ACTIVITY REPORT
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1. INTRODUCTION
Montenegro, as a small open economy, oriented itself on the monetary system based first on DEM (German mark) as legal tender, and later on EUR (Euro). This significantly determines basic functions of Central Bank of Montenegro as an independent organization with a legal authority.

Normative and institutional establishment of the Central Bank was done by enactment of the Law on Central bank of Montenegro, basic functions of the Central Bank being establishment and maintenance of healthy banking system and efficient payment operations system, and it was authorized to perform activities of the banker, consultant and fiscal agent of the state bodies and organizations in the Republic.

The Central Bank starting performing its functions on March 15 2001 with the appointment of the Council of the Central Bank. After that, the Central Bank's organization was determined as a prerequisite for personnel training and establishment of basis of information systems.

The basis of monetary policy was established by the legal regulation that specifies that the Central Bank cannot issue bank notes.

The Central Bank has a limited credit function and cannot give credits to the Government, legal and natural persons, except to banks for daily liquidity.

Basic activities of the Central Bank were directed towards regulation and control of the banking system because of its dominant participation in financial system of Montenegro and its great significance for the overall development.

During 2001, the Central Bank, as a regulator of monetary system, enacted 25 subordinated regulations, which, in accordance with law, were also coordinated with international banking standards and guidelines of the European Union.

The Central Bank prepared Law on bankruptcy and liquidation of banks which came into effect in October 2001, and drafting law on amendments of Law on
banks that anticipated significant improvements of the existing Law on banks, and it is now in enacting procedure.

In July 2001, Council of the Central Bank determined the policy of the Central Bank that anticipated basic activities in policies within the Central Bank’s competence.

For the purpose of establishment and maintenance of healthy banking system, the Central Bank reorganized the function of bank control after ten years.

Total performances of the banking sector were improved with constant supervision of the Central bank of business activities of banks and the process of coordination with new regulations and standards of banking operations. Indirect (off-site) and direct (on-site) controls were performed by application of international standards, as well as ranking of banks according to regulations and established methodology, and certain measures against banks were taken. The Central Bank started the activities of bank control with introducing interim administration in the biggest bank in Montenegro—“Montenegrobanka” ad. Podgorica, thus showing determination in solving the most complex problems in banking sector. In a complex procedure of banks’ coordination, by the end of 2001 five banks obtained license to continue with their business activities.

For the purpose of establishment and maintenance of efficient payment operations system in the Republic, which was in accordance with development of market economy and the process of reform was initiated in order to transfer payment operations to banks. Regulation dealing with conducting payment operations through banks was enacted, and future solutions will be tested through pilot projects. It was anticipated that this process would be finished at the same time when the state vault was established and new taxation laws were implemented.

In exercising payment operations\(^1\), Central Bank of Montenegro realized activities in the process of Mass voucher privatization: opening of privatization accounts, transfer of voucher points to family members and privatization funds, auctions, result calculations and informing citizens on state of privatization accounts.

In performing activities of banker, adviser and fiscal agent of bodies and organizations of the Republic, the Central Bank opened Main State account of the budget and accounts abroad, and for the purpose of more efficient manage-
ment of the budget income it conducted treasury bills auctions. The Central Bank gave advice and rendered other services connected to administration of national debt, and it participated in negotiations with international financial institutions and international creditors.

In realization of its legal competence the Central Bank provided an adequate quantity and denomination structure of money. It regularly controlled the quantity of money in circulation and its coordination with the needs of clients. In accordance with the adopted Program of activities of conversion process certain preparations were made for conversion of DEM in EUR.

For money supply control and maintenance of liquidity in payments, necessary analyses and technical preparations for providing information support were made, and decision on appropriation of statutory reserves of banks at the Central Bank, as an instrument of monetary policy of the Central Bank, was prepared.

As a part of its regular activities, the Central Bank performs macroeconomic analyses, primarily in monetary sphere, then in balance of payments of the Republic of Montenegro, and fiscal sphere, and it monitors economic trends. As a part of monetary sphere analysis monetary aggregates trends are monitored, money supply control instruments are created, and monetary accounts are prepared. The Central Bank also controls flows in balance of payment, both flow of goods and financial flows.

Central Bank of Montenegro as a new institution that started its work in 2001 faced with a number of real restrictions which are necessary to point out for the more objective insight in the achieved results of the Central Bank.

In the enclosures, which are part of the report, a documented basis on carrying out of basic functions of the Central Bank is given.
2. RESTRICTIONS IN REALIZATION OF BASIC PRINCIPLES
As a new institution Central Bank of Montenegro started with its business activities in 2001, in negative economic and social surroundings that made difficult realization of its functions through external and internal restrictions.

Basic external restrictions are:

- Difficult direct communication with international financial institutions and creditors;
- Impossibility of direct entering in international electronic payment systems;
- Initial barriers in opening accounts in other central banks;
- Underdevelopment of modern macroeconomic statistics and system of national accounts;
- Unsolved problem of reprogramming of foreign debts and servicing of "frozen foreign currency savings";
- Degrading of bank control function in the previous period of more decades;
- Inherited non-solid banking practice whose causes are in wrong ownership concept, imperfect accounting treatments, unstable currency and financial monopolies;
- Lack of communication with banking sector and absence of valid database in the previous period;
- Former policies of licensing of financial subjects;
- Huge lack of financial discipline and high level of macroeconomic illiquidity;
- Unconsolidated payment operations in the system of the Central Bank.
and inherited functions from the previous period that are not typical for modern payment operations;

• Unsolved relations with NBY (National Bank of Yugoslavia);

• Inherited indebtedness to the debit of reserves of Montenegro;

• Unsatisfactory synchronization of the reforms that concern reform determination from the competence of Central Bank of Montenegro;

Individual elaboration of all aforesaid external restrictions need a lot more attention, but it is indisputable that these restrictions are interrelated and their cumulative influence is much stronger than individual influence as far as the stated restrictions are concerned.

Internal restrictions mainly came from the fact that the Central Bank, although being a new institution, began its work with restructuring of the existing state, thus inheriting the following restrictions:

• Inadequacy of organization and personnel structure;

• Methodical, technological and informational expirations;

• Unsuitable evaluation of sophisticated work and need for professional training;

• Deficit of knowledge for performing and improvement of basic functions on different bases;

• Inappropriate information systems, accounting and financial policies and

• Absence of internal control and auditing.

The Central Bank overcame, or it took measures to overcome the most restrictions it could influence.

Regardless the total commitment of the Central Bank and made efforts, nature and mutual activity of the aforesaid restrictions made difficult the realization of proclaimed aims that represented the basis of the established policy of the Central Bank.
3. IMPLEMENTATIONS OF THE POLICY OF THE CENTRAL BANK
3.1. Economic reforms and aims of the policy of the Central Bank

Development of Montenegro imposes the need for economic revival that is inevitably based on construction of new economic system and institutions that enable development of economic liberties and market economy, and that creates the conditions for better quality of living.

Basic starting points for development of new institutional framework are:

1. private property and freedom of market transactions,
2. open (internationalized) economy and national treatment of foreign investments,
3. protection of economic freedoms and rights.

As a part of economic system Montenegro established legal infrastructure which, although mostly implemented, is not still enough for functioning of market economy.

Although being in the process of reform, banking system is dominant in financial system of Montenegro and represents its most developed part. With establishment of Securities and Exchange Commission of the Republic of Montenegro and Central Depository Agency as two basic institutions, as well as with establishment of stock markets and creation of legal assumptions for other participants in capital market, necessary conditions for functioning and development of capital market were created. Activities on reform of insurance system (including pension insurance) started with bill drafts.

Establishment of new economic system set the goals of economic policy of government of the Republic of Montenegro for 2001: economic recovery, moderate inflation, increase of export of goods and services, dynamization of privatization, decrease of unemployment, decrease of participation of grey
economy in total economic activities, increase income from taxation by expanding taxation tax base and decrease of tax rates, and improvement of living standard of the population.

All the above mentioned also influenced the policies of the Central Bank and determined activities and goals for 2001 that were stated in the Policy of the Central Bank.

3.2 Banking sector in Montenegro

3.2.1 Starting point

Development of financial market channels and increase of their cross border efficiency represents one of the compulsory conditions for every country that is trying to open investment cycle. Demand for long-term financing sources with price that satisfies attitude towards risk premium of most investors can find its supply only if sufficient domestic and foreign sectors are sure that banking system is functioning on the basis that offer satisfying protection of their interests. For that reason, the reform of banking sector in the activities of the Central Bank of Montenegro has been imposed as a priority in 2001.

In accomplishing this objective, the Central Bank in 2001 was faced with pioneer work on establishing banking supervision and imposition of grounds for banking sector functioning on different - modern basis.

It would be impossible to accurately understand efforts that Central Bank of Montenegro put in the establishment of efficiency and trust in the banking sector as a segment of financial system without being reminded of causes of its weakening.

The causes of banking sector weakening are numerous with deep system and time dependence. In economic and financial system established on wrong ownership basis, lack of efficiency in earning money, functioning of market and allocation of resources has had to result in inefficiency, irrationality and devastation of banking sector through the influence of founders that originated from such system.

Numerous analysis confirm that, generally, some of the best known factors of banking sector failure are: instability of domestic currency and non interest bearing transaction funds; lack or non profit strategy and banking operations policy especially credit activities; lack of disperse activities especially diversi-
fication of loan portfolio; inappropriate handling of balance between income and risk when taking decision on loan investments; high illiquidity in the entire economy and low degree of deposit potential recreation; expenditure growth above the growth of the collected income; inapplicability of international standards of operations, accounting and audit etc.

It should be emphasized that, generally, the bigger the bank is in terms of importance of economic subjects- depositors that encompasses and network of covered operations, the influence of the stated factors is more concentrated and more significantly expressed.

To make the picture completely unfavorable, bank supervision did not exist or, what is worse, contributed with its operations to make the financial sector unstable. Licensing of pyramid banks, selective granting of loans to banks from primary issue with orders as to whom the loans from these and other sources should be given to, selective implementation of regulations on banks, creating of speculative transactions to finance working capital of privileged entities, lack of permanent control, imperfection in prescribing and implementation of accounting procedures, connections with management structures in banking industry and many more, are not features of efficient bank supervision, but the features of supervision that we used to have on these areas for a long period to additionally, and in significant extent, contribute to deterioration of environment they have been operating in and losing of depositors' trust resulting in complete lack of confidence in the banking industry.

Therefore, reform of the banking industry has been initiated by putting grounds for functioning of financial system on different basis through establishment of new normative -institutional environment that would provide functioning of banking industry formulated in new legislation and Central bank of Montenegro as independent regulatory institution and introduction of convertible currencies as payment means.

### 3.2.2. Bank Supervision

#### 3.2.2.1. Basic principles of bank supervision

In accordance with law and for the purpose of realization of its supervisory function Central Bank of Montenegro applied basic principles and international standards. This legal foundation assumes adoption and application of principles that were given in references of international financial organizations, especially in frameworks that are given in Basle - "Basic principles of
efficient bank supervision, together with the methodology of accomplishment, other Basel articles and agreements, guidelines of European Union, documents of IMF and World Bank, and theoretic and practical postulates of modern banking practice.

3.2.2.2. CBM supervisory function and achieved results

Central Bank of Montenegro has stared performing supervisory function in 2001, and approached banking system reform. Reform of the banking system has been implemented through different activities:

a) change of institutional framework;

b) banking sector control

c) reconciliation of banking operations with new institutional framework and licensing;

d) implementation of measures against non solid banks;

e) development of communication with banking sector;

f) implementation of international accounting and auditing standards;

a) Change of Institutional Framework

Central Bank of Montenegro, as the regulator of banking market, aimed at establishment of sound banking system and financial stability on macro level and prepared a Draft bill on bankruptcy and bank liquidity\(^2\) and Draft bill on amendments of Law on banks\(^3\) and enacted 15 subordinated articles that are in accordance with the adopted international standards.

b) Banking sector control

Central Bank of Montenegro performs examination of credibility and legality of banks and financial institutions' operations by insight into business books and other documentation. If the examination establishes that a bank or financial institution acted opposite to regulations in a manner that endangers its credibility, the Central Bank shall issue order to the bank to correct irregularities and at the same time to use against them measures established in the law.

The Central Bank performs examination of credibility and legality of bank operations by:
• Following reports, information and data that a bank submits to the Central Bank (off-site examination);

• Direct review of business books, bookkeeping and other documentation in the bank (on-site examination);

• Grading of bank performance indicators, comparing with minimum, average domestic and recognized international standards.

Central Bank performs indirect or off-site control by permanent bank supervision by following reports, information and other data which bank submits in compliance with special regulation of the Central Bank. Supervision based on reports can quite often identify potential problems, providing early disclosure and urgent corrective action before the problems become more serious. In 2001 off site examination performed 30 off site analysis on bank operations according to reports submitted by the banks.

Direct or on-site control performs examination in direct review of business books and other documentation in the bank. On-site examination provides supervisors with instruments to examine or evaluate a number of things such as:

• Degree to which banks consider legal regulations.

• Accuracy of reports obtained from bank;

• Bank condition and its entire operations;

• Adequacy of risk management system and internal control procedures;

• Quality of loan portfolio and adequate loan loss reserves;

• Management capability;

• Accounting adequacy;

• Issues identified in reports or in previous examination;

In 15 on-site bank examinations performed in 2001 and 5 targeted examinations, supervisors have been identifying deficiencies in bank operations and, in the form of a minute and by agreements on correction of irregularities in operations, directed banks to perform operations on sound basis and with implementation of generally accepted international standards.
In performing on-site and off-site control CBM adopted and implemented internationally accepted CAMELS methodology, and ranked banks on the basis of the same methodological approach.

c) Licensing and Compliance

In accordance with legal regulations, CBM defined the procedure for issuing licenses to banks and it includes filing necessary documentation for estimating fulfillment of conditions necessary for foundation of a bank and its operations.

During the period of compliance of banks with the new regulations, CBM based its activities to:

- On-site and off-site control,
- Analysis of documents filed by banks as a proof of compliance of business activities, organization and acts, and pointed out to eventual omissions in the written articles,
- Analysis of presented audit reports,
- Work meetings with bank management
- Writing of its own studies and analyses.

After confirming that all legal conditions and adopted standards were met, Central Bank of Montenegro licensed banks that fulfilled legal conditions and prescribed standards in October 2001. Those are: Podgoricka Bank ad Podgorica, Hipotekarna Bank ad Podgorica, Euromarket Bank ad Podgorica and Crnogorska Commercial Bank ad Podgorica, and Ekos Bank ad Podgorica which was also licensed in December 2001.

Targeted examinations performed at Niksicka and Pljevaljska Bank established need for re-capitalization of those banks and with certain corrections in operations, banks have fulfilled condition to be licensed in 2002.

In the procedure of reconciliation with the law and requests for additional capitalization, Montenegrin banks have managed to increase their capital for DEM 21.6 million through new issue of shares. Realistic indicator of banking sector financial strength increase is the level of risk based capital which from DEM 79.5 million as of 06/30/2001 reached the level of DEM 91.2 million,
without data related to Montenegrobank ad Podgorica which has been in the regime of Interim Administration as well as Jugobank ad Podgorica and Development Bank ad Podgorica as nonsolid banks against which the Central Bank shall take adequate measures according to its authorities.

In 2001, Central Bank of Montenegro received the application to license two new banks: Atlasmont Bank ad Podgorica and Opportunity Bank ad Podgorica.

**d) Taking Measures against Non Solid Banks**

Central Bank of Montenegro has at its disposal adequate supervision measures for timely corrective actions for nonsolid banks, i.e. banks that were classified in the category of banks to be especially watched or banks in crisis. The criteria for such classification were set in accordance with the law and its subordinated regulations and internationally adopted methodology.

Central Bank of Montenegro has introduced Interim Administration in Montenegrobank on 04/09/2001 as a consequence of the examination conducted in December 2000. The examination showed unsatisfactory condition of the bank on all segments of its operations.

Introduction of Interim Administration in Montenegrobank in April 2001 was necessary in order to:

- Stop negative trends in its operations,
- Improvement of high illiquidity
- Detailed analysis of financial status and perspectives.

With the introduction of Interim Administration in Montenegrobank ad Podgorica CBM prescribed the following measures and activities:

1. Production of reports that realistically present financial and market position of the bank with the proposal of solution;
2. Prohibition of payment of depositors to avoid preferential treatment;
3. Prohibition of loan granting and other forms of risk investment of bank funds;
4. Undertaking activities and measures on collection of claims and increase of bank liquidity;
5. Undertaking measures for reduction of expenditures, and optimum use of organizational and personnel bank resources;

6. Realistic classification and evaluation of balance sheets and their compliance with IAS (International Accounting Standards);

7. Research of market possibilities for re-capitalization or bank sale.

Several studies were made during the Interim Administration and they resulted with drafting of Reorganization Plan.

The Bank reorganization plan was adopted in December 2001 upon prior initiative of the Government of Montenegro. The plan anticipated numerous activities in reorganization of the bank to be developed in 4 phases and based on projections of the bank's position till the end of the Interim Administration, and on the principles of scenario analysis.

Successful realization of the plan should enable continuation of business activities of Montenegrobank ad Podgorica, and introduction of international trust for the purpose of bank privatization by foreign investor.

All banks undergoing procedure of reconciliation of operations with legal regulations and new standards have been the subject of adequate measures through establishment of their condition, signalizing of directions in the procedure of reconciliation and follow up of that process.

e) Development of Communication with Banking Sector

In order to perform and improve examination function in a more quality way, the Central Bank contacts with bank management, supervisory committee, internal auditor and independent external auditor appointed by the bank and it also cooperates with bank association and other domestic and foreign institutions related to financial market. Approximately forty meetings were held in the procedure of reconciliation of operations, organization and acts with management and managing board of banks. Communication with banks achieved the biggest quality after the establishment of new Central Bank reporting system by banks and organization of seminars for banks' employees to easily apply new standards.

f) Implementation of International Accounting and Auditing Standards

Central Bank has started applying international banking standards on 06/30/
2001. As of that date, off-site reports have been produced based on documentation that banks submit to the Central Bank.

In the scope of implementation of international accounting standards, the Council of the Central Bank at its meeting held on 12/27/2001 adopted Decision on Chart of Account for Banks according to which banks will present their condition and change of assets, capital and obligations, income and expenditure and establish results of operations.

3.2.3. Structure of banking sector in Montenegro

Montenegro banking system in 2001 comprised 11 banks, 5 of them already being granted license on 31 December 2001 by the Central Bank of Montenegro according to current legislation (Euromarket Bank, Hipotekarna Bank, Montenegrin Commercial Bank, Podgoricka Bank, Ekos Bank), 5 banks are undergoing procedure of reconciliation with the law (Nikšicka Bank, Pjivevaljska Bank, Beranska Bank, Jugobank, Development Bank), while Interim Administration was introduced in Montenegrobank on 04/09/2001.

Total assets of Montenegrin banks, without Montenegrobank\(^5\), as of 12/31/2001 was DEM 718,053,000\(^6\) (of which 4 biggest banks make 82% of the total financial potential. Total bank capital as of 12/31/2001 was DEM 106 million and Hipotekarna Bank and Podgoricka Bank participated with 49% in that structure.

Considering relatively adverse situation in Montenegro economy and its environment, it is not realistic to expect fast and easy recovery of the entire banking system as well as its transition to the modern banking system. After resolution of the actual crisis situations the focus is on long-term solutions, such as restructuring of banking system, re-capitalization, primarily by attracting strategic investors, supported with implementation of modern technology and improvement of operations quality.

In 2001, 7 branches of banks whose head offices are in Serbia operated in Montenegro, of which three branches stopped operating\(^7\). As of 12/31/2001 liquid assets of these branches was DEM 15,693,000, while short-term liabilities were DEM 21,667,000. Participation of cash in short-term sources of funds is 72%, which satisfies minimal liquidity standards. Earnings realized by the branches in 2001 amounted DEM 8,123,000, while operating costs were DEM 7,236,000.
a) Banks Ownership Structure

Capital of Montenegrin banks in state ownership is 43% of total capital, participation of private individuals in the capital is 41% while foreign entities are owners of capital in the amount of 16% of the total capital as of 12/31/2001. Euromarket Bank is the only Bank with 100% of foreign capital. Participation of state capital in Development Bank is 100% and with other 5 banks in which the state is majority owner, it makes totaly 6 banks with dominant participation of the state in capital. Participation of private individuals in the capital of Hipotekarna Bank and Ekos Bank is over 90%. The overview of the equity ownership structure as of 12/31/2001 is given in Table 1, enclosure 2.

Banks assets whose capital is mostly in state ownership in Montenegro amounts to DEM 445,892,000 which makes 62% of total assets of all banks.

3.2.4. Banks operations in 2001

The total assets of the banks as on 12/31/2001 amounted to DEM 718,053,000, which is DEM 6.2 million more, or a growth of 0.87%, in comparison to the condition as of 06/30/2001 that amounted to DEM 711,844,000.

Such insignificant growth of assets is primarily the result of the application of new banking regulations in reporting that is not correspondent to IAS. Individual asset items are accordingly reduced by the reserves for potential operating losses and represent the items deductible from total assets. The reserves for potential losses increased from DEM 8,168,000 on 06/30/2001 to DEM 16,502,000, which is the growth of 102%.

The market participation of the four largest banks with the total assets of DEM 591,956,000 as of 12/31/2002 amounts to 82% and has not changed in relation to the comparable period.

a) Balance Sheet of Banks in Montenegro

In the structure of assets, the largest item are the loans (DEM 242,439,000, or 33.76% of the total assets. The loan amount fell by 1.4% as compared to the given period. The fall of lending activities was caused by poor performance at several banks that were not engaged in new lending in the given period while their loan loss reserves increased at the same time. With the impact of these banks on the total lending activity of all banks excluded, an expanding lending activity of other banks becomes evident.
The highest growth in the structure of assets in comparison to the given period is achieved at securities held by maturity (511.4%), and then at securities for resale (289.7%). The biggest fall in the same period is reported at investments in other banks (-64.7%), and investments in non-consolidated related companies (-25.53%).

Within other assets, DEM 171,344 or 75% relates to claims from FRY with respect to frozen foreign exchange deposits. A law is planned to be passed in 2002 to govern this matter so that these obligations are planned to be assumed by the government and removed from the balance sheets of banks. As a result, the banks' balance sheets will present a more realistic picture of their performance.

The participation of loans in the total assets of Montenegrin banks amounts to 34%, as compared to 50-74% in the Southeast European countries. Each year, the percentage is going down in these countries, except for Slovenia, where lending activity becomes an increasingly significant share of overall assets.

In the structure of liabilities, total liabilities of banks account for 85.18%, while the banks' capital contributes 14.82% to the total liabilities. Within total liabilities, deposits cover 40.36%, showing a slight growth of 0.92% during the observed period.

The largest nominal growth in liabilities is related to borrowings from other banks. A negative trend in the semiannual period amounting to the 4.36% fall is recorded at other obligations, which make 29.26% of total liabilities. In the observed period, the banks' capital increased in nominal terms by DEM 2,838,000, being a growth of 2.74%.

In the item "Other Liabilities" in the aggregate balance sheet, which amounts to DEM 210,072,000, banks' liabilities under frozen foreign exchange deposits contribute 84%.

The item 'Other Capital' at the liability side of the aggregate balance sheet is negative because three banks reported a loss during the observed period.

The evaluation of the quality of assets is the most important element of the evaluation of the stability of a bank's operation and is has significant impact on the bank's operating results. The proportion of non-performing loans (substandard, doubtful and loss) in the total loans is 7.58%. The proportion between non-performing loans and capital increased by loan loss reserve
amounts to 15%. The proportion between non-performing assets (w/o foreign loans and frozen FX deposits that are not subject to provisioning) and total assets is 4%.

Foreign loans of Jugobank amounting to DEM 77,712,000 make 32% of loan claims in the aggregate balance sheet of the banks. Frozen FX deposits at 5 banks totaling DEM 171,344,000 are included in "Other Assets" and account for 75% of this amount. The total assets of banks without foreign loans and frozen FX deposits, the treatment of which will be regulated in 2000 with the condition as of December 31, 2001, amount to DEM 468,997,000. The aggregate balance sheet of banks that excludes foreign loans and frozen FX deposits is shown in Table 4, enclosure 3.

b) Structure of Loans, Claims under Leasing Operations and Claims Due

Long-term loans in the banks' loan portfolio as of 06/30/2001 make 55% of the total loans (including the foreign loans of Jugobank), while short-term loans participate with 44%. In the structure of long-term loans, 69% are loans to public companies. Within short-term loans, 67% are loans to private companies. Loans to public and private companies account for 79% of all loans, loans to the Montenegrin Government 15%, loans to private individuals 1%, while loans to nonprofit organizations, banking institutions, non-bank financial institutions and other loans represent 5% of the total loan portfolio (Table 5 and 6, enclosure 3).

The lending activity slightly decreased during the semiannual period. The participation of long-term loans in total loans decreased to 52%, but compared to their nominal amount as of 06/30/2001, they fell by 5%. Short-term loans for the given period grew by 5%. Loans to public companies still make the largest share (72%) of long-term loans, while within short-term loans, loans to private companies contribute 64% of claims up to one year.

The biggest growth in the period (296%) is achieved in credits to private individuals, which account for only 5% of all loans as on 12/31/2001.

As for the loan concentrations by trades (industries), the loans for transport, storage, PTT and communications make 27% of all the extended loans as of 06/30/2001 and that percentage was maintained as of 12/31/2001. Loans for
the commerce increased in relation to the comparable period and their participation in total loans went up from 13% as of 06/30/2001 to 22% as of 12/31/2001. Regarding the remaining utilized loans as of 12/31/2001, then follows the mining with a 12% share, administrative activities and other public services with 8%, and finances with 6%, dropping from 12% as of 06/30/2001.

c) Structure of Deposits with Banks

The total deposits with banks as of 06/30/2001 amounted to DEM 287,193,000. As regards the maturity, 66% are demand deposits, 17% are deposits up to 3 months, 10% deposits up to one year and long-term deposits are 7% of all deposits.

Deposits with banks in Montenegro on this date originate mostly (62%) from private companies and partnerships, 11% from government agencies and 17% from other sources.

The total deposits increased by 0.92% during the semiannual period and amounted to DEM 289,824,000 as of 12/31/2001. Demand deposits are still the largest volume and account for 71% of all deposits. Deposits from private companies and partnerships contribute to total deposits at the percentage of 55%, which means that their participation reduced in comparison to the semiannual period. Deposits of government agencies account for 16% and record a growth in relation to the comparable period, while deposits of public companies contribute 8%, which is a fall compared to 06/30/2001 (Chart 1 and 2, enclosure 3).

There was an increase in savings at the end of 2001. This occurrence, in conditions of banking system reform, indicates that the quality of banking facilities, as well as presence of distinguished founders of banks will influence gradual restoring of confidence of economy sector and citizens in the baking system in the Republic.

d) Interest rates

Banks in Montenegro create interest rates freely in accordance with supply and demand of money, so their height defers from bank to bank. Active interest rates on short-term loans in 2001 slightly decreased in comparison to the end of 2000, and they were from 0.5% to 3.0% monthly. At the same time, interest rates on long-term loans mostly stayed on the level in December 2000, and they were from 0.33% to 3.0% monthly.
Passive interest rates on sight deposits stayed on the level in December 2000 (0.2% - citizens and 0.25% - enterprises). Interest rates on term deposits increased in comparison to December 2000 and they were from 0.25% to 0.69%.

**e) Aggregate Income Statement of Banks**

The achieved financial results of banks in Montenegro as per their income statements are mostly negative, partly because of objective, i.e. inherited problems, and on the other hand, due to subjective reasons (Table 7, enclosure 3).

In 2001, the commercial banks recorded a loss of DEM 2,369,000. Such amount is the result of adverse financial performance of three banks that incurred a net loss of DEM 8,939,000: Jugobank Podgorica (DEM 7,029,000), Nikšićka Bank (DEM 1,718,000) and Development Bank CG (DEM 192,000). Seven other banks made the profits of DEM 6,570,000.

Gross interest income at the level of the whole banking system was DEM 22,686 thousand and increased by DEM 12,376,000 or 120.0% in relation to 06/30/2001.

Interest expenses amounted to DEM 8,490,000 and in comparison to DEM 3,767,000 as of 06/30/2001 and increased by DEM 4,723,000 or 125.6%.

Net interest income amounted to DEM 14,196,000 and represents 63% of gross interest income.

Costs of loan losses amounted to DEM 16,006 thousand as of 12/31/2001 and grew by DEM 8,675 thousand or 118.3% in relation to 06/30/2001. The enormous increase in costs of loan losses in the second half of 2001 occurred after the completion of examination done by CBM supervisors and the banks following the imposed measures on the amount of reserves for loan losses under classification of assets and off-balance risk items.

The proportion of costs of loan losses in average assets is 4.66%.
The total net income from interest and fees amounted to DEM 25,973,000 as of 12/31/2001, which is an increase equal to DEM 14,010,000 or 117% over the comparable period.

Operating expenses amounted to DEM 23,123 thousand and increased by DEM 14,608 thousand or 172% in comparison to 06/30/2001. The relation of operating expenses and average assets is approximately 6.42%. Considering individual banks, these expenses are high at two banks, slightly increased at 5 banks and relatively well controlled at 3 banks.

A significant growth in extraordinary income is the result of the fact that two of the banks, on the basis of the then applicable Accounting Law, transferred the reserves from capital to extraordinary income, as well as the increased collection of doubtful loan as a result of stricter examination and subsequent more active approach of banks in that field.

According to the aggregate income statements of banks, the return on average assets was -0.68% and the return of average capital was -4.44% because of the loss shown. However, if the three banks that operated with losses were exempted, the return on assets for the banks that operated with profits would be 1.57% and the return on capital would amount to 7.37%.

Based on the shown data (Table 8, enclosure 3), the following conclusions can be made:

- Return on average assets (ROA) as a primary profitability indicator of Montenegrin banks is negative. It was mostly influenced by (a) growth in costs of loan losses and (b) growth in operating expenses.

- Return on capital is also negative, which is not good for banks, because this indicator is the key element of attraction for foreign investors. Having in mind new minimum capital standards, some banks will need to increase their capital through new investments if they want to continue to operate. Capital increase from their own sources (profits) can be done by few of the banks only.

The number of employees in Montenegrin banks as of December 31, 2001 was 751. The banks with majority government stake employ 600 persons, i.e. 80% of the total number of employees. With the staff of Montenegrobank included, the total number of employees in the banking industry amounted to 1,170 (Chart 3, enclosure 3).
3.3 Payment operations

3.3.1 Regular activities

2,039,907 cash transactions and 5,644,766 cashless orders in payment operations have been conducted at cash desks of Central Bank of Montenegro through its regular activities. Besides that, 1,855,793 cash orders from physical persons received through operating units of Post Office of Montenegro have been processed at the cash desks. 4,041 legal persons’ accounts have been opened, and they are recorded in a unique register of accounts of participants in payment operations.

In conducting these transactions in 2001, CBM registered 5,732 illiquid legal persons in the Republic with 91,780 employees and total of DEM 85,521,000 of outstanding liabilities, of which 5,315 legal persons are in economic sector with 66,676 employees and DEM 85,143,00 outstanding liabilities. Furthermore, 2,671 legal persons that are constantly illiquid were also registered with 27,813 employees and total debt of DEM 85,020,000.

Petitions of bankruptcy were filed in the Commercial court against 2,355 legal persons with 13,916 employees and total of DEM 70,048,000. Bankruptcy proceedings were brought against 2,280 legal persons in economic sector with 13,859 employees and DEM 70,048,000 outstanding liabilities, while the rest refers to legal persons in, so called public services.

The Central Bank monitored 6,485 legal persons, enterprises and cooperatives; 1,564 other legal persons; 5 insurance companies and 11 banks, and after it processed the given data, informed the public on their achieved financial results in semiannual accounts (I-VI 2001). Furthermore, in 2001, CBM monitored 7,007 enterprises and cooperatives; 1,940 other legal persons (funds, agencies, institutions and other); 5 insurance companies and 11 banks and after it processed the given data, informed the public on their achieved financial results.

In 2001, CBM monitored monthly all financial and cash flows of economic subjects in the Republic, and used data on cash flow (income and expenditures) in all business accounts: economy, public services, banks, insurance companies, Employment bureau, Health care fund, Pension fund, budget and administrative authorities. It monthly controlled and monitored paid net earn-
ings in economy, non-economy, banks, insurance companies, funds and the budget.

In performing payment operations activities the Central Bank monitored data on allocation of public income in 2001: gross payments and distribution of income. It monitored gross payments by analyzing two segments: budget income (taxes, dues, customs, etc.) and social insurance organizations income (health care contributions, contributions for the unemployed and pension fund). It also analyzed distribution of income in two segments: social insurance organizations income (health care fund, pension fund, employment bureau, etc) and budget income.

In realization of conversion plan (DEM in EUR) CBM made all preparations for undisturbed conversion, including necessary adjustments of software, preparation of instructions for employees who performed payment operations, and making necessary contacts with banks for the purpose of coordination of operation procedure in the process of conversion.

Together with the Ministry of Finance the Central Bank made all preparations for opening of the Main state account of the budget and for closing previous accounts of the budget of the Republic of Montenegro.

**3.3.2. Logistics support to the process of MVP (Mass Voucher Privatization)**

CBM performed activities in all phases of Mass voucher privatization process. In phase I (04/17/01 - 06/16/01) it participated in forming of Initial List of citizens who were entitled to vouchers, and on the basis of that list it printed voucher transfer orders. In phase II (06/18/01 - 10/18/01) it checked and transferred vouchers to family members and privatization funds and opened their accounts. After this phase, CBM conducted the final transfer of voucher points to privatization funds thus creating conditions for Privatization Council to eliminate the funds that did not reach the census. In phase III - auctions (11/05/01 - 12/08/01), orders that citizens (directly) and privatization funds used to exchange vouchers for shares of enterprises were processed. Preliminary account of auctions' results was made in phase IV and the Central Bank started with designing, publishing and distribution of information on results of mass voucher privatization for all shareholders.

211 enterprises whose estimated capital value was DEM 7.841.050,000 participated in MVP program, and DEM 2.361.868,631 were used for the process of MVP.
436,880 vouchers whose nominal value was 5,000 points were allotted at the beginning of MVP program. 391,113 citizens used their voucher points. Citizens directly invested 29.05% of total nominal value of voucher points in enterprises, and 69.47% through privatization funds.

3.3.3. Payment operations system reform

The aim of the Central Bank in payment operations system reform is to develop new payment operations system suitable for market economy and it has a request for fewer disturbances in payment operations flows of private and public sector.

The Central Bank has prepared Plan of payment operations reform activities that was reviewed and adopted by the government of the Republic of Montenegro for the purpose of synchronization with establishment of state vault and implementation of new tax legislation.

Planned activities established principles and the concept of payment operations system reform are based on transfer of a part of payment operations department (cash desk services and money operations) from the Central Bank to banks. According to those principles, the Central Bank would continue with interbank payment system (RTGS), processing of state accounts, central distribution of cash, and system of endorsement transfer for the account of legal persons.

Starting from the basic function of establishment and maintenance of efficient payment operations and regulating and controlling in this field, the Central Bank provided basic conditions for the process of reform not to jeopardize the principles of safety, efficiency, data protection, and continuation.

For the purpose of complete harmonization of payment operations reform with other reform processes in the Republic and with the basic request for not imposing solutions to banks, there was a modification of two basic models: for banks to provide payment operations services through transformed ownership of network of payment operations branches, or to develop their own network.

Structure and account method for prices of payment operations services will enable banks to make profit, but it will also enable users to choose bank with most acceptable terms. Prices of payment operation services of the Central Bank should be most acceptable for the ultimate beneficiary.
At the very beginning of the reform, banks accepted the offered concept and, through Committee for functional system improvement made of representatives of the Central Bank and other banks, joined the process in order to monitor it and give their support to the reform.

Practical activities in payment operations reform started with implementation of the "pilot project". The first bank that assumed payment operation services for its depositors was Euromarket bank in Podgorica. It conducts preventive control, data input, and liquidation, treasury and vault operations at the rented cash desk of the Central Bank in Ulcinj. All the banks that were licensed by the Central Bank showed interest in assuming payment operations activities. Preparations for transfer of cash desk services were also made for Crnogorska commercial bank, which will render payment operation services to its depositors at its cash desk in Bar.

As far as normative-regulatory activities are concerned, there were activities on preparation of six decisions and two instructions.

3.4 Other activities of Central Bank of Montenegro in 2001

3.4.1 Legal regulations

In accordance with legal authorization, the Central Bank prepared drafting bills that coordinates business activities in its jurisdiction, and enacted most of the subordinated articles it is authorized for.

Review of the subordinated articles that the Central Bank prepared and enacted in 2001 is given in the enclosure.

3.4.2 Banking and financial operations

3.4.2.1 Banking services to the budget

In performing function of fiscal agent of agencies and organizations of the Republic, with Minister of Finance as legally authorized person, the Central Bank concluded the Contract on conducting banking activities and services related to implementation of decisions on public debt.

Those activities relate to:
• Opening of the Main state account and preparation for closing other budget accounts

• Giving recommendations about financing of the budget deficit

• Activities connected to issuing treasury bills

There were five auctions of treasury bills in 2001. It should be emphasized that this was the first sale of treasury bills after a long time.

During the auctions, buyers of treasury bills offered return rates that were from 4.20% to 8.95%. Greater participation of buyers with mostly state capital were recorded at the auctions, i.e. buyers of the statutory bills were mainly banks and enterprises.

3.4.2.2. Foreign exchange management

For the purpose of realization of Conversion program (DEM in EUR) and foreign exchange management, cooperation with commercial banks in Germany, Switzerland, Italy, Great Britain and the USA was established, and there were some investments.

3.4.3. Activities concerning public debt

The Central Bank offers services to the budget concerning implementation of decisions on public debt as a part of its fiscal agent activities.

In realization of this function, the Central Bank worked on adjusting data of allocated and non-allocated debt\(^{10}\) together with National Bank of Yugoslavia (NBY), since the basic data base on non-allocated debt was in possession of NBY. Communication with NBY was difficult, but thanks to intervening of international organizations basic data on the debt were obtained.

Basic categories of Montenegrin public debt are:

1. International financial organizations (World Bank, European Investment Bank)

2. Paris club

3. London club

4. Other

---

\(^{10}\) Allocated debt is a debt whose ultimate beneficiary is known, and non-allocated debt is a debt made of credits that were used by ex SFRY.
Negotiations with European Investment Bank, World Bank and Paris club on multilateral level were finished in 2001, and negotiations with London club were initiated.

### Table 2
**Treasury bills auctions**

<table>
<thead>
<tr>
<th>Auction</th>
<th>I auction</th>
<th>II auction</th>
<th>III auction</th>
<th>IV auction</th>
<th>V auction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount of issue</strong></td>
<td>2,556</td>
<td>3,579</td>
<td>3,579</td>
<td>3,579</td>
<td>3,579</td>
</tr>
<tr>
<td><strong>Offered amount</strong></td>
<td>3,364</td>
<td>2,669</td>
<td>3,093</td>
<td>4,714</td>
<td>4,049</td>
</tr>
<tr>
<td><strong>Amount of purchased</strong></td>
<td>2,556</td>
<td>2,669</td>
<td>3,093</td>
<td>3,579</td>
<td>3,579</td>
</tr>
<tr>
<td><strong>Sales percent</strong></td>
<td>100</td>
<td>74.57</td>
<td>86.43</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td><strong>Minimum rate</strong></td>
<td>4.20%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td><strong>Maximum rate</strong></td>
<td>8.00%</td>
<td>8.95%</td>
<td>8.50%</td>
<td>8.95%</td>
<td>8.95%</td>
</tr>
<tr>
<td><strong>Average rate</strong></td>
<td>6.50%</td>
<td>6.89%</td>
<td>6.83%</td>
<td>7.31%</td>
<td>7.14%</td>
</tr>
</tbody>
</table>

### Table 3
**Results of treasury bills auction**

<table>
<thead>
<tr>
<th></th>
<th>I auction</th>
<th>II auction</th>
<th>III auction</th>
<th>IV auction</th>
<th>V auction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banks</strong></td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td><strong>Enterprises</strong></td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Private capital</strong></td>
<td>39%</td>
<td>21%</td>
<td>17%</td>
<td>28%</td>
<td>28%</td>
</tr>
<tr>
<td><strong>State capital</strong></td>
<td>61%</td>
<td>79%</td>
<td>83%</td>
<td>72%</td>
<td>72%</td>
</tr>
</tbody>
</table>

#### 3.4.3.1. World Bank

Negotiations with World Bank on terms and conditions of consolidated loans were held on November 1 and 2, 2001 in Washington. The purpose of the negotiations was to consolidate 22 loans the World Bank gave to Montenegro in a new loan(s) for the purpose of debt rescheduling. The Central Bank had been working on consolidation of data on debts and preparation of platform for negotiations with World Bank. The following terms and conditions were agreed upon:

1. Period of loan repayment is 30 years. Grace period is 3 years. Interest and installments are paid semiannually.
2. Loan currency is Euro (EUR).

3. Total liabilities of Montenegro towards World Bank on October 30, 2001 were USD 242,433,099.00. The following claims were included: due principal delayed liabilities, interest, commissions and a part of the principal to mature. Total amount will be determined on the day when the loan is signed. On that day the currency of different loans will be converted into a funding loan currency. The loan was structured in 3 sub-loans for the purpose of balancing the fiscal burden.

4. Interest rate is formed on the basis of LIBOR rate.

3.4.3.2. Paris club

Within the framework of Paris club, Montenegro has debts towards 9 countries: Austria, France, Germany, Italy, Holland, Sweden, Switzerland, Great Britain and USA. There is a debt towards Russia, too. Basic data on the debt servicing towards these countries were adjusted during 2001.

Negotiations on multilateral level finished in 2001 and the statement defining the terms and conditions under which these negotiations would be conducted (planned for 2002) was signed.

Negotiations with the representatives of Paris club were conducted in Paris during November 2001. The following terms and conditions were agreed upon:

1. All loans and credits till the cut-off date (December 20, 2001) are parts of a base for write-off and refinancing.

2. The basis for the write-off and refinancing are medium-term and long-term credits signed before cut-off date.

3. Grace period is 6 years.

4. Repayment period is 22 years.

5. Gradual repayment of principal that will be specified at bilateral level.

6. Write-off in two phases:

   a) I phase - write-off of 51% of the amount, in March 2002, after signing of the new agreement with IMF.

   b) II phase - write-off of 15% of the amount (or 30.61% of the rest =
15%), after the expiration of the agreement with IMF.

7. Capitalization of interests

a) Till March 2002 - 100% - interests are assigned to the debt and become a part of the base for write-off. Interests will be repaid in 14 equal installments starting from September 2001 to March 2011.

b) After the first write-off - 60% of interest will be capitalized and will be repaid from September 2007 to March 2014.

c) 40% of the interest will be repaid during the grace period.

8. Treatment of short-term credits - reprogram for 8 years with 4 years of grace period.

9. Interest rate - market interest rate (LIBOR), that will be defined at bilateral negotiations, will be round off at the nearest interest rate - 1/16 of the percentage.

Negotiations at bilateral level were planned for 2002.

3.4.4. Activities concerning the conversion process (DEM in EUR)

Council of the Central Bank adopted Program of activities on conversion (DEM in EUR) in August 2001. The program defined basic principles and deadlines for conversion process, as well as the activities concerning the process. The Central Bank started with conversion preparations in September 2001:

- Recommendations to the Government of the Republic of Montenegro for pricing in two currencies (DEM and EUR);

- Establishment of communication with banks abroad that will conduct the exchange;

- Technical preparations and working out the logistics of the process for activities of the vault and counters, delivery and distribution of money;

- Adjustment of information system and defining new software solutions for double-currency system and Euro.
• Establishment of operational procedures and instructions to banks concerning the conversion;

• Organizing of training programs for employees of the Central Bank, other banks, and organizations that deal with cash;

• Preparation of public campaign for the purpose of informing the public on the new currency;

3.4.5. Personnel development

In 2001, the Central Bank put an emphasis on employment of young people with university qualifications and knowledge of at least one foreign language, then on their advance training by organizing various courses, seminars, sending them to studying trips, etc. All that was done for their more successful business engagement. During last year 21 people with university qualifications were employed by the Central Bank.

Job interview consisted of several phases and was conducted by the selection panel.

Several people with special authorizations and responsibilities were named in 2001, as well as organization managers.

Elementary computer courses and English language courses were organized as a part of professional training of the employees.

Employees in the Central Bank attended several courses that were organized by IMF, and those were several programs of professional training and seminars that discussed about the topics necessary for operational activities of the Central Bank were organized in cooperation with USAID and other central banks and commercial banks from abroad.

The result of these programs was a higher level of professional skills of the employees and preparation for courses at higher level.

3.4.6. Public relations

As a new institution that still has to create its own image as a part of the image of reformed Montenegro, the Central Bank took an important place in media
in Montenegro and outside its borders.

Communication with the public was conducted in many ways:

- Appearance in regional and local media - television, radio, press, professional magazines;
- Organization of press conferences on current topics;
- Participation in professional discussions;
- Giving comments and statements at reporters’ request;
- Making bulletins, monthly, quarterly and annual reports and
- Making information brochures and other advertising materials.

Informative and educational campaign for introduction of EURO gave a significant contribution to the image of the Central Bank. An exhibition of money in Cetinje was opened on December 24 2001 as a part of this campaign. Making of information bulletin for employees of the Central Bank and putting it in the Internet presentation, billboards with messages of the Central Bank, and posters also contributed to the media presentation of the Central Bank.

There were also activities on preparation of complete Internet presentation of the Central Bank.

Besides appearances in the media, public relations also mean education of public on activities conducted by the Central Bank, and for that purpose and in accordance with the strategy of public relations, education programs through media and educational institutions are being prepared.

### 3.4.7. Relations with international financial institutions

During 2001, the Central Bank established and maintained good relations with international financial and other institutions. It was already emphasized that this communication was on federal level because of the imposed external restrictions.

As a part of Stand by arrangement, the IMF conducted three audits on fulfillment of the terms and conditions of the arrangement, which the Central Bank fulfilled. Macroeconomic data, monetary accounts and drafts of balance sheet
and income statement (in accordance with International Financial Statistics standards) were presented to the IMF. Representatives of the IMF also regularly monitored activities of the Central Bank related to the reform of banking system.

The Central Bank cooperated with World Bank on matters of consolidated loan and defining terms and conditions and mechanisms for structuring new loans and selection of loans purposes.

For the purpose of realization of macroeconomic assistance of the European Union, the Central Bank regularly submits reports on reached stages of the reform of banking system, and new macroeconomic indices are presented.

There were several meetings with the representatives of European Bank for Reconstruction and Development (OERD) during their visits to the Republic of Montenegro. Structuring programs of assistance and defining arrangements were discussed about at these meeting.

A contact with European Central Bank was made, and the program of activities on introducing EURO in the Republic of Montenegro was presented the occasion.
4. ENCLOSURES
Enclosure 1:
Organization scheme of Central Bank of Montenegro
Enclosure 2:

Basic macroeconomic developments in 2001

As a part of its regular activities the Central Bank monitors macroeconomic developments in real, monetary, and fiscal sphere, and in balance of payments. On the basis of the findings, it prepares monthly reports on developments in monetary sphere and on state of economy. Further on we present basic macroeconomic indices in 2001\textsuperscript{11}.

Real sphere developments

GDP and employment

On the basis of realized production and services, and overall macroeconomic parameters, it is estimated that realized GDP in Montenegro in 2001 was DEM 1,614 billion, which is by 30% more than in 2000, including price increase in 2000 and 2001. Level of GDP was determined by decrease of production (in comparison to 2000) in the field of industry by 0.7% (anticipated increase by 3.5%), forestry by 14.4% (anticipated increase by 5%), transportation by 1.4% (anticipated increase by 5%), trade by 11.5% (anticipated increase by 5%). Participation of these sectors in realization of GDP in 2000 was 65%.

What influenced GDP in 2001 was increase of agriculture production by 5% (anticipated increase by 3%), building construction by 6.8% (anticipated increase by 6%), and tourism by 26.9% with over four million overnight accommodations, inflow of foreign tourists by 49%, and overnight accommodations of foreign tourists by 57.8% (anticipated increase by 20% and realized 3.8 million overnight accommodations, and increase of foreign trade by 50%).

A number of employed in Montenegro in 2001 slightly increased in comparison to the average in 2000 (by 0.25 index points), and average monthly number of the employed was 114,100, and at the same time there were 81,612 unemployed persons or 2.9% less in comparison to the average number of

\textsuperscript{11} All analyses are based on official statistics.
unemployed in 2000. If data from surveys conducted by the Republic Bureau of Statistics (twice a year - in March and in October) are included in the official data on number of employed and unemployed, and number of employed in small enterprises and at entrepreneurs we get the average rate of unemployment in 2001 of 28.6%. It should be emphasized that this datum does not contain data on the employed in grey economy, which would make the rate of unemployment significantly lower.

**Prices**

Average retail prices in 2001 were higher by 23% in comparison to the average retail prices in 2000. Prices of services increased by 32.2% and prices of goods by 21%.

The biggest increase in total increase of prices of goods was in prices of industrial food products (above the average increase of retail prices) by 4.9%, and that increase was depreciated by prices of agricultural products. Anyway, prices of food products (both agricultural and industrial) increased by 26.9%, and they participate with 36.7% in forming overall retail prices index.

Increase of retail prices in 2001 influenced the increase in costs of living. The biggest influence was of prices of services, prices of lodging, prices of transportation and postal services, and prices of fuel and electricity. The least influence was of prices of clothes and footwear, price hygiene products, prices of household furniture, and prices of food products. The average increase of costs of living in 2001 was 21.9%.

Total increase of prices of industrial products was realized at more moderate rate of increase than the increase of retail prices. In comparison to the same period in the previous year, prices of manufacturers increased by 14.5% in the period January - December 2001. The biggest increase was of prices of consumer goods (27%), capital goods (19%), and reproduction material (about 8%). According to different sectors, the biggest increase was of prices of electricity (49%), and the lowest increase was of mining and quarrying (7.5%). Prices in manufacturing increased by 8.1%, where prices of food products and beer increased by 37.5%, tobacco products by 19.8%, and leather and leather products by 21.8%.

In the last three months of 2001 there was inflation pressure of EURO conversion because of round off of prices. However, with enactment of By-law on
pricing in two currencies (DEM and EUR) these effects were reduced and disposed during the double-currency period.

**Monetary developments**

Monetary developments in 2001 were rather restrictive since the use of sight deposits for credit activity of banks was limited. Namely, banks had the ability to approve loans (in DEM) from term deposits and their own assets, so the level of these assets could not interfere with the restrictive monetary policy. However, it should be emphasized that at the end of 2001 there was a significant increase of savings, which indicated gradual restoring of confidence of citizens in the banking system in the Republic.

**Monetary mass**

Tracking of monetary mass was done by tracking of deposit money, and some estimates were made concerning money held by the citizens. On the basis of research of several institutions the estimates were from DEM 250 million - DEM 300 million. Actual data on quantity of money held by the citizens will be available after EURO conversion.

There were some oscillations in change of deposit money during 2001. They show mainly a trend of growth when 90% of total deposits were realized.

![Change of deposits in 2001 yr](image)

Namely, deposit money in December 2001 was DEM 142,8 million, which was by DEM 48 million more, or a growth of 51% than at the end of 2000. Observed
by months, the biggest level of deposit money was in August when it was DEM 176 million, and the lowest in June when it was DEM 102 million. Deposits in economy that constantly made the biggest part of total deposits (average daily 52%), while participation of other sectors oscillated and was incomparably lower mainly influenced these changes.

One of the reasons for the growth of deposit money, especially in economy, was in the first results of the stamping out of the grey economy and its transfer into legal flows.

**Fiscal sphere**

Activities on the reform of fiscal sector and its role in overall economic relations in the Republic of Montenegro that started in 2000 continued throughout 2001 through reform of taxation system, payment operations, and public finances.

Budgetary expenditures in 2001 were based on measures of planned economic policy, as well as on the principles of budgetary expenditure that for its aim had financing of budgetary expenditures from the real sources.

Total income in 2001 was DEM 637,578,211.78. Planned income in 2001 was DEM 621,620,210.99, which was by 2.57% above planned. Total expenditure

<table>
<thead>
<tr>
<th>Date</th>
<th>Economy</th>
<th>Non-economy</th>
<th>FX reserves</th>
<th>Budget</th>
<th>Gov. instit.</th>
<th>Health care fund</th>
<th>Pension fund</th>
<th>Banks</th>
<th>Highways</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>25.12.00.</td>
<td>54.4</td>
<td>4.9</td>
<td>1.3</td>
<td>3.3</td>
<td>7.5</td>
<td>0.06</td>
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<td>8.5</td>
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<td>176</td>
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<td>29.09.</td>
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<td>1.5</td>
<td>2.4</td>
<td>5.3</td>
<td>10.8</td>
<td>48.1</td>
<td>166.7</td>
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<tr>
<td>31.10.</td>
<td>90.9</td>
<td>5.3</td>
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<td>2</td>
<td>3.1</td>
<td>5</td>
<td>10.8</td>
<td>35.7</td>
<td>173.1</td>
</tr>
<tr>
<td>29.11.</td>
<td>76.8</td>
<td>8.1</td>
<td>0</td>
<td>11</td>
<td>5.3</td>
<td>1</td>
<td>2.8</td>
<td>7.4</td>
<td>7.7</td>
<td>44</td>
<td>164.1</td>
</tr>
<tr>
<td>31.12.</td>
<td>71.4</td>
<td>6.4</td>
<td>0</td>
<td>4.9</td>
<td>3.1</td>
<td>0.94</td>
<td>7.6</td>
<td>9.2</td>
<td>6.8</td>
<td>32.46</td>
<td>142.8</td>
</tr>
</tbody>
</table>

Table 1: Deposit money of clients

One of the reasons for the growth of deposit money, especially in economy, was in the first results of the stamping out of the grey economy and its transfer into legal flows.
Basic category of the income of the Republic - taxation - was DEM 367,595,567,78, or 95.57% of the plan for 2001. In this category only turnover tax was realized above the planned (2.22%), whereas capital levy, property tax, while income from other taxes was much lower than planned. Total income, as a sum of taxes, dues and other income in the Republic was DEM 450,511,728,27 in 2001, which was 70.66% of total income.

77.71% or DEM 23,313,376,91 worth of grants were realized in 2001, which was 3.66% of total income, unlike the planned grants of DEM 30 million. Borrowings and loans were DEM 149,496,199,93 (23.45% of total income) at the end of the year, and income from loan repayment that was not planned in the budget were DEM 14,179,741,83, which was 2.23% of total income.

By looking at the basic categories of expenditures, it can be seen that gross wages and other income and compensations of employees that participate with 33.27% in the structure of expenditures were DEM 212,137,779,29, which represents 96.88% of the planned amount. The following expenditures were realized above the planned: expenditures for material and services (6.96%), capital expenditures (12.42%), debt repayment (11.33%). Other expenditure categories were realized slightly above the plan (about 2%).

At the end of 2001 constant budgetary reserve was DEM 1.7 million, which was 85% of the plan, while current reserve was DEM 10,936,653,27 (87.49%).

A difference between total income (less raised borrowings and loans) and total expenditures (less given borrowings and loans and principal repayment) in 2001 was DEM 5.94 million. According to the auditor’s opinion this amount should be increased with the amount of borrowings and loans given to enterprises that will not be collected at maturity because of the overall economic situation and economic status, so the total deficit is DEM 33,260,000.

Surpassing a part of budgetary deficit that refers to coverage of current liquidity is possible through short-term borrowings of domestic banking sector and treasury bills issue, while for the coverage of capital expenditures in deficit only loans raised in domestic banks or in foreign financial institutions can be used.

State funds had a total deficit of DEM 25.8 million in 2001. Pension fund, Employment Bureau and Development fund had a total surplus of DEM 41.1
million, while Health care fund had a deficit of DEM 29.9 million.

During January - December 2001, Republic Pension fund had a surplus of DEM 2.7 million. Total income in 2001 was DEM 263.3 million, where 60% made contribution income. Assistance from international community for the first nine months in 2001 was DEM 34,470,000, and in the last three months of the same year there was no assistance. Total expenditures at the end of 2001 were DEM 259.6 million, where pension expenses made about 70%. Pensions were paid regularly.

Republic Health care fund had a deficit of DEM 29.9 million in 2001. Total income in 2001 was DEM 132.2 million, where contribution made over 70% (from economy, non-economy and private sector), and the rest were income from Pension fund, Budget for the unemployed, farmers, income at special regulations, interest income and other income. Total expenditures at the end of the year were DEM 162.2 million. The main category - regular activity expenses - made over 90% of total expenditures.

Employment Bureau of Montenegro had a surplus of DEM 900,000, and in December it had a deficit of DEM 200,000. Total income in 2001 was DEM 22.1 million, and total expenditures were DEM 21.2 million.

Development fund of the Republic of Montenegro had a surplus of DEM 490,000 in 2001. Total income in 2001 were DEM 2,06 million, where total expenditures were DEM 1,57 million.

**Balance of payments**

It is necessary to emphasize that there were numerous problems concerning the scope and preciseness of data in forming the balance of payments. Checking and corrections are in progress and they mainly refer to unrecorded trade with Serbia and import of enterprises from Serbia through Montenegro due to lower customs rates. That amount is estimated at USD 100 million (of goods transactions).

Balance of payments of the Republic of Montenegro in 2001 was marked by several characteristic changes. Current account balance was made on the basis of balance of services and statement of earnings within balance of payments, and it officially recorded a deficit of USD 112.4 million. If this data
were corrected with estimates, then Montenegro would have a surplus in current account.

Trade balance recorded a deficit of USD 426 million. Realized export was USD 194.4 million, while realized import was USD 621.2 million. If estimated re-export to Serbia was calculated here, then deficit of trade balance would be USD 320 million.

There was a surplus in balance of services of USD 105.7 million and it was a result of positive net balance of transportation, tourist and financial services, while in other services the net balance was negative. These data should also be corrected on the basis of the estimates where the real transportation income was bigger by 12%.

There was a surplus in statement of earnings (USD 75.4 million). Positive balance was realized in current transfers - USD 133.3 million - mainly because of increased foreign assistance, while current transfers' expenditures were rather low.

During 2001, the Republic of Montenegro had an inflow of USD 24.6 million in the capital account, while state of financial account was USD 27.2 million (a growth of reserve assets of USD 19.2 million was recorded as a part of this account).

Enclosure 3:
Banking Sector

Table 1

<table>
<thead>
<tr>
<th>No.</th>
<th>Name of the bank</th>
<th>State participation in capital</th>
<th>%</th>
<th>Participation of private individuals</th>
<th>%</th>
<th>Participation of foreigners in capital</th>
<th>%</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Podgorička Bank</td>
<td>7.57</td>
<td>62%</td>
<td>4.56</td>
<td>38%</td>
<td>0</td>
<td>0%</td>
<td>12.13</td>
</tr>
<tr>
<td>2</td>
<td>Hipotekmarna Bank</td>
<td>798</td>
<td>4%</td>
<td>17.244</td>
<td>93%</td>
<td>593</td>
<td>3%</td>
<td>18.635</td>
</tr>
<tr>
<td>3</td>
<td>Crnogorska Komer.</td>
<td>1.275</td>
<td>17%</td>
<td>3.409</td>
<td>46%</td>
<td>2.648</td>
<td>36%</td>
<td>7.332</td>
</tr>
<tr>
<td>4</td>
<td>Euromarket Bank</td>
<td>0</td>
<td>0%</td>
<td>0</td>
<td>0%</td>
<td>11.141</td>
<td>100%</td>
<td>11.141</td>
</tr>
<tr>
<td>5</td>
<td>Ekos Bank</td>
<td>578</td>
<td>6%</td>
<td>9.023</td>
<td>94%</td>
<td>0</td>
<td>0%</td>
<td>9.601</td>
</tr>
<tr>
<td>6</td>
<td>Piševaljska Bank</td>
<td>5.359</td>
<td>97%</td>
<td>184</td>
<td>3%</td>
<td>0</td>
<td>0%</td>
<td>5.543</td>
</tr>
<tr>
<td>7</td>
<td>Nikšićka Bank</td>
<td>5.672</td>
<td>96%</td>
<td>206</td>
<td>4%</td>
<td>0</td>
<td>0%</td>
<td>5.878</td>
</tr>
<tr>
<td>8</td>
<td>Beranska Bank</td>
<td>3.141</td>
<td>80%</td>
<td>652</td>
<td>17%</td>
<td>113</td>
<td>3%</td>
<td>3.906</td>
</tr>
<tr>
<td>9</td>
<td>Jugobank</td>
<td>3.899</td>
<td>77%</td>
<td>1.14</td>
<td>23%</td>
<td>0</td>
<td>0%</td>
<td>5.039</td>
</tr>
<tr>
<td>10</td>
<td>Development Bank</td>
<td>10.508</td>
<td>100%</td>
<td>0</td>
<td>0%</td>
<td>10.508</td>
<td>0%</td>
<td>10.508</td>
</tr>
<tr>
<td>11</td>
<td>TOTAL:</td>
<td>38.8</td>
<td>43%</td>
<td>36.418</td>
<td>41%</td>
<td>14.495</td>
<td>16%</td>
<td>89.713</td>
</tr>
</tbody>
</table>

ENCLOSURE
## Total Assets of Banks in Montenegro (in thousands DEM)

<table>
<thead>
<tr>
<th>Description</th>
<th>06/30/2001</th>
<th>12/31/2001</th>
<th>Nominal</th>
<th>- 12/31/01</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Assets</strong></td>
<td>711,844</td>
<td>718,053</td>
<td>0,87</td>
<td>100,00</td>
</tr>
<tr>
<td>1. Cash in hand and deposit account with depository instit.</td>
<td>220,042</td>
<td>228,348</td>
<td>3,77</td>
<td>31,80</td>
</tr>
<tr>
<td>2. Securities for resale</td>
<td>1,053,104</td>
<td>289,74</td>
<td>57</td>
<td></td>
</tr>
<tr>
<td>3. Investments in other banks</td>
<td>6,978</td>
<td>2,467</td>
<td>-64,65</td>
<td>0,34</td>
</tr>
<tr>
<td>4. Loans, claims under leasing operations and claims due</td>
<td>245,909</td>
<td>242,439</td>
<td>-1,41</td>
<td>33,76</td>
</tr>
<tr>
<td>5. Securities held until maturity</td>
<td>289</td>
<td>1,767</td>
<td>511,42</td>
<td>0,25</td>
</tr>
<tr>
<td>6. Business premises and other fixed assets</td>
<td>13,229</td>
<td>15,664</td>
<td>18,41</td>
<td>2,18</td>
</tr>
<tr>
<td>7. Other real estates</td>
<td>1,050</td>
<td>3,783</td>
<td>260,29</td>
<td>0,53</td>
</tr>
<tr>
<td>8. Investments in non-consolidated related companies</td>
<td>11,323</td>
<td>8,432</td>
<td>-25,53</td>
<td>1,17</td>
</tr>
<tr>
<td>9. Other assets</td>
<td>220,169</td>
<td>227,551</td>
<td>3,35</td>
<td>31,69</td>
</tr>
<tr>
<td>10. Minus: Reserves for potential losses</td>
<td>8,168</td>
<td>16,502</td>
<td>102,03</td>
<td>-2,29</td>
</tr>
<tr>
<td>11. TOTAL ASSETS</td>
<td>711,844</td>
<td>718,053</td>
<td>0,87</td>
<td>100,00</td>
</tr>
<tr>
<td>12. Deposits</td>
<td>287,193</td>
<td>289,824</td>
<td>0,92</td>
<td>40,36</td>
</tr>
<tr>
<td>13. Borrowings - obligations due</td>
<td>48</td>
<td>194</td>
<td>304,17</td>
<td>0,03</td>
</tr>
<tr>
<td>14. Borrowings from other banks</td>
<td>130</td>
<td>2,912</td>
<td>2,140,00</td>
<td>0,41</td>
</tr>
<tr>
<td>15. Obligations to Government</td>
<td>1,660</td>
<td>2,625</td>
<td>58,13</td>
<td>0,37</td>
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<tr>
<td>16. Obligations under loans taken and other borrowings</td>
<td>99,561</td>
<td>105,990</td>
<td>6,46</td>
<td>14,76</td>
</tr>
<tr>
<td>17. Subordinated debt</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>18. Other obligations</td>
<td>219,654</td>
<td>210,072</td>
<td>-4,36</td>
<td>29,26</td>
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<tr>
<td>19. TOTAL LIABILITIES</td>
<td>608,246</td>
<td>611,617</td>
<td>0,55</td>
<td>85,18</td>
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<tr>
<td>20. Preferential shares</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>21. Common shares</td>
<td>78,655</td>
<td>89,713</td>
<td>14,06</td>
<td>12,49</td>
</tr>
<tr>
<td>22. Collected issue premiums</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>23. Unallocated profit/loss and capital reserves</td>
<td>22,062</td>
<td>21,328</td>
<td>-3,33</td>
<td>2,97</td>
</tr>
<tr>
<td>24. Other capital</td>
<td>2,881</td>
<td>-4,605</td>
<td>-259,84</td>
<td>-0,64</td>
</tr>
<tr>
<td>25. TOTAL CAPITAL minus 23 and 24, if loss</td>
<td>103,598</td>
<td>106,436</td>
<td>2,74</td>
<td>14,82</td>
</tr>
<tr>
<td>26. TOTAL LIABILITIES (19+25)</td>
<td>711,844</td>
<td>718,053</td>
<td>0,87</td>
<td>100,00</td>
</tr>
</tbody>
</table>
### Table 4.

#### Balance Sheet of Banks in Montenegro without Foreign Debt and Frozen FX Deposits (in thousands DEM)

<table>
<thead>
<tr>
<th>Description</th>
<th>12/31/2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Cash in hand and deposit account with depository insti.</td>
<td>228,348</td>
</tr>
<tr>
<td>2 Securities for resale</td>
<td>4,104</td>
</tr>
<tr>
<td>3 Investments in other banks</td>
<td>2,467</td>
</tr>
<tr>
<td>4 Loans, claims under leasing operations and claims due</td>
<td>164,727</td>
</tr>
<tr>
<td>5 Securities held until maturity</td>
<td>1,767</td>
</tr>
<tr>
<td>6 Business premises and other fixed assets</td>
<td>15,684</td>
</tr>
<tr>
<td>7 Other real estates</td>
<td>3,783</td>
</tr>
<tr>
<td>8 Investments in non-consolidated related companies</td>
<td>8,432</td>
</tr>
<tr>
<td>9 Other assets</td>
<td>56,207</td>
</tr>
<tr>
<td>10 Minus: Reserves for potential losses</td>
<td>16,502</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>468,997</strong></td>
</tr>
<tr>
<td>11 Deposits</td>
<td>289,824</td>
</tr>
<tr>
<td>12 Borrowings - obligations due</td>
<td>194</td>
</tr>
<tr>
<td>13 Borrowings from other banks</td>
<td>2,912</td>
</tr>
<tr>
<td>14 Obligations to Government</td>
<td>2,625</td>
</tr>
<tr>
<td>15 Obligations under loans taken and other borrowings</td>
<td>28,278</td>
</tr>
<tr>
<td>16 Subordinated debt</td>
<td>0</td>
</tr>
<tr>
<td>17 Other obligations</td>
<td>38,728</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td><strong>362,561</strong></td>
</tr>
<tr>
<td>18 Preferential shares</td>
<td>0</td>
</tr>
<tr>
<td>19 Common shares</td>
<td>89,713</td>
</tr>
<tr>
<td>20 Collected issue premiums</td>
<td>0</td>
</tr>
<tr>
<td>21 Unallocated profit/loss and capital reserves</td>
<td>21,328</td>
</tr>
<tr>
<td>22 Other capital</td>
<td>-4,605</td>
</tr>
<tr>
<td><strong>TOTAL CAPITAL minus 23 and 24, if loss</strong></td>
<td><strong>106,436</strong></td>
</tr>
<tr>
<td>23</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES (19+25)</strong></td>
<td><strong>468,997</strong></td>
</tr>
</tbody>
</table>

### Table 5.

#### Loans, Claims under Leasing operations and Claims Due as of 06/30/2001 (in thousands DEM)

<table>
<thead>
<tr>
<th>Description</th>
<th>Short-term &lt; 1 yr</th>
<th>Long-term &gt; 1 yr</th>
<th>Due claims</th>
<th>Paid/called off-bal. sheet obligations</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Loans and other claims</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>from Mont. Government</td>
<td>22,902</td>
<td>14,284</td>
<td>337</td>
<td>0</td>
<td>37,523</td>
<td></td>
</tr>
<tr>
<td>2 Governmental institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Public companies</td>
<td>6,752</td>
<td>93,245</td>
<td>136</td>
<td>100,13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Private companies&amp;firms</td>
<td>73,136</td>
<td>16,903</td>
<td>2,441</td>
<td>29</td>
<td>92,409</td>
<td></td>
</tr>
<tr>
<td>5 Nonprofit organizations</td>
<td>167</td>
<td></td>
<td></td>
<td></td>
<td>167</td>
<td></td>
</tr>
<tr>
<td>6 Banking institutions</td>
<td>2,976</td>
<td></td>
<td></td>
<td></td>
<td>2,976</td>
<td></td>
</tr>
<tr>
<td>7 Nonbank fin. Institutions</td>
<td>28</td>
<td></td>
<td></td>
<td></td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>8 Private individuals</td>
<td>641</td>
<td>2,438</td>
<td>44</td>
<td></td>
<td>3,123</td>
<td></td>
</tr>
<tr>
<td>9 Other</td>
<td>4,747</td>
<td>4,479</td>
<td>321</td>
<td>6</td>
<td>9,553</td>
<td></td>
</tr>
<tr>
<td>10 TOTAL:</td>
<td>108,373</td>
<td>134,22</td>
<td>3,281</td>
<td>0</td>
<td>245,909</td>
<td></td>
</tr>
</tbody>
</table>
Table 6.

Loans, Claims under Leasing operations and Claims Due as of 12/31/2001 (in thousands DEM)

<table>
<thead>
<tr>
<th>No.</th>
<th>Description</th>
<th>Short-term &lt; 1 yr</th>
<th>Long-term &gt; 1 yr</th>
<th>Due claims</th>
<th>Paid/called off-bal sheet obligations</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Loans and other claims from Mont. Government</td>
<td>19,149</td>
<td>7,316</td>
<td>1,01</td>
<td></td>
<td></td>
<td>27,475</td>
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<td>2</td>
<td>Governmental institutions</td>
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<td></td>
<td></td>
<td></td>
<td>3,308</td>
</tr>
<tr>
<td>3</td>
<td>Public companies</td>
<td>4,217</td>
<td>91,571</td>
<td>30</td>
<td></td>
<td></td>
<td>95,788</td>
</tr>
<tr>
<td>4</td>
<td>Private companies &amp; firms</td>
<td>73,096</td>
<td>22,547</td>
<td>30</td>
<td></td>
<td></td>
<td>95,673</td>
</tr>
<tr>
<td>5</td>
<td>Nonprofit organizations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>Banking institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>Nonbank fin. institutions</td>
<td>111</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>111</td>
</tr>
<tr>
<td>8</td>
<td>Private individuals</td>
<td>9,374</td>
<td>2,933</td>
<td>47</td>
<td></td>
<td></td>
<td>12,354</td>
</tr>
<tr>
<td>9</td>
<td>Other</td>
<td>4,351</td>
<td>3,373</td>
<td></td>
<td></td>
<td></td>
<td>7,724</td>
</tr>
<tr>
<td>10</td>
<td>TOTAL:</td>
<td>113,608</td>
<td>127,74</td>
<td>1,087</td>
<td></td>
<td>0</td>
<td>242,439</td>
</tr>
</tbody>
</table>

Grafikon 1.

Structure of Deposits by maturities in 2001

Types of Deposits by maturities
Table 7.
Aggregate Income Statements of Banking sector (in thousands DEM)

<table>
<thead>
<tr>
<th>Description</th>
<th>06/30/2001</th>
<th>12/31/2001</th>
<th>Nominal Growth % 06/30-12/31</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Interest income</td>
<td>10.31</td>
<td>22.686</td>
<td>120.0</td>
</tr>
<tr>
<td>2 Interest expenses</td>
<td>-3.767</td>
<td>-8.49</td>
<td>125.6</td>
</tr>
<tr>
<td>3 Net interest income/expenses</td>
<td>6.543</td>
<td>14.196</td>
<td>116.9</td>
</tr>
<tr>
<td>4 Cost of credit losses</td>
<td>-7.331</td>
<td>-16.009</td>
<td>118.0</td>
</tr>
<tr>
<td>5 Net income / expenditures</td>
<td>-7.885</td>
<td>-1.815</td>
<td>129.7</td>
</tr>
<tr>
<td>6 Fee income</td>
<td>6.565</td>
<td>15.328</td>
<td>133.9</td>
</tr>
<tr>
<td>7 Fee expenses</td>
<td>-1.145</td>
<td>-3.529</td>
<td>209.6</td>
</tr>
<tr>
<td>8 Net fee income / expenses</td>
<td>5.426</td>
<td>11.776</td>
<td>117.3</td>
</tr>
<tr>
<td>9 Net income / expenses from interest and fees</td>
<td>4.632</td>
<td>9.967</td>
<td>115.6</td>
</tr>
<tr>
<td>10 Other operating income</td>
<td>6.539</td>
<td>6.357</td>
<td>2.9</td>
</tr>
<tr>
<td>11 Operating expenses</td>
<td>-8.515</td>
<td>-23.123</td>
<td>171.2</td>
</tr>
<tr>
<td>12 Income/expenses before extraordinary items</td>
<td>2.656</td>
<td>-6.806</td>
<td>-356.2</td>
</tr>
<tr>
<td>14 Extraordinary income</td>
<td>902</td>
<td>6.621</td>
<td>634.0</td>
</tr>
<tr>
<td>15 Extraordinary expenses</td>
<td>-677</td>
<td>-1.088</td>
<td>61</td>
</tr>
<tr>
<td>16 Income/expenses after extraordinary items</td>
<td>2.881</td>
<td>-1.272</td>
<td>-144</td>
</tr>
<tr>
<td>17 Tax</td>
<td>0</td>
<td>-1.096</td>
<td>0</td>
</tr>
<tr>
<td>18 Net income</td>
<td>2.881</td>
<td>-2.369</td>
<td>-182</td>
</tr>
</tbody>
</table>

ENCLOSURE
### Table 8.

**Bank Profitability and Efficiency Ratios**

<table>
<thead>
<tr>
<th>No.</th>
<th>RATIO</th>
<th>06/30/01</th>
<th>12/31/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Return on average assets</td>
<td>0.81%</td>
<td>-0.68%</td>
</tr>
<tr>
<td>2</td>
<td>Return on capital</td>
<td>5.56%</td>
<td>-4.44%</td>
</tr>
<tr>
<td>3</td>
<td>Net interest income / Average assets</td>
<td>1.84%</td>
<td>4.06%</td>
</tr>
<tr>
<td>4</td>
<td>Net operating income / Average assets</td>
<td>3.36%</td>
<td>5.18%</td>
</tr>
<tr>
<td>5</td>
<td>Costs for loan losses / Average assets</td>
<td>2.06%</td>
<td>4.66%</td>
</tr>
<tr>
<td>6</td>
<td>Operating costs / Average assets</td>
<td>2.39%</td>
<td>6.62%</td>
</tr>
</tbody>
</table>

---

**Chart 3.**

**Number of Employees in Banking Sector at end 2001**

- **Montenegrobanka**: 419, 36%
- **Nikšićka bank**: 83, 7%
- **Jugobanka**: 193, 16%
- **Pogoriška bank**: 206, 18%
- **Crno gorska komercijalna bank**: 40, 3%
- **Beranska**: 32, 3%
- **Euromarket bank**: 27, 2%
- **Hipokarna bank**: 21, 2%
- **Development bank**: 193, 16%

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**ACTIVITY REPORT (2001)**
Policy of the Central Bank in 2001 was established by Council of the Central Bank at the conference held on July 20, 2001, in accordance with Article 17 of Law on central bank.

1. For the purpose of creating more efficient banking system and intensification of financial discipline, Central Bank of Montenegro (hereinafter called the Central Bank) will work on improvement of banks’ credibility and establishment of confidence in the banking system by:

(a) implementation of overall normative infrastructure, including International Accounting Standards, by establishing new institutional framework and strict policy of licensing;

(b) active monitoring of commercial banks by direct control of business records and other documents in banks (on-site control) and by control of banks on the basis of submitted reports (off-site control);

(c) undertaking prudential control by direct management of non-solid banks, if necessary;

(d) intensifying cooperation with international institutions, especially with the ones that deal with questions of banking control;

(e) regulating obligations of minimum foreign currency reserves in an account that domestic banks are obliged to keep in their accounts abroad, when necessary;

(f) creating credit potentials and development of financial intervention by gradual decrease of statutory reserves which are now 100% from sight deposit amount, down to 80% for the banks that are estimated as solid;

(g) creating conditions for earnings and wages of the employed, especially the ones employed in the public sector, as well as social welfare, to be paid out through bank and postal accounts.

(h) Activities on establishing limited system of deposit insurance.
2. The Central Bank will perform activities of fiscal agent of Ministry of Finance and Government of the Republic of Montenegro (hereinafter called the Government).

3. The Central Bank will render technical support services to the Government in connection to short-term government bonds issued for the purpose of short-term liquidity of budget of the Republic. Short-term government bonds will be used as means for carrying out certain activities of Central Bank. Therefore, government bonds will have a role of: (a) collateral for provision of credit for maintenance of daily liquidity, (b) alternative investment of free assets of banks and (c) creating channel for transfer of savings into investments.

4. The Central Bank will not give loans to the Government or any other legal or natural person.

5. The Central Bank will provide liquidity of financial system of the Republic by:

   a) approving loans for maintenance of daily liquidity from its own means to commercial banks that have license to commence business in the Republic. Loans are provided by securities collateral issued by authorized agency of the Republic or a country member of European Union. They will be approved at interest rate that is by 0.5% (at least) higher than activities interbank interest rate;

   b) performing activities in open market of short-term government bonds, and for the purpose of creating missing liquidity and withdrawal of excessive liquidity of banking system in the Republic;

   c) active use of statutory reserves instruments.

6. The Central Bank will administer foreign currency reserves of the Republic for the purpose of: (a) maintenance of general liquidity in payments abroad, (b) minimizing credit risk, liquidity risk, interest rate risk and exchange risk for reserve assets, (c) making profit on the basis of income from realized market interest rate for these assets and (d) enabling conversion of DEM in EURO.

   Administration of foreign currency reserves will be performed: (a) by placement of foreign currency reserves in prime commercial banks, (b) by pur-
chase of short-term securities issued by, or guaranteed by European Union or countries members of European Union and (c) by buying and selling foreign currency in domestic and foreign market, for the purpose of realizing optimum currency structure of foreign currency reserves and protection from negative intercurrency effects of convertible currencies. Foreign currency reserves that are kept abroad are limited with the amount that provides undisturbed functioning of payment operations.

7. The Central Bank will make special program for conversion of DEM into EURO, and in accordance with terms and dynamics specified by European Monetary Union, Bundesbank and European Central Bank.

8. The Central Bank will, as a part of its jurisdiction, develop cooperation and coordinate activities of government bodies with international financial institutions, and it will work on: (a) adjusting data on foreign debt with National Bank of Yugoslavia and (b) regulating relations with Paris club and London club on reprogramming of foreign debt.

9. The Central Bank will monitor dynamics of inflow and use of financial means given to the Republic at Donor conference in Brussels on June 26, 2001, and other means from abroad that were given to the Republic.

10. The Central Bank will do the control of payment operations in the Republic. The Central Bank will provide necessary quantity and denomination structure of German mark (DEM) as legal tender, and it will adequately distribute bank notes and coins in order to satisfy the needs of financial transactions.

11. The Central Bank will work on realization of Plan of activities of payment operations reform that was adopted by Government and that contains anticipated deadlines for transformation of Institute for Accounting and Payment. Anticipated deadlines can be submitted to revision depending on conditions for payment operation in banks, reform of fiscal system and qualifying the Central Bank for application of suitable regulations for banks and payment systems.

12. The Central Bank will encourage entry of credible foreign commercial banks in the Republic and broadening of financial market.
Enclosure 5:  
Program of the conversion process activities

Program was based on the following principles:

1. EURO will be introduced in payment operations of the Republic of Montenegro on January 1, 2001 as monetary unit, legal tender and reserve currency.

2. Double-currency payment system (DEM and EURO as simultaneous legal tenders) will become effective from January 1 to March 31 2002.  

3. DEM will be exchanged at the exchange rate determined by EU, and it is 1 EURO = 1.95583 DEM. Exchange of other currencies will be conducted at rates given in the enclosure.

4. Central Bank of Montenegro is the agent of Conversion plan and it will perform conversion of DEM into EURO for all subjects. Commercial banks and branches that, on January 1 2002, have license from Central Bank can perform conversion in accordance with their business interests.

5. Central Bank of Montenegro will convert bank notes and coins in circulation (DEM), as well as other currency convertible to EURO, until June 2002. Commercial banks will perform conversion during double-currency payment system - until March 31, 2002.

6. Central Bank of Montenegro will perform conversion without charging commission. Commercial banks will determine their own conditions under which they will perform conversion.

7. From January 1, 2002 assets in business account in payment operations department of Central Bank of Montenegro will automatically, by the unique exchange rate, convert in EURO. All payments through giro accounts and drawing money from accounts will be exclusively in EURO, which means that all legal persons will have EURO accounts. Cash payments in DEM will also be conducted during double-currency payment system, and payment operations department will perform conversion automatically.

8. Physical persons - citizens of Montenegro can convert DEM at counters.

12) It should be emphasized that European Central Bank approved double-currency system to function until the end of June 2002, and during that period every country individually can specify the period of validity of existing currency as legal tender. On November 8, 1999, Ministers of countries of European Union issued common declaration that double-currency system is to be limited to a period of maximum two months. By Third Act on introduction of EURO, Bundesbank regulated that, from 2002, EURO will be the single legal tender, that DEM will be in circulation by the end of February 2002, and that Bundesbank will convert money for an indefinite period, and at fixed rate (1 EURO = 1.95583 DEM).
of payment operation department and at commercial banks authorized for conversion by Central Bank of Montenegro. Conversion will be conducted in the period stated in article 5.

9. Commercial banks will perform conversion for citizens of other countries.

10. All citizens of Montenegro can, at any time, convert DEM 5 - 10.000. In a case of conversion of an amount bigger than DEM 10.000 it is necessary that one open an account in commercial bank and deposit money in the account. A citizen must show some identification when converting money.

11. Central Bank of Montenegro will contact and make a contract with a partner bank that will provide EURO bank notes and coins.

12. For the purpose of full information of the public, especially on the reasons for introduction of EURO, date of introduction, money value, design of bank notes and coins, and all the information on conversion, it is necessary to make a Plan of public campaign for introduction of EURO. The purpose of the public campaign is to, through directed public relations and announcements, reach the public by:

   a) Explaining the background of EURO (Why? How? When? Where?)

   b) Promoting EURO as a hard currency and symbol of Europe

   c) Dashing one's fear of exchange of the existing currency in EURO

   d) Encouraging that part of population that is skeptical about 'investigation on an asset origin' to exchange cash in authorized institutions.

**Enclosure 6:**

*List of subordinated acts*

1. Decision on Keeping Foreign Currency in Foreign Currency Accounts in Authorized Banks (Off. gaz. RMN, No. 8/01);

2. Decision on Supplement of the Resolution on Terms and Conditions
and Method of Payment in Cash (Off. gaz. RMN, No. 8/01);

3. Decision on Payment Operations with the Republic of Serbia and Kosovo and Metohia (Off. gaz. RMN, No. 15/01);

4. Decision on Measures for Rehabilitation of Nonsolid banks (Off. gaz. RMN, No. 16/01);

5. Decision on Procedure and Manner of Granting Licenses for Operating of Banks, Permits and Approvals as well as on Amount of Fees (Off. gaz. RMN, No. 24/01);

6. Decision on Minimal Standards of Management of a Concentration of Loans and Operating with Entities of the Bank (Off. gaz. RMN, No. 24/01);

7. Decision on Minimal Standards for the Capital of the Bank (Off. gaz. RMN, No. 24/01);

8. Decision on Criteria and Procedure for Classifying Assets and Forming Loan Loss Reserves (Off. gaz. RMN, No. 24/01);

9. Decision on Terms of Payment in Cash (Off. gaz. RMN, No. 33/01);

10. Decision on Conducting Exchange Transactions (Off. gaz. RMN, No. 37/01);

11. Decision on Basics of Bank Internal Control System (Off. gaz. RMN, No. 37/01);

12. Decision on Bank Internal Audit (Off. gaz. RMN, No. 37/01);

13. Decision on Bank External Audit of Financial Statements (Off. gaz. RMN, No. 37/01);

14. Decision on Management of Liquidity Risk (Off. gaz. RMN, No. 37/01);

15. Decision on the Methods and Procedures of and Fees for the Bank Supervision (Off. gaz. RMN, No. 37/01);

16. Decision on Bank reports to the Central Bank of Montenegro (Off. gaz. RMN, No. 37/01);
17. Decision on Approving Loans for Daily Maintenance of Liquidity of Commercial Banks (Off. gaz. RMN, No. 37/01);

18. Decision on the Tariff for Collecting Service Charges of the Central Bank of Montenegro (Off. gaz. RMN, No. 37/01);

19. Decision on Criteria and Methods of Setting a Cash Maximum (Off. gaz. RMN, No. 37/01);

20. Decision on Transactions and Organization of Payment Operations (Off. gaz. RMN, No.53/01);

21. Decision on Modification of the Resolution on the Tariff for Collecting Service Charges of the Central Bank of Montenegro (Off. gaz. RMN, No. 53/01);

22. Guidelines for the implementation of CAMELS Rating System on Banks (Off. gaz. RMN, No. 52/01);

23. Decision on Method and Procedure for Payment Operations Control of Transactions of bearers of Interbank Payment System and Giro System whose operator is the Central Bank of Montenegro (Off. gaz. RMN, No. 62/01);

24. Decision on Method and Procedure of Granting and Denying Permission to Banks for Payment Operations Transactions in Interbank Payment System and Giro System whose operator is the Central Bank of Montenegro (Off. gaz. RMN, No. 62/01);

25. Decision on Minimal Standards for Payment Operations Transactions in Interbank Payment System whose operator is the Central Bank of Montenegro (Off. gaz. RMN, No. 62/01);

26. Instructions for Method and Procedure for Conversion of DEM and other currency in EURO (Off. gaz. RMN, No. 64/01).

Prepared drafts of subordinated regulations:

- Draft of Decision on Granting and Denying Permission to Banks for Conducting Payment Operations Affairs in the Country;

- Draft of Decision on Amendments of Decision on Terms and Methods of
Payment in Cash;

• Draft of Decision on Method of Payment Operations Control of bearers of Payment Operations Transactions;

• Draft of Decision on Plan of Account of bearers of Payment Operations Transactions;

• Draft of Method of Opening and Closing of an Account with the Central Bank of Montenegro and other bearers of Payment Operations Transactions in the Country;

• Draft of Decision on Methods of conducting Payment Operations Transactions;

• Draft of Instructions for Technical and Organizational Standards for Banks in order to obtain License for conducting Payment Operations Transactions;

• Draft on Instructions for Operational Procedures in Payment Operations Transactions - Preventive Control, Claims Settlement, Treasury, and Vault.