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CONFIDENTIAL

January 29, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Review and Consultation Under Stand-By Arrangement

Attached for consideration by the Executive Directors is a report on the review and consultation under the stand-by arrangement for Yugoslavia. A draft decision appears on pages 15 and 16.

This subject, together with the staff report for the 1981 Article IV consultation with Yugoslavia (SM/82/24, to be circulated shortly), will be brought to the agenda for discussion on a date to be announced.

Att: (1)

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Review and Consultation Under Stand-By Arrangement

Prepared by the European Department 1/

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

Approved by L. A. Whittome and Subimal Mookerjee

January 29, 1982

I. Introduction

On January 30, 1981 Executive Directors approved a three-year stand-by arrangement for Yugoslavia in an amount equivalent to SDR 1,662 million, 400 per cent of quota. A third of this, SDR 554 million, was purchased during the first year of the arrangement, and the same amount is available for the second year (Table 1). In a letter dated January 15, 1981 requesting the stand-by arrangement, the Federal Secretary for Finance and the Governor of the National Bank of Yugoslavia said that they would consult with the Fund and reach understandings before or shortly after the beginning of the second year of the arrangement about that year's program. These consultations took place in Belgrade from October 26 to November 6, 1981, and from December 6 to December 18, 1981. Further discussions with the Yugoslav authorities took place in Washington, D.C., on January 18-20, 1982. The prospects and policies for 1982 are described in the attached letter, dated January 25, 1982 from the Federal Secretary for Finance and the Governor.

Yugoslavia's outstanding purchases on January 29, 1982 amounted to SDR 1,075 million, or 259 per cent of quota (Table 2); excluding holdings relating to purchases under the oil and compensatory financing facilities, they were SDR 790 million, or 190 per cent of quota. Total purchases under the stand-by arrangement may not exceed SDR 1,108 million by the end of the second year. It is proposed that the SDR 554 million that may be purchased during the year should be made available as follows: up to SDR 138.5 million until May 15, 1982, SDR 277 million until August 15, 1982, and SDR 415.5 million until November 15, 1982. If the full amount is purchased before the end of 1982, the Fund's holdings of Yugoslav dinars, excluding the oil and compensatory financing facilities, will rise to SDR 1,344 million on December 31, 1982, 324 per cent of quota.

1/ The staff team consisted of Messrs. Dakolias (Head), Manison, and Odling-Smee (all EUR), and Ms. Kirmani (ETR), with Miss Owen (TRE) as secretary on the first mission to Belgrade and Miss Stuart (ADM) on the second.

Article IV consultation discussions with Yugoslavia took place in Belgrade at the same time as the discussions about the program for the second year of the stand-by arrangement. The staff report and recent economic developments papers, that are complementary to this paper, will be issued shortly. The mid-year review of the 1981 program was presented in EBS/81/170 (8/17/81).

II. Stabilization in 1981

1. The medium-term context

A number of interrelated economic problems arose during the second half of the 1970s. The acceleration in domestic demand, especially in fixed investment, was not matched by an equivalent increase in supply. This was partly because the investment, encouraged by the authorities so as to create more employment opportunities, was not always allocated efficiently and did not produce the anticipated increase in productive capacity. The result of the imbalance between aggregate demand and supply was that pressures built up on the balance of payments and prices. The import substitution strategy was not wholly successful, and inefficiencies resulted from the insulation of the economy from international competition. Yugoslavia's share of world exports declined. The resulting large current account deficits were mostly financed by heavy foreign borrowing.

The external current account deficit rose sharply in 1979, to reach US\$3.7 billion, equivalent to 6 per cent of GSP. Inflation also rose to 24 per cent in the year to December 1979, from 16 per cent in 1978. Real domestic demand actually grew less rapidly in 1979 (5.7 per cent) than in 1978 (8.3 per cent), mainly because of a major deceleration in fixed investment and slower growth in private consumption. But there was still excess demand in general, and the balance of payments and inflation were aggravated by the rise in oil prices, a poor harvest, and the adverse effects of the Montenegrin earthquake.

In 1980 the authorities responded by strengthening the stabilization measures first introduced in 1979. The growth of money, credit, and public expenditure in 1980 was held well below the growth of nominal income, an incomes policy to achieve a significant reduction in real wages was introduced, and low priority investments were discouraged. As a result, real final domestic demand fell slightly (Table 3). The dinar depreciated by 30 per cent in terms of the Yugoslav currency basket, mainly because of the 23 per cent devaluation in June. While the balance of payments improved significantly, a large fall occurred in the growth of gross social product, from 7.0 per cent in 1979 to 2.4 per cent in 1980. Despite this, inflation continued to rise, reaching 39 per cent in the year to December 1980.

The authorities realized that there were major structural problems, especially relating to exports, that would prevent the achievement of growth rates similar to those experienced up until 1979 without attendant

balance of payments difficulties and inflation. These problems could only be overcome gradually, by mobilizing additional domestic resources and shifting them into the production of tradable goods and services and by exposing the economy to international competition and prices. During the transition period, the growth of final domestic demand would have to be held down, and GSP would not be able to grow very rapidly. Such a strategy was the basis of the medium-term Plan for the years 1981 to 1985.

2. Objectives and policies for 1981

The stabilization program for 1981 was both an extension of that in 1980, and the beginning of the medium-term strategy. The major objective was to reduce the balance of payments current account deficit to US\$1.8 billion, equivalent to 2.5 per cent of projected GSP (Table 4). The policies for achieving this were to be both short and medium term. A restraint of domestic demand that implied no real increase for the second year running was to be accompanied by exchange rate, price and incomes policies that aimed at improving competitiveness. All the growth on the demand side would come, as it did in 1980, from the improvement in the balance of payments.

Fiscal, monetary, and incomes policies were all planned to contribute to the restraint of domestic demand. The Federal Government budget deficit was to be reduced from an amount equivalent to 1.3 per cent of GSP in 1980 to 0.1 per cent of GSP in 1981 (Table 7). The deficit of the public sector as a whole would fall to a similar extent because other parts of the public sector were expected to be in balance or in slight surplus, as in 1980. Money and credit aggregates were planned to grow at a rate below that of nominal GSP (Table 3). Aggregate nominal personal incomes from employment were to grow no faster than the total incomes of enterprises. In other words, real personal incomes per employee were expected to rise in line with the projected increase in labor productivity of 1.3-1.5 per cent.

Longer-term measures aimed at moving resources into the production of tradable goods and services involved exchange rate, interest rate, investment, and pricing policies. Priority sectors for investment, mostly related to the need to increase exports and substitute for energy and agricultural imports, were defined, and they were to receive preferential treatment in the allocation of credit and foreign borrowing. Pricing policies, especially in agriculture, were planned to create appropriate incentives to increase production and stimulate more net exports of agricultural commodities. While these measures would yield some results in 1981, they would be especially important over the medium term.

It was expected that the relative stagnation in real domestic demand and wages in 1981, and the absence of any sharp changes in the exchange rate or in import prices in foreign currency would produce a reduction

in inflation over the year to December 1981 to 20-25 per cent. Price policy was altered to give greater influence to market forces. Price controls on a number of commodities were removed in October 1980, responsibility for monitoring and authorizing some price increases was transferred from the federal level to communities of interest operating at other levels of government (republican, provincial, and communal), and market-related criteria for price increases were embodied in legislation in March 1981.

There were four quantitative performance criteria for the first year of the stand-by arrangement, relating to total domestic credit, Federal Government borrowing from the National Bank of Yugoslavia, the National Bank's net foreign liabilities in convertible currencies, and the total outstanding medium- and long-term debt in convertible currencies (Table 10).

3. Developments in 1981

The 1981 program was implemented and in most respects the objectives and policies were achieved. In particular, the balance of payments current account deficit improved to an estimated US\$1.3 billion, equivalent to 2.0 per cent of GSP, which was below the original target of US\$1.8 billion and the actual deficits of US\$3.7 billion in 1979 and US\$2.3 billion in 1980 (Table 4). Even this may underestimate the improvement in the current account between 1980 and 1981, because some of the imports recorded in the statistics in 1981 were paid for and may have actually crossed the borders in 1980; the timing discrepancy is reflected in the large errors and omissions items in the 1980 and 1981 balances of payments. The improvement relative to plan occurred in the balance of trade with the nonconvertible currency area, which was about US\$0.8 billion better than expected (Table 6). This had the intended result of reducing the outstanding indebtedness on bilateral balances with the U.S.S.R., relating mainly to oil imports. The current account position with the convertible currency area is now estimated to be close to the original Plan, with smaller increases in both imports and exports (Table 5). The trade performance with respect to the convertible currency area was poor in the first half of the year (Table 6). Since then exports have risen at an increasing rate and imports have fallen to produce an improvement in the balance of trade with the convertible currency area compared with 1980. The effective exchange rate measured in terms of the Yugoslav currency basket depreciated by 23 per cent in 1981, with most of the change occurring in the second half of the year. The improvement in competitiveness in the second half contributed to the recovery of the balance of trade with convertible currency countries, although the decline in real domestic demand was probably a more important cause.

Net medium- and long-term external borrowing, excluding net purchases from the IMF, amounted to US\$1 billion, much less than was planned at the beginning of the year (Table 4). Suppliers' credits were lower

than projected because of the slower growth of imports; also some reluctance was encountered among foreign commercial banks to extend new financial loans. It was not possible to reduce the amount of short-term financial credits from commercial banks as planned. However, gross official international reserves were increased by US\$155 million, about half the increase planned, to bring them to a level equivalent to nearly two months' imports from the convertible currency area.

Gross social product grew at only 2.2 per cent in 1981, one percentage point less than planned (Table 9). Real final domestic demand (excluding stockbuilding) declined by about 2 per cent, compared with no planned change. Fixed investment fell by 4.5 per cent, and real private consumption also fell, rather than growing by 2.5 per cent as projected. Nominal private income did not respond fully to the unexpected rise in inflation. Whereas retail prices were projected to increase at 20-25 per cent over the year to December 1981, they are estimated to have actually grown at 39 per cent, the same rate as in 1980. Aggregate nominal personal incomes grew at about 7 percentage points below the rate of growth of nominal GSP in 1981; since labor productivity hardly increased, real personal income per employee fell by 6 per cent, following a 7 per cent decline in 1980.

Public sector bodies did not increase their nominal expenditures above planned levels, which were based on the original planned inflation rate. Consequently, real expenditure, especially on wages, fell considerably. On the other hand, the nominal revenues of republican, provincial, and communal governments and of self-managing communities of interest in the nonproductive sector tended to grow more rapidly than planned because of the higher inflation. The potentially large surpluses did not materialize, because steps were taken to return revenue to households and enterprises so as to avoid an excessively contractionary impact. Nevertheless, the remaining surpluses were sufficient to offset the small federal budget deficit which was reduced as planned to a level equivalent to 0.1 per cent of GSP (Table 7). This compares with deficits in 1980 equivalent to 0.7 per cent and 1.3 per cent of GSP for the consolidated public sector and the Federal Government, respectively, and it indicates the contractionary impact of fiscal policy in 1981 on domestic demand.

Price inflation was especially rapid in the first part of the year. Retail prices, grew at an average monthly rate of 5.0 per cent during the first quarter of 1981, at 2.6 per cent during the second quarter, at 1.4 per cent during the third quarter, and at an estimated 2.1 per cent during the fourth quarter; the annualized rate of price increase was 23 per cent in the second half of the year compared with 56 per cent in the first half. The rapid inflation at the beginning of the year was a continuation of the upward movement toward the end of 1980. Part of it reflected the passing on of higher costs, including higher oil prices and the prices of domestic energy, the effects of the devaluation of June 1980, higher turnover taxes, and the increase in agricultural producer prices. As the decline in aggregate real domestic demand and incomes removed generalized excess demand, only a small part of the

above average inflation was attributable to excess demand in a few sectors. Most of the price increase resulted from the behavior of enterprises, which took advantage of the gap between the removal of controls in October 1980 and the introduction of a new price system in March 1981 to improve their financial positions. They raised prices even though the authorities adhered to their monetary policy stance, and as a result there was a liquidity squeeze, mitigated by the rapid and unforeseen growth of inter-enterprise credit, and an effective strengthening of disinflationary pressures in the economy. Real money supply and the real stock of bank credit declined sharply (Table 3). It was the persistent implementation of restrictive monetary, fiscal and incomes policies, together with the strengthening of price controls in June, which led to the large decrease in the inflation rate in the second half of the year following the high level at the beginning of the year. This occurred even though subsidies on certain important commodities were reduced.

All the quantitative performance criteria for which information has become available were met, and those for December 1981 are expected to have been met (Table 10).

3. Evaluation of performance

Developments in 1981 show that the adjustment process is now well under way. For the second year in succession real domestic demand and real wages declined, and for the second year in succession the balance of payments current account improved, with exports of goods growing considerably faster than imports. Firm demand restraint was mainly responsible for this outcome. At the same time steps were taken, mostly through exchange rate and investment policies, to encourage a gradual shift of resources toward the tradable goods sector.

The main disappointments were inflation and the growth of exports to the convertible currency area. Both were to some extent the result of a failure by enterprises to appreciate the direction that the stabilization program, and indeed the medium-term plan as a whole, was taking. By raising prices excessively at the beginning of the year enterprises were unable to expand domestic sales and created liquidity difficulties for themselves since the Government did not ease monetary policy in the way that it had done in the past. Similarly, by not devoting more effort to exporting, enterprises allowed their stocks of goods to accumulate, again adding to their liquidity difficulties. The market structure in Yugoslavia and the financial discipline operating on enterprises are such that enterprises do not have to react immediately to policy and market signals and may take some time to make the necessary adjustments. The authorities are to be commended for ensuring consistent signals by maintaining their firm policies, and even strengthening them, despite the pressures on them to ease their stance because of the unexpectedly high inflation and the resultant liquidity difficulties. Positive results in the form of lower inflation and higher exports to the convertible currency area are now being achieved.

Although 1981 did not work out exactly as planned, the broad objectives of the stabilization program were achieved. All the major policy measures that were planned were enacted, although, in the opinion of the staff, action should have been taken on interest rates. By the second half of the year it could be said that the program was beginning to produce the desired outcome.

III. Prospects and Policies for 1982

1. Strategy

Policies for 1982 have been set in the context of the Medium-Term Plan that has been modified to take account of developments in 1981 and revised expectations and prospects for the remainder of the period. The Plan now envisages the elimination of the current account balance of payments deficit by 1983, two years earlier than foreseen in the original Plan, and surpluses in the remaining two years. The authorities are concerned about their future foreign debt situation and determined to minimize dependence on foreign borrowing. The aim of the Plan is to increase the mobilization of internal resources, improve their efficiency, and direct a significantly larger proportion of investible funds to priority sectors especially those related to tradable goods. Despite the planned fall in investment over the period to 1985, the share of investment in GSP will remain relatively high, and the share of total investment going to the priority sectors will increase to 75 per cent. Productive capacity will increase sufficiently rapidly to support a moderate rate of growth of output and employment, and an improvement in the balance of payments.

Employment in the social sector is expected to increase by 2.4 per cent a year over the four years to 1985, which is consistent with developments in the labor force. The increase in output and the improved efficiency of new investment will contribute to productivity growth of 1.1 per cent a year over the same period. The growth of real GSP is estimated to increase gradually and to average about 3.5 per cent, compared with 4.8 per cent in the original Plan. Increases in domestic demand have also been revised downward from 3.2 per cent a year over the four years to 1985 to 0.6 per cent. The policy stance will continue to be one of domestic demand restraint, for both consumption and investment, while appropriate exchange rate, interest rate, and price and incomes policies will support the efforts of the authorities to mobilize additional resources and use them efficiently. As indicated in the attached letter, the authorities are planning for a rapid reduction in inflation, with single digits being reached in 1984 if not earlier.

In 1982, real GSP is projected to increase by 2.5 per cent, with no change in private consumption, a further decrease, greater than that recorded in 1981, in the level of investment, and a small decrease in public consumption (Table 9). On the demand side, the growth in GSP will come about from an increase in exports, which are forecast to expand by 8.5 per cent. Industrial production is expected to grow at 3.5 per

cent and agricultural production at 4 per cent compared with 4 per cent and 1 per cent, respectively, in 1981. The rate of increase in retail prices is planned to fall to 15 per cent over the year to December 1982 which implies a year-on-year increase of 20 per cent in prices and 23 per cent in nominal GSP. Inflationary pressures will be restrained by policies of financial discipline supplemented by price and incomes policies, and output and employment will be promoted within the overall financial constraint by policies that limit the growth in nominal personal incomes and by realistic exchange rate and interest rate policies.

2. Fiscal policy

Fiscal policy will continue to have a contractionary impact on aggregate domestic demand in 1982. The budget of the Federation is planned to be in surplus by Din 2.4 billion, equivalent to 0.1 per cent of GSP, compared with an estimated deficit of about the same size in 1981 (Table 7). No provision is made in the budget for any new borrowing from the National Bank of Yugoslavia. The surplus in 1982 will be used to repay bank credits and amortize bonds. The budgets of other public sector bodies, lower levels of government and self-managing communities of interest in the social sector, are also expected to be in small surplus.

The expenditure of all levels of government will grow less rapidly than nominal GSP in 1982, as a continuation of the policy of reducing the share of resources taken by the public sector. Thus, Federal Government expenditures are planned to rise by 23 per cent in nominal terms, to Din 201.5 billion in 1982. However, if it turns out that the projected increase in revenues is not forthcoming, expenditure plans will be adjusted downward, as they were in 1981. Federal expenditure on administration and defense will grow less rapidly than nominal GSP, at 21.8 per cent and 22.7 per cent, respectively; and grants to other levels of government and selfmanaging communities of interest will grow more rapidly. Revenue raised by the Federation is planned to be 26.4 per cent higher than in 1981, reaching a level of Din 203.9 billion. The share contributed by the republics and provinces will remain approximately constant. However, a smaller share of total customs duties and other import fees will accrue to communities of interest for foreign economic relations than in 1981, and a larger share to the Federation. This will enable total federal revenue to grow at the projected rate, since the general turnover and sales tax receipts are expected to increase by only 21 per cent, because the tax base is expected to grow relatively slowly.

3. Monetary policy

As indicated in the attached letter, the authorities plan not to ease credit policy in 1982. The present tight policy is now beginning to produce results in terms of greater price restraint and better export performance. The ability of enterprises to extend further trade credit is limited, and liquidity difficulties are being experienced. Monetary

policy for 1982 has been formulated so as to avoid a serious liquidity problem, while at the same time maintaining the pressure on enterprises to increase sales, particularly exports, rather than prices.

In 1982 narrow money supply is expected to grow more slowly than nominal income, although the room for a further increase in income velocity may be very limited. Nominal income is projected to grow by 18 per cent over the year to December 1982, with prices increasing by 15 per cent and real output by about 2 1/2 per cent, and the rate of growth of money supply during 1982 has been estimated at 16.9 per cent (Table 8). It is expected that quasi-money will also increase at about 17 per cent, excluding any revaluation of foreign currency deposits resulting from changes in the exchange rate; such deposits comprised about 45 per cent of total quasi-money at the end of 1981. The significant improvement in the balance of payments current account in 1982 should be reflected in a smaller rise in the net foreign liabilities of the banking system than in recent years.

Domestic credit is planned to grow by 17.4 per cent during 1982, excluding any increase due to the revaluation of the stock of foreign currency credits at the end of December 1981. Quarterly ceilings have been set for the stock of domestic credit defined in this way, and they are incorporated as performance criteria for the second year of the stand-by arrangement. A subceiling of no additional credit during 1982 from the National Bank of Yugoslavia to the budget of the Federation has also been established as a performance criterion.

Interest rates in Yugoslavia have changed very little in recent years, despite the rise in inflation; in real terms they have become very negative. A transfer of real wealth from net lenders, primarily households, to net borrowers, primarily enterprises has been brought about. The low interest rates have also led to inefficiencies in the use of financial resources, and have discouraged savings in dinar deposits. In a decentralized economy like Yugoslavia's interest rates can have an important role to play in mobilizing and distributing resources efficiently. The authorities have therefore embarked on a more active interest rate policy. The discount rate of the National Bank of Yugoslavia was increased on January 28 1982, from 6 per cent to 12 per cent, and the interest rates charged on short-term selective credits of the National Bank of Yugoslavia were also increased: that on export credits from 1 per cent to 4 per cent, and that on credits to agriculture from 3 per cent to 6 per cent, with similar increases in the other selective credit rates. The Yugoslav Bankers' Association has been preparing proposals for increasing interest rates on the main components of commercial banks' borrowing and lending. These will go into effect in March 1982, and will involve, among other things, an increase in the interest rates on households' time deposits, from 9 per cent to 11 per cent for one-year deposits, and from 10 per cent to 13 per cent for two-year deposits, and to 15 per cent for deposits of three years or more. The authorities intend to keep interest rate policy under continuous review and to adapt it to the changing needs of the economy.

4. Prices and incomes policies

A strategy of reducing inflation by demand management policies alone would disrupt the expansion of output and employment and would take a long time. This is particularly true in Yugoslavia, because of the tendency for enterprises to postpone making the necessary adjustments, especially to prices and exports, in the face of reduced domestic demand until their liquidity situation becomes acute and they are forced to reduce output. Prices and incomes policies are designed to reinforce demand management policies by avoiding excessive disruption in production. By speeding up the reduction in inflation, they are expected to create room for real output growth within a given increase in nominal demand.

The policy for incomes in 1982 takes the form of agreements involving enterprises and governments, according to which the nominal wage bill of an enterprise should not grow faster than its nominal income. Over the economy as a whole, this is equivalent to the policy that the real wage should grow no faster than average labor productivity. The projections for 1982 show productivity increasing by 0.5 per cent, and no increase in real wages. Employment is projected to grow by 2 per cent, average prices by 20 per cent, and hence the aggregate nominal wage bill by about 22 1/2 per cent, which is slightly less than the increase in nominal income (GSP) of 23 per cent (Table 9). The restraint of wages in this way will help to keep down the growth of real private consumption in 1982.

Incomes policy is relevant to inflation and competitiveness as well as to real demand management. By effectively synchronizing the deceleration of nominal wages with that of prices, and thus determining the growth of real wages, large changes in income distribution are avoided. If such changes were to occur, they would make it more difficult to reduce inflation, because those adversely affected would take defensive action.

Given the incomes policy, prices policy will be used to facilitate the big reduction in inflation that is being planned. The institutional arrangements of communities of interest for prices at all levels of government will remain the same as in 1981. Also as in 1981, the basic criteria for assessing price increases are the relationship between supply and demand on the domestic market, the level of international prices and costs, labor productivity, and the distribution of income between industrial branches. In the Law on Prices in 1982, greater emphasis will be given to world prices in the formation of domestic prices. Precise price targets, consistent with the overall objective of a 15 per cent increase in industrial producer and retail prices over the year to December 1982, are to be set for 33 industrial branches. These are averages rather than ceilings, and some price increases may exceed them. Turnover taxes and subsidies may be adjusted to limit price increases, especially for key items in the cost of living; such changes would be within the budget constraints of the governments making them.

Prices policy takes the form of guidelines for prices; it therefore falls short of price controls, and cannot ensure that the 15 per cent target for inflation will be met. On the other hand, its flexibility in application will permit changes in relative prices. Such changes have a particularly important role to play in the medium-term strategy.

5. Investment planning

Although real fixed investment is planned to fall in 1982 for the third year in succession, it will still absorb about 30 per cent of GSP. To ensure that it contributes significantly to the restructuring of the economy, priorities have been defined and will be reflected in the allocation of credit and the authorizations for capital goods imports. Over the remaining four years of the Medium-Term Plan period, 75 per cent of investment funds are now to be devoted to the priority sectors, compared with 63 per cent in the original Plan. Greater emphasis is being placed in the revised Plan on investment in sectors that produce tradable goods and, to a lesser extent, agriculture and foreign tourism; and less emphasis on cement, chemicals, and other raw materials, and transportation. Investment in domestic energy sources, although it still has high priority, is not now planned to grow so rapidly, because of the lower projected rate of growth of output than in the original Plan and the success of energy conservation policies over the last two years.

6. External sector policies

The target for the balance of payments current account deficit in 1982 is US\$500 million, equivalent to 0.8 per cent of planned GSP, compared with an estimated outturn of US\$1,280 million (2.0 per cent of GSP) in 1981 (Table 4). It is expected that all of this deficit will be with respect to the convertible currency area, with which the deficit in 1981 was an estimated US\$1,620 million (Table 5). To achieve this improvement, total exports of goods are planned to grow by about 8.5 per cent in volume; exports of goods to the convertible currency area are planned to grow considerably faster, by 12 per cent in volume. A modest increase in the volume of imports is planned. Net invisibles are projected to increase by 25 per cent in current U.S. dollars, with the most rapid growth occurring in receipts from tourism.

The restraint of domestic demand will contribute to the achievement of these targets for the current account, as will those policies aimed at moving resources into the tradable goods sector. The exchange rate is an important instrument here. The depreciation of the dinar in terms of the Yugoslav currency basket by 20 per cent during the six months up to January 29, 1982 has improved competitiveness and will stimulate exports and import substitution during 1982. From the end of November 1981 to January 29, 1982 there was a 10 per cent depreciation. During the remainder of 1982 the authorities will continue to adjust the exchange rate to ensure that the economy remains sufficiently competitive. Adjustments will normally be made monthly, on the basis of expected developments in relative costs and prices and export performance.

The priority that is given to exports is also reflected in a number of specific measures for 1982, including the requirement that enterprises prepare specific export programs and the granting of priority for exports in the allocation of credit. Consideration is being given to expanding other export incentives, such as duty drawbacks. On the import side, priority will be given to imports of intermediate goods, especially those needed by export industries. The share of capital goods in imports will decline in response to the fall in fixed investment.

With a view to reducing external debt exposure, and in the light of current difficulties in foreign borrowing, a considerable reduction in borrowing is planned for 1982 compared with 1981. Furthermore, the structure of debt is to be altered, with short-term debt being substantially reduced. Net medium- and long-term financial credits, excluding purchases from the Fund, are planned to be US\$942 million during the year (Table 4). As in 1981, the National Bank of Yugoslavia will undertake the larger part of this borrowing. Taking account also of suppliers' credits, the stock of outstanding foreign medium- and long-term convertible debt (excluding net purchases from the Fund) is planned to increase by US\$460 million, compared with about US\$1 billion in 1981 (Table 5). Taking into account the seasonal pattern of disbursements and repayments, a ceiling of US\$700 million has been set on the growth in this convertible currency debt for the period up to the end of June 1982; thereafter such debts will decline, and a ceiling of US\$500 million has been set on the increase during the whole of 1982. These ceilings are incorporated as performance criteria in the stand-by arrangement. It is planned to reduce the outstanding short-term debt to the convertible currency area by US\$500 million. The authorities consider the level of gross official reserves to have reached a satisfactory level by the end of 1981, and hence plan no further reserve accumulation during 1982. The expected overall balance of payments deficit of about US\$600 million would therefore be financed by net purchases from the Fund.

In 1981 a large number of commodities was moved onto the liberalized import list. As indicated in the attached letter, the authorities intend to continue with the policy of import liberalization as the balance of payments improves.

7. Performance criteria

There are three quantitative performance criteria for 1982, relating to the stock of domestic bank credit, credits from the National Bank of Yugoslavia to the budget of the Federation, and the stock of outstanding medium- and long-term external convertible currency debt (Table 11). There was also a fourth performance criterion in the program for 1981, namely, the net convertible foreign assets of the National Bank of Yugoslavia. This did not provide the intended guide to exchange rate policy; it proved relatively easy to satisfy the criterion, independently of the actual exchange rate. The authorities have recently taken action to improve competitiveness through a significant depreciation, and they are firmly committed to a program for 1982 of monthly adjustments to the

exchange rate to maintain competitiveness. The definition of external debt that is the subject of a performance criterion in 1982 is wider than that in 1981, in that it includes compensatory borrowing by the commercial banks, which was included in the ceiling on the net convertible foreign assets of the National Bank of Yugoslavia in the 1981 program.

8. Mid-year review

In the attached letter of intent, the Yugoslav authorities say that in the middle of 1982 they will review with the Fund economic developments in the first part of the year, including the evolution of prices and the balance of payments, and the prospects for the remainder of the year. The review is to pay special attention to the role of the exchange rate, interest rates, and credit policies, with a view to making any adjustments that prove to be necessary for the achievement of the objectives of the program.

9. Staff appraisal

Developments in 1981, changed prospects for the future, and a more cautious attitude of the authorities toward sustained balance of payments current account deficits necessitated a significant revision of the Medium-Term Plan for 1981-85. The revised Plan envisages the elimination of the current account deficit in 1983 and the achievement of balance or small surpluses in the remaining two years, a reduction in inflation to single digits by 1984, and a lower rate of growth of real GSP. The authorities are determined to reduce significantly their reliance on foreign borrowing and to increase the mobilization of domestic resources to support their investment program. The growth of investment expenditures has been revised downward but the share of investments to be directed to priority sectors has been increased significantly. The planned increase in productive capacity should be such as to absorb the increase in the labor force. The authorities intend to continue with their policies of fiscal and monetary discipline and to influence wages and prices so that the reduced domestic demand will have a greater impact on inflation than on output and employment. The planned growth in real GSP is to be supported mainly from the expansion of exports, which are projected to increase by 10 per cent a year from 1982 to 1985.

The Annual Plan for 1982 described in the attached letter of intent has been formulated in the context of the revised Medium-Term Plan. The objectives of reducing the current account deficit of the balance of payments to US\$0.5 billion and the rate of inflation to 15 per cent are ambitious but realizable. In the staff's view, they are appropriate for Yugoslavia in present circumstances. The improvement in the balance of payments depends critically on the achievement of an increase of 8.5 per cent in the volume of total exports, and one of 12 per cent in exports to the convertible currency area. This may prove difficult given the world demand situation but the further reduction in real domestic demand, no increase in real wages, the implementation of an active exchange rate

policy, the impressive recovery of exports to the convertible currency area in the second half of 1981, and the export drive of enterprises, show that all available means are being used with some success already. The staff believes that the prospects for achieving the balance of payments target are favorable.

The reduction in the rate of inflation from 39 per cent during 1981 to 15 per cent during 1982 is, by any standards, a difficult target to achieve, but Yugoslavia is in a unique situation. The public sector is planned to be in surplus, credit policy will continue to be tight, interest rates have been increased, real wages and real domestic demand will not rise, and generalized excess demand has by now been removed. Furthermore, there will be no break in the continuity of price and incomes policies, such as occurred in late 1980 and early 1981 and contributed to the burst of inflation then. However, enterprises will be under some pressure, especially in the first part of 1982, from higher import costs, increased interest rates, and the effects of low capacity utilization on unit production costs. The next six months or so are therefore critical from the point of view of breaking the momentum of inflationary expectations. Developments in the second half of 1981 and the determination of the authorities to continue their counterinflationary policies suggest that the 15 per cent inflation target can be achieved. Moreover, it should be able to accommodate necessary changes in relative prices.

The major upward revision in the level of interest rates in 1982 represents a significant change in the attitude of the authorities toward the role of interest rates, following very little change in the prevailing low interest rates for many years. The staff welcomes this move as a step, but only a first step, toward an interest rate structure that will give the appropriate signals and incentives to the investment and saving decisions of enterprises and households. The authorities are reluctant to increase interest rates by large amounts in a short period, but they will keep interest rate policy under continuous review, and adapt it to the changing needs of the economy. The review of the program that is to take place in the middle of 1982 will provide a further opportunity to assess whether additional increases are necessary.

The program for 1982 represents a continuation and a strengthening of that for 1981. Monetary policy is tighter, both because real interest rates are less negative and because no easing of what turned out to be very tight credit conditions at the end of 1981 (much tighter than intended in the 1981 program) is to be permitted in 1982. Real wages are not going to rise, despite the fact that there was an unplanned fall of 6 per cent in 1981, following a fall of 7 per cent in 1980. The exchange rate will be adjusted continuously so as to maintain the competitive position of the economy. The planned reduction in the balance of payments current account deficit of US\$0.8 billion, following a reduction of US\$1.0 billion in 1981, represents a greater adjustment effort than was envisaged when the current three-year stand-by arrangement was formulated. The continued firm implementation of the stabilization program for another year will intensify the pressure on enterprises and

other economic agents to adjust, and thus improve on the favorable results that began to appear in the second half of 1981. Much of the room for avoiding adjustment by for example increasing inter-enterprise credit, is now thought to have been taken up, and any remaining hope among enterprises that the authorities will soon reverse stabilization policies, as has happened before, is evaporating.

The authorities are well aware that such a strong program requires a persistent political will to execute it. They have therefore been mobilizing public opinion in support of it, and explaining why it is necessary. The result is that there is widespread acceptance of the program, not only at the Federal level, but also in the republican and provincial governments and enterprises. There is no doubt of the authorities' determination to see the program through to a successful conclusion. The success of the medium-term Plan as a whole depends critically on the outcome of the program in 1982.

The policies summarized in the attached letter of intent and the determination of the authorities to implement them fully provide assurances that the program's objectives will be achieved. In the staff's view, the 1982 program warrants the Fund's support. The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Yugoslavia has consulted in accordance with paragraph 3(b) of the stand-by arrangement for Yugoslavia (EBS/81/5, Supplements 2, (2/2/81) and 3 (8/27/81)) in order to establish performance criteria subject to which purchases may be made by Yugoslavia during the second year of the stand-by arrangement.
2. The letter from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance of Yugoslavia, dated January 25, 1982, setting forth the policies and measures which the authorities of Yugoslavia will pursue for the second year of the stand-by arrangement, shall be annexed to the stand-by arrangement for Yugoslavia, and the letter of January 15, 1981, annexed to the stand-by arrangement, shall be read as supplemented by the letter of January 25, 1982

3. Yugoslavia will not make any purchase under the stand-by arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of its currency resulting from purchases of supplementary financing beyond 12.5 per cent of quota during any period in the second year of the stand-by arrangement in which:

- a. the limits on outstanding domestic credit of the banking system, referred to in the penultimate sentence of paragraph 10 of the annexed letter have been exceeded; or
- b. there has been an increase in credit by the National Bank of Yugoslavia to the Budget of the Federation, as mentioned in the last sentence of paragraph 10 of the annexed letter; or
- c. the limits on foreign debt mentioned in the last sentence of paragraph 14 of the annexed letter have not been observed.

4. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 138.5 million until May 15, 1982, the equivalent of SDR 277 million until August 15, 1982, and the equivalent of SDR 415.5 million until November 15, 1982.

Fund Relations with Yugoslavia 1/

Membership:	Yugoslavia is an original member of the Fund. It continues to avail itself of the transitional arrangements under Article XIV.
Quota:	SDR 415.5 million
Use of Fund credit:	Total outstanding purchases SDR 1,075.5 million, including SDR 277.0 million under CFF, SDR 8.3 million under the Oil Facilities, SDR 392.2 million under the credit tranches and SDR 398.0 million under the Supplementary Financing Facility.
Fund holdings of dinars:	SDR 1,491.0 million, or 358.9 per cent of quota; 194.4 per cent of quota excluding holdings related to CFF, Oil Facility, and SFF.
Current arrangement:	Stand-by program covering a period of three years from January 30, 1981 in the amount of SDR 1,662 million (400 per cent of quota), of which SDR 1,357.8 million is being provided under the Supplementary Financing Facility. (SDR 554 million had been purchased by end-December 1981.)
SDR position:	Net cumulative allocations amount to SDR 155.2 million. Holdings amount to SDR 71.9 million or 46.3 per cent of net cumulative allocations.
Gold distribution:	Received 177,144 fine ounces of gold in the four phases. Received profits amounting to US\$32.9 million in the three distributions; US\$11.0 million has been transferred to the Trust Fund.
Last consultation:	<p>The Staff Report for the 1980 Article IV Consultation with Yugoslavia (SM/80/119, 5/20/80) was considered by the Executive Board at EBS/80/114, 6/6/80). The Executive Board's decision on the 1980 consultation with Yugoslavia (Decision No. 6513 - (80/86), adopted June 6, 1980) was as follows:</p> <p>1. The Fund takes this decision in concluding the 1980 Article XIV consultation with Yugoslavia in the light of the 1980 Article IV consultation with Yugoslavia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).</p>

1/ Position as of January 25, 1982.

2. The Fund notes that the exchange and trade system has remained basically unchanged since the last Article IV consultation. It hopes that the planned improvement in the balance of payments will permit a continuation of progress made in recent years in reducing the complexity and restrictions of the exchange system. The Fund welcomes the ratification of the termination of the only remaining bilateral payments agreement with a Fund member.

Exchange rate
system:

The currency of Yugoslavia is the Yugoslav dinar. The authorities do not maintain the exchange rate of the dinar within announced margins and, therefore, all transactions, with the exception of those affected under the procedures set forth for certain countries with which Yugoslavia has bilateral payments agreements, take place at a fluctuating exchange rate. However, the authorities intervene in the foreign exchange markets, when necessary, to ensure orderly conditions and to smooth out fluctuations in exchange rates. The buying and selling rates for the U.S. dollar in the foreign exchange market in Belgrade on January 20, 1982 were Din 43.1695 and Din 43.2992, respectively, per US\$1. rates are quoted for certain other currencies.

Belgrade, Yugoslavia

January 25, 1982

Dear Mr. de Larosière:

1. At the beginning of the second year of Yugoslavia's three-year stabilization program, in support of which we requested the three-year stand-by arrangement from the Fund, we are writing to describe the progress made in the implementation of the 1981 annual plan and to set out the aims and policies incorporated in our annual plan for 1982. This is in accordance with our letter of January 15, 1981 to you in which it was said that the Yugoslav authorities would consult with the Fund and reach understandings at about this time on the program for the second year of the stand-by arrangement.

2. The stabilization measures of 1981 have already produced some favorable results. In particular, aggregate real domestic demand, after falling somewhat in 1980, showed a further significant decline in 1981. Generalized excess demand has now been removed. The balance of payments current account deficit reached a peak in 1979 of US\$3.7 billion, equivalent to 6 per cent of gross social product. In 1981 it is estimated at US\$1.3 billion, about the same level as in 1978. The improvement in the current account on all items other than energy imports and interest payments was US\$3.8 billion between 1978 and 1981, equivalent to 6 per cent of GSP. Merchandise exports in terms of U.S. dollars rose in 1981 by 15 per cent on a global basis and 10 per cent to the convertible currency area, despite sluggish world demand and protectionist measures abroad. Merchandise imports increased by 3 per cent. The decline in real domestic demand and exchange rate policy were mainly responsible for these results.

3. Unfortunately, inflation has taken some time to respond to the stabilization measures. Despite the fall in real domestic demand and the deceleration of money and credit growth, the sharp rise in inflation toward the end of 1980 was continued into the first few months of 1981. While there was some need for relative price changes the process led to an excessive rise in the general price level. Measures were therefore taken in the middle of the year, aimed at reducing the rise in prices in the remainder of the year. Limits placed on the price increases of enterprises helped to reduce the annualized rate of increase of the retail price index to 23 per cent in the six months to December 1981, compared with over 50 per cent in the preceding six months.

4. The five-year Plan covering the years 1981 to 1985 has been revised in the light of developments in 1981 and prospects for the remaining period. It now envisages the elimination of the balance of payments current account deficit by 1983, two years earlier than in the original Plan, and surpluses in the remaining two years. The Federal Executive Council intends to reduce Yugoslavia's dependence on foreign borrowing as quickly as possible. A rapid reduction in inflation is also planned, with single digits being reached in 1984 if not earlier. To achieve these objectives, domestic demand will be restrained throughout the Plan

period, price and incomes policies will continue to be restrictive, and realistic exchange rate and interest rate policies will be actively pursued. The aim is to increase the mobilization of resources to support investment and to allocate them more efficiently. In particular, it is planned that resources should move into the production of tradeable goods and services, so that much of the real growth in the economy will come from the growth of exports and import substitution. This shift of resources will occur despite the downward revision of investment expenditure in the Plan, because priority areas have been more clearly defined and are to receive a larger share of investment funds. Moreover, current investment policies in the individual Republics and Provinces are now more closely related to the medium-term development strategy than was the case in previous Plan periods.

5. We are under no illusion that the adjustment will be easy, and the next year is likely to be extremely difficult. Indeed, considerable hardships have already been experienced; real personal incomes per employee have declined for two consecutive years. In ordinary circumstances the Federal Executive Council would come under increasing pressure to ease policies. On this occasion, however, steps have been taken to explain fully the need for the present course of action and to mobilize support for it throughout the country.

6. The major objectives of our economic program for 1982 are to decrease the current account deficit of the balance of payments, primarily by means of a strong expansion of exports, and to reduce sharply the rate of inflation, while at the same time maintaining the growth of production. Inflationary pressures will be restrained by policies of financial discipline, and growth and employment will be promoted within the overall financial constraints by policies that limit increases in prices and nominal personal incomes. All these policies, together with a flexible exchange rate policy, will contribute also to the achievement of the balance of payments targets.

7. Real final domestic demand is to decline by 2 per cent in 1982 as a result of no change in private consumption, a further reduction in public consumption, and a fall of 6 per cent in fixed investment. Real GSP is planned to rise by 2.5 per cent. The decline in final domestic demand components compared with the growth of domestic production permits an improvement in the current account of the balance of payments. The volume of imports of goods and services is expected to fall further by 2.2 per cent and that of exports of goods and services to rise by 8.5 per cent.

8. In the year to December 1982 the increase in the retail price index will be limited to 15 per cent. The price policies pursued in the second half of 1981 will continue to be firmly implemented. In particular, price increases in key sectors will be closely monitored to ensure that there is no sudden upsurge in prices as occurred at the beginning of 1981. Greater emphasis will be given to world prices in the formation of domestic prices. As in the preceding two years, incomes policy in 1982

will be directed toward keeping the growth of personal incomes below that of enterprise incomes and GSP. In 1981 the growth of nominal personal income payments is estimated to be 7 percentage points below that of nominal GSP. For 1982 no increase in real personal incomes per employee is envisaged, despite the fact that they declined by 7 per cent in 1980 and by a further 6 per cent in 1981, and some growth in labor productivity is expected.

9. Fiscal policy in 1982 will continue to be restrictive. The share of public sector expenditure in GSP fell in 1981 and will fall further in 1982. It is planned that the Budget of the Federation will be in balance in 1982, compared with a deficit in 1980 equivalent to 1.3 per cent of GSP, the largest for four years, and an estimated deficit in 1981 of 0.1 per cent of GSP. The budgets of other levels of government and of communities of interest and other organizations providing public services are expected to be in surplus as usual.

10. The main instrument of monetary policy in 1982 will continue to be the direct control of bank credit. As a result of the strict control over credit expansion in 1981, despite the much higher inflation rate than expected, the velocity of circulation of money rose to a relatively high level, liquidity difficulties emerged, and organizations of associated labor (OALs) allowed trade credit to increase sharply. These phenomena have occurred in previous periods of monetary restraint and they have even caused the authorities to ease the stance of policy. On this occasion, however, no relaxation is being permitted. Money and quasi-money is estimated to grow at 17 per cent, excluding any increase due to the revaluation of foreign currency deposits, over the year to the end of 1982. This is a lower rate of growth than the 18 per cent at which nominal income is expected to grow. On October 31, 1981, outstanding domestic credit of the banking system was Din 1,873 billion and on December 31, 1981 is estimated to be Din 1,913 billion. Such credits, excluding any increase due to the revaluation of the stock of foreign currency credits at the end of December 1981, will not exceed Din 1,996 billion during the first quarter of 1982, Din 2,076 billion during the second quarter, Din 2,159 billion during the third quarter, and Din 2,247 billion during the fourth quarter. There will be no increase in National Bank of Yugoslavia credit to the Budget of the Federation during 1982, as the budget will be in balance.

11. A more active interest rate policy is being implemented in order to rationalize the use of financial resources and encourage savings. The first major step was taken in January 1982 when the discount rate of the National Bank of Yugoslavia was raised from 6 per cent to 12 per cent, and the interest rates on selective credits from 1-3 per cent to 4-6 per cent. In line with the higher National Bank rates, the commercial banks will raise their deposit and lending rates not later than March 1982. The interest rates on households' time deposits of one year and over are to be raised from 9-10 per cent to 11-15 per cent. We intend to keep interest rate policy under continuous review and adapt it to the changing needs of the economy.

12. The balance of payments policy for 1982 is to reduce further the current account deficit and to maintain an adequate level of international reserves. These increased to a relatively comfortable level in 1981, although there were some foreign borrowing difficulties, and are now adequate for meeting any unexpected developments in the balance of payments. The export targets for 1982 are ambitious; but all the necessary measures, including the preparation of specific export programs at the level of OALs, have been taken and we shall implement them with determination. On the import side, the policy measures are expected to change the composition of imports in favor of raw materials and intermediate goods which are needed to support the planned production targets. Net receipts from invisibles are expected to increase. In global terms, for 1982, the volume of exports is planned to increase by 8.5 per cent, the volume of imports will show some increase, and the current account deficit will be confined to US\$500 million. Although there may be some fall in gross reserves in the first part of 1982 as a result of seasonal factors, over the year as a whole they are expected to remain unchanged.

13. Exchange rate policy has been active in recent months. Between the end of November 1981 and January 1982, the dinar depreciated by 11 per cent in terms of a currency basket, following a depreciation of 13 per cent in the previous five months. We shall continue to alter the exchange rate to ensure that the economy remains sufficiently competitive. In particular, it will be adjusted monthly in 1982 on the basis of expected developments in relative costs and prices and exports.

14. The foreign borrowing policy is to reduce reliance on external financing, improve the debt structure, and contain debt service payments to a manageable level. The net foreign borrowing by the banking system, excluding net purchases from the Fund, is estimated at US\$442 million in 1982. This incorporates a reduction of US\$500 million in short-term foreign liabilities of the commercial banks which is important in order to bring short-term indebtedness to a normal level. Outstanding foreign debts (excluding net purchases from the Fund), repayable in convertible currencies and with an original maturity of over one year, will not be allowed to increase from their level at the end of December 1981 by more than US\$700 million during the period up to the end of June 1982; thereafter such debts will decline, and the increase from the end of December 1981 to the end of December 1982 will be limited to US\$500 million.

15. Exchange restrictions on imports were substantially reduced in 1981 by shifting a large number of commodities to the liberalized list. It is our intention to continue with this policy as the balance of payments situation improves. Plans will be made to expand and improve the operations of the foreign exchange market as a mechanism for mobilizing and allocating foreign exchange. We also plan to enhance the efficiency with which the international reserves of the National Bank and the commercial banks are utilized. The long-term objective is to establish the external convertibility of the dinar.

16. In the middle of 1982, we shall review with the Fund economic developments in the first part of the year, including the evolution of prices and the balance of payments, and the prospects for the remainder of the year. Special attention will be given to the role of the exchange rate, interest rates, and credit policies, with a view to making adjustments that prove to be necessary.

Radovan Makić
Governor, National Bank
of Yugoslavia

Ing. Petar Kostić
Federal Secretary
for Finance

Table 1. Yugoslavia: Drawings Under
the Stand-By Arrangement

	First year (Feb. 1981- Jan. 1982)	Second year (Feb. 1982- Jan. 1983)	Third year (Feb. 1983- Jan. 1984)	Total
Amount available				
In millions of SDRs	554	554	554	1,662
In per cent of quota	133	133	133	400
Amount drawn				
In millions of SDRs	554	--	--	554
In per cent of quota	133	--	--	133
Amount undrawn				
In millions of SDRs	--	554	554	1,108
In per cent of quota	--	133	133	267

Source: International Monetary Fund, Treasurer's Department.

Table 2. Yugoslavia: Fund Position

	December 31, 1981 1/		December 31, 1982 projection 2/	
	In millions of SDRs	In per cent of quota	In millions of SDRs	In per cent of quota
Holdings relating to:				
Oil facility	8.34	2.0	3.82	0.9
Compensatory financing facility	277.00	66.7	242.38	58.3
Supplementary financ- ing facility	397.95	95.8	928.67	223.5
Regular resources	392.21	94.4	415.50	100.0
Total	1,075.50	258.8	1,590.37	382.8

Source: International Monetary Fund, Treasurer's Department.

1/ This position was unchanged from December 31, 1981 through February 6, 1982.

2/ It is assumed that Yugoslavia will purchase the maximum sum permitted during the second year of the stand-by arrangement, SDR 554 million, before the end of 1982 (SDR 23.3 million from the Fund's ordinary resources and SDR 530.7 million from the supplementary financing facility).

Table 3. Yugoslavia: Main Variables

	1979	1980	1981		1982
	Actual		Proj.	Est.	Proj.
Increase over previous year (in per cent)					
Real GSP	7.0	2.4	3.2	2.2	2.5
Real final domestic demand	5.7	-0.3	-0.5	-2.2	-2.1
Real wage	--	-7.0	1.3-1.5	-6.0	--
GSP deflator	21	31	20	40	20
Increase during year (in per cent)					
Retail prices	24	39	20-25	39	15
Nominal wages	24	28	...	37	...
Effective exchange rate <u>1/</u>	-5.8	-30.0	...	-22.6	...
Money supply	19.0	23.0	21.9	23.5	16.9
Domestic credit	26.9	28.8	22.4	22.0	17.4 <u>2/</u>
Ratios to GSP (in per cent)					
Federal budget balance	-0.3	-1.3	-0.1	-0.1	0.1
Balance of payments current account	-6.0	-3.6	-2.5	-2.0	-0.8
Convertible currency debt <u>3/</u>	21.1	25.6	28.0	26.9	27.1

Sources: Tables 4 to 9; and data supplied by the Yugoslav authorities.

1/ Delivered in terms of the Yugoslav currency basket.

2/ Excluding any increase resulting from the revaluation of the initial stock of foreign currency credit.

3/ All short-, medium-, and long-term debt, excluding the International Monetary Fund, at the end of the year.

Table 4. Yugoslavia: Summary Balance of Payments, 1978-82

(In millions of U.S. dollars)

	1978	1979	1980	1981		1982
				Pro- jected <u>1/</u>	Latest estimate	Projected
A. Goods, services, and unrequited transfers	-1,283	-3,661	-2,291	-1,800	-1,280	-500
Exports, f.o.b.	5,809	6,794	8,978	10,550	-10,350	12,600
Imports, c.i.f.	-10,439	-14,019	-15,064	-16,530	-15,560	-18,033
Trade balance	-4,630	-7,225	-6,086	-5,980	-5,210	-5,433
Services and unrequited transfers (net)	3,347	3,564	3,795	4,180	3,930	4,933
Receipts	6,260	7,482	9,322	9,680	11,085	12,358
Of which:						
Workers' and emigrants' remittances	(2,950)	(3,393)	(4,050)	(4,280)	(4,820)	(5,100)
Travel	(1,130)	(1,183)	(1,645)	(1,800)	(1,975)	(2,500)
Payments	-2,913	-3,918	-5,527	-5,500	-7,155	-7,425
Of which: Interest	(-420)	(-821)	(-1,281)	(-1,450)	(-1,979)	(-2,165)
B. Medium- and long-term capital (net) <u>2/</u>	1,600	1,327	1,924	1,850	759	140
Loans received (net)	1,706	1,452	2,145	2,100	1,009	410
Drawings	3,146	3,154	4,151	4,242	3,220	2,800
Repayments	-1,440	-1,702	-2,006	-2,142	-2,211	-2,390
Loans extended (net)	-106	-125	-221	-250	-250	-270
C. Bilateral balances	-65	742	354	300	-500	70
D. Short-term capital (net) <u>2/</u>	82	218	739	-713	11	-500
E. Allocation of SDRs	--	37	37	38	38	--
F. Errors and omissions	37	-9	-935	-25	577	198
G. Total (A through F)	371	-1,346	-172	-350	-395	-592
H. Reserve movements (increase -)	-371	1,346	172	350	395	592
Use of Fund credit (net)	-21	213	304	650	550	592
SDRs	-7	-34	41			
Reserve position in the Fund	-81	81	--			
Gold	-5	-4	-5	-300	-155	--
Official foreign exchange	-257	1,085	-168			
Memorandum item:						
Current account deficit as percent- age of gross social product	2.6	6.0	3.6	2.5	2.0	0.8

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

1/ As contained in EBS/81/5 (1/16/81).

2/ Includes borrowing by the banking system.

Table 5. Yugoslavia: Summary Balance of Payments with the Convertible Currency Area, 1978-82

(In millions of U.S. dollars)

	1978	1979	1980	1981		1982
				Pro- jected <u>1/</u>	Latest estimate	Projected
A. Goods, services, and unrequited transfers	-1,272	-3,304	-2,204	-1,500	-1,620	-500
Exports, f.o.b.	3,971	6,766	5,656	7,050	6,230	7,730
Imports, c.i.f.	-8,373	-11,336	-11,321	-12,345	-11,540	-12,885
Trade balance	-4,402	-6,570	-5,666	-5,295	-5,310	-5,155
Services and unrequited transfers (net)	3,130	3,266	3,462	3,795	3,690	4,655
Receipts	5,984	7,104	8,875		10,655	11,908
Payments	-2,854	-3,838	-5,413		-6,965	-7,253
B. Medium- and long-term capital (net) <u>2/</u>	1,386	1,212	1,830	1,825	764	210
Loans received (net)	1,483	1,335	2,065	2,075	999	460
Drawings	2,819	2,903	3,909	4,037	3,060	2,650
Repayments	-1,336	-1,568	-1,844	-1,962	-2,061	-2,190
Loans extended (net)	-97	-123	-235	-250	-235	-250
C. Short-term capital (net) <u>2/</u>	82	218	739	-713	11	-500
D. Allocation of SDRs	--	37	37	38	38	--
E. Errors and omissions	175	491	-575	--	412	198
F. Total (A through E)	371	-1,346	-172	-350	-395	-592
G. Reserve movements (increase -)	-371	1,346	172	350	395	592
Use of Fund credit (net)	-21	218	304	650	550	592
SDRs	-7	-34	41)))
Reserve position in the Fund	-81	-81	--)))
Gold	-5	-4	-5)	-300)
Official foreign exchange	-257	1,085	-168)))

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

1/ As contained in EBS/81/5 (1/16/81).

2/ Includes borrowing by the banking system.

Table 6. Yugoslavia: Foreign Trade Developments 1978-82

	1978	1979	1980	1981			1982
				Jan.-Dec. Proj. 1/	Jan -June Actual	July-Oct. Actual	
				Nov. Est.	Jan.-Dec. Est.	Proj.	
(In millions of U.S. dollars)							
Exports							
Convertible area	3,971	4,766	5,656	7,050	2,851	591	7,730
Nonconvertible area	1,838	2,028	3 322	3,500	2,048	368	4,870
Total	5,809	6,794	8,978	10,550	4,899	959	12,600
Imports							
Convertible area	8,373	11,336	11,321	12,345	6,455	768	12,885
Nonconvertible area	2,066	2,683	3,743	4,185	1,999	277	5,148
Total	10,439	14,019	15,064	16,530	8,454	1,045	18,033
(Percentage change over corresponding period of previous year)							
Exports							
Convertible area	12.2	20.0	18.7	24.6	-0.3	27.4	24.1
Nonconvertible area	11.3	10.3	63.8	5.4	64.6	9.0	18.2
Total	11.9	16.9	32.1	17.5	19.4	19.4	21.7
Imports							
Convertible area	10.2	35.4	-0.1	9.0	12.9	-9.0	11.7
Nonconvertible area	-5.6	29.9	39.5	11.8	21.7	-4.0	28.1
Total	6.6	34.3	7.4	9.7	14.9	-6.5	15.9

Source: Data provided by the Yugoslav authorities.

1/ As in EBS/81/5 (1/16/81).

Table 7. Yugoslavia: Budget of the Federation
(In billions of dinars)

	1979	1980	1981		1982
			Proj. 1/	Est. 2/	Proj. 3/
Revenue					
Customs duties and other import fees	24.6	20.7	35.4	21.0	30.3
Contributions from republics and provinces	28.4	38.5	52.6	63.8	80.4
General turnover and sales taxes	37.7	47.4	73.4	73.4	88.9
Other taxes	0.1	0.2	0.2	0.2	0.6
Nontax revenues	<u>2.7</u>	<u>2.5</u>	<u>2.9</u>	<u>2.9</u>	<u>3.6</u>
Total revenue	93.6	109.4	164.5	161.3	203.9
Expenditure					
Administration	15.2	18.6	21.4	20.2	24.6
Defense	55.1	76.1	101.9	100.0	122.7
Grants to republics and provinces	10.5	14.3	16.3	16.0	20.8
Grants to funds and communities of interest	14.8	18.7	25.2	24.9	30.9
Investment	0.7	0.8	0.2	0.9	0.3
Other and discrepancy	<u>1.0</u>	<u>1.2</u>	<u>0.5</u>	<u>1.4</u>	<u>2.2</u>
Total expenditure	97.3	129.7	165.6	163.4	201.5
Surplus or deficit	-3.7	-20.3	-1.1	-2.1	2.4
(as per cent of GSP)	(-0.3)	(-1.3)	(-0.1)	(-0.1)	(0.1)
Financing, net domestic: total 4/	<u>3.7</u>	<u>20.3</u>	<u>1.1</u>	<u>2.1</u>	<u>-2.4</u>
Bond issues	--	13.3	--	--	--
National Bank credits	8.5	9.2	4.6	4.6	--
Repayment of bank credits	-1.7	-0.7	-3.0	-2.0	-1.6
Bond amortization	-2.9	-1.3	-0.2	-0.2	-0.5
Allocation to budgetary reserves	-0.2	-0.2	-0.3	-0.3	-0.3

Source: Data supplied by the Yugoslav authorities.

1/ The preliminary budget estimates reported in EBS/81/5 (Corrected: 1/27/81).

2/ The revised estimates made in December 1981, following the decision to reduce expenditure by Din 2.2 billion and repayment of bank credits by Din 1.0 billion, with a corresponding downward revision to revenue.

3/ From the Resolution for the Annual Plan for 1982.

4/ There was no external financing of the budget.

Table 8. Yugoslavia: Monetary Survey

	Net Foreign Assets	Domestic Credit <u>1/</u>	Money Supply <u>2/</u>	Quasi- money <u>3/</u>	Other Items (net)
Stock in billions of dinars					
at end of:					
1979	-112.0	1,217.7	375.2	575.9	154.6
1980	-257.3	1,568.3	461.6	785.5	63.9
1981					
First quarter	-283.2	1,661.5	477.2	827.6	73.5
Second quarter	-335.5	1,750.8	506.0	870.6	38.7
Third quarter	-343.9	1,831.0	545.6	941.8	-0.3
Estimates and projections					
made in January 1981:					
1980					
Fourth quarter estimate	-194.0	1,538.0	465.0	879.0	
1981					
First quarter projected	-208.0	1,634.0	484.0	942.0	
Second quarter projected	-218.0	1,717.0	507.0	992.0	
Third quarter projected	-225.0	1,797.0	537.0	1,035.0	
Fourth quarter projected	-240.0	1,883.0	567.0	1,076.0	
Estimates and projections					
made in January 1982:					
1981					
Fourth quarter estimate	-364.6	1,913.3	570.0	1,021.0	-42.3
1982					
First quarter projected	-394.6	2,000.3	588.0	1,064.0	-46.3
Second quarter projected	-409.6	2,084.3	611.0	1,118.0	-54.3
Third quarter projected	-419.6	2,171.3	640.0	1,173.0	-61.3
Fourth quarter projected	-436.6	2,264.3	666.5	1,240.0	-78.8
Change during 1982 in billions					
of dinars:					
Flow <u>4/</u>	-34.0	333.4	96.5	172.5	30.4
Revaluation of initial stock	-38.0	17.6	--	46.5	-66.9
Total	-72.0	350.0	96.5	219.0	-36.5
Change during 1982 as per					
cent of initial stock:					
Flow	9.3	17.4	16.9	16.9	
Total	19.7	18.3	16.9	21.4	

Source: Data supplied by the Yugoslav authorities.

1/ Comprises bank loans extended in both dinars and foreign currencies to domestic clients, including the Government, and investment in securities. The concept of domestic credit used for the estimates and projections made in January 1981 is slightly narrower than that shown in the other rows, because it excludes lending by the Post Office Savings Bank and the fund for financing trade. There is an offsetting adjustment in other items (net). The actual outturn on the basis of this concept was (in billions of dinars): Domestic credit: 1980, fourth quarter, 1,554.5; 1981, first quarter, 1,644.6; second quarter, 1,733.1; and third quarter, 1,813.1; quasi-money and other items (net): 1980, fourth quarter, 835.8; 1981, first quarter, 884.2; second quarter, 891.6; and third quarter, 923.6.

2/ Includes government deposits and excludes items in transit.

3/ Comprises foreign exchange deposits of residents, other sight deposits, time deposits, restricted deposits, securities issued by banks, and claims on banks in respect of pooled resources.

4/ The foreign currency components are converted to dinars at the assumed average exchange rate in 1982.

Table 9. Yugoslavia: National Accounts, Incomes, and Prices

(Percentage change from previous year)

	1979 Actual	1980	1981 Proj. <u>1/</u>	1981 Est.	1982 Proj. <u>2/</u>
National accounts (1980 prices)					
Private consumption	6.0	0.3	2.5	-1.0	--
Public consumption	7.9	1.6	0.7	-0.8	-0.2
Gross fixed capital formation	<u>4.6</u>	<u>-1.6</u>	<u>-5.3</u>	<u>-4.5</u>	<u>-6.0</u>
Final domestic demand	5.7	-0.3	-0.5	-2.2	-2.1
Stockbuilding and statistical discrepancy <u>3/</u>	<u>4.6</u>	<u>-2.4</u>	<u>0.5</u>	<u>-1.4</u>	<u>2.0</u>
Total domestic demand	9.2	-2.4	--	-0.6	0.1
Exports of goods and services	3.4	8.9	7.0	2.6	8.5
Imports of goods and services	<u>9.8</u>	<u>-10.0</u>	<u>-3.0</u>	<u>-7.7</u>	<u>-2.2</u>
Gross social product	7.0	2.4	3.2	2.2	2.5
Incomes					
Nominal gross social product	29	34	24	43	23
Nominal aggregate wages <u>4/</u>	26	24	...	37	22
Nominal wage <u>4/</u>	20	21	...	34	20
Real wage <u>4/</u>	--	-7	1.3-1.5	-6	--
Prices					
GSP deflator	21	31	20	40	20
Retail prices	22	30	...	46	20
Retail prices (growth during year)	24	39	20-25	39	15

Sources: Indeks; data supplied by the Yugoslav authorities; and staff estimates.

1/ Resolution for the Annual Plan for 1981.

2/ Resolution for the Annual Plan for 1982.

3/ The change in stockbuilding and the statistical discrepancy expressed as a percentage of GSP in the first year.

4/ Aggregate wages are equivalent to the official Yugoslav concept of total personal incomes from employment; the wage is equivalent to personal income per employee. These three rows refer to the socialized sector, which includes nonproductive activities and excludes individual workers.

Table 10. Yugoslavia: Quantitative Performance Criteria for First Year of Stand-By Arrangement

	Levels		Cumulative changes from		
	December 31, 1980		December 31, 1980 to:		
	Estimated	Actual	3/31/81	6/30/81	12/31/81
Net domestic assets of the banking system (in billions of dinars)					
Ceiling			96.0	179.0	259.0
Actual	1,538.0	1,554.5	90.1	178.6	258.6
Net credit of the National Bank to the budget of the Federation (in billions of dinars)					
Ceiling			4.6	4.6	4.6
Actual	77.9	78.7	4.6	4.6	4.6
Net convertible foreign assets of the National Bank <u>1/</u> (in millions of U.S. dollars)					
Ceiling			-150.0	-350.0	-550.0
Actual	-126.0	-338.0	-536.0
Convertible currency debt outstanding <u>2/</u> (in billions of U.S. dollars)					
Ceiling			...	1.0	...
Actual	14.1	14.3	...	0.9	1.7

Sources: Data supplied by the Yugoslav authorities; and ceilings from EBS/81/5 (1/16/81).

1/ Excludes medium- and long-term borrowing by the National Bank of Yugoslavia other than purchases from the Fund, and includes compensatory borrowing by commercial banks.

2/ Debt with original maturities of more than one year. Includes borrowing by the National Bank of Yugoslavia other than purchases from the Fund, and excludes compensatory borrowing by commercial banks.

Table 11. Yugoslavia: Quantitative Performance Criteria
for Second Year of Stand-By Arrangement

	Estimated level December 31, 1981	March 31, 1982	June 30, 1982	Sept. 30, 1982	Dec. 31, 1982
Domestic credit extended by banking system: maximum stock during quarter ended date shown (in billions of dinars)	1,913	1,996	2,076	2,159	2,247
Net credit of the National Bank to the budget of the Federation: maximum increase from December 31, 1981 to date shown (in billions of dinars)	83.3	--	--	--	--
Convertible currency debt outstand- ing 1/: maximum increase from December 31, 1981 to date shown (in billions of U.S. dollars)	15.9	0.7 2/	0.7 2/	...	0.5

Source: Data supplied by the Yugoslav authorities.

1/ Debt with original maturities of more than one year. Includes borrowing by the National Bank of Yugoslavia and commercial banks, other than net purchases from the Fund.

2/ This is the maximum increase during the whole period up to June 30, 1982.

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