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**FOR
AGENDA**

EBS/82/181
Supplement 1

CONFIDENTIAL

November 10, 1982

To: Members of the Executive Board
From: The Secretary
Subject: Yugoslavia - Stand-By Arrangement - Review of Developments

The attached supplement to the paper reviewing developments under the stand-by arrangement for Yugoslavia (EBS/82/181, 10/7/82) has been prepared on the basis of additional information.

This subject has been tentatively scheduled for discussion on Friday, November 12, 1982.

Att: (1)

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Stand-By Arrangement - Review of Developments -
Supplementary Information

Prepared by the European Department

Approved by L. A. Whittome

November 9, 1982

This note contains recent information obtained from the Yugoslav authorities during a short staff visit. 1/

1. Domestic economy

The measures introduced in July 1982 have met with some success in restraining the major domestic demand aggregates. In recent months both real personal incomes and the volume of retail sales have declined markedly compared with the high levels recorded in the latter part of 1981 and in the first quarter of 1982. Seasonally adjusted figures indicate that real fixed investment declined also in the summer months. While there has been some recent moderation in the growth of public consumption expenditures, the deceleration has not been as pronounced as planned.

The fall in domestic demand has been accompanied by flat industrial production and by a slackening of activity in the services sectors. Shortages of imported inputs, particularly of energy products, and weak foreign demand have contributed to the sluggishness of real economic activity. In the first nine months of 1982 industrial production was 0.6 per cent above its level in the corresponding period of 1981.

Notwithstanding the imposition of a price freeze in July 1982, domestic prices have continued to rise at a rapid rate. The retail price index increased by 3.9 per cent in the two months to September 1982. The 12-monthly rate of increase in retail price index was 32 per cent in September. The corresponding increase in the industrial producer price index was 28 per cent.

Monetary survey data for the months of August and September 1982 indicate some slowing in the growth of domestic bank credit and the monetary aggregates. All quantitative performance criteria under the stand-by arrangement for end-September were observed.

1/ Messrs. Whittome and Manison met with the Yugoslav authorities in Belgrade from October 27 to 29, 1982.

2. External economy

Balance of payment figures for the first nine months of 1982 show a current account deficit of \$1.3 billion with the convertible currency area compared with a deficit of \$1.9 billion in the same period of 1981 (Table 1). The growth of nominal merchandise exports slackened considerably in the third quarter of 1982 compared with the corresponding period of 1981, rising by 2.4 per cent against an increase of 8.6 per cent in the first half of the year. Declines in exports to Eastern European countries paid for in convertible currencies were an important factor contributing to the deceleration in the rise in exports. The shortfall in export receipts was more than offset by a 11 per cent decline in the value of imports in the first nine months of 1982. The surplus on invisibles in the third quarter was well below that earlier forecast due largely to shortfalls in receipts from tourism and to an acceleration in withdrawals from foreign exchange accounts held by Yugoslav nationals.

As a consequence of these developments it now seems highly unlikely that the target for the current account deficit of \$500 million with the convertible currency area for 1982 will be achieved. Uncertainties especially with respect to inflows of worker's remittances and withdrawals from foreign exchange accounts make the magnitude of the deficit for 1982 very difficult to predict, even in mid-November, but there seems little prospect of the deficit falling much short of \$1 billion. For balance of payments transactions with the nonconvertible currency area a current account surplus of \$600 million was recorded in the first nine months of 1982, with both exports to and imports from this area showing considerable declines. The surplus was used to reduce debt previously accumulated on a bilateral basis with the CMEA countries.

The lower-than-expected current account surplus in the third quarter of 1982 coincided with a further substantial net outflow of funds on capital account as short-term external bank debt was run down at a fast rate. As a result, external reserves did not record the seasonal increase normally expected in the third quarter, but rather a small decline. Official reserves fell slightly in October to reach \$918 million or equivalent to about three weeks of imports of goods and services from the convertible currency area; on October 20, 1982 commercial bank external reserves amounted to \$777 million.

3. Economic policies

In view of the unsatisfactory developments in the current and capital accounts, attesting both to inadequate price and nonprice competitiveness, the authorities took a number of economic policy measures during October 1982. At the then prevailing exchange rate, the demand for imports far exceeded the supply of foreign exchange, and the dinar was being traded at a substantial discount on unofficial markets. Thus the corrective measures included a discrete depreciation

in the value of the dinar against a basket of currencies on October 22 (Chart 1). The buying and selling rates against the U.S. dollar were changed from Din 52.7643 and Din 52.9229, respectively, to Din 63.3172 and Din 63.5070, respectively, representing a depreciation of 16.7 per cent. The depreciation in conjunction with tight domestic demand management policies is expected to provide an extra stimulus to the growth of exports of goods and services to the convertible currency area which had slackened in recent months. Pricing policies are being modified insofar as selective increases will be permitted for certain commodities with a high import content.

To assist in efforts to conserve foreign exchange, gasoline rationing was introduced on October 14, 1982, limiting monthly allocations to 40 litres per motorist except for foreign tourists, and restrictions were announced for heating and lighting in offices and private homes on October 15. Also, to discourage foreign travel by Yugoslavs, particularly that associated with the purchase of consumer goods from neighboring countries, Yugoslav citizens effective October 15, 1982, were required to deposit Din 5,000 with a bank or post office for the initial trip abroad for a period of 12 months and an additional Din 2,000 for each subsequent trip abroad during the calendar year; these deposits do not earn interest. In addition, the maximum value of consumer goods that can typically be brought across the border at one time by a private Yugoslav national was limited to Din 1,500 (\$24) as from October 15, 1982. To stem the run on foreign exchange deposits a "gentlemen's agreement" among banks was concluded in October limiting monthly cash withdrawals to \$250 per account.

Table 1. Yugoslavia: Balance of Payments
(Convertible Currency Area)

(In millions of U.S. dollars)

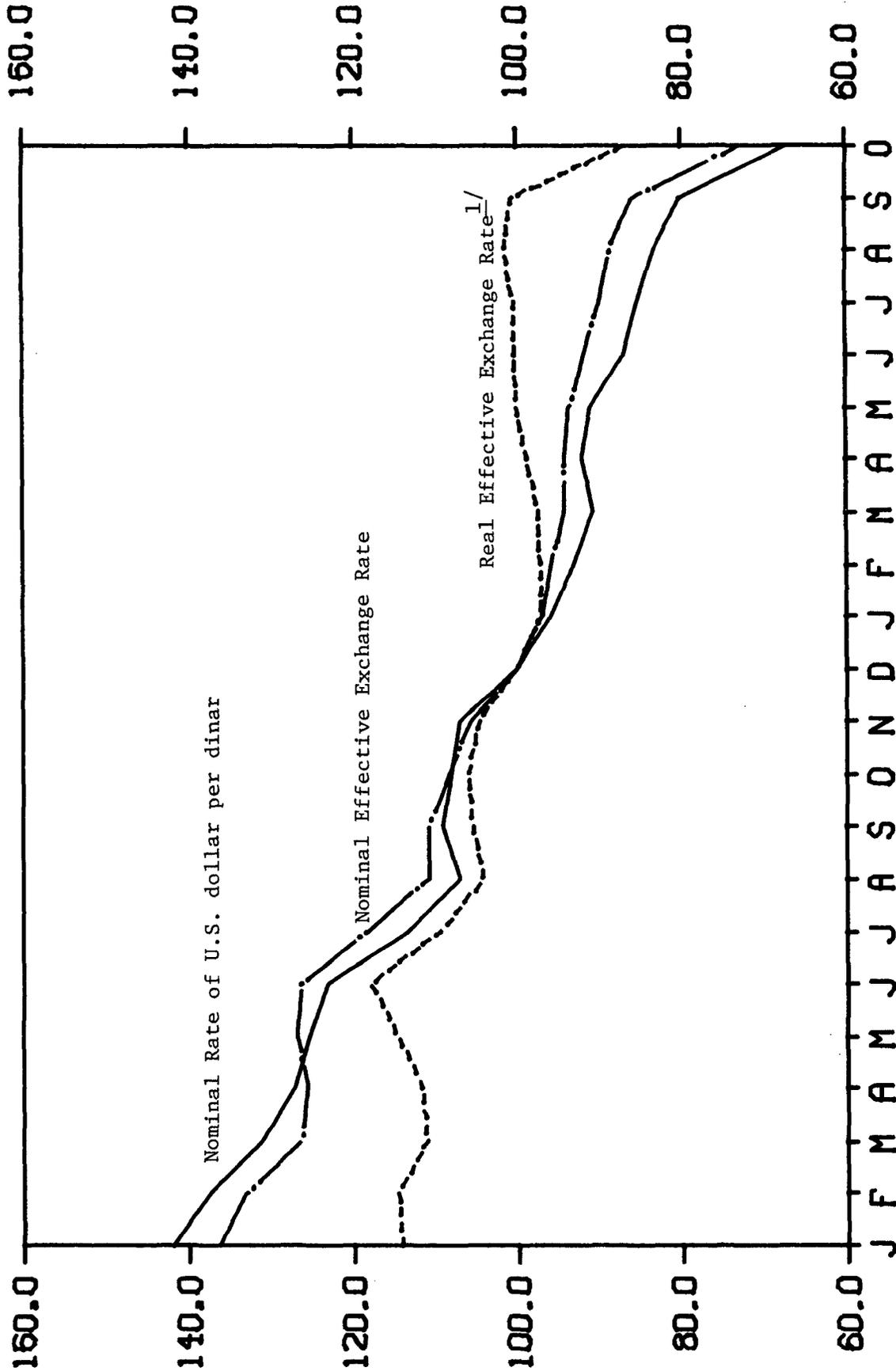
	January-September	
	1981	1982
A. Goods and services and unrequited transfers	-1,884	-1,278
Exports, f.o.b.	3,872	4,121
Imports, c.i.f.	<u>-7,981</u>	<u>-7,124</u>
Trade balance	-4,109	-3,003
Services and unrequited transfers (net)	2,225	1,725
B. Long-term capital		
Long-term capital received (net)	832	123
Drawings	2,041	1,411
Repayments	-1,209	-1,288
Long-term loans extended (net)	<u>-150</u>	<u>-163</u>
Total	682	-40
C. Short-term capital (net)	439	-636
D. Allocation of SDRs	--	--
E. Errors and omissions	375	734
F. Total (A through E)	-388	-1,220
G. Reserve movements		
Use of Fund credit SDRs	472	440
Reserve position in the Fund		
Gold		
Official foreign exchange (increase -)	-84	780

Source: National Bank of Yugoslavia; and staff estimates.

Chart I

Yugoslavia: Exchange Rate Developments

(End of period; 1981 = 100)



Sources: IMF, International Financial Statistics; and National Bank of Yugoslavia.
^{1/} Adjusted for relative producer prices.