



CHIEF ECONOMIST REPORT JANUARY-SEPTEMBER 2007

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Review of macroeconomic developments

	2006	IX 2007	
REAL SECTOR DEVELOPMENTS			
GDP (in current prices in EUR million)*	1.970,0	1.562,9	%
Industrial output index (compared to the same period the year before)	1,0%	-4,3%	---
Forestry (compared to the same period the year before)	15%	-18,3%	---
Construction (compared to the same period the year before)	46,3%	-2,5%	---
Employment			
Number of employed people	150,746	158.164	
Number of unemployed people	38.876	31.156	-19,9
Inflation rate			
CPI (compared to December the year before)	2,8%	5,5%	---
RPI (compared to December the year before)	2,0%	6,1%	---
Average salary (EUR, without taxes and contributions)	282	345	22,3
MONETARY DEVELOPMENTS			
M11 (EUR million)	1.098,5	1.436,2	30,7
Total deposits (EUR million)	1.075,8	1.819,7	69,2
Deposits by economy	321,0	551,4	71,8
Government deposits	113,5	148,3	30,7
Central government	21,0	23,8	13,2
Institutions and agencies of central government	20,1	32,5	61,8
Funds and municipalities	72,4	91,9	27,0
Deposits by financial institutions	75,1	117,3	56,3
Deposits by households (savings)	499,4	923,2	84,9
Deposits - other	66,8	68,1	1,9
Total loans (EUR million)	847,2	1.810,6	113,7
Loans to economy	471,3	1.085,5	130,3
Loans to government	42,9	41,2	-3,9
Central government	12,2	8,0	-34,2
Institutions and agencies of central government	3,7	8,8	137,9
Funds and municipalities	27,0	31,5	16,6
Loans to banks and financial institutions	6,5	11,1	71,1
Loans to private citizens	311,2	651,1	109,2
Other loans	15,3	21,5	40,4
Turnover in stock exchanges (EUR million)	377,0	614,30	---
NEX stock exchange	135,70	402,50	---
Montenegroberza stock exchange	241,30	211,80	---
Stock exchange indices			
NEX20	18.050,8	36902,99	104,4
NEX PIF	17.763,6	40.767,2	129,5
MOSTE	918,9	1.825,2	98,6
Average interest rates on 28-day T-bills, last recorded	no auctions		---
Average interest rates on 56-day T-bills, last recorded	no auctions		---
Average interest rates on 91-day T-bills, last recorded	no auctions		---
Average interest rates on 182-day T-bills, last recorded	no auctions		---
FISCAL DEVELOPMENTS			
<i>(EUR million)</i>			
Origin revenues	567,2	572,7	
Total expenditure and net borrowings	532,5	391,1	
<i>Surplus/deficit of the government</i>	34,6	181,6	
Financing	-32,1	-51,1	
Grants		0,1	
Privatisation revenues	6,3	5,1	
Net indebtedness	-38,5	-56,2	
EXTERNAL DEVELOPMENTS			
<i>Current account (EUR million)</i>			
Trade balance	-511,9	-511,1	
Balance of services	-849,3	-1.005,6	
% of trade deficit/other balances coverage	216,4	438,7	
	39,7	49,2	---
Current account in % of GDP (EUR)	26,0	32,7	---
External debt (EUR million)	504		---
Domestic debt (EUR million)	197,1		---

* Estimated by Montenegrin Secretariat for Development

MACROECONOMIC OVERVIEW

It is likely that 2007 will represent a continuation of expansion from the last few years. The economic activity growth was high and in the first ten months the year, GDP increased by 7.1%. Foreign direct investments were on an upward trend, budgetary surplus will reach a record amount, number of employees was increasing and very successful tourist season is behind us. The growth rates of loans, deposits and household savings are also record-breaking. On the other hand, the factors that suggest that it is necessary to manage the expansion in a prudent manner were inflation growth, foreign trade deficit growth and too high a growth rate of loans. Simultaneously, the level of diversification of Montenegrin economy is low and the economy largely depends on the two strategic products – aluminium and tourism – that may be a potential source of “vulnerability” for the Montenegrin economy.

Inflation was increasing. Measured by the cost-of-living index at end-September, it was 5.5% higher than at the end of previous year. The average inflation rate (January – September 2007 when compared to January – September 2006) was 3.2%. The reasons for inflation can be divided into two groups: internal and external. The internal reasons for inflation are primarily the consequence of removing price caps, i.e. an increase in electricity and fixed telecommunication service prices, as well as too high level of aggregate demand. Such a high aggregate demand is a consequence of a real increase in salaries, a high level of disbursed loans, revenues from real estates sale, privatization, and other. External factors that had an impact on inflation are connected with both record oil prices in the world stock exchanges and extremely high prices of agricultural and food products in the world markets, the latter being a result of unfavourable weather conditions and an increase in global demand for these products.

Even though it is still not monitored in methodology, it is certain that the core inflation rate in Montenegro is relatively low. Whenever there is a significant difference between the current and core inflation rates, as was the case in Montenegro, there are limited possibilities of economic and monetary policy influence on inflation movement. In such conditions, economic policy may

function in two directions. The first potential direction relates to limiting growth of aggregate demand, and the second one involves potential reduction of taxes on particular categories of products that have increased under the influence of external factors. Within this scope, the CBM introduced measures to limit credit expansion and thus affect aggregate demand. Within its competence, the Government proposed a reduction of the VAT rate as well as the introduction of the zero VAT rate on certain products that would be of temporary character. However, the announced significant increase in public expenditure in the budget proposal for 2008 will have an opposite effect.

Money supply, disbursed loans, household deposits and savings reached the record-breaking levels. In the last twelve months, household loans increased by 177.3%, deposits by 124.8% and savings by 162.4%. Such a high level of activity of the banking sector represented a great incentive for development of the economy. However, the growth rate of loans is too high and such a rate will not be sustainable in the following year. Namely, it may lead to the strengthening of maturity mismatch between the sources of funds and banks' investments and pressure banks on additional foreign borrowing. It also effect too high a level of aggregate demand, which contributes to inflationary pressure and the danger of “economy overheating” on one hand, and further increase of the already extremely high current account deficit, on the other hand. Therefore, the CBM measures aimed at limiting credit growth were necessary. The money supply (the broadest aggregate being M21) amounted to EUR 2.5 billion and almost doubled in the previous year.

Industrial production is on a downward trend. In the first nine months this year, when compared to the first nine months of the previous year, the level of industrial production was 4.3% lower. However, when it comes to industry, the main problems are in electric power production sector. In the first nine months, in relation the same period of the previous year, a lower level of production of even 40.3% was recorded in this sector. The reasons for such a bad performance come from unfavourable weather conditions and interruptions in the work of Thermal Power Plant Pljevlja, caused by the shortage in coal and regular

repairs. If the production in the electric power sector had been the same as in the previous year, the level of industrial production would have been 5.6% higher than in 2006. High growth rates in manufacturing industry point to the fact that it is possible to expect a reduction in the lagging of this branch until the year-end.

In the fiscal policy area, a record budgetary surplus was recorded. It is of great importance to manage this surplus in an adequate manner and avoid situation of its overflowing into consumption. The larger portion of this surplus should be redirected to capital investments and earlier foreign debt repayment. If it is directed towards consumption, it could lead to the "economy overheating, followed by a strong inflation pressure. One should also have in mind that the high surplus is largely the consequence of specific economic situation (a high increase in imports and real estates sale) that will probably not be of long-term nature.

The number of tourists who visited Montenegro in the first nine months this year, if compared to the same period of the previous year, was 19.1% higher. A great potential for tourism development lies in the expansion of tourist offer outside the coastal region, as well as in prolonging the tourist season. However, in order to ensure a long-term development of tourism, it is necessary to solve infrastructural problems and the shortage of qualified staff.

Transportation records remarkably high growth. The increase was recorded in all transportation aspects. Growth rates in this area fluctuated between 8.5%, which was an increase in cargo transport via railways, and 29.4%, which was an increase in the number of transported passengers in road transport. A negative growth rate was recorded in forestry, which was mainly the consequence of the delay in concluding concession agreements. In addition, a negative growth rate was recorded in construction, but it was not the worrying trend. The reason for this was extremely high level of activity in this sector in the previous year (growth rate being 46.3%) when two airports were reconstructed, then great investments in the transportation infrastructure, as well as investments in hotel complexes.

Price corrections occurred in the capital market. The volume of recorded turnover in the third quarter was half the volume in the previous quarter. All stock exchange indices also declined at the end of the quarter.

The current account deficit is on an increase. According to preliminary data, it amounted to EUR 512 million at end-September and was 61% higher in comparison with 2006. The visible trade deficit reached the amount of over one billion euro. A surplus in the services sector amounted to EUR 411 million and it doubled when compared to the previous year. Surpluses were also recorded in the other two current account sub-accounts, but they were still lower than in the same period of the previous year.

The reasons for such a high current account deficit were numerous. Surely, one of the most important factors is low competitiveness of the Montenegrin economy. Exports increased only 2%, but imports rose no less than 37%. Another reason for the high deficit is an oversized consumption, most often manifested by the import of consumer goods. The reasons for large consumption were: high household revenues from the sale of real estates, revenues from privatization, a high level of loans disbursed to households and a high level of withdrawn funds arising from leasing, an increase in real income of the household sector, and other. Another reason for the high current account deficit is related to a high level of foreign direct investments because foreign investors, in order to initiate production, had to purchase new equipment, raw materials, import furniture and interior decoration for modernizing hotels, and the like. The reason for large imports was also a high import dependence of the Montenegrin economy because, whenever we experience a high rate of economic growth, as was the case this year, then it is accompanied by an increase in imports. Additional reason was an extremely high import of energy products. On one hand, it is a consequence of the record level of oil prices on international stock exchanges, and a large import of electricity on the other, because electric power production was 40.3% lower in the first nine months this year than in the same period of 2006.

The inflow of foreign direct investments was on an increase. Net FDI inflow in the period January – September 2007 amounted to EUR 337.6 million and was 38.8% higher than in the same period in 2006. Two thirds of the current account deficit was covered by the foreign direct investments inflow, while the rest was financed from borrowing. For the first time this year Montenegrin companies appear as foreign investors to a larger extent. Thus in the first nine months of 2007, Montenegrin companies invested EUR 44.6 million abroad.

REAL SECTOR DEVELOPMENTS

1

1.1. Gross Domestic Product

According to data of the Montenegrin Secretariat for Development, GDP in the reporting period amounted to EUR 1,562.9 million, which was real growth of 7.1% in relation to the same period of the previous year. Besides this, the main characteristics of the reporting period were an increase in the number of employees and a reduction in the number of unemployed persons.

Cost-of-living in the first nine months of 2007 increased on average monthly rate of 0.6% and an increase in cost-of-living of 5.5% was recorded in September when compared to the end of the previous year. At the same time, retail prices recorded an increase of 6.1%.

Table 1.1 – Gross domestic product estimates, EUR million

	2006 I-IX	2007 I-IX	Real growth rate
GDP	1,414.1	1,562.9	7.1%

Source: Montenegrin Secretariat for Development

Box 1.1 – Reforms progress in Montenegro according to the EBRD estimation

In the latest “Transition Report”, the EBRD estimated the transition progress in 29 countries. Herein, we set forth the most important estimations for the Montenegrin transition process.

It is stated in the report that besides impressive results in regard to economic growth, inflation and budget, the economy is “vulnerable” in both medium-term and long-term period. The facts that the economy is largely dependant on two strategic products – “aluminium and tourism” are given as potential risks. The risks lie within the fact that the aluminium price is formed at the world stock exchanges and it can fluctuate to a great extent and the possible risk for tourism development can be a potential regional crisis, caused by the solving of the “Kosovo issue”. The fact that infrastructure (primarily water and power supply) can be an obstruction to further development was also recognized as a risk for tourism development. The third possible risk was the Government possibility to deal with a number of obligations arising from the restitution issues and to suggest careful budgetary surplus management in order to provide long-term sustainable development.

Good sides were economic growth, macroeconomic stability, progress in joining the EU and high FDI inflow. The report says that the banking sector and the CBM supervision performances were significantly improved in the previous years. As for the capital market, even though the capitalization growth was high, the impact of this market on economy development remained low. “Capital market and non-banking financial institutions” (as well as the competitiveness policy) were the two lowest rated fields with the mark of minus two.

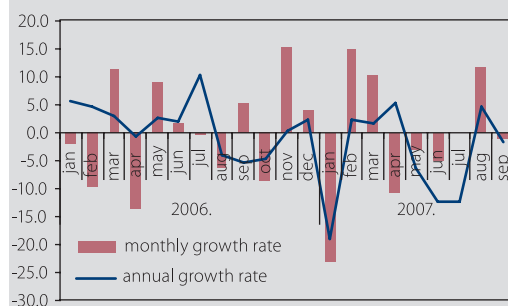
There are objections to the Montenegrin competition policy, which is the poorest rated field, but also the field experiencing the greatest progress in the last twelve years. It is also stated that a significant improvement is necessary in all aspects of infrastructure, except for telecommunications. In the infrastructure area, both reduction of government subsidies and a larger participation of private sector were recommended. The necessity to continue fight against corruption and improve process of registering companies is also emphasized.

1.2. Activities

1.2.1. Industrial output

Industrial production in the first nine months this year was 4.3% lower than in the same period of the previous year. It was primarily influenced by the fall in electric power, water and gas supply sector and mining and quarrying sector. If compared to the same period of 2006, growth was only recorded in manufacturing industry.

Graph 1.1 – Industrial output



Source: Monstat

In the **mining and quarrying sector**, production was 6.5% lower due to the lower output in the production of coal, lignite and peat by 32.9% and the mining of metal ore by 1.3%. The production of other ores and stones was 50.6% higher.

Growth in production of ten branches of **manufacturing industry**, that made up 64.3% of overall industrial production contributed to the higher production in this sector by 8.6%.

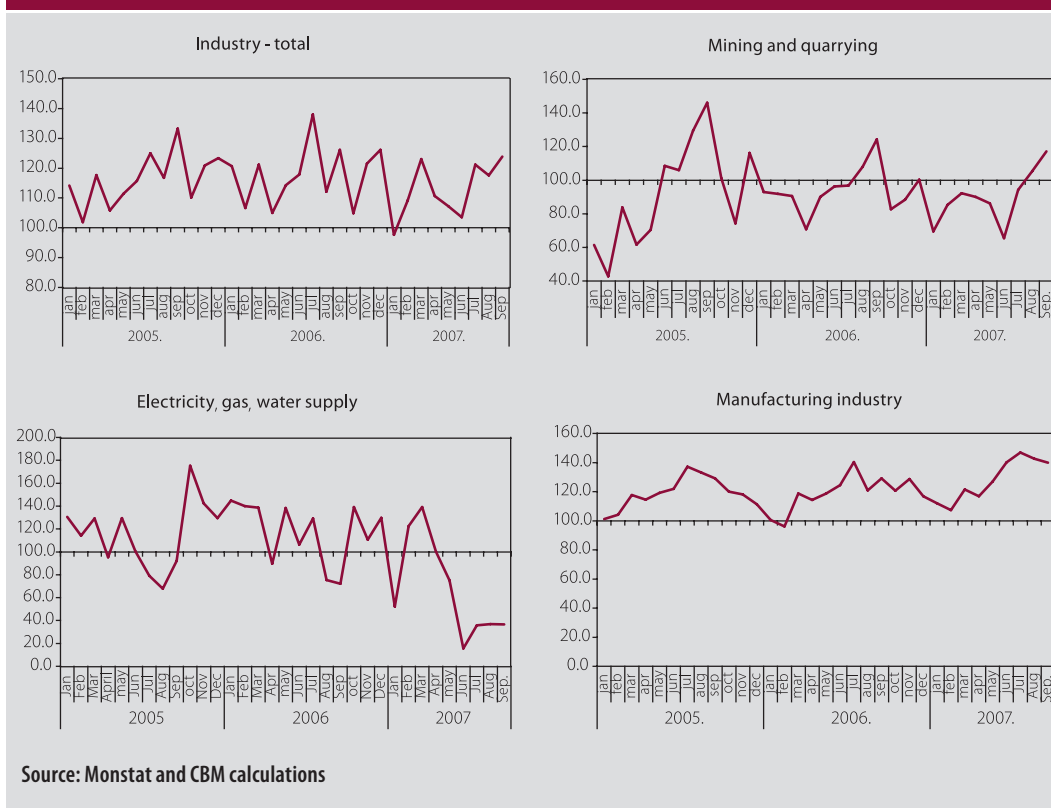
The highest growth was recorded in the manufacturing of leather products and footwear (261.5%), but this growth was a result of a very low base, because according to Monstat data, there was no production in this branch in the first quarter last year. A high increase was recorded in the manufacturing of electrical machines, devices and apparatus, excluding household appliances (65%), the manufacturing of chemicals and chemical products (54.9%), as well as the manufacturing of cellulose and paper, and paper processing (50.9%).

Branches of manufacturing industry which recorded output growths in the previous year continued to grow in this year as well. Thus the manufacturing of metal products (excluding machines) was 58.7% higher, manufacturing of basic metals 6% higher and the manufacturing of food products and beverages 2.8% higher. The share of these branches of manufacturing industry in overall industrial production amounted to 51.6%.

Seven branches of manufacturing industry recorded lower production in the reporting period. The declines ranged from -0.4% in the manufacturing of wood and cork and other products, to -26.9%, in the manufacturing of textile fibres.

The production of electricity, gas and water supply was 40.3% lower than in the same three-quarter period of the previous year. The reason for this was a very low production in the beginning of this year, due to unfavourable weather conditions and the lack of resources, as well as due to problems in the operation of the thermal power plant "Pljevlja", caused by the lack of coal and repairs. Although the situation improved in the February – April period, this was not enough to compensate for the beginning of the year. In addition, major repairs to the thermal power plant "Pljevlja", which started on 18 May this year and lasted almost four months (until 10 September), influenced the reduction of 40% in the overall volume of production in the nine-month period. Observed per months, in the first three quarters

Graph 1.2 – Industrial output by sectors, Ø 2000 = 100



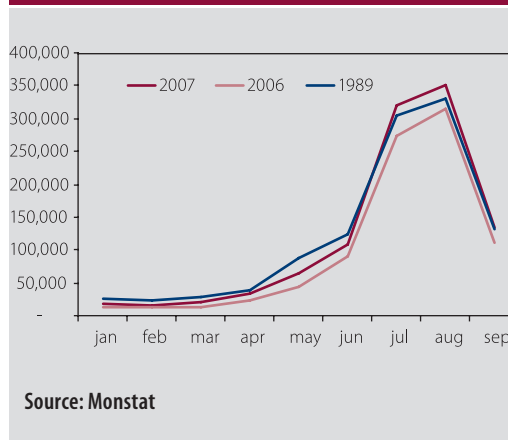
this year, only in March and April higher level of electric power production was recorded than in the previous year.

The physical volume of industrial production in September this year, in relation to the same month of the previous year, was 1.8% lower. A fall of 5.8% was recorded in the mining and quarrying sector, and 49.3% in the production of electricity, gas and water supply, whereas manufacturing industry achieved production increase of 8.2%.

1.2.2. Tourism

In the first nine months this year, 1,066.7 thousand tourists visited Montenegro, some 19.13% more than in the same period of the previous year, but this was still not the number of visits from the record-breaking 1989, when 1,097.7 thousand tourists visited Montenegro for the nine-month period. Namely, when making comparison between those two years, it can be concluded that the number of tourist arrivals in 2007 was significantly higher only in third quarter by some 5% in relation to the same period in 1989.

Graph 1.3 – Tourist arrivals, I-IX 2007



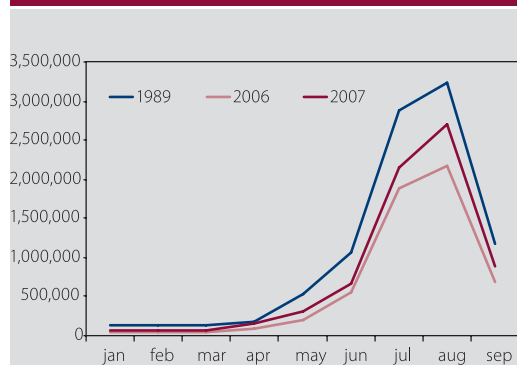
Of total tourist arrivals for nine months of the current year, 90.9% visited seaside resorts, and of overall number of overnights 96% were at the seaside. The mountain resorts were visited by 50.7% more tourists than in the same period of the previous year.

The number of overnights recorded in the first nine months (7,036.1 thousand) was 23.2% higher than in the same period in 2006, but the figures from 1989 were not attained when there was over 3 million overnights in August only.

A record number of tourist arrivals from Hungary (149.9 thousand more than in the same period of 2006) and Italy (133.5 thousand more) were also recorded in the third quarter, and there was a significant number of tourist arrivals from Scandinavian countries as well. In case of these three categories, the number of recorded overnights came close to a record-breaking level from 1989,

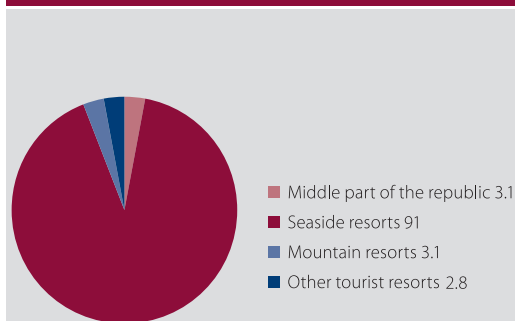
which points to the fact that Montenegro is becoming an attractive tourist destination again for tourist who come from the developed European countries. Regardless of the tourist offer at the 'International Tourism Fair (ITF) held in Berlin, which is one of the most important fairs of this type, number of tourists from Germany fell to some 21% in relation to third quarter of the previous year. An increase of some 21% was recorded with Czech tourists and this can be characterized as a result of good tourism promotion at the tourism fair held in Prague within the "Holiday World 2007".

Graph 1.4 – Tourist overnights, I-IX 2007



Source: Monstat

Graph 1.5 – Structure of tourist arrivals, by resorts, I-IX 2007, in %



Source: Monstat

Box 1.2 – WTTC assessments in cooperation with the research partner Oxford Economic Forecasting

According to WTTC/Oxford Economic forecasts, annual growth of tourism in Montenegro for 2007 will lag only behind China with forecasted growth of +9.1% but it will precede India (+7.9) and will be ahead of Croatia and Romania, which are the only remaining European countries between the top ten, according to WTTC.

If the employment in broader economy generated by tourism is observed, Montenegro is ranked as 34th on the WTTC list. If we presume continuation of positive trends in this field, there is a potential that during the next decade, employment in tourism will increase with the annual rate of 4.1% between 2007 and 2017. According to this forecast, Montenegro was ranked 12th among 176 countries monitored by the WTTC/Oxford Economics.

According to the data from July this year, there were 12,923 employees within the Hotels and Restaurants field, which is 8.1% of the total number of employees in that month, and WTTC projected 14,900 employees in tourism field for 2007.

Number of employees in this field is almost identical to the forecast presented in Human Resources Development Strategy for the Tourism Sector in Montenegro (12,000 employees for 2006) that was produced with the assistance of German Agency for Technical Cooperation (GTZ) which relates to the needs for qualified staff in the tourism sector from 2006 to 2016.

In this period, National Tourist Organization of Montenegro, inter alia, presented its offer at the RDA fair held in Cologne which is the largest European fair specialized in the bus tourism with the intention to provide concluding of contracts with various agencies on bus cruise visits to Montenegro.

The current activities were presented and the ones for the implementation of "Hiking & Biking" project were planned. Namely, "Wilderness Hiking and Biking" should be the new tourist product for the mountain region. This is, in fact, the new segment of tourist offer directed to tourists who spend their vacation outdoors. The activities regarding this project were directed to creation of such tourist "product" that will be in line with standards and expectations of the target groups which are generally highly solvent and educated people.

Within new projects aimed at sustainable tourism development in the north, special attention was paid to training and education of staff who work in the tourist industry sector, and this was stressed in the *Human Resources Development Strategy for the Tourism Sector in Montenegro* specifying the need for qualified staff in the tourist sector per branches, levels and priorities.

In addition to conducted large volume preparations and the fact that this season was one of the best in the last twenty years, if observed by the number of arrivals, there are still infrastructural problems which complicate development of tourism as the future significant branch of industry. This season was also recognized by a poorly solved solid waste and wastewater issue, water supply problems in the midst of the tourist season, insufficient number of parking lots and a number of other drawbacks.

The campaigns "Keep it clean!" and "Register the accommodation" contributed to further improvements when compared to the previous period. More beds were registered in private accommodations, but this did not eliminate grey economy in this area. Since tourism is a field that generates a number of other complementary fields such as transportation, trade and

agriculture, it is necessary to take care of its further improvement in an adequate manner. It should be continuously worked on its quality and enrichment of tourist offer. The creation of projects on alternative aspects of tourism (mountain-climbing, paragliding, caving, bird watching etc.) as well as the creation of the Programme for revitalization of old roads as projected in the National Strategy for Integrated Coastal Zone Management (NS IUOP) of the Republic of Montenegro will surely have impact on overall tourism development.

1.2.3. Forestry

In the field of forestry in the first nine months this year, a total of 194,571 m³ of wood products were produced, 18.3% less than in the same period of the previous year. The reason for the reduced cutting was the delay in the conclusion of concession contracts for state forests exploitation to forestry companies. Finally, at the beginning of the second quarter of the year, a contract was signed on granting long-term, favourable concessions for the exploitation of 135 thousand m³ of gross wood mass annually from the Pljevlja forests and some of the contracts were signed even later, in June and August.

1.2.4. Construction

The value of construction work in the first three quarters of the current year amounted to EUR 128.5 million¹, being 11.1% lower than in the comparative period of 2006. On the other hand, construction activity, if measured by effective working hours, decreased by 2.5%. Quarter-on-quarter, the value of construction work in the third quarter was 4.2% higher than in the preceding quarter of this year, while in relation to the third quarter of the previous year it was 27.6% lower.

According to Monstat data, new construction contracts, implying concluded contracts for constructing new, and reconstructing the

¹ Preliminary Monstat data

existing, residential buildings increased by 26.4% in the first nine months this year in relation to the comparative period, and other construction contracts (by definition, other land construction except residential buildings, every underground and aboveground construction, as well as hydraulic engineering) increased by 12.1%. However, a fall of activities in construction is not the worrying one, bearing in mind an extremely high base from the previous year.

1.2.5. Transportation

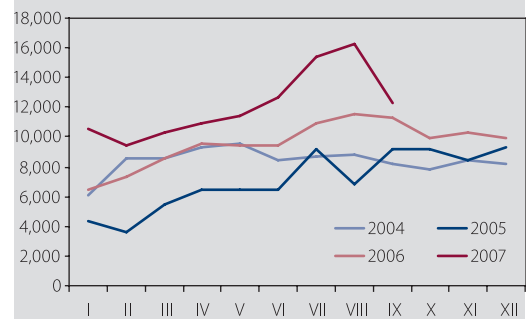
Positive results were achieved in transportation services in the reporting period. Observed as the number of transported passengers per kilometre in road transport, a growth of 29.4% was recorded for the first nine months of the current year in comparison with the same period in 2006. The road cargo transport recorded an increase of 20.9%.

The Analysis on Condition of Local Roads in Montenegro was produced in this period. One of the basic objectives of the Analysis is consideration of local roads condition in order to identify particular problems as well as to find efficient mechanism for solving them (financing, maintenance of local roads and alike). In this manner, the level of transportation services will be improved and quality and safe road transportation will be made possible. The proposal of measures for improving the local roads condition in Montenegro was also given in the Analysis.

The representatives of the Government of Montenegro and the French company "Lui Berge" signed the agreement on producing the feasibility study for constructing two motorways. The selected consultant should prepare the study by the end of April next year, and the agreed price for production is EUR 1.3 million. In producing the study, greater attention will be paid to construction of motorway from Bar to Boljari, and the priority section of this road is between Podgorica and Matesevo. In addition, the schedule for construction of motorways should be available by the beginning of next year.

Comparison of data on passenger transport via railways for the first nine months of the current year, shows a growth of 17.9% when compared to the same period in 2006. Prolonged tourist season significantly increased the number of transported passengers and only in the third quarter by 22.8% in relation to the same period of the previous year. The cargo transport in the reporting period was 8.5% higher.

Graph 1.6 – Road passenger transport



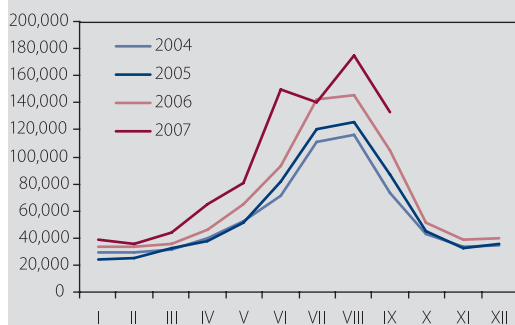
Source: Monstat

Certain activities with regard to starting the container train line from Bar to Budapest intensified. In this way, the goods turnover would increase in the railway transport and the Port of Bar will be linked to the Central and Eastern Europe through Budapest. It is estimated that the container transport could start functioning even at end-2007. Modern operations of two large systems such as the "Railways" and the "Port of Bar" are focused on international market. Excessive work of ports in the northern part gives a good chance to the Port of Bar to take advantage of its capital and strategic position in order to place the cargo delivered to this port to the Eastern Europe market.

Air transport also records positive results and 863,000 passengers were transported in the first nine months this year, 23.3% more than in the comparative period of 2006. A good tourist season, an increasing number of organized charter flights as well as concluded arrangements in early season for using air lines for transport of passengers from distant destinations together with positive results in tourism, had influence on this increase. The air cargo transport increased by 18.9% in this period if compared to the same period in 2006.

Total turnover in ports for the first nine months of the current year was 1.6 million tonnes, which was 8.6% more in relation to the same period in 2006. When compared to total turnover, 38.5% related to exports and it reduced by 23.7% while 61% related to imports which increased 51.2% in relation to the same period in 2006. The transport of goods, if observed per tonne miles, was 9.7% higher.

Graph 1.7 – Air passenger transport



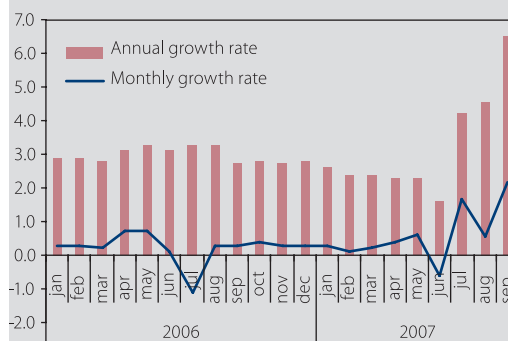
Source: Monstat

Average prices of all main categories of goods and services that are included in the Monstat calculation of overall cost-of-living index recorded a growth in the first nine months of 2007. However, the movement of prices in the reporting period was mainly influenced by food product prices, goods and services from both “housing” and “transportation and postal services” category.

1.3. Prices

In September 2007, in relation to the previous year-end, as measured by the cost-of-living index, prices increased by 5.5%, whereby the prices of goods increased by 4.8%, and the prices of services by 6.5%. At the annual level, prices in September were 6.5% higher. At a monthly level, an inflation of 2.1% was recorded in September.

Graph 1.8 – Cost of Living Index



Source: Monstat

Table 1.2 – Share of inflation for certain groups of goods and services in total inflation

	weight	IX07/XII '06	growth rate	contribution	share in total
TOTAL	10.000	105,54	5,54	5,54	100,00
Food products	5.046	104,02	4,02	2,03	36,62
Fresh and processed vegetables	629	110,84	10,84	0,68	12,31
Fresh and processed fruit	478	111,01	11,01	0,53	9,50
Tobacco and beverages	694	100,32	0,32	0,02	0,40
Clothing and footwear	845	101,05	1,05	0,09	1,60
Housing	1.259	115,68	15,68	1,97	35,64
electricity	605	130,92	30,92	1,87	33,77
Personal care items	712	100,56	0,56	0,04	0,72
Education and culture	460	102,75	2,75	0,13	2,28
Transportation and postal services	984	113,09	13,09	1,29	23,25
liquid fuels and lubricants	400	106,90	6,90	0,28	4,98
transportation and communication	414	123,66	23,66	0,98	17,68
Goods	8.994	104,83	4,83	4,34	78,42
Services	1.006	111,88	11,88	1,20	21,58

Source: Monstat and CBM calculations

The prices of food products rose by 4%, but their growth accounted for 36.6% of overall cost-of-living expenses. Such an influence of the prices of food products is reasonable because they have the highest weight (50.46%) in the overall basket of goods and services which was used for the calculation of the cost-of-living index. Average prices of all main food products, except fresh eggs, recorded a growth. The highest share in overall inflation was of fresh and processed vegetables prices (12.3%, with a growth of 10.8%), fresh and processed fruits prices (9.5%, with a growth of 11%) and prices of products from the "fats" group.

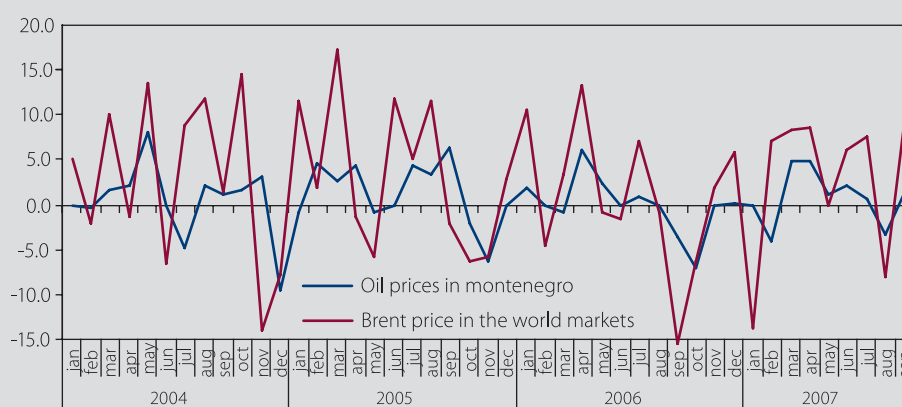
In the "housing" category, the electric power prices had the highest impact on overall inflation. Electric power prices had a growth of 30.9% and this upsurge accounted for 33.8% of overall inflation. However, the data on higher electric prices should be treated with a restriction. Namely, Monstat calculated higher electric prices only in July this year, even though the actual change in prices occurred before.

From the "Transportation and postal services" category, higher prices of transportation and postal services had the highest influence on inflation. With the growth of 23.7%, their share in overall inflation was 17.7%. An increase in prices of telephone charges of 20.7% which share was 9.1% in overall inflation as well as an increase in telephone subscription charges of 100% with the share of 7.4% was recorded in transportation and postal services category.

In the same category, on the second place, according to the influence on overall inflation, were the prices of liquid fuels and lubricants, owing to the oil price movements in the world. Oil prices in the world market during the nine-month period increased extremely, primarily due to geopolitical tension and speculative investments in the oil market. The oil prices fall was recorded in the mid-January, but the prices, on average, rose gradually until end-September (except for the fall in August in comparison with July), even though they fluctuated. Thus, during January, the price of the OPEC reference basket was USD 50.7/barrel, which was the lowest monthly average since May 2005, while the average OPEC price in September amounted to USD 74.18/barrel.

Under the influence of the world market, the prices in the category "liquid fuels and lubricants" in Montenegro recorded a fall in January, although it was not statistically registered in January but in February, because Monstat performs screening of prices of industrial non-food products by the tenth day in the current month, and the most notable fall in prices on the world market was in the second half of January. As of February and until the end-September (except for the fall in August in comparison with July), the prices of liquid fuels and lubricants in Montenegro constantly increased at the monthly level. In September, in relation to December 2006, the prices in the category "liquid fuels and lubricants" increased by 6.9%, thus accounting for 5% of overall inflation.

Graph 1.9 – Oil prices, monthly growth rate



Source: Monstat and "Monthly Oil Market Reports", OPEC

Box 1.3 – Inflation: Comparison with the neighbouring countries, EMU and EU

If we observe annual inflation rates (consumer prices) of the countries in the region, in September 2007, we can conclude that there was an increase in inflation in all the countries in the region except in Bosnia. The inflation in Economic and Monetary Union (Euro zone) was 2.1%, and in EU27 it amounted to 2.2%, thus it was somewhat higher even in this region when compared to the previous year. Also, one can perceive an increase in annual inflation rate in third quarter in almost every observed country.

Table 1 – Inflation in countries of the region, % (ranked as per the last column)

Country	XII '06/XII '05.	VII '07/VII '06.	VIII '07/VIII '06.	IX '07/IX '06.
Bulgaria	6.5	8.4	12.0	13.1
Serbia	6.0	4.2	6.5	8.0
Montenegro	2.8	4.3	4.6	6.5
Romania	4.9	4.0	5.0	6.0
Albania	2.5	2.1	4.2	4.4
Croatia	2.0	2.1	2.6	3.9
Macedonia	2.9	1.3	2.2	3.6
Slovenia	2.8	3.8	3.5	3.5
Bosnia and Herzegovina	4.6	0.3	0.9	1.6
EU-27	2.2	2.0	1.9	2.2
EMU (Euro zone)	1.9	1.8	1.7	2.1

Source: Central banks and statistical offices of the respective countries

The comparison of the prices growth rate in the first nine months of this, and the previous two years shows that prices increased at a faster pace in this year. Excluding the prices of tobacco and beverages, which recorded lower growth rate, all other categories recorded faster growth when compared to reporting periods from the previous two years. The most distinct difference was with the increase in heating and lighting expenses, “transportation and postal services” category prices and food product prices. It is noticeable that prices of services experienced a more rapid growth than the prices of goods, largely due to the above mentioned upsurge of telephone charges and subscription, in the “transportation and postal services” category.

Retail prices rose 6.1% during the first nine months due to the growth in the prices of agricultural products of 11.9%, industrial products of 5.3%, while the prices of services rose 8%. The annual growth rate of retail prices in September amounted to 6.4%.

Table 1.3 – Cost-of-living, growth rates

	IX '05 XII '04	IX '06 XII '05	IX '07 XII '06
TOTAL	1.3	1.7	5.5
Food products	0.4	2.2	4.0
Tobacco and beverages	6.3	0.4	0.3
Clothing and footwear	0.6	0.2	1.0
Housing	0.9	3.3	3.7
Heating and lighting	0.1	1.0	25.3
Furniture	-0.3	0.4	0.7
Personal care items	0.4	0.5	0.6
Education and culture	0.8	2.2	2.8
Transportation and postal services	7.0	2.9	13.1
Goods	1.3	1.8	4.8
Services	0.9	1.2	11.9

Source: Monstat

Producers' prices of manufactured products increased 10.8% during the first nine months, while the annual growth rate amounted to 9.9% in September. Monthly growth rate of these prices amounted to 0.2% in September.

The average cost-of-living growth rate (January-September 2007 in relation to the same period in 2006) was 3.2%.

Box 1.4 – Annual and average inflation

There are various inflation indicators: retail prices growth rate, cost-of-living price index, consumer price index, harmonized index of consumer prices, etc. The consumer prices index (CPI) or the harmonized index of consumer prices (HICP) are commonly used inflation indicators in Europe. The Central Bank of Montenegro decided to use the cost-of-living index as the inflation indicator. However, when it comes to this index, certain dilemmas can occur, because it increased by 5.5% in comparison with the end of the previous year, and if we compare the first nine months of this year to the same period last year, it then increased by 3.2%. Different methodology of the so-called annual inflation rate and average annual inflation rate is in question. In methodology for calculating annual inflation rate, the price of a certain product as at 31 December of the previous year is compared to the same product price on the same date of the current year. In methodology of average annual inflation rate, the amount of average price of certain product in specified time period of the current year is compared to the average price of the same product in the same time period of the previous year.

In order to get the clearer picture of difference between methodologies, we use a simple example which assumes that there is only one product in economy. Let us assume that the price of the observed product increased from 1 euro (price of the product during whole 2006) to 1.5 euro in September 2007 and that its price will not change during 2008. According to the "annual inflation rate" conception ("end year"), the price of this product was 1.5 euro at end-2007 and 1 euro at end-2006, thus the annual inflation rate was 50%. Since the product price will not change during 2008, then the annual inflation rate will be 0% in 2008.

According to the "average inflation rate", the price of this product was 1 euro during eight months this year, and during four months this year its price was 1.5 euro. This means that its average price in 2007 was 1.16 euro.² Since the price of the product was 1 euro during the whole previous year, this means that average annual inflation rate in 2007 amounted to 16%. However, since the price in the observed product in 2008 was 1.5 euro and the average price during 2007 amounted to 1.16 euro, it means that the average annual inflation rate in 2008 will amount to 29.3%, i.e. so-called inflation spillover effect in 2008 will occur.

1.4. Labour market

The number of employees in the first nine months of this year amounted to 155,830 on average, and was 4% higher in relation to the same period of the previous year. Observed by individual sectors, the highest growth was recorded in the field of state

administration and social insurance (79.5%), but it was the result of the changed coverage method applied by Monstat. Namely, as of this year, the statistical coverage includes employees of the Ministry of Interior and the army, but the change was not applied retroactively to the previous year, which makes the analysis and comparison more difficult. Among the sectors, the

² The average price is calculated when the sum of monthly prices of products is divided with 12.

growth in the number of employees was registered in the trade and repair sector (5.9%) and in hotels and restaurants (0.2%). However, the Monstat's change in methodology as well as the above mentioned increase in the number of employees in the trade and repair sector employing almost one fifth of the total number of employees, overwhelmed the impact of a drop in the number of employees in other sectors, resulting in an increase in total number of employees.

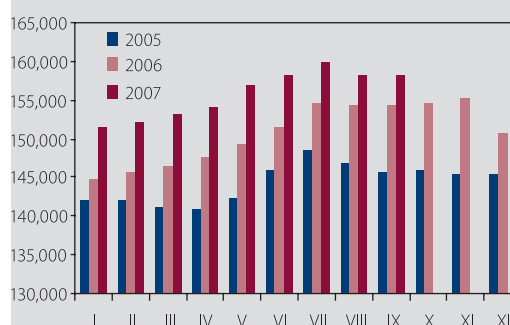
Observing the structure of employees through the main three sectors, manufacturing, services and the public sector, the largest number of employees in September (ongoing) was in the sector of services, followed by the public sector, and the production sector.

The number of registered unemployed persons in the first nine months of this year amounted to 35,325 on average, or -20.9% less than in the same period of the previous year. In September, according to the Employment Agency, there were 31,156 people looking for jobs.

A slowdown of positive trends in the labour market should be expected in the fourth quarter of this year if compared to the previous quarters, due to the cessation of the seasonal employment effects during the summer tourist season.

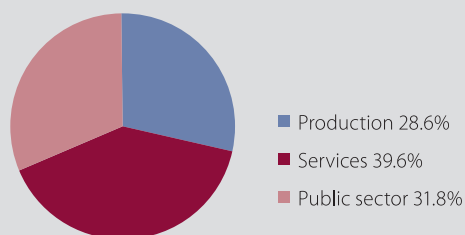
Several strategic documents were adopted with regard to the labour market: the National Employment Strategy for the period 2007-2010, the National Action Plan for Employment for the period 2007-2008, and the Employment Program for 2007. These documents define tasks and a complex set of measures which should be implemented in respect to structural changes in the economy, with the aim of reducing primarily a long-term unemployment. The implementation of tasks specified in these documents will have positive effects on all segments of the Montenegrin economy. In addition, all countries of the European Union, as well candidate countries, are obliged to prepare national action plans for employment in line with the common procedure and methodology. Therefore, bearing in mind that the strategic commitment of Montenegro is the EU accession, the creation of this document is becoming more and more important. This even more so when considering the limited possibilities of these defined measures to be financed by the Montenegrin Government and this may create the possibility to use resources from the EU funds.

Graph 1.10 – Number of employees



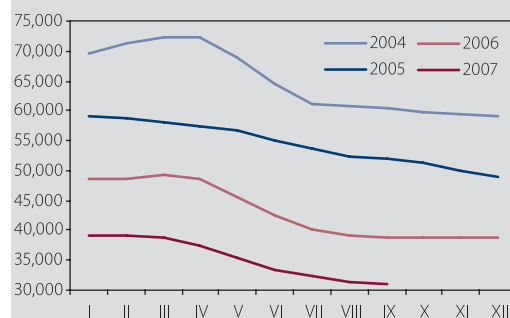
Source: Monstat

Graph 1.11 – Structure of employees, by sectors



Source: Monstat

Graph 1.12 – Number of unemployed people



Source: Employment Agency

Wages and salaries

At the beginning of this year, Monstat changed the method of calculating an average salary. Previously, an average salary had been calculated by dividing the total salaries paid by the number of employees at the end of the reporting month, as per personnel records, no matter if the employees received their salaries or not in that month. As of January this year, the total salaries paid in a month is divided with the number of employees to whom the effected payments refer. The changed methodology is also applied for the calculation of average salaries for 2006, so that the average salary in 2006 amounted to EUR 433 (instead of the previously published EUR 377), a salary without taxes and contributions amounted to EUR 282 (instead of the previously published EUR 245).

In the first nine months of the current year, the average salary in Montenegro amounted to EUR 483, which is 12.3% more than in the same period of 2006. A salary without taxes and contributions amounted to EUR 328, this being an increase of 17.1%. The highest salaries without taxes and contributions were recorded in the field of financial intermediation (EUR 736), while the lowest salaries received employees in the field of fishery (EUR 137), the latter recording a fall of 13.8%. The highest growth of salaries without taxes and contributions was recorded in construction (36.2%), financial intermediation (31.4%) and tourism (26.6%), these being the fields that recorded the most rapid growth in both last and current year.

The increase in salaries without taxes and contributions is explained, besides the growth in economic activity, by the implementation of the proportional taxation of personal income at the rate of 15% as well as by an increase in the minimum wage from EUR 50 to EUR 52.³

The Montenegrin Government, the Trade Unions of Montenegro, and the Union of Employers of Montenegro signed the agreement on determining the minimum wage, which served as the basis for the adopted Decision on the Minimum Wage ("Official Gazette of the Republic of Montenegro", no. 02/07) that specifies the minimum wage in 2007 as follows:

- in the first quarter of 2007 (as of 1 January) to the amount of EUR 52;
- in the second quarter of 2007 (as of 1 April) to the amount of EUR 53;
- in the third and fourth quarter of 2007 (as of 1 July) at the amount of EUR 55

Also, personal income of employees in the health and social insurance increased by 30% in September. The judges also received 30% higher salaries. However, this increase was not statistically included, for the very payment of salaries did not occur in September but later. Review of the Sector Collective Agreement was also announced for employees in the field of education, science and culture. According to the agreement, salaries for employees working in this sector will increase by 30%, of which 20% in October and 10% in January next year. Thus, an increase in salaries can be expected in the fourth quarter as well.

Box 1.5 – Average salaries in the former Yugoslavia countries, September 2007

Comparing the data on average salaries in countries of the former Yugoslavia, it can be seen that in September 2007 Montenegro occupies the fourth position on the scale, being ahead of Bosnia and Herzegovina and FYR Macedonia. However, these data should be regarded with restrictions, due to certain methodology differences in calculations, but this could not disrupt the general rating of differences and amount of salaries. Slovenia still leads in the observed group of countries, then follow Croatia. Serbia, Montenegro and Bosnia and Herzegovina, which are at almost the same level, while FYR Macedonia is at the rear of scale.

³ It should be taken into account that the salaries in a great number of companies are calculated by multiplying the amount of lowest salary by a defined coefficient.

Table 1 – Average net salaries in the former Yugoslavia counties, (ranked as per net amount), EUR

Country	Net salary	Gross salary
Slovenia	820	1,259
Croatia	651	946
Serbia	357	498
Montenegro	345	508
Bosnia and Herzegovina	333	493
FYR Macedonia	246	408

Source: Statistical offices and central banks of the respective countries

MONETARY DEVELOPMENTS

2

The credit expansion marked the first nine months of this year: the loans were more than two times higher at end-September than the level of loans at end-2006, while they increased 2.8 times when compared to the same period of the previous year. The average monthly growth of loans during the nine-month period of 2007 amounted to 8.8%, which was significantly above the average growth of loans recorded in previous years. Besides, observed per banks, the loans increased up to 4.5 times this year, with the annual increase being even up to 8.6 times.

The banks could not satisfy an increased demand for loans, especially the demand for long-term loans from their deposits and beside their extremely high growth that was on average 6.1% during the first nine months, primarily due to a problem of maturity mismatch of funds and investments, they therefore increased the use of credit lines from abroad. At end-September this year, the foreign borrowing amounted to 149.6% more than the debt at the end of 2006, with the annual growth being 223.6%.

The corporate and household sector remained the largest net debtors to banks, but also the largest depositors to banks, the household sector representing the net depositor with corporate sector being the net debtor to banks.

2.1. Money supply

With an average monthly increase of 5.2% during the reporting period, broad money M21 reached the amount of EUR 2.5 billion at end-September. This level was EUR 913.5 million or 57.6% higher for the first nine months, while the annual growth amounted to EUR 1.2 billion or 98.4%. (Table 2.2)

Note: Monetary base (**M0**) is comprised of banks' deposits with the CBM (banks' settlement accounts and allocated reserve requirements, excluding the portion banks keep as treasury bills)

Table 2.1 – Selected monetary indicators

Description/Period	IX 2007 XII 2006	IX 2007 IX 2006
Money supply M21	+57.6%	+98.4%
Banks' assets	+76.8%	+129.6%
Total loans	+113.7%	+ 177.3%
Corporate loans	+130.3%	+204.1%
Household loans	+109.2%	+181%
Total deposits	+69.1%	+124.8%
Corporate deposits	+71.8%	+120.1%
Household deposits	+84.9%	+162.4%
Allocated reserve requirements	+48.5%	+99.2%

and the estimated amount of cash in circulation. **Monetary aggregate M1** is comprised of M0, demand deposits by the non-banking sector with banks and the CBM, in EUR and other currencies, excluding deposits by the central government.

Monetary aggregate M11 comprises M1 plus the central government's demand deposits in EUR and other currencies.

Monetary aggregate M2 includes M1 and the non-banking sector's term deposits with banks and the CBM, in EUR and other currencies, excluding deposits by the central government.

Monetary aggregate M21 comprises M11 plus the non-banking sector's term deposits including the central government's deposits in EUR and other currencies.

In the structure of broad money M21, the money supply M11 was still dominant with a share of 57.4%, and the increase in the share of time deposits in M21 was also noticeable – from 31.3% in September 2006 to 42.6% in September 2007.

The increase in broad money M21 was contributed by time deposits that increased 169.9% for a year period, i.e. 118% for the nine-month period of 2007. The increase in time deposits included in the broad money M21 was largely contributed by

Table 2.2 – Money supply, EUR million

Description/Period	2006				2007		
	III	VI	IX	XII	III	VI	IX
M0	335.3	369.8	402.1	483.9	483,1	516.7	542.2
M1	589.0	714.3	832.1	1,078.8	1,165.7	1,324.7	1,404.4
M0	335.3	369.8	402.1	483.9	483.1	516.7	542.2
Demand deposits	253.7	344.6	430.0	594.9	682.6	808.1	862.2
M11	617.8	739.4	865.7	1,098.5	1,200.2	1,358.0	1,436.3
M0	335.3	369.8	402.1	483.9	483.1	516.7	542.2
Demand deposits	282.5	369.6	463.6	614.6	717.1	841.4	894.1
M2	809.1	954.9	1,170.9	1,507.1	1,721.4	2,028.7	2,283.3
M1	589.0	714.3	832.1	1,078.8	1,165.7	1,324.7	1,404.4
Time deposits	220.1	240.6	338.8	428.3	555.7	704.0	878.9
M21	874.1	1,012.6	1,259.9	1,586.7	1,834.3	2,194.0	2,500.2
M11	617.8	739.4	865.7	1,098.5	1,200.2	1,358.0	1,436.3
Time deposits	256.3	273.2	394.2	488.1	634.1	836.0	1,063.9

the time deposits of the central government with the CBM that increased for EUR 129.4 million or 250.2%. At the same time, the broad money M11 recorded an annual growth of 65.9% with the increase for the nine months of this year being 30.7%.

2.2. Liquidity of banks

The main indicators of liquidity⁴ point to a satisfactory liquidity in the banking sector during the first nine months this year.

The available liquid funds of banks in the country and abroad ranged between EUR 366 million and EUR 612 million in the first nine months this year and on average amounted to EUR 456.6

million, which was significantly above the average level recorded in the same period of 2006 (EUR 230 million).

The level of effected payments by banks was constantly much below the available funds, amounting to EUR 46.2 million on average for the first nine months of 2007. On the basis of available funds and effected payments movement, the surplus totalling EUR 410.4 million⁵ was recorded.

At end-September 2007, funds available for payments amounted to EUR 484 million, which was 22.6% more than at end-2006, i.e. 75.6% more than in the previous year. At the same time, the funds available for payments in the country accounted for 48% of overall banks' funds available for payment.

Table 2.3 - Average banks' available funds and effected payments, EUR thousand

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Banks' available funds	220,250	193,931	277,728	371,738	414,887	435,808	517,250
Executed payments	18,981	24,189	29,239	36,014	38,437	51,020	48,966
Surplus	201,269	169,742	248,489	335,724	376,450	384,788	468,284

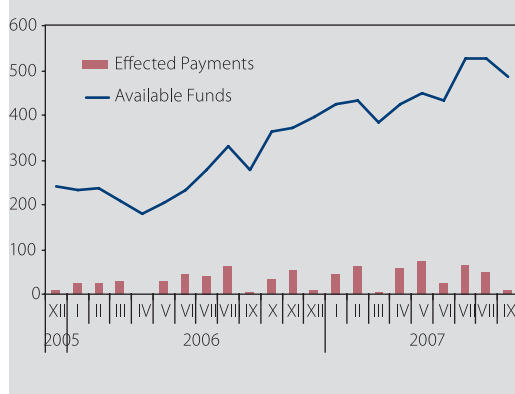
⁴ Not considering the liquidity management aspect

⁵ Source: Report on daily liquidity of banks

Table 2.4- Banks' available funds and effected payments, as at the last day in quarter, EUR thousand

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Available funds	209,902	232,589	275,690	394,757	385,662	432,363	484,024
Executed payments	29,046	45,156	3,406	9,191	3,274	26,202	6,801
Surplus	180,856	187,433	272,284	385,566	382,388	406,161	477,223

Graph 2.1 - Banks' available funds and effected payments, last day in month, EUR million



Banks' liquid assets amounted to EUR 674 million at end-September 2007, and in relation to end-September of the previous year they increased by EUR 264 million or 69%, while in relation to the previous year-end they were 26.4% higher. The share of liquidity in overall assets amounted to 25.6%, lower by 35.8% than at end-2006 and by 34.8% in September 2006.

Data from banks' ten-day liquidity reports shows that during the first three quarters this year the level of monetary assets in relation to short-term sources⁶, for the banking system as a whole, was constantly above the ten-day minimum (20%) prescribed for banks having a higher amount of loans than deposits and/or a large share of non-performing loans in their loan portfolio.

The ratio 'liquid assets/short-term liabilities' recorded a fall from 58% to 44% in the period September 2006 – September 2007.

⁶ Source: Banks' ten-day liquidity reports

⁷ Assets classified as the C, D and E categories.

The same fluctuation was characterized by the ratio 'liquid assets/overall liabilities' and the fall from 39.5% to 27.9%.

2.3. Aggregated Balance Sheet of Banks

The total assets of banks amounted to EUR 2,530.6 million at the end of third quarter. During the first nine months of 2007, it increased and amounted to EUR 1,099.2 or 76.8%, with the annual increase being EUR 1,428.4 million or 129.6%.

Observed by banks, all of them recorded an increase in assets in the first nine months of 2007, the increase in absolute amount ranging from EUR 6.8 million to EUR 385.9 million, i.e. from 18.5% to 234.5% if shown as the growth rates. If observed from the end of third quarter of 2006 to the end of third quarter this year, all banks were characterized by an increase in total assets, the increase itself being from EUR 6.8 million to EUR 470.3 million, i.e. from 31.7% to over eight times of that.

The share of interest-bearing assets in total assets increased by 6.9 percentage points for a period of one year (Sept 2006 – Sept 2007). The interest bearing assets made 83.8% of total assets at end-September 2007.

The share of non-performing assets⁷ in total assets at end-September 2007 was at the share level recorded at the end of the same period of the previous year (2.66%) while the relation between non-performing assets and the capital increased for the amount of reserves was 25.9%, and this ratio increased in relation to the same period of 2006, when it was 18.83%.

Table 2.5 – Selected monetary indicators and GDP

Description/Period	2000	2001	2002	2003	2004	2005	2006	IX 2007	Increase XII 2006-IX 2007
	in EUR million								
Loans	81.7	94.3	124.7	200.6	281.5	375.9	847.2	1,810.6	963.4
Deposits	155	176	206	211	273	488	1,076	1,820	743.9
Savings (Household deposits)	4	11	22	45	79	176	499	923	423.8
GDP ⁸	1,022	1,245	1,302	1,392	1,651	1,785	1,970	1,563	1,563
	in %								
Loans/GDP	8.0	7.6	9.6	14.4	17.0	21.1	43.0	115.8	61.6
Deposits/GDP	15.2	14.1	15.8	15.2	16.5	27.3	54.6	116.4	47.6
Savings (Household deposits)/GDP	0.4	0.9	1.7	3.2	4.8	9.8	25.4	59.1	27.1

The indicator of market concentration according to assets recorded a decline. (Table 2.6).

The largest share in the balance sheet of banks' assets at end-September was recorded with total loans (71.5%), and on the liabilities side with total deposits (71.9%). Except from investing in securities, all balance sheet positions recorded an increase, in relation to end-2006 as well as to the same period of the previous year.

2.3.1. Banks' lending activity

During the first nine months this year, banks' lending activity was very significant: the average monthly growth of loans was extremely higher, both in relation to the average growth recorded in the same period of previous years and the one recorded in the twelve-month period of previous years. Also, the annual growth rates recorded in the reporting period this year were significantly higher than those recorded in the previous years. (Table 2.7).

The average monthly increase in loans amounted to EUR 107 million or 8.8% during the first nine months of 2007, total loans reached the amount of EUR 1,810.6 million at end-September, which was 177.3% more than a year before, while an increase for the nine-month period of 2007 was 113.7%.

Table 2.6 – Banks' concentration ratio according to assets

	IX 2006	XII 2006	IX 2007
1 bank	0.42	0.38	0.37
3 banks	0.69	0.64	0.64
5 banks	0.85	0.80	0.82

Table 2.7– Increase in total banking loans, in %

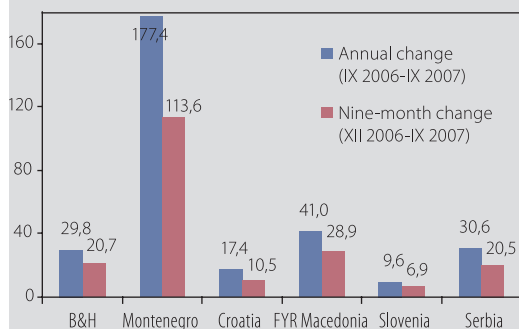
Description/Period	Average monthly change (I-IX)	Average monthly change (I-XII)	Annual change
2003	3.4	4.1	60.9
2004	2.0	2.9	40.3
2005	2.1	2.5	33.6
2006	6.3	7.0	125.3
2007	8.8		177.3

Data on recorded annual growth rates of total demands from domestic sectors at end-September 2007 in the neighbouring countries show that Montenegro is the leading country when it comes to an increase in these demands⁹. (Graph 2.2).

⁸ Source: Monstat and Secretariat for Development of Montenegro estimations

⁹ In case of Montenegro, the total demand consists of loans disbursed to domestic sectors.

Graph 2.2 – Increase in total claims on local sectors¹⁰, in %



Source: Central banks of the observed countries and the CBM calculations

Observed by banks, during the first nine months this year only one bank recorded a decline in loans, while others increased their lending activity. The growth rate fluctuated between 35.1% and 358.6%. The same fluctuation was recorded in one-year period: one bank recorded a decline in lending activity, while other banks increased their lending which fluctuated from 52% to 761%. Observed as absolute amount, the highest increase for the nine months this year was recorded with one bank which loans amounted to EUR 303.5 million, while the highest annual increase amounted to EUR 366.1 million.

The market concentration indicator according to loans recorded a reduction with one and three banks, as well as an increase with

five banks that granted 86% of total loans at end-September of the current year (Table 2.8).

If observed by sectors, the highest share of loans was distributed to the household and corporate sector. Of total loans at end-September 2007, 59.9% related to corporate and 35.9% to household sector. Simultaneously, these two sectors were characterized by the highest annual and nine-month increase: loans disbursed to corporate and household sector increased by 204.1% and 181% for a year period, and 130.3% and 109.2% for the nine-month period, respectively. Therefore, their contribution to overall increase in loans was the highest: corporate sector with 111.6 percentage points contributed to an increase in loans for one year, i.e. the share of this sector in the growth rate of overall loans was 62.9%. The household sector with 64.2 percentage points contributed to an annual increase in loans and recorded a share of 36.2% in the growth rate of overall loans. Similar share these two sectors also recorded in the growth rate of overall loans for the first nine months of 2007 (Table 2.9).

Table 2.8 – Banks' concentration ratio according to loans

	IX 2006	XII 2006	IX 2007
1 bank	0.40	0.38	0.35
3 banks	0.71	0.67	0.66
5 banks	0.84	0.84	0.86

Table 2.9 – Sector structure of total loans – contributions and shares in the growth

Description	Annual change (IX 2007 / IX 2006)				Nine-month change (IX 2007 / XII 2006)			
	Weight ¹¹ %	Growth rate %	Contribution, pp	Share in total growth rate, %	Weight ¹² %	Growth rate %	Contribution, pp	Share in total growth rate, %
Corporate sector	54.7	204.1	111.6	62.9	55.6	130.3	72.5	63.7
Households	35.5	181.0	64.2	36.2	36.7	109.2	40.1	35.3
General Government	7.1	-10.6	-0.7	-0.4	5.1	-3.7	-0.2	-0.2
Other	2.7	79.2	2.2	1.3	2.6	50.2	1.3	1.1
Total	100.0	177.3	177.3	100.0	100.0	113.7	113.7	100.0

Source: CBM calculations

¹⁰ The data for Croatia are for August 2007 The data for Macedonia include claims on all sectors, except on the state.

¹¹ The weight represent the loans share of individual sectors in total loans in the base month (September 2006).

¹² The weight represent the loans share of individual sectors in total loans in the base month (December 2006).

Table 2.10 – Maturity structure of loans, in %

Period/ Description	Up to three months	From three months to one year	From one to three years	Over three years	Total
IX 2006	12.9	30.4	21.3	35.4	100
XII 2006	4.3	27.7	30.0	38.0	100
IX 2007	8.1	19.3	22.9	49.7	100

The maturity structure of loans changed to the benefit of long-term loans. Their participation in total loans increased from 56.7% as at end-September 2006, i.e. from 68% as at end-December 2006 to 72.6% at end-September this year (Table 2.10).

In addition, in the time loans structure, the share of loans with maturity over three years increased, from 55.8% at end-2006 to 68.4% at end-September this year.

In terms of maturity structure, the highest growth in the period September 2006 – September 2007 characterized the loans with maturity over three years that amounted to EUR 900.5 million at end-September 2007 and increased almost four times in a year period. Then, granted loans with maturity of one up to three years increased by 197.7%, loans with maturity of three months up to one year increased by 76% and finally loans with maturity up to 3 months increased by 73.5%. Simultaneously, the share of loans with maturity up to 3 months in overall loans decreased 4.8 percentage points for a year, while the share of loans with maturity over three years increased by 14.3% percentage points.

The change in maturity structure of loans to the benefit of long-term loans and sectoral loan structure, which shows that the largest portion of loans was directed towards the corporate sector, represents the positive indicators with regard to the fact that long-term loans were directed to investments.

The past due loans made 5.1% of overall loans at end-September this year, which was more than in the same period of the previous year (4.61%).

2.3.2. Deposits

With an average monthly increase of EUR 82.6 million or 6.1% during the first nine months this year, overall deposits reached the amount of EUR 1,819.7 million at end-September, which

was significantly more than in the same period of previous years (Graph 2.3).

Deposits were EUR 1,010.3 million or 124.8% higher at end-September 2006, while the increase for the first nine months this year was EUR 743.9 million or 69.1%.

Observed by banks, two banks recorded a slight decline in deposits at end-September 2007 in relation to end-2006 (by EUR 1.6 million and EUR 1.3 million, respectively), while deposits of other banks increased and they ranged between EUR 15.5 million and EUR 299.6 million. In the one-year period, from September 2006 until September 2007, only one bank recorded a decrease in deposits (of EUR 2.3 million), while deposits of other banks increased and ranged between EUR 8.6 million and EUR 377 million.

The market concentration indicator according to deposits recorded a decline. (Table 2.11).

Observed by sectors, the highest share was of deposits by the household sector and the corporate sector. Of overall deposits at end-September this year, 50.7% referred to household sector and

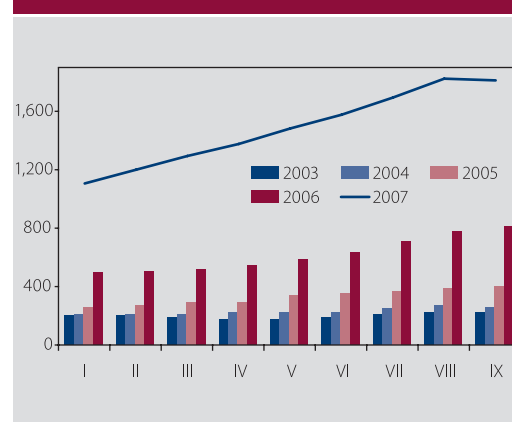
Graph 2.3 – Deposits, last day in month, EUR million

Table 2.11 – Banks' concentration ratio according to deposits

	IX 2006	XII 2006	IX 2007
1 bank	0.47	0.43	0.42
3 banks	0.72	0.68	0.71
5 banks	0.87	0.83	0.85

30.3% to corporate sector. At the same time, these two sectors were characterized by the highest annual and nine-month increase: deposits by the household sector increased by 162.4% for one-year period and 84.9% for the first nine months of 2007 while the deposits by the corporate sector increased by 120.1% and 71.8% for the same periods, respectively. Therefore, their contribution to the overall increase in deposits was the largest: the household sector with 70.6 percentage points contributed to an increase in deposits for one year, i.e. the share of this sector

in the growth rate of overall deposits amounted to 56.6%. The corporate sector with 37.2 percentage points contributed to an annual increase in deposits and recorded the share of 29.8% in the growth rate of overall deposits. These two sectors recorded a similar share in growth rates of overall deposits for the first nine months this year (Table 2.12).

The maturity structure of overall deposits showed a decrease in share of demand deposits and an increase in share of time deposits in the period September 2006– September 2007 (Table 2.13).

However, even though there was an increase in share of time deposits, the maturity structure remained unfavourable with a view to financing demand for long-term loans, i.e. investments: deposits with maturity over three years still have insignificant share in overall deposits (Graph 2.4).

Table 2.12 – Sector structure of total deposits – contributions and shares in the growth

Description	Annual change (IX 2007 / IX 2006)				Nine-month change (IX 2007 / XII 2006)			
	Weight ¹³ %	Growth rate %	Contribution, pp	Share in total growth rate, %	Weight ¹⁴ %	Growth rate %	Contribution, pp	Share in total growth rate, %
Corporate sector	31.0	120.1	37.2	29.8	29.8	71.8	21.4	31.0
Households	43.5	162.4	70.6	56.6	46.4	84.9	39.4	57.0
General Government	13.3	38.2	5.1	4.1	10.5	30.6	3.2	4.7
Other	12.2	97.2	12.0	9.6	13.3	38.7	5.1	7.4
Total	100.0	124.8	124.8	100.0	100.0	69.1	69.1	100.0

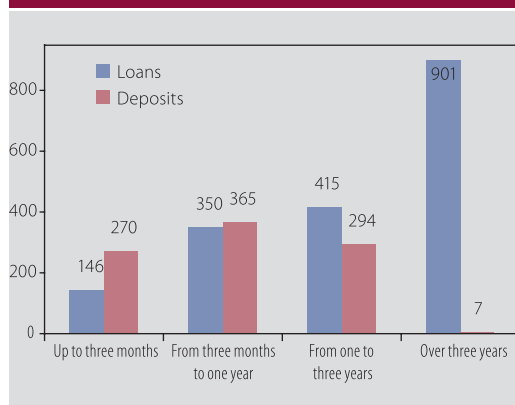
Source: CBM calculations

Table 2.13 – Maturity structure of total deposits, period end, in %

Period/ Description	Demand deposits	Time deposits				Total
		Up to three months	From three months to one year	From one to three years	Over three years	
IX 2006	55.44	6.98	34.73	2.40	0.45	100
XII 2006	56.76	6.64	23.19	13.00	0.41	100
IX 2007	48.59	14.85	20.05	16.14	0.37	100

¹³ The weight represents the loans share of individual sectors in total loans in the base month (September 2006).

¹⁴ The weight represents the loans share of individual sectors in total loans in the base month (December 2006).

Graph 2.4 – Loans and term deposits, September 2007, in EUR million

At end-September this year, 89.19% of overall deposits referred to interest bearing loans, which was 5.34 percentage points more than in the same period of 2006.

2.3.3. Banks' borrowings

Due to an inadequate match of maturity structure of deposits with the loans structure, banks mostly used foreign loans, often from their parent banks to satisfy the demand for long-term loans. Thus, of the total amount of borrowings banks used at end-September 2007, EUR 414.8 million or 94.1% were foreign borrowing.

Foreign borrowings amounted to EUR 390.6 million at end-September 2007. They increased by EUR 269.8 million or more than three times for one-year period, an increase for the first nine months this year being EUR 234.1 million or 149.6%. An increase in foreign borrowings resulted from an increase in loans demand. The loans demand and disbursed loans increased faster than deposits, therefore, the banks bridged the difference in

the sources of funds and investments by foreign borrowings (Table 2.14).

Also, an important factor that had impact on an increase in banks' foreign indebtedness was the maturity mismatch of loans and deposits: long-term loans were dominant in the loans structure and the short-term loans were dominant in the deposits structure (Table 2.15).

In order to make comparison between foreign indebtedness of Montenegrin banks and the banks in the neighbouring countries, the data on banks' foreign liabilities were used in order to avoid differences in the coverage and obtain comparable data series. According to an increase in foreign liabilities that comprises all banks' liabilities to non-residents, Montenegro is the first one on the list. The increase in foreign liabilities amounted to 101.3% in the first nine months this year with the annual growth being 182.4%. In the foreign liabilities structure, the share of foreign loans was 61.5% while the remaining portion referred to non-resident deposits and liabilities from the securities sold to non-residents. The foreign liabilities negative growth rates of banks in both Croatia and Serbia resulted from the measures that the central banks of these countries took with the aim to reduce credit growth and foreign indebtedness of the country (Graph 2.5).

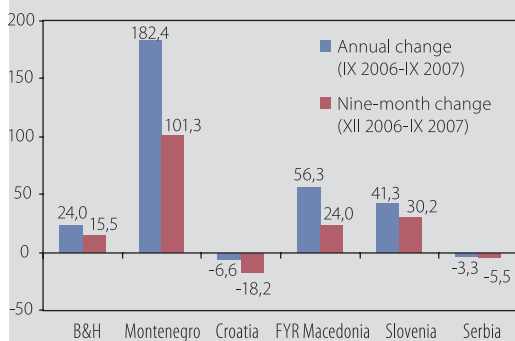
Table 2.15 – Maturity structure of total deposits, loans and banks' borrowings from abroad, IX 2007, in %

	Loans	Deposits	Banks' borrowings from abroad
Long-term (> 1 year)	72.6	16.5	95.6
Short-term (< 1 year)	27.4	83.5	4.4

Table 2.14 – Deposits, loans, banks' borrowings from abroad, period end, EUR million

	2006		2007			Change XII 2006-IX 2007		Change IX 2006- IX 2007	
	IX	XII	III	VI	IX	EUR mill	%	EUR mill	%
Loans	653.1	847.2	1,152.8	1,502.4	1,810.6	963.4	113.7	1,157.6	177.3
Deposits	809.4	1,075.8	1,299.7	1,581.5	1,819.7	743.9	69.1	1,010.3	124.8
Banks' borrowings from abroad	120.7	156.5	191.2	254.3	390.6	234.1	149.6	269.8	223.6

Graph 2.5 – Increase in foreign liabilities of banks, in %



2.3.4. Bank loans and deposits placed with banks (and banks' borrowings)

The loans to deposits ratio was not satisfactory at end-September this year: total loans were slightly lower than total deposits, thus the ratio loans/deposits was inconsiderably lower than 1 and amounted to 0.995. The value of this ratio deteriorated when compared to the end-September 2006 when it was 0.81.

In addition, the loans/deposits ratio increased for borrowings increased for one year, from 0.69 (September 2006) to 0.81 (September 2007).

2.3.5. Household sector

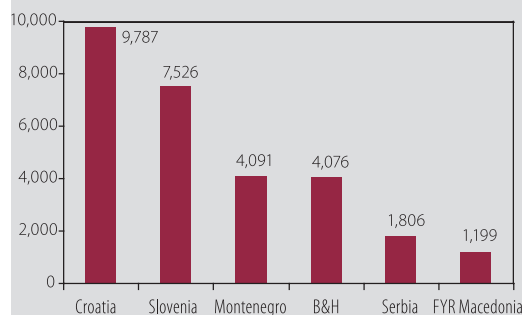
The household sector debt to banks, as per loans, amounted to EUR 651.1 million at the end of third quarter this year. The loans disbursed to household sector for the first nine months of 2007 increased for EUR 339.9 million or 109.2% while the debt of this sector increased for EUR 419.4 or 181% for one year.

Comparing the data on banks' total loan claims on the household sector per employee at end-September 2007, it showed that Montenegro was the third, right behind Croatia and Slovenia and ahead of Bosnia and Herzegovina, Serbia and Macedonia (Graph 2.6).

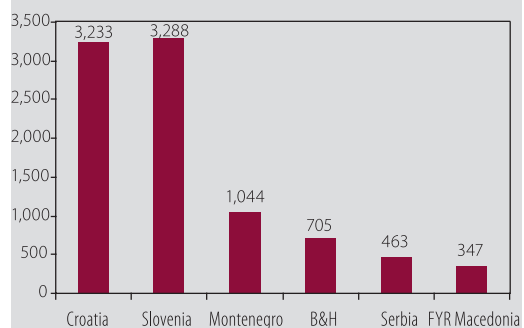
Montenegro has the same position when it comes to domestic household debt per capita. (Graph 2.7).

The maturity structure of loans to household sector was changed for the last year in favour of long-term loans with maturity over three years. Therefore, at end of third quarter of the previous year, maturity loans up to three years (52.3%) were dominant, while the majority share at end of third quarter this year was recorded among loans with maturity over three years (60.8%). While the share of loans with maturity over three years increased by 13.1 percentage points for one year, it increased by 5.1 percentage points in relation to the end of 2006. (Table 2.16).

Graph 2.6 – Banks' claims on households per employee, IX 2007¹⁵, in EUR



Graph 2.7 – Banks' claims on households per capita, IX 2007¹⁶, in EUR



¹⁵ The data for Croatia are for August 2007, and the ones for Macedonia include claims on local and foreign private individuals.

¹⁶ The data for Croatia are for August 2007, and the ones for Macedonia include claims on local and foreign private individuals.

Table 2.16 - Maturity structure of loans to households, in %

Description/Period	Up to three months	From three months to one year	From one to three years	Over three years	Total
III quarter 2006	3.0	8.5	40.8	47.7	100
IV quarter 2006	2.3	7.7	34.2	55.7	100
III quarter 2007	3.6	11.4	24.2	60.8	100

More favourable housing loans had impact on an increase of long-term loans share the banks implemented within the Government of Montenegro programme that relates to solving of housing issues of citizens under the more favourable conditions.

The household loans increased on average by EUR 47.1 million monthly or 7.1% during the first nine months this year and amounted to EUR 923.2 million an end-September. In nine months of 2007, household deposits were EUR 423.8 million or 84.9% higher while the annual increase amounted to EUR 571.4 million or 162.4%.

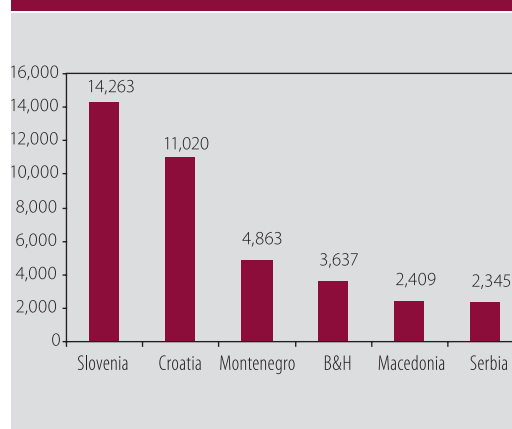
The maturity structure of household deposits, even though changed in favour of long-term deposits, was still unsatisfactory (Table 2.17). Demand deposits were still dominant although their share in household deposits decreased by 7.3 percentage points in the period September 2006 – September 2007. Simultaneously, the share of time deposits with maturity from one up to three years increased by 8.4 percentage points, while the share of deposits with maturity over three years was still extremely low.

Domestic household deposits were EUR 4,863 per employee at end-September 2007, according to which Montenegro was significantly behind Slovenia and Croatia, but ahead of Bosnia and Herzegovina, Macedonia and Serbia (Graph 2.8).

Montenegro has the same position when it comes to domestic household deposits per capita. (Graph 2.9).

The household sector was the constant net depositor in the banking system. The net savings of this sector amounted to EUR 272.1 million at end-September this year.

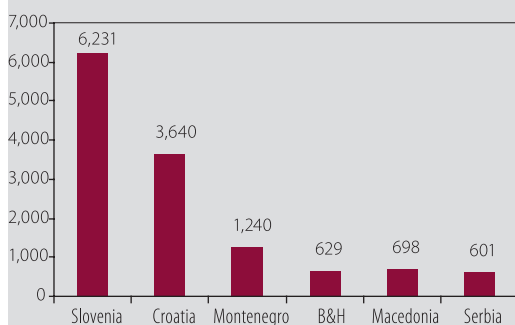
If we exclude the loans and deposits of the household sector from the ones that relate to foreign private individuals, then the net savings of resident households amount to EUR 121.9 million.

Graph 2.8 – Deposits by households per employee, IX 2007¹⁷, in EUR**Table 2.17 – Maturity structure of total deposits by households, in %**

Description/Period	Demand deposits	Time deposits				Total
		Up to three months	From three months to one year	From one to three years	Over three years	
30.09.2006	59.2	4.2	34.0	2.3	0.2	100
31.12.2006	59.0	5.2	22.8	13.0	0.1	100
30.09.2007	51.9	13.6	23.7	10.7	0.1	100

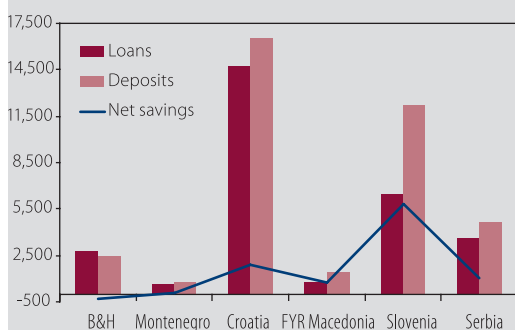
¹⁷ The data for Croatia are for August 2007, and the ones for Macedonia include deposits of local and foreign private individuals.

Graph 2.9 – Deposits by households per capita, IX 2007¹⁸, in EUR



In other neighbouring countries, except for Bosnia and Herzegovina, resident household sector represents the net depositor. (Graph 2.10).

Graph 2.10 – Net household savings, EUR million, IX 2007



Source: Central banks of the observed countries and the CBM calculations

2.3.6. Corporate sector

The corporate sector was characterized by an increase in indebtedness. The loans to this sector increased monthly by 9.8% on average during the first nine months of 2007, which was more than the average monthly growth recorded in the same period of previous years (2.5% in 2004, 2% in 2005, 5%

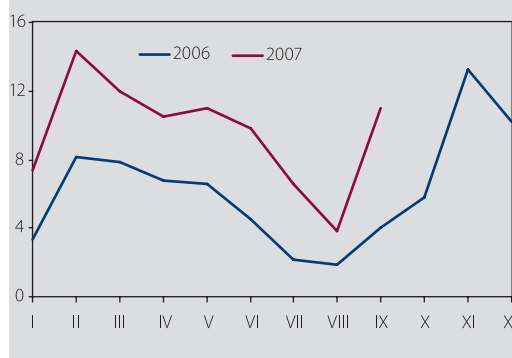
¹⁸ The data for Croatia are for August 2007, and the ones for Macedonia include deposits of local and foreign private individuals.

in 2006). Monthly growth was specially registered in the months prior to the main tourist season, which is, on the other hand, characterized by a lower loans demand, followed by an increase in deposits. (Graph 2.11).

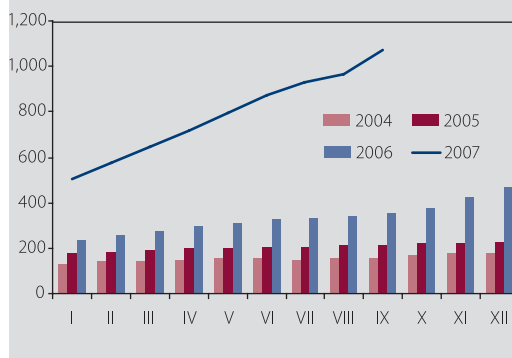
Due to a seasonal character of the loans and deposits in this sector, it is realistic to expect a further increase in loans in the fourth quarter. The loans structure according to activities confirms the seasonal character of these loans. Thus, the greatest number of loans was granted for trade, construction and services, tourism and catering (in total 72.3% at end-September 2007, i.e. 82.7% at end-September 2006).

The corporate sector debt to local banks, according to the loans, amounted to EUR 1,085.5 million at the end of third quarter this year. For the first nine months of 2007, the corporate sector debt increased by EUR 614.2 million or 130.3% while the annual growth amounted EUR 728.6 million or 204.1%.

Graph 2.11 – Monthly increase in loans to corporate sector, in %



Graph 2.12 – Loans to corporate sector, last day in a month, EUR million



According to the ownership, the structure of loans to corporate sector showed that the largest users of the loans were privately owned companies, which is reasonable if we take into an account the degree of privatization in Montenegrin economy. According to this criterion, of total corporate sector debt as per banks' loans in the country, 96.5% related to debt of privately owned companies, 2.9% to state owned companies and the remaining portion related to debt of entrepreneurs. The privately owned companies were also characterized by the highest annual growth of debt as per loans. Thus, the loans granted to these companies increased by 214.2%, to the state owned companies by 73.4% and to entrepreneurs by 16.4%.

The maturity structure of loans disbursed to corporate sector changed in the last year in favour of long-term loans (Graph 2.13). Their share increased from 41.2% at end-September 2006, i.e. 55.3% at end-December 2006 to 66.7% of total loans disbursed to the corporate sector at end-September 2007. In addition, the largest number of long-term loans to this sector related to the loans with maturity over three years (more than 65%). The change in maturity structure of loans to corporate sector represented the positive and desirable change, since the long-term loans, as a rule, were used for investments, not for current expenditure.

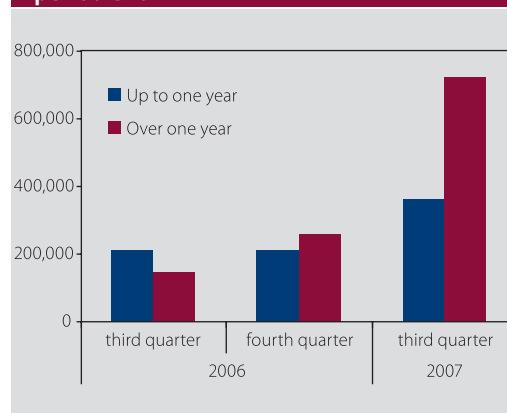
For the purpose of making comparison between the loans to corporate sector in Montenegro with the countries from the region, we have used a so-called "adjusted annual growth rate"¹⁹ for Montenegro in order to provide comparable data series. The adjusted annual growth rate of loans to corporate sector at end-September 2007 amounted to 206.9% in Montenegro which places Montenegro a way ahead of other countries from the region (Graph 2.14).

Deposits by the corporate sector amounted to EUR 551.4 million at end-September 2007. For the nine-month period this year, deposits by the corporate sector increased by EUR 230.4 million or 71.8%, with the annual growth being EUR 300.9 million or 120.1%.

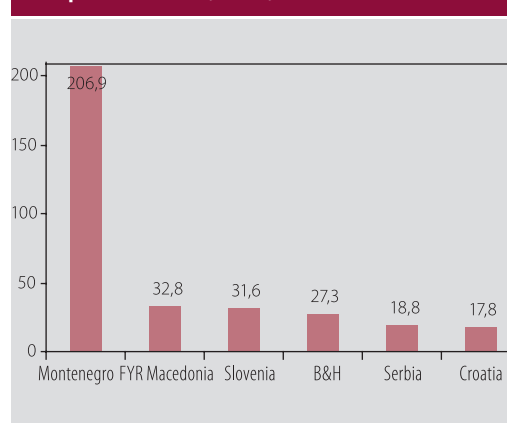
¹⁹ For the purpose of calculating the adjusted growth rate of loans to corporate sector from the loans disbursed to the corporate sector, the loans disbursed to entrepreneurs have been excluded.

²⁰ The data for Croatia are for August 2007.

Graph 2.13 – Maturity structure of loans to corporate sector, in EUR thousand, period end



Graph 2.14 – Annual increase in loans to corporate sector, in %, IX 2007²⁰



The structure of deposits by the corporate sector according to the activities showed that the highest share of deposits was by companies in the area of trade, transportation, warehousing and postal communication and services, tourism and catering (in total 79.8% at end-September 2007).

In relationship with the banks, the corporate sector had a constant net debtor position: the deposits of this sector were significantly lower than the loans it used from the banks. The net debt of the corporate sector amounted to EUR 354.4 million on average during the first nine months this year, and at end-September

2007 it was EUR 534 million. In the fast developing countries, the usual situation is for the corporate sector to be in the net debtor position and the household sector to be in the net depositor position. The situation when the corporate sector is in the net depositor position would be a sign that the corporate sector heads towards recession and that the companies refrain from investing available funds, estimating that there would be weak market perspectives for making profit.

Table 2.18 – Net savings of households and corporate sector, EUR million, period end

Description/Period	2006		2007
	IX	XII	IX
Net household savings	120	188	272
Net corporate savings	- 106	- 150	- 534

2.3.7. Capital of banks

The total capital of banks amounted to EUR 210.8 million at the end of the third quarter this year. In the first nine months of 2007, overall capital of banks increased by EUR 62.1 million or 41.7% while in the last twelve months it increased by EUR 78.8 million or 59.7%. In the structure of total capital, the share of capital and reserves was 93.6% while the remaining 6.4% referred to the positive financial result from the current period.

Observed by banks, only one bank recorded a decline in total capital (following the new investment evaluation) in one-year period (September 2006 – September 2007), while growth rates of capital in other banks ranged between 519 thousand and EUR 18.5 million, i.e. 8% and 201.4%, respectively. For the first nine months of 2007, two banks recorded the total capital decline, one being due to a decrease in revaluation reserves following the new property evaluation and the other being due to the negative financial results recorded in the reporting period. Observed in absolute terms, an increase in capital fluctuated between EUR 65 thousand and EUR 16.9 million in the first nine months of 2007, while the nine-month growth rates of total capital varied between 0.9% and 156.2%.

During the first three quarters, six banks issued shares. Besides, the largest part (59.7%) was recorded through the bid to the existing shareholders as per the pre-emptive right (Table 2.19).

Positive financial result was recorded in the first nine months of 2007 amounting to EUR 13.4 million for the banking system as a whole. In addition, only one bank recorded a negative financial result, while the profit of other banks was from EUR 2 thousand to EUR 7.1 million.

The return to the average assets was 1.02% at the end of third quarter this year, recording a slight fall if compared to both the end-2006 and the same period of the previous year. (Table 2.20).

The return to the average capital was 8.37% at the end of third quarter of 2007, recording a slight rise if compared to both the same period of the previous year and end-2006. (Table 2.21).

Table 2.19 – Recorded shares issue of banks, EUR million

Description/Period	I – IX 2007
Issue of shares by an open bid	16.2
Issue of shares to the existing shareholders as per the pre-emptive right	34.3
Issue of shares as per conversion of profit to shares – distribution of profits	5.7
Issue of shares by a closed bid	1.2
Total	57.4

Source: Securities Commission of Montenegro

Table 2.20 – Return on assets, aggregate level, %

Description/Period	2006		2007
	IX	XII	IX
Return on assets (ROA)	1.11	1.07	1.02

Table 2.21 – Return on equity, aggregate level, %

Description/Period	2006		2007
	IX	XII	IX
Return on equity (ROE)	6.78	6.82	8.37

Proprietary structure of capital showed dominant share of foreign owned capital – 74.7% while the share of local privately owned capital was 22.8%, the share of state owned capital being 2.5%. Besides, seven banks have major foreign ownership, of which four of them recorded a share of 100% foreign owned capital, while three banks recorded major share of domestic privately owned capital. Market share of the banks (measured by the assets) in major foreign ownership was 80.2% at end-September 2007.

Observed on the aggregate level, the solvency ratio was 16.44% at end-September this year and was slightly amended in relation to the same period of 2006. (Table 2.22).

Table 2.22 – Capital solvency ratio, aggregate level, %

Description/Period	2006		2007
	IX	XII	IX
Capital solvency ratio	16.85	21.28	16.44

2.4. Banks' Reserve Requirements

During the first nine months of 2007, deposits comprising the reserve requirement base ranged between EUR 1,002 million and EUR 1,601 million, resulting in an average of EUR 1,301 million. In addition to an increase in total deposits, a significantly higher calculation base in the nine-month period in relation to the same

period of the previous year (2.7 times higher), is a result of the broadened calculation base, as applied since April 2006.

Month-on-month, the highest level of deposits included in the calculation base was recorded in September (EUR 1,601 million, on average), whereas deposits not included in the base averaged EUR 118 million.

The aforementioned movements influenced the banks' allocation of EUR 256.5 million of total reserve requirements on 26 September 2007, which was 83.7 million or 48.5% more than at end-2006, while the growth rate amounted to 99.2% in comparison with September 2006 (Annex B, Table 12).

The structure of allocated reserve requirements at end-September 2007 significantly changed in relation to the same nine-month period of 2006. Thus, 7.1% was allocated on the reserve requirement account in the country and 92.9% on the Central Bank's accounts held abroad. The changes are the result of the decision of most banks to allocate the majority of their funds to the CBM accounts abroad. Besides, in the this period, only two 182-day T-bills auctions were held, on 9 January and 22 February, so that after the maturity of these bills the banks did not have an opportunity to allocate a part of their reserve requirements funds in T-bills (Table 2.24).

On 40% of reserve requirement funds allocated to the CBM account, the Central Bank calculated interest at the annual rate

Table 2.23 - Average reserve requirement calculation base, EUR million

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Average base	260	495	702	863	1,085	1,291	1,517

Table 2.24 - Structure of allocated reserve requirements, quarter-end, in %

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Reserve Requirement Account in the Country	54.0	48.0	52.0	9.3	8.6	9.2	7.1
T-Bills	11.0	6.0	4.0	1.9	1.4	0.8	–
Reserve Requirement on CBM accounts abroad	35.0	46.0	44.0	88.8	90.0	90.0	92.9

of 1% and paid banks EUR 643,384 in the first nine months of 2007. One bank used the reserve requirement funds for liquidity maintenance in the period of seven days, while lower levels of reserve requirements than that prescribed was registered with two banks during three days.

2.5. Microcredit Financial Institutions (MFI)

The first nine months of the current year were characterized by an uptrend in the micro-financial sector's activities, as well as an increase in the number of microcredit financial institutions, so that five microcredit institutions²¹ currently operate in Montenegro.

Total assets of MFI in Montenegro amounted to EUR 48.9 million at end-September this year, which was EUR 14.8 million or 44.7% more than at the previous year-end, while the annual increase amounted to EUR 22.7 million (86.5%).

An upward trend of the MFI's lending activity continued in the reporting period, resulting in the total of EUR 45.3 million worth loan claims at end-September. The amount of loans disbursed by these institutions increased by 39.6% in the first nine months this year, while in relation to September of the previous year this growth amounted to 78.4%. An average monthly growth rate was 3.8% during the reporting period.

In the structure of the loan portfolio of MFI by activities, the main share was of loans for agriculture, 68.5% at end-September 2007 (Table 2.27)

The maturity structure of loans disbursed by MFI shows the main share of long-term loans, 92.8% of total loans. The loan portfolio contained an insignificant share of past due loans (less than 1 %) during the reporting period.

In the structure of total loans, net loans accounted for EUR 44.6 million or 98.4%, and the remaining share was loan loss provisions.

Table 2.25 - MFI's total assets, as at quarter-end, EUR thousand

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Alter modus	7,009	7,873	7,854	9,064	10,584	11,403	11,038
Agroinvest	14,949	14,981	16,990	23,027	29,820	32,590	34,668
Montenegro Investment credit		596	981	1,017	1,059	1,354	1,708
Ozmont		342	411	705	953	994	1,203
Klikloan							301
Total	21,958	23,792	26,236	33,813	42,416	46,341	48,917

Table 2.26 - MFI's total loans, as at quarter-end, in EUR thousand

Description/Period	2006				2007		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Alter modus	6,859	7,841	7,586	8,658	9,704	10,967	10,761
Agroinvest	12,352	14,040	16,582	22,285	26,300	29,797	31,873
Montenegro Investment Credit		564	837	906	980	1,307	1,545
Ozmont		300	403	624	817	891	1,090
Klikloan							48
Total	19,211	22,745	25,408	32,473	37,801	42,962	45,317

²¹ A new MFI, „Klikloan“, Podgorica, started to operate in the reporting period.

Table 2.27 - MFI's total loans, by sectors, as at quarter-end

Description/ Period	2006				2007			Structure III quarter
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter	
	in EUR thousand							in %
Trade	2,434	2,864	3,050	3,565	3,978	4,656	4,799	10.6
Services	3,175	3,935	3,932	4,693	5,868	7,168	6,881	15.2
Production	901	862	905	838	873	998	913	2.0
Agriculture	12,701	14,630	16,781	22,570	26,152	28,849	31,061	68.5
Other		454	740	807	930	1,291	1,663	3.7
Total	19,211	22,745	25,408	32,473	37,801	42,962	45,317	100

MFI's monetary assets at end-September 2007 amounted to EUR 3.5 million or 7.1% of total MFI assets, while fixed and other assets amounted to EUR 0.9 million and made up 1.7% of total assets.

Total MFI's liabilities (liabilities for borrowings, conditional grants, subordinated debts and other liabilities), amounted to EUR 33.8 million or 69% of total MFI liabilities. The source of funds for microcredit institutions was mainly foreign capital which is disbursed as microcredit lines to agricultural producers, entrepreneurs in the field of services, small manufacturers, trade and others.

Total capital of MFI amounted to EUR 15.2 million or 31% of their total liabilities at end-September 2007. Of this amount, EUR 9.5 million or 62.6% referred to capital from donations, EUR 0.6 million or 4.1% to donations, while retained earnings amounted to EUR 4.8 million or 31.1%. At the third quarter-end of 2007, MFI recorded a positive result in the total amount of EUR 1.8 million.

MONEY MARKET AND CAPITAL MARKET

3

3.1. Money market

There were no T-Bills auctions in the third quarter, and the Government repaid the entire debt arising from the previously issued T-bills.

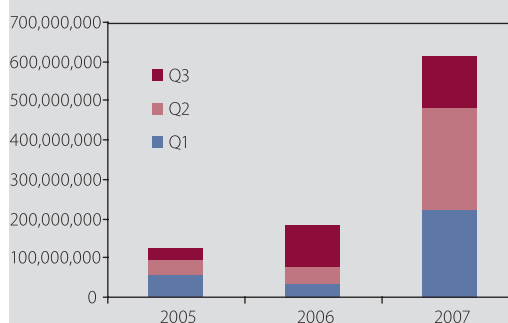
3.2. Capital market

The third quarter was characterized by declines in both turnover and volume of performed transactions on the Montenegrin stock exchanges. However, the total turnover amounted to EUR 614.3 million in the nine-month period, which is 62.9% more than in the previous year.

A turnover of EUR 132.3 million was recorded in the third quarter, which represents one fifth of the turnover recorded over the nine-month period. It was half the turnover recorded in the second quarter this year (EUR 260.7 million) and 22.6% more than in the same quarter of the previous year. This was achieved through 49.5 thousand transactions, which is 40.2% less than in the previous quarter this year. However, the quarter-on-quarter comparison shows that 281 more transactions were performed in the third quarter of 2007 than in the corresponding quarter of 2006.

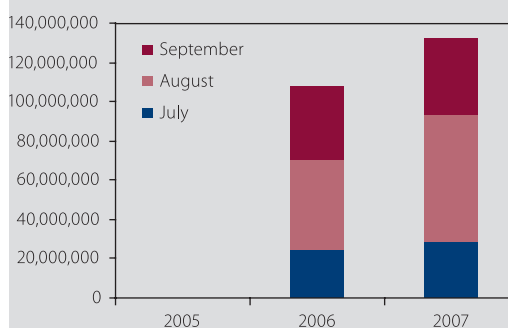
The main part of the turnover and transactions was achieved on the Nex Montenegro stock exchange (63.9% of total turnover and 72.8% of total transactions), and the remaining portion on the Montenegro stock exchange (36.1% of total turnover and 27.2% of transactions). Most of the turnover was achieved through the secondary trading, 95%, while only 5% related to the primary trading.

Graph 3.1 – Turnover on Montenegrin stock exchanges in first nine months of 2005, 2006 and 2007



Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Graph 3.2 – Turnover on Montenegrin stock exchanges in third quarters (by months) of 2005, 2006 and 2007



Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Table 3.1 – Comparative turnover growth rate on the Montenegrin stock exchanges (relative changes)

Period	Q3 / Q2 2007	$\frac{Q3\ 2007}{Q3\ 2006}$	$\frac{Q3\ 2007}{Q3\ 2005}$	$\frac{I-IX\ 2007}{I-IX\ 2006}$	$\frac{I-IX\ 2007}{I-IX\ 2005}$
Total turnover on Montenegrin stock exchanges	- 49,3%	+22,6%	+372,3%	+ 234,6%	+ 390%

Calculations: CBM

Turnover structure

As for the structure of trade in the third quarter this year, the main trade was with company shares (73.9%), then shares of mutual investments funds (23.8%), while the contribution of various bonds was a mere 2.3%.

A similar turnover structure was recorded in the corresponding quarter of 2006.

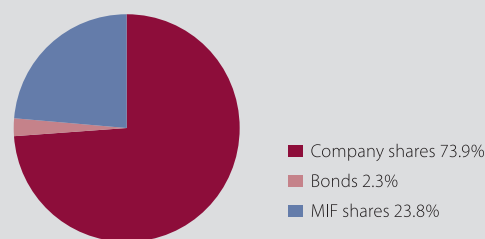
Company shares

Total turnover achieved through trading with shares of Montenegrin companies amounted to EUR 486.7 million achieved through 144 thousand transactions, thus accounting for 79.2% of total turnover and 73.2% of overall transactions. The turnover with these shares and the number of transactions were 253.3% and 264.8% higher than in the same period of the previous year, respectively.

Mutual investment funds' shares

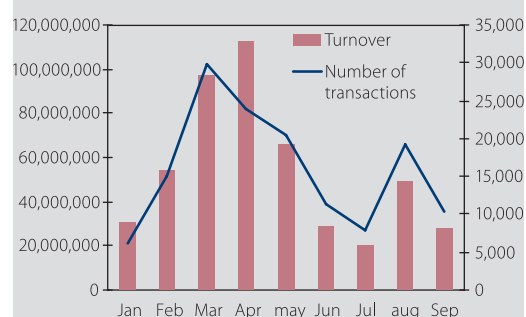
Turnover with mutual investment funds' shares in the first nine months of 2007 amounted to EUR 114.5 million, achieved through 38.6 thousand transactions. Compared to the same period of the previous year, this is a growth of 247.3%, while the number of registered transactions with this type of market material was 12.1% higher.

Graph 3.3 – Turnover structure at Montenegrin stock exchanges, III quarter 2007



Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Graph 3.4 – Turnover and number of transactions with company shares on Montenegrin stock exchanges in 2007



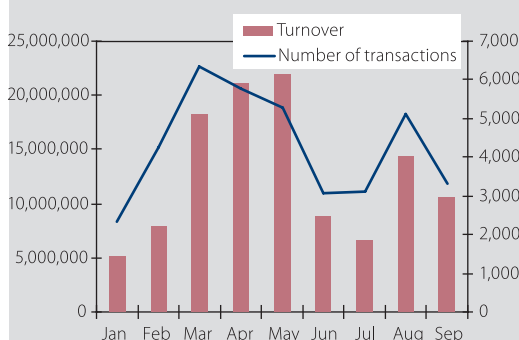
Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Table 3.2 – Total turnover and turnover structure in III quarters of 2007, 2006 and 2005

Turnover structure in III quarter	2005		2006		2007	
	Absolute amount	% Share in overall turnover	Absolute amount	% Share in overall turnover	Absolute amount	% Share in overall turnover
Shares	22,339,229	79.8	81,207,777	75.3	97,757,545	73.9
MIF shares	3,113,971	11.1	18,232,432	16.9	31,407,583	23.8
Bonds	2,552,081	9.1	8,451,340	7.8	3,101,625	2.3
Total	28,005,281	100.0	107,891,549	100.0	132,266,755	100.0

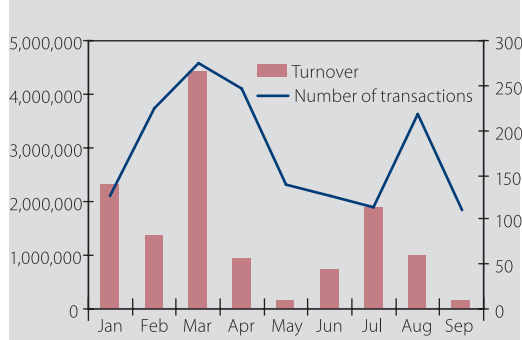
Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Graph 3.5 – Turnover and number of transactions with MFI's shares on Montenegrin stock exchanges in 2007



Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Graph 3.6 – Turnover and number of transactions with bonds on Montenegrin exchanges in 2007



Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Bonds

Trade with various types of bonds (frozen foreign currency deposit - FFCD bonds, municipal, restitution bonds and bonds for road reconstruction) was somewhat larger in first nine months of the current year than in the same period of the previous year, the increase being 1.5%, while the number of transactions was 47.9% lower.

Indices

Two stock exchange indices recorded a decline in the third quarter of the current year in comparison with the previous one. The

Moste index recorded an absolute decline of 275.3 index points or 12.6% and the NEX20 index declined by 1.040,63 index points or 2.6%. Only the NEXPIF index recorded an increase of 408.76 index points or 0.93%, but it was 8.7% lower than in mid-August when it recorded the maximum value. However, regardless of the reduced prices of market material in the last quarter, all three indices rose since the beginning of the year: Moste by 108.4%, NEX20 by 118.2% and NEX PIF by 148.9%.

Month-on-month, all three indices increased only in August (Moste by 7.6%, NEX 20 by 9.1% and NEXPIF by 14%), but in July and September they declined (in July Moste fell by 6.7%, NEXPIF by 3.5%, and NEX20 by 1.8%, and in September Moste decreased by 12.9%, NEX20 by 9.1% and NEXPIF by 8.2%).

Table 3.3 – General information on indices

	MOSTE		NEX 20		NEXPIF	
Value as at 30 September 2007	1.914,51		39.393,33		44.205,77	
Absolute change in third quarter of 2007	-234,0		-1.040,3		+408,8	
Initial index value	100,0		1000,00		1000,00	
Maximum index value in 2007	2.455,4	07.05.2007	48.617,88	17.05.2007	50.780,54	17.08.2007
Maximum historical value	2.455,4	07.05.2007	48.617,88	07.05.2007	50.780,54	17.08.2007
Minimum historical value	94.8	23.06.2004	918.57	14.04.2003	959.53	02.04.2003
Increase from 30 June 2007 to 30 September 2007	-12.6%		-2.57%		0.93%	

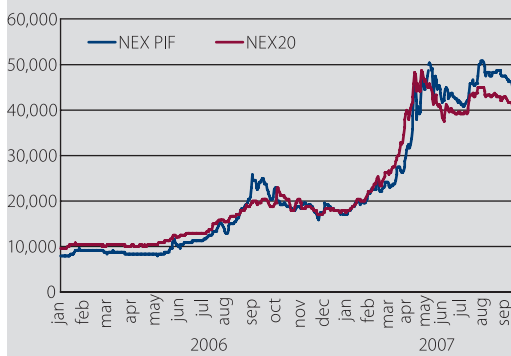
Source: Montenegro Stock Exchange and Nex Montenegro Stock Exchange

Graph 3.7 – Index MOSTE in 2007



Source: Montenegro Stock Exchange

Graph 3.8 – NEX20 and NEXPIF indices in 2007



Source: Nex Montenegro Stock Exchange

Block trade

The amount of turnover achieved through block trade was EUR 2.9 million in the third quarter of 2007.

Capitalization

Market capitalization on both Montenegrin stock exchanges at the third quarter-end was higher than at the previous quarter-end, 7.3% and 7.9% on Nex Montenegro and Montenegro stock exchange, respectively. Month-on-month market capitalisation in the third quarter on both stock exchanges showed an increase only in August, 18.1% and 13.6% on Nex Montenegro and Montenegro stock exchange, respectively, while in July and September market capitalisation was lower with the respective declines on the Nex Montenegro being 2% and 7.3%, and that on the Montenegro stock exchange 1.8% and 3.3%.

FISCAL DEVELOPMENTS

4

4.1. Budget overview

Budget revenues continuously grew over the first three quarters of 2007, resulting in a high fiscal surplus.

According to preliminary data of the Ministry of Finance, total budgetary revenues in the nine-month period amounted to EUR 579.7 million, thus being 25% higher than planned and 42% higher than in the corresponding period of 2006.

The structure of budgetary revenues shows continuation of a very dynamic growth of the current revenues that amounted to EUR 572.5 million and accounted for 98.8% of total budgetary revenues. In relation to the same period of 2006, current revenues increased by 42% owing to growth in all tax and other budgetary revenues (revenues from capital, fees and various compensations).

Revenues from property sale (financial and non-financial) amounted to EUR 5 million or 0.9% of overall revenues, being 59.4% lower than planned, yet 43% higher in relation to the same nine-month period of 2006 due to increased revenues from the sale of shares. Revenues from loan repayments by private individuals, public enterprises and other institutions amounted to EUR 3.8 million and were 8% lower than planned, but also 45.2% lower than in the comparative period of 2006. Foreign borrowings and loans amounted to EUR 2 million or 83% less than planned but 108% more than in the same period of the previous year. Revenues from donations and transfers were much lower than planned and amounted to EUR 62 thousand, yet 33% higher in comparison with the same period of 2006.

Box 4.1 – Structure of budgetary revenues

In the structure of current revenues, the largest share, 89.4%, was of revenues from taxes that grew continuously during the first nine months this year and reached the amount of EUR 508.5 million, which is 40.3% more than in the same period of the previous year. This increase was mainly due to the increased revenues from VAT and excise duties of 43.5% and 25%, respectively. Growth in these revenues was initiated by increased economic activity during the summer months, better financial discipline and a more efficient work of tax and customs offices. A share of VAT in revenues from taxes and current revenues amounted to 56.3%, and 50%, respectively, while excise duties contributed 11.8%. Revenues from direct and indirect taxes were both higher than planned and than in the comparative period of the previous year. A significant increase of 218% was recorded in revenues from corporate income taxes, as a result of strengthened economic activity, establishing of new companies, and an increase in the number of taxpayers. The share of these taxes in current revenues amounted to 5.7%. An increase in the number of employees, especially seasonal workers in construction and tourism sectors, as well as tax reliefs for newly employed influenced the increase in revenues from taxes on personal income of 9.4% and their share in total revenues amounted to 9.7%. A remarkable increase of 236% recorded revenues from property tax due to the continued boom in the sale of real estates. Revenues from taxes on international trade and transactions (customs duties) increased by 19.4% and they accounted for 8.7% of total revenues. The aforesaid revenues' growth was due to the increased visible imports, as a result of significant investments due to accelerated economic growth. Other republic taxes increased by 44% owing to a growth in revenues from taxes on motor vehicles and insurance premiums.

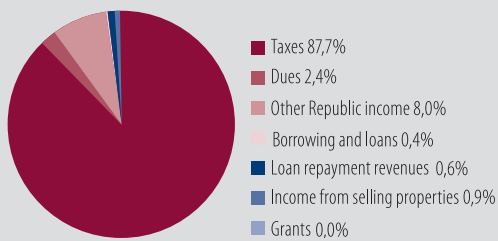
Revenues from various types of taxes were 39% higher in relation to the comparative period showing evident growth in all categories. Revenues from residential taxes increased by 48% as a result of a successful tourist season, amounting to EUR 0.5 million. However, revenues from taxes were still 6% lower than planned due to the worse collection of administrative fees. Positive trend also recorded revenues from various compensations with the share of 2.8%, and other republic revenues with the share of 5.2%, in the current budgetary revenues, which are much higher than in the same period of the previous year. A remarkable 314% higher collection was of compensations for the utilization of goods of common interest, while revenues from capital, not envisaged for the current year, were sixteen times higher.

Table .4.1- Comparative review of current revenues of Montenegrin Budget, EUR thousand

Revenues	Plan Jan-Sep. 2007	Recorded in Jan-Sep. 2007	Recorded in Jan-Sep 2006	% of collection in relation to plan for Jan-Sep. 2007	% of collection in relation to 2006
TAXES	397.35	508.51	362.50	127.98	140.28
Personal income tax	48.13	55.00	50.27	114.27	109.41
Corporate income tax	11.37	32.34	10.18	284.43	317.68
Property tax	4.94	13.66	4.06	276.52	336.45
Value added tax	222.62	286.45	199.59	128.67	143.52
Excise duties	59.27	67.03	53.81	113.09	124.57
Tax on international trade and transactions	47.55	49.33	41.32	103.74	119.39
Other republic taxes	3.47	4.70	3.27	135.45	143.73
DUTIES AND FEES	14.66	13.76	9.90	93.86	138.99
Administrative fees	9.97	6.95	5.56	69.71	125.00
Court fees	4.31	6.35	4.03	147.33	157.57
Resident taxes	0.38	0.46	0.31	121.05	148.39
Other taxes					
Registration fees					
FEES	14.50	16.54	12.79	114.07	129.32
Fee for public goods utilization	0.71	2.73	0.66	384.51	413.64
Fees for utilization of natural resources	3.01	2.18	2.55	72.43	85.49
Ecological fees	1.38	1.45	1.49	105.07	97.32
Fees for games of chance	2.73	3.17	2.42	116.12	130.99
Tolls	4.66	4.77	4.01	102.36	118.95
Other fees	2.01	2.24	1.66	111.44	134.94
OTHER REPUBLIC REVENUES	11.84	29.93	11.79	252.79	253.86
Revenues from capital		13.96	0.82	0.00	1702.44
Fines and seized property benefits	5.31	6.99	5.17	131.64	135.20
Revenues that bodies realize by performing their activities	2.96	2.90	2.80	97.97	103.57
Other revenues	3.57	6.08	3.00	170.31	202.67

Source: Ministry of Finance

Graph 4.1 – Budgetary revenues in period 1 January-30 September 2007



According to preliminary data of the Ministry of Finance, total **budgetary expenditures** during January-September 2007 amounted to EUR 448.8 million, which is 10% more in comparison with the same period of the previous year. Budgetary expenditures were 6% lower than planned, as a result of reduced current and capital expenditures and transfers.

Box 4.2 – Structure of budgetary expenditures

In the structure of total budgetary expenditures, the main share of EUR 228.8 million or 51% was of current expenditures, which rose 22% in relation to the comparative period of the previous year. Transfers to institutions, individuals, non-governmental and public sectors, and transfers for social insurance accounted for 26.4% or EUR 120.2 million of total expenditures. More funds than in the same nine-month period of the previous year were designated for non-governmental organizations, the Employment Agency, and less to the Pension and Disability Insurance Fund, social and health insurance, municipalities and for redundancies. Some 58% more or 7.5% of total expenditures were allocated for capital expenditures, the main share being for the infrastructure of public interest, construction objects and their maintenance. These funds were significantly lower than originally planned, with the note that the strategic investment projects requiring more funds are financed from the capital budget, which has been applied since January this year. Some 1% of budgetary expenditures were allocated for borrowings and loans disbursed to non-financial institutions, individuals and other borrowings, which is 23% less than last year, and the majority of these funds were used by individuals. At the same time, revenues from loan repayments amounted to EUR 3.8 million, resulting in a budget deficit on this basis of EUR 0.5 million. The state allocated EUR 58.3 million or 13% of overall expenditures for debt repayment, of which nearly four times more funds than in the same period of the previous year was repaid to residents. Loan repayments to non-residents also increased, while the repayment of prior period liabilities was lower in relation to the comparative period because these liabilities were regularly serviced during 2006. There were no payments arising from issued guarantees, while a mere 1% was allocated for budgetary reserves (permanent and current), which is 68% less in relation to the same period of the previous year.

As for the current budgetary expenditures, most of the funds were spent on gross earnings and contributions charged to employers, 57% (EUR 131 million) of the current expenditures, this being 15% higher in relation to the same period of 2006. Gross earnings represented 30% of overall expenditures and their share in GDP was 8.4%. In this period, 43% of total expenditures were for other categories of the current expenditures (expenditures for material and services, other expenditures, maintenance, rent, subsidies, and interest). These expenditures were lower than originally planned for the nine-month period, yet 24% higher than in the comparative period of 2006. Most of the expenditures were allocated for rent, material and services, and other expenditures.

**Table 4.2 – Review of budgetary expenditures for period 1 January-30 September 2007,
EUR thousand**

DESCRIPTION	Plan I-IX 2007	Recorded I-IX 2007	% realization in relation to the plan for I-IX this year	Realization I-IX 2006	% Realization in relation to I-IX 2006
Gross earnings and contributions paid by employers	134.84	131.02	97.17	112.71	116.25
Net earnings	78.55	77.50	98.66	66.28	116.93
Tax on earnings	14.62	14.22	97.26	13.76	103.34
Contributions charged to employees	21.95	20.38	92.85	15.56	130.98
Contributions charged to employers	17.66	16.97	96.09	14.95	113.51
Municipal surtax	2.06	1.95	94.66	2.16	90.28
Other personal income	16.62	13.56	81.59	7.36	184.24
Expenditures for material and services	56.50	41.69	73.79	29.82	139.81
Current maintenance	15.24	13.51	88.65	14.26	94.74
Interests	14.76	17.39	117.82	14.91	116.63
Rent	4.11	3.74	91.00	1.79	208.94
Subsidies	7.15	5.23	73.15	4.43	118.06
Other expenditures	4.30	2.61	60.70	1.60	163.13
Transfers for social insurance	34.19	31.99	93.57	28.81	111.04
Social insurance rights	26.53	28.07	105.80	25.31	110.90
Redundancies	7.66	3.92	51.17	3.50	112.00
Transfers to institutions, individuals, non-governmental and public sectors	90.14	86.64	96.12	89.75	96.53
Transfers to public institutions	18.90	16.86	89.21	17.25	97.74
Transfers to non-governmental organizations	4.62	4.75	102.81	2.11	225.12
Transfers to individuals	5.79	5.27	91.02	8.48	62.15
Transfers to Republic Pension and Disability Insurance Fund	48.25	47.69	98.84	50.83	93.82
Transfers to Republic Health Insurance Fund	5.16	5.16	100.00	5.87	87.90
Transfers to Employment Agency	4.93	5.95	120.69	4.18	142.34
Transfers to municipalities	1.56	0.67	42.95	1.03	65.05
Transfers to public companies	0.93	0.29	31.18		
Capital expenditures	58.57	33.59	57.35	21.22	158.29
Capital expenditures	58.57	33.59	57.35	21.22	158.29
Project loans					
Borrowings and loans	4.56	4.34	95.18	5.66	76.68
Repayment of guarantees	1.58	0.00	0.00	1.05	0.00
Repayment of obligations from the previous period and frozen foreign currency savings	11.56	28.00	242.21	44.79	62.51
Repayment of debts	17.39	30.06	172.86	11.88	253.03
Reserves	4.48	5.19	115.85	16.24	31.96
Current expenditures	253.52	228.75	90.23	186.88	122.40
TOTAL EXPENDITURES	475.99	448.56	94.24	406.28	110.41

Source: Ministry of Finance

Observing the amount surplus/deficit as a difference between revenues and expenditures, revenues being reduced for borrowings, accepted transfers donations and revenues from property sale, and expenditures reduced for repayment of capital in the country and abroad on the basis of a debt arising from loans taken and securities issued, the primary budget of the Republic recorded the surplus of EUR 182 million²² in the period 1 January – 30 September 2007(Annex D, Table 14) instead of the expected EUR 4.5 million deficit. In relation to the comparative period 2006, the budgetary surplus was almost three and a half times higher and significantly higher than the projected EUR 10.7 million for the entire 2007. A share of the surplus in GDP amounted to 11.6%.

If we observe the surplus as a difference between revenues and expenditures, then it amounted to EUR 131.1 million.

Graph 4.2 – Structure of budgetary expenditures in period 1 January – 30 September 2007

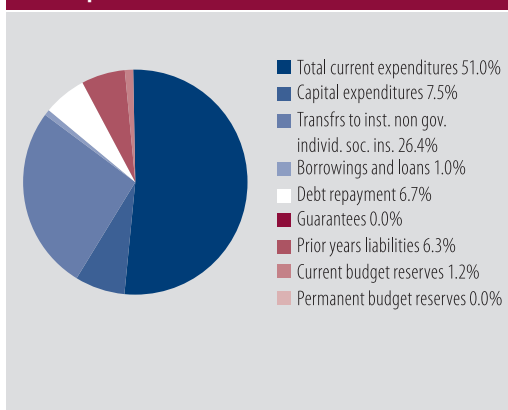


Table 4.3 – Movement of the budgetary surplus

DESCRIPTION	January	February	March	April	May	June	July	August	September	Jan- Sept 07	Jan-Sept 06
Overall revenues	38,20	44,19	59,57	67,81	65,38	70,17	72,28	94,11	67,98	579,71	408,54
Overall expenditures	33,75	39,42	49,45	52,30	44,29	65,55	56,36	52,74	54,91	448,78	406,30
Surplus / (deficit)	6,61	55,35	9,37	23,88	25,84	23,08	24,66	46,41	16,62	182,01	53,45

Source: Ministry of Finance

4.2. Overview of budgetary funds during January – September 2007

Republic Pension and Disability Insurance Fund (data of the Fund) in the first three quarters this year, recorded total revenues in the amount of EUR 166.4 million, which is 15% more than in the same period of the previous year. The source revenues of the Fund amounted to EUR 160.2 million and were 15% higher comparing to the same period of the previous year, owing to the better collection of revenues arising from contributions. Contributions, as the main source of financing of the Pension and Disability Insurance Fund, accounted for EUR 111 million, which is an increase of 15% in relation to the first nine months of the previous year and thus provided the

liquidity of the Fund and regular servicing of obligations. The structure of contributions shows increases in all categories of revenues - from the economy, non-economy, independent activities and agriculture. In overall revenues and source revenues contributions made up 67% and 69%, respectively, which points to their continuous growth and this is the result of the increased number of taxpayers, employees, and a better financial discipline. Besides contributions, positive effects on financial stability of the Fund had transfers from the state budget, revenues from share capital and the internal economy of the Fund. Transfers from the budget amounted to EUR 47.7 million or 29% of total

²² Surplus/deficit calculation methodology published in the "Official Gazette of Republic of Montenegro", 71/05.

revenues, while other revenues were 93% higher and amounted to EUR 1.4 million. In the reporting period, the Fund's revenues from equity capital amounted to EUR 3.3 million or 13% less in relation to the comparative period of the previous year, and it withdrew EUR 1 million of deposits and took commercial bank loans to the amount of EUR 2 million.

Total expenditures of the Fund amounted to EUR 163.6 million, which is 12% more comparing to the same nine-month period of 2006. Expenditures were higher than planned for 7%. The most important expenditure position is the expenditure for pensions, which amounted to EUR 123.5 million or 75.5% of total expenditures. The Fund spent EUR 32.8 million or 20% of overall expenditures on the basis of compensations, allowances, contributions for health insurance, remitted pensions and military pensions. Expenditures for gross earnings increased by 17% due to the harmonization of pension increases in the half-year intervals (on 1 January and 1 July), and regular payment of all liabilities. Operational expenses that cover current and capital expenditures, borrowings and loans, and transfers to individuals, institutions, and the public and non-governmental sectors amounted to EUR 4.3 million or 1.5% of overall expenditures and were 4% lower in relation to the same period of the previous year. The Fund designated EUR 2 million for loan repayment, and its time deposit amounts to EUR 1 million. The comparison of the current revenues and expenditures over January-September 2007 period shows that the Fund recorded a deficit of EUR 0.5 million.

The **Republican Health Insurance Fund**, according to their estimates, recorded the total revenues of EUR 87.7 million in the first nine months of 2007 or 12.3% more than the same period of the previous year, which is the result of an increased payment of contributions in all categories. Revenues from contributions cumulatively amounted to EUR 82.2 million or 93.7% of total revenues, which is 12.45% more than in the same period of the previous year. Transfers received from the budget were EUR 5.2 million, while other revenues increased by 18% and amounted to EUR 0.3 million.

Total expenditures of the Health Insurance Fund in the said period amounted to EUR 87 million and were 18.3% higher than in the same nine-month period of the previous year. The largest share in total expenditures of EUR 83.4 million or 96% was of expenditures for regular activity and procurement of medicines, while 4% of funds were spent on the Fund's operations. Such Fund's operations resulted in a surplus of EUR 0.7 million.

According to data of the **Employment Agency of the Republic of Montenegro**, this institution recorded the total revenues to the amount of EUR 17.3 million in the period January-September 2007. Current revenues (contributions, taxes, other revenues and revenues from loan repayment) amounted to EUR 10.6 million, and were 12.3% higher in relation to the plan. Transfers received from the budget were EUR 5.9 million, while donations amounted to EUR 0.2 million. Revenues from property sale amounted to EUR 0.5 million in the reporting period, which is significantly less than planned and in relation to the comparative period of the previous year.

Expenditures of the Agency in the first three quarters of 2007 amounted to EUR 17.4 million, of which EUR 5.1 million related to current expenditures, while transfers for social insurance and transfers to individuals, institutions and the public sector amounted to EUR 11.2 million. Some EUR 56 thousand was allocated for capital expenditures, while borrowings amounted to EUR 1.1 million. Revenues from loan claims amounted to EUR 3.1 million, resulting in a surplus of EUR 2 million.

Comparing the Agency's revenues, reduced for donations and privatized revenues, and expenditures during January-September, the Agency ran a EUR 0.8 million deficit.

The **Development Fond of the Republic of Montenegro** recorded revenues to the amount of EUR 1.4 million in the first nine months of 2007, which is 40% more than in the same period of 2006, as a result of increased revenues (interest on disbursed loans, transactions on the capital market and dividends), while the Fund's expenditures amounted to EUR 0.4 million, which resulted in a surplus of EUR 1 million (Annex D, Table 15).

EXTERNAL DEVELOPMENTS

5

After the record amount reached in 2006, the current account deficit continued increasing in 2007. This deterioration is a consequence of the increased visible trade deficit, which can be attributed to the increased visible trade import, for the most part. On the other hand, surpluses achieved in the other current account sub-accounts mitigated the negative visible trade trends only to a moderate extent.

According to preliminary data, the current account deficit amounted to EUR 511.1 million or 32.7% of the GDP in the first three quarters of 2007, which is 60.8% more than in the same period of 2006. The coverage of foreign trade deficit by surpluses achieved in other current account sub-accounts amounted to 49.2%, which is 0.6 percentage points more than in the comparative period.

Overall visible trade volume during the nine months is 27.1% higher in relation to the same period of 2006. The degree of visible trade imports/exports coverage amounted to 32.6%, which is 10.5 percentage points less than in the comparative period.

The volume of exchange of services in the period January - September 2007 amounted to EUR 750 million or 39% more than in the same period of 2006. The services sub-account recorded a surplus of EUR 438.7 million in the reporting period, whereas recorded in the comparative period of 2006 amounted to EUR 207.1 million.

In the first nine months of 2007 on the factor income account was recorded the surplus of EUR 15.6 million or 25.7% less than in the same period of 2006.

The FDI inflow in Montenegro in the said period amounted to EUR 708.1 million, and their outflow amounted to EUR 370.6 million.

Portfolio investments recorded an inflow of EUR 103.6 million, while their outflow amounted to EUR 93.9 million.

The inflow of funds from Other investments during January - September of 2007 amounted to EUR 754.9 million, while their outflow amounted to EUR 605.1 million.

Table 5.1 – Balance of payments, in EUR thousand and as GDP percentage

	Jan.- Sept. 2006.	Jan.- Sept. 2007.	Changes in %	% GDP
A. CURRENT ACCOUNT	-317.832	-511.112	160,81	-32,70
GOODS	-618.440	-1.005.612	162,60	-64,34
1. Revenues	468.722	486.084	103,70	31,10
1.1 Export in foreign trade statistics	454.588	463.542	101,97	29,66
1.2 Coverage adjustment	14.134	22.542	159,49	1,44
2. Expenditures	1.087.162	1.491.696	137,21	95,44
1.1 Import in foreign trade statistics	1.077.352	1.478.154	137,20	94,58
1.2 Coverage adjustment	9.810	13.542	138,04	0,87
SERVICES	207.063	438.695	211,87	28,07
1. Revenues	373.236	594.346	159,24	38,03
2. Expenditures	166.173	155.651	93,67	9,96
INCOME	21.030	15.629	74,32	1,00
1. Revenues	44.423	64.193	144,50	4,11
2. Expenditures	23.393	48.563	207,59	3,11
CURRENT TRANSFERS	72.514	40.176	55,40	2,57
1. Transfers to Montenegro	83.368	70.201	84,21	4,49
2. Transfers from Montenegro	10.853	30.025	276,64	1,92
B. CAPITAL AND FINANCIAL ACCOUNT	236.941	522.547	220,54	33,43
1. CAPITAL ACCOUNT	-12.746	-1.338	10,49	0,09
2. FINANCIAL ACCOUNT	249.687	523.884	209,82	33,52
2.1. Direct investments-net	243.252	337.565	138,77	21,60
2.2. Portfolio investments-net	6.565	9.636	146,78	0,62
2.3. Other investments-net	23.365	149.817	641,19	9,59
2.4. Change in Net Foreign Assets	38.253	234.025	611,78	14,97
2.5. Change in the CBM foreign reserve assets	-61.748	-207.159	335,49	-13,25
C. NET ERRORS AND OMISSIONS (A+B)	-80.892	11.435		

Source: CBM

5.1 Current account

According to preliminary data, the current account deficit in the period January – September of 2007 amounted to EUR 511.1 million. The share of the foreign trade deficit in GDP amounted to 64.3% of the projected GDP, which is 20.5 percentage points more than in the same period of the previous year. The services sub-account recorded a surplus of EUR 438.7 million or 28.1% of GDP. The factor income and current transfers sub-accounts

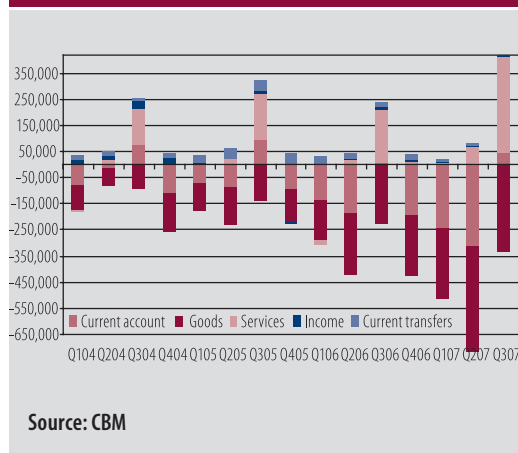
recorded declines in net inflows in relation to the same period of 2006. The coverage of the foreign trade deficit by the surpluses achieved in other current account sub-accounts amounted to 49.2%. This high current account deficit was financed from net FDI inflow (21.6% of GDP) and other investments (9.6% of GDP).

Table 5.2 – Current account, EUR thousand

	2004	2005	2006	Jan- Sept 2006	Jan- Sept 2007	Change Jan-Sept 07/06
CURRENT ACCOUNT	-119.642	-154.045	-511.902	-317.832	-511.112	160,81
1. GOODS	-416.436	-513.653	-849.325	-618.440	-1.005.612	162,60
1.1. Revenues	452.148	460.648	648.327	468.722	486.084	103,70
1.2. Expenditures	868.584	974.301	1.497.651	1.087.162	1.491.696	137,21
2. SERVICES	148.176	195.540	216.403	207.063	438.695	211,87
2.1. Revenues	249.529	329.765	433.550	373.236	594.346	159,24
2.2. Expenditures	101.353	134.225	217.147	166.173	155.651	93,67
3. INCOME	86.242	17.512	30.800	21.030	15.629	74,32
3.1. Revenues	135.455	62.291	65.334	44.423	64.193	144,50
3.2. Expenditures	49.213	44.779	34.534	23.393	48.563	207,59
4. CURRENT TRANSFERS	62.376	146.556	90.220	72.514	40.176	55,40
4.1. Transfers to Montenegro	73.493	163.455	108.555	83.368	70.201	84,21
4.2. Transfers from Montenegro	11.117	16.899	18.336	10.853	30.025	276,64

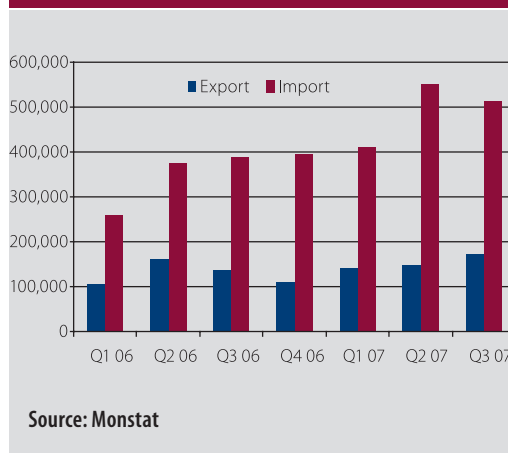
Source: CBM

Graph 5.1 – Current account sub-accounts by quarters, 2004- 2007, EUR thousand



influenced the increase in the visible trade deficit. Observed by quarters, a significant growth in the visible trade deficit was recorded in the second quarter of 2007, due to the largest imports in this quarter in both 2006 and 2007.

Graph 5.2 –Visible export and import in 2006 and 2007 by quarters, EUR thousand



5.1.1. Visible trade²³

An uptrend in the foreign trade deficit continued in 2007. Increased local consumption of, and demand for, imported goods and an FDI inflow increase in investment consumption

²³ METHODOLOGICAL REMARKS: Data on the visible export/import are in accordance with the BPM5 methodology (Balance of Payments Manual, Fifth edition, IMF, 1993). Methodological differences imposed the obligation of adjusting data obtained from foreign trade statistics for the needs of balance of payments due to which data on visible trade export/import in the balance of payments table do not match data on visible trade provided by Monstat.

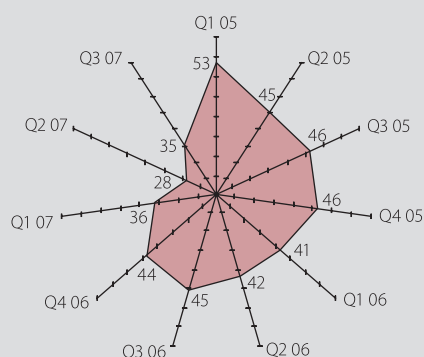
According to Monstat data, in the first nine months of 2007 the value of total exported and imported goods were EUR 463.5 million and EUR 1,478.1 million, respectively. A significant increase in visible imports led to a further increase in the foreign trade deficit, which reached the level of EUR 1.014,6 million.

As a consequence of a more rapid increase in visible imports over exports, the coverage of imports by exports was reduced from 42.2% in the first nine months of 2006 to 31.4% in the same period of 2007.

The Monstat data on **visible exports** show that in the first three quarters of 2007 the export increased by 2% comparing to the same period of the previous year, while simultaneously the import rose by 37.2%.

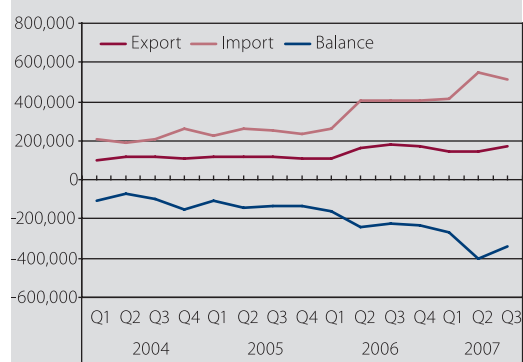
The structure of visible exports was significantly influenced by the exports of aluminium and aluminium products with a share in overall exports of 51.5%, followed by the export of iron and steel (9.5%), then mineral fuels and oils (8.7%) and beverages and alcohol (4.4%). Aluminium was mostly exported to Italy in the value of EUR 115.6 million, which accounted for 29.6% of total exports, then to Greece and Hungary, EUR 59 million and EUR 56.8 million, respectively.

Graph 5.3 – Visible export and import by quarters, 2005 – 2007, in %



Source: Monstat and the CBM

Graph 5.4 – Foreign trade of Montenegro, 2004 – 2007, in EUR thousand



Source: CBM and MONSTAT

Table 5.3- Structure of visible export by products, January – September 2007, EUR thousands

Description	Value	Share in %
Aluminium and related products	238 564,54	51.47
Iron and steel	43 851,32	9.46
Mineral fuels, mineral oils and product of their distillation ;bitumen material; mineral waxes	40 188,13	8.67
Beverages, alcohol and vinegar	20 551,98	4.43
Tobacco and related products	15 253,09	3.29
Wood and related products; wood coal	15 350,78	3.31
Fruits, including stone fruits; citrus fruit or cantaloupe and watermelon	12 745,40	2.75
Iron and steel products	12 342,23	2.66

Source: MONSTAT

According to Monstat data, the value of overall imported goods in the first nine months of 2007 amounted to EUR 1.478,1 million or 94.6% of the estimated GDP for this period. Mostly imported products were passenger vehicles with a share of 12.3% in total imports, followed by mineral fuels and mineral oils of 8.7%, and various reactors, boilers and mechanical devices with 9.4%. The import of passenger vehicles significantly decreased in September in comparison to August, when the Government's regulation on the import of vehicles which satisfy the Euro 3 standard came into effect. Most of the passenger vehicles in the reporting period were imported from Germany, France and Japan.

The most significant export partners of Montenegro were Italy, Serbia, Hungary and Greece, while in imports those were Serbia,

Germany and Italy. Data on foreign trade show that Montenegro achieved the highest turnover with the EU countries in the reporting period. In the first nine months of 2007, the export to the EU countries amounted to EUR 291.6 million (62.9% of total exports), while the import was EUR 670.7 million (45.4%).

Export to South-East European countries in the reporting period amounted to EUR 160.7 million or 34.7% of overall export, while the value of imported goods was EUR 562.2 million, which makes 38% of overall import. Observed by countries, 86% of overall export of goods was recorded on the markets of Italy, Serbia, Hungary, Greece and Bosnia and Herzegovina, while on the import side Serbia, Italy, Germany, Croatia and China have the share of 57% in overall visible trade.

Table 5.4 - Structure of visible import by products, January – September 2007, EUR thousands

DESCRIPTION	VALUE	% share
Vehicles, excluding rail and tram vehicles and their components and equipment	182 478,93	12,35
Mineral fuels, mineral oils and products of their distillation, bitumen material; mineral waxes	156 617,61	10,60
Reactors, boilers, machines and mechanical equipment and their components	138 540,79	9,37
Electrical machines and equipment and their components; machines for recording and reproducing, TV apparatus for recording and reproduction picture and sound, and related products	125 439,14	8,49
Products of iron and steel	54 985,84	3,72
Furniture, linen, mattresses, pillows and related products; lamps and other fluorescent items, etc.	52 898,47	3,58
Iron and steel	47 733,93	3,23
Plastic masses and related products	43 116,01	2,92

Source: MONSTAT

Table 5.5 – Structure of visible export and import by countries, January – September 2007, EUR thousand

COUNTRY	EXPORT	Share in %	IMPORT	Share in %
TOTAL	463 542,36	100	1 478 153,77	100
TOTAL EU	291 602,66	62,91	670 710,95	45,37
Italy	137 462,36	29,65	152 780,97	10,34
Hungary	61 585,00	13,29	13 544,46	0,92
Greece	59 197,55	12,77	49 811,33	3,37
Slovenia	16 617,44	3,58	52 183,84	3,53
Germany	6 633,40	1,43	155 859,20	10,54
Great Britain	1 989,99	0,43	17 390,69	1,18
Czech Republic	1 561,10	0,34	17 920,00	1,21
Netherlands	1 495,64	0,32	12 364,41	0,84
Turkey	883,18	0,19	17 781,97	1,20
Russian Federation	7 319,08	1,58	12 585,49	0,85
Austria	1 986,12	0,43	37 193,42	2,52
France	131,39	0,03	40 015,08	2,71
SEE COUNTRIES	160 717,71	34,67	562 167,23	38,03
Serbia	116 257,4	25,08	410 632,73	27,78
Bosnia and Herzegovina	22 155,62	4,78	51 036,17	3,45
Albania	12 027,46	2,59	8 183,16	0,55
Croatia	9 144,12	1,97	60 084,84	4,06
Macedonia	706,11	0,15	16 476,63	1,11
Romania	126,23	0,03	10 142,02	0,69
Bulgaria	300,77	0,06	5 611,68	0,38
OTHER COUNTRIES	11 221,99	2,42	245 275,59	16,59

Source: MONSTAT

Box 5.1 – Clusters as a form of connecting companies

Clusters are groups of related companies from the same or similar economic sectors in a specific geographic area. The main objective of connecting companies is an increase in productivity, larger flexibility, reaching the market standards and higher competitiveness on foreign markets. There are two forms of clusters: horizontal – connection within the same activity, and vertical – connection between similar groups of activities.

Advantages of forming clusters are numerous, for both companies and a country in which they are formed. In Montenegro is important formation of clusters in agricultural production and food industry, especially in the production of high-quality organic food, in which Montenegro has comparative advantages. European standards in this field are exceptionally high and large investments are needed for their implementation in order to comply with EU regulations and the products to be exported to the foreign market. Development of clusters in Montenegro would create better conditions for the access to production factors, expenses would be reduced, and a safer and better launching of products in foreign market would be made possible, which would affect a reduction in the foreign trade deficit.

An active role of the government is important in the establishment of clusters and encouraging their development in the priority sectors, i.e. those having comparative values. This active role would include the creation of development-friendly environment (investments in education, development of research institutions, and the like). Governments of many countries use clusters as the means for attracting FDI and promotional activities undertaken to encourage investments are usually connected with clusters.

5.1.2. Services

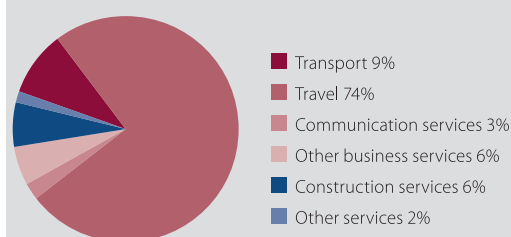
In the first three quarters of 2007, the services sector recorded a significant increase in the volume of services trade with abroad. The **overall volume of services trade** amounted to EUR 750 million, which is 39% more than in the same period of 2006.

Revenues from services in the period January - September of 2007 amounted to EUR 594.3 million and increased by 59.2% in relation to the same period of the previous year. The largest part of revenues was from travel, EUR 443.6 million, then transport, EUR 54.1 million, construction services, EUR 38 million, and other business services, EUR 32.7 million.

Expenditures on services amounted to EUR 155.6 million, which represents a 6.3% decline in comparison with the same nine-month period of 2006. This decrease was mainly due to a decline in expenditures on construction services of 59.8%.

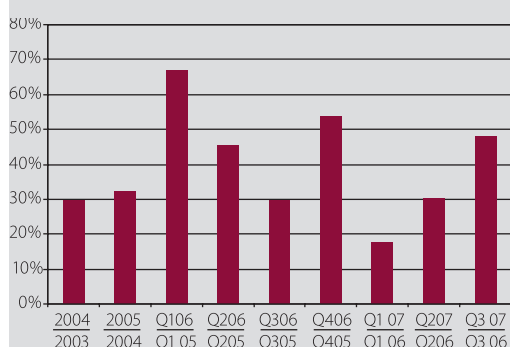
Observing the structure of expenditures, most of them were for transport - EUR 40.2 million, then other business services - EUR 34.4 million, and construction services - EUR 26.8 million. During the first three quarters of 2007, a surplus of EUR 438.7 million was recorded on the services account. Observed by types of services, the highest surplus was in travel (EUR 424.9 million).

Graph 5.6 – Structure of service revenues, January - September 2007



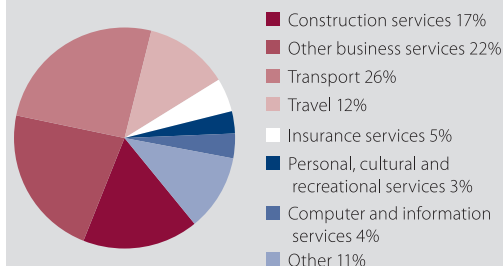
Source: CBM

Graph 5.5 – Movement of services trade volume, in %



Source: CBM

Graph 5.7 – Structure of service revenues during January - September 2007



Source: CBM

Transportation revenues amounted to EUR 54.1 million, which is 25.1% more than in the same nine-month period of 2006. An increase in visible imports significantly influenced an increase in revenues from transportation services. The largest revenues were in the maritime transport – EUR 23.1 million or 43% of overall transportation revenues, then air traffic – EUR 18.9 million or 34.9% of overall transport revenues. An increase in revenues from air traffic is a result of an increased number of existing, and the introduction of new, international flights. This year, the Airports Council International EUROPE declared the Podgorica International Airport as the best airport in Europe in the under 1 million passenger category, which represents an important promotion of Montenegro on the international market. In this period, revenues from air navigation also increased (revenues from consignments, lease, advertising, parking and trade).

The maritime transport recorded an increase in the volume of transported imported and exported goods and goods in transit which resulted in an increase in revenues from maritime

transport. Activities of the Port of Bar on the international market and an increase of container transport of goods significantly contributed to the development of this type of maritime transport and an increase in revenues. The opening of the new container shipping lines from other distributive ports to Bar, as well as the opening of a direct container shipping line from China are planned in the following period (the Port of Bar will become a distribution centre for Chinese goods designated for the market of Southeast and Central Europe). Increased revenues in maritime and railway transport are also owing to the international connection of the port and the railway and an increase in transportation of exported goods to Serbia, Hungary and Albania. The increase in transportation of goods via railways resulted in an increase of related revenues of 48.1% in comparison to the same period of 2006. The highest percentage growth in revenues was in road transport, 134.6%, which is the result of economic growth and development of the Montenegrin economy, as well as intensified activities on the improvement of road infrastructure and higher transport frequency during the tourist season.

Table 5.6 – Transport revenues during January - September 2006/2007, EUR thousand

Type of transport	I-IX 2006	Share in	I-IX 2007	Share in %	$\frac{\text{I-IX 2007}}{\text{I-IX 2006}}$	Difference
Maritime	22.069	50,99	23.074	42,61	104,55	1.005
Railway	2.272	5,25	3.364	6,21	148,06	1.092
Air	14.777	34,14	18.931	34,96	128,11	4.154
Road	1.901	4,39	4.457	8,23	234,46	2.556
Other	2.265	5,23	4.329	7,99	191,13	2.064
TOTAL	43.284	100,00	54.155	100,00	125,12	10.871

Source: CBM

Table 5.7 – Structure of transport revenues during January - September 2007, EUR thousand

Type of transport	Type of transport services			Total	Share in %
	Passenger transport	Freight transport	Other		
Maritime	2.463	345	20.267	23.075	42,61
Railway	0	3.356	9	3.365	6,21
Air	13.329	335	5.268	18.932	34,96
Road	607	3.659	190	4.456	8,23
Other	0	-1	4.328	4.327	7,99
TOTAL	16.399	7.694	30.062	54.155	100,00
Share in %	30	14	56	100	

Source: CBM

Revenues from passenger transport amounted to 30% of total transportation revenues, while revenues from cargo transport amounted to 14%. Passenger transport in the international railway transport declined in the reporting period as a consequence of cancelled fast train on the route Bar – Belgrade – Bar due to lack of capacities (engines and wagons).

Total **transportation expenditures** in the period January – September 2007 amounted to EUR 40.2 million and increased by 11.9% in relation to the same period of 2006. The main reason for this increase is higher passenger and cargo transport in the international railway and road transport, and the use of other railways' services.

The highest increase in expenditures was recorded in road transport, 46.6% more than in the same period of 2006. Expenditures in the field of air transport in the reporting period amounted to EUR 15.6 million, which is EUR 236 thousand or 1.5% less than in the same period of 2006.

A share of cargo transport expenditures in overall transport amounted to 49%, while the share of passenger transport expenditures accounted for 24%. Transportation services recorded a surplus of EUR 14 million in the period January – September 2007, which is 89.5% more than the surplus recorded in the same period of 2006.

Table 5.8 – Transport expenditures during January - September 2006/2007, EUR thousand

Type of transport	I-IX 2006	Share in %	I-IX 2007	Share in %	I-IX 2007 I-IX 2006	Difference
Maritime	5.388	15,01	4.386	10,92	81,40	-1.002
Railway	1.342	3,74	1.636	4,07	121,91	294
Air	15.825	44,08	15.589	38,82	98,51	-236
Road	11.948	33,28	17.522	43,63	146,65	5.574
Other	1.396	3,89	1.028	2,56	73,64	-368
TOTAL	35.899	100,00	40.161	100,00	111,87	4.262

Source: CBM

Table 5.9 - Structure of transport expenditures during January - September 2007, EUR thousand

Type of transport	Type of transport services			Total	Share in
	Passenger transport	Freight transport	Other		
Maritime	69	906	3.411	4.386	10,92
Railway	8	1.616	12	1.636	4,07
Air	9.124	140	6.326	15.590	38,82
Road	405	16.929	188	17.522	43,63
Other	1	4	1.022	1.027	2,56
TOTAL	9.607	19.595	10.959	40.161	100,00
Share in %	24	49	27	100	

Source: CBM

The revenues from **travel** are calculated by estimating tourism revenues, which are supplemented with data on the provided health-recreational services and expenses for education. In the period January – September 2007, there was an increase in tourism services rendered to non-residents, and estimated revenues from travel amounted to EUR 443.6 million, which is 63.6% more than in the same period of 2006. The growth in revenues from travel is a result of better-quality tourist offer and

intensified promotional activities on international market, as well as growth in the number of foreign tourists. The expansion of nautical tourism and increased interest of foreign sailors for the Montenegrin coast was also characteristic for this period. A surplus achieved in the field of travel amounted to EUR 424.9 million, which is 65.4% more in relation to the same period of 2006. This surplus significantly contributed to a decrease in the current account deficit.

Box 5.2 – Human resources deficit in tourism

Tourism is a branch of economy of priority importance for economic development of Montenegro. The creation of quality and competitive tourist product creates the conditions for growth in the number of tourists and tourism revenues, opening of new jobs, and an increase in living standards.

A dynamic development of the tourism sector in the previous period pointed to the problem of the lack of qualification of the local labour force and a human resources deficit. According to the latest indicators, the total number of employed non-residents in the period January – September 2007 amounted 65,189, while the number of unemployed persons in Montenegro in the same period was 30,908 (Source: Employment Agency of Montenegro). It is estimated that about 52,000 of non-residents worked in Montenegro during the tourist season. According to the assessments of the World Tourism and Travel Council (WTTC), about 43 thousand workers or 26.3% of the total number of employees in Montenegro will be employed in the tourism sector until 2017. It is expected that about 1,000 new qualified staff will be necessary each year in the next twenty years in order to meet the demand for qualified staff in tourism industry. That is why it is necessary to provide support to educational institutions in obtaining necessary qualifications in tourism and harmonizing with international standards through the implementation of the »Strategy of the Human Resources Development in Montenegrin Tourism« which was prepared in cooperation with the Ministry of Education and Science, Ministry of Labour and Social Care, Ministry of Tourism, and representatives of the tourism industry with the German Society for Technical Assistance and Cooperation (GTZ).

Revenues from **telecommunication services** amounted to EUR 15.5 million or 19.8% more than in the same nine-month period of 2006. This increase is a result of the tourism boom, which affected a growth in international phone traffic, and an increase in charges for incoming calls. The introduction of new telecommunication services, a strong growth in international phone traffic and the liberalization of the telecommunication market significantly influenced an increase in telecommunication revenues. Expenditures for telecommunication services amounted to EUR 4.5 million, which is 6.4% less in relation to the same period of 2006. The field of telecommunication services recorded a surplus of EUR 11 million in the reporting nine-month period, which is 35.5% more in relation to the same period of 2006.

Revenues from **other business services** reached the level of EUR 32.7 million, while simultaneously the expenditures amounted to EUR 34.4 million. Most of the revenues came from various business, professional and technical services (legal and accounting services, consulting, engineering services and services in the field of architecture), EUR 19.6 million, then from visible trade services (intermediation, representation, warehousing and the like) EUR 12.7 million.

About EUR 10.1 million was paid for legal, accounting and consulting services. The costs of promotion of domestic products and services at international fairs, the purchase of advertising material, market research and other types of media promotion amounted to EUR 8.9 million.

The inflow of funds from construction projects and installations of local companies outside Montenegro, as well as in Montenegro, amounted to EUR 38 million, which is an increase of EUR 18.6 million comparing to the same period of 2006. Large investment cycle and further improvement and construction of infrastructure led to higher employment of local construction capacities and significant increase in revenues from construction services. Revenues from construction services and installation from last year's EUR 6.3 million increased to EUR 24.5 million recorded in

2007. Expenditures arising from hiring of non-residents in the construction industry amounted to EUR 26.8 million, which is 59.8% less in relation to the same period of 2006. This is mainly due to declined expenditures from investment works performed by non-residents in the country (except for construction and installation) from EUR 44.5 million in the first nine months of 2006 to EUR 11.9 million in the same period of 2007, which resulted in a surplus of EUR 11.2 million in the field of construction services.

Box 5.3 – Construction industry

Montenegro has been entered an ongoing investment cycle and recorded exceptionally high growth in construction in the last few years. The construction of large investment facilities in the field of tourism, transport and public utility infrastructure, residential buildings and the like, affected an increase in hiring of construction workers.

Trends in construction industry pointed to the lack of local construction workers with respect to both technical equipping and staff qualification. The problem of unqualified labour force and highly professional staff was obvious in the previous period, as was the need for education and professional excellence of construction workers. There was a significant increase in expenditure arising from hiring operational staff for the implementation of large investment projects. In 2006, the outflow of monetary resources arising from construction services amounted to EUR 76.9 million, which is 93.6% more than in 2005. The first nine months of 2007 were characterized by a decrease in expenditures for construction services of 59.8% in relation to the same period of 2006, due to less investment in infrastructure and increased hiring of domestic operational staff.

The implementation of large investment projects in water supply and construction of new roads is expected in the following period, as well as the implementation of significant »greenfield« investments in tourism and power generation, which will result in more employment of construction capacities. That is why it is necessary to create a strategy of construction industry development in Montenegro which will define measures for strengthening the competitiveness of construction workers on the market and contribute to greater influence of this activity on the economic development of the country. It is necessary to create the conditions for consistent implementation of the law and technical regulations in construction, prevention of unlicensed construction and devastation of space by passing the adequate legislation (Law on facility construction, Law on the construction land that will be harmonized with the Property Law and Law on State Property).

5.1.3. Income

In the period January – September 2007, Montenegrin residents allocated EUR 8 million for international insurance services, which resulted in a deficit of EUR 7 million.

The third item of the current transactions sub-account consists of revenues and expenditures arising from ownership of production factors. This part includes employees' compensations (salaries, wages), then interest receivables and payables, investments, i.e. dividends.

Factor income revenues amounted to EUR 64.2 million in the first nine months of 2007, which represents an increase of 44.5% comparing to the same period of 2006. The main share of EUR 58.1 million referred to employees' compensations, while revenues arising from income from international investments amounted to EUR 6.1 million.

Income expenditures amounted to EUR 48.6 million, which is 107.6% more than in the same nine-month period of 2006. Of total income expenditures, EUR 44.8 million was income from international investments and EUR 3.8 million were non-residents' salaries. Expenditures for interest repayment on taken loans significantly increased in the reporting period and amounted to EUR 36.2 million, which is 84.3% more in relation to the same period of 2006. The **balance of factor income** during January - September 2007 was positive and amounted to EUR 15.6 million, which is 25.7% less in relation to the same period of 2006.

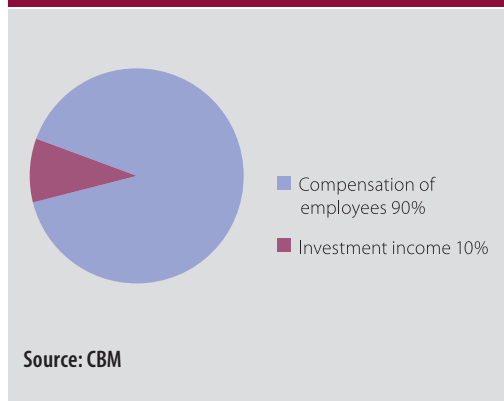
5.1.4. Current transfers

The declining trend in inflow on the current transfers account from 2006 continued in 2007. The current transfers balance during January - September 2007 amounted to EUR 40.2 million or 44.6% less than in the same period of 2006.

The total inflow of current transfers amounted to EUR 70.2 million. Of this amount EUR 3.7 million related to the government sector and EUR 66.5 million to 'other sectors'. Of the latter, EUR 45.9 million were remittances from abroad and EUR 20.5 million were other transfers (inheritance, support, and other gifts and assistance).

The current transfers outflow amounted to EUR 30 million, of which 'other sectors' accounted for EUR 25.2 million and the government sector EUR 4.8 million. An increased outflow was recorded in current transfers from Montenegro in the reporting period, and the largest part, EUR 14.5 million, related to the outflow arising from inheritance, gifts and various types of assistance.

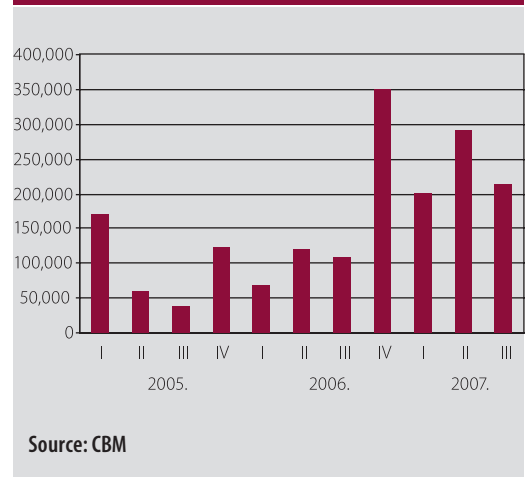
Graph 5.8 – Structure of factor income revenues during January– September 2007



5.2. Capital and Financial Transactions Account

In the first nine months of 2007, the capital and financial account recorded a significant increase in FDI and portfolio investments. Total FDI inflow in this period amounted to EUR 708.1 million, which is 139.6% more than in the same period of 2006. Net FDI inflow (inflow minus outflow) amounted to EUR 337.6 million, and comparing with the same period of 2006 this is an increase of 38.8%.

Graph 5.9 – Foreign direct investment inflow in period 2005 - September 2007 by quarters, EUR thousand

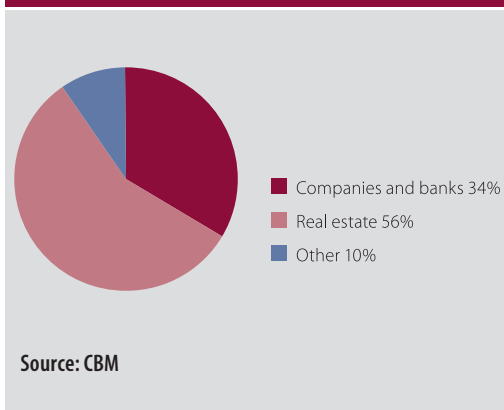


The inflow structure shows a continuation of growing investments in real estates. Of total inflow, EUR 399.6 million or 56.4% related to investments in real estates and related activities, while foreign investments in local companies and banks amounted to EUR 238.8 million or 34% of overall FDI inflow. In the reporting period, EUR 69.7 million was in the form of intercompany debt arising from loans, deposits and other receivables.

The FDI outflow in this period amounted to EUR 370.6 million, which is EUR 318.3 million more in relation to the same nine-month period of 2006. Observing the outflow structure, EUR 276 million related to real estates, EUR 48.5 million to the withdrawal of foreign capital share in local banks and companies, while EUR 44.6 million were local companies' investments abroad. Of total real estate outflow, EUR 38.3 million related to Montenegrin residents' purchase of real estate abroad, while EUR 237.7 million related to non-residents real estates sale in Montenegro.

The inflow of portfolio investments in the reporting period amounted to EUR 103.6 million, which is EUR 75.6 million more in relation to the same period of 2006. Their outflow amounted to EUR 93.9 million, which is EUR 72.4 million more than in the first three quarters of 2006. The inflow of investments in equity securities amounted to EUR 87 million, while the inflow of investments in debt securities amounted to EUR 16.6 million. The portfolio investments account recorded a net inflow of EUR 9.6 million, which is 46.8% more than in the same period of 2006.

Graph 5.10 – Structure of FDI inflow during January - September 2007



The 'other investments' account, covering loans, trade loans, cash and deposits, registered a significant increase in monetary resources inflow. In the period January – September 2007, the inflow of funds to this account amounted to EUR 754.9 million, being EUR 461.4 million higher in relation to the same period of 2006. Commercial banks and companies in the reporting period took loans to the amount of EUR 753.8 million, which is 166.5% more than in the same period in 2006, while debt repayment amounted to EUR 190.2 million. Outflow from 'other investments' amounted to EUR 605.1 million. The result of the aforementioned movements is a net inflow of EUR 149.8 million.

Net foreign assets of commercial banks were EUR 234 million less in relation to 31 December 2006. At the same time, the balance of funds on the Central Banks' international accounts and in the vault as at 30 September 2007 was EUR 207.2 million higher than as at 31 December 2006.

TOPIC OF THE ISSUE

6

Empirical research on an average housing value in Podgorica in 2007 – the real estate hedonic index in Montenegro

6.1. Introduction

Within the framework of real estate market research the CBM initiated the project of calculating the real estate hedonic index in Montenegro, as well as housing availability index, thus creating the base for August 2007. Namely, the real estate hedonic index represents an efficient technique to determine the “pure” changes in real estates prices, i.e. this technique extracts and measures the effects of qualitative housing characteristics that affect the overall price. It is logical to compare real estate prices only when their quality characteristics are kept constant. If this is not the case, that is, if qualitative features of real estate vary (number of rooms, housing age, number of balconies...), then they must be reduced to the same level through the corresponding model, and in accordance with the Laspeyres principle (once the basket of goods is defined, it must be kept as constant over time in order to ensure comparability). This is the essence of the hedonic model which, on the basis of the regression model, extrapolates and measures the influence of individual qualitative housing features on its price.

Thus, besides defining real housing prices in Montenegro, the main housing features are also taken into account with regard to their qualitative characteristics and their effect on the overall price.

The reason for monitoring the hedonic index is the fact that, as of end-2005, the real estate market in Montenegro has become a very important factor of liquidity, FDI inflow, effect on the foreign trade deficit and the citizens’ standard, i.e. this market, together with the capital market, has become an important factor that influences the main economic trends in Montenegro. That is why we deemed necessary to start monitoring this index since no systemic analysis has ever been made to address this extremely important market.

With regard to difficulties in providing a representative sample, the monitoring of real estate prices was limited only to the capital of Podgorica, but it could also be a good indicator of real estate prices movements.

6.2. Database and applied methodology of calculating the real estate hedonic index in Montenegro

The CBM took over the database of 72,917 housing objects from the Real Estate Directorate to represent the base for calculating the hedonic index. These housing objects cover three cadastral municipalities: Podgorica 1, Podgorica 2 and Podgorica 3 and the political municipality of Podgorica. Although the political municipality of Podgorica has no less than 82 cadastral municipalities, we have excluded from the sample all municipalities representing the Podgorica suburbs, as well as suburban settlements or villages near Podgorica which, as cadastral municipalities, belong to the political unit of Podgorica. The reason for their exclusion is the fact that most of the housing in Podgorica is concentrated in these three cadastral municipalities.

From the relevant population, the representative sample of 1,200 housing units was created by the random number method. The survey covering 33 questions necessary for creating the hedonic index was conducted on the appropriate sample. The survey was conducted by telephone and direct surveying at the addresses of the examinees.

The survey was conducted in the period 30 July – 24 August 2007. There were 204 successfully processed surveys (17%), of

which 190 observations entered into processing and analysis. Other 14 observations were excluded due to inappropriately completed questionnaires.

The questionnaire contained 33 questions relating to the following qualitative features of housing objects: (i) heating, (ii) internet connection, (iii) number of rooms, (iv) number of balconies, (v) housing area in square meters (vi) for how long the housing object is in the ownership of the current owner (vi) whether housing has a garage included, etc. The main objective of these questions was to determine a relative influence of these quality features on the housing value. Examinees' personal assessment of the housing value was determined by asking a question like: What is, in your opinion, the value of the housing object you possess, that is, what is the lowest price at which you would sell your apartment/house at this moment? The value is presented in EUR or EUR/m².

6.2.1. Econometric model

The survey results were entered into the software program Stata 9 for econometric analysis of the model, which served as the basis for calculating the hedonic index. The corresponding model provided the following information: (i) what is the average price of a square meter of a housing object in Podgorica; (ii) what are the standard deviations from the average price in each of the three monitored cadastral municipalities— i.e. what is the size of variations in prices of apartments in each of the

three zones in Podgorica; (iii) how much certain qualitative housing features (i.e. how much the implicit prices of individual qualitative characteristics of an apartment), contribute to its price, on average. This way we could determine how certain qualitative characteristics of a housing object are actually important in determining the price of the apartment.

The corresponding model applied is as follows:

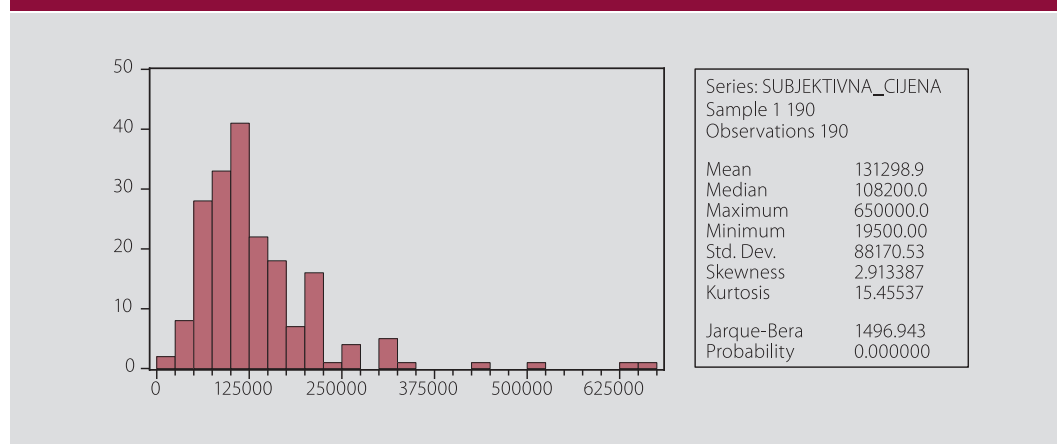
$$\ln_subject\ price = \beta_0 + \sum \beta_1 X_i + \beta_2 \ln_area\ size + \epsilon_i,$$

where *Ln_subject price* represents the logarithm of subjectively estimated housing value, *Ln area size* represents the logarithm of the housing area in square meters, *X_i*, for *i* = 1, 2, 3, 4, ..., *j*; represents qualitative housing features (number of rooms, internet connection, telephone line, the storey, age, etc).

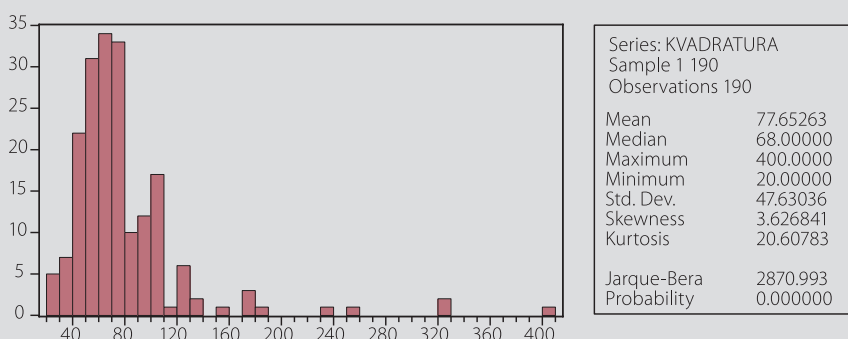
We can determine both time series from Graph 6.1 and Graph 6.2 – the prices of housing units and the area size have similar distribution and due to their limitations from the upper and the lower side (flats cannot be either smaller than 10 m² or bigger than 1,000 m², the same as their prices) we had to include logarithms in the econometric model instead of the levels.

In addition, we should note that these distributions are in accordance with the expected ones, i.e. movements of housing area size and their prices strongly resemble the income distribution curve.

Graph 6.1 – Histogram of prices distribution of housing units in Podgorica and their statistics



Graph 6.2 – Histogram of area size distribution of housing units in Podgorica and their statistics



6.3. Obtained results

The model provided the following results:

- A square meter in Podgorica amounted to EUR 1,697.56 in August, on average, which is some 100% more in comparison with the average price of a square meter estimated on the basis of taxpayers' tax declaration (as a basis we used the tax report of the annual real estate tax in the centre of the cadastral municipality Podgorica 1). As for the variations to the entire sample, the price of the square meter in the cadastral municipality Podgorica 1 amounted to EUR 1,927.16/m² on average in August 2007, EUR 1,839.09/m² in Podgorica 2, and EUR 1,419.48/m² in Podgorica 3.
- Table 1 presents data related to the maximum and minimum prices by cadastral municipalities Podgorica 1, Podgorica 2 and Podgorica 3. As it the table shows, the minimum price of a square meter ranged between EUR 650/m² in Podgorica 3, to EUR 890/m² in the cadastral municipality Podgorica 1. On the other hand, the maximum price of a square meter varied between EUR 2,580.6 in Podgorica 2 to EUR 3,333.33/m² in Podgorica 3 in August.

Table 6.1 – Basic statistics on prices movements in units Podgorica 1, Podgorica 2 and Podgorica 3, EUR thousand

	Podgorica 1	Podgorica 2	Podgorica 3
Average price	1,927.16	1,839.09	1,419.48
Maximal price	3,000.00	3,333.33	2,580.6
Median	2,000.00	1,800.00	1,300
Minimal price	888.89	800.00	650
Standard deviation	453.32	555.68	467.35

The largest variation in housing price movements was in cadastral municipality Podgorica 2, with an average deviation of EUR 556/ m². The reason lies in the fact that the cadastral municipality Podgorica 2 covers both very attractive and less attractive locations, which is why the price of a square meter of housing is the highest in this cadastral municipality.

- In addition to the average value, the model determined how much certain qualitative features of a housing object affect its value. Therefore, the ratio before the constant shows that the first square meter of a housing object in Podgorica in August 2007 amounted to EUR 2,461.77, on average.
- The coefficient in front of the Ln_area size variable shows an average percentage increase in the price of an apartment when its size increases by 1m². Therefore, if we assume that the area size of an apartment is 50m² its average value, according to the average in zones Podgorica 1, Podgorica 2 and Podgorica 3, is EUR 84,878. If the area size of the apartment increased by 1m², its price would rise by EUR 1,392.00, on average.

- The positive and significant coefficients (before variables like energy, balcony2, balcony 2+, up to 6 storeys, no garage) indicate how much apartments with these characteristics cost more than those in buildings over six storeys that have less than two balconies and use fuel for the heating.
- If we take a look at signs in front of coefficient of variables Up to 5 years old, Over 10 years old, we can see that apartments aged between 5 and 10 years are the most expensive ones. One of the potential reasons lies in the fact that most of these residential complexes were built in the suburbs, as well as in the fact that a large number of these apartments was bought during their construction at favourable prices.

The hedonic index base values have been generated from this model, **IHECG=100**, both at the aggregate level (an average price of m² of housing in Podgorica), as well as at the level of cadastral municipalities in Podgorica (an average price of m² of housing unit in Podgorica 1, Podgorica 2 and Podgorica 3).

Table 6. 2 – Empirical results of the average real estate price model in cadastral municipalities Podgorica 1, Podgorica 2 and Podgorica 3

Ln_subjective price	Coefficient	Std. Err.	t	P> t	95% Conf. Interval	
Ln quadrature	0,821	0,105	7,79***	0	0,612	1,029
Until 5 years of age	-0,304	0,127	-2,38***	0,019	-0,557	-0,051
Over 10 years of age	-0,223	0,095	-2,33***	0,022	-0,413	-0,033
Balcony0	0,102	0,074	1,37	0,174	-0,045	0,250
Balcony 2	0,118	0,068	1,73*	0,086	-0,017	0,252
Balcony 2plus	0,199	0,120	1,66*	0,1	-0,038	0,436
Room 1	-0,108	0,069	-1,57	0,12	-0,244	0,028
Room 2plus	0,117	0,081	1,45	0,149	-0,042	0,278
Electricity	0,489	0,100	4,88***	0	0,290	0,687
No Internet	-0,063	0,053	-1,19	0,236	-0,168	0,041
No garage	0,120	0,063	1,89*	0,061	-0,005	0,247
Until 6 floors	0,097	0,056	1,72*	0,087	-0,014	0,209
Constant	7,808	0,495	15,75***	0	6,826	8,790

Explanation: *significance on 10%, **significance on 5%, ***significance on 1%

Box 6.1 – Comparison with the region – example of Croatia

Taking into account the fact that the only available data on the hedonic index and real estate prices in other countries of South-East Europe are those for Croatia, since it has experienced a similar remarkable price growth in the coast region as Montenegro, it we have selected this country as the comparative base for the analysis of the real estate availability index.

According to the empirical research of the National Bank of Croatia²⁴, the price of a housing m² in Zagreb downtown costs EUR 2,037, while the corresponding prices published on websites of Croatian real estate agencies vary between EUR 1,700.00 and 3,800.00/m² (Maksimir, Iblerov trg, Frankopanska Street, Antuna Bauera Street etc.)²⁵.

However, when we take a look at the offer of these cities, we should take into account the ability of the citizens of Montenegro and Croatia to buy the corresponding housing objects. The real estate availability index, measured as the m² of housing object/average net monthly salary ratio, may serve as a comparative data. In this context, net monthly salary reflects the solvency of citizens as being able to take a residential loan. Namely, a net salary in Croatia amounted to EUR 642.37²⁶ in April 2007 (since information on an average real estate price in Croatia was published in April, we took into account that month's average net salary), and an average real estate price amounted to EUR 2,037.00, the availability index for Croatia is $I_{Croatia} = 3.17$. On the other side, an average price of m² in Podgorica amounted to EUR 1,697.56 in August 2007, while a net average salary in the same month amounted to EUR 338.00²⁷, so the average availability index amounted to $I_{Montenegro} = 5.02$. The indicators of real estate availability directly speak in favour of the conclusion that the housing purchasing power of private individuals in Montenegro is far lower than that of private individuals in Croatia.

Therefore, if a private individual in Montenegro has an average net salary of EUR 338, and wants to buy a housing object of 50m², it will cost him/her EUR 84,878, on average. According to the current banking system conditions in Montenegro, a person must have the initial deposit to the amount of 1/5 of the housing value or EUR 16,975.60. If a private individual wants to repay the remaining EUR 67,902.4 in a 25-year period, at the annual interest rate of approximately 7.18%, monthly instalment would be EUR 487.75, which is much more than their average net income of EUR 338. The interest repayment for this loan amounts to EUR 78,423. The aforementioned data speak in favour of the conclusion that, according to the current prices of housing objects in Montenegro, residential loans for private individuals with the average personal income are too expensive.

We assume that the current housing prices are largely under the influence of growing prices in the coast region. Still, the effect of growing demand is also obvious due to the two facts: the purchasing of apartments after selling real estates on the coast; and the other reason lies in the fact that Podgorica became the capital of an independent state, which entails the opening of foreign embassies, arrival of international organizations and other, which increased the demand for business premises for

these institutions, as well as housing objects for members of aforementioned institutions and their families. On the other side, moderate yet evident are the effects of an increase in the citizens' living standard and offer of banking residential loans under more favourable conditions than in the previous years. We believe that the Montenegrin real estate market is overestimated and that in the following period, together with a decline in demand and subsequently the level of real estate prices on the Montenegrin

²⁴ Application of Hedonic Method in Calculating the Real Estate Price Index in Croatia, draft version, April 2007

²⁵ <http://www.opereta.hr/web/list.aspx?lng=hr&tipnek=2&najam=0&idreg=17>

²⁶ Eco -Win Pro data base, 2007

²⁷ Bulletin CBM, October 2007

coast, a decrease in real estate prices in Montenegro could be expected. Therefore, we will initiate the calculation of a new index value in the following quarter, which will provide for the analysis of whether it came to any temporary stagnation, growth or decline in prices on the Montenegrin real estate market.

EU TOPICS

7

7.1. Overview of the latest European Commission Report on the improvement in Montenegro

In November 2007, the European Commission (hereinafter: the EC), published a set of documents related to the accession strategy for the Western Balkan countries, as well as individual progress reports for all countries in this region (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Kosovo).

In the Western Balkan countries progress report, the EC expressed its readiness for further enlargement of the European Union (hereinafter: the EU) respecting the agreement reached at the Thessaloniki Summit, which imposes reforms as the precondition for EU membership. As the „condition of all conditions“, emphasized are the “strengthening of judiciary and administrative capacities, and fight against corruption at an early stage”, emphasizing the benchmark mechanisms, i.e. standards settled for opening and closing the Stabilization and Association Agreement chapters. Also, the EC Report on Western Balkans states that “deeply rooted corruption”, as well as organized crime in these countries are matters of concern, and that administrative capacities for the implementation of the Stabilization and Association Agreement are at low levels. The report proposes that Regional School of Public Administration (RESPA) should be opened, with the aim of improving the performance of national administrations in the Western Balkan region.

Concerning the EU accession prospects of these countries, the EC estimated that this could happen in the middle- to long-term framework, taking into account the current level of readiness of the states.

The EC published (6 November 2007) a special Montenegro 2007 Progress Report. This comprehensive document analyzes the political and economic criteria progress towards meeting

the Copenhagen membership criteria, as well as the ability of Montenegro to gradually harmonize its legislation and policies with the EU acquis.

In the part of the report related to meeting the Copenhagen political criteria, each individual criteria is analyzed. General assessment is that there is some progress and that certain priorities, defined by the European Partnership with Montenegro²⁸, are implemented, although, problems are still present in the government administration reform, the judiciary system and the corruption. The EC estimates that the administration is still weak and inefficient, and that the training of employees is necessary in order to improve the coordination process between institutions in the process of implementing the priorities defined in the European Partnership and obligations arising from the Stabilization and Association Agreement. The EC considers the corruption is a serious problem not only in Montenegro, but also in other Western Balkan countries. To that end, the establishment of the Commission for the Fight against Corruption and Organized Crime is mentioned as a positive step and the first report of this Commission is considered as the initial step that should create conditions for further implementation of measures defined in the Action Plan for the implementation of the fight against corruption and organized crime strategy. The areas identified to bear a particular risk are construction, land-use planning, privatization, concessions and public procurements, and it was concluded that it is necessary to undertake actions in order to obtain better results in this area.

In the part referred to the assessment of political criteria the EC indicates that the greatest advancement has been achieved in the area of International obligations. The continuation of active regional cooperation is emphasized, and the country continued

²⁸ Revised European Partnership with Montenegro was adopted by the Council in January 2007 following the EC proposal

with compliance with respect for international obligations after gaining independence. Montenegro's commitment to regional cooperation—SEEP, RCC, CEFTA, as well as good relationship with neighbours is also emphasized.

It could be said that the EC assessment in this report with regard to the meeting of Copenhagen economic criteria²⁹ is more positive than in the previous report, as well as in relation to the political criteria. According to this, the expansion and rapid economic growth continued, structural reforms are being implemented, and macroeconomic stability has improved.

In the analysis of meeting the criteria relating to the existence of a functioning market economy, it was estimated that there has been further improvement in the setting up of a market economy. Overall macroeconomic stability has improved, and a rapid economic growth contributed to the creation of new jobs and a reduction in unemployment. Regardless of the present uptrend in inflation, it was estimated that the inflation rate is satisfactory and that it is helping the positive performance of the economy. Beside these positive results and trends, the existence of potential risks in the macroeconomic stability in the medium term is pointed, especially in the part of large external deficit and the electricity prices. The privatization process has slowed down since 2006, but the establishment of new companies has been made easier owing to lower costs and shorter time period for obtaining a business licence.

In the part of the report related to development of the financial sector in Montenegro, it is estimated that after the completion of the privatization process, the banking sector has continued with an accelerated growth and development. The delay in adopting the new Law on Banks would have negative effects on the banking sector in Montenegro. The current legal framework has deficiencies with regard to corporate governance and risk-management requirements. Therefore, any further delay in the adoption of the new Law on Banks will slow down the process of harmonization and implementation of European standards by the Montenegrin banking system. The pending adoption will strengthen the authorities of the Central Bank relating to enforcement and supervision powers, in accordance with international standards and it will create the legal requirements

for the implementation of Basel II. In the part relating to money laundering, the European Commission expressed a positive attitude towards the activities undertaken in recognizing suspicious transactions in the banking sector. However, the EC considers that there is no proper monitoring and control of suspicious transactions beyond the banking system, especially in relation to real estates and inward investments.

Analysing Montenegro's capacity for a gradual harmonization of its legislation and policies with the Acquis, related to internal market, sectoral policies and justice, freedom and security, in accordance with the Stabilization and Association Agreement and the European Partnership priorities, the EC estimates that a certain progress in this area has been achieved. A number of laws harmonized with EU regulations has been adopted, but some restrictions in their implementation are present due to the low level of administrative capacity.

In the part relating to statistics and its improvement it was stated that the amended statistical law has not yet had sufficiently positive impact on development of the national statistical system. Also, the improvement in foreign trade statistics is limited. It was emphasized that a significant progress has been achieved in the field of statistical business register which represents a solid basis from which updated data for statistical research may be taken. In the part of statistics which Central Bank of Montenegro produces and publishes it was estimated that the level of knowledge of the EU regulations and requirements has improved significantly.

The creation of the National Program for Integration is under way. The document represents the plan of harmonization of the Montenegrin legislation with EU standards and regulations in short term (2008–2009) and medium term (2009–2012). The National Program is structured in accordance with the Stabilization and Association Agreement requirements, aiming at more rapid and efficient implementation. This document should enable all institutions participating in the European integration process in Montenegro to have an insight into the level of harmonization of their legislation with the EU and of their priorities in the following five-year period.

²⁹ Conclusions of the European Council from Copenhagen, June 1993, which conditions the membership in the EU by the existence of a functioning market economy and possibilities for facing the competition challenges existing within the EU.

INTERNATIONAL ECONOMY

8

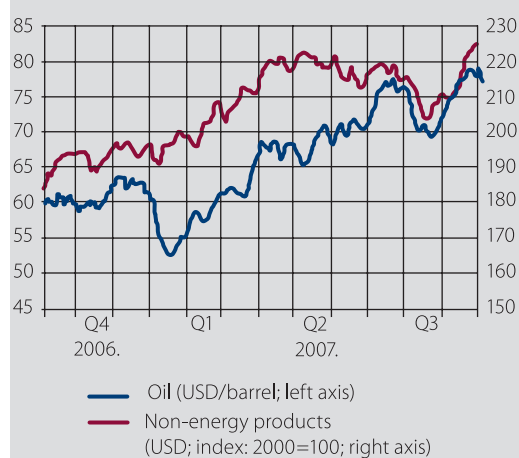
Global economic growth continued in the third quarter of 2007 and it was estimated that the global GDP growth will be exceed 5% at end-2007. Global inflationary pressures were present in the reporting period, mostly initiated by an increase in oil, agricultural and food prices in the world markets.

Record low oil prices characterized the beginning of 2007, followed by a continuous increase. During the third quarter of 2007, oil prices recorded an uptrend after a brief fall during August; thus, the oil price reached the level of USD 78.5/per barrel at end-September, which was 30% more than at the beginning of the year. According to the International Energy Agency (IEA) data, global oil demand this year will be 86 million barrels/day, on average, while in 2008 it is expected to increase by 2.5% to 88.18 million barrels/day. The IEA points that oil demand is becoming less „sensitive“ to price changes, because the share of the transportation sector, which must use fuel regardless of the price, will continue to increase within the overall energy consumption. According to the assessments, the prices of crude oil will remain at the current high by the year-end and will be under the influence of growing winter demand and geopolitical tensions.

8.1. Economic trends

According to estimates, the annual growth rate of GDP in the USA in the third quarter of 2007 amounted to 3.9%. Japan's economic activity is recuperating after somewhat lower growth rates in the first half of the year. Strong economic growth was recorded in China, which “drags” the whole region. In the eastern Asia, economic growth rates remained high, yet showing some slowdown. In Europe, economic growth outside the Euro area was significant and mostly driven by growth in local demand in the Central and Eastern European countries.

Graph 8.1 – Movement of oil prices during 2006, Q1, Q2 and Q3 2007



Source: ECB

8.1.1. Developed countries

USA – In the third quarter of 2007, the USA recorded real GDP growth of 3.9% after the increase of 3.8% in the second quarter and 0.6% in the first quarter. American economists revised downwards their forecasts of economic growth for the following year expecting that the decline in the housing market will be greater and last longer than initially expected. The decline in the housing market could reflect on private consumption and business investments in the forthcoming period. The estimates show that the USA will record growth of about 2% in 2007, and that that in 2008 will be 2.4%, as opposed to initially forecasted 2.6%. In spite of a moderate acceleration of growth expected for the next year, the economists estimate that new constructions on the housing market will be at the lowest level since 1993, while private consumption should record the lowest growth since 1991.

In September 2007, the inflation rate amounted to 2.8% at the annual level, which is 0.8% more than in the previous month (when the annual inflation rate amounted to 2%).

Box 8.1 – Financial crisis in the world financial markets and its consequences

There was a crisis in the world financial markets in mid-2007, incited by the developments in the US mortgage market, where borrowers could not meet their obligations due to an increase in interest rates. The impossibility of regular servicing of obligations by debtors in the US loan market resulted in liquidity crisis, an increase in interest rates in interbank crediting, as well as general distrust among participants in the loan market.

There is a fear that the consequences of this crisis will be felt for some time in the future, which could result in the global economic slowdown. Turmoil in the world financial markets will affect developing countries and may cause financial problems in most vulnerable economies and slow down their growth.

Owing to record growth rates and market reforms, Eastern European countries and those of the former Soviet Union have dealt very well with the current turmoil in the financial markets so far. In addition, the new EU member states remained relatively unaffected by adverse consequences of the crisis, but there is a danger that it could strike countries with large current account deficit in the medium term. Countries with a large balance of payments deficit, such as Latvia, Hungary, Bulgaria, Romania, Serbia, Montenegro, etc. are under pressure.

As one of the countries with a large current account deficit which is financed primarily through FDI, Montenegro may experience serious consequences in the medium term. Montenegro's economic growth relies on the import of foreign capital, but when that capital becomes more expensive, it may reflect on further deterioration in the balance of payments position, provided that the capital import continues with the same intensity.

EU – A significant economic growth was recorded in Europe in the third quarter of 2007, incited by powerful exports and increasing domestic demand. The GDP growth rate was 3.3% at the EU level. Positive economic trends enabled the opening of a great number of jobs and resulted in the unemployment rate of 6.8% in September 2007, which is 2% less in relation to end-2006. The annual HCPI inflation rate in the EU was 2.3% in September 2007.

Great Britain – The British economy experienced a more accelerated growth in the third quarter of 2007 than initially expected by economists, this owing to well functioning of the services sector, which is a sign that more expensive loans are yet to slow down economic activity. In the third quarter, GDP in Great Britain was 0.8% higher than in the previous quarter,

and the identical growth was recorded in the second quarter as well. The annual growth rate was 3.3%, which is the highest rate in the last three years. The services sector, which makes three quarters of the British economy, recorded growth of 1% owing to high increases in business and financial services. The annual inflation rate in Great Britain was 1.8% in September 2007. Economists forecast that economic activity in Great Britain will slow down by the year-end after the Bank of England's fifth increase of the reference interest rate. The IMF increased its estimation for this year's GDP growth to 3.1%. The next year's growth should be 2.3%.

In the third quarter of 2007, the annual HICP inflation rate in the Euro area amounted to 2.1%, which was somewhat above the target medium-term level (2%), but there are still inflationary

pressure risks due to the large credit growth. An increase in the prices of energy and food products in the reporting period was mentioned as the reason for inflation growth. GDP growth in the Euro area in the third quarter amounted to 2.6%. It is estimated that economic growth will slowdown to some extent in 2008 and the growth rate will amount to 2%. The reasons for the slowdown in the next year are lower growth of investments due to an increase in credit costs, a reduction in exports, and growth in oil and oil derivatives prices. The unemployment rate in the Euro area amounted to 7.3% in September 2007.

According to estimates, the new EMU member **Slovenia** will record economic growth of some 5% in 2007 (5.2% in 2006). In the first quarter of 2007, Slovenia recorded economic growth of 7.5%, which is the highest level since 1999. The annual inflation rate amounted to 3.6% in September 2007, and it is forecasted that the inflation rate will reach the level of some 3.2% by the end of the year.

Table 8.1 – Projected macroeconomic indicators for the Euro area

	2007p	2008p	Long-term projection
HICP (%)	2.0	2.0	1.9
GDP (%)	2.6	2.0	2.0
Unemployment rate (%)	7.0	6.7	-

Source: Consensus Economics

The ECB adjusted its inflation forecasts, and the latest ECB reports indicate that the inflation rate in the Euro area will range between 2% and 2.2% in 2007, i.e. from 2% to 3% in 2008.

A significant economic growth was recorded in the countries outside the Euro area, primarily initiated by growth in domestic demand, while the inflationary movements were different from country to country. A negative economic growth rate of 0.4% was recorded in Denmark, while in Sweden it was 0.9% of GDP. The reason for the slower economic growth in Denmark was a decline in private and government consumption. The annual inflation rate in Denmark and Sweden in August amounted to 0.9% and 1.2%, respectively.

Accelerated economic growth continued in South-East Europe, being significantly higher than in the EU. The expected GDP growth rate is about 5.9%. This growth is still largely initiated by large consumption and investments. "Big consumption stems from the households' wish to reach standard of living their counterparts in the rich countries of Western Europe have."³⁰

Strong growth of about 5% - 6% is expected in Bulgaria and Romania both this and the following year, because both countries will continue benefitting from the EU accession. Households are still important instigators of economic growth in South-East Europe. The households adjusted their consumption habits to the new and better living standard very quickly. Consumption was characterized by a rapid growth in revenues and facilitated access to the credit market. This was contributed by the impression of wealth due to rapid growth in real estate prices. Households are more and more inclined to investing in real estates, and there was a high demand for houses and apartments financed by mortgage loans. Households are still net depositors, but they also gradually redirect their savings and invest in real estates. Large demand for real estates in the context of still limited supply drove the prices of houses and apartments upwards. In addition to the high economic growth, Romania also recorded a high inflation rate (6.1% in September at the annual level). Bulgaria is the only EU country that recorded a two-digit inflation rate in the reporting period of 13.1% in September 2007 in relation to the same month of the previous year. According to estimations, inflation in Bulgaria will amount to some 8% at end-2007.

Romania experiences a strong FDI inflow which reduces the adverse effects of the high balance of payments deficit. In September 2007, FDI covered 40% of the balance of payments deficit.

The European Commission increased its forecast for Poland' economic growth from 6.1% to 6.5%. According to the EC, the main initiator of growth will be large domestic demand for products and services, encouraged by growth in salaries and transfers from the **European Union** funds. The HCPI annual inflation in Poland amounted to 2.7% in September 2007.

³⁰ Debora Revoltella, Chief Economist of the UniCredit Group for Central and Eastern Europe

Growth in trade surplus of no less than 62.7% was recorded in **Japan**, owing to the large export of cars and communication equipment in September 2007.

8.1.2. Developing countries

According to IMF estimations, Asian developing countries will achieve the economic growth rate of 9.6%, while a rate of 9.1% is expected in 2008. Inflationary pressures are still present in Asian countries, mostly as a consequence of China's economic trends.

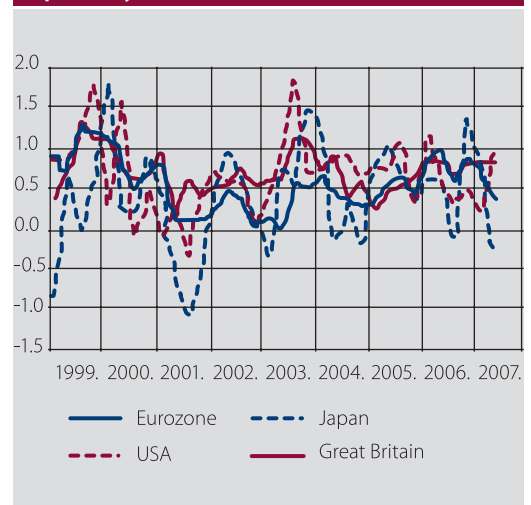
China – As the most rapid growing world economy in the third quarter of 2007, China recorded economic growth of 11.5%. The inflation rate was the highest in the last ten years; the trade surplus was on an uptrend, which put additional pressure on the central bank to increase interest rates for the fifth time since March 2007. Consumer prices were 6.5% higher at the annual level in September 2007, primarily due to an increase in the prices of food of 18.2%. The trade surplus in the third quarter 2007 rose by 33% to USD 24.97 billion, which creates cash surplus and the subsequent growth in real estate prices and overheating of the capital market.

Latin America continued with a significant economic growth. The annual industrial growth rate and the inflation rate recorded in **Brazil** in September 2007 amounted to 5.6% and 4.2%, respectively. The annual GDP growth amounted to 5.4% in the second quarter of 2007, representing a 1% increase in relation to the previous quarter (4.4%).

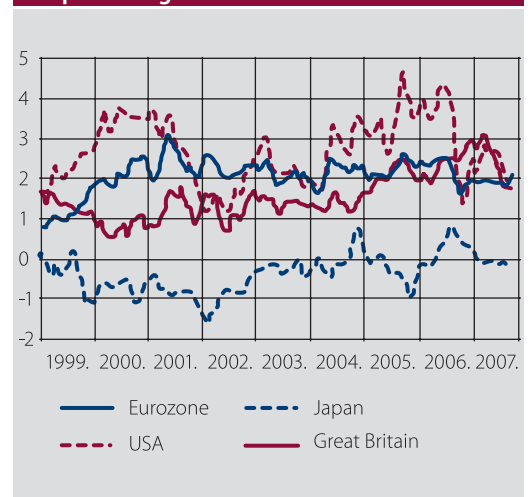
Argentina also recorded substantial economic growth, with the annual industrial growth of 9% in September 2007. The annual GDP growth rate in the second quarter was estimated at 8.7%. The annual inflation rate in August 2007 also amounted to 8.7%.

Mexico saw the annual growth in industrial production of 2.6% in September 2007, and the annual inflation rate in the same month amounted to 3.8%. According to estimations, economic growth in Mexico will amount to 3.1% in 2007, while in 2008 it should be at a somewhat higher level, amounting to some 3.5%.

Graph 8.2 – GDP growth rates in industrially most developed countries, quarterly data



Graph 8.3 – Inflation rate in industrially most developed countries, annual change in percentages



8.1.3. Economies in Transition

Strong economic growth continued in the Western Balkan countries. In **Croatia** economic growth is expected to reach the level of 5.5% – 6% in 2007 and continuing in 2008 in spite of some slowdown that will be caused by restrictive monetary policy measures. Real GDP growth in the second quarter, in relation to the same period of 2006, amounted to 6.6%. Economic growth was still under the large influence of growth in private consumption, which was 6.5% higher in the second quarter of

2007 than in 2006, but substantial results were also achieved in external trade. The influence of investments, which mostly drove high economic growth in the previous period, is somewhat lower, i.e. their growth is the lowest since the third quarter of 2005. Until September 2007, Croatia recorded a more rapid growth of exports over imports, which contributed to the improvement in import/export coverage in relation to the previous period, so this ratio amounted to 49.8% in September. However, the visible trade deficit is still high and it amounted to EUR 754.4 million in September 2007. The unemployment rate in Croatia was 14.1% in September this year, which represents an increase of 0.3% in comparison with August when this rate was 13.8%, which was the lowest rate registered in the last ten years.

Economic growth intensity in Serbia and Bosnia and Herzegovina is encouraged by strong domestic demand and favourable external conditions. However, sustainable medium-term growth in both of the countries depends on the advancement of their structural reforms.

During the third quarter of 2007, inflation in **Serbia** was somewhat higher than in the first two quarters, so the inter-annual increase in retail prices amounted to 7.4%. The increase in prices was encouraged by low supply of agricultural products and an increase in oil prices in the world market. It is expected that the annual inflation in Serbia will be around 9%, and the core inflation rate will be within the projected zone (4%–8%). Monetary policy of the National Bank of Serbia is still restrictive, and since inflation growth is expected in the following period, the reference interest rate increased by 25 base points in August,

now amounting to 9.75%. Depreciation of the Serbian Dinar (CSD) against euro (EUR) was discontinued in the third quarter, and the CSD appreciated by 1.3%. The mean exchange rate of CSD in the reporting period fluctuated around 80 Dinars for 1 Euro. GDP growth amounted to 7.7% in the second quarter of 2007.

Bosnia and Herzegovina recorded dynamic growth in the second quarter of 2007 owing to positive economic trends. According to estimations, the GDP growth rate will be at the last year's level of 6.2%. According to the analysis of the Central Bank of Bosnia and Herzegovina, the inflation rate in the second quarter was below 1%, and such low inflation was the consequence of a decrease in the prices of agricultural products in the reporting period.

8.2. Interest rates

Market analysts expect that the reference interest rates of the leading world economies will be on an uptrend in 2008. Interest rates are one of the important factors which still influence the cross-rate movements.

The European Central Bank (ECB) increased its reference interest rate last time in June 2007 to 4%, i.e. by 25 base points, which was the highest level in the last five years. The analysts expect that the ECB will increase the reference interest rate at least once more for additional 0.25 base points until the end-2007 in order to reduce the inflationary risk due to a large credit growth and medium-term risks.

Table 8.2 – Recorded and forecasted macroeconomic indicators in the selected transition countries

	GDP growth (in %)			Inflation (in %)		
	2006	2007 p	2008 p	2006	2007	2008 p
Albania	5.3	5.9	6.1	2.5	2.5	2.6
Bosnia and Herzegovina	6.2	5.9	6.2	7.4	2.6	2.6
Croatia	4.8	4.5	4.3	3.2	2.6	3.1
Macedonia	3.2	4.1	4.2	3.2	2.8	2.5
Serbia	5.7	6.0	5.8	6.6	5.8	5.6

Source: Consensus Economics

Table 8.3 – ECB reference interest rates in 2006 and 2007 (annual amounts in percentages)

Date	Deposit facilities	Main refinancing operations		Marginal loan arrangements
		Fixed rate	Minimum variable rates	
2007 13.06	3.00		4.00	5.00
2007 14.03	2.75		3.75	4.50
2006 13 December	2.50	-	3.50	4.50
11 October	2.25	-	3.25	4.25
9 August	2.00	-	3.00	4.00
15 June	1.75	-	2.75	3.75
8 March	1.50	-	2.50	3.50
2005 6 December	1.25	-	2.25	3.25

Source: ECB

The FED decided to reduce the reference interest rate once again by 50 base points in September (18 September 2007, from 5.25% to 4.75%), thus inducing a record boom in shares prices in the USA since 2003. This decision of the FED was influenced by the developments of inflation, economic growth and illiquidity in the financial market. There are also some expectations that this reduction could help in overcoming the largest crisis in the US housing market since 1991.

An increase in prices and better market conditions created the conditions for the Bank of Japan to terminate its remarkably expansive monetary policy it followed in the previous five years, which implied the maintaining of the zero reference interest rate. Therefore, the Bank of Japan increased its interest rate by 0.25 base points in July 2006 and again in February 2007, and now it amounts to 0.50%. Investors expect that there will be another increase of the BoJ reference interest rate until the end-2007.

Table 8.4 – FED reference interest rates movements during 2006 and 2007

Date	Changes (basis points)		
	Growth	Reduction	Amount (%)
18.10.2007		50	4.75
31.06.2007	-	-	5.25
31.03.2007	-	-	5.25
08.08.2006	-	-	5.25
29.06.2006	25	-	5.25
10.05.2006	25	-	5.00
28.03.2006	25	-	4.75
31.01.2006	25	-	4.50

Source: FED

The Bank of England did not change the reference interest rate in the third quarter of 2007 and it remained at the level of 5.75%.

The Chinese central bank increased its reference interest rate for the fourth time since March 2007 in order to stop the most rapid inflation rate growth since 1996 and slow down the capital market growth. In September 2007, the interest rate increased by 0.18 base points and it amounts to 7.02%, which is the nine-year maximum.

8.3. Exchange Rates

8.3.1. USD/EUR

The EUR depreciated during May and in the first half of June, but in the third quarter of 2007 it appreciated against the USD under the influence of economic indicators which pointed to higher economic growth in the Euro area than in the USA, the expectations that the FED will reduce the interest rate, a weak customer trust index, as well as deterioration on the US capital market. At the beginning of July 2007, the EUR/USD rate amounted to \$1.362USD/1EUR, while at end-September it reached the new record maximum of 1.4394USD/1EUR. It is expected that

the USD will continue depreciating against EUR until the end of 2007, primarily owing to investors' forecasts on deterioration of the USA housing market, the subprime crisis, unemployment growth, a decline in demand for durable goods, as well as due to expectations that the FED will again reduce the interest rate (due to the poor indicators which will confirm the weakness of the US housing market), and in that way reduce the attraction of USD-denominated properties.

8.3.2. JPY/EUR

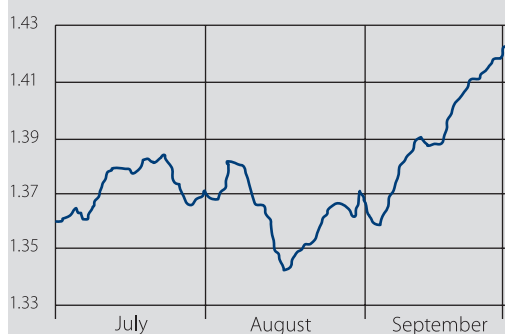
The exchange rate of JPY/EUR was fluctuating in the third quarter of 2007. JPY depreciated at the beginning of the reporting period due to investors' redirecting to higher yield currencies; afterwards, JPY started to appreciate against EUR as investors regained their interest in the Japanese currency. The EUR/JPY rate at the beginning of the third quarter amounted to 166.80, while it was 163.92 at end-September. The EUR/JPY exchange rate was 1.2% lower at end-September comparing to the beginning of July, but 12.2% higher than its average value during 2006. The reasons for such trends of the EUR/JPY rate are primarily of speculative nature that the losses on loan markets will discourage consumers across Europe, and the expected leap in the prices of shares in the Asian markets.

8.3.3. Other European currencies exchange rates trend

The GBP/EUR exchange rate declined in July 2007 owing to the tensions in Great Britain triggered by the last terrorist attack attempts. At the beginning of the reporting period, the EUR/GBP rate amounted to 0.674, recording growth at end-September. The reason for the weakening of the British Pound was caused by the anxiety about growing problems in the British financial sector initiated by the information about the small amount of funds available in the deposit insurance scheme.

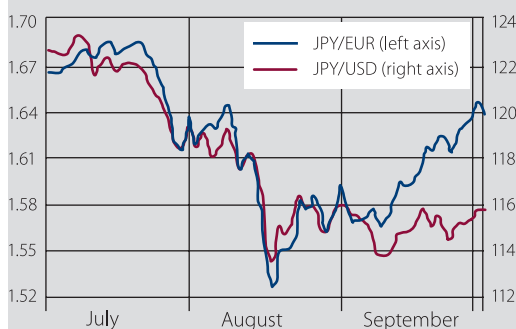
Since end-April 2007, the currencies covered by the ERM II – including the Slovenian crown and Lithuanian Litas (LTL), were relatively stable. In the third quarter, EUR was relatively stable in relation to CHF.

Graph 8.4 – The USD/EUR exchange rate movement in the third quarter 2007



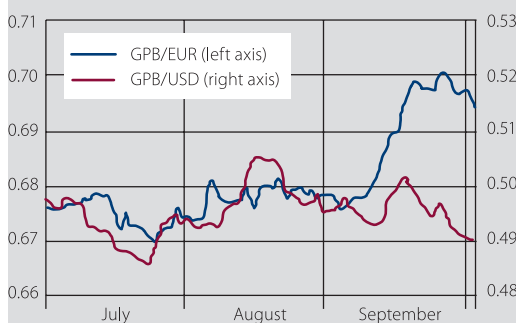
Source: ECB

Graph 8.5 – Movement of JPY/EUR rate and JPY/USD in the third quarter 2007



Source: ECB

Graph 8.6 – Movement of GBP/EUR and GBP/USD rates during the third quarter 2007



Source: ECB

Box 8.2 – European Central Bank (ECB) and EUR/USD exchange rate movements

The common European currency recorded a strong growth in relation to the US Dollar, which could restrict economic growth and force the ECB to reconsider its actions in the forthcoming period, the economic analysts consider. The main economic counsellor to the German Government considers the time of anxiety elapsed and that the ECB must act accordingly. “We behave as if the exchange rates movements are the matter of destiny, i.e. an inevitable natural phenomena”.

Since it has been established in 1999, the ECB never intervened “against” its currency. In order for the intervention to be efficient it must be supported by other central banks, and the readiness of the FED to support such intervention has not been obvious, but it has showed readiness to allow a further decline in the USD exchange rate. For these reasons, it is considered by many that the ECB must rely on verbal intervention which would imply agreement with other central banks and their common activity, bearing in mind that its other leverage – the interest rate level, is not a good option at the moment. If it reduces interest rates, it will then drive inflation which has already exceeded the preferred level of nearly, yet below 2%.

8.4. Forecast for the upcoming period

Oil prices have been continuously increasing since the beginning of 2007 and their movements may pose a threat to economic growth in 2008. Any additional bigger changes in exchange rates, primarily EUR/USD exchange rate, could cause an upheaval in international financial markets, further growth of interest rates in the capital market, and an adverse impact on global economic growth. The analysts think that global economy will experience a slowdown in 2008. The reasons for such forecasts are the increase in oil and oil derivatives prices owing to an ongoing increase in demand, reduced monetary and fiscal incentives in most countries, growth in interest rates, and geopolitical tensions.

IMPORTANT EVENTS

9

July

The Montenegrin Parliament adopted the Law on Yachts, Law on Compulsory Insurance in Traffic, the Law Amending the Law on Restitution of Expropriated Property Rights and Compensations, and Law Amending the Law on Tourism Organizations.

The Government adopted the Privatization Plan for the current year that envisages privatization of about 60 companies, by means of public tenders, auctions, and the sale of shares on stock exchange.

The German and Montenegrin Government representatives signed the Protocol on Cooperation in Podgorica which foresees an amount of EUR 29.2 million as the financial and professional support to the Montenegrin economy.

The Slovenian company "Petrol" set up a joint venture "Petrol Bonus" in Cetinje with "Montenegro bonus" company, which should invest over EUR 154 million in Montenegro in the following few-year period.

The beginning of construction of the Podgorica – Tirana 400 kilowatt trunk, which will make possible for the electric energy system of Montenegro and Albania a full access to the region and enhance the regional electric power network.

The Central European Free Trade Agreement (CEFTA) came into force in Montenegro, Albania, Macedonia, Moldavia and Kosovo.

August 2007

For the first time after Montenegro's regained independence, the Government of Montenegro and World Bank representatives signed financial contracts on USD 19 million worth loans designated for financing the projects on sustainable development of tourism and energy supply. Also, the contract was signed with a French company "Louis Berger" on the preparation of a feasibility study for the construction of two motorways in Montenegro.

The Directorate for Traffic and Association "Joint venture", represented by the members of the Faculty of Civil Engineering from Podgorica and the Road Centre of Vojvodina, signed the Contract on drafting the project for the motorway section from Smokvice to Verusa, worth nearly EUR 1.5 million.

The Ministry of Agriculture estimated that Montenegrin producers of crops, potatoes and continental fruit, due to drought, had by one third lesser yields and undertook measures for reducing the damage caused by extremely high temperatures recorded this summer. In August, the producers increased wholesale prices of flour by 20% to 30%.

The receivership of Berane Coal Mine and representatives of the Greek company "Balkan energy" signed the sale contract of EUR 1.5 million.

"Vektra" company from Podgorica bought the entire property of the construction enterprise "Građevinar" from Pljevlja for EUR 1.88 million and offered to invest over EUR 10 million in the following three-year period.

September 2007

The European Bank for Reconstruction and Development adopted the first Strategy for Montenegro, which joined this financial institution last year.

Representatives of the governments of Montenegro, Croatia and Albania signed the Ministerial Declaration on the Construction of the Ionian-Adriatic Gas Pipeline, which should be connected to the Trans-Adriatic pipeline.

The Montenegrin Government adopted the Strategy for Restructuring the Railways of Montenegro, envisaging the privatization of the transportation capacities until the end of the following year, as well as the complete return of the infrastructure ownership in the government hands.

The International Internet Association for names and addresses provision approved the request of Montenegro to be assigned “.me” domain, which should replace the current “.cg.yu” sub-domain.

Directorate for Development of Small and Medium Enterprises invited interested parties for the project «Energy Efficiency and Renewable Energy Sources», to apply for loans up to EUR 500 thousand.

Representatives of the Government of Montenegro and five Montenegrin banks signed the contract on the implementation of the “250 Housing Loans” project designated for employees in the public administration and those receiving salaries through the Health Insurance Fund.

ANNEX

10

Annex A: Real sector developments

Table 1 – Preview of macroeconomic developments

DESCRIPTION	2006	2007 (chain index)										
	XII/XI	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Industrial output (index)	104.0	115.0	110.5	89.5	97.1	95.1	99.9	111.8	98.9			
Cost of living (index)	100.3	100.1	100.2	100.4	100.6	99.4	101.7	100.6	102.1			
Retail prices (index)	100.2	100.0	100.3	100.7	100.3	100.2	102.3	100.1	101.9			

Source: Monstat

Table 2 – Industrial output

	Contribution in 2006.	ø 2006 = 100							LEVEL INDEX		
		2006			2007				IX 2007	IX 2007	I- IX 2007
		VIII	IX	I- IX	VIII	IX	I- IX	VIII 2007	IX 2006	I- IX 2006	
Industry-total	100.0	94.7	99.9	99.2	99.2	98.1	94.9	98.9	98.2	95.7	
Mining and quarrying	6.2	114.4	131.9	101.4	111.7	124.3	94.8	111.3	94.2	93.5	
Mining and quarrying of en. producing mat.	2.4	144.4	132.7	98.7	70.9	61.4	66.2	86.6	46.3	67.1	
Mining of pit coal, lignite and peat	2.4	144.4	132.7	98.7	70.9	61.4	66.2	86.6	46.3	67.1	
Mining and quarrying exept energy produc. mat.	3.8	96.1	131.4	103.0	136.8	162.8	112.3	119.0	123.9	109.0	
Mining of metal ores	3.1	82.7	114.9	102.1	121.9	77.0	100.8	63.2	67.0	98.7	
Other mining and quarrying	0.7	152.5	201.0	1'070	199.3	524.1	161.1	263.0	260.7	150.6	
Manufacturing	70.0	102.0	109.0	97.9	120.5	117.9	106.3	97.8	108.2	108.6	
Manufacture of food products, beverages, and tobacco	8.1	132.3	103.8	98.5	144.9	85.8	98.9	59.2	82.7	100.4	
Manufacture of food products baverages	7.3	137.4	101.7	97.1	130.1	94.9	99.8	72.9	93.3	102.8	
Manufacture of tobacco products	0.8	84.0	123.9	111.2	285.6		90.8			81.7	
Manufacture of textiles and textiles products	1.4	46.6	109.5	90.1	127.5	78.3	84.0	61.4	71.5	93.2	
Manufacture of textile fabrics	0.1	136.2	109.5	79.6	65.0	37.6	58.2	57.8	34.3	73.1	
Manufacture of wearing apparel and fur	1.3	40.3	109.5	90.8	132.0	81.2	85.8	61.5	74.2	94.6	
Manufacture of leather and leather products	0.1		227.8	79.3	372.2		190.7			240.5	
Manufacture of wood and wood products	2.2	179.7	148.5	94.8	216.0	142.3	94.4	65.9	95.8	99.6	
Manufacture of paper, publishing, and printing	0.9	115.7	112.5	107.1	162.0	90.7	113.5	56.0	80.6	106.0	
Manufacture of celuloze paper and paper products	0.3	105.7	92.7	102.7	259.1	116.3	155.0	44.9	125.5	150.9	
Publishing, printing and reproduction	0.6	120.9	122.8	109.4	112.0	77.5	92.1	69.2	63.1	84.2	
Manufacture of chemical products and fibres	4.3	67.4	113.2	87.3	167.0	216.7	135.2	129.8	191.4	154.9	
Manufacture of rubber and plastic products	0.1	64.2	135.2	80.5	78.8	74.7	103.0	94.8	55.3	128.0	
Manufacture of other non-metal minerals	6.1	104.7	97.8	99.4	107.7	99.2	99.5	92.1	101.4	100.1	
Manufacture of metal and metal products	44.3	94.8	109.0	99.0	108.5	117.4	107.4	108.2	107.7	108.5	
Manufacture of basic metals	42.1	94.8	108.8	99.5	106.1	115.9	105.5	109.2	106.5	106.0	
Manufacture of metals products, exept machinery	2.2	94.6	13.4	90.3	152.8	145.8	143.3	95.4	128.6	158.7	
Manufacture of other machinery and equipment	1.7	166.9	113.7	92.1	105.3	123.0	96.2	116.8	108.2	104.5	
Manufacture of other machinery and household appliances	0.1	105.7	105.7	99.0	128.3	339.6	162.7	264.7	321.3	164.3	
Manufacture of transport equipment	0.6	96.1	99.2	103.0	96.1	96.1	94.4	100.0	96.9	91.7	
Manufacturing N.E.C.	0.1	80.7	69.4	105.3	84.2	116.8	87.0	138.7	168.3	82.6	
Electricity, gas, water supply	23.8	67.9	64.9	102.5	33.3	32.9	61.2	98,8	50,7	59,7	

Source: Monstat

Table 3 – Industrial production

		Total			Mining and quarrying			Manufacturing			Electricity, gas, water supply		
		2000=100	Annual growth rate	Monthly growth rate	2000=100	Annual growth rate	Monthly growth rate	2000=100	Annual growth rate	Monthly growth rate	2000=100	Annual growth rate	Monthly growth rate
2001		99.3	-0.7		88.5	-11.5		101.6	1.6		93.9	-6.1	
2002		99.9	0.6		95.1	7.5		103.9	2.3		87.7	-6.6	
2003		102.3	2.4		96.5	1.4		101.8	-2.1		103.1	17.5	
2004		116.4	13.8		91.5	-5.1		115.1	13.1		124.7	21.0	
2005		114.2	-1.9		91.7	0.2		118.0	2.5		108.0	-13.4	
2006		115.3	1.0		94.4	2.9		118.1	0.1		111.3	3.1	
2004	Jan	100.8	-0.1	-17.4	56.3	21.5	-25.2	85.0	-1.4	-23.9	124.2	0.0	-4.1
	Feb	107.8	-3.5	9.4	71.7	7.4	27.6	95.4	-1.8	12.7	151.5	-7.6	2.3
	Mar	112.6	-1.1	2.3	46.1	-40.1	-35.6	123.3	14.9	28.9	103.9	-27.9	-35.9
	Apr	120.8	44.7	7.0	58.3	3.4	26.3	117.2	22.5	-5.3	150.3	155.7	45.1
	May	118.1	46.0	-2.2	53.8	-4.1	-7.8	113.3	15.2	-3.0	190.8	374.2	0.2
	Jun	119.5	16.5	-0.3	101.4	3.3	87.6	117.6	5.3	1.6	129.6	63.7	-13.9
	Jul	113.6	6.1	-9.3	100.0	-0.7	-1.0	119.3	13.0	2.8	77.0	-14.2	-40.6
	Aug	100.2	0.2	-6.2	90.4	-57.1	-9.6	114.0	16.5	-3.8	65.2	-9.3	-15.1
	Sep	121.9	14.6	10.6	164.3	-7.3	82.1	118.2	19.6	3.6	74.5	12.3	13.9
	Oct	112.3	7.3	1.4	102.1	-1.7	-37.9	123.4	9.0	4.5	173.3	3.9	14.4
	Nov	123.8	19.4	10.1	88.3	-0.3	-3.7	121.6	16.3	-1.5	140.4	32.5	64.7
	Dec	156.5	28.3	26.6	166.9	122.1	88.2	128.1	25.7	15.4	198.4	20.4	41.5
2005	Jan	114.2	13.3	-27.0	61.5	9.3	-63.0	101.1	19.0	-27.8	130.6	5.1	-16.3
	Feb	101.9	-5.5	-8.7	42.8	-40.4	-30.4	104.2	9.2	3.4	114.1	-24.7	-26.7
	Mar	117.6	4.5	13.1	83.8	81.7	96.1	117.6	-4.6	12.6	129.2	24.4	5.8
	Apr	105.8	-12.4	-10.3	61.6	5.7	-26.5	114.6	-2.2	-2.9	95.3	-36.6	-26.1
	May	111.4	-5.7	5.4	70.3	30.8	14.3	119.2	5.2	4.3	129.5	-32.1	7.5
	Jun	115.7	-3.2	2.3	108.4	7.0	53.4	122.0	3.7	0.2	100.3	-22.6	-1.9
	Jul	125.0	10.1	4.1	106.0	6.0	-1.9	137.1	14.9	13.9	79.0	2.7	-21.1
	Aug	116.7	16.5	-1.5	129.4	43.1	22.0	133.0	16.7	10.1	67.8	4.0	11.7
	Sep	133.2	9.3	3.8	146.1	-11.1	13.1	129.1	9.2	-3.1	92.1	23.6	35.3
	Oct	110.2	-1.9	-9.0	101.2	-0.9	-30.7	120.1	-2.7	-6.9	175.4	1.2	-11.5
	Nov	120.9	-2.4	9.3	74.3	-15.9	-26.7	118.1	-2.9	-6.9	142.3	1.4	65.0
	Dec	123.4	-21.2	2.2	116.1	-30.4	55.5	111.4	-13.0	3.3	129.4	-34.8	-9.0
2006	Jan	120.7	5.7	-2.1	93.0	51.3	-19.5	100.5	-0.6	-17.6	144.9	11.0	42.5
	Feb	106.7	4.7	-9.5	91.8	114.8	-1.3	96.0	-7.9	-4.1	139.8	22.6	-19.0
	Mar	121.2	3.0	11.3	90.5	8.0	-1.4	118.8	1.0	23.3	138.7	7.3	-7.4
	Apr	105.0	-0.8	-13.7	70.8	14.9	-21.8	114.2	-0.3	-4.1	89.8	-5.8	-35.1
	May	114.3	2.6	9.0	90.0	27.9	27.1	118.7	-0.4	4.1	138.3	6.8	21.8
	Jun	117.9	1.9	1.6	96.3	-11.2	6.6	124.4	2.0	2.6	106.2	5.9	-2.9
	Jul	138.0	10.4	-0.2	96.8	-8.7	0.8	140.3	2.4	1.7	129.2	63.5	-6.3
	Aug	112.2	-3.9	-6.2	108.0	-16.5	11.7	120.8	-9.2	-2.5	75.3	11.1	-24.2
	Sep	126.2	-5.3	5.5	124.3	-14.9	15.3	129.2	0.1	6.9	72.1	-21.7	-4.4
	Oct	104.9	-4.8	-8.5	82.8	-18.2	-33.3	120.7	0.5	-6.5	139.1	-20.7	-5.2
	Nov	121.5	0.5	15.5	88.4	19.0	6.5	128.7	9.0	6.7	110.6	-22.3	61.7
	Dec	126.2	2.3	4.0	100.3	-13.6	12.9	116.8	4.8	-0.7	129.8	0.3	17.5
2007	Jan	97.6	-19.1	-23.1	69.6	-25.2	-30.2	112.0	11.5	-13.0	52.2	-64.0	-48.9
	Feb	109.2	2.4	15.0	85.2	-7.2	22.4	107.2	11.7	-3.3	122.5	-12.4	97.3
	Mar	123.1	1.6	10.5	92.2	1.8	8.1	121.4	2.2	12.8	139.1	0.3	6.0
	Apr	110.6	5.4	-10.5	90.0	27.1	-2.4	116.7	2.2	-4.0	100.1	11.5	-27.8
	May	107.2	-6.2	-2.9	86.2	-4.2	-4.2	126.9	6.9	8.9	75.0	-45.8	-40.8
	Jun	103.5	-12.2	-4.9	65.5	-32.0	-24.2	140.1	12.6	8.1	15.6	-85.3	-73.6
	Jul	121.2	-12.2	-0.1	94.1	-2.7	43.9	146.9	4.7	-5.5	35.8	-72.3	75.9
	Aug	117.5	4.8	11.8	105.4	-2.4	12.1	142.7	18.1	10.0	36.9	-51.0	34.3
	Sep	123.9	-1.8	-1.1	117.1	-5.8	11.3	139.8	8.2	-2.2	36.6	-49.3	-1.2

Source: Monstat and CBM calculations

Table 4 – Industrial output

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Chain index	76.9	115.0	110.5	89.5	97.1	95.1	99.9	111.8	98.9			
ø 2006 = 100	84.6	97.3	107.5	96.2	93.4	88.8	88.7	99.2	98.1			
Same month in the preceding year	80.9	102.4	101.6	105.4	93.8	87.8	87.8	104.8	98.2			
The same period in the preceding year		91.1	94.7	97.2	96.5	95.0	94.0	95.3	95.7			

Table 5 – Retail prices

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Chain index	100.2	100	100.3	100.7	100.3	100.2	102.3	100.1	101.9			
ø 2006 = 100	101.0	101.1	101.4	102.1	102.4	102.6	104.9	105.0	107.0			
Same month in the preceding year	101.8	101.8	102	102.1	102.2	102.2	104.7	104.5	106.4			
The same period in the preceding year		101.8	101.9	102	102	102.0	102.4	102.7	103.1			
December 2006 = 100	100.2	100.2	100.6	101.3	101.6	101.8	104.1	104.2	106.1			

Table 6 – Cost of living

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Chain index	100.3	100.1	100.2	100.4	100.6	99.4	101.7	100.6	102.1			
ø 2006 = 100	101.8	101.9	102.1	102.5	103.1	102.5	104.2	104.8	107.0			
Same month in the preceding year	102.6	102.4	102.4	102.3	102.3	101.6	104.2	104.6	106.5			
The same period in the preceding year		102.5	102.5	102.5	102.5	102.3	102.5	102.8	103.2			
December 2006 = 100	100.3	100.4	100.6	101.1	101.6	101.1	102.8	103.3	105.5			

Table 7 – Producers' prices of manufactured products

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Chain index	100.6	101.0	102.5	101.6	99.9	100.2	104.8	99.6	100.2			
ø 2006 = 100	101.1	102.1	104.6	106.3	106.2	106.4	111.5	111.0	111.3			
Same month in the preceding year	101.7	103.1	105.6	107.2	106.7	106.6	111.1	110.7	109.9			
The same period in the preceding year		102.4	103.5	104.4	104.9	105.2	106.0	106.6	106.7			
December 2006 = 100	100.6	101.6	104.1	105.8	105.7	105.8	110.9	110.5	110.8			

Source: Monstat

Table 8 – Prices

		Retail prices						Costs of living		Producer's prices of manuf. products	
		Total		Goods		Services		Total		Total	
		Annual growth rate	Monthly growth rate	Annual growth rate	Monthly growth rate	Annual growth rate	Monthly growth rate	Annual growth rate	Monthly growth rate	Annual growth rate	Monthly growth rate
2002	Jan	20.3	1.7	19.0	0.6	26.5	6.9	18.3	1.3	7.3	0.6
	Feb	19.7	0.9	18.7	1.1	24.5	0.3	18.0	1.3	6.0	1.1
	Mar	19.8	0.6	19.2	0.8	22.3	0.0	18.2	0.9	7.9	1.0
	Apr	20.8	1.6	20.6	2.0	21.6	0.1	19.7	2.0	7.1	-0.2
	May	21.3	1.4	21.1	1.6	21.9	0.3	19.4	1.7	6.6	0.4
	Jun	20.7	0.8	21.2	0.9	18.2	0.2	19.1	0.8	3.8	-2.4
	Jul	19.4	0.1	20.7	0.1	13.5	0.2	17.6	-1.0	2.4	-0.3
	Aug	17.3	0.3	18.2	0.3	13.0	0.8	15.8	0.4	0.9	-0.6
	Sep	16.1	0.9	16.9	0.8	12.6	1.4	15.5	0.9	3.8	1.4
	Oct	15.7	0.3	16.4	0.3	12.7	0.2	15.1	0.2	4.2	-0.1
	Nov	12.8	0.3	12.4	0.0	14.7	1.9	11.0	0.1	3.9	0.1
	Dec	9.4	0.1	8.7	0.1	12.7	0.0	9.2	0.5	0.7	-0.3
2003	Jan	8.4	0.8	8.4	0.3	8.4	2.8	8.4	0.5	-0.7	-0.1
	Feb	8.0	0.5	7.5	0.2	10.3	2.1	7.2	0.1	-1.5	0.0
	Mar	8.0	0.6	6.8	0.1	13.8	3.2	6.5	0.2	-0.7	1.8
	Apr	9.7	3.2	8.1	3.2	17.3	3.2	7.7	3.1	3.8	3.8
	May	8.5	0.2	6.6	0.2	17.4	0.4	6.1	0.2	2.9	0.0
	Jun	8.0	0.3	6.0	0.4	17.1	0.0	6.6	1.3	6.7	0.9
	Jul	8.3	0.3	5.8	-0.2	19.8	2.4	6.9	-0.8	7.2	0.2
	Aug	8.0	0.1	5.7	0.1	18.9	0.0	6.7	0.2	7.9	0.0
	Sep	7.4	0.3	5.2	0.4	17.4	0.2	6.3	0.5	6.7	0.4
	Oct	7.1	0.1	5.0	0.1	17.2	0.0	6.3	0.2	7.0	0.1
	Nov	6.8	0.0	5.0	0.0	15.1	0.0	6.4	0.1	7.3	0.2
	Dec	6.7	0.0	5.1	0.2	14.3	-0.7	6.2	0.3	8.2	0.6
2004	Jan	5.2	0.1	4.2	0.1	10.3	0.2	5.2	0.1	6.3	-0.2
	Feb	5.7	0.5	4.5	0.2	11.1	2.3	5.4	0.2	6.9	0.5
	Mar	5.5	0.1	4.9	0.1	8.4	0.2	5.8	0.1	8.7	3.3
	Apr	2.3	0.1	1.7	0.2	5.0	0.0	2.6	0.0	6.3	0.6
	May	2.7	0.6	1.7	0.2	7.4	2.6	2.8	0.4	6.7	0.3
	Jun	2.4	0.0	1.3	0.0	7.5	0.1	0.9	-0.6	5.5	-0.4
	Jul	2.1	0.0	1.5	-0.1	5.0	0.1	0.9	-0.7	5.7	0.2
	Aug	2.1	0.1	1.4	0.1	5.0	0.0	0.8	0.1	6.0	0.3
	Sep	2.0	0.2	1.2	0.1	5.2	0.3	0.3	0.0	4.9	-0.6
	Oct	2.4	0.5	1.3	0.2	7.1	1.8	0.3	0.3	4.6	-0.1
	Nov	2.5	0.1	1.2	0.1	7.8	0.0	-0.1	0.1	4.0	0.0
	Dec	4.3	1.8	1.1	-0.1	18.1	9.5	1.5	1.6	3.6	-0.4
2005	Jan	3.7	0.1	0.9	0.1	16.5	0.0	1.2	0.1	3.6	0.1
	Feb	3.5	0.1	0.9	0.1	15.0	0.0	1.2	0.1	3.3	0.2
	Mar	3.6	0.2	1.0	0.2	15.2	0.2	1.3	0.2	2.5	2.2
	Apr	3.9	0.4	1.3	0.4	15.6	0.3	1.8	0.5	0.4	-1.5
	May	3.6	0.2	1.4	0.3	12.8	0.1	2.0	0.6	0.5	0.5
	Jun	3.8	0.2	1.6	0.2	13.2	0.4	2.9	0.3	1.7	0.8
	Jul	3.5	-0.2	1.3	-0.3	13.1	0.0	2.7	-1.0	1.5	0.0
	Aug	3.5	0.1	1.3	0.1	13.1	0.0	2.7	0.2	1.3	0.1
	Sep	3.7	0.3	1.4	0.3	13.2	0.3	3.2	0.4	2.1	0.2
	Oct	3.3	0.2	1.4	0.2	11.4	0.3	3.2	0.3	2.1	-0.1
	Nov	3.4	0.1	1.5	0.1	11.4	0.0	3.8	0.6	2.2	0.1
	Dec	1.8	0.1	1.8	0.1	1.8	0.0	2.4	0.2	3.5	0.8
2006	Jan	2.6	0.2	2.8	0.3	1.6	0.0	2.9	0.3	3.1	0.1
	Feb	2.3	0.1	2.5	0.2	1.6	0.0	2.9	0.3	-2.8	0.4
	Mar	2.0	0.1	2.2	0.1	1.5	0.1	2.8	0.2	2.3	1.0
	Apr	2.1	0.6	2.3	0.7	1.0	0.1	3.1	0.7	3.8	0.4
	May	2.2	0.3	2.5	0.4	0.9	0.0	3.3	0.7	3.9	0.2
	Jun	2.3	0.2	2.6	0.2	0.8	0.1	3.1	0.1	3.6	0.5
	Jul	2.3	-0.2	2.6	-0.2	0.9	0.0	3.3	-1.1	3.6	0.0
	Aug	2.3	0.2	2.4	0.1	1.6	0.7	3.3	0.3	3.8	0.2
	Sep	1.7	0.1	1.7	0.0	1.8	0.3	2.7	0.3	4.3	0.7
	Oct	1.7	0.0	1.6	-0.1	2.0	0.5	2.8	0.4	4.1	-0.4
	Nov	1.9	0.1	1.9	0.1	2.0	0.0	2.7	0.3	4.1	0.2
	Dec	2.0	0.2	2.0	0.2	2.0	0.0	2.8	0.3	2.9	-0.4
2007	Jan	1.8	0.2	1.8	0.3	2.0	0.0	2.6	0.3	1.7	0.6
	Feb	1.8	0.0	1.7	0.0	2.2	0.3	2.4	0.1	3.1	1.0
	Mar	2.0	0.3	2.0	0.4	2.2	0.0	2.4	0.2	5.6	2.5
	Apr	2.1	0.7	2.2	0.8	2.0	0.0	2.3	0.4	7.2	1.6
	May	2.2	0.3	2.2	0.4	2.1	0.0	2.3	0.6	6.7	-0.1
	Jun	2.2	0.2	2.2	0.1	2.4	0.4	1.6	-0.6	6.6	0.2
	Jul	4.7	2.3	5.0	2.6	3.1	0.8	4.2	1.7	11.1	4.8
	Aug	4.5	0.1	5.0	0.1	2.4	0.0	4.6	0.6	10.7	-0.4
	sep	6.4	1.9	5.9	0.8	8.6	6.3	6.5	2.1	9.9	0.2

Source: Monstat

Table 9 – Tourism

		2006		2007		Index	Structure
		IX	I-IX	IX	I-IX	$\frac{I-IX '07}{I-IX 06}$	
Arrivals	Total	110,988	895,405	132,981	1,066,676	119,1	100,0
	domestic	10,291	142,657	15,165	133,428	93,5	12,5
	foreign	100,697	752,748	117,816	933,248	124,0	87,5
Nights	Total	687,245	5,712,463	883,084	7,036,123	123,2	100,0
	domestic	56,832	842,837	90,630	795,623	94,4	11,3
	foreign	630,413	4,869,626	792,454	6,240,500	128,2	88,7

Source: Monstat

Table 10 – Number of employed and unemployed people

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Employed*												
2001	114,536	113,500	113,542	113,663	113,943	114,137	114,106	114,024	115,077	114,755	114,170	113,744
2002	113,594	113,597	113,953	113,663	113,943	114,137	114,422	113,684	113,526	113,676	113,679	113,425
2003	112,637	112,846	112,317	112,132	111,738	112,648	112,905	112,647	111,461	110,911	110,387	109,639
2004	108,562	107,359	108,634	109,623	109,642	109,863	110,886	111,158	110,049	109,696	110,055	108,228
2004***	142,081	142,834	142,361	143,224	143,845	146,696	145,160	142,634	143,447	143,113	143,992	142,438
2005***	142,145	142,072	141,298	140,959	142,248	145,852	148,528	146,744	145,739	145,923	145,528	145,261
2006***	144,978	145,753	146,554	147,517	149,321	151,678	154,723	154,289	154,236	154,652	155,156	150,746
2007***	151,535	152,114	153,140	154,074	156,817	158,190	160,045	158,392	158,164			
Unemployed**												
2001	81,238	82,158	82,453	83,091	82,629	82,140	81,823	80,686	80,952	80,668	80,440	81,069
2002	80,385	81,360	81,510	81,961	81,602	81,041	81,116	80,830	80,809	80,183	79,894	76,293
2003	76,584	76,077	76,165	74,976	73,520	69,735	66,951	66,277	67,664	71,023	72,544	68,625
2004	69,573	71,419	72,378	72,202	68,993	64,572	60,993	60,771	60,447	59,930	59,387	58,950
2005	59,115	58,774	58,075	57,557	56,772	55,199	53,683	52,494	51,843	51,266	49,886	48,825
2006	48,639	48,656	49,388	48,651	45,640	42,560	40,220	39,093	38,919	38,747	38,892	38,876
2007	39,104	39,155	38,714	37,571	35,356	33,393	32,205	31,271	31,156			

*Source: Monstat

** Source: Employment Bureau

*** New methodology applied

Annex B

Table 11 – Balance sheet of banks, EUR thousand

	2006			2007												Structure in %, 30.09.
	31.07.	31.12.	31.01.	28.02.	31.03.	30.04.	31.05.	30.06.	31.07.	31.08.	30.09.	Index 12:11	Index 12:3			
														2	3	
ASSETS																
1. Financial resources and deposits	305,169	511,902	494,608	488,341	503,474	502,248	523,716	538,124	616,855	697,813	647,466	93	126	25.6		
2. Credits	581,770	847,166	905,385	1,026,636	1,152,761	1,265,573	1,387,081	1,502,373	1,598,037	1,672,985	1,810,613	108	214	71.5		
2.1. Credit loss reservations	-14971	-19,048	-20,087	-21,156	-23,313	-24,694	-27,982	-30,470	-35,386	-38,295	-40,802	107	214	-1.6		
2.2. Net credits	566,799	828,118	885,298	1,005,480	1,129,448	1,240,878	1,359,099	1,471,903	1,562,651	1,634,690	1,769,811	108	214	69.9		
3. Securities	25,375	26,270	26,295	27,122	31,249	40,541	43,565	27,639	23,788	24,376	19,745	81	75	0.8		
4. Other assets	57,075	66,125	66,282	68,382	71,119	75,928	78,100	86,089	88,189	90,396	94,713	105	143	3.7		
5. Reserves	-1,011	-1,000	-1,028	-1,036	-1,198	-1,319	-1,136	-1,137	-1,030	-1,073	-1,070	100	107	0.0		
6. TOTAL ASSETS	953,407	1,431,415	1,471,455	1,588,289	1,734,092	1,858,277	2,003,344	2,122,618	2,290,454	2,446,202	2,530,666	103	177	100.0		
LIABILITIES																
1. Deposits	703,210	1,075,769	1,109,633	1,202,293	1,299,664	1,375,536	1,492,075	1,581,456	1,701,792	1,828,593	1,819,662	100	169	71.9		
1.1. Demand deposits	406,893	610,600	591,701	639,068	699,582	756,007	802,541	830,807	848,851	935,318	884,130	95	145	34.9		
1.2. Time deposits	296,317	465,169	517,932	563,225	600,082	619,529	689,534	750,649	852,941	893,275	935,532	105	201	37.0		
2. Short term borrowings from financial institut.	832	7,822	5,149	5,147	3,644	7,685	11,390	6,277	14,294	16,860	20,571	122	263	0.8		
3. Other borrowings	94,546	164,529	173,075	183,370	205,961	230,230	239,156	267,786	299,751	303,769	394,235	130	240	15.6		
4. Other liabilities	24,831	34,533,0	33,151	34,620	44,177	56,903	51,955	66,363	73,101	86,279	85,372	99	247	3.4		
5. Total capital	129,988	148,762	150,447	162,859	180,646	187,922	208,768	200,664	201,444	210,701	210,827	100	142	8.3		
5.1. Capital and reserves	125,709	139,755	148,794	159,480	175,563	180,533	200,417	189,615	188,751	196,844	197,406	100	141	7.8		
5.2. Profit / Loss (+,-) current year	4,279	9,007	1,653	3,379	5,083	7,389	8,351	11,121	12,764	13,857	13,421	97	149	0.5		
6. TOTAL LIABILITIES	953,407	1,431,415	1,471,455	1,588,289	1,734,092	1,858,276	2,003,344	2,122,618	2,290,454	2,446,202	2,530,666	103	177	100.0		

Source: Bookkeeping of banks

Table 12 – Review of calculated and appropriated reserve requirements, EUR thousand

Licensed banks	2006						2007						
	September			December			September						
1	Atlasmont bank	8,534	8,653	9,060	8,753	9,219	9,936	9,396	9,647	17,496	18,006	17,377	17,200
2	Crnogorska komercijalna bank	59,463	60,219	60,466	61,947	68,974	68,317	74,453	81,948	111,795	109,433	111,936	109,658
3	Hipo Alpe -Adria Bank	2,010	1,894	1,793	1,787	2,519	2,549	2,677	3,667	14,294	14,379	14,095	14,941
4	Hipotekarna bank	2,608	2,562	2,490	2,265	3,272	3,115	3,352	3,999	5,906	6,257	6,010	5,935
5	Komercijalna bank Budva	7,696	7,645	7,603	8,055	6,732	6,462	6,946	7,059	10,217	10,099	9,784	9,551
6	NLB Montenegro bank	17,858	17,971	17,844	19,289	21,867	23,630	24,435	25,668	35,508	35,943	35,673	36,805
7	Prva banka Crne Gore	2,251	2,218	2,183	2,418	3,291	3,721	4,570	8,284	20,253	19,961	20,625	21,398
8	Opportunity bank	9,633	9,828	10,522	11,042	16,054	16,774	17,145	18,190	26,147	26,044	25,972	25,534
9	Podgorička bank	12,116	11,818	12,354	12,509	13,661	14,257	13,979	13,329	14,903	15,245	15,019	14,930
10	Invest bank Montenegro	988	1,025	729	715	990	997	999	971	508	526	561	523
	Total (1-10)	123,157	123,833	125,044	128,780	146,579	149,758	157,952	172,762	257,027	255,893	257,052	256,475

Source: Central Bank of Montenegro

Annex C: Auctiones held in 2007

Table 13 – Auctions of 182-day T-bills

Auction	Issue date	Issued	Sold	Demand	Weighted rate
XXII Auction	09.01.2007	1.300,0	1.300,0	1.500,0	0,90%
XXIII Auction	21.02.2007	500,0	500,0	800,0	0,49%
Total	january -june 2007	1.800,00	1.800,00	2.300,00	

Source: Central Bank of Montenegro

Table 14 – Budgetary revenues and budgetary expenditures in 2007, EUR

REVENUES DESCRIPTION	Plan for 2007 Amount	01.01. - 31.12.2007											
		January Amount	February Amount	March Amount	April Amount	May Amount	June Amount	July Amount	August Amount	September Amount	Amount	% realization	
Prior year funds													0,00
Taxes	528.699.428,99	34.089.101,73	39.687.860,75	49.648.144,43	60.886.440,56	60.223.413,85	64.185.300,42	64.367.729,33	72.959.994,29	62.484.085,63	508.532.070,99	96,19	
Personal income tax	66.115.094,12	2.803.735,34	5.030.847,47	5.804.397,87	8.376.602,00	5.840.515,60	6.979.441,52	6.438.227,37	7.068.396,46	6.658.499,57	55.000.663,20	83,19	
Corporate income tax	15.030.960,15	923.271,79	2.655.806,10	7.002.500,81	10.166.096,38	3.137.550,02	2.241.851,31	2.097.993,47	1.791.373,96	2.329.455,41	32.345.899,25	215,20	
Property tax	5.930.715,07	794.909,63	1.032.438,97	1.593.303,68	1.718.997,67	1.791.971,73	1.691.939,80	1.644.568,42	1.934.179,45	1.459.917,74	13.662.227,09	230,36	
Value added tax and excise duties	376.485.246,88	26.465.530,54	26.865.454,28	29.709.002,19	35.032.219,71	42.441.750,80	46.665.382,47	46.226.749,55	54.251.040,86	45.832.462,61	353.489.593,01	93,89	
International trade and transactions tax	60.662.079,76	2.799.643,12	3.694.847,99	5.062.000,35	5.076.260,22	6.476.456,28	5.987.736,10	7.332.386,56	7.254.588,86	5.644.692,63	49.328.612,11	81,32	
Other taxes	4.475.333,01	302.011,31	408.465,94	476.939,53	516.264,58	535.169,42	618.949,22	627.803,96	660.414,70	559.057,67	4.705.076,33	105,13	
Dues	20.124.262,24	959.575,41	1.311.554,85	1.570.021,64	1.608.391,65	1.557.682,35	1.610.688,88	1.876.954,83	1.796.098,87	1.463.738,35	13.754.706,83	68,35	
Other Republic income	34.661.690,39	2.813.908,16	2.992.078,65	4.727.055,28	3.485.300,92	3.306.133,70	3.359.762,26	4.465.484,84	17.924.890,60	3.400.291,49	46.474.905,90	134,08	
Current income	583.485.381,62	37.862.585,30	43.991.494,25	55.945.221,35	65.980.133,13	65.087.229,90	69.155.751,56	70.710.169,00	92.680.983,76	67.348.115,47	568.761.683,72	97,48	
Real estate sale	11.397.772,50	0,00	12.400,00	3.423.355,00	1.356.400,00	110.000,00	10.000,00	19.880,00	20.945,00	125.770,00	5.078.750,00	44,56	
Loan repayment	5.507.365,23	344.713,78	72.814,11	169.333,04	419.271,66	64.072,23	841.610,81	1.372.835,01	232.916,10	248.248,69	3.765.815,43	68,38	
Donations and transfers	600.000,00	0,00	2.204,76	2.046,65	1.828,97	145,53	1.934,57	2.750,60	47.646,63	3.382,35	61.940,06	10,32	
Loans and borrowings	15.870.000,00	0,00	114.520,89	32.849,38	52.587,07	122.441,68	159.090,10	177.511,54	1.129.529,72	256.061,50	2.044.591,88	12,88	
TOTAL REVENUES	616.860.519,35	38.207.299,08	44.193.434,01	59.572.805,42	67.810.220,83	65.383.889,34	70.168.387,04	72.283.146,15	94.112.021,21	67.981.578,01	579.712.781,09	93,98	
EXPENDITURES													
Total current expenditures	332.094.285,93	18.497.643,45	23.999.443,45	27.376.817,48	24.027.255,60	23.617.055,91	30.122.365,00	26.441.447,78	25.785.209,48	28.891.207,73	228.758.445,88	68,88	
Gross wages and salaries	179.787.297,70	13.476.930,61	15.008.301,87	14.242.998,57	14.484.091,70	14.489.051,46	14.761.610,20	14.736.493,83	14.266.307,30	15.552.975,34	131.018.760,88	72,87	
Other earnings and compensation of employees	20.827.164,00	323.697,36	1.615.992,24	555.550,32	1.692.990,25	477.185,50	1.931.867,37	770.275,42	4.700.047,19	1.493.909,37	13.561.515,02	65,11	
Expenditures for material and services	72.485.028,20	1.591.019,68	4.475.515,12	5.112.688,78	4.693.471,25	5.793.777,12	4.836.419,82	6.721.729,15	3.568.549,63	4.894.665,31	41.687.835,86	57,51	
Interest rates	19.677.687,08	1.826.094,46	514.107,48	3.333.456,14	555.775,03	400.513,10	5.801.124,45	455.973,73	855.721,81	3.651.041,26	17.393.807,46	88,39	
Annuity	5.367.101,32	166.785,37	389.143,07	369.471,65	418.192,34	199.155,85	631.608,79	646.323,51	166.074,21	753.906,02	3.740.660,81	69,70	
Subventions	8.265.000,00	313.784,66	204.768,26	1.849.041,03	368.212,42	431.903,11	508.999,93	635.016,61	90.719,25	827.217,72	5.229.662,99	63,27	
Other expenditures	5.515.913,71	18.520,72	298.487,49	228.643,69	208.802,32	315.522,39	103.004,35	814.115,92	369.321,61	254.530,23	2.610.948,72	47,33	
Maintenance	20.169.093,92	780.810,59	1.493.127,92	1.684.967,30	1.605.720,29	1.509.947,38	1.547.730,09	1.661.519,61	1.768.468,48	1.462.962,48	13.515.254,14	67,01	
Capital expenditures	69.253.033,58	604.198,39	2.804.711,91	2.985.548,28	3.435.193,92	3.246.722,82	3.121.144,82	4.908.134,74	6.172.233,74	6.310.592,10	33.588.480,72	48,50	
TOTAL EXPENDITURES													
Transfers and social security	163.334.030,62	11.495.069,26	10.607.030,71	15.183.909,46	13.980.574,28	11.448.559,66	12.698.358,95	15.385.656,29	13.493.442,53	14.352.331,32	118.644.932,46	72,64	
Loans and borrowings	5.500.000,00	497.000,00	800.240,93	796.249,05	691.393,48	495.982,42	346.088,50	197.000,00	197.000,00	314.136,70	4.335.091,08	78,82	
Frozen FX and debt repayment	23.180.979,92	1.549.777,40	72.459,94	1.903.115,18	9.162.510,15	3.148.766,93	5.235.597,08	2.236.044,51	3.691.132,26	3.060.217,08	30.059.620,53	129,67	
Guarantees repayment	2.111.160,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	
Prior year liabilities payment	15.417.029,10	606.276,50	826.712,66	807.218,61	626.823,01	1.832.281,57	13.400.830,39	6.699.012,81	2.536.373,71	872.543,56	28.208.072,82	182,97	
Budget reserves	1.000.000,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	
Current budget reserves	4.970.000,00	502.091,10	317.568,65	404.876,72	379.935,92	503.563,07	630.446,25	489.320,68	852.063,69	1.109.277,42	5.189.143,50	104,41	
TOTAL EXPENDITURES	616.860.519,35	33.752.056,10	39.428.168,25	49.457.734,78	52.303.686,36	44.292.932,38	65.554.830,99	56.356.616,81	52.727.455,41	54.910.305,91	448.783.786,99	72,75	
Surplus/ (deficit)		6.611.296,88	5.535.312,71	9.367.153,40	23.885.051,59	25.839.418,25	23.078.958,85	24.661.444,52	46.413.950,42	16.618.818,89	182.011.405,51		

Surplus / Deficit as the difference between total revenues (reduced for borrowings, donations, transfers and revenues from sale of property) and expenditures for principal repayment of loans taken and securities issued in the country and abroad

Table 15 – Revenues and expenditures of funds, EUR million

DESCRIPTION/month	01.01.-31.12. 2006.	2007									Cumulative	
		I	II	III	IV	V	VI	VII	VIII	IX		
INCOME												
Pension Fund	206,1	13,37	16,88	17,98	22,53	17,45	20,39	18,00	20,53	19,32	166,4	
Health Care Fund	118,0	5,39	9,27	10,11	12,82	7,89	10,38	10,80	10,55	10,45	87,7	
Employment Bureau	23,3	1,4	1,5	2,0	2,1	1,8	2,7	2,1	1,8	1,8	17,3	
Development Fund	1,485	0,192	0,250	0,128	0,138	0,121	0,113	0,121	0,105	0,253	1,421	
EXPENDITURE												
Pension Fund	206,8	13,40	16,89	17,54	22,70	17,75	18,28	18,55	20,20	18,34	163,7	
Health Care Fund	119,0	7,1	9,2	10,0	9,5	9,6	9,9	10,6	10,0	11,0	87,0	
Employment Bureau	29,2	1,5	1,4	2,1	2,3	2,4	2,2	2,0	1,8	1,7	17,4	
Development Fund	0,770	0,077	0,033	0,035	0,028	0,062	0,029	0,029	0,036	0,040	0,370	
SURPLUS/DEFICIT												
Pension Fund	-0,70	0,0	0,0	0,4	-0,2	-0,3	2,1	-0,5	0,3	1,0	2,80	
Health Care Fund	-0,99	-1,8	0,0	0,1	3,3	-1,7	0,5	0,2	0,6	-0,5	0,68	
Employment Bureau	-4,41	-0,1	0,1	0,0	-0,2	-0,6	0,5		0,04	0,09	-0,28	
Development Fund	0,715	0,115	0,218	0,093	0,110	0,058	0,085	0,091	0,068	0,213	1,051	

Source: Republic Funds in Montenegro