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**FOR
AGENDA**

EBS/71/364

CONFIDENTIAL

December 21, 1971

To: Members of the Executive Board
From: The Acting Secretary
Subject: Yugoslavia - Change in Par Value

Attached is a proposal by Yugoslavia for a change in the par value of the Yugoslave dinar, together with the staff's analysis and recommendation. This subject will be placed on the agenda of a meeting of the Executive Board scheduled for 5:00 p.m. this afternoon, December 21, 1971.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Yugoslavia--Change in Par Value

Prepared by the European Department

(In consultation with the Exchange and Trade Relations Department,
the Legal Department, the Research Department, and the
Treasurer's Department)

Approved by L.A. Whittome

December 21, 1971

I. Introduction

In a communication sent from Belgrade dated December 21, 1971, the Government of Yugoslavia has requested Fund concurrence in a change in the par value of the Yugoslav dinar from .0592447 gram of fine gold per Yugoslav dinar to 0.0481478 gram of fine gold per Yugoslav dinar. The proposed change represents a devaluation of 18.7 per cent in terms of gold. It is proposed that the new rate become effective on December 22, 1971 at 0001 hours (Belgrade time); i.e., 1801 hours, December 21, 1971, Washington, D.C. time.

The initial par value of the Yugoslav dinar, 0.0177734 gram of fine gold, was established on May 24, 1949, and it was changed to 0.00296224 gram of fine gold, effective January 1, 1952. Subsequently, the exchange rate system became extremely complex, and a large number of effective exchange rates came into existence. Effective July 26, 1965, the par value of the dinar was changed to 0.000710937 gram of fine gold, and, at the same time, the multiple currency practices were abolished. On January 1, 1966, a new monetary unit, bearing the same name, was established. The new unit is equivalent to 100 old dinars. Accordingly, the par value of the new dinar was established at 0.0710937 gram of fine gold. Effective January 23, 1971, the par value of the dinar was changed to 0.0592447 gram of fine gold; this represented a devaluation by 16.7 per cent.

Economic developments and policies in Yugoslavia in 1970 have been described in detail in the staff report on the 1971 Article XIV consultation (SM/71/186, 7/16/71). The January 1971 devaluation is discussed in EBS/71/23, 1/23/71.

After August 23, 1971, the dollar continued to be bought and sold by the National Bank at its parity rate (Din 15 = US\$1). In this period, the National Bank periodically adjusted the rates at which it bought and sold other foreign currencies.

II. General Background

1. Underlying factors

In 1965, Yugoslavia introduced a wide ranging economic reform, which sought to bring about decentralization of economic decision-making, a stronger orientation toward market forces, and the integration of the economy into world market. Following a recessionary period which lasted until mid-1968, economic activity began to expand strongly in response to an increase in budget expenditures and an easy monetary policy. Since then, the authorities have had difficulties in controlling aggregate domestic demand and in preventing a deterioration of the balance of payments. The sharp deterioration in the trade account was matched by a sustained improvement in invisible receipts. Although the latter continued in 1970, it was no longer sufficient to offset the increase in the trade deficit. As a result, the international reserves fell and there was a sharp increase in foreign indebtedness. Late in 1970 the Government took a number of measures to stabilize the economy. Monetary policy was tightened, limits were put on budgetary expenditure, attempts were made to control wages, and a price freeze was introduced. Controls were put on certain categories of foreign borrowing. The devaluation of January 1971, an import surcharge, and some liberalization of the trade and payments system formed part of the program.

2. Recent economic developments

The measures taken in late 1970 and early 1971 to stabilize the economy did not, however, prove effective, and the boom continued during the first half of 1971. Some of the measures, notably the wage controls and the price freeze, proved difficult to implement, and in the second quarter an easing of monetary policy fed excess demand. The result was that the balance of payments remained in serious difficulty, and in the first half of 1971, imports were 33 per cent higher than a year earlier and exports were 1 per cent smaller. The National Bank's convertible reserves amounted to US\$140 million at the end of 1970, and at the end of November 1971 they had risen to only \$153 million.

It was in these circumstances that the authorities undertook additional restraining measures in mid-1971. The principal features of the program were a tightening of monetary policy, a continuation of fiscal restraint, and new measures to reduce the excessive expansion of investment expenditure. The authorities expect to be able to continue with liberalization of the trade and payments regime.

So far the program has had only slight success. Prices and wages continue to rise strongly. In November 1971, prices were about 17 per cent higher than a year earlier and earnings per worker in August were about 24 per cent higher. The balance of payments remains weak, although there are signs of moderating imports and strengthening exports. The trade deficit during the first 11 months reached US\$1,384 million compared with US\$1,194 million for the whole of 1970. Part of the increase

in imports was due to exceptionally large purchases of agricultural products, which were needed because of the poor harvest in 1970. Receipts from invisibles during January to August indicate that the surplus from services and transfers will significantly exceed the 1970 figure.

III. Staff Appraisal and Recommended Decision

The relative price effects of the devaluation in January 1971 on Yugoslavia's competitiveness have largely been eroded by the large increase in costs and prices that has occurred so far in 1971. In the staff's view, the last devaluation was sufficient only on the assumption that costs and prices could be quickly stabilized. This has proved to be impossible, largely because the effects of the pre-devaluation inflation have continued to permeate through the economy and the earlier stabilization measures could not be fully implemented. In these circumstances, the staff believes that the reasons which justified the devaluation in January 1971, viz., the need to provide an incentive to exports and to check the rate of growth of import demand, while making further progress in the liberalization of imports, are equally applicable now.

The staff agrees that the proposed devaluation is necessary, in the context of the general realignment of exchange rates, to correct a fundamental disequilibrium. The proposed change in par value represents for the Yugoslav dinar a devaluation of 18.7 per cent in terms of gold and in conjunction with other exchange rate changes already made and now under way, an effective depreciation of the Yugoslav dinar vis-à-vis Yugoslavia's main trading partners of about 20 per cent. The staff believes that it is essential to the success of the proposed devaluation that the current stabilization program be implemented effectively so as to ensure as much as possible that the necessary shift in the use of resources is not impeded by excessive increases in domestic demand and prices.

Accordingly, the following decision is recommended for the consideration of the Executive Directors:

1. The Government of Yugoslavia has proposed a change in the par value of the Yugoslav dinar to become effective on December 21, 1971.

Expressed in terms of gold, the proposed par value of the Yugoslav dinar is:

0.0481478 gram of fine gold per Yugoslav dinar;

646.000 Yugoslav dinars per troy ounce of fine gold.

2. The Fund concurs in the proposed par value.

3. Yugoslavia has notified the Fund that it avails itself of wider margins under paragraph 1(a) of Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. The Fund notes the intention of Yugoslavia to avail itself of wider margins.

Table 1. Yugoslavia--Balance of Payments, 1967-71

(In millions of U.S. dollars)

	1967	1968	1969	1970 Preliminary	1971 ^{1/} Forecast
Exports	1,253	1,265	1,475	1,680	1,800
Imports	<u>-1,708</u>	<u>-1,797</u>	<u>-2,135</u>	<u>-2,874</u>	<u>-3,280</u>
Trade balance	-455	-532	-660	-1,194	-1,480
Services and transfers	<u>373</u>	<u>426</u>	<u>552</u>	<u>854</u>	<u>1,115</u>
Goods, services, and transfers	-82	-106	-108	-340	-365
Nonmonetary capital (net)					
Long-term loans ^{2/}	178	165	253	269	275
Export credits ^{3/}	-39	-46	-92	-50	-66
Other, including errors and omissions	<u>8</u>	<u>-56</u>	<u>25</u>	<u>22</u>	<u>19</u>
Total capital	147	63	186	241	228
Allocation of SDRs	--	--	--	25	22
Monetary movements					
SDRs	--	--	--	-6	4
IMF accounts	33	-18	-38	-60	71
Gold and convertible exchange ^{3/}	--	-52	-158	109	--
Bank credits	-4	65	60	-40	--
Bilateral balances	<u>-94</u>	<u>48</u>	<u>58</u>	<u>71</u>	<u>40</u>
Total	-65	43	-78	74	115
International reserves of National Bank; end of period; gross	80	132	253	140	153 ^{4/}

Sources: Data supplied by the Yugoslav authorities; and International Financial Statistics.

^{1/} As forecast in November 1971.

^{2/} Extended by Yugoslavia.

^{3/} Of the banking system.

^{4/} November 1971, preliminary.

Table 2. Yugoslavia--International Reserves

(In millions of U.S. dollars)

End 1968	132
End 1969	253
1970 March	264
June	217
September	217
December	140
1971 January	143
February	150
March	158
April	192
May	178
June	180
July	176
August	172
September	136
October	140
November	153

Source: International Financial Statistics.