

# Monthly report - Montenegro

18 October 2010

Area (km <sup>2</sup> )	13.812
Population (in mln)	0,62
GDP per capita	4.720 € (I.2009)
President	Filip Vujanović
Predsednik vlade	Milo Đukanović



## First Eurobond Issued

### Important news

At the 65<sup>th</sup> session of the United Nations General Assembly held in New York, the Montenegro Minister of finance, Igor Lukšić, said that by 2015 Montenegro would reach nearly all the tasks set at the national level in the scope of the millennium development goals. Among the most important he highlighted the reduction of regional economic, social and cultural disparities as well as the strengthening of the rule of law and closer integration of environmental issues in sectoral development policies and strategies. "The strategic development priorities are based on implementing sustainable development principles, with increasing economic freedoms and a strengthened role of the private sector, as the precondition for a functioning democracy and improving the living standards of citizens by promoting quality public services through effective education, health and social welfare systems," said Minister Lukšić.

In early September, Montenegro issued its first Eurobond with 5-year maturity and in the total nominal amount of EUR 200 million. Part of these funds are planned to be used for covering this year's budget deficit and a part is to be transferred to the next budget year. The issue of the Eurobond enabled the Government to avoid the credit arrangement with the International Monetary Fund, as it was not prepared to accept its stringent conditions (despite the lower interest rate that would make the credit cheaper for the state). Most bonds were purchased by various funds (around 45%), followed by banks (38%), private banks (10%), various hedge funds (3%), etc. The Eurobond issue will cost Montenegrin citizens a good EUR 78 million, since a total of slightly more than EUR 278 million will have to be repaid in five years.

*In early september first issue of the eurobond was carried out*

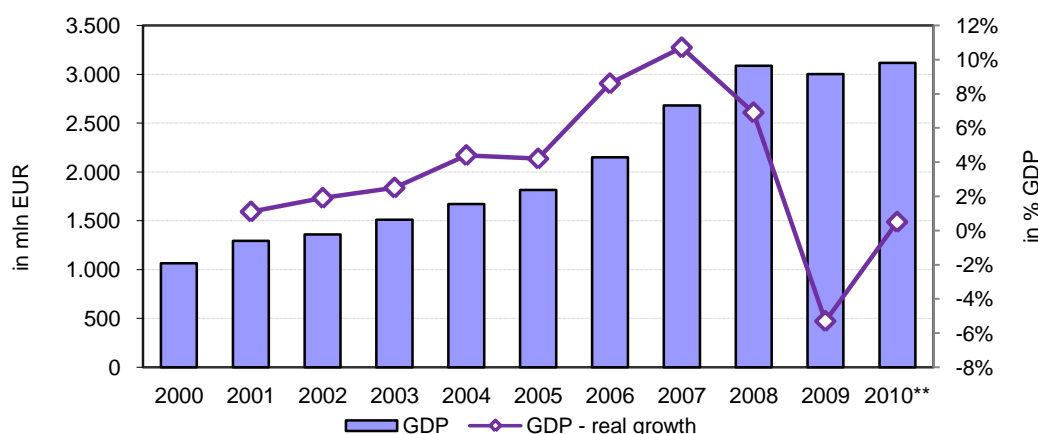
### Macroeconomic indicators

The Ministry of Finance estimates that last year the economic growth in Montenegro slowed down by 5.3%, whereas the respective estimate by the International Monetary Fund is 7%, chiefly on account of a high drop in domestic and foreign consumption. The basic concept of the 2010 economic policy is geared at the expected impact of the economic and financial crisis, the review of the options offered by the system to mitigate negative effects and the establishment of conditions for economic recovery. In 2010, budget policy will focus mainly on the promotion of SMEs and on the measures to promote the banking system so as to enable the implementation of projects envisaging increased turnover, scope of services and production, and the creation of jobs. **Ensuring system liquidity** is a priority in the process of economic revival. The promotion of banks' credit activity and credit measures for restructuring corporate and retail liabilities will create conditions for strengthening overall demand. Economic trends in the first half of the year were for the most part within the scope projected for 2010. Thus, the **movement in gross domestic product** in the first six months of the year indicates a downward trend in the economy, which started in the last quarter of 2008.

*In the first half of the year a noticeable slowdown in the trend of economic decline; slow recovery in sight*

According to preliminary data of the Central Bank, GDP decrease was -1.5% in the first quarter. The Government and the IMF forecast the respective figure will range between -2% and +0.5% this year.

**Picture 1** GDP Growth (mln €) and Real GDP Growth (% , y-o-y)

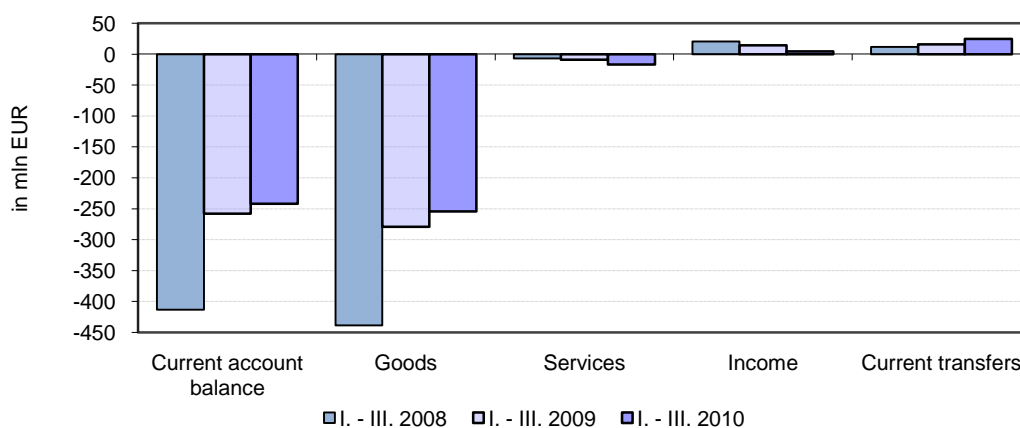


Source: Central Bank of Montenegro

Preliminary estimates show that budget revenues in the first six months of 2010 equalled EUR 511.0 million (16.4% of GDP). This is 2.5% less than planned and 1.9% more than in the respective period last year. The bulk arose from taxes, i.e. EUR 305.3 million, and excise duties (EUR 166.6 million). Budget expenditures, which were lower than initially planned, totalled EUR 522.9 million (16.8% of GDP), thus have grown by 11.6% over the same period in 2009. **Budget deficit** amounted to EUR 11.9 million or 0.4% of GDP.

Last year, the **current account of the balance of payments** recorded a deficit of EUR 896.3 million. Compared to the same period in 2009, it was almost 40% lower this year. The lower deficit was mainly due to the decline in the goods balance deficit, which decreased by EUR 710.8 million, whereas other sub-balances did not change considerably; a surplus was recorded in all. In the first quarter of this year, the deficit in the current account of the balance of payments was EUR 241.9 million.

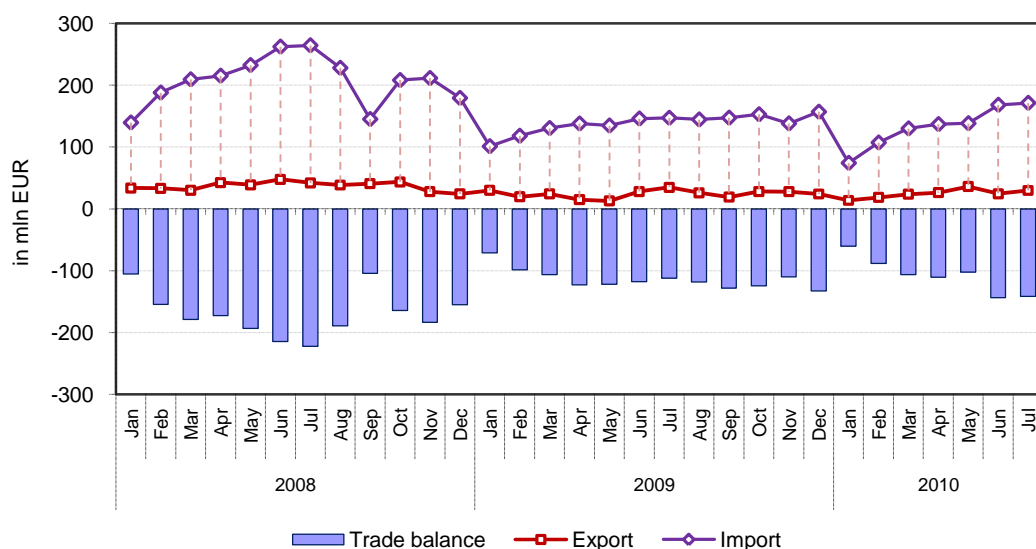
**Picture 2** Balance on Current Account (mln EUR)



Source: Central Bank of Montenegro

According to preliminary data, **total foreign trade** of Montenegro stood at EUR 1,096.9 million in the first seven months of 2010, which represents a 2.2% increase at the annual level. The country's exports rose by 9.3% or EUR 171.8 million over the same period last year and imports grew by 1% or EUR 925.1 million. Coverage of imports by exports stood at 18.57%. Montenegro exported most to Serbia (EUR 41.8 million), Greece (EUR 36 million) and Italy (EUR 18.1 million), and imported most from Serbia (EUR 237.8 million), Bosnia and Herzegovina (EUR 67.8 million) and Germany (EUR 67.7 million).

**Picture 3** Foreign trade

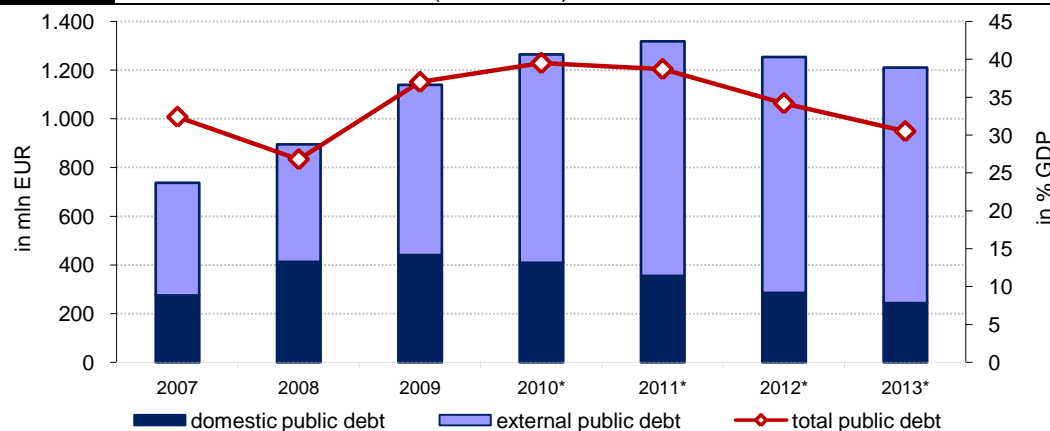


Source: Statistical office of Montenegro

*The issue of eurobond caused an additional increase in public debt*

At the end of June, **public debt** of Montenegro totalled EUR 1,115.3 million or 34.8% of GDP. External public debt stood at EUR 737.8 million (23.0% of GDP). It grew on account of credit withdrawn by various institutions totalling nearly EUR 40 million, the issue of the first Eurobond and the appreciation of the dollar against the euro, resulting in higher euro value of dollar loans. External debt does not include outstanding liabilities to Libya, Kuwait, Czech Republic and Slovakia nor UBS bank bonds issued in the scope of the London Club. Compared to the end of 2009, the internal public debt fell by EUR 62.8 million in the first half of the year. This was mostly due to smaller indebtedness of municipalities (EUR 14.2 million) and repayment of loans to banks and other financial institutions (EUR 29.4 million).

**Picture 4** The Structure of Public Debt (in mln EUR)



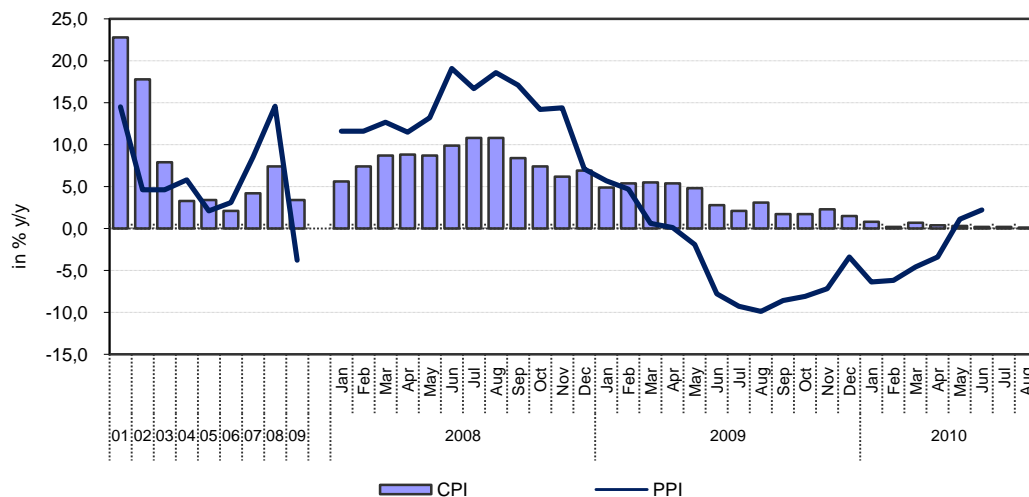
Source: Ministry of Finance of Montenegro

*A smaller inflow of FDI in the first half of the year*

According to preliminary estimates, the inflow of **net foreign direct investments** in the first six months was EUR 314.3 million, which is 3.7% less than in the same period last year, but still rather high given the fact that no major privatisation took place in the economy in this period. FDI totalled EUR 370.5 million, lagging behind the respective 2009 figure by 7.1%. The structure reveals that most investments went to banks and companies. These amounted to EUR 204.8 million, an 11.5% decrease at the annual level. Real estate investments dropped by 4.7% to EUR 77.3 million. The outflow of foreign direct investments in the period under scrutiny was EUR 56.2 million.

The Central Bank of Montenegro estimates that this year's increase in **consumer prices** will range between 0.5% and 2.5%. In the first seven months, prices ranged within the set framework. Thus, inflation measured at the annual level averaged 0.36%. In July and August, annual inflation rate was 0.2% and 0.1% respectively. Such low price growth was mainly due to lower prices of housing costs (-6.3% in July and -7% in August) and a low rise in the prices of food and alcohol beverages (1.1% in July and 0.9% in August).

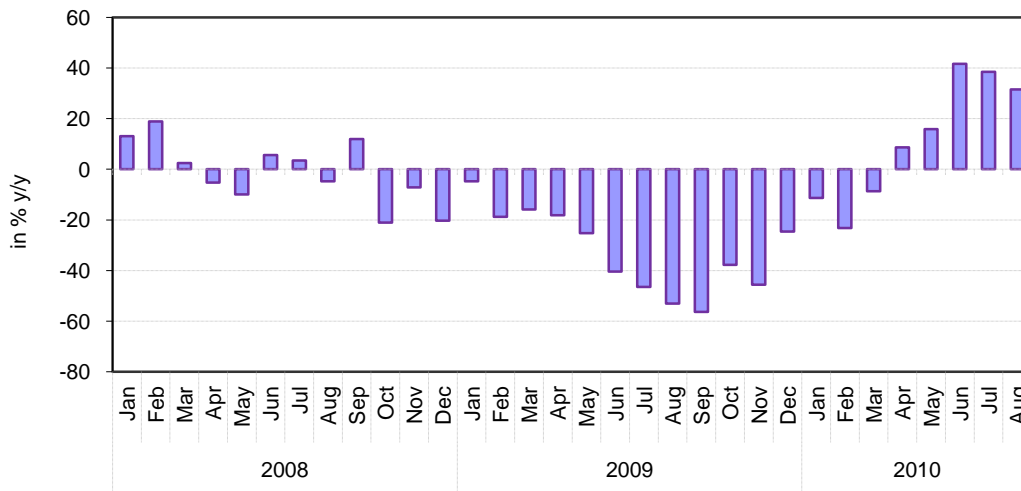
**Picture 5** Consumer and Producer Price Index



Source: Statistical office of Montenegro

Since April, the growth in **industrial production** at the annual level has again been positive. This year, peak growth was recorded in June and July, i.e. 41.6% and 38.5% at the annual level respectively. In the first eight months of 2010, growth was compared to the same period in 2009 seen in two industries, namely mining and quarrying (36.2%), and the production of electricity, gas and water (38.7%). Signs of recovery are observed also from monthly data, since after April and May, when the volume of industrial production recorded negative growth, June and August brought positive growth.

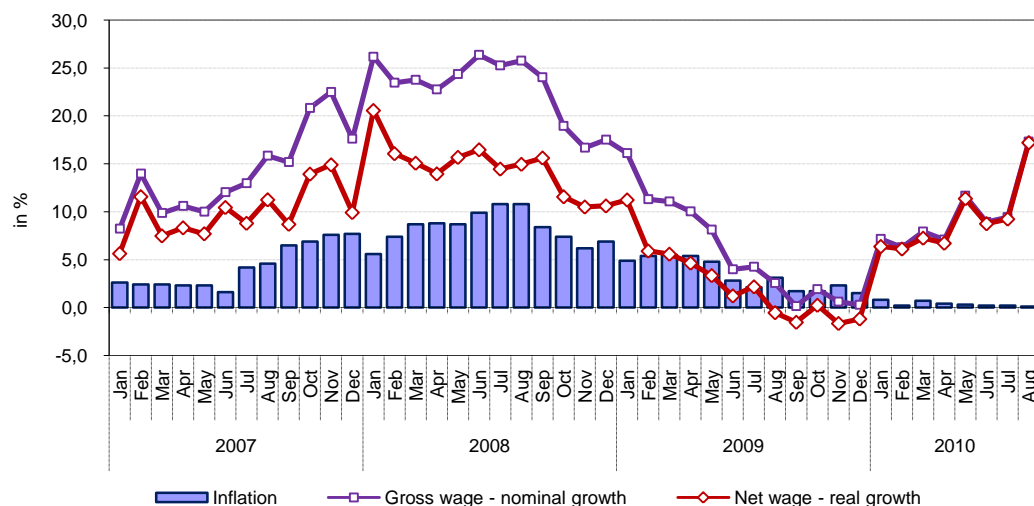
**Picture 6** Industrial production



Source: Statistical office of Montenegro

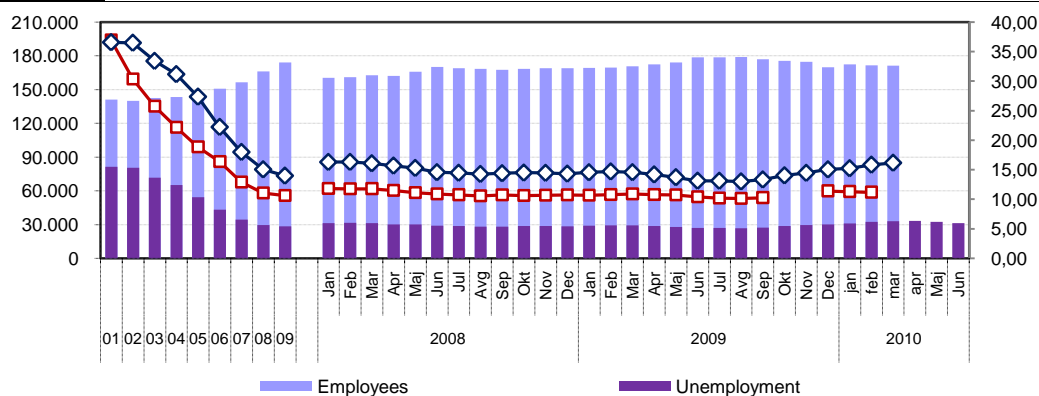
In 2010, salaries grew slightly compared to the year before. According to the data of the Statistical Office of Montenegro, **average monthly gross salary** in the first eight months of this year was EUR 707.5, which is 9.6% more than in the same period last year. Compared to June, salaries decreased in nominal terms by 1.4% in July, whereas in August they grew nominally by 8.0% over July. In August, average gross salary ranged between EUR 166 in the fisheries industry and EUR 831 in the financial consulting sector.

**Picture 7** Average monthly gross wage and nominal gross wage growth (% , y-o-y)



Source: Statistical office of Montenegro

**Picture 8** The number of employed and unemployed persons and unemployment rate (%)



Source: Statistical office of Montenegro

## Banking system and Central bank regulations

The Government passed the amendment to the Law on Central Bank of Montenegro, which refers to the composition of the Board of the CB that will from now on be composed of the Governor, two Vice-Governors and four members. The President of the State will propose the Governor to the Assembly and the Vice-Governor will be selected by the Governor. The role of the CB as the lender in emergency cases was also passed with this proposal. The Central Bank of Montenegro passed the amendment to the Banking Act referring to the banking authorisation, specifying that the Central Bank may revoke a bank's authorisation for banking services, if the bank fails to enable controls or submits inaccurate financial statements several times.

The Central Bank of Montenegro has also established the Financial Stability Committee tasked with taking preventive actions if conditions in the country deteriorate or the global crisis worsens. This Committee is composed of the Minister of Finance, the Governor of the Central Bank of Montenegro and the representatives of the Insurance Supervision Agency and the Securities Commission (KHOV).

The Economy, Finance and Budget Committee pointed out that if deposit insurance increases from the current EUR 5,000 to EUR 20,000 and to EUR 50,000 by 2013, there would not be sufficient funds for deposit protection to cover all banks. To this end, the Parliament was proposed to adopt some amendments to the Law on Banks, Bank Bankruptcy and Liquidation. The new proposal to increase guaranteed deposit amount and shorten the payment period from the current 90 or 60 days to 20 days (in the interim period the deadline would remain 45

days) is extremely good in the analysts' opinion, however, the Deposit Protection Fund would have enough funds to finance only 8 banks, while 3 would not be covered.

*The liquidity of the banking sector on satisfactory level; Loan to Deposit Ratio improved*

With the aim of gradually reviving the economic activity this year, the **banking sector** of Montenegro is in addition to ensuring the stability and vitality faced also with certain risks of the real sector. While liquidity of the banking sector is satisfactory, new loans are granted with greater caution because of high indebtedness of the real sector, increased business risk and a higher share of weighted risk-bearing assets of banks. At the end of June, overdue obligations of defaulters totalled EUR 210.6 million. This year, the "Loan to Deposit Ratio" improved. Thus, at the end of April, LtD ratio was 1.34, which is better than in the previous year, when it was 1.55. At the end of April, loans totalled EUR 2.3 billion, the bulk being accounted for by corporate and retail loans (94.6%), and the rest were loans to banks and other financial organisations (5.4%). Deposits amounted to EUR 1.7 billion in total. Total deposits grew by 1.5% compared to last April. Total capital of banks at the end of March rose by 15% at the annual level, whereas capital adequacy increased from 8.4% in 2009 to 10.4% this year.

## Money and Capital Market

This year's fifth auction of **128-day treasury bills** was held on the last day of August. The value of auctioned TB was EUR 39 million in total, and several domestic commercial banks and some banks from the region participated in the auction. Total demand exceeded the supply (EUR 47.99 million), but the bank decided to accept bids of EUR 39 million (100% of total issue). Average interest rate for accepted bids was 3.36%, which is less than the average weighted interest rate from the first auction in 2010, which was 3.96%. The first half of September witnessed the sixth auction of 3-month treasury bills this year. Treasury bills at this auction totalled EUR 7 million. Again, the demand was higher than the supply, i.e. by EUR 8.23 million. In the end, accepted bids totalled EUR 7 million, which again represented 100% of total issue. Average interest rate was 3.43%, which is less than the average weighted interest rate from the August auction. This indicates the downward trend in interest rates on treasury bills.

**Table 1** Government bond issue

	Issue date	Maturity	Currency	Amount offered	Received offers	Average interest rate
1	2 mar 2010	182 days	EUR	35,500.000	<b>35,500.000</b>	3.96%
2	16 mar 2010	182 days	EUR	7,000.000	<b>7,000.000</b>	3.56%
3	23 mar 2010	182 days	EUR	4,000.000	<b>3,160.000</b>	4.34%
4	28 apr 2010	182 days	EUR	9,500.000	<b>9,500.000</b>	3.50%
5	31 avg 2010	182 days	EUR	39,000.000	<b>39,000.000</b>	3.36%
6	14 sep 2010	182 days	EUR	7,000.000	<b>7,000.000</b>	3.43%

Source: Ministry of Finance of Montenegro

At the start of September, the Montenegro Government issued the first Eurobond in the history of this country. Total issue of 5-year bond was EUR 200 million (USD 254 million), which at the price of 99,501 represents an 8% yield to maturity. The main issuers of the Eurobond were Credit Suisse and Deutsche Bank. The principal purpose of the issue was to finance the budget deficit, which is projected at 4.2% of GDP for 2010. Montenegro planned to issue the Eurobond already in May or June, but the Government changed its mind due to the situation on the financial markets.

*The total turnover in MSE dropped by 81% in 2010*

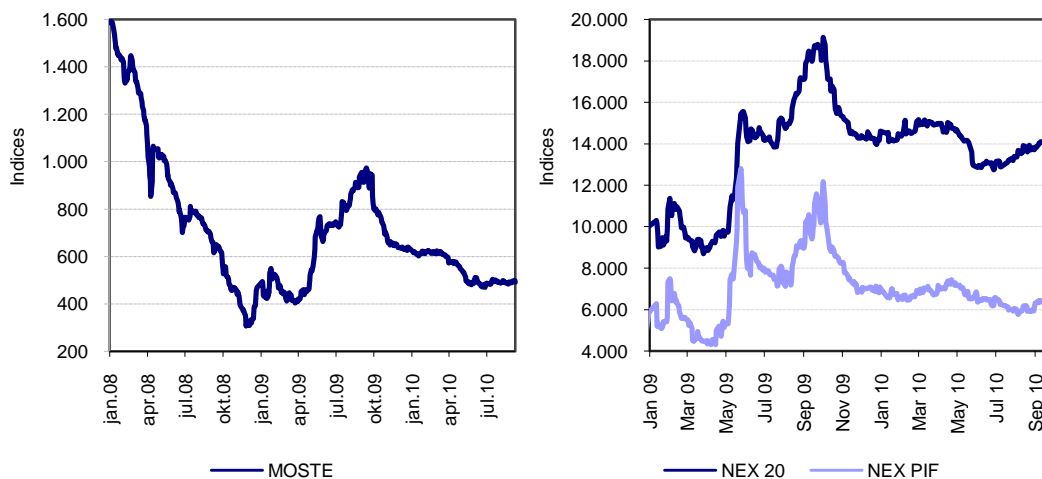
The developments on the capital market in the past six months were characterised by the global financial crisis, which caused oscillations of stock exchange indexes. In the first six months of 2010, the total turnover on the Montenegro Stock Exchange dropped by no less than 81% in comparison with the respective period in 2009. Thus, the **NEX 20** stock exchange index decreased by nearly 4%, however, it is still above 14,000.0 points. **NEX PIF** depreciated by a good 10%, while the greatest drop was recorded in **MOSTE index**, which fell by almost 15% to 490.09 points.

**Table 2** The movement of stock indices

Index	Date	Value	Change (in %)
NEX 20	13 apr 2010	14,595.09	↓ 3,85%
	16 sep 2010	14,033.29	
NEX PIF	13 apr 2010	6,976.87	↓ 10,34%
	16 sep 2010	6,255.34	
MOSTE	13 apr 2010	575.50	↓ 14,84%
	16 sep 2010	490.09	

Source: NEX Montenegro Stock Exchange

**Picture 9** The movement of stock indices on Montenegro stock exchange and NEX Montenegro



Source: NEX Montenegro Stock Exchange

## Credit rating of Montenegro

**Table 3** Credit ratings

	S & P	Moody's	Fitch	Main disadvantage
Montenegro	BB+	Ba3	-	Due to the financial crisis which deteriorated liquidity on domestic banking system, caused significant reduction in aluminium prices, and reduction in direct foreign investment is expected.
	Negative	Negative	-	

**Table 4** Data and forecast of macroeconomic indicators

Macroeconomic indicators	2009	Government	Business Monitor International			International Monetary Fund		
		2010E	2010E	2011F	2012F	2010E	2011F	2012F
GDP - real growth (in %)	-5,70	0,50	0,50	4,00	5,00	-1,80	4,50	5,50
GDP per capita (in €)	4720,00	/	5560,00	/	/	/	/	/
Inflation - dec/dec (in %)	1,50	2,00	1,50	/	/	/	/	/
Inflation – average (in %)	3,40	0,5 - 2,5	1,50	2,00	2,20	-0,60	3,00	3,00
Public debt (in mln €)	1140,20	1264,50	/	/	/	/	/	/
Public debt (in % GDP)	38,00	39,50	/	/	/	/	/	/
Current Account deficit/surplus (%GDP)	-29,85	-17,10	/	/	-5,40	-17,00	-12,20	-10,30
Budget balance (% GDP)	-2,30	-4,20	-6,40	-1,80	-1,40	/	/	/
Unemployment - registrered	14,02	12,00	/	/	/	/	/	/

**Table 5** Main macroeconomic indicators

Montenegro	GDP - real growth	Industrial production	CPI	PPI	Gross wages – nominal growth	Unemployment rate	Current account	Foreign trade	
12 month average index (in %, I-XII / I-XII)							S <sup>3</sup> in mln EUR		
2001	1,10	-0,70	22,80	14,50		37,00		-351,40	
2002	1,90	0,60	17,80	4,60		30,40		-443,00	
2003	2,50	2,40	7,90	4,60		25,80	-102,00	-359,33	
2004	4,40	13,80	3,30	5,80	11,80	22,20	-119,64	-416,44	
2005	4,20	-1,90	3,40	2,10	7,80	30,30	-154,00	-513,65	
2006	8,60	1,00	2,10	3,10	15,58	29,60	-531,21	-855,23	
2007	10,70	0,10	4,20	8,50	14,80	19,40	-1.060,64	-1.585,36	
2008	6,90	-2,00	7,40	14,00	22,50	15,09	-1.564,28	-2.093,99	
2009	-5,30	-32,20	3,40	-3,90	5,88	14,02	-896,27	-1.377,06	
2010*	0,50								
Annual Index (% , y-o-y)							S <sup>3</sup> in mln EUR		
2008	Jan	13,10	5,60	11,60	26,17	16,33		-105,56	
	Feb	18,90	7,40	11,60	23,47	16,34		-154,72	
	Mar	2,40	8,70	12,70	23,77	16,11	-413,498	-179,05	
	Apr	-5,30	8,80	11,50	22,76	15,72		-172,78	
	May	-9,90	8,70	13,20	24,38	15,32		-193,29	
	Jun	5,60	9,90	19,10	26,37	14,60	-498,210	-214,40	
	July	3,50	10,80	16,70	25,26	14,51		-222,42	
	Avg	-4,80	10,80	18,60	25,75	14,30		-171,69	
	Sep	12,00	8,40	17,10	24,02	14,43	-230,060	-202,79	
	Oct	-21,10	7,40	14,20	18,97	14,53		-164,78	
	Nov	-7,20	6,20	14,40	16,70	14,49		-183,53	
	Dec	-20,30	6,90	7,10	17,51	14,36	-422,519	-154,84	
2009	Jan	-4,70	4,90	5,70	16,13	14,59		-70,97	
	Feb	-18,80	5,40	4,70	11,30	14,73		-98,47	
	Mar	-15,90	5,50	0,60	11,07	14,60	-285,041	-106,21	
	Apr	-18,20	5,40	0,10	10,03	14,23		-122,83	
	May	-25,30	4,80	-1,90	8,14	13,75		-121,67	
	Jun	-3,5*	-40,40	2,80	-7,80	4,01	13,16	-293,503	-117,84
	July		-46,50	2,10	-9,30	4,26	13,15		-112,29
	Avg		-53,10	3,10	-9,90	2,56	13,04		-118,35
	Sep	-4,0*	-56,40	1,70	-8,60	0,16	13,37	-16,929	-128,12
	Oct		-37,70	1,70	-8,10	1,93	14,07		-124,67
	Nov		-45,60	2,30	-7,20	0,64	14,49		-110,09
	Dec		-24,60	1,50	-3,40	0,31	15,08	-327,824	-132,78
2010	Jan	-11,30	0,80	-6,40	7,18	15,27		-60,40	
	Feb	-23,20	0,20	-6,20	6,31	15,88		-88,33	
	Mar	-1,50	-8,70	0,70	-4,60	7,94	16,20	-241,894	-106,58
	Apr		8,70	0,40	-3,40	7,11			-110,58
	May		15,80	0,30	1,10	11,67			-102,13
	Jun		41,60	0,20	2,20	8,95			-143,58
	July		38,50	0,20		9,43			-141,44
	Avg		31,50	0,10		17,32			

Source: Central Bank of Montenegro, Statistical office of Montenegro

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Author:

**Rok Gabrovšek**  
(+386 1) 476 50 83  
[Rok.Gabrovsek@nlb.si](mailto:Rok.Gabrovsek@nlb.si)



**NLB d.d.**  
Področje finančnih trgov in zakladništva NLB Skupine  
Oddelek za analize  
Čopova 3  
SI-1000 Ljubljana  
T: +386 1 476 52 07  
F: +386 1 476 50 65