FOR AGENDA

EBS/79/272

CONFIDENTIAL

May 11, 1979

To: Members of the Executive Board

From: The Acting Secretary

Subject: Yugoslavia - Use of Fund Resources - Compensatory Financing Facility

Attached for consideration by the Executive Directors is a report on a request expected to be received from Yugoslavia for a purchase equivalent to SDR 138.5 million. A draft decision appears on page 14.

This subject, the staff report for the 1979 Article IV consultation with Yugoslavia (SM/79/111, 4/30/79), and Yugoslavia's request for a stand-by arrangement (EBS/79/255, 4/30/79), have been tentatively scheduled for discussion on Wednesday, May 23, 1979.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Use of Fund Resources--Compensatory Financing Facility

Prepared by the Research and European Departments

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

Approved by Charles F. Schwartz and A. Pfeifer

May 10, 1979

The Managing Director has been informed that the authorities of Yugoslavia will shortly request a purchase of the equivalent of SDR 138.5 million (or 50 per cent of quota) under paragraphs 2, 3, and 4 of the compensatory financing decision. The request, which is the first by Yugoslavia under the compensatory financing decision, is being made with respect to an export shortfall for calendar year 1978. The proposed purchase under the compensatory financing facility, together with the proposed purchase under the reserve and first credit tranches, would raise the Fund's holdings of the Yugoslav dinar from 140.6 per cent to 237.4 per cent of quota, and from 78.2 to 125 per cent of quota if the purchases under the oil facility and the compensatory financing facility are excluded.

This paper, which is circulated in advance of the formal request from Yugoslavia, is divided into four sections and one annex. The sections deal with (1) Yugoslavia's balance of payments position, (2) estimation of the export shortfall, (3) causes of the shortfall and export prospects, and (4) staff appraisal and proposed decision. Yugoslavia's relations with the Fund are summarized in Annex I.

1. Balance of payments

After a modest surplus in 1976, the current account of the balance of payments recorded deficits of SDR 1.4 billion in 1977 and SDR 0.8 billion in 1978 (Table 1). The deficits were due to a deterioration of the trade balance, since the surplus for net invisibles rose both in 1977 and 1978 mainly on account of larger receipts from tourism and workers' remittances. The deterioration of the trade balance resulted from the combination of a deceleration in the growth of exports (especially in 1978) and of a sharp increase in imports from 1976 to 1977. The poor performance of the last two years may be partly attributed to a slackening in the growth of foreign demand, partly to a decrease in competitiveness, and partly to supply constraints; a buoyant domestic demand in the context of slow growth in productive capacity encouraged imports and, to some extent, limited the

Table 1. Yugoslavia: Balance of Payments, 1976-79

(In millions of SDRs) 1/

	1976	1977	1978 Prov.	1979 Proj.
A. Current account				
Exports, f.o.b.	4,225	4,500	4,530	4,892
Imports, c.i.f.	-6,381	-8,252	-7,978	-8,432
Trade balance	-2,156	-3,752	-3,448	-3,540
Invisible balance	2,299	2,397	2,636	2,757
Current account balance	143	-1,355	-812	-783
B. Capital account				
Long-term capital received				
Drawings	1,816	2,283	2,157	1,875
Repayments	-782	-899	-1,118	-1,119
Long-term loans (extended)	-187	-182	-120	-139
Short-term capital, net 2/	-167	122	94	9
Of which:				
Compensatory borrowing	(43)	(64)	(240)	(116)
Capital account balance	780	1,323	1,012	626
C. Overall balance (A+B)	923	-33	200	-157
Excluding compensatory borrowing 3/	880	-97	-40	-273
D. SDR allocation	...	...	...	29
E. Monetary movements 4/				
Use of Fund resources	164	-96	-17)	
SDRs	21	-3	-4)	
Reserve position in the Fund	--	--	65)	
Gold	--	-2	-4)	127
Official foreign exchange	-1,042	-44	-205)	
Other	-66	178	95)	
Total	-923	33	-200	127
Memorandum item:				
Gross convertible international reserves (end of period)	2,329	2,283	2,415	

Sources: National Bank of Yugoslavia; and staff estimates.

1/ Converted from U.S. dollars at rates (U.S. dollars per SDR 1): 1976, 1.15452; 1977, 1.16752; 1978, 1.25200; and 1979, 1.29600.
2/ Includes net errors and omissions and changes in bilateral balances.
3/ Only identifiable short-term compensatory borrowing has been excluded. No account has been taken of the medium-term and long-term borrowings of enterprises that have been encouraged by the authorities in order to boost official reserves.
4/ Increase in assets (-).

supply available for export. In 1977, exports rose by 6.5 per cent, while imports increased by 29.3 per cent. In 1978, exports increased by less than 1 per cent but imports fell by 3.3 per cent, partly because the level of stocks was reduced and partly because import substitution could be intensified with the coming on stream of a number of investment projects.

The substantial current account deficits in 1977 and 1978 were financed largely by extensive borrowings abroad by enterprises and commercial banks. It has been Yugoslavia's official policy since the end of 1975 to maintain gross convertible international reserves, including holdings by the commercial banks, at a level equivalent to about three months' payments (current and capital) in convertible currencies in order to provide for sufficient flexibility to its external policies, especially in view of the relatively high level of foreign exchange deposits of Yugoslav residents resulting mainly from workers' remittances from abroad. Accordingly, the authorities permitted considerable external borrowings by enterprises and encouraged the commercial banks to undertake short-term borrowings and, consequently, gross convertible international reserves were maintained in 1978 at around the end-1976 level.

The current account deficit of the balance of payments is expected to be contained at around SDR 800 million in 1979. With more restrictive domestic policies and a continuation of the more active exchange rate policy that began in late 1977, exports are projected to increase by 8 per cent and imports 5.7 per cent, which would imply only a marginal increase in the trade deficit from 1978 to 1979. 1/ This marginal increase is likely to be offset by the expected rise in the surplus on the invisibles account resulting from higher receipts from workers' remittances.

The substantial amount of foreign borrowing in recent years has raised the external debt ratio with convertible currency countries to around 20 per cent by 1978, and the ratio with all currency countries to about 17 per cent. Although the authorities consider such rates of external debt servicing manageable, they do not wish to see them higher. Accordingly, in 1979 the planned increase in outstanding medium-term and long-term debt is about SDR 620 million, compared with SDR 920 million in 1978. Combined with planned net short-term compensatory borrowing by the commercial banks of SDR 116 million, this would result in an overall balance of payments deficit of about SDR 160 million in 1979 in contrast to a surplus of SDR 200 million in 1978.

In the first part of 1979, the balance of payments has been under pressure as imports have risen at a more rapid rate than planned. Gross

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1/ The projections for the balance of payments are likely to be revised when the damage caused by the April earthquakes and the resultant reconstruction program have been determined. While merchandise exports are unlikely to be significantly affected, the current account deficit is likely to be higher as a result of the adverse impact of the disaster on tourism receipts and the need for greater imports.

international reserves of the National Bank, which amounted to SDR 1.9 billion at the end of 1978, declined by over SDR 300 million in the first three months of 1979. In the light of these developments, the authorities have recently introduced more restrictive monetary policy.

2. Estimation of the export shortfall

Yugoslavia's export earnings have increased, on the average, by 13 per cent per year from 1958 to 1976. But the growth rate fell to 6.5 per cent in 1977 and only 0.7 per cent in 1978, which is taken as the shortfall year. The stagnation of export earnings is, however, expected to be temporary, since earnings are projected to increase by 8 per cent from 1978 to 1979 and by 16 per cent from 1979 to 1980. On the basis of this judgmental forecast, the amount of the shortfall in calendar year 1978 is equal to SDR 239.5 million 1/ (Table 2). This amount is nearly three fourths larger than the amount of the purchase expected to be requested (SDR 138.5 million), which is equivalent to 50 per cent of Yugoslavia's quota in the Fund.

3. Causes of the shortfall and export prospects

Yugoslavia has an export sector which is well diversified in terms of both the range of its export products and the geographical distribution of its outlets (Tables 3 and 4). Nevertheless, Yugoslavia's exports remain quite sensitive to fluctuations in the import demand of its main customers, the EC in particular. From 1975 to 1978, variations in the economic activity of industrial and oil exporting countries (upper part of Chart) clearly affected the growth of the volume and value of Yugoslav exports (lower part of the Chart). Exports were particularly sensitive to the fluctuations of economic activity in Italy, which is the single largest export outlet for Yugoslav exports apart from CMEA countries.

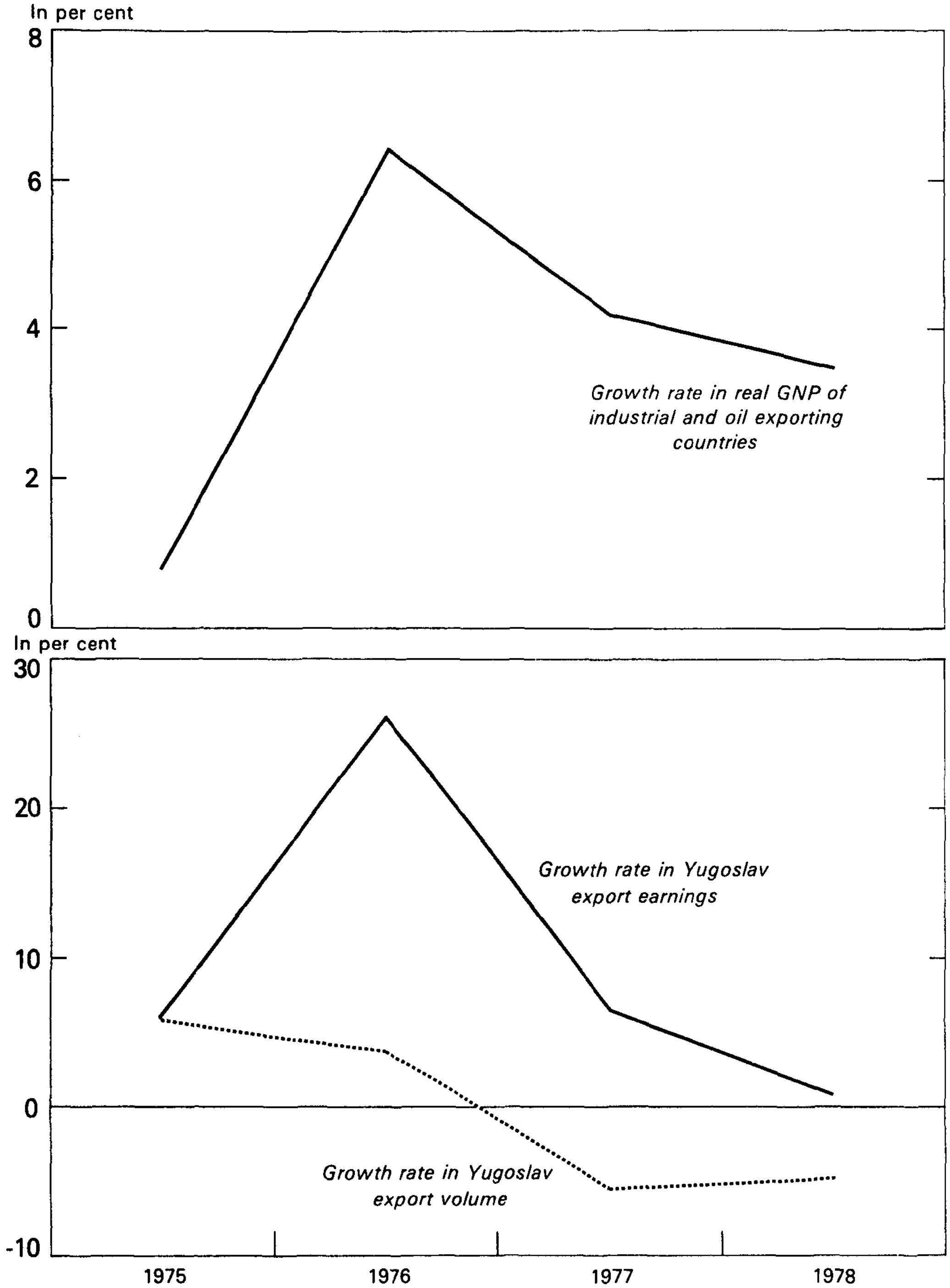
The export shortfall experienced by Yugoslavia in 1978 resulted from the combination of a weak external demand caused by a sluggish growth in European countries (Italy in particular), and a strong internal demand caused by an overheated economy. During the last two years, domestic consumption and investments increased by, respectively, 7 and 11 per cent per year in real terms. With this high rate of economic activity, employment in the social sector rose by more than 4 per cent per year, and the increase in the number of unemployed remained small despite migrations from rural to urban areas and despite the return of many Yugoslav workers who could not anymore find employment abroad. The domestic expansionary policy resulted, however, in high rates of inflation which reduced the competitiveness of Yugoslav exports; the strong domestic demand induced by that policy had also the effect of reducing the volume of goods available for export.

1/ Based on the extrapolation formula, the shortfall is equivalent to SDR 717 million.

CHART

YUGOSLAVIA

GROWTH IN EXPORTS IN RELATION TO GROWTH IN REAL GNP OF INDUSTRIAL AND OIL EXPORTING COUNTRIES 1/



1 The real GNP of industrial and oil exporting countries is constructed as trade weighted average of real GNPs of industrial and oil exporting countries. The real GNP series are obtained from the *World Economic Outlook Background Development* (ID/79/2), Table 1 and Table 29.

Table 2. Yugoslavia: Estimation of the Shortfall

(In millions of SDRs)

	Calendar years					
				Projected 1979-80 average		
	1976	1977	1978	Formula 1/	Judgmental 2/	Minimum 3/
Exports	4,225	4,500	4,529	6,489	5,295	5,043
Shortfall						
Formula			717.2			
Judgmental			239.5			
Minimum			138.5			

1/ Calculated from yearly earnings shown in the first row of Table 4 as:

$$\frac{(4,225.1 + 4,500.2)}{2} \cdot \frac{(4,529.4 + 4,500.2 + 4,225.1)}{(3,353.8 + 3,163.9 + 2,393.2)}$$

2/ Based on judgmental forecast shown in Table 4.
3/ Level at which the shortfall is equivalent to SDR 138.5 million or 50 per cent of quota.

Table 3. Yugoslavia: Direction of Trade

	Percentage share of total exports					Percentage growth in earnings from previous year 1/				
	1974	1975	1976	1977	1978	1974	1975	1976	1977	1978
Developed countries, of which:	46.4	35.6	41.9	40.0	38.7	9.9	-18.7	48.2	1.7	-2.6
United States	8.3	6.5	7.3	5.7	6.5	35.5	-17.0	41.4	-16.8	14.8
EEC, of which:	27.3	22.8	27.2	26.5	23.0	0.8	-11.5	50.2	3.8	-12.6
Germany	9.6	7.8	8.8	7.4	8.3	13.3	-13.9	42.0	-10.4	12.9
Italy	11.3	9.1	12.2	12.6	9.4	-8.4	-14.6	68.8	10.0	-24.9
Less developed countries, of which:	11.7	17.1	15.7	19.1	19.1	53.1	54.9	15.6	29.6	0.7
Oil exporting countries	3.9	6.0	6.8	8.1	9.3	124.2	63.1	42.7	26.9	15.6
CMEA and other socialist countries, of which:	41.8	47.2	42.4	40.8	42.2	62.1	19.7	13.1	2.5	4.2
U.S.S.R.	17.7	24.9	23.5	21.7	24.6	63.6	49.1	18.9	-1.6	14.2
Total	100.0	100.0	100.0	100.0	100.0	32.2	6.0	25.9	6.5	0.7

1/ In terms of SDRs.

Table 4. Yugoslavia: Export Earnings and Shortfalls by Major Commodity Groups

(In millions of SDRs)

	Calendar years							
	1973	1974	1975	1976	1977	1978	1979-80 average	Shortfalls 1/
Total exports	2,393.2	3,163.9	3,353.8	4,225.1	4,500.2	4,529.4	5,295	239.5
1. Raw materials and semi-manufactures	810.4	1,177.7	1,049.7	1,338.9	1,273.0	1,180.4	1,500	178.1
1.1 Non ferrous metals	223.2	365.5	297.5	323.7	259.1	240.9	350	63.9
Aluminum and aluminum processed	50.5	97.3	103.7	130.1	125.2	123.2	174	22.1
Copper and copper processed	128.6	182.6	108.2	126.9	69.0	57.1	100	33.5
Other non ferrous metals	44.1	85.6	85.6	66.7	64.9	60.6	76	8.3
1.2 Other raw materials and semi-manufactures	587.2	812.2	752.2	1,015.2	1,013.9	939.5	1,150	114.2
Wood and cork manufactures	175.2	200.7	160.6	289.5	343.5	273.8	332	40.4
Textiles	135.9	165.4	166.0	239.8	227.7	218.2	241	15.4
Metal manufactures	68.8	110.6	145.0	172.4	169.6	183.7	236	15.8
Iron and steel	148.5	251.1	173.0	189.7	153.3	150.2	194	26.0
Non-metallic mineral manufactures	29.3	46.6	66.6	77.1	71.9	71.0	93	10.2
Metal ores and scrap	29.5	37.8	41.0	46.7	47.9	42.6	54	6.4
2. Consumer goods	564.0	557.6	646.7	886.6	859.1	881.6	1,024	53.5
2.1 Manufactured goods	279.3	327.6	404.4	527.5	524.2	525.6	603	31.0
Clothing	114.9	123.9	168.0	203.5	192.7	187.7	213	14.3
Footwear	92.3	120.6	149.1	191.4	185.0	197.3	225	7.4
Furniture	72.1	83.1	87.3	132.6	146.5	140.6	165	9.3
2.2 Food	234.2	164.6	156.9	255.8	248.6	258.0	295	12.5
Meat and meat products	170.5	89.1	118.0	155.6	158.8	187.1	198	-7.6 (excess)
Maize (corn)	52.4	60.9	23.0	78.7	70.5	48.9	71	19.1
Fish and fish preparations	11.3	14.6	15.9	21.5	19.3	22.0	26	1.0
2.3 Beverages and tobacco	50.5	65.4	85.4	103.3	86.3	98.1	126	9.8
Beverages	22.1	30.3	25.5	31.0	35.5	37.3	45	1.4
Tobacco	28.4	35.1	59.9	72.3	50.8	60.8	81	8.4
3. Machinery and transportation equipment	590.5	733.7	940.6	1,180.6	1,437.2	1,440.1	1,562	-3.7 (excess)
Machinery other than electrical	115.8	155.5	222.4	351.7	473.7	435.3	484	10.5
Electrical machinery	190.4	251.9	289.9	343.0	383.7	388.2	434	8.4
Ships	149.2	205.8	250.4	248.6	354.6	339.5	295	-33.0 (excess)
Other transport equipment	135.1	120.5	177.9	237.3	225.2	277.1	349	10.4
4. Other merchandise	428.3	694.9	716.8	819.0	930.9	1,027.3	1,209	11.7
	(Annual rate of percentage change in export earnings from previous year)							
Total exports		32.2	6.0	26.0	6.5	0.7	11.0	
1. Raw materials and semi-manufactures		45.3	-10.9	27.6	-4.9	-7.3	17.3	
1.1 Non ferrous metals		63.8	-18.6	8.8	-20.0	-7.0	28.3	
Aluminum and aluminum processed		92.7	6.6	25.5	-3.7	-1.6	25.9	
Copper and copper processed		42.0	-40.7	17.3	-45.6	-17.3	45.3	
Other non ferrous metals		94.1	--	-22.1	-2.7	-6.6	16.3	
1.2 Other raw materials and semi-manufactures		38.3	-7.4	35.0	-0.1	-7.3	14.4	
Wood and cork manufactures		14.6	-20.0	80.3	18.7	-20.3	13.7	
Textiles		21.7	0.3	44.5	-5.0	-4.2	6.8	
Metal manufactures		60.8	31.1	18.9	-1.6	8.3	13.2	
Iron and steel		69.1	-31.1	9.7	-19.2	-2.1	18.6	
Non-metallic mineral manufactures		58.6	43.3	15.6	-6.7	-1.2	19.7	
Metal ores and scrap		27.9	8.7	13.8	2.6	-11.1	17.1	
2. Consumer goods		-1.1	16.0	37.1	-3.1	2.6	10.5	
2.1 Manufactured goods		17.3	23.4	30.4	-0.6	0.3	9.6	
Clothing		7.8	35.6	21.1	-5.3	-2.6	8.8	
Footwear		30.7	23.6	28.4	-3.4	6.6	9.2	
Furniture		15.3	5.1	51.9	10.5	-4.0	11.3	
2.2 Food		-29.7	-4.7	63.0	-2.8	3.8	9.3	
Meat and meat products		-47.8	32.5	31.9	2.0	17.8	3.8	
Maize (corn)		16.3	-62.3	242.6	-10.5	-30.7	28.2	
Fish and fish preparations		29.2	8.9	35.2	-10.2	14.0	11.8	
2.3 Beverages and tobacco		29.5	30.7	21.0	-16.5	13.7	18.2	
Beverages		37.6	-15.9	21.4	14.4	5.2	13.3	
Tobacco		23.6	70.7	20.7	-29.7	19.7	21.1	
3. Machinery and transportation equipment		24.3	28.2	25.5	21.7	0.2	5.6	
Machinery other than electrical		34.3	43.0	58.1	34.7	-8.1	7.3	
Electrical machinery		32.3	15.1	18.3	11.9	1.2	7.7	
Ships		37.9	21.7	-0.7	42.6	-4.3	-8.9	
Other transport equipment		-10.8	47.7	33.4	-5.1	23.0	16.6	
4. Other merchandise		62.2	3.2	14.3	13.7	10.4	11.5	

1/ Based on judgmental forecasts.

The factors which caused the 1978 export shortfall are believed to be temporary. External demand, especially by Italy, is expected to gain strength. Access to the EC market may be facilitated by the outcome of trade negotiations now under way, and the competitiveness of Yugoslav exports is likely to improve as a result of the depreciation in the effective exchange rate which accelerated in 1978. Moreover, the volume of goods available for exports is expected to increase substantially because production should rise in response to the high investments made in 1977 and 1978, while the growth of domestic demand should be lower than in 1977 and 1978 as a result of the stabilization program 1/ just adopted by the authorities.

Exports of raw materials and semi-manufactures were responsible for three quarters of the shortfall experienced by Yugoslavia in 1978, although they account for only a quarter of total export earnings. Exports of consumer goods were responsible for most of the remaining part of the shortfall and, in both cases, the shortfall in export earnings was essentially due to a shortfall in the volume of exports. 2/ No shortfall occurred in the case of machinery and transport equipment, which accounts for one third of total export earnings, but a small shortfall was registered for the group "other exports" (Table 4).

a. Raw materials and semi-manufactures

For this group of products, the shortfall is estimated at SDR 178 million, which exceeds the amount of the purchase expected to be requested. All the products listed in Table 5 incurred a shortfall, but the largest shortfalls occurred for aluminum (SDR 22 million), copper (SDR 34 million), wood and cork manufactures (SDR 40 million), and iron and steel (SDR 26 million).

After increasing rapidly from 1973 to 1976, the volume of aluminum exports declined by 20 per cent in 1977 and did not increase in 1978, partly as a result of the high domestic demand in the last two years. The volume of exports projected for 1979-80 is 30 per cent above the 1978 level because production capacity is planned to increase by 75 per cent.

After falling sharply in 1977, the volume of copper exports declined further in 1978, essentially because of a weak external demand. The world copper market had been depressed by the existence of large stocks, but the progressive lowering of these stocks led to a strong recovery which started

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1/ The nature of the stabilization policies and exchange rate policies are described in the Staff Report for the 1979 Article IV Consultation (SM/79/111) and the Request for Stand-By Arrangement (EBS/79/225) to be discussed simultaneously with this paper.

2/ In the case of raw materials and semi-manufactures, the amount of the shortfall is equivalent to 15 per cent of the 1978 value of export earnings and to 14 per cent of the 1978 volume of exports. In the case of consumer goods, the corresponding figures are 6 per cent for export earnings and 5.6 per cent for the volume of exports (Table 5).

Table 5. Yugoslavia: Value, Volume and Unit Value Indices for Major Commodities

(1978 = 100)

	Value share of total exports in 1978 (In per cent)	Calendar years 1973	1974	1975	1976	1977	1978	1979-80 average	Shortfall in per cent of level in shortfall year
Value	77.3	56	71	75	97	102	100	116	6.2
1. Raw materials and semi-manufactures	26.1	68	100	89	113	108	100	127	15.0
1.1 Non ferrous metals	5.3	94	153	124	135	108	100	145	26.6
Aluminum and aluminum processed	2.7	41	79	84	106	102	100	141	18.0
Copper and copper processed	1.3	225	320	190	222	121	100	175	58.6
Other non ferrous metals	1.3	73	141	141	110	107	100	125	13.4
1.2 Other raw materials and semi-manufactures	20.8	62	86	80	108	108	100	122	12.0
Wood and cork manufactures	6.1	64	73	59	106	125	100	121	14.6
Textiles	4.8	62	76	76	110	104	100	110	6.8
Metal manufactures	4.1	37	60	79	94	92	100	129	8.8
Iron and steel	3.3	99	167	115	126	102	100	129	17.2
Non-metallic mineral manufactures	1.6	41	66	94	108	101	100	131	14.2
Metal ores and scrap	0.9	69	89	96	110	112	100	126	14.8
2. Consumer goods	19.4	64	63	73	101	97	100	116	6.0
2.1 Manufactured goods	11.6	53	62	77	100	100	100	115	6.0
Clothing	4.1	61	66	90	108	103	100	114	7.8
Footwear	4.4	47	61	76	97	94	100	114	3.8
Furniture	3.1	51	59	62	94	104	100	117	6.4
2.2 Food	5.7	91	64	61	99	96	100	114	4.6
Meat and meat products	4.1	91	48	63	83	85	100	106	-4.0 (excess)
Maize (corn)	1.1	107	125	47	161	144	100	144	38.6
Fish and fish preparations	0.5	51	66	72	97	88	100	116	3.4
2.3 Beverages and tobacco	2.1	51	67	87	105	88	100	128	9.8
Beverages	0.8	59	81	68	83	95	100	121	4.0
Tobacco	1.3	47	58	99	119	84	100	133	13.8
3. Machinery and transportation equipment	31.8	41	51	65	82	100	100	108	-0.4 (excess)
Machinery other than electrical	9.6	27	36	51	81	109	100	111	2.4
Electrical machinery	8.6	49	65	75	88	99	100	112	2.2
Ships	7.5	44	61	74	73	104	100	87	-9.8 (excess)
Other transport equipment	6.1	49	43	64	86	81	100	126	3.8
Volume		96	101	107	111	105	100	112	8.0
1. Raw materials and semi-manufactures		108	123	137	122	106	100	121	14.0
1.1 Non ferrous metals		130	141	135	149	104	100	134	24.2
Aluminum and aluminum processed		72	101	107	125	100	100	131	17.4
Copper and copper processed		278	247	191	231	111	100	155	50.4
Other non ferrous metals		102	119	137	115	106	100	118	11.4
1.2 Other raw materials and semi-manufactures		105	105	86	107	103	100	111	6.4
Wood and cork manufactures		96	86	75	110	117	100	115	11.4
Textiles		82	71	66	108	97	100	106	3.4
Metal manufactures		68	81	96	78	92	100	101	-5.6 (excess)
Iron and steel		204	210	100	122	89	100	116	8.6
Non-metallic mineral manufactures		51	84	96	129	112	100	117	15.0
Metal ores and scrap		195	182	151	126	117	100	125	18.6
2. Consumer goods		89	81	82	108	98	100	111	5.6
2.1 Manufactured goods		79	78	89	106	100	100	108	4.4
Clothing		83	75	92	108	100	100	108	4.8
Footwear		67	81	95	105	95	100	105	2.0
Furniture		89	77	75	106	107	100	110	6.6
2.2 Food		119	89	69	119	100	100	114	9.4
Meat and meat products		83	51	77	80	77	100	105	-6.6 (excess)
Maize (corn)		279	238	31	273	194	100	148	72.6
Fish and fish preparations		74	83	81	110	86	100	114	4.8
2.3 Beverages and tobacco		67	75	84	89	81	100	126	4.4
Beverages		68	82	68	83	96	100	118	3.0
Tobacco		66	71	93	93	71	100	130	4.8
3. Machinery and transportation equipment		91	95	97	104	108	100	105	4.4
Machinery other than electrical		47	53	59	80	95	100	113	0.2
Electrical machinery		90	89	93	101	105	100	106	3.6
Ships		137	174	154	137	137	100	77	5.6
Other transport equipment		106	74	92	105	95	100	126	10.4

Table 5. (continued) Yugoslavia: Value, Volume and Unit Value Indices for Major Commodities

(1978 = 100)

	Calendar years 1973	1974	1975	1976	1977	1978	1979-80 average	Shortfall in per cent of level in shortfall year
Unit value	60	75	84	92	100	100	107	1.2
1. Raw materials and semi-manufactures	63	88	94	100	105	100	112	5.8
1.1 Non ferrous metals	166	101	90	90	103	100	118	5.8
Aluminum and aluminum processed	57	78	79	85	101	100	107	--
Copper and copper processed	81	129	99	96	109	100	113	6.2
Other non ferrous metals	71	119	103	96	101	100	106	1.8
1.2 Other raw materials and semi-manufactures	63	85	95	102	105	100	111	5.8
Wood and cork manufactures	66	85	79	96	107	100	105	2.6
Textiles	76	107	116	102	107	100	104	3.4
Metal manufactures	55	74	82	120	101	100	130	16.2
Iron and steel	49	80	115	104	115	100	111	8.2
Non-metallic mineral manufactures	81	78	97	84	90	100	111	-0.8 (excess)
Metal ores and scrap	35	49	64	87	96	100	102	-2.6 (excess)
2. Consumer goods	76	82	91	97	102	100	104	1.4
2.1 Manufactured goods	68	80	87	94	100	100	107	1.6
Clothing	73	88	98	100	103	100	105	2.6
Footwear	70	75	79	93	98	100	109	1.8
Furniture	58	76	82	89	97	100	106	-0.4 (excess)
2.2 Food	93	84	96	94	102	100	100	-0.8 (excess)
Meat and meat products	110	93	82	104	110	100	101	3.2
Maize (corn)	38	52	152	59	74	100	98	-14.2 (excess)
Fish and fish preparations	70	80	89	89	102	100	101	-1.4 (excess)
2.3 Beverages and tobacco	77	88	104	118	110	100	102	6.4
Beverages	86	99	100	101	99	100	102	0.8
Tobacco	71	81	106	128	117	100	102	9.8
3. Machinery and transportation equipment	48	60	72	82	94	100	104	-3.2 (excess)
Machinery other than electrical	57	67	86	101	115	100	99	2.8
Electrical machinery	54	73	80	87	94	100	105	-1.8 (excess)
Ships	32	35	48	53	76	100	112	-0.4 (excess)
Other transport equipment	46	59	70	81	85	100	100	-6.8 (excess)

in December 1978. The Yugoslav industry should be able to take full advantage of this recovery and export earnings from copper are projected 75 per cent above their 1978 level.

The shortfall in export earnings from wood and cork manufactures was mainly due to volume factors and reflected the sluggish growth of Italy, which absorbs nearly half of Yugoslav exports in that sector. With the expected recovery of the Italian economy, the volume of exports is projected to recover almost to its 1977 level. The shortfall in earnings from textiles was also mainly due to a decline in external demand, but only a modest recovery is expected in 1979-80.

Price and volume factors have contributed about equally to the shortfall in earnings from iron and steel exports, which was caused by the depressed state of the world market for these products in 1978. A market recovery was noticeable in the first quarter of 1979, and Yugoslavia may be able to take advantage of this recovery in view of the sizable increase in the production capacity of iron and steel during the next two years. For other ores and nonmetallic mineral manufactures, the shortfall was entirely due to a decline in the volume of exports. For metal manufactures, by contrast, the shortfall was entirely due to price factors and the volume of exports was higher in 1978 than in any of the preceding years.

b. Consumer goods

Export earnings from light manufactures (clothing, footwear, and furniture) increased rapidly from 1973 to 1976; they remained stagnant during the last two years partly because of the pressure of domestic demand, but are expected to recover; average earnings in 1979-80 are projected 16 per cent above the 1978 level. The fall in earnings from clothing exports in 1977 and 1978 was partly due to the weak demand in West Germany, which is the second largest importer after the U.S.S.R. Earnings from furniture exports, for which the U.S. is the main market, fell slightly in 1978. Earnings from footwear fell in 1977 but recovered in 1978, and the recovery is expected to be sustained in the next two years.

In the case of meat, the largest food export item, export earnings increased in 1978 entirely on account of a 30 per cent increase in the volume of exports, and a small excess in export earnings was registered in 1978. By contrast, earnings from maize exports declined in 1978 on account of a sharp fall in the volume of exports which was caused by the adverse effects of weather on the maize crop. Earnings from tobacco exports increased significantly in 1978, as the price decline was more than offset by a large increase in the volume of exports which is expected to be sustained in 1979-80.

c. Machinery and transport equipment

After increasing by 25 per cent per year from 1973 to 1977, earnings from exports of machinery and transport equipment remained stagnant in 1978. No shortfall is, however, estimated for this group of products because earnings are expected to increase by only 6 per cent per year in 1979-80. Machinery other than electrical had been the most dynamic item of the group. Export earnings from these items increased, on the average, by 42 per cent per year from 1973 to 1977, but they declined in 1978, and average earnings in 1979-80 are projected only marginally above their 1977 level. Export earnings from ships also declined in 1978 after a rapid increase from 1973 to 1977, but they are expected to decline further in 1979-80 in view of the depressed world demand for ships.

d. Other merchandise

A small shortfall (SDR 12 million) is estimated for "other merchandise" because of a slight deceleration of the growth of exports in 1978. The annual growth rate fell from 14 per cent in 1976 and 1977 to 10 per cent in 1978 and is expected to rise to 11.5 per cent in 1979-80.

4. Staff appraisal and proposed decision

Yugoslavia is expected to request a purchase of SDR 138.5 million, equivalent to 50 per cent of its quota for an export shortfall experienced during calendar year 1978. The amount of the purchase is substantially lower than that of the shortfall, since the latter is estimated at SDR 239.5 million on the basis of a judgmental forecast of the 1979-80 export earnings.

After a modest surplus in 1976, the current account of the balance of payments registered deficits of SDR 1.4 billion in 1977 and SDR 0.8 billion in 1978. In order to finance these deficits, the authorities encouraged enterprises and commercial banks to borrow extensively abroad and the level of international reserves remained about stable in 1977 and 1978. By applying more restrictive domestic policies and an active exchange rate policy, the authorities plan to keep the current account deficit in 1979 at SDR 0.8 billion and to limit the overall balance of payments deficit to SDR 0.16 billion; they plan to obtain the necessary surplus in the capital account by medium- and long-term borrowing (SDR 0.63 billion) and net short-term compensatory borrowing by commercial banks (SDR 0.116 billion). The projections of the balance of payments for 1979 were made, however, before the April earthquake; the effect of the earthquake may be to adversely affect tourism receipts and to require additional imports for reconstruction in 1979. Yugoslavia's balance of payments difficulties may therefore be greater than implied by the size of the deficits projected above. It should also be noted that the gross international reserves of the National Bank have already declined by SDR 300 million during the first three months of 1979. The staff, therefore, considers that the proposed purchases of SDR 138.5 million under the CFF and SDR 69.25 million under the first credit tranche are compatible with the balance of payments need of the member.

The current account deficit incurred in 1977 and 1978 resulted from the combination of a sharp increase in imports in 1977 and of a deceleration in the growth of exports in both 1977 and 1978. Yugoslavia's export earnings increased by 13 per cent per year between 1958 and 1976, but the growth rate fell to 6.5 per cent in 1977 and less than one per cent in 1978, which was taken as the shortfall year. The poor export performance in 1978 is due to the combination of a weak external demand caused by a sluggish growth in European countries (Italy in particular), a loss in export competitiveness, and a strong internal demand caused by an overheated economy. The expansionary policy followed by the authorities in 1977 and 1978 was adopted to avoid a sharp increase in unemployment that would have partly resulted from the return of many Yugoslav workers who could not anymore find employment abroad. It led, however, to high rates of inflation, which contributed to reduce the competitiveness of Yugoslav exports, and the strong domestic demand induced by that policy competed with external demand for a limited supply of exportable goods.

The factors which caused the 1978 export shortfall are believed to be temporary. External demand (especially by Italy) is expected to gain strength, while the competitiveness of Yugoslav exports is likely to improve as a result of a continued depreciation of the effective exchange rate. Moreover, the volume of goods available for exports is expected to increase substantially because production should increase in response to the high investments made in 1977 and 1978, while the growth of domestic demand should decelerate as a result of the stabilization program adopted by the authorities.

Three fourths of the export shortfall estimated for calendar year 1978 is attributable to raw materials and semi-manufactures, although this group of products accounts for only one fourth of total export earnings. Most of the remaining part of the shortfall is attributable to consumer goods, which account for one fifth of total export earnings. In both cases the shortfall in export earnings is essentially caused by volume factors. No shortfall occurred for machinery and transport equipment, which account for one third of total export earnings.

The purchase expected to be requested under the compensatory financing facility represents only 58 per cent of the amount of the estimated shortfall, which resulted from a combination of factors, among which a weak external demand and the desire to provide domestic employment to Yugoslav workers returning from abroad. The part of the shortfall for which a purchase is expected to be requested is, therefore, considered by the staff as caused by factors mainly beyond the member's control. The staff also considers that the shortfall is of a temporary character in view of the export recovery expected in 1979 and 1980.

This request for a compensatory financing purchase, which is the first by Yugoslavia under the facility, is expected to include a statement that Yugoslavia will cooperate with the Fund in an effort to find appropriate solutions for its balance of payments difficulties. Yugoslavia is also expected to request a purchase of SDR 69.25 million under a stand-by arrangement in the first credit tranche (EBS/79/225), which is to be considered by the Board simultaneously with this request.

The staff believes that the expected request from Yugoslavia for a purchase equivalent to SDR 138.5 million under the compensatory financing decision will meet all the requirements set forth in that decision. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request has been received:

1. The Fund has received a request by the Government of Yugoslavia for a purchase of the equivalent of SDR 138.5 million under paragraphs 2, 3, and 4 of the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), adopted December 24, 1975 as amended by Executive Board Decision No. 5348-(77/33) adopted March 11, 1977).

2. The Fund notes the representation of Yugoslavia and approves the purchase in accordance with the request.

Yugoslavia: Fund Relations

Quota:	SDR 277 million.
Use of Fund resources:	The last stand-by arrangement with Yugoslavia for SDR 83.5 million expired in July 1972 having been used in full. A gold tranche purchase equivalent to SDR 30 million was made on August 1, 1974. Purchases totaling SDR 340.7 million were made under the oil facilities. Total outstanding purchases of SDR 181.7 million consist mostly of SDR 172.8 million outstanding under the oil facilities.
Fund holdings of Yugoslav dinars:	SDR 389.3 million or 140.6 per cent of quota excluding outstanding oil facility purchases, SDR 216.5 million or 78.2 per cent of quota.
Proposed purchase under the compensatory financing facility:	Equivalent to SDR 138.5 million which would be the first purchase under the compensatory financing facility and would raise the Fund's holdings of Yugoslav dinars to SDR 527.8 million or 190.6 per cent of quota.
SDR position:	SDR 40.5 million, equivalent to 41.3 per cent of net cumulative allocations.
Direct distribution of profits from gold sales:	Yugoslavia has received US$9.3 million in the direct distribution of profits from gold sales; US$3.1 million has been transferred to the Trust Fund.
Gold distribution:	Yugoslavia has acquired 132,887 ounces of fine gold in the gold distribution program.
Exchange rate system:	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 April 20, 1979 were Din 18.9702 and Din 19.0272, respectively, per US$1. Rates are quoted for certain other currencies.

Exchange and trade restrictions:	Yugoslavia is in the process of introducing a new exchange and trade system based on self-management by the participants in foreign economic relations. The new system appears not to involve an increase in restriction. There has been substantial progress in elimination of bilteral payments agreements since the last consultations as all agreements with Fund members have been terminated.
Other use of Fund resources requested simultaneously with the CF purchase of SDR 138.5 million:	First credit tranche (SDR 69.25 million)(EBS/79/225).