

**GOVERNMENT OF MONTENEGRO
MINISTRY OF FINANCE**



INVESTOR UPDATE
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Contact info:

Milica Adžić

Adviser in Debt and Cash Flow Management Department, Directorate for State Treasury

milica.adzic@mif.gov.me

tel: +382 20 202 167

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The new Government of Montenegro, which took over duty in November 2016, has put sustainability of public finances in the very center of its economic policies. In that sense, the Government undertook steps already in December 2016, with the adoption of the **Public Finances Recovery Plan**, which prescribed instant measures aimed at boosting fiscal revenues while decreasing expenses.

That first consolidation package, among other things, included:

- 1) increase of excises on fossil fuels and derivatives (fiscal revenues+€32mn),
- 2) strengthening fiscal discipline (+€15mn),
- 3) decrease of allowances for mothers with three or more children and other social giving (-€17mn),
- 4) decrease of capital spending (-€10mn).

The overall effect of the measures is estimated at €127.5mn or 3.2% of GDP in year 2017.

Following successful implementation of the first package, the Montenegrin Government in June 2017 approved a new **Fiscal Strategy 2017-2020 (“Strategy”)**. This Strategy laid out a comprehensive set of short-and-medium-term fiscal consolidation measures and structural reforms aimed to turn the 5% budget deficit expected -for-this-year into a **4.5% surplus in 2020**. **Public debt is forecast to decrease to 67% of GDP in 2020** after peaking at 75% in 2018, while ultimate goal of Montenegro is to meet debt-to-GDP Maastricht criteria of 60%. The current data shows EU28 average debt to GDP ratio is 83,5%, while Euro Area Government debt to GDP is 89,2 % in 2016.¹

The net effect of the consolidation measures defined by the Fiscal Strategy totals **€117mn**, whereas **savings in funding requirements in period the 2017-2019 amount to €286mn** (compared to Government’s Economic Reform Programme 2017-2019). **The Strategy 2017-2020 underlines the following key points:**

Fiscal Consolidation Measures

- Increase of excises on cigarettes from 1-Aug-17
- Increase of excises on ethyl-alcohol from 1-Aug-17
- Increase of VAT rate from 19% to 21% from 1-Jan-18
- Increase of excises on sweetened sparkling water from 1-Jan-18
- Introduction of excises on coal from 2019
- Decrease of highest salaries in public sector by 6% from 1-Jul-2017
- Decrease of social giving (inter alia reconsideration of allowances to mothers as per decision of the Constitutional Court)
- Decrease of discretionary expenses
- Decrease of fund of gross salaries

Structural Reforms

- Reform of public finances management (budget planning and execution, internal and external audit)
- Reform of public administration
- Reform of pension system
- Reform of health system
- Reform of social and children protection
- Reform of educational system
- Improvement of financial stability (Law on recovery of systemic banks, new Law on banks)
- Improvement of doing business climate (new Labor Law etc.)

Macro and fiscal projections (Fiscal Strategy)²	2017	2018	2019	2020
Nominal GDP (€mn)	3,957.2	4,192.4	4,372.2	4,536.4
Nominal GDP growth rate	4.9%	5.9%	4.3%	3.8%
Real GDP growth rate	2.7%	3.2%	2.3%	2.1%
Inflation	2.3%	3.1%	2.1%	1.6%
Budget balance (€mn)	(197.1)	(111.5)	(31.0)	202.7
Budget balance-to-GDP	-5.0%	-2.7%	-0.7%	4.5%
Debt repayments (€mn)	220.4	215.3	529.3	759.5
Total financing needs (€mn)	417.5	326.8	560.3	556.8
General government debt (€mn)	2,888.2	3,126.6	3,236.0	3,038.5
General government debt-to-GDP	73.0%	74.6%	74.0%	67.0%

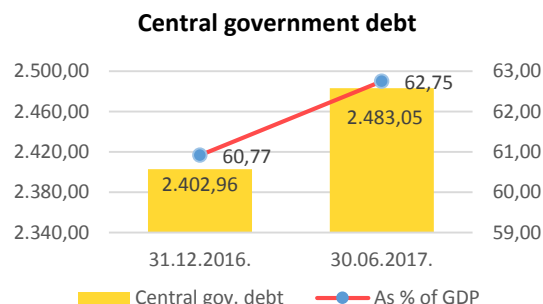
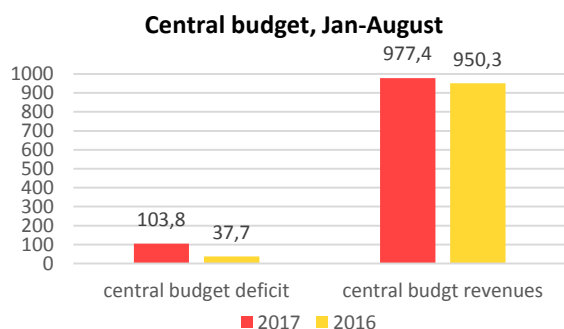
¹ Eurostat

² See Annex 1.

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Fiscal and Macro Economic developments during 2017 to date

- After expanding by 3.2% y/y in Q1 this year, **real GDP growth** accelerated to 5.1% y/y in Q2, which is much better than expected. For the first two quarters in 2017, **GDP** amounted to €1,694.5mn, with a real growth of 4.2%. The expansion in the second quarter was led by increase of consumption of 4.1% y/y in real terms. Government consumption jumped by 2.1% followed by household consumption with 4.6% increase. Gross fixed capital formation fell by 10.4% and net exports by 6.7% y/y in real terms.



- Central budget revenues** in the period Jan-Aug amounted €977.4mn or 24.7% of GDP, which is higher than in the same period in 2016 for €27.1mn or 2.8%.
- The central budget deficit** was €103.8mn or 2.6% of GDP and was higher by €66.1mn or twice more comparing to the same period in 2016. The difference comes from higher capital expenditures related to the highway project.
- The Central government debt of Montenegro as of 30 June 2017**, was €2,483,05mn or **62.75% of GDP**, while including deposits, the debt stood at €2,426.19mn or 61.31% of GDP.
- According to final data for 2016, published by MonStat (MNE Statistical Office), nominal GDP totalled €3,954mn, which is about 182 mn higher than projected. **Central government debt as end of 2016** was **60.77 % of GDP**, while including deposits, it was 59.58% of GDP.

- Inflation** recorded positive growth rates and average inflation in the first eight months of the year stood at 2.4%. Euro Area annual inflation was 1,5% in Sept 2017.³
- In the period Jan-Aug 2017, Montenegro had 17.3% more **tourists arrivals** and 10.5% more **overnight stays** in collective accommodation than in the same period last year. Foreign tourists made 90% of all overnight stays.



In August, tourists realized 14.6% more arrivals y/y in collective accommodation, while the number of realized overnight stays was 5.1% higher. The most of overnight stays in August were realized by tourists from Serbia (21.6%), Russia (18.4%), France (6.2%) and Poland (4.3%).

³ Eurostat

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- Positive growth rates for most types of **transport** in the period Jan-Jun 2017 stand in correspondence with tourist data. Passenger traffic at airports increased by 23.0%, railway transport increased by 59.4%, while cargo turnover in ports increased by 50.6%.
- In the period Jan-Aug 2017, **employment growth** of 3.6% was recorded, with a significant increase in the construction sector (8.8%).
- In the same period, the total volume of **foreign trade** amounted to €1,729,4mn, which is 9.1% more than in the same period of 2016. The value of exports of goods totaled €242mn – 19.5% increase y/y and imports of goods €1.49bn – +7.6% increase y/y.
- In the first six months of the year the value of **construction** works picked up by 45.3% and the effective working hours rose by 22.6% y/y.
- In the Jan-Aug period, the **industrial production** decreased by 6.7% y/y, as a result of the decline in a few sectors: Electricity, water and gas supply (-28.5%), and Manufacturing (-4.7%). Turnover in industry increased by 16.1% y/y, which is primarily driven by exploitation of ore and stone.
- In accordance with the Budget Law for 2017, it is planned that **funds for the financing of the budget**, in the amount of about €255mn, will be provided as credit arrangements with international or domestic financial institutions. In the first nine months, the total amount of Government's borrowings was around €173.4mn, while for the remaining funds for financing needs in 2017, the Ministry of Finance negotiate with international financial institutions in order to conclude a syndicated loan in the amount of €81mn, which would complete the financial construction for this year.
- The Government is negotiating with the World Bank on **Development Policy Based Guarantee (PBG)** in the amount of \$90mn., which could provide a loan arrangement in amount of € 200mn to 250mn. for repaying existing liabilities.

Recent rating actions

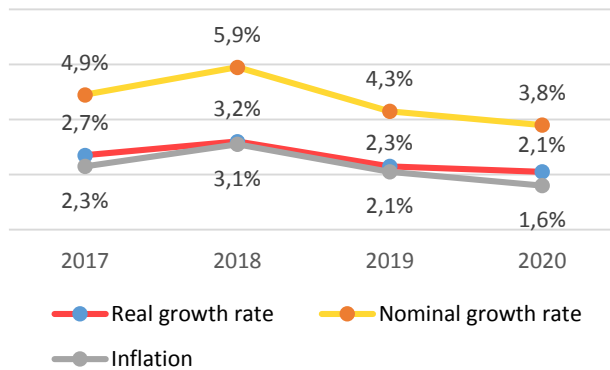
Moody's and Standard and Poor's recently upgraded their outlooks for Montenegro from negative to stable, and affirmed their respective current ratings. These actions, reflect the Government strong commitment to stabilize and improve the country's fiscal situation.

- On Sep 29, 2017, **Moody's** affirms Montenegro's 'B1' rating, and **changed its outlook from negative to stable** due to:
 1. The government's consolidation measures are likely to stabilize Montenegro's general government fiscal position.
 2. Large investment projects in transportation, tourism and energy sectors support Montenegro's medium-term growth outlook.
 3. Progress in EU accession negotiations and Montenegro's NATO membership strengthens institutions and improve the country's investment climate.
- On Oct 6, 2017, **S&P** Global Ratings affirms Montenegro's 'B' rating and **changed its outlook from negative to stable**, due to:
 1. Growth rates remain sound, though the potential for ongoing investments to bolster the economy is uncertain.
 2. Projected real GDP growth to average 3.4% in 2017-2018, driven by private consumption and investments, before slightly decelerating thereafter.
 3. Montenegro joined NATO in June 2017, underpinning the country's Euro-Atlantic integration aspirations.

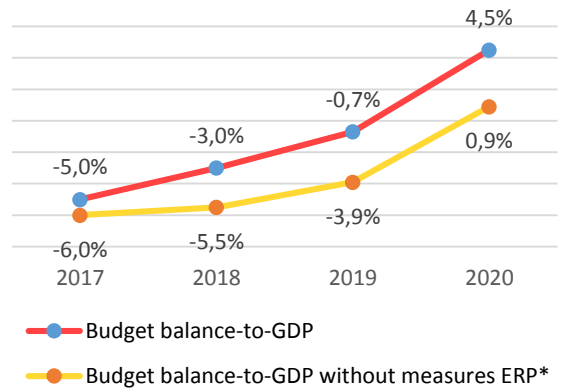
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Annex 1

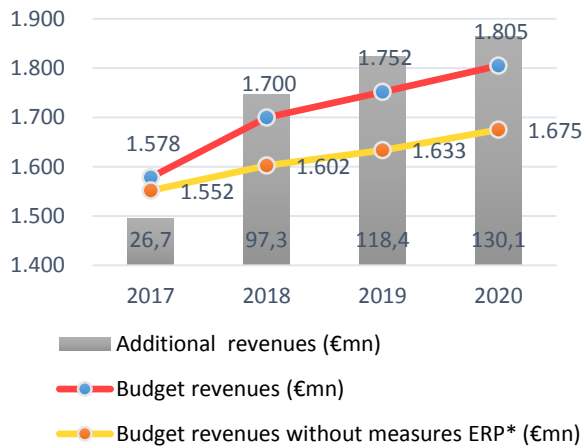
Growth and Inflation



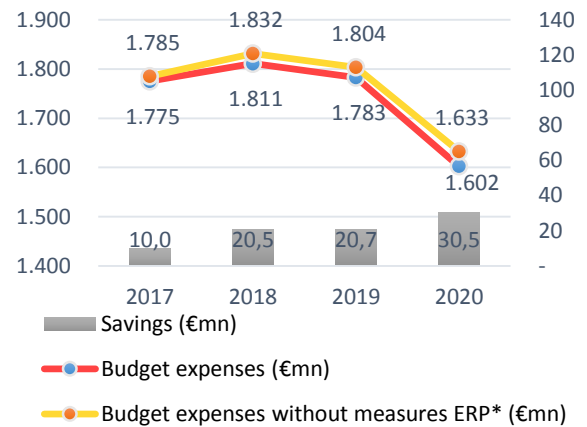
Budget Balance



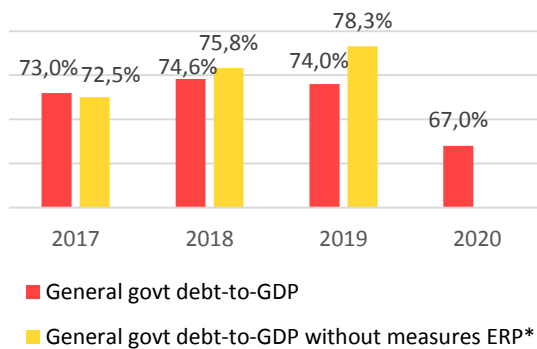
Budget Revenues



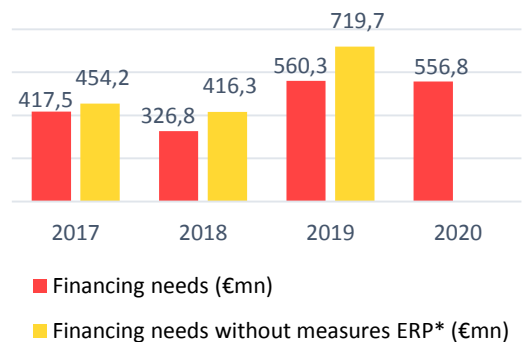
Budget Expenses



Public Debt Ratio



Financing Needs



* Economic Reform Programme 2017-2019