

DOCUMENT OF INTERNATIONAL MONETARY FUND
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**IMMEDIATE
ATTENTION**

EBS/85/83

CONFIDENTIAL

April 1, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Prolongation of Stand-By Arrangement

It is not proposed to bring the attached memorandum on the request by Yugoslavia for a prolongation of the current stand-by arrangement to the agenda of the Executive Board for discussion unless an Executive Director so requests by noon on Friday, April 5, 1985. In the absence of such a request, the draft decision that appears on page 3 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter. This will enable the Executive Board to consider Yugoslavia's request for a waiver of a performance criterion (EBS/85/84, 4/1/85) at the same time that it considers the staff report for the 1984 Article IV consultation with Yugoslavia and its request for a stand-by arrangement (EBS/85/85, 4/1/85).

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. L. Hansen, ext. 8872.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Prolongation of Stand-by Arrangement

Prepared by the European Department
(In consultation with other Departments)

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

April 1, 1985

1. Introduction

On April 18, 1984, the Executive Board approved a one-year stand-by arrangement for Yugoslavia in an amount equivalent to SDR 370 million (60 percent of quota). Yugoslavia has made three purchases under this arrangement, totalling SDR 280 million. The fourth purchase, SDR 90 million, was to become available as of April 15, 1985 subject to the observance of applicable performance criteria.

2. Recent developments under the stand-by arrangement

All performance criteria relating to the fourth purchase have already been or are expected to be met, except that relating to the adjustment of interest rates on April 1, 1985.

As described in the attached letter dated March 18, 1985 to the Managing Director from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance, the authorities, in connection with their request for a new one-year stand-by arrangement for 1985/86, request a waiver of the nonobservance of the performance criterion relating to the interest rate adjustment as of April 1, 1985. (See EBS/85/84, 4/1/85.) In order to have the Fund consider this request for a waiver at the same time that it considers the arrangement requested for 1985/86, the authorities have in the attached letter requested a short extension of the current stand-by arrangement beyond its expiration date of April 17, 1985. They have proposed that this arrangement be extended until May 15, 1985, on the assumption that the new stand-by arrangement, if approved by the Fund, would not become effective before May 16, 1985.

3. Staff appraisal and proposed decision

All performance criteria relating to the fourth purchase under the 1984 stand-by arrangement have been or are expected to be met, except that relating to the adjustment of interest rates on April 1, 1985. As described in the Board paper requesting a waiver of the nonobservance of this performance criterion, the staff recommends approval of the waiver in part on the basis of the interest rate policy measures in the proposed stand-by program for 1985/86. Accordingly, the request for the waiver can be assessed properly only in conjunction with the request for a new stand-by arrangement. In view of the foregoing, it is proposed that the Executive Board, pursuant to the explanatory letter sent by the Yugoslav authorities, grant a prolongation of the current stand-by arrangement until May 15, 1985.

The following draft decision is proposed for adoption by the Executive Board:

In paragraph 1 of the stand-by arrangement for Yugoslavia (EBS/84/65, Sup. 1 (4/19/84)) the phrase "For a period of one year from April 18, 1984" shall be replaced by "For the period from April 18, 1984 to May 15, 1985".

Belgrade
March 18, 1985

Dear Mr. de Larosiere,

1. In connection with our request for a one-year stand-by arrangement for 1985/86 that we submitted on March 15, 1985, we request a short extension of the current stand-by arrangement beyond its expiration date of April 17, 1985. We would propose that this arrangement be extended until May 15, 1985, on the assumption that the new stand-by arrangement, if approved by the Fund, would not become effective before May 16, 1985.

2. We are requesting the extension in order to have the Fund consider our request for a waiver of the application of the performance criterion relating to the interest rate in the current arrangement, at the same time that it considers the arrangement requested for 1985/86. Data that have just become available indicate that, according to the formula applied under the present arrangement, the rate of interest on three-month deposits would have to be raised from the present level of 54 percent per annum to 69 percent on April 1 (one percentage point above the percentage increase in the index of producer prices from February 1984 to February 1985). We believe that the price increase measured over this particular 12-month period is well above the current underlying rate of inflation in Yugoslavia. An excessive increase in interest rates on April 1--even though reversed in May--would add damaging distortions and inflationary impulses to the Yugoslav economy. To avoid these effects, it is our intention to raise the rate on April 1 to 58 percent thus limiting the increase to 4 percentage points. Starting in May, we shall adjust the rate of interest in accordance with the revised formula described in paragraph 18 of our letter of March 15, 1985. In view of the foregoing, we request a waiver with respect to the intention referred to in paragraph 4.d. of the stand-by arrangement approved by the Fund on April 18, 1984.

Sincerely,

Radovan Makic
Governor, National
Bank of Yugoslavia

Vlado Klemencic
Federal Secretary
for Finance