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1. INTRODUCTION

With a view to following contemporary trends in monetary policy, the Central Bank of Montenegro initiated the publication "Inflation Report" in mid-2005. The number of Central banks that publish this report is constantly increasing. Many European central banks and those implementing the inflation targeting policy publish this kind of report.

Even though this type of reporting varies by country, it still contains certain standard components. Unfortunately, Montenegrin statistics is still in their infancy and cannot provide any significant information for this kind of reporting, especially about personal consumption, investment consumption, certain supply aspects, sector growth rates etc.

Nowadays, different indicators can be used as inflation indicators: retail price index, living costs index, consumer price index etc. Indicated indices could be observed as annual, average annual etc. Usage of various indices makes it possible to obtain different inflation rates. Probably the best inflation indicator, used by most Central banks would be consumer price index, but Monstat still does not publish that data. Publishing is in the

preparation phase, and should be started during 2008, and starting from the next year, we will be able to use this index. This is the reason why CBM uses living costs index as inflation indicator, since it is the most similar to consumer price index. Being in dilemma which inflation indicator to use, either annual (end year) or average living costs index movement, we decided in favour of annual (end year) index, since, according to us, it has several advantages.¹ Firstly, by this index we compare real price level at the end of one year with the same real price level at the end of the next year, while in average rate concept average price of the observed item is used. Average price does not have to match real price in any period of time. Secondly, in order to forecast inflation rate using the average inflation rate concept, it is necessary to forecast not only the increase of certain products, but also in which month will this increase occur. This is particularly difficult in condition when administratively controlled prices represent a significant part of the inflation. It does not mean that monitoring of average annual living costs index movement as well should be neglected, but for the purposes of »Inflation Report«, we shall use annual living costs index as inflation index.

¹ For more details on differences between these two indices look the Report of Chief Economist for quarter III 2007.

2. INFLATION INDICATORS

According to Monstat data, living costs recorded a faster growth (4.4%) in comparison with the growth in previous quarter (0.4%). It resulted in annual inflation rate of 6.5% in september, i.e. inflation of 5.5% in first nine months of 2007.

During the third quarter of 2007, average prices of most major categories of goods and services which are included in Monstats' calculation of total living costs index recorded growth. However, prices of goods and services from the category „housing“, as well as prices of goods and services from the category “traffic and post and telecommunications” had main influence on price movement in the observed period.

From the category „housing“, increase of electricity prices had main influence on total inflation. Electricity prices increased 30.9%, which explains 42.3% of total inflation. However, data on increased electricity prices should be treated with reserve. Namely, Monstat calculated increase of electricity prices only in July 2007, although real price changes occurred even before.

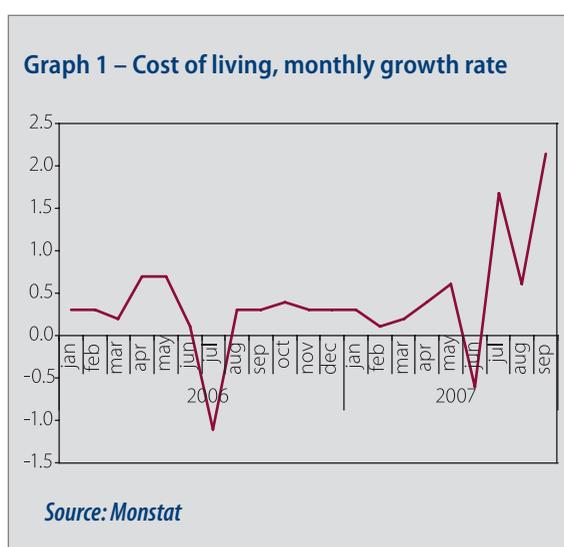


Table 1 – Inflation, %

	2006				2007		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Change to end month of previous year	0.8	2.3	1.7	2.8	0.6	1.1	5.5
Annual change	2.8	3.1	2.7	2.8	2.4	1.6	6.5
Quarterly change	0.8	1.5	-0.5	1.0	0.6	0.4	4.4

Source: Monstat

Food products prices increased 3%, but participation of these prices in total living costs was 34.2%. Such influence of food products prices is understandable, since these prices have highest weight (50.46%) in total basket of goods and services on the basis of which living costs index is calculated. Average prices of basic food products groups, apart from the grain products, recorded growth. Prices of fresh and processed vegetables take major participation in total inflation (23.8%, with growth of 16.8%), as well as prices from the group „fat“ (7.6%, with growth of 11.4%).

From the category „traffic and post and telecommunications“, prices of traffic and post and telecommunication services record major influence on total inflation, which, with the growth of 22.4%, participate in total inflation with 21%. From the category „traffic and post and telecommunications“, 20.7% growth of telephone impulses price is sorted out, which explains 11.4% of total inflation, as well as 100% growth of telephone subscription price, which explains 9.3% of total inflation.

According to Monstat, prices of liquid fuels and lubricants recorded decline of 1.7% in third quarter, and participated with -1.5% in total inflation. Such registered price decline is not in accordance with global oil prices, but it is justified with the fact that Monstat „records“ prices until the eleventh day of the month, and it can also be justified with time delay (lateness) in justification of domestic prices with global

prices. Undoubtedly, growth of these prices will be covered in the fourth quarter.

During the third quarter of 2007, extreme fluctuations of oil prices on the world markets were continued, and the prices, apart from the fall in August compared to July, significantly increased. OPEC reference basket price in July, August and September was: 71.8, 68.7 i 74.2 US\$/barrel, and respective growth rates were: 7.5%, -4.2% i 8%. Prices of the „brent“ oil in the same months were: 77, 70.7 i 76.9 US\$/barrel, and respective growth rates were: 7.6%, -8.1% and 8.7%. It should be pointed out that the average price of OPEC September basket of 74.2 US\$/barrel was a record price, and prices during the whole September recorded growth, which indicates that in forthcoming months even higher oil prices are expected. It is considered that key factors for oil prices jump at the end of the third quarter were geopolitical tension and speculative investments at the oil market.

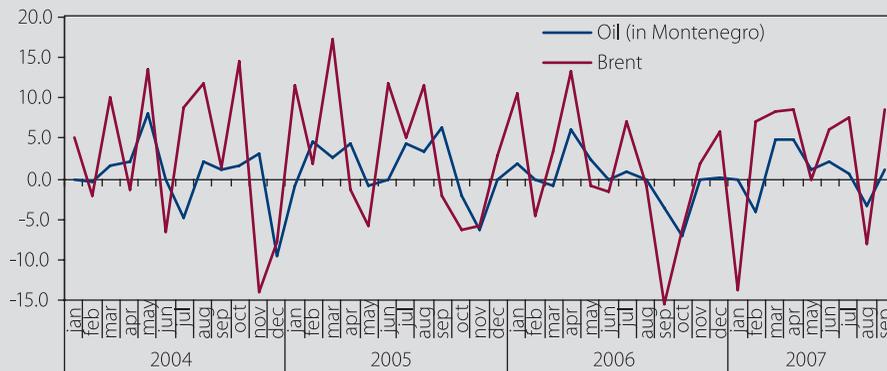
During the third quarter, prices of services recorded growth of 10.5% and were primary defined by already mentioned growth of traffic and post and telecommunication services prices i.e. telephone impulses and subscription. Besides, there is also slight impact caused by the growth of prices of services for education and public utility services. Growth of prices of services contributed to total inflation with 1.06 per cent points, i.e. relevant participation was 24%.

Table 2 – Share of inflation for certain groups of goods and services in total inflation

	Weight	IX '07/VI '07	Growth rate	Contribution	Share in total
TOTAL	10,000	104.43	4.43	4.43	100.00
Food	5,046	103.00	3.00	1.51	34.21
fresh and processed vegetables	629	116.76	16.76	1.05	23.81
Tobacco and beverages	694	99.96	-0.04	0.00	-0.06
Clothing and footwear	845	100.14	0.14	0.01	0.27
Housing	1,259	115.36	15.36	1.93	43.68
electricity	605	130.92	30.92	1.87	42.26
Tobacco and beverages	712	100.10	0.10	0.01	0.16
Education and culture	460	102.68	2.68	0.12	2.79
Transportation and postal services	984	108.66	8.66	0.85	19.25
liquid fuels and lubricants	400	98.30	-1.70	-0.07	-1.54
transportation and communication	414	122.43	22.43	0.93	20.98
Goods	8,994	103.74	3.74	3.37	76.04
Services	1,006	110.54	10.54	1.06	23.96

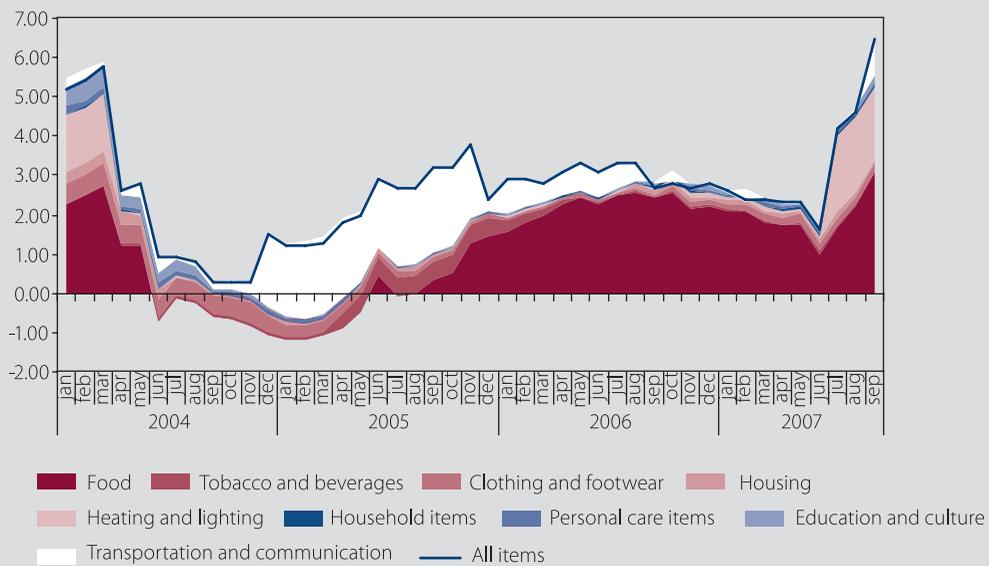
Source: Monstat, and CBM calculations

Graph 2 – Oil prices, monthly growth rate



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

Graph 3 – Components of cost of living index: contribution to annual growth rate (index points)

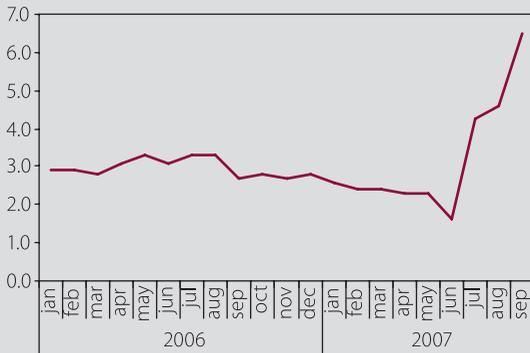


If we observe situation starting from the beginning of the year, annual living costs growth rate gradually decreased until June, and from 2.6% in January reached level of 2.4% in March and 1.6% in June. However, situation in the third quarter reversed trend from the first half of the year. Therefore, annual inflation in July was 4.3% which was primarily caused by the registered growth of electricity prices. Inflation in August

increased up to 4.6%, and in September, annual inflation rate was 6.5%, which was caused by already indicated growth of prices of certain food products and post and telecommunication services.

Average annual living costs growth rate (first nine months of the current year in comparison with first nine months of the previous year) is 3.2%.

Graph 4 – Cost of living, annual growth rate

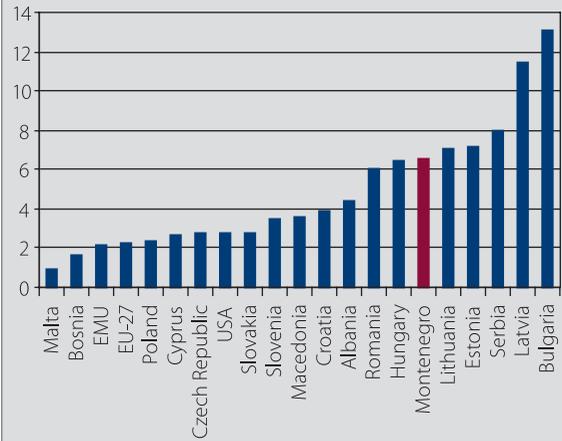


Source: Monstat

During the third quarter of 2007, **retail prices** recorded growth of 4.3%, caused by the growth of industrial products prices for 3.2%, services prices for 7.1% and agricultural products prices growth for 8.7%. Annual growth rate of retail prices in September was 6.4%.

Producers' prices of manufactured products increased for 4.6%, during the third quarter of 2007. Compared to the end of 2006, growth was 10.8%, while annual growth rate in September 2007 was 9.9%.

Graph 6 – Annual inflation rate, September 2007



Source: National Statistics Offices, and ECB

Comparison of inflation (annual inflation rate in September) in Montenegro with inflation in the selected countries of South Eastern Europe and with new members of EU indicates that Montenegro takes place in the upper part of the scale, whereof, selected EU countries – Lithuania, Estonia, Latvia and Bulgaria record higher inflation than Montenegro.

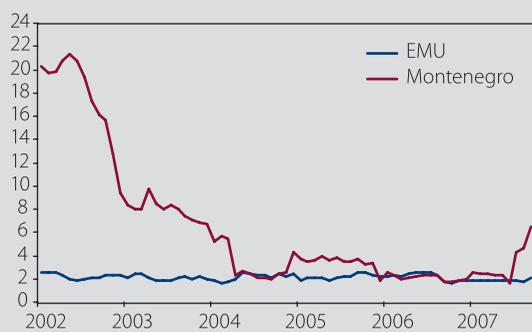
Also, annual inflation rate in Montenegro in September was significantly higher than the one realised in Eurozone, which was measured with the harmonized index of consumer prices. In September, in Eurozone, annual growth of the prices of 2.1% was recorded.

Graph 5 – Retail prices, monthly growth rate



Source: Monstat

Graph 7 – Inflation in EMU and Montenegro since introduction of euro (annual rate)

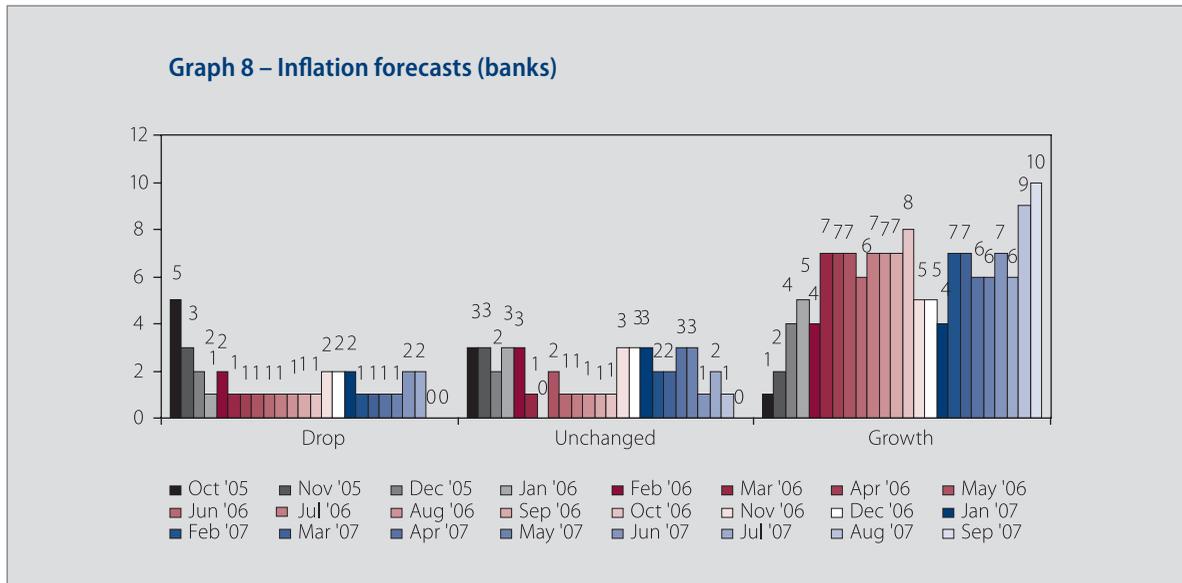
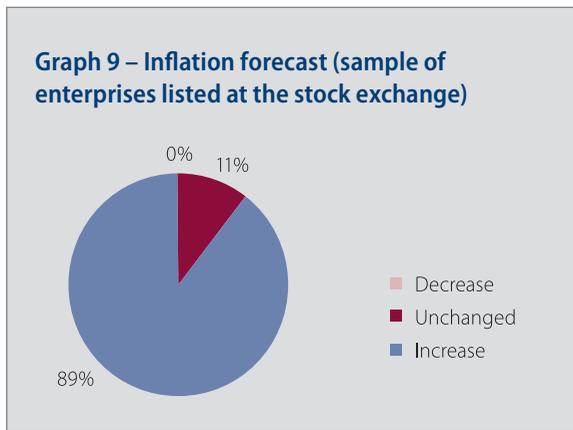


Source: Monstat, and ECB

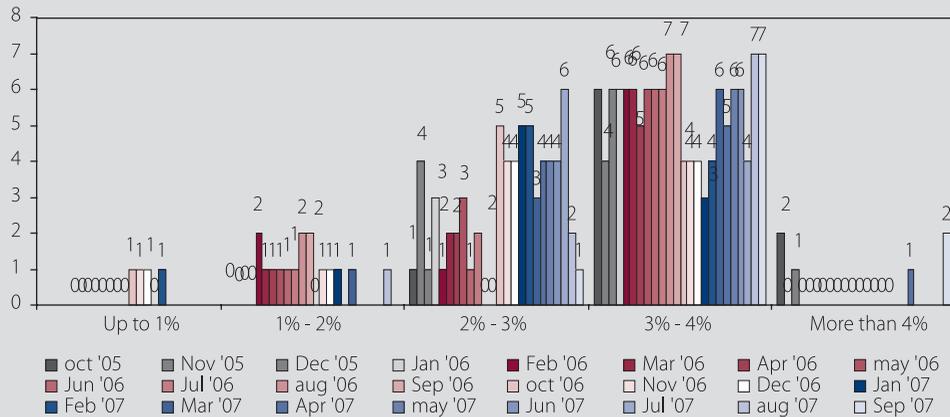
3. INFLATION FORECASTS

In September 2007, inflation forecasts of commercial banks' managers were at somewhat higher level in comparison to the second quarter-end of 2007. Namely, in September all ten banks expected higher inflation rate in 2007, in relation to the previous year (Graph which is convincingly the highest level of expectation in the whole year, even since when surveys on inflation expectations have been conducted

When it comes to forecasts by companies listed on the stock exchange, in September 2007, none of the surveyed companies forecasted a lower inflation rate, 11% forecasted the same inflation rate level, while 89% of surveyed companies forecasted inflation rate in 2007 higher than that in 2006 (Graph 9).



Graph 10 – Forecasted inflation rate level (banks)

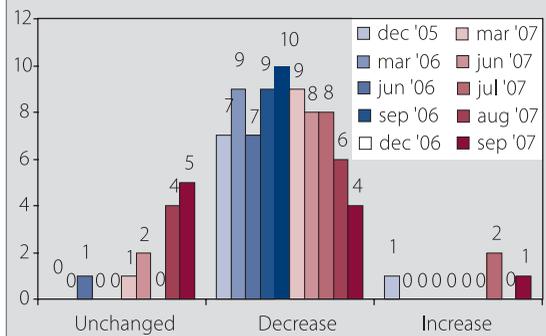


As for the inflation rate level, one bank forecasted the inflation rate to be 2-3%, seven banks expected inflation rate between 3-4%, while two banks forecasted inflation rate higher than 4% (Graph 10).

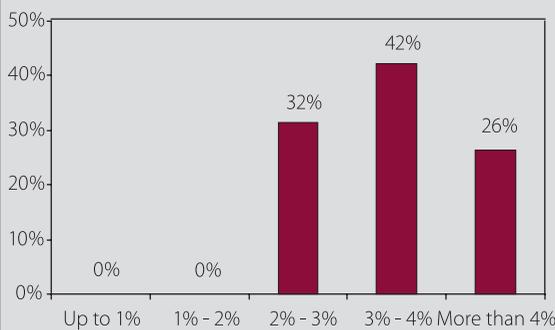
Most of the companies forecasted the inflation rate to range between 2 and 4% (Graph 11). If both groups of subjects were observed, then most companies and banks forecasted inflation rate within the range from 3% to 4%. This range of inflation rate forecasted 70% of surveyed banks and 42% of surveyed companies. While inflation rate above 4% forecasted 20% of surveyed banks and 26% of surveyed companies.

As for the nominal interest rates movements (nominal and effective), five banks expect their unchanged level, four banks expect their downtrend, and one bank expected the uptrend of interest rates in 2007, comparing to 2006 (Graphs 12 and 13).

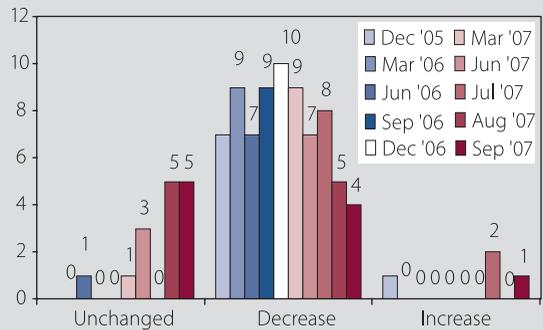
Graph 12 – Nominal interest rate movement forecasts



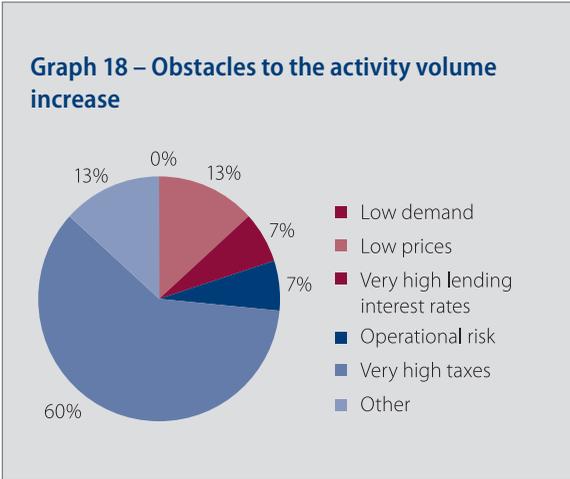
Graph 11 – Forecasted inflation level (sample of enterprises listed at the stock exchange)



Graph 13 – Effective interest rate movement forecasts



Most of the respondents see very high taxes (60%), and low prices (13%) as the main obstacles to increasing their activity. According to surveyed enterprises, too high interest rates and general operational risk are also obstacles to the increase in volume of their business activity. (Graph 18).

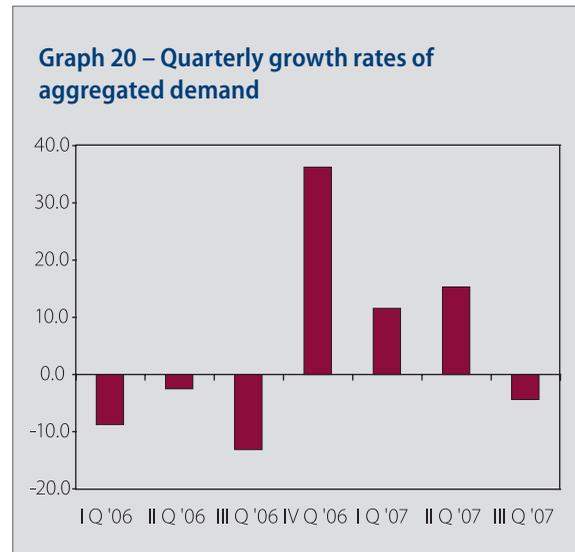
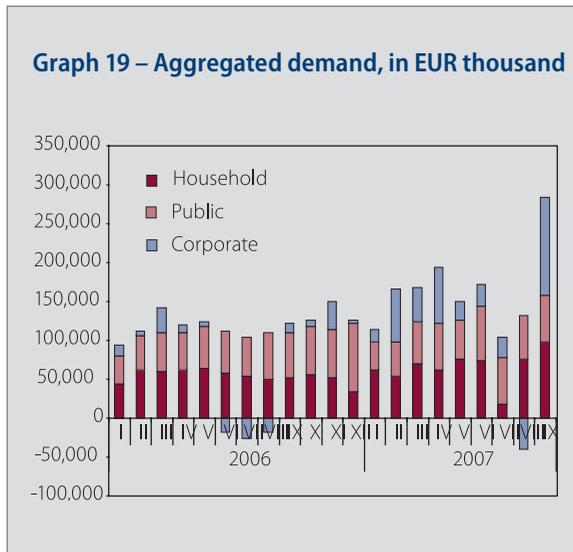


4. INFLATION DETERMINANTS

4.1. DEMAND

The aggregated demand in the third quarter 2007 was lower in comparison with the one in the previous quarter. Observed by sectors, decrease in demand comparing with the previous quarter was recorded in three sectors. Month-on-month, the highest level of aggregated demand

in the first nine months this year was recorded in September due to significant growth in corporate indebtedness in said month and public consumption growth, while the public sector growth was on the same level as in the previous month. This could be an announcement of the significant growth of the aggregated demand in the fourth quarter.



Box 1 - Aggregated demand calculation methodology

For the purpose of an in-depth monitoring of aggregate demand as the inflation determinant, the CBM has developed the aggregate demand calculation methodology. The starting point of this methodology is that the aggregate demand is the total demand by three sectors: Personal consumption (household), investment consumption (corporate sector) and public consumption.

However, taking into account the lack of numerous data necessary for calculating the aggregated demand, the existing data on aggregate demand should not be treated as an indicator of the exact amount of aggregate demand, but as an indicator showing in which direction the aggregate demand is going in. In the existing methodology, a number of significant data is not available, such as: corporate investments, revenues from selling shares, nonmarket income, shadowy economy revenues, and the like. The methodology for aggregate demand calculation is shown in the following equation:

$$AD=C+I+G$$

C=sum of paid salaries + sum of paid pensions + paid frozen foreign currency deposits + net compensations to households- net savings by households (savings- loans granted)

I= net savings of economy (deposits-loans)

G= public consumption- paid pensions- salaries paid from the budget- net savings by the Government (deposits-loans- Treasury bills)

AD- aggregate demand, **C**- personal consumption, **I**- investment consumption, **G**- public consumption

4.1.1. Salaries and other available demand determinants

The growth in average salaries, which characterized the first two quarters, continued also during the third quarter of this year.

Average salary without taxes and contributions amounted to EUR 345 at end-September and it was for 20.2% higher comparing to the same month of the previous year, while in relation to the previous year-end it increased by 12.4%.

Average salary for nine months this year amounted to EUR 328. Observed by quarters, the highest average salary was recorded in the third quarter

when it amounted to EUR 338, while the lowest average was recorded in the first quarter (EUR 314). Average salary in the third quarter this year was 2.4% higher than the average in the second quarter, while the increase in relation to the average in the first quarter amounted to 7.8%.

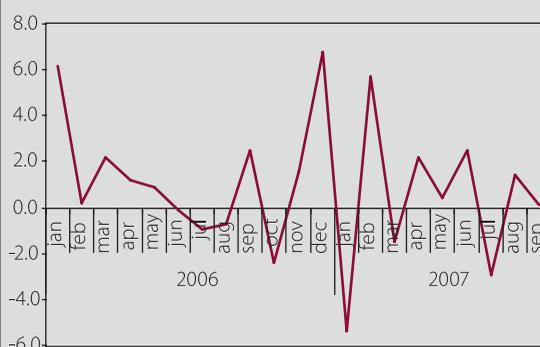
The growth of salaries in the third quarter, beside the growth in economic activity comparing to the previous quarter, influenced the increase of the minimum wage from EUR 53 to EUR 55. We should note that growth of employees' salaries being financed from the budget is expected in the fourth quarter, due to signing of collective contracts (health, insurance, education), together with the high budgetary surplus in the first nine months this year, enabled further increase of salaries in these fields.

Graph 21 – Average salaries without taxes and contributions in Montenegro



Source Monstat

Graph 22 – Real salaries (monthly growth rate)



If we take into account the cost of living, i.e. the movement of salaries in real amounts, we can conclude that salaries increased in February, April, May, June, August and slightly in September, while in other months (January, March and July) their real decrease was recorded (for 5.40%, 1.47% and 2.92 respectively).

The first three quarters this year characterized constant increase in household indebtedness arising from **loans** from banks. Average monthly growth in households' indebtedness on this basis amounted to 8.6% for the first nine months this year, while the highest monthly increase was recorded at end-March (13.1%). Observed by quarters, the highest average increase of loans was recorded in the first quarter (9.7%), while the average monthly growth in the third quarter amounted to 6.3%. At end-September this year the households indebtedness to banks amounted to EUR 651.1 million, which was 181% higher than in the same month of the previous year-end, while an increase in comparison to the end of 2006 amounted to 109.2%.

Beside banks' loan claims on households, their debt to microcredit financial institutions to which they owed EUR 45 million at end-September this year also increased.

Households' deposits also increased during the first three quarters this year, so that at end-September they amounted to EUR 923 million and were significantly above the level of disbursed loans. At end-September this year, loans/deposits ratio for this sector amounted to 0.71. Net households' savings to banks amounted to EUR 272 million at the third quarter-end, which is for EUR 46.7 million higher than at the previous quarter-end.

Another source for financing household consumption is the **inflow of foreign funds**.

The balance of payment statistics shows that the inflow of funds from abroad to physical persons in the third quarter 2007 was 2.6% lower comparing to the previous quarter. This inflow includes compensations to employees, pensions, remittances and other transfers.

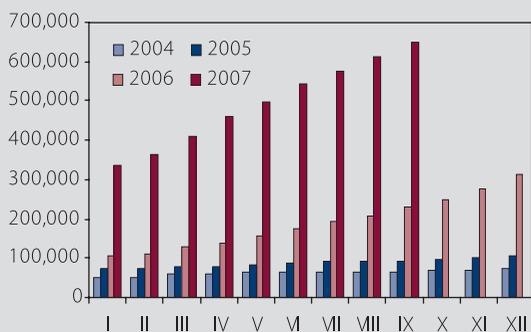
Observing the total demand of households by months in the third quarter, we can notice significant reduction in demand in July, as a result of high increase of households' deposits, then increase in demand in August and September.

Graph 24 – Inflow of funds from abroad to households, in EUR thousand



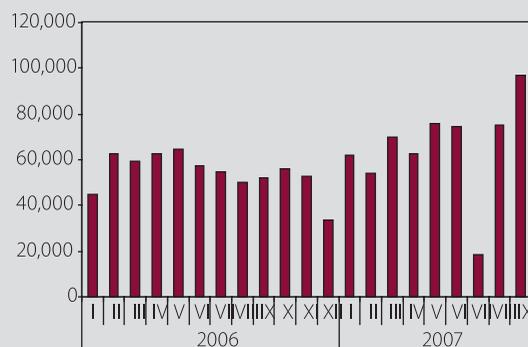
Source CBM

Graph 23 – Loans granted to private citizens, in EUR thousand



Source Monstat

Graph 25 – Households' demand, in EUR thousand



4.1.2. Budgetary analysis

According to preliminary data of the Ministry of Finance, total budgetary revenues in the first nine months 2007 amounted to EUR 579.7 million and were 25% higher than planned for the same period. In relation to the comparative period of 2006, revenues increased by 42%.

In the structure of budgetary revenues, current revenues recorded dynamic growth with the share of EUR 572.5 million or 98.8%. In comparison with the same period of the previous year, these revenues increased by 42%, as a result of a better collection of taxes, fees, compensations and other republic revenues. Revenues from the sale of property (financial and non-financial) amounted to EUR 5 million, or 0.9% of total revenues, which is 59.4% less than planned, yet 43% more in relation to the comparative period of 2006. The revenues from the repayment of loans taken by public companies, individuals and other institutions amounted to EUR 4.1 million, being 8% and 45.2% lower in relation to the plan and the same period of the previous year, respectively. In the first nine months of 2007, revenues from donations were significantly lower than planned and amounted to EUR 62 thousand or 13.7%, being 33% higher in relation to the first three quarters of the previous year. The government borrowed EUR 2 million or 83% less than planned in the first three quarters, but in relation to the previous year, borrowings and loans were 108% higher.

In the period January–September 2007, current budget revenues increased due to a better collection of taxes, which continued their growing trend with all categories and amounted to EUR 508.5 million or 89.4% of source budgetary revenues, and in comparison with the previous year these revenues were 40.3% higher. Revenues from fees (administrative, court, registration, residence and other fees) increased in relation to the same period of the previous year by 30%, but being 6% lower than planned and the reason for this was a poor collection of taxes. As a result of the successful tourist season, revenues from residence fees increased by 48% and amounted to EUR 0.5 million.

According to preliminary data of the Ministry of Finance, in the first three quarters of 2007, total expenditures of the budget amounted to EUR 448.8 million and were 22.6% lower than the revenues. The expenditures were 5.7% lower than planned, as a result of reduced current and capital expenditures and transfers. In relation to the comparative period of 2006, they were 10.5% higher.

In the structure of total budgetary expenditures, the main share, 51% or EUR 228.8 million, was of the current budgetary expenditures, which is 22% more in relation to the same period of the previous year. Expenditures for transfers to institutions, individuals, the non-governmental and public sectors, and social security amounted to EUR 118.7 million or 26.4% of total expenditures, which is at the level of expenditures from the previous year. Transfers to social security accounted for the main share, EUR 28.8 million, being 11% higher in relation to the comparative period, while expenditures designated for social insurance were 3% lower and amounted to EUR 89.6 million.

Some EUR 33.6 million or 58.3% more in relation to the previous year was appropriated for capital expenditures, and the main share of these resources went on the public realm infrastructure, construction objects and investment maintenance, while less was spent on equipment and local infrastructure. However, these resources were 43% lower than planned due to inadequately planned monthly dynamics. The Government repaid EUR 58.3 million of the debt or 13% of total expenditures which was at the same level in relation to the same nine-month period of the previous year. Borrowings and loans the Government disbursed were 24% lower in relation to the same period of the previous year and amounted to EUR 4.3 million.

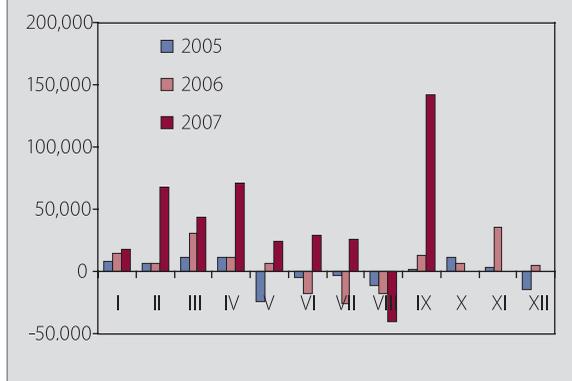
Observing the **surplus/deficit** as the difference between revenues and expenditures, whereby revenues are reduced for borrowings, transfers, donations and revenues from property sale, and expenditures reduced for principal repayment of loans taken in the country and abroad and issuing securities, the (primary) budget of the Republic registered a record surplus of EUR 182 million² in the period 1 January – 30 September 2007, instead of the planned EUR 4.5 million of deficit. If we observe the surplus as the difference between revenues and expenditures, then it amounted to EUR 130.9 million.

4.1.3. Corporate sector

Due to the absence of data on investments by the corporate sector, we can use net indebtedness of the corporate sector for demand approximation.

² *Methodology for calculating Surplus/Deficit, "Official Gazette of the Republic of Montenegro, no.71/05".*

Graph 26 – Net indebtedness of corporate sector, EUR thousand



These data show that loans disbursed to the corporate sector were significantly higher than their deposits, so the corporate sector represented the net debtor. What is positive is that the share of long-term loans in total loans disbursed to this sector at end-September amounted to 67%, which means they were dominantly used for increasing the volume of economic activity.

4.1.4. External demand and the current account

According to preliminary data, the current account deficit amounted to EUR 511.1 million or 32.7% of GDP in the first three quarters of 2007, which is 60.8% more than in the same period of 2006. The coverage of the foreign trade deficit by surpluses recorded on other current account sub-accounts amounted to 49.2%, which is 0.6 percentage points more in relation to the same period of 2006. The high current account deficit in the observed period was financed from the foreign direct investments net inflows and other investments, which were 21.6% and 9.6% of GDP, respectively.

Total volume of visible trade in the first three quarters of 2007 was 27.1% higher in relation to the same period of 2006. The recorded visible export/import coverage in the period January - September 2007 amounted to 32.6%, which is 10.5 percentage points less than in the comparative period. An increased domestic consumption and demand for imported goods, as well as the inflow of foreign direct investments and an increase in investment consumption, all had impact on visible trade deficit.

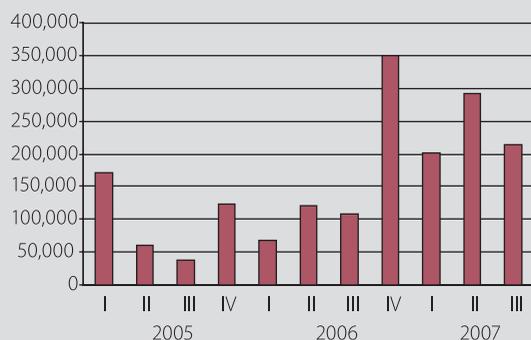
The growing volume of services trade with abroad was recorded in the period January - September 2007. Total volume of services trade amounted to EUR 750 million, which was 39% more in relation to the same period of 2006. **Revenues from services** amounted to EUR 594.3 million and increased by 59.2% in relation to the same period of 2006. The largest revenues were from travelling-tourism, EUR 443.6 million, then transport, EUR 54.1 million, construction services, EUR 38 million, and other business services, EUR 32.7 million. An increase in revenues from travelling was the result of an increase in the quality of tourist offer and intensive promotional activities in the markets abroad and consequently, an increase in number of tourists. Revenues from services in the reporting period amounted to EUR 155.6 million and they were 6.3% lower in relation to the same period of 2006. A decrease in revenues from services was largely contributed by the decrease in revenues from construction services by 59.8%. Observing the structure of services, the largest revenues were from transport, EUR 40.2 million, followed by other business services, EUR 34.3 million, and construction services, EUR 26.8 million. During the first three quarters of 2007, the services account recorded a surplus of EUR 438.7 million. Observed by types of services, the largest surplus was recorded in travelling (EUR 424.9 million).

During the first nine months of 2007, factor **income revenues** amounted to EUR 64.2 million, which was an increase of 44.5% in relation to the same period of 2006. The largest share of total income were employees' salaries in the amount of EUR 58.1 million while the revenues from international investments income amounted to EUR 6.1 million. The **income expenditures** amounted to EUR 48.6 million in the period January - September 2007, which was 107.6% more than in the same period of 2006. The expenditures from interest repayment on disbursed loans increased by 84.3% in relation to the same period of 2006 amounting to EUR 36.2 million. An income account recorded a surplus in the amount of EUR 15.6 million in the observed period, which was 25.7% less in relation to the same period of 2006.

A surplus of EUR 40.2 million was registered on the current transfers account in the period January - September 2007, which was 44.6% less than in the same period of 2006. Total inflow from current transfers amounted to EUR 70.2 million in the observed period, while their outflow was EUR 30 million.

On the capital-financial account, during the first nine months of 2007, favourable movements in the field of foreign direct investments were recorded in the field of foreign direct and portfolio investments.

Graph 27 – FDI inflow, quarterly, EUR thousand



Source: Central bank of Montenegro

Net inflow of foreign direct investments (inflow minus outflow) amounted to EUR 337.6 million in the observed period, which was 38.8% more than in the same period of 2006. Total foreign direct investments inflow in the period January – September 2007 amounted to EUR 708.1 million, being 139.6% more than in the same period of 2006.

Observing the inflow structure, an uptrend in investments related to real estate is noted. Investments related to real estates amounted to EUR 399.6 million or 56.4% of total foreign direct investments inflow in the period January – September 2007, while the foreign direct investments related to local companies and banks amounted to EUR 238.8 million. The amount EUR 69.7 million was recorded as inter-company debt, loans, deposits and other claims in the observed period.

Total foreign direct investments outflow in the period January – September 2007 amounted to EUR 370.6 million, being EUR 318.3 million more than in the same period of 2006. As for the outflow structure, EUR 276 million related to real estate, EUR 48.5 million was the withdrawal of a share of foreign capital from local banks and companies while EUR 44.6 million related to investments of local companies abroad. Of total outflow arising from real estate, EUR 38.3 million related to real estate purchase abroad while EUR 237.7 million related to withdrawal of funds from the real estates sale by non-residents.

A net inflow on the portfolio investments account in the period January – September 2007 amounted to EUR 9.6 million, being 46.8% more than in the same period of 2006. An inflow of portfolio investments

in the observed period amounted to EUR 103.6 million or 75.6 million more in relation to the comparative period of 2006 while at the same time their outflow amounted to EUR 93.6 million.

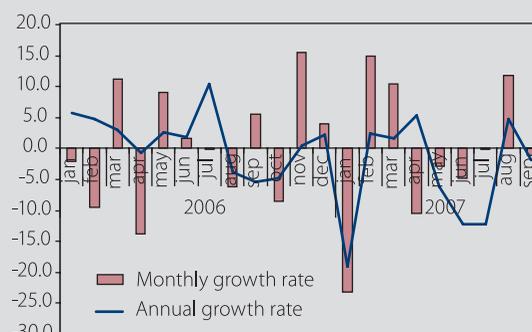
An inflow of funds on the Other investments account, which covers loans, commercial loans, cash and deposits, amounted to EUR 754.9 million, being EUR 461.4 million higher in relation to the same period of 2006. Commercial banks and companies borrowed funds to the amount of EUR 753.8 million, which was 166.5% more in relation to the same period 2006, while their debt reduced by EUR 190.2 million. An outflow from Other investments amounted to EUR 605.1 million. A net inflow of EUR 149.8 million was recorded on the Other investments account in the observed period.

4.2. SUPPLY AND PRODUCTION

In the first nine months of the current year, a real GDP growth of 7.1% was recorded, with GDP amounting to EUR 1,562.9 million.

The physical volume of industrial production in the third quarter of 2007 recorded a growth of 10.5% in relation to the previous quarter-end. If compared to the previous quarter-end, higher production was recorded in all three industrial production sectors. Observed by months, in the third quarter of 2007, an increase of 11.8% was recorded in August as a result of an increase in production in all three sectors, while a decrease in industrial production of 0.1% and 1.1% was recorded in July and September, respectively.

Graph 28 – Industrial production, monthly and annual growth rate



Source: Monstat

In the first nine months of 2007, industrial production was 4.3% lower in relation to the comparative period of 2006. Both a fall in electric power production sector of 40.3% and quarrying and mining sector of 6.5% contributed to a decrease in volume of industrial production, while, in relation to the same period of 2006, an increase in production of 8.6% was recorded only in manufacturing industry. Nine branches of manufacturing industry, which accounted for 64.3% of total industrial production, recorded production growths, while the remaining seven branches recorded lower output.

Total number of **tourists** who visited Montenegro in the first nine months of the current year amounted to 1,067 thousand, being 19.1% higher in relation to the same period of the previous year. In this connection, 87.5% were foreign tourist arrivals, while the remaining 12.5% were domestic tourist arrivals. There were 23.2% more tourist overnights in relation to the comparative period. Foreign and domestic tourist overnights made 88.7% and 11.3% of overall overnights, respectively.

Total **wood production** from the state-owned forests in the period January–September 2007 amounted to 194,571 m³ and it was 18.3% lower in relation to the same period of the previous year.

The value of **construction work** performed in the first three quarters of 2007 amounted to EUR 128.5 million³, which was 11.1% lower than in the comparative period. On the other hand, construction activity measured by the effective working hours was 2.5% lower. Observed by quarters, the value of performed construction works in the third quarter this year was 4.2% higher in relation to the previous quarter, while in relation to the third quarter of 2006 it was 27.6% lower.

The data on the volume of **transportation services** in the first nine months of 2007 point to positive trends with some types of transportation. All forms of transportation recorded positive results. Thus, road passenger and goods transport increased by 29.4% and 20.9%, respectively, and air freight and passenger transport rose by 18.9% and 23.3%, respectively.

In railway transport, the respective increases in passenger and cargo transport were 17.9% and 8.5%.

Data on maritime transport point to a 8.6% larger turnover in ports, and 9.7% larger cargo transport in tonne miles.

4.3. STOCK EXCHANGE INDICES

There was a decrease in value of two Montenegrin stock exchange indices in the third quarter of 2007 in relation to the previous one. The Moste index recorded an absolute decline of 275.3 index points or 12.6% in relation to the previous quarter-end while the NEX20 index recorded a decline of 1,040.63 index points or 2.6%. Only the NEXPIF index recorded a growth of 408.76 index points or 0.93% in this quarter, but it also recorded a decline of 8.7% in relation to the maximum value it recorded in mid-August. However, regardless of the decrease in prices in the last quarter, all three indices recorded a growth since the year start. Moste by 108.4%, NEX20 by 118.2% and NEX PIF by 148.9%.

Observed by months in August only, all three indices recorded the growth (Moste by 7.6%, NEX20 by 9.1% and NEXPIF by 14%) and all three indices

Table 3 – General data on indices

	MOSTE		NEX 20		NEXPIF	
As of 30 September 2007	1,914.5		39,393.33		44,205.77	
Absolute change in the third quarter of 2007	-234.0		-1,040.3		+408.8	
Base	100.0		1,000.00		1,000.00	
Maximum in 2007	2,455.4	07.05.2007	48,617.88	17.05.2007	50,780.54	17.08.2007
Maximum, all time	2,455.4	07.05.2007	48,617.88	07.05.2007	50,780.54	17.08.2007
Minimum, all time	94.8	23.06.2004	918.57	14.04.2003	959.53	02.04.2003
Growth rate, 30June – 30Sep 2007	-12.6%		-2.57%		0.93%	

Source: Montenegroberza SE, and Nex Montenegro SE

³ Preliminary Monstat data

recorded a decrease in July and September (in July: Moste decreased by 6.7%, NEXPIF by 3.5% and NEX20 by 1.8%, in September: Moste decreased by 12.9%, NEX20 by 9.1% and NEXPIF by 8.2%).

Graph 29 – Index MOSTE



Source: Montenegroberza Stock Exchange

Graph 30 – Indices NEX20 and NEXPIF



Source: Nex Montenegro Stock Exchange

4.4. MONEY IN CIRCULATION

Money in circulation (broad money M21) increased at a monthly rate of 5.2% in the period January – September 2007, reaching the amount of EUR 2,500.2 million at end-September. The level of money in circulation at end-September of the current year was above the money in circulation level in December 2006 by 57.6%, i.e. above the level in September 2006 by 98.4%.

Money supply M11, which accounted for 57.4% of the M21 structure, amounted to EUR 1,452.3 million at end-September, which was 30.7% more than at the previous year-end, while the annual growth rate amounted to 65.9%. Time deposits, which amounted to EUR 1,063.9 million, made up 42.6% of M21. Time deposits were 117.9% higher at end-September than at end-2006, while the annual growth amounted to 169.9%.

Graph 31 – Monetary aggregate M21, EUR million



5. MONETARY POLICY

The Council of the Central Bank of Montenegro enacted the new Decision on Classifying Assets and Forming Reserves in Case of Credit Losses.

With the implementation of this Decision, the Montenegrin banking system will develop the qualitatively new approach to credit risk estimations, based on international standards, and additionally improve security and stability of depositors and creditors in the banking system.

With regard to the current concept of allocating reservations per each separate credit risk exposure, the banks are additionally obliged to allocate the so-called general reserves which are calculated and allocated in relation to periodical credit portfolio increase. In that manner, every possible risk increase in the banking sector will be adequately secured by the reserves, which guarantees the higher degree of security for depositors. This measure will have impact on slowing down of credit expansion.

6. INFLATION FORECAST FOR 2007

Bearing in mind the fact that it is almost the year end, we can forecast with great certainty that the annual inflation rate in 2007, measured by the cost-of-living index, will fluctuate between 7.5% and 8% and that the average annual inflation rate will probably range between 4% and 4.5%.

We will make a forecast of the annual inflation rate for 2008 in the next issue of the publication once we receive the survey results on the expectations for 2008, but we expect that the annual inflation rate in 2008 will be significantly lower than that in 2007.