.2)
Surplus or deficit	13.5	17.6	13.9	18.7	37.9

Source: Data provided by the Yugoslav authorities.

1/ Includes budgets, funds, and communities of interest at all levels of government; excludes the Federal Fund for the Development of Underdeveloped Regions; net of transfers among public sector units.

2/ Includes taxes on incomes and profits of enterprises and individuals, social security contributions, employers' payroll taxes, and property taxes.

3/ Includes taxes on goods and services and on international trade and transactions.

4/ Includes expenditure for housing and communal amenities, investment, and subsidies for consumption.

Table 11. Yugoslavia: Public Sector Revenue and Expenditure 1/

Revenue for General Consumption															
	Community of Interest for Foreign Economic Relations 2/					Total 3/	Other	Revenue for collective consumption 4/	Public Sector Revenue (narrow definition) 5/ (in percent of GSP)	Cumulative change since end of preceding year in net asset position with banking system	Public Sector Expenditure (narrow definition) (in percent of GSP)	Public Revenue for Other Needs 6/	Public Sector Revenue (broad definition) 7/ (in percent of GSP)		
	Federation	Budgets		Local Republics, provinces	Governments										
(Amounts in billions of dinars)															
1981	95.2	129.3	57.1	33.6	5.6	320.8	386.6	707.4	(32.8)	18.0	689.4	(31.9)	129.0	836.4	(38.7)
1982	117.0	151.8	73.6	40.6	8.9	391.8	499.8	891.7	(31.1)	25.9	865.8	(30.2)	176.3	1,068.0	(37.2)
1983	161.2	197.3	87.5	75.0	8.6	529.6	643.0	1,172.6	(30.0)	25.5	1,147.1	(29.3)	261.0	1,433.6	(36.6)
1984	243.4	263.7	124.0	109.9	11.6	752.6	953.6	1,706.2	(28.1)	55.4	1,650.8	(27.2)	407.5	2,113.7	(34.8)
1985	74.2	80.3	36.0	30.0	7.9	228.2	323.3	551.5	(...)	71.3	480.2	(...)	158.6	710.1	(...)
Jan.-March	162.5	174.7	86.0	64.7	18.5	506.3	711.5	1,217.7	(...)	87.9	1,129.8	(...)	308.8	1,526.6	(...)
Jan.-June	268.5	286.5	149.4	104.0	34.6	843.0	1,187.5	2,030.6	(...)	184.8	1,845.8	(...)	474.6	2,505.2	(...)
Jan.-Sept.	414.6	442.0	229.3	145.0	29.2	1,260.1	1,793.3	3,053.4	(27.6)	132.6	2,900.8	(26.2)	682.0	3,735.4	(33.7)
1986	152.2	168.8	76.0	52.5	11.3	460.8	692.8	1,153.6	(...)	142.5	1,011.1	(...)	313.8	1,467.4	(...)
Jan.-March	42.3	44.6	28.3	21.3	107.4	38.7	32.4	35.2			31.0		24.6	33.5	
1982	22.9	17.4	28.9	20.9	58.5	22.1	29.3	26.0			25.6		36.7	27.7	
1983	37.7	30.0	18.9	84.5	-2.8	35.2	28.6	31.5			32.5		48.0	34.2	
1984	51.0	33.7	41.7	46.7	34.8	42.1	48.3	45.5			43.9		56.1	47.4	
1985	40.1	35.1	53.7	3.4	159.2	36.0	64.7	51.5			46.1		56.6	52.6	
Jan.-March	50.1	41.9	62.3	23.3	240.9	47.9	71.2	60.7			58.9		61.8	60.9	
Jan.-June	57.8	48.7	76.0	34.8	322.4	58.1	79.8	70.1			65.3		63.6	68.9	
Jan.-Sept.	70.4	67.6	84.9	31.9	151.7	67.4	88.1	79.0			75.7		67.7	77.6	
1986	105.1	110.2	111.1	75.0	43.0	101.9	117.2	109.2			110.5		97.8	106.6	
Jan.-March															

Sources: Social Accounting Service, Statisticki Milten and Saopstenje; and data provided by the Yugoslav authorities.

1/ Revenue on a cash basis, before transfers within public sector; expenditure estimated on basis of change in net asset position with banking system.

2/ Revenue comprises customs duties and other taxes on imports, earmarked for payments to export producers.

3/ Equal to total revenue of sociopolitical communities; for government administration, defense, the judiciary, etc.

4/ Revenue of communities of interest for collective consumption (health, education, culture, social welfare, etc.).

5/ Sum of revenues for general and collective consumption.

6/ Revenue of communities of interest for material production, joint reserve funds, solidarity funds, the Federal Fund for Underdeveloped Regions, etc.

7/ Sum of revenues for general and collective consumption, and for other needs.

Table 12. Yugoslavia: Monetary Survey 1/
(In billions of dinars; position at end of period)

	1981	1982	1983	1984				1985				1986	
				I	II	III	IV	I	II	III	IV	I	April
Money supply (M1)	584	740	889	944	1,007	1,133	1,272	1,318	1,371	1,556	1,864	2,025	2,212
Quasi-money	1,030	1,387	2,039	2,145	2,234	2,543	3,043	3,455	3,871	4,249	5,072	5,520	5,753
Of which:													
Foreign exchange deposits	(467)	(672)	(1,251)	(1,287)	(1,357)	(1,593)	(1,806)	(2,089)	(2,408)	(2,654)	(3,059)	(3,298)	(3,459)
Broad money (M2)	1,614	2,127	2,927	3,089	3,241	3,676	4,315	4,772	5,242	5,805	6,936	7,605	7,965
Net foreign assets	-375	-588	-1,197	-1,224	-1,474	-1,741	-2,088	-2,592	-3,208	-5,165	-3,406	-3,766	-4,039
Net domestic assets	1,989	2,714	4,125	4,312	4,715	5,417	6,403	7,365	8,449	8,970	10,342	11,371	12,004
Other items, net	62	345	942 ^{2/}	976	1,108	1,372	1,692	2,120	2,642	2,834	3,311	3,897	4,305
Domestic credit	1,928	2,369	3,176 ^{2/}	3,336	3,607	4,046	4,710	5,245	5,807	6,136	7,032	7,474	7,699
Memorandum items:													
M1	26.6	26.6	20.1	26.3	31.7	35.9	43.1	39.6	36.1	36.3	46.5	58.2	63.5
M2	26.6	31.7	37.7	33.4	32.7	39.2	47.4	54.4	61.7	59.1	60.7	59.4	62.2
NDA	34.0	36.4	52.0	43.5	42.9	48.6	55.2	70.8	79.2	65.6	61.5	54.4	56.6
Domestic credit	22.9	22.9	34.1	32.5	36.0	42.9	48.3	57.2	60.9	51.7	49.3	42.5	42.4

Source: National Bank of Yugoslavia.

1/ Includes valuation changes and public sector deposits.

2/ The definition of domestic credit was changed at the end of 1983, the main change being that some short-term foreign exchange credits which had previously been included in "other items, net" were moved to domestic credit. Figures for domestic credit and for "other items, net" are therefore not comparable with figures before December 1983.

Table 13. Yugoslavia: Selected Interest Rates

(In percent per annum)

	1981	1982		1983		1984		1985		1986	
		June	Oct.	Feb.	July	May	Oct.	Jan.	July	Feb.	April
Central Bank interest rates											
Official discount rate and liquidity credits 1/	6	12	14	22	30	30	47	54	70	68	73
Selective credits 2/	1-6	4-8	4-9	8-12	18-22	18-22	31-35	36-40	48-52	53-55	71
											56
											56
Commercial bank interest rates											
Deposit rates	--	1	1	4	4	4	4	4	4	4	4
Sight deposits of OALs 3/											
Dinar deposits of households											
Sight	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
3 months	...	...	...	12	12	30	47	54	70	68	73
6 months	...	...	...	15	15	...	...	...	...	...	...
Long term 4/	9-10	11-15	13-20	18-28	18-28	35-38	52-55	59-62	72-73	71-73	76-78
Foreign currency deposits of households 5/											
Sight	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Long term 4/	9-10	9-10	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5
											6/
Lending rates											
Short-term credits	9-12	9-16	9-21	17-30	30-38	39-42	47-62	59-63	60-80	60-80	60-82
Long-term credits	7-12	9-18	11-21	18-30	30-38	39-47	46-57	50-62	50-75	50-75	50-82
											...
											...

Source: National Bank of Yugoslavia.

1/ The rate on liquidity credits was 8 percent for the period 1978-81.

2/ Credits for exports, agriculture, and imports.

3/ Organizations of Associated Labor.

4/ The lower rate is for 1-year deposit; the higher rate is for 3-year deposit. From May 1984, the higher rate is for dinar deposits with 2-year maturity.

5/ No interest is paid on foreign exchange deposits of OALs.

6/ Effective July 1, interest rates on foreign currency deposits are to be 2 percentage points above the corresponding currency's home country.

Table 14. Yugoslavia: Balance of Payments
with the Convertible Currency Area, 1982-86 ^{1/}

(In millions of U.S. dollars)

	1982	1983	1984	1985	Jan.-April		1986 Off. Proj.
					1985	1986	
Exports, f.o.b.	5,526	6,047	6,470	6,496	1,789	2,126	7,500
Volume (percentage change) ^{2/}	-6.8	12.0	12.6	4.1	...	...	7.0
Unit value (percentage change)	3.7	-2.3	-8.1 ^{3/}	-3.6	...	...	7.9
Imports, c.i.f.	9,045	7,737	7,675	8,267	2,328	2,832	9,250
Volume (percentage change) ^{2/}	-12.5	-11.8	-4.4	7.6	...	...	5.6
Unit value (percentage change)	-2.5	-3.0	-- ^{3/}	0.1	...	...	6.0
Trade balance	-3,519	-1,690	-1,205	-1,771	-539	-706	-1,750
Services (net)	1,941	1,936	1,984	2,115	177	382	2,680
Workers' remittances	1,141	1,646	1,697	1,635	461	565	1,735
Tourism	1,226	746	860	909	117	163	1,153
Interest payments	-1,692	-1,469	-1,579	-1,610	-666	-660	-1,485
Other	1,266	1,013	1,006	1,181	265	314	1,277
Current balance	-1,602	246	779	344	-362	-324	930
Medium- and long-term capital (net)	-126	920	-59	-92	18	-542	-682
Loans received (net)	51	1,057	33	3	68	-472	-472
Drawings	(1,815)	(3,508)	(2,841)	(2,932)	(849)	(785)	(2,880)
Refinancing	[--]	[1,426]	[1,750]	[1,900]	[...]	[530]	[1,543]
Other	[1,815]	[2,082]	[1,091]	[1,032]	[...]	[255]	[1,337]
Repayments (-)	(-1,764)	(-2,451)	(-2,808)	(-2,929)	(-781)	(1,257)	(-3,352)
Refinanced	[--]	[1,426]	[1,750]	[1,900]	[...]	[530]	[1,543]
Other	[1,764]	[1,025]	[1,058]	[1,029]	[...]	[727]	[1,809]
Loans extended, net (-)	-177	-137	-92	-95	-50	-70	-210
Short-term capital through the banking system	-506	-670	-96	-36	-224	-3	--
Other short-term capital, including errors and omissions	637	-961	-100	58	80	874	215
Overall balance	-1,575	-465	524	274	-488	-5	463
Use of Fund credit	563	410	10	-66	-103	-22	-263
Purchases	608	590	290	251	--	76	156
Repurchases	45	180	280	317	103	98	418
Reserve movements (increase -)	1,012	55	-534	-208	591	17	-200

Sources: Data provided by the Yugoslav authorities; and staff estimates.

^{1/} Data for 1982 and 1983 are based on statistical exchange rates of currencies to the U.S. dollar which may result in significant over- or underestimation of balance of payments flows, depending on currency composition and actual movement of currencies against the dollar. Data after 1983 are based on market exchange rates.

^{2/} Derived from official estimates of volume and unit values for total trade flows.

^{3/} Change in unit value as compared with 1983 level calculated on the basis of market exchange rates.

Table 15. Yugoslavia: Balance of Payments
with the Nonconvertible Currency Area, 1982-86

(In millions of U.S. dollars)

	1982	1983	1984	1985	Off. Proj. 1986
Current account	956	-34	-302	489	60
Exports, f.o.b.	4,387	3,643	3,666	4,126	4,160
Imports, c.i.f.	-3,699	-4,085	-4,237	-3,956	-4,350
Trade balance	688	-442	-571	170	-190
Services (net)	268	407	269	319	250
Long-term capital	-61	3	-129	169	110
Long-term loans					
received (net)	-49	-8	-119	163	120
Drawings	(216)	(202)	(140)	(457)	(370)
Repayments (-)	(-265)	(-210)	(-259)	(-294)	(-250)
Loans extended, net (-)	-12	11	-10	6	-10
Short-term capital (net)	--	23	--	--	--
Errors and omissions	-90	-236	-11	-224	--
Total	805	-244	-442	434	170
Bilateral balance (surplus -)	-805	244	442	-434	-170

Sources: Data provided by the Yugoslav authorities.

Table 16. Yugoslavia: Global Balance of Payments, 1982-86

(In millions of U.S. dollars)

	1982	1983	1984	1985 Prel.	1986 Off. Proj.
Exports, f.o.b.	9,913	9,690	10,136	10,622	11,660
Percentage change in volumes	-6.2	--	11.4	9.4	1.6
Percentage change in unit values	3.7	-2.3	-8.1 <u>1/</u>	-3.6	8.0
Imports, c.i.f.	12,744	11,821	11,912	12,223	13,600
Percentage change in volumes	-10.0	-4.4	-1.6	2.5	5.0
Percentage change in unit values	-2.5	-3.0	-- <u>1/</u>	0.1	6.0
Trade balance	-2,831	-2,131	-1,776	-1,601	-1,940
Nonfactor services, credit	4,138	3,402	3,431	3,581	4,060
Nonfactor services, debit	1,357	1,167	1,290	1,134	1,330
Nonfactor services, net	2,781	2,235	2,141	2,447	2,730
Balance on exports of goods and nonfactor services	-50	104	365	846	790
Workers' remittances, net	1,157	1,620	1,734	1,651	1,735
Interest payments, net	-1,731	-1,512	-1,622	-1,664	-1,535
Current account balance	<u>-624</u>	<u>212</u>	<u>477</u>	<u>833</u>	<u>990</u>
Medium- and long-term capital, net	-187	923	-188	77	-572
Short-term capital, including errors and omissions	41	-1,844	-207	-202	215
Bilateral balance (surplus -)	-805	244	442	-434	-170
Overall balance	<u>-1,575</u>	<u>-465</u>	<u>524</u>	<u>274</u>	<u>463</u>
Use of Fund resources	563	410	10	-66	-263
Change in reserves (increase -)	1,012	55	-534	-208	-200

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Change in unit value as compared with 1983 level calculated on the basis of market exchange rates.

APPENDIX

Table 17. Yugoslavia: External Reserves
(In millions of U.S. dollars; end of period)

	National Bank of Yugoslavia Official Reserves					Foreign Assets of Deposit Banks	
	Reserve position in the Fund	SDRs	Gold ^{1/}	Foreign exchange	Total		Total
1976	--	10	62	1,980	2,052	658	2,710
1977	--	13	64	2,031	2,108	666	2,774
1978	81	20	69	2,288	2,457	783	3,245
1979	--	54	73	1,203	1,330	638	1,968
1980	--	13	78	1,371	1,462	1,102	2,567
1981	--	84	78	1,540	1,702	985	2,687
1982							
I	--	37	78	1,038	1,157	821	1,978
II	--	25	78	819	925	851	1,776
III	--	--	78	846	927	760	1,687
IV	3	--	78	771	850	825	1,675
1983							
I	--	--	78	769	843	828	1,671
II	--	--	78	858	936 ^{2/}	808	1,744 ^{2/}
III	--	--	78	975	1,035 ^{2/}	644	1,697 ^{2/}
IV	55	--	78	922	1,055	567	1,622
1984							
I	--	--	78	937	1,015	600	1,615
II	--	--	78	995	1,073	746	1,819
III	--	--	78	1,124	1,202	828	2,030
IV	--	--	78	1,159	1,237	919	2,156
1985							
I	--	--	78	920	998	774	1,772
II	--	--	78	968	1,046	1,011	2,057
III	--	--	78	1,102	1,180	1,131	2,311
IV	--	6	78	1,089	1,173	1,192	2,365
1986							
January	--	6	78	1,143	1,227	761	1,988
February	--	14	78	1,123	1,215	751	1,967
March	--	--	78	917	995	901	1,896
April	--	--	78	1,248	1,326	1,021	2,347

Source: Data provided by the Yugoslav authorities.

^{1/} Valued at US\$42.22 per ounce.

^{2/} Including BIS credits.

APPENDIX

Table 18. Yugoslavia: Financial Flows
vis-à-vis the Convertible Currency Area, 1983-86

(In millions of U.S. dollars)

	1983	1984	1985	<u>Off. Proj.</u> 1986
Sources of funds	<u>4,344</u>	<u>3,910</u>	<u>3,527</u>	<u>3,966</u>
Current account surplus	246	779	344	930
Government packages	816	750	679	502
Berne	816	250	143	--
Refinancing and financial credits	(476)	(--)	(--)	(--)
Suppliers' credits	(340)	(250)	(143)	(--)
Geneva	--	500	--	--
Refinancing	(--)	(500)	(--)	(--)
Supplier credits	(--)	(--)	(--)	(--)
1985 refinancing	--	--	536	245
1986 refinancing	--	--	--	257
Commercial bank packages	1,550	1,250	1,364	1,341
Refinancing	(950)	(1,250)	(1,364)	(1,041)
Other	(600)	(--)	(--)	(300)
IBRD	292	406	295	297
IMF	590	290	251	156
Other, mainly supplier credits	850	435	594	740
Uses of Funds	<u>4,344</u>	<u>3,910</u>	<u>3,527</u>	<u>3,966</u>
Amortization of medium- and long-term loans	2,451	2,808	2,929	3,352
Loans extended, net	137	92	95	210
Short-term debt, net	670	96	36	--
Other short-term capital flows, errors and omissions	961	100	-58	-215
Repayments to the IMF	180	280	317	418
Increase in reserves	-55	534	208	200

Sources: Data provided by the Yugoslav authorities; and staff estimates.

Table 19. Yugoslavia: External Debt Disbursed and Outstanding

(In millions of U.S. dollars; end of period)

	1981	1982	1983 <u>1/</u>	1984 <u>2/</u>	1985 <u>3/</u>
Repayable in convertible currency	18,337	18,488	19,002	18,818	19,110
Medium- and long-term	16,025	16,678	17,860	17,792	18,120
Public and publicly guaranteed	6,137	6,560	8,686	9,865	11,395
IMF	1,432	1,934	2,364	2,141	2,108
IBRD	1,483	1,576	1,722	1,961	2,160
Other <u>4/</u>	3,222	3,050	4,600	5,763	7,127
Private	9,888	10,118	9,174	7,927	6,725
Commercial banks	6,350	6,040	4,865	4,040	3,585
Other <u>4/</u>	3,538	4,078	4,309	3,887	3,140
Short-term	2,312	1,810	1,142	1,026	990
Repayable in bilateral currencies	1,531	1,482	1,474	1,355	1,518
Total debt	19,868	19,970	20,476	20,173	20,628

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Official figures calculated at statistical exchange rates in effect during 1983. According to staff estimates, total outstanding debt at the end of 1983 repayable in convertible currencies amounted to US\$18,572 million when converted at end-1983 exchange rates.

2/ Official figures calculated at statistical rates in effect during 1984. On the basis of the structure by currency as of the end of 1983, the total external debt repayable in convertible currencies as of the end of 1984 is estimated to have amounted to US\$18,096 million when converted at end-1984 exchange rates.

3/ At current exchange rates.

4/ Staff estimates.