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68903

Republic of Montenegro

Debt Sustainability Analysis

Final Draft

Confidential

February 8, 2007

Poverty Reduction and Economic Management Unit
Europe and Central Asia Region
World Bank

CURRENCY AND EQUIVALENT UNITS
(As of June 20, 2006)

Currency Unit	=	euro
US$1	=	0.79 euros

FISCAL YEAR
January 1 – December 31

ACRONYMS AND ABBREVIATIONS

BOP	Balance of Payments
CAD	Current Account Deficit
CAS	Country Assistance Strategy
CEDB	Council of Europe Development Bank
DSA	Debt Sustainability Analysis
EAR	European Agency for Reconstruction
EIB	European Investment Bank
FDI	Foreign Direct Investment
FFCDs	Frozen Foreign Currency Deposits
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Agency
IMF	International Monetary Fund
KAP	Montenegro's Aluminum Company
MONSTAT	Montenegro Statistical Office
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
RMSM	Revised Minimum Standard Model
SDR	Special Drawing Right
SEE	South East Europe
SFRY	Former Socialist Federative Republic of Yugoslavia
SNA	System of National Accounts
UNDP	United Nations Development Program
USAID	United States Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization

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ACKNOWLEDGEMENTS

This report was prepared by Abebe Adugna (Task Manager, ECSPE), and Evgenij Najdov (ECSPE). Evgenij Najdov developed, for the first time, the macroeconomic consistency framework (RMSM) for Montenegro, which formed the basis for the long-term macroeconomic projections and the debt sustainability analysis in this report. Lazar Sestovic (ECSPE) helped in debt data collection at an early stage of the work.

The report benefited from comments and suggestions by its peer reviewers, Nina Budina (PRMED) and Constatinos Stephanou (LCSPF). The report also benefited from useful discussions and effective collaboration with the Montenegrin authorities. The team would especially like to express its gratitude to the staff of the Debt Management Unit of the Ministry of Finance of the Republic of Montenegro.

The team would also like to thank the IMF team working on Montenegro for providing useful comments on an earlier draft of this report. We are grateful to Dorte Domeland-Narvaez (PRMED) for her comments on an earlier draft as well as for providing continuous technical support with the DSA templates. Bernard Funck (Sector Manager, Macro 2, ECSPE), and Ardo Hansson (Lead Economist, ECSPE) provided guidance and useful comments and insights, which helped finalize the report.

Executive summary

Montenegro is a small, open economy. With only about 620,000 inhabitants according to the most recent population census, and a GDP equal to about US$ 2 billion as of 2005, the economy is indeed very small. But it is highly open: its trade to GDP ratio stood at about 110 percent in 2005, with low import tariffs (average of 6 percent) and no export tariffs. As a small open economy, market integration within the framework of the EU and WTO accessions as well as managing shocks effectively will be important to its future prosperity.

Montenegro's economy is euroized. Since 2002, Montenegro has used the euro as the sole legal tender. With "euroization", inflation has dropped from 24.8 percent at the end of 2000 to 1.8 percent at the end of 2005; exchange rate risks have been mostly eliminated; and transaction costs associated with currency exchanges have been abolished, thereby enhancing Montenegro's commercial integration with the rest of the world, in particular with the EU. In return, it has sacrificed an independent monetary policy, a lender of last resort, and inflation tax and seigniorage. The economy has grown at a positive but sluggish rate of about 3 percent a year since the early 2000s, perhaps suggesting the presence of structural inflexibility in the economy.

With euroization adjustment to shocks has to be accomplished mainly through fiscal policy and structural reforms. Indeed, fiscal policy remains the only macroeconomic tool to maintain both internal and external balance. Luckily, the recent trends in fiscal policy have been encouraging. Montenegro's fiscal stance has been gradually tightened, with the consolidated general government deficit declining from an average of 5 percent of GDP in 2002 to 2.2 percent of GDP in 2005. Both tax and expenditure policies were strengthened. Going forward, further cuts in the wage bill, transfers to households and public enterprises, and more efficient spending in health and education are needed to reduce the remaining deficit and to create fiscal room for increased public investment, in particular in infrastructure.

Aided by Paris Club settlements, Montenegrin public debt has also fallen by well over 40 percentage points of GDP over 2002-05. The face value of Montenegro's public debt at end-2005 was equivalent to 44.5 percent of the republic's GDP. Domestic debt was equal to 13.6 percent of GDP, while external public debt equaled 30.9 percent of GDP, comprised almost entirely of long-term debt from official bilateral and multilateral creditors. The high privatization proceeds since 2005 have also helped bring down public debt, in particular domestic debt, but potential liabilities arising from the ongoing restitution process and contingent liabilities from state-owned enterprises and local governments could potentially significantly affect public debt sustainability. In addition, while external public debt has been reduced, private external debt has more than doubled from about 7.1 percent of GDP in 2003 to about 15.7 percent in 2005, raising concerns about external sustainability.

Montenegro faces little external vulnerability associated with changes in the exchange rates or interest rates. Its external public debt is denominated in euro, with a share of euro and dollar denominated debts amounting to 87 percent and 11 percent respectively. There

are therefore no significant currency mismatches. Similarly, with regard to interest rate composition, the bulk of Montenegro's debts are with fixed interest rates. The share of floating interest rate debt is very small, accounting for less than 15 percent of total external debt. Given the low share of the floating rate, the risks of sharp interest rate fluctuations on the real cost of debt are fairly insignificant in Montenegro.

This report assesses Montenegro's public and external debt sustainability under alternative scenarios. The baseline scenario assumes continued implementation of a macroeconomic stabilization and structural reform program, while the low case scenario describes the alternative of a sluggish growth environment due to policy slippage/weak reform. In addition, other sensitivity tests are conducted in order to highlight the vulnerability of the baseline case to specific shocks. The key results are as follows.

Public Debt Sustainability

The debt sustainability analysis has as its base case a more conservative medium term scenario than that that of the IMF framework. The main differences between the IMF medium term framework and the baseline scenario have to do with a more moderate growth outlook (5 percent vs. 6.5 percent), and a more moderate private sector investment (24 percent vs. 27.5 percent), current account deficit (10.3 percent vs. 14.5 percent), and foreign direct investment (10.6 percent vs. 22.2 percent). The baseline reflects a mid-case scenario where structural reforms would not be so strong as implicitly assumed under the IMF framework due to institutional and human resource constraints in Montenegro.

The report concludes that Montenegro's public debt would be highly sustainable if economic reforms continue at their current pace, the current fiscal policy (with small primary deficit of no more than 0.5 percent of GDP) is maintained, and real GDP grows at an average rate of 5 percent over the coming years. Under this scenario, the total public debt to GDP ratio declines by about 12 percent of GDP (from 41 percent to 29 percent) over 2006-2015, aided in part by a relatively small net foreign borrowing of the public sector. Overall liquidity considerably improves as public debt-to-revenue ratio declines from about 99 percent in 2006 to about 71.5 percent in 2015—a decline of 28 percent. If Montenegro were able to sustain faster than 5 percent growth rate (as envisaged under the most recent IMF framework for the period 2007-11), public debt sustainability would become even more robust.

Under this weak reform scenario, Montenegro's favorable downward trajectory of debt-to-GDP ratio is reversed. Public debt ratio declines up to 2008 (because of the assumed progressive but slow decline in real GDP growth in the early years), but continues to increase afterwards. The total public debt to GDP ratio declines to about 33.8 percent by 2009, but slowly rises to 52.2 percent in 2015, jeopardizing long-term debt sustainability. The resurgence in debt ratio is due Montenegro's slow growth, positive real interest rate, higher restitution debt, and because the government will run a higher primary deficit relative to the base case (Table 4.3). Liquidity indicators improve at a much lower pace than under the base case, as public debt-to-revenue ratio declines only slightly from about 99 percent in 2006 to about 95 percent in 2015, and gross public financing need initially declines but

climbs back to about the same percent of GDP in 2015 as in 2006 (6 percent). The weak reform scenario illustrates the importance for the government to stick to the current tight fiscal policy path over the medium term, without which the sustainability of public debt is clearly jeopardized.

The stress tests suggest that Montenegro's debt dynamics are particularly susceptible to a sudden surfacing of high (restitution) debt and to a negative growth shock. Montenegro's stock of outstanding public debt is still unclear due to lack of good estimates on the full potential liabilities arising from the ongoing restitution claims by citizens, and weak information on debt of public enterprises and local governments. In addition, there are plans to compensate for frozen foreign currency deposits held by Montenegro citizens in other ex-Yugoslav republics and other debt stock adjustments. If there were new debts emerging (e.g. restitution debt), whose magnitude 10 percent of GDP for two consecutive years (2007 and 2008), the debt to GDP ratio shoots from 41 percent to about 51 percent by 2011, after which the impact wears off and the ratio declines to 45 percent by 2015 (but still higher than the starting point).

Similarly, confirming Montenegro's high vulnerability to a negative growth shock, public debt ratios rise steadily in the case where real GDP growth slows down to 0.7 percent in 2007-08. Indeed, the analysis implies that a temporary export shock or tourism reversal or any other shock which causes a GDP growth to slow down to less than 2.8 percent for two consecutive years would lead to rising public debt position. This finding puts a premium on growth-enhancing policies, and the need for the Bank and other development partners to assist Montenegro in implementing structural reforms key to accelerated growth.

External Debt Sustainability

Montenegro has run large current account deficits in recent years, averaging about 8 percent of GDP. Montenegro's exports of goods and services are not diversified and remain largely dominated by tourism services and aluminum. On the other hand, imports of goods and services remain persistently high, with oil and gas and electricity as the most important import items. The current account deficit has been financed through significant increases in non-debt creating inflows (FDI and net transfers), but also some increases in foreign loans (by both the public and private sectors) in recent years. The recent increases in foreign loans obviously raise concerns about external debt sustainability.

The report concludes that Montenegro's external debt continues to be sustainable under the baseline scenario where sustained structural reform and fiscal adjustment support an average growth rate of about 5 percent per year, the current account deficit is reduced to an average of 6.5 percent of GDP over 2006-2015 (relative to the present 8 percent), and if Montenegro is able to continue to attract FDI inflows on the order of 7 percent of GDP. Under these assumptions, the net present value of external public debt declines from 26.8 percent in 2006 to 13.1 percent in 2015. External liquidity also improves,

with the ratio of debt service-to-exports declining from 3.4 percent in 2006 to 2.4 percent in 2015. Even under the low case of weak reform scenario, liquidity indicators marginally deteriorate relative to the base case, but external sustainability is still maintained as low growth translates into lower financing requirements and only marginally higher level of public debt.

As would be expected in a small open economy, the stress tests show that Montenegro's external public debt dynamics would be adversely affected by a negative export shock or smaller volumes of non debt-creating inflows (i.e. FDI and transfers). A severe negative export shock that lasts two consecutive years will sharply raise the net present value of public external debt, and leads to a worsening of external sustainability in the short term, although the impact wears off over the medium-term. Similarly, changes in net non-debt creating flows, in particular FDI and current transfers, will lead to a worsening of external sustainability in the short term.

The implication of this is that export-oriented growth (with minimum export volatility) is likely to be central to both reducing the large current account deficit as well as maintaining external sustainability. While tourism clearly holds considerable promise for export-oriented growth in Montenegro, turning this promise into reality requires substantial and well-targeted investments as well as the implementation of key structural reforms. In particular, Montenegro needs to facilitate the conditions for private investment in tourism through labor market and business environment reforms, address the public infrastructure constraints-- in particular in water, roads, and waste management—for coastal tourism development, and improve its competitiveness vis-à-vis neighboring countries, many of which currently offer a more competitive combination of quality and price to the same target markets. In the long-term, it will also need to diversify its tourism products. All of this will need to be done in an environmentally sustainable way.

Finally, in view of the rising private external debt, Montenegro will need to put in place a mechanism to monitor private sector external debt. Private sector borrowing has been rising in recent years (from around 7 percent to 15 percent of GDP over 2002-05). However, little information is available on the nature and maturity structure of private sector borrowing and the monitoring of private debt is almost non-existent. This makes it difficult to assess whether private sector debt poses significant risks for public debt sustainability. Still, sudden reversals or price corrections impair private sector balance sheets, reverse FDI, stress the banking sector, and adversely impact fiscal consolidation. A strong prudential supervision of the financial system, coupled with effective monitoring of private debt, is therefore needed to protect the economy against such potential surprises and to continue to ensure public and external debt sustainability over the medium term.

Overall, the analysis in this report supports the conclusion that with a continuation of current macroeconomic policies, and an acceleration of structural reforms aimed at enhancing growth and reducing export vulnerabilities, Montenegro can absorb an increasing share of non-concessional official financing and/or gradually access market based lending without major risks to its public debt and external sustainability.

I. INTRODUCTION

1.1 **On May 21, 2006, Montenegro voted for independence**. The vote ended the loose federation with the Republic of Serbia that had been in place since 2002. The Republic of Montenegro officially declared its independence on June 3, 2006.

1.2 **Montenegro has since applied for membership in the World Bank.** On July 17, 2006, the Government of Montenegro submitted its application for membership in the World Bank Group institutions. On July 19, 2006, the Bank country management sought approval of the Executive Directors for continued Bank Group activities in Montenegro, pending the finalization of Montenegro's membership. The Board subsequently granted approval for the continuation of Bank Group activities in Montenegro during the interim period. The membership application is being processed and expected to be finalized by the end of the year.

1.3 **In view of Montenegro's independence, debt sustainability analysis has become necessary to inform lending decisions of the Bank.** Debt sustainability refers to a condition whereby debt can be serviced without resort to exceptional financing or a major future correction in the balance of income and expenditure. For low income countries, debt sustainability analysis (DSA) plays an important role in determining the grant versus loan components of IDA allocations. In middle income countries like Montenegro where official concessional financing is still dominant, but there is limited market access, a debt sustainability analysis can help guide the lending decisions of the Bank to match the country's needs for funds with its current and prospective ability to service debt. Accordingly, this DSA intends to provide input to a broader assessment of Montenegro's IBRD creditworthiness for market based lending in connection with the World Bank Country Assistance Strategy (CAS) covering FY08-11.

1.4 **The rest of this report is organized as follows. Chapter 2** reviews recent economic developments and a medium term outlook for the economy that will provide a context for the fiscal and external debt sustainability analysis later. **Chapter 3** of the report examines the composition and dynamics of Montenegro's public and external debt. **Chapter 4** provides an analysis of both public and external debt sustainability under the base case and low case economic reform scenarios. It will also provide sensitivity analysis for negative export shocks (arising from reversals in tourism, a fall in aluminum price or both), real interest rate, and the variations in debt size. **Chapter 5** offers summary and conclusions.

II. RECENT ECONOMIC DEVELOPMENTS AND MEDIUM TERM OUTLOOK

A. RECENT ECONOMIC DEVELOPMENTS

1.5 The Republic of Montenegro, with the support of the international community,[1] has been engaged in a long series of macroeconomic stabilization, and market-oriented structural reforms since 1997. These reforms have yielded modest results in terms of macroeconomic stability and growth.

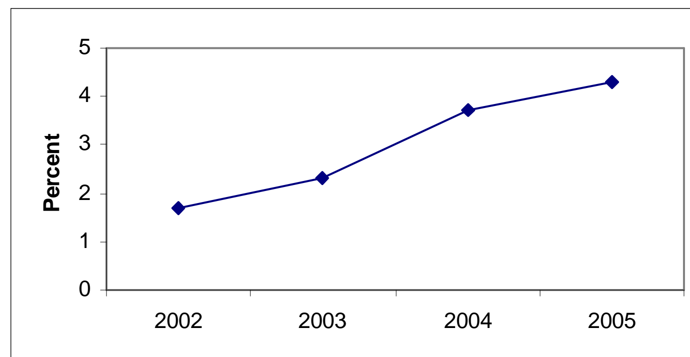
Growth

1.6 **Montenegro is a small, open economy**. With only about 620,000 inhabitants according to the most recent population census, and a GDP equal to about US$ 2 billion as of 2005, the economy is indeed very small. But it is highly open: its trade to GDP ratio stood at about 110 percent in 2005, with low import tariffs (average of 6 percent) and no export tariffs. As a small open economy, market integration within the framework of the EU and WTO accessions as well as managing shocks effectively will be important to its future prosperity.

1.7 **The economy is euroized**. Since 2002, Montenegro has used the euro as the sole legal tender. With "euroization", inflation has dropped from 24.8 percent at the end of 2000 to 1.8 percent at the end of 2005; exchange rate risks have mostly been eliminated; and transaction costs associated with currency exchanges have been abolished, thereby enhancing Montenegro's commercial integration with the rest of the world, in particular with the EU. In return, it has sacrificed an independent monetary policy, inflation tax, and seigniorage, and has no lender of last resort.

1.8 **Since the early 2000s, the economy has grown at a positive but sluggish rate.** Real GDP grew by an average of about **3** percent over 2003-2005, significantly below the regional average for peer countries. Moreover, the recorded output growth remains below its potential, as Montenegro's GDP remains far behind its pre-transition levels. On the demand side, the recorded growth came mainly from growth in (both private and public) consumption underpinned by strong domestic

Figure 2.1 Montenegro: Real GDP growth, 2002-05

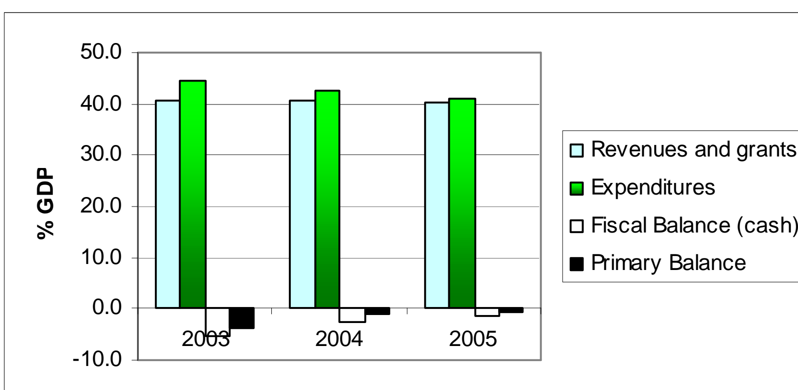


[1] Main donors in Montenegro include the United States Agency for International Development (USAID), the European Agency for Reconstruction (EAR), World Bank, and the United Nations Development Program (UNDP).

credit growth to households and the private sector, strong domestic investment growth (which increased from 15 percent of GDP in 2003 to about 22 percent of GDP in 2005) [2], and recovery of exports. On the supply side, no good data are available, but the services sector, comprising especially of tourism, transport, and financial services, and the manufacturing sector, comprising of the metal and energy industry, are estimated to have been the main sources of growth. Coastal tourism has been growing, as evidenced by recent rising number of tourist arrivals and nights. Montenegro's Aluminum Company (KAP) accounts for about 43 percent of total merchandise exports, and contributes significantly to value-added and employment. To a lesser extent, forestry (in particular wood processing) and agriculture and food processing may also have contributed to the growth of the economy.

1.9 **Looking ahead, Montenegro faces the challenge of increasing growth within the framework of "euroization".** In terms of policy, euroization limits flexibility, and puts the full burden of adjustment to shocks on prices, fiscal policy, and most importantly structural reforms including labor market, business environment, and financial sector reforms.[3] Indeed, Montenegro's sluggish growth and high unemployment (24 percent of workforce) appear to be symptomatic of inadequate structural flexibility in the economy, including in labor market, business environment, and infrastructure. Further structural reforms focused on these areas will therefore be crucial to speeding up growth and reducing unemployment, while further enhancing macroeconomic stability through a tighter and sustainable fiscal policy. A plausible growth outlook for the medium and long-term is discussed in the outlook section.

Table 2.2. Montenegro: Consolidated Government Fiscal Balance, 2003-05



Fiscal Policy

1.10 **Fiscal policy has been tightened in recent years.** Montenegro's consolidated government budget deficit was reduced from about 5 percent of GDP in 2002 to about 2 percent in 2005. The fiscal consolidation is approximately equally split between expenditure reducing and revenue increasing measures. The introduction of VAT in 2003 has supported a relatively high revenue-to-GDP ratio while reductions in transfers and interest payments helped lower public expenditures. However, general government expenditure remains high,

[2] With public investment remaining at 3-4 percent of GDP, most of the increase came from private investment.

[3] The loss of lender of last resort puts a premium on having a strong banking sector supervision and management of liquidity in the financial system.

mainly because of the high wage bill and social transfers, and relatively high spending on health and education.

1.11 **The wage bill is a source of high government spending.** According to government data, the wage bill accounted for about 10.6 percent of GDP in 2005. However, if one includes the wage bill in the health sector (financed under contractual arrangements through the Health Fund), the total wage bill is much higher: 13.4 percent of GDP in 2005. This is substantially higher (by 2-3 percent) as a share of GDP in comparison to other countries in the region and will need to be reduced.

Box 1.1. Montenegro: Functional composition of public expenditure

As in other countries in the region, social transfers to households and outlays on health and education services consume the bulk of public expenditure in Montenegro.

Social transfers to households, at about 17 percent of GDP in 2005, are comparable to the high regional average. The most important programs include benefits to pensioners through the Pension Fund, medical protection and health insurance through the Health Fund. Recent pension reforms[4] have helped ease the fiscal pressure coming from the Pension Fund although the Pension Fund is still running a deficit (about 1.5 percent of GDP in 2005). In view of the fiscal pressure, further reforms may be required to bring the system into balance. Furthermore, payment arrears need to be brought under control.[5]

Health care spending, at about 6.5 percent of GDP, is much higher than the average spending in the region (5.9 percent in SEE, and 4.7 percent in New Member States). While the operational deficit of the HIF is small (about 0.1 percent of GDP in 2005)[6], the current public health financing system in Montenegro may not be financially sustainable since it relies on relatively high payroll contribution rates (15% of gross salary compared to 6-8 percent in most of EU-15), which will have to be reduced in a planned manner in the medium term to encourage employment. Establishing a strong link between access to benefits and contribution payments and containing the generous benefits package will be key to bringing the growing health expenditures under control.

Education spending, at 5.4 percent of GDP in 2005,[7] is significantly above that of other countries in the region. Currently, a very high proportion of spending (82 percent) is on wages, which leaves insufficient room for other non-staff spending that will help improve the quality of education. The average for OECD countries for the share of non-staff cost in total recurrent expenditure is 25.6 percent. Further cost savings as well as increases in non-salary spending on other priorities can be achieved by reducing the wage and salary costs through staff reductions, rationalizing the school network, and reforming the vocational training programs.

1.12 **On the other hand, Montenegro's domestically financed capital expenditure is one of the lowest in the region,** accounting only for less than one-half of the average regional spending as a share of GDP (2 percent in Montenegro versus an average of about 4 percent in the region). Public infrastructure outlays accounts for about 0.5 percent of GDP.

[4] The Pension Insurance Act of September 2003 tightened the PAYGO parameters (increased the retirement age by five years over a ten-year period; widened the calculation period from ten best years to full career over a 15 year period; changed the indexation pattern from wage to a combination of wages and prices; introduced a point formula and lowered the accrual rates from more than 2 percent to 1 percent per year of service; and tightened disability conditions and eliminated most social-related benefits from the pension system).

[5] The stock of Pension Fund arrears stood at 22.2 million euros (1.4 percent of GDP) at end-2005.

[6] The stock of HIF arrears stood at 14.5 million euros at end-2005 (0.9 percent of GDP).

[7] This includes spending by social funds as well, but does not include the small amount spent by municipalities.

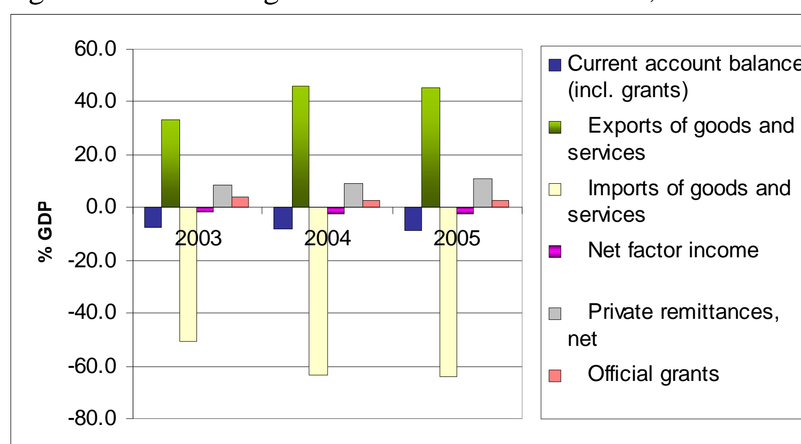
Furthermore, routine infrastructure maintenance does not appear to be carried out regularly and a large maintenance backlog has been accumulated. Increasing capital spending and reducing the maintenance backlog would be essential for increasing private-sector led growth.

1.13 **Going forward, further cuts in the wage bill, transfers to households and public enterprises, and more efficient spending in health and education are needed** to reduce the remaining deficit and to create fiscal room for increased public investment, in particular in infrastructure.

Balance of Payments

1.14 **Montenegro's recorded current account deficit (before grants) stood at 11 percent in 2005**.[8] The trade balance in goods and services stood at a deficit of 19 percent of GDP in 2005, showing the high imbalance between exports and imports. Montenegro's exports of goods and services, estimated at 45 percent of GDP in 2005, are not diversified and remain largely dominated by the export of aluminum (11 percent of GDP) and tourism (13 percent of GDP). On the other hand, imports of goods and services remain high, at around 64 percent of GDP, with oil and gas and electricity as the most important import items (accounting for 5 percent and 3 percent of GDP respectively). Net factor income was estimated at -2.6 percent of GDP in 2005, and composed mostly of net dividend payments. Net private remittances accounted for about 10.7 percent of GDP. With official grants accounting for about 2.4 percent of GDP, the recorded current account deficit after grants stood at 8.6 percent of GDP.

Figure 2.3. Montenegro: Current Account Balance, 2003-05



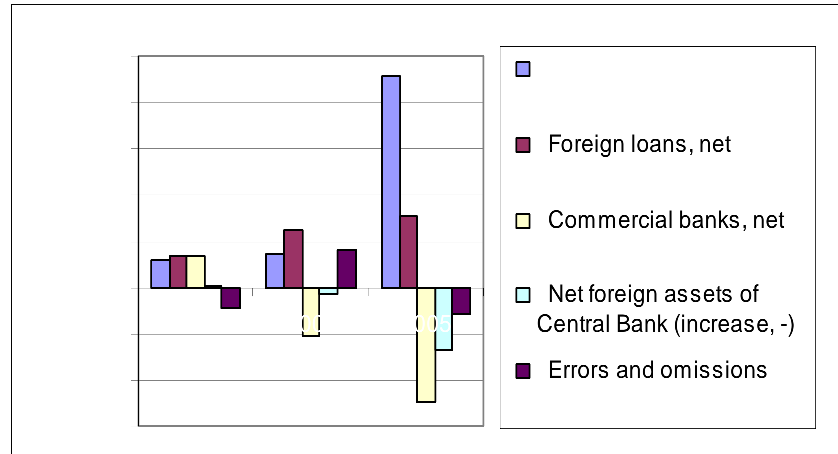
1.15 **The high current account deficit after grants was financed mainly through the exceptionally high foreign direct investment in 2005, and to a much less extent foreign loans, and high private foreign borrowing through commercial banks**. In 2005, net foreign direct investment was estimated at 23 percent of GDP, of which about 56 percent (213 million euros) came through privatization proceeds from tender and auction, while the rest (167 million euros) constituted greenfield investment. Net foreign loans to Montenegro (which were almost entirely of long term nature) accounted for about 7.6 percent of GDP in

[8] Montenegro still has problems in the compilation of BOP data due to capacity constraints.

2005, while net borrowing of commercial banks accounted for 12.5 percent of GDP. The balance, about 7 percent of GDP, was reflected in the increase in the net foreign assets of the Central Bank of Montenegro.[9]

1.16 **While the overall current account deficit has remained roughly constant during the last three years, its components have shown important changes.** Exports of goods and services grew by 12 percent of GDP over 2003-2005, while imports of goods and services grew by 13 percent of GDP over the same period. Private remittances increased by about 2.5 percent of GDP, while net factor income and official grants both declined by about 1 percent of GDP each.[10] On the financing side, foreign direct investment grew by 20 percent of GDP (from 2.8 percent in 2003 to 22.9 percent of GDP in 2005), foreign loans by 4.3 percent of GDP, and private sector foreign borrowing (through commercial banks) by 15.8 percent of GDP.

Figure 2.4. Montenegro: Capital Account Balance, 2003-05



1.17 **External sustainability remains a source of concern.** While it is not unusual for transition countries such as Montenegro to run a high current account deficit to facilitate capital replacement, the high deficit is concerning especially in view of a continuing shift from grants to non-concessional loan financing. With euroization, adjustment to a lower current account deficit will necessitate either domestic demand restraint and/or the expansion of exports. Prudent fiscal policy that will help contain demand and/or structural reforms aimed at expanding exports and competitiveness will thus be of central importance in ensuring external sustainability.

Debt

1.18 **The face value of Montenegro's public debt at end-2005 was equivalent to 44.5 percent of the republic's GDP**. Domestic debt was equal to 13.6 percent of GDP, while external public debt equaled 30.9 percent of GDP, comprised almost entirely of long-term debt from official bilateral and multilateral creditors. A detailed discussion of the recent trends in Montenegro's public debt—both domestic and external –are provided in chapter 3.

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[9] Errors and omissions stood at -2.8 percent of GDP, perhaps reflecting the poor BOP database.

[10] Grants may continue to decline further in the future as USAID, Montenegro's main donor, expects its assistance to Montenegro to be lower over the next five years compared to the past five years.

B. MEDIUM TERM MACROECONOMIC OUTLOOK

1.19 This section describes the medium term economic outlook (2006-2007), based on the most recent (December 2006) IMF macroeconomic framework for Montenegro, which is itself highly provisional.[11] This outlook anticipates that Montenegro's macroeconomic environment will remain stable over the medium term, with declining fiscal deficits, low and stable inflation (2-3 percent), and much improved growth (Table 2.1).

1.20 While the IMF outlook is presented herewith just for information, the debt sustainability analysis will adopt as its base case a more conservative medium and long-term macroeconomic scenario for Montenegro. The details of the main differences with IMF macroeconomic framework are outlined in Chapter 4.

Growth outlook

1.21 **Medium term GDP growth potential is estimated between 5.5 and 7 percent, supported by steady consumption, and strong private investment and exports growth (Table 2.1).** On the demand side, public consumption would slightly decline but private consumption would remain stable. However, investment would rise from 19.5 percent of GDP in 2005 to 26.2 percent in 2006 and 27.5 percent in 2007, on par with the level in the faster growing economies. Gross national saving would decline slightly from around 12 percent of GDP in 2005 10.6 percent in 2007, but higher foreign savings would finance most of the increases in investment. Exports of goods and services are projected to grow by 5 percent of GDP over 2005-07, driven largely by tourism and with little change in the contribution of aluminum.

1.22 **On the supply side, the services sector—in particular comprising of tourism, transport, and financial services —is expected to be the main driver of growth**. Tourism growth is likely to concentrate in the coastal areas, but the northern region with its hills, mountains, rivers, canyons and lakes can over time also complement the high seasonality of coastal tourism through development of landscape-based tourism. The manufacturing sector, in particular the metal and energy industry would continue to play an important role in the Montenegrin economy. Montenegro's Aluminum Company (KAP) accounts for well over 40 percent of total merchandise exports, and contributes significantly to value-added and employment. To a lesser extent, forestry (in particular wood processing) and agriculture and food processing will also continue to contribute to the growth of the economy.

1.23 **The acceleration of growth to between 5.5 - 7 percent in the medium term would crucially depend on a number of structural reforms,** including (i) making the labor market more flexible (through labor regulation reform) and reducing payroll tax rates; (iii)

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[11] The IMF does not currently have an active program with Montenegro. Until Montenegro's independence in June 2006, the IMF had had a single program for Serbia and Montenegro, wherein each republic's program performance was monitored separately. Montenegro applied for membership in the IMF in July 2006, and the membership process is underway. The authorities could request an IMF supported program after concluding membership. The medium term outlook here is based on IMF's provisional assessment in December 2006, which may change in view of new data and/or program arrangements with the authorities.

continued business environment reforms (enterprise privatization and restructuring, bankruptcy, and land title transparency and property rights protection); and, (iii) increasing investment in public infrastructure to better support private sector investment, in particular in tourism services. These measures would be key to attracting private investment (FDI in particular) and enhancing private sector-led growth and employment in Montenegro.

Fiscal policy outlook

1.24 **On the fiscal front, the consolidated general government balance would improve from a deficit of 2.3 percent of GDP in 2005 to a surplus of 1.6 percent of GDP in 2007.** Montenegro will continue to balance the budget and tighten fiscal policy, especially through expenditure cuts. A strong revenue performance is expected to continue, with revenue-to-GDP ratio holding steady, and underpinned by continued strong performance of the VAT. Starting in 2007, the Government intends to progressively reduce the personal income tax (PIT), which would lead to a revenue loss, but whose effect would be offset by corresponding reductions in current expenditure. In addition, further revenue and expenditure measures would allow for covering the costs of introduction of a second pillar pension, planned to be implemented from 2008 onwards by the government.[12]

1.25 **Medium term expenditure cuts will focus on wage bill, transfers to households and public enterprises, and interest payments**. These cuts will enable both to reduce the remaining deficit and create fiscal room for increased public investment in infrastructure. Domestic public investment will thus increase from 4.4 percent in 2005 to 5 percent in 2007. The modest increase in capital expenditure over 2005-07 reflects the limited institutional capacity of the government to design and implement capital projects without waste of money. Capital expenditures are expected to rise even further going beyond 2008.

1.26 **The sustainability of fiscal policy remains an important concern in Montenegro**. The medium term fiscal policy outlook envisages that the primary balance would improve from a deficit of 0.9 percent of GDP in 2005 to a surplus of 3.1 percent of GDP in 2007. Chapter 4 offers an assessment of whether Montenegro will need a more aggressive fiscal adjustment to achieve fiscal sustainability.

External outlook

1.27 **The current account balance will sharply deteriorate from a deficit of 7.2 percent in 2005 to a deficit of 16.9 percent in 2007.** Exports of goods and services would grow by 4.5 percent of GDP, and imports of goods and services by 10 percent of GDP over 2005-2007. Net factor income and official grants will decrease by 0.5 percent and 1.5 percent of GDP respectively, and private remittances by about 2.5 percent of GDP over the same period. On the financing side, FDI will continue at an exceptionally high level as has been the case since 2005, partly from privatization proceeds, and partly from associated greenfield

[12] The Bank has cautioned the authorities to move slowly on the introduction of second pillar pensions to make sure that the transitional costs are properly estimated, and regulatory and financial market environment are ready before embarking on such reforms.

investments mainly in tourism and related sectors.[13] In view of the large FDI, net foreign loans would decrease from 7.8 percent of GDP in 2005 to 1.8 percent of GDP in 2007, and the central bank would accumulate higher foreign reserves. In part because of less contracting of fresh debt but also because of higher growth and a more vigorous amortization schedule, the total stock of public debt would decline from 44.1 percent of GDP in 2005 to 37.6 percent of GDP in 2007.

C. RISKS TO THE MEDIUM TERM OUTLOOK

1.28 The above medium term outlook envisages sustained and high growth driven by high levels of private investment, low and stable inflation, and a widening CAD, backed by tighter fiscal policy, and continued and vigorous structural reforms. While such outcomes remain possible, there remain two important uncertainties.

1.29 **First, following independence, Montenegro is now in the process of transition to membership in the IMF and the World Bank Group**. The authorities could request an IMF supported program after concluding membership, but the nature of that program is not known at present. A shift to a less binding IMF program and/ or transition to full statehood can increase the risks of slippage in fiscal policy and structural reforms, including pressures or temptations to spend the large privatization proceeds and/or some fiscal indiscipline arising from state owned enterprises or at municipal levels of government.

1.30 **Second, Montenegro has very limited human, administrative, and institutional capacity for consistent design and implementation of structural reforms.** The IMF growth outlook of around 7 percent is predicated on the implementation of strong structural reforms in labor market and business environment, and improved investment in public infrastructure. However, in view of the limited capacity, implementation could proceed more slowly, which may in turn lead to a more moderate growth outlook. Further, the experience of neighboring countries shows that very few countries have had sustained long-term growth rates in excess of 5 percent (and an average growth rate of 4-5 percent).

1.31 For these reasons, the debt sustainability analysis will adopt as its base case a more conservative medium and long-term macroeconomic scenario for Montenegro. The detailed baseline scenario assumptions and projections are discussed in Chapter 4.

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[13] From 2009 onwards, however, these peter out, leading to lower imports and/ or drawdown of deposits in commercial banks.

Table 2.1. Montenegro: Key Economic Indicators and Medium Term Outlook, 2003-2007
(in percent of GDP unless otherwise specified)

	2003	2004	2005 (est.)	2006[1] (proj.)	2007[1] (proj.)
National Accounts					
GDP, % growth	**2.3**	**3.7**	**4..3**	**5..5**	**7.0**
Industrial output, % growth	**2.4**	**13.8**	**-1.9**	**1.5**	**…**
Gross national saving	**7.8**	**8.8**	**12.3**	**10.3**	**10.6**
Gross domestic investment	**15.1**	**16.4**	**19.5**	**26.2**	**27.5**
Prices and Wages					
Retail prices, % change (average)	**7.5**	**3.1**	**3.4**	**2.2**	**3.0**
Retail prices, % change (e.o.p.)	**6.2**	**4.2**	**1.8**	**2.2**	**3.0**
Average net wage (euro per month)	**173.9**	**195.3**	**213.1**	**248.3**	**…**
Money and Credit					
M2, % change					
Bank credit to private sector	**…**	**43.2**	**33.2**	**98.9**	**…**
Enterprises, % change	**…**	**40.6**	**30.2**	**73.7**	**…**
Households, % change	**…**	**49.4**	**39.7**	**152.5**	**…**
Fiscal Accounts[2]					
Revenues and grants	**41.8**	**39.9**	**39.5**	**43.5**	**43.6**
Expenditures	**46.6**	**42.7**	**41.6**	**42.4**	**42.4**
Cash Balance	**-5.9**	**-3.2**	**-2.3**	**0.9**	**1.6**
Primary Balance	**-3.7**	**-1.1**	**-0.9**	**2.1**	**3.1**
Privatization Receipts	**2.4**	**0.7**	**9..7**	**3.0**	**4.2**
Balance of payments[3]					
Current account balance (incl. grants)	**-7.3**	**-7.8**	**-7.2**	**-15.9**	**-16.9**
Exports of goods and services	**33.2**	**44.8**	**46.8**	**50.8**	**51.3**
***Of which*: Aluminum**	**7.9**	**11.7**	**11.0**	**14.4**	**13.4**
***Of which*: Tourism**	**9.8**	**11.0**	**13.1**	**17.9**	**19.1**
Imports of goods and services	**-51.0**	**-62.0**	**65.6**	**75.4**	**75.1**
***Of which*: Oil and gas**	**-3.6**	**-4.0**	**-5.2**	**-6.0**	**-5.9**
***Of which*: Electricity**	**-3.3**	**-3.1**	**-3.2**	**-3.2**	**-3.0**
Net factor income	**-1.5**	**-2.5**	**-2.6**	**-3.3**	**-3.2**
Private remittances, net	**8.2**	**9.1**	**12.0**	**10.2**	**9.5**
Official grants	**3.7**	**3.0**	**2.2**	**1.7**	**0.6**
Capital account balance	**9.5**	**4.4**	**21.4**	**19.8**	**27.4**
Foreign direct investment, net	**2.8**	**3.6**	**22.6**	**27.3**	**25.6**
***Of which*: Privatization proceeds**	**…**	**…**	**12.6**	**3.6**	**7.4**
***Of which*: Greenfield Investment**	**…**	**…**	**9.9**	**11.5**	**10.4**
Foreign loans, net	**3.4**	**6.0**	**7.6**	**3.0**	**1.8**
Disbursement	**8.2**	**9.3**	**10.5**	**5.2**	**4.6**
Amortization	**-4.9**	**-3.2**	**-2.9**	**-2.9**	**-2.9**
Commercial banks, net	**3.3**	**-5.3**	**-8.8**	**-10.6**	**0.0**
Net foreign assets of Central Bank (increase, -)	**0.0**	**-0.6**	**-6.7**	**-2.7**	**-9.8**
Errors and omissions	**-2.2**	**3.9**	**-7.5**	**0.3**	**0.0**
Debt					
Public Debt[1]	**52.3**	**51.3**	**44.1**	**42.0**	**37.6**
Domestic debt	**18.7**	**19.7**	**13.8**	**13.3**	**11.9**
External debt	**33.6**	**31.6**	**30.3**	**27.8**	**25.7**
External Debt	**40.7**	**43.1**	**46.6**	**45.2**	**42.8**
Public	**33.6**	**31.6**	**30.3**	**28.7**	**25.7**
Private	**7.6**	**11.0**	**16.8**	**18.5**	**18.7**
Government deposits	**1.8**	**1.4**	**4.6**	**7.6**	**10.4**

1/ Latest IMF projections for 2006-07 (provisional).
2/ Includes local governments, but excludes public enterprises.
3/ Based on Montenegro authorities' estimates of trade with Serbia and Kosovo.
***Source:* Ministry of Finance; Central Bank of Montenegro; Statistical Office of Montenegro; IMF.**

III. EVOLUTION OF PUBLIC AND EXTERNAL DEBT (2002-05)

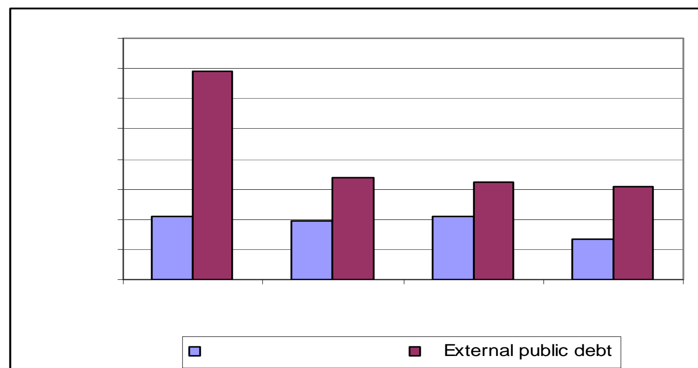
1.32 In this analysis, the public sector is defined as pertaining to the *general government,* and excluding the Central Bank of Montenegro.[14] Public debt is defined as consisting of central government (republican, and pension, health and employment funds) gross debt, including domestic payment arrears, and local government debt, but excluding the Montenegro Development and Restitution Funds and public enterprises.

A. EVOLUTION OF PUBLIC DEBT

1.33 **Montenegro's stock of outstanding public debt is still unclear.** The lack of clarity is due to several reasons. First, data on enterprises partly or wholly owned by the government is weak and the public debt could increase significantly due to quasi-fiscal losses or default on debt implicitly guaranteed by the government. Second, the process of restitution, underway since 2005, is far from complete, and the full potential liabilities arising from it are not well known. Finally, the allocation of external debts of the former Union of Serbia and Montenegro between the Republic of Serbia and the Republic of Montenegro, including Paris Club debts, are currently underway, and exact amounts will be known only after the process is completed.

1.34 **However, existing data indicate that Montenegro's total public debt stood at about 44.5 percent of GDP as of end-2005 (see Table 3.3 for details).** Domestic public debt—which includes debt for the repayment of Frozen Foreign Currency Deposits (FFCDs), debt toward commercial banks, treasury bills, municipal debt, and domestic payment arrears--accounted for about 13.6 percent of GDP in 2005. External public debt was estimated at 30.9 percent of GDP in 2005, down from 33.6 percent of GDP in 2003. With a debt write-off to Montenegro of some 26 million euros by the Paris Club creditors in 2006, the external debt position is set to improve even further.

Figure 3.1. Montenegro Domestic and External Public Debt



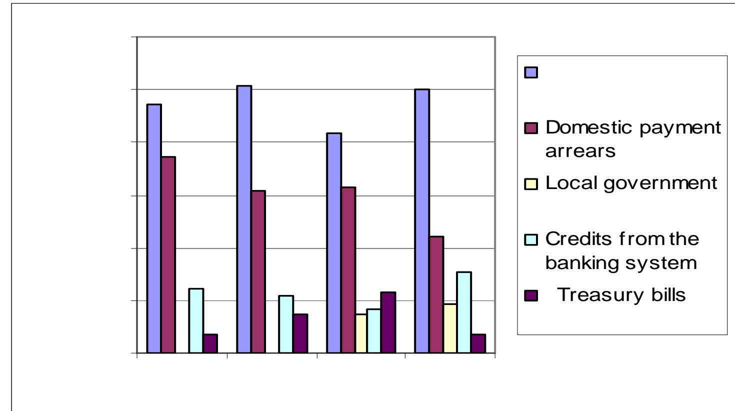
Source: **Ministry of Finance; IMF; Bank staff estimates.**

1.35 **About 50 percent of the domestic public debt is bonds, issued to compensate holders of foreign exchange deposits which had been frozen and confiscated during the early 1990s** (Figure 3.2). Planned repayments up to 2007 represent 6-9 million euros per year (or about 0.5 percent of Montenegrin GDP).The FFCD bonds are traded in stock markets. Upon maturity, the holder may use the securities to pay various taxes, such as turnover,

[14] Because of euroization of the economy, the Central Bank does not print money nor derive any seigniorage revenue. Since seigniorage is zero and the Central Bank is excluded, the measurement of the government's debt position does not net the Central Bank's net foreign asset position.

property, income, corporate and excise taxes. Before maturity, the holder may use the bond--subject to a 2 percent discount--to pay certain medical and funeral costs, but also to buy shares in privatized companies, banks, and state-owned real estate. The annual yields of the bonds have fallen progressively in recent years.

Figure 3.2. Montenegro Composition of Domestic Public Debt, 2002-05



1.36 **Domestic payment arrears, although progressively reduced in recent years, still accounted for about 2.5 percent of GDP in 2005**. Local government debt stood at 1.3 percent of GDP, and the stock of treasury bills represented less than 0.5 percent of GDP, reflecting the recent move by the Government to retire them using some privatization proceeds.

1.37 **Montenegro's public debt dynamics[15] in recent years has been most influenced by debt relief. Over 2002-05, Montenegro's public debt declined** approximately by approximately 50 percent (from 89 percent of GDP in 2002 to 44.5 percent in 2005). This reduction was driven largely by restructuring of debt toward the Paris club and bilateral donors (in 2001, 2003 and 2006) that helped reduce its external public debt significantly. Without debt relief, Montenegro's public debt would have been reduced by less than 10 percent of GDP in the past four years. Montenegro has had a lukewarm growth, low inflation, low real interest rate, and run primary deficits, which together have implied little changes in the (automatic) debt dynamics. In addition, having the euro as its currency, and almost all of its external debt denominated in euro, it has not seen major revaluation effects. On the domestic front, it has recently paid off some of the domestic debt (treasury bills, arrears) using its large privatization proceeds, which has further contributed to declining debt burden. Nevertheless, in view of rising private external debt, external debt sustainability remains a concern. A more detailed discussion of Montenegro's external debt sustainability is provided in Chapter 4.

1.38 **Montenegro's overall indebtedness indicators are comparable to those of its regional peers (Table 3.1)**. The public debt to GDP ratio is lower than that of most countries in the region. It is lower than Albania's and close to Croatia's, while Romania and Latvia have considerably lower ratio. Its liquidity, as measured by interest payments as a percent of GDP or government revenue, too compares favorable to these countries. In 2005, Montenegro's interest payments stood at 1.5 percent of GDP or 3.7 percent of general

[15] The evolution of the public debt stock is influenced by primary balance, an endogenous debt dynamics (that depends on growth of real GDP, real interest rate and real exchange rate movements), other debt creating flows (e.g. privatization proceeds) and a residual. The decomposition helps to identify whether the change in the debt burden indicators is largely driven by fiscal adjustment or results from the behaviors of interest rates, growth rates and/or price and exchange rate movements.

government revenue and grants—much lower than for other countries in the region except Estonia and Latvia.

Table 3.1. Public Debt Comparisons of Montenegro and selected IBRD Countries, 2005

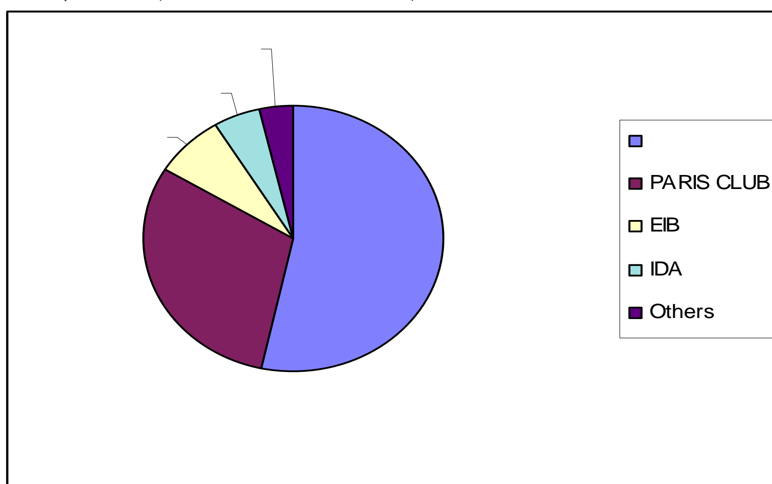
	Montenegro	Albania	Croatia	Bulgaria	Romania	Poland	Estonia	Latvia
Solvency								
Public Debt to GDP	**44.5**	**62.9**	**52.6**	**55.9**	**21.7**	**49.5**	**..**	**15.0**
Liquidity Ratios								
INT to GDP	**1.5**	**4.0**	**2.1**	**1.9**	**2.0**	**2.6**	**0.3**	**0.9**
INT to Revenue	**3.2**	**15.7**	**4.6**	**5.0**	**6.9**	**6.5**	**0.7**	**2.9**

Source: **IMF; WEO (World Economic Outlook) Database; GDF 2005; ECA Regional Tables, August 2005**

B. Evolution of External Debt

1.39 **Montenegro's external public debt was reduced from 33.6 percent of GDP in 2003 to 30.9 percent in 2005 (see Table 3.3).** Of total external public debt, about 85 percent is "old" debt inherited from the former Socialist Federative Republic of Yugoslavia (SFRY),[16] while the remainder has been contracted since 2000. The "old" loans were mostly extended by the International Bank for Reconstruction and Development and Paris Club creditors. "New" external public debt, contracted since 2000, has remained relatively small (15 percent of total), with the debt contracted from the European Investment Bank ($40 million) and from International Development Association ($25 million) being by far the most significant as at end-2005.

Figure 3.3. Montenegro: Composition of External Public Debt, 2005 (in millions of euro)



Source: Montenegrin Ministry of Finance; IMF; Bank staff calculations.
Note: IBRD=International Bank for Reconstruction and Development; EIB= European Bank for Investment; IDA= International Development Association.

1.40 **Most of Montenegro's external public debt is denominated in euro, with a share of euro and dollar denominated debts amounting to 87 percent and 11 percent respectively.** Most of the "old" debts, including the IBRD loans, are denominated in euro (upon inheritance). Of the Paris Club debt, 71 percent is denominated in euro, 26 percent in USD, and 3 percent in other currencies. With the exception of IDA credits (which are denominated in SDRs), all "new" loans contracted since 2000 are denominated in euro. Given the currency composition, Montenegro does not

[16] Since 1983, the former socialist federative republic of Yugoslavia (SFRY) had guaranteed all external public debt, which with its disintegration, had to be apportioned among its constituent republics.

fundamentally face any significant external vulnerability associated with changes in the exchange rates since most of its export earnings and capital inflows are in the same currency (euro) as that of its external debt.

1.41 **With regard to interest rate composition, the bulk of Montenegro's debts are with fixed interest rates**. The share of floating interest rate debt is very small, accounting for less than 15 percent of total external debt. About two-thirds of the old IBRD debt is in fixed terms. Of the Paris Club debt, only about 3.6 percent of the debt value is in variable interest rates (and 96.4 percent with fixed interest rate). Given the low share of the floating rate, the risks of sharp interest rate fluctuations on the real cost of debt are fairly insignificant in Montenegro.

1.42 **Debt relief has been the most important driver of Montenegro's recent external debt dynamics**.[17] Since 2002, Montenegro's net external debt has been reduced by about 20 percent of GDP.[18] The current account balance, FDI and the growth effect, together, would have implied a reduction in external indebtedness of only 9.5 percent of GDP during the same period. As in the case of total public debt, most of the remarkable reduction in external indebtedness was due to debt relief provided by official creditors. The restructuring of debt toward the Paris club and bilateral donors in 2003 helped reduce its external public debt significantly. With a debt write-off to Montenegro of some 26 million euros by the Paris Club creditors in 2006, the external debt position is set to improve even further.

1.43 **Montenegro's external indebtedness indicators, both for solvency and liquidity, compare favorably to the regional peers** (Table 3.2). Its ratio of net present value of total external debt to GDP, at about 29 percent in 2005, is much lower than that of other IBRD countries such as Estonia, Latvia, and Croatia. With the exception of Albania, Montenegro's net present value of external debt as percent of exports of goods and services (63.5 percent in 2005), is one of the lowest in the region. Montenegro's external liquidity indicators, measured by the level of external debt service (3.7 percent) and interest service (2.6 percent), are also lower than Estonia's and Latvia's. Although no comparative cross-country data are available, Montenegro's debt service as a percent of total government revenue remains low at around 10 percent.

Table 3.2. External Debt Comparisons of Montenegro and Selected IBRD Countries (averages for 2002-05)

	Montenegro	Albania	Croatia	Bulgaria	Romania	Poland	Estonia	Latvia
Solvency Ratios								
PV of EDT to GNI	**29.4**	**17**	**110**	**83**	**51**	**45**	**111**	**110**
PV of EDT to XGS	**63.5**	**51**	**194**	**143**	**136**	**121**	**132**	**239**
Liquidity Ratios								
DTS to XGS	**7.8**	**4.0**	**7.9**	**22**	**10.4**	**44**	**20**	**26**
INT to XGS	**2.6**	**1.0**	**4.6**	**5.0**	**4.1**	**4.0**	**5.0**	**6.0**

[17] The evolution of external indebtedness can be decomposed into current account balance, FDI (including equity investment), growth effect, and revaluation effect. For more on this, see Burnside (2003a), Burnside (2003b), and Bohn (1990).

[18] The central bank's foreign exchange reserves are included in the calculation of net debt.

INT to Govt. Revenue	3.2	15.7	4.6	5.0	6.9	6.5	0.7	2.9

Source: **World Bank, Global Development Finance, 2005 (Statistical Appendix)**

1.44 **The government has developed a debt management strategy, which has the objective of lowering public sector debt to less than 35 percent of GDP on average during 2007-11.**[19] The strategy indicates that domestic public debt will be reduced from 12.1 percent of GDP in 2005 to 9.2 percent of GDP in 2007. Gross financing requirements (including budget deficit and repayment of debt minus donations) are expected to remain stable at around 3 percent of GDP. New debt creation, calculated as the difference between gross funding requirements and withdrawal based on already signed loans, is expected to remain small and stable over the medium term.

1.45 **However, Montenegro's private external debt[20] has increased in recent years.** While external public debt has been reduced, private external debt has more than doubled from about 7.1 percent of GDP in 2003 to about 15.7 percent in 2005. The rising private external debt adds to the concern about external debt sustainability in Montenegro.

[19] See www.vlada.cg.yu/eng/minfin/vijesti.php?akcija=rubrika&rubrika=187 for more on the strategy. The strategy looks a bit out of date in light of new fiscal and other macroeconomic developments, but an effort to up date the strategy is underway.

[20] Data on private external debt are unreliable.

Table 3.3. Public Debt of Montenegro, 2002-05 (End-period stock; in millions of euro)

	2002 Est.	2003 Est.	2004 Est.	2005 Est.
Domestic	269.7	269.9	318.5	225.2
Treasury bills	9.6	19.5	36.6	7.9
Frozen foreign currency deposits	127.0	137.2	132.9	112.5
Domestic payment arrears	100.6	83.5	99.7	49.5
Local government	…	…	23.0	20.9
Credits from the banking system	32.5	29.6	26.3	34.4
Foreign	897.6	467.9	494.7	511.7
Debt accrued up to 1999	883.2	441.9	434.6	435.5
IBRD	...	...	267.9	267.9
PARIS CLUB	...	...	152.5	152.5
IFC	...	...	9.6	9.6
Council of Europe Development Bank (CEB)	...	...	3.2	3.2
Other			1.3	2.2
Bank Handlowy (Citigroup)	...	...	0.3	0.3
Anglo Yugoslaw Bank	...	...	1.0	1.0
Other			-1.3	-1.3
Debt accrued from 2000	14.4	26.0	60.2	76.2
EIB	6.0	10.0	22.4	40.0
IDA	0.0	7.6	22.3	25.2
EBRD	0.0	0.0	1.3	1.6
EU	4.0	4.0	4.0	5.5
KfW	4.4	4.9	5.1	5.2
Amortization (unspecified)	0.0	-0.5	5.1	-1.4
Memorandum items:				
Total public debt (in percent of GDP)	89.7	53.0	53.0	44.5
Domestic	20.7	19.4	20.8	13.6
External	69.0	33.6	32.2	30.9
Public enterprise foreign debt (guaranteed)	0.0	0.3	0.8	2.0
Total government deposits (percent of GDP)		1.8	1.4	4.6

Source: Montenegrin Ministry of Finance; IMF; and Bank staff estimates.

IV. PUBLIC AND EXTERNAL DEBT SUSTAINABILITY (2006-15)

1.46 **This chapter assesses Montenegro's public and external debt sustainability under alternative scenarios**, in particular a base case and low case scenarios. For each scenario, a set of long-term macroeconomic projections is made, providing the basis for the debt sustainability analysis and allowing the key debt indicators to be compared. In addition, under the baseline scenario, sensitivity analysis is conducted in order to highlight the vulnerability of the baseline scenario to specific shocks.

1.47 **This debt sustainability analysis adopts as its base case a more conservative medium term scenario than that projected by the IMF.**[21] The main differences between the IMF medium term framework and the baseline scenario have to do with a more moderate growth outlook (5 percent vs. 6.5 percent), and a more moderate private sector investment (24 percent vs. 27.5 percent), current account deficit (10.3 percent vs. 14.5 percent), and foreign direct investment (10.6 percent vs. 22.2 percent). The baseline reflects a mid-case scenario where structural reforms would not be so strong as implicitly assumed under the IMF framework due to institutional and human resource constraints in Montenegro.

- **GDP growth**: The base case assumes that Montenegro's economy will grow by an annual rate of 5 percent instead of the 5.5 -7 percent projected by the IMF. A moderate pace of structural reforms will cause the private sector response in terms of investment to be somewhat less than that projected by the IMF. Hence, private investments (including FDI) as well as exports growth will be more moderate over 2006-16.

- **Inflation and fiscal policy**: The inflation and fiscal policy projections in base case are the same with that of the IMF medium term framework– low and stable inflation rate (2-3 percent per annum) will prevail, and the government will maintain a tight fiscal policy stance.

- **Balance of payments**: The BOP projections for the base case envisage lower current account deficits (after grants) compared to the IMF medium term framework, with most of the differences coming from more moderate growth rates in exports and imports, and a much lower FDI under the baseline compared to the IMF framework.

1.48 **The analysis here uses the standard framework for fiscal sustainability for market access countries**, developed by the economic policy and debt group of the World Bank. The framework builds on previous work and new developments in the area, [22] and

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[21] Note that the IMF medium term framework covers only the period 2006-11, while this DSA covers 2006-16. Where comparisons of macro aggregates are made, they are both averages for the period 2006-11.

[22] For a theoretical exposition of the framework, see Burnside (2003a), Burnside (2003b), and Bohn (1990). Additional papers are also available at http://www wbweb.worldbank.org/prem/prmep/economicpolicy/mv/documents_mvfs.asp

includes an Excel-based template, accompanied by a technical manual to facilitate easy application.[23]

1.49 **The rest of the chapter is organized as follows**. Section A provides an assessment of public debt sustainability. The section begins with a description of the main assumptions and evolution of macroeconomic aggregates under the baseline scenario. It then presents the results under the base case, and subject the baseline to a variety of sensitivity analyses. Three scenarios are considered: a scenario where key macroeconomic variables are assumed to remain at their historical average, a full-fledged low case scenario where reforms are considerably slowed down relative to the baseline, and bound tests whereby we consider the impact on debt solvency and liquidity of temporary adverse deviations in key parameters from the baseline projections. Section B provides an analysis of external debt sustainability under the base case, and stress-tests it for a variety of alternative scenarios.

A. PUBLIC DEBT SUSTAINABILITY

Assumptions and Evolution of Macroeconomic Aggregates under the Baseline

1.50 **The baseline reform scenario assumes real GDP will grow by 5 percent per annum, supported by solid private investment and exports growth**. On the demand side, public and private consumption will remain steady but investment will grow slowly from 22.6 percent of GDP in 2006 to about 24.6 percent in 2016. Gross national savings will rise from about 12 percent of GDP in 2006 to 16 percent of GDP in 2016, with most of the growth coming from private saving. Exports of goods and services are projected to grow by an average of 8.6 percent of GDP over 2006-16, driven largely by tourism and a stable contribution of aluminum.

1.51 **Sustaining a high growth momentum will require the continuation (but progressive decline) of foreign direct investment, low and stable inflation, prudent fiscal policy, and continued implementation of structural reforms** in the labor market and business environment to improve the economy's flexibility. The recent surge in FDI, fueled in part by privatization of state owned enterprises, is likely to continue through 2008, after which it is assumed to decline as the privatization agenda of the government comes to completion. However, the decline in FDI over the medium term would be compensated by rising private domestic investment, so that total investment remains steady. The detailed projections and evolution of macroeconomic aggregates under the base case are provided in Annex 1.

1.52 **On the structural side, the 5 percent average growth over 2006-2016 will crucially depend on a number of reforms**, including (i) making the labor market more flexible and reducing payroll tax rates; (iii) continued business environment reforms; and, (iii) increasing investment in public infrastructure to better support private sector investment,

[23] See "Technical Manual of the Fiscal Sustainability Analysis Template", by Luca Bandieri, Nina Budina, Michel Klijn and Sweder van Wijnbergen, July 2006.

in particular in tourism development. These measures will be key to attracting private investment (FDI in particular) and enhancing private sector-led growth and employment in Montenegro.

1.53 **In the labor market, wage growth will be brought under control and dismissal costs will be reduced**. Wage growth will be restrained by keeping nominal wage settlements in line with developments abroad and protecting Montenegro's competitiveness. Payroll taxation will also be reduced in a fiscally responsible way – i.e., compensated by equivalent increases in cuts in expenditures—to encourage formal private sector employment and growth. With respect to the business environment, there will be considerable progress in enterprise privatization and restructuring, improving the functioning of the bankruptcy system, and improving land title transparency and property rights (mainly through the restitution process), especially along the coastal tourism sites, in order to reduce risks to investors and attract FDI. In parallel, the government will continue to make modest but steady improvements in public infrastructure in the coastal tourism areas, including more investment in water and sanitation, roads, and waste management.

Box 4.1. Montenegro: Data quality limitations and their implications for the DSA

This DSA is based on serious data limitations. Montenegro's statistical system is weak, basic macroeconomic data are not available or are not timely, and their compilation does not fully comply with international standards. The key problems relate to national accounts statistics, balance of payments, and debt data.

- **National Accounts.** National accounts statistics are compiled and published by MONSTAT, the statistical agency of Montenegro. Overall, there are no timely national accounts data (the latest available data are for 2004), their quality is poor, and the data sources are in need of improvement. While recent real GDP growth rates have been estimated by the Development Secretariat, the method of estimation is non-transparent and probably does not meet the System of National Accounts (1993 SNA) standards.

- **Balance of Payments.** Balance of Payments data, particularly estimations of trade in goods and services, and remittances are still very weak and not totally reliable. Further, capital account estimates such as Foreign Direct Investment are not reliable. The unreliability of these data adds considerable uncertainties to the projections of the external financial requirements.

- **Public and Private Debt.** Similarly, both public and private debt data are not complete and accurate. No good estimates are available for some components of domestic public debt (e.g. municipal debt and restitution claims), and the external debt allocation between the Republic of Serbia and the Republic of Montenegro is currently ongoing. On private debt, the Central Bank of Montenegro has not yet established a sound monitoring system and available data are only rough estimates.

Clearly, with better quality of national, BOP, and debt statistics, the underlying macroeconomic projections, and the ensuing simulations of Montenegro's public and external indebtedness analysis could be improved.

1.54 **On the fiscal front, Montenegro will continue to pursue tight fiscal policy, especially through expenditure cuts**. The continued strong performance in revenue on the one hand and expenditure cuts on the other will enable to implement crucial growth oriented fiscal reforms (such as personal income tax cuts, modest payroll tax reduction, and a modest increase in public investment in infrastructure). Medium term expenditure cuts will focus on wage bill, transfers to households and public enterprises, and interest payments. These cuts

will enable the authorities both to reduce the remaining deficit and create fiscal room for increased public investment in infrastructure. Domestic public investment will thus improve to about 4 percent of GDP over 2007-11, but will remain steady at an average of about 3.7 percent of GDP afterwards. The slow improvements in capital expenditure reflect the limited institutional capacity of the government to design and implement capital projects without waste.

1.55 **The medium term fiscal policy outlook under the baseline envisages that the primary balance would initially deteriorate from a surplus of 0.8 percent of GDP in 2006 to a deficit of about 2 percent in 2008 (due mainly to the assumed introduction of second pillar pension), but would steadily improve to a surplus of 0.7 percent of GDP in 2016**. While this may seem ambitious, it is feasible and consistent with Montenegro's maintenance of current policy. This fiscal adjustment scenario is consistent with the government's first economic and fiscal program, prepared in the context of its EU integration ambitions. As with all potential candidate countries (Bosnia, Albania, Montenegro and Serbia), the EU will undertake a regular monitoring and assessment of Montenegro's fiscal program—as does the IMF if a new program is agreed—which would also continue to strengthen the incentives for continued tight fiscal policy by the government.

1.56 **Government liabilities associated with restitution claims have the potential to raise domestic debt significantly over time.** The government started implementing the restitution law, which mandates compensation or restitution for land owned prior to nationalization, in 2005. The restitution committees have, as of end-November 2006, granted 52 million on 238 claims with over 8,700 further claims outstanding. The outstanding claims could easily be more than the existing debt stock, even assuming that the earlier claims were for the best properties. Under the baseline scenario, we assume that the rise in the restitution liabilities will be moderate, amounting to an increase of 50 million (or US$65 million) a year over 2007-11.

1.57 **On the external front, the current account balance will deteriorate up to 2010, but will start to improve afterwards.** Exports of goods and services will increase by an average of 8.6 percent and imports by 6.5 percent of GDP per year, resulting in gradual improvements in resource balance. Private remittances will decline from about 12 percent of GDP in 2006 to about 5 percent in 2016, mainly because of GDP growth (denominator), while official grants will decrease from 0.2 percent of GDP in 2006 to zero by 2010, where it will stay afterwards.

1.58 **Montenegro's external financing requirements will modestly rise over the next few years**. Total external financing requirements (for both private and public sectors) are projected to rise from US$ 377 million in 2006 to about US$ 439 million in 2016, but most of these financing needs are projected to be covered by non-debt-creating flows. Annual FDI flows, including from privatization, will remain high until 2008, but will decline afterwards mainly because the bulk of government's sale of main state-owned enterprises will wind up by 2008. In view of the declining FDI overtime, total net disbursements, including to the private sector, will increase (see Annex 1).

Table 4.1. Montenegro: Total Public Sector Financing Requirements under the Baseline, 2006-16 (in millions of US dollar)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Fiscal Financing											
Foreign Sources	20	5	0	-6	-6	-6	3	0	-4	-4	0
External Financing											
Gross Disbursements	37	29	29	30	31	35	52	55	63	68	74
Amortization	8	12	15	18	19	20	22	25	28	31	34
Net Foreign Borrowing	29	17	14	12	13	15	30	30	35	38	40
Total Fiscal plus External	22	14	6	6	9	33	30	31	33	40	22

Source: Bank Staff projections. See Annex 1 for more details.

1.59 **Financing requirements of the public sector will remain small (Table 4.1).** On the fiscal side, the budget sector needs little or no foreign financing for the foreseeable future. However, on the balance of payments side, net public sector borrowing would decrease from US$ 29 million in 2006 to US$ 12 million in 2009, but would slowly increase to $35 million in 2016.

- Most of the new borrowing in the initial years comes from multilateral agencies (assumed to be mostly IBRD), with an average of about $10 million every year up to 2012, and about $15 million per year after 2012. The terms of these loans are assumed to be as follows: 7.75% interest rate with a Grace Period of 5 years and repayment over 17 years.
- New borrowing from bilateral creditors starts in 2010 from a modest $2.5 million and increases to around $10 million by 2016. The terms of these loans are assumed to be as follows: 3% interest rate with a Grace Period of 6 years and repayment period of 22 years.
- Finally, we assume that the public sector starts to borrow new loans of $2.5 million from private creditors in 2011, which increases to $10 million by 2016. The terms of these loans are assumed to be as follows: 8% interest rate with a Grace Period of 1 year and a repayment period of 6 years.

1.60 **Montenegro's cost of borrowing has historically been very low, and the real interest rate is assumed to increase slowly under the baseline**. The bulk of domestic debt—bonds issued to compensate holders of Frozen Foreign Currency Deposits (FFCDs)—were issued at zero nominal interest rate, while the external debt has been highly concessional with an average real interest rate on foreign debt of only 0.8 percent. Due to high inflation until 2003, and the large initial level of debt denominated in local currency (the euro), the average real interest rate over 2002-2005 was a negative 5.1 percent. Going forward, the real interest rate on domestic debt is going to increase very slowly (thanks in large part to the zero nominal interest rate on both FFCDs and restitution claims bonds), rising to an average of 2 percent under the baseline. Similarly, the average real interest rate on foreign debt will remain low at 2.1 percent under the baseline, reflecting the relatively small impact of the projected new loans with much higher interest rate. Overall average real interest rate on both domestic and external debt would be positive at 1.8 percent under the baseline.

Public Debt Sustainability under the Baseline

1.61 **Fiscal sustainability requires that discounted present value of future government's primary balances be at least equal to the current debt-to-GDP ratio**. Since the present value is computed using the interest rate net of the economy's growth rate, it requires assumptions to be made regarding the likely future values of the real interest rate and the real growth rate of the economy. As discussed above, the average long-run growth of the economy under the base case is 5 percent. As for the real interest rate, Montenegro currently relies heavily on concessional borrowing, and interest rates on its existing and soon to be issued debt are probably not indicative of market forces.[24] However, under the terms outlined above of public sector borrowing from multilateral, bilateral, and private sector sources over the coming years, the average real interest rate is projected to reach about 3 percent per annum on account of the government taking on a higher proportion of debt on non-concessional terms.

1.62 **Under the above baseline assumptions and projections, Montenegro's public debt solvency improves over time.** The total public debt to GDP ratio declines by about 12 percent of GDP (from 41 percent to 29 percent) over 2006-2015. The considerable decline in the debt trajectory is due not only to Montenegro's relatively high growth, but also because it continues to maintain a fiscal policy that eliminates most of the current primary deficit, and because net foreign borrowing of the public sector remains very small (with net pay down up to 2012 and small borrowing afterwards) throughout the period.

1.63 **Liquidity indicators also improve over time** (Table 4.2).Under the baseline scenario, the budgetary sector requires no gross *fiscal* financing for the foreseeable future, in part because of the large privatization proceeds received in recent years as well as some more privatization revenues anticipated through 2008. Under the baseline scenario, gross public financing need, defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at the end of previous period, also declines from about 8.4 percent of GDP in 2006 (about US$ 200 million) to under 6 percent of GDP in 2015 (see Table 4.2.) Thus, overall liquidity considerably improves as public debt-to-revenue ratio declines from about 99 percent in 2006 to about 71.5 percent in 2015—a decline of 28 percent. Furthermore, since almost all existing and anticipated public debts are of long-term nature, the country faces very little roll-over risk from short term debts.

[24] Montenegro currently has BB rating with a positive outlook from Standard and Poor's, which might allow it to issue 10 year foreign bonds with a spread of just below 200 basis points.

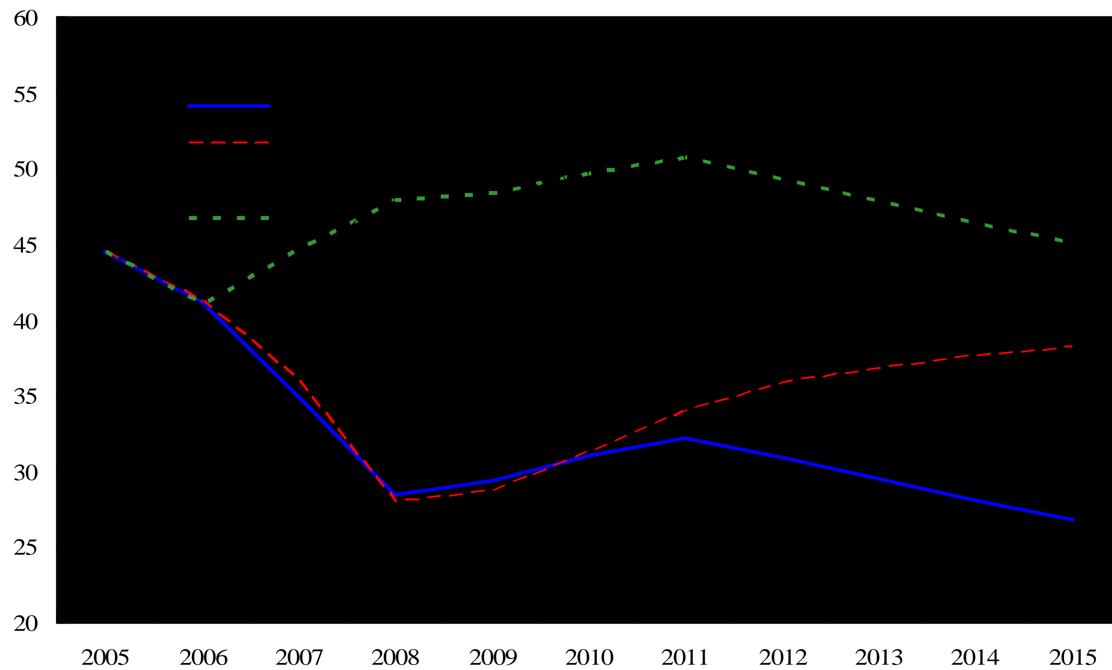
Table 4.2: Montenegro Public Sector Debt Sustainability Framework, 2006-2015

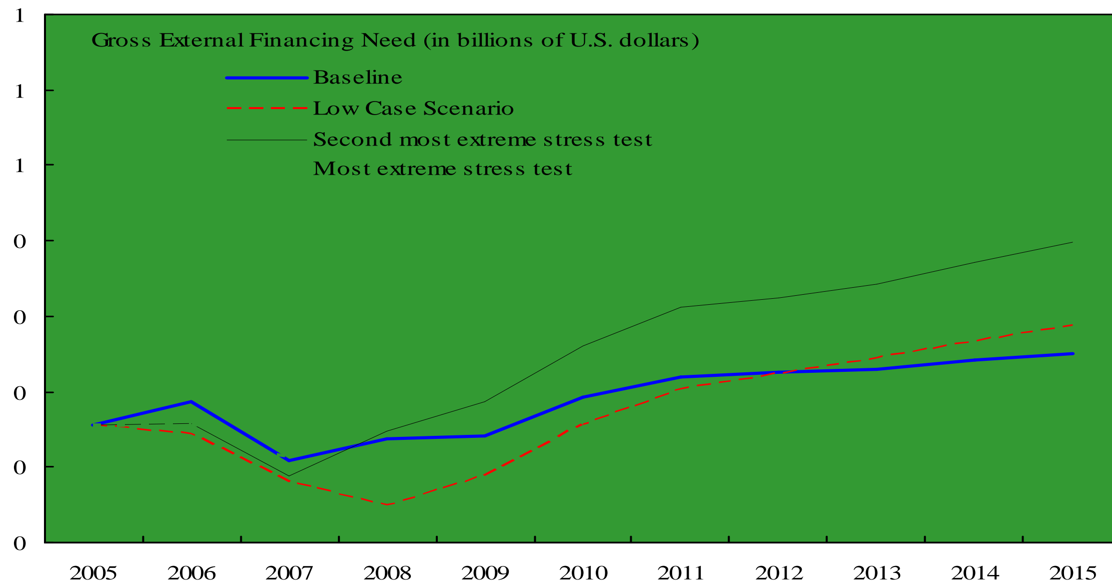
(In percent of GDP, unless otherwise indicated)

	Actual				Projections									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
					I. Baseline Projections									
Public Sector Debt 1/	**89.7**	**53.0**	**53.0**	**44.5**	**41.0**	**35.1**	**28.9**	**29.8**	**31.5**	**32.9**	**31.9**	**30.8**	**29.8**	**29.0**
Public Sector Debt-to-Revenue Ratio 1/	241.4	130.3	130.3	110.6	99.1	83.8	72.8	75.1	82.3	85.9	82.2	78.4	74.9	71.5
Primary Deficit that Stabilizes the Debt-to-GDP Ratio	4.8	40.4	1.1	9.3	2.4	4.3	7.0	-1.1	-1.4	-1.2	0.7	0.7	0.7	0.7
Gross Financing Need 2/	**4.5**	**7.4**	**5.1**	**7.6**	8.4	4.5	5.2	5.0	6.4	6.8	6.5	6.2	6.1	5.9
In billions of U.S. Dollars	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.3
A. Alternative Scenarios					**II. Stress Tests for Public Debt Ratio**									
A1. Key variables are at their historical averages in 2006-15 3/					43.5	40.3	34.0	36.5	39.0	41.3	41.1	40.8	40.5	40.3
A2. Low Case Scenario—No Reform 4/					41.0	36.4	30.9	33.8	38.1	44.0	46.3	48.2	50.2	52.2
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2007 and 2008					41.0	35.1	28.9	29.8	31.5	32.9	31.9	30.8	29.8	29.0
B2. Real GDP growth is at historical average minus two standard deviations in 2007 and 2008					41.0	38.0	35.9	40.2	45.3	49.9	51.8	53.5	55.3	57.1
B3. Primary balance is at historical average minus two standard deviations in 2007 and 2008					41.0	41.3	38.6	39.3	40.7	41.7	40.2	38.5	37.0	35.4
B4. Combination of 1-3 using one standard deviation shocks					41.0	40.7	37.1	38.0	39.6	40.7	39.3	37.7	36.2	34.7
B5. 10 percent of GDP increase in other debt-creating flows in 2007 and 2008					41.0	44.7	47.9	48.4	49.7	50.7	49.3	47.8	46.4	45.2

1/ Public debt is defined as consisting of central government (republican, and pension, health and employment funds) gross debt, including domestic payment arrears, and local government debt, but excluding the Montenegro Development and Restitution Funds and public enterprises.
2/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
3/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
4/ The implied changes in macroeconomic and other key variables under this scenario are discussed in the text, and the corresponding projections provided in Annex 2.

Figure 4.1. Montenegro: Public Debt Ratio and Gross External Financing Need, 2005-15





Note: For public debt ratio, the most extreme test is a "10 percent of GDP increase in debt creating (e.g. restitution debt) flows, while the second most extreme test is the real GDP growth shock. In terms of gross external financing need, the most extreme test is the real GDP shock , while the second most extreme test is a 10 percent of GDP increase in restitution debt.
Source: Staff calculations.

Sensitivity Analysis of Public Debt

Scenario 1: Key Variables are at their Historical Average

1.64 In this scenario, the key drivers of debt dynamics are assumed to stay at their historical averages. Since Montenegro does not have reliable economic data prior to 2002, estimates for 2002-05 are used for historical averages and standard deviations. Real output growth is thus lower, set at 3 percent per year as compared with about 5 percent per year under the baseline, while the real interest rate is negative, -5.1 percent, compared with about 2.2 percent under the base case.[25] Table 4.2 provides the assumptions pertaining to the historical scenario and how they compare with the baseline scenario.

1.65 **The resulting public debt dynamics under the historical scenario is much less favorable, as public debt to GDP declines by only about 3 percent of GDP over 2006-15.** Furthermore, the ratio first sharply declines from 41 percent of GDP in 2006 to about 34 percent in 2008, but slowly rises to about 40 percent in 2015 due mainly to the low growth, but also because of lack of strong fiscal adjustment that keeps the primary deficit higher by about 1 percent of GDP relative to the baseline.

Table 4.3. Key Macroeconomic Assumptions for the Historical Scenario

	Historical		Baseline Average	Low case Average
	Average (2002-05)	Std. Deviation	(2006-15)	(2006-15)
Real GDP growth (in percent)	3.0	1.2	5.1	3.3
Average real interest rate	-7.7	12.1	1.8	2.0
Average real interest rate on public domestic debt (nominal rate minus change in CPI, in percent)	-5.1	3.4	2.0	2.0
Average real interest rate on forex debt (nominal rate minus change in CPI, in percent)	0.8	1.4	2.1	2.4
Change in the real exchange rate (Local currency per US dollar) 13/	-8.8	16.1	-0.3	-0.3
Inflation rate (in percent)	5.4	3.2	2.3	2.3
Growth of real primary spending (deflated by CPI, in percent)	5.6	8.4	4.1	3.6
Primary deficit	1.6	1.4	-0.5	0.2

1.66 **However, one may reasonably argue that the last four years represented an early period of transition in Montenegro and that past performance, especially in terms of growth, may not be a good predictor of the future**. A better alternative may be to specify a full-fledged

[25] A low case scenario below combines a positive real interest rate with a slow growth and deteriorating fiscal path similar to that under the historical case to derive debt solvency and liquidity ratios.

low-case scenario, underpinned by transparent and explicit assumptions about key macroeconomic policies and aggregates. The next section presents such a case.

Scenario 2: Low Case Scenario—Weak Reform

1.67 **In the low case scenario, the government does not pursue, for lack of political will or other reasons, far-reaching structural reforms needed to spur private investment and growth**. Several structural reforms key to attracting private investment will therefore remain unimplemented over the medium term. The labor market will remain inflexible, payroll taxes will remain high, and some key barriers to private investment (licensing, bankruptcy, speedy resolution of commercial court cases, and protection of property rights) will remain unaddressed. In addition, investment in public infrastructure, a key element for supporting tourism development and private investment in the coastal areas, will not increase. The detailed projections and evolution of macroeconomic aggregates under the low case are provided in Annex 2.

1.68 **Real GDP growth will thus be considerably lower than under the baseline and will progressively decline from its peak of 5.5 percent in 2006 to 2 percent by 2012, where it will stay afterwards.** Investment will decline from its peak of 23 percent of GDP in 2006 to 20 percent in 2012, where it will stay afterwards. The growth in exports of goods and services will also be considerably slower relative to the base case scenario (an average of about 4 percent over 2006-16 under the low-case versus 8 percent under the base case), reflecting largely the slow private investment and response.

1.69 **On the fiscal front, general government fiscal balance will deteriorate from a deficit of 0.4 percent of GDP in 2006 to a deficit of 3.2percent of GDP in 2016.** The weak reform scenario assumes that fiscal reform is weaker. The primary balance is assumed to fall from a surplus of 0.8 percent of GDP in 2006 to a deficit of 1.8 percent in 2016. There will be little or no medium term expenditure cuts, and as a result, the overall deficit will remain higher than under the baseline (1.2 percent by 2016 under the low case versus 0.1 percent under the base case) and the authorities' ability to create fiscal room for public investment in infrastructure more limited. Domestic debt, driven by high restitution liabilities, is assumed to increase by US$100 million per year over 2007-11. Even under this low case scenario, however, there will be little external financing of the government's budget deficit until 2011 but a progressive increase in financing requirements for the budget afterwards (of about 2.5 percent of GDP) which is assumed to be financed mostly through domestic sources.

1.70 **On the external side, the lower investment and GDP growth means that the current account balance will not deteriorate as sharply as under the base case**. Both exports and imports of goods and services will grow by a slower pace relative to the base case, and private remittances will decline, thereby resulting in more moderate improvements in the current account deficit from about 11 percent of GDP in 2008 to about 6 percent in 2016. On the capital account side, FDI will progressively decline and net foreign loans (by both public and private sector) will nearly double over 2006-2016. Net foreign loans of the public sector will increase from about $US29 million in 2006 to about $US40 million in 2016, with similar terms and composition assumed under the baseline scenario above.

1.71 **Under this weak reform scenario, Montenegro's favorable downward trajectory of debt-to-GDP ratio is reversed.** Public debt ratio declines up to 2008 (because of the assumed progressive but slow decline in real GDP growth in the early years), but continues to increase afterwards. The total public debt to GDP ratio declines to about 33.8 percent by 2009, but slowly rises to 52.2 percent in 2015, jeopardizing long-term debt sustainability. The resurgence in debt ratio is due Montenegro's slow growth, positive real interest rate, higher restitution debt, and because the government will run a higher primary deficit relative to the base case (Table 4.3). Liquidity indicators improve at a much lower pace than under the base case, as public debt-to-revenue ratio declines only slightly from about 99 percent in 2006 to about 95 percent in 2015, and gross public financing need initially declines but climbs back to about the same percent of GDP in 2015 as in 2006 (6 percent). The weak reform scenario illustrates the importance for the government to stick to the current tight fiscal policy path over the medium term, without which the sustainability of public debt is clearly jeopardized.

Scenario 3: Bound Tests

1.72 **These tests consider the impact on solvency and liquidity of temporary adverse deviations in key parameters from the baseline projections**.[26] Information on market expectations of economic developments is rarely available for Montenegro, which leaves judgments on sources of economic vulnerability as the main basis for carrying out such sensitivity tests. In the case of Montenegro, important country-specific shocks may be the following:

- **Increases in real interest rate:** Montenegro's real interest rates, while currently low due to the high share of cheap domestic and concessional foreign loans, are projected to reach 3 percent per annum on account of the government taking on a higher proportion of debt on non-IDA terms. Montenegro's historical average real interest rate was -7.7 percent, while the historical standard deviation was 12.1 (see Table 4.3). The shock assumed here is therefore that real interest rate will be 16.6 percent (= -7.7 + (2*12.1)) in 2007 and 2008.

- **Lower GDP growth and/or deterioration in primary balance**: Montenegro's exports of goods and services remain largely dominated by exports of tourism (which accounts for 29 percent of exports of goods and services) and of aluminum (25 percent of the total value of exports of goods and services). This means that the country is highly vulnerable to export shocks such as tourism reversals (which could happen for a variety of global or local reasons) or a significant decline in aluminum

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[26] For stress testing, the template specifies two-year, two-standard deviation shocks to the main macroeconomic variables (see Table 4.2 above for historical standard deviations) as well as a one-standard deviation combined shock, which mimics the typical pattern observed in debt crises situations. In addition, the public debt template includes a contingent liability shock of 10 percent of GDP and a one-time 30 percent real exchange rate depreciation. Given that Montenegro uses the euro as official currency, the 30 percent real exchange rate depreciation may not be a very relevant case, and as such has been excluded for the discussion here.

prices. One way to think about such a negative export shock (e.g. tourism reversal) may be through its adverse impact on economic growth and/or adverse effects on tax revenue and therefore on the primary surplus.[27] Montenegro's historical average GDP growth and primary balance were, respectively, 3 percent and -1.6 percent, with their respective standard deviations over 2002-05 of 1.2 and 1.4. The shocks assumed here are: (a) a real GDP growth of 0.7 percent in 2007 and 2008 (considerably lower than the base case of 5 percent); (b) a primary deficit of 4.5 percent of GDP in 2007 and 2008; and, (c) a combination, whereby real GDP will grow by 1.8 percent in 2007-08 and the primary deficit will be 3 percent of GDP in 2007-08.

- **Uncertainties about the size of public debt, in particular restitution debt**: As pointed out previously, Montenegro's stock of outstanding public debt is still unclear due to lack of good estimates on the full potential liabilities arising from the ongoing restitution claims by citizens, and weak information on debt of public enterprises and local governments. In addition, there are plans to compensate for frozen foreign currency deposits held by Montenegro citizens in other ex-Yugoslav republics and other debt stock adjustments.[28] These would suggest that it would make good sense to simulate the impact on sustainability of a potential surfacing of new restitution debt of 10 percent of GDP each year in 2007 and 2008, which adds significantly to the public debt burden.

1.73 **The stress tests suggest that Montenegro's debt dynamics are particularly susceptible to a sudden escalation of restitution debt and to a negative growth shock** (Table 4.2). If the restitution debt, whose magnitude is not clearly known at the moment, suddenly escalates to as much as 10 percent of GDP for two consecutive years (2007 and 2008), the debt to GDP ratio shoots from 41 percent to about 51 percent by 2011, after which the impact wears off and the ratio declines to 45 percent by 2015 (but still higher than the starting point). Confirming Montenegro's high vulnerability to a negative growth shock, public debt becomes unsustainable in the case where real GDP growth slows down to 0.7 percent in 2007-08. Indeed, the analysis implies that a temporary export shock or tourism reversal or any other shock which causes a GDP growth to slow down to less than 2.8 percent for two consecutive years will lead to an unsustainable public debt position.

1.74 **For the other tests, public debt solvency deteriorates in the early years, but it remains broadly sustainable over the medium term**. This is

[27] The template does not lend itself to explicitly simulating the impact of a negative export shock on public debt sustainability. One needs to either calibrate such a shock in the underlying macroeconomic projections, or assume that the shock will lead to a lower growth and/or deterioration in the primary surplus. See the next section on external sustainability for a direct simulation of the impact of a negative export shock.

[28] Montenegro's debt to Italy increased by 12.5 mil following the implementation of the Paris Club agreement due to the capitalization of interest payments. With the breakup of the State Union of Serbia and Montenegro, Montenegro has assumed its share (5.88 percent) of debt owed to Kuwait (US$22.2 mil), Libya (US$2.7mil), and Czech Republic and Slovakia (US$1 mil).The government has also taken over debt from the state-owned company Railways of Montenegro (15 million) owed to EIB.

true for both the real interest rate shock and the primary balance. If the primary balance deteriorates to a deficit of 4.5 percent of GDP in 2007 and 2008, the debt to GDP ratio gradually declines to about 35 percent in 2015. Similarly, a combination shock, in which growth slows down (to 1.8 percent) and primary balance deteriorates (to 3 percent deficit) does not cause public debt to increase over time.

B. EXTERNAL DEBT SUSTAINABILITY

1.75 In the case of Montenegro, given the "euroization" of the economy, fiscal sustainability/ public debt sustainability may admittedly be more important from a policy standpoint. However, given the significant and rising external private debt, which in 2005 was slightly larger than the domestic public debt, external sustainability analysis may also provide additional insights into debt sustainability.

External Debt Sustainability under the Baseline

1.76 Analogous to the condition for public debt sustainability, a long-run external sustainability requires that the primary current account balance (the balance excluding interest payments, which is net exports of goods and services plus net transfer payments), plus net foreign direct investment, must not be less than the annuity value of the net stock of external debt.

1.77 The analysis of external debt sustainability is based on the same baseline macroeconomic framework and projections, discussed in the previous section. A summary of the baseline average values for the key drivers of external debt dynamics --non-interest current account balance, net FDI, real GDP growth, and GDP deflator –are provided in Table 4.4 below.

Table 4.4. Assumptions for Baseline and Low Case Scenarios

	Historical (2002-05)		Baseline Average	Low Case Average
	Average	Standard Deviation	2006-15	2006-15
Non-interest current account balance (in percent of GDP)	-7.4	1.8	-6.6	-6.2
Real GDP growth	3.0	1.2	5.1	3.3
GDP deflator in U.S. dollars	13.5	9.4	2.4	2.4
Export growth (US dollar terms, in percent)	19.8	31.9	11.7	7.3
Net transfers to GDP ratio	13.8	2.7	8.1	8.5
Net non-debt creating flows (FDI) to GDP ratio	8.9	9.3	7.3	6.1

1.78 **Under the above baseline assumptions, Montenegro's external debt burden indicators improve over 2006-15 (Table 4.5, Figure 4.2).** The net present value (NPV) of PPG external debt-to-GDP ratio declines from 26.8 percent to 13.1 percent—approximately by half. The NPV of external debt-to-exports ratio declines from 54 percent to about 23 percent.

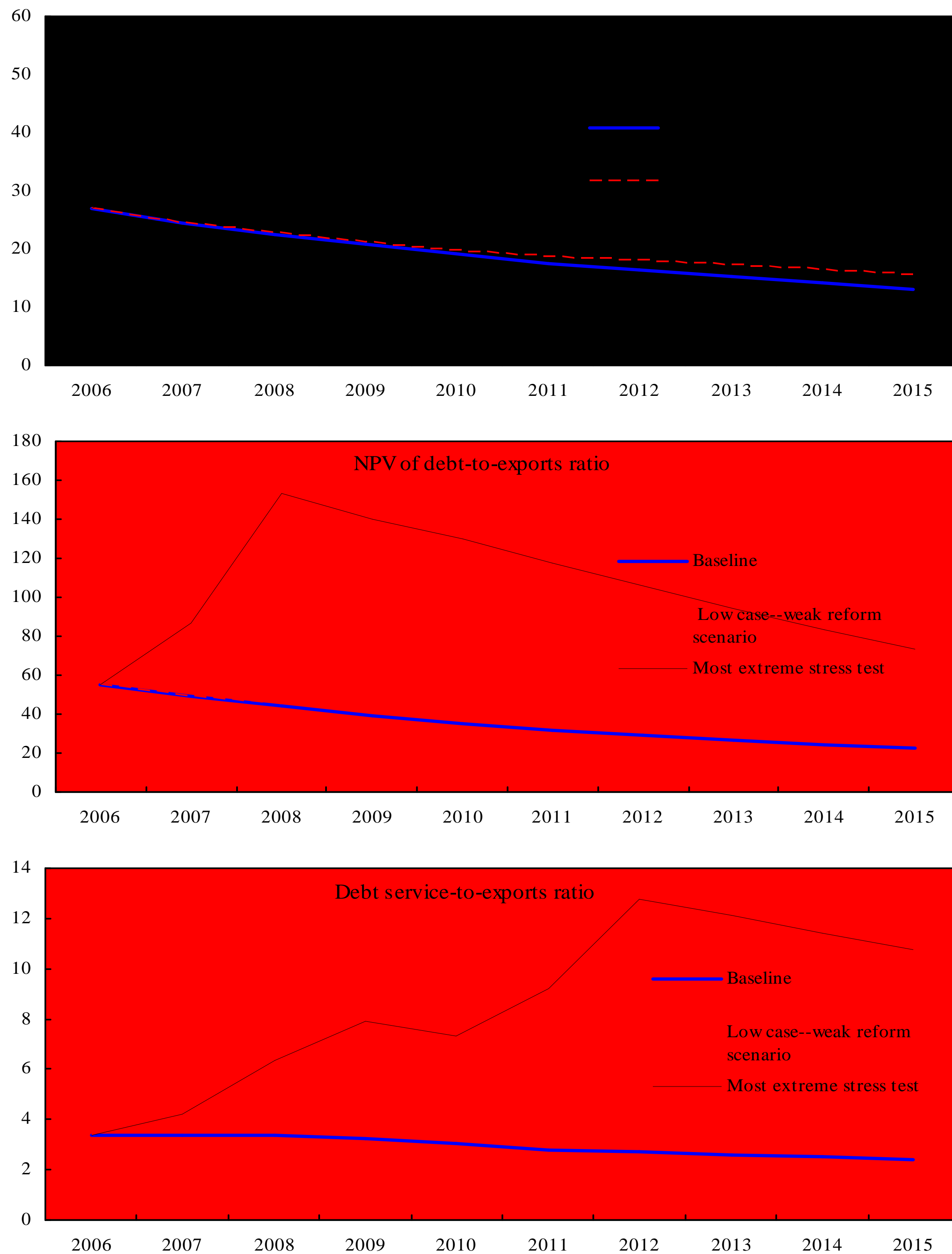
Table 4.5: Montenegro External Debt Sustainability Framework, Baseline and Alternative Scenarios, 2006-2015

(In percent of GDP, unless otherwise indicated)

	Actual				Projections									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
					I. Baseline Projections									
External debt (nominal) 1/	**49.6**	**44.8**	**46.9**	**45.6**	**46.7**	**44.8**	**44.0**	**45.6**	**44.4**	**44.2**	**46.0**	**47.4**	**48.6**	**49.4**
o/w public and publicly guaranteed (PPG)	49.6	36.5	34.7	29.4	28.1	26.1	24.1	22.2	20.5	19.0	17.8	16.6	15.4	14.3
NPV of external debt 2/	...	...	...	44.9	45.4	43.1	42.5	44.1	43.0	42.8	44.7	46.1	47.4	48.2
In percent of exports	...	...	...	99.4	93.0	85.8	83.4	83.6	79.4	76.7	79.5	81.2	82.5	83.2
NPV of PPG external debt	**...**	**...**	**...**	**28.7**	**26.8**	**24.5**	**22.6**	**20.7**	**19.1**	**17.6**	**16.4**	**15.3**	**14.1**	**13.1**
In percent of exports	...	...	...	63.5	55.0	48.8	44.3	39.2	35.2	31.5	29.3	26.9	24.6	22.5
Debt service-to-exports ratio (in percent)	0.0	18.9	11.5	9.4	11.4	10.6	10.3	9.8	9.6	9.4	9.3	9.6	10.0	10.1
PPG debt service-to-exports ratio (in percent)	0.0	18.9	11.5	3.4	3.4	3.4	3.4	3.3	3.0	2.8	2.7	2.6	2.5	2.4
Total gross financing need (Millions of U.S. dollars)	41.1	154.8	153.4	-232.9	13.3	-1.1	-8.9	129.0	195.7	238.5	264.3	276.6	286.9	286.8
Non-interest CA deficit that stabilizes debt ratio	15.7	11.2	3.9	8.4	7.1	10.5	9.6	7.1	8.9	6.9	4.1	3.4	2.6	2.2
A. Alternative Scenarios 3/					**II. Stress Tests for Public Debt Ratio**									
A1. New public sector loans on less favorable terms in 2006-15 4/					26.8	24.6	22.7	20.9	19.3	17.9	16.9	15.8	14.7	13.7
A2. Low Case Scenario—No Reform 5/					26.8	24.5	22.8	21.1	19.8	18.7	17.9	17.2	16.3	15.5
B. Bound Tests 3/														
B1. Export value growth at historical average minus one standard deviation in 2007-08					26.8	34.3	49.1	46.5	44.3	41.4	37.5	33.7	30.0	26.6
B2. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 6/					26.8	37.8	48.0	45.4	43.2	40.1	36.3	32.6	29.1	25.7
B3. Combination of B1-B2 using **one-half** standard deviation shocks					26.8	35.6	46.0	43.5	41.4	38.4	34.8	31.4	28.0	24.8

1/ Includes both public and private sector external debt.
2/ Assumes that NPV of private sector debt is equivalent to its face value.
3/ The reported ratios are NPV of PPG external debt-to-GDP ratios.
4/ Assumes that the interest rate on new borrowing is higher by 2 percentage points than in the baseline, while grace and maturity periods are the same as in the baseline.
5/ The changes in macroeconomic and other key variables under this scenario are discussed in the previous section, and laid out in annex Table A2.
6/ Includes official and private transfers and FDI.

Figure 4.2. Montenegro: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006-15



*Note***:** * The most extreme test is "Export value growth at historical average minus one standard deviation in 2007-08."

Source: Staff projections and simulations.

However, the net present value of total external debt –inclusive of private sector external debt—rises from about 45 percent in 2006 to about 48 percent in 2015, largely on account of the rising private sector debt (assumed under the baseline) and the fact that the NPV of private sector debt is assumed to be equivalent to its face value.

1.79 **As in the case of public debt, liquidity also improves over time (Figure 4.2)**. Under the baseline, the ratio of debt service-to-exports declines from 3.4 percent in 2006 to 2.4 percent in 2015. Total gross financing need, expressed in nominal US dollar terms, rises but much of the increase is due to private sector external amortization due, and current account deficit (including interest payments). Inclusive of servicing of the private sector debt, debt service-to-exports ratio declines only marginally from about 11 percent in 2006 to 10 percent in 2015.

Sensitivity Analysis of External Debt

1.80 **From the viewpoint of external sustainability, a scenario in which key variables are kept at their historical average does not make much sense for Montenegro**. This is mainly because the historical averages for net exports growth (nearly 20 percent) and net FDI inflows (9 percent) are too high (Table 4.4.) and unrealistic to expect them to be sustained going forward. The sensitivity analyses thus focus on three cases:

- New public sector loans are contracted at less favorable terms;
- A full-fledged low-case scenario, whose underlying assumptions and macroeconomic projections are discussed in the previous section; and
- Bound tests wherein we examine the impact on external debt sustainability of temporary two consecutive year shocks to net exports, and net FDI.[29]

Scenario 1: New Public Sector Loans are on Less Favorable Terms

1.81 **External debt sustainability continues to improve even when new loans are at less favorable terms.** This scenario assumes that the nominal interest rate on new public and publicly guaranteed (PPG) debt is 2 percentage points higher than in the baseline scenario. While this implies higher interest payments and amortization due, which in turn imply marginally higher financing need relative to the base case, the impact on debt ratio is minimal. The net present value of external public debt declines from 26.8 percent in 2006 to 13.7 percent in 2015. Given the relatively small amount of expected new public sector loans over 2006-15, it is not surprising that this shock does not impact the sustainability of external public debt. However, it is important to note that such an increase in interest rate will have a much bigger and far more important impact on the private external debt, whose stock and share is expected to rise over the coming years in Montenegro (because of large private sector financing requirements).

[29] Unlike in the case of public debt sustainability, a negative real GDP shock does not significantly affect the NPV of PPG external debt since it won't lead to changes in financing requirements (and the impact works mostly through changes in automatic debt dynamics). As a result, this shock is not considered here.

Scenario 2: Low Case Scenario—Weak Reform

1.82 **External debt sustainability indicators deteriorate only slightly under the low case scenario**. Even under the weak reform scenario, in which growth slows down to 3.3 percent, current account deficit remains steady (at 6.3 percent), and FDI inflow is significantly lower (6 percent of GDP), external sustainability is still maintained as low growth translates into lower financing requirements and leads only marginally to higher level of public debt. In contrast to the base case scenario, the net present value of external indebtedness will be worse by only 2 percent of GDP in 2015. Liquidity indicators also marginally deteriorate relative to the base case.

Scenario 3: Bound Tests

1.83 **A severe negative export shock that lasts two consecutive years will sharply raise the net present value of public external debt, leading to a worsening of external sustainability in the medium term, but the impact wears off over the long-term.** Montenegro's historical average export value growth during 2002-05 was 19.8 percent with a standard deviation of 31.9 (suggesting high volatility). The shock considered here is therefore a fairly severe negative export shock, where export value growth will be -12.1 percent in 2007-08 (considerably lower than the average baseline positive export growth of 11 percent). With this shock, the net present value of external public debt to GDP ratio shoots up from 26.8 percent in 2006 to 49 percent in 2008, but then gradually declines back to its 2006 level by 2015.

1.84 **Similarly, a negative shock in net non-debt creating flows, in particular FDI and current transfers, will lead to a worsening of external sustainability in the short term but the impact fades over the medium term.** Historically, net FDI and net transfers in Montenegro have averaged, respectively, 8.9 percent and 13.8 percent of GDP, with standard deviations of 9.3 and 2.7. Under this case, net FDI is assumed at -0.5 percent of GDP (net outflow) and net transfers stay at 11.1 percent of GDP in 2007-08. The net present value of external public debt will rise from 26.8 percent of GDP in 2006 to 48 percent in 2008, but will slowly decline to about 25 percent by 2015.

1.85 **A similar path of external public debt is produced by the combination shock** (wherein GDP growth will be at 2.4 percent, export growth at 3.8 percent, net current transfer at 12.4 percent of GDP, and net FDI of 4.2 percent at GDP in 2007-08). The net present value of external public debt rises to about 48.2 percent in 2008, but declines slowly back to its 2006 level in 2015. External sustainability is worsened over the medium term.

C. KEY RISKS TO DEBT SUSTAINABILITY

1.86 **Macroeconomic sustainability is significantly vulnerable to policy slippages as well as adverse external developments.** The most important downside risk is that of failing to achieve macroeconomic discipline and structural reform efforts due to lack of commitment to reforms. Government's efforts to accelerate and deepen the structural reforms should

consolidate public finances, improve labor market flexibility, reduce the cost of doing business, and reduce current account vulnerabilities that could exacerbate the effects of potential shocks. Continued vigilance in revenue mobilization and further expenditure cuts would be necessary to put public finances on a sustainable path. On the external side, promoting environmentally sustainable tourism and diversifying tourism products, including through attracting further greenfield FDI inflows, would consolidate Montenegro's ability to weather unexpected shocks. Without determined efforts to improve the business environment, that objective could remain elusive.

1.87 **In addition to vulnerabilities on the economic side, instances of misuse and mismanagement of resources, due to weak public institutions and poor governance, constitute major risks in Montenegro**. Despite modest improvements in public expenditure management, procurement and financial management policies and institutions, the accountability mechanisms in place for public officials are not yet performing adequately. The EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) in 2005 shows that corruption is a problem for doing business in Montenegro. Although the number of Montenegrin firms included in the BEEPS is small, the survey shows that bribe frequency and the percent of firms indicating corruption as a problem for doing business and state capture both increased between 2002 and 2005 in Montenegro. According to the Survey, bribes are frequent in government contracts, fire and building inspections, customs and imports, and public services, in particular telephone and electricity services. Montenegro would need to build effective administrative and financial systems and strengthen transparency and the institutional capacity of watchdog agencies (e.g. Supreme Audit Institution) to improve governance and accountability, and ensure public debt sustainability over the medium term.

1.88 **Uncertainties about the size of public debt, in particular the restitution debt and how well it is managed, would be another important risk for debt sustainability**. As pointed out earlier, Montenegro's stock of outstanding public debt is still unclear due to lack of good estimates on the full potential liabilities arising from the ongoing restitution claims by citizens, and weak information on debt of public enterprises and local governments. In addition, there are plans to compensate for frozen foreign currency deposits held by Montenegro citizens in other ex-Yugoslav republics and other debt stock adjustments. While the sensitivity tests included a sudden surfacing of a 10 percentage point of GDP shock each year in restitution and other liabilities over a two year period, such restitution claims and liabilities could potentially be much larger, if not managed well by the government.

1.89 **More broadly, the Republican government would urgently need to strengthen the mechanism and institutions for managing fiscal risks from contingent liabilities.** The state government urgently needs to strengthen oversight over local governments and state owned enterprises (SOEs). The MoF gathers partial information on local governments (i.e., excluding their extra-budgetary activities), does not check its accuracy, nor sanctions delays or inadequate reporting from local governments. Local governments have recently attempted to foster Private-Public Partnership (PPP) in infrastructure, for which there is currently no adequate legal or institutional mechanism to develop such projects in an orderly fashion. To prevent the emergence of fiscal risks related to these contracts, the government should develop a sound legal and institutional framework that covers the various aspects of PPP. In

addition, there is no centralized information on the SOE sector. Thus, if the financial position of local governments or SOEs were to weaken unexpectedly, the state government could find itself in a situation where it is asked to provide financial support without adequate information. To minimize the risks to debt sustainability arising from such contingent liabilities, the government would need to strengthen oversight over both local government and SOEs. While the MoF has recently set up a unit to monitor the operations and financial activities of local governments and SOEs, the unit should be strengthened to collect and compile quarterly statements on consolidated municipal government accounts (including extra-budgetary activities), and liabilities (including arrears and overdrafts), create a database on SOEs, collect and compile quarterly information on SOE liabilities including arrears.

1.90 **Finally, the rising private external debt--whose full magnitude, composition and maturity structure is not well known—is another risk for debt sustainability**. Private sector borrowing has been rising in recent years (from around 7 percent to 15 percent of GDP over 2002-05). However, little information is available on the nature and maturity structure of private sector borrowing and the monitoring of private debt is almost non-existent. This makes it difficult to assess whether private sector debt poses significant risks for public debt sustainability. Still, in view of the recent rise in real estate prices, for example, it is possible to imagine a situation in which there will be a large correction of real estate prices that could impair private sector balance sheets, reverse FDI, stress the banking sector, and adversely impact fiscal sustainability. In view of the rising private external debt, and the high rate of credit expansion, with a potential for financial and property bubbles, Montenegro will need to put in place a mechanism to monitor private sector external debt. A strong prudential supervision of the financial system, coupled with effective monitoring of private debt, is therefore needed to protect the economy against such potential surprises and to continue to ensure public and external debt sustainability over the medium term.

V. CONCLUSIONS

1.91 **Montenegro's economy is euroized**. Since 2002, Montenegro has used the euro as the sole legal tender. With "euroization", inflation has dropped from 24.8 percent at the end of 2000 to 1.8 percent at the end of 2005; exchange rate risks have been mostly eliminated; and transaction costs associated with currency exchanges have been abolished, thereby enhancing Montenegro's commercial integration with the rest of the world, in particular with the EU. In return, it has sacrificed an independent monetary policy, a lender of last resort, and inflation tax and seigniorage.

1.92 **With euroization adjustment to shocks can be accomplished only through fiscal policy and structural reforms**. Indeed, fiscal policy remains the only macroeconomic tool to maintain both internal and external balance. Luckily, the recent trends in fiscal policy have been encouraging. Montenegro's fiscal stance has been gradually tightened, with the consolidated general government deficit declining from an average of 5 percent of GDP in 2002 to 2.2 percent of GDP in 2005. Both tax and expenditure policies were strengthened. Aided by Paris Club settlements, Montenegrin public debt has also fallen by well over 40 percentage points of GDP over the same period. The high privatization proceeds since 2005 have also helped bring down public debt, in particular domestic debt, but potential liabilities arising from the ongoing restitution process and contingent liabilities from state-owned enterprises and local governments could affect public debt sustainability.

1.93 **This report has assessed Montenegro's public and external debt sustainability under alternative scenarios.** The baseline scenario assumes continued implementation of a comprehensive macroeconomic stabilization and structural reform program, while the low case scenario describes the alternative of a sluggish growth environment due to policy slippage/weak reform. In addition, other sensitivity tests are conducted in order to highlight the vulnerability of the baseline case to specific shocks. The key results are as follows.

Public Debt Sustainability

1.94 **The report concludes that Montenegro's public debt would decline significantly if economic reforms continue at their current pace, the current fiscal policy** (with small primary deficit of no more than 0.5 percent of GDP) is maintained, and real GDP grows at an average rate of 5 percent over the coming years. Under this scenario, the total public debt to GDP ratio declines by about 12 percent of GDP (from 41 percent to 29 percent) over 2006-2015, aided in part by a relatively small net foreign borrowing of the public sector. Overall liquidity considerably improves as public debt-to-revenue ratio declines from about 99 percent in 2006 to about 71.5 percent in 2015—a decline of 28 percent. If Montenegro were able to sustain faster than 5 percent growth rate (as envisaged under the most recent IMF framework for the period 2007-11), public debt sustainability would become even more robust.

1.95 **Under this weak reform scenario, Montenegro's favorable downward trajectory of debt-to-GDP ratio is reversed.** Public debt ratio declines up to 2008 (because of the assumed progressive but slow decline in real GDP growth in the early years), but continues to increase afterwards. The total public debt to GDP ratio declines to about 33.8 percent by 2009, but slowly rises to 52.2 percent in 2015, jeopardizing long-term debt sustainability. The resurgence in debt ratio is due Montenegro's slow growth, positive real interest rate, higher restitution debt, and because the government will run a higher primary deficit relative to the base case (Table 4.3). Liquidity indicators improve at a much lower pace than under the base case, as public debt-to-revenue ratio declines only slightly from about 99 percent in 2006 to about 95 percent in 2015, and gross public financing need initially declines but climbs back to about the same percent of GDP in 2015 as in 2006 (6 percent). The weak reform scenario illustrates the importance for the government to stick to the current tight fiscal policy path over the medium term, without which the sustainability of public debt is clearly jeopardized.

1.96 **The stress tests suggest that Montenegro's debt dynamics are particularly susceptible to a sudden surfacing of high (restitution) debt and to a negative growth shock.** Montenegro's stock of outstanding public debt is still unclear due to lack of good estimates on the full potential liabilities arising from the ongoing restitution claims by citizens, and weak information on debt of public enterprises and local governments. In addition, there are plans to compensate for frozen foreign currency deposits held by Montenegro citizens in other ex-Yugoslav republics and other debt stock adjustments. If there were new debts emerging (e.g. restitution debt), whose magnitude 10 percent of GDP for two consecutive years (2007 and 2008), the debt to GDP ratio shoots from 41 percent to about 51 percent by 2011, after which the impact wears off and the ratio declines to 45 percent by 2015 (but still higher than the starting point). Similarly, confirming Montenegro's high vulnerability to a negative growth shock, public debt ratios rise steadily in the case where real GDP growth slows down to less than 2.8 percent in 2007-08.

External Debt Sustainability

1.97 **Montenegro has run large current account deficits in recent years, averaging about 8 percent of GDP.** Montenegro's exports of goods and services are not diversified and remain largely dominated by tourism services and aluminum. On the other hand, imports of goods and services remain persistently high, with oil and gas and electricity as the most important import items. The current account deficit has been financed through significant increases in non-debt creating inflows (FDI and net transfers), but also some increases in foreign loans (by both the public and private sectors) in recent years. The recent increases in foreign loans obviously raise concerns about external debt sustainability.

The report concludes that Montenegro's external debt continues to be sustainable under the baseline scenario where sustained structural reform and fiscal adjustment support an average growth rate of about 5 percent per year, the current account deficit is reduced to an average of 6.5 percent of GDP over 2006-2015 (relative to the present 8

percent), and if Montenegro is able to continue to attract FDI inflows on the order of 7 percent of GDP. Under these assumptions, the net present value of external public debt declines from 26.8 percent in 2006 to 13.1 percent in 2015. External liquidity also improves, with the ratio of debt service-to-exports declining from 3.4 percent in 2006 to 2.4 percent in 2015. Even under the low case of weak reform scenario, liquidity indicators marginally deteriorate relative to the base case, but external sustainability is still maintained as low growth translates into lower financing requirements and only marginally higher level of public debt.

1.98 **However, the stress tests suggest that Montenegro's external public debt dynamics would be vulnerable to a negative export shock or smaller volumes of non debt-creating inflows** (i.e. FDI and transfers). A severe negative export shock that lasts two consecutive years will sharply raise the net present value of public external debt, and leads to a worsening of external sustainability in the medium term, although the impact wears off over the long-term. Similarly, changes in net non-debt creating flows, in particular FDI and current transfers, will lead to a worsening of external sustainability in the medium term.

1.99 **The implication of this is that export-oriented growth (with minimum export volatility) is likely to be central to both reducing the large current account deficit as well as maintaining external sustainability**. While tourism clearly holds considerable promise for export-oriented growth in Montenegro, turning this promise into reality requires substantial and well-targeted investments as well as the implementation of key structural reforms. In particular, Montenegro needs to facilitate the conditions for private investment in tourism through business environment reforms, address the public infrastructure constraints--in particular in water, roads, and waste management—for coastal tourism development, and improve its competitiveness vis-à-vis neighboring countries, many of which currently offer a more competitive combination of quality and price to the same target markets. In the long-term, it will also need to diversify its tourism products. All of this will need to be done in an environmentally sustainable way.

1.100 **Finally, in view of the rising private external debt, Montenegro will need to put in place a mechanism to monitor private sector external debt**. Private sector borrowing has been rising in recent years (from around 7 percent to 15 percent of GDP over 2002-05). However, little information is available on the nature and maturity structure of private sector borrowing and the monitoring of private debt is almost non-existent. This makes it difficult to assess whether private sector debt poses significant risks for public debt sustainability. Still, sudden reversals or price corrections impair private sector balance sheets, reverse FDI, stress the banking sector, and adversely impact fiscal consolidation. A strong prudential supervision of the financial system, coupled with effective monitoring of private debt, is therefore needed to protect the economy against such potential surprises and to continue to ensure public and external debt sustainability over the medium term.

1.101 Overall, the analysis in this report supports the conclusion that with a continuation of current macroeconomic policies, and an acceleration of structural reforms aimed at enhancing growth and reducing export vulnerabilities, Montenegro can absorb an increasing

share of non-concessional official financing and/or gradually access market based lending without major risks to its public debt and external sustainability.

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ANNEX 1. MONTENEGRO: BASELINE MACROECONOMIC PROJECTIONS, 2006-2016

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Macroeconomic Projections												
National Accounts												
GDP at market prices – In USD Million	2,061	2,231	2,422	2,620	2,821	3,023	3,240	3,473	3,722	3,990	4,276	4,583
Growth Rate of GDP	4.3%	5.5%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Per Capita GDP – In USD	3,333	3,609	3,918	4,238	4,563	4,891	5,242	5,618	6,021	6,454	6,917	7,413
Components of Aggregate Demand												
Consumption	96.9%	96.5%	94.7%	93.2%	91.7%	88.9%	87.4%	86.4%	85.0%	83.6%	82.4%	81.3%
Private	70.6%	70.3%	70.0%	68.9%	68.5%	66.8%	66.1%	65.6%	64.2%	62.9%	61.7%	60.6%
Public	26.3%	26.2%	24.6%	24.2%	23.2%	22.1%	21.3%	20.8%	20.8%	20.8%	20.7%	20.7%
Investment	22.1%	22.6%	23.6%	24.3%	24.5%	24.8%	24.9%	24.7%	24.7%	24.7%	24.8%	24.6%
Private	17.6%	18.9%	19.4%	20.3%	20.5%	20.9%	21.0%	20.9%	21.0%	21.1%	21.1%	21.0%
Public	4.5%	3.7%	4.2%	4.0%	4.0%	3.9%	3.9%	3.7%	3.7%	3.7%	3.6%	3.6%
Exports of Goods and Services	45.2%	48.8%	50.3%	51.0%	52.8%	54.2%	55.9%	56.2%	56.8%	57.4%	57.9%	58.4%
Imports of Goods and Services	64.2%	67.9%	68.6%	68.4%	69.0%	68.0%	68.1%	67.3%	66.5%	65.8%	65.1%	64.2%
Savings-Investment Balance												
Investment	22.1%	22.6%	23.6%	24.3%	24.5%	24.8%	24.9%	24.7%	24.7%	24.7%	24.8%	24.6%
Private	17.6%	18.9%	19.4%	20.3%	20.5%	20.9%	21.0%	20.9%	21.0%	21.1%	21.1%	21.0%
Public	4.5%	3.7%	4.2%	4.0%	4.0%	3.9%	3.9%	3.7%	3.7%	3.7%	3.6%	3.6%
Total Savings	22.1%	22.6%	23.6%	24.3%	24.5%	24.8%	24.9%	24.7%	24.7%	24.7%	24.8%	24.6%
Foreign Savings (-CAB)	8.5%	10.8%	10.9%	11.1%	10.7%	9.8%	8.6%	7.6%	6.9%	6.2%	5.5%	4.6%
National Savings	13.6%	11.8%	12.7%	13.2%	13.8%	15.0%	16.3%	17.0%	17.8%	18.6%	19.3%	20.0%
Public	3.0%	3.8%	5.2%	3.0%	3.8%	3.3%	3.7%	3.9%	4.0%	4.1%	4.1%	4.2%
Private	10.5%	8.0%	7.5%	10.3%	10.0%	11.7%	12.6%	13.2%	13.7%	14.5%	15.2%	15.8%
Prices												
Inflation (p.a.)	3.6%	2.6%	3.4%	3.0%	2.5%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
Average Exchange Rate (LCU/US$)	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804
Real Exchange Rate Index (LCU/US$)	1.000	0.994	0.991	1.016	1.035	1.050	1.066	1.081	1.097	1.113	1.130	1.146
Fiscal Projections												
Revenues and Grants	40.1%	41.5%	41.7%	39.1%	39.1%	37.6%	37.4%	37.5%	37.6%	37.5%	37.4%	37.4%
Expenditures	42.1%	41.8%	41.0%	40.8%	40.0%	38.9%	38.3%	38.1%	38.0%	37.8%	37.7%	37.6%
Current Expenditures	37.1%	37.7%	36.5%	36.1%	35.3%	34.3%	33.7%	33.7%	33.6%	33.4%	33.3%	33.2%
Capital Expenditures	5.0%	4.0%	4.5%	4.7%	4.7%	4.6%	4.6%	4.4%	4.4%	4.4%	4.3%	4.3%
Fiscal Balance	-2.0%	-0.3%	0.7%	-1.7%	-0.9%	-1.3%	-0.9%	-0.6%	-0.4%	-0.3%	-0.3%	-0.1%
Primary Balance	-1.0%	0.8%	1.7%	-1.9%	-1.3%	-0.5%	-0.1%	0.6%	0.7%	0.7%	0.6%	0.7%
Fiscal Financing	2.0%	0.3%	-0.7%	1.7%	0.9%	1.3%	0.9%	0.6%	0.4%	0.3%	0.3%	0.1%
Foreign Financing	1.1%	0.9%	0.2%	0.0%	-0.2%	-0.2%	-0.2%	0.1%	0.0%	-0.1%	-0.1%	0.0%
Privatization	9.9%	2.3%	5.5%	8.5%	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other	-9.0%	-3.0%	-6.4%	-6.7%	0.6%	1.4%	1.0%	0.5%	0.3%	0.4%	0.3%	0.1%

ANNEX 1. Montenegro: Baseline Macroeconomic Projections, 2006-2016 (continued)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Balance of Payments Projections												
Current Account												
Exports of Goods and Services	45.2%	48.8%	50.3%	51.0%	52.8%	54.2%	55.9%	56.2%	56.8%	57.4%	57.9%	58.4%
Imports of Goods and Services	64.2%	67.9%	68.6%	68.4%	69.0%	68.0%	68.1%	67.3%	66.5%	65.8%	65.1%	64.2%
Resource Balance	-15.6%	-16.3%	-14.9%	-12.6%	-11.2%	-11.1%	-10.6%	-9.6%	-9.4%	-9.2%	-9.0%	-8.7%
Net Factor Income	-2.7%	-4.1%	-3.8%	-3.7%	-3.5%	-3.6%	-3.4%	-3.1%	-3.3%	-3.5%	-3.7%	-3.7%
Net Private Transfers	12.9%	12.2%	11.1%	8.9%	7.7%	7.5%	7.1%	6.6%	6.1%	5.7%	5.3%	5.0%
Current Account Balance (before grants)	-8.7%	-11.0%	-11.0%	-12.3%	-12.0%	-9.9%	-8.6%	-7.6%	-6.9%	-6.2%	-5.5%	-4.6%
Official grants	0.2%	0.2%	0.2%	1.2%	1.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Current Account Balance (incl. grants)	-8.5%	-10.8%	-10.9%	-11.1%	-10.7%	-9.8%	-8.6%	-7.6%	-6.9%	-6.2%	-5.5%	-4.6%
Capital and Financial Account												
Net Foreign Direct Investment (FDI)	22.9%	13.5%	14.2%	14.7%	9.5%	6.7%	4.8%	3.7%	3.1%	2.6%	2.3%	2.0%
Privatization Proceeds	9.9%	2.3%	5.5%	8.5%	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Green Field Investment	12.7%	10.9%	8.5%	5.9%	8.8%	6.4%	4.5%	3.5%	2.9%	2.4%	2.1%	1.8%
Portfolio	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%
Net Foreign Loans (Long-term)	7.7%	2.4%	1.8%	2.6%	4.7%	1.9%	2.7%	4.8%	4.5%	4.4%	4.0%	3.5%
Disbursement	10.7%	5.4%	4.8%	5.7%	7.8%	5.0%	6.0%	8.2%	7.9%	7.8%	7.3%	7.6%
Amortization	3.0%	3.0%	3.0%	3.0%	3.1%	3.1%	3.3%	3.5%	3.4%	3.4%	3.3%	4.0%
Net Short-term Borrowing	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Commercial Banks	-12.5%	-1.8%	-0.3%	0.0%	0.0%	0.2%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%
Errors and Omissions	-2.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in Net Reserves (- is increase)	-6.8%	-3.3%	-4.8%	-6.3%	-3.5%	1.0%	0.9%	-0.9%	-0.7%	-0.8%	-0.8%	-0.9%
Foreign Exchange Reserves												
Gross Official Reserves (% GDP)	20.0%	22.6%	26.7%	32.5%	34.6%	31.0%	27.8%	27.0%	26.1%	25.4%	24.7%	24.2%
Gross Official Reserves (months of imports)	2.9	3.0	3.6	4.4	4.6	4.2	3.7	3.7	3.6	3.5	3.5	3.4
Memo items:												
Growth Rate of Exports of Goods and Services		13.8%	8.7%	8.4%	10.1%	8.7%	9.0%	6.4%	7.0%	7.0%	6.7%	6.7%
Growth Rate of Imports of Goods and Services		11.0%	5.9%	7.3%	7.7%	4.8%	6.6%	5.0%	5.2%	5.2%	5.2%	5.0%
Gross Financing Requirements - in USD million												
Financing Requirements	376.9	382.6	452.5	534.1	489.7	359.7	353.4	415.5	411.6	416.2	410.3	439.0
Current account deficit	174.9	240.8	263.8	289.6	302.4	297.1	277.4	264.4	258.2	246.5	235.8	210.9
Amortization	60.9	67.2	73.4	79.6	87.7	93.8	106.6	120.6	126.5	136.1	140.6	185.5
Private	58.2	59.1	61.8	64.5	69.8	74.9	86.2	98.5	102.0	107.8	109.7	151.3
Public	2.7	8.1	11.6	15.1	18.0	18.8	20.3	22.1	24.5	28.3	30.8	34.2
Reserves Changes	141.0	74.7	115.3	164.9	99.6	-31.2	-30.6	30.6	26.8	33.5	34.0	42.6
Financing sources	376.9	382.6	452.5	534.1	489.7	359.7	353.4	415.5	411.6	416.2	410.3	439.0
Private investment (net)	472.5	300.9	344.5	385.5	268.6	203.9	154.2	129.3	116.9	104.5	98.2	92.0
Disbursements (net)	220.1	121.5	116.0	148.6	221.1	150.8	194.2	286.2	294.7	311.7	312.1	347.0
Private	195.1	92.5	99.0	134.6	209.1	138.3	179.2	261.2	269.7	286.7	284.6	312.0
Public	25.0	29.0	17.0	14.0	12.0	12.5	15.0	25.0	25.0	25.0	27.5	35.0
Other	-315.8	-39.8	-8.0	0.0	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0

ANNEX 2. MONTENEGRO: LOW CASE MACROECONOMIC PROJECTIONS, 2006-2016

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Macroeconomic Projections												
National Accounts												
GDP at market prices - In USD Million	2,061	2,231	2,422	2,595	2,767	2,910	3,059	3,185	3,316	3,453	3,595	3,743
Growth Rate of GDP		5.5%	5.0%	4.0%	4.0%	3.0%	3.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Per Capita GDP - In USD	3,333	3,609	3,918	4,197	4,476	4,706	4,948	5,152	5,364	5,585	5,815	6,054
Components of Aggregate Demand												
Consumption	96.9%	96.5%	94.8%	93.8%	93.4%	92.1%	91.2%	90.4%	89.7%	89.1%	88.7%	88.3%
Private	70.6%	70.3%	69.0%	68.6%	68.4%	67.2%	66.4%	65.6%	64.8%	64.2%	63.8%	63.5%
Public	26.3%	26.2%	25.8%	25.2%	25.0%	24.9%	24.9%	24.8%	24.9%	24.9%	24.9%	24.8%
Investment	22.1%	22.6%	23.3%	22.6%	22.0%	21.4%	20.8%	20.3%	20.0%	19.8%	19.7%	19.5%
Private	17.6%	18.9%	19.5%	18.7%	18.2%	17.9%	17.5%	17.1%	16.7%	16.7%	16.7%	16.5%
Public	4.5%	3.7%	3.8%	3.9%	3.8%	3.5%	3.3%	3.3%	3.2%	3.1%	3.0%	3.0%
Exports of Goods and Services	45.2%	48.8%	50.3%	50.6%	51.1%	51.7%	52.0%	52.3%	52.5%	52.4%	52.2%	51.9%
Imports of Goods and Services	64.2%	67.9%	68.4%	67.0%	66.5%	65.2%	64.0%	63.0%	62.1%	61.3%	60.5%	59.8%
Savings-Investment Balance												
Investment	22.1%	22.6%	23.3%	22.6%	22.0%	21.4%	20.8%	20.3%	20.0%	19.8%	19.7%	19.5%
Private	17.6%	18.9%	19.5%	18.7%	18.2%	17.9%	17.5%	17.1%	16.7%	16.7%	16.7%	16.5%
Public	4.5%	3.7%	3.8%	3.9%	3.8%	3.5%	3.3%	3.3%	3.2%	3.1%	3.0%	3.0%
Total Savings	22.1%	22.6%	23.3%	22.6%	22.0%	21.4%	20.8%	20.3%	20.0%	19.8%	19.7%	19.5%
Foreign Savings (-CAB)	8.5%	10.8%	10.7%	9.9%	9.6%	9.0%	7.7%	6.5%	6.1%	5.8%	5.7%	5.5%
National Savings	13.6%	11.8%	12.6%	12.7%	12.3%	12.4%	13.1%	13.8%	13.9%	14.0%	14.0%	14.0%
Public	3.0%	3.8%	4.0%	4.5%	4.1%	2.6%	2.2%	2.2%	2.1%	2.1%	2.0%	2.0%
Private	10.5%	8.0%	8.6%	8.1%	8.3%	9.7%	11.0%	11.6%	11.8%	11.9%	11.9%	12.0%
Prices												
Inflation (p.a.)	3.6%	2.6%	3.4%	3.0%	2.5%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
Average Exchange Rate (LCU/US$)	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804	0.804
Real Exchange Rate Index (LCU/US$)	1.000	0.994	0.991	1.016	1.035	1.050	1.066	1.081	1.097	1.113	1.130	1.146
Fiscal Projections												
Revenues and Grants	40.1%	41.5%	41.7%	41.9%	41.4%	40.6%	40.3%	40.2%	40.0%	40.0%	40.0%	39.9%
Expenditures	42.3%	42.0%	41.9%	43.2%	43.3%	42.6%	42.6%	42.6%	42.5%	42.7%	42.9%	43.1%
Current Expenditures	37.8%	38.2%	38.1%	39.3%	39.5%	39.1%	39.3%	39.3%	39.2%	39.6%	39.9%	40.1%
Capital Expenditures	4.5%	3.7%	3.8%	3.9%	3.8%	3.5%	3.3%	3.3%	3.2%	3.1%	3.0%	3.0%
Fiscal Balance	-2.2%	-0.4%	-0.3%	-1.3%	-1.9%	-1.9%	-2.3%	-2.4%	-2.5%	-2.7%	-2.9%	-3.2%
Primary Balance	-1.0%	0.8%	0.9%	-0.1%	-0.7%	-0.9%	-1.2%	-1.3%	-1.4%	-1.6%	-1.6%	-1.8%
Fiscal Financing	-2.2%	-0.4%	-0.3%	-1.3%	-1.9%	-1.9%	-2.3%	-2.4%	-2.5%	-2.7%	-2.9%	-3.2%
Foreign Financing	1.1%	0.9%	0.2%	0.0%	-0.2%	-0.2%	-0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Privatization	9.9%	2.3%	5.5%	8.5%	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other	-8.8%	-2.8%	-5.4%	-7.2%	1.6%	2.0%	2.5%	2.2%	2.3%	2.5%	2.7%	3.0%

ANNEX 2. Montenegro: Low Case Macroeconomic Projections

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Balance of Payments Projections												
Current Account												
Exports of Goods and Services	45.2%	48.8%	50.3%	50.6%	51.1%	51.7%	52.0%	52.3%	52.5%	52.4%	52.2%	51.9%
Imports of Goods and Services	64.2%	67.9%	68.4%	67.0%	66.5%	65.2%	64.0%	63.0%	62.1%	61.3%	60.5%	59.8%
Resource Balance												
Net Factor Income	-2.7%	-4.1%	-3.8%	-3.7%	-3.5%	-3.3%	-3.2%	-3.0%	-3.3%	-3.5%	-3.7%	-3.8%
Net Private Transfers	12.9%	12.2%	11.1%	9.0%	7.9%	7.8%	7.6%	7.1%	6.9%	6.6%	6.3%	6.1%
Current Account Balance (before grants)	-8.7%	-11.0%	-10.9%	-11.2%	-11.1%	-9.4%	-8.1%	-7.1%	-6.8%	-6.7%	-6.7%	-6.6%
Official grants	0.2%	0.2%	0.2%	1.2%	1.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Current Account Balance (incl. grants)	-8.5%	-10.8%	-10.7%	-10.0%	-9.8%	-9.3%	-8.1%	-7.1%	-6.8%	-6.7%	-6.7%	-6.6%
Capital and Financial Account												
Net Foreign Direct Investment (FDI)	22.9%	13.5%	11.2%	9.6%	9.0%	5.1%	4.1%	3.1%	2.6%	2.6%	2.6%	2.7%
Privatization Proceeds	9.9%	2.3%	5.5%	8.5%	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Green Field Investment	12.7%	10.9%	8.5%	5.9%	8.8%	6.4%	4.5%	3.5%	2.9%	2.4%	2.1%	1.8%
Portfolio	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%
Net Foreign Loans (Long-term)	7.7%	2.4%	1.8%	1.8%	1.6%	3.7%	3.1%	3.4%	3.5%	3.1%	3.0%	2.9%
Disbursement	10.7%	5.4%	4.8%	4.8%	4.8%	6.9%	6.4%	6.8%	6.9%	6.6%	6.6%	6.4%
Amortization	3.0%	3.0%	3.0%	3.1%	3.2%	3.2%	3.3%	3.4%	3.4%	3.5%	3.6%	3.5%
Net Short-term Borrowing	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Commercial Banks	-12.5%	-1.8%	-0.3%	0.0%	0.0%	0.2%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%
Errors and Omissions	-2.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in Net Reserves (- is increase)	-6.8%	-3.3%	-1.9%	-1.4%	-1.0%	0.0%	0.3%	0.0%	0.0%	0.1%	0.1%	0.0%
Foreign Exchange Reserves												
Gross Official Reserves (% GDP)	20.0%	22.6%	23.2%	23.5%	23.2%	22.0%	20.6%	19.7%	19.0%	18.1%	17.3%	16.7%
Gross Official Reserves (months of imports)	2.9	3.0	3.1	3.2	3.2	3.1	3.0	2.9	2.8	2.7	2.6	2.5
Memo items:												
Growth Rate of Exports of Goods and Services		13.8%	8.7%	6.5%	6.4%	5.1%	4.5%	3.5%	3.1%	2.8%	2.4%	2.4%
Growth Rate of Imports of Goods and Services		11.0%	5.6%	4.3%	4.9%	2.4%	2.4%	1.7%	1.8%	2.0%	2.0%	2.0%
Gross Financing Requirements - in USD million												
Financing Requirements	376.9	382.6	448.4	501.9	454.1	325.8	305.9	347.3	341.0	355.8	368.0	381.5
Current account deficit	174.9	240.8	259.7	257.5	266.8	263.0	234.3	208.3	201.2	200.0	205.0	207.2
Amortization	60.9	67.2	73.4	79.6	87.7	93.9	102.1	108.5	113.0	122.3	129.0	131.8
Private	58.2	59.1	61.8	64.5	69.8	75.1	81.8	86.4	88.5	94.0	98.2	97.6
Public	2.7	8.1	11.6	15.1	18.0	18.8	20.3	22.1	24.5	28.3	30.8	34.2
Reserves Changes	141.0	74.7	46.9	37.2	26.8	-0.5	-9.8	-1.0	1.4	-2.6	-3.3	1.4
Financing sources	376.9	382.6	380.0	374.3	381.3	356.4	326.6	315.7	315.6	319.7	330.7	340.4
Private investment (net)	472.5	300.9	271.1	248.7	248.7	149.2	124.4	99.5	87.0	90.8	94.5	99.5
Disbursements (net)	220.1	121.5	117.0	125.6	132.6	202.2	197.3	216.2	228.5	228.9	236.2	240.9
Private	195.1	92.5	100.0	111.6	120.6	189.7	182.3	186.2	198.5	193.9	198.7	200.9
Public	25.0	29.0	17.0	14.0	12.0	12.5	15.0	30.0	30.0	35.0	37.5	40.0
Other	-315.8	-39.8	-8.0	0.0	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0